

Financial Inclusion in Africa, Monetary Policy and Financial Stability: Country Experiences



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Outline of Presentation

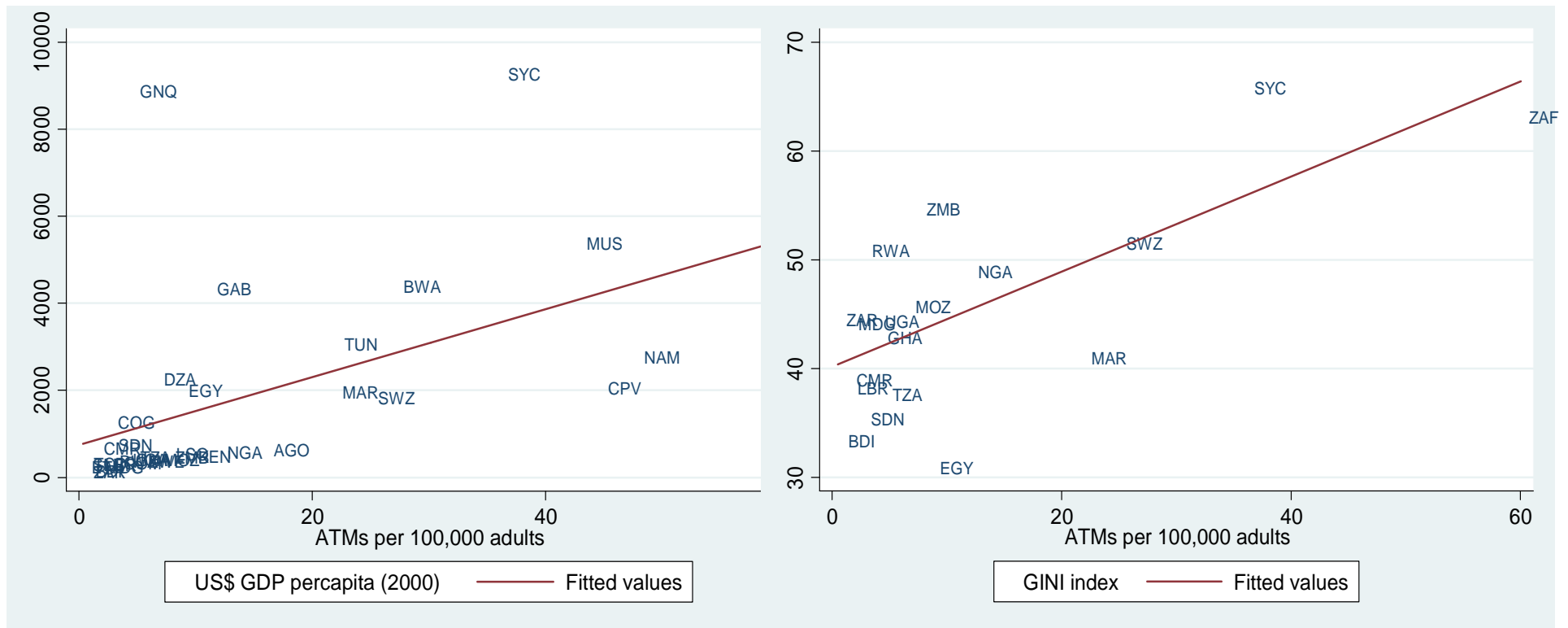
- **Introduction**
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- **Pushing the Frontier Outward: Trends**
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Overview

- **Definition:** The extent to which individual households and firms can directly access financial services.
- **Relevance:** Poses challenges for macro-stability and sustained growth and poverty/inequality reduction.
- **Barriers:** transaction costs (scale) and risks.
- **Measurement:** (i) number of users of basic financial services; (ii) subjective assessments of the quality of the financial services that firms obtain; (iii) physical and cost barriers to access.

