CENTRAL BANK OF KENYA

CREDIT OFFICER SURVEY

QUARTER ENDED JUNE 2014

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1.0 FOREWORD

1.1 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan banking sector recorded growth in the quarter ended 30th June 2014, compared to the first quarter ended 31st March 2014. Some of the sector's performance indicators for the quarter were as follows:-

- The aggregate balance sheet (total assets) increased by 5.3% from Kshs 2.82 trillion in March 2014 to Kshs 2.97 trillion in June 2014.
- Gross loans and advances grew by 5.3% from Kshs 1.69 trillion in March 2014 to Kshs 1.78 trillion in June 2014.
- Banking sector deposits increased by 5.4% from Kshs 2.04 trillion in March 2014 to Kshs 2.15 trillion in June 2014.
- Total shareholders' funds increased by 1.3% from Kshs 453.6 billion in March 2014 to Kshs 459.4 billion in June 2014.
- Cumulative unaudited pre-tax profits for the quarter ended 30th June 2014 stood at Kshs 71.03 billion compared to Kshs 61.47 billion for the quarter ended 30th June 2013, an increase of 15.6%.

1.2 CREDIT OFFICER SURVEY

Lending is the principal business activity for all banks and as a result credit risk is the single largest factor affecting the soundness of banks and the financial system as a whole. In the quarter ended 30th June 2014, the ratio of total loans to total assets for the Kenyan banking sector was 59.47%, a slight increase from 59.3%, in 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 in 2012.

For the quarter ended 30th June 2014, CBK received Credit Survey responses from all 43 institutions currently in operation. The list of the respondents is attached to this report as **Annex I**.

The key highlights of the June 2014 credit officer survey findings are:-

- Demand for credit generally remained constant in six economic sectors and increased in the other five economic sectors. Available investment opportunities, cost of borrowing and retention of CBR at 8.5% were cited as the main factors that led to increased demand for credit whereas political risk was reported as the main factor that contributed to decreased demand for credit.
- Credit standards remained generally unchanged across all economic sectors in Q2 of 2014. However, the credit standards were tightened for the Tourism and Agriculture sectors with escalating insecurity and low rains experienced in the quarter being cited as the main factors.
- NPLs are expected to generally remain constant in Q3 of 2014. However, the banks foresee increasing NPLs in the Trade, Tourism, Transport and Personal/Household sectors with the heightened political activity, insecurity and rising cost of living being cited as the driving factors.
- Most banks intend to intensify credit recovery efforts in Q3 of 2014 with Tourism, Financial Services, Transport and Energy/Water sectors expected to experience enhanced recovery efforts as banks improve the overall quality of their asset portfolio.

CENTRAL BANK OF KENYA
JULY 2014

2.0 EXECUTIVE SUMMARY

2.1 SURVEY METHODOLOGY

The credit officer survey for the quarter ended June 2014 comprised four questions that focused on:-

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

The survey, conducted in June 2014, 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 remained constant in six economic sectors and increased in five economic sectors in the quarter ended June 2014 compared to the quarter ended March 2014 when there was a general increase in demand for credit. Available investment opportunities, cost of borrowing and retention of CBR at 8.5% were cited as the main factors that led to increased demand for credit whereas political risk was reported as the main factor that contributed to decreased demand for credit.

2.2.2 Credit Standards

Credit standards remained generally unchanged across all economic sectors in Q2 of 2014. However, the credit standards were tightened for the Tourism and Agriculture sectors with escalating insecurity and low rains experienced in the quarter being cited as the main driving factors.

2.2.3 Non-Performing Loans

The banks generally expect NPLs to remain constant across the economic sectors in Q3 of 2014. However, banks foresee increasing NPLs in Trade, Tourism, Transport and Personal/Household sectors.

2.2.4 Credit Recovery Efforts

In Q3 of 2014, most banks intend to intensify their loan recovery efforts with Tourism, Financial Services, Transport and Energy/Water sectors expected to witness higher recovery efforts than other economic sectors.

