CENTRAL BANK OF KENYA

CREDIT OFFICER SURVEY

QUARTER ENDED MARCH 2014

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1.0 FOREWORD

1.1 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan banking sector recorded growth in the quarter ended 31st March 2014, compared to the fourth quarter to 31st December 2013. Some of the sector's performance indicators for the quarter were as follows:-

- The aggregate balance sheet (total assets) increased by 3.3% from Kshs 2.73 trillion in December 2013 to Kshs 2.82 trillion in March 2014.
- Gross loans and advances grew by 5.6% from Kshs 1.60 trillion in December 2013 to Kshs 1.69 trillion in March 2014.
- Banking sector deposits increased by 2.5% from Kshs 1.98 trillion in December 2013 to Kshs 2.03 trillion in March 2014.
- Total shareholders' funds increased by 5.11% from Kshs 431.49 billion in December 2013 to Kshs 453.61 billion in March 2014.
- Cumulative unaudited pre-tax profits for the quarter ended 31st March 2014 stood at Kshs 33.4 billion compared to Kshs 28.2 billion for the quarter ended 31st March 2013, an 18.4% increase.

1.2 CREDIT OFFICER SURVEY

Lending is the principal business activity for most banks and as a result credit risk is the single largest factor affecting the soundness of banks and the financial system as a whole. In the quarter ended 31st March 2014, the ratio of total loans to total assets for the Kenyan banking sector was 59.3%, a slight increase from 58.2% in the previous quarter. In order to identify potential shocks and enhance understanding of credit risk, the Central Bank of Kenya introduced a quarterly Credit Officer Survey in 2012.

For the quarter ended 31st March 2014, CBK received Credit Survey responses from all 43 institutions currently in operation. The list of the respondents is attached to this report as **Annex I**.

The key highlights of the March 2014 credit officer survey findings are:-

- Demand for credit generally increased in most economic sectors, with cheaper credit, retention of Central Bank Rate (CBR) at 8.5% and availability of investment opportunities being cited as the main driving factors.
- Credit standards remained substantially unchanged across all economic sectors in Q1 of 2014. However, the credit standards were tightened marginally for the Tourism sector while credit standards for the Trade sector were eased.
- NPLs are expected to remain constant in Q2 of 2014. However respondents foresee a slight increase in NPLs in the Agriculture, Tourism, Transport and Real Estate sectors with climatic conditions, insecurity and strict transport regulations cited as the driving factors.
- Most banks intend to intensify recovery efforts in six sectors (Agriculture, Building, Trade, Transport, Real Estate and Personal/Household sectors) to improve the overall quality of their asset portfolio while maintaining recovery efforts in the other five economic sectors.

CENTRAL BANK OF KENYA
APRIL 2014

2.0 EXECUTIVE SUMMARY

2.1 SURVEY METHODOLOGY

The credit officer survey for the quarter ended March 2014 comprised four questions that focused on:-

- Demand for credit.
- Credit standards.
- Non-performing loans.
- Credit recovery efforts.

The survey, conducted in March 2014, targeted senior credit officers of all 42 operational commercial banks and 1 mortgage finance company. Charterhouse Bank Ltd, which remains under statutory management, was excluded from the survey. All the forty three institutions responded.

2.2 KEY FINDINGS

The key findings from the survey are detailed below.

2.2.1 Demand for Credit

The demand for credit generally increased in most of the economic sectors in the quarter ended March 2014 compared to the quarter ended December 2013. The increased demand is mainly attributed to cheaper credit and availability of investment opportunities.

2.2.2 Credit Standards

Credit standards largely remained unchanged across most economic sectors in Q1 of 2014. However, the credit standards were tightened marginally for the Tourism sector while those for the Trade and Personal/Household sectors were eased.

2.2.3 Non-Performing Loans

Generally, the respondents expect NPLs to remain constant across all the eleven economic sectors. However, NPLs are expected to increase slightly in the Agriculture, Tourism and Real Estate sectors while the Energy and Water sectors are expected to experience a drop in NPLs.

2.2.4 Credit Recovery Efforts

In Q2 of 2014, most banks intend to intensify loan recovery efforts in six sectors namely the Agriculture, Building, Trade, Tourism, Transport and Personal/Household sectors while maintaining recovery efforts in the other five economic sectors.

