CENTRAL BANK OF KENYA

Keynote Speech by

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During the

KENYA INSTITUTE OF BANKERS (KIB) DINNER

Held at the Panari Hotel, Nairobi

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Mr. John Waka, Chairman, Kenya Institute of Bankers;

Members of the KIB Council Here Present;

Distinguished Guests;

Ladies and Gentlemen:

It is my pleasure to join you this evening on this annual occasion when the banking fraternity celebrates its' successes in the year and reflects on the challenges and the road ahead. I commend the Kenya Institute of Bankers for consistently and effectively putting together this function over the years. The purpose of tonight's' event is really as it were to ''break bread'' outside the usual formal settings. In line with this, I will keep my remarks brief to enable you spend more time networking and renewing old acquaintances.

Ladies and Gentlemen: 2010 has seen the Kenyan economy rebound on the backdrop of favorable weather conditions that supported the critical agriculture and energy sectors, promulgation of a new constitution and expanding opportunities in the East African Community. The economy is expected to grow at 5 percent having posted growth rates of 4.8% and 5.4% in the first and second quarters of 2010 respectively. The second quarter growth was driven by agriculture, construction, manufacturing and the financial sector. On the inflation front, the 12-month overall inflation declined from 8.6% in June 2009 to 3.5 percent in June 2010 and to 3.1 percent in October 2010. The decline was largely reflected in food prices due to the well distributed rainfall experienced in the last quarter of 2009 which continued in this year and of course the growth witnessed so far.

During the year, the Kenya shilling depreciated against all major currencies. Against the US dollar, the shilling weakened to exchange at Ksh 80.74 in October 2010 from Ksh 75.79 in January 2010. The trend in the Kenya shilling largely reflected increased demand for foreign currencies in the local foreign exchange market and the strengthening of the US dollar as a safe haven following confidence crisis attributed to effects of the global financial crisis and subsequent economic recession including the Greek Crisis in the second quarter of 2010.

Ladies and Gentlemen: The performance posted by the banking sector in the first three quarters of 2010 surpassed expectations boosted by the favorable macroeconomic environment. The highlights of the sectors' performance as at 30th September 2010 were:-

- The banking industry's assets increased by 25 percent from KSh.1.31 trillion in September 2009 to KSh.1.64 trillion at the end of September 2010 as banking institutions expanded their lending portfolio.
- Deposits increased from KSh.1.0 trillion in September 2009 to KSh.1.27 trillion at end of September 2010 due to aggressive deposit mobilization and expansion of branches and other delivery channels.
- The banking industry's capital base was strong with Total Capital to Total Risk Weighted Assets Ratio at 20.6 percent at end of September 2010, compared to the statutory minimum of 12.0 percent. This indicates that the Kenyan banking industry has a reasonable cushion against shocks in the short and medium- term.
- The industry's average liquidity as at the end of September 2010 was 46.7 percent well above the statutory minimum of 20.0 percent.
- Banking industry profits before tax increased by 44 percent from KSh.36.95 billion for the period ended 30th September 2009 to KSh.53.23 billion for a similar period in 2010. This reflects increased business from expansion and earnings from innovative products introduced by commercial banks.

Ladies and Gentlemen: While acknowledging the excellent performance by the sector, the cost of credit continues to be beyond the reach of most Kenyans. Let us not kill the goose that continues to lay the golden eggs for us. With an overall inflation rate of 3.1%, lending rates of above 10% are not tenable. The Monetary Policy Committee has in the year continued with its' policy stance of stimulating private sector credit to support economic growth. The Committee has also engaged the banking sector to gain a better understanding of the factors contributing to the high cost of credit. One of the contributory factors cited by the sector has been the high cost of doing business. The Central Bank has accordingly spearheaded various reforms in 2010 to reduce the cost of doing business and promote competition. These reforms combined with other ongoing reforms by the Government have drastically reduced the cost of doing business and this should translate into a lower cost of credit. Let me briefly highlight some of these reform initiatives.

First, banks have cited information asymmetry between banks and borrowers as one of the main contributors to the high cost of credit. Accordingly in July of this year, CBK in conjunction with the Kenya Bankers Association (KBA) rolled out the credit information sharing mechanism with the first data submissions to the Credit Reference Bureau in August. In the first two months after the rollout, a total of 765,586 records had been submitted to CRB Africa, by all institutions, whereas a total of 103,332 credit inquiries have been made by the subscriber institutions. Credit information sharing is expected to promote competitive risk based pricing of credit facilities and development of information capital for borrowers who may not have physical collateral.

Second, the Rolling Out of Agent Banking Model: Following the operationalisation of the Agent Banking Guidelines in May 2010, three banks have been granted approval to rollout their agency networks, while the applications of four others are under consideration by the Central Bank. As at the end of September 2010, the approved banks had contracted almost 6,000 agents. The use of agents will substantially lower the service delivery costs of banks while expanding their footprint.

Third, the revision of the Banking Act to accommodate the changing market landscape; The Banking Act has in recent years been amended to facilitate innovations such as Sharia Compliant Banking and to enable the Central Bank to safeguard the market without stifling innovation.

Fourth, the introduction of currency centres. The Central Bank has in recent years together with market players' embacked on modernization of national payment systems. However Kenya remains by and large a cash based economy and banks have been incurring substantial cash-in-transit costs. To ease these costs, CBK and KBA have partnered to set up currency centres on a pilot basis in Nyeri, Nakuru and Meru. The Nyeri Currency Centre begun operations at the end of 2009 and is already serving 88 bank branches in Central Kenya. The Centre accounts for an average of 9% of the national currency transactions processed by CBK. The Nakuru Centre will become operational on 18th November 2010 while the preparatory groundwork for the Meru Centre is at an advanced stage.

Fifth, swift approvals for new products using mobile phone delivery channels and are cost effective.

Finally, on a broader scale the new constitution that allows a new legal framework to protect the market.

Ladies and Gentlemen: As I draw to a close, let me underscore that the Central Bank remains committed to deepening its' reform initiatives to ensure that Kenya's banking sector is stable, efficient and inclusive. This will empower the sector to play its' pivotal role in financing Kenya's development aspirations as articulated by Vision 2030.

It now remains for me to wish you happy holidays and a rewarding 2011.

Thank you