Central Bank of Kenya

Credit Officer Survey

March 31, 2023

CENTRAL BANK OF KENYA COMMERCIAL BANKS' CREDIT OFFICER SURVEY FOR THE QUARTER ENDED MARCH 31, 2023

1.0 COMMERCIAL BANKS' CREDIT OFFICER SURVEY

1.1 BACKGROUND

Credit risk is the single largest factor affecting the soundness of financial institutions and the financial system. This is because lending is the principal business for banks. The ratio of gross loans to total assets increased marginally from 55.7 percent in the quarter ended December 31, 2022, to 56.9 percent in the quarter ended March 31, 2023.

The Central Bank of Kenya (CBK) undertakes a quarterly Credit Officer Survey to identify the potential drivers of credit risk. The survey requires senior credit officers of banks to indicate their banks perception or actual position in the immediate past quarter and the subsequent quarter in terms of demand for credit, credit standards, asset quality, credit recovery efforts, deployment of liquidity and impact of implementing new standards.

1.2 SURVEY METHODOLOGY

Senior Credit Officers[1] complete most of the survey and collate inputs from senior officers responsible for the other aspects. For the quarter ended March 31, 2023, 38 operating commercial banks and 1 mortgage finance company participated in the Commercial Banks Credit Officer Survey.

The survey sought to establish the lending behavior in the banking sector in respect to all the eleven economic sectors. Questions were posed on demand for credit, credit standards for approving loans, non-performing loans, credit recovery efforts, implementation of International Financial Reporting Standards (IFRS) 9 on Financial Instruments and IFRS 16 on Leases. 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 concerning liquidity in the banks. The banks were required to state their liquidity trend and appetite for the deployment of liquidity towards extension of credit, interbank lending, and other forms of investment.

Following the declaration by the World Health Organization of coronavirus (COVID-19) outbreak as a pandemic in March 2020, CBK has continued to assess the impact of the pandemic on the banking sector.

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[1] *These are officers involved in most of the credit and liquidity decisions hence are able to provide reasonably accurate and complete responses from their bank's perspective. They also collate input on non-credit aspects from their counterparts.*

1.3 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan Banking Sector recorded growth in the quarter ended March 31, 2023, compared to the quarter ended December 31, 2022. Some of the sector's performance indicators are as follows:

- The aggregate balance sheet increased by 2.7 percent to Ksh.6,771.7 billion in March 2023, from Ksh.6,596.6 billion in December 2022.
- Gross loans increased by 4.8 percent from Ksh.3,677.3 billion in December 2022, to Ksh.3,852.3 billion in March 2023. The increase in gross loans was largely witnessed in the Financial Services, Transport and Communication, and Manufacturing sectors. The increase in gross loans was mainly due to increased credit granted for working capital purposes, and loans granted to individual borrowers.
- Total deposits increased by 2.1 percent from Ksh.4,730.1 billion in December 2022, to Ksh. 4,828.3 billion in March 2023.
- The asset quality, measured by gross non-performing loans to gross loans ratio deteriorated from 13.3 percent in December 2022, to 14.0 percent in March 2023. This was due to a 10.9 percent increase in gross NPLs compared to a 4.8 percent increase in gross loans.
- The capital adequacy ratio decreased from 19.0 percent in December 2022 to 18.4 percent in March 2023. The capital adequacy ratio was above the minimum statutory limit of 14.5 percent.
- Quarterly profit before tax increased by Ksh.7.9 billion from Ksh.57.2 billion in December 2022, to Ksh.65.1 billion in March 2023. The increase in profitability was mainly attributable to a higher decrease in quarterly expenses by Ksh.5.2 billion and an increase in quarterly income by Ksh.2.7 billion.
- Return on Equity (ROE) increased from 25.6 percent in December 2022, to 27 percent in March 2023. The increase in ROE was due to increased quarterly profit before tax.
- Liquidity in the banking sector decreased marginally from 50.8 percent in December 2022, to 49.9 percent in March 2023. This was well above the minimum statutory ratio of 20 percent.

1.4 SUMMARY OF CREDIT OFFICER SURVEY FINDINGS

- **Demand for credit:** In the first quarter of 2023, the perceived demand for credit remained unchanged in seven economic sectors. It increased in four sectors (Agriculture, Manufacturing, Trade, and Personal and Household).
- **Credit Standards[2]:** In the first quarter of 2023, credit standards remained unchanged in all the eleven economic sectors.
- **Non-Performing Loans per sector:** Respondents indicated that the level of NPLs is expected to remain constant in ten economic sectors and decrease in Trade sector during the next quarter.

[2]*Credit standards are guidelines used by commercial banks in determining whether to extend a loan to an applicant.*

- **Credit Recovery Efforts:** For the quarter ended June 30, 2023, banks expect to intensify their credit recovery efforts in eight economic sectors and retain them in three sectors (Mining and Quarrying, Energy and Water, and Financial Services). The intensified recovery efforts are aimed at improving the overall quality of the asset portfolio.
- **International Financial Reporting Standard (IFRS) 9 on Financial Instruments:** Most banks have adopted a tight credit risk appraisal, ensuring that facilities are well secured and that alternative sources of repayment are available.
- **International Financial Reporting Standard (IFRS) 16 on Leases:** During the quarter ended March 31, 2023, 97 percent of the respondents had implemented IFRS 16. In the same quarter, 97 percent of the respondents had assessed the impact of IFRS 16 on their financial performance and position.
- **Liquidity risk:** During the quarter ended March 2023, 61 percent of the respondents indicated that their liquidity position had improved.
- Banks intend to deploy the additional liquidity towards lending to the private sector (38 percent), investing in Treasury Bills (19 percent), investing in Treasury Bonds (19 percent), interbank lending (16 percent), CBK liquidity management through repos (5 percent), and increase their cash holdings (3 percent).

