High Levels of Non-Performing Loans in Africa:
Determinants & Implications for Financial Stability & the Real Economy in the Region

Increase in Non-Performing Loans in Africa:
Inventory & impact on the financial stability

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Foreword

- ✓ **Compared to other regions, sub-Saharan Africa (SSA) has historically recorded high levels of nonperforming loans (NPLs) in the banking sector, NPL ratios have exceeded 10 percent on average since the mid-2010s.**
- ✓ **Two waves of rising NPLs have already occurred in SSA in recent decades, the commodity price shocks and fiscal crises in 1990s and the global financial crisis (GFC). The COVID-19 pandemic is likely to mark the beginning of a new wave.**
- ✓ **Sound management of economic environment and prudential regulation of banking sector are determinant factors in curbing the growth of problem loans in normal and stressed market conditions.**
- ✓ **Fiscal and Monetary supporting measures to banks and firms are critical factors to banking system to contain the consequences of crisis.**
- ✓ **Dealing with deterioration of credit quality during the COVID-19 crisis entails a sequential strategy focused on managing, resolving, and preventing problem loans.**
- ✓ **Fixing the negative impact of higher NPLs is a product of sound macroeconomic policies, prudential regulation, and the effective credit risk management of the banks' credit portfolio.**

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1) NPLs Definitions acc. to BIS

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- **All exposures that are "defaulted" under the Basel framework where applicable;**

  - The bank consider that the obligor is unlikely to pay its credit obligations to the banking group in full, without recourse by the bank to actions such as realizing security (if held).
  - The obligor is past due more than 90 days on any material credit obligation to the banking group. **(or)**

- **All exposures impaired in according to the applicable accounting framework; (or)**

- **All other exposures that are not defaulted or impaired but nevertheless are:**

(a) Material exposures that are more than 90 days past due; **or**

(b) where there is evidence that full repayment of principal and interest without realization of collateral is unlikely regardless of the number of days the exposure is past due.

2) NPLs in Africa "SSA"

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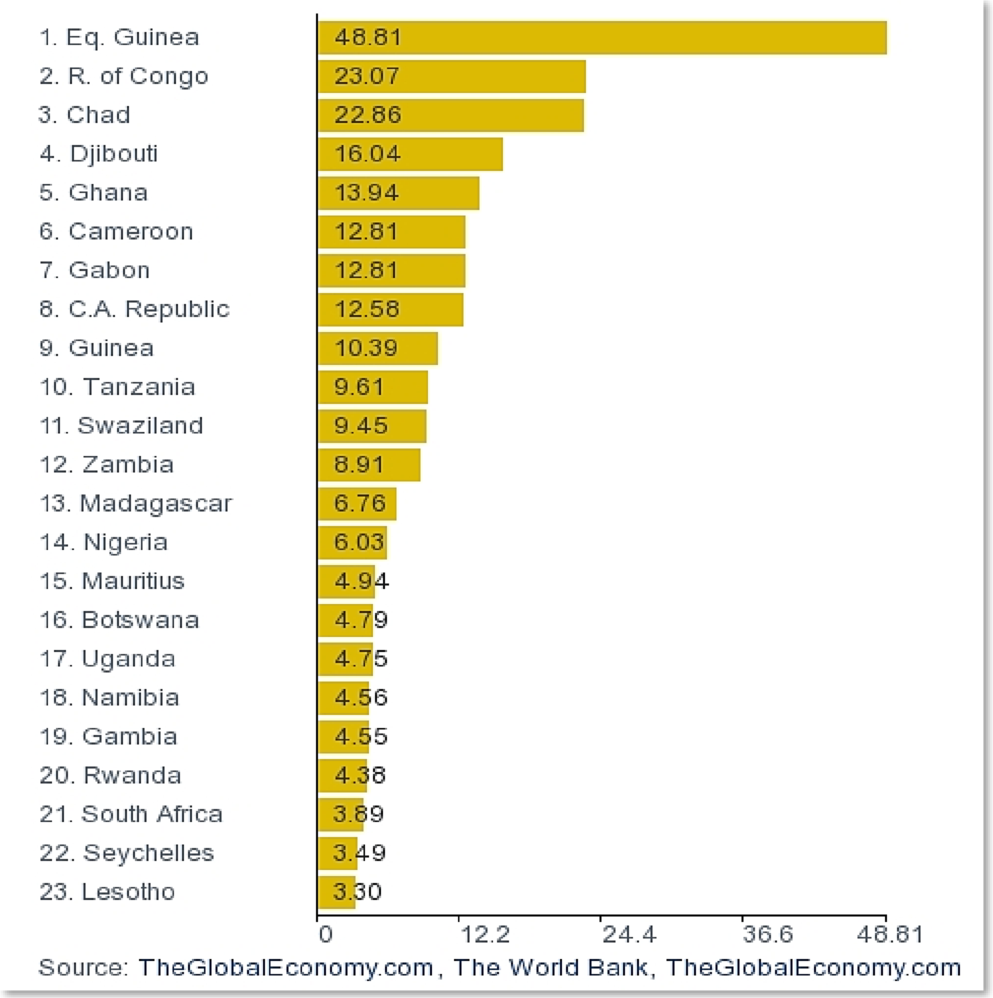
- **The rise in Non-Performing Loans (NPLs)** can impair banks' ability to pump fresh credit into economies struggling to recover from Covid-19.
- **Total amount of NPLs for banks in Africa** is estimated to be currently around **$60 billion**, compared to $600bn in Europe.
- **However, NPL ratios** to the total amount of outstanding loans in Africa are **above 10%** in more than 30 countries.

