



# REPUBLIC OF EQUATORIAL GUINEA

## SELECTED ISSUES

November 2016

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# REPUBLIC OF EQUATORIAL GUINEA

## SELECTED ISSUES

August 12, 2016

Approved By  
**The African  
Department**

Prepared by Neree Noumon, with inputs from the Equatorial Guinea Team

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# MACROFINANCIAL LINKAGES IN EQUATORIAL GUINEA<sup>1</sup>

*The negative economic impact of the 2014 oil-price slump highlights the close attention that macro-financial linkages require in Equatorial Guinea. Insufficient fiscal consolidation in response to falling oil prices and production has translated into arrears accumulation, leading to a sharp deterioration in commercial banks' balance sheets. Although banks' capital and liquidity ratio appear adequate, profitability has been shrinking, owing to weak economic activity and decelerating credit supply. Moreover, recent stress tests reveal a high sensitivity to negative liquidity and asset quality shocks. Financial development remains lackluster, which hurts economic development and effective structural transformation. Finally, strong macrofinancial linkages compounded by regional subsidiary-parent interlinkages call for increased scrutiny.*

## A. Introduction

**1. Highly hydrocarbon-dependent Equatorial Guinea has been severely hit by falling oil production and low oil prices.** Equatorial Guinea is the most oil-dependent economy in the CEMAC, with oil accounting for 60 percent of GDP, 80 percent of fiscal revenue, and 86 percent of exports. Despite the oil sector's state of decline, the non-oil sector is small with little contribution to government revenues, GDP, or exports, leaving the country struggling to meet its development agenda. This high dependence of the country on hydrocarbon is conducive to the rapid propagation of shocks emanating from the oil sector to the rest of the economy. Such shocks first deteriorate government revenues and buffers, negatively affect corporates and economic activity, and reach the financial sector, where they erode the profits and soundness of banks. The effects of the recent and protracted 2014 oil-price shock provide an illustration of the extent of macrofinancial linkages, reinforced by the secular decline in oil production. Other potential amplifying factors are banks' parent-subsidiary linkages within the CEMAC. Structural factors such as weak governance and poor business climate also substantially impede both financial and economic development.

**2. This paper analyzes financial sector vulnerabilities and shock transmission channels, and proposes policies that are conducive to sustaining financial sector stability and promoting financial development.** As Equatorial Guinea embarks on the second phase of *Horizonte 2020* (its economic diversification strategy)—and shifts the focus of spending from infrastructure to human development—it is crucial that the country adopts the appropriate policy mix, especially in a context of shrinking oil revenue. To help shape the design of such policies and promote financial development and stability, this paper: (i) analyzes the main characteristics of Equatorial Guinea's financial system and the banking sector's vulnerabilities to solvency and liquidity risks; (ii) investigates the linkages between oil sector developments and financial stability;

<sup>1</sup> This paper was prepared by Neree Noumon, with inputs from the Equatorial Guinea country team. The author would like to thank: (i) the authorities for the quality of the discussions and the comments received during the 2016 Article IV consultation; (ii) the CEMAC Team for sharing bank balance sheet data and the stress test results conducted during the CEMAC 2016 Article IV consultation; and (iii) AFR's Financial Network and AFR staff for their enriching comments.

(iii) analyzes the determinants of the country's weak financial development and the role oil wealth plays in that regard; and (iv) investigates the extent to which recent monetary easing has affected banks' behavior.

**3. The paper attempts to demonstrate how macro-financial analysis can be deepened even in the face of data shortages that constrain effective surveillance.** The paper heavily draws on monthly bank balance sheets and available financial soundness indicators (FSIs). There are relatively few high-frequency indicators of the fiscal stance (except for government deposits in the banking system), and almost no high-frequency indicators of real sector activity.

## B. Equatorial Guinea's Financial Sector: Stylized facts

### 4. Equatorial Guinea's financial landscape is dominated by a highly concentrated banking sector.

The banking sector consists of five banks, three of which hold 84 percent of total assets.<sup>2</sup> The rest of the financial sector consists of three microfinancial institutions and three insurance companies. All institutions are supervised by the COBAC, the regional supervisory agency, except the insurance sector which is supervised by the National Directorate of Banking and Insurance, under the Ministry of Finance, which implements at the national level the policies of the Regional Insurance Control Commission (CRCA).<sup>3</sup> Regional bond markets are shallow, and the Equato-Guinean government has only recently taken initial steps toward tapping this potential source of financing. Given the small size of microfinance, its limited partnership with banks, and the apparent profitability of the insurance sector,<sup>4</sup> financial stability is largely determined by the banking sector.

**Text Table 1: Equatorial Guinea Banking Sector**

Banks	Assets (Percent of total assets)	Deposits (Percent of total deposits)	Credit (Percent of total credit)
CCEIGE	41.4	34.2	58.2
BANGE	22.0	25.3	10.8
SGBGE	20.3	23.2	14.8
BGFI Bank	11.5	12.3	12.6
Ecobank	4.8	5.0	3.6

Source: BEAC and IMF Staff Calculations

**5. The financial sector is shallow and characterized by limited inclusiveness.** Equatorial Guinea's financial development gap is the highest among African oil-exporters, at one-fifth the level predicted by its income and other fundamentals.<sup>5</sup> (Text Figure 1). Financial deepening, as measured by deposit- and loan-to-GDP ratios, is less than a third of the EM average. The shallowness of the financial sector is mostly due to persistent structural bottlenecks, which include limited information

<sup>2</sup> The five banks of Equatorial Guinea are Ecobank a subsidiary of the pan-African Ecobank; three foreign-owned banks (Société Générale, CCEI/Afriland First, and BGFI) and one government-owned bank (BANGE).

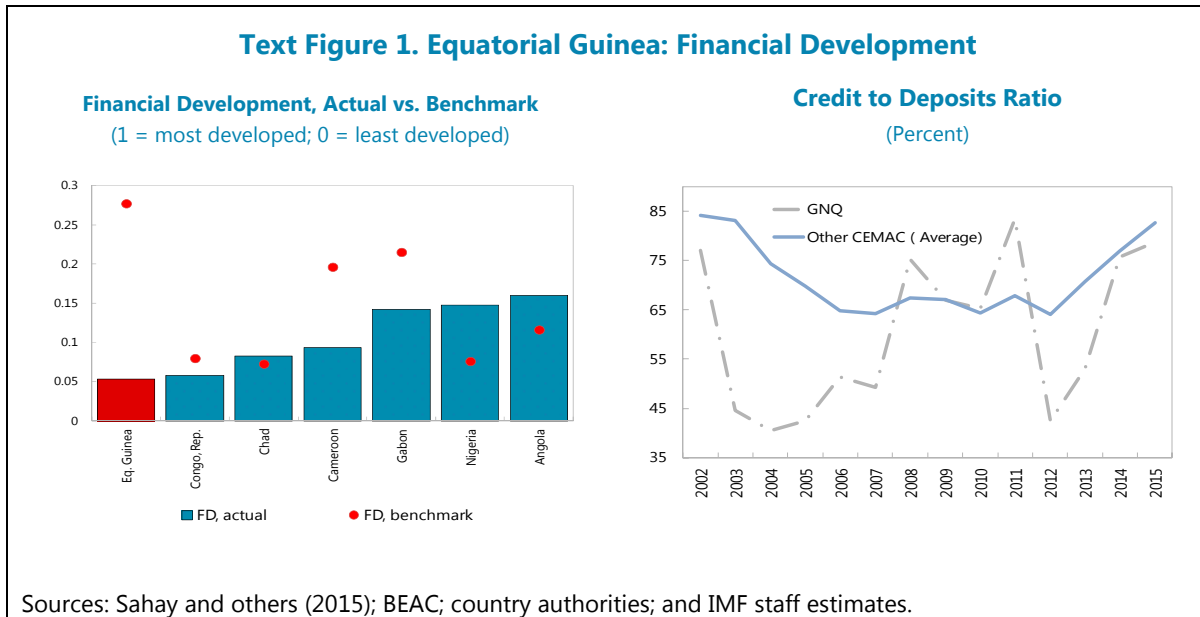
<sup>3</sup> The COBAC whose regulatory and supervisory capacity is weak, has recently progressed in implementing the 2015 FSAP recommendations. Progress was accelerated through increased staffing. The thirty-four new executives would enable a closer supervision and more frequent on-site inspection of banks and MFIs.

