CENTRAL BANK OF KENYA

CREDIT OFFICER SURVEY

QUARTER ENDED SEPTEMBER 2013

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1.0 FOREWORD

1.1 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan banking sector recorded significant growth in the quarter ended 30th September 2013, compared to the second quarter to 30th June 2013. Some of the sector's performance indicators for the quarter were as follows:

- The aggregate balance sheet (total assets) increased by 4.4 percent from Ksh 2.51 trillion in June 2013 to Ksh 2.62 trillion in September 2013.
- Gross loans and advances grew by 4.8% from Ksh 1.45 trillion in June 2013 to Ksh 1.52 trillion in September 2013.
- Banking sector deposits increased by 2.7% from Ksh 1.86 trillion in June 2013 to Ksh 1.91 trillion in September 2013.
- Total shareholders' funds increased by 4.1 percent from Kshs 394.4 billion in June 2013 to Kshs 410.6 billion in September 2013.
- Cumulative unaudited pre-tax profits for the quarter ended 30th September 2013 stood at Kshs 92.5 billion compared to Kshs 80.8 billion for the quarter ending 30th September 2012, a 14.5% increase.

1.2 CREDIT OFFICER SURVEY

Credit risk is the single largest factor affecting the soundness of banks and the financial system as a whole and lending is the principal business activity for most banks. In the quarter ended 30th September 2013, the ratio of total loans to total assets for the Kenyan banking sector was 58%, unchanged from the previous quarter. In order to identify potential shocks and enhance understanding of credit risk, the Central Bank of Kenya introduced a quarterly Credit Officer Survey effective March 2012.

The Q3 CBK Credit Survey polled and received responses from all 43 institutions currently in operation. The list of the respondents is attached to this report as **Annex I**.

Highlights of the survey's findings are given below:-

- Demand for credit generally increased in most economic sectors, with cheaper credit and increasingly available investment opportunities being the main driving factors; less significant drivers were the retention of the Central Bank Rate in September 2013 at 8.5% and a more stable political environment.
- Credit standards remained largely unchanged across most economic sectors in Q3 of 2013. However, these tightened marginally for consumer loans but eased for trade loans.
- In Q4 of 2013, NPLs are expected to increase in the personal/ household loan category while declining in the Trade, Tourism, Building and Transport sectors.
- In Q4 of 2013, most banks intend to intensify recovery efforts in four sectors namely Personal/Household, Transport, Tourism and the Building sector.

CENTRAL BANK OF KENYA
OCTOBER 2013

2.0 EXECUTIVE SUMMARY

2.1 SURVEY METHODOLOGY

The credit officer survey for the quarter ended September 2013 comprised five questions that focused on:-

- Demand for credit.
- Credit standards.
- Non-performing loans.
- Credit recovery efforts.
- Credit Information Sharing.

The survey, conducted in September 2013, targeted senior credit officers of all 42 operational commercial banks and 1 mortgage finance company. Charterhouse Bank Ltd, which remains under statutory management, was excluded from the survey. All the forty three institutions responded.

2.2 KEY FINDINGS

The key findings from the survey are detailed below.

2.2.1 Demand for Credit

The demand for credit generally increased in the quarter ended September 2013 compared to the quarter ended June 2013. The increased demand is mainly attributed to increased consumer confidence, an enhanced macroeconomic environment and a more stable political environment.

2.2.2 Credit Standards

Credit standards remained largely unchanged across most economic sectors in Q3 of 2013. However, the standards for consumer loans tightened marginally during the quarter while those for trade loans eased.

2.2.3 Non-Performing Loans

Overall, 59% of respondents expect NPLs to remain constant in the fourth quarter of 2013, 16% expect an increase while 25% expect a decrease. 41% of the banks forecast an increase in NPLs in the personal/ household sector in Q4 of 2013. In the same period, 38% of respondents foresee a decline in NPLs in the Trade and Tourism sectors while 28% expect a decrease in the Building and Transport sectors.

2.2.4 Credit Recovery Efforts

In Q4 of 2013, most banks intend to intensify loan recovery efforts in four sectors namely the Personal/Household, Transport, Tourism and Building sectors. The intention to intensify recovery efforts in the Personal/Household sector is in line with the banks' expectations that loan defaults on consumer loans will rise during the quarter ahead, continuing the trend witnessed in the first three quarters of 2013. Increased collection efforts in the Transport, Tourism and Building sectors are a pointer to the higher cash inflows expected during the tourism high season and flow of transport payments to the Transport and Building sectors.

2.2.5 Use of Credit Information Sharing

- 42 institutions (98% of respondents) indicated using the Credit Information Sharing (CIS) mechanism to enhance their credit risk management process.
- 79% of the respondents indicated that they requested credit reports for all credit applications.
- 38% of the respondents that did not request credit reports for all applications indicated reports were requested for applications exceeding specified limits, 12% regarded CIS as ineffective as a screening mechanism while 50% did not request credit reports owing to other internal reasons.

Overall, credit appraisal emerged as the most significant function that the use of credit reports facilitated.

3.0 DETAILED SURVEY FINDINGS

3.1 Demand for Credit

3.1.1 Observations

The Kenyan banking sector witnessed a general increase in demand for credit in the quarter ended 30th September 2013, continuing the trend observed in the quarter ended 30th June 2013. The highest growth in demand for credit was witnessed in the Personal/Household, Trade and Real Estate Sectors with 70%, 63%, 61% of the respondents citing growth. The increased demand for credit was mainly attributed by the respondents to:

- lower costs of borrowing.
- increased availability of investment opportunities.
- increased consumer confidence carried on from the previous quarter.
- a more stable political environment fostering sustained economic activity.

Chart 1 and **Table 1** below present, respectively, the change in the demand for credit in the quarter ended September 2013 as compared to June 2013.

