# FINANCIAL STABILITY FORUM

25 May 2022

SOUTH AFRICAN RESERVE BANK

# Key messages from the *FSR*

South African Reserve Bank

# SARB's assessment of financial stability during review period

- The South African financial system continues to be resilient under heightened volatility and challenging global and domestic conditions, and this resilience is expected to be sustained over the forecast period.
- There are persistent underlying vulnerabilities in some sectors of the financial sector, which weigh on overall resilience.
- In aggregate, prudentially regulated domestic financial institutions remain resilient, partly owing to their ability to maintain adequate capital buffers to absorb the impact of shocks.

# Initiatives and policy actions by the SARB to enhance financial stability

- The SARB's Financial Stability Committee (FSC) continued to assess various policy options to address the bank-sovereign nexus.
- The SARB collaborated with FSOC members to address some of the key risks to financial stability.
- The SARB continued with work to implement the new resolution and deposit insurance framework enacted in the Financial Sector Laws Amendment Act 23 of 2021 (FSLAA).
- The FSC maintained the countercyclical capital buffer (CCyB) at 0%.

# Global developments

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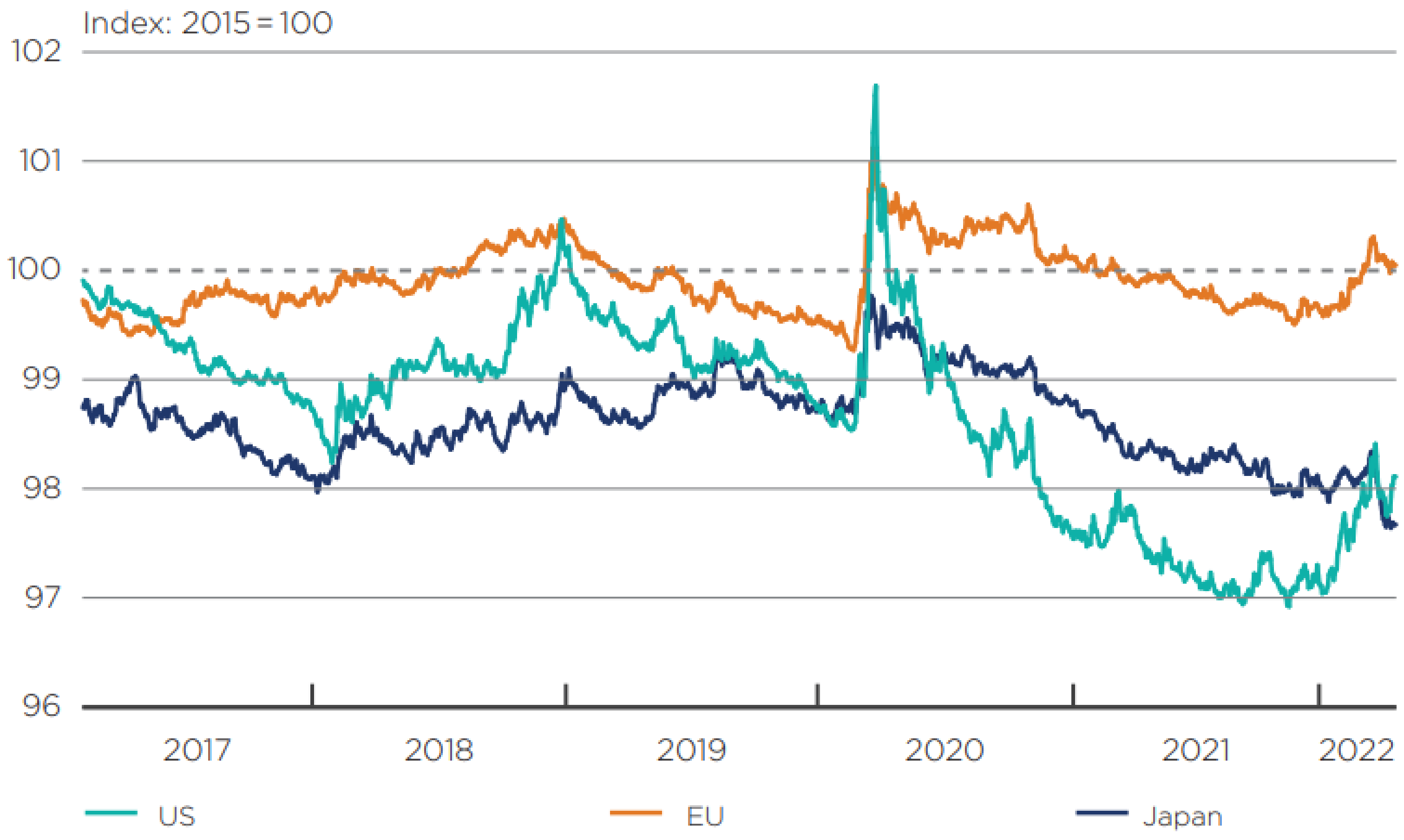
# Uncertainty, higher inflation and lower growth prospects

