Financial Stability Report

October 2025

Bank *of* Zambia

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This *Financial Stability Report* (FSR) is published pursuant to section 34 (2) of the Bank of Zambia Act, 2022. The report highlights key vulnerabilities and risks that may result in financial distress and thereby compromise financial stability. It also highlights macroprudential policy tool(s) that may be deployed to mitigate risks to the financial system.

The FSR was approved by the Financial Stability Committee ("FSC" or "Committee") in October 2025 and contains information available at the time of approval.

As prescribed under section 32 (1) of the Act, members of the FSC are as follows:

1. Governor – Chairperson (Dr. Denny H. Kalyalya)
2. Deputy Governor responsible for financial stability – Vice Chairperson (Dr. Francis Chipimo)
3. Deputy Governor responsible for administration (Ms. Rekha C. Mhango)
4. Bank of Zambia senior management staff responsible for research (Dr. Jonathan M. Chipili)
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7. Representative of the Securities and Exchange Commission (Mr. Philip K. Chitalu)
8. Representative of the Pensions and Insurance Authority (Ms. Namakau M. Ntini)

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Preface

Pursuant to section 5(1) of the Bank of Zambia Act, 2022, the Bank of Zambia formulates and implements monetary and supervisory policies to achieve and maintain price and financial stability. For the financial stability mandate, the Bank monitors the build-up of systemic risk wherein various indictors associated with components of the financial system are analysed individually and as a group. The Bank monitors and analyses developments in the macroeconomic environment, financial markets, institutions and market infrastructure.

Specifically, the FSC meets twice a year, in April and October, to review systemic risk developments over the past six months and decide on appropriate macroprudential policy measures. The decision-making process starts with the assessment of whether the buildup in systemic risk is sufficient to warrant action. Thereafter, an assessment of the macroprudential tool(s) that should be activated to mitigate the risk is/are identified. The activation of a macroprudential tool involves the determination of the type of instrument used, its timing (when) and its calibration (level). If an instrument is already active, a decision must be made whether to increase, maintain or decrease its level. While the FSC has several policy instruments at its disposal, the countercyclical capital buffer (CCyB) is its key instrument for macroprudential policy.

Glossary of Key Terms

Unless or otherwise stated, in this report,

Financial stability shall mean that the financial system, which is made up of financial intermediaries, markets, and infrastructure, is resilient to shocks and capable of smoothly conducting its core tasks of intermediation of funds, transmission of payments, pricing of instruments and redistribution of risks to positively contribute to sustained economic growth.

Systemic risk shall refer to the possibility that distress or failure of individual financial intermediaries, markets or infrastructure triggers a severe instability of the entire system with adverse consequences for the real economy.

A vulnerability shall be described as a weakness or pre-existing condition which, if it interacts with a realized risk, would amplify the financial system stress.

Resilience shall refer to the capacity of financial intermediaries, markets or infrastructure to absorb shocks and prevent them from amplifying and causing distress.

Macroprudential shall mean the use of prudential tools to limit systemic risks by strengthening the resilience of the financial system and decreasing the build-up of vulnerabilities, thereby ensuring a sustainable contribution of the financial sector to economic growth.

1. Overview of the Financial Stability Assessment

Risks to financial stability are assessed to have declined further since the April 2025 Financial Stability Report (Table 1 and Chart 1). This was after macroeconomic risks subsided and financial markets stress eased. However, concerns about the fragilities in, and threats to the financial system and economy which could undermine financial stability remain. The electricity supply deficit, low financial intermediation, dollarisation of loans and deposits as well as maturity mismatches remain key vulnerabilities and imbalances. Key threats are cyber-attacks, heightened global economic policy uncertainty and an escalation in geopolitical tensions which could have far reaching consequences through the trade and finance channels.

Table 1: Financial Stability Risks Heatmap*

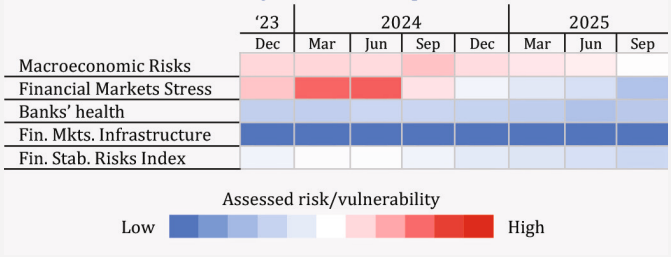
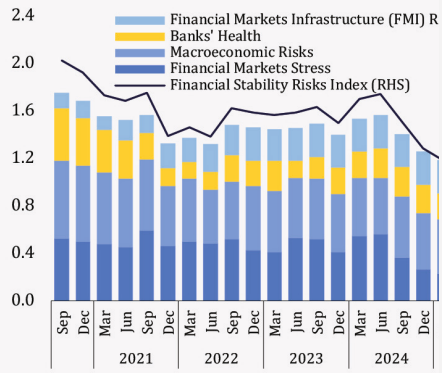


Chart 1: Financial Stability Risks Index**



Note: * The **Appendix** provides details on how to interpret the heatmap. ** The Financial Stability Index , **Chart 1**, depicts the evolution of systemic risk in the financial system. An increase in the index implies increasing systemic risk while a decrease represents a decline. It also shows the evolution of risk in the main segments of the financial system and their contribution to the overall financial stability index.

Against a backdrop of vulnerabilities in the macroeconomic environment, including the electricity shortages and low financial intermediation, macroeconomic risks have subsided since the *April 2025 Financial Stability Report*. This followed a moderation in growth, inflation and sovereign risks. The resilience of the external sector has also remained robust supported by buoyant copper prices, favourable terms of trade and adequate international reserves. However, global economic policy uncertainty and worsening geopolitics continue to cast a shadow over the resilience of the sector.

Financial markets stress is assessed to have eased further primarily due to higher equity valuations amid strong earnings. Similarly, valuations of longer dated Government and corporate bonds rose (yields fell) due to easing inflationary pressures and the expected decline in sovereign risk. While volatility in money markets was muted as the overnight interbank rate traded close to the Bank's policy rate, exchange rate volatility picked up as the local currency made significant gains.

The payment and settlement systems continue to support the efficient functioning of the financial system. However, pockets of operational incidents suggest operational risk remains an area of concern. Cybersecurity threats continue to beset the financial system as institutions continue to report breaches and fraud incidendts.

Banks have remained well capitalised with sufficient buffers to cushion against unexpected losses. Newly introduced capital rules, including the requirement to hold common equity tier one (CET 1), are expected to further enhance their resilience. Credit risk associated with their loan portfolio has continued to trend downward. However, they continue contending with fragilities relating to the high share of foreign currency credit and funding, as well as maturity mismatches.

Non-bank financial institutions have broadly continued posting positive growth. While pension funds' liquidity conditions have improved following a reduction in contribution arrears, insurance corporations are facing low profitability and solvency risk, and microfinance institutions are faced with rising credit risk due to the concentration of public service workers loans on their balance sheets.

The 2025 round of stress test results demonstrate that severely subdued global economic activity, induced by higher effective tariffs and an escalation in geopolitics, would indirectly constrain deposit mobilisation, limit loans growth, increase credit risk, weaken profitability and erode capital buffers. Nonetheless, the results further suggest that the banking sector would remain adequately capitalised.

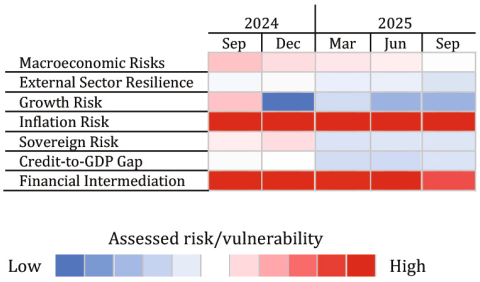
The banking sector has remained well capitalised with buffers above the regulatory requirement. Credit risk is low reflected in non-performing loans ratio significantly below the prudential threshold. It was also considered that recent economic gains are yet to be entrenched, and private credit is growing below its potential. The newly introduced capital rules are also expected to reinforce the resilience of the system. In view of the foregoing, FSC decided to maintain the **countercyclical capital buffer** (CCyB) at **0.0 percent**.

2. Systemic Risk Analysis

Macroeconomic Risks

Against a backdrop of vulnerabilities in the macroeconomic environment, including the electricity shortages and low financial intermediation, macroeconomic risks have subsided since the April 2025 report. This followed a moderation in growth, inflation and sovereign risks (Table 2 and Chart 2). The resilience of the external sector has also remained robust supported by buoyant copper prices, favourable terms of trade and adequate international reserves. However, global economic policy uncertainty and worsening geopolitics continue to loom over the resilience of the sector.

Table 2: Macroeconomic Risks Heatmap



Geopolitical Risks and Economic Policy Uncertainty Cloud Outlook for Trade, Finance and Growth

Global economic activity grew and financial conditions eased, positively influenced by trade-related developments and "releases of macroeconomic data"[1] . According to the International Monetary Fund (IMF), global growth was 0.3 percentage point higher in the first quarter of 2025 than projected in the April 2025 World Economic Outlook (WEO) following increases in international trade and investment. Global trade grew because of the front-loading of trade flows amidst the trade policy uncertainty, albeit there was evidence of this trend unwinding in the second quarter. Global financial conditions eased after a broad-based rebound in equity prices (Chart 3), policy rate cuts by some major central banks (Chart 4) and the depreciation of the US dollar (Chart 5), which helped ease inflationary pressures in emerging markets and developing economies. Conversely, bond yields rose (Chart 6) as markets fretted about growing fiscal imbalances in some advanced and emerging economies. The global inflation picture remains mixed, with inflation slowing down in many economies, including the euro area, while ticking up in the US, reflecting the pass-through from higher tariffs and the softer US dollar to consumer prices.

The IMF projects near and medium-term global growth would be lower than the 2024 outturn, but higher than the April 2025 forecast (Chart 7). Advanced economies are projected to grow at 1.5 percent in 2025 and 1.6 percent in 2026, with the US economy at 1.9 percent in 2025 on

Chart 2: Macroeconomic Risks Index

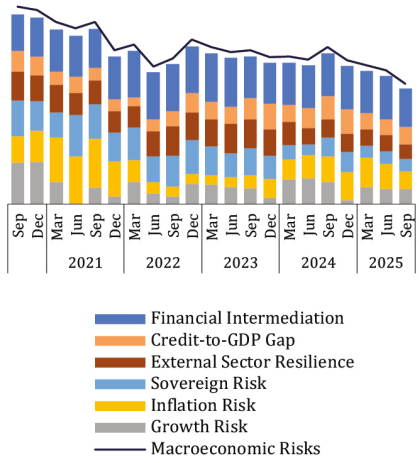
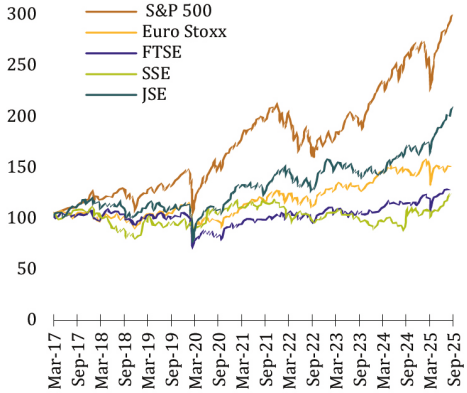


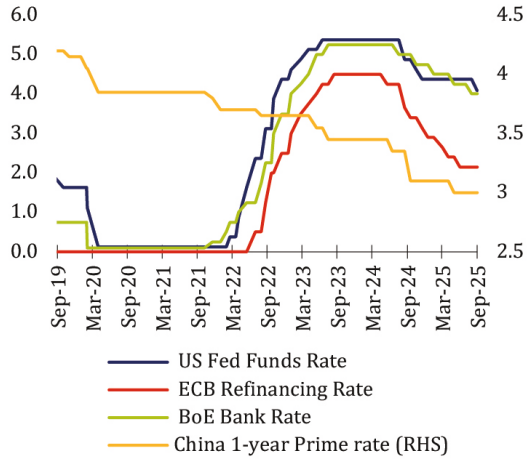
Chart 3: Selected Stock Market Indices



Source: Reuters and Bank of Zambia Compilations

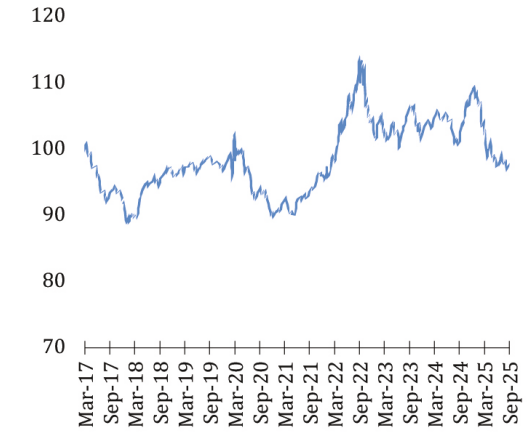
[1] July 2025 World Economic Outlook Update – International Monetary Fund.

Chart 4: Selected Central Bank Policy Rates (%)



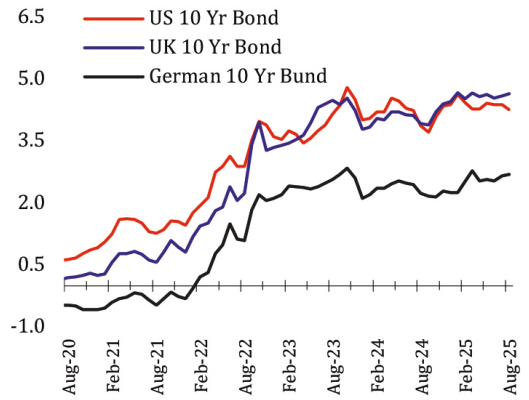
Source: Reuters and Bank of Zambia Compilations

Chart 5: US Dollar Index



Source: Reuters and Bank of Zambia Compilations

Chart 6 US, UK, and German Average 10-Year Benchmark Bond Yield Rates (%)



Source: Reuters and Bank of Zambia Compilations

expectation of lower tariffs than announced on April 2 and "looser financial conditions"[2] . The US economy is expected to tick up to 2.0 percent in 2026 on the back of "tax incentives for corporate investment" under the auspices of the One Big Beautiful Bill Act (OBBBA). The euro area economy is expected to expand at 1.0 percent in 2025 and to 1.2 percent in 2026, primarily due to "historically large increase in Irish pharmaceutical exports to the United States resulting from front-loading and the opening of new production facilities." Emerging market and developing economies are projected to expand at 4.1 percent in 2025 and 4.0 percent in 2026, with the Chinese economy expected to grow at 4.8 percent reflecting the stronger-than-expected economic activity in the first half of 2025 and lower effective tariff rates.

Global inflation is expected to remain on the downward trajectory, largely reflecting weaker demand and lower oil prices. Global trade volumes are expected to initially expand in 2025 due to the front-loading of flows, and later taper in 2026 due to more restrictive trade policy regimes.

Looking ahead, downside risks continue to overwhelm upside ones. Global economic policy uncertainty and geopolitical tensions have continued clouding the outlook for global trade, finance and growth. Global demand for commodities, goods and services could slacken and ultimately lead to a slowdown growth should the ongoing trade negotiations fail, and yield higher effective tariff rates. According to the IMF, non-tariff measures targeting critical inputs could lead to dislocations in global supply chains. Additionally, escalation in geopolitical tensions could further disrupt the global supply chains of critical commodities like oil and raise their prices. Inflationary pressures are likely to stem from higher tariffs and non-tariff policies. If this proves to be non-transitory, major central banks could be compelled to abandon the current monetary policy regimes of promoting growth and raise interest rates to rein in inflation. The ensuing strengthening of the US dollar could constrict capital flows to emerging markets and developing economies, and lead to the depreciation of exchange rates.

Aside from heightened economic policy uncertainty and geopolitical tensions, fiscal imbalances in a number of economies, including the US, could have adverse implications for financial markets and macroeconomic conditions. Larger fiscal deficits and higher public debt levels threaten to raise risk premiums and volatility in markets as well as trigger tighter financial conditions.

[2] July 2025 World Economic Outlook Update – International Monetary Fund.

External Sector Remains Resilient in the Shadow of Geopolitical Risks and Economic Policy Uncertainty

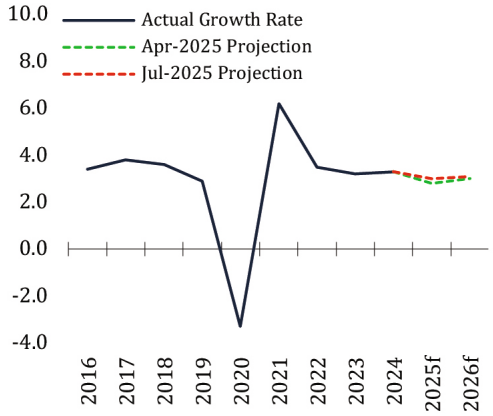
The resilience of the external sector has remained robust and continues to be supported by favourable copper prices and adequate international reserves. Reserve adequacy increased to 4.9 months of import cover in July (Table 3 and Chart 8) while copper prices rebounded after a significant drop on April 7 as traders front-loaded US copper imports in anticipation of higher tariffs on the commodity. It breached the US$10,000/ton mark on September 10 (Chart 9).

