Role of trade in financial services to economic growth and development: Ghana's Experience

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at

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Outline

- Background
- Interest rate control and directed credit regime
- Outcomes of interest rate control and directed credit policies
- Financial sector reforms
- Role of trade in financial services
- Summary and Conclusion

		Dec-00		Dec-10	
		Number of Institutions	% of total assets	Number of Institutions	% of total assets
Commercial banks:		16	76.9	26	75.1
Private		10	39.2	21	53.4
	Domestic	5	4.0	8	15.1
	Foreign	5	35.2	13	38.3
State		6	37.7	5	21.7
Rural Banks		113	2.0	135	2.7
Savings and loans companies		8	0.2	19	1.8
Mortgage finance companies		1	1.4	1	0.3
Insurance companies		22	3.4	42	3.6
Securities firms		35	1.5	92	1.6
Leasing and finance companies		21	1.2	27	2.5
Pension funds		1	12.5	1	12.4
Total financial sector assets to GDP			56.7		52.1

Background

- The current state of the Ghanaian banking system is best appreciated reviewing these phases:
  - Banking in the Colonia Era : 1890 -1945
  - The post war Era : 1945 – 1960
  - Banking in a Closed Economy: 1960-1983
  - Banking in the Structural adjustment era:1983 – 2000
  - Banking in self initiated reforms : 2000-2010

Background

- Three banks,
  - British Bank of West Africa

  (1897 now SCB) and
  - Dominion, Colonial and Overseas (1917 now BBG) with
  - Post Office Savings Bank (1887) operated in Ghana before independence.

Background

- Purpose of Colonial Banks
  - Serve expatriate staff working in Ghana.
  - Neglect of the indigenous people in the provision of financial services.
  - Based only in the city centres.
  - Farmers, fishermen and cottage industries have no access to credit

Interest rate control and directed credit regime (1960 -1983)

- Priority sectors for investment
  - Modernisation of agriculture
  - Industrialization
  - State Banks
- State Banks
  - Ghana Commercial Bank – 1953
  - National Investment Bank – 1963
  - Agricultural Development Bank - 1965

Interest rate control and directed credit regime (1960 – 1983)

- Credit Control regulation of 1964

  Bank of Ghana's approval for loan exceeding GH¢1 (less than $5) to sectors other than industry and agriculture

  Cash Reserve ratio of 48%

  Nostro balances backed by 100% deposit with BOG

- Price controls – Interest Rate and Exchange Rate Controls
  - **Exchange Rates and Interest rates were administratively controlled by the Bank of Ghana and controls imposed on the asset allocations of banks such as sectoral credit directives**

Interest rate control and directed credit regime (1960 – 1983)

- Lending rates for secured facilities were fixed between 6.5% and 7% in 1965 and 6.5% and 10 %for unsecured facilities
- Savings deposit interest rate was fixed between 3%% and 3.5% from 1960 to 1966 and revised downwards to between 2.5% and 3.5%in 1968

Interest rate control and directed credit regime (1960 – 1983)

- Inflation was however higher than nominal deposit interest rates and real interest rate were negative between 1960 and 1983
- Bank of Ghana in 1969 put a limit on the amount of bank loans for imports, construction, services and other sectors and loans were not to be higher than 10 percent of 1968 positions

Outcome of Directed credit policies

- Source of growth of bank credit was from public institutions and enterprises and government borrowings
- Erosion of banks' capital due to high non- performing loans and was 4.4 percent of GDP
- Required ceiling targets were unmet by 64 percent

Outcome of Directed credit policies

- Fiscal Dominance

  Persistent fiscal deficits financed by monetary accommodation

  Strong inertial inflation expectations embedded in the economy due to high inflation and exchange rate volatility

Results of Direct control policies

- The Direct Control policies failed to achieve the intended objectives:
  - Private sector credit as a percentage of GDP was 8.20% in 1970 (28.93% as of April 2012)
  - Non performing loans ratio was 41% in 1989 (13% as of May 2012)
  - Public sector banks became insolvent by non performing assets and had to be restructured
  - Bank for Housing and Construction and Cooperative Banks were liquidated in year 2000 due to insolvency

