Systemic Risk Survey

September 2024

Bank of Zambia

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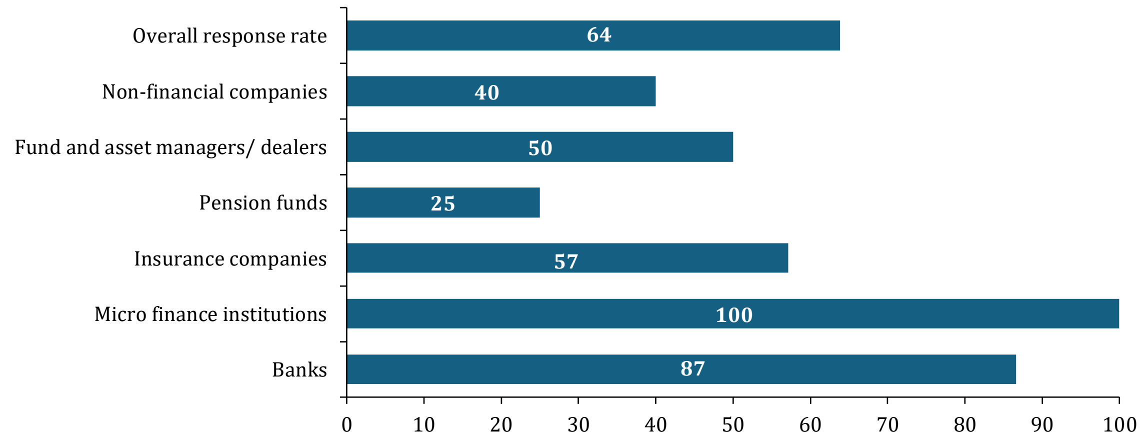
1.0 Introduction

The Bank of Zambia (BoZ) is mandated to formulate and implement macroprudential policy to mitigate systemic risk and maintain financial stability. The BoZ monitors the buildup of systemic risk wherein various indicators associated with components of the financial system are analysed individually and as a group. Risks, if allowed to materialise, could cause distress and significant loss of confidence in the overall financial system.

To reinforce its ongoing systemic risk surveillance and assessment, the BoZ introduced the Systemic Risk Survey (SRS). The survey is intended to help the Bank gain insights into financial sector's participants' perception of the buildup of vulnerabilities and risks to financial stability in the near term. Respondents comprise senior management executives responsible for risk or treasury management at commercial banks, microfinancial institutions, building societies, insurance companies, pension funds, asset managers and non-financial corporates.

This report presents the results of the September 2024 survey, which was conducted between 3 and 10 October 2024. A total of 30 firms participated in the September 2024 survey, representing a response rate of 64 percent (Figure 1).

Figure 1: Survey Response Rate (%)



Source: Bank of Zambia systemic risk survey and staff computations.