<sup>4</sup> In 2015, insurance companies earned CFA 63 billion in premia and paid out CFA 11 billion.

<sup>5</sup> See sub-Saharan Africa REO, April 2016 for details.

(continued)

on potential borrowers’ credit history and high collateral requirements. Furthermore, limited efforts to promote the microfinancial sector constrains the size of microfinancial services, thereby impeding access to financial services by low-income populations. Very little progress has been achieved in recent years to implement the country’s long-standing financial sector reform agenda, which includes establishing credit bureaus, upgrading collateral registries, strengthening contract and creditor rights enforcement, and improving SME access to financial services. The use of mobile banking in Equatorial Guinea is also lagging in Africa that has led the world in innovative financial services based on mobile telephony (SSA REO, April 2016).<sup>6</sup> Delayed by past policies, mobile banking will only be introduced after the imminent launch of internet banking.<sup>7</sup> The private sector should take advantage of the high mobile telephone penetration (about 90 percent), to diversify its product base and increase financial services’ provision through internet and mobile platforms. Overall, structural reforms would support diversification of banks’ lending portfolio, improving the financial sector resilience to shocks.



**6. The banking sector’s efficiency is hampered by funding volatility and a perception of high risk.** Despite high bank liquidity, commercial banks appear unable to effectively transform deposits into loans.<sup>8</sup> The private credit-to-deposit ratio is on average lower in Equatorial Guinea

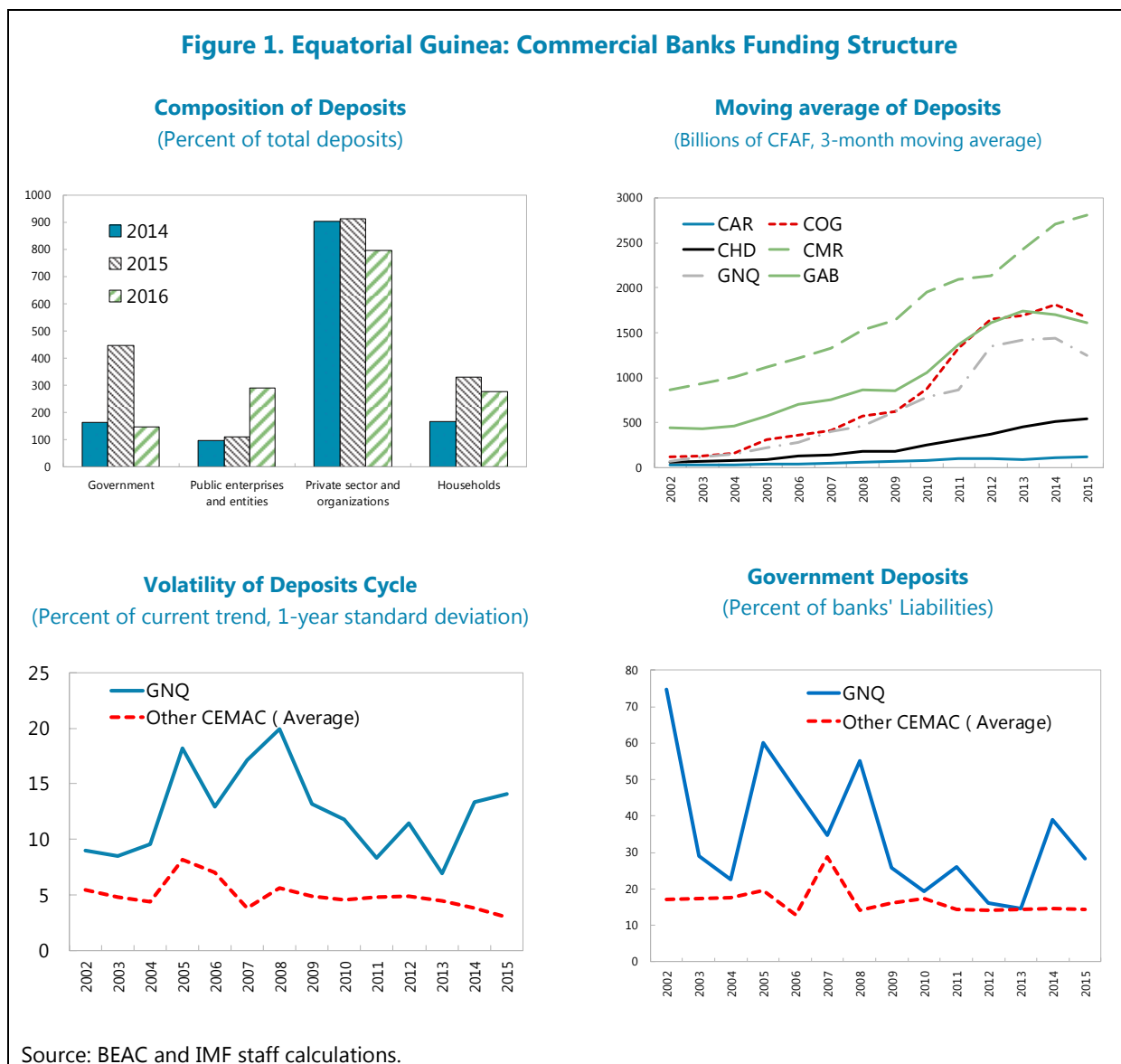
<sup>6</sup> Mobile banking has helped to incorporate a large share of Africa’s population into the financial system, especially in east Africa.

<sup>7</sup> Under the appropriate regulatory framework, Equato-Guinean authorities should better promote and facilitate the use of internet and mobile banking.

<sup>8</sup> CEMAC banks also hold excess liquidity buffers due to difficulties to refinance themselves at the BEAC. Indeed, in addition to having little eligible collateral, the pool of outstanding government bonds is small.

(continued)

than in other CEMAC countries (Text Figure 1), indicating that banks perceive high risk from lending exposure and constraints in terms of the availability of bankable projects. Shallow bank lending could also be explained by the high volatility of deposits (Figure 1) compared with the CEMAC average—mostly driven by large and irregular government payments to service providers.<sup>9</sup> Undiversified sources of funding, activities, and loans also help to explain the relatively shallow banking system and an inexistent interbank market. Weak operational efficiency in Equatorial Guinea is confirmed by reported high overhead costs and interest rate spreads, owing to high lending risk, and low competition due to the limited number of commercial banks.



