

Behind the scenes:

There is lack of transparency in determining market interest rates



1. Summary

This analysis seeks to understand the structure of the Mozambican financial sector and its impact on financing the economy, taking into account the role of monetary and fiscal policies and how these influence interest rates and the level of financing, as well as to understand the strategy of the financial institutions in determining interest rates.

Its justification arises from the fact that market interest rates are high, affecting the private sector and the fiscal policy of the State which, so that it can finance its budgets by issuing Treasury Bills, resorts to the commercial banks, submitting to high costs which substantively influence the structure of interest rates in the financial system.

CIP has concluded that the reason for this situation is that behind the scenes, **THERE IS A LACK OF TRANSPARENCY IN DETERMINING MARKET INTEREST RATES**. The factors are the following:

The national financial system is highly concentrated, despite the entry of new operators. By December 2019, the three main commercial banks (Millennium BIM, Banco Comercial de Investimentos and Standard Bank) controlled about 70.7%¹ of total deposits, 60.4% of credit to the economy and 66.7% of the total assets in the national financial system.

¹ Report on financial stability (Bank of Mozambique, June 2020).

Studies by the Bank of Mozambique show that 20%² of the deposits in the Mozambican financial system (excluding the central government's deposits with the Bank of Mozambique) come mostly from public institutions which, for example, are dedicated to the management of pension funds and ports and railways. The deposits from these institutions are mostly acquired by the three main commercial banks.

Despite Ministerial Diploma no. 23/2018 of 2 February, which approves the regulations on the management of the State's bank accounts, *the process of domiciling State funds with commercial banks does not seem to be based on public tenders* and most public institutions are autonomous to choose the banks in which to domicile their accounts.

Consequently the financial operations of the State, concerning collecting fiscal revenue, such as from VAT and IRPC, and transferring funds to pay the wages of public employees are mostly domiciled in the main commercial banks. This attraction of resources gives these banks an exceptional advantage to generate profits with funds that are practically without costs for them, which leads one to believe that there may be *a privileged relationship between the main commercial banks and the Mozambican State*.

One aspect worthy of mention is that the lack of transparent procedures in domiciling funds of the State *creates room for corruption in the financial system, since many commercial banks have attracted deposits by bribing*³ decision makers in public institutions. This practice, which is entrenched in the Mozambican financial system, influences the cost of granting loans because these bribes are imputed to the final consumer.

Additionally, another bottleneck which only benefits the commercial banks lies in the phase of attracting State resources, which allows the banks to use the State's funds to acquire Treasury Bills issued by this same State. This becomes a vicious cycle which generates significant profitability and zero risk for the financial institutions best positioned on the market

This behaviour generates a trade-off on the market, with the banks concentrating on the debt instruments of the State with theoretically zero risk, instead of financing the real economy. This is why industry remains incipient: that is, agriculture does not have packets adjusted to its activity and risk/return, since there is no innovation⁴ in terms of creating products and services for the market that differentiate. Even without financing the real economy, the banks thus guarantee dividends to their shareholders only with State bonds at a low average cost since these are the same banks in which the State resources are deposited.

At the same time, this context means that the remaining commercial banks in the financial system enter into a frantic competition for the remaining portion of State deposits available. These resources have been attracted through time deposits. Due to the higher cost of the structure of these deposits, the only option for the remaining commercial banks has been to apply high interest rates to the deposits under the heading of credit to the economy in order to compensate for the high cost of State resources, making them uncompetitive in comparison to the larger banks which benefit from State resources in the shape of demand deposits.

Taken together, these factors weaken the mechanism for transmitting the monetary policies of the Bank of Mozambique, and indicate *the need to introduce mechanisms oriented towards stimulating competitiveness, by reducing the concentration of State resources in certain commercial banks*. These mechanisms will also help reduce credit risk.

