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EFFECT OF INTEREST RATES CAPPING ON THE SHARES OF LISTED BANKS; A CASE STUDY OF KENYAN BANKS LISTED ON THE NAIROBI SECURITIES

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ABSTRACT

The capping of interest rates has been a subject of great debate across the world. As a cost of capital, the interest rate is one of the key macroeconomic variables that determine the direction of economic growth. The interest rate environment is, therefore, one of the key areas of focus for policymakers. In Kenya, the Central Bank, which is in charge of monetary policy in the country, introduced a cap on lending rates and deposit rates in September 2016. This was in response to continued calls to lower the high-interest rates that commercial banks were charging. The intention was, therefore, to lower the cost of credit and therefore increase access to credit. However, the enactment of the regulation brought about significant effects on banks, the stock exchange and the economy at large. The objective of this study was to establish the effect of the capping of interest rates on the share performance of banks listed on the Nairobi Securities Exchange. The study used all the eleven banks listed on the Nairobi Securities Exchange as the target population. Comparative analysis of share prices, the volume of shares traded and a market capitalization of the listed banks was carried out for three months prior to the introduction of the interest rates cap and for a further period of three months after the new law was enacted. The study purely relied on secondary data obtained from the NSE and the Central Bank of Kenya. The study found that the capping of interest rates had a significant negative effect on the performance of banks listed on the Nairobi Securities Exchange. Share prices of all the listed banks reduced significantly while volumes traded for nine out of the eleven banks also went down. Investors, therefore, lost significant value after the enactment of the new law. The study concluded that the introduction of the law that capped interest rates had significant adverse effects on the performance of stocks of banks listed on the Nairobi Securities Exchange. The banking stocks have therefore become less attractive for investors resulting in low demand for these stocks. In order to avoid the adverse effects on stock performance, the study recommends the removal of the interest rates cap. The study further recommends that the government should engage all stakeholders in coming up with a market-based pricing policy for loans to replace the interest rates cap.