# Indira Gandhi National Open University

## School of Continuing Education

# The Significance of Financial Sector to Economic Development: The Contribution of Deposit and Loan to the Ethiopian Economy

By

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ADDIS ABABA ETHIOPIA

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# Acronyms

**ATM** ---------Automated Teller Machine
**CBB**----------Construction and Business Bank

**CBE**----------Commercial Bank of Ethiopia

**CD**-----------Certificate of Deposit

**DBE**-----------Development Bank of Ethiopia

**ECM**----------Error Correlation Model

**EEA**------------Ethiopian Economics Association

**FDRE**----------Federal Democratic Republic of Ethiopia

**IMF**------------International Monetary Fund

**GDP**-----------Gross Domestic Product

**GDSA**---------Gross Domestic Savings

**IGA**------------Income Generating Activities

**MFIs**-----------Micro Financial Institutions

**NBE**------------National Bank of Ethiopia

**POS**------------Point of Sale

**SACCOS**-----Saving and Credits Co-operatives

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***Abstract***

*This paper deals with the behavior and contribution of savings and loan in Ethiopian economy and reviews the policy option and regulation toward it with different regimes. The study identified an important policy and non policy variables which determine the savings mobilization trends in deposit taking Ethiopian financial sector. Both descriptive and multiple regression analysis were applied with annual data sets covering 1975 to 2011 to assess factors highly influencing domestic savings as well as the impact of savings and loan on Ethiopia's economic growth. The long-run estimation approaches co-integration method while the short-run analysis employs an Error Correlation Model.*

*The empirical results showed statistically significant and positive influence of real GDP per capita (PCY), financial deepening (FLD), Investment (I), Accessibility of Bank branches(BBR) and negative influences of inflation rate (INFR), private consumption (PRCN), on savings mobilization. On the other hand, except exchange rate (exr), other variables including gross domestic saving(GDSA), domestic credit to government (DCG), domestic credit to private sector (DCP), and interest rate spreads (IRS) have showed positive impact on Ethiopia's economic growth both in short-run and long-run effect. The main findings of the study suggests workable policy action to improve the level of real per capita income and degree of financial depth to accelerate economic growth through fostering domestic savings and, exploring domestic credit access to small, medium and large scale enterprises and investors for capital formation as well as wealth accumulation in the national economy.*

Key words: Savings; loan; financial sector; Economic growth.

# CHAPTER ONE

## 1. Introduction

It is widely accepted that financial sector development is an essential element for economic growth. Mobilizing domestic resources and efficient uses of them help a country attain sustainable development and get rid of dependence on external resource for investment. In realization of this notion the issue of proper utilization and fair distribution of internal resources for development requires special attention in developing countries like Ethiopia. The new government, Federal Democratic Republic of Ethiopia has issued remarkable financial sector liberalization policy in 1992. Following the free-market economic policy a number of privately owned financial institutions have established. Recently they are contributing a lot to the economy through their intermediary role of channeling resources to investment.

Most of the financial institutions functioning in Ethiopia use deposits as an input for loan disbursement and allied activities. Therefore; mobilizing significant amount of savings and channeling it to productive investment through domestic credit is one of the major functions of them. This study deals with the roles and importance of financial sectors' loan and savings to the Ethiopian economy.

### 1.1 Statement of the problem

Ethiopia is one of the Less Developed countries whose economic performance is partly dependent on external resources. The country has ample material and human resources. Availability of resources is good opportunity for a country if properly managed and distributed wisely with sustainability. In Ethiopia domestic resource mobilization needs an extra effort and coordination with appropriate policy and right regulation to attain desired development.

Poverty has been the major challenge to the country for long period of time with different regimes mainly due to political instability, war, conflict and others. Different governments with different political beliefs is also other side of the poverty element. For example, the mixed economic policy of the Imperial government, command economic policy of the Derg regime and

Free-market economic policy of Federal Democratic Republic of Ethiopia. Such successive governments but different policy implementation has sound impact on sustainability. Because when one builds its own path, the next one may destruct it for its better use and survival. Of the three, the latest free-market economic policy is the better one for Ethiopia as the policy invites people to participate individually or in group to participate in any types of development endeavors. The establishment of the private sector is also the output of the new liberalization policy of 1992.Existence and strength of the private sector in an economy could smoothly facilitate the distribution of resource like an engine is needed to a vehicle. Though workable and potential economic policies were issued by FDRE, the status and share of some macroeconomic variables such as domestic savings and domestic credits have showed low progress. The aim of this paper is, therefore to investigate factors treat highly affect the progresses of savings and loan in Ethiopia.

### 1.2 Objective of the study

The general objective of this thesis is to analyze the role of loan and savings in Ethiopian economy. Pursuant to this the related specific objectives of the study were;

- To review key determinants of savings mobilization activities in Ethiopia
- To examine the growth pattern of gross domestic savings and domestic credit along the lines of the economic growth in the country
- To assess the impact of savings and loan in promoting the socio-economic development of the country.

- To evaluate the savings and loan products functioning in Ethiopian financial sector
- To analyze the legal framework governing financial activities in pre and post reform periods.
- To identify prospects for growth in resource mobilization and better credit access for the majority given the existing high demand for financial resources.
- To propose potential policy recommendation that would raise domestic savings rate sustainably

## 1.3 Research Questions

The basic issues this research is attempting to answer are;

- What are the major macroeconomic variables that affect saving behavior in Ethiopia?
- What are the impacts of these variables on loan, savings and economic socio-development?
- What are the major contributions expected from the Government, financial institutions and households to increase the share of loan and savings in the economic growth efforts.

## 1.4 Significance of the study

The outcome of this study will provide relevant recommendation to policy makers to look at the impact of the major factors and take necessary measures.

It could be used as a framework for financial institutions' management while designing deposit mobilization and loan disbursement strategy given the short-run and long-run magnitude and scope of the variables.

The study is also worthwhile in contributing to the existing good practice and frontiers of knowledge in the area.

Furthermore, it forwards valid theoretical and empirical understanding and used as a reference for those who want to make extensive investigation on the same.

### 1.5 Working hypothesis

Based on various macro economic variables behavior and several empirical evidences the relationship between dependent and independent variables is hypothesized that, real GDP per capita, financial deepening, level of investment, and interest rate have positive impact on savings mobilization. This may be due to the fact that, when individual's income increase and the degree of financial depth become improved, people are motivated to save part of their earning. In similar manner, when the minimum saving rate raised people expect more return which inspire them to save more. The same is true for investment meaning as level of investment increase; it creates job opportunity and increases production .On the other hand, private consumption, age dependency ratio, Government budget deficit and real interest rate negatively affect deposit mobilization in Ethiopia. This is due to the existing high inflation in the country; real interest rate reduces individual's ability to save by rising cost of living and uncertainty. Dependency ratio and private consumption also negatively affect domestic saving by increasing consumption expenditure at household level. Further; gross domestic savings, domestic credit to state owned enterprises, domestic credit to private sector and interest rate spreads have positive impact on Ethiopia's economic growth. That is as savings directly channeled to productive investment through domestic credit, the rate of economic growth shows a sustainable improvement.

### 1.6 Scope and Limitations of the study

The scope of the study covers all deposit taking and loan processing Ethiopian financial institutions rather than focusing on a specific financial institution using 36 years annual secondary data sets covering 1975 to 2011.The study faced the following limitations and challenges; the use of various financial sectors' data has been time consuming and exposed to relatively high cost. Lack of well studied and availability of related written documents in Ethiopia is another challenge to smoothly conduct the research.

### 1.7 Organization of the study

The study is organized in such a way that the first chapter deals with the objectives, significance and general overview of the paper. The second chapter is about the review of the related theoretical and empirical literature on the determinants of domestic savings and the relationship between loan, savings and economic growth. The model specified to interpret the data used in this paper is presented in chapter three. The forth chapter explains the descriptive and econometric analysis of factors influencing gross domestic savings, loan and economic growth in Ethiopia through regression and correlation analysis. The fifth chapter finalizes the entire task with policy conclusion and recommendation.

# CHAPTER TWO

## 2. Theoretical review

### 2.1 Institutional profiles of financial Institutions deal with savings and loan in Ethiopia:

Banks, Microfinance and Savings and credit cooperatives

These institutions were selected on the basis of their major activities of collecting funds from the supplier of funds called saver or depositor and channeling it to investment through domestic credits.

#### 2.1.1 Banking history in Ethiopia

Modern banking in Ethiopia was introduced in 1905.At that time an agreement was reached between Emperor Menelik II and a representative of the British owned National Bank of Egypt to open a new bank in Ethiopia. Based on the agreement 'Bank of Abyssinia' was inaugurated by Emperor Menelik II and started operation a year after its establishment agreement signed. According to the agreement, the Bank was allowed to engage in commercial Banking activities (selling shares, accepting deposits and effecting payment in cheques) and to issue currency notes. Its shares were sold in Addis Ababa, New York, Paris, London and Vienna. The Bank which was owned by British and managed by National Bank of Egypt started banking operation with capital of one million shillings opening branches at Harar,Dire Dawa, Gore and Dembi-Dolo as well as an agency office in Gambela and a transit office in Djibouti.(Fasil & Merhatbeb 2009,Belayneh 2011)

In 1931, the Ethiopian Government, under Emperor Haile Sellassie introduced reform in to the Banking system. Consequently, the Bank of Abysinia was liquidated. However; its shareholders were paid compensation. In its place Bank of Ethiopia was established which was fully owned by Ethiopians, with a capital of pound Sterling 750,000. The Bank started operation in 1932. The majority shareholders of the Bank of Ethiopia were the Emperor and the political elites of the time. It was authorized to combine the functions of central banking (issuing currency notes and coins) and commercial banking. The Bank of Ethiopia opened branches in Dire Dawa, Gore, Dessie, Debre Tabor and Harar. It was the first hundred percent African owned Bank on the continent (Fasil & Merhatbeb 2009).

Bank of Ethiopia was remaining in operation for few years owing to Italian invasion of 1936.During the invasion of five years, in contrast to the Bank of Ethiopia; the Italian Banks were become active until 1941. According to (Fasil & Merhatbeb 2009) With the Italian occupation of (1936-1941), the operation of the Bank of Ethiopia came to a halt, but a number of Italian financial institutions were working in the country. These were Banco Di Roma, Banco Di Napoli and Banca Nazionale del Lavora. Following the independence from five years invasion, Barclays Bank (British owned) had opened a branch and operated in Ethiopia during 1942-43.

After the libration in 1942, the state Bank of Ethiopia was established which became operational in 1943 with 43 employees and two branches and acted as the country's central bank .The bank also acted the country's main commercial bank while few foreign banks continued to operate. The country's first development bank was also founded in 1951.at that time the World Bank provided $ 2 million towards the founding of the Development Bank of Ethiopia, and invested a further $ 2 million in 1960.

