Bank of Namibia

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THE BANK'S CORPORATE CHARTER

VISION

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

MISSION

"In support of economic growth and development our mandate is to promote price stability, efficient payment systems, effective banking supervision, reserves management and economic research in order to proactively offer relevant financial and fiscal advice to all our stakeholders."

VALUES

"We value high-performance impact in the context of teamwork.

We uphold open communication, diversity and integrity.

We care for each other's well-being and we value excellence."

LIST OF ABBREVIATIONS

AML/CFT	Anti-money laundering and combating of financing of terrorism
BoN	Bank of Namibia
CBS	Central Statistics Bureau
CMA	Common Monetary Area
EMEs	Emerging market economies
FIA	Financial Intelligence Act
FIC	Financial Intelligence Centre
FNB	First National Bank
FSR	Financial Sector Review
GC10	Government Internal Registered Stock Maturing in 2010
GC12	Government Internal Registered Stock Maturing in 2012
GC15	Government Internal Registered Stock Maturing in 2015
GC18	Government Internal Registered Stock Maturing in 2018
GC24	Government Internal Registered Stock Maturing in 2024
HI	Herfindahl Index
IMF	International Monetary Fund
JSE	Johannesburg Stock Exchange
LHS	left-hand side (of graph)
NAD	Namibia dollar
NISS	Namibia Inter-bank Settlement System
NPL	non-performing loan
NSX	Namibian Stock Exchange
RHS	right-hand side (of graph)
SA	South Africa
SACU	Southern African Customs Union
SARB	South African Reserve Bank
T Bill	Treasury bill
US(A)	United States (of America)

CONTENTS

INTRODUCTION

The Bank of Namibia has a mandate *"to promote and maintain a sound monetary, credit and financial system in Namibia and sustain the liquidity, solvency and functioning of that system"*. The efficiency and soundness of the financial system is, therefore, of particular interest to the Bank. The Financial Stability Review (FSR) is a biannual assessment of the key vulnerabilities facing the Namibian financial system and its ability to withstand external shocks and to facilitate economic development. The FSR also summarises the Bank's other activities aimed at promoting financial system stability. The current issue covers the period since July 2009.

The financial system comprises financial institutions, financial markets, payment and settlement system, and financial infrastructure. The banking institutions are a key part of the financial system. Consequently, adverse shocks originating from the banking sector could be transmitted to the rest of the financial system and the real economy. The bulk of the financial stability assessment, hence, is devoted to the performance of the banking sector and its capacity to absorb unforeseen shocks.

The FSR starts with a brief outline of the relevant international and domestic developments, and underlines their possible impact on financial system stability in Namibia. The review also examines regulatory developments that might affect financial markets. The FSR, then, ends with a summary of risks and outlook.

All major sections of the FSR conclude with a rating, indicating the likely impact of the issues raised relative to the previous review period. The ratings, in ascending degree (of intensity) of impact, are as follows: low, moderate, and high[1].

[1] An issue is rated *high* if its impact could result in significant disruptions to the operations of the financial system. The other ratings (low and moderate) are interpreted accordingly.

1. SUMMARY OF THE STABILITY ASSESSMENT

The global financial and economic conditions have improved markedly since the last review, although the sustainability of recovery remained uncertain. Economic growth has widened and many advanced and emerging economies began to show positive output growth. Global production and international trade have also started to recover, albeit meekly. Improved economic fundamentals, coupled with extra-ordinary policy support, have eliminated the risk for a global depression and lifted market confidence and reduced uncertainty. Consequently, systemic risk remained subdued. Despite improvements in global economic and financial conditions, downside risks to the recovery continue. Although economic recovery widened and international trade recovered, the former remains sluggish, and the latter continues to be weak, while unemployment in some key economies stays high. Under these conditions, policy supports are needed to sustain the tender recovery.

Improving economic fundamentals, a reduction in macro-economic risks and sustained policy support calmed concerns about systemic financial collapse and spurred financial market conditions. As a result, overall financial market sentiment and risk appetite have rebounded, banks have raised capital and eased lending, and emerging market risks have fallen. Portfolio inflows into emerging market assets, mainly equities, have also recovered. However, financial stability remains fragile in advanced countries and some heavily affected emerging countries. In financial markets, the major challenges are to restore the health of the banking sector and revive the weak credit extension.

The Namibian real economy contracted by 1.1 percent in 2009 as the impact of the global financial crisis took its toll. The diamond and tourism sectors were the most inflicted. The two sectors experienced hefty output losses and labour shedding. However, the mining sector is expected to recover by 15.0 percent in 2010. On the other hand, the tourism sector is projected to contract by 2.0 percent during 2010 compared to a reduction of 20 percent in 2009. As a result, the Bank, in its latest economic outlook, has forecast GDP to recover by 4.2 percent, on account of projected global economic recovery and the rebound in domestic diamond and uranium mining. However, the impact of a possible reversal in global economic recovery and, hence, the outlook for Namibian main export commodities constitute the downside risks to the domestic economic recovery in 2010.

The improving economic conditions are expected to lead to improvements in the financial situation of households and support internal demand. Similarly, a rebound in domestic economic activity would sustain corporate prosperity. Both circumstances would result in further decreases in non-performing loans for the banking sector as a result of improved repayment ability of banking borrowers. This development would advance banking stability, going forward.

The real effective exchange rate (REER) of the Namibia Dollar (NAD) appreciated against the currencies of the major trading partners in the second half of 2009. **The real appreciation could have resulted in a loss of competitiveness of Namibia's exports as they become relatively more expensive**. Namibia's international reserves continued to increase in the second half of 2009, thanks to SACU inflows. This enhanced both the financial health of the domestic economy and financial stability. However, the country continues to be vulnerable due to its dependency on significant SACU inflows.

The Namibian banking sector's limited links, to the international financial markets ruined by the financial crisis, have insulated the sector from the negative impacts of the global financial crisis. As a result, the banking sector remains adequately liquid, profitable and well capitalised in the second half of 2009. In addition, non-performing loans continued to fall and cost efficiency improved during the period. This situation bodes well for banking sector stability. However, overdue loans have been rising since the first half of 2009 and capital adequacy ratios have slipped, although they remained above regulatory minima. These concerns notwithstanding, the banking sector remains safe and sound.

The Bank continued to carry out its oversight function of the performance of the National Payment System (NPS). The principal aim of these oversight activities is to ensure that the NPS is efficient and safe. Despite a few system glitches, the NPS performed adequately in the second half of 2009. The payment system, thus, poses no systemic risk to the financial system.

Although the impact of the global financial crisis on the Namibian banking sector has been limited, its consequences on the domestic real economy have been severe. The global financial crisis has negatively impacted key sectors of the real economy with heavy output losses and employment shedding. The domestic economy is expected to recover in 2010, in line with improvements in global economic fundamentals as well as a rebound in the domestic mining sector. The resumption in economic output would improve the financial conditions of both businesses and households and eventually boost banking performance and financial stability. The overall impact of the global financial stability is assessed to remain low in the foreseeable future, as long as the recovery continues to hold.

2. EXTERNAL ENVIRONMENT

2.1 MACRO-FINANCIAL CONDITIONS

The global economy has started to recover in the second half of 2009, after the unprecedented deep recession triggered by the subprime crisis and the subsequent economic and financial crises. Economic growth has returned and widened in the second half of 2009. A wide range of advanced and emerging economies began to record positive economic growth. International trade and global production has also begun to recover. Consequently, confidence has returned, as substantial monetary and fiscal support that drove the global rebound has allayed concerns about systemic collapse, supported demand, and eliminated the risk of a depression. Systemic risk has continued to subside in both advanced economies and emerging and developing countries. However, financial stability remains fragile, in many advanced countries and some hard-hit emerging market countries, underlining the pressing need to continue repairing the financial sector.

Improving economic fundamentals and sustained policy lifted confidence and helped financial markets conditions recover, although they remain fragile. Many banks in key financial markets have become less reliant on central bank emergency facilities and government guarantees. However, high public debt levels add to financial stability risks and complicate the exit process from the extra-ordinary amount of policy stimulus, without jeopardising economic growth. Although tightening of bank lending standards has moderated, bank credit extension is likely to remain sluggish in many advanced economies, given the need to rebuild bank capital and the possibility of further credit write-downs, among others.

Strong economic recovery in key emerging and developing economies gave way to very robust final demand. Consequently, commodity prices rose early during the recovery stage. This development was to a large extent due to strong recovery in emerging Asia and the onset of economic recovery in other emerging and developing economies. In turn, the rebound in commodity prices helped support economic growth in commodity-producers/exporters.

Financial conditions have also recovered in emerging and developing markets. In addition, strong economic fundamentals and quick policy responses have helped many emerging economies to cushion the impact of the unprecedented external shock. Portfolio-inflows into emerging markets, since the second quarter of 2009, have been backed by improved economic growth prospects for the economies. Capital inflows into emerging economies would help shift the pattern of global expenditures.

According to the IMF's World Economic *Update* of January 2010, the global economic recovery has been stronger and broader than anticipated. The global rebound was driven by extra-ordinary monetary policy and fiscal policy stimuli. At the same time, systemic risks have declined as economic fundamentals improved. However, economic recovery is expected to remain sluggish by past standards in most advanced economies. In many emerging and developing economies, by contrast, economic activity is expected to grow relatively strong.

The IMF anticipates global economic recovery, with output growth at 4.0 percent in 2010, to proceed at varying speeds in both advanced economies and emerging and developing economies; reflecting different initial conditions, external shocks, and policy responses. In the advanced economies, recovery, after a sharp decline in 2009, is expected to be protracted, with GDP growth at 2.0 percent in 2010. Real output will remain below its pre-crisis levels until late in 2011, when it is forecast to expand by 2.5 percent.

The IMF expects GDP growth in emerging and developing economies to rise to about 6.0 percent in 2010, after a modest 2.0 percent growth in 2009. In 2011, output is projected to accelerate further in these economies.

2.2 INFLATION RATES

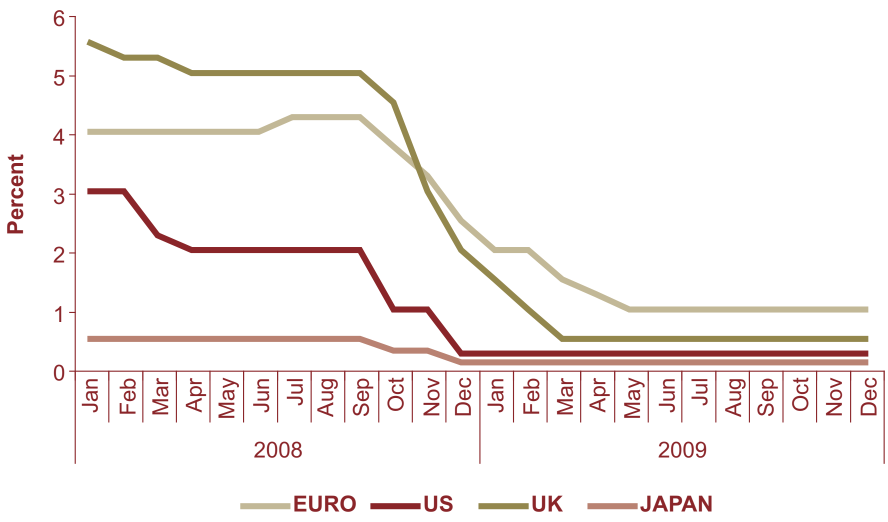
Low levels of capacity utilisation and uncertainty about the strength of the global economic recovery have subdued global inflation expectations and contained inflation pressures. Although commodity prices are expected to rise a bit further on the strength of global demand, especially from emerging economies, these upward pressures (on inflation) are expected to remain modest. In the advanced economies, headline inflation is expected to pick up from zero (0) in 2009 to 1.25 percent in 2010, as rebounding energy prices are expected to more than offset slowing labour costs.