Results of Direct Control Policies

- Financial depth as measured by M2+/GDP was 19% in 1970 (45.80% in April 2012)
- Erosion of capital of banks due to continuous losses
- Low savings rate due to negative real interest rates (average real savings rate was negative 23.40% in 1975)
- Bank Deposit to GDP was 12.40% in 1970(54.3% in April 2012)

Lessons of Direct Control Policies

- The main lessons learnt from the Direct Control Policies were:

  Direct Controls policies created incentives for rent-seeking / Kalabule

  EROSION of social capital – Banking thrives on trust and with erosion of trust it was difficult for banks to intermediate effectively

  Ghanaians developed an aversion for financial savings

  Banks developed an aversion to lending

  The results of these developments were:

  - Low intermediation
  - Low growth
  - High Inflation

IMF/World Bank Assisted Reforms

- The Financial Sector Adjustment Programme (FINSAP) supported by the IMF/World Bank in 1987 led to
  - Removal of control on deposit interest rates and lending rates.
  - Central Bank credit allocation directives were discontinued and
  - Banks were allowed to determine their own charges and fees in 1990.

IMF/World Bank Assisted Financial Sector Reforms

- One of the diagnoses of the problem of the financial sector was the unbridled government ownership.
  - Encouraged political interference in the operations of these banks.
- The government in its attempt to encourage competition in the banking sector sold its shares in commercial banks in 1992

IMF/World Bank Assisted Financial Sector Reforms

- Ghana Commercial Bank, Ghana's largest commercial bank's shares were offloaded on the Ghana Stock Exchange (GSE).
- The government in its attempt to deepen the financial market promulgated the Financial Institutions (Non-Banking) Law (PNDCL 328) in 1993
  - to regulate the operations of savings and loans companies, finance companies, credit unions, leasing companies and mortgage

IMF/World Bank Assisted Financial Sector Reforms

- Rural /Community Banks
- Securities Industry Law was passed in 1993 which paved the way for Securities Regulatory Commission
  - Surveillance over the securities market
  - Orderly, fair and equitable dealings in securities
  - Licence and authorise unit trust, mutual funds

In house Initiated Reforms (2002 -2008)

- BOG has in the recent past introduced a number of policy reforms to among others:
  - Promote efficiency, competition in the banking system and deepen the financial system;
  - Enhance transparency and competitiveness of the interbank money market.
  - Enhance the development of the capital market.
  - Reduce Asymmetric Information

In house Initiated Reforms (2002 -2008)

- Asymmetry Information (credit information and trust)
- Credit Reporting Act 2008
- Publication of APRs and bank charges
- Borrowers and Lenders Act 2008
- Know Your Customer (KYC)
- Anti-Money Laundering Act 2008
- Establishment of Collateral Registry

In house Initiated Reforms (2002 -2008)

