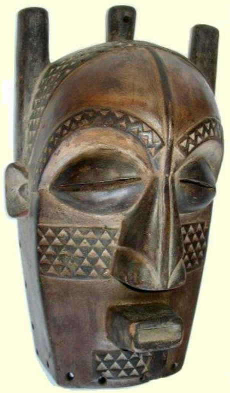
Sub-Saharan Africa
Financial Sectors: Issues, Challenges, and Reform Strategies



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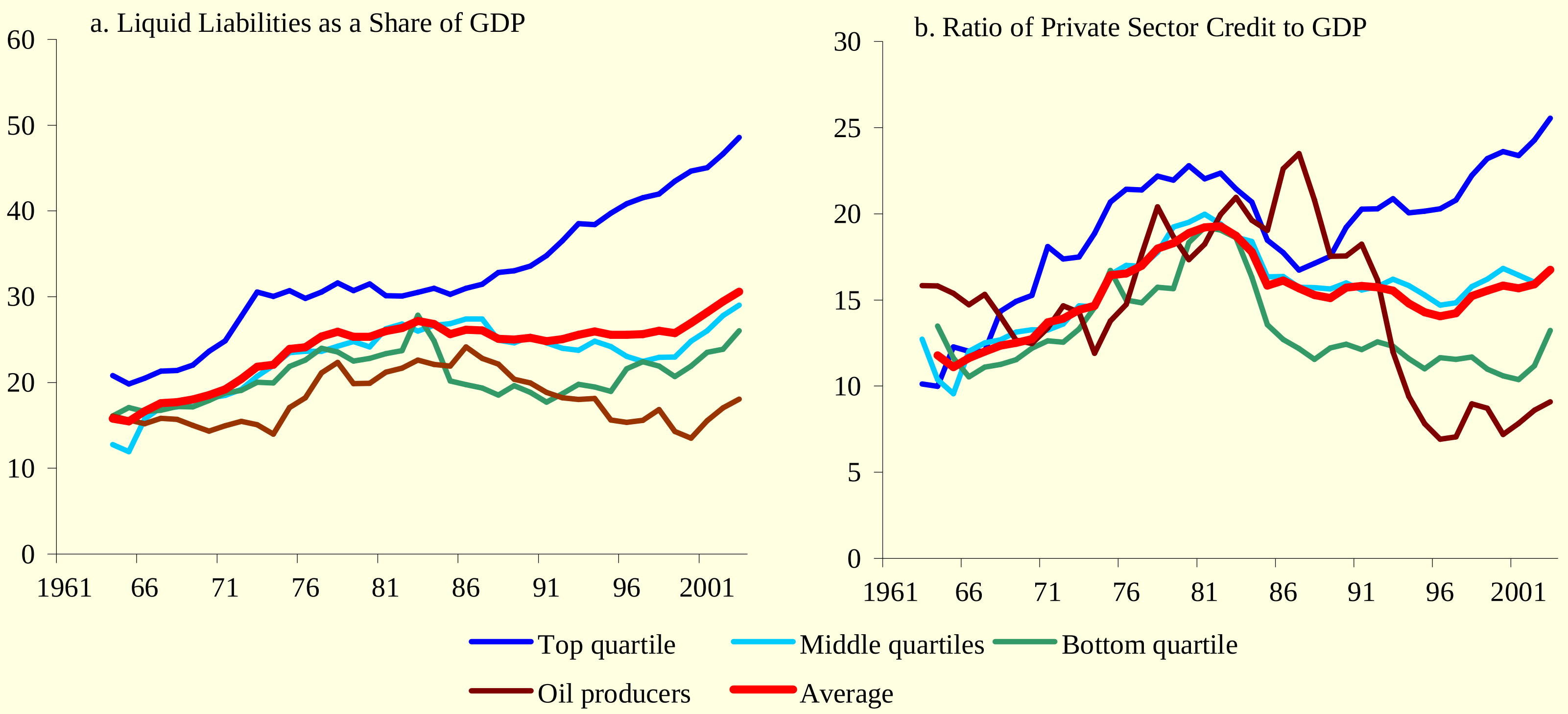
Financial Sector Development is Crucial for Growth

- Theory and empirical findings support the importance of finance for growth.
  - Countries with better-functioning financial systems grow faster.
- Financial development also helps reduce poverty.
- Financial sectors in low-income SSA are among the world’s least developed.
- Deeper and more efficient financial markets are needed to improve SSA’s economic prospects.

Financial Development and growth

Financial Development of Countries Classified by Growth (Percent)