2.0 SURVEY FINDINGS

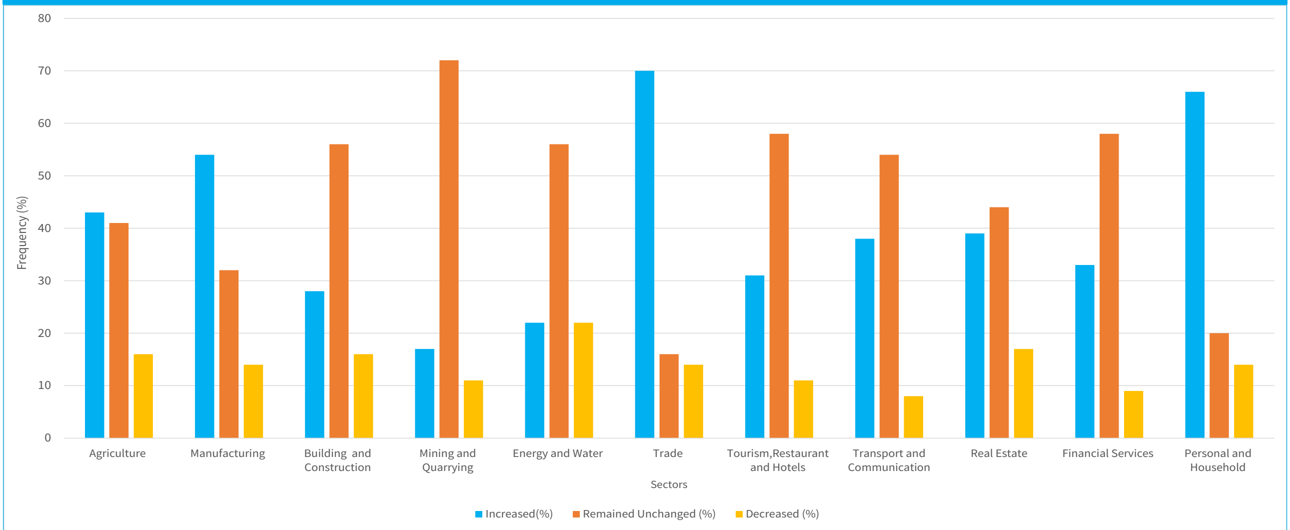
2.1 Demand for Credit

- In the first quarter of 2023, the perceived demand for credit remained unchanged in seven economic sectors. It increased in four sectors (Agriculture, Manufacturing, Trade, and Personal and Household).
- The main sectors with unchanged demand for credit are Mining and Quarrying, Financial Services, Tourism, Energy and Water, and Building and Construction.
- The perceived increased demand for credit in Agriculture, Manufacturing, Trade, and Personal and Household sectors is attributed to consumers being confident that the economy is on an upswing. The weather is also expected to perform better in 2023.
- **Chart 1** and **Table 1** below present the trend in the perceived demand for credit in the last two quarters.

Table 1: Change in Demand for Credit

Percentage (%)	December 2022			March 2023		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	29	58	13	43	41	16
Manufacturing	53	32	15	54	32	14
Building and Construction	31	53	17	28	56	16
Mining and Quarrying	11	78	11	17	72	11
Energy and Water	27	62	11	22	56	22
Trade	66	26	8	70	16	14
Tourism, Restaurant and Hotels	30	62	8	31	58	11
Transport and Communication	29	58	13	38	54	8
Real Estate	24	54	22	39	44	17
Financial Services	35	57	8	33	58	9
Personal and Household	54	30	16	66	20	14

Chart 1: Demand for Credit



2.2 Factors Affecting Demand for Credit

- In the quarter ended March 31, 2023, all the ten factors affecting demand for credit had no significant impact. This is depicted in **Chart 2** and **Table 2**.
- Issuance of equity, issuance of debt securities, and loans from non-banks were cited as having had the least impact on the demand for credit during the quarter under review. These were reported by 89 percent, 89 percent and 83 percent of the respondents respectively.

