South African Banking Outlook 2024:

Banks Are Largely Immune To The Faltering Economy

S&P Global
Ratings

Samira Mensah

Director – Financial Institutions Ratings

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This report does not constitute a rating action

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Key Takeaways

- South Africa's structural economic issues and infrastructure gaps are undermining the country's short- and medium-term growth prospects. S&P Global Ratings estimates GDP growth at less than 1.0% in 2023 and 1.5% in 2024.
- Credit conditions will remain tight in 2024, although inflation has slowed to 5.5% since June 2023. We expect inflation to average 5% in 2024, toward the top of the South African Reserve Bank's (SARB's) 3%-6% target range.
- We forecast that growth in credit to the private sector will be subdued at 5% in 2024. However, we expect banks to extend credit to the renewable energy sector because of electricity shortages. Private sector credit to GDP will remain stable, at about 70%. Households' disposable income will remain under pressure because of high interest rates and elevated food prices.
- We expect that the banking sector's credit loss ratio will remain slightly higher than the historical low of 0.75%, averaging 1.4% of total loans through 2024. Similarly, nonperforming loans will likely remain elevated, at above 4% of systemwide loans in 2024.
- Nonetheless, we anticipate that the sector will maintain strong risk-adjusted returns of 15%-16% on average, supported by net interest margins and transactional revenue. This, in turn, will support banks' internal capital generation.
- The sovereign-bank nexus underpins the limited availability of high-quality liquid assets in the South African capital market, and banks' appetite for sovereign risk in the weak economic environment.

Key Risks For South African Banks In 2024

Global liquidity

- While investors' risk-off sentiment toward emerging markets started shifting in 2023, the slow reform momentum, electricity crisis, and upcoming elections in South Africa could affect portfolio flows.
- While South African banks are less exposed to external refinancing risks, they are vulnerable to global investor sentiment and external financing conditions, which are tied to U.S. interest rates.
- South Africa remains on the global anti-money laundering and terrorist financing watchdog's grey list. A prolonged stay on the Financial Action Task Force's (FATF's) grey list could further increase financing costs.

Weaker asset quality

- Lingering weak economic growth prospects because of chronic under-investment in electricity infrastructure and ports could create long-term setbacks for the South African economy.
- Higher interest rates and inflation will likely affect households and small businesses, weighing on asset quality indicators in 2024 on the back of subdued loan growth.
- Commercial real estate (CRE) performance will remain under pressure amid high interest rates and inflation. Pressure on CRE valuations also stems from high vacancy rates in some city centers.

