An 'own goal' describes an act that unintentionally harms one’s own interests.

It is certainly a term that springs to mind when considering the Kenyan Banking Amendment Bill, which imposes interest rate caps on the Kenyan banking sector.

As is well known (and confirmed in a recent World Bank paper) interest rate caps are a highly ineffective means of lowering interest rates or increasing access to finance. They usually result in a marked reduction in credit extension to the private sector, accompanied by strong growth in informal and unregulated money lending, with banks restricting lending to lower risk individuals thus reducing the availability of credit to those who need it the most.

The World Bank also found such regulations led to reduced transparency, decreased levels of competition, lower levels of innovation and a decline in the range of products on offer to customers.

1% in credit extension can mean 0.2 to 0.3% increase in GDP

In macro-economic terms, the rate of growth in private sector credit extension makes an important contribution to overall economic growth, so dramatically reducing access to credit automatically impacts on economic growth.

Studies in Kenya found that a 1% change in credit extension is associated with an average increase of 0.2% to 0.3% in GDP growth. Thus if interest rate caps resulted in a decrease of 10% in total private sector credit extension, GDP growth could fall from 6% to 4%.

When economic growth slows, the number of non-performing loans (NPLs) increase. Thus the level of NPLs, already rising, are also expected to increase. As every banker knows, if one cuts off the supply of new credit, a lot of old credit goes bad.

The impact of interest rate caps are never evenly distributed, as banks have different risk exposures. The most severe impact is on banks that have a strong retail presence, target the lower end of the personal or SME market, and have longer-term exposures; all areas in which governments normally encourage banking activity.

The combined impact of rising NPLs and falling margins may depress the return on equity below a level at which shareholders are willing to invest (or recapitalise), triggering consolidation. This may also occur because there are fewer lending opportunities in the market in which the credit rating aligns with the allowed margin. With fewer lending opportunities looking attractive, banks have little choice other than to aggressively cut costs, principally by reducing their staff complements.

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