CENTRAL BANK OF SWAZILAND

UMNTSHOLI WEMASWATI

2013

GOVERNOR'S ANNUAL MONETARY POLICY STATEMENT

"SUPPORTING SUSTAINABLE ECONOMIC GROWTH IN SWAZILAND"

- Reserves
- Inflation
- Interest Rates
- Capital Markets
- Bank Supervision
- Exchange Control
- National Payment Systems

Presented by:
The Governor of the Central Bank of Swaziland
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on the 4th April 2013

MONETARY POLICY STATEMENT – 2013

1.0 INTRODUCTION

Global economic conditions remained subdued and uneven in 2012. The Eurozone and Japan fell into a recession with the US growing at a moderate pace, showing improvements in the employment and housing sector. However, fears around the outcome of the looming 'fiscal cliff' in the United States and the slow pace of job creation continued to undermine both consumer and business confidence. Eurozone data has been a little poorer than expected and it's clear that the economy remains in a deep recession coming into 2013. China and most emerging markets experienced slower growth as exports came under pressure due to weaker global growth. However, world imports have risen 22.3 percent between January 2006 and November 2012, which has been driven by emerging economies imports up 56 percent in the period. By contrast, advanced economies' imports are only 0.8 percent higher since 2006.

The sluggish pace of economic recovery prompted key central banks to pursue further monetary easing policies in 2012, expanding their quantitative easing programmes and lowering policy interest rates. These moves were meant to stimulate the much needed growth.

The International Monetary Fund's (IMF) 23rd January 2013 World Economic Outlook (WEO) indicates that the global economy will expand by 3.5 percent in 2013 and 4.1 percent in 2014 from 3.2 percent in 2012. Growth will strengthen gradually in 2013 supported by positive economic developments in the USA and upbeat performance in emerging and developing economies. The US GDP growth has been revised to 2.0 percent (from 2.1 percent in October 2012) in 2013, while the forecast for 2014 was upgraded to 3.0 percent from 2.9 percent. The Eurozone economy, which fell by an estimated 0.4 percent in 2012, is projected to contract by 0.2 percent in 2013 before expanding by 1.0 percent in 2014. The IMF is of the view that emerging and developing economies, along with the US, are expected to be the main sources of world growth in 2013.

In 2012, US real GDP grew 2.2 percent after the 1.8 percent rise in 2011. The economy fell by 0.1 percent q/q in 2012/Q4 after a 3.1 percent q/q growth in 2012/Q3, posting the first contraction since the 2007/09 recession as worries over the US "fiscal cliff" led to a plunge in government spending, with defence spending posting the largest decline since 1972. Also having a negative impact on GDP was the trade deficit, which widened as exports were limited due to the EU recession. Business investment rebounded and homebuilding growth made a positive contribution to GDP for the first time since 2005. However, the overall fall in GDP was limited as consumer spending (accounts for nearly 70 percent of total US GDP) accelerated 2.2 percent in Q4 from 1.6 percent q/q in Q3.

Despite continued job growth in 2012, with records showing 1.84 million jobs created, the unemployment rate remained elevated at 7.8 percent in December. The Fed has pledged continued monetary stimulus as long as unemployment remains above 6.5 percent, backing expectations for the fed funds rate to remain low for 2013.

The European economy is expected to continue to contract in 2013, albeit at a slower pace than in 2012, while sovereign debt problems persist in the peripheral. Demand remained subdued amid the regional recession with record high unemployment (11.8 percent in November) but a higher regional trade surplus, led by Germany and Italy, making a positive contribution to Euro Zone GDP in the last quarter of 2012.

Developments in the sovereign debt crises in Spain, Italy, Portugal and Greece will be key driving forces for the euro going forward. Italy and Spain (Europe's 3rd and 4th largest economies) remain deep in recession, maintaining a weak outlook for the Euro Zone, possibly leading the European Central Bank (ECB) to consider further monetary policy easing. The ECB has however indicated little will to cut interest rates in the short term suggesting stimulus will only come from government bond purchases if its programme is triggered by one of the countries' applying for a bailout.

The ECB has projected economic weakness to continue in 2013 in the Euro Zone, with gradual recovery later in the year. Financial market confidence has also improved significantly since the announcement of the bond buying programme at the September policy meeting. Inflation is expected to fall to approximately 1.4 percent in 2014, below the ECB's 2 percent target level.

Most emerging markets experienced slower growth in 2012 as exports came under pressure due to weaker global growth. In China, officials expect the country's trade performance to improve in 2013 from 2012. China wants domestic consumption to replace exports and investment as the key driver of GDP, which may lead the People's Bank of China to consider further monetary policy easing in 2013.

In many emerging and developing economies, output is already above pre-crisis trends, suggesting that recovery is complete and expansion under way. But this brighter outlook is balanced by fears of possible asset bubbles produced by the flood of investment capital into the region.

Sub-Saharan African economies recorded slightly lower growth in 2012 on the back of weaker external demand, particularly for commodities as China lost some momentum, while lower agricultural output due to dry conditions in some countries also contributed.

The region's biggest economy South Africa has had its GDP forecast downwardly revised downwards to 2.8 percent for 2013 from 3.0 percent in October by the IMF, but upwardly revised to 4.1 percent from 3.8 percent for 2014. South Africa has also suffered increased negative sentiment as indicated by the recent sovereign rating downgrades, suggesting that it will be more challenging to attract foreign capital to finance the current account deficit. The Reserve Bank of South Africa has therefore revised lower its growth forecast for 2013 with a view that the growth outlook has dimmed further in the short term due to both domestic and global factors.

In Swaziland, GDP is estimated to have grown by a meagre 0.2 percent in 2012 compared to a revised estimate of 0.7 percent in 2011. Sectorial analysis indicates that the primary and the secondary sectors are estimated to have recorded lacklustre performance whilst the tertiary sector recorded an insignificant positive growth rate. Within the primary sector: maize, citrus and livestock production are projected to have decreased whilst the forestry and 'mining and quarry' sub-sectors reflected positive growth. The mining and quarry sub-sector was buoyed by increases in coal and quarry production; whilst iron-ore mining activity at Ngwenya lost momentum in the third quarter of 2012.

The economic outlook for Swaziland is not optimistic, although the country's economic activity is expected to record a slight recovery in 2013, in tandem with expected subdued global and regional economic outlook. There are mixed signs about the recovery as some economic fundamentals do not point to sustained growth. Internally, the country's fiscal crisis, which has adversely affected the tertiary sector, remains unresolved despite the E7.1 billion SACU revenue for the 2012/13 financial year. There will be a need for government to take policy decisions that will reduce the country's dependency on customs revenue, reign-in public expenditure and enforce fiscal discipline. In addition, focus will have to be on long term public investment which will entail government investing in infrastructure that will enhance employment creation and sustainable economic growth. In terms of sectorial growth, agriculture followed by manufacturing should be the prime targets for growth in the coming years.

Swaziland's reserves recorded a substantial recovery in 2012 attributed to the improvement in government's revenue from customs union pool. Also contributing to the upturn were revaluation gains from the depreciation of the exchange rate against major trading currencies. In terms of import cover, foreign exchange reserves have gradually increased to record the highest level of 3 months of imports in October 2012.

Consumer inflation, a measure of the consumers' purchasing power, was relatively high in 2012 averaging 8.9 percent from a low of 6.1 percent recorded the previous year. The high inflation is attributable to the once-off effect of the VAT, introduced in April 2012, and other external factors such as high international food and oil prices, and the weak exchange rate against major currencies. Although latest data indicate that inflation is on a downward trajectory this is seen as a temporary phenomenon due to the expected higher food inflation driven by the impact of the weaker rand and generally elevated international prices of oil.

