KENYA BANKERS
ASSOCIATION

STATE OF THE BANKING INDUSTRY REPORT 2024

August 2024

CENTRE FOR RESEARCH ON
FINANCIAL MARKETS AND POLICY®

STATE OF THE BANKING INDUSTRY REPORT 2024

The Centre for Research on Financial Markets and Policy® was established by the Kenya Bankers Association in 2012 to offer an array of research, commentary, and dialogue regarding critical policy matters that impact on financial markets in Kenya. The Centre sponsors original research, provides thoughtful commentary, and hosts dialogues and conferences involving scholars and practitioners on key financial market issues. Through these activities, the Centre acts as a platform for intellectual engagement and dialogue between financial market experts, the banking sector and the policy makers in Kenya. It therefore contributes to an informed discussion that influences critical financial market debates and policies.

ABOUT THIS REPORT

The *State of the Banking Industry (SBI) Report* is an annual publication of the *Kenya Bankers Association Centre for Research on Financial Markets and Policy®* aimed at contributing to the understanding of the Kenyan banking industry.

The *report* is motivated by the fact that various stakeholders seeking perspectives on the Kenyan banking industry engage various sources, including market analysts, banks, the Kenya Bankers Association (KBA) Secretariat, the Central Bank of Kenya (CBK) and other financial sector players and regulators. The breadth of views in this report is underpinned by the respective institution's analytical work, making the report reflective of the diversity of analyses.

The Kenya Bankers Association Centre for Research on Financial Markets and Policy® has compiled a database of financials at the bank-level spanning two decades. Together with other secondary data whose source is duly acknowledged, the database buttresses this report's analyses. The financial database, indicated as KBA data in the report, is based on published financial statements by banks up to December 31, 2023.

The report's analysis is undertaken at industry level as well as in the three-Tier bank clusters – Large, Medium, and Small. It also draws on the background work that is published under the Kenya Bankers Association *Working Paper Series* and other relevant published work as cited in the report and links provided as appropriate.

This issue of the *SBI Report* has benefited from discussions, comments and suggestions from banks, analysts, and academic researchers. However, the analyses and inferences are entirely those of the report's authors and should not be attributed to the KBA General Body and Governing Council.

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FOREWORD

The sixth edition of the State of the Banking Industry (SBI) Report by the Kenya Bankers Association sheds light on diverse factors that influenced Kenya's economic growth path in 2023. The report highlights the role of the banking sector on the economy's growth, amidst the impacts of global and domestic shocks.

Moreover, the report highlights fascinating developments and performance within the banking sector, which continues to drive broad-based economic growth. It explores the elements that contributed to the economy's resilience, delving into the banking sector dynamics that shaped Kenya's economic momentum in 2024. These insights are presented across seven distinct sections in the SBI report.

The initial section provides a comprehensive overview of the state of the economy, by providing a holistic perspective. Subsequently, the SBI report dissects the industry's growth indicators, including assets, liabilities, and liquidity. Moreover, it examines asset quality and financial performance, shedding light on the robustness of the banking sector. The significance of deposit-taking microfinance banks and the embodiment of sustainable banking practices in the industry are also highlighted. Finally, the report concludes by offering perspectives on the outlook.

As you take a deep dive into this report, I hope you gain a deep and comprehensive understanding of the Kenyan banking sector.

Raimond Molenje,
Ag. Chief Executive Officer,
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ABBREVIATIONS

CAR	Capital Adequacy Ratio
CBK	Central Bank of Kenya
CIR	Cost-to-Income Ratio
CISI	Chartered Institute of Securities and Investments
CoF	Cost of Funding
DLR	Deposit-to-Liability Ratio
FX	Foreign Exchange
GDP	Gross Domestic Product
HHI	Herfindahl-Hirschman Index
IFRS	International Financial Reporting Standards
IIED	International Institute for Environment and Development
IMF	International Monetary Fund
KNBS	Kenya National Bureau of Statistics
LDR	Loan-to-Deposit Ratio
LLP	Loan Loss Provisions
MFBs	Microfinance Banks
MSME	Micro, small and Medium Enterprises
NIM	Net Interest Margin
NPL	Non-performing Loan
PMI	Purchasing Managers Index™
ROA	Return on Assets
ROE	Return on Equity
SFI	Sustainable Finance Initiative
TRWA	Total Risk-Weighted Assets
WWF	World Wide Fund
KBA	Kenya Bankers Association

> The banking sector's total assets surged by Ksh. 1.2 trillion to Ksh. 7.7 trillion in 2023, marking a 17.6% annual growth, reversing the modest growth of 2022.

EXECUTIVE SUMMARY

- The global economy faces risks in 2024, including geopolitical tensions, supply chain disruptions, and extreme weather. However, with inflation cooling off, there is potential for robust growth. Nonetheless, there has been mixed performance in key regions, with slowing growth in the US and Japan and recovery signs in Europe and China. But, Kenya showed resilience in 2023, with the economy growing by 5.6%, driven by the services and agricultural sectors.

- The growth of the banking sector in 2024 will be driven by four major developments: First, global growth trajectories which impacts Kenya through trade and financial linkages, with exchange rate movements and asset repricing amplifying these effects. Second, the direction of monetary policy and fiscal policy which impacts bank profitability. Third, the continued weakening of asset quality and, Fourth, government financing risks threatening exchange rate stability despite recent stabilization measures.

- The banking sector's total assets surged by Ksh. 1.2 trillion to Ksh. 7.7 trillion in 2023, marking a 17.6% annual growth, reversing the modest growth of 2022. Large banks led this growth with a 21.8% increase in assets. Asset diversification was notable, with shifts towards placements with other banks.

- Banking system deposits grew by 15.1% in 2023, exceeding the 13.1% growth in 2022, driven by mobile and online banking. Large banks saw significant deposit increases, while medium and small banks experienced modest growth. The dominance of large banks in total deposits was evident, reflecting market forces to mobilize deposits at higher costs as interest rates rose.

- Asset quality deteriorated in 2023, with non-performing loans (NPLs) rising to 14.8% of gross loans, the highest since 2007. NPLs grew heterogeneously across bank tiers, with small banks experiencing the highest growth. This deterioration necessitated banks to increase their provisions, adopt early collection strategies, and even strengthened portfolio management strategies to mitigate risks.

- The banking sector maintained strong capital positions, with the total capital to risk-weighted assets ratio at 18.6% in 2023, slightly down from 19.0% in 2022. Large, medium, and small banks all showed robust capital ratios, supporting their ability to absorb elevated credit risks without triggering systemic instability.

- The operating income rose by 21.0% in 2023, driven by growth in interest on loans, interest from government securities and diversified income streams bolstered overall income growth. On the cost side, operating expenses increased by 37.5% in 2023, with significant expansions in interest on borrowed funds and general administrative expenses. Consequently, the industry pre-tax profits declined by 9.1% to Ksh. 219.21 billion in 2023. Large banks experienced a notable profit decline, while medium banks saw slight growth.

- By comparing the performance of bank and non-bank sectors, it is evident that the banking sector's ROA and ROE continued to trail the telecommunication and manufacturing sectors. In 2023, banking sector ROA fell to 2.8%, while manufacturing and telecommunication ROAs were higher;

- Deposit-taking microfinance banks' (MFBs) assets declined by 8.8% in 2023, sustaining its trend decline. Net loans and advances decreased as liabilities fell. Asset quality worsened, with sub-sector NPL ratio rising to 31.7%.

- The economic outlook for 2024 presents both challenges and cautious optimism for Kenya. Domestic economy is expected to keep up with robust growth momentum, mainly driven by agriculture and services, despite risks from climate change, geopolitical tensions, deteriorating asset quality in the banking sector, and elevated fiscal policy constraints.

"Banking system deposits grew by 15.1% in 2023, exceeding the 13.1% growth in 2022, driven by mobile and online banking.

Chapter 1:

INTRODUCTION

The global economy is at a crossroad, where it is expected to remain resilient in 2024 and 2025, though it faces significant downside risks, including potential escalation of geopolitical tensions, further supply chain disruptions, and extreme weather conditions. On the upside, growth may be positively boosted by declining inflation. Economic growth in key regions, like the US and Japan, has started slowing down, while Europe and China show signs of recovery **(Table 1)**[1].

Domestically, Kenya's economic performance demonstrated remarkable resilience in 2023, driven by diverse sectoral growth. Overall, the economy grew by 5.6 percent in 2023, up from 4.9 percent in 2022, driven by robust growth in the service-oriented (7.0 percent) and agricultural (6.5 percent) sectors **(Figure 1a)**. Similarly, accommodation and food services surged by 33.6 percent as a result of rebound in activities in the tourism sector. Other key drivers of growth included Information and Communication (9.3 percent), Transportation and Storage (6.2 percent), Financial and Insurance (10.1 percent) and Real Estate (7.3 percent). However, the Mining and Quarrying sector recorded a 6.5 percent contraction.

Even so, there are weak sentiments in the manufacturing sector, with the Purchasing Manager's Index remaining below the 50 mark in the last quarter of 2023 **(Figure 1b)**; generally reflecting softening economic activity. This trend was mainly attributed to elevated production costs and depressed consumer demand (as new orders remained low).

1. https://www.imf.org/en/Publications/WEO

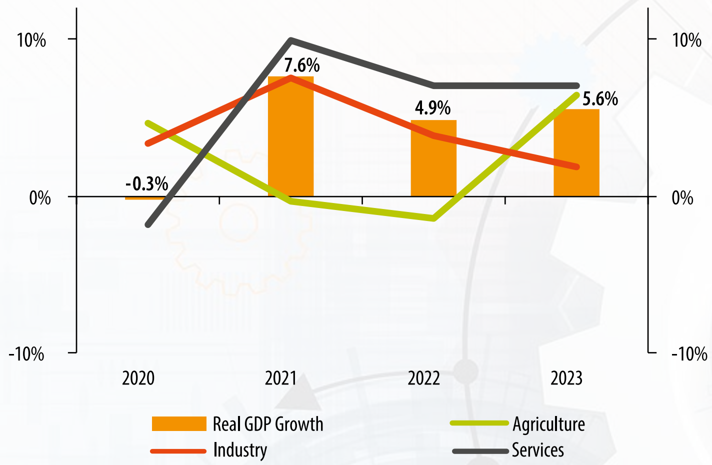
Table 1: World economic outlook projections (year over year)

	2022	2023	Projections	
			2024	2025
World Output	3.5	3.3	3.2	3.3
United States	1.9	2.5	2.6	1.9
Euro Area	3.4	0.5	0.9	1.5
Japan	1.0	1.9	0.7	1.0
United Kingdom	4.3	0.1	0.7	1.5
Canada	3.8	1.2	1.3	2.4
China	3.0	5.2	5.0	4.5
India	7.0	8.2	7.0	6.5
Russia	–1.2	3.6	3.2	1.5
Brazil	3.0	2.9	2.1	2.4
Nigeria	3.3	2.9	3.1	3.0
South Africa	1.9	0.7	0.9	1.2

Source: IMF World Economic Outlook (July 2024)

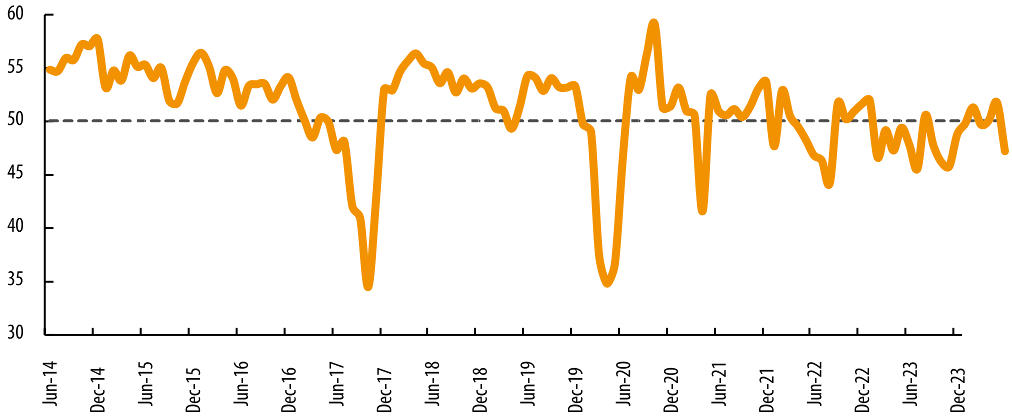
Figure 1: Trends in Economic Growth

1(a): Kenya's Economic Growth Rates (%)



Source: KNBS

1(b): Kenya's Purchasing Manager's Index



Source: IHS Markit®

> Growth in commercial bank lending to the private sector stood at 13.9 percent in 2023 compared to 12.5 percent in 2022 and 8.6 percent in 2021

These developments on the global and domestic front will be critical in shaping future economic and banking sector developments in Kenya in four fronts.

- First, the global growth trajectories will significantly impact Kenya's economic growth, both directly through trade and indirectly through financial linkages. Global growth is expected to reach 3.2 percent in 2024 and 3.3 percent in 2025, with variations across regions. The US and Japan face notable slowdowns, while Europe and China are on a recovery path. The exchange rate movements and asset repricing could further amplify these effects, making it essential for the banking sector to remain adaptive to the prevailing conditions.

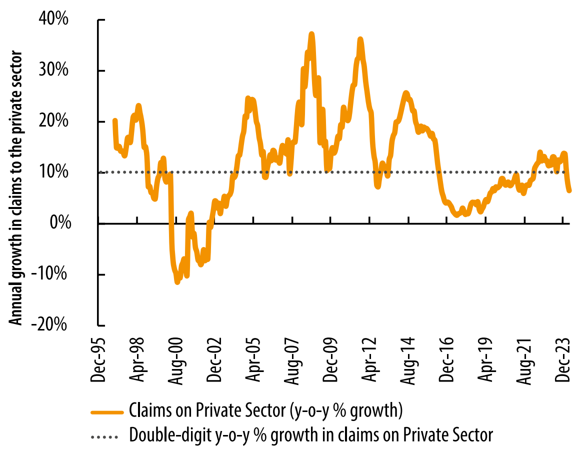
- Second, direction of monetary policy and fiscal policy which plays a critical role in shaping bank behaviour and profitability. Osoro and Kiplangat (2024)[2] showed that both monetary and fiscal policies significantly impact bank profitability, highlighting their interconnectivity. They found that for specific bank attributes, the prominence of these policies as influencers of profitability suggests that banks, as profit seekers, react more to policy adjustments in response to shocks than to the underlying economic outcomes.

- Third, weakening asset quality poses significant challenges to the sector. Growth in commercial bank lending to the private sector stood at 13.9 percent in 2023 compared to 12.5 percent in 2022 and 8.6 percent in 2021, on account of strong credit growth in manufacturing (20.9 percent), transport and communication (20.8 percent), trade (13.1 percent), and consumer durables (9.9 percent) sectors **(Figure 2a)**. Nonetheless, the ratio of gross non-performing loans (NPLs) to gross loans remained elevated on trend to close at 14.8 percent in December 2023 **(Figure 2b)**, raising concerns on its path going forward and impact on credit extension.

