FINANCIAL STABILITY REPORT

APRIL 2024

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NATIONAL BANK
OF ETHIOPIA

Financial Stability Report
April, 2024

Sudan Street, Addis Ababa, Ethiopia

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CONTENTS

LIST OF BOXES, TABLES AND FIGURES

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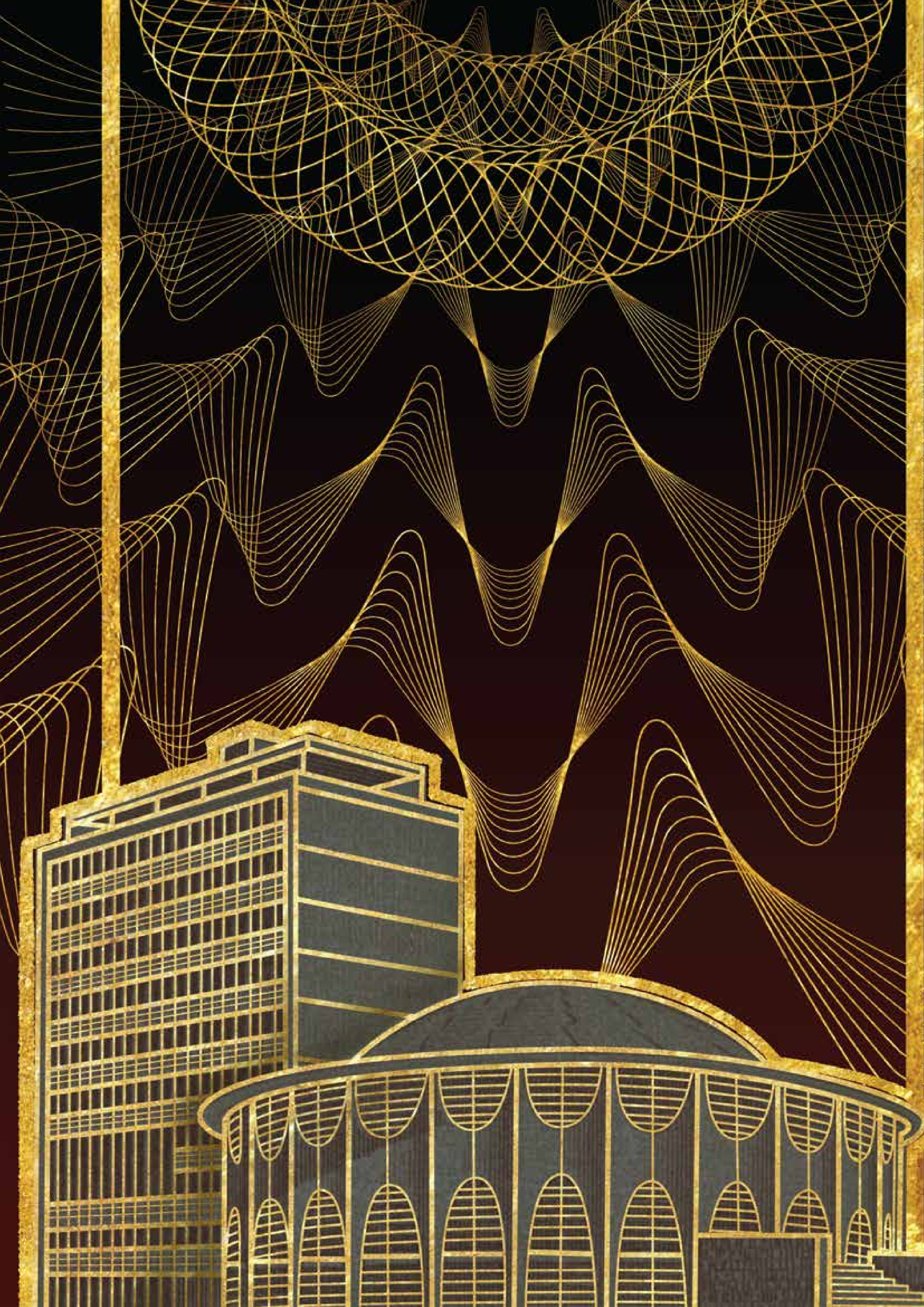
ABBREVIATIONS

ACH — Automated Clearing House
ATM — Automated Teller Machine
CAR — Capital Adequacy Ratio
CBE — Commercial Bank of Ethiopia
CRS — Credit Reference System
DBE — Development Bank of Ethiopia
DER — Debt-Equity Ratio
DFS — Digital Financial Services
EATS — Ethiopian Automated Transfer System
GDP — Gross Domestic Product
MFI —Microfinance Institution
MFISD — Microfinance Institutions Supervision Directorate
NBE — National Bank of Ethiopia
NFIS-II — National Financial Inclusion Strategy-II
NPLs — Non-Performing Loans
OSSR — Operational Self Sufficiency Ratio
P2P — Peer To Peer
PAR — Portfolio At Risk
POS — Point of Sale
RoA — Return on Assets
RoE — Return on Equity
RTGS — Real-Time Gross Settlement System
SACCO — Savings and Credit Cooperative



EXECUTIVE SUMMARY

The National Bank of Ethiopia (NBE) presents the inaugural Financial Stability Report (2023[1]) in accordance with its responsibility to uphold a sound financial system in Ethiopia. The report aims to address risks and promote financial stability in Ethiopia by examining progress and challenges in the country's economy and in the financial sector in particular during the post-COVID-19 recovery phase.

The report examines external developments and risks to the economy and the financial sector posed by the war in Ukraine and global monetary tightening. It also highlights domestic factors, including the potential impacts of droughts and conflicts in parts of Ethiopia, risks emanating from the financial industry structure, and the limitations and contributions of financial sector infrastructure to the stability of the financial sector. Since the stability of Ethiopia's financial system essentially depends on the health of the banking system, which accounted for 96.1 percent of the financial sector's total assets at the end of June 2023, this report provides a particularly detailed analysis of the stability of and risks for the banking sector.

According to the latest forecast by the International Monetary Fund (IMF), the Ethiopian economy grew by 6.1 percent in 2023 and is expected to grow by 6.2 percent in 2024. The growth will be supported by further liberalization, the peace dividend, and the rebounding tourism industry. Moreover, aided by NBE's limits on bank credit growth and direct advances to the government, inflation is projected to fall to 20.7 percent in 2024. Likewise, due to an anticipated rise in government revenue as a result of improvements in domestic resource mobilization, implementation of the fiscal consolidation strategy, and resumption of the influx of donor funds, the IMF expects the budget deficit to decrease to 2.5 percent of gross domestic product (GDP) in 2024. With the expected expansion of exports of goods and services, it also estimates that the current account deficit will decrease to 2.0 percent of GDP. Headwinds include drought in some parts of the country, debt vulnerabilities, and the effects of the wars in Ukraine and the Middle East.

A macroprudential risk assessment is crucial since Ethiopia's financial institutions may indirectly be impacted by global economic slowdown. In East Africa, including Ethiopia, high food prices have affected food security and raised inflation, foreign exchange risk and the interest rate risk of financial institutions. Risks to the stability

[1] The Report is based on official data for Ethiopia's fiscal year up to the end of June 2023 and incorporates, where appropriate, IMF data up to October 2023.

of the Ethiopian financial sector are likely to increase due to geopolitical tensions, Russia-Ukrainian war in Europe and the Middle East, tighter global monetary policy aimed at reducing inflation in developed nations, capital outflows from emerging and developing economies, high levels of inflation, and domestic vulnerabilities resulting from conflicts and droughts.

Nonetheless, Ethiopia's financial sector continues to be stable and resilient to the fallout from COVID-19 and other new threats. Notwithstanding the increase in credit, liquidity and operational risks as well as, to a lesser degree, market risk, banks remain sound and stable due to their strong capital and liquidity buffers, solid profitability, and other factors. As indicated by risk stress tests performed by NBE, these elements also contribute to the resilience of banks to shocks. In the microfinance sector, the capital adequacy ratio, non-performing loan (NPL) ratio, and liquidity ratio are all well within NBE's parameters and have improved over the course of the 2023 review period. The capital goods finance business sector's risk rating is moderate, with low capital risk and moderate ratings for asset quality and systemic risk. On the other hand, while the insurance sector remains resilient, earning and concentration risks are rated high and may call for regulatory actions.

Tighter regulatory standards on credit and deposit concentration risks are necessary, as indicated by the high concentration of loans and deposits. NBE intends to mitigate market risks by implementing prudent measures and enhancing governance standards and practices. These measures will address the significant open foreign exchange position and the discrepancy between the proportion of fixed rate assets and variable rate deposits.

The financial infrastructure is developing but is still nascent. It requires further improvements in structural, operational, and technical efficiencies. A more refined and explicit standard for robust risk measurement in keeping with the rapidly evolving landscape of digital financing technologies is needed.

Overall, policymakers, regulators and authorities have put in place the necessary policy measures. With market players and other stakeholders, they stand ready to do more to mitigate potential vulnerabilities and ensure macroeconomic and financial stability in Ethiopia.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1. INTRODUCTION

This 2023 Financial Stability Report is the first ever such report produced by NBE in line with its mandate to maintain a healthy financial system.[2] The report discusses developments and risks in Ethiopia's economy in general and in the financial sector in particular in the post COVID-19 recovery phase, and details how the financial sector has remained resilient. It examines external developments and risks to the economy and financial sector stability posed by the war in Ukraine and the global monetary policy tightening to stem rising inflation. The report also highlights domestic issues such as the potential impact of droughts and conflicts in various parts of Ethiopia, and the limitations of the financial sector infrastructure and its contribution to the financial sector's stability. It outlines recent policy and legal developments as well as new product and services that are expected to enhance financial stability in 2019—2023.

The Report is based on official data for Ethiopia's fiscal year up to the end of June 2023 [3] (at end-June 2023) and incorporates, where appropriate, IMF data released in October 2023.

The stability of Ethiopia's financial system is affected by multiple factors. These include the structure and operation of the financial sector and its sub-sectors, the financial system infrastructure, and factors related with the real sectors.

The following main chapters of the report address each of these three groups of factors. Following the Introduction, **Chapter 2** addresses developments in recent years and projected developments both in the global economy and the Ethiopian economy, drawing conclusions on how these developments constitute risks or stabilizing factors for Ethiopia's financial system. **Chapter 3** analyzes Ethiopia's financial sector and its subsectors, identifying inherent risks for systemic stability.
Chapter 4 analyzes the financial system infrastructure and related policy developments.

Going forward, NBE intends to publish Financial Stability Reports annually.

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[2] See Article 4 of Proclamation No. 591/2008.

[3] Ethiopia's fiscal year starts on the 8th of July and ends on the 7th of July, but this report bases its analyses on data up to the 30th of June of each year.

2.

ECONOMIC AND FINANCIAL CONDITIONS

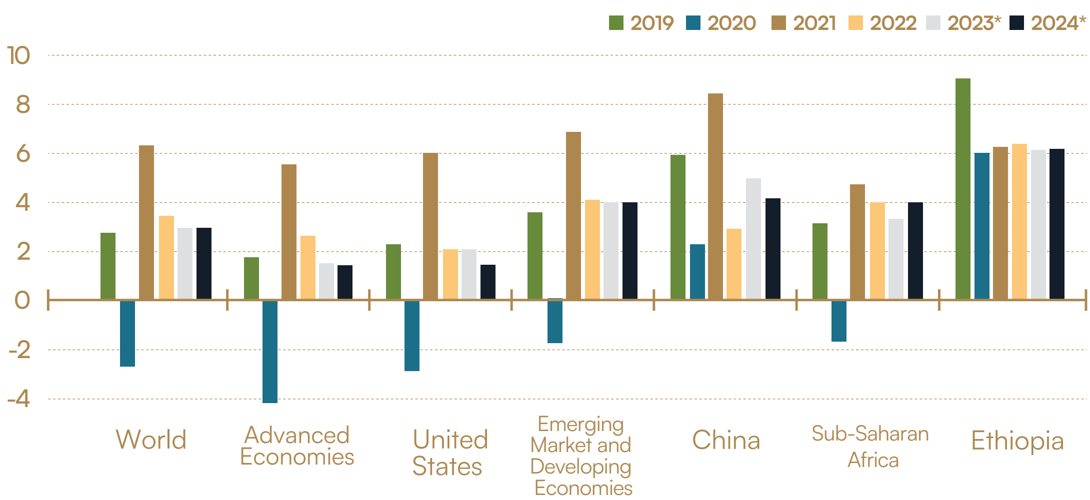
2. ECONOMIC AND FINANCIAL CONDITIONS

2.1. GLOBAL ECONOMIC CONDITIONS

The IMF's most recent projections, released in October 2023, predict a decrease in global economic growth from 3.5 percent in 2022 to 3.0 percent in 2023 and 2.9 percent in 2024. Economic activity has not yet returned to its pre-pandemic levels of growth. Advanced economies are anticipated to experience a decline in growth from 2.6 percent in 2022 to 1.5 percent in 2023 and 1.4 percent in 2024, with the US showing stronger momentum than expected but growth in the euro area falling short of expectations. Growth in emerging markets and developing economies is projected to decrease slightly from 4.1 percent in 2022 to 4.0 percent in 2023 and 2024 due to the crisis in the property sector in China (Figure 1).

In Sub-Saharan Africa, growth is expected to decline from 4.0 percent in 2022 to 3.3 percent in 2023 and is expected to recover to 4.0 percent in 2024. The projected decline for 2023 is associated, in a number of cases, with worsening weather shocks, global economic slowdown, and domestic supply issues. Growth in Nigeria is projected to decelerate from 3.3 percent in 2022 to 2.9 percent in 2023, reflecting weaker oil and gas production than expected, partially as a result of maintenance work. In South Africa, growth is expected to decline from 1.9 percent in 2022 to 0.9 percent in 2023, largely because of power shortages. However, Ethiopia's projected growth of 6.1 percent in 2023 and 6.2 percent in 2024 is only slightly lower than in 2022 (6.4 percent), positioning the country among the 20 fastest-growing economies in the world.

Figure 1: Annual Global GDP Growth, 2019-2024 (percent)

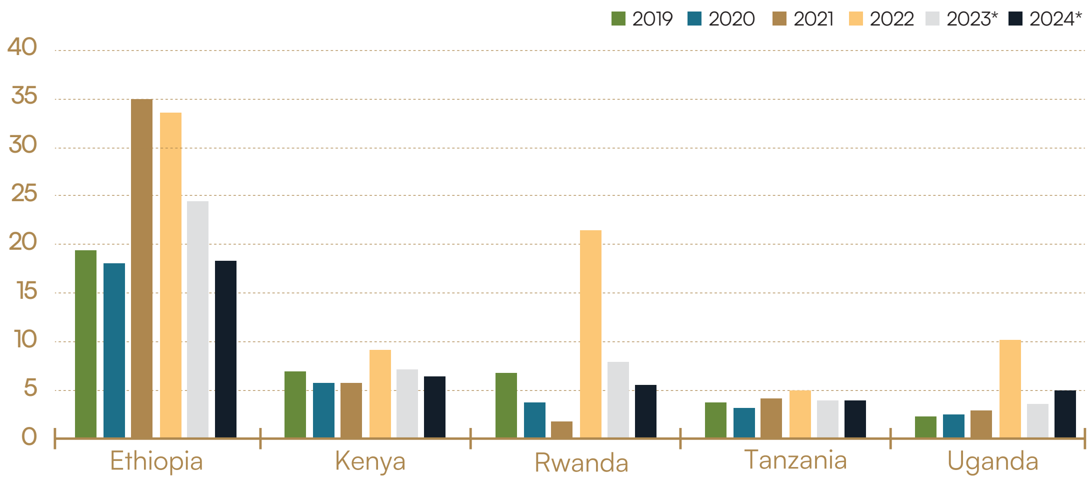


Source: IMF World Economic Outlook Database: October 2023 Edition; *Projections

Global annualized headline inflation is set to fall from 8.9 percent in December 2022 to 6.4 percent in December 2023 and 5.1 percent in December 2014. Monetary policy tightening is expected to gradually dampen inflation, but a central driver of the disinflation projected for 2023 and 2024 is declining international commodity prices.

With the exception of Rwanda and Uganda, which recorded 21.6 percent and 10.2 percent inflation in December 2022, respectively, annual inflation in most East African countries remained at single digits in 2022 despite the shock to commodity prices following the war in Ukraine. Ethiopia, which had previously seen double-digit inflation, saw a spike in December 2021 at 35.1 percent; and the rate hardly changed in 2022, standing at 33.8 percent in December 2022. But it is expected to drop to 24.5 percent and 18.5 percent by the end of 2023 and 2024, respectively (Figure 2).

Figure 2: Annual inflation rate in East African Countries, 2019-2024, December (percent)



Source: IMF World Economic Outlook Database: October 2023 Edition; *Projections

Currency fluctuations in 2023 against the United States Dollar presented a mixed picture (Table 1). Currencies of other developed economies showed limited fluctuations against the dollar, with the Euro showing a strong performance, probably reflecting the larger increase in policy interest rates in the euro area than in the United States. Most currencies of emerging economies continued to depreciate by up to 10 percent. Outliers with higher depreciation (above 20 percent) included the Turkish Lira, the Russian Ruble, the Egyptian Pound, and the Kenyan Shilling, all of which can be explained by country-specific reasons. Emerging markets whose currencies appreciated against the Dollar were the Brazilian Real and the Moroccan Dirham. The Ethiopian Birr depreciated slowly, at 3.8 percent over 11 months.

