Central Bank of Kenya

Credit Survey

January - March 2017

CENTRAL BANK OF KENYA (CBK) COMMERCIAL BANKS' CREDIT SURVEY JANUARY - MARCH 2017

1.0 BACKGROUND

1.1 COMMERCIAL BANKS' CREDIT OFFICER SURVEY

Credit risk is the single largest factor affecting the soundness of financial institutions and the financial system as a whole. Lending is also the principal business for banks. The ratio of total loans to total assets for the quarter ended 31st March 2017 was 61.09 percent; a marginal increase of 0.02 percent from 61.07 percent reported in December 2016.

The Central Bank of Kenya (CBK) undertakes a quarterly Credit Officer Survey to identify the potential drivers of credit risk. The Credit Officer Survey requires senior credit officers of banks to indicate their banks perception or actual position in the immediate past quarter and the subsequent quarter in terms of demand for credit, credit standards, interest rates, asset quality and credit recovery efforts.

1.2 SURVEY METHODOLOGY

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

For the quarter ended March 2017 Commercial Banks Credit Officer Survey, all 39 operational commercial banks and 1 mortgage finance company participated in the survey.

The survey sought to establish the lending behavior in the banking sector and targeted all the eleven economic sectors. Questions were posed on demand for credit, standards for approving loans, interest rates, non-performing loans and credit recovery efforts.

The survey questions are generally phrased in terms of changes over the past three months or expected changes over the next three months.

The March 2017 survey included questions regarding the effect of capping of interest rates that came into effect on 14th September 2016.

1.3 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan Banking Sector recorded growth in the quarter ended 31st March 2017, compared to the quarter ended 31st December 2016. Some of the sector's performance indicators are as follows:

- The aggregate balance sheet increased by 2.13 percent from KShs 3.76 trillion in December 2016 to KShs 3.84 trillion in March 2017. There was an increase in gross loans during the period.
- Gross loans increased by 2.15 percent from KShs 2.33 trillion in December 2016 to KShs 2.38 trillion in March 2017. The increase in gross loans was mainly attributable to loans granted to support working capital for some corporate clients.
- Total deposits increased by 3.40 percent from KShs 2.65 trillion in December 2016 to KShs 2.74 trillion in March 2017. There were deposits made by some companies engaged in supply of oil and telecommunication companies.
- The ratio of gross non-performing loans to gross loans increased from 9.1 percent in December 2016 to 9.5 percent in March 2017. The increase in gross non-performing loans was mainly attributable to a challenging business environment.
- The ratio of core capital to total risk-weighted assets increased slightly from 15.8 percent in December 2016 to 16.6 percent as at March 2017. The total capital to total risk weighted assets increased marginally from 18.7 percent in December 2016 to 19.4 percent in March 2017. The marginal increase in Total Capital and Core capital to Total Risk Weighted Assets is as a result of increase in Total Risk Weighted Assets of 7.0 percent between December 2016 and March 2017 as compared to 10.6 percent and 10.2 percent increase of Core Capital and Total Capital respectively over the same period. The capital adequacy ratios remained above the statutory minimum of 10.5 percent and 14.5 percent respectively.
- Return on Assets decreased to 2.9 percent in March 2017 from 3.3 percent in December 2016. This followed a higher growth in assets as compared to the growth in profitability.

- Return on Equity decreased to 22.2 percent in March 2017 from 24.8 percent in December 2016. There was a higher growth in shareholders’ funds as compared to the growth in profitability.
- The Average Liquidity Ratio increased to 43.8 percent in March 2017 from 41.4 percent in December 2016. There was a higher growth in total liquid assets compared to the growth in total short-term liabilities. Total liquid assets grew by 16.5 percent while total short-term liabilities grew by 9.9 percent.

1.4 SUMMARY OF FINDINGS

- Demand for credit: In the first quarter of 2017, the perceived demand for credit remained unchanged in nine sectors while it increased in two sectors (Trade and Personal/Household economic sectors). This reported increase in demand for credit in the two sectors may be attributed to interest capping which has reduced cost of borrowing.

- Credit Standards, which are guidelines that banks use in determining whether to extend a loan to an applicant, remained unchanged in nine out of eleven economic sectors in the first quarter of 2017. Banks mostly tightened credit standards in the Real Estate and Building and Construction sectors. Tightening of credit standards in the two sectors was attributted to difficulties in the two sectors and delayed government payments.

