



“THE BEST ECONOMIC SACRIFICE FOR KENYA: CAPPING INTEREST RATES”

An Economic Paper for Decision Making in Trade Unions in Kenya

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1.0 INTRODUCTION

The Central Organization of Trade Unions, COTU (K) remains pertinent to policy issues in the labour market as it acts as a watchdog to foresee worker-friendly policy initiatives and decisions. These policy concerns are in line with COTU (K)'s mandate to protect, promote and uphold decent work in Kenya through constant review of employment situation and opportunities in Kenya; promoting effective and consultative Social Dialogue; Enhancing Social protection by closely monitoring and influencing the operations of NSSF and NHIF while ensuring that the fundamental rights and freedoms of workers are upheld.

The current labour market challenges Kenya faces has seen industries close down, several job losses and rampant move towards temporary employment. In many cases, these challenges originate from inability of market players to break even. It is on this background that this month's economic paper focuses on interest rate capping to lobby for the President's accent to the Banking (Amendment) Bill. The paper also analyses the Consumer Price Indices and Inflation rates for the Period June 2015 to July 2016 to give a gist of the trend in Kenya's cost of living.

The next section looks at the economic benefits that Kenya will enjoy from the capping of interest rates

2.0 ACHIEVING KENYA'S VISION 2030 AND GLOBAL SUSTAINABLE DEVELOPMENT GOALS THROUGH INTEREST RATE CAPPING.

The global journey towards sustainable development faces stiff neck challenges that bar economic players from making optimum contributions. From institutions to individual economic players, inefficiencies, in-competitiveness, incapacity and ineffectiveness benchmark the insurmountable probabilities of failure.

In fact, information asymmetry and misplaced priorities lie within the institutional and individual journey in their struggle towards contributing a share of the economic pie. Albeit on this background, several individuals and institutions set goals and targets that are SMART but end up not adding up.

The Sessional Paper No. 10 of 1965 on *African Socialism and Its Application to Planning in Kenya* set the ball rolling and identified key development echelons that could have made Kenya the *World Economic Champion!* This paper envisioned rapidly growing public and co-operative sectors and viable but greatly controlled financial and banking institutions for greater economic growth. However, the public sector has been overtaken by the private sector given its contribution to economic growth and job creation.

The great Economist, *John Maynard Keynes* pointed out in his article “*Economic Possibilities for our Grand Children*” that economies are just suffering because of readjustments that occur between one economic face to the other. In particular, Keynes believed that “*the Banking and Monetary Systems of the World has been preventing the Rate of Interest from falling as fast as the equilibrium requires*”.

The Constitution of Kenya 2010 supports the Legislative Assembly arm of the government. In this August house, legislators, who have been “*terrorized*” by the harsh social and economic realities, still go through the same *Baptism by fire* to restore Kenya to its earlier economic glory.

Indeed the Banking (Amendment) Bill that sets to cap interest rates in Kenya puts the current legislators on the forefront as the champions of the great people of the great republic of Kenya. Of course the role of political economy is to promote participation in economic growth and development whose ground has been laid down by the bill that proposed capping of interest rates.

If Kenya were to have the bill signed by his Excellency the President, then Kenya will be catapulted to greater heights in the journey towards achieving its Vision 2030, the 2030 Global Sustainable Development Goals (SDGs) and the Africa Agenda 2063.

The interest rate capping will deliver ten key economic benefits as follows:

1. Learning from Keynes’ Economic Possibilities, capping of interest rates in Kenya will stimulate financial market towards equilibrium since it is the current banking and monetary system rigidities that prevents the rate of interest from falling as fast as equilibrium requires. I believe that this will enhance efficiency by stimulating the market against KIPPRA’s Prof Joseph Kieyah’s fear that

information asymmetry on supply and demand for credit by the government will take the lead (Refer to Daily Nation Monday August 22nd 2016, pp.15)

2. Drawing from George Akerlof's Market for "Lemons" and his confession that high interest rates were the highest contributors to landlessness in India, Capping interest rates will prevent the current exorbitant interest rates from rising further. Access to affordable credit will facilitate competition in the financial and money market, giving Kenya an upper hand international financial markets and a thrust to competitive domestic currency.
3. Capping interest rates instills banking discipline as it avails full information on the expected repayment value of credit. Borrowers will be able to calculate their repayment plans based on the cap. This will improve loan repayment rate while reducing rates of default.
4. Decision making by the buyers and sellers of credit will be prudent when interest rates are capped. This is based on perfect financial information available that is pegged on the interest rate cap, under the watch dog of the Central Bank of Kenya. I believe that as more borrowers decide to take credit, the financial institutions will be stimulated to supply the credit, stimulating the market further.
5. Capping interest rate will support Kenya's industrialization agenda through manufacturing as the industry players, most of whom have closed shop in Kenya due to higher costs of doing business get leverage through the affordable credits. Through this, Kenya will see the contributions from the manufacturing sector widen as well as more job opportunities are created for the youth.
6. Kenya is among the top African countries losing on the demographic dividend as most of the economically productive population is not economically producing but rather economic predators (dependents). To this extent, statistics have shown that lack of opportunities such as affordable credit draw the youth into utmost dependency. As such, for Kenya to use the advantage given by from its demographic dividend to achieve its development goals, interest rate capping is inevitable