In emerging and developing economies, inflation is expected to remain around 5.25 percent in 2010. However, some of these economies may face growing upward pressures from increased capital inflows.

2.3 INTEREST RATES

As part of the expansionary monetary policy (aimed at driving global economic rebound), policy interest rates remained at record low levels in most advanced and many emerging economies, during the second half of 2009. Economic recovery was expected to remain sluggish in advanced economies during the period, by past standards. Hence, the European Central Bank, the US Federal Reserve, the Bank of England and the Bank of Japan kept their respective policy rates at 1.0, 0/0.25, 0.5 and 0.10 percent since the second half of 2009 (Chart 1).

Chart 1: Major policy interest rates



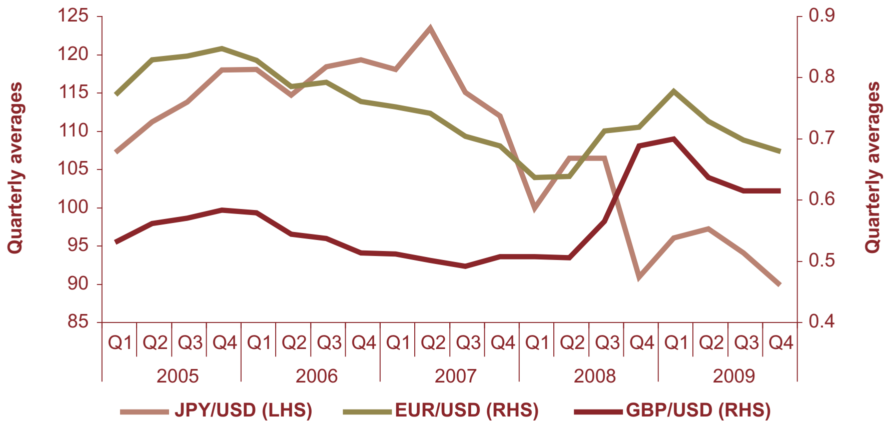
Source: Bloomberg

In contrast to lethargic economic recovery in advanced economies, economic activities were expected to be relatively strong in many emerging and developing economies. However, China has kept its policy rate unaltered in the second half of 2009, at 5.31 percent since December 2008, despite signs that the economy was expanding faster than anticipated. Although South Africa's economy returned to growth in the third quarter of 2009, after a recesseion, thanks to strong expansion in manufacturing, the authorities feared that recovery in the sector might be hindered by the Rand's gains against the US dollar (over the past 12 months). Consequently, the South African Reserve Bank (SARB) has kept its benchmark interest rate (the repo rate) unchanged at 7.0 percent since August 2009 during the second half of 2009. But in March 2010, the SARB cut its policy rate by 50 basis points to 6.5 percent.

2.4 EXCHANGE RATES

The global financial crisis and fragile economic recovery have continued to dominate the major international currency markets in the second half of 2009. The Euro, Pound and Yen appreciated against the Dollar during the period (Chart 2). The Dollar weakened as uncertainty reined about the strength and sustainability of the economic recovery and concerns over the high federal budget deficit. The weakness in the US currency was expected to remain for some time, given, among others, the high federal budget deficit and public debt. However, in 2010 the dollar appreciated against the Euro, Pound and Yen. At the end of March 2010, the dollar ended at 0.65980 pound, 0.74812 euro and 93.8600 yen. This compared favourably to 0.6116 pound, 0.6775 euro and 89.8473 yen at the end of December 2009.

Chart 2: Currency per US dollar



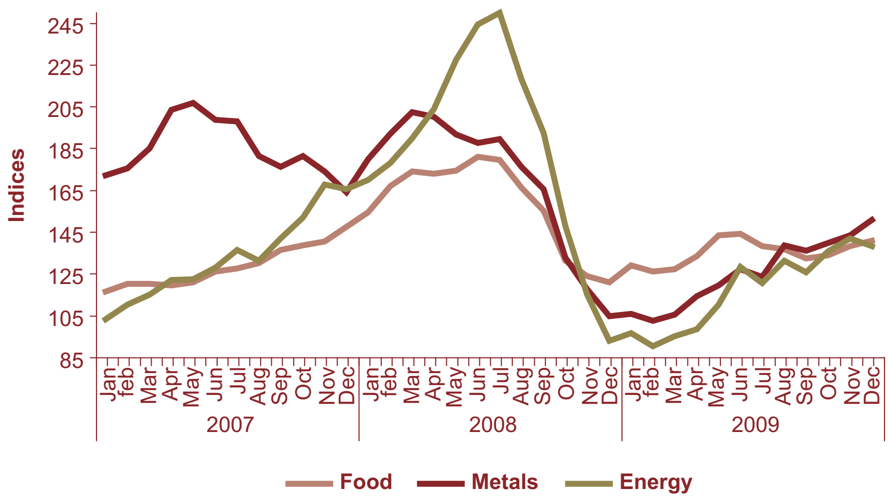
Source: Bloomberg

2.5 COMMODITY MARKETS

The upward pressure on commodity prices continued during the second half of 2009, although the energy prices slackened somewhat towards the end. The IMF all-commodity (fuel and non-fuel commodities) index rose by 8.6 percent from 126.6 in June 2009 to 137.5 in December 2009.

Metal prices have spearheaded the rise in commodity prices during the period, with the metal index rising by 18.3 percent from 126 at the end of June 2009 to 149 at the end of December 2009 (Chart 3). The substantial rise in commodity prices was mainly due to strong economic recovery in emerging Asia and to the start of a recovery in other emerging and developing economies. Improvements in global financial conditions during the period also aided the metal price increases. Commodity prices are expected to rise further, in 2010, thanks to strengthening global demand, especially demand for industrial metals from emerging economies and Asia (China, in particular).

Chart 3: Selected commodity price indices



Source: IMF

Gold price reached a record high level, of US$1,226.10 an ounce, in December 2009 from US$945.67 at the end of June 2009. The gold price increase, which brought the metal's total gains for the year (2009) to 25 percent, was helped by the weak US dollar and, hence, stronger gold's appeal to investors as an alternative better value investment. Jewellery demand, which was derailed by the global recession in 2009, is expected to recover modestly in 2010. In addition, the prospects of a prolonged slide in the US dollar (government debt levels, given lingering weakness in the economy, are likely to continue rising) and higher inflation in the future (central banks are likely to keep interest rates near zero) are likely to boost gold demand.

Early in 2010, however, hefty gains in the metal's price have slipped following the IMF's announcement to sell 191.3 tonnes of gold bullion to the open market and as the US dollar strengthened. Gold prices fell to US$1,096.50 an ounce at the end of March 2010. Gold prices are normally driven by the strength and/or volatility of the US dollar, oil prices and by the precious metal's demand and price.

Copper price rose from US$4,595.00 per metric tonne in June 2009 to US$6,682.44 a metric tonne at the end of December 2009. The copper price continued to be supported mainly by imports by China's fabricators as they replenish their inventories of copper and zinc. By the end of March 2010, copper price rose to US$7,530.00. The average price of zinc buoyed in the second half of 2009 by 4.7 percent to US$2,197 per metric tonne, as China continued to boost global zinc demand. Zinc price increased to US$2,265.00 per metric tonne at the end of the first quarter of 2010.

The average spot price for uranium fell by 10.3 percent from US$49.0 per pound in June 2009 to US$44.00 per pound at the close of the second half of 2009. By the end of March 2010, uranium prices declined further to US42.25 per pound. However, the market outlook for uranium for 2010 is strong due to a revived interest in nuclear energy, as uranium supply struggles to meet demand.

The energy (crude oil) prices increased (by 7.9 percent) during the period, with the oil price index moving from 127.6 at the end of the first half of 2009 to 137.0 at the end of the second half of 2009. At the same time, the food index fell by 2.1 percent from 143 in June 2009 to 140 in December 2009. Crude oil prices have risen from US$69.58 a barrel in June 2009 to US$74.49 per barrel at the end of December 2009. Oil prices in the second half of 2009 were partly boosted by evidence that the battered global economy was on the way to recovery; with the Euro zone, Japan and the United States escaping a fierce recession.

However, early in 2010 (Feb) sluggish crude oil demand has weighed (down) on oil prices as investors continued to worry about the health of the global economy. Consumer demand for fuels like gasoline and heating oil has also been weak. In addition, US crude oil stocks (supply) jumped (7.2 million barrels in the first week of Feb. 2010)

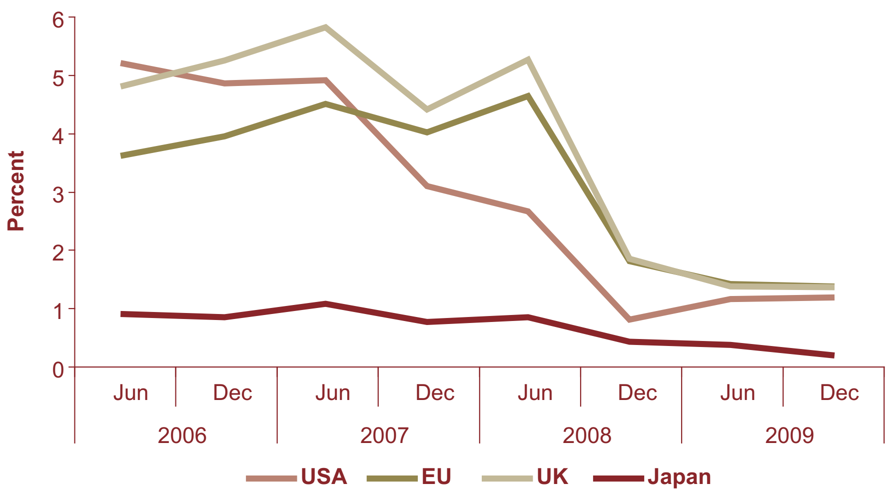
Crude oil price reached US$79.00 a barrel at the end of the first quarter of 2010. Oil price rebounded as stronger economic results from the US and China boosted investor optimism.

2.6 BOND MARKETS

The two-year bond yields in most major international bond markets continued to fall in the second half of 2009 (Chart 4). Market risk sentiments drove investors to buy government securities (bonds), thus bidding up their prices and driving down their yields given the inverse relationship between bond prices and yields. As consequence, yields in the Euro-zone and Japan two-year bonds fell from 1.4 and 0.3 percent in June 2009 to 1.3 and 0.2 percent in December 2009, respectively.

In the US and UK, by contrast, the bond yields were generally unmoved. Investor movement back into 'riskier' asset classes, such as equities, appeared to have halted as the global economic recovery remained uncertain. Both the US and UK two-year bond yields were unchanged at 1.1 and 1.3 percent, respectively, at the end of December 2009.

Chart 4: Two-year bond yields

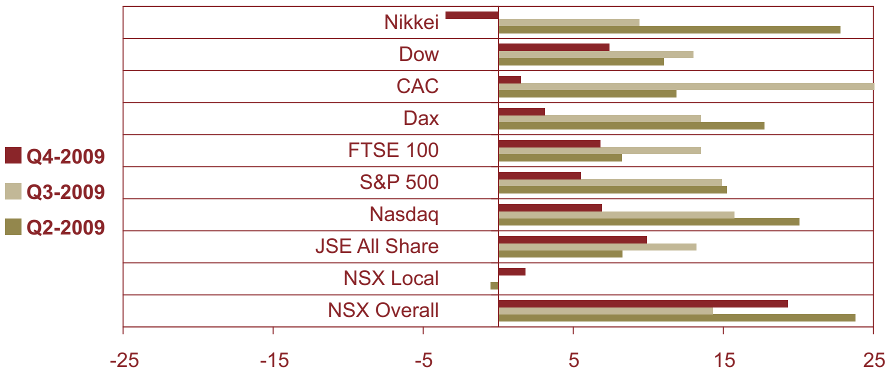


Source: Bloomberg

2.7 STOCK MARKETS

The global economic recovery and the concomitant improvements in financial conditions have led to a faster recovery in international financial markets. As a result of the subsequent overall reduction in systemic risk, equity markets have rebounded strongly and the intense volatility that characterised major international stock markets until the first half of 2009 has ceased. Most global stock indices rose substantially in the third quarter of 2009 (Chart 5). The CAC Index rose the highest in the third quarter of 2009, by 25.9 percent, followed by the Nasdaq index at 15.6 percent. During the same period, the Dow Jones and the JSE All Share indices rose by 13.0 and 13.2 percent, respectively. In the second quarter, however, the recovery in most stock markets was relatively modest; as signs appeared that the global economic recovery was likely to remain sluggish. For example, The Dow Jones and the JSE All Share indices moderated to 7.4 and 9.9 percent, respectively, while the CAC fell to 1.5 percent. During the period, the Nikkei index declined the most, by 3.5 percent.

