Finance sector and growth
ESRC/DFID

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Roles of financial sector

- Mobilize savings and keep safe
- Intermediate savings at low cost to efficient investment and to households for sustainable consumption, financing inclusive growth
- Manage risks for companies and individuals, eg in face of external shocks.
- Do no harm to rest of the economy, by avoiding causing fiscally and developmentally very costly and damaging crises.

SSA low income countries

- Have shallow financial sectors
- This has important disadvantages, like lack of access to finance by poor people and MSMEs. Partially overcome by mechanisms like M-PESA .Broad challenge of deepening financial sector and making more inclusive
- LICs have advantage of late-comers: learn good and bad lessons from other countries.
- SSA had no crises (excl Nigeria) in last decade

Some key findings ESRC/DFID project

- Focus on maintaining financial stability and promoting inclusive growth
- Key challenge, overcome insufficient credit and high cost of lending, especially to SMEs
- Spreads very high and do not decline or little
- Reasons and possible policy measures(further research needed)
- Other major challenge, provide long term finance infrastructure/companies

Average Financial Indicators

	LIC	**MIC**	**HIC**
Bank return on assets (% after tax)	2.15	1.40	0.80
Bank return on equity (% after tax)	19.17	13.04	6.20
Bank lending-deposit spread (%)	14.87	7.65	4.44
Source: World Bank Global Financial Development Database (GFDD)			

Spread (lending rate- deposit rate) in % 2013

	Kenya	Ghana	Ethiopia	Nigeria	LICs (*)
General	9.5	6.5	6.5	15.6	11.4
*LICs: 1990-2012 average *Source: Central Bank of Kenya, Bank of Ghana, Central Bank of Nigeria*					

Benefits of diversified financial system

- Large and small banks.
- Sectoral(eg SMEs) vs universal
- Domestic and foreign
- Private and public development banks
- Need “good”, well- run , development banks
- Diversification can reduce systemic risk, serve better needs of different customers and introduce more healthy competition

Challenges of financial regulation(1)

- Positive hardly any crises last decade in Africa, but no room for complacency.
- Need to adjust international regulation to country characteristics.
- Importance of expanding financial sector, to support growth, whilst avoiding excessively rapid growth of credit, especially linked to property booms. Tool:macro-prudential regulation.
- Skill sets adjusted to LICS' regulatory challenges

Challenges of financial regulation(2)

- Important comprehensive regulation, as often systemic risk emerges in less regulated institutions or instruments
- Regulation of new institutions and instruments important, eg M-PESA or credit to consumers by non-financial institutions , though regulation should be proportional
- Key aspect in LICs:regulating currency mismatches