STERLING CAPITAL LIMITED

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Cost of bank loans hit fresh all-time low

- Banks have cut the cost of credit to all-time low and reduced appetite to extend credit to high-risk borrowers in the wake of the Covid-19 pandemic that has raised defaults to a 13-year high.
- Latest Central Bank of Kenya (CBK) data shows that lending rates have fallen to an average of 11.89% in June following a consistent drop in the banking regulator's benchmark lending rate.
- This is the lowest average lending rate since the CBK started disclosing the rate in July 1991.
- The drop has eased fears of a rise in the cost of credit after the removal of the interest rate cap last November following pressure from banks and the International Monetary Fund (IMF).
- The removal of the legal cap led to fears of a likely return to the era of high cost of loans, which had at one point hit 25%.
- Industries and other businesses have cut down on their activities in response to the covid-19 pandemic, leading to job cuts and unpaid leave for retained staff as profitable firms move into losses.
- This has seen workers who had tapped mortgages and unsecured loans for purchase of goods such as furniture and cars and expenses like school fees default. Unsecured loans are given on the strength of one's salary. Firms that had borrowed based on the forecast of cash flows have also been struggling to repay their bank loans.
- The pandemic has affected both the supply and demand side of the credit. The growth is not so much just driven by price. An entity trying to survive the pandemic will not necessarily borrow more because of reduced price.
- The CBK data showed that credit to the private sector expanded by 7.61% in the year to June to hit KES.2.69Tn, well below the ideal rate of 12-15%.
- A slowdown in business activities and the uncertain future caused by the Covid-19 pandemic globally has forced many companies and investors to put a freeze on expansion plans.
- Despite the reduction in the price of credit, however, there has been an increase in non-performing loans.
- Data from the CBK shows that the ratio of non-performing loans (NPLs) rose from 12.5% to 13.1% in April the highest since August 2007 when it stood at 14.41%.
- Defaulted loans which is credit that remains unpaid for more than 90 days jumped to KES.379.9Bn in June from KES.349.9Bn in February.

Our View:

- **We expect the lending rate to remain low on account of a low Central Bank rate (7%) and CBK's requirements for credit profiling that limit bank's ability to increase rates to pre- rate cap levels. This will continue driving liquidity in the market and as a result subscription rates for government securities will remain high.**
- Banks are also taking a cautious approach in extending fresh credit in an environment where companies and individuals are increasingly seeking moratorium on their loans in the wake of the health crisis.
- The rise in loan defaults in Q2 are likely to be the highest as a result of imposed restrictions to curb the spread of coronavirus.
- Debt defaults and slowed economic activities are the key concerns for the remaining half of the year which will have an impact on interest income and profitability for FY2020.
- The limited activity in the education sector, concerns over debt obligations, and reduced development spending also remain as key risks to credit growth.

Source: Business Daily and Sterling Research