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The Impact of National Bank of Ethiopia's 27% Bond Purchase Directive on Credit Performance and Profitability of Private Banks

Mintesnot Seyoum(MA)[1] Semeneh Bessie (PhD)[2]
1.Awash International Bank of Ethiopia, Addis Ababa
2.Madda Walabu University, College of Business and Economics, Department of Economics

Abstract
The financial policy direction enacted by the National bank of Ethiopia in 2011 under directive number MFA/NBEBILL/001/2011 enforced banks to purchase a bond amount equivalent to 27% of every loan they disburse. However, this policy impact on credit performance and profitability of thereof banks was not yet examined. Hence the present study assessed the impact of NBE Bond purchase requirement on credit performance and profitability of private Banks. Secondary data was collected from six private banks. Ten consecutive years (2006-2015) time period data were taken to examine the impact of the directive. To supplement the result obtained from secondary data, key informants of the private banks were also interviewed. So as to test the hypothesis correlation, T-test and ANOVA were employed. The study found positive correlation between bond and credit performance. However, strong negative correlation was observed between bond and profitability of the study Private Banks. The result from the survey data also clearly revealed significant adverse impact of the bond purchase policy on both credit performance and profitability as tested by different statistical methods. This implies that the current government bond purchase directive has negative consequence on the credit performance and profitability of the private banks in Ethiopia rejecting the research hypothesis which states that National bank of Ethiopia's Bond purchase directive has no impact on credit performance and profitability of private banks in Ethiopia. This study recommends that the Ethiopian government should further strengthen its bond purchase policy direction and ignite the pace of the current growth and development.
Keywords: The impact, credit, profitability, private bank, ANOVA, Ethiopia

INTRODUCTION

The history of banking begins with the first prototype banks of merchants of the ancient world, which made grain loans to farmers and traders who carried goods between cities. This began around 2000 BC in Assyria and Babylonia. Later, in ancient Greece and during the Roman Empire, lenders based in temples made loans and added two important innovations: they accepted deposits and changed money. Archaeology from this period in ancient China and India also shows evidence of money lending activity.

Banking, in the modern sense of the word, can be traced to medieval and early Renaissance Italy, to the rich cities in the north such as Florence, Venice and Genoa. The Bardi and Peruzzi families dominated banking in 14th century, establishing branches in many other parts of Europe. Perhaps the most famous Italian bank was the Medici bank, established by Giovanni Medici in 1397. Evidences show that the oldest bank still in existence is Monte dei Paschi di Siena, headquartered in Siena, Italy, which has been operating continuously since 1472.

The development of banking spread from northern Italy throughout the Holy Roman Empire, and in the 15th and 16th century to northern Europe. This was followed by a number of important innovations that took place in Amsterdam during the Dutch Republic in the 17th century and in London in the 18th century. During the 20th century, developments in telecommunications and computing caused major changes to banks' operations and let banks dramatically increase in size and geographic spread. The financial crisis of 2007–2008 caused many bank failures, including some of the world's largest banks, and provoked much debate about bank regulation, (Heffern, 2005).

Banks are a vital parts of a nation's economy. In their conventional role as financial intermediaries, banks ensure the transmission of funds from surplus to deficit units and serve to meet the demand of those who need funding. Banks facilitate spending and investment, which fuel growth in the economy. However, despite their important role in the economy, banks are nevertheless susceptible to failure. Banks, like any other business can go bankrupt. However, unlike most other businesses, the failure of banks, especially very large ones, can have far-reaching implications. Researches show that during the great depression and most recently, during the global financial crisis and the ensuing recession, the health of the bank system (or lack thereof) can trigger economic calamities affecting millions of people. Consequently, it is imperative that banks operate in a safe and sound manner to avoid failure. One way to ensure this is for governments to provide diligent regulation of banks. Yet, with the advent of globalization, banking activities are no longer confined to the borders of any individual country. With cross-border banking activities rapidly increasing, the need for international cooperation in bank regulation has likewise increased (Larson, 2011).

Ethiopia joined the Banking industry in 1906, marked the beginning of banking in Ethiopia when the first Bank of Abyssinia was inaugurated by Emperor Menelik II. It was a private bank whose shares were sold in Addis Ababa, New York, Paris, London, and Vienna. The bank opened numerous branches including those in Harar (1906), Dire Dawa (1908), Gore (1912), and Dese (1920).One of the first projects the bank financed was the Franco-Ethiopian Railway which reached Addis Ababa in 1917. The bank then opened a transit office in Djibouti in 1920.

In 1931, Emperor Haile Selassie introduced reforms into the banking system The Bank of Abyssinia was liquidated the newly established Bank of Ethiopia, a fully government-owned bank, taking over management, staff and premises of the ceased bank. The Bank of Ethiopia provided central and commercial banking services to the country. The Italian invasion in 1935 brought the demise of one of the earliest initiatives in African banking. History reveals that During the Italian occupation, Italian banks were active in Ethiopia. On April 15, 1943, the State Bank of Ethiopia became the central bank and was active until 1963. By the time it ceased operations in 1963, the State Bank of Ethiopia had established 19 domestic branches, a branch in Khartoum, and a transit office in Djibouti.

