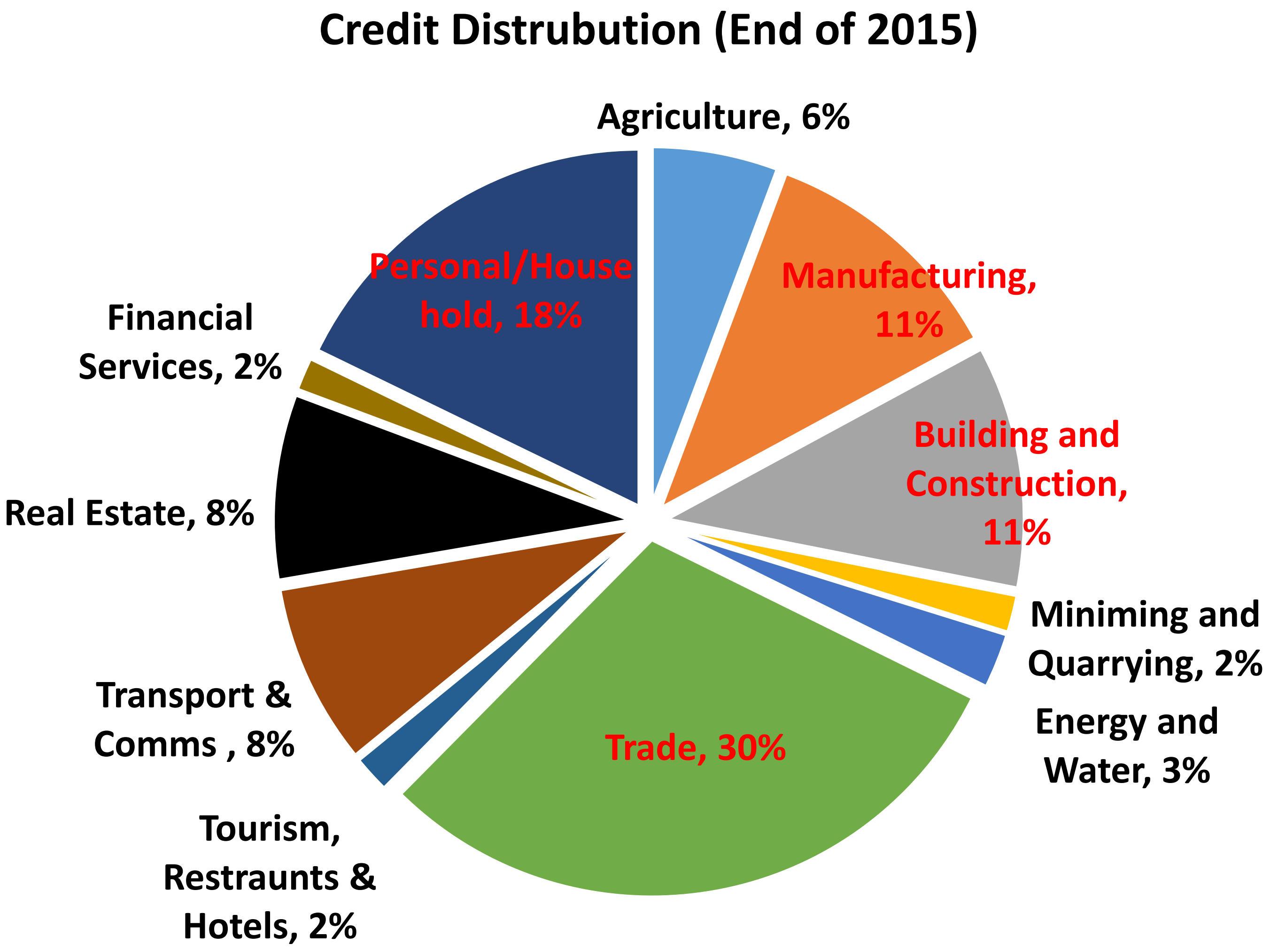
Tracking the effect of the Banking (Amendment) Act 2015 – Initial Evidence

Outline

- Credit market dynamics
- Other markets:
  - Capital market
  - Money market
- Initial implications

