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In the mind of BoT Governor

Guardian on Sunday Team

When American financial services Goliath Lehman Brothers Holdings suddenly collapsed on September 15 last year, it rang the starting bell on a plunging recession that the world has only just begun to feel respite from. As economic growth in developed countries across the map froze, economists warned that it was only a matter of time, before that paralysing force would infiltrate poorer countries like Tanzania.

As the world marks one year anniversary of economic crisis this week, The Guardian on Sunday team asked Central Bank Governor Benno Ndulu to reflect on the state of the economy and other issues the Bank spots on the horizon in this newly reshuffled global economic climate. In this excerpt, Professor Ndulu touches on the country's stability and previous insulation from the financial crisis, and challenges the BoT must meet as it guides the country toward economic development while it strives to recraft its image in the face of a skeptical public.

The state of our economy according to BoT verdict

Q: In twelve months since the world saw the first signs of how bad the global credit crunch would get, how has Tanzania's economy fared?

A: Well, one thing, which is definitely true, is that our financial sector didn’t suffer the same level of tremor that was suffered in other countries, especially in Europe and the USA. By and large we haven’t faced the credit freeze that a number of big countries went through during that period and our banks are still in very stable condition.

When we last assessed their situation in August, we found them well capitalised and able to meet all their obligations. They have enough liquidity – in fact a lot of liquidity at this stage, which is above the required international standards. The banks’ loan portfolio is very healthy; what we call the ratio of non-performing loans, meaning bad loans, is not more than 7.2 percent. And the required international standard is 10 percent. So capital requirement, or Capital Adequate Ratio, is at around 17 percent whereby the required international standard is 10 percent.

Just to give you a brief highlight of the situation, the liquidity ratio of our banks is around 40 percent and the international requirements standard is 20 percent. This shows that the banks are doing better than expected and most of them are still making profit. We haven’t seen any bank that has collapsed during that period.

So these are realities…it is not something that one can doubt because they are all based on audited results.

Q: **What enabled local banks to withstand the current global crisis while most banks in Africa and throughout the rest of the world suffered so heavily?**

A: First of all let me make it clear that I am not talking about the general economic situation…I am talking about the financial system, and specifically the banking sector. Let me correct you by saying that most banks in Africa did not suffer from this crunch as greatly as expected compared to Europe and the USA partly because we had limited exposure to the range of what we call toxic assets.

To a large extent these banks didn't rely on the flow of foreign capital of the type that other countries' economies have typically been exposed to. Our economy is still cash-based for the most part, not credit-based; in America if you miss paying your credit dues you can't survive, but not here. You know out of every Sh100 that we issue, 75 of it is in the hands of the public not the banks; so in that way, the banking system actually plays a small role in our economy proportionally.

On top of that we have been operating from a very conservative regulatory approach; you know, fortunately this has brought a blessing in disguise to our financial sector. Although the IMF and others have always been hovering over us, they made us do some things that we might not have done otherwise, had we been totally free to ignore those regulatory aspects.

Today, countries like the US and others are doing an FSAP—Financial Sector Assessment Process—something they had always refused to do before. The International Monetary Fund is currently doing it for the UK and the United States partly to ensure some discipline in the future.

So this stability recorded by our banks here is not a miracle – first it is mainly caused by the way our economies are structured and second we were conservative in our banking regulations. We didn't go for all these new products you see in the developed world which, typically have been the source of the current crisis.

Q: After giving us a brief overview of how the banking sector has performed during this past year's credit crisis, can you please assess for us the current state of the country's economy?

A: Definitely we have been affected by the global recession. Most of our products as you know are either sold outside or are sourced from outside. So far we have seen that a good number of export commodities like coffee, cotton, horticulture and Nile perch have experienced serious price drops. Minerals have also suffered from the crunch.

And I have said this publicly…I even gave a presentation in Parliament in January or February this year where I am on record saying that this country will have a problem based on what's happening abroad. But our projected economic growth rate is still much better than the projected growth rate for developed countries.

We think our economy will grow at a pace of between 5 and 5.5 percent. It is much less than the 7.5 percent we recorded last year and that is mainly due to the recession. So I believe we shall probably do more or less what we have projected, which is lower growth, but not disastrously low.

Q: **What successes have you had since you were appointed BoT Governor last year? Where do you see the bank heading in the next five years?**

A: Well I would single out four big achievements since I became involved with the bank. The first one is stabilisation of the markets—both in terms of the foreign exchange market and I would say the financial market. If you look at the way treasury bill rates and other interest rates related to that were moving upward until late 2007, and compare that with the pattern now, it is much smoother than it was previously. Not only that, I think interest rates have also moved downward particularly on the side of the treasury bills markets. Some lending rates also have come down – you know lending rates are not simply pegged at one level; they depend on how good you are at servicing your debts. This is why the interest rates charged are also very different. Currently interest rates range between 10 and 11 percent for good customers or borrowers all the way up to maybe 20 or 21 percent. But the average rates particularly on the treasury bills market has gone down. Right now banks lend to each other at around 1 percent overnight, while the rates for one to two weeks are between 2 and 4 percent.

