Central Bank of Kenya

Credit Officer Survey

June 30, 2021

CENTRAL BANK OF KENYA COMMERCIAL BANKS' CREDIT OFFICER SURVEY FOR THE THE QUARTER ENDED JUNE 30, 2021

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 as a whole. This is because lending is the principal business for banks. The ratio of gross loans to total assets decreased marginally from 55.0 percent in the quarter ended March 31, 2021, to 54.75 percent in the quarter ended June 30, 2021.

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 complete most of the survey and collate inputs from senior officers responsible for the other aspects. For the quarter ended June 30, 2021, 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 implementation of 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 with regard to liquidity in the banks. The banks were required to state their appetite for 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 through the credit officer survey assesses the impact of the pandemic on the banking sector.

The survey included questions relating to adverse impact of the pandemic on the banks and measures taken by banks to curb the adverse impact of the pandemic.

[1] These are officers involved in most of the credit 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 June 30, 2021, compared to the quarter ended March 31, 2021. Some of the sector's performance indicators are as follows: -

- The aggregate balance sheet increased by 2.7 percent to Ksh.5,679.99 billion in June 2021 from Ksh.5,528.44 billion in March 2021.
- Gross loans increased by 2.3 percent from Ksh.3,040.45 billion in March 2021 to Ksh.3,110.07 billion in June 2021. The growth in gross loans was mainly due to increased advances in the Trade and Real Estate sectors.
- Total deposits increased by 2.8 percent from Ksh.4,133.15 billion in March 2021 to Ksh.4,249.41 billion in June 2021.
- The asset quality, measured by gross non-performing loans to gross loans ratio improved from 14.6 percent in March 2021 to 14.0 percent in June 2021. This was attributed to a 1.7 percent decrease in non-performing loans and 2.3 percent increase in gross loans.
- The total capital adequacy ratio increased from 18.8 percent in March 2021 to 18.9 percent in June 2021. This is as a result of a higher increase in total capital (2.1 percent) as compared to the increase in total risk weighted assets (1.6 percent). The capital adequacy ratios reported in the two periods were above the minimum statutory limit of 14.5 percent.
- Quarterly profit before tax increased by Ksh.4.64 billion from Ksh.45.89 billion in March 2021 to Ksh.50.53 billion in June 2021. This was as a result of a higher increase in income (6.3 percent) as compared to increase in expenses (4.5 percent). Return on Assets increased to 2.71 percent in June 2021 from 2.65 percent in March 2021.
- Return on Equity increased from 21.96 percent in March 2021 to 22.67 percent in June 2021. This is as a result of a higher increase in quarterly profits before tax (10.11 percent) than the increase in total shareholders' funds (1.79 percent).
- Liquidity in the banking sector increased from 56.3 percent in March 2021 to 56.8 percent in June 2021. This was well above the minimum statutory ratio of 20 percent.

1.4 SUMMARY OF CREDIT OFFICER SURVEY FINDINGS

- **Demand for credit:** In the second quarter of 2021, the perceived demand for credit remained unchanged in seven economic sectors. It increased in two sectors and decreased in one sector.
- **Credit Standards[2]:** In the second quarter of 2021, credit standards remained unchanged in nine economic sectors and were tightened in two sectors namely Tourism and Real Estate sectors.
- Tightening of credit standards in the two sectors is attributed to the effects of COVID–19 pandemic.

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

- **Expected Non-Performing Loans levels during the next quarter:** 38 percent of the respondents indicated that NPLs are likely to fall in the third quarter of 2021. This is attributed to enhanced recovery efforts being implemented by most banks. However, an equal 38 percent of the respondents expect the level of NPLs to rise in the third quarter of 2021 as a result of the continued COVID-19 pandemic. The respondents indicated that all the eleven economic sectors will be affected negatively by the pandemic. 24 percent of respondents expect NPLs to remain constant.

- **Non-Performing Loans:** The respondents indicated that the level of NPLs is expected to remain constant in six economic sectors and increase in four sectors. The sectors with expected increase in NPLs are Personal and Household, Real Estate, Tourism, and Trade.

  The expected increase in NPLs is mainly due to a challenging business environment as a result of COVID-19 pandemic.

- **Credit Recovery Efforts:** For the quarter ended September 30, 2021, banks expect to intensify their credit recovery efforts in eight economic sectors. The intensified recovery efforts are aimed at improving the overall quality of the asset portfolio.

- **International Financial Reporting Standard (IFRS) 9 on Financial Instruments:** IFRS 9 introduced volatility in month on month impairment forecasting and actuals because of consideration of expected future loss as opposed to actual loss. Estimation of future looking Macro Economic overlays is especially challenging in a pandemic environment.

- **International Financial Reporting Standard (IFRS) 16 on Leases:** Most banks indicated that implementation of IFRS 16 increased their risk weighted assets, which has in turn negatively affected their capital adequacy ratios. Adoption of IFRS 16 resulted into additional notional expenses on account of depreciation on right of use assets and interest expense on lease liabilities held by banks.

- **Liquidity risk:** During the quarter ended June 2021, 67 percent of the respondents indicated that their liquidity position had improved. This is evident from the increased liquidity ratio in the banking sector from 56.3 percent in March 2021 to 56.8 percent. The ratio remained above the minimum statutory ratio of 20 percent.

- Banks intend to deploy the additional liquidity towards lending to the private sector (28 percent), investing in Treasury Bonds (23 percent), investing in Treasury Bills (20 percent), interbank lending (19 percent), CBK liquidity management through repos (8 percent), and invest in other instruments including offshore (3 percent).

