momentum
investments

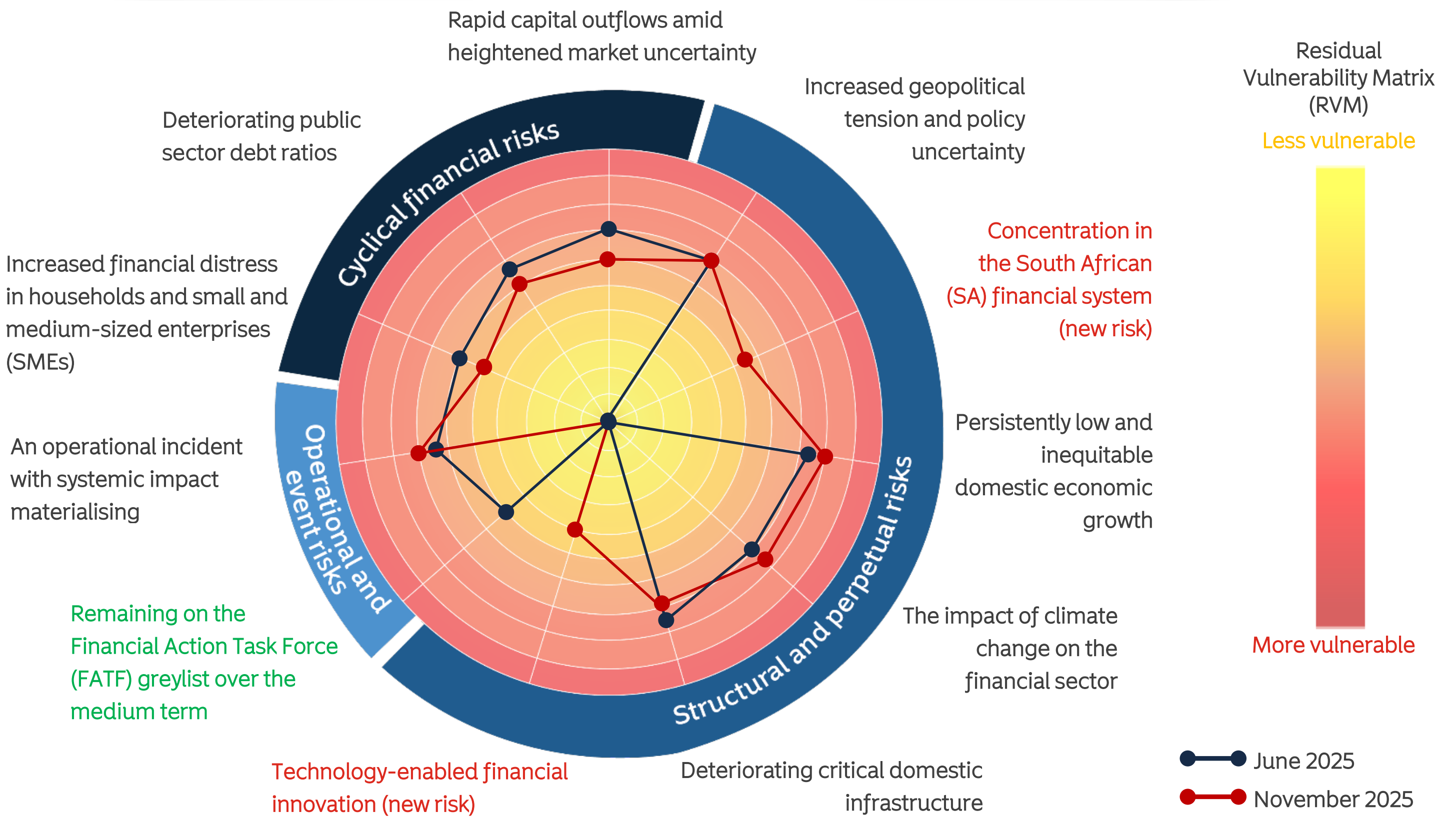
# in the moment

**Sanisha Packirisamy**
Chief Economist

**Tshiamo Masike**
Economist

# Financial stability review: Financial system resilience holds firm amid geopolitical and policy risks

## Removal from the greylist has eliminated the associated risk




## So what?

In the second edition of the Financial Stability Review (FSR), the SA Reserve Bank (SARB) maintained that financial system resilience has held firm since June 2025 and it is expected to remain resilient over the coming 12 months. Most of the risks monitored are structural and perpetual risks and the majority of the risks identified have moderated since the previous FSR. This suggests that while short-term concerns have lessened, ongoing vigilance is required to manage underlying, enduring risks.

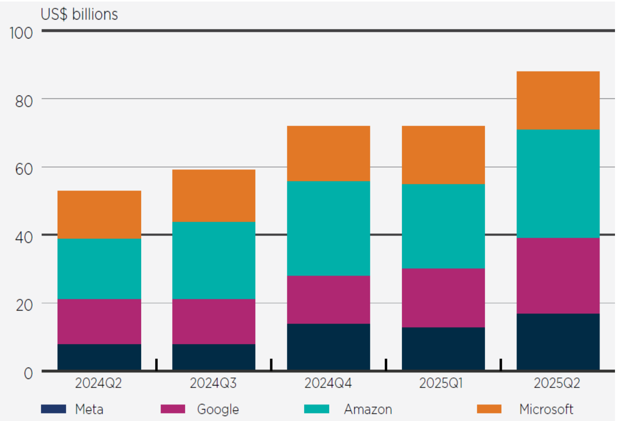
The November FSR highlighted the risk of an artificial intelligence (AI) bubble, noting that a correction in the valuation of United States (US) technology stocks would spill over worldwide. This would negatively impact SA's market stability and asset prices.

*Source: SARB, Momentum Investments*
*Dots in the diagram = assessment of the residual vulnerability of the financial system to each risk. Dots further away from the centre = higher residual vulnerability and vice versa. Residual vulnerability is based on the probability that the risk could materialise in 12 months and the likely impact should it materialise considering amplifying and mitigating factors.*

