Governor’s Annual Monetary Policy Statement

2019

Promoting A Healthy Economy

DECISSIONS

ACTIONS

“Ensuring Price and Financial Stability to Support Economic Growth under Fiscal Consolidation”

www.centralbank.org.sz
Presented By:
Mr. M.V. Sithole
Governor, Central Bank of Eswatini
2nd May 2019
“Ensuring Price and Financial Stability to Support Economic Growth under Fiscal Consolidation”
# TABLE OF CONTENT

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>4</td>
</tr>
<tr>
<td>Global Economic Developments</td>
<td>4</td>
</tr>
<tr>
<td>- Global GDP Growth</td>
<td>4</td>
</tr>
<tr>
<td>- Commodity Markets</td>
<td>5</td>
</tr>
<tr>
<td>Domestic Economic Developments</td>
<td>11</td>
</tr>
<tr>
<td>- Monetary Policy Transmission to The Wider Economy</td>
<td>11</td>
</tr>
<tr>
<td>- Annual Real GDP Developments</td>
<td>12</td>
</tr>
<tr>
<td>- Price Developments</td>
<td>15</td>
</tr>
<tr>
<td>- Private Sector Credit</td>
<td>16</td>
</tr>
<tr>
<td>- Gross Official Reserves</td>
<td>18</td>
</tr>
<tr>
<td>- Broad Money Supply</td>
<td>19</td>
</tr>
<tr>
<td>- Fiscal Sector</td>
<td>20</td>
</tr>
<tr>
<td>- External Sector</td>
<td>23</td>
</tr>
<tr>
<td>- Exchange Rates</td>
<td>24</td>
</tr>
<tr>
<td>Inflation Outlook and Monetary Policy Stance</td>
<td>25</td>
</tr>
<tr>
<td>Regulatory Policies Fostering Financial Sector Stability</td>
<td>26</td>
</tr>
<tr>
<td>- The Financial Sector Development Implementation Plan (FSDIP)</td>
<td>26</td>
</tr>
<tr>
<td>- Bank Supervision</td>
<td>27</td>
</tr>
<tr>
<td>- National Payment Systems</td>
<td>28</td>
</tr>
<tr>
<td>- Financial Technology (FIN Tech) Development</td>
<td>29</td>
</tr>
<tr>
<td>- Exchange Controls</td>
<td>31</td>
</tr>
<tr>
<td>- Operations</td>
<td>31</td>
</tr>
<tr>
<td>- Financial Sector Stability</td>
<td>32</td>
</tr>
<tr>
<td>Conclusion</td>
<td>34</td>
</tr>
</tbody>
</table>
### LIST OF ACRONYMS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ATM</td>
<td>Automated Teller Machine</td>
</tr>
<tr>
<td>APP</td>
<td>Asset Purchase Programme</td>
</tr>
<tr>
<td>BOJ</td>
<td>Bank of Japan</td>
</tr>
<tr>
<td>BoE</td>
<td>Bank of England</td>
</tr>
<tr>
<td>CAR</td>
<td>Capital Adequacy Ratio</td>
</tr>
<tr>
<td>CBE</td>
<td>Central Bank of Eswatini</td>
</tr>
<tr>
<td>CFI</td>
<td>Centre for Financial Inclusion</td>
</tr>
<tr>
<td>CPI</td>
<td>Consumer Price Index</td>
</tr>
<tr>
<td>CPDs</td>
<td>Currency Protection Devices</td>
</tr>
<tr>
<td>ECB</td>
<td>European Central Bank</td>
</tr>
<tr>
<td>EMDEs</td>
<td>Emerging Market and Developing Economies</td>
</tr>
<tr>
<td>FIRST</td>
<td>Financial Sector Reform and Strengthening Initiative</td>
</tr>
<tr>
<td>FSDIP</td>
<td>Financial Sector Development Implementation Plan</td>
</tr>
<tr>
<td>FinTech</td>
<td>Financial Technology</td>
</tr>
<tr>
<td>FSR</td>
<td>Financial Stability Report</td>
</tr>
<tr>
<td>FSU</td>
<td>Financial Stability Unit</td>
</tr>
<tr>
<td>FSRA</td>
<td>Financial Services Regulatory Authority</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>MFU</td>
<td>Micro Finance Unit</td>
</tr>
<tr>
<td>MoF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>MPC</td>
<td>Monetary Policy Committee</td>
</tr>
<tr>
<td>MSMEs</td>
<td>Micro, Small and Medium Enterprises</td>
</tr>
<tr>
<td>NFIS</td>
<td>National Financial Inclusion Strategy</td>
</tr>
<tr>
<td>NEER</td>
<td>Nominal Effective Exchange Rate</td>
</tr>
<tr>
<td>NPL</td>
<td>Non-performing loans</td>
</tr>
<tr>
<td>NPS</td>
<td>National Payment System</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>OPEC</td>
<td>Organisation of Petroleum Producing Countries</td>
</tr>
<tr>
<td>PAYE</td>
<td>Pay As You Earn</td>
</tr>
<tr>
<td>REER</td>
<td>Real Effective Exchange Rate</td>
</tr>
<tr>
<td>SACU</td>
<td>Southern African Customs Union</td>
</tr>
<tr>
<td>SARB</td>
<td>South African Reserve Bank</td>
</tr>
<tr>
<td>US FED</td>
<td>United States Federal Reserve Bank</td>
</tr>
<tr>
<td>VAT</td>
<td>Value Added Tax</td>
</tr>
<tr>
<td>SRA</td>
<td>Eswatini Revenue Authority</td>
</tr>
<tr>
<td>WEO</td>
<td>World Economic Outlook</td>
</tr>
</tbody>
</table>
1.0 INTRODUCTION

The Central Bank of Eswatini (CBE/Bank) is responsible for formulating and implementing a sound monetary policy to achieve financial stability. The primary goal of the Bank is to achieve and maintain price stability that is conducive to achieving sustainable growth. In response to the moderation in inflation in 2017/18, the Bank’s discount rate has remained accommodative, with a 25 basis points cut in March 2018 to 6.75 per cent, and has been maintained at that level to date. Inflation remained stable over the year 2018 and averaged 4.8 per cent for the year. Upward risks to inflation emerged and inflation is projected to be on a slight upward trajectory in the short to medium-term, with the Bank projecting it to average 5.41 per cent in 2019.

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 of financial and price stability are presented in Section 5, and Section 6 is the conclusion.

2.0 GLOBAL ECONOMIC DEVELOPMENTS

2.1 Global GDP Growth

The latest International Monetary Fund’s World Economic Outlook Report (IMF WEO) published in April 2019, highlights that a confluence of factors have affected major economies leading to a weakening global expansion in the second half of 2018. Activity softened amid an increase in trade tensions and tariff hikes between the United States and China, a decline in business confidence, a tightening of financial conditions, and higher policy uncertainty across many economies. Against this global backdrop, a combination of country and sector specific factors further reduced momentum. According the IMF WEO, because of these developments, global growth is now projected to decelerate from 3.6 per cent in 2018 to 3.3 per cent in 2019, before expanding to 3.6 per cent in 2020 (see Figure 1). The current forecast envisages that global growth will level off in the first half of 2019 before gaining momentum in the second half of the same year.

The projected pick up in the second half of 2019 is reliant on an ongoing build-up of policy stimulus in China, recent improvements in global financial market sentiment, the waning of some temporary drags on growth in the Eurozone, and a gradual stabilization of conditions in stressed emerging market economies. Conditions have, however, eased in 2019 as the US Federal Reserve signalled a more accommodative monetary policy stance and markets became more optimistic about a US-China trade deal, but uncertainty due to issues around the “Brexit” remain a course for concern.
2.1.1 Advanced Economies

The IMF reports that growth in advanced economies is projected to continue to slow down gradually as the impact of US fiscal stimulus fades and growth tends toward the modest potential for the group. Advanced economies will expand by 2.2 per cent in 2018 and slow down by 1.8 per cent in 2019. Furthermore, growth is projected to expand by 1.7 per cent in 2020 (see Figure 1).

Consistent with subdued overall price and wage pressures, and possibly reinforced by the slowing growth momentum, inflation expectations remain contained across advanced economies, and, in many cases, have softened recently (IMF WEO, April 2019).

