

CENTRAL BANK OF KENYA (CBK) CREDIT OFFICER SURVEY OCTOBER - DECEMBER 2016

Key findings:

- In the fourth quarter of 2016:-
 - The perceived demand for credit remained unchanged in six sectors while it increased in four sectors.
 - Credit standards remained unchanged in eight of the eleven economic sectors.
 - Interest rates decreased. This may be attributed to the capping of interest rates that came into effect on 14th September 2016 and the reduction of the Central Bank Rate (CBR) rate to 10.0 percent.
- Though most banks expect the level of NPLs to remain unchanged in first quarter of 2017, there is a significant increase in the number of respondents that foresee an increase in NPLs in eight economic sectors. These sectors include Agriculture, Real Estate, Personal/Household, Tourism, Building and Construction, Energy and Water and Trade.
- In the first quarter of 2017, most banks intend to intensify their loan recovery efforts in ten economic sectors. These sectors include Trade, Real Estate, Agriculture, Energy and Water, Building and Construction and Tourism.
- Interest rate capping has led to an increase in demand for credit according to 59 percent of the respondents. However, the actual credit advanced has not increased in the same proportion as demand for credit.

1.1 CREDIT OFFICER SURVEY

Credit risk is the single largest factor affecting the soundness of financial institutions and the financial system as a whole. Lending is also the principal business for banks. The ratio of total loans to total assets for the quarter ended 31st December 2016 was 61.07 percent; an increase of 1.89 percent from 59.17 percent reported in September 2016. In this regard, the Central Bank of Kenya (CBK) undertakes a quarterly Credit Officer Survey to identify the potential drivers of credit risk.

The Credit Officer Survey requires senior credit officers of banks to indicate their banks perception or actual position as to the trend in the immediate past quarter and the subsequent quarter in terms of demand for credit, credit standards, interest rates, asset quality and credit recovery efforts.

1.2 SURVEY METHODOLOGY

The Credit Officer Survey questionnaire is completed by senior officers responsible for credit in all operating commercial banks. These are officers involved in most of the credit decisions hence are able to provide reasonably accurate and complete responses from their banks perspective.

In the December 2016 Credit Officer Survey, all 40 operational commercial banks and 1 mortgage finance company participated in the survey. Charterhouse Bank Ltd and Imperial Bank Ltd were excluded from the survey.

The survey sought to establish the lending behavior in the banking sector and targeted all the eleven economic sectors. Questions were asked on demand for credit, credit standards for approving loans, interest rates, non-performing loans and credit recovery efforts.

The survey questions are generally phrased in terms of changes over the past three months or expected changes over the next three months.

The survey also included questions regarding the effect of capping of interest rates that came into effect on 14th September 2016.

1.3 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan Banking Sector recorded growth in the quarter ended 31st December 2016, compared to the quarter ended 30th September 2016. Some of the sector's performance indicators are as follows:

- The aggregate balance sheet decreased by 0.72 percent from KShs 3.78 trillion in September 2016 to KShs 3.76 trillion in December 2016.
- Gross loans increased by 2.64 percent from KShs 2.27 trillion in September 2016 to KShs 2.33 trillion in December 2016.
- Total deposits decreased by 1.54 percent from KShs 2,690.86 billion in September

2.0 SURVEY FINDINGS

2.1 Demand for Credit

- In the fourth quarter of 2016, demand for credit remained unchanged in six economic sectors and increased in four economic sectors.
 - The sectors that recorded unchanged demand for credit were Financial Services (73 percent), Mining and Quarrying (69 percent), Tourism Restaurant and Hotels (65 percent), Agriculture (65 percent), Energy and Water (63 percent) and Manufacturing (46 percent).
 - The sectors that recorded an increase in demand for credit were Trade (53 percent), Personal/Household (53 percent), Building and Construction (41 percent) and Real Estate (38 percent). This could be attributed to reduced cost of borrowing and available investment opportunities.
- 2016 to KShs 2,649.33 billion in December 2016.
- The ratio of gross non-performing loans to gross loans increased from 8.7 percent in September 2016 to 9.1 percent in December 2016. The increase in gross non-performing loans was mainly attributable to challenges in the business environment that led to cashflow constraints for borrowers.
 - The ratio of core capital to total risk-weighted assets decreased slightly from 16.32 percent in September 2016 to 15.79 percent as at December 2016. The total capital to total risk weighted assets decreased marginally from 18.96 percent in September 2016 to 18.7 percent in December 2016. The capital adequacy ratios remained above the statutory minimum of 10.5 percent and 14.5 percent respectively.
 - Return on Assets marginally increased to 3.3 percent in December 2016 from 3.26 percent in September 2016.
 - Return on Equity decreased to 24.8 percent in December 2016 from 27 percent in September 2016.
 - The Average Liquidity Ratio decreased to 41.4 percent in December 2016 from 42.9 percent in September 2016.

Chart 1 and Table 1 below present the trend in the demand for credit in the quarter

