KENYA BANKERS
ASSOCIATION

13TH ANNUAL
BANKING RESEARCH CONFERENCE

26th - 27th September 2024

Banking sector resilience:

Navigating macro-imbalances, responsiveness to evolving business landscape and driving sustainability

Convened at the

EMARA
OLE-SERENI

One Industry.
Transforming Kenya.

ABOUT KENYA BANKERS ASSOCIATION

Kenya Bankers Association is the umbrella body of Banks licensed by the Central Bank of Kenya with a current membership of 46. The Association promotes and develops sound and progressive banking principles, practices and conventions and contributes to the developments of the sector. It influences the policy landscape by proactively engaging the policy development stakeholders for the development of a conducive business environment on behalf of its members. It also manages the public relations aspects of banking as a service industry. Kenya Bankers Association plays a major role in maintaining industrial relations through employee representatives; negotiating terms and conditions of employment; and arriving at settlements, provision assistance and guidance to the industry in interpretation and implementation of cost of living awards. KBA works to maintain close co-ordination and liaison with the Central Bank of Kenya, financial institutions, the Chamber of Commerce, management and educational institutions, Federation of Kenya Employers, and other such organizations for realizing the objects and purposes of the Association.

Moreover, KBA owns and operates the Automated Clearing House and in partnership with the Central Bank of Kenya has developed initiatives such as the Modernisation of Payment Systems (including the Cheque Truncation Project), the establishment of Currency Centres across the country, and the Kenya Credit Information Sharing Initiative.

ABOUT THE CENTRE FOR RESEARCH ON FINANCIAL MARKETS AND POLICY®

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 involving scholars and practitioners, and conferences on key financial market issues. Through these activities, the Centre acts as a platform for intellectual engagement 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.

Visit ***www.kba.co.ke/research-center*** to access the suite of research publications.

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Welcome Remarks from the Ag. CEO, Kenya Bankers Association

It is my great pleasure to welcome you to the ***13th KBA Annual Banking Research Conference*** on *'Banking sector resilience: Navigating macro-imbalances, responsiveness to evolving business landscape and driving sustainability'.*

Our theme this year underscores the need to address the complex and interconnected challenges that define the current banking sector landscape.

First, with the growing economic uncertainty, marked by inflationary pressures, debt crises, and shifting monetary policies, understanding these macroeconomic dynamics is crucial to better navigate the risks posed by these imbalances and develop policies that foster stability and long-term resilience in the banking sector.

Second, rapid technological advancements and shifting expectations are transforming how consumers engage with financial services. As fintech innovations, digital banking, and personalized financial products redefine the activities in the market, the strategies adopted by banks to maintain competitiveness, relevance, and trust in a constantly evolving business environment remain fluid.

Third, the banking sector continues to play a fundamental role in funding climate change mitigation and adaptation, particularly in the context of mainstreaming climate and nature-related risks and opportunities. To this end, with the intensifying focus on climate related and sustainability aspects, banks are uniquely positioned to drive sustainable finance, funding green initiatives, and support the transition to a low-carbon economy.

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Our commitment to hosting the Kenya Bankers Association Banking Research Conference consistently over the past twelve years underscores our dedication to engaging meaningfully with our stakeholders and anchoring the banking sector policies on evidence derived from rigorous research and analytics work.

I am optimistic that the research papers being presented here will not only stimulate meaningful debate but also become a foundation for policy formulation at both institutional and national levels.

Raimond Molenje
Ag. Chief Executive Officer
Kenya Bankers Association

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Director, KBA Centre for Research on Financial Markets and Policy®

The ***13th Kenya Bankers Association Banking Research Conference*** presents an opportunity to focus on Banking sector resilience, particularly in navigating macro-imbalances, adapting to an evolving business landscape and embedding sustainability into the sector. This conference brings together industry practitioners, regulators, policymakers, researchers, and academia, thereby creating a platform for a productive exchange of ideas that balance theory, practical application, and policy relevance.

At its core, the discussions will be framed within the East African context, addressing the banking sector's challenges and opportunities arising from macroeconomic policies, market developments, shifting consumer demands and preferences, and the increasing focus on entrenching sustainability.

