

## *“my chat with a bank CEO”*

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*David Wachira*

*Chat Summary*

*Wednesday, 29<sup>th</sup> May 2013*

*Topic: The Interest Rates Environment*

*Time: 10:0am – 11:30am*



If you had the opportunity to chat with a Bank CEO, what would you talk about?

### Contents

1. *Factors affecting Interest Rates*
2. *Actions taken by banks to reduce interest rates*
3. *Other questions*
4. *Unanswered Questions*
5. *General Comments and Feedback*

## David's Opening Remarks

**DavidWachira:** interest rates are a very interesting topic mainly because it affects the players -- that is the banks and anyone involved in financial services; the policy makers as well as the banking population, both depositors and borrowers...none the less we all have a role to play and there are no scientific measures in discussing and determining interest rates. This is because it is a moving target that can change within hours, days or week...however, it has limitations in the sense that you do not change interest rates in practical sense as events take place...you have to give it time to adjust the interest rates...I welcome your questions and discussions on this topic.

## Factors affecting interest rates:

**samo:** Why is difference between deposit interest rate and lending interest rates high?

**DavidWachira:** Theoretically, interest rates are determined by the risk, the opportunity cost, and inflation...this applies both ways...and that is basically the difference between deposit rate and lending rate ...let me clarify...the difference between lending and deposit rates is the spread...and the spread is determined by the factors I mentioned i.e. risk, opportunity cost and inflation...this is in theory...but practically, the lending rate is a function of the cost of funds, the cost structure of an institution, and the risk factor...so in most cases you will find the lending rate more driven by cost of funds than the other factors...so the spread, has been coming down, mainly because the deposit rates are going up, and lending rates are not moving as fast as the cost of funds/deposit rates. This has been happening in the recent two years.

**samo:** I understand Mr. Wachira. Why can't the difference between lending interest rate & deposit interest rate be 6%?

**DavidWachira:** Samo...thank you for the follow-up...the spread is all dependent on the economic factors ...it is dependent of the cost of funds, the cost structures within a bank etc...So in my view we can achieve the 6 per cent you mention, subject to aforementioned factors...

**tonie007:** Isn't the average deposit rate around 6% at the moment, yet the average lending rate is still as high as 17%. Is that spread of 11% really as a result of risk and opportunity cost?

**DavidWachira:** Tonie007...depending on what you are borrowing, there could be that difference...but generally speaking there are banks which already have a single digit spread

**waruimaina:** Why is it that interest rates are high in commercial banks despite the reduction of base lending rate by the CBK?

**DavidWachira:** Warui asked earlier about commercial interest rates and the reduction of CBK base lending rate...first of all, I'd like to explain that the Central Bank does not have a base lending rate. The Central bank gives us the Central Bank Rate, or CBR as a signal of the direction of which the market should move... ...coming back to the commercial lending rate....one needs to understand where lending rates have come from...in the past year, lending rates have indeed been coming down in response to the CBR as well as other macroeconomic factors such as inflation, stability in the Foreign Exchange market and the economic recovery in general.

## Kenya Bankers Association

### “My 15 Min Chat with a Bank CEO”

#### 29<sup>th</sup> May 2013 Chat Log: The Interest Rates Environment with David Wachira

#### Factors affecting interest rates: (Continued)

**CapitalFMfans: Juma Shibu:** 1. What are the factors that affect the interest rates? 2. Government Bonds and debentures; are they affected by interest rates?

**DavidWachira:** As instruments in the financial market, government bonds and debentures more or less influence the interest rates...as opposed to the other way around...because the industry monitors the pricing of these bonds in view of the fact that they present a low-risk alternative investment to depositors and fund managers.

**Mbatia:** Does the competition from the banks affect the interest rates? Competition in terms of lending more without even considering securities?

**DavidWachira:** Mbatia you ask a good question...competition does indeed affect interest rates...both on the deposit and loan side...and also different banks have different products, which they compete on which also helps to bring down the interest rate.

**kareokey:** I'm a banker by profession but at times I feel the banking sector isn't in tandem with the aspirations of our fellow Kenyans. With the high interest rate regime in this country, aren't we stifling the dreams of so many of our fellow countrymen and Nation as a whole?

**DavidWachira:** Kareokey as a banker you would recognize that banking is an intermediary and we play a role of supporting the economic development of this nation...by providing the much needed credit facilities and also ensuring that the money we lend is also applied in the right place...so on the contrary, it is not the price of the money that we sell...it is what a customer does with it...because at the end of the day you borrow because you want to do something which gives you a good return...and when you do that...you support economic development...further banks do concentrate on providing the required financial resources, but in addition, they provide education to customers on how to utilise the borrowed funds...and that works towards development aspirations of the country...a different way of putting this is that people do not borrow because money is cheap...you do it because you want to create value by investing.