In 1963, a new banking law split the functions of the State Bank of Ethiopia in to central and commercial banking as the National Bank of Ethiopia and the commercial Bank of Ethiopia respectively. Both were government owned. The law allowed for other commercial banks to operate .this included foreign banks provided they were 51% owned by Ethiopians. The biggest of these was the Addis Ababa Bank. It was 40% owned by Grindlays Bank(British owned) and had 26 branches by 1975,there were also two foreign commercial banks; the Banco di Roma and the Banco di Napoli, which had eight branches and one branches respectively in 1975.(Charles n.d)

Following the 1974 Revolution, on January 1, 1975 all private banks and 13 insurance companies were nationalized and along with state owned banks, placed under the coordination, supervision and control of the National Bank of Ethiopia. The three private banks, Banco Di Roman, Banco Di Napoli and the Addis Ababa Bank S.C. were merged to form ―Addis Bank Eventually in 1980 this bank was itself merged with the Commercial Bank of Ethiopia S.C. to form the ―Commercial Bank of Ethiopia, thereby creating a monopoly of commercial banking services in Ethiopia.

Thus, from 1975 to 1994 there were four state owned banks and one state owned insurance company, i.e., the National Bank of Ethiopia (The Central Bank), the Commercial Bank of Ethiopia, the Housing and Savings Bank, the Development Bank of Ethiopia and the Ethiopian Insurance Corporation. (Fasil & Merhatbeb 2009)

After the fall of the socialist regime in 1991, liberalization policy was issued_by the current Ethiopian government in 1992. The licensing and supervision of banking business proclamation no 84/1994 was issued in 1994 which led the beginning of a new era for Ethiopian banking sector. Following the policy various private institutions were organized to work on market oriented economic policy framework. As result privately owned banks come in to flourish leading to 14 private banks and three state owned banks to operate in the country since June 2011.

### 2.1.2 Micro Financial Institutions in Ethiopia

Poverty is the main challenge to developing countries including Ethiopia for centuries. To overcome this severe situation, a number of nations set various actions to end the prolonged poverty and its consequences and most of them become successful .Many empirical findings suggested that alleviation of poverty and promotion of economic development can therefore be facilitated through providing credit to the poor.

Although the existence of formal financial sector accounted for a century in Ethiopia, majorities of the rural as well as the urban poor were unaccustomed to the credit facility provided by this sector. This and other facts have forced them to search for informal and semi-formal financial sources.

Addressing poverty has been the target of many development programs in Ethiopia. Microfinance has been one of the most prominent instruments in the development program and strategies issued by the Ethiopian Government and its development partners (Wolday 2008).

Indeed, since1970s some NGOs have been providing micro-credit to rural households in some parts of the country. The activities they have involved in have positive impact in rural poverty reduction and enhance the socio economic development of the area. However, as they provided rural credit besides the activities of delivering relief and development services and their scope of coverage was limited, formulating sound microfinance institution policy framework was became issue to policy makers in 90s.

The long-drawn-out challenges of rural and urban poor access to micro credit led to issuance of sound and standard law which governs Micro-finance institutions. Accordingly, the Federal Democratic Republic of Ethiopia has introduced a micro-finance law (proclamation no 40/96) to regulate and support micro-finance institutions. The law officially brought MFIs to accept deposit, grant credit in cash and in kind and stressed the need for sound commercial principle in the sector.

### 2.1.3 Savings and credits cooperatives in Ethiopia

Majority of the Ethiopian population have been making their livelihood in rural areas while the formal financial sectors in the country are operating in

Addis Ababa and in the regional urban towns due to a number of barriers like poor infrastructure, low banking habits and others. Therefore; emergency of other alternatives sector and access the great bulk of rural and urban poor may be treated as reasonable prospects.

With the very relevant purpose of serving rural community, the establishment of savings and credits cooperatives in Ethiopian dates back nearly half a century before the establishment of microfinance currently operating in the country.

The first savings and credit co-operative in Ethiopia was established in 1964 by employees of Ethiopian Airlines. During the same period, credit co-operatives were established by employees of the Ethiopian Roads Authority and the Telecommunication Agency. It is interesting to note that these organizations are among the most modern and relatively efficient enterprises in the country. The co-operative societies proclamation Act No.261/66 was passed in 1966.Existing co-operative societies were registered under this proclamation with the Ministry of Community Development and Social Affairs. (Dejene 1993)

A national promotion committee, known as the Ethiopian Thrift and credit co-operative Development, was set up in 1970 in order to promote savings and credit unions in the country. This committee, which was able to host the ninth African conference on the Mobilization of local savings, facilitated Ethiopia's affiliation with African Confederation of Co-operative Saving and Credit Association (ACCOSCA).It contributed to the increase in the number of Saving and Credit Co-operatives (SACCs) in Ethiopia, and it was able to secure assistance from a number of international donor agencies towards the development of SACCs. However; the National promotion Committee was not then granted legal status. That was one reason why it was succeeded by the Ethiopian National Thrift and credit Co-operatives society in 1973.This society was established by the already existing credit unions under the 1966 Co-operative societies proclamation Act No 241.It was administered by a board of directors elected by the general assembly of the representatives of each affiliated society. The national society was able to contribute to the further development of savings and credit unions in Ethiopia until its liquidation with the passage the 1976 Monetary and Banking Proclamation no 99 and the 1978 Co-operative societies Proclamation No 138. (Ibid)

The Derg government aggressively promoted the Co-operative movement to build a socialist oriented economic and political system. The regime issued Proclamation No 138/78 to promote, regulate and supervise different types of Co-operatives (producers' co-operatives; service co-operatives; thrift and credit co-operatives; and housing co-operatives) under different Ministries. Consequently, SACCOs (Thrift and credit co-operatives as they were called then) were licensed and regulated by the National Bank of Ethiopia, as part of the financial sector. (EEA, 2011) .SACCOs can be designated as semi-formal financial institutions. They are outside the control of the central authorities with respect to ownership of assets and management. As a semi-formal financial sector, it can establish a link between the informal (the iqqub and the iddir) and the formal sector.

### 2.1.4 Population and Financial Sector in Ethiopia

Financial sector development has continued to make progress from year to year especially after the private sector joined the market. At the end of the review period 2010/11 there were seventeen banks with 970 branches in the country serving 80.9 million people. Assuming bank branches were evenly distributed and each individual make use of banks; one bank gives services to 4.8 million and each braches to 82,000 people. However; the figure showed significant progress from 1991/92 where a single bank had given banking services to 18.3 million people. After a decade the number of banks were increased to nine and the ratio of population to bank declined to 6.8 million people in 2000/01.

The number of Micro Financial Institutions (MFIs) reached 31 in 2010/11 with 498 branches and 635 sub branches. Their client base was limited to 2.6 million or 3.2% of the population which played insignificant role in poverty reduction. Similar to MFIs, number of saving and credit cooperatives (SACCOs) were 4,337 with total member of 327,085 which was far below one percent of the population. (Sources; Banks & MIFs,NBE ; SACCOs,EEA,2011)

### 2.1.5 Financial Services and the Poor in Ethiopia

Poor are not bankable. They do not fulfill banks' requirement to get loan services what they look for immediate needs and income generating activities. Therefore; SACCs are probably preferable for them. According to (Dejene 1993) SACCOs are different from banks in that they are owned by all members who have a voice in their operations, whereas banks are owned by shareholders and are generally interested in big loans to rich people. Banks always ask for security, while credit unions consider good character and ability to pay in granting loans.

Delivering financial services to the poor has been identified as an important instrument capable of breaking the vicious cycle of poverty, as it would increase employment, income, consumption and empowerment of disadvantaged groups. Improving access to financial resources for the poor would also facilitate economic growth by easing liquidity constraints, and providing capital to startup new production related activities or adopt new technologies.(Wolday 2008)

## 2.2 Savings

**2.2.1 Definition of Savings:** Savings can be defined as the sacrificing of current consumption so as to increase the availability of resources for future consumption (needs).It can also be defined as the part of a member's income that has not been spent but rather stored for future use or invested in Income Generating Activities (IGA) so that it can earn more income in the future.

Saving is a discipline and requires sacrificing in addition to planning. It is a discipline because it teaches people to use their resources in a wise manner and sparingly to develop an asset in the future. It is a sacrifice because it teaches people to lower today's expenses and to withhold valuable resources for future needs instead of consuming immediately. Saving involves planning for tomorrow (future), because people need to forecast and prepare for possible risks and emergencies like bad harvest, sickness and death. It also teaches people to think on starting a new business or expanding existing ones and also teaches people to anticipating and preparing for upcoming events and expenditures like school fees, marriage, old age and retirements (Friends Consult n.d). That is Savings is an individuals' wise decision in uses of scarce resources to develop assets and predicting and doing necessary preparation for unexpected events. It involves choice between two periods present and future consumption.

### 2.2.2 Reasons for savings by individuals and/or firms

Savings has long history with ancient societies in various forms mostly in physical assets. In modern civilizations too people save their financial and non- financial assets for various reasonable purposes. (According to Friends Consult ltd n.d, various Banks' manual), some of them can be listed as follows;

- *Smoothening the household cash flow*: saving protects the household which mainly engage in agriculture as the major sources of livelihood/income against the uneven income stream due to seasonal fluctuations especially in the rural areas. When the members save, they can be able to meet household needs especially during the periods of no cash inflows such as when there is a major crop failure due to bad weather or during the dry seasons. Savings will therefore be used during the time of shortage.

- *Emergency purpose:* It is common phenomenon for individuals to set aside an emergency fund to cover an unexpected expense including sickness, sudden accident and severe situation in day to day life.
- *Future investment:* savings is an essential element of financial plan. An individual or group of people can save part of their income in order to accumulate an initial working capital to start small business or income generating activities based on its requirement in the surrounding community.
- *Wealth accumulation:* People plan to save money to finance the acquisition of real assets for production and earn real return therein. Whether in developed or developing countries, Savings is the best means for capital formation through short and long term investment which in turn promotes wealth accumulation in the national economy.
- *Down-payment of mortgage loan*: when an individual make housing loan contractual agreement, the person should set aside a fixed or regular amount for down payment purpose according to the agreement made with the lender. Here money saved from present consumption for this purpose can be considered as savings since real value of such assets adds explicit and implicit interest to the borrower.
- *Retirement*: Since retirement appear with reduction or total absence of income, people plan to

save part of their income at youth age in order to resist or cover huge expense like medical expense at elder stage

- *Re-investment***:** firms temporarily retain or save part of its earning to purchase short term securities or long term investment to earn real return and diversify its activities.

### 2.2.3 Nature of Savings

The question where to save and how to save needs special attention especially in developing countries where majority of the population live in rural areas and low income behavior. Though different savings scheme may be available, there are two major ways in which people save their cash or physical assets.

A. *Formal savings:* this type of savings incorporates individuals, firms and Government savings with licensed financial institutions in a country.

B. *Informal savings:* It is type of savings with neither licensed nor registered financial sectors by government organ. For example, hoarding money in houses, storing other assets in unknown places or savings in rotating and non rotating savings and credits unions are also considered as informal savings.

### 2.2.4 Savings mobilization

Domestic savings which is component of household savings, business savings and government savings is a crucial factor for economic development. It can be classified in to financial savings and non-financial savings (savings in kind). Savings placed in banks and other financial institutions usually referred as saving deposits in different types such as saving accounts, fixed time deposit account and demand deposit accounts while non-financial savings includes items kept or stored in non –monetary form like grains and livestock. Depending on the institutional type and purpose, savings can also be grouped in two categories; voluntary savings and compulsory savings (Wolday 2008, Friends Consult Ltd n.d)

I. **Voluntary savings:** is type of savings which people want to save in any one of formal, semi-formal and informal financial sector.