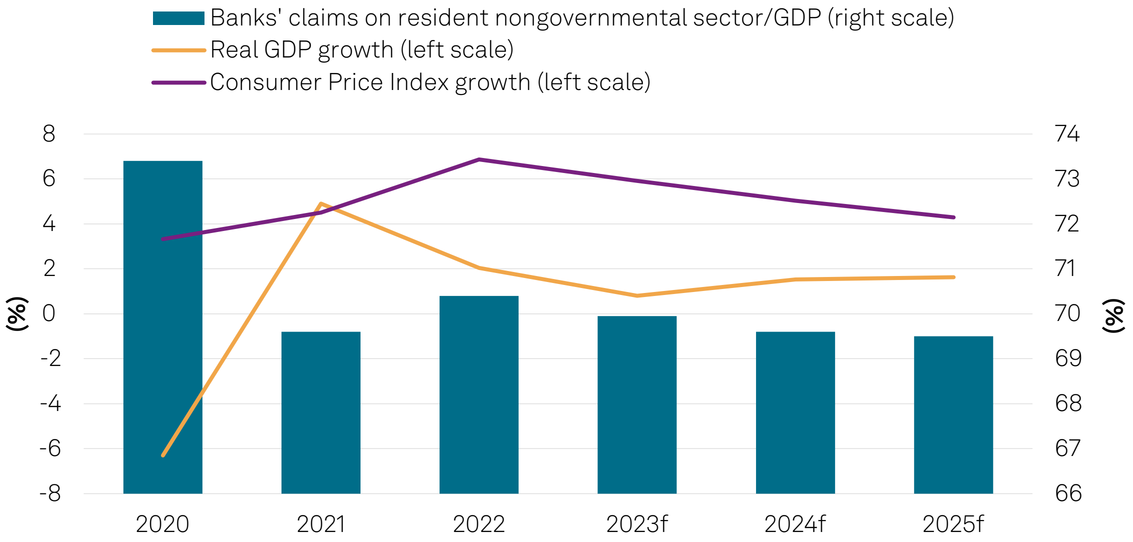
Policy choices

- The SARB's monetary stance will remain tight for at least the first half of 2024. This will constrain credit demand but support net interest margins. Inflation is set to decline to about 5% in 2024, toward the top of the 3%-6% target range.
- Banks' holdings of government securities increased to about 15% of the sector's total assets in 2023. Banks have the capacity to absorb additional government debt thanks to their liquid balance sheets and positive yields in real terms.
- The adoption of a resolution regime in South Africa will lead to the sustained issuance of capital instruments.

Demand For Credit Is Unlikely To Recover Meaningfully In 2024

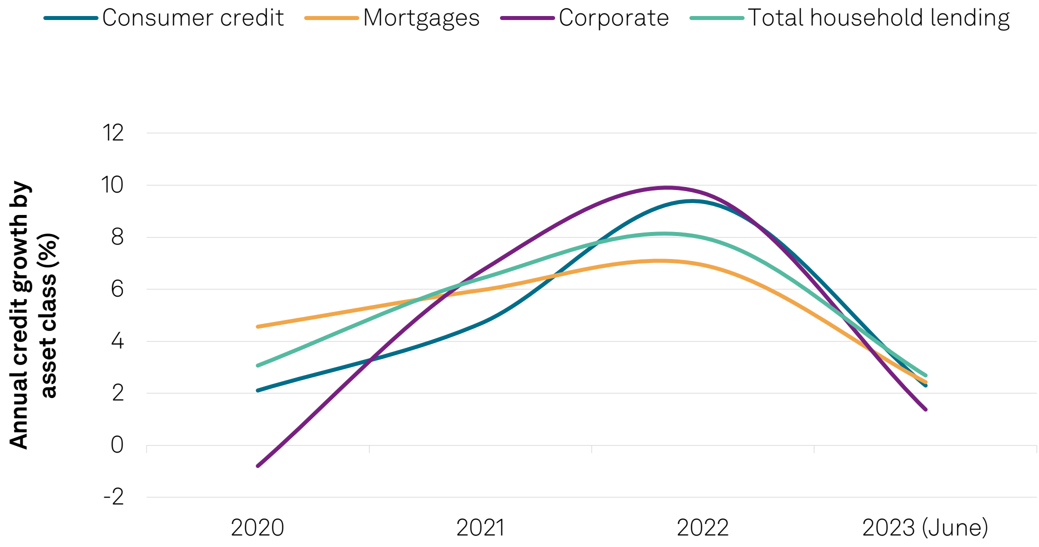
- Domestic credit growth will remain subdued in 2024, at about 5%, in line with our current estimate for 2023. Lending plunged in 2023, following a strong rebound in 2022, because banks tightened their risk appetite amid high interest rates and inflation.
- The SARB started tightening its overnight repurchase rate in November 2021, and had tightened it by a cumulative 475 basis points (bps) to 8.25% by May 2023 amid supply constraints and elevated food prices. The policy rate stands 200 bps above its pre-pandemic level of 6.25% in March 2020.
- Banks have extended credit to renewable energy companies and small and midsize enterprises that imported renewable energy equipment amid an acute energy crisis and very low consumer confidence among high- and middle-income households, whose disposable income has shrunk.

Private sector leverage held up despite a stagnant economy



f--Forecast. Source: S&P Global Ratings.

