Bank Lending Survey Report
Fourth Quarter - FY 2015/16

STATISTICS DEPARTMENT, BANK OF UGANDA

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Executive Summary

Statistics Department conducted the lending survey for supervised deposit-taking financial institutions, for the quarter ended June 2016. The objectives of the survey were to: enhance BOU's understanding of the lending behavior and loan financing conditions among deposit-taking financial institutions; capture leading information on credit developments and bank lending in the Ugandan market during the quarter ended June 2016 and expectations for the quarter ending September 2016.

Credit Standards

In the fourth quarter of FY 2015/16, credit standards on loans to enterprises were tightened at a slower pace compared to the previous quarter. This was due to lender's deliberate efforts to maintain the quality of the loan book arising from high default rates particularly from large enterprises; scarcity of long term deposits and tight liquidity conditions in the market.

Across firm size, credit standards were tightened for both SMEs and large enterprises in net terms albeit at a slower pace compared to the previous quarter. In terms of loan duration, banks tightened credit standards on both short and long term loans, on net basis, in the quarter ended June 2016.

Looking ahead to September 2016, banks expect to further tighten credit standards across enterprises and duration except short term loans. The main reasons cited by banks were: the need to respond to the budget tax increases during FY 2016-17 on particular commodities that will mainly impact of large enterprises and emphasis on credit history that will negatively impact on clients with poor credit history. The easing of short term credit standards was expected from the current decline in Central Bank Rate and higher demand from clients for working capital in preparation for year end.

For households, a higher percentage of banks also expect to tighten credit policy mainly due to the high default rate on consumer loans with no fall-back position, since they are largely unsecured and the need to reduce non-performing loan ratios.

Outlook on Demand for credit

In the quarter to September 2016, banks anticipate an overall increase in demand for credit from both enterprises and households. The increase in demand will be driven by the decline in lending rates, the resumption of investments following its deferral in the first quarter of 2016, improvement in general economic conditions, increased demand for education loan for the third term of the school year and bank's effort to grow portfolio particularly from less riskier clients.

Outlook on Terms & Conditions for credit

In the quarter to September 2016, on a net basis, most banks expect to tighten the margins on riskier loans while easing conditions for prime borrowers to enterprises and households. The expectation will be driven by banks' focus on customers with higher credit worthiness, the continued reduction in CBR and competition in the lending market.

All non-price terms and conditions (size of the loan, collateral requirements and maturity period) to enterprises and households will be tightened due to desire to improve the quality of loan portfolio, the decline in property values and difficulty in disposing off property; new regulatory requirement on higher Loan to Value (LTV) ratio, reconsideration of loan tenor in light of risks for some categories of employers and lack of long term funding.

Outlook on the default rate on loans

On a net basis, banks expect default rates on loans to enterprises to increase and default rates on loans to households to decline in the coming three months. The expected increase in default rate for enterprises is on account of the lagged effects of the previous high interest rate periods that take long to wind out. On the other hand, the expected decrease in default rate for households is based on the improved profiling of both employers and clients by lenders and budgetary release by government.

Interest Rate Expectations

The survey results indicate that the majority of banks expect their lending rates to remain unchanged over the next quarter to September 2016 while the rest

expect to reduce their lending rates. The average percentage decrease in lending rates over the next quarter to September 2016 is estimated at 0.27 percentage points.

1. Introduction

Objectives of the Survey

The lending survey conducted by Statistics Department captures past and prospective developments in the credit market. The survey is designed to complement existing quantitative data on credit and lending rates.

The main objectives of the survey are to:

i) Enhance BOU's understanding of the lending behaviour and loan financing conditions among the deposit-taking institutions; and

ii) Capture leading information on credit developments.

The survey covered the outturn for the quarter ended June 2016 and expectations for the quarter ending September 2016. Questionnaires were sent to all 25 commercial banks in Uganda, yielding a response rate of 92 percent.