- Level of Interest Rates: In the first quarter of 2017, 91 percent of the respondents indicated that their banks held their interest rates constant; whereas 9 percent of the respondents indicated that their banks decreased their interest rates. This downward trend on interest rates could be an indication of the banks complying with the Banking (Amendment) Act, 2016. The Act limits interest chargeable on loans at not more than 4 percent above the prevailing Central Bank Rate (CBR).

- Non-Performing Loans: Generally, banks expect an increase in the levels of NPLs in the second quarter of 2017 with 52 percent of the respondents indicating so. This expected rise in NPLs is attributed to the industry’s perception of increased political risk in light of the upcoming general elections.

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

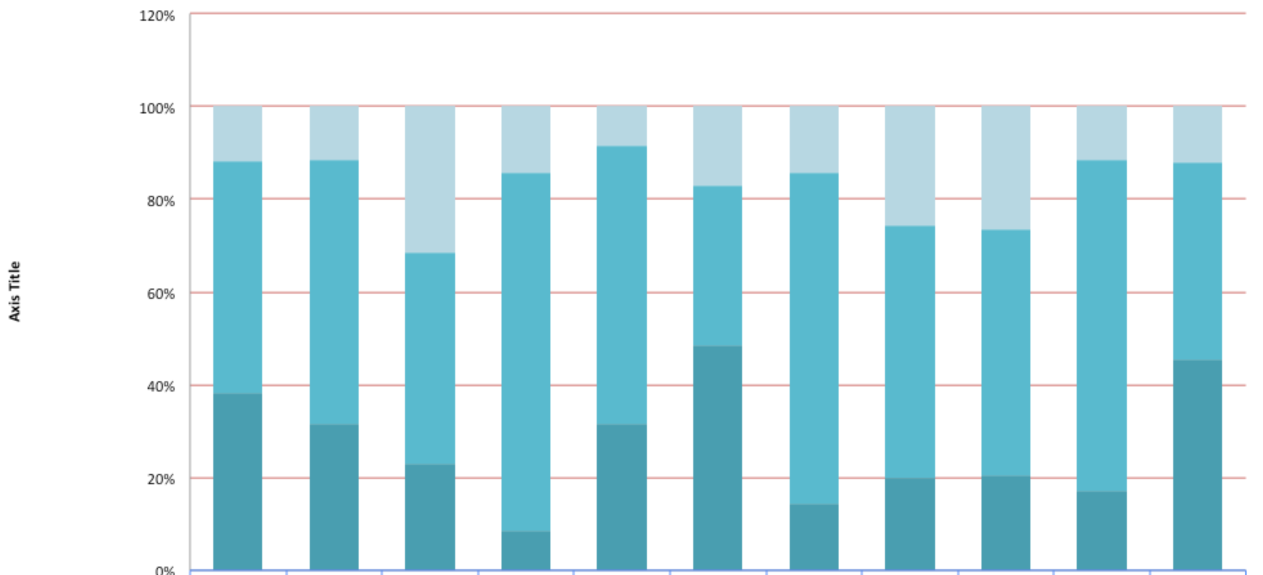
  i). Tourism and Agriculture sectors due to the seasonal fluctuations of cash flows.
  ii). Building and Construction sector to enhance collections from contractor payments by the Government of Kenya, in the second quarter of 2017.
  iii). The intensified recovery efforts in five sectors (Manufacturing, Trade, Transport Real Estate, and Financial Services sectors) aim at improving the overall quality of the asset portfolio in line with the banks expectations that loan defaults in these sectors will rise during the second quarter of 2017.

2.0 SURVEY FINDINGS

2.1 Demand for Credit

- In the first quarter of 2017, demand for credit remained unchanged in nine economic sectors. The top three sectors indicating the unchanged demand for credit are Mining and Quarrying, Tourism and Financial Services.
- However, demand for credit increased in Trade and Personal/Household economic sectors. The respondents indicated that interest rate capping has led to reduced cost of borrowing; this has resulted to increased demand for credit in Trade and Personal/Household sectors.
- **Chart 1** and **Table 1** below present the trend in the demand for credit in the quarter.

