

# Banking in Sub-Saharan Africa

## The Macroeconomic Context



Montfort Mlachila, Seok Gil Park, and Masafumi Yabara

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## Executive Summary

This paper<sup>1</sup> reviews the macroeconomic performance of sub-Saharan Africa (SSA) in the last decade and examines factors that have supported the region's generally robust growth and challenges going forward. It also assesses the main features and performance of SSA banking systems, while drawing attention to new developments that are taking place in SSA's financial sector. The main findings are as follows:

- SSA's sustained strong growth since the mid-1990s represents a sharp break with previous years; contributory factors include improved macroeconomic policies, trade and regulatory reforms, favorable commodity price trends and new resource discoveries, debt relief, and reduced levels of armed conflict in the region.
- Most SSA economies showed significant resilience during the global economic crisis, with annual growth of regional GDP now running at 5.4 percent per annum. Adverse new developments in the global economy would slow the pace of SSA growth, but the impact, in most countries, should be modest rather than severe.
- Banking systems in most of SSA remain underdeveloped as compared with other developing regions, but gradual financial deepening is under way in most countries. Impediments to development include the small size of national markets, low income levels, and weak creditor rights and judicial enforcement mechanisms.
- Recent developments, such as the expansion of mobile phone-based banking and the spread of pan-African banking groups, have the potential to significantly change the landscape for banking in much of SSA, but they also introduce new challenges for financial regulators.

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<sup>1</sup> This paper was originally prepared for a roundtable event hosted by the Economics Department of the European Investment Bank in Luxembourg on January 23, 2013, and the original version is available at <http://www.eib.org/infocentre/publications/all/economic-report-banking-africa.htm>. The authors greatly appreciate useful comments by Seán Nolan. The authors are also grateful for research assistance provided by Emily Forrest.

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## Introduction

Many countries in sub-Saharan Africa (SSA) have seen accelerated growth for an extended period since the mid-1990s, making a clear break with their long stagnant growth during the previous two decades. That said, the region faces significant challenges over the medium to long term, including reducing poverty, overcoming infrastructure bottlenecks, enhancing productivity and skill levels, and improving the business climate, among others. The banking sector remains underdeveloped in SSA, thus reducing its contribution to growth, although its limited integration with global financial markets helped countries weather adverse effects of the global financial crisis. It is imperative that the banking sector plays a more active role in SSA, in order to achieve sustainable growth led by the private sector.

This paper, building on the recent literature on SSA, discusses the main features of the region's growth and macroeconomic performance in recent years and the outlook for the coming years; it then reviews the main features of SSA banking systems and how they were affected by the global economic crisis, while flagging some factors that could influence financial sector developments in SSA in the period ahead.

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## Economic Growth in Sub-Saharan Africa

### Sub-Saharan Africa's Long-Delayed Growth Spurt

For the first time since the 1970s, a large number of countries in sub-Saharan Africa (SSA) have been enjoying an extended period of strong economic growth.<sup>2</sup> The pickup in growth began in the mid-1990s and has been maintained in good part during the extended global slowdown since 2008 (Figure 1). The acceleration in growth has been accompanied, and facilitated, by a sharp reduction in consumer price inflation: most SSA economies now typically record single-digit annual inflation, although inflation rates remain vulnerable to food and fuel price shocks.<sup>3</sup>

The pace of growth recorded in SSA since the mid-1990s is not exceptional by developing country standards, but it still represents a sharp break with the experience of falling living standards and macroeconomic instability in SSA during the previous two decades—a period when the region fell behind developing countries in other parts of the world. Key factors contributing to this turnaround in economic fortunes include the following<sup>4</sup>:

- *Improved macroeconomic policies*, including the strengthening of fiscal positions, the enhanced emphasis given to containing inflation, the liberalization of exchange controls and unification of exchange rates, and the building of foreign reserves to help contain the impact of adverse external shocks. These shifts in domestic policy were facilitated by international debt relief initiatives, which freed up fiscal space and eased external payments pressures.

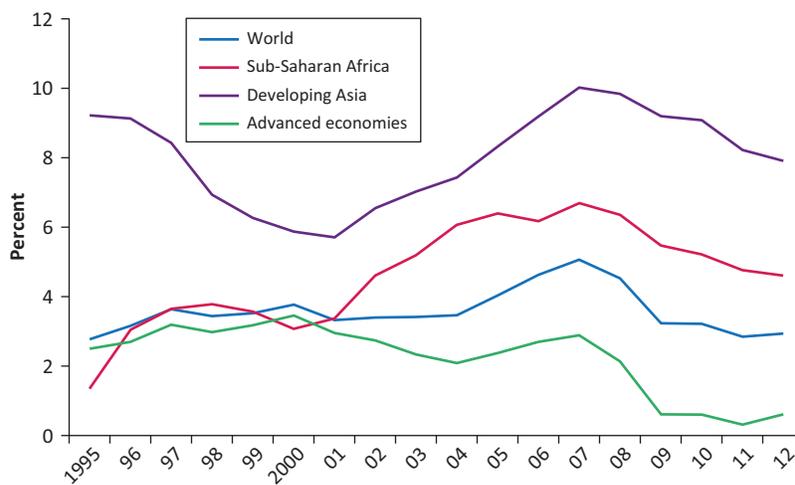
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<sup>2</sup> The definition of SSA used here follows that employed in the IMF's biannual publication, *Regional Economic Outlook: Sub-Saharan Africa*, available at [www.imf.org](http://www.imf.org). Most of the data cited excludes South Sudan, now included in SSA, due to lack of data availability.

<sup>3</sup> Twelve-month inflation over the course of 2012 is set to be in single digits in 36 of SSA's 45 economies, exceeding 20 percent in only one case.

<sup>4</sup> For elaboration on these issues, see IMF (2008), chapter 2, and IMF (2012b), chapter 1.

Figure 1. Real GDP Growth (4-year moving average)



Source: IMF, World Economic Outlook database.

- *Trade and regulatory reforms, with an associated scaling back of direct state participation in economic activity.* Trade liberalization and regulatory reforms increased domestic competition and reduced inefficiencies, as did the privatization or commercialization of poorly managed state enterprises. But there is still much more that can be done to improve the business climate in many countries, and intraregional trade, though rising, remains at modest levels.
- *Increased capital spending,* in both natural resource and other sectors, helped by an increase in domestic savings rates. The infrastructure deficit still remains very wide in many countries, acting as an important bottleneck to growth—but also providing opportunities for boosting output and productivity levels through appropriately selected and effectively executed investment projects.
- *Improvements in institutional capacity.* Although most indicators of good governance still show SSA lagging behind the rest of the world, the region is making up ground in some aspects, including in regard to public voice and accountability. And stronger governance has been an important feature of fast-growing SSA economies that are not resource-rich.
- *Favorable commodity price trends and new resource discoveries,* which have provided an important stimulus to growth in many mineral-rich economies. But growth has also been strong in numerous non-resource-rich countries whose terms of trade were adversely affected by surging oil prices; examples include Burkina Faso, Ethiopia, Mozambique, Rwanda, and Uganda.

- *Reduced armed conflict and social turmoil.* The incidence of armed conflict and civil turmoil has declined significantly over the past two decades, although security tensions still pose threats to growth in several countries.
- *Improved financial sector performance.* Although financial systems in most countries remain poorly developed relative to other regions, there has been significant financial deepening in most countries over time. Moreover, the incidence of systemic banking crises in SSA has come to a near halt since the mid-1990s (see Chapter 2, “The Banking Systems of Sub-Saharan Africa”).

