CENTRAL BANK OF KENYA

CREDIT OFFICER SURVEY

JULY - SEPTEMBER 2015

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1.0 EXECUTIVE SUMMARY

1.1 CREDIT OFFICER SURVEY

Credit risk is the single largest factor affecting the soundness of financial institutions and the financial system as a whole. Lending is also the principal business for banks. The ratio for total loans to total assets of the banking sector for the quarter ended 30th September 2015 was 62.68% a slight increase from 61.38% reported in September 2014. In order to identify the potential causes and enhance understanding of credit risk, the Central Bank of Kenya introduced a quarterly Credit Officer Survey in 2012.

For the quarter ended 30th September 2015, CBK received Credit Officer Survey responses from 40 operational banks and 1 mortgage finance company. The list of the responding banks is attached to this report as **Annex I**.

1.2 SURVEY METHODOLOGY

The credit officer survey for the quarter ended 30th September 2015 included four questions that focused on:-

- Demand for Credit.
- Credit Standards.
- Non-Performing Loans.
- Credit Recovery Efforts.

The survey, conducted in October 2015, targeted senior credit officers of all 40 operational commercial banks and 1 mortgage finance company. Charterhouse Bank Ltd and Imperial Bank Ltd which were under statutory management were excluded from the survey. All the forty one institutions responded.

1.3 KEY FINDINGS

The key findings from the survey are detailed below:

1.3.1 Demand for credit

The demand for credit generally remained constant in seven economic sectors and increased in four economic sectors in the quarter ended September 2015. Cost of borrowing, depreciation of the shilling, security risks, increased Central Bank Rate and Kenya Banks Reference Rate were cited as the main driving factors.

1.3.2 Credit Standards

Credit standards largely remained unchanged across all the eleven economic sectors in Q3 of 2015. However, credit standards were tightened for the Building, Real Estate, Tourism, Transport and Personal/Household sectors with escalating insecurity, bank's capital position and cost of funds cited as the main driving factors.

1.3.3 Non-Performing Loans

For the fourth quarter of 2015, most banks expect the levels of non-performing loans to generally remain constant in eight of the eleven economic sectors. However, banks foresee increasing NPLs in the Personal/Household, Building and Construction, Manufacturing, Real Estate, Agriculture and Trade sectors. Increase of the Central Bank Rate and Kenya Banks Reference Rate, increased interest rates, volatile exchange rates, delayed contractor payments from the central and county governments and adverse weather conditions were cited as some of the factors attributable to increased NPLs.

1.3.4 Credit Recovery Efforts

In Q4 of 2015, most banks intend to intensify their loan recovery efforts in seven of the eleven economic sectors to improve the overall quality of their asset portfolio.

2.0 SURVEY FINDINGS

2.1 Demands for Credit

2.1.1 Observations

- In Q3 of 2015, demand for credit generally remained constant in seven economic sectors and increased in four economic sectors. The seven economic sectors that recorded unchanged demand for credit were Agriculture, Mining and Quarrying, Energy and Water, Tourism, Transport and Financial Services while the four economic sectors that recorded increased demand for credit were Building, Trade, Real Estate and Personal/Household. This is **depicted in Chart 1 and table 1 below**.
- Compared to Q2 of 2015, Kenyan banks in Q3 indicated that demand for credit:-
  - Increased in three economic sectors in Q3 of 2015. The three sectors were Manufacturing, Mining and Energy and water which went up with a margin of 8%, 5% and 3% respectively.
  - Decreased in four economic sectors namely; Building & Construction, Trade, Transport & Communication and Real Estate. The reasons cited for decreased demand for credit were cost of borrowing, depreciation of the shilling against the dollar, security risks associated with the terror attacks, recent upward review of Central Bank Rate and Kenya Banks Reference Rate.

