FINANCIAL MARKET STABILITY

WILL THE ANCHOR HOLD?

On 24 March 2014, Dr. Mahamadu Bawumia, an eminent economist and former Governor of the Bank of Ghana, delivered a lecture in his capacity as visiting professor of economic governance at Central University College in Accra. Among other things, he sounded a note of caution regarding vulnerabilities in the financial sector due to the weak economy and Government's over-extension in the money market. This paper examines that caution and makes policy proposals in response to findings of this inquiry.

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Dr. Bawumia's lecture, "The IMF Bailout: Will the Anchor Hold", clearly has surfaced some pressing issues of policy credibility in our public governance and statistical input for policy formulation. Sound policy is driven by sound and credible data that should stand the test of methodological scrutiny; that continues to be a valid assumption. Another tacit assumption we (civil society) have been working with, and indeed have taken for granted, is the credibility of data churned out by public institutions who are deemed to possess the technical wherewithal for such onerous tasks. But do they? Unfortunately, the response to this inquiry is not the focus of this treatise but to stress-test the conclusion of Ghana's central bank that, Ghana's banking sector continues to be "sound and solvent" according to the February 2015 edition of the Financial Stability Report (Vol. 5. No. 2).

It's important to understand that Bank of Ghana's (BOG) prudential guideline for Financial Stability looks at metrics from five different performance dimensions; capital adequacy, asset quality, management efficiency, earnings and liquidity. BOG collects financial data to assess performance in these areas and draws conclusions on the overall stability of the financial sector, using the Banking system as proxy.

In Dr. Bawumia's lecture, he raised critical questions in the area of asset quality and used anecdotes from Standard Chartered Bank's books for illustration (ref: lecture transcript, pg. 32).

> "The NPLs in the non-Bank sector in particular is becoming explosive and the Bank of Ghana has signaled that it may soon review capital requirements for the entire system."

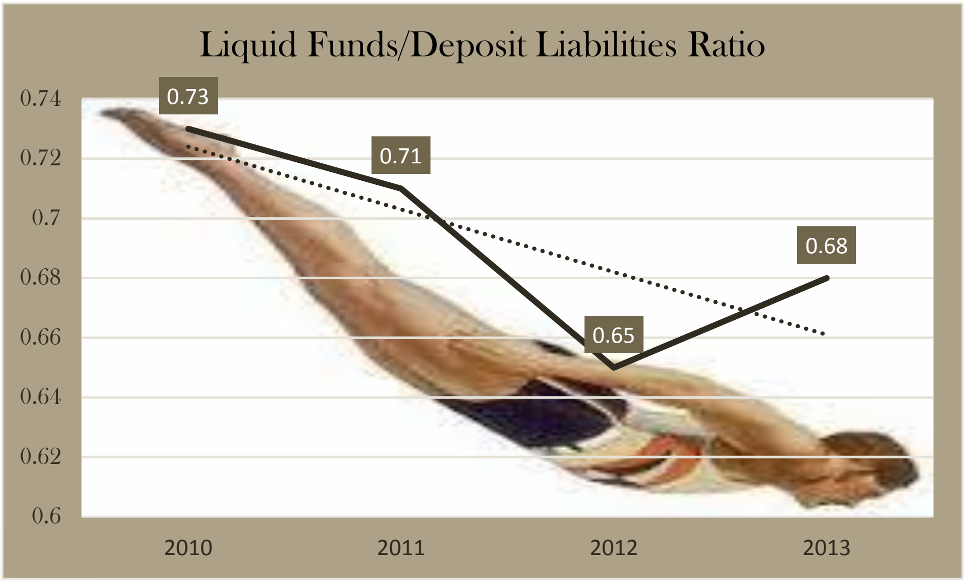
For context, here is a rehash:

"The entire financial system is at risk from rising non-performing loans (NPLs). Standard Chartered Bank for example, a well-managed bank, has seen its NPLs increase from 15.5% in 2013 to 27.3% in 2014. According to Stanchart's financial statement for 2014, "The increase is attributable to exposure of some of our customers to payment delays from government."

So, the logical question is; is the banking sector "sound and solid" as drummed up by BOG but refuted by Dr. Bawumia? Please note that this inquiry is of the banking sector and not the financial sector, which umbrellas' microfinance, Non-Banking Financial Institutions (NBFIs) and Financial NGOs. Indeed, there are legitimate questions to be asked why Bank of Ghana's Financial Stability Report does not directly account for earnings and asset/liability performance of these institutions in order to form a broader view of financial sector performance. This brief will however be limited to the issue of BOG's "sound and solid" claim.

