

Tanzanian Bankers Association Conference

An Overview of Banks Pricing Mechanism on Deposits and Loans

March 8, 2005



Today, tomorrow, together.

An Overview of Banks Pricing Mechanism on Deposits and Loans

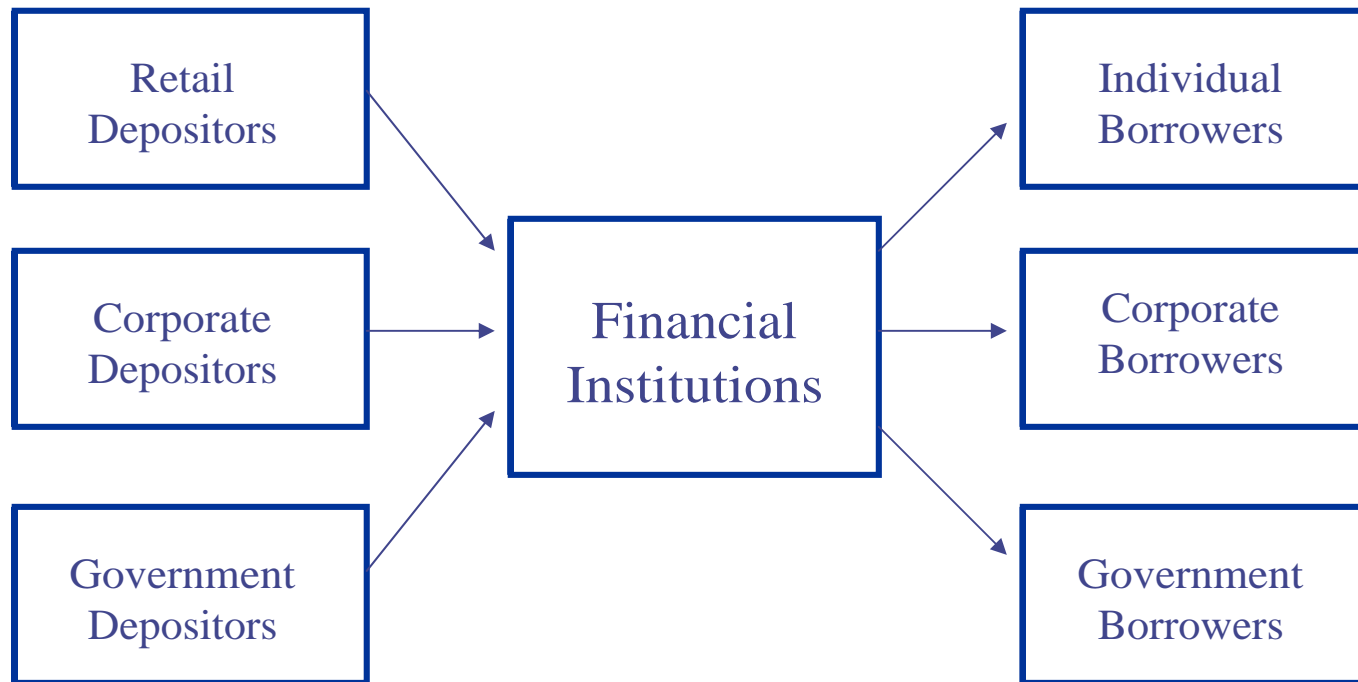
Presenter: Johann De Wet
Executive Director-NBC Ltd
Chartered Accountant (SA)

Chairperson: Ambassador C.M. Nyirabu
Chairman of NBC Ltd.
BA (London), MA (Econ)

