

# 2015



## GOVERNOR'S ANNUAL MONETARY POLICY STATEMENT

*“Financial Sector Stability for  
Sustained Investment Confidence”*

**PRESENTED BY:**  
Central Bank of Swaziland Governor  
Mr. M.V. Sithole  
12<sup>th</sup> June 2015



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## INTRODUCTION

Global growth remains moderate, with uneven prospects across the main countries and regions. According to the IMF World Economic Outlook (WEO) for April 2015 global growth is projected to be 3.5 percent in 2015. Global growth in 2014 was lower than initially expected, continuing a pattern of disappointing outturns over the past several years. Growth picked up only marginally in 2014, rising to 2.6 percent, from 2.5 percent in 2013.

Relative to last year (2014), the outlook for advanced economies is improving, while growth in emerging market and developing economies is projected to be lower, primarily reflecting weaker prospects for some large emerging market economies and oil-exporting countries.

Overall, growth in the first quarter of 2015 was slower, hurt by weaker-than-expected performance in the US and slower growth in China. Monetary policies remained divergent among major industrialized economies, with many countries still easing. Speculation over the future course of US monetary policy and dollar strength dominated markets, with markets initially expecting early sharp US interest rate rises, but later adjusting to more dovish signals from the US Federal Reserve. Equity markets continue to be supported by loose monetary policies.

The US was hurt by a number of once-off factors, including bad weather, and should see some improvement as the year progresses, while China is undergoing structural adjustments, as it relies less on external trade and more on internal demand. However, there was some positive news from Europe, where the prospect and onset of quantitative easing pushed the euro lower and helped competitiveness. Markets will continue to be influenced by speculation over how soon US interest rate normalization will start and how quickly it will progress. Against this background commodity prices continued to underperform, with commodity exporters struggling.

**United States:** On a year on year basis, real GDP increased by 2.4 percent in 2014 compared to a 2.2 percent growth in 2013. US GDP in 2015 is expected

to reach 3.2 percent before gradually decelerating to 2.4 percent in 2017. Growth will be boosted by both consumer demand and positive labour market momentum.

Latest available data reveals that US GDP grew at an annual rate of 0.7 percent in the first quarter of 2015, compared to an annualized 2.2 percent growth in the fourth quarter of 2014. The first quarter contraction was exacerbated by a widening trade deficit and increase in accumulated inventories.

The US Federal Reserve kept the interest rate at 0.25 percent during the meeting held in April but dropped the pledge to be patient on rate rise thus opening the possibility of higher borrowing costs as early as June 2015. In April Japan overtook China as the largest holder of US treasuries. This is the first time that this has happened since August 2008 as China continues to shed US treasuries.

The US Federal Reserve's Open Market Committee (FOMC) ended its quantitative easing (QE) programme at the end of October 2014, highlighting that significant underutilization of labour resources still remain and that the FED's assessment of economic recovery was not tied to any specific time period. The FED has indicated its tolerance of inflation below the 2 percent target, it is expected that the Fed will hike interest rates around mid-2015 on the back of this strong recovery.

Annual inflation in the US rose 0.8 percent in 2014 after a 1.5 percent increase in 2013. This is the second-smallest December to December increase in the last 50 years, trailing only the 0.1 percent increase in 2008. It is considerably lower than the 2.1 percent average annual increase over the last ten years. The low international oil price is the major factor underlying the low inflation rate in 2014.

The latest figures indicate that US consumer prices (CPI) were recorded at -0.1 percent year-on-year in March after recording zero percent in February due to lower energy cost. Disinflation pressures have forced US inflation back to negative territory as commodity prices remain low. In the first three months of 2015 inflation in the US had moved to negative territory and averaged -0.7 percent.

The unemployment rate held at 5.5 percent in March, the same as in February after increasing by 5.7 percent in January 2015. This was the lowest in nearly 7 years. US unemployment rate was also on a downward trend during 2014, falling to a low of 5.6 percent in December compared to 6.7 percent in December 2013.

**Eurozone:** For the year as a whole, gross domestic product (GDP) expanded by 0.9 percent in 2014 compared to a marginal 0.4 percent growth in 2013. The most recent data reflect that in quarter one of 2015, gross domestic product slowed to a seasonally adjusted and annualised 0.2 percent from 2.2 percent in the fourth quarter of 2014.

In an effort to support the fragile economic growth and low inflation rate, the Governing Council of the European Central Bank (ECB) maintained an accommodative monetary policy during 2014, with the benchmark interest rates at a historical low of 0.05 percent at the end of the year.

The European Central Bank (ECB) started purchasing euro-dominated public sector securities in the secondary market on March 9, 2015 an approach similar to the US quantitative easing programme as policymakers register their concerns over low inflation. During the year 2015, the ECB will continue with the purchase of asset-backed securities and covered bonds started in 2014.

The ECB at its meeting in April 2015 resolved that the monetary policy measures will remain in place until sustained gains in inflation are seen, and that the current implementation of the Eurozone quantitative easing (QE) was proceeding smoothly. The ECB benchmark interest rates remain unchanged at a record low of 0.05 percent.

Eurozone sovereign debt reached record levels in 2014. It climbed to a record 91.9 percent of GDP at the end of 2014, up from 90.9 percent in 2013. Greek government debt, the highest in the Eurozone, jumped to 177.1 percent of GDP from 175 percent in 2013. Italy's sovereign debt, the second highest after that of Greece, increased to 132.1 percent of GDP in 2014 from 128.5 percent in 2013.

Eurozone annual inflation was recorded at -0.2 percent at the end of December 2014, down

from 0.8 percent in December 2013. This was the lowest rate recorded since September 2009. The biggest downward impacts on the Eurozone annual inflation came from fuel and telecommunications. The weak prices seem to be persisting even this year with April 2015 inflation rate coming out at zero percent from -0.1 percent in March following a wider contraction of 0.3 percent in February. This marked the fourth consecutive month of declining prices, as energy prices continued to fall.

The Eurozone unemployment rate was steady for the third consecutive month at a seasonally adjusted 11.3 percent in March 2015 and was down from 11.7 percent 12-months earlier. The unemployment rate in the Eurozone remained sticky over the year 2014. The Eurozone seasonally-adjusted unemployment rate was 11.4 percent in December 2014, down from 11.8 percent in December 2013.

**United Kingdom:** Gross Domestic Product (GDP) was up 2.6 percent in 2014 compared to an increase of 1.8 percent in 2013. Pressure from the Eurozone, political uncertainty surrounding Greece, and signs of slower global growth will hamper UK growth, providing further impetus to keep interest rates on hold in the mid-term. In addition to this, the slump in global energy prices and commodity prices has been placing downside pressure on inflation.

Most recent data indicate that UK GDP eased to 2.4 percent year-on-year in the first quarter of 2015 from 3.0 percent in quarter four 2014, the lowest in five quarters, dragged down by a fall in mining and construction and a slowdown in services and manufacturing.

The Bank of England's (BOE) Monetary Policy remained accommodative throughout 2014. The Bank Rate remained at its historical low level of 0.5 percent and the stock of purchased assets financed by the issuance of central bank reserves was constant at £375 billion during 2014. The BOE left the benchmark interest rate and asset purchase programme unchanged at its policy meeting in March 2015. The BOE is expected to continue debating a rate hike in 2015 as the economy recovers and the labour trajectory improves.

The average inflation in the UK was recorded at 1.5 in 2014, the lowest since May 2000 compared to an average of 2.6 percent in 2013. The CPI remained

below the BOE's target of 2 percent since January 2014. Inflation has continued to come down in the first quarter of 2015 with CPI recording an average of 0.4 percent in the three months and recording zero percent in April 2015.

UK unemployment rate decreased to 5.7 percent in the three months to December of 2014 from 7.2 percent in the corresponding period of 2013, the lowest since mid-2008. It continued decreased to 5.6 percent in the three months to February of 2015.

**Japan:** Preliminary figures indicate that the 2014 GDP growth in Japanese economy was 0.2 percent. Looking forward, however, lower oil prices should help contain the cost of energy imports and support the recovery.

The Bank of Japan's (BOJ) Policy Board maintained the size of its monetary expansion programme at ¥80 trillion per year in December 2014. The previous statement on Monetary Policy adopted in December 2013, focused on the Bank of Japan conducting money market operations that will influence an increase in monetary base at an annual pace of about 60 -70 trillion yen. The BOJ further maintained the size of its monetary expansion programme at ¥80 trillion per annum at its meeting in March 2015. The Bank of Japan has further scope to expand stimulus in the economy given benign price pressures and slowing growth. The Japanese economy is currently in a recession; hence further easing is needed in order to spur spending in the economy.

The average inflation of Japan in 2014 was recorded at 2.7 percent compared to a lower inflation average of 0.4 percent in 2013. In the first quarter of 2015 inflation continued to be subdued and recorded 2.2 percent in February 2015 and 2.3 percent in March 2015.

Japan's seasonally adjusted unemployment declined to 3.4 percent in December 2014 compared to 3.7 percent reported in the same month of 2013 as the number of employed rose by 0.6 percent and the number of unemployed decreased by 6.7 percent. Japanese unemployment rate moderated to a seasonally adjusted 3.5 percent in February 2015 from 3.6 percent in January, while the jobs availability rose to the highest in more than 20 years.

**Emerging Markets:** According to the April 2015 IMF WEO, potential growth in emerging market economies, is likely to decline even further, from an average of about 6.5 percent during 2008-14 to about 5.2 percent during 2015-20. In China, the decline could be even larger because of the rebalancing of growth away from investment towards consumption.

**China:** Full-year economic growth in 2014 reached 7.4 percent, undershooting the government's target of 7.5 percent and marking the weakest expansion in 24 years. Cooling property market, weakening investment and unstable exports weighed on the growth. The cooling trend in China seems to be continuing even this year with Chinese GDP growth reported to have slowed to 7 percent year-on-year in the first quarter of 2015, from 7.3 percent in 2014/Q4, a 6-year low as both local and international consumer spending slowed.

The People's Bank of China (PBoC) has lowered its reserve requirements once more in April 2015, cutting the reserve requirements ratio by one percentage point to 18.5 percent after reducing the ratio to 19.5 percent in March from 20.0 percent on 4 February 2015. The benign inflation outlook further highlights the need for further policy easing by the PBOC.

China's annual inflation rate was 1.4 percent year on year in March 2015, unchanged from February. The politically sensitive food prices increased 2.3 percent while non-food cost rose at a slower 0.9 percent. Unemployment Rate in China remained unchanged at 4.1 percent in the first quarter of 2015 from 4.1 percent in the fourth quarter of 2014.

**South Africa:** The IMF downwardly revised its growth forecast for South Africa from 2.3 percent to 2.1 percent in 2015. While weaker global demand has played a part in this gloomy projection, it is structural constraints that will keep the economy on a slow growth path. The domestic growth outlook remains weak, amid continued electricity constraints as well as low and declining business activity and consumer confidence. The South African Reserve Bank's SARB's latest forecast for GDP growth is marginally down from the previous forecast of 2.5 percent in 2015 and 2.9 percent in 2016; growth is now expected to average 2.1 percent

and 2.2 percent in 2015 and 2016, respectively, and to increase to 2.7 percent in 2017.

For 2014 as a whole, GDP growth slowed to 1.5 percent from 2.2 percent in 2013. In 2014 GDP growth was subdued mainly in the first half of 2014 with economic activity undermined by numerous labour unrests. GDP in the South African economy was also negatively affected by the slow recovery in the developed countries especially in the Eurozone.

According to latest available data the economy slowed to a seasonally adjusted and annualised 0.2 percent in the first quarter of 2015 from 2.2 percent in the fourth quarter of 2014, partly due to base considerations following the stronger finish to 2014. In addition this was largely due to the effect of power disruptions, poor business confidence and weak external demand.

The outlook for the mining and manufacturing sectors remains mixed. Growth in 2015 will receive a boost from lower energy prices, as well as lower-for-longer interest rates. Economic growth will also depend on stability in the labour market, how well businesses adapt to the electricity constraint and how quickly government is able to deregulate to allow private sector solutions.

