Financial Risks and Bank Performance: A Literature Survey of Credit and Liquidity Risk in listed Egyptian Banks

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Abstract:

This literature survey examines the relationship between financial risks—specifically credit risk and liquidity risk—and bank performance measured by return on assets (ROA) and return on equity (ROE) from 2008 to 2025. The study is structured into three regional sections: developed economies, the Middle East and Africa (MEA), and Egypt. It synthesizes empirical findings and regulatory developments across these regions, highlighting how macroeconomic events, regulatory

reforms, and structural vulnerabilities shape financial risk exposure and bank profitability. The analysis underscores the importance of robust risk management frameworks in enhancing the resilience and long-term sustainability of banking systems.

Keywords: Credit risk, liquidity risk, return on assets, return on equity, bank performance, financial regulation, currency devaluation, Egypt, Middle East and Africa, developed economies.

الملخص

(ROA)

(ROE)

الكلمات المفتاحية:

Introduction:

This literature survey examines the impact of credit and liquidity risks on bank performance—measured by return on assets (ROA) and return on equity (ROE)—across developed economies, the Middle East and Africa (MEA), and Egypt from 2008 to 2025. In developed markets, post-crisis regulatory reforms such as Basel III have strengthened financial stability while moderating profitability. MEA banks, however, remain vulnerable to macroeconomic instability and weak regulatory structures, which intensify financial risk exposure. Egypt's banking sector presents a distinctive case, having weathered political upheaval, currency devaluations, and the COVID-19 crisis, all of which have significantly shaped risk dynamics and profitability. This article synthesizes empirical findings and regulatory developments across regions, highlighting the critical role of risk management frameworks and institutional resilience in sustaining bank performance amid evolving global and domestic challenges.

1. Financial Risks and Bank Performance in Developed Economies.

The 2008 global financial crisis (GFC) signified a pivotal change in the management of financial risks within advanced banking systems. Credit risk, characterized by the risks of

borrower failure, and liquidity risk, the incapacity to fulfil financing obligations, were pivotal to the crisis. Empirical research illustrates the direct influence of these risks on bank profitability.

Research conducted by Demirgüç-Kunt and Huizinga (2010) and Berger and Bouwman (2009) identified substantial negative connections between increasing non-performing loans (NPLs) and profitability indicators such as ROA and ROE. The initial liquidity freeze in interbank markets intensified these consequences, resulting in systemic losses. In response, authorities enacted Basel III, establishing elevated capital and liquidity requirements, which encompass the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR).

Post-crisis research, such as that by Altunbas et al. (2017) and Beck and Keil (2021), underscores a trade-off between enhanced stability and diminished profitability. Although risk exposure diminished, return on equity (ROE) also decreased due to capital accumulation mandates. Throughout the COVID-19 pandemic, well-capitalized banks with diverse funding exhibited enhanced profitability, underscoring the significance of regulatory buffers.

2. Financial Risks and Bank Performance in the Middle East and Africa.

Financial institutions in the MEA area function under an environment marked by macroeconomic fluctuations, political uncertainty, and inconsistent regulatory structures. These conditions exacerbate the impact of credit and liquidity risks on performance.

Ben Naceur and Omran (2011) noted that deficient legislative frameworks and elevated sovereign vulnerability elevate NPL ratios and diminish ROA/ROE. Liquidity is also constrained by superficial capital markets and restricted financing sources, as shown by Al-Khouri (2012). Credit and liquidity constraints escalated during the Arab Spring and amid COVID-19, with performance deteriorations most pronounced in banks with undiversified portfolios or inadequate supervision.

Reform initiatives, like the implementation of Basel III in the Gulf and North Africa, have enhanced resilience in certain markets. Naceur et al. (2018) and Samitas et al. (2022) demonstrate that banks exhibiting superior capital planning and liquidity management saw a more rapid recovery from economic shocks. Nonetheless, performance indicators continue to exhibit volatility, and further regulatory harmonization is required to stabilize ROA and ROE throughout the area.

3. Financial Risks and Bank Performance in Egyptian Banks

3.1 Introduction

The banking industry of Egypt serves as an intriguing case study for analyzing the relationship between financial risk and bank performance in a growing country. The nation has encountered a series of economic disturbances since 2008, comprising political instability post-2011 revolution, two significant instances of currency depreciation (in 2016 and 2022), ongoing inflation, and the economic repercussions of the COVID-19 epidemic. These shocks have significantly impacted credit and liquidity risk, two essential aspects of financial stability that directly affect banks' return on assets (ROA) and return on equity (ROE).

3.2 Credit Risk and Profitability in a Post-Revolutionary Environment

The consequences of the 2011 Arab Spring initiated a phase of heightened credit risk within Egypt's banking industry. Worsening macroeconomic conditions, a decline in private investment, and escalating fiscal imbalances diminished debtors' repayment abilities. El-Masry, Abdel-Bary, and Elamer (2022) reported a notable increase in non-performing loans (NPLs) from 2011 to 2014, especially in banks with investments in the

industrial and real estate sectors. Smaller private banks saw disproportionate impacts, leading to reduced ROA and deteriorating ROE.