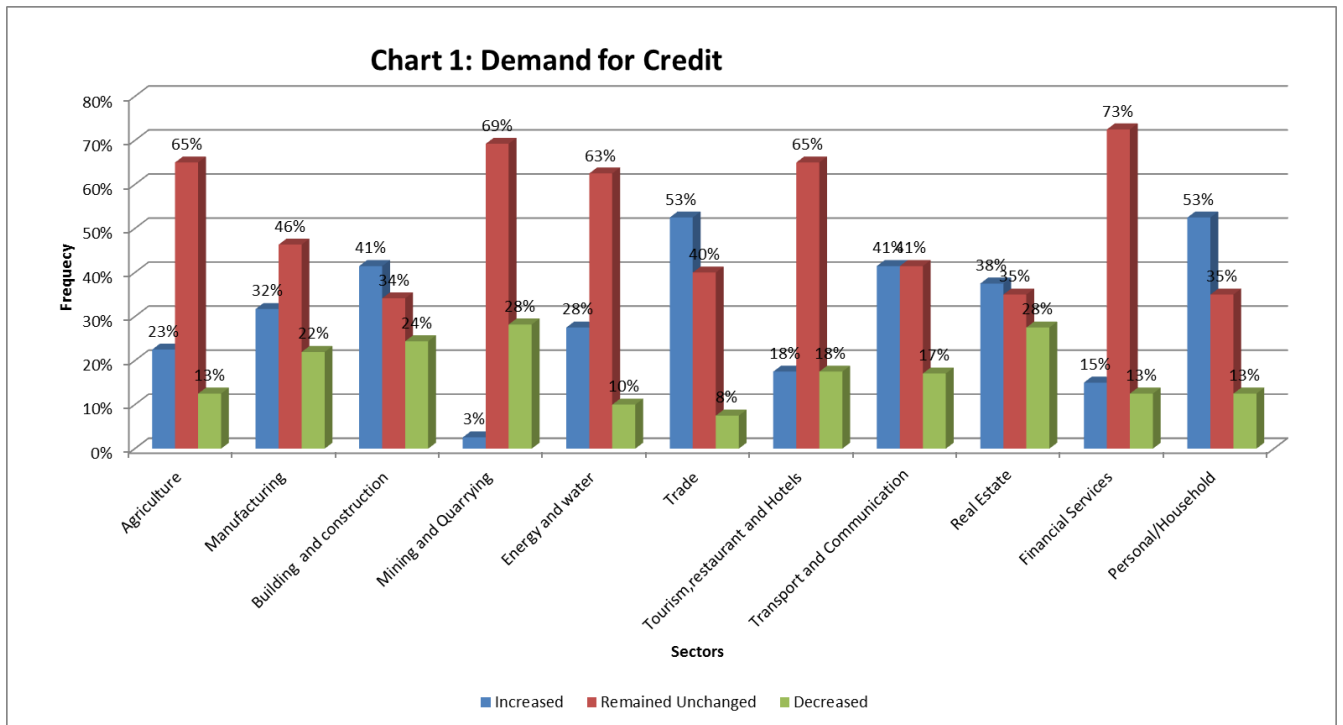


Table 1: Change in Demand for Credit

	December 2016			September 2016		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	23%	65%	13%	18 %	63 %	20 %
Manufacturing	32%	46%	22%	37 %	44 %	20 %
Building & Construction	41%	34%	24%	34 %	46 %	20 %
Mining and Quarrying	3%	69%	28%	8 %	74 %	18 %
Energy and Water	28%	63%	10%	24 %	63 %	12 %
Trade	53%	40%	8%	48 %	23 %	30 %
Tourism, Restaurant and Hotels	18%	65%	18%	20 %	63 %	18 %
Transport and Communication	41%	41%	17%	34 %	46 %	20 %
Real Estate	38%	35%	28%	40 %	38 %	23 %
Financial Services	15%	73%	13%	20 %	65 %	15 %
Personal/Household	53%	35%	13%	43 %	40 %	18 %

2.2 Factors affecting demand for credit

- In the fourth quarter of 2016, factors affecting demand for credit generally had little impact on demand for credit.
- Issuance of debt securities, issuance of equity, internal financing, loans from non-banks, retention of KBRR, loans from other banks, political risk and available investment opportunities were cited as having had the least influence on the demand for credit during the quarter under review. These were reported by 92 percent, 89 percent, 87 percent, 85 percent, 78 percent, 68 percent, 62 percent and 62 percent of the respondents respectively.
- Cost of borrowing and retention of CBR at 10 percent were cited in fourth quarter of 2016 as the factors that positively increased the demand for credit.

Chart 2 and **Table 2** below present the trend in the factors affecting demand for credit in the quarter