<sup>9</sup> The national payment committee meets infrequently, which leads to large payments when they occur. As a result, this could cause larger swings the long-run deposits trend, compared with other CEMAC countries.

**7. The current deep recession could worsen Equatorial Guinea’s stagnant financial development.** Bank credit to the private sector increased to 20 percent of GDP in 2015 from 5 percent of GDP in 2010, but remains heavily concentrated among large enterprises, especially those operating in the construction sector (Section B). This surge in credit was used to fund the acceleration in capital spending under the national development plan, and was boosted by ample liquidity. In the aftermath of the 2014 oil-price shock, poor prospects for a near-term growth recovery may increase risks of further credit retrenchment and financial shallowing. Similarly, a further deterioration of credit quality could exacerbate risk aversion, affect credit supply, and hamper financial depth. Finally, although microfinancial institutions (MFIs) have little impact on financial stability, a recent deterioration of their balance sheets could undermine financial inclusion and hinder poverty reduction.

**8. Although Equatorial Guinea’s banking sector has adequate capital and liquidity, asset quality and profitability are in decline.**<sup>10</sup> In 2013, amid disorderly fiscal tightening, nonperforming loans increased to 20 percent of total loans (Figure 2).<sup>11</sup> Asset quality has subsequently remained weak, with depressed economic activity and oil prices affecting banks. The impact of the oil shock mainly comes through the government channel, as fiscal consolidation and government arrears to suppliers and contractors affect firms’ ability to service loans (See Section C). The decline in banks’ return on equity to 8 percent reflects firms’ cash-flow difficulties, triggering an increase in overdrafts, with unpaid interest likely to have been added to loan amounts. An additional concern is the potential for under-provisioning. The ratio of provisioning is stable around 50 percent of NPLs and is relatively low given the potential for high future losses.<sup>12</sup> Finally, although the capital adequacy ratio remains comfortably above the regulatory 8 percent, the 2016 CEMAC Article IV mission recommends implementing the Basel pillar II approach. This would enable COBAC to initiate regulatory actions, in particular to adjust capital requirements to banks’ risk profiles. COBAC should also better monitor the quality of loan guarantees or collateral, which also affect the required level of provisioning. In particular, risk weights used in the calculation of the solvency ratio should be revised to accurately capture associated risks.

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<sup>10</sup> Capital and liquidity ratios are for now above regulatory requirements (8 percent and 100 percent of short-term liabilities).

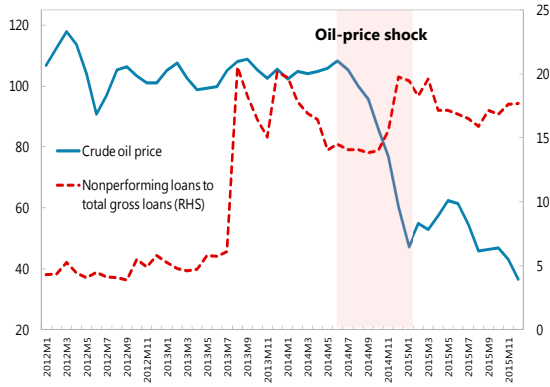
<sup>11</sup> Capital spending dropped by 23 percent in 2013 in relation with the completion of the first phase of Horizonte 2020. NPLs, net of provisions to total assets, also substantially increased to 43 percent in 2013 and remained high at around 40 percent in 2015 (See table A1).

<sup>12</sup> Loans are classified as NPLs after they are past due for 90 days; COBAC’ provisioning rules entail a full but gradual provisioning over three years, are not forward looking, and exempt state-guaranteed loans. Disciplinary measures penalize deviation from these rules.