The National Bank of Ethiopia was established in 1963 by Proclamation 206 of 1963 and began operation in January 1964. The establishment of the new organization was aided by U.S Department of State emissary, Earle O. Latham, who was the first Vice President of the Federal Reserve Bank of Boston.Prior to this proclamation, the bank carried out dual activities i.e. commercial banking and central banking. The proclamation raised the bank's capital to 10 million Ethiopian Dollars and granted broad administrative autonomy and juridical personality. However, monetary and banking proclamation No. 99 of 1976 came into force on September 1976 to shape the bank's role according to the socialist economic principle that the country adopted. Hence the bank was allowed to participate actively in national planning, specifically financial planning, in cooperation with the concerned state organs. The bank's supervisory area was also increased to include other financial institutions such as insurance institutions, credit cooperatives and investment-oriented banks. Moreover the proclamation introduced the new 'Ethiopian birr' in place of the former Ethiopian Dollar that ceased to be legal tender.

The proclamation revised the bank's relationship with Government. It initially raised the legal limits of outstanding government domestic borrowing to 25% of the actual ordinary revenue of the government during the preceding three budget years as against the proclamation 206/1963, which set it to be 15%.This proclamation was in force till the new proclamation issued in 1994 to reorganize the bank according to the market-based economic policy so that it could foster monetary stability, a sound financial system and such other credit and exchange conditions as are conductive to the balanced growth of the economy of the country.

Following the fall of the Derg regime in 1991 Ethiopia has undertaken different economic reformations. One of the reformations is the declaration of opening private banks. During the Derg regime only three state owned banks were available in the country. Unlike the previous regime, currently 16 private owned and three state owned banks are available in the country. Though this number seems small compared to other countries including neighboring countries like Kenya, the progress is not to be undermined. According to the law of the land, National Bank of Ethiopia (NBE) is the ruling and governing body for all financial institutions in the country. The strict directives it passes have its own positive and negative consequences in the development of the country’s economy that includes the financial industry.

According to IMF 2013 , the underdevelopment of the banking industry can be seen in the small proportion of the population that has a deposit account, less than 8 percent. This underdevelopment restricts economic growth because it dramatically reduces the ability of the banking industry to offer savings products, which in turn hinders greater bank lending to business and entrepreneurial developments.

As to the World Bank report of the same year,2013, by comparing the level of access to financial services in a neighboring country such as Kenya, it can be deduced that there is considerable room for expansion of these services in Ethiopia. Kenya has 5.2 commercial bank branches and 9.5 ATMs per 100,000 adults, in contrast with Ethiopia’s 2.0 and 0.3, respectively.

As the case is all over the world, central banks are the governing, makers, mentors, breakers and controllers regarding the operation of the financial institution. Weather the American Federal Deposit Insurance Corporation or Federal Reserve Bank or National Bank of Ethiopia all make almost similar activities of regulating the economy using their monetary policy. They protect the public interest by balancing the flow of money in the economy. Banking industry has been playing crucial role in economic growth and development of the country. For instance it provides important services in ensuring the objectives of our great renaissance.

Just to mention some of the experience in the countries bond purchase: The Great Ethiopian Renaissance Dam(GERD) Bond has the following Characteristics : It is a bond which enjoys full government Guarantee, It is a bond marketed to finance the great millennium Dam which the government stated build on Abay. The bond River have both Interest bearing Bond and Non- interest bearing bond that can only be sold to Ethiopian Nationals and foreign nationals with Ethiopian Origin. Interest accrued will be paid every six months and benefits of revenue accrued will be free from any tax. It can be used as collateral to get loans from banks. Since it has full government Guarantee it is risk free, It earns better interest than the normal savings rate. It can be transferred as an inheritance or to a third party. The bond has values ranging from 50 in Dollar, Euro and Pound Sterling to 10000 and from 50 to 1 million in Birr.

The government also has a long time experience in selling Treasury bills that have almost similar nature with bond except its being a short term ranging from 28 days to 364 days. The government utilizes the money from these T-Bills to cover its short term transactional financial requirement. In the same way with the GERD bond the benefit from T-Bills is exempted from tax. The minimum amount that should be offered for each type of Treasury bill is birr 5,000.00 and multiples thereof. The total value of T-Bill to be issued can be different at different time, usually in multiple millions and in billion.

In 2014 Ethiopia sold one billion worth of bonds in a very short time. Government bonds are an effective way of raising much needed investment money to fund mega projects. According to a Bloomberg news report the National Bank of Ethiopia will create a secondary market in government and corporate bonds in the year ending July 7, 2016. It is as this first time ever, the Ethiopian government sold one billion dollars worth bonds, although Ethiopia only offered to sale one billion dollar worth of bonds the demand by investors reached two billion dollars according to The Wall Street Journal. It was one of the largest first time bond sales from Africa. The reason there is such a high demand for the Ethiopian bonds is based on solid reasons. Ethiopia has one of the fastest growing economies in the world.

