NAMIBIA FINANCIAL STABILITY REPORT | APRIL 2024

Financial Stability Amidst Climate Change

Bank of Namibia

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PREFACE

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

Financial system stability is defined as the resilience of a financial system to internal and external shocks, be they economic, financial, political, or otherwise. Financial system stability can also be described as the absence of significant macroeconomic disruptions in the system of financial transactions between households, corporates, and financial institutions.

The financial system in Namibia consists of financial markets, instruments, institutions, and infrastructure. The regulatory structure, while not strictly a part of the financial system, plays an important role in regulating and monitoring the system.

Chapter 6 of the Bank of Namibia Act, 2020 (No. 1 of 2020) gives Namibia's central bank the explicit mandate of macroprudential oversight and of coordinating activities to safeguard financial stability in the country. Thus, the main functions of Namibia's Macroprudential Oversight Committee (MOC)[1] include consulting with the Namibia Financial Institutions Supervisory Authority (NAMFISA) and the Ministry of Finance and Public Enterprises (MFPE) to ensure that policies are in place to manage financial stability and to foresee and counter crises that could impact the entire financial system. The stability of Namibia's financial system is critical, as it provides important services to households, corporates, and the real economy.

The content of this financial stability report are reviewed and, if found satisfactory, approved by the Financial System Stability Committee (FSSC). This Committee was established to monitor risks affecting the financial system, to provide advice and make recommendations to the Bank of Namibia (BoN). The Committee also acts as a liaison between the MFPE, NAMFISA, and the BoN on matters related to Namibia's financial system stability.

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

MEMBERS OF THE FINANCIAL SYSTEM STABILITY COMMITTEE

Bank of Namibia

- Governor (Chairperson)
- Deputy Governors
- Director: Financial Stability and Macroprudential Oversight
- Technical Advisor to the Governor

Namibia Financial Institutions Supervisory Authority

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

Ministry of Finance and Public Enterprises

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

CORPORATE CHARTERS

BANK OF NAMIBIA

VISION

To be a leading central bank committed to a prosperous Namibia

MISSION

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

VALUES

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

NAMIBIA FINANCIAL INSTITUTIONS SUPERVISORY AUTHORITY

VISION

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

MISSION

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

VALUES

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

FINANCIAL STABILITY KEY HIGHLIGHTS

Namibia's financial system remained resilient, stable and sound amidst moderate economic growth.

Financial Stability Themes

Risks emanating from climate change have become an increasing concern.

The impact of cyber risk on the financial system continues to be a source of concern that require continuous monitoring.

Financial Action Task Force's (FATF) grey listing is a key concern as it affects financial stability through the country risk premium channel.

Risk Assessment and Outlook

Risks to the global economy have become balanced as inflation expectations have decelerated.

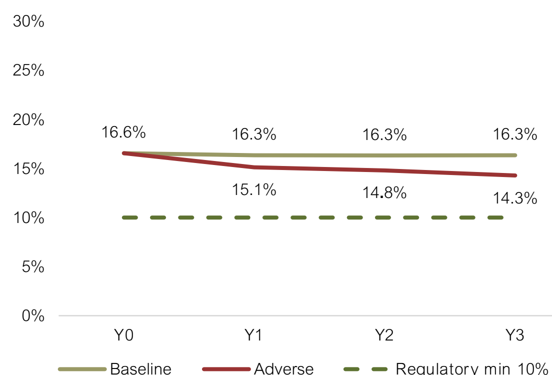
The unstable electricity supply and logistical constraints in South Africa continue to pose potential risks to Namibia.

Elevated geopolitical risks could lead to volatile prices and disruptions in commodity markets.

Namibia's domestic outlook is projected to slow down due to uncertain rainfall patterns and water supply interruptions.

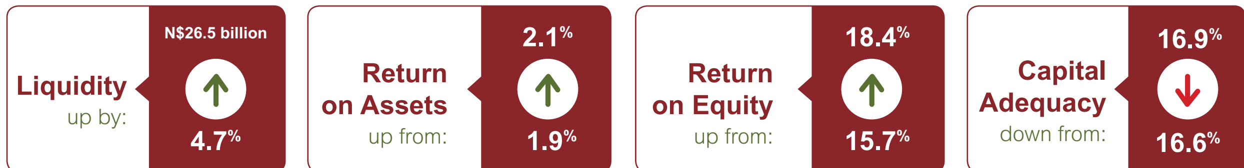
Solvency Stress Test: Banking Sector

Banks remain well capitalised in both baseline and adverse scenarios over the three year horizon.



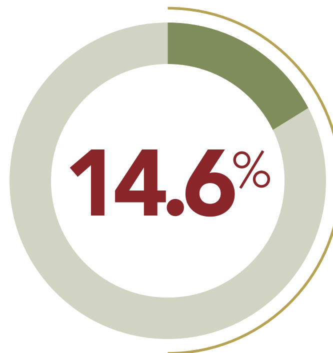
Performance of the banking sector

Banks remain liquid, profitable and well capitalised.



Performance of the NBFI sector

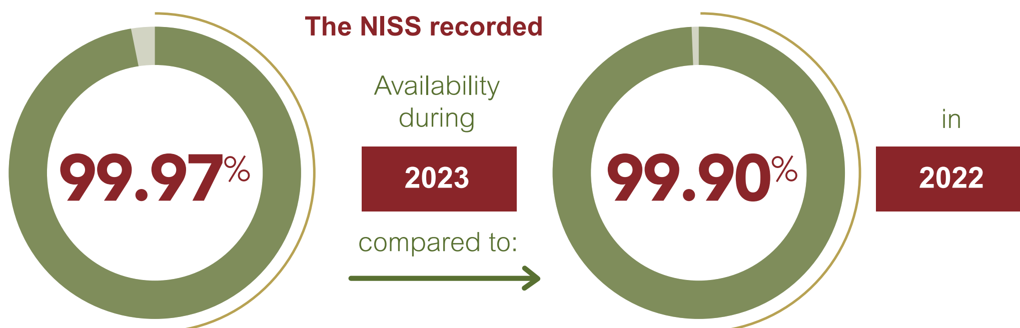
The NBFI assets expanded by



N$419.4 billion

The NBFI sector remained sound.

Payments infrastructure and regulatory developments



Policy Intervention

In response to challenges faced by the property market, the MOC concluded that there is a need to enable a macroprudential policy intervention on the existing LTV regulation. As such, the MOC intervened by implementing less strict LTV ratios to stimulate the demand in the property market.

1 INTRODUCTION AND OVERVIEW

INTRODUCTION AND OVERVIEW

The Namibian financial system remained stable, sound and resilient in 2023, despite slower economic growth compared to 2022. The growth momentum in the domestic economy stalled due to slower growth in the primary and secondary industries. The reduced momentum in the primary industry was due to a lacklustre performance in the diamond and agriculture sectors. Similarly, the growth in the secondary industry was underpinned by weaker global demand. The overall inflation for Namibia averaged 5.9 percent during the period under review, compared with 6.1 percent in 2022, which was mainly contained by the contractionary monetary policy stance. The financial system nonetheless continued to function efficiently amidst these macroeconomic developments. Both the banking and NBFI sectors maintained a sound and stable financial position during 2023. The payment system infrastructure also continued to contribute reliably toward the financial system's efficiency.

The global gross domestic product (GDP) growth rate slowed in 2023 due to elevated interest rates, long-term repercussions of the pandemic, and a gradual withdrawal of fiscal support. According to the International Monetary Fund's (IMF's) World Economic Outlook Update for April 2024, global growth remained resilient, albeit somewhat slow compared to historical standards. Thus, the global GDP growth rate moderated from 3.5 percent in 2022 to 3.2 percent in 2023. This was due to a contractionary monetary policy stance, the enduring effects of the pandemic, the gradual withdrawal of fiscal support amidst soaring debt, various conflicts, and persistent extreme weather events that impeded global economic activity. Economic growth in most advanced economies (AEs) and several emerging markets and developing economies (EMDEs) decelerated in 2023. An exception in this regard was the United States, where growth remained stable. On the other hand, China, Japan, and Russia experienced an upturn in growth during the same period. Going forward, global growth is projected to remain at 3.2 percent in both 2024 and 2025. The projection reflects restrictive monetary policies and withdrawal of fiscal support, as well as low underlying productivity growth. A steady decline is expected for global headline inflation amongst both AEs and EMDEs implying a softer-than-expected landing.

Both domestic household and corporate debt in Namibia rose in 2023, but at slower rates. The annual growth in household debt slowed marginally by 0.1 percentage point, to 3.3 percent by the end of 2023. The ratio of household debt to disposable income moderated from 43.3 percent in 2022 to 40.5 percent in 2023 partly due to inflationary salary adjustments coupled with recruitment by the Government during 2023. The total corporate debt stock increased by 11.5 percent during 2023, partly due to foreign direct investor long-term loans extended to subsidiaries in the mining sector. Consequently, the corporate sector's debt-to-GDP ratio rose from 70.7 percent at the end of 2022 to 72.4 percent at the end of 2023. The short-term risks to financial stability emanating from corporate debt appear to be moderate given the lower growth estimated for 2023. The probability of both household and corporate sector debt risks materialising in the next twelve months is medium, considering the current economic environment, coupled with fiscal relief measures put in place.

Namibia's banking sector remained profitable, well-capitalised and liquid in 2023, with some concern for asset quality. Total assets in the banking sector grew due to cash and balances with banks, net loans and advances, short-term negotiable securities and trading and investment securities. The banking sector reported capital and liquidity positions well above the prudential requirements. Furthermore, the banking sector reported a healthy profitability position on the back of higher net income, particularly interest income. Asset quality, as measured by the NPL ratio, deteriorated slightly during 2023, although it remained below the crisis-time supervisory intervention trigger point. Despite an increase in NPLs the overall impact of risks from the banking sector did not appear to be significant during the review period and were therefore not deemed to pose an imminent threat to financial stability in Namibia. The stress test results indicate that the banking sector would remain liquid and solvent if the test scenarios employed materialised. The probability and impact of downside risks to the financial system's stability stemming from liquidity constraints and asset quality deterioration ranged between low and medium.

Similarly, the NBFI sector remained sound during the period under review. Total NBFI assets increased by 14.6 percent year-on-year, to N$419.4 billion in 2023. Despite the contractionary monetary policy environment, demand for NBFI products remained strong in 2023. Volatility in the financial markets remains a concern for short to medium term viability of the NBFI subsectors with dominantly short-term liabilities.

The National Payment System (NPS) remained safe, secure and efficient during 2023. The BoN has continued to fulfil its regulatory mandate as the overseer of the NPS in accordance with the Payment System Management Act, 2023 (No. 14 of 2023). Similarly, the Namibia Interbank Settlement System (NISS) maintained high system availability throughout 2023. In comparison to 2022, total fraud in the NPS increased across all payment streams, primarily electronic fund transfers (EFTs) and e-money. To curb the rise in fraud and enhance cyber resilience, discussions are held at various NPS industry platforms for public education and awareness campaign initiatives, and continuous improvement of the payments infrastructure. Despite these challenges, risks within the financial system emanating from the NPS remained broadly unchanged and well-managed.

The domestic regulatory initiatives introduced in 2023 include the revision of the loan-to-value (LTV) ratio by the MOC. In response to challenges faced by the property market, the MOC concluded that there is a need to enable a macroprudential policy intervention on the existing LTV regulation. In this regard, the revised LTV regulation involved implementing less strict LTV ratios, i.e. no downpayments are required to purchase first and second residential properties. However, for the third and subsequent properties, prospective buyers are required to make a 10 percent deposit when acquiring a home loan. In terms of the national payment system, the Payment System Management Act, 2023 (No. 14 of 2023) was revised to empower the BoN to act as the sole regulator of the NPS. In addition, the BoN issued guidelines on the standardisation of quick response codes in the NPS.

The Namibian financial stability outlook is shaped around three key themes: climate change, cyber risk and the recent grey listing by the Financial Action Task Force (FATF). Risk emanating from climate change has become an increasing concern in the global arena because it has a potential impact on the financial system. Banks, for example, are exposed to climate change through their lending activities. Non-bank financial institutions (NBFIs) are exposed to this risk through, amongst other things, insurance products that are issued to sectors exposed to the impact of climate change, but that does not adequately account for such risk. In respect of cyber risk, its impact on the financial system continues to be a source of concern and requires continuous monitoring. The potential impact of idiosyncratic risks on the financial system, such as the February 2024 grey listing by the FATF is a key concern as it affects financial stability through the country risk premium channel.

Namibia's financial system remained resilient, stable and sound despite a moderation in economic growth.

2 SUMMARY OF RISK ANALYSIS

SUMMARY OF RISK ANALYSIS

This section presents a brief analysis of the main risks to the stability of the domestic financial system. In line with sections 3 to 9 of this report, the analysis identifies risks arising from the external macroeconomic environment, trends in household and corporate debt as well as property market analysis. Furthermore, it outlines trends in the financial soundness indicators for domestic banking institutions, stress test simulations and developments in the NBFIs sector. The section concludes with an analysis of the payment and settlement system.

The risks are analysed and rated from low to high, based on their probability of occurrence as well as their potential impact on financial stability in Namibia, should they be realised. This report considers risks since the April 2023 Financial Stability Report. Table 1 summarises the risk position of the Financial System Stability Committee, which shows the direction of risks since the April 2023 Financial Stability Report as well as the probability and impact of the cited risks materialising.

Table 1: Risks to financial stability in Namibia

Nature of risk	Direction of risk[2] since April 2023	Probability of risk materialising in 2024	Impact of risk materialising in 2024
Macroeconomic environment events/risks			
Global economic slowdown	Unchanged		
Global financial turbulence	Down		
Domestic economic slowdown	Up		
Adequacy in international reserves	Unchanged		
Sovereign credit rating downgrade: Namibia	Down		
Sovereign credit rating downgrade: South Africa	Unchanged		
Excessive Namibia/South African Rand depreciation	Up		
Public sector debt risk			
Unsustainable increase in public sector debt	Down		
Household debt risk			
Excessive increase in household debt	Unchanged		
Corporate debt risks			
Excessive increase in corporate debt	Unchanged		
Banking sector risks			
Liquidity risk	Unchanged		
Credit risk	Unchanged		

Nature of risk	Direction of risk[2] since April 2023	Probability of risk materialising in 2024	Impact of risk materialising in 2024
National Payment System risks			
Security of retail payments	Unchanged		
Settlement in last window	Unchanged		
Non-banking financial institution risks			
Funding position[3]	Unchanged		
Cash flow risk[4]	Unchanged		
Market risk[5]	Down		
Solvency position[6]	Unchanged		
Cyber risk[7]			
AML\CFT - Grey listing[8]			
Climate risk			

Key | ***Low*** | ***Medium*** | ***High***

[2] Compared with the April 2023 Financial Stability Report
[3] Relates to retirement funds.
[4] Relates to retirement funds.
[5] Relates to retirement funds, collective investment schemes and long-term insurers.
[6] Relates to long-term insurers.
[7] Cyber, AML/CFT grey listing, and Climate risks direction of risk are not provided as they were not outlined in the previous FSR.
[8] Relates to adherence to international standards governing anti-money laundering, combating the financing of terrorism, and combating proliferation financing.

According to the IMF's April 2024 *Global Financial Stability Report,* a sense of optimism has pervaded financial markets in recent months. This is amid investor confidence that global inflation is entering its "last mile" and that central banks will ease monetary policy in the coming months. Stock markets around the world have increased by 20 percent while corporate and sovereign borrowing spreads have narrowed. This has resulted in the easing of global financial conditions. Furthermore, capital outflows across all emerging markets are expected to decline over the next year supported by the risk-on environment which several frontier markets have taken advantage of by issuing sovereign bonds.

Near-term global financial stability risks have receded, however, there are several salient risks along the last mile. This includes growing strains in the commercial real estate sector and signs of credit deterioration among corporates and in some residential housing markets. Stalling disinflation could surprise investors, leading to a repricing of assets and a resurgence of financial market volatility, which has been low despite considerable economic and geopolitical uncertainty. Beyond these more immediate concerns, other medium-term vulnerabilities are building, particularly debt accumulation in both public and private sectors. Some governments may find it difficult to service debt in the future, whereas the private sector's leveraged exposures to financial assets may foretell elevated financial stability risks in the coming years. In addition, while cyber incidents have thus far not been systemic, the probability of severe cyber incidents has increased, posing an acute threat to macrofinancial stability. Considering the near-term salient risk and medium-term vulnerabilities, the key recommendation is that the central banks should avoid easing monetary policy prematurely and push back appropriately against overly optimistic market expectations for policy rate cuts. It is further recommended that policy makers need to improve the breadth and reliability of the data used to monitor and assess the risks associated with the rapid growth of lending by non-bank financial institutions to firms.

Risks emanating from the macroeconomic environment to domestic financial system stability remained broadly unchanged in 2023, although potential risks may soon emerge because of foreign exchange volatility coupled with a slower economic growth projection. Although these risks remained broadly unchanged for the review period, their probability of materialising in the next 12 months is rated medium, with an overall medium impact (Table 1). Furthermore, risks emanating from public sector debt remained moderate in 2023 and are anticipated to improve over the Medium-Term Expenditure Framework (MTEF). In addition, the risk of the depreciation of the Namibia Dollar against major currencies remained medium.

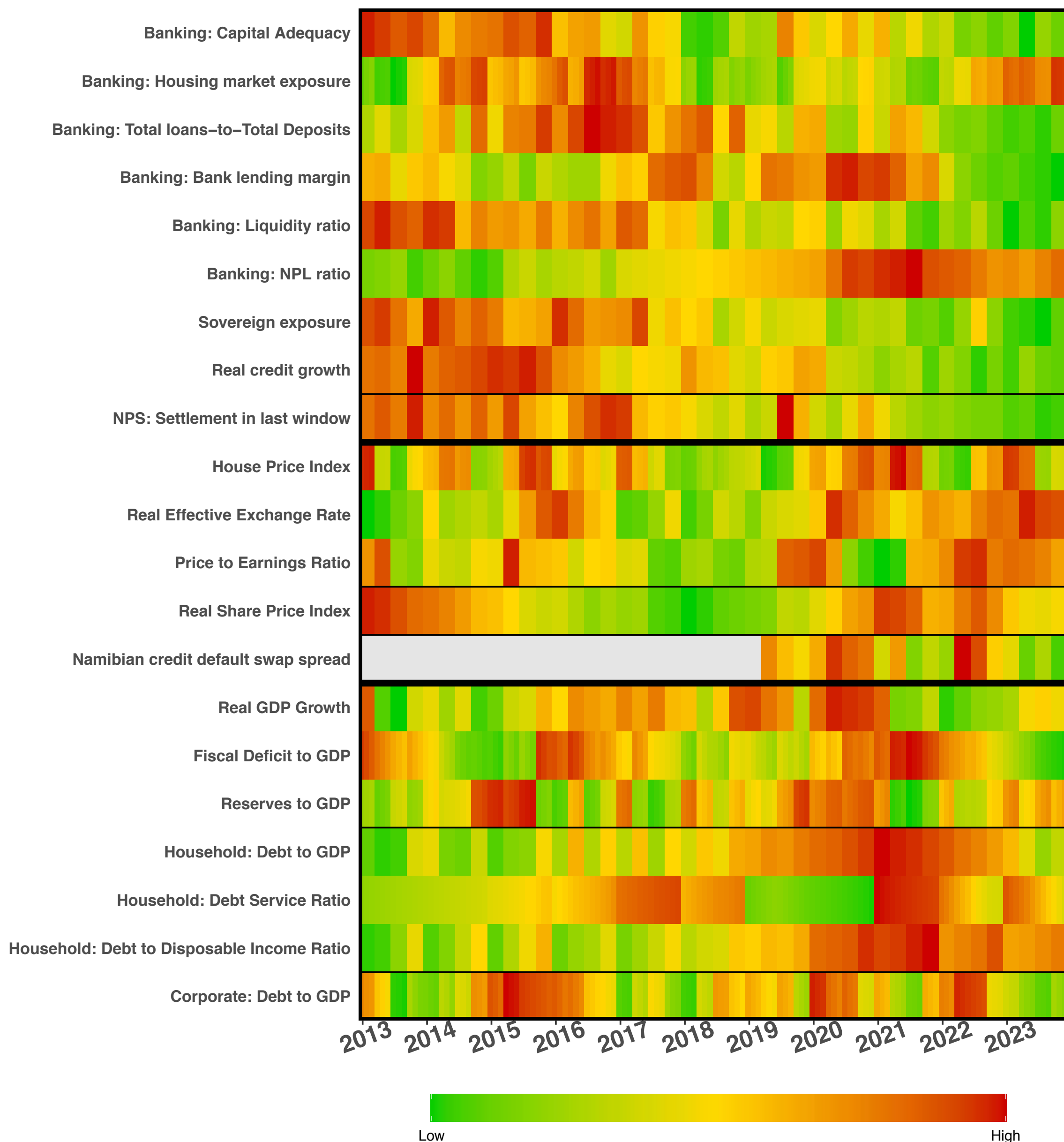
The risk to the financial system emanating from the banking and payments sector remained unchanged during the period under review. The banking sector remained liquid, well-capitalised and profitable despite a deterioration in asset quality, as such risks stemming from the banking sector remained unchanged in 2023. However, the probability of credit risk deteriorating further is medium. On the other hand, liquidity risk is anticipated to be low, with an overall medium impact on financial system stability. Risks from the household and corporate sector debt remained unchanged during the period under review. However, the probability and impact of an excessive increase in household and corporate sector debt in the next 12 months is assumed to be medium especially given the anticipated fiscal relief. The risks from both the security of retail payments and settlement in the last window remained unchanged in 2023. The probability and impact of risks associated with the security of retail payments are determined as low for 2024. However, the probability and impact of the risk of settlement in the last window are assumed to be medium in 2024.

In respect of risks inherent to NBFIs, three of the four key risks monitored remained unchanged during the review period. The exposure to market risk improved in 2023, owing to the recovery in both the equity and debt markets from the lows recorded in 2022. The likelihood of retirement funds and long-term insurers becoming insolvent in 2024 is low, ceteris paribus. This is due to these two subsectors' liabilities having long-term maturities, as well as the magnitude of reserves maintained. The shortfall of retirement funds' contributions received relative to benefits paid is expected to worsen in 2024. This is because, in line with the relatively slower economic growth expected for 2024, it is expected that the growth rate of the size of active members in retirement funds will remain subdued – translating to a subdued expected growth rate of contributions received in 2024. On the other hand, benefits paid are expected to increase faster than contributions received, due to the maturity levels of retirement funds. Nonetheless, the shortfall of contributions received relative to benefits paid is absorbable by the subsector's reserves and is therefore not expected to affect the viability of the subsector in 2024. This informs the low impact of cash flow risk in 2024. Although overall risks to financial stability in

Namibia eased during 2023, the immediate future shows cyber risks, climate risks, grey listing by the FATF and uncertainty in the macroeconomic environment being of principal concern.

The BoN uses a wide range of financial stability indicators that show potential build-up of cyclical changes in the financial system which, if left unattended, could lead to vulnerabilities. A snapshot of all material developments is communicated through the financial stability heatmap in Figure 1 below. The heatmap visually depicts the statistical transformation of a wide range of financial stability indicators against their historical developments. Thus, the tool flags areas that require deeper analysis and further scrutiny. Most of the indicators used in the heatmap are discussed throughout the Report, particularly those that are relevant to financial stability risks in Namibia.