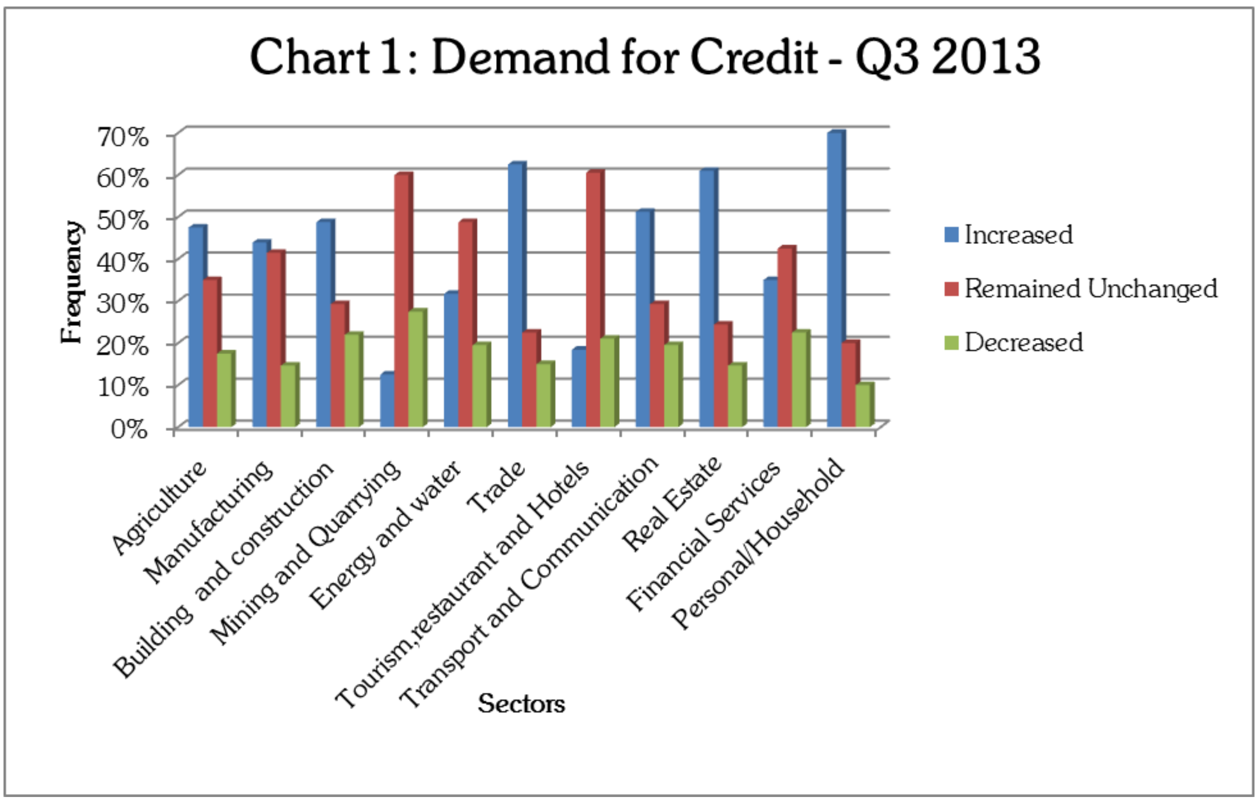


Table 1: Change in Demand for Credit - Q3, 2013						
	September 2013			June 2013		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	48%	35%	18%	41%	44%	15%
Manufacturing	44%	41%	15%	39%	49%	12%
Building & construction	49%	29%	22%	40%	40%	19%
Mining and Quarrying	13%	60%	28%	7%	62%	31%
Energy and water	32%	49%	20%	29%	52%	19%
Trade	63%	23%	15%	67%	14%	19%
Tourism, restaurant and Hotels	28%	48%	25%	28%	48%	25%
Transport and Communication	51%	29%	20%	51%	29%	20%
Real Estate	61%	24%	15%	50%	29%	21%
Financial Services	35%	43%	23%	39%	41%	20%
Personal/Household	70%	20%	10%	63%	15%	22%

3.2 Factors affecting demand for credit

3.2.1 Observations

43% of the respondents attributed the rise in demand for credit reported in the quarter ended 30th September 2013 to lower costs of borrowing and increased availability of investment opportunities. Retention of the Central Bank Rate (at 8.5% in September 2013 from July 2013) and reduced political risk were cited by 37% and 26% of respondents respectively as contributing to increased demand for credit. Respondents who reported decreased credit demand attributed this to higher borrowing costs (31%) and availability of alternative finance from non-bank sources (30%). The issuance of debt and equity securities was cited by 5% of respondents as having the least influence on the demand for credit during the quarter under review. These responses are presented in **Chart 2** and **Table 2** below.