Credit Market

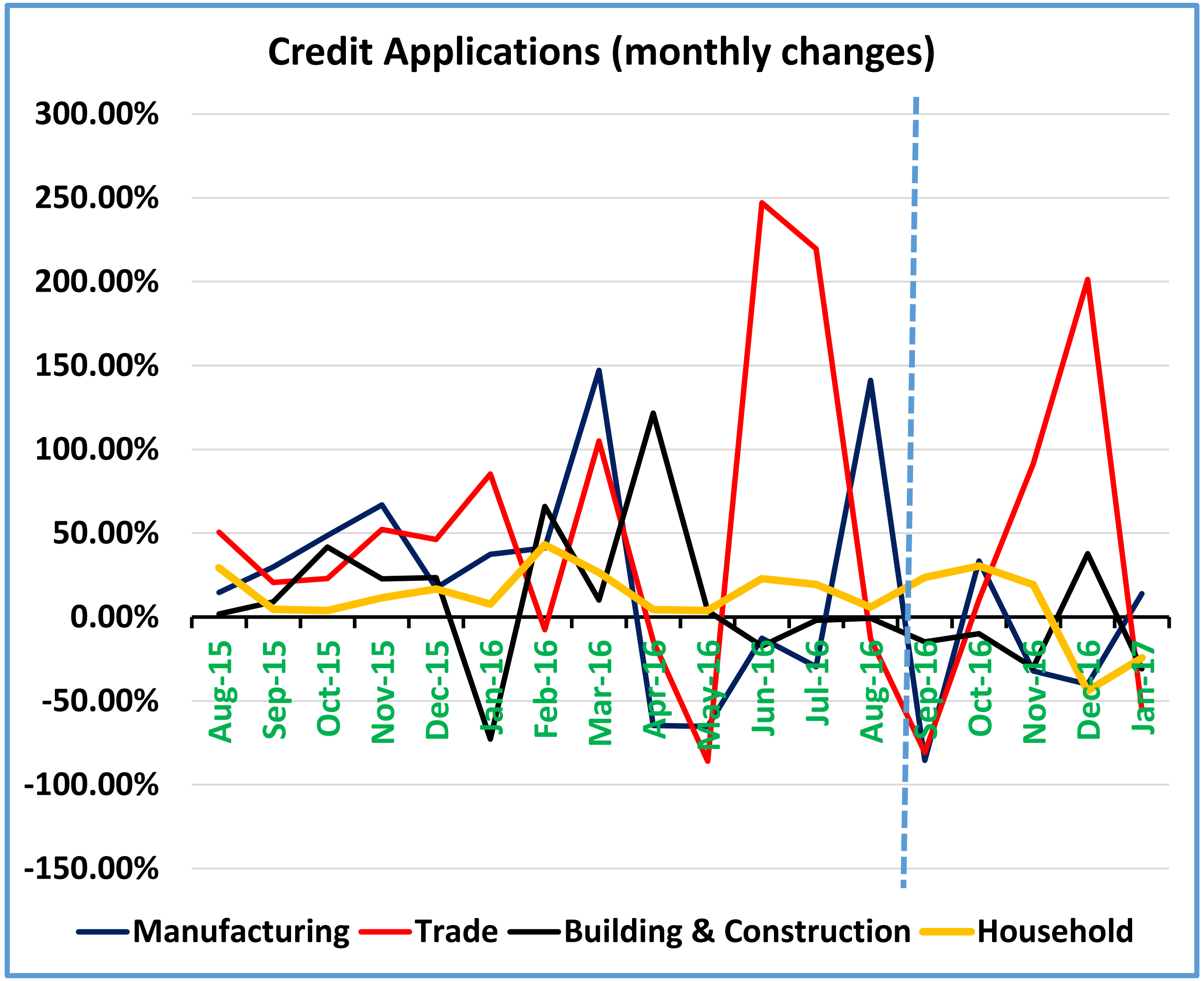
Credit - Underlying Dynamics

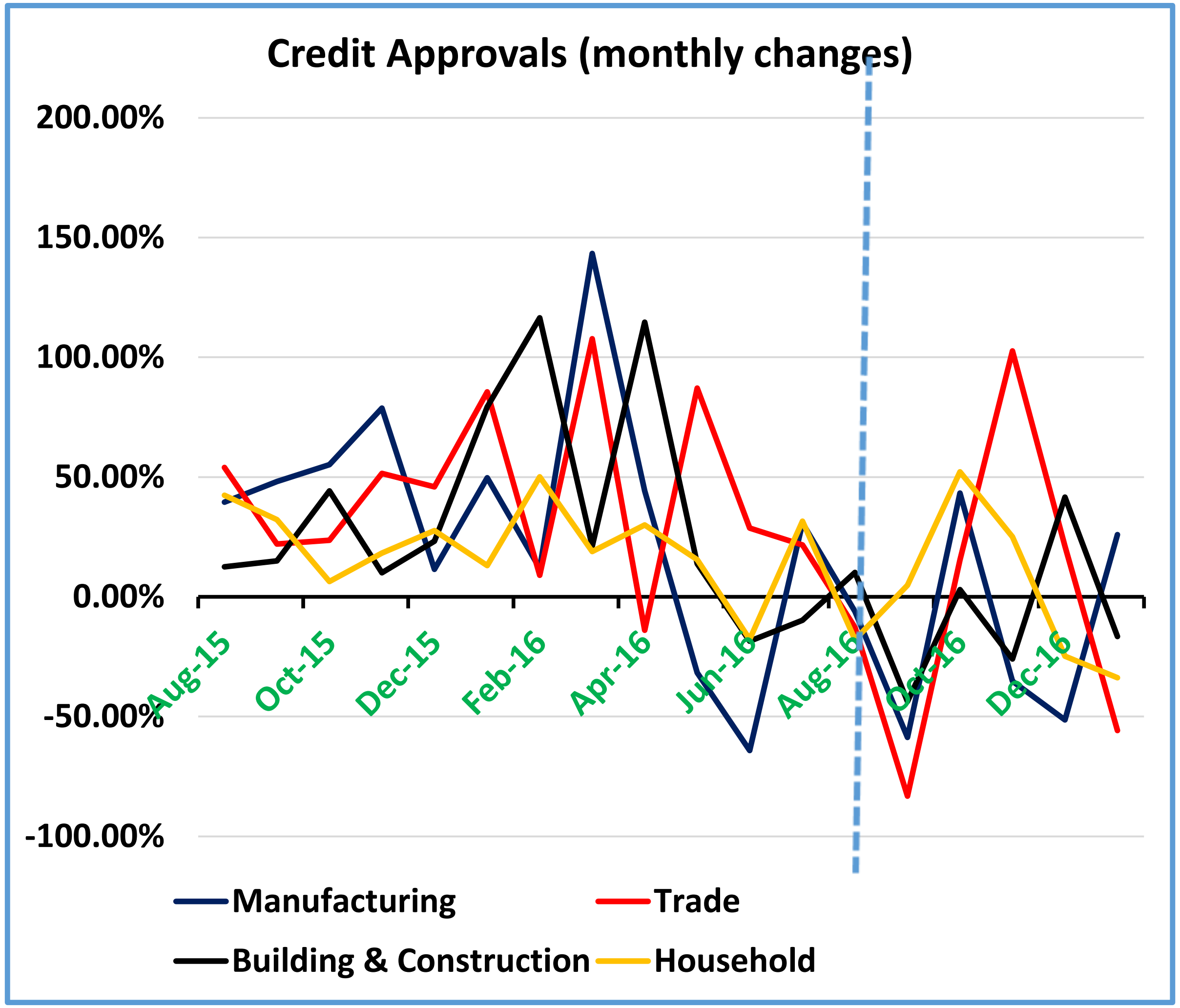


Source: CBK; BSR 2015

- Credit skewed towards:
  - Household; Trade; Manufacturing; and Building & Construction (accounting for 70% of credit)