Figure 1: Financial stability heatmap



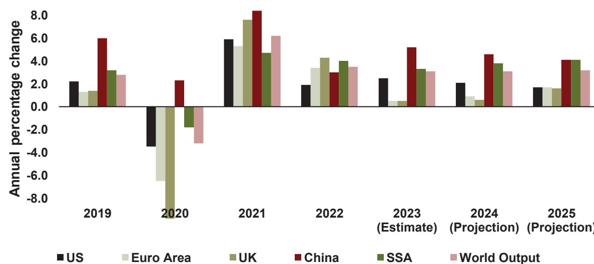
Note: GDP = gross domestic product; NPL = non-performing loan; NPS = National Payment System
Source: BoN

3 MACROECONOMIC ENVIRONMENT

MACROECONOMIC ENVIRONMENT

The global growth rate is estimated to have declined somewhat in 2023 from the rate recorded in 2022. Global growth remained resilient but slowed marginally during 2023 due to high interest rates, the gradual withdrawal of fiscal support amidst soaring debt, the enduring effects of the pandemic, the fallout from regional conflicts, and persistent extreme weather events that impeded global economic activity. According to the IMF's April 2024 World Economic Outlook, the global GDP growth rate moderated from 3.5 percent in 2022 to 3.2 percent in 2023. Economic growth in most AEs and several EMDEs decelerated in 2023, except in the United States, where expectations are that growth remained stable. On the other hand, China, Japan, and Russia experienced an upturn in growth during the same period. Going forward, global growth is projected to remain at 3.2 percent in both 2024 and 2025 (Figure 2). This projection reflects restrictive monetary policies and withdrawal of fiscal support, as well as low underlying growth in productivity.

Table 2: Global growth and projections (annual percentage change)



Source: IMF April 2024 World Economic Outlook Update

Global headline inflation declined in 2023, as supply chains eased and transportation costs declined, with the result that policy interest rates remained unchanged in the latter part of 2023. Global headline inflation is expected to fall from an estimated 6.8 percent in 2023 to 5.9 percent in 2024 and 4.5 percent in 2025. The decline in inflation was generally due to still-tight monetary policies, a related softening in labour markets, and pass-through effects from earlier and ongoing declines in relative energy prices and transportation costs, coupled with a decline in the cost of food due to an abundant supply of agricultural products attributed to favourable weather conditions.

The global GDP growth slowed in 2023 due to elevated interest rates, long-term repercussions of the pandemic, and a gradual withdrawal of fiscal support.

In 2023, most of the AEs and EMDEs raised their policy rates with Japan being a notable exception, keeping its call rate unchanged, while Brazil and China reduced their rates respectively. Regarding the AEs, the US responded by increasing its federal funds rate to 5.25–5.50 percent, the Bank of England to 5.25 percent, and the European Central Bank to 4.50 percent in response to combat high inflation. Japan's call rate remained unchanged at -0.10 percent during 2023. Furthermore, in the EMDEs, India raised its repo rate to 6.50 percent to tackle elevated inflation and achieve alignment with its target tolerance range of 4 percent ± 2 percent. Similarly, the South African Reserve Bank (SARB) and the Central Bank of Russia raised their policy rates by 125 and 850 basis points, respectively. Conversely, the People's Bank of China and the Central Bank of Brazil both reduced their policy rates by 20 and 200 basis points to support weak economic activity in China and the declining inflation in Brazil, respectively.

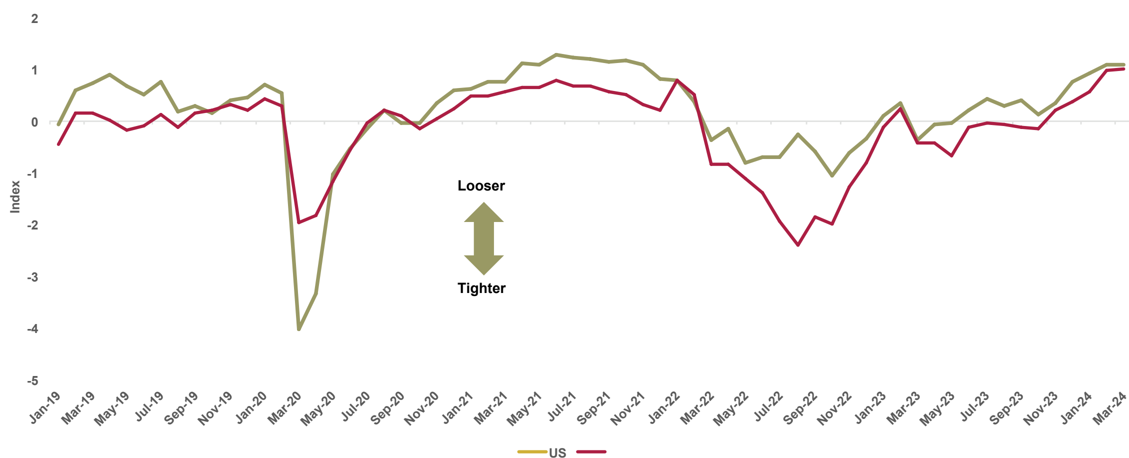
Risks to the global economic outlook are broadly balanced. Regarding the upside risk, inflation is expected to decelerate rapidly, on the back of a stronger-than-expected pass-through from lower fuel prices which is expected to lead to an expansionary monetary policy stance. Furthermore, expansionary fiscal policy could result in temporary stronger growth, while artificial intelligence and stronger supply-side reform momentum could boost productivity growth over the medium term. Downside risks include conflict escalating in the Middle East and Eastern Europe. These elevated geopolitical risks could lead to volatile prices and disruptions in commodity markets. Among other risks, there is financial stress due to elevated real interest rates, persisting core inflation, weaker-than-expected activity in China, trade fragmentation, and climate-related disasters. More

extreme weather shocks, including floods and drought, could, together with the El Niño phenomenon, also cause food price spikes, exacerbate food insecurity, and jeopardise the global disinflation process.

Developments in financial markets

Global financial conditions have been improving slightly, with markets continuing to focus on the pace of disinflation and monetary policy expectations. Financial conditions generally reflect the availability of liquidity in global markets and tend to be monitored closely by central banks, given the perceived correlation of such conditions with future growth. This gradual improvement in financial conditions indicates that, globally, investors are becoming less concerned about interest rate increases than they were previously. Investors are expecting a return to more normal financial conditions with reduced interest rate expectations and forecasts that global headline inflation will be falling year-on-year (Figure 3). This comes after numerous crises experienced during 2023, such as the Russia-Ukraine conflict and multiple bank failures.

Figure 3: Bloomberg Financial Conditions Index



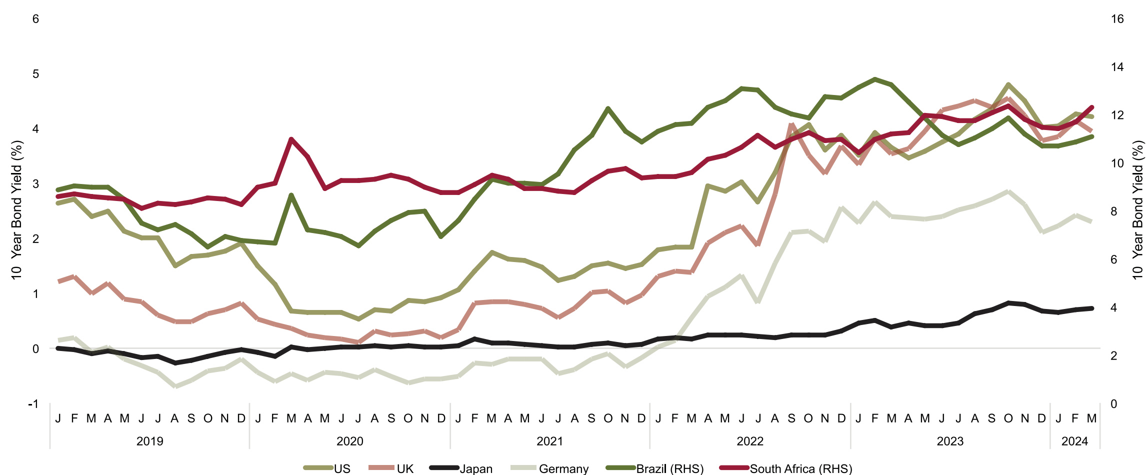
Source: Bloomberg and BoN

Important developments also occurred in the cryptocurrency market. Bitcoin, the world's largest cryptocurrency, not only jumped by 150 percent during 2023 but America's Securities and Exchange Commission also approved the first US-listed exchange traded funds to track Bitcoin. This is a milestone in the global financial industry and, more specifically, for cryptocurrencies, as larger institutions now have easy access to this asset class. During 2023, the rise of digital currencies became more apparent leading to many of the world's monetary authorities stepping up their efforts to move into the implementation phase of central bank digital currencies (CBDCs). CBDCs have the potential to bring about more resilience, greater safety, and lower costs compared with the current private forms of digital money issued and managed by private entities. Currently, only three countries have introduced CBDCs: the Bahamas, Jamaica, and Nigeria. Some 68 others are in an advanced phase of exploring, developing, piloting or launching a CBDC, which highlights the growing relevance and importance of this central bank tool.

Throughout most of 2023, global bond prices weakened amidst rising yields before experiencing one of the biggest rallies in the final two months of the year. From the onset of 2023, investors were still worried that rates would continue to increase globally in an attempt by central banks to curb inflation, causing bond prices to weaken. After that, following almost three years of consecutive declines, the fixed income market experienced a remarkable two-month rally with global bond yields having fallen significantly since October,

especially at longer maturities. The sharp drop in bond yields during the final two months of 2023 has since eased the pressure on corporates, households and governments, which have been facing the steepest borrowing costs since 2018. This was also a welcomed development for highly indebted countries, as this translated into lower borrowing costs for governments issuing debt in international markets and lessened the overall burden of servicing their debt. Furthermore, the 10-year bond yields between the UK and the US and, after them, Brazil and South Africa, began converging and aligning more closely compared with previous periods (Figure 4). This potentially signals a convergence in these markets' expectations, economic conditions, and the perceived risk among these countries. However, the indications of a soft landing and improvements in bond prices can end abruptly, with potential adverse surprises to inflation and unexpectedly severe geopolitical tensions in the Middle East.

Figure 4: Ten-year bond yields in selected countries

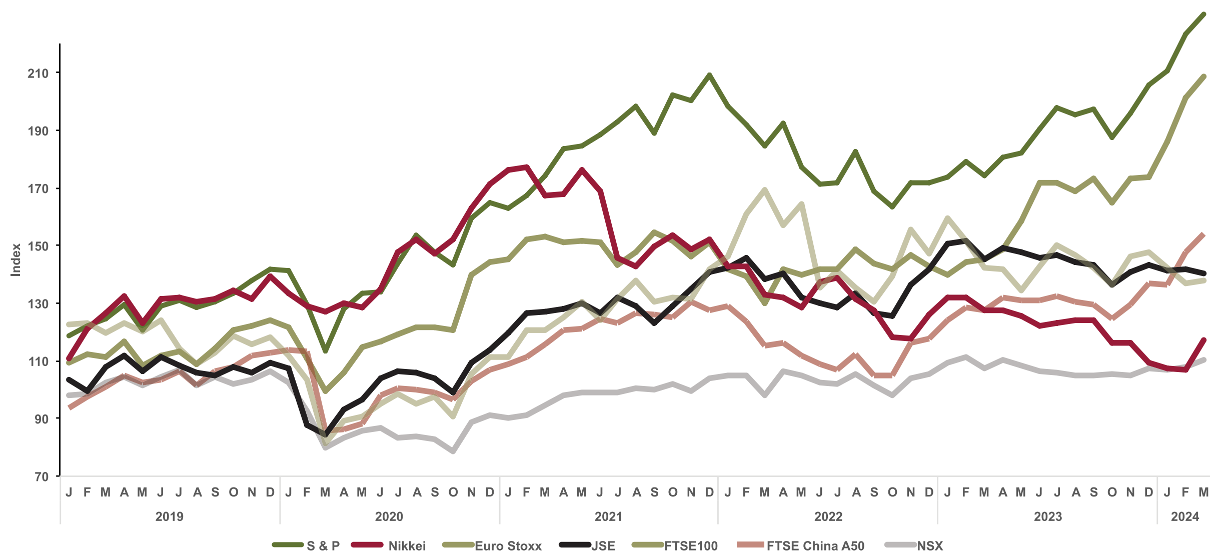


Source: Bloomberg and BoN

After a lacklustre performance during 2022, global stock markets showed significant improvement during 2023, with stocks powering ahead across developed and emerging economies. The Morgan Stanley Capital International All Country World Index, designed to measure the equity market performance of EMDEs, increased by 22.2 percent on an annual basis, showcasing the upward rally of global equity markets. China, however, has been the exception with global stock market performances. Being the world's second largest economy, China experienced a faltered recovery during 2023 as well as a property crisis showing no signs of letting up. As the Financial Times Stock Exchange (FTSE) China A50, tracking the performance of stocks in China, shows, the country has been experiencing significant downward trends since late 2021.

There was less equity market volatility in 2023 compared with 2022. This further helped spur the increases in indices such as Standard and Poor's (S&P) 500, the Nikkei, and Euro Stoxx (Figure 5). The S&P 500 saw a 11.2 percentage points quarter-on-quarter growth in the third quarter of 2023 alone. This growth was mainly dominated by growth in technology stocks, which were spurred on by the explosion of artificial intelligence. In addition, the Namibian Stock Exchange Overall Index (NSX) showed no notable upward or downward trend. (Figure 5). The Johannesburg Stock Exchange (JSE) All Share Index also saw a 6.23 percentage points increase in the fourth quarter of 2023. Furthermore, strong corporate earnings drove these increases in some of the major indices, as profits continued to soar amidst initially lower growth and economic expectations. In addition, firms linked to advances made in artificial intelligence skyrocketed as investors backed the increased potential of the technology.

Figure 5: Stock price indices



Source: Bloomberg and BoN

With the loosening of the Global Financial Conditions (GFC) Index, improved bond market performance and increasing stock market performance, global financial conditions fared better than expected during 2023. However, with the ongoing geopolitical tensions in the Middle East, the slow recovery in the Chinese economy, and investors' constant reassessment of monetary policy and inflation expectations, financial markets could still experience heightened volatility and increased volatility spillovers. These spillovers could be exaggerated by the tensions in Palestine and Israel because, should this spread into neighbouring territories which produce significant amounts of oil and gas, commodity price spikes are likely to increase. In addition, the continued attacks in the Red Sea - through which 11.0 percent of global trade flows - and the war in Ukraine have caused further supply shocks to the overall global recovery, leading to spikes in key inflation components such as food and energy. This could potentially trigger a rise in the expected interest rates and, consequently, a fall in asset prices, leading to weakened financial market performances and increased bond yields - as observed during 2022 and early 2023. Hence, it is imperative that central banks across the globe continue with their proactive risk assessments and preventative measures to ensure that regional and global financial systems remain stable.

Domestic economy

Output and outlook

During 2023, the Namibian economy lost growth momentum on the back of slower developments in the primary and secondary industries. This was further underscored by weaker demand in both global and domestic economies. Compared with the 5.3 percent recorded in 2022, the Namibian economy expanded more gradually in 2023 by 4.2 percent, on the back of slower growth in the primary and secondary industry. Slacker development in the primary industries is ascribed to lacklustre performance of the diamond mining and agriculture sectors. Similarly, less rapid advances in the secondary industries are ascribed to weaker demand in global and local operational dynamics. More gradual economic growth is also projected for 2024, as characterised by weak growth in the mining and agricultural sectors, owing in part to uncertain weather conditions.

Risks to the domestic economy remained tilted to the downside – mainly reflecting global factors. These factors include a prolonged tight global monetary policy stance amidst renewed inflationary concerns as the geopolitical tensions intensify. Geopolitical tensions, the divergent and rocky global economic recovery, geo-economic fragmentation, and weaker-than-anticipated economic recovery in China also pose significant risks to global growth – and, by implication, to Namibia. Moreover, the unstable electricity supply and logistical constraints in South Africa continue to pose potential

risks to Namibia. Internal risks include uncertain rainfall patterns and water supply interruptions, particularly at coastal towns. It is imperative that these internal risks be addressed to ensure Namibia's sustained economic progress and inclusive development.

Figure 6: (a): Headline and Core inflation trends

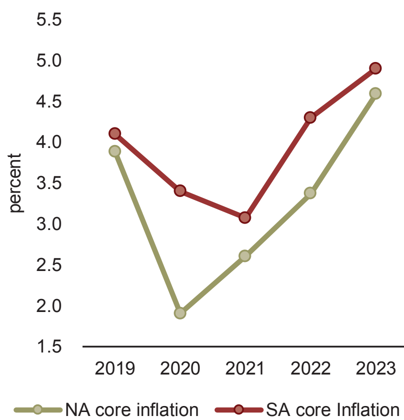
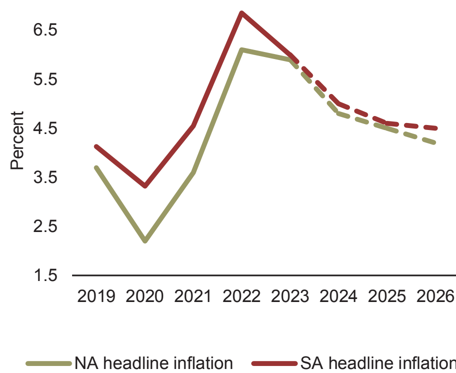


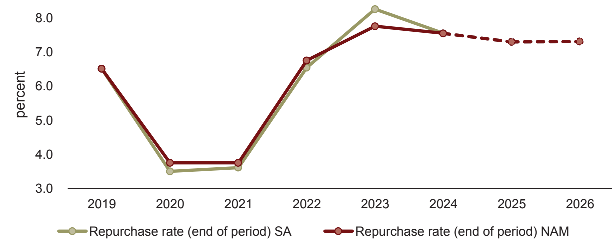
Figure 6: (b): Headline and Core inflation trends



Source: BoN and SARB

Namibia's headline inflation rate eased during 2023 compared with the previous year, providing some relief to consumers' purchasing power. Overall inflation for Namibia declined by 0.2 percentage point to average at 5.9 percent during the period under review, as the effects of a tight monetary policy stance filtered through the economy (Figure 6a-b). This decelerated inflation was observed in transport inflation supported by softer fuel prices. In South Africa, headline inflation breached its target point for more than 13 months from May 2022 until June 2023, before easing in the second half of 2023. Inflation is expected to decelerate in both countries over the projected period which will offer some relief on households' purchasing power and reduce the risks to financial stability.

Figure 7: Policy expectations in South Africa and Namibia



Source: SARB

Both the BoN and the SARB tightened monetary policy during 2023. The BoN increased its repo rate by an aggregate of 100 basis points during 2023, from 6.75 percent at the end 2022 to 7.75 percent at the end of 2023 (Figure 7). These increases were necessitated to contain inflationary pressures and their second-round effects, as well as for anchoring inflation expectations. The tightening continued during the first four months of 2023 with a 25-basis point increase at the BoN's February and April meetings, respectively. The SARBs repo rate remained below inflation from November 2021 implying a broadly accommodative stance through the normalisation phase; however, the policy rate moved into restrictive territory following the May 2023 rate increase. Going forward, the SARB policy rate is projected to remain restrictive, although it might tilt downwards by 75 basis points in 2024, based on the Quarterly Projection Model forecasts. This is sufficient to maintain inflation within the midpoint of the 3-6 percent target range over the medium term.

International reserves

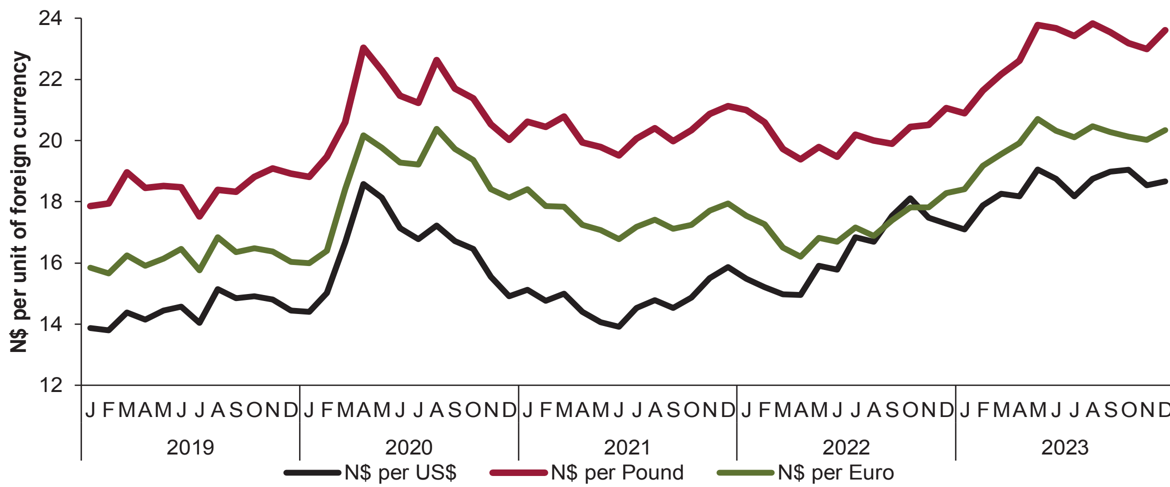
At the end of 2023, the stock of foreign reserves rose on an annual basis, supported by Southern African Customs Union (SACU) receipts and Government foreign borrowing. The stock of international reserves increased on an annual basis by 10.9 percent to N$53.2 billion at the end of 2023. The increase was supported not only by higher SACU receipts, but as well as by foreign borrowing by the Namibian Government in the form of a loan from Kreditanstalt für Wiederaufba (KfW) and the increase observed under net customer foreign currency placements. Moreover, the depreciation of the Namibia

Dollar against the US Dollar over the reporting period supported the rise in the stock level of reserve assets. In terms of the adequacy measure of international reserves, the import coverage of goods and services stood at 3.8 months in 2023, compared to 4.7 months in 2022, which remains above the international benchmark of 3.0 months. Going forward, the stock of foreign reserves is projected to increase to N$54.3 billion by the end of 2024. This increase is mainly on account of higher SACU receipts being anticipated in comparison with 2023.

Exchange rate developments

During 2023, the Namibia Dollar/ South African Rand weakened against major trading currencies, triggered by global recessionary fears and South Africa's subdued economic growth and export performance. The NAD depreciated against the US Dollar, British Pound and Euro by 12.8 percent, 14.2 percent, and 16.7 percent, respectively (Figure 8). The depreciation was largely due to an increase in interest rates in advanced economies, coupled with South Africa's weaker domestic growth in line with its widening budget deficit. Moreover, growth was slower than expected in South Africa's private sector, and higher levels of load-shedding coupled with a widening current account deficit further detracted from the strength of the ZAR to which the NAD is pegged.