In discussing trends for SSA as a whole, it is important to keep in mind the striking diversity of the region, whose 45 countries vary markedly in terms of population size, income levels, resource endowments, access to international transportation corridors, and the extent of sociopolitical stability.<sup>5</sup> These diverse conditions have had significant effects on the pace of growth over the past two decades—although, in some cases (e.g., landlocked versus coastal, resource-rich versus non-resource-rich), the impact on growth has been less marked than one might have expected. Specific points worth noting include the following:

- South Africa, the region’s largest and most developed economy, has grown at a significantly slower pace than the region as a whole, reflecting both post-apartheid challenges and the reduced opportunity for “catch-up” given already high productivity levels.
- Countries affected by internal conflict and enfeebled governments (“fragile states”) have done much less well than others in the region, typically experiencing stagnant or falling living standards (e.g., Côte d’Ivoire, Democratic Republic of the Congo).<sup>6</sup>
- Leaving aside oil exporters, low-income countries not classified as fragile have experienced above-average growth by regional standards, averaging annual growth of 5.5 percent during 1995–2010, as compared with 3.4 percent for other non-oil SSA economies and 1.8 percent for fragile states.

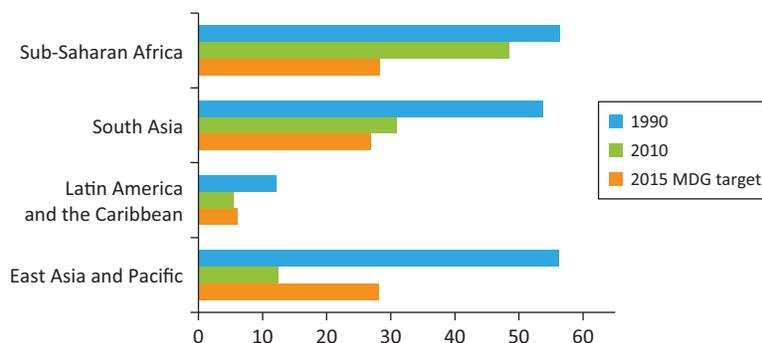
Finally, although output growth across most of the region has been strong since the mid-1990s, this growth spurt, in many cases, took place from a very low base in terms of income and productivity levels, in part reflecting dismal economic performance during the previous two decades. Per capita income in most SSA countries remains very low by international standards, and poverty headcounts, although falling, are higher than in other developing regions of

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<sup>5</sup> Note that South Africa and Nigeria together account for about one-half of SSA GDP, thus playing a very important role in influencing the evolution of the macroeconomic aggregates for the region as a whole.

<sup>6</sup> For a listing of fragile states, based on the World Bank’s IDA Resource Allocation Index, see IMF (2012c).

**Figure 2. Sub-Saharan Africa: Headcount Poverty Index Using the \$1.25 a Day Poverty Line**



Source: World Bank, World Development Indicators.

Note: MDG = the United Nation's Millennium Development Goals.

the world (Figure 2).<sup>7</sup> Much has been achieved in recent years, but strong growth will be needed for many years to come if poverty levels are to be reduced decisively in SSA.

## Recent Macroeconomic Developments and Near-Term Outlook

The onset of the global economic crisis in late-2008 saw a marked slowdown in the pace of global economic growth, most notably in the advanced economies. Global growth, running at about 5 percent per annum in the precrisis period, fell to below 3 percent per annum during 2009–12, with an absolute decline in output recorded in 2009. The near-term outlook is for a marginal pickup in activity in 2013, with growth on the order of 3.3 percent for the global economy and some 1.2 percent in the advanced economies, with significant downside risks still remaining (Table 1).

Most SSA economies (Figure 3) have shown significant resilience in the face of these adverse external developments. Growth slowed noticeably in the region in 2009, but there were marked differences between the experience of many middle-income countries (notably South Africa), where closer integration into international markets resulted in a sharp adverse shock to GDP, and non-oil, low-income countries, where the slowdown was quite modest. Oil exporters were hit by the sharp drop in world prices in 2009, although growth was sustained in Nigeria (despite the adverse effects of the 2012 floods) by the use of sizable oil revenue savings accumulated in previous years to support public spending levels and non-oil activity. Since 2009, growth has been strong—albeit below precrisis levels—across most of the

<sup>7</sup> Twenty-five of the thirty-four countries now classified as “low income” by the World Bank are in SSA.

Table 1. Sub-Saharan Africa: Macroeconomic Indicators

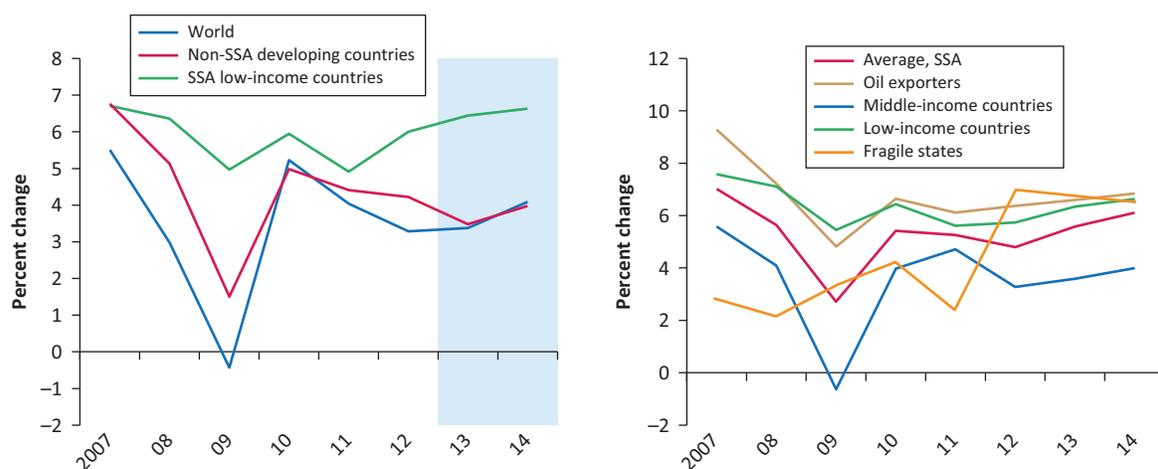
	2004–08	2009	2010	2011	2012	2013	2014
Real GDP growth			(Percentage change)				
Sub-Saharan Africa (Total)	6.4	2.7	5.4	5.3	5.1	5.4	5.7
<i>Of which:</i>							
Oil-exporting countries	8.6	4.8	6.6	6.1	6.4	6.6	6.8
Middle-income countries <sup>1</sup>	5.0	-0.6	4.0	4.7	3.3	3.6	4.0
<i>Of which:</i> South Africa	4.9	-1.5	3.1	3.5	2.5	2.8	3.3
Low-income countries <sup>1</sup>	7.3	5.5	6.4	5.6	5.7	6.3	6.6
Fragile states	2.5	3.3	4.2	2.4	7.0	6.8	6.5
Memo item: World GDP growth	4.6	-0.6	5.2	4.0	3.2	3.3	4.0
Inflation, end-of-period	8.8	8.6	7.2	10.1	7.9	6.9	5.8
			(Percent of GDP)				
Fiscal balance	1.9	-5.6	-3.9	-1.3	-1.7	-2.7	-2.8
<i>Of which:</i> Excluding oil exporters	-0.7	-4.8	-4.6	-3.7	-4.5	-4.1	-3.2
Current account balance	0.6	-3.1	-1.3	-1.7	-2.8	-3.5	-4.1
<i>Of which:</i> Excluding oil exporters	-5.1	-5.3	-4.7	-5.0	-7.9	-7.8	-7.9
			(Months of imports)				
Reserves coverage	4.8	5.1	4.2	4.5	4.7	4.9	5.1

Source: IMF, World Economic Indicator database.

Note: Excludes South Sudan.

<sup>1</sup>Excluding fragile states.

Figure 3. Sub-Saharan Africa and Other World Regions: Real GDP Growth, 2007–13



Source: IMF, World Economic Outlook database.