- The Russian invasion of Ukraine and ensuing war was the main shock to the global economy and financial system during the period under review.
- The global financial system was affected by high uncertainty and market volatility, further flare-ups of COVID-19 variants, renewed supply chain disruptions and sanctions.
- High inflation outcomes and lower growth forecasts present a risk of global stagflation
- Major central banks react to inflation through faster monetary policy tightening . . .
- . . . against a backdrop of high debt levels and a tentative global recovery from COVID-19.
- Material spillover effects on emerging markets are expected.

# Tightening global financial conditions




Source: Bloomberg



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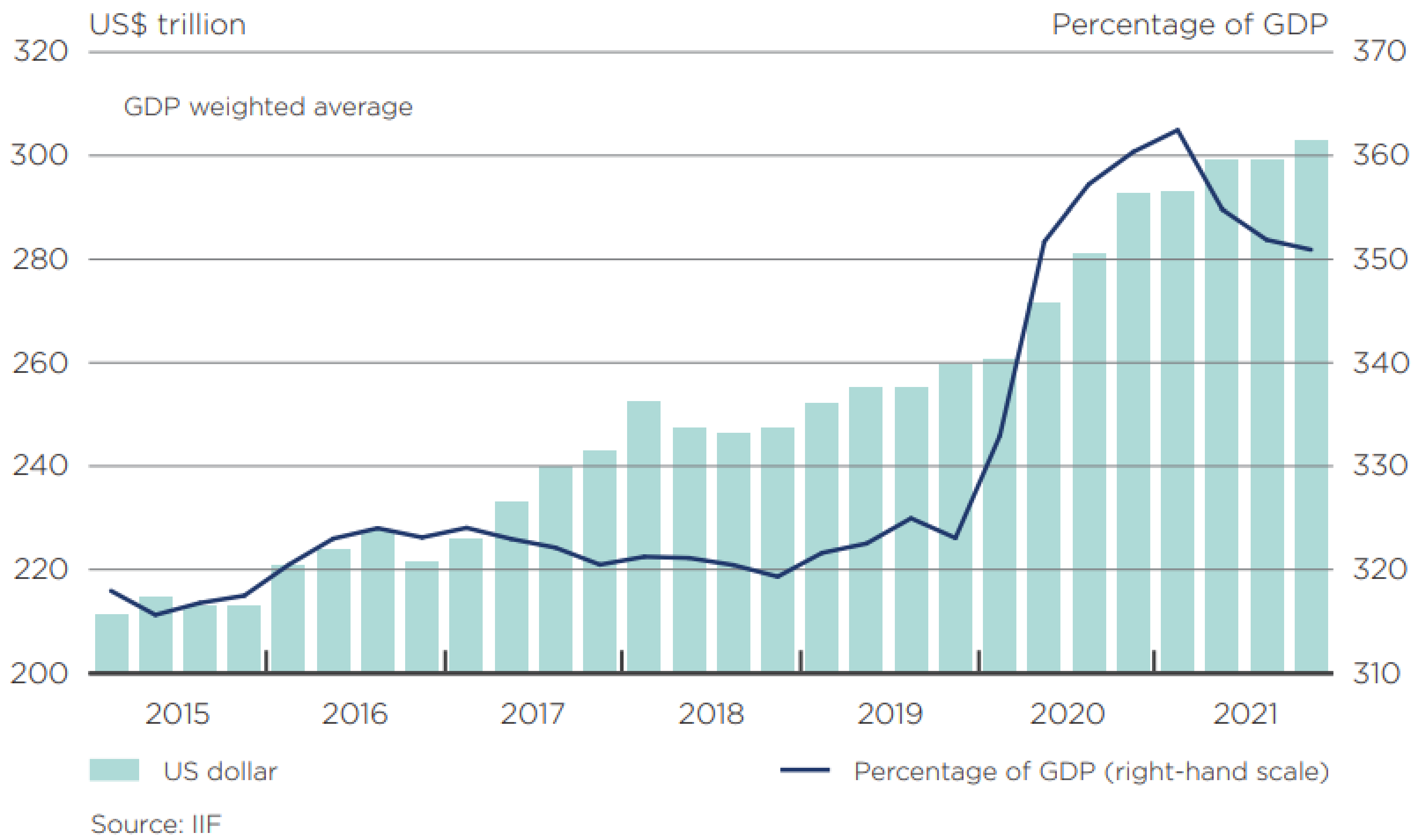
# Increasing global debt levels