3.0 DETAILED SURVEY FINDINGS

3.1 Demand for Credit

3.1.1 Observations

- In Q2 of 2014, Kenyan banks indicated that demand for credit increased in five sectors led by Trade, Personal/Household and Transport sectors with 56%, 56% and 52% of the respondents reporting increased demand for credit.
- Six economic sectors led by Mining, Agriculture, Energy, Financial Services and Tourism were reported to have recorded unchanged demand for credit.
- The number of banks that reported an increased demand of credit from the Mining sector went up by 6% compared to Q1 of 2014. This may be attributed to the improving investor confidence following discovery of new mineral resources across the country as well as the on-going reforms in the Mining sector.

Chart 1 and **Table 1** below present the trend in the demand for credit in the quarter ended June 2014 as compared to March 2014.

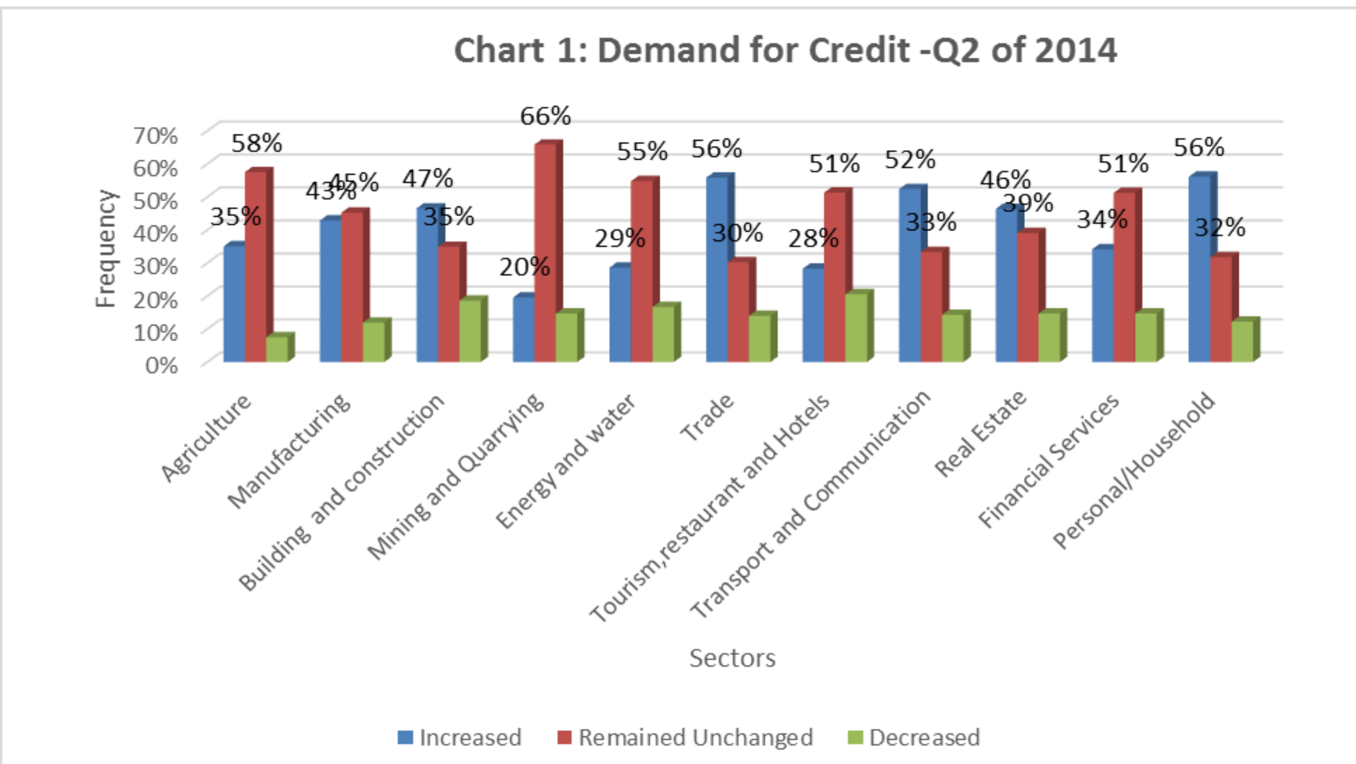

Table 1: Change in Demand for Credit

	June 2014			March 2014		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	35%	58%	8%	51%	41%	7%
Manufacturing	43%	45%	12%	43%	38%	19%
Building & Construction	47%	35%	19%	60%	24%	17%
Mining and Quarrying	20%	66%	15%	14%	71%	14%
Energy and Water	29%	55%	17%	26%	45%	29%
Trade	56%	30%	14%	69%	21%	10%
Tourism, Restaurant and Hotels	28%	51%	21%	32%	44%	24%
Transport and Communication	52%	33%	14%	50%	40%	10%
Real Estate	46%	39%	15%	50%	31%	19%
Financial Services	34%	51%	15%	34%	51%	15%
Personal/Household	56%	32%	12%	59%	24%	17%