II. **Compulsory savings:** this kind of savings is well known form of savings in microfinance institutions. In this sector a member has to save minimum value of Birr in order to get credit facility and upon loan disbursement certain percentage of the loaned amount shall be maintained as compulsory savings for installment loan and end loan. Even it is forced savings it develops savings habit through time. According to Wolday (2008) all Microfinance Institutions provide compulsory saving products to promote savings culture and serve them as collateral for the group loan.

### 2.2.5 Types of savings (saving accounts)

Financial institutions may introduce various savings options depending on reasonable importance to the community. The depositors could decide which kind of savings account is preferable in line with their areas of interests. As can be seen in most banks' annual reports, there are three major types of deposits accounts.

a. **Basic or regular savings account:** this type of savings is the most common type especially in an economy where financial markets is not introduced or expanded .It is the simplest one for use and its withdrawals is also restricted to the depositor only unless otherwise noticed by the saver . Sometimes it is referred as "passbook" savings. Such kind of saving account may require small initial amount or balance for opening and help easy access for withdrawals.

However; its withdrawals may be limited within a day more than a time as the case it may be. It offers the depositor low interest relative to the other type of saving accounts.

b. **Demand deposit or current account:** type of saving well known with business people as they use the money frequently without limitation on withdrawals up on demand. Since such type of savings account may not available with material balances for further use by the bank, it is registered under non-interest bearing account .Most of the time its transactions carried out by cheque which can be easily endorsed to third party by the payee or the bearer. Its payment is effected immediately at sight upon valid endorsement. Though it does not earn explicit interest to the depositor, it is more preferable by businessmen for safety and easy access.

c. **Time deposit or Certificate of Deposit (CD):** Savings is an essential element of financial plan. While planning to save money, people consider various factors in choosing type of saving accounts. The primary factor is time horizon which depends on the distinct purpose of the saving plan. Time deposit account is preferable by people when they are not in immediate needs of the money and looking for better return in relatively longer time. Because of this, it is sometimes considered as a simple and straight forward form of investing money. It is type of saving account which offers safety and reasonable return than any kind of saving accounts. However; it lacks flexibility due to early withdrawals may result in penalty.

### 2.2.6 Factors influence savings performances.

A number of factors determine savings performance of a country. The most common and important variables are income growth of the people, saving interest rate, real interest rate, financial sector development ,demographic factors, fiscal policy, investment and consumption pattern.(Wiseman J & Hitiris T 1982,Mark 1988, Laura E.et al 1999,EEA 2000, Mahmoud 2008, Bozena 2011)

***Financial development:*** Improvement in area of financial intermediation develops trusts of savers in the financial markets and induces the process of monetization of savings (Wiseman J & Hitiris T 1982).The degree of financial sector development and the range and availability of financial assets to suit savers represents another important factor in promoting savings. The expansion of bank branches and improving the accessibility to banking facilities will result in reducing to cost of banking transactions, and thus motivate individuals' savings. (Mahmoud, 2008)

***Income, consumption and savings*****:** The consumption function assumes that individuals' consumption behavior in a given period is related to their income in that period. The life-cycle hypothesis views individuals, instead, as planning their consumption and saving behavior over long periods with the intention of allocating their consumption the best possible way over their entire lifetimes. The theory views savings as resulting mainly from individuals' desire to provide for consumption in old age. (Fischer s. and Dornbusch R, 1992; 299) Choices by individuals and families about their savings are a set of fundamental determinants of national savings. These decision makers decide the current increment to their resources between consumption, satisfaction of current wants and savings that in turn influences their ability to satisfy in future (Mark, 1988).

***Inflation and macroeconomic uncertainty*****:** Individuals and households face various uncertainties that affect their welfare. Because savings provides resources that are available in the future when these uncertainties are resolved and because the return on savings be uncertain (mark 1988) Where political turmoil, high inflation and uncertain about the future prevail, savers will try to accumulate real assets rather than deposit their money in savings accounts (Laura E.et al, 1999)

***Interest rate*****:** the life cycle theory introduced that the net effect of the real interest rate on saving is unclear. The net effect of the real interest rate on saving can be decomposed into two effects. The substitution effect implies that a higher interest rate increases the current price of consumption relative to the future price, and thus affecting savings positively. The other effect, which is called the income effect, indicates that if the household is a net lender, an increase in the interest rate will increase lifetime income, and so increase consumption and reduce savings. Therefore; it is expected that the interest rate will have a positive impact on saving ratio only when the substitution effect dominates the income effects. In developing countries where financial markets are still not well developed, substitution effect is expected to be much greater than income effect, and thus the real interest rate is likely to have a net positive impact on domestic saving (Ozcan et al, 2003 cited in Mahmoud, 2008). Given consistency in the other influences on the form in which savings are kept, a rise in the interest rate will induce some transfer from tangible to financial assets. The higher the rewards in the financial markets, the more will be the volume of tangible assets which converted in to financial assets will be supplied in the markets (Theodore & Jack 1982).people that accumulate large sums of money react to interest rate. People who accumulate small sums of money don't react to interest rates. People who have information about efficiency of different financial products are more likely to react to interest rates (Bozena, 2011)

***Demographic factors*****:** demographic factors such as population age structure and dependency ratio affects savings performance. During childhood and old age, people on average consume more than they produce through their labor. During middle years, people produce more than their consumption (Mahmoud 2008).Percentage of the children and old people are very important determinants of savings because this section of country's population is not expected to generate income as well as savings. Besides, this group is dependent on the remaining part of the population for maintaining their livelihood (Bozena 2011)

***Investment*:** It is an accepted truism in economics that future economic growth, inter alia,is largely a result of current investment activities. These investments could be expended in the development of human resources to increase efficiency as well as in building up productive capacity to exploit its natural resources. Investment, in turn is mainly a function of savings from current income (EEA 2000)

***Fiscal policy:*** the Neo-classical version of the lifecycle model assumes that a decline in government saving (more budget deficit) will tend to raise consumption and discourage saving by shifting the tax burden from present to future generations. As a result of that, a decline in government savings will cause a decline in national savings. (Mahmoud, 2008)

### 2.2.7 Evolution of Deposit Banking

The use of deposit banking dates back a number of centuries. As described in (Murray, 2008: 87, 91) deposit banking began in ancient China in eighth century, when shops accepted valuables and received a fee for safeguarding. After a while the deposit receipts of these shops began to circulate as money. Finally, after two centuries, the shops began to issue and hand out more printed receipts than they had on deposit; they had caught on to the deposit banking. It was also known in ancient Greece and Egypt, and appeared in Damascus in the early thirteenth century and in Venice a century later. It was prominent in Amsterdam and Hamburg in the seventeenth and eighteenth centuries.

### 2.2.8 Regulatory framework that governs deposit of funds in Ethiopia

In Ethiopia deposit mobilization by financial sector (modern banking) was started during Emperor Menelik II in 20$^{th}$ century. Mobilizing domestic resources for productive purpose and safeguarding by regulatory organ of government is reasonable in all countries to enhance public confidence. For this and the rest rationale, Commercial and Civil code of Ethiopia (1960) set appropriate laws accordingly.

- Deposit of funds is a contract between two parties; a person and the bank whereby a person agrees to transfer the ownership of the funds and the banks also agree to pay under the conditions stipulated in the contract. Then the bank may dispose these funds in respect of its professional activity, subject to repayment under the conditions provided in the contract. /Art 896/.As described in this article, the bank can lend the money to its customers in accordance with National Bank directives for further productive uses. Nevertheless; when deposit is associated with "coins and other individual monetary tokens", the bank shall not acquire the title to nor the right to dispose such items, in respect of which there is a provision that they shall be refunded in kind.
- Deposit account: the contract of deposit of funds results in the opening of an account. The bank shall open an account in the name of depositor of funds and enters all transactions by the way of credit upon deposits made by the depositor and debit account where the same make withdrawals by himself or his behalf with third parties./Art 897/

- ❖ Form of deposit: the mode or type of account opened may be demand deposit where a depositor of funds shall be at sight and the holder of the account may dispose at any time or on demand of the whole or part of the balance. Also an account may be saving account where the right of depositor may be limited on withdrawals of large amount without notice in a given period. The articles further states that an account may be Time deposit account in which the right of the depositor to dispose the funds may be subject to notice or the expiry of a fixed period/Art 897,898/

### 2.2.9 Deposit mobilization

Deposit mobilization is one of the major functions of financial institutions beside other services. They use these funds as an essential input to lend to business people and firms and the interest income earned from the loan constitute significant part of their income. These deposits have mobilized using different saving accounts; they are basically three types; Demand deposits, Saving Deposits and Fixed time Deposit. Without these funds offerings full-fledged and efficient service could be serious challenges to these sectors. Because of these mobilizing deposits is major performance indicator for them.

## 2.3 LOAN

### 2.3.1 Short history of Loan and Loan Banking

It is usual phenomena from ancient time to recent that people borrow from each other or institutions for various purposes. (Murray, 2008: 83), Factors, Investment banks, Finance companies and money lenders, are just some of the institutions that have engaged in loan banking. In the ancient world, and in medieval and pre modern Europe, most of these institutions were forms of "money lending proper" in which owners loaned out their own saved money. Loan banks in the sense of intermediaries, borrowing from savers to lend to borrowers, began only in Venice in the late middle age.

2.3.2 Loan and advances: It is the major function of financial institutions and means of generating profits. According to (Jhingan 2004:66) one of the primary functions of a commercial bank is to advance loan to its customers. A bank lends a certain percentage of the cash lying in deposits on a higher interest rate that it pays on such deposits. This is how it earns profits and carries on its business.

**2.3.3 Loan and advances in Ethiopian Financial institutions**

Granting loan to individuals, groups and firms from their deposits of funds is the main activities of the financial institutions in executing their intermediary role. Beside it promotes recourses utilization and distribution, loan and advances make significant share of their financial assets. For this purpose Ethiopian commercial code, civil code and Banking Business proclamation set relevant and valid statement as follows;

"*loan" or "advance" means any financial assets of a bank arising from a commitment to advance funds by a bank to a person that is conditioned on the obligation of the person to repay the funds ,either on specified date or dates on demand, usually with interest , or from in direct advances such as unplanned overdrafts, participation in loan syndication and the purchase of loans from another lender ,and includes a contractual obligation of a bank to advance funds to or on behalf of a person's claim evidenced by a lease financing transaction in which the bank is the lessor, and an overdraft facility to be funded by a bank on behalf of a person/Banking Business Proclamation No 592/2008 Art 13/* .According to this Article, banks has the right to lend or advances its fund to a person or its customers with conditional obligation of claiming the principal of the disbursement with interest.

Civil code of Ethiopia (1960)also clearly define the loan of money and other fungibles as "*The loan of money and other fungibles is a contract whereby a party, the lender, undertakes to deliver to the other party ,the borrower, a certain quantity of money or other fungible things and to transfer to him the ownership thereof on the condition that the borrower will return to him as much of the same kind and quality*"/Art 2471/.*The bank dispose of its deposits of funds in respect of its professional activity, subject to their repayment under the conditions provided in the contract./Commercial code, Art 896*/.Based on these and others sound legal support and protection that Ethiopian financial sectors grant or disburse loan and advances to their customers with objectives of earning profits and sustainably in the sector.