The Central Bank continued with its endeavour to contribute towards economic growth and supported government policy towards this goal. However, despite the Central Bank maintaining an accommodative monetary policy stance throughout the year 2012, credit extended to the private sector, particularly to the business sector, remained subdued in 2012. Over the year credit extended to the business sector decelerated from a double digit growth of 36.7 percent in 2011 to a negative 3.7 percent at the end of 2012. The decline in demand for credit designated for investment purpose, despite the low interest rates environment, is a major concern to the Central Bank because such credit is an integral part to economic growth. This decline was discernible in the agriculture, manufacturing and construction sectors.

Swaziland's overall balance of payments position improved significantly during 2012, recording a surplus of E459.7 million in the third quarter compared to the deficit of E86.1 million recorded in the third quarter of 2011. This was underpinned by the improvements in the trade and current account which posted surpluses largely due to an increase in merchandise export earnings against a slow rate of growth in imports, and a surge in current transfers which mainly comprise SACU receipts. The country continued with its endeavour to attract foreign direct investment (FDI) with the country recording a net inflow of E38.4 million in the third quarter of 2012 against an inflow of E358.1 million in September 2011. Reinvested earnings continued to be the major contributor to FDI in 2012, whilst new FDI inflows remained low.

The Monetary Policy Consultative Committee (MPCC), which meets bi-monthly, presided over economic issues during 2012 which were punctuated by international slowdown in demand for developing countries' exports and consequently low economic growth. The MPCC recommended a 50 basis points reduction in the discount rate to 5 percent in July 2012. Subsequently, the discount rate has been maintained at that lower level, a decision prompted by the desire to redirect credit extension from the financial sector to the private sector particularly for investment purposes, creating employment and promoting economic growth.

The MPCC also discussed other issues related to the fiscus in order to advise the Minister of Finance accordingly and therefore synchronizing the monetary policy decisions with fiscal policy. The highlights of discussions and decisions undertaken during these meetings are set out as follows:-

Government Cash Flow Management: The MPCC commended the good work done by the cash flow committee consisting of Government and Central Bank staff. During the year 2012 the MPCC observed that the cash flow committee has managed to help government address contributions due to Public Sector Pension Fund (PSPF).

However, the MPCC remained concerned about the government cash flow position which remained constrained notwithstanding the SACU windfall receipts of E7.1 billion. The precarious financial position of government is underpinned by the persistence increase in expenditure in line with increasing ministries' commitments. The MPCC stressed on the need for parliament to expedite the passing of the Public Expenditure Management Bill, which seek to assist the Ministry of Finance to control Government expenditure by introducing fiscal rules in the budget implementation process.

The escalating expenditure by Government which despite the SACU windfall resulted in Government depleting the country's reserves. As a result of this development the MPCC observed that Government should to pursue fiscal discipline by controlling unproductive expenditure whilst diversifying on revenue collection to sustainable level, rather than resort to drawing down on its balances with the Central Bank.

Further to its quest to assist Government raise funds domestically, the Central Bank submitted a paper for consideration by the Ministry of Finance focusing on the Government Bond Issuance Program to finance major capital projects. In addition the paper recommends issuance of a suppliers bond to clear the domestic arrears that have been not budgeted for in 2012/13.

It is anticipated that the momentum on the issuance program will be maintained by systematically issuing smaller amounts for longer duration, thereby restoring confidence of institutional investors.

RECENT ECONOMIC DEVELOPMENTS

Macro Indicators

GDP Developments

Preliminary estimates reflect that real output growth dipped further to 0.2 percent in 2012 after recording 0.7 percent in 2011 and 1.9 percent in 2010. As a small open economy, Swaziland suffered from the general slowdown in global economic activity in 2012. The Eurozone crises affected the country in two ways: first directly through Swaziland's trade links with the EU and secondly indirectly through South Africa's trade links with the EU. The poor performance in the EU and South African markets, which collectively consumes about 70 percent of Swaziland's exports, translated to a slower performance in the domestic economy. From the domestic front, the economy endured the second round effects of the fiscal crisis which was evident not only in the government sector but also in other sectors which are directly and indirectly linked with the government sector. These included inter alia; commerce, construction and financial intermediaries.

Developments in the primary sector were mixed. The agriculture subsector recorded an overall decline of 1.3 percent in 2012 after expanding by 8.5 percent in the previous year. Significant decreases were noted in maize, citrus and livestock production. Sugarcane production continued to benefit from the completion of the LUSIP and KDDP projects. Cane production, however, increased by a slower rate of 6 percent in 2012 compared to 12 percent in 2011. On the other hand, the forestry sector portrayed signs of recovery from the prolonged negative effects of the 2008 forest fires. The mining and quarry subsector output doubled buoyed by a significant rebound in coal and quarried stone production which rose by 27 and 49 percent, respectively. This subsector was further boosted by the re-opening of the

Ngwenya iron ore mine which started operating in the last quarter of 2011. The mine intensified its operations during the course of 2012.

The secondary sector contracted by a slower rate of 0.7 percent in 2012 compared to a 2.1 percent decline in 2011, mainly benefiting from a slight improvement in the manufacturing subsector. The real value added by the manufacturing subsector rose slightly from 0.4 percent in 2011 to 0.7 percent, largely due to slight increases in the production of sugar and sugar related products, edible concentrates, timber products and printing products. Growth in the manufacturing sector was however limited by the poor performance in export destination markets notably the EU and South Africa which translated to lower demand for the country's export products. The textile sector was one of the sectors negatively affected by the global downturn. The real output for electricity, and water supply sector decreased significantly due to a notable drop in power generation. The construction subsector remained subdued in 2012 in the absence of major public sector infrastructural development undertaken in the year under review.

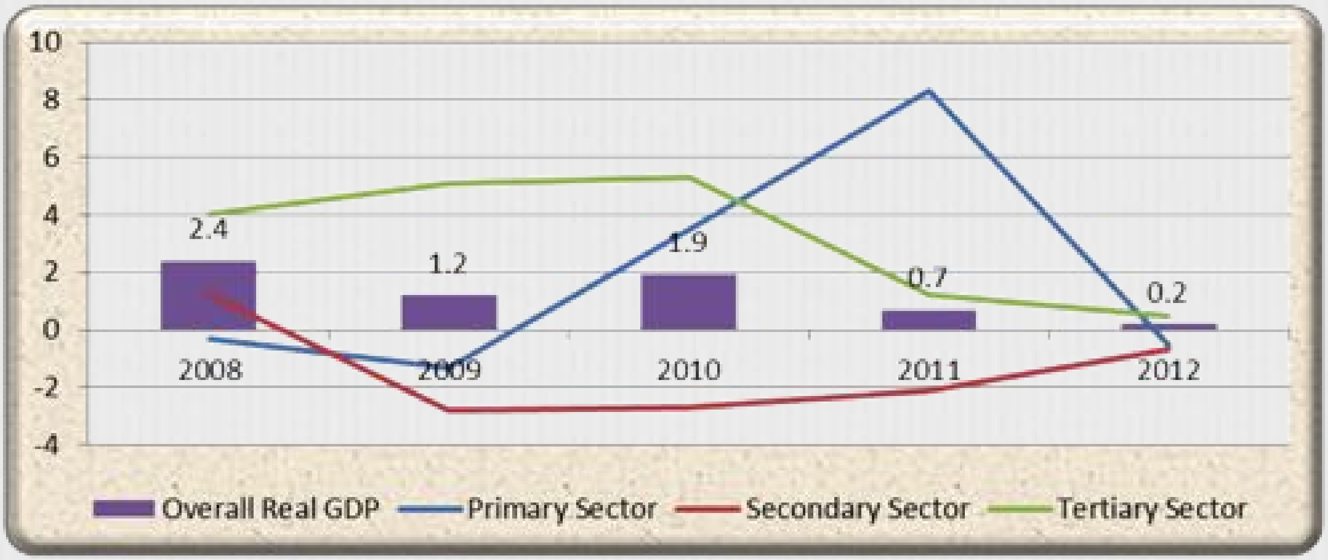
Growth in the value added by the tertiary sector slowed to 0.5 percent in 2012 compared to 1.2 percent the previous year. The second round effects of the fiscal crisis were predominantly felt in the general government services and wholesale and retail subsectors. The general government grew by a meagre 0.1 percent in 2012 compared to 0.4 percent in 2011 in line with the three-year hiring and wage freeze proposed in the Fiscal Adjustment Roadmap (FAR). The public-wage freeze coupled with relatively higher inflation rates exerted pressure on real disposable incomes and affected spending patterns. As a result, the real output for the wholesale and retail trade subsector decreased by five percentage points to -2 percent in 2012. The financial intermediation subsector contracted by a slower rate of 3 percent in 2012 after decreasing by 5 percent in the previous year. Credit to the private sector was mute in the period under review despite lending rates staying at record low levels.

