Governor's Annual Monetary Policy Statement Address - 2023

Programme Director

Honourable Minister for Finance

Members of both Houses of Parliament

Board of Directors of the Central Bank of Eswatini

Members of the Monetary Policy Consultative Committee

Leadership of commercial banks & nonbank financial institutions

Distinguished Guests

Ladies and Gentlemen, all protocol observed. Good Morning!

Introduction

1. It is my honour to present to you this year's Governor's Annual Monetary Policy Statement for the Central Bank of Eswatini under the theme "Ensuring Price and Financial Stability under a Volatile Economic Environment".

2. Distinguished ladies and gentlemen, I would first like to thank the Bank's stakeholders who continuously support our activities. This helps us as a Central Bank of Eswatini, to fulfil our primary mandate of achieving price and financial stability that is conducive to economic growth and development in the country.

3. Globally, the year 2022 has been a challenging one characterised by sluggish economic growth and soaring inflation. Inflation has remained above the target range for most economies owing to the ongoing Russia-Ukraine war, amongst other factors. This resulted in many central banks pursuing aggressive contractionary monetary policy in an effort to curb the inflationary pressures.

4. My address this morning shall outline some of the key international, regional, and domestic economic developments that influenced the Bank's monetary policy

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decisions over the past year. I will further provide insight on the monetary policy path for the 2023/24 financial year.

Programme Director, distinguished ladies and gentlemen, let me start by highlighting developments in the Global Economy.

5. According to the IMF's World Economic Outlook published in April 2023, global growth is projected to slow from an estimated 6.0% in 2021 to 3.4% in 2022 and 2.8% in 2023. The downward revision highlights the Russia-Ukraine war's direct impact on the global economy and related spill overs. In 2024, the global economy is forecasted to grow by 3.0%.

6. Advanced economies are expected to see a pronounced growth slowdown, from 2.7% in 2022 to 1.3% in 2023. An estimated 90% share of advanced economies are expected to see a decline in 2023. For 2024, the group's GDP growth is projected at 1.4%.

7. Emerging markets and developing economies (EMDEs) are expected to slow down from a 4.0% expansion in 2022 to 3.9% in 2023 before recovering to grow by 4.2% in 2024.

8. Uncertainty, clouds the short and medium-term outlook as the global economy adjusts to the shocks of 2020-22 and the recent financial sector turmoil. Recession concerns have gained prominence, while worries about stubbornly high inflation persist, prompting further monetary tightening than currently anticipated.

9. According to the IMF, global inflation is expected to decline at a rapid rate in most economies. It, however, remain elevated amid financial sector stress. Global inflation is forecasted to recede to 7.0% in 2023 from 8.7% in 2022. For 2024, world consumer prices are expected to edge lower to 4.9%.

10. The projected disinflation reflects declining fuel and nonfuel commodity prices as well as the expected cooling effects of monetary tightening on economic activity.

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Ladies and Gentlemen let me now turn to economic developments in the neighbouring South Africa which is Eswatini' s major trading partner.

11. According to the Statistics Agency of South Africa, economic growth moderated to 2% in 2022, following a 4.9% expansion in 2021. The main drivers of growth were a 4.7% increase in private investment and a 2.6% increase in household consumption.

12. The IMF in its World Economic Outlook Report forecasts the South African economy to grow by a meagre 0.1% in 2023. This is attributable to weaker external demand, power shortages, and structural constraints.

13. The annual average consumer inflation rate in South Africa is 6.9% for 2022 compared to 4.6% recorded in 2021. During 2022, there were significant increases in electricity prices, and food price inflation, keeping the overall average headline inflation higher as compared to 2021. In the first quarter of 2023, inflation has averaged 7.0%, remaining above the SARB's target range of 3 to 6%.

14. Since January 2022, the South African Reserve Bank increased the repo rate by a cumulative 400 bps from 3.75% to 7.75% in March 2023 citing inflationary pressures.

15. The SARB forecasts inflation to urge lower to 6.0% in 2023 and 4.9% in 2024. However, risks to the outlook remain elevated.

Programme Director let me now shift focus to developments in the domestic economy. I will start by outlining the monetary policy stance adopted by the Central Bank for eSwatini during the review period.

