

ASSOCIATION DES BANQUES CENTRALES AFRICAINES



ASSOCIATION OF AFRICAN CENTRAL BANKS

**ASSOCIATION OF AFRICAN CENTRAL BANKS
(AACB)**

**SECOND CONTINENTAL SEMINAR OF THE YEAR 2021 ON THE THEME:
'HIGH LEVELS OF NON-PERFORMING LOANS IN AFRICA:
DETERMINANTS AND IMPLICATIONS FOR FINANCIAL
STABILITY AND THE REAL ECONOMY IN THE REGION'**

Organised by: Central Bank of Egypt
(28th – 30th June 2021)

Terms of reference

INTRODUCTION

Under Article 3 of its Statutes, the Association of African Central Banks (AACB) organises each year a Continental Seminar as part of the achievement of its objectives. The Continental Seminar provides a forum for discussions between central banks, international and continental institutions, and resource persons to promote the exchange of ideas and experiences related to monetary, banking, financial issues and cooperation in Africa.

Following the 2008 financial crisis, the global economic slowdown weakened the banks' balance sheet by significantly increasing non-performing loans (NPLs), particularly in Europe. Indeed, the banks in the disturbed eurozone countries remained undermined by a large and growing stock of bad loans, resulting from the weight of companies' debt and the economic slowdown. Generally, non-performing loans are loans for which the borrowing institution probably will not receive all or part of the sums due, regarding the commitments made by the counterparty, under the initial contractual provisions due to financial difficulties of this counterparty. For reporting purposes, the European Banking Authority considers non-performing any credit risk exposures presenting overdue payments of more than 90 days or which can not probably be recovered without recourse to collateral realisation, whether or not they are past due.

Despite the notable improvement in bank equity over the past decade, the NPLs rate remains relatively high worldwide. In its report on financial stability, published on the 16th of October 2019, the International Monetary Fund (IMF) sounded the alarm by claiming that in the event of a sharp downturn, in the pessimistic scenario, 40% of corporate debt in the eight largest economies, representing \$19,000 trillion (euro 17,000 trillion), would be at risk default, more than the level observed during the last financial crisis.

However, Africa did not remain on the sidelines of this phenomenon. Despite the increased resilience of the region's financial system in many countries to the exogenous shocks in recent years, banks' bad debts remained rising, coupled with a deterioration in the level of equity and the quality of assets.

Given their negative impact on the economy's financing and the banks' profitability, due to the costs they generate (recovery, provisioning, refinancing, etc.), non-performing loans became a significant concern for governments and banking supervisors, notably the central banks.

This context led the 42nd ordinary meeting of the Assembly of Governors, held in Kigali, Rwanda, on the 1st of August 2019, to select the following theme for the 2020 Continental Seminar *'High Levels of Non-Performing Loans in Africa: Determinants and Implications for Financial Stability and the Real Economy in the Region'*. However, the Seminar was postponed to 2021 due to the COVID-19 pandemic that did not allow its organisation in 2020.

The present terms of reference specify the context and objectives of the second AACB Continental Seminar, the main topics discussed and the organisational framework.

I. CONTEXT AND OBJECTIVES OF THE SEMINAR

Nowadays, banks continue to take a predominant place in the global financial sector, particularly in Africa, representing more than 90% of the assets. Over the past two decades, the banking sector underwent profound changes in Africa (Beck and Cull, 2019)¹, especially the financial liberalisation and related reforms, the expansion of cross-border banking activities, with the rapid development of networks of pan-African banking groups, which have considerably contributed to changing the African banking and financial landscape.

Previously dominated by government institutions and affected in their operations by restrictive regulations, Africa's banking systems are now more profound and more stable, with the incidence of systemic banking crises declining sharply over the past two decades. They did relatively well when facing the turmoil of the global financial crisis, despite indirect pressures induced by international trade links.

However, in recent decades, some African banks have experienced high exposure to credit risk, which has contributed to a deterioration of the quality of their portfolios. Indeed, according to available data², the rate of non-performing loans of African banks stood at 11.1% of total loans in 2019 compared to 6.0% globally. This NPLs rate increased from 8.6% in 2010 to 11.1% in 2019, after reaching 12.0% in 2017.

Nevertheless, these figures mask disparities between countries. According to the most recent data published by the International Monetary Fund³ (IMF), NPLs remained relatively low for some countries such as Lesotho (3.3% in 2019 compared to 3.7% in 2018), Seychelles (3.5% in 2019 compared to 4.4% in 2018), South Africa (3.9% in 2019 compared to 3.7% in 2018) and The Gambia (4.5% in 2019 compared to 3.2% in 2018). In contrast, the NPLs rate remained high in some African countries. These include Equatorial Guinea (48.8% in 2019 against 36.7% in 2018), Congo (23.1% in 2019 against 18.2% in 2018), Chad (22.9% in 2019 and 28.6% in 2018) and Djibouti (16.0% in 2019 and 17.8% in 2018).

