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Unlocking Economic Growth with Credit

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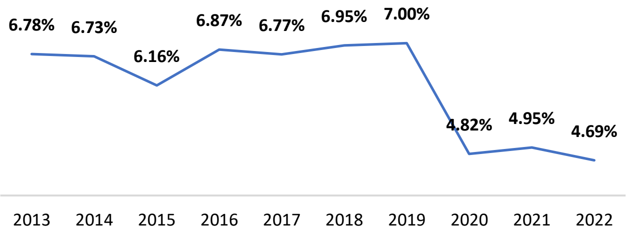
Tanzania's Economic Landscape – A decade's worth of a story

According to Tanzania's third Five-Year Development Plan (FYDP III) spanning from 2021/22 – 2025/26, the government set out a Gross Domestic Product (GDP) growth target of 8% per annum, which they deemed necessary to eradicate absolute poverty in the country. However, according to economic growth data published by the National Bureau of Statistics between 2013 – 2022, real GDP has been able to grow at an average of 6.17%, with growth recorded between 2020 – 2022 at 4.82%, which is lower than the 10-year average with data from the Bank of Tanzania suggesting that GDP growth is likely to rebound to 5.2% in 2023 and 5.5% in 2024. The reason behind the recent slowdown in economic growth is due to slower output growth recorded from key sectors of the economy such as agriculture, construction, transport and storage, manufacturing, as well as Wholesale and retail trade, whose sectors have, on average, made up about 63.84% of the total Gross Domestic Product between 2013 – 2022.

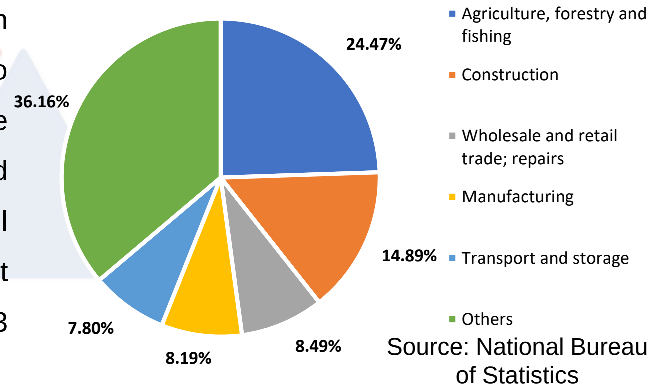
The government has implemented several initiatives to put the Tanzanian economy on the right growth track in response to the slow economic growth. Some include placing Tanzania on the global scale as an attractive investment destination across the African Continent, which has put Tanzania on the road to recovery in terms of Foreign Direct Investment Inflows with significant investments made primarily in manufacturing, services, and real estate sectors. Other efforts include the introduction of initiatives aimed at bolstering the agricultural sector, such as the Agenda 10/30, which aims to accelerate the pace of output growth in the sector to 10% by 2030, Increased government spending, which saw a 275.59% increase in the budget for agriculture from TZS 294 Billion in 2022/23 to TZS 954 Billion in 2023/24, as well as strategies, focused on increasing the value of agricultural exports to USD 5 Billion in 2030.