The effect of slow demand in the South African markets was also manifested in the tourism subsector. The total number of tourist arrivals in 2012 decreased to 1,278,530 from 1,328,366 in 2011 mainly due to a 5.7 percent decrease in arrivals from South Africa. As a result, the real output growth of the hotels and restaurants subsector remained negative for the third consecutive year since 2010.

On a positive note, 'transport, storage and telecommunications' and 'real estate and business services' subsectors reflected resilient growth in the period under review. The transport, storage and communications subsector grew by 3.5 percent in 2012 compared to 4 percent in 2011. The transport subsector benefited from the improved performance of the manufacturing and mining subsectors. The communication sector on the other hand improved mildly due to increased number of subscribers and the usage of data internet services. However, the unresolved disputes between the two major players in the communications subsector clouded the subsector's performance in 2012.

The real output for real estate and business services grew by 2.1 percent in 2012 compared to 0.2 percent in 2011. The accommodative monetary policy stance adopted by the Central Bank which kept interest rates at record low levels boosted this sub-sector. The growth of this sector was however limited by uncertainties caused by the fiscal crisis (especially for civil servants) which in turn constrained financial intermediation.

Figure 1: Swaziland Real GDP Growth Rates



Source: Central Bank of Swaziland

Table 1: Sectorial Breakdown of Real Output Growth Rates

Sectors	2008	2009	2010	2011*	2012#
Primary Sector	**-0.3**	**-1.3**	**3.5**	**8.3**	**-0.5**
Agriculture & Forestry	-0.1	-2.0	3.3	8.5	-1.3
Mining & Quarry	-16.0	-21.0	27.0	-15.0	106.3
Secondary Sector	**1.2**	**-2.8**	**-2.7**	**-2.1**	**-0.7**
Manufacturing	1.6	-2.0	-3.2	0.4	0.7
Electricity, Gas & Water	2.4	5.7	9.9	-3.2	-16.5
Construction	-3.0	-3.0	-2.6	-25.0	-10.0
Tertiary Sector	**4.0**	**5.1**	**5.3**	**1.2**	**0.5**
Wholesale & Retail	4.1	4.9	4.5	3.0	-2.0
Transport & Communication	7.2	5.6	9.2	4.0	3.5
Financial Intermediation	3.0	5.0	1.0	-5.0	-3.0
General Government	1.6	4.0	5.4	0.4	0.1
TOTAL	**2.4**	**1.2**	**1.9**	**0.7**	**0.2**

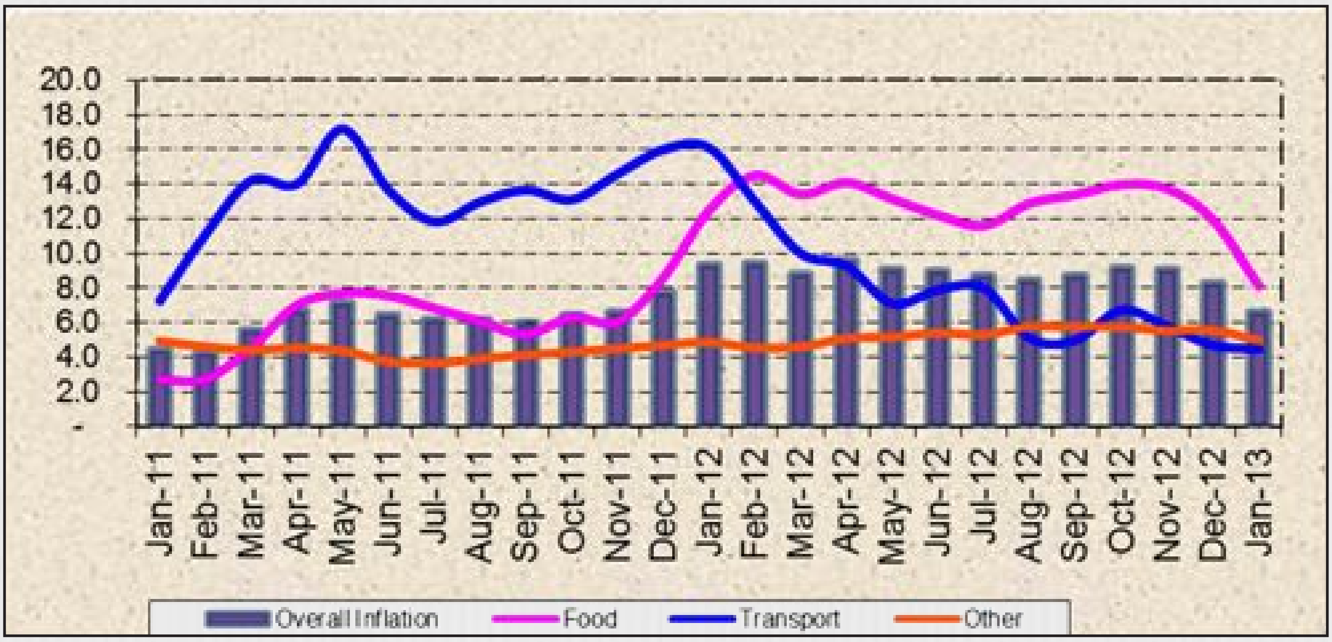
*Source: CSO, CBS and MEPD. *represents revised estimates by the CBS and MEPD and # represents official estimates by CBS and MEPD as of December 2012. (NB: The CBS uses these estimates pending availability of official actual data produced by the CSO National Accounts section.)*

Price Developments

Swaziland headline inflation accelerated to 8.9 percent in 2012 from 6.1 percent recorded in 2011. The 'food and non-alcoholic beverages' component, which constitutes 37.7 percent of the consumption basket, was the main driver of inflation in 2012. Food inflation surged from 5.9 percent in 2011 to 13.1 percent in 2012 and accounted for about 5 percentage points in the overall inflation outcome. Significant increases were noted in the prices of meat, cereal products and 'fish and seafood products'.

