South Africa Banking Outlook 2025

Improving Economic Prospects Will Boost Banks' Performance

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S&P Global Ratings

This report does not constitute a rating action

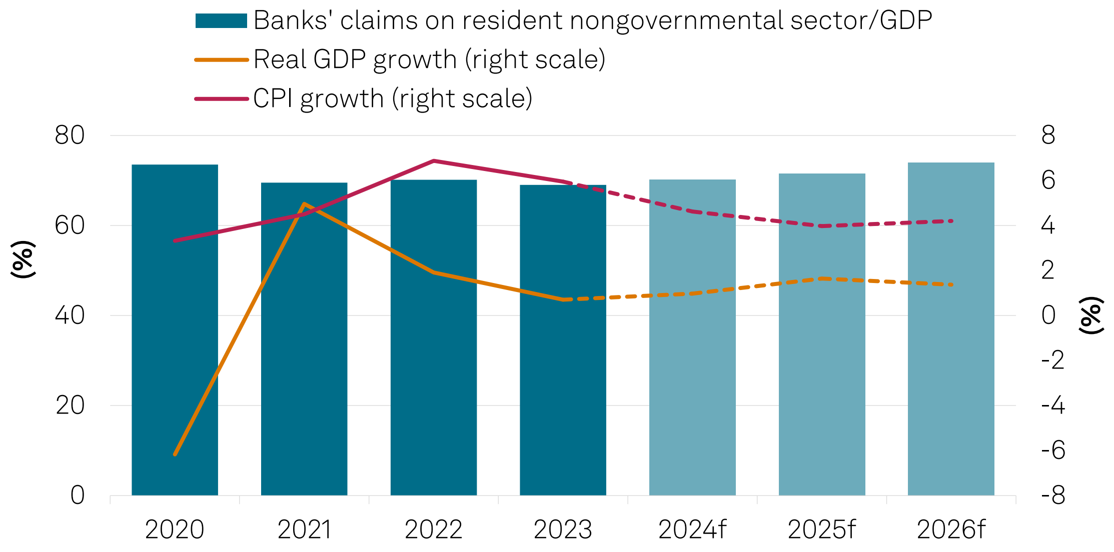
Key Takeaways

- Improving economic reform momentum driven by the Government of National Unity (GNU), combined with continued progress in addressing infrastructure deficiencies, could bolster South Africa's economic prospects.
- Credit conditions are set to ease gradually through 2025 amid moderating inflation and interest rate cuts.
- We forecast that growth in credit to the private sector will accelerate and hover around 8%-9% in 2025, mainly stemming from investments in infrastructure, including logistics and renewable projects. Private sector credit to GDP will slightly increase to about 80% from an estimated 76% in 2024.
- We expect the banking sector's credit loss ratio to normalize below 1%, closer to historical trends, in 2025 as pressure on households' disposable incomes eases because of lower inflation and decreasing interest rates.
- We anticipate that the sector will maintain strong average return on equity of 15%-16%, despite lower interest rates, supported by higher credit growth, noninterest income, and lower provisioning.

