STANDARD Digital

Market fears as another interest rate rise looms

Economists are raising fears over a likely surge in the cost of commercial bank loans as the Government borrows heavily from the domestic market to finance its revenue shortfalls.

This comes despite the Central Bank of Kenya's attempts to control interest rates by keeping its benchmark-lending rate unchanged at 8.5 per cent to drive the economy through increased household and business spending. Faced with increasing expenditure pressures and slow growth in revenues, the Government has experienced a budget deficit, which has been financed through borrowing.

Latest statistics from the Central Bank of Kenya show the Government's borrowing requirement from the local markets rose to Sh25 billion during the first week of the 2013/2014 financial year.

This pushed the Government's gross domestic debt to Sh1.08 trillion from Sh1.05 trillion at the end of June 2013, on account of treasury bonds and Government overdraft at the Central Bank. "In my view this level of domestic debt is already too high. Borrowing from the domestic market is going to affect interest rates because you must pay the price for that. There will certainly be pressure for the interest rates to go up," Dr Thomas Kibua, a senior economist at the African Development and Economic Consultants told The Standard yesterday.

Dr Kibua, however, questioned the rationality of Government borrowing while the same Government is losing 30 per cent of its annual budget on wastage. "We should not be borrowing at all. I think we have to be careful because we may burden our next generation with a debt which they may not be able to sustain," he said. "It is just a conventional wisdom theory that if there is very high Government borrowing then interest rates tend to go up. What this means is that the Government is crowding out the private sector from the money markets," said John Kirimi, Executive Director, Sterling Capital. "As soon as the Government borrowing goes up interest rates will go up," he added.

According to Kirimi, the purpose for which the borrowed funds are used for is also critical because if the funds are spent well on development projects the economy grows and the Government collects more taxes but the economy suffers if the government borrows to finance its recurrent spending.

According to CBK's weekly Economic data report Government securities accounted for 96.2 per cent of the gross domestic debt. However, the share of Government securities held by banking institutions, insurance companies and parastatal declined marginally during the period under review.

Excessive borrowing particularly from the domestic market carries the danger of crowding out the private sector from credit and throwing the country's debt to gross domestic product (GDP) ratio out of proportion. "We are looking at a situation where the prices of

goods will rise and this is not good for Kenyans," said Martin Napisa, National Coordinator of the National Taxpayers Association (NTA). He said the Government's heavy borrowing from the domestic market will definitely have a serious impact on interest rates. "Banks will adjust their rates upwards and it will be very expensive for anyone to borrow money from a bank," added Napisa.

National Treasury plans to borrow a total of Sh106.7 billion to finance part of its budget deficit estimated at Sh330 billion. The amount is part of the Government's overall Sh1.64 trillion budget for the 2013/14 fiscal year. National Treasury is partly targeting grants, commercial loans and domestic borrowing to finance its budgetary shortfall.

The National Treasury also eyes a US$1billion sovereign bond issue this fiscal year to fund infrastructure.