Additional inflationary pressures came from the 'health' and 'housing and utilities' indices. The health index grew from 3.0 percent in 2011 to 10.2 percent in the period under review mainly propelled by a significant increase in the prices for out-patient medical services. The housing and utilities index grew by 8.6 percent in 2012 compared to 6.7 percent the previous year, mainly due to notable increases in the prices for actual rentals and rising costs of electricity following an 8.3 percent tariff hike in June 2012. The introduction of Value Added Tax (VAT) replacing the General Sales Tax (GST) in April 2012 had a once-off effect on prices as it led to an increase in prices of goods and services that attracted VAT but previously excluded in the GST schedule.

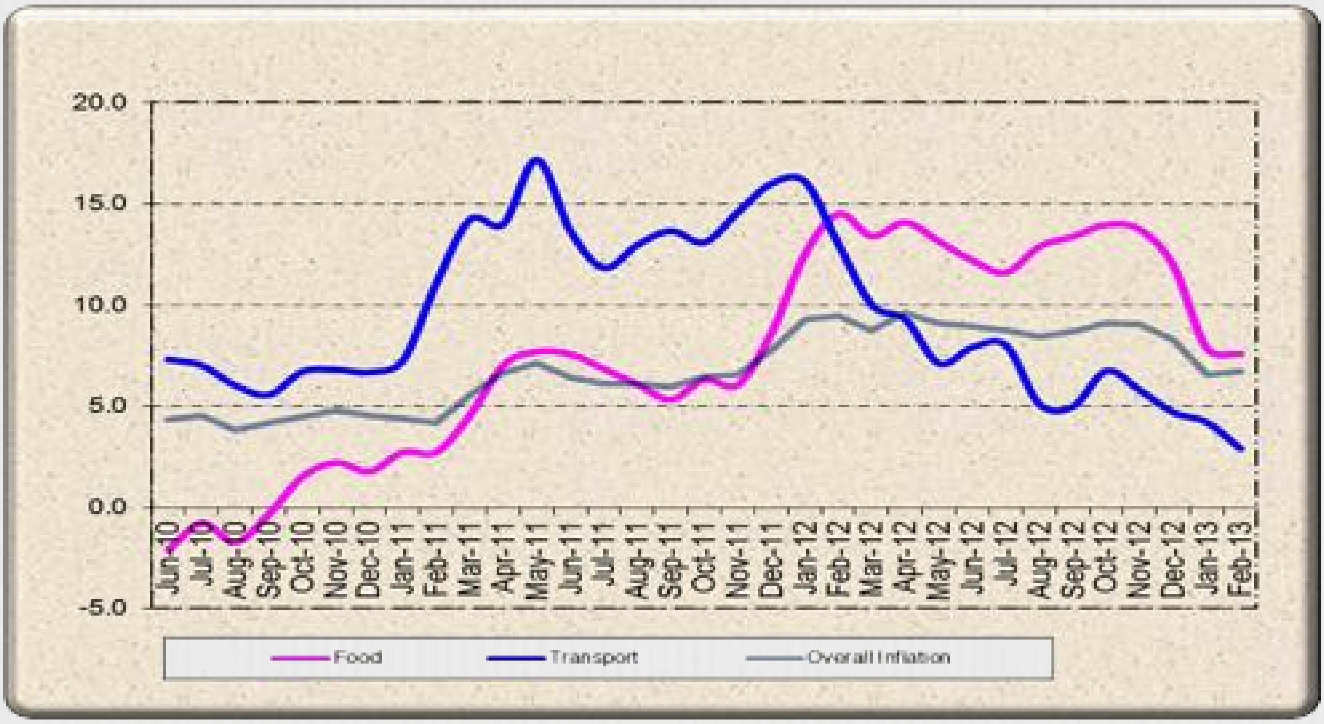
Figure 2: CPI and Headline Inflation Trends



Source: Central Statistical Office

The above inflationary pressures were somewhat counteracted by slower increases in the price indices for 'transport', 'education' and 'miscellaneous goods and services'. Despite fuel prices staying at elevated prices, the transport index grew by a slower rate of 8.2 percent in 2012 compared to 13.3 percent in 2011 due to base effects. Average fuel prices rose by 153 cents/litre in 2012 compared to an increase of 206 cents/litre in 2011. Persistently high international oil prices coupled with a relatively weaker exchange rate in 2012 translated to increases in domestic fuel prices. On the other hand, education prices grew by a slower rate of 7.5 percent in 2012 compared to 12.5 percent the previous year while prices for miscellaneous goods and services dropped by 3.7 percentage points during the year under review.

Figure 3: Food and Non-Food Inflation trends



Source: Central Statistical Office

In 2013 the sharp depreciation of the local currency against the US Dollar may be associated with a surge in international food and fuel prices. This development of the local currency against the US Dollar (observed in the early months of 2013) poses an inflationary threat in the medium-term. This is likely to be further be aggravated by developments in administered prices particularly the proposed 36.5 percent increase in electricity tariffs by the Swaziland Electricity Company. If approved, this hike will result in inflation increasing by about 1.5 percentage points everything held constant.

EXTERNAL SECTOR

Balance of Payments Developments

Featuring prominently in the country's Balance of Payments Statement for 2012 was a turnaround in the trade account from a deficit to a surplus and a turnaround in the overall balance to a surplus in the second and third quarters of 2012. Preliminary figures indicate that Swaziland's overall balance of payments position improved significantly during 2012, recording a surplus of E459.7 million in the third quarter compared to the deficit of E86.1 million recorded in the third quarter of 2011. This was mainly a result of a turnaround in the current account from a deficit to a surplus in the quarter ending September 2012.

The current account turned around to record a surplus of E349.8 million in the quarter ending September 2012 compared to a deficit of E1,124.3 million in the third quarter of 2011. During the first three quarters of 2012 the current account posted a surplus of E382.4 million compared to a deficit of E2,932.1 million in the first 3 quarters of 2011. This marked improvement in the current account was due, largely, to a surge in current transfers which mainly comprises SACU receipts and an improvement in the trade account. The services and income accounts remained in deficit whilst the trade balance improved in the 2012.

A notable development in the country's Balance of Payments in 2012 was a turnaround in the trade account from a deficit to a surplus position. The trade account recorded a surplus of E748.1 million in the first 3 quarters of 2012 against a deficit of E616.7million in the corresponding period in 2011. The improvement in the trade balance is attributed to an increase in merchandise export earnings against a slow rate of growth in imports.

Export receipts from miscellaneous edibles continued to be the highest export revenue earner followed by sugar in 2012. Sugar exports were negatively affected by declining demand in traditional markets including the EU and the USA in the first two quarters of 2012 but picked during the third quarter. Focus therefore, has been on expanding market share in the regional markets, which also offer competitive prices. Other major exports include textile, zippers, beef, canned fruit, coal, iron ore and citrus fruit.

The import bill registered a 10.8 percent increase in the first three quarters of 2012 compared to the first nine months of the previous year, to E11,456 million. Preliminary data on merchandise imports indicate that machinery and transport equipment, manufactured goods, chemicals and related products were the main contributors to imports during 2012. Other significant contributors to imports were electricity, fuel and petroleum products.

The services account remained in a deficit position during 2012 mainly reflecting the higher importation of services mainly from South Africa. The services deficit was at E4,523.9 million in the first three quarters of 2012, higher than a deficit of E3,204.0 million in the corresponding period in 2011. Services inflows increased by 4.7 percent in the first three quarters of 2012 compared to the first three quarters of 2011, whilst outflows increased by a higher 31.6 percent over the same period. Major contributors to services outflows were transport services and other business services, which include legal, accounting and management consultancy services. Services inflows comprised mainly transportation services and tourism receipts during 2012.