Figure 8: Currency movement of the NAD against selected currencies

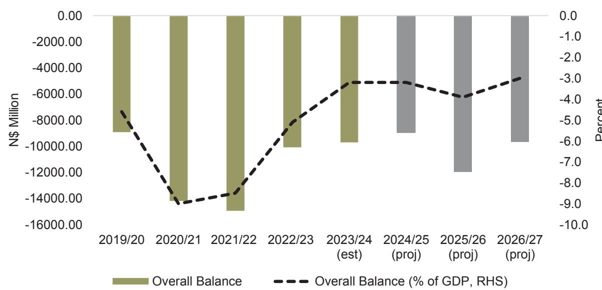


Source: SARB

Public finance

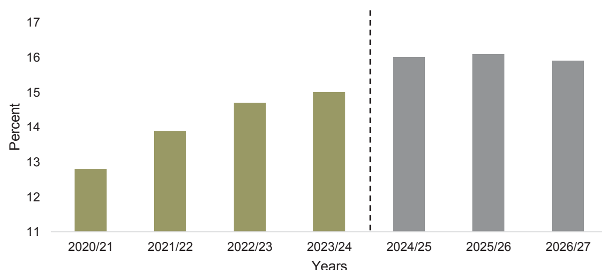
Central Government's budget deficit is estimated to narrow during FY2023/24, compared with the previous fiscal reporting period. The Central Government fiscal projections were comprehensively revised. The fiscal deficit is estimated to narrow during FY2023/24, compared to the preceding fiscal year, and also over the Medium-Term Expenditure Framework (MTEF) period (Figure 9). The budget deficit as a percentage of GDP is estimated to narrow to 3.2 percent from the initial 5.1 percent registered during the previous fiscal year. The narrowing of the deficit was ascribed to a pronounced increase in Government revenue compared with expenditure, which is estimated to increase by 26.0 percent to N$81.1 billion. This was due to an increase in income tax collection from individuals, an increase in diamond mining and non-mining tax, and the rise in SACU receipts. Over the MTEF period, the budget deficit as a percentage of GDP is projected to narrow to 3.0 percent in FY2026/27 as revenue is estimated to increase at an average of 10.3 percent, outpacing the rise in expenditure. Debt servicing as a percentage of revenue rose to 15.0 percent in FY2023/24 and anticipated to increase over the MTEF period due to a partial redemption of the Eurobond (Figure 10).

Figure 9: Public finance



Source: BoN and Ministry of Finance and Public Enterprises (MFPE)

Figure 10: Government debt service to revenue



Source: BoN and MFPE

Central Government debt stock rose in 2023, compared with the prior reporting year and was driven mainly by higher levels of domestic debt. The total Government debt stock stood at N$148.8 billion at the end of December 2023, reflecting an 8.1 percent gain driven by domestic debt issuance in the form of Treasury Bills and Internal Registered Stock. Total debt as a percentage of GDP stood at 65.3 percent at the end of 2023, representing a decline of 0.9 percentage point from the prior reporting year, on the back of debt rising at a slower pace than economic growth. Going forward, the total debt stock as a percentage of GDP is anticipated to start declining, moderating to 56.4 percent of GDP by the end of FY2026/27.

Namibian and South African sovereign credit ratings

Both Moody's Investor Service and Fitch Ratings maintained Namibia's long-term foreign currency credit rating at B1 and BB-, respectively, with a stable outlook, during 2023. Moody's B1 rating reflected Namibia's weak average real GDP as well as a stable and predictable business environment. The stable outlook balances risks, both upside and downside (Table 2). Upside risks stemmed from a more sustained and broader economic recovery than anticipated in Moody's baseline scenario, supporting a durable stabilisation in fiscal accounts and eventual reduction in the Government debt-to-GDP ratio. Downside risks stemmed from larger than anticipated dislocations triggered by Russia's invasion of Ukraine, resulting in persistent balance of payment disruptions that could weigh on the economy's foreign exchange reserve buffer. Fitch affirmed Namibia at BB- with a stable outlook, citing that it was supported by its strong governance indicators, institutional framework, and fiscal financing flexibility underpinned by the large NBFI sector. This outlook is balanced against elevated fiscal deficits, a rigid fiscal structure, high government debt levels, and moderate medium-term growth prospects. The stable outlook reflects Fitch's view that the Government's fiscal consolidation efforts will limit the rise in Government debt and lead to its stabilisation over the medium term.

In April 2024, Moody's Investor Service changed Namibia's outlook to positive and affirmed the B1 rating on the back of improved growth prospects and renewed investments. According to Moody's, Namibia's improved growth prospects reflect not only a strong cyclical recovery in the traditional mining sector and higher commodity prices in a post-pandemic environment but also the rapid development of new industries. These include promising oil and gas developments, in addition to foreign-funded investments in the renewable energy sector which could potentially have a transformative impact on the Namibian economy over the next decade.

Table 2: Namibia's sovereign credit rating and outlook

Rating agency	Rating	Outlook	Date of update	Action
Moody's	B1	Stable	18 July 2023	Rating affirmed and stable outlook
Fitch	BB-	Stable	02 June 2023	Rating affirmed and stable outlook
Moody's	B1	Stable	05 April 2024	Rating affirmed and positive outlook

Source: Moody's and Fitch

Fitch affirmed South Africa's sovereign credit rating during 2023 and maintained a stable outlook. Given the NAD's peg to the ZAR, sovereign credit rating decisions in South Africa play a role for financial stability in South Africa as well as Namibia. Fitch outlined that the key rating drivers and actions taken with respect to South Africa were related to credit fundamentals and the weak economic growth outlook for the country's economy. Fitch kept the rating stable at BB-, reasoning that South Africa's low economic growth continued to be hampered by power shortages, high levels of inequality and a high - and rising - government debt-to-GDP ratio, while still having a modest path of fiscal consolidation (Table 3). However, the ratings were slightly bolstered by a favourable debt structure, consisting of securities with long maturities denominated mainly in the local currency as well as by a credible monetary policy framework.

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

Rating agency	Rating	Outlook	Date of update	Action
S&P	BB-	Stable	08 March 2023	Rating affirmed and outlook downgraded
Fitch	BB-	Stable	17 July 2023	Rating affirmed and outlook stable

Note: On 8 March 2023, Standard and Poor's (S&P) changed their outlook for South Africa from "positive" to "stable". The rating remains BB-, which is three notches below investment grade.
Source: S&P and Fitch

During March 2023, S&P further downgraded South Africa's credit rating outlook from positive to stable and affirmed its debt grade at BB-. According to the rating agency, the stable outlook was due to expectations that economic growth may face increasing pressure from infrastructure constraints, particularly severe electricity shortages. S&P further noted that reforms to address infrastructure shortfalls and improve governance and performance at State-owned enterprises (SOEs) were slow and were impeding economic growth. South Africa could improve its credit rating if there was increased confidence that the high government debt-to-GDP levels would stabilise and if medium-term growth prospects improved to the extent that they could support fiscal consolidation.

On 23 February 2023, Namibia was grey listed by the Financial Action Task Force (FATF) which posed a potential risk to the financial system. FATF grey listing implies that Namibia is subject to increased monitoring, due to remaining concerns over complying with international Anti-Money laundering (AML), Combating the Financing of Terrorism (CFT) and Combatting Proliferation Financing (CPF) standards. The grey listing consequently means that all financial transactions with Namibia will require enhanced due diligence. In the short term, the immediate implication is that costs will arise from processing, monitoring, and reporting. Moreover, the implications of Namibia remaining greylisted for an extended period include reduced foreign investment, as investors will perceive Namibia as a high-risk investment destination. This, in turn, can potentially affect Namibia's financial stability through the country-risk-premium channel. However, the country's strong commitment to meet all concerns raised by the FATF through accelerating progress towards full effective compliance with international standards, thereby enhancing Namibia's rapid exit from the FATF grey listing is a crucial step towards further safeguarding the stability and integrity of the national financial system.

4 DOMESTIC HOUSEHOLD AND CORPORATE DEBT INDICATORS

DOMESTIC HOUSEHOLD AND CORPORATE DEBT INDICATORS

Household debt to disposable income

A marginally reduced growth rate was reported for household indebtedness for 2023 on the back of a lower uptake in credit. The annual growth in household debt inched lower to 3.3 percent at the end of 2023, in comparison with a growth of 3.4 percent in 2022 (Table 4). The growth reduction – from 4.7 percent in 2022 to 3.0 percent in 2023 –- was mainly due to a lower uptake of credit from banking institutions by individuals. Notably, however, individuals borrowed mainly from NBFIs during 2023, particularly microlenders as it registered a growth rate of 6.1 percent in 2023 compared with a contraction of 7.8 percent in 2022. Considering the banks' evolving credit standards, individuals are increasingly turning to alternative lending sources, such as microlenders to meet their financing needs. The increase in borrowing from microlenders, who are often associated with higher costs compared to banks, may be a sign of strain on household cash flows and no further scope for banking sector credit. This does not bode well for the domestic economy's financial stability, by way of potential overextension and debt serviceability challenges.

Table 4: Ratio of disposable income to household debt

Disposable income and household debt	2019	2020	2021	2022	2023
Disposable income (N$)	136,462	138,328	134,362	149,480	164,663
Ratio of credit to disposable income (%)	42.4	43.7	46.0	43.3	40.5
Total credit extended to households/Individuals (N$)	57,921	60,518	61,791	64,723	66,648
Adjusted credit to households/individuals* (N$)	63,774	66,573	69,107	71,465	73,805
Growth rate in household debt (%)	3.9	4.4	3.8	3.4	3.3
Adjusted credit of households/Individuals-to-disposable income** (%)	46.7	48.1	51.4	47.8	44.8

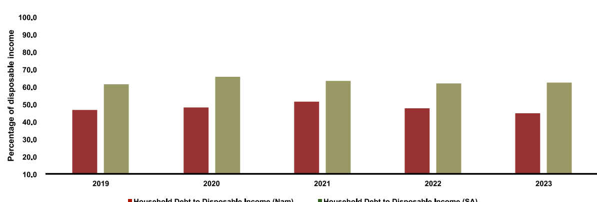
* The ratio of household debt to disposable income is calculated based on data received from the National Accounts.
** This category includes credit extended to households by both banking and non-bank financial institutions.
Source: BoN

The ratio of household debt to disposable income declined in 2023, as the growth of income exceeded that of debt. Household debt constituted 40.5 percent of disposable income in 2023, compared to 43.3 percent in 2022 (Table 4). The lower ratio was due to disposable income outpacing the increase in household debt during the period under review. In this regard, disposable income grew annually by 10.2 percent in 2023, compared to a growth of 11.3 percent reported in 2022. Although the growth in disposable income was lower than in the previous year, it was higher than the 3.3 percent growth in household debt registered during 2023. The uptick in disposable income was mainly on account of a N$6.5 billion increase observed during 2023 under the Compensation of employees category. This is due to inflationary adjusted salaries coupled with recruitments by the Government. Nonetheless, a lower ratio of this nature does not necessarily point to reduced household indebtedness or to subdued demand for credit by individuals; rather, it indicates the change in credit relative to disposable income. Generally, a lower ratio is a positive development for the stability of the financial system. Going forward, risks to financial stability emanating from household credit thus remain minimal, especially given the tax relief in early 2024 and the anticipated bank rate cuts in the second half of 2024.

The unadjusted ratio of household debt to disposable income in Namibia remained lower than that of South Africa in 2023. Namibia's ratio of household debt to disposable income declined to 44.8 percent in 2023, from 47.8 percent registered during 2022 (Figure 11). The decline in the ratio is mainly due to an increase in disposable income which outpaced the marginal growth experienced in household debt. However, as a percentage of nominal disposable income, household debt in South

Africa increased marginally by 0.4 percentage point to 62.4 percent in 2023. The increase in the ratio during 2023 was due to the increase in household debt which exceeded that in households' nominal disposable income.

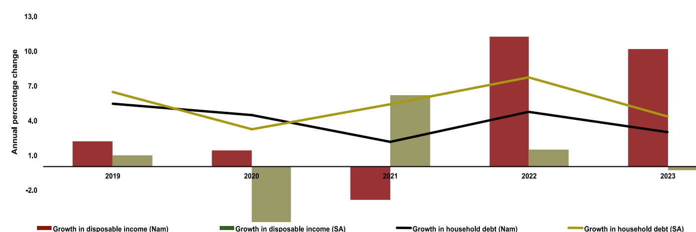
Figure 11: Household debt to disposable income (Namibia and South Africa)



Source: BoN and SARB

The annual growth in household disposable income declined marginally in Namibia during 2023. The magnitude of growth in household disposable income slowed by 1.1 percentage points to 10.2 percent in 2023 from its level of 11.3 percent in 2022 (Figure 12). This was ascribed to higher growth in the Primary income payable component, which increased by 35.0 percent during 2023 in comparison with its 2022 level. Notably, the Compensation of employees category continued to experience a higher growth during 2023. On the other hand, real household disposable income in South Africa contracted by 0.3 percent during 2023 in comparison with the previous year (Figure 12).

Figure 12: Growth in household debt and disposable income – Namibia (NA) and South Africa (SA)



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

Debt servicing ratio

The ratio of debt servicing to disposable income declined during 2023. This ratio declined from 6.3 percent in 2022 to 5.9 percent in 2023 (Table 5). The decline in the ratio was due to lower growth in credit extension coupled with growth observed in disposable income during 2023.

Corporate debt

Namibia's total corporate debt stock increased in 2023 mainly due to an increase in foreign debt. The total debt increased from N$157.8 billion at the end of 2022 to N$176.0 billion at the end of 2023 (Table 6). Although the growth in total debt was mostly driven by foreign debt, domestic debt also rose by N$1.2 billion during the period under review. The upsurge in domestic debt was due to increased demand for overdraft facilities by public non-financial corporations, particularly those operating in the

Table 5: Debt servicing ratios (percent)

	Gross Income Growth (Y-o-Y)	Disposable Income Growth (Y-o-Y)	Annual Debt Servicing Growth (Y-o-Y)	Debt Servicing to Gross Income	Debt Servicing to Disposable Income	Adjusted Debt Servicing to Gross Income	Average Prime Rate
Dec-2019	1.4	1.4	4.4	6.7	6.0	9.8	10.3
Dec-2020	-1.8	0.1	-6.3	6.4	5.6	9.4	7.5
Dec-2021	1.6	-0.9	1.8	6.4	5.8	9.4	7.5
Dec-2022	12.0	9.9	19.2	6.8	6.3	10.0	10.5
Dec-2023	10.0	13.3	6.3	6.6	5.9	9.6	11.5

Source: BoN

telecommunications sector. The significant increase of N$17.0 billion in foreign debt was primarily because of increased borrowing by companies in the mining sector from their related entities abroad, coupled with higher deposits by non-resident entities in the domestic banks. This heightened level of foreign debt was exacerbated by the depreciation of the NAD against the US Dollar.

Corporate debt as a percentage of GDP has increased since the last Financial Stability Report. Namibia's corporate debt as a percentage of GDP increased from 71.9 percent at the end of 2022 to 73.0 percent at the end of 2023 (Table 6). Similarly, the ratio of foreign corporate debt to GDP increased from 49.6 percent in 2022 to 52.8 percent in 2023. The increase in domestic corporate debt does not pose a significant risk to the stability of the domestic financial system as most of the increase emanated from sectors that boost growth in the economy. However, for financial stability purposes, it is still important to continue monitoring foreign corporate debt given its exposure to exchange rate risk.

The total SOE debt stock declined during 2023. Overall, SOE debt fell to about N$9.7 billion by the end of 2023, down by 2.6 percent from N$10.0 billion at the end of 2022 (Table 6). Total SOE debt fell as the parastatals, for the most part, repaid some of the principal amount on their foreign debt during the reporting period, while their domestic debt increased significantly, by N$1.0 billion during 2023, up from the N$365.0 million registered during 2022.

Total foreign private sector debt servicing increased during the period under review. The total value of

Table 6: Domestic and external corporate debt (corporate and parastatals)

N$ million	2019	2020	2021	2022	2023
Domestic debt	45,713	44,842	44,874	46,173	47,351
Local corporate debt	44,853	44,307	44,258	45,808	45,979
Local debt of SOEs	860	535	616	365	1,372
Foreign debt	80,656	82,435	94,671	111,672	128,687
Foreign corporate debt	71,058	72,367	85,201	102,036	120,315
Foreign debt of SOEs	9,598	10,068	9,470	9,636	8,373
Total SOE debt	10,458	10,603	10,086	10,001	9,745
Total debt	126,369	127,277	139,545	157,845	176,038
Nominal GDP	181,211	174,243	183,292	205,549	227,831
Corporate debt as a % of GDP	64.0	67.0	70.6	71.9	73.0
Foreign corporate debt as a % of GDP	39.2	41.5	46.5	49.6	52.8
Foreign debt as a % of total debt	63.8	64.8	67.8	70.7	73.1

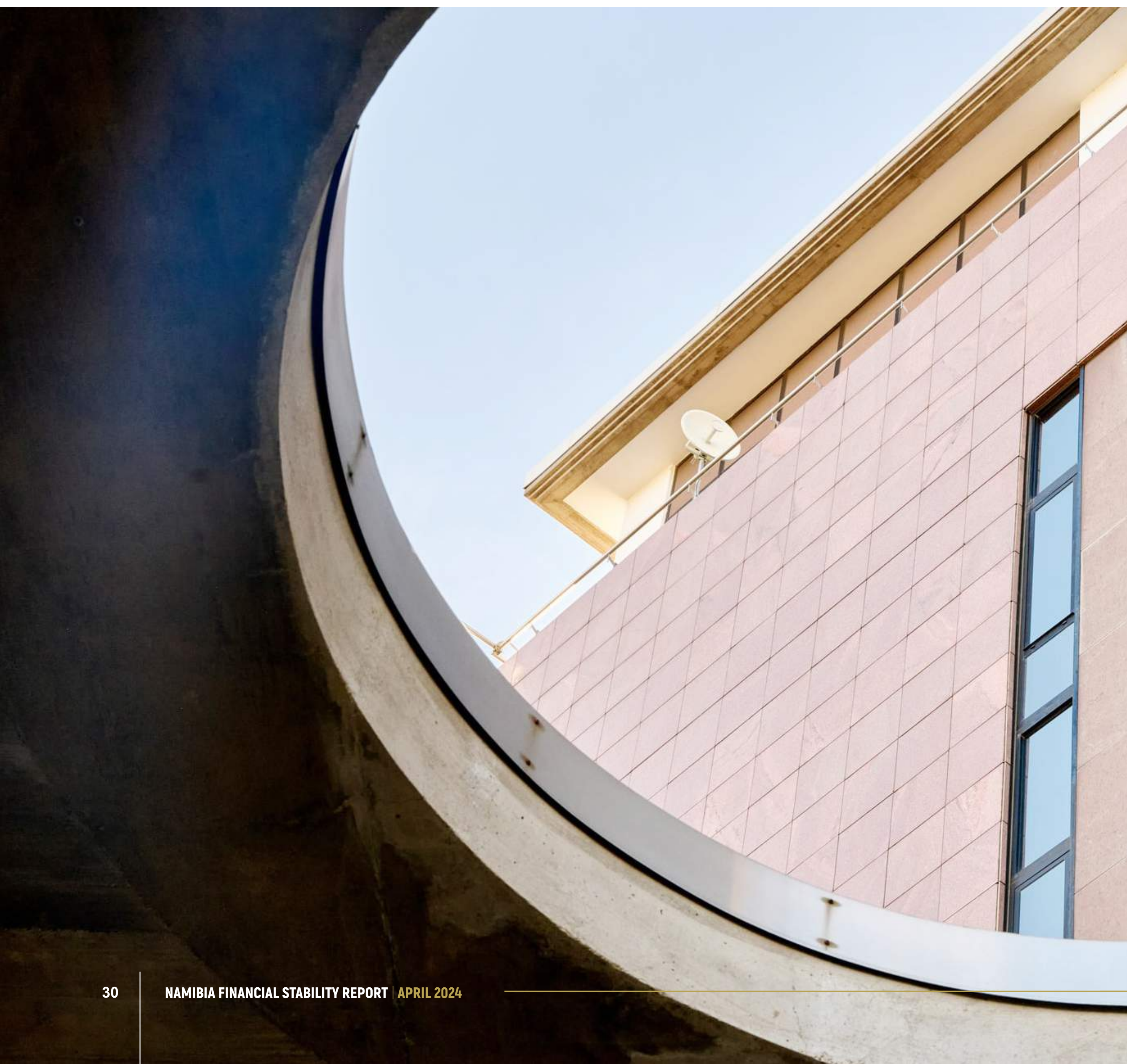
Source: BoN and NSA

repayments on Namibia's foreign private sector debt increased to N$35.6 billion in 2023, 38.2 percent higher than in the previous reporting period (Table 7). This was mainly driven by higher debt servicing by foreign-owned subsidiaries operating in the mining sector, to their foreign parent enterprises. The increase in private sector debt servicing was also due to loans being repaid and trade credit obligations being met by local entities in the retail sector.

Table 7: Foreign private sector debt and debt servicing

N$ million	2019	2020	2021	2022	2023
Total foreign private sector debt	80,656	82,435	94,671	111,672	128,687
Total foreign private sector debt servicing	21,644	16,614	16,816	25,760	35,608

Source: BoN



Growth in both household and corporate debt slowed during 2023.

5 PROPERTY MARKET ANALYSIS

PROPERTY MARKET ANALYSIS

Mortgage loans continued to dominate the banking sector total loans and advances at the end of 2023. Domestically, residential housing represents a larger proportion of the households' total credit, accounting for 68.2 percent of the total household credit at the end of 2023. This is marginally lower when compared to the 68.4 percent recorded in 2022. On the other hand, mortgage credit for the corporate subsector accounted for 30.0 percent in 2023, lower compared to 31.5 percent noted in 2022 (Table 8). Additionally, mortgage advances constituted approximately 52.6 percent of the banking sector total loans and advances, lower compared to the 53.1 percent observed in 2022. Mortgage advances contribute to the largest portion of the banks' NPL, amounting to 55.1 percent at the end of 2023, compared to 55.6 percent in 2022. This underscores the need to not only monitor the property market continuously, but also recognise that fluctuations in property prices alongside high borrowing costs could have an impact on the performance of the banking sector.

Table 8: Household and corporate mortgage share as a percentage of total household and corporate loans and advances

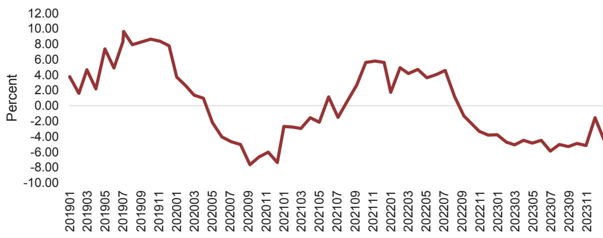
Credit category and percentage share of total credit	N$ million				
	2019	2020	2021	2022	2023
Household credit					
Total household credit	61,352.1	60,518.0	61,791.4	64,722.6	66,648.2
Total mortgage credit	41,302.9	41,872.0	42,958.6	44,270.8	45,466.5
Household mortgage credit % share	67.3	69.2	69.5	68.4	68.2
Corporate credit					
Total corporate credit	41,419.2	44,307.0	44,258.4	45,808.4	45,978.5
Total mortgage credit	12,048.7	12,363.0	13,086.4	14,412.9	13,772.9
Corporate mortgage credit % share	29.1	27.9	29.6	31.5	30.0

Source: BoN

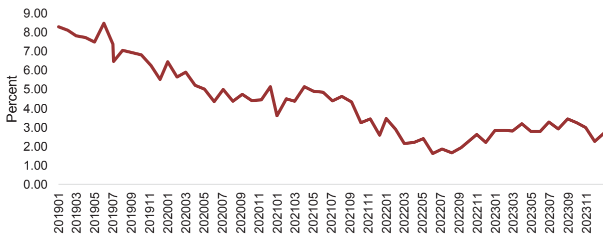
Credit developments

The annual growth in total credit extension for the mortgage market remained low in 2023 from a slower growth observed in 2022. Overall, annual growth in total mortgage credit increased by 0.9 percent in 2023, which is lower when compared to 1.1 percent observed in 2022 (Figure 13c). The lower growth is eminently reflected in the uptake of mortgage credit from the corporate sector, which contracted by 4.4 percent on an annual basis (Figure 13a). Conversely, despite progressing at a slower pace, the mortgage credit extension in the household sector continued to show signs of improvement, recording an annual growth rate of 1.0 percent in 2023 (Figure 13b). Notwithstanding this improvement, the level of mortgage credit remained muted compared to historical trends. Additionally, a high interest rate environment, sluggish job creation, and conservative lending practices by the banks towards mortgage credit may have dampened consumer confidence and reduced appetite for property related investments. Slow income growth may have also contributed to consumers having limited capacity to take on additional debt for mortgage expenditure, thus contributing to subdued credit expansion in the market.

