Release of the Financial Stability Review

1st edition 2023

29 May 2023

South African Reserve Bank

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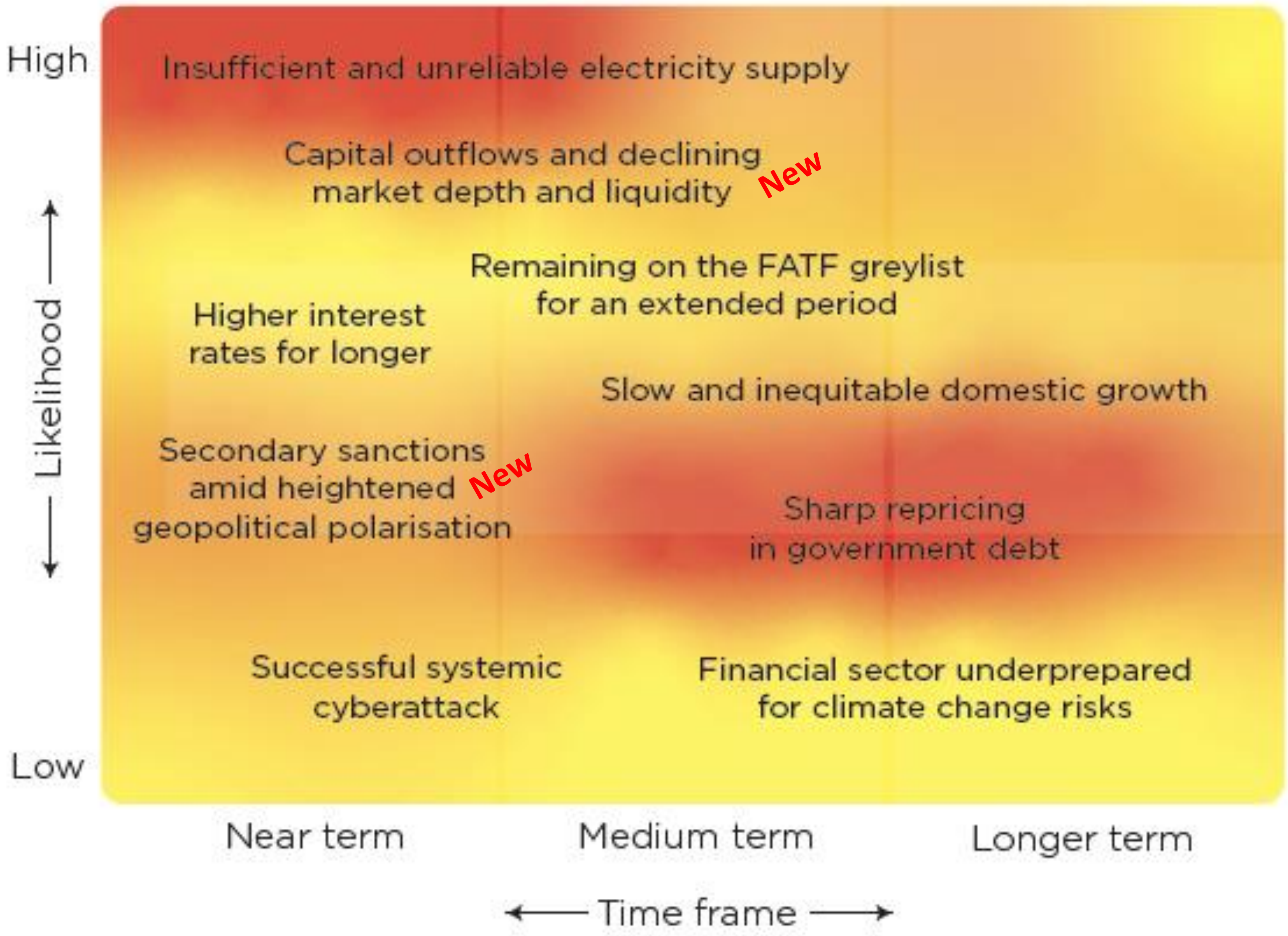
‘Financial stability’ refers to a financial system that is resilient to systemic risks and shocks and that can efficiently intermediate funds, even in adverse conditions, thereby bolstering confidence in the financial system and financial institutions.

Financial stability risks, vulnerabilities and outlook

The SARB's Risk and Vulnerability Matrix (RVM)



