

## **CREDIT CRUNCH—THE ETHIOPIAN VERSION**

- **Lending by Ethiopia’s private banks is coming to a virtual standstill. We find that the average private bank has recently been giving out just 30 million birr in loans per month, or almost half the peak lending volume seen in recent years.**
- **The Ethiopian version of the credit crunch is only bound to get worse in the coming months given recent tightening actions by the central bank. By our calculations, private sector credit growth will not be much higher than 10-13 percent this fiscal year, the slowest growth in roughly half a decade.**
- **Though the primary source of the excessive monetary growth in recent years has been the public sector, the burden of monetary adjustment seems to be falling mainly on Ethiopia’s private sector.**

**CREDIT CRUNCH—The Ethiopian Version**

**Bank loan data for the first half of the fiscal year show that the average private bank has provided only about 177 million birr in loans over the six month period—equivalent to new loans of just 30 million birr per month.** Based on discussions with several private banks and information from industry insiders, the volume of lending by the largest private banks ranged from -49 to 416 million in the July and December 2008 period, or just -8 to 56 million on a monthly basis. As seen in below in Table 1, one private bank actually showed a decline in total loans at end-December 2008 relative to June 2008. To get a sense of the magnitude of the slowdown, loans extended during the boom days of FY2006 were almost double their current levels, or near 54 million Birr per month. Given that the size of an average loan is near 1 million birr at Ethiopia’s private banks (according to data from banks’ annual reports), lending just 30 million birr per month translates into serving about 30 new borrowers per month. And with private banks each having an average of 45 branches, this appears to translate into less than one borrower per bank per branch per month—a major slowdown in bank operations by any measure.<sup>1</sup>

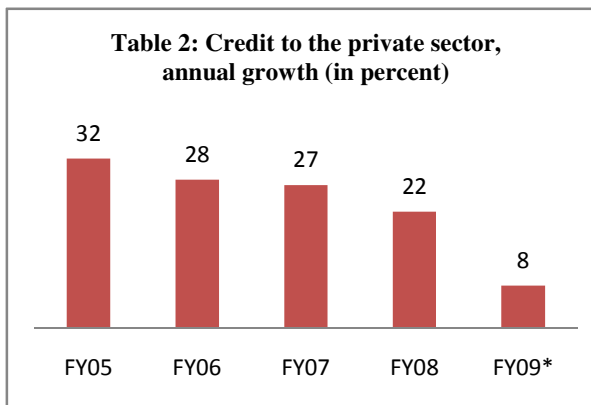
**Table 1: Loan Books of Six Largest Private Banks**  
(Figures in Birr millions)

	FY 2008-09 First half <u>Loan Increase</u>	Average Monthly <u>Loan Increase</u>
Bank A	-49.2	-8.2
Bank B	36.1	6.0
Bank C	124.3	20.7
Bank D	203.5	33.9
Bank E	333.5	55.6
Bank F	416.1	69.4
Average for Six Largest Private Banks:	177.4	29.6

**The slowdown in credit growth shows that the NBE’s monetary policy tools, however rudimentary, can still work to achieve their intended objectives.** Interest rate policies are virtually unused in the conduct of monetary policy in Ethiopia given the lack of short-term money markets. But available tools such as reserve and liquidity requirements are turning out to be quite powerful, even if effective with a lag. For example, given banking system deposits of around 58 billion (as per the NBE’s January 2009 Macroeconomic Indicators report), around 9 billion in potentially loanable funds are being withdrawn by the tripling of central bank reserve requirements to 15 percent. We note also that while deposit growth has slowed, this does not appear to be what is holding back new loans: deposits during the July-December period were up by an average of 577 million birr at the six private banks, but the banks lent out only 177 million (or less than a third) of these additional deposits.

**The slowdown in loan growth seen up to December 2008 does not even yet reflect the central bank’s more recent moves to limit credit growth.** According to press reports, also confirmed by conversations with staff at several private banks, large private banks have in March 2008 been instructed to hold the line on credit growth (such ‘moral suasion’ by the central bank is common in some countries as a supplement to regular monetary policy instruments). Banks who have received such guidance from the central bank (the smallest ones apparently have not) are thus likely to essentially maintain their loan books at their recent levels.<sup>2</sup> If bank loan levels were held flat for the rest of the year, credit growth would be near 8 percent, i.e., the growth rate seen in the first half of the year. Even allowing for a couple percentage points in extra growth in the second half of the year,

**Table 2: Credit to the private sector, annual growth (in percent)**



\*Source: NBE and IMF, FY 09 data for first half only

<sup>1</sup> Of course, while the average loan may be near 1 million birr, this likely reflects many small-sized loans and a much more limited number of very large-value loans (the median size of loans, instead of the average, may thus be more representative if such data were available). Still, the average figures give an indication of the broad orders of magnitude involved.