Financial conditions in advanced economies have tightened since the second half of 2018. The US FED at the start of 2018 maintained its target range of the federal funds rate unchanged at between 1.25 - 1.5 per cent but signalled a rate hike in March 2018. Since that meeting the FED has been on a steady tightening cycle, having raised rates four times to stand at 2.25-2.5 per cent in December 2018. At its December 2018 meeting, the Federal Open Market Committee highlighted that the labour market has continued to strengthen and that economic activity has been rising at a strong rate. Job gains have been strong, on average, in recent months, and the unemployment rate has remained low. In 2019, the US FED has so far held the target range for the fed funds rate unchanged at

Consumer price inflation remained muted across advanced economies, given the drop in commodity prices. Consumer price inflation was recorded at 1.7 per cent in 2017 and it edged up to 2.0 per cent in 2018. Recent IMF projections indicate inflation will average 1.6 per cent in 2019 and 2.1 per cent in 2020. For most countries in this group, core inflation was well below central bank targets despite the pickup in domestic demand in the past two years. While wage growth has been picking up across most advanced economies, notably in the United States and United Kingdom, it was still sluggish despite lower unemployment rates and diminished labour market slack.
2.25 – 2.5 per cent, and signalled that it now expects rates to remain at current levels at least until the end of the year, compared to December 2018’s projection of two rate hikes (US FED Monetary Policy Stance, 28 February and 20 March 2019).

US FED Chair, Jerome Powell recently highlighted in a meeting, that over the past few months some crosscurrents and conflicting signals were observed. Financial markets have become more volatile and financial conditions did not support growth prospects. Growth has slowed in some major economies, particularly China and Europe. Furthermore, uncertainty is elevated around several unresolved government policy issues, including Brexit and ongoing trade negotiations.

The U.S. Federal Reserve is gradually removing stimulus in response to low unemployment and near-target inflation amid pro-cyclical fiscal stimulus. Major central banks also appear to be adopting a more cautious approach (US FED Monetary Policy Stance, 28 February and 20 March 2019).

According to excerpts from the minutes of the monetary policy meeting of the Governing Council of the European Central Bank, held in December 2017, ECB policy makers agreed that the language pertaining to various dimensions of the monetary policy stance and forward guidance would be revisited in early 2018. Furthermore, that communication would need to evolve gradually as the bloc’s economy continues to grow. The ECB has maintained the benchmark refinancing rate unchanged at zero percent throughout 2018, whilst bringing to an end its €2.6 trillion bond/asset purchase programme (APP) in December 2018. The ECB, at its latest policy meeting in March 2019 held its refinancing rate at 0 per cent and pushed out the timing of its first rate hike, in nearly eight years, to 2020. This will be done in order to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2 per cent over the medium term (European Central Bank Monetary Policy Stance, 7 March 2019).

To varying degrees, central banks in other advanced economies currently have even less policy space. The Bank of Japan (BoJ) for instance, has consistently left short-term interest rates unchanged at -0.1 per cent for at least the last two years. Policy makers at their December 2018 meeting also kept the target for the 10-year government bond yield at around zero per cent. They further maintained their upbeat view on the domestic economy despite slowing growth in China, coupled with the US-China trade disputes and volatile financial markets. At its latest monetary policy meeting in March 2019, the BoJ did not alter its policy stance, but offered weaker views on exports and output amid rising global headwinds (Bank of Japan Monetary Policy Stance, 15 March 2019).

In the UK, as early as February 2018 the Bank of England(BoE) warned that interest rates may rise sooner than anticipated, as the economy will expand faster than expected over the next couple of years lifting inflation above 2 per cent target. While the BoE maintained the Bank Rate at 0.5 per cent as widely expected in February 2018, the first hike for the year was effected in July, with the BOE raising the Bank rate to 0.75 per cent. Policymakers said that if the economy continues to develop in line with forecasts, further tightening will be appropriate. The stock of UK government bond purchases, financed by the issuance of central bank reserves, was maintained at £435 billion (Bank of England Monetary Policy Stance, 21 March 2019).

As of December 2018 the BoE has maintained
the bank rate at 0.75 per cent, highlighting that Brexit uncertainty had intensified while inflation is expected to ease below the 2 per cent target amid falling oil prices (then). The Bank of England’s Monetary Policy Committee voted unanimously to hold the Bank Rate at 0.75 per cent during its March 2019 policy meeting and reaffirmed its pledge to gradually limit rate rises over the forecast period, despite persistent concerns about Brexit. Policymakers further noted the continued softening in global GDP and trade growth (Bank of England Monetary Policy Stance, 21 March 2019).

While unconventional monetary policies could again be deployed, their effectiveness in returning inflation to target and supporting growth is subject to debate. Recent financial market pressures that have been associated with sizable currency depreciations and capital outflows have compounded policy challenges across many EMDEs. Weaker exchange rates have pushed up inflation across many EMDEs, particularly in some key commodity exporters, highlighting the role of the exchange rate pass-through to domestic prices (e.g., Argentina, Brazil and South Africa) (US FED, ECB, BOJ, IMF WEO – 2018-2019).

2.1.2 Emerging Market and Developing Economies

Global growth in 2019 is also expected to be weighed down by the emerging market and developing economies (EMDEs), where GDP growth expanded by a lower 4.5 per cent in 2018, following a 4.8 per cent expansion in 2017 (see Figure 2). The decline in growth relative to 2018 reflects lower growth in China and the recession in Turkey, with an important carryover from weaker activity in late 2018, as well as a deepening contraction in Iran.

Conditions are projected to improve during 2019 as stimulus measures sustain activity in China and recession strains gradually ease in economies such as Argentina and Turkey. In 2020, growth is projected to rise to 4.8 per cent from 4.4 per cent in 2019, driven almost entirely by an expected strengthening of activity in these economies on the back of policy adjustment and some easing of strains in countries affected by conflict and geopolitical tensions. According to the IMF April 2019 WEO, in sub-Saharan Africa, growth is expected to pick up from 3.0 per cent in 2018 to 3.5 per cent in 2019, and 3.7 per cent in 2020.

Consumer prices for a majority of EMDEs inflation have been hovering in a range of between 1 per cent and 5.5 per cent. In 2017, EMDEs’ annual consumer price inflation was recorded at 4.3 per cent, and is estimated to rise to 4.8 per cent and 4.9 per cent in 2018 and 2019, respectively.

Among emerging market economies, core inflation has remained below 2 per cent in China as activity has moderated. In other cases, inflation pressure has eased toward the lower bound of the central bank’s target range with the drop in commodity prices and slowdown in food inflation (India). For some economies, currency depreciations have passed through to higher domestic prices, partially offsetting downward pressure from lower commodity prices.
The headline numbers for the region marks significant variation in performance, with over one-third of sub-Saharan economies expected to grow above 5 per cent in 2019 and 2020.

Recent financial market pressures that have been associated with sizable currency depreciations and capital outflows have compounded policy challenges across many EMDEs. Weaker exchange rates have pushed up inflation across many EMDEs, particularly in some key commodity exporters, highlighting the role of the exchange rate pass-through to domestic prices (e.g., Argentina, Brazil and South Africa) (US FED, ECB, BOJ, IMF WEO - 2018-2019).

2.2 Commodity Markets
According to the Organisation of Petroleum Producing Countries (OPEC) Monthly Oil Market Report for March, the OPEC Reference Basket (ORB) continued to rise amid continuing strengthening oil market fundamentals and improving market sentiment, which were supported by the commitment of OPEC and participating non-OPEC countries to restore global oil market stability. The ORB value increased m-o-m by $2.54, or 4.0 per cent, to settle at $66.37 a barrel. Throughout the month, prices have been bolstered by strong physical crude demand, especially from Asia Pacific, and lower crude availability due to persistent geopolitical tensions, as well as expectations for continued market balancing by OPEC and participating non-OPEC producing countries (OPEC Monthly Oil Market Report - April 2019).

Over the past two years, global oil demand has turned out to be higher than expected, supported by healthy economic activities, particularly in the OECD. With economic momentum expected to slow down in the current year, this makes economic developments in the major consuming nations a key factor to monitor going forward. Further uncertainties affecting oil demand growth this year are seen to be trade concerns, the strength of substitution with natural gas and other fuels, the effect of commissioning, delays, and closure of petrochemical projects, as well as the implementation of subsidies and energy efficiency programmes, particularly in the transportation sector.
3.0 SOUTH AFRICAN ECONOMIC DEVELOPMENTS

3.1 Economic Growth

According to Statistics South Africa, real gross domestic product increased by 1.4 per cent in the fourth quarter of 2018, following an increase of 2.6 per cent in the third quarter of 2018 (see Figure 3).