Table 1 : Performance of Selected Countries' Currencies (end of year)

	Country	Currency	*2019*	*2020*	*2021*	*2022*	*2023 (Nov)*	*Change 2023 (+Dep/ -App)*
Developed economies	Euro Area	Euro	0.89	0.81	0.88	0.94	0.91	-2%
	Canada	Dollar	1.31	1.29	1.29	1.36	1.36	0%
	Japan	Yen	71.27	73.05	74.30	82.79	83.35	1%
BRICS	Brazil	Real	4.03	5.20	5.58	5.22	4.93	-5%
	China	Yuan	6.99	6.53	6.37	6.99	7.13	2%
	India	Rupee	71.27	73.05	74.30	82.79	83.35	1%
	Russia	Ruble	61.91	73.88	74.29	70.34	88.88	26%
	South Africa	Rand	14.03	14.69	15.91	16.99	18.86	11%
East Africa	Ethiopia	Birr	31.80	39.18	49.19	53.34	55.38	4%
	Kenya	Units	101.34	109.17	113.14	123.37	153.15	24%
	Rwanda	Franc	922.52	972.48	1,009.62	1,070.71	1,227.48	15%
	Tanzania	Shilling	2,287.93	2,298.46	2,297.61	2,324.74	2,505.93	8%
	Uganda	Shilling	3,665.21	3,650.07	3,544.41	3,715.69	3,817.26	3%
Other developing economies	Egypt	Pound	15.99	15.68	15.66	24.69	30.89	25%
	Morocco	Dirham	9.59	8.90	9.28	10.45	9.91	-5%
	Saudi Arabia	Riyal	3.75	3.75	3.75	3.75	3.75	0%
	Türkiye	Lira	5.95	7.35	12.99	18.72	28.91	54%

Source: IMF, International Financial Statistics: for data in italics — www.oanda.com

Interest rate developments in 2023 diverged across countries but rates mostly increased throughout the year (Table 2), reflecting continued attempts to reduce inflation. For example, the European Central Bank and the Fed increased policy rates from 2.5 percent and 4.4 percent in December 2022 to 4.5 percent and 5.4 percent in November 2023, respectively. Among the BRICS, India, Russia, South Africa and other emerging economies such as Morocco and Saudi Arabia increased their policy rates [Türkiye registered the highest increase, from 9.0 percent in December 2022 to 40.0 percent in November 2023] Only Brazil and China had lower policy rates at the end of November 2023 than 11 months prior. Ethiopia held its rate constant throughout the period, reflecting a balancing approach to keeping inflation at bay without stifling growth.

Table 2: Policy (Benchmark) Interest Rates of Selected Countries, 2019-2023

		2019	2020	2021	2022	2023 (Nov)
Developed economies	Euro area	0	0	0	2.5	4.5
	United States	1.625	0.125	0.125	4.375	5.375
BRICS	Brazil	4.5	2	9.25	13.75	12.25
	China	4.15	3.85	3.8	3.65	3.45
	India	5.15	4	4	6.25	6.5
	Russia	6.25	4.25	8.5	7.5	15
	South Africa	6.5	3.5	3.75	7	8.25
Other developing economies	Morocco	2.25	1.5	1.5	2.5	3
	Saudi Arabia	2.25	1	1	5	6
	Türkiye	12	17	14	9	40
	Ethiopia	7	7	7	7	7

Source: Bank for International Settlements; for Ethiopia — NBE.

Overall, Ethiopia’s financial institutions face variety of risks due to the state of the global economy, with multiple macroeconomic shocks implied by the weakening of global growth along with high food, fuel and other commodity prices. This affects Ethiopia’s external position by driving up import costs and stifling exports. Consequently, there by raises the risks for financial institutions in the country. Furthermore, developments in various foreign exchange markets and the trend towards higher benchmark (policy) interest rates could increase the foreign exchange and interest rate risks that financial institutions face in Ethiopia.

Positively, though, global growth has proven remarkably resilient against a background of rising geopolitical tensions and violent conflicts. In addition, the diversity of developments across economies offers an opportunity to reduce risks by building diversified portfolios of economic relations.

2.2 DOMESTIC ECONOMIC CONDITIONS

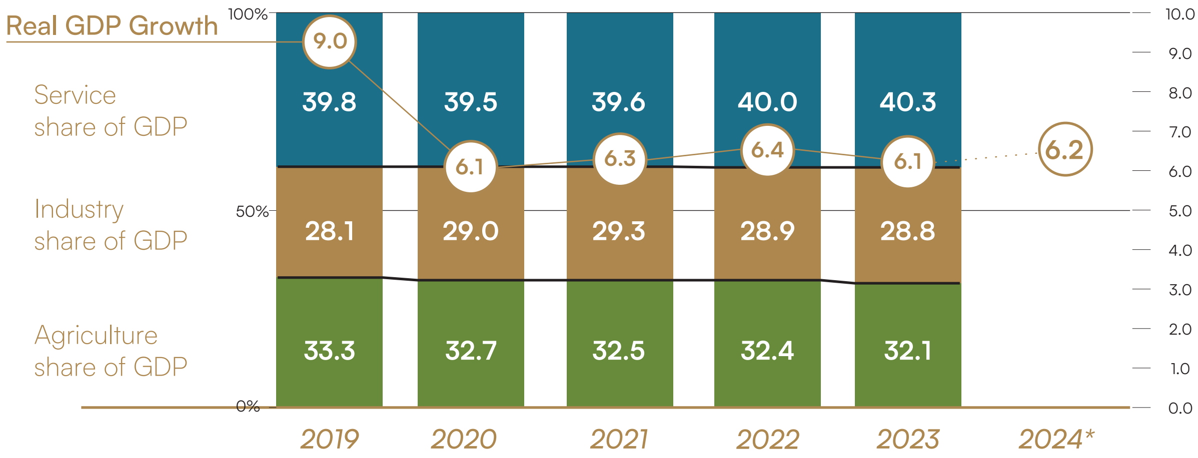
Domestic factors will also impact the health of the Ethiopian financial system. According to the analysis, certain factors raise risk while others support stability and resilience.

a) Economic Growth

Over the last five years, Ethiopia's economy has registered high growth, which is projected to continue in the coming years (Figure 1). Real GDP growth at above 6.0 percent remains higher than the average growth for Sub-Saharan Africa (projected at 3.3 percent for 2023 and 4.0 percent for 2024).

The composition of GDP continued to change gradually, recovering from the distortions caused by the COVID-19 pandemic. The share of services in GDP increased slightly from 40.0 percent in 2022 to 40.3 percent in 2023 — surpassing the level of 39.8 percent in 2019, and thus recovering from the contraction induced by COVID-19 (Figure 3). The share of industry decreased slightly from 28.9 percent in 2022 to 28.8 percent in 2023 — above the 2019 (pre-COVID) level, indicating a strong performance of the sector in the longer term. The share of agriculture declined steadily from 33.3 percent in 2019 to 32.1 percent in 2023.

Figure 3: Ethiopian GDP by Sector and Economic Growth, 2019-2024 (percent)



Source: NBE and *projections by the IMF World Economic Outlook: October 2023 Edition

b) Inflation

Over the last two years, domestic interest rates have remained stable, despite the fact that inflation is still high (Figure 4). Notwithstanding a number of unfavorable factors, such as droughts, inflation expectations, lack of foreign exchange, instability in some parts of the country, and the effect of the war in Ukraine on commodity prices, the average annual rate of inflation fell from 34.0 percent in 2022 to 29.3 percent in 2023.

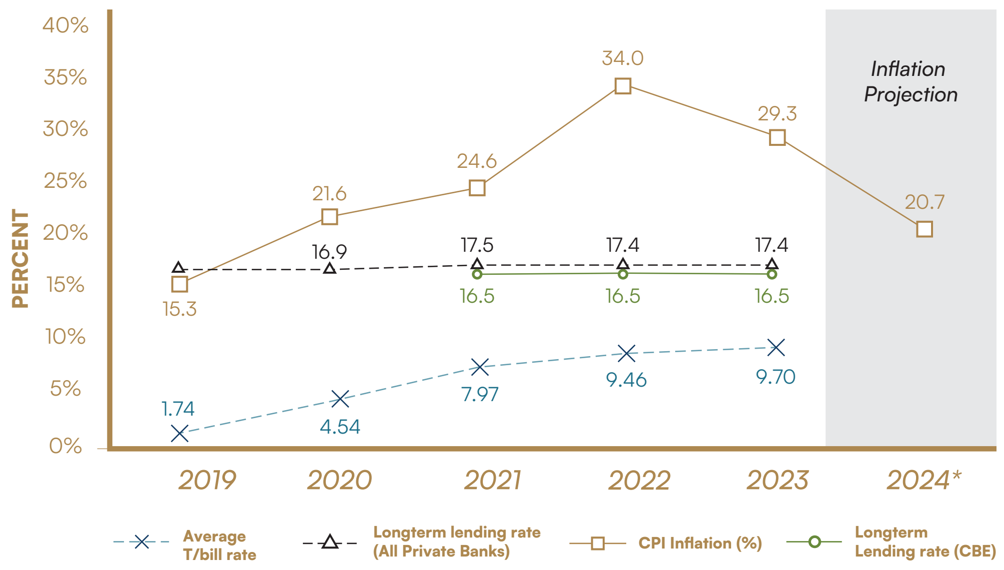
c) Inflation and Yields

The yearly weighted average yield on government T-bills was 9.7 percent in 2023, slightly up from 9.5 percent in 2022 (Figure 4). The average long-term lending interest rate of the Commercial Bank of Ethiopia (CBE), the largest state-owned bank, and private banks remained at 16.5 percent and 17.4 percent, respectively, in both 2022 and 2023.

Global annualized headline inflation is set to fall from 8.9 percent in December 2022 to 6.4 percent in December 2023 and 5.1 percent in December 2014. Monetary policy tightening is expected to gradually dampen inflation, but a central driver of the disinflation projected for 2023 and 2024 is declining international commodity prices.

With the exception of Rwanda and Uganda, which recorded 21.6 percent and 10.2 percent in December 2022, respectively, annual inflation in most East African countries remained at single digits in 2022 despite the shock to commodity prices following the war in Ukraine. Ethiopia, which had previously seen double-digit inflation, saw a spike in December 2021 at 35.1 percent; and the rate hardly changed in 2022, standing at 33.8 percent in December 2022. But it is expected to drop to 24.5 percent and 18.5 percent by the end of 2023 and 2024, respectively (Figure 2).

Figure 4: Inflation and Interest Rates, 2019-2024 (percent)

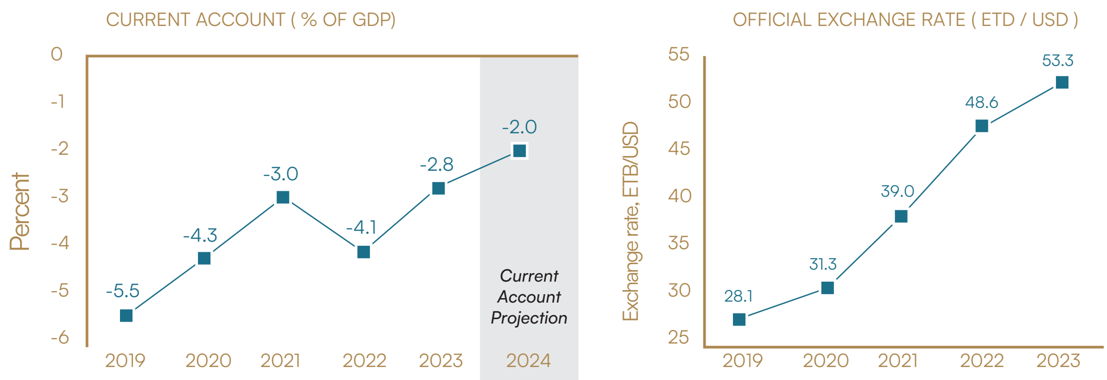


Source: NBE and projections by the IMF World Economic Outlook: October 2023 Edition

d) Current Account Balance

While the current account deficit has shrunk, the value of the Birr has decreased. The weighted average Birr exchange rate on the interbank market in 2023 was 53.3 per USD, a 9.7 percent decline from 2022 (Figure 5). Due to the significant increase in the surplus of the services trade balance and the narrowing of the merchandise trade deficit, the current account deficit decreased from 4.1 percent in 2022 to 2.8 percent of GDP in 2023.

Figure 5: Current Account and Exchange Rate, 2019-2024 (Percent of GDP, ETB/USD)



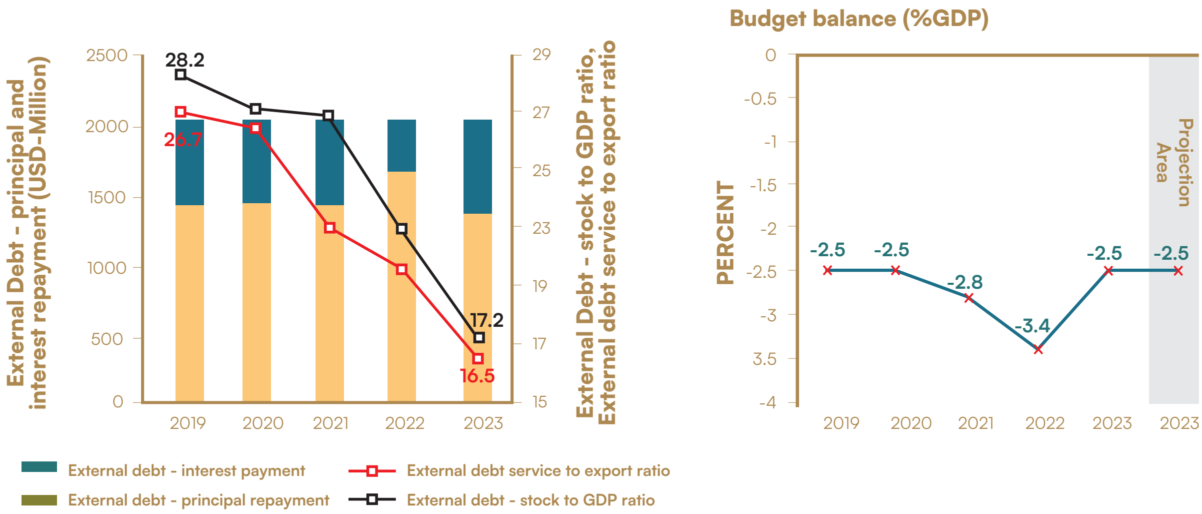
Source: NBE and projections by the IMF World Economic Outlook: October 2023 Edition.

e) Fiscal Operation in Public Debt

Both external debt and budget deficit decreased in 2023. Public external debt decreased from 28.2 percent of GDP in 2019 to 17.2 percent of GDP in 2023 (Figure 6). In the years 2020 and 2021, Ethiopia had benefited from the G20 Debt Service Suspension Initiative. However, Fitch and S&P downgraded Ethiopia's sovereign rating from B to CCC when the country applied for the G20 Common Framework for debt restructuring in 2021.

As revenue growth surpassed the increase in spending, the budget deficit went down from 3.4 percent of GDP in 2022 to 2.5 percent of GDP in 2023. Similarly, the ratio of external debt service to exports dropped from 20.4 percent in 2022 to 16.5 percent in 2023.

Figure 6: Public Debt Service Repayments and Budget Balance, 2019-2024



Source: NBE and projections by the African Economic Outlook team

f) Conclusion

In general, domestic economic conditions are expected to improve in 2024. It is anticipated that the economy will grow strongly by 6.2 percent, equally driven by services, agriculture, and industry from the supply side, and by personal spending and investment from the demand side. The growth is expected to be supported by economic liberalization, the peace dividend, and a recovery of the tourism industry.

Furthermore, following the peace dividend and NBE's stringent policies on bank credit growth and direct advances to the government, inflation is projected to fall to 20.7 percent in 2024. Likewise, due to an anticipated rise in government revenue as a result of improvements in domestic resource mobilization, implementation of the fiscal consolidation strategy, and the resumption of the influx of donor funds, the budget deficit is predicted to sustain at 2.5 percent of GDP in 2024.

The current account deficit is anticipated to decrease to 2.0 percent of GDP in 2024 with the expected expansion of exports of goods and services. External debt service to export dropped from 20.4 percent in 2022 to 16.5 percent in 2023. On the other hand, headwinds include drought in parts of the country, debt vulnerabilities, a widening gap between the official and parallel exchange rate, and the effects of the Russia-Ukraninan war in Europe and the Middle East.

3.

FINANCIAL SECTOR STABILITY AND RISK

3. FINANCIAL SECTOR STABILITY AND RISK

This chapter analyzes [4] stability and risks in the Ethiopian financial sector across the banking, microfinance and capital goods financing, and insurance sectors, which are all regulated and supervised by NBE.[5] Policy actions taken by the government and the regulator remain supportive to the sector's resilience and financial stability.[6]

Primary and secondary financial markets are not yet properly established although significant work on launching capital markets has proceeded with a new proclamation on Capital Market Authority and perparation is underway for the establisment of Ethiopian Stock Exchange in 2024.

3.1 OVERVIEW OF THE FINANCIAL SECTOR

At end-June 2023, total assets of the financial sector amounted to Birr 3,120.5 billion, 20.4 percent higher than a year earlier (Table 3). These assets constituted 35.8 percent of GDP [7], compared with 42.1 percent at end-June 2022. The financial sector continued to be dominated by the banking sector, whose total assets accounted for 96.3 percent of total financial sector assets at end-June 2023 (slightly less than a year before because of a stronger growth of the microfinance sector). This implies that the stability of Ethiopian financial system/sector largely depends on the health and stability of the banking sector. As a result, the banking sector is analyzed in more detail in the following sections.