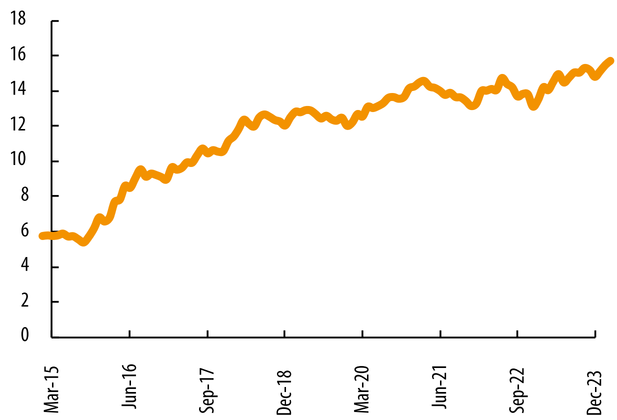
2. Osoro J. and Kiplangat J., (2024), *"Fiscal and Monetary Policy Interaction During Economic Shocks: A Wedge or Bridge for Bank Profitability?",* KBA Centre for Research on Financial Markets and Policy® Working Paper Series No 76(WPS/02/24), May. [https://www.kba.co.ke/wp-content/uploads/2024/06/Fiscal-and-Monetary-Policy-Interaction-During-Economic-Shocks-A-Wedge-or-Bridge-for-Bank-Profitability.pdf]

Figure 2: Credit market dynamics

2(a): Year-on-year growth in private sector credit



2(b): Movement in industry Asset quality



Source: CBK

- Fourth, Government financing risks continue to pose risks to the stability of the exchange rate. The Kenya shilling has strengthened against the dollar, supported by strong export earnings from tea, coffee, horticultural exports and inward remittances. Moreover, two other measures were adopted to stabilize the Kenyan shilling. First, on 10th March 2023, Kenya signed agreements with Aramco, ADNOC, Global Trading Ltd, and ENOC for petroleum supply to address USD liquidity challenges and exchange rate volatility. With this, it was envisaged that it would result in increased foreign reserves, stable exchange rates, reduced speculative pressure, and assured petroleum supply with cost savings.[3] Second, the Central Bank of Kenya (CBK) issued the Kenya Foreign Exchange Code (FX Code) on 22nd March 2023 to commercial banks to enhance the integrity and effectiveness of Kenya's wholesale FX market. The code is anchored on six principles: ethics, governance, execution, information sharing, risk management, and settlement processes, promoting a resilient and trustworthy market[4]. However, government financing risks going forward, including from the rejection of the Finance Bill 2024 and Moody's downgrade in July 2024, pose significant threats. These risks could exert upward pressure on the exchange rate and necessitate the sustenance of high domestic interest rates.

This report reflects the interplay between the state of the economy, the broader macroeconomic policy and regulatory environment, and it is presented in seven chapters. **Chapter 2** discusses the growth of the industry, while **chapter 3** discusses asset quality evolution, **chapter 4** and **5**, present the performance banking sector and deposit taking microfinance banks, respectively. **Chapter 6** outlines developments on sustainable banking practices in Kenya, and finally, **chapter 7** concludes with a brief outlook of the economy and the sector.

3 *https://www.treasury.go.ke/wp-content/uploads/2023/09/Press-Statement-on-the-Gvt-to-Gvt-importation-of-petroluem-products.pdf*

4 *https://www.centralbank.go.ke/uploads/press_releases/432835675_Press%20Release%20-%20Kenya%20Foreign%20Exchange%20Code.pdf*

> Investment in government securities, however, showed a declining trend, from 29.8 percent in 2021 to 29.0 percent in 2022, and a further dropping to account for 24.5 percent in 2023.

Chapter 2:

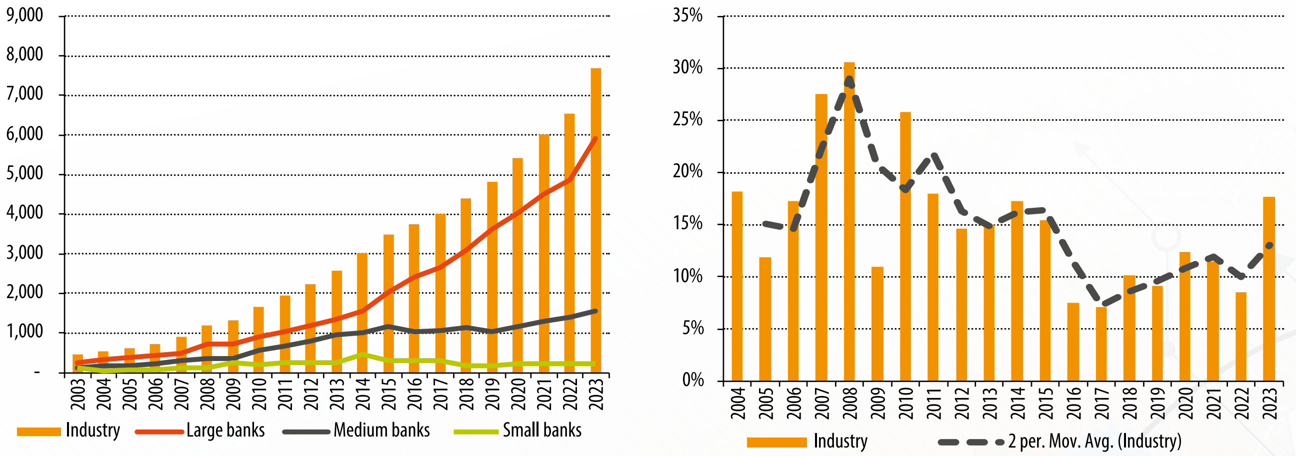
INDUSTRY GROWTH

2.1 Banking System Total Assets

The banking sector's asset base increased by Ksh. 1.2 trillion in 2023 to Ksh. 7.7 trillion (Figure 3a), representing a year-on-year growth of 17.6 percent in 2023, compared to the 8.5 percent growth reported in 2022 (Figure 3b). This growth reverses the modest growth experienced in 2022, putting the sector back on a double-digit growth trajectory, similar to the periods before 2015 and during 2020-2021 era. At tier level, large banks saw their assets rise from Ksh. 4.9 trillion in 2022 to Ksh. 5.9 trillion in 2023, reflecting a significant growth rate of 21.8 percent in 2023. Similarly, medium and small banks registered growths in their asset base, by 11.5 percent and 5.0 percent, respectively. In quantum terms, the total assets for medium and small banks stood at Ksh. 1.5 trillion and Ksh. 221.0 billion in 2023, respectively.

Figure 3: Banking System Total Assets

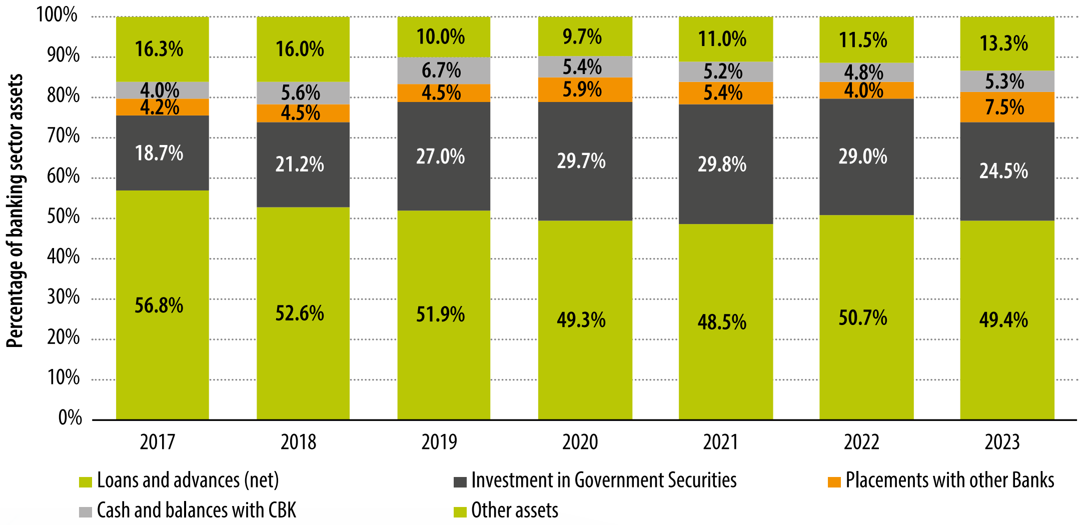
3(a): Total Assets, Annual (Ksh. Billion) | **Figure 3b. Y-o-Y growth in assets**



Source: KBA

In terms of the asset structure, the sector has remained diversified, with notable shifts towards placements with other banks and other assets becoming more evident in 2023. This shift reflects portfolio adjustments driven by the operating environment and individual bank strategies in response to emerging challenges in the credit market and their varying risk appetites. First, loans and advances (net) which has consistently formed the largest portion of assets, grew from 48.5 percent in 2021 to account for 50.7 percent in 2022 before slightly decreasing to 49.4 percent in 2023. Investment in government securities, however, showed a declining trend, from 29.8 percent in 2021 to 29.0 percent in 2022, and a further dropping to account for 24.5 percent in 2023. Placements with other banks fluctuated, decreasing from 5.4 percent in 2021 to 4.0 percent in 2022, then rising to 7.5 percent in 2023. Other assets increased steadily from 11.0 percent in 2021 to 13.3 percent in 2023 **(Figure 4)**.

Figure 4: **Disaggregated Asset Structure of the Kenyan Banking System**

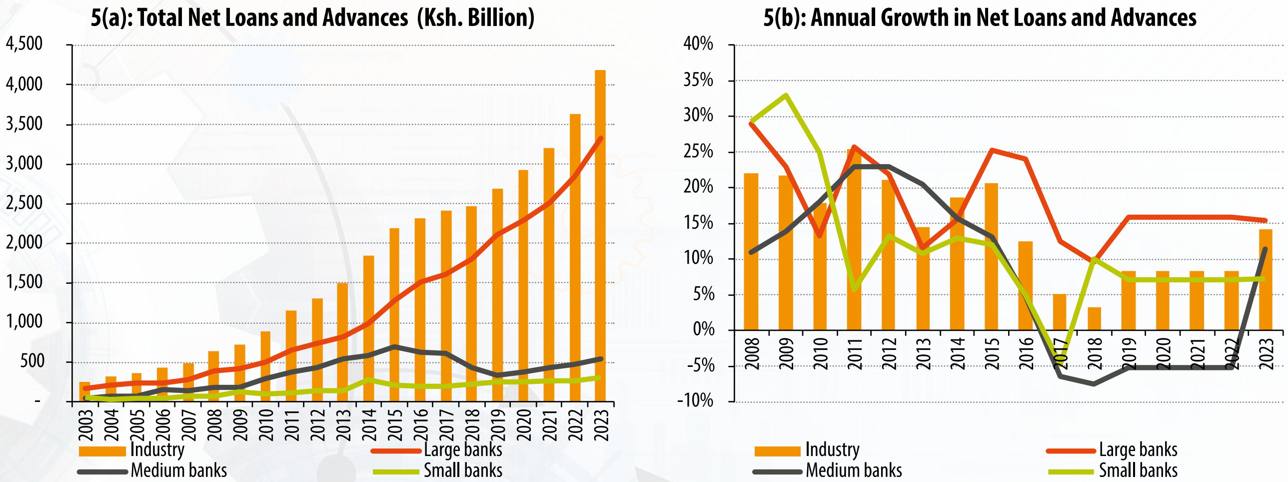


Source: KBA

2.2 Banking System Loans and Advances

The growth in banking system's gross lending remained entrenched on a double-digit level for the second consecutive year, significantly higher than the single-digit levels recorded between 2016 and 2021. Loans and advances (net) grew by 15.3 percent in 2023, to close at Ksh. 4.18 trillion from Ksh. 3.63 trillion in 2022 **(Figure 5a).** While the industry mirrored the overall market trend on the growth of loans and advances, heterogeneity across banks was evident. Among the large and medium banks, which jointly accounted for 91.31 percent of total industry loans in 2023, grew by 17.4 percent and 13.8 percent, respectively. Loans and Advances by small banks grew by 13.8 percent over the period **(Figure 5b)**.

Figure 5: **Banking System Loans and Advances**



Source: KBA

The growth in industry loans and advances was broad-based, and largely driven by growth observed in the Financial Services, Agriculture, Trade and Manufacturing, on account of increased credit demand in services and productive sectors to support the working capital needs **(Table 2)**. However, the capacity of a bank to grow its loans in 2023 was largely determined by its capital to asset ratio position, such that banks with higher capital ratios generally recorded higher loan growth compared to those with lower capital ratios **(Figure 6)**. Aligned to recent studies [e.g. Gambacorta, L., & Shin, H. S. (2018)[5]] banks with higher capital ratios tend to have a greater capacity to lend, because they are better able to absorb potential losses, which reduces their risk of insolvency and regulatory pressures.

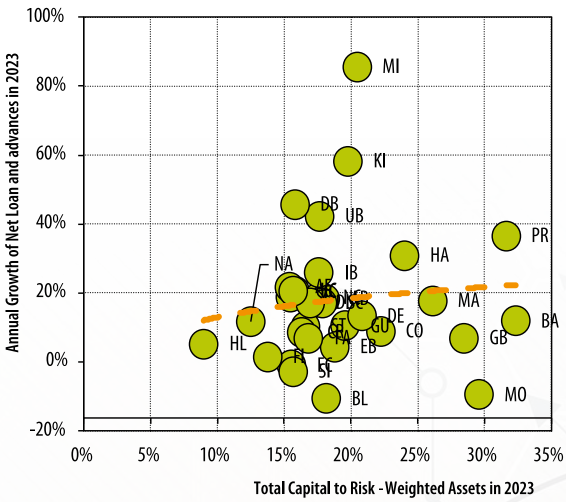
Figure 6: Sectoral Loan Distribution, Loan growth and capital ratio

Table 2: Banking System Sectoral Loan growth rate (%), December 2022 – December 2023

	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Agriculture	4.2	1.9	4.2	4.3	11.5
Manufacturing	3.7	3.7	6.8	6.2	2.7
Trade	-1	3.6	1	3.4	4.5
Building and construction	-2.1	4	1.4	4.5	-1.5
Transport & communications	3.3	6.5	3.1	4.5	5.3
Finance & insurance	6.5	23.4	1.3	5.8	21.2
Real estate	2.1	-0.8	2.4	3.7	1.7
Mining and quarrying	9	3	-13.1	23.8	3.9
Private households	1.8	2	0.9	2.1	-2.4
Consumer durables	2.8	3.4	2.7	1.3	2.2
Business services	5	2.6	2.6	1	1.3
Other activities	0.1	-6.1	14	-7.4	17.5

Source: CBK

6(b): Association between Capital-to-Asset ratio and Loan Growth



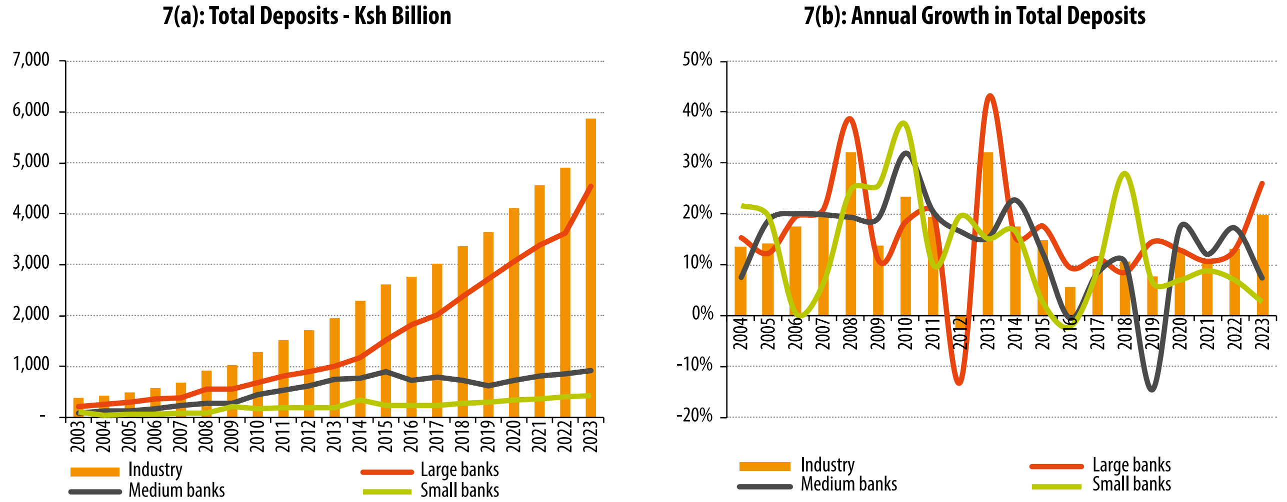
Source: KBA

2.3 Banking System Deposits

In 2023, growth in banking system deposits showed a significant improvement, building on the growth momentum posted since 2020, when it grew more than reversing the single digit growth registered between 2016 and 2020. The pick up of momentum in the growth of banking system deposits – an important source of working capital for banks – has been catalysed by the mobilization of deposits through mobile banking and internet/ online banking platforms, a trend that has gained immense traction in the industry. Overall, industry deposits grew by 15.1 percent, surpassing the 13.1 percent growth in 2022 **(Figure 7a)**. Large banks experienced a notable increase, with their deposits growing from Ksh. 3.6 trillion in 2022 to Ksh. 4.5 trillion in 2023. Medium banks saw modest growth of 7.4 percent, rising from Ksh. 856.1 billion to Ksh. 919.29 billion. Small banks reported a similar pattern, with deposits increasing by 2.7 percent in 2023; a moderation from 7.0 percent in 2022 **(Figure 7b)**. The share of large banks to total deposits remains significant; its trend posing significant influence on the overall deposits growth.