Financial Inclusion – Stylized Facts

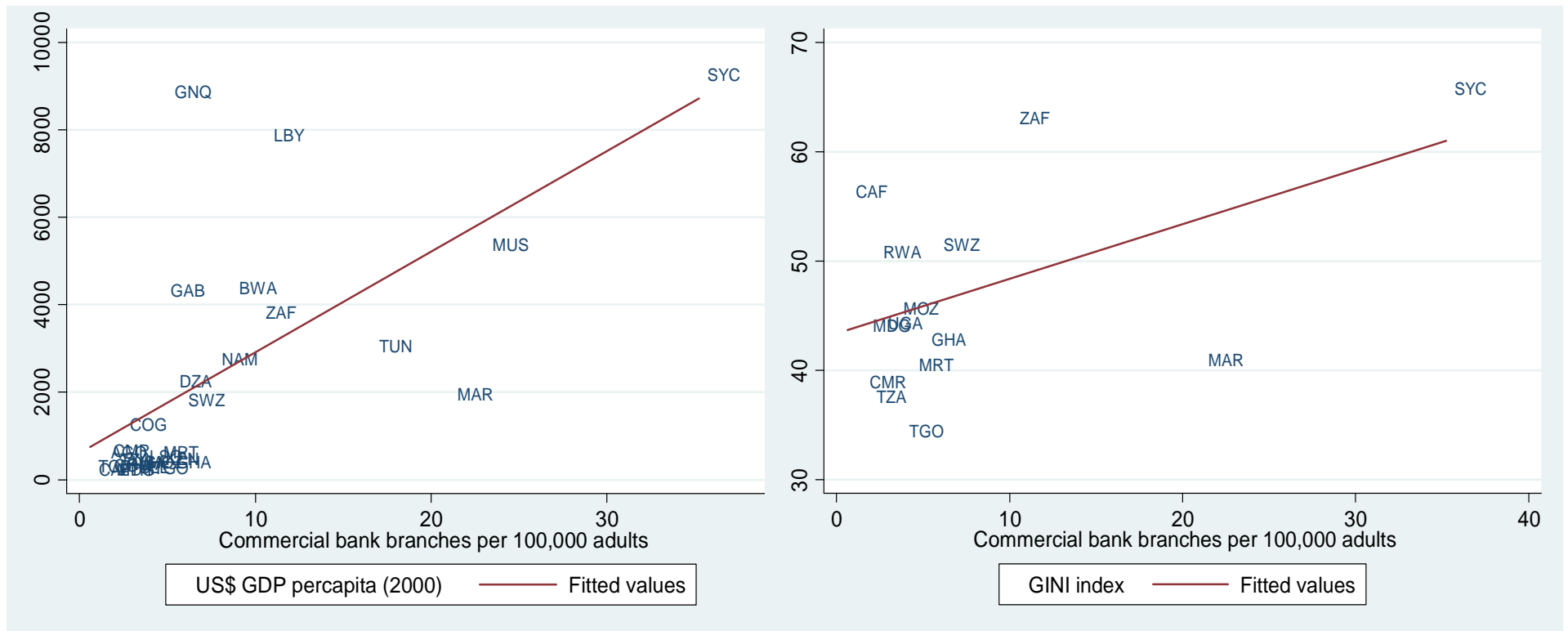
Financial outreach varies across countries in Africa



Source: Staff calculations.

Financial Inclusion – Stylized Facts

Financial outreach varies across countries in Africa



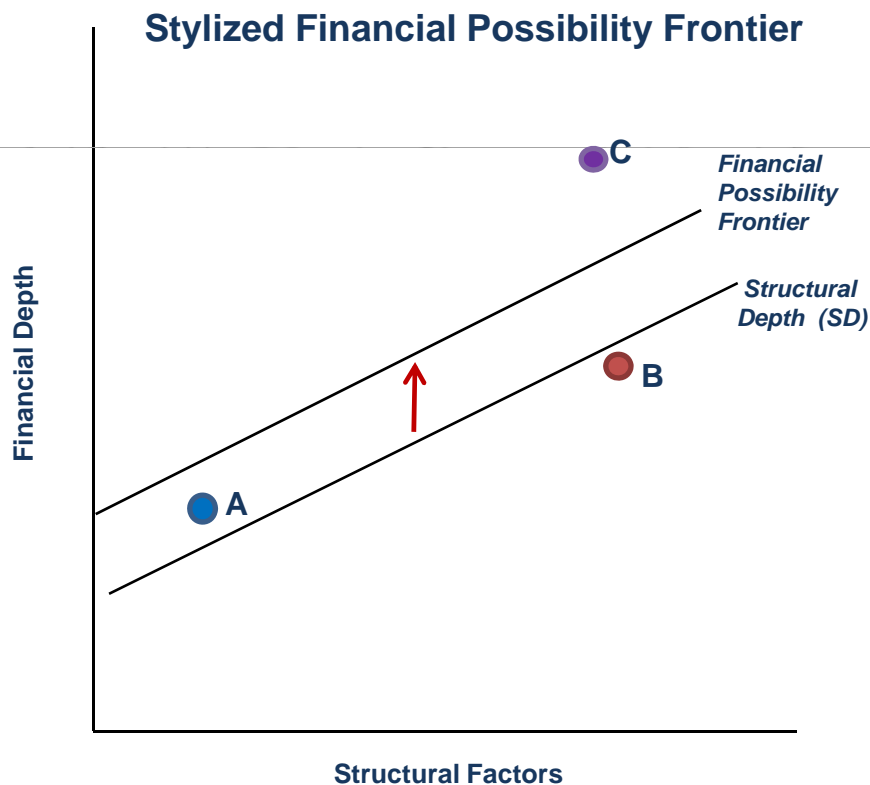
Source: Staff calculations.

Useful Conceptual Framework

- **Access Possibilities Frontier (APF):** the maximum potential clients base that can be served by financial institutions prudently.
 - Given the existing technological and the macroeconomic and institutional framework (*state variables*).
- **Financial Possibilities Frontier (FPF):** the maximum sustainable level of financial system depth.
 - Given the existing level of income, population size, density, age, other (*state variables*).

Financial Possibility Frontier

- The access possibility frontier raises the issue of determining the level of deepening that can be realistically achieved.