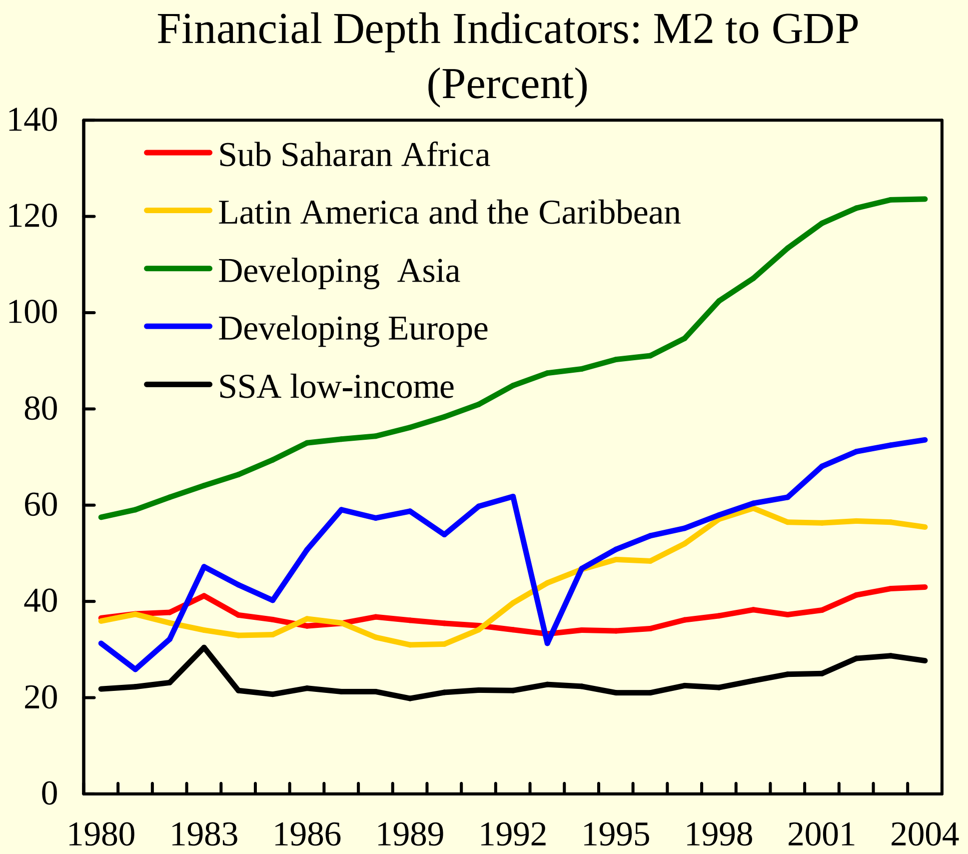


Source: IMF World Economic Outlook database, 2004.

Note: The six oil-producing countries are classified separately. The remaining countries are classified by quartiles, according to real growth over 1960–2003.

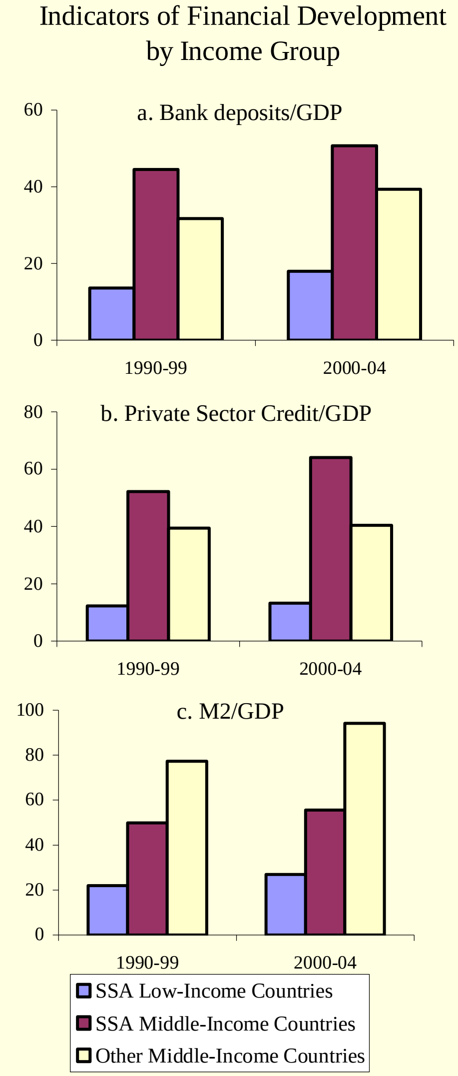
Very Limited Financial Sector Development

- Financial depth—as measured by M2 to GDP—is lower than in most other developing regions.
- High M1 to M2 ratio show the importance of cash over other financial instruments.



SSA Middle-Income countries Have Deeper, Sounder, More Diversified Sectors

- Key financial depth indicators in middle-income SSA are comparable or higher than in other middle-income countries.
- Populations have greater access.
- Banking sectors are more efficient and sound.
- But banking in oil producers is similar or more constrained than in low-income SSA countries.