<sup>2</sup> This need not imply that there is zero new lending at banks. Since a large share of bank’s loans are short-term, as much as a quarter or a third of a bank’s loans may be due within a year; thus, even banks aiming to keep their loan levels roughly constant can provide new loans by recycling loan repayments that are falling due.

this would imply that credit growth is likely to be in the low teens (10-13 percent), a major decline from the 20-30 percent growth rates recorded in recent years (Table 2). Reflecting this slowdown, the stock of credit to the private sector is set to fall from 10.2 percent of GDP in 2007-08 to what we project will be near 8 percent of GDP this year.

**The sharp slowdown in credit growth raises the question of whether the central bank's monetary growth target—confirmed in the recent IMF program—is indeed still 20 percent for FY2008/09.** With a broad money growth target of 20 percent, credit to the private sector would normally be allowed to grow by a roughly similar amount assuming that the country's foreign assets are kept broadly unchanged and as long as the government is not a major user of the loanable funds in the banking system. Given that banks private sector credit has grown by only 8 percent so far this year, this would seem to suggest still substantial room for growth (before reaching the 20 percent target). However, the apparent need of the central bank to limit private sector credit growth to just around half the targeted growth in broad money suggests two possibilities: (i) most of this year's 20 percent growth in broad money is to be concentrated in foreign asset growth (which implies that domestic credit must be restrained), and/or (ii) most of the new domestic credit this year is being programmed for non-private sector borrowers such as the government or public enterprises.<sup>3</sup> We think that the desire to cap private sector credit at their recent levels reflects *both* these considerations: in particular, NBE is working to raise its foreign assets (part of its aim of building foreign reserves to 1.8 months import cover) and a still sizeable share of domestic credit is apparently being programmed for public enterprises.<sup>4</sup>

**The burden of monetary adjustment is being felt most acutely by the private sector, even though the source of Ethiopia's rapid monetary expansion in recent years emanated from the public sector.** Previous analysis by Access Capital has shown that the lion's share of banking system credit was absorbed by the public sector in recent years; for instance, more than three-quarters of the 19.2 billion birr in new loans provided by the banking system last year went to the government and public enterprises. Despite this, it appears that in restraining broad money growth, priority is being given to the central bank's build-up of foreign exchange reserves (which itself is taking away foreign exchange funds that could have otherwise flowed to the private sector) and also to maintaining some level of continued credit flows to public enterprises. Reflecting all these factors, loan availability for many (even creditworthy) borrowers has been cut sharply in recent months.

**How long is Ethiopia's credit crunch likely to last?** Ethiopia's credit crunch is being driven by its own local dynamics—namely the task of addressing high inflation and excess domestic demand—and there is thus no reason to expect that its easing will follow a similar timeline as that of the outside world. In fact, we think that credit easing in Ethiopia will primarily be driven by developments on the inflation front; once the authorities feel inflation is under control there will be little reason to restrain credit growth so sharply. With respect to the inflation outlook, while month-on-month inflation has recently turned positive for two months in a row (reversing the very welcome price declines seen in the prior three months), the most recent monthly price increases have been very modest and we do not see a break in the trend decline seen since last fall. Accordingly, we remain of the view that year-on-year inflation will fall sharply by June 2009, allowing a somewhat more relaxed monetary policy stance—and thus an easing of the credit crunch—soon thereafter.

---

<sup>3</sup> By accounting identity, growth in broad money must equal the growth in the banking system's foreign assets plus the growth in the banking system's domestic assets (the latter being comprised mainly of loans to government, loans to public enterprises, and loans to the private sector). The NBE's 20 percent target for growth in broad money target must thus be split between growth in banks' foreign assets and growth in banks' domestic assets; if most of the 20 percent growth is take up by growth in foreign assets, then domestic credit has very little room to expand; also for any given growth in domestic credit, this must be split between government, public enterprises, and the private sector.

<sup>4</sup> Alternatively, the central bank may be aiming to limit broad money growth to well below its stated 20 percent target. However, we do not think there has been a reduction in the official target for broad money growth, as inflation is clearly on a downward path (in contrast to conditions about a year ago) and it would be highly unusual for tighter targets to be set now when the inflation outlook has become quite favorable and when economic conditions both domestically and externally are slowing and potentially in need of loosening/stimulus measures (as observed in much of the rest of the world).