Bank *of* Zambia

FINANCIAL STABILITY STATEMENT

(This Statement is issued pursuant to Section 34(1) of the Bank of Zambia Act, 2022).

The Financial Stability Committee (FSC), at its Meeting held in October 2024, assessed risks to financial stability to have edged up slightly since the *May 2024 Financial Stability Report*. This mostly reflected reduced domestic economic activities amid a drought-induced electricity supply shortage. In addition to the electricity supply deficit, low financial intermediation, sovereign-bank nexus, concentration of banks' loans and deposits, dollarisation of loans as well as maturity mismatches remain key vulnerabilities the financial system is faced with. Extended periods of load shedding, lower domestic growth, rising geopolitical tensions, higher inflation, and higher exchange rate volatility (due to demand and supply timing mismatches) represent key risks to financial stability.

The results of the inaugural *Systemic Risk Survey (SRS)* also indicated an expected increase in systemic risk in the near term. Respondents cited heavy reliance on hydro power, undiversified economic system, high concentration of credit and funding as well as liquidity mismatches as key vulnerabilities. In terms of risks, climate change, increased loadshedding, higher inflation, liquidity challenges, and lower domestic growth were identified as the key risks to financial stability.

The Committee noted the improved flow of credit to corporates, businesses and households. However, this was moderate as the credit-to-GDP gap remained below the recommended Basel III threshold of 2 percentage points. Money market liquidity conditions moderated after the Bank of Zambia left its policy rate unchanged at 13.5 percent and undertook accommodative open market operations. Exchange rate volatility receded as the depreciation in the exchange rate steadied in the wake of, *inter alia*, increased foreign currency supply. While external buffers have been augmented primarily by the strengthening of reserves adequacy, risks to the external sector have grown owing to the escalation in geopolitics.

Banks' capital and liquidity buffers have continued to reinforce the resilience of the financial system. However, there remains some vulnerabilities on their balance sheets, including the growing maturity mismatch, elevated share of foreign currency exposures, and concentration of loans and deposits. In the non-bank financial institutions (NBFIs) space, insurance and private pension firms have also broadly remained resilient. However, they face challenges related to subdued economic activity and higher inflation.

The above highlighted challenges notwithstanding, the Committee maintained the Countercyclical Capital Buffer (CCyB) at 0.0 percent considering that the banking system has remained resilient on the back of high capital buffers and GDP growth has significantly slowed due to the impact of the drought. Despite the nominal increase in credit to the private sector, the credit-to-GDP gap has remained below the Basel III threshold, an indication that the growth in credit is a minimal threat to financial stability.

The next FSC Statement will be issued in April 2025.

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