High vulnerability
Moderate vulnerability

* Residual vulnerabilities after considering mitigating factors

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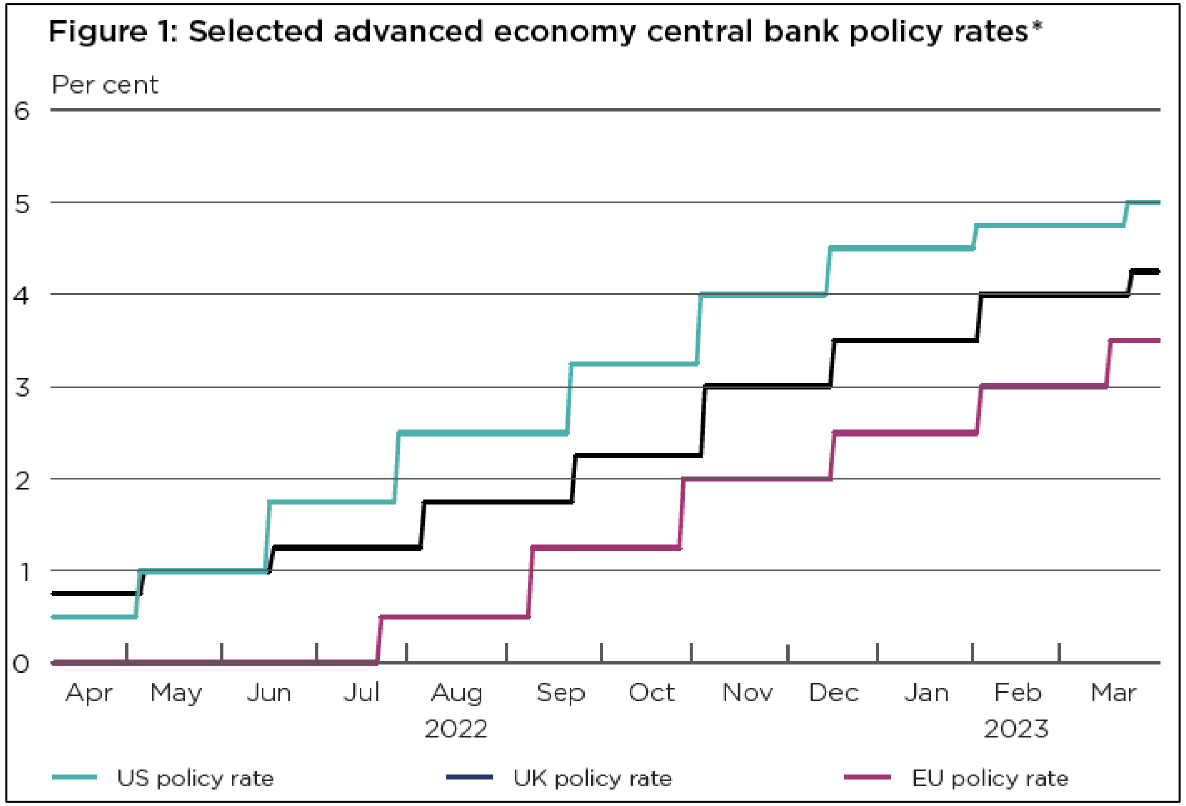
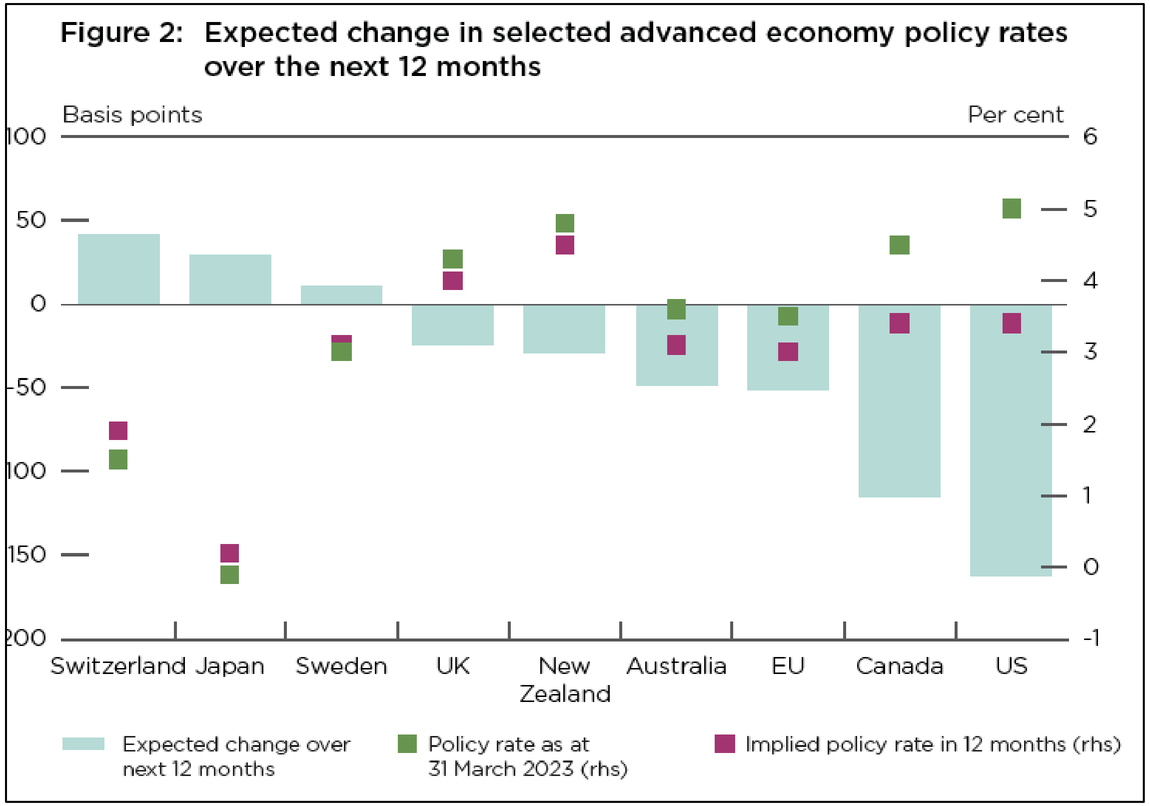
1. Higher interest rates for longer





- Higher cost of funding globally
- High inflation erodes affordability and creditworthiness
- Risk of recession
- Higher risk of capital outflows from emerging markets

