Central Bank of Kenya

CREDIT SURVEY

APRIL - JUNE 2017

CENTRAL BANK OF KENYA (CBK) COMMERCIAL BANKS' CREDIT SURVEY APRIL - JUNE 2017

1. BACKGROUND

1.1 COMMERCIAL BANKS' 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 June 30, 2017 was 58.97 percent; a decline of 2.12 percent from 61.09 percent reported in March 2017.

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 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

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

For the quarter ended June 2017 Commercial Banks Credit Officer Survey, all 41 operational commercial banks and 1 mortgage finance company participated in the survey.

The survey sought to establish the lending behavior in the banking sector and targeted all the eleven economic sectors. Questions were posed on demand for 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 June 2017 survey included questions regarding the effect of capping of interest rates that came into effect on September 14, 2016.

1.3 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan Banking Sector recorded growth in the quarter ended June 30, 2017, compared to the quarter ended March 31, 2017. Some of the sector's performance indicators are as follows:

- The aggregate balance sheet increased by 2.86 percent from KShs 3.84 trillion in March 2017 to KShs 3.95 trillion in June 2017. There was an increase in investment in Government securities during the period.
- Gross loans decreased by 0.84 percent from KShs 2.38 trillion in March 2017 to KShs 2.36 trillion in June 2017. This decrease in gross loans was mainly attributable to a reduction in loans granted to support the Transport and Communication, Trade, Agricultural, Real Estate and Mining and Quarrying sectors.
- Total deposits increased by 4.01 percent from KShs 2.74 trillion in March 2017 to KShs 2.85 trillion in June 2017. The increase in deposits was attributed to deposits made by oil supply companies, telecommunication companies and government agencies.
- The ratio of gross non-performing loans to gross loans increased from 9.5 percent in March 2017 to 9.91 percent in June 2017. The increase in the gross non-performing loans was mainly attributable to a challenging business environment.
- The ratio of core capital to total risk-weighted assets increased slightly from 16.6 percent in March 2017 to 16.8 percent as at June 2017. The total capital to total risk weighted assets increased marginally from 19.4 percent in March 2017 to 19.6 percent in June 2017. The capital adequacy ratios remained above the statutory minimum of 10.5 percent and 14.5 percent respectively.
- Return on Assets decreased to 2.8 percent in June 2017 from 2.9 percent in March 2017. This followed a higher growth in assets as compared to the growth in profitability.
- Return on Equity increased to 22.3 percent in June 2017 from 22.2 percent in March 2016. There was a higher growth in shareholders' funds as compared to the growth in profitability.

- The Average Liquidity Ratio increased to 44.7 percent in June 2017 from 43.8 percent in March 2017. There was a higher growth in total liquid assets compared to the growth in total short-term liabilities. Total liquid assets grew by 5.7 percent while total short-term liabilities grew by 3.76 percent.

1.4 SUMMARY OF FINDINGS

- **Demand for credit:** In the second quarter of 2017, the perceived demand for credit remained unchanged in nine sectors while it increased in two sectors (Trade and Personal/Household economic sectors). The respondents attributed this increase in demand for credit in the two sectors to reduced cost of borrowing as a result of interest capping.

- **Credit Standards,** which are guidelines that banks use in determining whether to extend a loan to an applicant, remained unchanged in all the eleven economic sectors in the second quarter of 2017.

  However, in comparison to the first quarter of 2017, an additional 14 percent and 4 percent of the respondents tightened their credit standards in the Transport and Communication and Agriculture sectors respectively. This was attributted to a challenging business environment and the prolonged drought being experienced in the country.

- **Level of Interest Rates:** In the second quarter of 2017, 98 percent of the respondents indicated that their banks held their interest rates constant; whereas 2 percent of the respondents indicated that their banks decreased their interest rates. This downward trend on interest rates could be an indication that the commercial banks are complying with the Banking (Amendment) Act, 2016. The Act limits interest chargeable on loans at not more than 4 percent above the prevailing Central Bank Rate (CBR).

- **Non-Performing Loans:** Generally, the commercial banks expect an increase in the levels of NPLs in the third quarter of 2017 with 42 percent of the respondents indicating so. This expected rise in NPLs is attributed to the industry's perception of increased political risk in light of the upcoming general elections.

- **Credit Recovery Efforts:** The banks expect to tighten their credit recovery efforts in eight out of the eleven sectors. Banks intend to intensify credit recovery efforts in the following sectors:-

  i). Tourism and Agriculture sectors: due to heightened political risk during the election period and the seasonal fluctuations of cash flows respectively.
  ii). Building and Construction sector to enhance collections from contractor payments by the Government of Kenya, in the third quarter of 2017.
  iii). The intensified recovery efforts in five sectors (Manufacturing, Trade, Real Estate, Transport and Communication, Personal/Household and Financial Services sectors) aim at improving the overall quality of the asset portfolio. This is in line with the banks expectations that loan defaults in these sectors will rise during the third quarter of 2017 due to slowdown in economic activity.