Chart 1: 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/ Household
Decreased	12%	11%	31%	14%	9%	17%	14%	26%	26%	11%	12%
Remained Unchanged	50%	57%	46%	77%	60%	34%	71%	54%	53%	71%	42%
Increased	38%	31%	23%	9%	31%	49%	14%	20%	21%	17%	45%

Table 1: Change in Demand for Credit

	March 2017			December 2016		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	38%	50%	12%	23%	63 %	20 %
Manufacturing	31%	57%	11%	32%	44 %	20 %
Building & Construction	23%	46%	31%	41%	46 %	20 %
Mining and Quarrying	9%	77%	14%	3%	74 %	18 %
Energy and Water	31%	60%	9%	28%	63 %	12 %
Trade	49%	34%	17%	53%	23 %	30 %
Tourism, Restaurant and Hotels	14%	71%	14%	18%	63 %	18 %
Transport and Communication	20%	54%	26%	41%	46 %	20 %
Real Estate	21%	53%	26%	38%	38 %	23 %
Financial Services	17%	71%	11%	15%	65 %	15 %
Personal/Household	45%	42%	12%	53%	40 %	18 %

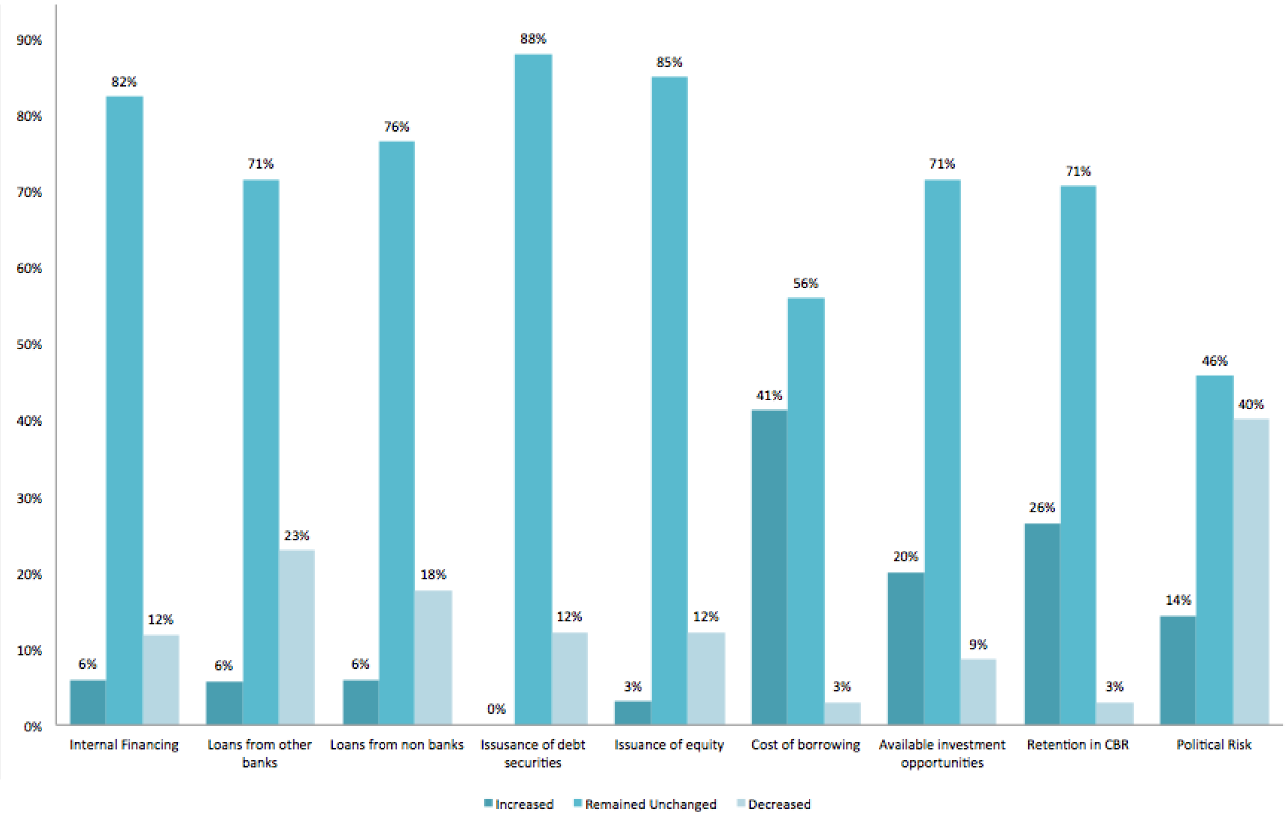
2.2 Factors Affecting Demand for Credit

- In the quarter ending March 2017, all factors affecting demand for credit had no impact on demand for credit as indicated in Chart 2 below.
- However, cost of borrowing (41%) had the highest effect on increasing demand for credit whereas political risk (40%) had the highest impact in decreasing demand for credit.
- **Chart 2** and **Table 2** below present the trend in the factors affecting demand for credit in the quarter.