2.0 SURVEY FINDINGS

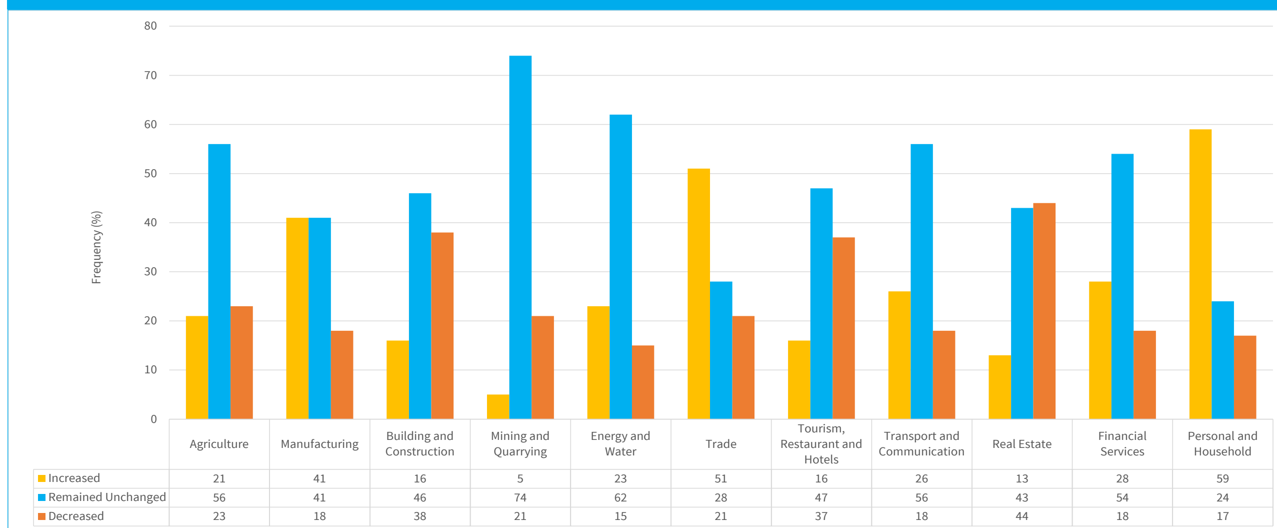
2.1 Demand for Credit

- In the second quarter of 2021, the perceived demand for credit remained unchanged in seven economic sectors. It increased in two sectors and decreased in one sector.
- The main sectors with unchanged demand for credit are Mining and Quarrying, Agriculture, and Energy and Water
- Perceived demand for credit significantly decreased in the Real Estate sector due to subdued demand for housing units.
- Perceived demand for credit increased in Personal and Household, and Trade sectors as a result of economic challenges brought about by the pandemic.
- **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 (%)	March 2021			June 2021		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	20	62	18	21	56	23
Manufacturing	54	33	13	41	41	18
Building and Construction	16	46	38	16	46	38
Mining and Quarrying	8	74	18	5	74	21
Energy and Water	23	56	21	23	62	15
Trade	60	24	16	51	28	21
Tourism, Restaurant and Hotels	21	42	37	16	47	37
Transport and Communication	30	49	21	26	56	18
Real Estate	13	43	44	13	43	44
Financial Services	33	51	16	28	54	18
Personal and Household	45	37	18	59	24	17

Chart 1: Demand for Credit

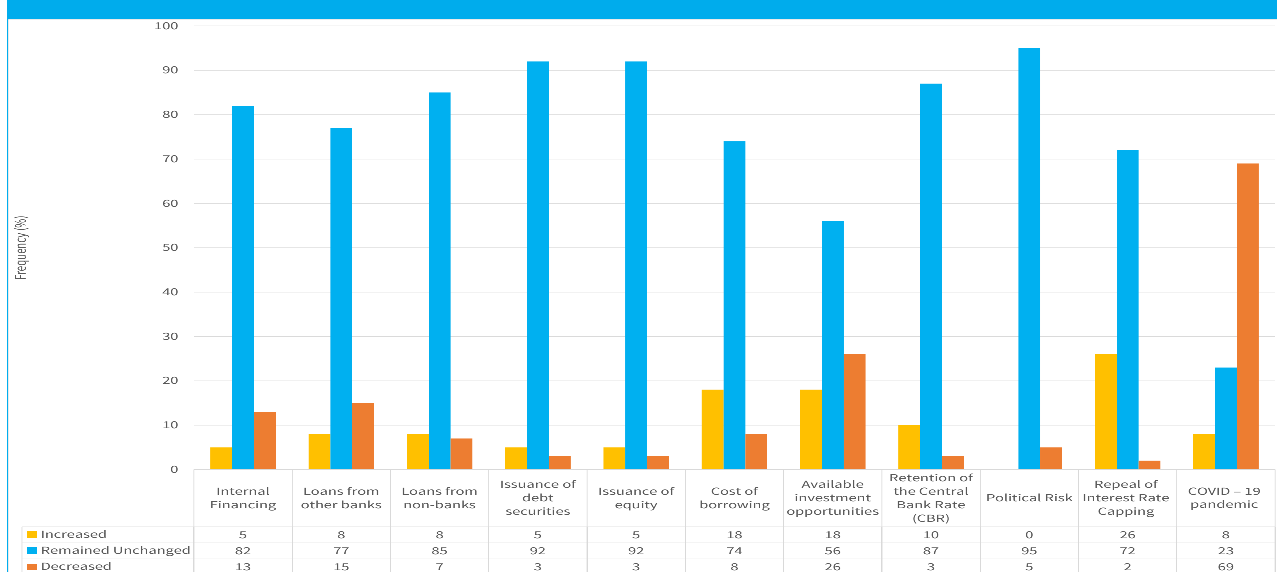


	Agriculture	Manufacturing	Building and Construction	Mining and Quarrying	Energy and Water	Trade	Tourism, Restaurant and Hotels	Transport and Communication	Real Estate	Financial Services	Personal and Household
Increased	21	41	16	5	23	51	16	26	13	28	59
Remained Unchanged	56	41	46	74	62	28	47	56	43	54	24
Decreased	23	18	38	21	15	21	37	18	44	18	17

2.2 Factors Affecting Demand for Credit

- In the quarter ended June 30, 2021, ten of the eleven factors affecting demand for credit had no impact. The only factor that negatively impacted the demand for credit is COVID-19 pandemic as reported by 69 percent of the respondents. This is depicted in **Chart 2** and **Table 2**.
- Political risk, issuance of equity, issuance of debt securities, and retention of the Central Bank's rate (CBR) were cited as having had the least impact on the demand for credit during the quarter under review. These were reported by 95 percent, 92 percent, 92 percent and 87 percent of the respondents respectively.