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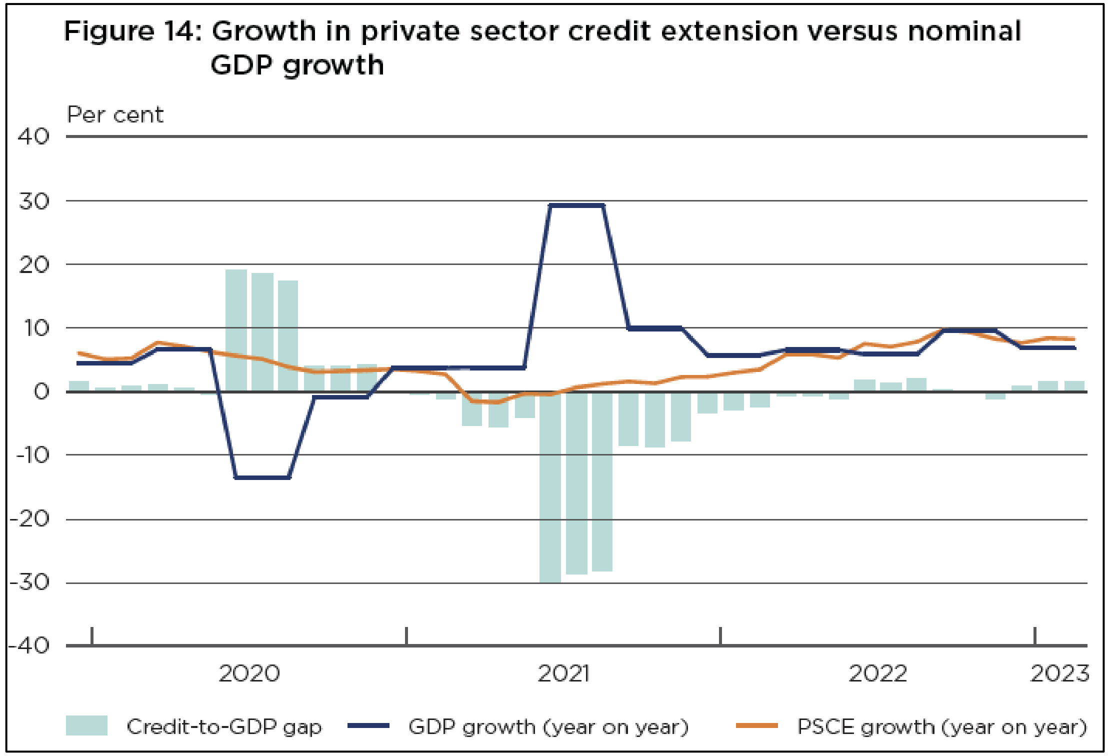
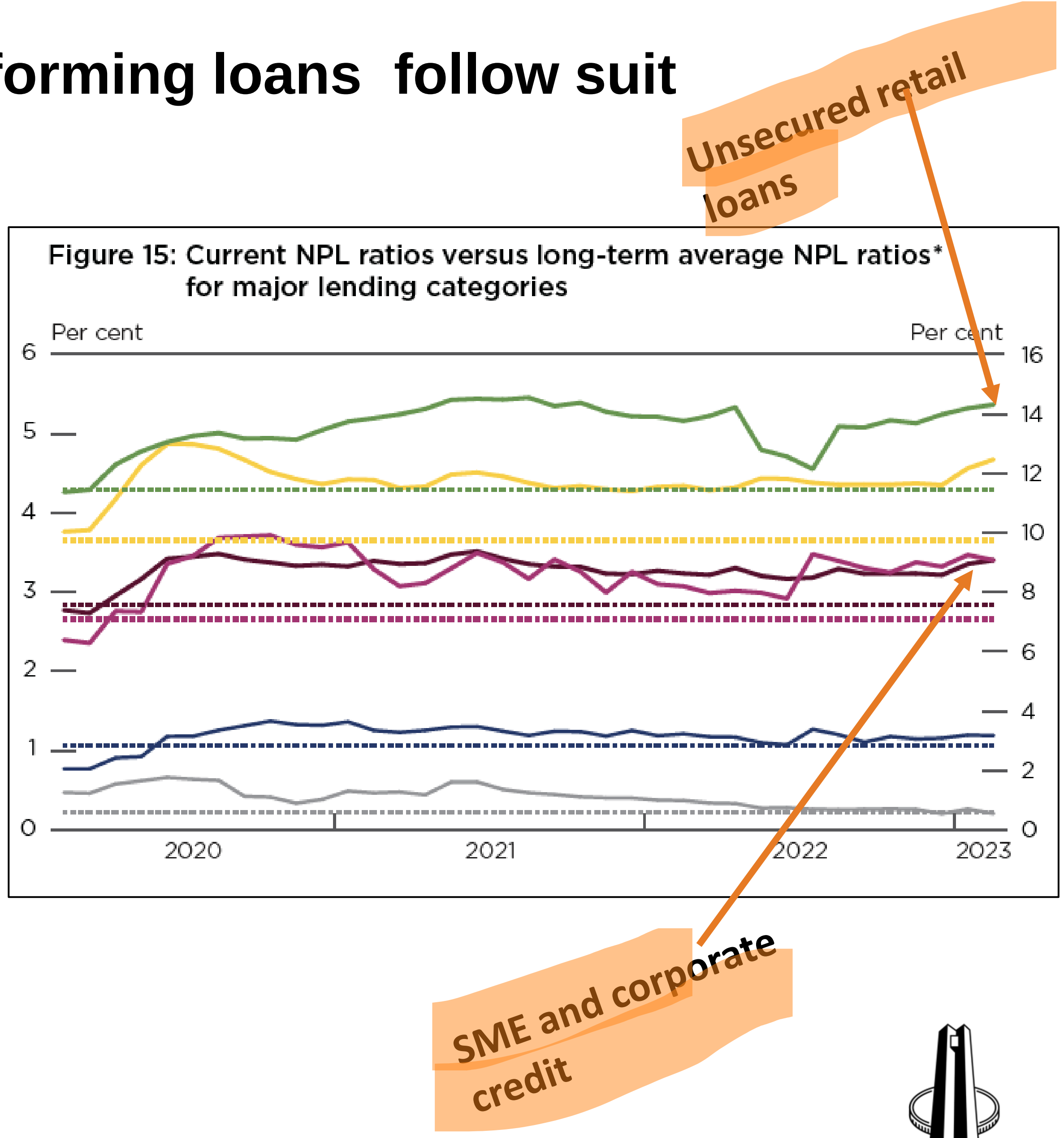
Turmoil in US and European banking sectors