Table 2: Factors Affecting Demand for Credit

	March 2017			December 2016		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	6%	82%	12%	5%	92 %	5 %
Loans from other banks	6%	71%	23%	11%	73 %	22 %
Loans from non-banks	6%	76%	18%	0%	85 %	8 %
Issuance of debt securities	0%	88%	12%	0%	92 %	8 %
Issuance of equity	3%	85%	12%	3%	95 %	5 %
Cost of borrowing	41%	56%	3%	59%	38 %	13 %
Available investment opportunities	20%	71%	9%	23%	63 %	10 %
Retention of CBR	26%	71%	3%	54%	30 %	5 %
Political Risk	14%	46%	40%	10%	80 %	10 %

Chart 2: Factors affecting demand for credit



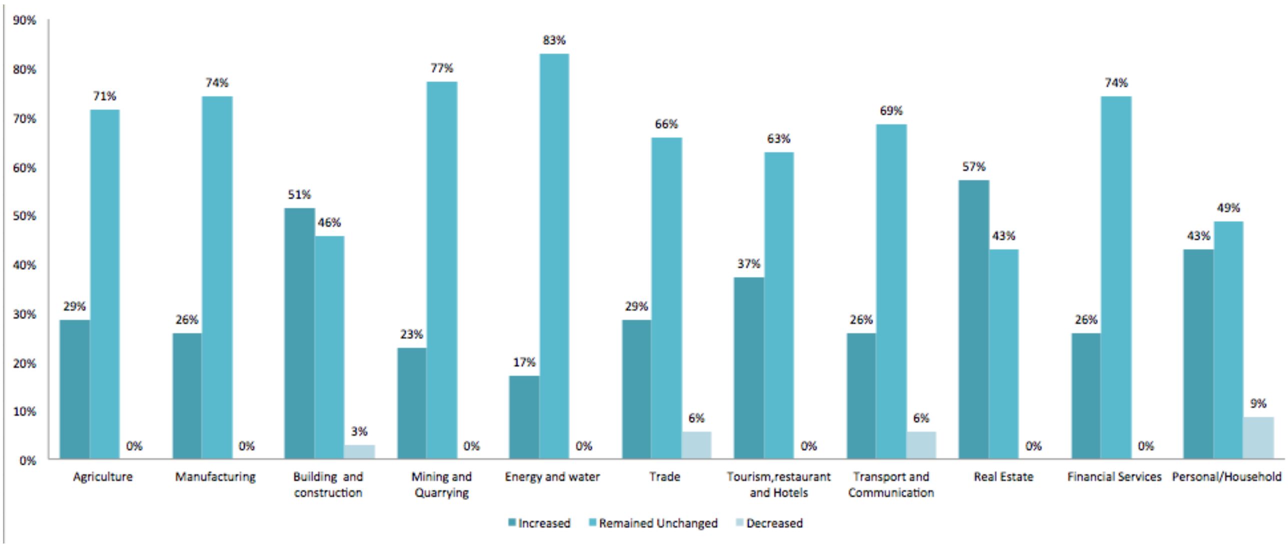
2.3 Credit Standards

- Credit Standards in nine out of the eleven economic sectors remained unchanged in the first quarter of 2017.
- However, the respondents reported tightened credit standards for Real Estate, and Building and Construction
- sectors. The political climate in the country, the banks' capital position and delayed government payments were cited as the main driving factors for tightening of credit standards in the aforementioned sectors.
- These responses are presented in **Chart 3** and **Table 3** below:

Table 3: Credit Standards for Loans to Various Economic Sectors

	March 2017			December 2016		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	29%	71%	0%	41%	59%	0%
Manufacturing	26%	74%	0%	34%	63%	2%
Building & Construction	51%	46%	3%	59%	37%	5%
Mining and Quarrying	23%	77%	0%	34%	66%	0%
Energy and Water	17%	83%	0%	25%	75%	0%
Trade	29%	66%	6%	37%	56%	7%
Tourism, Restaurant and Hotels	37%	63%	0%	41%	59%	0%
Transport and Communication	26%	69%	6%	43%	50%	8%
Real Estate	57%	43%	0%	63%	38%	0%
Financial Services	26%	74%	0%	34%	66%	0%
Personal/Household	43%	49%	9%	53%	45%	3%