Table 3: Total Assets of the Financial System and the GDP, 2022-2023 (billions of Birr and percent)

Sector/Assets/GDP	June 2022	Share in total assets (%)	June 2023	Share in total assets (%)	June 2023 vs. June 2022 (%)
Banks [8]	2,500.8	96.5	3,003.7	96.3	20.1
Microfinance	46.1	1.8	61.7	2.0	33.8
Capital Goods Finance	5.0	0.2	5.4	0.2	8.0
Insurance	40.8	1.6	49.7	1.6	21.8
Total Assets	**2,592.7**	**100.0**	**3,120.5**	**100.0**	**20.4**
GDP [9]	6,157.0	-	8,722.3	-	41.7
Total assets (%) of GDP	**42.1**	**-**	**35.8**	**-**	**-6.3 percentage points**

Source: NBE Database

4 All financial data used in this chapter are provisional (not audited)
5 In line with international practice, the Board of NBE has approved an independent supervisory agency for the insurance sector.
6 The report does not provide a detailed analysis of Savings and Credit Cooperatives (SACCOs) and pension funds, which are not regulated by NBE.
7 Nominal
8 Including the Development Bank of Ethiopia.
9 Nominal

3.2 BANKING SECTOR

At end-June 2023, 31 (all domestic) banks operated in Ethiopia;[10] of these, the Development Bank of Ethiopia (DBE), a development finance institution, accounted for nearly five percent of the banking sector's assets. The rest are three full-fledged interest-free banks, five MFIs that had graduated to commercial banks, and 22 conventional commercial banks, including the country's largest bank, the Commercial Bank of Ethiopia (CBE). Except for DBE and CBE, all are private banks. As the following sections show, the banking sector is assessed as safe, sound and stable at the end of June 2023.

3.2.1 Commercial Banking Industry

3.2.1.1 Role in the Economy

The banking sector is of high importance to the Ethiopian economy. Total deposits at end-June 2023 reached Birr 2.2 trillion, 24.8 percent of GDP; and total loans & bonds of banks amounted to Birr 1.9 trillion, 21.7 percent of GDP (Table 4 and Figure 7). Total bank deposits grew by 24.6 percent, reflecting rapid growth in both saving and time deposits. Similarly, loans & bonds grew by 24.3 percent. However, GDP increased at a faster rate. Accordingly, the share of deposits in GDP decreased from 28.2 percent of the previous year to 24.8 percent at end-June 2023, and that of loans & bonds from 16.0 percent to 14.3 percent. The share of loans in GDP is low by international comparisons, and the objective is to increase it significantly in the medium term, thereby also reducing credit concentration risk (see Section 3.2.1.3 below). A related positive development in this regard is the shift in the loan portfolio. Since 2021, total credits to the private sector have exceeded loans to the public sector (Figure 8).

Notwithstanding droughts and conflicts in parts of the country, and the war in Ukraine and the associated global commodity price shock, total assets of commercial banks reached Birr 2,845.9 billion at end-June 2023 — an increase of 19.9 percent from the previous year due to Ethiopia's strong economic growth (see Section 2.2 above),. The major contributors to total asset growth were loans & advances and bonds, which together accounted for the largest share (66.4 percent) of total assets.

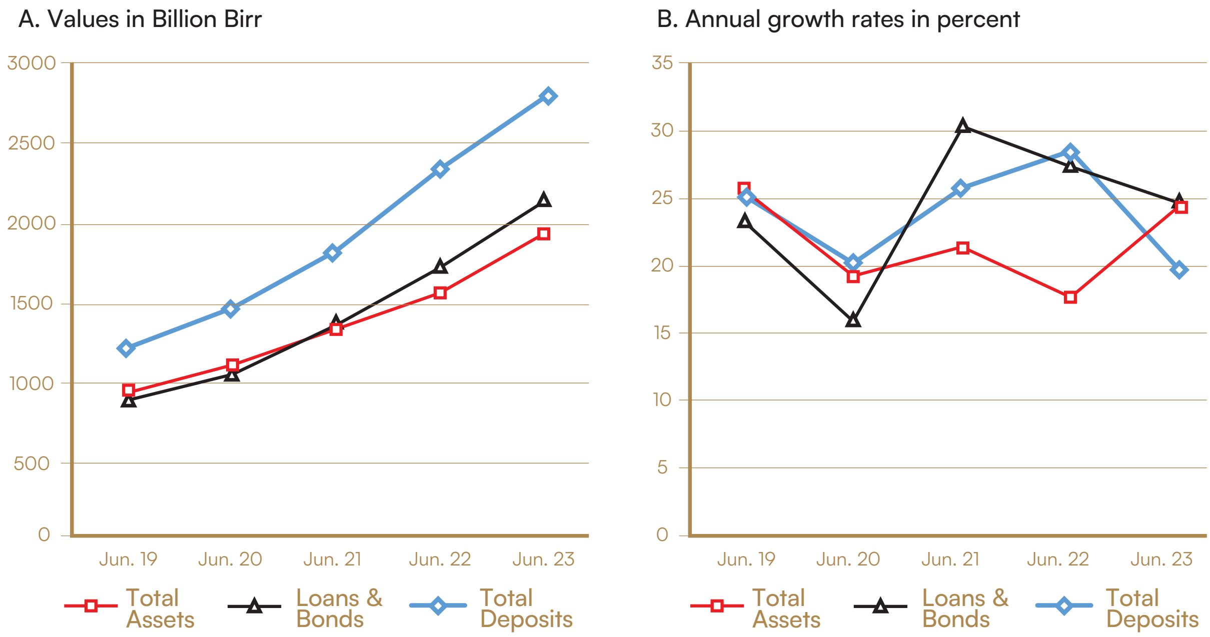
[10] One additional bank, Siket Bank, graduated from MFI and was relicensed as a bank as of August 2023.

Table 4: Banks' Major Balance Sheet Items (billion Birr)

PARTICULARS	06/2019	06/2020	Growth(%)	06/2021	Growth(%)	06/2022	Growth(%)	06/2023	Growth (%)
Total Assets (net)[11]	1,215.1	1,462.4	20.4	1,843.2	26.0	2,374.1	28.8	2,845.9	19.9
Loans & Bonds	912.3	1,085.8	19.0	1,317.3	21.3	1,521.1	15.5	1,890.3	24.3
Loans and Advances (net)	443.6	559.0	26.0	766.9	37.2	986.7	28.7	1,247.5	26.4
Bonds [12]	468.7	526.8	12.4	550.4	4.5	534.4	(2.9)	642.8	20.3
Total Deposits	**898.9**	**1,041.9**	**15.9**	**1,360.1**	**30.5**	**1,735.3**	**27.6**	**2,162.2**	**24.6**
Saving deposits	518.0	622.5	20.2	855.8	37.5	1,085.3	26.8	1,370.1	26.2
Demand deposits	316.8	356.4	12.5	439.6	23.4	567.1	29.0	679.9	19.9
Time deposits	64.1	63.1	(1.6)	64.7	2.5	83.0	28.3	112.2	35.2
Regulatory Capital	93.8	105.2	12.2	121.9	15.9	168.9	38.5	212.4	25.7
GDP [13]	2,690.8	3,374.7	25.4	4,341.0	28.6	6,157.0	41.8	8,722.3	41.7
Share (%) of Loans in GDP	16.5	16.6	0.1	17.7	1.1	16.0	1.6	14.3	- 1.7
Share (%) of Deposits in GDP	33.4	30.9	-2.5	31.3	0.5	28.2	3.1	24.8	-3.4
Share (%) of Loans & Bonds in GDP	33.9	32.2	-1.7	30.3	- 1.8	24.7	5.6	21.7	-3.0
Share (%) of Loans & Bonds in Total Assets	75.1	74.2	-0.8	71.5	-2.8	64.1	7.4	66.4	2.4

Source: NBE Database & Monetary and Financial Analysis Directorate of NBE

Figure 7: Bank Assets, Loans & Bonds, and Deposits, 2019-2023



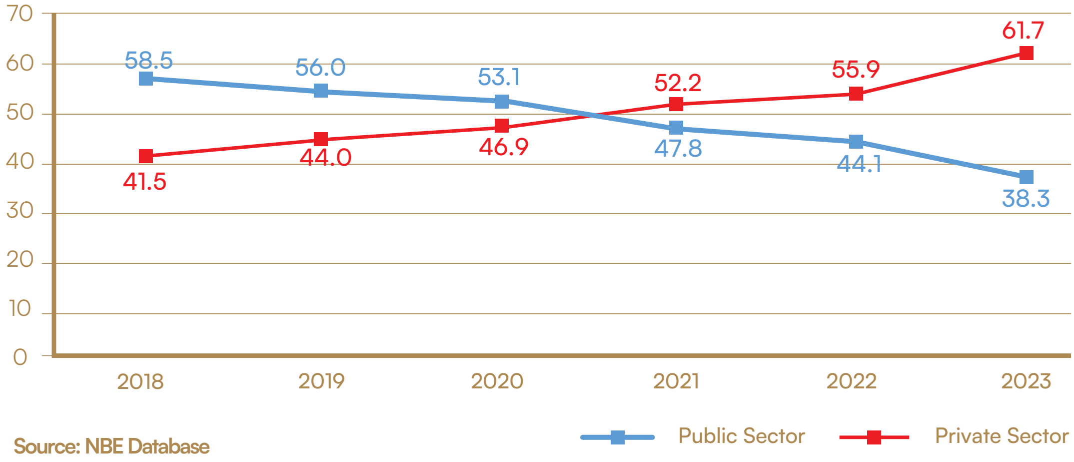
Source: NBE Database

[11] Net of loan loss provisions, depreciation, amortizations etc.

[12] Includes NBE Bills, DBE Bonds, Government Bonds and Corporate Bonds

[13] Nominal

Figure 8: Banking Sector Credit Distribution to Public and Private Sectors, 2018-2023 (percent of total banking sector credit)



Source: NBE Database

In line with international trends, Ethiopia established a deposit insurance scheme in 2021 (Box 1). By reducing the likelihood of bank runs, this is expected to contribute significantly to stability in the banking and microfinance sectors, and hence, to the overall financial system.

Box 1:
Ethiopia's Deposit Insurance Fund

የኢትዮጵያ የተቀማጭ ገንዘብ መድን ፈንድ
ETHIOPIAN DEPOSIT INSURANCE FUND

The Ethiopian Deposit Insurance Fund (The Fund) was established as per Council of Ministers Regulation No. 482/2021 to serve as a financial safety net for depositors of commercial banks and microfinance institutions. The Fund is an institution with a legal personality that is accountable to NBE. It is mandated to determine initial and annual premiums, set the coverage ceilings for insured money deposits (which may not be more than Birr 100,000), make payments to eligible depositors up to the extent of insured deposits, recover the payments made from the liquidation proceeds of failed financial institutions, collect premiums from member financial institutions [14] and various contributions from other sources, and deal with parties at fault in member financial institutions' failure and manage court cases.

The main objective of the Fund is to contribute to the safety, soundness, and stability of the Ethiopian Financial System. It also aims to protect depositors by introducing a deposit insurance fund. The Fund is expected to enable payments to member financial institutions' depositors with insured deposits in case of an insurance event. In doing so, it is also anticipated to mitigate risk and contribute to the stability of the financial system. The Fund has issued a directive related to initial and annual premium contributions and managed to collect Birr 2.8 billion in 2023/24 Q2 in the form of initial and annual premiums, which were invested in short-term governmen securities.

[14] Membership in the Fund is compulsory for banks and MFIs

3.2.1.2 Industry Structure and Systemic Risk

Of the 30 commercial banks registered before end of June 2023 in Ethiopia (excluding the DBE), one is a state-owned bank; three are private interest-free banks; five [15] are micro-finance institutions (MFIs) transformed into commercial banks; and the rest are conventional private commercial banks.

NBE distinguishes (based on asset size) three types of commercial banks: large, medium, and small banks. Their respective roles in the market are as follows (Table 5):

Large Bank: The only large bank in the country that also dominates the industry is the state-owned Commercial Bank of Ethiopia (CBE). At end-June 2023, its total assets and deposits constituted almost half (49.5 percent and 48.7 percent, respectively) of the whole banking sector. However, its total capital accounted for just over a quarter (27.5 percent) of the total. Although its market share had declined from the previous year, CBE is clearly a domestic systemically important bank.

Medium-sized Banks: At end-June 2023, the combined assets of the five medium-sized banks [16] accounted for 28.0 percent of the sector's total assets, slightly higher from the previous year. Their total deposits accounted for 29.4 percent of the sector's total, marginally lower than at end-June 2022. On the other hand, their entire capital was 31.0 percent of the sector's total, up from 28.8 percent of the previous year. None of these banks is currently regarded as a systemic bank, despite their growing market share.

Small Banks: At end-June 2023, the combined assets and deposits of the 24 small banks [17] accounted for 22.5 percent and 21.9 percent, respectively, of the whole banking sector — an annual increase of 3.4 and 2.6 percentage points, respectively. Likewise, their combined total capital share increased from 40.2 percent of the sector's total capital in 2022 to 41.6 percent at end-June 2023. The growth of the small banks' aggregate market share can be explained by the increase in their number (two more banks had joined the banking sector) and the rapid initial expansion of recently established banks. However, with an individual share in assets, deposits, and loans & bonds of less than one percent, none of the small banks can be considered a systemic bank.

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[15] Of which, one is full-fledged interest-free bank

[16] Awash Bank, Bank of Abyssinia, Cooperative Bank of Oromia, Dashen Bank, Hibret Bank.

[17] Abay Bank, Addis International Bank, Ahadu Bank, Amhara Bank, Berhan Bank, Bunna Bank, Enat Bank, Gadaa Bank, Global Bank, Goh Betoch Bank, Hijra Bank, Lion International Bank, Nib International Bank, Omo Bank, Oromia Bank, Rammis Bank, Shabelle Bank, Sidama Bank, Siinqee Bank, Tsedey Bank, Tsehay Bank, Wegagen Bank, ZamZam Bank, Zemen Bank.

Table 5: Banking Industry Market Shares, June 2023 vs. June 2022 (percent)

	Total Assets		Total Loans & Bonds		Total Deposits		Total Capital	
Type of bank	June 2022	June 2023	June 2022	June 2023	June 2022	June 2023	June 2022	June 2023
BY SIZE CLASS								
Large	54.0	49.5	52.0	46.7	51.3	48.7	31.0	27.5
Medium	26.9	28.0	29.0	30.5	29.5	29.4	28.8	31.0
Small	19.1	22.5	19.1	22.9	19.3	21.9	40.2	41.6
BY OWNERSHIP								
Public	54.0	49.5	52.0	46.7	51.3	48.7	31.0	27.5
Private	46.0	50.5	48.0	53.4	48.7	51.3	69.0	72.6

Source: NBE Database and Off-site Reports

Assessment of Systemic Risk Stemming from Industry Structure

As indicated above, CBE is a systemic bank in the Ethiopian banking system and can therefore entail systemic risk. Because of its relatively strong capitalization, CBE is believed to have withstood a number of recent negative domestic and external shocks, including local conflicts and droughts, global inflation, disruptions to the supply chain brought on by the war in Ukraine, changes in the price of oil and other commodities, climate change and others.

Yet CBE has a high cushion of regulatory capacity as its capital adequacy ratio (CAR) is significantly above NBE's 8 percent minimum capital requirement, and its liquidity position is also above the 15 percent minimum requirement. Thus, at all levels of risk stress, CBE's CAR and liquidly position will remain above the regulatory minima.

However, because the majority of the bank's paid-up capital is government-issued promissory bond (Proclamation No. 994/2017 Government Bond) that has not yet been fully paid for in cash; CBE's capital position requires targeted policy and regulatory attention in the event of unfavorable circumstances. Furthermore, even though the stress tests performed show that the systemic bank is resilient to credit risks (see Section 3.2.1.5 below), NBE will continue to monitor the bank's exposure to loans transferred to the Liability and Asset Management Corporation. [18]

[18] The Liability and Asset Management Corporation was established by the Government in 2021 to manage the consolidation and servicing of a portion of the debt of the country's state-owned enterprises (SOE) and other state-owned assets.

3.2.1.3 Credit Concentration

Banking Industry Credit Concentration by Economic Sector

Even though manufacturing continued to account for the largest share of loans and advances (23.2 percent) from Ethiopian banks at end-June 2023, domestic trade and services increased in importance, expanding by 3.8 percentage points to 20.7 percent (Table 6). The faster growth in loans to domestic trade and services could mean that domestic demand for credit financing has increased as a result of the government's import substitution policy,[19] and that banks are turning to domestic business as a result of issues in the global market.

Compared to other sectors, the import sector's share of loans declined at a faster pace — by 3.9 percentage points. Main reasons for this were unfavorable international economic conditions such as the war in Ukraine, supply chain problems, shortage of foreign exchange, and stringent NBE regulations pertaining to the surrender of foreign currency proceeds.

Overall, the loan portfolio across sectors is relatively diversified.

Table 6: Banking Loans by Sector (billion Birr)

Sector	June 2022		June 2023		Change in percentage points (B-A)
	Amount (billion Birr)	Share (%) (A)	Amount (billion Birr)	Share (%) (B)	
Agriculture	43.4	4.2	83.7	6.4	2.2
Building & Construction	115.9	11.3	132.3	10.1	-1.2
Manufacturing	260.7	25.3	304.6	23.2	-2.1
Import	118.3	11.5	99.3	7.6	-3.9
Export	176.4	17.1	205.4	15.7	-1.5
Domestic Trade & Servi ces	173.8	16.9	270.9	20.7	3.8
Staff & Consumers	90.7	8.8	138.2	10.5	1.7
Other Business	50.4	4.9	76.5	5.8	0.9
Total	**1029.6**	**100.0**	**1311.0**	**100.0**	**100.0**

Source: NBE Database

Banking Industry Credit Concentration

The banking sector's loans and advances are concentrated in the hands of a few large borrowers. The top ten borrowers from the banking industry held 23.5 percent of total loans & advances of the banking industry at end-June 2023, a significantly higher share than a year earlier (18.7 percent).