Note: SSA = sub-Saharan Africa.

region, with the exceptions including South Africa, where sluggish demand growth in Europe has contributed to a muted recovery, and a number of politically fragile states.

What explains the resilience of economic activity in SSA during the crisis, a marked contrast with the region's experience in previous global downturns? Contributory factors include the following:

- The buildup of solid fiscal positions in the precrisis period allowed many countries to support domestic demand by maintaining or increasing public spending levels; declines in budget revenues were instead reflected in higher fiscal deficits.
- Key prices for SSA commodity exports, including oil, have remained at relatively high levels since 2010, helped by continued strong demand from Asia.<sup>8</sup>
- Supply-side factors have been generally favorable—natural resource discoveries, continued agricultural output growth, dynamism in selected service activities—although adverse climate shocks have seen sharp fluctuations in food production in the Sahel and eastern Africa.
- SSA financial systems were relatively insulated from the global financial turmoil (see Chapter 2, “The Banking Systems of Sub-Saharan Africa”), ensuring that few countries were significantly affected by disruptions to credit availability.

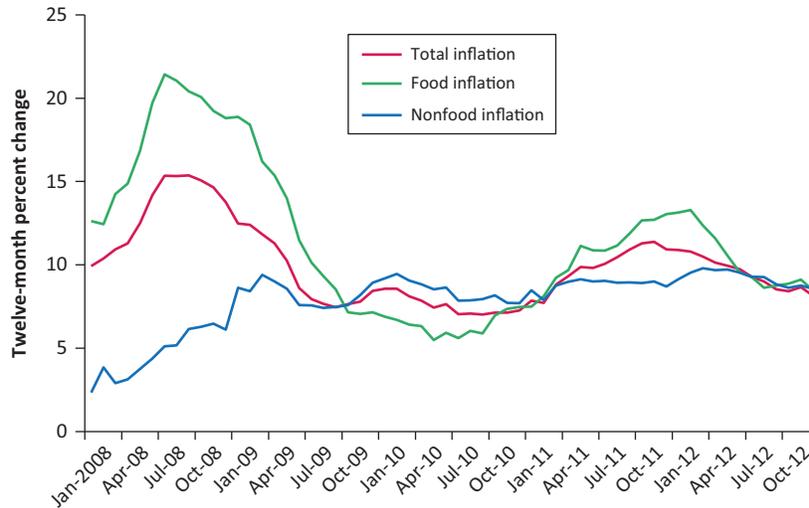
Inflation in SSA has shown significant volatility since 2008, mainly due to movements in world food and fuel price levels, although domestic food supply conditions played an important contributory role in some subregions (Figure 4). The volatility has been most marked in low-income countries, where food and fuel products account for a larger share of the consumer price index and where central banks, in many cases, have more limited capacity to influence the pace of inflation. Of late, easing price pressures in global commodity markets, coupled with the impact of monetary tightening (notably in East Africa) and recovery from drought in the Sahel and the Horn of Africa, have contributed to a significant slowing of inflation, which declined to a (weighted) average rate of below 8 percent as of end-2012, with some further easing expected in 2013.

Fiscal positions have weakened across most of SSA since 2008, reflecting policy decisions to support economic activity by maintaining public spending levels notwithstanding revenue erosion and, in several cases, to take advantage

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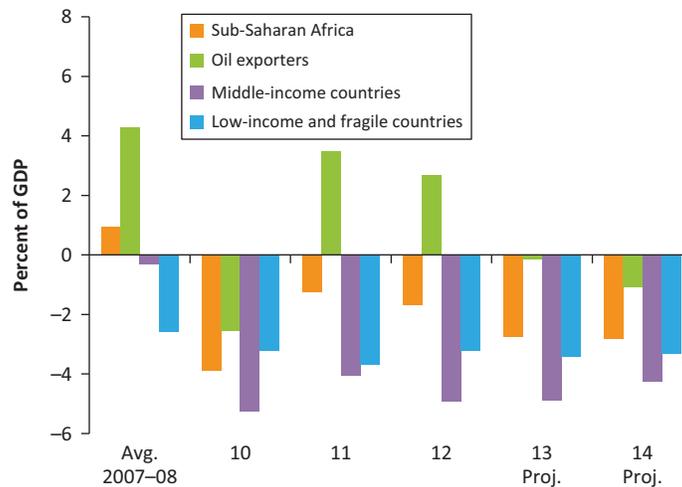
<sup>8</sup> For discussion of the reorientation of SSA trade and investment toward nontraditional partners, most notably China, see IMF (2011), chapter 3.

**Figure 4. Sub-Saharan Africa: Food and Nonfood Inflation, January 2008–December 2012**



Sources: IMF, African Department database; and IMF, *International Financial Statistics*.

**Figure 5. Sub-Saharan Africa: Overall Fiscal Balance, 2007–14**



Source: IMF, World Economic Outlook database.

Note: Excludes South Sudan.

of post-debt relief borrowing space to finance new public investment projects (Figure 5). Oil exporters have seen a return to fiscal surpluses since 2010, helped by stronger world prices, but significant fiscal deficits remain the norm in the other country groupings. Sluggish economic recovery continues to constrain the scope for fiscal consolidation in South Africa, whereas

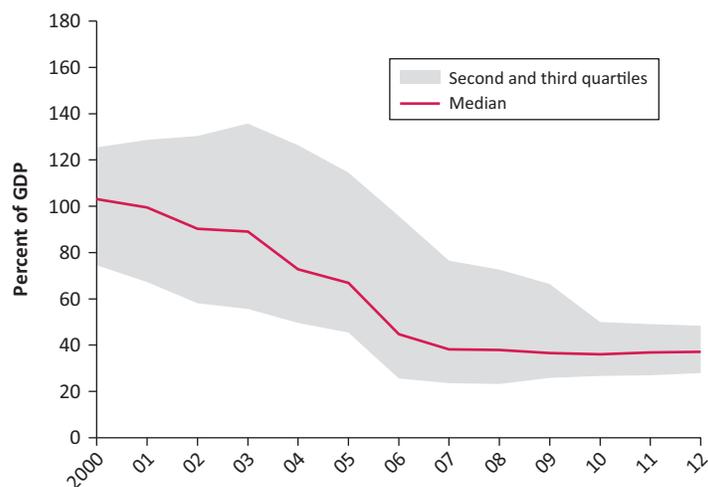
political factors (e.g., resistance to scaling back energy subsidies) and public investment needs are constraining fiscal tightening in many other countries.

The impact of larger fiscal deficits on public debt burdens across the region as a whole has been limited (Figure 6), although experience at the country level has been varied. Debt burdens in several middle-income countries have risen significantly since 2008, given the conjunction of larger deficits and slower growth. South Africa’s public debt rose from 28 percent of GDP at end-2008 to 42 percent of GDP by end-2012. For low-income countries, debt burdens have fallen sharply in several cases (such as Côte d’Ivoire, Democratic Republic of the Congo, and Liberia) with the completion of multilateral debt relief processes, but have drifted upward since 2008 in a number of post-debt relief cases (such as Tanzania and Uganda).

The weak external environment since 2008 has adversely affected exports from the region, contributing to a weakening of external current account positions in many countries, although rising investment levels and associated imports of capital goods have also made an important contribution (Figure 7). Service exports and remittances have generally remained quite strong across the region. Helped by ongoing capital inflows, foreign reserve levels have risen in absolute terms in most SSA countries, but import coverage ratios (foreign reserves divided by monthly imports of goods and services) have typically fallen, given fast-growing import levels.

