CENTRAL BANK OF SWAZILAND

GOVERNOR’S ANNUAL MONETARY POLICY STATEMENT

“Price and Financial Sector Stability for Sustained Economic Growth and Development”

Presented by:
Mr. M.V. Sithole
Governor, Central Bank of Swaziland

2018
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12th April 2018
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1.0 INTRODUCTION

The price and financial stability objectives continue to guide monetary policy formulation and implementation in Swaziland, hence the Bank continued to pursue a tight monetary policy stance to curb inflation at the beginning of the year 2017 and increasing unsecured loans. The discount rate increased from 7 per cent to 7.25 per cent in January 2017 and this monetary policy stance was maintained throughout the year 2017. The Bank lowered the discount rate by 25 basis points to 7 per cent in January 2018 citing sustained improvements in international economic conditions as well as subsiding domestic and international inflationary pressures. However, risks to the inflation outlook remain.

The rest of this Policy Statement is organised as follows. Section 2 reviews the international economic developments while section 3 reviews domestic economic developments with emphasis on the impact of the past year's monetary policy stance. The inflation outlook and monetary policy stance is presented in section 4, while other developments in support to financial and price stability are presented in Section 5, and Section 6 is the conclusion.

2.0 GLOBAL ECONOMIC DEVELOPMENTS

According to the IMF World Economic Outlook Update released on 22 January 2018, global economic activity continues to firm up with global gross domestic product (GDP) estimated to have grown by 3.7 per cent in 2017, following a 3.2 per cent growth in 2016. The pickup in growth has been broad based, with notable upside surprises in Europe and Asia. The global growth upswing also appears to be increasingly driven by fundamental economic forces rather than just cheap and ample money. Stronger manufacturing activity and robust global trade, underpinned by higher corporate investment, provided the momentum, spurring job creation and bolstering consumer confidence in most advanced countries and in some key emerging market economies.

Figure 1: World and Advanced Economies Output Growth

<table>
<thead>
<tr>
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<th>2016a</th>
<th>2017a</th>
<th>2018f</th>
<th>2019f</th>
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<td>1.7</td>
<td>2.3</td>
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<td>2.2</td>
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Source: IMF World Economic Outlook Update, January 2018
Among advanced economies, growth is estimated to have expanded by 2.3 per cent year-on-year in 2017 compared to 1.7 per cent in 2016. Advanced countries are forecasted to grow by 2.3 per cent and 2.2 per cent in 2018 and 2019, respectively.

GDP growth in key emerging markets and developing economies expanded by 4.7 per cent year-on-year in 2017 compared to 4.4 per cent in 2016. Among BRICS\(^1\) countries, the Chinese economy registered stronger growth, boosted by improvements in the services sector and relatively firm and steady conditions in the manufacturing sector. For others, economic activity was either turning the corner or picking up at a moderate pace.

The recovery in most commodity-exporting countries continued and broadened in the last quarter of 2017. They mainly benefitted from rising exports boosted by stronger global demand and firmer international commodity prices. The turnaround in export sectors’ fortunes began to translate into some recovery in domestic demand at the end of 2017 mainly driven by moderate employment gains, easing inflation and lower interest rates. Going forward, Emerging Market and Developing Economies (EMDES) are forecasted to grow by 4.9 per cent in 2018 and 5.0 per cent in 2019.

Figure 2: Emerging Market and Developing Economies (EMDEs) GDP Growth Rates

![Graph showing GDP growth rates for EMDEs]

**Source:** IMF World Economic Outlook Update, January 2018

\(^1\)A cluster of 5 major emerging market countries that include Brazil, Russia, India, China and South Africa: The BRICS members are all leading developing or newly industrialized countries, but they are distinguished by their large, sometimes fast-growing economies and significant influence on regional affairs
2.1 Commodity Markets Outlook and Inflation

An improving global growth outlook, weather events in the United States, the extension of the OPEC and Russia Cooperation Agreement to limit oil production, and geopolitical tensions in the Middle East have supported crude oil prices, which have risen by about 20 per cent in the last quarter of 2017 to over $60 per barrel. The increase in fuel prices raised headline inflation in advanced economies, but wage and core-price inflation remain weak. Among emerging market economies, headline and core inflation have ticked up slightly in recent months after declining earlier in 2017.

The oil price is currently at the highest level since 2014, despite the underlying fundamentals remaining unchanged; global supplies are still well in excess of demand, which means that the fundamental oil glut remains in place. However, the oil price has become increasingly sensitive to market sentiment and comments from OPEC in particular. OPEC extended its production cuts in November 2017 up until the end of 2018, promising to maintain a high compliance rate (OPEC Monthly Output Report, 20 February 2018).

Consumer prices in EMDEs have remained relatively contained. In 2016, consumer price inflation in EMDEs was recorded at 4.3 per cent, and is estimated to be at a lower 4.1 per cent in 2017. Despite higher inflationary pressures in most EMDEs during late 2017, due to hikes in administered prices and higher food prices, inflation remains at historically low levels in emerging market nations.

2.2 Monetary Policy in Advanced Economies

Developments in Advanced economies have substantial effects on EMDEs. Monitoring such developments ensures that EMDES are well informed and thus ensure that their policies are relatively resistant to negative spillovers emanating from the interlinkage of EMDEs and Advanced Economies.

The Federal Open Monetary Committee (FOMC) in the USA continued to gradually increase the federal funds rate target during the year 2017, reflecting solid economic performance. The Fed increased the interest rate three times in 2017, amounting to an increase of 75 basis points over the year. Inflation in the US average 2.1 per cent in 2017, above the target of 2.0 per cent. Another rate hike in March 2018 lifted the federal fund rate to between 1.5-1.75 per cent.

Though still accommodative, the Bank of England increased its policy rate by 25 basis points in November 2017 for the first time since 2008, due to upward inflationary pressures fuelled by depreciation of the Sterling and diminishing slack in the economy.

Inflation in other advanced economies, which are the Eurozone and Japan, continued to be below the 2.0 per cent target and these economies continued to pursue an accommodative monetary policy stance, in an effort to achieve their inflation target. The European Central Bank continued to maintain interest rates at historically low levels of 0.0 per cent while the Bank of Japan continued with its stimulus program to achieve the 2.0 per cent inflation target and maintained interest rate at -0.1 per cent.
According to the World Economic Outlook (January 2018), in advanced economies, continued monetary accommodation is more desirable due to persistence in output gaps and inflation below central bank target. The focus of fiscal policy should however be on medium-term objectives while ensuring that sustainable public debt dynamics and external imbalances are minimised.