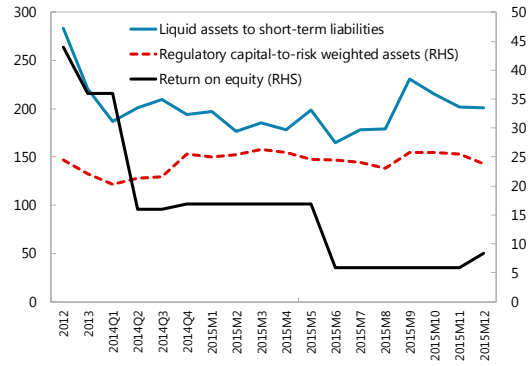


**Figure 2. Equatorial Guinea: Financial Soundness Indicators**

**Oil Price and Non-performing Loans**  
(Percent of total loans and USD per barrel)

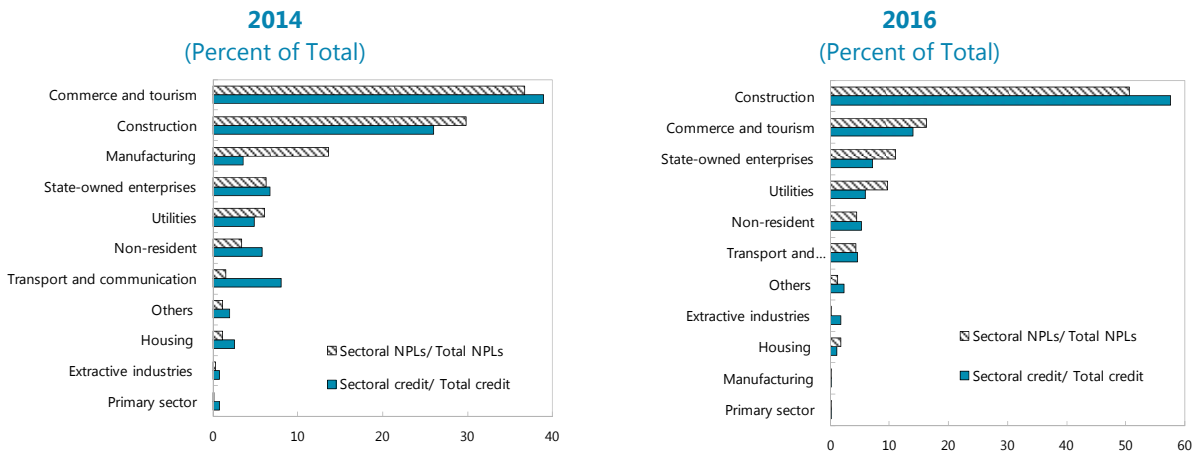


**Equatorial Guinea: Capital, Liquidity, and Profitability**  
(Percent)



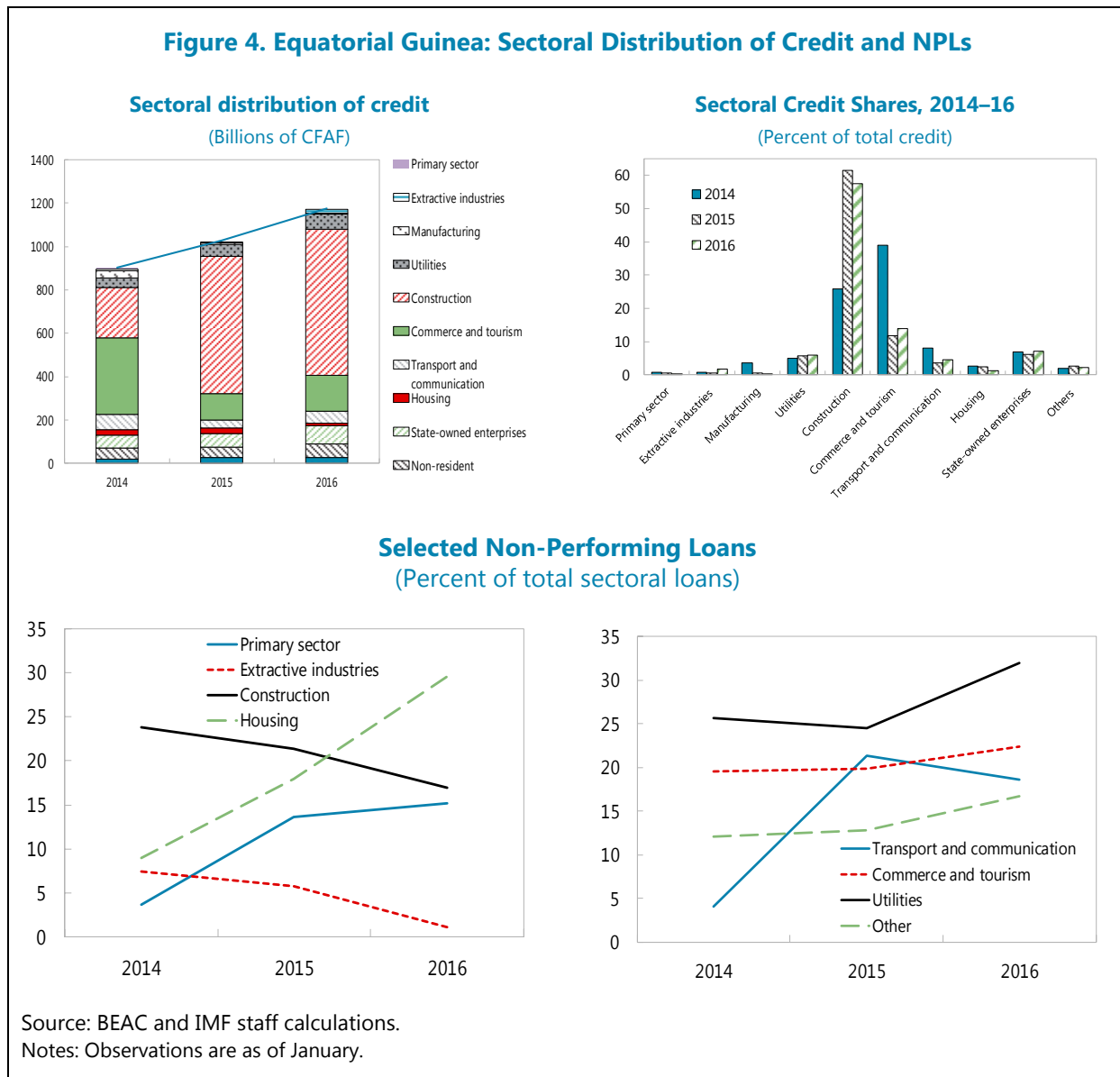
Sources: BEAC; country authorities; and IMF staff estimates.

**Figure 3. Equatorial Guinea: Banking Sector Credit and NPLs, 2014 and 2016**



Source: BEAC and IMF staff calculations.

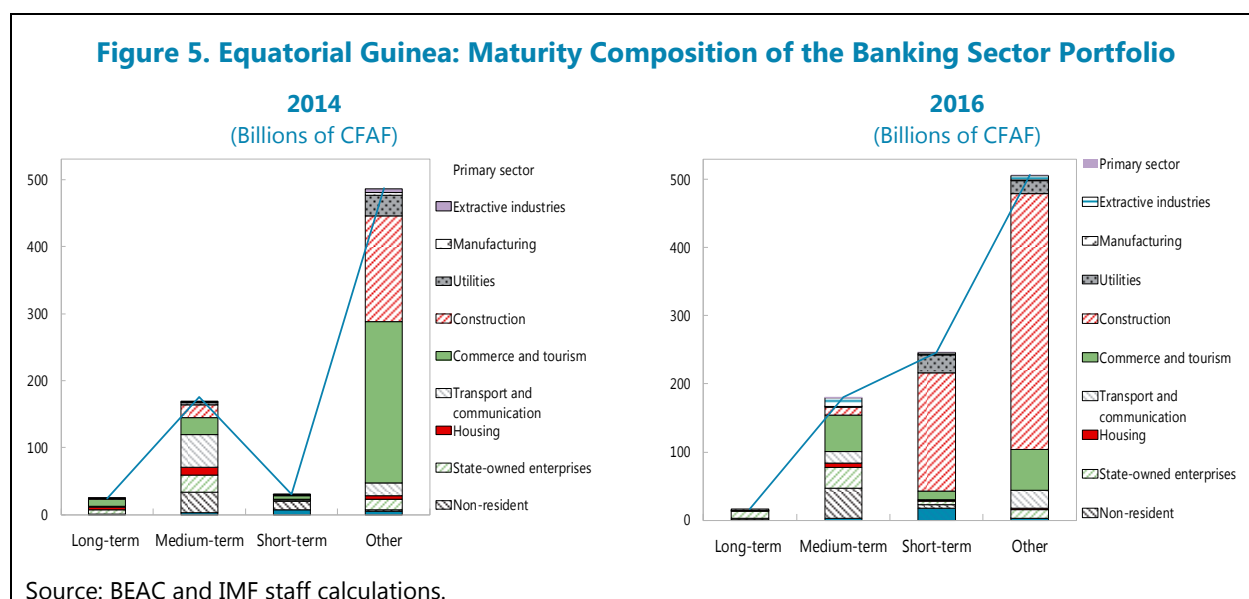
**9. Highly concentrated bank lending amplifies banks’ vulnerability to shocks and limits economic development.** Around 80 percent of loans are extended to large enterprises and construction firms depending on government contracts. The sectoral distribution of non-performing loans reveals that the deterioration of asset quality was largely linked to the construction sector, whose share of total credit increased to 58 percent in January 2016, up from 30 percent in 2014 (Figure 3). The construction sector is under heavy stress, with its output estimated to decline by 14 percent in 2015, and the situation is likely to remain difficult as fiscal consolidation continues.



**10. The recent shift in banks’ loan maturity structure reveals substantial liquidity tensions.**<sup>13</sup> As in most CEMAC countries, long-term financing is low, increasing from 1.4 percent of total loans in 2014 to 2.6 percent in 2016. However, short-term credit provision has dramatically

<sup>13</sup> Short-term is used for a maturity that is less than a year; medium-term (1–5 years) and long-term (over five years).

increased since 2014, especially to the construction sector, reflecting increasing demand of short-term debt from government contractors seeking to maintain operations. However, as opposed to most CEMAC countries, the bulk of this short-term credit comes in the form of overdrafts, suggesting automatic credit rollovers, as known as ‘ever-greening.’ The prevalence of short- and medium-term financing points to significant rollover risks and increase vulnerability to protracted shocks. The dominance of credit with no specified maturity also complicates the banks’ risk management and the classification of the delinquent loans.



