CENTRAL BANK OF KENYA

CREDIT OFFICER SURVEY

QUARTER ENDED JUNE 2012

Table of Contents

Contents Page

List of Charts

List of Tables

1.0 FOREWORD

1.1 KENYAN BANKING SECTOR PERFORMANCE

For the quarter ended 30th June 2012, the Kenyan Banking Sector demonstrated continued growth. Some of the sector's performance indicators were as follows:

- The aggregate balance sheet increased by 4.8 percent from Kshs 2.1 trillion in March 2012 to Kshs 2.2 trillion in June 2012.
- Gross loans and advances expanded by 4.0 percent from Kshs 1.24 trillion in March 2012 to Ksh 1.29 trillion in June 2012.
- Deposits grew by 6.4 percent from KShs 1.56 trillion in March 2012 to Kshs 1.66 trillion in June 2012.
- Total capital increased by 4.8 percent from Kshs 280.9 billion in March 2012 to Kshs 294.3 billion in June 2012.
- Gross non-performing loans increased by 7.1 percent from Kshs 53.7 billion in March 2012 to Kshs 57.5 billion in June 2012.
- Unaudited pre-tax profits stood at Kshs 28.5 billion for the quarter ending 30th June 2012 compared to Kshs 24.7 billion for the quarter ending 31st March 2012, a 15.4% increase.

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 activity for most banks. The total percentage of loans to total assets for the period ended 30th June 2012 was 58.7%. In order to identify potential risks and enhance an understanding of credit risk, the Central Bank of Kenya introduced a quarterly Credit Officer Survey effective March 2012. In this regard, CBK undertook the initial banking sector credit officer survey for the quarter ended March 2012. The second credit officer survey for the quarter ended 30th June 2012 was conducted in July 2012 targeting senior credit officers of all 42 operational banks and 1 mortgage finance company. Charterhouse Bank Ltd which is currently under statutory management was excluded from the survey.

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

Comparison of findings obtained in the quarter ended March 2012 and the quarter ended June 2012 reveals that:-

- Demand for credit in the quarter ended June 2012 increased in manufacturing and personal and household sectors but reduced for building and construction and real estate sectors.
- Credit standards were tightened for the building and real estate sectors in June 2012.
- Supply of international trade finance remained unchanged for all the sectors.
- Banks expect NPLs to personal and household and trade sectors to rise and to remain unchanged for all the other sectors.
- The June 2012 credit survey shows that banks have intensified their credit recovery efforts in building and construction, trade, transport and communication and real estate sectors.

CENTRAL BANK OF KENYA
AUGUST 2012

2.0 EXECUTIVE SUMMARY

2.1 Survey methodology

The credit officer survey for the quarter ended June 2012 comprised five questions that focused on the following aspects:-

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

The survey has been complemented with questions dealing with demand for credit and credit standards by including factors which can have an impact on these two variables.

The survey conducted in July 2012 targeted senior credit officers of all 42 operational 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. 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

Demand for credit in the agriculture, mining and quarrying, tourism as well as energy and water sectors remained largely unchanged in the second quarter of 2012. Demand for credit increased in the personal/households and manufacturing sectors. Demand for credit decreased in real estate and building and construction sectors.
The survey indicated that Cost of borrowing was the greatest factor that led to a decrease of demand for credit.

2.2.2 Credit Standards

Credit standards were tightened for the building and real estate sectors in June 2012. Some banks expect the new land laws to adversely affect the performance of loans under building and construction as well as the real estate sectors. This is due to the envisaged lengthy and more complex credit appraisal procedures.

Competition from deposit taking microfinance institutions, SACCOs and other non bank credit providers was cited as not having a significant impact on banks credit standards. Bank's cost of funds and balance sheet constraints were reported to have led to tightening of credit standards.

2.2.3 International Trade Finance

Generally the banks willingness to supply international trade finance to various sectors remained unchanged in the quarter.

2.2.4 Non-Performing Loans

The forecast for NPLs for July to September 2012 indicate that 39 percent of the respondents expect the NPLs in the personal and household sector to increase as compared to 64 percent who expected NPLs in the same sector to increase as reported in March 2012 survey. This could be informed by the lowering of Central Bank Rate (CBR) from 18 percent to 16.5 percent which is likely to translate to lower lending rates hence lower default.

2.2.5 Credit Recovery Efforts

The June 2012 credit survey shows that banks have intensified their credit recovery efforts in building and construction, trade, transport and communication and real estate sectors.