5. Gambacorta, L., & Shin, H. S. (2018). Why bank capital matters for monetary policy. Journal of Financial Intermediation, 35, 17-29. (See the paper here: https://doi.org/10.1016/j.jfi.2016.09.005)

Figure 7: **Banking System Deposits**

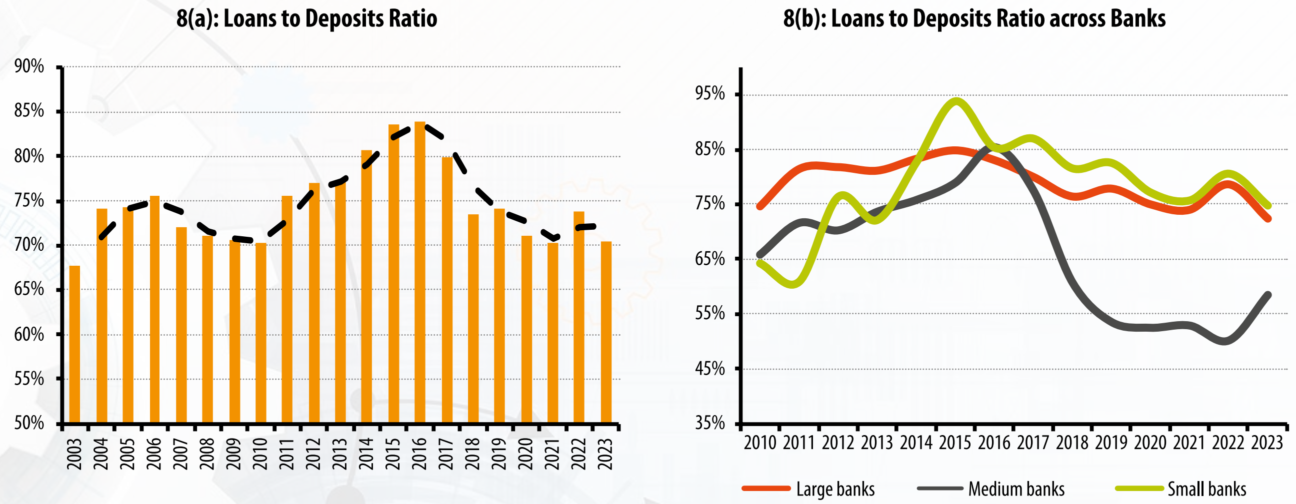


Source: KBA

2.4 Banking System Loan-to-Deposit Ratio

Bank's loan-to-deposit ratio, which measures structural liquidity profile, in 2023 stood at 71.1 percent compared to 73.7 percent in 2022, reflecting a faster build up in banking systems deposits growth—which grew by 15.34 percent – outpacing the growth in gross loans (which grew by 12.89 percent) **(Figure 8a)**. The loan-to-deposit ratio remained the highest among small banks, at 74.8 percent compared to 78.9 percent in 2022 mirroring slower growth in gross loans. Additionally, medium banks saw their loan-to-deposit ratio rise to 58.4 percent in 2023, as large-sized banks' ratio declined to 74.8 percent in 2023 **(Figure 8b)**.

Figure 8: **Banking System Loan-to-Deposit Ratio**

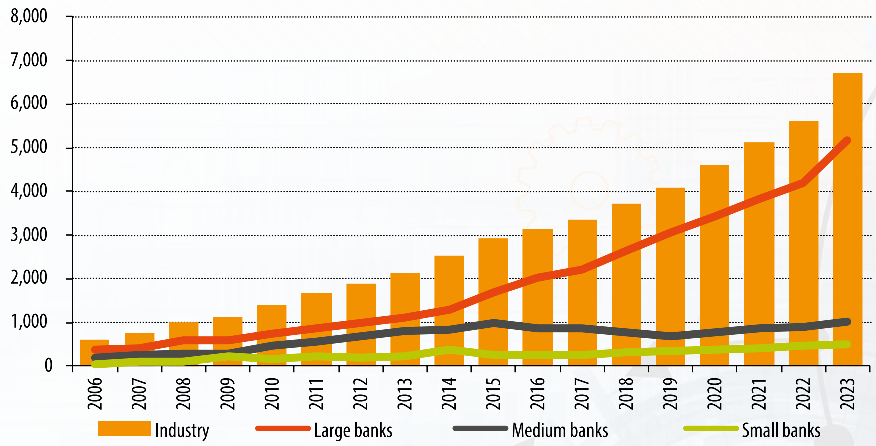


Source: KBA

2.5 Banking System Liabilities

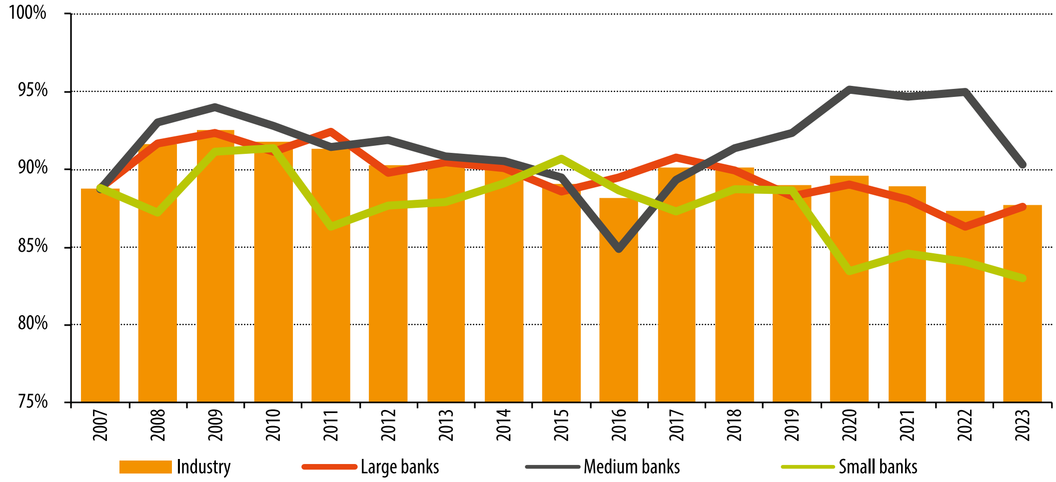
The banking system's liabilities, which are largely customer deposits, surged by 19.3 percent to Ksh. 6.7 trillion, a pointer to heightened deposit mobilization strategies. Mirroring this growth, strong growth was evident across the bank tiers, where liabilities of the large banks increased from Ksh. 4.1 trillion in 2022 to Ksh. 5.2 trillion in 2023, while the medium banks recorded 13.0 percent growth in their liabilities, rising from Ksh. 901 billion in 2022 to Ksh. 1,018 billion in 2023. However, small banks saw more modest growth, with liabilities increasing from Ksh. 481 billion in 2022 to Ksh. 500 billion in 2023 **(Figure 9)**; reflecting fewer differences that characterised competition for deposits.

Figure 9: Banking System Liabilities



Source: KBA

Figure 10: **Banking System Deposit-to-Liability Ratio**



Source: KBA

2.6 Banking System Deposit-to-Liability Ratio

The deposit-to-liability ratio in the banking system, which indicates how much banks rely on wholesale funding to reduce costs on the liability side of their balance sheets, remained relatively stable. The ratio stood at 87.3 percent in 2022 compared to 87.7 percent in 2023 **(Figure 10)** reflecting banking sector reliance on deposits to fund its operations/intermediation functions. However, a mixed trend was evident across bank tiers, with large banks mirroring industry trends, by marginally rising from 86.3 percent in 2022 to 87.6 percent in 2023. In contrast, the ratio declined among the medium-sized and small banks, to 90.3 percent and 83.0 percent in 2023, respectively.

2.7 Banking Sector Market Structure

The banking sector demonstrated remarkable resilience in 2023, with its assets constituting 49.90 percent of GDP, a rise from 48.93 percent in 2022. This upward trend is mirrored by the sector's credit book, which stood at 27.13 percent of GDP in 2023. On the liabilities side, the deposits-to-GDP ratio climbed to 35.08 percent in 2023, reflecting a notable increase from the previous year's 35.08 percent.

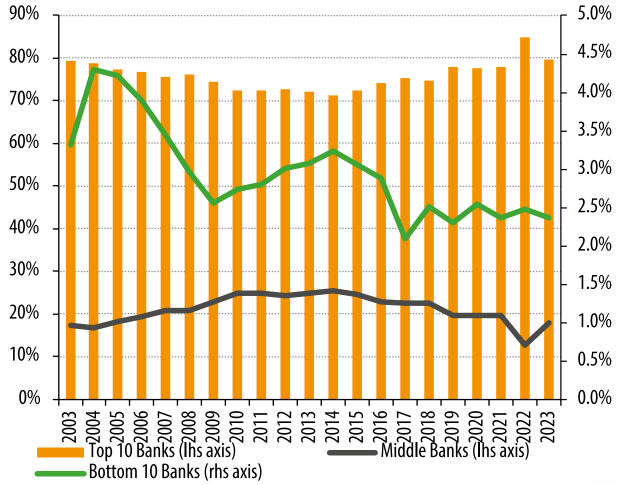
Amidst these growths, the top 10 banks have consistently remained dominant, holding a significant share of total industry assets (with a 20-year average of 75.9 percent, and 79.6 percent in 2023, down from 84.9 percent in 2022), with the rest being accounted by middle-tier banks (18.0 percent) and small-tier banks (2.4 percent) in 2023 **(Figure 11a)**. Similarly, loan concentration remained striking in 2023, with the top 10 banks maintaining over 80 percent of total loans **(Figure 11b)**, pointing to the significant lending power held by large banks in influencing credit allocation and market dynamics within the banking sector. On the liability side, deposit concentration also demonstrated a notable trend towards consolidation among the top banks, rising from 77.7 percent in 2022 to 80.2 percent in 2023 **(Figure 11c)**. These developments on the liability side characterize the banking sector in respect to the dominance in deposit concentration among large banks that highlight the preference of depositors towards larger, possibly driven by perceptions of safety and broader service offerings.

However, the overall market concentration in Kenya's banking sector, measured by the Herfindahl-Hirschman Index (HHI)[6], peaked at 909.4 in 2022 before declining to 852.96 in 2023 **(Figure 11d)**. The index remains below the critical 1,000 threshold, suggesting a moderately competitive environment.

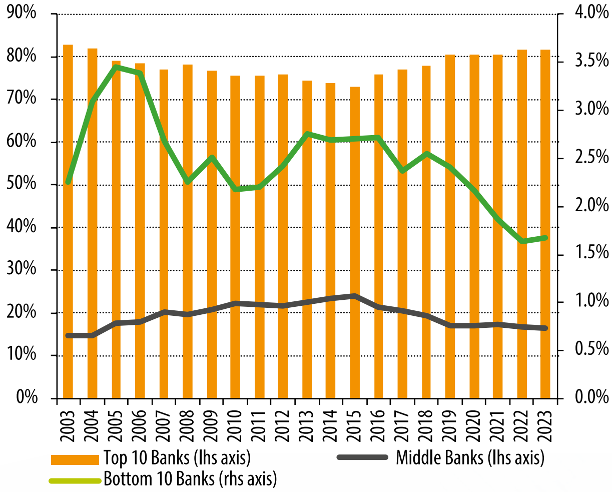
6. The Herfindahl-Hirschman Index (HHI) -attributed to the U.S Department of Justice - is a measure of the level and trend of concentration in a particular market. The HHI is calculated by squaring each entity's market share (relative to the total market), and summing the values attained. The U.S. Department of Justice considers a market with an HHI of less than 1,500 to be a competitive marketplace, an HHI of 1,500 to 2,500 to be a moderately concentrated marketplace, and an HHI of 2,500 or greater to be a highly concentrated marketplace.