The largest positive contributors to growth in GDP in the fourth quarter were the transport, manufacturing and finance industries. Transport, storage and communication industry increased by 7.7 per cent and contributed 0.7 of a percentage point to GDP growth. The manufacturing industry increased by 4.5 per cent and contributed 0.6 of a percentage point. The finance, real estate and business services industry increased by 2.7 per cent and contributed 0.5 of a percentage point. Negative contributions to GDP growth came from mining, trade and general government services.

Figure 3: South Africa GDP Quarterly Growth Rates

On an annual basis real GDP for 2018 increased by 0.8 per cent following an increase of 1.4 per cent in 2017. The muted increase in annual real GDP in 2018 was due to increased economic activity in finance, real estate and business services, which contributed 0.4 of a percentage point based on growth of 1.8 per cent, and general government services, which contributed 0.2 of a percentage point based on growth of 1.3 per cent.

Notably, the South African economy sunk into a technical recession in 2018, its second since the early 1990s. The 2018 recession spanned the first two quarters of the year, with the economy shrinking by 2.7 per cent in the first quarter and contracting further by 0.5 per cent in the second quarter. Despite the recession, growth in the third (2.6 per cent) and the fourth (1.4 per cent) quarters was just enough to push overall growth for the year into positive territory. Growth prospects deteriorated in early 2019, hurt by renewed unreliable and limited electricity supply, continued legislative and political uncertainties and slowing global economic momentum. The latest GDP figures confirm that growth remains subdued (Statistics South Africa, 7 March 2019). The South African Reserve Bank (SARB) forecast the economy to grow by 1.3 per cent in 2019, 1.8 per cent in 2020 and further increase to 2.0 per cent in 2021 (SARB, 28 March 2019)

Source: IMF World Economic Outlook Update, April 2019
3.2 Monetary Policy
The South African Reserve Bank (SARB) maintained its benchmark repo rate at 6.5 per cent for the better part of 2018 before raising it to 6.75 per cent at its November 2018 Monetary Policy Committee (MPC) meeting (see Figure 4). It was the first hike since March 2016, amid a rise in the inflation, which continues to deviate from the mid-point of the target range of 3-6 per cent. The SARB at its March 2019 monetary policy meeting highlighted that it has taken note of the improved inflation outlook, especially in the near-term and it left the repurchase rate unchanged at 6.75 per cent. The SARB MPC remains of the view that current challenges facing the economy are primarily structural in nature. Furthermore, they are of the view that the implementation of credible structural policy initiatives that make a marked impact on potential output and employment and lower the cost structure of the economy should be prioritised.

3.3 Consumer Prices
South Africa’s consumer price inflation on a yearly average basis has been contained within the target range of between 3-6 per cent for the past two years. Year-on-year inflation as measured by the consumer price index (CPI) averaged 4.6 per cent in 2018 compared to 5.3 per cent in 2017. In February 2019, annual inflation rate stood at 4.1 per cent, 0.4 percentage points below the mid-point of the target range (Statistics South Africa, March 2018). The SARB forecasts inflation to rise to 4.8 per cent in 2019, before increasing to 5.3 per cent in 2020 and moderating to 4.7 per cent in 2021. Core inflation averaged 4.3 per cent in 2018 and is forecasted to average 4.8 per cent in 2019, 4.9 per cent in 2020 and 4.5 per cent in 2021 (SARB Monetary Policy Statement, 28 March 2019).
4.0 DOMESTIC ECONOMIC DEVELOPMENTS

4.1 Monetary Policy Transmission to the Wider Economy

During the year ended March 2019, monetary conditions remained accommodative, in line with generally subdued inflation outcomes. Throughout the period under review, inflation was well contained within a range of 4 and 5.3 per cent. Consequently, monetary policy was relaxed once in March 2018 as the Bank reduced the discount rate by 25 basis points from 7 per cent to 6.75 per cent. Since then, monetary policy remained unaltered. Notably, since November 2018, the discount rate was at par with the South African repo rate thus eliminating the 25 basis points differential that existed. This was done taking into account economic development data for the Kingdom of Eswatini. Our own analysis shows that a differential of 50 basis points may be suitable to curb excessive capital flight. Corresponding with the 25 basis points fall in the discount rate, the banks’ prime lending rate declined from 10.5 per cent to 10.25 per cent in April 2018 (see Figure 5). This level has been maintained to date.

Figure 5: Interest Rate Trends; March 2018 - March 2019

The speed of monetary policy transmission differs with each macroeconomic variable. This implies that some variables react faster than others 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. The sections below will consider movements in the main economic variables in the previous year.
4.1.1 Annual Real GDP Developments

Economic activity, as measured by real GDP, is estimated to have grown by 0.6 per cent in 2018, an upward revision from a projection of -0.4 per cent published in September 2018, but lower than the 1.9 per cent recorded in 2017. The ongoing government’s cash flow challenges triggered the accumulation of domestic arrears and reinforced the need for fiscal consolidation, which manifested through cuts in both recurrent and capital expenditure as well as increases in some tax rates in 2018/19 fiscal year. This weighed negatively on construction activity and other services sectors. On the external sector side, the poor performance of the South African economy in 2018 resulted in a slowdown in the demand for the country’s exports, as South Africa is the country’s major trading partner. This affected production of export-oriented products, which are mainly destined to the South African market.

The demand factors notwithstanding, agriculture, agro-processing, electricity and water supply subsectors are estimated to have performed well in the period under review largely boosted by a full recovery from the effects of the El Nino induced drought experienced in 2015 and 2016.

(a) Primary Sector Developments
The primary sector is estimated to have grown by 5.9 per cent in 2018 from a contraction of 4.2 per cent recorded in 2017 mainly boosted by the better performance in crop and animal production, which were supported by favourable weather conditions in the review period. Crop production grew by 19.4 per cent in 2018 with significant growth observed in sugarcane production, which recorded double-digit growth benefiting from the combination of favourable weather conditions and continuous expansions under the Lower Usutu Smallholder Irrigation Project (LUSIP), resulting in an increase in area under sugarcane production.

On a negative note, poor performance was observed in the ‘forestry’ and ‘mining and quarrying’ subsectors. The forestry subsector was slightly affected by forest fires and weak market conditions for forestry products. The mining and quarrying subsector recorded a decline of approximately 0.8 per cent in 2018 compared to a growth of 7.3 per cent in 2017. Coal production decreased by 29 per cent mainly due to worsening geological conditions that resulted in a significant decrease in coal yields. Quarried stone production, on the other hand, decreased by 11 per cent reflecting a slowdown in construction activity.

(b) Secondary Sector Developments
A stagnant growth is estimated for the secondary sector in 2018, down from 3 per cent in 2017, due to subdued manufacturing and construction activity. The slowdown in economic activity in the South African market affected the demand and manufacturing of some export-oriented products. The slower growth under manufacturing was observed for the ‘manufacturing of beverages’, ‘manufacturing of wood and wood products’ and ‘manufacturing of textile and wearing apparel’ subsectors. On a positive note ‘manufacturing of food products’ which is dominated by sugar processing recorded significant growth in line with increased sugarcane production.

Above normal rains recorded in 2017 and 2018 resulted in a significant improvement in dam levels in the country. This, in turn, supported a notable increase in hydro-power generation and water supply. Local power generation increased by approximately 17 per cent while water supply rose by 2.9 per cent. The construction subsector, which is highly linked to the government sector’s capital programme, is however estimated to have decreased due to cut-backs in
capital expenditure effected in the second half of 2018. This development resulted in a notable slowdown in the implementation rate of public sector infrastructural projects in the 2018/19 fiscal year.

(c) Tertiary Sector Developments
The tertiary sector is estimated to have grown at a slower rate of 0.2 per cent in 2018 compared to 2.0 per cent in 2017. Fiscal cash-flow challenges which resulted in a significant accumulation of arrears and necessitated cuts in recurrent and capital government spending as well as upward adjustment in some taxes, led to the slower growth in the tertiary sector. Government performance remained subdued due to the cash-flow challenges resulting in some of the fiscal consolidation measures, such as a wage-and-hiring freeze and other measures to curtail spending. Even though the ‘wholesale and retail trade’ sector was one of the most affected sectors by the deterioration of real disposable incomes, it managed a growth of 1.1 per cent in 2018, largely due to a slight increase in domestic demand in the second half of the year. This is partially linked to factors such as elections, favourable inflation environment, as well as the clearing of some of government’s arrears during the period. Growth in other subsectors such as the ‘accommodation and food services’ and ‘transportation’ remain broadly muted due to slow activity in key sectors such as the manufacturing and government sectors.

