



UNION OF COMOROS

SELECTED ISSUES

December 2016

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UNION OF THE COMOROS

SELECTED ISSUES

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COMPARATIVE FISCAL PERFORMANCE¹

The fiscal performance of and outlook for Comoros continues to be adversely affected by a number of systemic challenges in the areas of revenue administration and public financial management. In particular, Comoros experiences a structural imbalance between domestic resource mobilization and current spending, especially on public wages and salaries, leaving little scope for domestically-financed capital spending that is essential for spurring economic growth and social development. This fiscal imbalance is more pronounced compared to similar sub-Saharan African countries even taking into account the sizeable one-off budget grants the Comorian economy has benefited from.

A. Background

1. One of the key challenges of economic policy in sub-Saharan Africa over the last decade or more has been to create fiscal space for meeting the needs of economic and social development. The creation of fiscal space can involve any or all of increased revenue mobilization, more efficient spending, and sustainable financing, whether internal or external. As financing will eventually need to be repaid, the ultimate sources of fiscal space have to be better revenue mobilization and more efficient spending. It should, therefore, not come as a surprise that increased revenue collection and more efficient spending have been official government objective in most, if not all, sub-Saharan African countries for a long time, including Comoros.

2. The results of the analysis of various fiscal indicators this paper discusses suggest that fiscal performance of sub-Saharan countries have been decidedly mixed. Some countries have managed to substantially increase their tax revenues while others have managed to reduce their current spending, notably on wages and salaries. A few have had some success on both scores, such as Mozambique and Guinea-Bissau. Comoros' efforts are impeded by an electricity crisis, dilapidated economic and social infrastructures, and a poor business environment, which have discouraged private sector initiative and kept foreign direct investment at bay. Taking into account the fragility of the Comorian economy and its limited capacity to pay back its loans, non-concessional loans remain inappropriate and the short-term avenues for expanding fiscal space available to the economy are limited.

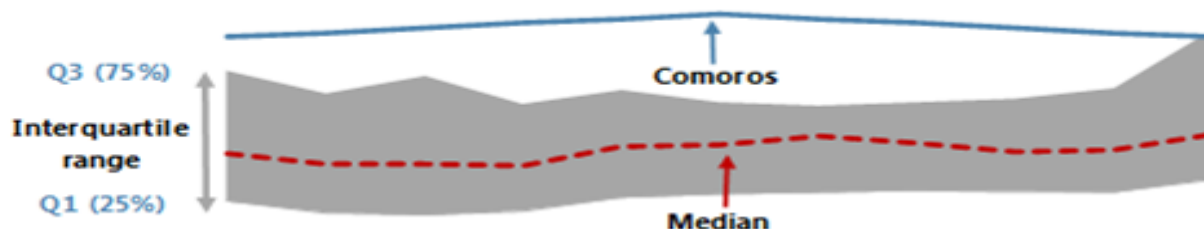
B. Methodology

3. This paper assesses the main fiscal trends of the Comorian economy over the period 2005-2015 while drawing attention to some chronic structural imbalances from which the Comorian economy continues to suffer. Through conducting a detailed analysis of the various fiscal indicators for the Comorian economy, key avenues for addressing its fiscal imbalances and creating fiscal space are highlighted. In this paper, quartiles and the interquartile ranges are used to

¹ Prepared by Mounir Bari (AFR).

compare and contrast the trends in the main fiscal indicators of Comoros vis-a-vis similar sub-Saharan African countries.

4. In the charts to be presented, Comoros will be represented by a solid blue line, the sample median by a broken red line. The grey area represents the second and third quartiles of the distribution of the corresponding indicators for the comparator countries, as shown below.



5. The comparator group (Table 1) used in the analysis consists of 30 PRGT² eligible low-income, non-oil exporting countries in sub-Saharan Africa (SSA). Out of the 33 SSA PRGT eligible countries, Cameroon, the Republic of Congo, and Zimbabwe were excluded from the sample used for analysis since these countries derive a significant portion (over 20 percent) of their government revenues from oil and, as a result, do not serve as good comparators for Comoros. The sample includes both large and small economies; some have been stable for a long time while others are still fragile. Therefore, the sample group should be representative of the sub-Saharan African experience for non-oil exporting countries over the period 2005- 2015.

Table 1. Sample of sub – Saharan African PRGT – Eligible Countries

Benin	The Gambia	Niger	Côte d'Ivoire
Burkina Faso	Guinea	Rwanda	São Tomé and Príncipe
Burundi	Guinea-Bissau	Sierra Leone	Senegal
Chad	Liberia	South Sudan	Ghana
Comoros	Madagascar	Tanzania	Kenya
Democratic Republic of the Congo	Malawi	Togo	Lesotho
Eritrea	Mali	Uganda	Zambia
Ethiopia	Mozambique	Cabo Verde	

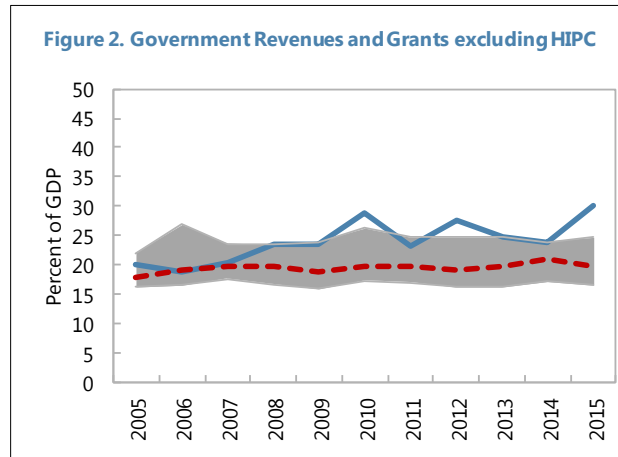
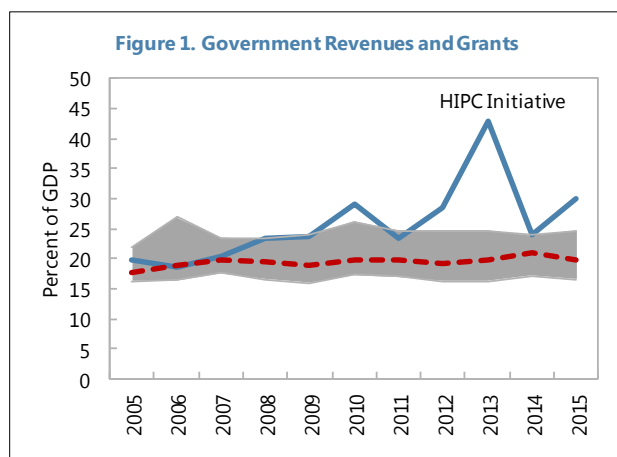
Source: Eligibility to Use the Fund's Concessional Facilities for Concessional Financing (SM/15/158); Fund WEO, World Bank, World Development Indicators, and OP 3.10, Annex C, of July 2015.

C. Government Revenues

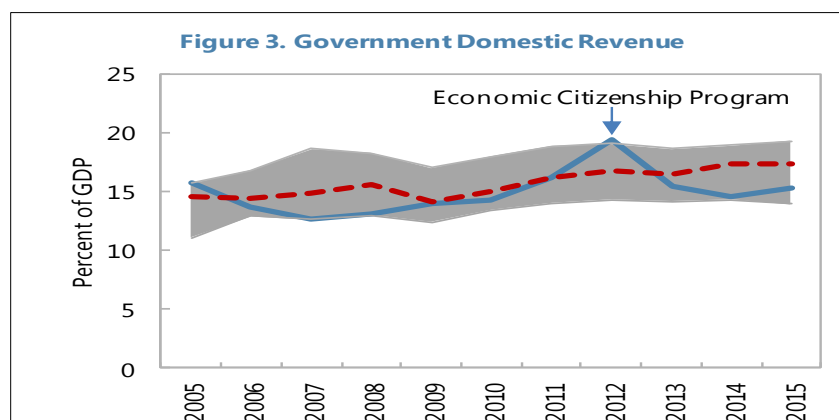
6. Total resources, both internal and external, available to the Comorian economy over the last decade have exceeded those available to most similar sub-Saharan African countries,

² IMF country members with low per-capita income levels and without durable and substantial access to international markets.

with a particular peak in 2013 as a result of the HIPC³ Initiative (Figure 1). Even when the debt relief grant provided under the HIPIC Initiative in 2013 is excluded, the picture remains the same (Figure 2); the resources available to the Comorian economy over the last decade have generally been above average for the sample of sub-Saharan African countries.



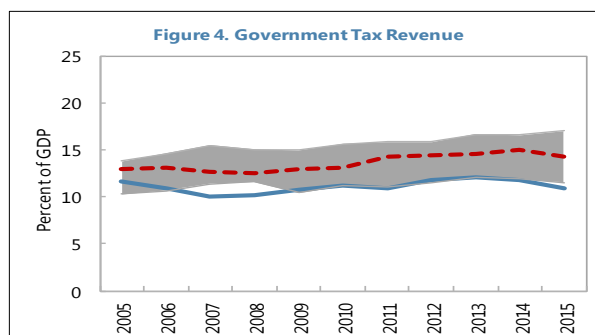
7. However, the picture changes considerably when external project grants and other grants financing are excluded. Domestic revenue – both tax and non-tax revenue - has been mostly below the median for the country sample used (Figure 3). The only exception is 2012, when receipts from the Economic Citizenship Program (ECP)⁴ peaked, bringing domestic revenue up to 19 percent of GDP.