3.0 DETAILED SURVEY FINDINGS

3.1 Demand for Credit

3.1.1 Observations

The Kenyan banking sector witnessed a general increase in demand for credit in the quarter ended 31st March 2014, continuing the trend observed in the quarter ended 31st December 2013. The highest growth in demand for credit was witnessed in the Building and Construction, Trade, and Personal/Household sectors with 60%, 69%, and 59% of the respondents citing growth.

However, marginal reduction in demand for credit was reported in three sectors; Energy and Water, Tourism and Real Estate. 71% of the respondents in the Mining sector indicated that the demand remained unchanged. This may be attributed to the wait and see attitude as investors await the outcome of the ongoing reforms in the Mining sector including enactment of the Mining Bill currently before Parliament.

Chart 1 and **Table 1** below present the trend in the demand for credit in the quarter ended March 2014 as compared to December 2013.

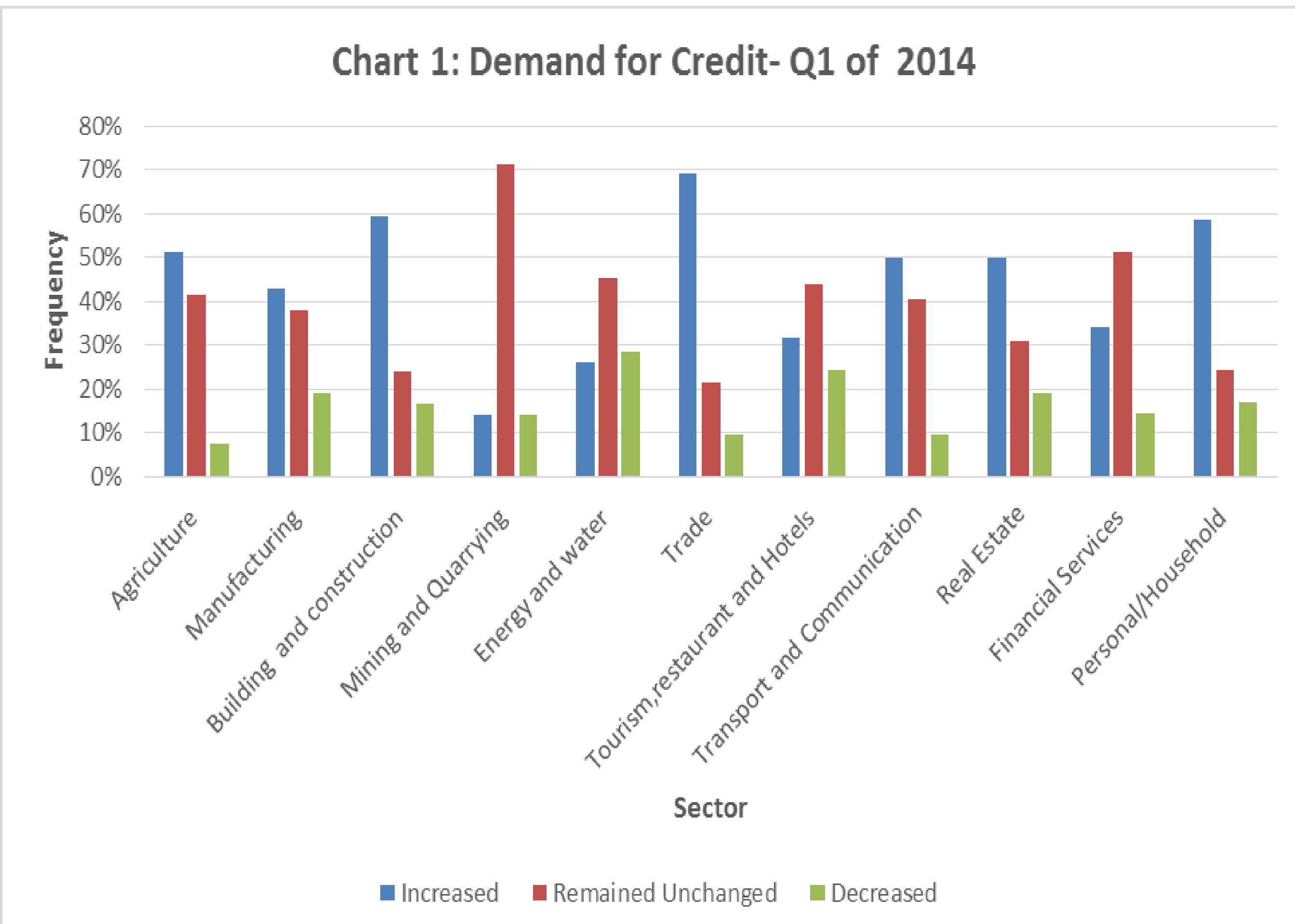

Table 1: Change in Demand for Credit

	March 2014			December 2013		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	51%	41%	7%	44%	44%	12%
Manufacturing	43%	38%	19%	48%	33%	19%
Building & Construction	60%	24%	17%	39%	39%	22%
Mining and Quarrying	14%	71%	14%	14%	64%	21%
