FACTS ABOUT THE KENYA BANKS REFERENCE RATE

What is Kenya Banks Reference Rate?

The Kenya Banks’ Reference Rate (KBRR) was introduced in July 2014 following discussions between commercial and microfinance banks, mortgage finance institutions, Kenya Bankers Association (KBA), Central Bank of Kenya (CBK), and The National Treasury. It is part of their recommendations to explore ways of enhancing the supply of private sector credit and mortgage finance in Kenya. The primary purpose of the KBRR is to ensure that banks are transparent with respect to the cost and pricing of their products. This is made possible through the KBRR framework that requires banks to disclose and explain to their customers the effective base rate (KBRR) and any additional premium (K) above the base rate. This premium is to be broken down to enable clients to understand its components. This also allows the Government and the Central Bank to make targeted policy interventions to lower the premium.

Computation of KBRR

KBRR is computed as an average of (a) the Central Bank Rate (CBR) and (b) the 2-month weighted moving average of the 91-day Treasury bill rate. The 91-day Treasury bills reflects the floor of risk free assets while CBR reflects the stance of monetary policy. A customer should therefore expect to be charged a lending rate of KBRR + ‘K’. The KBRR should be seen as the minimum price for banks to participate in the credit market. The charges may relate to the individual customer’s risk profile, the type of loan or the risks associated with the investment. These factors may vary from customer to customer depending on the individual ratings reports from Credit Reference Bureaus (CRBs). It also means that any charges above KBRR must be explained to the customer. The charges above KBRR must also be explained to the CBK so that policy or
administrative interventions such as the collateral process and charges can be effected to create a level playing field, thereby increasing the supply of credit in the economy.

**Operationalization of the KBRR**

The KBRR is reviewed and announced by the CBK through the Monetary Policy Committee (MPC) Press Release after its meeting every six months from the effective date and is operationalized through Banking Circulars. At its inception on 8th July, 2014 the CBK computed and set the KBRR at 9.13 percent. It was reviewed to 8.54 per cent on 14th January, 2015 following a reduction in the 2-month weighted moving average of the 91-day Treasury bill rate. To further enhance transparency, in the future, the Central Bank will publish comparative data on ‘K’ for various loan products offered by banks. This will facilitate decision making by customers and promote competition in credit pricing.

**THE TRANSMISSION OF MONETARY POLICY - THE ROLE OF THE KENYA BANKS’ REFERENCE RATE (KBRR)**

Monetary Policy Transmission refers to the process through which monetary policy decisions affect the economy in general and the price level in particular. It therefore refers to various channels through which monetary policy alters prices or output in the real economy.

The Kenya Banks’ Reference Rate (KBRR) is the base rate for lending by commercial banks and microfinance banks as well as for pricing mortgage products. Since one of the components of the KBRR is the Central Bank Rate (CBR), movements in the KBRR will enhance the monetary policy transmission through the lending rate channel. Studies on the transmission of monetary policy via the lending rate have shown that movements in the CBR, which reflect the monetary policy stance, affect the inflation profile and economic activity.

One of the advantages of the KBRR framework is that it minimises information search costs since all banks have the same base rate. In addition, the efficiency in pricing credit ought to allow for competition and a level playing field. However, while the direction and pace of changes in lending interest rates are influenced by changes in the KBRR, it is important to note that there is no one-to-one correspondence between KBRR and
lending rates, due to risk profile differences between individual clients, sectors and types of loans. Therefore, the value of ‘K’ above the KBRR will depend on various factors such as the lender’s perceived customer risk profile, speed and cost of collateral perfection at the Lands Registry, and other costs arising from the due diligence processes. The CBK, KBA, and National Treasury are working with the relevant stakeholders to ensure that the factors that increase lending rates above KBRR are addressed. The CBK would like to parade and analyse these factors over time, in order to inform policy. Consequently, administrative and policy interventions as well as legal amendments will enable the financial system to increase the supply of credit and avail mortgages at affordable rates, while enhancing competition in the market.

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