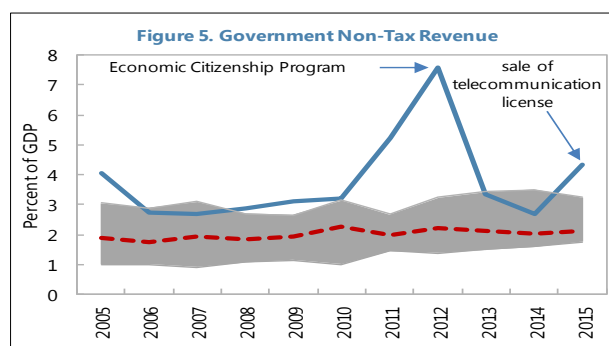
³ Comoros received extensive irrevocable debt relief in 2013, which resulted in a decline in nominal external debt from 40.3 percent of GDP at end-2012 to 18.5 percent at end-2013. In 2014, France unilaterally cancelled a debt of about \$6.6 million Comoros owed to the French Post Office.

⁴ The ECP involved the selling of passports to foreign nationals in some Middle Eastern countries, mainly the United Arab Emirates. Revenues from the program declined steeply in 2013 following the imposition of tighter controls in response to earlier irregularities.

8. Tax revenue mobilization has been weak. The tax revenue performance of Comoros, when analyzed in isolation, generally drops into the first quartile (Figure 4). In other words, three-quarters of countries in the sample analyzed generally have performed better in raising tax revenue than Comoros. Inefficient revenue administration, both at the general tax and customs administration levels, has been an important factor. At the same time, it is important to note that success in raising tax revenue relative to GDP in most sub-Saharan African countries over the last decade has been limited. Thus, Comoros is certainly not the sole country to experience difficulties in mobilizing additional tax revenue, but its performance is nevertheless well below average.

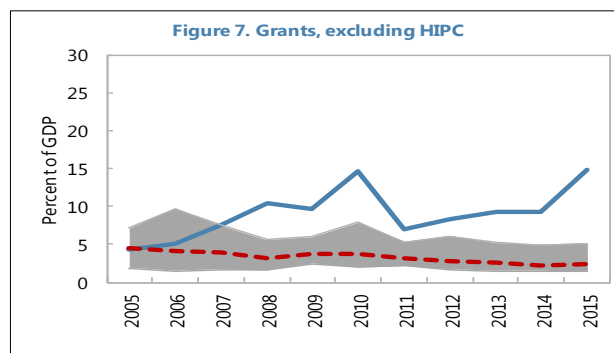
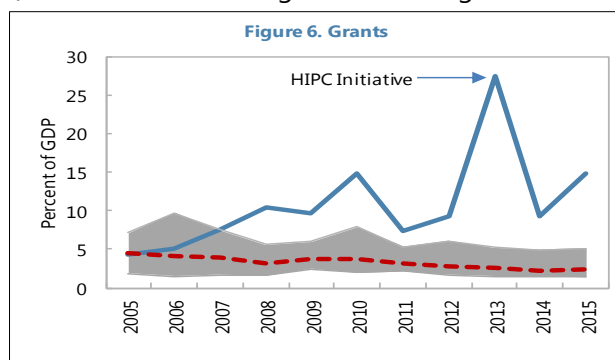


9. In contrast to tax revenue, Comoros has performed better than most peers when it comes to non-tax revenue (Figure 5); not only because of the proceeds from the Economic Citizenship Program (ECP) in 2012 and the sale of the second telecommunication license in 2015, but in general.



D. Grants

10. The Comorian economy has benefited from sizeable one-offs budget grants. Regarding external grants, it would appear that the international community has been quite generous to Comoros over the last decade, relative to most other similar sub-Saharan African countries (Figure 6). This is true including and excluding the HIPC debt relief received in 2012-2013 (Figure 7).



11. Most of the grants that Comoros has received and continues to receive are project grants; that is grants that donors spend on the projects they are supporting in the country. The level of project grants—three to four times higher than the median for the sample — is quite

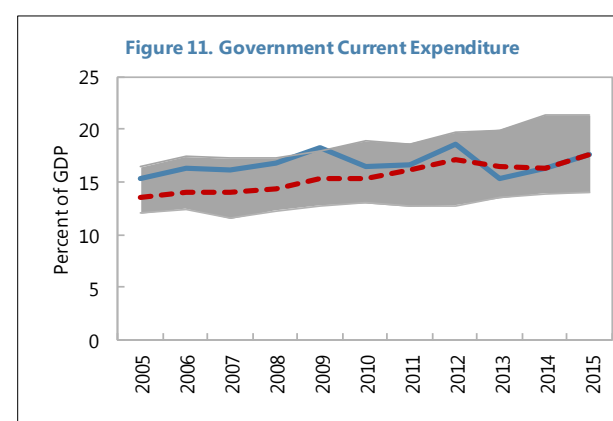
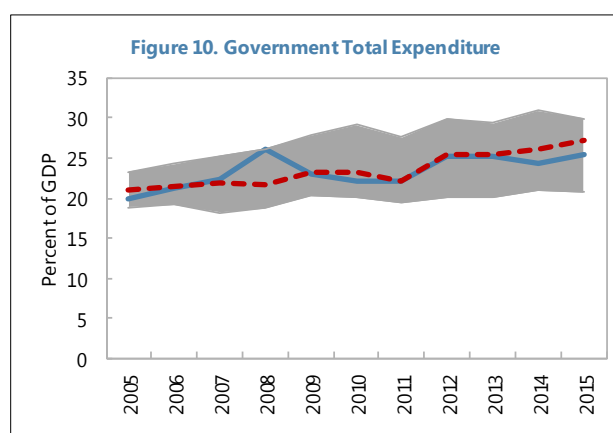
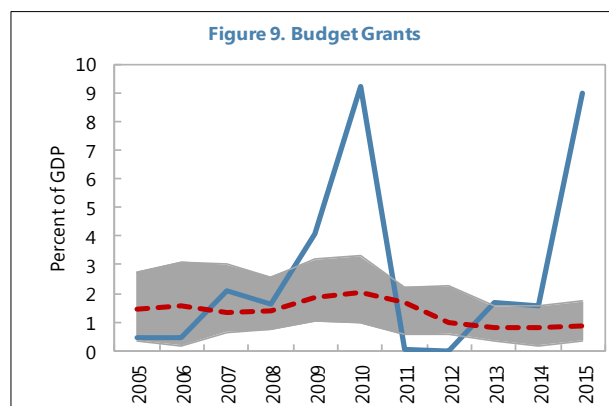
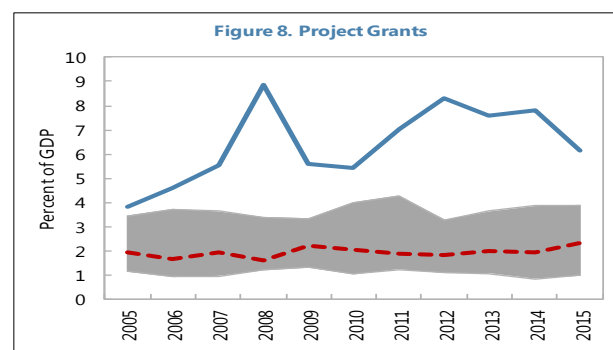
striking (Figure 8). As of end-2015, the level of project grants in Comoros represented 6.1 percent of GDP while the respective average of SSA countries was about 2.3 percent of GDP.

12. Budget grants have generally been significantly lower than project grants and also much more volatile. The two peaks, shown in Figure 9, represent one-off budget grants from Qatar in 2010 and from Saudi Arabia in 2015. While these large grants were crucial in allowing Comoros to pay government salaries and finance other expenses, this chart underscores the danger of relying on budget grants for financing recurrent spending.

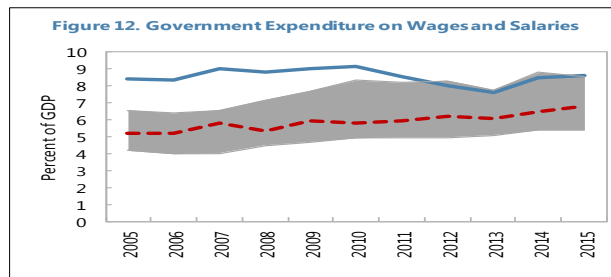
E. Government Expenditures

13. Total expenditure by the Comorian government over the last decade fall very much in the middle of the sample (Figure 10). In fact, total spending has been close the sample median for the last decade of about 23 percent of GDP.

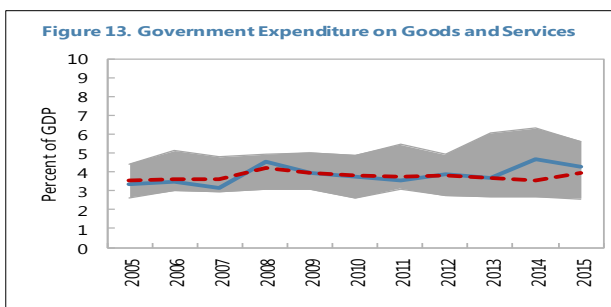
14. Current spending in Comoros was above average for the sample during most of the last decade, but has converged to the median more recently (Figure 11). However, this appears to be mostly because current spending in the sample countries has generally been on the rise, whereas in Comoros it has remained broadly flat relative to GDP with the exception of a dip in 2013.



