

Ghana's weak financial intermediation system

Credit worthy clients subsidise risky borrowers

Financial Intelligence

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Monday 31st May, 2010

As a result of existing challenges in differentiating credit worthy clients from risky borrowers, Ghanaian businesses pay high interest rates to compensate for huge loan defaults in the system, a renowned policy institute has noted.

The institute points out that despite attempts by banks to heed to calls to reduce the high spreads between lending and borrowing rates, significant loan defaults hanging on their necks will continue to inhibit these efforts.

According to the Centre for Policy Analysis (CEPA), efficiency in bank financial intermediation can be measured by the spread between average lending rates and average deposit rates, explaining Ghana's long-standing large spreads signifies a weakness in the financial intermediation process.

“Currently, the spread which had been large appears somewhat compressed even though provisions for non-performing loans (NPLs) have increased. This suggests that the banks have succeeded in reducing their operating costs and therefore able to respond to the call to reduce lending rates, even if for now, by small margins.”

CEPA however notes that progress in further reduction in lending rates can only come from arresting the continued rise in the stock of NPLs.

Quoting from the latest Monetary Policy Committee (MPC) report, Joe Abbey, Executive Director for CEPA pointed out that as of February this year, one-fifth of all loans and advances in the banking system was classified as non-performing.

There is currently a Credit Reference bureau which is fully operational in the country, but their existence has yielded no significant dividend as banks are dragging their feet in releasing data for their operations.

Dr Abbey explained that government is partly to blame for the high defaults in the banking system.

“The evidence firmly suggests that the payment arrears of the GOG to contractors and other suppliers of goods and services must bear a large share of blame for the non-performing loans in the banking system. This is particularly so of the Tema Oil Refinery (TOR) debt to the Ghana

Commercial Bank (GCB),” he stated, adding, “action to clear these payment arrears is needed to help the banks improve both access and costs of loans to the indigenous SMEs”.

The CEPA boss mentioned that on account of the inefficiencies of the financial intermediation process, the private sector is unable to play the assigned role of lead engine for economic growth and job creation.

Dr Abbey was speaking at the launch of a CEPA publication titled ‘The Year 2010: From a Cocoa Economy to an Oil Economy’ in Accra last Friday.

The central bank’s policy rate has fallen in recent times in line with declining inflation, signaling the policy direction, with Treasury bill rates following suit. Base and lending rates of commercial banks have however been slow to respond, and even so only marginally.

CEPA notes that the policy rate is a very short-term rate, and the market rates that affect spending and output, however, are not so short-term.

“Effective transmission of policy actions requires that these market rates respond predictably in line with movements in the policy rate. This requirement of predictable response is perhaps best achieved if the expected policy rate is relatively stable in the sense of it not being subject to frequent reversals,” the centre states in a release accompanying the publication.

Analysts also attribute this to inefficiencies in the financial transmission system in Ghana.

The centre observes that the tardy and slow response of bank base and lending rates to the policy rate is a source of concern to businesses.

But despite a general decline in business confidence, CEPA states that consumer confidence appeared driven by expectations of improved economic conditions, employment opportunities and a slowdown in inflation “perhaps on account of the anticipated entry of the economy into the oil era.”