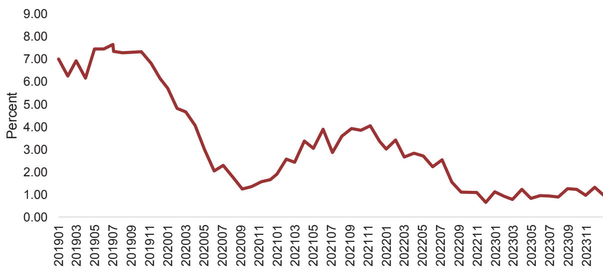
Figure 13(a)-(c): Corporate mortgage credit growth



(b) Household mortgage credit growth



(c) Total mortgage credit growth

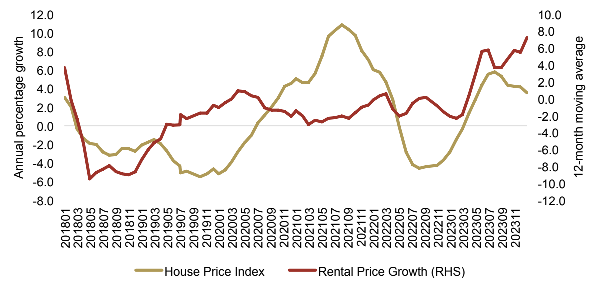


Source: BoN

House price developments

The House Price Index (HPI) witnessed a notable improvement during the review period. Notwithstanding the elevated interest rate environment, and subdued economic activity, the HPI improved indicating positive momentum in the housing market. In 2023, the HPI increased by 3.9 percent, a significant improvement following the period of stagnation, and negative growth of 2.9 percent recorded in 2022 (Figure 14). The improvement was primarily driven by robust growth in the Coastal, Southern, and Northern regions, where the value of property transactions increased, while that of the Central region declined. Despite total mortgage credit growing at a slower pace during the review period, the increase in the HPI is in line with the increase in the uptake of mortgage credit by the household subcategory.

Figure 14: House Price Index and Rental Price Index



Source: First National Bank Namibia (FNB), 2023

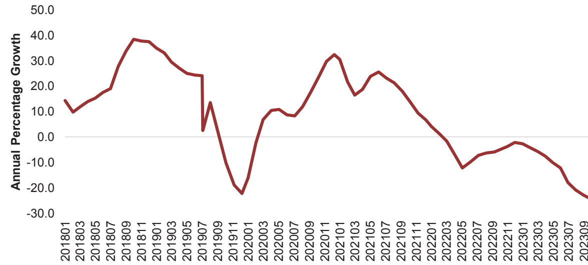
Growth in rental prices increased during the period under review, despite the weak consumer environment. Following contractions noted in the first quarter of 2023, the Rental Price Index increased by 7.2 percent at the end of December 2023, from a decline of 2.1 percent growth observed in the corresponding period of 2022 (Figure 14). The growth continues to be dominated by an upswing in the rentals of 3 bedroom, 2 bedroom, and one-bedroom rental categories, while growth in the demand for +3 bedroom rental category declined during the review period. Overall, the observed growth in the rental prices is a positive development from the homeowner's perspective given how reliant homeowners are on this income stream to continue servicing their mortgage debt. This is particularly important during periods of sluggish wage growth and limited employment opportunities in Namibia.

Property sales

The volume of sales in the housing market remained low during 2023, but is expected to improve in 2024. The volume of housing sales declined significantly by 24.5 percent in September 2023, relative to a growth of 6.0 percent observed in September 2022 (Figure 15). The continuous negative growth in the volume of property sales can be attributed to several factors influencing lending behaviour. Notably, the prevailing high interest rate environment amplified borrowing costs and deterred both businesses and households from taking on additional debt for property investment, thereby constraining overall credit expansion in the property market. Despite the contractions noted, the volume of sales is anticipated to improve in 2024 on the back of enhanced financial conditions, driven by the expansionary fiscal policy measures. This enhancement includes the increase in civil servant salaries, the new tax regime and the housing subsidy adjustments, which are all not only substantial in boosting disposable income for

a wide range of economic agents, but also promote land and property acquisition.

Figure 15: National Volume Index (Sales)

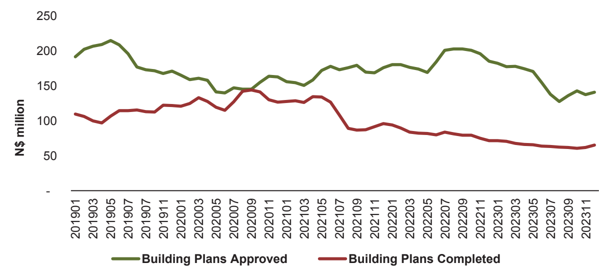


Source: FNB, 2023

Supply side developments

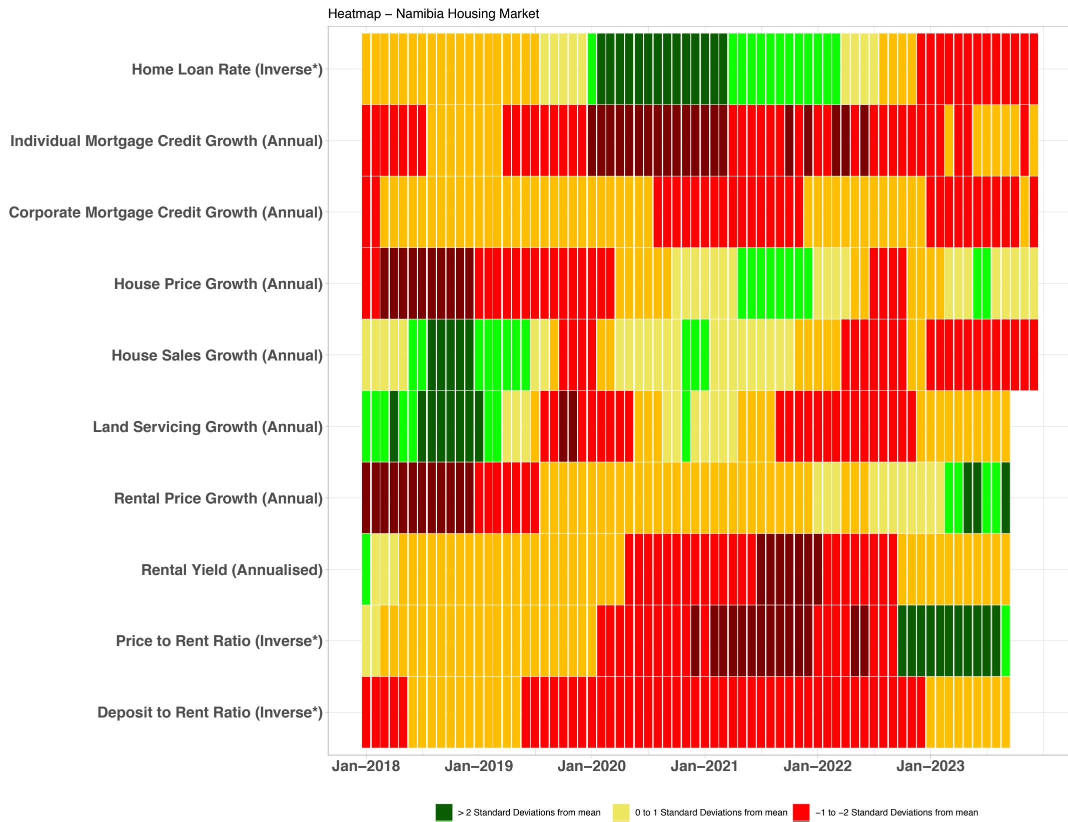
The number of building plans approved and completed increased at the end of 2023, compared to the corresponding period of 2022. Following a contraction in the last quarter of 2022 and the first quarter of 2023, both building plans approved and completed showed consecutive increases at the end of 2023 (Figure 16). Notably, the number of building plans completed has been trending marginally downwards since 2021, mainly due to the elevated inflation and interest rate environment. These two factors make financing more expensive especially regarding the cost of materials, which in turn reduces construction activity. Looking ahead, the developments on building plans approved and completed are expected to improve further on the back of moderate inflation forecast. This suggests that the rate at which the cost of materials and labour grows is likely to decelerate, thus creating an environment conducive for stimulating construction activity.

Figure 16: Building plans approved and completed (12-month moving average)



Source: FNB, 2023

Property market risk heatmap



Source: BoN

The property market heatmap analysis revealed that the property sector exhibited noteworthy trends during the period under review, when compared to the preceding period. During 2023, the property market reflected an improvement from the prior reporting year, which had experienced considerable pressure. The maintenance of the repo rate at 7.75 percent since June 2023 brought a sense of stability to the property market during the period under review. Notwithstanding this, interest rates remained high during 2023 and continued to pose challenges for prospective home buyers. Household mortgage credit continued to display improvements in 2023 compared to 2022, while mortgage credit to the corporate sector remained vulnerable throughout 2023, potentially reflecting underlying economic uncertainties.

Several favourable developments were noted in the house prices and rental sector during the review period compared to 2022. Such developments included the enhanced rental rates, an improved deposit-to-rent ratio, increased rental yields, as well as a more favourable price-to-rent ratio, all of which are favourable to landlords and property investors. Positive trends in house prices and the rental market suggest a healthy environment for both homeowners and investors. Overall, the property market showed no significant signs of vulnerability in 2023, except for the high interest rates and limited growth in credit extension, particularly within the corporate subsector.

Going forward, the overall performance of the property market is anticipated to improve. The positive prospect rests on the domestic inflation outlook which suggests a moderation in 2024, in turn potentially signalling eased financial conditions in relation to interest rates. In addition, expansionary fiscal policy measures such as housing subsidies and tax benefits are anticipated to alleviate homeowner burdens, boost disposable income for certain economic agents, and potentially stimulate mortgage credit uptake. Lastly, the policy initiative undertaken by the BoN to revise the loan-to-value (LTV) ratio regulation in October 2023 to support economic activity, might also improve the overall performance of the property market.

Review of macroprudential policy intervention

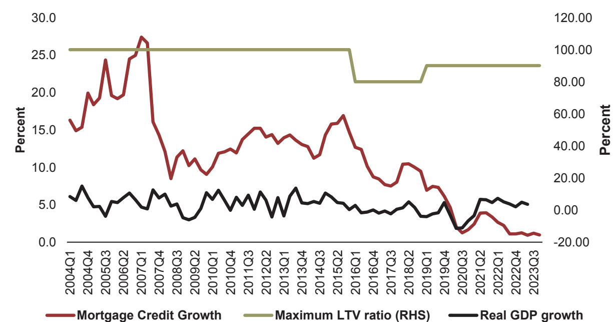
The main objective of macroprudential policy in Namibia is to promote and safeguard financial stability through the early identification and mitigation of systemic risks. In line with the Bank of Namibia Act (Act No 1 of 2020), and the Financial Stability and Macroprudential Oversight Framework (2023), the BoN is mandated to exercise macroprudential oversight over the financial system. The BoN is also tasked with coordinating activities involved with safeguarding the stability of the financial system.

The decision-making powers to execute this macroprudential mandate have been entrusted to the Macroprudential Oversight Committee (MOC). The MOC is in turn supported by the FSSC which acts as its advisory body. The MOC meets twice a year and at any other time if the need arises. The decisions of these meetings are published in the form of MOC statements on the BoN's website. This section on the review of the macroprudential policy interventions thus provides an overview of the analyses considered by the MOC during 2023.

Overview of LTV ratio regulation in Namibia

The LTV regulation was introduced in 2016, effective March 2017. This was in response to the rapid growth in house prices and to contain the risk of credit concentration of the commercial banks' loan books to mortgage loans. Subsequent to the introduction of the LTV regulation, the overheated property market cooled down as the house price growth contracted by 3.1 percent at the end of 2017 compared to 12.5 percent from the first quarter of 2017. Similarly, mortgage credit contracted by 8.4 percent and 12.7 percent, respectively, during the same period (Figure 17). The housing market activity was further impacted by a slow down in real GDP growth due to downturns in the mining, construction, wholesale and retail trade, as well as manufacturing sectors. The contraction was primarily attributed to fiscal consolidation, coupled with inflationary pressures and higher interest rates from 2016 to 2017 which played a significant role in the strain observed in mortgage credit extension and house prices. Given the weak development in the property market, the BoN amended the 2016 LTV regulation in 2019 to correct the sharp decline in the demand for mortgage credit, house prices, and rapid deleveraging in the banking sector. Despite the eased LTV limits, the housing market continued to perform poorly, coupled with weak economic growth (Figure 17).

Figure 17: Growth in mortgage credit and real GDP versus LTV ratio trends[9]



Source: BoN

At its first meeting in 2023, the MOC concluded that macroprudential policy intervention was needed to support the domestic economy. This was primarily in response to the challenges faced by the property market. The dampened demand was reflected in the contraction of mortgage credit extension, sales volumes nationwide and muted economic activity particularly in the construction sector. Thus, the regulation governing the LTV ratio was revised and came into effect on 31 October 2023.

The LTV ratio regulation revisions align with the macroprudential authority's objectives of promoting a balanced and sustainable property market while safeguarding financial stability. The 2023 intervention involved implementing less strict LTV ratios, i.e. no downpayments are required to purchase first and second residential properties. However, for the third and subsequent properties, prospective buyers are required to make a 10 percent deposit when acquiring a home loan. This is contrary to the LTV ratio requirements imposed in 2016 and 2019, which mandated deposits for both second and subsequent properties. By strategically easing lending restrictions in targeted segments of the market, the revision of the LTV ratio as a macroprudential policy intervention was aimed at stimulating demand for property by reducing upfront costs for buyers. This was not only particularly beneficial for investors or individuals

[9] The LTV ratio displayed in Figure 2 is the maximum LTV ratio for the first non-primary residential mortgages for the respective periods under review

seeking to expand their property portfolios, but it also aimed at stimulating economic activity particularly in the construction sector. The intervention was also geared towards fostering a more resilient and dynamic property market and ultimately supported overall financial sector stability.

Notwithstanding this positive development, it remains imperative to exercise caution to ensure prudent lending practices within the banking sector. The recently implemented amendment of the LTV ratio regulation serves as a complementary measure to existing microprudential supervision and to the commercial banks' internal risk management practices. Thus, while the LTV ratio regulation reinforces the existing set of credit risk mitigation tools, it is not intended to address all aspects of credit risk associated with borrowers or to replace commercial banks' existing internal credit assessment policies and procedures. In this regard and in the context of enhancing the macroprudential policy toolkit to mitigate various risks in the banking sector, the BoN is considering implementing a countercyclical Capital Buffer (see Box Article 1). This is in alignment with ongoing efforts by the BoN to enhance its risk monitoring framework to ensure financial system stability.

ARTICLE 1: IMPLEMENTATION OF A CCYB AS A MACROPRUDENTIAL POLICY INSTRUMENT IN NAMIBIA

Introduction

On 7 December 2023, at its second Macroprudential Oversight Committee (MOC) meeting, the BoN announced its intention to implement the countercyclical capital buffer (CCyB) in Namibia. The CCyB is a key macroprudential policy instrument that the MOC will be using to deliver on its mandate of protecting and enhancing the resilience of the Namibian financial system. Generally, macroprudential instruments aim to enhance the overall resilience of the financial system with the goal of providing more effective protection to the real economy by addressing systemic risks posed by financial cycles. This Article, therefore, provides an overview of the CCyB conceptual framework and assesses the performance of the common reference guide for taking CCyB decisions in Namibia.

The origin of the CCyB

The Basel Committee on Banking Supervision (BCBS) introduced the CCyB to enhance the resilience of the global banking system. The aftermath of the 2008 global financial crisis (GFC) has prompted reforms of the global financial regulatory architecture in which new standards, tools, and practices are increasingly being developed and implemented. The BCBS, through Basel III[3], introduced reforms that aimed to strengthen the regulation, supervision and risk management of the global banking sector to enhance its resilience. These reforms were also intended to address flaws in the regulatory framework and strengthen the resilience of financial system, especially those deficiencies that had contributed to the GFC. The reforms further strengthened the microprudential regulation and supervision while adding a macroprudential overlay that included capital buffers such as the CCyB, to reduce the extent to which economic shocks could be amplified by the banking system.

The objective of the CCyB

The primary objective of the CCyB is to ensure that the banking system is well-prepared to withstand potential shocks and stress during economic downturns. Thus, the CCyB serves as a measure of protection to the banking sector against the build-up of systemic risks associated with periods of excessive aggregate credit growth. Protecting the banking sector in this regard is not merely to ensure that banks remain solvent during a period of stress, as the minimum capital requirements and capital conservation buffer (CCB) are already designed to fulfil this objective. Instead, the CCyB's aim is to ensure that the banking sector has adequate capital readily available to help maintain the flow of credit in the economy, without its solvency being questioned when the financial system experiences stress, after a period of excess credit growth.

The CCyB seeks to ensure that the banking sector accumulates additional capital during credit boom periods and releases it when credit is constrained. The additional capital can be used ("released") to absorb losses or meet increased capital requirements when systemic risk manifests. These measures will help minimise the risk of credit supply constraints, which could in turn undermine the performance of the real economy and result in additional credit losses in the banking system. Thus, the CCyB guarantees that capital requirements for the banking sector consider the macroeconomic environment in which they operate, which, on the other hand, will ensure that the flow of credit is not constrained by weak macroeconomic fundamentals. This dual function promotes both financial stability and economic activity.

In the context of Namibia, banks are required to maintain minimum capital requirements, as well as a capital conservation buffer (CCB) as part of the Basel II / III regulatory requirements. While the minimum capital adequacy ratio and the CCB aim to shield individual banks from potential exposure to common systemic risks, the CCyB supplements these two measures by safeguarding the banking sector against cyclical risks. This makes the CCyB an extension of the CCB.

[10] The third Basel Accord is a framework that sets international standards for bank capital adequacy, stress testing and liquidity requirements.

Table 1A outlines the capital requirements of domestic systemically important banks (DSIBs), as part of the Basel III Capital Accord. Not included in Table 1 are the requirements of non-DSIBs, which are required to comply with the Basel II Capital Accord. The latter requirements comprise a Common Equity Tier 1 ratio of 7.5 percent and Tier 2/3 capital ratio of 2.5 percent.

Table 1A: DISBs minimum capital ratios and capital buffers[1]

Policy Instrument	Required ratio
Macroprudential	
Countercyclical capital buffer	0% up to 2.5%
Microprudential	
Minimum capital ratios	
Common Equity Tier 1 ratio	6.0%
Additional Tier 1 ratio	1.5%
Tier 2 capital adequacy	2.5%
Capital conservation buffer	2.5%

Source: Bank of Namibia, Determination on the Measurement and Calculation of Capital Charges for Credit Risk, Operational Risk and Market Risk for Domestic Systemically Important Banks (BID-5A).

Key principles in establishing a CCyB framework

According to the BCBS guidelines in operating the CCyB, a clear set of principles needs to anchor CCyB judgements applied by the various jurisdictions so that decision-making in setting is sound. The guidelines set out five operating principles that inform CCyB decisions, jurisdictional reciprocity, frequency and communication of buffer decisions, handling of surplus capital upon buffer removal, and the interaction of the CCyB with other capital requirements of the Basel III Accord. These principles are essential in the CCyB decision making process and should be integral to its overall operation. The five principles are summerised as follows:

a. Buffer decisions should be guided by the buffer's objectives,
b. The credit-to-GDP gap guide should be the common reference point,
c. Assessments should consider the risk of misleading signals,
d. There should be a prompt release of the buffer at the appropriate time, and
e. There should be additional macroprudential tools to compliment the buffer.

Calibration of the CCyB rate

Regulatory authorities are expected to prepare for the implementation of a CCyB policy at a national level. To assist national authorities, the BCBS has proposed a methodology to calculate an internationally consistent buffer rate guide that can serve as a common reference point for taking buffer decisions. The buffer rate should be set as a percentage of risk-weighted assets (RWAs) of the banking institutions operating in the country in question. The buffer rate guide entails the following three steps in setting the buffer rate:

a) Calculate the aggregate private sector credit-to-GDP ratio as a percentage.

b) Calculate the credit-to-GDP gap expressed as the difference between the credit-to-GDP ratio and its long-term trend. To achieve this, a one-sided Hodrick-Prescott (HP) filter with a high smoothing parameter of 400,000 should be used as recommended by the BCBS guidelines. The HP filter is preferred over the simple moving average and linear time trend as it allocates higher weights to more recent observations, which is more useful to effectively deal with structural breaks.

c) Transform the credit-to-GDP gap into the indicative buffer add-on, expressed as a percentage of RWAs.

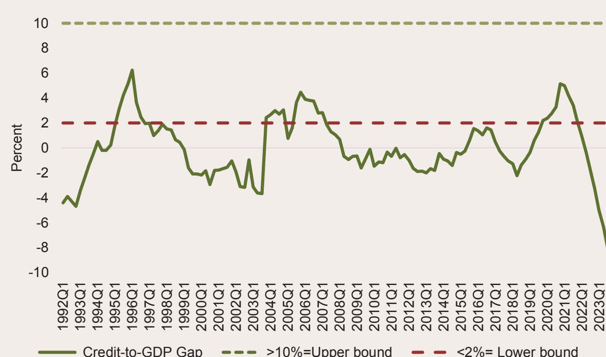
The proposed methodology outlines that the implementation of the buffer add-on depends on deviations of the actual credit-to-GDP ratio from its long-term trend. According to the BCBS guidelines, and subject to the five operating principles mentioned above, a buffer add-on is to be set at 0 percent when the credit-to-GDP ratio is below its long-term trend. However, a buffer add-on should be adjusted to its maximum rate of 2.5 percent when the credit-to-GDP ratio exceeds its long-term trend, as this suggests a period of excessive credit growth and the heightening of systemic risk. In cases where the credit-to-GDP ratio ranges between the lower and upper thresholds of 2 and 10 percent, the buffer add-on should be adjusted linearly between 0 percent and 2.5 percent.

[11] Additional Tier 1 capital and CCB are only applicable to the DSIBs.

Calculating the credit-to-GDP gap in Namibia

Using data over the period 1992 to 2023, the proposed methodology suggests that imposing the CCyB should be considered during periods of excessive credit extension or if the credit-to-GDP ratio is above its long-term trend. The credit-to-GDP gap declined during the periods between 1992Q1 to 1994Q3, 1999Q1 to 2003Q3, 2008Q2 to 2015Q2, 2017Q2 to 2019Q2 and 2022Q2 to 2023Q3 (Figure 1A). This decline indicates a shift from a credit boom phase to a credit contraction phase, signalling a moderation in credit growth and a potential cooling off, of the economy, such as a slowing down in general economic activity, increased unemployment, and the tightening of other macro-financial indicators. The macroprudential authority should monitor trends closely during periods of credit contraction and, if necessary, release the CCyB to mitigate risks associated with such contractions and their impact on financial stability. Furthermore, Figure 1A reveals four credit boom periods (1996Q2 to 1996Q3, 2003Q4 to 2004Q4, 2005Q3 to 2007Q1, and 2019Q4 to 2021Q4) in which the macroprudential authorities would activate a positive buffer add-on as per the BCBS guidelines. This is to ensure that banks maintain an additional capital buffer to counteract potential risks arising from excessive credit growth and potential systemic imbalances.