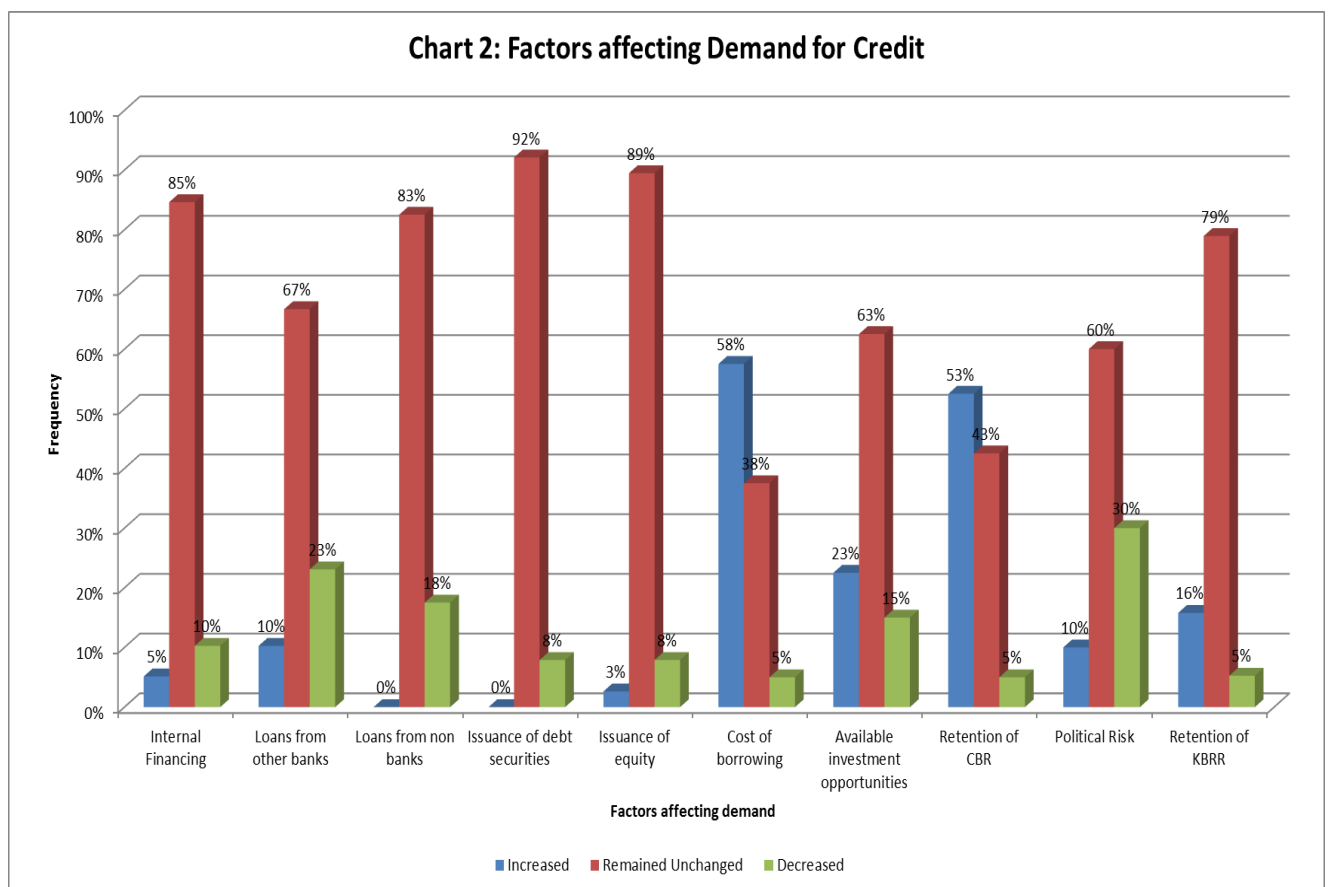


Table 2: Factors affecting Demand for credit

	December 2016			September 2016		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	5%	87%	8%	3%	92 %	5 %
Loans from other banks	11%	68%	21%	5 %	73 %	22 %
Loans from non-banks	0%	85%	15%	8 %	85 %	8 %
Issuance of debt securities	0%	92%	8%	0 %	92 %	8 %
Issuance of equity	3%	89%	8%	0 %	95 %	5 %
Cost of borrowing	59%	36%	5%	50 %	38 %	13 %
Available investment opportunities	23%	62%	15%	27 %	63 %	10 %
Retention of CBR	54%	41%	5%	65 %	30 %	5 %
Political Risk	10%	62%	28%	10 %	80 %	10 %
Retention of KBRR	16%	78%	5%	21 %	74 %	5 %

2.3 Credit Standards

- Eight out of the eleven economic sectors recorded unchanged credit standards in fourth quarter of 2016. These are Energy and Water (75 percent), Financial Services (66 percent), Mining and Quarrying (66 percent), Manufacturing (63 percent), Agriculture (59 percent), Tourism, Restaurant and Hotels (59 percent), Trade (56 percent) and Transport and Communication (50 percent).
- However, Credit standards in the fourth quarter of 2016 were tightened in three economic sectors (Personal/Household Real Estate and Building and

Construction economic sectors) with delayed government payments, political risk due to the upcoming elections, banks' capital position and cost of funds, cited as the main driving factors.

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

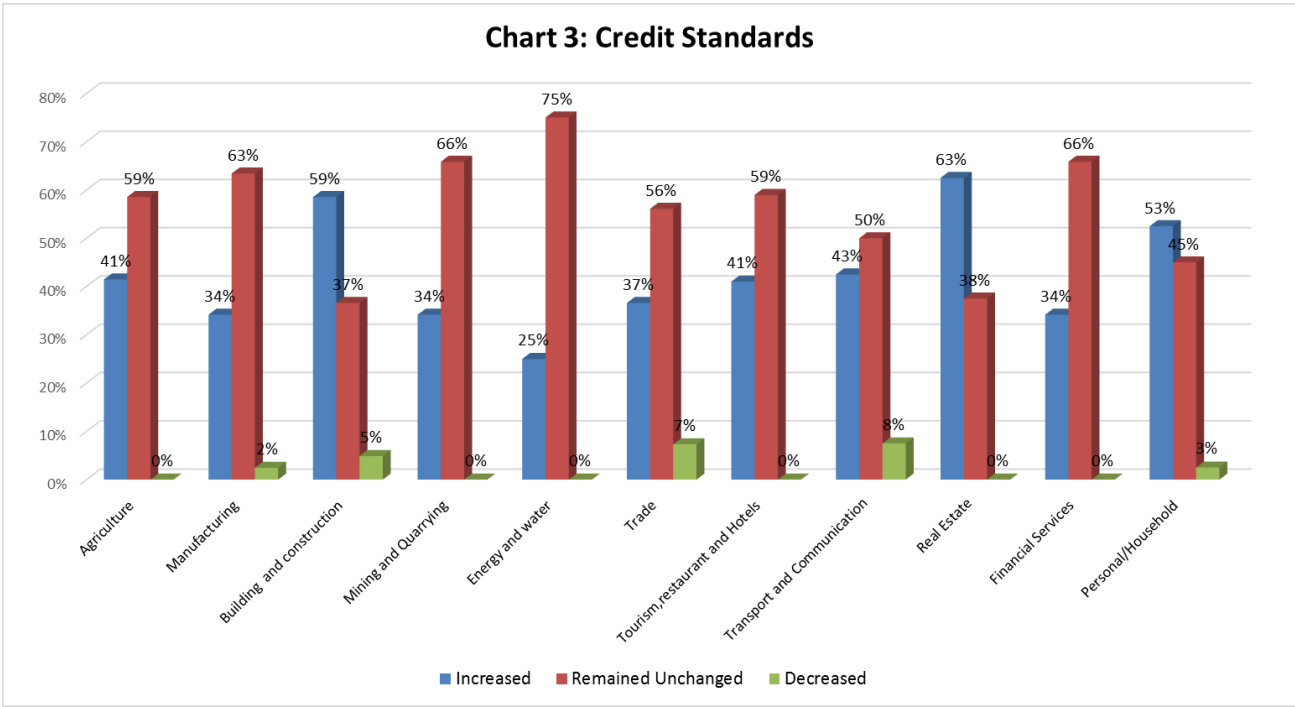


Table 3: Credit Standards for Loans to Various Economic Sectors

	December 2016			September 2016		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	41%	59%	0%	38%	63%	0%
Manufacturing	34%	63%	2%	39%	59%	2%
Building & Construction	59%	37%	5%	54%	41%	5%
Mining and Quarrying	34%	66%	0%	27%	73%	0%
Energy and Water	25%	75%	0%	34%	66%	0%
Trade	37%	56%	7%	46%	49%	5%
Tourism, Restaurant and Hotels	41%	59%	0%	43%	55%	3%
Transport and Communication	43%	50%	8%	49%	44%	7%
Real Estate	63%	38%	0%	58%	40%	3%
Financial Services	34%	66%	0%	40%	60%	0%
Personal/Household	53%	45%	3%	55%	43%	3%

2.4 Factors affecting credit standards

- In the fourth quarter of 2016, six factors (bank’s capital position, competition from other banks and other credit providers, retention of CBR, political risk and retention of KBRR) had little impact on credit standards.
- However, expectations regarding the general economic activity and bank’s cost of funds seem to have led to tightening of credit standards with 60 percent and 56 percent of the respondents indicating so.