2.3 South Africa Economic Developments
According to Statistics South Africa, the South African economy grew by 1.3 per cent in 2017 up from 0.3 per cent in 2016. After a contraction in the first quarter of 2017, the economy saw sustained growth for the subsequent quarters of the year. A higher growth of 3.1 per cent was observed in the final quarter of 2017 (quarter on quarter and seasonally adjusted). The strengthening in economic activity over 2017 was supported by a recovery in the agriculture industry, which grew by 17.7 per cent compared to the previous year, which was mainly affected by the El Nino induced drought. Other main contributors to growth were mining and finance which grew by 4.6 per cent and 1.9 per cent, respectively. Negative contributors to growth were trade, manufacturing and construction sectors.

The South African Reserve Bank (SARB) forecasts economic growth outlook at 1.4 per cent for 2018 and 1.6 per cent for 2019. The favourable outlook is in line with the further increase in the South African Reserve Bank composite leading business cycle indicator of activity. The outlook is further expected to be impacted positively should the recent political developments lead to a sustained business and consumer confidence. Contrary to the SARB’s forecasts which has shown an improvement in the outlook, the International Monetary Fund (IMF) has revised down the South African economic growth to 0.9 per cent for the next two years from 1.1 per cent and 1.6 per cent in 2018 and 2019, respectively. The basis for the downward revision are the rising political uncertainty, which is expected to weigh heavily on business confidence and investment.

The year-on-year inflation, as measured by the consumer price index (CPI) averaged 5.3 per cent in 2017 compared to 6.3 per cent in 2016, falling within the target range of 3-6 per cent. The moderation was mainly driven by a decrease in food prices as the drought effect continued dissipating. The South African Reserve Bank forecast inflation to average 4.9 per cent in 2018 and 5.4 per cent in 2019. The main basis for the favourable forecast were the stronger exchange rate and lower electricity price assumption. Latest figures from Statistics South Africa indicate that inflation grew by 4.0 per cent in February 2018 compared to 4.4 per cent in January 2018. In 2017, the South African Reserve Bank cut the repo rate by 25 basis points to 6.75 per cent in June and further down to 6.50 in March 2018, in part due to the continuous moderation in inflation.

3.0 DOMESTIC ECONOMIC DEVELOPMENTS

3.1 Actions and Outcomes of the 2017 Monetary Policy Statement
During the year 2017, the Central Bank pursued a restrictive and steady monetary policy stance, maintaining the discount at 7.25 per cent throughout the year. The restrictive monetary policy stance was pursued in order to restore price stability that was threatened by higher food prices at the beginning of the year and later on increasing unsecured personal loans. In January 2018, the Bank lowered the interest rate by 25 basis points to 7 per cent and further down to 6.75 per cent in March 2018. This was due to the continued easing of inflationary pressures mainly
benefiting from the continuous moderation in food prices and the strengthening Lilangeni exchange rate. Following an increase in liquidity requirements from 20 per cent to 25 per cent and from 20 per cent to 22 per cent in 2016 for commercial banks, and savings and development banks, respectively, the Central Bank left the liquidity requirement unchanged in 2017. The reserve requirements for banks was also left unchanged at 6.0 per cent.

Figure 3: Interest Rate Trends: March 2017 to March 2018

In the short to medium-term, the outlook for monetary policy will be guided by inflation outcomes and forecasts by the Bank. The current favourable inflation will be largely sustained by decelerating food prices as well as the recent Lilangeni strengthening. However, risks may be posed by increases in administered prices of some utilities and the increase in value added tax (VAT). The Central Bank will therefore continue to monitor such developments and act accordingly to uphold price stability conducive to economic growth of the country.
3.2 Monetary Policy Implementation Review: Impact on Key Indicators

The monetary policy transmission mechanism is the responsiveness of prices and general economic conditions to monetary policy decisions. Such decisions are intended to influence the aggregate demand, interest rates, and amounts of money and credit in order to affect the overall performance of the economy.

The speed of monetary policy transmission differs with each macroeconomic variable. This implies that some variables react faster than others do to changes in the monetary policy, with the slowest transmission being on GDP growth. This underscores the lag effects of monetary policy on GDP growth.

3.2.1 Annual Real GDP Developments

Preliminary estimates for GDP reflect that overall economic activity expanded by 1.9 per cent in 2017 compared to 1.4 per cent in 2016, mainly supported by an improvement in the primary and secondary sectors. These sectors broadly benefitted from a recovery from an El Nino induced drought, which commenced in 2015 and intensified in 2016. Improved weather conditions particularly the above normal rains received in the last months of 2016 and early months of 2017 supported a recovery in agricultural production, agro-processing, water supply and hydropower generation.

The primary sector is estimated to have increased by 0.7 per cent in 2017 up from a decline of 5.6 per cent in 2016. Crop production, which is dominated by sugarcane, grew by 17.2 per cent in 2017 compared to a decline of 21.9 per cent the previous year. Maize output rose from 33,462 metric tonnes in 2015/16 harvesting season to 84,000 metric tonnes in the 2016/17 harvesting season. Sugarcane production on the other hand rose by 7.2 per cent in 2017 following a decline of 14.7 per cent the previous year. The negative effects of the recent drought have, however, kept livestock production on a negative growth trajectory as livestock farmers gradually work on restocking their lost herds.

Developments in the mining and quarrying subsector were mixed in 2017. On a positive note, coal production rose by 28 per cent in 2017 compared to a 12 per cent increase in 2016, largely reflecting improved coal yields. On the other hand, quarried stone production fell by approximately 30 per cent due to a slowdown in construction activity in 2017. The overall output for the mining and quarrying subsector increased by 14.8 per cent in 2017 compared to 10.2 per cent in 2016.

