



Economic Situation and Strategy

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Microcredits: a profitable concept for poverty reduction?

Today we can buy almost anything on credit: Bicycles, cars, houses. We even borrow the tuition fees. But not everyone has so much leeway. Especially people in emerging countries with low incomes often have no access to credit. Microcredits are one possible solution. They are designed to help people help themselves and have been an important instrument of development work in recent decades. Microfinance is aimed at financial inclusion and supports people with low incomes in starting, expanding or maintaining an income-generating activity. This is intended to strengthen the lower middle class in emerging countries and contribute to the stabilization of these economies. Overall, around two thirds of microfinance customers worldwide are women.

Muhammad Yunus: The banker of the poor

The Bangladeshi economist Muhammad Yunus has been fighting poverty since the 1970s. In order to create a fairer financial system, he founded the Grameen Bank ("Rural Bank") in his home country in the early 1980s, the world's first microfinance institution to grant small loans to poor people and small businesses in developing countries. Yunus received the Nobel Peace Prize for this in 2006 and became known as the "banker of the poor". Microloans usually involve loan amounts of 50 to 1,500 euros and have a short term of one to two years. There are now a whole range of such credit institutions, which in turn work together with investment companies.

How is the lending process structured? Microloans are granted by so-called microfinance institutions, or MFIs for short, which are usually based in emerging and developing countries. Of course, they do not lend the money for free: the interest rates are usually much higher than those charged by banks. This may sound like exploitation at first, but local money lenders also charge higher interest rates. Only part of the interest on loans flows into the coffers of the MFIs. The institutions in turn pay interest to cooperating banks or investment companies, which collect money for the MFIs via funds. In Germany, the products available to most investors are structured as bond funds, as microfinance funds generally invest in unsecured loans to selected microfinance institutions in emerging and developing countries.

At the end of 2022, the assets managed by microfinance funds amounted to around USD 20.4 billion. Ten years ago, this figure was just under USD 10 billion.¹ This growth is partly due to the introduction of new technologies such as online banking, which facilitates access for people in developing countries. On the other hand, the demand for sustainable investments is increasing. Microfinance funds are classified as Article 9 funds under the EU Disclosure Regulation.

Is it worth investing in microloans?

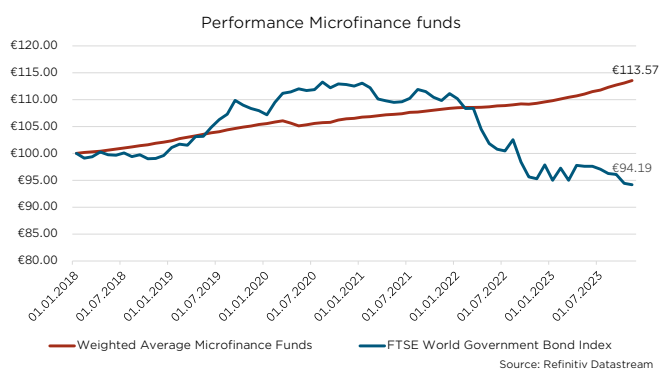
According to a recent study by Scope, which examined twelve microfinance funds, the average net return of microfinance funds in 2022 was around three percent. Over a three-year period, the average return was 1.71 percent p.a., and 2.40 percent p.a. over a five-year period. At first glance, these yields do not appear particularly attractive.

¹ source: [https://www.scopegroup.com/dam/jcr:4a57a467-bfde-48e1-8775-8143ef6712a1/Scope](https://www.scopegroup.com/dam/jcr:4a57a467-bfde-48e1-8775-8143ef6712a1/Scope%20Marktanalyse) percent20Marktanalyse

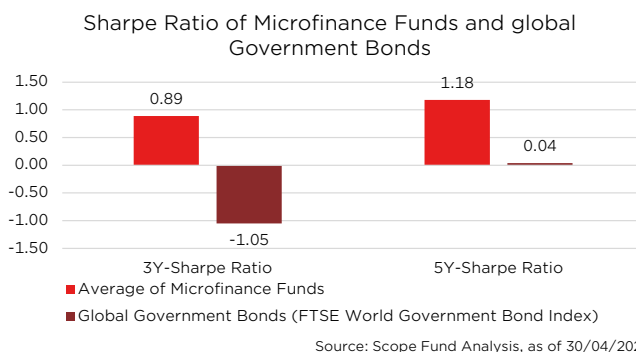
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However, it is interesting to note that these returns were achieved consistently and thus relatively independently of the market environment. Eleven out of twelve microfinance funds in Germany achieved price gains in 2022, even though the market environment was difficult and bond and equity funds predominantly suffered price losses. At 1.82 percent over the last three years and 1.67 percent over the last five years, the average volatility of the microcredit funds analyzed by Scope is significantly lower than in other bond segments.