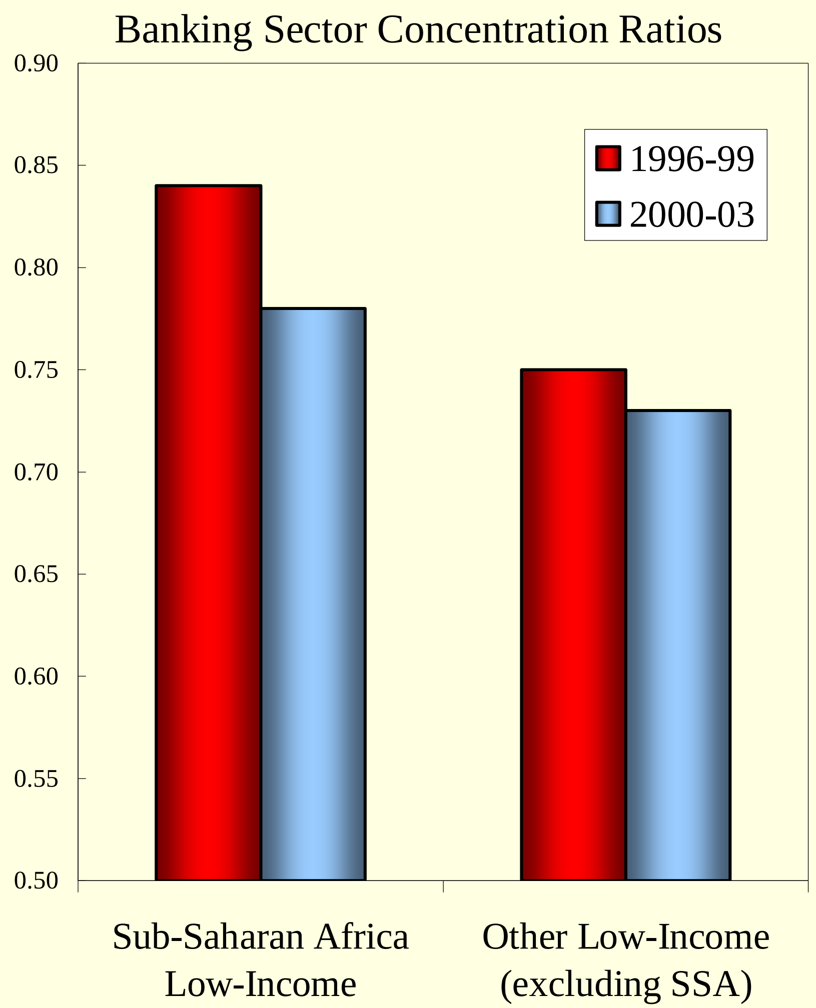


Banking Soundness

- Most banking systems are reasonably sound, but weakness persist in some countries and banks.
- However, standard indicators may not fully capture the risks to which SSA banking systems are exposed.
- While banking systems are profitable, they are less efficient than elsewhere in the world.

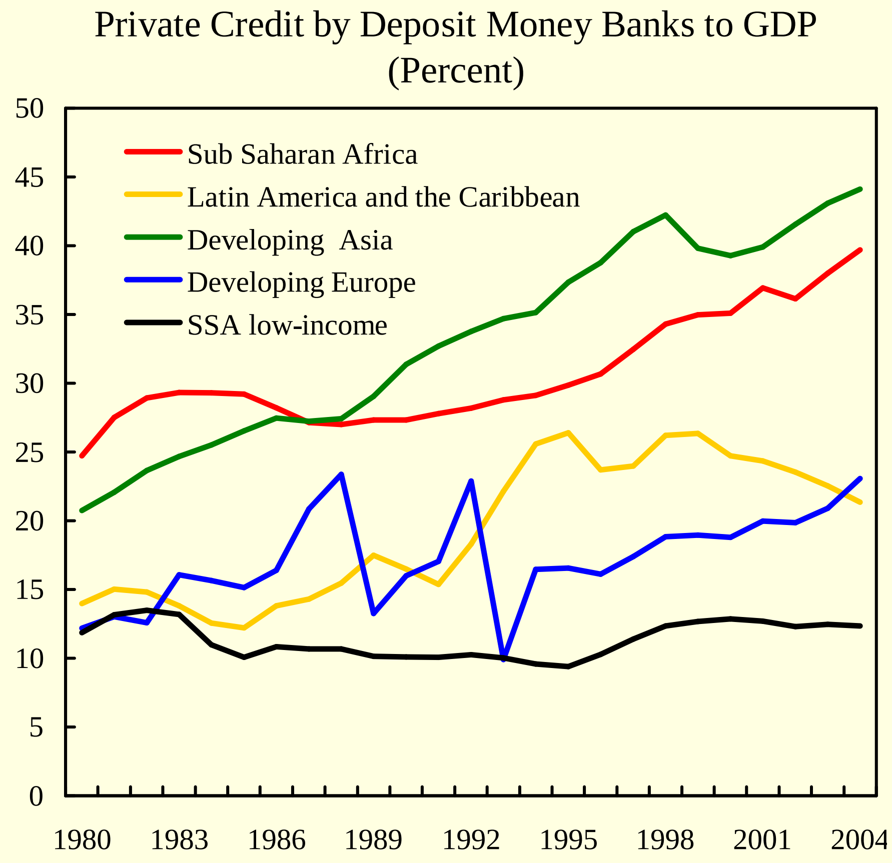
Banking Efficiency and Profitability

- Though banking systems are concentrated, they are becoming more competitive.
  - Small market size contributes to concentration, given need for institutions to reach economies of scale.
- Less efficient than global comparators.
- Despite high overhead costs, SSA banks are profitable.