For the year 2014 in an effort to counter inflationary pressures, the repo rate was increased by 25 basis points to 5.75 percent in July 2014. The repo rate was maintained at this level until the end of 2014. Despite the weak economic performance, the South African Reserve Bank Monetary Policy Committee (SARB MPC) left interest rates unchanged at 5.75 percent in March 2015, from the historical low of 5 percent in the last quarter of 2013. However, it signalled that a raise may be coming in the second half of 2015 forced by increase in inflationary pressures.

The SARB is of the view that the growth outlook will remain subdued in the medium term, with risks to growth being moderately to the downside. The rand remains vulnerable to changes in global investor sentiment as the normalization of international interest rates approaches. The currency depreciation, together with possible above-inflation wage increases, poses an upside risk to inflation.

South African annual inflation rate averaged 6.1 percent in 2014, slightly above the inflation target range of 3 to 6 percent. This figure is much higher than the average inflation of 5.8 percent recorded in 2013. The high inflation in 2014 was recorded despite a substantial decline in oil prices in the second part of 2014. However, lower inflation seems to be emerging in the first few months of 2015 with consumer prices dipping to the lower end of the inflation target; in February 2015 the CPI climbed less at 3.9 percent year-on-year and slightly ticking up at 4 percent in March 2015.

The key risks to the inflation outlook remain global oil prices and the rand. International oil prices are expected to rise and the rand is likely to come under renewed pressure as interest rates in US and UK start to move higher in the second half of this year. The risks to the inflation outlook therefore remain on the upside.

South African unemployment rate decreased to 24.3 percent in the last three months of 2014 from 25.4 percent in the previous quarter. It is the lowest rate in a year as employment rose for the third consecutive quarter and the labour force decreased.

#### **Central Bank of Swaziland Monetary Policy Consultative Committee**

The Monetary Policy Consultative Committee (MPCC), which meets bi-monthly to deliberate on economic issues leading to monetary policy decisions, continued with its responsibility during the year 2014. The year 2014 was punctuated by international slowdown in demand for developing countries' exports and consequently low economic growth rates. The MPCC, in consideration of the international, regional and domestic economic fundamentals continued to pursue an accommodative monetary policy stance throughout 2014. The MPCC resolved to maintain a differential of 50 basis-points lower than the SARB during this review period. The discount rate was at 5 percent for the first six months of 2014 and 5.25 percent for the remaining months of that year. The core underlying rationale for the MPCC to maintain the discount rate was supported by the economic fundamentals in the local economy and the underlying intention by the MPCC to support credit extension to stimulate economic growth and development. During 2014,

average inflation recorded 5.7 percent though inflation edged upwards towards the second half of 2014. The increase in inflation particularly in the last three months 2014 has been largely due to the adjustment in regulated prices (electricity, water, public transport and fuel) which has affected the transport component of the consumer price index.

#### ■ Financial Sector Strategy for Swaziland Study

The Financial Sector Development Implementation Plan (FSDIP) is a multi-year plan driven by the Ministry of Finance, the Central Bank and Financial Services Regulatory Authority (FSRA) to develop, strengthen, deepen and modernize the entire financial sector in Swaziland. The FSDIP take a comprehensive approach to the financial sector covering both Non-Bank Financial Institutions (NBFIs) and the Domestic commercial Banks. Further, the Plan addresses Payments Systems and Infrastructure and issues of financial inclusion. The main objective of the project is to produce a financial sector development plan that seeks to introduce reforms in the sector with a view to develop and align forward-looking policies and legislation to meet and be relevant to the dynamic nature and structure of the financial sector in Swaziland. The FSDIP seeks to develop a financial sector that could be more inclusive, deeper, and more diverse so as to support the poor, underserved, small firms and producers, and women.

The MPCC in its deliberations noted the progress made in the formulation of the on-going Financial Sector Strategy for Swaziland. This study is done in collaboration with the World Bank and IMF. The objectives of the study are:

- ❖ to ensure stability of the financial sector and ensure increased access to financial services by a larger proportion of the country's populace through promoting financial inclusion;
- ❖ to modernize the financial sector taking stock of what has happened since the last study was undertaken in Swaziland in 1995;
- ❖ to harmonize legislative framework and responsibilities to ensure efficient operation of the financial sector in Swaziland;
- ❖ to ensure that the FSDIP complements the country's overall developmental framework by

ensuring that the financial sector reforms are aligned with other development policies and strategies adopted by the Government;

- ❖ to ensure stability through prioritizing a number of reforms needed in the further development of the stable, safe, efficient, and accessible financial sector;
- ❖ to provide a targeted approach to financial sector development through developing a strategic financial sector implementation plan which is coordinated, prioritized and well-sequenced;
- ❖ To bringing safe and prudent financial products and services to a greater number of the poor and underserved, and fostering a more diverse range of financial products;

#### ■ Assessment of Bank Charges in the SADC Region

The Central Bank of Swaziland Governor meets with the Managing Directors of Commercial Banks every month with a view to discuss emerging issues. During 2014, one of the key issues discussed in these monthly meetings was the issue of bank charges. This topical issue was also raised at the level of the MPCC. The MPCC also noted the various initiatives by the Central Bank in an effort to implement financial sector reforms and commended the Bank's proposal to engage commercial banks on the emerging contentious issue of Bank charges. The MPCC has been updated by the Central Bank on the status of domestic commercial banks' policies and practices on Bank charges levied in the domestic economy. Noting the sensitivity and importance of the issue of bank charges in financial sector development the Central Bank has established a committee to look closely at this matter.

#### Government Cash Flow Management

The Cash Flow Committee was formed during the 2010/11 domestic financial crisis following the Government of Swaziland's adoption of a new set of macroeconomic and structural policies aimed at improving public financial management. This development was mainly driven by the precipitous drop in SACU receipts and was targeted at addressing the macroeconomic challenges facing the country at that time. The main aim of the cash flow committee was to support fiscal consolidation,



while preserving developmental and poverty-reduction objectives. Key in the committee formulation operations was the close management of cash flow movements in the public sector through closer coordination between the Central Bank of Swaziland and the Ministry of Finance and other relevant stakeholders.

The MPCC noted the work of the Cash Flow Committee which included two major achievements;

- ❖ The first one being the approval of a new E2 billion Note Programme by Government which was listed on the Swaziland Stock Exchange (SSX). The listing of the New Note Programme became necessary as the E2 billion Programme of 2010 was near exhaustion as the remaining portion was reserved for re-openings of existing 7 and 10-year bonds. The 5-year bond SG020 auctioned in October 2014 was issued under the

new Note Programme, 2014. The Programme is in line with the objectives of financing Government budgetary needs and developing the domestic bond market. The amount listed under this Programme is to be raised over a maximum period of 5 years. The SSX acts as a regulator, and the listing of the New Note Programme adds a credibility to the Issuance Programme, as it has undergone and complied with the necessary listing requirements. All Government bonds are listed on the SSX.

- ❖ The second one was the granting of status of Debt Sponsor accorded to the Central Bank of Swaziland by the Financial Services Regulatory Authority (FSRA). This was a new regulatory change from FSRA which eliminated the need for listing via a Sponsoring Broker. The delays of compliance with the regulatory changes meant that the bond SG020 originally planned to be issued in August 2014 was delayed to October 2014.

## ANNUAL REAL GDP DEVELOPMENTS

Preliminary forecasts for real GDP growth indicate that the economy grew by 2.5 percent<sup>1</sup> in 2014 which is lower than the revised estimate of 3.0 percent in 2013. The slowdown in real output growth resulted from a loss of momentum in the secondary sector, mainly 'manufacturing' and 'electricity and water supply' subsectors. Manufacturing which accounts for about a third of GDP is projected to have grown by 1.3 percent in 2014 compared to 1.9 percent the previous year. Poor performance of Swaziland's traditional export market destinations, notably South Africa and the EU, affected the export oriented industrial sector. The effect of falling global demand characterized by falling prices was also evident in the mining sector where iron ore production was halted in the last quarter of 2014 following a plunge in international iron ore prices. This affected both mining and services sectors, notably transport, which was one of the key beneficiary sectors after the re-opening of the iron-ore mine.

Positive prospects were noted in 'agriculture and forestry', 'wholesale and retail', 'tourism' and 'central government services' subsectors. Agriculture sector continued to benefit from the implementation of the Lower Usutu Smallholder

Irrigation Project (LUSIP) which resulted in increased area under irrigation which predominantly benefits sugarcane production. The forestry sub-sector maintained its recovery which supported increased processing of timber related products. Relatively lower inflation and above-inflation wage settlements for both public and private sector raised real disposable incomes which supported growth for the wholesale and retail trade subsector.

The real output for government services sub-sector, which directly constitutes 15 percent of GDP, is projected to have grown by 2.5 percent in 2014 compared to 4.3 in 2013. The growth in 2014 is in line with the steady increase in government payroll numbers. Increased allocation on government capital programme also facilitated growth in real output for the construction sector which heavily relies on government capital projects.

Further positive gains came from the weaker Rand/Lilangeni exchange rate against major trading currencies in 2014 which cushioned sales returns (that fetched lower international prices) from outside SACU region. The weaker exchange rate also benefited the tourism sector which is estimated to have grown marginally by 2.1 percent in 2014 from a 3.8 percent decline the previous year.

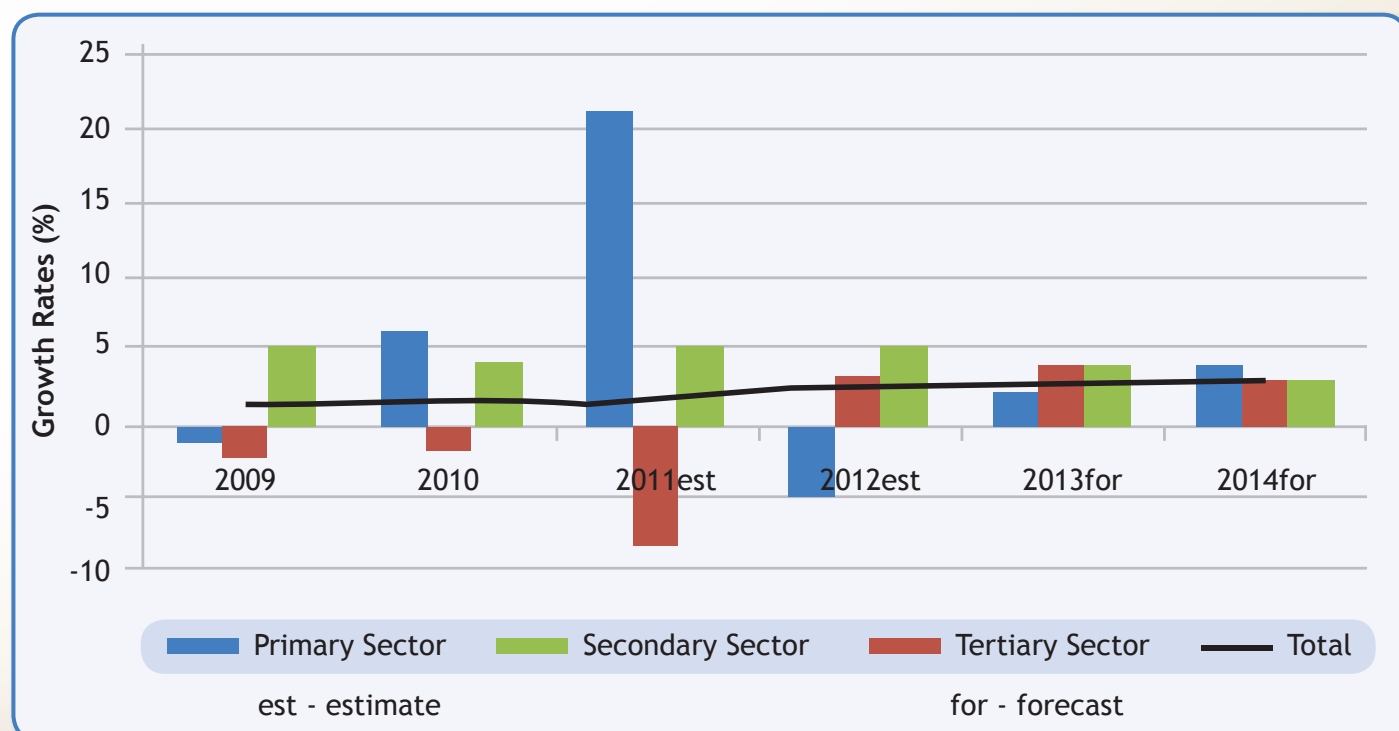
<sup>1</sup>This is based on projections done in August 2014 by Macro-forecasting team (CBS-real sector and MEPD-Macro Division). 2011 and 2012 GDP numbers are CSO's provisional estimates whilst 2013 and 2014 GDP numbers are preliminary forecasts by the macro-forecasting team