Chart 3: Credit Standards



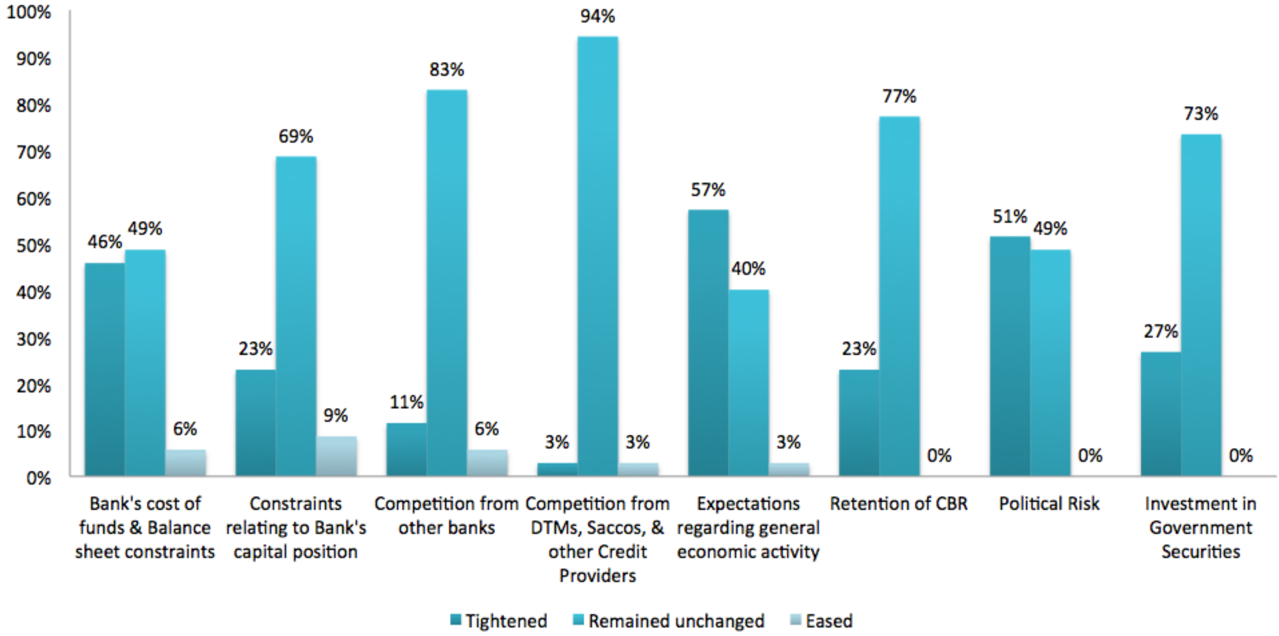
2.4 Factors Affecting Credit Standards

- During the quarter ended March 2017, six factors (Banks' cost of funds, constraints relating to banks' capital position, competition from other banks, competition from DTMs, retention of CBR) had little impact on credit standards.
- However, expections regarding the general economic activity and political risks due to the upcoming elections were cited as factors that led to tightening of credit standards with 57% and 51% of the resposondents indicating so. A comparison of the trend in the factors affecting the banks' credit standards are shown in **Chart 4** and **Table 4** below.

Table 4: Impact of factors affecting credit standards

	March 2017			December 2016		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds & Balance sheet constraints	46%	49%	6%	56%	44%	5%
Constraints relating to Bank's capital position	23%	69%	9%	34%	63%	10%
Competition from other banks	11%	83%	6%	3%	85%	12%
Competition from DTMs, Saccos, & other Credit Providers	3%	94%	3%	5%	93%	7%
Expectations regarding general economic activity	57%	40%	3%	60%	44%	10%
Retention of Central Bank Rate (CBR)	23%	77%	0%	32%	51%	12%
Political Risk	51%	49%	0%	40%	76%	0%
Retention of KBRR	27%	73%	0%	17%	65%	13%

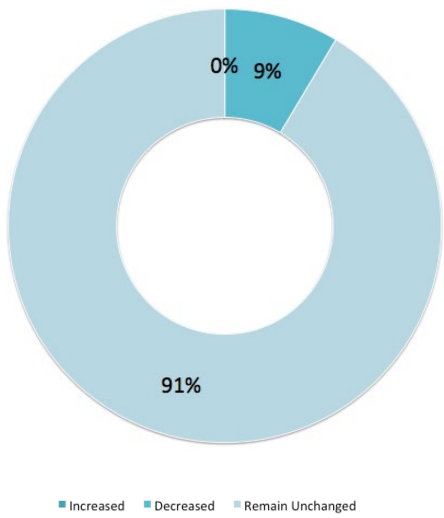
Chart 4: Factors Affecting Credit Standards