The balance of risks to external sector resilience is tilted to the upside. Tailwinds are expected to emanate from three main areas. First, there is an expectation that the country's terms of trade would improve on the back of rising export earnings – due to the combination of buoyant copper prices and increased mining output – and lower oil prices amid a supply glut from OPEC+ and weaker global demand. With this scenario unfolding, the trade surplus would expand and foreign currency inflows would improve. This would render support to the local currency. Second, there is an expectation of an upgrade in the sovereign credit rating as the country nears the full conclusion of the debt restructuring. Third, major central banks are expected to continue pursuing accommodative monetary policy, especially if the ongoing trade negotiations yield favourable and predictable arrangements for global trade, risks to global growth and inflation would subside.

However, the resilience of the external sector could be tested should the policy uncertainty surrounding global trade linger. Since the *April 2025 Financial Stability Report*, trade tensions have persisted as the US proceeded to impose tariffs, ranging between 10 and 41 percent, on imports from several trading partners after the expiry of the 1 August deadline. In the absence of predictable and transparent long-term frameworks for global trade, the prolonged uncertainty and higher tariffs are expected to weigh on global growth and trade. The ensuing reduction in demand for commodities such as copper could reduce export earnings and unwind the already favourable terms of trade.

Additionally, an escalation of geopolitical tensions in the Middle East could disturb critical shipping routes and push energy costs higher. Zambia is reliant on crude oil imports from the Middle East, with about 38 percent of petroleum products imported directly from

Chart 7: Global GDP Growth (%)



Source: IMF April 2025 World Economic Outlook (WEO) and Bank of Zambia Compilations

Table 3: External Sector Resilience Heatmap

	2024		2025		
	Sep	Dec	Mar	Jun	Sep
External Sector					
Current a/c bal-GDP					
Price of copper					
Reserves adequacy					
NRIGS					

Note: NRIGS stands for non-resident investments in Government securities.

Chart 8: International Reserves Adequacy

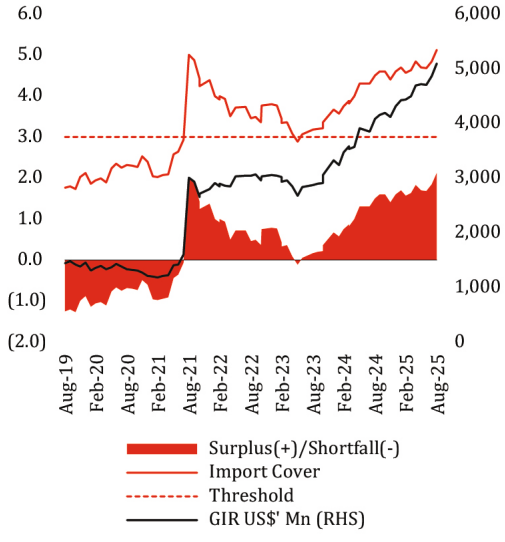
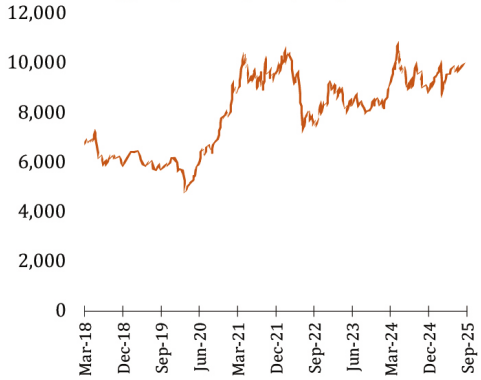
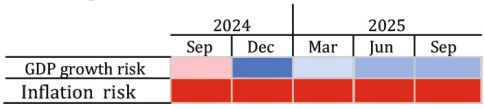


Chart 9: Copper prices (US$/ton)



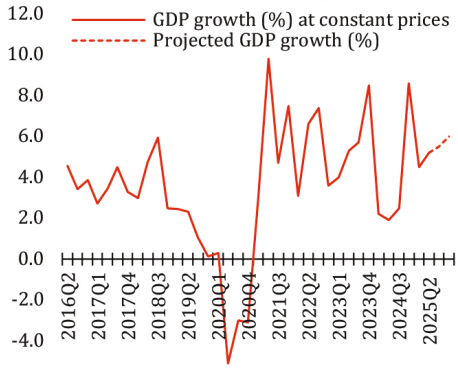
Source: Reuters and Bank of Zambia Compilations

Table 4: Growth and Inflation Risks Heatmap



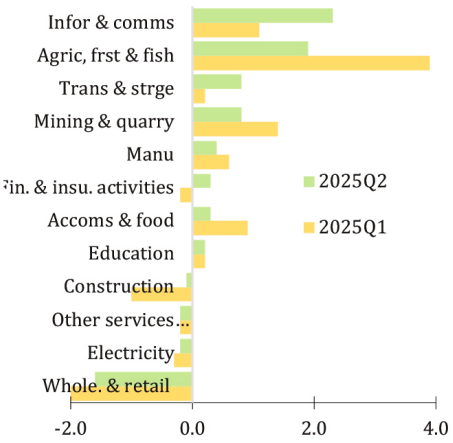
Note
While disinflation has picked momentum and positively contributed to the dissipation of macroeconomic risks, it returns the red colour on the heatmap as it above the target range of 6-8 percent.

Chart 10: Real GDP Growth (%)



Source: ZSA, Ministry of Finance, BoZ Staff Calculations

Chart 11: Sectoral Contribution to Growth



Source: ZSA, BoZ Staff Calculations

the region in 2024. Therefore, the country is exposed to developments in the region that affect the supply and pricing of crude oil — a critical input to many key sectors. In the recent past, geopolitical tensions in the Middle East have disrupted the transit of cargo through critical shipping routes. The escalation of tensions in the region has at times resulted in surges in the price of crude oil as traders price in geopolitical risk.

Growth and Inflation Risks to Moderate Further Despite Continued Electricity Shortages

Financial stability risks associated with economic growth and inflation have moderated since the *April 2025 Financial Stability Report* (Table 4). The economy expanded by 5.2 percent in the second quarter of 2025 (Chart 10) following increased output in multiple sectors, including information and communications, agriculture, transportation, and mining (Chart 11). This outturn was 0.7 percentage point higher than the growth rate in the first quarter. Inflation fell – in succession – during the period, with the latest reading for September reported at 12.3 percent (Chart 12). The stronger local currency as well as falling food and energy costs weighed on consumer prices. However, inflation remains high as it's notably above the inflation target of 6–8 percent.

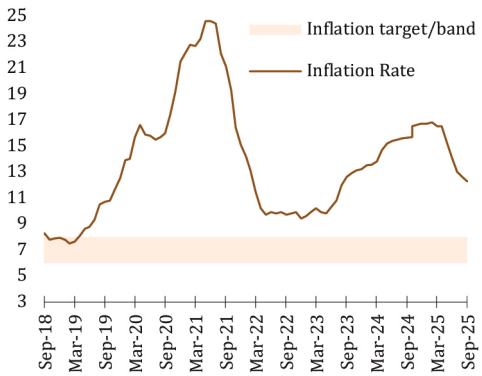
The continued electricity shortages remain a prominent vulnerability in the financial system and the economy at large. The undersupply of power poses challenges to business and industries as they have to rely on expensive alternative energy sources to plug the power supply gap and sustain production. This has the potential to keep inflation and interest rates at elevated levels. Electricity shortages could also potentially raise operational risk to financial markets infrastructure (FMI) – see section *Payment Systems Maintain Resilience Amid Risks.* Nonetheless, it is noteworthy that this vulnerability is dissipating as the electricity deficit has shrunk (Chart 13) since the *April 2025 Financial Stability Report*.

In the near term, growth and inflation risks are expected to reduce further. The latest Ministry of Finance and National Planning (MoFNP) projections show that the economy would grow at a faster pace of 5.8 percent in 2025, while Bank anticipates inflation to continue on downward trajectory. Economic activity is expected to pick up on the back of increased communications and technology, mining and agriculture output, as well as the narrowing of the electricity deficit supported by the ongoing expansion of power generation capacity. The rate of growth in consumer prices is expected to fall into the 6–8 percent target band in the first quarter of 2026. Disinflation is projected to gain momentum on the back of "lagged effects of an appreciated

exchange rate as well as lower food and energy prices" (see *August 2025 Monetary Policy Report*). This could yield higher income levels for households and businesses, as well as subdued price pressures. Higher incomes levels and lower inflation contribute to the preservation of financial stability within the context of helping limit default risk – higher incomes and lower- interest rates enhance borrowers' capacity to meet debt servicing obligations.

On the contrary, growth and inflation risks could rebound should the economy succumb to negative external shocks related to geopolitical tensions and global economic policy uncertainty (see section *External Sector Remains Resilient in the Shadow of Geopolitical Risks and Economic Policy Uncertainty*).

Chart 12: Annual Inflation (%)



Source: ZSA,BoZ Staff Calculations

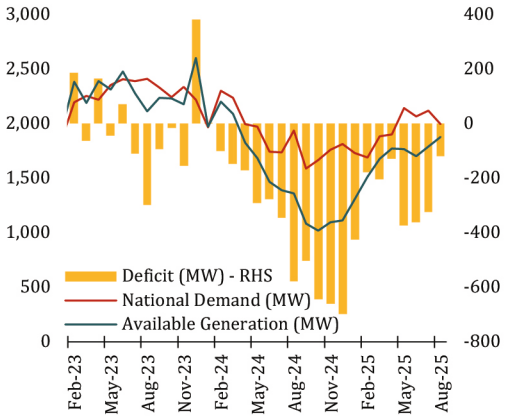
Sovereign Risk Expected to Reduce

The sovereign risk to financial stability has tapered as fiscal imbalances reduced (Table 5). As stated in the *August 2025 Monetary Policy Report*, preliminary data point to a lower fiscal deficit in the second quarter of 2025 than expected "mainly due to lagged reporting on the implementation status of various foreign-financed capital projects".

Over the medium-term, the sovereign-related risk to financial stability is expected to reduce further, with the fiscal deficit projected to trend downward (Chart 14) as fiscal consolidation gains are safeguarded through expenditure rationalisation and enhanced domestic revenue mobilisation. This could see the sovereign-bank nexus taper as banks' exposure to the Government would moderate further (Chart 15).

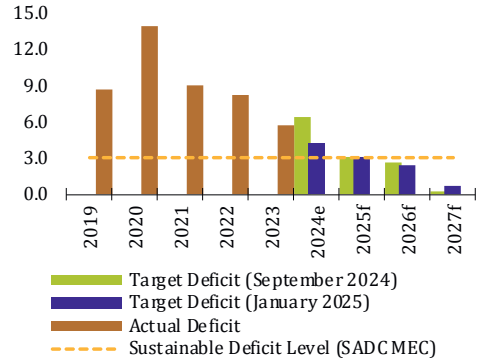
However, there remain downside risks to fiscal resilience in the medium-term. Elevated policy uncertainty and fiscal imbalances in the US could exert upward pressure on US dollar interest rates. Higher US dollar rates could constrain capital flows to developing economies like Zambia, thereby restricting foreign currency supply and causing the depreciation of the exchange rate. Given the strong exchange rate pass-through to consumer prices, Kwacha interest rates could rise if the central bank responds by hiking its policy rate to rein in inflation. This would in turn increase Government's borrowing costs and constrain funds available for discretionary spending.

Chart 13: Power generation, demand and deficit in megawatts (MW)



Source: Zambia Electricity Supply Corporation Limited (ZESCO), BoZ Staff Calculations

Chart 14: Fiscal Deficit Projections (%)



Source: Ministry of Finance and National Planing, BoZ Staff compilations

Financial Intermediation Nudges Up While Private Credit Growth Slows

Private sector credit has slowed further whereas financial intermediation has risen marginally since the *April 2025 Financial Stability Report*. Private sector credit, which is the total credit flow to the real sector that excludes loans and

Chart 15: Sovereign-Bank Interlinkages, by Banks Exposure to Govt (K'Billion)

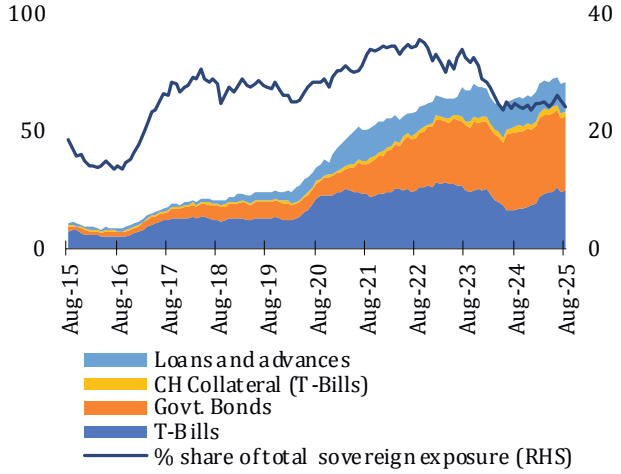


Chart 16: Private Credit (K'billion)

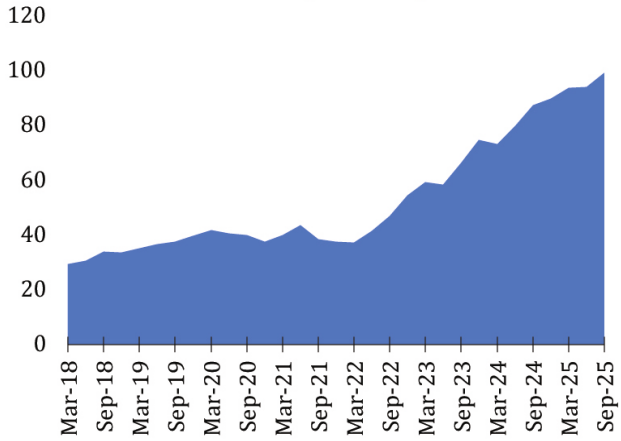


Chart 17: Financial Intermediation

Chart 18: Credit-to-GDP Gap

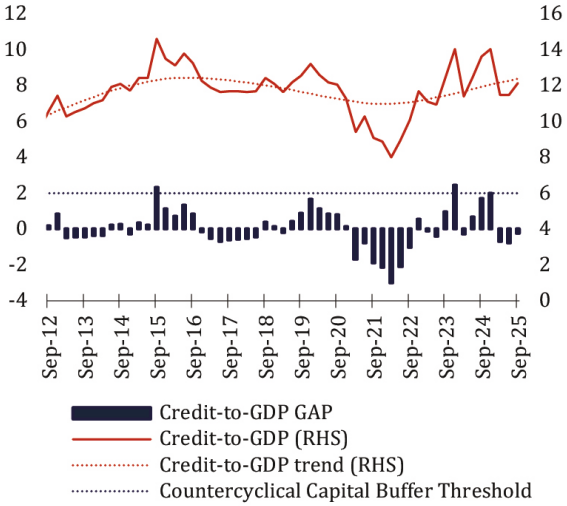


Chart 19: Credit-to-GDP Ratio (%)

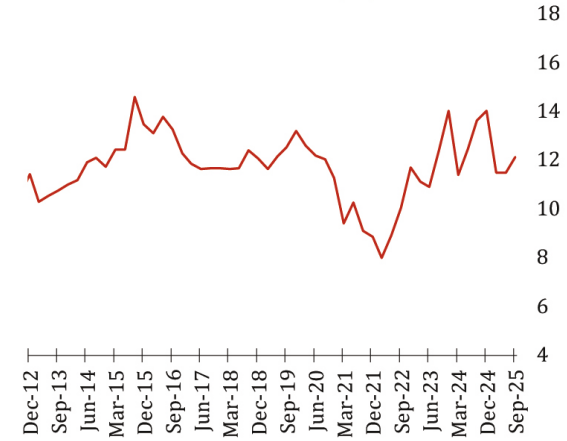
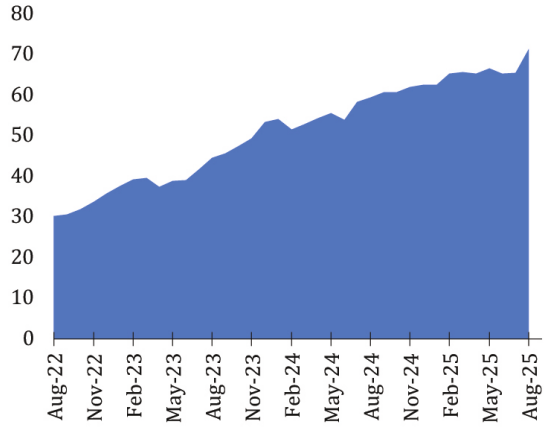


Chart 20: NFC Debt (K' billion)



advances to Government, grew at 5.7 percent, compared with the 7.5 percent growth observed in the six months to March 2025 (Chart 16). The largest contributor to credit growth were loans denominated in local currency, which increased by 9.7 percent.