Depth determined by:

- Structural factors (SD)
- Policies (position relative to the SD line)

Situating countries:

- Low possibility frontiers
- Financial systems below the frontier
- Moving beyond the frontier

Financial Possibility Frontier

- The financial possibilities frontier can shift over time.
- Technological advances can make it possible for countries to support higher levels of financial activity.
- Institution building such as upgrading legal and contractual frameworks (e.g., defining property rights over land), and improvements in information frameworks (e.g., credit registries) can also push out the frontier over time.

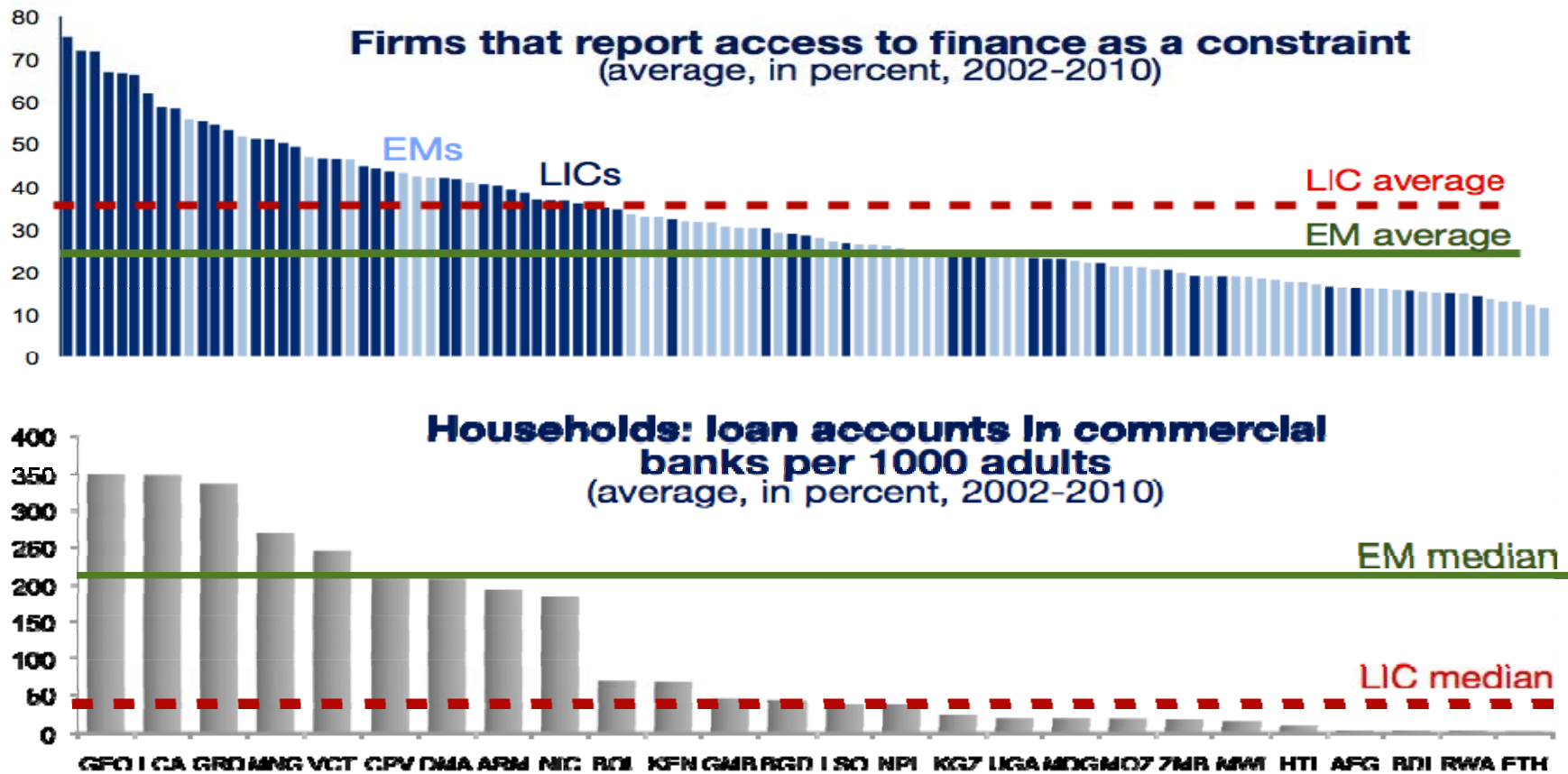
Policies to Push the Frontier Outward

- Balance between market-friendly actions, appropriate macro-prudential oversight, and careful calibration of public policies.
- Develop information and market infrastructure, address collateral issues, and limit excessively intrusive interventions and dominance.
- Interventions that support technological innovation, promote competition, and create infrastructures can help achieve economies of scale and reduce costs in financial services provision.
- Require a concomitant widening of the regulatory and supervisory perimeter to minimize regulatory arbitrage and financial system risks.
- Rapid expansion of non-bank intermediary sector, which traditionally has been outside the regulatory remit, can pose challenges for financial stability.