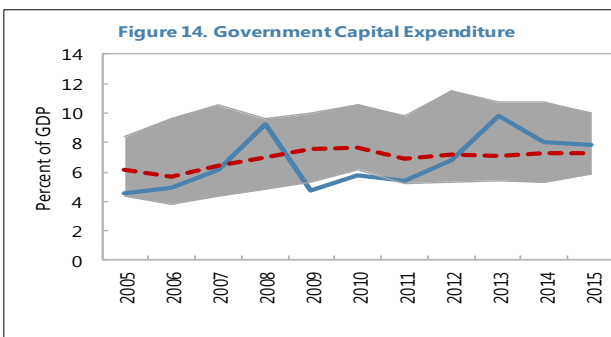
15. Spending on wages and salaries has been very high. For Comoros, the size of the wage bill relative to GDP has been well above average for the last ten years and remains so even though there appears to have been an upward trend in the wage bill in the sample countries in recent years (Figure 12).



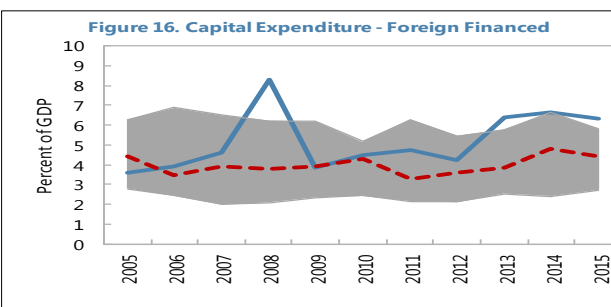
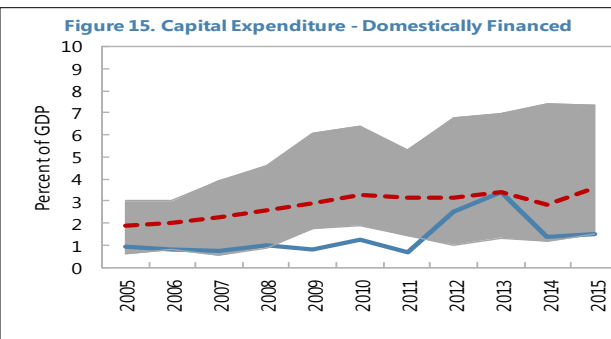
16. Regarding spending on goods and services, Comoros appears to be very much in line with the sub-Saharan African country average (Figure 13). Over the last decade, Comoros' average spending on goods and services was about 3.9 percent of GDP.



17. Total capital spending in Comoros has been broadly in line with the sub-Saharan African average (about 6.6 percent of GDP) although it has exhibited much more volatility than current spending (Figure 14).



18. It is noticeable that, for Comoros, externally financed capital spending is above average for the sample (Figure 15). In fact, externally financed capital spending in Comoros stood at 6.3 % of GDP in 2015 while the sample median was about 4.4% of GDP end of the same year. Given that capital spending has been broadly in line with the sample average, this implies that domestically-financed capital spending has generally been much more constrained than in most of the sample countries (Figure 16); the only exception in the period when proceeds from the ECP were at their peak.



F. Structural Fiscal Imbalance

19. A high wage bill remains a chronic challenge to the Comorian government. The wage bill in Comoros has consistently consumed more than 60 percent of domestically-generated revenue over the last decade, a much higher share than on average in other sub-Saharan African countries (Figure 17). As a result, there is very little room for spending on non-wage items such as social services and education or infrastructure projects.

20. This imbalance is even more pronounced when looked at in terms of the ratio of the wage bill to tax revenue. This ratio has typically been close to 80 percent. In this regard, Comoros is a clear outlier in the sample (Figure 18).

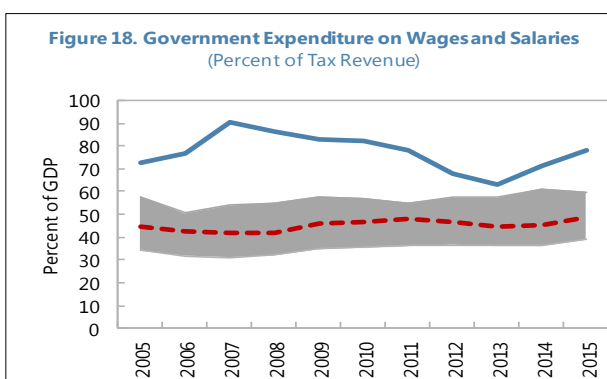
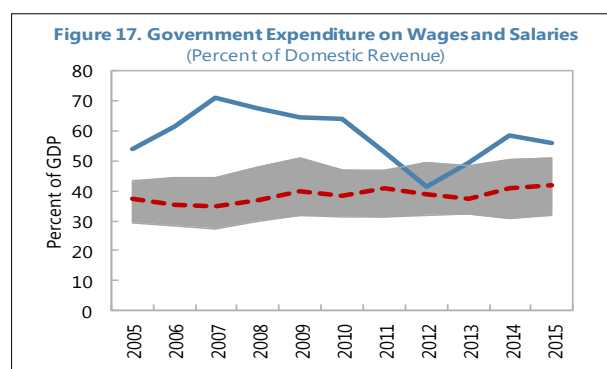
G. Conclusions

21. Comoros is an outlier compared to other Sub-Saharan countries in terms of tax revenues and the weight of its wage bill. While similar in several fiscal aspects, such as government total expenditure and spending on goods and services, the level of tax revenues (in terms of GDP) is lower in Comoros than in most other countries. Moreover, the wage bill absorbs a disproportionately large share of these revenues. This creates a structural imbalance that has been growing and needs to be addressed in order to create fiscal space, necessary to finance increased capital spending, dedicate sufficient resources for social spending and build resilience against external shocks, including natural disasters.

22. Volatile, and at times very large external inflows have masked the structural fiscal imbalance. Large external inflows in the form of budgetary grants, but also the sale of passports, which have proven very volatile, have allowed the authorities to maintain overall spending, while at the same time masking the growing imbalance. These volatile external resources should be used to finance extraordinary expenses (e.g., to create buffers, execute one-off important structural projects, or address structural problems in the state enterprises) rather than for ordinary current spending. Additional sustainable domestic resources need to be mobilized and the wage bill reduced to be able to finance current expenses on a sustainable basis.

H. Data Sources

Country Authorities; WEO and IMF staff calculations.



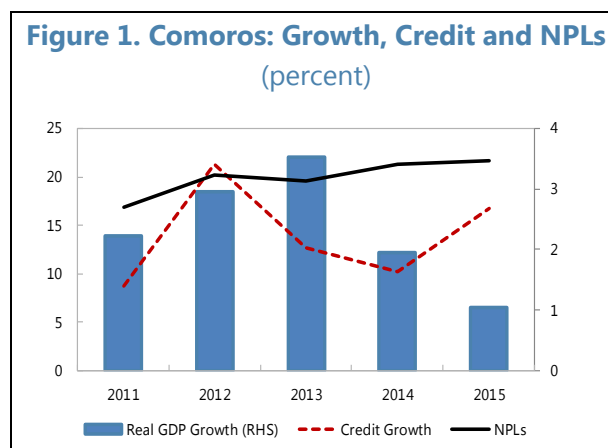
FINANCIAL SECTOR DEVELOPMENTS, RISKS AND INCLUSION¹

Vulnerabilities in the already-fragile Comorian financial sector mounted in 2015 against the backdrop of stagnation in the real economy. This chapter reviews financial sector developments in the Comoros and highlights the financial stability and inclusion challenges faced by the sector. It finds that although the financial system is underdeveloped and mildly concentrated in an absolute sense, it is deeper and more liquid and efficient than comparators in low-income Sub-Saharan Africa. Further, the financial sector is on the whole well-capitalized and liquid, with limited financial interconnectedness reducing the scope for systemic spillovers. However, concerns regarding the quality of credit allocation have increased, and the situation of some individual institutions, for example the state-owned postal bank, is problematic. Financial sector inclusiveness is limited, with financial access unequal across income and gender, and difficult for the overwhelmingly rural population of Comoros.

A. Background

1. Financial institutions in Comoros operate in a challenging macroeconomic environment. Real GDP growth slowed to an estimated 1 percent in 2015, down from 2 percent in the previous year. Lackluster growth was due largely to the persistent electricity crisis and weak execution of the public investment program. Inflation remained moderate. The current account balance recorded a surplus of 0.9 percent of GDP in 2015, due to favorable one-off factors, including a Saudi budget grant equivalent to 7.5 percent of GDP. The same factors also moved the overall fiscal balance from a deficit of 0.8 percent of GDP in 2014 to a surplus of 3.6 percent of GDP in 2015, while domestically-generated resources were insufficient for meeting the current obligations of the State.

2. The stagnation of the real economy in 2015 accentuated vulnerabilities in the already-fragile financial system (Figure 1). Credit to the private sector grew by about 16 percent, up from 10 percent the year before. However, higher credit growth was accompanied by a continued increase in non-performing loans (NPLs), raising concerns over the quality of credit allocation and loan repayment capacity. Sluggish profitability, with a sector-wide return on assets of less than 1 percent, also pointed to the continued fragility of some financial institutions. The difficulties faced by the state-owned postal bank, SNPSF (*Société Nationale des Postes et Services Financiers*), continued unabated.