### 2.3.4 Major causes for high demand and low supply of loan facility by private banks:

***First.*** *Most* of the Ethiopian financial institutions especially private banks rely on their deposits to finance the high demand for loan from the public but National Bank of Ethiopia's (NBE) policy regard to this deposits offers low freedom to them to use it. For instance the long standing credit-ceiling imposed on private banks which removed on April 2011 was challenged them to accompany the high demand for loan at that time.

Following the removal of credit ceiling, NBE introduces another directive No.MFA/NBEBILLS/001/2011 which obliges private banks to purchase NBE Bill equivalent to 27% of loan disbursement with low interest rate (3%) per annum while the private banks receive deposit at minimum saving rate of 5% per annum. While the 3 percent purchasing rate may be unfair, its revolving behavior is another debatable issue. That is the maturity date of the NBE Bill purchased by a bank is five years. The bank cannot claim before that. On the other side, usually private commercial bank's loan maturity is less than five years.

The same borrower may apply for loan facility twice within five years period upon full settlement of first disbursement. When this is the case the same bank is forced to purchase the Bills twice despite the borrower is same.

Here one can observe two opposing argument

*I*. Exploring credit access to the majority even to urban and rural poor through these institutions stands at rational side.

*II.* Due to liquidity problem mainly resulted from purchase of the NBE Bill plenty of the urban business people remain outside of the bank's loan access.

Monetary policy review made by access capital 2011 validates the above notion with relevant statements the new NBE Bill directive;

- applies to gross new disbursement per month
- covers all "loan and advances"
- designates "National Bank of Ethiopia Bills" having five year maturities as the sole eligible government financial instrument that private banks must purchase
- applies retroactively to all private bank loans given since July 1,2010
- Excludes the commercial Bank of Ethiopia and the Development Bank of Ethiopia.

***Second.*** Priority oriented state banks' credit policy**:** in line with Government sustainable development endeavors the giants; Commercial Bank of Ethiopia and Development Bank of Ethiopia credit policy gives priority to productive sectors like Manufacturing, Agriculture and export. Its importance is obvious. However; it does not welcome individuals and firms moving on other line of activities which forces them looking for private commercial banks for the purposes.

***Third.*** The overall economic growth in the country; this is an indicator that initiates people to involve in to small and medium business which in turn stimulates the production of consumer goods and investment goods. In order to finance their shortage of working capital, these people definitely walk to the nearby financial institution to get loan facility.

### 2.3.5 Savings and loan management

Savings and loan needs special attention because depositors are concerned about safety and easy access of their money when need arise as sight. On the other hand banks plan to be profitable with its main objective of survival. In order to be fit for both, the issue of safety, liquidity and profitability needs utmost care always with operational activities. In this regard central bank (NBE) plays significant role due to it is lender of last resort in the country. Therefore close administration of the liquidity status of each bank is the necessary task to National Bank of Ethiopia.

### 2.3.6 Liquidity management

The amount of cash kept in the bank's vaults ready for instant redemption is its reserve. (Murray 2008:95).Banking business proclamation No.592/2008 Art 20 describes as any bank shall maintain adequate liquidity and reserve .Reserve and Liquidity management policy of a central bank may be subject to change or revision based on rigorous analysis of the existing situation in the country. It may be universal that fund users (Banks) could not utilize or dispose 100 percent of its deposit of funds. Central bank can decide what fraction of the deposit kept as reserve and liquidity in its vault to safeguard safety of the depositors. Much excess reserve or high liquidity problem is not advisable. Under this theme, the case of loan to deposit ratio of banks matters.

In Ethiopia the issue of deposit of funds is debatable topic for the fund users (banks) and NBE. Both of them might be reasonable as the case it may be. Given the macroeconomic uncertainty (double digit inflation rate) and Banks' priority areas of interest in financing project (whether priority sector of government or not), NBE took tight monetary policy action on bank's reserve and liquidity different times. Currently 20 percent of cash deposits (reserve + liquidity ratio).One more, the 27 percent of NBE Bill purchases on loan and advance disbursement each month with 3 percent interest rate per annum is other way round of that. A little different from non- interest bearing reserve and liquidity vault at there. To validate this statement, private commercial banks' loan to deposit ratio stood at only 52.1% at 2010/11. This figure tells us that out of Birr 100 mobilized by private banks with various implicit and explicit costs, they dispose only Birr 52 to their customers. The remaining portion is at NBE vault. But they pay interest expense to depositors on total amount of the deposits. Because of this liquidity problem, it is timely worry of each private bank. Investing in NBE Bill and keeping available reserve and liquidity is for good purpose but its magnitude matters.

### 2.3.7 Information asymmetry and Risk management

Loan and advances constitutes the largest share of assets on balance sheet of financial institutions engaged in the activities. Financial institutions lends some amount of money with aim of getting real return in addition to the principal on or before the given maturity date. This is working principles of the institutions. However; for some reasons controllable or not, rarely this statement could not be valid and the disbursed amount changed to problem loan.

Lending institutions are faced with four major problems in the course of undertaking credit activity:

- **a.** To ascertain what kind of risk the potential borrower is (adverse selection).
- **b.** To make sure the borrower will utilize the loan properly once made, so that he will be able to repay it (moral hazard).
- **c.** To learn how the project really did in case the borrower declares his inability to repay.

**d.** To find methods to force the borrower to repay the loan if the borrower is reluctant to do so. sited in Abraham, 2002.).

### 2.3.8 Causes for problem loans

Main causes for problem loans were well explained by Hung Linh(2009):Regardless of precautions taken during the appraisal, approval and underwritten processes, there will be situations when a loan will not perform as agreed for various reasons, within or outside of the control of the borrower or even of the bank .Any loan can become a problem loan, for a number of reasons.

1. Reasons under the borrower's control: faulty planning, poor management, wrong decisions.
2. Reasons under bank's responsibility: faulty appraisal, poor loan underwriting, funding delays, lack of monitoring.
3. Reasons outside the control of both parties: adverse economic development, industry problems, laws & regulations, labor problems, acts of nature.

Morris(1985) cited in Abreham,2002)also found out primary causes of high arrears in India, according to the findings, rapid expansion of lending in response to government pressures to achieve mandated credit disbursement targets. He listed the following as causes of loan default

a. failure to tie lending to productive investment,

b. neglect of marketing and linking credit recovery to the sale of the product,

c. defective loan policies, delayed loan disbursement, too much or too little credit and unrealistic repayment schedules;

d. misapplications of loans;

e. ineffective supervision;

f. indifference of bank management with respect to recovering loans and

g. lack of responsibility and discipline on the part of borrower.

### 2.3.9 Risk management

Loan portfolio constitutes the largest portion of risk-weighted assets in Ethiopian financial institutions. Therefore; management, control and monitoring of risk will protect the institutions and safety of depositors.

### 2.3.10 Types of risks that encounter financial institutions

Basically there are four types of risks that financial institutions should manage. These are credit risk, interest rate risk, liquidity risk and operational risk. Credit risk arises when a bank cannot get back the money from loan or investment. Interest rate risk arises when the market value of a bank asset, loan or security falls when interest rate rise. The solvency of bank would be threatened when the bank cannot fulfill its promise to pay a fixed amount to depositors because of the decline in the value of the assets caused by increase in interest rate. Liquidity risk arises when the bank is unable to meet the demands of depositors and needs of borrowers by turning assets in to cash or borrow funds when needed with minimal loss. Operational risk arises out of inability to control operating expenses, especially non-interest expenses such as salaries and wages. In a competitive environment, high operational expenses would jeopardize the banks prospects to survive. (Machiraju, 2003)

### 2.3.11 Savings, Loan and development in Ethiopia

Financial institutions development contribute a lot to economic development in different ways particularly in developing countries including Ethiopia where level of monetization is very low. Strong and well structured financial sector facilitates economic growth by providing variety of services based on needs of the different economic sectors. The major contributions of financial institutions to the development processes are;

I. ***Facilitates capital formation process and fasten economic growth***: Financial sectors are crucial for developments because funds are channeled to investment by them through domestic credits. Investments in turn contribute a lot to GDP or economic growth in different ways .It promotes endogenous technical progress, human and physical capital formation. According to (Orji, 2012) Investment has three- fold effects on economic growth. Firstly, demand for investment goods forms part of aggregate demand in the economy. Thus a rise in investment demand will, to the extent that the demand is not satisfied by imports, stimulate production of investment goods which in turn leads to high economic growth and development. Secondly, capital formation improves the productive capacity of the economy. Thirdly, investment in new plant and machinery raises productivity growth by introducing new technology and innovation which would also lead to faster economic growth.

II. ***Contribute to government revenue:*** one of the direct contributions of financial institution to government is tax revenue. Recently tax revenue generated from banking industry has increased continuously. As banks are established by share holders they are subject to double taxation. One and the most is business profit tax on their annual profits. Second is shareholders are individually pay tax when the received dividends. Further, employees of all the financial institutions pay income tax on the monthly basis. Recent data 2010/11 has showed that business profit tax revenue generated from commercial banks alone reached Birr 2.2 billion (NBE, commercial banks consolidated financial statement, 2011) constituting 11.3% of overall direct tax revenue.

III. ***Employment creation:*** where financial sector branch network expansion and diversification of activities are there, hiring additional employee is inevitable. Currently the number of people employed in banks and micro finance have continuously increasing from year to year. The job opportunity opened for new employee by banking industry take the highest share compared to other financial institutions. As at the end of 2010/11 total staff strength of banks is 31,197.The share of public banks accounted for 48.2 percent of the total employment. (Banks' annual report 2011)

IV. ***Introduces modern financial services products*:** the history of loan and savings date back long period with human civilization However; the way and forms of saving and borrowings varies through times and place to place. Even in a country savings mechanism vary from urban to rural due to various factors like lack of awareness, low level of infrastructure development, lack alternatives to choose better one. Most of the time poor are not bankable. They do not fulfill bank requirement to get loan facility and they want small amount of loan. This pushes away them from banking services. Because of this they look for the nearby informal sector. In Ethiopia in order to capture this barrier the number of Micro Financial Institutions and savings and credit co-operatives are performing better. Indeed the area coverage by these institutions is insignificant so far but on progress. Few people are utilizing the financial services provided by the institutions. Welcoming them to such a like small loan facility and voluntary and compulsory savings products improves the degree of monetization in the country.

V. ***Innovation and Globalization*:** Banking transactions are highly interrelated with global banking system. Imports from abroad and exports to there are undertaken on the basis of international trade rules and regulations. Major foreign trade transactions including Letter of Credits, Inward bills for collections and International Telegram transfer payments are effected through banks to the abroad beneficiary. This and allied cross country transactions helps banks to move with global transaction. Further Ethiopian commercial banks are being offering customer needs based saving products which are not known before. These probably new savings products include;

- **Special demand deposit:** it is also known as 'non-interest bearings saving accounts'. This type of account is operated using a saving passbook alike demand deposit or current account but does not bear interest .It is designed for people who do not want interest earned on their account.
- **Special saving accounts;** This account combine features from saving and checking (demand) accounts. It is operated with cheque book but earn interest to the holder limited with frequency of withdrawals within a month.
- **Minor's saving account:** This type of saving is designed for under eighteen which can be opened and operated by parents or guardians. It bears attractive interest rate higher than normal saving accounts.
- **Holiday, vacation and special purpose saving account;** it can be opened by individuals or groups for special events. These types of account also bear higher interest.

