Financial Stability Forum

November 2022

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South African Reserve Bank

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The SARB's financial stability mandate

- Financial Sector Regulation Act: Legislative mandate to SARB to protect and enhance financial stability in South Africa

- Financial sector should be capable to perform its functions without interruption, despite changes in economic circumstances
  - Resilient to shocks
  - Efficiently intermediate funds
  - Even in adverse conditions
  - Public confidence in the financial system and institutions

- Financial stability complements the primary mandate of price the stability in the interest of balanced and sustainable economic growth

Global developments with implications for financial stability

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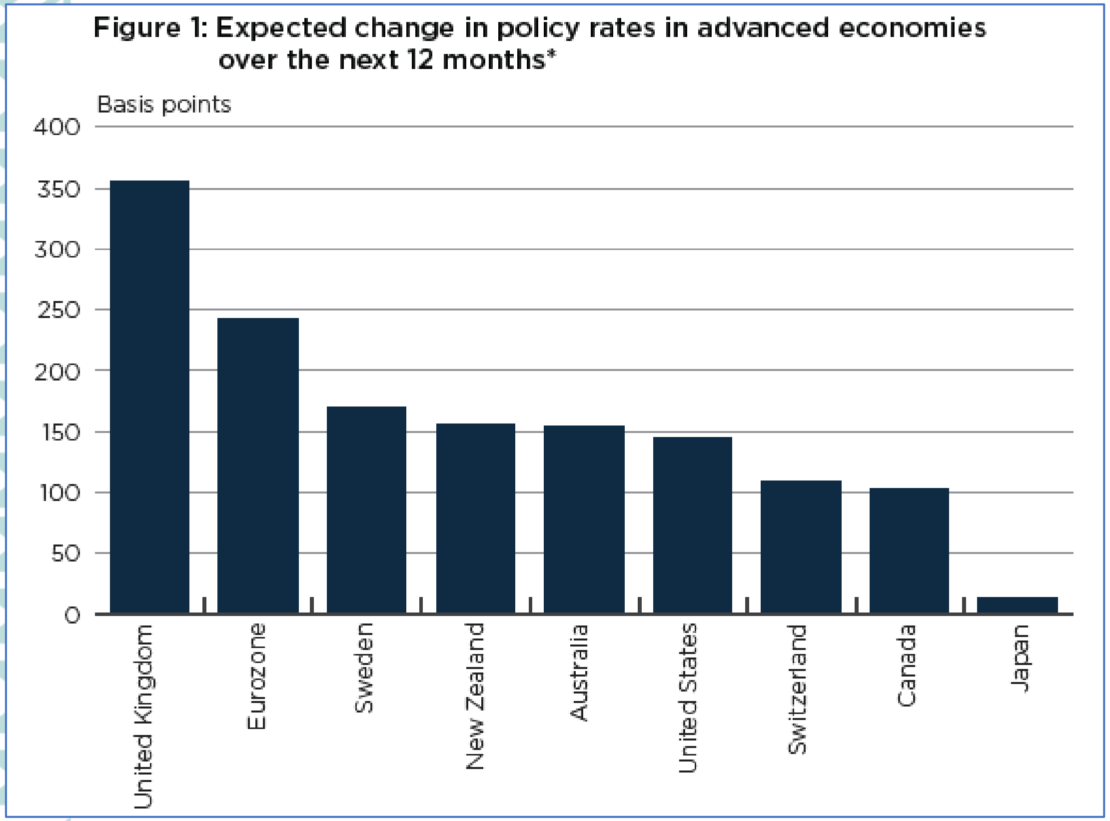
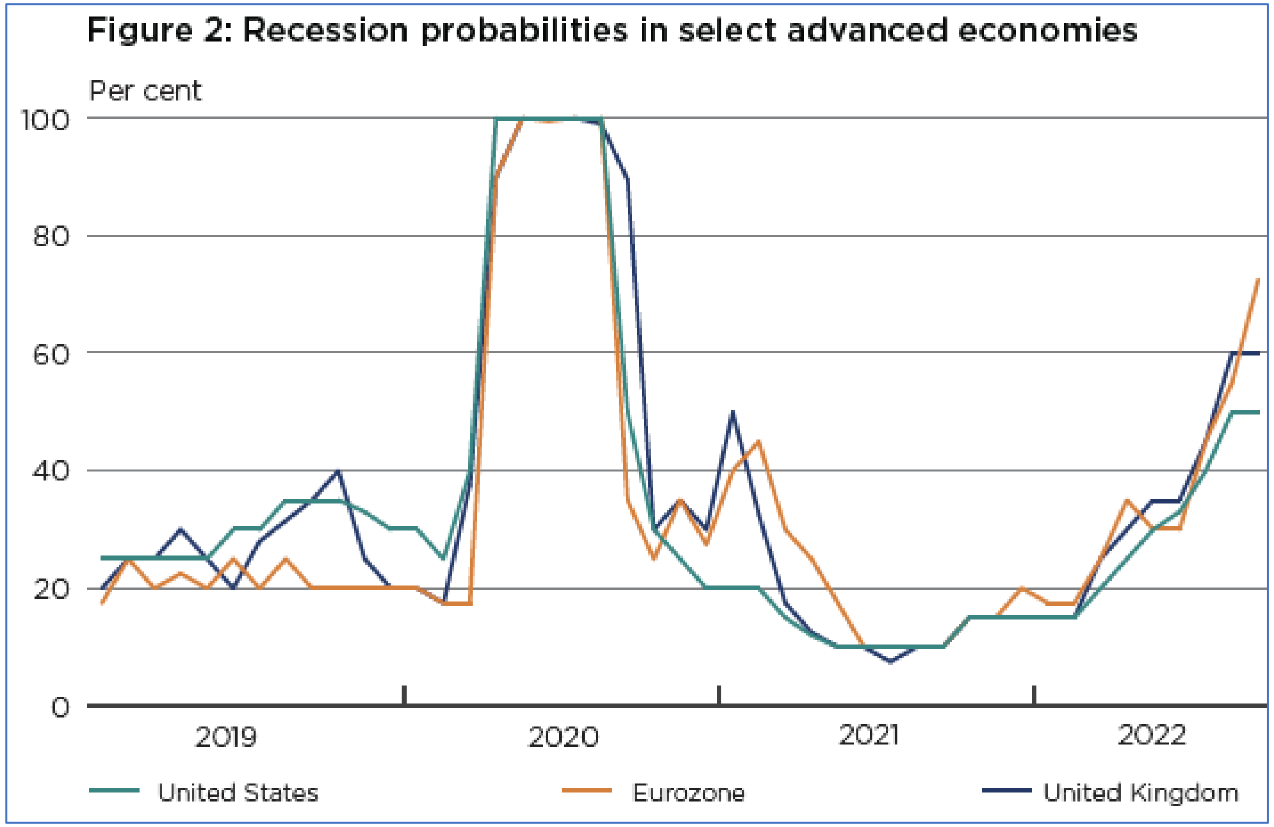
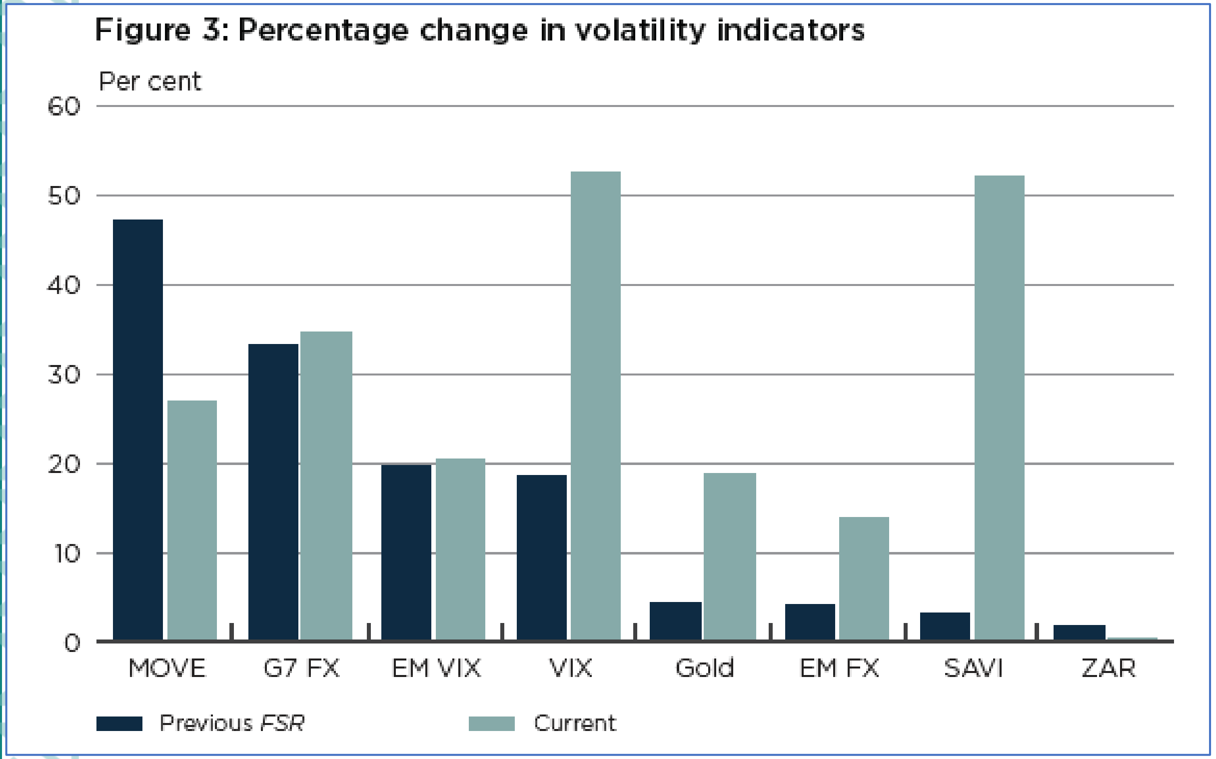
High inflation, rising interest rates and fears of recession in advanced economies

