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Coping with Price Spikes: The Impact of Food & Fuel Inflation on MFIs

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Peter Siu (CGAP)

Third in a *Microfinance Learning and Innovations After Hours* mini-series on the impact of the global financial crisis on MFIs & their clients.

February 11, 2009



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USAID/MD

- First Generation: Capitalize MFIs
- Second Generation: Aid MFIs access private capital
- 3G: ?



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“Crisis is a terrible thing to waste!”

- Inflation
- Financial



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EFFECTS OF FOOD INFLATION ON MFIS AND BORROWERS

Tanir Helayel (MF Analytics)

February 11, 2009



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Background

- MF Analytics (“MFA”) undertook a survey-based study to qualify & quantify food and fuel inflation’s effects on MFIs & their clients.

THE PROBLEM:

- Unprecedented demand for grains due to increased prosperity in Emerging Markets & demand for biofuels in Western Markets have led to rising food prices.
- Early 2008: median inflation in developing countries had risen from 3.9% to 7.7%, with 1/3 of these countries experiencing 10%+ inflation.
- In the past, individuals in these countries would spend approx. 45% of their income on food & fuel but now spend 50%+.
- 42% of the world’s population may face double digit inflation which will drive over 100 million people into poverty.

THE SURVEY

- Responses collected from 96 individuals (senior management, loan officers & borrowers) across 8 MFIs in Nicaragua, Haiti & Bangladesh.
- These 8 MFIs represent 6.7 million borrowers and loans outstanding of USD 787 million.

PARTICIPATING MFIS						
Country	MFI	Portfolio (USD)	Borrowers	PAR 30 (%)	As of	
Nicaragua	Prestanic	18,701,979	12,921	4.4	Jun-08	
	FAMA	38,047,527	42,918	4.8	Jun-08	
	FDL	53,263,569	71,992	1.6	Dec-07	
Haiti	SOGESOL	11,611,185	11,776	7.6	Jun-08	
	Fonkoze	8,286,168	20,916	13.8	Jun-08	
	ACME	9,696,289	20,112	5.6	Jun-08	
Bangladesh	BRAC	631,032,626	6,397,635	2.3	Jun-08	
	Shakti	16,610,216	145,888	1.3	Dec-07	



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Inflation Proxies

No indicator, no matter how well correlated to inflation, can be assumed to be caused by inflation. Therefore MFA looked for correlation across these three proxies which, if found, would imply causality with inflation.

**Delinquency
Rate**

- Borrowers shift income to basic needs; there is less money to service debt.
- Borrowers loan from multiple MFIs & find themselves borrowing to service debt.

**Loan
Restructuring**

- MFIs use this to keep their delinquency #s artificially low; measuring the # of restructurings can shed light on the inflation effect.

**Shifting Loan Type
in Portfolio**

- MFIs may shift capital deployments away from borrowers most at risk of inflation, e.g. originating more agriculture loans & and less urban consumption loans.



Results From the MFIs

EFFECT

REASON

Higher Delinquencies

- § Borrower's can no longer afford servicing debt
- § Borrower's incomes have decreased (not due to inflation)

Higher Operating Costs

- § Cost of fuel
- § Increase in salaries

Lower Return on Invested Capital

- § Higher bad debt reserve
- § Lower real interest income

Restructuring

- § The frequency and term of payments are changing, but not the amount or interest payments



Results From the Borrowers

EFFECT

Shift in Consumption Patterns

Increase in Debt

Asset Sales

REASON

- § Reallocated monies from debt service to other basic necessities
- § Eating less
- § Spending less on education & healthcare

- § Loan officers noted an increase in borrowing from friends in family
- § Borrowers did not validate this phenomenon

- § In Bangladesh and Haiti assets have been sold to cover increased living costs, though this effect isn't yet as strong as expected



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Mitigants to the Inflation Effect

Borrowers:

- Inflation lowers value of outstanding debts so payments are less burdensome w/high inflation. But does their income rise in line with inflation? (Unlikely for workers in the service & manufacturing sectors –i.e. most borrowers).
- Many ag industry borrowers should see a rise in income related to increasing grain prices. Unfortunately the rising prices are often captured by intermediaries, not the small farmers.

MFIs

- MFI loans are typically short duration & have a natural hedge against inflation as interest rates are reset every time they mature.