The income account remained in a deficit position in 2012. The income account deficit increased by 2.3 percent to E1,299.6 million in the three quarters to September 2012 compared to the same period in 2011. Income inflows increased by 80.3 percent to stand at E1,552.8 million in the first 3 quarters of 2012. Outflows increased by 33.8 percent to E2,852.3 million in the three quarters ending September 2012 compared to the same period in 2011. Compensation of employees, mainly representing earnings by Swazis employed in South African mines continued to be the major contributor to income inflows during 2012. Other major contributors to the inflows in the income account were interest earned by the official sector, as well as interest earned by the banking and the private sector.

Current transfers continued to record the highest net inflow in the current account in 2012. The account posted a surplus of E5,547.7 million in the first three quarters of 2012, which is much higher than the net inflow of E2,158.6 million recorded in the same period in 2011. This is largely explained by a rise in Southern African Customs Union (SACU) receipts which are the major component in this account.

The country's financial account excluding reserves posted a net inflow of E364.0 million in the quarter ending September 2012. This net inflow emanated from significant net inflows in both direct investment and other investments.

FDI into Swaziland recorded a net inflow of E38.4 million in the third quarter of 2012 against an outflow of E330.4 million recorded in the previous quarter and a net inflow of E358.1 million in September 2011. Reinvested earnings continued to be the major item influencing FDI in 2012, whilst fresh FDI inflows remained low. Portfolio investment recorded a net outflow of E13.2 million in the third quarter of 2012 against a net outflow of E26.8 million the previous quarter, reflecting slight increases in portfolio assets abroad. Other investment recorded a net inflow of E338.9 million in the quarter ending September 2012, due to a decline in external assets of the banking sector.

MONETARY SECTOR

During the year 2012, the country's monetary conditions remained largely stable maintaining a balance on the fragile growth prospects and rising inflationary pressures. Domestic growth was to a large extent weakened by persistent growth constraints in major regional and advanced economies as well as reduced domestic economic activity mainly attributed to fiscal restraints. Inflationary pressures on the other hand emanated from higher food and transport indices as well as the depreciation of the rand/lilangeni exchange rate.

The Bank therefore eased monetary policy only once during the year by reducing its policy rate by 50 basis points. The accommodative stance has been maintained as further easing would be undermined by upside risks to the inflation outlook. Accordingly, in July 2012, the Bank reduced the discount rate from 5.5 percent to 5 percent and has been maintained at that level to date. Similarly, commercial banks also reduced their prime lending rate from 9 percent to 8.5 percent.

Outlook for the remainder of 2013 is uncertain as inflationary pressures are likely to persist and domestic and global economic activity remains weak. The stable monetary policy is therefore expected to be maintained throughout the year in order to stimulate growth and contain inflationary pressures. However, further deterioration in regional and global prospects may increase chances for monetary policy easing.

At E7, 927.8 million at the end of February 2013, the country's net foreign assets rebounded from the negative growth of 25.1 percent recorded the previous year to register a notable 94.9 percent increase. The substantial recovery in net foreign assets was attributed to the improvement in government's revenue from the customs union pool. Also contributing to the upturn were revaluation gains from the depreciation of the exchange rate against major trading currencies. The increase in net foreign assets was registered in both the official sector and other depository corporations. In line with the rise in net foreign assets of the official sector, gross official reserves increased by 56.1 percent over the year to E6, 314.9 million. Accordingly, the estimated import cover of the reserves increased from 2.3 months to 3.3 months at the end of February 2013.

The short to medium term outlook for the country's official reserves is positive as the SACU receipts for the 2013/14 fiscal year will not fall below the current fiscal year's level. However, in order for the reserves to be maintained above internationally recommended levels, it remains critical for the government to expeditiously implement measures to control expenditure and broaden the revenue base including other policy interventions outlined in the Updated Fiscal Adjustment Roadmap (UFAR).

Over the year, credit extended to the private sector decelerated from double digit growth of 18.2 percent to 1.4 percent in February 2013. The decline in credit was mainly a result of loan repayments leading to the levelling-off of the previous year's substantial credit to the sugar industry coupled with the notable sluggish economic activity. Growth in credit extended to businesses alone decreased from 39.5 percent in February 2012 to -2.4 percent in February 2013. The decline was discernible in the agriculture, manufacturing and construction sectors. Over the same period, growth in credit extended to households declined from 14.5 percent to 0.4 percent. The decline was registered in credit finance for motor vehicles while credit for housing and other personal category recorded slight increases.

In line with the recovery in net foreign assets, year-on-year growth in broad money supply (M2) accelerated from 4.3 percent in February 2012 to a double digit 25.6 percent in February 2013. Both narrow (non-interest earning) and quasi (interest earning) money supply reflected increases demonstrating the depositors' heightened propensity to hold money for transactions as well as investment and precautionary purposes. Narrow money supply growth alone increased from 9.4 percent the previous year to 55.9 percent. Growth in quasi money supply representing interest earning deposits rose from 2.3 percent the previous year to 12.1 percent in February 2013.

FISCAL SECTOR

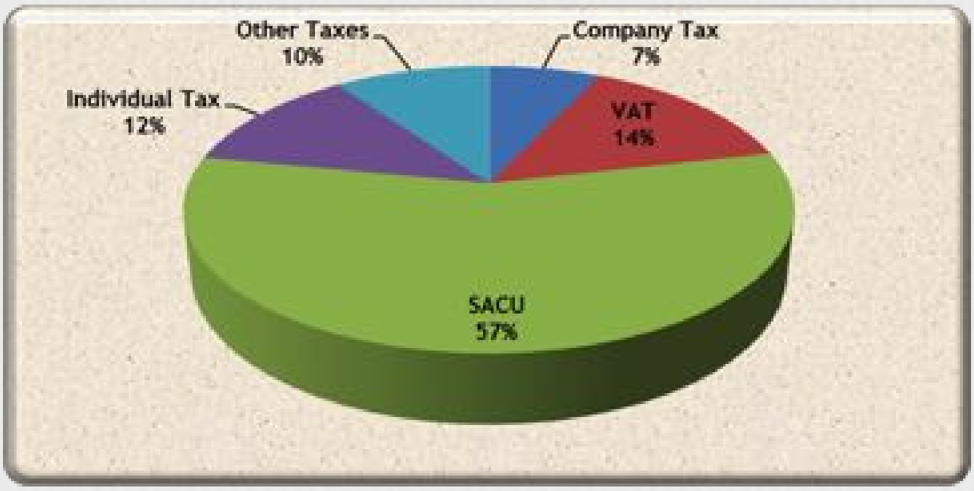
Budget Review

The actual outturn for 2011/12 indicates a budget deficit of E1, 652.9 million, an equivalent of 5.4 percent of GDP. This was an improvement from the original budget of 10.7 percent of GDP recorded in 2010/11. This development was mainly a result of the strong performance of domestic revenue coupled with a marginal increase in SACU receipts.

The estimated outturn for 2012/13 shows a surplus of E77.3 million or 0.2 percent of GDP. This was mainly driven by a 145 percent surge in SACU receipts. This has enabled government to significantly reduce arrears, repay the Bank's line of credit and augment reserves to a level above 17 percent of GDP as recommended by the IMF.