Figure: NPL Ratios (as % of all bank loans), 2019



NPLs in Africa "SSA"

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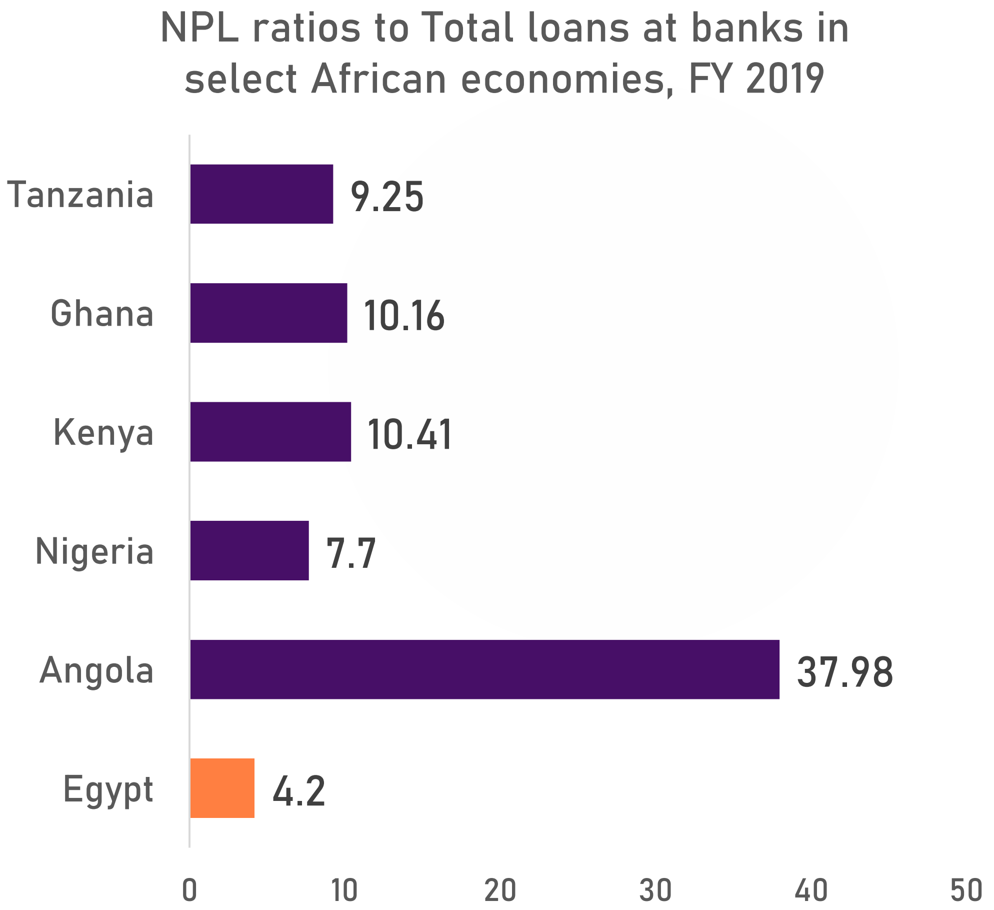
According to S&P Global latest data:

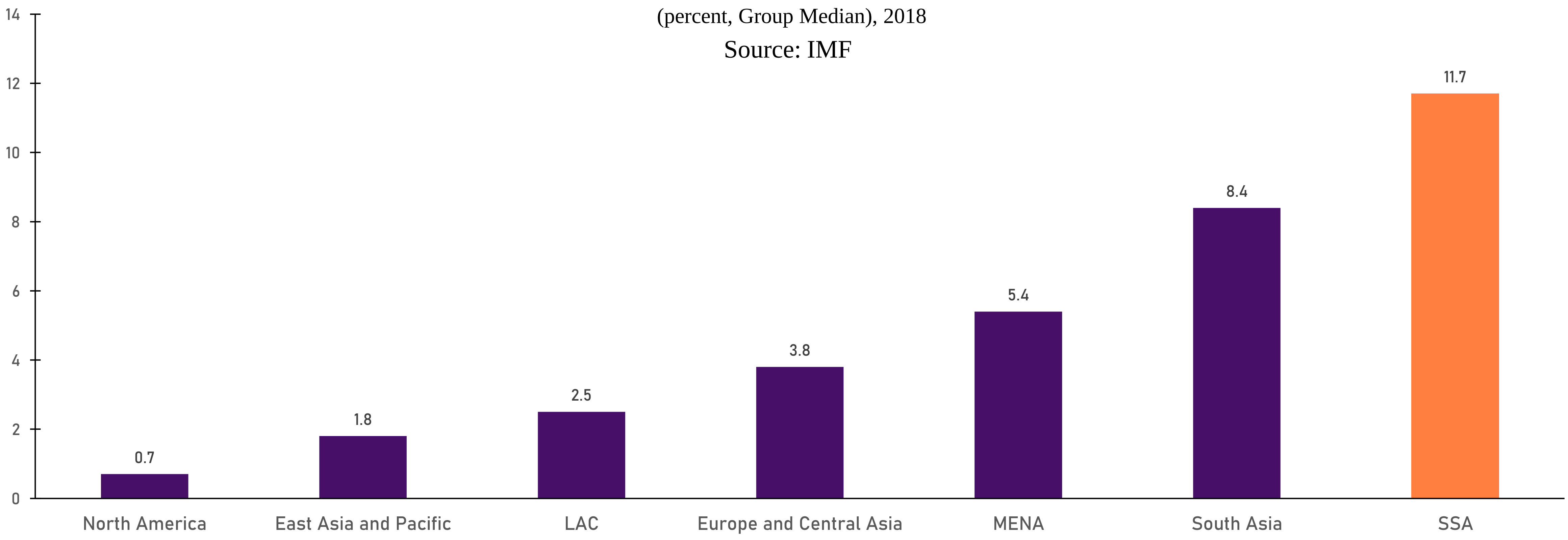
- Banks in **South Africa**, the largest banking market by assets in Africa, had about **$12.6 billion** of problem loans on their books as of end-Dec 2020, constituting **6.22%** of their total loans.
- **Moroccan banks** recorded a higher NPL ratio at **9.13%, Nigeria's NPL ratio** stood **at 7.7% for 2019,** while in **Kenya and Ghana** it was just **over 10%,** and **Egypt's NPL ratio** was at **4.2% in 2019.**
- **The International Finance Corporation (IFC) initiative to stimulate a secondary market in Africa for recycling NPLs is expected to boost banks,** by establishing regional platforms that will create economies of scale in West Africa, North Africa, sub-Saharan Africa and East Africa.