3. Against this backdrop, this paper analyses three key issues. First, it reviews the Comorian financial sector and benchmarks its development in a regional context. Second, emerging threats to

¹ Prepared by Cameron McLoughlin (AFR)

financial sector stability are examined. Third, the situation regarding household financial inclusion in Comoros and potential implications for financial stability are analyzed.

B. Overview of Financial Sector Developments

4. The financial system in Comoros comprises eight financial institutions engaged in deposit taking from and lending to the general public. These institutions consist of four commercial banks and three microfinance institutions, as well as the SNPSF. Large international money transfer agencies (e.g. Western Union) are present in Comoros and act indirectly through partnerships with the banks or licensed microfinance networks. These agencies are complemented by a local money transfer and exchange entity, the *Maison Comorienne de Transfert des Valeurs* (MCTV). Other features of the financial system – such as insurance, pensions and capital markets – do not exist. Table 1 summarizes the structure of the financial system.

5. The financial sector in Comoros is shallow, underdeveloped and mildly concentrated. Financial institution assets amounted to just over 47 percent of GDP in 2015. These assets are principally held domestically, with net foreign asset holdings insignificant and limited to transactional needs (Table 2). Domestic assets consist mainly of loans to the private sector and deposits at the central bank, with the latter being well in excess of prudential requirements (a minimum of 15 percent of deposits). High liquidity levels reflect underdeveloped financial markets that constrain investment opportunities, as interbank financial markets are nonexistent. Lending by financial institutions to the public sector is limited. The three largest financial institutions in Comoros control about 57 percent of total sector assets (the Herfindahl index for asset concentration is 0.16).²

² The Herfindahl index of asset concentration is calculated by summing the squares of the market share of each financial institution, and then normalizing it to lie between zero and one. A higher index value denotes that the market is more concentrated.

Table 1: Comoros: Overview of Financial System

Financial Institution	Date Established	Parent Company	Legal Structure in Comoros
Banque pour l'Industrie et le Commerce – Comores (BIC-C)	1991	BNP Paribas – 51% Comorian Govt – 34% Individuals – 15%	Commercial Bank
Exim Bank – Comores (EB-C)	2007	Exim Bank-Tanzania.	Commercial Bank
Banque Fédérale de Commerce (BFC)	2009	Owned by Kuwaiti investors.	Commercial Bank
Banque de Développement des Comores (BDC)	1981	Comorian Gov't – 37.5% IPAE (French consortium) – 37.5% AFD – 12.5% EIB – 12.5%	Commercial Bank
Société Nationale des Postes et des Services Financiers (SNPSF) ¹	2004	Owned by the State.	Postal Services / Financial Institution
Maison Comorienne de Transfert des Valeurs (MCTV)	2009	Owned by Comorian private investors	Financial Intermediary
Mutuelles d'Épargne et de Crédit ya Komori (MECK)	1995	Owned by network members	Microfinance Decentralized Local Branch Network
Anjouan SANDUK network	2006	Owned by network members	Microfinance Decentralized Local Branch Network
Mohéli SANDUK network	2011	Owned by network members	Microfinance Decentralized Local Branch Network
¹ Provides postal services and limited banking services. Banking services provided are similar to those of the other banking institutions, and include management of deposit accounts (CCP post office accounts and savings passbooks) and financing by credit or overdraft.			

Table 2: Comoros: Overview of Deposit Money Banks
(percent of GDP)

	2010	2011	2012	2013	2014	2015
Net Foreign Assets	0.81	2.19	0.25	2.60	0.23	0.70
Net Domestic Assets	24.02	23.26	28.29	25.17	28.00	30.46
Cash Holdings	0.74	1.00	1.18	0.89	1.00	1.08
Deposits at the central bank	9.61	10.54	12.54	8.64	10.44	10.55
Domestic Credit	29.13	29.44	34.10	31.30	34.30	37.26
Net Credit to Government	0.37	-0.34	-0.15	-0.08	-0.16	-0.34
Claims on Public Enterprises	1.11	0.55	0.22	0.40	0.30	0.31
Claims on Private Sector	17.32	17.60	20.21	21.35	22.64	25.62
Bank Reserves	10.18	11.54	13.72	9.53	11.44	11.63
Other Items net	-5.11	-6.19	-5.81	-6.13	-6.30	-6.80
Total deposits	24.83	25.45	28.53	27.77	28.22	31.16
Demand Deposits	11.90	13.18	15.00	14.23	14.44	16.84
Term and Savings Deposits	12.93	12.27	13.53	13.54	13.78	14.32

Source: BCC and IMF staff calculations

6. The financial sector in Comoros, while shallow in an absolute sense, is deeper and more liquid and efficient than comparators in low-income Sub-Saharan Africa (SSA), lagging however behind the financial sectors of frontier SSA economies (Figure 2). Traditional metrics of financial sector depth and intermediation indicate that at end 2015, the Comorian financial sector was deeper than the low-income Sub-Saharan Africa (SSA) average, yet significantly shallower than frontier SSA economies.³ Financial institutions in Comoros are liquid, with lending financed primarily by deposits. Despite the mild concentration of the financial sector, efficiency and competition was also comparable to low-income SSA in 2015, as indicated by the lower lending-deposit rate spread.⁴

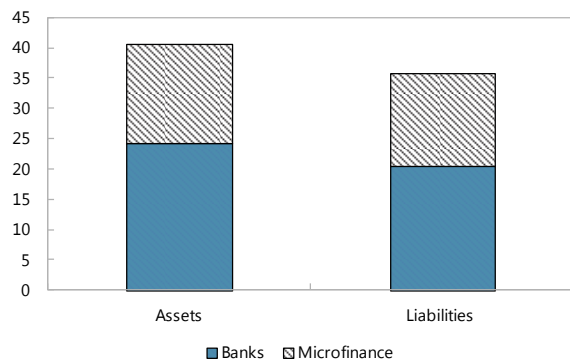
³Low-income SSA countries are defined as PRGT-eligible countries in Sub-Saharan Africa, excluding oil exporters and Zimbabwe, which is an outlier with respect to financial development. Frontier SSA economies are Angola, Côte d'Ivoire, Ghana, Kenya, Mauritius, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Uganda and Zambia.

⁴The peg of the CFA franc exchange rate to the euro and the resulting lower inflation may also have contributed to lower interest rate spreads in Comoros. It is not possible to compare interest rate spreads in Comoros with those in other CFA franc zone countries due to data unavailability.

Figure 2. Comoros: Selected Indicators of Financial Sector Development

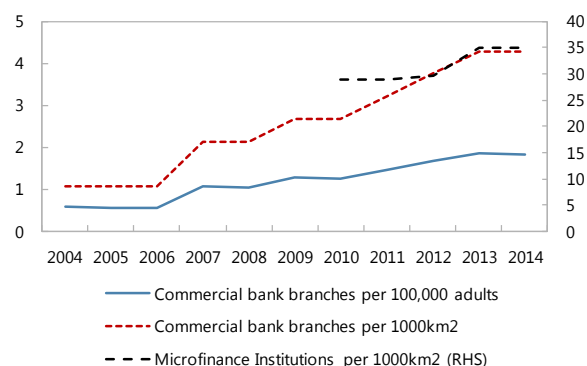
The Comorian financial system is dominated by the commercial banks....

Financial Sector Assets & Liabilities, 2015
(percent of GDP)



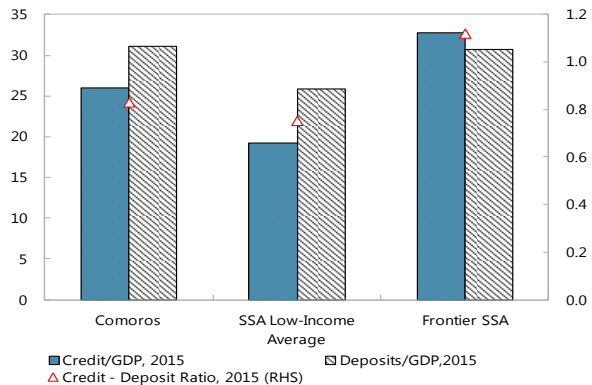
...although microfinance institutions spread in recent years.

Bank branches and microfinance institutions
(number)



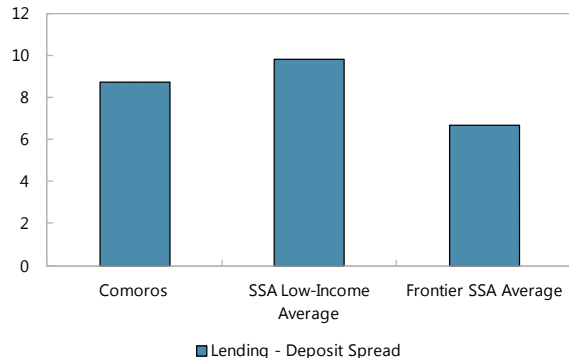
The financial system is relatively deep and liquid....

Financial depth, 2015
(percent, ratio)



...and also comparatively efficient and competitive.