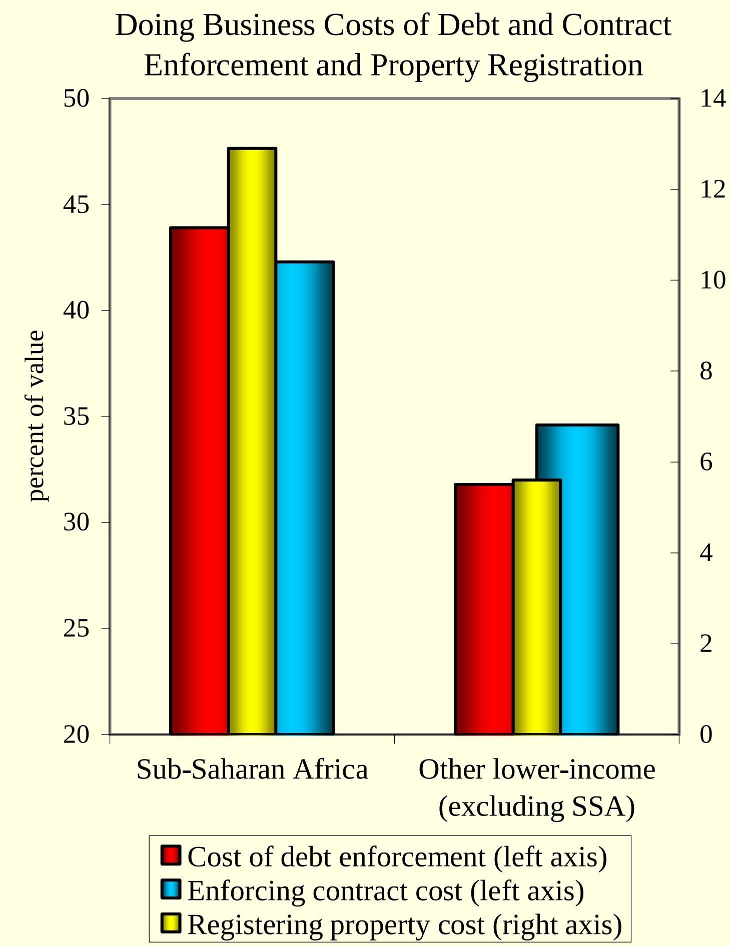
Financial Markets and Market Infrastructure

- Banks' financial intermediation role is limited:
  - Bank deposits were 19 percent of GDP in low-income SSA in 2004, compared to 38 percent in other developing regions.
  - Private sector loans were only 13 percent of GDP.
- Interbank activity is constrained and efforts to enhance financial market infrastructures have not yet had visible effects.



Difficult Operating Environment: Legal Environment

- Financial market activity is constrained by poor legal systems, weak property rights and poor enforceability of contracts.
  - Strong correlation between private loans as a share of GDP and credit information and legal framework indices.
- Difficulties of enforcing commercial contract through the courts:
  - On average, creditors go through 35 steps, wait 15 months, and pay 43 percent of country per capita income before receiving payment.

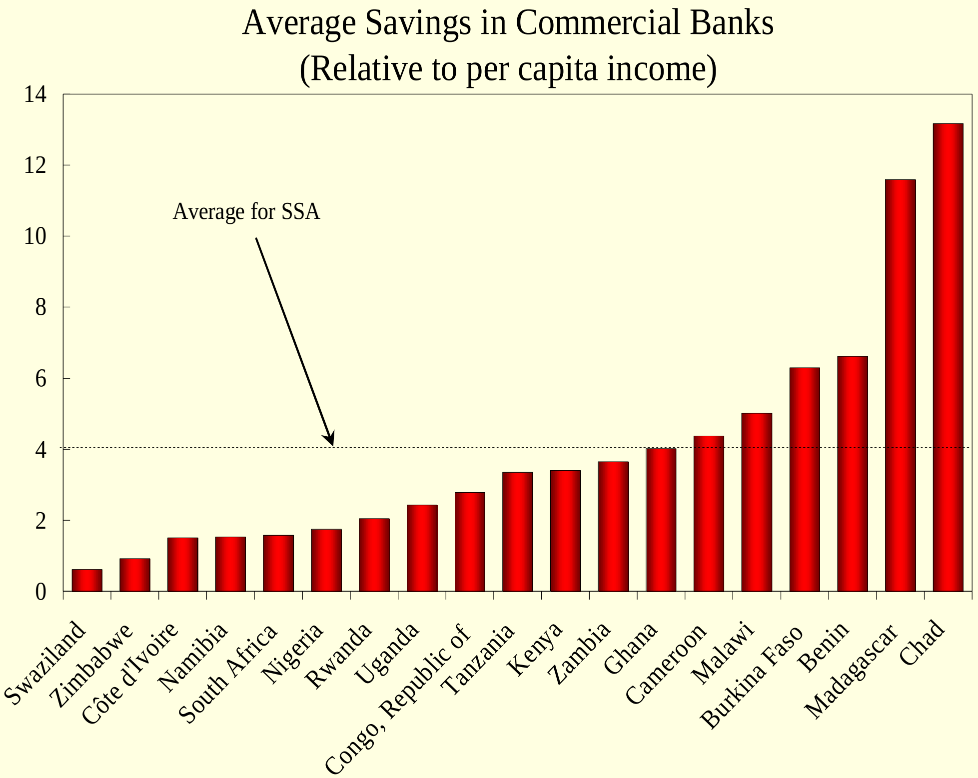


Difficult Operating Environment : Regulation and Supervision

- While many regulatory requirements are largely in line with international norms, implementation of supervision is often constrained.
  - Limited independence of supervisors lessens power to demand “prompt corrective action”
  - Greater forbearance
  - Resource constraints

Economic Challenges Arising from Financial Sector Weakness

- Access to financial services—savings and loans—is lower in SSA than in other LICs
- Few households are able to have accounts with a formal institution
  - Limited physical access to bank branches
  - High bank charges or minimum balances
  - Administered interest rates



Source: IMF staff calculations.