## Concentration of technology stocks increases systemic risk

The 'Magnificent Seven's[1]' weight in the S&P 500 benchmark index has more than tripled from 11% in September 2015 to 35% in September 2025. This reflects a decade of strong earnings and dominance in high-growth digital products. The recent surge in their valuations has been driven by global enthusiasm for AI, with these companies notably increasing AI investments between the second quarter of 2024 and the second quarter of 2025 (see chart 1), in anticipation of future profits. This has underpinned the resilience in global financial markets in a world of heightened trade and geopolitical uncertainties.

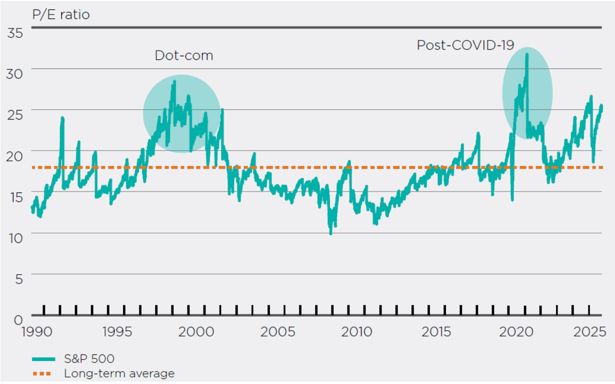
Chart 1: Surge in AI-related capital expenditure




*Source: SARB*

Despite high valuations, they remain below the peaks seen during the dot-com bubble and post-COVID-19 pandemic (see chart 2). However, the SARB warns that the reliance on a few major corporations for performance and corporate spend has increased systemic risk. If AI returns disappoint, the impact could be widespread. An MIT (Massachusetts Institute of Technology) study found that about 95% of firms have yet to see measurable results from their AI investments.