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# Heightened volatility


Source: Bloomberg



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# South Africa's financial stability conjuncture and outlook

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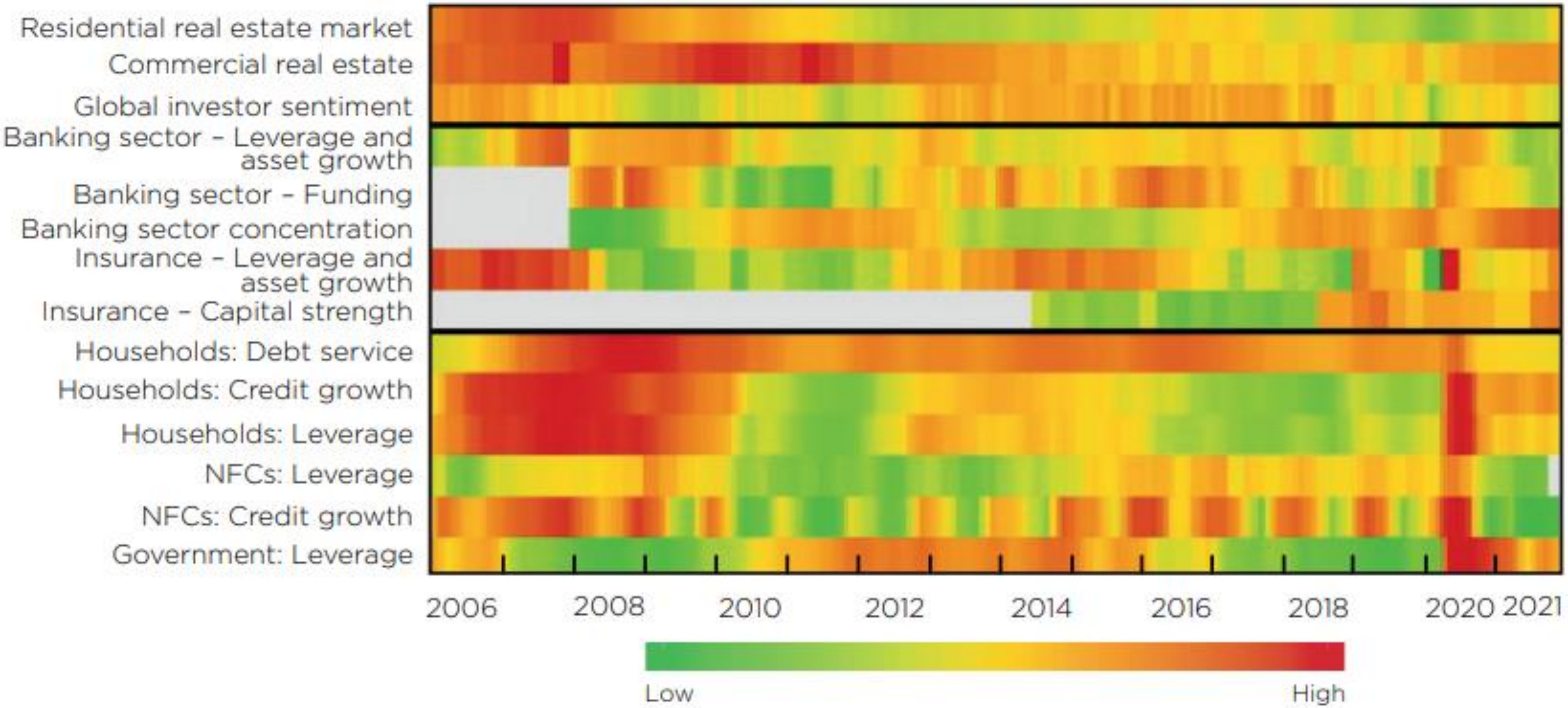
# Financial institutions operate in a challenging environment

- Downside risks to the growth outlook create a challenging operating environment for financial institutions.
- Low and inequitable growth, combined with rising cost of living, increases the risk of costly episodes of social unrest.
- Limited direct exposures to Russia and Ukraine, but the SA financial sector is affected by global developments through various transmission mechanisms.
- Some mitigating factors: Relatively moderate inflation outcomes to date and high commodity prices provide support to the exchange rate, investor sentiment and government's fiscal consolidation efforts.