Source: S&P Global market intelligence, Central Bank of Egypt.

NPLs in Africa "SSA"

The following chart indicate the NPL ratio by region;



3) Determinant Affecting NPLs

A) Macroeconomic Determinants;

- Macroeconomic Environment,
- Public Debt.

B) Bank-level Determinants;

- Efficiency & profitability,
- Bank Lending & Moral Hazard
- Governance.

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A) Macroeconomic Determinants;

1) A deteriorated ***macroeconomic environment*** is associated with ***lower asset quality***. The decline in economic growth reduces the borrowers' capacity to service debt, and increasing the country NPL ratio. An econometric analysis was conducted by IMF staff on bank-level data that relies on a sample of 617 banks in 43 SSA countries covers 1994–2018 , find out that a *1 % point decline in economic growth reduces the borrowers' capacity to service debt, increasing instantaneously the country NPL ratio by 0.2 % at impact, and 0.4 - 0.6 % in the medium term).*

2) **2)** An increase in ***public debt*** is found to lead to higher ***NPLs***. This may be because higher public debt increases the sovereign risk premium, affecting banks' funding costs and lending rates. High debt could also increase the probability of government arrears accumulation, which would translate into NPLs. The crowding-out effect (which raises borrowing costs for the private sector and increases the likelihood of borrower's default).

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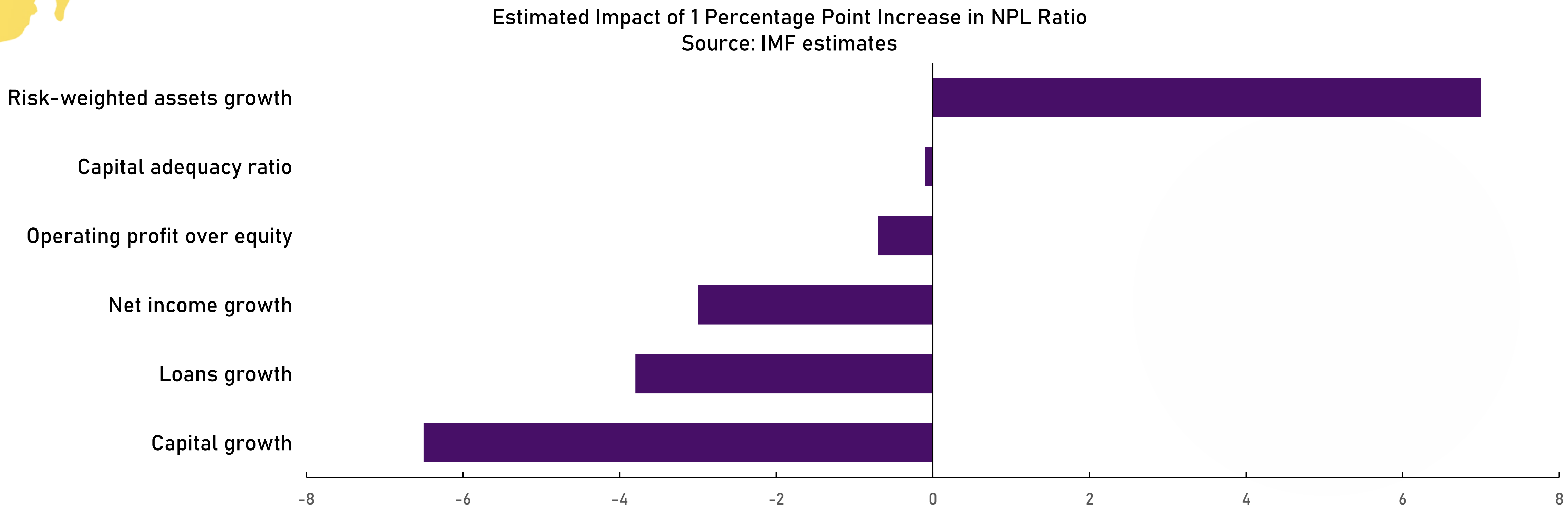
B) Bank-level Determinants;

1) ***Efficiency and profitability***, Inefficient banks, as measured with profitability indicators; (ROA) & (ROE) or the net interest margins, most probably have higher ***NPL*** ratios.

2) ***Bank Lending & Moral Hazard,*** The highly ***leveraged banks*** have higher ***NPL*** ratios, because they tend to take more risks. Also The lower ***capital buffers*** create risk-taking incentives, which would translate into higher NPLs.

3) ***Governance,*** Bank ***NPLs*** seem to be linked negatively to the degree of financial development and the quality of supervisory mechanisms.