Figure 1A: Namibia's HP filter credit-to-GDP gap



Source: BoN

Determination of the buffer rate in Namibia

Determining the CCyB rate also includes discretionary elements, in that the set rate does not need to be automatically set equal with that suggested by the reference guide indicator. Rather, the specific rate is determined after an overall assessment of systemic risks and vulnerabilities, including an analysis of complementary indicators and the consideration of the prevailing economic conditions, credit cycle dynamics, and financial stability objectives. Thus, all these macro-financial indicators should help assess whether the MOC stance regarding the CCyB should be "Neutral," "Tightening," or "Loosening" relative to the signal generated by the reference guide indicator Credit-to-GDP gap. Table 2A summarises these CCyB stances.

Table 2A: CCyB decision descriptions

MOC CCyB stance	Description
Neutral	Maintains the CCyB rate/ unchanged
Tightening	Justifies a higher buffer rate during an expansionary phase to enhance banking sector stability
Loosening	May implement a lower rate or may remove the buffer rate altogether during a contractionary phase to address potential negative effects on the banking sector on credit supply.

Communication of the CCyB rate

The MOC is responsible for setting and communicating the buffer rate on a bi-annual basis. In executing the macroprudential mandate, the MOC is supported by the Financial System Stability Committee as the advisory body to the BoN. The MOC therefore will set the buffer rate in this capacity, in consultation with NAMFISA and the Ministry of Finance and Public Enterprises as per the Financial Stability and Macroprudential Oversight Framework (2023) and the Bank of Namibia Act, 2020 (Act No. 1 of 2020).

CCyB-related decisions should be transparent and comprehensible to the public in order to increase the effectiveness of the CCyB. For this purpose, the MOC will communicate its CCyB rate decisions in a timely and transparent manner, to the financial industry, relevant stakeholders, and the public. As per the BCBS guidelines, the BoN will evaluate the CCyB at regular intervals in line with the FSSC and MOC meetings to decide whether to increase, decrease, or maintain its level. In this regard, when the CCyB rate is increased, the banks will be given up to 12 months to raise their capital ratios to meet the additional capital requirements

before they take effect. Reductions in the buffer would take effect immediately to help reduce the risk of the supply of credit being constrained by regulatory capital requirements. Notably, however, changes could be made at any point in the year should circumstances warrant it. The BoN will publish its assessments on the appropriate CCyB levels through MOC statements and the Annual FSR.

Concluding remarks

This article emphasises the technical aspects involved in implementing the CCyB, which includes the methodology, the common reference indicator (Credit-to-GDP gap), the additional variables to consider, as well as the communication strategy for its implementation. This serves as a preliminary assessment in preparation for potential implementation of the CCyB in Namibia. Notably, this assessment is not exhaustive, as the BoN is currently continuing to explore the potential implementation of the CCyB.

CCyB-related decisions should be transparent and comprehensible to the public in order to increase the effectiveness of the CCyB.

6 PERFORMANCE OF THE BANKING SECTOR

PERFORMANCE OF THE BANKING SECTOR

In 2023, the banking sector's balance sheet growth remained positive, amidst moderate economic conditions. The total assets in the banking sector grew by 6.1 percent to N$174.4 billion in 2023, a moderate growth rate compared to 2022. The growth in total assets was observed in cash and balances with banks, net loans and advances, short-term negotiable securities, and trading and investment securities. The increase in cash and balances with banks was due to higher foreign currency holdings, driven by diamond proceeds. Net loans and advances, constituted 61.9 percent of the banks' total assets, and rose by 2.2 percent to N$107.9 billion owing to the utilisation of overdraft facilities, as well as instalment sales and leases. In terms of total capital and liabilities, their main driver was non-bank funding (deposits) with banks, as observed in call deposits, negotiable certificates of deposit and foreign currency deposits. Banking sector assets grew at a decelerating pace in line with the country's slower economic growth. Nonetheless, the rate of growth in these assets was slightly higher than the prevailing inflation rate, which boded well for financial stability.

Namibia's banking sector remained liquid, profitable and well capitalised.

Risk analysis

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

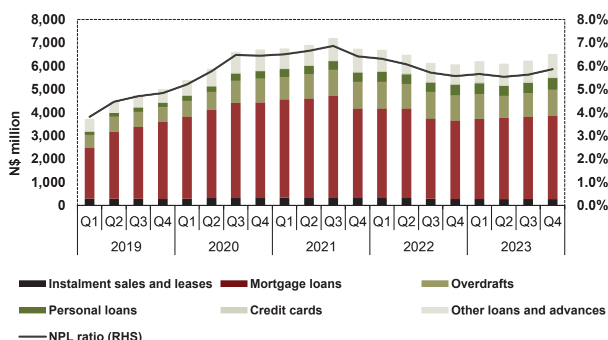
Credit risk

Credit risk is defined as the risk of default by borrowers and the potential impact on profitability and capital adequacy. Banking sector assets are comprised mainly of loans granted to corporates and households. The interest earned on these assets is a significant component of banks' income and profit but is subject to the risk of borrowers defaulting on their loans. Thus, the risk of default determines the quality of the assets themselves: the higher the rate of default, the lower the quality of the assets concerned; conversely, the lower the credit risk, the higher the asset quality. Once the industry trigger benchmark is breached, the BoN will deal with the individual affected banks to understand the effectiveness of their internal NPL strategies. The BoN has directed the banking sector to implement NPL recovery options which include amongst others write-offs, debt-to-equity options, debt restructuring and asset securitisation as complementary to their own strategies. Furthermore, banks are required to hold more capital when their asset quality deteriorates to a higher level which impose a risk to capital. This is to cover the related credit risk while also accounting for higher provisions in preparation for the expected losses, thus impacting on profitability.

Asset quality

The non-performing loans (NPLs) to total gross loans increased, amidst moderate economic growth in 2023. Asset quality, as measured by the NPL ratio, deteriorated marginally from the 5.6 percent reported in 2022 to 5.9 percent at the end of 2023 (Figure 18). The increase in the NPL ratio was ascribed to the following loan categories: Mortgage loans (6.6 percent); Overdrafts (4.7 percent); Personal loans (5.3 percent), Credit cards (16.4 percent) and Other loans and advances (19.5 percent). Conversely, the NPL ratio for Instalment sales and leases improved by 4.0 percent. In terms of loans and advances by sectoral distribution, the NPLs were more pronounced in the Individuals, Agriculture, Construction as well as Trade and Accommodation categories. Although the NPL ratio deteriorated during the period under review, it remained below the crisis time supervisor intervention trigger point of 6.0 percent. Moreover, the NPL ratio is a lagged indicator of stress experienced by borrowers, as such NPLs can still be rehabilitated and migrate from non-performing to performing status.

Figure 18: Non-performing loans as a percentage of total gross loans



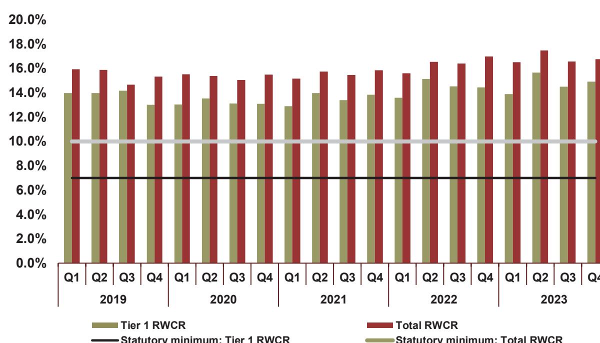
Source: BoN

Credit risk emanating from asset quality was moderate. Its relation to banking sector capital adequacy and profitability is important. A higher capital adequacy ratio indicates that because of the availability of capital, the banks are in a better position to deal with unexpected losses. The higher the asset quality (lower NPLs) in the banking sector, the higher the return on assets (ROA) and the return on equity (ROE), which are profitability indicators. The banking sector remained well capitalised and profitable during the period under review.

Capital adequacy

The banking sector remained adequately capitalised during 2023 and maintained a capital position well above the prudential requirement. During the period under review, both the total risk-weighted capital ratio12 (RWCR) and Tier 1 RWCR recorded values above their respective minimum regulatory requirements of 10.0 percent and 6.0 percent. Total eligible capital increased from N$18.4 billion in 2022 to N$19.0 billion in 2023 (Figure 19). Although the nominal value of total eligible capital increased, the total RWCR declined marginally by 0.4 percentage point from its 2022 levels to reach 16.6 percent at the end of 2023. The decline in this ratio was due to an increase observed in risk-weighted assets coupled with a decline in Tier 2 capital during the period under review. On the other hand, total eligible Tier 1 capital increased by N$1.3 billion to N$17.2 billion during the period under review mainly due to an increase in retained earnings and general reserves. Consequently, the Tier 1 RWCR increased by a similar margin to that of total RWCR, namely by 0.4 percentage point to 15.0 percent at the end of 2023. A favourable capital position serves as a buffer for the banks, from losses and risks associated with banking business. The banking sector thus remained well capitalised in 2023, which encourages the mitigation of credit risks in the banking sector and, thus, financial stability.

Figure 19: Capital adequacy



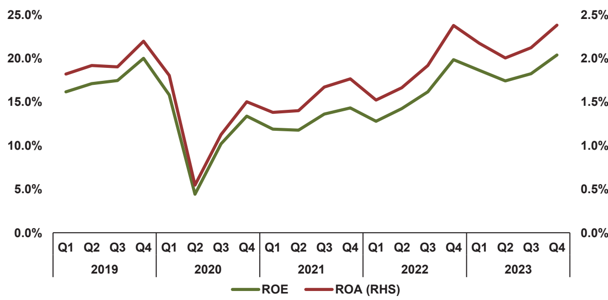
Source: BoN

Profitability

The banking sector reported healthy profitability levels on the back of net interest income when compared to the previous reporting period. The profitability of the banking sector, as measured by the return of assets (ROA) and return on equity (ROE) ratios, remained solid and above its pre-Covid-19 pandemic levels, amidst a moderate economic recovery. The ROA ratio remained at 2.2 percent, broadly similar to what was reported a year ago while the ROE ratio improved by 2.9 percentage points to 18.7 percent (Figure 20). The improved profitability position was on account of an increase in net interest income. Moreover, should interest rates remain elevated, the banks are expected to maintain healthy profitability levels throughout 2024. The share of non-interest income for the banking sector was reported as, contributing 42.3 percent to total income. Although interest income remained the dominant source of income for banks, non-interest income is generally considered to be a more stable source of income due to lower procyclicality.

[11]The prudential requirement for the total RWCR was increased from 10.0 percent to 11.0 percent prior to the Covid-19 pandemic to account for the capital conservation buffer; however, as a Covid-19 relief measure, the buffer was released so that the prudential requirement is back at 10.0 percent. The statutory minimum of the total RWCR is therefore reflected as 10.0 percent throughout the five-year period presented in Figure 19; for consistency, the same approach was applied in Figure 24 under the solvency stress test results.

Figure 20: Profitability



Source: BoN

Adequacy of provisions

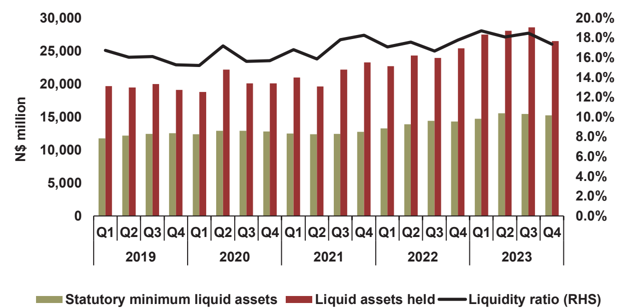
Total provisions rose during 2023 when compared to 2022, in line with the increase in the NPL portfolio. During the period under review, total provisions increased by 15.4 percent to N$3.4 billion. This elevation offered some respite against the pressure experienced by the banking sector's loan book due to elevated interest rates coupled with adverse economic conditions. Specific loan loss provisions increased by 16.3 percent year-on-year to N$2.1 billion which is in line with the slight increase in the NPL ratio. As a result, the banks are required to have adequate buffers in place to protect against potential losses and manage credit risk effectively.

Despite a marginal increase in the NPL ratio, credit risk to the financial system remained moderate in 2023. This was supported by a capital position well above the regulatory threshold. The banking sector credit risk remained moderate during the period under review, despite the NPL ratio increasing to levels close to the supervisory intervention trigger point. Thus, the commercial banks remained well capitalised which serves to cushion them from losses and risks associated with banking business. Moreover, the banking sector's profitability ratios improved due to an increase in net income, particularly in respect of interest income. Going forward, interest rates are projected to tilt downwards, thus implying that credit risk is likely to be lower in 2024.

Liquidity risk

The banking sector continued to hold liquid assets well above the statutory minimum liquid asset requirement throughout 2023. Liquid assets held increased by 4.2 percent, from N$25.4 billion in 2022 to N$26.5 billion in 2023 (Figure 21). The increase in the liquidity position was driven by a combination of factors such as portfolio investment inflows on the part of asset managers, higher diamond sales and a N$6.8 billion inflow from the settlement of the Heineken/NamBreweries transaction. Similarly, the statutory minimum liquid assets increased by 6.8 percent year-on-year, from N$14.3 billion in 2022 to N$15.3 billion in 2023. The liquidity ratio, however, declined marginally by 0.5 percentage point to 17.3 percent in 2023, driven by an increase in average liabilities, which exceeded the growth in average liquid assets held. Nonetheless, the sector's liquidity ratio of 17.3 percent remained well above the statutory minimum liquid asset requirement of 10.0 percent of average total liabilities to the public.

Figure 21: Liquid assets and liquidity ratio



Source: BoN

Both the loan-to-deposit (LTD) and the loan-to-funding (LTF) ratios remained below 100 percent during the period under review. The LTD ratio moderated from 83.7 percent in 2022 to 80.1 percent in 2023. This decline in the ratio implies that banks have made relatively more use of deposits to fund total loans and advances than they have of other funding sources such as debt capital, which normally tend to be more expensive and volatile. Similarly, the banking sector LTF ratio declined to 75.0 percent in 2023 from 77.8 percent in 2022. This means that 25.0 percent (22.2 percent in 2022) of total funding, capital and equity was available for use on liquid and other assets. A high LTF ratio limits banks' ability to further expand their loan book while simultaneously managing their liquidity risks. Overall, both ratios remained at manageable levels.

Liquidity risk from the banking sector to the financial system remained minimal throughout 2023. The overall liquidity position in the banking sector improved in 2023 when compared to the preceding year. Furthermore, both the LTD and LTF ratios experienced declines over the course of 2023. These trends suggest that the

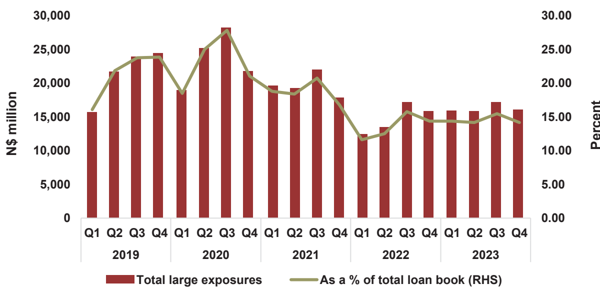
banking sector has effectively managing its liquidity risk, demonstrating a notably conservative approach. In this respect, the FSSC maintained the perspective that liquidity risk has consistently been well-maintained and anticipates this trend to continue into 2024, particularly given the positive investment prospects in the country. As such, the probability of liquidity risk to the financial sector from the banking sector deteriorating in 2024 is low, with medium impact.

Concentration risk

Large exposures

At the end of 2023, large exposures[14] in the banking sector increased slightly in relation to that reported in 2022. Thus, the value of large exposures increased marginally by 0.9 percent, from N$15.9 billion in 2022, to N$16.0 billion in 2023 (Figure 22). This marginal increase was mainly due to disbursement of new credit facilities to companies operating in the *Mining and quarrying,* as well as *Manufacturing* sectors. Notably, however, repayments over the review period were also observed in companies that operated in the Property development and *Mining and quarrying sectors*, which resulted in slower growth in total large exposures. Furthermore, the marginal growth in large exposures during 2023 could be ascribed to demand constraints, as well as more stringent market lending practices, especially given that the banks acted more prudently in the interest of managing credit risk. However, large exposures as a percentage of total loans and advances declined from 14.4 percent in 2022 to 14.2 percent at the end of 2023. In this regard, concentration risk from a financial stability perspective remains low and does not pose a threat to overall financial system stability.

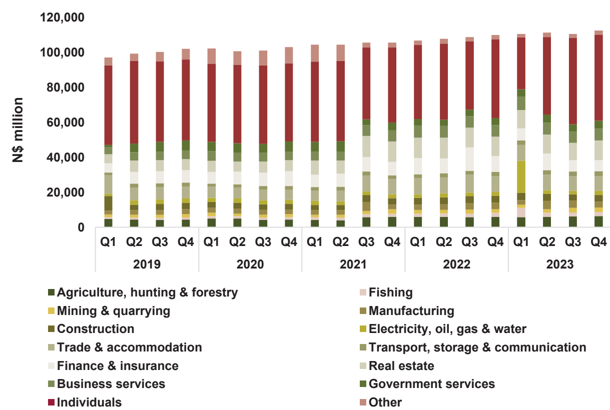
Figure 22: Total large exposures



Source: BoN

During 2023, the sectoral distribution of total loans and advances remained broadly diversified across sectors. At the end of 2023, the sectoral distribution of total loans and advances was dominated by the *Individuals sector* with a share of 43.9 percent, followed by loans extended to the real estate sector with a share of 10.0 percent at the end of 2023. In this regard, loans extended to the *Individuals* sector increased by 3.2 percentage points when compared to 40.7 percent reported in 2022. The following sectors' share from total loans and advances remained relatively unchanged: *Fishing* (2.1 percent); Business services (6.0 percent); and *Electricity,* oil, gas and water (2.1 percent) (Figure 23). However, the share of total loans and advances of the following sectors declined to reach their respective shares of sectoral distribution during the period under review: *Manufacturing* (3.0 percent); *Construction* (3.2 percent); Trade and Accommodation (7.7 percent); Finance and Insurance (5.6 percent); and Other (2.0 percent). Furthermore, the share of total loans and advances of the following sectors increased to: *Agriculture, hunting and forestry* (5.6 percent); *Mining and quarrying* (2.4 percent); *Transport, storage and communication* (2.4 percent); Real estate (10.0 percent); *Government services* (4.0 percent); and Individuals (43.9 percent). Thus, the banking sector's large exposures remain adequately diversified and pose minimal concentration risk to the financial system.

Figure 23: Sectoral composition of large exposures



Source: BoN

The ratio of large exposures to private sector credit

[14] A large exposure is any exposure to a single person or group of related persons that, in aggregate, is equal to or exceeds 10 percent of a banking institution's capital funds.

extension (PSCE) increased marginally during the period under review. With the nominal value of credit extended to the private sector having outpaced the borrowing by large borrowers, the share of large exposures as a percentage of total PSCE increased marginally by 0.2 percentage point to 34.7 percent during the period under review (Table 9). However, large exposures as a percentage of credit extended to businesses declined slightly to 14.2 percent at the end of 2023, compared to 14.3 percent reported in 2022. This is an indication that the demand for credit by businesses remained weak, in line with the current economic conditions coupled with repayments by the corporates in the Manufacturing, Construction, Trade and accommodation sectors during the review period.

Table 9: Large exposures in relation to PSCE

	2019	2020	2021	2022	2023
Total large exposures	24 379	21 726	17 741	15 811	15 959
Total PSCE	102 774	104 825	106 049	110 531	112 627
PSCE to businesses	44 853	44 307	44 258	45 809	45 979
Large exposures as a % of PSCE	23.7	20.7	16.8	14.4	14.2
Large exposures as a % of business PSCE	54.4	49.0	40.1	34.5	34.7

Source: BoN

ARTICLE 2: CLIMATE CHANGE RISKS

THE IMPLICATIONS OF CLIMATE-RELATED RISKS ON THE FINANCIAL SYSTEM IN NAMIBIA

Introduction

Climate change can pose significant financial risks to banks and the broader financial system if left unmanaged. The heightened frequency and severity of extreme weather events, coupled with rising average temperatures, have the potential to reduce the value of certain assets and income sources for borrowers. As a result, regulators have been focusing increasingly on climate risks. For example, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), an expanding group that currently comprises 134 members including the BoN, has embarked on the task of integrating climate-related risks into supervision and financial stability monitoring. The Intergovernmental Panel on Climate Change (IPCC) asserts that considerable efforts are necessary to cap global warming at 1.5°C above pre-industrial levels, a target set by the Paris Agreement. Even if these objectives are achieved, this level of Global warming is anticipated to bring about elevated sea levels and an escalation in the frequency and intensity of extreme weather events, encompassing storms, heat waves, and droughts.

Namibia is already prone to extreme climate conditions, including recurring droughts, floods, water scarcity, extreme heat, and wildfires. The recurring drought conditions and wildfires are due to Namibia's hot and erratic rains. According to the International Disaster Database, the severe drought that occurred in 2013, with an estimated cost of N$617.6 million affected nearly 37 percent of Namibia's population and was declared a national disaster. This type of event can have a potential impact on the Namibian financial system due to its direct linkage to agricultural loan facilities offered by financial institutions. This Article therefore discusses the implications of climate-related risks on the financial system in Namibia.

Financial institutions' exposure to climate-related risks

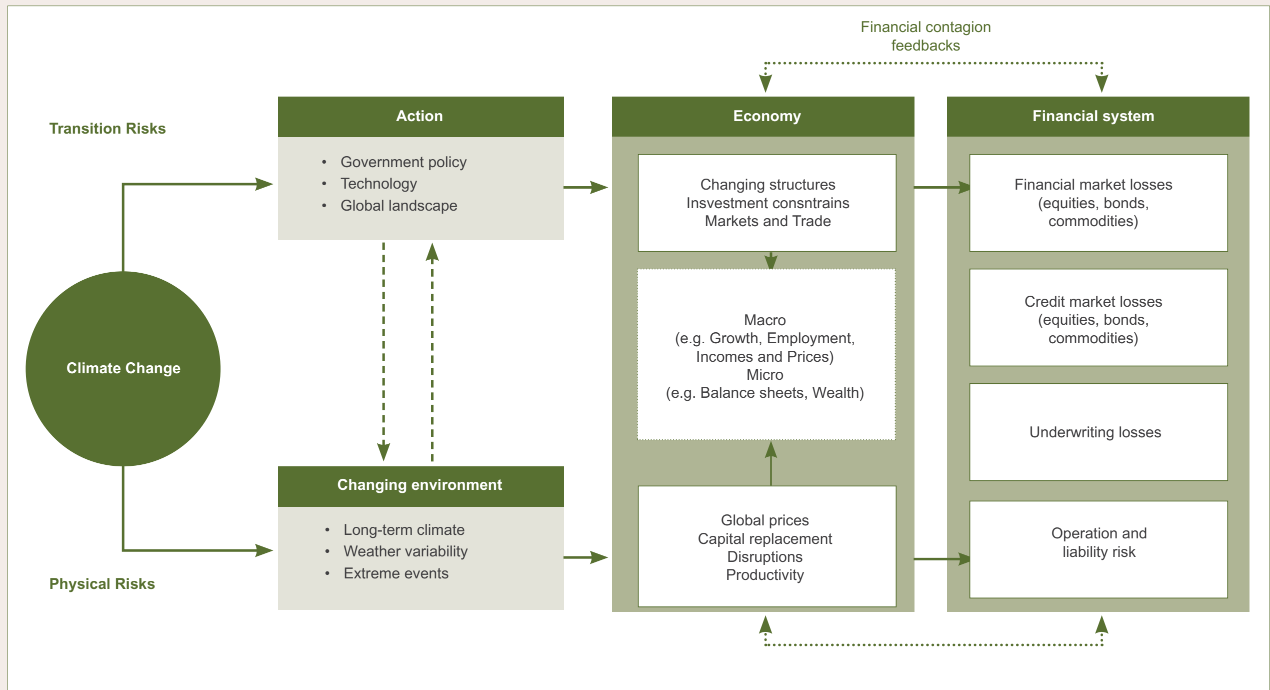
Climate risks are typically categorised as either physical or transition risks, as follows:

a. Physical risk: Disruptions to economic activity or reductions in asset values resulting from the physical impact of climate change, such as drought, flooding, and wildfires.

b. Transitional risk: The impact of changes in regulation or pricing introduced to facilitate a transition to a low-carbon economy to mitigate climate change.