Lending dipped in 2023 amid an acute energy crisis

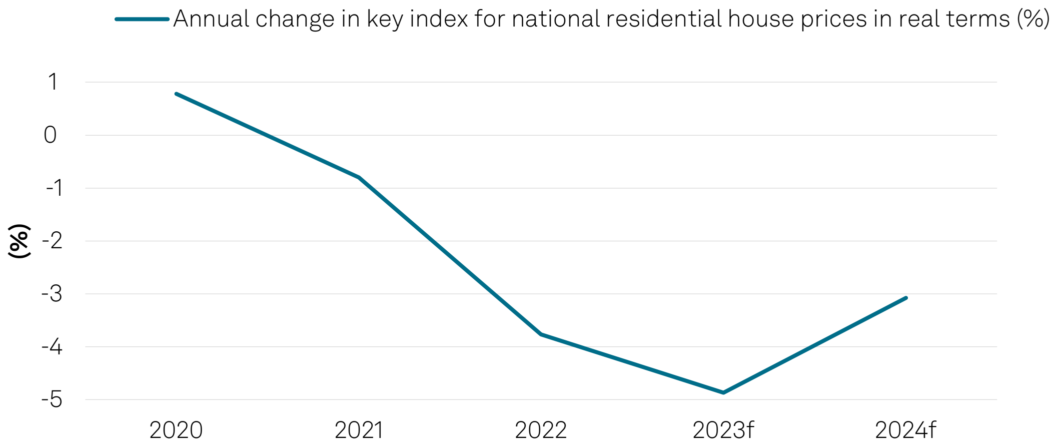


Source: South African Reserve Bank.

The Real Estate Market Is Under Pressure Due To High Interest Rates

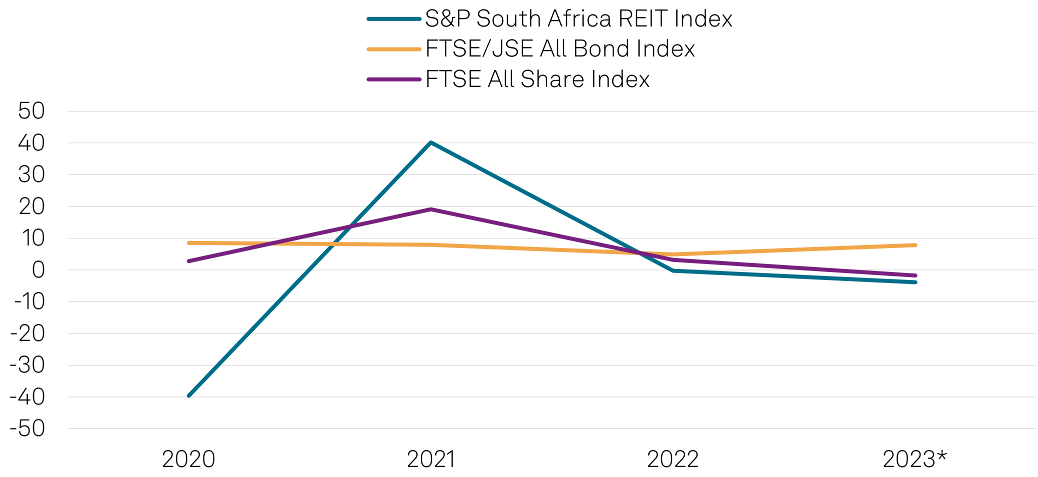
- Credit conditions remain tight and will constrain credit demand in 2024 across all segments, including corporates. This is because of weak investor sentiment, the slow pace of addressing infrastructure gaps, and the electricity crisis.
- Despite a strong rebound in 2021, CRE performance remains under pressure amid high interest rates and inflation. Pressure on CRE valuations also stems from high vacancy rates in some city centers, although the energy crisis has led to a return to offices. The South Africa REIT Index tracks a diversified pool of assets (more than two-thirds of assets), including retail assets (25%).
- The trend of decreasing house prices will start reversing in 2024 as inflation recedes. Mortgage lending will likely remain subdued, however, as interest rates will only gradually moderate and real growth per capita will remain below 0.5%.

House price decline linked to high inflation and interest rate cycle



f--Forecast. Source: S&P Global Ratings.