Figure 6: GDP Developments 2013 - 2018

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Domestic Product</td>
<td>6.4</td>
<td>1.9</td>
<td>0.4</td>
<td>3.2</td>
<td>1.9</td>
<td>0.6</td>
</tr>
<tr>
<td>Primary Sector</td>
<td>8.24</td>
<td>(14.09)</td>
<td>(4.90)</td>
<td>(7.10)</td>
<td>(4.21)</td>
<td>5.92</td>
</tr>
<tr>
<td>Secondary Sector</td>
<td>3.29</td>
<td>3.77</td>
<td>0.83</td>
<td>2.17</td>
<td>3.13</td>
<td>0.02</td>
</tr>
<tr>
<td>Tertiary Sector</td>
<td>8.53</td>
<td>5.16</td>
<td>1.15</td>
<td>5.74</td>
<td>2.05</td>
<td>0.18</td>
</tr>
</tbody>
</table>

Notes: The GDP numbers for 2013-2017 are based on the Central Statistics Office (CSO) provisional numbers released in August 2018. The estimates for 2018 are based on the GDP Projections by the Macro-Forecasting Team (MEPD & CBE) released in March 2019.

Source: CSO, MEPD and CBE

4.1.2 GDP Growth Outlook
Even though the short to medium-term growth outlook is expected to remain challenged as the fiscal situation is not expected to improve (at least in the short-term), it is expected to gradually recover in the medium-term. Growth in 2019 is forecasted at 1.1 per cent, a downward revision of 0.6 of a percentage point from the September 2018 projections (see Figure 7). The revision is in line with the lower output than earlier anticipated in the
The growing of crops, partly due to high base effect in sugarcane production, combined with continued declining activity in the construction sector.

The impact of the fiscal challenges remain on both recurrent and capital spending which will reduce demand for goods and services in the country. Growth in the short-term is expected to be driven by supply side developments, mainly agriculture, manufacturing, and energy subsectors. External demand is also expected to recover in the short to medium-term, which will support export-oriented manufacturing.

**Figure 7: Medium Term GDP Projections**

![Medium Term GDP Projections](chart.png)

**Notes:** The GDP numbers for 2013-2017 are based on the Central Statistics Office (CSO) provisional numbers released in August 2018. The estimates for 2018 are based on the GDP Projections by the Macro-Forecasting Team (MEPD & CBE) released in March 2019.

**Source:** CSO, MEPD and CBE

### 4.1.3 Quarterly GDP Developments

The Central Statistics Office (CSO) released the first set of seasonally adjusted quarterly GDP figures with a historical series from 2013 to 2018 in March 2019 (see Figure 8). Recent trends reflect that after recording a negative growth of about 3 per cent in the second quarter of 2018, the economy had a stronger rebound in the second half of the year. Economic activity is estimated to have increased by 3.7 per cent in the third quarter of 2018 before slowing to 1.5 per cent in the last quarter of 2018. Positive growth was mainly observed in the ‘whole-sale and retail’, ‘communication’ and ‘fi-nancial services’. Sectors that performed poorly included ‘manufacturing’, ‘mining and quarrying’, ‘hotels and restaurants’ and ‘construction’.
4.1.4 Price Developments

(a) Overall Inflation

The annual headline consumer inflation averaged 4.8 per cent in 2018, down from 6.2 per cent in 2017 as inflationary pressures were on the downside for most part of the year. 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 1.0 per cent in 2018, down from an average of 6.9 per cent the previous year, mainly backed by a significant slowdown in food inflation. The CPI for services, on the other hand, increased to an average of 8.6 per cent in 2018 from 5.8 per cent in 2017. Inflationary pressures on services were mainly observed in the ‘housing and utilities’ category which averaged 12.4 per cent in 2018 compared to 7.0 the previous year, driven by a 15 per cent and 13.5 per cent increase in electricity and water tariffs respectively.
(b) Food and Transport Inflation
Food inflation recorded an overall zero growth in 2018 compared to 8.1 per cent in 2017. Favourable weather conditions resulted in an improvement in food production both locally and regionally, supporting a deceleration in food prices particularly maize, maize products and other products that use maize as an input in their production. Similarly, the improved weather conditions aided an increase in other agricultural production and resulted in slower increases in prices for ‘sugar and sugar products’, ‘vegetables’ and ‘fruits’ over the review period. Food inflation recorded negative growth between April and September 2018 and closed the year below 1 per cent.

In addition to food inflation, slower increases were observed in the price indices for ‘clothing and footwear’, ‘furnishing and household equipment’ and ‘miscellaneous goods and services’. These categories recorded decreases of 6.2, 4.2 and 3.1 percentage points respectively under the review period. Transport inflation on the other hand rose marginally to record 4.0 per cent in 2018 compared to 3.9 per cent in 2017 in line with a modest increase in domestic fuel prices, which cumulatively rose by 40 cents/litre during the course of 2018 (see Figure 10). Additional inflationary pressures were observed in the price indices for ‘education’, ‘health’ and ‘restaurants and hotels’ which rose slightly by 0.3, 0.5 and 0.7 of a percentage points, respectively, in the period under review.

Figure 10: Selected Inflation Components; February 2018 to February 2019

(c) Core Inflation
Core inflation which is CPI excluding food, auto-fuel and energy averaged 6.7 per cent in 2018 compared to 5.5 per cent in 2017 reflecting that underlying inflationary pressures were on the upside in 2018.

4.1.5 Private Sector Credit

(a) Total Private Sector Credit
Annual growth in credit extended to the private sector persisted but at a lower rate of 6.0 per cent at the end of February 2019,
from 11.0 per cent in February 2018 (see Figure 11). The growth in credit extended to the private sector was largely underpinned by the relatively lower borrowing rates during the review period. The increase was recorded in credit to Businesses and Other unclassified sectors while credit to Households declined. Annual credit to the business sector grew by 12.0 per cent in February 2019 compared to 5.0 per cent recorded the previous year. The rise in credit to businesses was mainly discernible in the Manufacturing, Construction, Distribution & Tourism, Transport & Communications and the Mining & Quarrying sectors.

**Figure 11: Private Sector Credit Annual Changes; February 2018 - February 2019**

(b) Household Credit

Year-on-year credit extended to the household sector declined by 2.6 per cent in February 2019, contrary to the growth of 5.8 per cent recorded the previous year (see Figure 12). Within the household sector, the fall was attributed to motor vehicle and housing loans while other personal (unsecured) loans continued to rise. Credit extended for motor vehicles contracted notably by 17.1 per cent in February 2019 after falling by 6.7 per cent the previous year. Credit for housing purposes contracted by 0.4 per cent in February 2019 contrary to growth of 6.5 per cent registered the previous year. Other personal loans grew by 3.6 per cent in February 2019 compared to 15.5 per cent growth recorded the previous year.
Private Sector Credit Outlook
In the short to medium-term, growth in private sector credit is likely to remain positive reinforced by persistent recovery in agricultural production owing to good rains obtained as well as subdued lending rates.

4.1.6 Gross Official Reserves
Year-on-year, gross official reserves declined by 20.3 per cent over the year ended February 2019 to reach E5.6 billion; compared to a high of E7.1 billion in February 2018. The reserves worsened from the 6.2 per cent fall recorded the previous year. The fall in reserves was largely attributed to lower SACU receipts during the 2018/19 fiscal year at E5.8 billion compared to E7.1 billion during the 2017/18 fiscal year. Accordingly, the reserves were enough to cover 2.5 months of imports, lower than 3.4 months recorded the previous year (see Figure 13). At this level, the import cover was below the internationally recommended level of 3 months.
Short to medium-term prospects for a turnaround in the reserves are positive as Government’s cash flow challenges may ease somewhat as SACU receipts for the 2019/2020 fiscal year are estimated to increase slightly. The reserves may also be enhanced by the Bank’s efforts to buy foreign exchange from banks as well as issuing securities in the international market, taking advantage of the country’s credit rating. The Bank will thus continue to monitor developments and offer appropriate advice to Government in order to retain the reserves at levels above the internationally recommended threshold of three months.