The secondary sector is estimated to have expanded by 0.7 per cent in 2017 compared to 0.5 per cent recorded in 2016. Growth in the secondary sector was largely driven by manufacturing particularly agro-processing, electricity and water supply. Manufacturing output is estimated to have increased by 1.8 per cent in 2017 following a flat growth recorded in 2016, mainly supported by an increase in sugar production. Sugar production rose by 9.1 per cent in 2017 after declining by 15.7 per cent the previous year, largely benefiting from improved weather conditions, which resulted in higher cane and sucrose production.

The tertiary sector is estimated to have grown by 2.7 per cent in 2017 compared to 3.2 per cent recorded in 2016. Positive growth rates were mainly observed in the output for ‘general government services’, ‘communication’ and ‘financial intermediation’ and ‘wholesale and retail trade’. Sub-sectors that underperformed in the tertiary sector in 2017 included ‘transport and storage’, ‘tourism’ and the ‘health’ subsectors.
Figure 4: GDP Developments by Sector for 2013-2017

Notes: The GDP numbers for 2013-2016 are based on the Central Statistics Office (CSO) provisional numbers released in November 2017. The estimates for 2017 are based on the GDP Projections by the Macro-Forecasting Team (MEPD & CBS) released in January 2018.

Source: CSO, MEPD and CBS

Economic activity is projected to decelerate to 1.3 per cent in 2018 before picking up to 2.0 and 2.7 per cent in 2019 and 2020, respectively. The slowdown in 2018 is mainly linked to the government cash-flow challenges that have led to an accumulation of arrears from the previous two years. This will weigh heavily on the performance of the ‘construction’, ‘financial’ and ‘wholesale and retail’ sub-sectors.

3.2.2 Price Developments

(a) Overall Inflation
The annual consumer inflation averaged 6.2 per cent in 2017 compared to an average of 7.8 per cent in 2016. Inflationary pressures were generally on the downside throughout the year, with the consumer price inflation reaching a low of 4.7 per cent in December 2017 from a peak of 8.2 per cent in January 2017. A significant slowdown was observed in the consumer price index (CPI) for goods mainly non-durable goods, which are mainly dominated by food price developments. The CPI for goods rose by an average of 6.9 per cent in 2017, down from an average of 11.8 per cent the previous year. The CPI for services, on the other hand, increased to an average of 5.6 per cent in 2017 from 4.5 per cent in 2016. Overall inflation pressures remained on the downside in the opening months of 2018 decreasing to 4.0 per cent in February 2018 from 4.6 per cent in January 2018.
Figure 5: Consumer Inflation for February 2017 to February 2018

Source: Central Statistics Office (CSO)

(b) Food and Transport Inflation

Food inflation decelerated from a record high of 19.0 per cent in December 2016 to a record low of 2.6 per cent in December 2017 and averaged 8.1 per cent in 2017 compared to 14.4 per cent the previous year. Improved weather conditions in 2016/17 season resulted in a bumper harvest both locally and regionally which reversed the adverse negative effects of an El Nino induced drought that prevailed in 2015/16. This trend has been sustained in the opening months of 2018 with food inflation decreasing to 1.1 per cent in February 2018 from 2.5 per cent the previous month.

Apart from food inflation, slower increases were observed in the price indices for ‘transport’, ‘communication’ and ‘clothing and footwear’. Even though fuel prices rose by a cumulative 200 cents/litre during the course of 2017, transport inflation averaged 3.9 per cent in 2017 compared to 9.6 per cent in 2016. The slower growth was largely due to high base effects from the previous year where there was an upward adjustment in public transport fares.
(c) Core Inflation
Core inflation which is CPI excluding food, auto-fuel and energy averaged 5.5 per cent in 2017 compared to 5.0 per cent in 2016. This reflected that underlying inflationary pressures were modestly on the upside in 2017, indicating the presence of second round effects of the supply-side inflationary pressures observed in 2016. Core inflation decreased from 5.3 per cent in January 2018 to 5.1 per cent in February 2018.

Source: Central Statistics Office (CSO)
3.2.3 Private Sector Credit

(a) Total Private Sector Credit
Annual growth in credit extended to the private sector gained further momentum from 7.4 per cent a year ago to 12.7 per cent at the end of January 2018. The growth in credit extended to the private sector was registered in all its components namely; Business, Households and Other (unclassified) sectors. Annual credit to the business sector accelerated by a double digit of 21.2 per cent in January 2018 compared to only 6.1 per cent recorded the previous year. The rise in credit to businesses was mainly discernible in the Distribution & Tourism, Transport & Communications and the Mining & Quarrying sectors.

Figure 8: Private Sector Credit Annual Changes; January 2017 to January 2018

(b) Household Credit
Year-on-year credit extended to the household sector rose by 5.6 per cent in January 2018, slightly lower than the 8.7 per cent growth recorded the previous year. Within the household sector, other personal (unsecured) and housing loans recorded increases while motor vehicles loans fell. Other personal loans grew by 18.1 per cent in January 2018 compared to 20.9 per cent recorded the previous year. Credit for housing purposes on the other hand increased by 6.2 per cent in January 2018 reflecting an improvement from the 5.8 per cent growth registered the previous year. Credit extended for motor vehicles, however, turned around and declined by 9.5 per cent in January 2018 from an increase of 3.2 per cent obtained the previous year.

Source: Central Bank of Swaziland and Commercial Banks
3.2.4 Gross Official Reserves
The country’s gross official reserves declined by 6.2 per cent over the period ended February 2018 to reach E7.1 billion. This decline, however, indicated a slight improvement from the 14.4 per cent fall recorded the previous year. The slight improvement was attributed to higher SACU receipts during the 2017/18 fiscal year at E7.1 billion compared to E5.3 billion during the 2016/17 fiscal year. Accordingly, the reserves were enough to cover 3.5 months of imports, the same cover recorded the previous year as imports eased slightly. At this level, the import cover was above the internationally acceptable level of 3 months. As at 23 March, reserves were at E6.6 billion, equivalent to 3.3 months of imports.

Source: Central Bank of Swaziland
The short to medium-term prospects for the country’s reserves are uncertain as the Government continues to face cash flow challenges and SACU receipts for the 2018/2019 fiscal year are likely to decline. The Bank will thus continue to monitor developments, undertake initiatives to boost reserves and offer appropriate advice to Government in order to retain the reserves at levels above the internationally recommended threshold of three months.