### 2.4 Empirical review

Domestic saving mobilization by commercial banks and credit allocation functions stem from their role as the financial intermediaries in the domestic economy. The link between domestic savings, commercial bank credits and economic growth is not a new discovery**.** Its debate has a pedigree and is marked with conflicting conclusions. The difference in conclusion is due not only to differences in theoretical perspectives, but also to the way in which the link between them is taken in to account by researchers. (Orji 2012)

There are some empirical studies that deal with impact of bank savings and bank credits**.** Some authors have found a significant positive relationship between savings and per capita income (Orji 2012, and Mahmoud 2008) The study made by Tochukwu (N.d) revealed that a unit change in income growth will bring about a 0.3 percentage change in private saving in Nigeria. Mahmoud(2008) found that degree of financial depth has significant positive impact on domestic savings and negative relationship between budget deficit and domestic savings in Egypt. Ibid (2012) investigated bank savings and bank credits in Nigeria: determinants and impact on economic growth. The result showed that significant positive relationship of per capita income and financial deepening on domestic savings. On the other hand, bank savings, bank credits and interest rate spreads significantly determine economic growth.

Lack of (or easy access) empirical results on the relationship between domestic savings, loans economic growth in Ethiopia needs further attention by researchers.

## CHAPTER THREE

### 3.1 Data Sources and Methodology

#### 3.1.1 Sources of data and it collection

Data used in this paper was obtained from secondary sources which are published and unpublished documents, Articles, proclamations, books and annual reports. The study undertakes empirical analysis on savings and loan in Ethiopian financial institutions using time series data from **1975 to 2011**. The data collected through observation techniques will be treated and interpreted with the help of analytical tools such as ratios, percentage share, graphs and tables to show the volume and magnitude of loan and savings.

#### 3.1.2 Method of analysis

The paper presentation will used both descriptive and econometric models to show the influence of policy and non-policy variables on savings and loan as well as economic growth in Ethiopia. The descriptive statistics used to summarize the qualitative and quantitative aspect of the study. It also supports the soundness of the econometric approach. The study applies *co-integration method and Error Correlation Model.*

#### 3.1.3 Methodology

#### 3.1.4 Model specification

In this section different factors that are influencing savings and loan in Ethiopia were estimated .Based on the nature of the aim of the study, co-integration and ECM models were adopted. In the first objective of analyzing factors influences gross domestic savings in Ethiopia. Model adopted by (Orji, 2012) is modified to arrive at model of domestic savings in Ethiopia.

**Model I**

**DSA=F (PCY, FLD, RIR, SIR, ADR, PRCN, I, FB) ......................................... (1)**

Where:

Domestic Savings (DSA): (is the total savings mobilized by financial institutions in Ethiopia)

1. ***Per Capita Income (PCY):*** (here is real GDP per capita income of people). Various economic theory and empirical evidences confirms that an increase in people income influences positively their savings capacity.
2. ***Financial Deepening (FLD):*** Financial deepening is the degree of financial depth or development represented by broad money ($M_2$) as a ratio to GDP. Financial deepening enhances the degree of monetization of the economy. Strong financial intermediation facilitates financial deepening. That is financial performance of different sectors of the economy are highly dependent on level of monetization. Based on this premises financial deepening have positive impact on savings.
3. ***Investment (I):*** Investment and savings are more interrelated macroeconomic variables that feed each other. In most case savings support investment as an input .on other side investment creates job opportunity for people, adopt new technology, and improves standards of livings at national level. The expected sign here is positive.
4. ***Real Interest Rate (RIR):*** is the difference between nominal interest rate on savings deposit and annual inflation rate. Its impact on savings depends on the annual inflation rate of a country. In Ethiopia where double digit

annual inflation rate is experienced recently, it impacts negatively on savings.

5. ***Private Consumption (PRCN):*** gross private consumption .people uses their disposable income for consumption and savings. Even at the condition of absence of income people consume by borrowing or selling their assets to survive what is called ***autonomous consumption***. That means consumption is compulsory needs of human life. High consumption implies less saving in the households and economy and vice versa. Here consumption has negative impact on savings.
6. ***Age Dependency Ratio (ADR):*** Demographic factors such as population age structure and dependency ratio influences savings behavior of the economy. Of the three stages in human life childhood, middle age or youth stage and old age, people consume more than they produce during childhood and old age. Age dependency ratio here is the ratio of the sum of people younger than 15 and the ratio of people older than 64 to the working age population. Life cycle hypothesis assumes that when there are too many dependent people in the country, consumption tends to increase and savings decline. Therefore; the expected sign here is negative
7. ***Saving Interest Rate (SIR):*** can be defined as an incentive or benefit made to savers on the money saved for various purposes. When saving interest rate is relatively high people encouraged to save their money instead of hoarding or holding with physical assets. It has positive relationship with savings.
8. ***Fiscal Balance (FB):*** is the overall surplus or deficit as percentage of GDP. This variable helps evaluate the Recardian equivalence on Ethiopia's budget deficit. Regard to the government budget deficit impact savings there are two opposing views whether it decreases or no effect on

national savings. Owing to the long standing deficit trend in the country the expected sign is negative.

*To make empirically verifiable equation, (1) has to be transformed in to econometric equation;*

$$DSA = \beta o + \beta 1PCY + \beta 2\ FLD + \beta 3\ RIR + \beta 4SIR + \beta 5\ ADR + \beta 6PRCN + \beta 7\ I + \beta 8FB + \mu \ldots \ldots \ldots \ldots \ldots. \quad (2)$$

Where;

$\beta i$ = Parameter to be estimated

$\mu$ = Error term which incorporates other determinants that are not included in this model

Equation (2) can be re-write as follows;

$$\Delta\ DSA = \beta o + \beta 1(\Delta\ PCY) + \beta 2\ (\Delta\ FLD) + \beta 3\ (\Delta\ RIR) + \beta 4(\Delta\ SIR) + \beta 5\ (\Delta\ ADR) + \beta 6(\Delta\ PRCN) + \beta 7(\Delta\ I) + \beta 8(\Delta\ FB) + \mu \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots. \quad (3)$$

Where;

$\Delta$ =Difference operator

$\mu$ =Error term

**Model 2**

Model 2 shall be used to analyze the second objective of impact of gross domestic savings and domestic credit on economic growth. The model can be specified as follows;

**GDP =F (DSA+DCSE+DCP+IRS+EXR) ------------------------------------ (4)**

Where:

GDP: Gross Domestic Product (proxy for economic growth in Ethiopia) at current market prices

DSA: Domestic Savings

DCSE: Domestic Credit to State Enterprises (domestic credit disbursement by financial institution government owned enterprises)

DCP: Domestic Credits to Private sector (domestic credit disbursement by financial institution to privately owned sector in Ethiopia)

IRS: Interest Rate Spreads (the difference between maximum lending rate and floor saving interest rate)

EXR: Exchange rate (Birr per unit foreign currency)

$$\boldsymbol{GDP = \beta o + \beta 1DSA + \beta 2DCSE + \beta 3DCP + \beta 4IRS + \beta 5EXR) + \mu - - - -(5)}$$

$$\boldsymbol{\Delta GDP = \beta o + \beta 1 (\Delta DSA) + \beta 2(\Delta DCSE) + \beta 3(\Delta DCP) + \beta 4(\Delta IRS) + \beta 5(\Delta EXR). (6)}$$

**CHAPTER FOUR**

**4.1 Data analysis and interpretation**

**4.1.1Descriptive statistics**

**4.1.2 Review of gross domestic savings in Ethiopia (1975 to 2011)**

Ethiopia has experienced low domestic savings rate in the two successive regimes (the Derg & the FDRE) for 36years. From 1974/75 t0 2010/11, average saving rate as a percentage of GDP was 7.1 percent. During the Derg regime (1973/74 to 1990/91) the average percentage share was fall down to 6.7% from that of 11.3% from 1960/61 to 1973/74(EEA, 2011).This high decline rate was mainly due to the political instability, successive war and conflict in the regime. While in FDRE, the gross domestic saving rate in the first decade (1992 to 2002) showed insignificant change and registered 7.7% of GDP. In the last nine years (2003 to 2011) it was declined to 6.5%. Though the country has following the free-market economic policy for the last two decades and private sectors involvement have flourished, gross domestic saving rate did not show progress than that of former regimes.

The major reason for this is frequent fluctuation of savings interest rate with declining phase i.e. from

1992/93 -1996 /97------------------------------------------------------------------- 10%, 1997/98 ------------------------------------------------------------------------------- 7%,

1998/99 –2000/01---------------------------------------------------------------------6%,

2001/02-2007/08--------------------------------------------------------------------- 3%

2008/09 -2010/11----------------------------- ---------------------------------------- 4%,

2010/11 to date------------------------------------------------- -----------------5%

***(Source NBE)***

Where saving interest rate continuously decreased people are not motivated to save their money rather, they look for other alternative options like buying tangible assets.

The second reason may be double digit inflation rate which deteriorates the purchasing power of money.

When the Ethiopia's domestic saving rate compared with sub-Sahara African countries and the Asian countries, it remain at low level. According to IMF 2009a and 2009b cited in The Gabrehan 2010),From 1997 to 2010,the average saving rate in low-income countries of the region was about 9 percent, while it was about 19 percent for middle-income countries. In the same period, the average saving rate of "fragile" sub-Saharan

African countries were 11.5 per cent, still higher than Ethiopia's rate of 4 percent. Far from this, the average saving ratio in the newly industrialized Asian economies has remained greater than 30 percent, except during the recent crises years when it decreased to about 29 percent in 2009-10.

### 4.1.3 Deposit mobilization behavior in the Derg (1974 to 1991) & the EFDR (1992 to 2011).

In the Deg regime deposit mobilization was undertaken by public banks .At the end of the regime in 1991/92 all deposits (100%) was mobilized by Commercial Bank of Ethiopia (CBE) and the other two banks were involved in making loan mainly to state enterprises. Following the fall of the regime, the issuance of free-market economic policy, and new Banking business proclamation No 84/94 ,private banks were established and started banking business since 1994.By the 2010/11 with fourteen private banks and three public banks' competition, the deposit mobilization share of CBE fall down to 62.3%. The market share of the two public banks (Development Bank of Ethiopia and Construction and Business Bank) was only 2.2% and 35.5% was mobilized by the fourteen private banks.