3.0 DETAILED SURVEY FINDINGS

It has been observed from April to June 2012 that demand for credit in the agriculture, mining and quarrying, tourism as well as energy and water sectors remained largely unchanged. Demand for credit increased in the personal/households and manufacturing sectors. Demand for credit decreased in real estate and building and construction sectors as indicated in Chart 1 below. It was observed in the survey for quarter ending June 2012, that 40 percent of respondents expect demand for credit to manufacturing to rise as compared to 25 percent of respondents in the survey for quarter ending March 2012 who expected demand for credit to the manufacturing sector to rise. 42 percent of the respondents in the June 2012 survey expect demand for credit to personal and household sector to rise as compared to 29 percent of the respondents in the March 2012 survey who expect demand for credit to sector to increase.

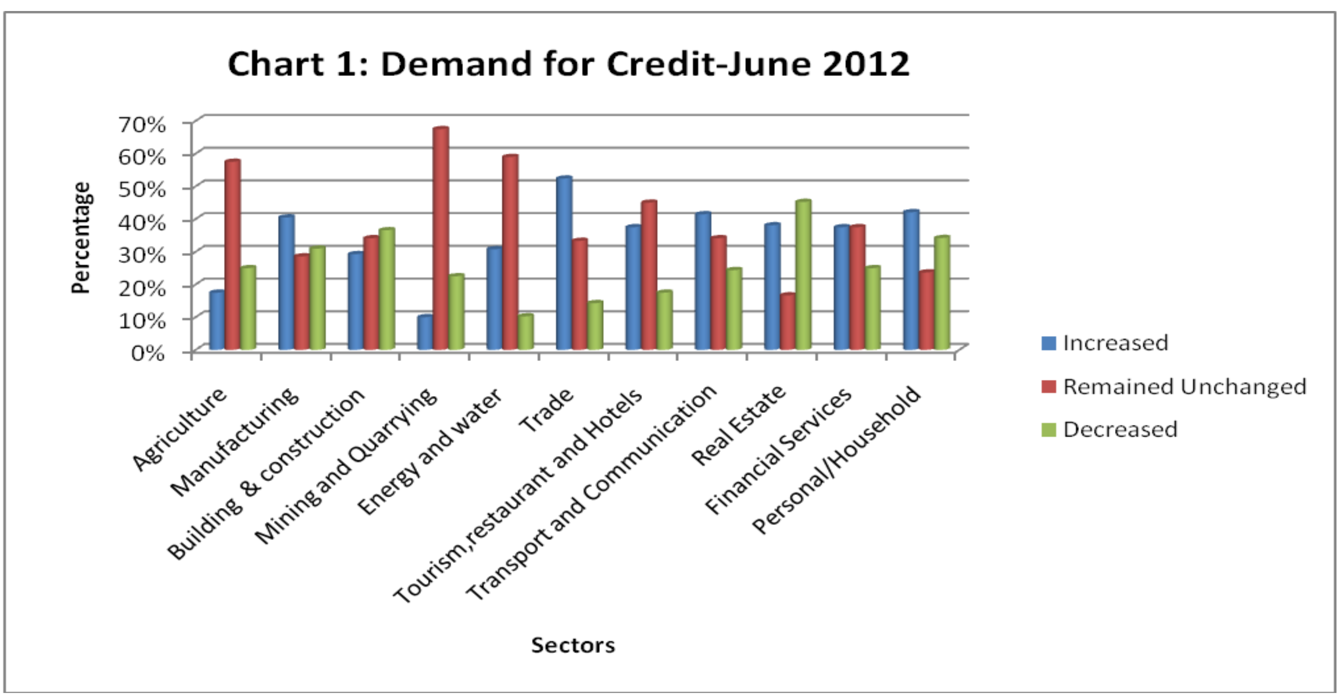

Table 1: Demand for Credit						
	June 2012			March 2012		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	18%	58%	25%	21%	55%	24%
Manufacturing	40%	29%	31%	25%	43%	33%
Building & construction	29%	34%	37%	38%	25%	38%
Mining and Quarrying	10%	68%	23%	15%	67%	18%
Energy and water	31%	59%	10%	21%	55%	24%
Trade	52%	33%	14%	63%	22%	15%
Tourism, restaurant and Hotels	38%	45%	18%	17%	56%	27%
Transport and Communication	41%	34%	24%	30%	43%	28%
Real Estate	38%	17%	45%	26%	31%	43%
Financial Services	38%	38%	25%	25%	53%	23%
Personal/Household	42%	24%	34%	29%	22%	49%

Credit applications for building and construction sector dropped from 800 in **March 2012** to 428 in **June 2012**, while credit applications for real estate sector dropped from 611 in **March 2012** to 402 in **June 2012**.

