Patrick Njoroge: Kenya's experience and prospects in banking and economic infrastructure development

Opening remarks by Dr Patrick Njoroge, Governor of the Central Bank of Kenya, at the 4th KBA (Kenya Bankers Association) Annual Banking Research Conference, Nairobi, 24 September 2015.

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Good morning! I am very pleased to be here at this opening of the 4th KBA Annual Banking Research Conference*.* I am grateful to KBA for inviting me to this important forum and appreciate the presence of all the participants.

This Conference's theme, ***Kenya's Experience and Prospects*** in ***Banking and Economic Infrastructure Development*** is indeed relevant to our current context. This is because most of the countries across Africa and the world are experiencing huge infrastructure gaps, and Governments are grappling with the challenges of coming up with innovative solutions to financing these investments. The importance of reliable infrastructure in raising the economy's growth potential cannot be overemphasized. In most Sub-Saharan African countries, the infrastructure deficit is in critical sectors such as energy, transportation, health, water, sewerage, and telecommunications, and is a significant drawback to the continent's economic performance.

Vision 2030, Kenya's development blueprint, gives prominence to infrastructure development as a key driver of long-term growth. In recognition of the important role the private sector can play, the Government is committed to creating an enabling environment to facilitate private participation. With support from the World Bank, the Government initiated the Infrastructure Finance and Public Private Partnership (IFPPP) Project and has put in place a supportive legal and regulatory framework through the PPP Act, 2013 and the related Regulations, giving private participation a central role in the Government's long-term development strategy.

The complementary roles of the Government and private sector in infrastructure funding were most recently highlighted at the UN's 3rd International Conference on *Financing for Development*, held in July 2015 in Addis Ababa, Ethiopia. At this summit, participants reiterated the vital roles both Governments and the private sector can play in infrastructure delivery, sustainable development and poverty eradication. Involving the private sector, not only eases the fiscal and administrative burden on Governments but also enhances efficiency in the delivery of key public services. In this regard, Public-Private Partnerships (PPPs) are an increasingly popular mechanism by which the private sector has been brought in. PPPs are therefore among the options that have been sought by Governments to address this funding challenge.

It is clear that there is interest in PPP projects in Kenya. As of July 2015, the National Treasury had approved 71 projects in transport, energy, education, water, health, agriculture and the hospitality sectors. Whereas many of these projects are still at the negotiation and feasibility stage, a number have reached financial closure, with several banks participating through syndicated lending. The 71 PPP projects so far identified present a pipeline of investable opportunities for the Kenyan financial sector.

In addition, the Government's efforts in recent years to tap into other sources of infrastructure finance, include:

- Direct borrowing from foreign governments and multilateral lenders such as the African Development Bank (AfDB) to fund specific projects.
- Issuance of tax-free infrastructure bonds targeting investors to finance capital projects.

- Issuance of a USD 2 billion sovereign bond (Eurobond) in 2014 to raise development funds from the international market.

As of June 2015, the Government had raised approximately Ksh.250 billion through infrastructure bonds, which have drawn both domestic and international participation. In a bid to widen potential sources of funding even further, the Government is also considering *Sukuk* and *Samurai* bonds as options for further sovereign bond issuance. These will further widen investor participation and deepen the market.

There is clearly a case for participation in PPPs by banks and other private financial institutions. However, there are a number of challenges that could arise from such participation, which I would like to highlight for your consideration in this forum.

First, many infrastructure investments are long-term in nature, generating cash-flows many years after project inception. However, the maturity of most bank deposits is short-term. There is therefore a need for banks to manage this intermediation, taking a more long-term view about the economy, which we flag as the single most-important constraint. Additionally, alternate sources of longer-term funding could be sought. I am happy to note that banks in Kenya have started to explore solutions such as collaboration with multilateral lenders and development finance institutions to obtain long-term funding for infrastructure projects.

Secondly, given the huge scale and long duration of many infrastructure projects, lenders are likely to find themselves exposed to significant credit, liquidity and political risks. It is therefore vital that all project proposals be thoroughly and reliably assessed for their economic, financial and technical viability before loans are disbursed. More importantly for banks, projects should have a clear and equitable contractual structure that optimally allocates project risks among participants. Such risks should be well-mitigated at the outset to make projects bankable.

Thirdly, participation in infrastructure projects by banks would also be constrained by legal and prudential limits on the proportion of banks' lending as a share of their core capital. Given the considerable financial outlays involved in infrastructure projects, commercial banks would need to enhance their capital base to participate in PPPs while remaining compliant with regulatory requirements.

Finally, given the increased investments in infrastructure and the environmental implications, I do hope that the studies lined up for discussion in this conference will give consideration to the green economy (green growth) aspects. This proactive discussion by the Kenyan banking industry will no doubt contribute towards adopting sustainable finance principles as per the commitments of the Addis Ababa *Financing for Development* Summit earlier mentioned.

In view of the large size, huge cost and complexity of infrastructure projects, I would urge banks and other financial institutions to build the requisite legal and technical capacities to evaluate the value for money of PPPs relative to traditional asset classes. This will assist in identifying the potential risks and the risk mitigation to be put in place in advance before the commitments are undertaken.

I take that the engagement you will have for the next two days will be an on-going conversation and the research work arising from this conference's theme will inform future research in the area. I am optimistic that the banking industry will continue to play an important role in supporting the various sectors of the economy and in particular, the challenge to address the nation's infrastructure gap. The Central Bank is committed to creating an enabling regulatory environment that facilitates the banking sector to effectively execute its intermediation function.

With those remarks, it is my honour to declare the 4th KBA Annual Banking Research Conference officially open. I wish you fruitful deliberations.

Thank you.