While climate change is not yet a significant threat to financial stability in Namibia, it is becoming increasingly important for investors and institutions to take account of and manage these risks. Figure 1 below demonstrates how physical and transition risks can affect the financial system.

Figure 1: Potential financial stability risks associated with climate change

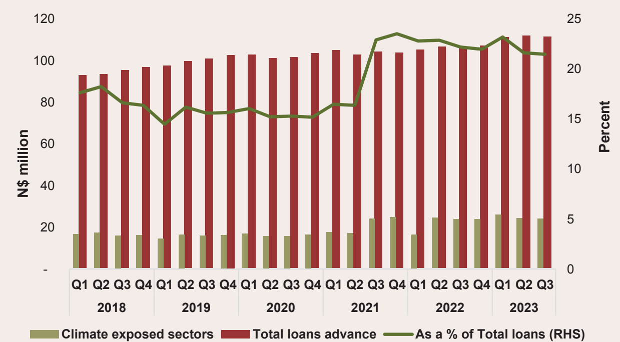


Source: International Food Policy Research Institute (IFPRI) and CGIAR (formerly the Consultative Group for International Agricultural Research)

The physical effects of climate change can have a significant impact on Namibian financial institutions. For instance, a rise in the frequency and intensity of natural disasters is likely to elevate the occurrence of damage or destruction of physical assets, which are either insured or utilised as collateral. Assets vulnerable to heightened physical risks, such as properties situated in flood-prone regions, may experience a decline in value, especially if these risks become difficult to insure. Climate change could also reduce certain types of business income that are used to service loans. Examples include changing rainfall patterns that result in lower or less predictable income from agriculture and sectors exposed to climate risk.

Amongst other risks, banks are exposed to climate change through their lending activities. Climate change can result in a decline in the income or value of collateral, thereby increasing the risk of default and potential losses. These effects extend beyond industries directly impacted by climate change, such as agriculture (including fisheries and forestry), water, transport and communication, and tourism, and reach households and businesses reliant on income from these sectors. This directly influences banks' credit risks, as they extend loans to sectors vulnerable to climate-related impacts. Notably, loans from banks to climate-exposed sectors have surged, increasing from N$15.7 billion at the end of 2018 to N$23.7 billion by the third quarter of 2023 (Figure 2). This constitutes 21.4 percent of the total loans advanced by the banking sector during the reporting period.

Figure 2: Sectoral distribution of bank loans[15]



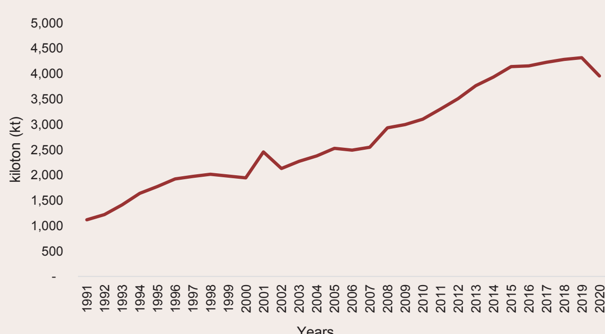
Source: BoN

[15] 1Climate-exposed sectors include agriculture, fishing, mining and quarrying, real estate, and transportation.

Insurers constitute the subsector most directly exposed to the physical impacts of climate change. This exposure can arise through natural disaster claims as well as claims for health and life insurance. While insurers can increase their premiums to reflect higher risk, it is difficult to accurately price new and uncertain climate risks. If insurers under-price these risks, it could threaten their viability in the event of extreme weather events resulting in very large losses. On the other hand, overpricing would impede the risk-pooling function provided by insurance and would unduly limit economic activity. Even if correctly priced, more of these risks may become uninsurable, forcing households, businesses, or governments to bear this risk.

Namibian financial institutions with exposure to carbon-intensive industries such as power generation and mining and quarrying, or those with ties to energy-intensive firms, face potential exposure to transition risk. Transition to a lower-carbon economy can also affect institutions with exposure to individuals reliant on these industries. The sudden or unexpected regulatory change could quickly lower the value of such assets or businesses, some of which may become economically unviable or 'stranded'. Such regulatory changes could either be domestic or come from abroad, given the carbon intensity of Namibia's exports. Namibia's own carbon emission levels have tripled since Independence in 1990, increasing from 1 118 kt in 1990 to 3 953 kt in 2020 some 30 years later (Figure 3). However, Namibia is a net carbon sink and makes a negligible contribution - accounting for less than 0.01 percent - global emissions.

Figure 3: Namibia's carbon emissions



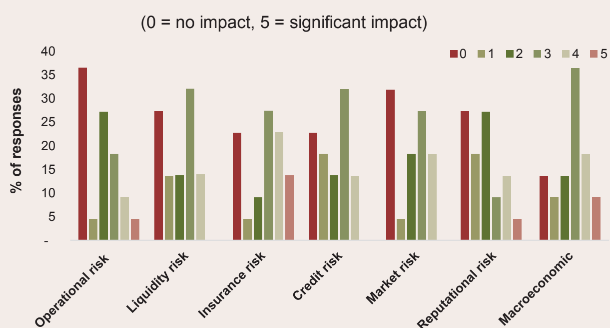
Source: World Bank

Transition risk could also arise if a large investment in technologies allowed new entrants to displace established but emission-intensive practices, or if consumer preferences shifted rapidly towards 'green' products. If such changes were to occur abruptly, certain sectors or firms would face large losses – which could in turn impact the financial system. Transition risk will be greatest for banks that lend to firms in carbon-intensive industries and to individuals or businesses that are reliant on such firms. Other financial institutions investing in carbon-intensive industries, such as asset management companies, are also exposed to the risk that climate change will diminish the value of their investments. This could occur both through direct investments in carbon-intensive industries, or through indirect investments in banks that lend to these industries.

Survey results analyses

To assess the awareness and implementation of climate related policies in the financial system, a survey was administered to the banks and insurance companies. The survey was administered to the four banks known as the Domestic Systemically Important Banks (DSIBs) and 29 insurance companies. The survey results indicated that most financial institutions were acquainted with the Paris Climate Agreement. Climate-related risk policies were also in place at around 50 percent of DSIBs and 23 percent of insurance companies.

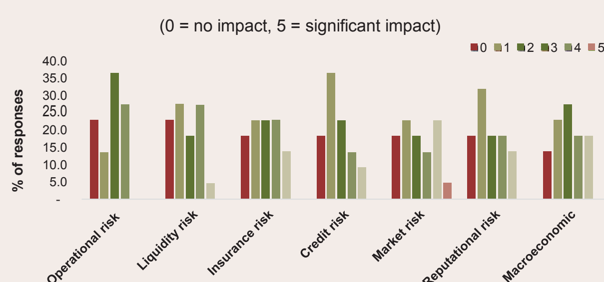
Figure 4: Expected impact from climate related physical risk



Source: BoN

The top risks to the financial institutions emanating from both physical and transition risks included operational, credit, insurance, and liquidity risks. As illustrated in Figure 4 above, the majority of institutions reported a moderate to severe impact across various areas of their business due to physical climate-related risks. The impact was more pronounced for liquidity and credit risk where 32 percent of the respondent's risk-rated it at Grade 4. In terms of the impact of transition risk on various business areas, most of the respondents rated it between low to moderate (Figure 5).

Figure 5: Expected impact from climate related transition risk



Source: BoN

The identified physical and transition risks to the financial sector remained centred around Namibia's climatic variability. Regarding the impact of various types of physical risk, most respondents pointed to drought episodes, pandemics, floods and wildfires, which could have severe impacts on their institutions (Figure 6). The top transition risks identified comprised policy, stranded assets, adaptation, and product risks (Figure 7). The survey also found that the banking and insurance sector had embraced new products and changed some existing products in response to climate change and its associated risks. The main products for the banking sector include extending loans to finance energy-efficient projects followed by green bonds, as well as green corporate and household loans. In terms of the insurance sector products offered include Environmental Social, and Governance (ESG) funds, insurance products that encourage lower carbon emissions, green asset finance, green funds and, to a limited extent, participation in green bonds. A third of the insurance institutions partially priced in risks associated with climate change while only four percent fully price in climate risks.

Stress tests is another important tool for financial institutions to assess the potential impact of climate change and its associated risks on their business operations. The survey revealed that only 28 percent of insurance institutions and 50 percent of the DSIBs had a stress test framework that included both physical and transition risks. The respondents who had not attempted stress tests had been challenged by the lack of good quality and granular data, difficulties in modelling climate risks, insufficient internal resources and, in some cases, the institution concerned not considering such risks a priority.

Concluding remarks and way forward

The climate risk survey presented insightful views into the actions being taken by DSIBs and insurance institutions to cover such risk. The results demonstrate that the institutions are aware of climate change and its implications on their operations. Some respondents had climate-related frameworks in place and were embracing new products in response to climate change. However, the survey participants were unfamiliar with the recommendations of the Task Force on Climate-related Financial Disclosures instituted by the Financial Stability Board, the international body monitoring the global financial system. These recommendations are important for risk assessment, capital allocation and to make better-informed decisions on where and when to allocate capital, and strategic planning to better evaluate risks and exposures over the short, medium, and long term.

The Bank has joined the Network of Central Banks and Supervisors for Greening the Financial System to embark on the task of integrating climate-related risks into supervision and financial stability monitoring. The Network allows central banks to grasp the importance of climate change for financial stability and to learn from each other and conduct further research in this area. Moreover, BoN is currently assessing the possibility of new tools to determine the degree to which domestic financial institutions are exposed to climate risks. In this regard, BoN is currently exploring the possibility of developing climate-related stress tests to measure the risks faced by the sector under different plausible scenarios.

7 STRESS TEST

STRESS TEST

This chapter provides a quantitative assessment of the resilience of the banking sector through stress test[16] scenarios using the Cihák Model and the Dynamic Bank Balance Sheet Tool.

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

Credit risk

Global and domestic economic developments have a bearing on interest rate developments in Namibia and, thus, affect credit risk. According to the IMF April 2024 WEO, global growth was projected at 3.2 percent in both 2024 and 2025, with the 2024 forecast being 0.1 percentage point higher than that in the January 2024 WEO. This is on account of greater-than-expected resilience in the United States and several large emerging market and developing economies, as well as fiscal support in China. With this improved outlook, the risk to global outlook remains broadly balanced. Domestic downside risks are predominantly in the form of water supply constraints, drought conditions and high costs of key import items that are likely to persist for a long time.

The solvency stress test indicate that the banking sector remained well capitalised in all the scenarios.

Nonetheless, domestic inflation slowed during 2023 on the back of a deceleration in inflation for the transport category supported by softer fuel prices.

The domestic repo rate increased by an aggregate of 100 basis points in 2023. At its January 2024 meeting, the SARB opted to maintain the repo rate at 8.25 percent. The policy stance is on the basis that achieving permanently lower inflation and interest rates requires inflation expectations to be closely anchored to the mid-point of the target band. At the current repo rate, policy is restrictive, consistent with the inflation outlook and the need to address adverse inflation expectations as the forecasted trajectory for the repo rate implies an inflation-adjusted (or real) repo rate of 2.6 percent in 2023 and 3.1 percent in 2024. Similarly, at its meeting in February 2024, the BoN opted to maintain the repo rate at 7.75 percent. This decision aimed at continuing to safeguard the NAD-ZAR peg while supporting the domestic economy. Thus, in all three stress-test scenarios, the starting point was the current repo rate of 7.75 percent. From this level, the following repo rate decisions were assumed in the stress test:

- **Baseline scenario:** Increase the repo rate by a total of 50 basis points over the next 12 months.
- **Intermediate scenario:** Increase the repo rate by a total of 150 basis points over the next 12 months.
- **Severe scenario:** Increase the repo rate by a total of 300 basis points over the next 12 months.

The NPL ratio increased during the fourth quarter of 2023. The NPL ratio, increased from 5.6 percent in the third quarter of 2023 to 5.9 percent in the fourth. Furthermore, asset quality is expected to deteriorate in

[16] The stress scenarios used in this chapter are not a forecast of macroeconomic and financial conditions. It is a hypothetical, coherent, tail-risk setting designed specifically to assess the resilience of the banking sector to hypothesised deterioration in macroeconomic conditions.

the coming 12 months as disinflationary monetary policy has the potential to negatively impact both households and corporates capacity to service their debt. It is, therefore, important to consider what the potential ramifications for the banking sector's solvency position would be if these risks were to materialise. In the stress test, the following trajectories were assumed under each scenario:

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

Liquidity risk

Liquidity risk measures the banks' ability to honour their financial obligations in a timely manner. Although the overall liquidity position of the banking sector improved in 2023 relative to 2022, stress tests are concerned with the resilience of the sector in the event of a liquidity shock. The concern of the BoN is whether commercial banks would be able to withstand a sudden withdrawal of funds from the banking system, despite the banks being liquid, profitable, and well capitalised. The following assumptions on withdrawals by depositors are therefore assumed in the stress test:

- Baseline scenario: 20 percent of demand deposits (equivalent to 11.88 percent of total deposits) withdrawn over five days.
- Intermediate scenario: 40 percent of demand deposits (23.76 percent of total deposits) withdrawn over the same period, and
- Severe scenario: 60 percent of demand deposits (35.64 percent of total deposits) withdrawn over the same period.

Summary of stress test scenarios

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

Table 10: Summary of stress test scenarios

Variable	Moderate	Intermediate	Severe
Credit Risk			
Repo Rate	Increase repo rate by 50 basis points	Increase repo rate by 150 basis points	Increase repo rate by 300 basis points
NPL ratio	2.0 percentage point increase	4.0 percentage point increase	6.0 percentage point increase
Liquidity Risk			
Liquidity	20% of demand deposits withdrawn over 5 days (11.88% of total deposits)	40% of demand deposits withdrawn over 5 days (23.76% of total deposits)	60% of demand deposits withdrawn over 5 days (35.64% of total deposits)
Other variables: 30% for baseline, 35% for intermediate and 40% for severe; haircut on collateral 50% assumed provisioning of the new NPLs			

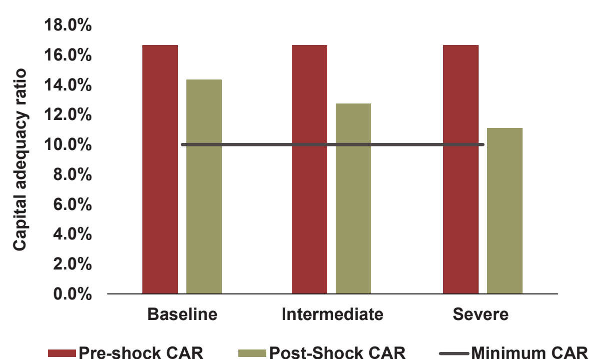
Source: BoN

Stress test results

Solvency

The stress-test results indicate that the banking sector remained solvent in all three scenarios. The pre-shock capital adequacy ratio (CAR), as per the Chák Model, stood at 16.7 percent. In the baseline scenario, the post-shock CAR fell to 14.4 percent, but it was still 4.4 percentage points higher than the statutory minimum limit of 10.0 percent. The intermediate scenario recorded a post-shock CAR of 12.7 percent, whereas in the severe scenario, the post-shock CAR was quite low, at 11.0 percent (Figure 24). The 12-month projection of the Cihák Model thus points toward a solvent banking sector in all three scenarios. The capital base of the banking sector is therefore adequate to absorb credit risk shocks, if all else remains constant.

Figure 24: Solvency stress test results

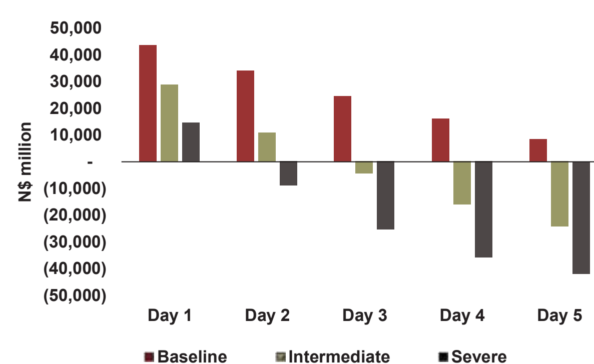


Source: BoN

Liquidity

The liquidity position of the banking sector in the event of a liquidity shock would remain sound in the baseline scenario, with a noticeable deterioration in both the intermediate and severe scenarios. In the baseline scenario, the liquidity position for the banking sector remained sound, but declined gradually over the five days (Figure 25). The intermediate scenario produced similar results, but with a much steeper downward trend over the five-day period, moving into negative territory from Day 3. The severe scenario, on the other hand, produced a much steeper downward trend, starting in negative territory as from Day 2. The banking sector would therefore only be able to meet its payment obligations in the baseline scenario. Furthermore, in the intermediate scenario, it would only meet its liquidity obligations on the first and second days; and in the severe scenario, it would only do so on the first day. However, the banks could make use of other sources of funds to avert a liquidity crisis. These alternatives include credit lines with their parent companies; cash and central bank cash reserve deposits that exceed minimum reserve or liquid asset requirements; available repo facilities; unencumbered assets not at the central bank; foreign exchange market liquidity or investment securities available for sale; securitised assets; and interbank funding. The banks also have liquidity contingency plans in place to guide them in the event of a shock.

Figure 25: Liquidity stress test results



Source: BoN

Dynamic Bank Balance Sheet Tool (DBBST)

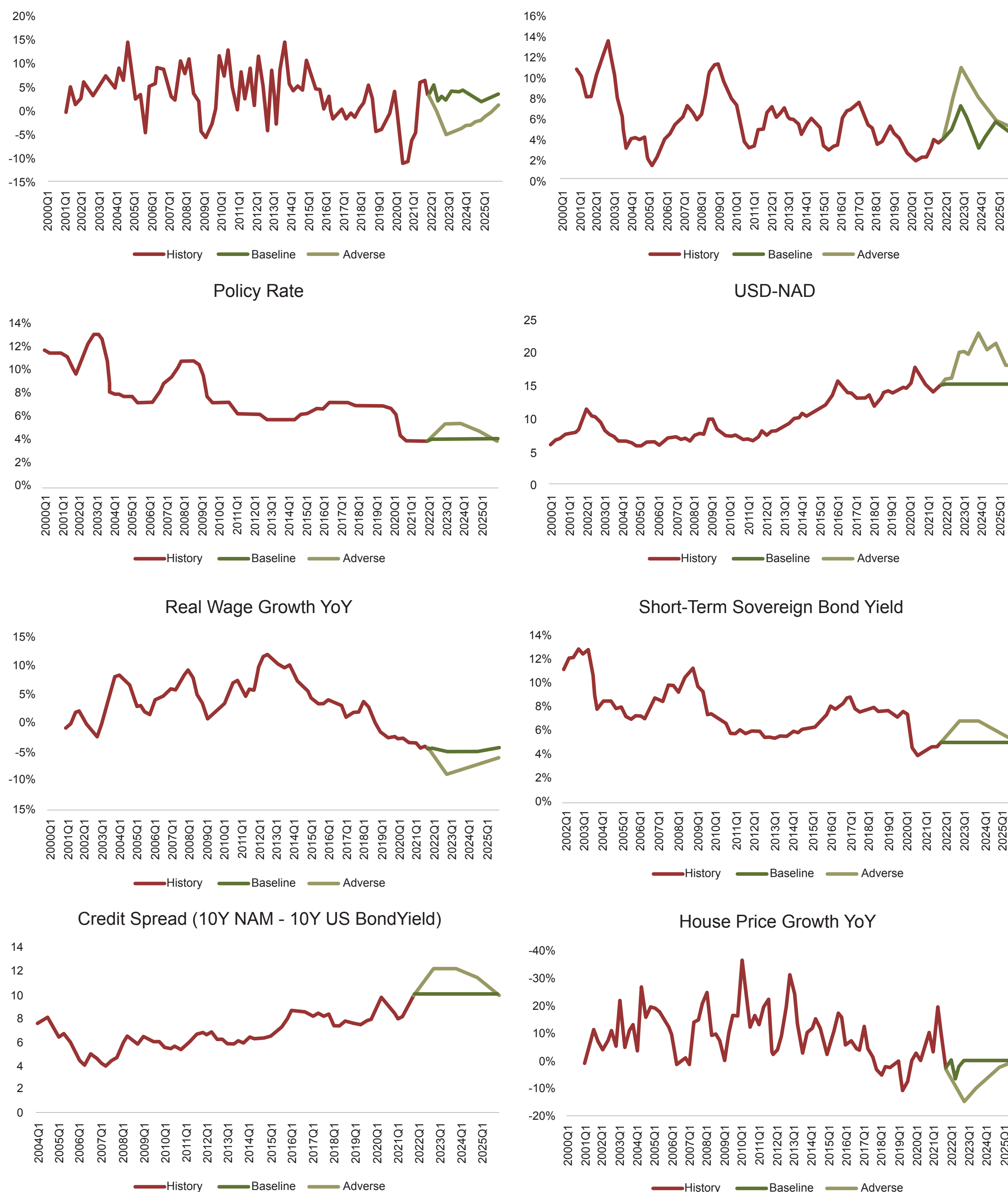
The DBBST is a multi-year, dynamic bank balance sheet projection tool with a projection horizon of 5 years. This tool has been added to the stress test toolkit to allow for a longer-term projection, while also taking into consideration historical macroeconomic developments, which is not the case for the Cihák model. In as much as the tool can capture a five-year horizon, it is more practical to consider a three-year horizon to best capture the potential build-up of risks and to avoid significant uncertainty from both macroeconomic variables and banks' balance sheets. In addition to the variables considered for the Cihák model, the DBBST requires the following variables: Real GDP, inflation, sovereign bond yields (3 and 10 year), repo rate, prime rate, house prices, and exchange rates. The BoN introduced the DBBST to quantitatively assess the financial sector resilience in case of different macro-financial risk scenarios as part of financial stability analysis.

Calibration of the DBBST scenarios

The application of the DBBST in Namibia covered only the nation's domestic systemically important banks (DSIBs). These DSIBs represents about 82 percent of total banking system assets as of 31st December 2023. Two scenarios were considered for this exercise, namely the baseline and the adverse scenario. The baseline scenario ('business as usual') was aligned with the BoN macroeconomic forecast published in the December 2023 Economic Outlook Report and other consensus forecasts from external sources such as the SARB's January 2024 Monetary Policy Committee (MPC) forecasts. The adverse scenarios, on the other hand, duly considered the identified financial stability risks to the Namibian banking system, calibrated to a hypothetically severe yet plausible scenario.