This survey report therefore presents the findings from the analysis of the responses received from the commercial banks only. <u>The methodology used in the analysis is detailed in *Appendix 1.*</u>

2. Survey Findings

2.1 Enterprises

2.1.1 Credit Standards to Enterprises

Credit standards consist of internal banking rules/criteria/guidelines which will determine (based on the classification by sector, area, size, financial indicators, etc.) what types of loans (collaterised, non-collaterised, investment, overdraft etc.) to be provided and to which clients. This survey measures changes in such standards including cases when a bank has introduced new lending policy or amended the implementation of an existing lending policy.

In the fourth quarter of FY 2015/16, credit standards on loans to enterprises were tightened at a slower pace compared to the previous quarter.

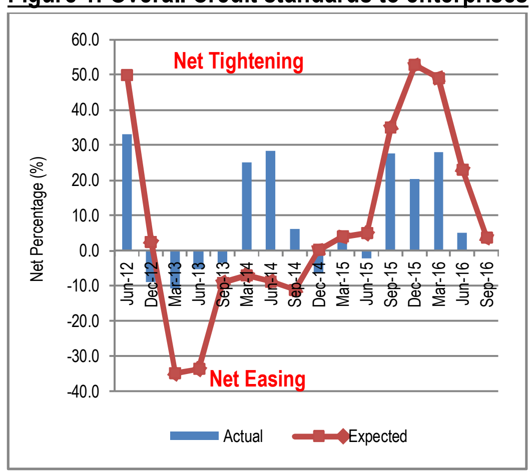
Banks reported tightened credit standards in net terms at 28.1 percent in March 2016 compared to 5.1 percent in the quarter ended June 2016. The net tightening was also lower than what banks had anticipated (23.2 percent) in the previous survey. (*See Table 1 and Figure 1).*

Across firm size, credit standards were tightened for both SMEs (13.1 percent) and large enterprises (5.0 percent) in net terms albeit at a slower pace compared to the previous quarter.

In terms of loan duration, banks tightened credit standards for short and long term loans, on net basis, in the quarter ended June 2016 (*See Table 1*).

Key reasons cited for the tightening include: deliberate efforts to maintain the quality of the loan book arising from high default rates particularly from large enterprises; scarcity of long term deposits and tight liquidity conditions in the market.

<u>Figure 1: Overall Credit standards to enterprises</u>



Source: **Bank of Uganda**

<u>*Notes:*</u>

(a) Net percentage balances are calculated by obtaining the difference between the percentage of lenders reporting that, a factor has tightened/increased and those reporting that it has eased/decreased. A negative balance indicates that more credit is available.

(b) The bar graph shows the net percentage over the previous three months. The line graph shows the expectation over the next three months.

(c)Expectations have been moved forward one quarter so that they can be compared with the actual outturn in the following quarter.

Table 1: Credit Standards as applied to approval of loans to enterprises

	Overall		Loans to SMEs		Large enterprises		Short-term Loans		Long-term Loans	
Bank's action	Mar-16	Jun-16	Mar-16	Jun-16	Mar-16	Jun-16	Mar-16	Jun-16	Mar-16	Jun-16
Tightened(A)	28.1	5.1	45.7	14.0	33.8	5.0	3.1	3.9	24.0	18.1
Unchanged	70.0	94.9	54.3	85.1	65.5	95.0	90.6	94.9	53.8	81.9
Eased (B)	0.0	0.0	0.0	0.9	0.7	0.0	6.3	1.2	0.0	0.0
Net %(A-B)	**28.1**	**5.1**	**45.7**	**13.1**	**33.1**	**5.0**	**-3.2**	**2.7**	**24.0**	**18.1**
Interpretation: Negative-net easing, positive-net tightening										

Source: Bank of Uganda

In the quarter to September 2016, banks expect to further tighten credit standards for overall loans to enterprises; albeit at a slower pace.

Banks indicated that they expect to further tighten credit standards in the quarter to September across enterprises and duration except for short term loans (*See Figure 1 and Table 2*).