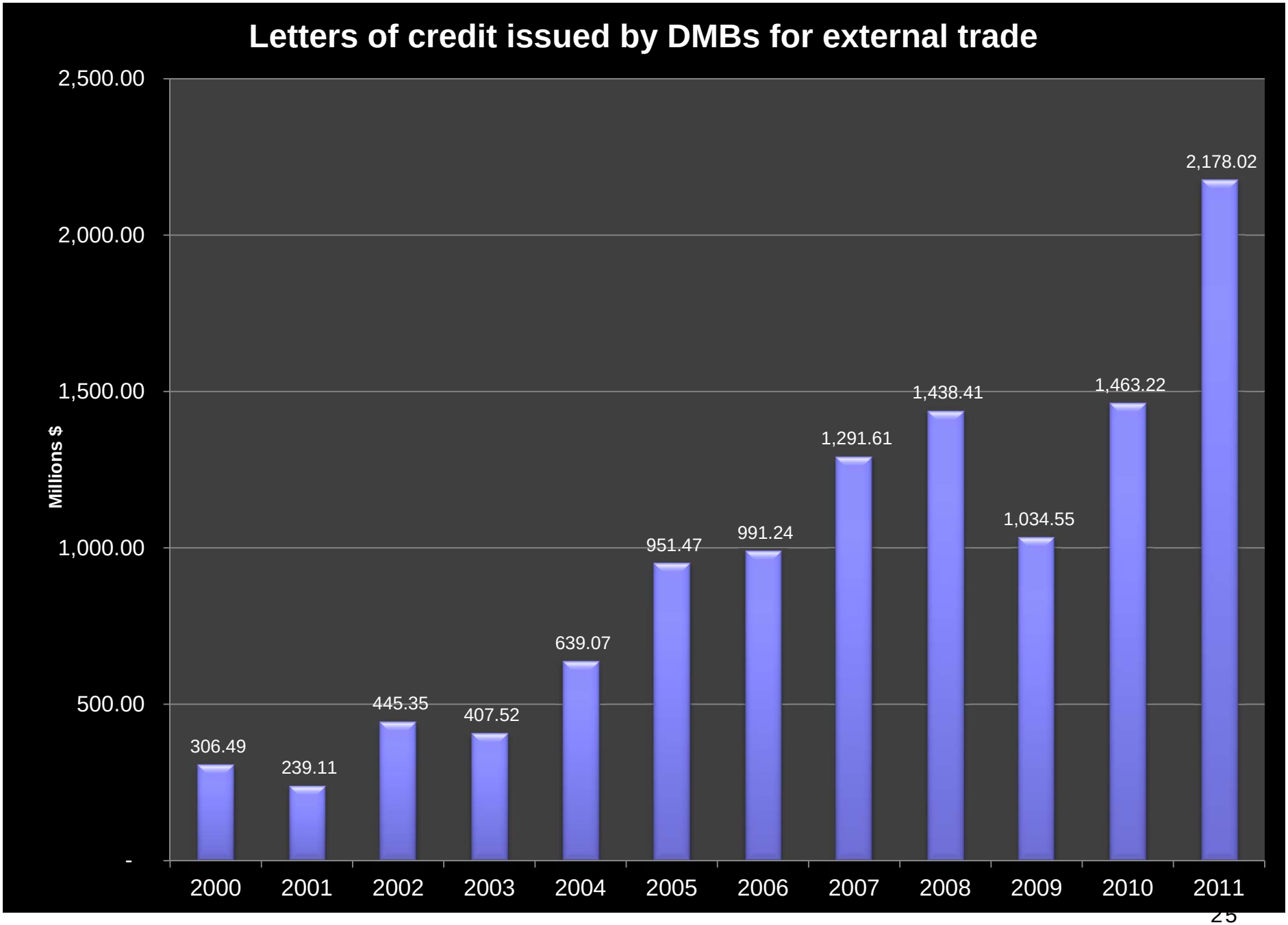
- Other Reforms
- Abolition of secondary reserve requirements
- Non-resident participation in domestic government securities and passage of Foreign Exchange Act 2006
- Payments systems Act 2003 (ACH ,GHIPSS and RTGS)

In house Initiated Reforms (2002 -2008)