REITs' negative returns persist amid high interest rates

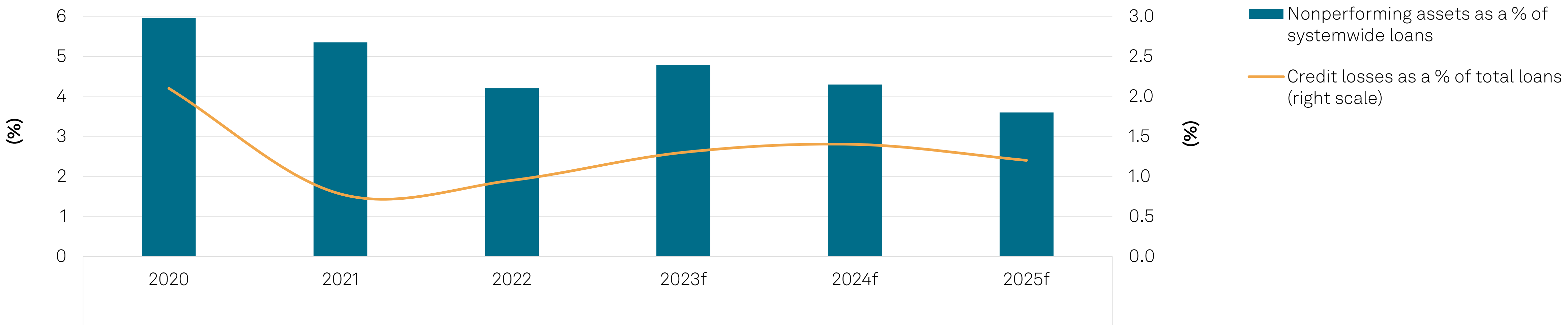


*South Africa REIT data as of Dec. 8, 2023, and All Share and Bonds Index data as of Dec. 11, 2023. REIT--Real estate investment trust. Sources: The JSE, S&P Global Ratings.

Banking Sector Credit Losses Have Risen But Are Manageable

- The South African private sector's debt-absorption capacity is underpinned by moderate wealth levels stemming from a contraction in real GDP per capita in 2023, high unemployment, and wide income disparities. Households' disposable income will remain constrained by high interest rates and elevated food prices.
- We expect that the banking sector's credit loss ratio will be higher than the historical low of 75 bps, averaging 1.4% through 2024. Similarly, nonperforming loans will remain at about 4.0% of systemwide loans through 2025.

South African banks' asset quality will improve slightly through 2025

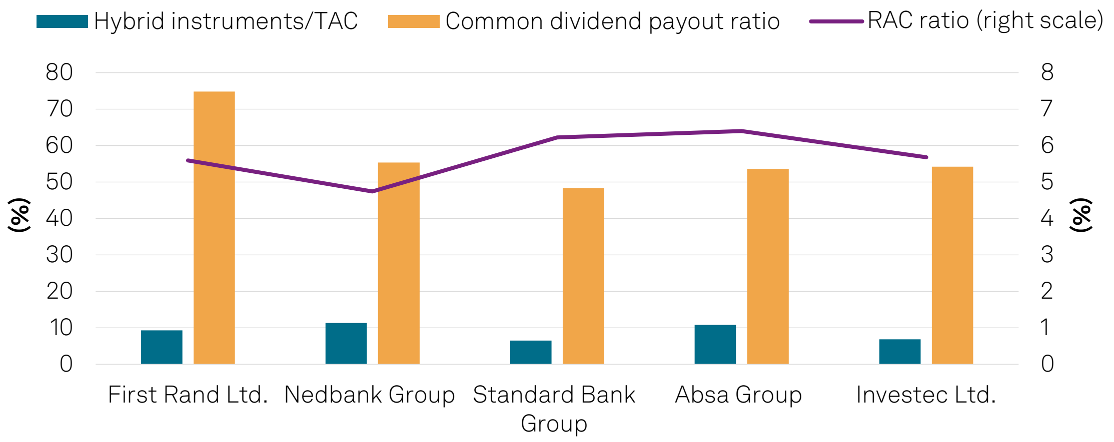


f--Forecast. Source: S&P Global Ratings.

