World Economic Situation and Prospects
Weekly Highlights

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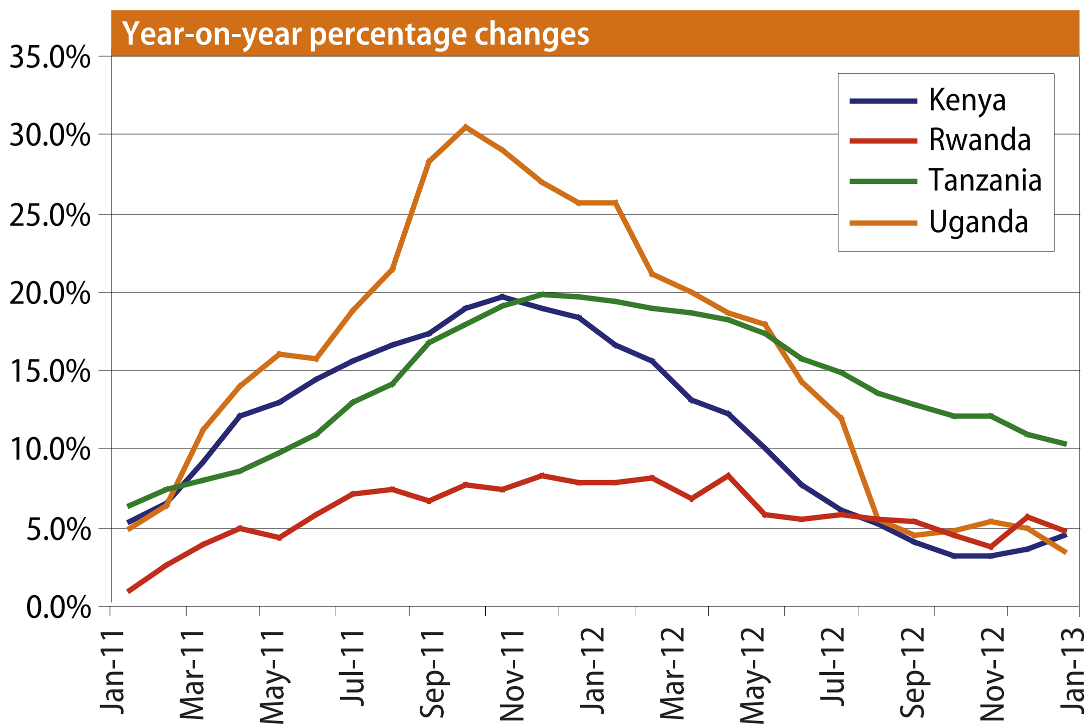
Elevated Lending Rates in some East African economies

Inflation spiked between late 2011 and early 2012 in a number of East African economies such as Kenya, Rwanda, Tanzania and Uganda, mostly owing to the effects of a serious drought on food prices (figure 1). In response, the respective central banks raised interest rates to relatively high levels, which may have limited credit demand, import demand and thereby imported food price inflation. In reaction to those increased central bank rates, commercial banks in those countries raised interest rates on loans, albeit with a slight lag. Inflation has since moderated as harvests have been better and the central banks have cut rates to relatively lower levels.

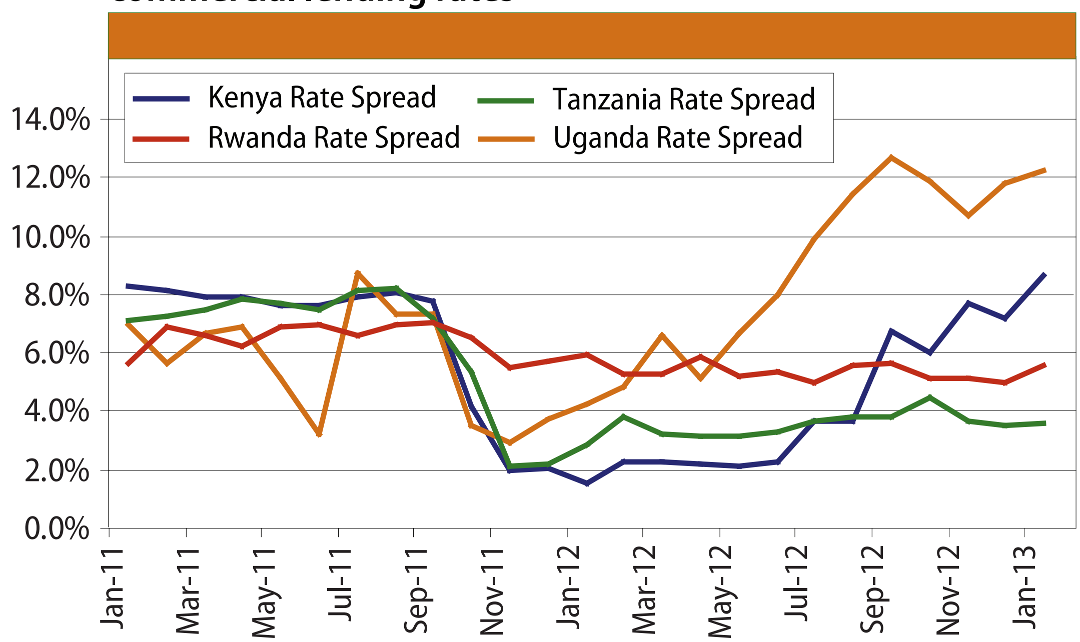
Figure 1: CPI inflation rates



Sources: Kenya National Bureau of Statistics, Bank of Uganda, Tanzania National Bureau of Statistics, National Institute of Statistics of Rwanda

At the same time, the commercial banks have maintained those higher lending rates even as the central banks cut back policy rates. This has led to increasing spreads between commercial rates and central bank discount rates, particularly in Uganda and Kenya (figure 2). The spreads initially dropped between October and November of 2011 with the rising central bank discount rates, but have increased rapidly since mid-2012 as central banks enacted significant cuts. While there are consistently higher spreads between central bank rates and commercial bank rates in these economies, it appears that recent movements have boosted spreads above their normal levels for Kenya and Uganda. There has been some concern that these high spreads are reducing demand for credit and last month Kenya's parliament considered a bill to limit lending rates in order to attempt to bring down the spread between the two rates.

Figure 2: Spread between central bank discount rates and commercial lending rates



Source: Central Bank of Kenya, National Bank of Rwanda, Bank of Tanzania, Bank of Uganda.