CENTRAL BANK OF KENYA

Keynote Speech by

PROF. NJUGUNA NDUNGU

GOVERNOR

CENTRAL BANK OF KENYA

During the

KENYA INSTITUTE OF BANKERS (KIB) ANNUAL DINNER

HELD AT PANARI HOTEL, NAIROBI

On 25th November, 2011

The Chairperson, Board of Directors, KIB;

Members of the KIB Council Here Present;

The Chief Executive, Management and Staff, KIB;

Chief Executive Officers of banks and financial institutions;

Distinguished Guests;

Ladies and Gentlemen:

I am pleased and honoured to join you this evening. I therefore take this early opportunity to thank the Kenya Institute of Bankers (KIB) for inviting me to speak at this 2011 Annual Dinner. This is a valuable opportunity to celebrate our successes, reflect on the challenges during the year and chart our future path.

Ladies and Gentlemen: In many ways 2011 has been a challenging year given the global and domestic shocks hitting the economy. The characteristic supply shocks – like fuel prices – have affected negatively both domestic prices and output.

Despite the shocks, the economy has remained resilient and is expected to register a modest growth of 5% in 2011 compared with 4.6% in 2010. Having endured the shocks buffeting the economy, the Central Bank has focused its policy response on containing inflation and stabilizing the exchange rate. The Central Bank tightened monetary policy by raising gradually both the CBR and CRR to 16.5% and 5.25%, respectively. We have started to see these measures bearing fruit: there are signs of easing in domestic demand pressures while the exchange rate is stabilizing.

Ladies and Gentlemen: Even with the shocks hitting the economy and the policy responses putting us on a tight rope, the banking industry performance in the first three quarters surpassed expectations. Let me highlight some of these performance indicators;

- The industry's deposit base grew by an impressive 21% as at end October 2011 compared to October last year. Deposit mobilization efforts were boosted by the new delivery channels introduced in the year, including the adoption of agency banking that has taken root with more than 8,700 agents spread across the country.

- Branches of banks also continued to grow and by September 2011, bank branches stood at 1,113. The banking sector now has a presence in each of Kenya's 47 counties, which provides banks with a vantage position to contribute to the development agenda of the nascent Counties.

- The asset base hit the KSh.2 trillion mark in September 2011. This is mainly attributed to the banks continued expansion of their lending portfolio through introduction of loan products that suit the needs of different market niches. The gross loans stood at KSh.1.2 trillion as at October 2011, a 35% increase from October 2010.

Ladies and Gentlemen: The policy response to shocks has its pitfalls. Right now, the concern is on interest rates and fear of non-performing loans rising. Some commercial banks in November 2011 have revised their base rates to as high as 25%.

There is growing public concern on the rising lending rates and the wide interest rate spread. Banks will, therefore, need to read the public mood and keep any increases to a minimum to take into account the difficult circumstances that borrowers are facing.

We recognise that pricing of credit risk by banks had proved a major challenge in the past; however, the introduction of credit information sharing in 2010 has minimized this challenge. So far, over one million credit reports have been requested by banks and about 4000 by bank customers. In this regard, the Central Bank has spearheaded reforms aimed at lowering the cost of doing business. These include introduction of credit information sharing, roll-out of agency banking and setting up of Currency Centres. Banks should therefore pass on the cost savings from these initiatives to customers as you review lending rates.

On the National Payment Systems front, the retail payments system continued to evolve in line with the payments system reform and modernization strategy. In particular, the Central Bank in conjunction with the Kenya Bankers Association successfully implemented the Cheque Truncation System that will eliminate the hitherto manual cheque clearing by automating the entire clearing cycle. The benefits accruing from improvement in the national payment system should be passed on to your customers.
I am glad to inform you that on 23rd November 2011, Parliament finally passed the National Payments System Bill, 2011. The Bill seeks to provide for the regulation and supervision of Payment Systems and Payment Service Providers. In particular, the Bill will enables Kenya's payment system to comply with the Bank for International Settlement Core Principles and give Central Bank enhanced legal and regulatory powers over the payment systems.

Ladies and Gentlemen: Looking into the future, the economic outlook for the next 12 months is positive given the current short rains that have improved the food situation in the country; the Governments' concerted efforts in implementing Vision 2030 flag ship projects and the current coordinated policy measures including monetary-fiscal policies aimed at maintaining macroeconomic stability while boosting broad based growth.

On the financial sector front, the Central Bank in conjunction with the Government will scale up reforms to enhance the sector's competitiveness, efficiency, access and stability as well as making Kenya a financial hub in the medium term. The banking sector is also expected to continue with its' excellent performance underpinned by regional expansion and lowered cost of business as the various reforms take root.

Looking ahead for Monetary Policy, the priority is to reverse inflation and inflationary expectations and exchange rate volatility to protect the economic growth base. Tight monetary policy will be sustained until inflationary pressures have been reversed and the foreign exchange market stabilized. From a historical perspective, we have seen the same measures work and we still have confidence it will work in 2012. The Bank will also continue with regular interactions with key stakeholders including market players to enhance the effectiveness of the transmission mechanism of monetary policy and other policy strategy actions.

In closing, **Ladies and Gentlemen**, let me thank you all for the support and cooperation in developing the financial sector. I look forward to more fruitful collaboration and partnership going forward and in addressing any challenges facing the sector. Lastly, let me end by wishing you all a happy holiday season and fruitful 2012.

THANK YOU