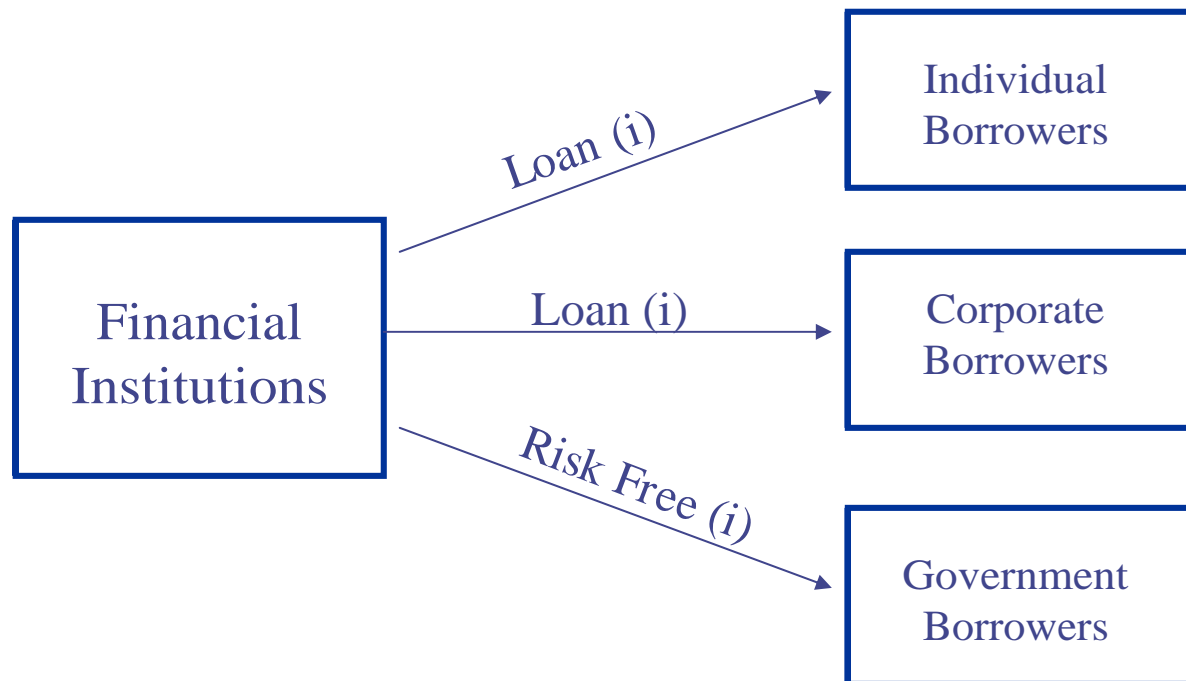


Today, tomorrow, together.

The Financial System in Tanzania



The Pricing of Loans in the Tanzanian Market



The Pricing of Loans in the Tanzanian Market

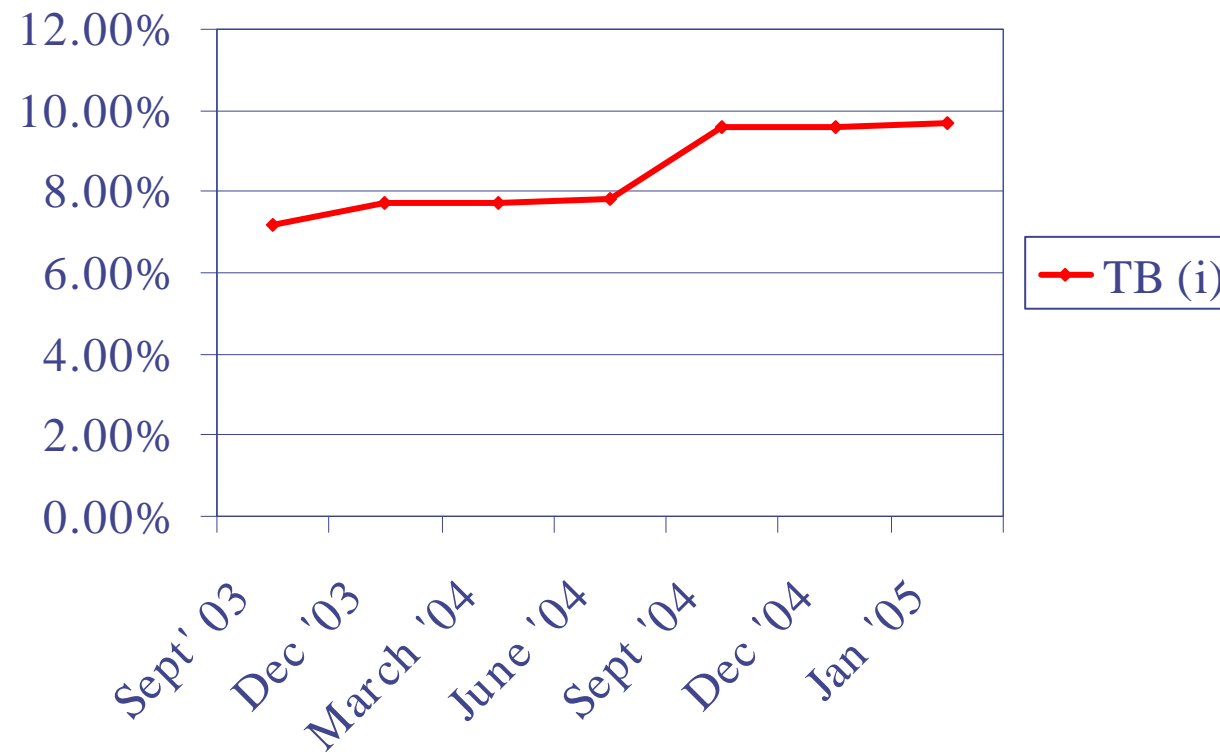
$$\text{Loan (i)} = \text{Risk Free (i)} + \text{Credit Risk Premium}$$

Loan (i) = Interest Rate Paid by Borrower

Risk Free (i) = One Year Treasury Bill rate

Credit Risk Premium = C+C+C+C (the four C's of credit risk)

