

# New Interest Rate System Good News For Depositors

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 call to the Middle East Times

below at least 7 percentage points purchasing power of this deposited money. If inflation is approximately 20 percent per annum, as is the case in Egypt, the purchasing power of the £100,000 savings deposit will be reduced to only £80,000 after twelve months. Add the £13,000 earned as interest during the year and you are left, after inflation, with £93,000.

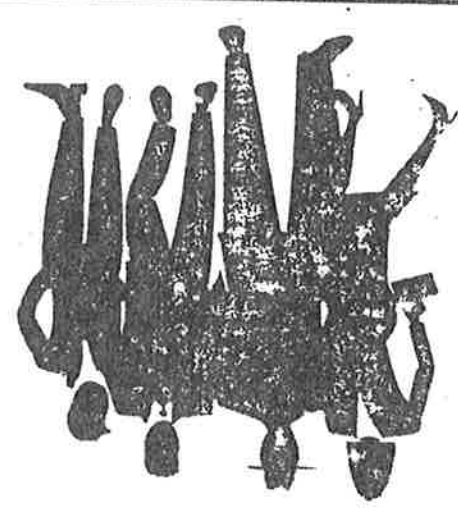
But inflation works to reduce the purchasing power of this deposited money. That was the old system. I wonder so many people gambled by investing their money in other financial institutions that offered interest rates higher than those of the government controlled banks? When El Rayan and others began offering returns to depositors exceeding 20 percent per annum. Let me give an example. Let us say I had the collateral to obtain an £1 million loan for one year. I take this money and buy a beautiful mansion in Maadi. If inflation is running at approximately 25 percent, the value of the mansion will have appreciated to £1,250,000 by the end of the year. Were these households to blame for dying to find a way to insure that give to the bank their £1 million plus the £180,000 in interest and pocket £70,000. I also lived in a nice house for a year. Everyone ends up happy... almost. The government began to realize over time that this interest rate structure was being abused by real estate traders and others in similar professions.

If you are asking the question of how banks made money under a system where they could not charge interest rates above the rate of inflation, the answer is simple. Depositors paid them to keep the system in operation. If I receive only 13 percent for keeping money in a savings account

The government's recent announcement that it will fine up interest rates and loans based on a Central Bank minimum. Banks are given discretion to set their interest rates freely in a competitive nature within the Central Bank's minimum interest requirement, or above it if the market permits.

It is quite late in coming. The previous system of government controlled interest rates had led to a number of problems that affected the lives of many Egyptians. For example, the fixed interest rate system with fixed rates on annual savings deposits encouraged Egyptians to look for alternatives that provided higher financial returns.

Because the government's annual savings rate for a one year deposit



**What this new interest rate system has done is to bring the banking system back to reality. After all, it never made sense to lend investors money at 18 percent per annum.**

Let me repeat. You put £100,000 into the bank for one year and at the end of the year you get back £93,000 worth of purchasing power. That was the old system. I wonder so many people gambled by investing their money in other financial institutions that offered interest rates higher than those of the government controlled banks? When El Rayan and others began offering returns to depositors exceeding 20 percent per annum. Let me give an example. Let us say I had the collateral to obtain an £1 million loan for one year. I take this money and buy a beautiful mansion in Maadi. If inflation is running at approximately 25 percent, the value of the mansion will have appreciated to £1,250,000 by the end of the year. Were these households to blame for dying to find a way to insure that give to the bank their £1 million plus the £180,000 in interest and pocket £70,000. I also lived in a nice house for a year. Everyone ends up happy... almost. The government began to realize over time that this interest rate structure was being abused by real estate traders and others in similar professions.

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for one year, and a bank can charge 18 percent for a loan to someone else for the same period of time, the bank simply pockets the difference at the depositor's expense.

The new interest rate structure instituted by the government will eventually cause interest rates on loans to increase. Of course, this could affect the level of investment in Egypt for years to come, but the old system of nominal interest rates was causing too many distortions. Can anyone endorse a system in which lenders were getting subsidized interest rates at the expense of depositors?

Believe it or not, many government officials once supported such a system and many still do.

The old interest rate system will always remind me of the great difficulties it caused for Egyptians who desperate to save their savings from the ravages of inflation, invested their money with the so called Islamic investment houses. Now that the old system is dead, it is my hope that it will stay buried.