7. Micro, Small and Medium enterprises are major contributors to employment creation. In most cases, these enterprises depend on credit to carry out their business. However, experience has shown that most of these entrepreneurs struggle to repay their loans because the interest rates are so unfriendly, taking almost all the profit margins. Interest rate capping therefore provides a financial hope to this important sector of the economy to thrive.
8. Although Kenya has journeyed through financial reforms from the early 1990s, it seems credit pricing is not responsive. Given the basic role of credit in stimulating economic growth and development, it is relevant that the government have a control to monitor the responsiveness. This window is best provided by interest rate capping.
9. It is truly arguable that the Kenya Banks Reference Rate (KBRR) has not been able to adequately and positively impact on the affordability of interest rates in Kenya. Under this condition, interest rate capping provides the best counter policy towards affordable credit to save Kenya from such economic sabotage.
10. Lastly, several interventions that the government has been initiating towards improving Kenya's domestic borrowing have been hardly hit by the high costs of borrowing domestically. In this regard, interest rate capping provides a better benchmark to peg financial interventions.

3.0 BRIEF ANALYSIS OF THE CONSUMER PRICE INDICES FOR THE PERIOD JUNE 2015 TO JULY 2016

The CPI increased by 0.64 per cent from 169.76 points in June 2016 to 170.84 points in July 2016. It was observed that during the month of July 2016, there were notable increases in prices of basic food items and fuel pump prices that have negatively affected the transport sector.

The Consumer Price Indices for the last 14 months are as shown in table 1 that follows (February 2009=100)

Table 1: CPIs for Kenya for the Period June 2015 - July 2016

| Month | Consumer Price Indices | | | | | | |
|---------------|------------------------|------------------------------|----------------------------|-----------------------------|----------------------------|------------------|---------------------|
| | Kenya | % change from previous month | Nairobi Lower Income Group | Nairobi Middle Income Group | Nairobi Upper Income Group | Nairobi Combined | Rest of Urban Areas |
| June 2015 | 160.46 | 0.3 | 162.47 | 140.70 | 139.25 | 156.34 | 160.46 |
| July 2015 | 160.57 | 0.07 | 162.74 | 141.17 | 141.35 | 156.72 | 160.57 |
| August 2015 | 160.90 | 0.21 | 162.78 | 141.66 | 143.53 | 156.96 | 160.90 |
| Sept 2015 | 161.33 | 0.27 | 163.13 | 142.04 | 143.35 | 157.30 | 161.33 |
| Oct 2015 | 162.13 | 0.50 | 164.26 | 141.93 | 143.05 | 158.07 | 162.13 |
| Nov 2015 | 162.97 | 0.39 | 166.02 | 141.75 | 142.70 | 159.29 | 162.97 |
| Dec 2015 | 164.72 | 1.07 | 167.48 | 145.22 | 143.34 | 161.20 | 164.72 |
| January 2016 | 165.37 | 0.39 | 167.60 | 144.24 | 144.30 | 161.09 | 165.37 |
| February 2016 | 164.67 | -0.42 | 167.38 | 143.39 | 144.19 | 160.72 | 167.44 |
| March 2016 | 165.92 | 0.76 | 169.19 | 143.78 | 144.21 | 162.12 | 168.58 |
| April 2016 | 167.07 | 0.69 | 170.86 | 143.97 | 145.61 | 163.42 | 169.62 |
| May 2016 | 167.99 | 0.68 | 171.89 | 144.59 | 145.93 | 164.32 | 170.55 |
| June 2016 | 169.76 | 0.01 | 174.08 | 145.59 | 146.21 | 166.15 | 172.29 |
| July 2016 | 170.84 | 0.64 | 175.19* | 146.52* | 147.15* | 167.21* | 173.39* |

