CENTRAL BANK OF KENYA

CREDIT OFFICER SURVEY

JANUARY-DECEMBER 2014

Table of Contents

Contents **Page**

1.0 FOREWORD

1.1 KENYAN BANKING SECTOR PERFORMANCE

For the year 2014, the Kenyan Banking Sector recorded continued growth. Some of the sector's performance indicators are as follows:

- The aggregate balance sheet increased by 19.36% from Kshs 2.73 trillion in December 2013 to Kshs 3.26 trillion in December 2014.
- Gross loans increased by 22.85% from Kshs 1.60 trillion in December 2013 to Kshs 1.97 trillion in December 2014.
- Deposits grew by 17.68% from Kshs 1.98 trillion in December 2013 to Kshs 2.33 trillion in December 2014.
- Total shareholders' funds increased by 22.85% from Kshs 431.49 billion in December 2013 to Kshs 530.09 billion in December 2014.
- Total income increased by 15.86% from Kshs 358.26 billion in December 2013 to Kshs 415.07 billion in December 2014 while total expenses increased by 17.12% from Kshs 233.93 billion in December 2013 to Kshs 273.97 billion in December 2014.
- Interest income on loans increased by 16.29% in December 2014 to Kshs 245.7 billion up from Kshs 211.19 billion in December 2013.
- Interest expenses on deposits increased by 24.03% to Kshs 89.58 billion in December 2014 up from Kshs 72.22 billion in December 2013.
- Unaudited pre-tax profits for 31st December 2014 stood at Kshs 141.09 billion compared to Kshs 124.34 billion for 31st December 2013 recording an increase of 13.47 per cent.

1.2 CREDIT OFFICER SURVEY

Credit risk is the single largest factor affecting the soundness of financial institutions and the financial system as a whole and lending is the principal business for most banks. The ratio for total loans to total assets for the year ended 31st December 2014 was 59.48% a slight increase from 58.2% reported in December 2013. In order to identify the potential causes and enhance understanding of credit risk, the Central Bank of Kenya introduced a quarterly Credit Officer Survey in 2012.

For the quarter ended 31st December 2014, CBK received Credit Officer Survey responses from 42 operational banks and 1 mortgage finance company. The list of the responding banks is attached to this report as **Annex I**.

CENTRAL BANK OF KENYA
JANUARY 2015

2.0 EXECUTIVE SUMMARY

2.1 SURVEY METHODOLOGY

The credit officer survey for the year 2014 predominantly included four questions that focused on:-

- Demand for credit.
- Credit standards.
- Non-Performing loans.
- Credit recovery efforts.

The survey, conducted in January 2015, 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. The list of the respondents is attached to this report as **Annex I**.

2.2 KEY FINDINGS

The key findings from the survey are detailed below.

2.2.1 Demand for credit

In year 2014, demand for credit generally increased in six economic sectors and remained constant in five economic sectors. The surveys established that available investment opportunities, cost of borrowing, the Kenya Bankers Reference Rate (KBRR) and retention of CBR at 8.5% were cited as the main factors that led to increased demand for credit.

2.2.2 Credit Standards

In 2014, credit standards generally remained unchanged in all the eleven economic sectors. This indicates that banks adopted relatively conservative credit policies in 2014 as they did in 2013.

2.2.3 Non-Performing Loans

For the first quarter of 2015, most banks expect the levels of non-performing loans to generally remain constant across the economic sectors. However, banks foresee increasing NPLs in Energy and Water, Manufacturing, Real Estate and Household sectors. For the Household sector, this may be attributed to cyclical reduction of customers' disposable income as a result of increased expenditures by customers during the December/January festivities.

2.2.4 Credit Recovery Efforts

In Q1 of 2015, most banks intend to intensify their loan recovery efforts in all the eleven economic sectors with Agriculture, Energy and Water, Transport and Personal/Household sectors expected to witness higher recovery efforts than other economic sectors.

3.0 SURVEY FINDINGS

3.1 Demand for Credit

3.1.1 Observations

The demand for credit generally increased in the eleven economic sectors in 2014. This is supported by the expansion in gross loans from Kshs 1.60 trillion in December 2013 to Kshs 1.97 trillion in December 2014. Comparison of the eleven economic sectors shows that the highest growth in demand for credit was witnessed from Personal/Household, Transport and Communication, Agriculture and Trade sectors.

At the beginning of the year the Kenyan banking sector witnessed a general increase in demand for credit driven by lower cost of borrowing, increased investment opportunities and the retention of CBR at 8.5%. This increasing trend was also observed in the second and third quarters of 2014.