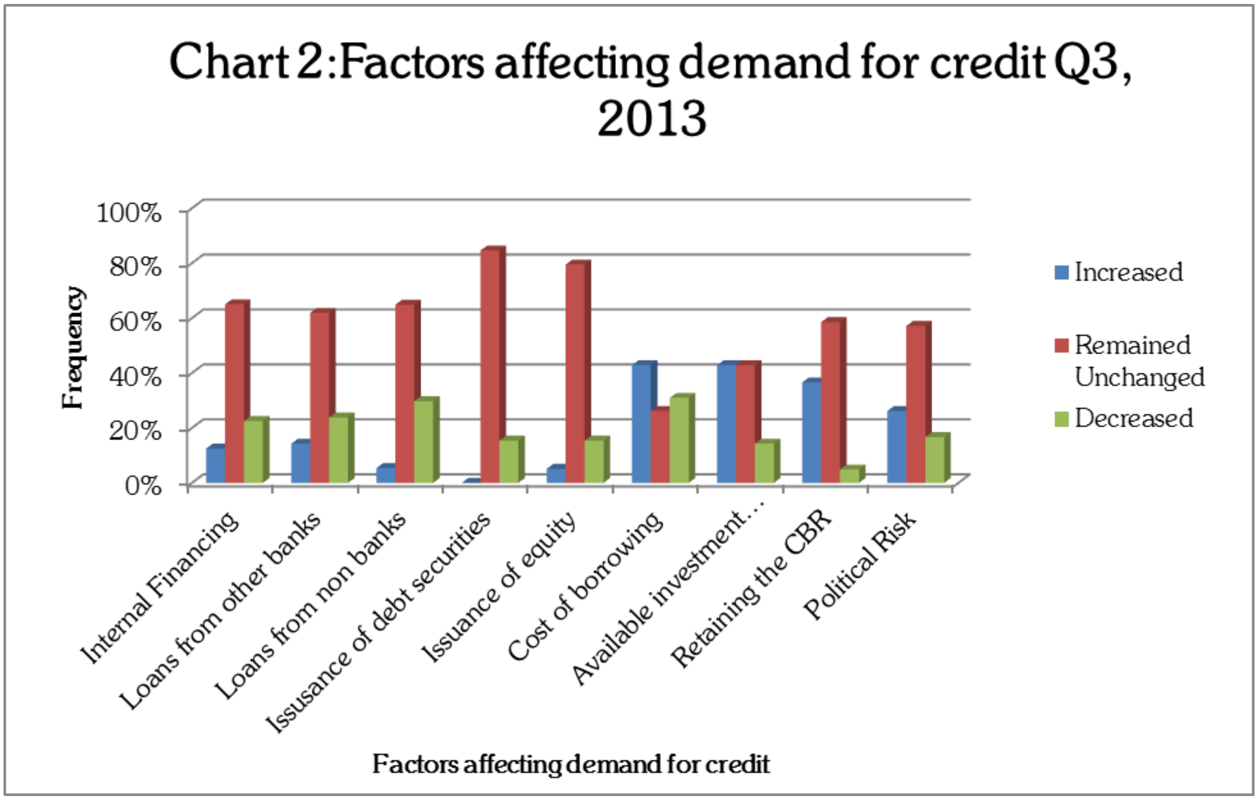


Table 2: Factors affecting Demand for credit

	September 2013			June 2013		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	13%	65%	23%	12%	68%	20%
Loans from other banks	14%	62%	24%	14%	49%	37%
Loans from non-banks	5%	65%	30%	12%	52%	36%
Issuance of debt securities	0%	85%	15%	3%	79%	18%
Issuance of equity	5%	79%	15%	0%	80%	20%
Cost of borrowing	43%	26%	31%	40%	28%	33%
Available investment opportunities	43%	43%	14%	48%	45%	7%
Retention of CBR	37%	59%	5%	54%	41%	5%
Political Risk	26%	57%	17%	63%	30%	7%

3.3 Credit Standards

3.3.1 Observations

From respondents' feedback, credit standards remained substantially unchanged over the three months to 30th September 2013. 80% of respondents reported no major change, 13% reported a tightening of standards while 7% reported credit standards as having eased. With regard to individual economic sectors, 95% of respondents indicated that standards had least changed in the mining and energy sectors. Access to credit had tightened most for the building and personal/household sectors (27% each) followed by the real estate sectors(24%). 20% of the respondents felt that access to credit had eased most in the trade sector followed by 15% and 12% for the personal/household and real estate sectors respectively.

Chart 3 and **Table 3** below present the responses on changes in credit standards in Kenya's banking sector over the three months to 30th September 2013.

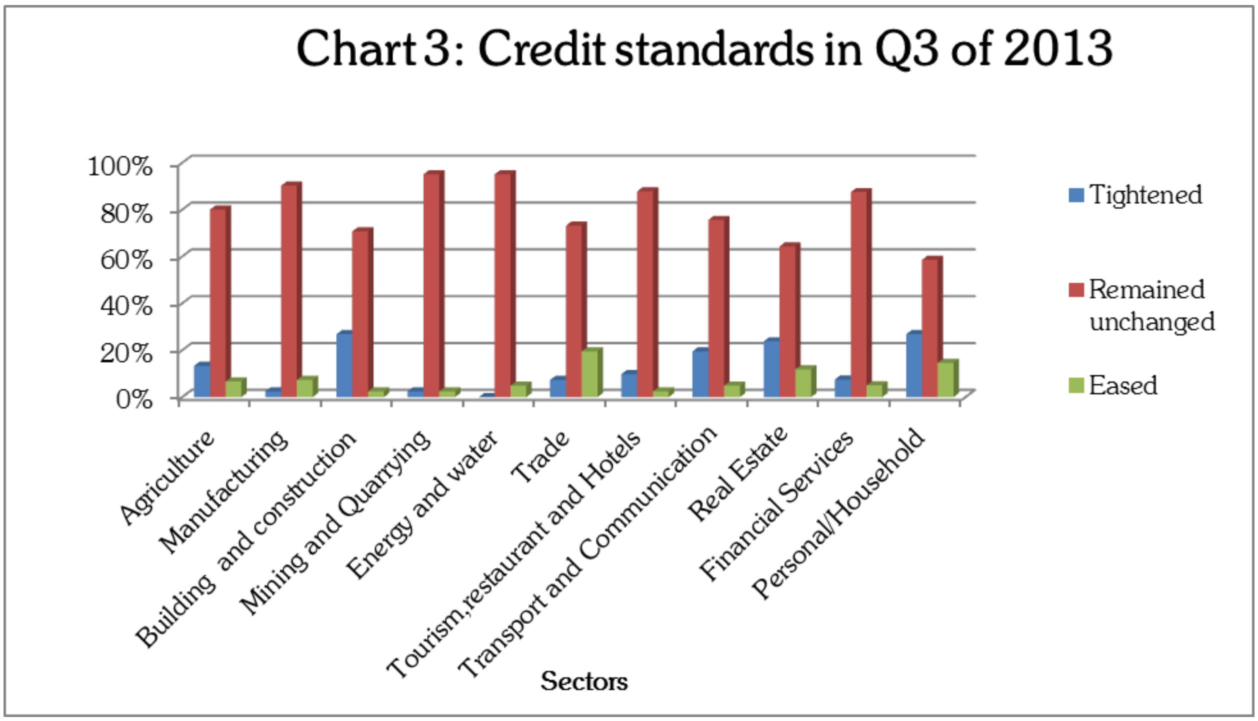


Table 3: Credit Standards in Q3 of 2013

	September 2013			June 2013		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	13%	80%	7%	8%	83%	5%
Manufacturing	2%	90%	7%	3%	83%	10%
Building & Construction	27%	71%	2%	21%	57%	10%
Mining and Quarrying	2%	95%	2%	5%	83%	7%
Energy and water	0%	95%	5%	0%	88%	3%
Trade	7%	73%	20%	7%	71%	12%
Tourism, Restaurants and Hotels	10%	88%	2%	10%	63%	2%
Transport and Communication	20%	76%	5%	14%	67%	5%
Real Estate	24%	64%	12%	19%	60%	7%
Financial Services	8%	88%	5%	7%	78%	2%
Personal/Household	27%	59%	15%	17%	60%	8%

3.4 Factors affecting credit standards

3.4.1 Observations

Over the three months to 30th September 2013, 80% of respondents indicated that credit standards remained largely unchanged from the previous quarter. 13% indicated reported tighter credit standards while 7% reported that their standards had eased. Respondents that tightened credit standards were largely influenced by the cost of bank credit (as indicated by 31% of respondents), economic prospects (21%) and political uncertainty (19%). Institutions that eased their credit standards, on the other hand, were driven largely by competititon from other banks (as indicated by 33% of respondents), competititon from non-bank sources and economic prospects as well (each indicated by 19% of respondents). Overall, the findings suggest that credit standards during the 3rd quarter remained constant.