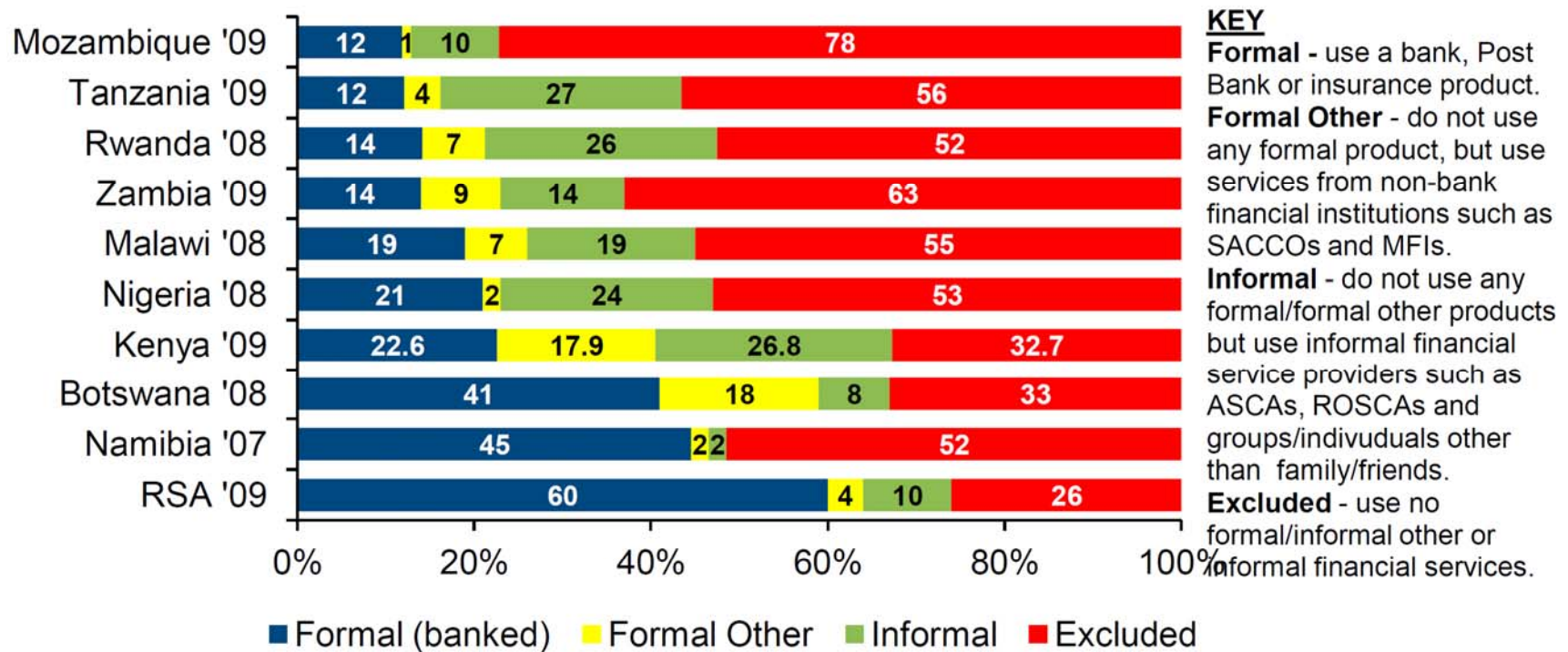
Trends Affecting Access and Financial Possibilities Frontiers

- Steady increase in financial inclusion in Africa over the past decade.
- Banks still dominate landscape but new nonbank institutions cover more people.
- Widespread use of informal financial services.
- Two successive innovations:
- *Credit-led inclusion*
 - Microfinance (MFI) and cooperatives have become an important segment of the financial system.
 - Overcoming (idiosyncratic) risks.
- *Payment-led inclusion*
 - Mobile finance services (MFS).
 - Overcoming scale barriers and transaction costs.