Chart 2: Factors affecting Demand for Credit

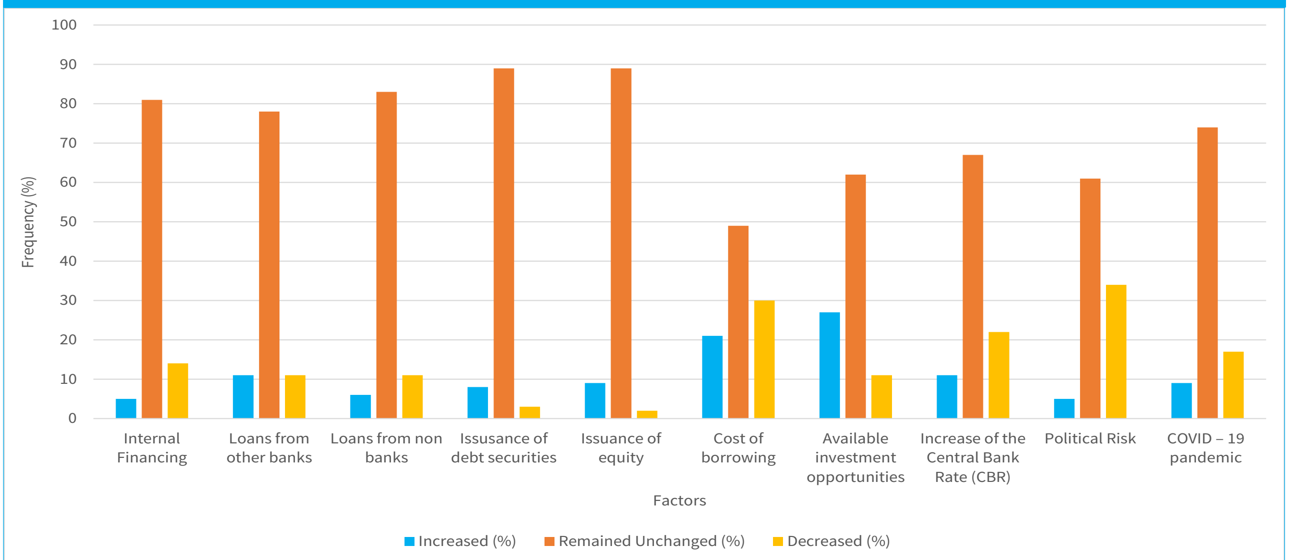


Table 2: Factors Affecting Demand for Credit

Percentage (%)	December 2022			March 2023		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	11	79	10	5	81	14
Loans from other banks	5	82	13	11	78	11
Loans from non-banks	5	87	8	6	83	11
Issuance of debt securities	5	95	0	8	89	3
Issuance of equity	3	95	2	9	89	2
Cost of borrowing	13	66	21	21	49	30
Available investment opportunities	28	59	13	27	62	11
Increase of the Central Bank Rate (CBR)	5	84	11	11	67	22
Political Risk	15	59	26	5	61	34
COVID – 19 pandemic	15	74	11	9	74	17

2.3 Credit Standards

- In the first quarter of 2023, credit standards remained unchanged in all the eleven economic sectors.
- This is presented in **Chart 3** and **Table 3** below.

Chart 3: Credit Standards

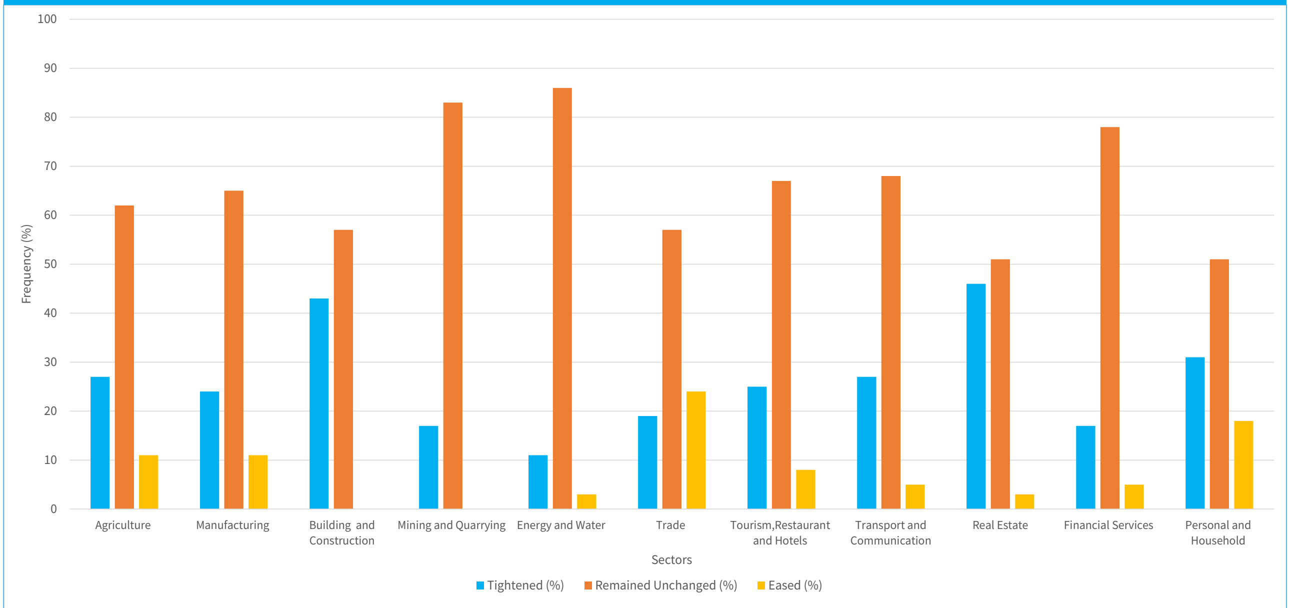


Table 3: Credit Standards for Loans to Various Economic Sectors

Percentage (%)	December 2022			March 2023		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	18	77	5	27	62	11
Manufacturing	18	72	10	24	65	11
Building and Construction	29	68	3	43	57	0
Mining and Quarrying	13	87	0	17	83	0
Energy and Water	11	89	0	11	86	3
Trade	15	59	26	19	57	24
Tourism, Restaurant and Hotels	24	68	8	25	67	8
Transport and Communication	21	71	8	27	68	5
Real Estate	41	54	5	46	51	3
Financial Services	13	82	5	17	78	5
Personal and Household	26	58	16	31	51	18

2.4 Factors Influencing Credit Standards

- In the quarter ended March 31, 2023, seven factors had little impact on credit standards whereas COVID-19 and Expectations regarding general economic activity, led to tightening of credit standards especially in building and construction sectors.
- Investment in Government Securities, Competition from DTMs, Saccos, and other Credit Providers, and Competition from other banks are the main factors that had no impact on credit standards. These were reported by 89 percent, 86 percent and 81 percent of the respondents respectively.
- A comparison of the trend in the factors affecting the banks' credit standards are shown in **Chart 4** and **Table 4**.