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

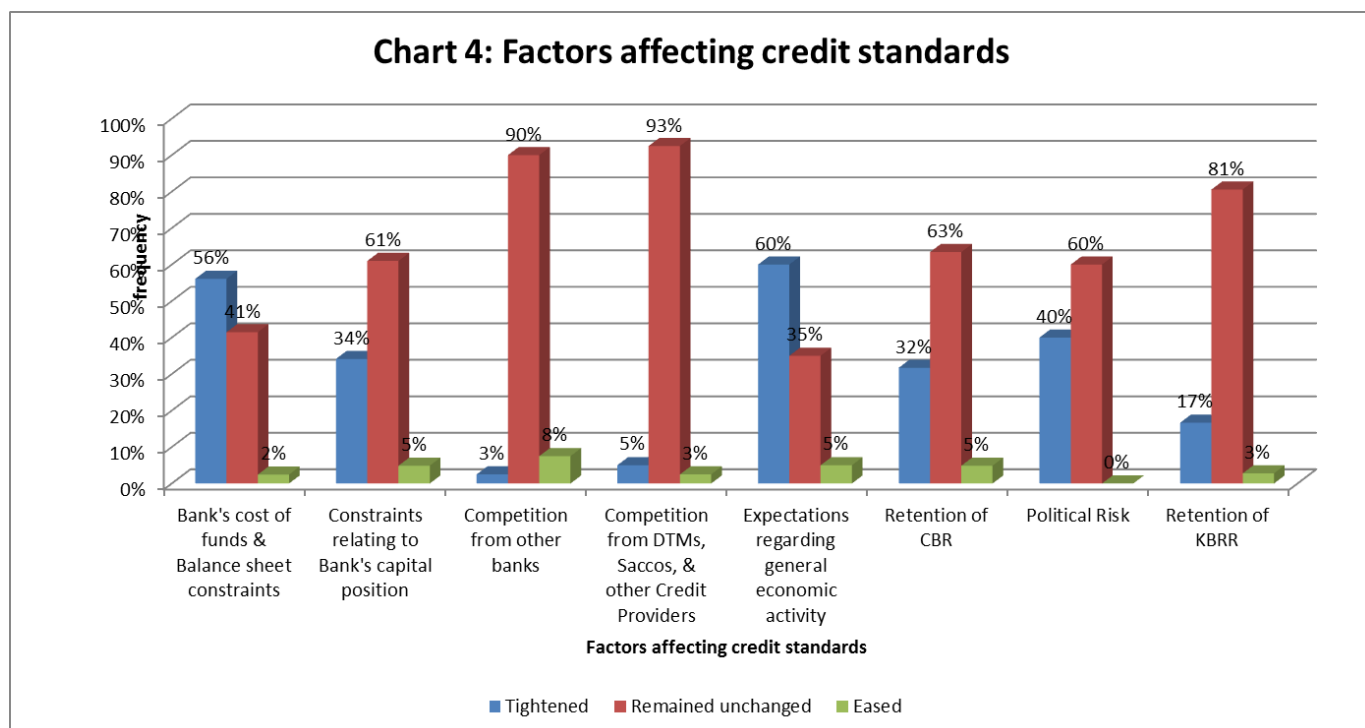


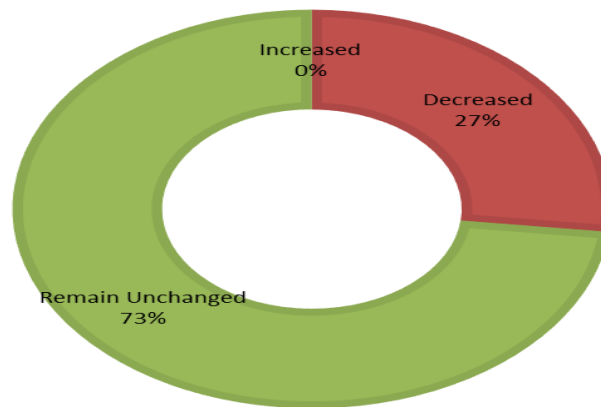
Table 4: Impact of factors affecting credit standards

	December 2016			September 2016		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds & Balance sheet constraints	56%	41%	2%	51%	44%	5%
Constraints relating to Bank's capital position	34%	61%	5%	28%	63%	10%
Competition from other banks	3%	90%	8%	2%	85%	12%
Competition from DTMs, Saccos, & other Credit Providers	5%	93%	3%	0%	93%	7%
Expectations regarding general economic activity	60%	35%	5%	46%	44%	10%
Retention of Central Bank Rate (CBR)	32%	63%	5%	37%	51%	12%
Political Risk	40%	60%	0%	24%	76%	0%
Retention of KBRR	17%	81%	3%	23%	65%	13%

2.5 Interest rates movements

The movement of interest rates is mainly attributed to the capping of interest rates that came into effect in September 2016; CBK's retention of the KBRR and the reduction of the CBR rate to 10 percent. The interest rates movements in the quarter under review are depicted in **Chart 5**.

Chart 5: Interest rates movement



73 percent of the banks held their interest rates constant, 27 percent reduced their interest rates while none of the banks reported an increase in their interest rates. This could be an indication of the banks complying with the Banking (Amendment) Act 2016, which applies to institutions licensed under the Banking Act. The Act limits interest rates chargeable on loans at not more than 4 percent above the prevailing Central Bank Rate (CBR). It also sets a floor on the interest rate payable by institutions on interest earning deposits at not less than 70 percent of the CBR.