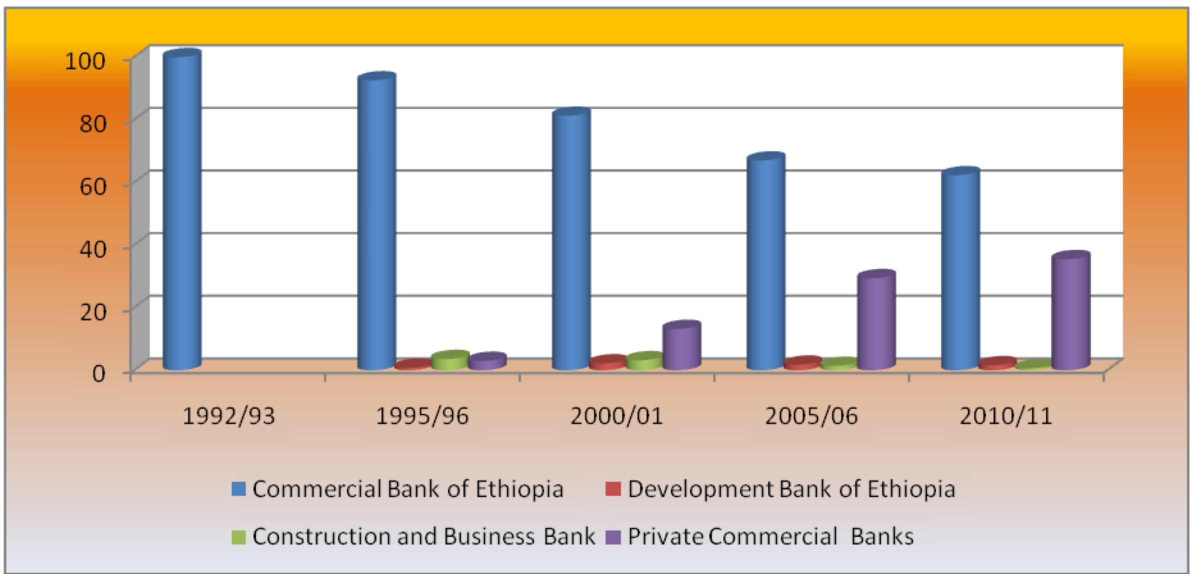


**Figure4. 1: composition of total deposits with Banks** **Source: NBE**

Out of the total deposit by all banks in 2010/11 demand deposit constituted (50.4%) followed by saving deposit (45.9%) and time deposit (3.7%).This figure indicates that on average Ethiopian banks pay interest expenses only on half of their deposit balance in the reporting period.

Regard to deposit mobilization by institutional type: though the numbers of Microfinance Institutions have reached 31 in 2010/11, total deposits mobilized by them constitute only 2.7% of bank deposits. That is MFIs' capacity of intervention in rural areas for resources mobilization is in significant .Because of this, their rural credit disbursement potential was also very low in reducing rural poverty.

## 4.2 Loan disbursement and collections

### 4.2.1 Features of loan disbursement in Ethiopia in the pre and post reform periods

The three successive regimes in Ethiopia; the Imperial; the Derg and the current Federal Democratic Republic of Ethiopia issued various proclamations, directives and regulatory frameworks in line with their economic policies and political ideology.

***A. During the imperial regime:*** domestic credit made during this regime had different features with informal, semi-formal and formal sectors.

disbursement by formal sector: domestic credit performance in this period was depended on urban centered banking operation with high collateral requirement and sectoral discrimination specially paying low attention to agriculture.(According to Dejene 1993) 'credit during the pre-revolution in Ethiopia was characterized by concentration of bank operations in few urban centers(e.g. Addis Ababa alone accounted for 64% of the bank branches),high collateral and minimum loan requirements which favored big businessmen ,and then the virtual neglect of the agricultural sector, By 1974 agriculture had received no more than 10% of the total bank credit in spite of the fact that the sector had accounted for more than 50%of GDP. The interest rate varied from 4.5% to 9.5%per year depending up on the type of project and borrower (whether Co-operative, State enterprise or individuals)

*Loan by informal sector*: in the imperial regime landlords were potential sources of rural credit. Like modern formal financial sectors they had considered different factors as stated by Mouri 1987, (cited in Dejene 1993). Prior to 1974, money lenders were often rich land owners. Following the nationalization of land, landlords have disappeared as a social class, and their roles as money lenders are being replaced by rich traders. The financial operations of money lenders are simple, cost-effective and flexible compared to those of banking system. Interest rates, which are never stated in the agreement made with the borrower, are influenced by the extent of personal relations, degree of risk involved, availability of funds in the community, length of the maturity period and extent of competition from the formal financial market (Mauri, 1987, p.15 sited in Dejene1993)

***B. The Derg regime(1973/74 to 1990/91):***the remarkable economic reform introduced by Derg regime was the state of socialist system whereby all privately owned financial institutions were nationalized to provide financial services to mainly to public projects, state farms and co-operatives giving low attention to private sector .

Disbursement to State owned enterprise and private sector:

Domestic credit disbursement in the Derg regime was mainly channeled to public projects or state owned enterprises. When the ruling party came to power in 1975 before nationalization policy was implemented, the share of domestic credit disbursement to public projects was only 34 %.In 1980 it was increased by more than two folds and reached at 74.4 % as a result of the 1975 nationalization policy and 1978 of Co-operative Societies Proclamation No.138/78 which gave little attention to the private sectors. After a decade the figure was declined to 60.2% in 1990/91. From 1980/81 to 1990/91 the average domestic credit disbursement to public project and co-operatives were constituted 72.1% of the total loan disbursement.

Where disbursement by institutions is reviewed, in 1980/81 CBE made the highest (79.7%) followed by DBE (18.6%).By the end of 1990/91, the share of CBE fall to 62.5% and the other two banks' share was raised to DBE (28.7%) and that of CBB (8.8%) of the total disbursement.

Disbursement by sector wise; 1n 1980/81 the highest was to Agriculture (29.5%) followed by import (18.4%) and housing and construction (12.7%).After a decade, 81.1 percent of total loan disbursement was made to three sectors; agriculture (49.9%) half of total disbursement, Housing and construction (17.1%) and Industry (14.1%).

### C. *disbursement in the post economic reform period (since 1992)*

The issuance of economic reform and liberalization policy by the new Government, Federal Democratic Republic of Ethiopia was put incredible change in the country's financial sector profile .On top of others, the Licensing and supervision of Banking proclamation No 84/94 and Monetary and Banking proclamation No 83/94 results in re-organization and transformation of privately owned financial sector in the country.

The policy moderately removed the sector discrimination on domestic resources distribution especially in domestic credit allocation with establishment of private banks and some internal policy adjustment of state owned banks. It is noteworthy that at the first year of the new government the share of private sector raised to 52.2% in 1992/93 from low level of 39.8% in 1990/91 .Further by 2005/06 it was jumped to 81.7%.However; the ratio was declined to 67.8% in 2010/11. Argument regard to the fall is the long standing credit ceiling which was removed in 2011 and 27% of loan and advances disbursement NBE Bill purchase by private commercial banks. From the total loan disbursement during EDRE, on average, 76% has made to private sectors.

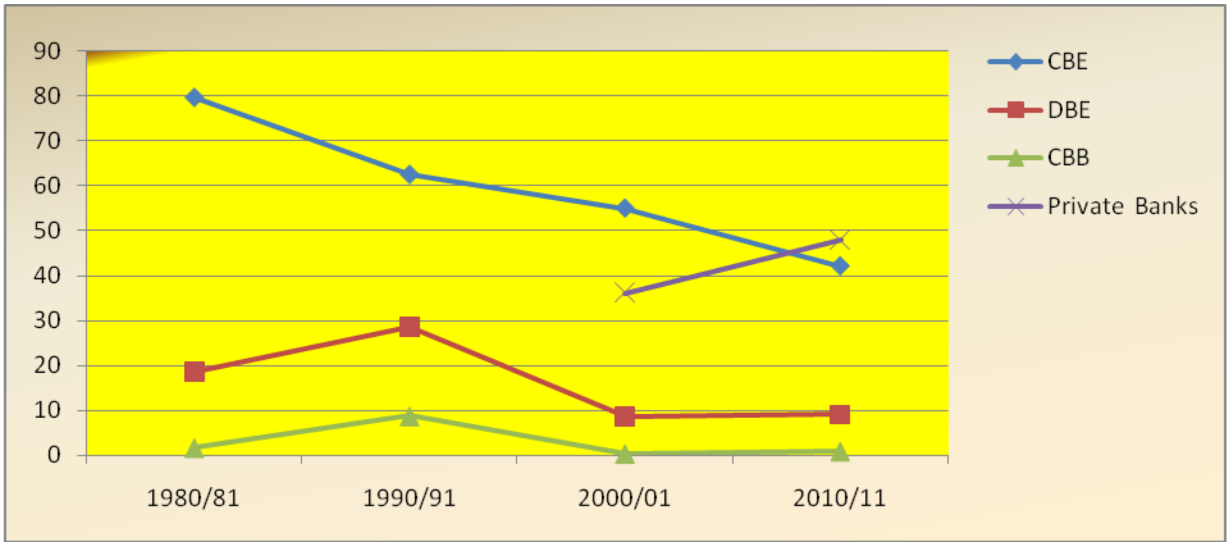


**Figure 4.2: Total Loans disbursements by banks (percentage)** **Source: NBE**

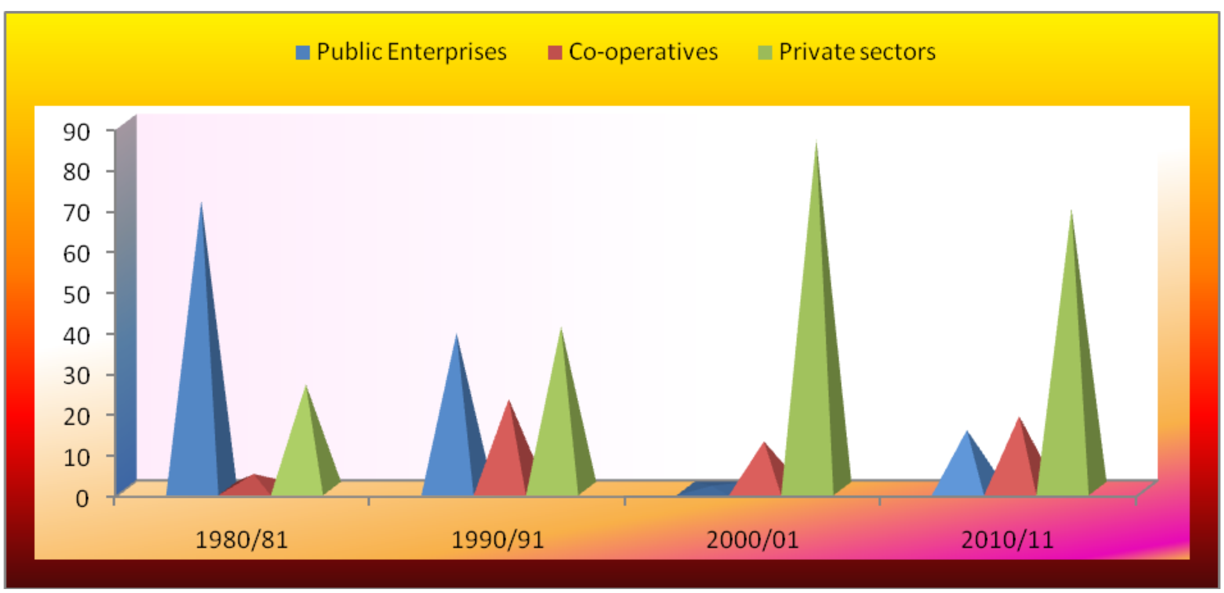


**Figure 4.3: Credit disbursements by clients** **Source: NBE**

**Disbursement by sector**: as of 2010/11 the highest loan was disbursed to International trade (25.1%), followed by Industry (24.8%), Agriculture (19.5%), Domestic trade (16%) and export. Agriculture contributes the largest share to GDP and the major employer in the country but bank loan disbursed to this sector has been significantly declining. It was fall down to 19.5 percent of total disbursement from 49.9 percent before two decades at 1990/91. With equal attention to that of Agriculture the share of Industry was relatively satisfactory.