Risk Free (i) = 1 Year Treasury Bill rate

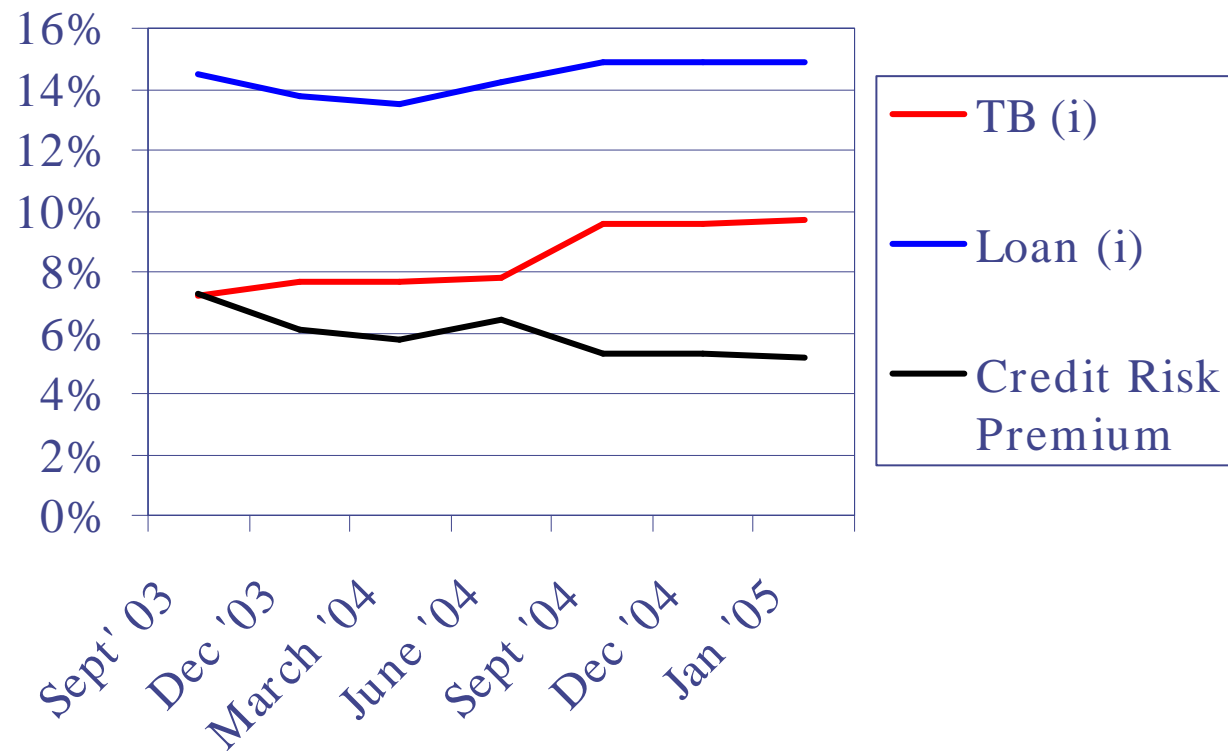


Credit Risk Premium = C+C+C+C

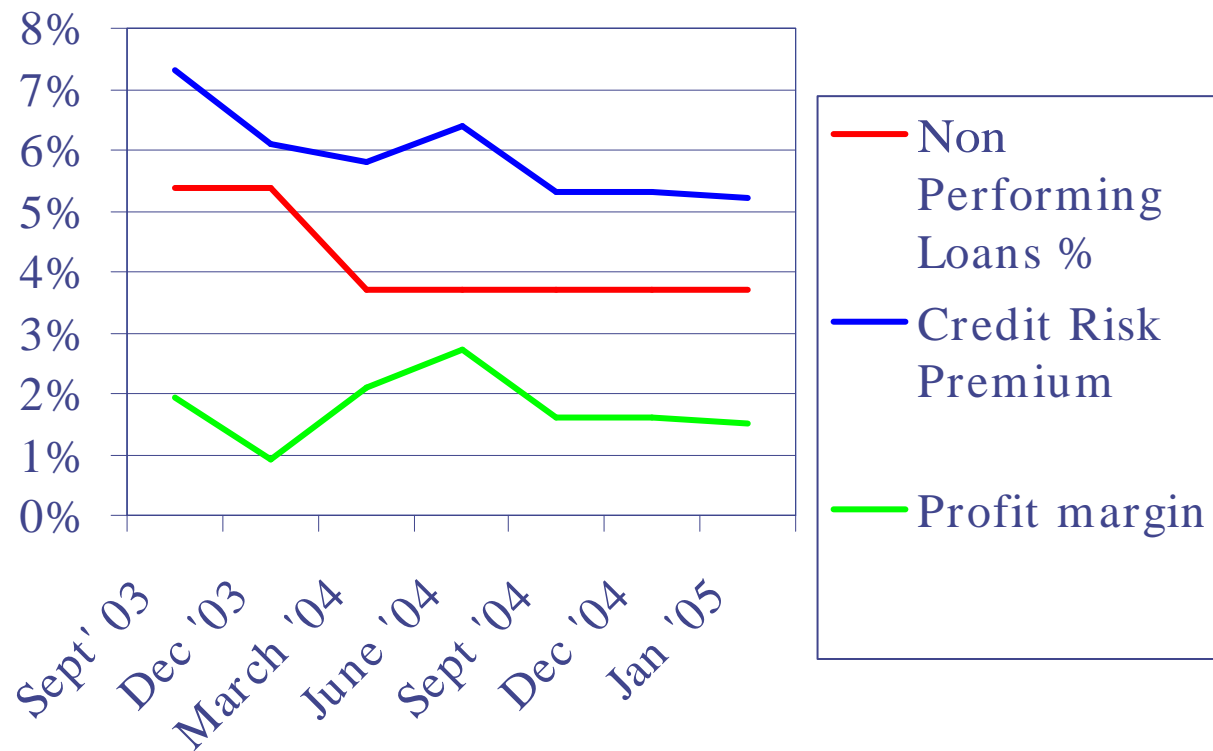
The Four C's of Credit Risk

- ✓ Character – Integrity of management and their commitment to repay the loans
- ✓ Capacity – The availability of cash to repay loans
- ✓ Collateral – The value of assets offered as security for loans
- ✓ Covenants – The terms and conditions contained in the lending agreement