The responses are presented in **Chart 4** and **Table 4** below.

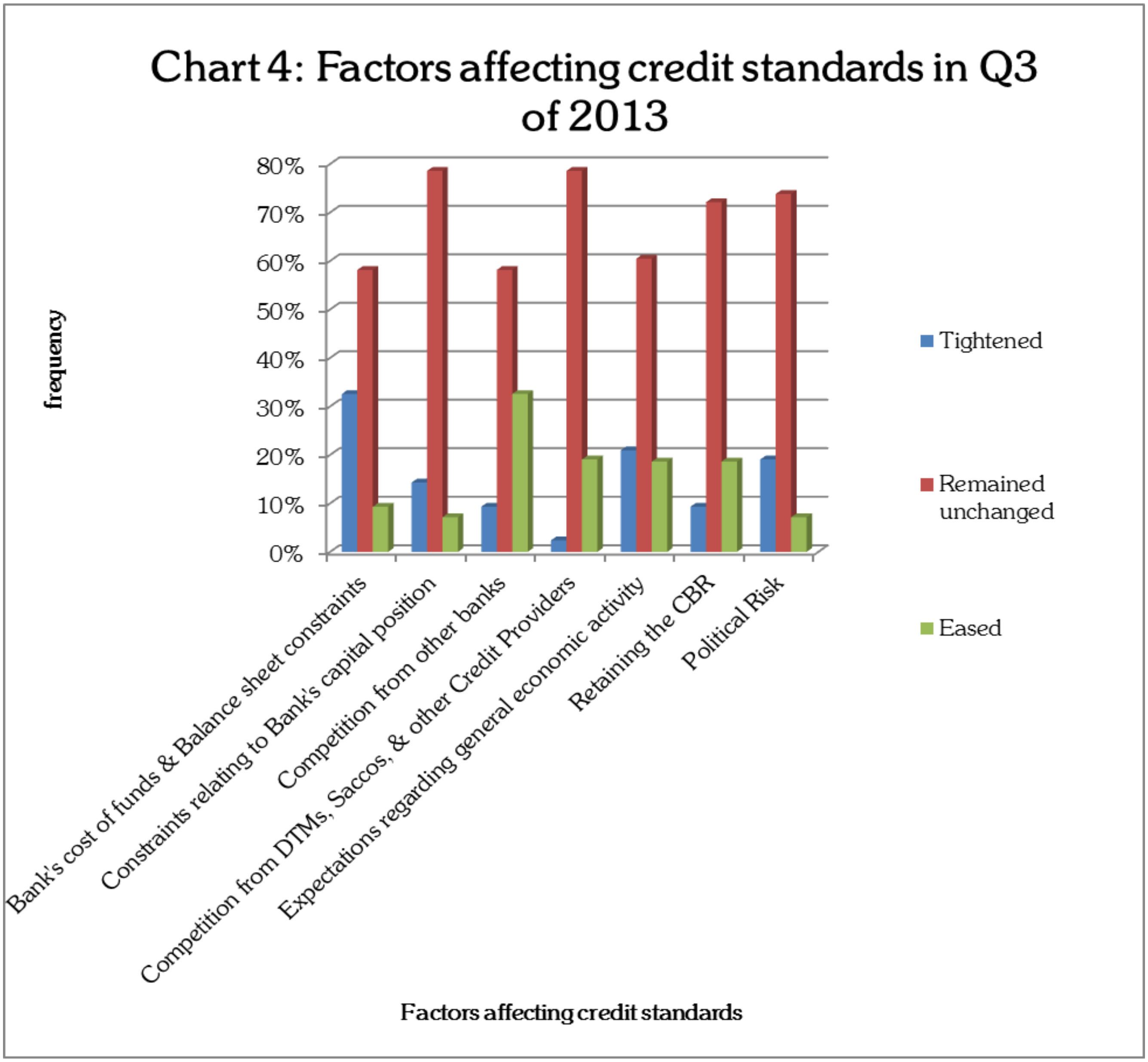


Chart 4: Factors affecting credit standards in Q3 of 2013
frequency
80%
70%
60%
50%
40%
30%
20%
10%
0%
Bank's cost of funds & Balance sheet constraints
Constraints relating to Bank's capital position
Competition from other banks
Competition from DTMs, Saccos, & other Credit Providers
Expectations regarding general economic activity
Retaining the CBR
Political Risk
Tightened
Remained unchanged
Eased
Factors affecting credit standards

Table 4: Impact of factors affecting credit standards

	September 2013			June 2013		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds & Balance sheet constraints	33%	58%	9%	40%	44%	16%
Constraints relating to Bank's capital position	14%	79%	7%	12%	76%	12%
Competition from other banks	9%	58%	33%	9%	56%	35%
Competition from DTMs, Saccos, & other Credit Providers	2%	79%	19%	2%	77%	21%
Expectations regarding general economic activity	21%	60%	19%	12%	56%	33%
Drop in Central Bank Rate (CBR)	9%	72%	19%	5%	60%	35%
Political Risk	19%	74%	7%	26%	63%	12%

3.5 Non-Performing Loans (NPLs)

3.5.1 Observations

Overall, 59% of respondents expect NPLs to remain constant in the fourth quarter of 2013, 16% expect an increase while 25% expect a decrease. By loan category, 41% of respondents foresee increased NPLs in the Personal/Household sector, 39% foresee no change while 20% predict a fall. On the other hand, 38% of respondents foresee a decline in NPLs in the Trade and Tourism sectors while 28% of respondents also expect a decrease in the building and transport sectors.

The forecasted increase in NPLs in the personal/household sector could be attributed to the increased consumer lending witnessed over the first three quarters of 2013, which is expected to continue in Q4 of 2013 as the festive season approaches. It is felt that NPLs should rise in tandem with the volume of lending. The lower NPLs expected in the Trade and Tourism sectors may be an indication of banks' positive expectations of stronger performance and better loan repayment capacity of players in both sectors as the tourism high season draws near.

Chart 5 and **Table 5** below indicate respondents' expectations on NPL trend in Q4 of 2013.