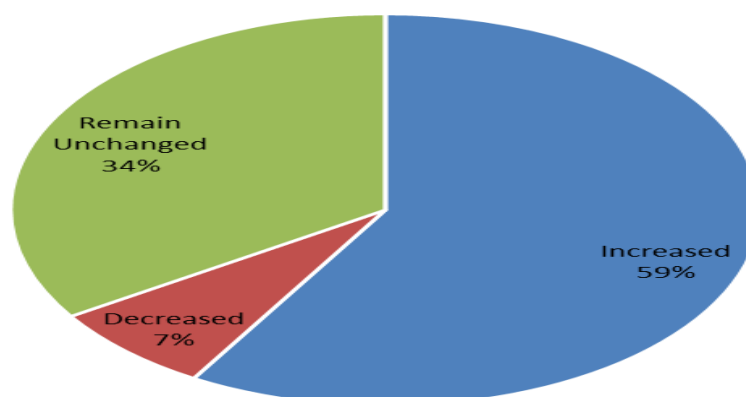
2.6 Capping of interest rates

With the interest rate capping that came into effect on 14th September 2016, the credit survey sought to find out the impact it had on demand for credit, actual new credit granted over the period to 31st December 2016 and the expectations of changes over the next three months. Further, the survey sought to find out how NPLs in the first quarter of 2017 will be affected by the interest rate capping.

2.6.1 Effect of interest rate capping on demand for credit

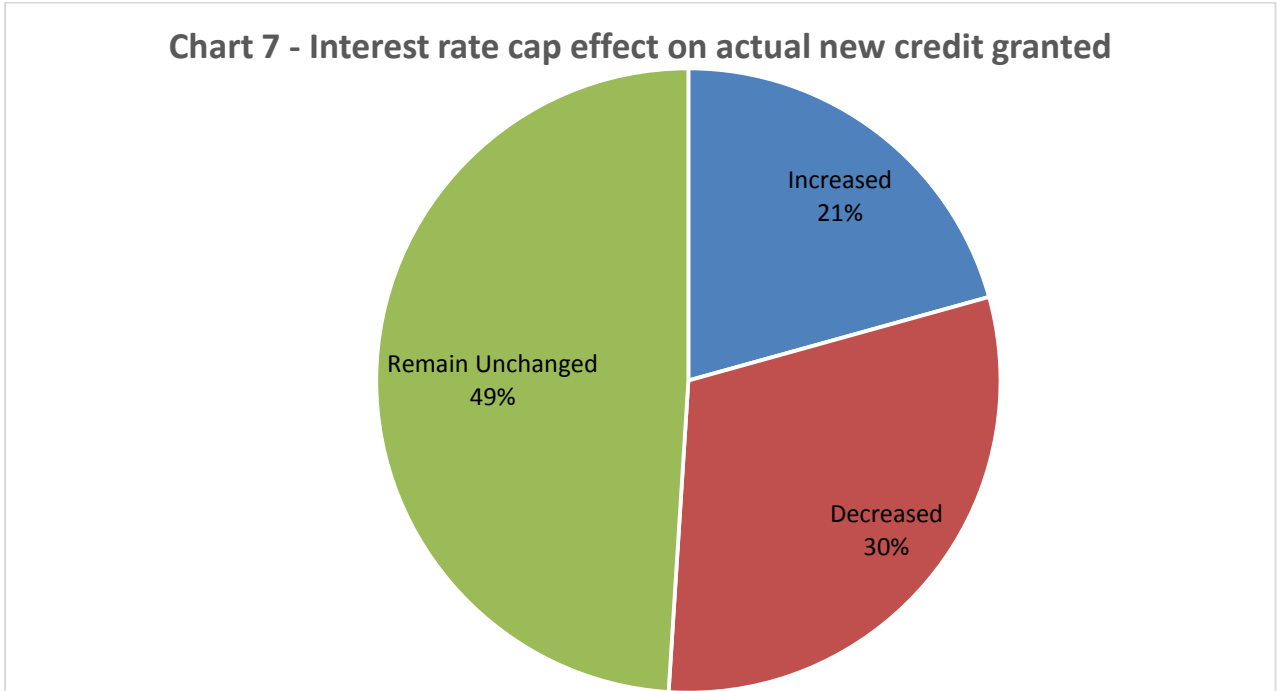
Interest rate capping led to increased demand for credit as indicated by 59 percent of the respondents who attributed this to cheaper credit. 34 percent of the respondents indicated that the demand for credit remained unchanged while 7 percent noted that demand for credit decreased as depicted in **chart 6**. This trend was the same in the third quarter. However, the increased demand for credit has had little impact on the actual credit advanced (**chart 7**).

Chart 6 - Interest rate cap effect on demand for credit



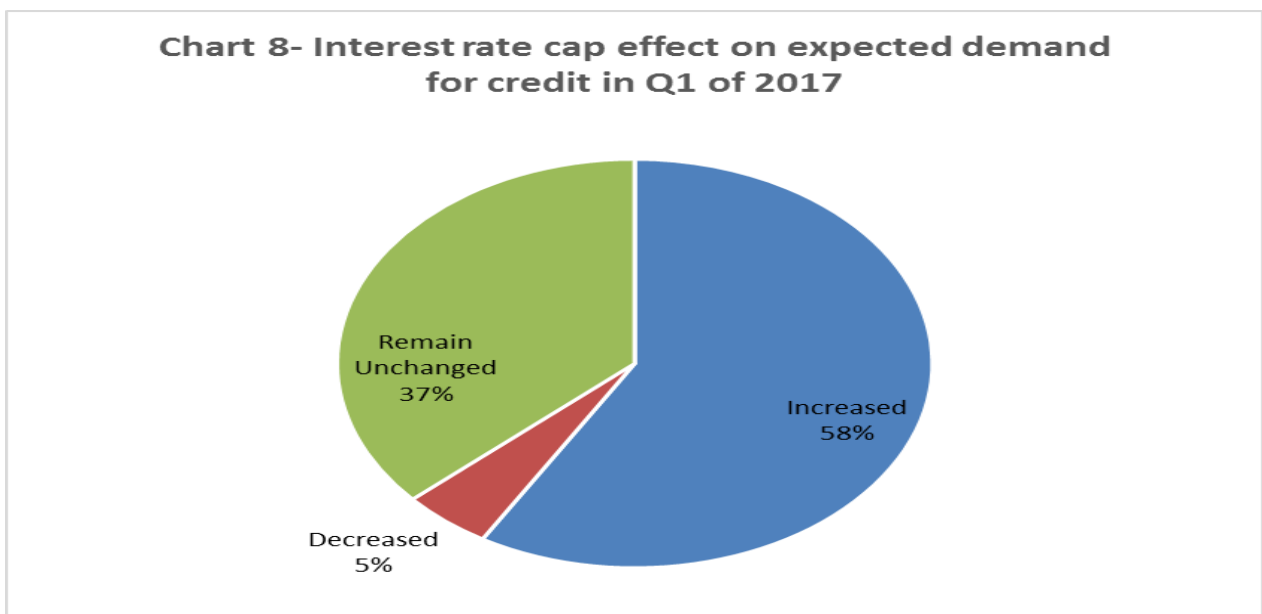
2.6.2 Effect of interest rate capping on actual new credit granted

