CENTRAL BANK OF KENYA

CREDIT OFFICER SURVEY

QUARTER ENDED JUNE 2013

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1.0 FOREWORD

1.1 KENYAN BANKING SECTOR PERFORMANCE

For the quarter ended 30th June 2013, the Kenyan Banking Sector demonstrated an improved growth compared to the first quarter ended 31st March 2013. Some of the sector's performance indicators for the quarter were as follows:

- The aggregate balance sheet increased by 3.7 percent from Kshs 2.42 trillion in March 2013 to Kshs 2.51 trillion in June 2013.
- Gross loans and advances expanded by 3.6 percent from Kshs 1.40 trillion in March 2013 to Kshs 1.45 trillion in June 2013.
- Banking sector deposits grew by 4.5 percent from to Kshs 1.78 trillion in March 2013 to Kshs 1.86 trillion in June 2013.
- Total shareholders' funds increased by 5 percent from Kshs 375.6 billion in March 2013 to Kshs 394.4 billion in June 2013.
- Unaudited pre-tax profits for the quarter was Kshs 61.5 billion compared to Kshs 53.2 billion for the quarter ending 30th June 2012, a 15.6% 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. The total loans to total assets for the Kenyan banking sector in the quarter ended 30th June 2013 was 55.7%. 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.

Out of the forty three questionnaires sent out, CBK received responses from all the institutions. The list of the respondents is attached to this report as **Annex I**.

Highlights of findings obtained in the quarter ended June 2013:-

- The demand for credit generally increased in all economic sectors. Reduction of political risk had the most significant impact on increasing demand for credit; followed by reduction in Central Bank Rate and available investment opportunities.
- No institution tightened its credit standards as compared to the first quarter of 2013. However there was a slight easing of credit standards in trade, tourism, restaurant & hotels and personal/household sectors.
- For the quarter ending 30th September 2013, institutions expect the non-performing loans to generally decrease in Agriculture, Building & Construction and Tourism, Restaurant & Hotel sectors
- 76% and 56% of the respondents reported their intention to increase their credit recovery efforts in Personal/Household and Trade sectors while most of the respondents reported their intention to maintain their credit recovery efforts in most of the other economic sectors.

CENTRAL BANK OF KENYA
JULY 2013

2.0 EXECUTIVE SUMMARY

2.1 SURVEY METHODOLOGY

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

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

The survey conducted in July 2013 targeted senior credit officers of all 42 operational commercial banks and 1 mortgage finance company. Charterhouse Bank Ltd, which is currently 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

Compared to the quarter ended March 2013, the demand for credit generally increased in all economic sectors in the quarter ended June 2013. The increased demand for credit was mainly attributed to increased investor confidence as a result of the peaceful political transition, reduction in lending rates, fairly stable exchange rate and positive economic environment.

2.2.2 Credit Standards

There was generally no change in credit standards for all the sectors in the quarter ended June 2013. Despite improvement in the economy, some institutions continued to apply prudent credit appraisal criteria introduced in 2012 when high interest rates were witnessed.

2.2.3 Non-Performing Loans

34 percent of the banks forecast an increase in NPLs in the personal/ household, 17 percent forecast increase in NPLs in real estate and 15 percent forecast increase in NPLs in building and construction, and trade sectors.

2.2.4 Credit Recovery Efforts

Most banks intend to intensify their recovery efforts in all economic sectors to tap cash flows expected to generally improve in quarter ending 30th September 2013. This positive future outlook is attributable to the prevailing stable economic environment, expected honouring of outstanding payments by the government on completed/ongoing projects, onset of the tourism high season and better yields from agricultural activities given the recently witnessed favourable rains.

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 June 2013 unlike in the quarter ended 31st March 2013 when demand generally decreased. The highest growth in demand for credit was witnessed in the Trade, Personal/Household, Transport & Communication and Real Estate Sectors with 67%, 63%, 51% and 50% of the respondents citing growth. The increased demand for credit was mainly attributed to:

- increased investor confidence as a result of the peaceful political transition following elections in March 2013,
- reduced lending rates by banks,
- fairly stable exchange rate, and
- positive economic environment.