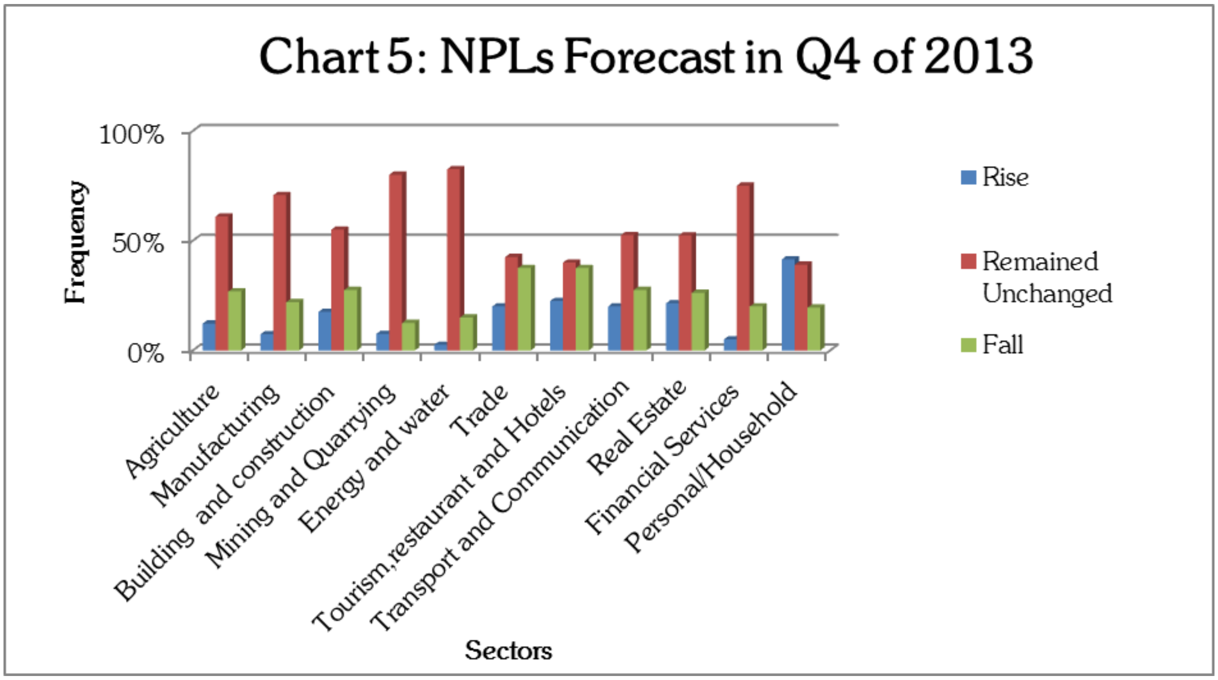


Table 5: Non Performing Loans Trend

	Sep 2013			June 2013		
	Rise	Remained Constant	Fall	Rise	Remained Constant	Fall
Agriculture	12%	61%	27%	2%	61%	37%
Manufacturing	7%	71%	22%	5%	66%	29%
Building & construction	18%	55%	28%	15%	43%	43%
Mining and Quarrying	8%	80%	13%	5%	82%	13%
Energy and water	3%	83%	15%	8%	65%	27%
Trade	20%	43%	38%	15%	34%	51%
Tourism, Restaurants & Hotels	23%	40%	38%	0%	55%	45%
Transport & Communication	20%	53%	28%	10%	48%	43%
Real Estate	21%	52%	26%	17%	38%	45%
Financial Services	5%	75%	20%	6%	81%	13%
Personal/Household	41%	39%	20%	34%	29%	37%

3.6 Credit Recovery Efforts

3.6.1 Observations

In the quarter ending 31st December 2013, banks intend to intensify recovery efforts in four sectors (Personal/Household, Transport, Tourism and Building sectors) to improve the overall quality of their asset portfolio.

The Personal/Household sector is expected to witness the greatest recovery efforts in the fourth quarter of 2013, with 71% of respondents predicting a step-up of efforts in this regard. This will be followed by the Transport, Tourism and Building sectors as indicated by 59%, 58% and 58% of the respondents respectively.

The intensification of recovery efforts in the Personal/Household sector is in line with the banks expectations that loan defaults on consumer loans will rise during the quarter in question, continuing the trend witnessed in the first three quarters of 2013. The expectations may also be due to the anticipated reduction in disposable income as the enhanced VAT regime kicks in. Increased collection efforts in the Transport, Tourism and Building sectors are a pointer to the higher cash inflows expected during the tourism high season and flow of payments to the Transport and Building sectors.

The responses on the expected credit recovery efforts by the banks during the quarter ending 31st December 2013 are depicted in **Chart 6** and **Table 6** below.