Tanzanian Economic Growth Rate from 2013 - 2022



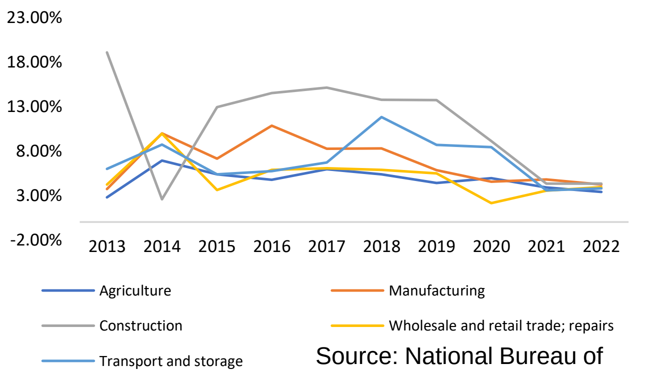
Source: National Bureau of Statistics

Share of GDP, across Economic Sectors as of 2022



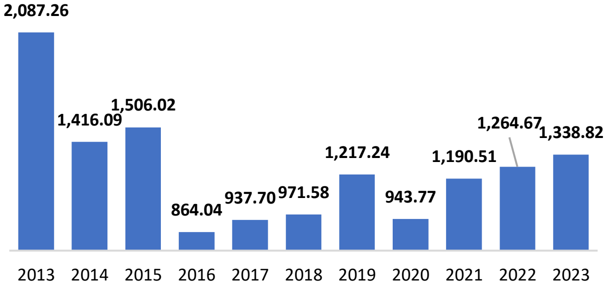
Source: National Bureau of Statistics

GDP Growth from Selected Economic Sectors



Source: National Bureau of Statistics

Tanzania Foreign Direct Investments in Millions USD



Source: Bank of Tanzania

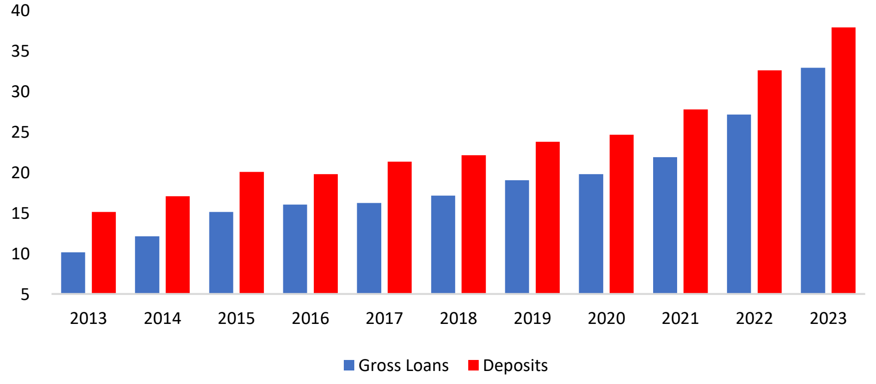
In the transportation and storage sector, strides have been made to increase transport infrastructure and improve storage capabilities' efficiency. Notable efforts made recently include the Intergovernmental Agreement (IGA) made between the United Republic of Tanzania and the United Arab Emirates, giving Dubai Port (DP) World a 30-year concession to invest over USD 250 Million in the course of 5 years and operate specified berths in the Dar es Salaam port to improve its operational efficiencies. Increased investments in Air Tanzania Company Limited amounting to over TZS 3.6 Trillion and the finalization of the Standard Gauge Railway, which has already begun its testing phase by the time of writing. And investments in constructing a USD 5 Billion oil pipeline between Uganda and Tanzania.

As far as wholesale and retail trade is concerned, efforts have been made to make the business environment as friendly as possible, with notable incidents such as government interventions on strikes made by Tanzania's largest marketplace place, Kariakoo, to reduce traders' tax burdens and costs of doing business.

The Banking Sector – A Story of Financial Resilience

The performance of a country's banking sector is said to mirror the performance of that country's respective economy. Nothing could be said less about Tanzania's banking sector, which has witnessed remarkable growth over the past decade, with gross loans disbursed across the economy growing by 223.70% from TZS 10.16 trillion in 2013 to TZS 32.85 trillion as of the end of December 2023. Meanwhile, commercial bank deposits grew by 150.40% from TZS 15.12 trillion in 2013 to TZS 37.87 trillion during the same period.