Chart 5: Global stock exchanges quarterly growth rates (USD terms)



Source: Bloomberg

2.8 SUMMARY ASSESSMENT

The impact of the improvements in the global economic and financial conditions on the Namibian financial system was largely limited to the NSX, through the JSE, in the second half of 2009. The global economic recession, on the other hand, had a severe impact on the Namibian real economy in 2009. The fall in demand for Namibian primary and services exports led to a decline in output for the key export sectors: diamond mining and tourism. The resulting decline in output led to massive labour shedding, most of which remained unrecovered. However, the overall impact on the banking sector continued to be limited so far, although there were some notable pressures on banking balance sheets.

The global economic recovery and improvements in financial conditions will boost exports and result in benefits for the Namibian real economy. This will also have positive spinoffs for the banking sector and financial stability, going forward.

3. DOMESTIC ECONOMY

3.1 ECONOMIC CONDITIONS AND FINANCIAL MARKETS

3.1.1 Economic performance

The global economic recession had a severe impact on the Namibian economy in 2009. The fall in global demand for export commodities and prices was felt mostly through the contraction in the diamond mining and tourism sectors. Most of the lost jobs are yet to be recovered.

The Namibian economy is expected to recover by 4.2 percent during 2010 after it suffered a contraction of 1.1 percent in 2009. The recovery is in line with the projected global economic improvement, which is expected to boost mineral exports/production and thus economic growth. The mining sector is projected to grow by 15 percent in 2010 from an estimated contraction of 48.3 percent in 2009. The principal driver of the sector recovery will be the resurgence in diamond mining/production (18.8 percent in 2010 from -58.2 percent in 2009) in view of greater optimism about global economic upturn. Uranium mining is also expected to expand production in 2010. The envisaged re-opening of copper mines will further boost mining production. The tourism sector, on the other hand, is expected to contract by 2.0 percent in 2010, compared with reduction of 20 percent in 2009.

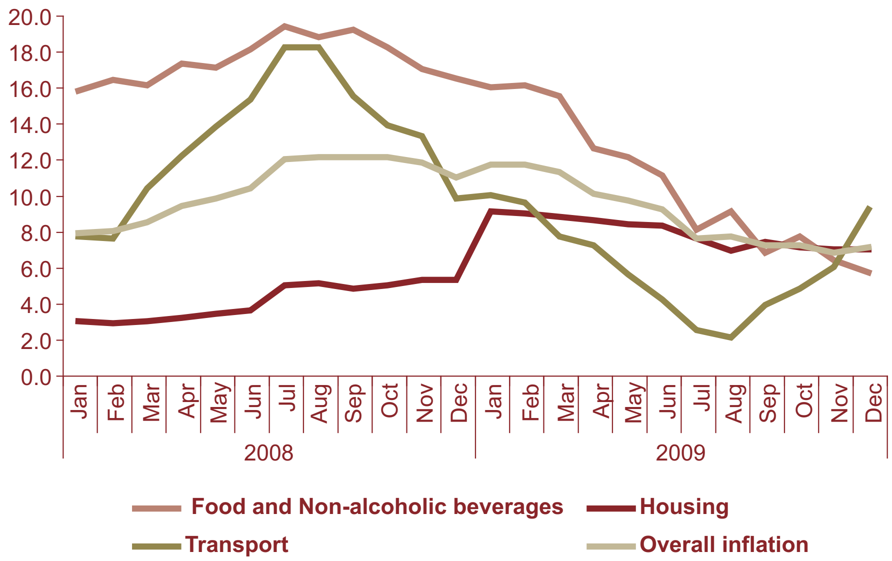
The global economic recovery, coupled with improvement in external demand and trade, will expand export growth and fuel economic expansion. Accelerated economic activity would boost the incomes of both firms and households. This would have a positive effect on the balance sheets of banking institutions and financial stability. While the expected recovery in the global economy is the necessary pre-condition for the revival of the domestic economy, domestic policies should aim to support the recovery until it gained sustainable momentum. There are, however, downside risks to the domestic outlook. They include the uncertainty about the strength and sustainability of the global economic recovery and the possible effects of a surge in oil prices.

3.1.2 Consumer prices

The declining trend in the overall inflation moderated in the second half of 2009 (Chart 6). The annual inflation of the *food* and *non-alcoholic beverages* sub-category and the annual inflation of the *housing* sub-category dropped substantially from the end of June 2009 to the end of December 2009. By contrast, the annual transport sub-category inflation rose significantly over the same period. The annual *transport* inflation was, in turn, fuelled by acceleration in the annual inflation for the sub-category of *personal transport equipment*, mainly reflecting the increases in domestic pump fuel inflation during the period. Consequently, the overall inflation fell to an annual rate of 7.0 percent at the end of the second half of 2009 from 9.1 percent in June 2009. Inflation continued to abate, reaching annual rate of 6.3 percent in February 2010.

The outlook for inflation in Namibia is clouded by uncertainty and concern about possible big electricity price increases and relatively high wage demands in South Africa, given that most of Namibia's imports come from, or go through, that country.

Chart 6: Contributions to CPI

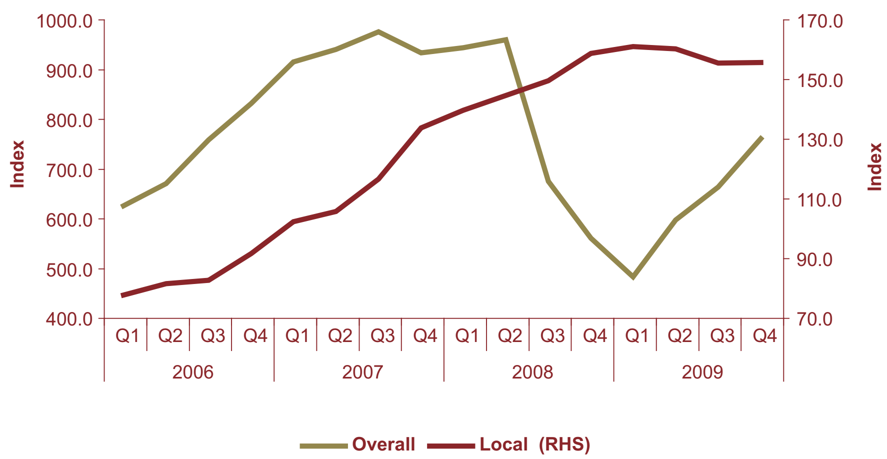


Source: Central Bureau of Statistics

3.1.3 Equity markets

The overall price index of the Namibia Stock Exchange (NSX) rose by 27.6 percent from 593 points in June 2009 to 756.7 points in December 2009 (Chart 7). The overall index comprises the performance of both local and dual-listed companies. The latter are simultaneously listed on both the NSX and the Johannesburg Stock Exchange (JSE). The positive impact of the global economic recovery, and the subsequent fall in systemic risk and return to risk appetite, on the overall index, came through the JSE and mirrored share prices around the world during the period.

Chart 7: Namibia stock exchange price indices



Source: Namibia Stock Exchange

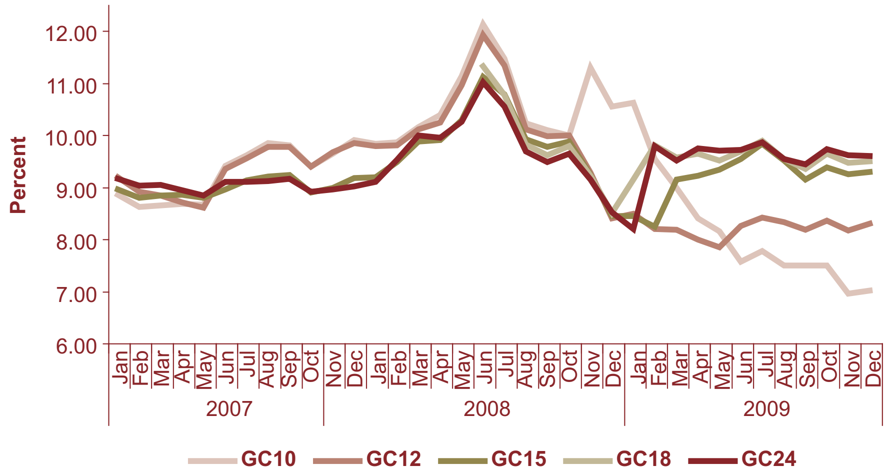
The total overall market capitalisation of the NSX rose by 30.8 percent to N$1, 024.1 billion at the end of December 2009 from N$783.0 billion at the end of June 2009. The hefty increase in the overall market capitalisation is in line with the positive performance in global equity markets.

The local index of the NSX closed 2.3 percent lower at 155 points at the end of the second half of 2009 from 159.5 points at the end of the first half of 2009. The local market capitalisation increased (by 23.3 percent) from N$5.7 billion in the first half of 2009 to N$7.1 billion at the end of the second half of 2009. The relative stability of the local market derived from its insulation from the global equity markets and from the illiquidity (lack of trading) of the local shares.

3.1.4 Bond markets

The yields on Namibian bonds across the yield curve were mixed in the second half of 2009. The yield on the GC10 fell from 7.52 per cent in June to 6.96 percent in December 2009, and dropped to 6.74 per cent during December 2009. At the same time, the yield on the GC12 rose only slightly from 8.09 percent in June to 8.25 percent in December 2009.

Chart 8: Government Bond yields



Source: Bank of Namibia

On the other hand, the yields on the longer-dated government bonds were marginally changed during the second half of 2009. The yields on the GC15, and GC24 fell, respectively, from 9.50 and 9.76 percent at the end of the first half of 2009 to 9.25 and 9.55 percent at the end of the second half of 2009. The yield on the GC18 rose from 9.31 percent to 9.45 percent over the same period. The bond yields follow the general direction of the benchmark and central bank rates, both for Namibia and for the benchmark country, South Africa.

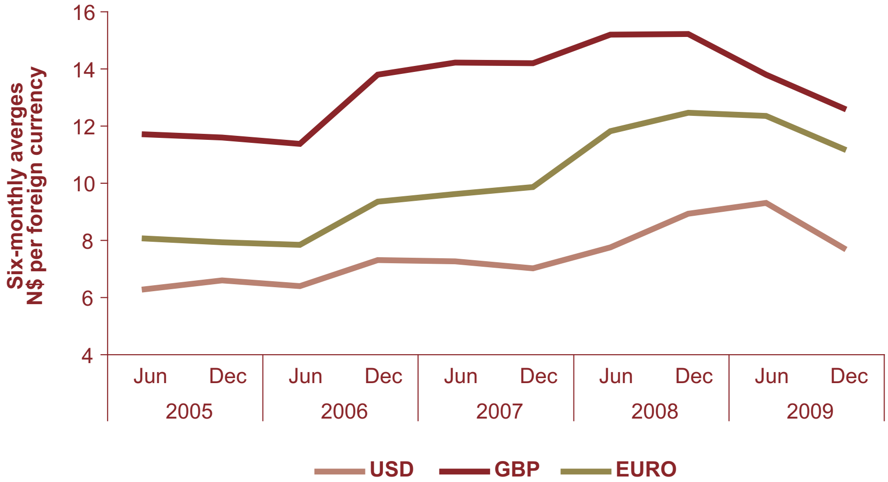
3.1.5 Exchange rate

The Namibia Dollar (NAD) appreciated against the US dollar, Pound and Euro in the second half of 2009[2]. The currency derived its strength against the dollar from improvements in the prices of key export minerals; a rebound in demand for high-yielding, emerging market assets; and dollar weakness from concerns over the high federal budget deficit and the fledgling economic recovery. The NAD strength against the pound and euro appears to have derived from, inter alia, the relative susceptibility of advanced economies to the impact of the global economic recession.