- Funding and liquidity stress
- Realised losses on overvalued assets
- Governance and risks management deficiencies
- Confidence failures

As bank credit increases, non-performing loans follow suit





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Rising costs and interest rates affect affordability in the property market

Figure 25: Real house prices, mortgage advances growth and prime lending rates

Figure 26: Rental prices and vacancy rates

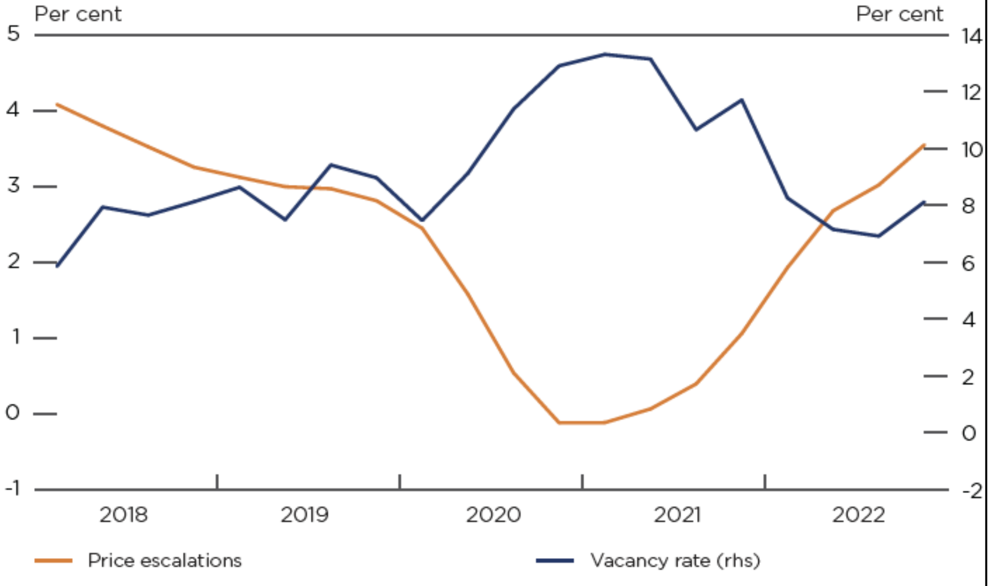
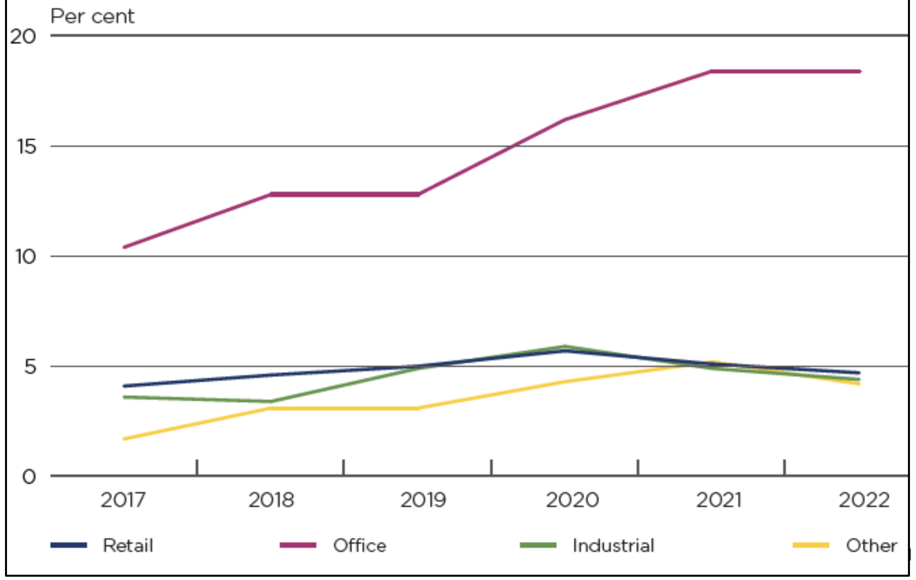