The rationale behind the 27% bond Purchase requirement introduced in 2011 by National bank o Ethiopia is due to Private Banks loan disbursement to long term projects was not more than 20%. The majority of loan was to short term (domestic & international trade) which can maximize profit of private banks. Hence, to increase the role of private banks in supporting economic growth via financing of long term priority sector projects the bill purchase is introduced.

Objectives of the study

To assess the impact of NBE's 27% bond purchase directives in influencing loan to deposit ratio credit performance of private banks in Ethiopia.

To investigate the impact of NBE's 27% bond purchase directive on profitability of private banks.

Theoretical Framework

On the bank balance sheet, deposit is a liability which a bank is obliged to pay at demand to its depositors and pays interest on it. But loan is an asset for the bank and recorded as receivable. This loan bears interest for the bank which is treated as income. These two things reflect their own counter parts on the income statement of the banks. Similarly, deposit is bearing interest expense and loan brings interest income. The bond purchase policy stated that when a bank purchases 1 birr with the given minimum interest rate (5% per annum in Ethiopian case or above Based on agreement) it will calculate additional costs of funds per 1 birr and is expected to sell that given 1 birr with an interest rate with some rate above the total cost of fund. Any factor that decreases the money available for sale (loan able fund) below 1 birr has impact to hinder the bank's credit performance and profitability. So this study is designed in a way that assessing the extent of one of the factors that decrease the available birr for sale.(i.e government 27% bond purchase directive). As the bank purchases the deposit amount with an interest rate above or equal to 5% the feasible matching part at the right side is to lend it as a loan with an interest rate above cost of fund with some added profit margin. The factor that decrease the proportion of quantity sold (loan) below the quantity purchased (deposit) and the extent of this factor's impact on credit performance and profitability is the concern in this study.

Research Design

In this study, data was collected from the annual financial statement of private banks before and after introduction of the bond purchase policy in Ethiopia. The research aimed to see the impact of the bond purchase directive on the private banks credit and profitability using the data before and after enactment of the directives. Hence the before and the after performance analysis was applied. To this effect, the five years data before the bond and five years data after the bond purchase directives were collected (i.e.2006-2010 & 2011-2015). This assisted the researcher to measure the impact of NBE bond purchase directive on the credit and profitability of the study private banks. The impact was measured by comparing the differences in the phenomenon before and after the directive. The financial statements (The Balance sheet and Income statement part) were examined. The components of the income, expense profit deposit and loan were separately seen. In addition, the growths, ratios and relationships were computed. Finally, the difference in these financial statement components before and after the above stated directive were examined and analyzed.

Types and Sources of Data

As mentioned earlier, secondary data was collected and used in the research. The secondary data were collected from the regular annual report of the banks to analyze the before and after situation of bond, and its implication on bank's loan to deposit ratio (credit performance) as well as Return on Asset (profitability). Other available secondary data sources such as internet, magazines, published and unpublished books, thesis and journals were assessed. In addition to this, key informants of the private banks were also interviewed on the major changes happened. The opinions of these key informants are summarized and used as an input for the final conclusion and recommendation.

Study Population

As the purpose of this study is to undertake an assessment on the impact of NBE's 27% bond purchase directive on credit performance and profitability of private banks, the study population was therefore the private banks in Ethiopia. Hence, this study has made an attempt to generalize its findings to all similar private Banks in Ethiopia.

Sample Design

The population of the study as mentioned above is the private banks in Ethiopia and the sampling frame was the 16 banks that exist in the country. Purposive sampling was used to select 6 banks so as to bring a rational comparison of. As the bond purchase directive has stayed five years after introduction the researcher's plan was to consider five years back before the directive and then five years after the directive so as to show the impact using the comparative analysis. This in effect requires the sample banks to serve in the country for at least 10 years. Six out of the sixteen private banks in the country were purposely selected. This include: Awash international Bank s.c, Dashen Bank s.c, Bank of Abysinia s.c., Wegagen Bank s.c. United Bank s.c. Nib international bank s.c.,). The six banks were selected because these are the banks that served in the country for above 10 years. As we are considering a continuous data of 10 years, this banks are the only banks that can avail the required data.

Data collection methods

To analyze the impact of the bond purchase directive on the banks credit performance and profitability data were collected from the annual financial reports of the banks. n addition to that document analysis was widely undertaken as a major means data collection method. The financial statements of the banks specifically the balance sheet more specifically the deposit, bond, loan asset, and the profit and loss statement of the banks are critically examined. A face to face interview method was also used to collect data from key informants.