In Q4 of 2014, highest growth in demand for credit was witnessed in Tourism, Personal/Household, Transport and Communication, Agriculture and Trade sectors by 15%, 12%, 10% and 6% respectively. As much as the demand for credit increased, some of the respondents felt that demand for credit remained constant in the sectors due to the wait and see attitude as investors wait for the full effect of KBRR.

Table 1 below details the reported trend in demand for credit over the four quarters of 2014.

	Dec-14			Sep-14			Jun-14			Mar-14		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	39%	46%	15%	33%	55%	13%	35%	58%	8%	51%	41%	7%
Manufacturing	45%	29%	26%	50%	38%	12%	43%	45%	12%	43%	38%	19%
Building & Construction	51%	40%	9%	60%	26%	14%	47%	35%	19%	60%	24%	17%
Mining and Quarrying	7%	80%	12%	21%	65%	14%	20%	66%	15%	14%	71%	14%
Energy and Water	23%	60%	16%	37%	51%	12%	29%	55%	17%	26%	45%	29%
Trade	72%	21%	7%	67%	28%	5%	56%	30%	14%	69%	21%	10%
Tourism, Restaurant and Hotels	35%	42%	23%	20%	49%	32%	28%	51%	21%	32%	44%	24%
Transport and Communication	54%	46%	0%	44%	42%	14%	52%	33%	14%	50%	40%	10%
Real Estate	55%	33%	12%	57%	33%	10%	46%	39%	15%	50%	31%	19%
Financial Services	17%	66%	17%	31%	60%	10%	34%	51%	15%	34%	51%	15%
Personal/Household	65%	30%	5%	53%	38%	10%	56%	32%	12%	59%	24%	17%

3.2 Factors affecting demand for credit

3.2.1 Observations

In 2014, the main factors that caused the demand for credit to increase were internal financing, loans from other banks, drop in cost of borrowing, increased available investment opportunities as a result of a stable macroeconomic environment, KBRR and the retention of CBR at 8.5%.

In Q4 of 2014, issuance of equity, debt securities, retention of CBR at 8.5% and loans from non-banks were cited by 95%, 85%, 71% and 67% of the respondents respectively, as having had the least influence on the demand for credit during the quarter under review.

Table 2 : details the factors affecting demand for credit over the four quarters of 2014.

	Dec-14			Sep-14			Jun-14			Mar-14		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	18%	62%	21%	12%	69%	19%	10%	69%	21%	7%	73%	20%
Loans from other banks	29%	12%	59%	11%	60%	29%	16%	58%	26%	10%	54%	37%
Loans from non-banks	3%	67%	31%	5%	70%	25%	10%	64%	26%	13%	55%	33%
Issuance of debt securities	3%	85%	13%	3%	85%	13%	0%	86%	14%	5%	83%	13%
Issuance of equity	0%	95%	5%	3%	92%	5%	5%	78%	17%	6%	81%	14%
Cost of borrowing	32%	46%	22%	27%	42%	31%	28%	42%	30%	35%	37%	28%
Available investment opportunities	45%	45%	10%	49%	42%	9%	47%	44%	9%	43%	43%	14%
Retention of CBR	26%	71%	2%	21%	74%	5%	23%	70%	7%	33%	62%	5%
Political Risk	15%	66%	20%	19%	67%	14%	9%	60%	30%	19%	60%	21%
KBRR	0%	59%	5%	26%	68%	5%	0%	0%	0%	0%	0%	0%

3.3 Credit Standards

3.3.1 Observations

In 2014, credit standards generally remained unchanged for all the eleven economic sectors as most of the factors that influence changes on banks credit standards had little impact. This supports the finding that credit standards to all economic sectors generally remained unchanged in the four quarters. This seems to indicate that banks adopted conservative credit policies in 2014 as was the case in 2013.

In 2014 access to credit was tightened for the Tourism sector by 27% (Q1) , 34% (Q2), 39% (Q3) and 40% (Q4) of the respondents whereas access to credit had been eased for the Trade sector by 24% (Q1) , 17% (Q2), 21% (Q3) and 19% (Q4) of the respondents.

Table 3 shows the trend in credit standards over the four quarters of 2014.

