Macroeconomic impact series

Broadening financial inclusion in sub-Saharan Africa

Policies should prioritise financial stability

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Key messages

- The recent IMF and World Bank annual meetings focused on how to achieve more inclusive growth, particularly in low-income, fragile economies.
- Despite instances of significant financial innovation, financial inclusion in lower-income countries is uneven, especially in the regional case of sub-Saharan Africa.
- Increased banking coverage must happen simultaneously with the necessary, domestic macro-prudential policies that protect against the greater risks of transmitting financial shocks.

The IMF's three numbers

At the recent IMF and World Bank annual meetings, among the many statistics quoted, IMF director Christine Lagarde singled out three: 1.4%, 1.6% and 1.8% denoting the IMF's 2016 projection for sub-Saharan Africa's (SSA) GDP growth, the projection for US GDP growth, and the estimate for export growth in the advanced economies.[1] Lagarde noted that the IMF's projection for SSA's GDP growth of 1.4% is particularly disappointing given the SSA's potential growth rate.

Inclusive growth in developing economies, therefore, became a key focus – growth that lowers the poverty rate and ensures equality of access to markets, resources and an unbiased regulatory environment.[2] And improved financial inclusion – access to and availability of financial services to all – would play a crucial role in this. Fragile states, in particular, would benefit from more jobs for the vulnerable in low-income states, which would also bring increased security to the economy.

The quality of jobs would be important too. SSA's vulnerable employment, in own account and unpaid family work, is estimated at 70% of total employment.[3] However, even though financial inclusion and better financial intermediation is proven to encourage growth with higher paid jobs in the formal sector, around half of working age adults still lack access to financial services – an estimated 2 billion people.[4]

Uneven financial inclusion

Financial development can protect against risks during an economic downturn. And more broadly, it can boost growth and dampen the impact of shocks for firms and households by alleviating borrowing constraints, and helping to calibrate dollar liabilities.[5] However, financial inclusion in lower-income countries is uneven, especially in the regional case of SSA.

Many SSA economies have seen significant financial innovation. Private sector credit has experienced its median ratio to GDP increase by 10 percentage points from 1995 to 2014 (though at 21%, it is still around only half of that in the Middle East and North Africa, and East Asia).[6] For lower-income households and firms, microfinance has enabled financial inclusion. And mobile banking services, such as M-Shwari and M-Pesa in Kenya, have promoted stronger domestic banking systems, reducing the reliance on informal savings mechanisms.[7]

Yet SSA's efforts towards financial inclusion have fallen behind. Only 34% of the population have bank accounts, compared to 94% in high-income OECD countries. While only 7.3% of the SSA population report using an account to receive their wages.[8] Low coverage extends to South East Asia: Vietnam and Cambodia's share is a respective 21.1% and 3.3% of their (over 25) populations.[9]

A macroeconomic policy reset

The macroeconomic impact of increasing banking coverage has systemic consequences. The simultaneous relaxing of financial constraints, such as greater access to bank accounts and a lower cost of financial intermediation, can amplify growth significantly.[10] A key channel is the mobilisation of savings that provides future access to liquidity, allowing households to manage financial risks and to cushion against shocks.

However, more finance does not automatically lead to more growth. Its effect on economic growth is 'bell shaped' and weakens at higher levels of financial development. This weakening stems from premature financial deepening (increased size of market), rather than from greater access.[11] From a macroeconomic perspective, broader banking coverage would heighten the impact of monetary policy-driven interest rate changes.

If financial inclusion is to increase, a policy reset is needed to safeguard domestic financial stability alongside SSA financial deepening. Although the complexity of SSA economies' supervisory capacity varies significantly,[12] strengthened macro-prudential policy can protect against the greater risks of transmitting financial shocks – a key policy gap in some pan-African banks.[13] Stability and inclusion can be achieved through better banking supervision[14] and, more concretely, in adopting international standards such as loan loss provisioning and financial reporting. Given the uncertain economic outlook in the year ahead, regulatory progress would lay the foundations for broader banking coverage by the next 2017 Autumn meetings.

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