# The financial sector held up well despite some indicators of stress

## The SARB’s financial stability heatmap




Source: SARB

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# Some pertinent developments in the financial sector

- Financial markets: Lower liquidity in the South African government bond market as foreign investor participation declines and domestic investors adopt buy-and-hold strategies.

- Banking sector: Credit growth and NPLs recovering at a moderate pace, profitability holding up and overall capital adequacy remains healthy, but there are pockets of strain. Exposure to government debt continues to grow on attractive risk/return dynamics within a lacklustre macroeconomic environment.

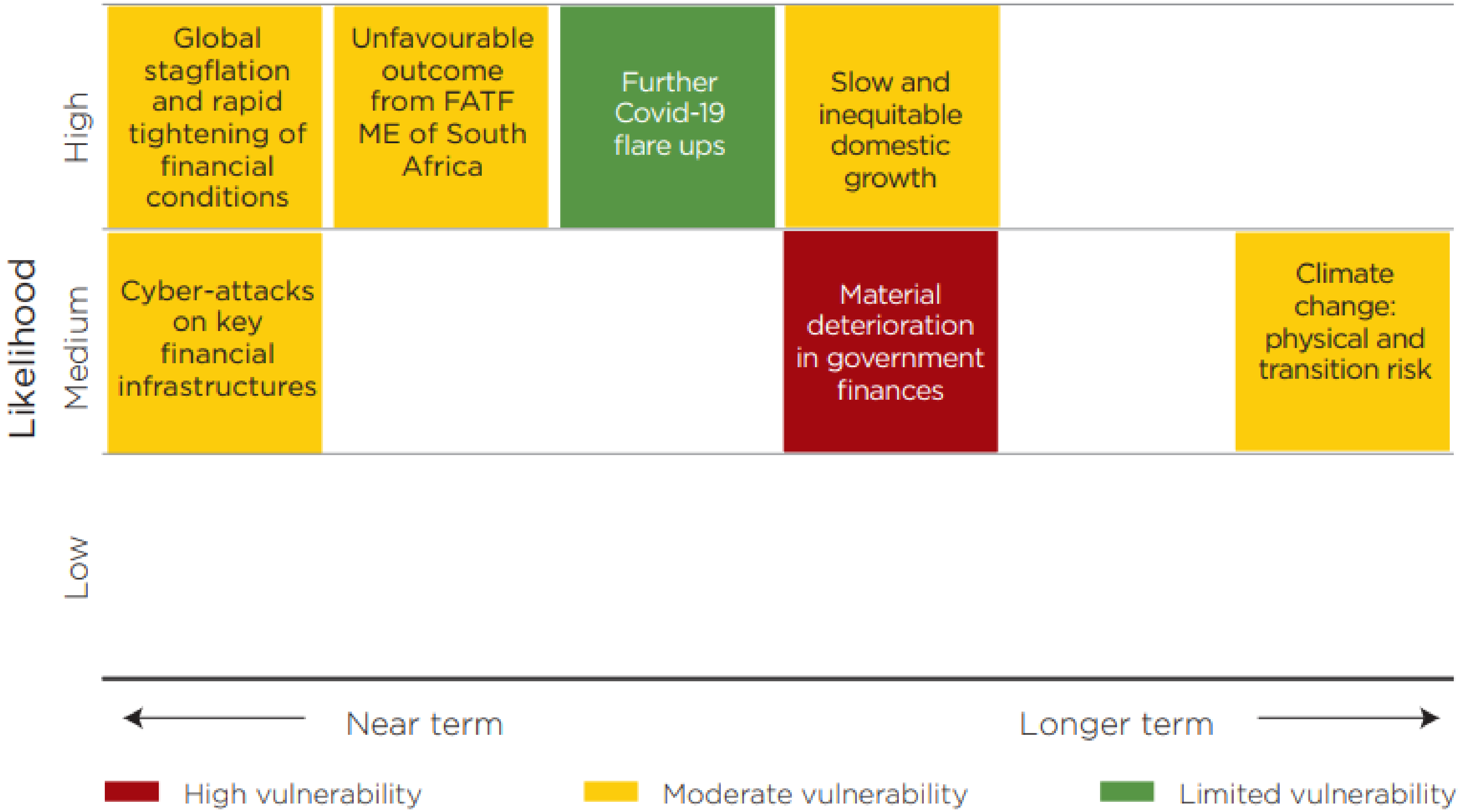
- Insurance sector: Social unrest, climate-related events and COVID-19 impacted both the life and non-life insurance sectors notably. Sasria had to be recapitalised by government, but the rest of the sector remained adequately capitalised and in aggregate meets prudential requirements.