### 11. Potential regional spillovers from parent banks could amplify the effects of oil shocks.

The expansion of foreign and pan-African banks in the CEMAC has been useful in promoting greater economic integration and financial inclusion. However, parent-subsidiary bank linkages are potential conduit of shocks that need to be closely monitored, even if no imminent risks exist given the broadly sound aggregate CEMAC banking sector.<sup>14</sup> These regional linkages are being monitored by the COBAC, although through relatively nascent frameworks from consolidated regulation, supervision, and internal governance. Three of five Equato-Guinean banks are majority foreign-owned. Some of the banks’ parents are located in CEMAC and share similar vulnerabilities vis-à-vis oil prices and high government exposure. Banks have been relying increasingly on their network to finance their operations, which could be problematic if the parent companies themselves were to run into trouble. Therefore, the presence of the subsidiary-parent linkage amplifies the magnitude of financial risk in the banking sector (Box 1).

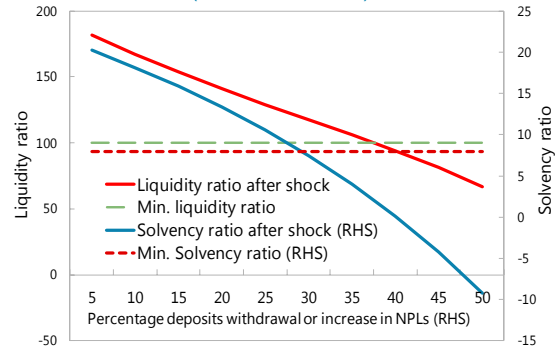
<sup>14</sup> See the Staff Report for the 2016 CEMAC AIV Consultation.

**Box 1. Implications of CEMAC Stress Tests for Equato-Guinean Banks**

**Stress tests performed during the 2016 CEMAC regional consultation reveal liquidity and solvency vulnerabilities in Equato-Guinean banks.**<sup>15</sup> Although these vulnerabilities have worsened since 2014, they remain less pronounced than in CEMAC peers.

Nonetheless, Equatorial Guinea appears more vulnerable to a shock to liquidity, such as a sudden withdrawal of deposits.<sup>16</sup> Conversely, other CEMAC oil exporters which started with higher liquidity ratios in early 2016 than in 2014, were more resilient to funding shocks in 2016, compared with 2014.<sup>17</sup> Banks' sensitivity to solvency shocks remains high in Equatorial Guinea with a slight improvement.<sup>18</sup>

**Effect of Liquidity and Solvency Shocks, January 2016**  
(Percent of the total)

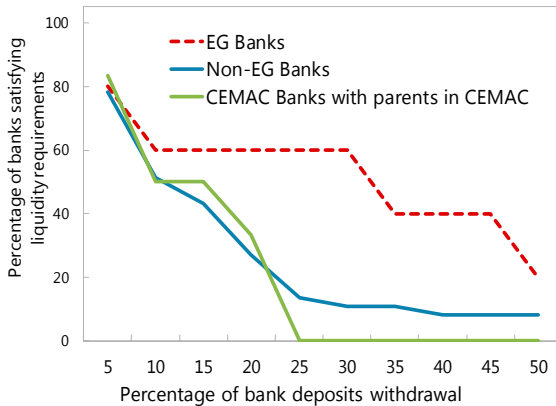


Source: BEAC and IMF staff calculations

**Although more resilient to shocks, the possible regional spillovers should be closely monitored.**

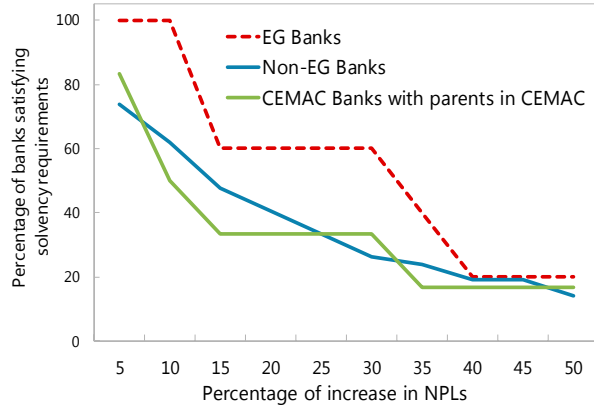
Banks with parents in the CEMAC appear sensitive to solvency and liquidity shocks. Only a third of banks with parent in the CEMAC satisfy liquidity and solvency requirements after a 15 percent shock. Furthermore, a 25 percent shock brings all banks with capital originating in CEMAC countries below the minimum liquidity requirement. A deterioration in parents' financial soundness would reduce the extent to which subsidiaries can benefit from parents' refinancing.

**Effect of funding shocks on liquidity**



Source: BEAC and IMF staff estimates.

**Effect of asset quality shocks on solvency**



<sup>15</sup> For solvency, the shock consists of a given deterioration in asset quality; for liquidity, the shock consists of percentage withdrawal in deposits. For technical details on methodology, see the 2016 CEMAC Staff Report.

<sup>16</sup> The threshold above which funding shocks brings liquidity ratio below regulatory levels reduced to 40 from 50 percent of deposit withdrawals in Equatorial Guinea.

<sup>17</sup>The shock's magnitude leading to inadequate liquidity ratios has increased to 15 percent in 2016, compared with only 5 percent in 2014.

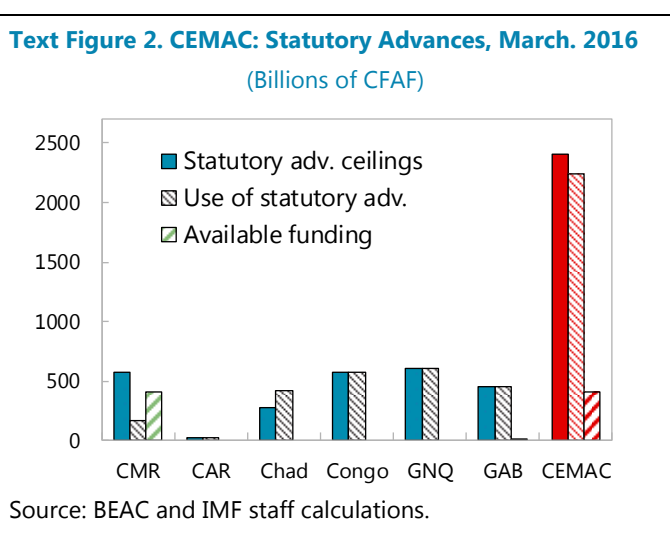
<sup>18</sup> The shock's size bringing solvency ratios below regulatory levels increasing to 30 percent of asset quality deterioration, from 20 percent in 2014.