Chart 4: Factors affecting Credit Standards

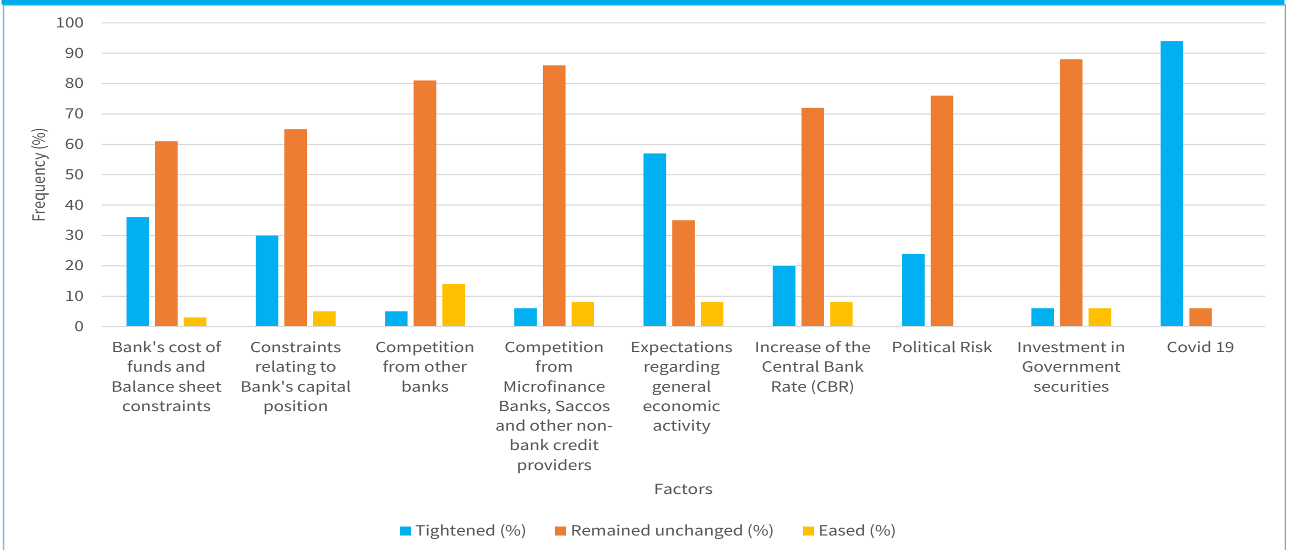


Table 4: Factors affecting credit standards

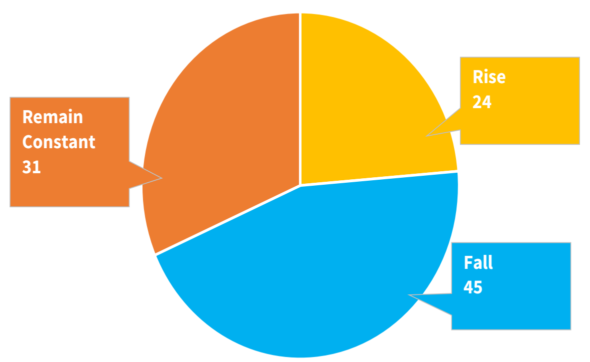
Percentage (%)	December 2022			March 2023		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds and Balance sheet constraints	33	64	3	36	61	3
Constraints relating to Bank's capital position	31	64	5	30	65	5
Competition from other banks	10	82	8	5	81	14
Competition from DTMs, Saccos, and other Credit Providers	13	79	8	6	86	8
Expectations regarding general economic activity	41	44	15	57	35	8
Increase of the Central Bank Rate (CBR)	18	79	3	20	72	8
Political Risk	21	69	10	24	76	0
Investment in Government Securities	11	84	5	6	88	6
COVID-19	94	6	0	94	6	0

2.5. Non-Performing Loans (NPLs)

2.5.1 Expected Movements of Non-Performing Loans in the next quarter

- 45 percent of the respondents indicated that NPLs are likely to fall in the second quarter of 2023. This is attributed to enhanced recovery efforts being implemented by most banks.
- 32 percent of the respondents expect the level of NPLs to remain constant and 24 percent of the respondents expect the level of NPLs to rise in the second quarter of 2023. These are depicted in **Chart 5**.

Chart 5: Expected movements of NPLs in the next Quarter (%)