Over the two days, ten research papers and a methodological session will be presented, focusing on three key questions:

- **First**, how macro-imbalances, fiscal, and monetary policies individually or collectively impact the banking sector's performance.
- **Second**, is weather the banking sector is effectively adapting to evolving consumer preferences; and
- **Third**, is the role the banking sector is playing in funding climate mitigation and adaptation, and addressing related risks.

While the conference may not answer all these questions explicitly, it will spark a comprehensive reflection on the same. With contributors drawn from academia, policy institutions, and the banking sector, the diverse perspectives will ensure a rich interrogation of key issues. The rigorous presentations offer valuable insights for all players in the banking sector.

Beyond the conference, we keep alive the debate on the subject matters. At the end, all the conference papers will be reviewed and published under the *KBA Working Paper Series.*

Dr. Samuel Tiriongo
Director, KBA Centre for Research on Financial Markets and Policy®

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GUEST SPEAKER:

Prof. Victor Murinde, Executive Director, African Economic Research Consortium

Prof. Victor Murinde is the Executive Director of the African Economic Research Consortium (AERC). Prior to joining the AERC, Prof. Murinde was the AXA Professor of Global Finance at the School of Oriental and African Studies (SOAS), University of London.

Prof Murinde is a distinguished financial economist with more than 25 years of experience post-PhD, mainly involving university research and teaching, but also including senior-level stints in practitioner, policy, and consultancy roles for governments and leading international organizations.

In his scholarly endeavours, Prof Murinde has contributed over 120 research papers on economics, banking, and finance topics.

He is also the founding Director of the African Development Institute at the African Development Bank (2011-2014); and has carried out major consultancy projects for a range of international organizations.

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DAY 1 PROGRAMME: THURSDAY 26th SEPTEMBER,2024

8:30 – 8:40 am	Welcome Remarks – **Dr. Samuel Tiriongo, KBA**
8:40 – 8:50 am	Remarks by the Ag. CEO, KBA - **Raimond Molenje**
8:50 – 9:00 am	Remarks - **Vice Chair of the KBA Governing Council** **Betty Korir, CEO, Credit Bank**
9:20 – 10:00 am	Key presentation by AERC Exec. Director – **Prof. Victor Murinde**
10:00 – 10:40 am	***Health Break and Photo Session***
10:40 – 11:40 am	***Access to Bank Finance by MSMEs: Size and Turnover Effects*** **Presenters:** Samuel Tiriongo, Roselyne Njino & Hillary Mulindi **Discussant:** David Ndwiga, NCBA Bank
11:40 – 12:40 pm	***Macro – imbalances and Bank lending: A case of Kenya's banking industry*** **Presenters:** Raphael Agung; Anthony Muli; David Ndwiga and Samantha Njoroge **Discussant:** Jared Osoro
12:40 – 2:00 pm	***Lunch Break***
2:00 – 3:00 pm	***Bank Demand for Government Securities and Systemic Risk: Insights from the Kenyan Banking Sector*** **Presenters:** Dr. Rogers Ochenge, Kenyatta University & Strathmore University **Discussant:** Dr. Peter Wamalwa, CBK
3:00 – 4:00 pm	***Monetary Policy at The Turn of Financial Markets: A Forerunner or A Follower?*** **Presenters:** Jared Osoro and Camilla Chebet, UNHCR **Discussant:** Raphael Agung, NCBA
4:00 – 5:00 pm	***Sovereign Debt Sustainability and Private Sector Credit in Kenya*** **Presenter:** Prof. Odongo Kodongo, Wits Business School, S. Africa **Discussant:** Dr. Radha Upadhyaya, University of Nairobi

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DAY 2 PROGRAMME: FRIDAY 27th SEPTEMBER, 2024