4.1.7 Broad Money Supply
Year-on-year broad money supply (M2) grew slightly by 1.9 per cent in February 2019, lower than the 15.4 per cent growth realised the previous year. The growth was largely supported by the growth in credit extended to the private sector. Both narrow and quasi money supply contributed to the increase. Notably, narrow money supply (M1) which is an indicator of depositors’ propensity to spend went up by 2.5 per cent in February 2019 compared to 13.7 per cent recorded the previous year. Quasi money supply, which is an indicator of depositors’ propensity to save for investment purposes, grew by 1.6 per cent compared to that of 16.2 per cent registered the previous year (see Figure 14).
4.1.8 Fiscal Sector
The national budget for 2019/20 was presented by the Minister of Finance on 27 February 2019. The budget was presented in the wake of an unprecedented economic crisis. The economy has stagnated; with negative Foreign Direct Investment (FDI), low growth projections, and intensifying trade tensions. The budget strategy for 2019/20 therefore is focusing on fiscal consolidation, creating fiscal space through enhanced expenditure prioritisation, allocative efficiency and revenue mobilisation. Government has proposed to cut overall expenditure by 10 per cent in an effort to bring government finances back on track.

- **Budget Review**
The overall balance for 2019/20 is projected to stand at minus E3.0 billion, which is equivalent to a deficit of 4.4 per cent to GDP. This depicts a slight improvement from the revised deficit of 5.4 per cent of GDP projected for the end of 2018/19 financial year. The actual budget outturn for 2017/18 reflects a deficit of minus E2.9 billion which translates to 4.6 per cent of GDP (see Figure 15).
Figure 15: Budget Summary; 2017/18 to 2019/20

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Revenue and Grants</th>
<th>Total Expenditure</th>
<th>Net Budget Surplus/Deficit</th>
<th>Net Budget Deficit (% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017/18*</td>
<td>16.7</td>
<td>19.6</td>
<td>-2.9</td>
<td>-4.6</td>
</tr>
<tr>
<td>2018/19~</td>
<td>16.2</td>
<td>19.8</td>
<td>-3.6</td>
<td>-5.4</td>
</tr>
<tr>
<td>2019/20”</td>
<td>18.9</td>
<td>21.8</td>
<td>-3.0</td>
<td>-4.4</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance

Total revenue for 2019/20 is projected to reach E18.9 billion, marking an increase of about 17 per cent. The increase is a result of the proposed revenue policies that are envisaged to be implemented during the 2019/20 fiscal year. These policy measures include amongst others: increase in fuel tax, implementation of Value Added Tax (VAT) on electricity and the increase in the marginal tax rate payable by income earners above E250 000 per annum from 33 per cent to 36 per cent.

Figure 16: Government Major Revenue Components

Source: Ministry of Finance
While SACU receipts remain the largest contributor to government revenues, currently contributing 34 per cent of total revenue, SACU contributions to total revenue is on a downward trend as VAT and Pay-As-You-Earn (PAYE) improve (see Figure 16). The increase in revenue is set to come from improvements in Eswatini Revenue Authority domestic collections and from the implementation of the new revenue measures.

4.1.9 Public Debt
Preliminary figures for the period ending February 2019 indicate that total public debt stood at €16.1 billion; an equivalence of 26.2 per cent of GDP (see Figure 17).

This reflects an increase of 42.5 per cent when compared to the opening position of €11.3 billion for the current fiscal year. The increase in debt was mainly driven by the financing needs of government. As such, domestic debt increased by 60.5 per cent from €6.1 billion to €9.8 billion in the period under review. The different instruments that were issued include; plain vanilla bonds, infrastructure bonds, private placements and suppliers’ bond and Bank advance to the government. On the other hand, external debt increased by about 21 per cent from €5.2 billion to €6.3 billion. This increase takes into account payments made to active loans, drawdowns made on project loans as well as valuation changes.

Figure 17: Total Public Debt: March 2017 to February 2019

- Domestic Debt Market Developments in 2018/19
During the 2018/19 financial year, the Government of Eswatini in collaboration with the Bank continued to issue bonds under the Vanilla and Infrastructure bonds programmes already listed in the Eswatini Stock Exchange (see Figure 18). Private placements, which are of shorter-term compared to the above-mentioned bonds, were also made with various financial institutions under the Suppliers’ bond programme. All these efforts were aimed at assisting government to meet her financial obligations whilst at the same time offering investment avenues for investors and ensuring stability in the financial sector.
A total of E1.05 billion was scheduled to be raised through public auction for the financial year 2018/19 comprising of E600 million of Plain Vanilla bonds and E450 million in Infrastructure bond. E641.38 million in total was raised where E489.56 Million was raised in Plain Vanilla bonds and E151.82 million raised in Infrastructure bonds showing an overall success rate of 61 per cent. In the same financial year, a total of E1.27 billion was raised through private placements in suppliers’ bond programme and an additional E160 million raised through private placements in Plain Vanilla bonds programme taking the total amount raised in the domestic market to be E2.07 billion out of the E1.05 billion planned to be raised through the public auctions. The overall issuance programme of the financial year 2018/19 was a very huge success as the total funds raised were 197 per cent of scheduled amount.

Figure 18: Domestic Debt Market Instruments as at 28 February 2019

Source: Ministry of Finance & Central Bank of Eswatini

4.1.10 External Sector
Preliminary figures for 2018 indicate that the current account surplus continued in 2018, though declining by 39.5 per cent from the surplus of E7.385 billion in 2017 to a surplus of E4.466 billion in 2018. The slowdown in the current account balance was attributed to a deficit posted in the goods account coupled with a narrower surplus recorded in the secondary income account. At this level, the current account surplus was equivalent to 7.2 per cent of GDP from 12.5 per cent in 2017.

The goods account swung from a surplus of E3.058 billion in 2017 to a deficit of E250 million in 2018 mainly on account of stagnating exports when compared to imports, as the growth in imports overshadowed the growth recorded in exports. Export earnings in 2018 amounted to E24.650 billion depicting a marginal increase of 2.9 per cent year-on-year from E23.952 billion in 2017. Major export commodities for 2018 were miscellaneous edibles, sugar and sugar confectionary, wood and wood articles as well textile and textile articles, all accounting for over 80 per cent to the overall export basket for 2018. The import bill on the other hand grew in 2018, amounting to E24.900 billion, up by 19.2 per cent from E20.893 billion in 2017. Major import commodities during 2018 were cereals; energy products;
4.1.11 Exchange Rates Developments

The exchange rate of the Lilangeni/Rand against major currencies depreciated in the year 2018 against all major currencies. The local unit opened the year at an average of E12.20 and it ended the year at an average of E14.20 to the US dollar following policy uncertainty in South Africa around the land policy and the slow pace, and weak political will in tackling corruption. The local unit strengthened in the first quarter of 2018 against major currencies following a positive budget delivered in South Africa after a positive leadership in the ANC by Cyril Ramaphosa. The budget was well received by the markets resulting in a positive assessment by Fitch. The ratings agency, which has rated South Africa at sub-investment grade at BB+ with a stable outlook, issued a positive report on the national budget.

In the second quarter of 2018, the local unit depreciated against the major currencies as south Africa recorded weak economic growth and a wider than expected current account deficit. The trade war that ensued between the US and China extending to some emerging economies, imposing tariffs on steel and aluminium further caused weakening in the local unit. This encouraged capital flight from emerging economies, which was reinforced by a positive growth outlook in developed economies and a tightening of the Federal Reserve Bank interest rates. In the third quarter of 2018, the local unit depreciated further taking pressure from mixed communication by the African National Congress (ANC) on land policy, scaring investors that the constitution will be changed to allow expropriation of land without compensation. Fortunes of the local unit further diminished in the fourth quarter of 2018 taking a knock from political uncertainty in a Brexit deal and a wait and see attitude adopted by investors in South Africa pending the upcoming general elections.

This resulted in the local unit ending the year at E14.39 to the US dollar, E18.24 to the Pound Sterling and E16.4387 to the

commodities combined constituted for more than 60 per cent of the import bill for the year 2018.
Euro after opening the year at E11.94 to the US dollar, E16.94 to the Pound Sterling and E14.85 to Euro.

The local unit is expected to depreciate in 2019 following the outcome of the pensive mood around the general elections in South Africa and the division in the ruling party in South Africa, which may dampen the political will to fight corruption.