3.1 Factors affecting demand for Credit

3.1.1 Observations

Cost of borrowing had the most significant impact in reducing demand for credit, followed by internal financing and loans from non banks as shown in **Chart 2** and **Table 2** below. 89 percent of the respondents reported that the high cost of borrowing reduced demand for credit. Similarly, 46% and 45% of the respondents indicated that internal financing and loans from non-banks contributed to reduced demand for credit. Internal financing points to the preference for potential borrowers to finance expansion and operations from retained earnings as opposed to credit.

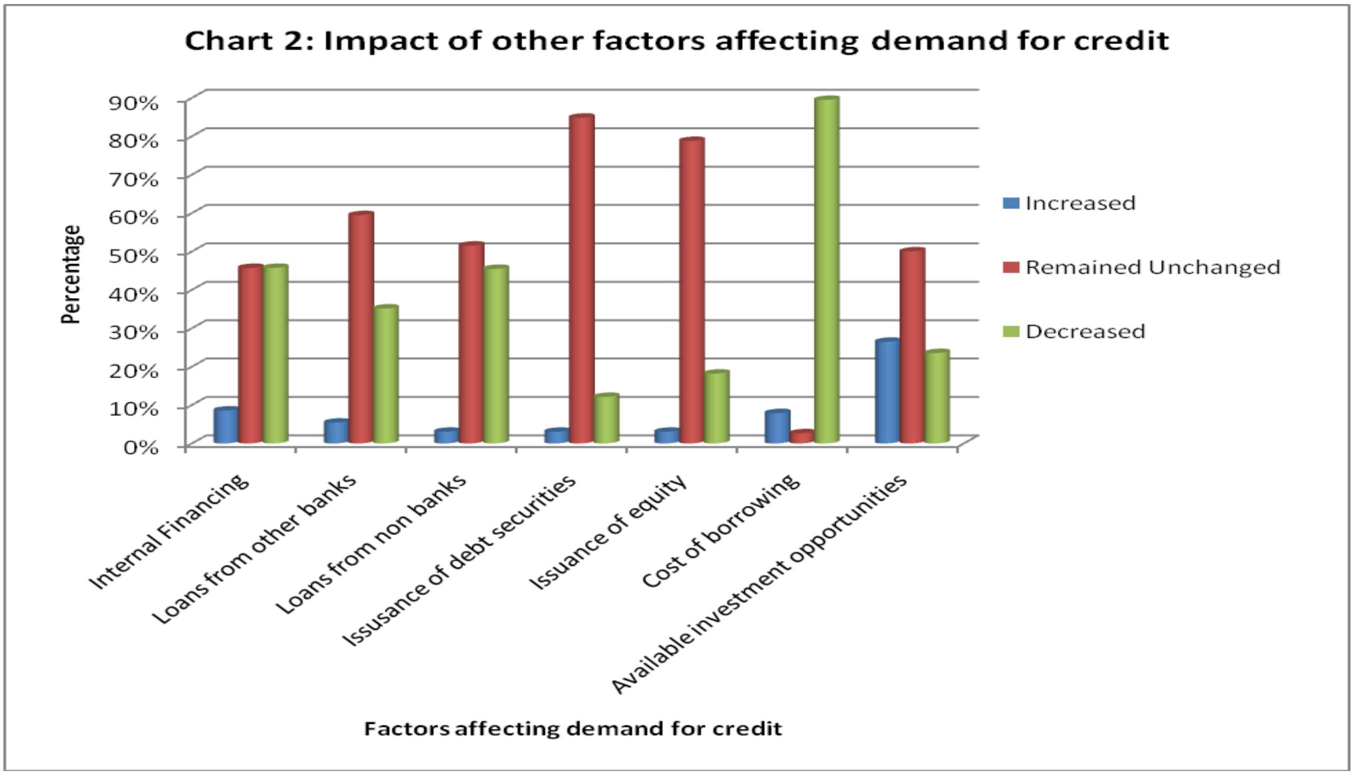

Table 2: Factors affecting Demand for credit

	Increased	Remained Unchanged	Decreased
Internal Financing	9%	46%	46%
Loans from other banks	5%	59%	35%
Loans from non banks	3%	52%	45%
Issuance of debt securities	3%	85%	12%
Issuance of equity	3%	79%	18%
Cost of borrowing	8%	3%	89%
Available investment opportunities	26%	50%	24%

3.2 Credit Standards

3.2.1 Observations

In the quarter ended June 2012, there was generally no major change in credit standards to most of the sectors. However, credit standards for the building and construction, and real estate sectors were tightened in the quarter just as had been done in the quarter ended March 2012. Nonetheless, the tightening in these two sectors appears to be easing with 39% of the respondents reporting increased tightening unlike in March 2012 when 66 percent and 73 percent of the respondents who reported tightened credit standards to the building and construction, and real estate sectors respectively. **Chart 3** and **Table 3** below details the responses on credit standards in the quarter ended June 2012.