# Vulnerabilities in the non-financial sector

- Non-financial corporate sector: An uneven recovery from the effects of Covid-19, low borrowing and high savings – good for credit risk, bad for bank lending and economic growth prospects.
- Households: Although aggregate balance sheets appear healthier, there are underlying vulnerabilities relating to unemployment, the unequal impact of COVID-19, highly indebted households and rising costs of living.
- Residential real estate: House price increases moderated, mortgage lending recovered to above pre-COVID-19 levels, but non-performing mortgage loans show signs of underlying stress.
- Commercial real estate: Rental occupation remains well below pre-COVID 19 levels, with material differences among economic sectors. Overall, non-performing loans on commercial mortgages are well contained.
- Government: Despite an improved outlook, the high level of government debt and committed expenditure items still pose a risk to domestic debt sustainability.

# Several risks and vulnerabilities affect the outlook for financial stability

## The SARB Risks and Vulnerabilities Matrix (RVM)




Source: SARB

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# Thematic focus: A new resolution and deposit insurance framework

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# Financial Sector Laws Amendment Act 23 of 2021 (FSLAA)

- Introduces a strengthened resolution framework and deposit insurance as key elements of the financial safety net.
    - Prudential regulation and supervision aim to prevent failures of financial institutions by enforcing effective risk management and sufficient loss absorbing capacity.
    - However, in the event that a financial institution does fail, the resolution and deposit insurance framework aims to minimise the impact on customers, the rest of the financial system and the economy.
- Pre-FSLAA, regulators were responsible for dealing with failing institutions, with insufficient powers. The 2008 financial crises revealed shortcomings in this arrangement.
- The FSLAA makes SA compliant with new international standards. The SARB becomes the Resolution Authority for failing designated financial institutions, with strengthened resolution powers and depositor protection arrangements.
- Implementation schedule to be approved by the Minister of Finance.

# New resolution powers designed for a wider range of resolution options

Currently, regulators can resolve failing institutions through either curatorship or liquidation. The new powers in the FSLAA make a wider range of resolution outcomes possible:

- Bail-in is a new mechanism through a failing institution can be recapitalised without relying on a capital injection by government, mainly designed for SIFIs.
- Powers enabling the transfer of assets and liabilities and the creation of bridge institutions enable the RA to restructure a failing institution, either to restore its viability or to facilitate a sale to another healthy institution.
- A number of general powers are introduced to limit contagion effects, ensure the continuation of critical functions, and to take over control and management of a failing institution where necessary.

Resolution planning and resolvability assessments are introduced as a legal requirement applicable to all designated financial institutions, irrespective of how healthy and safe they are.

# Deposit insurance will protect ordinary depositors

- Main objective: protect covered depositors' access to their funds in the event of a bank failure, including when a bank is closed and liquidated.
- Funded by the banking industry itself, not by government.
- Ensures fast and certain payout without having to wait for a liquidation process.
- Coverage limit of R100 000 per depositor per bank. This fully covers more than 90% of depositors.
- Administered by the SARB as a subsidiary – the Corporation for Deposit Insurance (CoDI).
- Critical success factor: high degree of public awareness about its existence and the protection it provides.

# Conclusion

- There were no material episodes of financial instability during the period under review.
- Despite displaying a high level of resilience during the review period, there are some underlying vulnerabilities that could be exacerbated by international developments such as global stagflation and the spillover effects of the Russia-Ukraine war.
- Prudentially regulated financial institutions remain resilient and continue to demonstrate the ability to maintain adequate capital buffers to absorb the impact of shocks.
- The SARB is closely monitoring developments and stands ready to adjust policy if necessary.

# THANK YOU

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