3.2.5 Broad Money Supply
Year-on-year broad money supply (M2) grew by 15.6 per cent in January 2018, slightly more than the 13.5 per cent growth realised the previous year. The observed growth impetus was largely provided by the expansion in private sector credit extension. Both narrow and quasi money supply reflected moderate increases. Notably, narrow money supply (M1), which is a measure of transaction balances, accelerated by 15.6 per cent in January 2018 from 8.7 per cent recorded the previous year. Quasi money supply, which is a measure of interest earning balances, grew by 15.6 per cent but was slightly lower than the 16 per cent rise recorded the previous year.

Figure 11: Money Supply Annual Changes; January 2017 to January 2018

![Money Supply Annual Changes](image)

Source: Central Bank of Swaziland and Commercial Banks

3.2.6 Exchange Rates Developments
The exchange rate of the Lilangeni/Rand against major currencies strengthened in 2017, particular against the US dollar. The local unit strengthened to reach the E12:00 mark against the US dollar, which was last recorded in the third quarter of 2015. The strengthening of the local unit against the US dollar was more pronounced in the fourth quarter of 2017 on the back of recovered business confidence in the Republic of South Africa due to the outcome of the African National Congress (ANC) December 2017 elective conference despite the negative sentiments from unfavourable economic ratings by Standard and Poor’s, Moody’s and Fitch. Against the Pound Sterling and Euro, the local unit ended the period under review slightly strengthened due to regained business confidence and
dampened uncertainty by trade agreements as the European Union grapples with Brexit.

The strengthening of the local unit against the US dollar throughout the year 2017 was generally due to:
- A positive budget delivered in the Republic of South Africa,
- An improvement in the Republic of South Africa’s current account balance,
- Moderating inflation in the Republic of South Africa and higher emerging markets yields and
- Improved business confidence in the Republic of South Africa.

Notably, in the last quarter of 2017, the currency regained its strength against major currencies as expectations of a Cyril Ramaphosa’s victory in the ANC conference gained momentum. The anticipated interest rate hikes in the US Federal Reserve and the likely imposition of tariffs barriers to trade by the Donald Trump administration will weigh negatively to the local unit going forward. The local unit ended the year 2017 at E12.39 against the US dollar, E16.69 against the Pound Sterling and E14.81 against the Euro after closing the previous year at E13.63 to US dollar, E16.73 to the Pound Sterling and E14.35 to the Euro.

Expressed against a basket of trading partners’ currencies, the value of the domestic currency as measured by the Nominal Effective Exchange Rate (NEER) further appreciated by an average of 3.36 per cent in 2017 after strengthening by an average of 2.32 per cent in the year ended December 2016. The inflation adjusted effective exchange rate value of the currency as measured by the Real Effective Exchange Rate (REER) also appreciated during the period under review, strengthening by an average of 3.03 per cent after a previous appreciation of 2.52 per cent in 2016. These developments are in line with the strengthening of the local unit in particular against the US dollar for the better part of 2017. The lower appreciation of the REER compared to the NEER appreciation is an indication that domestic inflation has been increasing at a slower pace compared to those of our trading partners.

The outlook of the local unit is set be positive as South Africa implements a reform agenda and details plans for policy implementation to avoid credit rating downgrades. Expectation of monetary policy tightening in the developed world and threatening trade wars debacles remain a threat to the local unit. The Central Bank of Swaziland remains committed in maintaining the fixed exchange rate regime with South Africa despite the negative effects on exports brought about by the strengthening of the South African Rand. The parity peg to the South African Rand appeals to cross-border trading with CMA countries.
Figure 12: Average Exchange Rates; February 2017 to February 2018

Source: Central Bank of Swaziland

3.3 Fiscal Sector
The Minister of Finance, on March 01, 2018, delivered the national budget for 2018/19 to Parliament. The budget was presented under serious fiscal challenges faced by the country; hence, it is aimed at anchoring fiscal prudence. A number of fiscal consolidation measures and reform strategies will be pursued to curtail the deficit. This is in line with His Majesty’s Speech from the Throne when opening the 5th Session of the 10th Parliament where he entrusted Government to prepare a budget that is based on available resources in order to smoothen payment of suppliers and implementation of planned projects.

3.3.1 Budget Review
The budget deficit for 2018/19 is projected to stand at E4.3 billion, an equivalent of 6.7 per cent of GDP. This indicates an improvement from the deficit of 8.3 per cent of GDP for 2017/18, which is a result of fiscal consolidation measures and reform strategies to be implemented. The actual outturn for 2016/17 shows a deficit of E4.2 billion, an equivalent of 7.7 per cent of GDP.
Total revenue and grants are projected to increase by 2.3 per cent to reach E17.3 billion. The increase is attributed to policies to be implemented in 2018/19 which include; increasing VAT from 14 per cent to 15 per cent, collection of licence fees from mobile companies, additional tax on alcohol & tobacco products, review of user fees and fuel tax and introduction of import levy on non-SACU used vehicles. The proposed introduction of VAT that was to be levied on electricity has since been withdrawn.

The policy measures to be implemented coupled with continued efficiency of SRA tax collection are expected to result in an approximately 17 per cent increase in domestic revenue. SACU, the major source of Government revenue, is set to decline by 18.3 per cent from E7.1 billion recorded in 2017/18 to reach E5.8 billion in 2018/19. This source of revenue accounts for 34 per cent of total revenue and grants compared to 43 per cent the previous fiscal year.

Total expenditure is estimated to remain relatively flat. It is estimated that in 2017/18 will amount to E21.7 billion and is appropriated at E21.6 billion in 2018/19. Government has committed to rationing to prioritise only the most pressing concerns. The budget deficit without adequate financing remains a major concern as it exerts pressure on the domestic economy. It tends to lead to cash flow challenges, which, in turn, result in accumulation of arrears. The establishment of an Arrears Management Committee that will develop strategies for clearance and prevention of further arrears, as announced by the
During the 2017/18 fiscal year, the Government of Swaziland in conjunction with the Central Bank of Swaziland (as Agent to Government) listed in the Swaziland Stock Exchange (SSX) a E2 billion first ever Infrastructure Bond Programme in mid-July 2017. The Programme is expected to run between 3 and 5 years wherein Government will be tapping into the market at regular intervals when there is a need to finance the projects stipulated in the accompanying Prospectus. The Programme will run concurrently with the normal (Plain Vanilla) Issuance Programme (where E2 billion was also listed in the SSX) as both issuances play different roles towards the development of the economy. Funds raised from the Infrastructure Bond will be used to finance targeted infrastructure projects in key sectors of the economy that support investment and employment creation. All investors; local and abroad are invited to participate in these Programmes as efforts are being made to develop the economy and reach the level of other more developed economies as the country strives to achieve the King’s Vision of attaining the First World status by 2022.