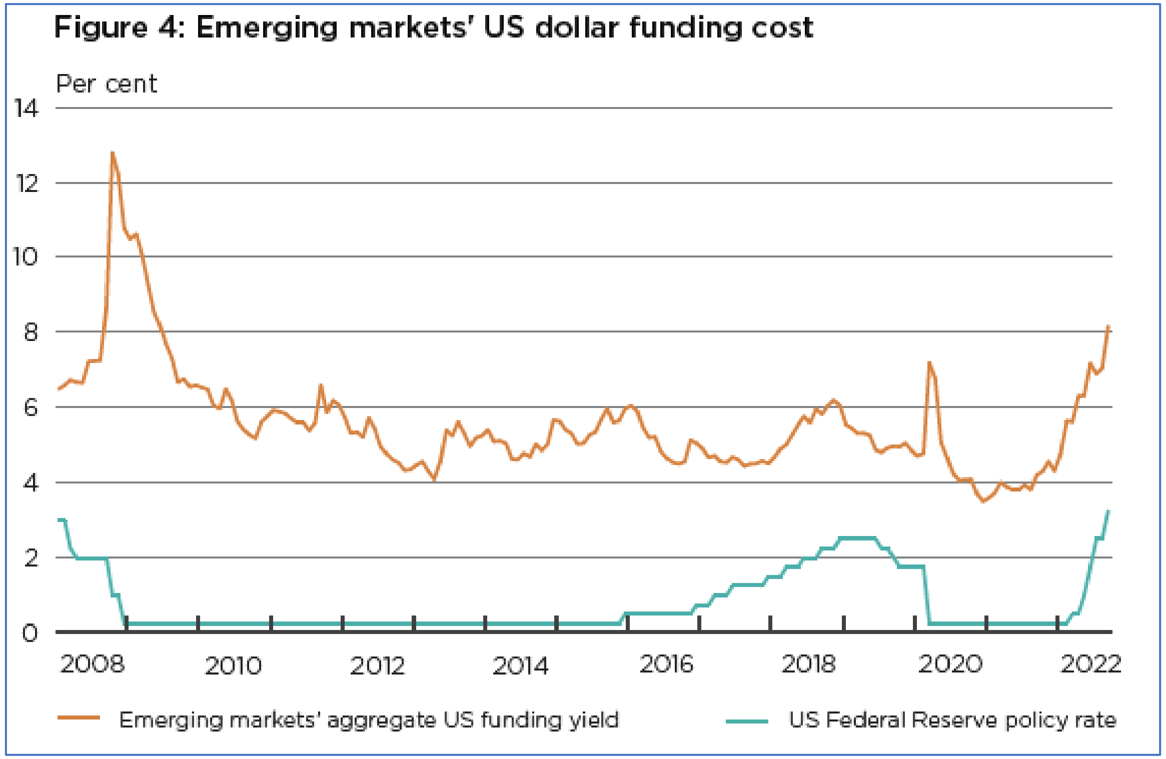




* As on 30 September 2022

Increased market volatility and funding costs