Loan (i) = Treasury Bill (i) + Credit Risk Premium



Non-performing Loans % vs. Credit Risk Premium



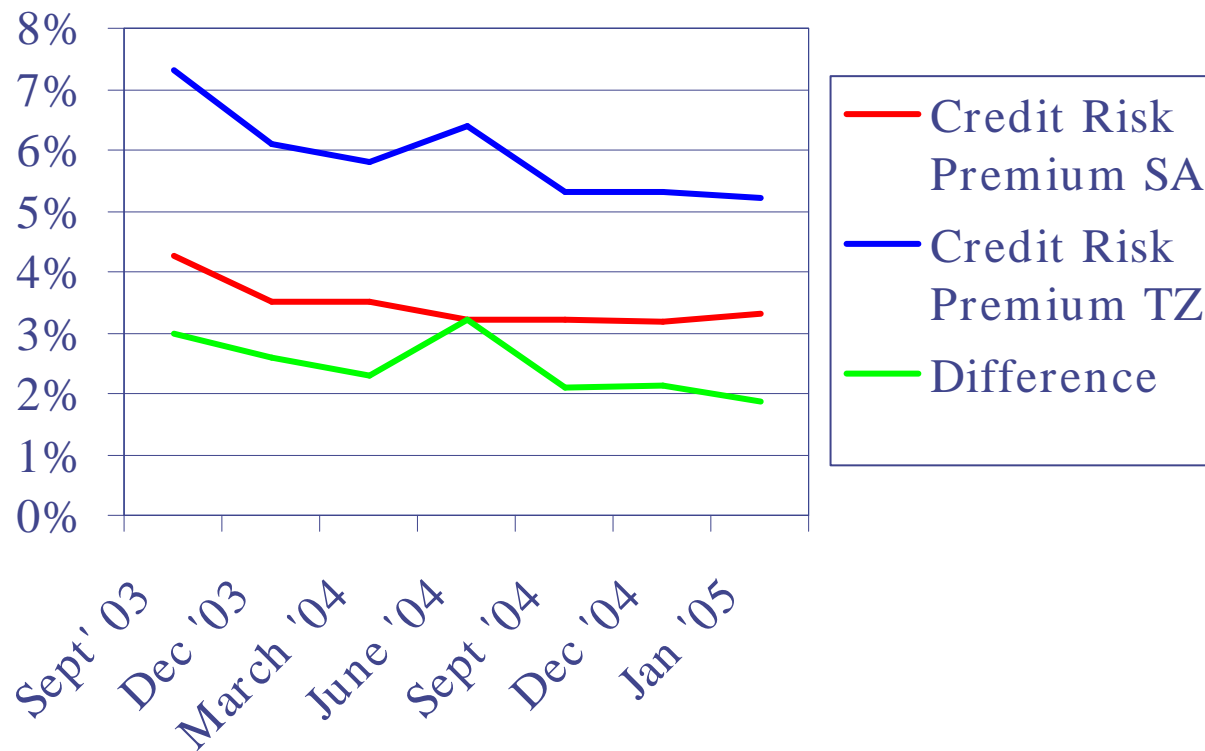
Non Performing Loans % vs. Credit risk premium

- ✓ Non Performing Loans % - This is a historical reflection on the four C's of credit risk in the Tanzanian economy. Currently 3.7 % of all loans become non performing
- ✓ Credit risk premium – This is the credit risk premium charged by banks after analyzing and evaluating the four C's. Currently banks charge on average 5.2 %
- ✓ Profit Spread – This is the margin left after providing for the non performing assets that banks can use to cover operating expenses. Currently only 1.5 %

Non Performing Loans % vs. Credit risk premium

- ✓ There is a downward trend in both the Non Performing Loans % as well as the credit risk premium charged by banks.
- ✓ This is an indication that the private sector's performance in terms of the four C's of credit risk is continuously improving.
- ✓ On the other hand banks have recognized this improvement by reducing the credit risk premium charged accordingly.