Table 1: Sectorial Breakdown of Real Output Growth Rates

Sectors	2010	2011	2012	2013*	2014#
Primary Sector	6.1	21.2	-5.1	1.7	3.7
Agriculture & Forestry	5.9	21.5	-5.4	1.5	4.0
Mining & Quarry	27.0	-14.4	35.6	19.1	-23.4
Secondary Sector	-2.1	-8.4	3.0	3.7	2.7
Manufacturing	-1.9	-9.2	1.1	1.9	1.3
Electricity, Gas & Water	-6.0	2.4	2.4	5.3	-7.1
Construction	-2.6	-4.3	20.2	16.9	14.1
Tertiary Sector	4.1	5.1	5.2	3.9	2.9
Wholesale & Retail	2.0	4.5	6.1	9.0	3.7
Transport & Communication	5.9	7.0	8.5	6.5	4.3
Financial Intermediation	-3.0	18.0	-13.0	-1.4	12.7
General Government	5.4	4.0	2.0	4.3	2.5
<b>TOTAL</b>	<b>1.8</b>	<b>1.3</b>	<b>2.7</b>	<b>3.0</b>	<b>2.5</b>

Source: CSO, CBS and MEPD; GDP numbers for 2010-2012 are sourced from CSO whereas \*represents official provisional estimates by CBS and MEPD forecasting team as of August 2014 and # represent preliminary 2014 projections (NB: The CBS uses these estimates pending availability of official actual data produced by the CSO National Accounts section.). Estimations are based on data collected during Annual Company Surveys, half year data collected from selected big companies, trade accounts, financial sector data and government accounts. It is also important to note that the CSO is in the process of finalizing GDP Rebased which may also alter the above reported numbers.

Figure 1: Swaziland Real GDP Growth Rates



Source: Central Bank of Swaziland

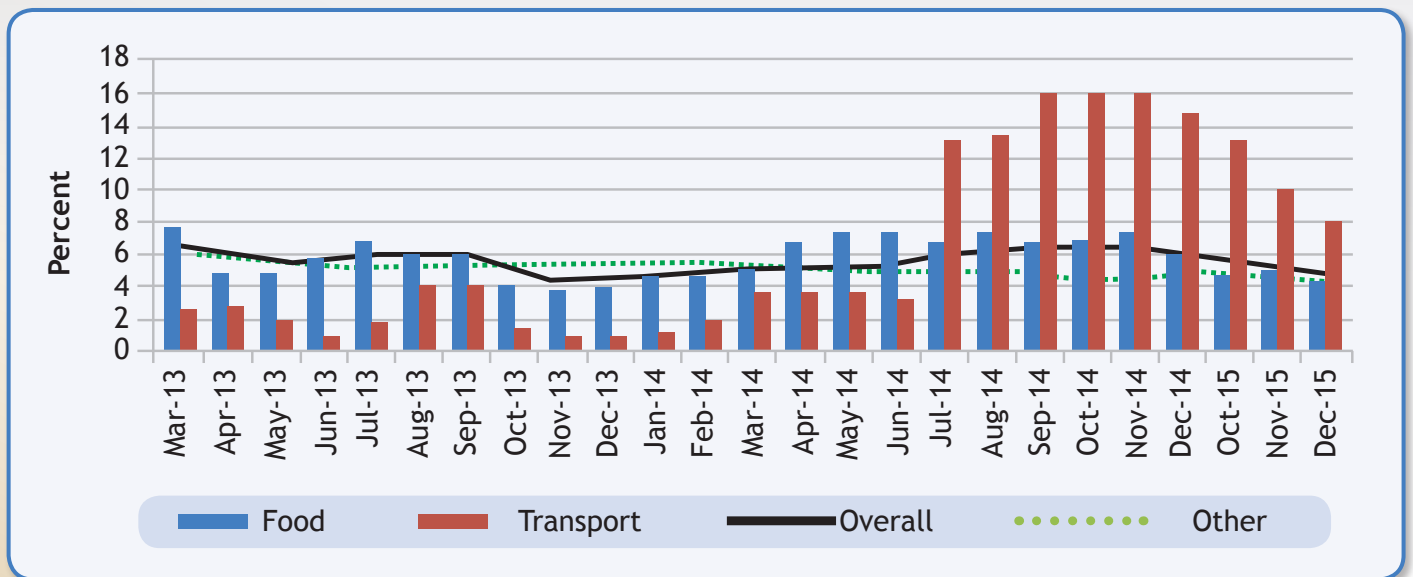
**Price Developments**

Swaziland consumer inflation averaged 5.7 percent in 2014, which was 0.1 percent higher than 5.6 percent observed in 2013. Inflationary pressures mainly came from administered prices notably in the transport category. Fuel prices cumulatively increased by 110 cents per litre in 2014 compared to a 25 cent decline in 2013. In line with the increases in fuel prices, public transport fares, which had not been increased in more than 5 years, were hiked by 25 percent in July 2014. As a result, transport inflation accelerated from an average of 2.4 percent in 2013 to 8.8 percent in 2014. Food inflation also averaged 6.3 percent in 2014 higher than the average of 5.7 percent recorded in the previous year. The slight increase in food prices was mainly due to increases in the prices of milk, fruits, vegetables and meat products. Further notable

increases were observed in the price indices for “clothing and footwear”; “restaurants and hotels” and “miscellaneous goods and services”.

The above inflationary pressures were partially offset by slower increases in the price indices for “housing and utilities”; “health” and “furnishing and household equipment”. The “housing and utilities” index grew by 3.5 percent in 2014 compared to 5.5 percent in 2013 mainly benefitting from slower increases in prices for ‘actual rentals’. The growth rate for the price index for “health” eased to 7.3 percent in 2014 from 12.9 percent in the previous year due to slower increases in prices of medical products and services. On the other hand, the index for “furnishing and household equipment” slowed by 0.4 of a percentage point to 4.6 percent in 2014.

Figure 2: Inflation Trends



Source: CSO and CBS

Following a significant decline in international oil prices in the last quarter of 2014, domestic fuel prices were adjusted downwards by 270 cents per litre between November 2014 and February 2015. As a result, transport inflation receded from double digits experienced throughout the second half of 2014 to single digits at the end of the first quarter in 2015. Food inflation also subsided in the opening months of 2015 due to slower increases in prices for fruits, vegetables and ‘oil and fats’ products. In line with the favourable developments in both

food and transport inflation, the overall consumer inflation depicted a downward trend averaging 5.1 percent in the first three months of 2015.

The medium term outlook for inflation is mixed. The relatively subdued international oil prices compared to the previous years is expected to keep inflationary pressures at bay especially transport related inflation. However, inflationary pressures from food and administered prices remain imminent. Drought experienced in Swaziland and

in South Africa (the main supplier of maize in the region) is expected to lead to an increase in food prices, especially in the second half of 2015. On administered prices, electricity tariffs were adjusted by 11.7 percent effective April 2015 whilst Swaziland Water Services Corporation has applied for a 7.2 percent tariff increase for three years. Other administered prices include anticipated increases in bread prices and a pending 25 percent increase in public transport. The latter is a part of the 50 percent public transport fares increase approved by the Parliament in 2014 which was supposed to be staggered over a two-year period. Whilst the first phase of this adjustment was effected in July 2014, the remaining 25 percent adjustment (which was supposed to be effected in 2015) has been somewhat watered-down by the subdued fuel prices. On the other hand, the weakening Rand/Lilangeni against major trading currencies continues to pose an upside risk to the inflation outlook.

After averaging 5.1 percent in the first quarter of 2015 as expected, the Central Bank inflation forecasts reflect that inflation will close the year

on an upward trajectory averaging 5.3 percent in the second and third quarter then rising to 5.7 percent in the last quarter of 2015. The medium term forecasts also show that inflation will average 5.9 percent in 2016 and 6.1 percent in 2017.

## EXTERNAL SECTOR

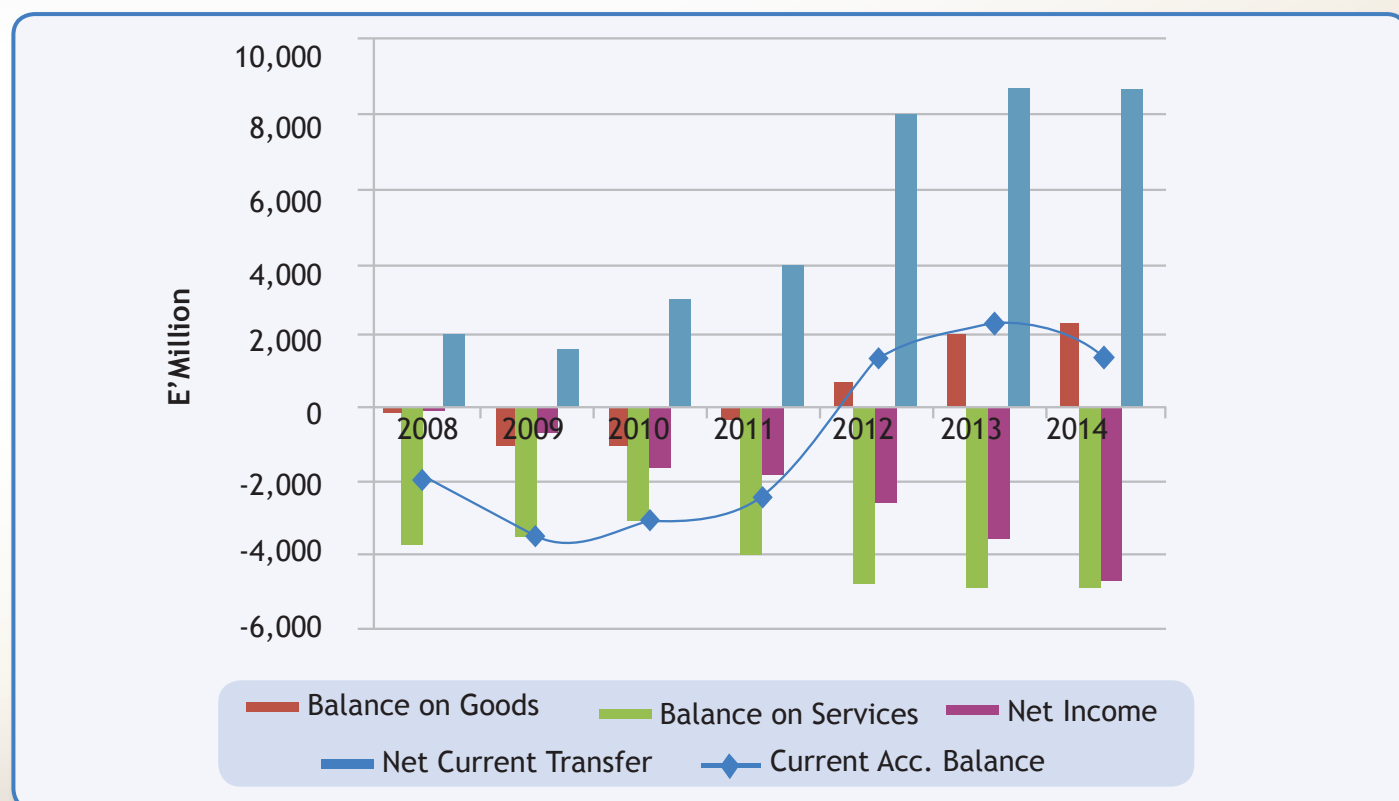
### Balance of Payments Developments

Despite an overall deficit of E252.3 million the country's balance of payments performed well during 2014, recording a surplus in the trade account and the current transfers account. The overall deficit during 2014 was mainly due to deficits recorded in the services and income accounts as well as the financial account.