Hence it is urgent that, given this situation, transparent procedures are implanted. For example, by means of a public tender for allocating State funds in the banking system and thus allowing healthy competition between the banks. It is important that there should be a "*level playing field*"⁵ to ensure that the beneficiaries of State deposits are not only the banks but also the holders of loans. The fact that the banks use funds with low costs should result in access to credit in the commercial banks with a structure of interest rates more beneficial to the holders of loans, which is currently not the case.

2 Financial stability bulletin (Bank of Mozambique, December 2019).

3 Interviews with staff from the market room of various commercial banks. One of the functions of the market room is to manage the liquidity and deposits of a financial institution.

4 In other countries, there are specific products and services to attend to the specific needs of the markets. For example, within the package of financing for the agriculture sector, there are specific packages just for fertilisers, and others for different phases of the business.

5 The situation where all the players have to obey the same rules, without some having benefits that others do not have.

2. Specific features of the financial sector in Mozambique

The national financial system is highly concentrated, even with the entry of new operators. Current practices do not stimulate the competitiveness of the financial system, which would benefit the private sector because the commercial banks are operating as if they were a cartel.

By December 2019, the three main commercial banks (Millennium BIM, Banco Comercial de Investimentos and Standard Bank) controlled about 70.7%⁶ of total deposits, 60.4% of credit to the economy and 66.7% of the total assets in the national financial system. M-Pesa controls 0.7% of the total deposits in the financial system, and this is more than commercial banks such as Ecobank and Banco Mais with market share of 0.6% and 0.3% respectively.

The financial institutions are grouped into 3 Tiers. This grouping was structured as a function of market share. Tier 1 indicates a financial institution with a significant market share and able to influence the price in effect in the national financial sector. Tier II covers financial institutions of medium size and with some impact on the price in effect in the national financial sector. Tier III covers small financial institutions which are takers of prices in the national financial sector.

Table 1. Market share

	Tier 1	Tier 2	Tier 3					Electronic currency
Item / Bank	BIM, BCI and Standard Bank	ABSA	Moza	Banco Mais	Ecobank	Mpesa		
Credit	60.4%	7.2%	10.5%	4.6%	0.7%	0.6%	0.2%	N/A
Deposit	70.7%	7.4%	6.9%	5.3%	0.8%	0.3%	0.6%	0.7%

Source: Financial report on financial institutions and the Bank of Mozambique (2019)

Table 2. Distribution of assets and structure of deposits (2017-2019)

Tier	Tier I									Tier II						Tier III					
Bank	BIM			BCI			Standard bank			ABSA			Moza			Banco Mais			Ecobank		
Year	2017	2018	2019	2017	2018	2019	2017	2018	2019	2017	2018	2019	2017	2018	2019	2017	2018	2019	2017	2018	2019
Treasury bills and bonds	15%	23%	25%	0%	19%	5%	45%	39%	35%	0%	33%	20%	29%	23%	8%	10%	12%	11%	37%	36%	37%
Applications in other banks	12%	10%	13%	23%	18%	23%	21%	24%	33%	36%	28%	32%	10%	17%	20%	0%	39%	1%	35%	27%	50%
Credit to clients	73%	68%	62%	77%	64%	72%	34%	36%	32%	64%	40%	48%	62%	60%	72%	90%	49%	87%	28%	37%	13%
Total assets sensitive to interest rates	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Client deposits	99,622	112,835	118,056	113,002	115,772	125,379	65,729	73,940	88,479	21,400	27,478	31,508	17,960	24,893	29,346	1,920	2,393	1,404	1,820	2,036	2,379
Term deposits	49,465	54,210	59,469	42,236	42,892	44,655	8,544	9,534	13,700	1,821	3,960	4,869	11,128	16,404	18,163	809	1,678	862	889	1,262	556
Term deposits (%)	50%	48%	50%	37%	37%	36%	13%	13%	15%	9%	14%	15%	62%	66%	62%	42%	70%	61%	49%	62%	23%
Transformation ratio	62%	44%	38%	64%	57%	53%	33%	38%	32%	48%	43%	52%	85%	72%	81%	58%	48%	102%	30%	55%	17%

Source: Accounts of the respective institutions (2019)

It is worth recalling that the core business of a bank is to lend money to the market, but in 2017 Standard Bank held 45% of its payable balance sheet in State securities and only 34% in credit to clients, a trend which continued to 2019, clearly showing a reversal of priorities.