Energy and Water	26%	45%	29%	30%	51%	19%
Trade	69%	21%	10%	60%	23%	16%
Tourism, Restaurant and Hotels	32%	44%	24%	39%	46%	15%
Transport and Communication	50%	40%	10%	53%	28%	19%
Real Estate	50%	31%	19%	51%	37%	12%
Financial Services	34%	51%	15%	30%	58%	13%
Personal/House-hold	59%	24%	17%	59%	15%	27%

3.2 Factors affecting demand for credit

3.2.1 Observations

- The three top factors cited as having led to general increase in demand for credit are lower cost of borrowing, increased investment opportunities and the retention of CBR at 8.5% in March 2014.
- 43% of the respondents attributed the rise in demand for credit reported in the quarter ended 31st March 2014 to increased availability of investment opportunities. 35% attributed it to lower cost of borrowing while 33% attributed it to retention of CBR.
- Respondents, who reported decreased credit demand attributed this to availability of alternative finance from other banks (37%), finance from non-banks (33%) and political risks (21%).
- The issuance of debt, internal financing and equity securities were cited by 83%, 81% and 73% of respondents respectively, as having had the least influence on the demand for credit during the quarter under review.

The responses on factors affecting demand for credit in Q1 of 2014 are presented in **Chart 2** and **Table 2** below.

