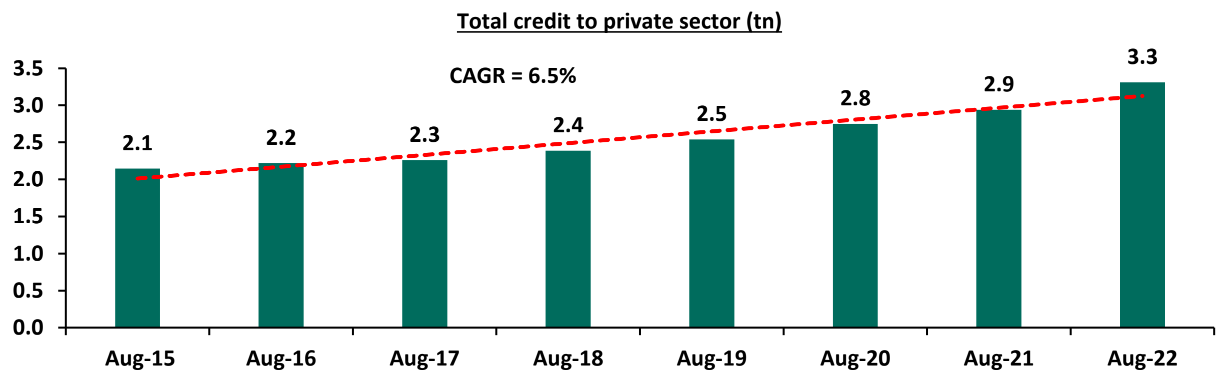
Kenya's Private Sector Credit Growth has been on an upward trajectory increasing to 12.5% in August 2022, but there is a lot of room for growth

Private sector credit from the banking sector currently stands at Kshs 3.3 tn, equivalent to approximately 26.1% of the GDP. This continues to lag behind other advanced economies such as USA where the Private sector credit to GDP ratio stood at 216.0% in 2020. Kenya has some work to do to bridge the gap in Private sector credit. Below is the private sector growth performance and the recommendations on how to improve it;

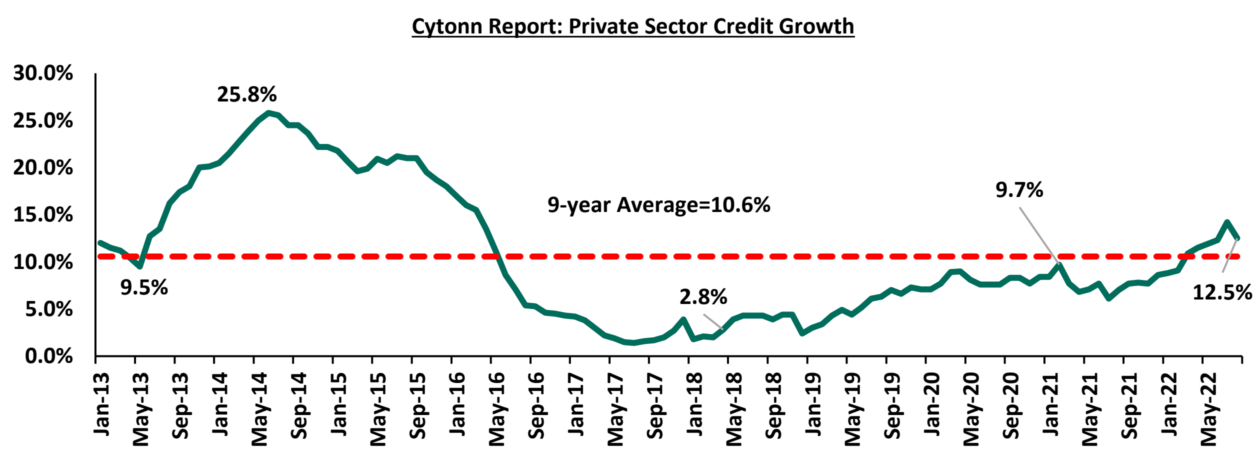
1.**Private Sector Credit Growth Performance**

There has been a significant rise in banks' lending to the private sector over the years, with the total domestic credit extended to the private sector credit increasing to Kshs 3.3 tn in August 2022. The chart below shows total credit to private sector growth at a 7-year CAGR of 6.5%;



