الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

Republic of South Africa

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TRUST . TRANSPARENCY . INDEPENDENCE

ECONOMIC OVERVIEW

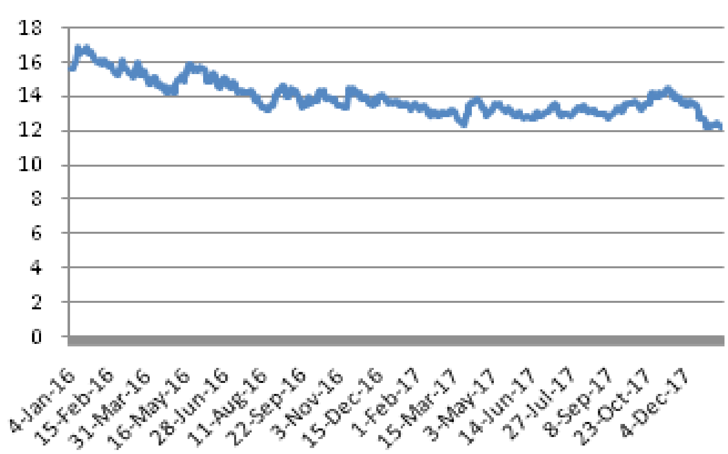
The Republic of South Africa ("South Africa" or "SA" or "the country") is the third largest economy in the African sub-continent with a GDP of ZAR4,339b[1] (~US$295.5b[2]) at 2016 lagging Nigeria (US$404.6b) and Egypt (US$332.8b). With a population of about 56.5m at June 2017 and a GNI per capita of US$5,490[3], the country is classified as an upper middle income economy; however, income inequality remains one of the major challenges for SA. Moreover, the income per capita in the country has stagnated over the last few years.

Table 1: SA Economic Indicators

Amounts and ratios as stated	2014	2015	2016	Q2'17	Q3'17
Population (million)	53.9	54.8	55.6	56.5	N.A.
GDP per capita (ZAR)	72,425	75,780	80,067	81,453	N.A.
GDP at current prices (ZAR'b)	3,905	4,149	4,453	4,604*	4,662*
Real GDP growth rate (%)	1.7	1.3	0.3	2.5*	2*
Inflation (CPI Year End, %)	6.1	4.6	6.4	5.1^	5.1#
Unemployment rate (%)	24.3	25.4	26.5	27.7	27.7
Current account balance as % of GDP	-5.3	-4.4	-3.3	-2.4	-2.3
Fiscal balance as % of GDP (a)	-4.2	-4.6	-3.9	N.A.	N.A.
Primary balance as % of GDP (a)	-1.1	-1.3	-0.5	N.A.	N.A.
Total central government debt (ZAR'b)	1,788	1,998	2,243	2,309	2,419
Gross government debt % of GDP	46.6	49.4	50.7	50.2	51.9
Gross External debt (US$'b)	145	124	143	159	163
Gross International Reserves (ZAR'b)	569	714	648	618	667

South Africa has been facing economic headwinds leading to deceleration in growth which exacerbated during 2016 on multiple grounds. In the backdrop of political uncertainties, these included weak domestic demand, contraction in agriculture due to severe drought conditions and continued sluggishness in the mining sector due to operational challenges despite some improvement in the commodities prices since H2'16. All these factors led to sharp contraction in real GDP to 0.3% in 2016 from 1.3% in 2015 and weakest performance since 1994. Being a commodities-based economy, the country's growth was affected by lower mining export volumes due to weak global demand during the year. This also led to weak investment activity in the country. Nonetheless, the growth rebounded during Q2'17 at an annualized rate of 2.5%, followed by a 2% annualized growth during Q3'17 after posting consecutive contractions over the previous quarters. This improvement was led by improved activities in agriculture, mining coupled with boosted commercial banking and trading activities in the tertiary sector. Full year growth expectations for SA in 2017 and 2018 as per IMF is 0.7% and 1.1%, respectively.

Figure 1: ZAR per US$ Trend



(Source: SARB)

On the other hand, SA's current account deficit has marginally narrowed on a timeline. Improvement in export volumes during 2016 and continuing over 2017 have supported the overall balance. Most part of the deficit is financed through net portfolio inflows, which tend to be volatile. Furthermore, lower tax collections have dragged the country's budget deficit resulting in rising public debt levels over the years.