Limited household and firm access to finance



Cross-country comparison in financial access

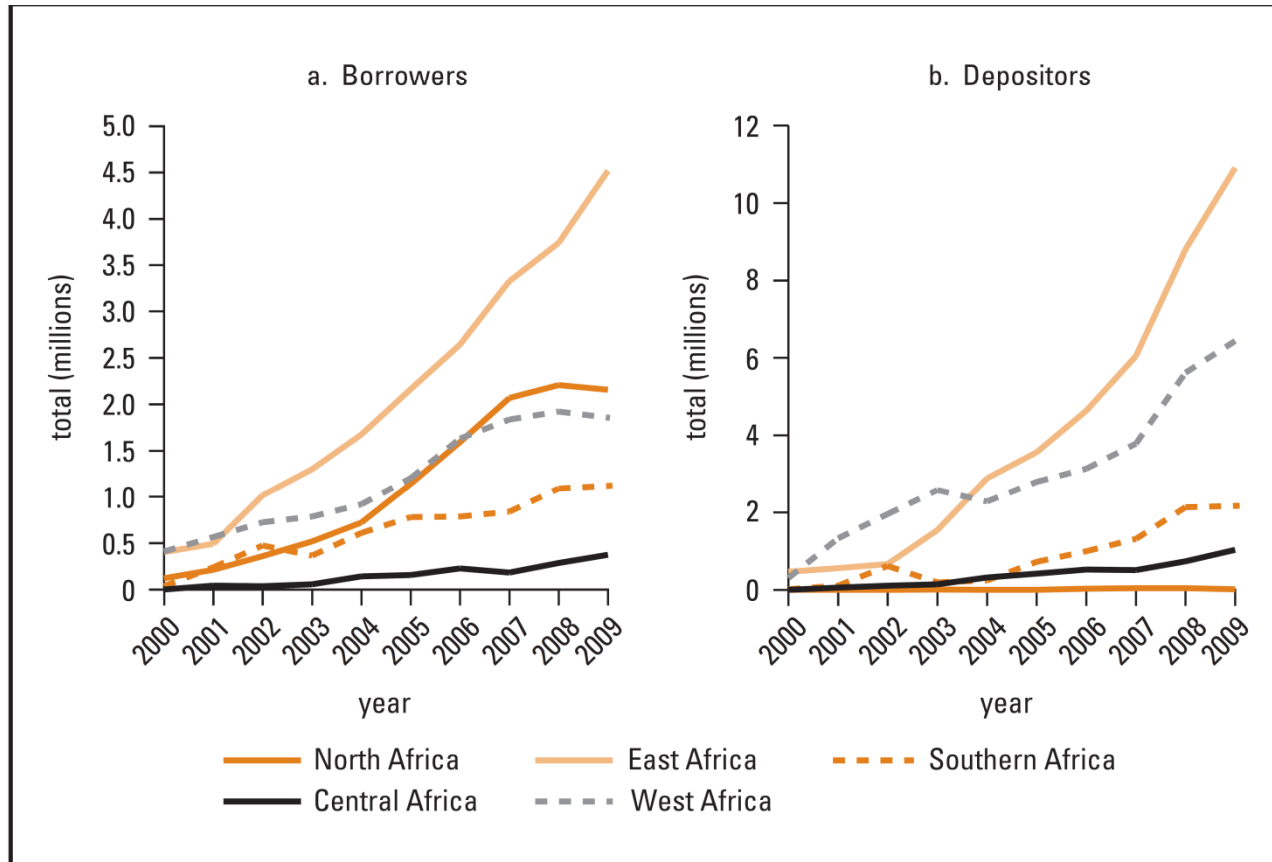


Source: FinScope Zambia (2009) and FinAccess (2009)

The Case of Uganda

- Enabling legislation for microfinance and savings and credit cooperatives (SACCOs), played a key role in spurring access to financial services.
- Credit guarantee mechanisms allowed for risk sharing between banks and guarantors in agricultural loans, leasing and innovative collateral, helping expand agricultural credit.
- Number of SACCOs doubled in two years to reach 2,800 in 2011.
- Greater access to be balanced with rapid proliferation of unregulated entities and distortions created by government support.
- Potential for emerging new technologies to facilitate access further.

Microfinance Expansion

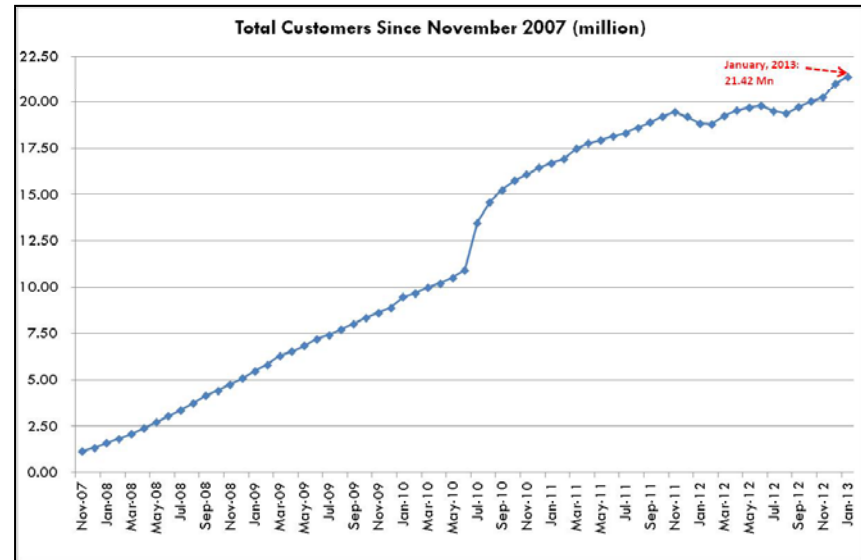
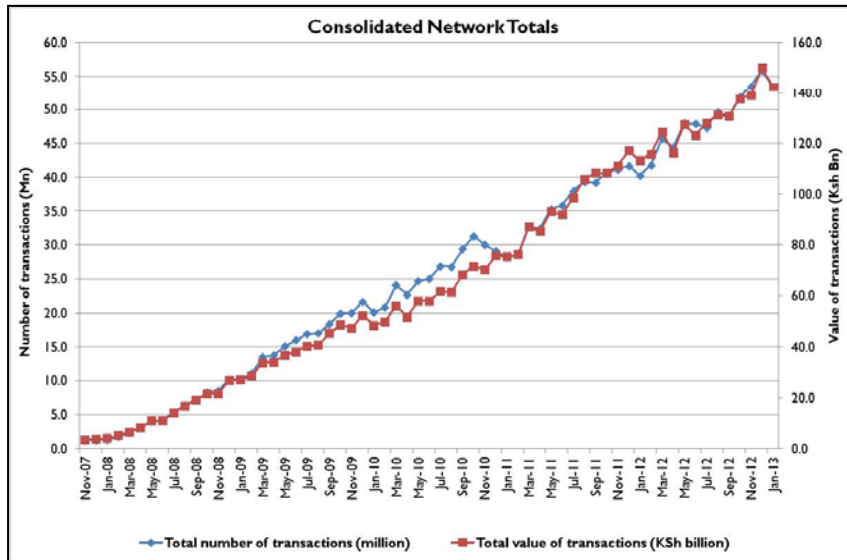


