MINISTÈRE
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DES FINANCES
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EXECUTIVE SUMMARY
ECONOMIC LETTER OF EAST AFRICA AND THE INDIAN OCEAN (EAIO)

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Banking sector in EAIO

Key numbers

- As of December 2021, the **total banking assets in the EAIO** amounts to $196.1 billion or 54% of the region's GDP, with **Kenya** ($57.1 billion), **Mauritius** ($49.6 billion), and **Ethiopia** ($44.3 billion) concentrating 77% of the region's banking assets.
- 3 countries, **Kenya**, **Tanzania** and **South Sudan**, are on the **FATF's grey list.**
- On average, only 28.9% of the population in the EAIO holds **accounts with financial institutions**, and 25.8% have **mobile money accounts**.
- **Credit to the private sector** increased following the pandemic (15%), but slowed to 11.3% on average in 2023.
- The **ratio of non-performing loans to total loans** averaged 7.5% in the region in 2023.

In summary...

Heterogeneous banking sectors in EAIO and low financial inclusion

The banking sectors in the EAIO region are at different development stages in terms of size, financial inclusion and depth. In recent years, they have benefited from a favourable economic context that has enabled them to expand and consolidate. With the support of donors, countries are gradually aligning themselves with international banking standards by implementing standards that comply with the various levels of the Basel Accords (I to III) and the FATF and EU AML/CFT regulations. Although credit to the private sector has picked up following the pandemic, access to bank financing remains a challenge in the region. In response to inflation and the sharp depreciation of currencies, Central Banks have tightened interest rates, which has had repercussions across the yield curve and slowed lending. Banks in the region remain sufficiently liquid and well capitalised, but asset quality has deteriorated overall, with a rise in non-performing loans. Three countries are still on the FATF's grey list.

In detail...

Heterogeneous banking systems, not yet inclusive

The financial sectors in the East Africa and Indian Ocean (EAIO) region exhibit varying levels of development. All dominated by banks, the total banking assets in the EAIO, as of December 2021, amounts to \$196.1 billion, with Kenya (\$57.1 billion), Mauritius (\$49.6 billion), and Ethiopia (\$44.3 billion) concentrating 77% of the region's banking assets. Six countries have total assets below \$5 billion (Rwanda, Madagascar, Djibouti, Seychelles, Somalia, and Comoros). Kenya stands out with 38 active banking institutions (compared to an average of 20 in the EAIO) and the preeminence of Kenyan banks, which alone account for approximately 28.6% of EAIO assets. In other EAIO countries, foreign banks and subsidiaries of foreign groups play a significant role (such as Standard Chartered and Absa Bank). French banking actors are only present in Madagascar (local subsidiaries of Société Générale and Baobab microcredit bank) and Djibouti (where Banque pour le Commerce et l'Industrie Mer Rouge is 51% owned by BRED).

Financial inclusion has improved due to mobile telephony, but challenges remain. On average, only 28.9% of the population in the EAIO holds accounts with financial institutions, and 25.8% have mobile money accounts. Disparities persist: while Mauritius, Kenya, and Ethiopia surpass the Sub-Saharan Africa average (39.7%) in terms of financial services access (with respective rates of 90%, 50.6%, and 46.1%), Kenya (68.7%), Uganda (53.8%), and Tanzania (44.6%) lead in mobile money adoption within the region. Banks' adoption of new technologies should also serve as a means to streamline costs, enhance bank profitability, and improve control processes, particularly in terms of anti-money laundering and counter-terrorism financing regulations.

Towards international standardisation and strengthening the fight against AML/CFT

Banking regulations in the region have gradually been brought into line with international standards. Today, five EAIO Central Banks (Burundi, Mauritius, Rwanda, Somalia and Uganda) comply with the Basel III Accords. They require banks to have a minimum Capital Adequacy Ratio of between 10.5% and 14.5% and a Liquidity Coverage Ratio of over 100%. In most other countries, regulations straddle the Basel II and Basel III Accords: liquidity is controlled, but standards are less stringent than under Basel III. The banking law adopted in Madagascar in 2020 should enable a switch to the Basel III directives. In addition, since 2019, with the support of the IMF, Ethiopia has been working to move to Basel II at the same time as it plans to liberalise its banking and financial sector. Only Sudan is still aligned with the Basel I agreements. Finally, the Bank of Eritrea does not have the resources to perform the functions of a Central Bank. It encourages foreign investment and imports of capital goods.

In addition, the Central Banks have all set up an AML/CFT control process, more or less effective and independent, in response to the FATF requirements. The removal of Tanzania (2014), Sudan (2015), Ethiopia (2019), Mauritius (2021) and Uganda (2024) from the FATF's list of jurisdictions under enhanced scrutiny, "grey list", testifies of the progress that has been made in this area. However, the efforts made are largely insufficient and Kenya was placed on the grey list at the beginning of 2024, Tanzania and South Sudan remain on it and certain countries are at high risk without appearing on the grey list (Djibouti, Somalia). Madagascar is also at risk of being included in 2027. Djibouti is not on the grey list, but AML/CFT risks remain high and the country is being assessed under the Middle East and North Africa Financial Action Task Force (MENAFATF) until November 2024.

Banking environment: rising interest rates and deteriorating credit quality

Despite credit growth across the region, access conditions remain restrictive for a variety of reasons: asymmetric information between the lending bank and the borrower (Uganda), low bank penetration, high borrowing rates and bank charges, heavy regulation by the Central Bank and lack of competition in the banking sector (Ethiopia). Credit to the private sector increased following the pandemic, reaching an average of 15% by 2022. However, credit growth stalled in 2023, slowing to 11.3% on average. Faced with high inflation and the depreciation of local currencies, most Central Banks have tightened their monetary policy, to varying degrees: since January 2022, the CBK's key rate has risen by 600 basis points and the BoU's by 375 basis points. As a result, deposit and lending rates have also risen: in Kenya, the lending rate increased by 227 basis points between the end of 2021 and the end of 2023, and in Uganda, it increased by 141 basis points between June 2021 and June 2023.

At the end of 2023, the sectors are all sufficiently liquid and well capitalised, with the exception of the Sudanese and South Sudanese sectors, which are chronically undercapitalised. However, the portfolio quality of banks in the EAIO region has deteriorated since the pandemic, with the ratio of non-performing loans to total loans averaging 7.5% in the region. They increased in 6 countries between 2019 and 2023: Seychelles (+5.5 pp), Ethiopia (+2.7 pp), Kenya (+2.6 pp), Mauritius (+0.4 pp), Madagascar (+0.2 pp) and Rwanda (+0.1 pp). In the Seychelles, NPLs reached a record level of 8.2% at the end of December 2023, and in Kenya they fell back to 12.3% due to the business environment and late payments. On the other hand, the ratio has fallen significantly in the Comoros (-11.7 pp), but remains at a high level (14% in 2023), due to poor judicial enforcement of contracts and claims against defaulting debtors.

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