Figure 24: CRE vacancy rates



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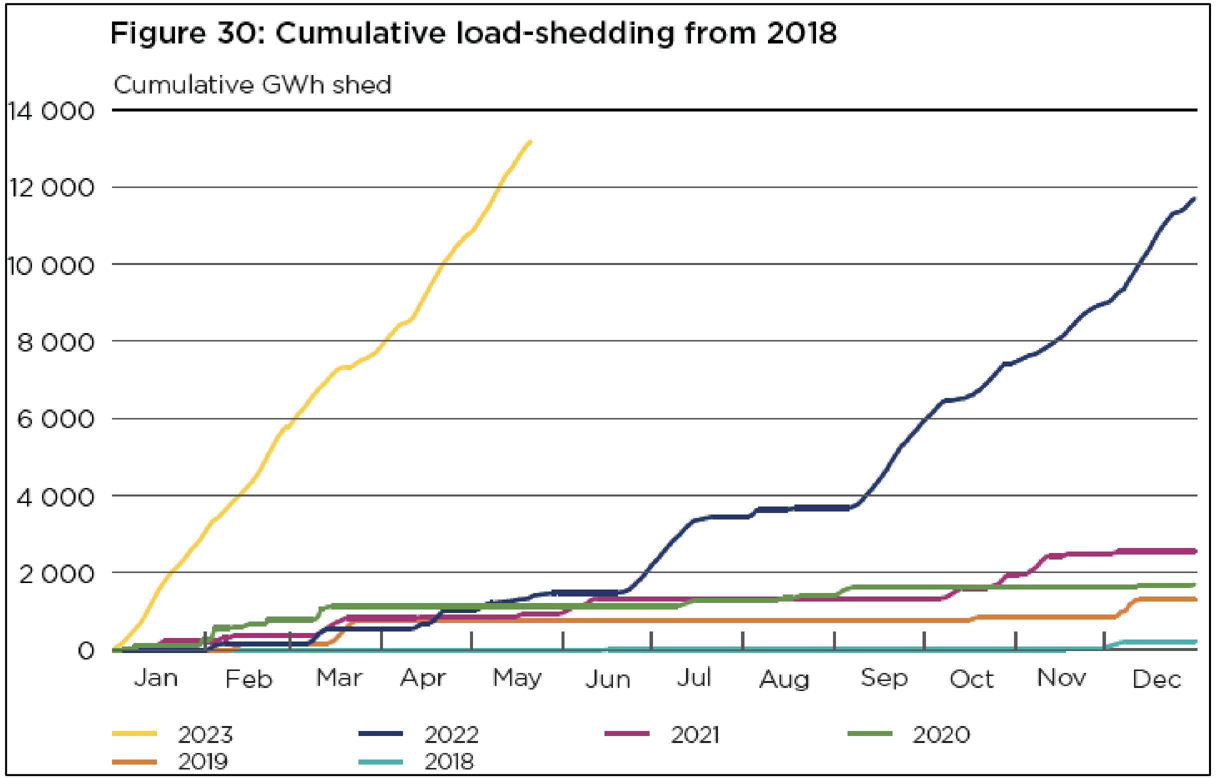
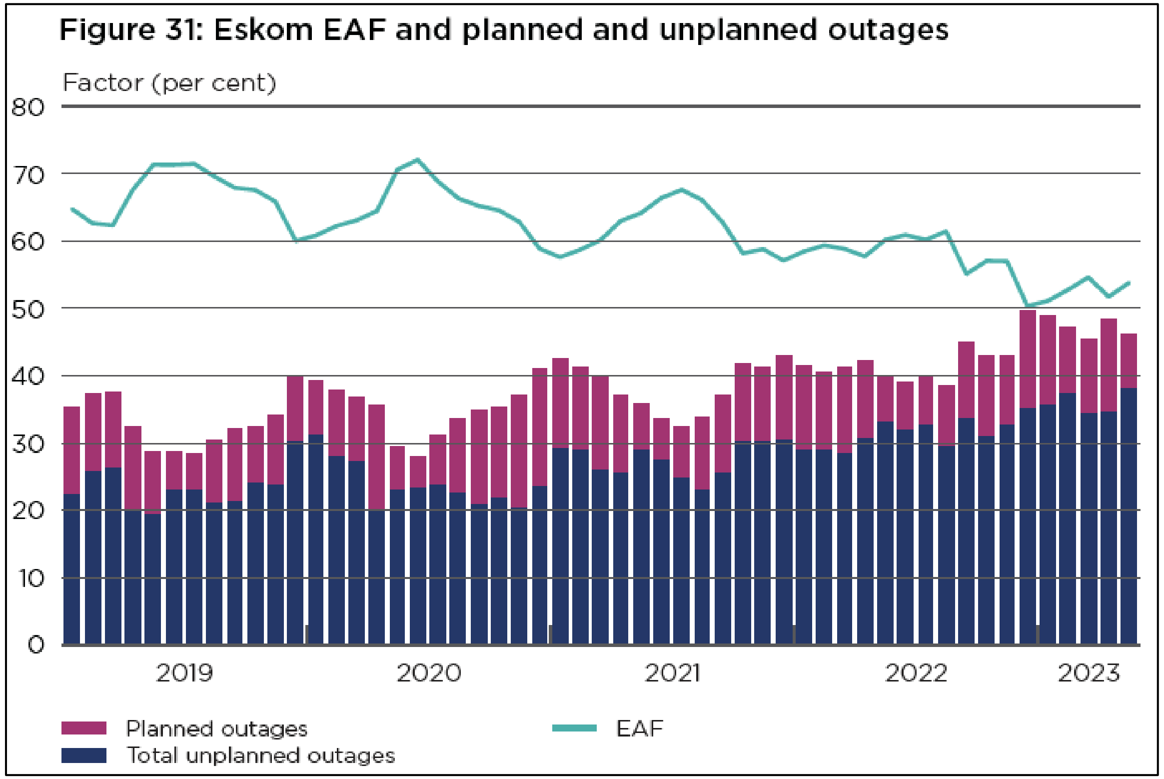
2. Insufficient and unreliable electricity supply





- Cost of doing business affects viability of FIs and their customers
- Lower municipal and government revenue
- Investor confidence
- Unavailability of critical infrastructure
- Unlikely but possible risk of electricity grid failure

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3. Sharp repricing in government debt

- High exposures and concentration in financial markets
- Risks to fiscal consolidation
- Increased market volatility
- Lower levels of private savings and investment (crowding out effects)
- Accounting practices may not reveal unrealized losses