Chart 2: Price-to-earning (P/E) ratio elevated




*Source: SARB*

> Given that US equities accounted for about 60% of global market capitalisation in 2023, any correction would ripple worldwide, tightening global financial conditions as risk aversion increases and liquidity conditions deteriorate.

Historically, such shifts have hurt emerging markets through investment outflows, weaker currencies and higher risk premia. For SA, these global disruptions could heighten market volatility and negatively affect asset prices across equities, fixed-income and currency markets.

Contrary to heightened optimism in the equity market, the SARB noted that bond market investors are more cautious. Government debt levels continue to rise globally with the debt ratio projected to reach almost 100% of global GDP in 2030. Locally, the fiscal position is improving which triggered a sovereign credit rating upgrade by S&P Global Ratings.

The SARB's Financial Conditions Index (FCI) indicates that local financial conditions have eased over the past six months, mainly due to higher equity prices and lower bond yields across the curve.

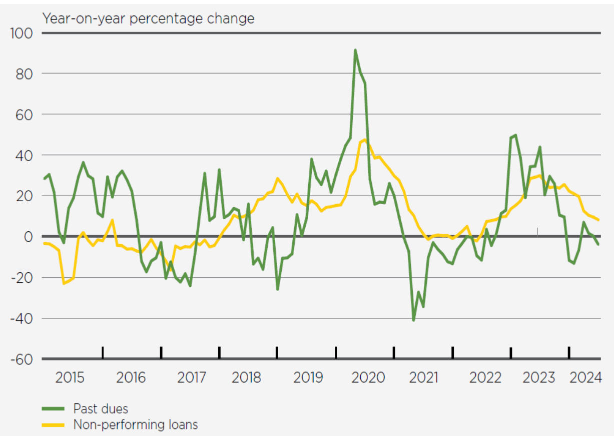
[1] Includes Apple, Microsoft, Nvidia, Alphabet (Google's parent company), Amazon, Meta (Facebook's parent company) and Tesla

## Longer-dated overdue loans are reliable leading indicators for future non-performing loans

In an assessment to test whether overdue loans could act as a leading indicator for future non-performing loans (NPLs), the SARB discovered that loans overdue for between 61 and 90 days have a strong correlation with NPLs and can therefore be used as an early warning indicator for future NPLs. Overdue loans between 31 and 60 days are also a reliable early warning indicator, though to a lesser extent, while overdue loans for one month or less are a far less reliable early warning indicator.

> NPLs are a key metric to monitor, as high NPLs can reduce a bank's profits and capital which would limit the banks' lending capabilities and slow economic growth.

Chart 3: Strong correlation between past due loans and NPLs




*Source: SARB*

In the November 2023 FSR, the SARB indicated that NPLs were rising faster in non-systemic banks compared to systemically important financial institutions. This trend suggests that despite the increase in non-performing loans among smaller banks, the resilience of systemically important institutions continues to help protect the broader financial system. Nevertheless, the banking sector's profitability remained above its 10-year average over the review period and regulatory capital levels remained higher than long-term averages, highlighting the sector's resilience.

For the first time since the third quarter of 2020, total credit extension in relation to economic output (the credit-to-GDP gap) surpassed its long-term average in the first quarter of 2025. This growth was mainly driven by increased corporate lending for investment in renewable energy and borrowings for working capital needs. Although the credit-to-GDP gap is now marginally positive, it remains well below the two-percentage point level that would prompt the SARB to activate the countercyclical capital buffer.

In the question-and-answer session of the November 2025 FSR release, the SARB confirmed that Pepkor received approval to launch a bank in SA. *BusinessTech* reported that Pepkor will announce details of its offering and target customers in March 2026.