Data Analysis and Presentation

Data collected from the secondary sources, were organized and tabulated. After the raw data were collected they were filled in to table then percentages, growth rates, ratios and sums were computed. After organizing the data in this way, then they were filled in to SPSS for further quantitative data analysis. The relationship between variables was tested through Pearson's correlation test and then independent sample T-test and ANOVA were used to see the statistical significance of the impact of the independent variable on the dependent variable. The dependent variables in the study are credit performance and profitability of the private banks. The independent variable is the 27% purchase directives which were thought to have an impact on the dependent variables.

RESULTS AND DISCUSSION

In this chapter, two issues are discussed. First the results of descriptive statistics such as correlation analysis, T-test, and ANOVA are discussed. Then the key informants view are incorporated and summarized.

This paper has showed the impact of NBE's 27% bond purchase directive on credit performance and on profitability of private banks as a main objective. It has also three specific objectives of assessing the impact of NBE's 27% bond purchase directives in influencing loan to deposit ratio of private banks in Ethiopia. showing what impact does the NBE bond has on credit performance, what impact does the NBE bond has on profitability and also to investigate the credit performances and profitability of the private banks before and after introduction of the 27% bond purchase directives.

As it can be observed from the table 2 below the total asset part of the banks during all the year considered is greater than the debt part (i.e deposit). This showed the debt to asset ratio of banks under consideration is found to be normal. The loan during all the year is also less than the deposit which indicates no liquidity problem. It can also be seen before 2011 the balance of bond was nil, which shows there was no such thing named "bond" on the balance sheet of private banks. In addition the increasing trend of the items under consideration show there is a relatively regular growth trend of items considered.

Table 2: Major Components of Balance Sheet and Income statement

Year	Deposit	Loan	Bond	Asset	Profit
2006	13,993,217	9,095,591,	0.00	19,768,483	480,688
2007	16,217,318,	11,189,950	0.00	23,667,968	580,578
2008	21,016,971	16,067,824	0.00	29,007,212	725,623
2009	28,022,240	16,359,290	0.00	35,712,417	992,336
2010	34,164,180	18,344,849	0.00	45,264,596	1,310,852
2011	43,141,745	21,869,850	6,876,603	55,879,990	1,791,264
2012	48,755,209	28,654,729	11,025,610	64,294,482	2,181,929
2013	59,721,744	34,822,641	15,433,765	77,207,235	2,218,410
2014	68,606,517	38,729,394	19,461,955	89,497,361	2,511,841
2015	83,017,933	49,651,502	26,553,650	104,899,805	2,633,115

The above time serious data were illustrated using an appropriate figure below. The figure depicted that the amount of assets has been continually increasing for the last ten years. Similarly the bank depot, loan discussed, pond purchased and the profit generated have shown an increasing trend.

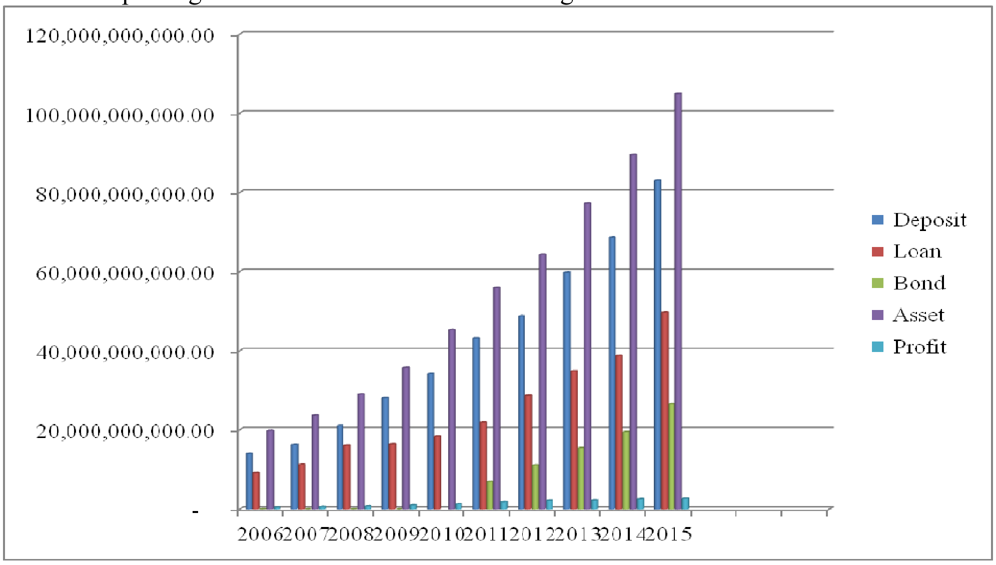

Figure1: Major Components of Balance Sheet and Income statement related to the subject under research.

The following figure 2 shows separate analysis on growth rates of the data under consideration. The result showed that highest growth rate was observed the year 2009. Whereas the least growth rate was found in the year 2012. The reason for high growth in the 2009 and the least growth record in the 2012.