### Current Account

In 2014 the current account recorded a lower surplus of E1.394 billion from a revised E2.248 billion surplus the previous year. The 2014 surplus is equivalent to 3.8 percent of GDP down from 6.6 percent in 2013. The 2014 surplus was dampened by a widening deficit in the income account during the year.

Figure 3: Current Account



Source: Central Bank of Swaziland

### Trade Account

Since 2013 the country's trade account has recorded surpluses. In 2014 the trade surplus stood at E2.307 billion, which was 18.2 percent higher than the surplus in 2013. The lower world oil prices eased the import bill during the review period, while the depreciation in the local exchange rate against major currencies supported export receipts.

Export earnings from goods increased by 12.9 percent to E20.646 billion in 2014 compared to the previous year. However this growth was slower compared to a growth rate of 15.7 percent in 2013. Data show that 61 percent of the country's merchandise exports were destined for the South African market.

During 2014 the country's major exports continued to include traditional commodities, namely miscellaneous edibles, sugar and sugar based products, zippers, beef, textiles and minerals. Export of miscellaneous edibles which comprise mainly food items remained the highest contributor to the country's exports revenue, contributing 50 percent to total export receipts. Earnings from miscellaneous edibles stood at E10.235 billion in 2014 reflecting a 24.7 percent rise from the previous year. The impressive growth was attributable to increased exports volumes by the industry and the depreciating exchange rate of the lilangeni against major currencies during the year, which improve the competitiveness of local exports.

Despite a marginal decline in export earnings of sugar and sugar confectionary, this industry remained the second highest contributor to the country's export revenue in 2014. During 2014 export earnings of sugar and sugar confectionary posted a 1.2 percent annual decline to E4.170 billion. Since 2011, the markets for domestic sugar have not performed well mainly in terms of prices. For the most part, the downward trend is a result of world production surplus driven by Brazil which is the largest sugar producer, affecting EU prices in the process.

Revenue from textiles and textile products rose to E2.463 billion in 2014, which reflects a 29.2 percent growth from 2013. This positive development was realized despite the fact that the country lost its eligibility to the US preferential market under the Africa Growth and Opportunity Act (AGOA) and as

such witnessed the closures of a few textile firms during the last quarter of 2014. However these events did not do much to dampen the export earnings from the sector which were cushioned by exchange rate effects. During the review period, 39.3 percent of textiles were exported to South Africa.

Earnings from the export of minerals dropped by 46.6 percent to E374.8 million in 2014. This was largely accounted for by the closure of the only iron ore mine in the country, which halted operations during the second quarter of the year. This development leaves coal as the only export product in the country's narrow mining sector.

Imports of goods rose by 12.2 percent year-on-year to E18.340 billion in 2014, of which 87 percent originated from South Africa. Explaining this notable increase are fuel imports which rose by 19.4 percent during the review period. Fuel imports were supported by increased volumes due to high demand as world oil prices fell drastically during 2014.

### Services Account

Swaziland continued to be a net importer of services in 2014, with services account recording a deficit of E4.867 billion which was marginally higher compared to a deficit of E4.858 billion recorded in 2013. Services inflows amounted to E3.224 billion in 2014, against outflows of E8.090 billion.

Inflows of transport services increased from E396.0 million in 2013 to E529.2 million in 2014. The biggest contributor to the 33.6 percent growth in inflows in the year was an increase in the demand for local freight services in 2014 compared to 2013. Other services inflows increased from E1.854 billion in 2013 to E2.695 in the review period.

Dominating services outflows in 2014 was other business services which recorded a net outflow of E3.285 billion in 2014, which was lower than a net outflow of E3.605 billion in 2013. Other services outflows amounted to E5.018 billion in 2014 up from E4.625.3 billion the previous year. Major contributors to other business services outflows during the review year were legal, accounting, management consultancy, merchanting and other trade related services. Other significant contributors to services outflows during 2014 were

royalties and license fees, travel and transport services.

### Income Account

The income account deficit persisted in 2014, amounting to E4.703 billion, reflecting a 32.7 percent increase from the previous year. This deterioration was due to a considerable increase in income outflows to E7.005 billion, whilst income inflows increased by a smaller margin.

During 2014, income inflows rose by 26.7 percent to E2.301 billion when compared with the previous year. Compensation of employees however, declined from E180.2 million in the preceding year to E160.2 million in 2014, mainly due to a decline in the number of Swazi mine workers employed in South African mines. Inflows related to interest earned by banks, government and other sectors amounted to E1.027 billion, making a significant contribution to the increased inflows in the income account inflows.

The increase in income inflows, were not enough to mitigate the effect of the outflows which remained elevated during 2014. Income outflows

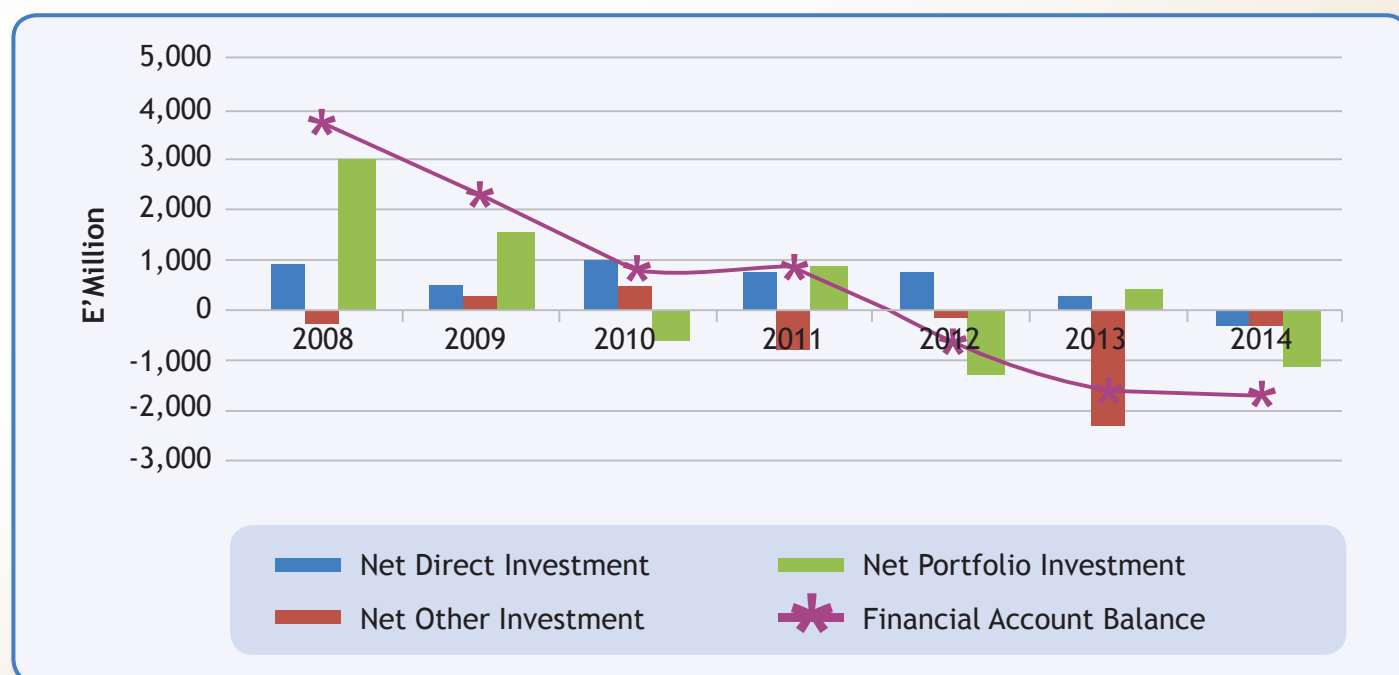
rose by 30.7 percent in 2014 to E7.005 billion. The biggest drivers of income outflows were dividends and distributed profits which grew from E4.763 billion in 2013 to E6.052 billion in 2014. The rise in dividends indicates that domestic companies were still profitable in 2014.

### Current Transfers Account

The Current transfers account remained the major item financing the current account in 2014 with a surplus of E8.657 billion, reflecting a marginal decrease from the E8.699 billion surplus recorded in 2013. Current transfers inflows improved marginally to E10.258 billion in 2014, reflecting a 2.3 percent increase from the previous year. SACU receipts dominated current transfers inflows amounting to E7.404 billion in 2014, up from the E7.131 billion in 2013.

Current transfers outflows amounted to E1.600 billion in 2014, higher than the E1.321 billion outflows recorded in 2013. Main contributors to current transfers outflows during 2014 were gifts, migrant transfers as well as contributions by Government to international organizations.

Figure 4: Financial Account



Source: Central Bank of Swaziland

### Financial Account

Preliminary figures reflect that during 2014 the financial account deficit persisted for the third year in succession, widening to E1.752 billion, up from a deficit of E1.635 billion in 2013. The financial account deficit is explained by net outflows posted in all the three sub-components of the financial account in the review period.

For the first time in nine years, foreign direct investment recorded a net outflow in 2014. During 2014, foreign direct investment posted a deficit of E310.3 million. This reflects a turnaround when compared to the net inflow of E281.2 million the previous year. The deterioration in the net position of FDI was to a large extent attributed to a significant net outflow in the other capital component of FDI emanating from the transfer of shares from a foreign entity to domestic investors in one of the major companies in the domestic forestry industry. During 2014 reinvested earnings net inflows increased by more than two folds to E710.5 million, thereby mitigating the effect of net outflows in inter-company lending, resulting to the subdued deficit in the foreign direct investment account.

The net outflow in the foreign portfolio investment account persisted in 2014, though subsiding to E294.3 million from E2.286 billion in 2013. The local asset requirement which requires Fund Managers to invest 30 percent of their assets in the domestic economy continued operating during 2014 and the Financial Services Regulatory Authority is working on enforcing it. The portfolio investment account is still dominated by assets held by resident entities abroad, mainly South Africa.

The other investment component of the financial account continued to be volatile in 2014, recording a deficit of E1.147 billion. Trade credits extended

and banking sector outflows contributed largely to the deficit in the other investment account. Government continued servicing its external debt obligation with repayments on public and publicly guaranteed debt amounting to E155 million in 2014 against drawdowns of E225.2 million, resulting in a net inflow of E70.2 million.

