Central Bank of Kenya

Credit Officer Survey

December 31, 2021

CENTRAL BANK OF KENYA COMMERCIAL BANKS' CREDIT OFFICER SURVEY FOR THE THE QUARTER ENDED DECEMBER 31, 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 slightly from 54.85 percent in the quarter ended September 30, 2021, to 54.07 percent in the quarter ended December 31, 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[1] complete most of the survey and collate inputs from senior officers responsible for the other aspects. For the quarter ended December 31, 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 concerning liquidity in the banks. The banks were required to state their appetite for the deployment of liquidity towards an 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 also 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 and liquidity 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 December 31, 2021, compared to the quarter ended September 30, 2021. Some of the sector's performance indicators are as follows: -

- The aggregate balance sheet increased by 3.2 percent to Ksh.6,008.0 billion in December 2021, from Ksh.5,822.1 billion in September 2021.

- Gross loans increased by 1.7 percent from Ksh. 3,193.3 billion in September 2021, to Ksh. 3,248.7 billion in December 2021. The growth in gross loans was mainly due to increased advances in the Trade, and Personal and Household sectors.

- Total deposits increased by 2.2 percent from Ksh.4,345.7 billion in September 2021, to Ksh. 4,441.9 billion in December 2021.

- The asset quality, measured by gross non-performing loans to gross loans ratio improved from 13.6 percent in September 2021, to 13.1 percent in December 2021. This was attributed to a 2.0 percent decrease in non-performing loans and a 1.7 percent increase in gross loans.

- The total capital adequacy ratio increased from 18.8 percent in September 2021, to 19.6 percent in December 2021. This is as a result of an increase in total capital (6.7 percent) compared to a lower increase in total risk-weighted assets (2.3 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.0.2 billion from Ksh.49.1 billion in September 2021, to Ksh.49.3 billion in December 2021. This was as a result of a higher increase in quarterly income by Ksh.9.3 billion (5.9 percent) compared to a higher increase in quarterly expenses by Ksh.9.1 billion (8.4 percent). Return on Assets remained unchanged at 2.6 percent in December 2021, as was in September 2021.

- Return on Equity decreased from 22.0 percent in September 2021, to 21.6 percent in December 2021. This is a result of a lower increase in quarterly profits before tax (0.4 percent) compared to the increase in total shareholders' funds (2.3 percent).

- Liquidity in the banking sector decreased slightly from 56.7 percent in September 2021, to 56.2 percent in December 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 fourth quarter of 2021, the perceived demand for credit remained unchanged in eight economic sectors and increased in three sectors (Trade, Personal and Household and Manufacturing).
- **Credit Standards[2]:** In the fourth quarter of 2021, credit standards remained unchanged in nine economic sectors and were tightened in two sectors (Tourism and Real Estate). Tightening of credit standards in the two sectors is attributed to the adverse 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:** 44 percent of the respondents indicated that NPLs are likely to fall in the first quarter of 2022. This is attributed to enhanced recovery efforts being implemented by most banks. 41 percent of respondents expect NPLs to remain constant. 15 percent of the respondents expect the level of NPLs to rise in the first quarter of 2022, as a result of the continued COVID-19 pandemic.
- **Non-Performing Loans per sector:** Respondents indicated that the level of NPLs is expected to remain constant in nine economic sectors during the next quarter. In Trade sector, respondents indicated that the level of NPLs is expected to fall.
- **Credit Recovery Efforts:** For the quarter ended March 31, 2022, banks expect to intensify their credit recovery efforts in nine economic sectors and in two sectors, Mining and Quarrying, and Energy and Water, the recovery efforts will not change. The intensified recovery efforts are aimed at improving the overall quality of the asset portfolio.
- **Implementation of International Financial Reporting Standard (IFRS) 9 on Financial Instruments:** In the fourth quarter of 2021, majority of the banks had implemented IFRS 9 and had assessed the impact of the same on their financial performance and position. Banks indicated that implementation of IFRS 9 had a negative impact on banks' capital adequacy requirement due to increased provisioning. Banks are continuously improving their business models to incorporate forward-looking credit risk assessment models in compliance with IFRS 9 requirements.
- **International Financial Reporting Standard (IFRS) 16 on Leases:** In the fourth quarter of 2021, majority of the banks had implemented IFRS 16 (97 percent), and had assessed the impact of IFRS 16 (92 percent) on their financial performance and position. The banks indicated that implementation of IFRS 16 increased their risk weighted assets, which in turn decreased their capital adequacy ratios.
- **Liquidity risk:** During the quarter ended December 2021, 77 percent of the respondents indicated that their liquidity position had improved.
- Banks intend to deploy the additional towards lending to the private sector (28 percent), investing in Treasury Bonds (23 percent), investing in Treasury Bills (20 percent), interbank lending (17 percent), CBK liquidity management through repos (7 percent), and increase their cash holdings (5 percent).