The average of the treasury bill rates is somewhere around 4.7 percent and we have managed to bring this down partly by making sure that we don't sell too much in the way of treasury bills on the market because we also use other instruments like selling foreign exchanges. So to that extent we have been able to lower the interest rates.

The other market of course is the Foreign Exchange market, where we have also done well. In July 2007, the dollar was trading at Sh1300 to 1350 per dollar – today, almost two years on, the shilling is still trading at Sh1300 to 1320 per dollar. This is fairly stable considering that previously we were used to seeing the shilling depreciate every year at not less than 10 or 15 percent—meaning that the shilling was always sliding down. We took measures to ensure that the market plays the role it should…and we broke the notion that the only way the shilling trades is always in one direction, down. That's an achievement I would also like to underline.

Third, we have also built up our Foreign Exchange Reserves tremendously. I remember in 2007 we were down close to about $2.4 billion, but today we have $3.6 billion in reserves, which is larger than any other East African country in terms of the absolute amount. Neither Uganda nor Kenya is at that level at this stage, which I consider a great achievement.

We have also been able to introduce much greater transparency in the way we manage the Central Bank. We have regular meetings with the CEOs of all banks, every month after our policy meeting. We also engage with media – we are not in hiding and we think that's important as a basis for improving governance.

We have had a tough time in terms of simply dealing with the history, but we didn't run away from that history because it is part of the history of this institution. So far we have come out and tried to deal with each one of those issues that faced the bank…great care has been taken but we are not yet home free. We are continuing with the process of building a reputable institution, and I think this is also an important achievement.

Finally, I think through various measures we have taken, we are now better positioned to retain the young talent currently at the Central Bank. Because one of my visions is to foster the next generation of central bankers by giving opportunities to our young people, who are very professional both in their own capabilities and in the extent to which they hold the rest of us accountable for our performance. I also think that the management of the supply of money has been highly improved. When you exclude food, which we have no control over, right now inflation minus food is at 2 percent, notwithstanding that overall inflation is at about 12 percent. So we have really been able to control inflation.

I see the bank in the next five years becoming much more technologically equipped. We want to make sure that we become more and more paperless, adopting an electronic flow as far as information is concerned. There will be much more vibrant leadership particularly at the middle management level, and I expect to see a Central Bank that has a very respectable reputation after the trials and tribulations that we have seen in the past.

Q: There has been a recent trend in which Tanzanians are now being charged for many things in US dollars rather than shillings. What is your take on this, and what does the law say about it?

A: In terms of the dollarisation, first let me clarify what the law says. The law allows a Tanzanian to hold foreign currency and also to pay in foreign currency without being forced to do so. The law allows a Tanzanian resident to also hold a bank account denominated in foreign currency…this was a major change that was enacted in 1992 and it has remained the same.

So what's unlawful is to force people to pay in foreign currency or for someone to refuse the shilling as legal tender. If we do get a tip that there's that kind of a person or institution working out there, we actually take legal action and we can prosecute those individuals.

You may quote prices in foreign currency but you can't force anybody to pay in that currency. But if let's say that willingly you go ahead and pay in US dollars you are not breaking the law and neither is one accepting your payment.

Now when the shilling was depreciating every year, people found the use of foreign currency, and especially the dollar, as a way of protecting their wealth so that it didn't lose value when the local currency lost value. As a result today, when you look at all money in this country as we measure it in broad terms, a third of the money supply is actually held in foreign currency, and mainly in bank accounts.

Tanzanian residents hold not less than $1.5 billion privately in their homes, and the banks hold another $600 to $700 million. Now once you have that much foreign currency in the country, you shouldn't be surprised that there's also trading in that currency. But my main suggestion in dealing with this issue is to call upon all those people who have been forced to pay in foreign currency to report to us and we shall take legal action. I think to a large extent the biggest part of the problem can be solved by boosting confidence in our local currency. Over time, as our shilling gains strength or stabilises, so will the decrease in the use of foreign currency. And we have seen some positive changes whereby currently the proportion of money being held in foreign currency has fallen to 26 percent from 33 percent. We think as the shilling continues to stabilise we will witness more positive gains.

Q: According to a survey conducted by the Fine Scope group in 2007, the total number of Tanzanians who are bankable is 21 million, yet only 1 million have bank accounts; what is the problem and how can we increase the banking base in this country?

A: Actually the percentage of Tanzanians who own bank accounts is only 9 percent; in Kenya it is 19 or 20 percent, while in Uganda it is about 17 percent. I think one of the main ways we can reach more of the un-banked is with new technology, especially through mobile instruments like M-Pesa or other mobile banking mechanisms. Second, I think we have to adopt the culture of using microfinance institutions to reach the really remote places.

Q: **Let's now move beyond our borders where there have been plans to have a single monetary union in East Africa by 2012. As one of the key players, do you see this as a viable project?**

A: We are all focused on trying to meet that target, but we are also realistic. The realism in this case means considering what needs to be put in place before you can proceed with that union — which includes also having an economic community, a step that is scheduled to be operative from January 2010. We know there are challenges ahead of us that need to be addressed, but so far we have commissioned a team that's making an assessment of the timeframe. It hasn't completed its work…it is still going around the member countries right now and part of it is linked to the European Central Bank. When we have the team's conclusions, we hope to get a better assessment of this plan.