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Recommended Actions

- Risk management is key. Often senior management isn't aware of delinquency trends in their portfolio and therefore can't act in anticipation of problems.
- Index loans to inflation.
- Inflation indexed savings products.
- Diversify capital structure such that the currency mismatches aren't as pronounced as they currently are. Conversely better utilize currency hedges.



Advancing financial access for the world's poor

The Impact of Food & Fuel Inflation on MFIs

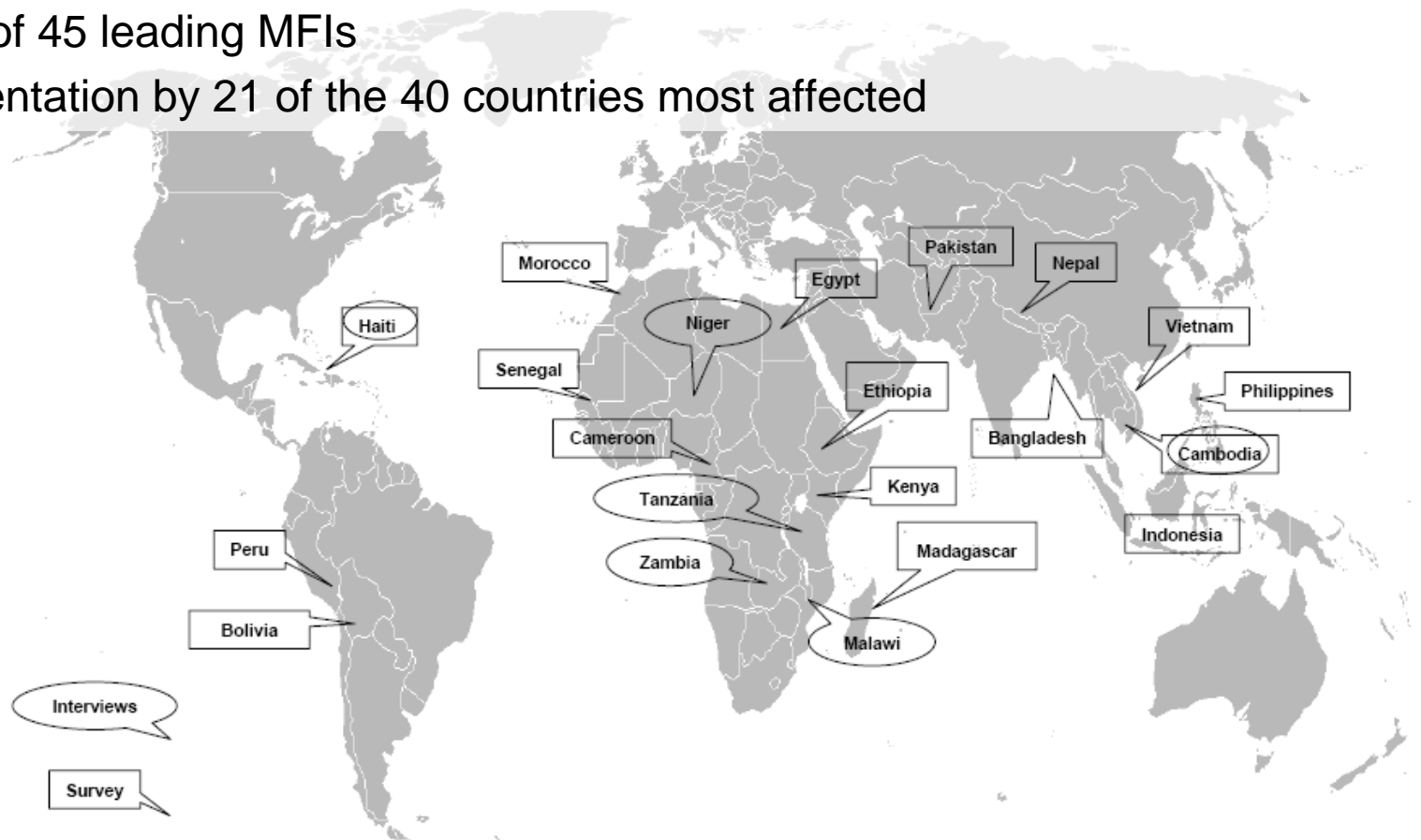
Peter Siu (psiu@worldbank.org)

February 11, 2009

CGAP's Survey on the Food Crisis

Background on the survey

- Undertaken in August 2008 by Eric Duflos and Barbara Gähwiler
- Survey of 45 leading MFIs
- Representation by 21 of the 40 countries most affected



What is the impact of inflation on MFIs and their borrowers?