For respondents who reported decreased demand for credit, they cited salaried customers opting to source for micro loans from other lenders rather than commercial banks and delay in Government payments as the new government was constituted.

The demand for credit in the June 2013 quarter as well as a comparison of the demand for credit in the quarters ended March 2013 and June 2013 are depcited in **Chart 1** and **Table 1** below.

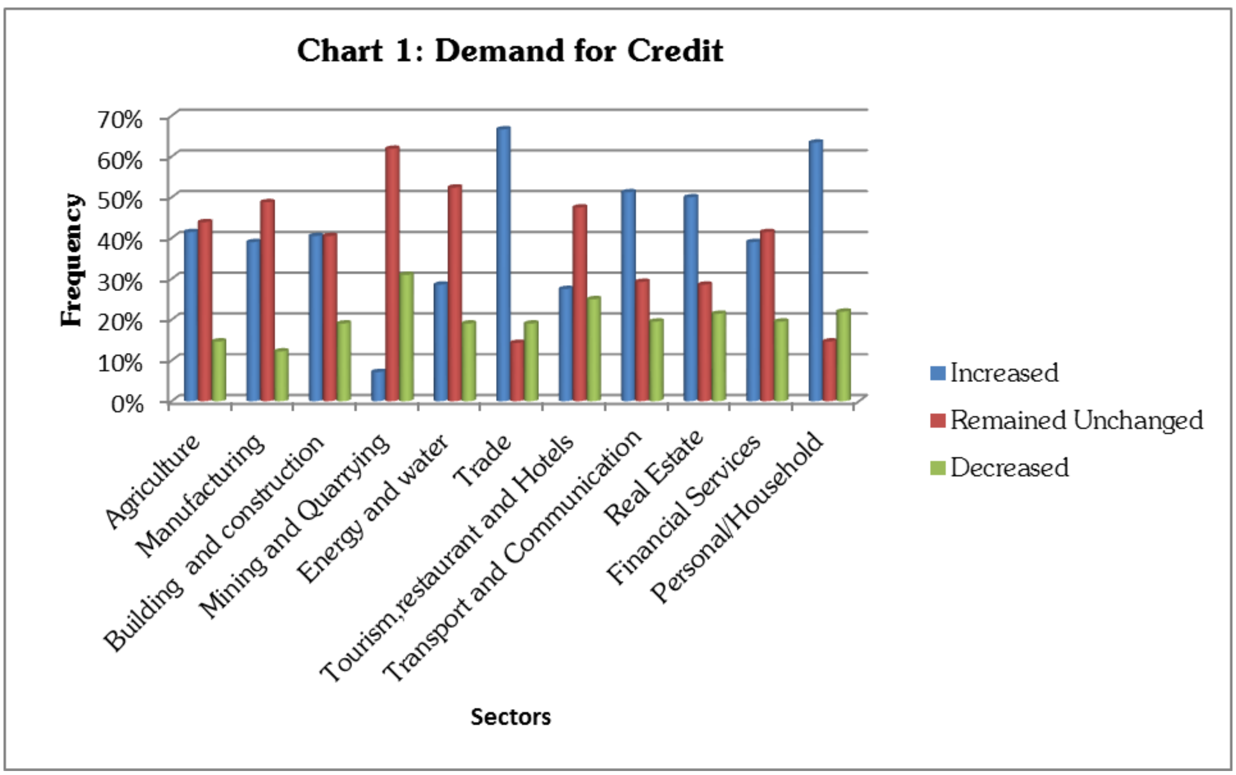

Table 1: Demand for Credit						
	June 2013			March 2013		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	41%	44%	15%	14%	36%	50%
Manufacturing	39%	49%	12%	16%	34%	50%
Building & construction	40%	40%	19%	26%	24%	50%
Mining and Quarrying	7%	62%	31%	8%	42%	50%
Energy and water	29%	52%	19%	12%	38%	50%
Trade	67%	14%	19%	26%	24%	50%
Tourism, restaurant and Hotels	28%	48%	25%	13%	37%	50%
Transport and Communication	51%	29%	20%	23%	27%	50%
Real Estate	50%	29%	21%	31%	19%	50%
Financial Services	39%	41%	20%	12%	38%	50%
Personal/Household	63%	15%	22%	30%	20%	50%