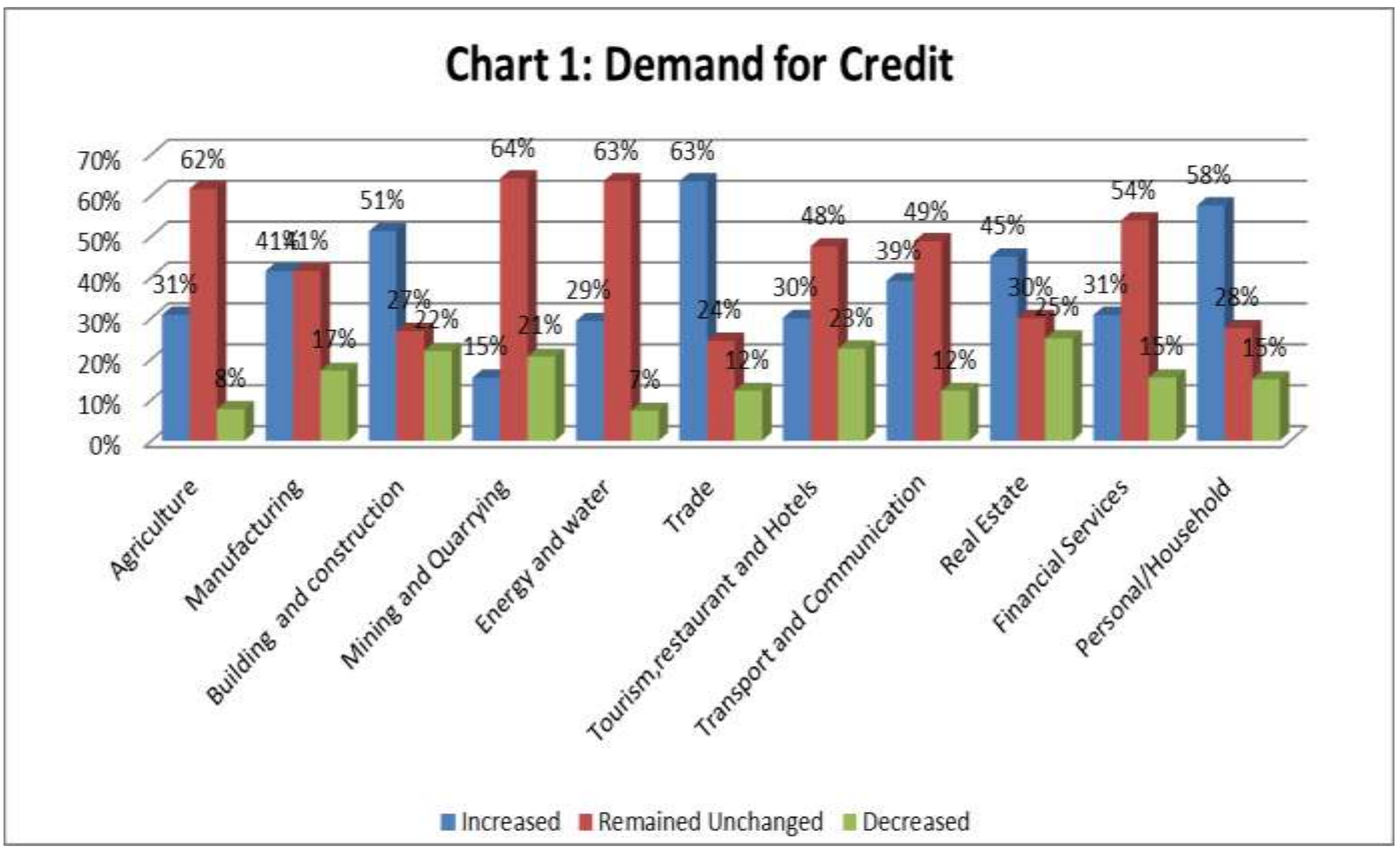

Table 1 below presents the trend in the demand for credit in the quarter ended September 2015 as compared to June 2015.

Table 1: Demand for Credit

	September 2015			June 2015		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	31%	62%	8%	44%	46%	10%
Manufacturing	41%	41%	17%	33%	51%	16%
Building & Construction	51%	27%	22%	58%	26%	16%
Mining and Quarrying	15%	64%	21%	10%	74%	17%
Energy and Water	29%	63%	7%	26%	56%	19%
Trade	63%	24%	12%	70%	21%	9%
Tourism, Restaurant and Hotels	30%	48%	23%	33%	38%	29%
Transport and Communication	39%	49%	12%	42%	49%	9%
Real Estate	45%	30%	25%	45%	43%	12%
Financial Services	31%	54%	15%	34%	51%	15%
Personal/Household	58%	28%	15%	59%	22%	20%

2.2 Factors affecting demand for credit

2.2.1 Observations

- In Q3 of 2015 credit survey, factors affecting demand for credit generally had no impact in eight economic sectors as depicted in **Chart 2** and **Table 2** below.
- Some Kenyan banks indicated that cost of borrowing (73%) and recent upward review of Central Bank Rate (45%) and increase of KBRR (51%) had the most impact in reducing the demand for credit.
- Issuance of equity, Issuance of debt securities, Internal Financing, Political Risk, Loans from non-banks and Loans from other banks were cited by 90%, 90%, 83%, 83%, 78% and 63% of the respondents respectively, as having had the least influence on the demand for credit during the quarter under review.
- Available investment opportunities were cited as the main factor that led to increased demand for credit by 29% of the respondents.