2. SURVEY FINDINGS

2.1 Demand for Credit

- In the second quarter of 2017, demand for credit remained unchanged in nine economic sectors. The top three sectors indicating the unchanged demand for credit are Mining and Quarrying, Tourism, Energy and Water and Financial Services.
- However, demand for credit increased in Trade and Personal/Household economic sectors. The respondents indicated that interest rate capping has led to reduced cost of borrowing; this has resulted to increased demand for credit in Trade and Personal/Household sectors.

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

Chart 1: Change in Demand for Credit

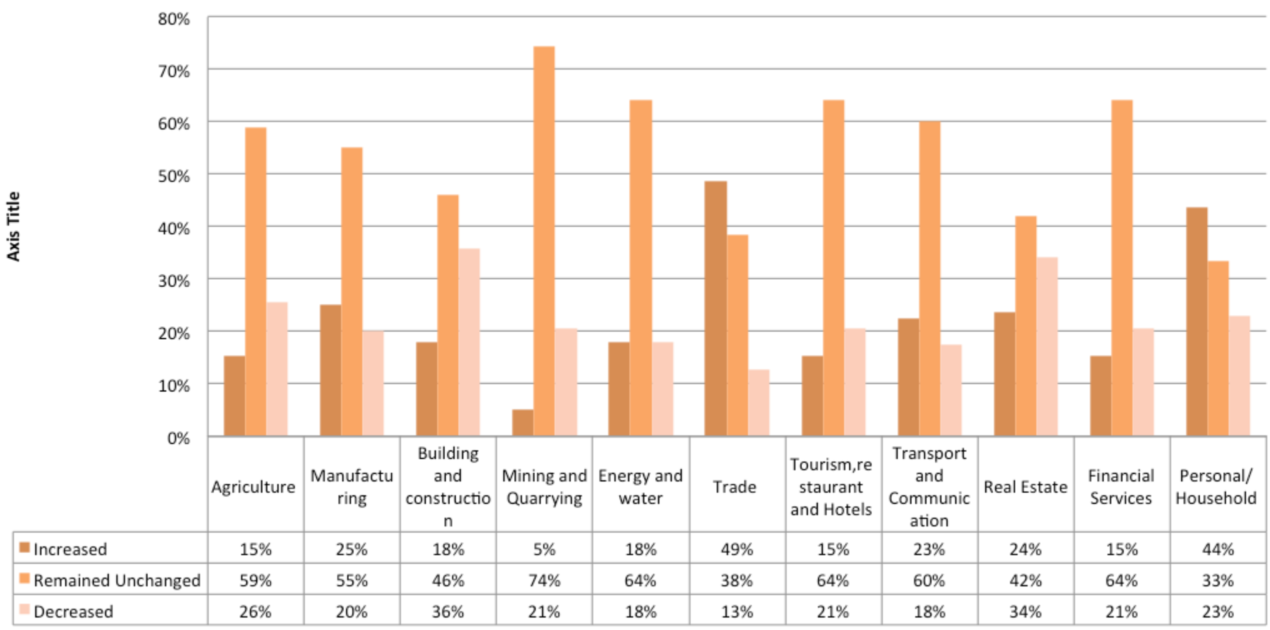


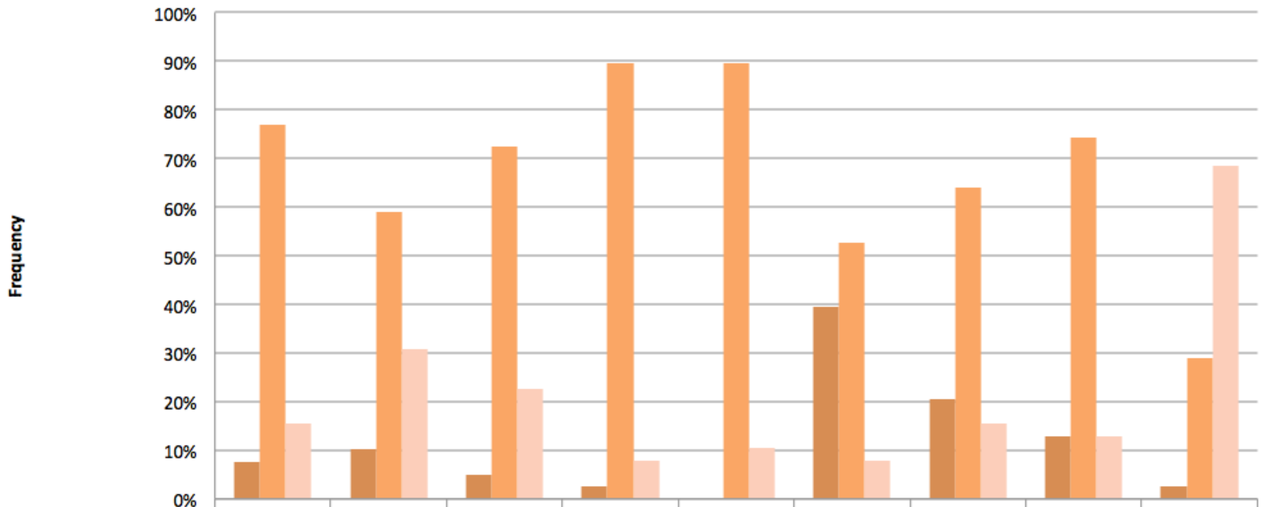
Table 1: Change in Demand for Credit

	June 2017			March 2017		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	15%	59%	26%	38%	50%	12%
Manufacturing	25%	55%	20%	31%	57%	11%
Building and construction	18%	46%	36%	23%	46%	31%
Mining and Quarrying	5%	74%	21%	9%	77%	14%
Energy and water	18%	64%	18%	31%	60%	9%
Trade	49%	38%	13%	49%	34%	17%
Tourism, Restaurant and Hotels	15%	64%	21%	14%	71%	14%
Transport and Communication	23%	60%	18%	20%	54%	26%
Real Estate	24%	42%	34%	21%	53%	26%
Financial Services	15%	64%	21%	17%	71%	11%
Personal/Household	44%	33%	23%	45%	42%	12%

2.2 Factors Affecting Demand for Credit

- In the quarter ending June 2017, nine factors affecting demand for credit had no impact on demand for credit as indicated in Chart 2 below.