16. In 2022, monetary policy was restrictive. The central bank was responding to the rising inflationary pressure in Eswatini in-line with the anchor economy. During the period, January 2022 to March 2023, the Bank increased the

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discount rate by a cumulative 350 basis points. This meant the discount rate increased from 3.75% January 2022 to 7.25% in March 2023. Curbing inflationary pressure through tighter monetary policy stance preserves the purchasing power and sustained long-term growth.

Distinguished Guests let me now turn to the developments in the domestic economy.

17. According to macro-economic projections of January 2023 by the Macro-Forecasting Team, economic activity as measured by the Gross Domestic Product, grew by a slower 0.4% in 2022, from a significant growth of 7.9% in 2021. The muted growth was on account of; high base effects from previous year; softening external demand in the wake of global supply chain disruptions associated with the Russia-Ukraine conflict; fiscal cashflow challenges; as well as weaker local demand due to strained real disposable incomes owing to high inflationary pressures in the review period.

18. Sectoral developments indicate that the primary sector is estimated to have grown by 2.3% in 2022, from 2.5% in 2021. Positive performance was observed in 'crop production' and 'mining & quarrying' activities.

19. The secondary sector contracted by 1.2% in 2022, down from an increase of 15.4% in 2021, contributing negative 0.41 percentage points to the overall growth outcome for 2022.

20. The tertiary sector grew by 0.9% in 2022, compared to 4.1% in 2021. Developments in the sector were mixed. Subsectors that performed negatively include 'wholesale & retail', 'financial services', 'health' and 'public administration' subsectors whilst the others contributed positively to growth.

21. Economic activity, as measured by the Quarterly Gross Domestic Product, grew by a slower 3.8% on a year-on-year basis (seasonally adjusted) in the

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fourth quarter of 2022, from a revised growth of 6.9% in the third quarter of 2022. On a quarter-on-quarter basis, economic activity contracted by 1.8% (seasonally adjusted) in the fourth quarter of 2022, from a significant growth of 6.7% in the previous quarter.

Programme Director, I now turn to inflation developments.

22. Annual consumer price inflation averaged 4.8% in 2022, up from an average of 3.7% in 2021. The upsurge in consumer prices was a result of increases observed in the CPI for goods.

23. Core inflation which is CPI excluding 'food', 'auto-fuel and energy' averaged 1.8% in the period under review, from 2.5% in the previous period. This reflected that underlying inflationary pressures from the demand side were modest in 2022 as growth rates in the CPI for 'services' and 'durable products' were broadly contained.

Ladies and Gentlemen, I will now talk about monetary sector developments in the domestic economy.

24. Credit extended to the private sector remained resilient but at a slower pace than in 2021. Partly weakening the growth in credit was the rapid rise in lending rates since January 2022; in line with the Central Bank's efforts to reduce inflationary pressures.

25. Private sector credit growth averaged 4.2% in 2022 compared to an average of 8.2% in 2021. However, during the first three months of 2023, credit growth accelerated to reach 10.7% in March 2023. The growth in credit was mainly reflected in the business sector which registered an average growth of 11.1% in 2022 compared to an average of 6.2% in 2021. During the first three months of 2023, credit to the business sector increased even further to reach 20.8% in March 2023.

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26. Credit to the household sector depicted a lower average growth of 5.8% in 2022 compared to 10.1% in 2021. During the first three months of 2023, credit to the household sector increased by an even lower rate of 3.9% in March 2023; partly reflecting the higher lending rates which continue to weigh heavily on household finances.

27. In the short to medium term, private sector credit growth is likely to remain positive, supported by the persistent recovery in economic activity. However, the pace of credit growth may be weakened by economic uncertainties, inflationary pressures due to the on-going Russia-Ukraine war as well as the elevated lending rates.

28. In 2022, gross official reserves decelerated from the relatively higher levels observed in 2021. This development was to a significant extent influenced by the fall in SACU receipts during the 2022/2023 fiscal year resulting in increased financing needs by the government, persistent net outflows of foreign currency from trades with local banks in response to demands from their customers. As a result, the reserves decelerated to a low level of E7.6 billion in December 2022 compared to E9.0 billion in December 2021. The reserves, therefore, were sufficient to cover 2.5 months of imports in December 2022 compared to 3.5 months covered in December 2021.