Strong Profitability And Quality Of Capital Support Banks' Creditworthiness

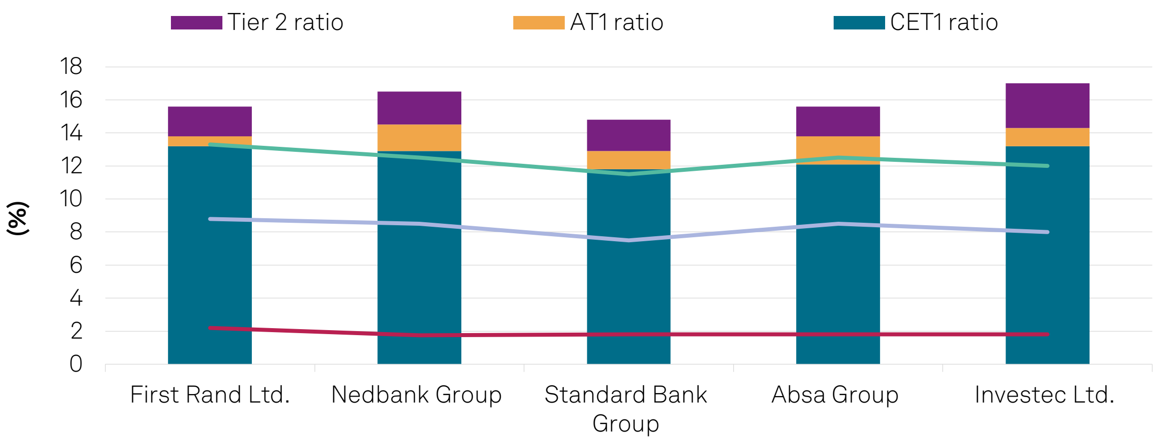
- Quality of capital is good. Hybrid instruments accounted for just under 10% of banks' total-adjusted capital for the 2022-2023 financial year. Banks issued additional tier 1 debt in 2023, despite muted lending growth, as they continue to optimize their capital structures. South African banks issued a cumulative ZAR45 billion in the first half of 2023, 15% more than at end-2022.
- Our risk-adjusted capital (RAC) ratio averages 5.7% for the top-tier South African banks in 2022-2023, ranging from 4.8%-6.2% on the back of generous dividend payouts (dividends divided by net income).
- South African banks will continue to maintain robust buffers against the minimum requirements, with an average common equity tier 1 buffer of 400 bps. Banks plan to start issuing additional loss-absorbing capacity debt in 2024, if the regulatory calibration is finalized.

Consistent and strong profitability through the cycle



RAC--Risk-adjusted capital before adjustment for diversification. TAC--Total adjusted capital. Source: S&P Global Ratings, Dec. 31, 2022 (except Investec Ltd. as of March 31, 2023, and FirstRand Ltd. as of June 30, 2023).

Banks operate with ample regulatory capital buffers

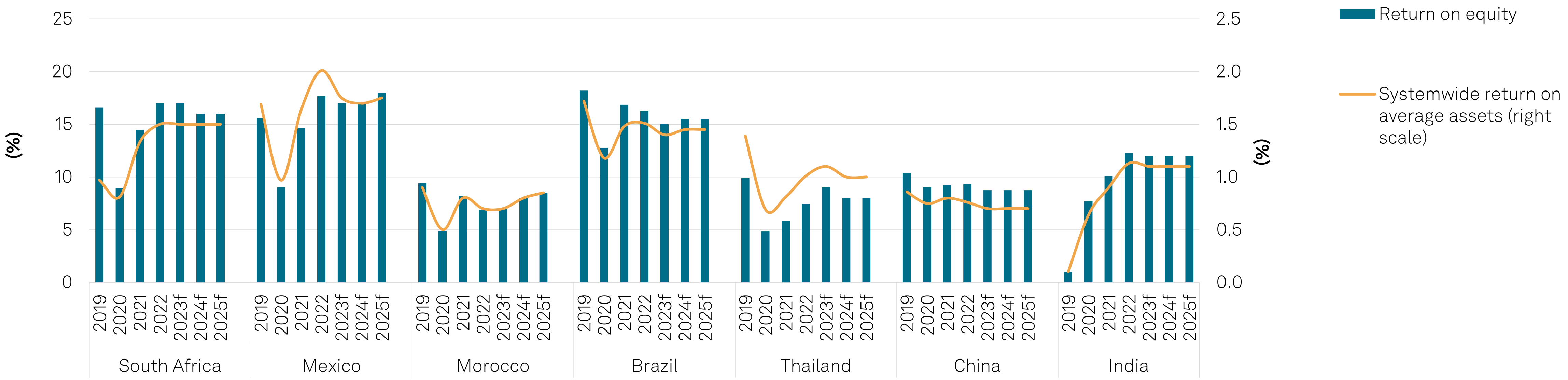


AT1--Additional Tier 1. CAR--Capital adequacy ratio. CET1--Common Equity Tier 1. Source: Banks' Pillar III reports, Sept. 30, 2023 (except FirstRand Ltd., which is as of June 30, 2023).