- Issuance of equity, issuance of debt securities, internal financing, retention of CBR, loans from non-banks, available investment opportunities, loans from other banks and cost of borrowing were cited as having had the least influence on the demand for credit during the quarter under review. This was reported by 89%, 89%, 77%, 74%, 73%, 64%, 59% and 53% of the respondents respectively.
- However, political risk (68%) had the highest effect on decreasing demand for credit.
- Chart 2 and Table 2 below present the trend in the factors affecting demand for credit in the quarter under review.

Chart 2: Factors Affecting Demand for Credit



	Internal Financing	Loans from other banks	Loans from non banks	Issusance of debt securities	Issuance of equity	Cost of borrowing	Available investment opportunitie s	Retention of CBR	Political Risk
Increased	8%	10%	5%	3%	0%	39%	21%	13%	3%
Remained Unchanged	77%	59%	73%	89%	89%	53%	64%	74%	29%
Decreased	15%	31%	23%	8%	11%	8%	15%	13%	68%

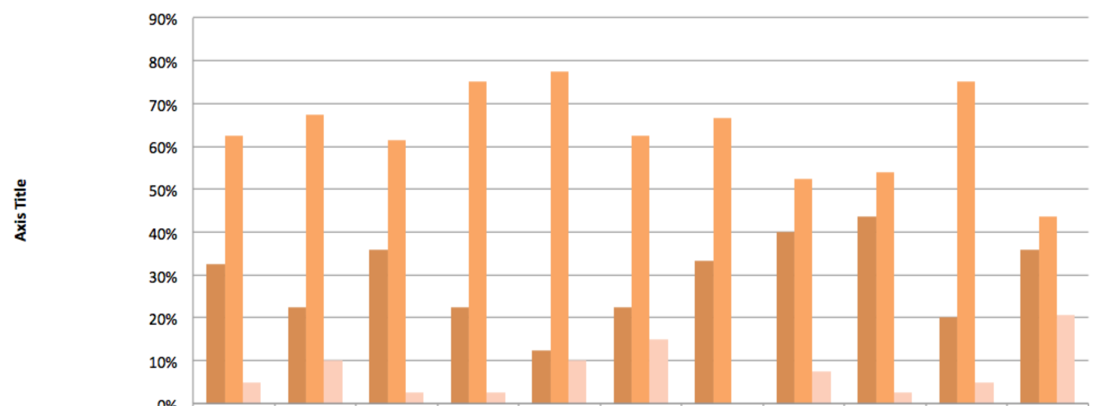
Table 2: Factors Affecting Demand for Credit

	June 2017			March 2017		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	8%	77%	15%	6%	82%	12%
Loans from other banks	10%	59%	31%	6%	71%	23%
Loans from non-banks	5%	73%	23%	6%	76%	18%
Issuance of debt securities	3%	89%	8%	0%	88%	12%
Issuance of equity	0%	89%	11%	3%	85%	12%
Cost of borrowing	39%	53%	8%	41%	56%	3%
Available investment opportunities	21%	64%	15%	20%	71%	9%
Retention of CBR	13%	74%	13%	26%	71%	3%
Political Risk	3%	29%	68%	14%	46%	40%