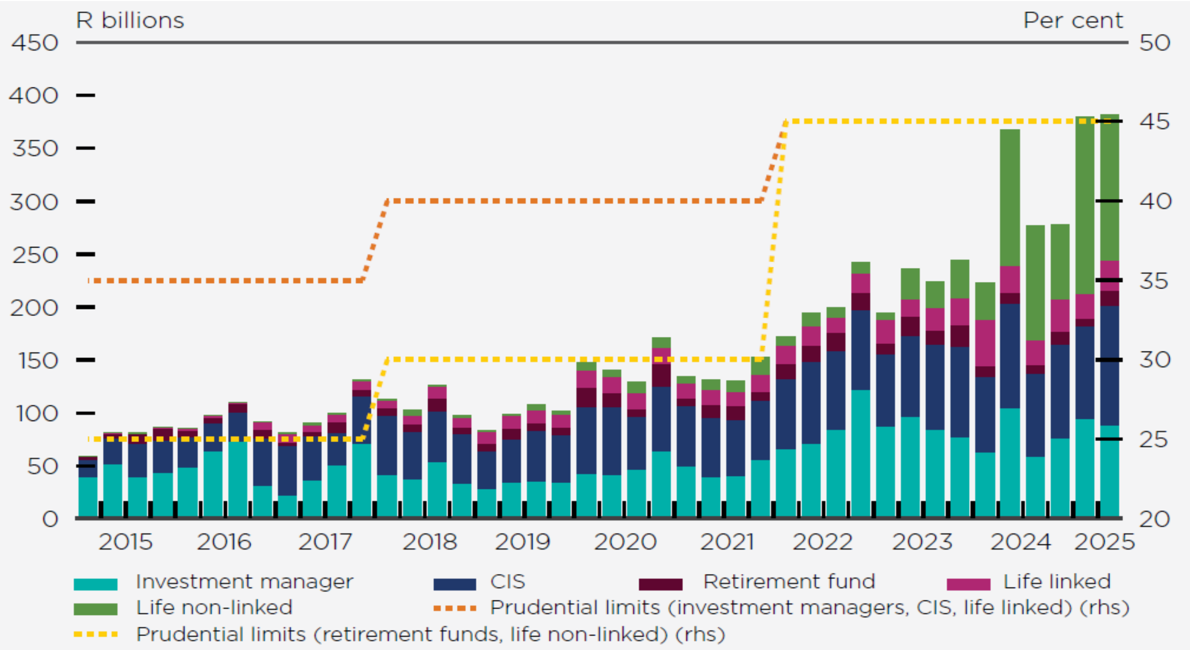
## SA investors have preferred offshore investments over the past decade

Since 2015, investment flows by SA residents have cycled between offshoring (sending funds abroad) and onshoring (bringing funds back home). Institutional investors have played a leading role in the magnitude and direction of flows, generally favouring investments outside SA.

> However, during times of financial stress, particularly during the COVID-19 crisis, these investors redirect funds locally, helping to mitigate the impact of foreign capital outflows.

Over the years, net outflows have trended upwards, corresponding with rising foreign investment limits. While investment managers and collective investments remain the main drivers of gross flows, life non-linked insurers have become increasingly prominent over the past decade (see chart 4).

Chart 4: Gross resident flows* by investor type, contrasted with prudential limits on foreign asset holdings

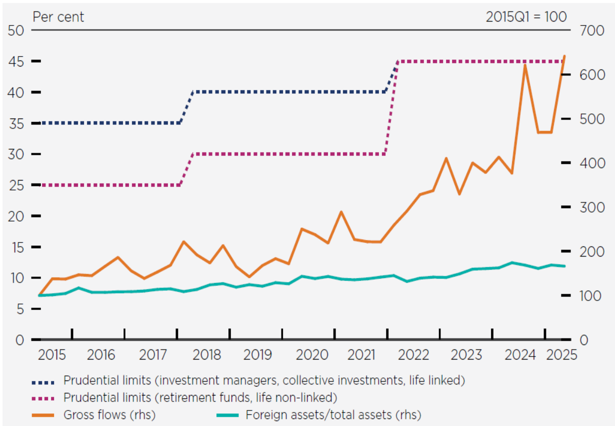



** Sum of inflows and outflows in absolute terms*
*CIS = Collective investment scheme*
*Source: SARB*

Between 2015 and 2025, growth in gross institutional investor flows has surpassed the increase in their foreign asset holdings (see chart 5). The SARB indicated that although investment flows into foreign assets have risen sharply since late 2021, the overall share of offshore assets in resident portfolios has stayed broadly unchanged.