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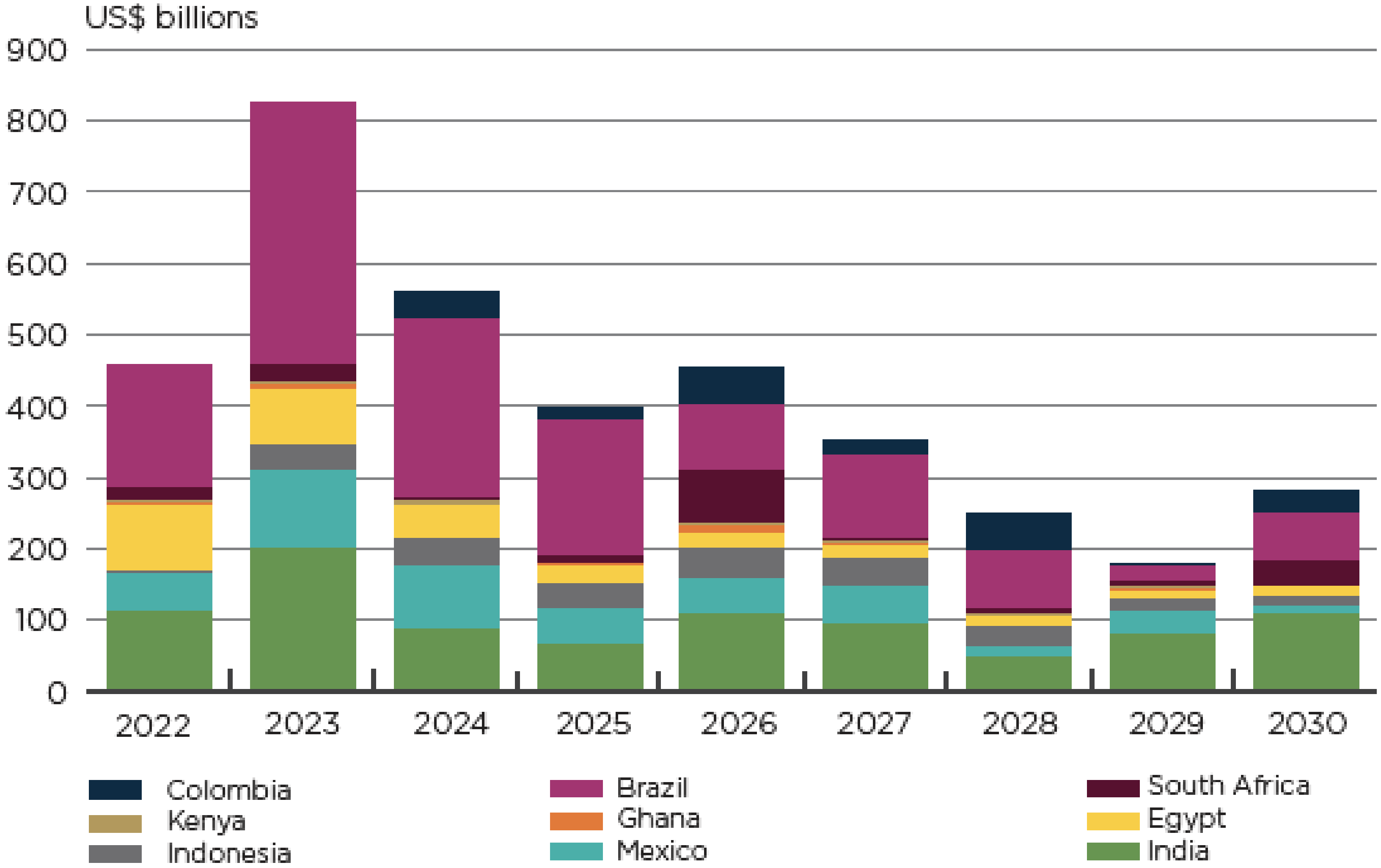
Debt refinancing risks for emerging market governments

