CTPD'S MONDAY OPINION

This is a weekly column aimed at sharing CTPD's perspective and steering public debate on various issues pertaining to Trade & Investment Law, Public Finance Management, Extractives and Human Development.

TODAYS TOPIC:

Can Government's Bank Recapitalization Plan Reduce Interest Rates in Zambia? With Mr Boyd Muleya

LAST week we covered what interest rates are, their types and essence to the broader economy. In this week's edition of Monday Opinion, we explain why the proposed Government recapitalization of state-owned banks is not a panacea to lower interest rates in Zambia.

Zambia is among countries in Africa with high lending rates. Currently, we have commercial banks charging rates on loans as high as 35% per annum or 26.5% margin above monetary policy rate.For microfinance institutions, interest charges go as high as 77% per annum or 68.5 % margin above the policy rate.Accordingly, this is felt on Government's debt repayment obligations, reduced investment by the private sector and stifled consumption by households.

So, **why is recapitalization an inappropriate panacea to lower interest rates in Zambia?**

Recapitalisation can take many forms such as Government issuing bonds, buying shares, and meeting capital adequacy requirements, subsequently increasing government's equity position. In anycase, recapitalization entails injecting money into an institution with the hope of increasing money supply, hence the link with interest rates.

However, it is not up to Government to apportion itself shares in a bank, unless it's in consideration of expropriation. The challenge of using innovative recapitalization methods besides directly pumping money is limited by stock market rules and restricted control that come with minority interest in an organisation.

Furthermore, ***the hurdle with the recapitalization strategy is that no bank in Zambia has majority state ownership, except for the newly attained 65% majority by NAPSA in Zambia Industrial Commercial Bank (ZICB). The very few banks with some government or quasi government ownership mostly present a minority interest.***

Given the challenges of employing innovative recapitalisation means in Zambia, the concept points to the direct pumping of money, a vice which is against the spirit of financial self-sustainability of state-owned banks. This way, recapitalisation theory is redundant and renders the whole interest rates strategy unrealistic.

In addition, a host of factors are at play in determining interest rates in Zambia. Besides monetary policy rate adjustments, higher interest rates in Zambia reflect higher levels of risk compared to other jurisdictions with lower rates. Based on the prevailing market rates, monetary policy rate contributes less than 25% to interest rate determination, while lending institutions command over 75%. This over 75% stimulus consistsof risks and factors such as:inflation, default, exchange rate, liquidity, maturity, interbank rate, yield on treasury bills, demand and supply, expropriation, political, government debt burden and bank margins.

A strong negative link exists involving interest rates and inflation, that is why the Bank of Zambia tracks inflation as its nominal anchor, currently in the range 6-8%. This means that lower interest rates cannot be achieved in isolation of factors such as a lower inflation, strong kwacha, sustainable government debt levels, non-market interventionist tendencies and availability of accessible credit.

Recapitalisation of state-owned banks is not a panacea towards interest rates reduction in Zambia.This is because the transmission mechanism from recapitalisation of state-owned banks to interest rates is very weak. Whichever method of recapitalisation is used, the mechanism is based on injecting money into an institution, hoping to revitalise it through raising its capital base, adjust its capital structure and hopefully, increase money supply. Unfortunately, interest rates through money supply from recapitalisation are highly inelastic, hence the insignificant effect.

Recapitalization of state-owned banks can be proposed to enhance competition with private banks, or to rebuild the financial foundation of any failing state-owned financial institution. Obviously, government will be misfiring by promoting recapitalisation in a quest to lower interest rates in a supply and demand driven credit pricing environment, and besides, none of the supposedly state-owned banks in Zambia is known to be at the brink of failure. It will be wise to spare taxpayer's funds and not further stress the fiscal deficit.

In view of our discussion, Government should consider the following recommendations:

1. Focus on setting the level playing field and reduce the cost of doing business for all lending institutions.
2. Set a good precedence by ensuring no further default on any of its foreign debt obligations in order to restore a good credit rating, confident and reduce the risk of default.
3. Manage its level of external debt and hence easy the pressure on the kwacha.
4. Embark on a policy mix to deal with supply side economic challenges - major drivers of our current high inflation. This will allow for easing of inflationary pressures on interest rates.
5. Should not recapitalise by just pumping money directly into state-owned banks or non-bank financial institution but should use innovative financial means such as bond issuance that will not have direct pressure on fiscal space. But will have to deal with the limitation that comes with equity ownership.

About the Author: Mr. Boyd Muleya is Head of Research at the Centre for Trade Policy and Development, he is an Economist and Banker by training, and his areas of interest in research includes Monetary Economics, Financial Markets, Investment Analysis and Financial Inclusion.

EXECUTIVE DIRECTOR
P.O. Box 50882, Lusaka, Zambia
Plot 123, Kudu Road, Kabulonga
Tel: +260 211 264409
Email: info@ctpd.org.zm
or nyimbilimwaka@yahoo.com

Centre for Trade Policy & Development

www.ctpd.org.zm

+260975876038

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