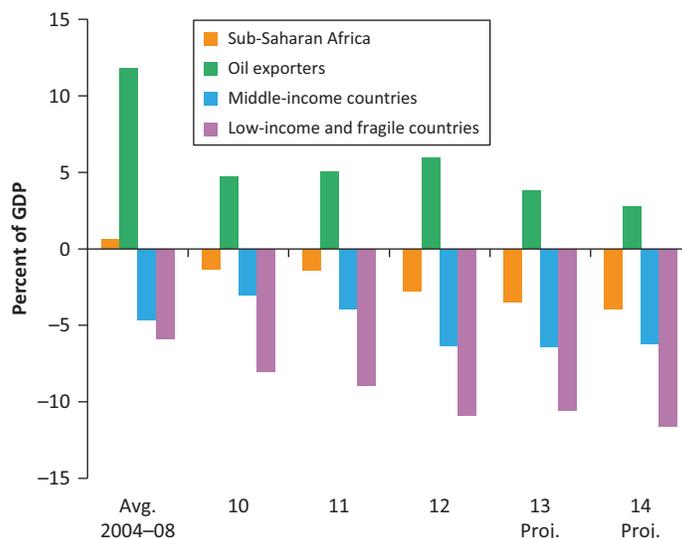
Looking ahead to 2013 and 2014, a moderate acceleration of growth at about 5.5 percent is expected for the whole SSA, with middle-income countries

**Figure 6. Sub-Saharan Africa: Government Debt Ratios, 2000–12**



Source: IMF, World Economic Outlook database.

Figure 7. External Current Account Balance, 2004–14



Source: IMF, World Economic Outlook database.

continuing to expand at a slower pace than other country groupings. The main risks to the outlook come from the external environment, although domestic political and security risks pose specific threats in several countries (as highlighted by developments in Mali and, more recently, the Central African Republic). Further weakening of the global economy would undoubtedly have an adverse effect on prospects for SSA—but the experience since 2008 suggests that, absent some major destabilizing shock, the impact on regional growth should be moderate rather than dramatic.

## Longer-Term Challenges: Diversification and Structural Transformation

The strong growth recorded in much of SSA since the mid-1990s has been based in part on the gathering of “low-hanging fruit”: reversing the policy errors of the past, containing or recovering from internal conflict, taking advantage of expanded aid flows, and debt relief. But progress in achieving significant structural transformation and diversification of production and exports has been modest.<sup>9</sup> Productivity growth in agriculture has been high in relatively few countries. Manufacturing sectors—the driver of growth in most versions of the “Asian miracle”—have shown dynamism in very few cases. Service sector growth has seen the expansion of high productivity sectors (such as telecommunications) but also of low-productivity informal sector activities.

<sup>9</sup> For further discussion of the issue of structural transformation, see IMF (2012c), chapter 3.

Demographic trends point to a surge in the working-age population in the region in the coming years—a stimulus for growth, in the form of expanded labor supply, but also a challenge to policymakers to create the appropriate environment for rapid job creation. What are the prospects for meeting this challenge?

On the positive side:

- The price outlook for SSA's main commodity exports is broadly favorable, given expectations of continued strong growth in China and other large emerging market economies—although “rebalancing” of demand within these countries could adversely affect commodities, such as copper, that are closely linked to construction.
- Exports of nonrenewable natural resources appear set to rise in many countries, given new discoveries in both established producers (such as Angola) and new producers (such as Mozambique and Tanzania).
- Crop yields in most SSA countries are very low by international standards, providing opportunities to boost agricultural productivity through effective water management, expanded use of fertilizers, and improved extension services.
- Rising wage levels in China and other established producers of labor-intensive manufactures in the coming years are likely to push large numbers of jobs offshore, including to competitive low-wage economies in SSA.

But taking full advantage of these opportunities and achieving broad-based inclusive growth will require that governments deliver in several key areas<sup>10</sup>:

- Infrastructure deficits, notably in electricity provision and transportation, will need to be overcome. Financing the required investments will need a mix of fiscal measures to free up budgetary resources and judicious external borrowing, preferably on concessional terms, whereas government capacity in such areas as project appraisal and management will need strengthening if investments are to deliver the desired results.
- Skill/productivity levels will need to be improved, including through better education and basic health services; this in turn will require both additional budgetary resources and improvements in the quality of service delivery.

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<sup>10</sup> For an interesting recent discussion of these challenges, placing emphasis on the importance of policy reforms to improve public service delivery, see Devarajan and Fengler (2012), echoed in World Bank (2012).

- Promoting agricultural development, key to ensuring growth is inclusive, will require policy initiatives to improve water management and access to fertilizers, new seeds, and knowledge—pointing to the need to build capacity to deliver such services.
- Private sector expansion at a pace needed to absorb the labor force in higher productivity jobs will require significant improvements in the business climate, including further deregulation and active measures to strengthen judicial systems, professionalize tax administration, and appropriately target measures to enhance access to finance in a sustainable manner for small to mid-sized enterprises.

Of course, maintaining the track record of sounder macroeconomic management, greater reliance on markets over administrative controls, and expanded integration with the international economy will remain essential if the current pace of growth is to be sustained. Finally, addressing the special challenges faced in fragile states, where development partners have an important supporting role to play, is an imperative if SSA's growth is to be truly inclusive, in the sense of delivering growth in living standards across the region as a whole.

## The Banking Systems of Sub-Saharan Africa

### Stylized Features

Financial sectors are generally underdeveloped in sub-Saharan Africa (SSA), with banking systems accounting for the preponderance of financial sector assets and activities.<sup>11</sup> Helped by reform efforts (Kasekende, 2010), the depth and coverage of financial systems—as measured by the ratios of broad money (M2) and private sector credit to GDP—have been gradually increasing over the past decade, albeit from a low base (Figure 8, Panels A and B). But the scale of financial intermediation in the region remains significantly lower than in other developing regions of the world, whereas access to financial services is also relatively low, reflecting a combination of low income levels, small absolute size, and infrastructure weaknesses (Figure 8, Panel C). Confirming these observations, a recent World Bank study notes that SSA typically scores lowest among the world's developing subregions on various dimensions of financial development, such as depth and efficiency of financial institutions (Čihák et al., 2012).