Figure 11: **Banking Sector Market Structure**

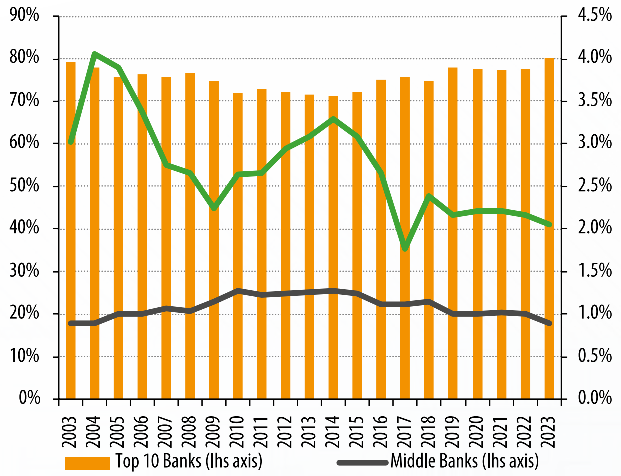
11(a): Concentration of Assets



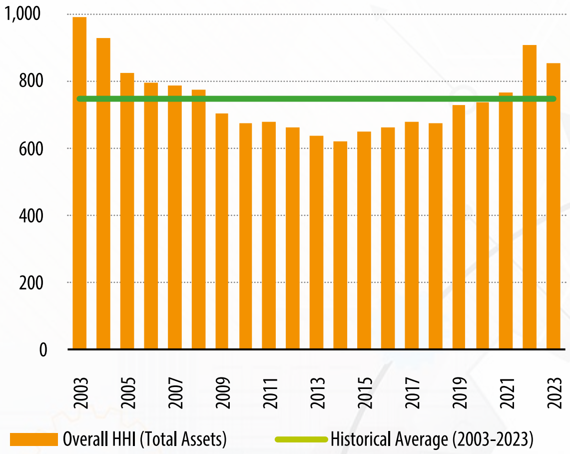
11(b): Concentration of Loans



11(d): Concentration of Deposits



11(d): Banking System Concentration (HHI)



Source: KBA

Chapter 3:

ASSET QUALITY

3.1 Asset Quality

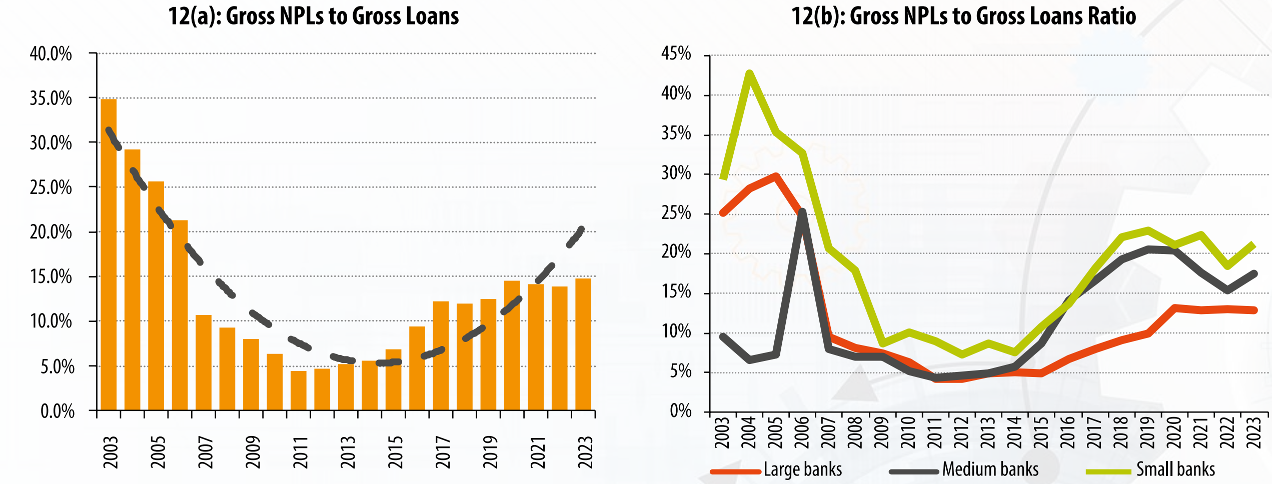
Driven by adverse business conditions during the year, the assets quality deteriorated slightly in 2023. The stock of non-performing loans (NPL) in the banking system continued to edge upwards during the period, to approximately Ksh. 621.3 billion from Ksh. 503.2 billion in 2022 **(Figure 12a)**, and as a share of gross loans, it stood at 14.8 percent, the highest since 2007. That elevated NPLs triggered risk averseness among banks and consequently led to a decline in credit growth to the private sector.

NPLs' distribution across banks was heterogeneous across all bank tiers. Among large banks, the rate of growth of gross NPLs in 2023 was 12.8 percent, as the NPLs among medium and small banks grew to 17.5 percent and 21.3 percent, respectively **(Figure 12b).** The evolution of non-performing loans (NPLs) in the industry, particularly with foreign currency-denominated loans, reflected an elevated credit risk in the economy, necessitating the adoption of several bank-level strategies to mitigate further deterioration of bank assets: Higher provisions were implemented to cushion against potential losses as early collections were prioritized to address overdue payments and management of portfolios was strengthened from an early stage to identify and address risks sooner.

At the sectoral portfolio level, asset quality was also non-homogeneous with building and construction (whose NPL ratio stood at 25.9 percent), Manufacturing (20.9 percent), Real Estate (20.0 percent), Trade (17.4 percent), Mining and Quarrying (16.5 percent), Agriculture (15.5 percent), Tourism, Restaurant and Hotels (14.1 percent), Transport and Communication (12.2 percent), Energy and Water (10.8 percent), Personal and Household (14.8 percent) and Financial Services (21.9 percent) having the

> **Among large banks, gross NPLs grew by 12.8 percent in 2023, as medium and small banks grew to 17.5 and 21.3 percent**

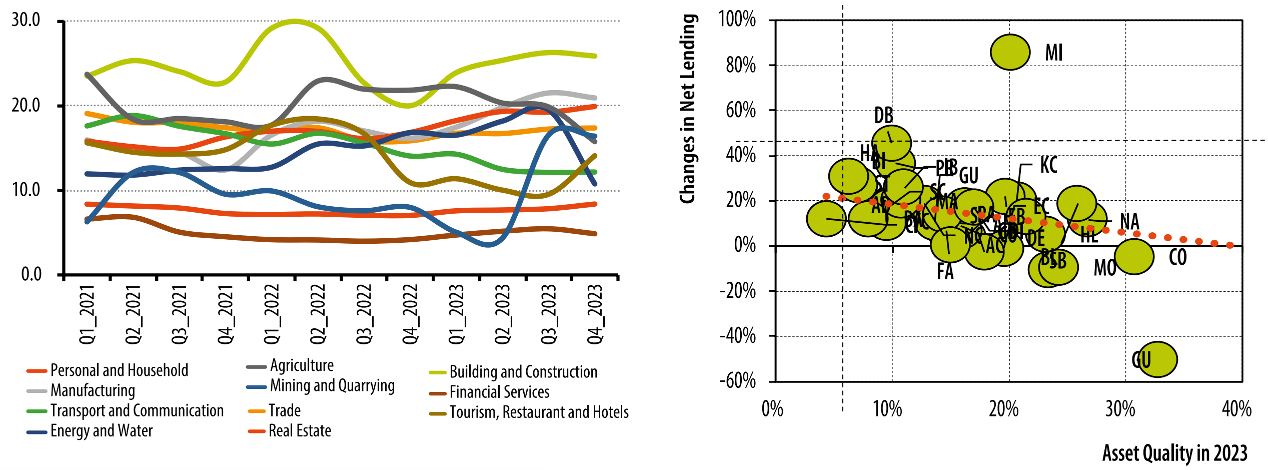
Figure 12: Banking System Gross Non-Performing Loans to Gross Loans



Source: KBA

Figure 13: **Banking System Sectoral Asset Quality in 2023**

13(a): Sectoral Asset Quality (Ratio of Gross NPLs to Gross Loans) **13(b): Asset quality and loan growth correlations**



Source: CBK

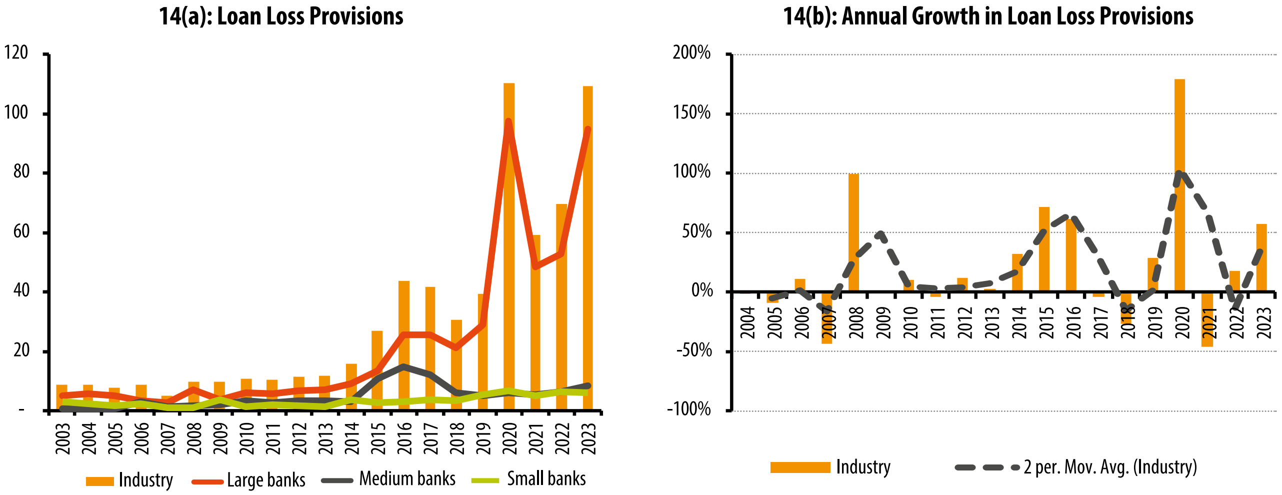
bulk of the deteriorating assets **(Figure 13a).** In effect, this had profound implications on the banking sector mainly in three fronts hindering banks from allocating credit in the economy. This was primarily through its effects in reducing bank profitability, increasing loan loss provision , and increased funding costs from counter-parties. Meanwhile, write-downs and write-offs deplete capital. Moreover, NPLs crowd out new lending, as banks saddled with elevated NPLs have a constrained capacity to extend new credit **(Figure 13b).**

3.2 Loan Loss Provisions

Due to the adverse business conditions and deteriorating quality of assets held by banks, the provisioning for loan losses (LLPs) expanded sizably in 2023 compared to 2022. However, it remained slightly lower than the peak levels recorded in 2020 during the COVID-19 pandemic. In 2023, the loan loss provisions stood at Ksh. 109.51 billion compared to Ksh. 68.8 billion in 2022 **(Figure 14),** representing a 59.17 percent growth on a year on year basis, mainly driven by a 67.3 percent expansion among large banks, as small and medium banks carried somewhat modest expansions (24.2 percent and 15.7 percent, respectively) as banks took measures to aver expected credit losses in late 2023 and 2024.

Notable changes in loan loss provisions relative to total loans and risk-weighted assets were evident in the sector. First, the analyses of loan loss provisions as a proportion of the net loans and advances (that is, the cost of risk) shows that LLPs covered 2.9 percent of net loans in 2023 compared to 2.1 percent in 2022, with the cost of risk varying widely across banks. More specifically, small, medium, and large banks depict LLPs ratios of 2.2 percent, 1.8 percent, and 3.1 percent of net loans, respectively **(Figure 15a).**

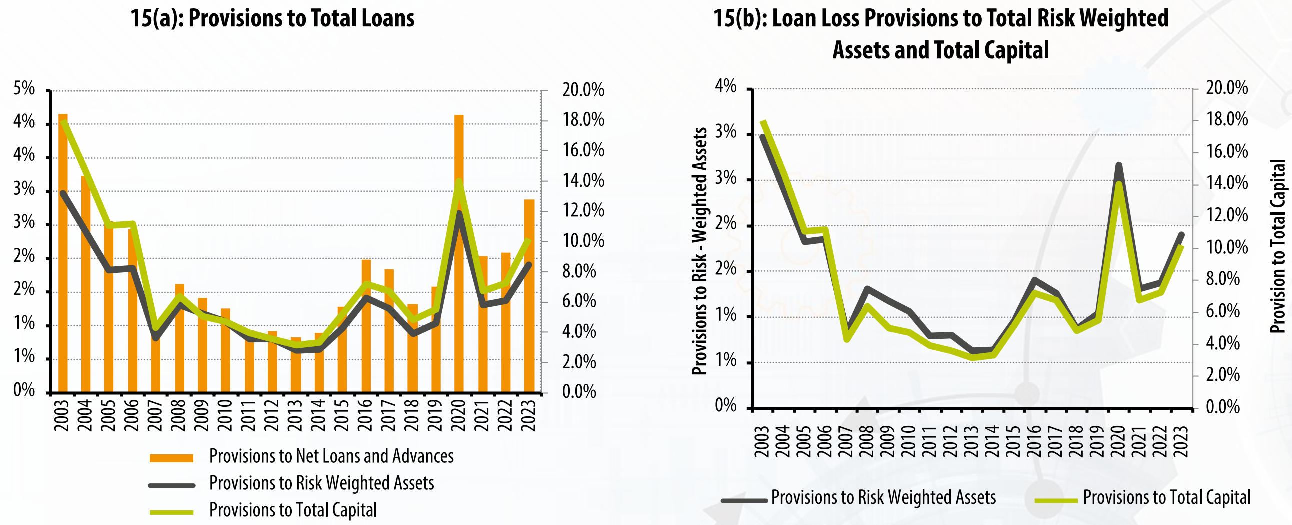
Figure 14: Banking System Loan Loss Provisions



Source: KBA

Second, as a proportion of total risk-weighted assets, provisions in 2023 stood at 1.9 percent compared to 1.4 percent in 2022; with the rise mainly driven by a significant rise in provisions. In the case of large banks, the ratio of total provisions to total risk-weighted assets stood at 1.7 percent, as medium and small banks had 1.2 percent and 1.7 percent, respectively. With the total provisions surging significantly, the ratio of provisions to total capital equally went up to 10.2 percent in 2023 from 7.2 percent in 2022 **(Figure 15b)**. Across banks, the ratio of total provisions to total bank capital stood at 11.3 percent, 5.1 percent, and 8.9 percent for large, medium and small banks, respectively; reflecting increasing significance of provisions affecting capitalisation of banks should loan losses materialise.

Figure 15: Banking System Coverage Ratio

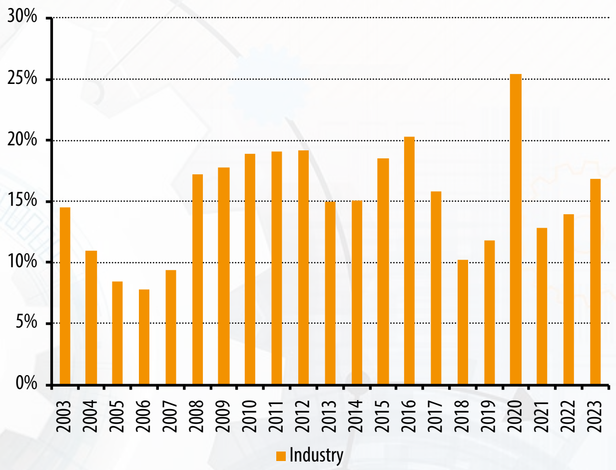


Source: KBA

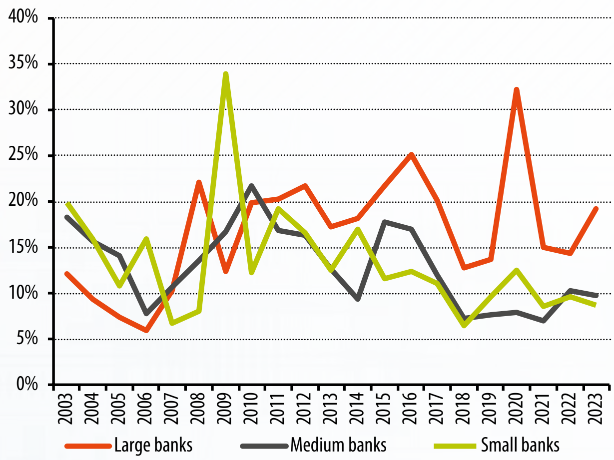
The industry-wide provisions to NPLs ratio increased from 13.9 percent in 2022 to 16.9 percent in 2023 **(Figure 16a),** pointing to the heightened focus by banks on credit risk management. However, this trend varied across the bank sizes, with large banks, on one hand, reporting a rise in provision from 14.3 percent in 2022 to 19.3 percent in 2023. On the other hand, medium and small banks experienced a slight decline to post 9.7 percent and to 8.7 percent , respectively, in 2023 **(Figure 16b).** The diversity reflects banks' heterogeneities and uniqueness of NPLs exposure, as well as assessments on potential recoveries across assets and asset classes.