3.2 Factors affecting demand for credit

3.2.1 Observations

Reduced political risk following peaceful political transition was cited by 63% of the respondents as having had the most significant impact in increasing demand for credit in the quarter ended 30th June 2013. Drop in the Central Bank Rate (CBR) from 9.5% to 8.5% in May 2013 and available investment opportunities were cited by 54% and 48% of the respondents as having contributed to the increased demand for credit. This is as shown in **Chart 2** and **Table 2** below. Internal financing, loans from other banks and non-banks were cited as factors that decreased the demand of credit. It is notable that due to deepening of the financial sector, customers have an increased range of choices with most banks competing on service and pricing resulting in an upsurge in customers retention efforts and loan buy offs.

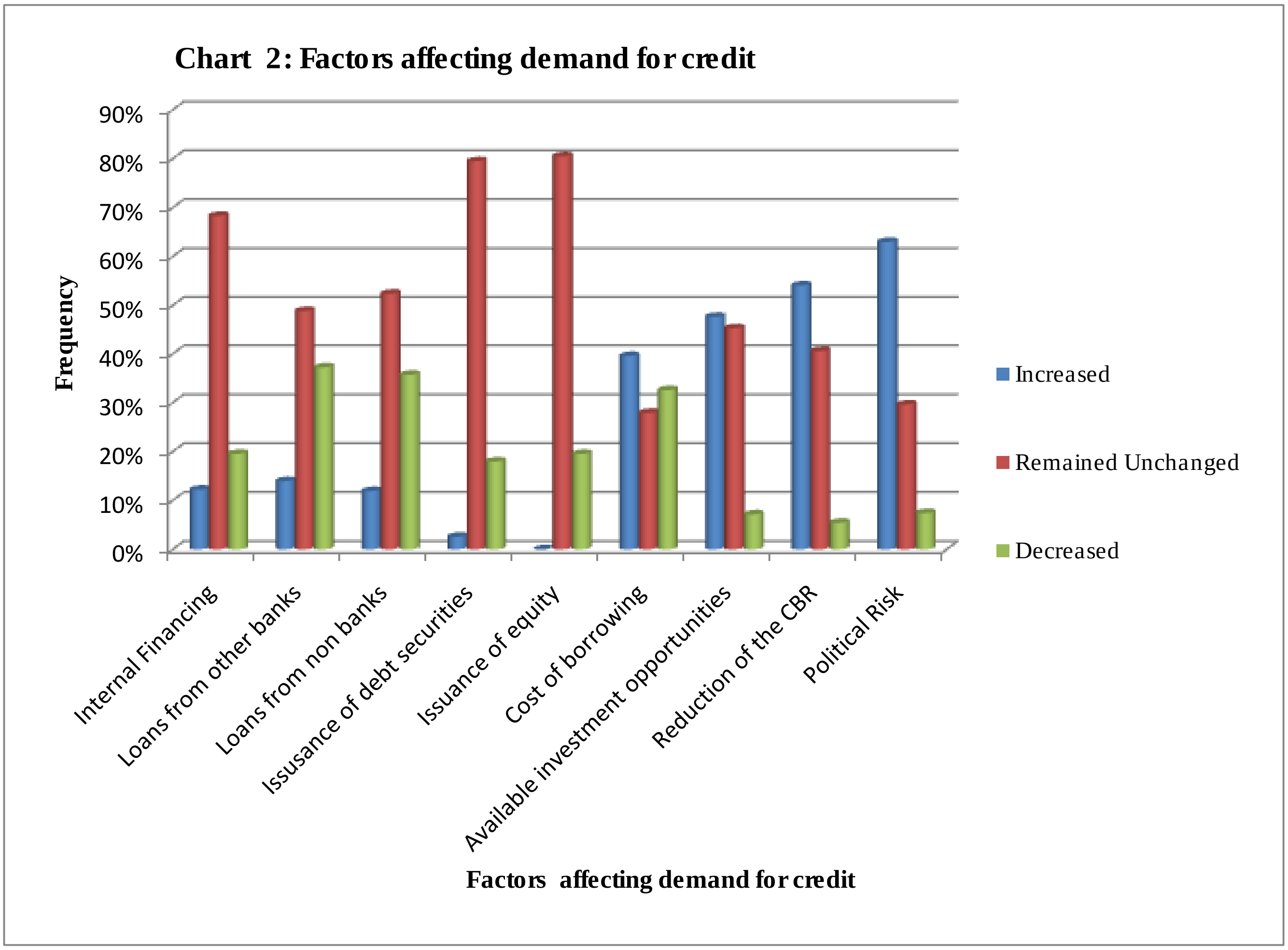

Table 2: Factors affecting Demand for credit

	June 2013			March 2013		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	12%	68%	20%	12%	24%	65%
Loans from other banks	14%	49%	37%	19%	39%	42%
Loans from non-banks	12%	52%	36%	15%	30%	55%
Issuance of debt securities	3%	79%	18%	18%	35%	47%
Issuance of equity	0%	80%	20%	23%	46%	31%
Cost of borrowing	40%	28%	33%	28%	49%	23%
Available investment opportunities	48%	45%	7%	29%	57%	14%
Drop in CBR	54%	41%	5%	35%	65%	-
Political Risk	63%	30%	7%	10%	15%	75%

3.3 Credit Standards

3.3.1 Observations

In the quarter ended June 2013, there was generally no major change in credit standards to all economic sectors. However, some banks reported slight easing of credit standards unlike in the quarter ended 31st March 2013. This implies that with the improving economic conditions, banks have started to ease the tight credit appraisal criteria introduced in 2012 when higher interest rates and volatile exchange rates were witnessed. Credit standards to the Trade, Personal/Household and Tourism sectors recorded some easing of credit standards. This is reflected by the increased demand for credit from these sectors. It is also worth noting that Manufacturing, Agriculture and Real Estate sectors also benefited from minimal easing of their credit standards. **Chart 3** and **Table 3** below depict the trend in Kenya's banking sector credit standards in the quarter ended June 2013.