2.0 SURVEY FINDINGS

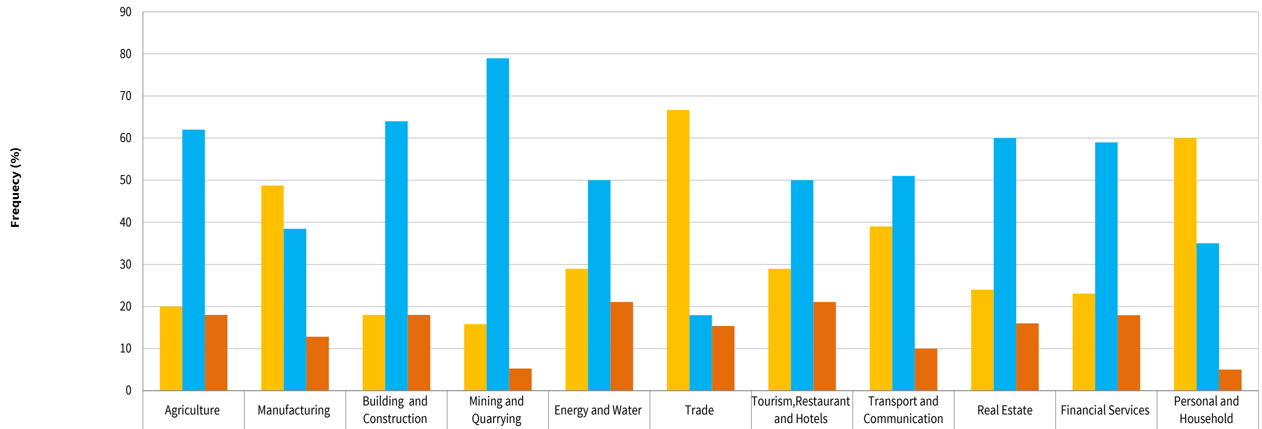
2.1 Demand for Credit

- In the fourth quarter of 2021, the perceived demand for credit remained unchanged in eight economic sectors and increased in three sectors. The same responses were reported in the quarter ended September 30, 2021.
- Perceived demand for credit increased in Trade, Personal and Household and Manufacturing sectors. This is attributed to the ongoing re-opening of economic activities.
- The main sectors with unchanged demand for credit are Mining and Quarrying, Building and Construction, Agriculture and Real Estate.
- **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 (%)	September 2021			December 2021		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	21	63	16	20	62	18
Manufacturing	50	39	11	49	38	13
Building and Construction	22	62	16	18	64	18
Mining and Quarrying	11	81	8	16	79	5
Energy and Water	19	73	8	29	50	21
Trade	55	29	16	67	18	15
Tourism, Restaurant and Hotels	17	61	22	29	50	21
Transport and Communication	32	55	13	39	51	10
Real Estate	38	57	5	24	60	16
Financial Services	26	63	11	23	59	18
Personal and Household	54	35	11	60	35	5

Chart 1: Demand for Credit

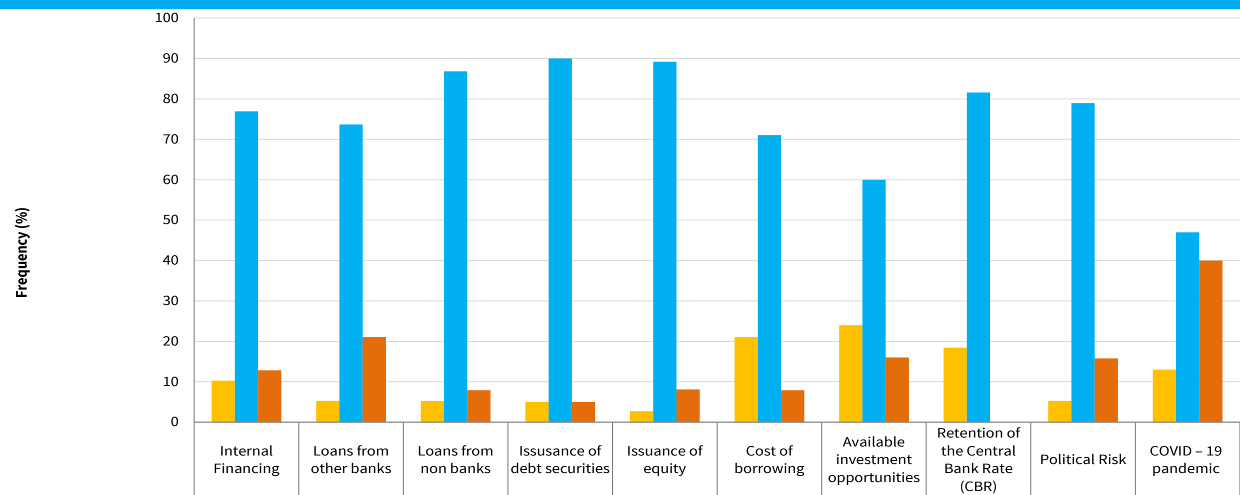


	Agriculture	Manufacturing	Building and Construction	Mining and Quarrying	Energy and Water	Trade	Tourism,Restaurant and Hotels	Transport and Communication	Real Estate	Financial Services	Personal and Household
Increased(%)	20	49	18	16	29	67	29	39	24	23	60
Remained Unchanged (%)	62	38	64	79	50	18	50	51	60	59	35
Decreased (%)	18	13	18	5	21	15	21	10	16	18	5

2.2 Factors Affecting Demand for Credit

- In the quarter ended December 31, 2021, all the ten factors affecting demand for credit had no significant impact. This is depicted in **Chart 2** and **Table 2**.
- Issuance of debt securities, Issuance of equity, loans from non-banks and retention of the Central Bank rate were cited as having had the least impact on the demand for credit during the quarter under review. These were reported by 90 percent, 89 percent, 87 percent and 82 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	COVID – 19 pandemic
Increased (%)	10	5	5	5	3	21	24	18	5	13
Remained Unchanged (%)	77	74	87	90	89	71	60	82	79	47
Decreased (%)	13	21	8	5	8	8	16	0	16	40