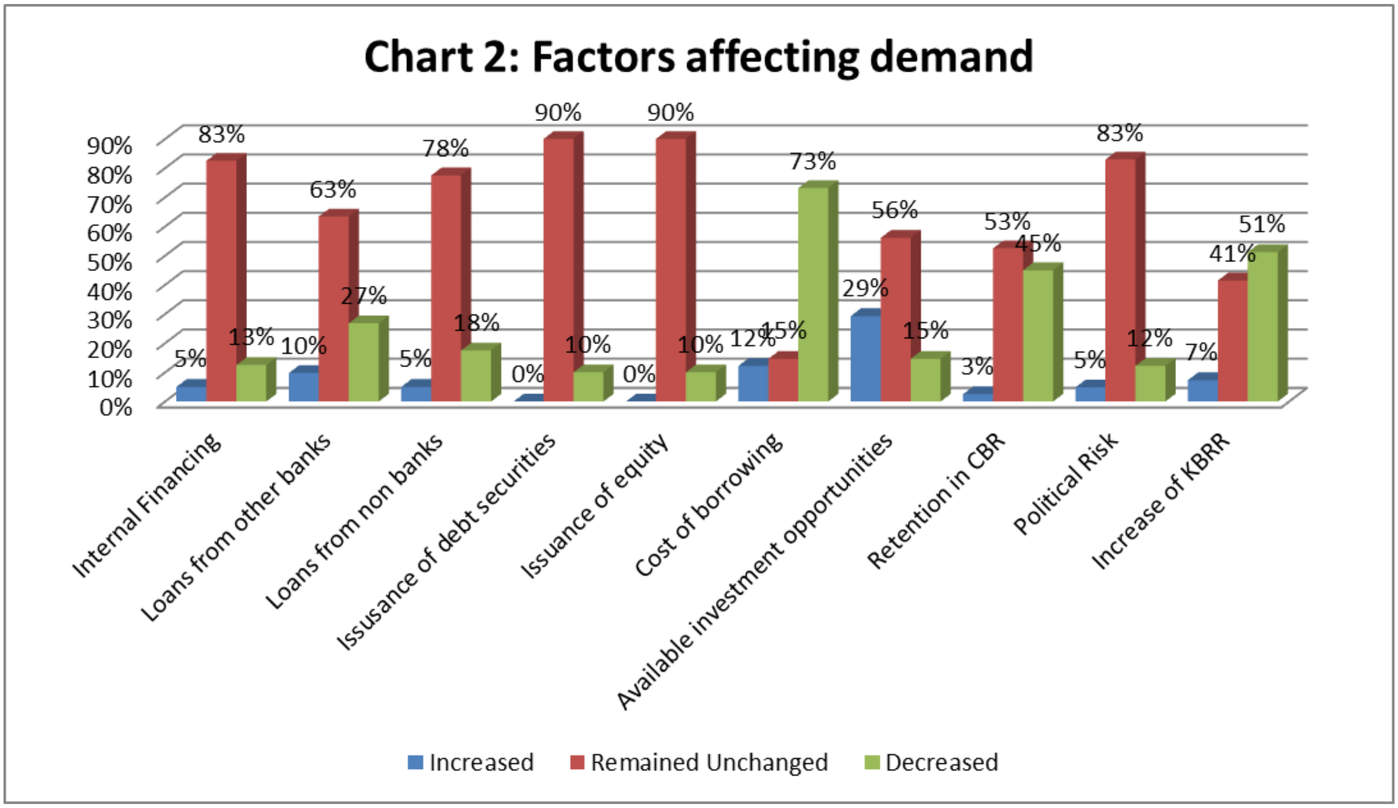

Table 2: Factors affecting Demand for credit

	September 2015			June 2015		
	Increased	**Remained Unchanged**	**Decreased**	**Increased**	**Remained Unchanged**	**Decreased**
Internal Financing	5%	83%	13%	12%	79%	10%
Loans from other banks	10%	63%	27%	18%	61%	20%
Loans from non-banks	5%	78%	18%	5%	75%	20%
Issuance of debt securities	0%	90%	10%	5%	88%	7%
Issuance of equity	0%	90%	10%	18%	78%	4%
Cost of borrowing	12%	15%	73%	26%	50%	24%
Available investment opportunities	29%	56%	15%	16%	70%	14%
Increase in CBR	3%	53%	45%	14%	65%	21%
Political Risk	5%	83%	12%	20%	73%	7%
Increase of KBRR	7%	41%	51%	20%	75%	5%

2.3 Credit Standards

2.3.1 Observations

- Similar to the last last two quarters, the survey established that credit standards generally remained unchanged for all economic sectors over the three months to 30th September 2015.