Table:3 Showing the growth rates of the data under consideration

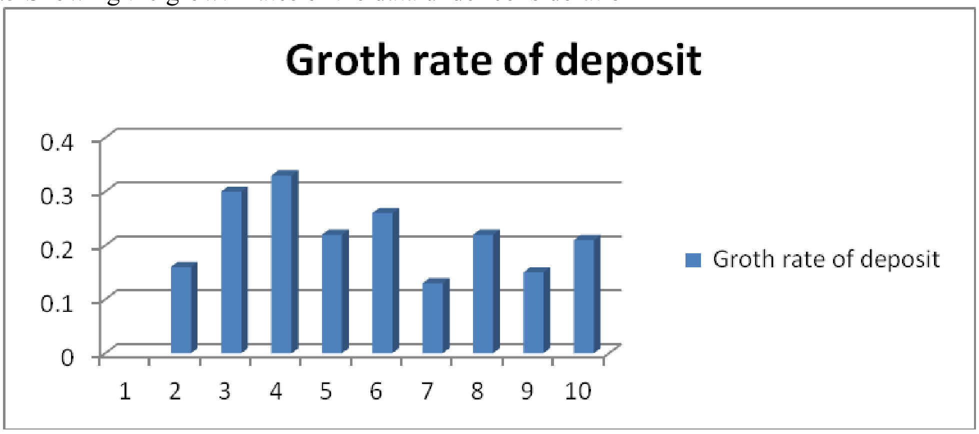

Figure2: Growth rate of Deposit

The growth and trends of pond purchase since its establishment was also investigated. The result from figure 3 below described that the bond purchase was highest when government introduced the bond purchase policy. The main factor contributing for the success of this policy may be extensive government promotion towards construction of the Ethiopian great dame. However, it becomes lowest in the 2015. Various reasons are mentioned for the decline in bond purchase in the 2015. One of the main reasons could be low of the individuals and lack adequate promotion on the sides of the government.

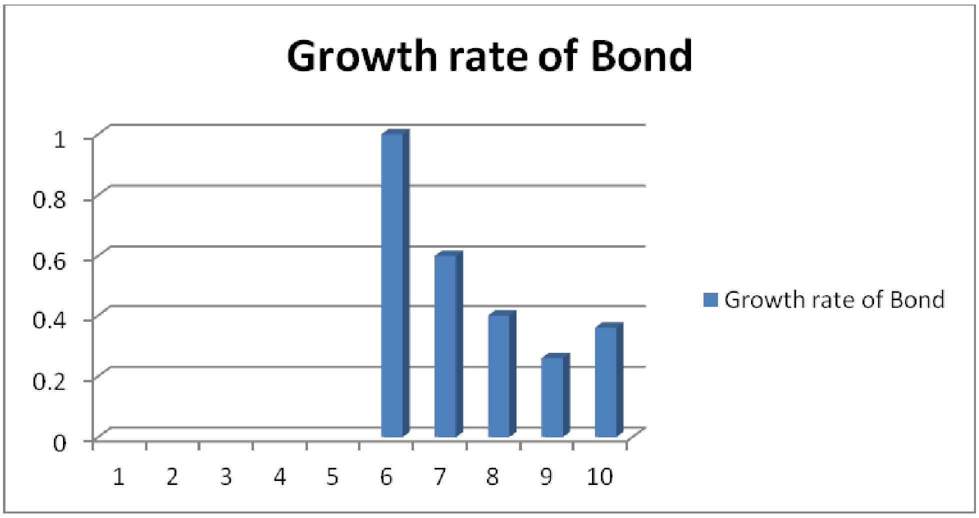

Figure 3 has also depicted the growth rate of LTDR.