The Programmes had a total of E1.2 billion offered during the 2017/18 fiscal year; of which E834.1 million was raised as at 31 March 2018 indicating an allotment rate of 69.5 per cent. The subscription rate was

### Figure 15: Total Public Debt; February 2017 to February 2018

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<tr>
<td>Dec-17</td>
<td>7.3</td>
<td>5.5</td>
<td>12.8</td>
<td>21.6</td>
</tr>
<tr>
<td>Jan-18</td>
<td>7.2</td>
<td>5.4</td>
<td>12.6</td>
<td>20.2</td>
</tr>
<tr>
<td>Feb-18</td>
<td>7.4</td>
<td>5.2</td>
<td>12.6</td>
<td>20.2</td>
</tr>
</tbody>
</table>

**Source:** Ministry of Finance & Central Bank of Swaziland

3.3.3 Domestic Debt Market Developments in 2017/18

During the 2017/18 fiscal year, the Government of Swaziland in conjunction with the Central Bank of Swaziland (as Agent to Government) listed in the Swaziland Stock Exchange (SSX) a E2 billion first ever Infrastructure Bond Programme in mid-July 2017. The Programme is expected to run between 3 and 5 years wherein Government will be tapping into the market at regular intervals when there is a need to finance the projects stipulated in the accompanying Prospectus. The Programme will run concurrently with the normal (Plain Vanilla) Issuance Programme (where E2 billion was also listed in the SSX) as both issuances play different roles towards the development of the economy. Funds raised

in February 2017. The surge was mainly driven by domestic debt issuances during the period. Accordingly, domestic debt increased from E5.9 billion in February 2017 to reach E7.4 billion or 11.9 per cent of GDP in February 2018. External debt increased from E4.7 billion to reach E5.2 billion (8.3 per cent of GDP) during the review period.
recorded at 109.6 per cent. A total of E216.4 million matured during the year resulting in a net financing of E617.7 million.

On the other hand, Treasury Bills Issuances continued in 2017/18 and were mainly used to finance Government cash shortfalls. Out of the total outstanding domestic debt portfolio, Treasury bills account for 30.8 per cent, with bonds accounting for 48.4 per cent (Infrastructure, Plain Vanilla and Suppliers’ Bond Programmes), Promissory Notes at 4.0 per cent and CBS Advance accounting for 16.8 per cent. A total of E5.76 billion was offered for T-bills during the year. E5.16 billion was allotted against maturities amounting to E4.46 billion; resulting in a net financing of E706.7 million.

The Ministry of Finance, in consultation with the Bank, will soon develop and publish an issuance plan for the 2018/19 fiscal year, which will be guided by the potential demand for Government Securities as informed by the domestic debt market size.

Figure 16: Domestic Debt Market Instruments as at 28 February 2018

Source: Ministry of Finance & Central Bank of Swaziland

3.4 External Sector

Preliminary figures indicate that the current account recorded a surplus of E8.64 billion in 2017, an 8.6 per cent decline from E9.45 billion registered in 2016. The slight plunge in the current account balance was attributed to a widened deficit in the services account coupled with a narrower positive trade balance. Although the secondary income account recorded an increase in 2017 compared to 2016, it failed to counter the effects of the negative movements of the other accounts on the current account balance.

Export earnings in 2017 amounted to E24.07 billion compared to E24.38 billion in 2016, indicating a marginal decline of 1.25 per cent. Major exports for 2017 were products of miscellaneous edibles, sugar and sugar confectionary as well as textile and textile articles, contributing 50.8 per cent, 19.7 per cent and 12.5 per cent, respectively, to the overall export basket for 2017. Import receipts grew in 2017, totalling E19.19 billion up by 3.7 per cent from E18.51 billion in 2016.
In 2017, preliminary data shows a net outflow in the services account, as Swaziland remains a net importer of services. This account recorded a broader deficit of E3.71 billion, compared to a deficit of E3.06 billion in 2016. Services exports amounted to E1.66 billion in 2017, showing an improvement of 14.7 per cent from the exports of 2016. Services imports grew in 2017 to E5.98 billion, increasing by 32.5 per cent from an import bill of E4.51 billion incurred during 2016. The secondary income account posted an improved surplus of E7.91 billion in 2017, influenced by higher SACU receipts for the year. The account recorded an impressive 16.5 per cent surge in 2017 from E6.78 billion in 2016.

The financial account deficit decelerated to E7.16 billion in 2017 from E8.47 billion deficit posted in 2016. The deficit in the financial account was due to a net decline in FDI liabilities recorded in 2017 coupled with net increase in foreign portfolio assets and “other investment” assets. FDI net outflows amounted to E1.87 billion against net inflows of E390.3 million in 2016, while foreign portfolio investment recorded a net outflow of E603.6 million from a net inflow of E290.4 million in the previous year. The “other investment” sub-account posted a net outflow of E5.37 billion in 2017 lower than E9.29 billion in the preceding year. The net outflow, though subdued, was influenced by net acquisitions of financial assets relative to the incurrence of financial liabilities during the year.

**Figure 17: Current Account Components; 2014 - 2017**

![Figure 17: Current Account Components; 2014 - 2017](image)

**Source:** Central Bank of Swaziland

### 4.0 INFLATION OUTLOOK AND MONETARY POLICY STANCE

Monetary policy continues to remain uncertain in the short to medium term but will continue to be guided by inflation outcomes and forecasts. Inflation continues to be a key variable in determining monetary policy, and during the year 2017, inflation demonstrated a decelerating trend amidst an unstable regional political atmosphere. An upward biased outlook on inflation is however, expected in the short to medium term due to an expectation of higher oil prices resulting from OPEC countries implementing their production cut program. The VAT and administered price increases also pose an upward risk to inflation. In light
of this, inflation is expected to average 5.41 per cent in 2018. Over the medium term, inflation is expected to increase to 6.08 per cent in 2019 and 6.4 per cent in 2020.