### MONETARY SECTOR

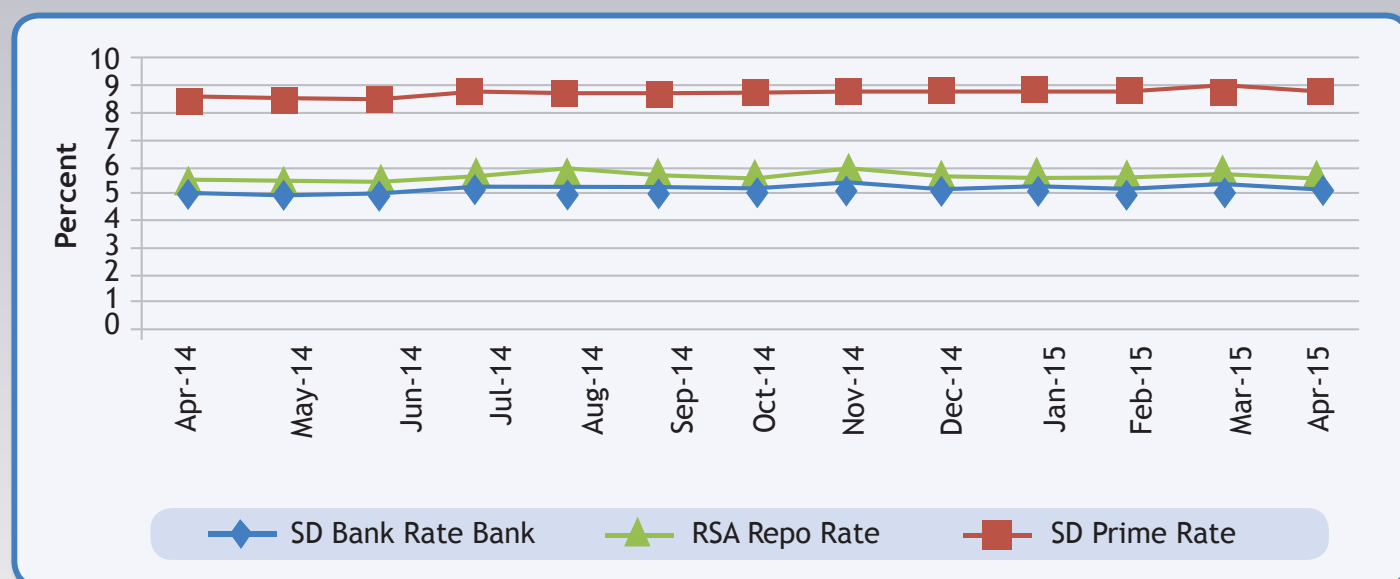
Monetary conditions in 2014 and the first four months of 2015 were mixed but largely stable as the Bank's monetary policy tightened slightly in July 2014 and then remained unchanged. The tight monetary policy stance in July was pursued amid mounting inflationary pressures and outlook within domestic, regional and international markets.

Accordingly, the bank rate increased by 25 basis points to 5.25 percent in July and remained at that level throughout the rest of 2014 and the first four months of 2015. The upward movement in the bank rate was lower than in South Africa where the repo rate increased by 75 basis points over the same period. This has resulted in a 50 basis points differential between the bank rate and the repo rate. This differential exists as an effort by authorities to lessen the burden of higher lending rates on borrowers thus encouraging banks to increase credit extension that will boost investment and economic growth.

The Bank will therefore, as in the past, find an opportune time to reduce the differential and align its bank rate to the repo rate. This will be done to normalise the situation particularly avoiding capital flight to South Africa for arbitrage purposes and further limiting the pressure on the country's foreign exchange reserves.



Figure 5: Interest Rates Trends



Source: Central Bank of Swaziland and Commercial Banks

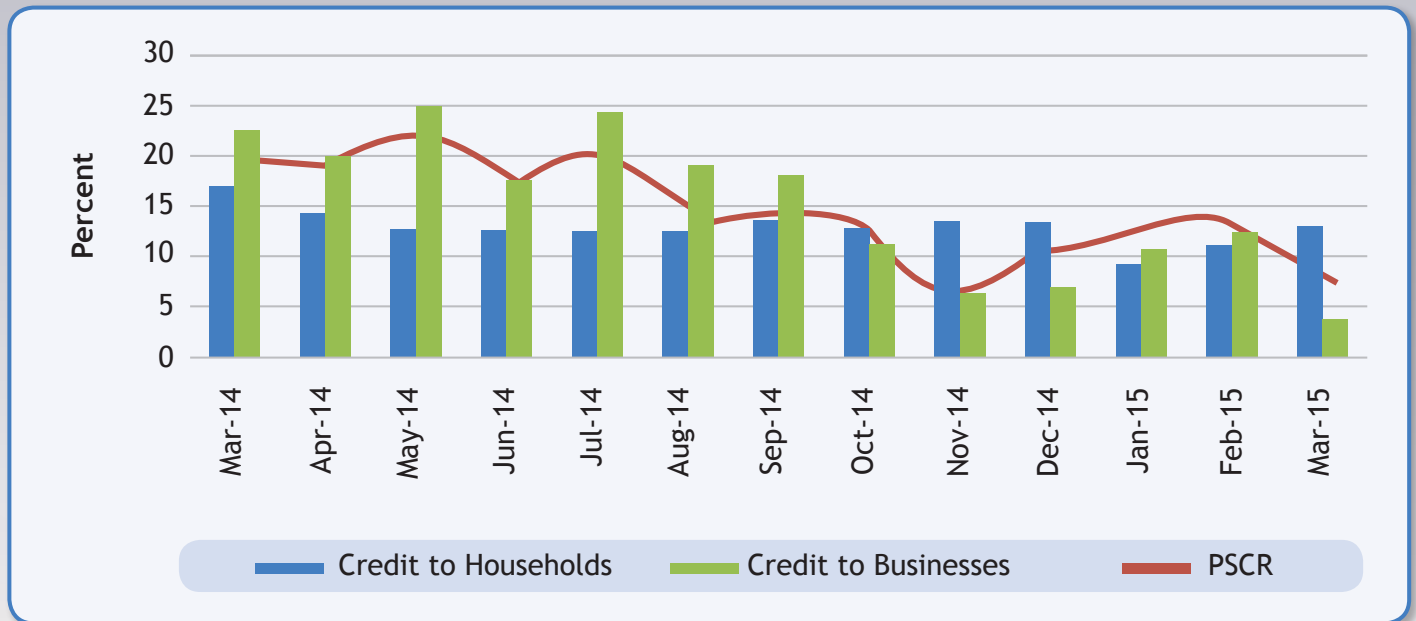
Short to medium-term outlook for monetary policy remains uncertain but largely stable against a backdrop of sharply lower global oil and other commodity prices which have reduced inflationary pressures substantially. However, moderate interest rates hikes are expected towards the end of the year depending on rising interest rates in the USA and UK, strong rebound in oil prices and notable rand/lilangeni weakness. Prospects on economic growth present substantial downside risks given the persistent sluggish economic activity domestically, the wide current account deficit, ongoing electricity constraints and labour tensions in neighbouring South Africa, weaknesses in Europe and Japan, slowdown in China, geopolitical events such as conflicts in Ukraine and Middle East and lower global growth forecasts. The broad stance of monetary policy will therefore be to keep inflation stable whilst providing support for accelerated economic growth.

On a year-on-year basis, credit extended to the private sector continued to grow but at a slightly slower pace of 9.0 percent in March 2015 compared to 20 percent recorded the previous year. This was mainly a result of the levelling-off of credit

from high levels induced by base effects and the lacklustre demand for credit by the business sector. Annual credit to businesses which represent the productive sector of the economy grew by a lower 4 percent compared to 22.6 percent recorded the previous year. The lower credit to businesses was mainly discernible in the manufacturing, mining & quarrying as well as community, social & personal services sectors. However, increases were registered in the agriculture & forestry, transport & communication and distribution & tourism sectors.

Annual growth in credit to the household sector, which contributes to consumer expenditure, slowed moderately from 17.1 percent the previous year to 13.0 percent in March 2015. The decline was observed in other 'unclassified' personal loans which turned around from a rapid increase during the second half of 2013 reaching a peak in January 2014. Thereafter, the other personal loans started to decline gradually throughout 2014 and the first quarter of 2015. On the contrary, housing and motor vehicle finance reflected moderate increases of 13.7 percent and 24.7 percent, respectively over the review period.

Figure 6: Private Sector Credit: Annual Changes

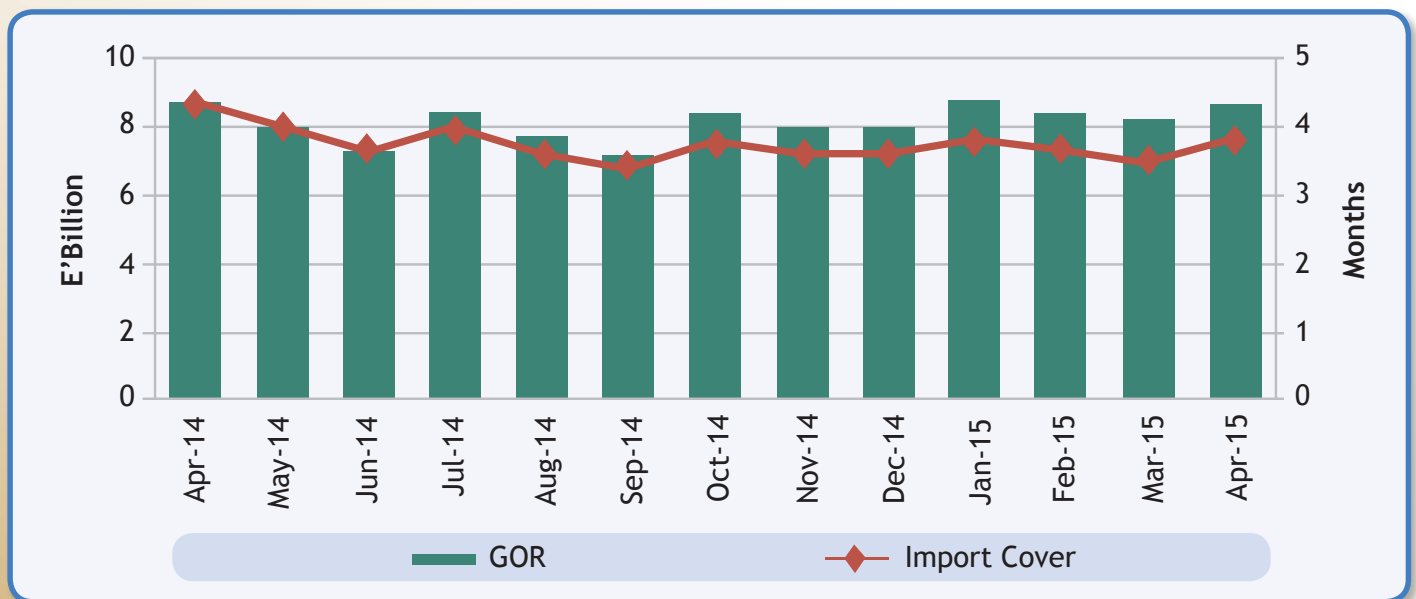


Source: Central Bank of Swaziland and Commercial Banks

Over the year ended April 2015, the country's gross official reserves declined by 1.1 percent to reach E8.6 billion. This was mainly attributed to higher growth in government expenditure vis-à-vis revenue growth compared to the previous fiscal

year. Consequently, the import cover of the reserves decelerated from 4.3 to 3.8 months over the review period. Though declining over the year, the import cover remained above the internationally acceptable level of 3 months.