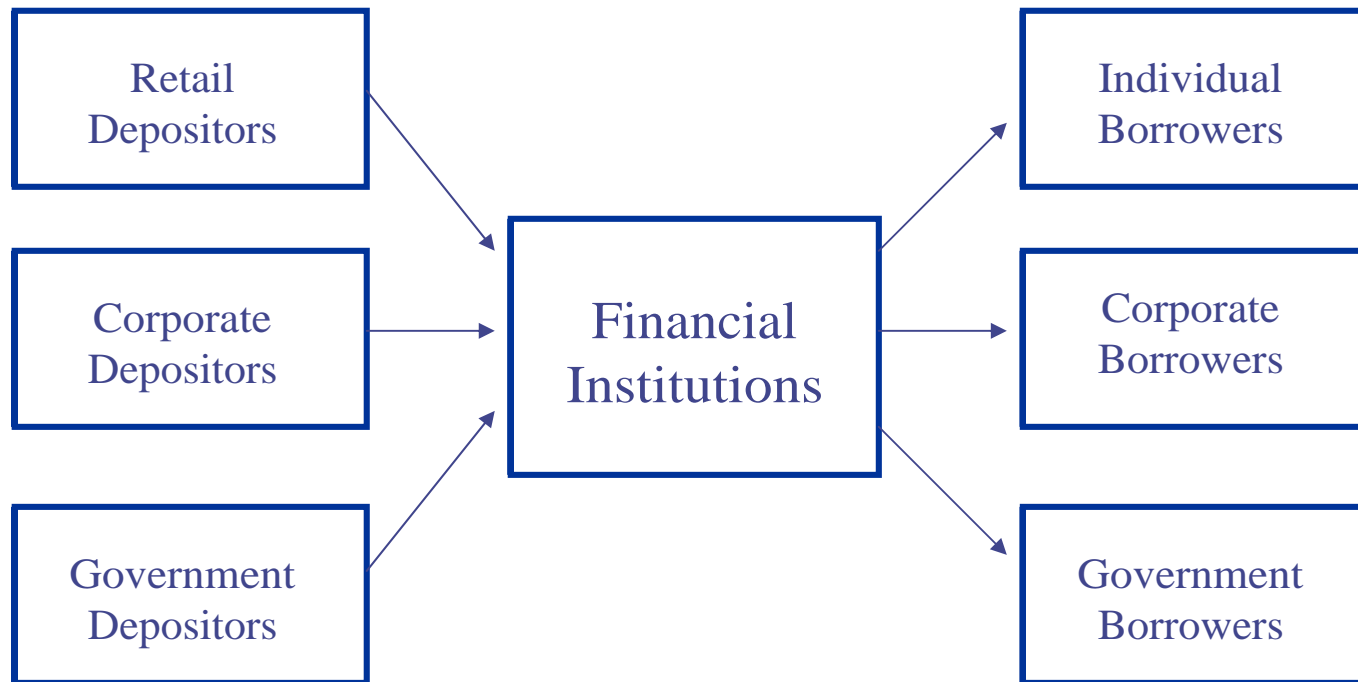
Credit Risk Premium TZ vs. Credit Risk Premium SA



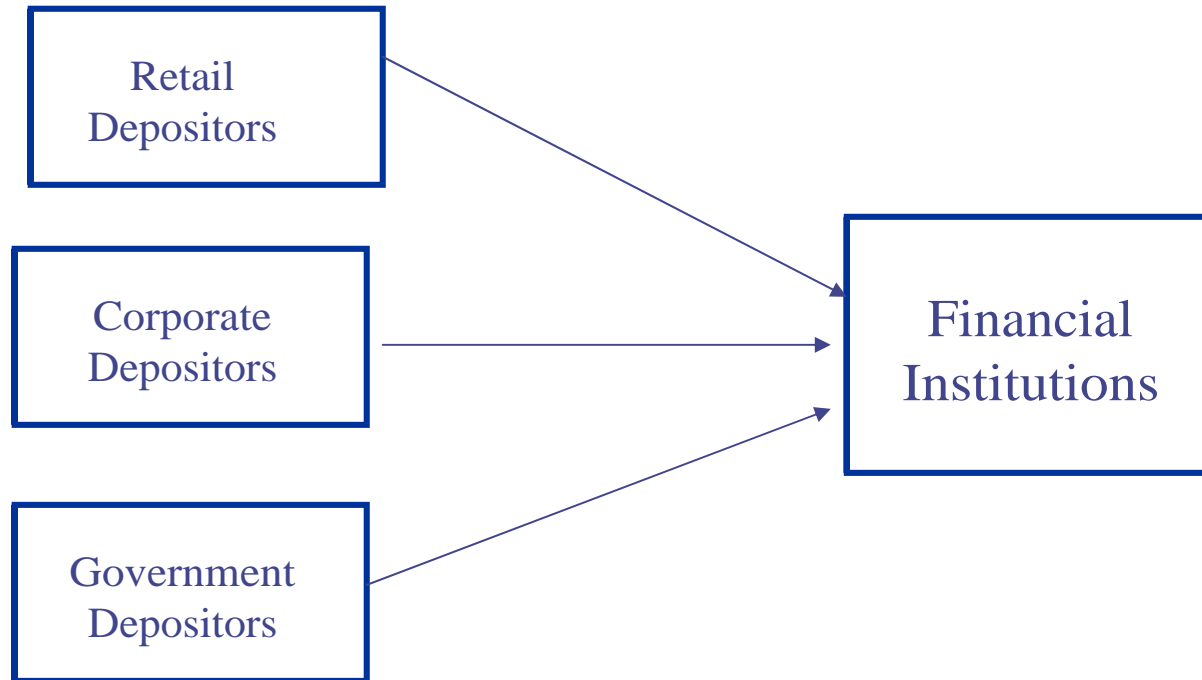
Credit Risk Premium TZ vs. Credit Risk Premium SA

