28

ABSTRACT

Intercst Rates in Zimbabwe

This paper is one of a series of brief analyses, "snapshots," of the financial sectors of the countries in East and Southern Africa where the RHUDO is active. The emphasis in these papers is on the interest rate structure. The need for these papers arises from several factors. The financial sectors are being called upon to shoulder a large share of the job of marshalling development resources; there is concern about whether deposit and lending rates are positive in real terms, particularly for shelter finance; and finally, we know relatively little about what is happening to these sectors and how they work.

Studies have been done on Botswana, Kenya, Malawi, and Zimbabwe.

January 8, 1991

INTEREST RATES IN ZIMBABWE

Introduction

This paper is one of a series of brief analyses of the financial sectors of the countries in East and Southern Africa where the RHUDO is active. Other papers have been done on Kenya, Malawi, and Botswana. The emphasis in these papers is on the interest rate structure. The need for these papers arises from several factors -- the financial sectors are being called upon to play a greater role in bringing together and allocating development resources, there is concern about whether their deposit and lending rates are positive in real terms, particularly for shelter finance, and, finally, we do not know enough about how these sectors work.

Zimbabwe's financial system is among the most developed in Africa. It consists of the Reserve Bank of Zimbabwe (the central bank), five commercial banks, four accepting houses, two discount houses, three building societies, and the Post Office Savings Bank (POSB). The accepting houses, two discount houses, also called merchant or wholesale banks, specialize in serving corporate customers through trade-related financing and medium-term loans, and fund their lending through subscriptions rather than deposits. The discount houses, modeled on similar institutions in England, accept call money from other financial institutions and invest these funds in a wide range of financial assets, mainly with short maturities. They also serve as market makers in government securities, buying securities from the Reserve Bank and reselling them to financial institutions and the general public. The finance houses provide hire-purchase credit, leasing finance, and medium-term loans, including most financing of consumer durables. They are not allowed to accept deposits of less than 30 days' maturity because of the longer-term nature of their lending operations. The building socities provide mortgage finance for residential and commercial construction. The POSB, a statutory corporation, accepts savings and fixed deposits, and invests them in securities issued by the Government and parastatal enterprises. Because interest on POSB deposits is exempt from income tax and therefore provides a relatively attractive net return, the amount of fixed deposits that any firm or individual may hold with the savings bank is subject to an upper limit, although individual limits may be aggregated within households. Since November 1986, interest on certain deposits with building societies has also been exempt from income tax. Twenty-five percent of these tax exempt funds must be used for low-cost housing.

Several nonbank institutions channel funds to specific areas of economic activity, in particular agriculture and industry. These include the Zimbabwe Development Bank (ZDB), the Industrial Development Corporation (IDC), and the Agricultural Finance Corporation (AFC). In addition, a large number of insurance companies and pension funds operate in Zimbabwe, in part because firms and individuals have had to establish their own pension plans in the absence of any government established social security scheme.

Current Regulatory Practice

Zimbabwe's interest rate structure is regulated by the Reserve Bank of Zimbabwe, which sets maximum or minimum levels by institutional or lending category, as shown in Table 1. One of the objectives of interest rate policy in Zimbabwe is to maintain the relative attractiveness of central government borrowing instruments, and to help restrain excess demand pressures.

There is a floor on interest rates for commercial bank lending. This floor is set at 13 percent, and in the past there has been no cap on this rate. The discount rate for acceptances to finance trade (imports or exports) are influenced by the discount rate set by the Reserve Bank, which acts as discounter of last resort. Discount rates on government bonds theoretically are purely market determined. Rates on "hire purchase", or consumer loans, are governed by the Hire Purchase Act. Effectively hire purchase rates are set by the Registrar of Finance Institutions, and are fixed at 20 percent for new equipment and 23 percent for second-hand equipment. There is a cap on the mortgage rates charged by building societies for various types of building structures. That is, building society interest rates are a maximum, but there is no established floor and one building society in fact charges below the 12.5 percent rate on low income mortgages. All requests for an increase in mortgage rates require the concurrence of the Registrar of Finance Institutions and the Reserve Bank. While there is no prohibition on decreases, the Reserve Bank would be asked to concur.

Liberalization of the Interest Rate Structure and Its Impact

The Reserve Bank has argued that in a highly regulated economy such as Zimbabwe's, interest rates are a blunt instrument of policy and resource allocation. A senior economist at the bank stated that as overall liberalization of the economy takes place it will be appropriate and necessary to free up interest rates, including those for building societies. Thus, the Reserve Bank announced in October, 1989, the first step in moving progressively toward more market determined terms of lending. The new base lending rate, basically a prime rate, is to be varied much more frequently than in the past to take account of monetary policy objectives, and to vary according to market conditions, particularly the cost of funds. The USAID Mission in Zimbabwe supports such moves. The economic strategy benchmarks in the 1987 CDSS include de-emphasis on government regulation and control, including interest rates, while fostering government policies promoting employment and investment.