Most Frequent Impact on MFIs

>70% Increased operating costs

“We had to increase our salaries more than planned.”

Alexandria Business Association, Egypt

>50% It's harder to collect savings

>40% We cannot reach our plans (e.g., expansion, diversification)

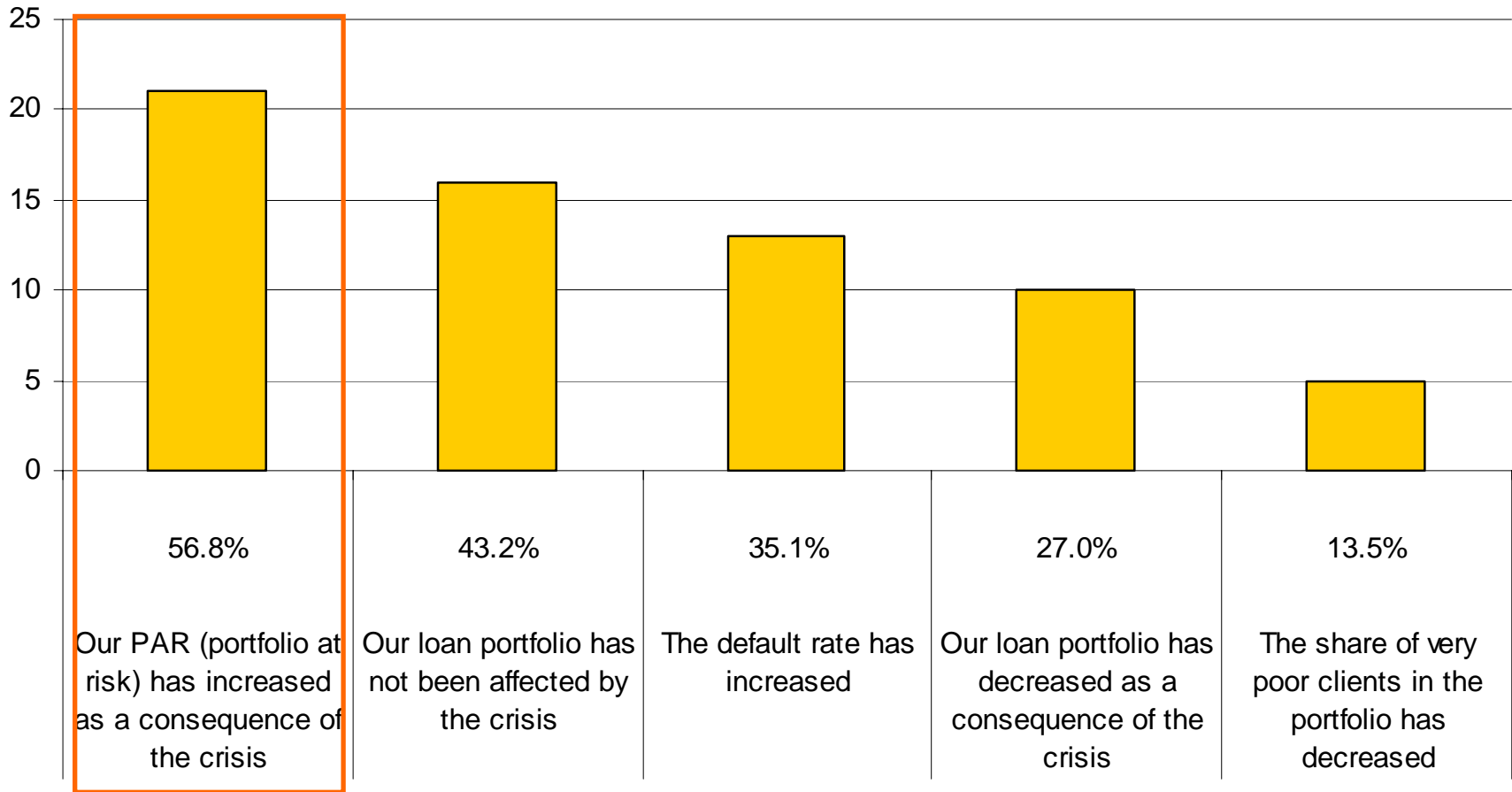
>25% We face liquidity problems

Only 3 / 45 MFIs say their organization has not been affected by the crisis

Source: 2008 CGAP Food Crisis Survey

What is the impact of inflation on MFIs and their borrowers?