## C. Linkages between Oil Prices and Financial Stability

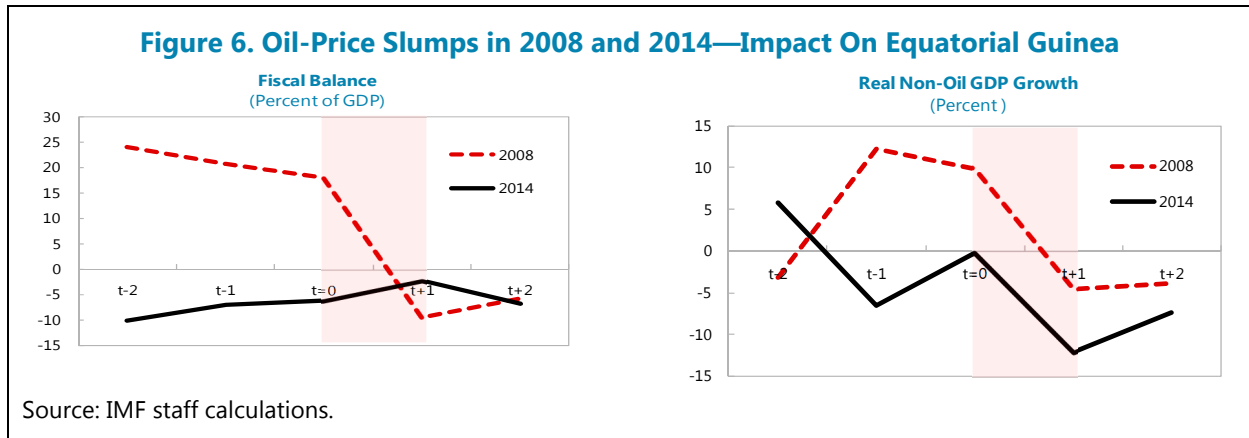
**12. Commodity price shocks can threaten financial stability through macro-financial linkages (Kinda *et al.* 2016).** The linkages between the government, economic activity, and banks constitute the bulk of transmission channels of the shocks (See appendix II). As in most CEMAC members, the recent oil-price slump has widened deficits and reduced the government's ability to pay suppliers and contractors, increasing the likelihood of accumulating arrears. This has translated into a deterioration of banks' asset quality in many CEMAC countries (e.g., Gabon and Equatorial Guinea). Given the low diversification of CEMAC's economies, the oil-price shock has substantially weakened economic activity, which in turn has reduced firm profits and household income, and their ability to repay their debt. These dynamics create a vicious cycle, whereby further deterioration in banks asset quality reduces banks' ability to extend credit, weakening economic growth and fiscal performance due to lower tax receipts, and so on.<sup>19</sup>

**13. Due to limited sources of deficit financing, oil shocks de facto force the government to run procyclical policies.** Equatorial Guinea has virtually no access to the international capital market and has recently reached of possible domestic financing from the central bank (Text Figure 2). Given the rapid erosion of fiscal buffers, the large revenue shock leaves no viable alternatives to a sharp contraction in government spending, which affects economic activity. This same dynamic played out following the 2008 oil-price shock, where the fiscal balance fell from 18 percent of GDP to -9.5 percent, alongside a sharp fall in non-oil GDP growth (from 9.9 percent to -4.5 percent).

After the 2014 oil-price shock, the fiscal deficit improved from -6.1 to -2.2 percent, whereas non-oil growth substantially contracted from -0.3 percent to -12.1. (Figure 6).



<sup>19</sup> Although oil-price shocks are likely to deteriorate asset quality in most banks, direct shocks transmission across banks is likely to be limited because of the undeveloped interbank market. However, shocks could be transmitted from an ailing bank to others via common loan exposures.



**14. The magnitude of the impact of oil-price shocks on financial stability depends on structural factors and available fiscal and financial buffers.** The key factors amplifying the impact of oil price shocks on banks’ asset quality are well documented (Kinda *et al.*, 2016; Gabon 2015 SIP). Economic diversification and developments in the real sector substantially determine the extent of oil-price shocks on the financial sector through the corporate sector. In some countries with excess production capacity, oil production levels could be used to mitigate government revenue shortfalls and limit the spread of the oil-price shocks. This is not the case for Equatorial Guinea, which faces secularly declining oil production due to maturing oil fields. Indeed, the oil-price shock effects are amplified. Insufficient fiscal buffers<sup>20</sup> tend to exacerbate the adverse effects of a shock as the government (with revenue shortfall) is forced to engage in fiscal consolidation. Finally, sound micro-prudential policies in the form of counter-cyclical capital and liquidity buffers also mitigate the exposure of the banking sector to weak economic activity, through their role as shock absorbers.

**15. Long-term trends in credit supply appear to be associated with lagged oil prices dynamics.** Long-term credit growth has been on an upward trend, with occasional deceleration in relation to changes in the oil price trends. Robust OLS regressions of changes in credit trends show that oil price changes tend to have lagged effects (Text Table 1, Figure 7).<sup>21</sup> Although a boom in oil price does not necessarily translate into higher credit the year after, developments in the second and third years suggest a strong association. This also means that, in line with recent credit trends (Figure 4), oil price reversals tend to be associated with a deceleration in credit growth two to three years after the fact.

**Text Table 2. Dependence structure of oil and credit**

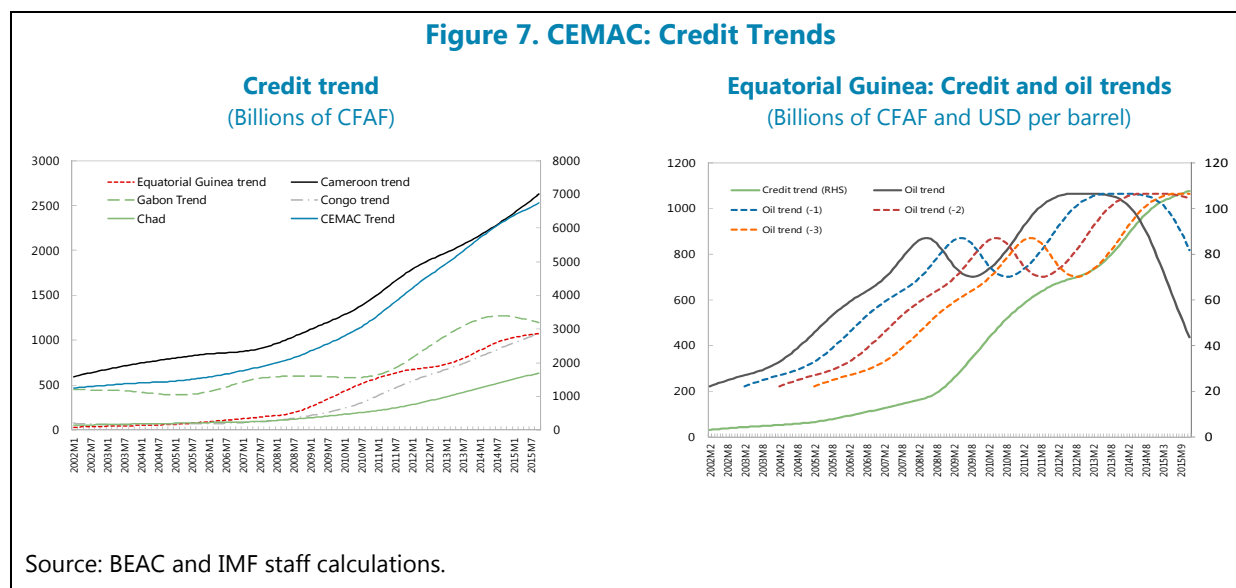
Dependent variable OLS estimates	Changes in credit trend			
	(1)	(2)	(3)	(4)
Changes in credit trend, lagged	0.47*** (0.05)	0.63*** (0.07)	0.48*** (0.05)	0.77*** (0.06)
Changes in oil trend, lagged	-0.74* (0.42)			0.40 (0.27)
Changes in oil trend, 2-year lagged		1.65*** (0.46)		2.15*** (0.35)
Changes in oil trend, 3-year lagged			3.14*** (0.37)	3.64*** (0.35)
Constant	4.01*** (0.61)	1.97*** (0.60)	2.19*** (0.53)	-1.72*** (0.66)
Observations	153	141	129	129
R-squared	0.34	0.31	0.47	0.55

Robust standard errors are in parentheses. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1.