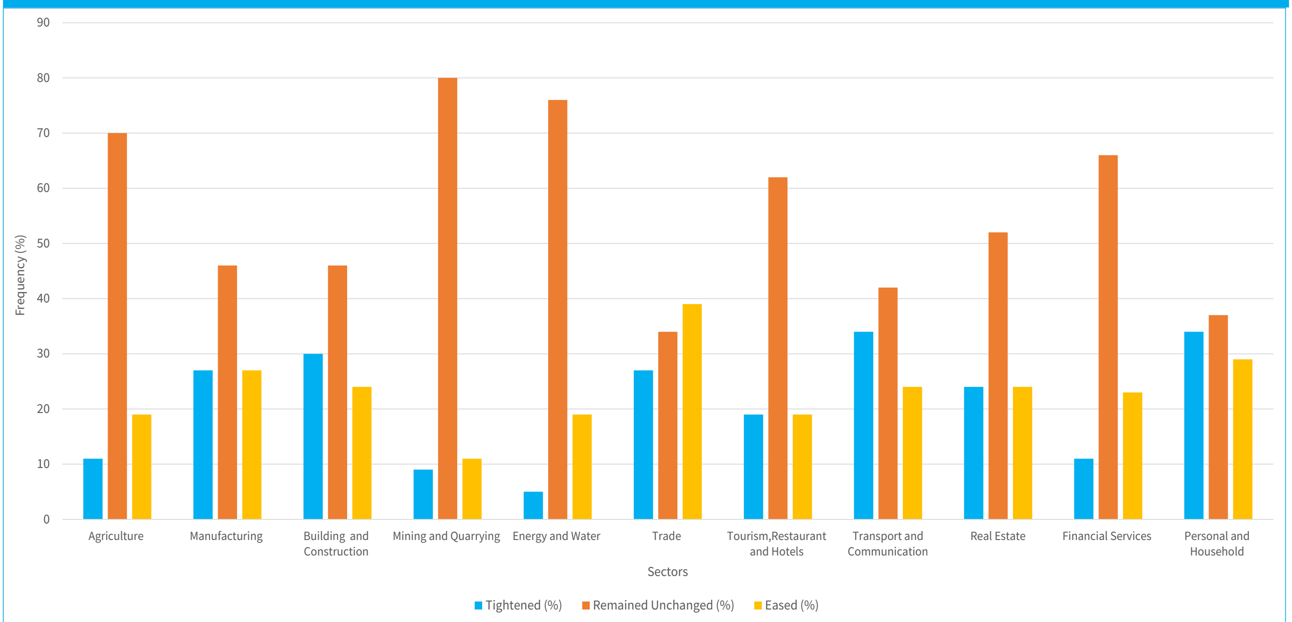
2.5.2 Expected Non-Performing Loans per sector during the next Quarter

- Respondents indicated that the level of NPLs is expected to remain constant in ten economic sectors and decrease in Trade sector during the next quarter.
- **Table 5** and **Chart 6** depict this.

Table 5: Non-Performing Loans Trend Per Economic Sector

	December 2022			March 2023		
Percentge (%)	Increase	Remain constant	Decrease	Increase	Remain constant	Decrease
Agriculture	18	71	11	11	70	19
Manufacturing	15	53	32	27	46	27
Building and Construction	19	54	27	30	46	24
Mining and Quarrying	3	86	11	9	80	11
Energy and Water	3	84	13	5	76	19
Trade	15	41	44	27	34	39
Tourism, Restaurant and Hotels	13	58	29	19	62	19
Transport and Communication	18	56	26	34	42	24
Real Estate	18	45	37	24	52	24
Financial Services	6	72	22	11	66	23
Personal and Household	19	46	35	34	37	29

Chart 6: Non-Performing Loans Trend per Economic Sector



2.6 Credit Recovery Efforts in the next Quarter

- For the quarter ended June 30, 2023, banks expect to intensify their credit recovery efforts in eight economic sectors and retain them in three sectors (Mining and Quarrying, Energy and Water, and Financial Services). The intensified recovery efforts are aimed at improving the overall quality of the asset portfolio.
- The main sectors that banks intend to intensify credit recovery efforts are:

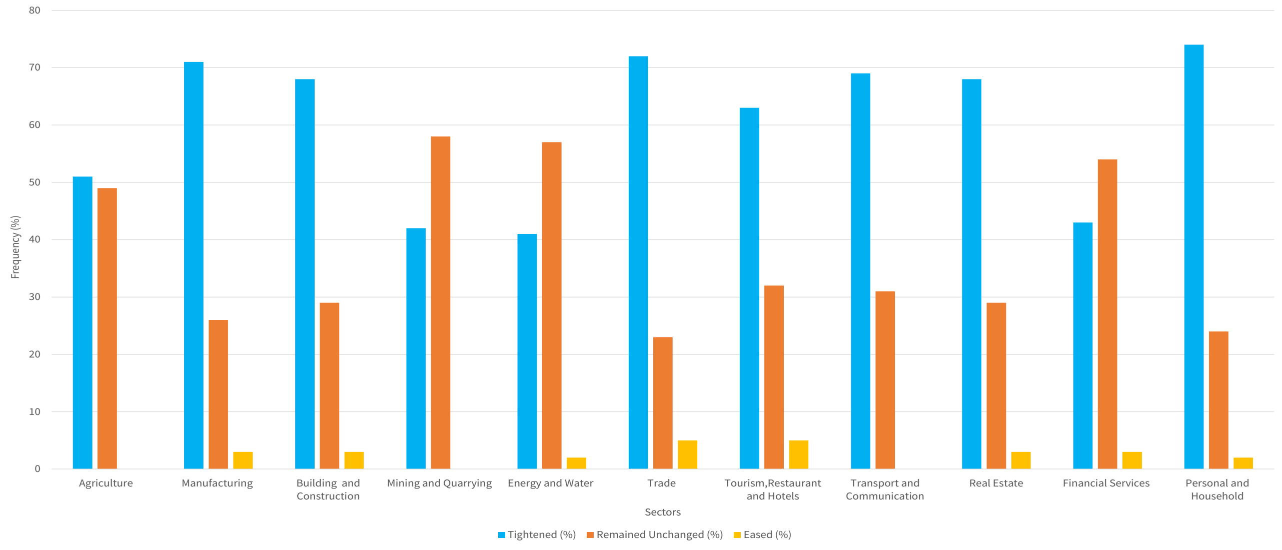
i. Personal and Household (80 percent).
ii. Trade (71 percent).
iii. Transport and Communication (71 percent).
iv. Manufacturing (70 percent).
v. Real Estate (67 percent).
vi. Building and Construction (62 percent).