2.5 Interest Rates Movements

- The movement of interest rates is mainly attributed to the capping of interest rates that came into effect in September 2016; as well as reduction of the CBR rate to 10 percent.
- The interest rates movements in the quarter under review are depicted in **Chart 5.**
- 91 percent of the banks held their interest rates constant, 9 percent reduced their interest rates while none of the banks reported an increase in their interest rates. This could be an indication of the banks complying with the Banking (Amendment) Act 2016. The Act limits interest rates chargeable on loans at not more than 4 percent above the prevailing Central Bank Rate (CBR). It also sets a floor on the interest rate payable by institutions on interest earning deposits at not less than 70 percent of the CBR.

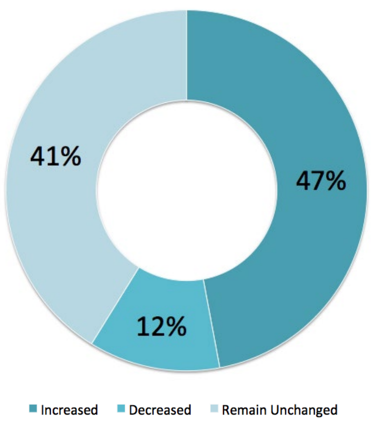
Chart 5: Interest Rate Movements



2.6 Capping of Interest Rates

- With the interest rate capping that came into effect on 14th September 2016, the credit survey sought to find out the impact it had on demand for credit, its effect on lending to SMEs, actual credit granted over the quarter to 31st March 2017 and the expectations of changes over the next three months. Further, the survey sought to find out how NPLs in the second quarter of 2017 will be affected by the interest rate capping.

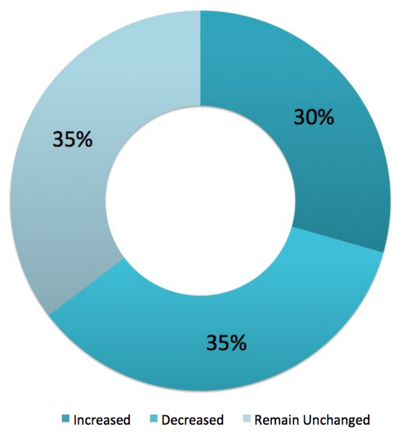
Chart 6: Interest Rate Cap Effect on Demand For Credit



2.6.1 *Effect of Interest Rate Capping on Demand for Credit*

- Interest rate capping led to increased demand for credit as indicated by 47 percent of the respondents who attributed this to cheaper credit.
- 41 percent of the respondents indicated that the demand for credit remained unchanged while 12 percent noted that demand for credit decreased as depicted in **chart 6.** This trend was the same in the previous quarter.
- However, this increased demand for credit had little impact on the actual credit advanced **(chart 7).**

Chart 7: Interest Rate Cap Effect on Actual Credit Granted



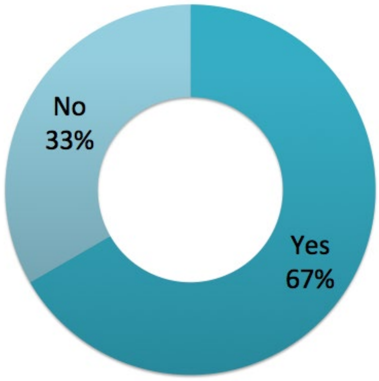
2.6.2 *Effect of Interest Rate Capping on Actual Credit Granted*

- 35 percent of the respondents indicated that interest rate capping had little effect on the actual credit granted. 30 percent recorded that the actual credit granted increased while 35 percent were of the view that the actual credit granted decreased as depicted in **chart 7** below. This depicts a situation of mixed reactions as the commercial banks take a wait and see approach on how the market will react to the capping of interest rates.

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

- 67 percent of the commercial banks indicated that interest rate capping negatively affected their lending to SMEs since it has necessitated banks to increase risk mitigation measures which as a result has locked out potential customers below certain risk thresholds that the bank would have invested in if it was adequately pricing for risk. This is indicated in chart 8 below.