- ✓ The credit risk premium paid by the private sector in TZ compared to the credit risk premium paid by the private sector in SA shows that the premium in Tanzania is currently 1.9 % higher.
- ✓ This should be seen in context. The Non performing asset % in TZ is also significantly higher than the same index in SA.
- ✓ The above is an indication that there is still some room for improvement by the private sector with reference to the four C's of credit risk in order for us to compete on level playing fields with our counterparts in SA

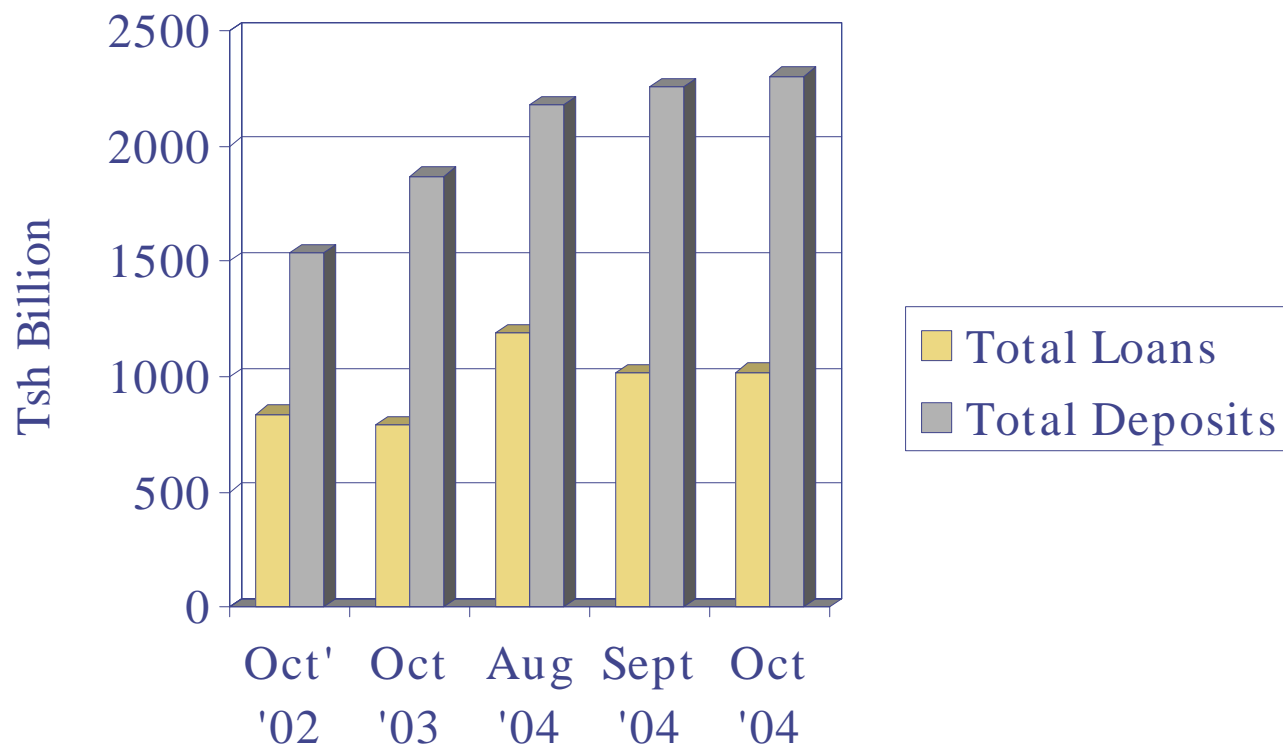
The Financial System in Tanzania



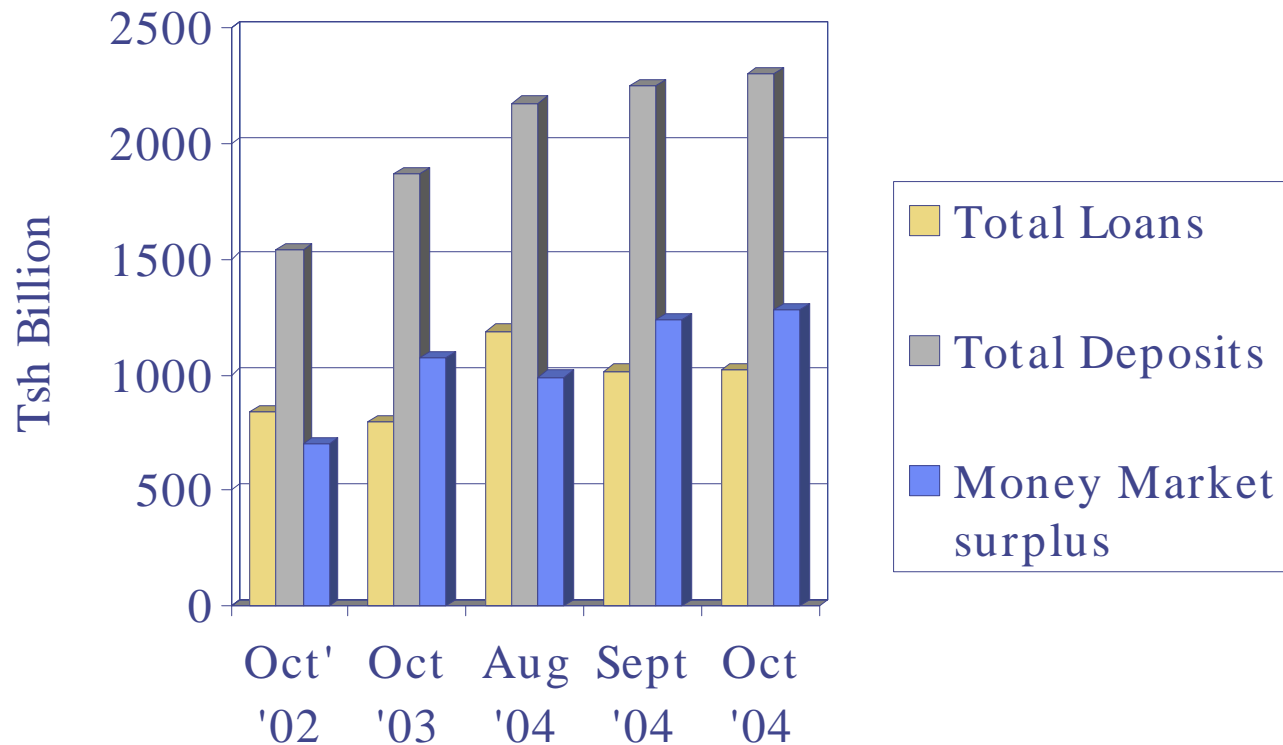