2.3 Credit Standards

- Credit Standards in all the eleven economic sectors remained unchanged in the second quarter of 2017.
- However, in comparison to the first quarter of 2017, an additional 14 percent and 4 percent of the respondents tightened their credit standards in the Transport and Communication and Agriculture sectors respectively.
- Slowdown in economic activity and the prolonged drought being experienced in the country were cited as the main driving factors for tightening of credit standards in the aforementioned sectors respectively.
- These responses are presented in **Chart 3 and Table 3 below:**

Chart 3: Credit Standards



	Agriculture	Manufacturing	Building and construction	Mining and Quarrying	Energy and water	Trade	Tourism,restaurant and Hotels	Transport and Communication	Real Estate	Financial Services	Personal/ Household
Increased	33%	23%	36%	23%	13%	23%	33%	40%	44%	20%	36%
Remained Unchanged	63%	68%	62%	75%	78%	63%	67%	53%	54%	75%	44%
Decreased	5%	10%	3%	3%	10%	15%	0%	8%	3%	5%	21%

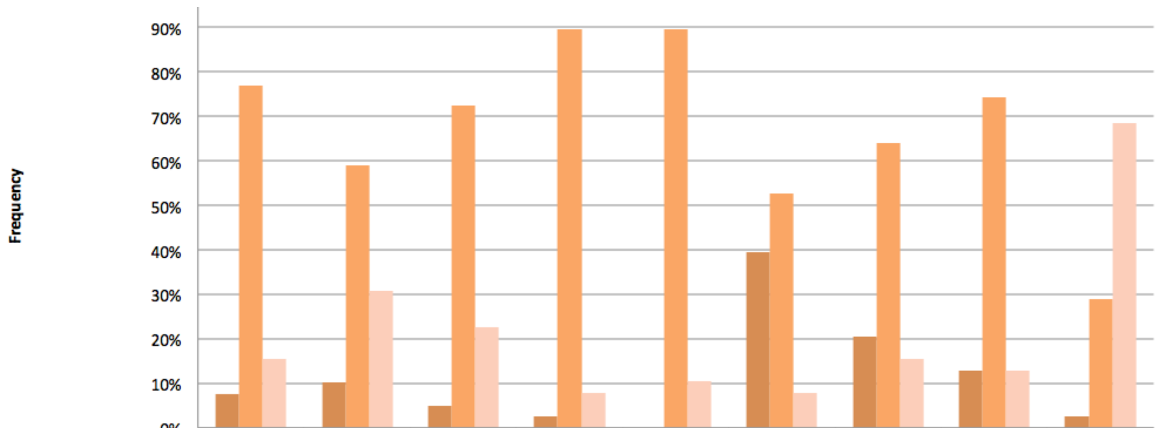
Table 3: Credit Standards for Loans to Various Economic Sectors

	June 2017			March 2017		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	33%	63%	5%	29%	71%	0%
Manufacturing	23%	68%	10%	26%	74%	0%
Building and construction	36%	62%	3%	51%	46%	3%
Mining and Quarrying	23%	75%	3%	23%	77%	0%
Energy and water	13%	78%	10%	17%	83%	0%
Trade	23%	63%	15%	29%	66%	6%
Tourism, Restaurant and Hotels	33%	67%	0%	37%	63%	0%
Transport and Communication	40%	53%	8%	26%	69%	6%
Real Estate	44%	54%	3%	57%	43%	0%
Financial Services	20%	75%	5%	26%	74%	0%
Personal/Household	36%	44%	21%	43%	49%	9%

2.4 Factors Affecting Credit Standards

- During the quarter ended June 2017, six factors (competition from other banks, competition from DTMs, investment in Government Securities, retention of CBR, constraints relating to banks' capital position and Banks' cost of funds) had little impact on credit standards.
- However, expections regarding the general economic activity and political risks due to the upcoming elections were cited as factors that led to tightening of credit standards with 55 percent of the resposondents indicating so. A comparison of the trend in the factors affecting the banks' credit standards are shown in **Chart 4 and Table 4 below**.

Chart 4: Impact of factors affecting credit standards



	Internal Financing	Loans from other banks	Loans from non banks	Issuance of debt securities	Issuance of equity	Cost of borrowing	Available investment opportunitie s	Retention of CBR	Political Risk
Increased	8%	10%	5%	3%	0%	39%	21%	13%	3%
Remained Unchanged	77%	59%	73%	89%	89%	53%	64%	74%	29%
Decreased	15%	31%	23%	8%	11%	8%	15%	13%	68%

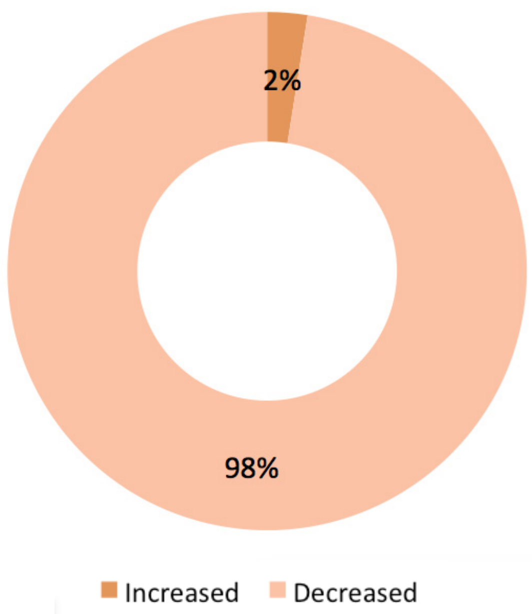
Table 4: Impact of factors affecting credit standards