> This indicates that while outflows are historically high, they are broadly consistent with the growth in local institutional assets under management, rather than signalling an unusual shift in investor behaviour.

Chart 5: Offshore outflows align with portfolio growth




*Source: SARB*

## Financial stability risks have eased but two new risks have emerged

The SARB has categorised key risks to domestic financial stability into three categories namely cyclical financial risks, structural and perpetual risks as well as operational and event-specific risks. The SARB defines these risks as:

- 'Cyclical financial risks: Relate primarily to asset valuations, credit extension and real economic conditions that typically rise and fall in line with economic and financial cycles'.
- 'Structural and perpetual risks are those associated with the operating environment of the financial sector and which do not rise and fall with the domestic economic and financial cycles'.
- 'Operational risk refers to any shock that could disrupt the operations of the financial sector on a systemic scale. Event risks may include extreme weather events, incidents of social unrest and ad hoc events that can have financial stability implications for SA'.

Table 1: The majority of the associated vulnerabilities to risks have decreased

| Key risks | Changes since the June 2025 FSR |
|---|---|
| Cyclical financial risks | |
| Rapid capital outflows amid heightened market uncertainty | Financial system vulnerability to this risk has decreased, mainly because rand volatility is lower and resident investors help mitigate the impact of volatile capital flows. |
| Deteriorating public sector debt ratios | Vulnerability has decreased slightly supported by positive fiscal developments year-to-date, compression of government bond yields, a lower inflation target to 3%, removal from the FATF greylist and a sovereign credit rating by S&P. |
| Increased financial distress in households and SMEs | Vulnerability has eased but remains elevated. Positives include lower debt-service costs as a share of household income and a resilient residential property market. |
| Structural and perpetual risks | |
| Increased geopolitical tension and policy uncertainty | Vulnerability remained unchanged as geopolitical tensions and policy uncertainty remain elevated. |
| Concentration in SA's financial system (new) | Banking sector is highly concentrated. This is a source of vulnerability because it contributes to 'too-big-to-fail' risks and it can lead to rapid and widespread contagion of distress events throughout the financial system. The Insurance sector is relatively less concentrated. |
| Persistently low and inequitable domestic economic growth | Vulnerability has increased slightly due to the wide-ranging social impact of low economic growth, high unemployment, a stagnant tax base and increasing social grant recipients. |
| Technology-enabled financial innovation (new) | Crypto assets may be used to bypass the provisions of the Exchange Control Regulations. Crypto assets may affect financial stability through confidence effects, exposures of financial institutions, market capitalisation and wealth effects as well as payments and settlement. |
| Deteriorating critical domestic infrastructure | Compounds other financial stability risks, notably by intensifying the challenges associated with low economic growth and worsening public debt ratios. There have been improvements in recent years, particularly in the energy sector. |
| The impact of climate change on the financial sector | Vulnerability has increased due to heightened global uncertainty about climate policy. Natural catastrophe insurance is a key instrument for mitigating losses but there is a large uninsured portion which is expected to increase as climate change intensifies. |
| Operational and event risks | |
| An operational incident with systemic impact materialising | Risks include cyber-incidents and the failure of critical third-party providers. Vulnerability has increased because the number of reported digital banking fraud incidents has increased sharply. |
| Remaining on the FATF greylist over the medium term | Vulnerability associated with this risk has reduced to zero following the removal of SA from the greylist on 24 October 2025. |

*Source: SARB, Momentum Investments*