Closing Remarks by

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"Step by Step – Let's Solve the Finance Puzzle to Accelerate Growth and Shared Prosperity"

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Members of the Diplomatic Corps,

Distinguished Panelists,

Staff of the World Bank in Uganda,

Distinguished Guests,

Ladies and gentlemen.

I would like to begin by commending the World Bank for publishing the eighth edition in the series of Uganda Economic Updates, which over the last few years, have provided a valuable source of economic analysis for everyone with an interest in the Ugandan economy.

I would also like to thank the presenters, discussants and other contributors for all of the important insights they have given us this morning.

Given the main theme of this latest Economic Update, I would like to take this opportunity to offer my own perspective on the development of the financial sector in Uganda, its role in the economy, and the challenges which it faces.

To begin, I think that it is important to recognise the progress which the financial sector, and especially the banking sector, has made over the last decade.

Between the 2005/06 and 2015/16 fiscal years, commercial bank credit to the private sector expanded by more than threefold in real terms, at an average real rate of 12 percent per annum.

Although bank deposits also grew strongly over this period, by two and a half times in real terms, there was a marked rise in bank intermediation, with the ratio of bank loans to bank deposits rising from 53 percent to 70 percent.

Secondly, there has been a notable strengthening of competition in banking markets. The Herfindahl Hirschman Index of market concentration in the banking market fell from 1,508 in June 2006 to 909 in June 2016, denoting a substantial reduction in market concentration and an implicit rise in competition.

The fact that competitive pressures have intensified in the banking market over the last 10 years is also reflected in a secular fall in the industry's after tax returns on equity, from 32 percent in 2005/06 to 14 percent in 2015/16.

It is no longer tenable to argue that banks in Uganda make excessive profits.

Thirdly, although there have been occasional incidents of bank distress and failure over the last 10 years, prompt regulatory interventions by the Bank of Uganda have ensured that the interests of depositors have been fully protected, as was the case with the resolution of Crane Bank. This is in line with the mandate given to the BOU under the Financial Institutions Act, which priorities the safety of deposits.

In that regard I do not understand why the Economic Update should have concluded that there are "low levels of public confidence in formal financial institutions" which discourage the public from holding bank deposits. This conclusion is not borne out by the rapid growth in both the number of bank accounts and the real value of bank deposits over the last 10 years.

Notwithstanding the strides made by the banking industry, it still faces major challenges. The cost of doing banking business is high, partly because the industry has not yet realised optimal economies of scale.

As a result, annual operating costs average approximately 11 percent of income earning assets, which accounts for a major share of the large interest rate spread. Spreads will only be reduced when banks can become more efficient and reduce their operating costs.

I believe that automation and new technologies to deliver financial services will offer avenues for banks to reduce their operating costs over the medium to long term, although this will also expose banks to new forms of operating risks.

Banks may also be able to exploit synergies with other financial services, such as insurance, to improve efficiency.

The Economic Update argues that the "high cost and limited access to credit has become a binding constraint on Uganda's economy".

While I do not dispute that bank lending rates are too high and need to be reduced in a sustainable manner over the long term, I do not think that this claim is really tenable. It implies that, if only banks and other financial institutions could lower their lending rates and expand the volume of their lending, substantial numbers of businesses in the real sector of the economy would be able to borrow money for investment in order to expand their output and thereby both service their debt and increase their incomes.

Unfortunately the conclusion that access to credit is the binding constraint on economic growth is premised on a rather over-optimistic view of the real sector and its borrowing capacities. Formal sector, creditworthy businesses, which are the main business clients of the commercial banks, comprise a small share of the Ugandan economy. There is a much larger pool of informal businesses and micro-enterprises, but the capacity of this sector to utilise credit effectively is constrained by a raft of problems, including scarcities of business and technical skills, the high costs of inputs, and often volatile market conditions.

The ability of these businesses to make profits consistently and thereby service loans is precarious.

The problems are most acute in small holder agriculture where qualitative changes in agricultural practices are a prerequisite for farmers being able to utilise credit productively.

Land reform is also needed to support the transformation of agriculture in many parts of Uganda.

The argument that micro-loans alone can transform the fortunes of household enterprises, whether in agriculture or other sectors, is not supported by empirical evidence, either in Uganda or elsewhere in Africa.

In addition, attitudes towards borrowing are poor throughout society; loans meant to fund business expenses are sometimes diverted for personal expenses or speculative purposes and the culture of loan repayment is weak.

Until a much stronger private business sector can develop in Uganda, characterised by good, modern business management, and a clear separation of business and personal interests on the part of business owners; it will be very difficult for banks and other financial institutions to further raise the level of intermediation in Uganda.

To conclude, I believe that it is necessary to be realistic about what can be expected from the financial sector.

The shallowness of the financial system in Uganda reflects the structure of our economy much more than the deficiencies of the financial sector itself or of the institutional and regulatory environment in which it operates.

In many respects – technology, productivity, levels of professionalism, the application of modern business practises – the financial sector is one of the most advanced sectors of our economy.

Most of the other sectors of the economy are not as advanced as the financial sector, and some lag far behind it. It is the structural problems afflicting the real sectors of our economy which provide the largest obstacle to greater use of financial services, and especially credit, in Uganda.

Thank you for listening.