Chart 2: Factors affecting Demand for Credit



	Internal Financing	Loans from other banks	Loans from non-banks	Issuance of debt securities	Issuance of equity	Cost of borrowing	Available investment opportunities	Retention of the Central Bank Rate (CBR)	Political Risk	Repeal of Interest Rate Capping	COVID – 19 pandemic
Increased	5	8	8	5	5	18	18	10	0	26	8
Remained Unchanged	82	77	85	92	92	74	56	87	95	72	23
Decreased	13	15	7	3	3	8	26	3	5	2	69

Table 2: Factors Affecting Demand for Credit

Percentage (%)	March 2021			June 2021		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	8	79	13	5	82	13
Loans from other banks	5	82	13	8	77	15
Loans from non-banks	5	84	11	8	85	7
Issuance of debt securities	0	89	11	5	92	3
Issuance of equity	3	92	5	5	92	3
Cost of borrowing	23	77	0	18	74	8
Available investment opportunities	18	59	23	18	56	26
Reduction of the Central Bank Rate (CBR)	15	82	3	10	87	3
Political Risk	0	95	5	0	95	5
Repeal of Interest Rate Capping	23	77	0	26	72	2
COVID – 19 pandemic	8	21	71	8	23	69

2.3 Credit Standards

- In the second quarter of 2021, credit standards remained unchanged in nine economic sectors and were tightened in two sectors namely Tourism and Real Estate sectors.
- Tightening of credit standards in the two sectors is attributed to the adverse effects of COVID – 19 pandemic. This was to avoid possibility of non-performing loans as a result of the pandemic.
- This is presented in **Chart 3** and **Table 3** below.

Chart 3: Credit Standards

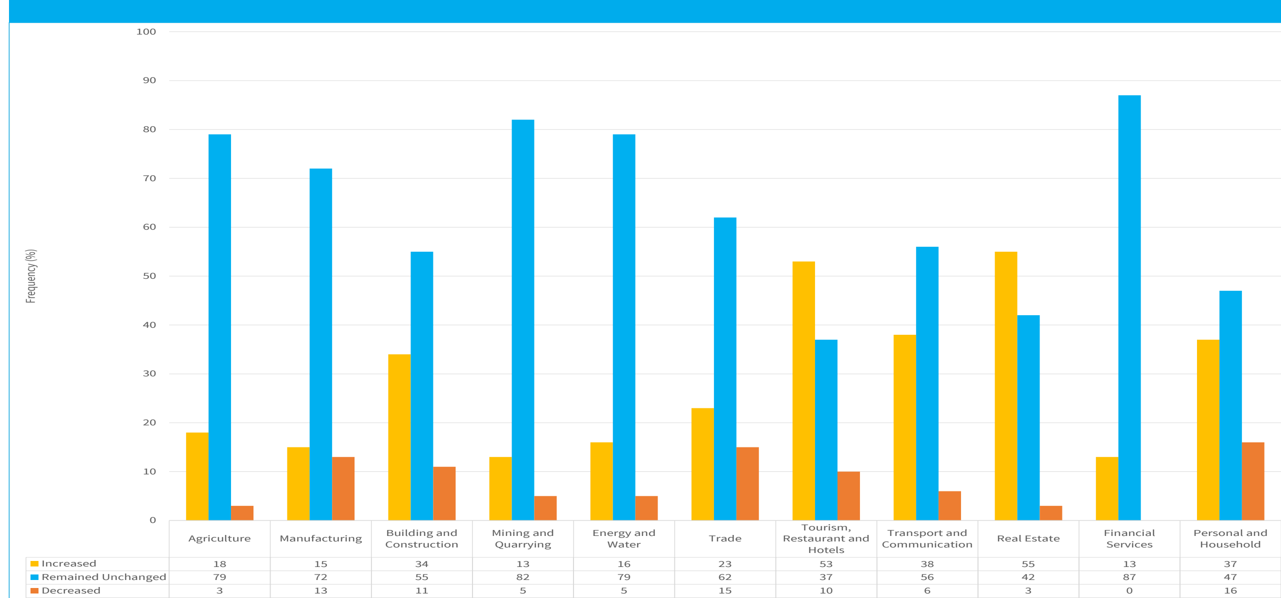


Table 3: Credit Standards for Loans to Various Economic Sectors

Percentage (%)	March 2021			June 2021		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	11	89	0	18	79	3
Manufacturing	13	79	8	15	72	13
Building and Construction	37	63	0	34	55	11
Mining and Quarrying	15	82	3	13	82	5
Energy and Water	18	79	3	16	79	5
Trade	26	62	12	23	62	15
Tourism, Restaurant and Hotels	53	42	5	53	37	10
Transport and Communication	41	56	3	38	56	6
Real Estate	50	47	3	55	42	3
Financial Services	15	82	3	13	87	0
Personal and Household	46	46	8	37	47	16

