Patrick Njoroge: Bend but do not break

Keynote address by Dr Patrick Njoroge, Governor of the Central Bank of Kenya, at the Fourth Annual Bankers Conference, organized by the Uganda Bankers' Association, 27 July 2021.

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As Prepared for Delivery

Good morning! I am honoured to join you at your Fourth Annual Bankers Conference. At the outset, let me express my gratitude to my brother Governor Mutebile, for inviting me to speak at this important conference. I also applaud Uganda Bankers' Association (UBA) for organizing the conference with the timely theme, ***how the financial sector can thrive in the era of the fourth industrial revolution.*** We are meeting virtually, but I recall Uganda's warm hospitality, beauty, and vibrancy. I am optimistic that we shall soon be able to meet physically, in the but also elsewhere.

We convene at a critical juncture, firstly, having struggled globally with the ravages of the coronavirus (COVID-19) pandemic for one-and-a-half years. Secondly, we are at the cusp of the Fourth Industrial Revolution, whose transformative powers are already evident in the financial sector, and will transform the way we live, work, and relate to one another. In the words of Professor Klaus Schwab, who popularized this label: *"It is characterized by a fusion of technologies that is blurring the lines between the physical, digital, and biological spheres."*[1]

Both these elements portend stormy times, for our way of life, society, families, and the institutions that we represent. But how should we react? We can attempt to stand firm, unyielding against these perils, and fully aware that they may destroy us. Or we can accommodate some of the pressures with the grace of a palm tree, and build back better—*bend, but don't break*. Allow me to set the stage by highlighting three disruptive trends in the current global context.

First, the entrenchment of globalization. This product of the third industrial revolution has redefined the terrain for governments, businesses and citizens, shortening distances and brought together disparate people in common markets. Global supply chains have overhauled the traditional manufacturing and production processes with resultant efficiency gains. Markets have increasingly opened up allowing businesses to expand their global footprints. The absence of a navigable route to the sea for Uganda and other landlocked countries need no longer be a handicap to economic development. Closer home, regional integration efforts particularly the East African Community (EAC) have borne fruits with banks extending their reach across the region. The imminent operationalization of the African Continental Free Trade Area (ACFTA) is expected to create an Africa-wide market with resultant benefits from economies of scale.

Financial markets have increasingly become global. In particular, the U.S. financial markets have become a *global bellwether* with an outsize influence including in emerging and developing countries. Given the dominance of the U.S. dollar as a global reserve currency, we in the EAC are not immune to the dynamics in the U.S. financial markets. Global movements in the dollar exchange rate and interest rates are increasingly impacting our markets. On the one hand, as we expand our presence in the international Eurobond markets, we are becoming increasingly vulnerable to movements in global bond yield curves. On the other hand, with a growing influence of foreign investors in our markets, we have to be alive to their short-term horizons and their potential flight to safety in turbulent times.

Nevertheless, there are other urgent concerns that must be recognized and attended to. The cost of globalization in terms of the industries that are wiped out and livelihoods that are altered, must be addressed. We have also seen the rise of nationalism in the last few years, particularly in Britain, Europe and the United States, threatening to reverse the gains made by globalization. There has been an increasing retreat to protectionism as large segments of the populace particularly in the West feel excluded from the global economy. The COVID-19 pandemic has presented the two sides of the coin in this issue. On one side, the vaccine nationalism particularly by western countries has shown the ugly face of the retreat from globalization. On the other side, the pandemic has emphasized the need for global cooperation and coordination as n*o one is safe until we are all safe.* We are certainly treading dangerous ground.

Second, is the proliferation of innovations and new technologies. From mobile banking to cloud computing, artificial intelligence to blockchain technology, internet of things, and robotics, all heralding significant opportunities to re-engineer the operations of governments and business and transform lives and livelihoods.

Even before the COVID-19 pandemic, digitalization had transformed the African financial sector landscape. In Kenya, we had seen access to financial services triple from 26 percent of adults in 2006 to 83 percent in 2019. These transformational financial inclusion stories riding on digitalization were replicated across the continent including in Uganda, Tanzania, Rwanda and Ghana.

Undoubtedly, digitalization has been the silver lining during this pandemic. With various containment measures including social distancing, lockdowns, and stay-at-home protocols, digitalization has enabled access to not just financial services but also other essential services including health and education. E-commerce has exploded as businesses pivoted to the digital marketplace. Businesses in diverse sectors ranging from hotels, retail, transport, communications, entertainment, health to education, have to a large extent transformed their businesses riding on digital rails and platforms.

Workplaces have changed with a shift to *working-from-home* on a scale that was unimaginable before the pandemic.

Additionally, technologies and innovations are being adopted rapidly.[2] New ideas and products are spreading at an exponential pace, putting pressure on innovators and promoters to compromise on the quality of their products.

Third, is the rise of sustainability concerns. It is now widely appreciated that businesses can only be as successful as the societies they operate in and draw their existence from. Environmental, Social and Governance (ESG) considerations are now paramount in any organization's strategy and operations. Most notably, the adverse impact of climate change has become evident. Natural disasters, associated previously with developing countries, have spectacularly reared their ugly heads in the developed countries. In the last few weeks, once-in-a-millennium floods have ravaged Europe, while heatwaves and bushfires have scorched the western parts of the U.S.

