



CSBAG BUDGET NEWS BRIEF



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Advocating for a People Centered Budget that Dignifies Humanity



In whose interest are interest rates priced?

Civil Society Budget Advocacy Group (CSBAG), is pushing for the amendment of the Financial Institutions Act, to have interest rates charged on loans by commercial banks, capped at 5%.



Julius Mukunda Coordinator CSBAG, Carol Namagembe and David Walakira of CSBAG addressing journalist at a press conference on capping interest rates held 3rd September 2016

Having worked on Public Finance Management issues for the past five years and having analyzed the economic trends in the county in the financial subsector and the role of Bank of Uganda (BoU) in Monetary Policy affairs, and having analyzed the impact of the Central Bank Rate (CBR) on the financial markets especially interest rates, CSBAG is concerned that if there is no action taken to curb interest rates, the cost of doing business in Uganda will remain high and uncompetitive in the region. And business sentiment such as bail outs will continue to agitate the economy which is not a good sign for investment. Importantly also is that Small and Medium Enterprises (SMEs) and farmers who would have otherwise grown their businesses or shifted from subsistence to commercial will not grow.

The free market question in the financial sector!

2. The key mandate of any government is to protect its citizens and consumers from circumstances that are beyond their control like market failures. In principle, government intervention to regulate the market should be in response to political, economic, social or cultural pressures that are likely to negatively affect the ability of its citizens to live a decent life and for government to achieve its development goals.

3. The determination of prices in the economy should ideally be premised on the free market notion, where it is assumed that demand and supply will determine the price, no market entry and exit restrictions-no regulator or rules governing the entry, no cartels, there are thousands of participants on the supply and demand side, the goods and services are homogeneous, however branding can be used to distinguish between the supplier and quality.

4. However, the financial sector in Uganda does not satisfy the criteria/conditions in a free market. First there is a barrier to entry-in the case of Uganda, the BoU is the regulator and therefore determines entry in the market. There are restrictions on the exit of the market-no financial institution can exit the market until BoU is notified and certain conditions are met. There are few players on the supply side – there are 25 banks in Uganda today and millions of customers. Furthermore, the price is determined by banks and not supply and demand mechanisms. It is also true to say that banks have a cartel through the Uganda Bank Association (UBA) and yet the bank.

International and regional outlook on capping interest rates!

5. Because of good business ethics and strong consumer protection institutions funded by governments, banks in the USA, UK and other EU countries, tend to be more disciplined and behave as if they are capped. The interest rates charged to their customers tend to revolve around the base rate set by the reserve banks, very rarely above 2%.

6. More than 17 countries in the sub-Saharan Africa, have introduced interest rate caps to protect consumers from high interest rates charged by Financial Institutions. In 2013, the West Africa Economic and Monetary Union, which includes eight francophone African countries, lowered the interest rate ceiling - initially established in 1997 by three percent. According to the Council of Ministers, the new maximum effective interest rate banks can charge is 15%; MFIs can charge 24%. The Economic and Monetary Community of Central Africa, comprised of 6 countries (Cameroon, the Central African Republic, Chad, the Republic of Congo, Gabon, and Equatorial Guinea), set up an interest rate ceiling in October 2012. The interest rate ceiling specific to the microfinance sector is calculated by applying a margin of 33% to the average effective interest rate charged by microfinance institutions during the previous six months.

7. Recently in Kenya, President Uhuru Kenyatta defied the position of the Central Bank of Kenya and the Industry to sign into law a legislation that imposes limits on bank lending and deposit rates. Under the new Kenyan law, lending rates will be capped at 4% points above the CBR rate while deposit rates must be at least 70% of the benchmark rates.

The case for Uganda!

8. The conduct of Monetary Policy (MP) in Uganda today, dubbed, Inflation Targeting rate, uses a policy indicator called the Central Bank Rate (CBR) as an indicator of the MP direction. This rate is supposed to guide the direction of lending rates that commercial banks use in the financial market. However, we have witnessed that the rate is only effective when it indicates for the banks to increase the lending rates. In instances where the CBR indicates to commercial banks to reduce the lending rates to borrowers, serious reasons for non-response of the commercial banks come out, to include; high cost of money and high risk profile of borrowers despite the existence of the Credit Reference Bureau and the National Identity Card.