The Basel Committee on Banking Supervision (BCBS) stress-testing principles prescribe that scenarios should be designed to be 'sufficiently severe but plausible' to ensure that the exercises produce meaningful insights. The adverse scenario was assumed to entail increasing inflationary pressure as well as rising interest rates in the rest of the world. Initial and notable currency depreciation and capital outflow pressure would be counteracted in South Africa by the SARB raising interest rates. Given the currency peg between the NAD and the ZAR, which is expected to be maintained, the NAD is expected to depreciate against key international currencies, too, and the BoN is forced to raise its repo rate in parallel to the SARB repo rate, leading to an increase in the prime rate. The NAD/USD exchange rate would depreciate by a postulated 30 percent at the peak, while the NAD effective exchange rate would drop by about 10 percent at the end of 2025. GDP growth in Namibia would fall by about 11.1 percent on an annual basis by the end of 2024, while inflation would surpass 10 percent momentarily on an annual basis during 2026 (Figure 26). Furthermore, concerns about the sustainability of public debt, accompanied by increased market interest rate expectations, lead to a sharp repricing in debt markets and elevated government bond yields. Finally, due to the deterioration in the economic outlook, real estate prices would also drop considerably. Consequently, the financial sector would face higher credit losses and shrinking profits as collateral value and debt servicing capacity decline in both households and businesses.

Figure 26: Namibia: Macro-Financial Scenario-Selected Features



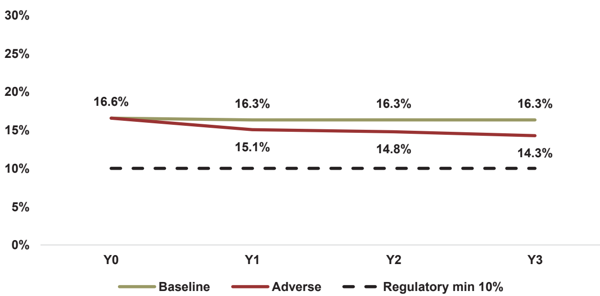
Notes: The chart collection shows some selected macro-financial variables under the baseline and adverse scenario for Namibia, covering the 3-year horizon from 2023-2026.

Source: BoN

Results

The stress test results for the DSIBs indicate that the domestic banks remain well capitalised in both baseline and adverse scenarios. In the baseline scenario, the industry's regulatory CAR position declines marginally from 16.6 percent to 16.3 percent between the reference date and the end of the stress horizon, staying well above the regulatory minimum. However, the CAR deteriorates in the adverse scenario, although remaining well above the prudential minimum of 10 percent (Figure 27). In the latter scenario, the CAR declines by 230 basis points on a start-to-trough basis, with capital deterioration primarily driven by a combination of higher credit losses and a decline in income generation.

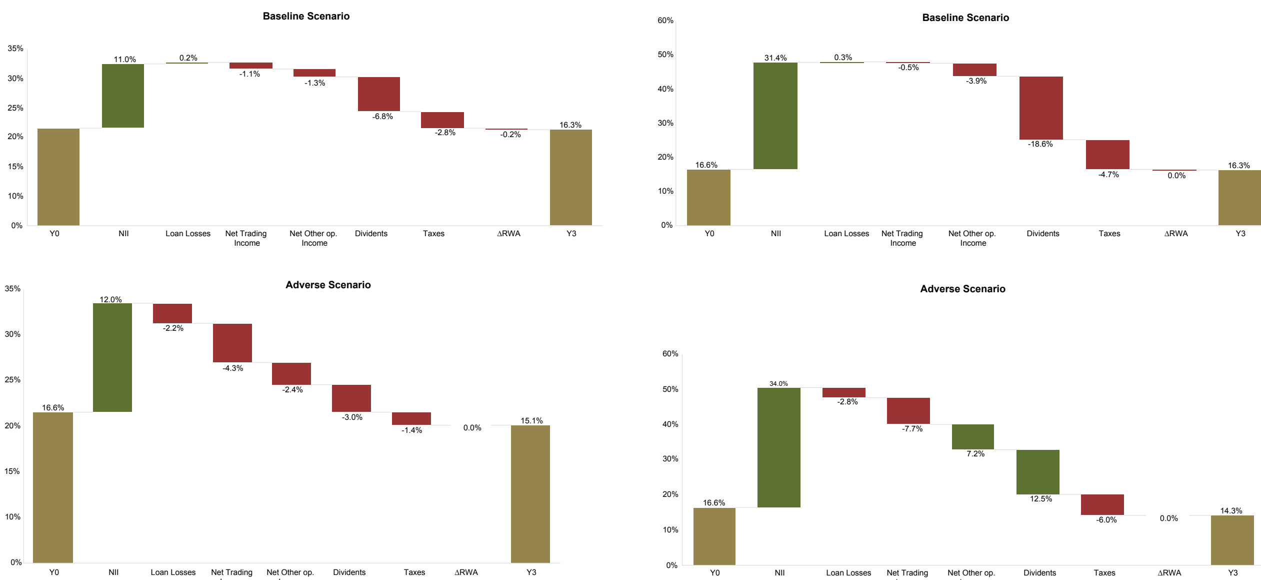
Figure 27: Regulatory Capital Ratio for the Banking System



Source: BoN

The capital depletion is driven by a combination of loan losses, mark-to-market losses, and losses from other operating income. In the adverse scenario, the contribution from loan losses amounts to -2.3 percentage points up to Year 1, and -2.8 percentage points up to Year 3 (Figure 28). Over the one-year horizon in the adverse scenario, the Net Interest Income (NII) contribution would increase the CAR by 11.8 percentage points, however; this is overwhelmed by increased credit and other losses (-13.3 percentage points). As a result, the capital ratio falls in the adverse scenario from 16.3 percent to 15.1 percent. Over the three-year horizon in the adverse scenario, it should be noted that the capital adequacy of banks continues to gradually decline as a result of loan losses and higher losses in net trading income when compared to the baseline scenario. Furthermore, the Market Risk loss contribution from inflating values of sovereign bond holdings due to rising interest rates is most sizeable in Year 1 under the adverse scenario, implying a -4.3 percentage points shift which continued to increase to -7.7 percentage points in Year 3. Other operating income contains primarily fees and commission income. It is the third notable source of capitalisation pressure in a downturn and reflects the decline in fee income-generating transaction flows on the side of the banks' customers (Figure 28). However, although there is a visible impact in the adverse scenario, the CAR is still above the prudential requirement. As such, the banking sector remains solvent, within the confines of the scenarios, assuming all else remains constant.

Figure 28: Contribution to CAR over the stress test horizons



Source: BoN

Conclusion

The 2023 stress test results confirm that the DSIBs remain well capitalised and are able to withstand the severe, yet plausible, shocks simulated under the adverse scenarios of the exercise. The resilience of banks' solvency positions largely stems from their strong initial capital and profitability buffers, which allow them to absorb most of the potential credit and market losses. In the adverse scenario, the DSIBs profitability deteriorated due to higher credit losses and low income from fees and commission, although this is partially offset by higher net operating income. Furthermore, the solvency stress test results from the Cihák Model indicate that the banking sector remained solvent in all the scenarios. In terms of liquidity, however, the Cihák stress-test exercise results show that the banking sector would only be able to meet its payment obligations in the baseline scenario whilst in the severe scenario liquidity needs will be apparent as from the Day 2. However, the banks could access other sources of funds to avert a liquidity crisis. The outcome of the stress test underscore the importance of banks maintaining vigilance in risk management and sustaining robust capital and profitability positions to navigate potential challenges effectively.

8 PERFORMANCE OF THE NBFI SECTOR

PERFORMANCE OF THE NBFI SECTOR

NBFI sector assets expanded by 14.6 percent in 2023, recording their fastest year-on-year growth rate over the last ten years, effective 2014. The expansion in NBFI assets is a function of global financial markets recovering from losses realised in 2022, as well as resilient demand for NBFI products, despite the elevated inflation and interest rates.

Retirement funds and long-term insurers are expected to remain financially sound in the short to medium term. This is owing to the long-term nature of their liabilities as well as the level of capital reserves they maintain. Similarly, short-term insurers are expected to remain financially sound in the short to medium term. Collective investment schemes and investment managers are expected to remain sound in the short to medium term as well, despite the contractionary monetary policy environment.

Table 11: Size of non-bank financial institution (NBFI) sector assets

Subsector	N$ million				
	2019	2020	2021	2022	2023
Long-term insurers	60,165	61,681	66,672	68,757	74,260
Short-term insurers	6,830	6,487	7,188	7,200	7,745
Medical aid funds	2,028	2,359	2,287	2,001	2,097
Retirement funds	173,427	182,234	212,909	205,817	237,145
Collective investment schemes	56,703	59,390	61,622	60,974	73,147
Investment managers	7,669	8,775	12,584	14,654	17,888
Friendly societies	1.7	1.9	2.0	2.3	2.5
Microlenders	5,853	6,055	7,316	6,743	7,157
Total NBFIs	**312,677**	**326,983**	**370,582**	**366,149**	**419,441**
	Percent				
Growth	7.8	4.6	13.3	-1.2	14.6

Source: NAMFISA

Collective investment schemes

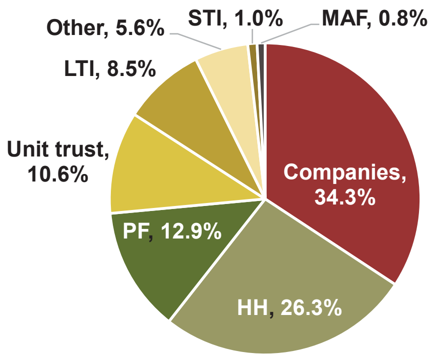
Collective investment schemes' assets under management increased by 12.7 percent year-on-year to N$89.1 billion. Despite the macroeconomic environment, the value of new investments exceeded the value of disinvestments. The ratio of new investments to disinvestments was measured at 1.07:1 during the review period. Furthermore, 83.2 percent of the subsector's investment income recorded in 2023 was in the form of interest earned and/or accrued. This is in line with the subsector primarily allocating assets under its management to interest-bearing investment instruments.

Sources and allocation of funds per location

Despite households' investments being discretionary, they remained a stable source of funds for this subsector, especially in the contractionary monetary policy environment. Funds sourced from households expanded by 11.3 percent to N$21.5 billion in 2023. This made-up 26.3 percent of the funds managed by collective investment schemes. The most recent year-on-year contraction in funds sourced from households was observed in 2021, which amounted to 2.6 percent. This contraction in funds sourced from households was a function of uncertainty surrounding the magnitude of COVID-19, as well as reduced economic activity at that time.

Furthermore, funds sourced from companies increased by 14.2 percent to N$30.5 billion in 2023. Funds sourced from companies made up 34.3 percent of the subsector's assets under management (Figure 29).

Figure 29: Collective investment schemes – Sources of funds



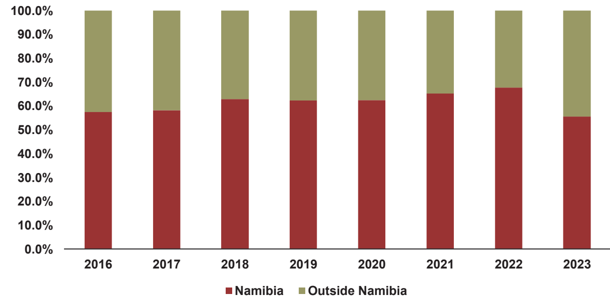
PF=Retirement funds; HH=Natural persons; LTI=Long-term insurance; STI=Short-term insurance; MAF=Medical aid funds.

Source: NAMFISA

The collective-investment-scheme subsector has the potential to contribute to liquidity constraints within the financial system, given its relatively shorter-term investment mandates. Nonetheless, disinvestments are not expected to exceed new investments in the short to medium term in this subsector. This assumption is supported by the expansionary change in fiscal policy to ease inflation rates, and the market expectation that interest rates will, at worst, be maintained at the current levels for the short to medium term.

Owing to interest rate differentials, the subsector moved a sizeable amount of funds under its management from Namibia into the Common Monetary Area. The assets under the subsector's management, held domestically, contracted by 7.4 percent to N$49.5 billion in 2023. Conversely, the funds held in the Common Monetary Area expanded by 65.2 percent to N$33.2 billion during the reporting period. This was evidently an investment decision to optimise returns. Of the subsector's assets under management, funds held domestically accounted for 55.6 percent in 2023 (Figure 30). Safeguards such as the minimum domestic holding requirements exist to guard against the uncontrolled flow of funds from Namibia to other jurisdictions. Therefore, the aforesaid safeguards allays any concern of a loss of liquidity from the Namibian financial system, in the short to medium term.

Figure 30: Collective investment schemes – allocation per geographic location

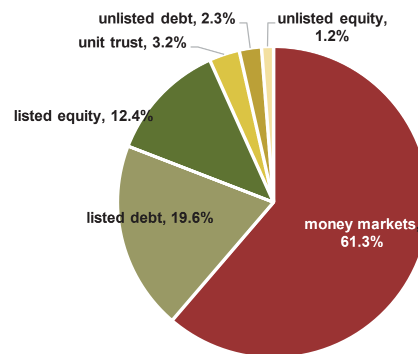


Source: BoN and Ministry of Finance and Public Enterprises (MFPE)

Allocation of funds per instrument

During the review period, 86.3 percent of the assets under the subsector's management were held in interest-bearing investment instruments (Figure 31). Funds held in money market instruments expanded by 20.5 percent to N$54.6 billion in 2023. During the review period, the subsector realised a return on investments amounting to 6.4 percent in respect of its clients. In the short to medium term, funds under the subsector's management are expected to perform positively in line with the interest rate expectations over the short to medium term in Namibia as well as South Africa.

Figure 31: Collective investment schemes – Allocation per instrument



Source: NAMFISA

Retirement funds

The retirement fund subsector's assets increased by 15.2 percent to N$237.1 billion in 2023. The subsector remains a significant source of funds for the domestic financial system. Its viability is therefore important to the financial system's stability. Developments in financial markets, membership demographics and the viability of participating employers are all vital for growth in the subsector's assets.

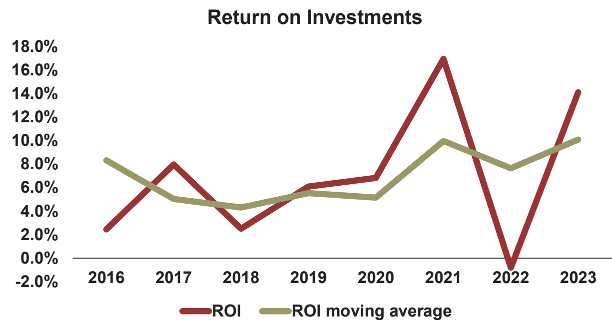
Although developments in financial markets are uncertain, market risks are not expected to be a threat to the retirement funds viability in the short to medium term. This is attributed to the long-term nature of the subsector's liabilities. The BoN, in its Economic Outlook published in December 2023, projected that the domestic economy would expand by 3.4 percent in 2024. Furthermore, in its Inflation Outlook published in February 2024, the BoN projected a moderation in inflation for both 2024 and 2025. Therefore, concerns around participating employers' viability are expected to be allayed in the short to medium term. Similarly, it is not anticipated that this would be a channel of shock to the subsector's viability in the short to medium term.

The scale of employment, which has remained largely unchanged over the past five years, is reflected in the relatively subdued growth in membership of retirement funds. This has contributed to the maturity level within the subsector. Although not a concern to viability in the short to medium term, it threatens the long-term viability of particularly the defined benefit subset of the subsector, where elements of cross subsidisation apply.

Market risks

Recessionary fears, elevated interest and inflation rates, geopolitical tensions and the expected systemic effect of the failure of the Chinese property sector as well as the failure of European and US banks counted among the drivers of global financial markets in 2023. Despite the aforesaid concerns, retirement funds' investment assets realised a 14.1 percent return on investment in 2023 (Figure 32). Admittedly, this return was aided by low base effects, with many global financial markets recording double-digit returns in 2023 after plummeting in 2022. In consideration of the long-term nature of the subsector's liabilities, a three-year moving average return on investments was computed. Accordingly, the subsector's investment assets were observed to have realised a growing return on investment from 2018. This consistency in the performance of investment assets is essential for the maintenance of a sound funding position. Furthermore, the positively sloped multiperiod return on investments affirms that developments in financial markets are unlikely to affect the subsector's soundness in the short to medium term.

Figure 32: Retirement funds – Return on investment (ROI)

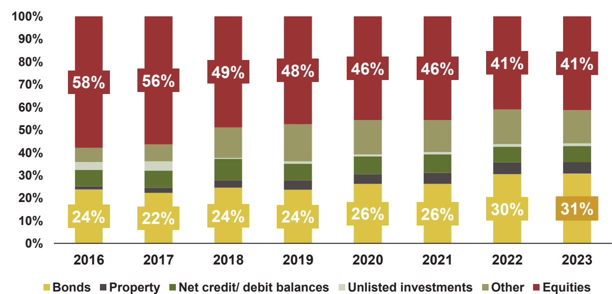


Source: NAMFISA

Investment mix

The proportion of the subsector's exposure to equities has been diminishing since 2016 (Figure 33). This is attributable to the combination of domestic holding requirements as well as a lack of depth in the domestic equity market. The way the subsector's investment assets are allocated with respect to asset classes is not expected to threaten the subsector's viability in the short to medium term.

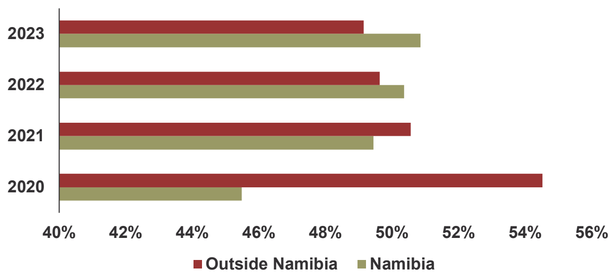
Figure 33: Retirement funds – Allocation per asset class



Source: NAMFISA

The subsector's investment assets channelled into the domestic economy increased by 15.1 percent to N$118.6 billion in 2023. The subsector's domestic asset holdings during the review period as a proportion of the 2022 GDP amounted to 49.3 percent. This underscores the subsector's significance to the domestic financial system. Despite the double-digit growth in the absolute value of investment assets held domestically, their proportional exposure remained largely unchanged. Proportionally, the retirement fund subsector held 50.9 percent of its investment assets in Namibia in 2023, 0.5 percentage points more than the proportions recorded in 2022 (Figure 34).

Figure 34: Retirement funds – Allocation per geographic location



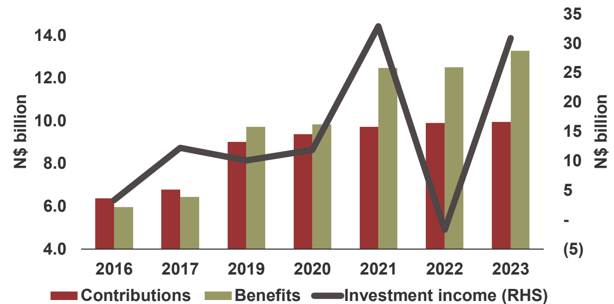
Source: NAMFISA

Some 47.6 percent of the domestically held investment assets are held in fixed investment instruments, predominantly Government debt. In 2023, Fitch affirmed Namibia's credit rating at BB- with a stable outlook. Despite the Financial Action Task Force grey listing Namibia, the subsector's exposure to credit risks relative to Namibian Government bonds was assessed to have remained relatively unchanged, with a low likelihood of materialising in the short to medium term.

Contributions vs benefits

The gap between benefits paid and contributions received widened further in 2023, signifying the maturity of the retirement funds subsector. Benefits paid expanded by 6.0 percent to N$13.3 billion in 2023, while contributions received expanded marginally by 0.4 percent to N$9.9 billion over the same period (Figure 35). A continuation of the widening gap between benefits paid and contributions received is not a threat to the viability of the subsector in the short to medium term. This is because investment income sufficiently covers the shortfall during these terms, ceteris paribus. However, the regulator continues to monitor for potential intervention, if warranted.

Figure 35: Retirement funds – Contributions vs Benefits

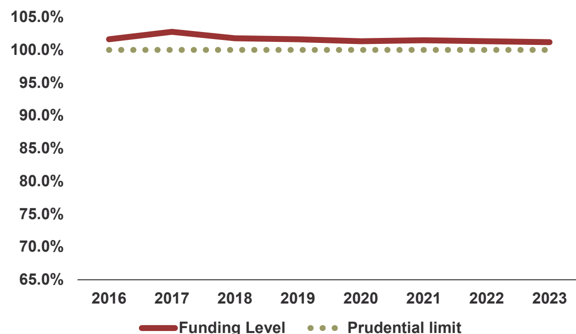


Source: NAMFISA

Funding position

The subsector remained sound during the review period, supported by a recovery in financial markets despite the challenging macroeconomic environment (Figure 36). In the short to medium term, the subsector is expected to remain sound. A cause for concern in the long run is the limited creation of new employment in the economy, which is primarily responsible for the relatively stagnant growth in membership and contributions received.

Figure 36: Retirement funds – Funding position



Source: NAMFISA

Long-term insurance

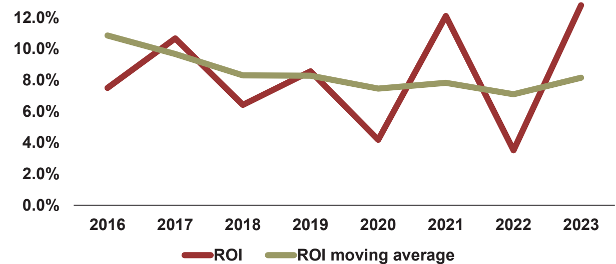
The long-term insurance subsector's assets expanded by 8.0 percent to N$74.3 billion in 2023. As is the case with retirement funds, this subsector is a significant source of funds for the domestic financial system and is therefore also crucial to the stability of the Namibian financial system. Developments in financial markets, economic development and changes in policyholder demographics are some of the factors that are expected to influence growth in the subsector's assets.

Due to the subsector's capital reserves as well as the long-term nature of its liabilities, developments in financial markets are not expected to have an adverse effect on the subsector's soundness in the short to medium term, ceteris paribus. The stable economic outlook affirmed by the BoN in its December 2023 Economic Outlook supports the expectation that demand for long-term insurance products will remain resilient in the short to medium term.

Market risks

The subsector's investment assets returned 12.8 percent in 2023, on the back of a rally in equity markets dominated by technological stocks. In consideration of the long-term nature of the subsector's liabilities, a three-year moving average return on investments was computed. This computation showed that the subsector's investment assets have delivered an average return of 8.2 percent from 2021 to 2023 (Figure 37). Thus, the subsector's investment assets outperformed inflation over the same period. Notably, however, the degree of concentration in the US stock markets is a likely source of system risk and is therefore a cause for concern. In the short to medium term, the subsector is expected to withstand any adverse developments in the financial markets and remain sound, ceteris paribus.

Figure 37: Long-term insurers – Return on investment (ROI)

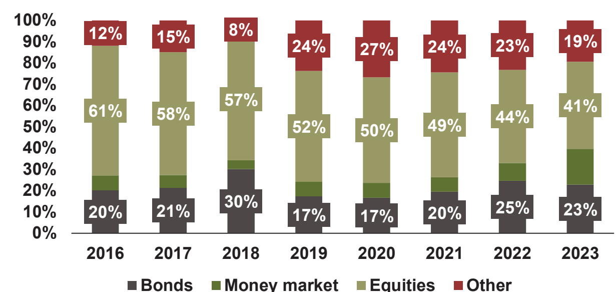


Source: NAMFISA

Investment mix

As was the case with retirement funds, the long-term insurance subsector's exposure to equities has been diminishing over time. Thus, between 2016 and 2023, the proportion of exposure to equities has dropped from 61 percent to 41 percent (Figure 38). This decline is attributable to investment regulations which prescribe that a minimum of 45 percent of the subsector's investment assets be held domestically. Long-term insurance investments are generally matched with the corresponding liabilities' time to maturity. Therefore, despite the downward trend in exposure to equities, there were no concerns with the optimality of allocation of investment assets with respect to asset classes during the review period.