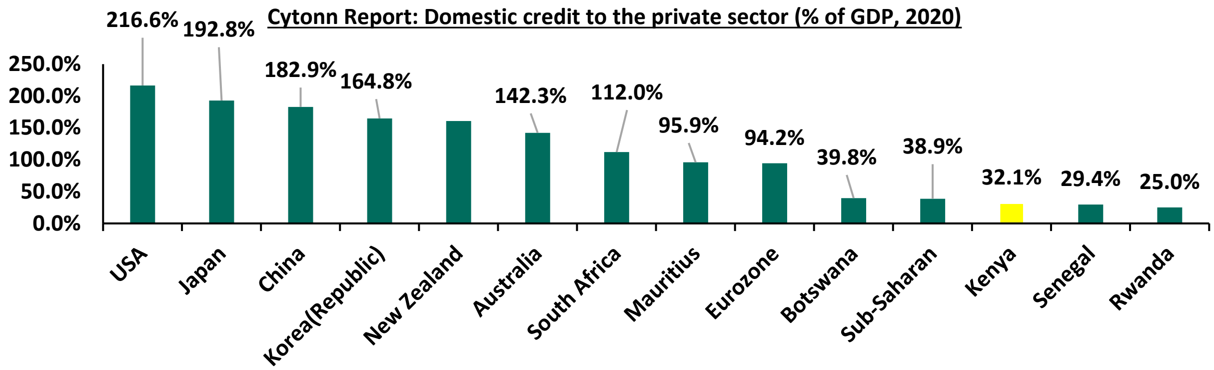
Source: Central Bank of Kenya

In terms of Private sector credit growth, y/y credit growth as at August 2022 came in at 12.5%, but below the historical levels, such as 25.8% in June 2014 as seen below. The chart below shows the movement of the private sector credit growth;



Source: Central Bank of Kenya

The graph below shows the comparison of Kenya's domestic credit to private sector as a percentage of GDP in comparison to selected countries;



Source: World Bank

2. Factors that have influenced Private Sector Credit growth

i) **Interest rates –** Interest rates affects supply side of the credit market. For instance, the capping of interest rates in August 2016 led to low credit growth averaging at 3.7% for the capping period (August 2016-November 2019) with banks minimizing credit access due to the small profit margins. Additionally, high interest rates stifle the demand side of the credit market by increasing the cost of borrowing,

ii) **Government domestic borrowing -** Commercial banks have continued to hold the highest proportion of Government domestic debt, coming at 47.5% as at October 2022, due to the risk-free nature of the investment, effectively crowding out the private sector, which is considered riskier,

iii) **High risk perception by lenders which contribute to high risk premiums** – Commercial banks charge higher interest premiums on the loans borrowed, driven by increased credit risk. According to the Central Bank of Kenya (CBK), the tightened macroeconomic environment in 2022 has resulted in increased credit risks as banks recorded deteriorating asset quality with non-performing loans (NPLs) to gross loans ratio coming in at 14.7% in Q2'2022, above the historical average of 9.7%,

iv) **High cost of credit** – there are other associated overhead costs incurred during borrowing such as bank fees, legal fees and government levies, valuation fees and insurance that are borne by the borrower, in addition to the interest charged on loans,

v) **Over-reliance on the banking sector -** The Kenyan private sector is over dependent on lending from commercial banks due to under development of alternative sources of funding as currently, the banking sector provides 99.0% of capital to businesses while alternative sources contribute a combined 1.0%,

vi) **Political Risk –** The private sector growth in Kenya is susceptible to political tensions attributable to uncertainties surrounding the business environment as witnesses in the August 2022 electioneering period where private sector credit demand declined by 1.6% to Kshs 79.6 bn in Q2'2022 from Kshs 124.1 bn recorded in Q1'2022.

3. Recommendations to enhance Private Sector Credit Growth

The private sector is a significant contributor to the Kenyan GDP. However, credit availability remains a major hindrance for the sector's growth. Below are some of the recommendations that the government can adopt;

i. **Enhance financial literacy to the public** – The government needs to come up with ways of sensitizing the public on financial literacy in terms of debt management and budgetary skills, as well as, an understanding of the different financial instruments and credit within the Kenyan financial market,

ii. **Establish a regulatory framework to enhance consumer protection** by enforcing consumer-centred financial laws, ensuring financial products are transparent and competitive, as well as handling of consumers complains and issues,

iii. **Develop the capital markets to offer alternative sources of capital–** The capital market in Kenya is under-developed as it contributes about 1.0% of total funding to businesses in Kenya. Developing the capital markets framework will unlock a key financing avenue that businesses can tap into,

iv. **Enhancing oversight on fund initiatives to promote transparency -** The government needs to come up with measures or an independent institution that will oversee the running of funds such as the Uwezo Fund and Youth Development Fund in terms of timely publication of updates on amounts disbursed, disclosure of beneficiaries already covered and requirement regulations,

v. **Adoption of concessionary loans** - Allow the banking sector to provide concessionary loans to small and medium enterprises with focus on the Agricultural sector as it is the leading contributor to the GDP and accounts for 70.0% of employment of the rural population,

vi. **Enhance Fiscal consolidation –** The high borrowing rate by the government is to finance its budget deficit, however, the government can bridge the deficit gap through expenditure reduction measures and prioritization of government projects limit capital expenditure to projects which the economic benefits outweighing costs.

For more information, kindly see our topical on [Private Sector Credit Growth]