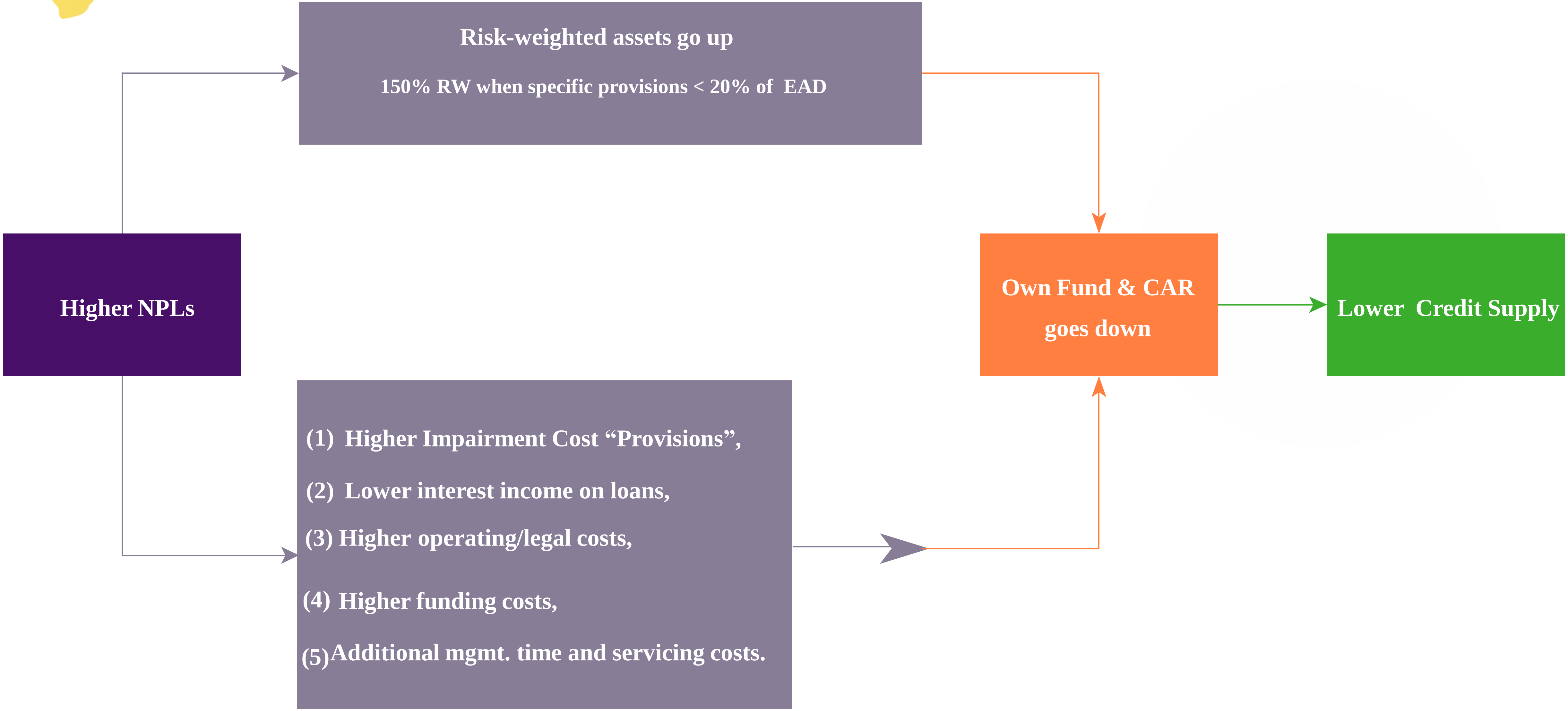
Determinant Affecting NPLs



According to bank-level analysis “**IMF African Department**”, an increase in banks’ NPL ratio by 1% is associated with:

- Increase risk-weighted assets by about 6.9%.
- Reducing banks’ capital by 6.5%.
- Decline in bank lending by about 3%
- Reduction in banks’ operating profits.

Impacts of NPLs on Credit Supply,



4) Covid-19 Impacts on the level on NPLs

- The assessment to the epidemiological and economic performance of countries when the Covid-19 pandemic has not yet run. it is imprudent to draw final conclusions on the ultimate toll of the pandemic in health, economic, or political terms.

- ***Moody's forecasts that***, NPLs in Africa will double in 2021 versus 2019 as payment holidays during the pandemic expire, while increased provisioning needs, reduced business generation, and margin pressure will erode banks’ profitability,

  Overall, the banks’ financial stability will be broadly maintained. Stable local currency deposit funding, high liquidity in local currency, good capital buffers, and gradual improvements in risk management will help to contain banks’ risk over the next 12 to 18 months.

5) SSA authorities' Response to Covid-19 Crisis

- Some authorities incentivized loan repayment moratoria and other forms of loan restructuring, with the expectation that borrowers' repayment incapacity would be temporary. These measures could also contribute to further NPL increases, even though loans covered by the restructuring arrangements should not systematically be reclassified as nonperforming merely for the suspension or changes in the principal and interest payments.

1) Moratorium on debt repayments for exposed firms or individuals,

(Angola, Cabo Verde, Lesotho, Malawi, Mauritius, Namibia, São Tomé, The Seychelles, WAEMU). For instance,

The *Central Bank of the West African Economic and Monetary Union (BCEAO)* set up a framework inviting banks and microfinance institutions to accommodate demands from customers with COVID-related repayment difficulties to postpone for a three-month renewable period debt service falling due.

In Mauritius, commercial banks provided a six-month moratorium on capital repayment for existing commercial loans of households and economic operators affected by the pandemic, with the central bank subsidizing the interest payments for low-income households.

2) **Encouragement of banks to restructure loans, especially for small and medium-sized enterprises;**

*(Congo DRC, Malawi, Mozambique, Nigeria, Tanzania, Uganda, Zambia).*For instance,

in *Zambia*, financial service providers were encouraged to renegotiate the terms of credit facilities with borrowers affected by the pandemic.

In *Mozambique*, the central bank encouraged prudent loan restructuring by introducing a foreign currency credit line for institutions participating in foreign exchange markets for a period of nine months and waiving the constitution of additional provisions by credit institutions and financial companies in cases of renegotiations of the terms and conditions of loans for affected clients.

3) Easing of prudential norms on capital;

(*Botswana, Congo DRC, Guinea, Lesotho, São Tomé and Príncipe, South Africa, WAEMU).*

The West Africa Economic and monetary Union authorities extended by one year the five-year period initiated in 2018 for the transition to Basel II/III bank prudential requirements.