- **Chart 3** below indicates that relative to the other sectors, credit standards were tightened for Building & Construction, Real Estate, Tourism, Transport and Personal/Household sectors. This was cited by 46%, 43%, 35%, 27% and 25% of the respondents respectively. In comparison to Q2 of 2015, An additional 14%, 13%, 11% (for Building & Construction, Trade, and Personal/Household) and 10% of the respondents respectively tightened their credit standards to these sectors compared to the reported position in Q2 of 2015. This is depicted in **Table 3** below:

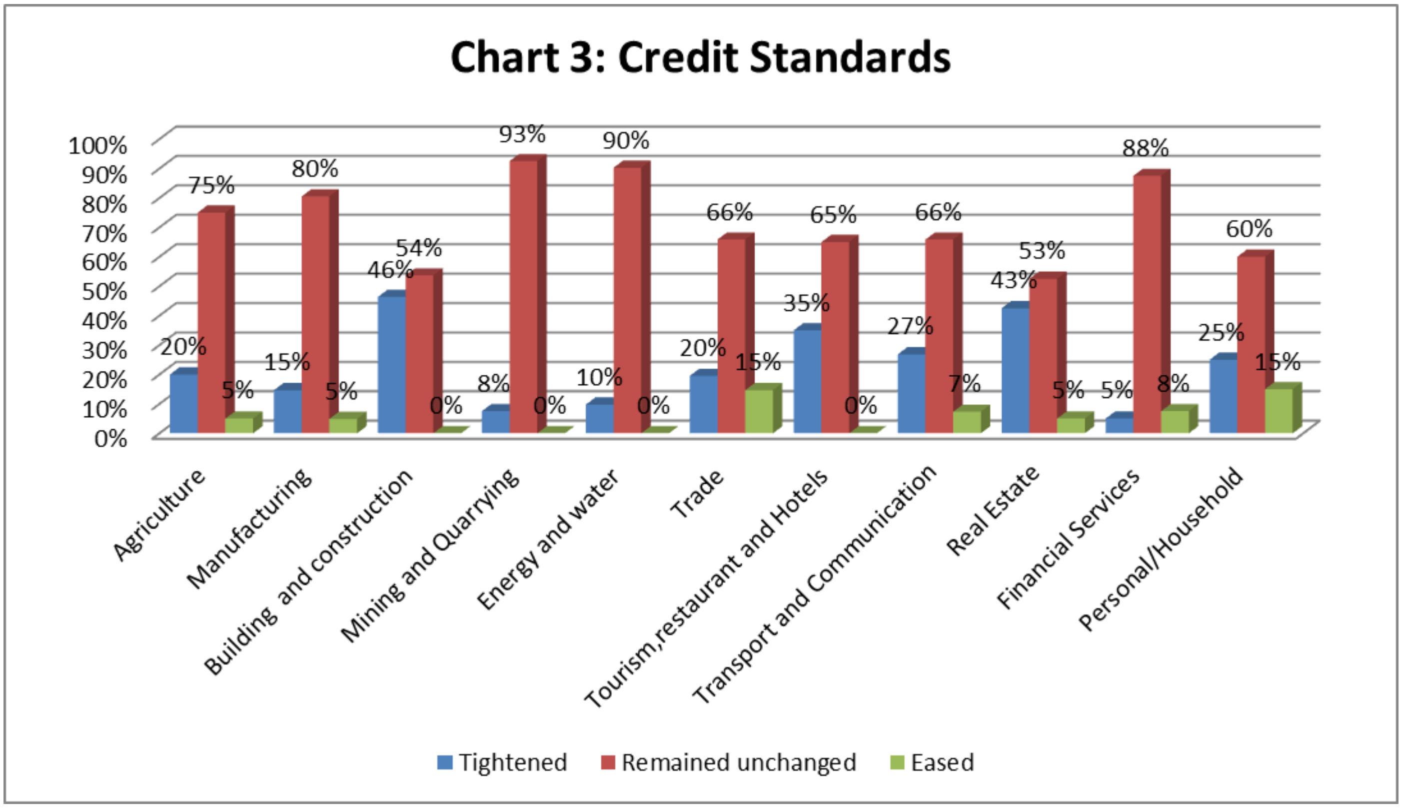

Table 3: Credit Standards

	September 2015			June 2015		
	Tightened	**Remained Unchanged**	**Eased**	**Tightened**	**Remained Unchanged**	**Eased**
Agriculture	20%	75%	5%	7%	83%	10%
Manufacturing	15%	80%	5%	5%	81%	14%
Building & Construction	46%	54%	0%	35%	56%	9%
Mining and Quarrying	8%	93%	0%	10%	88%	2%
Energy and Water	10%	90%	0%	7%	88%	5%
Trade	20%	66%	15%	9%	70%	21%
Tourism, Restaurant and Hotels	35%	65%	0%	38%	60%	2%
Transport and Communication	27%	66%	7%	21%	67%	12%
Real Estate	43%	53%	5%	29%	61%	10%
Financial Services	5%	88%	8%	5%	90%	5%
Personal/Household	25%	60%	15%	14%	57%	29%

2.4 Factors influencing credit standards

2.4.1 Observations

- In the quarter ended 30th September 2015, most of the factors that influence changes on banks credit standards had little impact as shown in Chart 4 below. This supports the finding that credit standards to all economic sectors generally remained unchanged in the quarter.
- 24% of the respondents reported that they eased their credit standards due to competition from other Banks as shown in **Chart 4**.
- 63% of the banks tightened their credit standards due to Bank's cost of funds & Balance sheet constraints, 27% due to Expectations regarding general economic activity and Increase of Central Bank Rate (CBR), 24% due to increased KBRR and 23% due to Constraints relating to Bank's capital position.
- Compared to Q2 of 2015, banks' cost of funds and balance sheet constraints, increase in Central Bank Rate (CBR) and KBRR and expectations regarding general economic activity were the key factors that led to tightening of credit standards as depicted in **Table 4**.