2.4 Factors Affecting Credit Standards

- In the quarter ended June 30, 2021, eight factors had little impact on credit standards whereas two factors had an impact.
- Investment in Government Securities, political risk, and Competition from Saccos, Microfinance banks, and other Credit Providers are the main factors that had no impact on credit standards. These were reported by 97 percent, 90 percent, and 87 percent of the respondents respectively.
- Expectations regarding general economic activity and removal of interest rate capping led to tightening of credit standards in Tourism and Real Estate sectors.
- 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

	Bank's cost of funds and Balance sheet constraints	Constraints relating to Bank's capital position	Competition from other banks	Competition from DTMs, Saccos, and other Credit Providers	Expectations regarding general economic activity	Retention of the Central Bank Rate (CBR)	Political Risk	Investment in Government Securities	Removal of Interest rate capping	COVID -19 pandemic
Increased	26	26	13	8	49	15	8	0	69	8
Remained Unchanged	69	67	79	87	38	79	90	97	28	85
Decreased	5	7	8	5	13	6	2	3	3	7

Table 4: Factors affecting credit standards

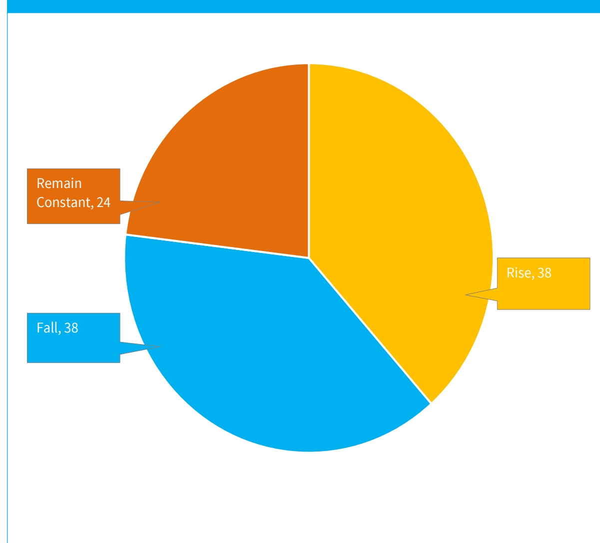
	March 2021			June 2021		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds and Balance sheet constraints	31	67	2	26	69	5
Constraints relating to Bank's capital position	26	72	2	26	67	7
Competition from other banks	13	79	8	13	79	8
Competition from DTMs, Saccos, and other Credit Providers	8	87	5	8	87	5
Expectations regarding general economic activity	54	36	10	49	38	13
Reduction of the Central Bank Rate (CBR)	8	82	10	15	79	6
Political Risk	8	92	0	8	90	2
Investment in Government Securities	5	90	5	0	97	3
Removal of Interest rate capping	74	26	0	69	28	3
COVID –19 pandemic	11	84	5	8	85	7

2.5. Non-Performing Loans (NPLs)

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

- 38 percent of the respondents indicated that NPLs are likely to fall in the third quarter of 2021. This is attributed to enhanced recovery efforts being implemented by most banks.
- 38 percent of the respondents expect the level of NPLs to rise in the third quarter of 2021 as a result of the continued COVID-19 pandemic. The respondents indicated that all the eleven economic sectors will be affected negatively by the pandemic.
- 24 percent of respondents expect NPLs to remain constant. This is 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 six economic sectors and increase in four sectors during the next quarter.
- For Transport and Communication sector an equal number of respondents indicated that the level of NPLs is expected to increase and remain constant.
- The sectors with expected increased NPLs are Personal and Household, Real Estate, Tourism, and Trade as a result of the adverse effects of COVID-19 pandemic.
- **Table 5** and **Chart 6** and depicts this.

Table 5: Non-Performing Loans Trend Per Economic Sector

Percentage (%)	March 2021			June 2021		
	Rose	Remained Unchanged	Fell	Rose	Remained Unchanged	Fell
Agriculture	18	72	10	18	69	13
Manufacturing	24	61	15	26	61	13
Building and Construction	39	42	19	34	48	18
Mining and Quarrying	5	87	8	11	84	5
Energy and Water	3	92	5	8	84	8
Trade	45	32	23	39	37	24
Tourism, Restaurant and Hotels	53	37	10	50	26	24
Transport and Communication	57	32	11	41	41	18
Real Estate	58	29	13	50	24	26
Financial Services	16	76	8	16	76	8
Personal and Household	61	24	15	47	29	24

Chart 6: Non-Performing Loans

2.6 Credit Recovery Efforts in the Third Quarter of 2021

- For the quarter ended September 30, 2021, banks expect to intensify their credit recovery efforts in eight economic sectors. 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, in order to enhance reduction of NPLs therefore improving the overall quality of their asset portfolio, are: -
    i. Personal and Household (84 percent).
    ii. Building and Construction (79 percent).
    iii. Real Estate (76 percent).
    iv. Transport and Communication (74 percent).
    v. Trade (74 percent).
- Credit recovery efforts are expected to remain constant in three sectors namely Mining and Quarrying (55 percent), Energy and Water (54 percent), and Financial services (54 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

	March 2021			June 2021		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	56	41	3	51	46	3
Manufacturing	71	26	3	71	26	3
Building and Construction	82	16	2	79	18	3
Mining and Quarrying	50	47	3	42	55	3
Energy and Water	49	49	2	43	54	3
Trade	82	16	2	74	24	2
Tourism, Restaurant and Hotels	76	21	3	70	27	3
Transport and Communication	84	13	3	74	24	2
Real Estate	79	18	3	76	21	3
Financial Services	57	43	0	46	54	0
Personal and Household	87	11	2	84	13	3