Furthermore, CIP ascertained that the collection of fiscal revenue benefits, for example, BCI and Standard Bank, and much of the payment of wages to public employees is done in the Millennium-BIM.

The Tier 2 banks strive to attract deposits from other State institutions such as, for example, the important funds of the INSS. This process is theoretically decided by auction. However, there are strong signs that bribes are paid to attract these deposits.

⁶ Report on financial stability (Bank of Mozambique, June 2020).

Political economy of the financial system

All the financial institutions include in the executive management structure, or on the board of directors, administrators who facilitate the coordination with the ruling political power. CIP noted that there is a positive correlation between the participation of managers associated to political power and the position of the banks in the market. In general, the banks include on their Boards of Directors, or on the business management commission, figures (chairperson of the board or chief executive officer) who are designated as “politically exposed persons”, and who can influence the “lobbying” for deposits and transactions mainly from the public sector. For example, Moza Banco will provide financial services to the “Sustenta” project, but the criteria for choosing this financial institution are not clear.

Table 3. Pillars in the administration of the commercial banks

Bank	Chairperson of the Board	Chief executive officer/PCE
BIM	Rui Fonseca	José da Costa
Standard Bank	Tomás Salomão	Chuma Nwokocho
BCI	José Guilherme	José Furtado ⁷
ABSA	Luisa Diogo	Rui Barros
MOZA	João Figueiredo Júnior	Joana Matsombe ⁸
BANCO MAIS	Narciso Matos	Luis de Almeida
Banco Único	Magid Osman	António Correia
Firstcapitalbank	Hitesh Anadkat	Tiago Contente
BancABC	Luisa Capelão	Tawanda Munalwa
Ecobank	Silvino Moreno	Nadeem Almada

Source: Accounts reports of the respective institutions (2019)

Table 1. Deposits of Public institutions

Institution	Deposits (MZN 10 ⁶)	Weight
INSS	25.142	7%
CFM	6.513	2%
Pension Fund of Workers of the Bank of Mozambique	9.167	2%
ENH	3.535	1%
CMH	2.363	1%
Financial system (excluding central Government)	380.780	100%

Source: Accounts reports of the respective institutions

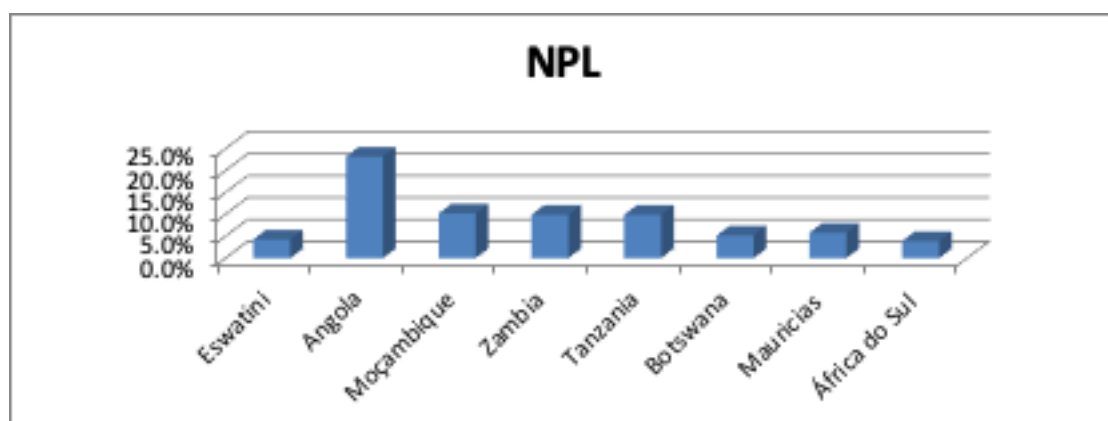
⁷ As from September 2019, designated Coordinator of the Executive Commission. Source: Report and accounts 2019

⁸ She is a member of the Executive Commission which is headed by the Chairperson of the Board. The name of Joana Matsombe has been put here to avoid repetition in the two columns.