29. As at 28th April 2023, the Gross Official Reserves stood at E9.3 billion, equivalent to 3.0 months of imports. In the short term, the reserves position is expected to improve significantly due to the bumper SACU receipts in the current fiscal year 2023/2024.

Programme Director, ladies and gentlemen, I will now turn to developments in the fiscal sector.

30. For 2023/24 fiscal year, the national budget stands at E26.44 billion and Government will run a E1.8 billion budget deficit which translates to 2.2% of

GDP. This is an improvement from the budget deficit of 4.9% of GDP for the 2022/23 fiscal year.

31. As at end of March 2023, total public debt is estimated at E32.9 billion, an equivalent of 40.5% of GDP. This signifies an increase of 19.2% from E27.6 billion recorded in March 2022. The increase can be attributed to an increase in external debt. New loans were contracted and disbursed for food security programme, water supply & sanitation, agricultural development & dam construction as well as roads construction projects. Also contributing to the increase in total public debt was the continued issuance of government securities.

Programme Director, distinguished ladies and gentlemen, allow me to walk you through the developments in Financial Markets.

32. The Central Bank actively participated in the domestic market by purchasing foreign currency acquired through export proceeds from the local banks in an endeavour to build reserves and to provide a buffer against the effects of net outflows.

33. Since this exercise started in May 2018, an equivalent of E17.4 billion has been settled as at 31st March 2023. The total volume of trades conducted over the financial year from April 2022 to 31st March 2023 amounted to E5.3 billion, with unmatured forward positions at the end of the period amounting to E240 million.

34. The Government of the Kingdom of Eswatini fiscal challenges continued during the 2022/23 fiscal year. To assist Government pay her recurrent expenditure obligations, the Bank provided an Advance to government as enshrined in the CBS Order 1974, as amended.

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35. Government's total domestic debt portfolio increased by 6% from E16.7 billion in March 2022 to E17.8 billion in March 2023. The increase was driven by positive net issuance in Treasury Bonds.

36. ***Ladies and gentlemen***, the Bank is at an advanced stage of introducing the Government of the Kingdom of Eswatini as a sovereign borrower in the South African Market. A R4 billion Programme will be listed at the Johannesburg Stock Exchange and the target is to conduct the first issuance during the 2023/24 financial year.

Ladies and gentlemen allow me to turn to developments in the external sector

37. The country's external sector recorded an overall balance of payments deficit of E970.1 million in 2022 following a surplus of E220.2 million in the previous year.

38. The country registered a current account deficit amounting to E1.9 billion in 2022, after a E1.8 billion surplus in the previous year. Notably, this is the first current account deficit recorded since 2011. This is due to a shrinking merchandise trade surplus and a widening services account deficit that nearly doubled in 2022 when compared with the year 2021.

39. In the year ended December 2022, the external value of Lilangeni/Rand was weaker against the US Dollar and stronger against the Pound Sterling and Euro. Following a notable recovery in 2021, the domestic unit lost ground and fell significantly by 10.7% against the US Dollar in 2022. In the year under review, the Rand/Lilangeni reverted to COVID-19-years levels to reach an average of E16.37 per US Dollar. A combination of global monetary policy developments, geopolitical events particularly the ongoing Russia-Ukraine war and negative domestic economic growth prospects in South Africa posed as main drivers of the significant depreciation of the Rand/Dollar exchange rate.

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40. The Rand/Lilangeni extended its losses during the first quarter of 2023 depreciating against the US Dollar to trade at an average of E17.74. The domestic currency weakened on the back of worsened negative markets' sentiments towards South Africa. South Africa's power supply shortage problem, South Africa's grey listing decision from the Financial Action Task Force, and the unexpected downgrade of South Africa's credit ratings outlook by S&P Global (from positive to stable) all proved detrimental to the Rand.

41. The Rand/Lilangeni outlook is bias to the negative as global risk sentiments driving the Rand are expected to remain volatile. Further volatility is expected as concerns over the looming banking crisis in advanced economies is expected to support a risk-off phase on emerging market assets. Meanwhile, worries over high inflation in advanced economies which may warrant further interest rate hikes remain a major downside for the Rand.

Programme Director, distinguished ladies and gentlemen, allow me to talk about the inflation outlook and monetary policy stance.