The Pricing of Deposits in the Tanzanian Market



Total Loans vs. Total Deposits



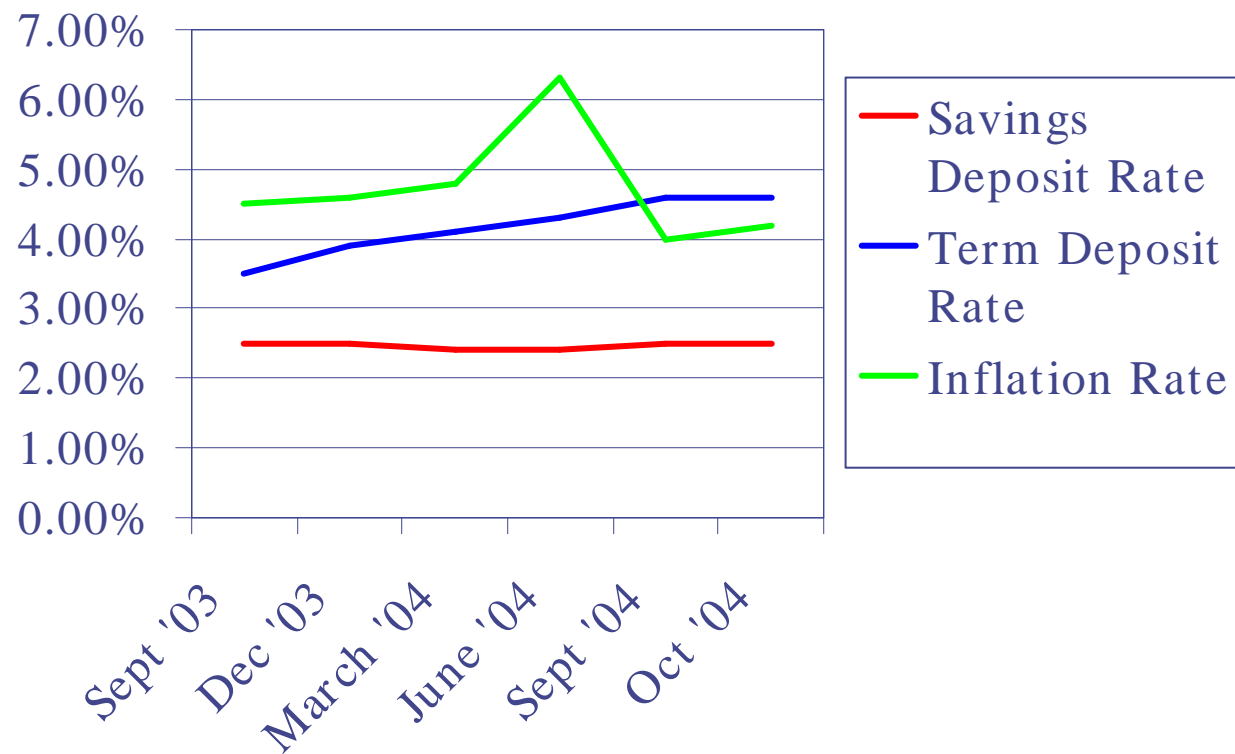
Money Market Surplus



Money market surplus

- ✓ Surplus – Currently a money market surplus exists. Therefore supply is bigger than demand i.e. deposit base is larger than loans to the private sector
- ✓ What happens to the surplus ? – Banks place surplus money with off shore banks and with the Bank of Tanzania at relatively low yields but at the same time at lower credit risk.
- ✓ Effect on deposit rates – Like with any commodity an oversupply will result in the price of the commodity being depressed.