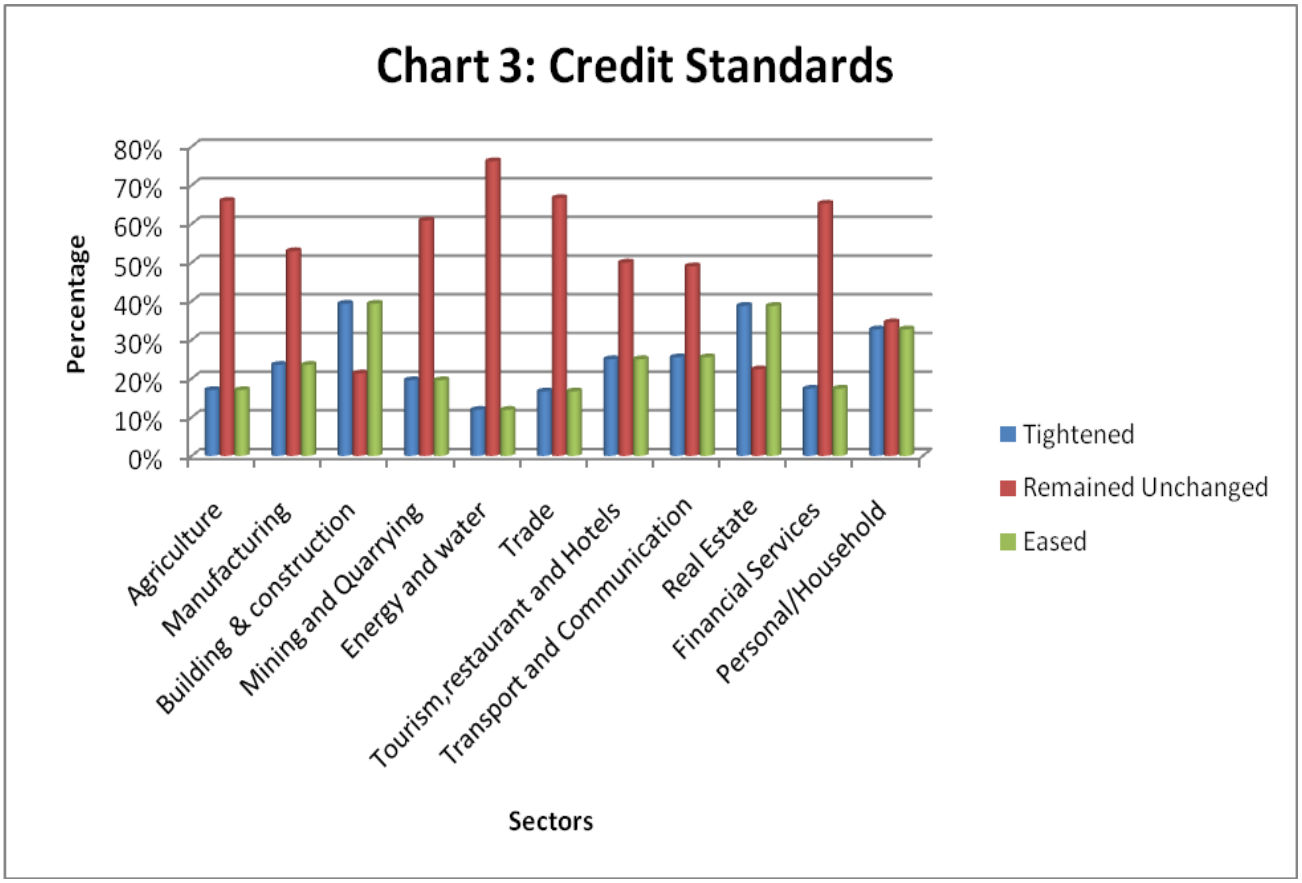

Table 3: Credit Standards

	June 2012			March 2012		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	17%	66%	17%	37%	63%	0%
Manufacturing	24%	53%	24%	43%	55%	3%
Building & construction	39%	21%	39%	66%	27%	7%
Mining and Quarrying	20%	61%	20%	36%	59%	5%
Energy and water	12%	76%	12%	24%	71%	5%
Trade	17%	67%	17%	40%	50%	10%
Tourism, restaurant and Hotels	25%	50%	25%	31%	62%	8%
Transport and Communication	25%	49%	25%	44%	46%	10%
Real Estate	39%	22%	39%	73%	20%	7%
Financial Services	17%	65%	17%	35%	58%	8%
Personal/Household	33%	35%	33%	57%	40%	2%