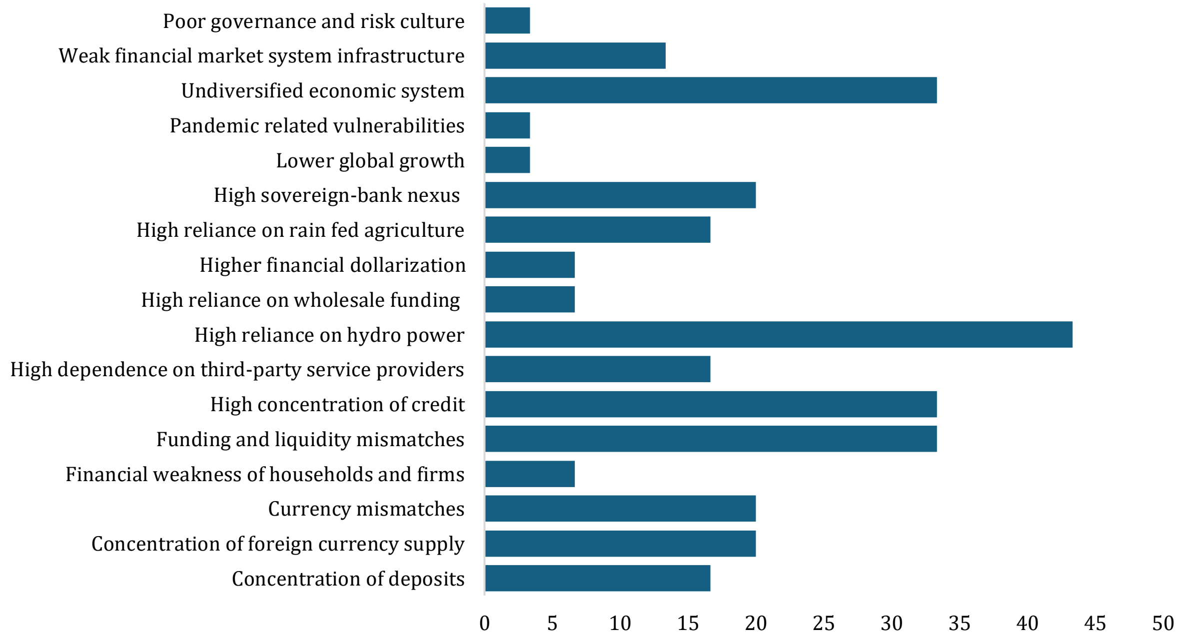
2.0 Key Results

The survey consisted of five questions which were divided into key sub-headings below:

2.1 Key vulnerabilities in the domestic financial system

Respondents were asked to list three key vulnerabilities in the domestic financial system. The survey respondents cited heavy reliance on hydro power, undiversified economic system, high concentration of credit, and funding and liquidity mismatches as the top key vulnerabilities in the domestic financial system (Figure 2). In the case of the top cited vulnerabilities, this is consistent with country's undiversified economic system with heavy reliance on hydro power – which has heightened financial exposures given the current drought- induced electricity supply deficit.

Figure 2: Key vulnerabilities in the domestic financial system (%)



Source: Bank of Zambia systemic risk survey and staff computations

2.2 Top risks to financial stability in the near-term

Respondents were asked to list the top three risks they thought would have the greatest impact on the domestic financial system in the near-term. Respondents most frequently cited higher inflation, liquidity risk, climate risk, cyber-attacks, and increased loadshedding (Figure 3). Respondents view climate risk relating to drought and floods as the greatest threat to financial stability in terms of potential impact (Figure 4). This is followed by higher inflation, liquidity risk, threat of cyber-attacks and increased load shedding.

Figure 3: Most cited risks (%)

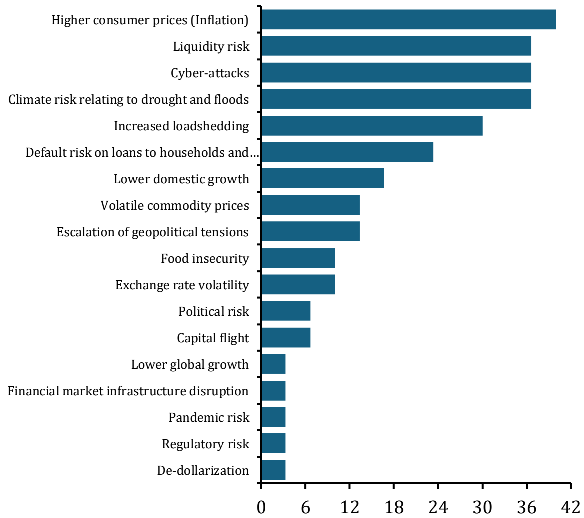
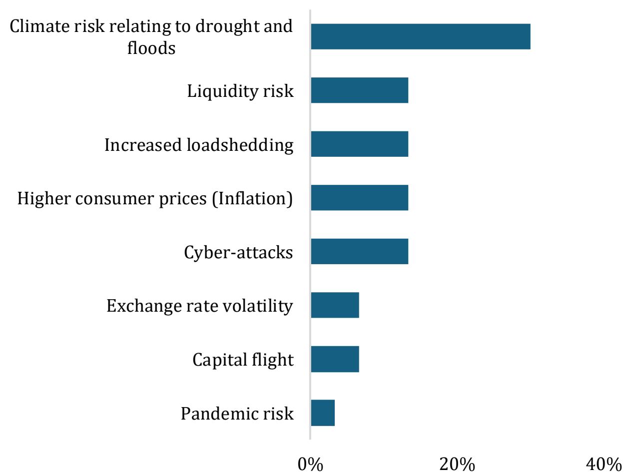


Figure 4: Highly ranked risks threatening financial stability (%)