Figure 5: Emerging markets' government debt maturity profile



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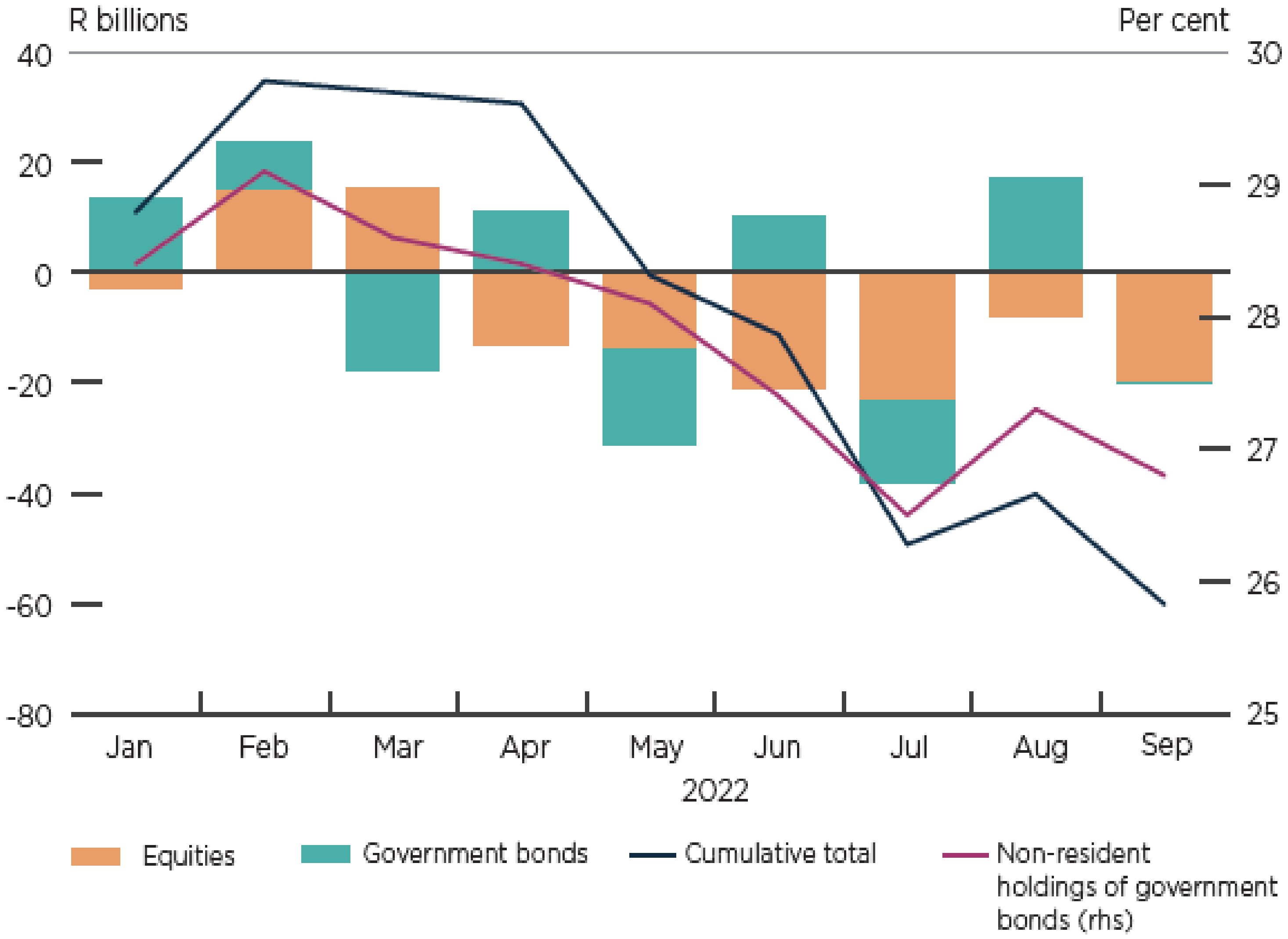
Key sectoral developments since May 2022

Global and domestic factors fuel negative sentiment and capital outflows

South African portfolio flows and non-resident holdings of government bonds



- Lower investment returns
- Declining market liquidity

Financial institutions remain resilient under challenging conditions

- Bank credit extension increased notably, but credit risk is benign
- Sufficient cash and liquid assets in the banking sector
- Interconnectedness and concentration present vulnerabilities
- Insurance profitability under pressure as investment portfolios underperform
- But solvency ratios are still adequate