3.3 Factors affecting credit standards

3.3.1 Observations

71 percent of the respondents reported that banks' cost of funds and balance sheet constraints are the main factors which contributed to the tightening of credit standards. 54 percent of the

respondents cited expectations regarding the general economic activity to have led to tightening of credit standards. The other factors like bank's capital position, competition from other banks, banks liquidity constraints and competition from DTMs, Saccos and other credit providers were cited not to have had much impact on credit standards. **Chart 4** and **Table 4** below indicates the impact of various factors on credit standards.

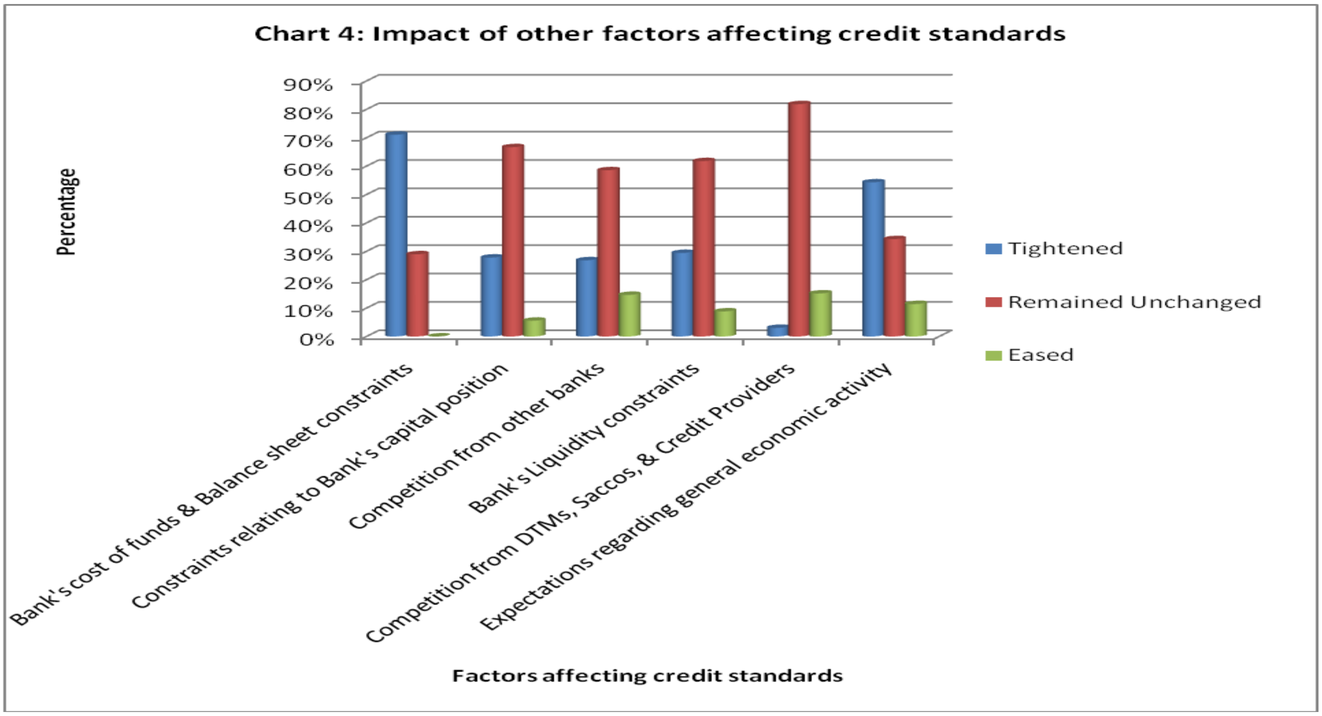

Table 4: Factors affecting credit standards (June 2012)

	Tightened	Remained Unchanged	Eased
Bank's cost of funds & Balance sheet constraints	71%	29%	0%
Constraints relating to Bank's capital position	28%	67%	6%
Competition from other banks	27%	59%	15%
Bank's Liquidity constraints	29%	62%	9%
Competition from DTMs, Saccos, & other Credit Providers	3%	82%	15%
Expectations regarding general economic activity	54%	34%	11%

The banks cost of funds rose from an average of 2.6% in 2011 to 6.2% as at end of June 2012. This supports the finding that banks' cost of funds is the main factor that contributed to the tightening of credit standards by banks.