Figure 7: Gross Official Reserves and Import Cover



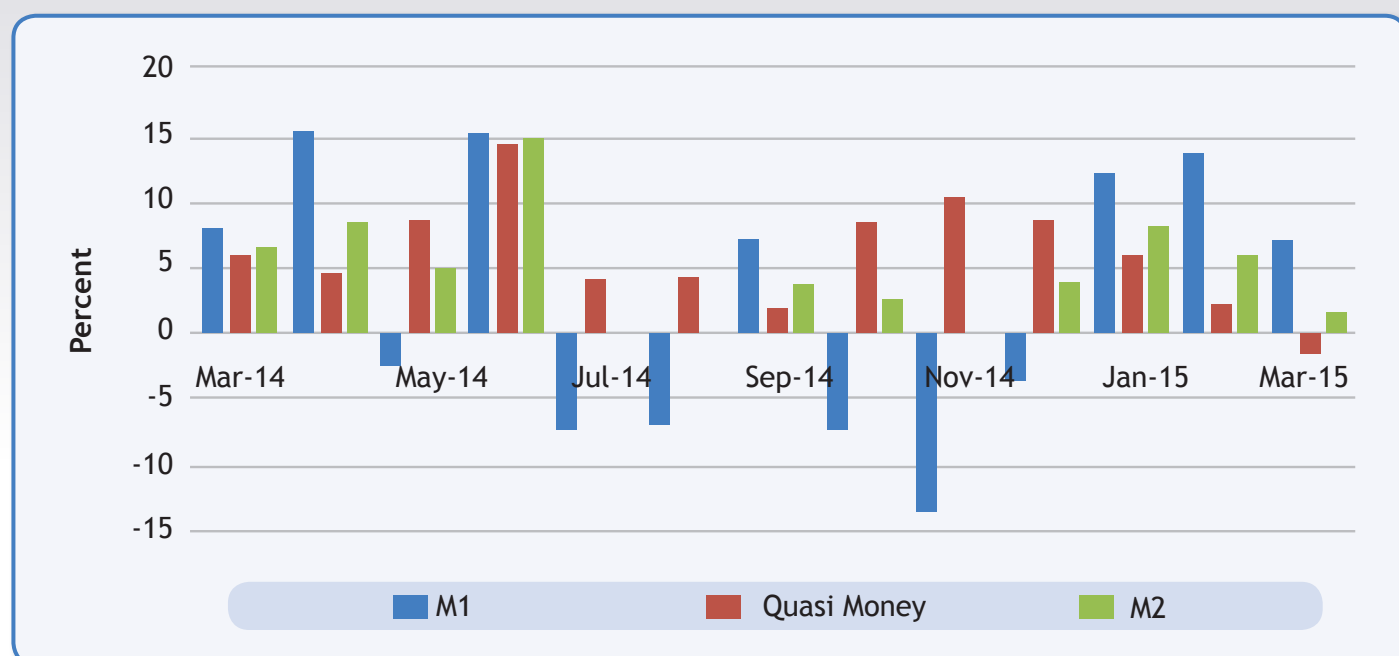
Source: Central Bank of Swaziland

The short to medium-term outlook for the country's foreign exchange reserves is somewhat negative as SACU revenue for the fiscal year 2015/16 is projected to fall below the 2014/15 fiscal year's level. This calls for the government to accelerate expenditure restraint measures as well as to broaden the revenue base. These efforts would ensure that the reserves are maintained at a healthy position and further accumulate to levels that can serve as a buffer from unexpected shocks.

In line with the lower growth in net foreign assets and private sector credit extension, annual broad

money supply (M2) grew by a lower 1.8 percent in March 2015 compared to 6.7 percent registered the previous year. A notable downward trend was reflected in quasi money supply (interest earning deposits) which fell by 1.2 percent in March 2015 compared to growth of 6.0 percent recorded the previous year. Narrow money supply (M1) growth decelerated slightly from a high of 7.9 percent the previous year to 7.1 percent in March 2015. The rise in narrow money supply against a fall in quasi money indicated the depositors' increased propensity to hoard money for transactions' purposes rather than for investment purposes.

Figure 8: Money Supply - Annual Changes



Source: Central Bank of Swaziland and Commercial Banks

## FISCAL SECTOR

The Minister of Finance presented the 2015/16 National Budget to Parliament on 27<sup>th</sup> February 2015. The Budget was in line with His Majesty the King Speech from the Throne when opening the 2<sup>nd</sup> Session of the 10<sup>th</sup> Parliament where he counselled the Nation to *“Save for rainy days during good years”*.

To complement the Speech from the Throne, the theme for the 2015/16 Budget as presented by the Minister is *“Achieving more with less spending: sustaining economic growth and protecting*

*social development”*. Key priorities identified under difficult fiscal circumstances included:

- ❖ Building a strong and resilient economy with emphasis on macroeconomic stability;
- ❖ Undertaking strategic infrastructure rehabilitation and expansion;
- ❖ Enhancing human capital through protecting the vulnerable, improve access and quality of health and education; and
- ❖ Enhancing service delivery.

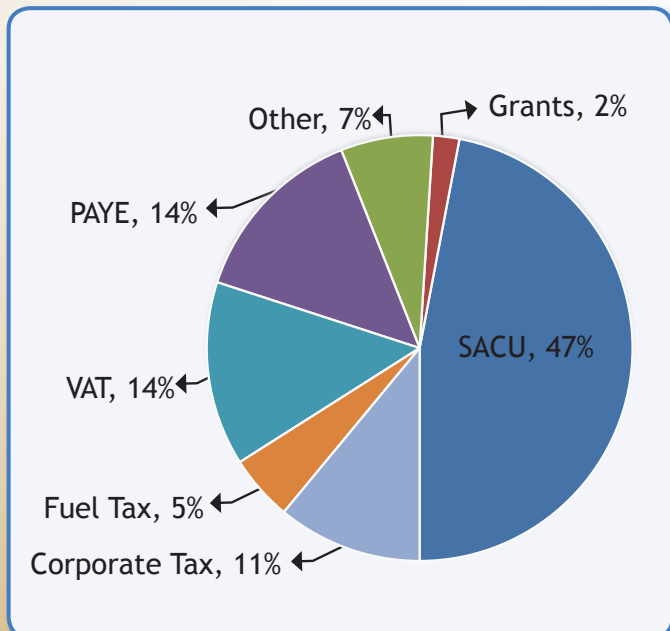
**Budget Review**

The actual outturn for 2013/14 shows a marginal budget surplus of E216 million or 0.5 percent of GDP. The surplus realised contributed to a strengthened reserves and domestic financial position. On the other hand, the estimated outturn for 2014/15 indicates a budget deficit of E823 million, an equivalent of 2 percent of GDP.

Estimates for 2015/16 indicate that Government will run a deficit of E1.3 billion, corresponding to 3 percent of GDP. Revenue to be collected in 2015/16 will decrease by 1.3 percent from E14.8 billion achieved the previous fiscal year to reach E14.6 billion. This is mainly attributed to an 8.7 percent decline in SACU receipts.

SACU receipts still remain the largest component of Government revenue as they account for 47 percent of projected revenue in 2015/16 fiscal year. SACU remains a major source of Government revenue despite the decrease from E7.5 billion recorded in 2014/15 to E6.9 billion projected for 2015/16.

**Figure 9: Government Revenue Major Components 2015/16**



Source: Central Bank of Swaziland

Swaziland is not reliant on grants for financing of its budget as they account for only 2 percent of the total budget.

VAT, which accounts for 14 percent of total revenue is projected to increase to E2.1 billion from E1.9 billion the previous year. PAYE and Corporate taxes are also projected to increase by 10.5 and 23.1 percent, respectively. Efficiencies in tax collections by the Swaziland Revenue Authority to increase domestic revenue are commendable.

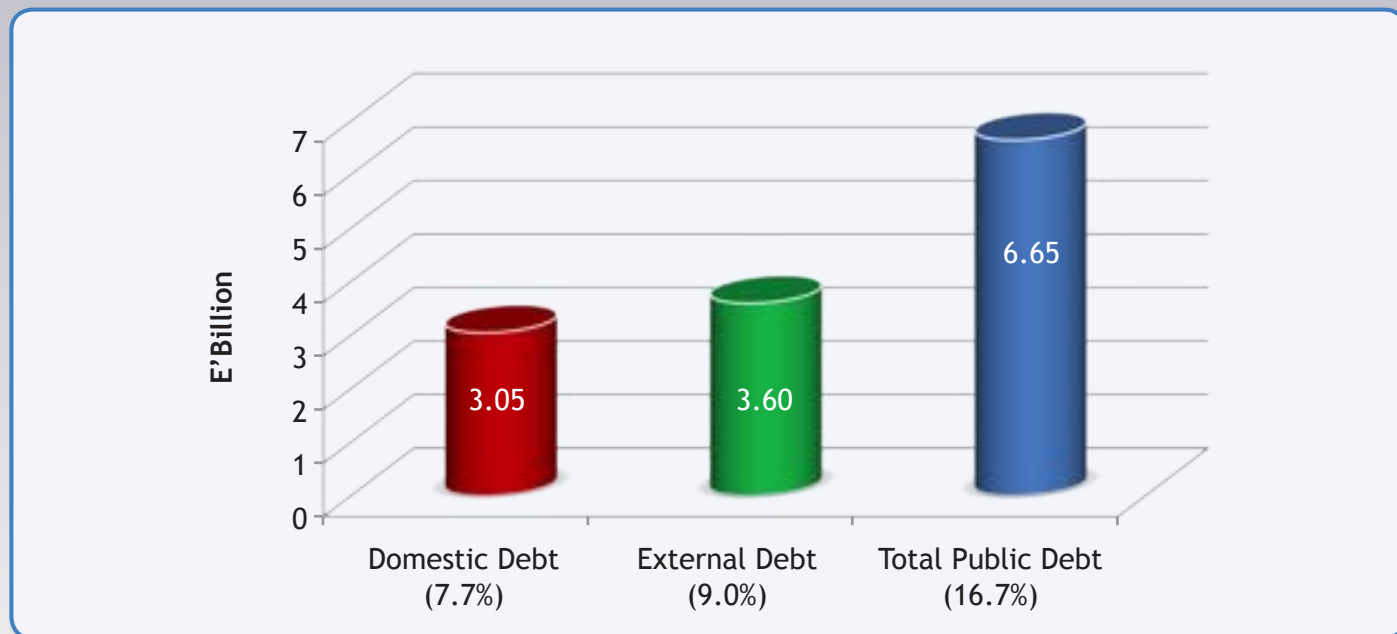
Total expenditure is projected to reach E16 billion in 2015/16, an increase of 1.9 percent from E15.7 billion the previous fiscal year. Recurrent expenditure is estimated at E12.7 billion; of which 41 percent account for the wage bill which is above the internationally acceptable level of 35 percent. Capital expenditure is estimated at E3.2 billion, a decrease of 13.5 percent from the previous fiscal year. Key projects earmarked for the capital expenditure are Sicunusa-Nhlangano Road, Mbadlane-Manzini Road, establishment of Strategic Oil Reserve at Phuzamoya and the construction of a Hotel and International Conference Centre at Ezulwini.

On the financing of the budget deficit, the Minister of Finance indicated that about E1 billion will be sourced from the domestic debt market. To support that, the Bank has engaged the Financial Services Regulatory Authority and other stakeholders to map a way forward on how to develop the domestic capital market in order to ensure that Government financing needs are met and at the same time address investors' diverse needs.

**Public Debt Developments**

Total public debt was recorded at E6.65 billion or 16.7 percent to GDP at end of March 2015. This marks an increase of 6.1 percent from the E6.27 billion recorded in March 2014. The increase was mainly attributed to the continued issuance of Government Bonds coupled with disbursements of loans for on-going projects during the period being reviewed.

Figure 10: Total Public Debt As At March 31, 2015

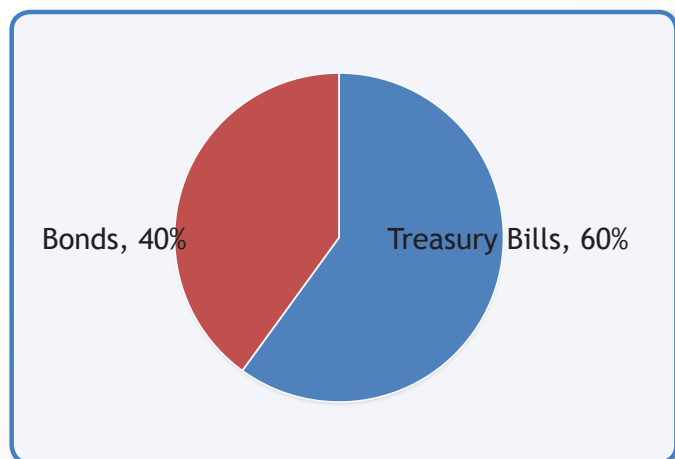


Source: Central Bank of Swaziland

External debt was recorded at E3.60 billion, an equivalent of 9.0 percent to GDP at end of March 2015. This indicates a 4 percent increase from the E3.46 billion recorded in March 2014. The increase was largely due to the disbursements of loans for on-

going projects during the period under review. Also attributing to the increase was the depreciation of the lilangeni against the US Dollar and other major currencies in which most of the country's external liabilities are denominated.