#### Actions taken by banks to stabilize interest rates:

**Linda:** What measures have you taken to stabilize the interest rates? Sometimes one borrows when it is at 16% for example then ends up paying as high as 19%

**DavidWachira:** Linda...you raise a good question...the interest rate depends on the product eg variable rate or fixed rate....if you negotiated a variable rate then you should expect that rate to move depending on market circumstances...as opposed to if you negotiated a fixed rate which will remain fixed for the period of the loan

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### “My 15 Min Chat with a Bank CEO”

29<sup>th</sup> May 2013 Chat Log: The Interest Rates Environment with David Wachira

#### Actions taken by banks to stabilize interest rates: (Continued)

**@DelanorSadia:** @capitalfm\_kenya Banks will Profit More with low interest rates, hence development. @kenyabankers, my question is how can this be done? #myceochat

**DavidWachira:** @DelanorSadia you raise a volume vs. price model argument...which may not always be the case...I mentioned earlier that the decision to borrow is not always the price of the money...you may lend at zero per cent but the capacity for the borrower to repay may be zero...so there is no assurance that when you reduce the interest rate more people will borrow, and be able to repay.

**CapitalFMfans Clere asks:** Almost all Sacco's offer better interest rates than banks, why can't banks follow suit considering they have access to larger deposits? I transferred mine to my Sacco after this discovery mainly so that I can save. Is this a step banks are likely to follow?

**DavidWachira:** Clere...thank you for your question...the effective interest on borrowed funds is dependent on how often you compute interest rates...ordinarily banks give you an interest rate on per annum basis...other lending institutions calculate interest based on a monthly basis...so when you look at the effective interest rate that a bank gives you may find it is actually lower.

#### Other Questions:

**mjoemaina:** How much penalties and interests am I supposed to pay in a loan?

**DavidWachira:** mjoemaina...there is no specific penalty, it is dependent on the terms and conditions of the loan...the best rule of thumb is to comply with the terms and conditions of whatever contract you sign to avoid penalties.

**mbatia:** With the current lending rate from the government to fund youth and women empowerment what impact in future will it have on the interest rates and our economy since the niche market is flooded with small businesses i.e. shops and *bodabodas*?

**DavidWachira:** Mbatia...thank you for your question...in my view, Government programs targeting youth and women is a relatively small proportion of the total lending and is not likely to have a major impact on interest rates...there are also other specialised funds that are channeled to specific groups in the economy, e.g. agriculture, and these also are not likely to affect interest rates.

## Kenya Bankers Association

### “My 15 Min Chat with a Bank CEO”

#### 29<sup>th</sup> May 2013 Chat Log: The Interest Rates Environment with David Wachira

##### Other Questions

**@NMutie:** @KenyaBankers how do interest rates affect prices of quoted companies?

**DavidWachira:** @NMutie asked how interest rates affect listed companies...if a company is experiencing high financial costs, that would affect the bottom line...if that does happen, then it means the dividends expected by the shareholders will be lower and that would affect the share price.

##### Unanswered Questions:

**Allen:** Good morning, was just wondering how come when banks increase interest on loans they don't increase interest on savings by the same margin?

**Shaw\_me:** Hi David, been a keen follower on the interest rate environment in Kenya and was wondering with the stable inflation & stable exchange rate, why do we still have banks with higher interests rates than others?

**CapitalFMfans: James asks:** What basis does the Central bank base its lending rate on? Why can't this be reduced or what measures are being effected so that more Kenyans can afford credit??

##### General Comments and feedback

**DavidWachira:** As we wind up, first and foremost I thank you for participating in this Chat. I'd like to say that it is important that you take away that lending terms and conditions are always negotiable...so you should always be prepared to negotiate

The other point is that the industry is very supportive of economic development in this country...and we are making every effort to create access of financial services to the public...meanwhile, the Government should continue to invest in agriculture, in tourism, in manufacturing, so that we can create more jobs, and be able to empower our people to invest in productive areas and the banks will provide the necessary credit.

We will continue to do our part...we shall continue participating in Government programs that are meant to provide a conducive environment for a thriving private sector. For example infrastructure bonds. Our other major role is to continue educating the public about financial services, management of borrowed funds, and creating transparency so that people can borrow with the intention to repay.

**HabilO:** David, thank you. That was a very enlightening discussion on a topic that is close to the hearts of most of us, be we borrowers or depositors.

**DavidWachira:** Thank you very much Habil...we are working together.

**Linda:** thank you for your time Mr Wachira