- The responses on the expected credit recovery efforts by the banks are depicted in **Chart 7** and **Table 6**.

Table 6: Credit Recovery Efforts

	December 2022			March 2023		
Percentage (%)	Intensify	Remain Constant	Ease	Intensify	Remain Constant	Ease
Agriculture	51	49	0	55	45	0
Manufacturing	71	26	3	70	30	0
Building and Construction	68	29	3	62	38	0
Mining and Quarrying	42	58	0	42	58	0
Energy and Water	41	57	2	36	64	0
Trade	72	23	5	71	24	5
Tourism, Restaurant and Hotels	63	32	5	59	41	0
Transport and Communication	69	31	0	71	29	0
Real Estate	68	29	3	67	33	0
Financial Services	43	54	3	39	61	0
Personal and Household	74	24	2	80	20	0

Chart 7: Credit Recovery Efforts



2.7 International Financial Reporting Standard (IFRS) 9 on Financial Instruments

- The International Financial Reporting Standard (IFRS) 9 on Financial Instruments became effective from January 1, 2018. This standard replaced International Accounting Standard (IAS) 39 on Financial Instruments (Recognition and Measurement).
- IFRS 9 introduced a new method of determining provisions for expected losses on loans extended by lending institutions.
- Institutions are required to recognize expected credit losses at all times and to update the amount of expected credit losses recognized at each reporting date to reflect changes in the credit risk of financial instruments.
- In the quarter ended March 31, 2022, the Central Bank of Kenya assessed: -
    i. The challenges that banks still experience in the implementation of IFRS 9 and mitigation measures implemented.
    ii. Whether the banks have made any changes in the assumptions used in IFRS 9 and if they are more reliable.

2.7.1 Challenges experienced in the Implementation of IFRS 9

- Most banks have adopted a tight credit risk appraisal, ensuring that facilities are well secured and that alternative sources of repayment are available.
- However, implementation of IFRS 9 has had some challenges. The prevalent challenge pointed out by the respondents are: -
    i. Need for knowledge enhancement for the various consumers within the group.
    ii. Incorporation of forward-looking information e.g. In 2023 the inflation and exchange rates have risen significantly while net export, consumption per capital and GDP figures are not available on a regular basis.

2.7.2 Mitigation Measures implemented in dealing with challenges faced in the Implementation of IFRS 9

- Banks have implemented the following mitigation measures: -

    i. Continuous trainings conducted within the group network.
    ii. Regular update of the IFRS 9 parameters.
    iii. Continuous monitoring of the high-risk customers and the dynamic evolution of the various portfolios.

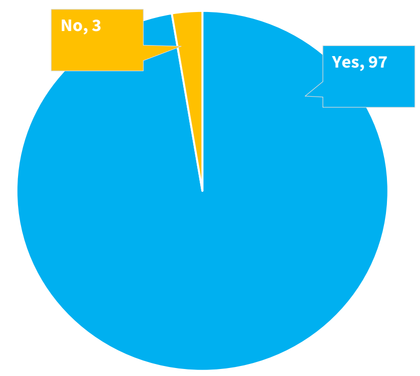
2.8. International Financial Reporting Standard (IFRS) 16 on Leases

- The International Financial Reporting Standard (IFRS) 16 on Leases became effective from January 1, 2019. This standard replaced International Accounting Standard (IAS) 17 on Leases.
- The main difference between IAS 17 and IFRS 16 is the treatment of operating leases by lessees. Under IAS 17, a lessee was not obligated to report assets and liabilities from operating leases on their balance sheet but instead report the leases as off-balance sheet items. IFRS 16 changed this by requiring lessees to recognize operating leases right of use (ROU) assets and lease liabilities on the balance sheet.
- IFRS 16 aims to improve the quality of financial reporting for companies with material off balance sheet leases.

2.8.1 Implementation of IFRS 16

- During the quarter ended March 31, 2023, 97 percent of the respondents had implemented IFRS 16.
- 3 percent of the respondents had not implemented IFRS 16. They indicated that they are not able to determine the most appropriate discounting rate for lease payment. This is depicted in **Chart 8**.

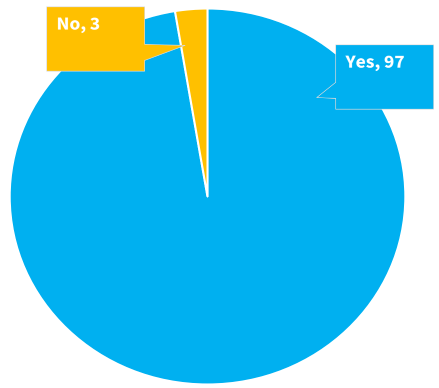
Chart 8: Banks that have implemented IFRS 16 on Leases (%)



2.8.2 Assessment of the Impact of IFRS 16

- During the quarter ended March 31, 2023, 97 percent of the respondents had assessed the impact of IFRS 16 on their financial performance and position. This is depicted in **Chart 9**.

Chart 9: Banks that assessed the likely impact of IFRS 16 (%)



2.8.3 Impact of IFRS 16 on Banks' Financial performance and position

Most banks indicated that implementation of IFRS 16 :-

- Increased their risk weighted assets.
- Increase in operating lease costs arising from straight lining of depreciation on the resultant right of use asset (ROU) and an additional finance charge based on the net lease liability and an appropriate discount rate (IBR).