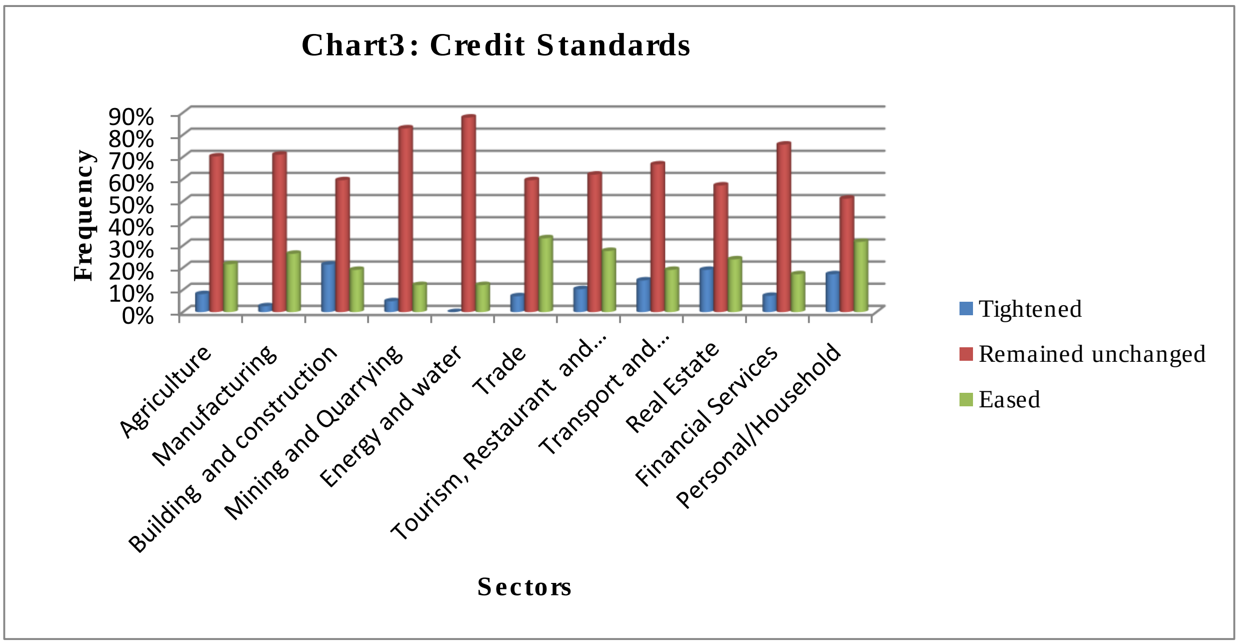

Table 3: Credit Standards

	June 2013			March 2013		
	Tightened	**Remained Unchanged**	**Eased**	**Tightened**	**Remained Unchanged**	**Eased**
Agriculture	8%	70%	22%	13%	83%	5%
Manufacturing	3%	71%	26%	7%	83%	10%
Building & Construction	21%	60%	19%	33%	57%	10%
Mining and Quarrying	5%	83%	12%	10%	83%	7%
Energy and water	0%	88%	12%	10%	88%	3%
Trade	7%	60%	33%	17%	71%	12%
Tourism, restaurant and Hotels	10%	62%	28%	34%	63%	2%
Transport and Communication	14%	67%	19%	29%	67%	5%
Real Estate	19%	57%	24%	33%	60%	7%
Financial Services	7%	76%	17%	20%	78%	2%
Personal/Household	17%	51%	32%	33%	60%	8%

3.4 Factors affecting credit standards

3.4.1 Observations

In the quarter ended June 2013, most of the factors expected to affect credit standards had little impact. This supports the finding that credit standards generally remained unchanged. However, the drop in CBR, positive expectations on the economic activities and competition from other banks were the leading factors to the slight easing of credit standards in the quarter. On the other hand, some banks tightened their credit standards due to cost of funds and balance sheet constraints as well as potential political risks. A comparison of the trend in the factors affecting the banks' credit standards are shown in **Chart 4** and **Table 4** below.