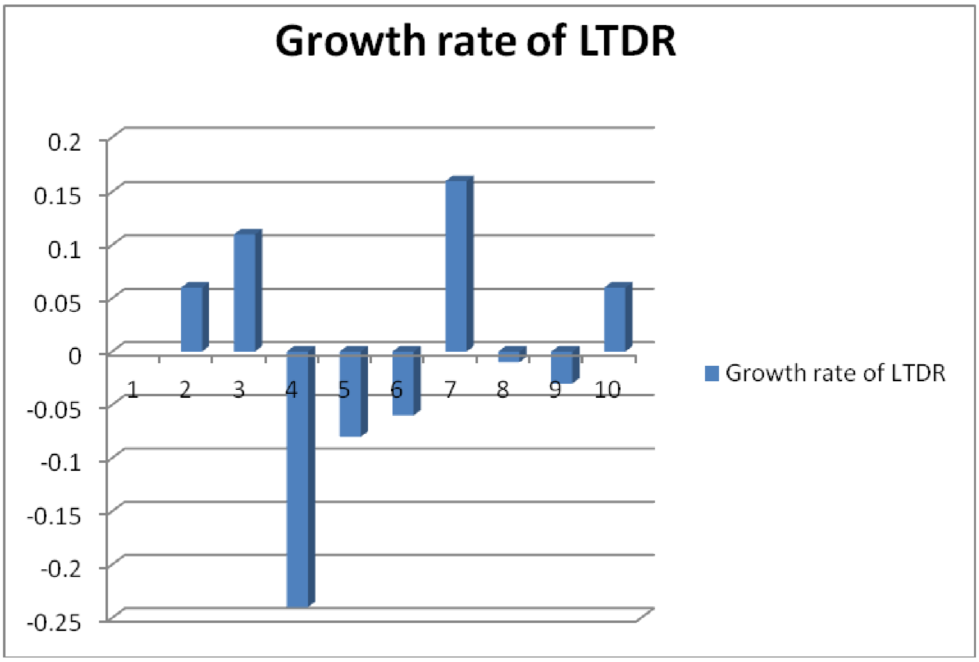

Figure 4: Growth rate of Loan to Deposit ratio

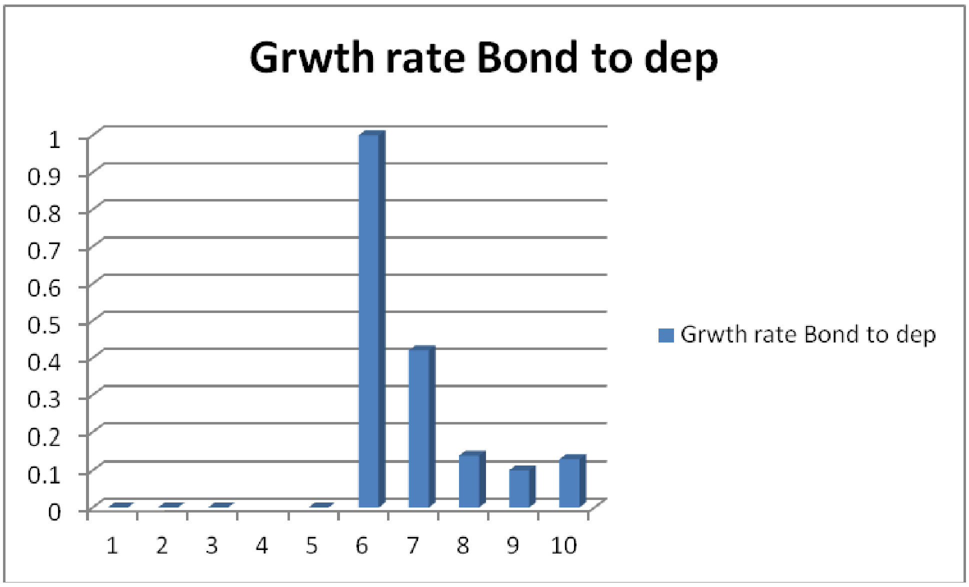

Figure 5: Growth rate of Bond to Deposit Ratio

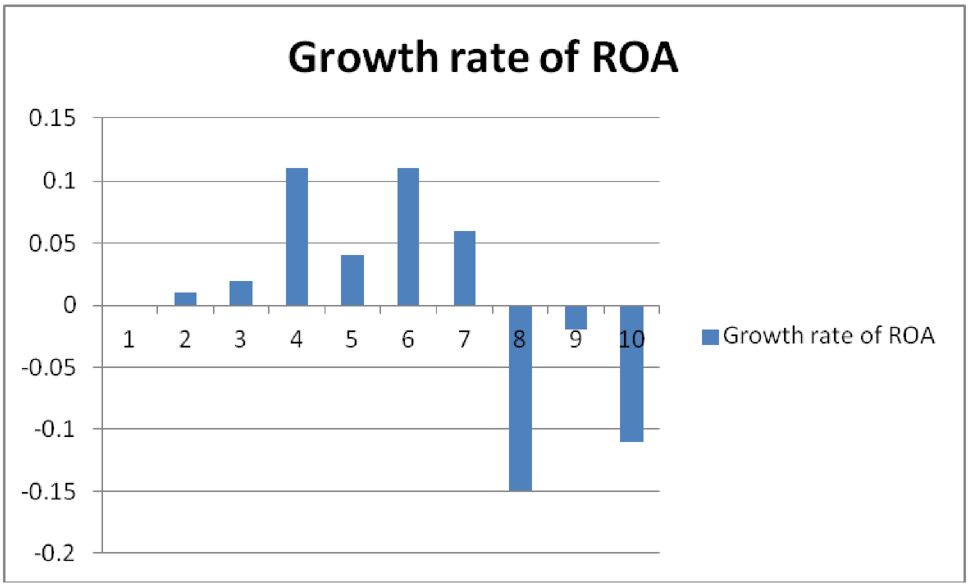

Figure 6: Growth Rate of Return on Asset

Generally it can be concluded that he growth rate of deposit and bond was positive but the growth rate of loan to deposit ratio and return on asset has shown an inclusive of negative trend in their growth. Particularly the growth rate of return on asset has a continuous negative growth trend in it.