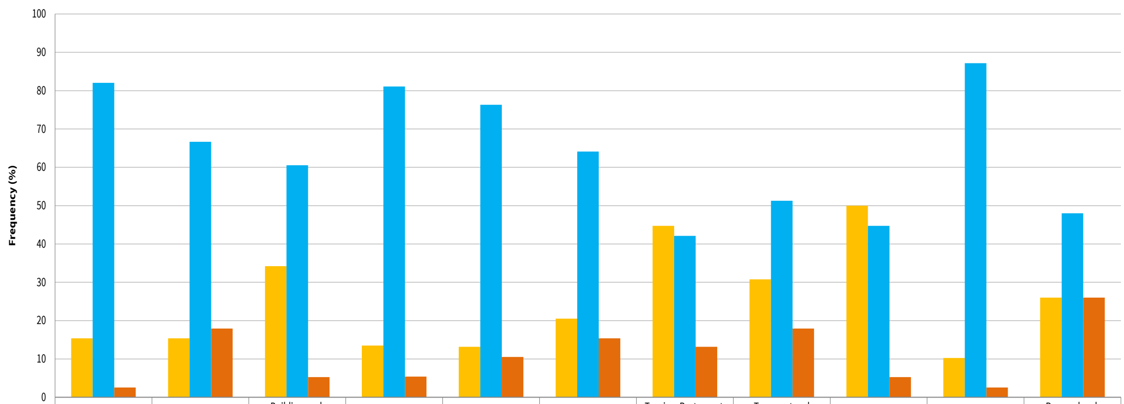
Table 2: Factors Affecting Demand for Credit

Percentage (%)	September 2021			December 2021		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	3	87	11	10	77	13
Loans from other banks	5	77	18	5	74	21
Loans from non-banks	3	85	13	5	87	8
Issuance of debt securities	3	92	5	5	90	5
Issuance of equity	3	92	6	3	89	8
Cost of borrowing	18	72	10	21	71	8
Available investment opportunities	22	70	8	24	60	16
Reduction of the Central Bank Rate (CBR)	18	82	0	18	82	0
Political Risk	8	82	11	5	79	16
COVID – 19 pandemic	8	23	69	13	47	40

2.2 Credit Standards

- In the fourth quarter of 2021, credit standards remained unchanged in nine economic sectors and were tightened in two sectors (Tourism and Real Estate).
- 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



	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
Tightened (%)	15	15	34	14	13	21	45	31	50	10	26
Remained Unchanged (%)	82	67	61	81	76	64	42	51	45	87	48
Eased (%)	3	18	5	5	11	15	13	18	5	3	26

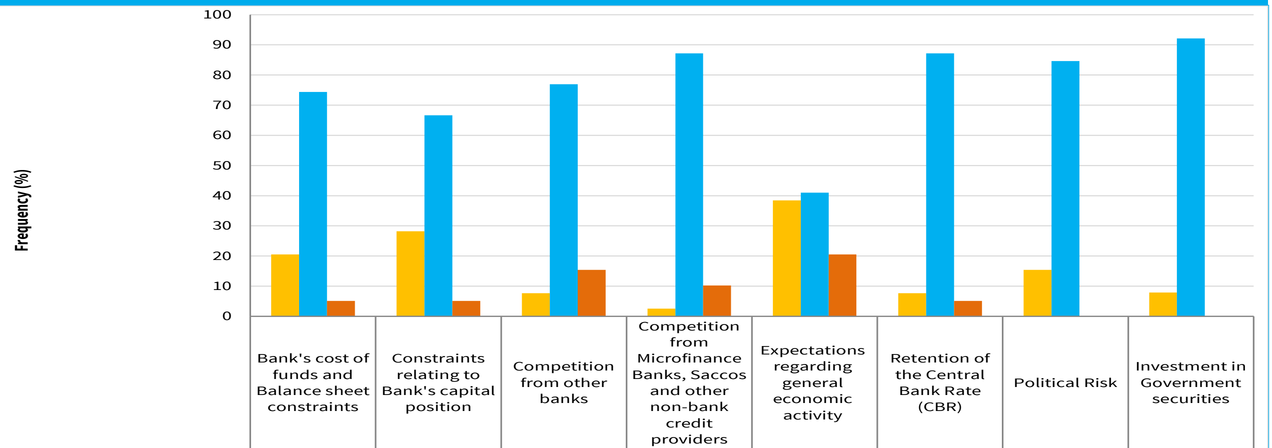
Table 3: Credit Standards for Loans to Various Economic Sectors

Percentage (%)	September 2021			December 2021		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	16	84	0	15	82	3
Manufacturing	13	71	16	15	67	18
Building and Construction	32	65	3	34	61	5
Mining and Quarrying	8	84	8	14	81	5
Energy and Water	16	78	5	13	76	11
Trade	21	58	21	21	64	15
Tourism, Restaurant and Hotels	47	39	13	45	42	13
Transport and Communication	30	65	5	31	51	18
Real Estate	54	41	5	50	45	5
Financial Services	10	87	3	10	87	3
Personal and Household	39	39	21	26	48	26

2.4 Factors Influencing Credit Standards

- In the quarter ended December 31, 2021, all eight factors had little impact on credit standards.
- Investment in Government Securities, Retention of the Central Bank Rate (CBR), Competition from Saccos, Microfinance banks, and other Credit Providers, and Political risk are the main factors that had no impact on credit standards. These were reported by 92 percent, 87 percent, 87 percent and 85 percent of the respondents respectively.
- 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 Microfinance Banks, Saccos and other non-bank credit providers	Expectations regarding general economic activity	Retention of the Central Bank Rate (CBR)	Political Risk	Investment in Government securities
Tightened (%)	21	28	8	3	38	8	15	8
Remained unchanged (%)	74	67	77	87	41	87	85	92
Eased (%)	5	5	15	10	21	5	0	0