8:45 – 9:00 am	Welcome Remarks – **Dr. Samuel Tiriongo, KBA**
9:00 – 9:40 am	***Assessment of Credit-risk Profiles of MSMEs in Kenya: The Influence of Cultural and Industrial Variations across 10 Major Regions (Methodological Session)*** **Presenter:** Gideon Kipyakwai, Group CEO, Metropol CRB
9:40 – 10:40 am	***Twin Deficits or Distant Cousins? Why The Distinction Matters for Banks in Kenya*** **Presenters:** Josea Kiplangat, KMRC and Jared Osoro **Discussant:** Samuel Tiriongo, KBA
10:40 – 11:00 am	***Tea Break***
11:00 – 12:00 pm	***Does Bank Credit Mitigate the Effect of Nature and Climate Changes on Cereal Production*** **Presenters:** Peter Wamalwa, Anne Kamau, Maureen Odongo, Roseline Misati, CBK **Discussant:** Priscilla Were, Stanbic Bank; Lucy Maru, KCB Bank
12:00 – 1:00 pm	***Macro-imbalances evolution and Bank Industry Performance*** **Presenter:** David Ndwiga, NCBA and Geraldine Makunda, FSD Kenya **Discussant:** Dr. Eliud Moyi, KIPPRA
1:00 – 2:00 pm	***Lunch Break***
2:00 – 3:00 pm	***Capital, Competition and Stability Nexus in The Kenya Banking Sector*** **Presenter:** Dr. Samuel Kiemo, CBK **Discussant:** Caspah Lidiema, JKUAT
3:00 – 4:00 pm	***Banking Sector Asset Quality Drivers in Kenya*** **Presenter:** Andrew Njeru, formerly KCB Bank **Discussant:** Dr. Caroline Kariuki, Strathmore University
4:00 pm	Closing Remarks by Ag. CEO, KBA - **Raimond Molenje**

Overview of Conference Papers

1. Access to bank finance by MSMEs: Size and Turnover Effects

Authors: Samuel Tiriongo, Roselyne Njino & Hillary Mulindi (KBA)

Micro, Small and Medium-sized Enterprises (MSMEs) are crucial drivers of economic growth. In Kenya, MSMEs represent about 98 percent of all businesses and contribute over 30 percent to the GDP. Despite their essential role in the economy, these enterprises face substantial challenges in accessing bank finance, thereby hindering their growth and development. On this account, this study uses Kenya Bankers Association (KBA) Inuka Impact survey data with the propensity score matching and difference in difference analysis to examine the impact of banking sector's intervention program on MSMEs ability to access bank credit. The results shows that while the program has had a positive effect on MSMEs' ability to access bank credit, there are heterogeneous effects across the enterprises size and their average annual turnover levels. Moreover, among the control variables, the age of the entrepreneur, and the sector of the enterprise operation played a role in determining whether an MSME would access bank credit.

2. Macro – imbalances and bank lending: A case of Kenya's banking industry

Authors: Raphael Agung; Anthony Muli; David Ndwiga and Samantha Njoroge, NCBA

The paper examines the effect of macro imbalances on bank lending with emphasis on exchange rate movement, inflation differential and fiscal deficit. In the study, bank lending is modelled by gross loans and advances, assets quality and risk appetite. The panel GMM model results found the shilling depreciation increases bank lending, improves asset quality and increases risk appetite. Inflationary pressures increase bank lending, worsens asset quality and leads to risk aversion. Lastly, fiscal deficit reduces bank lending, improves asset quality and but increases risk appetite. This finding supports bank behaviour during the study period- where the single obligor limits may not have been a consideration given low lending toward capital expenditure. The findings suggest the need for macroeconomic prudence policy framework and fiscal prudence in the country. Moreover, there is a need for banks to factor macroeconomic developments and projections in their balance sheet optimization decisions.

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3. *Monetary Policy at The Turn of Financial Markets: A Forerunner or A Follower?*

Author: Jared Osoro and Camilla Chebet

This paper seeks to establish whether the monetary policy stance of Central bank of Kenya (CBK) at the turn of financial markets is pre-emptive or a cleanup. The feedback loop between monetary policy reaction and the markets' response presupposes a sequencing that runs from the former to the latter. That hardly rule out the possibility of monetary policy decisions responding to financial markets' actions, not necessarily pre-empting them. Deploying a structural vector autoregressive (SVAR) model on Kenyan data for the period December 2013 to June 2024, we establish that there is a dynamic interaction among key financial market prices, not necessarily at the prompting of monetary policy. This points to how financial markets are pre-emptive, and the monetary authority playing catchup. Such sequencing comes with the possibility of monetary policy reacting to market movements more than markets responding to monetary policy signal, underlying the tension between monetary policy and fiscal policy. The direct connection between the CBK's policy signal and the inter-bank rate justifies the CBK's interest rate corridor around the former. We however consider that as a necessary but not sufficient framework for efficient policy signalling and transmission unless it is accompanied by measures to address inter-bank market segmentation and injects vibrancy in the horizontal repo market. We further contend that the positioning of the foreign exchange policy in support of monetary policy objectives is encumbered by the small-open-economy attributes that limits the assumption that full flexibility is sufficient for full effectiveness.