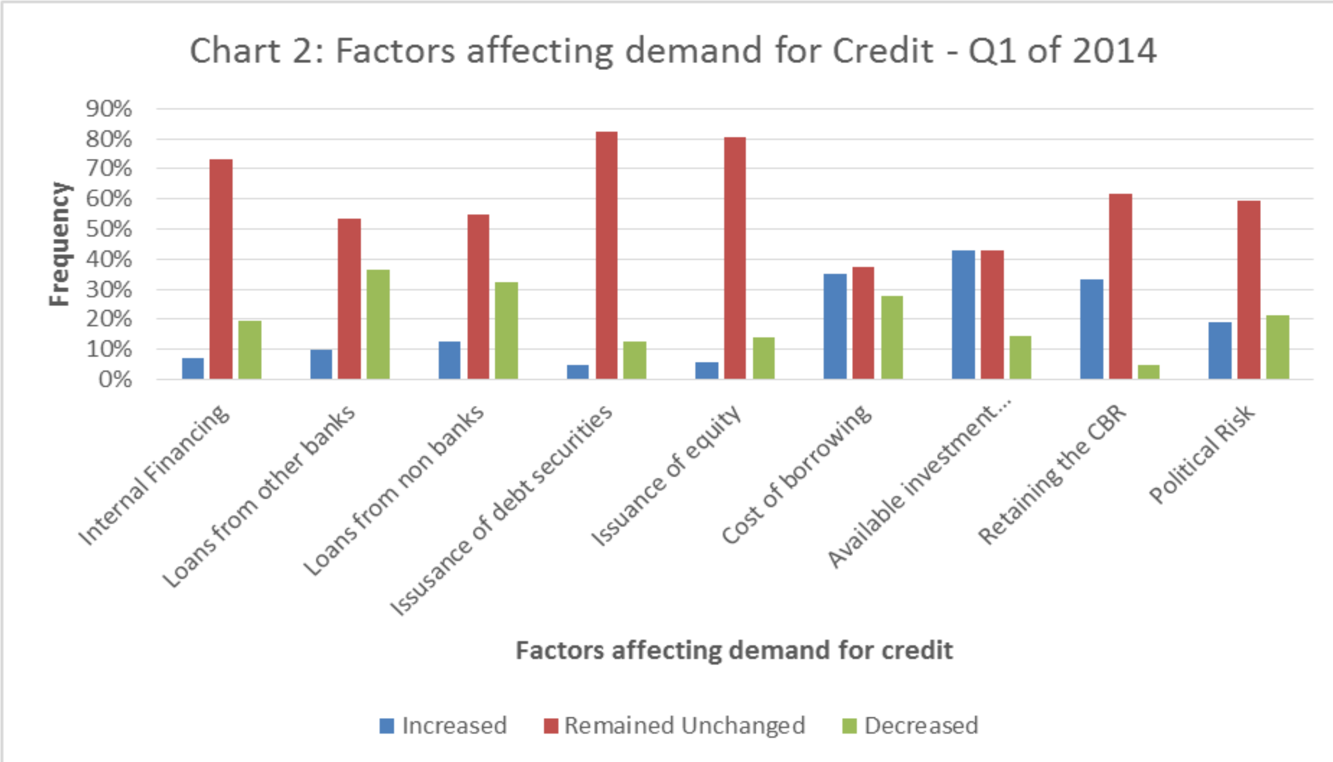

Table 2: Factors affecting Demand for credit

	March 2014			December 2013		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	7%	73%	20%	10%	68%	23%
Loans from other banks	10%	54%	37%	17%	62%	21%
Loans from non-banks	13%	55%	33%	7%	59%	34%
Issuance of debt securities	5%	83%	13%	7%	78%	15%
Issuance of equity	6%	81%	14%	10%	80%	10%
Cost of borrowing	35%	37%	28%	37%	37%	26%
Available investment opportunities	43%	43%	14%	49%	37%	14%
Retention of CBR	33%	62%	5%	37%	56%	7%
Political Risk	19%	60%	21%	30%	53%	16%

3.3 Credit Standards

3.3.1 Observations

- Feedback from the respondents indicate that credit standards remained substantially unchanged for all economic sectors over the three months to 31st March 2014.
- Access to credit was tightened for the Tourism sector by 27% of the respondents whereas access to credit had been eased for the Trade sector by 24% of the respondents.

These responses are presented in **Chart 3** and **Table 3** below:

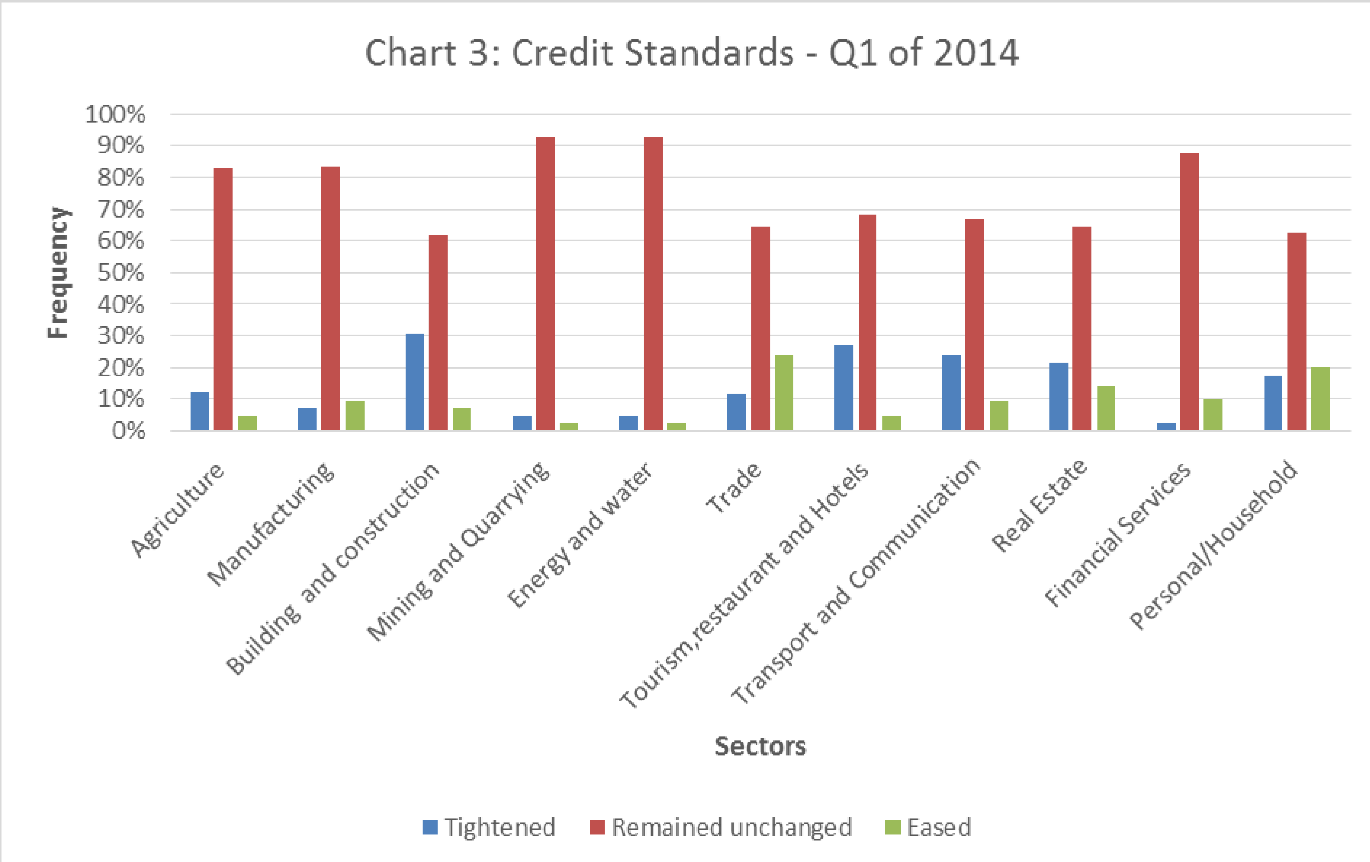

Table 3: Credit Standards

	March 2014			December 2013		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	12%	83%	5%	17%	71%	12%
Manufacturing	7%	83%	10%	5%	85%	10%
Building & Construction	31%	62%	7%	38%	57%	5%
Mining and Quarrying	5%	93%	2%	12%	86%	2%
Energy and Water	5%	93%	2%	12%	86%	2%
Trade	12%	64%	24%	17%	62%	21%
Tourism, Restaurant and Hotels	27%	68%	5%	10%	78%	12%
Transport and Communication	24%	67%	10%	34%	56%	10%
Real Estate	21%	64%	14%	23%	51%	26%
Financial Services	3%	88%	10%	7%	83%	10%
Personal/Household	18%	63%	20%	29%	46%	24%

3.4 Factors affecting credit standards

3.4.1 Observations

- In the quarter ended 31st March 2014, most of the factors expected to affect credit standards had little impact. This supports the finding that credit standards to all economic sectors generally remained unchanged in the quarter.
- Varied expectations on the trend of economic activity resulted in 31% of the banks easing their credit standards while another 14% tightening their credit standards.
- 35% of the banks tightened their credit standards due to cost of funds and balance sheet constraints whereas 37% of the banks eased their credit standards due to competition from other banks.

A comparison of the trend in the factors affecting the banks' credit standards are shown in **Chart 4** and **Table 4** below.