Source: BEAC and IMF staff calculations.

<sup>20</sup> Mostly owing to running procyclical fiscal policy over the years.

<sup>21</sup> The data consists of monthly observations ranging from January 2002 to December 2015. Private credit is obtained from the IMF’s monetary survey and oil prices are from WEO. Trends are obtained through HP filtering.

**Figure 7. CEMAC: Credit Trends**

## D. Monetary Policy Effects on Commercial Banks' Behavior

**16. The BEAC's accommodative monetary policy has temporarily eased the government and banks' difficulties.** The BEAC has responded to the common oil-shock through direct and indirect accommodative monetary policy.<sup>22</sup> To help countries cope with increasing budgetary pressures, in August 2015 the BEAC raised the ceiling of its statutory advances to 20 percent of the previous year's fiscal revenue, which led to a 52 percent increase in its lending to the region. In terms of indirect monetary tools, in April 2016 the BEAC raised commercial banks' refinancing ceilings for government paper and halved reserve requirements, *de facto* injecting additional liquidity into the banking system equivalent to one-fifth of outstanding statutory advances.

**17. The BEAC's monetary stance may distort banks' lending behavior, especially in the presence of structural bottlenecks.** Monetary easing in a context of already high liquidity does not necessarily increase private credit supply, but will likely be used to purchase government paper<sup>23</sup> that would ultimately be discounted at the central bank.<sup>24</sup> The resulting liquidity may induce weak banks to finance weak firms that would otherwise not be financed, thereby reducing the probability that loans will be repaid (Acharya and others, 2015). This distorted behavior could ration out high quality firms that are most likely to repay their debt. The conclusion of Acharya and others (2015) is based on the existence of a sticky bank-borrower relationship, which implies that private firms, less able to utilize alternative funding sources, are stuck with weakly capitalized banks. In Equatorial Guinea, this effect is exacerbated by the lack of information on borrowers, and thus exacerbates adverse selection problems.

<sup>22</sup>These measures have delayed fiscal consolidation, limited monetary transmission, and undermined BEAC's reforms towards a fully market-based monetary policy.

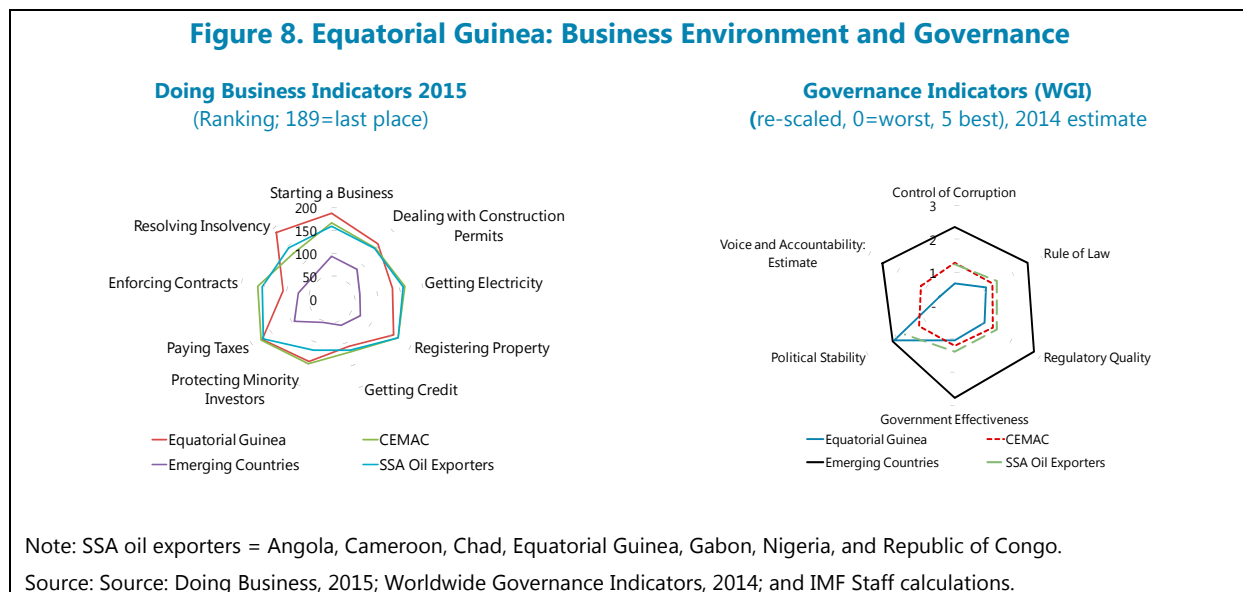
<sup>23</sup> Prudential regulations constrain government financing beyond the short term.

<sup>24</sup> BEAC refinancing of commercial banks on sovereign collateral are limited to 35 percent of fiscal revenue. This limit has not been reached.

## E. Oil Prices and Financial Development

**18. Equatorial Guinea’s oil wealth in the context of weak governance and business climate is likely to have delayed financial development.** The country still ranks among the weakest performers in terms of governance and business climate indicators (Figure 8). In particular, indicators of corruption and contract enforcement are weak, which could inhibit financial development (Bhattacharyya and Holder, 2014). Indeed, the absence of strong contracting institutions may prevent creditors from enforcing contracts, and reduce debtors’ incentive to repay their debt. As such, private investors and banks might be reluctant to borrow and lend in the first place, even when highly liquid. The heavy reliance on the oil sector has also negatively affected financial development through demand and supply of financial services. On the demand side, the government has mostly relied on oil revenue for consumption smoothing, which has likely weakened the incentive to build an effective financial system to serve as a buffer to smooth consumption over the business cycle (Gylfason, 2006). On the supply side, higher investment in the natural resource and construction sectors could have lowered investment in the financial sector and drawn away skills from the financial system (Beck, 2011).

**19. Financial sector development could help reduce volatility of growth and support economic diversification.** Indeed, over the past years, financial development has been associated with reduced growth volatility in sub-Saharan Africa, where most countries are below the threshold beyond which financial development hurts growth (IMF, 2016). To mitigate the impact of links between the non-oil economy and government spending (see Section B), it has become urgent to re-orient the financial system to support economic diversification and private sector initiatives, providing much needed resources for increased non-oil sector activity (aside from construction) and building resilience to shocks. Financial system development could also help better allocate resources, reversing high credit supply concentration and compensating for the negative effects of Dutch disease.





## F. Policy Recommendations

**20. Improving the financial sector resilience shocks and financial development will require action at both the national and regional levels.** As a CEMAC member monetary policy and financial surveillance is conducted by the BEAC and COBAC respectively.