Source: Mix Market (database), Microfinance Information Exchange, Washington, DC, <http://www.mixmarket.org/data-center>.

The Case of Kenya

- Kenya is at the cutting edge of the MFS revolution.
- M-Pesa, supported by flexible regulation, helped lower costs and promoted access to payments services to underserved segments of the population.
- Formal institutions now able to offer new integrated mobile-based payments services and banking products.
- Better regulation rather than more regulation, encourage prudent market behavior.

Kenya: Mobile Transfers Revolution



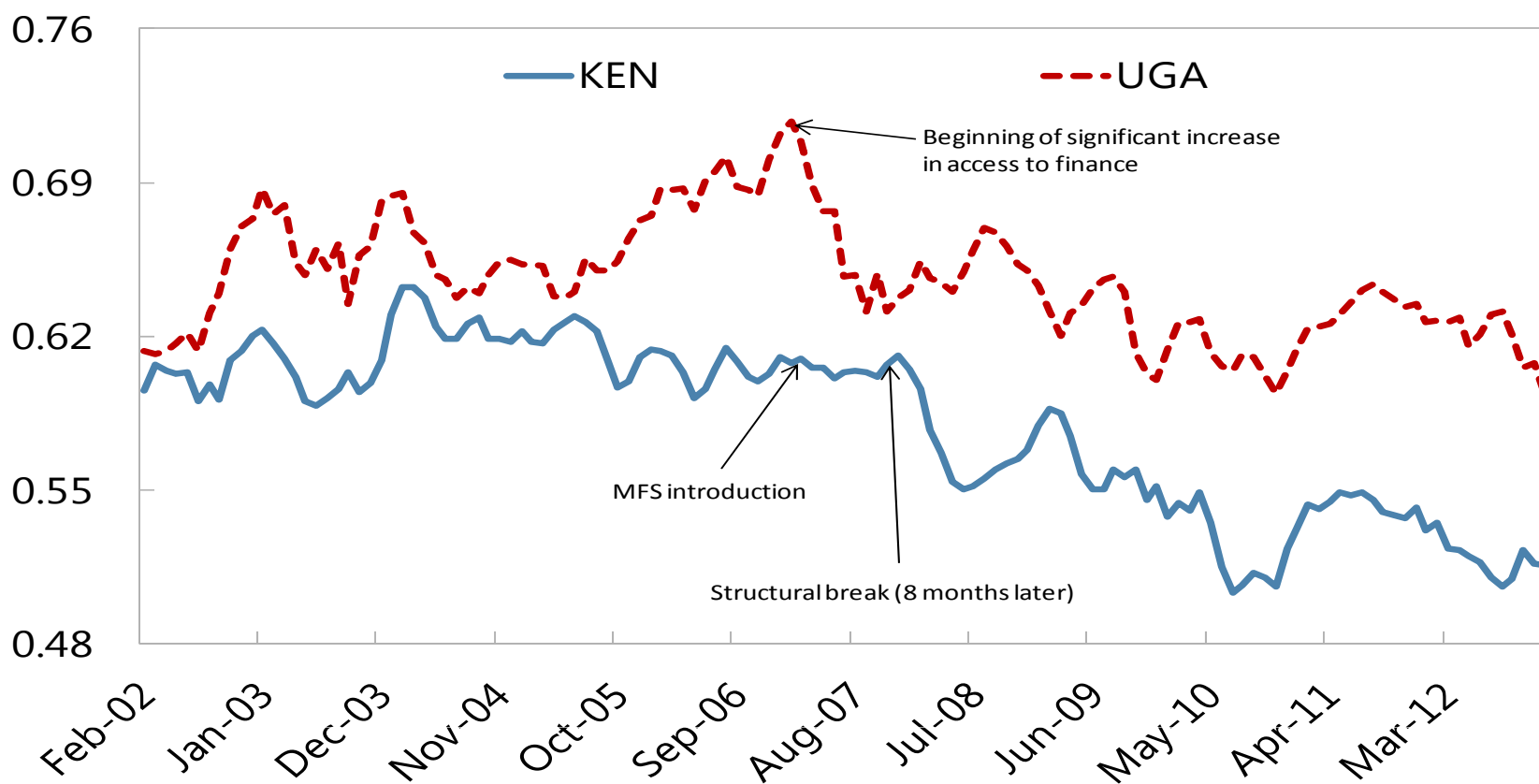
Source: Central Bank of Kenya

Implications of Innovations for Monetary Policy

- Move from frameworks centered on periodic quantitative targets for money aggregates towards more flexible operational targets and liquidity management.
