Capping Bank Lending Interest Rates is not a Panacea to Accessing Affordable Credit in Uganda

Dr. Thomas Bwire
Bank of Uganda

Executive Summary

The real interest rates charged by commercial banks are very high, and as a result, some countries in Africa and elsewhere have legislated for interest rate caps to protect borrowers, on the assumption that caps on loan prices will protect borrowers from excessive interest rates thereby making loans more affordable and improve access to credit. Instead, interest rate caps, where they have been implemented, have resulted in undesirable outcomes, including reduced intermediation and transparency, shifted the commercial banks asset portfolio towards Government securities, banks have typically stopped lending to borrowers who are costly to serve, those who are less credit worthy, and those who require banks to undertake high levels of due diligence, which combined has slowdown credit growth in these countries. High lending rates are a confluence of the cost of funds, the Treasury bill rates on the risk free public sector borrowing, the country's risk rating from an investor perspective and the high cost of doing business in Uganda. Realistically therefore, capping interest rates on loans is not a panacea to improving access to affordable credit because it does not address the binding constraints to credit expansion.