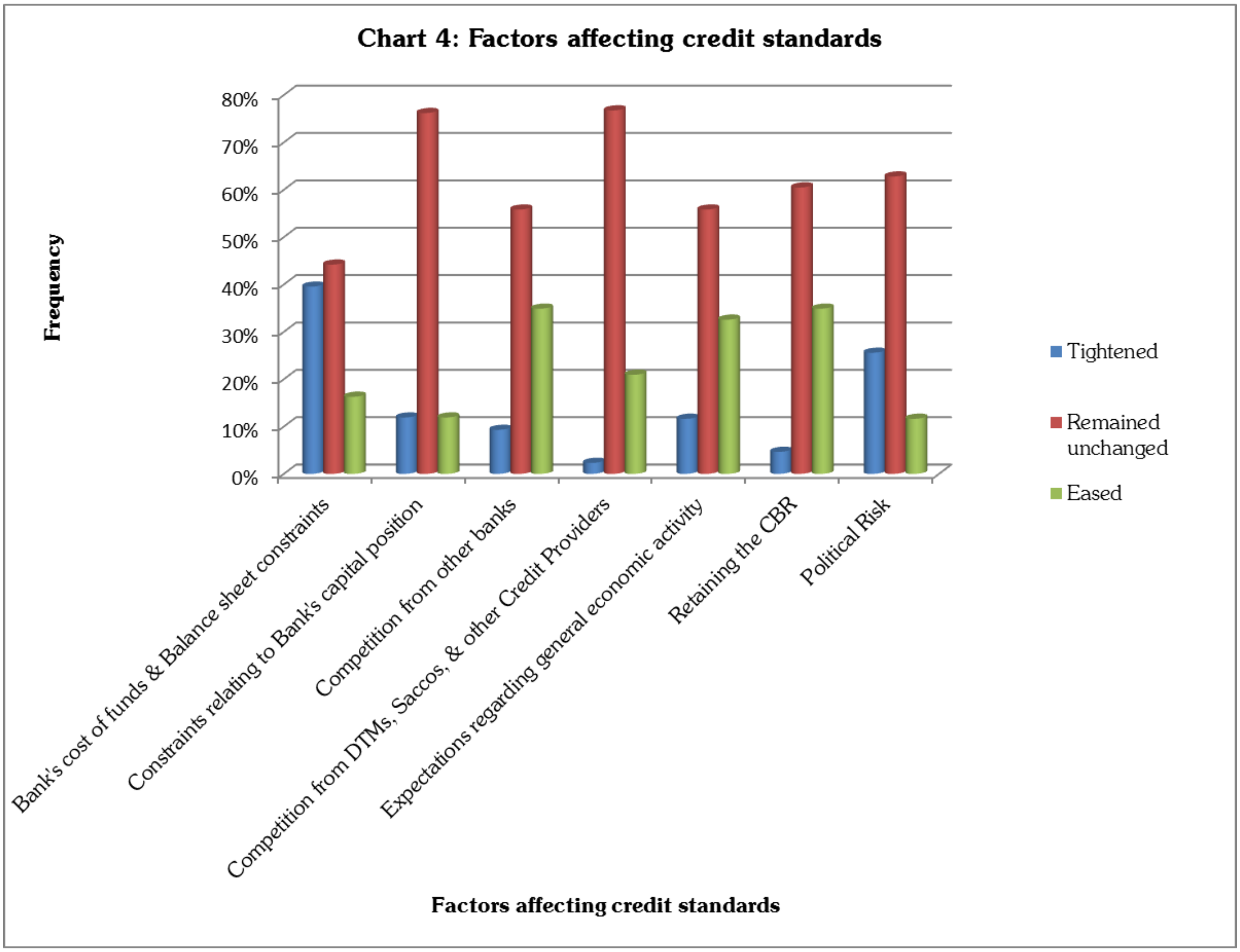

Table 4: Impact of factors affecting credit standards

	June 2013			March 2013		
	Tightened	**Remained Unchanged**	**Eased**	**Tightened**	**Remained Unchanged**	**Eased**
Bank's cost of funds & Balance sheet constraints	40%	44%	16%	28%	63%	9%
Constraints relating to Bank's capital position	12%	76%	12%	12%	88%	0%
Competition from other banks	9%	56%	35%	7%	60%	33%
Competition from DTMs, Saccos, & other Credit Providers	2%	77%	21%	2%	84%	14%
Expectations regarding general economic activity	12%	56%	33%	40%	42%	19%

	June 2013			March 2013		
	Tightened	**Remained Unchanged**	**Eased**	**Tightened**	**Remained Unchanged**	**Eased**
Drop in Central Bank Rate (CBR)	5%	60%	35%	19%	55%	26%
Political Risk	26%	63%	12%	54%	39%	7%

3.5 Non-Performing Loans (NPLs)

3.5.1 Observations

Banks have forecast that their NPLs will generally remain constant in the third quarter ended 30th September 2013. However, some banks have forecasted a drop in the level of NPLs in the Trade, Tourism, Real Estate, Transport and Building Sectors. The forecast could be attributed to the expected positive economic activity in the country including the onset of the peak tourism session and expected favourable agricultural outputs. Further, with the new financial year, investors in building and construction expect their business with the Government to pick up as the year progresses.