Gross Loans and Deposits Trend from Commercial Banks in Trillions TZS



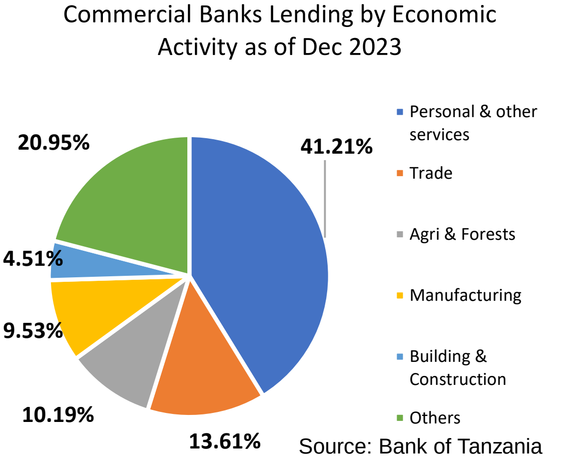
Source: Bank of Tanzania

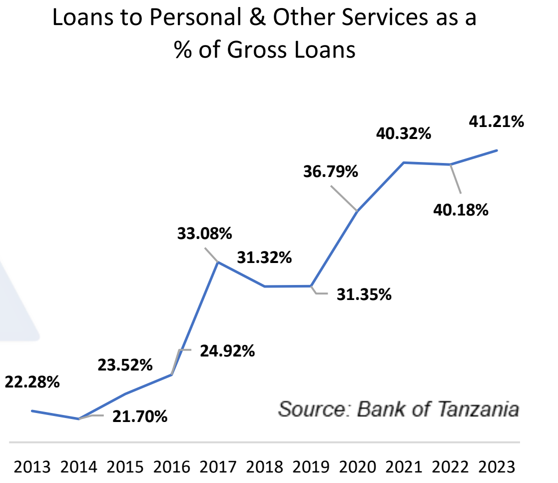
Despite the growth experienced in the banking sector, particularly that of gross loans. Most loans disbursed by the banks have been concentrated on facilitating personal and household consumption. If we look at domestic lending by economic activities made by commercial banks in 2023, you will observe that over 41.21% of the TZS 32.87 trillion has been lent towards the "Personal & other services segment". Furthermore, the contribution of Personal and Household loans has almost doubled in the past 10 years, with an increasing year-over-year growth rate since 2018.

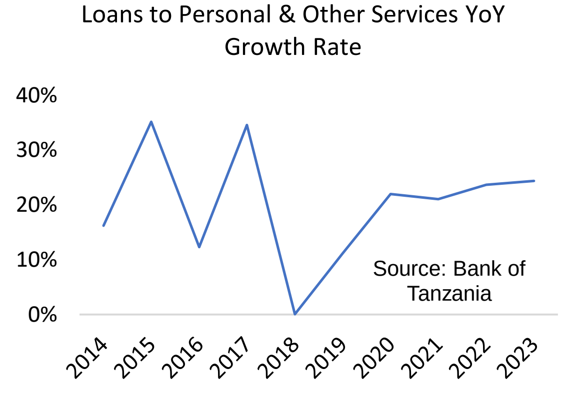
Providing credit to facilitate personal and household consumption is not bad since household consumption is a significant element alongside investments, government spending, and net exports in arriving at the Gross Domestic Product figure. In fact, household consumption has been the biggest contributor to GDP over the previous decade. However, it's worth noting that its contribution to total GDP has been steadily declining due to a rapid rise in investments.

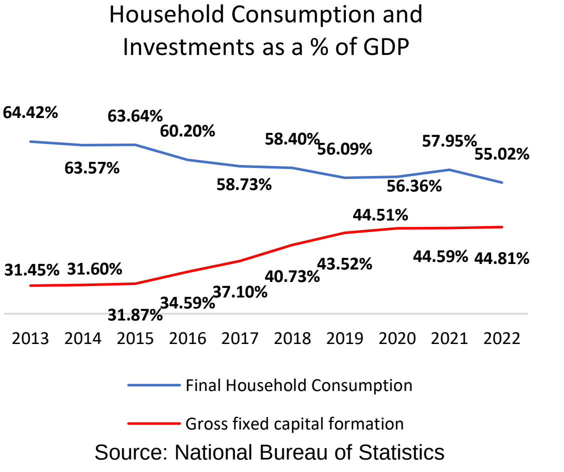
The problem we are observing with commercial banks is that their loan portfolio is concentrated on increasing consumption without giving a lot of attention to other significant economic sectors which, if provided with greater access to capital, we could see growth in the quality and quantity of output along with increased employment activities, household incomes and government revenue via taxes all of which could play a significant part in allowing the Tanzanian economic machine to grow at the targeted rate set out by the third Five-Year Development Plan (FYDP III).

The reason why Tanzania's Commercial Banks have their loan portfolio set up like this is perhaps due to the fact that personal loans tend to have lower default risks than those of other economic sectors. The Central Bank has not disclosed figures on which economic sector contributes to the most non-performing loans. However, we've noticed a negative correlation between commercial banks' increased lending towards individuals and households and the banking sector's non-performing loan ratio.