Following the appreciation, the local currency exchanged at averages of N$7.2, N$12.5 and N$11.1 against the USD, Pound and Euro, respectively, in the last six months of 2009 (Chart 9). Consequently, the NAD gains against these currencies during the period reached 17.0, 8.8 and 9.4 percent, respectively.

[2] The Namibia Dollar trades one to one against the South African Rand (ZAR) and is therefore referred to interchangeably against international currencies. The rates being referred to are period averages of mid-rates, per one foreign currency.

Chart 9: Namibia dollar per foreign currency



Source: South African Reserve Bank

However, the currency depreciated to a monthly average of N$7.73 against the USD in February, before recovering in March. By the end of March 2010, the NAD has appreciated against the dollar to a monthly average of N$7.41. This brings the NAD appreciation against the dollar to 2.0 percent in the first quarter of 2010.

The real effective exchange rate (REER)[3] index of the NAD rose from 90.1 points in June 2009 to 92.0 points in December 2009, which presents an appreciation of 2.1 percent in real terms. This could imply a loss in competitiveness for Namibia's export commodities as they became more expensive relative to the six major trading economies.

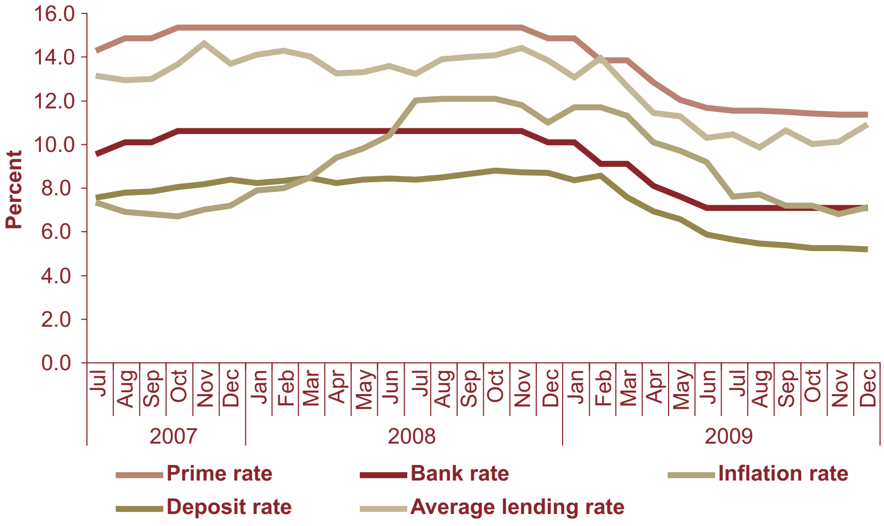
3.1.6 Interest rates

Except for the average lending rate, the key interest rates in Namibia have continued their downward trend in the second half of 2009 (Chart 10). The Bank of Namibia last cut its Repo (Bank) rate in June 2009, from 7.5 percent to 7.0 percent. The policy rate was kept lower as part of the effort to boost depressed domestic/consumer demand and to revive economic growth.

In the light of policy rate reductions, banking institutions realigned their rates, accordingly. As a result, the prime lending rate was lowered from 11.56 percent in June 2009 to 11.25 percent in December. However, the average nominal lending rate rose (by 0.54 percentage points) from 10.21 percent to 10.75 percent during the same period. At the same time, the average nominal deposit rate slipped (by 0.68 percentage points) to 5.11 percent from 5.78 percent.

[3] The REER index is the deflation of the NEER with the relative consumer price index, that is, the rations of Namibia's CPI and those of six below mentioned major trading partners. The NEER index is a trade-weighted index of the bilateral nominal exchange rate of the Namibia Dollar against the currencies of six major trading economies, namely, the Euro, Pound Sterling, Rand, US Dollar and Yen.

Chart 10: Interest and inflation rates



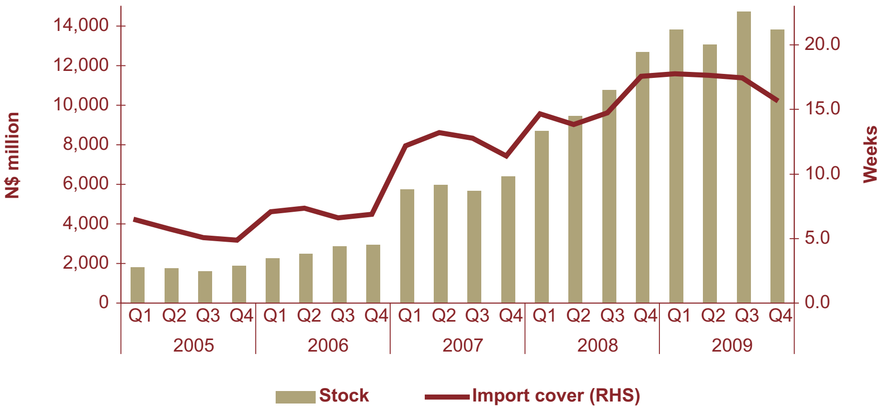
Source: Bank of Namibia

3.1.7 Foreign Exchange Reserves adequacy

When access to foreign borrowing and credit lines is limited or withdrawn, such as could be the case in a financial crisis, foreign-currency liquidity shortage or crisis occurs. Under these circumstances, foreign-exchange reserves serve to mitigate the impact of the shortage or shock. Adequate foreign-exchange reserves, therefore, are critical to a country's ability to withstand external shocks).

The level of foreign exchange reserves in Namibia increased (by 6.2 percent) from N$13.0 billion at the end of June 2009 to N$13.8 billion at the end of December 2009 (Chart 11). The increment in reserves in the second half of 2009 was chiefly ascribed to inflows of SACU revenues, ZAR notes repatriated to South Africa (insert an explanatory note), and interest income received. The major outflows (of reserves) during the period consisted of commercial banking purchases of ZAR from the Central bank and Government payments to foreign countries.

Chart 11: Quarterly international reserve stock and import cover



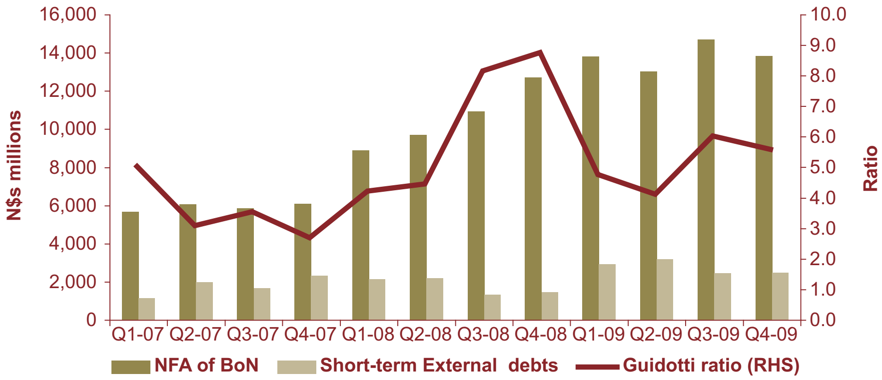
Source: Bank of Namibia

Foreign exchange reserves also allow a country to pay for its imports and to carry out its other obligations. Import cover[4] is a measure traditionally used to gauge a country's ability to withstand external shocks and to discharge its external obligations. Namibia's import cover fell from 17.5 weeks of imports in June 2009 to 15.6 weeks of imports in December 2009. The import cover, which is well above the international benchmark of 12 weeks of import cover, means that the country could continue to import goods and services for up to 16 weeks, if all other sources of foreign exchange earnings dried up.

The so-called Guidotti ratio (the ratio of official reserves to short-term external debt/liabilities falling due in 12 months) is another indicator of an economy's vulnerability to external shocks or foreign currency liquidity risk. The country's ratio rose from 4.1 at the end of June 2009 to 5.5 at the end of December 2009 (Chart 12). The rise in the Guidotti ratio was a result of an increase of 6.2 percent in official reserves that outstripped a 22.1 percent fall in short-term external debt. As a convention, a country's Guidotti ratio should be greater than one, meaning that a country should hold reserves adequate to cover short-term liabilities more than once.

Namibia's ratio at the end of second half of 2009, at 5.5, is, therefore, able to cover 550 percent or 5.5 times of its short-term liabilities.

Chart 12: Guidotti ratio



Source: Bank of Namibia

Based on the above indicators, Namibia's foreign reserve position has remained adequate in the second half of 2009, despite a fall in the import cover. The accumulation in foreign exchange reserves would lessen the impact of a foreign exchange liquidity shock. This should, therefore, boost financial stability, going forward.

3.1.8 Summary assessment

Commodity prices have continued to improve in the second half of 2009. However, global inflation expectations have remained fixed and, as a result, global inflation has remained subdued during the same period. Global inflation is expected to continue to be suppressed mainly on account of a sluggish world economy. The overall inflation in Namibia has also been restrained during the period. In early 2010, inflation in Namibia has started to fall, thus affording the monetary authorities the opportunity to maintain lower interest rates longer in order to stimulate economic recovery. At the same time, lower costs of borrowing would augur well for corporate financial performance and improve their credit worthiness. In addition, low inflation would boost household disposable incomes, in real terms. All this would, eventually, benefit banking institutions and contribute to financial stability.

The rebound in the international equity markets has boosted the NSX, with the impact coming mostly through the JSE, in the second half of 2009. On the other hand, the effect on the local component of the NSX remained modest in most part. Namibian banking institutions hold no equity portfolios; hence, the impact on them of the global equity markets on the NSX continued to be limited in the second half of 2009.

[4] The measure, in weeks of import cover, is expressed as the ratio of total foreign exchange reserves over total imports. It is an indicator of how long a country would continue importing goods and services when all other sources (inflows) of foreign exchange are unavailable.

The NAD appreciated against the US dollar in the first half of 2009. The currency appreciation continued in the second half of 2009. The strength of the currency is supported by the return to risk appetite for emerging market assets; while the dollar weakness derived mainly from uncertainties about the strength of the global economic recover. The currency, however, depreciated against the dollar by 2.0 percent between December and March. The trade-weighted real effective exchange rate appreciated in the second half of 2009, making Namibian exports less competitive against its major trading partners.

In the second half of 2009, the overall position of Namibia's international reserves continued the improvement that started in the first half of 2009. The expansion has contributed to financial health and strengthened financial stability. However, as noted previously, Namibia is vulnerable to fluctuations in SACU revenues, where most of the increase in reserves came from. The above notwithstanding, the foreign exchange reserves level does not cause a concern for financial stability.

