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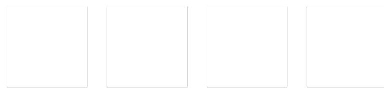
Mozambique's banks swim against the tide

Peter Wise | 1/10/2018 9:00 am

Banks in Mozambique are finding ways to thrive amid a period of low economic growth. Peter Wise looks at how they are remaining profitable in such an environment.



Banks in Mozambique are no strangers to pressure. Economic growth has fallen to historically low levels over the past two years while a dollar shortage has hit the volume of foreign exchange transactions. Asset quality ratios have also deteriorated as the level of non-performing loans (NPLs) doubled over the past two years.

In the aftermath of the country's hidden debt crisis in 2016, the central bank was forced to intervene in four banks, rescuing Moza Banco, the country's fifth largest lender by assets, with a $136m capital injection and revoking the licences of three others. "The whole sector has faced some very challenging years," says José Reino da Costa, chief executive of Millennium-Banco Internacional de Moçambique (BIM).

Profits amid pitfalls

Despite these headwinds, the six largest Mozambique banks, accounting for 85% to 90% of total assets, loans and deposits, almost trebled their net profits in 2017, according to research by Eaglestone Securities. At the same time, a 25% increase in revenues more than offset a modest 5% rise in costs as average return on equity (ROE) and return on assets rose to multi-year highs of 18.4% and 3.1%, respectively.

"Mozambique's financial system as a whole has shown itself to be robust and capable of meeting the challenges it has faced," says António Correia, chief executive of Banco Único, the country's sixth largest bank by assets. "This is an important sign of the maturity of the sector."

Banco Comercial e de Investimentos (BCI), the largest bank by assets, lifted net consolidated profit by 62.6% to $39.5m in 2017. Millennium BIM, the second largest and most profitable lender in the country, posted a 22.9% increase to $104m, marking its seventh straight year of strong growth.

Standard Bank Moçambique, the country's third largest bank by assets, more than doubled its 2017 net profit to $94.8m, partly reflecting a sharp decline in loan impairments, which had more than trebled in 2016, after the bank significantly downgraded the credit ratings of some of its clients. Barclays Bank Moçambique, the fourth largest lender, also doubled its net profit in 2017 to $18.7m, with revenue growth comfortably compensating for higher costs.

The steep rise in bank profits reflected a three-fold reduction in the net loss posted by Moza Banco, the fifth largest lender by assets, to $24.7m. But even excluding this factor, the combined net profit of the other five banks increased by a notable 53.4%. Overall, combined net profit for the top six banks was 3.4 times higher in 2017 than in 2010.

Asset growth slows

Total combined revenue for the top six banks has been increasing at impressive annual rates of more than 20% over the past three years. Growth in net assets, however, slowed

significantly in 2017, decelerating to 4.7% compared with an annual average of almost 20% for 2010 to 2016. This reflected a sharp fall in net loans as a weaker economy and higher interest rates hit demand, while treasury instruments offered much higher returns. Overall, the net loan portfolios of the top six lenders contracted in 2017 by 17% and 19.1%, respectively, for local and foreign currency-denominated lending. Net loans accounted for 41.8% of their total assets in 2017, having been above 50% in recent years. Local currency loans accounted for more than two-thirds of the 2017 total.

"Banks have experienced a big drop in business opportunities, particularly in terms of viable, economically rational lending," says Mr Correia of Banco Único. "We have had to be even more rigorous in analysing the capacity of companies to repay loans. I remain convinced, however, that lending to firms, particularly to small and medium-sized enterprises [SMEs] is needed to stimulate an economy that needs to diversify."

BCI, in which Portugal's Caixa Geral de Depósitos and Banco BPI hold stakes of 61.5% and 35.7%, respectively, believes lifting the low level of bank lending to farmers would help increase productivity in agriculture. Although agriculture, mostly at a subsistence level, accounts for 72% of the working population in Mozambique, production is currently only 15% of its estimated potential, with only about 14% of 36 million hectares of arable land in use.

"Recourse to bank financing, although it has grown over the past two years, is still very low," says a BCI official. "Rapid change is required and needs to go beyond staff training policies to involve the government, farmers and banks. Lack of planning for factors such as the weather and an over-dependence on external factors means banks still see agriculture as a high-risk sector."

Banco Único, of which South Africa's Nedbank owns 50% 'plus one share', lifted net profit 18.4% in 2017 to $8.8m, with a strong improvement in operating income substantially outweighing higher loan impairments and taxes. The bank, which focuses on SME business, reported strong growth in commissions related to bank guarantees, transfers and electronic banking. "We consider the partnership between banks and SMEs fundamental to the growth of the economy," say Mr Correia.

Well covered

For an African country with a population of 27 million, Mozambique is relatively well banked, according to Tiago Dionísio, chief researcher at Eaglestone. As well as 19 licensed banks, the country has nine micro-lenders, eight credit co-operatives and 430 microfinance operators. No banks are listed in their own right, most being units of foreign lenders or controlled by foreign investors.

Millennium BIM, controlled by Millennium BCP, Portugal's largest listed bank, operates the largest commercial network in Mozambique. Its 190 branches represent about 30% of the national total and are supported by an additional 350 banking agents. "We are making a big effort to get closer to the rural population and to deliver direct financial services," says Mr Reino da Costa. "We are also strongly committed to increasing financial literacy and financial inclusion rates.

"Our long term strategy remains focused on sustainable growth and operational efficiency based on continuous innovation and cost control, robust risk control, strong capital adequacy and profitability, keeping ROE above 20%," he adds. ROE at Millennium BIM in 2017 was 21.5%, slightly up on the previous year.