**Figure 20: Average Exchange Rates; March 2018 to March 2019**

<table>
<thead>
<tr>
<th>Month</th>
<th>USD</th>
<th>GBP</th>
<th>Euro</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar-18</td>
<td>11.84</td>
<td>16.53</td>
<td>14.60</td>
</tr>
<tr>
<td>Apr-18</td>
<td>12.11</td>
<td>17.05</td>
<td>14.86</td>
</tr>
<tr>
<td>May-18</td>
<td>12.54</td>
<td>16.89</td>
<td>14.82</td>
</tr>
<tr>
<td>Jun-18</td>
<td>13.30</td>
<td>17.67</td>
<td>15.53</td>
</tr>
<tr>
<td>Jul-18</td>
<td>13.41</td>
<td>17.67</td>
<td>15.67</td>
</tr>
<tr>
<td>Aug-18</td>
<td>14.06</td>
<td>18.12</td>
<td>16.24</td>
</tr>
<tr>
<td>Sep-18</td>
<td>14.79</td>
<td>19.31</td>
<td>17.24</td>
</tr>
<tr>
<td>Oct-18</td>
<td>14.41</td>
<td>18.21</td>
<td>16.65</td>
</tr>
<tr>
<td>Nov-18</td>
<td>14.09</td>
<td>17.99</td>
<td>16.03</td>
</tr>
<tr>
<td>Dec-18</td>
<td>14.20</td>
<td>17.87</td>
<td>16.16</td>
</tr>
<tr>
<td>Jan-19</td>
<td>13.87</td>
<td>17.94</td>
<td>15.84</td>
</tr>
<tr>
<td>Feb-19</td>
<td>13.80</td>
<td>18.94</td>
<td>15.65</td>
</tr>
<tr>
<td>Mar-19</td>
<td>14.37</td>
<td>18.94</td>
<td>16.24</td>
</tr>
</tbody>
</table>

Source: Central Bank of Eswatini

**4.1.12 Inflation Outlook and Monetary Policy Stance**

**(a) Inflation Outlook**

Monetary policy is expected to remain broadly accommodative in the next few months. There is uncertainty in the short to medium-term with inflation forecasts showing upward pressures. The inflation forecasts are influenced by upside risks posed by a weaker exchange rate, broad price pressures coming from proposed implementation of VAT on electricity, increases in sin taxes and increases in administered prices. On the international front, oil prices are expected to moderate with the US increasing its oil supply in an effort to counter OPEC’s decision to restrict oil supply thus posing a downside risk to inflation. The inflation outcome is therefore expected to average 5.41 per cent in 2019 up from an average of 4.8 per cent recorded in 2018. In the medium-term, inflation is expected to further increase slightly to 5.99 per cent in 2020 as upward pressures in inflation continue to dominate.
(b) Monetary Policy stance
The Bank will remain prudent and vigilant in its monetary policy stance. The Bank will continue to anchor inflation by protecting the Lilangeni’s parity with the South African Rand by keeping the appropriate levels of international reserves cognisant of the fiscal challenges faced by the country. The Bank will continue to adjust its discount rate and other monetary policy instruments in line with its mission of fostering price and financial stability that is conducive to the economic development in Eswatini.

In the short to medium-term, monetary policy is envisaged to remain stable before embarking on a mild tightening stance to curb mounting inflationary pressures. The inflationary pressures may arise domestically from increases in administered prices of some utilities and externally from recovery in global oil prices as well as the vulnerable Rand/Lilangeni exchange rate. The Bank will thus monitor such developments and respond appropriately in order to maintain price stability supportive to economic growth.

5.0 REGULATORY POLICIES
FOSTERING FINANCIAL STABILITY

5.1 The Financial Sector Development Implementation Plan (FSDIP)
During 2018, the tripartite of the Ministry of Finance (MoF), the Central Bank of Eswatini (Bank) and the Financial Services Regulatory Authority (FSRA) continued to collaborate in the implementation of the Financial Sector Development Implementation Plan (FSDIP), with private sector involvement. The World Bank and the Financial Sector Reform and Strengthening Initiative (FIRST) continued supporting the FSDIP implementation over the year. All the governance structures of the FSDIP were fully operational during the year with working groups delivering on the technical issues whilst the Technical Committee provided guidance to the working groups and the FSDIP Council providing strategic direction to the FSDIP implementation.

As at October 2018, 10 out of the total of 51 recommended policy actions in FSDIP had been achieved. During 2019, World
Bank consultants’ missions are scheduled to deliver on some recommended policy actions with funding from the World Bank to support FSDIP implementation. It is anticipated that the World Bank consultancy work will ensure that best international practices are incorporated in FSDIP implementation. The law reform support, provided by the International Monetary Fund (IMF) to FSRA and Bank during 2018 made a huge impact in updating and harmonizing the financial sector laws, which is a major recommendation in FSDIP. The Bank as a secretariat continued to coordinate the activities of FSDIP. In this regard, over 30 meetings of the FSDIP working groups were held during 2018.

Considering the significance of law reform across the FSDIP, a FSDIP Legal Committee has been established and approved by Council. Its main function is to update and harmonise financial sector laws, regulations and policies. The Legal Committee comprises legal officers from MoF, Bank, FSRA and the Attorney General’s office. The Legal Committee has held 5 meetings in 2018 and one retreat in the first quarter of 2019.

5.2 Bank Supervision
The Bank is at the apex of the financial system in the kingdom of Eswatini and has a vested obligation of promoting the safety and soundness of the domestic banking system, which will translate into financial stability and further have a positive impact in the real economy. This constitutionally enshrined mandate is achieved through a rigorous regulatory framework, which is a precursor for sound risk management systems in the banks we supervise.

On-going surveillance of the domestic banking system is equally important in the Bank’s pursuit to foster financial sector stability as it provides financial soundness indicators that serve as early warning signs in the detection of vulnerabilities in the banking sector. Therefore, the health of the banking system is an integral ingredient in stimulating economic growth and development in the country.

5.2.1 Banking Sector Performance
The sector continues to be predominantly dominated by foreign subsidiaries of South African banks. The banking sector’s total assets amassed E20.4 billion in the fourth quarter of 2018 from E20.3 billion reported in September 2018, depicting a slight 0.72 per cent increase. On the other hand, gross loans and advances decreased to E10.98 billion over the course of the reporting period against E11.19 billion recorded in the preceding quarter. Total banking sector deposits totalled E16 billion, from E15.7 billion reported in the third quarter of 2018. The industry remained profitable with after-tax-profits recorded at E353 million at the end of 2018. The banking system was adequately capitalised with an industry Capital Adequacy Ratio (CAR) of 20 per cent, however it is threatened by deteriorating asset quality as evidenced by an increase in Non-performing loans (NPL) ratio. NPL ratio worsened to 9.3 per cent in December 2018 from 8.1 per cent recorded in September 2018.

5.2.2 Developments during the year
(a) Basel II implementation
In line with the Basel II implementation blueprint, the Bank went live on 1st April 2018, with the first Basel II Pillar 1 compliant returns submitted in the second quarter of 2018. Full and final implementation of Pillar 1 is subject to publication of the Legal Notice on the “computation of minimum capital requirements” in the government gazette. Basel II implementation is a success story for the Bank and is in train; with the next phase focusing on Pillar 2 (Supervisory Review and Evaluation Process) and Pillar
(b) Licensing of Farmers Bank (Pty) Ltd
The year 2018, saw the Bank issuing a banking license to a new entrant namely; Farmers Bank (Pty) Ltd., which is a 100 per cent foreign owned entity and is yet to commence operations.

(c) Legal Notice on Moratorium on bank tariffs
In consideration of the prevailing economic situation in the Kingdom of Eswatini, and in response thereto, the Bank, in exercise of its powers bestowed upon it by Section 41 of the CBS Order of 1974, deemed it necessary to impose a banking tariffs increase moratorium applicable to all banks and the building society for a period not exceeding eighteen (18) months, effective 1st April 2019 pending publication in the Government Gazette.

5.3 National Payments Systems
Eswatini, payment & settlement systems continue to be a key component of the financial system. Any disruption to the payment & settlement systems would have adverse consequences for the country’s economy. In that regard, the Bank continues to promote and regulate payment and settlement systems to support financial stability in the financial sector through its oversight function.

The Bank also continues to support and implement measures aimed at modernising the payment & settlement systems. The Eswatini National Financial Inclusion Strategy for 2017-2022 makes a commitment to grow the percentage of adults with access to formal financial products from 43 per cent to 75 per cent by amongst other things growing mobile money and remittances and deepening reach in financial services.