3.2 Factors affecting demand for credit

3.2.1 Observations

- Available investment opportunities, cost of borrowing and retention of CBR at 8.5% were cited as the main factors that led to increased demand for credit. 47%, 28% and 23% of the respondents respectively cited these factors as having led to increased demand in credit. However, the significance of cost of borrowing contributing to increased credit demand decreased from 35% of the respondent in Q1 of 2014 to 28% in Q2 of 2014. As a result of this, 30% of the respondents indicated that cost of borrowing decreased demand of credit.
- Political risk was also reported as being the other main factor that contributed to decreased demand in six economic sectors, as was cost of borrowing.
- Issuance of debt, equity securities and retention of CBR at 8.5% were cited by 86%, 78% and 70% of the respondents respectively, as having had the least influence on the demand for credit during the quarter under review.

The responses on factors affecting demand for credit in Q2 of 2014 are presented in **Chart 2** and **Table 2** below.

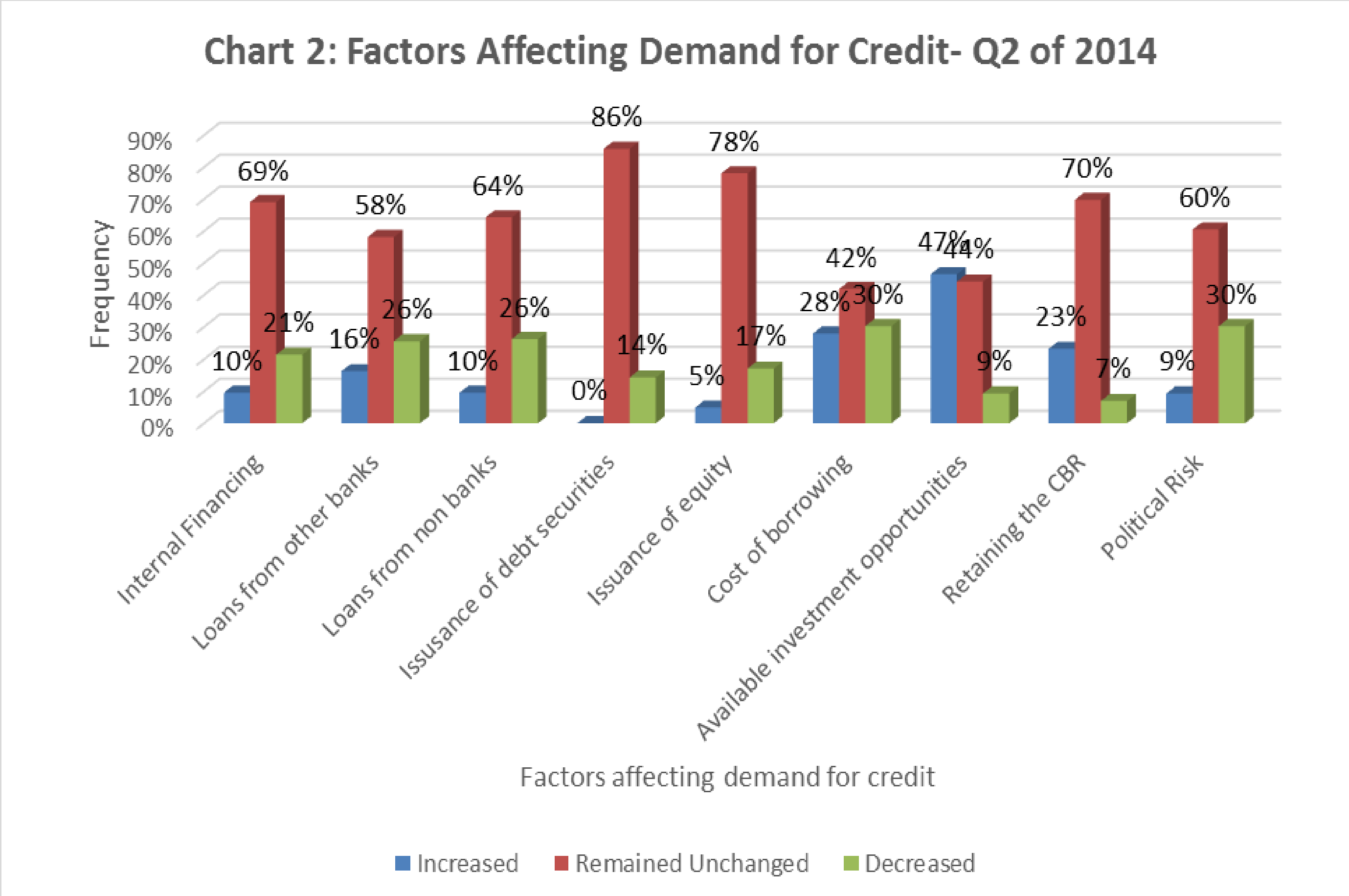

Table 2: Factors affecting Demand for credit

	June 2014			March 2014		
Factors	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	10%	69%	21%	7%	73%	20%
Loans from other banks	16%	58%	26%	10%	54%	37%
Loans from non-banks	10%	64%	26%	13%	55%	33%
Issuance of debt securities	0%	86%	14%	5%	83%	13%
Issuance of equity	5%	78%	17%	6%	81%	14%
Cost of borrowing	28%	42%	30%	35%	37%	28%
Available investment opportunities	47%	44%	9%	43%	43%	14%
Retention of CBR	23%	70%	7%	33%	62%	5%
Political Risk	9%	60%	30%	19%	60%	21%

3.3 Credit Standards

3.3.1 Observations

- The survey established that credit standards generally remained unchanged for all economic sectors over the three months to 30th June 2014 continuing the trend observed in Q1 of 2014.
- However, credit standards in Q2 were tightened for the Tourism and Agriculture sectors when the survey results are compared to those of Q1 of 2014. An additional 7% and 5% of the respondents tightened their credit standards compared to the reported position in Q1 of 2014.
- The banks tightened the credit standards to the Energy, Trade and Financial Services sectors marginally by 2% each.

These responses are presented in **Chart 3** and **Table 3** below:

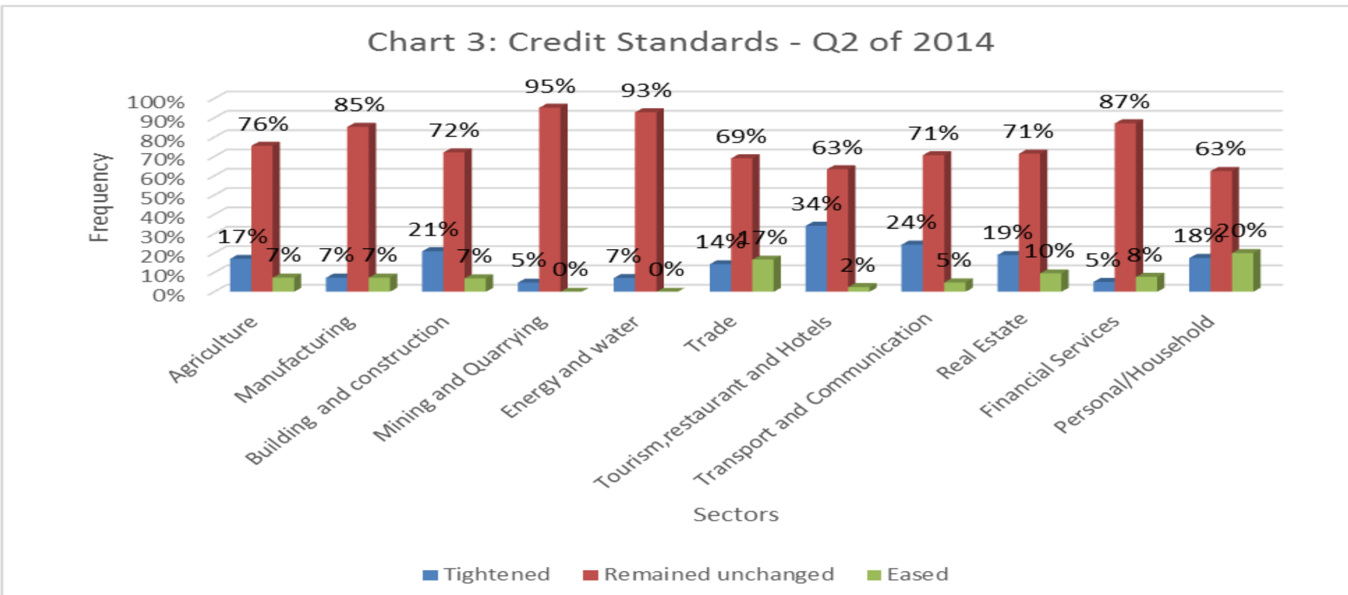

Table 3: Credit Standards

	June 2014			March 2014		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	17%	76%	7%	12%	83%	5%
Manufacturing	7%	85%	7%	7%	83%	10%
Building & Construction	21%	72%	7%	31%	62%	7%
Mining and Quarrying	5%	95%	0%	5%	93%	2%
Energy and Water	7%	93%	0%	5%	93%	2%
Trade	14%	69%	17%	12%	64%	24%
Tourism, Restaurant and Hotels	34%	63%	2%	27%	68%	5%
Transport and Communication	24%	71%	5%	24%	67%	10%
Real Estate	19%	71%	10%	21%	64%	14%
Financial Services	5%	87%	8%	3%	88%	10%
Personal/Household	18%	63%	20%	18%	63%	20%

3.4 Factors affecting credit standards

3.4.1 Observations

- In the quarter ended 30th June 2014, 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 quarter.
- However, when compared to the quarter ended March 2014, political risk and economic activity contributed to tightening of credit standards by an additional 13% and 12% respectively. 30% of the banks tightened their credit standards due to political risk and 26% due to economic activity.
- Competion from other credit providers, constraints due to bank's capital position, retention of CBR rate, and bank's cost of funds and balance sheet constraints did not have a significant impact on credit standards with 81%, 79%, 74% and 65% of the respondents respectively indicating so.

A comparison of the trend in the factors affecting the banks' credit standards are shown in **Chart 4** and **Table 4** below.