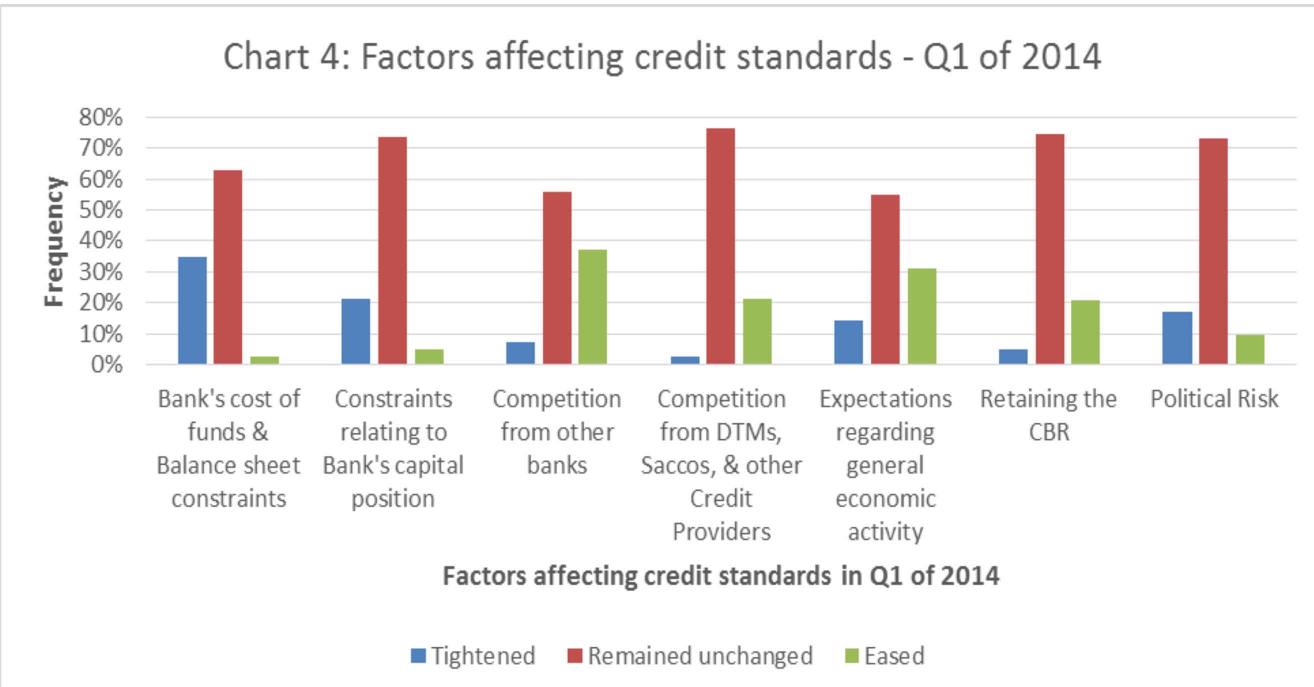

Table 4: Impact of factors affecting credit standards

	March 2014			December 2013		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds & Balance sheet constraints	35%	63%	2%	34%	61%	5%
Constraints relating to Bank's capital position	21%	74%	5%	23%	74%	2%
Competition from other banks	7%	56%	37%	9%	56%	35%
Competition from DTMs, Saccos, & other Credit Providers	2%	76%	21%	2%	74%	23%

	March 2014			December 2013		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Expectations regarding general economic activity	14%	55%	31%	9%	63%	28%
Retention of Central Bank Rate (CBR)	5%	74%	21%	7%	70%	23%
Political Risk	17%	73%	10%	21%	67%	12%

3.5 Non-Performing Loans (NPLs)

3.5.1 Observations

- Generally, all banks expect NPLs to remain constant in Q2 of 2014. However, respondents foresee a slight increase in NPLs in the Agriculture, Tourism and Real Estate sectors while the Energy and Water sectors are expected to experience a drop in NPLs.
- The expected increase of NPLs in the Agriculture sector may be explained by reduction in tea prices arising from over production and glut in the market, and the prevailing delayed onset of long rains (March – May 2014), which may result in food shortage. The current spate of insecurity in the country may be attributed to expected increase in NPLs in the Tourism sector while the high interest rates is expected to impact negatively on real estate sector.
- The drop in NPLs in the Energy and Water sector may be attributed to the Government's efforts in boosting its power sector and reduction of cost of electricity through the production of electricity using geothermal steam which is cheaper thus resulting in a sharp reduction in the cost of electricity. Though there is a drop in the number of banks expecting NPLs in the Personal /Household sector to increase, 34% of the respondents still expect an increase as compared to 22% who expect a drop in NPLs in the sector.
- The forecasted constant NPLs across all economic sectors is consistent with the banks indication that they will not be changing their credit standards to most of the economic sectors.

Chart 5 and **Table 5** below indicate respondents' expectations on NPL trend in Q2 of 2014.