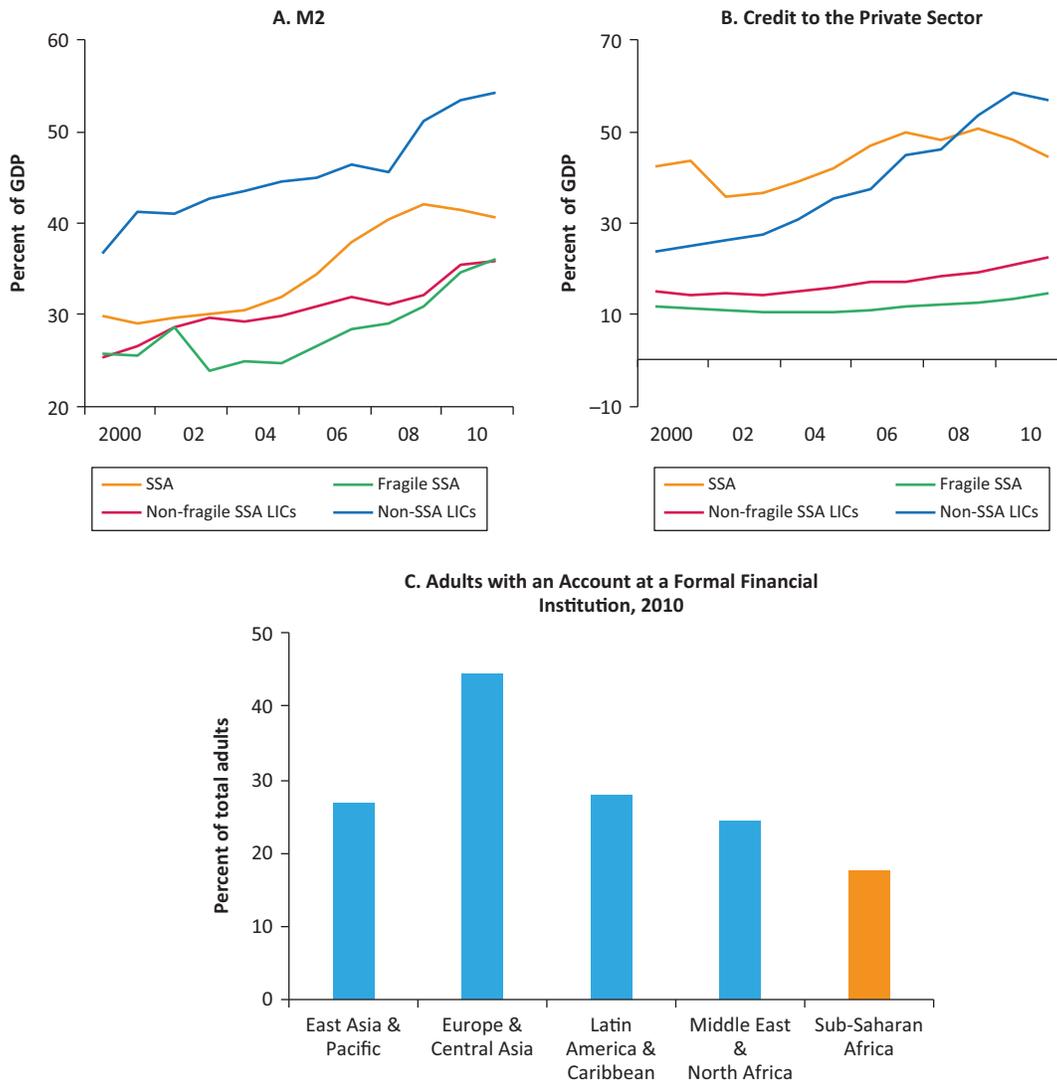
Most banking systems in SSA are small in absolute and relative size.<sup>12</sup> They are characterized by low loan-to-deposit ratios (Figure 9, Panel A) and, as a corollary, large shares of assets held in the form of government securities and liquid assets. Lending is mainly short-term in nature, with about 60 percent of loans having a maturity of less than one year. Market structures are typically oligopolistic, as indicated by the high share of total assets accounted for by the three largest banks (Panel B), which tends to constrain the intensity of competition. SSA banks are typically high-cost operations

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<sup>11</sup> The discussion here focuses primarily on banking and financial systems in SSA's low-income countries. The level of financial sector development is significantly more advanced in a number of middle-income countries in the region—including South Africa, its smaller partner countries in the Southern African Customs Union, and Mauritius.

<sup>12</sup> For a fuller discussion of SSA banking systems, see IMF (2006), chapter 4, and Beck et al. (2011), chapter 2.

Figure 8. Financial Depth and Access to Financial Services

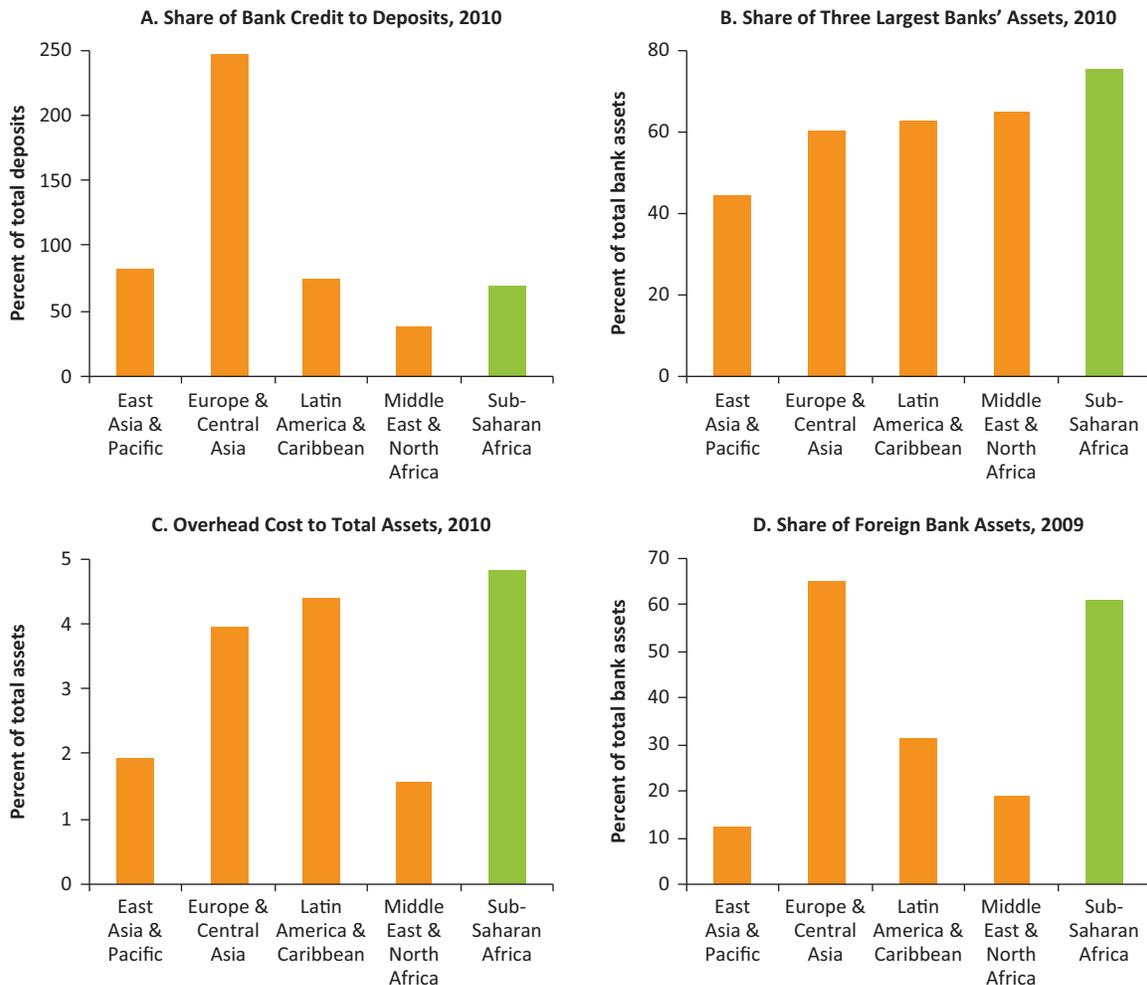


Source: World Bank, World Development Indicators and Global Financial Development Database.

Note: Zimbabwe is excluded from Panels A and B. High-income countries are excluded from Panel C. LICs = low-income countries; SSA = sub-Saharan Africa.

(Panel C), notwithstanding the concentration of branches in a small number of urban centers. As a corollary, interest rate spreads and service fee levels are comparatively high. Foreign banks play a key role in SSA banking systems (Panel D), having recovered market share as banking systems were restructured and state banks privatized under reform programs in the 1980s and 1990s. Finally, banking systems are characterized by modest reach in terms of providing financial services to the population; the share of the population that is unbanked is very large, with small and medium enterprises typically tightly constrained in their access to any form of credit.

Figure 9. Commercial Bank Indicators



Source: World Bank, Global Financial Development Database.

Note: High-income countries are excluded.

These stylized features of SSA banking systems reflect a combination of factors, including the small absolute size of banks and banking systems; low income levels, large informal sectors, and low levels of financial literacy; weak contractual frameworks for banking activities, including weak creditor rights and judicial enforcement mechanisms; and political risk (Andrianaivo and Yartey, 2009; Beck et al., 2011; McDonald and Schumacher, 2007).