Chart 7: Credit Recovery Efforts

	Agriculture	Manufacturing	Building and Construction	Mining and Quarrying	Energy and Water	Trade	Tourism, Restaurant and Hotels	Transport and Communication	Real Estate	Financial Services	Personal and Household
Increased	51	71	79	42	43	74	70	74	76	46	84
Remained Unchanged	46	26	18	55	54	24	27	24	21	54	13
Decreased	3	3	3	3	3	2	3	2	3	0	3

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.
- The Central Bank of Kenya assesses: -

i). The challenges the banks have experienced 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.

iii). What the banks have done to ensure that the assumptions 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.
- In addition, banks have changed their lending policies to align them with IFRS 9. However, implementation of IFRS 9 has had some challenges. These include: -

i. Negative impact on capital adequacy due to increased provisioning.

ii. Estimation of future looking Macroeconomic overlays is especially challenging in a pandemic environment

iii. Incorporating reliable macro-economic factors in the model is challenging in an uncertain economy.

iv. Cost implication for the relevant technology, consultants and personnel training.

v. Incorporating an effective interest rate in the model is difficult as its cumbersome to implement without automation.
vi. Minimal growth in loan book due to rigorous risk profiling and credit appraisal standards leading to a negative impact on profitability.
vii. Lack of adequate historical data for assessment and re-modeling of the IFRS 9 assumptions and parameters including Probability of Default (PD) and Loss Given Default (LGD).
viii. Continuous improvement of the business model.

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

- Banks have implemented the following mitigation measures in dealing with challenges faced in implementing IFRS 9: -

i. They have injected additional capital to accommodate the expected rise in credit losses.
ii. Some banks have developed internal rating models to assess credit risks across all sectors including for SMEs. Banks have therefore introduced unsecured credit products for SMEs.
iii. Automation of the model to minimize errors and gaps in implementation.
iv. Banks have engaged consultants to validate the assumptions to ensure that they are reliable.
v. The focus of banks is now more on secured lending.
vi. Banks have revamped their credit recovery efforts.

2.7.3 Changes made by commercial banks on the assumptions used in IFRS 9

- The use of forward-looking information is a key component of the Expected Credit Loss (ECL) impairment approach. Commercial banks are now considering historic, current and forward-looking information (including macro-economic data).

  This aims at ensuring that credit losses are recognized at an early stage, rather than waiting for an incurred loss event to occur before credit losses are recognized.

- ECLs are measured in a way that is not just determined by evaluating a range of possible outcomes, adjusted for the time value of money, but also considering 'reasonable and supportable' information about past, present and future events and economic conditions.

- During the quarter under review, the survey revealed the following:-

i. Some of the respondents indicated that they have updated their assumptions to include the current macro-economic indicators.
ii. Banks are facing challenges in modeling data related to the global COVID-19 pandemic and its predicted impact on loan performance.

    Banks are still assessing the effects of COVID-19 to generate different assumptions that will need to be included in the models.

iii. Whereas IFRS 9 provides a 30 day back stop in roll over from stage 1 to stage 2, banks have maintained a more conservative measure of 1 day past due as the change over from stage 1 to stage 2.

2.7.4 Actions by the commercial banks to ensure that the assumptions are reliable

- Some of the respondents have indicated that they are currently reviewing their assumptions on a quarterly basis to ensure that they are reliable. This aims at ensuring that losses in different sectors are reflected accurately in the model.
- Some banks have also indicated that their model parameters (probability of default and Loss Given Default) are updated twice yearly to ensure all parameters are up to date and relevant.
- Some banks have done data cleanup to ensure its integrity and automation of the model to minimize errors.
- Change assumptions on Probability of Default (PD) computation from portfolio based to sector based.

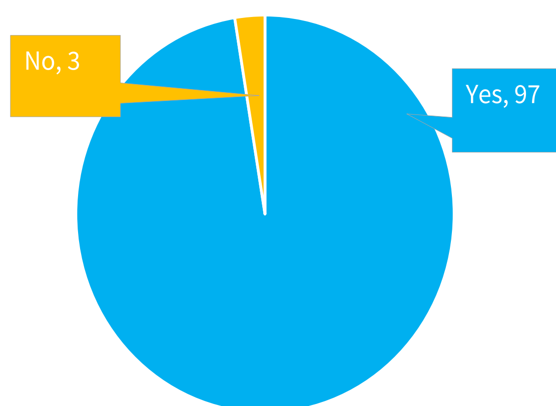
2.8 International Financial Reporting Standard (IFRS) 16 on Leases

- 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 changes 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 June 30, 2021, 97 percent of the respondents had implemented IFRS 16. This is depicted in **Chart 8**.

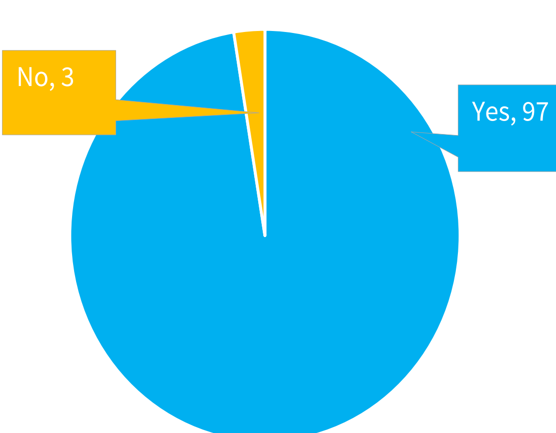
Chart 8: Banks that have implemented IFRS 16 on Leases (%)



2.8.2 Assessment of the impact of IFRS 16

- During the quarter ended June 30, 2021, 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 of banks indicated that implementation of IFRS 16 increased their risk weighted assets, which has in turn decreased their capital adequacy ratios. It also had a negative impact on the banks' retained earnings.
- This called for capital injection to strengthen the banks' capital adequacy.