A further characteristic of the Mozambican financial system lies in the lack of transparent procedures in domiciling State funds both in Tier 1 and in Tier 2 banks, which results in illicit financial flows, the costs of which are passed on to the clients of the banks. This is why there is currently rigidity on the part of the commercial banks in responding to the instruments of monetary policy, particularly in situations of reductions in interest rates.

It should be noted that credit to clients remains the main heading in the structure of total assets of the financial sector, with an average weight of 34.3% in December 2019. As for the quality of assets, credit that is 90 days overdue, designated as NPL (*non-performing loans*), reached a volume of 29,077 million meticaís in December 2019, corresponding to a ratio of 10.2% above international standards of 5%. The trade and industry sectors are the main contributors to NPL, with 33.8% and 20.6% respectively. The level of non-compliance in Mozambique, of 10.2%, is lower only than that of Angola, with an NPL of 23.2%⁹.

Graph 1. NPL in southern Africa



Source: Bank of Mozambique (2019)

This non-compliance in clients repaying loans to the financial institutions is regarded as more of a consequence of the rising cost of credit in the national financial system. Hence the high risk associated with granting credit to clients is the main factor for the weak preference of financial institution to grant loans to clients, as explained below.

Hence, in general, the banks opt for attracting the resources of the State, through treasury bills, or demand deposits, or time deposits, some with costs near to zero and other by means of bribes, in a process which shows that the liquidity of the State comes from the State itself only for the benefit of the banks and to damage the final consumer.

Taken together, these factors weaken the mechanism for transmitting the monetary policies of the Bank of Mozambique, and indicate the need to introduce mechanisms oriented towards stimulating competitiveness, by reducing the concentration of State resources in certain commercial banks.

The situation described above, nourished by the corruption in the financial system, if it continues, will always create the perception that monetary policy is ineffective, and its instruments are not sufficiently robust to influence a reduction in interest rates. The reason for this is that there are other factors to do with lack of transparency and the legislation which regulates efficiently the distribution of State resources in the financial system.

In general, the management of public resources on the African continent and its relationship with commercial banks is not regulated, and follows the dynamic of lobbying, resting on the relations between political power and the financial institutions.

Commercial banks with public capital and financial institutions with senior managers who in the past held government office normally control the flow of public resources in Africa. However, some countries are tending to improve the management of public resources. The Zambian government has launched, on a bi-annual basis, a public tender to select the financial institutions that will provide financial services to the State. In Burundi, the State controls only 3.6% of the total capital (shareholder structure) of the commercial banks and public companies represent 31.6% of the deposits in the financial system. The State also has power to appoint and influence the management of the commercial bank through appointing members of the boards of directors of the financial institutions¹⁰.

⁹ Financial stability report (Bank of Mozambique, June 2020)

¹⁰ The financial sector in Burundi (2012).