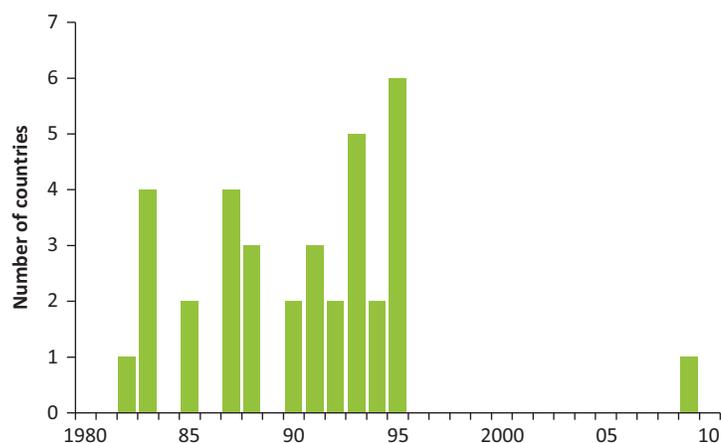
Other features that warrant mention include the following:

- In many countries, banking systems are characterized by significant excess liquidity, reflecting the scarcity of what banks deem to be credit-worthy borrowers. In such circumstances, monetary policy is relatively

ineffective as a tool for influencing lending conditions and the broader monetary aggregates (and, by extension, economic activity and inflation).

- Following reform programs introduced in the 1980s and 1990s, banks have moved to strengthen their capital bases and improve risk management (Mlambo, Kasekende, and Murinde, 2012). In addition, the reduced role of state-owned banks or, in some cases, their reorientation toward operating on commercial lines has contributed to the strengthening of banking systems' financial health. As a result, the incidence of systemic banking crises—a relatively common event in SSA in the 1980s and early 1990s—has declined markedly, with only one major crisis recorded since 1995 (Figure 10).
- African banking systems rely on the domestic economy for their funding base, with funding from nonresidents a very minor source of funds in almost all cases (Figure 11). This is in many ways a demand-side phenomenon: as noted, the limited supply of what banks deem to be credit-worthy borrowers is a binding constraint on the growth of lending activity in most countries.
- Even controlling for the role of income levels, the economic importance of banking systems in SSA economies varies significantly across countries—reflecting differences not merely in public policies but also in economic size, population density, legal code (common versus civil law), resource dependence, and history.<sup>13</sup>

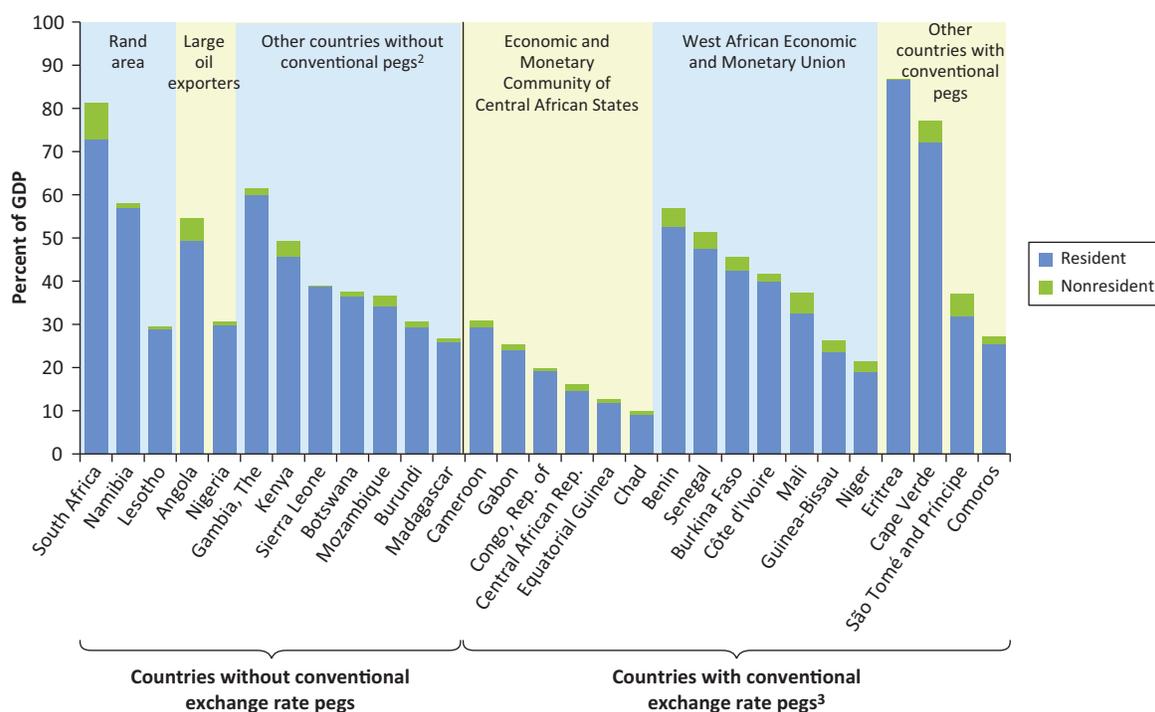
**Figure 10. Sub-Saharan Africa: Systemic Banking Crises, 1980–2010**



Sources: Laeven and Valencia (2008); and IMF staff estimates.

<sup>13</sup> See Beck et al. (2011), chapter 2.

Figure 11. Sub-Saharan Africa: Banking System Funding, June 2011<sup>1</sup>



Source: IMF, Statistics Department, International Financial Statistics (IFS) database.

<sup>1</sup>Includes banking system data from disaggregated information submitted to the IMF for the preparation of monetary statistics and the compilation of summary data presented in the IFS. About half the sample is reporting under the new standardized format.

<sup>2</sup>Includes all sub-Saharan Africa countries whose exchange rate regime is classified as either a conventional peg or a currency board, according to the IMF's 2011 *Annual Report on Exchange Arrangements and Exchange Restrictions*.

<sup>3</sup>Excludes countries in the rand area, which in the chart are grouped along with South Africa for analytical purposes.

## Banking Sector Developments during the Global Economic Crisis

SSA banking systems were well positioned to handle the financial turmoil created by the onset of the global financial crisis in 2008, given low leverage, generally healthy capitalization levels, ample liquidity, little reliance on external funding, and little if any exposure to toxic financial assets.<sup>14</sup> Systemic financial stress was recorded only in Nigeria, where the flight of foreign portfolio capital contributed to the collapse of a stock market bubble that had been fueled, in good part, by margin lending by banks to equity investors.<sup>15</sup> The Central Bank

<sup>14</sup> For further discussion of the issues covered here, see IMF (2012b), chapter 2.

<sup>15</sup> Other factors contributing to the difficulties faced by several Nigerian banks included fraud and mismanagement, poor internal governance, and weak financial disclosure practices.

of Nigeria eventually took control of 10 banks, collectively accounting for one-third of banking system assets, which had suffered large losses on their loan portfolios. Some major international banks with a significant African footprint experienced stresses during the crisis period, but the spillover impact on their (largely self-funded) African operations was very modest.

Banking systems in SSA, in the main, came under pressure indirectly via international trade linkages, as the global economic downturn fed into reduced exports and slower domestic economic growth, in turn adversely affecting borrowers and contributing to rising levels of nonperforming loans (NPLs). These effects were more marked in countries where income growth slowed substantially, as happened in several middle-income countries, but also occurred in some countries where aggregate growth remained robust throughout, such as Zambia. Also, sharp exchange rate depreciations in a number of countries during 2008–09 created difficulties for bank clients with significant net open foreign exchange positions.

The impact of these developments on financial sector soundness in the region was relatively modest in the aggregate, although banks in some countries experienced significant adverse, albeit not destabilizing, shocks (e.g., Liberia, Zambia). Available financial soundness indicators point to a modest decline in reported capital adequacy ratios in 2010, with rising NPLs taking a toll on profitability (Figure 12).<sup>16</sup> There was some recovery in capital adequacy ratios in 2011, along with a reported drop in the NPL ratio—but the latter may in part reflect the impact of loan write-offs and rapid expansion of the loan portfolio itself. Although bank profitability levels in the region have typically been quite high, the data point to a trend decline in returns on assets and on equity over the past several years, with 2009, unsurprisingly, being a particularly bad year.