49 percent of the respondents indicated that interest rate capping had little effect on the actual credit granted. 30 percent recorded that the actual new credit increased while 21 percent were of the view that the actual credit granted decreased as depicted in **chart 7** below. This depicts a situation of mixed reactions as the commercial banks take a wait and see approach on how the market will react to the capping of interest rates. This may be attributed to increased cost of funds following the Banking Amendment Act, 2016.



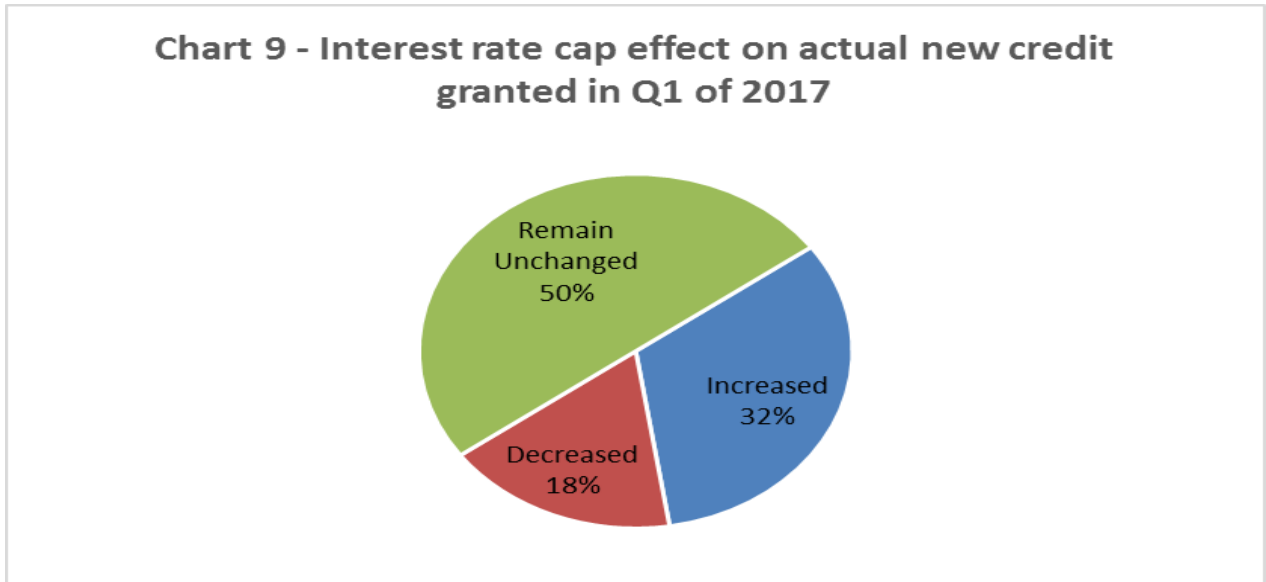
2.6.3 Effect of interest rate capping on expected demand for credit in first quarter of 2017

Going forward, 58 percent of the respondents indicated that interest capping will increase demand for credit while 37 percent responded that the demand will not change as indicated in **chart 8** below.



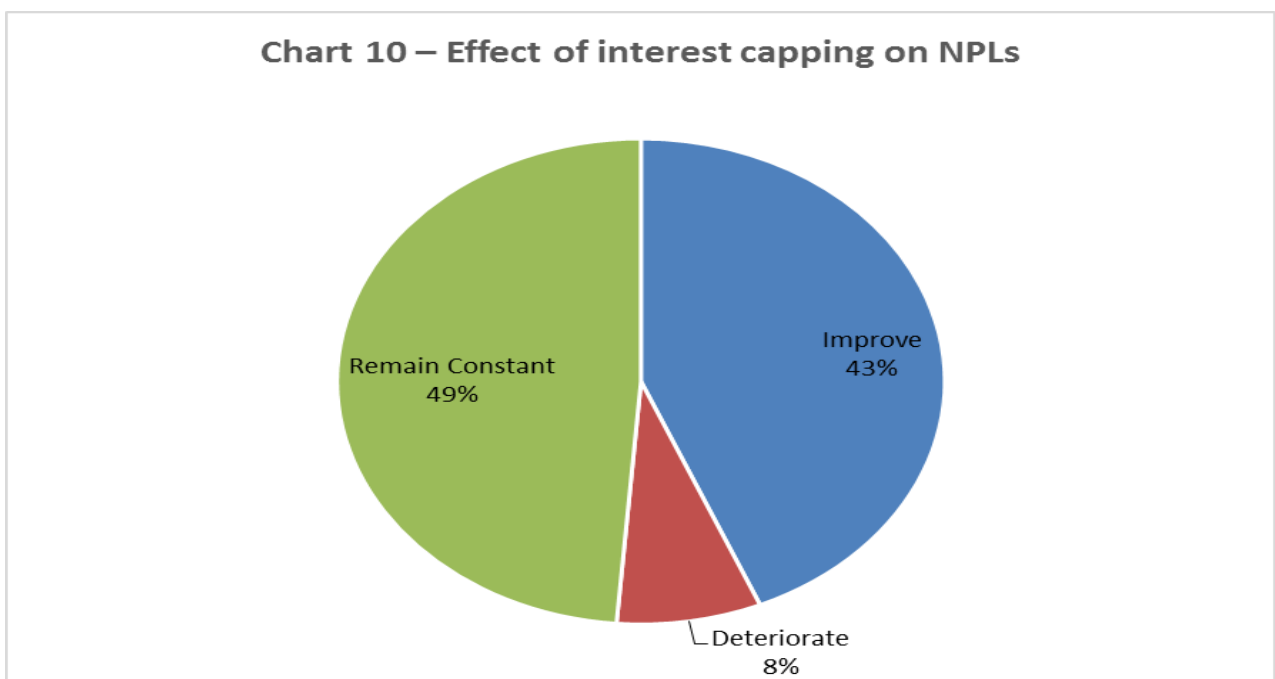
2.6.4 Interest rate cap effect on actual new credit granted in first quarter of 2017

With regards to expected actual credit advanced in first quarter of 2017, most of the respondents anticipate that interest rate capping will have little impact on actual credit advanced as indicated by 50 percent of the respondents. However, 32 percent of the respondents felt that interest capping will lead to an increase in actual credit advanced while 18 percent felt that the actual credit advanced will decrease as shown in **chart 9** below.