The downside

Mozambique's economic downturn has generated a sharp increase in problem loans. According to Eaglestone research, the total NPL ratio for the top six banks rose from 5.42% in 2016 to 6.76% in 2017, up from about 3% in previous years. After surging 66.9% in 2016, loan-loss provisions increased a further 22.9% in 2017, representing 7.65% of total loans.

The NPL coverage ratio (provisions over NPLs) rose to 113.2% in 2017, up from 97.1% in 2016. "Following the recapitalisation of Moza Banco last year, the combined solvency ratio of the six banks recouped significantly in 2017 to 19.3%, compared with only 5.5% in 2016," says Eaglestone's Mr Dionísio. "This was well above the minimum regulatory requirement of 12%."

In the wake of the 2016 crisis, which led to international donors freezing aid and the missing of several external borrowing payments, the Banco de Moçambique, the central bank, significantly tightened regulatory measures in an effort to contain financial sector risks. It raised the minimum solvency ratio from 8% to 12% (10% for Tier 1 capital) and set a minimum liquidity ratio (liquid assets over short-term liabilities) of 25%, to be reported daily.

Disclosure rules were also strengthened to improve transparency. Banks are now required to publish their solvency ratios as well as details of credit, market and operational risks every six months. Information on capital, asset quality, efficiency, profitability and liquidity has to be provided quarterly.

"The economic environment we have experienced in recent years has led to our adopting much stricter requirements in terms of risk, compliance and governance," says Mr Correia of Banco Único. "This in turn has forced us to improve our risk management." Difficulties in finding skilled professionals equipped to deal with more complex and demanding banking regulations is also a challenge, he adds.

Sovereign risk

Despite strong solvency ratios, increased bank exposure to government debt is a cause for concern. In 2017, a jump of almost 45% in the net interest income reported by the six largest lenders reflected a higher interest rate environment in which banks increased their exposure to treasury instruments offering attractive returns. According to Eagelstone, net interest income accounted for 74% of their total banking income in 2017, up from 64.1% in 2016.

In an Article IV report in March 2018, the International Monetary Fund (IMF) warned about the increasing exposure of banks to sovereign risk. "Given the high and rising level of such exposures, some institutions cannot further accumulate claims on the government and, at times, the weekly T-bill market auctions have been deserted," the IMF said.

Joel Rodrigues, chief executive of Banco BIG Moçambique, sees potential business openings for investment banks in helping debt-laden state-owned companies recover. "The financial sector is highly exposed to sovereign credit risk through public debt or state-owned companies and some of these companies may face financial and business challenges," he says. "This could represent an opportunity

for a bank with a business model such as ours to help corporates restructure their balance sheets and to assist the state in reorganising its asset portfolio."

The IMF warned in March that "in the absence of corporate restructuring [of loss-making state-owned enterprises], restoring a sustainable debt level would require partial debt forgiveness or adjusting debt service terms". If banks were to fully provision for the debt at risk, it added, "the banking system's capital adequacy would drop by about five percentage points to 16%, with a few banks close to or below the minimum required ratio".

Mr Rodrigues believes that a planned initial public offering of Hidroeléctrica de Cahora Bassa, the state-controlled company that operates southern Africa's largest hydropower dam, could become "a catalyst for further capital market transactions involving state-owned enterprises".

BCI and BIG have been appointed global coordinators for the sale of up to 7.5% of the company, which is 85% state-owned. The prospectus for the sale on the Mozambican Stock Exchange is currently being prepared for approval by the central bank and security market authorities, but no firm date has yet been fixed for the transaction.

BIG hopes

Growing capital markets business has helped BIG, a subsidiary of Portugal's Banco de Investimento Global, achieve strong results over a relatively short period. "We closed 2017, our first full year of activity, with a small profit of about $1m and a low double-digit return on equity," says Mr Rodrigues. "By August this year we had already doubled both those figures."

The senior management of BIG's parent bank, he says, saw in Mozambique the same opportunities they had witnessed in Portugal in the 1980s and 1990s – that is, helping to develop the country's capital markets, supporting the Treasury in issuing public debt securities and assisting companies seeking access to capital market finance.

"The development of the stock market over the past two years has been impressive," says Mr Rodrigues. "A number of companies are also using the capital markets to fund their needs. A typical ticket size two years ago would have been about $5m. Now we're looking at firms that can raise $20m."

Project pipeline

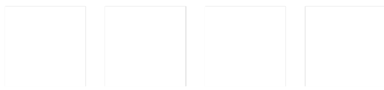
In the same way that Cahora Bassa, the 2000-megawatt dam on the Zambezi river, helped transform Mozambique's economy in past decades, the huge natural gas projects under way off the north coast are seen as potentially transformative investments for future generations.

Sérgio Magalhães, chief financial officer of Barclays Bank Moçambique, says managing the funds flowing through the economy from these projects without creating imbalances will be challenging. "The added liquidity in the system may create the need to increase the complexity of financial products in a market that is currently plain vanilla," he says. "The oil and gas sector will also demand new standards of execution from local lenders and greater connectivity and exposure to the global banking sector."

The impact of gas projects on bank balance sheets and operations will place extra pressure on technology, in terms of both systems and infrastructure, as well as on compliance and pricing, according to Mr Magalhães. "It will be challenging for local banks to participate in these mega-projects as they are several times bigger than the banks' own balance sheets, not to mention the financial and legal complexities involved," he says.

"Mozambique has a big opportunity to leverage these mega-projects and use them to develop a strong and sustainable local business community capable of generating dividends that will remain in the country and have a multiplier effect in the local economy," adds Mr Reino da Costa of Millennium

BIM. “The way local companies are able to integrate with these projects will be key for sustainable growth in the future and the local banking sector will be one of the main enablers of this process.”



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