Figure 16: Banking System's Provisions to Non-Performing Loans Ratio

16(a) Provisions to NPLS (By Industry)



16(b) Provisions to NPLS (By bank tiers)



Source: CBK

3.3 Capital Adequacy

The banking sector reported strong capital positions, which enabled the sector to absorb the impact of elevated credit risks without triggering systemic instability. As shown in **Table 3,** the ratio of total capital to the total risk-weighted asset declined from 19.0 percent in 2022 to 18.6 percent in 2023, supported by an increase in the total capital growth (21.65 percent) which outpaced the growth in total risk-weighted assets (18.72 percent) during the period. The ratio of core capital to total risk-weighted assets and core capital to total deposits stood at 15.8 percent and 15.4 percent, respectively. At a disaggregate level, large banks registered core capital/TRWA ratio of 15.4 percent and a total capital/TRWA ratio of 18.4 percent, with core capital to total deposits at 17.1 percent. Medium banks show higher ratios at 21.1 percent and 22.6 percent respectively, but lower core capital/total deposits at 15.9 percent. Small banks ratios stood at 19.2 percent, 19.5 percent, and 16.2 percent, respectively **(Figure 17).**

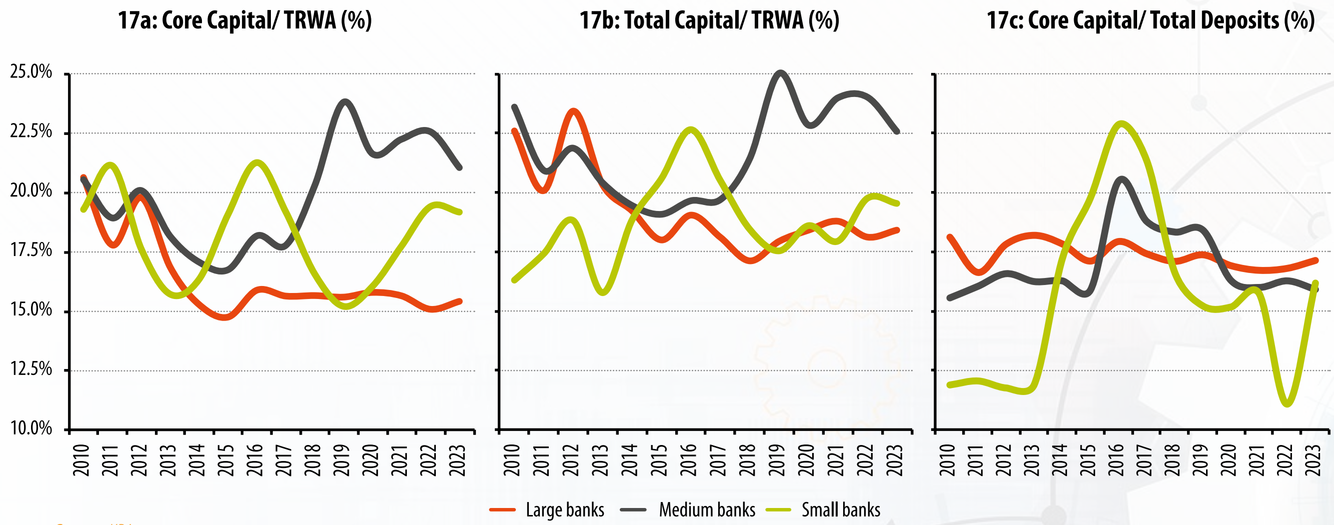
Table 3: Capital Adequacy

	2017	2018	2019	2020	2021	2022	2023	Min. Capital Adequacy Ratios (%)
Total Capital/ TRWA (percent)	18.7	18.0	18.8	19.0	19.5	19.0	18.6	14.5
Core Capital/ TRWA (percent)	16.4	16.6	16.6	16.6	16.5	16.3	15.8	10.5
Core Capital/ Total Deposits (percent)	18.1	17.3	17.4	16.7	16.4	16.7	15.4	8.0

Notes: TRWA: Total-Risk-Weighted-Assets; CAR: Capital Adequacy Ratios

Source: KBA

Figure 17: Capital adequacy, by bank tiers



Source: KBA

Chapter 4:

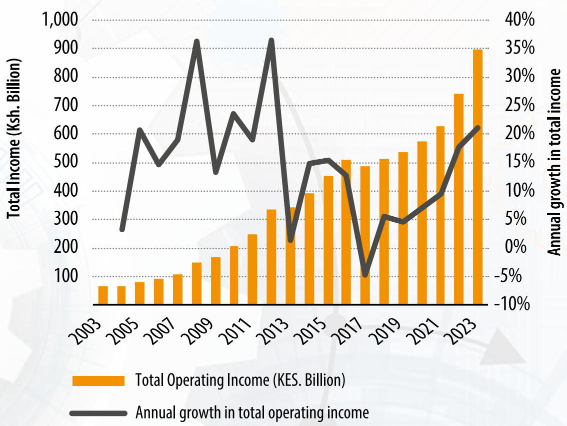
FINANCIAL PERFORMANCE

4.1 Operating Incomes

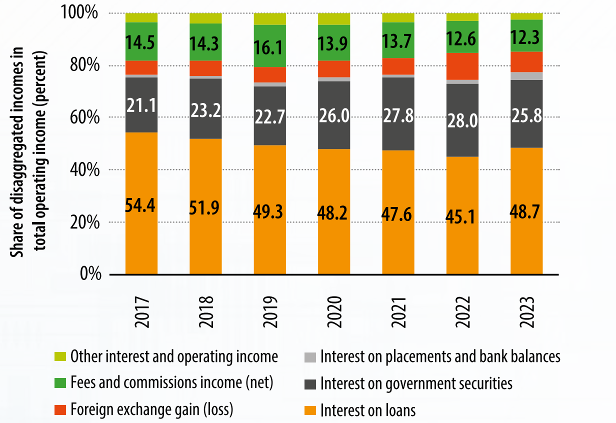
Total operating income sustained its growth momentum in 2023, rising by 21.0 percent, higher than 17.7 percent growth in 2022 (Figure 18a). The overall operating income growth reflects the impact of diversified income streams within the sector, but more importantly, robust loan growth and investments in government securities. Interest on loans remained the largest contributor to operating income in 2023, rising to account for 48.7 percent as interest from investments in government securities was the second-largest contributor, accounting for 25.8 percent. Fees and commission incomes

Figure 18: Banking System Operating Incomes

18a: Total Operating income (Ksh. Billion) and Annual Growth



18b: Share of Disaggregated Incomes in Total Operating Income



Source: CBK

were the third contributor at 12.3 percent of total incomes followed by foreign exchange gains at 7.8 percent. Other interest and operating income accounted for 2.5 percent of operating income **(Figure 18b).**

4.2 Operating Costs

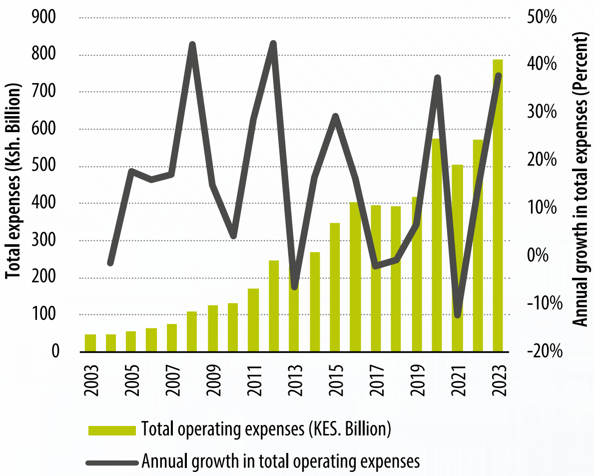
Driven by a rise in all cost components, somewhat in tandem with the rising operating income, the total operating expenses increased by 37.5 percent to Ksh 788.6 billion in 2023 **(Figure 19a).** Interest on borrowed funds, deposits & placements posted significant expansion, with a 148.3 percent growth (to Ksh. 36.72 billion in 2023), while general administrative expenses, interest on deposits, loan loss provisions and other interest & operating expenses were up by 61.0 percent, 42.7 percent, 28.5 percent and 17.3 percent, respectively. As a share of total cost, interest on deposits and loan loss provisions rose slightly to 27.7 percent and 13.9 percent, respectively, in 2023, while general administrative expenses and other interest and operating expenses' share in total costs decreased to 34.7 percent and 19.1 percent, respectively in 2023 **(Figure 19b)**.

4.3 Cost-to-Income Ratio

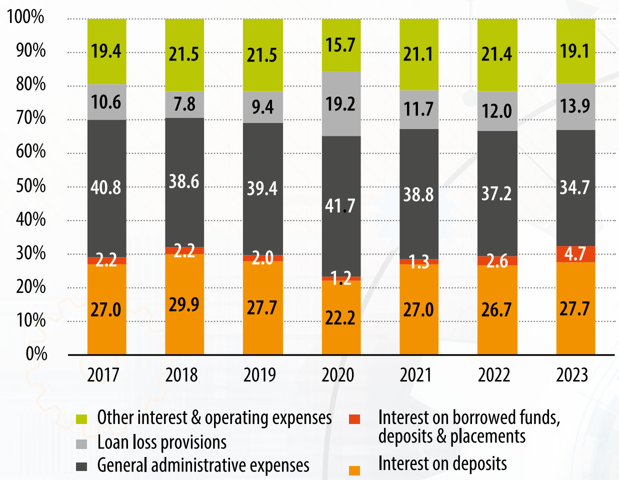
The cost-to-income ratio, a key indicator of efficiency and productivity for banks[7], deteriorated at the industry level reflected heterogeneity across bank tiers. At industry level, banks' aggregate cost-to-income deteriorated with costs

Figure 19: Banking System Operating Costs

19a: Total Operating Costs (Ksh. Billion) and Annual Growth



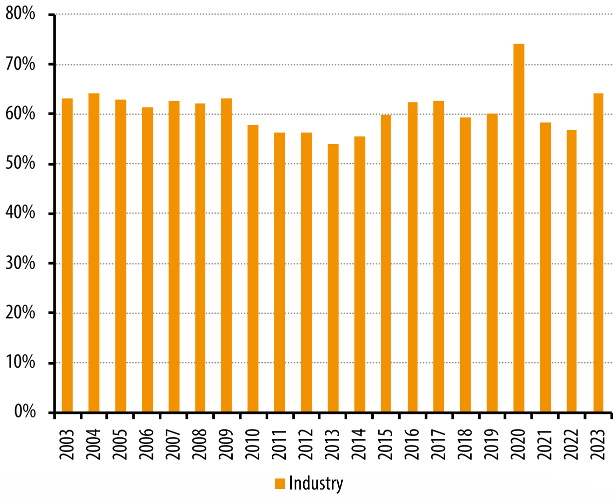
19b: Share of Disaggregated Costs in Total Operating Costs



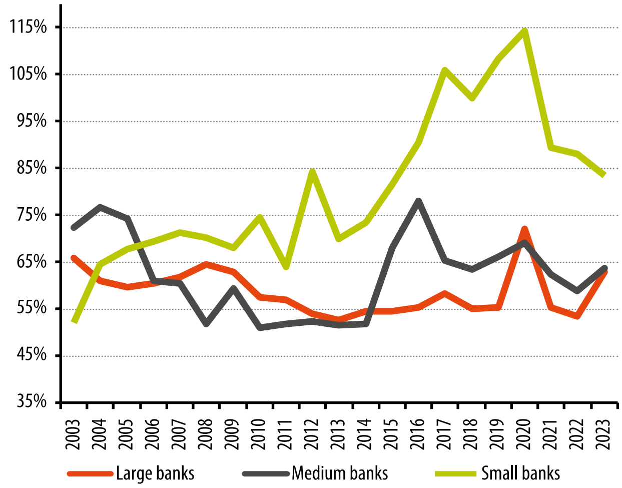
7. Lower cost-to-income ratios generally indicate higher efficiency. However, this ratio can be affected by several factors, such as the bank's business model and size.

Figure 20: Banking Sector Cost-to-Income Ratio

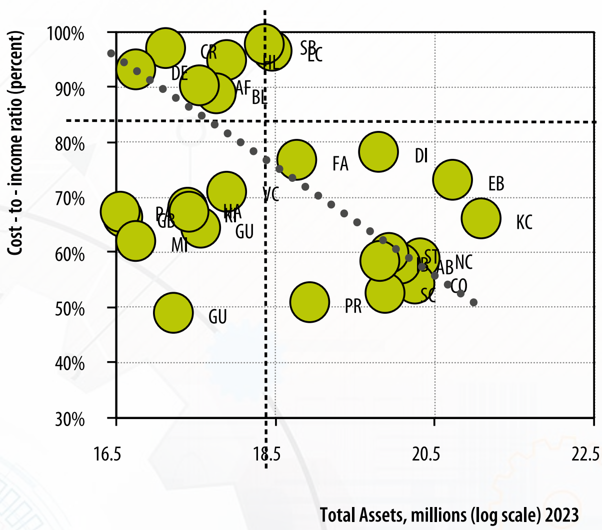
20a: Industry Cost-to-Income Ratio



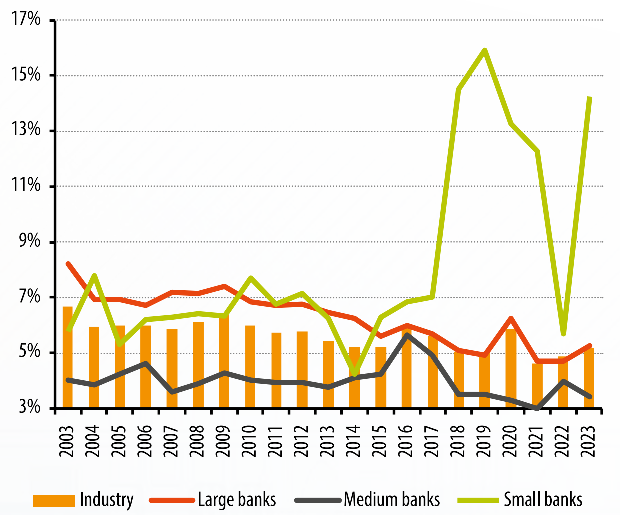
20b: Industry Cost-to-Income Ratio Across Bank Tiers