Source: Bank of Zambia systemic risk survey and staff computations

A sector-by-sector analysis (Table 1) shows that non-financial corporations consider higher inflation, climate risk and geopolitics to be high-impact risks whilst pension firms believe its inflation as well as lower domestic growth. Commercial banks frequently cited cyber-attacks, liquidity risk, climate risk, increased loadshedding and higher consumer prices while insurance firms mostly cited liquidity risk and climate risk. Microfinancial institutions indicated increased loadshedding, climate risk, exchange rate volatility, higher inflation and default risk on loans while fund and asset managers cited financial market infrastructure disruption, de-dollarisation, volatile commodity prices, and pandemic risk.

Table 1: Perceived risks likely to have greatest impact on financial stability by firm (%)

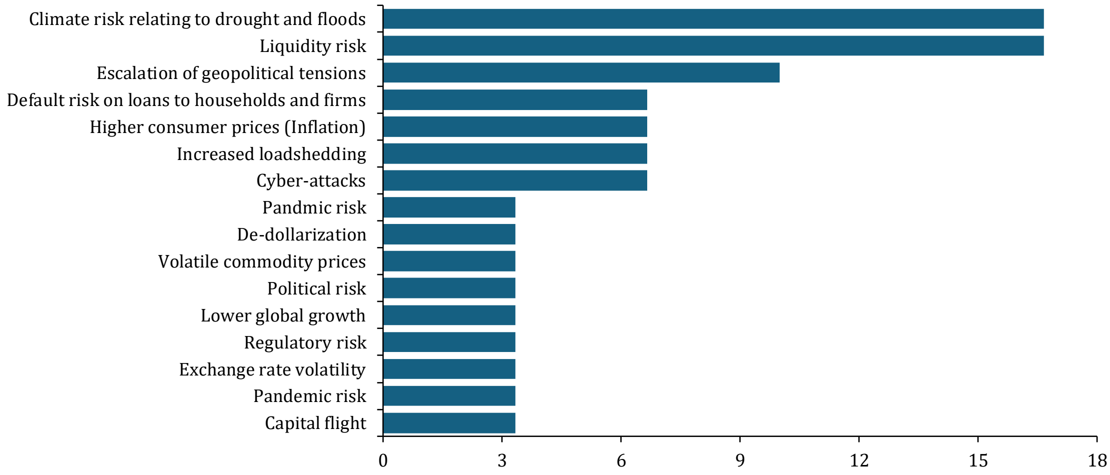
	Banks	Microfinancial institutions	Insurance companies	Non-financial companies	Fund and asset managers/ dealers	Pension funds
Capital flight	0	20	25	0	0	0
Climate risk relating to drought and floods	**38**	**40**	**50**	**50**	0	0
Cyber-attacks	**62**	20	0	25	33	0
De-dollarization	8	0	0	0	33	0
Default risk on loans to households and firms	23	**40**	25	25	0	0
Escalation of geopolitical tensions	15	0	0	**50**	0	0
Exchange rate volatility	8	**40**	0	0	0	0
Higher consumer prices (Inflation)	**31**	**40**	25	**75**	**33**	**100**
Increased loadshedding	**31**	**60**	25	25	0	0
Liquidity risk	**46**	20	**75**	0	33	0
Volatile commodity prices	0	20	25	25	33	0
Lower domestic growth	15	0	25	25	0	**100**
Political risk	8	0	25	0	0	0
Regulatory risk	8	0	0	0	0	0
Pandemic risk	0	0	0	0	**33**	0
Financial market infrastructure disruption	0	0	0	0	**33**	0
Lower global growth	8	0	0	0	0	0
Food insecurity	8	0	25	0	0	**100**

Source: Bank of Zambia systemic risk survey and staff computations

2.3 Risks firms would find the most difficult to manage

Respondents were asked which of the three risks they identified would be the most challenging to manage, should they materialise. Climate risk relating to drought and floods and liquidity risk were cited as the most challenging to manage should they materialise (Figure 5). This possibly speaks to the devastating impact the drought-induced electricity supply deficit has had on business operations and economic activity, and the resultant liquidity strains. For instance, banks consider climate risk to be the most difficult to manage whereas insurance companies regard liquidity risk as the most challenging to handle (Table 2), reflecting the pressure the slowdown in growth would have on their revenues. Microfinancial institutions consider cyber-attacks while non-financial companies consider geopolitical risk to be most challenging to manage. Higher inflation was cited as the most challenging risk to manage by pension funds while de-dollarisation, pandemic risk and liquidity risk were cited as the most challenging risks to manage by funds and asset managers.