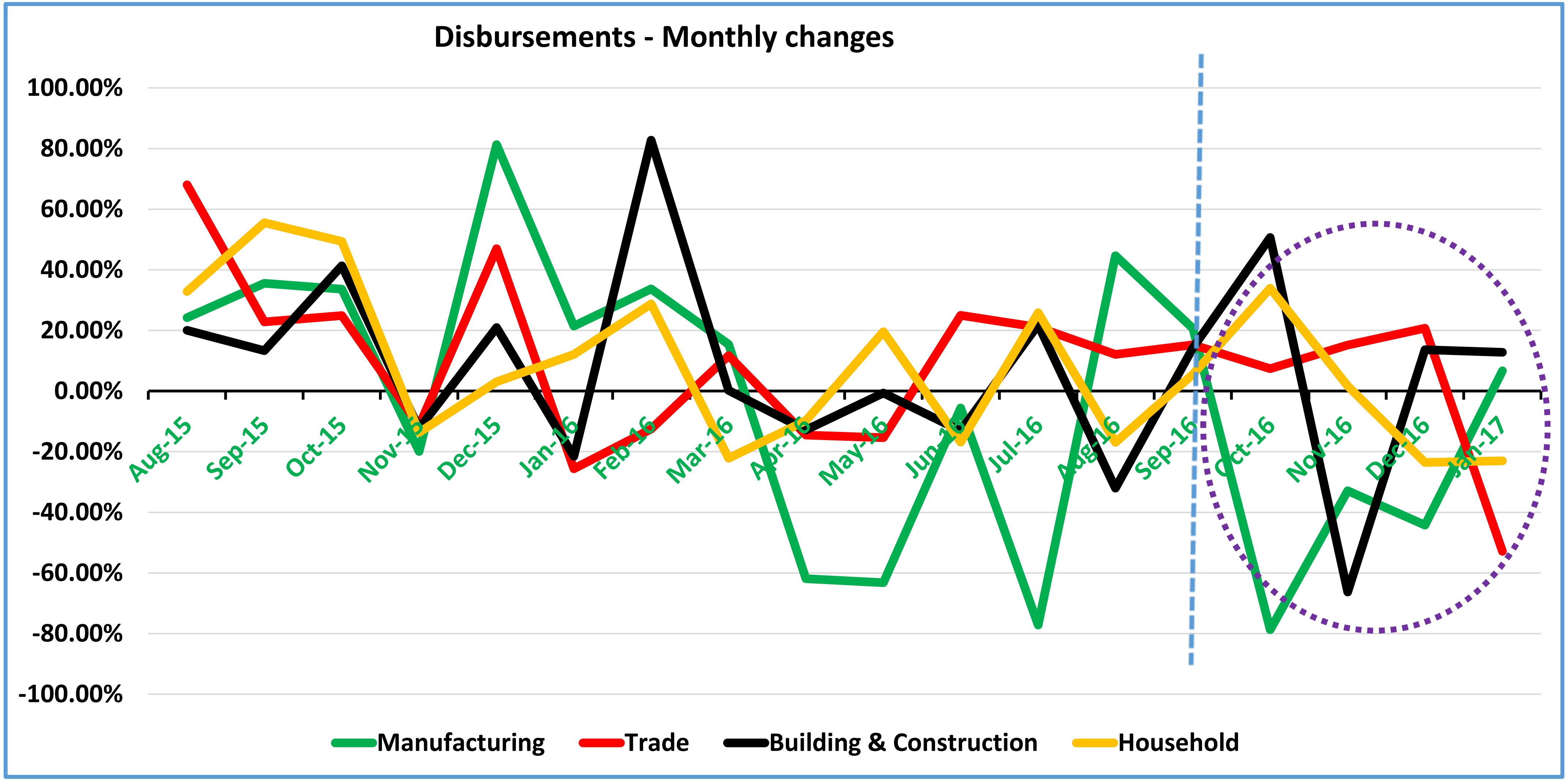
Credit Applications and Approvals





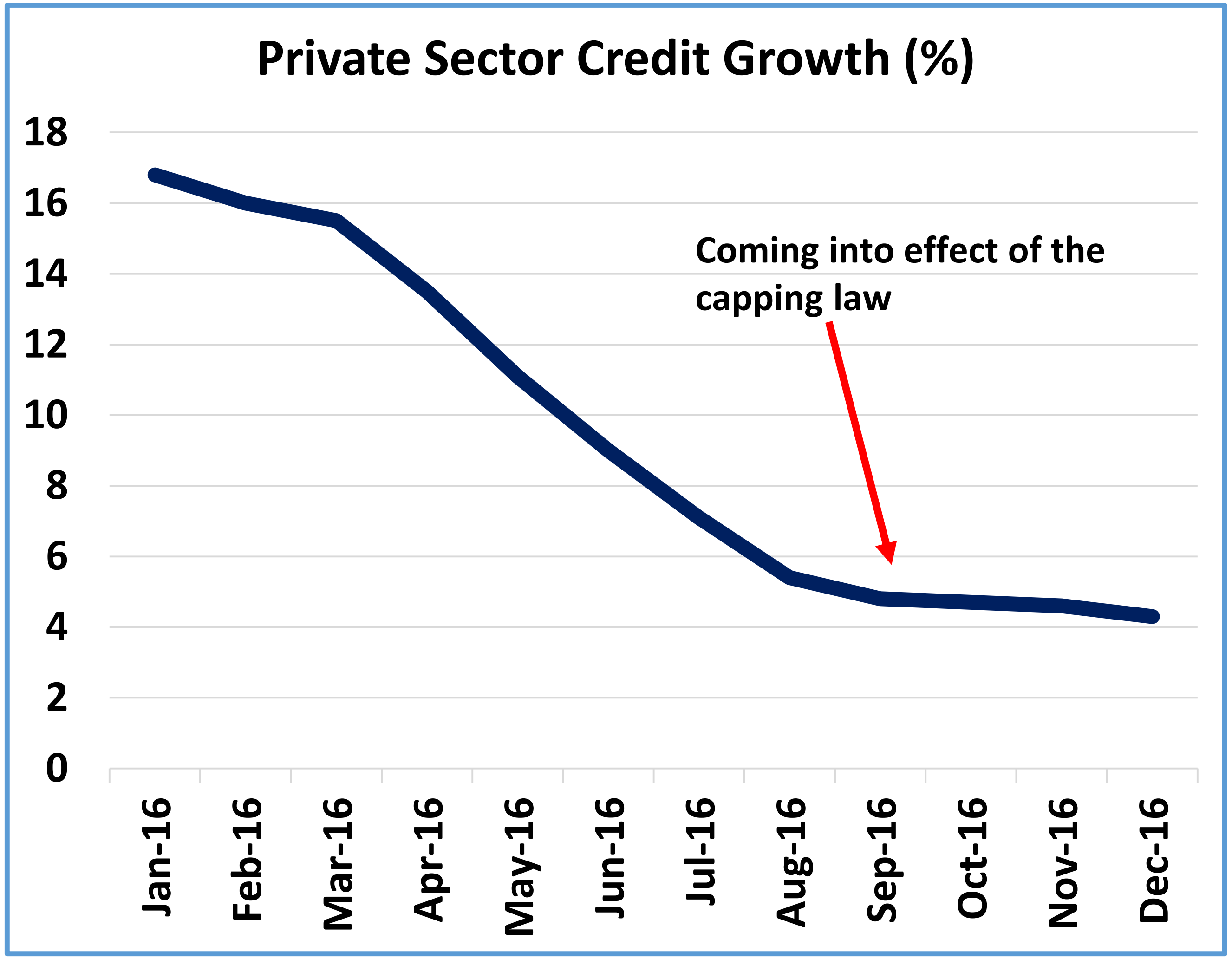
Similar Patter; but approvals have slowed down subsequent to June 2016

Disbursements