Commercial banks' financial intermediation, measured as the ratio of total loans and advances to customers' total deposits (the loan-to-deposit ratio), nudged up by 2.7 percentage points to 41.5 percent (Chart 17) since the *April 2025 Financial Stability Report*. However, financial intermediation has remained low and represents one of the prominent imbalances in the financial system. It reflects the slow pace at which banks create money as they only lend out less than half the funds they mobilise in deposits. It is also indicative of the limited credit lenders are channeling out to businesses and households for investment and consumption, which has the potential to constrain the economy's ability to sustain growth.

Further evidence of limited flow of credit to the private sector is reflected in the negative credit-to-GDP gap, which narrowed to -0.3 percent from -0.7 percent previously (Chart 18). Although it has narrowed, the negative gap suggests that private credit is growing below its potential, relative to economic growth. With the narrowing of the negative gap, the ratio of private credit to GDP increased modestly by 0.7 percentage point to 12.1 percent (Chart 19). It has remained significantly low relative to GDP.

Credit to Non-Financial Corporates Grows

The flow of credit to non-financial corporations (NFCs) grew following increased disbursements to the energy and manufacturing sectors. Since the *April 2025 Financial Stability Report*, NFC's total liabilities to banks increased by 8.7 percent to K71.4 billion (Chart 20). With this expansion, NFCs indebtedness relative to GDP has inched up 0.7 percentage points to 8.7 percent of GDP (Chart 21). Despite the increase, the share of business' loans remains low, which could be reflective of the underdevelopment of the credit market.

Going forward, NFCs could experience tailwinds originating from the expected increase in economic activity and slumping inflationary pressures. This would help ease borrowing costs and enhance access to finance. However, according to the findings of the *September 2025 Systemic Risk Survey* (SRS), NFCs view exchange rate volatility and the risk of cyber-attacks as key risks to financial stability, with the latter cited as the most difficult to manage (see *Box A*).

Chart 21: NFC's Indebtedness to GDP (%)

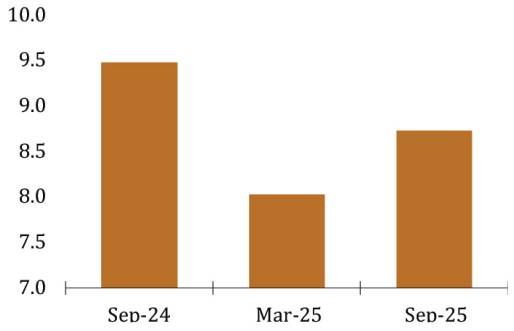


Chart 22: Household Loans (K'billion)

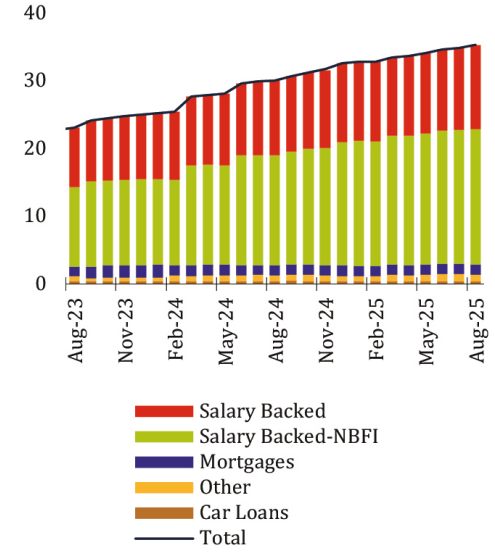
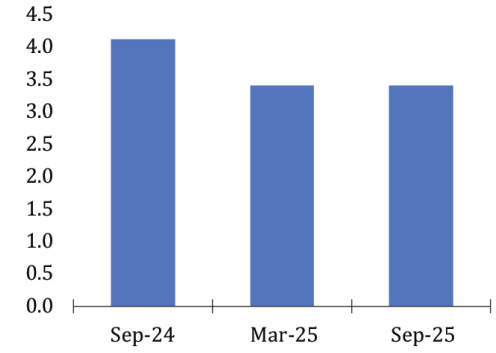


Chart 23 Households' Indebtedness to GDP (%)



Households Debt Posts Modest Growth

Household debt posted modest growth in the review period after an expansion in the portfolio of payroll-based lending. Household debt rose 4.9 percent to K35.4 billion after a 5.9 percent growth in salary-backed loans (Chart 22). However, households' indebtedness relative to GDP has remained unchanged, at 3.4 percent, since the *April 2025 Financial Stability Report* (Chart 23). Even though 97 percent of financial institutions' exposure to households is secured (backed by assets including salaries, real estate and motor vehicles), there are concerns regarding the high rate of default associated with their public service workers' loans portfolio (see section *Microfinance Institutions Face Rising Concentration and Credit Risks*).

Household digital credit disbursements declined significantly (Chart 24) during the review period following the scaling back of loans issuances by some providers, as they instituted stricter controls to curb misuse by some customers. At the end of the second quarter, the past due class (90 days or more) stood at K0.1 billion, accounting for 21.3 percent of the total digital loans (Chart 25). Limitations in the quality and completeness of customer data have undermined the effectiveness of automated credit screening and impede loan recovery efforts. Therefore, the pullback reflects how the growth of digital loans is being curtailed by high delinquency rates faced by some institutions.

Chart 24: Household Digital Credit Disbursements (K'billion)

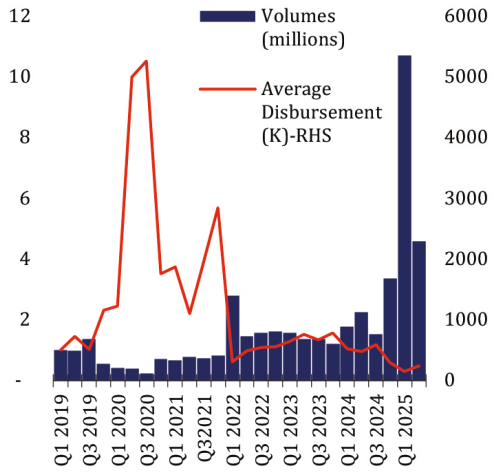
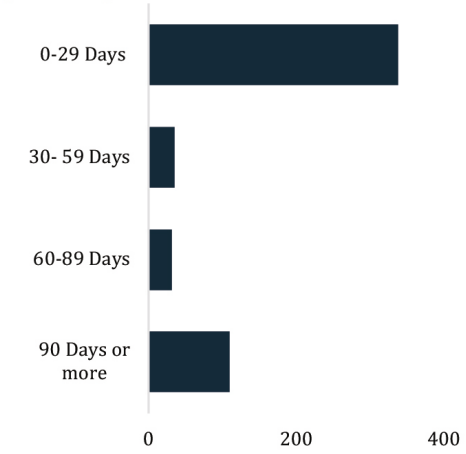


Chart 25: Digital Loan Classification Q2-2025 (K'million)



Financial Markets Stress

Financial markets stress is assessed to have eased further primarily due to higher equity valuations amid strong earnings. Similarly, valuations of longer dated Government and corporate bonds rose (yields fell) due to easing inflationary pressures and the expected decline in sovereign risk (Table 6 and Chart 26). While volatility in money markets was muted as the overnight interbank rate traded close to the Bank's policy rate, exchange rate volatility picked up as the local currency made significant gains.

Table 6 : Financial Markets Stress Heatmap

Financial Markets Stress	2024 Sep	2024 Dec	2025 Mar	2025 Jun	2025 Sep
Interest rates					
Fx Rate Volatility					
Equity Mkt Strength					

Money Market Interest Rates Remain Stable; Government Securities Yields Mixed

Money market interest volatility was muted as the overnight interbank interest rate stayed close to the policy rate for most of the period (Table 7, Chart 27 and Chart 28). However, a decline in liquidity towards the tail end of the second quarter triggered a rise in the interbank rate, explaining the slight surge in volatility and widening of spreads observed over the review period,

Chart 26: Financial Markets Stress Index

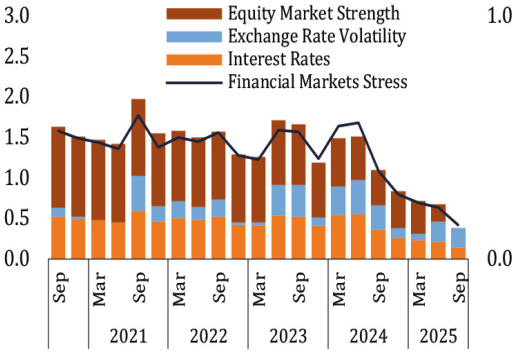


Table 7: Interest rates Heatmap

Interest Rates	2024 Sep	2024 Dec	2025 Mar	2025 Jun	2025 Sep
T-bills					
Govt. bonds					
Av. Spread on eurobond					
IB Interest rates spreads					
IB interest rate volatility					

Chart 27: Overnight Interbank Rate (%)

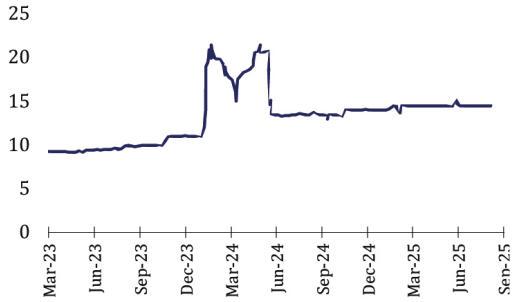


Chart 28: Interbank rate 21-Day volatility (%)

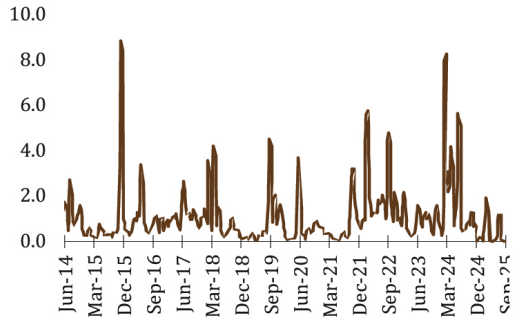
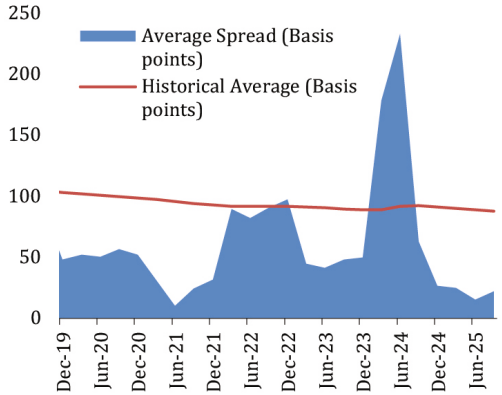


Chart 29: Interbank Interest Rate Spread



albeit low by historical standards (Chart 29). The above notwithstanding, the interbank money market remains fragmented, and participation limited due to perceived counterparty credit risk (see *Box B*).

Eurobonds, the foreign currency denominated government securities, appear to have weathered uncertainties surrounding global economic policy, with the yield on the 2033 Eurobond having declined (Chart 30). Similarly, yields across most maturities of the local currency government bonds fell amidst strong demand (Chart 31). In contrast, subdued demand for shorter-dated securities led to an up-tick in yields on treasury bills. The yield curve has therefore shifted lower (Chart 32) since *April 2025 Financial Stability Report* . This possibly reflects the alignment of market expectations with the projected lower inflation and tapering fiscal imbalances in the medium-term.

Corporate Bonds Valuations Rise

Valuations of floating rate local currency corporate bonds have risen while credit spreads on new issuances have narrowed on account of lower yields and declining sovereign risk premiums (Chart 33 and Chart 34). By implication, corporates face reduced financing costs on publicly listed debt. Considering that the majority of local currency issuers are non-bank financial institutions, lower interest expenses could lead to increased profitability, and further strengthen capital buffers if earnings are reinvested.

Conversely, foreign currency denominated corporate bonds have faced no variation in their yields as all outstanding issuances were made at fixed rates. But exchange rate variations pose currency risk to foreign currency bonds if issuers do not have matching foreign currency inflows. About 78 percent of the corporate bond portfolio is denominated in US dollars, of which Copperbelt Energy Corporation (CEC) Renewables accounts for 73 percent of the issuances (Chart 35). Nonetheless, risks arising from currency mismatches are minimal as the dominant issuers have US dollar receivables. Given the possibility of timing differences between receipt of cash flows and bond maturity dates, issuers with local currency cash inflows require prudent currency and liquidity management to meet foreign currency bond repayments.

Exchange Rate Volatility Increases

Exchange rate volatility has increased following a

marked appreciation in the domestic currency on the back of improved foreign currency inflows from the mining companies. Exchange rate volatility peaked at the beginning of the third quarter due to heightened movements in the currency between large appreciations and moderate depreciations. Volatility has since been below historical standards (Chart 36) as the domestic currency was steady against the US dollar over the course of the third quarter.

A key influence on the exchange rate and its volatility has been the evolution of outstanding demand orders. The build-up of pipeline demand orders often induces pressure on the Kwacha to depreciate. The situation is reflective of constrained liquidity in the foreign exchange market, which results in timing mismatches between demand and supply. Since 2020, reduced liquidity conditions have contributed to increased variations in the exchange rate (Chart 37). Improved liquidity conditions tend to relieve such pressures, resulting in exchange rate gains, which can be substantial and raise volatility depending on the volume of foreign currency inflows as observed in the six months to September.

Recent developments have brightened prospects for stability in the foreign exchange market. The projected increase in mining production could ease liquidity constraints. Further, reforms in the procurement of petroleum products through – the Tanzania Zambia Mafuta (TAZAMA) Pipelines Limited – open access pipeline framework could dampen demand from oil marketing companies—some of the major contributors to outstanding demand. These developments are likely to complement the implementation of the Bank of Zambia Currency Directives, 2025 which are expected to support the efficient functioning of the foreign exchange market by strengthening the use of the local currency for domestic transactions. However, global economic policy uncertainty and geopolitical risks should still be kept in perspective as higher effective tariffs or worsening geopolitics could induce capital outflows and cap trade receipts from copper exports.