3.4 International Trade Finance

It has been observed that from April to June 2012, the supply of International Trade Finance remained unchanged in all the sectors as was observed for the quarter ended March 2012 as indicated in **Chart 5** and **Table 5** below. 63 percent of the respondents reported that supply for international finance in the quarter ended June 2012 remained constant as compared to 60 percent reported in the quarter ended March 2012. 56 percent of respondents reported that supply to international finance remained constant in June 2012 compared to 55 percent which was reported in the March 2012 survey.

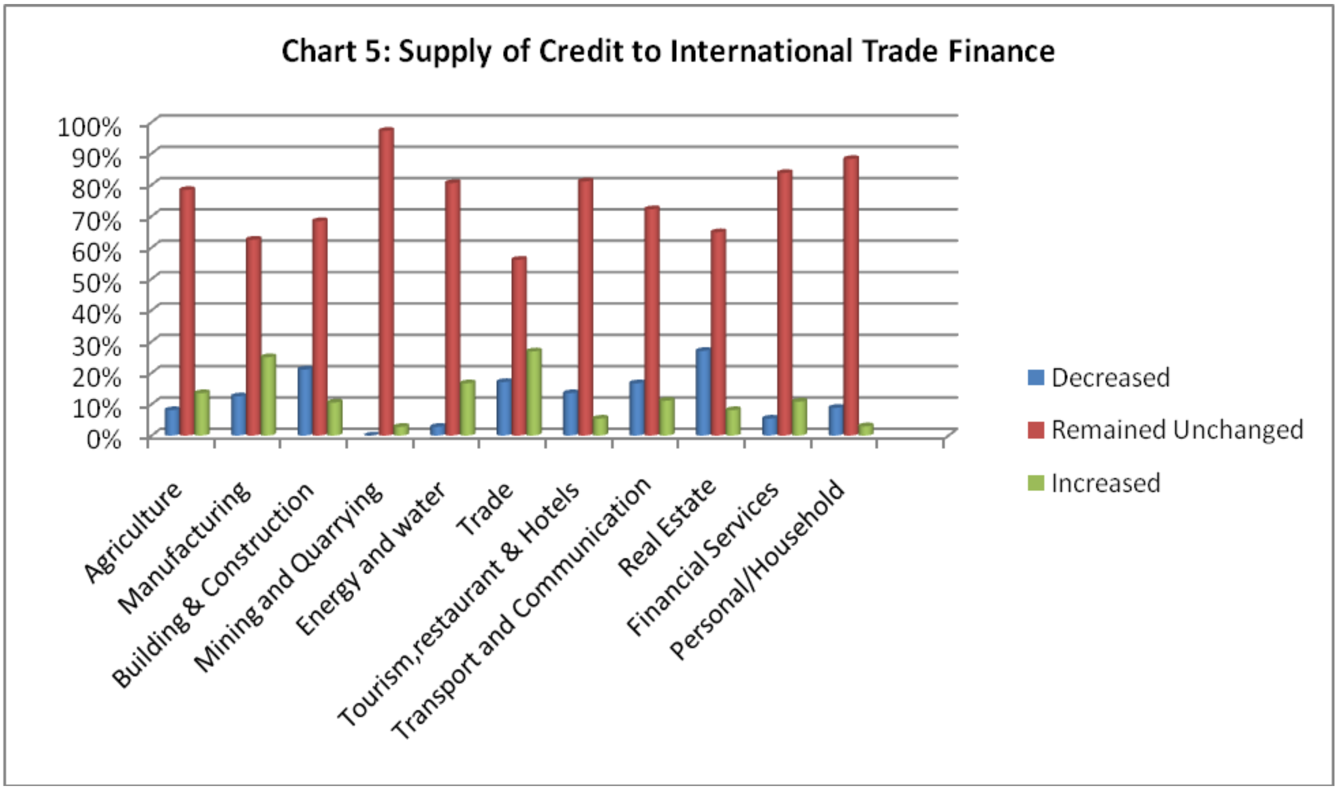

Table 5: Supply of International Trade Finance

	June 2012			March 2012		
	Fall	Remained Constant	Increased	Fall	Remained Constant	Increased
Agriculture	8%	78%	14%	10%	74%	15%
Manufacturing	13%	63%	25%	13%	60%	28%
Building & construction	21%	68%	11%	10%	79%	10%
Mining and Quarrying	0%	97%	3%	8%	89%	3%
Energy and water	3%	81%	17%	3%	78%	19%
Trade	17%	56%	27%	10%	55%	35%
Tourism, Restaurant & Hotels	14%	81%	5%	11%	74%	16%
Transport & Communication	17%	72%	11%	13%	76%	11%
Real Estate	27%	65%	8%	19%	72%	8%
Financial Services	5%	84%	11%	5%	84%	11%
Personal/Household	9%	88%	3%	19%	70%	11%