The Central Bank of Egypt (CBE) implemented changes to augment risk governance and elevate asset quality. These encompassed more stringent provisioning regulations, obligatory stress testing, and enhanced integration of credit bureau data. The banking industry had a reduction in the NPL ratio from 10.5% in 2011 to below 4% by 2019 (IMF, 2023). Nonetheless, despite these advancements, credit risk continues to be a formidable concern, particularly in a high-inflation, low-growth environment.

3.3 Liquidity Risk and Foreign Currency Constraints

Liquidity limitations in Egypt have traditionally been intensified by restricted access to foreign money, especially during times of capital outflows and diminishing tourism and remittance inflows. The years leading up to the 2016 devaluation were characterized by acute foreign exchange shortages, causing postponed import transactions and interrupted banking operations.

KPMG (2020) concluded that banks increasingly depended on short-term central bank facilities to satisfy liquidity requirements from 2014 to 2016, particularly as the dollarization of deposits

escalated. The profitability of banks was negatively impacted by the elevated expenses associated with liquidity assistance and the diversion of assets into low-yield, risk-free government securities. This maintained liquidity buffers but decreased income from conventional lending, thereby impairing both ROA and ROE.

3.4 The 2016 Currency Devaluation and Its Ramifications

The flotation of the Egyptian pound in November 2016, under the framework of the IMF-supported economic reform initiative, was a pivotal event. The adjustment of the currency rate—from EGP 8.8/USD to above EGP 18/USD—precipitated a further wave of macro-financial stress. The devaluation reinstated foreign investor confidence and stimulated capital inflows, enhancing foreign exchange reserves and allowing for more monetary policy flexibility. Conversely, it exacerbated both credit and liquidity problems in the short term.

From a credit risk standpoint, business borrowers with unhedged foreign currency debt faced significant escalations in payback obligations. Loan defaults increased momentarily, especially in industries depending on commerce and imports (Seliem, 2022). Banks reacted by augmenting provisions, which negatively impacted profitability metrics. Furthermore, cost

inflation diminished consumer disposable income, adversely affecting retail loan performance and escalating delinquencies.

Liquidity risk was alleviated by the resurgence of foreign currency deposits and portfolio inflows subsequent to the devaluation. Financial institutions successfully replenished their liquidity reserves, while the Central Bank of Egypt's implementation of open market operations and foreign exchange auctions contributed to the stabilization of economic circumstances. Enhanced liquidity indicators, including the Liquidity Coverage Ratio (LCR), facilitated the gradual recovery of loan activities by 2018. Notwithstanding initial profitability challenges, several banks claimed enhanced ROE by 2019, attributed to expanded interest rate margins and augmented investments in high-yield government securities.

3.5 COVID-19 Pandemic and the 2022 Devaluation: A Renewed Cycle of Stress

The COVID-19 crisis presented new issues for Egyptian banks, reawakening some weaknesses observed in previous years. The CBE instituted temporary forbearance measures, including as loan payment deferrals and reduced reserve requirements, to avert an increase in non-performing loans (NPLs). Although these steps mitigated immediate credit risk,

profitability suffered as banks were compelled to augment provisioning in expectation of future failures.

The problem was exacerbated by the 2022 devaluation, spurred by external factors like as increasing global interest rates, the Russia–Ukraine conflict, and heightened capital outflows. The Egyptian pound has plummeted once again, surpassing EGP 30/USD, therefore rekindling some credit and liquidity stress patterns noted in 2016.

In contrast to the 2016 incident, the banking sector approached this crisis with enhanced capital levels and improved risk management procedures. IMF (2023) evaluations indicate that banks sustained capital adequacy ratios over 15% and maintained sufficient liquidity buffers. Profitability indicators have once more deteriorated, indicating margin compression, reduced loan growth, and increased exposure to sovereign risk.

3.6 Strategic and Regulatory Responses

In the last ten years, the CBE and the banking sector have implemented several structural changes to tackle the fundamental causes of persistent financial distress. These encompass:

- **Credit Risk Management**: Enhanced credit scoring, risk-based pricing, and tighter underwriting standards.

- **Liquidity Risk Management**: Adoption of Basel III LCR and NSFR metrics, introduction of FX hedging tools, and increased reliance on domestic currency liabilities.
- **Profitability Protection**: Diversification of revenue through digital banking, bancassurance, and fee-based services.
- **Capital Planning**: Sustained capital adequacy through retained earnings, Tier 2 bond issuances, and periodic recapitalizations.

These measures have enabled Egyptian banks to better withstand shocks; but, external vulnerabilities, particularly those associated with exchange rate volatility, persist in exerting pressure on long-term performance.

3.7 Conclusion

The banking system in Egypt illustrates the dynamic interplay of macroeconomic instability, financial risk, and institutional resilience. Currency devaluations in 2016 and 2022 acted as stress events that exacerbated credit and liquidity concerns, resulting in immediate negative impacts on bank profitability. Nonetheless, these incidents also prompted advancements in regulation and enhancements in risk management. In the future, the potential of Egyptian banks to sustain robust ROA and ROE will hinge on their ability to navigate exchange rate fluctuations, alleviate credit deterioration, and diversify funding sources within a hostile external landscape.

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