Currency Derivatives Trading Increases

Trading in currency derivatives, specifically foreign exchange forwards and swaps, increased since the *April 2025 Financial Stability Report* (Chart 38 and Chart 39). Interbank trades as well as transactions between domestic banks and foreign financial institutions dominated trading activity. While these instruments are typically used to hedge against both currency and

Chart 30: Zambia 2033 Eurobod Yileds (%)

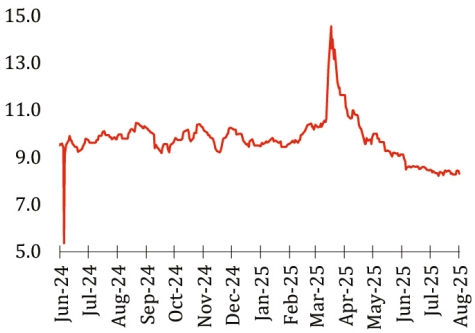


Chart 31: Composite Government Securities yields (%)

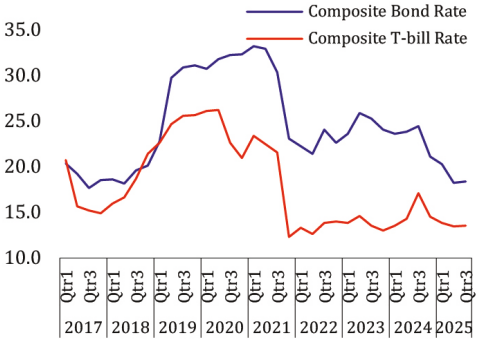


Chart 32: Government Securities Yield Curve (%)

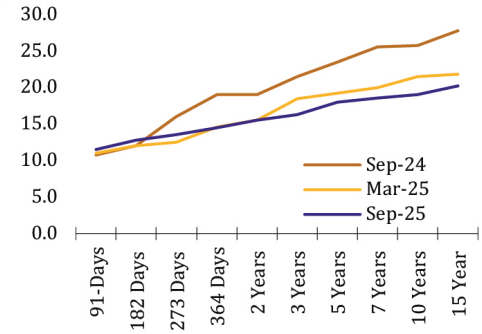
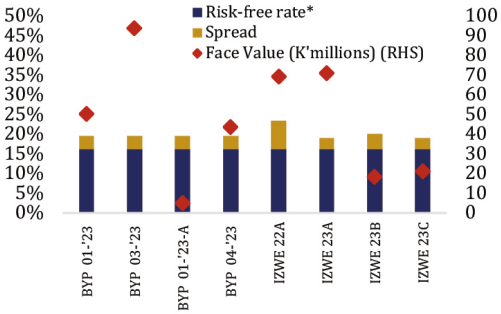


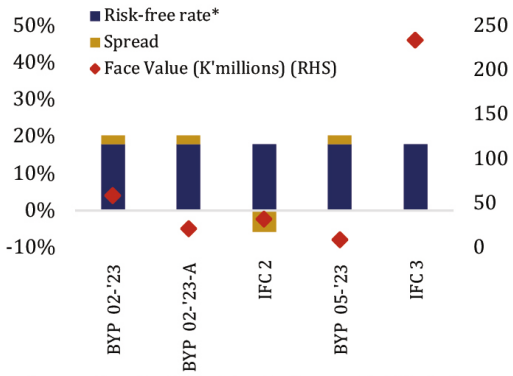
Chart 33: 3-Year Corporate Bond Yields, Spreads and Values



Source: Lusaka Securities Exchange (LuSE), BoZ Staff Calculations

Note
*The risk free rate is the yield rate on 5-year Government bond
BYP- Bayport

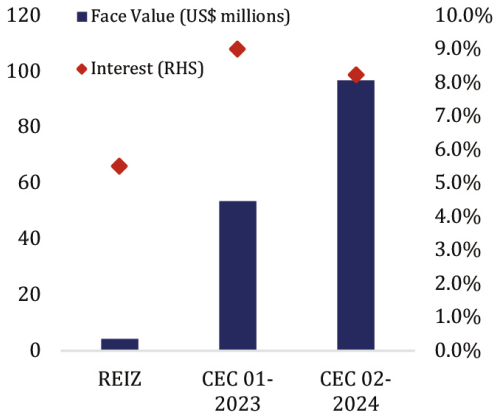
Chart 34: 5-Year Corporate Bond Yields, Spreads and Values



Source: Lusaka Securities Exchange (LuSE), BoZ Staff Calculations

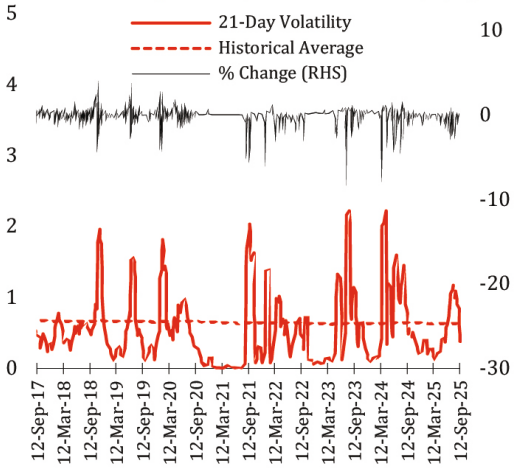
Note
*The risk free rate is the yield rate on 5-year Government bond
BYP- Bayport

Chart 35: Foreign Currency Denominated Corporate Bond



Source: Lusaka Securities Exchange (LuSE), BoZ Staff Calculations

Chart 36: Daily 21-Day Forex volatility (%)



liquidity risks, domestic banks predominately rely on them to bridge temporary local currency funding gaps and mitigate liquidity risk. On the other hand, NFCs, especially those in the energy, transport and manufacturing sectors, use derivatives to hedge against exchange rate risk, albeit on a small scale (Chart 40).

The use of derivative instruments have some inherent risks which should be managed. These include counterparty risk due to the over-the-counter nature of the trades as well as exchange rate risk for forward contracts arising from adverse currency movements, and liquidity risk in cases when positions must be unwound prematurely. Nonetheless, given the modest size of the market, these risks may not be considered material and systemic. The majority of trades are short-term, with relatively small volumes extending beyond overnight tenors (Chart 41). The limited duration generally minimises the risk of loss from adverse exchange movements. Further, transactions are typically conducted within banks' credit limits, and in the case of foreign counterparties, with parent banks or related companies, reflecting the cautious risk appetite.

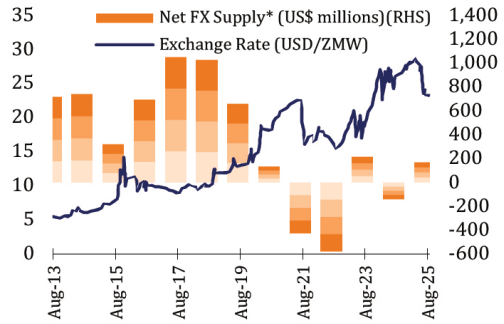
The limited use of these products by NFCs reflects the financial system's constraint in effectively performing one of its core functions of providing tools for risk management. Considering bouts of heightened currency volatility observed over the last decade, it would be expected that the demand for instruments to hedge against this risk would be high. However, persistent losses on NFCs' foreign currency forward purchases could possibly be one of the factors explaining the aversion toward employing these instruments (Chart 42). The unfavourable positions stem from forward premiums frequently surpassing spot prices prevailing at the contracts maturity (Chart 43). Developing market infrastructure such as an exchange platform with a central counterparty (CCP) could support the market for derivatives and provide heightened regulatory oversight. A formal exchange would also provide transparency in pricing and trading which enhances price discovery.

Further, addressing structural constraints—such as limited foreign exchange availability—and enhancing the legal enforceability of GMRA and ISDA contracts, as outlined in *Box B*, would support greater market participation. Additionally, providing consumer education on the structure and use for derivatives contracts could enhance informed participation by NFCs.

Equities Soar

The Lusaka Securities Exchange All Share Index (LASI)

Chart 37: USD/ZMW Exchange Rate and Net FX Supply



*Net FX supply here is defined as the surplus (deficit) of commercial banks' purchases of US dollars from the public over sales. This excludes Bank of Zambia (BoZ) interventions, including those from mining taxes paid directly to BoZ.

Chart 38: Curreny Swap Transaction Values – Near Date (USD and ZMW)

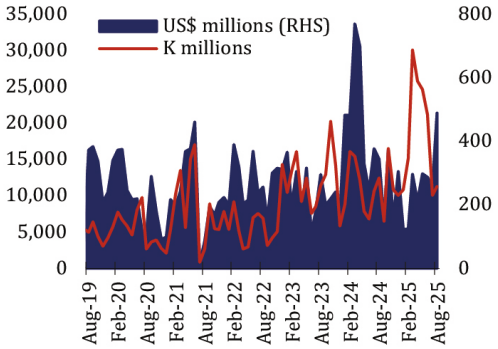


Chart 39: Commercial Banks Forward Sales and Purchases of US dollars (US$ millions)

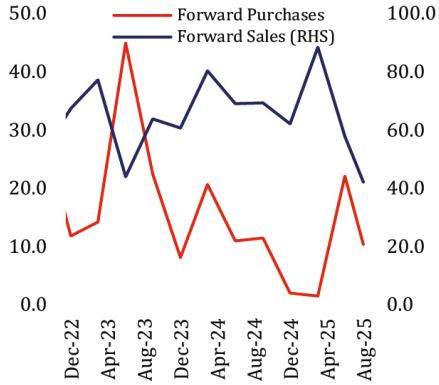


Chart 40: Market Participation by Sector (April - August 2025)

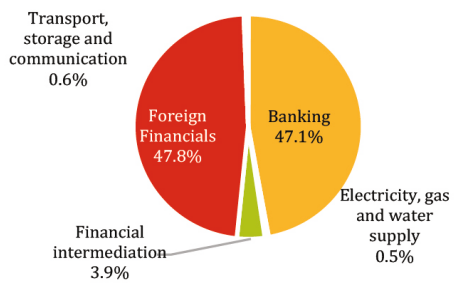


Chart 41: Swap Market Tenor Distribution (Days)

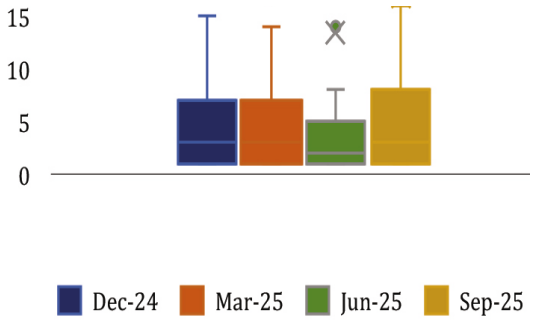


Chart 42: Net Profit/(Loss) by sector on US dollar Forward Purchases (K' millions)

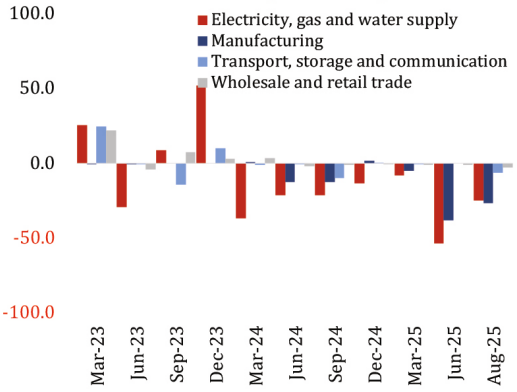
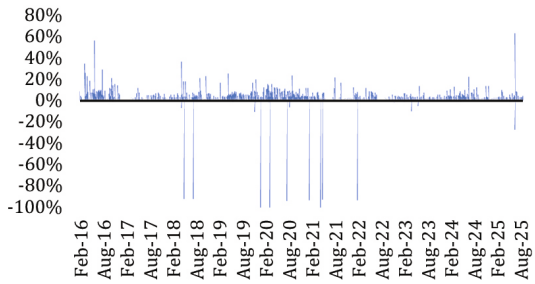
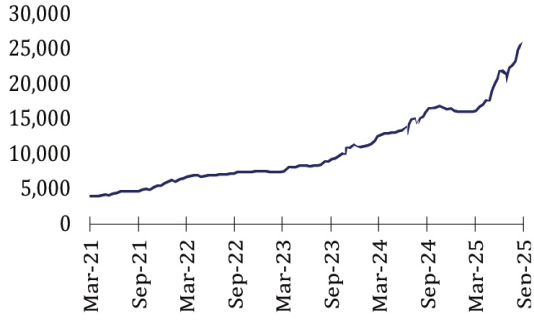


Chart 43: Forward Premiums and Discount for USD/ZMW transactions



The forward premium/(discount) is the percentage difference between the forward rate and the spot rate. Positive values indicate how much the quoted currency (in this case the Kwacha) is expected to depreciate while negative values

Chart 44: LASI



rose markedly, tracking increases in energy, banking, retail trade and manufacturing stocks (Chart 44 and Chart 45). This followed heightened interest in local equities supported by dividend payments and positive investor sentiment amid improving growth prospects.

Since the *April 2025 Financial Stability Report* , foreign portfolio investors have continued to divest from domestic equities (Chart 46). As dominant investors in the local equity market (Chart 47), their divestment raises financial stability concerns as a widespread sell-off of equity could increase stock market volatility and demand for foreign currency. While they help boost liquidity in the equities market, the concentration of foreign institutions equity placements may be considered an imbalance in the financial system as shifts in their behaviour can sway market dynamics such as pricing and liquidity. In this regard, continuing investor education as outlined in the *Capital Markets Master Plan* is required to support increased domestic participation in the equity markets.

Financial Markets Infrastructure

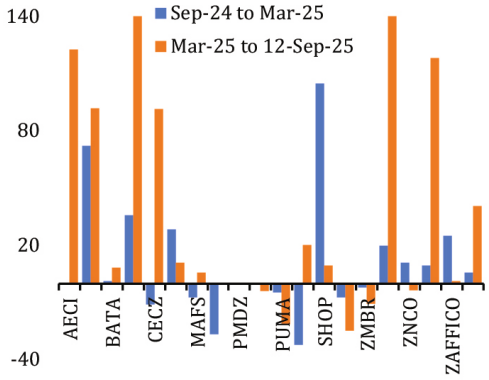
The payment and settlement systems continue to support the efficient functioning of the financial system. However, pockets of operational incidents suggest operational risk remains an area of concern stemming from incidences of downtime reported over the review period. Cybersecurity threats also continue to beset the financial system as a number of institutions continue to report incidences of breaches and/or fraud.

Payment Systems Maintain Resilience Amid Risks

The payment and settlement systems continued to support the operation of the financial system. Transaction volumes increased following the adoption of extended operating hours. However, the number of transactions processed through Zambia Interbank Payment and Settlement System (ZIPSS) remained well below the daily capacity of 60,000.

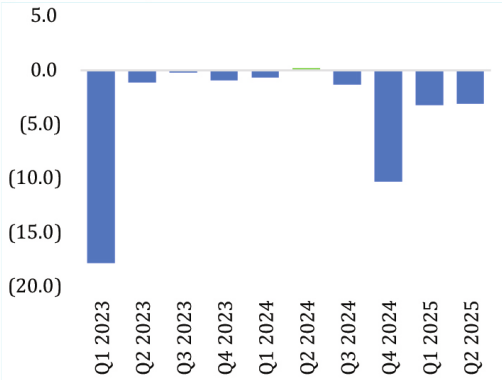
There were four incidences of downtime recorded since the *April 2025 Financial Stability Report*, with the longest outage lasting over 7 hours. As a result, the ZIPSS system availability fell below the required standard (Chart 48). The incidents were attributed to interruptions in power supply to supporting critical ICT infrastructure as well as disruptions to third-party internet services providers. While no known material losses were suffered, the interruptions undermined the high degree of operational reliability required for systemically important FMIs as defined in the Principles for Financial Market Infrastructures (PFMI)[3] . To enhance the resilience of systemically important payment systems, the BoZ

Chart 45: Equity Price Changes (%)



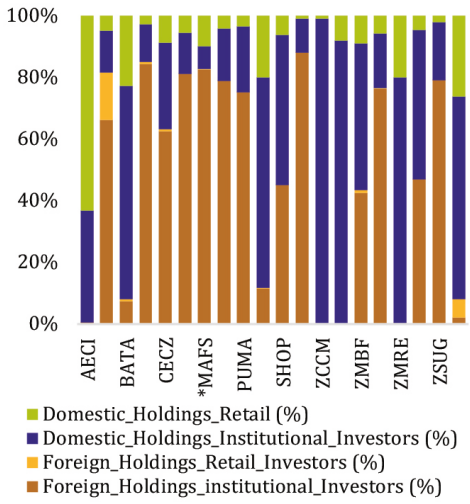
Source: Lusaka Securities Exchange (LuSE), BoZ Staff Calculations

Chart 46: Net Foreign Portfolio Movements (US$ millions)



Source: Securities and Exchange Commisssion (SEC), BoZ Staff Calculations

Chart 47:Equity Holdings by Investor Type (Q2-2025)(%)



Source: Securities and Exchange Commisssion (SEC), BoZ Staff Calculations

[3] https://www.bis.org/cpmi/info_pfmi.htm

conducted a six-day business continuity management (BCM) exercise in August 2025 wherein selected operations were performed from the Bank's secondary site. The objective was to review the effectiveness of the business continuity plan and prepare for a coordinated response to disruptive events. The operations of critical market infrastructure, including the ZIPSS and central securities depository were, within the scope of the exercise which involved all market participants.

Cyber Risks Remain

Cyber risks persist as threats to the financial market infrastructure. Cybercriminals could employ ransomware, distributed denial of service (DDoS) attacks and social engineering to target institutions across all sectors[4] . The growing interconnectedness between FMIs, financial institutions and third-party service providers could amplify the effects of cyber incidents across the financial ecosystem. Major cyber incidents could compromise financial stability through loss of confidence in targeted institutions leading to cyber runs[5] . The impact of such incidents could be systemic, particularly if targeted institutions or market infrastructure are not easily substitutable or highly interconnected.

Over the review period, a ransomware attack was recorded causing disruption to some of the critical financial system services. Another incident involved a database breach arising from unauthorised access. Digital fraud, another dimension of cybercrime, has also been on the rise with direct losses increasing markedly in the second quarter of 2025 (Chart 49). These trends highlight growing risks to financial stability as cybercriminals exploit vulnerabilities in technology (software, hardware, networks), and human weakness. Strengthening the resilience of the financial sector to cyber risk is critical to mitigating the effects of cyber incidents that could lead to a broader financial crisis. The Bank of Zambia is establishing a dedicated Financial Sector Cyber Incident Response Team (FinCIRT) to monitor, identify and respond to cyber incidents in the financial sector. The FinCIRT will enable early detection of emerging cyber threats, provide coordinated and timely response to cyber incidents and support vulnerability management. In addition, the FinCIRT will provide a platform for information sharing among financial service providers (FSPs) about cyber and fraud incidences. The FinCIRT is expected to be commissioned in 2026, with the blueprint having already been developed.