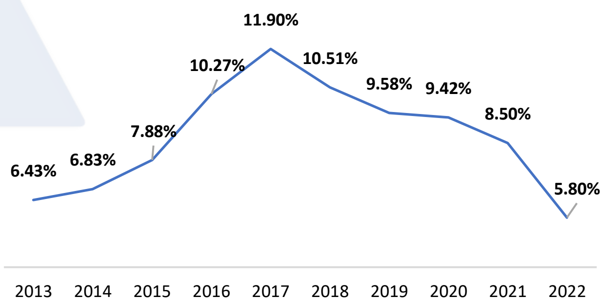
As a result, such commercial banks are better positioned to maintain a lower stock of Non-Performing Loans, hence preserving their capital buffers in line with the thresholds set out by the Central Bank.

Additionally, commercial banks are not incentivized to take on higher risks, which is evident when the Bank of Tanzania enforced a new regulation in 2021 stating that commercial banks would not be allowed to pay out dividends to shareholders if their cost-to-income ratio exceeds 55%, and their non-performing loan ratio exceeds 5%. Commercial Banks whose main objective is maximizing profits and increasing shareholders' value would henceforth not be willing to diversify their loan portfolios into other economic sectors with higher default risks at the expense of their shareholders' wellbeing.

Domestic Lending by Economic Activity, Percentage Share in Total Loans (Table 1)

Years	Agriculture & Forestry	Building & Construction	Manufacturing	Transport & Communication	Trade
2013	9.67%	5.07%	11.43%	7.16%	21.29%
2014	8.96%	5.45%	11.45%	7.64%	21.90%
2015	7.99%	4.91%	11.23%	8.16%	20.38%
2016	7.07%	4.63%	10.17%	7.38%	20.93%
2017	7.00%	4.83%	9.83%	5.85%	19.54%
2018	5.67%	3.75%	12.18%	7.13%	18.84%
2019	9.68%	5.94%	10.96%	5.57%	17.75%
2020	8.75%	5.42%	9.50%	5.77%	15.44%
2021	7.31%	4.57%	9.66%	4.82%	16.74%
2022	8.59%	4.43%	9.99%	4.45%	16.81%
2023	10.19%	4.51%	9.53%	4.32%	13.61%

Gross NPLs to Gross Loans Ratio



Source: Bank of Tanzania

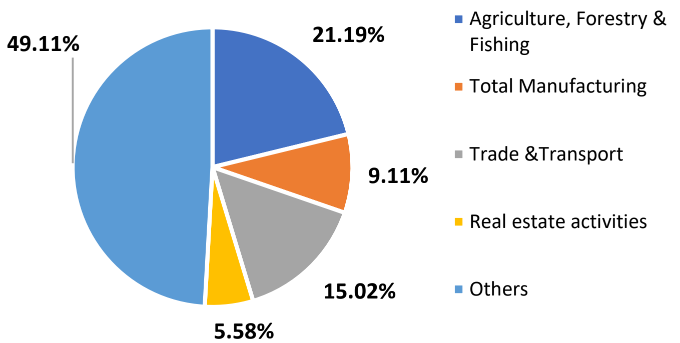
* *It's* worth noting that NPLs peaked during 2016 – 2017 due to redundancies and layoffs made by the government in the public sector towards employees who lacked professional qualifications for their positions

East African Economies Loan Distribution – How others are playing the game

Rwanda:

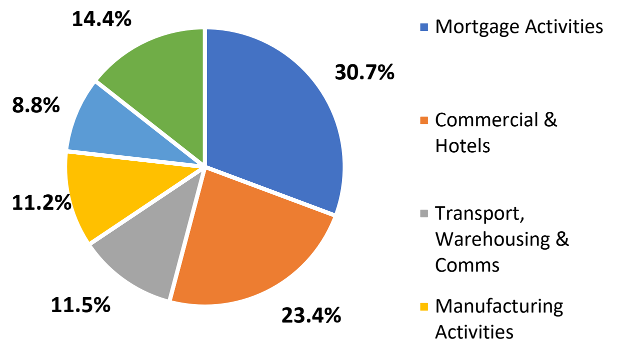
Rwanda's Real GDP has experienced remarkable economic growth over the past 6 years, recording an average growth rate of 7.48% between 2018 and 2023. Rwanda's economy is mainly driven by economic sectors such as Trade and Transport, Agriculture, Manufacturing, and Real estate, which have recorded double-digit growth rates except for real estate and agriculture. Looking at the National Bank of Rwanda's data as of December 2022. We can observe that the lion's share of the loans disbursed into the Rwandan economy goes into Mortgage Activities and Hotels, which resonates with the economy's real-estate sector, Transport, Warehousing, and Communication, which goes hand in hand with its Trade and Transport sector, and Manufacturing Activities which make up a significant amount of the value produced in the economy.