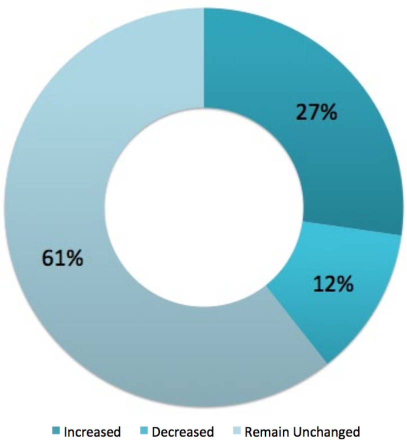
Chart 8: Effects of Interest rate capping to lending to SMEs



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

- In the second quarter of 2017, most of the respondents anticipate that the interest rate capping will have little impact on actual credit advanced as indicated by 66 percent of the respondents.
- However, 9 percent of the respondents still felt that interest rate capping will lead to an increase in new credit advanced while 25 percent felt that the new credit advanced will decrease as indicated in **chart 10** below.

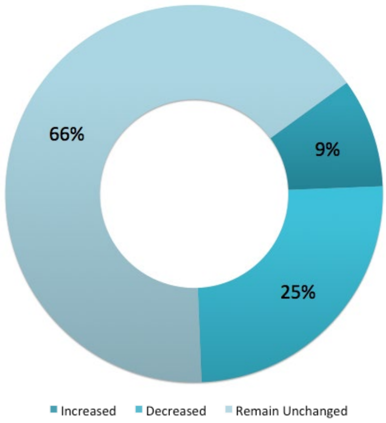
Chart 10:Interest rate cap effect on actual credit granted in Q2 2017



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

- With regards to the expected demand for credit in the second quarter of 2017, most of the respondents anticipate that interest rate capping will have little impact on actual credit advanced as indicated by 61 percent of the respondents. This is due to the continuation of capping of interest rates and upholding of the tightened credit standards. However, 27 percent of the respondents felt that interest capping will lead to an increase in actual credit advanced while 12 percent felt that the actual credit advanced will decrease as shown in **chart 9** below.

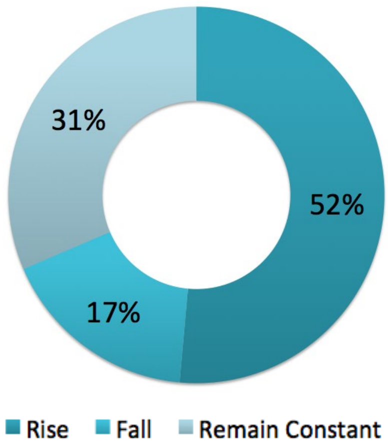
Chart 9 - Interest rate cap effect on actual new credit granted in Q2 2017



2.6.6 *Effect of Interest Rate Capping on the Level of NPLs*

- In the second quarter of 2017, 58 percent of the respondents were of the view that the NPLs would not change since the pricing of the loan has no impact on repayment ability as the monthly installment is agreed upfront. 32 percent of the respondents expect the capping of interest rates to have a positive impact on NPLs.
- Favorable interest rates have led to cheaper credit. 10 percent reported that NPLs would deteriorate as indicated in **chart 11.** This mixed reaction may be due to the wait and see approach on how the market will react to the capping of interest rates.