Chart 48: ZIPSS Availability (%)

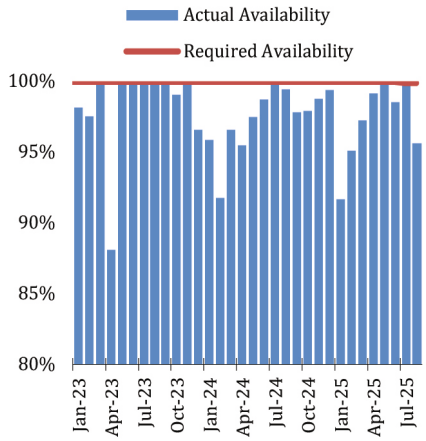


Chart 49: Digital Fraud Trends

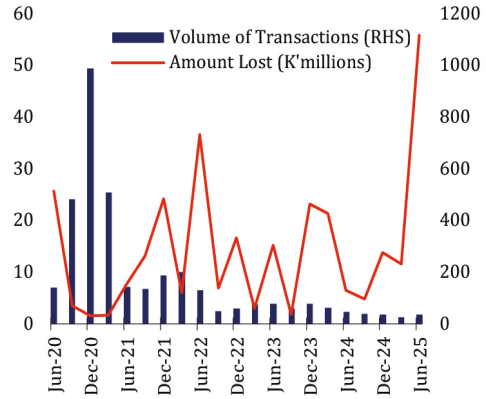


Table 8: Banks' Health Heatmap

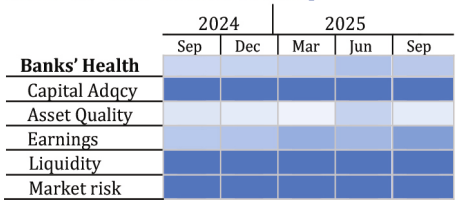
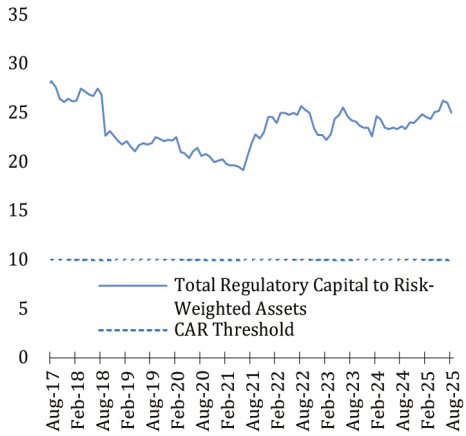


Chart 50: Capital Adequacy Ratio (%)



[4] INTERPOL Africa Cyberthreat Assessment Report 2025.

[5] Duffie, D., and Younger, J. (2019) *Cyber runs*.

Chart 51: CET 1 anhid Components (K'billion)

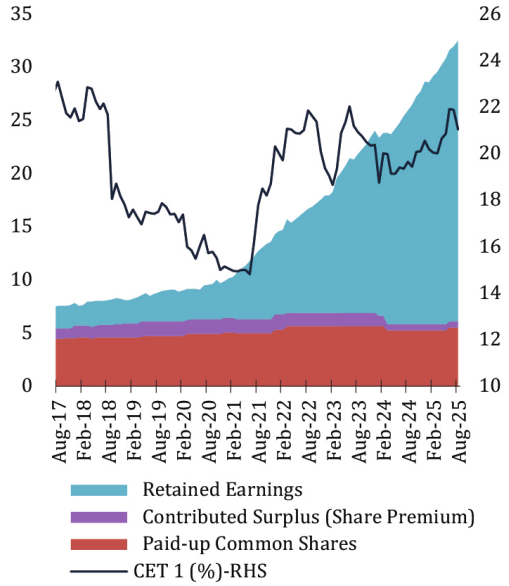


Chart 52: Leverage Ratio (%)

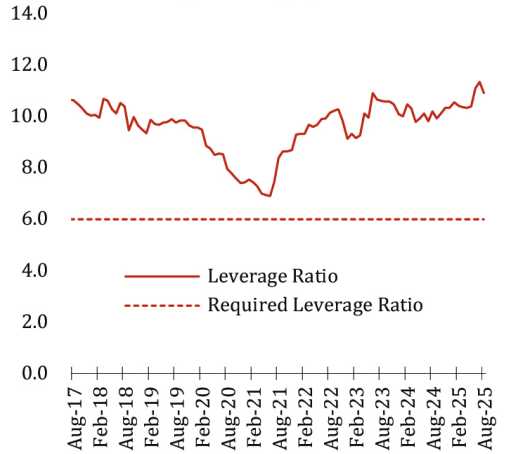
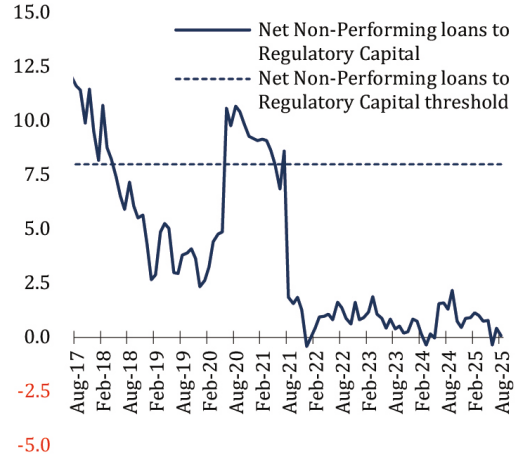


Chart 53: Net NPLs to Total Regulatory Capital (%)



Banks' Health

Banks have remained well capitalised (Table 10) with sufficient buffers to cushion against unexpected losses. Newly introduced capital rules, including the requirement to hold common equity tier one (CET 1), are expected to further enhance their resilience. Credit risk associated with their loan portfolio has continued to trend downward. However, they continue contending with fragilities relating to the high share of foreign currency credit and funding as well as maturity mismatches.

Capitalisation Continues to be Robust and Support the Resilience of the Financial System

The resilience of the banking sector has remained high following an increase in capital adequacy. The sector-wide capital adequacy ratio rose by a percentage point to 25 percent (Chart 50) since the *April 2025 Financial Stability Report* . With total regulatory capital equivalent to a quarter of the risk-weighted assets (RWA), commercial banks have broadly maintained adequate buffers considering that the prudential threshold is 10 percent of RWA.

In addition, commercial banks' balance sheets consist of healthy levels of high quality capital including, common shares, retained earnings and share premium, key components of common equity tier one (CET 1) capital, which they will be required to maintain at 6 percent of RWA post 31 December (see *Box C* for more details). CET 1 rose by a percentage point to 20 percent (Chart 51) since the April Financial Stability Committee Meeting. Relatedly, the leverage ratio, "a non-risk based measure of CET 1 to the total sum of assets and off balance sheet exposures", was little changed at 10.9 percent (Chart 52). Therefore, all these measures of the industry resilience are a clear demonstration of its capacity to absorb losses and shore up the financial system in the face of shocks.

The low net non-performing loans (NPL) relative to regulatory capital ratio lends credence to banks' strong loss absorption capacity. Since the *April 2025 Financial Stability Report* , the net NPL-to- regulatory capital ratio contracted 0.9 percentage point to 0.1 percent, falling further away from the prudential maximum benchmark of 8.0 percent (Chart 53). A low net NPL-to- regulatory capital ratio capital suggests that banks' impaired loans, after accounting for provisions, are small relative to its regulatory capital. This indicates banks' capital at risk from net non-performing loans is low, manifesting sufficient level of loan loss reserves and minimal residual credit risk. It is also a manifestation of their satisfactory asset

quality (see section *Share of Non-performing Loans Tapers* and risk management, which positively contributes to the preservation of financial stability.

Share of Non-performing Loans Tapers

The share of NPLs contracted further after loans and advances grew slightly. The NPLs ratio, which reflects the share of bank credit where borrowers have not met contracted repayments of the principal and interest for more than 90 days, inched down by 0.2 percentage point to 3.8 percent (Chart 54). This is indicative of low credit risk associated with the system-wide balance sheet. As noted at the April meeting, the NPLs ratio has been on the downward trajectory post-Covid, remaining significantly below the prudential threshold of 10 percent. A low NPL ratio supports their satisfactory asset quality.

Additionally, loan loss provisioning levels have been satisfactory, with the loan provision coverage ratio remaining above the regulatory threshold of 80 percent, at 99.1 percent (Chart 55). The loan provision coverage ratio reflects the proportion of capital that banks set aside to absorb losses associated with loan defaults. A high ratio suggests that they are able to buffer themselves against losses if loan delinquencies escalate.

Elevated Foreign Currency Borrowings Remain a Major Imbalance on Banks' Balance Sheets

The elevated share of foreign currency denominated credit[6] on banks' balance sheets has continued to be a source of concern as it poses a threat to financial stability. The share of foreign currency-denominated loans and advances relative to banks' total loans and advances, increased to 41.8 percent (Chart 56). This was on the back of increased credit flow to the manufacturing as well as the energy sector.

The distribution of banks foreign-currency denominated credit has continued to be uneven. It has remained skewed towards the manufacturing sector, whose share rose by a percentage point to 41 percent (Chart 57) since the *April 2025 Financial Stability Report* . Mining and agriculture sectors hold 12 percent each while wholesale and retail trading sector is the fourth largest sector banks are exposed to, holding a 10 percent share. As a collective, the four sectors account for three quarters of the total

Chart 54: Non-performing Loans Ratio (%)

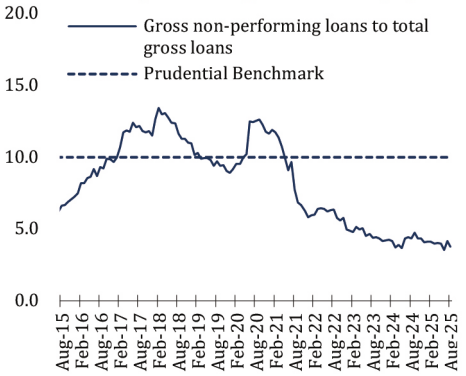


Chart 55: Allowance for loan losses to gross NPLs

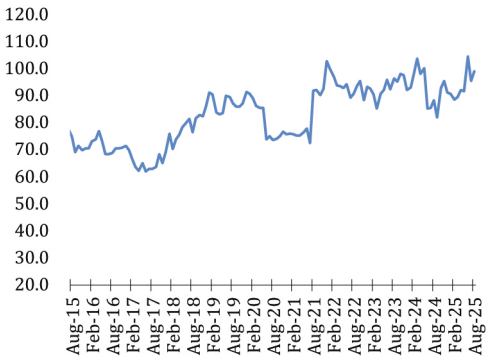
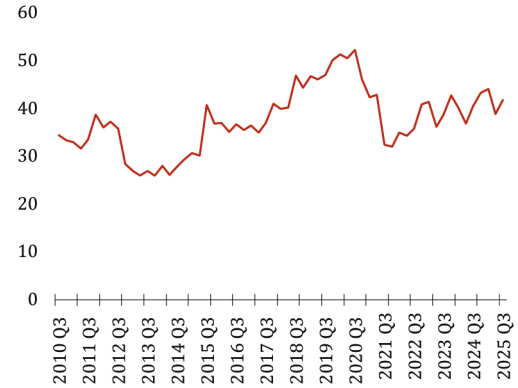


Chart 56: Foreign Currency-Denominated Loans to Total Loans (%)



[6] Several factors could have possibly led to the increase in foreign currency lending over the years. Demand side factors include high differentials (margin) between the interest rates charged on local-currency-denominated and foreign-currency-denominated loans (especially pre-Covid), and expectations of further exchange rate depreciation and high local currency interest rates. On the supply side, these include banks' inherent desire to match the growing stock of foreign- currency-denominated deposits with loans, and the dominance of foreign-owned banks who have strong linkages with parent banks with robust foreign currency funding and liquidity.

Chart 57: Sectoral Distribution of Foreign Currency Loans

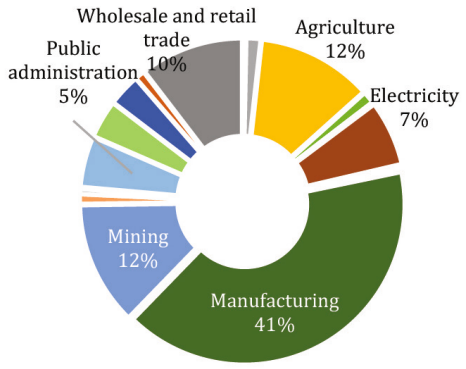


Chart 58: Distribution of Foreign Currency Loans By Bank Type (US$ billion)

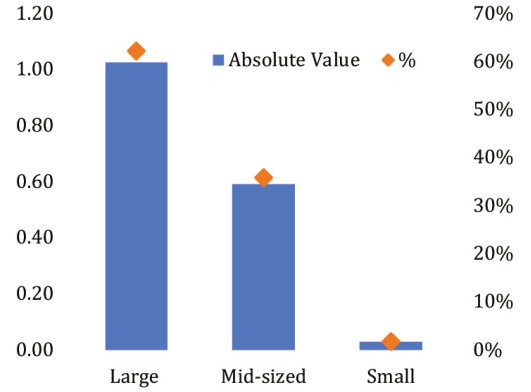
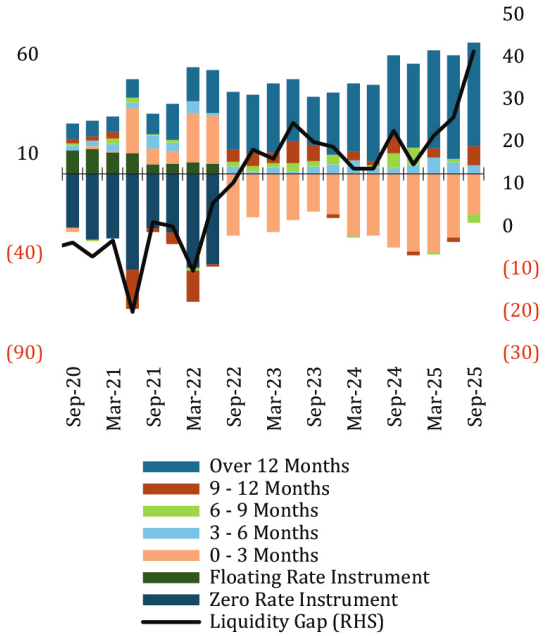


Chart 59: Maturity Mismatches (K'billion)



foreign currency denominated exposures. Similarly, the distribution of foreign currency lending by bank is also unbalanced, with three large banks holding 62.3 percent market share (Chart 58). With an elevated level of foreign currency lending on their balance sheets, banks continue to be materially exposed to market risk – exchange rate and interest rate risks.

The weakening of the domestic currency indirectly raises credit risk for foreign currency borrowers, especially those with unhedged liabilities. In terms of interest rate risk, an unexpected increase in foreign currency interest rates would most likely threaten the performance of loans denominated in foreign currency. For example, foreign currency borrowers' risk of default would rise if major central banks like the Federal Reserve abandon the recently effected accommodative monetary policy regime and raise interest rates should inflationary pressures from the tariffs pass-through to consumer prices be persistent. Therefore, this would also threaten the performance of particularly manufacturing and agro-based foreign currency borrowers[7], and the soundness of seemingly systemically important banks in terms of asset quality, profitability and solvency.

Besides liquidity and interest rate risks, heightened foreign currency borrowings on banks' balance sheets undermine the potency of the monetary policy transmission mechanism as demand and supply conditions of foreign currency credit are not responsive to the BoZ monetary policy adjustments.

Growing Maturity Mismatches Expose the Banking Sector to Liquidity and Interest Rate Risks

The banking sector vulnerability to liquidity and interest rate risks has grown following an increase in maturity mismatches. The overall discrepancy between assets and liabilities across all maturities expanded further to K41.3 billion, with the liquidity gap[8] remaining positive after the stock of assets in the longer-dated maturity bucket (over 12 months) increased further (Chart 59). Naturally, banks have continued experiencing a negative cash flow gap between inflows and outflows in the shortest time horizon (0 – 3 months) considering their maturity transformation function where they leverage short-term

[7]Mining sector foreign currency borrowers are fully hedged as they invoice their products in foreign currency.

A positive gap occurs when banks have a surplus of interest-sensitive assets over their interest-sensitive liabilities, whereas a negative gap

[8]A positive gap occurs when banks have a surplus of interest-sensitive assets over their interest-sensitive liabilities, whereas a negative gap occurs when interest-sensitive liabilities exceed interest-rate sensitive assets.

deposits, mostly demand deposits, to fund longer-term assets including, loans, mortgages and Government bonds.