2.8.4 Financial indicators for Leases

- Following the implementation of IFRS 16 on January 1, 2019, the value of the financial indicators for leases in the banking industry as at March 31, 2023, are indicated in **Table 7**.

Table 7: Financial elements bank value as at March 31, 2023

Banking Industry (Ksh '000)	December 2022	March 2023
Right of use (ROU) assets	32,054,540.64	34,901,705.11
Lease liabilities	25,463,712.19	28,894,529.12
Depreciation of the right of use asset	7,910,069.32	4,764,318.89
The finance charge associated with the lease liability	3,035,344.68	1,372,175.14

2.8.5 Challenges experienced in the Implementation of IFRS 16

- Most banks indicated that the major challenges they faced in implementation of IFRS 16 include: -
  i. Clarity of lease agreement especially the issues related to restoration cost and possible maximum period of extension.
  ii. Coming up with the best discounting rate.
  iii. The judgmental nature in the application of the IFRS 16 including the assumptions taken on the renewal options for the leases.

2.8.6 Mitigation measures on the challenges experienced in Implementation of IFRS 16

- Banks are continuously bridging the gap through continuous training for their staff and ensuring regular updates in the changes in the leasing space. In addition, depreciation on ROU asset and interest expense on lease liability are charged to income statement replacing rent expense. Included in the Balance sheet is the ROU asset and lease liability which increases the total assets and liabilities prospectively.

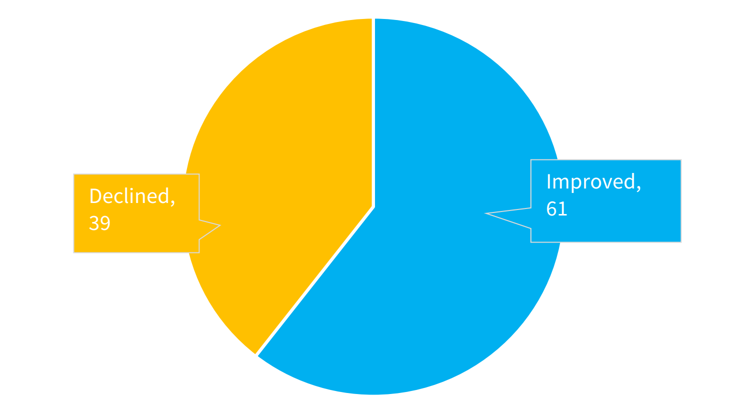
2.9 Liquidity Risk

- Banks were required to state the status of their liquidity positions, factors that led to improved liquidity, their plans with improved liquidity, measures being taken with deteriorated liquidity and their involvement in interbank activities during the quarter ended March 31, 2023.

2.9.1 Commercial Banks' liquidity positions

- During the quarter ended March 2023, 61 percent of the respondents indicated that their liquidity position had improved as indicated in **Chart 10**.

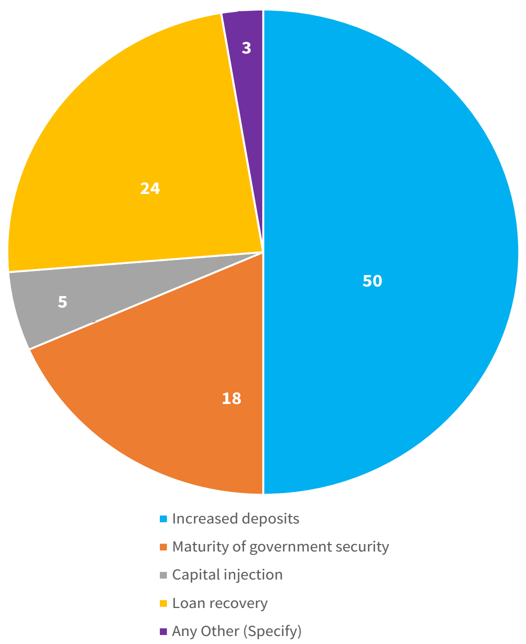
Chart 10: Movement in liquidity position (%)



2.9.2 Factors that led to improved liquidity in the quarter ended March 31, 2023

- During the quarter ended March 31, 2023, liquidity improved mainly as a result of: -
  - i). Increased deposits (50 percent).
  - ii). Loan recovery (24 percent).
  - iii). Maturity of government securities (18 percent).
  - iii). Capital injection (5 percent).
- The drivers of improved liquidity are indicated in **Chart 11**.

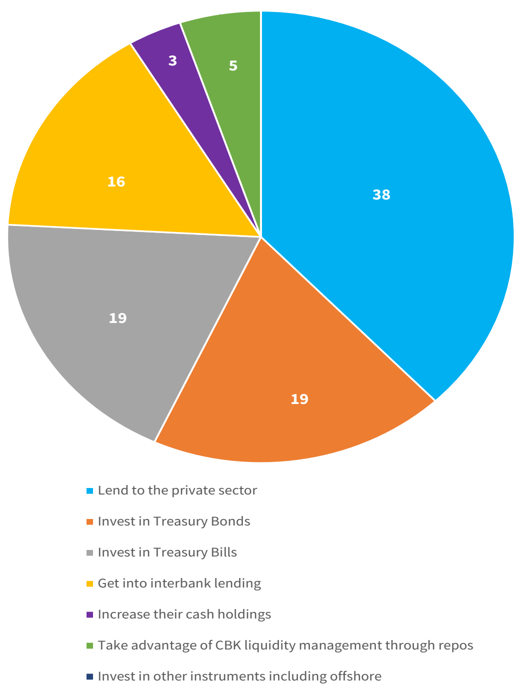
Chart 11: Reasons for improved liquidity (%)



2.9.3 Commercial Banks' plans with improved liquidity

- As indicated in **Chart 12**, with the improved liquidity, it is expected that in the second quarter of 2023, credit to private sector will increase as several banks intend to deploy the additional liquidity towards lending to the private sector (38 percent), investing in Treasury Bills (19 percent), investing in Treasury Bonds (19 percent), interbank lending (16 percent), CBK liquidity management through repos (5 percent), and increase their cash holdings (3 percent).