	June 2017			March 2017		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds & Balance sheet constraints	35%	55%	10%	46%	49%	6%
Constraints relating to Bank's capital position	25%	63%	13%	23%	69%	9%
Competition from other banks	5%	88%	8%	11%	83%	6%
Competition from DTMs, Saccos, and other Credit Providers	5%	88%	8%	3%	94%	3%
Expectations regarding general economic activity	55%	38%	8%	57%	40%	3%
Retention of Central Bank Rate (CBR)	23%	78%	0%	23%	77%	0%
Political Risk	55%	40%	5%	51%	49%	0%
Retention of KBRR	13%	83%	5%	27%	73%	0%

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; as well as retention of the CBR rate to 10 percent.
- The interest rates movements in the quarter under review are depicted in **Chart 5 below.**
- 98 percent of the banks held their interest rates constant, 2 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. 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.

Chart 5 : Interest Rate Movements



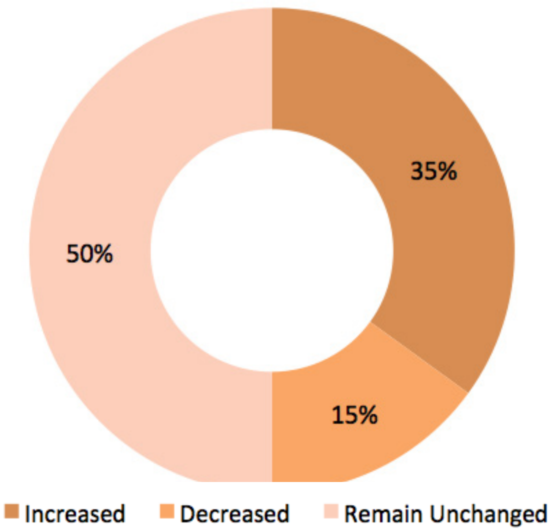
2.6 Capping of Interest Rates

- With the interest rate capping that came into effect on September 14, 2016, the credit survey sought to find out the impact it had on demand for credit, its effect on lending to SMEs, actual credit granted over the quarter to June 30, 2017 and the expectations of changes over the next three months.
- Further, the survey sought to find out how NPLs in the third 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 35 percent of the respondents who attributed this to cheaper credit.
- 50 percent of the respondents indicated that the demand for credit remained unchanged while 15 percent noted that demand for credit decreased as depicted in **chart 6.**
- This trend was the same in the previous quarter. However, this increased demand for credit had little impact on the actual credit advanced as indicated in **Chart 7.**

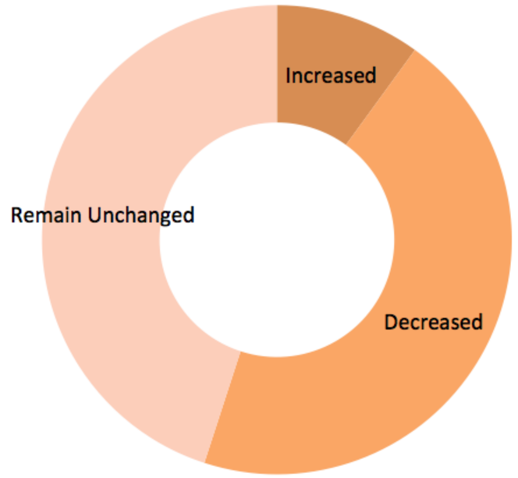
Chart 6 : Interest Rate Cap Effect on Demand for Credit



2.6.2 Effect of Interest Rate Capping on Actual Credit Granted

- 45 percent of the respondents indicated that interest rate capping had little effect on the actual credit granted.
- 10 percent of the respondents recorded that the actual credit granted increased while 45 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.