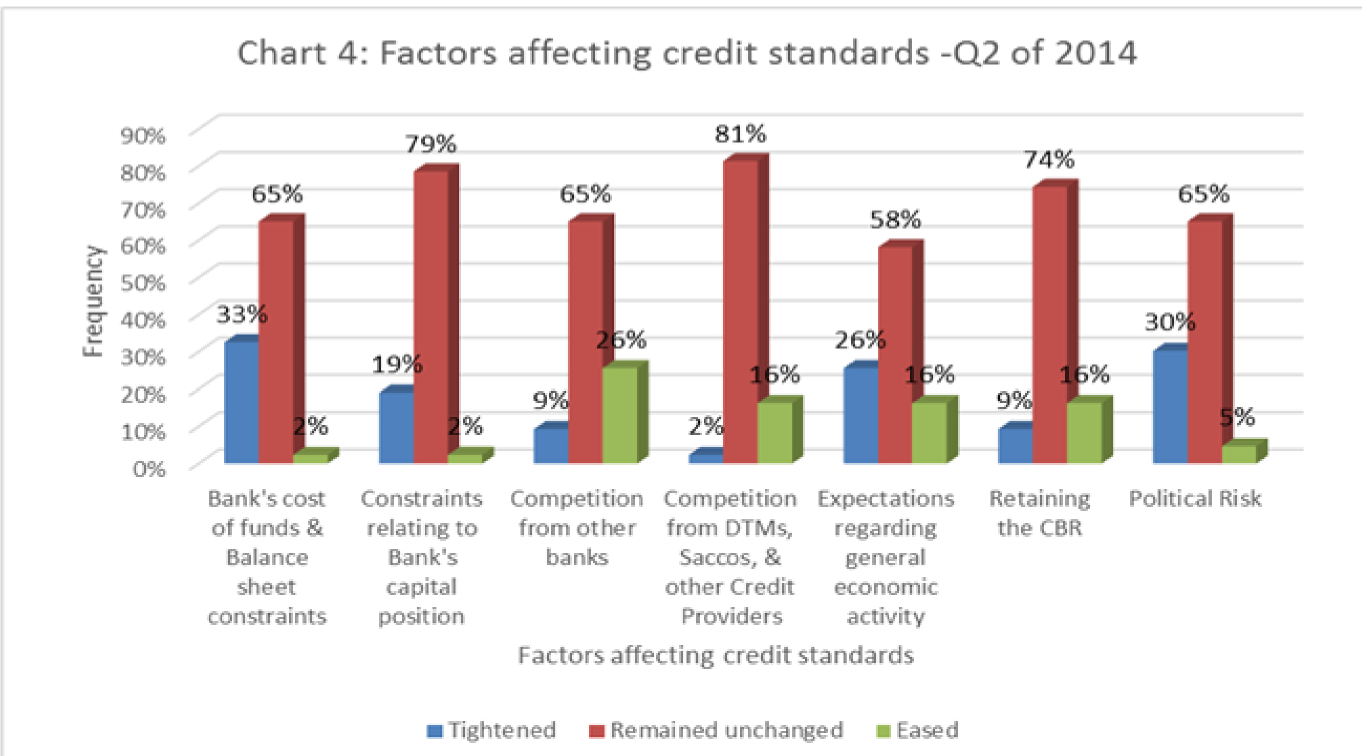

Table 4: Impact of factors affecting credit standards

	June 2014			March 2014		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds & Balance sheet constraints	33%	65%	2%	35%	63%	2%
Constraints relating to Bank's capital position	19%	79%	2%	21%	74%	5%
Competition from other banks	9%	65%	26%	7%	56%	37%
Competition from DTMs, Saccos, & other Credit Providers	2%	81%	16%	2%	76%	21%
Expectations regarding general economic activity	26%	58%	16%	14%	55%	31%
Retention of Central Bank Rate (CBR)	9%	74%	16%	5%	74%	21%
Political Risk	30%	65%	5%	17%	73%	10%

3.5 Non-Performing Loans (NPLs)

3.5.1 Observations

- Though most of the banks expect level of NPLs to remain unchanged in Q3 of 2014, there was a significant increase in the number of respondents that foresee 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.
- The current spate of insecurity in the country especially at the Coast and the heightened political activity may support the expected increase in NPLs in the Tourism sector. The high cost of living and inflationary pressure (inflation rate in June 2014 was 7.39%, a 0.09% increase from 7.3% in May 2014) are expected to impact negatively on the Personal/Household sector. The expected increase in NPLs in the Transport sector may be due to new transport rules introduced by the National Transport and Safety Authority, which may pose operational constraints to public transport operators in the short term.

Chart 5 and **Table 5** below indicate respondents' expectations on NPL trend in Q2 of 2014.