Let's start with liquidity.

Data from PricewaterhouseCooper's (PwC) 2014 annual Banking Survey report, indicates that although liquidity remains strong, year-on-year data from 2010 to 2012 showed a downward trend. This inched up in 2013, according to the report.



Data Source: PwC. Ghana Banking Survey, 2014.

So what does this mean? Let's triangulate with data from Bank of Ghana's Financial Stability Report. With aggregate growth in bills and securities of 11.2% in 2014 to reach GH¢ 12.09 billion (compared to 2013 growth of 45.7% in same period), there may be liquidity questions regarding how to fund year-on-year growth in deposit liabilities (39% to reach GH¢32.43 billion as compared to growth of 19.2% for same period in 2013 – Source: Financial Stability Report, Vol. 5 No. 2, February 2015). In other words, deposit liabilities are growing faster than aggregate liquid assets. This may have positive outcomes for credit creation as shown in the increase weighting of loans and advances in the total asset composition [43.2% in 2014 from 42.6% in 2013]. Albeit, the Central Bank attributes changes in the aggregate asset composition to Bank's response to changes from 9% to 11% in April 2014 (revised downwards to 10% later), there is a need for certainty that other factors are not at play that may be more responsive to market dynamics than to policy tweaks. The regulator ought to be doubly certain for this simple reason; liquidity takes primacy over aggressive asset growth when it comes to prudential management, therefore any concerns merits policy attention.

> "The NPLs in the non-Bank sector in particular is becoming explosive and the Bank of Ghana has signaled that it may soon review capital requirements for the entire system."
>
> - Dr. M. Bawumia

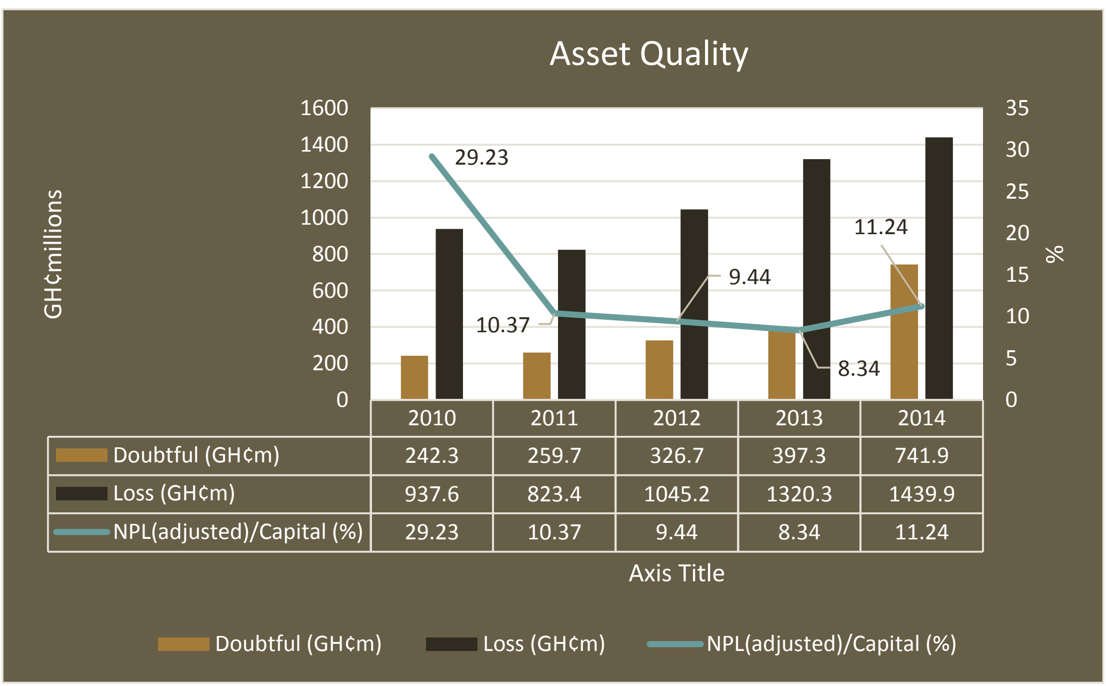
Asset Quality

Dr. Bawumia argues, "The entire financial system is at risk from rising non-performing loans (NPLs). Standard Chartered Bank for example, a well-managed bank, has seen its NPLs increase from 15.5% in 2013 to 27.3% in 2014." Again he posits, "The NPLs in the ***non-Bank sector*** in particular is becoming explosive and the Bank of Ghana has signaled that it may soon review capital requirements for the entire system." First things first, so let's address the first issue; burgeoning non-performing loans.