Table 4: Factors affecting credit standards

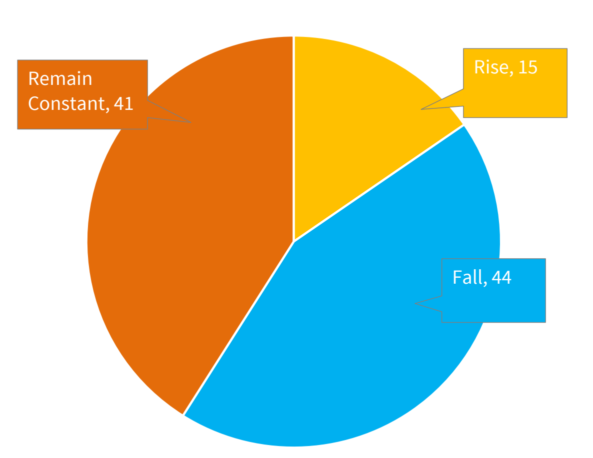
	September 2021			December 2021		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds and Balance sheet constraints	16	76	8	21	74	5
Constraints relating to Bank's capital position	26	66	8	28	67	5
Competition from other banks	8	82	11	8	77	15
Competition from DTMs, Saccos, and other Credit Providers	5	89	5	3	87	10
Expectations regarding general economic activity	45	34	21	38	41	21
Reduction of the Central Bank Rate (CBR)	5	90	5	8	87	5
Political Risk	0	97	3	15	85	0
Investment in Government Securities	3	95	3	8	92	0

2.5. Non-Performing Loans (NPLs)

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

- 44 percent of the respondents indicated that NPLs are likely to fall in the first quarter of 2022. This is attributed to enhanced recovery efforts being implemented by most banks.
- 15 percent of the respondents expect the level of NPLs to rise in the first quarter of 2022, as a result of the continued COVID-19 pandemic.
- 41 percent of respondents expect NPLs to remain constant. This is depicted in Chart 5.

Chart 5: Expected movements of NPLs in the next Quarter (%)



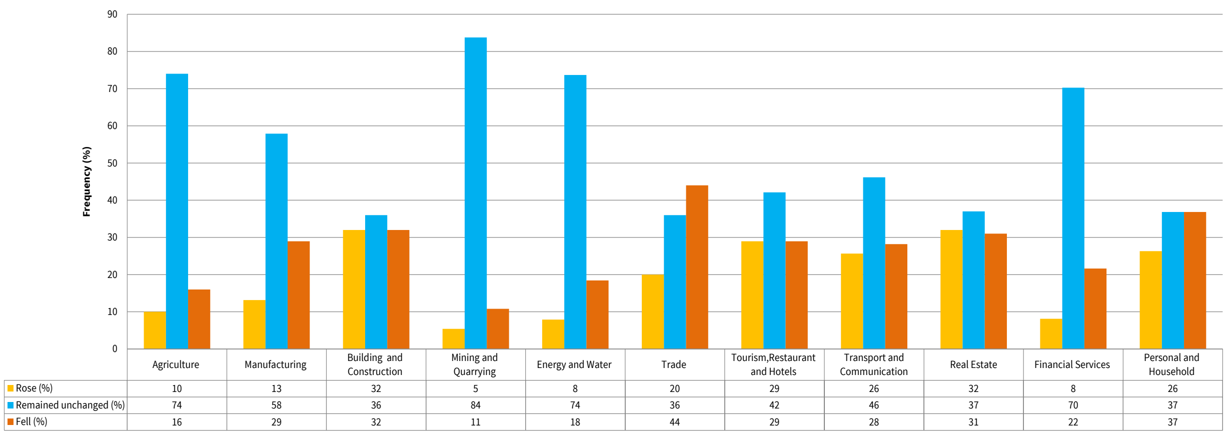
2.5.2 Expected Non-Performing Loans per sector during the next Quarter

- Respondents indicated that the level of NPLs is expected to remain constant in nine economic sectors during the next quarter.
- Respondents indicated that NPLs in the Trade, and Personal and Household sectors are expected to fall in quarter one of 2022, due to continued recovery of the economy.
- **Table 5** and **Chart 6** depicts this.

Table 5: Non-Performing Loans Trend Per Economic Sector

	September 2021			December 2021		
Percentage (%)	Rose	Remained Unchanged	Fell	Rose	Remained Unchanged	Fell
Agriculture	13	74	13	10	74	15
Manufacturing	16	57	27	13	58	29
Building and Construction	27	43	30	32	36	32
Mining and Quarrying	6	86	8	5	84	11
Energy and Water	8	78	14	8	74	18
Trade	32	34	34	20	36	44
Tourism, Restaurant and Hotels	32	43	24	29	42	29
Transport and Communication	29	47	24	26	46	28
Real Estate	32	42	26	32	37	31
Financial Services	11	64	25	8	70	22
Personal and Household	37	39	24	26	37	37

Chart 6: Non-Performing Loans



2.6 Credit Recovery Efforts in the Fourth Quarter of 2021

- For the quarter ended March 31, 2022, banks expect to intensify their credit recovery efforts in nine economic sectors and remain constant in two sectors namely Mining and Quarrying and Energy and Water. 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: -