The trend in factors affecting the banks' credit standards are indicated in **Chart 4** and **Table 4** below.

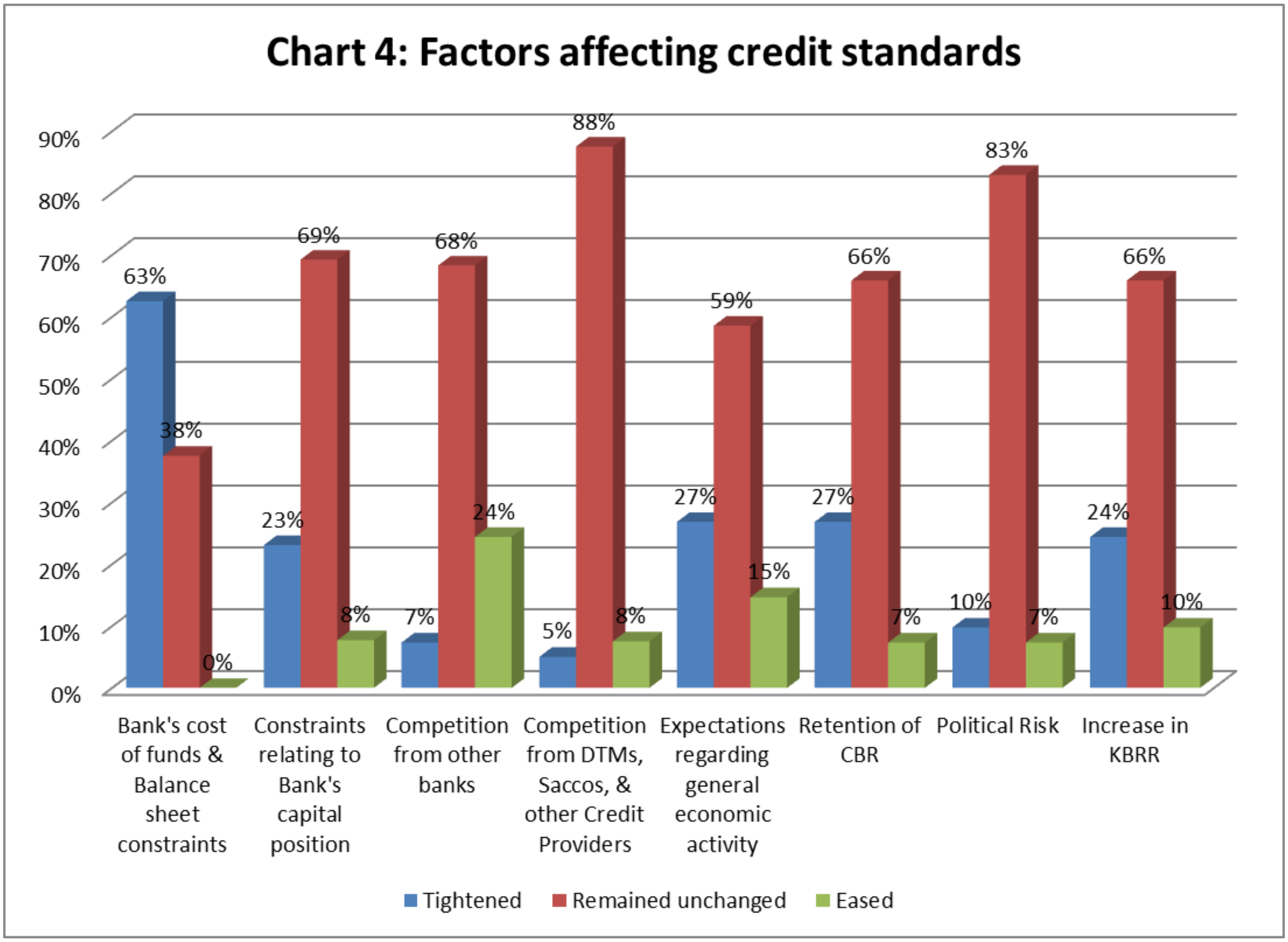

Table 4: Impact of factors affecting credit standards

	September 2015			June 2015		
	Tightened	**Remained Unchanged**	**Eased**	**Tightened**	**Remained Unchanged**	**Eased**
Bank's cost of funds & Balance sheet constraints	63%	38%	0%	43%	55%	3%
Constraints relating to Bank's capital position	23%	69%	8%	24%	74%	3%
Competition from other banks	7%	68%	24%	9%	81%	9%
Competition from Microfinance Banks, Saccos, & other Credit Providers	5%	88%	8%	2%	71%	27%
Expectations regarding general economic activity	27%	59%	15%	21%	62%	17%
Increase of Central Bank Rate (CBR)	27%	66%	7%	17%	79%	5%
Political Risk	10%	83%	7%	14%	83%	2%
KBRR	24%	66%	10%	5%	90%	5%

2.5 Non-Performing Loans (NPLs)

2.5.1 Observations

- Most banks expect the level of NPLs to remain unchanged in Q4 of 2015 in eight of the eleven economic sectors as depicted in **Chart 5** below.
- Though most of the banks expect level of NPLs to remain unchanged in Q4 of 2015, there was a significant increase in the number of respondents that foresee higher NPLs in the Personal/Household, Building and Construction, Manufacturing, Real Estate, Agriculture and Trade sectors. These were 32%, 21%, 21%, 17%, 13%, and 12% increase in the number of respondents respectively as compared to the quarter ended June 2015.
- Some respondents predicted that the increase of the Central Bank Rate and Kenya Banks Reference Rate as likely factors to increase the risk of financial distress going forward.
- This increase in NPLs in the Building and Construction, Manufacturing, Real Estate and Trade may be attribute to increased interest rates, volatile exchange rates, delayed contractor payments by the National and County Governments.
- Other respondents attribute increased NPLs in the Agriculture sector to adverse weather conditions as a result of the predicted El-nino rains which may affect expected yields.
- Other respondents envisioned that due to depreciating Kenya Shilling, importers will probably reduce their merchandise or raw materials importation resulting in reduction in profit which would lead to rise in NPLs.

Chart 5 and **Table 5** below indicate respondents' expectations on NPL trend in Q4 of 2015.