Developments in the non-financial sector

- Loadshedding and weak economic growth threaten the viability of corporates, in particular SMEs
- Higher interest rates increase debt-servicing cost
- Household budgets are under pressure
- An increase in unsecured lending to households could be an early sign of distressed borrowing to cover living expenses
- Commercial real estate sector has some reprieve from removal of lockdown measures, but suffer under high costs and non-paying tenants
- Slower growth in house prices, but rental market improved
- Government revenue and debt metrics improve, but underlying risks remain

The outlook for financial stability

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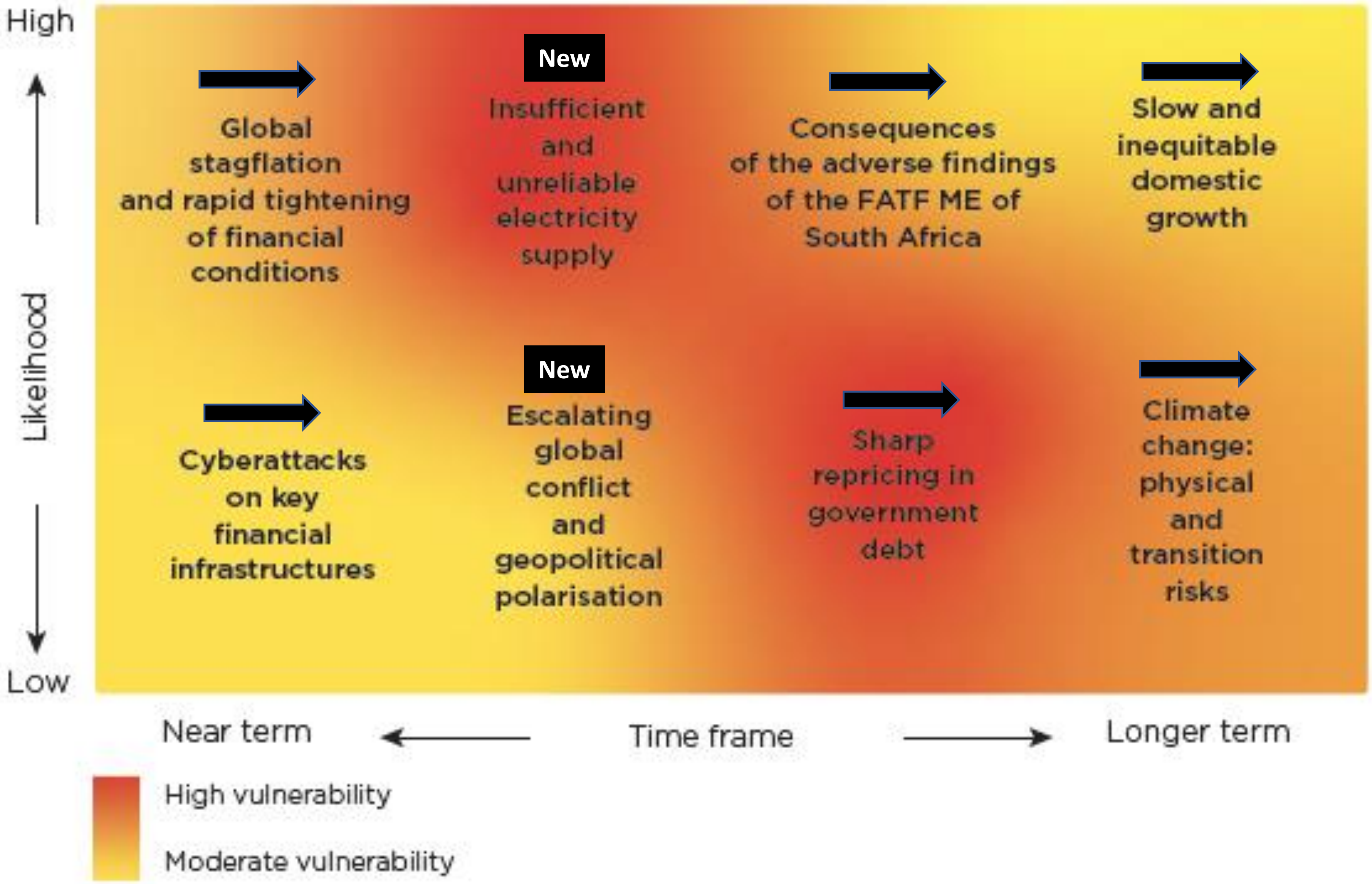
SARB Risk and Vulnerability Matrix