Improving Macroeconomic Conditions Will Support Credit Growth In 2025

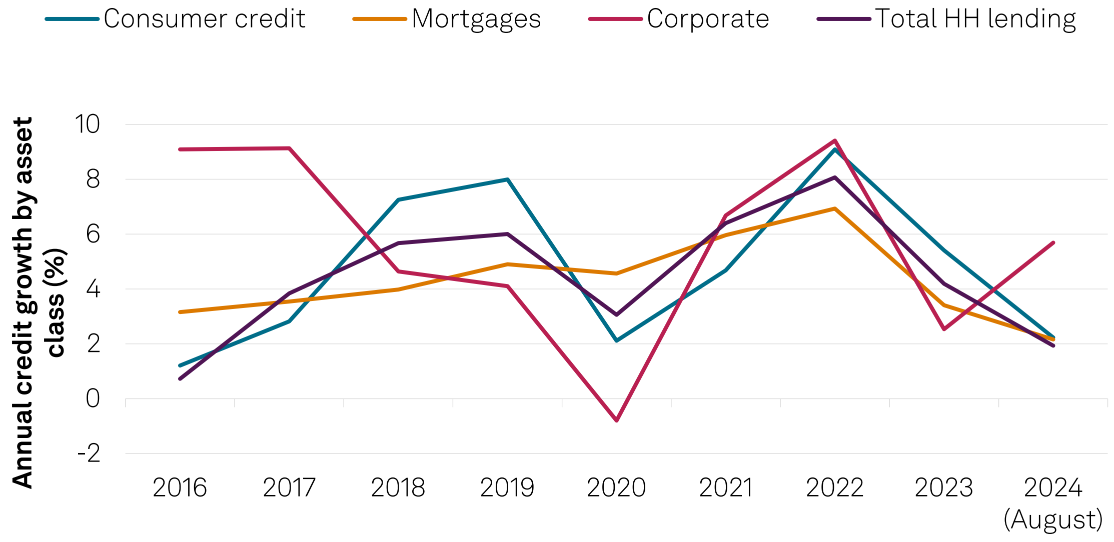
- Progress in addressing the energy constraints in the country and a pick-up in private investment will support economic growth in 2025.
- Planned economic reforms under the GNU, which largely focus on addressing infrastructure deficits particularly in the railway, ports, energy, and water sectors, will create lending opportunities for banks. For example, the private sector pipeline of 22,500 MW of energy generation projects is nearly South African rand (ZAR) 400 billion over the medium term. This will also be supported by the decrease in interest rates.

Demand for credit could firm up in 2025



f--Forecast. CPI--Consumer price index. Source: S&P Global Ratings.

Household lending dipped in 2023 and 2024 amid high inflation and interest rates



HH--Household. Source: South African Reserve Bank.

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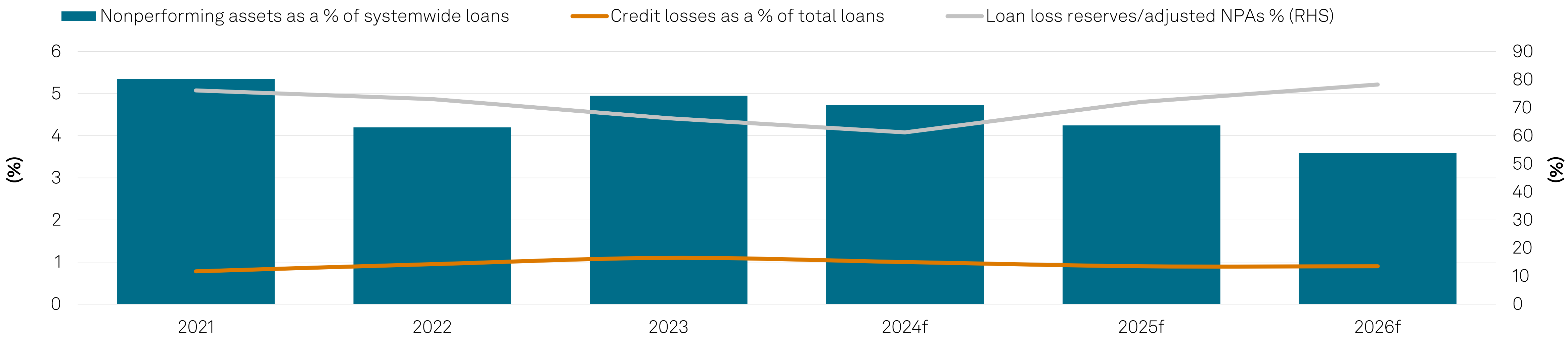
Banking Sector Credit Losses Will Normalize Closer To Historical Levels

- Although improving, banks' asset quality metrics remained under pressure in 2024 mainly driven by their retail portfolios. Households' disposable incomes and ability to repay debt was constrained by high interest rates as well as relatively high food prices.
- We anticipate that improving macroeconomic conditions in South Africa, and the ability of households to access part of their retirement savings through the recent two-pot retirement system, will ease pressure on their capacity to service debt.
- We expect that the banking sector's credit loss ratio will normalize, averaging 90 bps in 2025, from an estimated 100 bps in 2024. Similarly, nonperforming loans will improve toward 4.4% of total loans at year-end 2025 from an estimated 4.7% in 2024.