High and rising holdings of government debt

Figure 3: SAGBs as a share of South African banks' total assets

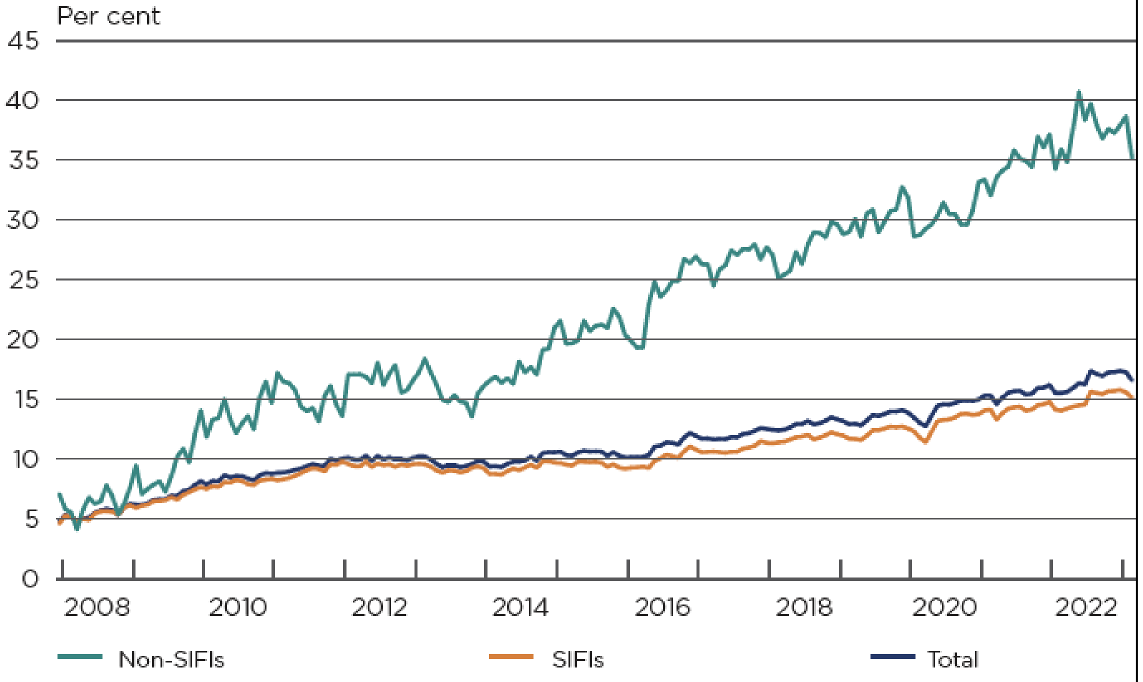
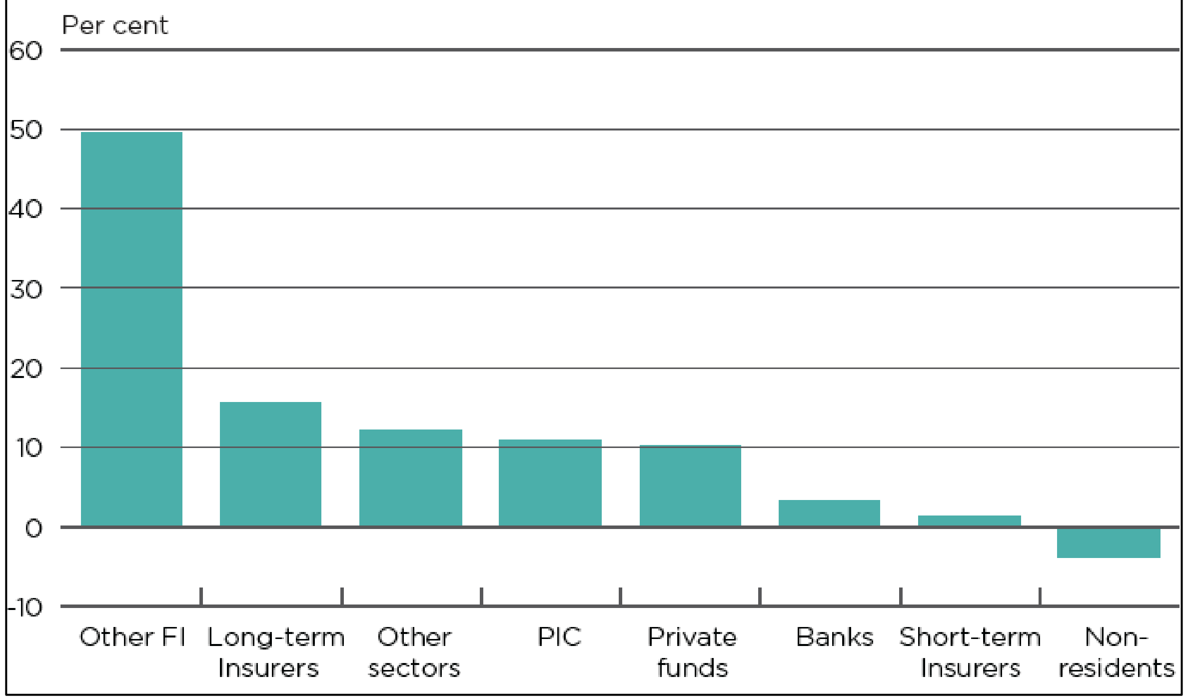


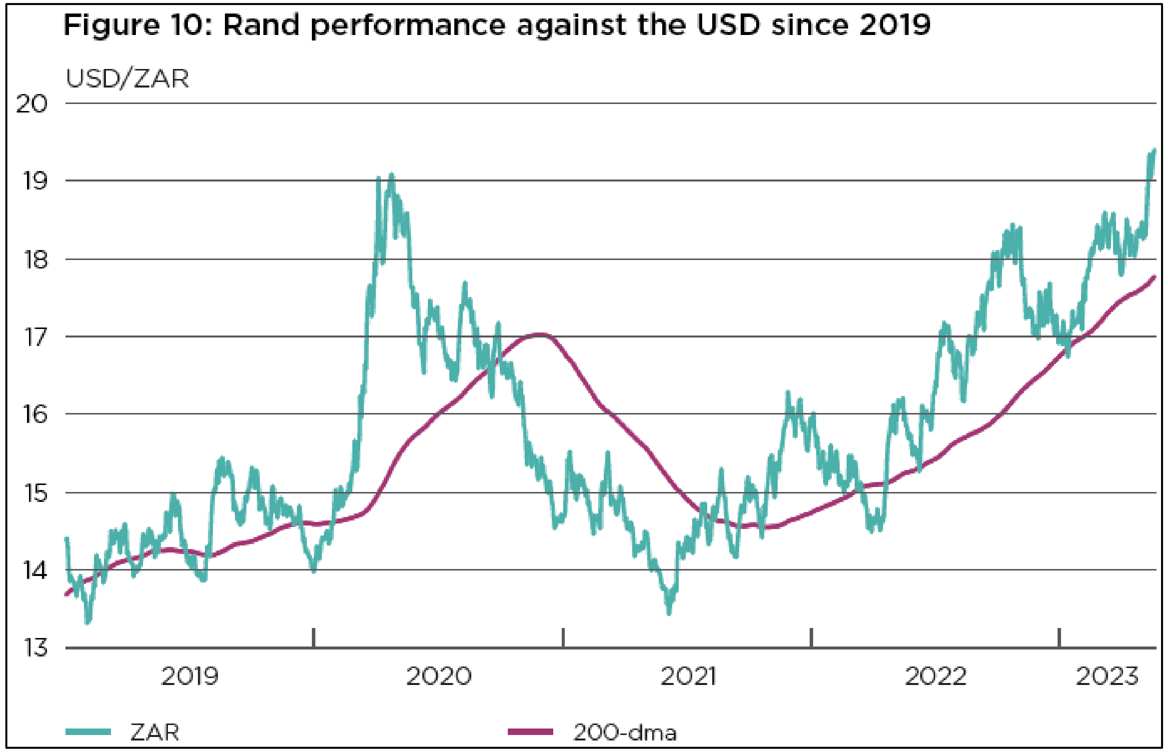
Figure 5: Accumulation of SAGBs since the previous FSR