This imbalance makes banks vulnerable to liquidity risk if they cannot meet short-term obligations when they are due because their longer-term assets cannot be easily liquidated or simply converted to cash. A sudden increase in cash outflows or difficulty in rolling over short-term liabilities could trigger liquidity challenges. The concentration of deposits (Chart 60) also adds to this risk as unexpected withdrawals by the largest wholesale depositors would cause material liquidity shortages in banks.

A mismatch in maturities also makes banks vulnerable to interest rate risk as interest rate movements can affect their net interest income and profitability. With a positive liquidity gap, banks could suffer from shrinking interest rate margins, net interest income and profitability should the profile of interest rates shift downward as their portfolio of interest sensitive liabilities could reprice faster than their interest sensitive assets. Despite the benefits of lower interest to borrowers, banks' profitability could decline, and their solvency undermined should the BoZ adopt an accommodative monetary policy regime, considering the projected inflation trajectory (see section *Growth and Inflation Risks to Moderate Further Despite the Continued Electricity Shortages*).

Foreign Currency Deposits Increase

The stock of foreign currency deposits has risen sharply since the *April 2025 Financial Stability Report*. Foreign currency deposits soared 23.3 percent to US$4.5 billion (Chart 61) while their proportion relative to total deposits expanded 4 percentage points to 52 percent (Chart 62). Drivers of this growth over the years include the expansion in economic activity, businesses and households desire to hedge against exchange rate-induced inflation[9] and more recently, the statutory requirement for exporters to remit proceeds into domestically domiciled accounts.

Naturally, mining companies dominate the list of banks' largest foreign currency depositors with just over a quarter of the market share (Chart 63). Wholesale and retail traders come second with a market share of 10.4 percent. In terms of the distribution by bank, large lenders collectively hold just over half of the foreign

[9] This could explain the slow uptake of derivative products (see section *Currency Derivatives Trading Increases*) .

Chart 60: Deposit Concentration (Share of Largest 20 Depositors)-%

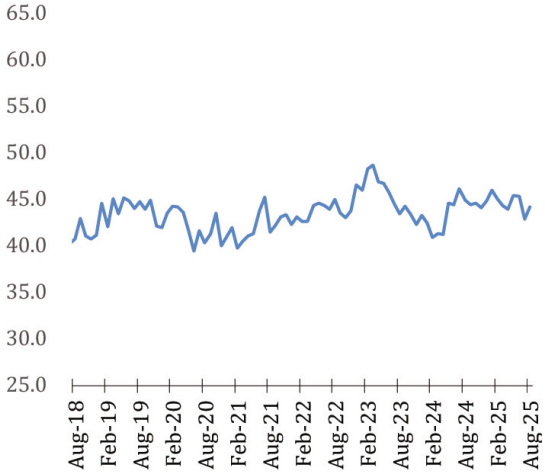


Chart 61: Foreign Currency Deposits (US$ billions)

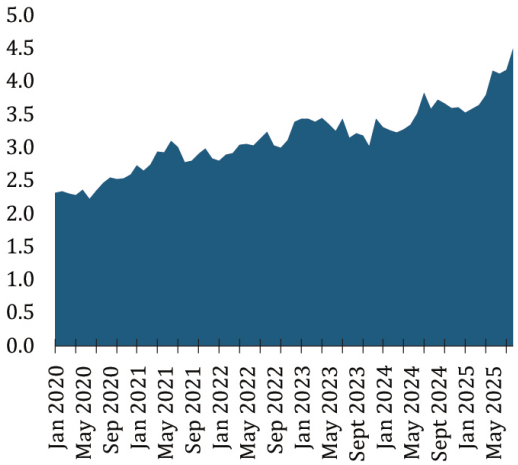


Chart 62: Share of Foreign Currency Deposits

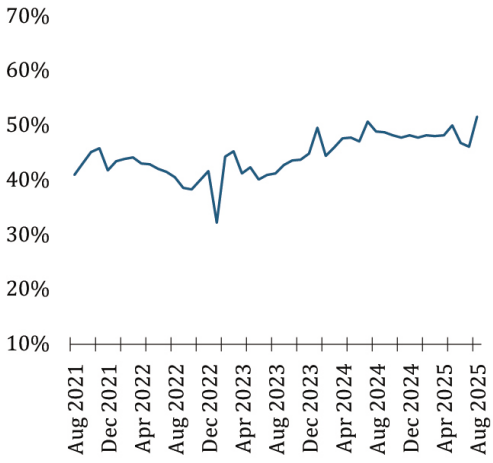


Chart 63: Sectoral Distribution of Foreign Currency Deposits

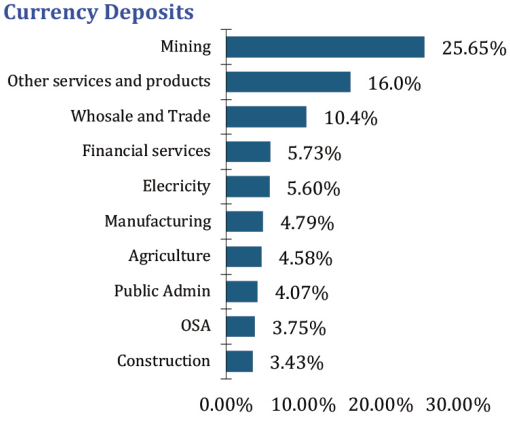


Chart 64: Distribution of Foreign Currency Deposits By Bank Type (US$ billion)

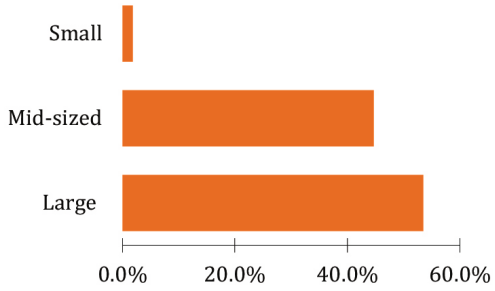


Chart 65: NBFI Exposure to Government Emloyees (K'billion)

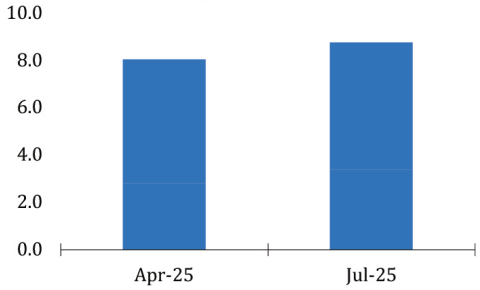
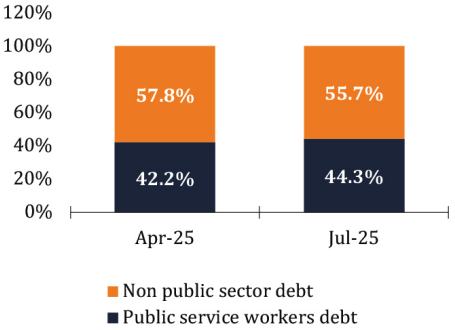


Chart 66: Share of Public Service Workers Loans



currency deposits (Chart 64).

While foreign currency denominated deposits help businesses and households to mitigate inflation risk, it raises financial stability concerns to some extent. Its growth exposes banks to financial risks through currency mismatches on their balance sheets. A currency mismatch occurs when there is an excess of either liabilities or assets, usually measured by their net open position (NOP). Notwithstanding the fact that the system-wide NOP, in relation to regulatory capital, has stayed well below the prudential limit of 15 percent over the last several months, a material expansion of this gap could lead to losses and the erosion of capital buffers in the wake of heightened exchange rate variations.

Non-Bank Financial Institutions (NBFIs)

Non-bank financial institutions have broadly continued posting positive growth. While pension funds liquidity conditions have improved following a reduction in contribution arrears, insurance corporations are facing low profitability and solvency risk. Microfinance institutions are faced with rising credit risk due to the concentration of public service workers loans on their balance sheets.

Microfinance Institutions Face Rising Concentration and Credit Risks

The asset quality of non-bank lenders[10], broadly microfinance institutions, has deteriorated, with the exposure to government employees and the proportion of the associated NPLs rising. The total exposure of non-bank financial institutions to public service workers has risen 9.1 percent to K8.8 billion (Chart 65) since the *April 2025 Financial Stability Report*. Consequently, the share of public service workers' debt increased by 2.1 percentage points to 44.3 percent (Chart 66). Relatedly, the total stock of NPLs related to government employees rose steeply by 142.4 percent to K1.6 billion, with the ratio of civil servants' NPLs to the total exposure to civil servants soaring 9.7 percentage points to 17.7 percent (Chart 67). A sub-sector analysis reveals that non-deposit taking financial institutions are more exposed to government employees than deposit-taking financial institutions (Chart 68) while the latter faces a higher risk of default as the share of NPLs on their balance sheets is larger by 16.5 percentage points (Chart 69).

Even though most non-bank financial institutions are deemed non-systemic and largely underwrite salary-backed loans, the fact that their credit portfolio is highly concentrated and faces growing credit risk raises financial stability concerns. In an event that civil servants face

[10]This comprises microfinance institutions,building societies as well as a savings and credit bank.

difficulties in repayments, microfinance institutions could have liquidity challenges and capital shortages. Moreover, the interconnectedness that exists between non-bank financial institutions and banks suggests the former's liquidity challenges could be amplified by cascading to banks.

There is need for microfinance institutions to taper their dependence on the public sector and diversify away from public workers loan if they are to manage the growing credit risk. They need to offer innovative credit products that would cater for the needs of private sector borrowers.

Financial Soundness Risk Looms in the Insurance Industry

Insurance corporations' profitability rose further following increased demand for policies relating to motor, accident, property, life, and health insurance cover. Insurers' gross written premiums (GWP), which measure the total direct and assumed premiums written by an insurer before deductions for reinsurance and ceding commissions, rose 14 percent to K5.6 billion in the year to June (Chart 70). Non-life insurance policies accounted for 68 percent of the total GWP, with motor insurance policyholders dominating at 70 percent of the non-life contribution. In terms of life insurance cover, health insurance policyholders overwhelm others, accounting for 51 percent of the remaining 32 percent GWP. Net earned premiums increased by 19.6 percent to K3.5 billion in the year to June, albeit a reduction of 38.8 percent compared with the 2024 fourth quarter outturn (Chart 71).

Conversely, insurers' profitability-related frailties were manifested in the combined ratio, with the life insurers' combined ratio inching up 4.4 percentage points to 124.3 percent while it decreased by 12.1 percentage points to 103.9 percent for non-life insurance businesses (Chart 72). It is concerning that insurers, especially life businesses, have continued to make underwriting losses as the combined ratio has remained above 100 percent[11]. Underwriting losses are indicative of insurers struggle to cover expenses related to underwritten premiums, including operating and claims expenses.

[11] Calculated as the sum of net incurred losses and underwriting expenses divided by net earned premiums, the combined ratio measures profitability of an insurance company's underwriting. A ratio less than 100 percent indicates profitable underwriting while a ratio of above 100 percent indicates loss underwriting.

Chart 67: Public Workers NPLs

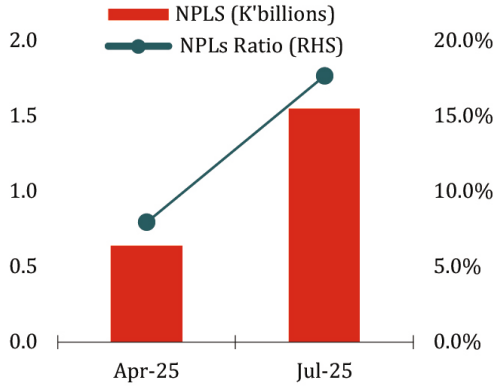
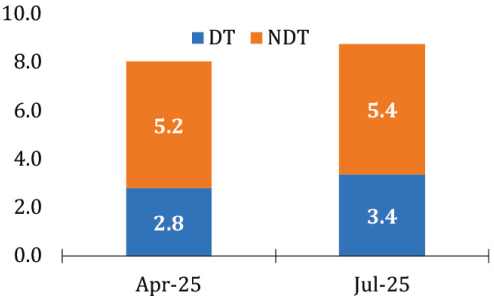


Chart 68: Sub-sector Exposure to Public Workers Loans (K billion)



Note
DT stands for deposit-taking and NDT for non-deposit taking

Chart 69: Sub-sector Public Sector Workers NPL Ratios

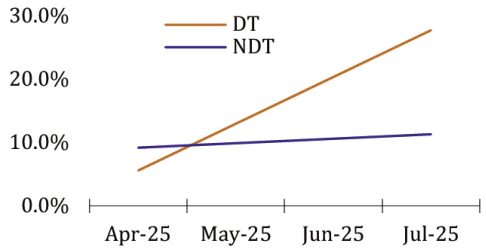
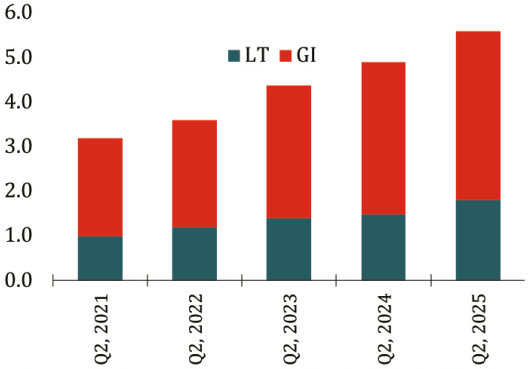
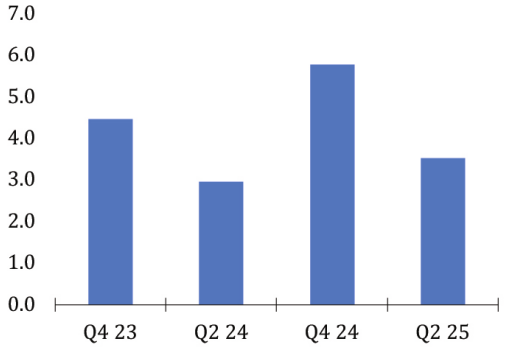


Chart 70: Insurance Corporations Gross Written Premiums (K'billion)



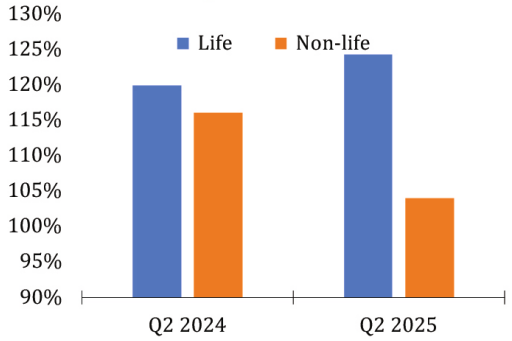
Source: Pensions and Insurance Authority (PIA), BoZ Staff Calculations

Chart 71: Insurance Corporations Net Earned Premiums (K'billion)



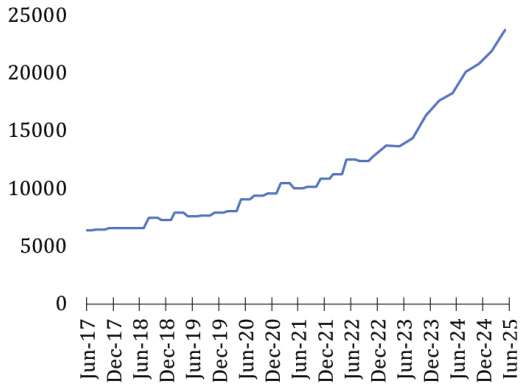
Source: Pensions and Insurance Authority (PIA), BoZ Staff Calculations

Chart 72:Combined Ratios for Life and Non-life Insurance Corporations



Source: Pensions and Insurance Authority (PIA), BoZ Staff Calculations

Chart 73: Private Pension Industry Net Assets (K'billion)



Source: Pensions and Insurance Authority (PIA), BoZ Staff Calculations

Going forward, the primary headwind insurers will have to navigate relates to financial soundness risk in light of the recently implemented insurance laws and regulations. As stressed in *April 2025 Financial Stability Report* , the new Insurance Act, 2021 and the Insurance (General) Regulations, 2022, could see several insurance companies fall short of the required capital adequacy by the end of the transition period on 31 December 2025. The new regulations require insurers to achieve a CAR of at least 150 percent to be considered solvent. Other headwinds relate to the longstanding challenges they face in terms of delays in collecting premiums and their lingering appetite to underwrite bonds and guarantees. These add to the heightened financial soundness risks in the sense that the new capital adequacy regime precludes receivables aged over 14 days and requires insurers to set aside capital equivalent to at least 15 percent of the sum guaranteed for bonds underwritten in a financial year.

