

Special Report

North African Bank Exposure to the International Financial Market Crisis: Why their Contagion Risk is Limited

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Introduction

At a time when financial markets have seen an unprecedented confidence crisis, resulting in a severe reduction in liquidity in the interbank market, the closing of some debt markets around the globe and a reduced risk appetite for emerging markets, Fitch Ratings would like to provide a better understanding of the extent of exposure of North African banks to this market turmoil. In this comment, the agency has analysed the potential for the global financial crisis to spread to those North African markets that it covers (namely Moroccan, Tunisian and Algerian banks).

Moroccan Banking System

Based on Fitch's consultation with the Moroccan Central Bank, Bank-Al-Maghrib (BAM), the Moroccan banking system appears to be in a position to withstand the global market turmoil. The exposure of Moroccan banks to foreign financial markets is limited as the country's tight regulatory framework has prevented significant exposure to foreign counterparties despite a gradual easing since 2007. As a result, only a tiny part of total banking assets and liabilities are invested in foreign currencies (4% and 3%, respectively, at end-August 2008). FX assets are mainly in the form of deposits with banks (mostly French banks, and to a lesser extent UK, various European banks, Gulf Cooperation Council (GCC) and US banks). Since mid-September 2008, banks have reduced their interbank exposures to potentially troubled entities through netting and, currently, they have no exposure to failed US banks and neither have they incurred losses. Few FX assets are invested in government debt securities. Other FX assets are related to investments in subsidiaries in relation to particular Moroccan banks' business mix and expansion strategies. These are Attijariwafa Bank (AWB), BMCE Bank (BMCE) and to a lesser extent Crédit Populaire du Maroc, respectively, the second-, third- and first-largest Moroccan banks.

On the liabilities side, funding is largely domestic, retail-based and MAD-denominated. Client deposits grew by 11% in the first nine months of 2008 and the trend is continuing so far. FX exposure liabilities include deposits in FX from non residents (representing a low 1% of total client deposits) and exporters, the risk being that these funds could have been transferred to banks located in countries with a 100% state-guarantee on deposits or to better-rated foreign banks. BAM has stated that there have been no substantial outflows. On the domestic interbank market, banks' needs for FX funds are fulfilled by BAM and medium-term loans granted by foreign banks are very scarce. FX transactions are client-driven and relate mostly to trade finance. Derivatives are virtually all client-driven, and include commodities and FX options, for which risks are moderate. Financial innovation (structured products offered to Moroccan pension funds to replace their excess liquidity, based on European equity or commodity indices) that was developing in 2007 stopped with the crisis.

The share of total banking assets held by foreign investors (mainly majority French shareholders) has reached 22% at end-September 2008. BAM considers that most minority shareholders (for example, Groupe Caisse d'Epargne holds 1% in Caisse des Depots, Credit Mutuel-CIC holds 10% in BMCE, Groupe Caisse d'Epargne holds 23.4% in Crédit Immobilier et Hôtelier) have a historical participation and are very unlikely to sell in the near future.

Risk of capital outflows from the local equity market exists as mutual and pension funds are reducing their emerging market exposure as liquidity needs increased and vulnerabilities have risen in a number of emerging markets (Central and Eastern Europe, Asia, GCC). However, even if flows to equity markets have reversed in Morocco in October 2008, they represent a small part of the total equity markets. BAM anticipates that the current international crisis and its negative impact on the world economy will have a minor effect on Morocco's economy: forecasts for the average 2008 and 2009 GDP growth are at 6.5% and 5% respectively.

Tunisian Banking System

The picture for the Tunisian banking system is not very different from the Moroccan one in its exposure to the global financial crisis, and Fitch expects good resilience from Tunisian banks to the international banking turmoil.

Strict regulatory controls on exchange (namely limits on foreign borrowings from financial institutions and corporates, prohibition of investing in foreign capital markets, restrictions on FX and derivatives transactions) resulted in a limited exposure of onshore banks to the international financial markets. Offshore banks, which are subject to a smoother regulation and supervision from the Tunisian central bank (BCT), represented a low part of total banking assets (7% at end-April 2008). Although available information is poor, Fitch views it unlikely that the financial crisis could spread through offshore banks to the Tunisian banking system.

Banks' FX assets accounted for 8% of total bank assets at end-April 2008, and were largely dominated by deposits with banks, with a minor exposure to the international debt market filtering through from offshore banks (0.3% of total banking assets at end-April 2008). Fitch believes that these figures remained in the same range in Q308. Although data were not available to the agency to get a more precise picture, it does not expect Tunisian onshore banks to undergo losses from any possible exposure to troubled banking entities or to the failed banks in the US as these are not traditional counterparties to the Tunisian banks. In addition, the business of Tunisian banks is predominantly domestic and exposure through subsidiaries is low as these are only operating in countries largely isolated from the current global financial crisis (ECOWAS countries).

On the liabilities side, liquidity is supported by increasing client deposits, which represent the bulk of bank funding. Fitch estimates that offshore client deposits which may be potentially more volatile, should account for not more than 12% of total client deposits. In addition, liquidity in the local TND-interbank market remains comfortable and FX-funding from foreign sources is minor. FX deposits (clients and interbank) accounted for 12% of balance sheet footings at end-April 2008 (9% when excluding offshore banks). Medium- and long-term funding from foreign banks to Tunisian onshore banks is small (less than 10% of banks' funding) and is exclusively related to FX resources provided by multilateral/supranational financial institutions. There is no reliance on the international debt market. FX transactions are largely client-driven and trade finance-related. Derivative positions are scarce and limited to swaps and are nearly all client-driven. FX transactions are largely made with foreign counterparties, traditionally European banks. However, as for Moroccan banks, Fitch expects Tunisian banks facing more costly and less external FX short-term financing from foreign banks to switch to the Tunisian central bank counterparty, which used to be the historical counterparty until recent times.