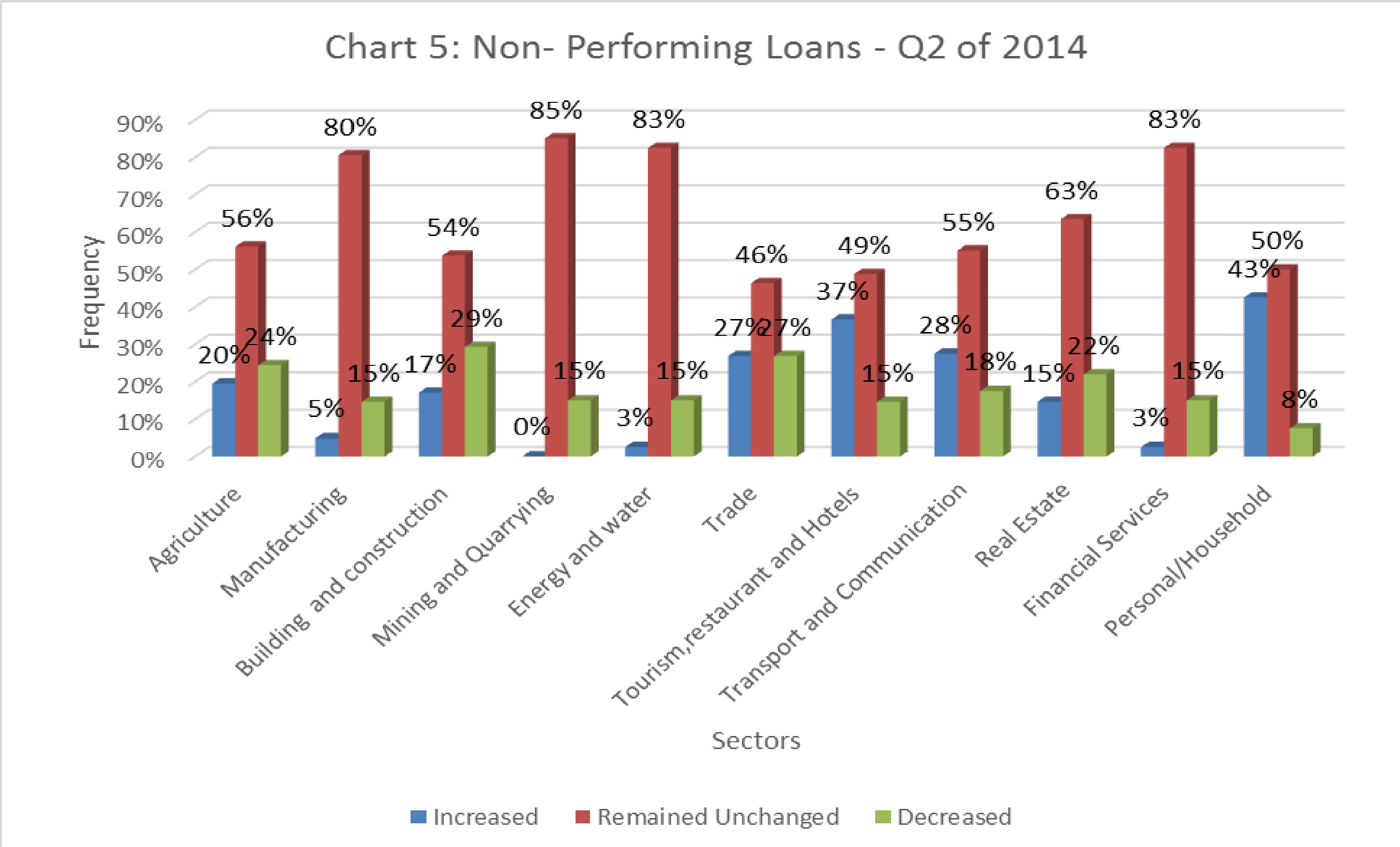

Table 5: Non Performing Loans Trend

	June 2014			March 2014		
	Rise	Remained Constant	Fall	Rise	Remained Constant	Fall
Agriculture	20%	56%	24%	20%	54%	27%
Manufacturing	5%	80%	15%	5%	73%	22%
Building & construction	17%	54%	29%	18%	45%	38%
Mining and Quarrying	0%	85%	15%	3%	80%	18%
Energy and water	3%	83%	15%	0%	80%	20%
Trade	27%	46%	27%	18%	43%	40%
Tourism, Restaurant & Hotels	37%	49%	15%	25%	58%	18%
Transport & Communication	28%	55%	18%	20%	59%	22%
Real Estate	15%	63%	22%	22%	54%	24%
Financial Services	3%	83%	15%	5%	78%	18%
Personal/Household	43%	50%	8%	34%	44%	22%

3.6 Credit Recovery Efforts

3.6.1 Observations

- In the quarter ending 30th September 2014, banks generally intend to increase their credit recovery efforts to improve the overall quality of their asset portfolio.
- Tourism and Financial Services and sectors are expected to witness the greatest recovery efforts in Q3 of 2014, with 10% and 9% more banks intensifying their recovery efforts than it was in

Q1 of 2014. These are followed by the Transport and Energy sectors with 8% and 3% more respondents increasing recovery efforts than in Q1.

- The intensified recovery efforts in the Tourism, Financial Services, Transport and Communication and Energy and Water sectors are in line with the banks expectations that loan defaults in these sectors will rise during Q3 of 2014.
- Banks cite heightened political activity, the current spate of insecurity and new transport regulations as reasons for them to intensify credit recovery in the Tourism and Transport sectors.