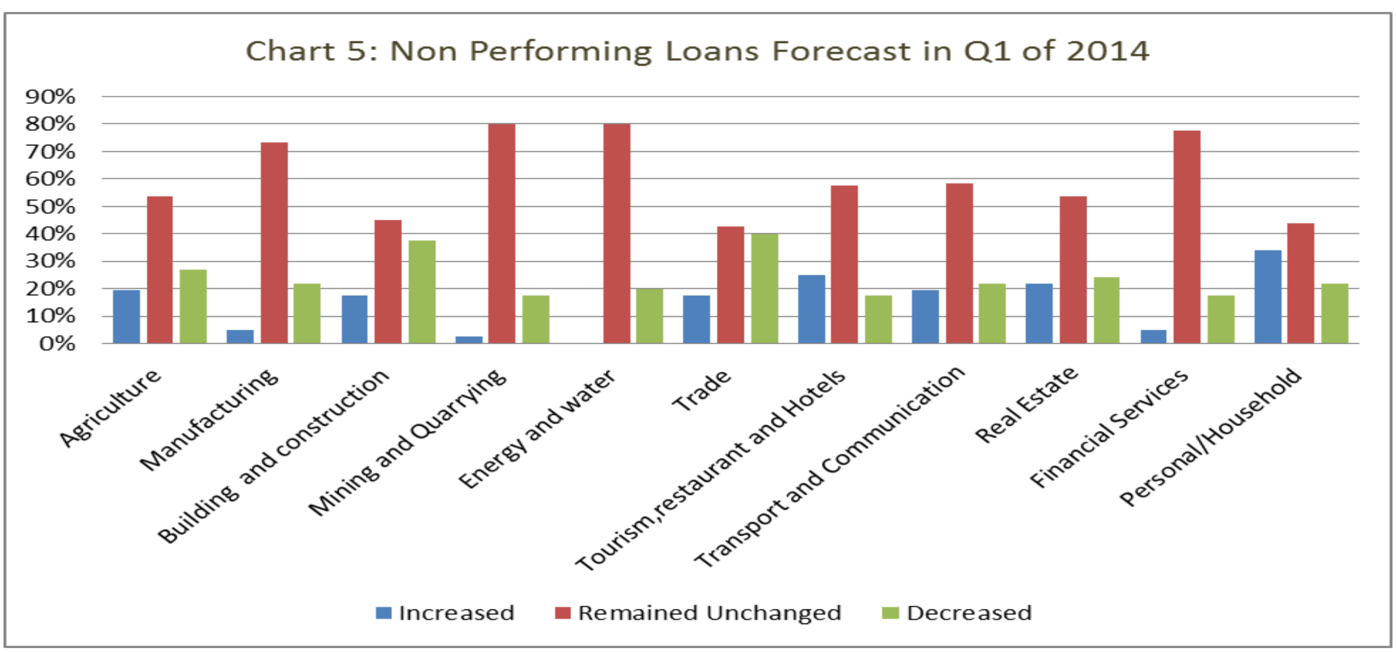

Table 5: Non Performing Loans Trend

	March 2014			December 2013		
	Rise	Remained Constant	Fall	Rise	Remained Constant	Fall
Agriculture	20%	54%	27%	10%	63%	27%
Manufacturing	5%	73%	22%	7%	68%	24%
Building & construction	18%	45%	38%	15%	48%	38%
Mining and Quarrying	3%	80%	18%	3%	83%	15%
Energy and water	0%	80%	20%	8%	78%	15%
Trade	18%	43%	40%	18%	43%	40%
Tourism, Restaurant & Hotels	25%	58%	18%	15%	48%	38%
Transport & Communication	20%	59%	22%	25%	43%	33%
Real Estate	22%	54%	24%	10%	58%	33%
Financial Services	5%	78%	18%	3%	73%	25%
Personal/Household	34%	44%	22%	44%	33%	23%

3.6 Credit Recovery Efforts

3.6.1 Observations

- In the quarter ending 31st March 2014, banks intend to intensify recovery efforts in six sectors (Agriculture, Building, Trade, Transport, Real Estate and Personal/Household sectors) to improve the overall quality of their asset portfolio.
- The Trade and Personal/Household sectors are expected to witness the greatest recovery efforts in Q2 of 2014, with 68% and 61% of respondents respectively, predicting a step-up of efforts in this regard. This is followed by the Building, Transport, Agriculture and Real Estate sectors as indicated by 58%, 56%, 54% and 52% of the respondents respectively.
- The intensified recovery efforts in the Agriculture, Tourism and Real Estate sectors are in line with the banks expectations that loan defaults in these sectors will rise during the quarter.
- Banks cite forecasted low rains and new transport regulations for the banks expectation to intensify recovery in the Agriculture and Transport sectors.

The responses on the expected credit recovery efforts by the banks during the quarter ending 31st March 2014 are depicted in **Chart 6** and **Table 6** below.

