

By Zaved Ahmed and Camilla Nestor, Grameen Foundation

# FEATURE ARTICLES

MICROBANKING BULLETIN, ISSUE 18, SPRING 2009

Approximately 1 billion people — or nearly one-sixth of the world's population — subsist on less than USD 1 per day. Of this population, 162 million survive on less than USD 0.50 per day. According to the International Food Policy Research Institute, increasing food prices have the greatest effect on poor and food-insecure populations, who spend between 70 and 85 percent of their household income on food. This issue is especially acute for the poorest people within developing countries — the very clients that many microfinance institutions (MFIs) serve. This article will provide a general overview of the evolving global situation surrounding inflation linked to increasing food commodity prices and its impact on microfinance institutions supported by Grameen Foundation and their clients.

During mid–2008, rising food prices, particularly for staples like rice, soybeans and wheat, raised significant concern in the microfinance community given the disproportionate impact of such high prices on microfinance clientele and the potential effects on the clients' long-term health and food security, as well as on the MFIs. While global attention has largely turned away from this issue to focus on the global financial meltdown, the reality is that food prices in developing countries remain elevated — in many cases above international market prices — and continue to negatively impact microfinance clients.

Although global food prices have come down from the mid – 2008 highs, data from the United Nations Food and Agriculture Organization (FAO) indicate that this has not trickled down to the retail level. For example, the price of rice — the principal source of food for much of the developing world — remains significantly higher in most developing countries than it was in December 2006. To demonstrate this, Grameen Foundation looked at retail prices of rice in 10 countries during the period 2007 to 2008. In our calculations, we took quarterly data listed on the FAO website and indexed it against Q1 2007 prices. **Table 1** highlights this.

Even as the price of rice fell from the mid–2008 highs, on average, the price of rice in these countries increased 50 percent between late 2006 and 2008. This has forced families who previously spent up to 85 percent of their income on food to either eat less or consider ways to increase their income. Conversely, some microfinance clients are fortunate enough that family members are paid in food grains. Anup Kumar Singh, Managing Director of Sonata in India observed the role the informal 'barter system' has played to balance the increased cost of food: "As wages, most of the agricultural laborers are not receiving cash, but they receive 5 kg grains...per day. During the harvesting season they try to earn as much as they can... to meet their other daily expenses. They [make] purchases against the exchange of stored grains."

**Table 1** Index of Retail Prices of Rice by Quarter

	Bangladesh	Brazil	Egypt	India	Mozambique	Pakistan	Peru	Philippines	Senegal	Vietnam
1Q 07	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
2Q 07	100.05	96.32	100.00	100.00	100.78	122.36	99.30	102.37	92.40	98.02
3Q 07	110.48	96.32	110.25	100.00	101.71	122.36	105.96	106.48	99.20	99.82
4Q 07	144.06	102.45	112.70	113.33	120.34	130.80	112.63	106.39	107.60	112.16
1Q 08	160.85	107.36	153.69	120.00	123.38	174.26	116.14	136.01	120.00	124.92
2Q 08	160.70	142.33	148.77	133.33	143.65	200.00	135.44	162.07	186.80	184.64
3Q 08	150.38	137.42	N/A	146.67	148.64	200.00	142.81	N/A	184.00	163.11
4Q 08	124.26	126.99	N/A	146.67	156.04	199.83	142.46	N/A	180.00	151.04

There are several reasons for the disconnect between international market prices and retail prices in developing countries. As reported by the Financial Times: "Food aid officials attribute the disconnect between local and international food prices to time lags, poor harvests in developing countries and... lack of trade finance."<sup>1</sup> We researched the possibility that excess profiteering by wholesalers was another cause of the disconnect, but this did not bear out in the analysis.<sup>2</sup>

High food prices are likely to persist in the medium term. While forecasts in the current environment are subject to considerable uncertainty, the World Bank expects food prices will remain high in 2009 and 2010.

**Table 2** shows that prices are likely to remain well above 2004 levels through 2015 for most food crops. These forecasts are broadly consistent with those of other agencies such as United States Department of Agriculture and the FAO. While world grain production is forecast to grow, increased utilization is expected to lead to a decline in stocks in the 2008/2009 crop year. The FAO predicts that total grain end stocks will reach a 25 – year low by the end of crop year 2008/2009.

## Impact on Microfinance Borrowers

**Change in food consumption:** During GF's conversations with MFIs, they raised serious concerns about the quantity of food consumed by their borrowers. The increased costs of essentials are forcing them to eat less. Dr. Aris Alip, Managing Director of CARD in the Philippines brought this out: "The immediate impact on our clients was on food security. I heard stories of mothers cutting down on consumption of meat (from once a week to once

a month) or for worse-off clients, cooking rice into porridge so a kilo of rice would suffice for a day for a family of six."