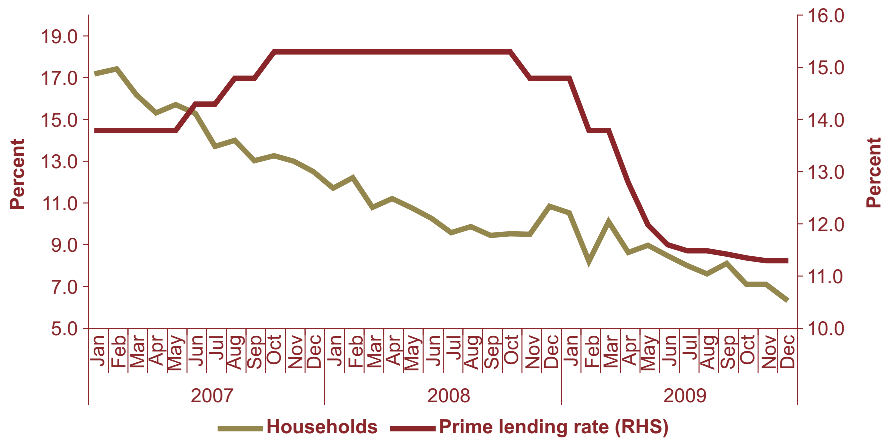
3.2 BANKING INSTITUTIONS' BORROWERS

Total claims on the private sector (that is, private corporations and households) reached N$36.4 billion in December 2009 from N$33.9 billion at the end of June 2009. The growth represented an annual acceleration of 7.4 percent. On quarterly basis, the growth in total claims on the private sector by banking institutions grew by 3.6 percent in both the third and fourth quarters of 2009.

3.2.1 Household sector

Growth in credit to households slowed, on an annual basis, to 6.3 percent at the end of December 2009, from 8.4, at the end of June 2009 (Chart 13). This brought the total extension to the sector to N$23.2 billion from 22.4 billion over the period. The deceleration in the growth rate of credit extension to the sector was mainly as a consequence of the category other *loans and advances* that grew by 2.1 percentage points less than its June 2009 pace of 9.5 percent. On quarterly basis, growth in credit extension to the households rose from 0.8 percent in June 2009 to 1.6 and 2.3 percent, respectively, in the third and fourth quarters of 2009.

Chart 13: Claims on households

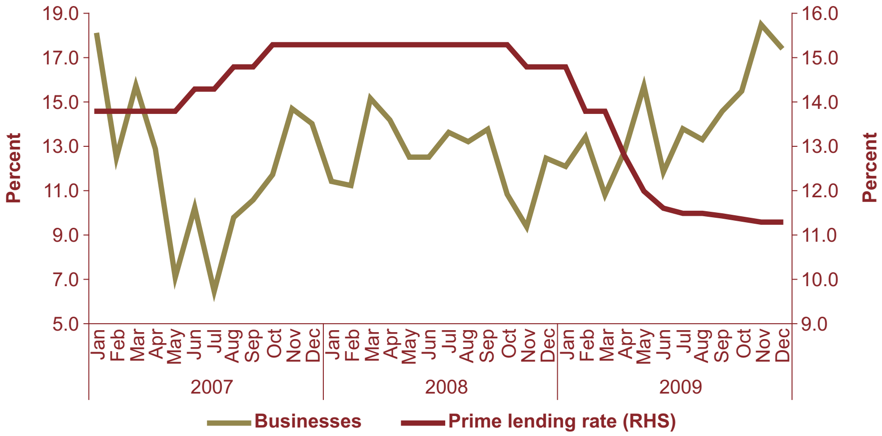


Source: Bank of Namibia

3.2.2 Corporate sector

Total claims on the corporate sector rose from N$11.6 billion in June 2009 to N$13.2 billion at the end of December 2009. Growth in credit extension to the corporate sector, on year-on-year basis, rose from 11.8 percent in June 2009 to 17.4 in December 2009 (Chart 14). Growth in credit extended to the corporate sector advanced by 7.3 and 5.9 percent in the third and fourth quarters of 2009, respectively. The bulk of the growth in loans to the business sector came from the *loans and advances* category that rose at an annual rate of 19.0 percent in the second half of 2009.

Chart 14: Claims on businesses



Source: Bank of Namibia

As an integral part of the banking institutions' borrowers, corporate balance sheet performance plays a key role in the determination of banking performance and hence financial stability. The mining and tourism sectors, prominent corporate sectors, suffered a contraction in activities due to the global financial crisis in the second half of 2009. Corporate profits remained weak and lost employment continued to be unrecovered. However, despite the adverse economic conditions, credit extension to the corporate sector has grown significantly. This could be a good indication of confidence that the banking sector is having in the prospects of economic recovery.

3.2.3 Summary assessment

The Namibian economy has suffered a contraction in 2009, due to the global economic recession. The impact fell hardest on the country's mining and tourism sectors, resulting in hefty output and job losses. Consequently, household budgets were curtailed and consumer expenditures were strained. Besides, diminished corporate profits lowered debt servicing capacity.

However, the current global economic recovery could stimulate economic recovery in Namibia and have a domino effect on the banking borrowers, banking institutions and financial stability. In addition, the sustained lower interest rate environment would help strengthen the expected domestic economic recovery. The latter would, in turn, further enhance the banking borrowers' financial situation and, thus, their capacity for debt repayment. The negative impact of the global financial crisis on financial stability, therefore, (as was the case in the three previous reviews,) is assessed to be low.

3.3 BANKING SECTOR PERFORMANCE

3.3.1 Banking structure

The structure of a banking system is generally used as a gauge of potential competition, and hence as a predictor of easiness/degree of credit accessibility and the level of borrowing costs. The banking sector in Namibia has been characterised by a high degree of concentration. The number of banking institutions in the system has been four (4), until very recently. A fifth banking institution has just been awarded a license to start banking business. The Bank of Namibia has granted Fides Bank Namibia Limited a certificate of authorisation to establish a banking institution in Namibia, with effect from February 1, 2010. The permanent license issued permits the new banking institution to engage in formal or informal banking activities (with any person) in Namibia, especially soliciting public deposits.

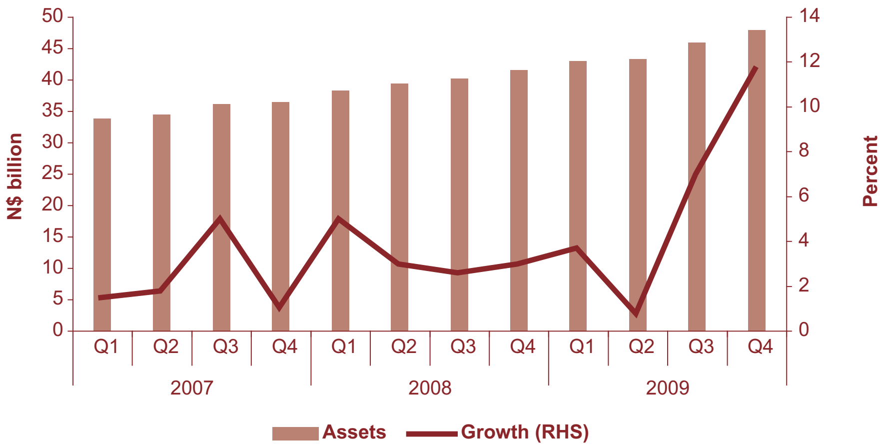
Two other widely used indicators of banking structure (the HHI and Gini index) also indicate a highly concentrated banking sector. The Gini index and the HHI index continued to be high, at 11.5 and 2,690 points respectively, at December 2009 (Table 1). An HHI of 2,690 points compares very unfavourably with an HHI of 1,000 points, which is universally considered an indication of limited concentration. Similarly, a banking system is concentrated when the Gini index exceeds 10 percent. By these measures, the Namibian banking system continue to be highly concentrated and, therefore, less competitive. Banking services could, hence, be relatively costly and banking access limited.

3.3.2 Balance sheet structure

The structure of the balance sheet of a banking sector can, among others, provide information on the risk profile of the banking sector.

The total assets of the banking sector grew at a rapid pace of 10.2 percent in the last half of 2009 (Chart 15), compared with a growth rate of 4.1 percent in the first half of the year. The growth on the liabilities side of the balance sheet was chiefly supported by a strong 11.6 percent increase in non-bank funding, predominantly customer deposits, in second half of 2009. Banking institutions have, therefore, mobilised more customer/retail deposits from the public in the last six months of 2009. This increase is chiefly due to an increase in Negotiable Certificate of Deposits (NCDs) held by the public, foreign deposits and demand deposits. Bank funding, consisting largely of intragroup and interbank deposits and borrowings, fell significantly by 69.9 percent over the same period. The fall in bank funding reflected significant decreases in intra-group and inter-bank borrowings and money borrowed from the Bank of Namibia.

Chart 15: Banking sector assets and growth rates



Source: Bank of Namibia

The asset side of the balance sheet growth, on the other hand, was headed by gains in the loans and advances sub-category (7.5 percent), cash balances (2.2 percent) and trading and investment portfolio (19.0 percent). At the same time, balances with banking institutions grew by 35.4 per cent. Within the loans sub-category, mortgage loans rose by 6.4 percent in the second half of 2009, after growing by 5.5 percent in the first half of 2009.

At 99.3 percent of total funding liabilities, non-bank funding (money from the public) remained the principal funding source in the second half of 2009. At the same time, loans and advances, at 85.5 percent, continued to constitute the major application of funds, followed by investments. The balance sheet structure of the banking sector, therefore, did not change appreciably during the last half of 2009.

The growth in both the banking sector assets and loans has picked up pace significantly from 4.1 and 3.2 percent at the end of June 2009 to 10.2 and 7.5 percent, respectively, at the end of December 2009.

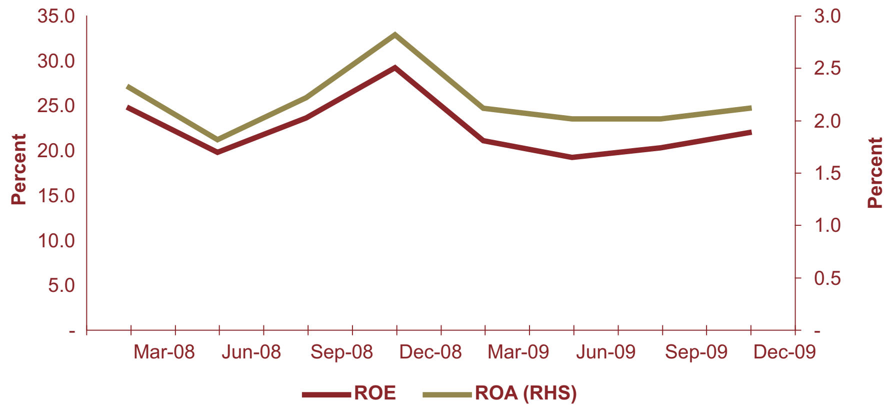
3.3.3 Profitability, capitalisation and cost efficiency

Profitability

Banking profitability enhances sustainable banking operations and adequate capital levels. The two are a pre-requisite for banking solvency and financial stability. Banking profitability is mainly determined by movements in total income, provisions and costs/expenses containment. Below is an analysis of how these parameters interacted to determine the profitability of the banking sector in the final half of 2009.

After-tax income in the banking sector improved significantly in the second half of 2009, mainly due to a 13.4 percent increment in non-interest income (other operation income). Net interest income, on the other hand fell by 2.1 percent and while interest expense declined by 11.3 percent).

Chart 16: Post-tax return on assets and return on equity



Source: Bank of Namibia

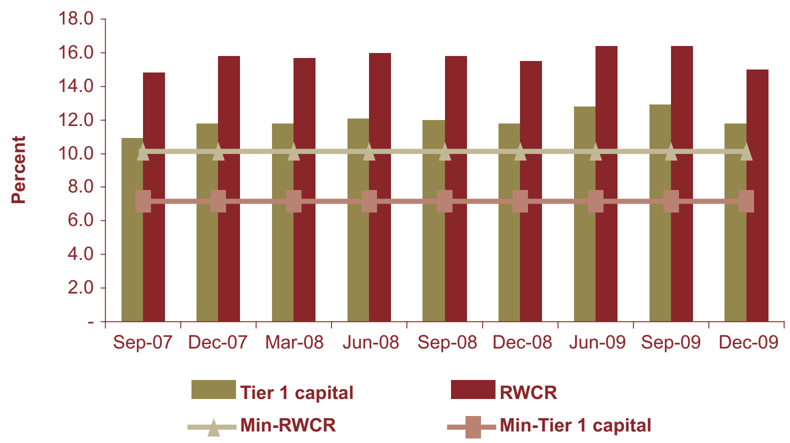
Following the improvement in the after-tax income, both return on assets (ROA) and return on equity (ROE) improved to 2.1 and 21.8 percent in December 2009, from 2.0 and 19.0 percent, respectively, in June 2009 (Chart 16). The improvement in profitability bodes well for the sustainability of banking sector operations and maintenance of adequate capital levels. Furthermore, the two ingredients are critical for solvency and financial stability.