- ***The government should promptly tackle increasing arrears to avoid negative repercussions on financial stability.*** Going forward, decisive effort is required to improve PFM, public investment program (PIP) management, and rebuild fiscal buffers.
- **Maintain adequate capital, liquidity, and provisioning in the banking sector to mitigating exposures of to weak economic activity.** Stress tests show that liquidity and solvency are highly sensitive to macroeconomic shocks. Given the protracted oil shock, Equatorial Guinea should encourage the regional supervisor to put in place action plans to ensure bank compliance with prudential norms and provisioning against accumulated NPLs, and cooperate with the COBAC to undertake an asset quality review and in closely monitoring of government-guaranteed loans.
- ***Advocate coordinated regional approach for developing bank supervision on a consolidated basis.*** The COBAC and the BEAC should develop a regional strategy to better monitor and tackle macro-financial spillovers through parent-subsidiary linkages. Improving the quality and timeliness of financial stability indicators is indispensable for accurate assessment and timely intervention.
- **Implement crosscutting financial sector structural reforms to close the financial development gap, support the transformation plan, and allow banks to play a more supportive role in economic growth.**

## Appendix I. Financial Soundness Indicators

**Table A1. Equatorial Guinea: Financial Soundness Indicators for the Banking Sector, 2010–15**

	(Percent)								
	2010	2011	2012	2013	2014	2015			
						Q1	Q2	Q3	Q4
<b>Capital</b>									
Regulatory capital to risk-weighted assets <sup>1,2</sup>	20.2	18.2	24.5	22.3	25.5	26.3	24.4	25.7	23.8
Tier 1 capital to risk-weighted assets <sup>2</sup>	20.1	18.2	24.5	22.5	26.2	27.0	25.0	26.4	24.4
Capital to assets	11.0	13.4	10.6	10.9	11.6	11.4	11.4	11.5	12.6
<b>Asset quality</b>									
Non-performing loans (gross) to total loans (gross)	4.7	4.4	5.8	20.1	19.7	19.6	16.8	17.1	17.7
Non-performing loans less provisions to total capital	-3.2	-4.8	-8.1	42.9	40.5	44.9	36.6	36.5	40.4
<b>Earnings and profitability</b>									
Return on assets <sup>3</sup>	0.3	0.9	0.8	0.6	0.7	n.a.	0.7	n.a.	1.1
Return on equity	10.2	24.3	22.5	14.1	16.9	n.a.	5.9	n.a.	8.4
<b>Liquidity</b>									
Liquid assets to total assets	45.5	37.6	59.2	48.7	43.8	42.2	40.4	42.4	34.9
Liquid assets to short-term liabilities	220.5	185.7	283.1	220.2	194.0	185.5	164.5	230.7	200.7
Loans to deposits	67.0	83.1	49.1	64.3	64.2	68.6	81.3	70.3	82.6

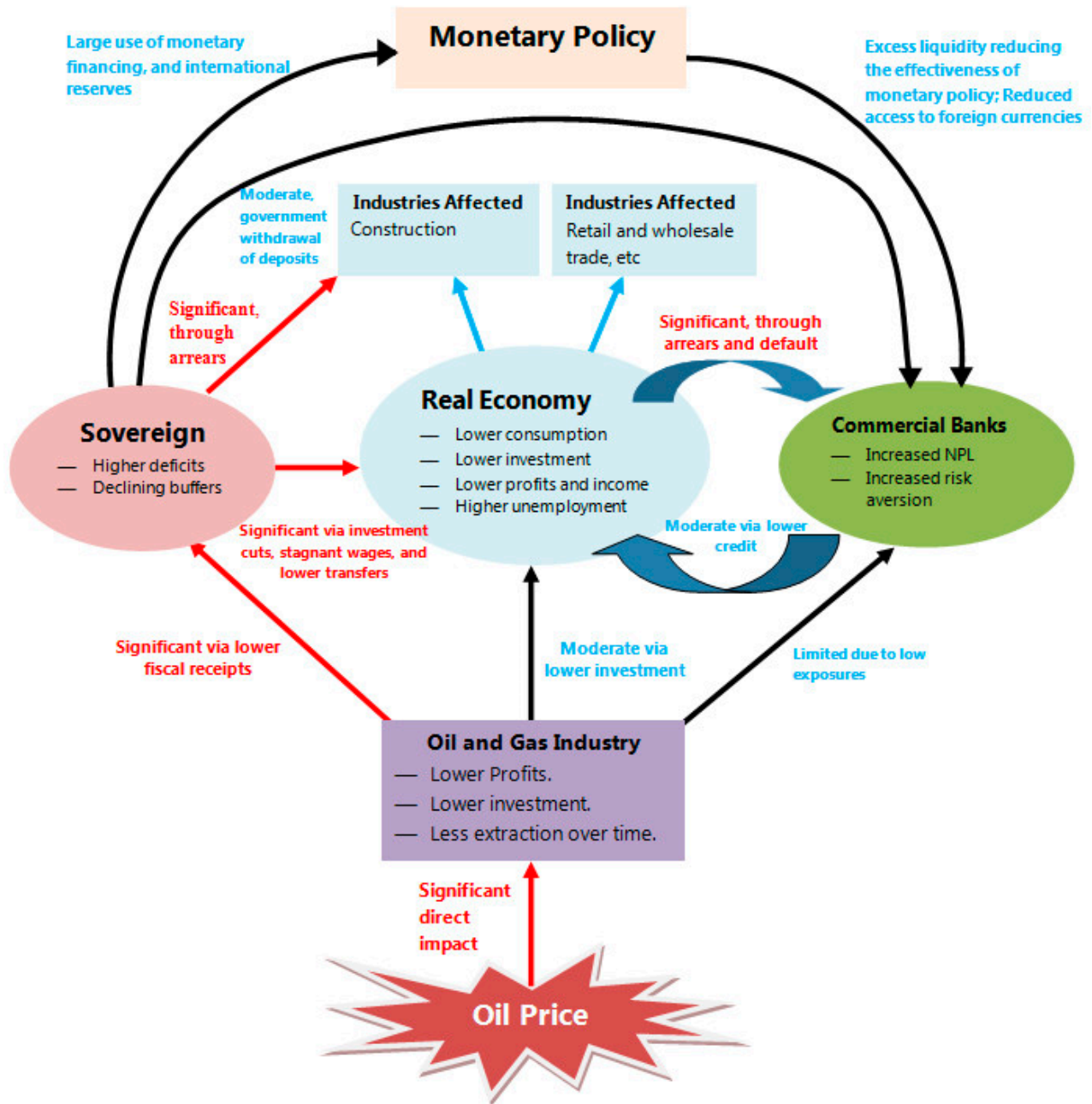
Source: Staff estimates based on COBAC data and FSI definitions from IMF's "Compilation Guide on Financial Soundness Indicators."

<sup>1</sup> Current year profits are excluded from the definition of regulatory capital, following the Basel I capital accord guidelines. General provisions are included in Tier 2 capital up to an amount equal to 1.25 percent of risk-weighted assets. Regulatory capital is the sum of Tier 1 capital, and the minimum of Tier 1 and Tier 2 capital.

<sup>2</sup> The risk-weighted assets are estimated using the following risk weights: 0 percent - cash reserves in domestic and foreign currency and claims on the central bank; 100 percent - all other assets.

<sup>3</sup> The ratio of after-tax profits to the average of beginning and end-period total assets.

## Appendix II. Macro-financial Spillovers from Lower Oil Prices



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