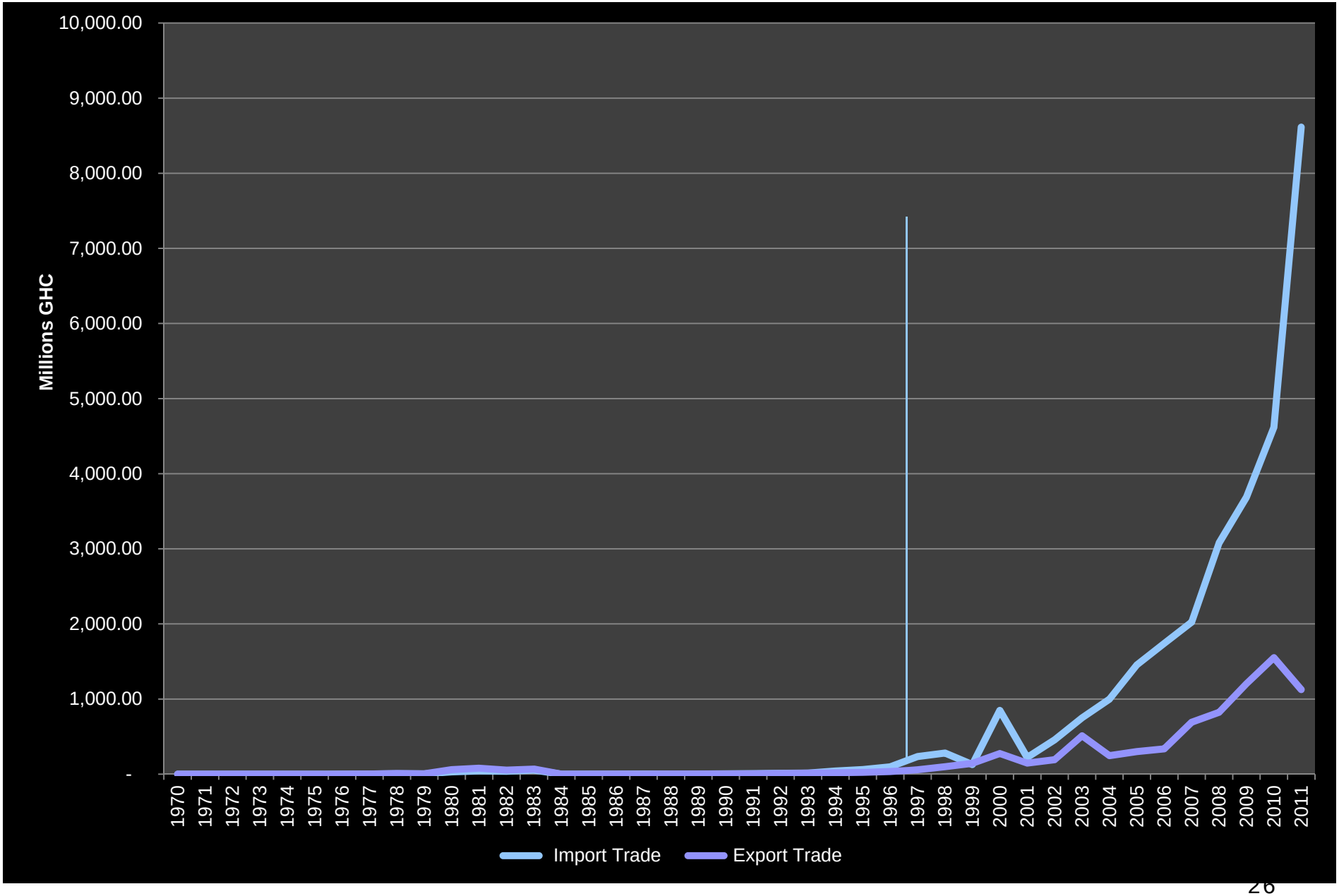
- National Pension Act 2008
- Insurance Act 2006
- Banking Act 2004 and Banking Amendment Act 2007 – Offshore Banking
- Central Securities Depository Act 2007