Bank of Ghana in their February 2015 MPC Press Release (para.14. pg.6) states, "The non-performing loans (NPL) ratio of the banking system, adjusted for fully provisioned loans, increased to 5.6 percent at the end of December 2014 compared with 4.6 percent in the corresponding period in 2013. However, the unadjusted NPL ratio declined to 11.3 percent from 12 percent in 2013.”

What do these numbers mean? Again, data triangulation would provide some useful context. There are two ways of looking at this. (1) A review of the industry aggregate impairment ratios, and (2) extrapolating system-wide exposure to NPL performance of the top 5 Banks. The top 5 banks, as at December 2014, commanded 39.2% of industry share in deposits, down from 45% in 2013, hence their balance sheet exposure may hold sway for industry stability.

Data from BOG’s Financial Stability Report shows mixed outcomes in loan quality indicators. While the Non-performing Loan ratio trended downwards from 14.1% in 2011 to 11.3% in 2014, the adjusted NPL to capital moved from 10.37% to 11.24 within the same period. So notwithstanding apparent improvement in portfolio quality, the proportion of capital at risk due to quality deficits has increased.



	2010	2011	2012	2013	2014
Doubtful (GH¢m)	242.3	259.7	326.7	397.3	741.9
Loss (GH¢m)	937.6	823.4	1045.2	1320.3	1439.9
NPL(adjusted)/Capital (%)	29.23	10.37	9.44	8.34	11.24

Data Source: Bank of Ghana – Financial Stability Report Feb. 2015, Vol. 5 No.2

The table below provides data on the top 5 banks with respect to the gross NPLs and impairment ratios. Analysis of the data trend reveals improvement in aggregate portfolio quality notwithstanding outlier characteristics of Standard Chartered and Agric. Bank.

Asset Quality of Top 5 Banks

Top 5 Banks	2012	2013	2014
	Loan Loss Prov./Gross Advances		
GCB Bank	15.0	12.0	
Barclays Bank	-	-	
Standard Chartered	4.0	5.0	
Agric. Devt. Bank	7.57	10.4	
Ecobank	4.1	4.2	
	Gross Non-Performing Loans Ratio		
GCB Bank	17.0	14.0	
Barclays Bank	16.25	13.13	
Standard Chartered	10.0	15.54	27.36
Agric. Devt. Bank	10.53	12.42	
Ecobank	8.0	6.10	3.20

Except for Standard Chartered and Agric. Development Bank, all other banks herein tabulated had no figures publicly available for 2014 financial year.

Source: Annual Reports

Albeit Standard Chartered Bank and Agriculture Development Bank shows deterioration in their loan portfolio, the other members of the top 5 group seem to maintain a tight rein on credit risk management. So considering the fact Standard Chartered is an outlier within its immediate peer group, as per this data set alone, it may seem premature to conclude that the entire financial system is at risk from rising non-performing loans. However, a note of caution at this point would be appropriate. Since Dr. Bawumia made reference to the “entire financial system, it would be imprudent for any serious policy analyst to dismiss his concerns outright without having the benefit of a more comprehensive data set that encapsulates the performance of actors within the non-bank sector as well. Indeed, serious questions remains for the Bank of Ghana to address. According to its own records (BOG), the number of licensed Microfinance Institutions (MFIs) as at October 2014 was 409, not counting Non-Bank Financial Institutions (NBFIs), Money Lenders and Financial NGOs. The seeming dearth of regulatory sanity in the MFI sector as evidenced by recent reports of collapse and liquidity crunch lends credence to suspicion of sector vulnerability as reported by Dr. Bawumia in his lecture on IMF Bailout. According to Ghana Association of Microfinance Companies (GAMC), 30 MFIs collapsed, with devastating impact on depositors, in 2013 alone. Most of these institutions maintain accounts with the big universal and commercial banks, hence a pass-through shock is a palpable liquidity risk for the banking system.

Policy Recommendations

1. Bank of Ghana must, make available publicly, all prudential reports and reports of examinations in accordance with section 33 of Non-bank Financial Institution Act, 2008 Act 774.
2. Parliamentary Select Committee on Finance must take a key interest in this matter and mandate a comprehensive sector performance returns to be submitted by BOG on regular basis.
3. Consider the feasibility of an apex body in the mold of ARB Apex Bank, for the Microfinance Sector, particularly within the domain of tier 2-4 activities.