The low price fluctuations and the relatively low but steady returns can be clearly seen in the volume-weighted average price performance of the microcredit funds licensed in Germany compared to a global government bond index (example: FTSE World Government Bond Index).² The chart also shows that investments in microloans as an asset class have a rather low correlation to traditional bond or equity products and therefore have a stabilizing effect on a portfolio.



The attractive return and risk characteristics of microfinance funds are also confirmed by the Scope study. It examined the Sharpe ratios of twelve microfinance funds and came to the conclusion that they have had a more efficient risk/return profile over the last three and five years than a global bond fund and have therefore generated a higher return per point of risk.



What if the loans default?

The microfinance model may be reminiscent of P2P loans. However, microfinance funds have a low default rate, so the probability of a total loss for the investor is low. Each microfinance fund invests in several MFIs, which in turn grant loans to many small borrowers. This broad diversification means that the default risk is low. As investors invest in microloans via a fund shell, their invested capital is considered a separate asset. This means that it is held separately from the fund company's assets and cannot be used to settle debts in the event of the fund company's insolvency.

Do microloans really fight poverty?

An admixture of microfinance funds therefore makes perfect sense from an investor's point of view. But do microloans also have a positive effect on the real economy? Critics doubt this. Generally speaking, there have been few reliable studies on this topic to date. It is clear that microcredits are not sufficient as the sole instrument for combating poverty.³ Microloans can neither strengthen the infrastructure nor the education systems in the countries concerned, let alone contribute to the observance of human rights. Other critics warn that microloans can drive their recipients into a debt trap. Cambodia in particular is often mentioned in this context. According to reports, up to 50 percent of Cambodians were over-indebted or at risk of over-indebtedness in 2017. The corona crisis has further exacerbated this development.⁴ However, it can be noted that in the past, microloans based on the innovative concept of Muhammad Yunus have succeeded in channeling funds directly to those affected and creating an offer for self-help.

² Only micro-funds that are structured as bond funds and invest in debt instruments are taken into account.

³ source: <https://www.dw.com/de/mikrokredite-kein-allheilmittel-gegen-armut/a-51123088>, 28.02.2024

⁴ source: <https://www.fian.de/wp-content/uploads/2022/02/FIAN-Ueberschuldungsstudie-Studie-17.02.pdf>, 28.02.2024

What is our conclusion?

Around 50 years ago, Muhammad Yunus established microfinance as an important instrument for fighting poverty. Even though the market has grown in recent years, it remains manageable. At around two percent p.a., the average net return has not been exorbitantly high in recent years, but it has remained very constant. In view of the low interest rates that will prevail until July 2022 and a difficult year 2022, this is not a bad result. Rising yields for corporate and government bonds in 2023, which were hardly taken into account in the Scope study, will also make the conditions for microloans from MFIs more expensive in the long term and have a positive impact on

the return expectations of microfinance funds. However, the low price fluctuations in particular and the associated good Sharpe ratios also speak in favor of investing in microloans. In addition, all microfinance funds licensed in Germany are classified as article 9 funds and are therefore suitable for sustainability-oriented investors. Even for opportunity-oriented investors, an admixture of microfinance funds can make sense, as steady profits can be expected even in difficult market phases, thus offering valuable diversification potential at portfolio level.

We would like to thank Jan Mooren for his active support for this article.