The main reasons cited by banks for the expected tightening in credit standards, in the quarter to September 2016 include: the need to respond to the budget tax increases during FY 2016-17 on particular commodities that will mainly impact large enterprises and emphasis on credit history that will negatively impact on clients with poor credit history.

The easing of short term credit standards is expected from the current decline in Central bank Rate (CBR) and higher demand from clients for working capital in preparation for year end.

Table 2: Expectations for Credit Standards as applied to approval of loans to enterprises

	Overall		Loans to SMEs		Large enterprises		Short-term Loans		Long-term Loans	
Bank's expected action	Jun-16	Sep-16	Jun-16	Sep-16	Jun-16	Sep-16	Jun-16	Sep-16	Jun-16	Sep-16
Tighten (A)	30.3	9.1	42.4	18.8	35.5	16.0	28.0	9.1	46.5	23.9
Unchanged	62.5	85.7	48.4	69.6	63.5	82.7	63.0	80.1	54.8	70.9
Ease (B)	7.2	5.3	7.9	11.5	1.0	1.2	9.0	10.8	0.0	5.3
Net %(A-B)	23.2	3.8	34.5	7.3	34.5	14.8	19.1	-1.8	46.5	18.6
Interpretation: Negative-net easing, positive-net tightening										

Source: Bank of Uganda

2.1.2 Credit Standards by Economic Sector

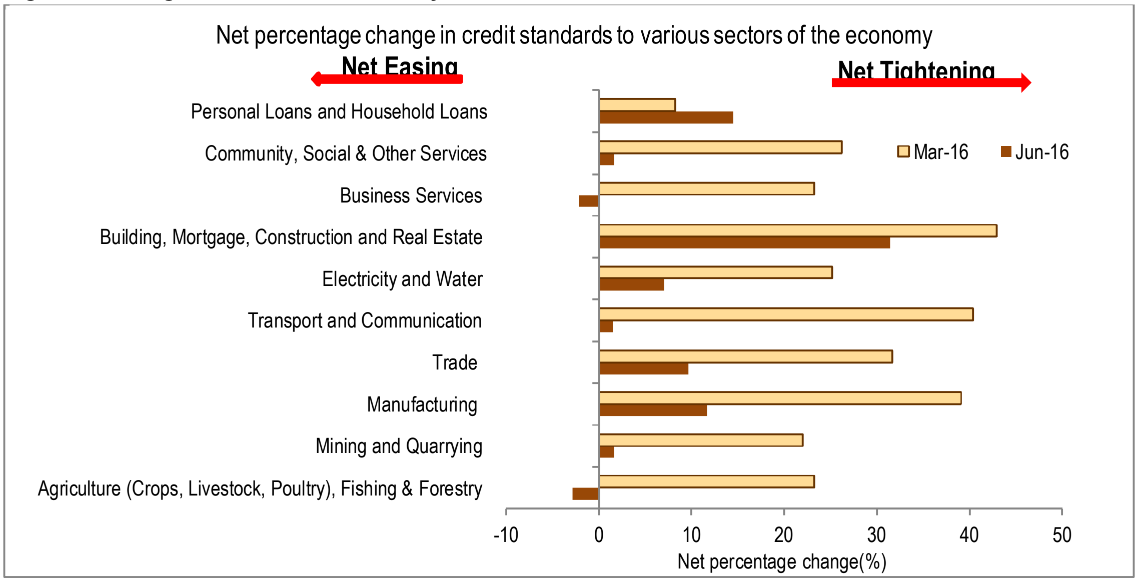
Banks were asked to indicate how their credit standards had changed for the different sectors of the economy. Compared to March 2016, majority of sectors were noted to have registered slower pace of net tightening in credit standards in June 2016.

The personal and household loan sector however registered higher pace of tightening while business services and the agriculture sectors had net eases in credit standards (*See Figure 2*).

The higher net tightening in the personal and household sector was due to the high credit risk resulting from layoffs as companies down size, defaults in public service loans and the high interest rates which have impacted the fixed income earners ability to repay.