Capitalisation

In terms of financial stability analysis, capital adequacy is mainly used to assess the capacity of the financial sector to absorb losses. This makes adequate banking capital indispensable for a safe and stable banking system. The Banking Institutions Determination 5 (BID-5) requires all banking institutions in Namibia to hold prescribed capital minima. The regulatory risk-weighted capital ratio (RWCR) of not less than 10 percent is prevailing. Of the said ratio, 7.0 percent should constitute tier 1 or primary capital. Tier 1 capital leverage ratio, at 6.0 percent, is another capital-adequacy measure.

The overall capital adequacy of the industry weakened during the second half of 2009, as reflected in falling capital adequacy ratios. The RWCR and Tier 1 capital ratio of the banking sector averaged 15.0 and 11.8 percent, respectively, at the end of the second half of 2009, from 16.4 and 12.8 percent in the first half of 2009 (Chart 17). The decline in the capital adequacy ratios could be attributed to growth in risk-weighted assets that outpaced additions of transfer profits and retained earnings during the period.

Chart 17: Capital adequacy for banking institutions



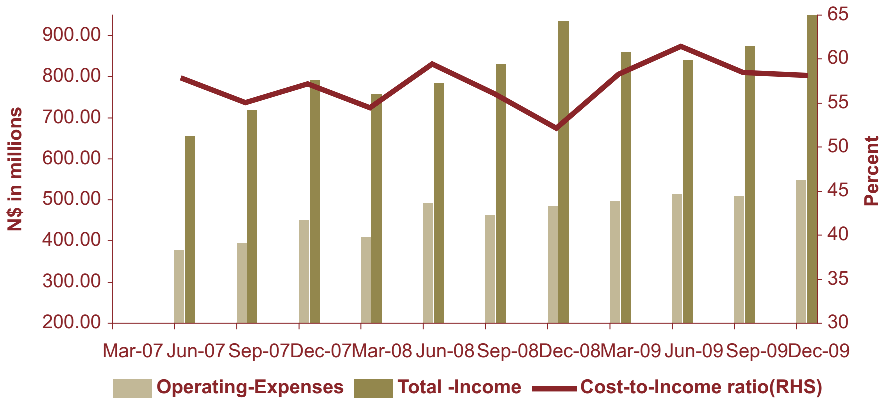
Source: Bank of Namibia

The profitability of the banking sector has improved, and remained sustainable, in the second half of the year. Although the capital adequacy ratios have declined, the industry capital levels remained above regulatory requirements and the banking industry, therefore, continued to be well capitalised and in position to absorb losses. As a result, the current state of capitalisation in the banking sector poses no foreseeable financial stability concerns.

Cost efficiency

The cost-to-income (C/I) ratio, which is traditionally used as an indicator of cost efficiency in the banking sector, continued to improve during the second half of 2009. The ratio declined from 61.2 percent in the first half of 2009 to 57.9 percent (Chart 18). The fall in the ratio came mainly as total income rose by 12.9 percent, while other (operating) expenses rose by 6.7 percent, thus causing the C/I ratio[5] to decelerate. The deceleration in the cost-to-income relationship, however, could not prevent the cost efficiency ratio from exceeding the international benchmark of 50.0.

Chart 18: Banking costs, income and cost-to-income ratio



Source: Bank of Namibia

The increase in operating expenses mainly resulted from an enlargement in staff cost, administration and other overheads, directors' fees, and marketing costs. These costs together rose by 74.3 percent, in the second quarter of 2009. However, the enhancement in the banking sector's cost efficiency would likely boost banking sector profitability, going forward.

3.3.4 Liquidity risk

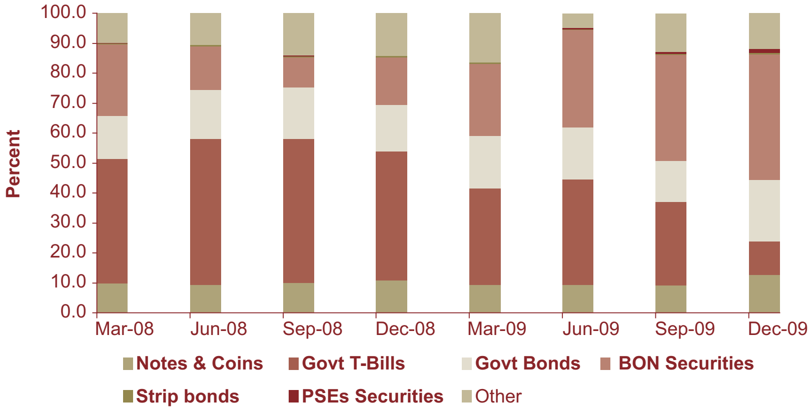
The ability of banking institutions to fund growth in assets and to meet obligations as they fall due at acceptable costs, the so-called liquidity, is paramount to sustainable banking system operations. In addition, liquidity shortfalls in one banking institution may systemically affect other banking institutions. Effective management of liquidity risk is; therefore, critical to banking stability. In addition, effective liquidity management was also one the most important lessons from the global financial crisis. In general, banking liquidity is measured by a number of factors, including: the relationships between actual liquidity held relative to liquidity required; composition of liquid assets; loans-to-assets; loans-to-deposits; composition of funding-related liabilities (e.g., retail deposits); and liquidity conditions in the interbank market.

The liquid asset holdings of the banking sector grew by 11.6 percent, from N$4.3 billion at the end of June 2009 to N$4.8 billion at the end of December 2009. At the same time, liquid assets required in the banking sector rose by 13.5 percent to N$4.2 billion. Consequently, the banking sector as a whole complied with the regulatory minimum liquidity holding requirements in the second half of 2009.

The composition of liquid assets held by the banking sector has changed somewhat during the period. Government treasury bills have lost their dominance by slipping from 35.3 percent of liquid assets to 11.3 percent (Chart 19). On the other hand, Government bonds and Bank of Namibia Securities rose to prominence; from 17.3 and 32.6 percent to 20.5 and 42.0 percent, respectively.

[5] Cost-to-income ratio is also referred to as cost efficiency ratio and measures the relationship between operating expenses and total income (net interest income plus operating income).

Chart 19: Structure/Composition of liquid assets



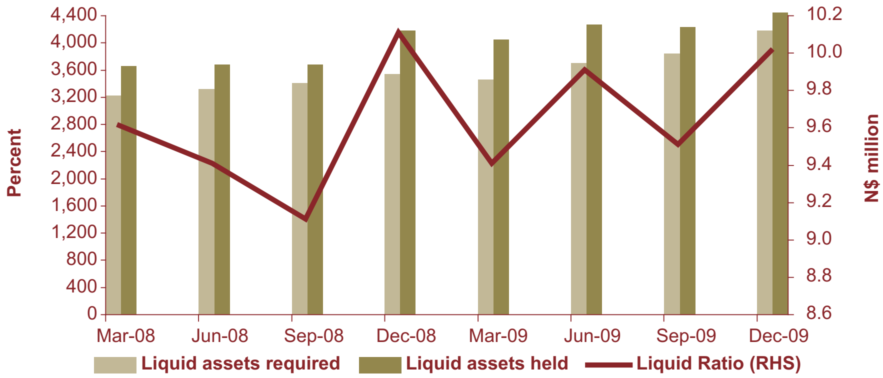
Source: Bank of Namibia

The liquid assets ratio[6], the conventional measure of banking liquidity, rose slightly from 9.9 percent at the end of June 2009 to 10.0 percent at the end of December 2009 (Chart 20). The meagre increase in the ratio was due to the growth in liquid assets held of 11.6 percent that outpaced the growth in total assets of 8.8 percent at the end of the second half of 2009.

Loans expressed as a percentage of total assets decreased slightly during the first half of 2009 from 74.6 percent to 72.8 percent at the end of the second half of 2009. The loans-to-assets ratio compares favourably to the international benchmark of 75 percent. The ratio, therefore, does not raise any stability concerns.

Another measure of liquidity in the banking sector is the relationship between loans and deposits. The loans-to-deposits (LTD) ratio – a banking institution's (gross) loans divided by total deposits) – indicates the percentage of a banking institution's loans that are funded through deposits. The higher the ratio (that is over 100 percent), the more the banking institution is likely to rely on borrowed funds, which are generally more costly than most types of deposits. In addition, significant rise in the LTD ratio may indicate that a banking institution has less of a cushion to fund its growth and to protect itself against a sudden recall of its funding. In other words, a higher ratio raises the possibility of a deteriorating financial soundness.

Chart 20: Liquid assets and liquidity ratio



Source: Bank of Namibia

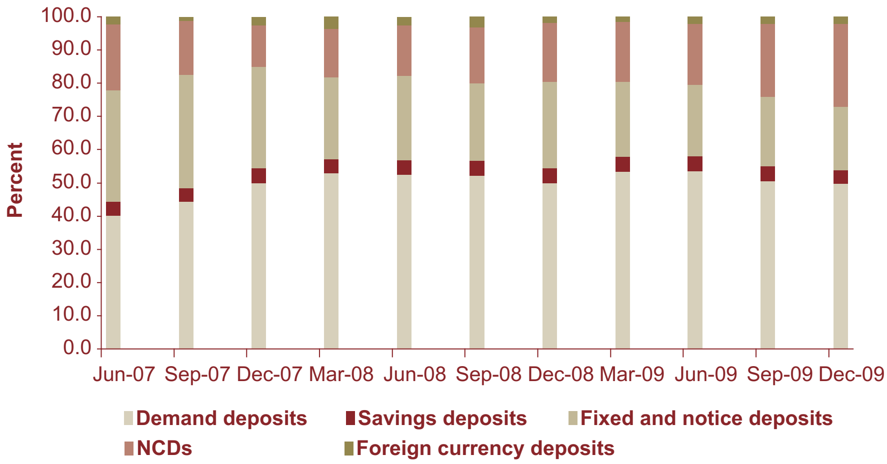
[6] Liquid assets ratio means total liquid assets held expressed as a percentage of total assets.

The LTD ratio, reported by Namibian banking institutions, fell during the period from 87.1 percent to 85.3 percent. A relatively high ratio (of close to 100 percent) signifies heavy reliance on customer deposits and less dependency on other possibly riskier and more expensive sources of funding. As long as the banking institutions manage to maintain a high loans-to-deposit ratio, their exposure to turbulence in financial markets will remain limited. The current LTD ratio of the Namibian banking system is quite below the 100 percent threshold and leaves enough room for further lending before resorting to relatively more expensive non-deposit funding sources. The ratio, therefore, does not expose the banking institutions to significant liquidity or credit risks.

The structure of funding-related liabilities also influences the degree of liquidity risk faced by banking institutions. Customer/retail deposits, a cheaper and stable source of funding, account for the largest funding share of Namibian banking institutions. The funding sources, therefore, does not impose undue burden to the banking sector.

The composition of customer/retail deposits is another factor that could have an important influence on the liquidity risk faced by banking institutions. There have been some shifts in deposit utilisation from demand, savings and fixed deposits to notice deposits in the second half of 2009. The share of demand deposits in total deposits slipped from 53.4 percent June 2009 to 49.7 percent at the end of December 2009 (Chart 21). At the same time, the shares of savings deposits and fixed deposits fell, respectively, from 4.7 and 21.4 percent to 4.1 and 19.1 percent. On the other hand, the share of notice deposits rose from 18.2 to 24.9 percent. The shares of the more stable fixed and notice (time) deposits, hence, remained relatively higher (at 19.1 and 24.9 percent, respectively); while the proportion of volatile demand deposits fell to 49.7 percent. There is a lesser risk of illiquidity, if liquidity stresses arise, when a stable deposit base is the primary funding source.