[19] The import substitution strategy of Ethiopia, which was introduced to alleviate the shortage of foreign currency in the country, promotes domestic production and consumption of goods.

Moreover, even though borrowers with an individual credit exposure of above Birr 10 million constituted only 0.5 percent of the total, they held almost three quarters (73.7 percent) of the entire banking sector loans — again, a higher share than the year before. Virtually all loans (99.8 percent at end-June 2023) were held by borrowers from urban areas.[20]

3.2.1.4 Soundness Indicators

The commercial banking industry in Ethiopia is considered sound and resilient based on an assessment of financial soundness indicators — capital adequacy ratio, liquidity position, and NPLs.

A. Asset Quality Indicators

As a result of low NPLs and adequate provisioning for non-performing loans, the quality of assets of the Ethiopian commercial banking industry was generally sound at the end of June 2023.

The ratio of NPLs to gross loans fell from 3.9 percent at end-June 2022 to 3.6 percent at end-June 2023 (Figure 9), well below the regulatory maximum of 5.0 percent .

Furthermore, provisioning increased from 122.9 percent of NPLs in the previous year to 132.5 percent of NPLs at end-June 2023 (Figure 10), more than covering reported NPLs. These figures suggest that the industry's profitability was not overstated and capital was of good quality.

Figure 9: Banks NPLs to Gross Loans, 2019-2023 (percent)

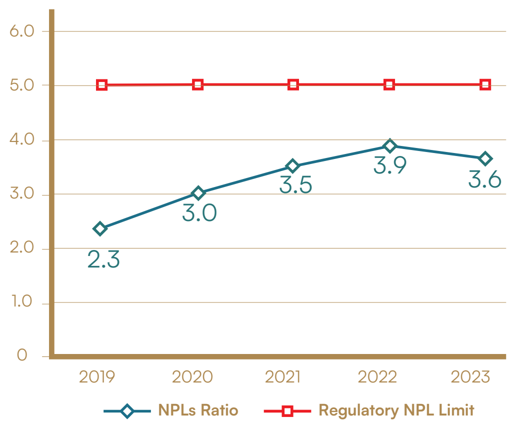
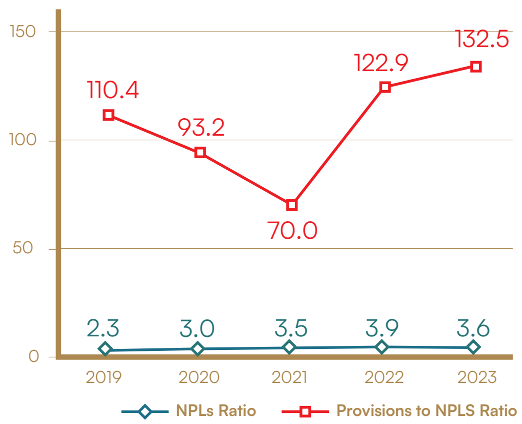


Figure 10: Banks NPLs and Provisions, 2019-2023 (percent)



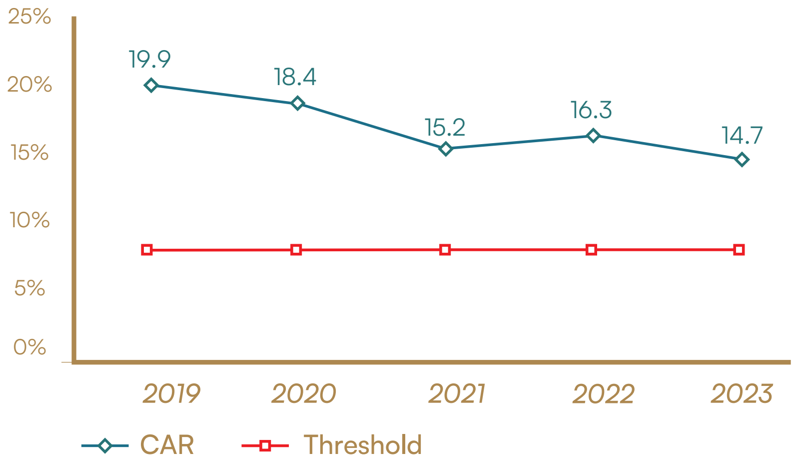
Source: NBE Database

[20] Urban areas are those settlements with population of 20,000 and above or regional capitals and zonal capitals. Rural towns are those with population of less than 20,000 or which are not regional capitals and zonal capitals.

B. Capital Adequacy Indicators

The regulatory capital to risk-weighted assets ratio for the banking sector slightly fell from 16.3 percent in the previous year to 14.7 at end-June 2023, but it is still much higher than the 8.0 percent regulatory minimum (Figure 11).

Figure 11: Banking Industry Capital Adequacy Indicators, 2019-2023 (percent)



Source: NBE Database

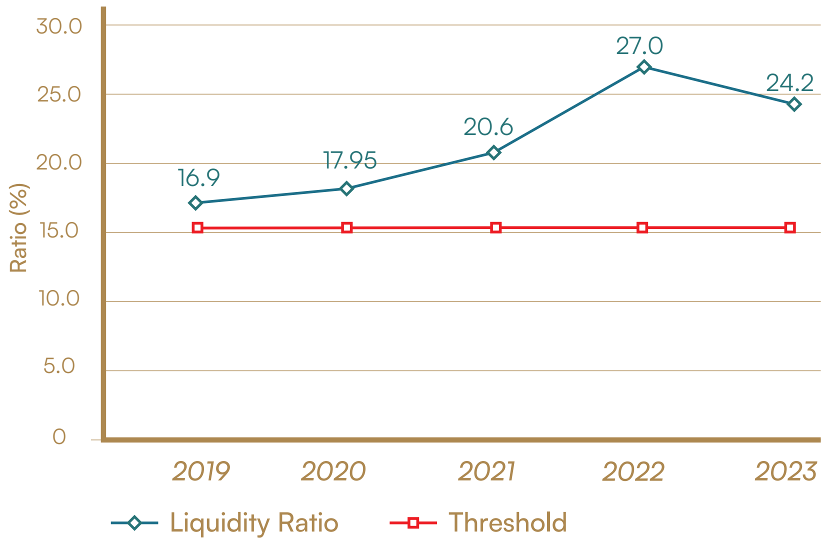
C. Liquidity Indicators

The liquid assets to deposits ratio of the banking sector decreased from 27.0 percent in the previous year to 24.2 percent at end-June 2023, but it is still much higher than the 15.0 percent regulatory minimum (Figure 12).

During the same period, the ratio of loans to deposits rose by 0.9 percentage points to 60.6 percent. While, the ratio of loans & bonds to deposits dropped slightly to 90.3 percent. This is still very high, though, and suggests that nearly all depositors' money is held by borrowers rather than being liquid assets, which could lead to a liquidity problem under unfavorable circumstances.

The decrease in the liquidity ratio may have been caused by increased lending, particularly to agriculture, domestic trade and services, and households (staff and consumers) (see Table 6 above). This is in line with the general policy that encourages lending to the key sectors of the economy.

Figure 12: Banking Industry Liquidity Indicators (percent)



Source: NBE Database

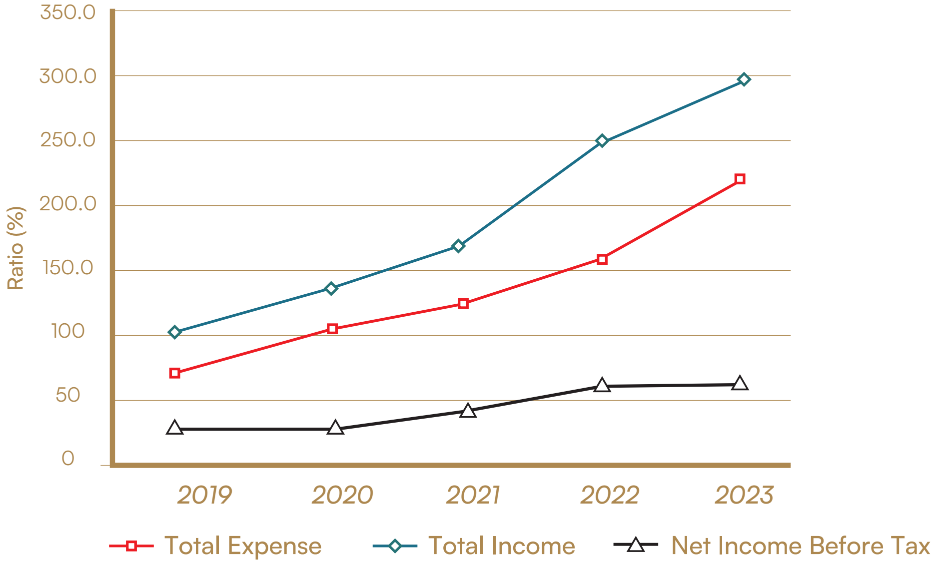
High concentration of deposits and the difference in maturities between deposits and loans may create liquidity risk in the banking sector despite the existing high liquidity ratio. At the end of June 2023, 56.3 percent of the total banking sector deposits was held by only 0.5 percent of the total banking sector depositors. In addition, the liquid assets of banks only incorporated a small share of high-quality liquid assets (cash). As a result, some banks were facing real time transaction-level liquidity shortages. This is analyzed further as part of the liquidity risk stress test in section 3.2.1.5.

D. Profitability Indicators

Total income of the banking sector reached Birr 297.5 billion at end-June 2023, up from Birr 247.0 billion in the previous year (Figure 13). Expenses grew with the expansion of activities, and the total number of bank employees rose by 26.0 percent to 187,450. Hence, net income before tax remained almost stable (Birr 62.9 billion at end- June 2023, compared with Birr 61.8 billion of the previous year).

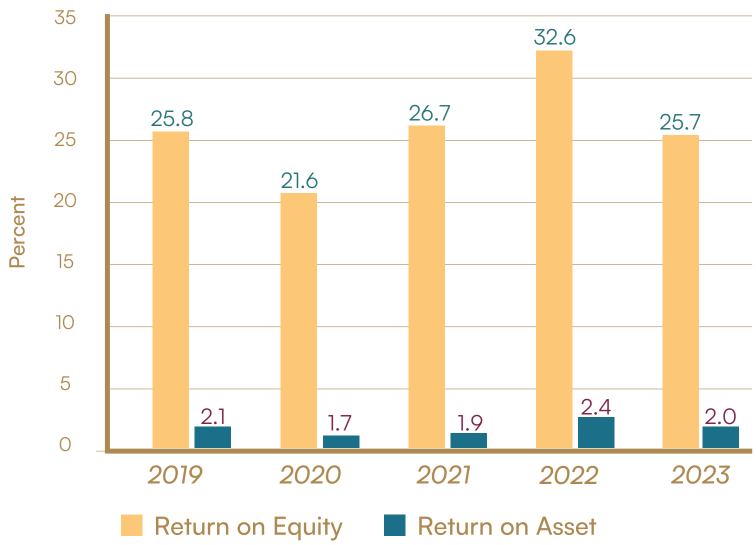
The profitability of the banking industry decreased but is still sufficient. Return on equity and return on assets, measures of profitability, were 25.7 percent and 2.0 percent at end-June 2023, respectively. These figures were marginally lower than those of the previous year, primarily because of an increase in bank provisioning (Figure 14).

Figure 13: Ethiopian Banking Industry income, expenses and net income before tax, 2019-2023



Source: NBE Database

Figure 14: Ethiopian Banking Industry's Profitability Indicators, 2019-2023



Source: NBE Database

3.2.1.5 Risk Stress Tests

A. Credit Risk Stress Test

NBE performed a banking sector credit risk stress test at end-June 2023 for the 12 months ahead under a baseline, moderate and severe scenario. The scenarios were calibrated according to domestic and international shocks that could negatively impact the recovery and, eventually, the credit risk of the banking industry. [21]

[21] A preliminary assessment had established that capital to total risk-weighted assets ratio (regulatory CAR) of all banks was higher than the 8.0 percent minimum statutory requirement. Thus, all banks were included in the stress test.

The *baseline scenario (pre-shock)* anticipated that the economy will grow according to the IMF forecast, with international and domestic conditions improving, and the country free of droughts and conflicts. The *moderate scenario* assumed that NPLs in the banking industry will increase to 10.0 percent. In principle, this could happen as a result of deteriorating domestic and/or external circumstances, such as drought and heightened conflict or an increasing foreign currency shortage. The *severe scenario* assumed that NPLs will increase to 30.0 percent.

The credit risk stress test results (Table 7) provide an assessment of banks' capital erosion following asset quality impairment under moderate and severe scenarios if the unfavorable circumstances occur by end-June 2024. The results indicate that all banks have sufficient capital to withstand a moderate shock. Twelve banks would fail the stress test due to an increase in NPLs under the severe scenario, requiring additional capital equal to 1.5 percent of risk-weighted assets. Not all banks have the same requirement for capital injection. Specifically, the systemic bank and the majority of MFIs that converted to banks (in the small banks class) have more capital and do not require capital injections.

Table 7: Results of Credit Risk Stress Test (increase in NPLs)

Impact on Minimum Regulatory CAR due to increase in NPLs	Baseline Scenario (Pre-Shock) *	Moderate Scenario	Severe Scenario
Assumed level of NPL (%)	3.6	10.0	30.0
Pre - shock Regulatory Capital Ratio (%)	14.7	14.7	14.7
Post- shock Regulatory Capital Ratio (%)	-	14.5	10.6
Number of banks below minimum regulatory CAR	-	-	12

Source: NBE Database and off-site reports; *based on data as of June 2023

B. Liquidity Risk Stress Test

The liquidity stress test considers the aggregate impact on the banking sector liquidity if the top 10 depositors in each bank suddenly withdraw all their money.

The stress test results (Table 8) show that the banking sector liquidity ratio would fall from 24.0 percent in the pre-shock situation (based on data as of end of June 2023) to 13.0 percent — slightly below the 15 percent regulatory minimum requirement. However, some of the banks would be in worse situation than the industry average. Even though the systemic bank shows resilience to the shock, 18 banks would fail to meet the regulatory minimum requirement — four medium-sized banks and 14 small banks.

These results suggest that many Ethiopian commercial banks are highly sensitive to liquidity risk from sudden withdrawals by a few big depositors. The banking industry has also become more sensitive at end-June 2023 than in the previous year. Exposed to the same shock, only six banks would have failed to meet the minimum liquidity requirements at end-June 2022.

Table 8: Result of Liquidity Risk Stress Test (withdrawal of top 10 depositors)

Impact on Minimum *Regulatory Liquidity* Ratio due towithdrawal of top 10 depositors	Stress Test Based on June 2022 Data		Stress Test Based on June 2023 Data	
	Baseline Scenario (Pre-Shock)	Top 10 depositors' withdrawal Scenario	Baseline Scenario (Pre-Shock)	Top 10 depositors withdrawal Scenario
Size of the Shock	Birr 465.5 billion liquid assets	Withdrawal ofBirr 219.2 billion	Birr 524.7billion liquid assets	Withdrawal of Birr 288.8 billion
Pre-shock Regulatory Liquidity Ratio (%)	26.8	26.8	24.0	24.0
Post-shock Regulatory Liquidity Ratio (%)	-	16.3	-	13.0
Number of Banks Below minimum Regulatory Liquidity Ratio	-	6	-	18

Source: NBE Database and Off-site Reports

3.2.1.6 Summary of Risk Assessment and Outlook

In 2022—2023 (the review period), the banking sector remained stable and resilient against the backdrop of a strong domestic economic growth, effective monetary and financial policies aimed at containing the lingering impact of the COVID—19 pandemic, and conflicts and droughts in some parts of the country. Overall, the outlook for 2024 is also positive. Underpinned by sufficient capital and profitability, the sector is expected to remain stable and resilient, which is supported by the Banking Sector Risk Stress Test results performed based on end-June 2023 data. However, there are downside risks associated with potential domestic and external shocks.

Credit Risk

The banking industry's credit risk remained moderate during the review period but is expected to increase in 2024. Credit risk could increase because of droughts and conflicts in some parts of the country. Deterioration in the external sector — the implication of the global monetary policy tightening on domestic interest rates, the exchange rate and capital flows; and the impact of the wars in Ukraine and the Middle East on trade and other transactions — could increase credit risk. These risks are accentuated by the high credit borrower concentration, suggesting the need for tighter regulatory standards on credit concentration risks.

Since loans and advances, and bonds constitute the lion's share of bank assets, credit risk remains one of the most important and inherent risks that banks need to effectively manage. Therefore, it is imperative to follow prudent and principle-based lending and financing practices that are in line with the bank's risk strategy and appetite as well as any applicable legal requirements. In this regard, the asset quality of the banking system in Ethiopia as a whole and of most banks is found to be satisfactory as their NPL ratio is below NBE's 5 percent maximum. However, in light of the aforementioned systemic risks and the less satisfactory performance of some banks, NBE is closely monitoring banks with relatively higher NPLs in order to reduce their NPLs for them to maintain an acceptable NPL exposure and credit portfolio.

Liquidity Risk

Liquidity of the banking industry remained moderate and stable during the review period; liquidity risk is also expected to remain moderate, albeit increasing in the short and medium terms. The banking industry is expected to maintain a robust liquidity position and resilience to short-term liquidity shocks. However, downside risks persist, including failure to meet weekly liquidity requirements, Real-Time Gross Settlement System (RTGS) payment requirements, asset and liability mismatches and funding gaps at the short-term maturity buckets, and high deposit concentration. The latter may suggest the need for tighter regulatory standards on deposit concentration risks.