Informal conversations with members of the financial community, senior government staff, and international donor staff were unanimous that while liberalization is welcome, and necessary to reduce distortions in allocation of resources among sectors, the present structure is <u>not</u> holding back interest rates that are waiting to explode. Therefore, actual market rates are not expected to jump sharply with liberalization. The financial sector is fairly liquid, returns are considered adequate, and spreads are positive. In this regard, the regulated structure in Zimbabwe has not been nearly as constraining nor as disruptive as highly regulated interest rate structures are normally assumed to be. One example of this is that, even in Zimbabwe's regulated market, risk is addressed, though perhaps not perfectly. As one would expect, riskier ventures, such as hire purchase, crop loans, and longer-term commitments command higher interest rates.

<u>The Building Societies and Real Interest Rates</u>

The nominal and real interest rates for building societies and other lending institutions are shown in Table 2. The latter figures depend directly on the reliability of inflation rate estimates, also shown in the table. It is clear that variations in real interest rates are the result of sharp fluctuations in the inflation rate from year to year.

Over the last three years interest rates to homeowners have been significantly positive in real terms, on average by 2.7 percentage points. The interest rate of the building societies' overall mortgage portfolio is close to 14.0 percent. The final data for 1989 compiled by the Central Statistical Office indicate an inflation rate of 11.6 percent. Even if the rate is slightly higher, this increase over 1988 and 1987 would be a result of the partial lifting of the price controls in July, 1989. Even under these conditions the average interest rate for the building societies' portfolio remains positive.

Positive real interest rates are viewed by financial analysts as necessary to protect lending institutions against decapitalization. The building societies in Zimbabwe are run by sophisticated capital managers, and are among the strongest financial institutions in Africa. They have protected themselves against decapitalization through positive real lending rates, and by maintaining a positive spread between their costs and their lending rates. This is confirmed by the fact that they pay an average of 9.5 percent for deposits, and lend in a range of 11.5 to 18.75, depending on the type of mortgage.

Finally, it should be kept in mind that building society lending rates, though established by concurrence between the societies and the Reserve Bank, can be raised to maintain their real positive position if circumstances so require. The Reserve Bank has responded favorably in the past to the building societies' requests for adjustments in interest rates. Importantly, mortgages in Zimbabwe are actually variable rate mortgages, though presently capped by the Reserve Bank. An increase in rates affects not only current lending rates, but also the interest rate on outstanding mortgages. Thus, the Zimbabwe building societies would be very unlikely to duplicate the decapitalization experience of the Texas savings and loans in a rising interest rate environment.

Recent Events

In August, 1990, the Reserve Bank raised key interest rates to curb inflationary pressures, and in anticipation of structural adjustment and the implementation of market oriented economic policies.

Money supply was growing at the rate of 22.5 percent a year while real investment was constrained by a shortage of foreign currency. Inflation had risen from 11.6 percent in 1989 to an estimated 15.0 percent in the first six months of 1990.

Commercial banks were required to begin paying a minimum interest of 5 percent on current account demand deposits, and to raise the savings account rate from 7 percent to 9 percent. Base lending rates for commercial banks were raised from 11.5 to 12.0 percent, while base lending rates for finance houses increased from 14.0 to 14.5 percent.

As part of the same policy directives, building societies and other institutions offering mortgage financing increased their interest rates for non-owner occupied housing loans from 14.75 to 18.75 percent. The down-payment on non-owner occupied housing loans was raised from 30 to 40 percent. Interest rates on owner-occupied housing loans were raised from 13.25 to 13.75 percent, but the downpayment remains the same at 15 percent. Interest rates on building society savings accounts were increased from 7.75 to 9.75 percent.

While the Reserve Bank's policies do not stem from a whole-hearted attempt at liberalization as yet, they do exhibit a much more sensitive attitude toward market pressures. With regard to the building societies, the increases maintain the societies' healthy spreads, and the interest rate of their overall mortgage portfolio is kept abreast of inflation -- that is, positive in real terms.

Conclusion

As stated above, the USAID Mission's policies support liberalization of the interest rate structure. However, the housing sector loan guaranty program proposed by the Regional Housing and Urban Development Office and USAID, is designed to operate just as well in either the present system or in a more liberalized interest rate environment. The most likely option for attracting increased amounts of funds to the building societies, the negotiable certificate of deposit instrument, can be implemented in either environment, and the mortgages under the program would not be made under any special conditions. Thus, the building societies would continue to maintain their spread as well as lend at positive real rates.