Chart 21: Composition of retail deposits



Source: Bank of Namibia

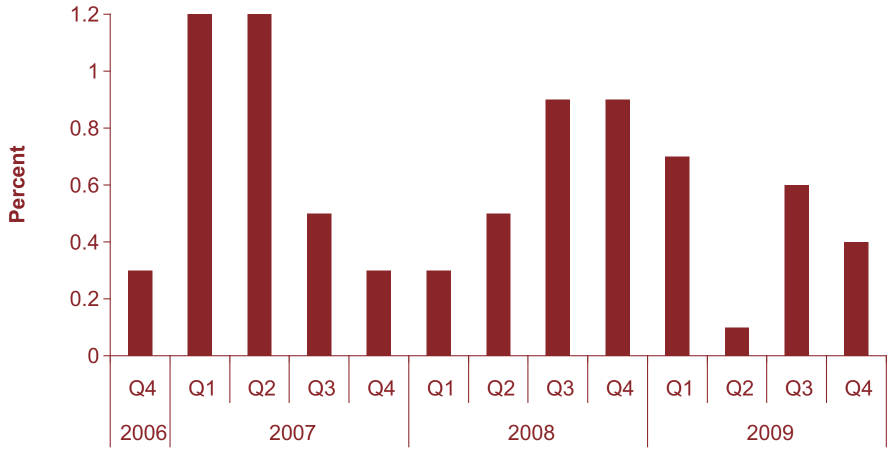
Liquidity conditions in the interbank market are a major determinant of the easiness with which banking institutions can raise funds on short notice through the interbank borrowing or deposits. Inter-banking institutions borrowings and deposits were 0.3 and zero percent of industry capital and liabilities (total funding), respectively, at the end of December 2009. The local inter-bank market is, therefore, very small and, hence, less inter-dependent. Consequently, the likelihood of a liquidity problem, being transmitted from on banking institution to another and causing a liquidity risk, is non-existent.

Given the satisfactory levels of key liquidity indicators, the banking sector's vulnerability to liquidity risk and, hence, financial stability is, consequently, minimal.

3.3.5 Exchange rate risk

The net open position in foreign currency is generally used (in terms of financial stability) to identify the banking sector's equity risk/exposure compared to capital funds. It measures the mismatch (open position) of foreign currency asset and liability positions to assess the potential vulnerability of the banking sector's capital position to exchange rate movements. Expressed as a proportion of net foreign currency assets to the banking institutions' tier 1 capital funds, net open position rose from 0.1 percent in the second quarter of 2009 to 0.6 percent in the third quarter of 2009, before it fell to 0.4 percent in the fourth quarter of 2009 (Chart 22). The relative movements between the net open position in foreign currency (the numerator) and tier 1 capital funds (the denominator) determine changes in the ratio. The latter rose in the third quarter following an increase in net foreign currency assets (166 percent), which outweighed the rise in (tier 1) capital funds (1.3 percent). Similarly, in the fourth quarter, the ratio fell, following a 78.6 percent decline in net foreign currency assets compared with a fall of 4.4 percent in the (tier 1) capital funds. Although the increase in the ratio signifies an increase in the exchange rate risk of the banking sector, the level remains far below the regulatory limit of 20 percent of capital funds. The position, therefore, poses no financial stability concerns.

Chart 22: Net open position



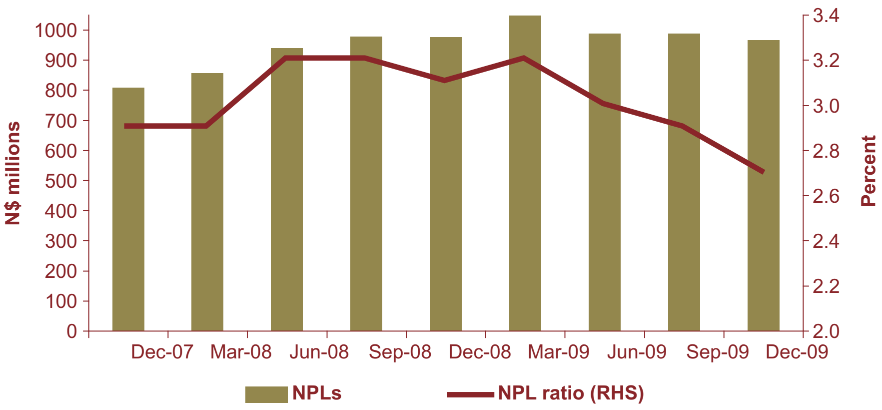
Source: Bank of Namibia

3.3.6 Credit risk

The non-performing loan ratio is one of the indicators used to assess vulnerabilities emanating from credit risk in banking loans portfolio. The quality of the banking sector's loan portfolio has continued the improvement that started in the first quarter of 2009. The ratio of non-performing loans (NPL ratio) as a percentage of the banking loan book slowed further from 3.0 percent at the end of June 2009 to 2.7 percent at the end of December 2009 (Chart 23). During the period, loans and advances advanced by 7.3 percent, while the NPLs fell by 2.3 percent. The fall in NPLs was mainly a result of upgrading to better categories of NPLs (especially, to the sub-standard category). This normally takes place after a banking institution has recovered some outstanding amounts or arrears paid. At this level, the ratio is well within the acceptable range[7].

[7] In term of the CAMELS rating system, the NPL ratio of less than 5 percent is considered to be very low.

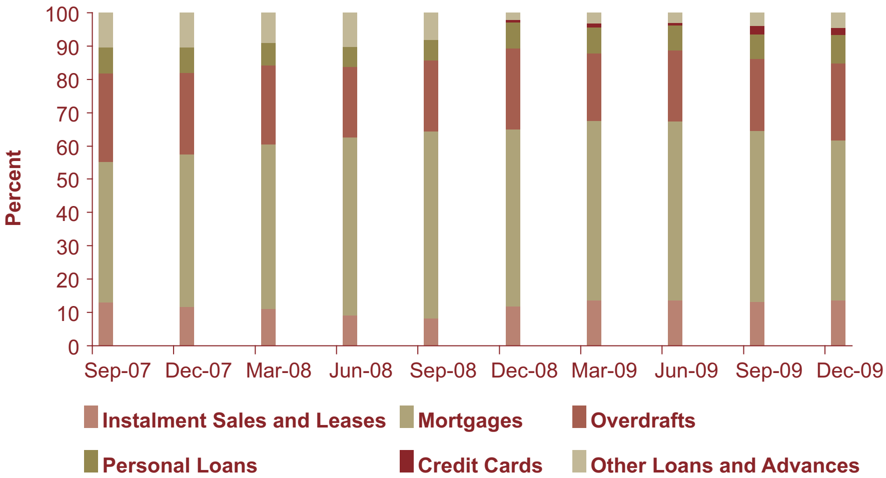
Chart 23: Banking asset quality



Source: Bank of Namibia

In the second half of 2009, overdue loans grew by 33.3 percent to N$2.8 billion from 2.1 billion at the end of June 2009. As a result of a fall in NPLs, the proportion of NPLs to overdue loans fell from 46.4 percent to 34.2 percent during the period. The significant growth in overdue loans could be ascribed to weak domestic economic conditions.

Chart 24: Non-performing loans by category



Source: Bank of Namibia

Non-performing mortgage loans, at 47.9 percent, were the largest share of the non-performing loans at the end of the second half of 2009 (Chart 24). This fraction, however, represented a decline from 53.7 per cent at the end of June 2009. At the same time, the overdrafts and personal loans categories (of NPLs) gained ground from 21.5 and 7.3 per cent to 23.2 and 8.6 percent, respectively.

Non-performing mortgage loans as a proportion of total mortgage loans extended by banking institutions has continued to improve, from 3.0 at the end of June 2009 to 2.6 percent at the end of December 2009 (Chart 25). However, the proportion of overdue mortgage loans in total mortgage loans rose dramatically (in the second half of 2009) from 6.5 percent in June 2009 to 11.3 percent (at the end of December 2009). Most of the increase took place in the “amount overdue for less than one month”.

The banking sector’s asset quality has improved and assessed to be satisfactory; the NPL ratio has fallen since March 2009. In addition, the composition of NPLs is generally similar to the structure of total loans and advances. Despite the increase in overdue loans, the risk from credit risk is assessed to be minimal and requires only minimal monitoring.

Chart 25: Non-performing mortgage loans

Source: Bank of Namibia

At the end of the second half of 2009, the banking sector's statutory large exposures (exposures that are at least 10 percent of industry qualifying capital) accounted for 14.1 percent of the total loan portfolio of the banking institutions, compared with 16.8 percent in the fourth quarter of 2008. As a proportion of banking industry capital funds, large exposures stood at 137.5 percent compared with 112.3 percent at the end of June 2009. The Determinations on Single Borrower Limit (BID 4) set 30 and 800 percent statutory-limits for single borrowers and aggregate large exposures as a percentage of industry capital funds, respectively. Large exposures to the mining and related sectors, as a share of banking industry capital funds rose from 26.8 percent in the second quarter of 2009 to 34.0 percent in fourth quarter of 2009. This share is considered to be relatively small, however, and its likely impact on banking stability is, therefore, moderate.

3.3.7 Summary assessment

Consequent to the very restricted links the Namibian banking sector has to the international financial markets affected by the global financial, the overall impact of the global financial crisis on the sector remained modest, at best. The banking institutions continued to be liquid, adequately capitalised and solvent, in the second half of 2009.

Furthermore, banking profitability indicators (ROE, ROA) improved in the second half of 2009, after falling in the first six months of the year. Improvements in banking earnings have supported capital levels. Moreover, non-performing loans as a share of total loans have been on the decline since the first half of 2009. In addition, improvements in banking cost efficiency would have a positive effect on banking profitability, going forward.

Nevertheless, the impact of the global financial crisis has continued to cause increases in overdue loans as a proportion of total loans, in the second half of 2009. Additionally, there is still a risk that the fledgling global economic recovery would falter. Consequently, its negative impact on Namibia's real economy could harm the banking sector, by crippling corporate performance and, hence, raising non-performing loans. Continuous monitoring is, therefore, justified under these circumstances.

The banking sector has continued to perform satisfactorily in the second half of 2009, despite the notable concerns. Furthermore, in tandem with global economic recovery, the domestic economy is expected to recover in 2010. This would enhance banking financial performance and improve the sector' debt repayment capacity.

As it were in the last two reporting periods, the overall impact of the global financial crisis on the banking sector is assessed to be limited and the sector continues to be stable, by and large. The impact on the banking sector of the global financial crisis, as a result, is deemed to be low.