3. Fiscal policy, the evolution of interest rates and financing the economy

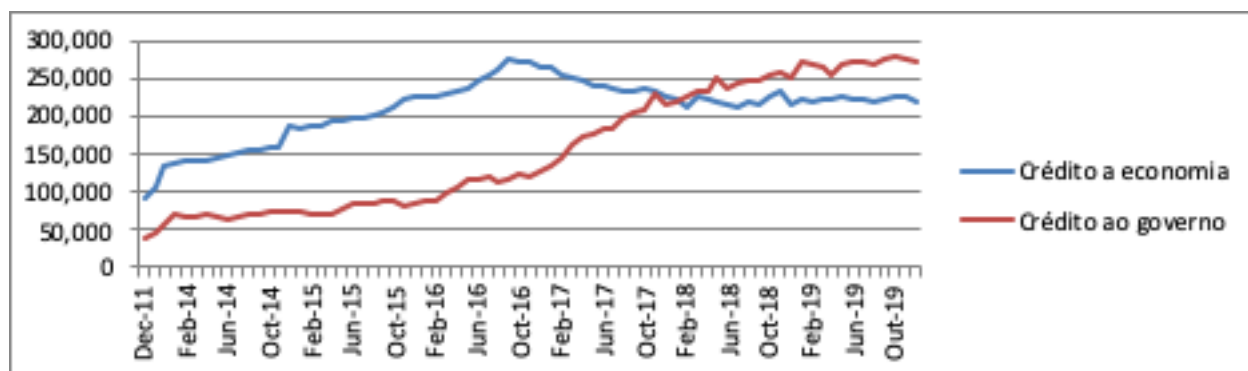
Variations in public expenditure have different effects on private investment in the economy. The increase in public expenditure creates additional pressure on public indebtedness in the Mozambican context where the State does not have sufficient resources of its own, which in turn generates pressures for increased interest rates, as explained earlier. This effect is called the “crowding out” of the private sector, because high interest rates ensure that only the strongest private agents can gain access to the banking system to obtain credit. Consequently there is a reduction in economic activity, since the majority do not form part of this group. It should be noted that the public sector is inelastic with regard to interest rate increases, unlike the private sector.

On the other hand, public expenditure may create an environment favourable to the expansion of national private investment, should there be a competitive environment for the provision of goods and services which meet the needs of Government expenditure (for example, through the provision of services to support the creation of infrastructure).

Between January 2011 and September 2016, credit to the economy and to the government followed the same growth trend. But, as from October 2016, credit to the economy went into decline. “Crowding out” came into action, driven by the increase (graph 3) in interest rates corresponding to treasury bills and bonds.

On the other hand, contractionary monetary policy, characterised by revising the benchmark interest rates upwards, tripled the cost of financing in local currency which, together with economic activity, led to the closure of many economic agents who ceased to pay their financial obligations, thus increasing the level of the NPL of the sector. This situation has led to the constitution of disparities between non-performing loans and write-offs, and creating greater rigidities in the analysis of granting credit. All this was the consequence of the public knowledge of the hidden debts.

Graph 2. Financing the government and the economy (2011-2019)



Source: Bank of Mozambique (2019)

Graph 3. Evolution of the average Treasury bill interest rate (2015-2019)



Source: Bank of Mozambique (2019)

4. Conclusions and recommendations

The Mozambican financial sector is highly concentrated. The main commercial banks have privileged access to cheap funds from public institution. There are signs of a privileged relation between the main commercial banks and the Mozambican state.

The flow of deposits is influenced by the dynamic of the liberalised process of opening accounts of public sector institutions. Most of these institutions have autonomy in choosing where their bank accounts will be domiciled.

Given this situation, it is urgent to implant transparent procedures for allocating State funds in the banking system and thus allowing healthy competition between the banks. The allocation of State funds to commercial banks to support specific public projects may be done by using public tenders. Moza Banco will provide financial services to the “Sustenta” project. However, the criteria for choosing this financial institution are not clear.

Zambia has adopted the model of public tenders and this makes it possible to improve, to some extent, transparency in the relationship between the public sector and the financial sector. The instruments of monetary policy end up affected by other factors which influence the mechanism of transmission and credit to the economy.

Hence the government should introduce reforms to ministerial diploma 23/2018, of 2 February, in order **to strengthen competition in the Mozambican financial system**. The result should be a reduction in the current high level of concentration in the sector.

The distribution of the Treasury’s resources should follow a vision of a “*level playing field*” in order to give opportunities to all the banks and to reduce the current costs and bribes. The revised diploma should include a centralised platform for the management of opening public sector bank accounts, and to make viable an equitable distribution of deposits between financial institutions, which in turn will contribute to lower active interest rates over the long term. Transparency in the opening of public sector bank accounts will significantly reduce the existing “lobbying”.



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