On the other hand, the net easing in the business services and the agriculture sectors were driven by improving conditions in the sectors.
(*See Figure 2*).

Figure 2: Changes in credit standards by economic sector



Source: Bank of Uganda

2.1.3 Expectations in the Terms and Conditions for Credit to Enterprises

Credit terms and conditions refer to the specific obligations agreed upon by the lender and the borrower. In the context of this survey, they consist of:

a) Price-related terms and conditions - these include the direct price or interest rate.

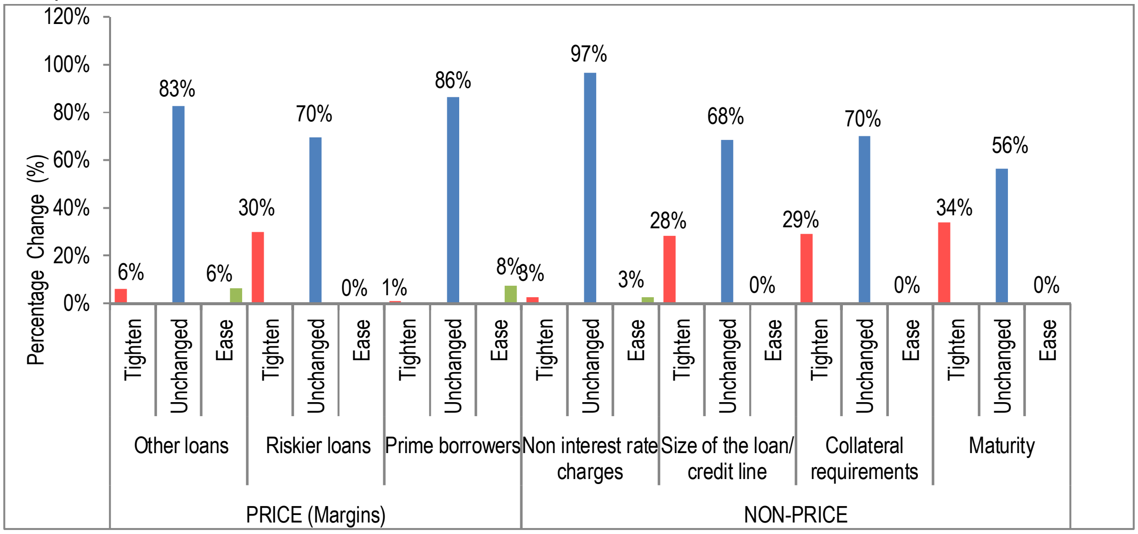
b) Non-price related terms and conditions - these include the maximum size of the loan and the access conditions as well as other terms and conditions in the form of: non-interest charges (e.g. fees); collateral requirements (including compensating balances); loan covenants and maturities (short-term versus long-term).

In the quarter to September 2016, the percentage of banks that expect to keep both price and non-price terms unchanged exceed 50 percent for the different price and non-price terms and conditions.

On a net basis, most banks expect to tighten the margins on riskier loans while easing conditions for prime borrowers, driven by banks' focus on customers with higher credit worthiness

All the non-price terms and conditions (size of the loan, collateral requirements and maturity period) are expected be tightened due to lenders' desire to improve the quality of loan portfolio and lack of long term funding (See Figure 3).

Figure 3: Expected changes in terms & conditions for approving loans to enterprises (July – September 2016)



Source: Bank of Uganda

2.1.4 Demand for Credit by Enterprises

In the quarter to September 2016, 30.4 percent of banks anticipate an overall increase in demand for credit while 60.4 percent expect demand to remain unchanged. The expected increase in demand cuts across all enterprises and duration of the loans (*See Table 3* below).

Some of the major reasons given for the expected increase in demand by enterprises above include:

a) The decline in lending rates which is likely to attract demand for credit.

b) The resumption of investment following its deferral in the first quarter of 2016.