- Velocity and money multipliers subject to fluctuations that complicate monetary policy analysis:
 - Unstable and/or unpredictable money demand.
 - Unstable relation between the intermediate target (broad money) and the operational target (reserve money) under a money targeting framework.
- Relationship between inflation and broad money growth has weakened over time, in part, because of payment-led inclusion revolution.
- Less cash outside the banking system could improve the transmission mechanism in IT-like monetary policy regime.

The currency in circulation as a share reserve money is declining in all three countries.

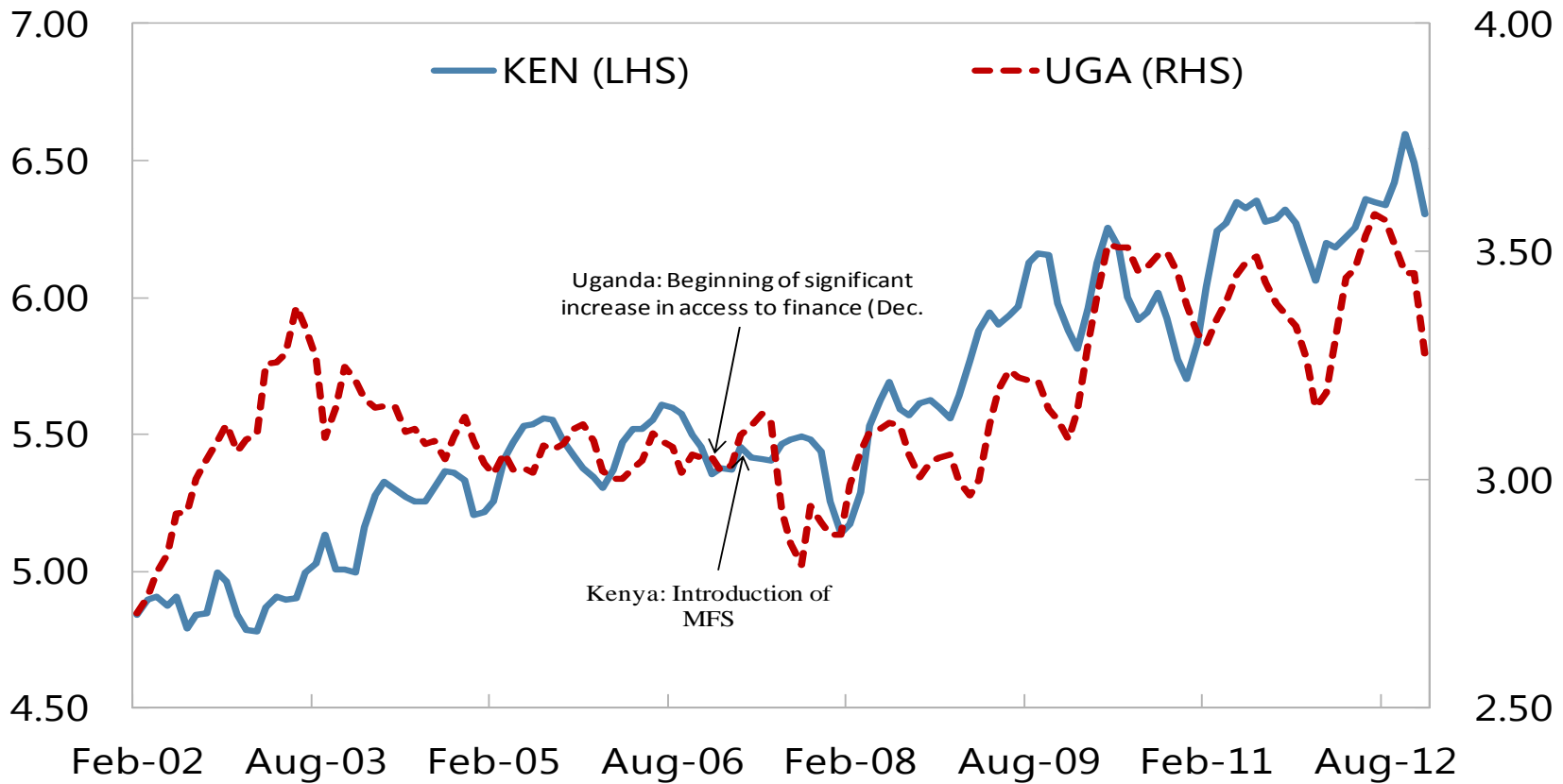
Currency Outside the Banks (As a share of base money)



Sources: Countries authorities.