20c: Association between Bank Size and Cost-to-Income



20d: Cost-to-Asset ratio

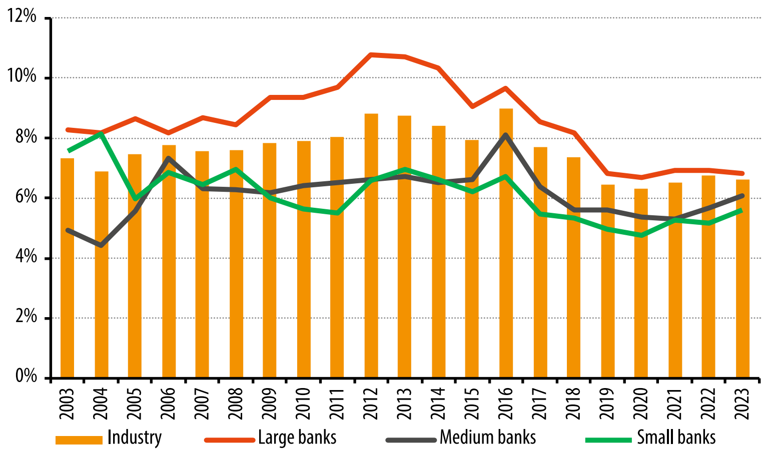


absorbing 64.2 percent of the incomes in 2023 compared to 56.7 percent in 2022 **(Figure 20a)**. Mirroring this trend, large and medium sized banks cost-to-income ratios deteriorated to 62.8 percent and 63.7 percent, respectively **(Figure 20b)**. In contrast, small banks improved their cost-to-income (CIR) ratios to 83.4 percent in 2023. Nonetheless, as **Figure 20c** shows, large banks posted the lowest cost-to-income ratios, pointing to two conceptually distinct, but closely related phenomena. First, consistent with the economies of scale hypothesis, larger banks tend to be more cost-efficient than smaller banks because they can spread overheads over a larger revenue base. Second, larger banks tend to operate closer to the production frontier, in that they have the capacity to incur costs beyond the minimum necessary to sustain output at a certain level. Overall, however, the industry cost-to-assets ratios remained relatively stable in the last five years, with total costs absorbing 5.16 percent of assets in 2023 **(Figure 20d).**

4.4 Net Interest Margin

Banking sector's net interest margin (NIM) declined slightly from 6.8 percent in 2022 to 6.6 percent in 2023, suggesting a modest surge in industry competitiveness consistent with the drop in HHI index (by assets). However, this trend varied significantly across different bank tiers. Large banks experienced a slight decrease, with their NIM falling to 6.8 percent in 2023 from 7.2 percent in 2022. Smaller banks, on their part, dropped to 5.6 percent in 2023 from 5.2 percent in 2022. Conversely, medium-sized banks, NIM saw an increase to 6.1 percent, up from 5.6 percent in 2022 **(Figure 21).**

Figure 21: Banking Sector Net Interest Margin

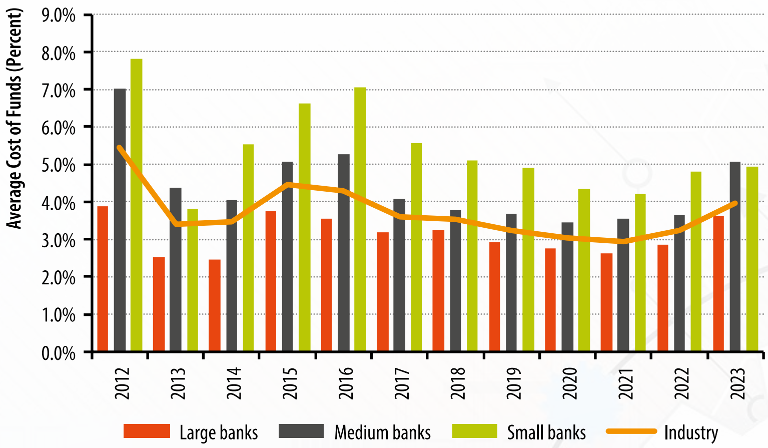


4.5 Cost of Funding

The average banking sector's funding costs rose marginally in 2023, reflecting the pass-through effects of the tight monetary conditions that prevailed particularly in the second half of year. The average industry cost of funds increased to 3.95 percent in 2023, up from 3.14 percent in 2022 **(Figure 22)**, thereby reversing the declining trend recorded since 2015.

Large banks posted a notable increase in the cost of funds, rising to 3.63 percent in 2023 from 3.02 percent in 2022, albeit remaining below the industry average, as medium and small-sized banks also experienced a significant rise in funding costs, increasing to 5.07 percent in 2023 from 3.67 percent in 2022, and from 4.82 percent in 2022 to 4.95 percent in 2023, respectively. Unlike the large-sized banks, medium and small banks face challenges in cost efficiently mobilizing retail deposits that are often cheaper than wholesale deposits, and in accessing non-deposit funding avenues, such as specialized lines of credit and capital markets.

Figure 22: Banking System Cost of Funding

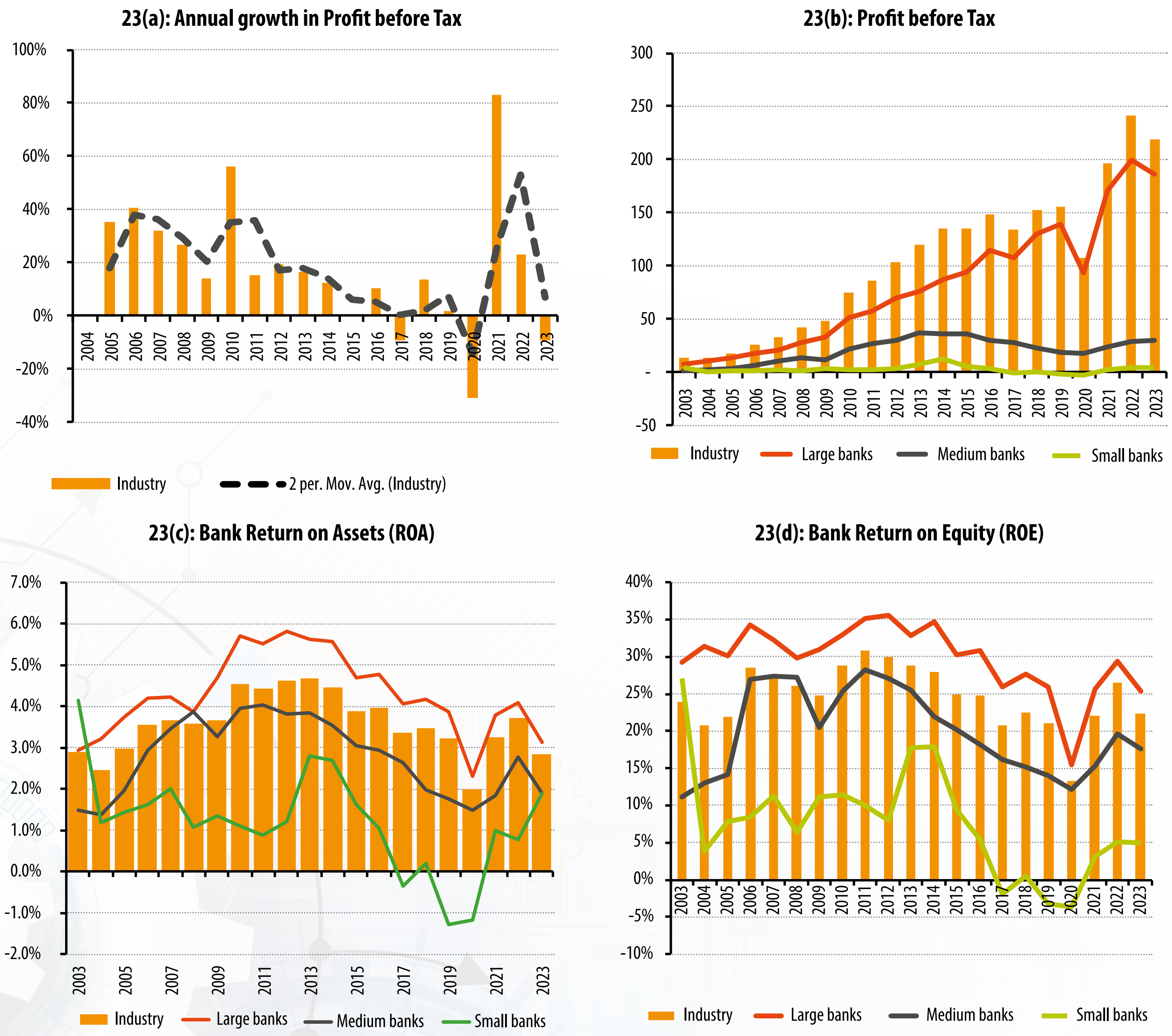


4.6 Profitability

The industry's total pre-tax profits declined by 9.1 percent to Ksh. 219.21 billion in 2023 from Ksh. 241.52 billion in 2022 **(Figure 23a).** Across banks, divergences were evident, with the pre-tax profits among small banks declining to Ksh. 4.21 billion in 2023 from Ksh. 4.26 billion in 2022, while medium bank's profits grew by 0.7 percent to Ksh. 29.36 billion over the period. Pre-tax profits for the large banks during the period declined by 10.8 percent to Ksh. 185.65

billion in 2023 from Ksh. 208.1 billion in 2022 **(Figure 23b).** At an industry level, these developments translated to an average return on assets (ROA) of 2.9 percent in 2023 down from 3.7 percent in 2022, and an average return on equity (ROE) of 22.33 percent in 2023 compared to 26.55 percent in 2022. The return on assets and equity also varied across banks. Large banks in 2023 posted 25.35 percent average ROE and 3.14 percent average ROA, while ROE and ROA for the medium and small banks, respectively stood at 17.69 percent and 1.90 percent for medium banks, and 5.04 percent and 1.90 percent for the small banks in 2023 **(Figure 23c** and **Figure 23d).**

Figure 23: Banking System Profitability

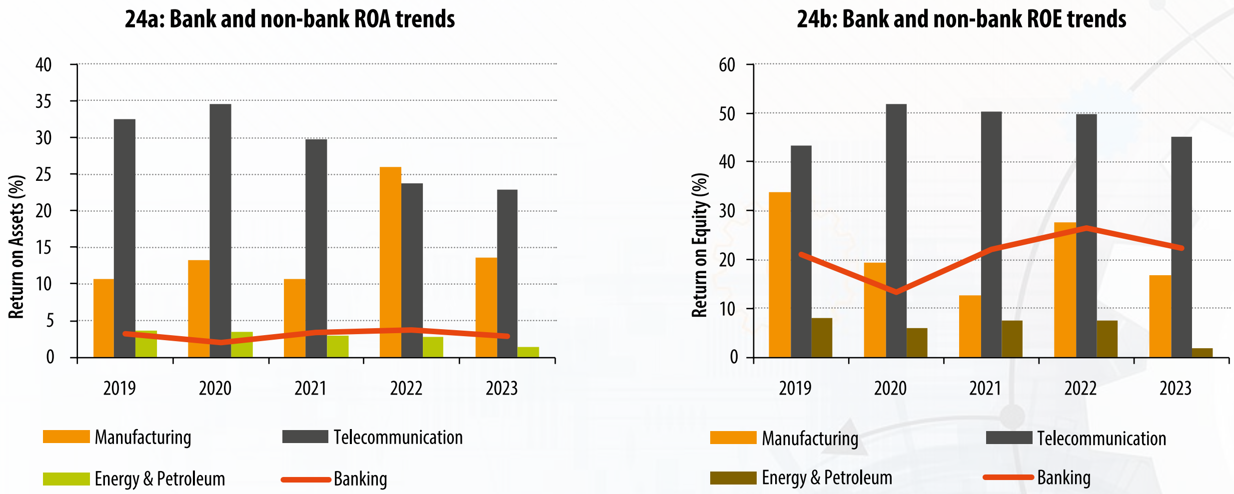


4.7 Bank versus non-bank performance analysis

The banking sector Return on assets and Return on Equity continues to trail the telecommunication and manufacturing sectors (Figure 24). In 2023, the banking sector's ROA declined to 2.9 percent, reflecting increased competition and economic pressures. At the time, the manufacturing sector's ROA stood at 13.6 percent, amidst supply chain disruptions and inflation pressures that persisted during the year.

While the banking sector's ROA (2.9 percent} was lower than telecommunication (22.8 percent) and manufacturing (13.6 percent), it was higher than energy and petroleum sector's (1.4 percent). However, the sector's ROE (22.3 percent) was only lower than telecommunication sector's (45.1 percent) compared to manufacturing (20.1 percent) and energy and petroleum sector's (1.9 percent).

Figure 24: Return on asset and Return on Equity



Chapter 5:

PERFORMANCE OF DEPOSIT TAKING MICROFINANCE BANKS

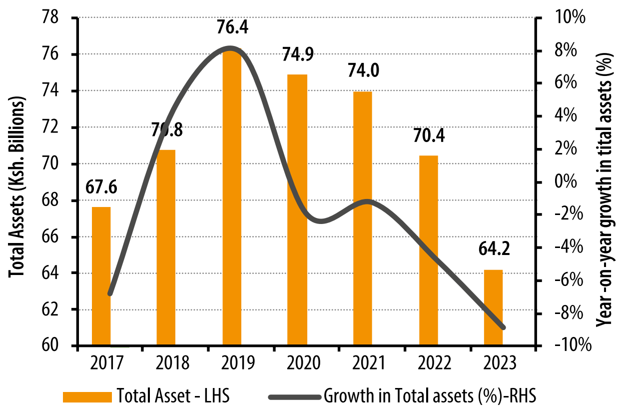
5.1 Assets, composition, and growth

The deposit-taking microfinance banks' (MFBs') total asset declined by 8.8 percent in 2023, marking the fourth consecutive year that it has been on a downward trajectory. The total assets stood at Ksh. 64.2 billion in 2023, compared to Ksh. 70.4 billion in 2023 in 2022 **(Figure 25a)**. This involved a steady decline in net loans and advances to customers that dropped to Ksh. 37.5 billion in 2023 from 39.3 billion in 2022 **(Figure 25b)**.

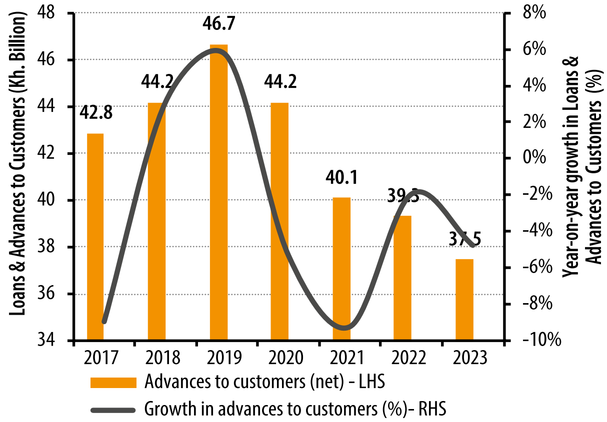
"The share of advances to customers (net) that stood at 58.4 percent of total assets in 2023, expanded by 2.5 percentage points compared from its share in 2022.

Figure 25: **MFB's assets, and asset growth**

25a: MFBs Total Assets, Annual (Ksh. Billion)



25b: MFBs Net loans to customers, Annual (Ksh. Billion)



Asset composition of deposit-taking microfinance banks, however, saw minimal changes over the year. The share of advances to customers (net) that stood at 58.4 percent of total assets in 2023, expanded by 2.5 percentage points compared from its share in 2022. This decline reflected less appetite by deposit-taking microfinance banks to hold short-term deposits with banks, as reflected by 3.5 percent contraction in deposits in 2023, that was driven by rising cost of funds against growing needs to remain liquid.