The budget estimates for 2013/14 project a deficit of E396.9 million, which translates to 1.1 percent of GDP. SACU windfall is once again the main revenue contributor to the government resource envelope: a development which will enable government to undertake more fiscal reforms.

Figure 1: Government Revenue major Components in 2013/14



Source: Central Bank of Swaziland

Total revenue and grants is projected to increase to E12, 839.3 million in 2013/14 from E11, 913.6 million in 2012/13. The increase was mainly driven by a good performance of domestic revenue. SACU receipts alone are projected to stand at E7, 156.6 million which includes a once-off payment of E650 million that is to be received from the Revenue Pool. This development is a result of good performance by the pool in 2011/12.

Total expenditure is projected to reach E13, 236.2 million in 2013/14 from E11, 836.3 million recorded in 2012/13. Recurrent expenditure will remain at around E10, 308.7 million, of which approximately 50 percent account for the wage bill. Capital expenditure is projected to stand at E2, 927.5 million. With most of this developmental expenditure is mainly to cater for on-going projects. These include Sikhuphe International Airport, Sikhuphe-Mbadlane Road, Sicunusa-Nhlangano Road and the Lubombo Regional Hospital.

Public debt

At the end of February 2013, total public debt recorded E4, 835.9 million, an equivalent of 14.6 percent of GDP. This reflects an increase of 5.1 percent from E4, 573.9 million (equivalent to 14.1 percent of GDP) recorded in February 2012. The increase is attributed to the surge in domestic debt over the period under review.

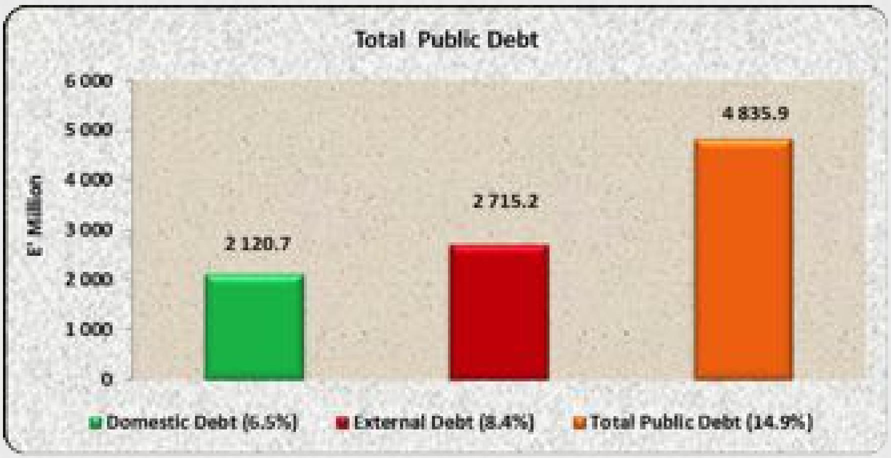
Public external indebtedness in Emalangeni terms declined in February 2013. Total public external debt stood at E2, 715.2 million or 8.4 percent of GDP in February 2013 compared to E2, 772.9 million or 8.5 percent of GDP recorded the previous year. The external debt for the central government remains the largest component of the public debt portfolio accounting for 96.3 percent in February 2013.

Based on critical ratios established by the Brettonwoods Institutions, the International Monetary Fund and the World Bank for Highly Indebted Poor Countries; Swaziland's debt ratios have been comparatively low compared to other African countries. At the end of February 2013, the ratio of public external debt stock to exports of goods and services stood at 17.4 percent while public external debt stock to GDP ratio was at 8.4 percent. Meanwhile, the ratio of public external debt service to exports of goods and services was estimated at 1.9 percent.

All these ratios are still within acceptable levels. However, for a small economy like Swaziland, it is important to ensure that public debt remains within sustainable levels while addressing the many challenges facing the country and at the same time keeping expenditure patterns focused on productive undertakings.

Public domestic debt rose by 17.8 percent to reach E2, 120.7 million or 6.5 percent of GDP in February 2013 from E1, 801.0 million (5.6 percent of GDP) recorded the previous year. The rise in domestic debt was mainly a result of increased issuances of the 91, 182 and 364-days papers.

Figure 2: Total Public Debt As At February 28, 2012



Source: Central Bank of Swaziland

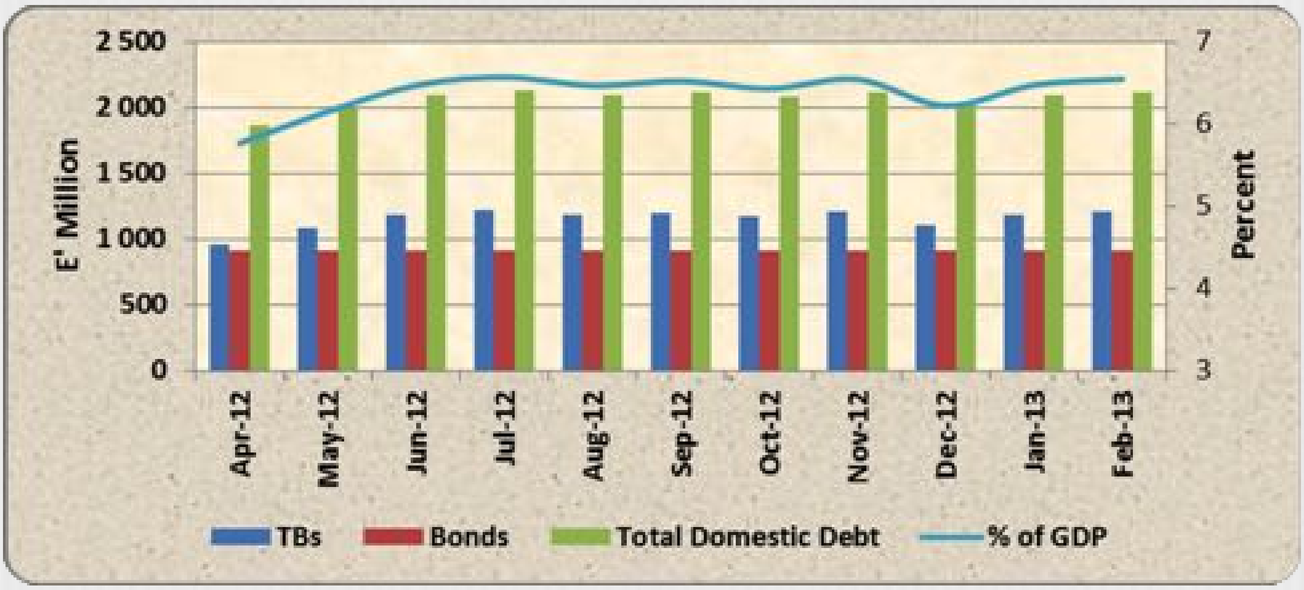
In most countries the proportion of domestic debt to external debt is kept at around the 60:40 ratio. Swaziland's ratio of domestic debt to external debt currently stands at 43:57. The practice in other CMA countries is to keep the proportion of domestic debt to external debt ratio at around 80:20. Considering that Swaziland is advocating for the development of the domestic debt market, it is recommended that in the medium to long-term, efforts should be directed towards structuring the country's public debt portfolio to be in line with the practice in the other CMA countries.

Following the indefinite suspension of the Bonds Issuance Programme in 2011 as the decline in the appetite for bonds surfaced, Government is advised to resuscitate the bond issuance programme and thereby encourage long-term borrowing from the domestic market in order to finance the maturing bonds and essentially keep the borrowing program alive. Government has already made tangible efforts to improve investors' confidence hence the proposal to revive the program. Efforts directed at improving investor's confidence include the significant reduction of domestic arrears, full repayment of central bank advance to government and improving the overall fiscal balance in the medium term.