42. The Bank has revised its short-term forecasts slightly upwards while the medium-term is revised downwards. While South African inflation is presenting a downward trend, food inflation is expected to remain elevated exerting upward pressure on domestic inflation via food prices. Increases in global oil prices are expected to decelerate, but the expected weaker exchange rate will put fuel prices under pressure.

43. The annual average inflation forecast is slightly revised upwards to 5.56% (from 5.54%) for 2023 and 5.29 per cent (from 5.23%) for 2024, whilst 2025 is revised down to 5.14% (from 5.47%).

44. In the short to medium-term, monetary policy is envisaged to gradually tighten in-line with the tightening regional and global monetary conditions as the globe

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continues to grapple with high inflation. However, the Bank will remain considerate of the need to support growth.

Programme Director, I will now turn to Bank Supervision.

45. The Central Bank regularly assesses the performance of banks in Eswatini in order to foster safety and soundness of the banking system and the overall stability of the financial system.

46. The banking sector continued to be well capitalized and fundamentally sound during the period under review. Capital adequacy is satisfactory with industry Capital Adequacy Ratio (CAR) and Common Equity Tier 1 (CET 1) reported at 18.4% and 16.2%, respectively; both ratios improved when compared with the previous quarter where they stood at 17.0% and 14.8%, respectively. These ratios satisfied the minimum regulatory requirements of 8.0% and 4.5%, respectively.

47. The industry total assets grew by 7.2% in the period under review, from E25.7 billion in December 2021 to E27.7 billion in December 2022, while deposits slightly increased from E20.7 billion to E20.9 billion in the same period reflecting an increase of 1.1%. Deposits which are considered the cheapest funding source, continued to entirely fund loans with the loans-to-deposit ratio sitting at 69.9% as of December 2022.

48. Asset quality was notably stronger in the period under review registering Non-Performing Loans (NPL) ratio of 6.61%, down from 6.8% in the previous period in December 2021. This favourable movement highlights the positive results that the Central Bank made through its regulatory interventions during the COVID -19 pandemic era.

49. The industry improved in the period under review, recording an after-tax ROE of 6.0% as of December 2022, up from 5.7% in the same period in 2021. This reflects

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an improvement in the industry's profitability considering difficulties banks faced during the COVID-19 pandemic era.

50. Total industry after-tax profit increased by 22% from E486 million in 2021 to E581 million in December 2022, reflecting an increase of 20%. Cost to income ratio slightly increased from 64.3% recorded in December 2021 to 69.7% recorded in December 2022. This ratio is above the international benchmark of 60% which may mean lack of efficiency for the banks to generate sufficient profits from their operating expenses.

51. Banking sector liquidity remained resilient and compliant even when the minimum statutory liquidity ratio was increased to 22.0% for commercial banks and 20.5% for development and savings banks; Liquidity ratio for the industry was recorded at 34.9% for the period ended December 2022.

52. The Bank has fully implemented Basel II and selected aspects of Basel III. The banks continue to submit their Internal Capital Adequacy Assessment Process (ICAAP) documents and published their Pillar III disclosure requirements.

53. Programme Director, you will recall that in the year 2020, the Central Bank adjusted downward the statutory liquidity and cash reserves requirements to release more liquidity to banks for credit intermediation during the period of COVID-19 to maintain the flow of credit in the financial system.

54. Upon a thorough analysis, the Central Bank decided to revise the statutory liquidity and cash reserve requirements. The statutory liquidity requirement increased by 250 basis points for both commercial banks and development banks. The cash reserve requirement on the other hand increased by 100 basis points. It was noted in our analysis that the excess liquidity had not been used for financial intermediation hence leaving these requirements at the current level would make it difficult and costly for the Central Bank.

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55. The Bank believes that it has significantly lowered the perceived barriers to entry in the industry by opening for more players through the introduction of a new Bank Licensing Policy that accommodates various types of licenses at tiered levels. Our concerted effort to market the financial sector in Eswatini as a lucrative investment destination for banking business has certainly started to bear fruits as we have observed an increase in expression of interests to apply for a banking license under the different categories.

Programme Director, I will now speak on the national payments system.