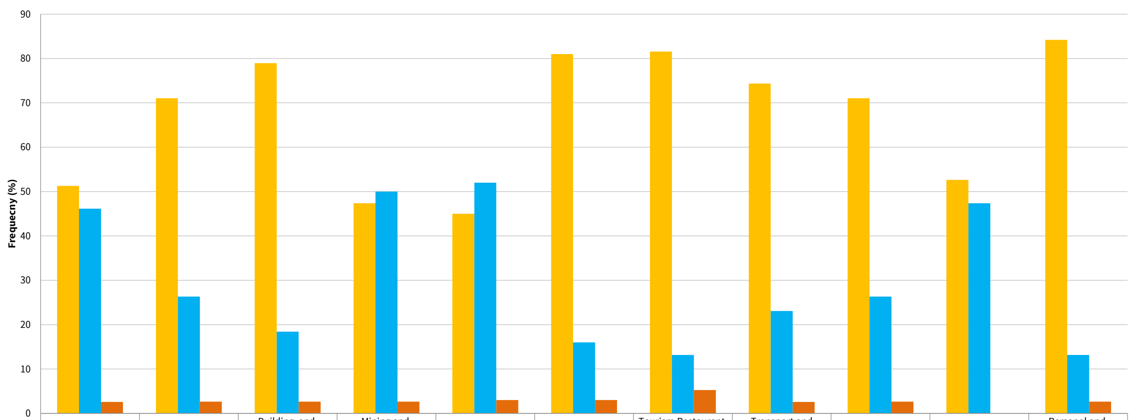
i. Personal and Household (84 percent).
ii. Trade (81 percent).
iii. Tourism, Restaurant and Hotels (82 percent).
iv. Building and Construction (79 percent).
v. Transport and Communication (74 percent).

- The responses on the expected credit recovery efforts by the banks are depicted in **Chart 7** and **Table 6**.

Table 6: Credit Recovery Efforts

	September 2021			December 2021		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	61	37	3	51	46	3
Manufacturing	78	19	3	71	26	3
Building and Construction	81	16	3	79	18	3
Mining and Quarrying	51	46	3	47	50	3
Energy and Water	51	46	3	45	52	3
Trade	87	11	3	81	16	3
Tourism, Restaurant and Hotels	76	21	3	82	13	5
Transport and Communication	74	24	3	74	23	3
Real Estate	79	18	3	71	26	3
Financial Services	54	46	0	53	47	0
Personal and Household	86	11	3	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
Intensify (%)	51	71	79	47	45	81	82	74	71	53	84
Remain constant (%)	46	26	18	50	52	16	13	23	26	47	13
Ease (%)	3	3	3	3	3	3	5	3	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 that banks still experience 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 and if they are more reliable.

2.7.1 Challenges experienced in the Implementation of IFRS 9

- A majority of the banks have implemented IFRS 9 and assessed its impact thereon. Some of the challenges faced by the banks include:-
  - i. Negative impact on capital adequacy due to increased provisioning.
  - ii. IFRS 9 introduced volatility in month on month impairment forecasting and actuals because of consideration of expected future loss as opposed to actual loss.
  - iii. Estimation of future looking Macroeconomic overlays is especially challenging in a pandemic environment.
  - iv. Incorporating reliable macro-economic factors in the model is challenging in an uncertain economy.
  - v. Cost implication for the relevant technology, consultants and personnel training.
  - vi. Incorporating an effective interest rate in the model is difficult as it is cumbersome to implement without automation.

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).

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

- Banks have implemented the following mitigation measures: -

  i. Continuous review and improvement of business models.
  ii. Injected additional capital to accommodate the expected rise in credit losses.
  iii. Revamped loans recovery mechanisms to enhance portfolio performance.
  iv. Developed internal rating models to assess credit risks across all sectors including for SMEs. Banks have therefore introduced unsecured credit products for SMEs.
  v. Automation of the models to minimize errors and gaps in implementation.
  vi. Banks have engaged consultants to validate the assumptions to ensure that they are reliable.
  vii. Banks have revamped their credit recovery efforts and have adopted a tight credit risk appraisal, ensuring that facilities are well secured and that alternative sources of repayment are available.

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

- Some of the respondents have not made any changes on the assumptions used in IFRS 9. However, for those that have made changes to their assumptions, have reported that: -

  i. Changes have been made in their credit risk scoring when assessing credit requests.
  ii. They are now factoring micro and macroeconomic assumptions in the credit assessment.
  iii. They have updated the segmentation of the loan book to incorporate aspects of the on-going COVID-19 pandemic. Loan segmentation has moved away from the size of the loans and is now based on the industry of the customer.
  iv. The impact of COVID-19 in the loan book prompted changes to assumptions regarding the treatment of significant changes in credit risk in the portfolio, changes to expected period of recovery impacting the bank's Loss Given Default determination, and changes to macro-economic factors impacting the forward-looking information.

  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.

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

- Commercial banks have made deliberate efforts in ensuring that the assumptions used in IFRS 9 are reliable. These actions include the following: -

  i. Continuous review of the effectiveness of assumptions made in light of industry related changes being witnessed locally and globally.
  ii. Engagement with peers across the industry both locally and globally, with a view of benchmarking against best practices.
  iii. Banks through external consultants continue to monitor and review the macroeconomic factors against the model assumptions and how best the assumptions are applicable to the current scenario. unsecured credit products for SMEs.
  iv. Use of long-term macroeconomic forecasts.

v. Collective assessment of the significant increase of credit risk.

vi. Engagements with external IFRS 9 consultants to continuously review the assumptions to ensure that they are still relevant and reliable even with COVID-19 effects.

vii. Ensuring that all risk components used in the measurement of expected credit losses (ECL) reflect the current economic conditions and credit risk behavior of customers in the bank.