	Dec-14			Sep-14			Jun-14			Mar-14		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	10%	83%	7%	7%	83%	10%	17%	76%	7%	12%	83%	5%
Manufacturing	5%	88%	7%	9%	77%	14%	7%	85%	7%	7%	83%	10%
Building & Construction	38%	52%	10%	30%	56%	14%	21%	72%	7%	31%	62%	7%
Mining and Quarrying	5%	90%	5%	7%	91%	2%	5%	95%	0%	5%	93%	2%
Energy and Water	5%	90%	5%	2%	91%	7%	7%	93%	0%	5%	93%	2%
Trade	7%	74%	19%	5%	74%	21%	14%	69%	17%	12%	64%	24%
Tourism, Restaurant and Hotels	40%	52%	7%	39%	59%	2%	34%	63%	2%	27%	68%	5%
Transport and Communication	31%	62%	7%	28%	60%	12%	24%	71%	5%	24%	67%	10%
Real Estate	27%	68%	5%	33%	58%	10%	19%	71%	10%	21%	64%	14%
Financial Services	2%	95%	2%	2%	90%	7%	5%	87%	8%	3%	88%	10%
Personal/Household	24%	64%	12%	17%	64%	19%	18%	63%	20%	18%	63%	20%

3.4 Factors affecting credit standards

3.4.1 Observations

In the four quarters of 2014, credit surveys highlighted eight factors which led to the credit standards remaining constant. Constraints relating to the banks capital, competition from other credit providers, retention of the Central Bank Rate(CBR) and political risk were reported by the respondents as being the main factors that contributed to credit standartds remaining constant.

The quarterly credit survey for 2014 demonstrated that the recent spate of insecurity in the country may be attributed to the tightened access to credit in the Tourism sector whereas the banks eased their credit standards due to competition from other banks.

Table 4 below shows the trend in factors influencing credit standards over the four quarters of 2014.

	Dec-14			Sep-14			Jun-14			Mar-14		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds & Balance sheet constraints	38%	57%	5%	34%	61%	5%	33%	65%	2%	35%	63%	2%
Constraints relating to Bank's capital position	24%	71%	5%	27%	71%	2%	19%	79%	2%	21%	74%	5%
Competition from other banks	5%	67%	29%	5%	54%	41%	9%	65%	26%	7%	56%	37%
Competition from DTMs, Saccos, & other Credit Providers	0%	81%	19%	0%	80%	20%	2%	81%	16%	2%	76%	21%
Expectations regarding general economic activity	14%	67%	19%	15%	63%	22%	26%	58%	16%	14%	55%	31%
Retention of Central Bank Rate (CBR)	5%	86%	10%	2%	88%	9%	9%	74%	16%	5%	74%	21%
Political Risk	7%	79%	10%	16%	74%	9%	30%	65%	5%	17%	73%	10%
KBRR	0%	0%	0%	3%	75%	23%	30%	65%	5%	17%	73%	10%

3.5 Non-Performing Loans (NPLs)

3.5.1 Observations

In the first quarter of 2014, most banks forecasted an increase in the Agriculture, Tourism and Real Estate sectors while the Energy and Water sectors are expected to experience a drop in NPLs in Q2. However, the actual expectations on NPLs for the quarter ended 30th June 2014 increased in personal/household, Transport and Communication and Tourism sectors by 9%, 8% and 12% of the respondents respectively whilst NPLs in the Agricultural sector remained constant.

In the second quarter of 2014, most of the banks expected level of NPLs to remain unchanged in Q3 of 2014. However, there was a significant increase in the number of respondents that expected higher NPLs in the Tourism, Personal/Household, Trade and Transport sectors. These were 12%, 9%, 9% and 8% increase in the number of respondents respectively as compared to the quarter ended March 2014.

In the third quarter, banks had forecasted that the level of NPLs would remain constant across all economic sectors. There was a significant increase in the number of respondents that saw higher NPLs in the Building and Construction, Mining and Quarrying, Real Estate and Tourism sectors. These were 15%, 8%, 4% and 3% increase in the number of respondents respectively as compared to the quarter ended June 2014.

It is worth noting some of the factors that contributed to the increased NPLs in 2014 include:

- The increase in NPLs in the Personal and Household sectors was attributed to the cyclical reduction of customers' disposable income as a result of increased one off expenditures during the December/January festivities.
- The recent spate of insecurity in the country and the heightened political activity may support the expected increase in NPLs in the Tourism sector.
- The expected increase of NPLs in the Agriculture sector was explained by reduction in tea prices arising from over production and glut in the market, and the prevailing delayed onset of long rains (March – May 2014).
- The expected increase in NPLs in the Transport sector was attributed to new transport rules introduced by the National Transport and Safety Authority, which imposes operational constraints to the public transport operators in the short term.
- The expected increase in NPLs in the Building and Construction, Real Estate, Mining and Quarrying sector in the third quarter was attributed to the impasse between the Ministry of Lands and the National Land Commission, uncertainties in the on-going reforms in the Mining sector and slow payments by government to its contractors.

Though most of the banks expect level of NPLs to remain unchanged in Q1 of 2015, there was a significant increase in the number of respondents that foresee higher NPLs in the Manufacturing, Energy and Water, Real Estates and Personal/Household sectors. These were 3%, 2%, 3% and 12% increase in the number of respondents respectively as compared to the quarter ended September 2014.