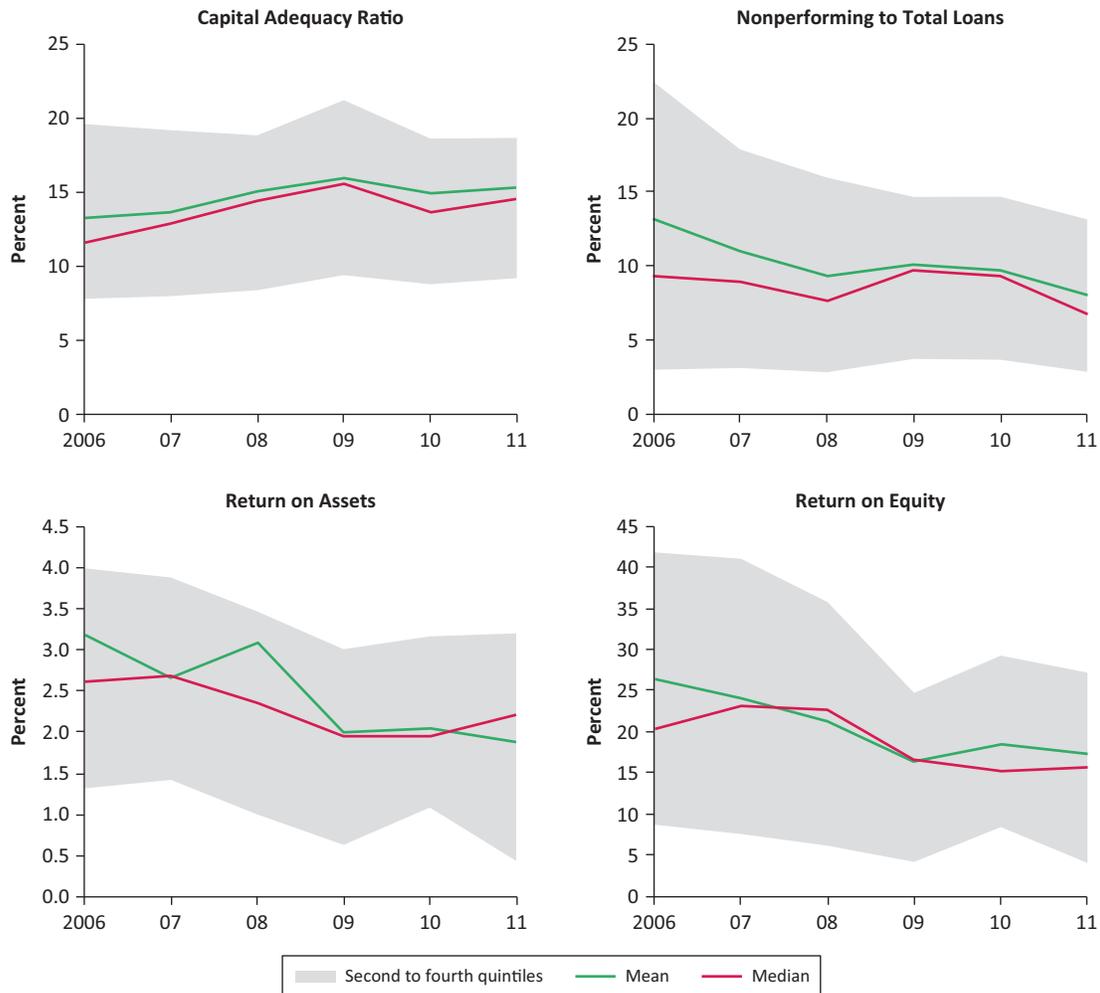
Looking ahead, the relatively sluggish global economy and ongoing European financial stresses should not, absent seismic shocks, pose major risks for SSA banking systems in light of the experience during 2008–12.<sup>17</sup> Homegrown risks may prove to be a greater cause of concern, especially in those countries that have been experiencing sustained rapid growth in private sector credit. Nigeria's experience in 2009 provides a good example of how the conjunction of governance weaknesses and a sluggish supervisory response to macro-financial developments can produce a full-blown banking system crisis—one that, even if well managed, is likely to impose significant economic costs and disruption.

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<sup>16</sup> The data reported in Figure 12 are of uneven quality; caution is warranted in interpreting trends.

<sup>17</sup> Intensified pressures on Portuguese-domiciled banks could have adverse spillover effects on banking systems in some Lusophone countries. Reliance on domestic funding sources should provide solid protection for most subsidiaries, although supervisors would need to be proactive in tracking developments.

Figure 12. Sub-Saharan Africa: Financial Stability Indicators (Selected countries)<sup>1</sup>



Sources: IMF, African department database; and country authorities.

<sup>1</sup>The official definition of financial soundness indicators varies by country. The sample includes up to 33 of the 45 countries in sub-Saharan Africa.

## SSA Banking Systems: New Forces at Work

Financial systems expand and evolve as the economies they serve develop over time, with the pace of change subject to influence by targeted policy reforms (e.g., support for payment system infrastructure, improvements in creditor rights). We note briefly here new forces at work in SSA that can help accelerate the pace of financial sector development, expand its reach to new segments of the population, and enhance its contribution to economic growth.

## **Evolving Information and Communication Technologies**

The evolution of information and communication technologies has already shown its potential to widen access to financial services in SSA, especially for rural populations. The rapid diffusion of mobile phone technology has produced “real-time” connectivity between cities and hitherto remote rural areas and provided the infrastructure for new payment systems and basic banking services. The recent experience of Kenya, with the rapid expansion of its mobile phone–based payments system, M-PESA, is often cited as an illustration of how new information and communication technologies can produce striking financial innovation.<sup>18</sup> Launched in 2007, M-PESA enables customers to transfer money quickly and cheaply without needing to have a (costly) bank account; money can be uploaded and withdrawn from a network of agents and used for transfers, bill payments, and airtime purchase. More recently, a partnership between the leading telecommunications company and a commercial bank has seen the introduction of M-kesho, mobile phone–based deposit accounts, providing a financial savings instrument with low transactions costs to customers who do not have physical access to a bank. By now, more than 80 percent of adult Kenyans have made use of mobile money services (Fengler, 2012), and mobile money is gaining popularity in neighboring countries such as Uganda and Tanzania, albeit at a more gradual pace. The development of mobile payments systems in some other subregions, such as Central Africa, has been less successful, pointing to the important role of “enabling” conditions in determining the impact of financial innovation.

The growth of cell phone–based banking provides opportunities for banks to expand their operational reach while also introducing new competitors in the form of the telecommunications companies. The benefits from these developments to consumers have been sizable, but they also pose challenges from both a financial stability and consumer protection perspective. It is noteworthy in this context that the Central Bank of Kenya was involved from the outset in the development of M-PESA, and hence it had both the capability and knowledge to oversee developments and, where warranted, facilitate system development via the modification of preexisting regulations (e.g., enabling third parties [agents] to conduct banking activities on behalf of financial institutions).

