CENTRAL BANK OF KENYA

KEYNOTE ADDRESS

by

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at the

KENYA INSTITUTE OF BANKERS ANNUAL DINNER

"ACHIEVEMENTS, CHALLENGES AND REFORM INITIATIVES FOR THE BANKING SECTOR IN KENYA"

Panari Hotel, Nairobi
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Chairman, Kenya Institute of Bankers;
Distinguished Members of the Council here present;
Distinguished Guests;
Ladies and Gentlemen:

1. I am pleased to join members of the banking fraternity for the Kenya Institute of Bankers (KIB) Annual Dinner. This event has over the years become the premier event for Kenyan bankers to toast to their successes, ponder on the challenges in the year and more importantly reflect on opportunities in the coming year. I must therefore salute the Chairman and Council of the Kenya Institute of Bankers for consistently organizing this forum over the years. I am honoured to be the one to deliver the Keynote Address at this important dinner. I will keep my remarks brief, as I do not want to stand between you and the festivities that follow tonight.

2. The year has been a challenging one not just for the banking sector but also for the economy at large. The global financial crisis that escalated in 2008 drove down our efforts through second and third round effects. However efforts by all players to stimulate the economy dampened the effects of the crisis in Kenya. Globally, efforts by governments have stemmed the crisis and the green shoots of recovery are beginning to sprout.

3. **Ladies and Gentlemen:** On the monetary policy front, the Central Bank conducted a procyclical monetary policy in the year with a view to stimulating private sector credit and economic growth. The Monetary Policy Committee (MPC) lowered the Central Bank Rate (CBR) from 8.5 percent to 7.75 percent and the Cash Reserve Ratio (CRR) from 6.0 percent to 4.5 percent between December 2008 and September 2009. These efforts managed to lower and stabilize short-term interest rates. The reduction of the Cash Reserve Ratio induced banks to expand credit to the private sector and thus stimulate economic growth. Analysis of the banking sector indicators shows that gross loans to most sectors increased in absolute terms.

4. But the cost of credit and interest rates spread remain high. The spread is a major challenge in the banking sector because it acts as an impediment to expansion of credit and development of financial intermediation and signals inefficiency in the sector. We need to come together, the market and the regulators, to deal with structural binding constraints that prevent the cost of credit to re-align itself with available incentives, market conditions as well as returns on investment.

5. **Ladies and Gentlemen:** Allow me now to briefly focus on the performance of the banking sector. In 2009, the Kenyan banking sector has continued to exhibit resilience in the midst of the global financial turbulences. The performance posted by banks and mortgage finance companies in the first three quarters of 2009 surpassed expectations as exhibited by the following indicators as at the end of September 2009:-

   - The sector's assets increased by 11 percent from Ksh.1.18 trillion in September 2008 to Ksh.1.31 trillion at the end of September 2009 as banks continued to expand their lending portfolio.
   - Deposits increased from Ksh.895 billion in September 2008 to Ksh.1 trillion on the back of deposit mobilization and expansion of branch networks by banks.
   - The Total Capital to Total Risk Weighted Assets Ratio stood at 20 percent which was above the statutory minimum of 12 percent. This is an indicator that the sector has a reasonable cushion against periodic shocks.
   - The sector's average liquidity at end of September 2009 was 40.8 percent well above the statutory minimum of 20 percent.
   - The profit before tax for the banking sector increased by 7 percent from Ksh.34.68 billion for the period ended 30th September 2008 to Ksh.36.95 billion for a similar period in 2009. This reflects the increased business from expansion and diversification drives by banks.
   - The number of branches stood at 918, an increase of 130 branches from the corresponding period in 2008.

6. **Ladies and Gentlemen:** It is worth noting that in the year, significant steps were made in operationalising a credit information sharing mechanism for the banking sector. The Banking (Credit Reference Bureau), 2008 Regulations became operational in February 2009. The Regulations empower the Central Bank to license and supervise Credit Reference Bureaus (CRBs). The bureaus will collate credit information from banks that will facilitate credit risk decisions. This is the most significant step towards building information capital. It will allow us to influence the collateral technology in use currently. The licensed Credit Reference Bureaus will join the family of financial sector actors.

7. **Ladies and Gentlemen:** The National Payments System sits at the centre of the financial system. It is imperative that payments systems are secure and efficient. The Central Bank continues with its initiatives to modernize the national payments system. Accordingly, from 1st October 2009, value capping was effected with all payments above Kshs.1 million being made through the Real Time Gross Settlement System (RTGS). This initiative will enhance the security and efficiency of high value payments. Let me at this juncture thank banks, government ministries and other market players for their support in implementing value capping. The Central Bank will continue working with all concerned players to educate the public on value capping and to address implementation bottlenecks that may arise.

8. Whilst initiatives to modernize the payment system continue, we remain cognizant of the cash based nature of our economy. The Central Bank is therefore reviewing currency management to ensure availability of "clean money" at a reasonable cost to Kenyans. The Bank is, in conjunction with the Kenya Bankers Association (KBA), exploring the establishment of currency centres. These centres are expected to reduce the operational costs incurred by banks in moving cash to existing Central Bank branches. This move is also expected to support the provision of "clean" notes and coins to Kenyans across the country. Pilot currency centres identified jointly with KBA in Nyeri, Meru and Nakuru are expected to be operational very soon once modalities are finalized.

9. **Ladies and Gentlemen:** As I draw to a close, let me briefly highlight developments in the bond market with regard to infrastructure bonds. The Central Bank successfully raised Ksh.18.5 billion for the Government through an infrastructure bond in February 2009. This bond has not only facilitated financing of the Government's infrastructure program but also set the pace for the issuance of similar bonds by corporate entities.

10. The recent successful bond issuances by KENGEN and Safaricom are illustrative of this trend. The success of these bonds undoubtedly would not have been possible without the support of the banking sector. We look forward to this continued support including the recently launched Second Government Infrastructure Bond. This, coupled with automated trading in the Nairobi Stock Exchange will be important for a vibrant bond market.

11. **Ladies and Gentlemen:** These developments are in line with core mandates of the Central Bank and also the policy drive provided by the Vision 2030 blueprint.

Finally, as we draw towards the festive season, let me wish you happy holidays and a rewarding 2010.

Thank You and God bless you