Box A: The Global Plan for Recovery and Reform

The leaders of the Group of Twenty (G-20) met at the Pittsburgh G-20 Summit (USA) to review the progress made since the Washington and London Summits (in April 2009). While the Washington and London G-20 Summits focused on preventing economic catastrophe, the Pittsburgh Summit, which ran from September 24-25, 2009, took a significant step toward securing economic recovery and transition into "strong, sustainable and balanced economic growth." The G-20, which includes developed nations and fast-growing emerging economies such as Brazil, China, India, and South Africa; is quickly replacing the G-8 as the leader of world economic management. This box article summarises the outcome of the Pittsburgh Summit. To this end the G-20 leaders committed themselves to:

a) Create a 21first Century International Economic Architecture;
Shift at least 5 percent in IMF's quota shares from over-represented countries to under-represented emerging markets and developing economies, with the goal to improve the organisation's effectiveness by increasing voting shares and access to IMF loans for developing counties. In addition, at least 3 percent of the World Bank's share will shift to these emerging countries. They also designated the G-20 to be the premier forum for international economic co-operation.

b) A Framework of strong, sustainable, and balanced growth of the world economy;
A strong regulatory and macro-economic policy is necessary for such an economy. The leaders committed themselves to develop a process whereby they set out their objectives, put forward policies to achieve these objectives and together to assess their progress.

c) Bold and co-ordinated actions from crisis to recovery;
The G-20 expressed the need to continue developing co-operative and co-ordinated exit strategies. Noting further that those credible exit strategies should be designed and communicated clearly to anchor expectations and re-enforce confidence. In the short-run they must continue to implement stimulus programs to support economic activity until the recovery clearly has taken hold.

d) Tighter regulations to be enforced on financial systems, such as enforcing new guidelines for financial pay schemes, in order to limit risk taking and build new capital; and

e) Act on global energy and climate change challenge;
The G-20 individually and collectively committed to: increase energy market transparency and market stability; improve regulatory oversight of energy markets; rationalise and phase out (over the medium term) inefficient fossil fuel subsidies (which are the main sources of global warming according to scientists) that encourage wasteful consumption; stimulate investment in clean energy, renewable, and energy efficiency and provide financial and technical support for such projects in developing countries; and take steps to facilitate the diffusion or transfer of clean energy technology. In addition, the leaders underscored anew their resolve to take strong action to address the threat of dangerous climate change.

f) Support for most vulnerable and a partnership on food security.
The G-20 pledged to co-operate to improve access to food, fuel, and finance for the poor. They further reaffirmed their commitment to meet the Millennium Development Goals and their respective Official Development Assistance (ODA), including commitments on Aid for Trade, debt relief, and those made to sub-Saharan Africa, to 2010 and beyond. They further pledged support to efforts taken by different organisations aimed at tackling food insecurity.

The G-20 agreed to meet again in Canada in June 2010 and in Korea in November 2010.

Table 1: Banking sector indicators

Structure	Dec-06	Jun-07	Dec-07	Jun-08	Dec-08	Jun-09	Dec-09
Number of banks	4	4	4	4	4	4	4
Total assets of banks	33,397,304	34,448,220	36,504,795	39,443,450	41,562,708	43,275,865	47,669,192
Gini concentration index	14.1	12.5	11.6	12.2	11.3	10.8	11.45
Herfindahl index	2,730	2,769	2,678	2,705	2,689	2,677	2,690
Capital adequacy (%)							
Tier 1 leverage ratio	7.5	7.4	7.9	7.9	7.9	8.6	7.8
Tier 1 capital ratio	11.2	10.9	11.8	11.9	11.8	12.8	11.7
Total RBC (regulatory capital RWA's)	14.2	14.9	15.8	15.8	15.5	16.4	15.0
Asset quality (%)							
NPL's/Total gross loans	2.6	3.0	2.9	3.2	3.1	3.0	2.7
Gross overdue/Total loans and advances	3.3	3.8	3.8	3.9	5.7	6.5	8.0
Provisions/ Total loans	2.4	2.3	2.1	2.1	2.0	1.9	1.8
Provisions/NPL's	90.3	78.9	77.2	68.6	64.7	62.8	66.2
Specific provision/NPLs	45.6	41.8	37.0	33.8	29.2	27.2	28.7
Earnings and profitability (%)							
Return on assets	1.0	2.1	2.4	1.9	2.8	2.0	2.1
Return on equity	10.9	24.0	26.6	20.0	29.0	19.7	21.8
Net interest margin	5.4	5.0	5.7	468	4.7	4.3	4.5
Cost to income ratio	63.7	57.5	56.9	59.2	51.9	61.2	57.9
Liquidity (%)							
Liquid asset to total assets	9.1	9.8	9.2	9.3	10.1	9.9	10.00
Total loans/Total deposits	92.8	89.2	89.9	86.4	87.9	87.1	85.3
Total loans/Total assets	73.6	76.8	76.2	74.2	75.2	74.6	72.8

Box B: Consolidated Supervision

In line with its objective to foster financial stability, the Bank, through its Banking Supervision Department is implementing consolidated supervision. The principal reason for this approach is the need to face the accelerating pace of consolidation in the financial industry and the intensification of links between financial markets. Over the past years, a number of cross-sector groups combining banks, securities firms and insurance companies have been created and have become of significant importance in Namibia. The continuing growth in the size and complexity of such financial conglomerates exposes these firms to a wide array of potential risks, while at the same time making it more difficult for a single supervisor to have a complete view of group-wide risks and controls.

Laws and regulations dealing with different financial sectors, on solo basis, were rendered inadequate to deal with these developments and such laws have traditionally adopted different approaches with different definitions of capital, different types of risks and different capital requirements. For instance, banking supervisors have historically been primarily concerned with the assets side of the balance sheet as the principal source of risk, although an examination of the source of funding is an important aspect of the supervisory process. Insurance supervisors, on the other hand, regard the liability side of the balance sheet as the main source of risk, although assets are of course monitored too. Securities supervisors require securities firms to have sufficient liquid assets to repay all liabilities at any time. Consolidated Supervision intends to ensure the stability of the financial market, establish common prudential standards for the supervision of such financial groups, and introduce level playing fields and legal certainty between financial institutions spanning across these different sectors.

Consolidated supervision of a financial conglomerate encompasses the parent company and its subsidiaries, and allows the Bank to understand the organization's structure, activities, resources, and risks, as well as to address financial, managerial, operational, or other deficiencies before they pose a danger to the group's subsidiary depository institutions.

Consolidated Supervision approach allows the bank to establish consolidated capital standards for financial conglomerates, which in turn assists to ensure that a financial conglomerate maintains adequate capital to support its group-wide activities, and is able to serve as a source of strength for its depository institution subsidiaries, thus contributing to financial stability.

On the whole, Consolidated Supervision enhances the Bank's ability to help prevent financial crises and to manage such crises should they occur, thus complementing other supervisory responsibilities including the objectives of fostering financial stability.

3.4 FINANCIAL INFRASTRUCTURE AND REGULATORY DEVELOPMENTS

3.4.1 Financial infrastructure

In the second half of 2009, the Bank of Namibia continued its oversight function in assessing the performance of the payment system and related activities. The focus was mainly on payment business activities and the management of system risks. The conclusion was that the payment system has performed satisfactorily and inherent risks were well managed, during the review period. In addition, the on-site inspection revealed that participant banking institutions were compliant with the Bank's oversight policy and payment system regulations. Key reform projects were also on track. Efforts are also underway to ensure effective on-going (continuous) payment system oversight, going forward.

3.4.2 Regulatory developments

Amendment Bill

The Bank of Namibia has amended the Banking Institutions Act of 1998, to give the institution more power in its oversight of banking institutions. The Amendment Bill was tabled in Parliament during the third week of February 2010. Once passed, the Bill would empower the Bank of Namibia to:

a) Introduce certain restrictions to the ownership and shareholding structure of foreign-owned banking institutions in Namibia, and to recommend to the Finance Minister the extent of shareholding any resident or non-resident of Namibia could hold individually or collectively in banking institutions;

b) Regulate and supervise holding companies of banking institutions; and

c) Issue spot fines to banking institutions if they do not comply with prudential requirements.

Other amendments would:

a) Require banking institutions to give a written notice to the Bank of Namibia about the appointment of a new Managing Director or a director on the board, 30 days before such an appointment;

b) Prohibit directors and bank managers from being part of discussions on loan approvals when it involves conflict of interest;

c) Make it further easier for credible foreign banking institutions to set up branches in Namibia, without the requirement of a full banking licence first; and

d) Prohibit/outlaw pyramid schemes in Namibia.

Determination on Cheque Item Limit

In October 2009, the Bank of Namibia has issued a determination on the reduction of domestic cheque item limit within the Namibia National Payment System (NNPS). The purpose of the determination is to effect the reduction of the domestic cheque item limit from N$5,000,000 to N$500,000. The determination applies to all banking institutions, Namclear, businesses and individuals that issue, accept and process domestic cheque payments within the NNPS.

This determination shall become effective on 10 June 2010.

3.4.3 Summary assessment

The National Payment System has performed adequately in the first half of 2009. The system was mostly available and safe, and there were no major system breakdowns. The NPS, therefore, posed no systemic risk to financial system stability during the period under review.

4. OUTLOOK, RISKS AND OVERALL ASSESSMENT

4.1 GLOBAL OUTLOOK

Global economic recovery has grown stronger and broader than expected, according to the IMF's Update for January 2010. Global production and trade recovered in the second half of 2009. Consequently, the IMF expects world economic output to grow by 4.0 percent in 2010. However, economic activity in most advanced economies will continue to be slow, while activity is expected to be stronger in many emerging and developing economies. The institution expects economic activity to grow by 2.0 percent in advanced economies and by 6.0 percent in emerging and developing economies in 2010.

However, the IMF warns that, even with overall improvement in global economic and financial conditions, there are still pressing challenges from the crisis, and financial stability remains fragile. Accordingly, new risks are emerging as a result of the extra-ordinary support by the policy measures. For instance, there are significant increases in the risk to sovereign balance sheets and the consequent increase in debt burdens that, in turn, raises the risks for financial stability in the future. Rising concerns about worsening budgetary positions and fiscal sustainability could raise borrowing costs for households and companies and unsettle financial markets and stifle the economic recovery. A premature and incoherent/disjointed exit from the supportive policies would undermine global economic growth. At the same time, there are concerns about upward pressures on both asset prices and exchange rates in emerging market economies where recovery will be strong.

4.2 DOMESTIC OUTLOOK

The Namibian economy suffered a 1.1 percent GDP contraction in 2009 due to the global financial crisis. With the risks to the domestic economic recovery still on the downside, Namibia's GDP is expected to grow only by 4.2 percent in 2010.

Furthermore, there are downside risks to the global outlook for 2010. They include the major risk that the global economy could experience a "double dip" or economic stagnation. This could undermine the recovery in external demand for Namibian exports and diminish government revenues. Furthermore, tourism is expected to decline further, thereby negatively affecting growth and incomes.

4.3 OVERALL ASSESSMENT

The global economic fundamentals have improved by the second half of 2009. Economic recovery, although to varying speeds among regions, has returned to advanced economies and widened to emerging and developing countries. Consequently, systemic risk has continued to subside in both advanced and emerging and developing countries, as policy stimuli remained in place. Global production and trade have improved and commodity prices have risen in the second half of 2009, lifted by strong recovery in emerging Asia, in particular, and by improved global financial conditions. However, global inflation remained subdued on concerns over the sluggish global economic recovery.

Improved economic fundamentals and the return to economic growth and sustained policy support led to improvements in global financial conditions. Financial markets have recovered stronger and faster than anticipated and risk appetite has returned, while equity markets have improved. In advanced economies, tightening of bank lending standards has moderated and many banks have become less dependent on central bank emergency facilities and government guarantees.

Financial conditions have also improved in emerging and developing countries, where risk appetite for their assets has improved. Capital/portfolio inflows to these economies have resumed, mainly into equity, and further easing financial conditions. Despite improvements, financial stability remains fragile in many advanced and hard-stricken emerging market countries. Furthermore, financial conditions are likely to remain challenging than prior to the global financial crisis and bank credit extension continued to be sluggish.

Limited exposure, to the global financial markets affected by the global financial crisis, insulated the Namibian banking sector from the impact of the crisis. The impact of the global financial crisis on the banking sector, therefore, continued to be restrained in the second half of 2009. The banking institutions sustained adequate liquidity, capital, and solvency. In addition, profitability (ROE) has improved and the ratio of non-performing loans to total loans continued to fall. However, capital adequacy ratios declined slightly but remained above regulatory minima. Overdue loans as a share of total loans also rose since the first half of 2009. Overdue loans, as they feed into NPLs, have potential of threatening banks' asset quality. The Namibian economy contracted in 2009 because of weak external demand due to the global financial and economic crises. Key economic sectors (diamond mining and tourism) experienced severe slumps in economic activities and hefty job losses during the period. However, economic growth is expected to rebound, in 2010, in line with global economic recovery. This would improve the financial conditions of both banking institutions and their borrowers. The risk on banking stability is, consequently, assessed to stay low in the medium term.

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