3.5 Non-Performing Loans

The forecast for NPLs for the quarter ended September 2012 indicate that 39 percent of the respondents expect the NPLs to personal and household sectors to increase. However, this is a drop from 64 percent of the respondents in the March 2012 survey who expected NPLs in personal and household sector to increase. This was also observed in the real estate sector where 35 percent of respondents expect the NPLs to rise in June 2012 survey as compared to 66 percent who expected NPLs to increase in March 2012. The lower NPL forecast could be informed by the lowering of CBR from 18 percent to 16.5 percent which is likely to translate to lower lending rates and hence lower default rates. The March 2012 survey forecast an increase in NPLs in trade, real estate, personal and building and construction sectors. The June 2012 data on actual NPLs supported this forecast except for building and construction sector which recorded a decrease in NPLs. The forecast of NPLs increase in building and construction sector was based on assumption that new land laws would negatively impact the loans in the building sector. **Chart 6** and **Table 6** below indicates the banks expectations on NPL trend.

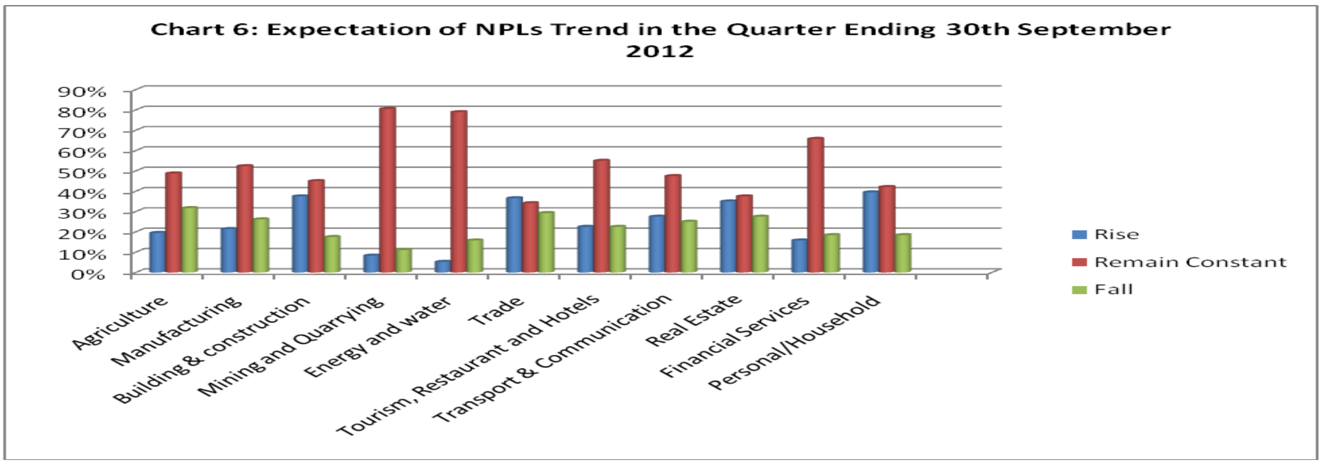

Table 6: Non Performing Loans

	June 2012			March 2012		
	Rise	Remained Constant	Fall	Rise	Remained Constant	Fall
Agriculture	20%	49%	32%	26%	55%	18%
Manufacturing	21%	52%	26%	36%	54%	10%
Building & construction	38%	45%	18%	58%	26%	16%
Mining and Quarrying	8%	81%	11%	19%	70%	11%
Energy and water	5%	79%	16%	14%	78%	8%
Trade	37%	34%	29%	51%	31%	18%
Tourism, Restaurant & Hotels	23%	55%	23%	31%	53%	17%
Transport & Communication	28%	48%	25%	41%	46%	13%
Real Estate	35%	38%	28%	66%	22%	12%
Financial Services	16%	66%	18%	21%	68%	11%
Personal/Household	39%	42%	18%	64%	24%	12%

3.6 Credit Recovery Efforts

A majority of respondents in the survey for quarter ended June 2012 reported that Credit recovery efforts will generally be intensified in most of the sectors in the quarter ended September 2012. This differs from the survey for the quarter ended March 2012 when banks expected to intensify recovery efforts in the real estate and personal and household sectors only. For the quarter ended September 2012, recovery efforts on loans to only mining and quarrying, energy and water, and financial service sectors are expected to remain constant. The detailed responses on the expected credit recovery efforts in the quarter ended September 2012 are indicated in **Chart 7** and **Table 7** below.