Lending - Deposit Spread, 2014
(percent)



Note: SSA frontier markets are Angola, Côte d'Ivoire, Ghana, Kenya, Mauritius, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Uganda, Zambia

Source: World Development Indicators, Financial Access Survey, International Financial Statistics and IMF Staff calculations.

C. Financial Sector Risks and Vulnerabilities

7. Since 2013, all financial institutions are subject to the harmonized banking law, reducing the scope for regulatory arbitrage. The original banking law, dating from 2004, regulated banks and microfinance institutions differently. These institutions offered different types of financial services and were subject to separate taxation regimes. The new banking law of 2013 is a unified regulatory framework, whereby all financial institutions are required to respect the same norms (e.g. prudential ratios, rules for the distribution of risk, etc.), except as relates to the minimum required level of capital and internal control mechanisms. Consequently, both banks and microfinance institutions are now permitted to offer the same range of financial services. Since 2015, harmonized taxation rules also apply to financial institutions; however, one microfinance institution continues to enjoy a special taxation status.

8. The markets for deposits and loans are dominated by a few large financial institutions (Figure 3). In 2015, the three largest financial institutions account for over 65 percent of system-wide deposits, while for loans, the top three account for just over 55 percent of the total. One microfinance institution is the second largest deposit-taker and largest loan provider, reflecting its reach throughout the three islands of the Union. The concentration of deposits and loans in a few institutions increases the systemic importance of these individual establishments to the domestic financial system.

9. These concentration risks are mitigated by the limited interconnectedness between financial institutions in Comoros, which reduces the scope for spillovers between banks in the event of financial distress. There is no market for interbank lending and inter-institution deposits are strictly limited to parking the excess liquidity of microfinance institutions. These deposits are small in relation to the overall deposits of individual microfinance institutions. Financial institutions do not participate in the capital of other institutions.

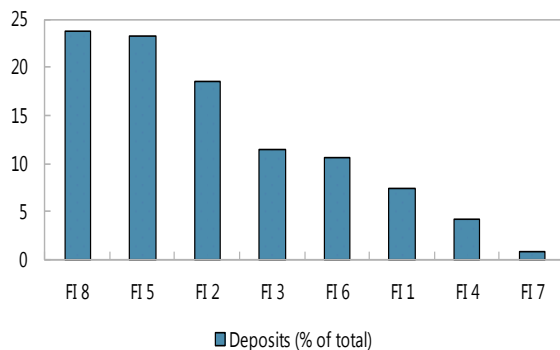
10. The available industry-level data on lending suggest that in 2015, lending was not oriented towards productive economic sectors (Figure 3).⁵ Lending by Comorian financial institutions is generally not made for productive investment activities, with around 70 – 80 percent of total loans extended to general commerce, the informal sector, and for financing imports. In 2015, commerce and household sectors together accounted for around 50 percent of total new loans, while the shares of manufacturing (11 percent) and construction (8 percent) industries were significantly lower. Although the authorities report that individual bank portfolios are well diversified, lessening concentration risk, a prolonged downturn in consumption, induced for example by a reemergence of salary arrears, and a generalized economic stagnation may tighten loan repayment capacity and negatively affect bank balance sheets. Around half of lending is short-term, while long-term loans comprise less than 5 percent of loans.

⁵ The database of the central risk bureau (Centrale des Risques et Incidences des Paiements) maintained by the central bank of Comoros is in the process of development and will in the future contain full historical data on the sectoral breakdown of lending and non-performing loans. At the current time, industry-level loan data are only available for the flow of new lending made in 2015, hence it is not a representative sample of the total stock of loans and NPLs held by financial institutions in Comoros.

Figure 3. Comoros: Selected Indicators of Financial Vulnerabilities

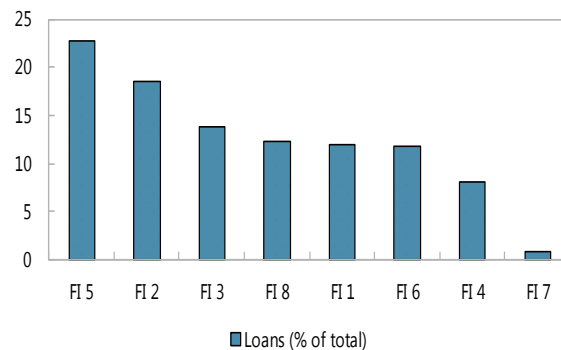
A few large players dominate the sector.

Deposits at Financial Institutions
(percent)



Note: FI = Financial Institution

Loans Extended by Financial Institutions
(percent)

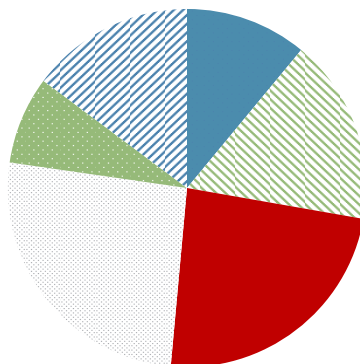


Note: FI = Financial Institution

Lending in 2015 was generally not oriented towards productive economic sectors.

Comoros: Lending by Industry in 2015
(percent of total industry credit)

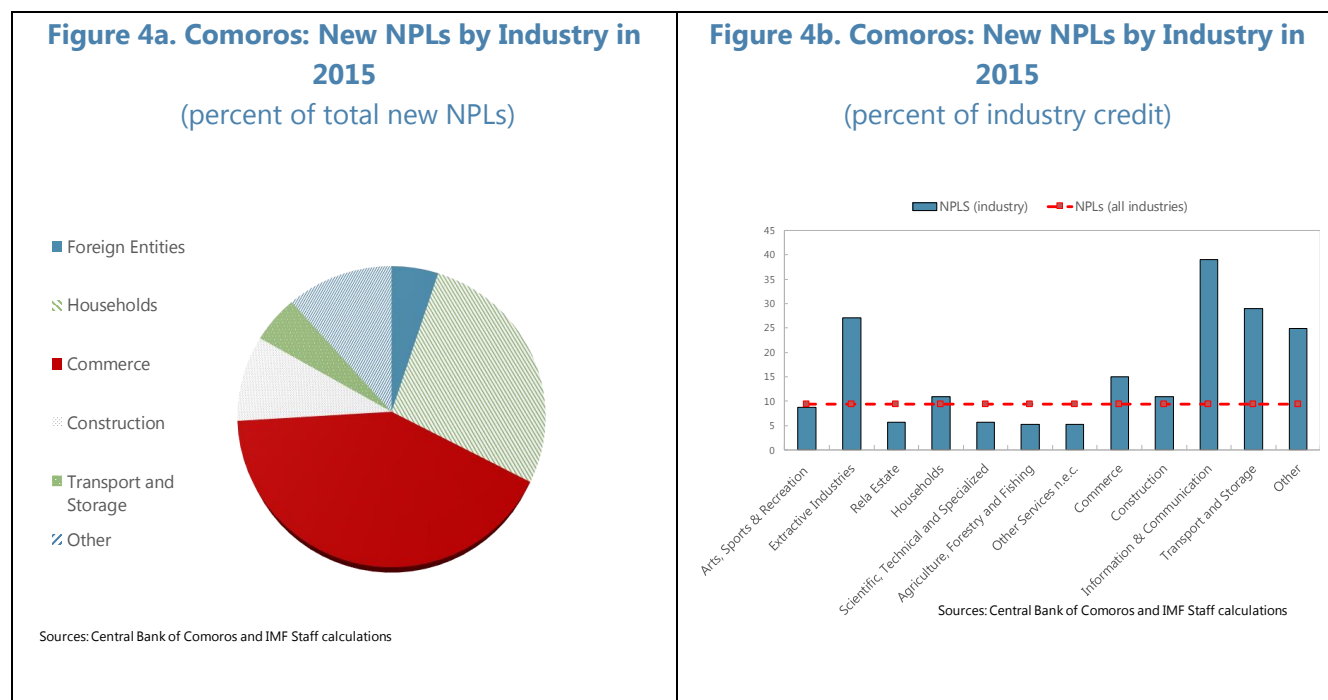
- Manufacturing
- ▨ Foreign Entities
- Households
- ▨ Commerce
- Construction
- ▨ Other



Source: Central Bank of Comoros and IMF Staff calculations

11. Similarly, the distribution of NPLs is heterogeneous across industries (Figures 4a and 4b).

General commerce and households accounted for more than two thirds of total new NPLs in 2015. When scaled by the amount of new credit in each industry, it is evident that information and communication, extractive, and transport and storage industries exhibited particularly high rates of non-performing loans in 2015.