Table 3: Demand expectations for the next three months (July-September 2016)

	Overall		Loans to SMEs		Large enterprises		Short-term Loans		Long-term Loans	
Bank's expected action	**June-16**	**Sep-16**	**June-16**	**Sep-16**	**June-16**	**Sep-16**	**June-16**	**Sep-16**	**June-16**	**Sep-16**
Increase(A)	71.1	30.4	87.0	34.4	40.4	29.4	89.7	39.0	35.5	19.8
Unchanged	18.1	60.4	10.0	57.4	47.9	62.0	7.3	56.1	52.7	62.0
Decrease(B)	3.0	0.3	1.3	3.3	10.1	3.6	1.3	0.0	10.1	10.1
Net %(A-B)	**68.1**	**30.1**	**85.7**	**31.1**	**30.3**	**25.8**	**88.3**	**38.8**	**25.4**	**9.7**
Interpretation: Negative-net decrease, positive-net increase										

Source: Bank of Uganda

2.2 Households and Individuals

2.2.1 Credit standards to households

Similar to enterprises, banks tightened credit standards to households and individuals on a net basis. This is contrary to net easing observed in the previous period (*See Appendix 1*).

In the quarter to September 2016, a higher percentage of banks expect to tighten credit policy to households, a net tightening of 23.3 percent compared to outturn of 12.7 percent in the quarter ended June 2016 (*See Appendix 1*).

Banks noted the high default rate on consumer loans with no fall-back position since they are largely unsecured and the need to reduce non-performing loan ratios as major reasons for tightening credit standards.

2.2.2 Outlook on Terms and Conditions for Credit to Households

Although both price and non-price terms and conditions for consumer credit largely unchanged over the next three months to September 2016, banks indicated that on a net basis, they expect to reduce interest rate margins on average and prime borrowers and widen margins of riskier borrowers in the coming quarter to September 2016. Banks also indicated that they expect to increase non interest rate charges, reduce the size of loan and maturity period and tighten collateral requirements. (*See Appendix 1*).

The key reason cited for the net ease in price terms and conditions include: the continued reduction in CBR; competition in the lending market. On the other hand, the reasons cited for the net tightening of non-price terms and conditions include: the decline in property values and difficulty in disposing of defaulter's property; new regulatory requirement on higher Loan to Value (LTV) ratio and reconsideration of loan tenor in light of risks for some categories of employers.

2.2.3 Demand for Credit by households

Credit demand by households is expected to increase in the three months to September 2016. 65.7 percent of respondents noted that the demand will increase driven by the reduction in interest rates, improvement in general economic conditions, increase in demand for education loan for the third term of the school year and bank's effort to grow portfolio particularly from less risky clients.

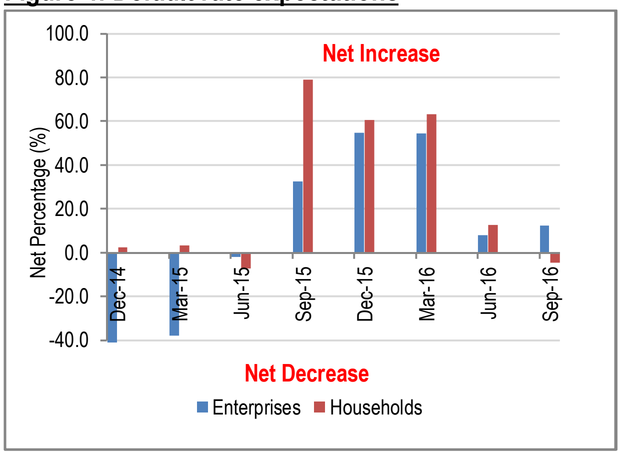
Only 3.3 percent of banks expect demand to decline on account of tightened credit policy to households (see Appendix 1).

2.3 Expected Default rate on loans to enterprises and households

Banks were asked to report their expectations on the change in default rates on loans to enterprises and households over the quarter to end September 2016. On a net basis, 12.0 percent of the banks expect default rates on loans to enterprises to increase and 5.0 percent expect default rate on loans to households to decline in the coming three months (See Appendix 1).

The expected increase in default rate for enterprises is on account of the lagged effects of the previous high interest rate period that take long to wind out.