TABLE 1A

Principal Interest Rates

Institutional Category	1987	1988
Government of Zimbabwe		
Treasury Bills	8.46	8.46
3-year bonds	9.07	9.07
25-year bonds	13.00	13.00
Commercial Banks		
CDs 6-Mon	9.35-10.00	9.35-10.00
12-Mon	9.75-10.00	9.50-10.00
24-Mon	11.25-11.50	11.75-12.00
Loans and Advances	13.00	13.00
Other Financial Institutions		
Post Office Savings Bank		
Savings Accounts	8.50	8.50
Fixed; 12-months	10.00	10.00
Agricultural Finance Corp.		
Long and Short Term Loans	12.00	12.00
Building Societies		
Savings Accounts	7.75	7.75
Fixed: 12 - months	9.75	9.75
60 - months	10.50	10.50
Loans		
Houses under Z$12,000	12.50	12.50
over Z$12,000	13.25	13.25
Non owner occupied	13.75	13.75
Commercial property	14.75	14.75

Source: Reserve Bank of Zimbabwe
Note: US$1.00 equaled Z$2.25 in 1989. EIU, Profile 1989-90.

TABLE 1B

Principal Interest Rates

Institutional Category	1989	1990
Government of Zimbabwe		
Treasury Bills	8.46	9.00
3-year bonds	9.07	9.07
25-year bonds	13.00	16.00
Commercial Banks		
CDs 6-Mon	10.00	11.00
12-Mon	10.00	12.00
24-Mon	13.00	12.50
Loans and Advances	13.00	13.50
Other Financial Institutions		
Post Office Savings Bank		
Savings Accounts	8.50	9.25
Fixed; 12-months	10.00	10.25
Agricultural Finance Corp.		
Long and Short Term Loans	12.00	13.00
Building Societies		
Savings Accounts	7.75	9.25
Fixed: 12 - months	9.75	10.50
60 - months	10.50	10.75
Loans		
Houses under Z$12,000	12.50	12.50
over Z$12,000	13.25	13.75
Non owner occupied	13.75	18.75
Commercial property	14.75	14.75

Source: Reserve Bank of Zimbabwe
Note: US$1.00 equaled Z$2.25 in 1989. EIU, Profile 1989-90.

TABLE 2

Trends in Selected Real Interest Rates

Institutional Category	Year	Nominal Interest Rate	Inflation Rate* (CPI)	Real Interest Rate
1. Building Society Loans Under Z$12,000 (low income)	1987	12.5	10.4	+ 2.1
	1988	12.5	8.0	+ 4.5
	1989	12.5	11.6	+ 0.9
	1990	12,5	15.0.	- 2.5
Non-owner Occupied Property	1987	13.75	10.4	+ 3.35
	1988	13.75	8.0	+ 5.75
	1989	13.75	11.6	+ 2.15
	1990	18.00	15.0	+ 3.00
2. Commercial Bank CDs 12 - mos.	1987	10.00	10.0	- 0.4
	1988	10.00	8.0	+ 2.0
	1989	10.00	11.5	- 1.6
	1990	12.00	15.0	- 2.5
3. Commercial bank loans	1987	13.00	10.4	+ 2.6
	1988	13.00	8.0	+ 5.0
	1989	13.00	11.6	+ 1.4
	1990	13.50	15.0	- 2.5
4. Post Office Savings Accounts	1987	8.50	10.4	- 1.9
	1988	8.50	8.0	+ 0.5
	1989	8.50	11.6	- 3.1
	1990	9.25	15.0	-5.75

Source: Reserve Bank of Zimbabwe

* The inflation rate for 1990 is based on the first nine months of CPI data compiled by the Central Statistical Office. It is the average of the index for lower income families and higher income families.

Sources

(1) International Monetary Fund; internal memorandum "Zimbabwe - Staff Report for the 1988 Article IV Consultation," September 14, 1988.

(2) .....; internal memorandum "Zimbabwe - Staff Report for the 1989 Article IV Consultation," November 7, 1989.

(3) .....;internal memorandum "Zimbabwe - Recent Economic Developments," November 17, 1989.

(4) Economist Intelligence Unit; Zimbabwe country Profile, and, 1989-90.

(5) Government of Zimbabwe; Quarterly Digest of Statistics - March 1989, Central Statistical Office.

(6) .....; Quarterly Economic and Statistical Review December 1989, Reserve Bank of Zimbabwe

(7) First Merchant Bank of Zimbabwe; Quarterly Guide to the Economy - September 1989, and, September 1990.

(8) "Industrialists Say Reserve Bank Changes Positive," The Financial Gazette, Harare, August 17, 1990.

Interviews, November 20-22, 1989

(1) Paul Larson, U.S. Embassy Economist, Harare.

(2) Lloyd McKay, World Bank Economist, Harare.

(3) R. Nyadzyo, Chief Economist for Capital Markets, Reserve Bank of Zimbabwe, Harare.

(4) S.M.T. Malaba, Chief, Economics Section, Reserve Bank of Zimbabwe, Harare.

(5) S. Tshabangu, Registrar of Financial Institutions, Ministry of Finance, Harare.

(6) Simon Grey, Economist, Merchant Bank of Central Africa, Harare.

(7) Graham Hollick, Deputy General Manager, Central Africa Building Society, Harare.

6479F:CM:ekm:1/8/91