MINISTRY: FINANCE
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THE FUTURE OF BANKING IN AFRICA
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I would like to thank the Economist for the opportunity to talk to you this morning.

Let me begin with five observations about our continent:

- Over the next few decades, economic growth in Africa is expected to be strong, with many economies expected to post growth of between 4 and 8 per cent per annum.
- Approximately half of Africa's population is under 19 years of age, and within a century, half of children under 18 will be African.
- Africa is also expected to reap a 'demographic dividend' – with a young and increasingly techno-savvy and globally-connected population;
- Disposable income is expected to rise to one trillion US dollars, concentrated in a growing middle class; and
- Africa's share of global foreign direct investment is rising, as more companies seek exposure to African growth.

All of these factors reinforce a virtuous cycle of increased investment and economic growth.

Indeed, the African continent is on the rise, and with it, the African financial sector.

African banking sector

African banking groups are expanding their activity, filling the space left by advanced economy banking groups, particularly in the wake of the global financial crisis. At the same time, African sovereigns have increasingly been tapping global capital markets taking advantage of global monetary conditions.

These two developments have resulted in greater integration of African banking industries, the broader financial sectors as well as the economies of African countries. This integration will result in greater correlation of economic performance across African economies.

Regionalisation has some interesting hallmarks and in some respects it mirrors what is happening in other emerging market regions. These include:

1. Substantial internationalization of African banks. Various indicators suggest that African banking sector internationalisation is increasing. For example, although aggregate cross-border claims (which include loans, deposits, debt securities and other financial instruments) dipped sharply in 2008, they have now surpassed pre-crisis levels.

2. Different approaches to how banks expand. There are considerable differences at the institutional and country level regarding the degree of international activity, and strategies for market penetration in other African countries. To some extent, this may be driven by underlying business models, with retail banking-focused operations favouring subsidiaries, and more centrally funded business lines tending to favour branches. In some countries, regulatory developments have also been a factor driving foreign banks to establish subsidiaries.

Drivers of Africa's banking expansion are similar to those that have characterised expansions into other emerging regions in the past. These drivers include reduced opportunities at home and the pursuit of domestic clients as they expand their operations across the continent or globally.

However, the expansion of African banks is happening within a more competitive environment. In the past, increased foreign bank participation benefited from extensive financial sector liberalisation, often in the wake of emerging market financial crises. Today, the conditions in many emerging market banking systems have changed significantly, with tighter regulatory environments and more competitive domestic banking sectors.

On this basis, African banks may be better positioned to capture significant market share in smaller frontier economies, where divestments or more limited activities by other financial institutions create opportunities for new players.

Cui Bono? (Who benefits?)

So what of the costs and benefits of regionalisation and globalization of African banks? Potential benefits, such as allocative efficiency, better availability of specialised financial services (e.g. trade and project finance), market deepening and regional risk-sharing, will have to be traded off against potential costs. The flip side of diversification benefits, for example, is greater potential for spillovers at the institutional and system levels, particularly for those African countries where foreign bank operations account for a relatively large share of the assets of the domestic system. Put simply, the more complex African banking becomes, the more likely it may create a financial crisis.

This, in turn, raises new challenges in terms of the complexity and management of regional banks' operations, and can strain existing market and supervisory infrastructures.

Policy implications

For policymakers, the changes occurring within the context of the African banking sector require two principal considerations.

First, we must improve our regulatory environments and market infrastructures, and

Second, we should develop crisis prevention and resolution mechanisms.

For South Africa, as with many other countries around the world, the last few years have seen improvements being made to our system of financial regulation. This is a never ending process.

These policy challenges are already being contemplated regionally as they have been internationally. Through the Sub Saharan African Regional Consultative Group (RCG), which is the Financial Stability Board's outreach forum for sub-Saharan Africa, African financial sector policymakers and supervisors are discussing challenges relating to increasingly synchronized monetary conditions, consistent regulatory frameworks and crisis prevention measures.

Regarding regulatory environments and market infrastructure, constraints on the ability of banks to better hedge their balance sheet risks can be eased by stepping up efforts to improve local market infrastructure (e.g. further developing local markets for bonds and related hedging instruments), while formulating explicit supervisory guidance to help improve banks' risk management and stress testing frameworks (e.g. incorporating regional shocks into stress test scenarios).

In addition, supervisors may need to enhance their efforts to monitor and address balance sheet mismatches, such as those arising from foreign currency funding, while balancing the costs and benefits of any associated regulatory measures (e.g. subsidiarisation or constraints on certain types of funding).

On crisis prevention and resolution mechanisms, steps can be taken to better address spillovers as well as strengthen existing safety nets. In both cases, regional efforts have a particular role to play, building on established frameworks, such as supervisory colleges or regional forums. This can be particularly challenging in countries where supervisors and other authorities have limited resources or experience in managing cross-border issues.

Despite their relatively small size overall, regional financial arrangements, when sufficiently developed, offer a number of possible advantages in terms of the provision of confidence-enhancing effects and in helping to address idiosyncratic and regional shocks – provided that effective conditionality arrangements can be put in place.

Financial Inclusion

As we continue putting in place economic and financial regulatory reforms to strengthen the financial system and address social and economic problems facing the African continent, we should keep in mind the fundamental objective of improving the lives of the poor.

We should continue fostering responsible financial inclusion, recognizing that the long-term stability and sustainability of our society are dependent on our ability to serve and enable all members in society. As we pursue increased economic development, we must ensure that we create an economic environment in which all Africans participate in, and derive benefit from, these development. Financial inclusion is a necessary part of our toolkit in this journey towards a better life for all.

There is a perception that financial inclusion efforts will necessarily lead to increased financial risk and hence have a negative effect on financial stability. However, if financial inclusion is approached from a systemic perspective and pursued responsibly, the opposite is true.

A study commissioned by the G20 Global Partnership for Financial Inclusion and undertaken by the Consultative Group to Assist the Poor (CGAP) found that linkages exist between inclusion, stability, integrity and market protection. This study used South Africa’s experience in pursuing financial inclusion as the basis for examining these linkages and resulted in the development of what is known as the inclusion, stability, integrity and protection (ISIP) model which seeks to balance risks and benefits of financial inclusion against the costs of regulation and supervision.

This study showed that it is possible to identify and pursue positive linkages and to avoid, or at least curtail, any negative linkages. It is thus possible to advance financial inclusion in such a way that stability, integrity and market protection are enhanced.

Conclusion

In conclusion, ladies and gentlemen, welcome to Africa. Welcome to the future. We look forward to a prosperous future for our continent and our people. I hope this conference will be a source of much debate and discussion, and that you will come away excited about the future of African banking; and indeed, about the African continent.

Thank you