Figure 5: Risks most challenging to manage as a firm (%)



Source: Bank of Zambia systemic risk survey and staff computations

Table 2: Risks most difficult to manage by sector classification (%)

	Banks	Micro finance institutions	Insurance firms	Non-financial companies	Fund and asset managers/ dealers	Pension funds
Capital flight	0	20	25	0	0	0
Climate risk relating to drought and floods	**31**	20	0	0	0	0
Cyber-attacks	0	**40**	0	0	0	0
De-dollarization	0	0	0	0	**33**	0
Default risk on loans to households and firms	15	0	0	0	0	0
Escalation of geopolitical tensions	15	0	0	**50**	0	0
Exchange rate volatility	8	0	0	0	0	0
Higher consumer prices (Inflation)	0	0	25	0	0	**100**
Increased loadshedding	0	20	0	25	0	0
Liquidity risk	15	0	**50**	0	**33**	0
Volatile commodity prices	0	0	0	25	0	0
Political risk	8	0	0	0	0	0
Regulatory risk	1	0	0	0	0	0
Pandemic risk	0	0	0	0	**33**	0
Lower global growth	8	0	0	0	0	0

Source: Bank of Zambia systemic risk survey and staff computations

2.4 Overall systemic risk assessment in the near- and medium-term

Respondents were asked about how they assessed the evolution of the overall systemic risk in the near- and medium term. In the near-term, 63% of respondents indicated that systemic risk would increase while the rest cited that it would remain unchanged (Figure 6). In the medium-term, 43% of the survey respondents cited that systemic risk would decrease while 40% cited that it would increase against 17% who indicated that it would remain unchanged (Figure 7).

Figure 6: Expected near-term changes in systemic risk (%)

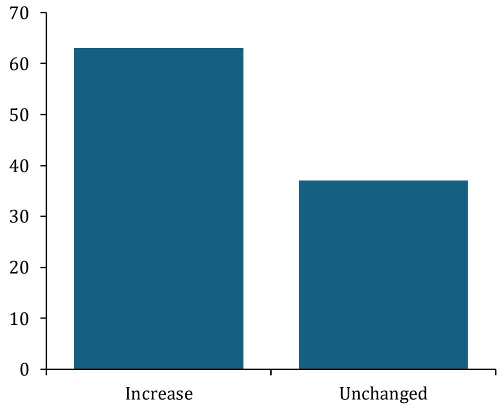
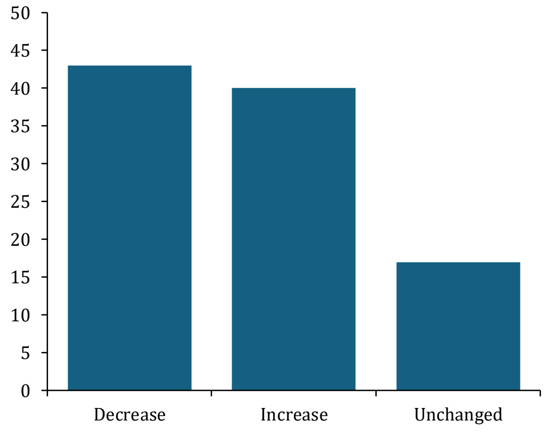


Figure 7: Expected medium-term changes in systemic risk (%)



Source: Bank of Zambia systemic risk survey and staff computations

3.0 Conclusion

The results of the September 2024 systemic risk survey reveals that financial sector participants expect the overall systemic risk to increase over the next 12 months, but later taper over the medium-term. They perceive heavy reliance on hydro power, undiversified economic system, high concentration of credit, and funding and liquidity mismatches as key vulnerabilities in the domestic financial system. They also view climate risk relating to drought and floods to be the greatest threat to financial stability in terms of potential impact. This is followed by higher inflation, liquidity risk, threat of cyber-attacks, increased load shedding, lower domestic growth and default risk on loans to households and firms. Respondents have cited climate risk, relating to drought and floods, and liquidity risk as the most difficult to manage.