Asset quality metrics are expected to continue improving



NPAs--Nonperforming assets. f--Forecast. Source: S&P Global Ratings.

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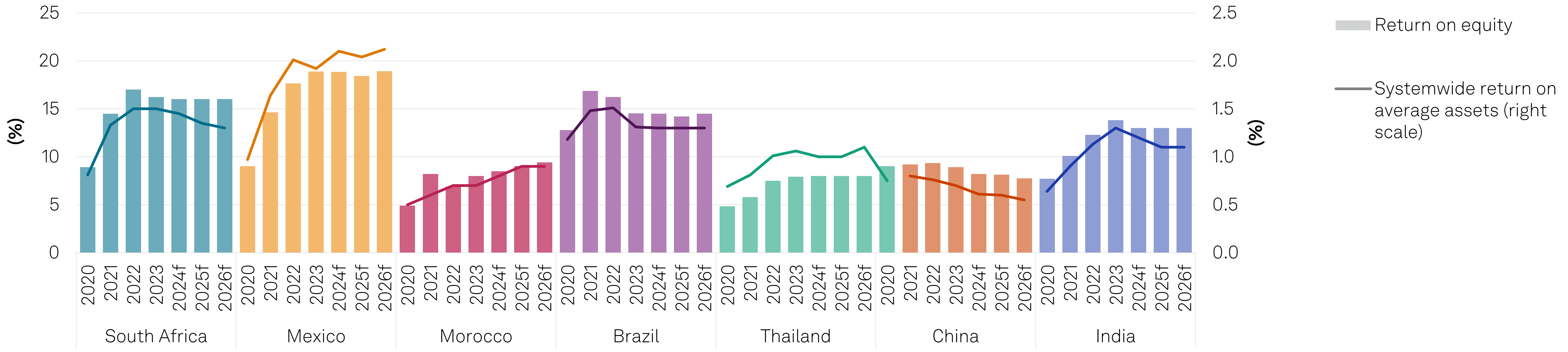
Profitability To Stay Strong Despite Decreasing Interest Rates

- We expect banks' profitability to remain strong supported by higher credit growth, noninterest income, and lower provisioning. We expect a 20-bps net interest margin compression by the end of 2025 relative to 2024 because of the anticipated interest rate cuts.
- Banks' diversified revenue bases, with 41% of their operating revenue stemming from noninterest revenue in 2024, will support their performance in a decreasing interest rate environment.
- We anticipate that the sector will maintain adequate return on equity of 16% and 1.4% of return on assets on average in 2025. This compares well in the broader emerging market context.