Table 1: Disparity between the Commercial Bank interest rates and the CBR

Bank	Current lending rate (%)	Central Bank Rate (%)	Disparity
Centenary Bank	24	14	10
DFCU	25	14	11
Barclays Bank Uganda	28	14	14
Orient Bank	19	14	5
Stanbic Bank Uganda	26	14	12
Bank of Africa	27	14	13
Housing Finance Bank	27	14	13

Source: CSBAG Market Survey August 2016

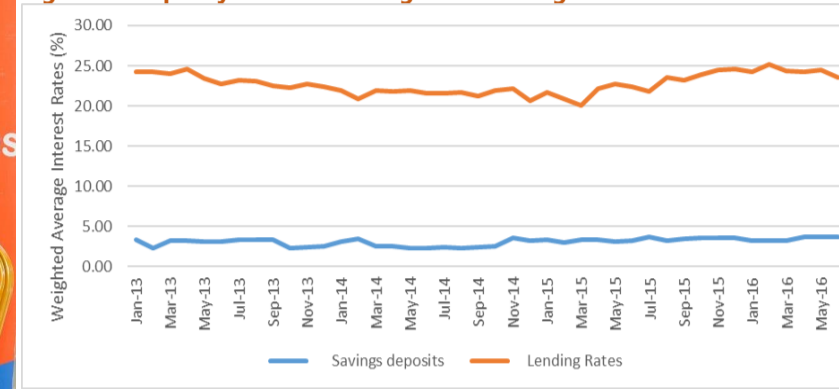
9. The structure of Uganda's financial market is far from free and presents key features of cartels with a few banks holding most of the asset portfolio in the market, and banks through their association reach common positions, on lending rates, that do not favor the citizens and business environment.

10. Coupled with this is that the interest rate that the banks offer to customers on their deposits is dismal and does not in any way encourage the saving of money in banks. This means that if you saved UGX 1,000,000/= with a commercial bank, you would earn interest at a rate less than 2%, and yet if you attempted to borrow the same, the bank would slap you with an interest rate of about 30% excluding arrangement fees, insurance and other administrative costs.

This development in our financial market, presents a predatory scenario that the Central Bank has continuously shied away from with arguments of the free markets while negating government's roles to regulate and protect citizens from these practices.

11. it's not surprising that in Uganda many agree that complete lack of regulation for lending rates is no longer desirable. Equally however, excessive government financial regulation could yet back fire and as such the best of both worlds is an enactment of smart policies like interest rate capping.

Figure 1: Disparity between savings and lending rates



Source: Bank of Uganda statistics August 2016

11. it's not surprising that in Uganda many agree that complete lack of regulation for lending rates is no longer desirable. Equally however, excessive government financial regulation could yet back fire and as such the best of both worlds is an enactment of smart policies like interest rate capping.

Why does the Ugandan borrower need protection?

12. Lower interest rates make the cost of borrowing cheaper and this will encourage SMEs to take out loans to finance greater spending and investment, an ingredient of inclusive growth.

13. A cap in interest rates will increase disposable and discretionary income. This will leave households with more disposable income and should cause a rise in consumer spending on other goods which have a multiplier effect in the real economy.

14. Affordable rates from regulated institutions reduces the risks of associated with loan sharks and also encourages financial inclusion.

Why the Ugandan Banker should support capping interest rates?

15. Capping interest rates will increase number of borrowers therefore, when you stop focusing of the Net Interest Margin per borrower and focus on the number of borrowers, the banks will still make a good return on investment.

16. According to the BoU Annual Supervision report 2015, a stress test revealed that if NPLs increased by 100% 4 banks would become undercapitalized by UGX 25.5bn and that if the NPL double to 200% 11 Commercial Banks would be undercapitalized with an aggregate capital short fall of 310bn. Capping interest rates therefore would make loan repayments more affordable and reduce the risk of NPLs.

Planned Action

- Have interest rates capped at 5% (+/-) in relation to the CBR.
- Cap the deposit rates to 50% of the CBR
- Make it mandatory for Commercial Banks to contribute (0.5% of annual profit) to a rural financial inclusion fund that will finance promotion of financial literacy in the rural areas. According to the Annual Bank of Uganda supervision report 2015, ALL commercial banks as at 31st Dec 2015 had a cumulative total profit after tax of UGX 541.2bn. This proposal would earn the financial inclusion programme over UGX 2bn but most importantly is that commercial banks will be the net beneficiaries when the population is more financially literate.
- Ensure that similar loan products are handled in a standardized way across all providers
- Establish the National Consumer Tribunal (CT) to adjudicate on Consumer complaints and disputes with Loan and credit providers,

Conclusion

17. In the interim, we recognize the market will be jittery about the move to cap interest rates but this we believe these negative market sentiments shall dissipate in the short term. We also believe that the commercial banks will only give back portion of their profitability to the development of Uganda but not in anyway push them into losses.

18. We call upon the Bank of Uganda to orchestrate this regulation for the cohesive support towards inclusive growth of Uganda as we aspire to be a middle income country by 2020.

QUICK FACTS ON CAPPING INTEREST RATES - AFRICAN AND BEYOND

USA, UK, EU –interest rates charged revolve around a base rate set very rarely above 2%

More than 17 countries in sub-Saharan African have introduced interest rate caps to protect consumers from high interest rates

Kenya Capped its interest at 4% above the CBR while deposit rates must be at least 70% of the benchmark rates

OUR WEEK IN PICTURES



CSBAG members and staff this were privileged to host a delegation from the Ford Foundation



Some of the CSOs that attended a CSBAG training on Budgeting and Public Finance Management in August 2016. Training targeted CSOs at both National and Local level.