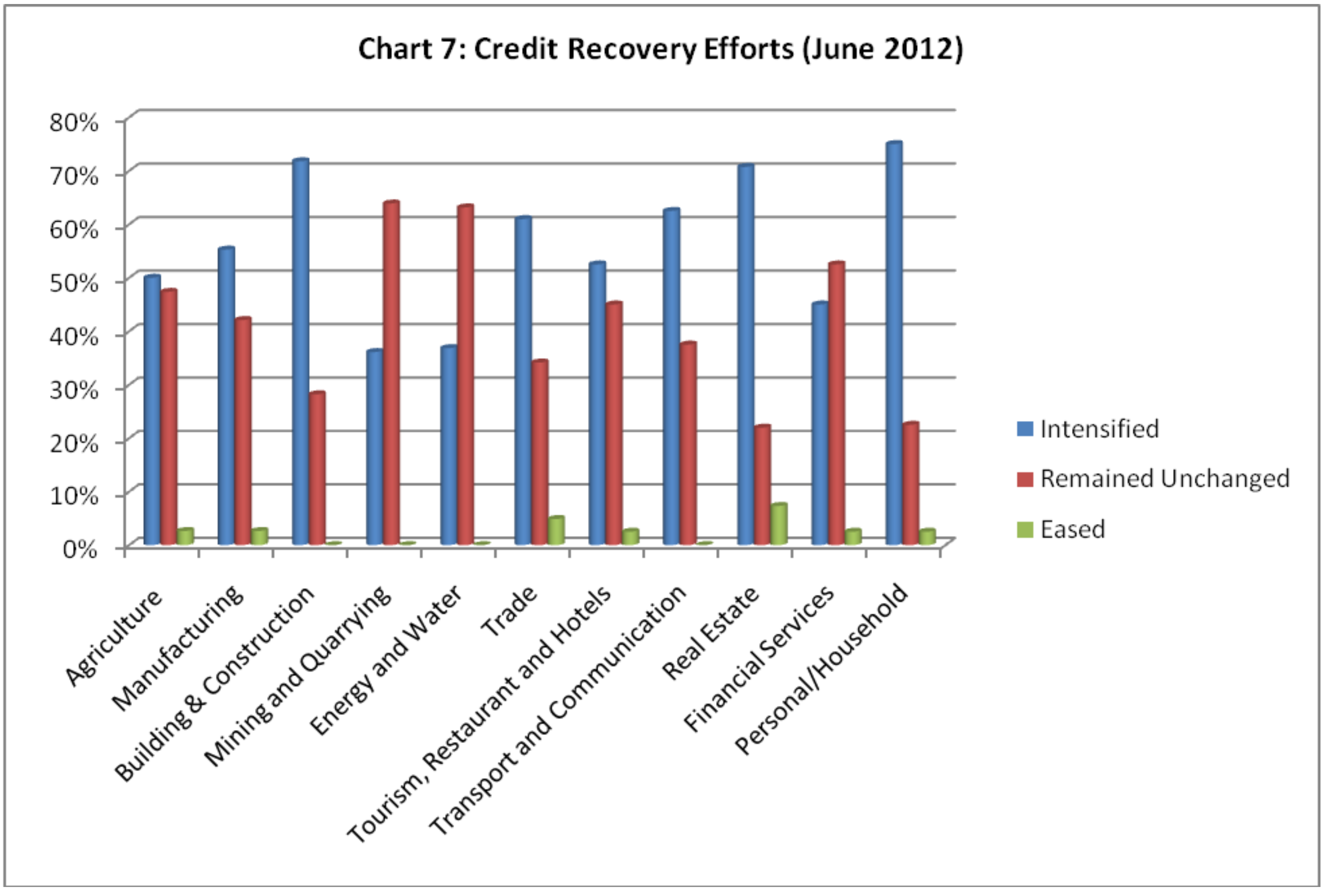

Table 7: Credit Recovery Efforts

	June 2012			March 2012		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	50%	47%	3%	20%	48%	33%
Manufacturing	55%	42%	3%	22%	51%	27%
Building & construction	72%	28%	0%	38%	44%	18%
Mining and Quarrying	36%	64%	0%	9%	80%	11%
Energy and water	37%	63%	0%	5%	78%	16%
Trade	61%	34%	5%	35%	35%	30%
Tourism, Restaurant & Hotels	53%	45%	3%	23%	54%	23%
Transport &	63%	38%	0%	26%	49%	26%

	June 2012			March 2012		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Communication						
Real Estate	71%	22%	7%	38%	35%	28%
Financial Services	45%	53%	3%	16%	66%	18%
Personal/Household	75%	23%	3%	43%	40%	18%

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.