Figure 4: Default rate expectations



Source: Bank of Uganda

The expected decrease in default rate for households is based on the improvement in liquidity conditions for households, improved profiling of both employers and clients by lenders and budgetary release by Government.

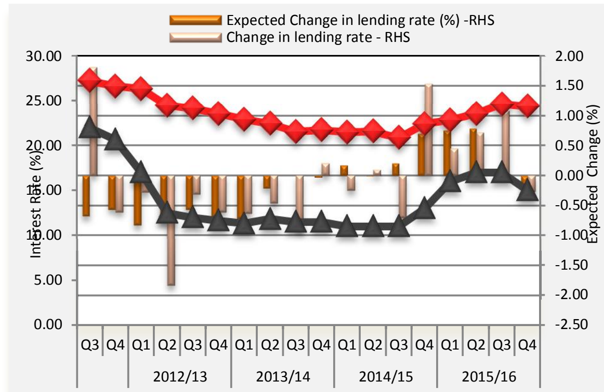
2.4 Interest Rate Expectations for Q1 FY 2016/17

In an effort to understand the direction of lending interest rates from lenders, banks were asked to indicate the direction and magnitude of the change in interest rate in the coming three months.

The survey results indicate that the majority (61 percent) of banks expect their lending rates to remain unchanged over the next quarter to September 2016 while the rest expect to reduce their lending rates.

The average percentage decrease in lending rates over the next quarter to September 2016 is estimated at 0.27 percentage points. In the previous quarter, lenders expected to change the lending rate by 0.25 percentage points compared to an outturn of 0.27 percentage points, as shown in *Figure 5*.

Figure 5: Changes in interest rates vis-à-vis Net Expectations



Source: Bank of Uganda

Notes: The line graphs show actual lending rate and CBR outturns over the quarter. The bar graphs show the average percentage, by which lending rates were expected to increase over the next quarter following the survey and the actual change in lending rates over the quarter. Expectations have been moved forward by one quarter so as to be comparable with the actual outturns.

The anticipated decline will largely be driven by the downward trend in the CBR, relative stability in the exchange rate and pick up in the economy.

3. Conclusion

The bank lending survey results indicated that banks tightened credit standards at a slower pace to both enterprises and households in Q4 FY 2015/2016. Tightening was due to deliberate efforts to maintain the quality of the loan book arising from high default rates, particularly from large enterprises; scarcity of long term deposits and tight liquidity conditions in the market.

In the coming months to September 2016, banks expect to further tighten credit standards across enterprises and duration except short term loans.

Credit standards are also expected to be tightened to households mainly due to the high default rate on consumer loans with no fall-back position since they are largely unsecured and the need to reduce non-performing loans.

The demand for credit from both enterprises and households is expected to increase while default rate will increase for enterprises and decline for households

The survey results indicate that the majority of banks expect their lending rates to remain unchanged over the next quarter to September 2016. The banks that expect lending rates to ease cited the downward trend of CBR as a key factor.