**Loan collection**

During the Derg regime loan collection feature of Agriculture, Industry and Housing and construction was relatively low (66.9%, 80.6% and 91.7% respectively) to that of Domestic trade, International trade, and Import and export sector. In the post reform at the end of the review period, loan collection from the public sector was low compared with collection from private sector (85%). When the institutional aspects analyzed, in the year 2010/11 loan collection status of both the public banks and private banks was showed progressive performance making 90.9% for the public and 91.6% for private one. The aggregate progress observed in loan collection by the banking sector is result of proper policy and regulation of NBE, necessary analysis on pre disbursement, and close loan follow –up scheme by each banks.

### 4.2.2 Outstanding loan and advances

When outstanding loan and advances of Ethiopian banks is reviewed the average outstanding loan of private sector has escalated to (70.2%) at 2010/11 from (24.4%) in the last decade of former government 1990/91. The market share of CBE was (46.3%) followed by DBE (16.2%), CBB (2.3%) and the fourteen private banks have shared 35.2% of the total outstanding loan and advance.

When the outstanding loan status by sectoral distribution is reviewed, Industry takes the highest (27.9%) followed by International trade (24.4%), and Agriculture stood at third stage with percentage share of (14.3%).

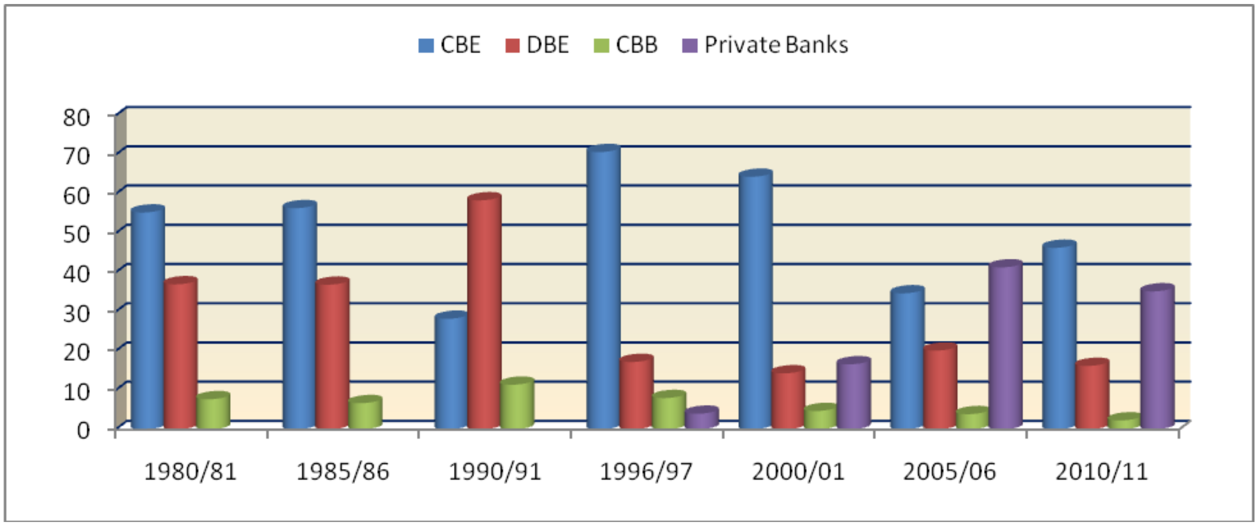


**Figure4. 4: Composition of outstanding loans by Banks** **Source: NBE**

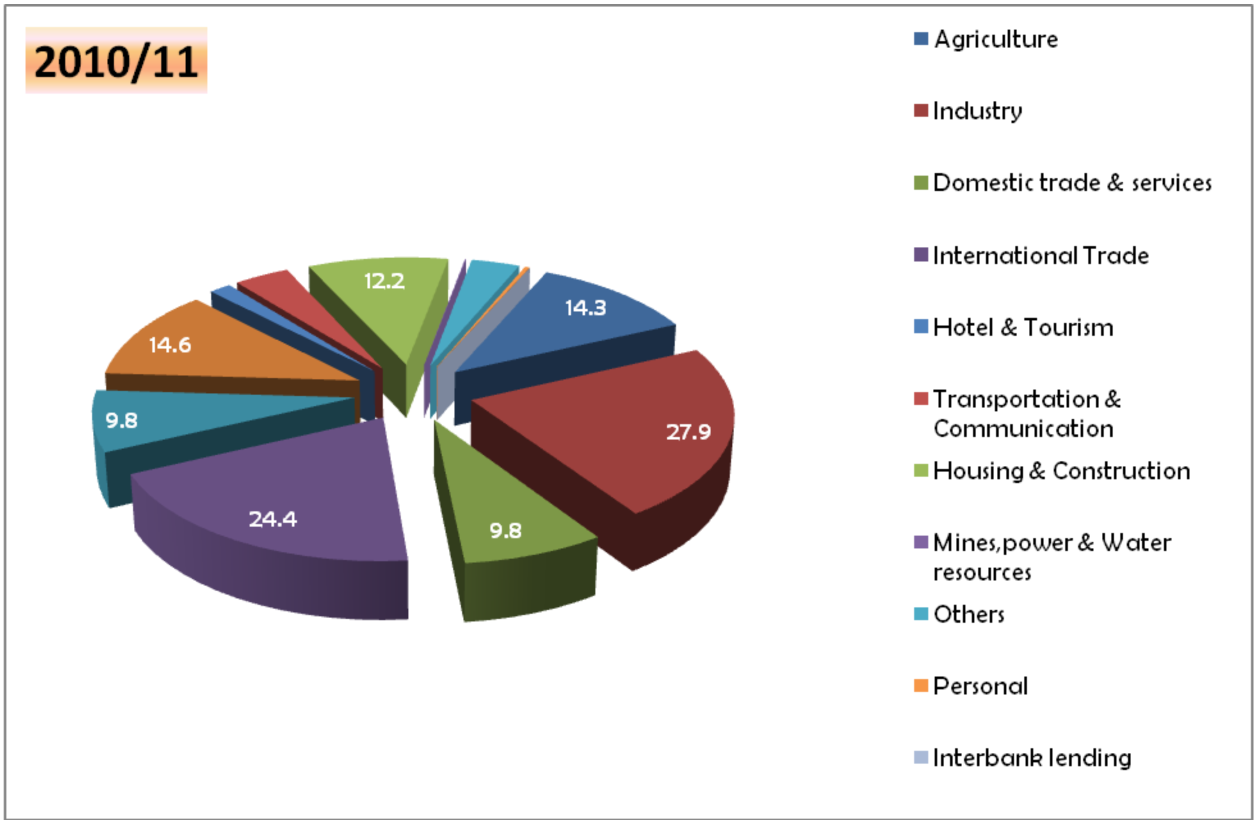


**Figure4. 5: Composition of outstanding loans by Sector** **Source: NBE**

In addition to the banking sector all Micro finances have disbursed Birr 7 billion to their members. The total small credit made by them constitutes only 9.5% of the outstanding loan and advances of banks and 1.4% of GDP in 2010/11.

The share and magnitude of private credit has been increasing at increasing rate except for the recent few years. The outstanding loan made by all banks was 14.5 % of GDP. However; the share is remaining stagnant for the past three decades which was 14.2% of GDP in 1980/81. Because of this low percentage of loan to GDP with different successive government accessibility of credit facility remains constraint to the majority of business people and investors.

#### 4.2.3 Savings and Investment trends (1980/81 to 2010/11) as percentage of GDP

Several economic theories confirm that savings and investments are very interrelated macroeconomic variables. The figure 6 below shows that, during the last three decades the average gross domestic saving rate from 1980/81 to 2010/11 was 7.2 percent of GDP. On other hand, the average gross fixed investment in same period is 18.2 percent of GDP showing wide resources gap of 11% that witnesses heavy dependence on foreign sources for investments. During the last two decades in FDRE, the average gross investment was 20.5 percent of Gross Domestic product while the average gross domestic savings was 7.1 percent of GDP at 2010/11 Widening the gap to 13.4 percent.

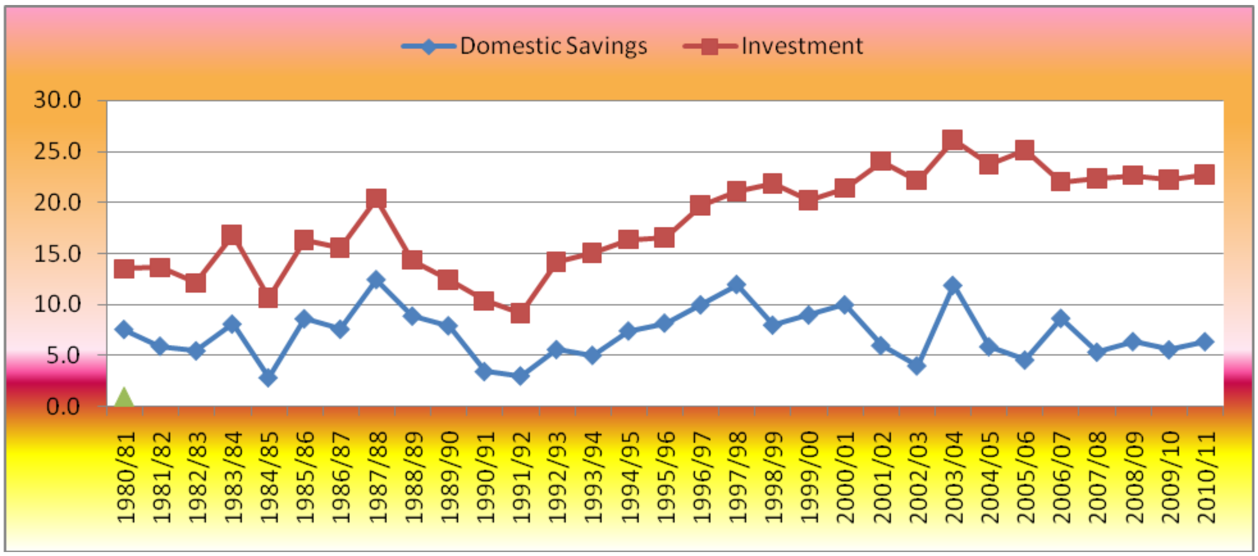


**Figure 4.6: Domestic Saving and Investment** **Sources: NBE**

### 4.2.4 Empirical results

Model I results

Stationary tests on GDSA

D=First difference operator

**Table 4.1 Unit root tests**

| Variable | Lag | t-prob | T-ADF |
|---|---|---|---|
| DPCY | 0 | 0.000 | -3.682*** |
| ADR | 0 | 0.080 | -3.675*** |
| PRCN | 0 | 0.115 | -2.617* |
| DFLD | 0 | 0.005 | -4.360*** |
| RIR | 0 | 0.033 | -3.675*** |
| FB | 0 | 0.490 | -2.969** |
| DSIR | 0 | 0.026 | -5.420* |
| DI | 0 | 0.802 | -9.284** |

***,**,*** denotes rejection at 10%,5% and 1% respectively***

The result in table 4.1 shows that there is unit root problem in some variables. Hence those variables were differenced and showed stationery at first difference.