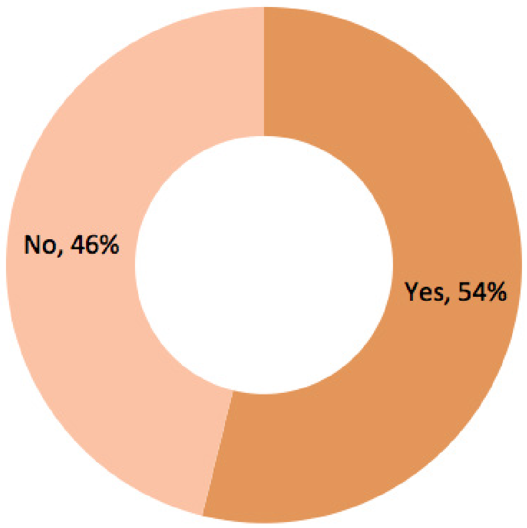
Chart 7 : Interest Rate Cap Effect on Actual Credit Granted



2.6.3 Effect of Interest Rate Capping on Lending to SMEs in Second Quarter of 2017

- 54 percent of the commercial banks indicated that interest rate capping negatively affected their lending to SMEs. Interest rate capping has compelled banks to increase their risk mitigation measures. As a result, this has locked out potential customers below certain risk thresholds on existing products standards. This is indicated in **chart 8** below.

Chart 8 : Effects of interest rate capping to lending to SMEs



2.6.4 Interest Rate Cap Effect on Demand for Credit in Third Quarter of 2017

- With regards to the expected demand for credit in the third quarter of 2017, most of the respondents anticipate that interest rate capping will have little impact on actual credit advanced as indicated by 70 percent of the respondents. This is due to the continuation of capping of interest rates and upholding of the tightened credit standards. However, 7 percent of the respondents felt that interest capping will lead to an increase in actual credit advanced.
- 23 percent of the respondents felt that the actual credit advanced will decrease attributing it to slowdown in economic activity. Expected movement on demand for drecit in the third quarter is shown in chart 9 below.

2.6.5 Effect of Interest Rate Capping on New Credit over the next three months

- In the third quarter of 2017, most of the respondents anticipate that the interest rate capping will have little impact on actual credit advanced as indicated by 75 percent of the respondents. This was attributed to the slowdown in economic activity and the heightened political risk.
- However, 2 percent of the respondents still felt that interest rate capping will lead to an increase in new credit advanced while 23 percent felt that the new credit advanced will decrease as indicated in **chart 10** below.

Chart 9- Interest rate cap effect on expected demand for credit in Q2 2017

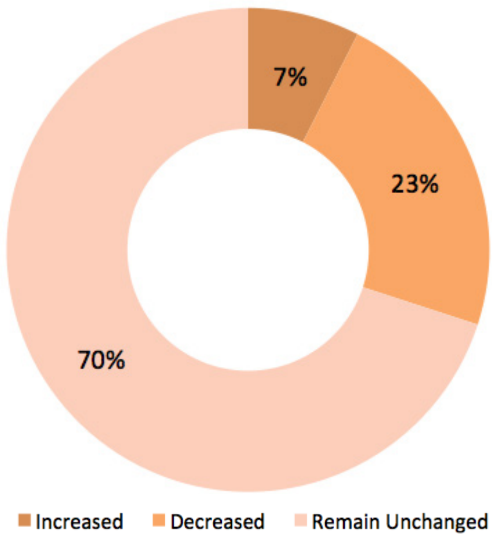
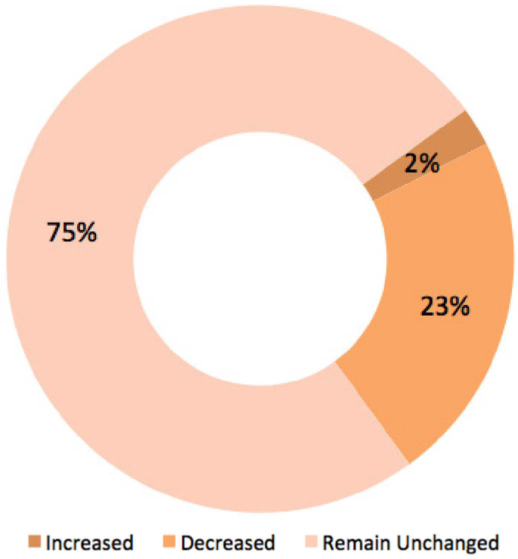


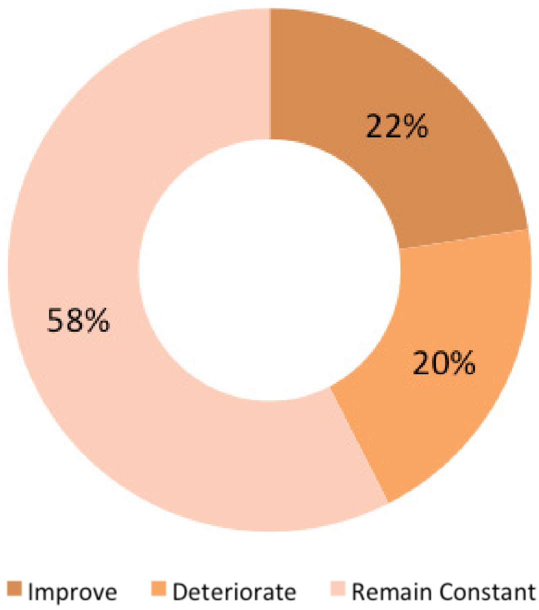
Chart 10 - Interest rate cap effect on actual new credit granted in Q2 2017



2.6.6 Effect of Interest Rate Capping on the Level of NPLs

- In the third quarter of 2017, 58 percent of the respondents were of the view that the NPLs would not change since the pricing of the loan has no impact on repayment ability. This is due to the monthly installment being agreed upfront.
- 22 percent of the respondents expect the capping of interest rates to have a positive impact on NPLs. This was attributed to the favorable interest rates which led to cheaper credit.
- 20 percent reported that NPLs would deteriorate as indicated in **chart 11.** This mixed reaction may be due to the wait and see approach on how the market will react to the capping of interest rates and slowdown in economic activity.