Innovative Attempts to Expand Financial Services

- Finmark Trust is benchmarking access and defining unmet demand at household level in southern Africa.
- Efforts contributed to adoption of “Financial Access Charter” in South Africa.
  - Mzansi accounts (low-cost banking for low-income earner) created.

Selected Findings from FinScope Surveys
(Percent of respondents)

	Botswana	Namibia	South Africa
General characteristics			
Financially included	54	55	63
Served by banks	43	51	47
Served by other formal institutions	6	3	8
Served exclusively by informal market	5	1	8
Product usage			
Savings	51	50	…
Transactions	43	41	…
Insurance	33	25	…
Credit	21	22	…

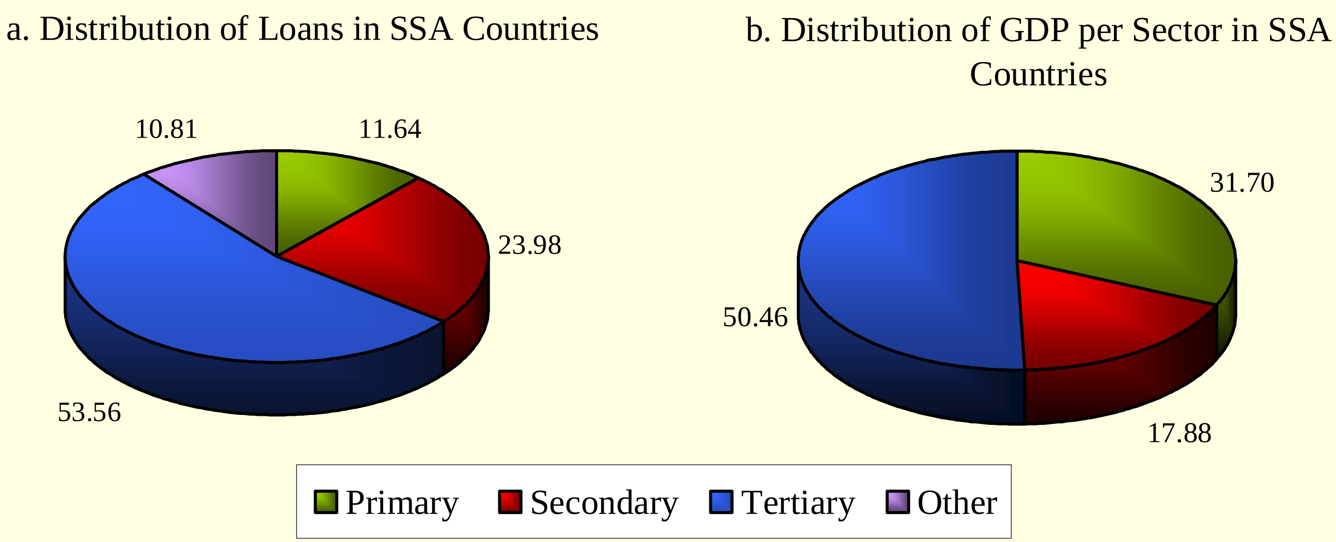
Source: FinScope, 2005.

Note: FinScope defines financially included individuals as those who use formal, informal or interpersonal financial products (excluding transfers). Among this group, the “banked” refer to those who use at least one or more bank products. Formal providers include registered microlenders.

Insufficient Financing of the Economy

- Access to credit and cost of financing identified in surveys as key obstacles facing enterprises
- Most sectors suffer from financing constraints, but agriculture faces the greatest challenges.

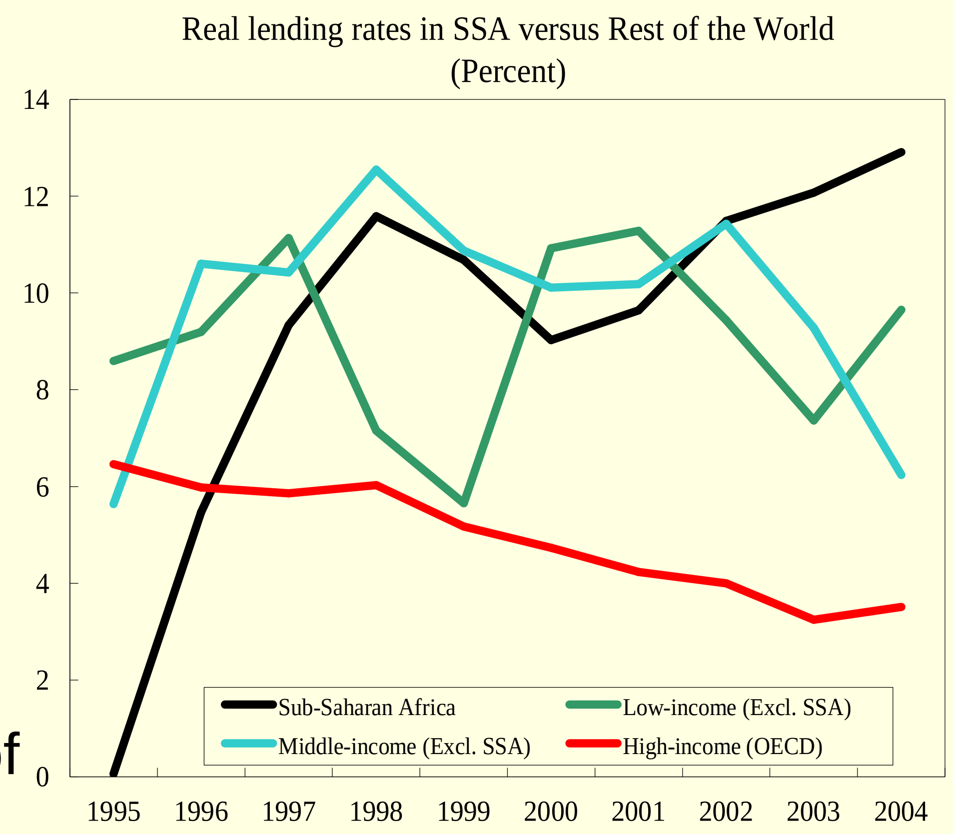
Sub-Saharan Africa: Distribution of Loans and GDP by Sector