The Bank supports this target through various support to institutions that provide these services in ensuring that they deliver quality and affordable services to the people of Eswatini. In the past year, the Bank licenced a second mobile money service provider and approved a cross-border remittance product offering by one of the mobile network operators.

The Bank is alive to the risks posed by new products and emerging technological trends in digital financial services and seeks to achieve a balance in permitting new products and entrants into the market whilst simultaneously ensuring that financial integrity is maintained and innovation is not unnecessarily stifled.

The Bank through its FinTech Unit recently launched a Regulatory Sandbox which is an environment set up to allow Financial Technology (FinTech) start-ups and other innovators to conduct live experiments in a controlled environment under appropriate supervision. This platform will allow for better understanding of domestic and global innovation trends and the potential impact in our economy and how regulation can better catch up with technological advancement.

The Bank continues to coordinate reforms in the payment systems legal framework, which is primarily aimed at mitigating operational risks. Specifically, the Bank successfully finalised the review of the Practice Note for Mobile Money Service Providers. A review of the National Clearing and Settlement Systems Act, 2011 is an ongoing initiative.

The Bank has in addition lined up a review of the five (5)-year NPS Vision and Strategy
Framework to guide developments in the national payment systems space which would take into account innovation and emerging products and services.

5.4 Financial Technology (FinTech) Developments

The bank has reinforced efforts to exploit the increased retail supply and affordability, of technology that impacts the financial ecosystem. The bank endeavors to support and accelerate the adoption of technology in the financial system. In order to maximize the potential of technology to improve national financial and monetary agendas whilst maintaining the stability and integrity of the financial system amidst the influx of hybrid financial services models.

5.4.1 Eswatini FinTech Landscape

The Bank monitors domestic and global FinTech developments to better position the bank, to regulate multifaceted financial intermediaries and technology-driven disintermediation, and their respective roles in the implementation of monetary policy. The bank identified the local institutions that lead and impact the application of technology in financial services, that is, the Eswatini FinTech Landscape. The wholesale and retail side of Eswatini FinTech is dominated by commercial banks that use a combination of software, internet, mobile and hardware technology to provide access channels, financial products and complement banking services.

Consistent with global trends, Telecommunication Companies leverage their technology and customer and agent network to offer financial services in Eswatini. There are two telecommunications service providers that offer mobile money services. The Bank is currently reviewing two applications to offer digitized loans through mobile money, with the two mobile money service providers collaborating with credit institutions to provide short-term loans to their customers.

The bank licensed another non-financial services company, a retail company, to provide cross-border remittances over the period under review. Small and new (start-ups) companies are leveraging new technologies to offer micro-credit products in the sector. These non-traditional financial services providers are regulated through collaboration of respective national regulators, to ensure that the country takes advantage of innovation, in pursuit of a modernized financial sector that better serves real economy.

5.4.2 Global Regulatory Developments

Globally, regulators are revising their supervisory approach to the financial sector. Most regulators are opting for a collaborative approach, adopting collaborative frameworks between regulators themselves, both in-country and internationally, and their existing and potential licensees. The Financial Conduct Authority (FCA) in the UK, has mobilized and formed a Global Financial Innovation Network (GFIN) of regulators for collaborative regulatory learning and knowledge sharing. In South Africa, the Financial Intelligence Centre (FIC), the Financial Sector Conduct Authority, the National Treasury, the South African Revenue Service (SARS) and the South African Reserve Bank (SARB) have formed an Intergovernmental Fintech Working Group (IFWG) to meet the growing interest in financial technology, innovation and crypto-assets and develop a common regulatory framework for FinTech. Many regulators have introduced regulatory sandboxes and innovation hubs in their jurisdictions. This approach encourages and promotes an ecosystem of innovation and regulators to adopt FinTech friendly policies.
5.4.3 FinTech Strategy
The Bank has prepared a FinTech strategy, with the guidance of the IMF-World Bank Bali FinTech agenda, as presented to the Commonwealth Central Bank Governors (CCBG) in October 2018. The strategy provides a roadmap for sustainable improved access and provision of financial services, through policy and infrastructure to meet the demands of the rapidly changing financial system. The strategy is currently under a bank-wide review by departments, to ensure institution-wide contribution to the collaborative approach of fintech regulation that the sector demands.

5.4.4 Regulatory Sandbox
The CBE Regulatory Sandbox launched in March 2019 will, with the guidance of the Bank’s Innovation Committee, serve as a central point of coordinating live market testing of the impacts of non-traditional financial services business and products. This platform will facilitate the collaboration of regulators and licensees to test the adequacy of the existing legislation and contribute towards new legislative reforms and regulatory frameworks. The Sandbox will equip both regulators and licensees with vital experience in identifying inherent risks and necessary safeguards, to ensure that local financial soundness indicators improve as financial services become increasingly digital and innovative.

5.4.5 Global Financial Innovation Network
The Bank is a member of the Global Financial Innovation Network (GFIN), a network launched in January 2019 by an international group of financial regulators and related organization. GFIN is a network of 27 organizations committed to supporting financial innovation in the interest of consumers. The GFIN seeks to provide a more efficient way for innovative firms to interact with regulators, helping them navigate between countries as they look to scale new ideas. The Bank aims to be part of GFIN’s effort to create a new framework for co-operation between financial services regulators on innovation related topics, sharing different experiences and approaches.

5.4.6 FinTech Challenge
In August 2018, the Bank in partnership with the Financial Services Regulatory Authority (FSRA), Eswatini Communications Commission (ESCCOM) and Royal Science and Technology Park (RSTP) launched a CBE FinTech Challenge. The challenge aimed to obtaining input for regulatory and policy reform to meet the demands of a FinTech environment, to monitor the advancement of local start-ups and to catalyze the development of local start-ups. Through the FinTech Challenge, the bank and partners identified gaps in the local FinTech start-ups ecosystem, ranging from lack of problem-solving skills and understanding of prevalent product risks, to poor awareness of regulation relevant to new financial products.

The Bank, with the initial support of the Center for financial regulation and inclusion (Cenfri), has planned to initiate a national central bank digital currency (CBDC) diagnostic. This proposed project will serve to inform policy makers about the potential of emerging distributed ledger remittance technologies for the Eswatini economy, both at a wholesale and retail banking perspective.

The bank continues to monitor the scale of digital financial services in the country, to assess and mitigate emerging risks on an on-going basis and foster the use of technology to achieve a modern and inclusive financial sector.
5.5 Exchange Controls
The Bank continued to strengthen efforts to uphold the integrity of the financial sector thereby promoting the stability of the financial system. Following technical assistance received from the IMF, the Bank has developed an anti-money laundering and counter financing of terrorism risk-based supervisory framework. This framework will assist the Bank in identifying and understanding the money laundering and financing of terrorism risks in the financial sector as well as individual financial institutions. Once the risks are understood, the Bank will be in a position to evaluate the adequacy and effectiveness of controls implemented by the financial institutions in mitigating the risks in compliance with the Money Laundering and Financing of Terrorism (Prevention) Act, 2011 (as amended) and international standards.

The Eastern and Southern African Anti-Money Laundering Group has scheduled a Mutual Evaluation Assessment for the country in 2020 to evaluate the country’s compliance with international standard on anti-money laundering and counter terrorist financing. The Bank has joined hands with national stakeholders to ensure preparedness of the country for the evaluation exercise by participating in a mock Mutual Evaluation that was hosted by the Ministry of Finance. The Bank will improve its controls by addressing the gaps that have been identified during the mock mutual evaluation. This will ensure that a robust supervisory framework is in place to maintain the integrity of the financial system.

5.6 Operations
5.6.1 Issuing and Redeeming of Currency
During the period ended 28th February 2019, notes issued amounted to E5.4 billion compared to E6 billion issued in the same period the previous year, whilst coins issued over the period to February 2019 amounted to E23.4 million, indicating a decrease from prior year’s E25.7 million. Currency in circulation was E1.017 billion as at the end of February 2019.

The Bank has an ongoing project whose main objective is to move from a strict exchange control regime - which requires economic agents to seek prior approval for exchange control classified transactions - to a regime of financial surveillance - which emphasises increased liberalisation and enhanced monitoring. This shift entails empowering local Authorised Dealers (banks and bureaus) to authorise foreign exchange transactions on behalf of their customers without the need to obtain prior Central Bank approval.

