



Financial Stability

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Below is the summarised version of the Eswatini Financial Stability review. For the full Financial Stability Report, please refer to the Bank's website.

Overview

- » The Bank is continuously monitoring economic developments to ensure that imminent risks are swiftly corrected to preserve financial stability. The aim is to ensure that the financial system is capable of withstanding internal and external shocks.
- » Over the year ended December 2022, key risks to the financial system stability were elevated when compared to the previous years, but with no destabilising impact. Risks emanating from the external economic environment, domestic economic environment, household sector, corporate sector and banking sector remained high. On the other hand, risks from the payment and settlement system remained relatively low over the year ended December 2022.

External Economic Environment

Eswatini's financial system remains resilient in the face of ongoing disruptions associated with the COVID-19 pandemic and the Russia-Ukraine war. These disruptions have adversely affected the global and domestic economy, including external supply chain shocks, the post-pandemic economic recovery, and other headwinds to growth. Systemic risks to the banking sector remain heightened as the spill-over effects from external risk factors continue to pass through to the domestic macroeconomy and financial system. Consequently, global and domestic inflation remain above central banks' target ranges, prompting global and domestic tightening in liquidity and monetary conditions. The full effects of rising inflation and slow economic activity are yet to fully pass through to the banking sector - likely to test banks' resilience to shocks over the medium-term.

Domestic Economy

Macro risks remain elevated in the period under review. These include the exchange rate volatility, geopolitical tensions, wider spread of the pandemic, risk of foreign capital outflows, and rising public debt.

Economic activity remained sluggish on account of persistently high inflation, rising interest rates, and tightening financial conditions. Sustained higher fiscal budget deficit has contributed to strained Government finances, low

public investment, upward pressure on the cost of public debt and failure to eradicate existing Government arrears. Protracted period of weak economic growth has resulted in subdued aggregate demand, upward pressure on unemployment levels, low corporates' earnings and profitability as well as household income, low private investment, and downward pressure on Government revenue via tax revenues.

In addition, tightening financial conditions have led to reduced profits, high household indebtedness, and weakened financial institutions' asset quality. Furthermore, social/civil unrest has resulted in the destruction of corporate and state assets/ infrastructure, low investor confidence, and reduced business-operating times.

Household Debt

Credit risk remains elevated and credit growth remains subdued. The full impact of prevailing macro shocks is yet to fully pass through to NPLs. Household debt is on an upward trajectory as higher interest rates increase debt-servicing costs for households. There is a notable rise in unsecured lending to households, which could be an early sign of distressed borrowing to cover living expenses. Non-Bank Financial Institutions (NBFIs) dominated credit extension to the household sector in the period under review.

Corporate Sector Health

Credit risk remains a concern with corporate debt servicing costs still rising and the full effects from emerging macro risk factors and COVID-19 credit relief loans (whose repayment is in arrears), still to manifest in the performance of banks. Profit margins have been negatively affected by reduced operating times, destruction, and vandalism of corporate assets, as well as rising operating and labour costs.



 Group picture taken during the launch of the 2022 Financial Stability Report.

Further deterioration in corporate sector earnings and profitability has brought about challenges in servicing debt obligations; prolonged subdued domestic investment; and staff lay-offs contributing to rising unemployment rate. The increased level of corporate indebtedness has weakened debt service capacity thereby leading to loan defaults and weakened creditor assets. As alluded to above, social/ civil unrest contributed to losses through damages and vandalism to business establishments, as well as depressed corporate profits – mainly due to reduced operating times and retrenched staff.

Banking Sector

The banking system remained safe and sound. The sector remains prepared for and resilient to a wide range of shocks, supported by: (a) Strong aggregate capital and liquidity positions; (b) Reopening of the economy after the pandemic; and (c) Decisive policy measures implemented by the CBE. The banks complied with minimum capital requirements. On aggregate, liquidity risk remains low, as supervised financial institutions hold strong liquidity buffers against potential shocks, underpinned by increased investment in Government securities and improved deposit mobilisation. On the other hand, funding conditions remained stable, while concentration risk remained relatively high for Eswatini banks - from both funding and lending perspectives.

Non-Bank Financial Institutions Sector

There are persistent underlying risks and vulnerabilities in some sectors of the NBFIs, which weigh on the overall resilience of the financial system. The two main NBFIs sectors' risks are summarised below;

Insurance Sector

Concentration risk remain high in the insurance sector, with two long-term insurers making up over 80.0 per cent of the total long-term insurance

industry assets. The short-term insurance industry is also controlled by two short-term insurers, constituting approximately 91.0 per cent of the total short-term insurance industry assets. There is an underwriting risk leading to persistently weak insurance profits. Margins between underwriting expenses and net insurance premiums remain narrow, leading to persistently weak insurance profits. This has the potential of leading to the erosion of earnings and profitability of the insurance sector in the long-term.

Retirement / Pension Funds Sector

The retirement funds industry is highly concentrated - the biggest players being the statutory funds (Public Service Pensions Fund and Eswatini National Provident Fund) - with a market share of 73.0 per cent and 11.0 per cent, respectively. This level of concentration also poses a risk to financial stability. The failure of either of these institutions would, therefore, have a significant adverse impact on the entire economy. This is to be expected since the retirement funds sector is intertwined

with the broader financial system and the real economy through high investments in Government securities and issuance of loans to corporates and equity holdings. On the other hand, market risk remains high in the retirement funds sector owing to their exposure to the South African stock market, mainly the Johannesburg Stock Exchange (JSE). There is an increasing exposure to Eswatini Government and interconnectedness of the pension sector with regard to financial intermediation to the economy.

Other Financial Stability Strategic Initiatives

Deposit Protection Scheme

The development of the Deposit Protection Scheme continues. The Steering Committee, chaired by the Governor and charged with overseeing the development and implementation of the Scheme and the rollout of its roadmap is now in place. The Scheme is meant to compensate and protect depositors in the event of a bank failure.