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 June 30, 2021 are indicated in **Table 7**.

Table 7: Financial elements bank value as at June 30, 2021

Banking Industry (Ksh '000)	March 2021	June 2021
Right of use (ROU) assets	35,500,958	33,639,644
Lease liabilities	31,154,869	29,553,247
Depreciation of the right of use asset	3,693,126	3,999,702
The finance charge associated with the lease liability	913,201	1,569,755

2.8.5 Challenges experienced in the Implementation of IFRS 16

- Most banks indicated that the major challenge they faced in implementation of IFRS 16 include:

  i) Cost of training their staff for compliance with the standard.

  ii) The judgmental nature in the application of IFRS 16 including renewal option in future.

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

- As a mitigation measure, banks have indicated that they are: -

  i) Banks are continuously bridging the gap through continuous training for its staff and ensuring they are updated in the changes in the leasing space.

  ii) Ensuring lease contracts are thoroughly vetted and drawn by professionals.

  iii). Regularly monitoring of lease contracts.

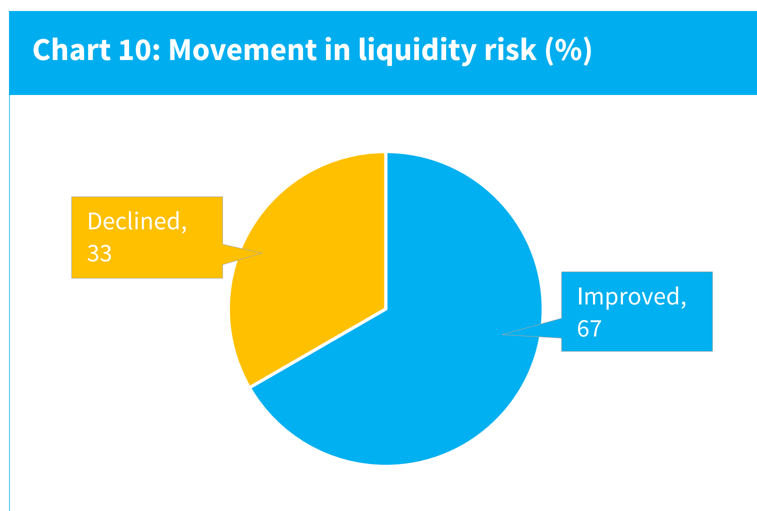
2.9 Liquidity Risk

- 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.

2.9.1 Commercial Banks' liquidity positions

- During the quarter ended June 2021, 67 percent of the respondents indicated that their liquidity position had improved as indicated in **Chart 10**.

Chart 10: Movement in liquidity risk (%)



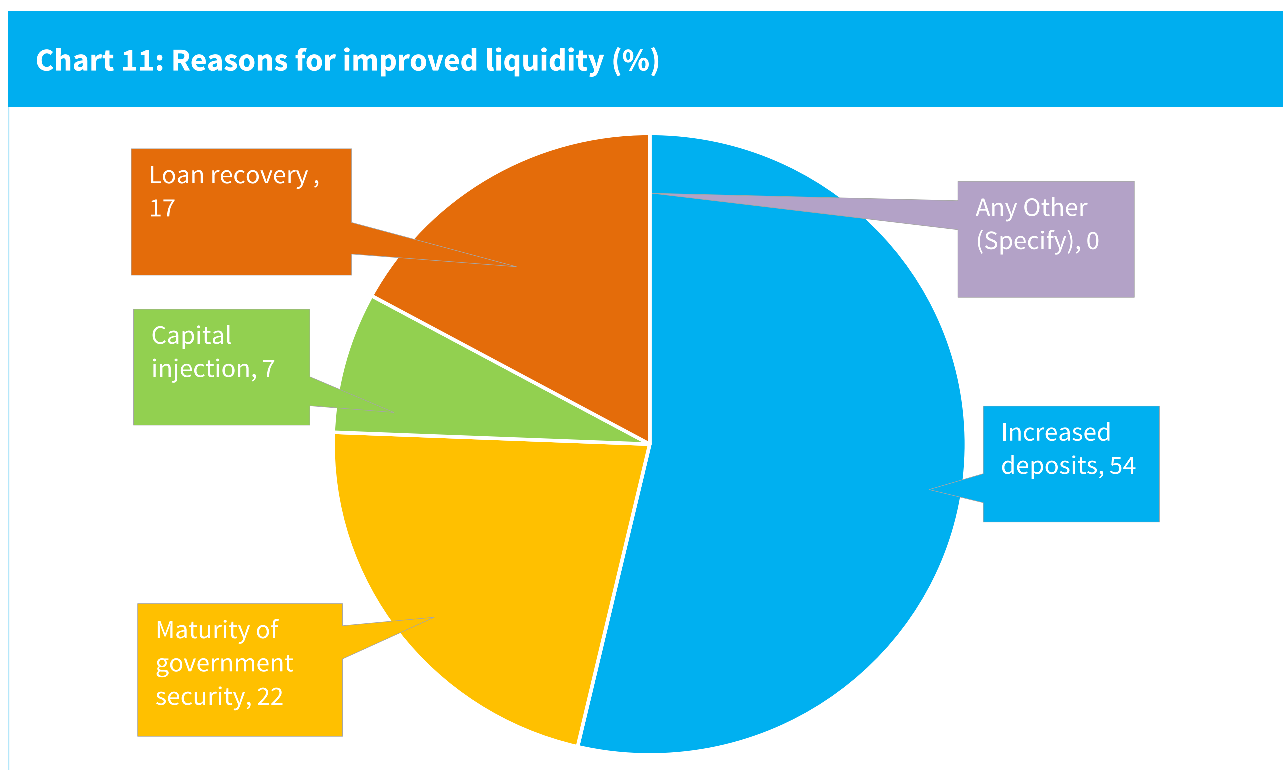
2.9.2 Factors that led to improved liquidity over the second quarter of 2021

- During the quarter ended June 30, 2021, liquidity improved mainly as a result of: -

  i). Increased deposits (54 percent).
  ii). Maturity of government securities (22 percent).
  iii). Loan recovery (17 percent).
  iv). Capital injection (7 percent).