2.6.5 Effect of interest rate capping on the level of NPLs

In the first quarter of 2017, 43 percent of the respondents expect the capping of interest rates to have a positive impact on NPLs. This was attributed to the favourable interest rates, which led to cheaper credit. 8 percent felt that NPLs will deteriorate while 49 percent felt that the NPLs will not change as indicated in **chart 10**. This mixed reaction may be due to the wait and see approach on how the market will react to the capping of interest rates.



2.7 Non-Performing Loans (NPLs)

Banks expect the level of NPLs to remain unchanged in first quarter of 2017 in all the economic sectors as depicted in **Chart 11** below.

- Most banks expect the level of NPLs to remain unchanged in first quarter of 2017.
- However, in comparison to the quarter ended September 2016, there is a significant increase in the number of respondents that foresee an increase in NPLs in eight economic sectors.
- These sectors are Agriculture (16 percent), Personal/Household (10 percent), Real Estate (8 percent), Trade (6 percent), Energy and Water (6 percent), Tourism (5 percent), Transport and Communication (5 percent) and Building and Construction (3 percent).
- The increase in NPLs in the Agriculture and Energy and Water sectors is attributed to the current drought being experienced in most parts of the country.
- Most of the respondents predicted a drop in NPLs in the Financial Services and Manufacturing sectors in the first quarter of 2017. This is attributed to the retention of the CBR rate at 10 percent and the capping of interest rates effected in September 2016. These have resulted to better repayment ability of loans by customers since the loans have become affordable.

Chart 11 and **Table 5** indicate respondents' expectations on NPL trend in first quarter of 2017.

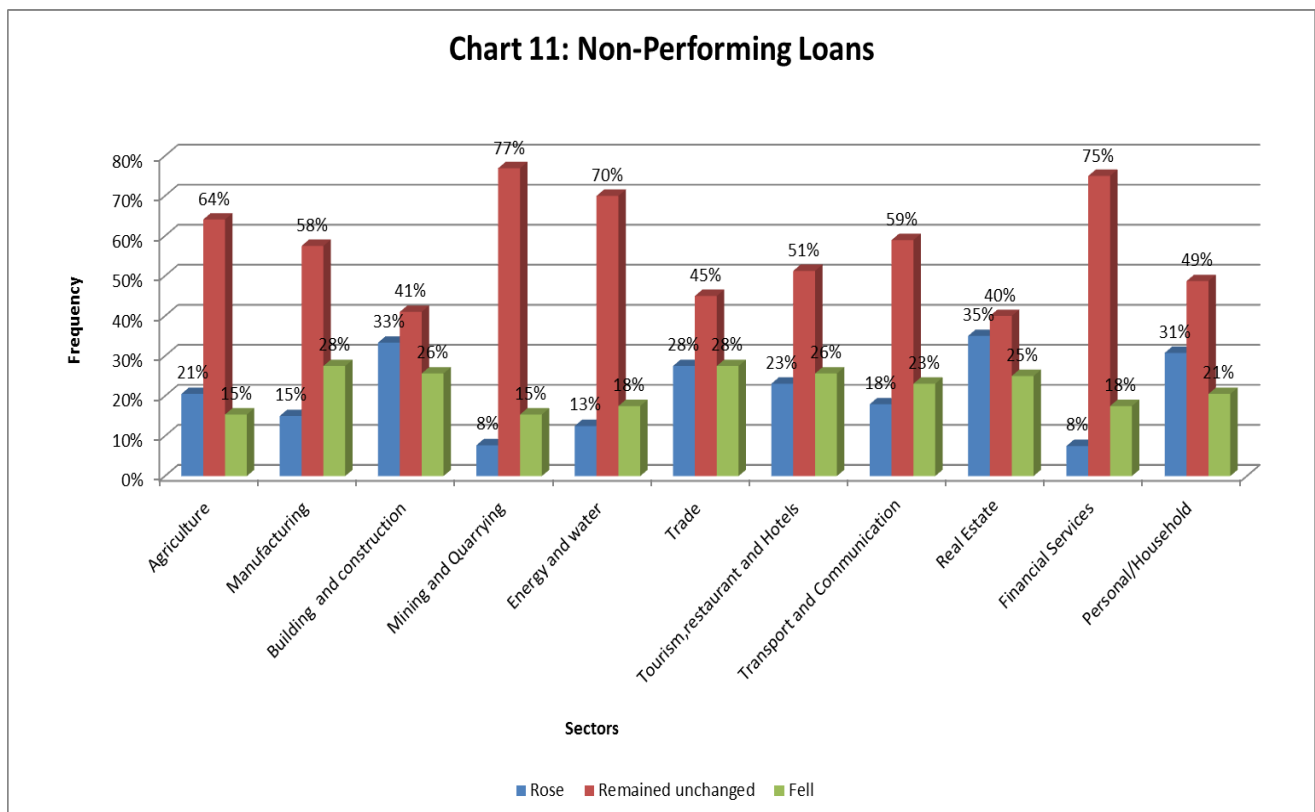


Table 5: Non Performing Loans Expectation Trend Per Economic Sector

	December 2016			September 2016		
	Rose	Remained Unchanged	Fell	Rose	Remained Unchanged	Fell
Agriculture	21%	64%	15%	5 %	64 %	31 %
Manufacturing	15%	58%	28%	15 %	59 %	27 %
Building & construction	33%	41%	26%	30 %	45 %	25 %
Mining and Quarrying	8%	77%	15%	8 %	73 %	20 %
Energy and water	13%	70%	18%	7 %	71 %	22 %
Trade	26%	46%	28%	20 %	40 %	40 %
Tourism, Restaurant & Hotels	23%	51%	26%	18 %	55 %	28 %
Transport & Communication	18%	59%	23%	13 %	58 %	30 %
Real Estate	33%	41%	26%	23 %	54 %	23 %
Financial Services	8%	75%	18%	10 %	76 %	15 %
Personal/Household	31%	49%	21%	23 %	40 %	38 %