**Figure 18: Inflation Projections for 2018 (Fan-Chart)**

![Inflation Projections for 2018](image)

*Source: Central Bank of Swaziland*

The Bank’s monetary policy stance in the year will continue to focus on the need to anchor inflationary expectations to continue with its moderation trajectory. This would be achieved using the instruments of monetary policy at the disposal of the Bank while also ensuring that domestic economic activity is not constrained and that financial stability is maintained.

Monetary policy formulation and implementation will also continue to support Government’s broader economic objectives, and in the process assist in the endeavour to meet His Majesty’s directive, which is about restoration of fiscal balance and achieving more with less, whilst addressing socio-economic problems. Furthermore, the Bank will continue striving to keep reserves above the conventional 3 months of imports of goods and services, as well as ensuring that the peg to the South African rand is supported and maintained.

5.0 REGULATORY POLICIES

**FOSTERING FINANCIAL STABILITY**

5.1 The Financial Sector Development Implementation Plan (FSDIP)

During 2017, Government adopted the Financial Sector Development Implementation Plan (FSDIP) - a comprehensive and progressive vision for the entire financial sector in the country that will underpin economic growth and poverty reduction. This three-year national strategy to guide the development of the financial sector is wide ranging, touching on all components of the financial system. In support of the country’s vision 2022, the vision of the strategy is to have a stable, diversified, modern and competitive financial system that provides quality affordable and accessible services to all to support economic growth and development.
One of the major objectives of FSDIP is to broaden financial inclusion in Swaziland.

The implementation of the strategy is ongoing with all stakeholders in the national financial system participating. The Central Bank is actively coordinating the implementation of this important national strategy.

5.2 Bank Supervision
A strong banking system has been a hallmark of the financial sector in Swaziland due to the regulation and supervision of banking institutions. This resilience has been as a result of strong and prudent risk management practices by banks coupled with sound regulatory and supervisory standards.

5.2.1 Banking Sector Performance
Profitability of the banking sector showed a slight deterioration in 2017. Financial performance indicators show that after-tax profits were recorded at E419.8 million as at 31 December 2017 down by 28 per cent from the E586.7 million recorded in the previous year. Total assets have increased from E18.3 billion in December 2016 to reach E19.5 billion as at 31 December 2017, representing a 7 per cent increase. Net loans and advances were at E10.4 billion as at 31 December 2017 which is a 5 per cent growth rate from the previous year. Total deposits were recorded at E15.04 billion as at year-end 2017, a 4.0 per cent growth from E14.5 billion recorded in the previous year. The Banking sector continues to be adequately capitalized as all four banks posted capital ratios well above the required minimum regulatory capital ratio of 8 per cent, liquidity ratio above 25 per cent for the 3 banks that are South Africa subsidiaries and 20 per cent for Swazi bank.

5.2.2 Review of Legislations
The Central Bank continues to foster initiatives aimed at enhancing the regulatory and supervisory framework of the banking sector. Developments in this area include the following:

(a) Issuance of the Corporate Governance Guidelines for banks No.2 of 2017
In September 2017, the Central Bank issued Corporate Governance Guidelines for banks. These guidelines set out the Central Bank’s expectations on banks corporate governance practices. They are aimed at strengthening individual bank soundness by imposing minimum standards which in-turn feeds into the improvement of overall banking sector stability. This is especially important given that governance weaknesses in one bank can be transmitted to the banking sector as a whole.

(b) Central Bank’s Enforcement Framework
The Central Bank has put in place an Enforcement Framework which sets out the Central Bank’s approach to Enforcement and describes how the Central Bank’ Policy and Enforcement Division will ensure that the focus of its Enforcement efforts will be closely aligned with that of the Central Bank’s Supervisory Divisions (Bank Supervision Division and Exchange Control Division). The aim is to create an enforcement regime where the threat of enforcement action will be one that drives regulated entities towards the adoption of a proactive attitude towards compliance with the Financial Institutions Act, Exchange Control Order and the Money Laundering (Prevention) Act as well as the supporting regulations, bye-laws, guidelines, circulars etc.

(c) Issuance of Enforcement Procedure Guidelines No.3 of 2017
The Central Bank has issued Enforcement Procedure Guidelines which indicate
the procedures that the Central Bank will generally follow in carrying out the administrative sanctions for breaches of supervisory and regulatory requirements as prescribed under the Financial Institutions Act, Exchange Control Order and the Money Laundering and Financing of Terrorism (Prevention) Act.

(d) Inquiry Guidelines for banks No.4 of 2017

These Inquiry Guidelines were issued in September 2017 and set out the procedures which the Central Bank ordinarily proposes to follow when holding an Enforcement Inquiry for cases where it suspects on reasonable grounds that a prescribed contravention is being or has been committed.

(e) Guideline on the Implementation of IFRS 9 (Financial Instruments) for the banking sector

In July 2014, the IASB issued the final version of IFRS 9 (Financial Instruments) to replace IAS 39 (Financial Instruments: Recognition and Measurement) which requires all reporting entities that have adopted IFRS to implement the new accounting standard by January 1, 2018. This accounting standard prescribes new guidelines for the classification and measurement of financial assets and liabilities, making fundamental changes to the methodology for measuring impairment losses, by replacing the “incurred loss” methodology with a forward-looking “expected loss” model. The Central Bank has issued a guideline that communicates the Central Bank’s expectations on banks’ implementation of the new accounting standard, especially on those areas where banks are expected to exercise considerable judgment allowed under the standard.

(f) Draft Guideline on Banking Practice

The Central Bank is in the process of finalising this guideline after having received comments from banks on the draft. This guideline is aimed at setting out minimum regulatory standards for banking practice and is to be observed by all banks in dealing with and providing services to their customers to ensure that consumers of banking services are adequately protected and treated fairly. It also documents the roles and responsibilities of the Central Bank, banks and consumers in ensuring that the standards set are met.