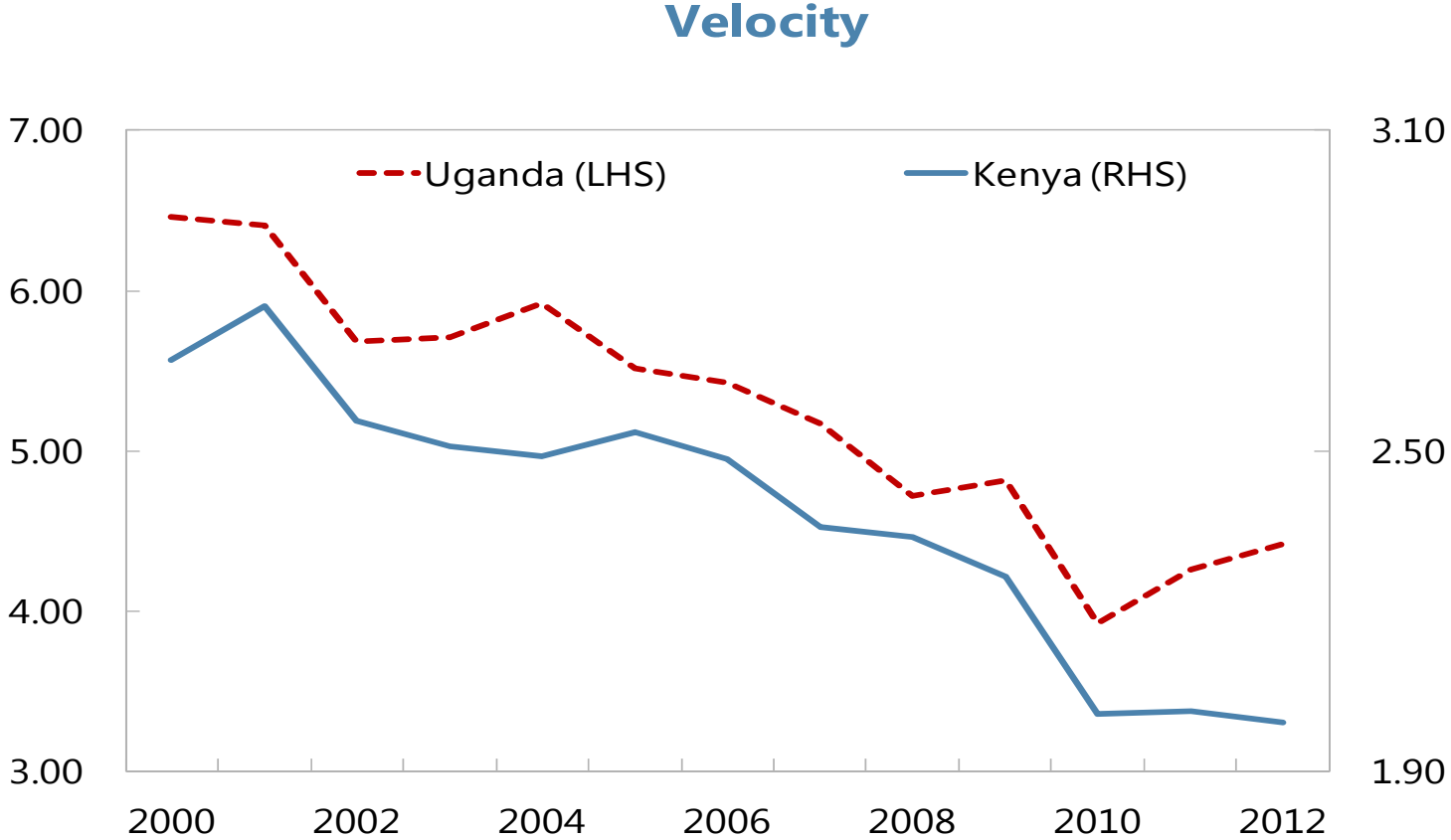
Money multipliers are broadly increasing

Money Multiplier



Sources: Countries authorities.

Velocity of money is declining in the two countries--
indication of increasing financial depth.



Sources: Countries authorities.

Pushing the Frontier Outward: IMF initiatives

- The Fund recognizes the heterogeneity across its membership.
- Enhanced focus on financial systems in Article IV:
 - Provide context: peer comparison; go beyond soundness indicators, leverage FSAP findings, etc.
 - Informing policy advice
 - Constraints of implementation of macroeconomic policies
 - Advice on financial regulation and supervision.
- Addressing information gaps:
 - Financial Access Survey.
 - Establishment of a new joint IMF-World Bank macrofinancial data portal for LICs.

Conclusion

- Policies to broaden financial access require a concomitant widening of the regulatory and supervisory perimeter to minimize regulatory arbitrage and financial system risks.
- More generally, the rapid expansion of the non-bank intermediary sector, which traditionally has been outside the regulatory remit, could pose challenges for financial stability.
- Balance between market-friendly actions, appropriate macro-prudential oversight, and careful calibration of public policies.
- Implications for the conduct of monetary policy need to be thought through as financial inclusion gains ground.
- Better integrating existing data sources, encouraging the collection of more data and qualitative information, and making them more accessible for bilateral surveillance are important steps.

Thank you