As banks mobilize short term deposit and invest same in long term assets, they normally face an asset-liability time mismatch in their books. To this end, it is critical for banks to manage their liquidity risk and maintain adequate liquidity that will enable them to proactively and effectively meet their obligations at all times. Most banks in Ethiopia comply with NBE's 15 percent minimum liquidity ratio requirement and have a proven track record of meeting payment obligations in the RTGS. NBE is closely monitoring banks with liquidity challenges and weaker liquidity risk management practices by undertaking supervisory meetings with their leaderships. It also engages with such banks to ensure that corrective and remedial actions for addressing the observed liquidity issues are implemented to prevent any negative spillovers to the overall financial system.

Going forward, NBE will take the necessary measures to ensure that banks implement sound and comprehensive liquidity management supported by adequate liquidity risk management tools including governance, limits, stress tests, contingency planning, and cash flow projections, among others.

Market Risk

Market risk is moderate but is increasing. In a rising interest rate environment, banks' funding costs may increase since deposit liabilities are at variable rates, while a large amount of assets — corporate bonds held by CBE and DBE, and treasury bonds held by private banks — are at fixed rate. Therefore, bank profitability may deteriorate somewhat.

Commercial banks' overall open foreign currency position was 81.7 percent short at end-June 2023, lower than a year earlier but still well above NBE's maximum limit of 15 percent. Commercial banks have experienced fluctuation in the downside open positions. The large open position was concentrated in five banks (the large bank, three medium-size banks and one small bank).

Market risks rise in the short-term in a continued high interest rate environment. Banks often have an imbalance between variable rate deposits and a large proportion of the fixed rate assets they hold. NBE will put in place cautious measures to reduce these risks as well as exchange rate risks.

Operational Risk

There is significant operational risk in the Ethiopian commercial banking industry and is expected to rise further in the short to medium terms. Incidents of social engineering, insider threats and third-party risks are on the rise. The cost of bank fraud and forgeries almost doubled to Birr 1.0 billion in just a year. These cases occurred at 20 banks, mainly through the use of fake cash notes and cheques, embezzlement, the issuance of unauthorized bank guarantees, withdrawals using stolen ATM cards, and false calls or texts. Moreover, robberies amounting to Birr 0.2 billion were reported by three banks at end-June 2023.

Commercial banks are introducing technology-based new products and services that enhance efficiency and financial inclusion but entail significant operational risks. Moreover, an increasing number of banks are applying to introduce digital micro credit & saving services that are provided through partnerships with third parties. As a consequence, incidences of fraud and embezzlement could increase. Major policy developments need to focus on implementing regulations that outline effective strategies for measuring and mitigating operational risks.

3.2.2 Development Finance Institution

The total assets [22] of the DBE grew by 19.8 percent from the previous year to Birr 157.8 billion at end-June 2023. The increase was largely because of the growth of loans and advances by 25.0 percent. Total regulatory capital increased by 2.8 percent from the previous year's Birr 30.1 billion to Birr 31.0 billion. Deposit liabilities more than doubled, but the regulatory capital ratio fell to 30.0 percent, reflecting a large increase in provisioning that by the end of June 2023 more than covered NPLs. Mainly due to regulatory forbearance and enhanced loan collection, the ratio of NPLs to total loans decreased significantly from 24.3 percent to 7.1 percent. Profitability increased, with return on assets reaching 3.3 percent, and return on capital 15.5 percent (Figure 15, Figure 16 and Annex A).

Figure 15: DBE Balance Sheet-Based Soundness Indicators, June 2022-2023 (percent)

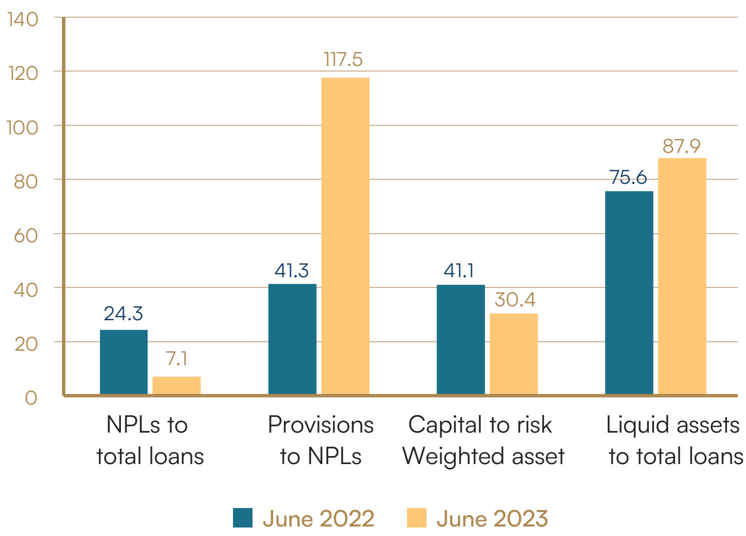
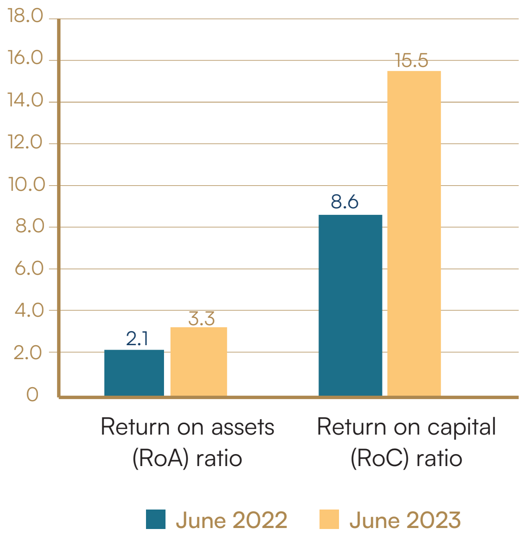


Figure 16: DBE Profitability Indicators, June 2022-2023 (percent)



Source: Annex A

Overall, the vulnerability of DBE to risks decreased substantially during the review period.

[22] All data used in this analysis are provisional (not audited).

3.3 MICROFINANCE AND CAPITAL GOODS FINANCE BUSINESS SECTORS

This section focuses on the stability and vulnerability to risks for the microfinance and capital goods finance business sectors. Given their share, these sectors are not expected to pose a significant risk to Ethiopia's overall financial system. At end-June 2023, all MFIs together accounted for 2.0 percent of the financial sector's total assets, and all Capital Goods Finance Companies for 0.2 percent (see Table 3 in section 3.1 above). Therefore, the analysis in this section is limited when compared to that of the banking sector, but more details are provided in the Annexes.

At end-June 2023, 47 microfinance institutions (with a total of 1,109 branches) and six Capital Goods Finance Companies [23] (with a total of 55 branches) were operating in Ethiopia.

3.3.1 Microfinance Sector[24]

The microfinance sector grew strongly in the year to end-June 2023. Total assets and deposits increased by 33.7 percent (from Birr 46.1 billion to Birr 61.7 billion) and 28.8 percent (from Birr 21.7 billion to Birr 27.9 billion), respectively. Liquid assets and net loans also increased significantly (Table 9). Capital increased by 39.4 percent and further increase is anticipated because each microfinance institution is required to reach a minimum of Birr 75 million within seven years.[25]

Table 9: Major Balance Sheet Items of the Ethiopian MFI sector, 2019-2023 (billion Birr)

	Major items	June 2019	June 2020	June 2021	June 2022	June 2023	Change 2022-2023 (%)
A	**Assets**						
1	Total liquid assets	7.1	6.9	8.6	9.7	12.3	26.9
2	Gross loans	16.7	22.1	25.3	31.7	39.2	23.8
3	Provisions	0.7	1.1	1.4	1.5	1.2	-21.0
4	Net loans	16.0	21.0	24.0	30.2	38.0	25.9
5	Gross NPLs (PAR>90 days)	1.0	1.6	2.2	2.5	1.7	-32.5
6	Total assets	25.5	30.8	36.1	46.1	61.7	33.7
B	**Liability and Capital**						
7	Total deposits	14.3	16.2	19.1	21.7	27.9	28.8
8	Borrowings	2.3	2.6	3.8	8.5	11.3	32.6
9	Total capital	5.9	6.1	7.0	12.1	16.8	39.4

Source: NBE Database

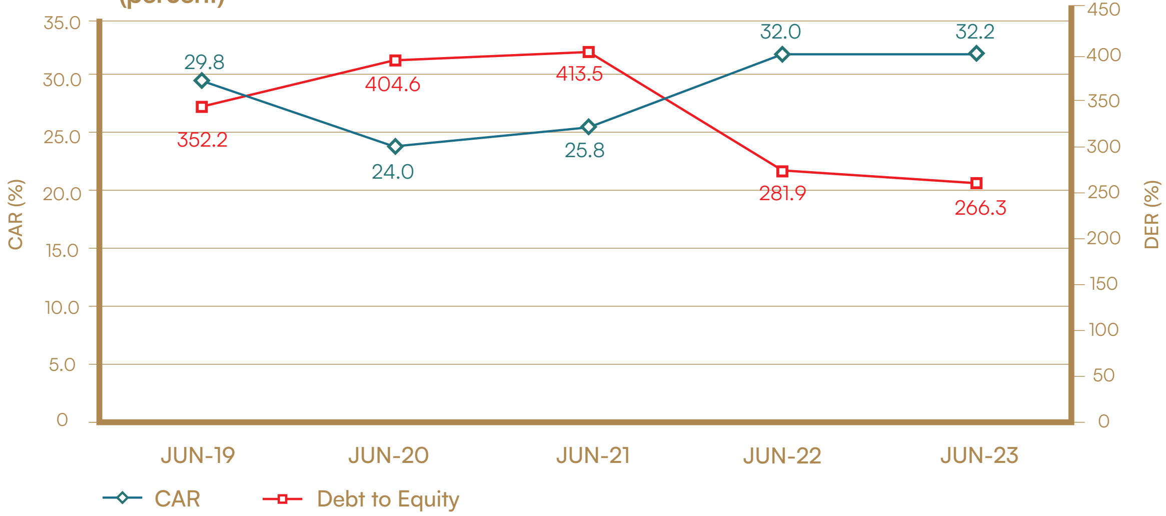
[23] Waliya Capital Goods Finance Business S.C, Oromia Capital Goods Finance Business S.C, Addis Capital Goods Finance Business S.C, Debub Capital Goods Finance S.C., Kaza Capital Goods Finance Business S.C, and Ethio Lease Ethiopia Goods Finance Business S.C.

[24] The analysis for the microfinance sector excludes data for the microfinance institutions that have been transformed into banks in the period end-June 2019 to end-June 2023 (Amhara Credit and Saving Institution, Oromia Credit and Saving Institution, OMO MFI, Somali MFI, and Sidama MFI).

[25] This applies to MFIs established in 2023 and later; already existing MFIs must reach the Birr 75 million by the end of January 2028; see NBE Directive No. MFI/36/2023.

The capital adequacy ratio, one indicator for financial soundness, was 32.2 percent at end-June 2023, well above levels seen during COVID-19 (Figure 17) and NBE's 12 percent minimum requirement. This indicates that the microfinance sector has a low and stable risk level as it has sufficient capital on reserve to manage adverse financial shocks.

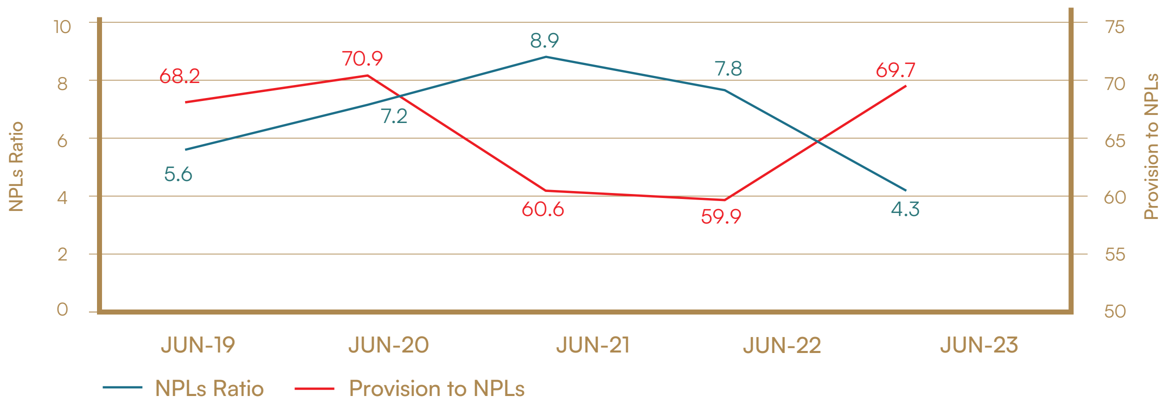
Figure 17: Capital Adequacy and Debt Equity Ratios in the Microfinance Sector, 2019-2023 (percent)



Source: NBE Database

Asset quality has improved, indicating a recovery from the COVID-19 period. At end-June 2023 and for the first time in five years, the NPL ratio at 4.3 percent met NBE's requirement of less than 5.0 percent (Figure 18). This again indicates a low risk level for the sector. Likewise, provisions to NPLs increased to 69.7 percent, also suggesting a significant recovery from the COVID-19 period.

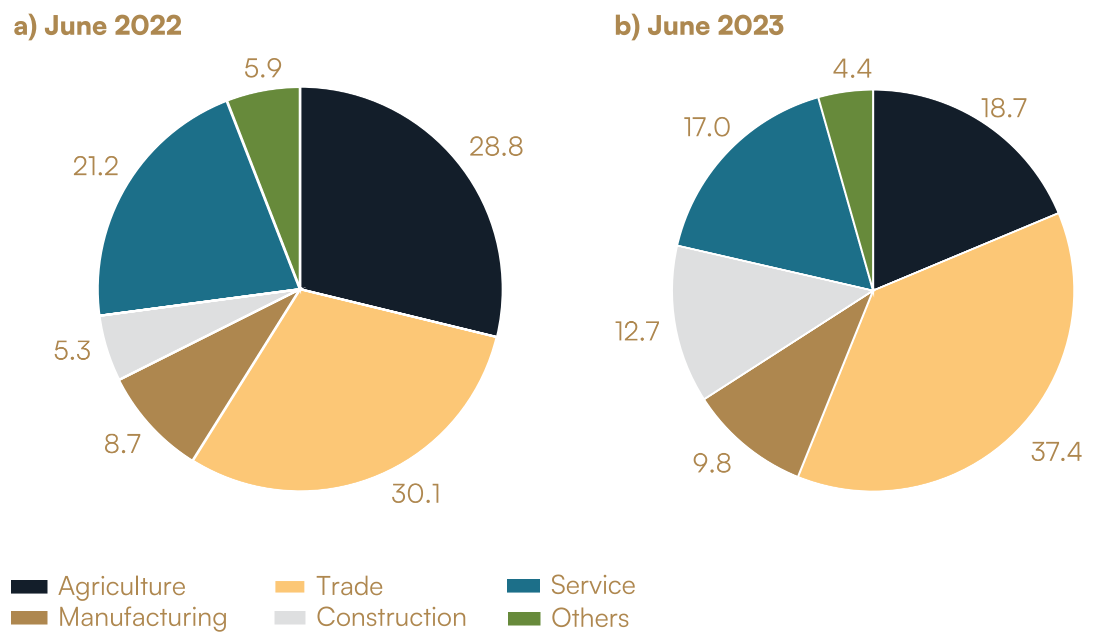
Figure 18: Asset Quality Ratios of the Microfinance Sector, 2019-2023 (percent)



Source: NBE Database

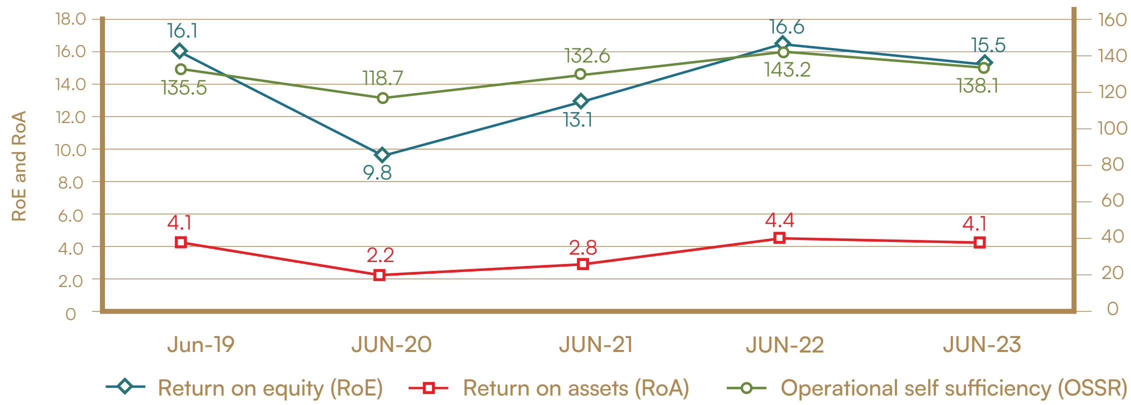
The composition of MFI loans by sector shifted markedly in the year to June 2023 (Figure 19). Loans to agriculture decreased from 28.8 percent of total microfinance loans of the previous year to 18.7 percent at end-June 2023, whereas loans to the trade sector increased from 30.1 percent to 37.4 percent. Furthermore, there is a high sectoral credit concentration risk. Loans to agriculture accounted for the highest share of NPLs (see Figure 30 in Annex B).