5.2.3 Migration to Basel II

Pillar 1

Basel II implementation has been effected. A parallel run for the submission of the Form B commenced in September 2017. The go live date has been scheduled for the quarter ending June 2018. Financial institutions have been cooperative in submitting the returns to the Central Bank.

Pillar 2

Guideline for the Internal Capital Adequacy Assessment Process for the banks (ICAAP): The ICAAP forms part of the overall implementation of Basel II capital accord in Swaziland. The ICAAP is the formal process through which a bank adequately identifies, measures, aggregates and monitors material risk, to ultimately build a risk profile that would become the basis for allocating economic capital i.e. the amount of capital that a bank holds and allocates internally to support the risks it takes on. The ICAAP document should clearly state the Board and senior management oversight, establish policies, procedures, limits and controls, comprehensive assessment of risks, stress testing and internal controls review. The banks have started submitting their ICAAP document to the Central bank for review.

5.3 National Payments Systems

The Central Bank of Swaziland (CBS) continues to promote and regulate payment
and settlement systems to support financial stability in the Swaziland financial sector through its oversight function of designated national payment and settlement systems, digital financial services and remittances. Payment systems by their very nature and the central role they play in the economy also involve significant exposures and risks for participants and could also serve as a channel for transmitting shocks across the financial system. For this reason, the CBS is entrusted with a mandate to support financial stability through exercising payment systems oversight, the aim of which is to ensure that national payment systems operations are secure, safe and efficient.

The CBS is taking care not to hamper competition and innovation that comes from the ongoing domestic and international financial technology developments. The CBS continues to monitor developments associated with financial technology to safeguard integrity of the financial system. The brighter side of this financial technology would be the introduction of financial products and services to meet the needs of the market. To this end the Bank has set up a Fintech Unit to undertake research around Fintech developments and help inform policy formulation.

The national agenda on financial inclusion would also be expected to benefit from these new developments coupled with possible reduction in the cost of financial services. Stakeholder partnerships are encouraged to leverage on the existing payment systems infrastructure and to create benefits from economies of scale. Financial institutions are also encouraged to continue with system developments to enable settlement of retail cross border payment transactions on the SADC regional payment system through the SADC Regional Clearing and Settlement Operator. These developments are aimed at enhancing transparency in cross-border activity and operational efficiencies.

The CBS and licensed banking institutions continue to participate in the SADC Intergrated Regional Electronic Settlement System (SIRESS) and the activity continues to grow in terms of volume and value. The SIRESS serves as a payments platform that is aimed at supporting intra-regional trade and transmission of funds between the SADC member countries. In order to guide and to facilitate harmonization of the supporting legislation in the member countries, the SADC Committee of Central Bank Governors have also adopted the SADC Payment System Model Law and the SADC Mobile Money Guidelines. The CBS has taken cognizance of this development and is receiving technical assistance to review the National Oversight Policy Framework, 2008, the National Clearing and Settlement Systems Act, 2011 and the Practice Note for Mobile Money Transfer Operators 2015.

5.4 Exchange Controls
In 2016, the country amended the Money Laundering and Terrorist Financing (Prevention) Act, 2011 to introduce, amongst other things, a risk based approach to dealing with money laundering and terrorist financing matters in compliance with international standards. In implementing the amendments, the Central Bank received technical assistance from the International Monetary Fund to develop a risk based supervisory approach. The technical assistance entailed the development of supervisory tools and training to both management and technical staff on the risk based approach to supervision. We are hopeful that with these tools the Central Bank will better understand the money laundering and terrorist financing risks of the banking sector while testing the effectiveness of the controls in mitigating the risks. By extension, understanding
the banking sector risks will contribute positively to the ongoing National Risk Assessment that aims to understand the country’s threats and vulnerabilities posed by money laundering and terrorist financing.

5.5 Operations

5.5.1 Issuing and Redeeming of Currency
During the period ended 28\textsuperscript{th} February 2018 notes issued amounted to E6 billion compared to E5.6 billion issued in the same period the previous year, whilst coins issued over the period to February 2018 amounted to E25.7 million, indicating a decrease from the prior year’s E37.7 million. The large coin issuance in 2016/17 was as a result of the new coins that were released into circulation coupled with the demonetisation of the old coins. Currency in circulation decreased from E925 million in February 2017 to E894 million in February 2018.

5.5.2 New Notes
As part of the Central Bank mandate, the Bank has released new E100 and E200 into circulation on 26\textsuperscript{th} March 2018. The substrate of the banknotes is still the hybrid but with enhanced security features. The new notes were formally launched on 13\textsuperscript{th} December 2017 at the Bank’s Matsapha Cash Centre and the public, through various campaigns, is being sensitized about the introduction of these new notes.

Legal Notices No.10 and No.11 of 2018 were issued in February 2018 for the new E100 and E200 respectively. The new E10 was released into circulation in July 2017 under Legal Notice No.102 of 2017.

5.5.3 Commemorative Coins
In commemorating the country’s 50\textsuperscript{th} Independence Anniversary and His Majesty the King’s 50\textsuperscript{th} Birthday, the Bank has minted an E5 commemorative coin. A school competition for children aged 6-16 years was held for the design of the coin. The winner of the competition was 14-year old Mlandvo Motsa from Mhlatane High School and thus his design is on the reverse side of the commemorative coin. The coins will be released into circulation in April 2018.

5.5.4 Coin Destruction
The coin destruction project for the old coins that were withdrawn from circulation was finalised in November 2017. Legal Notice No. 147 of 2016 stipulates that all withdrawn coins can be exchanged for face value until 30\textsuperscript{th} September 2021 and thus the Bank will periodically arrange for the destruction of any other old coins that will be received until then.

5.5.5 Coin Processing
The Bank acquired and installed a coin processing machine during the year under review which was commissioned in September 2017. This has resulted in improvements in coin processing efficiencies. Collaboration with industry participants is being explored on how best to promote the circulation of coins in the country.

5.5.6 Currency Awareness Campaigns
To improve the management of currency in circulation, the Bank periodically holds Currency Awareness Campaigns countrywide. The campaign that has been running from November 2017 to February 2018 has been focused on encouraging the public to circulate coins and use them for buying instead of hoarding including the introduction of the new E100 and E200.