In *Congo DRC*, the central bank postponed the adoption of new minimum capital requirements. In Botswana, the adoption of the 25 percent single borrower limit and concentration risk limit was postponed.

In *South Africa*, a temporary relief on bank capital requirements was put in place, while the liquidity coverage ratio was reduced from 100 to 80 percent to provide additional liquidity and counter financial system risks.

4) Use of capital buffers;

(CEMAC, Ghana, Namibia).

In *the Central African economic & monetary Community "CEMAC",* for instance, banks were informed that they could use their capital conservation buffers of 2.5 percent to absorb pandemic-related losses.

In *Ghana*, the central bank lowered the capital conservation buffer from 3 to 1.5 percent.

In *Namibia*, it was reduced to 0% for at least 24 months to support banking institutions to supply credit.

5) Easing of supervisory guidelines on handling credit impairments by revising or suspending provisioning and classification rules for specific loan categories;

(Ghana, Guinea, Mozambique).

For example, in *Guinea*, the central bank announced flexibility to banks regarding loan classification and provisioning for loans that were performing before the pandemic struck but were restructured due to the pandemic.

In *Mozambique*, the constitution of additional provisions by credit institutions and financial companies was waived in cases of renegotiations of the terms and conditions of the loans, before their maturity, for affected clients.

SSA authorities' Response to Covid-19 Crisis

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6) **Suspension of negative credit information.**

For instance, in *Kenya* this suspension affected borrowers whose loans became nonperforming after April 1, 2020, for a six-month period.

7) **Issue guidance on dividend and cash bonuses distribution to ensure bank capital preservation;**

(CEMAC, South Africa, Uganda, WAEMU).

In *South Africa*, for instance, banks were directed to defer dividend payments and bonuses for at least 90 days to ensure capital adequacy.

CEMAC banks were prohibited from distributing dividends for the three-year period 2019–21. In December 2020, *The Central Bank of West African States "BCEAO"* instructed *WAEMU* banks to refrain from distributing dividends with a view to strengthening their capital buffers in anticipation of the impact of the crisis on asset quality.

SSA authorities' Response to Covid-19 Crisis

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8) **Credit support by encouraging banks to continue to lend to the private sector (through public guarantees on bank loans or the provision of term funding to banks that provide credit to businesses) and by allowing public institutions such as central banks or development banks to lend directly to the private sector;**

(Angola, CEMAC, Democratic Republic of Congo "DRC", Kenya, Lesotho, Mauritius, Niger, Uganda, WAEMU, Zambia).

In *Lesotho*, for example, the authorities have expanded their credit guarantee facilities during the crisis.

In *DRC*, the Central Bank has created a new collateralized long-term funding facility for commercial banks to support the provision of new credit for import and production of food and other basic goods.

The Development Bank of Mauritius provided Rs10.2 billion (2.3 percent of GDP) in credit to distressed enterprises and cooperatives

SSA Economic Outlook;

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Indicators	Actual				Projections	
	2010-17	2018	2019	2020	2021	2022
Real GDP "Growth Rate"	**4.4%**	**3.2%**	**3.2%**	**- 1.9%**	**3.4%**	**4.0%**
Overall Fiscal Balance / GDP	**- 3.3%**	**- 3.5%**	**- 4.1%**	**- 6.9%**	**- 5.6%**	**- 4.7%**
Government Debt / GDP	**34.5%**	**48.3%**	**51.5%**	**57.8%**	**56.2%**	**56.2%**
Current Account Balance / GDP	**- 2.6%**	**- 2.6%**	**- 3.7%**	**- 3.7%**	**- 3.7%**	**- 3.7%**
External Debt / GDP	**15.1%**	**22.1%**	**23.6%**	**27.8%**	**26.7%**	**26.1%**
Reserves "Months of Imports"	**4.9**	**4.7**	**6.0**	**4.8**	**4.6**	**4.3**

Sources; IMF

Based on IMF Projections; There's a recovery in GDP growth rates with sustained structural imbalance in the other above mentioned indicators.

6) Egyptian authorities' respond to Covid-19

Since 2004 , CBE developed a restructuring plan with the objective of strengthening the banking sector and increasing its robustness to enable it to face global and region competition effectively and support achievements the targeted economic growth. The plan started in 2004 and ended in 2008 it based on the following main pillars:

o Privatization and consolidation within the banking sector,

o Addressing the issue of non performing loans (NPLs),

o Financial and managerial restructuring of state owned banks,

o Upgrading CBE banking supervision.

In view of the recent global developments following the COVID-19 outbreak, and with the aim of sustaining the achievements of the economic reform program, CBE and MoF has taken measures to curb the negative impact of Covid which include,

Fiscal measures;

The Egyptian Ministry of Finance (MoF) dedicated the fiscal year 2020/21 budget to achieving sustainable and inclusive growth while fostering human development and implementing wide ranging structural reforms.

- **A stimulus package of 100 billion Egyptian pounds (EGP) – Eq. USD 6.4 bn.,**
- **Tax incentives ;**

➢ Increase the tax exemption limit - create new low-value (2.5%) tax bracket - reduce the tax burden on the affected sectors by making a settlement of the tax arrears .

Fiscal measures;

- **Cost reductions;**

- Reduce the price of natural gas & electricity for industry ,
- Launch an EGP 50 billion **Eq. USD 3.2 bn.,** fund for real estate financing for middle-income citizens .

- **Alleviate the burden on affected industries;**

- Pumped EGP 3 billion **Eq. USD 0.2 bn.,** to support the Export Development Fund in providing additional liquidity to exporters.
- It increased public spending by an additional EGP 10 billion **Eq. USD 0.64 bn.,** to pay the dues of contractors and suppliers.