The mandate of the bank, however, remains unchanged, but is underpinned by the collection, analysis and dissemination of cross-border foreign exchange flows. To enable the initiative to be successful, two relaxations were introduced: Firstly, individual investors can now invest a maximum of E4 million per annum, and Secondly, the facilities for foreign investment by institutional investors will be increased by 5% across all facilities.

5.6.2 New Notes
The release of the new E200 and E100 in April 2018 with enhanced security features was a success and well received by the public. These two denominations are also of hybrid substrate and co-circulate with the old series.

All our new banknotes and coins going forward will show the effect of the country’s name change from Swaziland to Eswatini including the name change of the Bank from Central Bank of Swaziland to Central Bank of Eswatini.
5.6.3 Commemorative Coins
In commemorating the country’s 50th Independence Anniversary and His Majesty the King’s 50th Birthday, a 50/50 commemorative coin was released into circulation in April 2018. The 14 year old designer of the coin, Mlandvo Motsa of Mhlatane High School, was honoured by the Bank at a press conference held in April 2018.

5.6.4 Coin Management Efficiencies
The Bank is continuing in exploring strategies of improving coin re-circulation. It has been noted that there is a tendency to hoard coins and the public is encouraged to use these so that they continue to circulate and particularly the low denomination coins.

5.6.5 Dye Stained Notes
During the period under review, the dye stained guidelines issued by the Bank have since been operationalised. These are aimed at mitigating the risk of ATM bombings and/or cross-pavement carriers through dye staining of banknotes via Currency Protection Devices (CPDs). The public is warned not to accept any stained banknotes as these may be the proceeds of crime, instead efforts should be made to report such to the nearest police station. The Bank or any other financial institution may not exchange or give value for dye-stained banknotes in circulation that land in their hands, as there is a presumption that such notes are the proceeds of crime.

5.7 Financial Sector Stability
In 2018, the Financial Stability Unit (FSU) published the second edition of the Annual Financial Stability Report (FSR) and presented it to stakeholders and media through a media briefing. 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. After the first publication, risks to financial stability stemming from the external economy, domestic economy and corporate sectors increased somewhat. Challenging domestic conditions and external spillovers continued to contribute to lethargic economic outlook in the short to medium-term. On the other hand, risks from the banking sector subsided, while risks emanating from payment systems, non-banking sector and household debt remained constant.

5.7.1 Crisis Preparedness and Management
With the assistance of the Toronto Centre, the Bank conducted a workshop on crisis preparedness and management. The workshop was attended by participants from the Ministry of Finance, Financial Services Regulatory Authority (FSRA) and the Bank. Crisis preparedness through contingency planning helps minimise the cost of a crisis to taxpayers and to society. Emphasis was on developing a crisis binder to ensure preparedness. The crisis binder outlines and clarifies specific roles, responsibilities and accountabilities of stakeholders in the eventuality of financial crises. Finalising a crisis binder, developing a Crisis Management framework, developing a Deposit Insurance framework, reviewing the adequacy of legal powers and developing a resolution framework are activities that are yet to be undertaken for a developed financial stability framework.

5.7.2 Financial Inclusion
In January 2018, the Ministry of Finance launched the country’s National Financial Inclusion Strategy (NFIS). The strategy, which covers the period from 2017 to 2022, intends to remove constraints that are currently preventing certain groups of the Eswatini population from accessing and using financial products and services. The Ministry acknowledged the effective role
and commitment of the Bank, FSRA, the financial sector, as well as the Micro Finance Unit (MFU) in coordinating and leading the process to formulate this Strategy Document. The National strategy seeks to have achieved the following objectives by 2022:

“Increase the depth of financial inclusion by growing the percentage of adults with access to two or more formal products from 43 per cent to 75 per cent, to reduce the financial excluded from 27 per cent to 15 per cent by growing mobile money and remittances, deepening bank reach, getting credit basics right, ensuring risk management products are available, and enabling alternative channels to serve the poor.”

In addition to the National Financial Strategy, the Ministry of Finance formerly launched the Centre for Financial Inclusion (CFI), formerly known as the Micro Finance Unit (MFU). The CFI’s objective is to bridge the gap between the regulators, financial services providers, the MSMEs and the consumers through facilitating access to relevant financial and business information to improve inclusive growth. To ensure the effective implementation of the NFIS and monitor the impact of financial inclusion on poverty alleviation, the CFI will coordinate with all the key actors within the financial inclusion space to enhance reach to financial services for the key segments of the Swazi population.

Great progress has been observed in the financial inclusion space in Eswatini, which includes the uptick in the usage of mobile money services. MTN Mobile Money’s total number of active customers increased from 46,036 in December 2011 to 513,287 as at December 2017, transacting over E5.9 million per month. The latest assessment indicates that Eswatini has made commendable strides in improving financial inclusion. The number of financially included individuals has increased from 414,000 in 2014 to 553,000 in 2018. The proportion of the excluded adult population has declined from 27 per cent in 2014 to 13 per cent in 2018. The proportion of the formally served went up to 85 per cent in 2018 from 65 per cent in 2014.

Eswatini Mobile became an official Mobile Money services provider, which further accelerated Mobile Money usage. Additional services added to the existing Mobile Money platforms included the MTN MOMO Pay, which was a product of MTN’s partnership with retailers and restaurants. This product works like a debit card, and allows you to tap at point of sale machines. All you need to do is punch in your PIN to authorise a transaction. Another exciting service that was introduced to Mobile Money users was an allowance for parents to pay school fees for selected schools in the comfort of their homes or work places. The Eswatini Bank and Eswatini Building Society have also collaborated with MTN Mobile Money to make an allowance for Mobile Money users to use their Automated Teller Machines (ATMs) to make withdrawals at any time. The Non-Banks have also actively participated in financial inclusion initiatives. This was seen through the partnership of Old Mutual Insurance with MTN to bring Mobile Money users a product called Likhandlela Insurance, which is a funeral assistance payout to help with preparations towards the funeral of only the policyholder (MTN Mobile Money customer who has passed away).

Financial inclusion is an international policy priority and demand-side initiatives including financial education have an important role to play in helping individuals to access and use appropriate, formal financial products. The Bank acknowledges the importance of improved and increased financial inclusion, consumer protection and financial education for financial stability.
and inclusive development. To this end, the Bank, through the Financial Stability Unit hosted a Financial Education Framework Workshop in October 2018. Representatives from the banking and non-banking industry, the FSRA, the Ministry of Education as well as the National Curriculum Centre attended this workshop. The purpose of the workshop was to provide the participants with an overview of financial literacy and education, focusing on its importance and how best to go about designing, developing and implementing financial literacy programmes. The value of Public Private Partnerships on financial literacy was discussed in great depth to make the different stakeholders aware of the roles and responsibilities they can play in furthering the financial literacy objective. Emphasis was placed on the approach to take to reach marginalised groups with financial education as well as coming up with ideas for digital strategies that can best suit the Eswatini landscape. The positive response and active participation in this workshop by all the stakeholders gave hope that future initiatives in the Financial Education space would be fully supported and the required commitment from the relevant stakeholders would be shown.

6.0 CONCLUSION

The annual consumer headline inflation was stable in 2018 averaging 4.8 per cent, down from 6.2 per cent in 2017 as inflationary pressures were on the downside for most part of the year. Accordingly, the Bank reduced the discount rate by 25 basis points in March 2018. Inflation is forecasted to continue being stable in 2019 with an average of 5.41 per cent.

Real GDP is estimated to have expanded by 0.6 per cent in 2018 in the wake of weakening fiscal and external positions. The economic outlook indicates modest growth with average of below 2 per cent in the short to medium-term. The ongoing government’s cash flow challenges continue to pose downside risks to the country’s economic growth prospects. This is further augmented by the weak global and regional economic environment. The government cash flow challenges continue to be a concern for monetary policy.

The current reserve position is not acceptable to the Central Bank of Eswatini. Efforts are underway to ensure that the acceptable level of reserves is restored. The Bank relies on the Government to build on the work of the Central Bank of Eswatini in accumulating reserves above the SADC Macroeconomic Convergence target of 6 months of import cover in the medium term.

The banking sector remains sound, sustainable and meet all statutory requirements. The risks to this stem from deteriorating asset quality as NPLs rise. The minister’s plans to urgently settle domestic arrears is supported and will go a long way in reversing this trend.

The Bank will continue to monitor 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.
REFERENCES