But I think with all our minds focused we shall attain this goal. Right now we have already taken many measures including harmonising our payments system for East African countries, but we probably have to do more as Tanzanians especially by integrating our capital markets. All these are initiatives toward the East African single currency proposal.

So I would say we stand a very good chance of attaining this goal…we have been there before and that was our history. I think we'll get there – not necessarily in 2012 at 100 percent, but one day we'll make it.

Q: Last year, East Africa's most profitable company—Safaricom —issued its Initial Public Offering (IPO) at the Nairobi Stock Exchange, extending the offer to other regional members. Surprisingly, the BoT barred Tanzanians from buying shares – why?

A: The Foreign Exchange Act has certain provisions on the flow of foreign currency, including investments. Inward investment is allowed and Safaricom was advised to invest at the Dar es Salaam Stock Exchange by cross-listing its shares. But the question then was whether Tanzanians were allowed by law to cross the border and invest in Kenya's IPO rather than Safaricom coming here.

The law says you can't externalise capital as a Tanzanian unless you get exemption from the BoT—meaning essentially that the governor would have to issue those exemptions. Now it doesn't make sense to give one exemption with one IPO…if we would have allowed people to go and buy shares in Kenya, but they couldn't then trade those shares in the market, then you could actually end up more or less inhibiting them from making the decisions that they should be able to make on their own.

So we said look, we are in the process of trying to change this law so that we can have that platform for Tanzanians to trade in shares in the region, and people should wait until we have changed the law rather than issuing exemptions for those who wish to do so currently. Because then my job would have been just issuing millions of exemptions every day and that wouldn't make sense.

By the way, a lot of people who were making efforts to buy Safaricom shares and couldn't have since come back to say thank you because other participants from Uganda and Rwanda and even Kenya have gotten burnt on this one. They bought shares at a very high price, but suddenly share prices just collapsed and they lost a lot of money.

Q: Last year you commissioned an independent auditor to review the actual value or the value for money of the Twin Towers. Is the job fully completed, and if so, what are the findings? Is it true that the cost of these towers was inflated?

A: It's the Board of the Central Bank that decided that, look, everybody is saying something about these buildings, so why don't we have a group of experts come and evaluate whether what we see is worth what's on paper. By then Ernst and Young had already gone through the process of establishing the eligible cost—which is the cost that we can truly say has been used for these buildings.

What we wanted those guys to do was to establish value for money—to compare their assessment of the value of the buildings with what actually was put as expenditure in building these towers. Now the Board has two objectives – one was just to satisfy itself because this is a big project, and the other was, in the event that we know there's been discrepancy and we can make attributions, to actually be able to get refunded some costs. In order to be able to use that type of information for making a claim, it has to be done very rigorously because the ones who built these buildings have top qualified engineers. They will be able to defend themselves against any move to hold them accountable, so it's important that this work is done properly.

I hope when it's done it will be proper. We have gone through the process of selection and the appointed firm has been working on it. They haven't completed their work, and hopefully once it's done we shall have more information on the quality of the construction itself. Because you can't go to court with poor quality assessment; they will take you apart. Really this was the main purpose…and since it can be linked to another question here, by the time that we went ahead to do this, the Prevention and Combating of Corruption Bureau (PCCB) had already been working on this question for more than nine months.

But for them, the focus was on the process of decision making and not necessarily doing the technical engineering work of assessing the values of the buildings. So this was supposed to be a complement to that work and they went ahead and have already taken people to court on the basis of the process evaluation. That's really their part…there's no duplication and what we intend to get from our assessment is a very different answer.

We are using engineers who will actually do the measurement, look at the type of the materials used, and be able to say whether what is on paper was really delivered. Their focus should not be whether the Board sat down to approve this or that…hopefully if we do get those results and they don't stand at international standards, we may be able to use that to make certain claims if possible.

Q: Finally, what is your message to the players in the financial industry as well as the general public?

A: Well, the Central Bank has gone through a rough patch recently and we are doing all we can to put that right. For us, our duty is to make sure that the economy is stable, the payments system works well, and that the banks are safe through our supervision so that depositors can have confidence when they deposit their money there; and also to facilitate investment and production as well as trade. Those are our core functions… we should be judged primarily by our achievements of those core functions.

There's always trouble but for us the important thing is to deal with that trouble without necessarily compromising our focus on the core functions. So that's one big message. Second this institution values transparency and accountability…we have made many changes during the past few years but I only mentioned a few of them. But we have also made changes in the procurement system as well as in several other areas.

It's a long road to reclaim the reputation of this institution as the primary institution to be counted on as far as facilitating development across the country.

I hope I won't be judged as I finish my term in building a new generation of central bankers, so that we can carry on with the quality and the commitment of our technical staff that typically the bank has. Notwithstanding the problems we have had, most of our staff are dedicated, honest and knowledgeable.

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