Several factors (internal and external) are driving this significant deterioration in the quality of some banks' portfolio in Africa. These include, among other things, the unfavourable economic and security situation, the fall in the prices of export products and, above all, inappropriate behaviour of the companies, notably the Small and Medium Enterprises (SMEs), which are known as bad borrowers, due to their lack of liquidity.

Furthermore, the critical level of corporate debt since the international financial crisis could also explain the deterioration in the banks' portfolio quality. According to the IMF mentioned above report, in the first quarter of 2019, the total corporate debt (excluding the financial sector) reached 91.4% of global Gross Domestic Product (GDP), up to 20 percentage points over 20 years. It is now higher than that of the governments (87.2% of GDP, 30 points since 2000) and households (59.4%, up to 16 points).

^{1/} Beck, T., R. Cull and P. Valenzuela (2019): « Banking in Africa », Oxford University Press, November 2019.

^{2/} https://www.theglobaleconomy.com/rankings/Nonperforming_loans/Africa/

^{3/} <https://data.imf.org/regular.aspx?key=61404590>

In addition, the current health crisis related to the COVID-19 pandemic could induce a significant increase in bad debts, relaunching the debate on NPLs. Unlike past financial crises, which were mainly exogenous, the COVID-19 pandemic particularly affected companies in the industrial and tourism sectors because of significant increases in overdue payments, bankruptcies and job losses. This situation should result in an accumulation of bad debts for the banks. However, the easing of regulatory provisions governing banking activity by regulatory authorities during the COVID-19 pandemic should mitigate the rise in the NPLs' level.

Owning NPLs has two significant consequences for a bank. If a loan is not repaid or no longer repaid, the bank must make provisions (accounting obligation) and potentially set aside more equity (regulatory obligation), which reduces its ability to grant new loans. Furthermore, the bank's profitability declines when bad debts increase. That could lead to economic survival problems for the bank and undermine the confidence that its financial partners could place in the bank. Thus, the bad loans' "burden" poses a threat to the solvency of banks, limiting their profitability, which reduces their ability to support economic activities.

To guard against the default risk, banks often adopt prudent behaviour by limiting the credit granting, resulting in maintaining bank excess liquidity.

In a context marked, on the one hand, by financial globalisation with the generalisation of capital movements, the proliferation of new financial instruments and economic turbulence and, on the other hand, by the persistence of endogenous and exogenous shocks, development control and supervision tools to anticipate bank difficulties become inescapable. In this perspective, it is necessary to strengthen micro-prudential mechanisms to ensure banks' efficiency and financial soundness, given the negative impact of NPLs on financial system stability and the real economy.

In this regard, the following main objectives are assigned to the second 2021 Continental Seminar:

- Contribute to better understand the concept of non-performing loans and to highlight their extent in credit institutions in Africa;
- Assess the impact of NPLs on the financial system stability and the real economy;
- Highlight the factors that determine the accumulation of non-performing loans in African economies and initiate discussions to propose strategies aimed at reducing these overdue loans because of their negative impact on financial stability;
- Contribute to a better understanding of the impacts of the current health crisis on the stability of the financial system, in particular, the dynamics of the evolution of non-performing loans;
- Highlight the interactions between non-performing loans and financial inclusion while emphasizing transmission mechanisms.

II. ARTICULATION OF THE SEMINAR

The Seminar could be organised around the following lines:

- Presentations on the current state of non-performing loans in Africa, their evolution and the challenges as well as the risks they could present for the stability of the financial system;
- Presentations on the determinants of non-performing loans in African economies and their potential impact on the real economy;
- Presentations on the impact of the current health crisis on non-performing loans and measures adopted to mitigate their impact on the banking system and the economic activity financing;
- Reflections on the role central banks can play in dealing with non-performing loans in African countries to improve bank profitability.

III. ORGANISATIONAL FRAMEWORK

3.1. Participants

About fifty participants from the following institutions are expected:

- Central Banks members of AACB;
- European Central Bank (ECB);
- African Union Commission (AUC);
- United Nations Economic Commission for Africa (UNECA);
- African Institute for Remittances (AIR);
- Common Market for Eastern and Southern Africa (COMESA);
- Southern African Development Community (SADC);
- Central Africa Economic and Monetary Community (CAEMC);
- Economic Community of Central African States (ECCAS);
- Economic Community of West African States (ECOWAS);
- Maghreb Arab Union (MAU);
- West African Economic and Monetary Union (WAMU);
- Eastern African Community (EAC);
- West African Monetary Agency (WAMA);

- West African Monetary Institute (WAMI);
- International Monetary Found (IMF);
- Worl Bank;
- African Development Bank (AfDB);
- Federal Reserve Bank of New York (FRBNY);
- Make Finance Work for Africa (MFW4A);
- GIZ;
- Smart Africa.