It is also vital that government continues to develop the capital markets to provide liquid instruments for the private sector to benchmark their securities should they require funds in the future. The benefit of government issuing the bonds will therefore assist in;

(i) Meeting government budgetary requirements;
(ii) Facilitating financial intermediation;
(iii) Developing the secondary market; and
(iv) Establishing a fair price which will compensate both the borrower and investors for interest rate risks.

Figure 3: Total Public Debt For The Period 1 April 2012 – 28 February 2013



Source: Central Bank of Swaziland

Of the outstanding domestic debt, E913.6 million represented government bonds whilst treasury bills accounted for E1, 207.1 million. Commercial banks continue to dominate participation in government securities accounting for 68.1 percent of holdings as at February 2013 followed by other financial institutions at 20.6 percent.

Table 1: Public Domestic Debt Outstanding By Holder as At February 28, 2013 (E'000)

Holder	Government Bonds	Treasury Bills	Total	Share of Holdings (%)
CBS	59,872	540	60,412	2.8
Commercial Banks	396,063	1,048,510	1,444,573	68.1
Other Financial	321,137	114,470	435,607	20.6
Institutions	136,497	43,580	180,077	8.5
Other				
Total	**913,569**	**1,207,100**	**1,120,669**	**100**

Source: Central Bank of Swaziland

Considering that treasury bills accounted for E1, 207.1 million in February 2013 (78 percent held in the 91-days paper, 20 percent in 182-days paper whilst 2 percent accounted for the 364 -days paper), a strategy must be put in place to gradually reduce the 91-days paper's holdings in the medium term in line with government's desire to reduce liability on the shorter end of the yield curve. To smoothen the maturity profile, government is advised to reduce the weekly amount offered for the 91-days paper from the current E100 million weekly to E70 million beginning 1st April 2013. This should be clearly communicated to the market. Investors are already fully participating in the 182, 273 and 364-days papers offered alongside the popular 91-days paper hence efforts should be made to increase the amounts offered on the longer-end of the yield curve to satisfy investors' appetite. Government is advised to finance the maturing bonds through issuances of 3 and 5-year papers during the course of the 2013/14 fiscal year. Following the unsuccessful issuance program in 2011, to revive the program, a strategy needs to be put in place with the underlying considerations:-

(i) Unless bonds are issued on a private placement basis, the bonds must be in reasonably small amounts considering the low appetite for long-term papers;
(ii) Government must endeavour to be transparent to the market so that any developments are known;
(iii) The bonds tenors should be at least 5 years; and
(iv) An auction calendar should be published so that market players can plan for their investments well in advance.

BANK SUPERVISION

The Central Bank of Swaziland through the Bank Supervision Division is fully committed to achieving its mission of promoting the soundness of the domestic banking system and to contribute to financial sector stability. The Division continues to monitor the soundness of the banking sector through applying risk based supervisory techniques geared at facilitating the early detection of potential bank fragility.

Effective surveillance of the banking institutions ensures compliance with applicable statutory minimum requirements in capital, liquidity and reserves. Issues of prudence in risk management and corporate governance practices are also becoming more significant in the supervision processes.

Corporate Governance

The Bank encourages boards of directors and senior management to adopt best practices in the manner business operations and affairs of banks are governed as these lead to the overall satisfactory performance of the banks. The Central Bank is cognizant of the fact that board of directors are ultimately responsible for the management of risk and financial soundness of a bank. It is on that premise that the Bank will continuously review regulations that seek to promote best practice on issues of corporate governance. Nevertheless, we note that the banks operating in Swaziland are largely in line with generally acceptable corporate governance principles.

New Developments in the Banking Industry

The Central Bank welcomes new developments and innovation in the delivery of financial services. We note that cell phone banking and internet banking have been entrenched into our banking system and that these service delivery channels come with new risks and benefits. It is in this background that the Bank Supervision Division issued a Risk Management Guideline to the industry that provides risk management guidance on operational risks associated with new products and innovations.

The Central Bank would also like to highlight that, mobile money transfers services are merely a payment system or delivery channel which does not constitute to deposit taking. Accordingly, mobile money transfers should operate on a credit push principle where all e-money value is backed by pre-funded balances which are held in banking institutions.

On that note, financial institutions are encouraged to leverage on this impelling development in the area of mobile banking as an effective distribution network for financial products to various segments of the transacting public.

Industry Growth

The Financial Institutions Act, 2005 empowers the Central Bank to licence banking and credit institutions. We are encouraged by the interest we are receiving from prospective investors looking into entering the banking market. It is in the interest of the Bank to see the banking industry growing through expansion of the existing banks or new entrants into the system as it ensures enhanced financial inclusion and improves competitiveness in the system. The licencing procedure and the licencing requirements of the Financial Institutions Act, 2005, seek to help protect the interests of depositors and the public and to prevent incidences of bank failures from occurring within the system.

The evaluation of bank licence applications considers the entrants ability to meet mainly the following key requirements:

- Have suitable shareholders and transparent ownership;
- Have adequate financial strength including adequate capital and earnings prospects;
- Have management with sufficient character, integrity and experience to operate a banking institution in a safe, sound and lawful manner; and
- Have the ability to serve the public interest by protecting the interests of depositors, the public and the banking system in Swaziland.

Capacity Building

With the evolving financial world the Bank Supervision Division continuously improve skills development within its staff members through in-house and external training programmes. The Central Bank maintains firm cooperation with regional and international capacity building institutions like MEFMI and AFRITAC, among others, which have been very supportive particularly in specialised banking supervision training programmes.

Illegal Deposit Taking

It is with concern that reports of illegal activities relating mainly to deposit taking are still received by the Central Bank. It is further noted that members of the public in some quarters assist perpetrators in concealing such activities. The Bank will continue to foster its mandate to safeguard financial stability by enforcing provisions of the law on individuals suspected to be engaged in regulated activities in terms of the Financial Institutions Act, 2005.

Banking Sector Performance

From a regulatory perspective, all banks in Swaziland, including the Swaziland Building Society complied to set minimum prudential and statutory requirements in as far as cash reserve management, capital adequacy, and liquidity requirements are concerned. For these reasons it would be safe to say that the Swaziland banking system remained stable and banking institutions were operating in a safe and sound manner.

Industry Balance Sheet

Capital adequacy ratios for the banks were above the minimum statutory requirements. Capital provides a safety net to depositors and shareholders against losses that might occur in a financial institution. Total industry capital as a percentage of total industry risk-weighted assets was recorded at 25.2 percent which compared favourably with the statutory requirement of 8 percent.

The banking sector assets increased from E11,877 million in December 2011 to E12,540 million at the end of December 2012, representing a growth rate of 5.6 percent.

The banks were in full compliance with the liquidity requirements level of 20 percent for commercial banks and 17 percent for development bank.

Industry Income Statement

The banking sector's profitability ratios remained strong throughout the year 2012. The pre-tax return on capital was 18.4 percent in December 2012, compared to 18.9 percent at the end of December 2011, while the pre-tax return on assets remained flat year-on-year at 3.3 percent in December 2012.

The industry's total cost-to-total income ratio which is a measure of its operational efficiency was recorded at 63.2 percent in December 2012 which is somewhat comparable to the international benchmark of 60 percent. The same ratio was recorded at 63.7 percent in December 2011.