Impacts on MFI loan portfolios



What is the impact of inflation on MFIs and their borrowers?

Another 100 million people will fall into poverty

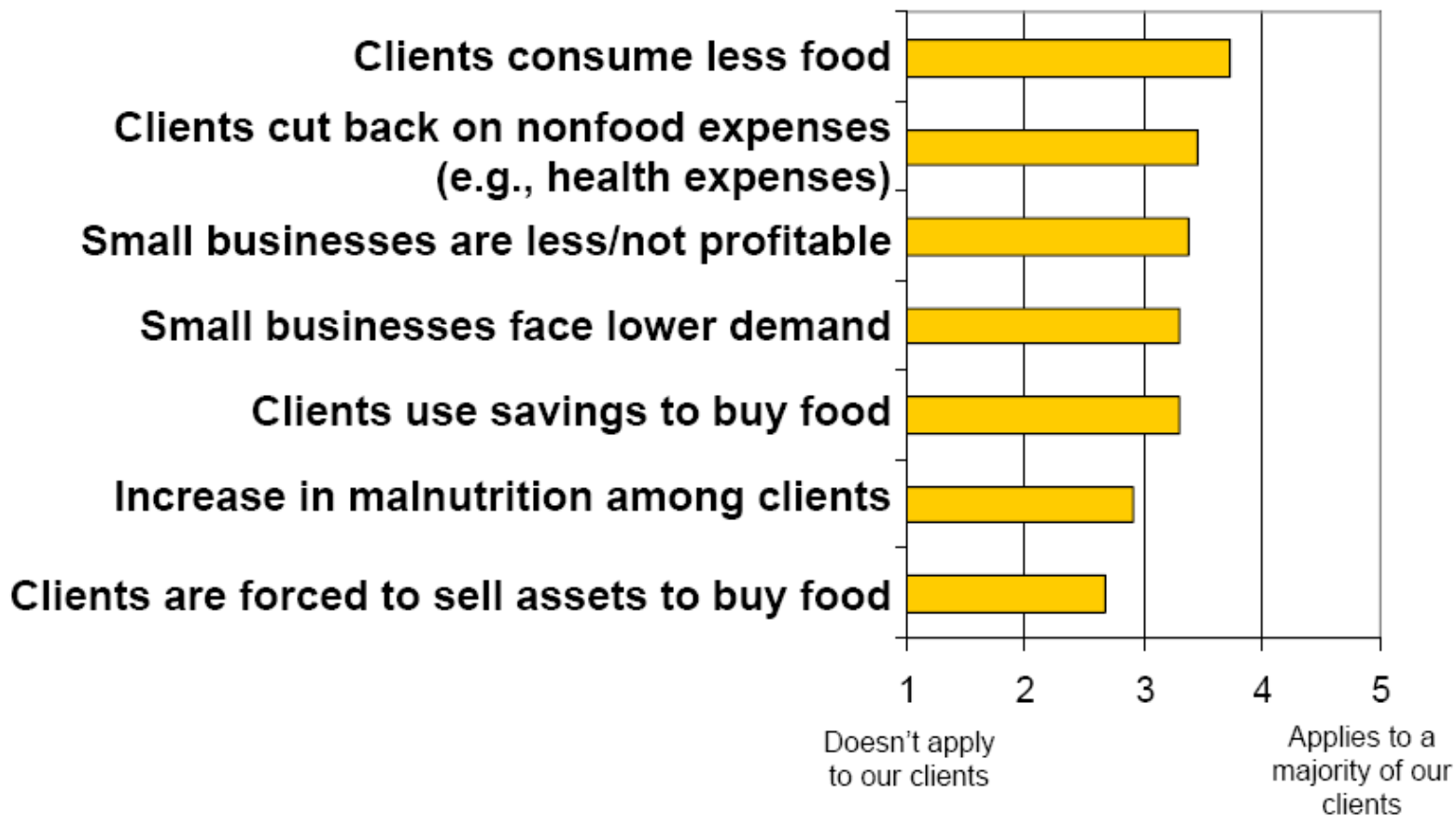
The rising food and fuel prices may have negative impact on human development in four dimensions by:

1. Increasing poverty
2. Worsening nutrition
3. Reducing the utilization of education and health services
4. Depleting the productive assets of the poor

Source: Guidance for Responses from the Human Development Sectors to Rising Food and Fuel Prices, World Bank, August 2008

What is the impact of inflation on MFIs and their borrowers?