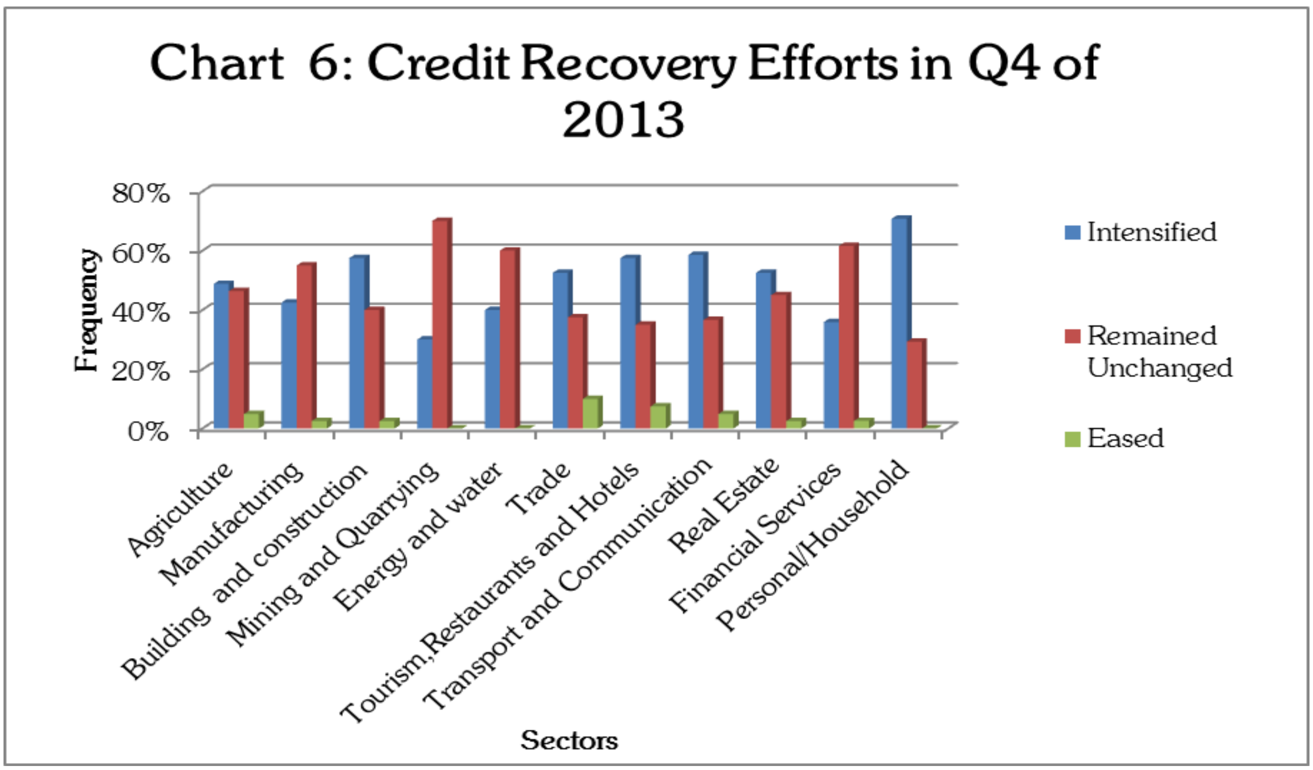


Table 6: Credit Recovery Efforts

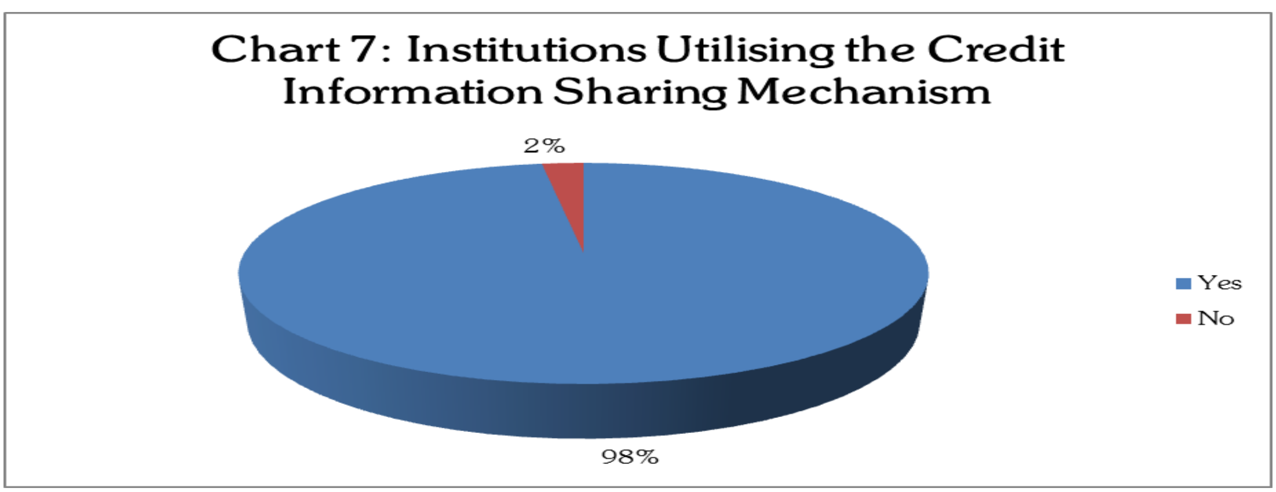
	September 2013			June 2013		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	49%	46%	5%	40%	53%	8%
Manufacturing	43%	55%	3%	22%	67%	11%
Building & construction	58%	40%	3%	55%	38%	8%
Mining and Quarrying	30%	70%	0%	31%	67%	3%
Energy and water	40%	60%	0%	32%	63%	5%
Trade	53%	38%	10%	56%	34%	10%
Tourism, Restaurants & Hotels	58%	35%	8%	43%	45%	13%
Transport & Communication	59%	37%	5%	51%	41%	8%
Real Estate	53%	45%	3%	55%	33%	12%
Financial Services	36%	62%	3%	33%	60%	8%
Personal/Household	71%	29%	0%	76%	17%	7%

3.7 Credit Information Sharing

3.7.1 Use of Credit Information Sharing Mechanism

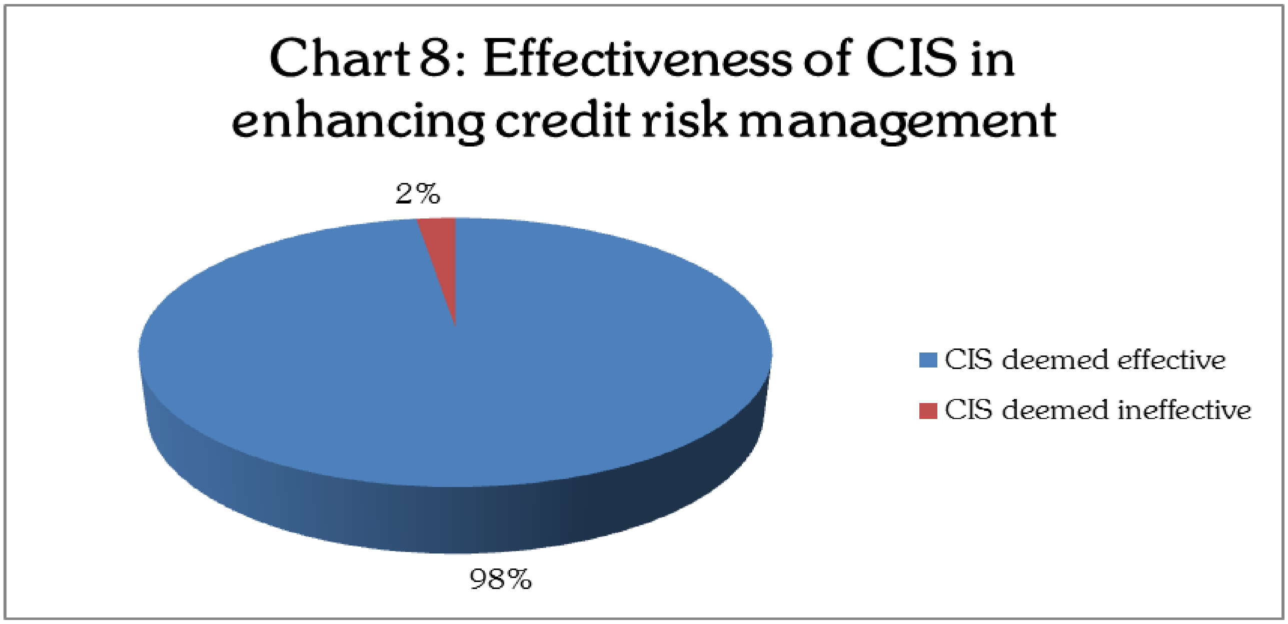
42 institutions (98% of respondent banks) indicated that they use the Credit Information Sharing (CIS) mechanism to enhance their credit risk management process. This high proportion of users is an implicit acknowledgement by the banking industry of the growing significance of information capital as a consideration in credit allocation decisions.