This increase in NPLs in Q1 of 2015 may be attributed to:

- ✓ Delayed payments to contractors by the government.
- ✓ The general drop in income may also affect traders, contractors and employed persons as well as delayed salaries to the teachers due to industrial unrest thus increasing NPLs in the Personal/Household sectors.
- ✓ Failed/late rains which will impact NPLs in Agriculture sector resulting to poor harvest and to food shortages. Cost of farming is also not commensurate to sale proceeds from farm produce; most farmers are experiencing losses instead of gains.

Table 5 below: The trend on expectations of NPLs is shown in

	Dec-14			Sep-14			Jun-14			Mar-14		
	Rise	Remained Constant	Fall	Rise	Remained Constant	Fall	Rise	Remained Constant	Fall	Rise	Remained Constant	Fall
Agriculture	10%	71%	20%	10%	68%	22%	20%	56%	24%	20%	54%	27%
Manufacturing	5%	66%	29%	2%	80%	17%	5%	80%	15%	5%	73%	22%
Building & Construction	29%	44%	27%	32%	41%	27%	17%	54%	29%	18%	45%	38%
Mining and Quarrying	3%	80%	18%	8%	88%	5%	0%	85%	15%	3%	80%	18%
Energy and Water	5%	75%	20%	3%	85%	13%	3%	83%	15%	0%	80%	20%
Trade	10%	63%	27%	17%	56%	27%	27%	46%	27%	18%	43%	40%
Tourism, Restaurant and Hotels	35%	48%	18%	40%	43%	18%	37%	49%	15%	25%	58%	18%
Transport and Communication	12%	63%	24%	18%	63%	20%	28%	55%	18%	20%	59%	22%
Real Estate	22%	59%	20%	19%	62%	19%	15%	63%	22%	22%	54%	24%
Financial Services	0%	85%	15%	0%	88%	13%	3%	83%	15%	5%	78%	18%
Personal/Household	32%	49%	20%	20%	55%	25%	43%	50%	8%	34%	44%	22%

3.6 Credit Recovery Efforts

3.6.1 Observations

In year 2014, credit recovery efforts were intensified in all the eleven economic sectors. The increase was mainly driven by banks seeking to recover NPLs which had consistently built up in the year. Energy and Water, Agriculture, Transport, Personal/Household and Trade sectors are expected to witness the greatest recovery efforts in Q1 of 2015, with 16%, 10%, 8%, 7% and 5% more banks intensifying their recovery efforts compared to Q3 of 2014. These are followed by the Trade, Financial Services and Manufacturing sectors with 5%, 5%, and 3% more respondents increasing recovery efforts than in Q3.

The intensified recovery efforts in six sectors (Agriculture, Building, Trade, Tourism, Transport and Personal/Household sectors) to improve the overall quality of their asset portfolio in line with the banks expectations that loan defaults in these sectors will rise during Q1 of 2015.

Banks cite heightened political activity, the current spate of insecurity and pending Mining Bill in parliament as reasons for them to intensify credit recovery in the Tourism and Mining and Quarrying sectors.

In Personal/Household sectors banks expect that due to the end of the festivities period characterised by increased consumer spending, borrowers will now be better able to service their facilities over the next 3 months.

The trend on credit recovery efforts is shown in **Table 6**.

	Dec-14			Sep-14			Jun-14			Mar-14		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchange d	Eased	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Ease d
Agriculture	49%	51%	0%	39%	59%	2%	54%	46%	0%	54%	46%	0%
Manufacturing	48%	50%	2%	45%	55%	0%	43%	55%	2%	48%	50%	2%
Building & Construction	64%	33%	2%	64%	29%	7%	50%	45%	5%	58%	38%	5%
Mining and Quarrying	24%	76%	0%	24%	76%	0%	23%	78%	0%	22%	76%	2%
Energy and Water	36%	60%	5%	20%	73%	8%	25%	73%	3%	22%	73%	5%
Trade	59%	41%	0%	54%	44%	2%	57%	40%	2%	68%	29%	2%
Tourism, Restaurant and Hotels	63%	37%	0%	63%	38%	0%	51%	41%	7%	41%	56%	2%
Transport and Communication	59%	41%	0%	51%	49%	0%	60%	40%	0%	56%	41%	2%
Real Estate	48%	52%	0%	53%	48%	0%	45%	52%	2%	52%	40%	7%
Financial Services	30%	70%	0%	25%	75%	0%	27%	73%	0%	18%	82%	0%
Personal/Household	73%	27%	0%	66%	32%	2%	61%	37%	2%	61%	39%	0%

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. First Community Bank Limited
22. Guaranty Trust Bank Ltd.
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. UBA Kenya Bank Ltd.
42. Housing Finance Ltd.
43. Victoria Commercial Bank Ltd.