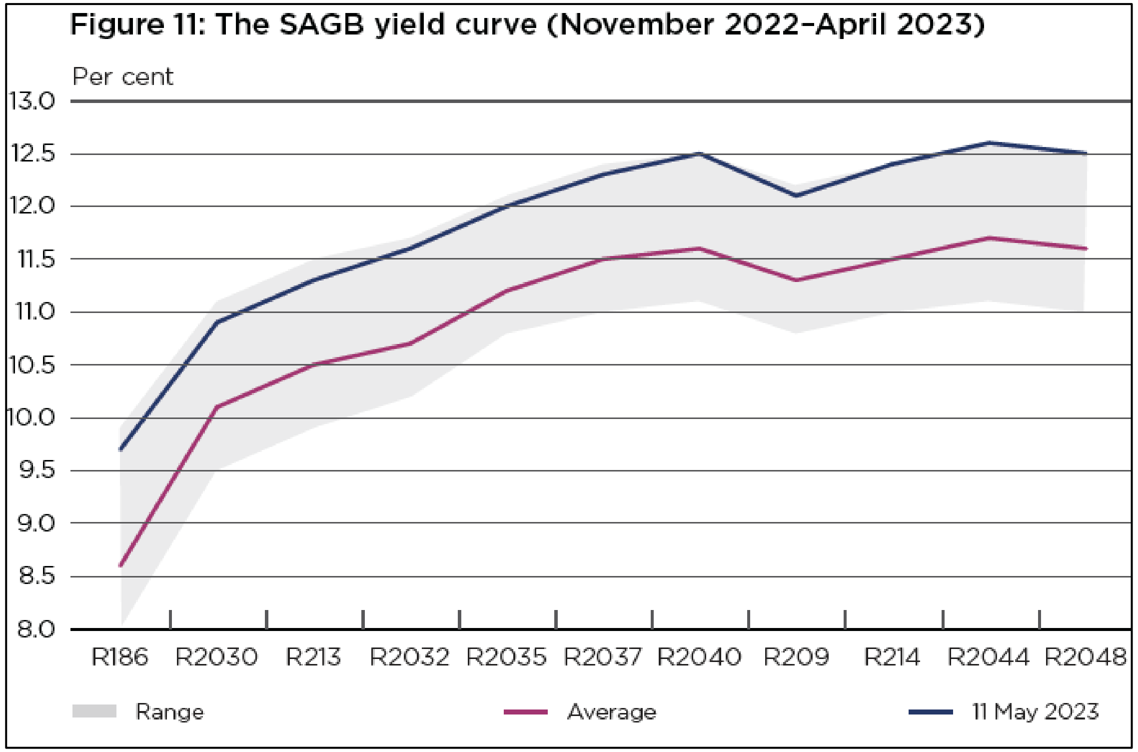


4. Remaining on the FATF greylist for an extended period

- Initial impact had been priced in before the actual greylisting
- Possible lasting impact if SA does not get off the greylist in 24 months
- Higher transaction costs on international payments
- Higher country risk premium increases cost of funding in international markets
- Reputational damage and capital outflows
- Regional spillovers

Rand reaches record lows, bond yields rise





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5. Secondary sanctions amid heightened geopolitical polarisation