The share of MFBs' assets accounted for by investments in government securities remained stable at 7.0 percent in 2023 as cash and bank balances' share in total assets rose from 18.8 percent in 2022 to 19.5 percent in 2023 **(Figure 26)**.

Figure 26: **Dynamics of MFB's Asset Composition**

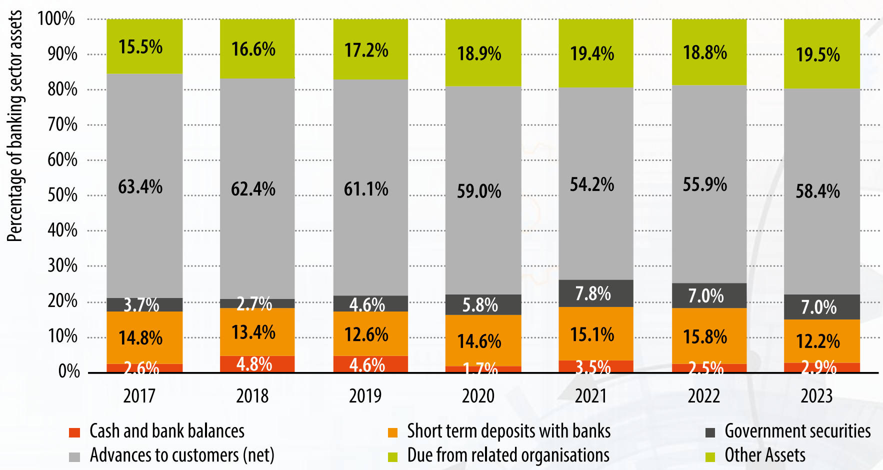
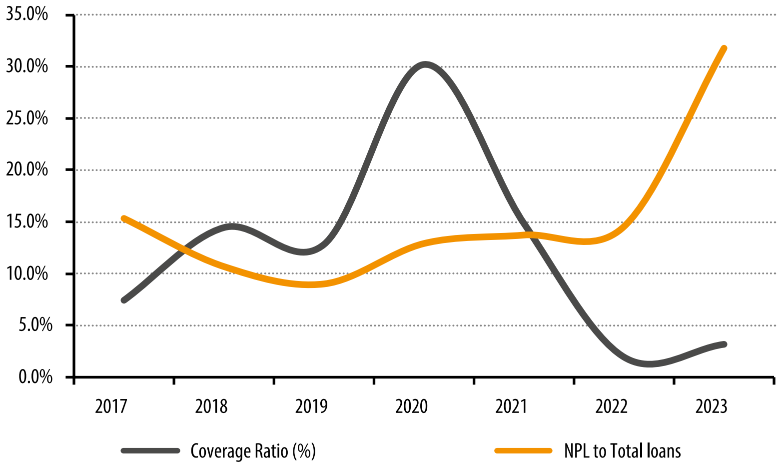


Figure 27: Asset Quality of Deposit-Taking MFBs, 2017-2023



Source: CBK

5.2 Asset Quality Dynamics

Asset quality of deposit taking microfinance banks deteriorated in 2023; with NPL's ration rising to 31.7 percent in 2023 from 14.5 percent in 2022. However, the sub-sector's coverage ratio – that is, provision for loan impairment as a proportion of net NPLs – increased to 3.2 percent in 2023, from 2.0 percent as at 2022 **(Figure 27)** reflecting measures taken by players to enhance stability amidst rising loan impairments.

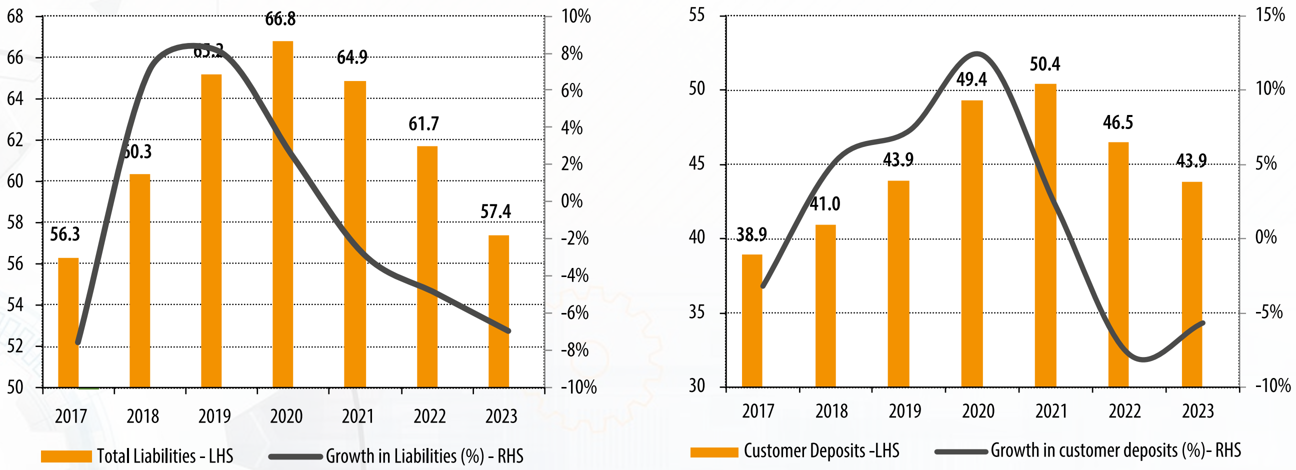
5.3 Liabilities, composition, and growth

The sector's total liabilities continued to decline in 2023; dropping by 6.93 percent to Ksh. 57.4 billion in 2023 from Ksh. 61.7 billion in 2022 **(Figure 28a)**. This largely affected a decline in customer deposits which fell by5.65 percent to Ksh. 43.9 billion in 2023 from Ksh. 46.5 billion in 2022 **(Figure 28b).**

Figure 28: MFB's liabilities, composition, and growth

28(a): MFBs Total Liabilities, Annual (Ksh. Billion)

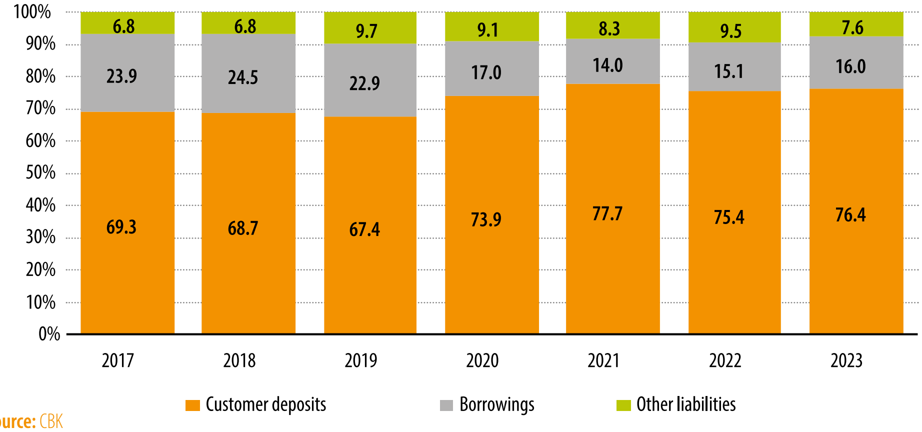
28(b): Customer Deposits, Annual (Ksh. Billion)



Source: CBK

The liability structure remained stable, with customer deposits representing 76.4 percent of the total liabilities, while borrowing and other liabilities accounted for 16.0 percent, and 7.6 percent respectively **(Figure 29)**.

Figure 29: MFB's Liability Structure

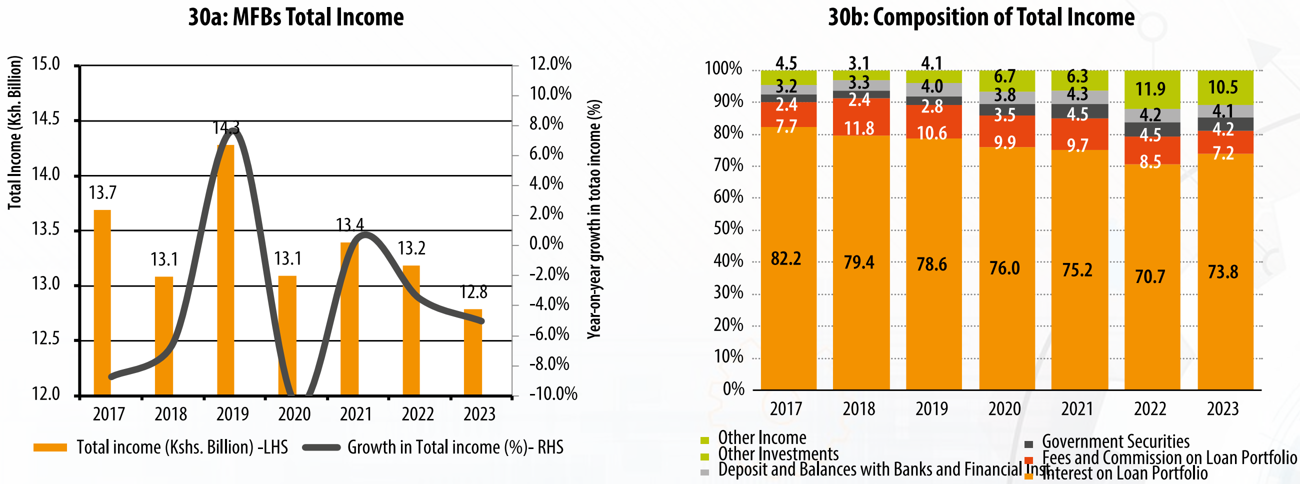


Source: CBK

5.4 Total income, growth, and composition

Total income in 2023 experienced a further decline of 3.0 percent, reducing to Ksh. 12.8 billion in 2023 from Ksh. 13.2 billion in 2022 **(Figure 30a).** The income structure remained relatively stable. Interest on loan portfolio accounted for 73.8 percent of the total income, as fees and commissions accounted for 7.2 percent, while income from investment in government securities accounted for 4.2 percent. Deposits and balances with banks and other financial institutions accounted for 4.1 percent in the year **(Figure 30b).**

Figure 30: MFB's incomes, composition, and growth

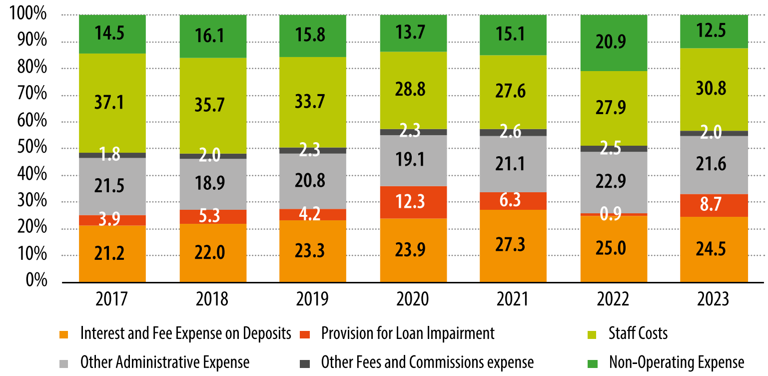


Source: CBK

5.5 Total expenses, composition, and growth

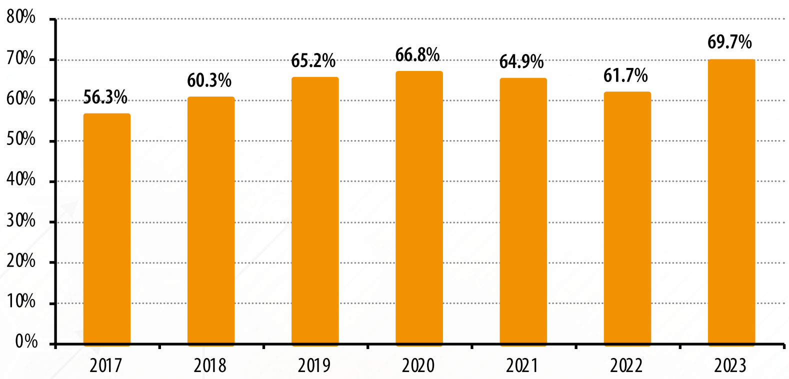
Total expenses edged upwards, rising by 6.25 percent to Ksh. 13.9 billion in 2023 from Ksh. 13.1 billion in 2022. Staff costs remained the largest component of expenses at 30.8 percent, followed by interest and fee expense on deposits at 24.5 percent, while other administrative expenses stood at 21.6 percent **(Figure 31)**

Figure 31: MFB's Expenses Compostion and Growth



Source: CBK

Figure 32: Cost-to-Income ratio of Deposit-Taking MFBs, 2017-2023



Source: CBK

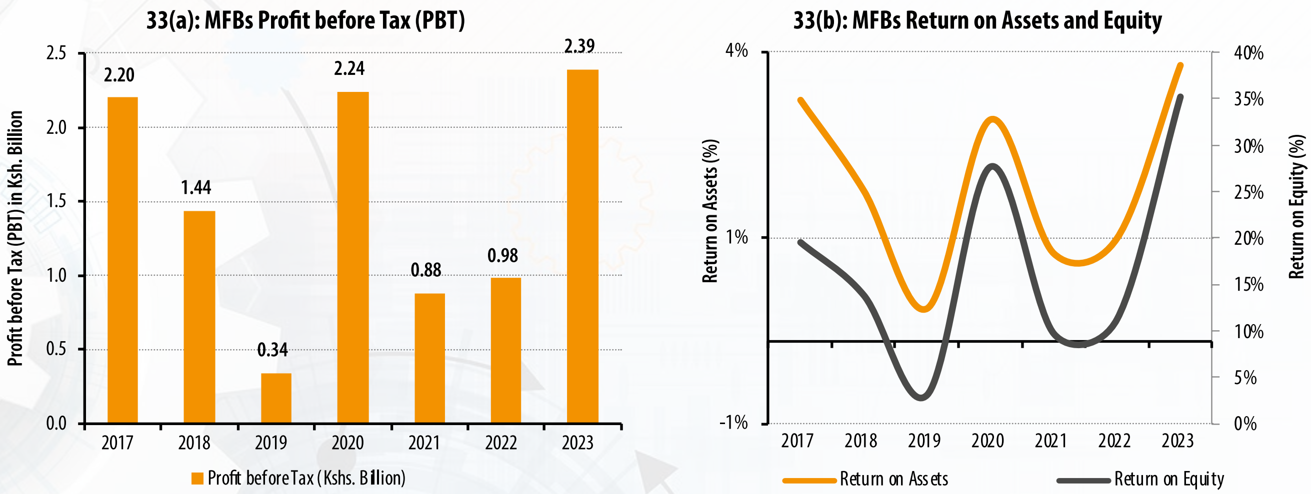
5.6 MFBs Cost-to-income ratio

The cost-to-income ratio of deposit taking microfinance banks deteriorated reflecting reduction in efficiency and productivity in the sub-sector. In 2023, the cost-to-income ratio for the microfinance sector increased to 69.7 percent compared to 61.7 percent in 2022, largely minimising the impact of rising cost of funds and narrowing interest income margins as NPLs escalated **(Figure 32).**

5.7 MFBs Profitability Dynamics

Profitability in the sub-sector increased in 2023 as profits before tax rose to Ksh. 2.39 billion from Ksh. 0.98 billion in 2022 **(Figure 33a)**. Return on equity (ROE) increased to 35.1 percent in 2023 from 11.2 percent in 2022, and return on assets (ROA) edged up to 3.72 percent in 2023 compared to 1.39 percent in 2022. This reflected increased returns on loans as market interest rates increased **(Figure 33b)**.