Profitability through the cycle compares well with that of most peers

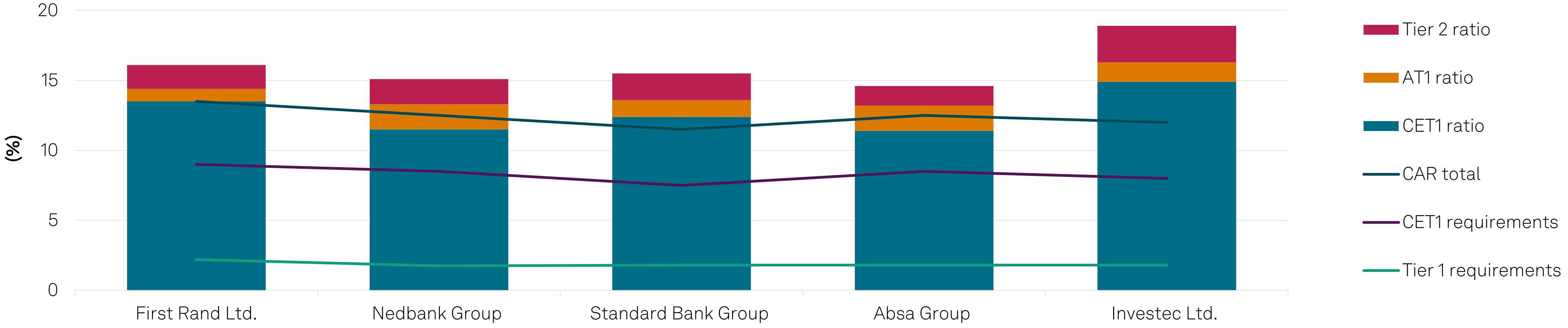


f--Forecast. Source: S&P Global Ratings

Strong Profitability And Quality Of Capital Support Banks' Creditworthiness

- South African banks will continue to maintain robust capital buffers against the minimum requirements, with an average common equity tier 1 buffer of 400 bps. Strong profitability is expected to support stable capitalization levels despite generous dividend payout ratios averaging 50%-60%.
- Quality of capital is good, with a modest share of hybrid instruments. Additional tier 1 capital accounted for just under 10% of banks' total-adjusted capital in financial year 2023.
- Banks are expected to start issuing first loss after capital (Flac) instruments in 2026, a one-year delay from the previously expected start date of 2025. They have three years to ramp up issuance to achieve 60% of Flac requirements and six years to fully meet the requirements.

Banks operate with ample regulatory capital buffers

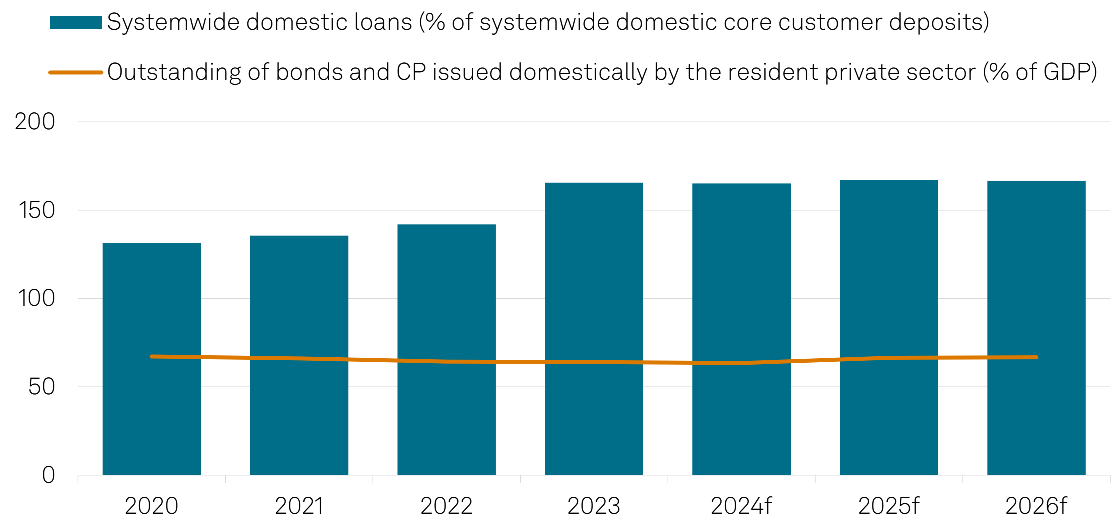


Source: Banks' Pillar III reports, Sept. 30, 2024 (except FirstRand Ltd. & Investec, which is as of June 30, 2024). CET1 1 (common equity tier 1), AT1 (additional tier 1), CAR (capital adequacy ratio).