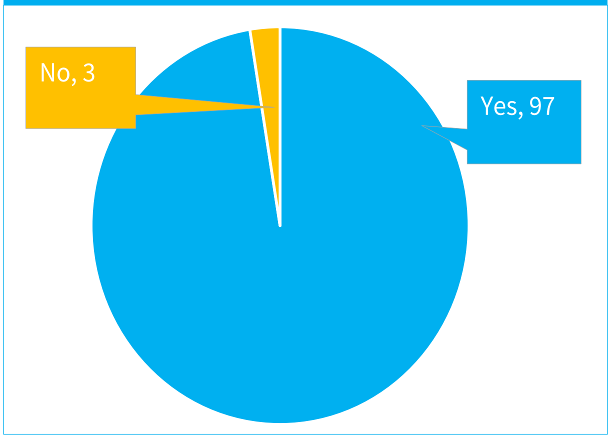
2.8 International Financial Reporting Standard (IFRS) 16 on Leases

- 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 December 31, 2021, 97 percent of the respondents had implemented IFRS 16. The scenario is similar to what was reported in quarter ended September 30, 2021. This is depicted in **Chart 8**.

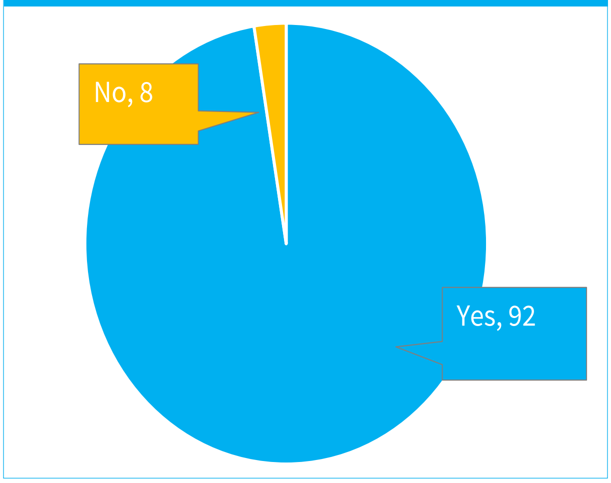
Chart 8: Banks that have implemented IFRS 16 on Leases (%)



2.8.2 Assessment of the impact of IFRS 16

- During the quarter ended December 31, 2021, 94 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 the 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.
- Some respondents have reported an increase in leased assets and financial liabilities on the balance sheet. As a result, banks with material off-balance sheet lease commitments are bound to encounter significant changes in their regulatory capital, key financial metrics such as the leverage ratio, return on investment.

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 December 31, 2021, are as indicated in **Table 7**.

Table 7: Financial elements bank value as at December 31, 2021

Banking Industry (Ksh '000)	September 2021	December 2021
Right of use (ROU) assets	33,445,169	35,292,160.80
Lease liabilities	28,099,976	30,950,491.09
Depreciation of the right of use asset	8,154,244	8,697,785.27
The finance charge associated with the lease liability	2,954,058	2,751,059.69

2.8.5 Challenges experienced in the Implementation of IFRS 16

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

  i) Increased administration costs such as cost of training staff on the applicability of IFRS 16 for compliance.
  ii) Adverse impact on Capital Adequacy ratios.
  iii) Measurement and re-measurement of leases.
  iv) Lease definition and identifying discount rate assumption.
  v) The updating and amortization of the lease schedule especially when the bank enters into new lease.
  vi) Determination of Effective Interest Rate especially due to the volatility in interest rates movements.

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

i) Banks are continuously bridging the gap through continuous training for its staff and ensuring they are updated on the changes in the leasing space.
ii) Capital raising initiatives enhanced. Buy or Lease decisions are now relevant in investments.
iii) Banks have automated their IFRS 16 computations for more efficiency.
iv). Regular monitoring of lease contracts.

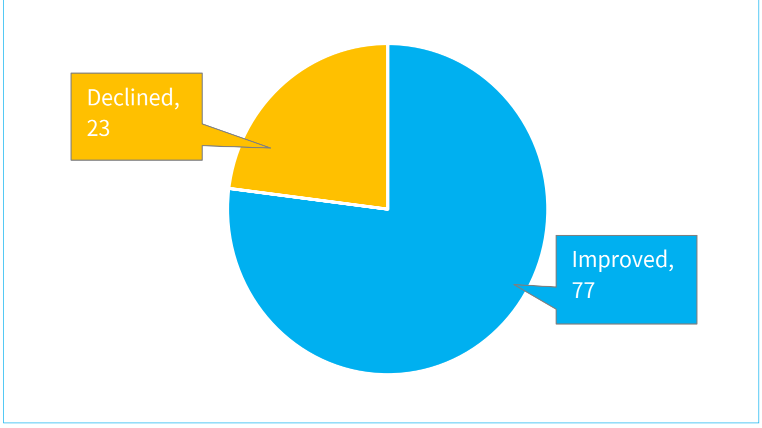
2.9 Liquidity Risk

- 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 during the quarter ended December 31, 2021.

2.9.1 Commercial Banks' liquidity positions

- During the quarter ended December 2021, 77 percent of the respondents indicated that their liquidity position had improved as indicated in **Chart 10**. This was mainly due to increased deposits and loan recovery.