Source: IMF staff calculations.

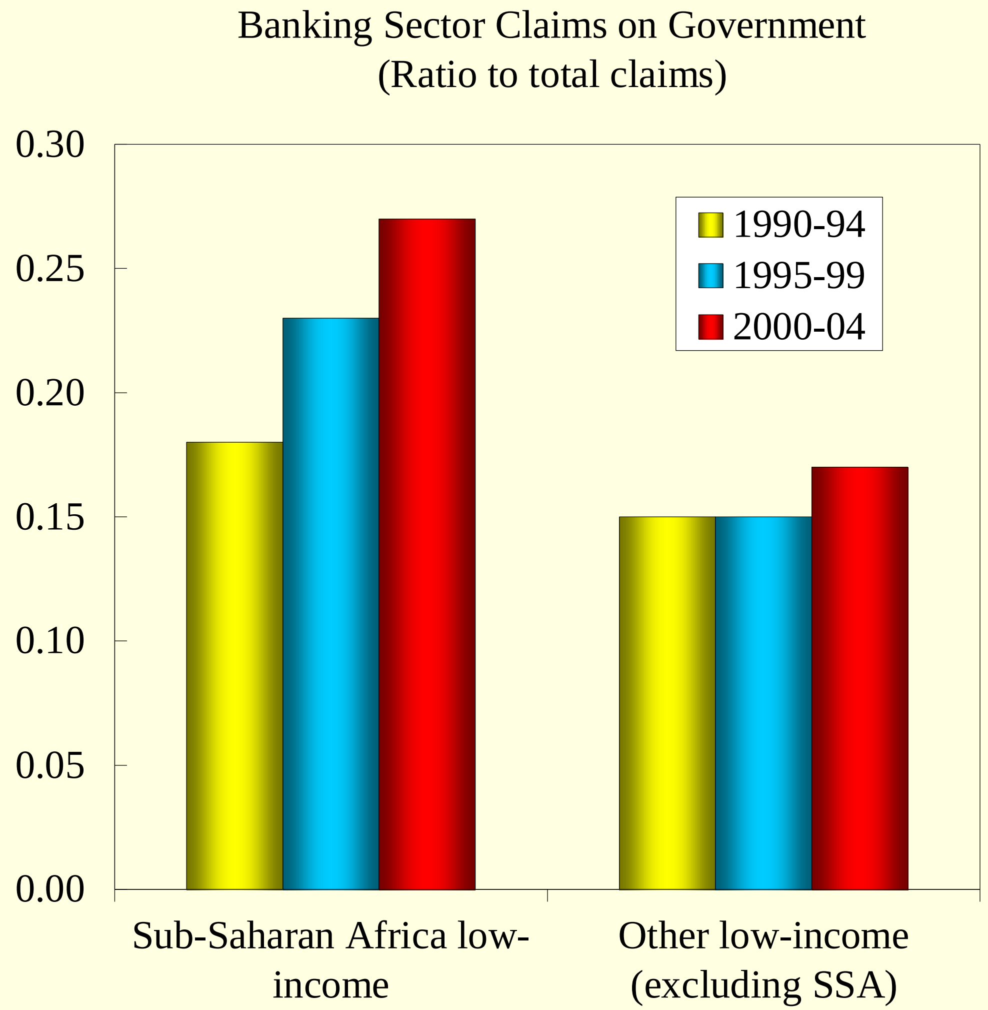
Insufficient Financing of the Economy (Cont.)

- Main impediments to increased lending
  - High real lending rates
  - Weak property rights system for both land and movable property limit collateral
    - Unclear land titles due to lack of documentation, overlapping systems of rights and ownership, and overstretched legal systems