Monetary and Banking Measures;

- **Decreasing interest rates,**

  - The CBE lowered the overnight deposit rate by 400 basis points during the period of March 2020 – November 2020.

  - the CBE reduced the interest rates to 8% from 10% percent for mortgage finance for the middle-income class.

- **Delaying credit dues,**

  - The CBE delayed all credit dues for all individuals, SMEs, and corporations for a period of six months. without late interest or additional fees for late payments.

Monetary and Banking Measures;

- **Supporting the renovation of hotels,**
  - The CBE provided EGP 50 billion **Eq. USD 3.2 bn.,** at an interest rate of 8% over a period of 15 years.
- **Supporting financially stressed companies and individuals.**
  - CBE supported companies that had bad and doubtful debts with an outstanding debt balance of less than EGP 10 million, **Eq. USD 0.64 mn.**
  - The CBE supported individuals that had a total outstanding debt with all banks of less than EGP 1 million.
  - **The CBE allocated EGP 100 billion through banks at an interest rate of 8% to finance private sectors.** This included manufacturing, contracting and agriculture for corporates and SMEs.

The Economic Outlook for Egypt ;

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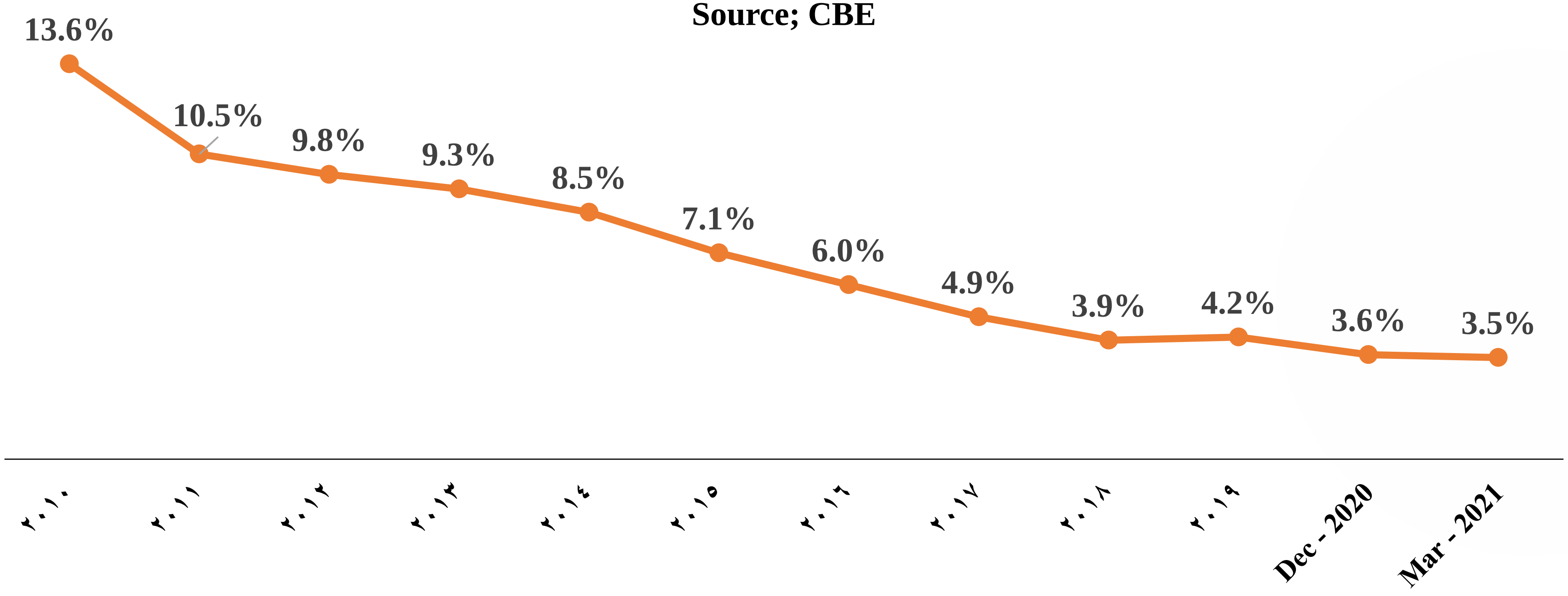
Indicators Sources; IMF	Actual			Projections		
	2010-17	2018	2019	2020	2021	2022
Real GDP "Growth Rate"	**4.3%**	**5.3%**	**5.6%**	**3.6%**	**2.5%**	**5.7%**
General Government Fiscal Balance / GDP	**- 8.6%**	**- 9.6%**	**- 7.9%**	**- 7.0%**	**- 7.5%**	**- 6.0%**
Current Account Balance / GDP	**- 0.9%**	**- 2.4%**	**- 3.6%**	**- 3.1%**	**- 4.0%**	**- 4.0%**
Total Gross External Debt / GDP	**23.6%**	**37.4%**	**34.1%**	**34.3%**	**38.1%**	**33.4%**

Based on IMF Projections; There's a gradual recovery in GDP growth rates with sustained structural imbalance in the other above mentioned indicators.

NPLs in the Egyptian Banking sector

Source; CBE



The achieved programs for banking sector reform had enhanced & sustained the resilience of banks to control the NPL, in addition to the fiscal & monetary measures to curb Covid negative impacts.