Chart 7 below illustrates the respective proportions of institutions that made use of the CIS mechanism as well as those that were yet to utilize the mechanism as 30th September 2013.



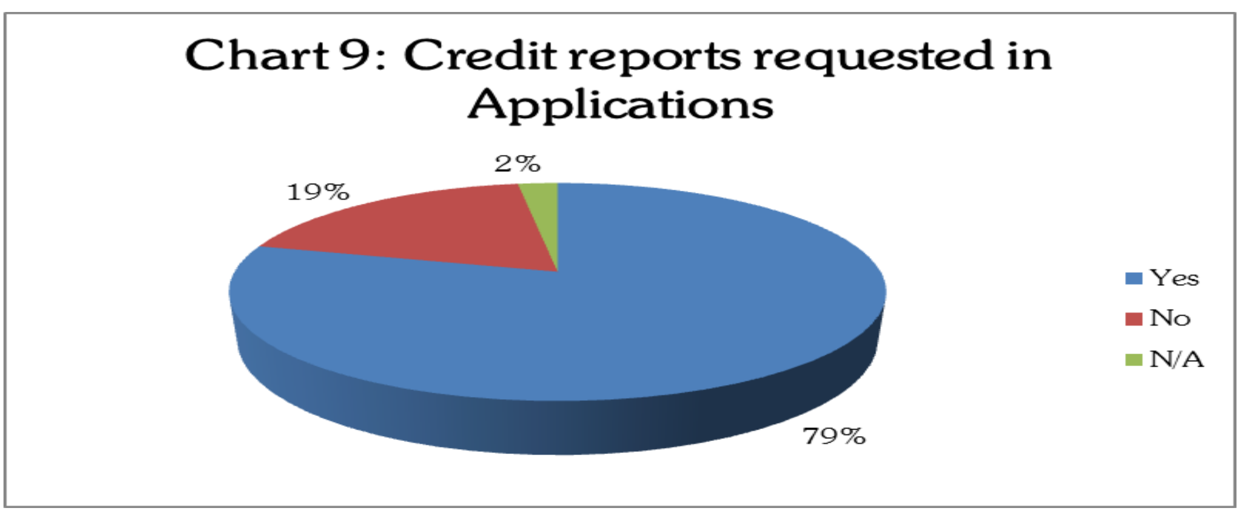
3.7.2 Effectiveness of Credit Information Sharing Mechanism

98% of the respondents utilizing the CIS mechanism all reported having benefitted from the mechanism through enhanced credit management processes. This is an indication of growing appreciation by the banking industry of the potential utility of the CIS mechanism in facilitating selection and pricing of credit risks and ultimately in improving asset quality. The responses are depicted in **Chart 8** below.



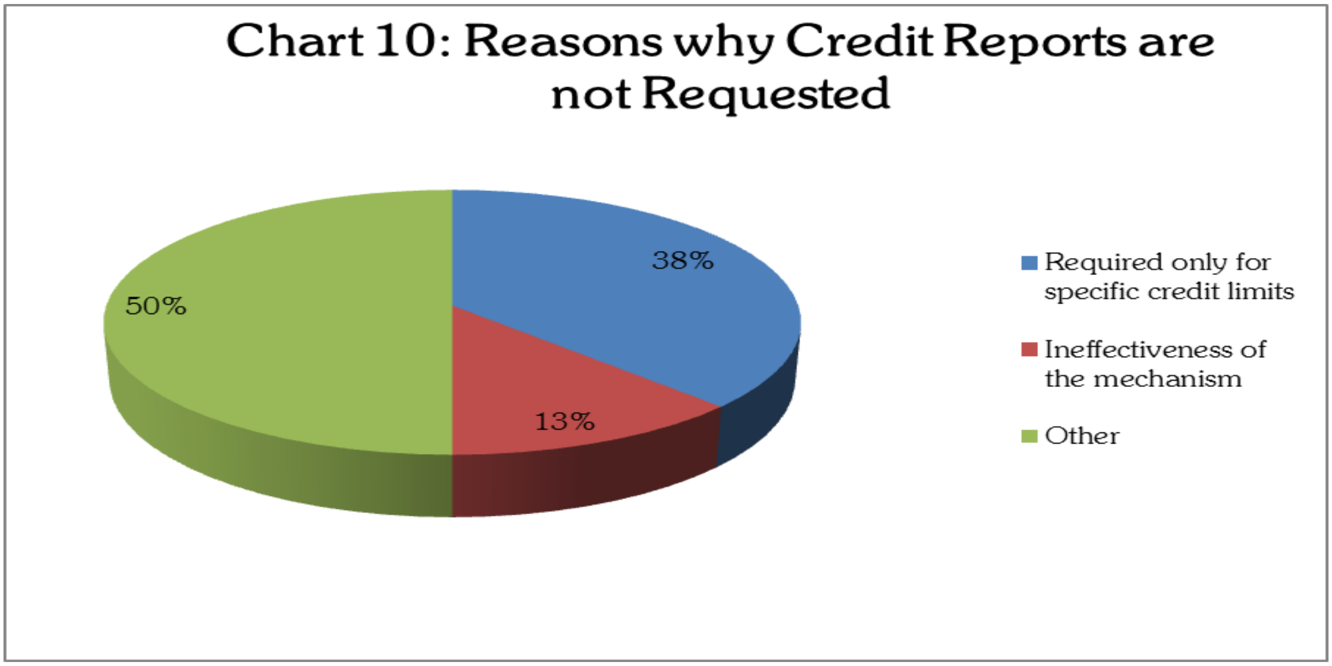
3.7.3 Requirement for Credit Reports in Credit Applications

79% of the respondents indicated that they requested credit reports for all credit applications while 8 (19%) indicated they did not request reports in each and every instance. This indicates that, despite the growing acceptance of borrowers' credit histories in evaluating applications, credit reports are yet to become integral to all credit applications. The responses are depicted in **Chart 9** below.