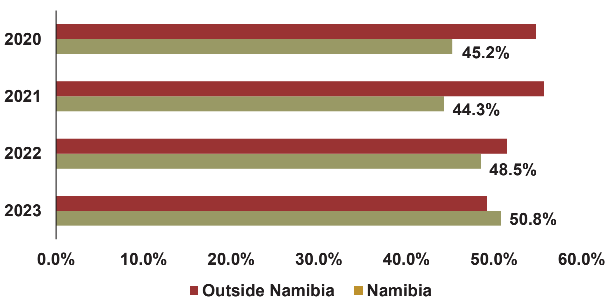
Figure 38: Long-term insurers – Allocation per asset class



Source: NAMFISA

Owing to the domestic holding requirement, 50.8 percent of the subsector's assets were held in Namibia during the reporting year. This percentage equated to a monetary amount of N$32.9 billion, underscoring the significance of the subsector as a source of funds in Namibia (Figure 39). The subsector's biggest individual domestic exposure during the review period was to Government debt. In the short run, concerns relating to the subsector's exposure to credit risk have been allayed by Fitch's affirmation of the country's outlook being stable. Therefore, the subsector's exposure to Namibian Government bonds is expected to remain stable in the short to medium term.

Figure 39: Long-term insurers – Allocation per geographic location

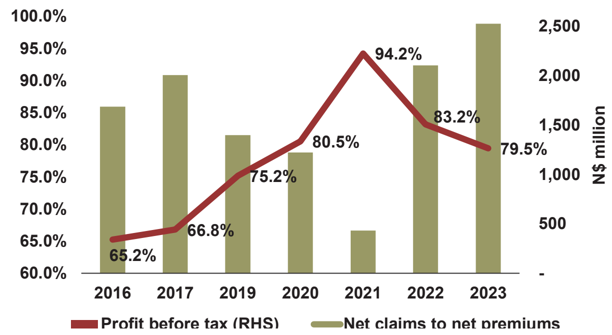


Source: NAMFISA

Claims experience

The subsector's claims experience continued its recovery to the pre-COVID-19 pandemic levels. Long-term insurers' loss ratio contracted by 14.8 percentage points from its peak in 2021, to 79.5 percent in 2023 (Figure 40). Consequent to the normalising claims experience, and compounded by a recovery in investment income, the subsector's profit levels increased by 19.9 percent year-on-year to N$2.5 billion in 2023.

Figure 40: Long-term insurers – Earnings and profitability



Source: NAMFISA

Solvency position

The subsector remained sound during the review period, on the back of a favourable claims experience, recovery in financial markets, and resilient demand for long-term insurance products – despite the challenging macroeconomic environment. The subsector is expected to remain sound in the short to medium term. Unexpected and sizable changes to mortality and disablement events as well as aging retirees are some of the factors that could affect the subsector's viability in the long run.

The NBFI sector remained sound, despite the contractionary monetary policy environment.

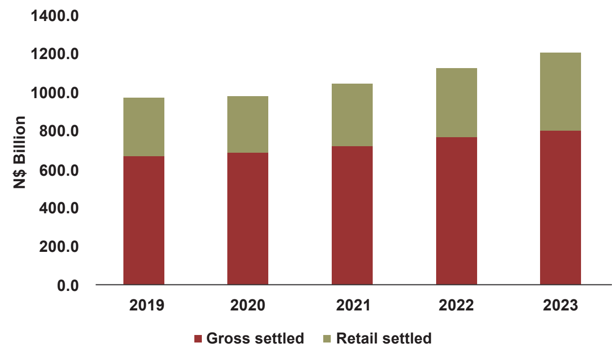
9 PAYMENTS INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

PAYMENTS INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

Operational and settlement risks remained relatively low within the NPS, while the total value of fraud increased across all payment streams. Payment systems are a crucial part of the financial infrastructure of a country. In Namibia, the regulatory mandate to oversee the National Payment System (NPS) was carried out through risk-based off-site oversight activities. The BoN conducted several of these activities by monitoring system participants through assessments based on information provided by the regulated institutions in the NPS. During the review period, the BoN conducted five risk-based inspections of various participants. The observations from the assessments were shared with the respective participants for resolution within agreed timelines. Following the self-assessment against the Principles for Financial Market Infrastructures, Namibia's automated clearing house, Namclear, a designated financial market infrastructure, implemented the resulting recommendations.

During 2023, the BoN noted a slight increase in both the volume and value of inter-bank settlements. The aggregate inter-bank settlement value recorded in the Namibia Interbank Settlement System (NISS) during 2023 was N$1.205 trillion, with a volume of 95,539 transactions, which translated into an average of 319 transactions per settlement day. In comparison with 2022, the total value and volume settled through the NISS in 2023 increased by 6.6 percent and 5.7 percent, respectively. Moreover, the share of bilateral transactions settled in the NISS amounted to N$800.5 billion, which translates into 66.4 percent of the total value settled. The value of multilateral retail payment transactions cleared through Namclear was N$405.3 billion, which represents 33.6 percent of the total value settled in the NISS (Figure 41).

Figure 41: Value of payments processed in the NISS

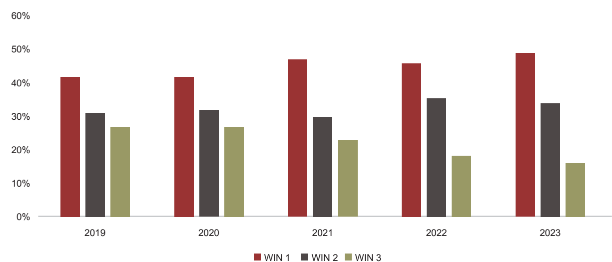


Source: BoN

NISS settlement windows

Settlement and operational risks remained moderate within the NPS in 2023. The bulk of the payments settled in earlier windows (i.e., Windows 1 and Window 2), accounted for 83.52 percent (N$1,007.0 trillion) of the aggregate settlement, while the remainder of payments were settled during the later window, Window 3 (Figure 42). To deter settlement and operational risks, it is preferable for most settlement obligations to occur during earlier settlement windows, allowing participants ample time to fulfil their settlement obligations promptly. In line with this ideal, the NISS settlement statistics in Figure 42 indicate that in 2023, 49.2 percent (N$593.9 billion) of payments settled in Window 1 (08h00 to 12h00); 34.3 percent (N$413.3 billion) settled in Window 2 (12h00 to 15h00); and 16.5 percent or N$198.8 billion settled in Window 3 (15h00 to 16h40).

Figure 42: Proportions of payments settled in each NISS settlement window



Source: BoN

Disruptions to the NISS

The NISS continued to maintain high system availability throughout 2023. The NISS recorded 99.97 percent availability during 2023, which was slightly above the target availability of 99.90 percent.

In 2023, the BoN provided inter-bank settlement services through the NISS to authorised institutions. The inter-bank transactions settled through the NISS comprise bilateral time-critical transactions processed by NISS participants as well as multilateral retail payment transactions such as Electronic Funds Transfer (EFT) and card transactions that are cleared through Namclear. During 2023, the BoN conducted an announced NISS disaster recovery exercise during the first quarter of the year. The exercise was unsuccessful because the two-hour recovery time objective was not met due to Information Technology (IT) issues. The BoN engaged in work to resolve these issues, which resulted in the success of a subsequent unannounced NISS disaster recovery exercise conducted during the third quarter of 2023. In respect of business continuity management, the BoN did not conduct any exercises during 2023 due to IT infrastructure upgrades.

Security of retail payments

In comparison to 2022, the total value of fraud across all payment streams increased substantially during 2023. The Card, EFT and E-money streams recorded respective increases in fraudulent transactions of N$18 million (58 percent), N$17 million (14 percent) and N$11 million (12 percent). The increase in payment card fraud was primarily due to card-not-present payment incidents carried out through internet banking platforms and/or mobile applications. Card-not-present is a type of payment fraud that occurs when a customer uses their card at a non-secure merchant, where transactions are not authenticated with a one-time password (OTP), and therefore, no OTP confirmation is required from the customer. In most cases, the customers are refunded because they are not at fault, and they request a chargeback from the merchant. In contrast, EFT fraud was carried out primarily via phishing, while that in E-money payments resulted from incidents that were perpetrated via phone scams, especially targeting e-money wallets. The total fraud perpetrated within the NPS remained within the Fraud Safety Index indicator of 0.05 percent, as per the BoN's Strategic Goal, with a figure of 0.0033 percent being recorded.

Various initiatives are under discussion and are slated for implementation by the industry to enhance the security posture of the NPS. The Payment Card Industry Data Security Standard (PCI-DSS) is a set of security standards that ensures institutions accepting, processing, storing or transmitting card information maintain a secure environment. The PCI Security Standards Council updates the PCI-DSS regularly to ensure institutions are protected against existing and new exploits. The industry is expected to comply fully with version 3.2.1 of the standards by the end of 2025, with the remaining few non-compliant participants making significant steps to achieve compliance within their set timelines. The BoN continuously monitors compliance with this initiative and engages the industry through the Payments Association of Namibia (PAN) to encourage participants to manage identified risks appropriately.

Additionally, the risk of wholesale payment fraud related to endpoint security is addressed by a BoN-led initiative throughout the industry. Work is in-progress to enhance the NISS participants' endpoint security, with minimum-security requirements and guidance provided to address identified gaps. The Settlement System Operator will continuously monitor the NISS participants' progress in implementing the recommendations to prevent wholesale payment fraud.

Following the establishment of the Cyber Security Council during the latter part of 2022, the Council further created a Cybersecurity Council Working Group in 2023. The purpose of this Working Group is to identify and assess cybersecurity challenges facing the industry and recommend solutions to resolve them. During 2023, the Council developed the Cyber Risk and Resilience Strategy for the Financial Sector, which was shared with stakeholders for approval. The Strategy was developed to establish the critical aspects of public-private engagements across the financial sector, in addition to prudential policy and supervision. During the period under review, the Working Group collaborated with various industry associations and regulatory bodies to achieve its objectives. The finalisation of its Plan for the Financial Industry Cybersecurity Council Working Group is slated for 2024.

Developments in payment and settlement systems

The review period saw the Payment System Management Act, 2023 (No. 14 of 2023) being introduced. The BoN began revising its regulatory framework to ensure that all regulations, determinations, directives, etc. aligned with the new Act. The new Act empowers the BoN to act as the sole regulator of the NPS. This entailed that the powers previously vested in the PAN to license and oversee payment service providers were withdrawn. However, PAN will still operate as an advisory and collaborative body for setting technical rules and standards for its members' participation in the NPS. The term payment service provider collectively refers to both banking institutions and NBFIs authorised and licensed to offer payment services as listed in the Schedule of the Act. In line with this, the BoN revised the Determination on Issuing of a Payment Instrument (PSD-1) issued in 2007, to provide requirements for the licensing and authorisation of payment service providers in Namibia. The revised PSD-1, titled the Determination on the Licensing and Authorisation of Payment Service Providers in Namibia (PSD-1), includes specific requirements for different payment service provider categories and repeals various instruments currently used to license and oversee payment service providers in the NPS. The revised PSD-1 was gazetted on 15 February 2024.

During the period under review, the BoN issued Guidelines on the Standardisation of Quick Response Codes in the National Payment System. The Guidelines took effect in 2023. The NPS industry is expected to adopt specifications for Quick Response (QR) codes outlined in the Guidelines, during 2024.

The BoN remained a participant in the Southern African Development Community (SADC) Real Time Gross Settlement (SADC-RTGS) system. The SADC-RTGS is a regional settlement system that processes time-critical or high-value payments between participating SADC countries. At the end of the 2023 reporting period, the system had 95 participants (i.e. registered banking institutions as well as central banks within the respective SADC jurisdictions) of which five – including the BoN – were Namibian. During 2023, the total value of payments processed in the SADC-RTGS amounted to ZAR2.2 trillion, of which ZAR641 billion (29 percent) was processed by the Namibian participating banks. This demonstrates a significant use of the SADC RTGS system by the Namibian participating banks, which supports regional payment integration in accordance with the SADC Protocol on Finance and Investment.

The SADC-RTGS System Operator collaborated with the SADC Banking Association to support the adoption of ISO 20022 messaging standards for cross-border payments. The SADC Banking Association subsequently launched an ISO 20022 Migration Project to ensure the timely adoption of these standards by SADC countries. Swift, the society for worldwide interbank financial telecommunications service, has directed all financial institutions using its current global messaging text (MT) standards to migrate to the messaging standards of the International Organization for Standardization (ISO) 20022 by November 2025. Engagements are underway at both regional and domestic levels to ensure compliance with Swift's deadline. At a regional level, the SADC-RTGS System Operator and the ISO 20022 Migration Project have proposed that the provisional implementation date for the ISO 20022 standards in the SADC Region be June 2024. The BoN will continue to ensure domestic compliance with the ISO 20022 and other relevant international standards as part of its oversight efforts. To further support the ISO 20022 migration efforts, the BoN issued a Guidance Note to the NPS participants to ensure timely migration to the new standards by 30 October 2025.

BOX ARTICLE 1:
CYBERSECURITY IN THE NATIONAL PAYMENT SYSTEM

The ongoing modernisation of the NPS propelled by the digitisation of payments, advances in financial technology, automated processes, and artificial intelligence (AI) integration has enhanced efficiency and cost-effectiveness. However, it has also brought about cyber threats and vulnerabilities within the NPS. According to the National Institute of Standards and Technology in the United States (US), a cyber threat refers to any circumstance or event that could harm organisational operations, assets or individuals through unauthorised access or destruction or disclosure or modification of information. Common cyber threats include the following:

a. **Malware:** These malicious software variants include viruses, trojans, worms and ransomware, which pose a significant risk by infiltrating, damaging or disabling computer systems and networks.

b. **Phishing:** Fraudulent attempts to obtain sensitive information such as login credentials or financial data by impersonating reputable sources through social engineering techniques, email or other forms of communication.

c. **Denial-of-Service (DoS) Attacks:** Targeted attacks aimed at flooding a network with false requests, causing a disruption of normal business operations.

d. **Insider Threats:** Unauthorised access or misuse of information, systems or resources by an individual within an organisation, either knowingly or unknowingly.

To safeguard against cyber threats that pose significant risks to the integrity, confidentiality and availability of financial data and systems, a multi-layered cybersecurity approach is crucial. Again, the US's National Institute of Standards and Technology defines cybersecurity as the ability to protect or defend the use of cyberspace from cyber-attacks. Various cybersecurity tools and technologies play a crucial role in fortifying defences against cyber threats, which include:

a. **Firewalls:** These serve as a barrier between trusted internal networks and untrusted external networks, controlling incoming and outgoing traffic to prevent unauthorised access and malicious activities.

b. **Endpoint Protection Solutions:** This entails the use of antivirus software and host-based intrusion detection systems to detect and eliminate malware, prevent unauthorised access, and safeguard against endpoint vulnerabilities.

c. **Encryption Technologies:** This involves employing robust encryption mechanisms to ensure the confidentiality and integrity of transmitted data, thereby safeguarding sensitive information.

d. **Access Control Systems:** This involves the implementation of role-based access control and multifactor authentication to manage and enforce user permissions and authentication requirements, thereby preventing unauthorised access to critical systems and data.

e. **Regular Security Testing:** This entails conducting penetration testing and vulnerability assessments to identify and rectify weaknesses in infrastructure, applications and configurations, thereby reducing the risk of cyber-attacks and data breaches.

f. **Cybersecurity Awareness Training:** This means educating employees and stakeholders about cybersecurity best practices, including raising awareness of phishing techniques and social engineering tactics, to mitigate human-related risks effectively.

The NPS plays a pivotal role in the economy, encompassing a diverse range of payment-related activities, processes, institutions, infrastructure and regulations. The NPS comprises of interconnected systems, including core banking systems and payment switches, that connect to other essential systems such as the national automated clearing house, Namclear, and the real time gross settlement facility, the Namibia Interbank Settlement System (NISS). However, this interconnectedness exposes the NPS to heightened vulnerability from cyber threats. A cyber threat targeting the NPS has the potential to disrupt core banking systems and critical infrastructures, unleashing systemic risk. This disruption can lead to failures in the facilitation of payments as well as clearing and settlement, spreading the effects of a contagion throughout the financial system and posing a threat to the country's financial stability.

Recognising the growing threat posed by cyber risks, regulatory authorities have taken proactive measures to enhance cybersecurity within the NPS. In Namibia, at a national level, the establishment of the Financial Industry Cybersecurity Council serves as a fundamental initiative, providing a dedicated platform for fostering discussions and formulating operational strategies aimed at combating cyber fraud effectively. Similarly, operating at an industry level within the NPS, the Financial Institutions Fraud and Security Committee assumes a critical role in disseminating vital information regarding fraud tactics employed by potential perpetrators, thereby enhancing public awareness and vigilance.

From a regulatory standpoint, the BoN issued the Determination on Information Security (BID-30), which mandates banking institutions to implement robust information security programs. These programs are specifically designed to mitigate the business impact of operational information security vulnerabilities or incidents and maintain them within acceptable risk levels. For the NPS, the Determination of the Operational and Cybersecurity Standards within the National Payment System (PSD-12) mandates the adoption of stringent security measures such as two-factor authentication, regular vulnerability assessments or penetration tests, encryption of customer and financial data across all NPS participants, and a recovery time objective of two hours following a disaster or cyber incident. PSD-12 also aims to enhance password protection, preserve data integrity and ensure the uninterrupted availability of payment systems by imposing strict timeframes for system downtime and data loss incidents.

The BoN also adopts and adheres to international leading practices and appropriate standards in overseeing the NPS. Financial market infrastructures such as Namclear and the NISS are held to high-risk management international standards. These international standards include Principles for Financial Market Infrastructures (PFMI) and reducing the risk of wholesale payments fraud related to endpoint security, among other relevant standards. Moreover, the industry participants in the NPS are committed to implementing the Payment Card Industry Data Security Standard (PCI-DSS), ensuring the maintenance of secure environments for processing, storing or transmitting card information, among other critical security measures. Simultaneously, proactive efforts are undertaken through continuous cybersecurity awareness campaigns led by NPS participants, the Payments Association of Namibia, and the BoN. These campaigns serve to heighten awareness, educate stakeholders, and foster a culture of vigilance against cyber threats, thereby reinforcing the collective resilience of the NPS ecosystem.

Cybersecurity is a key pillar for a well-functioning NPS. Instilling confidence in the financial system, cybersecurity paves the way for continued innovation and advancement in the digital economy. As such, prioritising cybersecurity measures remains imperative to uphold the integrity and reliability of the NPS to ensure financial system stability.

10 CONCLUDING REMARKS AND POLICY IMPLICATIONS

CONCLUDING REMARKS AND POLICY IMPLICATIONS

Despite moderate economic conditions, the financial system in Namibia maintained its soundness, profitability, and resilience. Given the current challenging macroeconomic environment, the financial system continued to function efficiently and met all the relevant statutory requirements. The ratio of household debt to disposable income decreased in 2023 owing to rising disposable income and slower household debt growth. Credit extended to the corporate sector also registered lower growth in tandem with moderate economic activity. Therefore, the risk to the financial stability from both the household and corporate sectors remained moderate. In the banking sector, although asset quality deteriorated, edging closer to the crisis-time supervisory-intervention trigger point, the banks remained liquid, profitable and well capitalised. Moreover, asset growth in the banking sector continued to surpass the inflation rate in 2023. The NBFIs were financially sound and stable during 2023, despite the prevailing contractionary monetary policy environment. Notwithstanding the strong growth in NBFI assets during the period under review, the volatility of the financial markets remains a concern to the short-to-medium term viability, particularly for NBFI subsectors with dominantly short-term liabilities. The payment system and infrastructure remained stable and contributed efficiently to ensuring reliability in payments, thus facilitating financial system stability within the country.

Going forward, risks to the Namibian financial system require continuous monitoring given the emergence of new idiosyncratic risk. Overall, risks to financial stability remained broadly unchanged. Nonetheless, some risks centred around climate change, cybersecurity, and the FATF grey listing may require continuous monitoring. Specifically, climate-related risk, is causing deepening concern around the globe and has the potential to affect Namibia's financial system through physical and transition risks. Furthermore, idiosyncratic risks such as grey listing by the FATF have the potential to elevate systemic risks and undermine the outlook for financial stability in Namibia. However, risks to financial stability in Namibia will be monitored accordingly under the advisory guidance of the Financial System Stability Committee and the direction of the Macroprudential Oversight Committee.

The Macroprudential Oversight Committee approved the revision of the LTV regulation, following developments in the property market. In this regard, the revised LTV regulation involved implementing less strict LTV ratios, with no downpayments required to purchase first and second residential properties. However, for the third and subsequent properties, prospective buyers are required to make a 10 percent deposit when acquiring a home loan. Besides the change in the LTV regulation and the exploration of a countercyclical capital buffer, there were no other specific policy recommendations deemed necessary during the period under review. The MOC will continue to carefully assess and monitor unfolding developments and, when warranted, take the necessary remedial macroprudential actions with the tools at its disposal.

Despite moderate economic conditions, the financial system in Namibia maintained its soundness, profitability and resilience.

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Other resources

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LIST OF ABBREVIATIONS

AEs	Advanced Economies
AML	Anti-Money laundering
BCBS	Basel Committee on Banking Supervision
CFT	Combating the Financing of Terrorism
BoN	Bank of Namibia
CAR	Capital Adequacy Ratio
CEO	Chief Executive Officer
CBDC	Central Bank Digital Currencies
CCB	Capital Conservation Buffer
CIS	Collective Investment Schemes
CCyB	Countercyclical Capital Buffer
DSIBs	Domestic Systemically Important Banks
EFT	Electronic Funds Transfer
EMDEs	Emerging Market and Developing Economies
ESG	Environmental Social, and Governance
FATF	Financial Action Task Force
Fed	Federal Reserve System
FinTech	Financial Technology
FSR	Financial Stability Report
FSSC	Financial System Stability Committee
FMI	Financial Market Infrastructures
GDP	Gross Domestic Product
GFC	Global Financial Conditions
HPI	House Price Index
IMF	International Monetary Fund
IPCC	Intergovernmental Panel on Climate Change
LTD	Loan-To-Deposit
LTF	Loan-To-FundingLTI
LTV	Loan-to-Value
MAF	Medical Aid Funds
MOC	Macroprudential Oversight Committee
LTI	Long-term Insurance
MoFPE	Ministry of Finance and Public Enterprises
NAD	Namibia Dollar
NAMFISA	Namibia Financial Institutions Supervisory Authority
NBFI	Non-Bank Financial Institution
NGFS	Network of Central Banks and Supervisors for Greening the Financial System
NISS	Namibia Interbank Settlement System
NPL	Non-Performing Loan
NPS	National Payment System
QPM	Quarterly Projection ModelRFs
RHS	Right Hand Side
RFs	Retirement Funds
ROA	Return on Assets
ROE	Return on Equity
ROI	Return on Investment
PCI SSC	Payment Card Industry Security Standards Council
PCI-DSS	Payment Card Industry Data Security Standard
PFMI	Principles for Financial Market Infrastructures
PSCE	Private Sector Credit Extension
RWCR	Risk-Weighted Capital Ratio
SACU	Southern African Customs Union
SADC	Southern Africa Development Community
SADC-RTGS	SADC Real-Time Gross Settlement System
SARB	South African Reserve Bank
SOE	State-Owned Enterprise
STI	Short-term Insurance
SWIFT	Society for Worldwide Interbank Financial Telecommunications
S&P	Standard & Poor's
US	United States of America
UK	United Kingdom
WEO	World Economic Outlook
ZAR	South African Rand

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