Deposit rates



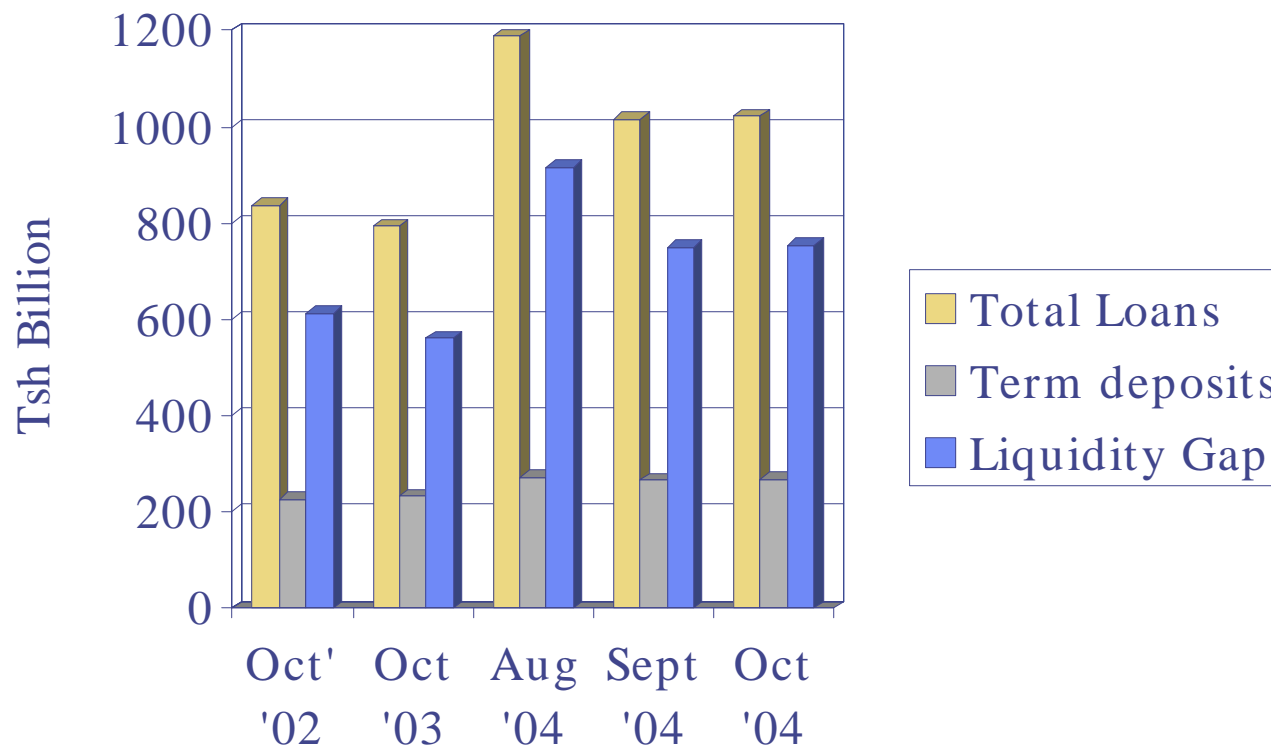
What impacts on the level of deposit rates ?

- ✓ Surplus/ Deficit – Currently the majority of banks have surplus funds as explained in previous slides. An over supply results in lower deposit rates.
- ✓ Term of deposits – Banks run a liquidity risk having to lend long-term money funded by shorter term deposits. This results in banks being willing to pay higher rates on longer term deposits but lower rates on short term deposits.

What impacts on the level of deposit rates ?...continuing

- ✓ Credit rating of Banks – Banks with higher credit ratings will offer lower deposit rates as the risk of default to the customer is lower. Same principle as the four C's approach used to analyze credit risk of Loans.
- ✓ Operating cost – The cost of making deposited funds available to clients by means of delivery channels i.e. branch networks, Atm's and internet banking will impact on deposit rates. The bigger and the more sophisticated the delivery channel infrastructure the higher the cost of delivering the service to the client. In return the customer has access to funds 24/7 as well as from the convenience of his PC.

The Liquidity Risk of Banks



Deposit trends in the Tanzanian Market

- ✓ Banks have started increasing the interest percentage payable on term deposit. Unfortunately the level of term deposits have not increased significantly indicating depositors preference to keep money at lower rates as long as it is on call.
- ✓ Term deposit rates are now higher than the inflation rate resulting in a positive real return for depositors willing to place money on term deposit.
- ✓ Call deposit rates remain low in line with international practice as banks run a liquidity risk on these funds.

Information Sources

- “The South African Financial System” (1998) Absa
- “Schweser Study Program ”CFA
- “Bank of Tanzania Monthly Economic Review” Nov. 2004
- “Published Results by Tanzanian Banks”



The end.

Thank you.

The floor is open for discussion under the Chairmanship of
Ambassador C.M. Nyirabu.



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