The following table 3 vividly showed the results of sample descriptive statistics (see table 4 below).The average bank depots during the 10 years study period was found to be 41665707835 with the growth rate of 0.22%. Similarly the average the loan disbursed in the study period was fond to be 24478562309.

Table 3 Descriptive Statistics of the data included for the 10 years

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Bank deposit	10	13993217876	83017933140	41665707835	23324876028
Growth rate of Deposit	10	.13	.33	.2140	.06670
Loan or credit	10	9095591619.	4965150241	24478562309	13146682549
Growth Rate of Credit					
Bond	5	6876603472	26553650067	15870316904	7608911134
Growth Rate of Bond	5	.26	1.00	.5240	.29339
Loan to deposit	10	.51	.76	.6060	.07457
Growth Rate of Loan to Deposit Ratio	9	-.24	.16	-.0033	.11906
Bond To deposit Ratio	5	.16	.32	.2500	.06000
Growth rate of Bond to Deposit Ratio	5	.10	1.00	.3580	.38147
Total Asset of bank	10	19768483247	10489980565	54519955385	29104117959
Annual Profit	10	480688437.0	2633115713.	1542664075	825499153.7
Return on Asset	10	2.43	3.39	2.7850	.32708
Growth rate of Return on Asset	10	-.15	.11	.0070	.08460
Valid N (list wise)	5				

An independent-samples t-test was conducted to compare Loan to deposit ratio in before the bond and after the bond conditions. According to the test made there was not a significant difference in the scores for Without bond (M=.57, SD=0.036) and With bond (M=0.644, SD=0.087) conditions; t(8)=-1.801, p = 0.109. These results suggest that NBE bond really does have a statistically significant impact on credit performance. Specifically, our results suggest that after bond directive is introduced in to private banks it hasn't brought statistically significant impact on their credit performance.

The impact of bond on the growth rate of Loan to Deposit ratio was also tested for the conditions before bond directive and after bond directive. According to the result of the test it was found that the impact of bond on the growth rate is also statistically not significant. Without bond being (M =.02, SD=0.09) and with bond (M=-.036, SD=0.15), P=0.51. The result indicates though there exists a mean difference in the growth rate of LTD under the two conditions, the impact of NBE bond on the loan to deposit ratio growth rate is not statistically significant.

The same independent sample t-test was done for ROA to compare return on asset in before the bond and after bond conditions. According to the test made there was not a statistically significant difference in the scores for Without bond (M=2.96, SD=0.35) and With bond (M=2.6, SD=0.21) conditions; t(8)=-1.9, p = 0.094. These results suggest that NBE bond really does have a statistically significant impact on profitability of private banks. Specifically, our results suggest that in the period with bond directive to private banks it hasn't brought statistically significant impact on their profitability.

The independent T-test was also computed to see the impact of National bank of Ehiopia's bond on growth rate of Return on asset. The result of the test showed though there exists a mean difference in the two conditions of before the bond and after the bond, the impact is seen to be not statistically significant. The condition without bond (M= 036 SD=0.44) and with bond (M=-.0220, SD=0.109) ;t(8)= -1.096, p= -.058 indicates the difference existed in the means of the two conditions is not statistically significant.

Correlation between Variables

As it can be observed from the above table 5 there existed moderate negative relationship between bond and Loan to deposit ratio(r =-0.549, n =10, p = 0.323while the relationship between bond and growth rate of Loan to deposit ratio (LTD) is seen to be positive but weak [r = 0.261, n =9, p = 0.498]. This finding indicates the increment in bond has a negative relationship with the amount of loan to deposit ratio. As bond increases the amount of money available for loan decreases. But on the other hand the bond has insignificant but positive relationship with the growth rate of loan to deposit ratio. This positive relationship of growth is considered to be the effect of ceasing the credit cap directive of NBE that existed before NBE's bond, which used to prohibit growth of loan to deposit ratio. That means the loan to deposit ratio of banks has started to show growth during the bond time than the previous credit cap time that prohibited growth.

In the same manner the relationship between bond and return on asset is seen to be positive but weak [r = 0.142, n =10, p = 0.696] while the correlation between bond and growth rate of return on asset is seen to be negative and strong[r = -0.639, n =5, p = 0.046]. The result indicates there exist a positive relationship between bond and profitability but the magnitude is not significant. As bond increases it is shown profit also increases but it express it in a small magnitude. On the other hand the increase in the NBE bond has a strong negative impact on the growth rate of profitability of private banks. This indicates private banks profitability growth rate declines as the bond increases. This result also shows during the bond time the banks profit has shown betterment but its growth is hindered.

Assuming all fund available have a demand on the market by the borrower, (full demand) and taking the average annual lending interest rate of private banks (13.2% as per IMF and NBE report) it can be shown how much banks are losing due to NBE Bill.