Credit Institutions

Credit institutions are important players in financial intermediation and strong prudential and regulatory reviews of the sector are continuously conducted to ensure overall safety and soundness of the entire financial system. Currently, there are four credit institutions licensed under the Financial Institutions Act, 2005, namely: Blue Financial Services, Letshego Financial Services, First Finance Company and Relief Financial Services.

NATIONAL PAYMENT SYSTEM DIVISION

Operations of the national payment systems continued to run smoothly during the period January to December 2012. The designated national payment systems include the Swaziland Interbank Payments and Settlement System (SWIPSS) operated by the Central Bank of Swaziland; the Electronic Fund Transfers (EFTS) and Cheque Clearing System operated by the national interbank clearing house.

Oversight of Payment Systems

With regard to oversight and regulation of payment systems and in line with international best practice, the Central Bank of Swaziland continued to monitor financial and technical integrity of national payment systems including the recent introduction of the mobile money payment stream. In this way, payment systems continued to contribute to and support financial sector stability.

Future Developments and Projects

- **Government EFTs**

Following implementation of the Ministry of Finance module on the Real Time Gross Settlement System (RTGS) platform in 2011, the Central Bank of Swaziland continued to support the Swaziland Government to grow transactions processed through electronic funds transfers (EFTs). Implementation of this development is aimed at enhancing efficiency in payment streams, reduction of cheque based payments and associated risks. These EFTs are processed through the interbank clearing house as credit push mechanisms designed to transfer funds for and on behalf of the Swaziland Government.

- **SADC/COMESA Regional Payment Systems**

In line with the national endeavour to grow regional economic activity through trade and investment, the Central Bank of Swaziland continued to participate in the on-going regional development of payment systems in order to facilitate transfer of funds in both the SADC and COMESA regions. While the COMESA Regional Payment and Settlement System was implemented late last year (2012), the SADC Integrated Regional Settlement System is scheduled to commence live operations in July 2013. However, this would initially be a “Pilot System” to prove the concept in the CMA region. To facilitate growth in activity and to enhance safety and efficiency in the transfer of funds, cheque payments would be discontinued in the CMA Region at implementation of the electronic payment system under the SADC initiative.

CAPITAL MARKETS DEVELOPMENT

Securities Regulatory Framework

The Financial Services Regulatory Authority (FSRA) appointed a substantive Registrar of Capital Markets who assumed the duties in November 2012. This function which had previously vested with Governor of the Central Bank was, with effect from 1 January 2013, transferred together with the Capital Markets Development Unit (CMDU) and the Swaziland Stock Exchange (SSX) to FSRA under their Capital Markets Department.

FSRA was constituted under the FSRA Act, 2010 to regulate non-bank financial institutions that include capital markets.

Domestic debt market

With the assistance of the Bank, Government maintains six (6) bonds it has issued and listed on the SSX with a total outstanding nominal value of E913.6 million.

This is in addition to the E1.184 billion raised in Treasury Bills issuances the Bank manages on behalf of Government.

Thus, the total outstanding domestic debt that the Bank has assisted Government raise is approximately E2.1 billion. The Bank trusts that Government will pursue the Fiscal Adjustment Roadmap (FAR) and other related recommendations by international organisations such as IMF aimed at improving its overall fiscal position.

Automating capital and financial markets operations

The Bank acknowledges the significant role played by technology in world markets, particularly in the management and settlement of Treasury Bills, Government bonds and other securities. This has become even more important as the country anticipates the participation of foreign investors in these markets.

In this regard, the Bank has been evaluating tenders it received from service providers for the possible procurement and implementation of a central securities depository (CSD) facility. The Bank envisages that acquiring a CSD facility would greatly enhance the overall issuance, management, custody and settlement of both capital and financial market products.

EXCHANGE CONTROL DIVISION

Relaxations of Exchange Controls

Capital Goods
In November 2012 the Central Bank increased the limit of “50% per cent” advance payment on capital goods to be imported to “100 per cent” of the ex-factory cost not exceeding a total value of E 10 million. Payment for the importation of capital goods in excess of E 10 million may only be provided up to 50 per cent of the ex-factory cost of the goods to be imported.

Foreign Investment by Private Individuals (natural persons) facility
With effect from March 2012 and due to market demand the Foreign Investment by Private Individuals (natural persons) facility limit of Emalangeni 2 million per private individual was increased to Emalangeni 4 million.

Further enhancement of Cross Border Foreign Exchange Transaction Reporting System (CBFETRS)
To be in line with the International Monetary Fund (IMF) requirements on categorising cross border transactions, the Bank intends to conform to the IMF version 6 category codes. The move intends to make the data collected through the Reporting System more refined and meaningful for decision making and statistical purposes.

Anti-Money Laundering
The Money Laundering and Terrorism Financing (Prevention) Act, 2011 has been promulgated into the Law. This development has positioned the Bank in fulfilling its mandate in ensuring that financial institutions have in place sound anti-money laundering programmes.

The Exchange Control Department has conducted onsite inspections on two financial institutions with regard to Money Laundering Prevention and Terrorism Financing.

THE NON-BANK FINANCIAL SECTOR

The rapidly growing size of the non- bank financial sector continues to challenge the authorities to ensure effective regulation and surveillance to limit systemic risks that may occur resulting from failure of one of them. During the year ended December 2012, the country’s financial sector continued to be dominated by non-bank financial institutions. In terms of asset size, non-banks owned an estimated 68 percent while banks owned 32 percent. Within the non-banks, retirement funds accounted for the largest proportion of assets (43.6 percent) followed by collective investment schemes (17.6 percent). Insurance companies and Savings and Credit Cooperatives (SACCOs) accounted for lower single digit proportions of 5.4 percent and 1.5 percent, respectively. The recent establishment and operationalization of the Financial Services Regulatory Authority (FSRA), however, is a welcome development in this regard.

CONCLUSION

The global economic rebound remains a mirage with down side risks aggravated by continued imbalances despite a flicker of hope shown by the invasive economic recovery in the United States of America. In Sub-Sahara Africa economic fortunes depend on external demand particularly from the emerging economies of China and India which if favourable will provide an upward trajectory in growth for these economies. The outlook for Swaziland's economy remains uncertain as any optimism will be derived from several reforms that have to be implemented to create a positive investment climate and introduce fiscal discipline based on the Investor Roadmap and Fiscal Adjustment Roadmap initiatives respectively. Despite the Central Banks continued easing of interest rates, growth in the banking sectors credit expansion has been dismal, this development which occurs when the banking system is highly liquid evidences structural weaknesses that impede intermediation. The failure of banks to channel local savings into investments and economic growth may be a reflection of either low demand for credit as a result of the continued recessionary conditions that continue to plague the economy or are as a result of structural rigidities reflecting financial sector inability to effect the transmission mechanism of monetary policy. In the latter case, a strategy for long term development of the financial sector has to be in place where effective financial services are put in place to accelerate economic growth. The Central Bank will, in the coming year, be working with the financial sector to address the rigidities that continue to contribute to the impediments to monetary policy transmission for economic growth.

Finally, the optimism that has been created by the latest increased inflow of customs revenue should provide an opportunity for fiscal adjustment while addressing growth opportunities which will pave the way for the financial sector to increase its role in intermediation.
In conclusion, on behalf of the Board of Directors of the Central Bank and staff, I wish to extend the Bank's appreciation of the assistance and cooperation from the Minister of Finance and his officials, Chief Executive Officers of financial institutions in Swaziland and all other stakeholders in the financial sector who have contributed to the resilience of this sector during our economic challenges for the past two years.

Notes

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