4. *Does Bank Credit Mitigate the Effect of Nature and Climate Changes on Cereal Production*

Author: Peter Wamalwa, Anne Kamau, Maureen Odongo, Roseline Misati (CBK)

The study analyzed the relationship between climate change, bank credit, and cereal production in Kenya based on quarterly data covering the period 2000-2023 using autoregressive distributed lag approach. The study used CO_2 emissions, average precipitation, and average temperature as indicators of climate change and private sector credit and credit to agriculture sector as indicators of bank credit. The empirical findings show that there is a long-run relationship between cereal production and banks' domestic credit, CO_2, average precipitation, average temperature, and cereal production area. The results also indicate that

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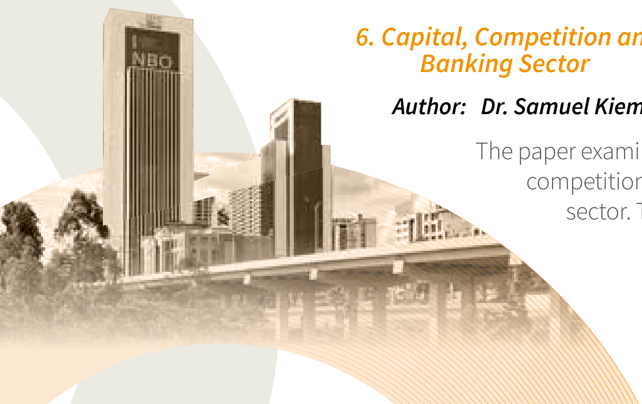
bank credit, average precipitation and increase in cereal production area stimulate cereal production, while CO2 emissions and average temperature reduces cereal production in the long run. In the short run, precipitation, bank credit, mechanisation increase cereal yield, while CO2 emissions and acreage under cereal cultivation, average temperature reduce cereals production. The increase in CO2 emissions and average temperature interfere with growth and development of plants and hence the yields. However, bank credit enables farmers to counteract the impacts of climate change as it facilitates purchase of farm inputs, which in turn boost cereal production. These findings imply that there is need to mitigate climate change, because it has adverse impact on cereal production. There is also a need to enhance lending to the agriculture sector so that farmers can boost cereal production, enhance capacity to mitigate climate change as well as wither the impact of climate change on cereal production.

5. *Sovereign Debt Sustainability and Private Sector Credit in Kenya*

Author: Prof. Odongo Kodongo (Wits Business School, South Africa)

Typical debt metrics characterize Kenya's sovereign debt situation as "unsustainable" since 2019. Further, the data show that, over time, banks' private sector lending has declined while lending to the government has grown. Given these observations, this paper sought to establish whether debt sustainability has a discernible relationship with private credit growth in Kenya. The paper finds a distinct negative relationship between sovereign debt and private credit growth. The negative relationship is stronger during periods of debt unsustainability. Informed by this finding, the paper tests for the possible existence of a threshold level of sovereign debt at which the negative relationship worsens: the results are mixed and inconclusive. Among others, the paper recommends greater use by the government of alternative financing arrangements such as private-public partnerships.



6. *Capital, Competition and Stability Nexus in The Kenya Banking Sector*

Author: Dr. Samuel Kiemo

The paper examines the nexus between capital, competition and stability in the Kenya banking sector. This is achieved by applying panel

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data analysis model on annual bank level data for the period 2000 to 2022. The paper estimated H-Statistics and Bank Stability Index to measure evolution of banking sector competition and stability respectively. The results revealed four key findings. First, Kenya banking sector competition conditions is monopolistic with few large banks dominating. Secondly, on average the banking sector remains stable, with considerable gain in long-term resilience. Thirdly, increase in capital promotes competition first, however significant increase in capital reduces competition. Fourth, increase in capital promotes banking sector stability. The paper concludes that, capital positively effects both banking sector competition and stability. However, significant increase in bank capital reduce competition. The paper recommends appropriate capital regulation reforms should be implemented taking cognizance of the adverse implication on significant increase in capital on banking sector competition.