Role of trade in financial services

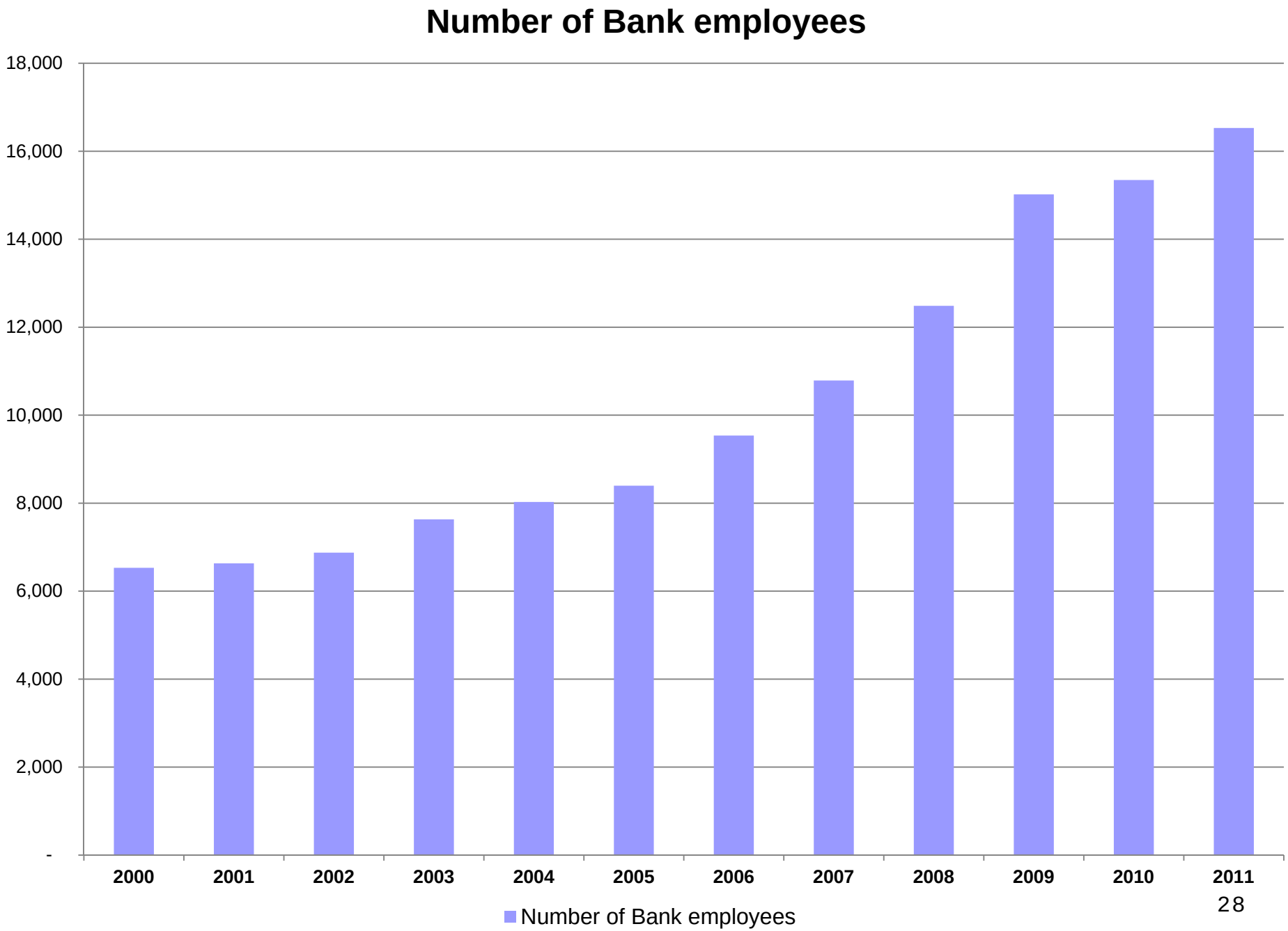
- Ghana allowed entry of foreign banks as part of financial sector reform in 1987
- Foreign banks controlled 54% of banking sector asset as at April 2012 and introduced various innovative products:
  - Cashless Account ,Saturday banking, ATM and other electronic products
- Quality service delivery makes foreign banks preferred choice


Letters of credit issued by DMBs for external trade
Millions $
2,500.00
2,000.00
1,500.00
1,000.00
500.00
-
306.49
239.11
445.35
407.52
639.07
951.47
991.24
1,291.61
1,438.41
1,034.55
1,463.22
2,178.02
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011