Chart 11 – Effect of interest rate capping on NPLs

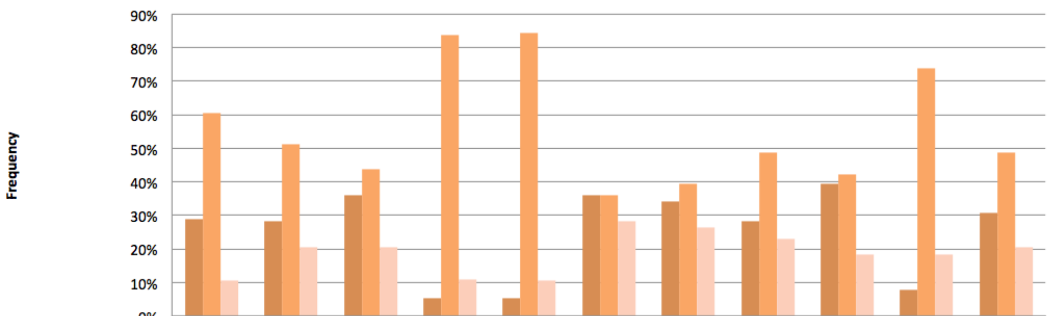


2.7 Non-Performing Loans (NPLs)

2.7.1 Non Performing Loans during the quarter ended June 30, 2017

- The levels of NPLs remained constant in second quarter of 2017 in ten economic sectors. The Mining and Quarrying, Energy and Water and Financial Services had the highest number of respondents who felt that the NPLs levels did not change. This was reported by 84%, 84% and 74% of the respondents respectively. This is depicted in **Chart 12** below.

Chart 12: Non-Performing Loans



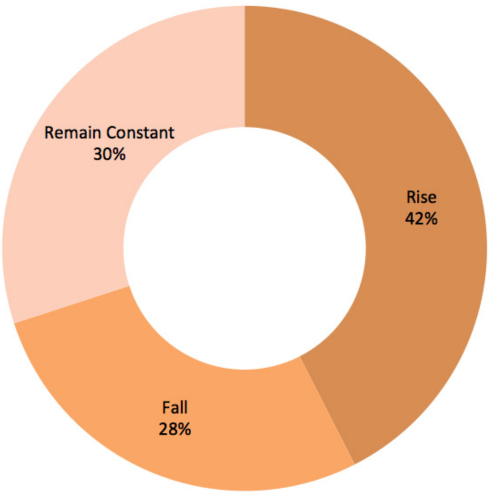
	Agriculture	Manufactu ring	Building and constructi on	Mining and Quarrying	Energy and water	Trade	Tourism,re staurant and Hotels	Transport and Communic ation	Real Estate	Financial Services	Personal/ Household
Rose	29%	28%	36%	5%	5%	36%	34%	28%	39%	8%	31%
Remained unchanged	61%	51%	44%	84%	84%	36%	39%	49%	42%	74%	49%
Fell	11%	21%	21%	11%	11%	28%	26%	23%	18%	18%	21%

Table 5: Non Performing Loans Expectation Trend Per Economic Sector						
	June 2017			March 2017		
	Rose	Remained Unchanged	Fell	Rose	Remained Unchanged	Fell
Agriculture	29%	61%	11%	22%	69%	9%
Manufacturing	28%	51%	21%	27%	55%	18%
Building and construction	36%	44%	21%	35%	41%	24%
Mining and Quarrying	5%	84%	11%	6%	85%	9%
Energy and water	5%	84%	11%	3%	83%	14%
Trade	36%	36%	28%	21%	53%	26%
Tourism, Restaurant and Hotels	34%	39%	26%	26%	56%	18%
Transport and Communication	28%	49%	23%	26%	53%	21%
Real Estate	39%	42%	18%	35%	44%	21%
Financial Services	8%	74%	18%	6%	74%	20%
Personal/Household	31%	49%	21%	35%	44%	21%

2.7.2 Expected Non Performing Loans Levels during the Next Quarter

- 42 percent of the respondents expect the level of NPLs to rise in the third quarter of 2017. This is because of the industry's perception of increased political risk in light of the upcoming general elections in August 2017. This is depicted in **Chart 13** below.