Figure 11: Domestic Debt Share of Holdings as at March 31, 2015

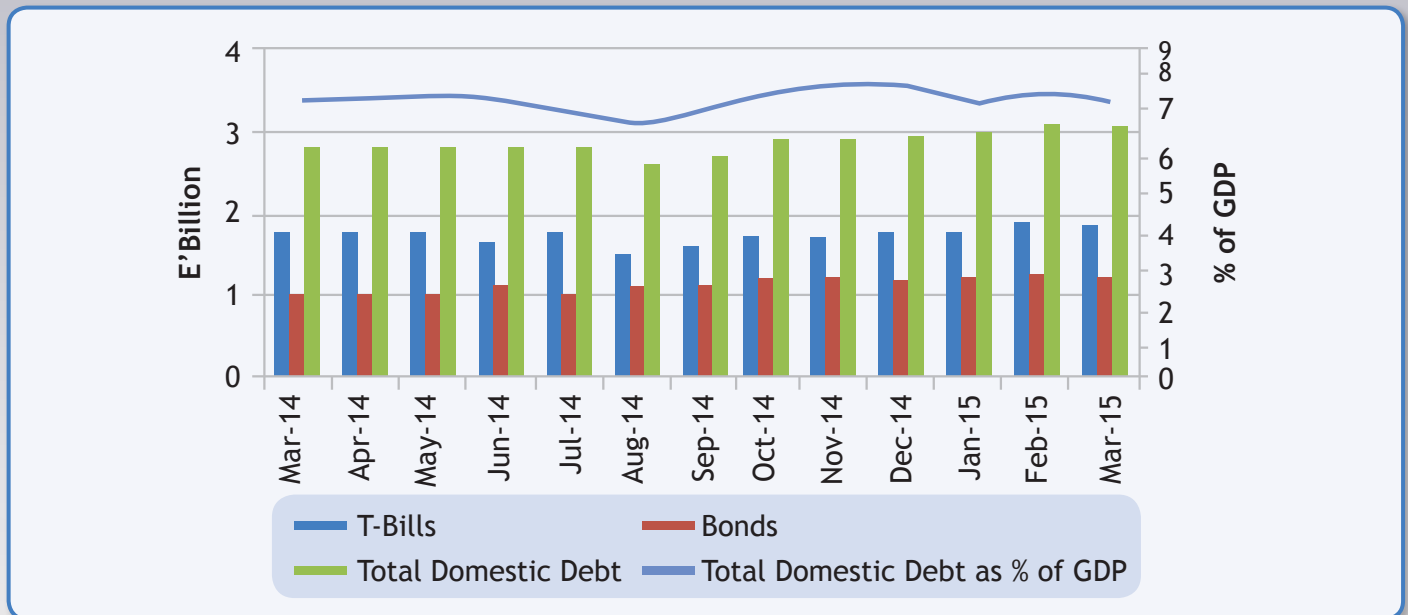


Source: Central Bank of Swaziland

On the other hand, domestic debt increased from E2.81 billion in March 2014 to E3.05 billion (7.7 percent to GDP) in March 2015. The increase was mainly a result of continued issuance of Government Bonds during the period under review which was nevertheless offset by redemptions in the same period.

Domestic debt is still concentrated at the shorter end of the yield curve; i.e. on Treasury bills. Despite the challenges experienced in raising funds through Bond Issuances, the Bank is committed to address this problem through the continued consultation with all stakeholders, which in the medium to long-term, will help address the issue of roll-over risk currently observed.

Figure 12: Public Debt Trend



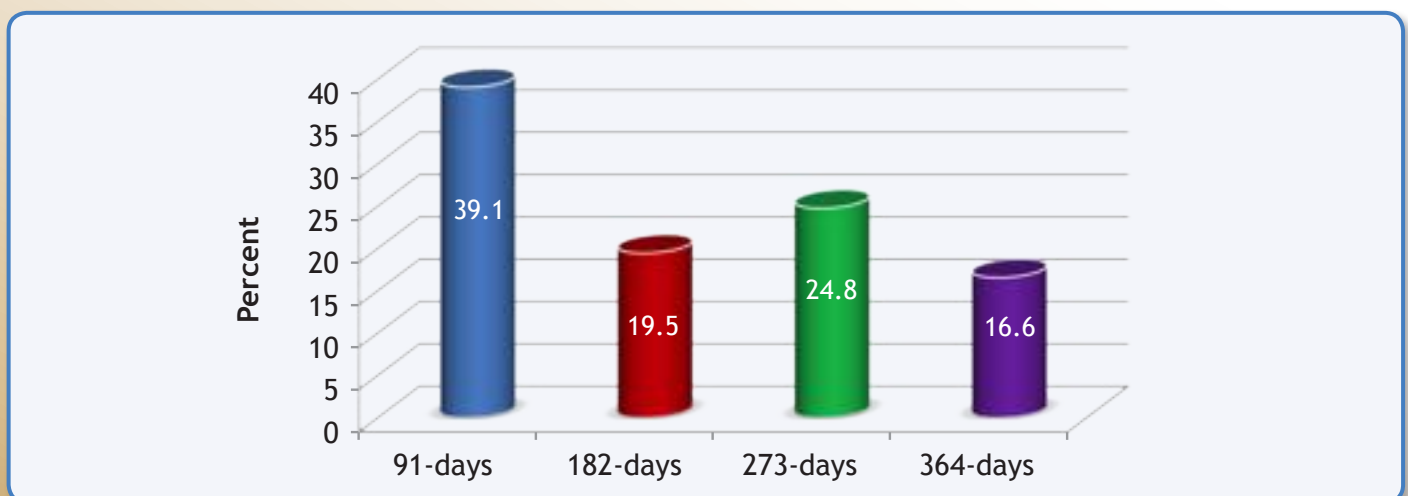
Source: Central Bank of Swaziland

Commercial banks continue to dominate participation in Government securities accounting for 52 percent of holdings followed by NBFIs at 35 percent with “other” investors holding the remaining 13 percent as at end of March 2015.

Treasury Bills (T-bills) Issuances continued in 2014/15 and were mainly used to finance government cash shortfalls rather than to

finance the budget deficit of 3 percent to GDP as announced by the Minister of Finance when delivering the Budget Speech in Parliament on 21<sup>st</sup> February 2014. T-bills recorded an increase of 2.8 percent from the previous fiscal year to reach E1.83 billion in March 2015. The 91-days paper remains the most popular paper amongst investors accounting for 39.1 percent of total T-bills outstanding at the end of March 2015.

Figure 13: Percent Share of T-bills as at March 31, 2015



Source: Central Bank of Swaziland

In contrast, Government Bond issuances during the 2014/15 fiscal year have not been successful. The domestic financing gap for the fiscal year 2014/15 was estimated at E800 million and a recommendation was made to raise the full amount through the issuance of domestic, fixed interest rate bonds. The rationale for raising the funds through bond issuances was mainly to lengthen the yield curve and reduce roll-over risk.

The Issuance Calendar was duly published in an effort to increase transparency, thereby allowing prospective investors to plan for their investments. Primary Dealers were engaged as one of their major roles is to be market makers in all Government securities. In the course of the year, the amount was revised down to E600 million from the originally planned E800 million, as the amount scheduled for issuance for the 5-year SG020 bond was reduced to E100 million from E300 million. This was based on investor feedback which indicated low market appetite for Government paper.

In the fiscal year 2014/15, the E600 million was offered at four (4) different auctions for papers of varying maturities (3, 5, 7 and 10 years). When taken as a whole, the key ratios indicate that the programme was undersubscribed with bids received recorded at 84 percent of the total amount offered. Allotments made amounted to E226.9 million indicating that only 38 percent of the amount sought was successfully raised. This indicates that the programme has not met expectations.

Impediments to the success of the programme observed include, but not limited to, the "Low participation of Non-Bank Financial Institutions (NBFIs)". Investor feedback from local fund managers indicates that most funds are now complying with the 30 percent local asset requirement and do not want to increase their exposure to Government. Most funds have a short-term mandate and do not invest in long-term papers; as such there were no bids from NBFIs in the re-openings of the 7 and 10 year bonds. This has resulted in a sharp decline in investor participation in bond auctions coupled with a rise in average cost of borrowing.

The poor market response indicates little scope to significantly increase the issuance of Government debt in the 2015/16 fiscal year. The Bank, in collaboration with Government and other

stakeholders, will continue its efforts to stimulate activity in the domestic debt market.

## **BANK SUPERVISION DIVISION**

The Bank Supervision Division (BSD) of the Central Bank Swaziland is responsible for supervising banking and credit institutions in terms the Financial Institutions Act, 2005. The key objective of the division is to promote the soundness and stability of domestic banking system.

### **Industry Growth**

The Central Bank of Swaziland continues to receive enquiries on new banking licenses from prospective investors. The Bank is welcome to new entrants who will identify and serve a niche within the banking industry. There remains an existing untapped gap in the provision of financial and banking services which potential investors may take advantage of, in pursuant of the financial inclusion agenda.

The Central Bank, however, is always careful in its evaluation and assessment of new applications to avoid instances of bank failures which causes an undesired instability in the financial system. New applicants are therefore encouraged to conduct a due diligence exercise on the development of their business concepts to ensure success of their applications.

To sustain investor confidence and protect the interest of depositors and the public, the Bank requires financial institutions to comply with laid down licencing procedures and requirements of the Financial Institutions Act, 2005.

### **Illegal Deposit Taking**

The Bank Supervision Division will continue keeping a watchful eye on persons operating business that offer services deemed to be a regulated service in terms of Section 6 of the Financial Institutions Act, 2005. Illegal deposit taking remains the biggest single threat to the stability of the financial system. We have conducted consumer education on matters of illegal deposit taking and implore the public to be as watchful.

### **Banking Sector Performance**

The performance of the banking industry remains strong as indicated by positive growth in both assets

and profitability. All institutions are in compliance with statutory requirements on liquidity, cash reserves and capital adequacy. Hence, it suffices to say that the players in the banking industry were operating in a safe and sound manner.

#### Industry Balance Sheet

The banks had capital ratios above the minimum statutory requirements. Being well capitalized is very crucial, particularly where a financial institution has been hit by losses. The banking sector assets exhibited a growth rate of 4.3 percent, increasing from E12.879 billion in December 2013 to E13.437 billion at the end of December 2014.

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

#### Industry Income Statement

The banking sector's profitability ratios remained strong throughout the year 2014. Pre-tax return on capital was 28.4 percent in December 2014, compared to 22.8 percent at the end of December 2013, while pre-tax return on assets was 3.8 percent compared to 2.9 percent at the end of December 2013.

The industry's total cost-to-total income ratio which is a measure of its operational efficiency was recorded at 65.6 percent in December 2014 which compares favourably to the international benchmark of 60 percent. This ratio was recorded at 66.7 percent in December 2013.

#### Credit Institutions

The Bank currently supervises three Credit institutions licensed under the Financial Institutions Act, 2005, which are Blue Financial Services, Letshego Financial Services and First Finance Company. The Bank is closely monitoring the financial condition of Blue Financial Services which has been affected by the systematic effects from its parent company in South Africa. It is worth noting that after promulgation of the Financial Services Regulatory Authority's Act, 2010, a new regulator is now in place to regulate and supervise all non-bank financial institutions. These institutions are now expected to be licensed under this new Act.

#### New Developments in the Banking Industry

The Central Bank is encouraged by the continuous improvement on the product range offered by the banking industry. Innovation and technology is continuously opening new opportunities for banking institutions to diversify products and reach to those markets that were previously excluded. Over the recent years we have observed the rolling out of Mobile Money products, Internet Banking, Debit Cards and many other technology-inspired products.

The advent of these products calls for the Central Bank to be even more robust in its regulatory and supervisory approach. As banking products are becoming more sophisticated, inherent operational risk within the banking sector also increases.

It is against this background that the Central of Swaziland is continuously reviewing its approach on prudential regulation. The BSD is currently working on exploring a migration to Basel II Capital Framework. This framework will define the calculation of minimum capital requirement considering not only credit and market risks, but also operational risk within the individual banks.