3.7.4 Reasons for not Requesting Credit Reports

Of the institutions that did not request credit reports in all instances, 38% indicated that they required reports only for new customers and applications exceeding specified limits. 12% regarded CIS as ineffective as a screening mechanism while 50% did not request credit reports due to other internal reasons, such as where applicants were existing, well-known customers with an acceptable past repayment record. The responses are depicted in **Chart 10** below.

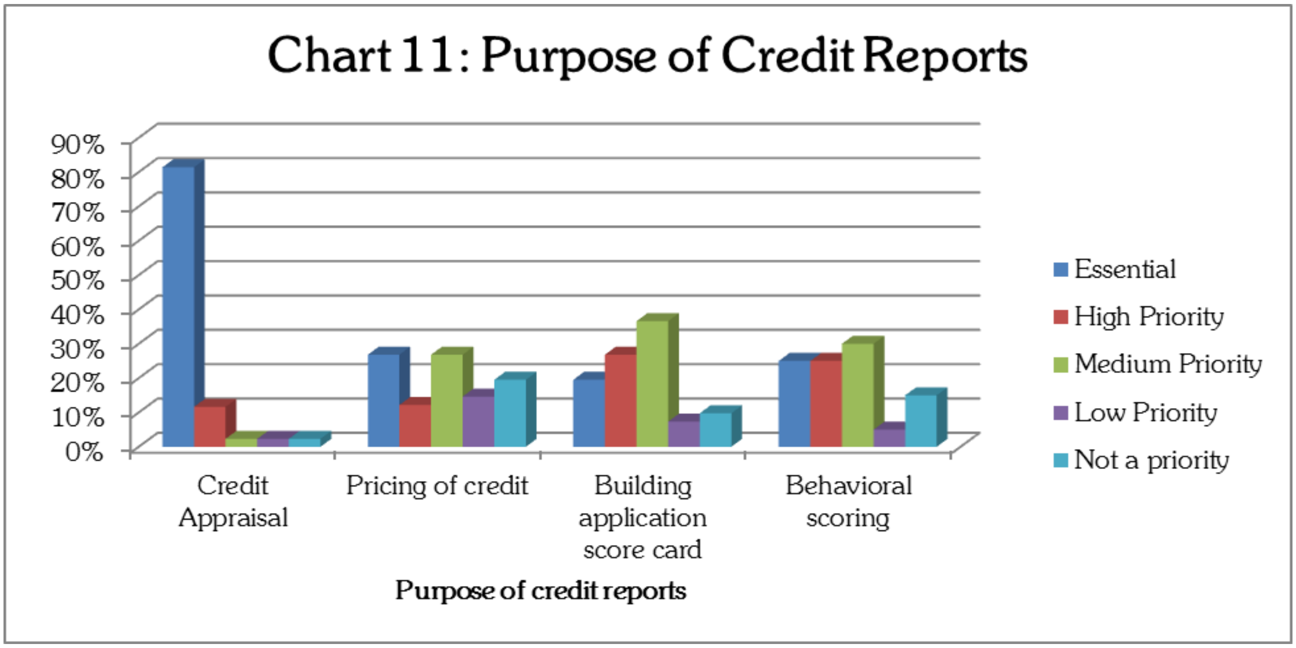


3.7.5 Purposes of Credit Reports

The survey sought to establish the purposes for which institutions used credit reports and to determine the significance of credit reports in facilitating achievement of those purposes.

Overall, credit appraisal emerged as the most significant function facilitated by credit reports, with 81% of the respondents terming it essential and 2% regarding it as not a priority. 27% of the respondents regarded credit pricing as the most essential function enabled by credit reports while 20% considered it not a priority. 20% of the respondents considered building application score cards as essential while 10% considered it a not a priority. 25% regarded behavioural scoring as the essential function accomplished through use of credit reports while 15% termed it a non-priority. The responses are depicted in **Chart 11** below.

Other purposes given include determination of applicants' present debt levels as well as past default levels as an indicator of possible future loan losses and corroboration of customer information.



The above responses collectively point to the growing importance of credit reports as a source of information for banks in evaluating and, to a lesser extent, in pricing credit risks. It is an indication that the banking industry is gradually embracing information capital as alternative collateral for prospective borrowers. If sustained, this trend could, in the long run, open access to credit for the high number of potential borrowers who are presently excluded from credit owing to inability to advance acceptable collateral.

Given the above responses, there is need to move from using credit referencing mainly for appraisal to pricing of risks as this is when the benefits of lower cost of credit will accrue. The current reliance on the CIS mechanism for appraisal is understandable as credit referencing has hitherto focused just on negative information. With new regulations coming up encompassing positive information and bringing in Deposit-Taking Microfinance institutions, pricing of credit, building application scorecards and behavioural scoring should become more important. This is what will tie credit pricing to risk and reward good borrowers based on their information capital.

Annex I (List of Respondents)

1. African Banking Corporation Ltd.
2. Bank of Africa Kenya Ltd.
3. Bank of Baroda
4. Bank of India
5. Barclays Bank of Kenya Ltd.
6. CfC Stanbic Bank Ltd.
7. Chase Bank (K) Ltd.
8. Citibank N.A Kenya.
9. Commercial Bank of Africa Ltd.
10. Consolidated Bank of Kenya Ltd.
11. Co-operative Bank of Kenya Ltd.
12. Credit Bank Ltd.
13. Development Bank of Kenya Ltd.
14. Diamond Trust Bank (K) Ltd.
15. Dubai Bank Kenya Ltd.
16. Ecobank Kenya Ltd.
17. Equatorial Commercial Bank Ltd.
18. Equity Bank Ltd.
19. Family Bank Ltd.
20. Fidelity Commercial Bank Ltd.
21. Fina Bank Ltd.
22. First Community Bank Limited.
23. Giro Commercial Bank Ltd.
24. Guardian Bank Ltd.
25. Gulf African Bank Limited.
26. Habib Bank A.G Zurich.
27. Habib Bank Ltd.
28. I & M Bank Ltd.
29. Imperial Bank Ltd.
30. Jamii Bora Bank Ltd.
31. Kenya Commercial Bank Ltd.
32. K-Rep Bank Ltd.
33. Middle East Bank (K) Ltd.
34. National Bank of Kenya Ltd.
35. NIC Bank Ltd.
36. Oriental Commercial Bank Ltd.
37. Paramount Universal Bank Ltd.
38. Prime Bank Ltd.
39. Standard Chartered Bank (K) Ltd.
40. Trans-National Bank Ltd.
41. Victoria Commercial Bank Ltd.
42. UBA Kenya Bank Ltd.
43. Housing Finance Ltd.