Rwanda Share of GDP, across Economic Sectors as of 2023



Source: National Institute of Statistics of Rwanda

Rwanda Commercial Banks Lending by Economic Activity as of Dec 2022

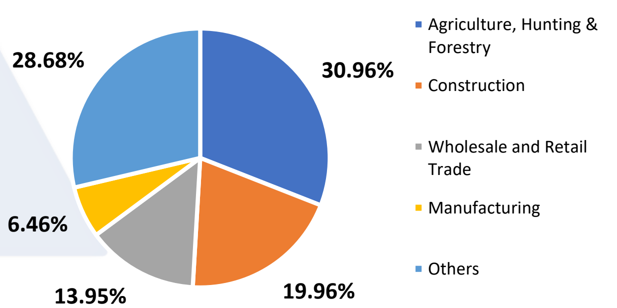


Source: National Bank of Rwanda

Ethiopia:

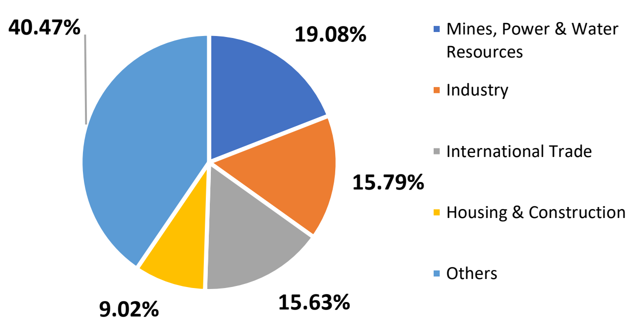
Ethiopia's real GDP recorded strong economic growth over 6 years between 2016/17 and 2021/22, with an average economic growth of 6.96%. The economic growth has mainly been attributed by growth in trade, manufacturing, construction and agriculture. According to the National Bank of Ethiopia, commercial banks' loan portfolio has had a strong concentration towards Mining, Power, & Water Resources, perhaps because of the construction of the USD 5 Billion Grand Renaissance Dam, which began initial operations in 2020. Aside from this, significant financing has been directed toward Housing & Construction, which aligns with the construction sector. International trade, which would resonate with wholesale and retail trade, and Industry which would resonate with the manufacturing sector.

Ethiopia Share of GDP, across Economic Sectors as of 2021/22



Source: National Bank of Ethiopia

Ethiopia Commercial Banks Lending by Economic Activity as of 2021/22

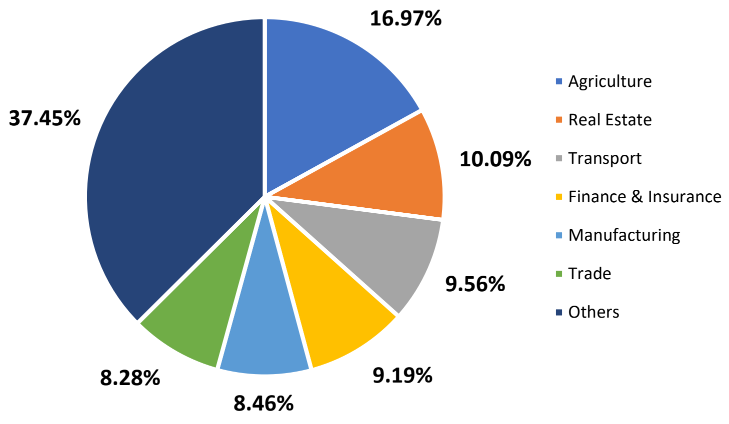


Source: National Bank of Ethiopia

Kenya:

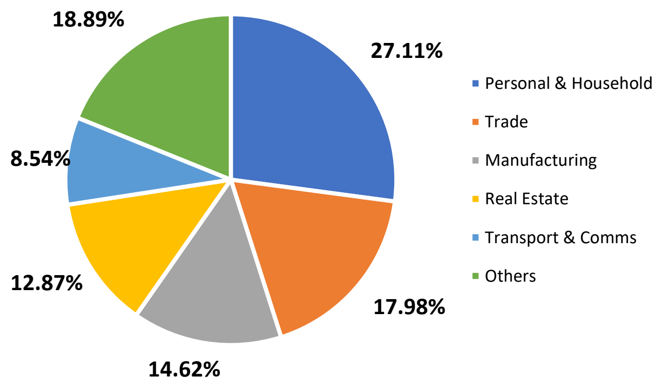
Kenya has had strong economic growth over the past 6 years, with real GDP growing at an average rate of 4.46% from 2017 to 2022. Kenya's GDP mainly comprises economic sectors such as agriculture, real estate, transport, finance and insurance, manufacturing, and trade. These sectors contributed to over 62.55% of the Gross Domestic Output produced by Kenya in 2022. Looking at Kenya's Banking Sector's disbursement of gross loans, we can see that despite having the highest exposure in Personal and Household Loans, its contribution to the overall gross loan portfolio is not as concentrated as in Tanzania. Notable investments are being made across the trade sector, manufacturing, real estate, transport, and communications, all contributing significantly to Kenya's overall gross domestic output.

Share of GDP, across Economic Sectors as of 2022



Source: Kenya National Bureau of Statistics

Kenya Commercial Banks Lending by Economic Activity as of 2021/22



Source: Central Bank of Kenya

The way forward

- **Removing regulations that discourage Commercial Banks from investing in risky economic sectors**

Regulations such as the cap on the maximum Non-Performing Loan Ratio and Cost to Income ratio, which may have had the best intentions geared towards improving operational efficiency across the banking sector have come at the expense of encouraging essential risk taking which could have involved providing financing towards risky yet crucial economic sectors that would have had marginal impacts on Tanzania's overall economic growth.

- **Provision of government support that would encourage banks to invest in risky sectors of the economy**

If there is one common trait observed in the economies studied in this report, it's that agriculture makes up a significant proportion of the economies of East African GDPs and yet when it comes to loan disbursements, the least amount of loans are directed towards the sector. In Tanzania's case however, from Table 1 we can notice that since 2021 the share of loan disbursements towards agriculture have been increasing and this is in part due to a TZS 1 trillion special loan facility provided by the Central Bank towards commercial banks to provide credit financing towards the agricultural sector at a less than 10% interest rate with incentives provided such as a reduction of the Statutory Minimum Reserves in proportion to the loan they extend to the agricultural sector and a reduction in the risk weight of different loan categories in line with the regulatory capital requirements for commercial banks. Such initiatives have helped encourage Tanzania's commercial banks to aggressively finance what is perhaps one of the riskiest sector to provide credit financing to, hence such government support would be deemed necessary in allowing banks to venture into economic sectors that seem to carry high risk with little prospects of high returns.

- **Exploring other financing opportunities**

Business Firms in need of debt financing to grow their businesses could potentially look raising finances via other avenues such as via issuing corporate bonds. Tanzania's corporate bond market has gained a lot of traction as of recent with back to back issuances of corporate bonds from commercial banks and other related businesses in the finance sector. Despite the tremendous success there has been very few non-governmental organizations outside the finance sector that issued corporate bonds. In fact, according to data from CMSA's annual reports since 2010 to date there has only been 1 non-finance corporate bond issued by Alaf Ltd in 2015. Indicating that there is perhaps a need for players in the Capital Markets to increase engagement with businesses from sectors such as Manufacturing, Construction, Trade and Transport to use the bond markets as an alternative way to raise debt financing in order to pursue business expansion. Additionally, the bond markets seem to historically been accessed by large corporations and there is perhaps a need to incentivize bond listing from Medium Enterprises as well.

- **Reducing the cost of debt**

Providing lending towards other segments of the economy comes about with greater default risks than providing the traditional personal and household loans hence the interest rate charged on such loans would more likely be higher than that of Personal Loans which may perhaps discourage businesses from accessing the right amount of capital to scale their operations. Lending Rates have declined since the start of the century however the rate at which these rates has been declining has been rather slow compared to the early 2000s. An improvement in the overall credit rating of the country to B1 Positive outlook by Moody's as of March 2024, in addition to robust finance performance from Tanzania's commercial banks as of recent should coincide with their ability to raise capital at lower costs as their risks of default gradually become less and this should henceforth be reflected in the lending rates of the country.

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