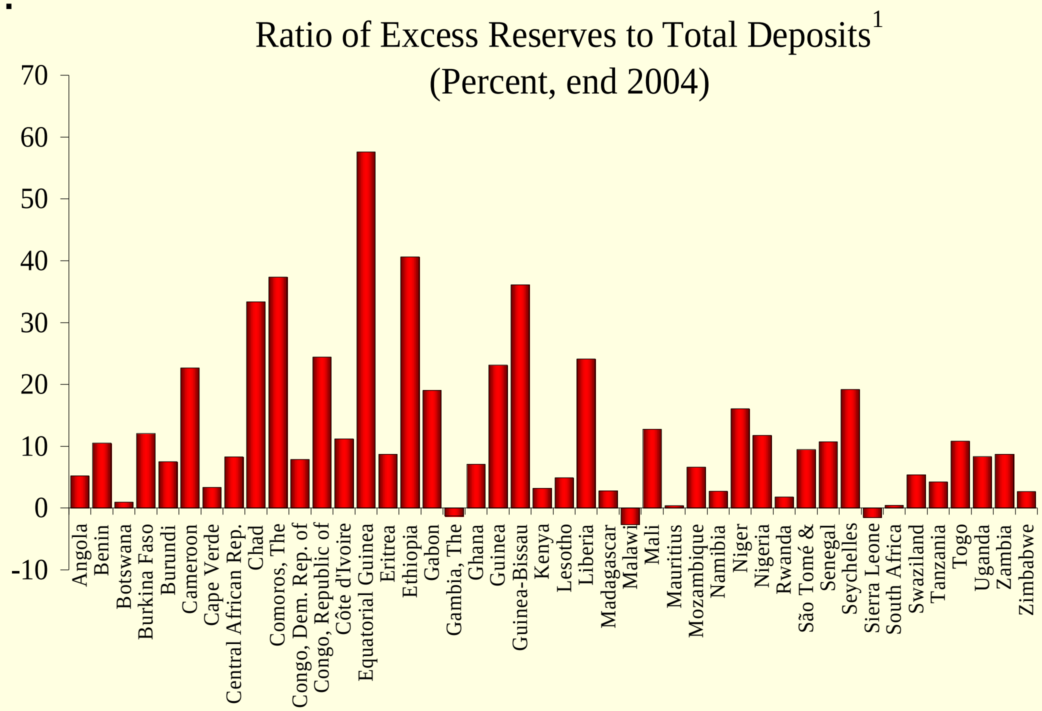
Insufficient Financing of the Economy (cont.)

- Main impediments to increased lending (cont.)
  - Attractiveness to banks of providing funds to the government.



Financial sector Environment Complicates Monetary Policy Implementation

- Monetary policy implementation hindered by:
  - Structural excess liquidity in the banking system
  - Shallow interbank markets
  - Underdeveloped thin government securities markets
  - Insufficiently deep and liquid foreign exchange markets.
- Use of rules-based monetary instruments such as reserve requirements imposes significant costs on banks.

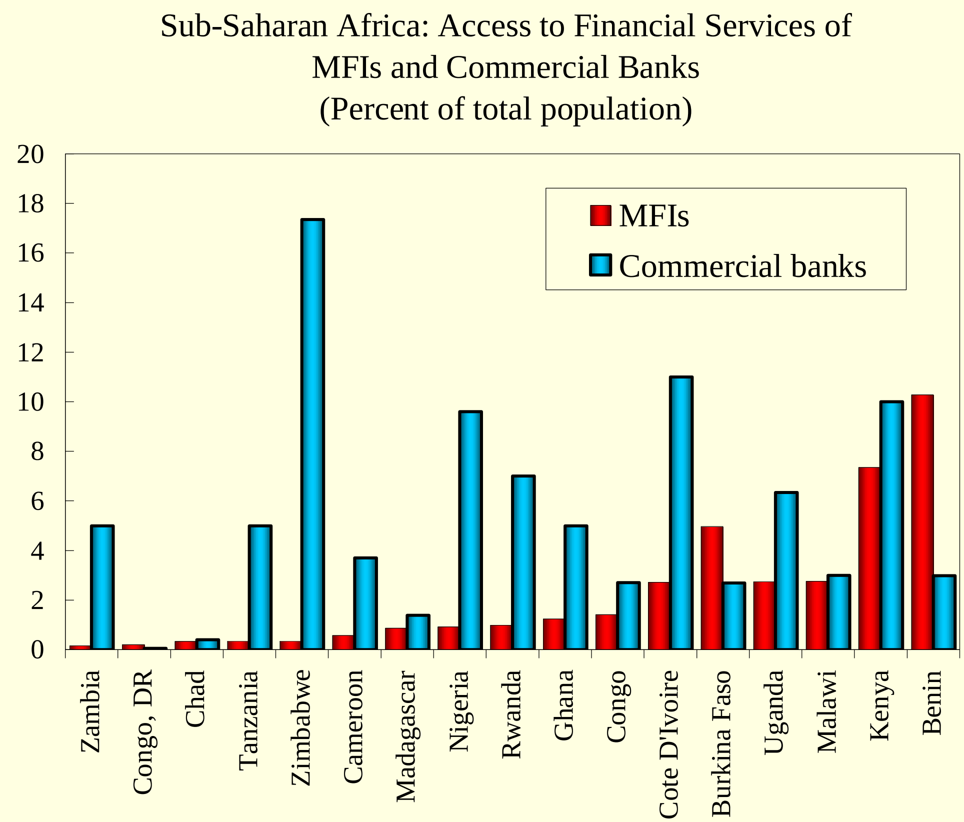


Source: IMF staff calculations.

[1] Where 2004 year-end data are not available, the most recent data point is used.

Financial Sector Reforms: Microfinance

- Government and NGOs are promoting microfinance as a vehicle to promote access to financial services by the poor.
- Sector has been growing fast, and has successfully targeted the poor.