- The drivers of improved liquidity are indicated in **Chart 11** below.

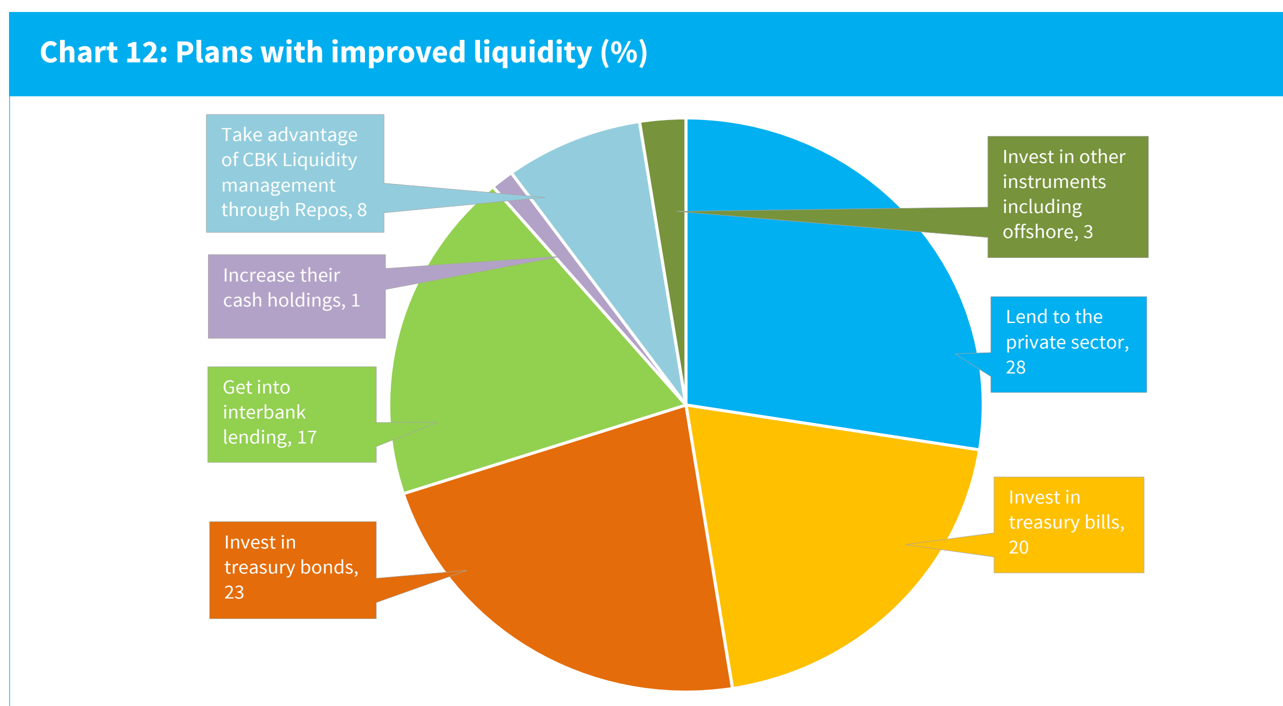
Chart 11: Reasons for improved liquidity (%)



2.9.3 Commercial Banks' plans with improved liquidity

- As indicated in **Chart 12**, with the improved liquidity, it is expected that in the third quarter of 2021, issuance of credit will increase as most banks intend to deploy the additional liquidity towards lending to the private sector (28 percent), investing in Treasury Bonds (23 percent), investing in Treasury Bills (20 percent), interbank lending (19 percent), CBK liquidity management through repos (8 percent), and invest in other instruments including offshore (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 June 2021, 33 percent of the respondents indicated that their liquidity position had deteriorated as indicated in **Chart 10**.
- Banks are enhancing their deposit mobilization campaigns to enhance their deteriorated liquidity positions.

2.9.5 Commercial Banks' interbank activities during the quarter

- During the quarter ended June 30, 2021, 57 percent of the respondents indicated that their interbank lending activities increased. This is indicated in **Chart 13** below.
- 63 percent of the respondents indicated that their interbank borrowing decreased. This is indicated in **Chart 14** below.
- Interbank borrowing has generally decreased due to tightening of credit standards by institutions of facilities of all categories.

Chart 13: Increase in interbank lending(%)