Source: KNBS

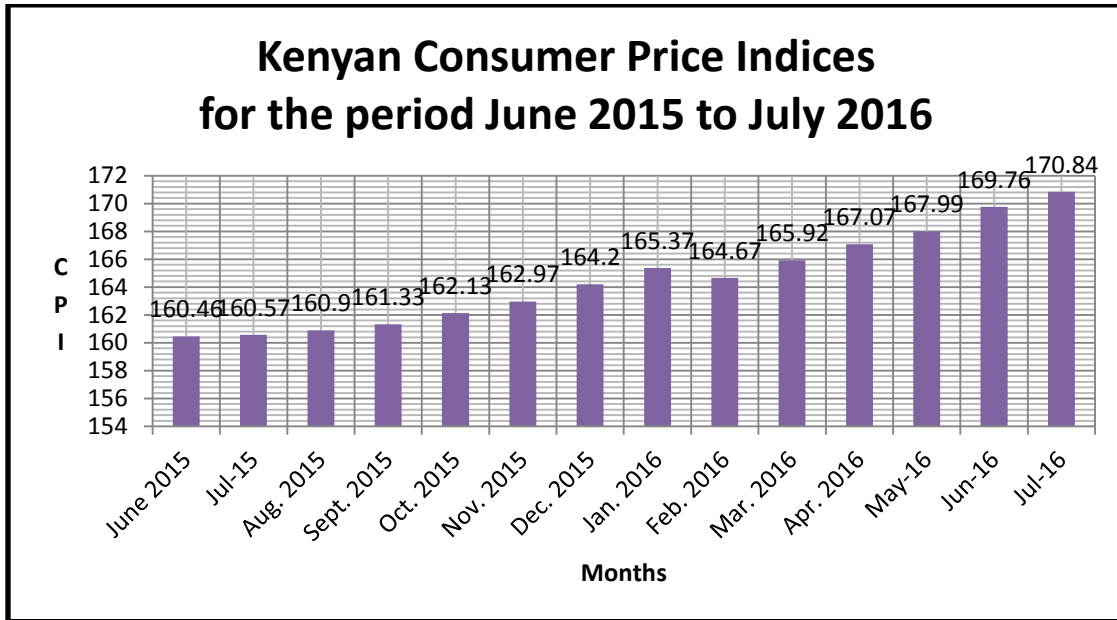
Notes: 1. * Authors' estimates based on overall change in the CPI

2. Nairobi Lower Income Group are households that spent less than Kshs. 23,670 in October 2005; Nairobi Middle Income Group are households that spent between Kshs. 23,671 to Kshs. 119,999 in October 2005 while Nairobi Upper Income Group are households that spent above Kshs. 120,000 in October 2005. The Rest of urban areas

are Mombasa, Malindi, Machakos, Nyeri, Thika, Nakuru, Kisii, Kisumu, Eldoret, Nyahururu, Garissa and Bungoma.

The graphical representation of the CPI for the 14 months is shown in figure 1 that follows:

Figure 1: Graph of Kenya’s CPIs for the period June 2015 - July 2016



Source: Author’s construction based on KNBS data

The data presented on table 1 and figure 1 depict two steady trends of the Consumer Price Indices (CPIs). The first trend starts at 160.46 points in June 2015 and rises steadily to a peak of 165.37 points in January 2016. The CPI then declines slightly to 164.67 points in February 2016 and climbs steadily to 170.84 points in July 2016.

These trends show that the cost of living has continued to rise despite major improvements in the macroeconomic management. It is however critical to note that the major contributing factor to the cost of living indices is the monthly regulation of prices by the energy regulatory commission (ERC), the seasonal weather variations coupled with socioeconomic and political challenges such as insecurity.

The trend analysis calls for a comprehensive mechanism to save workers from the heightened costs of living so that they can achieve decent lives given their limited pay.

4.0 BRIEF ANALYSIS OF THE INFLATION RATES FOR THE PERIOD JUNE 2015 TO JULY 2016

The overall inflation rate for the month of July 2016 has been stated by the Kenya National Bureau of Statistics (KNBS) as 6.39 per cent. This is a 10.17 per cent increase from the June 2016 inflation rate of 5.80 per cent.

The inflation rates for the last 14 months are as shown in table 2 that follows (February 2009=100)