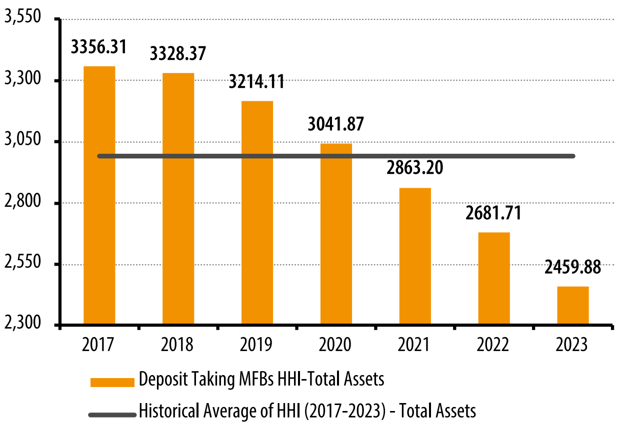
Figure 33: MFB's liabilities, composition, and growth



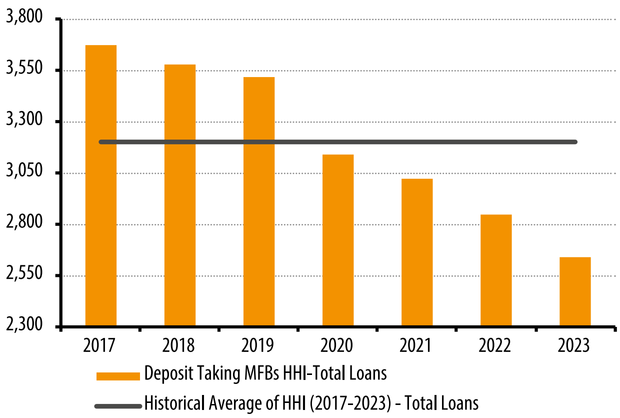
Source: CBK

Figure 34: Market Structure of Deposit-Taking MFBs, 2017-2023

34(a): MFBs Herfindahl - Hirschman Index (HHI) on Assets



34(b): MFBs Herfindahl - Hirschman Index (HHI) on Loans



Source: CBK

5.8 Market Structure Dynamics

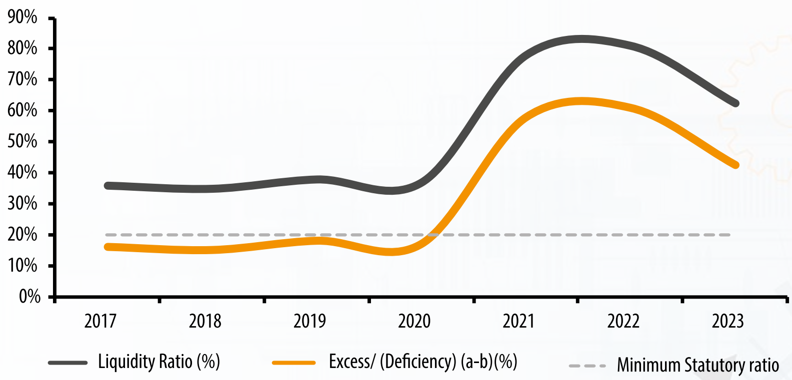
Structure of the deposit-taking MFBs continued to improve in 2023. The sector's Herfindahl-Hirschman Index (HHI), based on total assets declined to 2,460 in 2023 from 2,682 in 2022 and has consistently been on a downward trend since 2015, suggesting increasing competitive market structure features **(Figure 34a)** despite the sector remaining highly concentrated.

Similarly, the index based on total loans and advances has also been on down trend **(Figure 34b)**. However, the sector continues to be dominated by a few players with the 30 percent of the MFBs accounting for 91.91 percent of the total industry assets.

5.9 Liquidity and Capital Positions

The deposit taking MFBs have high levels of liquid assets and the liquidity positions continue to remain adequate with significant buffer positions. The aggregate liquidity position of deposit taking MFBs, stayed well above the regulatory threshold of 20 percent, at 62.5 percent in 2023 despite declining from 81 percent in 2022, indicating some short-term outflows of funds **(Figure 35).** Similarly, the capital position of the sub-sector remained robust and capital buffers were above statutory minimum levels. The aggregate capital adequacy ratio (CAR) of the sector stood at 11.8 percent as at end- 2023, against a minimum statutory requirement of 12 percent; mainly due to the outlier effects of low capital position in one of the major MFB, having recorded a capital position of 0.2 during the year.

Figure 35: Liquidity Position of Deposit-Taking MFBs, 2017-2023



Source: CBK

> There is an emerging appreciation of the need for finance to intersect with environmental and social responsibility and corporate governance.

Chapter 6:

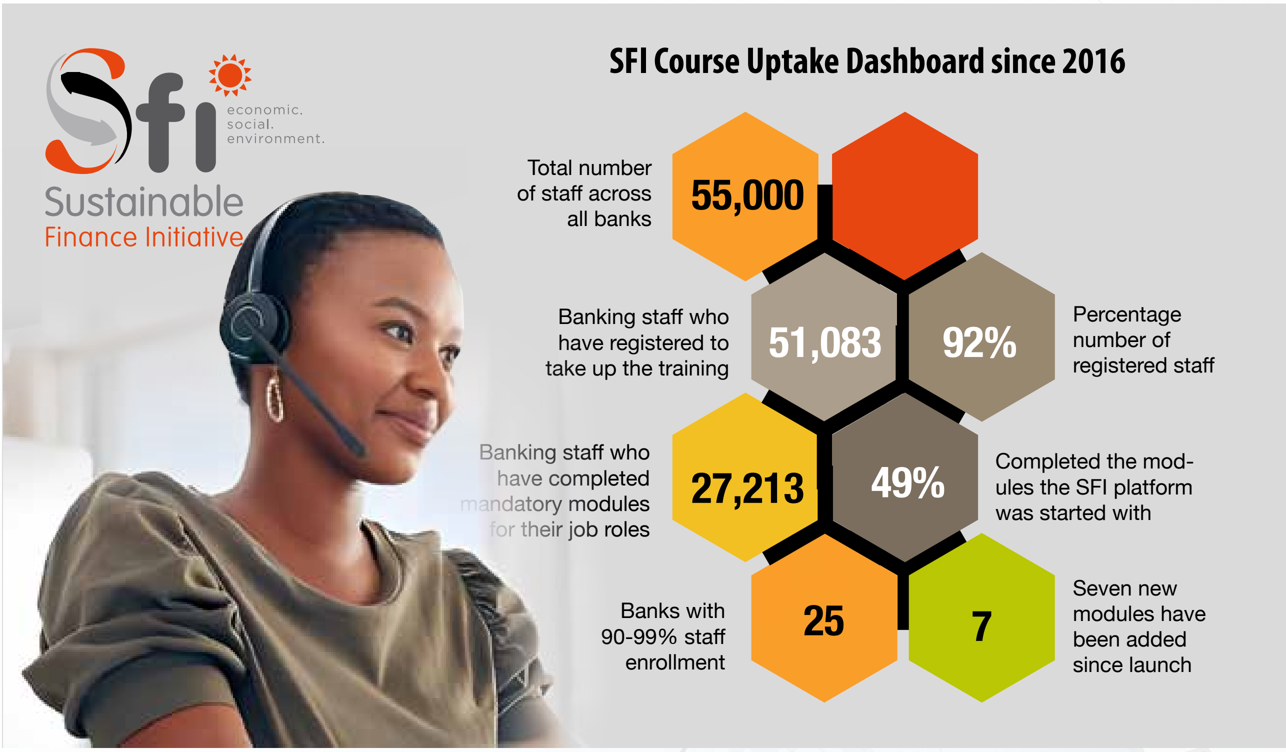
DEVELOPMENT IN SUSTAINABLE BANKING PRACTICE

6.1 Introduction

In the wake of growing environmental challenges and social inequalities, there is an emerging appreciation of the need for finance to intersect with environmental and social responsibility and corporate governance. The urgency of addressing these challenges is prompting global acknowledgment of a "sustainability emergency".

While political spheres have designed interventions to tackle these challenges, there is a rising recognition among financiers that their role is pivotal towards mitigating environmental and social risks. They are gaining understanding that the financial sector stability greatly hinges on their ability to address climate change, social inequality and other factors that may hamper the country's economic growth.

In response to addressing the developing sustainability emergency, Kenya Bankers Association (KBA) rolled out the Sustainable Finance Initiative (SFI) in 2015. The initiative has been pivotal towards promoting the industry-wide adoption of the SFI Guiding Principles. The principles currently steer banks to balance their business goals with the economy's future priorities and socio-environmental concerns. The principles have been entrenched successfully as a result of the sustained capacity building efforts undertaken by KBA through its SFI e-learning training. Over 50 thousand bank staff (some of whom have transitioned from the banking industry) have been equipped with knowledge of how to look beyond their financial returns and factor in economic and socio-environmental concerns in their lending practices and operations.



Beyond the e-learning training, the Association forged a number of partnerships in 2023 that led to empowering banks to further their goals in driving sustainable finance practices. The Association partnered with Chartered Institute of Securities and Investments (CISI) and managed to introduce three new training courses that were delivered through webinars. They included: Principles and Guidance for Sustainability Linked Loans (delivered in April); role of banks in combating modern slavery and human trafficking (delivered in June); and Fostering the Development of a Domestic Green Bonds Market (Delivered in September).

Additionally, KBA organized a series of physical workshops targeting specific job roles in the banking industry. In partnership with Adelphi and IKEA Foundation, member banks were trained on how to finance the circular economy. The training was instrumental in guiding product development and credit officers in banks in designing instruments that would benefit MSMEs in the circular economy. Additionally, KBA partnered with WWF-Kenya and Finance in Motion and trained Chief Financial Officers and Sustainability Heads of Banks on Environmental, Social and Governance Reporting. The session also enabled the partners to empower banks on IFRS S1 and S2 disclosure requirements.

6.2 Shaping the Sustainable Finance Landscape in Kenya

Kenya's socio-economic development needs offer the financial services sector with a great opportunity to tap into innovative sustainable finance solutions. Currently, according to the 2023 Kenya Climate and Nature Financing Options Analysis report by International Institute for Environment and Development (IIED), there is a total annual climate and nature financing gap of approximately USD 5.13 billion. This shortfall can be met in the short and long term if public policies are successful in accelerating climate and nature investment.

In 2022, the National Treasury issued the draft Green Fiscal Incentives Policy Framework. The framework is the Government's solid response to encourage the transition to a low-carbon development pathway through the use of policies relating to the way in which it spends and raises financial resources. The policy identifies a suite of instruments such as green bonds, carbon mechanisms and green investment banks that are designed to fund climate change responses.

In support in also meeting the climate finance gap, the Central Bank of Kenya (CBK) also issued the draft Kenya Green Finance Taxonomy. The taxonomy seeks to guide the banking industry and other sectors in the definition and classification of green or environmentally sustainable economic activities and support financing decisions towards green investments. In 2021, CBK also issued the Guidance on Climate Related-Risk Management as a means to help banks integrate climate risk into their governance, risk management, strategy and disclosure frameworks. This is enabling banks develop roadmaps towards decarbonising their loan portfolios.

Indeed, these policies are building on other regulations that have greatly contributed towards creating an enabling environment for banks. Today, banks are innovating their product offerings to address climate change and social inequality. Indeed, as seen in a recent survey by KBA, the various policies and initiative has led to more than, 51% of commercial banks and 43% of microfinance banks reporting innovations or ongoing projects related to climate change, marking an increase from 33% and 36%, respectively from 2022.

The distribution of sources of sustainable finance in Kenya by sector is not well tracked and recorded. However, a depiction can be derived from recent data on climate finance. According to the Landscape of Climate Finance in Kenya report, the total climate-related financial flows (from both private and public sectors) in 2018 amounted to Ksh 243.3 billion. The main sources of climate finance in 2018 were international public institutions, which provided 60% (KSh 146.2 billion) of the total flows, mainly in the form of loans (Ksh 122.8 billion) and grants (Ksh 23.4 billion).

6.3 Unlocking SMEs' Potential through Financial Literacy

Micro, Small and Medium-sized Enterprises (MSMEs) are the cornerstone of the country's economy. More than 7.4 million MSMEs in the country, provide employment to approximately 14.9 million Kenyans according to the Kenya National Bureau of Statistics (KNBS).

However, many MSMEs fail to celebrate their third year in business due to a myriad of challenges, such as, high competition from other businesses; insufficient working capital; and inaccessibility to affordable finance. In order to address this, the Association in 2018 launched the Inuka Enterprise Program. The capacity building program was carefully designed to de-risk entrepreneurs to enable them to access affordable finance, as well as sharpen their financial management skills to run viable and profitable businesses. As at end July 2024, more than 70 thousand MSMEs have received financial literacy training under the program, with more than 5.8 billion shillings being extended to viable businesses through bank partnerships via the program.

6.4 Outlook

Banks are not wavering in their commitment to address climate change and social inequality. Banks have innovated in their allocation and management of resources to stimulate inclusive economic growth despite the challenges occasioned. They are actively seeking out opportunities that would greatly address the sustainable finance gap in the country.

ENTERPRISE PROGRAM

inuka

Elimika na Uendeleshe Biashara!

57,160 entreprenuers have registered accounts on the platform with **1,496** registering in the last one month.

53,085 entreprenuers have filled out their business profiles up from **52,279** a month ago

45,759 entreprenuers have enrolled for at least one module with **979** registering in the last one month.

39,352 entreprenuers have successful-ly completed **7 modules** of Inuka.

40 mentorship sessions have been held for entreprenuers' benefit

Chapter 6:

OUTLOOK

2024 presents a mixed bag of challenges and cautious optimism on global and domestic economic prospects. For global growth, it is projected to grow at approximately 3.2 percent in 2024 and 2025, because of the ongoing recovery efforts post-COVID-19.

Even so, this growth rate remains low compared to the historical growth average due to persistent challenges such as high borrowing costs, reduced fiscal support, and underlying issues like weak productivity growth and geopolitical tensions. At the domestic front, the economy is expected to build on the robust growth recorded in 2023 on account of further expansion of agricultural and services-oriented sectors.

However, several downside risks loom. First, Kenya remains vulnerable to climate change-induced weather volatility, which threatens production in the agricultural sector, and potentially fuel domestic inflation. Second, escalating geopolitical tensions could drive up global commodity prices, posing a significant risk to domestic inflationary trends on account of its pass-through effects.

Third, the persistent deterioration in asset quality that continues to attract a combination of tighter lending standards by banks and weaker demand for new loans in the higher interest rate environment is expected to dampen private sector credit growth.

Lastly, the government's constrained fiscal policy environment, coupled with the budget cuts occasioned by the withdrawal of the Finance Bill 2024, may constrain liquidity and impact overall demand dynamics, adding another layer of uncertainty to the economic landscape.

Foreign exchange market movements (in Shilling appreciation) may continue to limit private sector loan book and impact on risk-weighted capital buffers, as asset quality deterioration heightens capital vulnerabilities through 2024.

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