There is evident slowdown in disbursements for much of 2016; especially so subsequent to the Banking Amendment Act 2015 coming into effect.

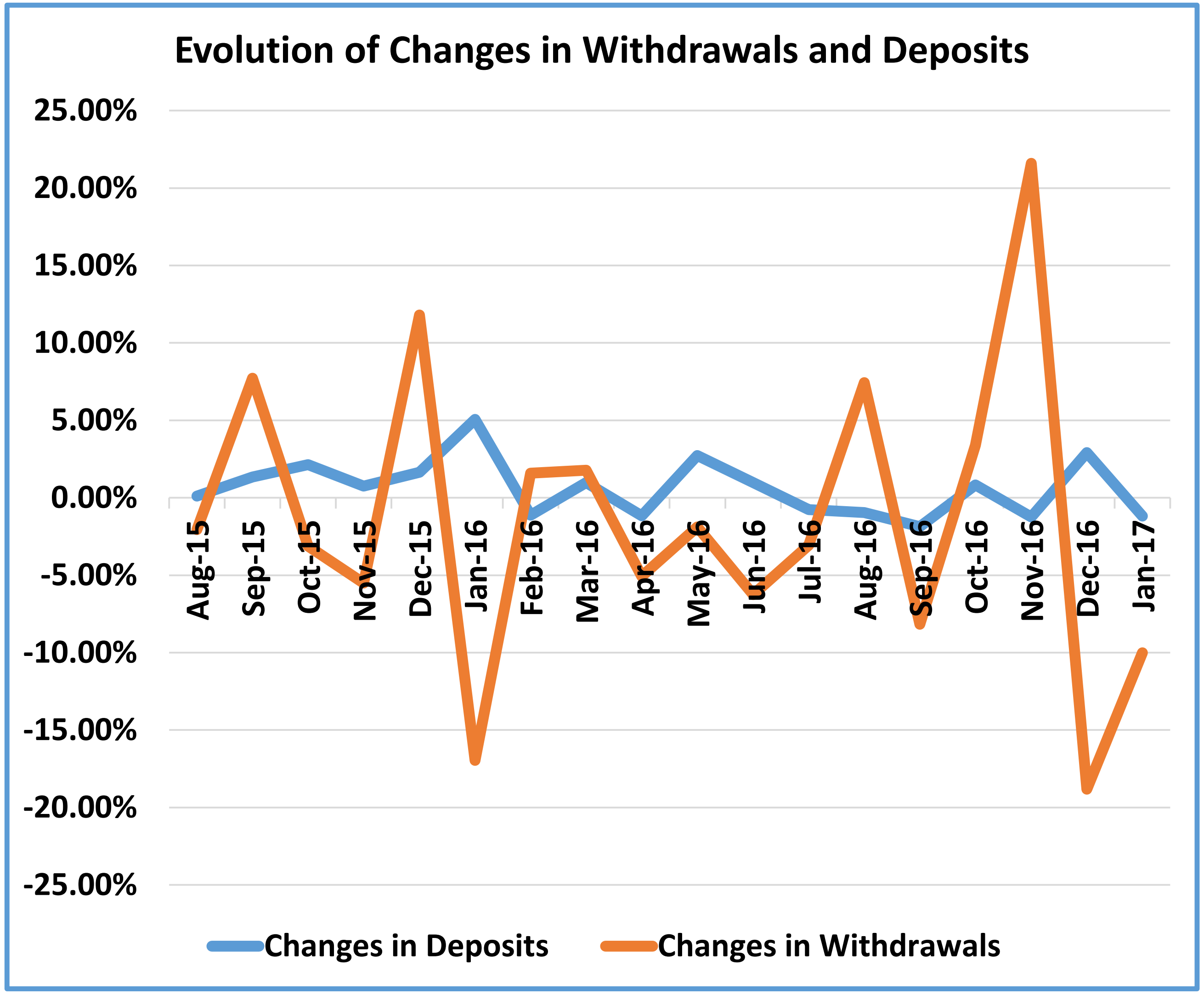
Evolution of Credit Expansion to the Private Sector