Impact on Clients

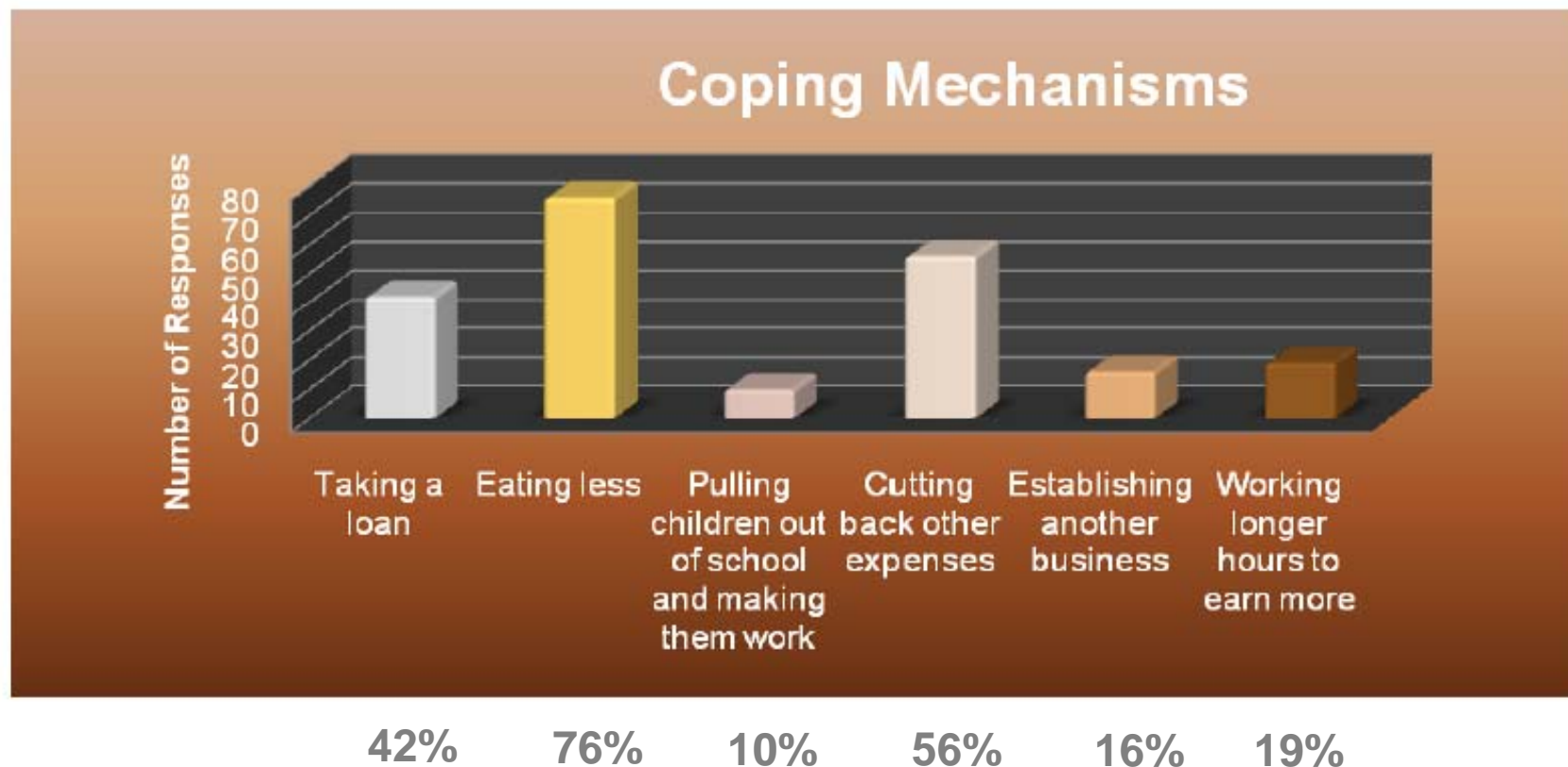


Rating Average on a scale from 1 to 5

Source: 2008 CGAP Food Crisis Survey

What is the impact of inflation on MFIs and their borrowers?