Chart 5 and **Table 5** below indicate the banks expectations on NPL trend.

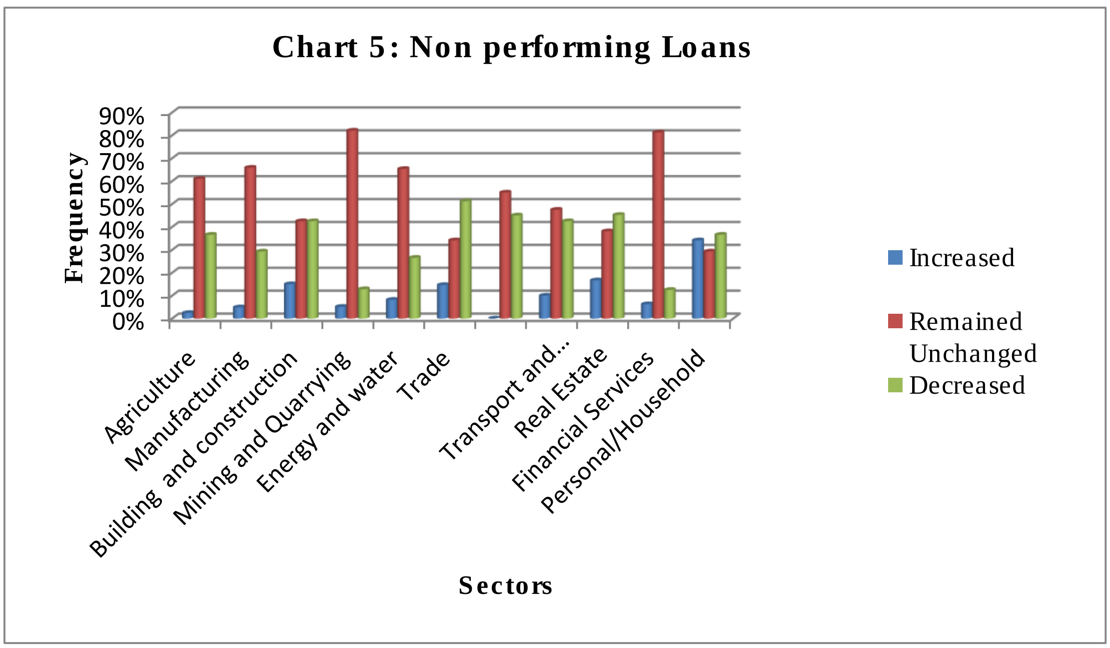

Table 5: Non Performing Loans Trend

	June 2013			March 2013		
	Rise	**Remained Constant**	**Fall**	**Rise**	**Remained Constant**	**Fall**
Agriculture	2%	61%	37%	5%	57%	38%
Manufacturing	5%	66%	29%	7%	49%	44%
Building & construction	15%	43%	43%	15%	40%	45%
Mining and Quarrying	5%	82%	13%	5%	74%	21%
Energy and water	8%	65%	27%	5%	73%	22%
Trade	15%	34%	51%	10%	37%	54%
Tourism, Restaurant & Hotels	0%	55%	45%	10%	33%	58%
Transport & Communication	10%	48%	43%	15%	33%	53%
Real Estate	17%	38%	45%	12%	37%	51%
Financial Services	6%	81%	13%	0%	68%	32%
Personal/Household	34%	29%	37%	10%	43%	48%

3.6 Credit Recovery Efforts

3.6.1 Observations

Banks intend to intensify recovery efforts in five sectors (Personal/Households, Trade, Building, Real Estate and Transport) to tap into expected improved cash flows to these sectors in quarter ending 30th September 2013. This positive future outlook is attributable to the prevailing stable economic environment, expected payment of outstanding bills by the Government on completed/ongoing projects, onset of tourism peak session and better yields from agricultural activities. The intended intensity of recovery efforts is in line with the banks expectations that NPLs will fall in the cited economic sectors.

