Growth Research Programme

Ten things I learned from the DEGRP roundtable debate on **Covid-19 and Africa's financial sector**

Chair's summary by Dirk Willem te Velde, 8th June 2020

On 26th May, DFID-ESRC Growth Research Programme (DEGRP) finance researchers convened to discuss **the implications of Covid-19 on Africa's financial sector**. Panellists included researchers **Panicos Demetriades** (Leicester University), **Stephany Griffith-Jones** (Columbia University and Senior Research Associate at the Overseas Development Institute (ODI)), **Thorsten Beck** (Cass Business School), **Victor Murinde** (SOAS University of London), **Peter Knaack** (University of Oxford), and **Judith Tyson** (ODI). Participants included representatives from **DFID, World Bank's IFC, UN's Economic Commission for Africa, FSD Africa, FSD Kenya, African Economic Research Consortium, Gatsby Africa, Prudential**, and others. As chair of the roundtable, these were my 10 takeaways from the discussion:

1) The major challenges in Africa's real sector require an ambitious fiscal and health response

There was acknowledgement that the challenges being faced by African economies are real, adding to the already significant structural issues. Roundtable participants discussed the economic impacts through GDP effects, declines in foreign direct investment (FDI), remittances, exports, and cross border truck queues (for example, of over 40 miles at the Kenya/Tanzania border). Governments were urged to do whatever it takes to get the virus under control. **A fiscal response targeting transport and infrastructure can have a significant pay off.** Some academic papers in the *American Economic Review* suggest the fiscal multiplier in a crisis can be as high as 1.5, with fiscal expansion lowering the debt to GDP ratio.

2) There are no signs of systemic financial crises…yet

There is less evidence that Africa's financial sectors have already been severely affected or that systemic financial crises have already developed. However, most are worried that the **financial sector will be performing significantly badly if the real economic crisis carries** on for too long. Firms listed at Africa's stock market had already adjusted revenues down by 24% due to Covid-19 and profitability was down by 12%.

3) Specific characteristics of African banking sectors

There are several **notable characteristics of African banking sectors and economies which influence appropriate policy responses**. African banking sectors have high capital and liquidity buffers and a strong influence from regional banks, but exposure is often concentrated in a few sectors. African banks already had a relatively high share of non-performing loans, at 11%. Informality is a further challenge in terms of reaching those in need. Firms often rely on friends, not savings, when dealing with crises.

4) Long term finance and the role of development banks

This crisis can lead to a debate to restructure African finance, considering **long-term finance** and the countercyclical role played by **development banks**. There was significant interest in understanding the role of **pension funds** to address the liquidity crisis and whether and how restrictions on them could be lifted to ease direct investments.

5) Mobile money presents significant opportunities for Africa's financial sector

Mobile money drove financial inclusion across Africa including in Kenya (though so countries, for example, Mozambique, are still weakly covered). It is important to lower the transaction costs on using mobile money. Creating a national ID is also important, although it may not be sufficient to reach particular groups, such as migrants.

6) There are trade-offs in using different types of financial instruments

There are trade-offs in using different types of instruments, such as **loans** versus **grants**. Should government authorities extend loans to firms via commercial banks using guarantees, or should they provide direct grants or take equity stakes and have a say over the firm? Often the devil is in the detail on why some instruments work best over others.

7) There are varied views on the role of monetary financing in Africa

Some suggest that **monetary financing**, or borrowing from central banks by governments, is crucial for addressing the crisis now, as long as governance and central banks' independence can be guaranteed. Monetary financing need not be inflationary, according to some. Others expressed fears of inflationary effects of monetary financing, referring to Zimbabwe.

8) The role of micro finance institutions

More thinking is required to understand how micro finance institutions (MFIs) can best be supported. Some would like to consider **regulatory responses** by the central banks, others suggest that flexible and **rapid credit availability** is crucial.

9) Loan loss provisioning and regulatory forbearance

Many bring up the importance of **loan loss provisioning or regulatory forbearance**, for example, to allow debt or non-performing loans (NPLs) due to Covid-19 to be classified separately. For this to happen, it is crucial to know whether only temporary liquidity is required or whether the problems are more of a permanent nature and related to solvency. This needs data collection and analysis. Policy-makers should avoid 'zombie' firms and banks with large NPLs. NPLs tend to go up 30% during crises and a rush towards bankruptcy is likely. A fresh look at the insolvency and bankruptcy regimes is needed, possibly even a ban on filing for bankruptcy because of Covid-19.

10) What international donors can do

International donors can help in several ways including through **funds and supporting more research and analysis**. They can support debt restructuring deals so that countries (and companies) in distress do not need to pay interest for a year or longer. They can also support data collection and surveys, especially in the banking sector, which are needed to formulate appropriate policy responses.

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Research jointly supported by the ESRC and DFID