Source: CBK

- Credit to private sector was already on a downward trend;
- The monetary policy decision at the time (MPC of 20th Sep. 2016 was meant to support reversal of the trend
  - CRB Reduced from 10.5% to 10.0%
- Fourth Quarter operations of banks characterised by:
  - Adjustment to the new pricing regime;
  - Orienting operations (credit and treasury);
  - Low private credit growth levels.

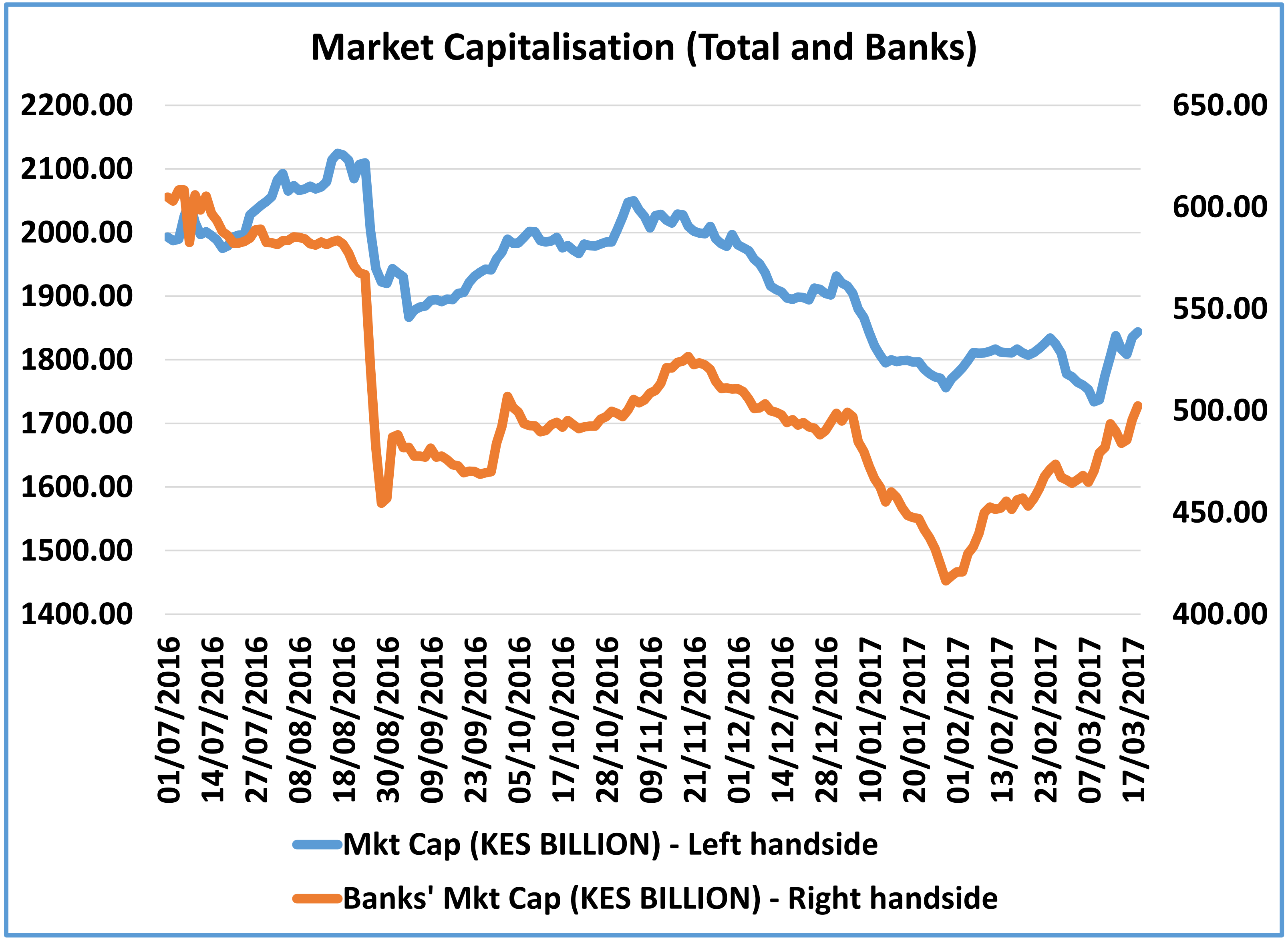
The Deposits – Withdrawal Behaviour



- Withdrawals aligned to consumption/expenditure patterns.
- Deposits behaviour aligned to incomes; no evidence of response to returns incentive.