In the short-run, such frugal practices by microfinance clients may not have a significant impact, but if continued on a prolonged basis, can lead to permanent health damage to them and their families.

**Depletion of Savings with MFIs:** In some of the countries where MFIs are allowed to accept savings, MFIs have started reporting a decrease in the voluntary savings rate. It is still too early to determine if this is a general trend or is restricted to specific regions or countries. However, some MFIs have noticed that mature clients are withdrawing their savings to finance their working capital needs, instead of taking a new loan. This has been reported by MFIs in Philippines and in Nigeria.

For MFIs that offer savings, this trend has naturally impacted savings as a funding source for the MFI. It has also reduced the cushion that clients might have to weather continued price increases.

**Loan Funds Diverted for Consumption:** In extreme cases, clients may be diverting loan funds to buy essentials to survive. MFIs have to maintain close contact with clients to identify those who are hit the hardest by inflationary pressures and take specific measures to align loan purpose with usage.

**Higher Incidence of School Drop-outs:** Some GF partner MFIs reported that their borrowers have stopped sending their children to school so that children can support the family's income generating activities. This may have severe repercussions on borrowers' struggle to break free from the cycle of

<b>Table 2 Index of Projected Real Food Crop Prices (2004 = 100)</b>					
	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2015</b>
Maize	139	175	165	155	148
Wheat	154	215	191	166	140
Rice	130	243	208	183	160
Soybeans	119	156	147	139	115
Soybean Oil	136	187	173	160	110
Sugar	133	157	167	176	182

SOURCE: The World Bank

<sup>1</sup> 'Poor still hit by high food prices, says UN' Javier Blas, Financial Times, March 19, 2008.

<sup>2</sup> To test this hypothesis, GF did an analysis comparing retail and wholesale prices of rice in four countries; there was not a significant differential between the retail and wholesale prices, indicating that middlemen are not at fault for driving the prices up. Lack of reliable data prevented us from testing this with a larger sample size.

poverty. In Pakistan, one MFI informally reported that the drop-out level of clients' children has almost doubled during this period.

**Impact on Loan Sizes:** The impact on loan sizes is not consistent. In some countries, microfinance borrowers are requesting larger loans, driven in part by the increased cost of running their existing ventures. In other cases, the borrowers feel the need to establish new ventures to make ends meet, creating additional funding pressure for MFIs. For example, the average loan size for the three MFIs GF works with in Nigeria has increased by 45 percent during the last 12 months.

On the other hand, some MFIs are reporting decreased demand and in turn, decreasing average loan sizes. For example, in the Philippines, Dr. Alip of CARD said: "What is striking is that our clients are themselves reducing their borrowing (eligible for Peso 5,000 but they will now borrow Peso 3,000) since they say that business is not good." It seems that basic business practice of frugality during tough times may be lost on certain Wall Street executives, but not on poor borrowers in the Philippines.

## Impact on the MFI

The impacts noted below are driven in part by inflation (fueled by food price increases) but are also attributable to the global financial meltdown. Given the interconnected nature of global financial and economic trends, it is not possible to cleanly separate the impact of one particular driver from the others; as such, GF has noted the general trends it is seeing among the MFIs it supports below.

**Portfolio Quality:** Although it was expected that rising food prices would impact clients' ability to repay, based on the 4Q 2008 data, there is no rise yet in delinquencies among GF's partners. Nevertheless, several MFI leaders have noted that they expect to

see an uptick in portfolio at risk (PAR) if food prices remain elevated.

**Refinancing Risk:** As has been reported elsewhere, refinancing risk is a major issue facing MFIs due to the twin pressures of contracting liquidity in local bank markets and among some of the microfinance investment vehicles, coupled with a reduction in risk appetite by lenders. The inability to refinance on attractive terms, or in some cases at all, will likely slow MFI growth significantly in 2009. Among the 20 MFIs in GF's Growth Guarantees portfolio, average quarterly growth slowed to 11.2 percent in Q4 2008 from 25.0 percent in Q4 2007.

**Increased Operating Expenses:** The nature of the microfinance industry is such that wages and salaries are the single largest expense component for most MFIs. Inflation will naturally drive wages and salaries up. Hence, MFIs will either have to find a way to absorb most of this increase or face the unattractive option of raising interest rates to end borrowers.

The world in general has moved on from the food price issue and is focusing all of its resources on combating the financial sector meltdown. That coupled with the drop in international food prices from mid-2008 highs has led to a situation where the food price issue hardly registers on the radar screen now. As we have shown, however, local food prices are not tracking international prices, and it is clear that a prolonged period of continued elevated food prices will have a significant impact on microfinance clientele.

To date, clients have shown an amazing degree of resiliency and innovation in absorbing the increase in food prices. However, these clients' coping remedies may have significant long term consequences on their families' well being — the impact of which is still too early to measure.