The sector to witness the highest intensity in recovery efforts is the Personal/Household by 76% of the respondents. This points to the banks desire to recover from the recent rise in NPLs in this sector in the first and second quarters of 2013.

The responses on the expected credit recovery efforts by the banks during the quarter ending September 2013 are indicated in **Chart 6** and **Table 6** below.

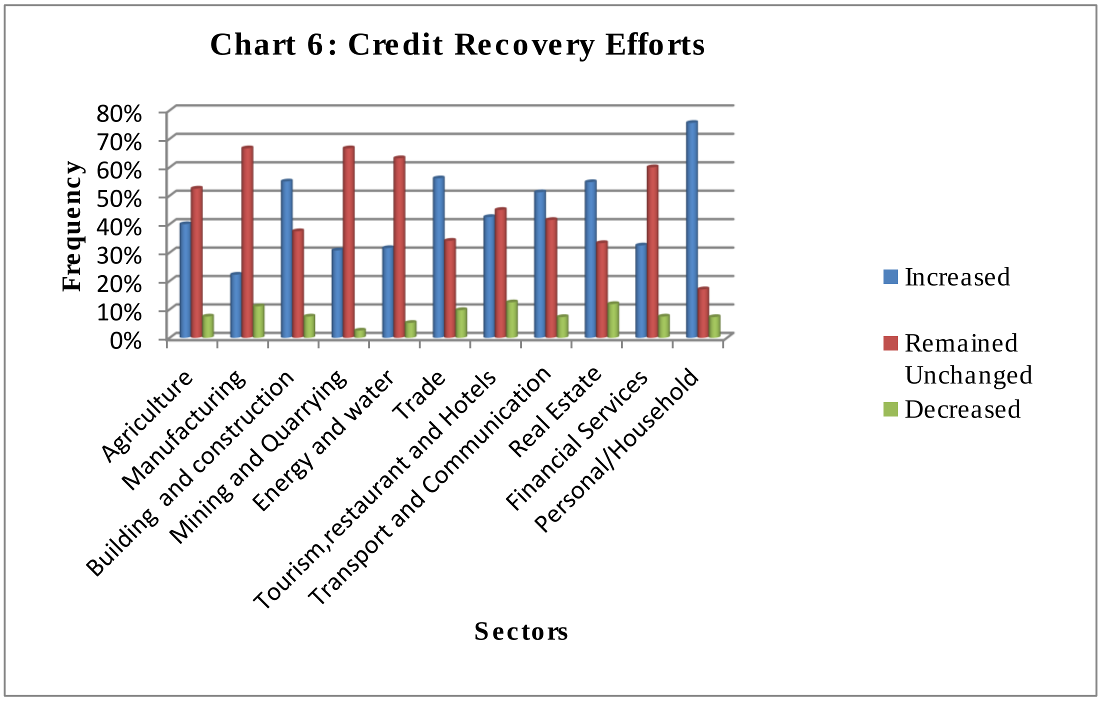

Table 6: Credit Recovery Efforts

	June 2013			March 2013		
	Intensified	**Remained Unchanged**	**Eased**	**Intensified**	**Remained Unchanged**	**Eased**
Agriculture	40%	53%	8%	39%	51%	10%
Manufacturing	22%	67%	11%	45%	40%	14%
Building & construction	55%	38%	8%	48%	45%	8%
Mining and Quarrying	31%	67%	3%	31%	64%	5%
Energy and water	32%	63%	5%	36%	59%	5%
Trade	56%	34%	10%	56%	29%	15%
Tourism, Restaurant & Hotels	43%	45%	13%	40%	45%	15%
Transport & Communication	51%	41%	8%	46%	39%	15%
Real Estate	55%	33%	12%	52%	33%	14%
Financial Services	33%	60%	8%	33%	58%	10%
Personal/Household	76%	17%	7%	58%	30%	13%

Annex I (List of Respondents)

LIST OF THE 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.