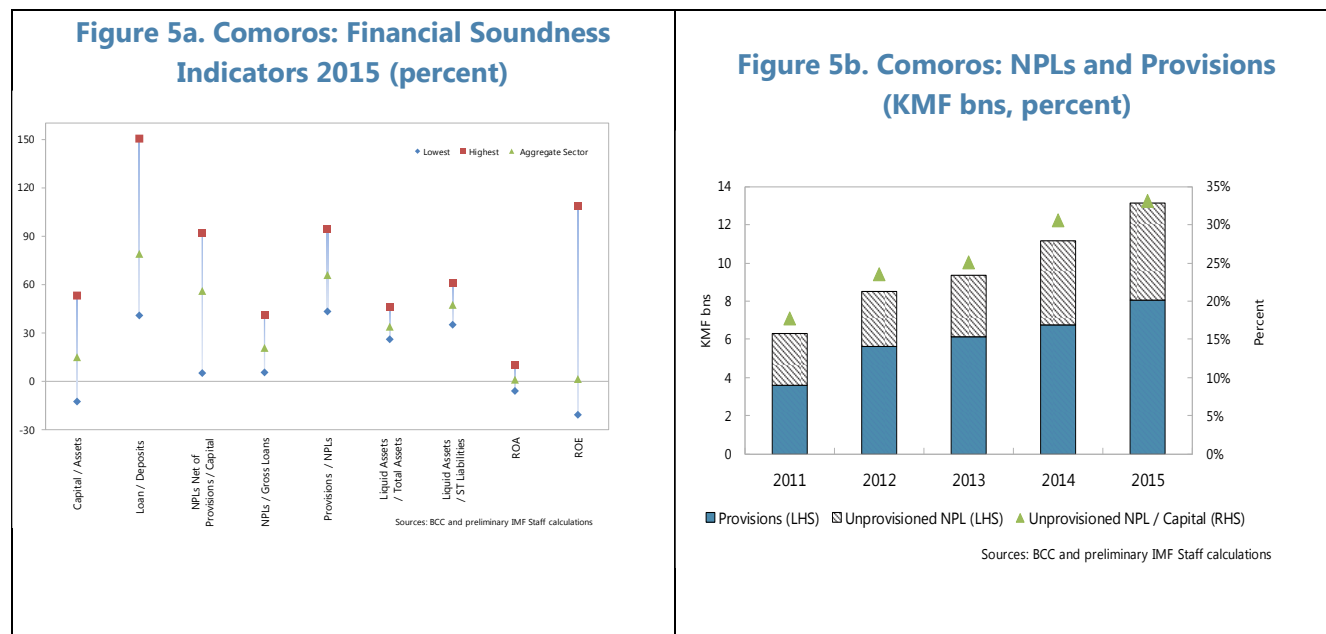
12. Financial stability indicators (FSIs) show on the whole that the financial sector is well-capitalized and liquid, although individual FSIs show a degree of heterogeneity across institutions (Figure 5a, Tables 3 and 4).⁶ The ratio of capital to assets for individual banks remains well over the regulatory minimum of 10 percent, although the sector-wide aggregate has declined slightly since 2011. Liquidity ratios are also broadly satisfactory; however, FSIs for individual institutions exhibit a degree of variability and are in some cases disconcerting. The provisioning rates of some institutions are lagging, also for those for which NPLs are above the sector-wide benchmark (Table 3). However, although financial institutions are on the whole well-capitalized, NPLs net of provisions are rapidly approaching 100 percent of own capital in one case.

13. The trend increase in non-performing loans (as a percentage of gross loans) in recent years raises concerns over the quality of credit allocation (Figure 5b). At end 2015, the ratio of NPLs to gross loans reached 21.7 percent, rising sharply to 27.4 percent as of end March 2016.⁷ Some of the increase in the overall NPL ratio in recent years may be attributable to legacy loans that date back many years, for

⁶ Caution should be used in interpreting FSIs across institutions, as there are no common bank accounting standards in Comoros.

⁷ This acceleration related to the reclassification of a bad loan on the books of SNPSF that was made in the real estate sector.

example to the vanilla crisis of the early 2000s.⁸ Yet the NPL ratio may rise further in the near term as existing debts on the books of financial institutions are fully accounted for, as well as in the case of continued sluggish economic growth. The increase in NPLs is worrisome, all the more so as loan provisioning has not kept pace with the increase in doubtful loans.



⁸ NPLs include old discount loans of about KMF 1.3 billion to the vanilla sector that have been non-performing since the early 2000s. The central bank of Comoros is coordinating efforts to have these loans written off. An agreement signed in 2014 between interested parties stipulated that affected borrowers would repay a third of the outstanding loan amount over a three-year period, while a further third would be written-off by the banks.

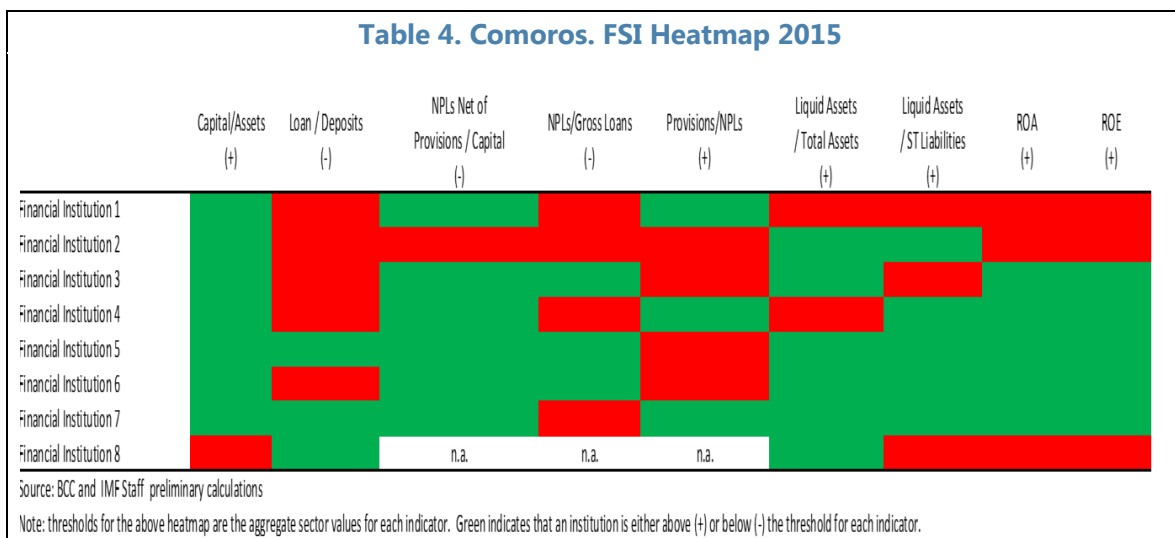
Table 3. Comoros. Financial Soundness Indicators for the Banking Sector, 2011 – 2015

(percent)

	2011	2012	2013	2014	2015
Capital Adequacy					
Capital / Assets	23.4	20.3	20.9	21.9	21.7
Asset Quality					
NPLs / Gross Loans	16.9	20.2	19.6	21.3	21.7
Provisions / NPLs	57.4	66.4	65.6	60.7	61.2
NPLs Net of Provisions / Capital	17.8	23.5	25.1	30.6	33.2
Liquidity					
Liquid Assets / Total Assets	47.4	45.8	41.3	39.1	37.6
Liquid Assets / ST Liabilities	58.4	53.2	48.2	45.9	43.8
Loans / Deposits	63.5	60.5	66.7	69.2	70.6
Liquid Assets / Total Deposits	64.4	57.9	52.3	49.6	47.3
Profitability					
Return on Assets	n.a.	-0.9	1.0	0.8	0.8
Return on Equity	n.a.	-1.3	1.8	1.4	1.4
Exposure to FX Risk					
Foreign Exchange liabilities / total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Central bank of Comoros and IMF staff preliminary calculations.

Table 4. Comoros. FSI Heatmap 2015



14. Variations in the price of gold are a systemic market risk for lending institutions that have on-balance sheet or off-balance sheet gold exposures. Secured bank lending against gold jewelry is widespread in Comoros, largely because using other types of security is difficult due to the uncertain legal environment. Jewelry items are not standardized products and can only be resold on the local auction market; hence, they are relatively illiquid and their value depends on both local demand and the price of gold. Fluctuations in the price of gold, therefore, constitute a systemic risk to those lending institutions in Comoros that accept gold jewelry as security.

15. While the ongoing difficulties of the state-owned postal bank, SNPSF, represent a significant fiscal risk to the state's balance sheet, systemic financial system implications may be limited. As the sole shareholder of SNPSF, the Comorian government is obliged to financially backstop the bank in times of hardship. Action is required in order to resolve the ongoing difficulties experienced by the bank, and the scope of action needed would have a material impact upon the government finances. The SNPSF is a significant player in the deposit market, since all government salaries and some funds from public enterprises are deposited with this institution.⁹ However, its links with other financial institutions are limited to relatively small deposits of excess liquidity by microfinance institutions, limiting the possibility of contagion of any eventual distress

16. Weak institutional and judicial frameworks that afford inadequate protection of creditor rights continue to retard the development of the Comorian financial system and pose a risk to the health of individual financial institutions. Significant difficulties surround the enforcement of financial contracts in Comoros, especially in a few notable cases where the recovery of claims by creditors has been stymied by weak judicial processes. As noted above, the uncertain legal environment has also led banks to lend against collateral that is linked to fluctuations in gold prices, exposing some financial institutions to systemic market risk. Moreover, tightly-knit social relations in the Comoros also hinder even-handed application of the law. Reinforcement of legal institutions, improving property rights and the quality of collateral, and the rigorous and the systematic application of financial contracts are, therefore, critical for the health of individual financial institutions, overall financial stability and further financial deepening.

D. Financial Inclusion

17. Recent evidence indicates that enhancing financial inclusion is important for achieving sustainable medium-term economic outcomes. Improved financial access permits all economic agents, including households, to take advantage of a greater range of economic opportunities and conduct basic economic transactions. Reducing financial market frictions and allowing greater household participation in financial markets may, therefore, promote sustainable economic growth and reduce poverty and inequality (Sustainable Development Goals 2015).

