STERLING CAPITAL

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Banks loan rate jumps to two-year high on demand

- The average interest charged on loans by Kenya's commercial banks has risen to its highest level in two years amid increased demand for credit as the economy recovers from Covid-19 disruptions.
- The latest data by the Central Bank of Kenya (CBK) shows the lending rate hit 12.17% in February - the highest since February 2020 when it stood at 12.19%.
- Demand for credit has gone up in the personal and household, trade and manufacturing segments, with banks seeking regulatory approval to raise rates on riskier borrowers.
- Several lenders have sought approval from the CBK to switch to risk-based loan pricing, setting the stage for expensive credit for small traders and workers in the informal sector.
- Equity Bank was the first commercial bank to publicly reveal that the regulator had approved the risk element in its lending formula, two years after discussions started.
- The increase in lending rates signals a higher cost of credit to households and businesses in the coming months as the economy rebounds.
- At the peak of the Covid-19 pandemic, industries and corporates cut down their activities in adherence to the restrictive measures undertaken, in what saw a dip in consumption, resulting in job cuts and income losses among employees.
- Bank executives had protested to the International Monetary Fund (IMF) over the CBK's reluctance to approve their applications to raise the cost of loans following the scrapping of interest rate controls on 7th November, 2019.
- On its part, CBK has said it had examined the new loan pricing models presented by banks and found them wanting, sending the lenders back to the drawing board.
- Banks have been eager to price loans to different clients based on their risk profile but this flexibility remained a mirage after the CBK stepped in as the de facto controller of the cost of credit.
- According to the CBK, the number of loan applications and approvals in the private sector remained strong with the transport and communication sector at 24.1%, consumer durables (14%), business services (11.6%), trade (8.9%) and manufacturing (7.6%).

Our view

- **We expect lending rates to continue on an upward trend in the short and medium term on account of increased demand and the imminent CBK approval of banks' credit risk based pricing formula.**
- Improved economic activity following the lifting of containment measures by the Government in Q3 2021 has had a positive impact on credit demand as indicated by private sector credit from the CBK.
- Deposit rate rose from 6.47% in February 2021 to 6.61% Yoy largely due to the rise in T-Bill rates with banks looking to attract capital for both lending and investment in Government securities.
- In the long-run, institutions and high net-worth individuals may still prefer the returns in the 91, 182 and 364-day treasury bills which offer in interest rates of: 7.377%, 8.219% and 9.743% respectively, as compared to prevailing deposit and savings rates.
- The approval of loan pricing formula will provide significant potential upside to the banking sector with yields on loans estimated to increase by 50 - 100 basis points (bps) upon approval.
- The foregoing coupled with a return in digital transactions for banks that will boost Non-Funded Income (NFI) means that the top line for most banks will see a significant shift upwards in the medium to long term.

Source: Business Daily and Sterling Research