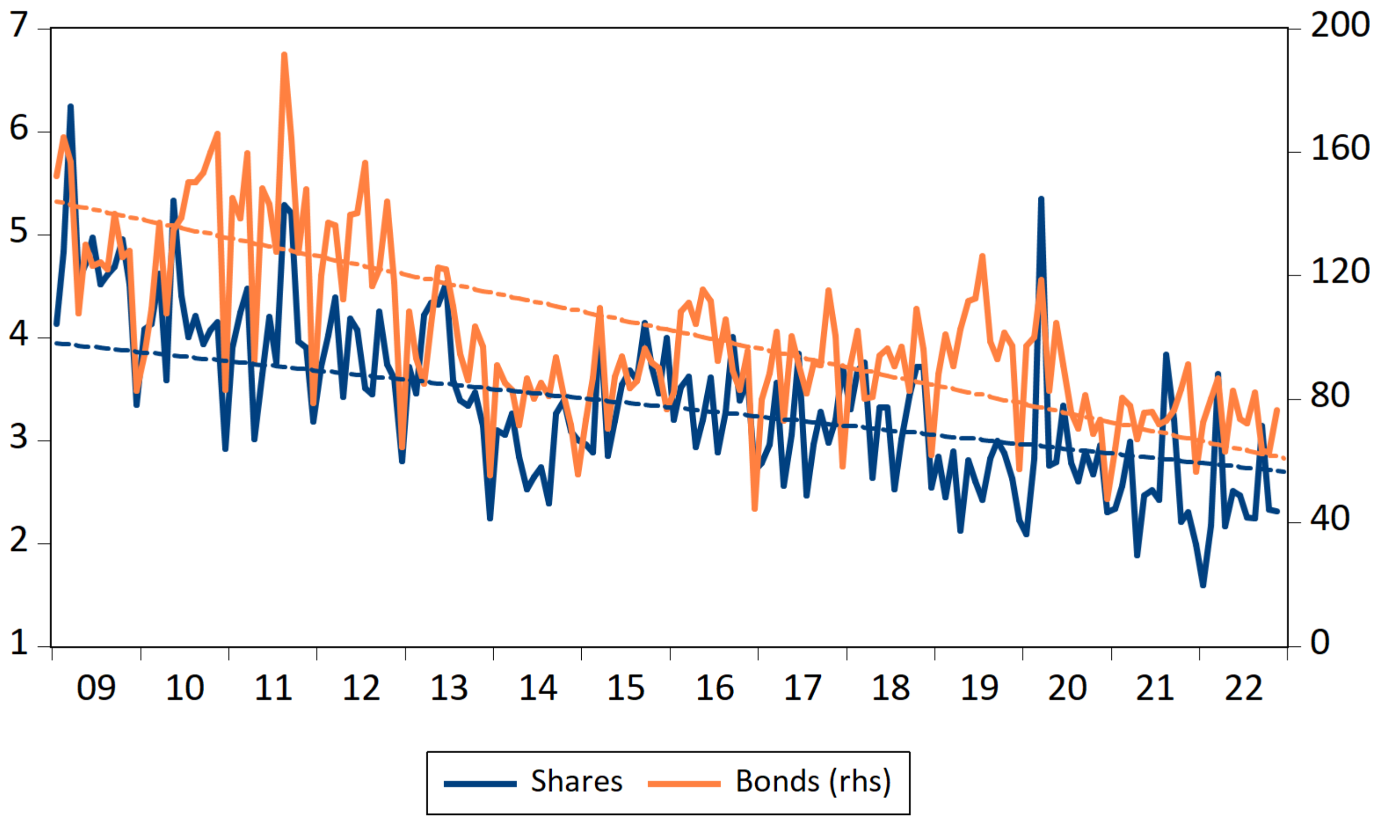
- South Africa’s political neutrality increasingly being questioned
- BRICS membership and bilateral political engagements add to complexity maintaining a convincing neutral stance
- Mere anticipation of possible sanctions affect risk appetite for exposures to South Africa
- An actual event, depending on the nature and extent thereof, could have the following effects:
  - Restrict SA’s ability to make payments in USD
  - Loss of correspondent banking relationships
  - Damage to relations with SA’s main trading partners and possible loss of preferential trade agreements
  - Sudden stop to capital flows
  - Severe regional impact

6. Slow and inequitable domestic growth

- Interacts with most other risks and vulnerabilities
- Infrastructure degradation, slow progress with structural reforms
- Direct and indirect impacts on the financial sector
- Financial institutions are resilient so far, but . . .
- Longer term impact on FI business models require close supervision
  - Increased risk taking and increased fees to protect profit margins
  - Reduced product offerings to cut costs
  - Uninsurable risks as certain events become systemic

7. Capital outflows and declining market depth and liquidity

Monthly value traded as % of total market capitalisation



- Reduced appetite from foreign investors
- Buy-and-hold strategies of domestic investors
- Increased concentration in domestic market
- Less diversified ecosystem reduces resilience
- More frequent market disruptions / volatility
- Ability to raise liquidity in stress situations

8. Financial sector underprepared for climate change risks

- High concentration of carbon-intensive activities, increase in uninsurable risks, immature international regulatory framework
- Move to energy alternatives, establishment of Presidential Climate Financial Task Team, carbon tax
- Affluent, paying consumers more likely to adopt energy alternatives - erodes Eskom’s and municipal income base
- Increased cost of short-term insurance
- Loss of competitiveness and higher funding costs as the world shifts to carbon neutrality

9. Successful systemic cyberattack

- Growing dependency on IT for transactions and communication
- Increased reliance on 3rd party service providers
- Increased centralization of key IT infrastructure and reliance on global financial market infrastructures
- Significant spending on IT security
- Smaller FIs relatively more exposed, but lesser systemic impact

Assessment of financial stability conditions and policy actions

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Assessment of financial stability conditions

- Systemic risk increased against an adverse global backdrop
- Idiosyncratic domestic factors continue to weigh on domestic financial sector resilience
- In aggregate, prudentially regulated institutions remain resilient and meet regulatory requirements
- SA financial system remained resilient, but even slower and more inequitable growth will test resilience beyond the forecast period.

Policy actions anchored in the SARB's legal mandate and powers

- Continued collaboration with members of the Financial Sector Oversight Committee (FSOC)
- Countercyclical capital buffer (CCyB) maintained at 0%, but resolved to determine a future positive neutral level.
- Implementation of the resolution and deposit insurance framework
- Planning for an unlikely but possible scenario of an electricity grid shutdown
- Consideration whether sovereign-bank nexus requires policy intervention

Briefings on selected topics

Five topics covered in Chapter 3

- The financial stability implications of an insufficient and unreliable electricity supply
- Progress with the establishment of the Corporation for Deposit Insurance
- Progress with the implementation of the resolution framework
- Risk of secondary sanctions imposed on South Africa
- The failure of SVB: A spotlight on accounting treatments

THANK YOU

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