7. *Twin Deficits or Distant Cousins? Why The Distinction Matters for Banks in Kenya*

Author: Jared Osoro (FSDA) and Kiplangat Josea (KMRC)

This paper seeks to determine the interaction mechanism between the domestic imbalance and the external imbalance in Kenya and why it matters for banks. Whenever an economy has is on a path of soaring fiscal and current account deficits like Kenya has been over the past decade, concerns on the implication in stability is palpable. The influence of the imbalance on banks' behaviour crucially depends on whether one deficit occasions the other in short order, hence the twin moniker, or not. If the two are twins, then the interaction between them has an influence on economic growth and consequently bank profitability. We demonstrate that the two deficits not only exert a direct influence on the economy but also indirectly affect financial sector performance via their impact on growth. While this finding endears itself to the twin deficit conclusion, the channel of influence is through the implication of the imbalances on stability more than it is through growth. We argue that while banks seldom miss the opportunity to maximize earnings from positions they take in both money and foreign exchange markets on the back of the twin deficits, policy makers ought to maintain a focus on how financial stability could be assured through regulation at the first level and pursuit of sustainability in each of the imbalances.

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8. *Bank Demand for Government Securities and Systemic Risk: Insights from the Kenyan Banking Sector*

Author: Dr. Rogers Ochenge (Kenyatta University & Strathmore University)

This study investigates the demand for government securities by Kenyan banks using annual data from 2005 to 2022. Employing a fixed-effects panel regression model, the research examines the factors influencing banks' sovereign debt holdings and their implications for systemic risk. Key findings reveal that fiscal deficits, attractive bond yields, and capital adequacy requirements significantly drive banks' appetite for government securities. Over time, the similarity in sovereign holdings across banks has increased, raising concerns about systemic risk due to potential correlated exposure to sovereign debt shocks. The study also identifies a negative relationship between private sector lending and sovereign debt holdings, highlighting potential "crowding out" effects. These insights are critical for informing regulatory policies aimed at mitigating systemic risks in the Kenyan banking sector.

9. *Macro-imbalances evolution and Bank Industry Performance*

Author: David Ndwiga and Geraldine Makunda

The study investigates the effects of macroeconomic imbalances on the banking sector performance in Kenya from the financial intermediation cost perspective for 2020q4 – 2024q1 period. Employing dynamic panel GMM model, the study finds that inflation pressures above the upper bound target, external debt unsustainability, monetary policy tightening and current account deficit to GDP ratio lead to increase in the intermediation cost. The findings call for need to anchor the inflation rate below the upper bound target, exercise prudence fiscal measures, effective application of the monetary policy instruments and development of a matrix of interlinkages between the macroeconomic – imbalances.

10. *Analysis of Macroeconomic drivers of asset quality; sector performance, Interest rates and the legal operating environment*

Author: Andrew Njeru

The very purpose and objective of a financial institutions that operate under fractional reserve banking framework imply that the loans and advances grow exponentially as the intermediation

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rises, implying that the lending activity has a disproportionate effect on all bank performance ratios. It is therefore not meaningful to analyse bank performance ratios as determinants of asset quality. Such a relationship is a spurious relationship.

We also established that a decay model can explain the short run evolution of non-performing asset quality for financial institutions in Kenya where the institutions grapple with long duration of turning around the distressed assets. The policy makers, the Judiciary and regulators can work towards simplifying and shortening the process of unwinding distressed assets thereby releasing held up cashflows and this would help to manage the non-performing assets quality for financial institutions especially in the periods of lower than average economic growth and rising interest rates. The policy makers can also work towards managing the fiscal policy to contain the rise of interest rates as this also affects the growth of the non-performing loans.

As a footnote to this paper, we sought to do an analysis of exchange rate, which affects non-performing assets; We found that risk aversion behaviour in the exchange rate market in a small open economy like Kenya can lead to a rapid appreciation of the shilling. The finding may inform policy makers to craft policies to smooth the frictions in exchange rate market by allowing retail players ease of access to the hard currencies especially of the volatility persists to the point of affecting the normal business operations.