Zoom in on Kashf



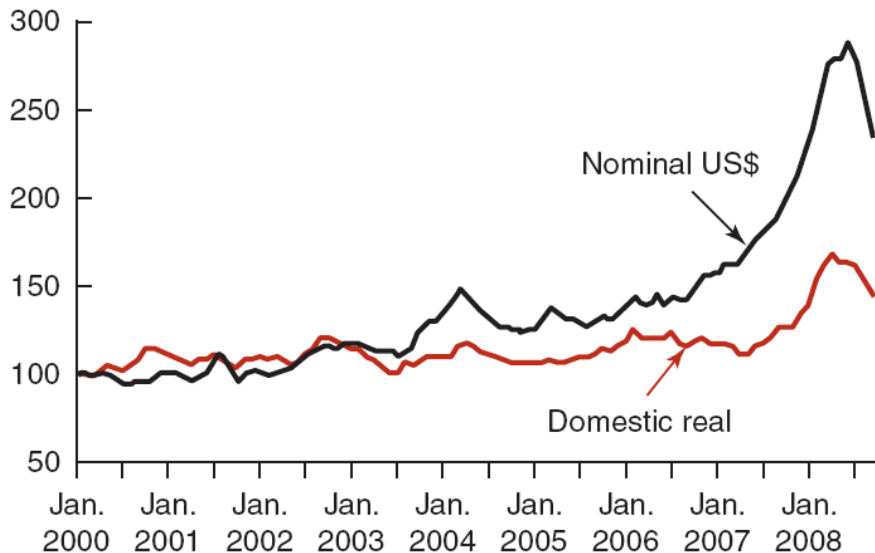
Source: Food Security Study: Identifying trends of food consumption of Group Lending microfinance clients, Kashf Foundation/Pakistan, September 2008

Is this a temporary problem or a permanent market issue?

Food prices will likely continue to fall

Food price indexes

US\$ nominal and domestic CPI-deflated price indexes
(Jan. 2000 = 100)



Source: World Bank.

Note: Individual country data deflated by local consumer price index and aggregated by country shares in global imports.

“However, they [commodity prices] still remain a lot higher than they were at the start of the boom and are expected to remain higher than during the 1990s over the next 20 years, owing to biofuel-driven demand for food grains.

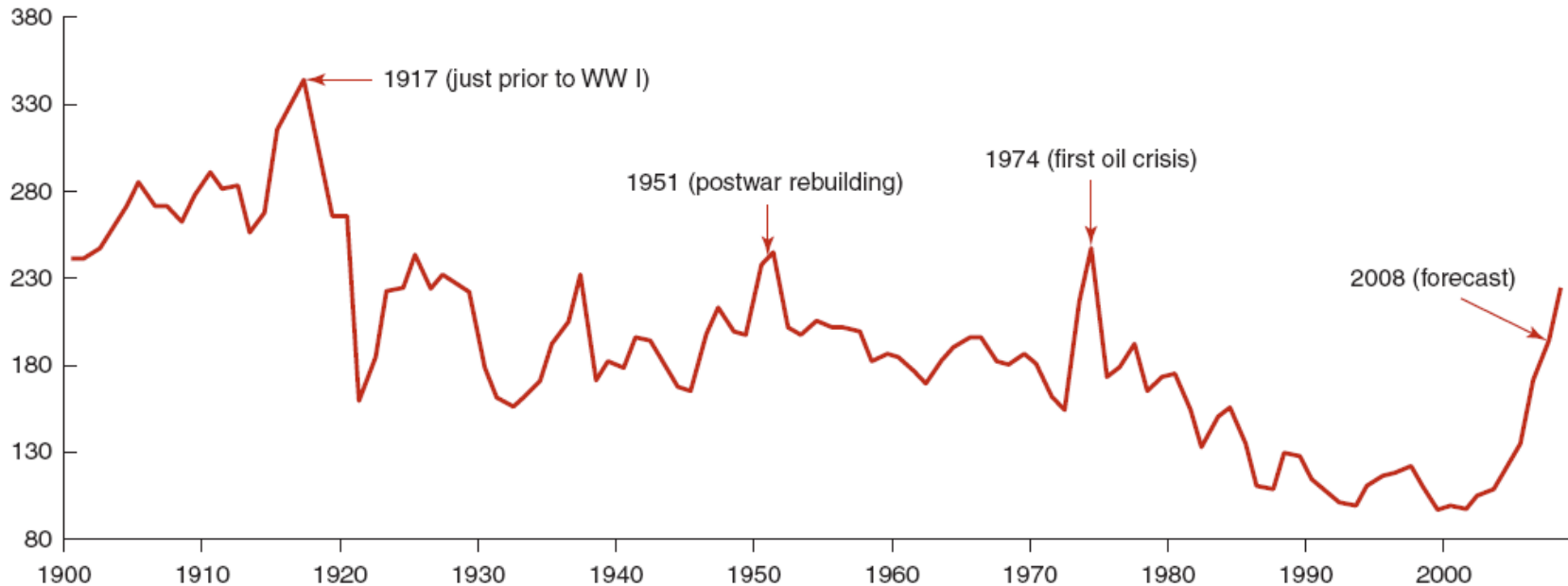
Oil prices are likely to average about \$75 a barrel next year and, for the next five years, **real food prices** worldwide are expected to **remain about 25 percent higher** than they were in the 1990s.”