As indicated in table 6 above private Banks have lost Birr 26 Billion during the five years stay of the bond money that could have gone to loanable fund. This could have in effect increased the loan to deposit ratio to some extra point of 0.90 averagely from the average 0.64. On the other hand the forgone amount of NBE bond has made the banks to lose a 76.9% of income from the money deposited at NBE for the purchase of bond. Had this money been lent to borrowers of the bank at the given minimum interest rate, it could have brought a 10.3 Billion ETB interest income instead of a 2.38 billion ETB. It can be concluded that NBE Bond have a negative impact both on loan to deposit ratio that is credit performance and on profitability.

In the same manner what is lost by private banks is also mentioned in the study of Shibiru Amsalu's impact assessment. As per his study the result depicted the share of lost income because of purchase of NBE bills marked an increasing trends during the last three fiscal years. This reflects that if the directive carries on in this manner it would make private commercial banks unprofitable.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The correlation the result have shown a moderate and negative relationship between loan to deposit ratio and bond on one side and but weak positive relationship between bond and Return on asset on the other. The impact of bond purchase policy on credit performance is has showed negative but statistically the impact is not insignificant effect. It is also observed there exists a statically weak positive relationship between profit and bond. The relationship is further seen on the growth rate of these variables. Accordingly the impact of bond on the growth rate of loan to deposit ratio is seen to be positive but weak in the years under consideration. This impact is considered due to extraneous impact of credit cap that did exist before the bond. As credit cap prohibited growth rate of LTD its ceasing brought a slight difference in the growth of the next period's loan on deposit ratio. The impact of bond on the growth rate of profitability was also seen further and the result showed a strong negative relationship between the two variables. Generally the impact of bond was more of seen as the growth rather than the amount itself.

The descriptive statics and tables depicted that the amount lost by banks due to the bill is was found to be huge. What made it paradox is the impact is not seen on the total profitability of the bank. This result Ws confirmed by the response from the key informants.

Though the findings have shown there is a strong relationship between bond and credit performance and bond with banks profitability, the magnitude was found to be less during the period under investigation. In this regard, result has shown somewhat less impact than expected. Holding this information the researcher has went again to some key informants of the private banks under consideration. The key informants included were finance department directors, Credit department directors and executive management members. As per their explanation for the result creating a paradox, the following facts have contributed for the profitability of the banks.

Liquidity requirement by National bank of Ethiopia has fallen to 15 % from 25% in 2013 as per the NBE directive number SBB/57/2014. (The liquidity requirement is the directive by NBE stating banks should at least hold 15% of their liability in a liquid form. This shows 15% of the fund is idle, prior to 2013 it was 25%). This freeing of idle fund helped banks to at least divert the amount of money that was kept under reserve and liquidity requirement with Zero interest rate to the minimum but better interest earning NBE bond. This has helped to some extent to compensate the marginal loss incurred between the saving rate (5%) and NBE bond interest rate (3%).

NBE credit cap is ceased since the introduction of NBE bond. The credit cap used to prohibit banks no to lend an amount exceeding the credit limit set for them by the National bank of Ethiopia, even if banks have excess fund to lend. The termination of his directive has helped them to lend the excess fund at hand.

These days, banks are striving for survival (by mobilizing more deposit) so that they will have adequate money for lending. This has made the banks to have better money to lend and at least to cover the gap for the portion that goes to NBE Bond. To do this Banks have aggressively done branch expansion by opening at almost all towns of the country. The more they approach to customers the more they mobilize deposits. As the NBE bond directive doesn't have a maximum limit like that of credit cap as long as they get the deposit the banks are allowed to lend more and more.

The other factor that contributed for banks to not incur a significant loss is the fact that Banks have also made marginal interest rate increments that may marginally increase their earning from loan. This increment in the loan price has increased the total income from loan as the income is calculated on the amount of loan multiplied by interest rate(interest income=PRT= principal*rate*time)

Banks have also managed to earn some amount of income from of balance sheet transactions like bank Guarantee, advance payment guarantee, trade credit guarantee, commission and service charges both locally and internationally. These incomes increase their income but don’t have an attachment with balance sheet. As this income also doesn’t necessarily need a cash outflow their positive impact has increased as they are given much concern than ever.

Recommendations

As it is seen on the impact assessment results, the impact of NBE bill on credit performance and profitability is not significant, showing as long as the impact is not significant the bond purchase directive should persist as its long term benefit in the development of the country is high.

The introduction of the bond has awaken the banks to utilize their maximum capacity and forced them to go extra miles to look for deposit, more customers, different means of income and expense reduction. As this directive has increased bank efficiency the bond purchase directive should persist up to any tolerance level.

As separately seen on the table that shows the loss banks incurred due to NBE bond, which can be considered as an opportunity cost, the bond can have a more significant impact which invites more investigation for researchers in the future.

It is also advisable for the government to strength such means of capital mobilization that is double sword. On one hand it encourages the banks to compete for deposit mobilization, approach the areas that didn’t have bank coverage, give better customer oriented services to attract more customers and use their resource effectively. On the other hand the money from this bond goes to the development of the country by building mega project that will help the countries growth.

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