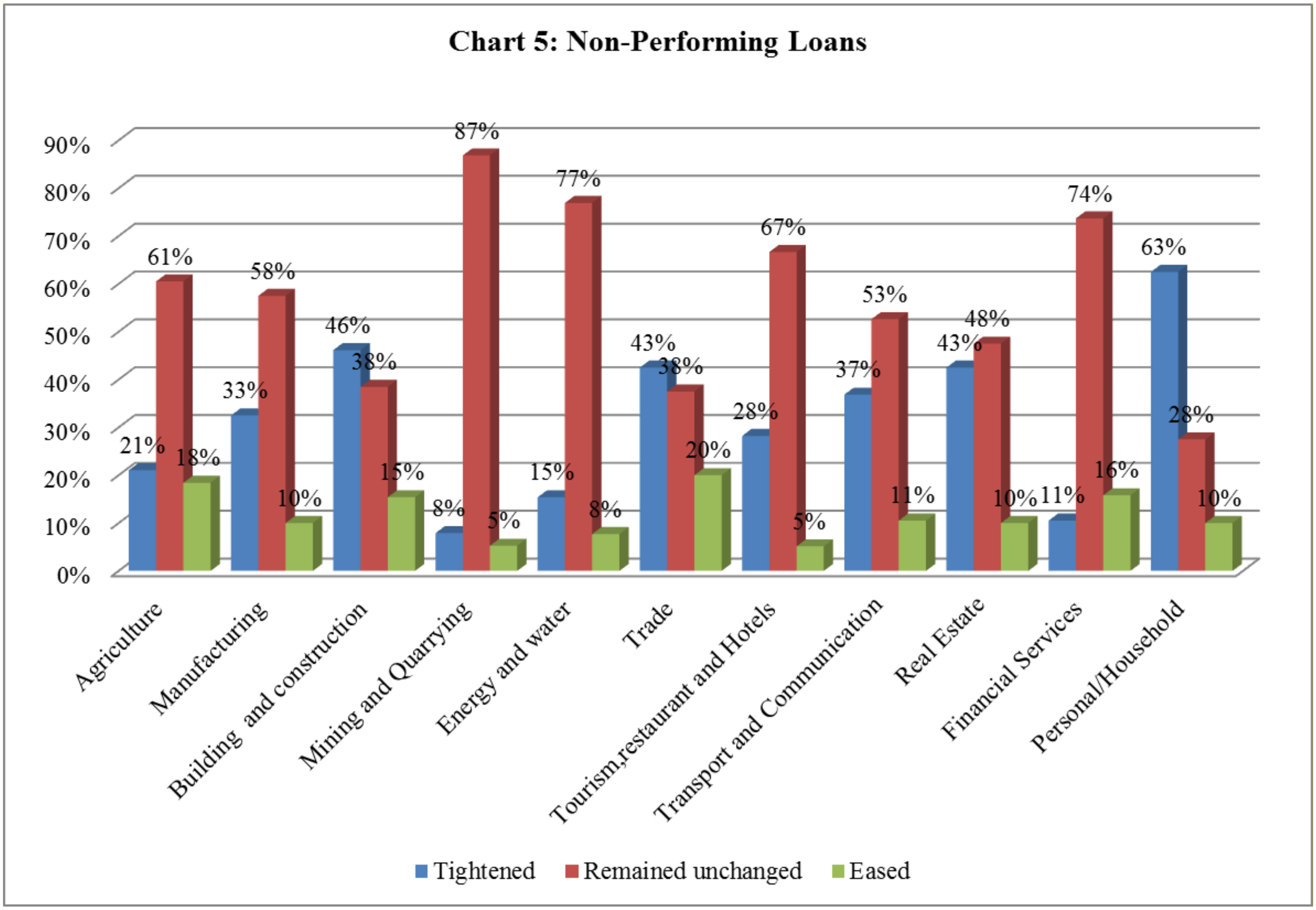

Table 5: Non Performing Loans Trend

	September 2015			June 2015		
	Rise	**Remained Constant**	**Fall**	**Rise**	**Remained Constant**	**Fall**
Agriculture	21%	61%	18%	8%	70%	23%
Manufacturing	33%	58%	10%	12%	60%	29%
Building & construction	46%	38%	15%	25%	55%	20%
Mining and Quarrying	8%	87%	5%	5%	88%	8%
Energy and water	15%	77%	8%	8%	86%	5%
Trade	43%	38%	20%	31%	50%	19%
Tourism, Restaurant & Hotels	28%	67%	5%	41%	30%	30%
Transport & Communication	37%	53%	11%	30%	50%	20%
Real Estate	43%	48%	10%	26%	52%	21%
Financial Services	11%	74%	16%	5%	78%	18%
Personal/Household	63%	28%	10%	31%	49%	20%

2.6 Credit Recovery Efforts

2.6.1 Observations

- For the quarter ending 31st December 2015, banks predict that credit recovery efforts will be intensified in seven of eleven sectors. The banks expect to intensify their credit recovery efforts in Building & Construction, Personal/Household, Trade, Real Estate, Transport and Communication Tourism and Manufacturing sectors. Credit recovery efforts towards Agriculture, Mining and Quarrying, Energy and Water and Financial Service sectors are expected to generally remain constant. This is depicted in Chart 6 below.
- Banks indicated that they intend to intensify credit recovery efforts so as to mitigate the likely increase in non-performing loans due to increase in interest rates and to improve their overall quality of asset portfolio.
- For sectors, such as Tourism and Agriculture which experience seasonal fluctuations of cash flows, banks intend to intensify recovery efforts so as to collect amounts due during the boom season.
- Some banks cited the growth in retail loan book portfolio as a trigger of intensified credit recovery efforts to counter any possible non-performing loans in the Personal/Household Sector. In this regard, some banks aim at intensifying monitoring of loan accounts through regular review of accounts and customer visits to enable banks detect early warning signs and address them.
- Compared to Q2 of 2015 Credit Survey, this survey indicates that banks intend to intensify their credit recovery efforts for Manufacturing, Building, Mining and Quarrying, Trade, Transport, Personal/Household and Real Estate sectors. This is majorly attributable to the increase in the interest rates charged by banks following the upward revision of the CBR and KBRR by the CBK. This is depicted in Table 6 below.

The responses on the expected credit recovery efforts by the banks during the quarter ending 30th June 2015 are depicted in **Chart 6** and **Table 6** below.