The Closed Rand System And Broad And Deep Capital Markets Supports Funding

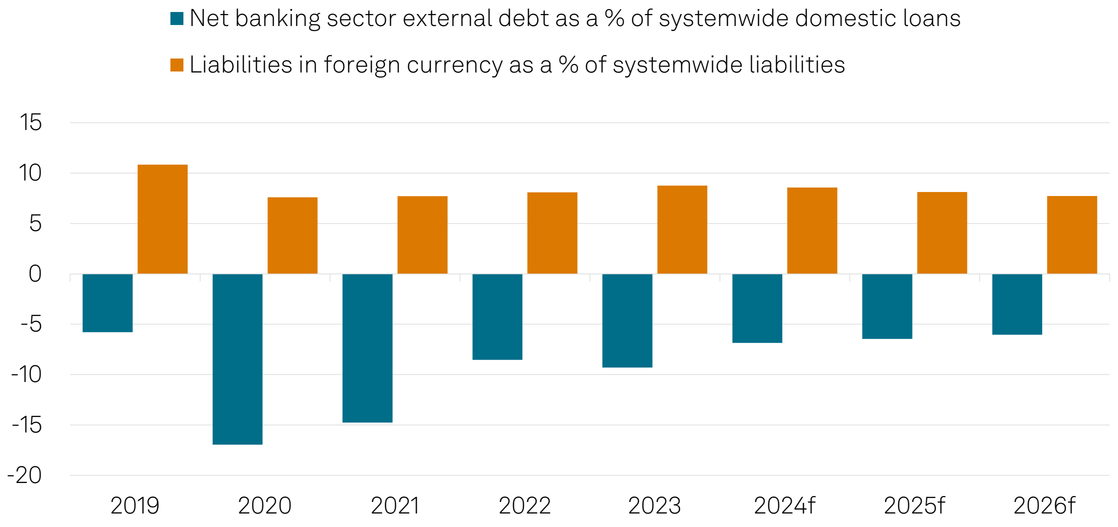
- Banks source local-currency deposits from nonbank financial institutions (30%-40% of their funding base) because professional money managers dominate contractual savings. However, in a hypothetical crisis, resident exchange controls mitigate banks' exposure to institutional funding and strengthen the stability of domestic deposits.
- South Africa has broad and deep capital markets, providing an alternative source of funding for banks.
- Major banks are not exposed to external refinancing risks, but the financial sector remains vulnerable to global investor sentiment and external financing conditions, which are tied to U.S. interest rates and a prolonged stay on the FATF grey list.

Reliance on stable short-term and wholesale funding



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

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



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

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Sovereign Creditworthiness Constrains Most Bank Ratings

South African banks: Ratings and outlooks

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

SACP--Stand-alone credit profile. ICR--Issuer credit rating. Data as of Jan. 13, 2025. Source: S&P Global Ratings.

- Top tier South African banks' stand-alone credit profiles (SACPs) remain at 'bbb-', but the 'BB-' sovereign foreign currency rating constrains the issuer credit ratings.
- We do not rate financial institutions in South Africa above the level of the foreign currency sovereign ratings, given the direct and indirect impact that sovereign distress would have on domestic banks' operations.
- The banks' SACPs reflect our expectation that their financial performance will be resilient through the cycle. They boast a long track record of sound asset quality and robust regulatory capital buffers, helping them withstand economic downturns.
- We have a positive outlook on most banks' ratings, which reflects the outlook on South Africa. National scale ratings do not have outlooks.
- All else equal, our ratings on banks will move in tandem with the sovereign ratings. A sovereign upgrade would arise if an improving track record of effective reforms resulted in the structural strengthening of economic growth and reduced government debt and contingent liabilities.

Related Research

- South African Banks Outlooks Revised To Positive On Similar Sovereign Action, Nov. 20, 2024
- South Africa Outlook Revised To Positive On Improved Reform And Growth Potential, Nov. 15, 2024
- Global Banks Country-By-Country Outlook 2025: Cautiously Confident, Nov. 14, 2024
- Banking Industry Country Risk Assessment: South Africa, July 31, 2024

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