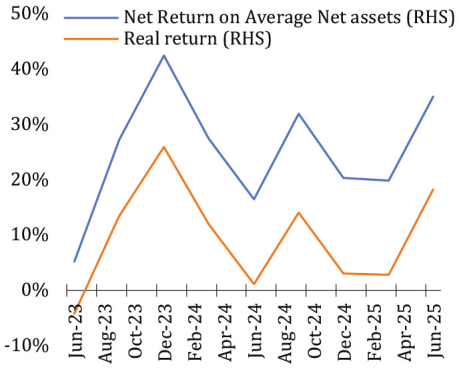
Pension Funds Record Further Growth as Profitability Rises and Contribution Arrears Fall

Since the *April 2025 Financial Stability Report* , pension funds have continued registering growth, with their net assets expanding further due to higher domestic equity valuations. Between March and June 2025, net assets rose 8.3 percent to K 23.8 billion (Chart 73) as the LASI posted further growth (see section *Equities Soar*). Relatedly, their investment income jumped 69.4 percent to K2.1 billion due to increased fair value gains and dividends from local equities. This, coupled with tapering inflationary pressures (see section *Growth and Inflation Risks to Moderate Further Despite the Continued Electricity Shortages*), led to a steep increase in the net return on average net assets, which grew from 19.8 percent at the end of March to 35 percent , and real return, which rose by 15.5 percentage points to 18.3 percent (Chart 74).

Pension funds' total contributions rose further by 11.3 percent to K0.8 billion. The proportion of contribution arrears continued on the downward trend, declining to 58.0 percent in June from 64.6 percent in March (Chart 75). Declining arrear contributions translates to improved prospects for liquidity. Declining levels of contribution arrears weigh on liquidity and default risks in terms of enhancing pension funds ability to meet their obligations such as benefits payment when they are due.

Prospects for pension funds are mixed. Downside risks would emanate from interest rate risk related to local currency Government securities, the growing global policy uncertainty and an escalation in geopolitical tensions which could have an adverse impact on global

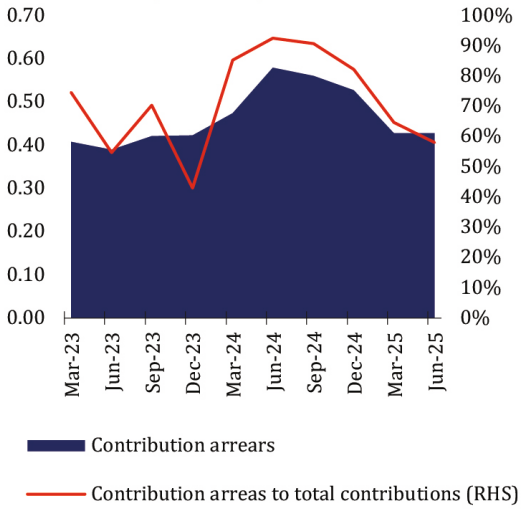
Chart 74: Net Return on Average Net Assets and Real Return (%)



Source: Pensions and Insurance Authority (PIA), BoZ Staff Calculations

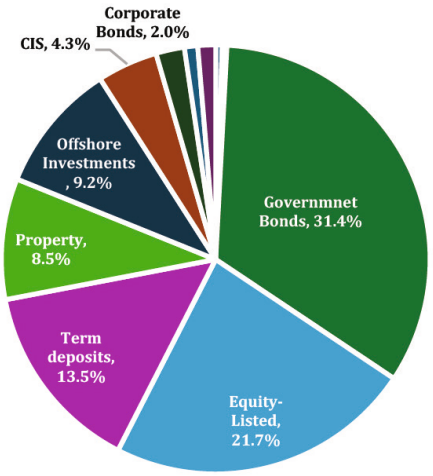
finance (see section *Geopolitical Risks and Economic Policy Uncertainty Cloud Outlook for Trade, Finance and Growth*). With the investments in local currency Government securities equivalent to a third of their portfolio (Chart 76), pension funds risk having lower returns considering the increase in withholding tax (from 15 percent to 20 percent) and the anticipated lower interest rates amid disinflation and enhanced fiscal consolidation efforts. Their placements in offshore equities also directly exposes them to global macrofinancial dynamics. To mitigate these risks, pension funds should continuously seek having a well diversified portfolio.

Chart 75: Total Contributions and Arrear Contribution (K' billion)



Source: Pensions and Insurance Authority (PIA), BoZ Staff Calculations

Chart 76: Pension Funds Investment Split



Source: Pensions and Insurance Authority (PIA), BoZ Staff Calculations

Stress Test

The 2025 round of stress test results demonstrate that severely subdued global economic activity, induced by higher effective tariffs and an escalation in geopolitics, would indirectly constrain deposit mobilisation, limit loans growth, increase credit risk, weaken profitability and erode capital buffers. While there would be pockets of undercapitalisation across the sector, banks would broadly remain adequately capitalised.

The 2025 cycle of stress test has been designed to assess the potential impact of depressed global growth on the health of financial institutions in Zambia. Hypothetically, stress scenarios were based on the moderate and severe impact of slowing global growth caused by higher effective tariffs, geopolitical conflicts and heightened policy uncertainty. Overall, the effects of the depressed global growth would be transmitted to the domestic economy through the trade and finance channels. The ensuing unfavourable macroeconomic conditions would then filter through to financial institutions balance sheets.

It is noteworthy that the scenario described below is **hypothetical** and **not a prediction** of future developments.

The Stress Scenario: Impact of depressed global growth

The scenario assumes a depressed global growth in the medium term as global risk aversion rises. Heightening protectionist trade policies coupled with escalating geopolitical tensions contribute to increased fragmentation of supply chain and lower businesses activity. Increased trade tariffs and retaliatory measures among major advanced and emerging economies constrains global trade, while escalating geopolitical tensions causes supply and demand shocks, magnifying trade fragmentation and leading to a large contraction in global growth. There are supply-side inflationary pressures, including higher crude oil and food costs. Rising energy prices, increase production costs in manufacturing and other high energy consuming sectors.

Global inflation resurges, with central banks such as the US Federal Reserve, European Central Bank (ECB) and Bank of England (BOE) resuming monetary policy tightening in the near term. This increases borrowing costs for developing economies, including Zambia, in terms of increased costs of servicing external debt. This also leads to rushed capital outflows and the depreciation of the exchange rate.

Higher global energy prices would increase Zambia's import bill and domestic inflation, especially that Zambia is a net importer of most petroleum products. Further, the delays of imports/exports or higher freight costs due to an escalation of tensions in the Red Sea or Suez Canal, could hurt trade and contribute to inflationary pressures in Zambia.

The significant contraction in global growth due to a slowdown in major economies like the US, China, or the Eurozone reduce external demand for commodities, especially copper – Zambia's main export accounting for over 70 percent of foreign exchange earnings. In turn, copper prices slump leading to reduced export revenues, lower GDP growth, fiscal pressures, and currency depreciation. As a result, inflation rises sharply.

Consequently, BoZ would be compelled to hike the monetary policy rate to rein in heightened inflationary pressures. Higher interest rates drag credit growth down. Given that the country has not fully recovered from the fallout of the 2023/2024 drought[12], the significant slowdown in global growth plunges the domestic economy into a recession, increasing unemployment and constraining income generation and growth for firms and households. The fiscal sector gets strained as revenues dwindle amidst slower income growth, widening the fiscal deficit. Public debt grows as more securities are issued[13], potentially deepening the sovereign-bank nexus.

The resulting unfavourable macroeconomic conditions cascade to financial institutions in the form of lower deposits and funding, higher default risks, increased credit losses, reduced

[12] Despite the favourable rainy season recorded in 2024/25, electricity load shedding has continued, putting a strain on production capacity and costs.

[13] Government borrows more on the domestic securities market to bridge the gap created by reduced donor support. This reverses fiscal consolidation efforts, resulting in increased debt burden and credit rating downgrade.

profitability and diminishing capital levels.

Given the preceding scenario, the following are the key baseline and stress test assumptions:

Baseline Assumptions

a) The MPR is maintained at 14.5 percent.
b) Copper prices average US$9,553.5/ton in 2025, US$9,762.0/ton in 2026 and US$9,811.9/ton in 2027.
c) An average GDP growth of 5.5 percent in 2025, 5.4 percent in 2026 and 4.5 percent in 2027[14].
d) Government expenditure of 1.20 times of revenues and grants in 2025, 1.05 in 2026, and 1.03 in 2027.
e) South African inflation averages 3.2 percent in 2025, 4.2 percent in 2026 and 4.4 percent in 2027.
f) US inflation averages 3.0 percent in 2025, 2.4 percent in 2026 and 2.1 percent in 2027.
g) US federal funds rate averages 3.9 percent in 2025, 3.6 percent in 2026 and 3.4 percent in 2027.

Stress Assumptions

Following the scenario described above, two scenarios were assumed – a moderate scenario with a 15 percent tariff rate, and a severe scenario in which case the tariffs is set at 50 percent. The assumed adverse variations in the concerned variables are given below:

Moderate Stress Scenario

a) The MPR is raised to 16.7 percent and maintained at that rate throughout the simulation horizon.
b) Copper prices average US$8,288.7/ton in 2025, US$7,239.3/ton in 2026 and US$7,263.5/ton in 2027.
c) An average GDP growth of 4.0 percent in 2025, 2.5 percent in 2026 and 1.3 percent in 2027.
d) Government expenditure of 1.46 times of revenues and grants in 2025, 1.69 in 2026, and 1.67 in 2027.
e) South African inflation averages 4.5 percent in 2025, 6.7 percent in 2026 and 6.9 percent in 2027.
f) US inflation averages 3.7 percent in 2025, 4.2 percent in 2026 and 3.7 percent in 2027.
g) US federal funds rate averages 4.8 percent in 2025, 5.1 percent in 2026 and 4.9 percent in 2027.

Severe Stress Scenario

a) The MPR is raised to 17.5 percent and maintained at that level throughout the simulation horizon.
b) Copper prices average US$7,179.6/ton in 2025, US$4,973.8/ton in 2026 and US$4,986.1/ton in 2027.
c) An average GDP growth of 2.9 percent in 2025, 0.3 percent in 2026 and -0.9 percent in 2027
d) Government expenditure of 1.46 times of revenues and grants in 2025, 2.23 in 2026, and 1.67 in 2027.
e) South African inflation averages 4.7 percent in 2025, 7.1 percent in 2026 and 7.3 percent in 2027.
f) US inflation averages 4.4 percent in 2025, 5.6 percent in 2026 and 5.2 percent in 2027.
g) US federal funds rate averages 5.1 percent in 2025, 5.6 percent in 2026 and 5.4 percent in 2027.

Simulation Results

Deposits growth would contract under the severe stress scenarios: Funding, as proxied by bank deposits, would slow down over the simulation horizon under stressed conditions (Chart 77). A severe stress scenario would see deposit base contract by 7 percent to K194.1 billion by the second quarter of 2027, while it would remain steady and grow marginally by 0.2 percent to reach K210.2 billion in a moderate stress scenario. This compares with 17 percent growth to reach K246.2 billion in the baseline. The retardation in deposit growth under both stress scenarios could be reflective of lower disposable incomes due to subdued economic activity and depositors' preference to place funds in higher-yielding Government securities as Government's

[14]Average quarterly GDP growth projection the Bank of Zambia.

Chart 77: Response of deposits (K' Billion)

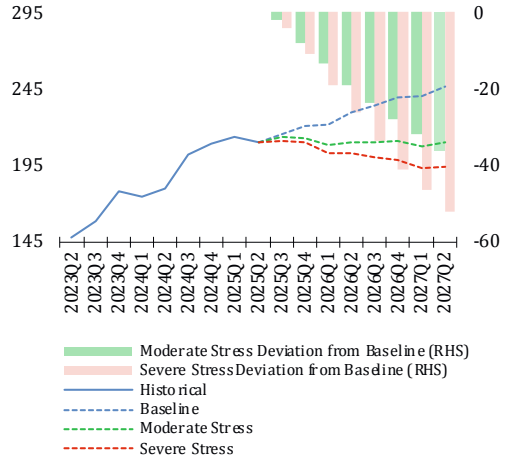


Chart 78: Response of gross loans (K' Billion)

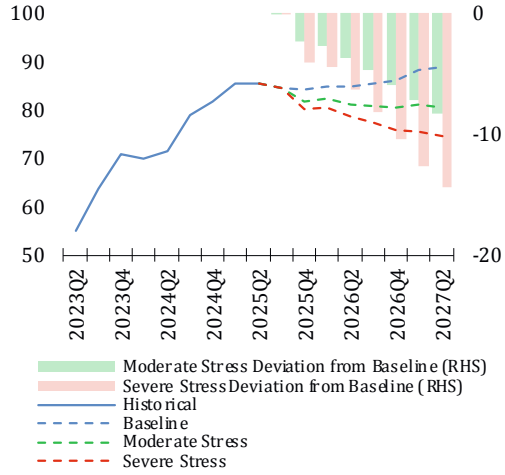
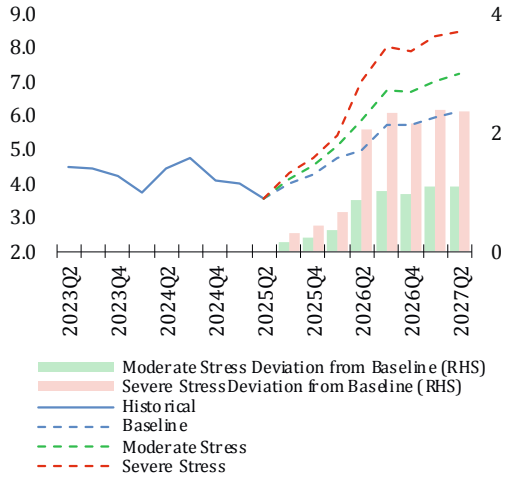


Chart 79: Response of the NPL ratio (%)



reliance on domestic funding rises.

Gross loans would contract: Credit extension would contract in both stress scenarios, with results showing that gross loans would contract by 13 percent to reach K74.6 billion by the second quarter of 2027 in a severe stress scenario, and decline by 6 percent to reach K80.7 billion in a moderate stress scenario (Chart 78). These growth rates compare with 4 percent increase (to K88.9 billion) in the baseline. The decline in loans growth could be indicative of how a stressed environment marred with subdued economic activity, increased Government domestic borrowing and higher interest rates would dampen both the demand and supply of credit.

Credit risk would increase: Under the stress scenario, credit risk would increase, with the NPL ratio increasing at a faster pace in a severe stress scenario. The NPL ratio would rise to 8.5 percent by the second quarter of 2027 in the severe stress scenario and 7.2 percent in the moderate stress scenario. These results compare with 6.1 percent in the baseline (Chart 79). The increase in the share of bad loans could be attributable to borrowers' growing debt servicing costs amid higher interest rates and lower incomes.

Banks' profitability would drastically fall: Following an increase in the share of non-performing loans, banks would incur substantial losses under the stress scenario due to higher provisions and impairments coupled with reduced net interest income from loans. The net income and the return on assets (ROA) fall into negative in the fourth quarter of 2026, in the case of a severe stress scenario (Chart 80). By the second quarter of 2027, the ROA would descend to -1.3 percent in the case of a severe scenario, 1.0 percent in the moderate scenario and 4.2 percent in the baseline.

Bank capital buffers would fall, but the sector would remain resilient: While the increase in credit losses and lower profitability would have a knock-on effect on banks' solvency, their capitalisation would remain strong. The banking sector's share of capital relative to risk-weighted assets would fall to 20 percent and 23 percent under the severe and moderate stress scenarios, respectively (Chart 81). This compares with 26.5 percent in the baseline.

Chart 80: Response of ROA (%)

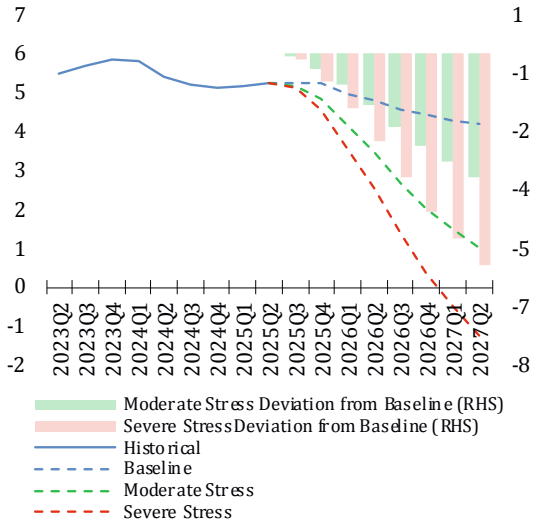
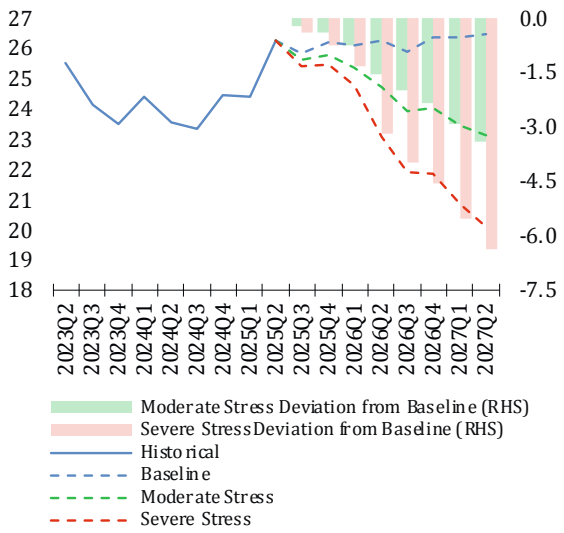


Chart 81:Banks' CAR's response (%)



3. Policy

Risks to financial stability are assessed to have declined further since the *April 2025 Financial Stability Report*. This was largely after macroeconomic risks subsided and financial markets stress eased.