⁹ Deposits of public enterprises constitute about 20 percent of total deposits at SNPSF

18. Improving financial inclusion can have benefits for financial stability, yet may also entail risks. Enhanced financial inclusion may bolster financial stability by for example providing a more solid deposit base for banks during times of stress and providing clients of financial firms with better risk management tools, thus boosting their resilience (as for example more resilient borrowers imply more resilient banks). But some types of financial inclusion can, in the absence of appropriate regulation, be detrimental for financial stability; for example, the impact of broadening access to credit depends on the quality of banking supervision. When bank supervision is weak, broadening credit access may have negative effects on bank stability (IMF 2015).

19. Household survey data indicate that in 2011, 21.7 percent of households in Comoros held an account at a formal financial institution.¹⁰ The proportion of survey respondents aged 15 years and over in Comoros with access to an account at a financial institution ('financial access') in 2011 was well above the average for low-income SSA countries. This favorable rate of financial access, though well below that of SSA frontier markets, may reflect the influence of the recently expanding microfinance sector, and is likely to have increased further in recent years.

20. Inequality across both income levels and gender mars financial access and the use of other basic financial services (Figure 6). Financial access in Comoros is more unequal across both income levels and gender than in comparator countries. The ratio of the bankable 'better-off' to the 'poor' is higher in Comoros than for low-income SSA countries.¹¹ The poor are also particularly restricted in their ability to save, to borrow from financial institutions, and use mobile phones for financial transactions, given the relatively high telecommunications costs in Comoros. Furthermore, the ratio of financial access for males to that for females is higher in Comoros than on average in comparator countries.

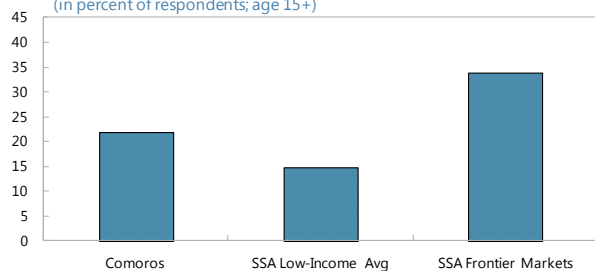
¹⁰ The Global Findex survey, conducted by the World Bank in conjunction with the Gallup World Poll and funded by the Bill & Melinda Gates foundation, provides in-depth data on how individuals save, borrow, make payments and manage risks. The survey was first conducted in 2011 and updated in 2014. Comoros was not included in the survey update.

¹¹ The 'bankable' population is the share of the adult population with access to a formal financial account. The better-off and the 'poor' are respectively the top income quintile and the bottom income quintile of the adult population.

Figure 6. Comoros: Financial Access, 2011

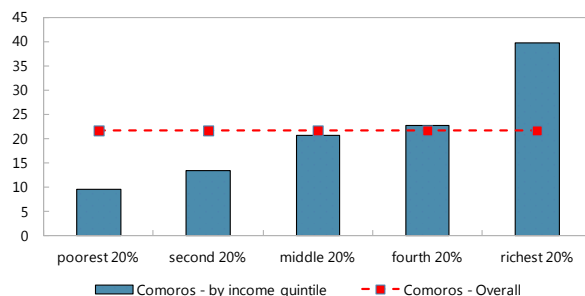
Financial access in Comoros is on par with SSA...

Account at a Bank or Other Type of Financial Institution, 2011
(in percent of respondents; age 15+)



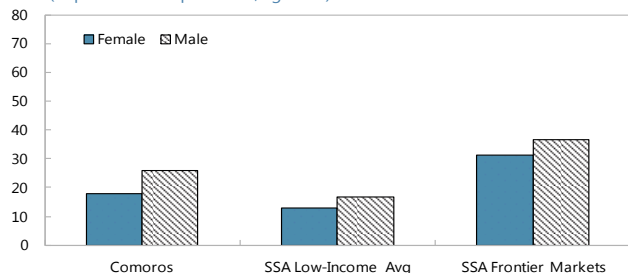
... but is unequally distributed across income levels...

Financial Access by Income Level
(percent)



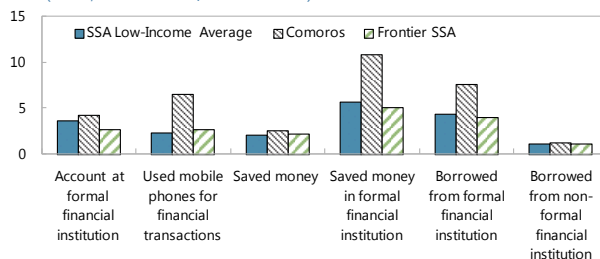
...and also gender.

Account at a Bank or Other Type of Financial Institution
(in percent of respondents; age 15+)



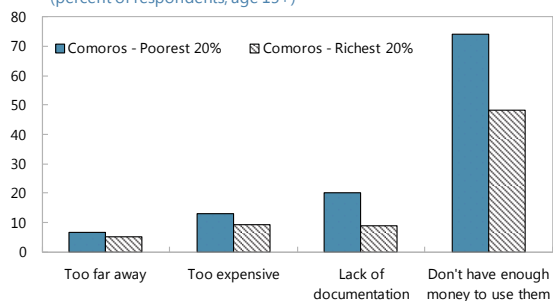
Access to other financial services is more unequal than in comparator countries.

Inequality in Household Access to Financial Services, 2011
(Ratio, Richest 20% / Poorest 20%)



Lack of funds and documentation are key barriers to financial access for the poor.

Reasons for not having a formal financial account
(percent of respondents, age 15+)



Bank accounts are used chiefly to receive wages.

Account Usage
(in percent of respondents; age 15+)

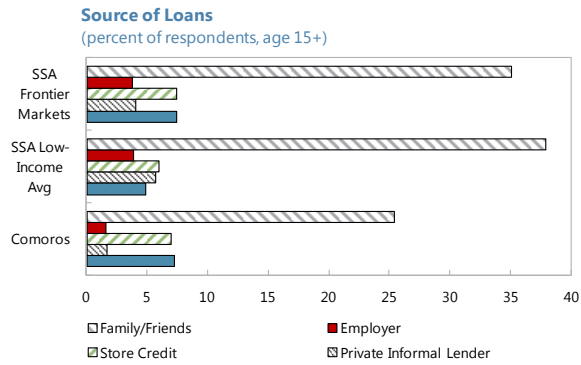


Source: Global Findex 2011, IMF Staff calculations

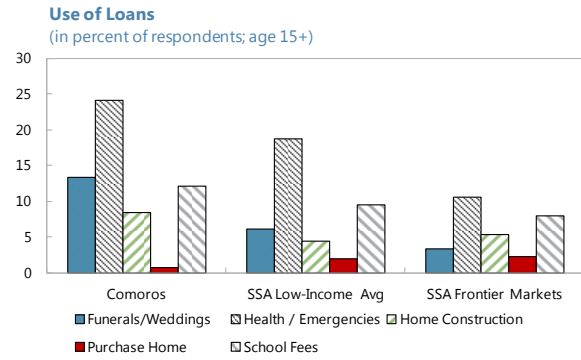
Note: Frontier SSA economies comprise Angola, Côte d'Ivoire, Ghana, Kenya, Mauritius, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Uganda and Zambia

Figure 6. Comoros: Financial Access, 2011 (concluded)

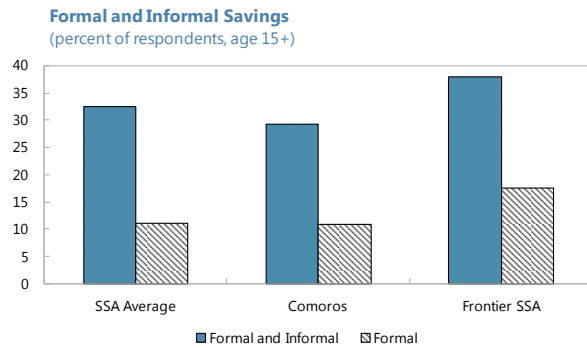
Informal means play an important role in lending...



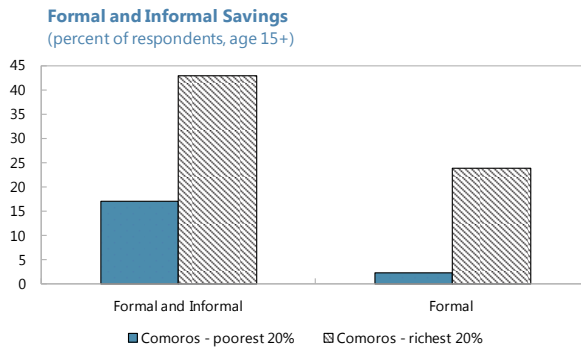
...chiefly to cover health costs and emergencies.



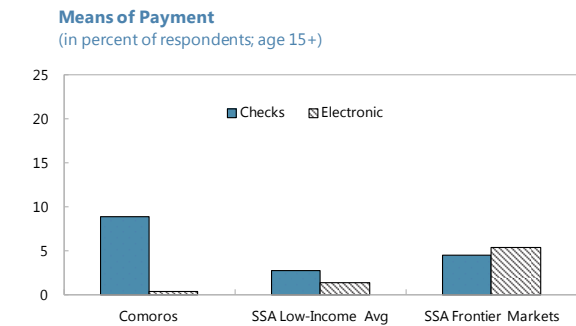
Informal channels are also used to save....