APPENDICES

Appendix 1: Summary of Bank Lending Survey results

Period		2014/15				2015/16			
Part I: Enterprises		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Credit policy as applied to the approval of loans or credit lines to enterprises									
Overall	Past three months	6.1	-6.3	3.9	-2.2	27.7	20.4	28.1	5.1
	Next three months	0.3	5.8	5.1	35.1	52.8	49.2	23.2	3.8
SMEs	Past three months	2.5	14.3	19.8	18.2	35.8	51.2	45.7	13.1
	Next three months	4.8	-0.7	7.3	37.3	48.8	45.5	34.5	7.3
Large enterprises	Past three months	8.1	-6.3	11.8	4.8	28.8	34.3	33.1	5.0
	Next three months	4.4	4.9	5.1	20.4	36.3	42.7	34.5	14.8
Short term loans	Past three months	-25.7	-12.3	2.7	-4.3	25.5	4.4	-3.2	2.7
	Next three months	-26.7	-44.9	-17.0	12.2	7.7	25.1	19.1	-1.8
Long term loans	Past three months	32.5	26.6	20.8	16.4	44.6	45.3	24.0	18.1
	Next three months	1.5	38.2	22.0	39.0	55.1	53.3	46.5	18.6
Credit policy as applied to the approval of loans or credit lines to enterprises to different sectors									
Agriculture (Crops, Livestock, Poultry), Fishing & Forestry	Past three months	-14.6	-3.5	12.2	0.7	0.3	13.7	23.2	-2.8
Mining and Quarrying	Past three months	3.6	5.8	3.3	0.9	6.9	15.1	22.0	1.7
Manufacturing	Past three months	-3.9	-6.7	1.6	3.8	6.0	33.2	39.1	11.6
Trade	Past three months	-2.5	-1.2	2.7	1.8	5.6	19.7	31.7	9.6
Transport and Communication	Past three months	10.8	-5.0	16.5	0.4	11.5	30.6	40.4	1.5
Electricity and Water	Past three months	-2.7	-10.1	0.0	2.9	4.1	9.8	25.2	7.1
Building, Mortgage, Construction and Real Estate	Past three months	31.8	29.3	30.0	37.3	38.4	46.2	43.0	31.3
Business Services	Past three months	-3.7	-15.1	2.0	0.0	2.0	-2.1	23.3	-2.1
Community, Social & Other Services	Past three months	-3.5	-13.3	-0.5	-4.2	13.9	7.9	26.3	1.6
Personal Loans and Household Loans	Past three months	0.6	-9.3	0.3	-1.0	2.7	10.5	8.2	14.5
Terms and conditions for approving loans or credit lines to enterprises									
Margin on average loans	Next three months	-25.7	4.1	17.5	4.1	17.5	12.4	31.1	33.9
Margin on riskier loans	Next three months	56.1	58.9	58.9	58.9	58.9	43.6	49.4	58.8
margin on prime borrowers	Next three months	-21.1	-22.2	13.0	-22.2	13.0	5.0	19.7	23.1
Non-interest rate charges	Next three months	-2.8	6.7	9.0	6.7	9.0	4.2	10.6	16.6
Size of the loan or credit line	Next three months	-2.8	2.7	13.4	2.7	13.4	11.8	21.1	52.2
Collateral requirements	Next three months	31.3	39.3	25.3	39.3	25.3	23.8	37.7	38.6
Maturity	Next three months	4.3	32.3	29.1	32.3	29.1	22.3	40.7	43.5
Demand for loans or credit lines by enterprises(apart from normal seasonal fluctuations)?									
Overall	Next three months	58.4	26.2	30.4	34.8	-38.9	-37.9	68.1	30.1
SMEs	Next three months	29.0	27.0	34.5	32.2	-40.2	-34.4	85.7	31.1
Large enterprises	Next three months	48.3	42.1	27.9	32.8	-52.0	-43.9	30.3	25.8
Short term loans	Next three months	53.2	35.4	36.4	42.9	1.1	-21.8	88.3	39.0
Long term loans	Next three months	1.1	-3.4	28.2	33.2	-17.5	-46.4	25.4	9.7
Default rate on loans to enterprises									
Overall	Next three months	-43.3	-37.9	-2.0	32.5	54.7	54.4	8.1	12.0
SMEs	Next three months	-18.6	-12.6	16.8	35.3	49.5	54.4	26.4	12.0

