Innovations have enhanced financial inclusion in Uganda - IMF chief

In a question and answer session with *Daily Monitor's* **Martin Luther Oketch**, the IMF Resident Representative in Uganda, Ms Mira Clara, gives insight into the country's banking sector.

Rural populations are still underserved by commercial banks in Uganda. Do you think there is need to increase the number of formal institutions in the country?

About In the last few years, financial innovations, mostly mobile money, have enhanced access and financial inclusion. Uganda currently has 21 million registered users and transactions are valued at about 44 per cent of Gross Domestic Product. Credit companies and micro finance institutions continue to offer innovative financial products. So while it is true that formal access remains low, with only 28 per cent of the adult population having a bank account according to the World Bank Findex and commercial bank penetration low, mobile money/new technologies have been helping bridge this gap.

Additional necessary improvements to expand access to financial services to rural areas can thus come from both the traditional banking sector and the newer sectors. Newly introduced arrangements such as agency banking are expected to play a key role facilitating access to banking services in areas with limited or no branch presence.

What is your view on the current state of Uganda's banking industry in relation to banking services at the international scene?

Our understanding is that the banking sector remains sound and well capitalised, with most banks meeting or exceeding Basel III capital requirements and their liquidity coverage is adequate. However, Non- Performing Loans (NPLs) remain at higher than previous levels. Lending costs remain structurally high. In this context, credit to the private sector remains low with banks participating very actively in the domestic government debt market.

The Central Bank has over the months reduced the policy rate (CBR) but little has been achieved regarding reduction in the lending rate which impacts negatively on the economy. What must be done to have the lending rates drop to reasonable levels?

The contributing factors to the high spreads are mostly related to structural rigidities, including high operating costs and high funding costs associated with the low deposit base. Furthermore, commercial banks devote a large share of their assets to invest in domestic government debt, showing cautious risk taking and, in the context of high NPLs, heightened risk aversion. The need to provision for these bad debts also contributes to high rates.

In the last one year banks in Uganda have registered increased levels of non-performing loans which reached 10.3 per cent in December 2016. What are the risks in Uganda's financials in relation to the international financial system?

Indeed, NPLs have increased and the increase affected many sectors, including agriculture, construction, trade and commerce. A recent survey conducted by Bank of Uganda among banks highlights that key causes behind the high borrower default rates include the impact of political instability in South Sudan; domestic arrears; cost overruns; and diversion of funds from borrowers. Subdued economic activity and the recent drought have also taken a toll. High NPLs are likely to continue to weigh on bank's business decisions and profitability, making them more cautious and less inclined to lend to the private sector.

In terms of the international financial system, risks are limited. Some channels would include the increase in global interest rates which could lead to capital outflows in frontier economies and more expensive financing costs, and a likely stronger dollar, given the expected US fiscal stimulus and more rapid normalisation of monetary policy.

Furthermore, Uganda is highly connected with other countries as there is a dominant presence of subsidiaries of foreign banks. However, according to our previous research, risks of cross-border reversals do not seem high.

What must be done to deepen Uganda's financial sector which remains shallow?

Uganda has come a long way in improving access to the financial sector, including by the use of financial innovations. Some reforms could further deepen the system, including offering attractive products and fostering access in rural areas in cost effective ways (through programmes to boost agricultural financing in rural areas); reforming the pension system by expanding its coverage; further improving financial literacy and consumer protection; and improving and expanding land registration.

The IMF Resident Representative in Uganda, Ms Mira Clara. PHOTO BY RACHEAL MABALA.

How do you view the future of Uganda's banking industry in the next five to 10 years?

Uganda's banking industry has a significant potential to continue prospering and benefiting from financial innovations.

21m

THE NUMBER OF REGISTERED MOBILE MONEY USERS IN UGANDA

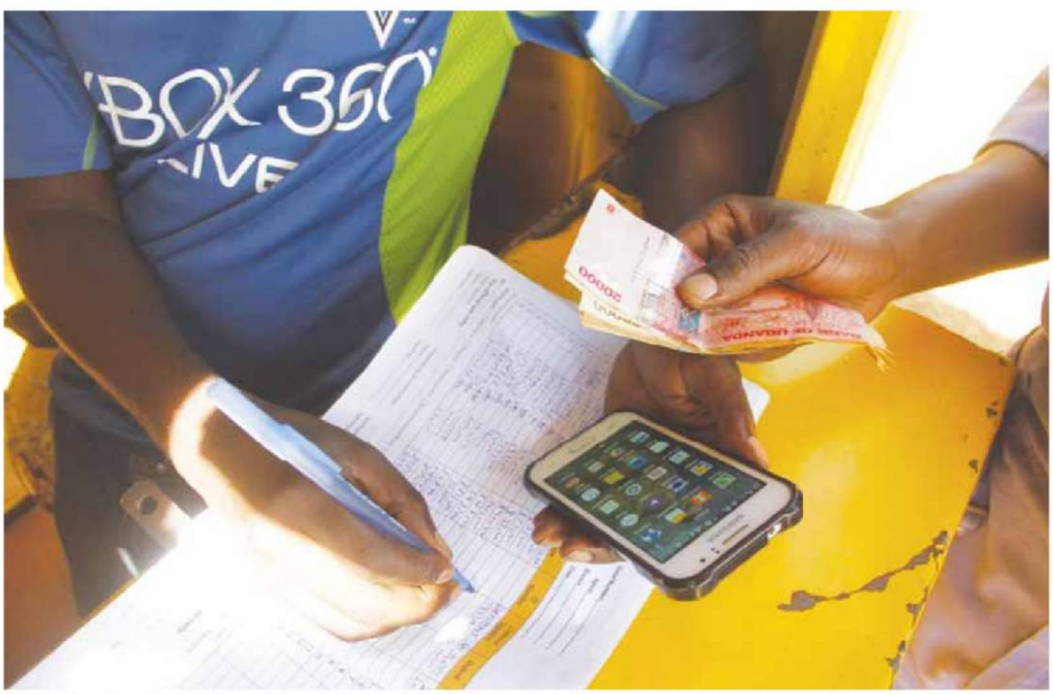
With technology expanding access and thus expanding the banks' potential new clients, business opportunities linked to the development of the oil sector and the continuation of the regional integration process, the sector's potential is high if they leverage technology and opportunities well. Regulation and supervision have an essential role to play to keep up with innovations and ensure the stability of the system.

Uganda has only one development bank, which is even undercapitalised to provide long term credit needed by the private sector. How can government make Uganda Development Bank a sound financial institution to support the country's economic programmes?

Government can facilitate the financing of the economic programmes through many means, including by providing a sound business climate that attracts private sector investment. Another way is the use of development banks, which can contribute to addressing market failures and provide resources to underfunded sectors, catalyse private sector financing and expand financial access and thus inclusive growth. International experience shows that for development banks to work efficiently, it is essential that they focus on crucial sectors for the development of the country, have sufficient capabilities, and are administered and operated in a transparent, professional way, shielded from political pressures.

What is likely to be the impact of technology in Uganda's banking industry?

Technology is likely to further revolutionise Uganda's banking sector. Following the development of mobile money, the introduction of agency banking and other innovations are expected to contribute to reducing costs and enhancing inclusiveness. Technology is so far a major contributory factor to enhancing financial inclusion. In this context, it is important to ensure that the innovations are properly regulated and supervised, without complicating excessively their development.



A customer hands over money during a mobile money transaction. Mobile Money is one of the innovations that have greatly impacted financial inclusion in Uganda. PHOTO BY RACHEAL MABALA.