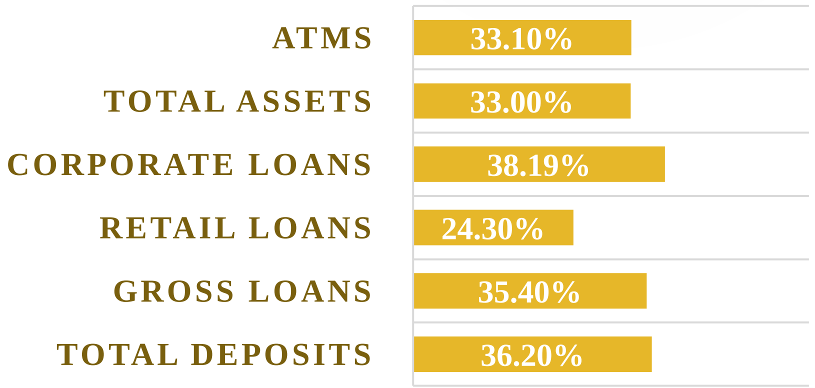
NBE Profile

- State owned established 1898,
- Paid-up capital ; EGP 50 bn. ; $ 3.2 bn.
- Capital Base ; EGP 140 bn. ; $ 9 bn.
- Extensive branch network (500+ branches) + international presence (UK, USA, China, UAE, Sudan & others),

Rating Agencies	NBE	Egypt
S&P	B, Stable	B, Stable
Moody’s	B3, Stable	B2, Stable
Fitch	B+, Stable	B+, Stable

Indicators	NBE Mar. 21	Min. Regulatory Requirements
Capital Base / RWA	16.43%	13.5%
Tier 1 Capital / RWA	14.4%	9.5%
Leverage Ratio	4.4%	3%
LCR	1578%	100%
NSFR	206%	100%

SOUND & SIGNIFICANT MARKET SHARE



7) NBE experience in managing NPLs

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NBE had taken a strategy to transform from a state-owned bank business model to regional bank business model to achieve sustainable growth in value and resilience that based on the following building blocks,

1st Restructuring The Organization;

EX; a) Enhancing segregation of duties & responsibilities, **b)** Corporate governance, **c)** Support the efficiency of market access by centralizing corporate banking, enhance product based approach for small exposures "SME's & Retail", **etc.**

2nd Enhancing the capabilities of Human Capital;

EX; a) New management group to synergize with the existing staff, **b)** Provide integrative training programs for all cadres, **etc.**

NBE experience in managing NPLs

3rd Inclusive development for I.T and Operating System;

4th Risk management;

EX; a) The increased focus on risk and the supporting governance framework Through “three lines of defense”; (Business – Risk and Support – Internal audit),

b) Integrated risk management Approach (Enterprise Risk Management),

c) Risk tolerance buffer against regulation requirements,

d) Developing risk technology, **e)** Early warning system, **etc.**

NBE experience in managing NPLs

<u>**5th Work-out the problem Loans;**</u>

a) Corrective actions “addressing NPL inventory” :

- Define strategy for the NPL unit,
- develop clear policies and procedures to manage the unit’s activities. measure and evaluate to refine the NPL management strategies and action plans.
- Portfolio Work-out Planning based on Portfolio Segmentation,
- Design target operating model to align NPLs unit’s operating model with work-out solutions,
- Identifying Routes to Recovery & supporting NPLS’ clients to be back in business again through depending on Study the cause roots , Identifying Routes to Recovery;

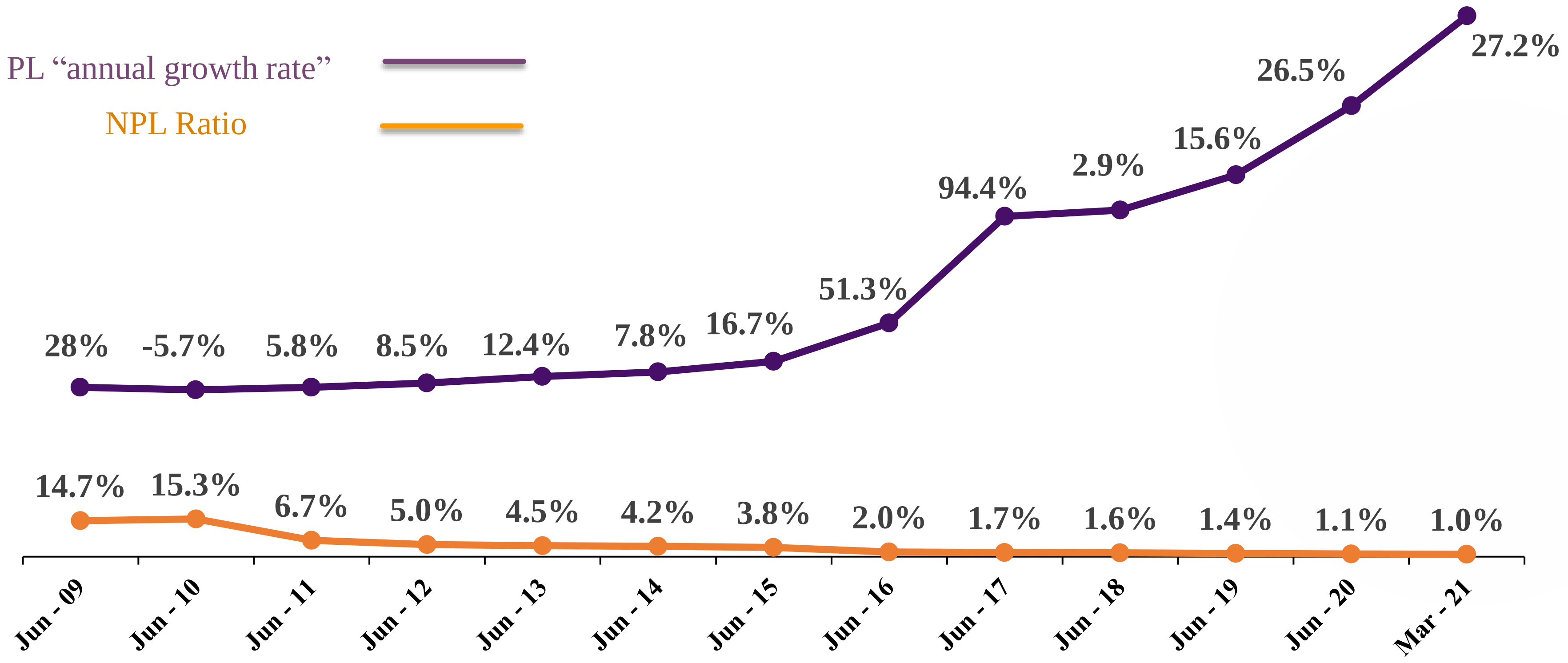
- *Restructuring according to the business cash flow,*
- *Floating according to the business opportunities & needs,*
- *Capitalization and/or inject fresh new capital ,*
- *Settlement “cash and/or in-kind” according to situation assessment.*