2.8 Credit Recovery Efforts

For the quarter ending 31st March 2017, banks predict that credit recovery efforts will be intensified in nine of the eleven sectors. The banks intend to allocate more resources on monitoring and recovery of loans as well as use of external parties in the recovery process. Banks intend to intensify credit recovery efforts in the following sectors:-

- i. Tourism, Agriculture, Energy and Water sectors due to the on-going drought and seasonal fluctuations of cash flows.
- ii. Building and Construction sector to enhance collections from contractor payments by the Government of Kenya which are expected to be paid in the first quarter of 2017.
- iii. Personal/Household sectors banks expect that due to the end of the festivities period characterized by increased consumer spending, borrowers will now be better able to service their facilities over the next three months.
- iv. The intensified recovery efforts in six sectors (Manufacturing, Trade, Transport Real Estate, Financial Services and Personal/Household sectors) aims at improving the overall quality of the asset portfolio in line with the banks expectations that loan defaults in these sectors will rise during first quarter of 2017.

The responses on the expected credit recovery efforts by the banks during the quarter ending 31st December 2016 are depicted in **Chart 12** and **Table 6** below.

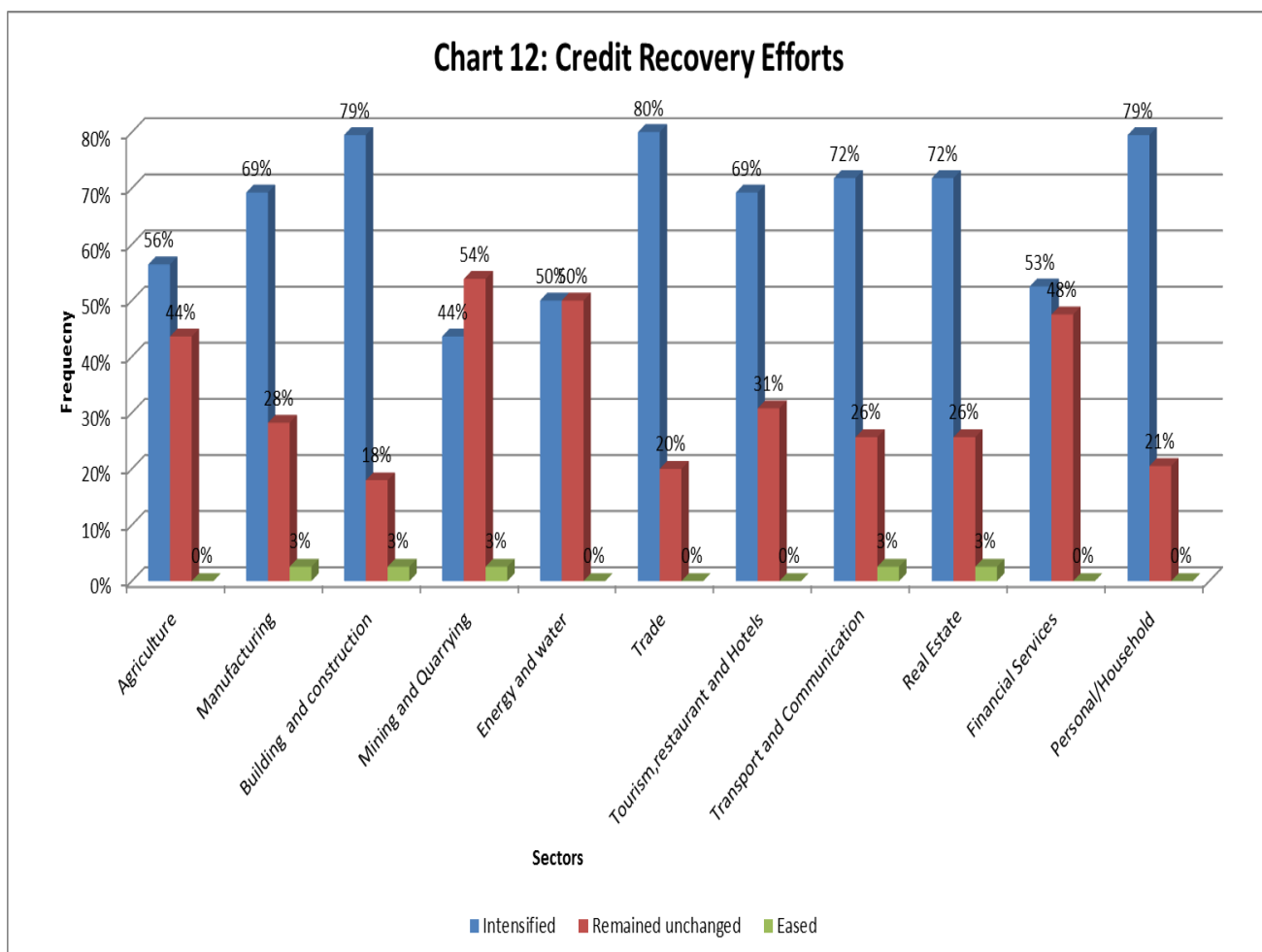


Table 6: Credit Recovery Efforts

	December 2016			September 2016		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	58%	43%	0%	55 %	45 %	0 %
Manufacturing	70%	28%	3%	71 %	29 %	0 %
Building & construction	80%	18%	3%	78 %	23 %	0 %
Mining and Quarrying	45%	53%	3%	48 %	53 %	0 %
Energy and water	51%	49%	0%	49 %	49 %	2 %
Trade	80%	20%	0%	78 %	20 %	3 %
Tourism, Restaurant & Hotels	70%	30%	0%	68 %	33 %	0 %
Transport & Communication	73%	25%	3%	75 %	25 %	0 %
Real Estate	73%	25%	3%	70 %	30 %	0 %
Financial Services	54%	46%	0%	59 %	41 %	0 %
Personal/Household	80%	20%	0%	80 %	18 %	3 %

LIST OF RESPONDENTS

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