The share of total banking assets held by foreign investors (mainly majority French shareholders) has reached 37% (when excluding unlisted banks), predominantly related to strategic investors. Fitch remains convinced that the French banks will maintain their investments in the Tunisian banking market as part of their strategy is to expand their retail business. The impact of any capital outflow from equity markets is limited in Tunisia as foreign strategic and non-strategic investors

represented a moderate and fairly stable 22% of the total equity markets on 17 October 2008. However, local investors have become nervous since October and prices have been globally trending down since then, with the Tunisian stock exchange index “TUNINDEX” plunging by 11.6% in the first three weeks of October, although still up by 18.1% yoy. This very much reflected an excessive reduction in confidence from investors stemming from the worldwide financial markets depression rather than an anticipation of some deterioration in corporate and financial institutions’ fundamentals, as listed companies broadly reported improving performance in Q308, with similar expectations for FY08. However, this may indicate rising doubts on the Tunisian economy’s ability to withstand a harsher and longer than expected worldwide economy slowdown. BCT considers the Tunisian local economy as resilient: average GDP growth is expected to be around 5.5% in 2008. For 2009, Tunisia’s GDP growth should be similar to 2008 according to Fitch’s expectations, showing moderate signs of impact from the European recession. In terms of inflation, Fitch anticipates a 5% average rate in 2008 (4.5% at end-August 2008) and 4% in 2009.

Algerian Banking System

Similar to Morocco and Tunisia, Algerian banks appear largely shielded from any liquidity pressure or exposure to international financial markets. Most resident banks (which account for the bulk of banking assets) enjoy good loans/deposits ratios, supported by a broad base of customer deposits, and are little dependent on wholesale market funding. Transactions on the interbank market are permitted only when DZD-denominated. Spreads on the interbank market have increased only slightly in the last months, and remain acceptable to market participants. In addition, the local banking regulation prohibits resident banks from taking on foreign banking counterparty risk in FX and banks have the obligation to place all their FX deposits with the local central bank (“Banque d’Algérie”, ‘BDA’) and all FX transactions are done with the BDA. FX deposits represented a small 8% of total client deposits at end-August 2008 and a negligible part was related to non-resident clients. Resident banks are also not allowed to invest in foreign assets nor grant loans to non-resident entities.

The performance and solidity of Algerian banks will continue to mirror the quality of their operating environment. According to the IMF analysis, the Algerian economic environment, which remains tightly state-controlled, should remain favourable by end-2008 and in 2009. GDP increased by 4.6% in 2007 and IMF expects it to grow by 4.9% in 2008 and 4.5% in 2009.

Conclusion

On the whole, Fitch views that the Moroccan, Tunisian and Algerian financial banking sectors are broadly immune to the international financial crisis and possible negative impacts on banks would be very limited. Any contagion would come from the macroeconomic side, as GDP in advanced European countries (the main economic partners of North African countries) is strongly likely to fall sharply in 2008 and 2009 according to Fitch forecasts, with recession announced in 2009 and no recovery anticipated before 2010 (see Fitch’s special report entitled “*Global Economic Outlook*” available at www.fitchratings.com). The IMF’s forecasts indicate that the current international financial crisis and subsequent economic slowdown would have a moderate impact on North African countries’ GDP growth in 2008 and 2009. However, a question-mark may remain about the continued ability of those countries to resist a longstanding global economic deceleration. Banks could therefore report lower performance and asset quality deterioration as a result of less favourable local macroeconomic environments. This may exacerbate the banking system’s current problems such as weak asset quality and capitalisation, and jeopardise the recent progress achieved by Moroccan and Tunisian banks in this regard.

Appendix

Ratings Assigned by Fitch to North African Banks

	Foreign Currency LT IDR/Outlook	Foreign Currency ST IDR	Individual Rating	Support Rating	Support Rating Floor
Morocco					
Attijariwafa Bank	BB+/Stable	B	C/D	3	BB+
BMCE Bank	n.r.	n.r.	n.r.	3	n.a.
Société Générale Marocaine de Banques	n.r.	n.r.	n.r.	2	n.a.
Crédit du Maroc	n.r.	n.r.	n.r.	2	n.a.
Banque Marocaine du Commerce et de l'Industrie ^a	n.r.	n.r.	n.r.	2	n.a.
Tunisia					
Société Tunisienne de Banque	n.r.	n.r.	n.r.	2	n.a.
Banque Nationale Agricole	n.r.	n.r.	n.r.	2	n.a.
Banque de l'Habitat	n.r.	n.r.	n.r.	2	n.a.
Banque Internationale Arabe de Tunisie	n.r.	n.r.	n.r.	2	n.a.
Amen Bank	n.r.	n.r.	n.r.	3	n.a.
Arab Tunisian Bank	BBB+/Stable	F2	D	2	n.a.
Union Bancaire pour le Commerce et l'Industrie	n.r.	n.r.	n.r.	2	n.a.
Banque Tuniso-Koweïtienne	n.r.	n.r.	n.r.	2	n.a.
Banque de Tunisie et des Emirats	n.r.	n.r.	n.r.	2	n.a.
Algeria					
BNPParibas Al-Djazair ^b	n.r.	n.r.	n.r.	3	n.a.

^a rated 'AAA(mar)'/F1+(mar)/Stable Outlook on the Moroccan national scale

^b rated 'AAA(dza)'/F1+(dza)/Stable Outlook on the Algerian national scale

Source: Fitch

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