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Slow and inequitable domestic growth

Risks/vulnerabilities:

- Challenging operating environment for financial institutions
- Dampened demand for financial products
- Impact on investor sentiment, investment returns, funding costs and operational costs
- Impact on risk taking, business models and offering of financial products by financial institutions

Mitigators:

- Profitability, supervision and regulatory compliance

Global stagflation and rapid tightening of financial conditions

Risks/vulnerabilities:

- Preference for safe-haven assets, capital outflows, impact on financial markets and exchange rate
- Higher funding costs for financial institutions
- Higher debt-servicing costs and credit risk
- Temptation to indulge in excessive risk taking to boost returns

Mitigators:

- Flexible exchange rate and FX reserves
- Low FX mismatches on bank and sovereign balance sheets
- Domestic inflation expectations anchored

Insufficient and unreliable electricity supply

Risks/vulnerabilities:

- Further dampening effects on growth, business activity and investor sentiment
- Higher stages of load shedding could affect financial market infrastructures
- Increased operational cost of financial institutions
- Increased insurance claims from loadshedding
- Low probability but high impact of a blackout scenario

Mitigators:

- Announcement of actions to address energy crisis

Consequences of the adverse findings of the FATF mutual evaluation of SA

Risks/vulnerabilities:

- Potential “grey listing” will require closer scrutiny of SA financial institutions
- Higher funding and compliance costs
- Reduced and more expensive correspondent banking relationships
- Capital outflows
- Reduced cross-border transactional ability and access to global funding markets

Mitigators:

- Coordinated response through government-led interdepartmental committee
- Good progress in financial sector to address adverse findings
- But: some remedial actions outside financial sector may not be implemented timeously

Cyberattacks on key financial infrastructures

Risks/vulnerabilities:

- Growing dependency on IT for transactions and communication
- Growing reliance on 3rd party service providers
- Increased centralisation of IT infrastructure globally
- Global financial market infrastructures used by domestic financial institutions
- Smaller institutions relatively more at risk
- Large tail risk: Single successful systemic attack can have crisis proportions

Mitigators:

- Large IT security spending and focus in financial sector
- Structures for coordinated responses in financial sector
- Most attacks do not have systemic consequences

Escalating global conflict and geopolitical polarisation

Risks/vulnerabilities:

- Flight to safety contribute to capital outflows
- Uncertainty from changes in trade and financial flows with possible lasting consequences
- Supply chain interruptions, inflationary pressures

Mitigators:

- Anchored domestic inflation expectations
- Well-regulated financial institutions

Sharp repricing of SA government debt

Risks/vulnerabilities:

- High level of government debt and committed spending items
- High exposure of financial sector to government debt
- Lower liquidity in SAGB market
- Increases risk for sharp repricing and disruption in the event of a shock

Mitigators:

- Government debt largely rand denominated with long maturities
- Large, diversified banks are less exposed and better hedged – lower systemic impact
- Fiscal outlook is improving, commitment to fiscal consolidation

Climate change – physical and transition risks

Risks/vulnerabilities:

- High concentration of carbon intensive activities
- Lack of clarity around financial sector’s exposures, comparable taxonomies and granular data
- Relatively high risk of climate-related damages

Mitigators:

- Voluntary disclosures by some financial institutions
- Presidency’s JET IP
- Establishment of climate stress testing by SARB

Overall assessment of financial stability conditions

- Systemic risk increased during the period under review
- Financial system remains resilient under challenging global and domestic conditions
- Some factors exogenous to financial sector add pressure
- Prudentially regulated institutions in aggregate maintain adequate capital and liquidity buffers to absorb shocks

Policy measures by SARB

- Collaboration with financial sector regulators and industry to identify and address key risks
- Use of countercyclical capital buffer (CCyB) as macroprudential policy tool, maintained at 0%
- Continued implementation of strengthened resolution and deposit insurance frameworks

Briefings on selected topics

Update on FATF mutual evaluation and remedial actions implemented

- Efforts to either avoid a grey listing or work towards a rapid removal of grey listing

Reflecting on the promise of crypto: 14 years on

- Financial stability considerations and the road to regulation

Overview of SA's financial stability coordination structures

- How we operationalise a shared policy mandate

Zaronia

- Introduction of a new market reference rate to replace Jibar

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Access the full publication on the SARB website www.resbank.co.za

Thank you

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