Table 2: Kenya's Inflation rates for the period June 2015- July 2016

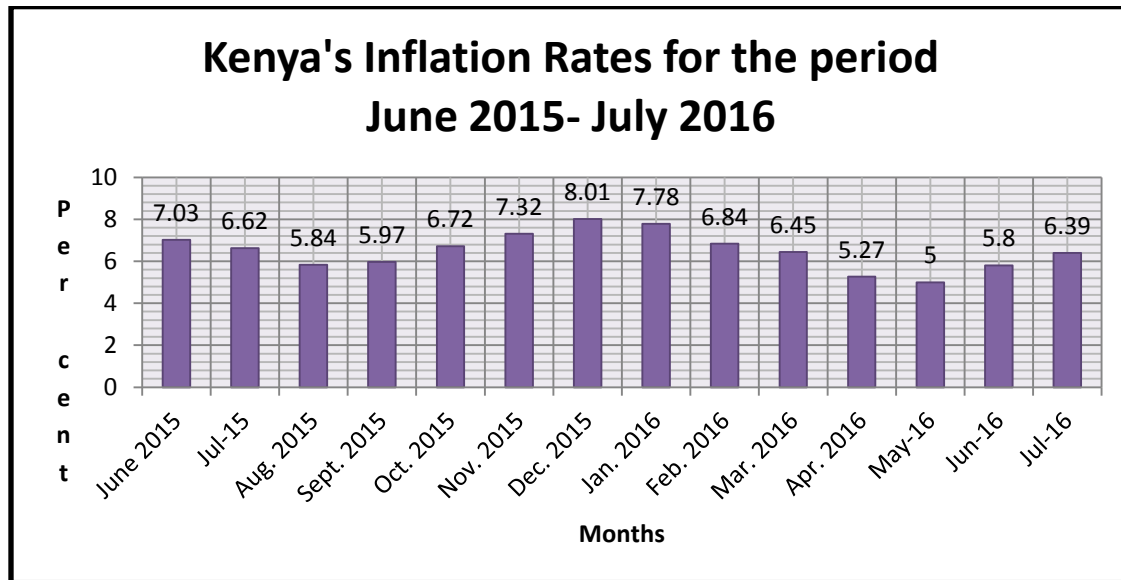
| Month | Inflation Rates (%) | | | | | | |
|---------------|---------------------|------------------------------|--------------------------|-----------------------------|----------------------------|-----------------|-------------------|
| | Kenya | % change from previous month | Nairobi Low Income Group | Nairobi Middle Income Group | Nairobi Upper Income Group | Nairobi Overall | Other Urban Areas |
| June 2015 | 7.03 | 2.33 | 7.32 | 4.63 | 1.77 | 6.53 | 7.38 |
| July 2015 | 6.62 | -5.83 | 7.26 | 4.22 | 2.95 | 6.44 | 6.75 |
| August 2015 | 5.84 | -11.78 | 6.03 | 4.34 | 2.56 | 5.54 | 6.05 |
| Sept 2015 | 5.97 | 2.23 | 6.18 | 4.84 | 2.79 | 5.77 | 6.10 |
| Oct 2015 | 6.72 | 12.56 | 7.23 | 4.87 | 3.50 | 6.58 | 6.82 |
| Nov 2015 | 7.32 | 8.93 | 8.60 | 5.03 | 3.38 | 7.63 | 7.12 |
| Dec 2015 | 8.01 | 9.43 | 8.70 | 7.09 | 4.83 | 8.21 | 7.87 |
| January 2016 | 7.78 | -2.87 | 7.68 | 5.91 | 5.44 | 7.22 | 8.16 |
| February 2016 | 6.84 | -12.08 | 6.94 | 5.24 | 5.51 | 6.53 | 7.04 |
| March 2016 | 6.45 | -5.70 | 6.54 | 4.88 | 5.21 | 6.13 | 6.67 |
| April 2016 | 5.27 | -18.29 | 5.57 | 4.52 | 5.76 | 5.35 | 5.22 |
| May 2016 | 5.00 | -5.12 | 6.05 | 4.05 | 5.02 | 5.58 | 4.61 |
| June 2016 | 5.80 | 16 | 7.15 | 3.48 | 5.00 | 6.28 | 5.48 |
| July 2016 | 6.39 | 10.17 | 7.88* | 3.83* | 5.51* | 6.92* | 6.04* |

Source: KNBS

*Author's estimates based on overall change in inflation

The graphical representation for the Inflation rates for the 14 months is shown in figure 2 that follows.

Figure 2: Kenya's Inflation rates for the period June 2015 - July 2016



Source: Author's construction based on KNBS data

The data presented on table 2 and figure 2 shows that inflation declined slightly from 7.03 per cent in June 2015 to 5.97 per cent in September 2016. The inflation rates then rose to 8.01 per cent in December 2015 thereafter declining to 5.0 per cent in May 2016, the lowest since June 2013. However, the inflation rates rose again to 5.8 per cent in June 2016 and further to 6.39 in July 2016.

These trends in inflation depict the magnitude of the monetary initiatives. They show that the inflationary policy initiatives have just been able to contain inflation for shorter periods. Remarkably, better inflationary policies should be in place to contain inflation in the long run.

5.0 CONCLUSION

This paper has provided clear policy implications that lie ahead for Kenya should it cap interest rates. The Central Organization of Trade Unions remains keen to see the ascent into law of the Banking (Amendment) Bill into law enhance Kenya's economic growth and development while delivering on the decent work agenda

Capping the interest rates in Kenya will indeed be a greater constitutional and democratic step to be undertaken by the great republic of Kenya. There will indeed be greater economic outcomes that assure Kenya of double digit economic growth, achieving its vision 2030 and the 2030 global sustainable development goals as well as the Africa Agenda 2063 while reaping the benefits of its Demographic Dividend.

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