# Njuguna Ndung'u: Putting banking at the centre of the economy's sustainable growth

Remarks by Professor Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the opening of the KBA 3rd Annual Banking Research Conference, Nairobi, 25 September 2014.

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***The Chairman, KBA Governing Council;***

***Members of the KBA Governing Council;***

***Banks' Chief Executive Officers;***

***Distinguished participants;***

***Ladies and Gentlemen:***

It is my honour and pleasure to join you this morning at this very important Conference that focuses on the role of the banking sector in the economy's growth. It is therefore my singular pleasure to be invited to open the KBA Third Annual Banking Research Conference and to make some remarks at its commencement.

First and foremost, I would like to commend the KBA for its consistency in hosting the Annual Banking Research Conference. This is further evidence that the banking industry is keen on having its operations and strategic focus informed by analytical work.

This being the Third Annual Conference, the body of knowledge that the process has generated is without a doubt going to be beneficial to all stakeholders. Research and its output is a "public good". The broader benefits arising from knowledge cannot be restricted to those who have a direct interest in the research. Research that improves the policy environment benefits all and indeed the economy at large.

This year's Conference theme of "***Putting banking at the centre of the economy's sustainable growth***" is an example of this point.

Several papers focusing on finance and economic growth have confirmed the causal relationship. It is on that basis that I consider this Conference's theme on sustainability of this relationship to be inspiring, given that it provides an opportunity for deeper reflection taking us beyond the general finance – growth nexus.

The Kenyan economy has an ambitious real output growth target of at least 10 percent to enable the realization of the aspirations of Vision 2030. The high and sustained growth targets will only be achieved through increased investment and increased productivity. The Banking industry must intermediate and provide the funding required for the investment but even more important is long-term finance with attractive terms.

***Ladies and Gentlemen:*** The presentations lined up for this Conference give me confidence that we are embarking on a conversation that will lead to the consolidation of the gains to the economy from the dynamism of the banking industry. Let me make a quick reflection over the five areas around which the Conference presentations focus;

- Firstly, increasing support for agriculture is important and in the right direction. This is because the agricultural sector – the leading contributor to the economy's output, to direct and indirect employment, and to export earnings – does not attract as much bank credit as it requires. The importance will be supported by tangible solutions for financing agriculture.
- Secondly, sustainable development is a very important subject today. A market-led process that will culminate in the development and adoption of sustainable finance principles must be backed by research. Sustainability in this case must also look at

the investments supported by the banking sector and their outcomes to growth. This also looks at boom-bust cycles.

- Thirdly, the interactive dynamics of the banking industry and housing development is a further area that touches on both commercial and social interests of households. Facilitation of home ownership needs to be seen beyond mortgage financing, which is only a demand side remedy; there are a host of supply side constraints some of which are financial in nature while others are non-financial – both sets require critical examination. But more important are the macro-prudential indicators and property boom we have seen.
- Fourthly, a credible measure that tracks the changes in housing prices is very important. Our mandate at the Central Bank, particularly as the Monetary Policy Committee, of ensuring stability in the economic system necessitates that we look at all the key markets and track price evolution beyond inflation dynamics; the foreign exchange market is always on our radar, given that its policy management is under our purview; we are also able to track price evolution in the securities market. Given that instability could emerge from the housing market, making it imperative that we have a price tracking measure that can stand the test of scrutiny and therefore can be relied upon to identify any early signs of volatility from that segment of the economy that easily proliferates to other sectors, as has been proved internationally. It is gratifying therefore, that the KBA desires to have a housing price index that will fill this gap. We need to move away from the thinking of a bubble in the market and especially property prices driven on one hand by a supply constrained market, and on the other hand a transitioning demographic structure.
- Fifthly and finally: a revisit to the dynamics of credit demand for the private sector, its drivers and whether there are international dimensions that influence the domestic credit market is interesting. This is an area that is at the heart of the finance-growth nexus. Beyond the policy interest of determining how credit affects aggregate demand, a clear understanding of what motivates the private sector to seek bank credit enables the industry to react in a timely manner. And by identifying constraints, it can propose modalities for overcoming them. At the top in this agenda is to link it to investment. Is our investment constrained by credit? We need to know more.

***Ladies and Gentlemen:*** The body of research work arising from the Conference's theme will obviously not be definitive; but it will surely provide a good platform for reflection on the many ways through which the banking industry is readying itself towards further enhancing its role in the economy's progress. There is also a possibility that ideas will emerge which have a quick response that can be put into practice in the short run; furthermore, there is an opportunity to pick areas for further investigation.

I am confident that the banking industry, that has remained stable on the back of the steady growth seen over the past decade, will continue to play an important role in supporting the various economic sectors through provision of credit. With an asset base of Ksh.2.70 trillion as at the end of December 2013 compared to Ksh.2.33 trillion as at the end of 2012, the industry is clearly maintaining the growth path. Similarly, customer deposits grew by 14 percent in the period from Ksh.1.71 trillion to Ksh.1.94 trillion. The banking industry's asset growth of 16 percent between 2012 and 2013 at a time when the economy's real growth rate was less than 5 percent points to the possibility of the acceleration of the growth momentum emanating from finance. That growth will be accelerated once the overall cost of doing business that is being addressed, declines. This will ensure that the underlying asset quality accompanying the growth in the banking industry remains good.

As a country, we are making strides in ensuring that financial inclusion is enhanced. The FinAccess 2013 survey results revealed that Kenya's financial inclusion landscape has undergone considerable improvement. The proportion of the adult population using different forms of formal financial services was at 66.7 percent in 2013 compared to 26.4 percent in 2006. This is a notable achievement. The proportion of the adult population totally excluded from financial services has declined to 25.3 percent in 2013 from 38.4 percent in 2006. Similarly, the proportion of Kenyans accessing informal financial sources dropped from 35.2 percent in 2006 to 7.8 percent in 2013. This is a reflection of the positive outcomes of policy initiatives by the Government and the Central Bank as well as the initiatives of the financial sector players and their innovations.

There is scope for further deepening of the financial sector, and especially the banking industry, and as a result, this will lead to further financial inclusion. Even with the industry's assets looking impressive at the levels I highlighted earlier, they still remain below 50 percent of our GDP. Economies that have achieved higher levels of development, accompanied by high levels of financial inclusion have a higher banking assets to GDP ratio, with some well over 100 percent. With the level of innovation and dynamism in our banking space, there is no reason why we cannot aspire to be like those economies and grow our assets with strong banks and a strong policy drive to financial inclusion for financial development.

I see research being at the centre of such growth. As a researcher myself, I know that collaboration will remain core. I commend the KBA for seeking collaboration with other institutions, among them the Central Bank, in its research efforts. I see that collaboration in this research Conference manifested in the diversity of paper authorship.

I look forward to seeing the Conference papers reviewed and put in the public domain so that the intended purpose of promoting an idea-based engagement is realized as well as development based on a certainty policy path.

With those remarks, I declare this Conference officially open, and wish all the participants fruitful engagements over the next two days.

***Thank you for your kind attention.***