#### NATIONAL PAYMENT SYSTEM DIVISION

The Central Bank of Swaziland (CBS) will continue to support financial sector stability through promotion, regulation and supervision of designated national payment systems this year (2015). The designated national payment systems are the Real Time Gross Settlement System (RTGS) operated by the CBS; and the clearing & settlement system that processes Electronic Fund Transfers (EFTs) and paper-based instruments (mainly cheques) operated by the Swaziland Automated Electronic Clearing House (SAECH).

#### Review of Cheque Limit

In line with international best practice, the CBS will continue to encourage growth in electronic transfer of funds transactions to reduce risks and inefficiencies associated with processing of paper based transfer of funds. In order to grow activity in electronic payments associated with mitigation of financial risk, the Central Bank of Swaziland



has engaged commercial banks to reduce cheque limits from E500,000-00 to E100,000-00 with effect from July 2015. This will be accompanied by the introduction of cheque imaging and truncation to reduce the clearing cycle and processing costs associated with the movement of cheques between clearing banks and the clearing house. In this way, modernization of the processes would be expected to create efficiencies and cost effectiveness in the delivery of banking services to clients.

### Financial Inclusion

The CBS also continued to support the Swaziland Government Programme for financial inclusion under the Ministry of Finance. In an endeavour to inform and create public awareness to aspiring financial service providers, the CBS recently posted a "Practice Note on Mobile Money Transfer Operators" on its CBS website ([www.centralbank.org.sz](http://www.centralbank.org.sz)). This Practice Note outlines authorization and/or the licensing procedures to aid application and consideration relating to the provision of mobile money transfer services. In line with international best practice, mobile money transfer service providers shall be expected to have an integrated approach to managing risk that adequately identifies, measures, monitors and controls risk. It is believed that Mobile Network Operators will continue to reach out to the unbanked population through researched and sound solutions and product outlay that meet the needs of the targeted consumer segment. Of priority here is the populace in the country side where financial services are lacking in terms of accessibility. According to the FinScope Consumer Swaziland 2014 survey results, the majority of the population still find the formal financial sector expensive due to the fact that most financial products are pegged on regularity of income.

### Systems Compatibilities

Another development in the financial sector is the recent introduction of MasterCard compliant ATM card network by Swazi Bank. This development is expected to increase banking products and to create convenience that comes with interoperability between banking systems, locally and globally. While introducing new technology and robust systems in the banking sector, commercial banks

are required to manage the risk that comes with innovation with the high intention of safeguarding the interest of clients against financial risks. In line with international principles for financial market infrastructures, the CBS will continue to engage commercial banks to facilitate local settlement of domestic ATM Card and Point of Sale transactions.

### Regional Integration

The CBS and the four commercial banks continued to transmit and settle cross-border transfer of funds through the SADC Integrated Regional and Electronic Settlement System (SIRESS) sponsored under the European Union Regional Economic Integration Support (REIS) Programme. In line with the objective of the REIS of supporting an enabling environment to enhance the movement of goods and services within SADC, 63 banks from nine (9) member countries are active on SIRESS. The activity is expected to grow as some of the remaining member states have reached system test mode. The SIRESS activity hit ZAR 1 trillion on 29<sup>th</sup> April 2015. It is believed that this milestone is not only appealing to the SADC member countries; it is also seen as a positive indicator for success in advancing the economic integration program in the SADC region. Furthermore, it is believed that the benefits of real time payment and settlement would add value in the support of regional trade when compared to settlement delays associated with correspondent banking arrangements.

Based on the foregoing developments in the payment systems space, the financial sector continues to show commitment to raise the bar in consumer service through banking system reform and exercising leverage on innovation.

### EXCHANGE CONTROL

A cautious approach has been adopted by the Bank in ensuring that exchange controls liberalization are done gradually taking cognizance of the fact that relaxations must be approached from a position of strength to ensure that information loss is minimized if not totally eliminated and data accuracy is not comprised. This will be achieved through enhanced offsite surveillance by the Exchange Control Division.

In the year 2014, the following facilities were further relaxed:

- ❖ The Single Discretionary Allowance for Private Individuals was increased from E750 000 to E1 million per annum. This facility is utilised for travel, gift, donation and maintenance allowance.
- ❖ Emigration by Permanent Residents was increased from E2 million to E4 million per individual.
- ❖ This is in addition to related facilities like export of household items and personal motor vehicles.
- ❖ Foreign Investment by Private Individuals was increased from E2 million to E4 million per tax paying individual above the age of 18 years.

#### Innovation

The introduction of new remittance methods by banks as well as Money Transfer Operators (MTO's) driven by technological innovations which are not properly addressed by prevailing Central Bank legislation has been observed in the last few years. Rather than stifle growth, efforts are continuously being made by Central Bank to amend legislation to accommodate such new products to cater for domestic as well as cross border transfers.

The granting of a licence to Interchange Swaziland, the first Bureau de change to open up in the country to do cross border remittances in partnership with Western Union is a significant milestone in opening up the remittance space.

This indicates the bank's commitment to open up the use of the formal financial system by low income earners as operations of this nature permit walk-in customers as opposed to serving account holders only and offers affordable remittance costs for low value amounts whilst increasing market players which will hopefully promote competition whilst driving down the much complained charges. Spiralling effects will range from minimising black market operations to promotion of financial inclusion and accurate capturing of the country's economic activities.

Other applications are underway for rolling out remittances into poor and rural communities

through the use of infrastructure outside the formal banking systems.

#### Anti-Money Laundering Issues

The introduction of the new methodology in the assessment of compliance by the Financial Action Task Force (FATF) to international Anti-Money Laundering Combating of Terrorist Financing and Proliferation of Weapons of Mass Destruction has brought a challenge to countries who are expected to come up with legislation to combat these crimes and also more importantly implement them. Another Key Area that is of importance is the international and national cooperation in terms of information sharing given the fact that these crimes are cross jurisdictional.

Emphasis now lies on demonstrating the effectiveness of existing controls to deter and detect money laundering and terrorist financing and not just the mere existence of internal controls. Countries are also expected to produce statistics on the number of successful cases on Money Laundering and Terrorist Financing which have been tried in courts of law to demonstrate the effectiveness of their laws. This raises the bar for countries as they strive to be seen to be compliant.

The first two countries which will be assessed in 2013 by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), to which Swaziland is a member, are Zimbabwe and Uganda. The evaluation for Swaziland is scheduled for 2017.

A major development that worked in favour of the region is the acknowledgment by the FATF that some of the set standards are impossible to apply in the African continent. FATF has realised that not all countries have formal or well defined residential addresses thus lenient on Know Your Customer (KYC) measures are now permissible like the use of the identity document only for account opening for low income earners as opposed to the requirement for utility bills for all account holders. Also alternative verification of address methods are permissible provided a risk assessment exercise has been conducted to justify their introduction and demonstrate that there is a low risk of money laundering and terrorist financing occurring.

Such lenient measures have been introduced to ensure that AML/CFT requirements do not lead

to financial exclusion. This has improved access to financial services by low income earners thus accelerating the country's financial inclusion initiatives.

Efforts to identify other areas where less stringent requirements can be introduced are continuously being made as part of the Bank's Financial Inclusion (FI) initiatives.

## FINANCIAL STABILITY UNIT

The macro-prudential policy approach is dependent on the co-operation with other policy making and regulatory authorities. While the mandate of financial stability lies with the Central Bank, other regulators must also take into account the financial stability implications of their activities, and assess all systemic risks potentially arising from any institutions that they may be supervising. This translates to the Bank taking a leading and co-ordinating role as it is not solely responsible for financial stability and hence the active part in external structures for communication and policy co-ordination around financial stability.

Pre-emptive policy action needs mechanisms for early identification and assessment of systemic risk. Substantial work still needs to be done to develop analytical tools that can help identify and measure systemic risk in a forward looking way, and thus support improved policy judgements.

The difficulty of this task should not be underestimated and this remains very much work in progress at CBS with much Technical Assistance needed. Our understanding of systemic risk and of the fault lines in the structure of the financial system that makes it prone to instability or failure is incomplete. In addition, there are still important limitations in terms of the link between real and the financial sector and significant data gaps couple with the current model of micro prudential tools.

The conduct of macro prudential regulation at CBS involved the formulation of a macro prudential policy framework which saw the establishment of an independent Financial Stability Unit. The identification and availability of relevant data is critical for an effective macro prudential policy framework. The recent financial crisis revealed

major gaps in the information available to authorities to assess and monitor systemic risk.

A number of initiatives are underway to enhance the data infrastructure, priorities include:

- ❖ Improving information on maturity and liquidity mismatch, and on leverage for the banking system,
- ❖ Improving information on credit and savings,
- ❖ Enhancement to data on sectorial balance sheets, portfolio investments,
- ❖ Analysis of data for the insurance, retirement and pension funds sector, and
- ❖ Improving information on common risk exposures and interconnectedness.

Improving data for systemic risk analysis will necessitate improvements in data collection frameworks, especially to provide the authorities with sufficient powers to collect the requisite data. One such initiative is to work on the arrangement for information exchange with FSRA to promote effective data sharing so as to strengthen the assessment of system-wide risks at national level.

Given these inter-linkages, an effective macro-prudential framework requires institutional arrangements and governance structures, tailored to national circumstances, that can ensure an open and frank dialogue among policy makers on policy choices that impact on systemic risk, resolve conflicts among policy objectives and instruments, and mobilise the right tools to limit systemic risk. It is for this reason that the Financial Stability Unit has proposed the formation of a multi-disciplinary committee structure.

It is proposed that a three-tier committee structure be established to adequately address the execution of financial stability responsibilities, namely a Financial Stability Committee, Financial Stability Panel and the Financial Forum.

The primary responsibility of the financial stability rests with the Financial Stability Committee (FSC). The objective of the FSC shall be to complement the price stability objective of the Bank through

formulation and implementation of appropriate macro-prudential policy measures to limit the cost of system-wide distress in the financial system.

The purpose of the FSC would be to co-ordinate at national level the work of financial supervisory authorities and government standard setting ministries in order to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies whilst also assessing the vulnerabilities affecting the financial system, identify and oversee action to address them.

The role of this committee would be to bring together the regulators of financial institutions, with a mandate of contributing to the efficiency and effectiveness of regulating the financial system in Swaziland.

Global economic recovery is expected to continue consolidating, led by developed countries and mainly the US. Emerging market performance is expected to remain subdued in the short to medium term, mainly undermined by low commodity prices. The low commodity prices are expected to continue keeping inflationary pressures in both developed and developing countries in check giving countries room to keep policy rates at low levels to boost economic activity. Despite the existing opportunities for low interest rates, it is anticipated that countries, both developed and developing, will start tightening policy rates in the short to medium term.

In the domestic economy the establishment and operation of the Swaziland Financial Services Regulatory Authority present an opportunity for the full scale supervision of the entire financial sector in the country. In its operations, it is expected

that domestically generated savings will be used for the development of the country as the 30 percent local asset requirement is enforced. This will lead to increased employment opportunities in the financial sector and other parts of the real sector as non-bank financial institutions invest domestically to meet this requirement. The FSRA is encouraged to further define and disaggregate local asset requirement by giving more weight on investment in priority sectors, and minimum weight to all cash held at banks, in order to address the current undermine of the policy that sees Non-Bank Financial institutions keeping the money in commercial banks and fund managers only for the money to find its way out of the country.

As part of the drive of the Bank to be a benchmark and to be amongst the top five Central Banks in the region, the Bank plans to develop a roadmap that will migrate it towards Basel III compliance.

In conclusion it is important to mention that we are at a point where interest rates have reached their lowest levels and going forward we are expecting interest rates to start charting an upward trend in the region and in the domestic market. The tightening of monetary policy will be carefully monitored to ensure that it has minimal negative effects on our low growth.

In the cause of pursuing its mandate the Bank will drive the financial inclusion agenda while not compromising on the health of the financial sector recognizing the advantages brought by technological advancement. Further, through the operations of the Financial Stability Unit and cooperation of government and other regulators in the financial sector, the Bank will have the pulse of the financial sector in terms of financial stability levels at any given time.



**Notes:**

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