Chart 12: Plans with improved liquidity (%)



2.9.4 Measures being taken by Commercial banks to enhance deteriorated liquidity

- During the quarter ended March 2023, 39 percent of the respondents indicated that their liquidity position had deteriorated as indicated in **Chart 10.**
- Banks continue to maintain adequate liquidity levels with sufficient headroom to withstand any unforeseen liquidity shocks.
- Banks have in place a stringent and robust liquidity management framework.

2.9.5 Commercial Banks' interbank activities during the quarter

- During the quarter ended March 31, 2023, 50 percent of the respondents indicated that their interbank lending activities increased. This is indicated in **Chart 13**.
- 59 percent of the respondents indicated that their interbank borrowing decreased. This is indicated in **Chart 14**.

Chart 13: Increase in interbank lending (%)

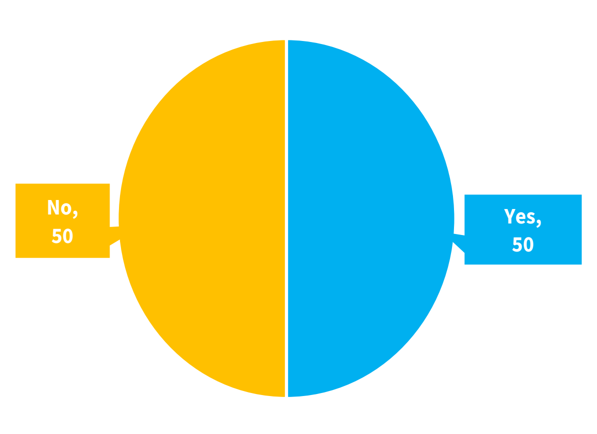
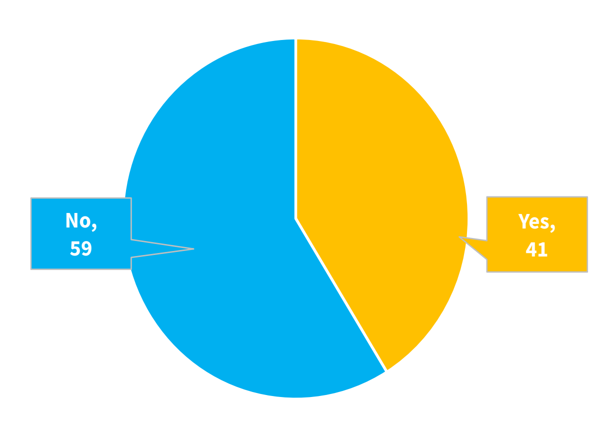


Chart 14: Increase in Interbank borrowing (%)



2.10 Impact of Coronavirus (COVID-19) Pandemic on the Banking Sector

- The economic impacts of COVID-19 were adverse and wide-ranging, disrupting international trade, transport, tourism, and urban services activity. CBK through the credit survey assessed the impact of the pandemic on the banking sector. In the quarter ended March 31, 2023, the survey covered areas relating to: -

i) Adverse impact of the pandemic on the banks.
ii) Measures banks are taking to curb the adverse impact of the pandemic on banks' business.
iii) The key risks that have been increased by the pandemic.
iv) Opportunities that have arisen from the pandemic.

2.10.1 Adverse Impact of Coronavirus (COVID-19) pandemic on the banks

- The commercial banks have indicated that the pandemic has had an adverse impact on their business including. This includes delay in loan repayments in some key sectors even after moratoriums issued expired as many sectors in the economy are yet to fully recover from COVID-19 effects.

2.10.2 Measures taken by banks to curb the potential impact of coronavirus pandemic

- Commercial banks have digitized transactions to enable clients access bank products through digital channels hence reducing face to face contacts.

2.10.3 Key Risks arising from Coronavirus (COVID-19) pandemic on the banks

Some of the key risks increased by the pandemic include:

- **Credit risk**: Delayed repayments on loans due to the adverse effect of the pandemic on the economy hence affecting customers' ability to meet their financial obligations. There is also uncertainty on customer incomes and employment coupled with reducing collateral values.
- **Operational risk**: Use of online channels that are complex to customers thus reducing the effectiveness of the service offered.
- **Cyber security risk**: Due to increase in use of digital platforms to transact.

2.10.4 Opportunities arising from Coronavirus (COVID-19) pandemic on the banks

Some of the opportunities arising from the pandemic include:

- Some of the banks' clients who are medical suppliers have had an increase in demand for their pharmaceutical products hence banks are able to give them additional loan facilities.
- Business Continuity process review.
- Automation of processes through digitization.
- Redefining of new products that would cushion the customers during the recovery period.
- Introduction of work from alternate site.

LIST OF RESPONDENTS

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

Central Bank of Kenya

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