**Table 4.2 Residual test**

| Variable | T-ADF | lag | t-prob |
|---|---|---|---|
| Residual | -2.975** | 1 | 0.0045 |

***NB:** indicates e is stationary at 5%level of significance***

From Dickey Fuller Test for unit root; since e is stationary, it confirms that the relationship between gross domestic savings and the explanatory variables are significant at 5%level.This means that the variables are co-integrated. Therefore; long run relationship is a necessary condition for running an error correlation model to check the adjustment to equilibrium by applying error correction method from residual test.$ECM_{t-1}$ generates the speed of adjustment to equilibrium in the model.

The empirical result in Table 4. 3 below shows that all the explanatory variables were statistically explained the approximately 85 % of the variation of gross domestic savings

**Table 4.3 DSA by OLS results**

| Variable | *coefficient* | Standard Error | t-prob |
|---|---|---|---|
| PCY | 20.18751 | 3.33413 | 0.000 |
| FLD | 524660.26 | 17130.37 | 0.005 |
| RIR | -161.8218 | 72.26038 | 0.033 |
| SIR | 893.9582 | 379.0402 | 0.026 |
| ADR | -7722.245 | 4279.09 | 0.080 |
| PRCN | -29297.28 | 17990.17 | 0.115 |
| I | -148.6301 | 284.5271 | 0.606 |
| FB | 253.3368 | 362.4995 | 0.490 |
| $ECM_{-1}$ | -080588 | .353888 | 0.822 |
| $R^2$ =85 | | | |

**Estimation Results.**

***PCY*:** The result in the Table 4.3 shows that per capita income has statistically significant positive impact on gross domestic savings behavior in Ethiopia. It is highly significant in determining (at 1%).Therefore; a unit increase in per capita income at present results in 20 units increase in the gross domestic savings in Ethiopian economy. That means increase in real GDP per capita income of people have positive and significant impact in mobilizing domestic savings and national economy in the short run and long run .

***FLD*:** Financial deepening which represents broad money supply to GDP(M2/GDP)as an indicator of financial development or degree of monetization in the economy. This variable is also positively and significantly (at 1%) influences gross domestic savings. The result tells us that financial sector development in Ethiopia has significant and positive impact on savings at national level.

***RIR*:** Real interest rate in Ethiopia has statistically significant negative relationship with level of domestic savings. As the result shows a one percent increase in real interest rate leads to a 161% decline in size of savings in the Ethiopian economy.

***SIR*:** the above regression results show that saving interest rate has significant positive impact on savings mobilization. It is highly significant (at 1%).Hence raising savings interest rate increases size of savings in long run.

***ADR*:** the above results show age dependency ratio has statistically significant negative influence on savings behavior of households' in Ethiopia .It is significant( at 10%).It confirms with the prior expectation**.** This significant influence of age dependency ratio on gross domestic savings is owing to high population with low income.

***PRCN*:** gross private consumption in this result has showed negative but insignificant impact on savings in Ethiopia.

***I*:** Investment in this regression case did not show significant impact on savings mobilization. This is probably due to low level of investment to contribute to gross domestic savings.

***FB*:** fiscal policy has major role in influencing level of savings in the economy. According to this regression result fiscal balance has showed insignificant positive relationship with savings in Ethiopia. That is government budget deficit has no impact on gross domestic savings. This result met the theory of Recardian equivalence which says when government budget deficit increases or public savings decline, people tend to save expecting future burden. Thus private saving is perfect substitute of public savings.

## Error Correlation Mechanism (ECM)

The above empirical result shows that the error correlation mechanism of the immediate past (ECM $_{t-1}$). In the long run the error term adjust itself to equilibrium position at the speed of 8%.This low speed adjustment on savings mobilization is mainly due to the low degree of monetization in the economy, low saving trends and other economic factors.

**Table 4.4 Residual test**

| Variable | T-ADF | lag | t-prob |
|---|---|---|---|
| Residual | -3.682*** | 1 | 0.002 |

***NB:*** indicates significant at 1%***

From the Dickey Fuller test for unit root, residual is stationary at 1% level .The variables are co integrated.

**Table 4.5 Modeling GDP by OLS**

| Variable | *coefficient* | Standard Error | t-prob |
|---|---|---|---|
| DSA | 5.281678 | 1.535987 | 0.002 |
| DCSE | 7.179595 | 1.798473 | 0.000 |
| DCP | 4.557884 | 1.056471 | 0.000 |
| IRS | -2412.388 | 2810.153 | 0.398 |
| EXR | -3664.42 | 2325.632 | 0.126 |
| ECM_1 | -.7163364 | .2088911 | 0.002 |
| $R^2$ =0.984 | | | |

## Model II Regression results

The estimated model fits the data quite well. Here $R^2$ value 0.984 is about 98.4% of the variation in GDP in the long run is explained by the model.

***Domestic Savings (DSA):*** The regression results shows that gross domestic savings positively related to economic growth represented by gross domestic product. It is statistically significant. As indicated in the above table a 1% increase in gross domestic savings leads to 5.3% in GDP in long run. The result confirms the prior estimation of increase in savings promotes investment which in turn contributes to growth. Thus an increase in domestic savings has strong impact on economic growth.

***Domestic Credits to State owned Enterprises (DCSE):*** the regression result of Domestic credit to state owned enterprise shows significant positive influences on economic growth in Ethiopia. That is economic growth in Ethiopia is promoted by huge government expenditure financed by banks. This result is similar with prior expectation that government expenditure increases outputs which facilitate economic growth. In this case 1% increase in bank loan to state enterprise leads to 7% increase to Ethiopian economic growth.

***Domestic Credit to Private sector (DCP):*** The regression result reflects domestic credits to private sectors have statistically significant positive impact on economic growth. This confirms the prior expectation that bank loans to private sector enhance investment in income generating activities which accelerate economic growth.

***Interest rate spreads (IRS):*** In 1998, the NBE liberalized lending interest rate, while only maintaining a floor on deposit interest rates (EEA2011).The result for interest rate spreads in Ethiopia shows no impact on economic growth. This might be due to instability of saving interest rate (since 1992 saving interest rate has revised six times) which fluctuates the spreads over times. On the other side, following the liberalization of lending interest rate for banks, the rate in the market so far vary from bank to bank.

**Exchange rate (EXR):** regression result for exchange rate shows exchange rate has no significant effect on economic growth in Ethiopia. This implies that Birr earning per unit Dollar have no impact on overall economic growth.

Error Correlation Mechanism (ECM_1): In the long run the error term adjust itself to equilibrium position at the speed of 71.6%.

## CHAPTER FIVE:

## Conclusion and recommendation

### 5.1 Summary of Findings

This paper has investigated determinants of domestic savings and the impacts of savings and loan on economic growth in Ethiopia for the period between 1975 to 2011.The coefficients of determination ($R^2$) of the models were found high which indicates the explanatory variable were able to show the variation in dependents variables.

The empirical results shows growth in income, degree of financial depth and saving interest rate have significant positive impact on savings mobilization whereas age dependency ratio and real interest rate have significant negative impact on savings in Ethiopia. From the second model domestic savings, credit of state enterprises and credit to private sector have showed significant positive influence on economic growth.

### 5.2 Conclusion

**Proposed deposit mobilization strategies**

The performance of savings and savings mobilization in Ethiopia with different successive regimes was assessed to arrive at efficient and workable savings mobilization strategies. Accordingly, the domestic savings performance observed so far is very low. This trend implies that, deposits mobilization becomes one of the confronting activities of deposit taking financial institutions in Ethiopia to readdress the increasing demand for loan. They should design various deposit mobilization strategies considering the existing situation in the country. In compliance with National Bank of Ethiopia directives, the following statements could be commendable strategies for Ethiopian financial institutions:

- Provide adequate training to staff in order to raise their participation and awareness on importance of deposit mobilization to the institution as well as to the national economy.
- Gain customer trust by building strong relationship with potential customers to build strong deposit base that insure safety, sustainability and profitability of the institution.
- Look out other financial institution's services and facilities to provide customer preference oriented based on customer needs analysis.
- Increase customer access to funds by implementing modern banking technology and use best system such as ATM, POS and online banking services.
- Apply aggressive promotion through electronic media and printed materials to attract new deposit and maintaining close connection with depositors.
- Expand outreach by identifying different target markets such as potential farmers, associations, co-operatives, unions, NGOs, investors, pastoralists, wholesalers, retailers and others.
- Develop personalized banking relationship with potential depositors by appointing customer relationship manager.
- New product development based on customer needs and areas of interest.
- Offer variable saving interest rate limited the types of account, time and amount of the deposit.
- Introduce public awareness program particularly on fund usage in order to adapt them with banking habit and inculcate saving culture in the community.
- Open sub-branches in rural areas where seasonality is matter like during grain collection and coffee harvest farmers have potential to save their money.

## 5.3 Recommendation/Policy Implication/

**First:** The macroeconomic policy in Ethiopia should be to develop the productive base of the economy to increase the real income growth of the people and minimize unemployment. This can be achieved that since the country's GDP growth is from agriculture due attention should be given to the sector than what has been done so far by introducing or expanding modern commercial farming with proper fertilizer and improved seeds in order to increase agricultural productivity which in turn increases households income. In urban areas, government policy should gear its effort in creating jobs and income generating activities.

**Second:** Financial sector development should be improved because degree of financial depth or degree of monetization significantly encourages savings. Where sound financial sector is available and appropriate domestic savings is mobilized, domestic credit could be available to the existing high demand which will accelerate economic growth.

**Third:** In FDRE regime saving interest rate is revised six times and most of them were at declining trend. Saving interest rate analysis result shows strong relationship with domestic savings In FDRE regime saving interest rate revised six times and most of them were declining trend. Increase in saving interest rate encourages depositors. Therefore; government policy should give necessary attention to increase the floor saving rate.

**Forth:** there is need of government to reduce the level of real interest rate as it is statistically significant and negatively influences savings. The recent double digit inflation increases cost of living and uncertainty which limits ability to save. Necessary actions should be taken in order to reduce current inflation rate to single digit.

**Fifth:** Demographic factors also found that age dependency ratio has significant negative impact on savings. This is due to Ethiopia is a country with the largest population with low income which increases dependency burden on households. Government policy should make more effort in family planning and management to all people in order to adjust things in line with existing situation in the country.

**Sixth:** The focus of development policy should pay more attention regard to domestic credit allocation as it found statistically significant and positively influences economic growth. Both credit to state enterprise and private sectors have showed significant impact in the analysis. The capacity of financial sector should be improved in credit disbursement. As observed during the descriptive analysis, private banks are in trouble of liquidity risks. That is loan to deposit ratio of private commercial banks were only 52%.Nearly half of their deposit of funds were not directly invested on loan and advances rather 20 percent is held in reserve and liquidity account and 27 percent is NBE Bill purchase at very low interest rate. Here it is better if the percentage of NBE Bill purchase or reserve and liquidity rate is revised again in order to stretch the private commercial banks' hands in credit disbursement magnitude.

**Seventh:** The concerned bodies are advised to introduce financial literacy education program like budgeting and planning mainly focusing on savings through school curriculum and mass media.

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