Figure 19: Distribution of Microfinance Loans by Sector, June 2022 and June 2023 (percent)



Source: NBE Database, see Annex B

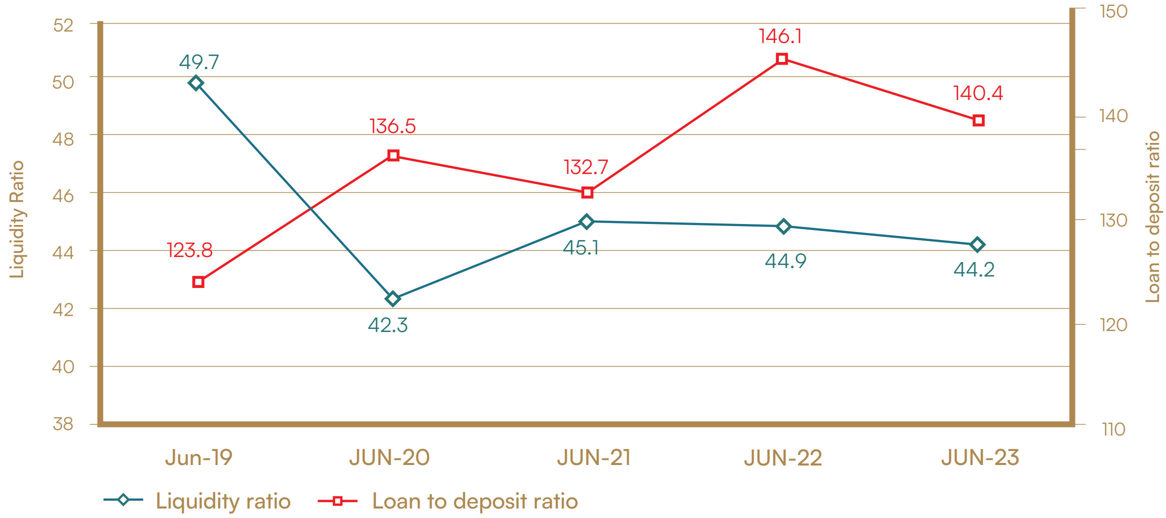
Figure 20: Major Earning Ratios of the Microfinance Sector, 2019-2023 (percent)



Source: NBE Database, see Table 20 in Annex B.

Finally, the microfinance sector has met its liquidity requirements but remains highly interconnected with and reliant on commercial banks (Figure 21). The liquidity ratio remained relatively steady at 44.2 percent, well above NBE's 20.0 percent minimum requirement. However, a loan-to-deposit ratio of 140.4 percent indicates that the sector is heavily dependent on borrowing from depositors and domestic banks. In the opposite direction, 90.0 percent of the sector's liquid assets are held at banks.

Figure 21: Microfinance Sector Liquidity Ratio Indicators, 2019-2023 (percent)



Source: NBE Database

In sum, overall risk of the microfinance sector is considered to be low and stable. The capital adequacy ratio, NPL ratio, and liquidity ratio are all well within NBE's parameters and have improved over the review period. There is also sufficient profitability in the sector. However, the high credit concentration leaves MFIs susceptible to negative economic shocks that impact specific sectors such as agriculture and trade. Close links to the banking sector also makes the microfinance sector vulnerable to potential spillovers from the banking sector. These two risks may need to be addressed through appropriate policy measures.

3.3.2 Capital Goods Finance Business Sector

The capital goods finance business sector grew by 27.3 percent to Birr 2.8 billion in the year to June 2023 (Table 10). Total assets also increased by 10.2 percent to Birr 5.4 billion, but total liquid assets declined by 15.1 percent to Birr 756.7 million. NPLs increased sharply by 132.8 percent in the year to end-June 2023 (Table 10).

This mainly represented a return the NPL ratio two years before, at 5.1 percent, after a notable value of 2.8 percent a year earlier; the ratio had been higher in previous years. The sector's asset quality at-end June 2023 was close to the regulatory maximum of 5.0 percent, implying a moderate credit risk.

Table 10: Major Balance Sheet Items of the Capital Goods Finance Sector, 2019-2023 (million Birr)

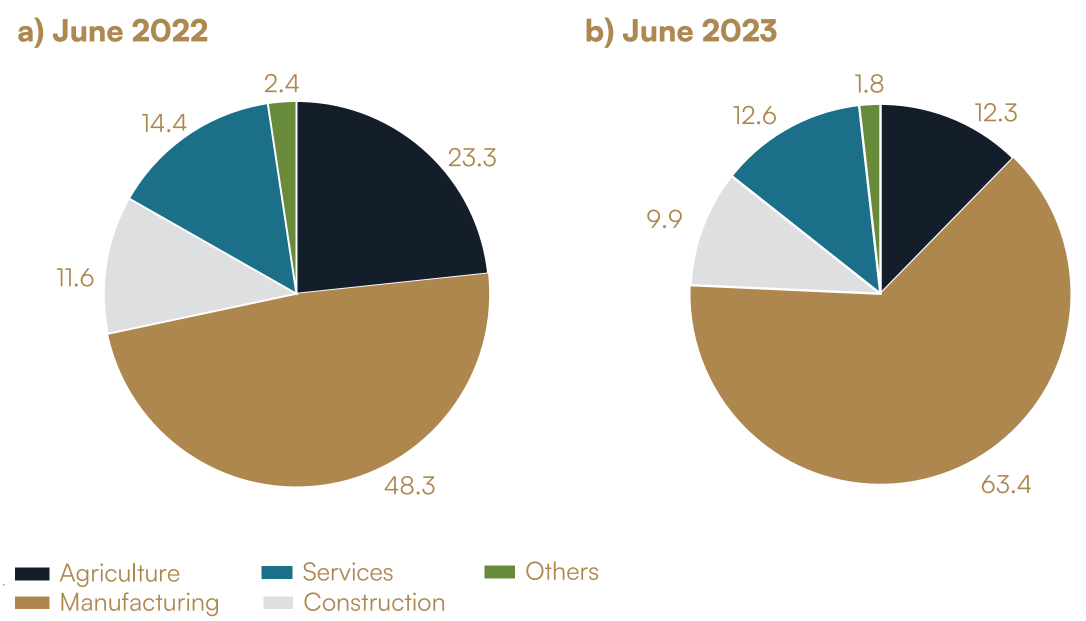
No	Major items	June 2019	June 2020	June 2021	June 2022	June 2023	Change 2022-2023 (%)
A	**Assets**						
1	Total liquid assets	956.1	775.5	972.3	891.4	756.7	(15.1)
2	CGF	735.9	981.8	1,550.0	2,173.1	2,767.4	27.3
3	Gross NPLs	116.2	84.8	82.3	60.2	140.1	132.8
4	Total assets	2,890.4	3,906.7	4,563.5	4,936.5	5,438.3	10.2
	Gross NPLs/CGF (%)	*15.8%*	*8.6%*	*5.3%*	*2.8%*	*5.1%*	
B	**Liability and Capital**						
5	Borrowings	1,213.3	1,611.8	2,145.0	2,470.5	3,167.2	28.2
6	Total capital	1,648.5	2,218.8	2,300.3	2,349.7	2,582.3	9.9

Source: NBE Database

Capital Goods Finance Companies do not accept deposits and rely on banks for a significant portion of their financing. This exposes Capital Goods Finance Companies to the risk of contagion from adverse shocks in the banking sector.

Sectoral concentration of loans granted by Capital Goods Finance Companies was high and increased in the year to end-June 2023 — the share of loans to the manufacturing sector grew from 48.3 percent to 63.4 percent (Figure 22) due to the nature of the business. This implies a high credit concentration risk from exposure to the manufacturing sector.

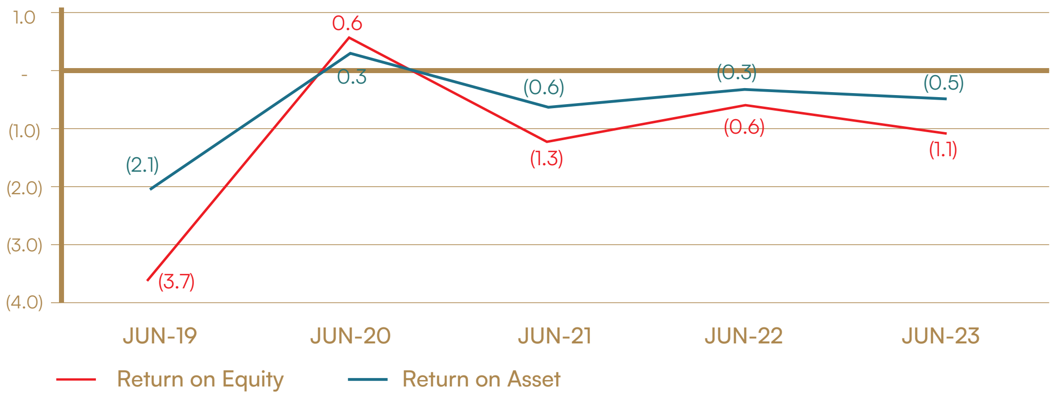
Figure 22: Capital Goods Finance by Client Sector, June 2022 and June 2023 (percent)



Source: NBE Database

In terms of profitability, the capital goods finance sector has incurred losses in four out of the last five years, including in the most recent two. Return on capital and return on assets stood at 1.1 percent and 0.5 percent at end-June 2023, respectively (Figure 23). This indicates a structural problem and high risk for the sustainability of operations, and it calls for corresponding policy measures to help the sector return to profitability.

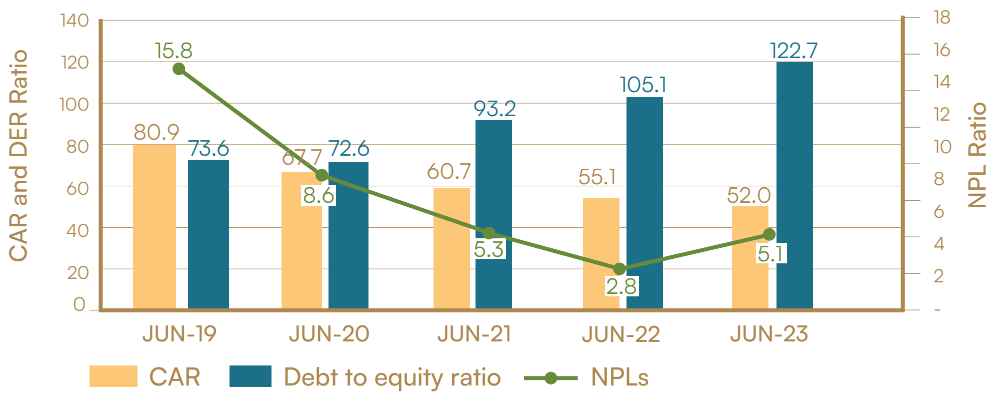
Figure 23: Major Profitability Indicators of the Capital Goods Finance Sector, 2019-2023 (percent)



Source: NBE Database, see Annex C

With respect to financial soundness, the sector is considered to be sound and facing limited although increasing risk (Figure 24). At end-June 2023, the capital-to-risk weighted asset ratio was 52.0 percent, the lowest since 2019, while the debt-to-equity ratio reached 122.7 percent, the highest since 2019 — but still far below the threshold debt-equity ratio of 7:1, which signals that the sector is still significantly below its maximum borrowing capacity.

Figure 24: Capital Goods Companies Soundness Indicators, 2019-2023 (percent)



Source: NBE Database, see Annex C

Overall, the capital goods finance business sector's risk is rated as moderate and stable. Capital risk is assessed as low; asset quality and systemic risk are rated moderate. However, earnings and concentration risks are rated high, and may require regulatory measures.

3.4 INSURANCE SECTOR

Ethiopia's insurance sector consists of general insurance and long-term insurance, and insurance companies need to have separate licenses for each. At end-June 2023, the insurance industry in Ethiopia consisted of one state-owned and 17 private insurers — 12 operate in both general and long-term insurance and the remaining six in general insurance only. At present, there are no insurance companies dedicated exclusively to providing long-term coverage. In addition, one locally incorporated Reinsurance Company, around 2,716 insurance agents, 62 insurance brokers, 114 loss assessors and three surveyors are operating in the sector. Africa Re and PTA Reinsurance Company (ZEP-RE), which have considerable presence in the sector, have contact offices in Ethiopia. These two reinsurance companies transact their reinsurance business in local currency.

NBE issued directives on minimum paid-up capital required for insurance companies and on risk-based internal audits. It also formulated a directive on external auditors, carries out both on-site inspections and off-site surveillance of insurance companies, and monitors the implementation of supervisory concerns to strengthen the resilience of insurance companies.

A. Performance of the Sector

At end-June 2023, total assets, liabilities, and capital of the insurance sector stood at Birr 49.7 billion, Birr 33.4 billion and Birr 16.3 billion, respectively (Table 11). While general insurance accounted for 90 percent or more of each, life insurance remained a nascent business. The insurance industry accounted for slightly less than two percent of the total assets of the financial sector, but saw an increase of 21.8 percent from the previous year.

The growth in assets is largely attributed to the increase in current assets of bank deposits, which constituted 39.0 percent of total assets and increased by 34.7 percent from the previous year. The 21.8 percent growth of total assets was financed by an increase in liabilities (by Birr 6.0 billion; 67.4 percent of the total asset increase) and equity (by Birr 2.9 billion, 32.6 percent of the total increase).

Table 11: Financial Performance of the Insurance Sector (billion Birr)

Item	June 2019	June 2020	June 2021	June 2022	June 2023	Change 2022-2023 (%)
Assets						
Total Assets	**20.8**	**29**	**39.1**	**40.8**	**49.7**	**21.8%**
Total Investment	13.2	15	19	22	28.9	31.4%
Investment In Equity	2.6	2.8	3.6	4.9	5.9	20.4%
Bank Deposit	9.5	10.3	13.3	14.4	19.4	34.7%
Current Assets	13.3	20.3	29.1	28.3	35.1	24.0%
Liabilities and Capital						
Total Liabilities	**12.7**	**19.4**	**28**	**27.4**	**33.4**	**21.9%**
Total Equity	**8.2**	**9.5**	**11.1**	**13.4**	**16.3**	**21.6%**
Current Liability	12.2	18.9	27.3	26.7	32.5	21.7%
Outstanding Claims	3.6	7.6	13.5	10.4	11.6	11.5%
Net profit/loss Before tax	1.9	2.3	2.7	3.3	4.1	24.2%

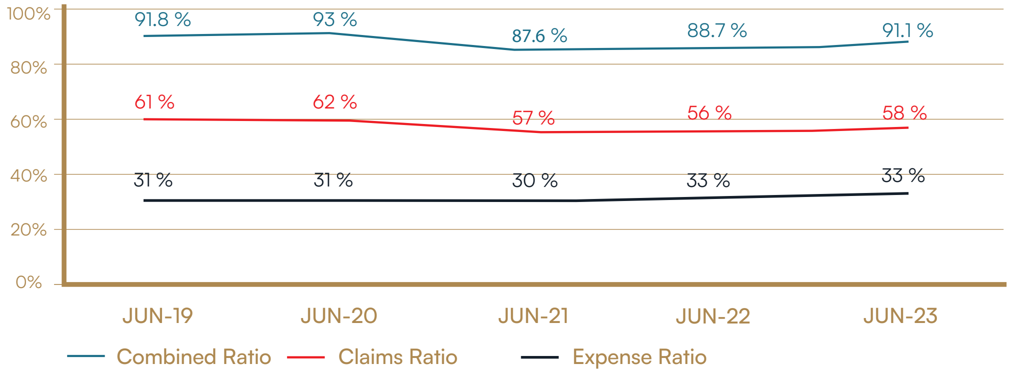
Source: NBE Database

The profitability of the sector is sound. It generated a net income before tax of Birr 3.7 billion and Birr 0.4 billion from the general and long-term insurance business, respectively, corresponding to a return on equity of 25.0 percent for both classes of business. However, inflation led to losses on insurers' fixed income holdings of bank deposits, their largest asset class. Five-year average return on investment of the sector was 10.0 percent.

The insurance sector's premium grew by 37.5 percent to Birr 22.9 billion at end-June 2023, roughly in line with the level of inflation (or reflecting about zero real growth). Compared to 7.8 percent growth of life insurance, the general insurance business increased at a faster rate by 40.1 percent to reach Birr 21.5 billion (see Annex D).

Profitability of the sector as measured by a combined ratio — the aggregation of the loss ratio (net incurred claims relative to net earned premium) and the expense ratio (underwriting expenses relative to net earned premium) — remained below 100 percent in 2019—2023, indicating that the sector is making profits from insurance operations (Figure 25). During this period, the historic loss-making motor class of the business exhibited improvements in claims ratio due to measures taken, which included increasing premium rates and a more cautious management of risks covered in this class of business.

Figure 25: General Insurance Business Operational Performance

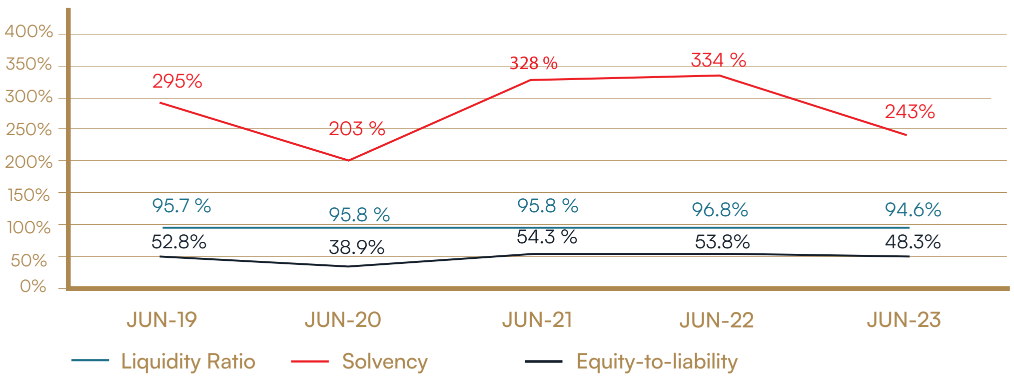


Source: NBE Database

Net claims to the industry grew by 46 percent from the previous year at end-June 2023, higher than inflation.