The responses on the expected credit recovery efforts by the banks during the quarter ending 30th June 2014 are depicted in **Chart 6** and **Table 6** below.

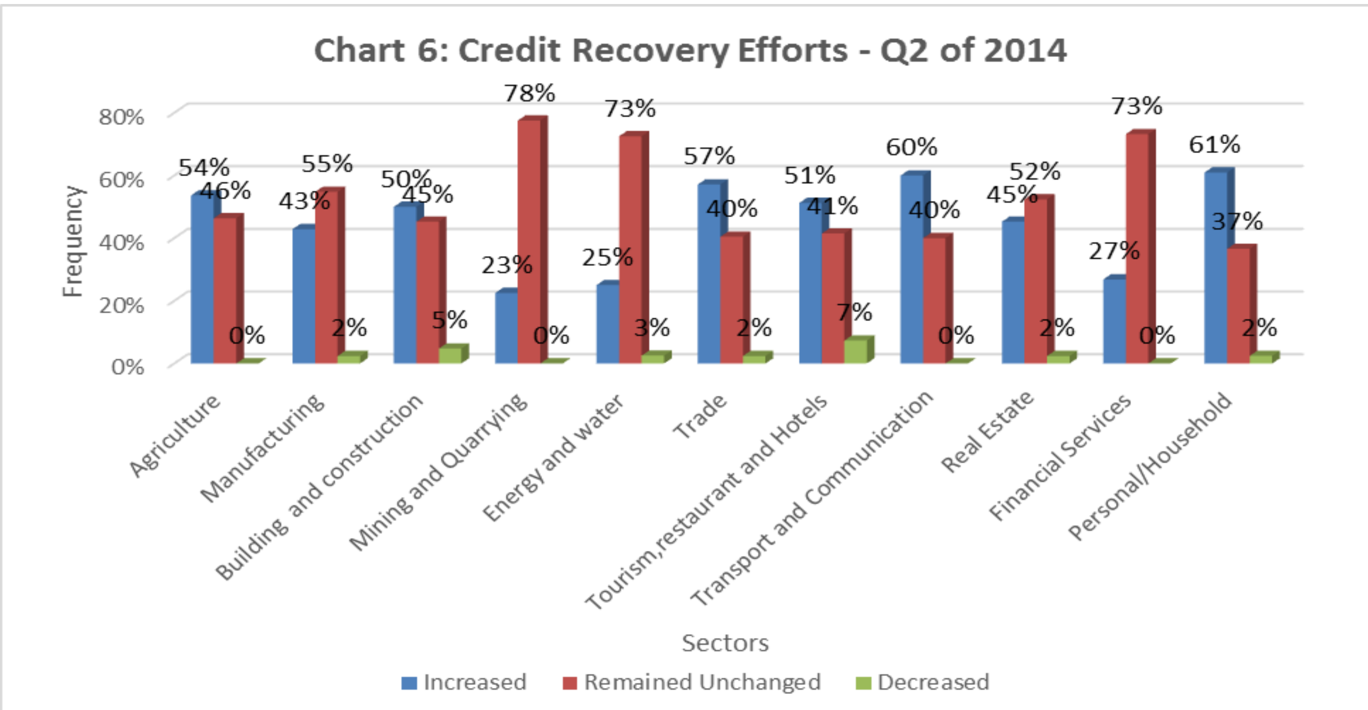

Table 6: Credit Recovery Efforts

	June 2014			March 2014		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	54%	46%	0%	54%	46%	0%
Manufacturing	43%	55%	2%	48%	50%	2%
Building & construction	50%	45%	5%	58%	38%	5%
Mining and Quarrying	23%	78%	0%	22%	76%	2%
Energy and water	25%	73%	3%	22%	73%	5%
Trade	57%	40%	2%	68%	29%	2%
Tourism, Restaurant & Hotels	51%	41%	7%	41%	56%	2%
Transport & Communication	60%	40%	0%	56%	41%	2%
Real Estate	45%	52%	2%	52%	40%	7%
Financial Services	27%	73%	0%	18%	82%	0%
Personal/Household	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. Guaranty Trust Bank (Kenya) 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.