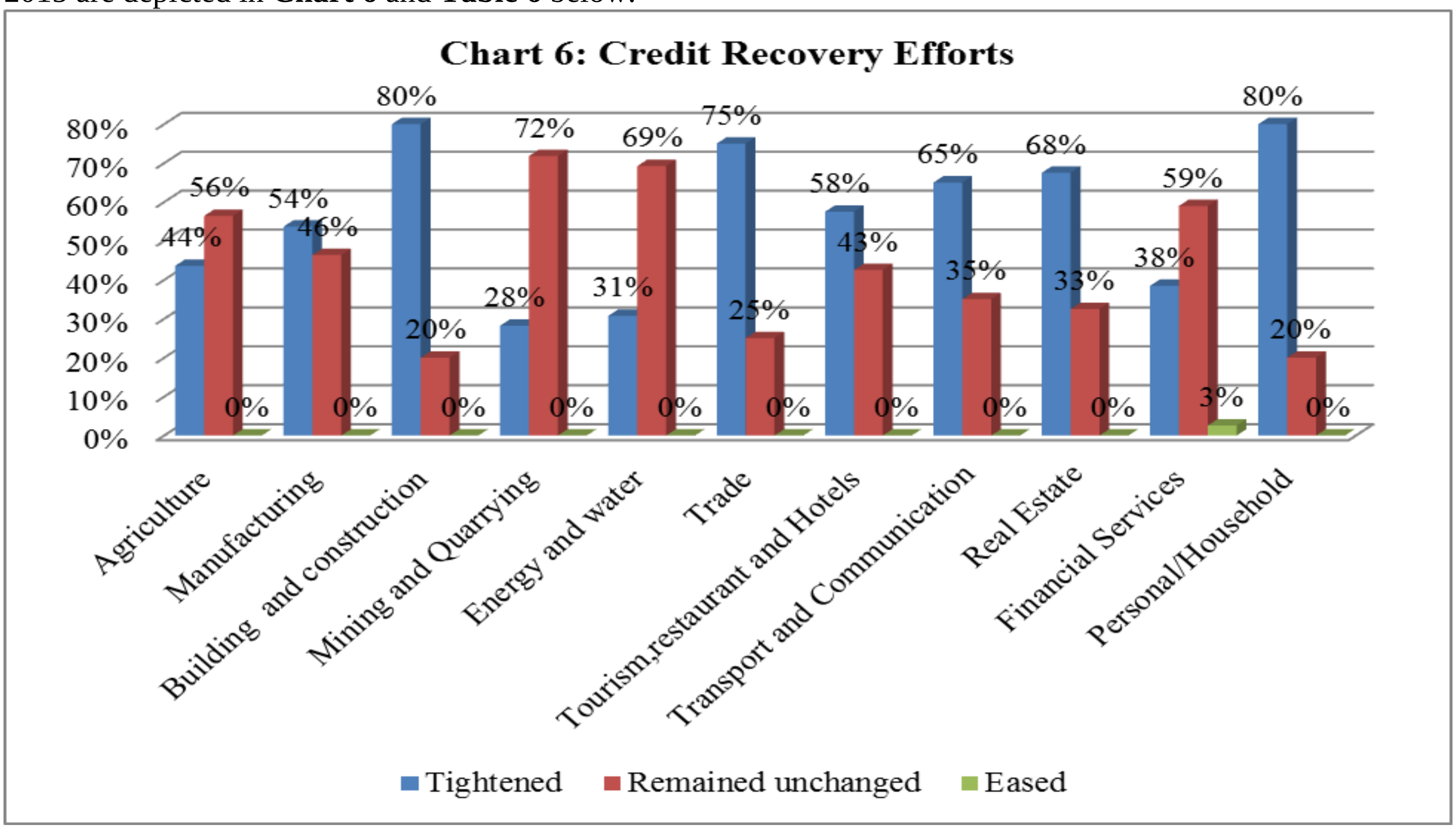

Table 6: Credit Recovery Efforts

	September 2015			June 2015		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	44%	56%	0%	44%	54%	2%
Manufacturing	54%	46%	0%	51%	47%	2%
Building & construction	80%	20%	0%	69%	29%	2%
Mining and Quarrying	28%	72%	0%	25%	75%	0%
Energy and water	31%	69%	0%	33%	64%	2%
Trade	75%	25%	0%	63%	34%	2%
Tourism, Restaurant & Hotels	58%	43%	0%	67%	33%	0%
Transport & Communication	65%	35%	0%	62%	38%	0%
Real Estate	68%	33%	0%	64%	36%	0%
Financial Services	38%	59%	3%	38%	63%	0%
Personal/Household	80%	20%	0%	74%	24%	2%

Annex I (List of 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. Ecobank Kenya Ltd.
16. Equatorial Commercial Bank Ltd.
17. Equity Bank Ltd.
18. Family Bank Ltd.
19. Fidelity Commercial Bank Ltd.
20. Guaranty Trust Bank (Kenya) Ltd.
21. First Community Bank Limited.
22. Giro Commercial Bank Ltd.
23. Guardian Bank Ltd.
24. Gulf African Bank Limited.
25. Habib Bank A.G Zurich.
26. Habib Bank Ltd.
27. I & M Bank Ltd.
28. Jamii Bora Bank Ltd.
29. Kenya Commercial Bank Ltd.
30. K-Rep Bank Ltd.
31. Middle East Bank (K) Ltd.
32. National Bank of Kenya Ltd.
33. NIC Bank Ltd.
34. Oriental Commercial Bank Ltd.
35. Paramount Universal Bank Ltd.
36. Prime Bank Ltd.
37. Standard Chartered Bank (K) Ltd.
38. Trans-National Bank Ltd.
39. Victoria Commercial Bank Ltd.
40. UBA Kenya Bank Ltd.
41. Housing Finance Ltd.