3.2. Seminar program

3.2.1 Organisation of a face-to-face Seminar

According to the schedule below, the Seminar could be organised over three (3) days, in plenary sessions and workshop discussions.

First day - morning

The morning of the first day will be devoted to presentations on the following three sub-themes:

- *'Increase in Non-Performing Loans in Africa: Inventory and impact on the financial stability'*. This sub-theme would analyse the evolutions of the bank's non-performing loans in Africa and their impact on the financial system stability. Particular emphasis could be placed on the impact of the current health crisis on non-performing loans;
- *'Interaction between Non-Performing Loans (NPLs) and Financial Inclusion'*. This sub-theme would analyse the links between non-performing loans and financial inclusion. It would describe the way or the mechanism by which bad debts could affect financial inclusion or vice versa;
- *'Resolution of Non-Performing Loans: What Strategies for African Central Banks?'*. This sub-theme aims at highlighting the solutions and strategies that banking supervisors, in particular central banks, could reduce the rate of deterioration of the banks' portfolio. A significant decline in this rate is likely to strengthen confidence between banks and their customers, prompting banks to increase their support to finance the economy. In addition, the measures adopted by central banks in the context of the COVID-19 pandemic could be discussed.

First day – afternoon

The afternoon will be devoted to experiences presented by the central banks of the AACB sub-regions, concerning the main theme of the Seminar:

- North Africa (Banque d'Algérie, Bank Al-Maghrib);
- West Africa (Bank of Ghana, Central Bank of Nigeria);
- East Africa (Bank of Tanzania, Bank of Uganda);
- Central Africa (Banque Centrale du Congo, BEAC);
- Southern Africa (South African Reserve Bank, Bank of Zambia).

Second day - morning

The morning of the second day will be reserved for break-out sessions. Participants will be divided into three groups to discuss specific sub-themes and make recommendations:

- Session Group 1: the proposed sub-theme is *'Non-Performing Loans: Determinants, Implications for the Financial Stability and Economic Growth'*;
- Session Group 2: the proposed sub-theme is *'Interactions between Financial Inclusion and Non-Performing Loans'*;
- Session Group 3: the proposed sub-theme is *'Health Crisis of COVID-19 and Non-Performing Loans: Impacts and Challenges'*.

Second day – afternoon and third day

The afternoon of the second day and the third day will be devoted to the restitution of the Session Groups' work, as well as to the development and adoption of the conclusions and recommendations of the Seminar.

3.2.2 Organisation of the Seminar in virtual format

If the Seminar is organised virtually, the three days could be retained, with some modifications in the program to take into account the difference in time zones.

First day - morning

The morning of the first day will be devoted to presentations on the following three sub-themes:

- *'Increase in Non-Performing Loans in Africa: Inventory and impact on the financial stability'*. This sub-theme would analyze the evolutions of the bank's non-performing loans in Africa and their impact on the financial system stability. Particular emphasis could be placed on the impact of the current health crisis on non-performing loans;
- *'Interaction between Non-Performing Loans (NPLs) and Financial Inclusion'*. This sub-theme would analyze the links between non-performing loans and financial inclusion. It would describe the way or the mechanism by which bad debts could affect financial inclusion or vice versa;
- *'Resolution of Non-Performing Loans: What Strategies for African Central Banks?'*. This sub-theme aims at highlighting the solutions and strategies that banking supervisors, in particular central banks, could be led to consider to reduce the rate of deterioration of the banks' portfolio. A significant decline in this rate is likely to strengthen confidence between banks and their customers, prompting banks to increase their support to finance the economy. In addition, the measures adopted by central banks in the context of the COVID-19 pandemic could be discussed.

First day – afternoon

In the afternoon, instead of two presentations per sub-region, one presentation per sub-region could be presented. Thus, the following Central Banks will present their experience:

- North Africa (Banque d'Algerie);
- West Africa (Central Bank of Nigeria);
- East Africa (Bank of Tanzania);
- Central Africa (BEAC);
- Southern Africa (Bank of Zambia).

Second day - morning

Three (3) Group Sessions will be organised.

3.3. Date and place of the Seminar

At the end of its second virtual meeting, held on the 26th of November 2020, the AACB Bureau confirmed the organisation, between March and July 2021, of the 2021 Continental Seminar, which should be held in Cairo, Egypt. However, if the COVID-19 pandemic does not abate to allow a face-to-face meeting, the Bureau approved the option of holding the meeting virtually.

IV. COST OF THE SEMINAR

Following the budget of the Association for the year 2021 approved by the Bureau during its virtual meeting held on the 26th of November 2020, the cost of the Seminar, except transportation costs and travel expenses of the AACB Secretariat, shall be covered by the host institution (in the event the meeting was held face-to-face). Accommodation and subsistence costs for delegations are covered by Central Banks and invited institutions.

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