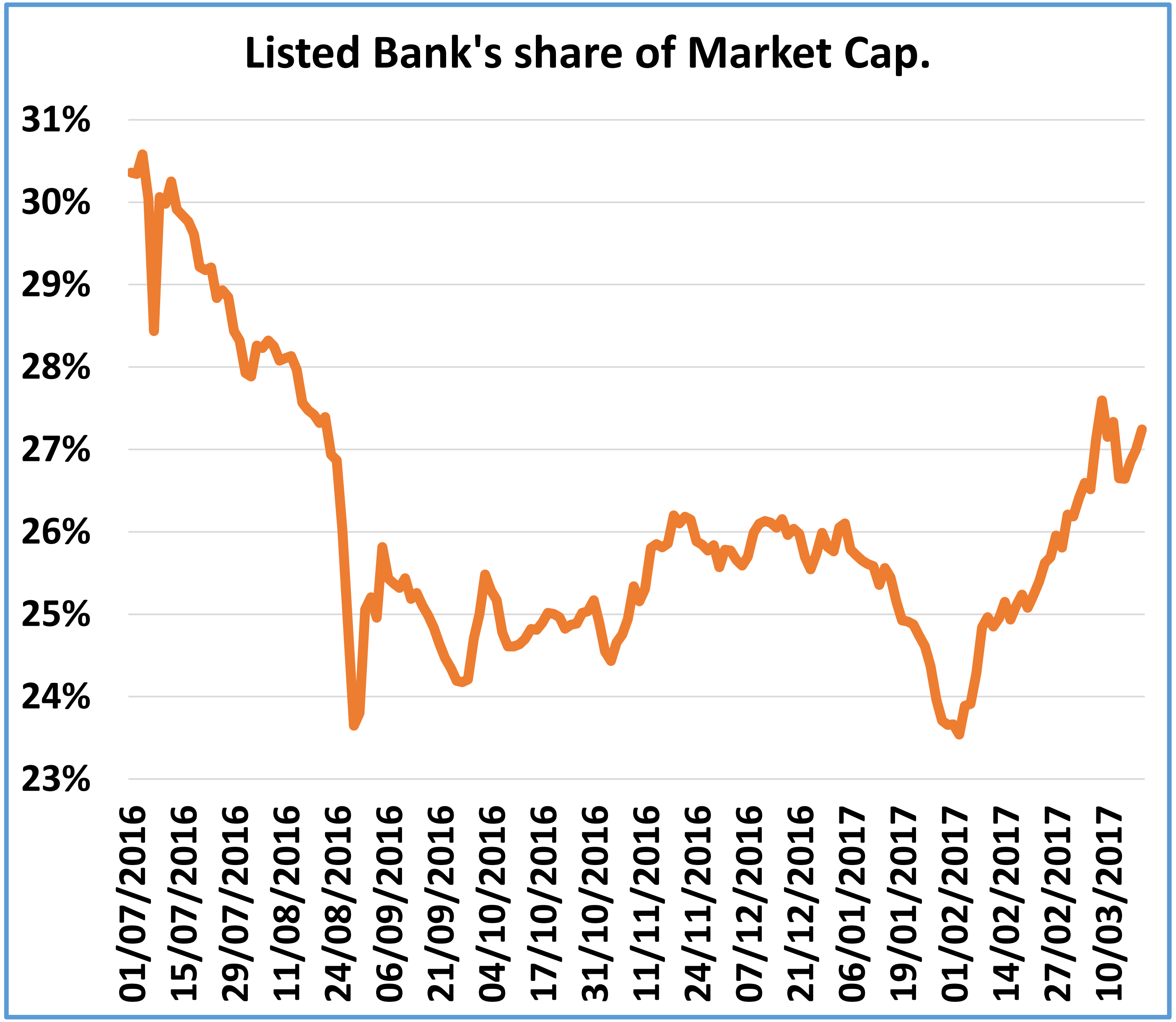
Other Markets

Capital Markets



- Market Cap. Down: KES 2.1 Trillion to KES 1.8 Trillion as at 20th March 2017.
- Banks Market Cap Down: KES580 billion to KES 520 Billion in 20th March 2017