[1] *National Treasury - SA*
[2] *Source: World Bank*
[3] *World Bank classification*

Other key critical issues facing the country include high unemployment, inflation, sharp currency depreciation, and political uncertainties. High inflation levels during 2016 particularly caused due to food prices coupled with subdued growth levels and ZAR depreciation led the South African Reserve Bank ("SARB" or "the central bank") to raise the policy rate twice by a cumulative 75bps during the year; however, an improved inflation outlook during 2017 provided room for SARB to cut the rate by 25bps, for the first time in 5 years, to incentivize growth. Besides internal political uncertainties, the country has been most vulnerable to external factors like low business confidence and rating actions on the country leading to volatility pressure on ZAR which has followed a sustained depreciating trend over 2015-2016. While temporary stability was noted in early 2017 supported by relatively better trade surplus, recent domestic developments including the announcement of the medium-term budget policy statement followed by the cabinet reshuffle caused further weakening in the currency.

In terms of policy continuity, the most recent ANC (ruling party) leadership election could bode well for the economy in the coming periods; however, the implementation of planned reforms is to be monitored closely.

BANKING SECTOR

Table2: ABL vis-à-vis SA Banking Sector

Ratios as stated	ABL		SA banking sector	
	2016	**H1'17**	**2016**	**H1'17**
Deposits growth YoY	4.7%	8.7%	3.8%	2.1%
Asset growth YoY	5.4%	9.3%	1.0%	2.1%
ROAE	6.7%	9.2%	17.6%	16.6%
ROAA	0.8%	1.1%	1.3%	1.3%
Efficiency	75.3%	68.9%	55.1%	55.6%
Gross NPFs ratio	3.0%	2.2%	2.9%	2.9%
CAR	15.3%	15.74%	15.73%	16.48%
Tier 1	14.1%	14.25%	12.65%	13.46%
Top 10 depositors	5.1%	5.3%	16.2%	17.2%

SA's banking sector comprises a total of 69 institutions that include 19 registered banks, 3 mutual banks, 2 cooperative banks, 15 local branches of foreign banks and 30 foreign banks with approved local representative offices. However, among these institutions the 5 largest banks hold over 90% of the total banking sector assets that indicates the banking sector's high vulnerability to systemic risk. The overall banking assets stood at about ZAR4,947b at H1'17, representing about 107% of the GDP.

Despite the weak economic growth, overall banking in SA has remained resilient with good profitability and robust capitalization and supported by an effective regulatory regime. The financial soundness indicators of SA's banking sector generally remained stable in 2016. Nonetheless, the spill-over effects of subdued economy were noted in the activity levels which depicted sharp decline in both deposit and credit volumes, following about 9% average growth over the prior 3 years. This was also on account of stringent lending rules implemented by the supervisory authrorities in SA. The credit risk levels have risen in absolute terms in the sector mostly emanating from the retail segment; however, the impairments have been maintained at 2.9% and adequately cushioned by the sector's strong capitalization. The sector's overall credit exposure to the public sector was contained at about 2.3% at H1'17. Liquidity coverage ratio[4] also exceeds the minimum requirement of 70%.

Comparison: ABL's growth has outpaced the banking sector growth in terms of deposits and assets in 2016 and H1'17. Performance indicators like return ratios, efficiency and CAR have trailed the banking sector average as shown. However, other parameters including tier 1 capitalization and impairments have compared favorably vis-à-vis the industry.

Islamic finance in SA: Given the country's demographics with Muslims representing minorities[5], there is no formal regulatory infrastructure for Islamic finance. However, there is gradually growing demand of Shari'a compliant products and services arising even from the non-Muslim population which has led to the government enacting certain legislative