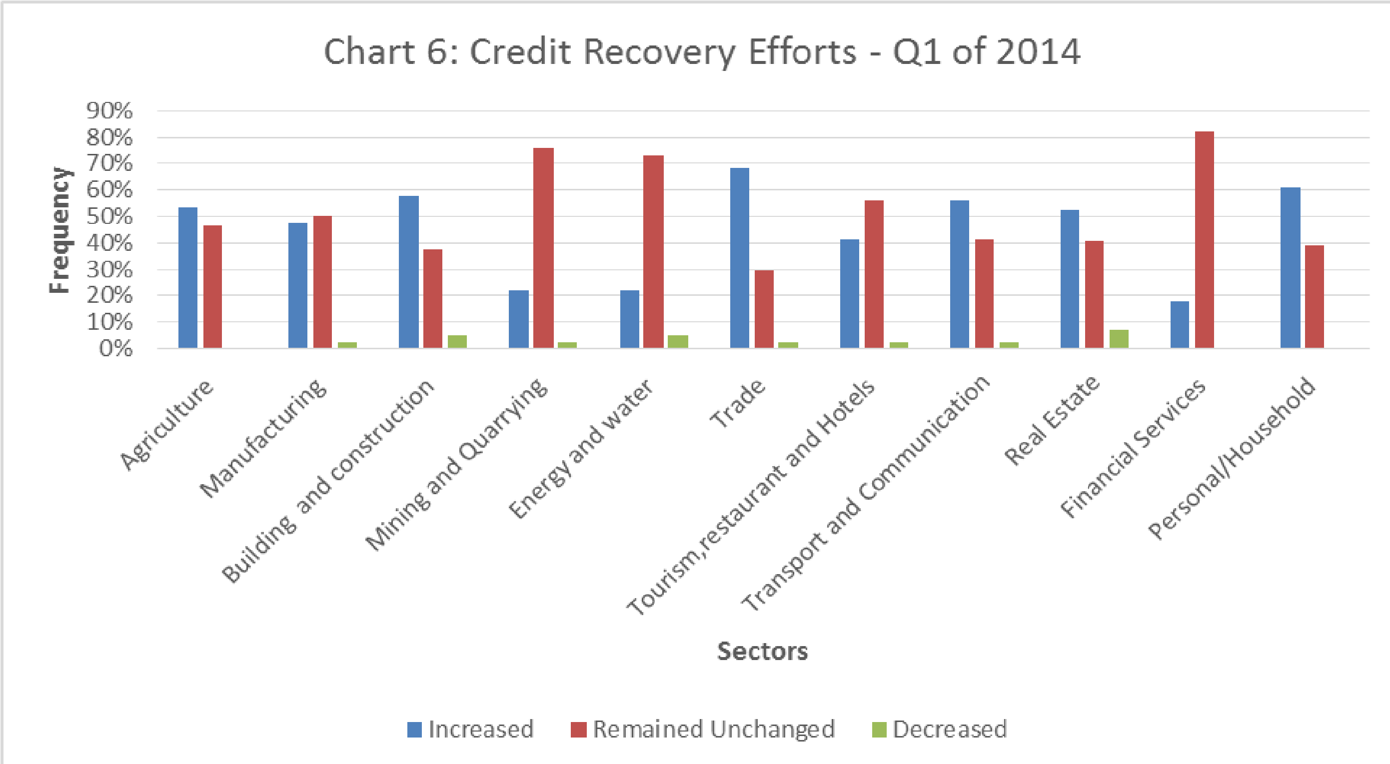

Table 6: Credit Recovery Efforts

	March 2014			December 2013		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	54%	46%	0%	51%	44%	5%
Manufacturing	48%	50%	2%	45%	52%	2%
Building & construction	58%	38%	5%	54%	44%	2%
Mining and Quarrying	22%	76%	2%	29%	71%	0%
Energy and water	22%	73%	5%	37%	61%	2%
Trade	68%	29%	2%	61%	37%	2%
Tourism, Restaurant & Hotels	41%	56%	2%	41%	54%	5%
Transport & Communication	56%	41%	2%	66%	29%	5%
Real Estate	52%	40%	7%	43%	55%	2%
Financial Services	18%	82%	0%	35%	60%	5%
Personal/Household	61%	39%	0%	68%	27%	5%

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. 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.