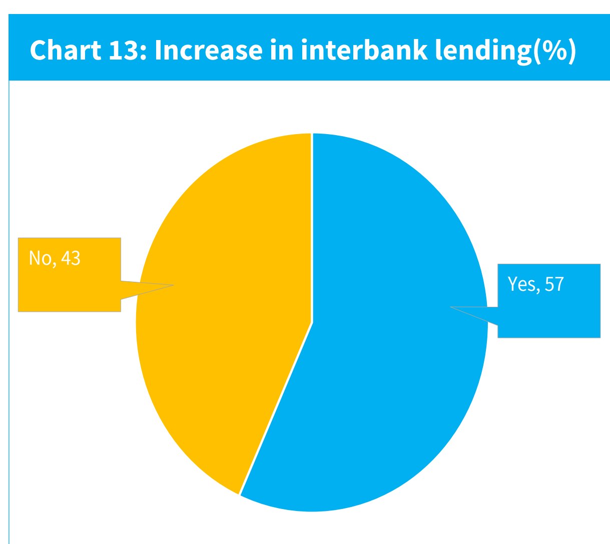
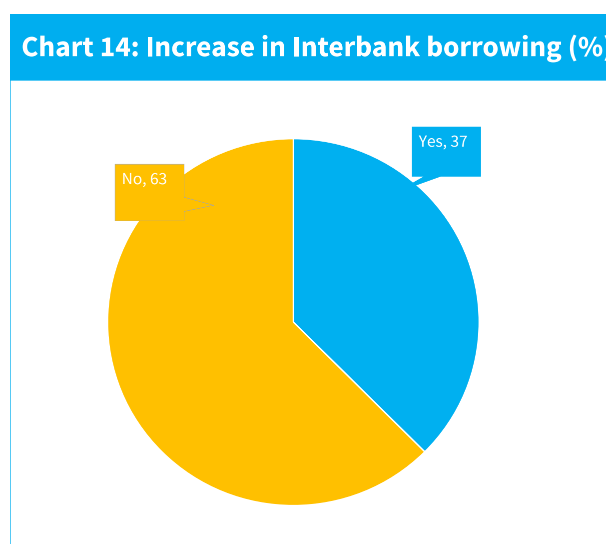


Chart 14: Increase in Interbank borrowing (%)



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

The ongoing COVID-19 pandemic has devastated many countries, with significant human, economic and social costs. The global economic outlook has been highly uncertain, with unprecedented volatility in the financial markets.

The adverse effects of the pandemic on the Kenyan economy points that the impact may be severe. In this regard, CBK through the credit survey assessed the impact of the pandemic on the banking sector. The survey covered areas relating to: -

The survey covered areas relating to:

i) Adverse impact of the pandemic on the banks.

ii) Opportunities that have arisen from the pandemic.

iii) The key risks that have been increased by the pandemic.

iv) Measures banks are taking to curb the adverse impact of the pandemic on banks' business.

v) Banks' experience after the expiry of the emergency measures on restructured loans introduced by CBK to mitigate the impact of 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 impact on their business.

Some of the adverse effects include:

- Reduction in earnings due to likelihood of additional loan loss provisions and low loan revenue due to reduction in lending rates.

- Banks have had to absorb significant operational costs in extending forbearance credit support in terms of payments holidays and restructures for affected customers, this has led to deterioration of core capital position.
- Increased expenditure. Banks have been compelled to purchase Personal Protective Equipment (PPE) for staff as well as ensuring that their premises are well fumigated.
- Increased Non-Performing Loans, which may be attributed to slowdown in business, business closures and job losses.
- Decreased loans advanced to customers as banks become more cautious due to the high risk of credit default.

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

The commercial banks have indicated that the pandemic has had an impact on their business.

Some of the opportunities arising from the pandemic include:

- Need for digital platforms of lending.
- Increase in Lending to the Private Sector to support them pull through COVID-19.
- Institutions have devised methods of working from home as dictated by the effects of the pandemic leading to cutting of costs related to working in the office.
- Institutions have been able to conduct online meetings which may help cut meeting costs in the future if the same is continued.

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

The commercial banks have indicated that the pandemic has had an impact on their business. Some of the key risks increased by the pandemic include:

- **Credit risk**: Due to increased requests from clients to avail moratorium on their facilities, non-performing loans are likely to increase with uncertainty on when the economic and COVID-19 pandemic situation will improve. There is also uncertainty on customer incomes and employment coupled with reducing collateral values.
- **Operational risk**: Need for enhanced business continuity plans given risk of COVID-19 infection of bank staff.
- **Cyber security risk**: Due to increased use of digital banking.

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

Commercial banks have put in place the following measures to curb the adverse impact of the pandemic: -

- Banks have implemented their Business Continuity Plans (identification of critical processes, critical staff and their back-ups).
- Granting client requests on moratorium depending on sectors.

- Banks have put in place work rotation plans for all staff members and automated their processes to ensure social distancing.
- Banks have assessed the various industries and the expected impacts thereon and are reaching out to the affected customers to discuss restructuring to manage the situation.
- Banks have tightened their credit standards on granting of new loans to enable the assessment of the impact of the pandemic in each industry.
- Banks are actively reaching out and working with customers to understand their constraints caused by the pandemic and offering a number of reliefs including restructuring of facilities and providing moratoriums on both interest and principal where necessary.
- Giving payment holidays to the customers who have been adversely affected by the pandemic. This will enable them stay afloat and eventually be able to recover and get back to businesses.
- Supporting customers with working capital financing to cover the increase in working capital gap (due payments to suppliers and fixed costs) attributed to slowdown in sales revenue/ no revenue.

2.10.5 Respondents experiences after the expiry of the emergency measures on restructured loans by CBK to mitigate the impact of COVID-19

The respondents indicated their experiences after the expiry of the emergency measures on restructured loans as outlined below;

i. Some customers who were offered payment holiday have not reverted to their previous income level to service loans hence facilities have started rolling forward.

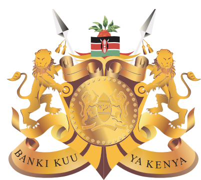
ii. Some businesses are still struggling to recover from the effect of COVID-19 and have not resumed full operations hence not able to meet their monthly obligations.

iii. The banks NPLs increased due to the reclassification of the accounts that had been given a reprieve and they have not fully recovered and hence are still not performing as expected

iv. Reduction of profits by banks due to increase in provisions as a result of reclassifying the non-performing loans due to COVID-19 pandemic.

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 Ltd.
39. UBA Kenya Bank Ltd.



Central Bank of Kenya

Haile Selassie Avenue P.O. Box 60000 - 00200 Nairobi |Tel: (+254) 20 - 286 0000 / 286 1000 / 286 3000

www.centralbank.go.ke | www.facebook.com/CentralBankKenya | @CbkKenya