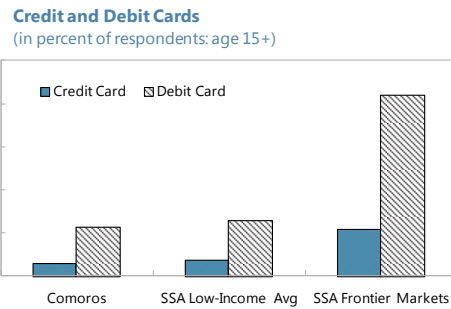
...while the well-off have better access to formal savings.



Electronic payment methods are not widespread in Comoros...



...nor is the use of credit and debit cards.



Note: Frontier SSA economies comprise Angola, Côte d'Ivoire, Ghana, Kenya, Mauritius, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Uganda and Zambia

Source: Global Findex 2011, G20 Financial Inclusion Indicators, IMF Staff calculations

21. Inadequate funds and insufficient documentation are key barriers to financial access for the poor in Comoros. The most common reasons cited by those in the bottom income quintile for not having an account at a formal financial institution were lack of funds and necessary documentation. A significant proportion of poor households also found formal financial accounts to be too expensive.

22. A considerable proportion of households source loans from outside the formal financial system, while the rich have better access to formal savings and borrowing channels (Figure 6). As in the rest of SSA, informal channels, particularly loans from families/friends, are an important source of credit for Comorian households. Yet financial institutions in Comoros were almost as important a source of household credit as in frontier economies. On the savings side, the rich are better able to utilize formal savings accounts, reflecting their higher rate of financial access.

23. The payments system is not well developed in Comoros. This is reflected in the small proportion of households using electronic payment methods. The utilization of other means of payment, such as checks and debit cards, is also low compared to comparators.

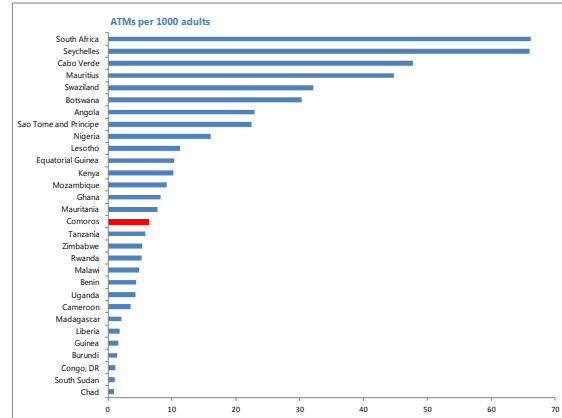
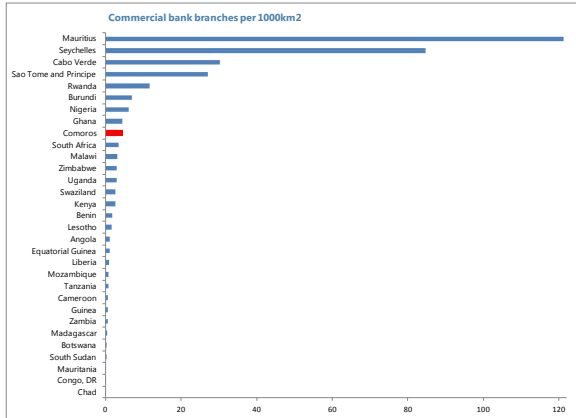
24. Commercial banks do not serve the overwhelmingly rural population of Comoros well (Figure 7). In 2014, Comoros ranked well behind comparator countries such as Cabo Verde and Sao Tomé & Príncipe with regard to physical access to commercial bank branches. Although Comoros fared slightly better than low-income SSA on physical access to automated teller machines, per capita access to commercial bank services is relatively poor.

25. Policies to improve financial inclusion in Comoros should focus on financial services access by the poorest households. Given the inequalities in financial access outlined above, the objective of policies to enhance financial inclusion should be to boost participation of poor households in formal financial markets. For example, introducing low-fee or fee-free accounts and improving the quality of documentation of the poor would reduce transaction costs and allow them to better access financial services.

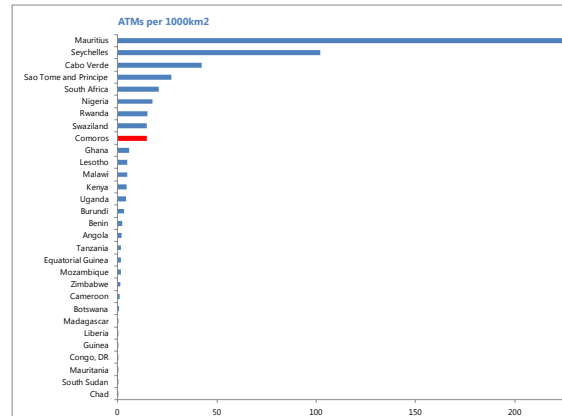
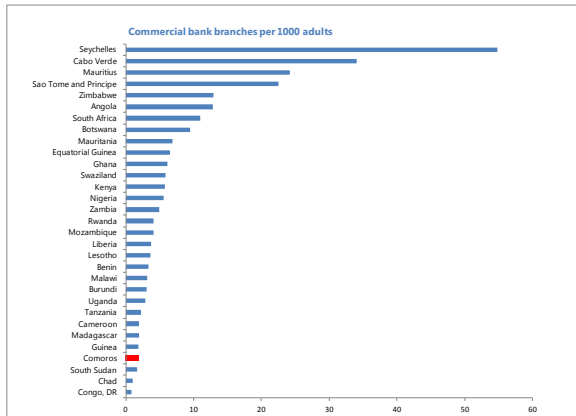
26. Expansion of new payment methods and more rigorous judicial enforcement in the financial system could also boost financial inclusion in Comoros. Increasing geographical penetration of financial institutions and greater access to electronic payment methods could facilitate access to financial services for those in remote areas and benefit commerce and overall business activity. In this light, the recent sale of a second telecommunications license to the Malagasy telecommunications company TELMA could provide a unique opportunity to expand the use of mobile banking services in Comoros. The pending introduction of a mobile money transfer service (known as 'Rial Pay') by the Comorian money transfer network MCTV should also bolster financial inclusion, especially in rural areas. Insisting upon more rigorous contract enforcement in the financial system would improve creditor rights and entice potential borrowers into the formal financial system and make it more attractive for financial institutions to lend.

Figure 7. Comoros: Banking Sector Outreach, 2014

Access to commercial bank services is geographically restricted....



...as is demographic access.



Sources: Financial Access Survey (2014), IMF Staff calculations.

27. Policies aimed at enhancing financial inclusion in Comoros should, however, weigh the benefits of increased financial access against potential risks to financial stability.

Improving some forms of financial inclusion, such as broadening credit access, may bring significant benefits, yet could pose risks to financial stability, to the extent that they encourage unsound lending practices in the absence of a sufficiently strong regulatory framework. Given the recent upward trend in NPLs, policymakers should remain watchful that greater access to credit not come at the cost of rising doubtful loans and financial stability concerns.

28. Improving financial access for the poor in Comoros need not, however, come at the expense of financial instability. Increases in the use of financial services other than credit have generally weak overall links to financial stability (IMF 2015). Hence, increasing the access of the worse-off to financial services is likely to have limited implications for the stability of the financial sector. Regarding broadening credit access, measures aimed at increasing the credit supply by removing market imperfections may help minimize potential financial stability effects. For example, implementation of new lending technologies that reduce transaction costs and improve borrower identification may mitigate the problem of asymmetric information between borrower and lenders (IMF 2015). In this vein, the implementation and strengthening of the credit bureau (Centrale des Risques et des incidents des paiements) by the central bank of the Comoros is a welcome step in the right direction

E. Conclusions

29. Development of the relatively underdeveloped and fragile financial sector in Comoros would be beneficial for the country's medium term growth prospects, but to achieve this a number of issues must be resolved. The depth of the financial sector in Comoros is comparable to that of low-income SSA, but it lags behind frontier SSA countries in this respect. The financial system is also fragile, with vulnerabilities related to accelerating non-performing loans, lagging provisioning, the troubles of SNPSF and also problems related to financial contract enforcement. Fostering development of the financial system in these circumstances will be challenging, the more so in the current difficult macroeconomic environment.

30. At the same time, ensuring that a diffuse, largely rural, population that is spread across three islands has adequate access to financial services will also be challenging. While the spread of microfinance institutions has done much to broaden the supply of financial services in recent years, new technologies, such as mobile banking, offer a unique opportunity to improve financial access for the rural poor.

31. Financial development, inclusion and stability goals can be complementary. Further development of the financial sector may be achieved with financial inclusion and stability goals in mind. For example, alleviating asymmetric information between borrowers and lenders through implementing new lending technologies would reduce transaction costs, improve borrower information and hence broaden access to credit. Furthermore, increasing the depth of deposits through bringing poor 'unbanked' individuals into the financial system may also spur financial intermediation and increase the resilience of financial institutions.

32. But reaching financial stability and inclusion objectives will involve the careful management of the associated tradeoffs. For example, policy actions aimed at resolving the situation of SNPSF would be beneficial for financial stability, yet may be a net negative for financial inclusion as the state-owned bank ensures that public employees have a minimum level of access to financial services.

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