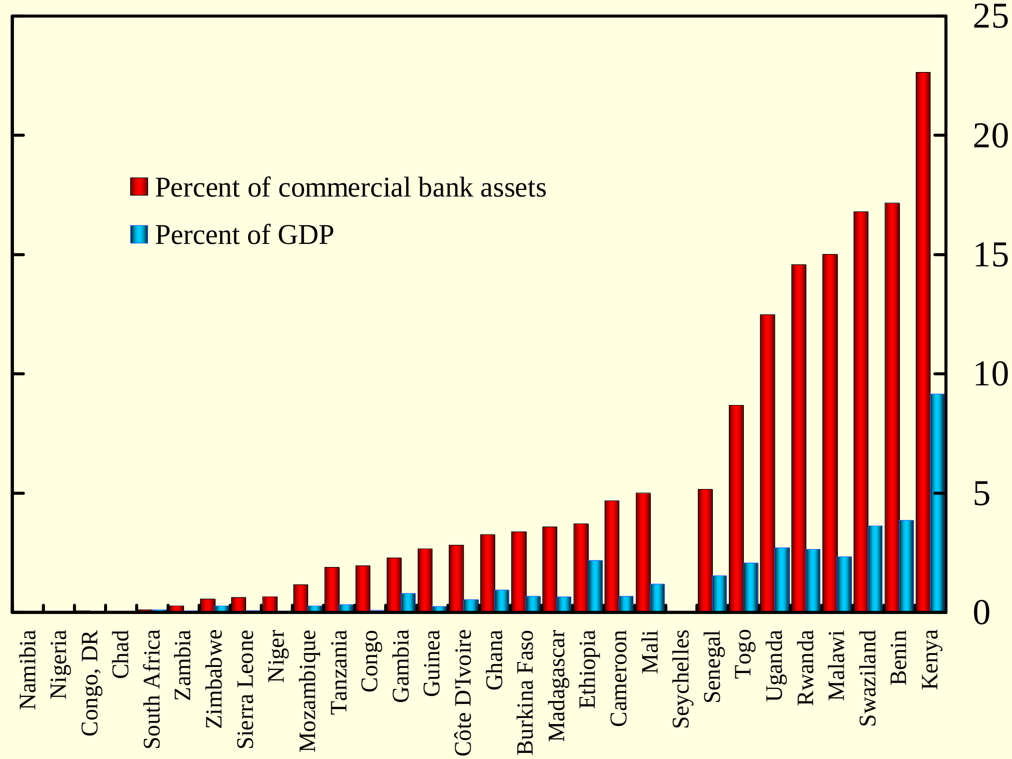


Sources: CGAP database; Claessens (2005); and IMF staff calculations.

Financial Sector Reforms: Microfinance

- However, the sector remains much smaller than the banking sector and suffers from low profitability.

Size of the Informal Financial Sector
(Percent)



Sources: CGAP Database; and IMF staff calculations.

Financial Sector Reforms: Enterprise Financing

- Some countries are opting to use state and development banks to promote more financing to priority sectors.
  - These efforts could be fraught with same types of risks experienced in the past.

Financial Sector Reforms: Enterprise Financing (Cont.)

- While stock markets have helped listed companies acquire finance, few companies are listed and turnover is low.
  - High costs and lack of supporting infrastructure are a concern.

Sub-Saharan Africa: Indicators of Stock Market Development, 2004

Country	Number of Listed Companies	Market Capitalization (Percent of GDP)	Value Traded (Percent of GDP)	Turnover (Percent)
Botswana	18	29.4	0.6	2.1
Côte d'Ivoire	39	13.6	0.3	2.5
Ghana	29	30.7	0.8	3.2
Kenya	47	24.9	2.1	8.0
Malawi	8	9.0	1.0	11.1
Mauritius	41	39.3	1.6	4.4
Namibia	13	8.1	0.3	4.7
Nigeria	207	20.1	2.3	13.9
South Africa	403	214.1	76.5	45.0
Swaziland	6	9.3	0.0	0.0
Tanzania	6	6.2	0.2	2.5
Uganda	5	1.4	0.0	0.2
Zambia	11	8.0	0.1	1.1
Zimbabwe	79	87.9	14.0	3.9
Egypt	792	51.3	7.5	17.1
Malaysia	962	161.3	50.8	33.4
Mexico	152	25.4	6.3	29.1
Thailand	465	70.6	66.7	93.8

Source: World Bank, World Development Indicators.

Financial Reforms:
Other Institutions and Operating Environment

- With financial liberalization, the Non-Bank Financial Intermediaries (NBFI) sector is growing.
  - NBFIs are a diverse group of institutions with a potential to increase the level of products and services available.
- Many countries are trying, with varying success to improve the operating environment through changes to the legal and regulatory framework.

Financial Sectors Need to be a Reform priority for SSA

Key priorities include:

- Eliminate distortions from interest rate controls, excessive use of costly regulatory monetary instruments, and supervisory forbearance.
- Increase market size by promoting financial integration in existing monetary unions and harmonized approach to regulation in other countries.
- Promote a prudential framework in line with economic structures.
- Use alternative instruments (e.g. leasing) or alternatives to collateralization (e.g. group guarantees, reversible equity stakes) to overcome bottlenecks.
- Avoid new specialized state-owned institutions.
- Apply the legal and regulatory framework even-handedly.