Banks have remained well capitalised with sufficient buffers to cushion against unexpected losses. Newly introduced capital rules, including the requirement to hold higher quality capital in form of common equity tier one (CET 1), introduction of a 3 percent capital conservation buffer in form of CET 1 and the leverage ratio of 6% are expected to enhance their resilience further. Credit risk associated with their loan portfolio has continued to trend downward.

Financial stability risks related to economic growth and inflation have moderated. There are expectations that they will reduce further given the expected growth in the communications and technology, mining and agriculture sectors as well as the narrowing of the energy supply gap. While economic growth is expected to pick further, it is not yet entrenched.

There is also limited flow of credit to the private sector as reflected in low loans to deposit ratio and the negative credit-to-GDP gap, which narrowed to -0.3 percent from -0.7 percent previously. The negative gap suggests that private credit is growing below its potential, relative to economic growth.

Considering the foregoing, the FSC decided to maintain the countercyclical capital buffer (CCyB) at 0.00 percent.

4. Boxes

Box A: September 2025 Systemic Risk Survey Results

Market players expect risks to financial stability to remain unchanged in the near-term

The results of the *September 2025 Systemic Risk Survey* (SRS) have revealed that market players expect the overall systemic risk to remain unchanged over the next 12 months (Chart A1). Conversely, they anticipate risks to financial stability to increase over the 2–5 year horizon (Chart A2). Respondents polled have cited concerns about the risk evolution in the medium-term, pointing to uncertainties relating to climate change and geopolitical tensions among other factors.

Risk managers polled are of the view that overall systemic risk has remained unchanged since the release of the April 2025 Financial Stability Report (Chart A3). This is according to 46 percent of respondents, against 27 percent each who viewed systemic risk to have decreased and increased, respectively.

Market players' perception of the top three vulnerabilities residing in the domestic financial system included funding and liquidity mismatches, electricity shortages and sovereign bank nexus. These fragilities are structural, and the electricity shortages corroborate with the ongoing energy challenges in the country.

Respondents polled cite cyber-attacks, exchange rate volatility, and economic policy uncertainty as the top three risks to financial stability. They also cite cyber-attacks followed by exchange rate volatility as the most difficult risks to manage. A sector-by-sector analysis reveals that banks, microfinance, life insurance, fund managers and non-financial companies all considered cyber-attacks as the most challenging risk whilst non-life insurance companies and pension funds considered the exchange rate volatility to be the most challenging. Concerns about cyber-attacks have heightened as financial institutions and businesses increasingly integrate digital processes and services into their operations. At the same time, fraudsters are deploying more sophisticated tools like ransomware, phishing, and AI-powered attacks to exploit vulnerabilities. As financial systems become more interconnected with third-party vendors and payment platforms, a breach in one area can quickly cascade across others, posing a systemic threat to financial stability.

Chart A1: Expected near-term changes in systemic risk

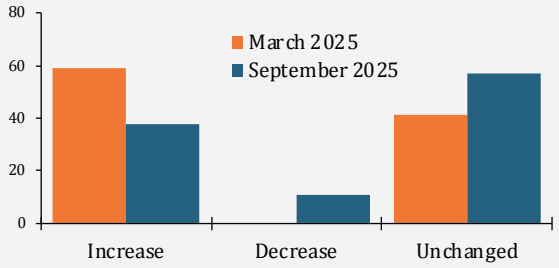


Chart A2: Expected medium-term changes in systemic riskt

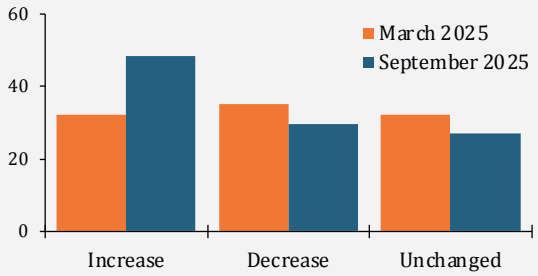
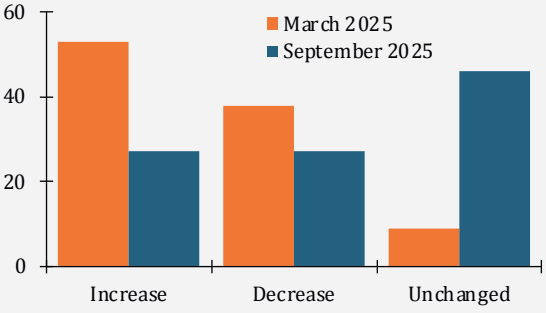


Chart A3: Systemic risk assessment over the past six months



Box B: The State of Banks Interconnectedness and Contagion Risk

Increased interbank exposures could signal greater interconnectedness and a higher risk of contagion as an adverse shock at one financial institution could spill over to other institutions. This would disturb the efficiency of the financial markets and reduce confidence in the interbank money market – the intermediate channel for monetary policy transmission.

Over the review period, the interbank market was moderately interconnected, with banks connected to an average of four counterparties through interbank credit exposures. This reflects the segmentation arising from perceived counterparty credit risk. However, bank by bank assessment shows that one bank was highly exposed through interbank borrowing (Chart C1 and Chart C3) with exposures to 11 of the 14 participating banks in the interbank market. Notwithstanding that most (62.7 percent) of the bank's borrowing during the quarter was backed by collateral, a liquidity shock at the bank could be propagated to its counterparties, with cascading effects amplifying market-wide disruption.

Also of systemic concern is the dominance of the providers of money market liquidity. One lender[15] supplied about 39 percent of funds lent during the quarter (Chart C2 and Chart C3). In the event of a liquidity shock at the bank, it is unclear whether more liquid banks would compensate the shortfall. The drying up of interbank market liquidity would compromise the transmission of monetary policy. Further, a contraction in interbank money market turnover would make it more difficult for banks to access short-term funding. Banks would turn to more expensive funding sources, eroding their profitability and capital buffers. The distress could spill over to the real economy as banks cut back on real sector lending and raise borrowing costs.

Addressing underlying structural rigidities is critical to enhancing the efficiency of the interbank money market and minimising systemic risk. These could include measures to reduce counterparty credit risk such as enhancing the legal enforceability of Global Master Repurchase Agreement (GMRA) and International Swaps and Derivatives Association (ISDA) contracts as is being pursued in the Bank's 2024-2027 Strategic Plan. The GMRA provides a standardised legal contract to govern

Chart B1: Banks directly exposed to Bank 11

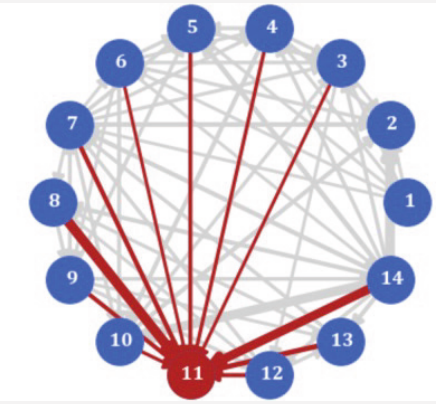


Chart B2: Bank 14 Direct Exposures

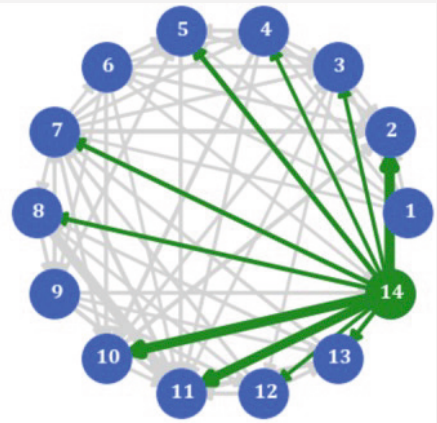
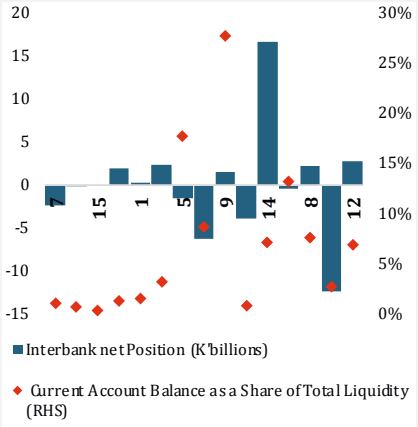


Chart B3: Commercial Bank Liquidity and Inter-bank Positions (Q2-Q3 2025)



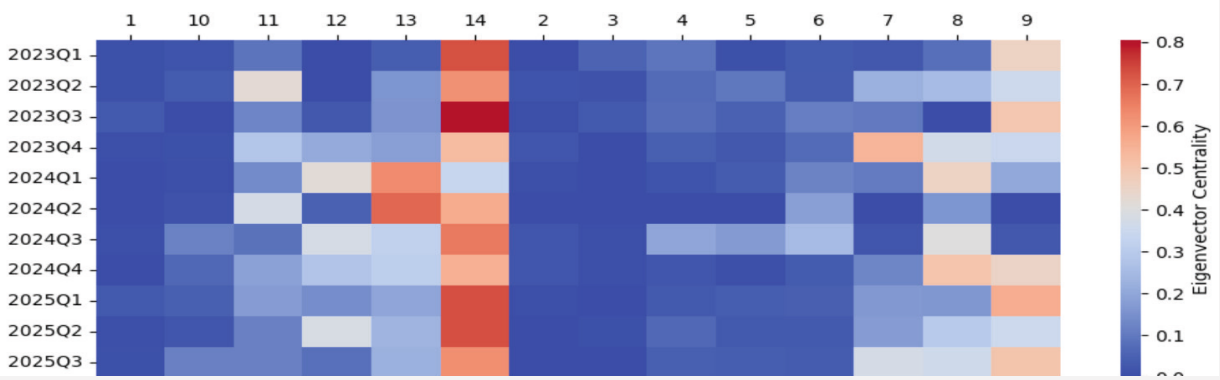
[15] The bank recorded the highest eigenvector centrality (Chart 4), a network metric capturing a nodes influence by considering its own connections as well as the importance of its neighbours.

repurchase agreements. Credit risk is addressed by legally establishing securities traded in the transaction as collateral. This would allow lenders to liquidate collateral and recover outstanding amounts in the event of default. This contrasts the current method of collateralised interbank lending where there is no legal transfer of title for pledged securities. The contracts also contain close-out netting clauses which provide for the termination of outstanding transactions. upon a counterparty's default or insolvency.

Multiple obligations are consolidated into a single net amount, reducing overall exposure. This prevents the non-defaulting party from having to pay out while facing potential non-recovery on incoming amounts. ISDA contracts serve a similar purpose, promoting the use of over-the-counter derivative transactions such as swaps.

In addition, the Bank is facilitating the implementation of the Umbrella Guarantee Facility (UGF) by Frontclear to address segmentation in the interbank market. Under this arrangement, Frontclear will provide a platform for interbank trading known as Tradeclear. Frontclear will serve as an intermediary on this platform, acting as a guarantor for interbank loans. The institution has already engaged most commercial banks and onboarding to the Tradeclear platform has commenced. This initiative will address the perceived credit risk and is expected to enhance interbank trading activity.

Chart B4: Eigenvector Centrality of the Interbank Money Market (Kwacha)



Box C: Strengthening Capital Resilience

In response to vulnerabilities exposed by the 2007/08 global financial crisis, international standard setting bodies led by the Basel Committee on Bank Supervision (BCBS) introduced reforms to enhance the resilience of banks. These reforms focused on improving the quality of capital.

The Bank of Zambia has taken steps to align its regulatory framework with these global standards. Through the Statutory Instrument 62 of 2025, the Bank issued new Banking and Financial Services (Capital Adequacy) Rules which aim to strengthen Zambia's financial system's resilience.

Capital Adequacy Reforms

The Capital Adequacy Rules, 2025, align Zambia's regulatory framework with Basel II and III guidelines. Key features include:

Tiered Capital Structure

The revised capital rules introduce Common Equity Tier 1 (CET1) capital as the highest quality capital available for absorbing losses. Complementing this is Additional Tier 1 (AT1) capital, which forms the second layer of regulatory capital. Together, CET1 and AT1 constitute the primary capital of a financial service provider. Under the new framework, the CET1 ratio is set at 6% of risk-weighted assets, while the primary capital ratio is set at 8% for commercial banks and 10% for financial institutions and financial businesses.

The third tier of capital, referred to as secondary capital instruments, includes instruments such as subordinated debt. When combined with primary capital, these form the institution's regulatory capital, which is set at 10% of risk-weighted assets. An exception applies to microfinance institutions, for which the regulatory capital requirement is set at 15%.

Capital Buffers

The revised capital framework introduces the Capital Conservation Buffer (CCB) alongside the existing Countercyclical Capital Buffer (CCyB). The CCB is set at 3% of risk-weighted assets, held in the form of Common Equity Tier 1 (CET1) capital. It must be maintained above the minimum CET1 requirement and serves as an additional layer of protection that can be drawn down during periods of financial stress. Institutions that fall short of the CCB requirement will face restrictions on profit distributions, including dividends, share buybacks, and discretionary bonuses. The CCyB, also held in CET1, remains at 0% following the October 2025 decision by the Financial Stability Committee (FSC). It may be adjusted between 0% and 2.5% of risk-weighted assets depending on the build-up of systemic risks. Any upward adjustment will be communicated publicly, along with a specified timeframe for compliance.

Leverage Ratio

Complementing the risk-based capital measures, the new capital rules introduce a non-risk-based Leverage Ratio requirement. Banks and financial institutions must maintain a minimum Leverage Ratio of 6%, calculated as a proportion of the sum of total assets and off-balance sheet exposures. This requirement is designed to curb the accumulation of excessive leverage in the financial system, thereby strengthening institutional resilience and promoting overall financial stability.

Operationalisation

To support the implementation of the new capital rules, the Bank has issued a comprehensive set of Directives. These include:

• *Risk-Weighted Asset Computation Frameworks:* Directives outlining methodologies for calculating risk-weighted assets across credit, market, and operational risk. Notably, operational risk has now been

incorporated into the capital framework, unlike the previous regime ensuring that banks and financial institutions allocate capital to absorb potential losses arising from operational failures.

• *Forward-Looking Capital Planning:* Institutions are required to undertake capital planning that goes beyond minimum regulatory requirements, addressing risks not fully captured under the standardised approach. This is facilitated through the Internal Capital Adequacy Assessment Process (ICAAP), in line with Basel Pillar II expectations

• *Enhanced Public Disclosures:* Additional directives mandate greater transparency in risk and capital disclosures to the public. These disclosures are intended to strengthen market discipline by enabling stakeholders to better assess the risk profile and capital adequacy of financial institutions.

Applicability and Transition

The rules apply proportionally across financial service providers, with full compliance expected from banks. Transitional arrangements are in place until 31 December 2025.

Appendix

Heatmap at a Glance

A heatmap is a two-dimensional representation of data in which values are represented by colours. It shows a visual summary of various vulnerabilities and risk indicators whilst providing an easy interpretation of the historical evolution and movement of systemic risk metrics. Ideally, a heatmap displays the evolution of distress in the financial system based on prescribed risk categories. It is not designed to predict the timing or severity of a financial crisis but to identify underlying vulnerabilities that could potentially lead to a crisis. It helps signal the potential threats to financial stability. In terms of interpretation, the 'blue' colour indicates low risk or vulnerability, 'red' is representative of high risk or vulnerability and 'white' represents medium risk or vulnerability.

While the colours are assigned to fixed scales in the case of those indicators with pre-determined trigger points, they are assigned to relative values where the percentile system is used. This means that the evolution of colours is dynamic, and can therefore, change with the addition of more observations to the distribution.

Table AP 1: Full Heatmap