Banks credit for Import and Export trade 1970 - 2011



		1963-1986				1987-2010		
	α	β_1	β2		α	β_1	β2	
Sectors		Lending rates	Deficits finance	Std. Error		Lending rates	Deficits finance	Std. Error
Agriculture	-3.750	5.150	0.308	2.261	3.563	1.388	-0.188	0.553
Mining & Quarrying	-4.809	5.559	0.268	2.446	2.725	1.626	-0.225	0.811
Manufacturing	-3.438	4.993	0.303	1.976	4.519	1.012	-0.224	0.540
Construction	-2.876	4.410	0.265	2.121	5.033	0.378	-0.189	0.568
Electricity, Gas & Water	-3.821	4.146	0.218	2.455	1.488	2.308	-0.292	0.983
Commerce & Finance	-2.514	4.564	0.207	1.850	4.599	1.051	-0.289	0.675
Import Trade	-2.510	4.104	0.602	1.565	2.777	1.863	-0.242	0.678
Export Trade	-2.764	4.301	0.147	1.827	2.465	1.817	-0.211	0.621
Others	-2.870	4.621	0.223	1.985	6.964	-0.699	-0.333	0.860
Transport, Storage & Communication	-4.294	4.994	0.377	2.117	5.884	-0.404	-0.234	0.691
Services	-2.732	4.160	0.238	1.902	5.444	0.236	-0.279	0.731
Miscellaneous	-2.687	3.896	0.215	2.076	3.819	1.177	-0.304	0.788


Number of Bank employees
18,000
16,000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
-
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
Number of Bank employees

							Indicators of Concentration and Competition					
	Dec-00	Dec-01	Dec-02	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11
Market Share (Top 5 banks)	77.6	77.6	74.5	69.5	65.6	61.1	57.4	55.6	51.9	49.8	45.0	44.4
Gini Concentration Index	60.7	60.4	57.4	52.9	50.2	50.9	51.8	48.4	45.8	45.1	38.6	40.0
Herfindahl Index	1,413.7	1,466.6	1,361.2	1,141.3	1,065.9	960.7	870.7	838.0	744.0	693.1	600.0	590.1
							Indicators of Financial Depth and Intermediation					
							Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11
Asset to GDP	43.6	38.1	39.8	40.6	39.2	37.9	45.1	55.8	65.6	64.9	67.1	70.8
Private Sector Credi/GDP	14.1	11.7	12.5	13.2	13.1	15.9	18.2	24.2	29.7	26.6	26.7	27.6
Total Credit to GDP	19.0	16.5	14.8	16.9	16.1	18.4	21.9	29.7	36.6	32.0	30.8	30.0
Deposits to GDP	26.8	22.2	23.9	25.5	25.2	24.5	29.4	35.2	42.6	41.5	45.6	51.3
% of Revised GDP												
Asset to GDP							27.7	33.7	35.4	38.1	38.8	38.8
Private Sector Credi/GDP							11.2	14.6	16.0	15.6	15.4	15.1
Total Credit to GDP							13.5	17.9	19.8	18.8	17.8	16.5
Deposits to GDP							18.1	21.2	23.0	24.3	26.4	28.1

Conclusion

- The banking landscape has become competitive
- Increased intermediation and improved loan quality
- Banks' trade finance with respect to establishment of letters of credits was $2.2 billion in 2011 compared with $300million in 2000

Conclusion

- Private sector credit to GDP was 4.7 percent in 1990 as against 27.6 in 2011

- Credit to export sub sector was GHC4.7million ($2m) in 1970 compared with GHC 1.13 billion ($735m) in 2011

Conclusion

- Opening access to a wider segment of the population
  - Banks' branch network increased from 295 in 2003 to 850 as at April 2012
  - Non-bank financial institutions were 257 in 2000 and 615 in December 2010
- Creating new asset classes and products such as consumer loans, mortgages, ATM services, online telephone and internet banking

Conclusion

THESE ARE THE FRUITS OF FINANCIAL SECTOR LIBERALIZATION AND SOUND POLICIES

GHANA: TOP GLOBAL REFORMER IN IMPROVING ACCESS TO CREDIT- WORLD BANK & IFC 2011