Global Economic Prospects 2009: Commodities at the Crossroads; World Bank

Is this a temporary problem or a permanent market issue?

“The recent commodity boom was the largest and longest of any boom since 1900”

Real non-energy commodity prices, index (1977–79 = 100)



Source: Grilli and Yang (1988) for 1900 to 1947; World Bank for 1948 to 2008.

Is this a temporary problem or a permanent market issue?



But:

- Food prices may rise
- Local shortages may occur

“**Food prices may rise** because a **lack of credit for farmers** curbed their ability to buy seeds and fertilizers and may limit production, Nestle SA Chairman Peter Brabeck-Letmathe said.

‘Many farmers over the world didn't have access in October, November, December for credits,’ the chairman of the world's biggest food company said in an interview at the World Economic Forum in Davos, Switzerland, on Jan. 31. ‘They were **limited in acquiring seed and acquiring fertilizer.**’“

- *Food to Rise on Lack of Credit, Nestle's Brabeck Says*, Bloomberg 2/2/09

How do MFIs cope or manage inflation risk?

Most frequent measures taken:

- >50%** Finding solutions on a case-by-case basis
- >40%** Applying a more flexible loan policy
- >30%** Increasing loan sizes to compensate for inflation
- >25%** Rescheduling loans
- >20%** Working together with relief organizations

Only 4 out of 45 MFIs give out food

Source: 2008 CGAP Food Crisis Survey

What role can the development community play in addressing this problem?

What role should microfinance play?

- >75%** Microfinance should serve as an instrument to increase agricultural production
- >75%** MFIs should adapt their policies to alleviate the consequences of the food crisis as long as this does not affect their financial sustainability
- >50%** MFIs should focus on expanding access to finance and not take up relief activities
- >40%** MFIs should take up emergency measures to assist people suffering from the crisis
- >30%** MFIs should serve as a channel to distribute aid (food/money)

Source: 2008 CGAP Food Crisis Survey

What role can the development community play in addressing this problem?

Takeaways for MFIs

1. Focus on core business while adopt measures to reduce risks of bad debt
2. Support relief efforts in a constructive way that is appropriate to MFI capacities

“We sponsor food, but don’t distribute it ourselves. We don’t want to dilute our image. We are a financial service provider, not a relief organization.”

Pride, Tanzania

3. Improve risk management practices
4. Support strengthened agricultural value chains

What role can the development community play in addressing this problem?

Takeaways for governments

1. Preserve macro-economic stability and avoid export restrictions
2. Promote agriculture without imposing interest rate subsidies
3. Play a role in strengthening social safety nets

What role can the development community play in addressing this problem?

Takeaways for donors and investors

1. Assist MFIs in adopting better risk management
2. Foster the development of long term, diversified funding sources
3. Help rural MFIs develop adapted products for farmers on basis of global lessons learned



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MINISTRY FOR FOREIGN AFFAIRS OF FINLAND



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Thank you!

A screencast of this presentation will be available shortly at www.microlinks.org/afterhours.

For more news and resources on the global financial crisis, visit www.microlinks.org/financialcrisis.

The fourth seminar in this mini-series,
on “Savings and the Crisis,”
will take place in March 2009.