Large enterprises	Next three months	-37.7	-35.2	0.6	13.9	24.8	34.7	14.7	16.6
Short term loans	Next three months	-52.8	-41.3	-2.5	6.0	33.3	51.3	27.4	13.5
Long term loans	Next three months	-41.1	-35.8	-2.9	12.2	47.8	37.9	19.7	21.2
Period		2014/15				2015/16			
Part II: Households		Q1	Q2	Q3	Q4	Q1	Q2	Q2	Q2
Credit policy as applied to the approval of loans to households and non-enterprises	Past three months	-26.3	5.1	-10.4	-0.9	6.9	26.8	-13.0	12.7
	Next three months	-35.5	-51.8	-6.6	-17.6	42.7	48.7	0.2	22.9
Demand for loans to households and non-enterprises (for purposes of consumer credit)	Next three months	58.5	73.9	0.7	32.7	-35.0	-52.5	8.3	62.5
Terms and conditions for approving loans or credit lines to households									
Margin on average loans	Next three months	-11.0	-2.2	36.8	22.7	28.8	40.1	5.6	-9.4
Margin on riskier loans	Next three months	9.3	21.0	38.3	31.0	32.2	43.6	10.7	6.7
Margin on prime borrowers	Next three months	-9.7	-3.1	-10.1	9.6	12.9	30.4	5.9	-10.5
Non-interest rate charges	Next three months	21.8	-2.8	-8.3	2.6	8.8	24.2	5.4	2.2
Size of the loan or credit line	Next three months	-27.7	-24.1	-12.0	11.6	23.3	42.1	18.8	5.6
Collateral requirements	Next three months	2.5	9.9	-4.6	13.1	15.1	27.4	7.1	6.9
Maturity	Next three months	1.2	22.9	21.9	8.8	10.6	21.8	5.4	4.5
Default rate on loans to households	Next three months	2.4	3.3	-7.3	78.9	60.7	63.2	12.5	-5.0
Period		2014/15				2015/16			
Part III: Occasional Questions		Q1	Q2	Q3	Q4	Q1	Q2	Q2	Q2
Lending rates expectation									
Increase(+)/Decrease(-)	Next three months	0.3	7.5	53.1	78.3	37.8	45.8	-21.4	-39.4
Percentage change	Next three months	0.00	0.20	0.69	0.75	0.78	0.02	0.25	0.27

Note: All figures are on net basis except where stated. Net percentage balances are calculated by the difference between the weighted balance of lenders reporting that, demand was higher/lower or credit standrads were tighter/looser.
Positive balances indicate that lenders, on balance, reported/expected demand/default rate to be higher than over the previous/current three-month period, or that the credit standards/ terms and conditions on which credit was/ will be provided became tighter/ are expected to tighten.

APPENDIX 2: Methodology

Questions:

The questions in the lending survey questionnaire distinguish between two categories of loans namely: a) loans to enterprises and b) loans to households and individuals. For each category, questions were posed on credit standards for approving loans; credit terms and conditions; default rate; as well as credit demand and its determinants.

Weighting:

The results of the survey were weighted by the respective institutions' market share in the credit market. This approach takes into account the varying sizes and participation of the different respondent institutions in the formal credit market during the period under review. The weights used in the computation were derived by taking the sum of each institution's market share of credit over the three month period (January – March 2016), as represented by each bank's new gross extensions to total new gross extensions of the commercial banking sub sector for the same period.

Analysis of data:

For the analysis of aggregate results, lenders who report that credit conditions have changed 'considerably' are summed together with those who report that conditions have changed 'somewhat'. The results are summarized by calculating '*net percentage balance*' which is the difference between the weighted balances of lenders reporting that, say, demand had increased/ decreased or credit standards were tightened/ eased. The net percentage balances are scaled to a range between -100 and +100.

Positive net percentage balances indicate those lenders that reported/expected demand/default rate to be higher than the previous/current three-month period, or rather that the credit standards/ terms and conditions on which credit was/ will be provided became tighter/ are expected to tighten.(See *illustration below)*

On the other hand, interest rate expectations were derived by asking commercial banks whether they were likely to charge higher or lower lending rates in the next three months, compared to the previous quarter's levels and by how much.

Illustration:

'Eased somewhat' + 'Eased considerably' = Eased

'Tightened somewhat' + 'Tightened considerably' = Tightened

Response	**Fraction of total giving response (%)**
Eased / Decreased	X
Unchanged	Y
Tightened / Increased	Z
Net percentage change	Z- X

Interpretation of percentage change:

-100 0 +100

Eased / Decreased Tightened / Increased