56. The Central Bank of Eswatini in collaboration with the Eswatini payments industry continued to implement the National Payment Switch Project from 2020 to the period under review. This Project is aimed at modernizing the Eswatini payments landscape, lower transaction costs and to foster interoperability between different payment systems and service providers. The project is informed by a Preliminary Study Report 2021 which outlined the areas for development and features of the payments switch including identification of stakeholders that can be supported through this infrastructure.

57. The implementation of the domestic switch has been phased into streams and entails:

   a. a Fast Payments stream that is aimed at realizing quick gains in the payments space;
   b. it will be followed by a Card Point of Sale and ATM streams;
   c. the open banking stream that will open further channels and to fast-track e-commerce initiatives;

58. The prioritization was determined by the Bank working with the Payments Industry. The implementation will take approximately 36 months.

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Programme Director, allow me to now talk about financial technology (FINTECH) developments.

59. In pursuing its mandate, the Bank considers the development of FINTECH as critical. In this regard, the Bank requested and was recently awarded technical support by the Alliance for Financial Inclusion to conduct a detailed fintech scoping exercise in Eswatini. The primary objective of the exercise was to understand the current fintech landscape in the country and to develop a roadmap that can assist with the formulation of a National Fintech Strategy and the future development of the Eswatini Fintech Working Group.

60. The exercise revealed that the fintech ecosystem is still at its nascent stages of development, with the incumbent players dominating the sector. It highlighted that whilst Eswatini is well-positioned to provide fintech solutions to the wider SADC region, there are still significant challenges that the fintech players face in the country. These include among others, the limited opportunities for collaboration and access to funding and talent. The findings of the exercise will serve as a foundation and source of information for the development of a national fintech strategy, policies, and initiatives aimed at advancing the local fintech ecosystem.

61. The rapid growth of cryptocurrencies has sparked growing interest and investment in this emergent asset class across the globe. This has pushed governments and financial sector regulators to explore ways to regulate cryptocurrencies. To further research on this critical topic, the Bank is collaborating with the Financial Services Regulatory Authority to form a Crypto Assets Task Force (CATF).

62. The CATF aims to produce a national policy recommendations paper that will provide comprehensive guidelines on how to regulate cryptocurrencies, establishing a secure and stable environment for investors and consumers,

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promoting responsible innovation, and maintaining overall financial stability. By implementing this framework, Eswatini can facilitate responsible innovation while minimizing the risks associated with digital assets.

63. Further, the Bank partnered with international technology group Giesecke Devrient (G+D) in September 2022 to research and explore the development of a Central Bank Digital Currency (CBDC) - an electronic form of money for the Kingdom of Eswatini. G+D's appointment stemmed from the completion of the 1st Phase of the CBDC Diagnostic Study conducted in 2020 which found that a retail CBDC presented the strongest and direct opportunity for the adoption of a digital currency in Eswatini.

64. To ensure that consumers continue to have access to legally backed Central Bank money, through the CBDC project, the Bank has continued its investigation into the possibility of issuing a Digital Lilangeni as a complement to cash. This involves understanding use cases and exploring design concepts of a potential digital currency in Eswatini which includes aspects of governance, accessibility, interoperability, security, programmability whilst assessing the potential impact on monetary policy.

65. Key project milestones and outputs include developing the Bank's body of knowledge on CBDC, stakeholder mapping and engagement, industry analysis, preparation of localized CBDC design paper and experimentation through Proof of Concept and a CBDC Pilot. The project is expected to be completed by October 2023.

Programme Director, ladies and gentlemen, I will now move forward to touch on Financial Surveillance.

66. In line with the Bank's strategy to invest in technology to improve supervisory process, the Bank deployed a new version of Cross Border Foreign Exchange Transaction Reporting System in March 2023. The new version of the

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reporting system aligns the country with the IMF BPM6 Codes and the SADC Harmonized Codes.

67. The Reporting System will facilitate accurate and comprehensive reporting of data relating to cross border foreign currency transactions. As a result, the Bank will enhance the monitoring of cross border transactions which have influence on the country's foreign exchange reserves, tracking of illicit financial flows and supporting the anti-money laundering regimes.

The Bank continues to monitor that financial institutions have put in place comprehensive and effective AML/CFT programs. Interaction with the financial sector has been intensified.