5.5.7 Banknote Educational App
The Bank is in the process of registering with apple store and google store a Banknote Educational App which promotes the public ‘know and trust your money’ slogan. This App will specialize on educating the public, in both SiSwati and English, about
the country’s banknotes and will detail the specifications and security features of all the banknotes currently in circulation including the new E100 and E200.

5.5.8 Dye Stained Notes
Swaziland has experienced an upward trajectory in the prevalence of brazen and repeated bombings of Automatic Teller Machines (ATMs) by use of explosives and other forms of less sophisticated criminal attacks. This phenomenon is not unique to the country and has been reported to have happened in other parts of the world. The situation in Swaziland is untenable and it poses a risk to the financial institutions, Cash-in-Transit operators and the general public as well as threatening financial inclusion efforts by the country. This therefore calls for serious and effective counter-measures to be put in place urgently to deter further attacks.

The Central Bank of Swaziland has a statutory obligation to protect the integrity and value of the currency and as such has resolved to support effective risk mitigates and or counter measures. One such risk mitigate is the deployment of Currency Protection Devices (CPDs) to deter criminal attacks on ATMs, static safes and Cross Pavement Carriers (CPCs) by removing the incentive and or taking away the prize.

The Bank is working with the players in the cash management cycle as well as the South African Reserve Bank to enable the use of Cash Protection Devices and hence staining of notes in the event of any tempering with an ATM or cross-pavement device. The public is warned not to accept any stained notes as these may just be the proceeds of crime, instead efforts should be made to report such to the nearest police post.

The Central Bank or any other financial institution may not exchange or give value for dye-stained banknotes in circulation that land in the hands of the public as there is a presumption that such notes are the proceeds of crime. The Bank has indeed issued guidelines to industry players to govern the deployment of these devices and we expect that such will reduce the prevalence of the attacks as seen during the last quarter of 2017.

5.6 Financial Sector Stability
In the year 2017, the Financial Stability Unit (FSU) successfully hosted its second Annual Financial Stability Conference. The theme was, “Understanding Financial Stability, Adopting a Macro-prudential Perspective.” The main focus of the 2017 Financial Stability Conference was the official launch of the Central Bank of Swaziland’s first ever issue of the Financial Stability Report (FSR). While Swaziland largely maintained a stable financial system and a resilient economy in 2016/17, risks to financial stability remain. The early detection of risks to the financial system is necessary to give policymakers sufficient lead-time to take pre-emptive action to avert a systemic crisis. The broad objectives of the FSR is to capture the main risks and vulnerabilities of the financial system and open a channel of communication between stakeholders on issues pertaining to financial stability. The FSR shall be published annually, and is intended to enhance the understanding of financial system vulnerabilities among policymakers, financial market participants and the general public.

5.6.1 Financial Stability Act
The FSU received technical assistance from the IMF to help in the drafting of the Financial Stability Bill. This Bill sets out the powers of the Central Bank of Swaziland as a Macro-prudential Authority, establishes the Macro-prudential Forum and its supporting bodies, and establishes an institutional framework for crisis management and preparedness.
5.6.2 Crisis Simulation Exercise
Subsequent to the recommendations made by the IMF Technical Assistance mission that visited Swaziland from 19 to 26 April 2016, which endorsed that ahead of the inception of the Financial Stability Panel, the Central Bank of Swaziland (CBS) should be preparing a draft of the crisis manual so that it can be submitted for discussion without delay once the Financial Stability Committee is operational. The other previously recommended measures concerning Emergency Liquidity Assistance and the Lender of the Last Resort function are fully within the remit of the CBS and should be implemented as soon as possible. Flowing from that, the CBS has requested the World Bank to provide technical assistance to aid the Bank in conducting the Crisis Simulation Exercise in order to design a plan and framework for contingency planning. Crisis simulation exercises are powerful tools used in stressful and unpredictable environment to test how authorities in charge of managing financial crisis are better prepared to handle the situation.

5.6.3 Financial Inclusion
The CBS through the FSU plays a significant role in assisting with the advancement of the financial inclusion program in the country. The CBS in collaboration with the Centre for Financial Inclusion (CFI) and Junior Achievement (JA) will be undertaking financial consumer education initiatives to raise awareness about financial literacy. The Bank also participates in the Global Money week (GMW) event which is created from the principle that children and youth are the next generation of change makers and builds from the country’s National Financial Inclusion Strategy whose main objective is to inform and educate members of the public (both young and old) on money matters.

The theme for the 2018 Annual Global Money Week was “Money Matters Matter”. This year theme aligns with the aspirations of the Ministry of Education and Training to produce students and pupils who are financially literate to make well-informed decisions as well as think about career choices that will provide the desired financial dreams.

In trying to fulfil the financial inclusion mandate, the CBS has modified statutory returns submitted by the banks in order to capture financial inclusion data.

Moving forward, the FSU will continue to monitor system-wide risks to financial stability and strengthen tools for assessing systemic risk. The previous year has seen the FSU reaching milestones in terms of; a) identifying different sources of risks; b) mapping changes in macroeconomic variables onto bank variables; c) recognizing different sources of contagion; d) assessing resilience; and e) assessing adequacy of liquidity management.

The CBS in collaboration with the COMESA Monetary Institute will develop a Macro and Micro Stress Testing manual that will provide all steps for conducting macro and micro stress testing. The manual will elaborate different methodologies and techniques currently used for macro and micro stress testing. It will also advise on some best practices to follow in applying these techniques. It will also contain the entire cycle of the stress testing process. It is worth mentioning that the CBS is currently utilizing a stress-testing framework, which was developed with support from an IMF expert.
6.0 CONCLUSION

The year 2017 saw the near stagflation situation dissipating as inflation moderated at a faster pace and prospects of economic growth improving. Economic growth for 2017 is estimated at 1.9 per cent up from an estimate of 1.4 per cent for 2016. The Government cash flow challenges pose a threat to the short to medium term growth prospects. The downside risks to growth are further augmented by the uncertain global and regional economic environment. The continuous public arrears continue to be a cause for concern for monetary policy. The financing of the fiscal deficit and public arrears pose an opportunity to develop a vibrant financial market but also poses a threat to destabilise the financial market.

The Bank will continue to assess global, regional and domestic developments, and use all the instruments at its disposal in pursuit of its price and financial stability objective in order to ensure an environment conducive for sustainable economic growth.