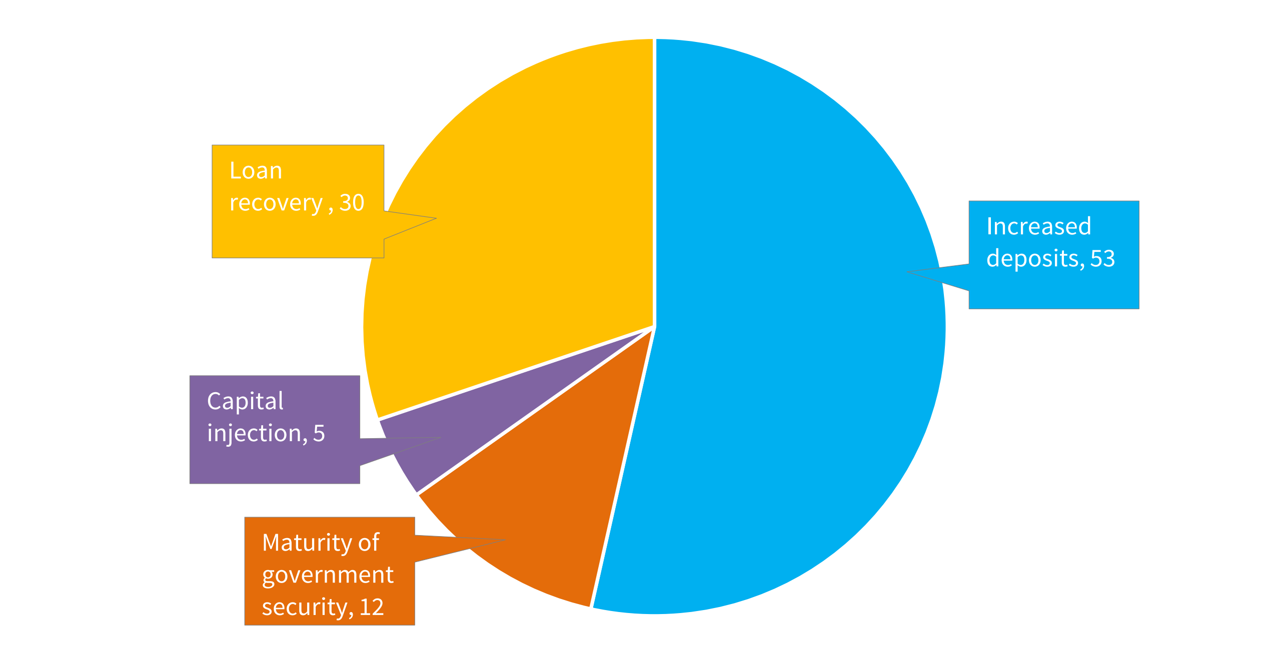
Chart 10: Movement in liquidity risk (%)



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

- During the quarter ended December 31, 2021, liquidity improved mainly as a result of: -
  - i). Increased deposits (53 percent).
  - ii). Loan recovery (30 percent).
  - iii). Maturity of government securities (12 percent).
  - iv). Capital injection (5 percent).
- The drivers of improved liquidity are indicated in **Chart 11** below.

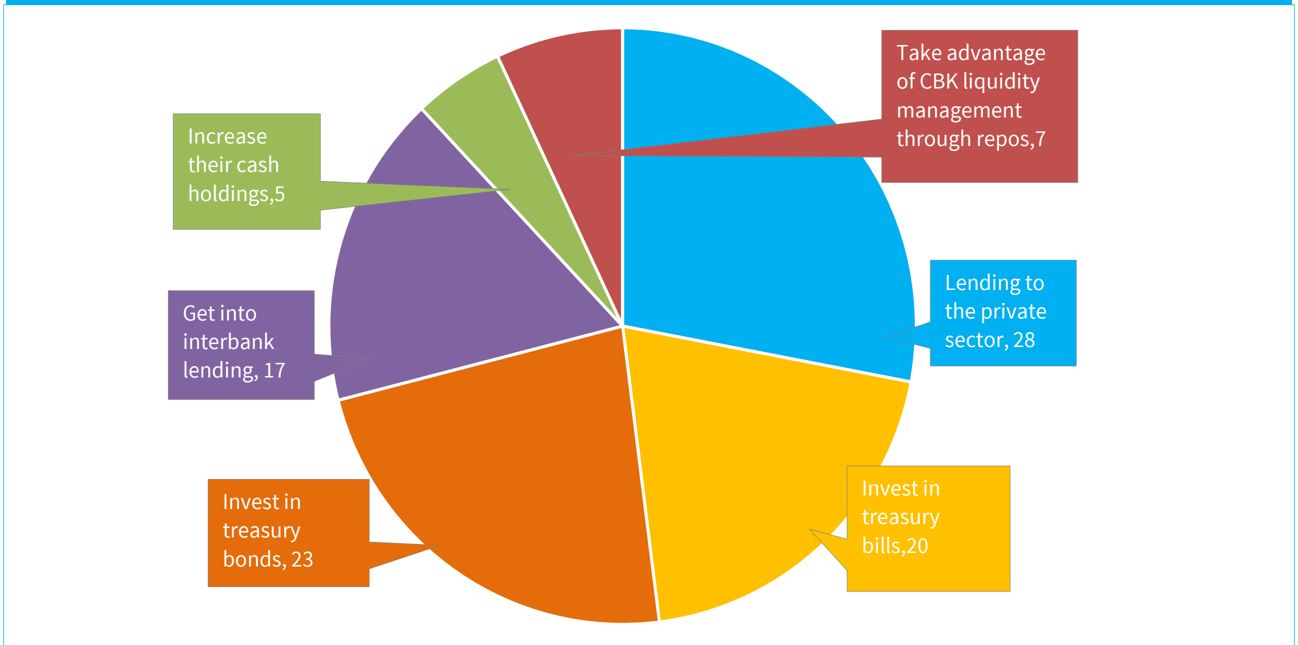
Chart 11: Reasons for improved liquidity (%)



2.9.3 Commercial Banks' plans with improved liquidity

- As indicated in **Chart 12**, with the improved liquidity, it is expected that in the first quarter of 2022, credit to private sector 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 (17 percent) and CBK liquidity management through repos (7 percent).