Ladies and gentlemen, I will now move on to speak on to operational issues at the Central Bank of Eswatini.

68. During the period ending 31st March 2023, notes issued amounted to E6.8 billion showing a slight increase from the E6.5 billion issued in the same period in the previous year. Coins issued over the period amounted to E34 million, indicating an increase from the E27.6 million reported in the prior year. As at the end of March 2023, currency in circulation was E1.240 billion, the same level as 2022.

69. The Central Bank has noted that there are uncontrolled dye-stained banknotes resulting from ATM bombings. The Bank published notices on social media platforms educating the public about dye-stained banknotes. The public is reminded that dye-stained banknotes are presumed to be proceeds of crime. The public is advised not to accept dye-stained banknotes and to report such notes to the Central Bank of Eswatini or the police.

70. The coin management efficiency project yielded positive results since the pilot of the coin vending machine at a retail outlet. A total of E6.3 million worth of coins was collected this financial year and since the rollout of the coin vending

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machine, in December 2021, a total of E 8.3 million has been collected. The public deposits coins in the coin machine, which produces a receipt that they utilize inside the shop to buy goods. As the project continues, the Bank shall procure additional coin vending machines.

71. The public is reminded and encouraged to use coins in their possession for purchasing goods and services to ensure the effective recirculation of coins.

Programme Director allow to make some remarks on financial sector stability.

72. Over the year, the financial sector experienced heightened risks leading to deterioration in the sector stability and increased vulnerabilities. These risks emanated from the severe disruptions in commodity markets as well as domestic shocks. The financial system's responsiveness to these shocks remain compromised and financial soundness weakened.

73. Risks from the global economy continue to be elevated and a sharper than expected slowdown in global growth was experienced. Outlook estimates reveal further increases in financial stability risks and are expected to persist in the medium to long term.

74. The household sector remains vulnerable to elevated risks emanating from the increasing erosion of disposable income. The rising interest rates increases pressure on the already highly indebted households as debt servicing becomes costlier, whilst also negatively impacting their purchasing and saving power.

75. The corporate sector experienced depressed performance over the last few years due to the effects of COVID-19 and domestic civil unrest which significantly affected economic activity. Recovery is expected to reflect in the medium-term as the economy recovers.

76. The non-bank financial institutions sector continues to grow and plays a significant role in financial intermediation. There is a need to keep a close eye

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on sectors such as the pension sector which is highly concentrated as two pension funds hold the highest market share. A distress to either of these two institutions would significantly impact the whole financial system, given the level of interconnectedness of the sector with the broader economy.

77. Programme Director, before I conclude, I wish to add that whilst the banking system remained well capitalised and sound, the Bank has realised an increased need for more vigilance. Consistency in applying and ensuring banks' compliance standards in the sector will continue to be the focus of the Bank. This emanates from noting the recent developments where banks such as Silicon Valley Bank in the US being placed under curatorship. Upscaling work on Basel II principles is expected to continuously improve the Central Bank's regulatory framework and ensure resilience of the banking sector.

78. ***Programme Director, distinguished guests, in conclusion, let me emphasise*** that the year 2022 presented a number of challenges with high global inflation, fast tightening monetary conditions and a volatile global economic environment characterised with supply chain disruptions.

79. In line with the fast tightening global and regional monetary conditions triggered by inflationary pressures, the Bank pursued a restrictive monetary policy stance over the review period.

80. However, the supply nature of the inflationary pressures poses challenges for monetary policy to be highly effective, hence the need for a coordination with fiscal policy to address the supply bottlenecks.

81. Despite these challenges, may I assure the country that the Bank will continue to monitor developments at global, regional, and domestic level, and use all the instruments at its disposal, in pursuit of its price and financial stability objective, in order to ensure an environment conducive for sustainable economic growth.

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82. Finally, I would like to extend my sincere thanks and appreciation to the Minister for Finance and his Officials, the Bank's Board of Directors, MPCC members, Financial Institutions, all staff of the Bank as well as other key stakeholders for their cooperation, commitment and dedication to the attainment of price and financial stability that is conducive to the economic development of the Kingdom of Eswatini. I have no doubt that I can continue to rely on them for unwavering support and dedication in the execution of our mandate in the interest of all Emaswati.

I thank you all Ladies and Gentlemen!!!

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