Market data

Stock markets	As of	Change versus				
	01.03.2024 1003	23.02.2024 -1 week	31.01.2024 -1 month	30.11.2023 -3 months	28.02.2023 -1 year	29.12.2023 YTD
Dow Jones	38996	-0.3%	2.2%	8.5%	19.4%	3.5%
S&P 500	5107	0.4%	5.4%	11.8%	28.6%	7.1%
Nasdaq	16092	0.6%	6.1%	13.1%	40.5%	7.2%
DAX	17741	1.8%	5.0%	9.4%	15.5%	5.9%
MDAX	25902	-0.4%	-0.2%	-1.1%	-9.6%	-4.6%
TecDAX	3396	0.1%	1.6%	6.2%	5.9%	1.8%
EuroStoxx50	4881	0.2%	5.0%	11.4%	15.2%	7.9%
Stoxx 50	4287	-0.5%	1.8%	7.6%	10.0%	4.7%
SMI (Swiss Market Index)	11489	-0.1%	1.4%	5.8%	3.5%	3.2%
Nikkei 225	39911	2.1%	10.0%	19.2%	45.4%	19.3%
Brasilien BOVESPA	129020	-0.3%	1.0%	1.3%	23.0%	-3.8%
Russland RTS	1124	5.6%	-0.2%	0.8%	18.8%	3.7%
Indien BSE 30	73657	0.7%	2.7%	10.0%	24.9%	2.0%
China CSI 300	3538	1.4%	10.0%	1.2%	-13.1%	3.1%
MSCI Welt	3337	0.1%	4.1%	10.4%	22.9%	5.3%
MSCI Emerging Markets	1021	-0.7%	4.6%	3.4%	5.9%	-0.3%
Bond markets						
Bund-Future	132.65	-52	-320	36	-26	-457
Bobl-Future	115.95	-54	-258	-155	77	-333
Schatz-Future	105.07	-18	-113	-32	8	-148
3 Monats Euribor	3.94	4	5	5	120	6
3M Euribor Future, Dec 2024	3.02	7	58	13	-39	72
3 Monats \$ Libor	5.60	1	3	-3	63	1
Fed Funds Future, Dec 2024	4.60	0	64	29	59	77
10 year US Treasuries	4.27	0	32	-8	35	41
10 year Bunds	2.46	12	34	5	-15	46
10 year JGB	0.72	0	1	4	21	9
10 year Swiss Government	0.85	3	2	-3	-59	15
US Treas 10Y Performance	586.75	0.1%	-2.1%	1.7%	0.8%	-2.4%
Bund 10Y Performance	551.00	-0.3%	-1.9%	0.9%	4.8%	-2.5%
REX Performance Index	439.07	-0.2%	-1.2%	2.8%	-0.1%	-2.0%
IBOXX AA, €	3.44	5	29	-13	-35	37
IBOXX BBB, €	4.04	8	26	-29	-59	29
ML US High Yield	8.02	6	6	-54	-66	23
Commodities						
MGBase Metal Index	380.88	-0.1%	-1.7%	0.9%	-8.3%	-2.6%
Crude oil Brent	81.95	-0.6%	0.0%	1.6%	-2.4%	5.5%
Gold	2040.13	0.3%	-0.4%	0.1%	11.7%	-1.2%
Silver	22.63	-1.4%	-2.1%	-10.4%	8.6%	-6.7%
Aluminium	2186.74	2.3%	-2.4%	1.4%	-6.1%	-6.8%
Copper	8401.50	-0.9%	-1.2%	0.2%	-6.1%	-0.7%
Iron ore	114.57	-9.7%	-15.2%	-12.2%	-8.9%	-16.0%
Freight rates Baltic Dry Index	2111	13.1%	51.0%	-28.1%	113.2%	0.8%
Currencies						
EUR/ USD	1.0809	-0.2%	-0.3%	-1.1%	1.8%	-2.2%
EUR/ GBP	0.8554	0.2%	0.3%	-0.7%	-2.3%	-1.3%
EUR/ JPY	162.82	-0.1%	1.6%	1.0%	12.1%	4.2%
EUR/ CHF	0.9577	0.6%	2.4%	0.2%	-3.7%	3.4%
USD/ CNY	7.1987	0.0%	0.4%	0.8%	3.8%	1.3%
USD/ JPY	149.99	-0.4%	2.1%	1.2%	10.1%	6.3%
USD/ GBP	0.79	0.4%	0.8%	0.2%	-4.2%	0.9%

Source: Refinitiv Datastream

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