South African Banks Show Strong Profitability Through The Economic Cycle

- Earnings capacity is supported by banks' diversified business models and their ability to generate a consistent share of noninterest income.
- The SARB's tight monetary stance will likely persist in 2024, which will benefit net interest margins. This is partly supported by banks' government securities portfolios, which increased in 2023 to about 15% of total assets from a 10% average in past years.
- We anticipate that the sector will maintain a strong return on equity of 16% on average. This compares adequately to South Africa's closest banking sector peers such as Brazil and Mexico.

Profitability through the cycle compares well with that of most peers

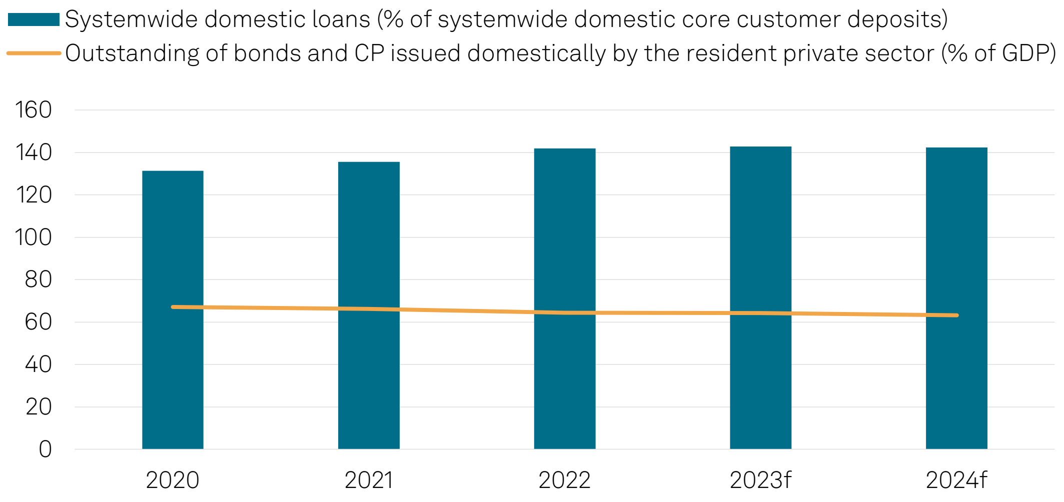


f--Forecast. Source: S&P Global Ratings

The Closed Rand System Mitigates Funding Risks

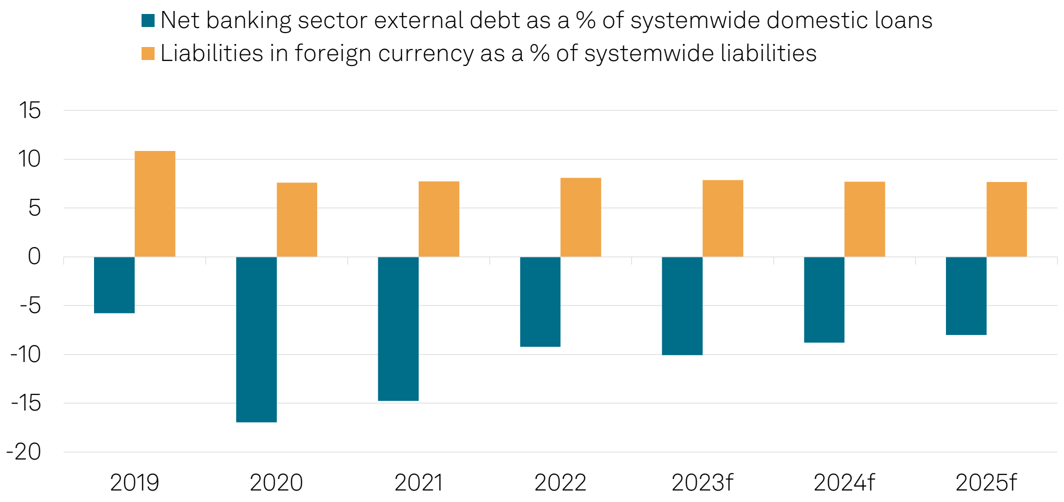
- Banks source local-currency deposits from nonbank financial institutions (25% of the funding base) because professional money managers dominate contractual savings. The increase in offshore pension fund exposures to 45% could affect this ratio. Nonbank financial institutions' assets account for a material amount of GDP, about 220%, while banking assets stand at about 110% of GDP.
- South Africa has deep liquid capital markets. Corporates, including banks, issue short-term instruments, providing a diversified funding base.
- Major banks are less exposed to external refinancing risks, but the financial sector remains vulnerable to global investor sentiment and external financing conditions, which are tied to U.S. interest rates and a prolonged stay on the FATF grey list.