[4] *As of Oct. 2017: 118.52%; Dec. 2016: 107.8%*

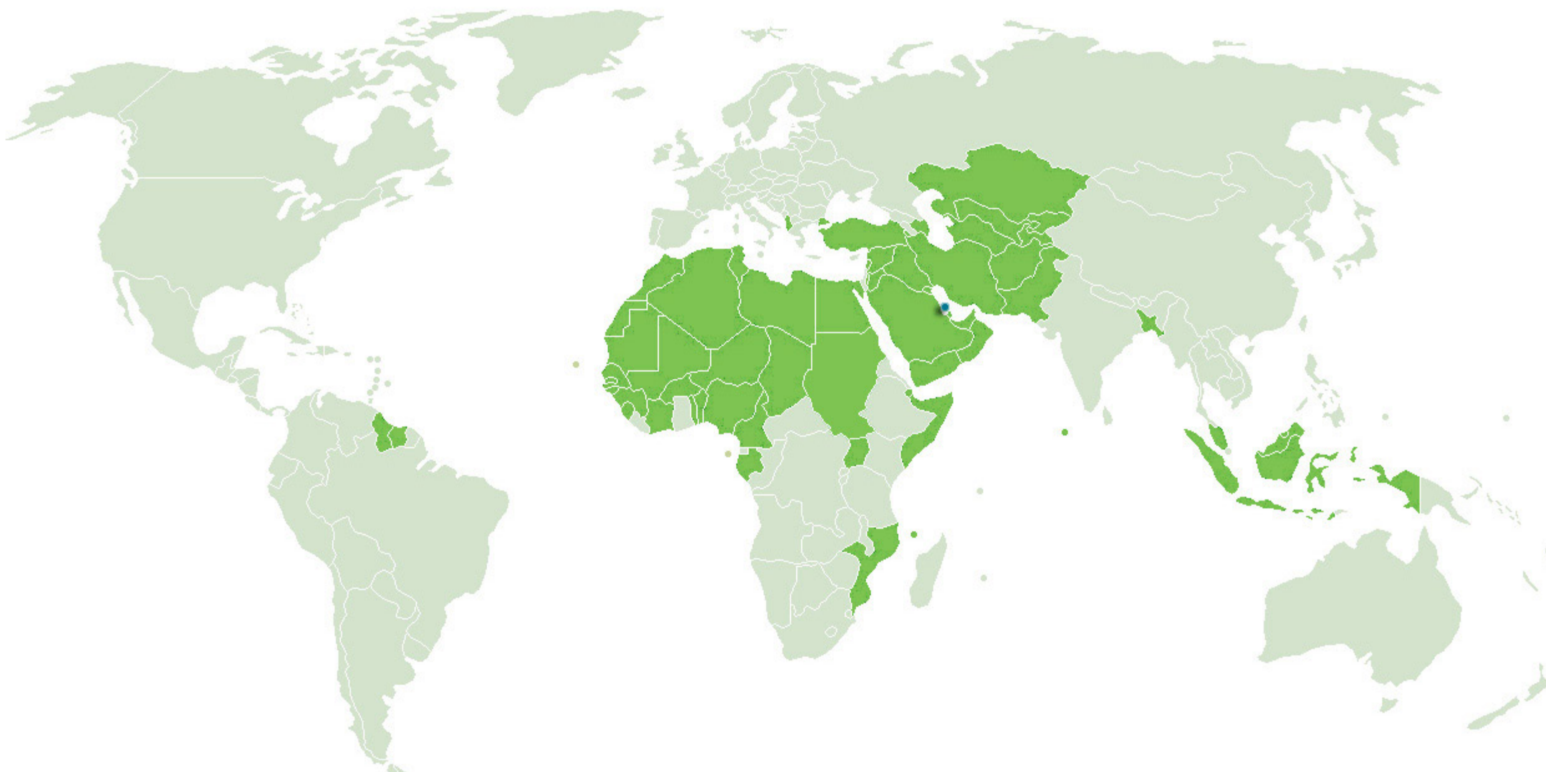
[5] *Representing about 1.5% of total population*

amendments. Under the Taxation Laws Amendment Act of 2010, the country recognized diminishing musharka, murabaha and mudaraba as financing alternatives equivalent to conventional forms for preventing additional taxation arising on utilization of these modes of financings. In the following year, further amendments were effected to introduce sukuk. Most recent amendments in 2015 related to the extension of sukuk issuance to state owned enterprises from government previously. The country also issued its debut US$500m sovereign sukuk in 2014 utilizing Shari'a compliant financing at the government level. In terms of entities, there are 4 other banks besides ABL which offer some Shari'a compliant products through their specialized divisions and Islamic windows. Further there are NBFIs operating as Shari'a compliant fund managers.

Brief financial sector regulatory developments in SA: The regulatory environment in SA is stringent and yet evolving. Most recent set of regulations that would likely have major implications for the overall banking sector including the bank include:

- In August 2017, the Financial Sector Regulations ("FSR") Act were effected that would lead to spliting the the financial service industry under twin peak regulatory framework – Prudential Authority and Financial Sector Conduct Authority.
- Amendment of provisions of The Financial Intelligence Center Amendment Act ("FICA"): Under the amended provisions of FICA, the focus has shifted to follow a risk based approach concerning AML / CFT and KYC regulatory regime.
- Protection of Consumer Information Act ("PoPI") would imply heightened responsibility on part of all the institutions while collecting, processing, storing and sharing a person / entity's private information.

[5] *HBZ Bank Limited, FirstRand Bank Ltd, The Standard Bank of South Africa, Absa Bank; (Source: The Banking Association, South Africa)*



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