Equity as a percentage of liability stood at 48.3 percent, which is well above the 20 percent minimum prudential requirement. Solvency ratio — statutory capital to required capital — which is expected not to fall below 100 percent, stood at 243.0 percent. The sector is liquid with a liquidity ratio of 94.6 percent (Figure 26).

Figure 26: Key Soundness Indicators in the General Insurance Business, 2019-2023



Source: NBE Database

B. Risk Assessment and Outlook

The main risks faced by the insurance sector are insurance risk, operational risk, market risk, concentration risk, and risks due to the economic environment. Pressing concerns are market penetration, specifically in the life class of the business; a shortage of insurance professionals such as actuaries; and inadequate IT infrastructure in both the industry and regulatory body.

Risks due to the economic environment: Shortage of foreign currency for making premium payments to reinsurers significantly affects the business of insurance companies. Reinsurers may decline to provide risk coverage, potentially cancelling existing contracts when insurers fail to remit premiums in foreign currency as per their reinsurance contract terms and conditions. In addition, the shortage of foreign currency has an impact on some classes of business such as marine insurance.

Operational risk: Lack of technical expertise in insurance is a real constraint. Most insurance companies' operations continue to be underdeveloped and not automated. Insurance risk is the risk that inadequate or inappropriate underwriting, product design, pricing and claims settlement that expose an insurer to financial loss and a consequent inability to meet its liabilities. Ethiopia's insurance sector is known for its stiff price competition in all classes of business. Insufficient premiums could lead players in the industry into failure to meet obligations from claims.

Concentration risk: The government-owned insurance corporation accounts for 30 percent of the market share. In addition, the Ethiopian Reinsurance Company receives 25 percent of treaty cession and 5 percent of each policy insurer underwrite. Moreover, 55 percent of the general class of business is motor insurance.

Market Risk: The investment portfolio of insurers is restricted to bank deposits and government bonds. Such provisions inhibit insurers from earning higher returns that could have encouraged further development of the sector. Insurance companies are encouraged to invest in accordance with the applicable directive, as the policy contracts issued are short-term and require insurers to hold more liquid assets.

In sum, the industry is considered resilient and stable. NBE is currently taking steps to create an independent supervisory authority that is expected to have a positive impact on the performance of the industry. Technology development and automation are necessary to tackle operational risks. The sector also needs to build its capacity to expand the pool of insurance professionals.

3.5 Highlights on SACCOs and Pension Funds

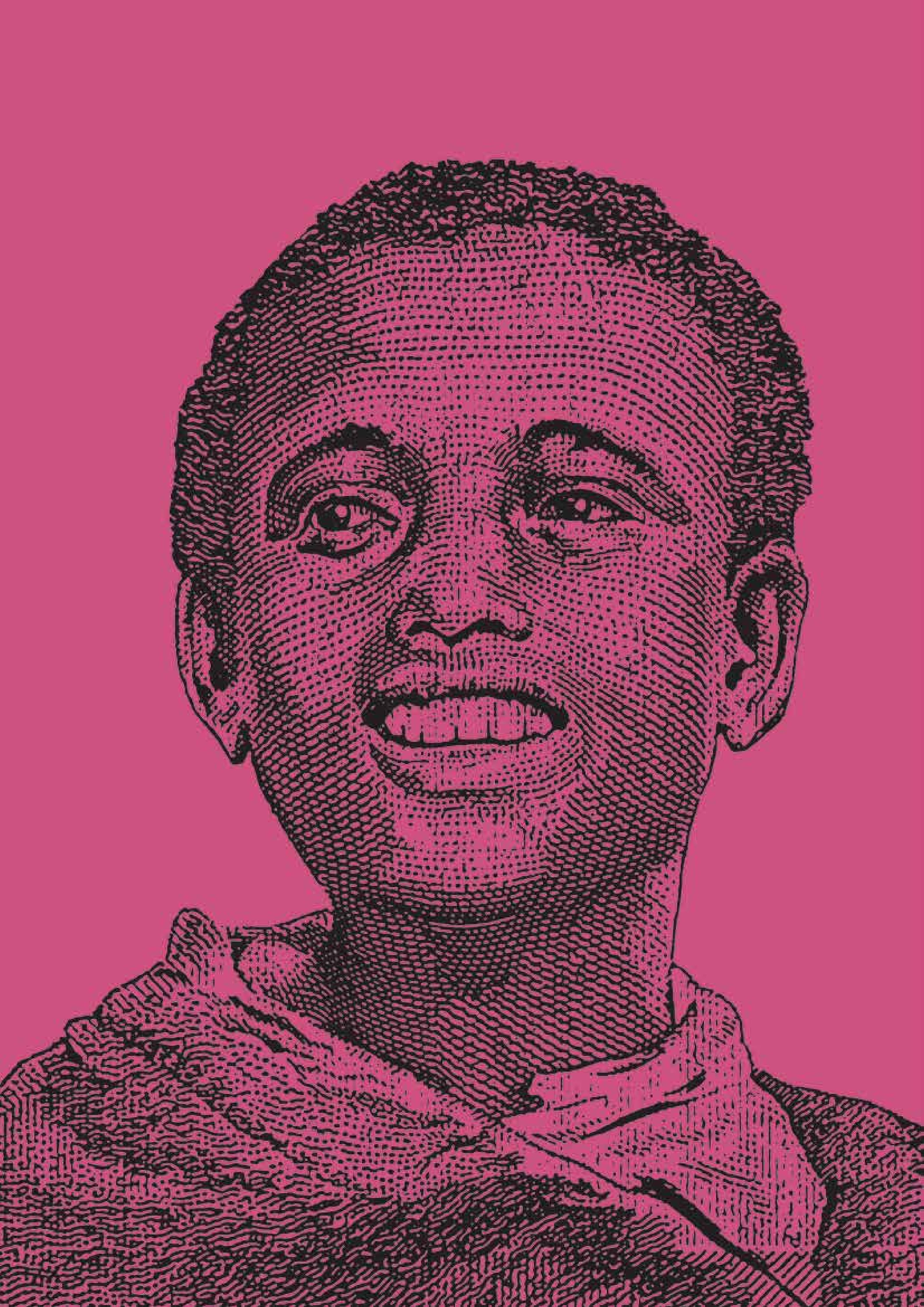
SACCOs

Ethiopia has a large network of SACCOs [26] — over 21,000 in total — which can play an important role in financial inclusion, especially in the underserved rural areas. Nevertheless, SACCOs have limited capacity to increase their market share due to limitations in size, skills, products, and operational models to be truly competitive financial institutions. From the point of view of financial system stability, SACCOs pose no systemic risk due to the limited size of the sector.

Pension funds

Pension funds in Ethiopia are administered by two agencies. They are the Public Employees Social Security Administration Agency as per provisions of Proclamation No.1267/2022 and the Private Organization Employees Social Security Fund Administration Agency as per the provisions of Proclamation No. 1268/2022.

[26] Cooperative societies in Ethiopia are established and administered in accordance with Proclamation No. 985/2016.



4.

FINANCIAL SYSTEM INFRASTRUCTURE DEVELOPMENT AND RISKS

4. FINANCIAL SYSTEM INFRASTRUCTURE DEVELOPMENT AND RISKS

This chapter discusses developments and risks for the stability of Ethiopia's financial system related to the infrastructure of the financial system. The infrastructure comprises currency management, the payment and settlement system, credit market infrastructure, and financial inclusion & consumer protection.

4.1 NATIONAL PAYMENT SYSTEMS DEVELOPMENT

Payment systems in Ethiopia were radically modernized in 2011 after NBE launched the Ethiopian Automated Transfer System (EATS), a modern clearing and settlement system. NBE owns and manages the payment system infrastructure. It includes the Real-Time Gross Settlement system (RTGS), which provides facilities for final settlement of payments between financial institutions; [27] and the Automated Clearing House (ACH), which provides clearing and netting services for bulk payments.[28] Before 2011, all payments in the country, including bank-to-bank transfers, were made through the exchange of letters; as a result, a single interbank transfer took days to be settled.

The dependency of the financial sector on the RTGS infrastructure has increased. Therefore, the safety and efficiency of RTGS has become critical for the stability of the financial system. The regulatory framework, which plays a very important role in this, needs to be constantly updated in line with technological and financial sector developments.

[27] The RTGS is an electronic form of funds transfer for high value or sensitive payments, where money transfer takes places from one participant to another in real-time and on an individual basis. All participants maintain a payment and settlement account in RTGS for final settlement of the transactions between them.

[28] ACH is a system where low value large volume transactions (bulk transactions) are cleared and a net settlement instruction is produced. It is an electronic clearing house for cheque, Credit Transfer (CT) and Direct Debit (DD) instruments. In ACH, settlement does not happen; rather, it produces net settlement instructions and sends them to RTGS for final settlement. Each instrument, which is cleared in the ACH, requires a separate rule and arrangement.

Box 2:
Payment System Regulatory Framework and Developments

The legal and regulatory framework plays a critical role in creating a safe, secure, and efficient enabling environment for inclusive payment services. The national payment system Proclamation No. 718/2011 and Proclamation No. 1282/2023, the payment system operators Directive No. ONPS/02/2020 and the payment instrument Directive No. ONPS/09/2023, among others, all constitute the current active regulatory framework to ensure the safety, security, and efficiency of the national payment system.

NBE has also taken initial steps toward enabling digital payments through the development of infrastructure, encouraging adoption of digital payments, revising regulations, and promoting innovation by launching National Digital Payments Strategy (NDPS). The vision of the NDPS is to build a secure, competitive, efficient, innovative, and responsible payment ecosystem to support a cash-lite and financially inclusive economy.

4.1.1 Payment Systems Performance

A. Ethiopian Automated Transfer System

At end-June 2023, 32 financial institutions had participated in EATS, of which two were MFIs. No major system interruption on EATS was reported in the year. The system processed more than Birr 3.9 million transactions (up by 35.2 percent from the previous year) with a value of more than Birr 4.8 trillion (an annual increase of 28.7 percent).

Table 12: EATS Performance, 2019-2023 (number and value of transactions)

DESCRIPTION	JUNE 2019	JUNE 2020	JUNE 2021	JUNE 2022	JUNE 2023
RTGS transactions					
Total number	211,460	720,666	1,734,409	2,739,763	3,901,069
Total value (billion Birr)	764.3	1814.1	2,598.2	3,754.8	4,863.2
Cheque transactions					
Total number	681,054	886,456	461,237	414,869	355,566
Total value (billion Birr)	35.4	54.0	48.9	52.1	43.9

Source: NBE Database

B. Digital Financial Services (DFSs)

Following a recent NBE directive, domestic non-bank payment service providers are allowed to issue electronic money instruments and/or obtain a payment systems operator license to provide payment and remittance services. Table 13 shows the development of DFS access points since 2019.

Table 13: DFS Access Points (channels and instruments), 2019-2023 (number)

Fiscal Year Ending	ATM Terminals	POS Terminals	Debit Cards (million)	Mobile Banking accounts (million)	Internet Banking accounts (million)	Mobile Money accounts (million)	Mobile Money Agents
June 2019	4,896	8,936	11.2	4.5	0.5	3.6	12,863
June 2020	6,259	9,780	16.0	9.1	1.5	8.0	22,725
June 2021	6,343	9,208	21.2	11.9	2.3	15.3	35,964
June 2022	6,902	11,760	30.7	16.3	4.4	43.3	156,876
June 2023	7,858	12,016	38.4	27.3	6.8	68.7	233,036
Change 2022-2023 (%)	*13.9%*	*2.2%*	*25.1%*	*67.5%*	*54.5%*	*58.7%*	*48.5%*

Source: NBE Database,

ATMs: The number of ATMs throughout the country grew by 13.9 percent from the previous year to 7,858 at end-June 2023.

Mobile Money Agents: The number of mobile money agents increased by almost half (48.5 percent) from the previous year and reached over 233 thousand at end-June 2023. The increase is mainly attributed to the entry of Telebirr in the market.

POS: The number of POS terminals deployed within financial institutions and at merchant locations increased slightly from the previous year by 2.2 percent to 12,016 at end-June 2023. Going forward, they are expected to expand further at a faster rate through the concerted effort of the private sector and the relevant authorities.

Debit Cards: The number of debit cards rose from the previous year by 25.1 percent to 38.4 million at end-June 2023 — a three and half fold increase in just four years.

Mobile Banking: Currently, mobile banking is considered to be the most convenient and accessible digital payment channel. Consequently, the number of registered accounts increased from the previous year by two-thirds (67.5 percent) to 27.3 million at end-June 2023.

The number of **mobile money/wallet** users increased by 58.7 percent from the previous year to 68.7 million at end-June 2023. The rapid growth was largely attributed to the introduction of Telebirr mobile money services by Ethio-telecom.

Internet banking is still relatively in its infancy with 6.8 million users at end-June 2023 but is growing rapidly.

Digital payments are growing at an exponential rate (Table 14). At end-June 2023, payments worth more than Birr 4.7 trillion were processed digitally, almost three times the value of the previous year. This growth is the result of successful implementation of the National Digital Payment Strategy and NBE's reform activities.

Table 14: Transactions processed through DFS, 2019-2023
(number of transactions and value in billion Birr)

Fiscal Year	ATM		POS		Mobile Banking		Internet Banking	
	Volume	Value	Volume	Value	Volume	Value	Volume	Value
Jun-19	99,529,312	87.4	2,259,754	5.3	4,697,907	29.7	256,135	15.0
Jun-20	153,191,706	142.1	1,358,651	4.8	11,623,265	68.4	525,284	22.5
Jun-21	225,603,984	236.1	2,951,802	7.4	39,560,999	326.2	2,411,331	26.6
Jun-22	171,068,129	197.5	2,339,255	62.2	88,012,896	1,163.6	1,094,038	129.6
Jun-23	356,384,957	478.3	6,601,796	40.8	474,917,286	3,442.6	5,804,292	358.1

Fiscal Year	Internet Banking		Agent Banking		Mobile Money Subscribers		Aggregate	
	Volume	Value	Volume	Value	Volume	Value	Volume	Value
Jun-19	256,135	15.0	2,275,304	0.9	2,309,618	1.1	111,328,030	139.54
Jun-20	525,284	22.5	4,241,547	1.4	4,241,512	3.0	175,181,965	242.20
Jun-21	2,411,331	26.6	22,999,839	8.9	7,246,442	5.9	300,774,397	611.18
Jun-22	1,094,038	129.6	34,392,909	23.0	48,502,862	24.4	345,410,089	1,600.24
Jun-23	5,804,292	358.1	101,948,951	76.5	298,826,380	380.3	1,244,483,662	4,776.77

Source: NBE Database,

4.1.2 Interoperability

Interoperability is key to a stable, successful, and inclusive digital payment ecosystem. The vast majority of countries worldwide have recognized the importance of a local switch that covers three functions: enabling interoperability through ATMs, POS devices, P2P, electronic payments, and more; providing an optimal infrastructure for banks to connect to; and allowing real-time payments 24/7.

The successful attainment of a local switch addressing these three items creates a strong foundation for the scaling-up of digital payments by promoting quick, safe, and efficient transactions. Eth-switch, since 2016, has enabled interoperability of ATMs and POS terminals operated by all banks. As a result, the number and value of transactions have grown exponentially (Table 15). Currently, it is also rolling out projects to achieve the interoperability of other digital payment platforms operated by all financial service providers in Ethiopia.

Table 15: Interoperability performance through ATM, POS and P2P, 2020-2023

	June 2020	June 2021	June 2022	June 2023
ATM transactions				
Number	15,044,699	24,166,034	39,894,113	71,433,041
Value (billion Birr)	12.78	26.56	44.9	89.7
POS transactions				
Number	1,107	109,506	361,317	970,434
Value (billion Birr)	1.02	0.2	0.3	2.6
P2P transactions				
Number	0	29,881	2,067,710	14,140,881
Value (billion Birr)	0	0.2	19.9	113.3

Source: NBE Database

4.1.3 Payment System Risk Assessment and Outlook

Payment systems risk includes potential losses to entities or individuals such as a bank's customers or third parties that send or receive payments. Accordingly, it is important for a bank's risk management practices and internal controls to evolve and keep up with changes in the bank's payment systems, products, and services. Like any other system globally, developments in the country's payment system are exposed to several risks, including operational, liquidity, compliance, reputation, settlement, and cybersecurity risks.

Operational risks refer to potential disruptions in the functioning of payment systems due to factors such as system failures, human errors, and operational deficiencies. The consequences of such risks can be far-reaching, including financial losses, reputational damage, and disruptions in financial services. No major disruptions hindering the smooth functioning of the payment system were reported at end-June 2023. However, maintenance of the operational resilience of the payment system in the future requires implementing and upgrading a robust IT infrastructure with redundancy, regularly testing disaster recovery, and business continuity plans.

Liquidity risk refers to the risk for participants from lack of sufficient funds to meet their settlement obligations, which leads to disruptions in the smooth functioning of the system and settlement failure. This reduces the efficiency and reliability of the payment system, affecting peer participants and their clients. At end-June 2023, short term liquidity problems were seen on the system by a few participants. NBE is working closely with the participants to resolve the issue.

Compliance risk refers to the potential for adverse consequences from failure to comply with relevant laws, regulations, and industry standards, leading to increased exposure to other risks such as operational, credit, and liquidity risks. At end-June

2023, no major compliance issues were registered. NBE has established robust regulatory frameworks to reduce the likelihood of non-compliance, and maintains a strong reputation for adherence to legal and regulatory standards.

Reputation risk refers to the potential for adverse consequences arising from negative public perception or damage to the payment system's failure to perform as expected, leading to loss of trust among participants, customers, and the public. At end-June 2023, no event occurred that would have led to a loss of trust from participants and customers. NBE will continue to regularly monitor the payment system to mitigate any potential risk.