Reliance on stable short-term and wholesale funding



CP--Commercial paper. f--Forecast. Source: SARB, S&P Global Ratings.

A net external asset position and low FX liabilities underscore low refinancing risks



f--Forecast. Source: S&P Global Ratings.

S&P Global Ratings

Sovereign Creditworthiness Constrains Most Bank Ratings

South African banks: ratings and outlooks

	SACP	Issuer credit rating	National scale rating	Outlook
Absa Bank Ltd.	bbb-	N/A	zaAA/--/zaA-1+	N/A
African Bank Ltd.	b	B/B	zaA-/--/zaA-2	Positive
Capitec Bank Ltd.	bb	BB-/B	zaAA/--/zaA-1+	Stable
Investec Bank Ltd.	bbb-	BB-/B	zaAA/--/zaA-1+	Stable
FirstRand Bank Ltd.	bbb-	BB-/B	zaAA/--/zaA-1+	Stable
Nedbank Ltd.	bbb-	BB-/B	zaAA/--/zaA-1+	Stable

Data as of Jan. 15, 2024. N/A--Not applicable. SACP--Stand-alone credit profile. Source: S&P Global Ratings.

- Top tier South African banks' stand-alone credit profiles (SACPs) remain at 'bbb-', but the 'BB-' sovereign rating constrains the issuer credit ratings.
- We do not rate financial institutions in South Africa above the level of the foreign-currency sovereign ratings, given the direct and indirect impact that sovereign distress would have on domestic banks' operations.
- The banks' SACPs reflect our expectation that their financial performance will be resilient through the cycle. They boast a long track record of sound asset quality and robust regulatory capital buffers to withstand the weak economic prospects.
- We have a stable outlook on most banks, which reflects the outlook on South Africa. National scale ratings do not have outlooks.
- Our ratings on banks will generally move in tandem with the sovereign ratings, but a sovereign upgrade is unlikely in the next 12 months. A negative rating action would arise if economic and governance reforms do not progress as planned, resulting in further deterioration in economic growth, or higher fiscal financing needs than we expect.

Related Research

- Global Banks: Our Credit Loss Forecasts Asset Quality Faces Rising Risks, Nov. 17, 2023
- South Africa 'BB-B' Foreign Currency And 'BB/B' Local Currency Ratings Affirmed; Outlook Stable, Nov. 17, 2023
- SLIDES: Property-Loan Risk Is Manageable For Most Emerging Market Banks, Nov. 2, 2023
- Banking Industry Country Risk Assessment: South Africa, June 15, 2023
- Sub-Saharan Africa's Fading Tailwinds And Missed Opportunities, May 30, 2023

Analytical Contacts

Samira Mensah

Director & Lead Analyst,
Financial Institutions Ratings

+ 27 11 214 4869

samira.mensah@spglobal.com

Mohamed Damak

Managing Director & Sector Lead,
Financial Institutions Ratings

+971 4 372 7153

mohamed.damak@spglobal.com

Zahabia Gupta

Director,
Sovereign Ratings

+971 4 372 7154

Zahabia.gupta@spglobal.com

Charlotte Masvongo

Senior Analyst,
Financial Institutions Ratings

+27 11 214 4816

charlotte.masvongo@spglobal.com

Sergey Voronenko

Director & Lead Analyst,
Financial Institutions Ratings

+971 (0) 50 106 4966

sergey.voronenko@spglobal.com

Adnan Osman

Rating Analyst,
Financial Institutions Ratings

+27 83 285 3798

Adnan.osman@spglobal.com

spglobal.com/ratings

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