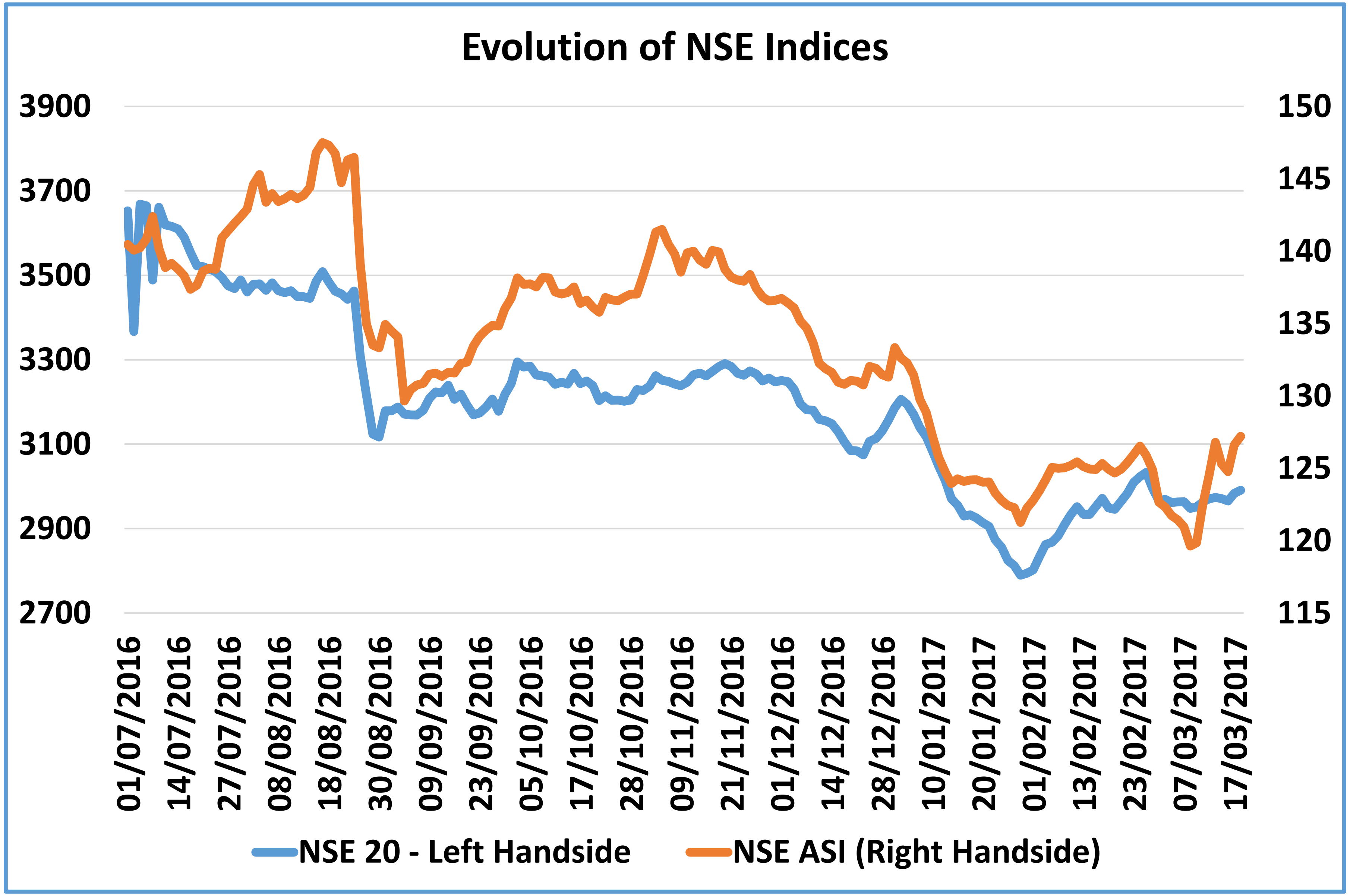
Capital Markets



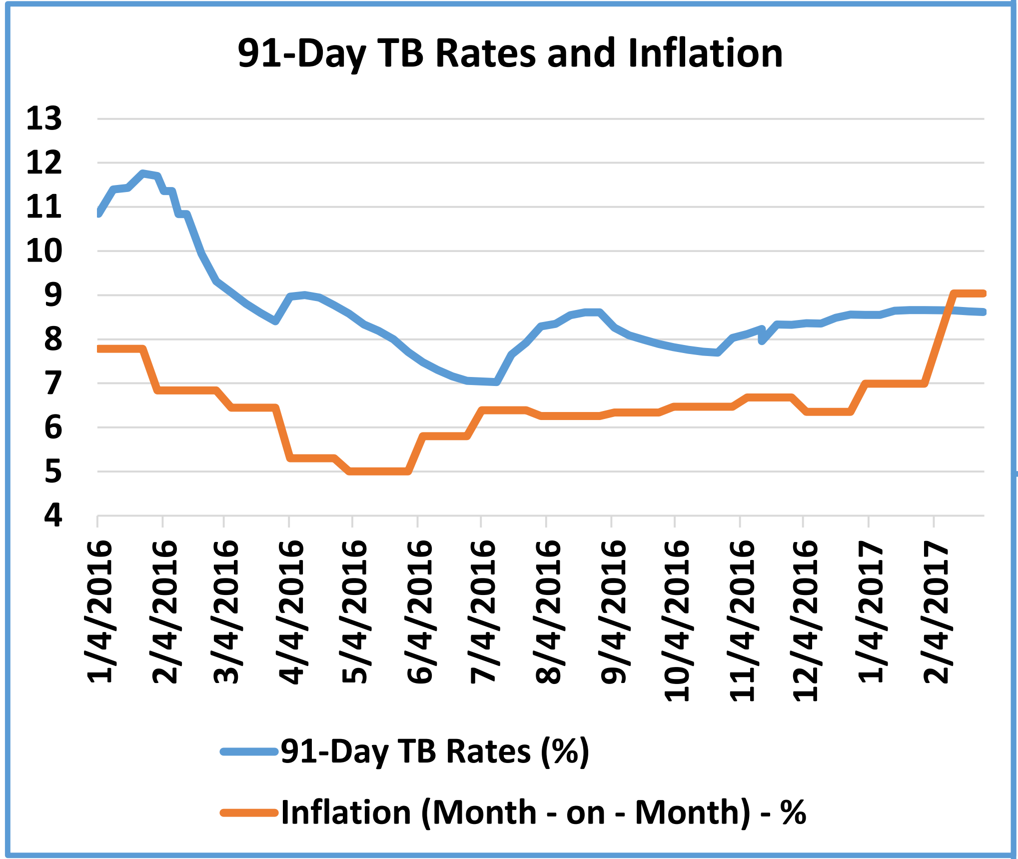
- Banks share of Market Cap. Down:

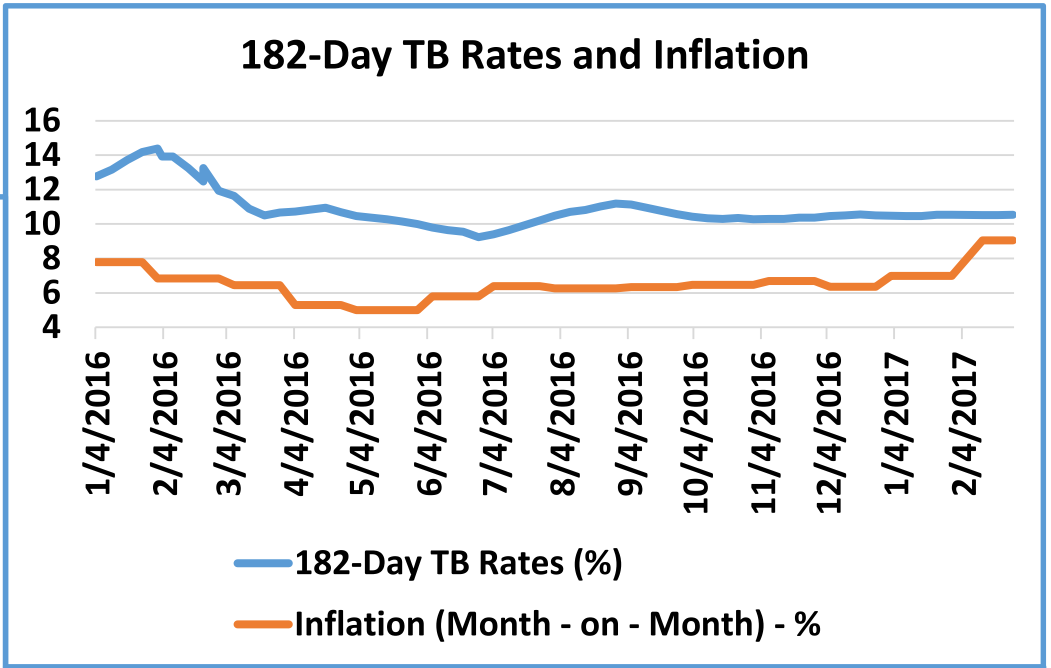
Over 30% to about 27% by 20th March 2017.

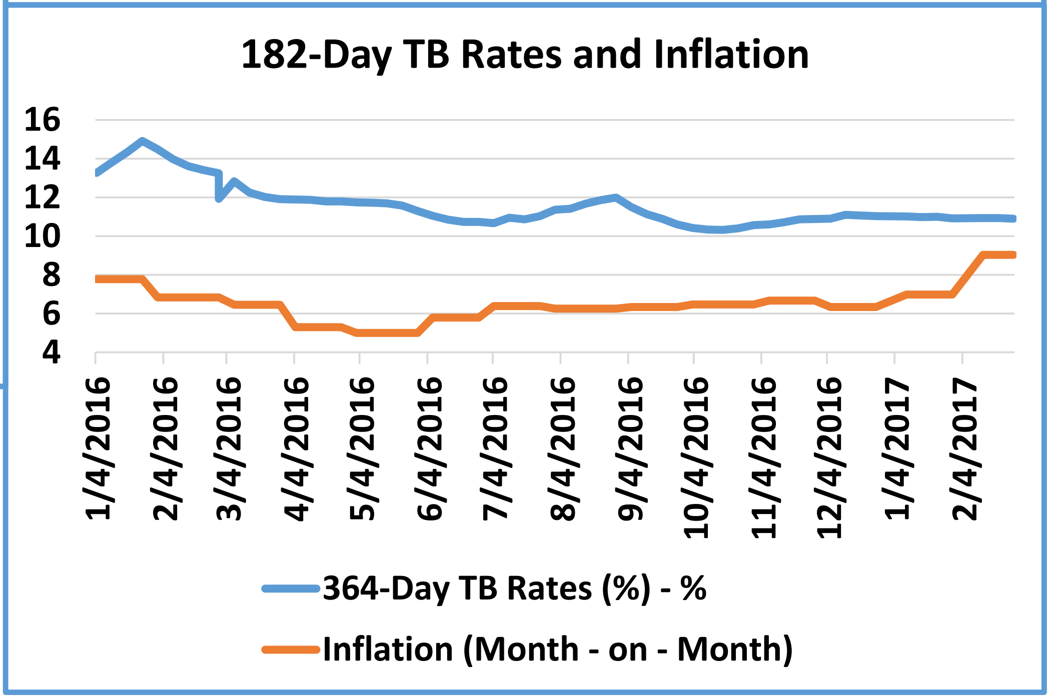
Capital Markets



Money Markets







- The capping is the upper constraint; otherwise rates become distortionary;
- Inflation is the lower constraint; otherwise the rates become negative in real terms.

Initial Implications

Initial implication

- The downward trend of credit to the private sector is showing signs of being exacerbated by the capping of interest rates;
- Even though credit growth to the private sector was to stabilise at the current lower level, evidence of credit reallocation is emerging and is to the disadvantage of households and sectors amenable to SMEs (e.g. trade);
- The trend of deposits does not show any sign of response to the returns' incentive;
- The strong linkages, and the evident bank-dominance in the financial system has seen the capital markets adversely affected:
  - The entire market is affected;
  - Investor base affected – pensions, insurance, and retail investors.
- The effects on the money market presents a dilemma:
  - There is an incentive to invest in government securities (upward pressure on money market rates); yet the capping may lead to distortions in pricing structure if rates break above the capping level;
  - Inflationary pressure could lead to negative returns
- The effect on the overall economy is therefore evident: credit to private sector is one of the financial predicators of future economic performance (the others are house prices and stock prices).