## **Pan-African Banking Groups**

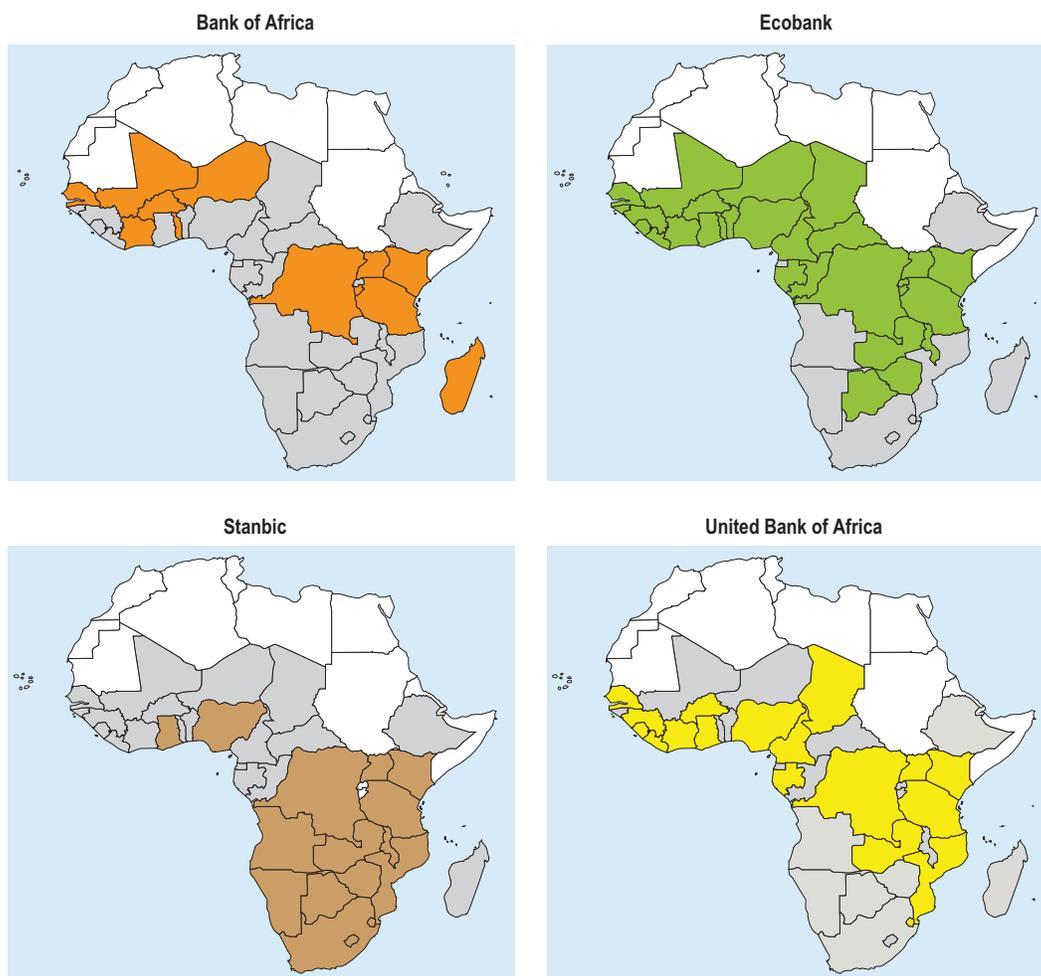
A striking feature of SSA banking developments in recent years has been the rapid expansion across borders of pan-African banking groups, most often

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<sup>18</sup> For a fuller discussion of the M-PESA experience and related references, see IMF (2012a), chapter 1.

based in Nigeria and South Africa, the region’s two largest economies.<sup>19</sup> By now, at least nine SSA-domiciled financial groups operate banks in seven or more other SSA countries; Ecobank, domiciled in Togo but with close to half of its business originating in Nigeria, has the broadest footprint in the region, with a presence in some 33 of the 45 countries and is featured as one of the five largest banks in 18 countries. Several South African and Nigerian banking groups have also expanded aggressively in the region, including Standard Bank/Stanbic (South Africa) and United Bank for Africa (Nigeria). The Bank of Africa group, originally established in Mali, currently operates in 11 SSA countries. Collectively, these four banking groups are managing more than 30 percent of deposits in at least 13 SSA countries (Figure 13).

**Figure 13. Sub-Saharan Africa: Selected Pan-African Banking Groups, June 2011**



Source: IMF, African Department database.

<sup>19</sup> For further discussion of the growth of pan-African banks, and the supervisory challenges posed by this development, see IMF (2012b), chapter 2.

The spread of pan-African groups has enhanced competition in national banking systems and facilitated the spread of new technologies: regional banking groups may be better positioned to compete in the general banking market (as distinct from the “high end” of multinational companies and high-wealth individuals) than non-African-domiciled banks, given their experience in serving this wider market in home markets. The expansion of such groups also raises supervisory challenges for regulators in the region, who need to expand cooperation and information exchanges as these groups extend their reach. Analysts have noted important supervisory weaknesses in SSA in the areas of consolidated banking supervision and of coordination between home and host supervisors (Beck et al., 2011; Lukonga, 2010).

### **Regional Financial Integration**

The development of SSA banking systems continues to be impeded by the small economic size of national markets. Regional economic integration holds out the prospect for escaping the disabilities of small domestic market size—but the pace of financial sector integration, even within common currency areas, has been disappointing to date. Initiatives such as the development of the regional securities market of the West African Economic and Monetary Union, which became operational in 1999, have contributed to increased financial depth in some segments of the West African Economic and Monetary Union financial system (e.g., the market for government securities), but they have not significantly affected the operation of domestic banking systems. By contrast, the diffusion of South African banks across the four countries of the common monetary area in Southern Africa has produced effective financial sector integration in the subregion, albeit with the same limitations in reaching the underbanked segments of the economy, including small and medium-sized enterprises, that are observed in South Africa itself.

Looking ahead, efforts to harmonize bank regulatory frameworks in subregions, integrate payments systems, and promote cross-border operations of subregional banks can collectively help to overcome the disabilities of small national markets. However, as the European experience has shown, this will require strong political will in the various subregions, including overcoming the vested interests of those currently benefiting from limited competition in domestic markets. Country blocs sharing a common currency have a head start in pursuing integration efforts—but significant progress can be achieved in subregions lacking a common currency (such as the East African Community) if there is sufficiently strong political commitment to realizing the benefits of integration.

### **Portfolio Flows to Frontier Markets**

International investors have begun to show increased interest in investing in government bonds and equity markets in frontier markets, including in SSA. Such inflows can help promote the development of domestic capital markets—but, with adequate market size and liquidity a precondition for attracting most investors, the bulk of such inflows are likely to be concentrated in a small number of the more advanced frontier markets in SSA (such as Nigeria and Kenya). The deepening of capital markets in these countries will, over time, help to reduce the dominant role of the banks in their national financial sectors, but this process is likely to be gradual.

### **Policy Challenges for Regulatory Authorities**

In framing banking sector policies, SSA governments have to balance the distinctive priorities of promoting financial sector development, innovation, and inclusion; limiting risks to financial sector stability; and providing adequate protection to potentially ill-informed consumers.<sup>20</sup> Although compromising on the objective of ensuring financial sector stability would be dangerous, policymakers and regulators also need to be open to financial innovation, allowing experimentation and encouraging competition from various sources.

The experience gleaned from the joint IMF–World Bank financial sector assessments in SSA points to several areas where actions are currently needed to strengthen regulatory oversight in SSA countries.<sup>21</sup> Supervisory capacity is weak in many countries, reflecting both underresourcing of supervision activities and deficient legislative arrangements: increased resourcing of supervision and the provision of adequate legal protections and corrective powers to supervisors are a pressing reform priority in such cases. Even where such weaknesses have been addressed, there is typically a need to give more attention to consolidated supervision of financial conglomerates, covering both bank and nonbank operations. As noted earlier, the spread of pan-African banking groups implies a need for home country regulators to give full attention to the foreign operations of these groups and to coordinate actions and share information with host country supervisors.

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<sup>20</sup> Given space constraints, the brief commentary here is selective rather than comprehensive.

<sup>21</sup> The financial sector assessments jointly undertaken by the IMF and the World Bank under the Financial Sector Assessment Program (FSAP) seek to give due attention to both the stability and developmental aspects of financial sector regulation and oversight.

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