Chart 13 : Expected movements of the NPLs



2.8 Credit Recovery Efforts in the Next Quarter

- For the quarter ending September 30, 2017, banks predict that credit recovery efforts will be intensified in eight 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 and Agriculture 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, in the third quarter of 2017.

iii) The intensified recovery efforts in five sectors (Manufacturing, Trade, Transport, Personal/ Household, Real Estate, and Financial Services sectors) aim at improving the overall quality of the asset portfolio. This is in line with the banks expectations that loan defaults in these sectors will rise during second quarter of 2017 due to slowdown in economic activity.

- The responses on the expected credit recovery efforts by the banks during the quarter ending September 30, 2017 are depicted in **Chart 14** and **Table 6** below.

Chart 14: Credit Recovery Efforts

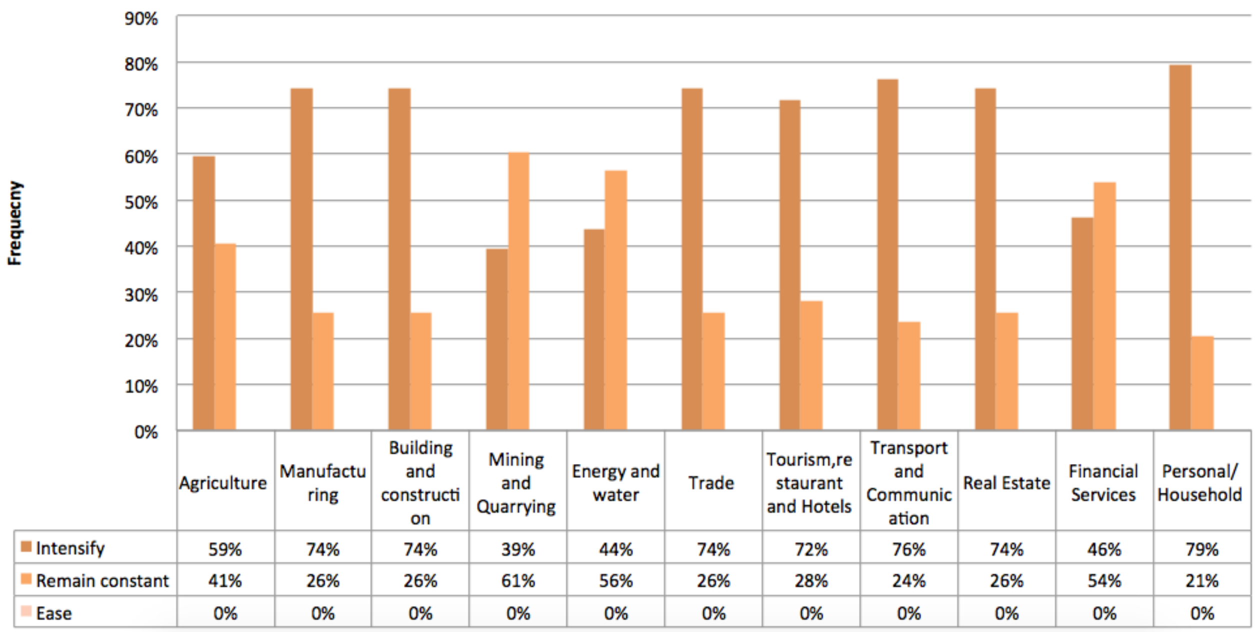


Table 6: Credit Recovery Efforts

	June 2017			March 2017		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	59%	41%	0%	59%	41%	0%
Manufacturing	74%	26%	0%	74%	26%	0%
Building and construction	74%	26%	0%	69%	31%	0%
Mining and Quarrying	39%	61%	0%	41%	59%	0%
Energy and water	44%	56%	0%	39%	58%	3%
Trade	74%	26%	0%	69%	28%	3%
Tourism, Restaurant and Hotels	72%	28%	0%	70%	27%	3%
Transport & Communication	76%	24%	0%	73%	24%	3%
Real Estate	74%	26%	0%	75%	25%	0%
Financial Services	46%	54%	0%	48%	45%	6%
Personal/Household	79%	21%	0%	81%	16%	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. Chase Bank (K) Ltd.
8. Citibank N.A Kenya.
9. Commercial Bank of Africa Ltd.
10. Consolidated Bank of Kenya Ltd.
11. Credit Bank Ltd.
12. Co-operative Bank of Kenya Ltd.
13. Development Bank of Kenya Ltd.
14. Diamond Trust Bank (K) Ltd.
15. Ecobank Kenya Ltd.
16. Spire Bank Ltd.
17. Equity Bank Ltd.
18. Family Bank Ltd.
19. SBM Bank (Kenya) Ltd.
20. Guaranty Trust Bank (Kenya) Ltd.
21. First Community Bank Ltd.
22. Guardian Bank Ltd.
23. Gulf African Bank Ltd.
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. M Oriental 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.

Central Bank of Kenya

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