Cybersecurity risks: Globally, attacks on information and communication technology systems (cyber-attacks) are increasing, targeting mainly the financial sector. This poses significant threat, among others, to the integrity, confidentiality, and availability of financial transactions, leading to data breaches, disruptions of services, fraudulent transactions, and reputational damage. At end-June 2023, no cybersecurity threats were reported to NBE by participants of EATS and by other DFS providers. Strong security controls, vendor security assessments, the establishment of redundant and backup systems, and collaboration with law enforcement agencies can reduce this risk and offer better protection against potential threats.

Overall, the national payment system is considered to be safe, efficient, and trusted by users; and it shall remain so going forward. The EATS and DFS products are expected to show continuous growth both in value and volume, and will continue to evolve and contribute to financial stability in Ethiopia.

4.2 CREDIT MARKET INFRASTRUCTURE

Ethiopia's Credit Reference Bureau (initially Credit Information Centre) was first established in 2004. Its main purpose was to lessen the difficulty of getting adequate and timely credit information that enables the satisfactory assessment of credit worthiness of borrowers in the banking sector. This will improve the loan portfolio and the stability of the banking system. Initially, credit information was made available to lending banks manually, and banks were mandated to grant loans and advances of Birr 200,000 or more only after first obtaining information from the Credit Information Centre. The system was upgraded and expanded in 2012 and then in 2019, [29] incorporating MFIs and Capital Goods Financing Companies as subscribers, data providers and users.

[29] NBE Directive No. CRB/02/2019 (as amended)

At end-June 2023, the total number of borrowers registered in the Credit Reference System (CRS) database stood at almost 4.4 million, a 1,992 percent increase from the previous year. The surge was mainly the consequence of incorporating borrowers from MFIs in the database. All banks and MFIs (a combined total of 83) are subscribers to the CRS.

Table 16: Credit Reference Bureau Statistics, 2019-2023

	June 2019	June 2020	June 2021	June 2022	June 2023
Number of subscribers to the CRS	19	19	19	23	83
Total number of borrowers listed in the CRS	108,917	131,167	170,456	208,090	4,354,141
Individual borrowers	99,419	120,728	157,541	193542	4,233,466
Non Individual borrowers	9,498	10,439	12,915	14548	120,675
Total number of credit accounts in the CRS	263,508	312,037	388,329	456,439	4,643,796

Source: NBE Database

In sum, the expansion in CRS coverage has contributed substantially to ensuring an adequate loan portfolio in the banking and MFI industries. Going forward, modernization of the CRS — including upgrading of the IT infrastructure, modernization and streamlining of databases, and updating of the service level agreements — will ensure that CRS' operational risk remains stable.

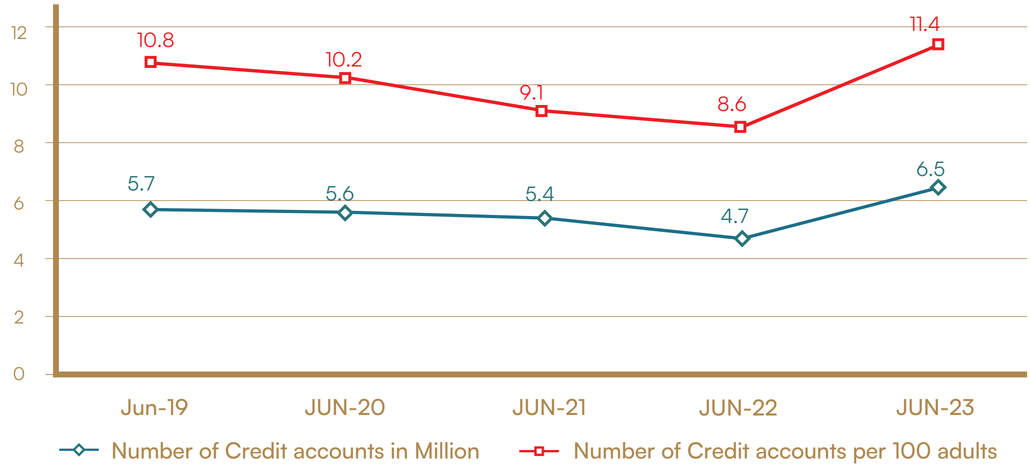
4.3 FINANCIAL INCLUSION AND CONSUMER PROTECTION

Financial inclusion is an essential prerequisite for sustainable development and will play a key role in the stability of the country's financial system, job creation, digital transformation, and Ethiopia's continued economic growth. It is a national priority and NBE's long-standing target. Financial inclusion makes a positive contribution to the stability of the financial sector by broadening the customer and deposit bases of financial institutions. It allows financial institutions to access diversified funding sources and improve their ability to manage their liquidity risks.

In response to these policy objectives, the first National Financial Inclusion Strategy of Ethiopia was implemented for five consecutive years 2016—2020, enabling ground-breaking regulatory and financial infrastructure improvements. The second National Financial Inclusion Strategy (NFIS-II) was issued in 2021 and will be implemented until 2025. It envisions achieving universal, high-quality, and sustainable financial inclusion; and ensuring that 70.0 percent of adults are included by 2025. Complementing the NFIS-II, NBE put into effect the National Financial Education Strategy in 2021 to address the financial capability and awareness gap among Ethiopian adults.

According to the recent Global Financial Findex report, total transaction account ownership has reached 46.0 percent in 2022, against 35.0 percent in 2017 and 22.0 percent in 2014. The adoption and usage of mobile money has increased by 60.0 percent and reached 69.6 million mobile accounts in June 2023, against 43.5 million a year before. The total number of credit accounts increased from 4.7 million in June 2022 to 6.5 million in June 2023 and accounted for a 38.3 percent growth rate (Figure 27). During the year, there were a total of 2.3 million new digital credit users. Credit accounts per 100 adults reached 11.4 at end-June 2023 against 8.6 at end-June 2022, turning around the decrease in the preceding years affected by the COVID-19 pandemic.

Figure 27: Number and Density of Credit Accounts, 2019-2023



Source: NBE Database

Financial consumer protection is another important intervention area by NBE. The Bank aims to enhance the trust and confidence of the general public by ensuring the protection of their interests. At the end of August 2020, NBE issued the Financial Consumer Protection Directive FCP/01/2020 to promote financial inclusion, ensure financial stability; and stimulate growth, innovation, and efficiency in the financial system. In 2023, NBE established a directorate dedicated to the supervision of the market, dispute resolution, and financial education to ensure financial consumer rights are fully protected and market confidence is maintained.

ANNEX

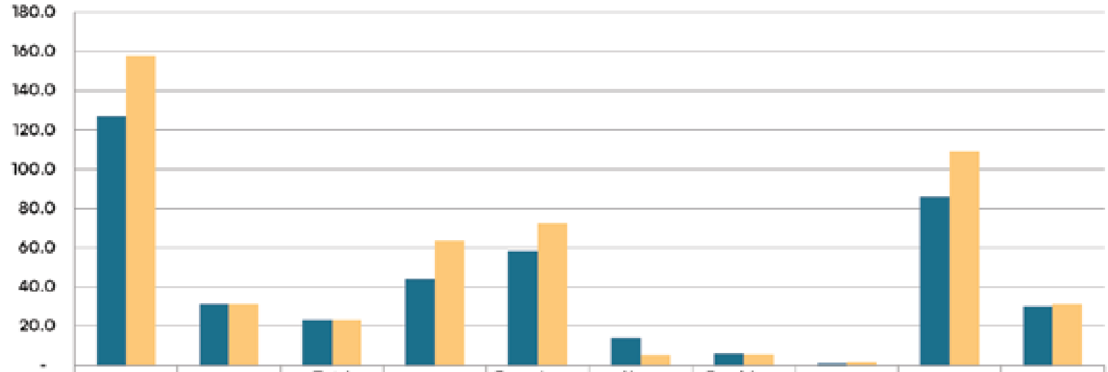
A. SELECTED FINANCIAL DATA FOR THE DBE

Table 17: DBE Key Balance Sheet Items and Ratios, June 2022-2023

	June 2022	June 2023	% Change
Items (billion Birr)			
Total Assets	126.7	157.8	24.53
Treasury Bills	31.1	31.1	-
Total Bonds(Excluding T-Bills)	23.1	23.0	-0.36
Total Liquid Assets	44.0	63.6	44.73
Gross Loans and Advances	58.2	72.4	24.46
Non-Performing Loans	14.1	5.1	-63.87
Provisions for Loan Loss	5.8	5.6	-3.63
Total Deposits	0.7	1.6	130.41
Borrowings	86.0	108.8	26.49
Total Capital	30.1	31.0	2.83
Ratios (percent)			**Change in percentage points**
NPLs to Total Loans	24.3	7.1	-17.2
Provisions to NPLs	41.3	117.5	76.2
Capital-to-Risk Weighted Asset	41.1	30.4	-10.6
Net worth to Risk weighted Assets	47.5	38.2	-9.3
Liquid Assets to Total Deposits	6391.7	4015.0	-2376.7
Liquid Assets to total loans	75.6	87.9	12.3

Source: DBE

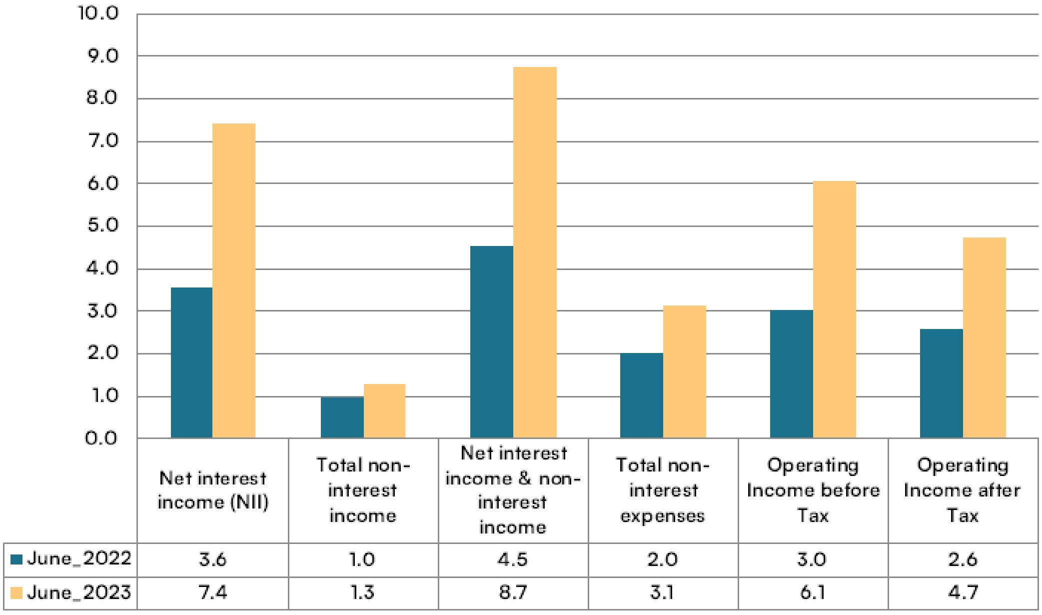
Figure 28: DBE Major Balance Sheet Items, June 2022-2023 (billion Birr)



	Total Assets	Treasury Bills	Total Bonds(Excluding T-Bills)	Total Liquid Assets	Gross Loans and Advances	Non-Performing Loans	Provisions for Loan Loss	Total Deposits	Borrowings	Total Capital
Jun-22	126.7	31.1	23.1	44.0	58.2	14.1	5.8	0.7	86.0	30.1
Jun-23	157.8	31.1	23.0	63.6	72.4	5.1	5.6	1.6	108.8	31.0

Source: DBE

Figure 29: DBE condensed Income Statement, June 2022-2023 (billion Birr)



	Net interest income (NII)	Total non-interest income	Net interest income & non-interest income	Total non-interest expenses	Operating Income before Tax	Operating Income after Tax
June_2022	3.6	1.0	4.5	2.0	3.0	2.6
June_2023	7.4	1.3	8.7	3.1	6.1	4.7

Source: DBE

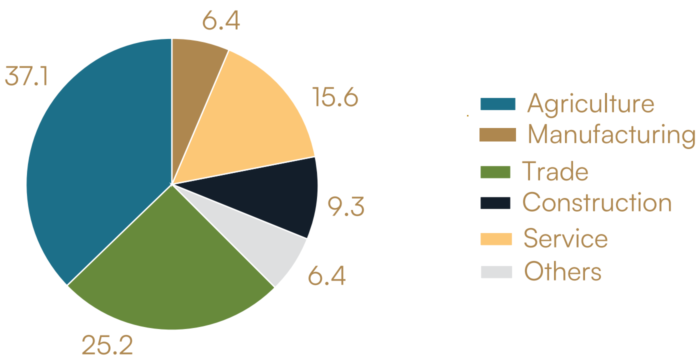
B. SELECTED FINANCIAL DATA FOR THE MICROFINANCE SECTOR

Table 18: Microfinance Loan Distribution by Sector, 2019-2023 (billion Birr)

Year	Agriculture	Trade	Manufacturing	Construction	Service	Others	Total
June 2019	6.7	3.9	1.1	0.9	1.7	1.3	15.6
June 2020	6.7	5.3	1.5	0.9	2.8	1.4	18.5
June 2021	7.1	6.0	1.7	1.1	3.8	1.7	21.3
June 2022	8.1	8.5	2.5	1.5	6.0	1.6	28.1
June 2023	7.3	14.6	3.8	5.0	6.7	1.7	39.1

Source: NBE Database

Figure 30: Distribution of MFIs' NPLs by Borrowing Sector, June 2023 (percent of total)



Source: NBE Database

Table 19: Major Profitability Items of the Microfinance Sector, 2019-2023 (billion Birr)

No	Major items	June 2019	June 2020	June 2021	June 2022	June 2023	Change 2022-2023 (%)
1	Total income	2.9	3.6	3.5	5.2	8.1	55.1
	O/w interest income	2.1	2.8	2.5	3.8	6.0	56.2
2	Total expense	2.2	3.0	2.6	3.6	5.9	61.4
	O/w interest expense	0.8	1.1	0.9	1.2	2.5	110.0
3	Net income before tax	0.7	0.5	0.9	1.6	2.2	40.8

Source: NBE Database

C. SELECTED FINANCIAL DATA FOR THE CAPITAL GOODS FINANCE BUSINESS SECTOR

Table 20: Capital Goods Finance by Sector, 2019-2023 (million Birr)

Items	June 2019	June 2020	June 2021	June 2022	June 2023	Change 2022-2023 (%)
Agriculture	20.4	151.1	370.3	506.7	341.1	(32.7)
Manufacturing	572.7	608.0	799.6	1,050.7	1,754.3	67.0
Construction	26.2	82.9	107.0	251.3	274.8	9.4
Services	104.8	96.7	221.0	312.7	347.4	11.1
Others	11.8	43.0	52.1	51.7	49.7	(4.0)
Total	**735.9**	**981.8**	**1,550.0**	**2,173.1**	**2,767.4**	**27.3**

Source: NBE Database

Table 21: Profitability of the Capital Goods Finance Sector, 2019-2023 (million Birr)

Items	June 2019	June 2020	June 2021	June 2022	June 2023	Change 2022-2023 (%)
Total income	141.2	248.1	397.1	371.8	537.7	44.6
Total expense	241.0	239.8	439.3	434.7	546.7	25.8
Net income/loss before tax	(60.3)	8.4	(1.0)	(17.3)	(28.6)	(65)
Return on equity (%)	(3.7)	0.6	(1.3)	(0.6)	(1.1)	(0.5)
Return on assets (%)	(2.1)	0.3	(0.6)	(0.3)	(0.5)	(0.2)

Source: NBE Database

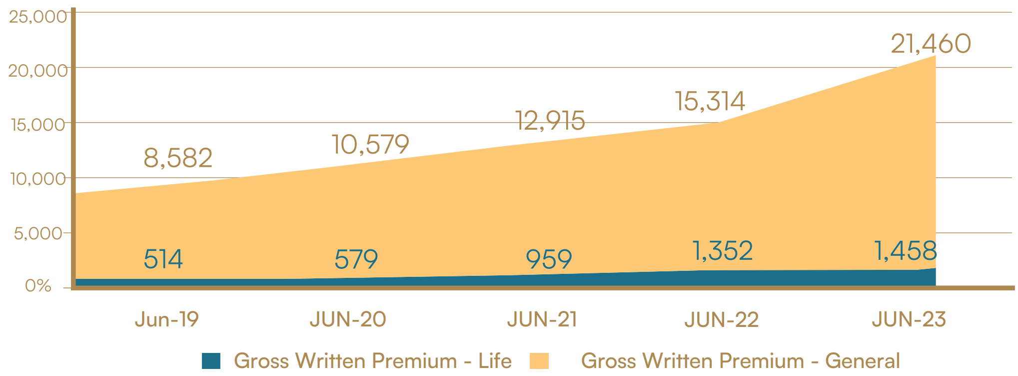
Table 22: Capital Goods Companies Soundness Indicators, 2019-2023 (percent)

No	Major items	June 2019	June 2020	June 2021	June 2022	June 2023	Change 2022-2023 (%)
1	**Capital Adequacy**						
	Capital to risk weighted assets (CAR)	80.9	67.7	60.7	55.1	52.0	(3.1)
	Debt to equity ratio	73.6	72.6	93.2	105.1	122.7	17.5
2	**Asset quality**						
	PAR>90 days to gross loans	15.8	8.6	5.3	2.8	5.1	2.3

Source: NBE Database

D. SELECTED FINANCIAL DATA FOR THE INSURANCE SECTOR

Figure 31: Gross Premium by Class of Business, 2019-2023 (million Birr)



Source: NBE Database

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