Chart 12: Plans with improved liquidity (%)



2.9.4 Measures being taken by Commercial banks to enhance deteriorated liquidity

- During the quarter ended December 2021, 23 percent of the respondents indicated that their liquidity position had deteriorated as indicated in **Chart 10**.
- The affected banks are upscaling their deposit mobilization campaigns to enhance their liquidity positions.

2.9.5 Commercial Banks' interbank activities during the quarter

- During the quarter ended December 31, 2021, 58 percent of the respondents indicated that their interbank lending activities decreased. 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 for all categories of facilities.

Chart 13: Increase in interbank lending (%)

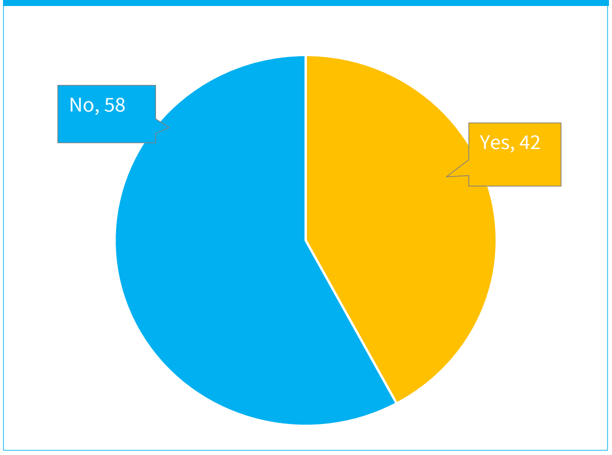
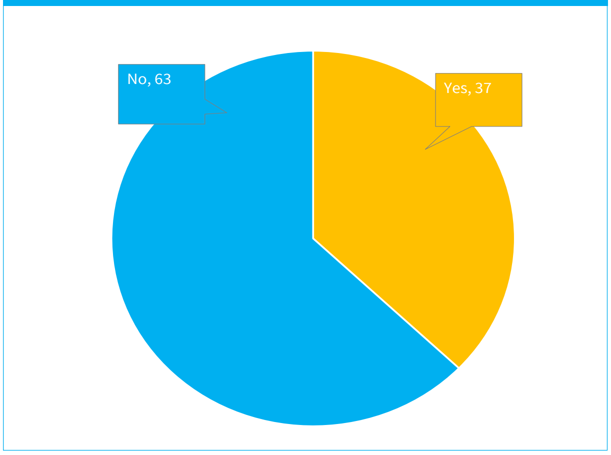


Chart 14: Increase in Interbank borrowing (%)



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

With the ongoing COVID-19 pandemic, 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 has been 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: -

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.

Responses received from the banks include: -

- Expected deterioration of core capital position as the bank absorbs the impact of the waivers to the customers and further downgrade of non-performing loans.
- Reduction in cashflows due to loan restructures and rescheduling.

- 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 capital position.
- Delay in loan repayments in some key sectors even after moratoriums issued expired. This is due to the fact that some sectors in the economy are yet to fully recover from COVID-19 effects.
- Fall in demand of credit as businesses shy from investment. It is worth noting that banks have become more cautious due to the high risk of credit default.
- Reduction in earnings due to additional loan loss provisions and low loan revenue due to reduction in lending rates.
- Increased Non-Performing Loans, which may be attributed to slowdown in business, business closures and job losses.

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

Commercial banks have indicated that the pandemic has had a positive impact on their business. Some of the opportunities arising from the pandemic include:

- Increased need for the banks to adopt digital platforms of lending.
- The pandemic has enabled the bank retest and enhance its resilience and business continuity plans.
- Proving funding support to the manufacturing sector as banks aim to seize opportunities presented by new areas of manufacturing brought about by reduced importation and need for Personal Protective Equipments.
- Emerging opportunities in trade sector as schools need additional funds to put in place COVID-19 prescribed measures as well as introducing virtual learning in schools.

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

Some of the key risks increased by the pandemic include:

- **Liquidity risk due** to reduced loan repayment and customers withdrawing funds to help their businesses stay afloat.
- **Credit risk**: The pandemic has increased volatility in income, which by extension impacts the projected growth in capital supply and the ability of the bank to further support growth in risk weight assets without aggressively conserving capital.
- **Operational risk** is elevated due to the complex operating environment. there is an increased 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: -

- Closer monitoring of clients' credit performance and enhanced loan recovery efforts.
- Enhanced risk assessment by incorporating the current environment factors.
- Enhanced loan appraisal standards to minimize risk of loan defaults at inception.
- Restructure the portfolio for customers impacted negatively by the pandemic by 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 business.

- Banks have implemented their Business Continuity Plans (identification of critical processes, critical staff and their back-ups.
- Banks have tightened their credit standards on granting of new loans to enable the assessment of the impact of the pandemic in each industry.
- 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 revenues.

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' experiences after the expiry of the emergency measures on restructured loans include;

i. Stability in most sectors with resumption of repayment in various economic sectors save for Tourism and hospitality that continue to be adversely affected by slow down on economic activity due to the COVID-19 pandemic.
ii. Increased NPLs and delayed repayments especially in the Tourism, Restaurant and Hotels, Personal and Household and Trade sectors, leading to increased provisions and reduced interest income.
iii. Banks have had to enhance their recovery efforts to improve the loan portfolios.
iv. Banks noted that the reclassification of the accounts that had been given a reprieve and had not fully recovered contributed to increased NPLs.
v. Reduction of profits by banks due to increase in provisions as a result of reclassifying the non-performing loans due to COVID – 19.

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.

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