In these circumstances, the urgency to meet targets to reduce greenhouse emissions under the Paris Climate Agreement has been amplified. Significant financing will be required as the world moves to mitigate and adopt to climate change. Will banks rise to this challenge? The consequences of failure are dire to society and banks specifically as they reel from the damage to their loan portfolios from extreme weather events. Further, banks may be left with stranded assets, if they do not keep abreast with the transition to a *net zero* emissions global economy.

Against the backdrop of the significant transformation foreshadowed by the three themes highlighted above, how will bankers bend without breaking in this environment? How will they guide their institutions to thrive and not just survive? I want to draw on an analogy from football, appropriately so in the wake of the recently concluded Euro 2020 tournament. For the first time in over 50 years, England was on the cusp of winning its first major global tournament. Unfortunately, the trophy *did not come home but went to* Rome. As English fans absorbed their loss, they must have remembered their retired talisman David Beckham, who could have very likely made the difference. In his heyday Beckham had the knack of kicking the football and bending its flight past the wall of defenders and into the goal. Analogously, how will banks develop fit-for-purpose strategies and business models, bending their way around the obstacles that come up every day in their field of play? Will the institutions *bend but not break* in the face of the disruptive trends? Let me identify the walls we must navigate around in three areas.

First, we must not forget that it is all about people. While Returns On Equity (ROEs), Price-Earnings (P/E) ratios and the bottom-line are easy clutches, people-centricity must be at the heart of products, services and operations of financial institutions. The needs of citizens globally have grown over the last 18 months as lives and livelihoods have been upended by the pandemic, which has adversely impacted implementation of the Social Development Goals (SDGs) and threatened the vision of shared prosperity for all by 2030. Recent World Bank assessments indicate a reversal in the global fight against poverty following the pandemic—an estimated 130 million people could slip into extreme poverty by 2030, if concerted global action is not urgently taken. Closer home, the African Development Bank estimates that 30 million people in Africa slipped into extreme poverty in 2020 and a further 39 million could slide into extreme poverty in 2021. Micro, Small and Medium Enterprises (MSMEs), women and youth have borne the brunt of the pandemic.

Supporting the recovery process will be at the heart of banks that will thrive in the new age. Targeted financial services to MSMEs and other vulnerable groups particularly women and the youth will be imperative. This will need to be supplemented by ***finance plus***, particularly in the form of business advisory services, as MSMEs pivot their business models to fit in the new normal.

Second, innovation presents opportunities but also risks. How do we maximize opportunities while minimizing risks? Emerging technology including Artificial Intelligence is a goldmine in building credit profiles and enhancing access to financial services for segments of our populace with *thin credit files* and who lack collateral. For financial institutions saddled with moribund ICT legacy systems, the cloud presents an opportunity to upscale to the *anytime anywhere* cutting-edge financial services platforms demanded by today's discerning customers.

Even as we reap from innovation, we must remain alive to the risks. Recent devastating cyber attacks including Solarwinds, Colonial Pipeline and Kaseya in the U.S. come into mind. In the region, we have also seen an upsurge in online scams, identity theft and social engineering attacks. We must therefore reinforce our cyber defenses internally to neutralize the insider threat. Externally, as a financial sector we must build a circle of trust, nationally, regionally and globally to share information and co-ordinate our cyber responses.

Third, strong governance should underpin the culture in banks. This goes beyond the classical tenets of an effective board, management and staff with clearly defined responsibilities and accountability. Governance in the age of the fourth industrial revolution would also be about the public good, for instance, supporting appropriate behavior in the financial markets. Banks play a critical role in foreign exchange markets and are key players in the government securities markets. Misbehaviour in these markets adversely affects society through distortions in foreign exchange rates and raising the cost of debt for government. Appropriate market conduct is therefore imperative to avoid short term profitability gains jeopardizing the long term societal good.

Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) is another key facet of supporting the public good. Lapses in AML/CFT can be devastating given the consequences particularly of terrorism. Kenya, for instance has borne the brunt of terrorism including the Dusit 2 complex attack in 2019 that took advantage of vulnerabilities in AML/CFT frameworks of part of the financial sector. Technology now offers banks, cutting-edge technologies to monitor and analyse transactions and reinforce their AML/CFT defenses.

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As I draw to a close, I want to emphasize that we must all act with courage to do the right thing, and not just survive but thrive. We must have the courage to *Bend it like Beckham*, to go around the walls to attain the goals of people-centricity, balanced innovation, and stronger governance. I am sure you will reach deep and find the courage to *bend it like Beckham* one day after another, as we are in a marathon and not a sprint.

Across the street from my office, is a large mural of Kenya's Marathon Champion Eliud Kipchoge with his mantra *No Human is Limited*. Along with the millions of his fans, I will be rooting for Kipchoge on August 8, as he defends his Olympic Marathon Gold medal title against other strong contenders such as the Ugandan Team led by Stephen Kiprotich. We may not agree on who is best placed to win the 2020 Olympic Marathon, but I am sure we will agree that, in as much as *No Human is Limited*, the financial sector must and will find a way *to bend without breaking* in order to thrive in this new age.

Thank You!

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[1] Schwab, Klaus "The Fourth Industrial Revolution: what it means, how to respond" January 2016.

[2] Brynjolfsson, Erik and Andrew McAfee, "The Second Machine Age: Work, Progress, and Prosperity in a Time of Brilliant Technologies" W. W. Norton & Company, 2014.