5th Work-out the problem Loans;

b) Preventive actions “addressing NPL flow”:

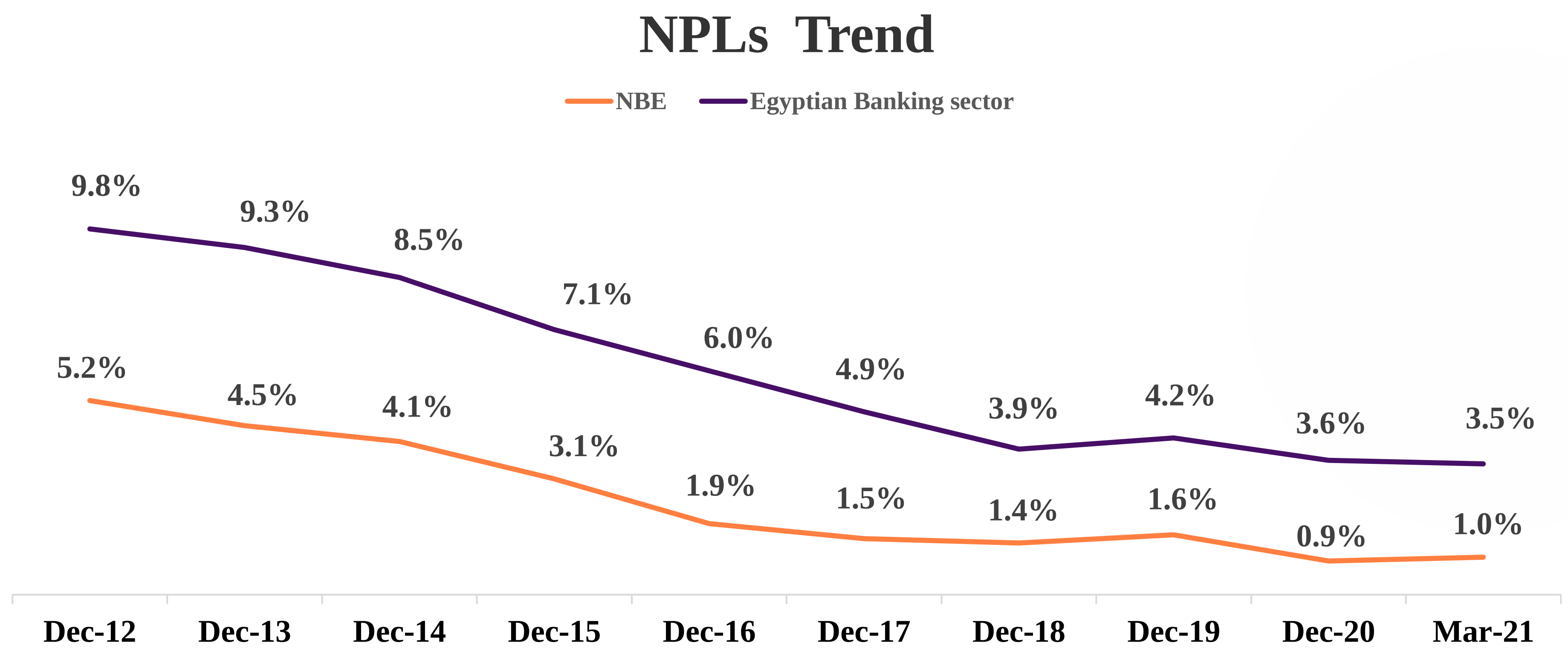
- Develop robust underwriting criteria, policies and procedures,
- Portfolio Diversification / Limit Mgmt. / Industries’ analysis & celling.
- Active Follow up.
- Early warning systems.

NBE experience in managing NPLs



The bank has achieved a balanced strategy between growth, credit quality and capital adequacy to sustain its value , and insure the resilience against stressed market conditions.

NBE experience in managing NPLs



The NPL trend is decreasing in view of the preventive and corrective actions implemented.

Conclusion

- Sound management of economic environment, in terms of sustainable real GDP growth, balanced public budget & external current account, and prudential regulation of banking sector are determinant factors in curbing the growth of problem loans in Normal and stressed market conditions.
- Fiscal and Monetary bailout supporting measures to banks and firms are critical factors to banking system to contain the consequences of crisis.
- Dealing with deterioration of credit quality during the COVID-19 crisis entails a sequential strategy focused on managing, resolving, and preventing problem loans.
- Banks should recognize the deterioration of their assets' quality by applying rules in force related to loan classification and provision.

Conclusion

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- To address the negative impact of higher NPLs on banks' capital, supervisors may allow the use of capital buffers (where they exist) and monitor capital restoration plans for the banks that fall below regulatory norms.
- "Recycle bad debt" may be one of the appropriate solution, if there's a market for bad loans.
- Once countries have implemented comprehensive resolution strategies, they should shift their focus toward preventing a re-accumulation of new arrears, which could undo past efforts.
- The fundamental of sound credit risk management that are based on a robust underwriting criteria and policies, diversification & limit management, risk governance, integrated risk management, early warning system and balance between growth, credit quality and capital adequacy, etc.. are vital to sustain the value of the banks and to increase the resilience against normal and, stressed market conditions.

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Thank You