Chart 11: Effect of interest rate capping on NPLs



2.7 Non-Performing Loans (NPLs)

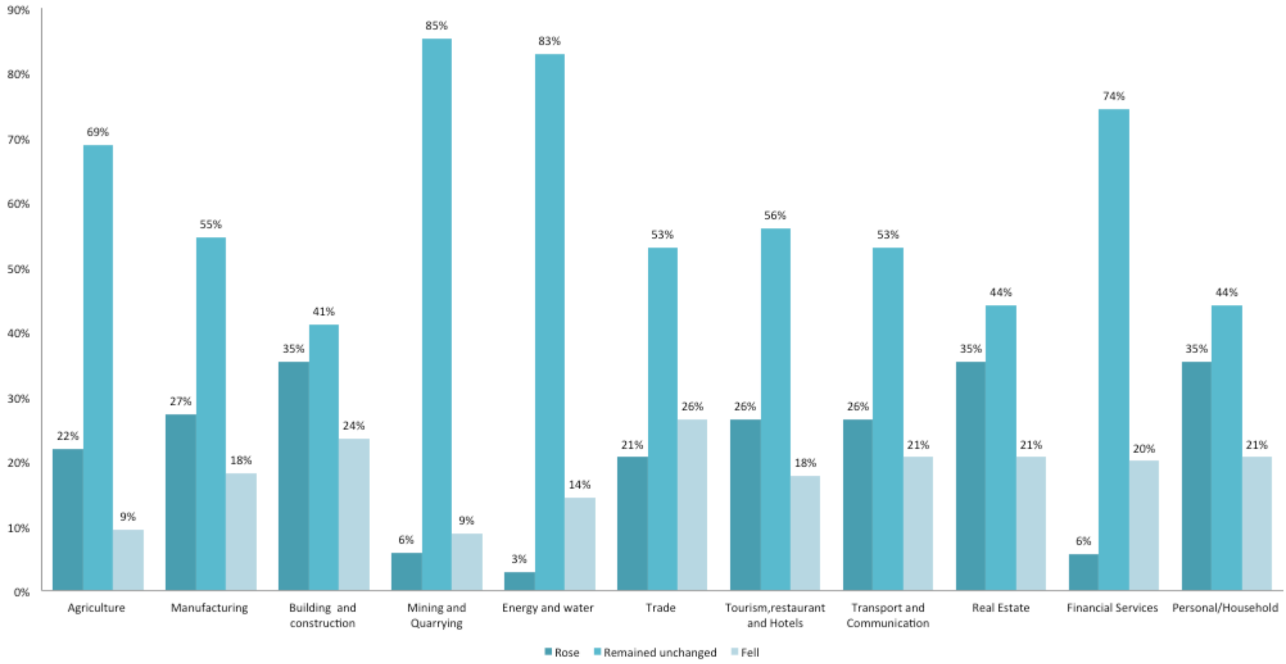
2.7.1 Non Performing Loans during the quarter ended 31st March 2017

- The level of NPLs remained constant in first quarter of 2017 in all the economic sectors. This is depicted in Chart 12 below.

Table 5: Non Performing Loans Expectation Trend Per Economic Sector

	March 2017			December 2016		
	Rose	Remained Unchanged	Fell	Rose	Remained Unchanged	Fell
Agriculture	22%	69%	9%	21%	64 %	31 %
Manufacturing	27%	55%	18%	15%	59 %	27 %
Building & construction	35%	41%	24%	33%	45 %	25 %
Mining and Quarrying	6%	85%	9%	8%	73 %	20 %
Energy and water	3%	83%	14%	13%	71 %	22 %
Trade	21%	53%	26%	26%	40 %	40 %
Tourism, Restaurant & Hotels	26%	56%	18%	23%	55 %	28 %
Transport & Communication	26%	53%	21%	18%	58 %	30 %
Real Estate	35%	44%	21%	33%	54 %	23 %
Financial Services	6%	74%	20%	8%	76 %	15 %
Personal/Household	35%	44%	21%	31%	40 %	38 %

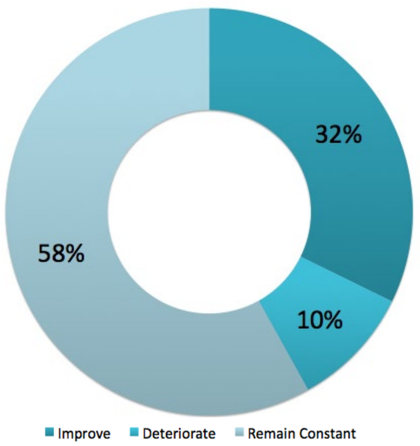
Chart 12: Non-Performing Loans



2.7.2 Expected Non Performing Loans Levels During the Next Quarter

- 52 percent of the respondents expect the level of NPLs to rise in second quarter of 2017. This is because of the industry’s perception of increased political risk in light of the upcoming general elections as depicted in Chart 13 below.

Chart 13: Expected movements of the NPLs



2.8 Credit Recovery Efforts in the Next Quarter

- For the quarter ending 30th June 2017, banks predict that credit recovery efforts will be intensified in nine of the eleven sectors. The banks intend to allocate more resources on monitoring and recovery of loans as well as use of external parties in the recovery process. Banks intend to intensify credit recovery efforts in the following sectors:-

i) Tourism and Agriculture sectors due to the seasonal fluctuations of cash flows.

ii) Building and Construction sector to enhance collections from contractor payments by the Government of Kenya, in the second quarter of 2017.

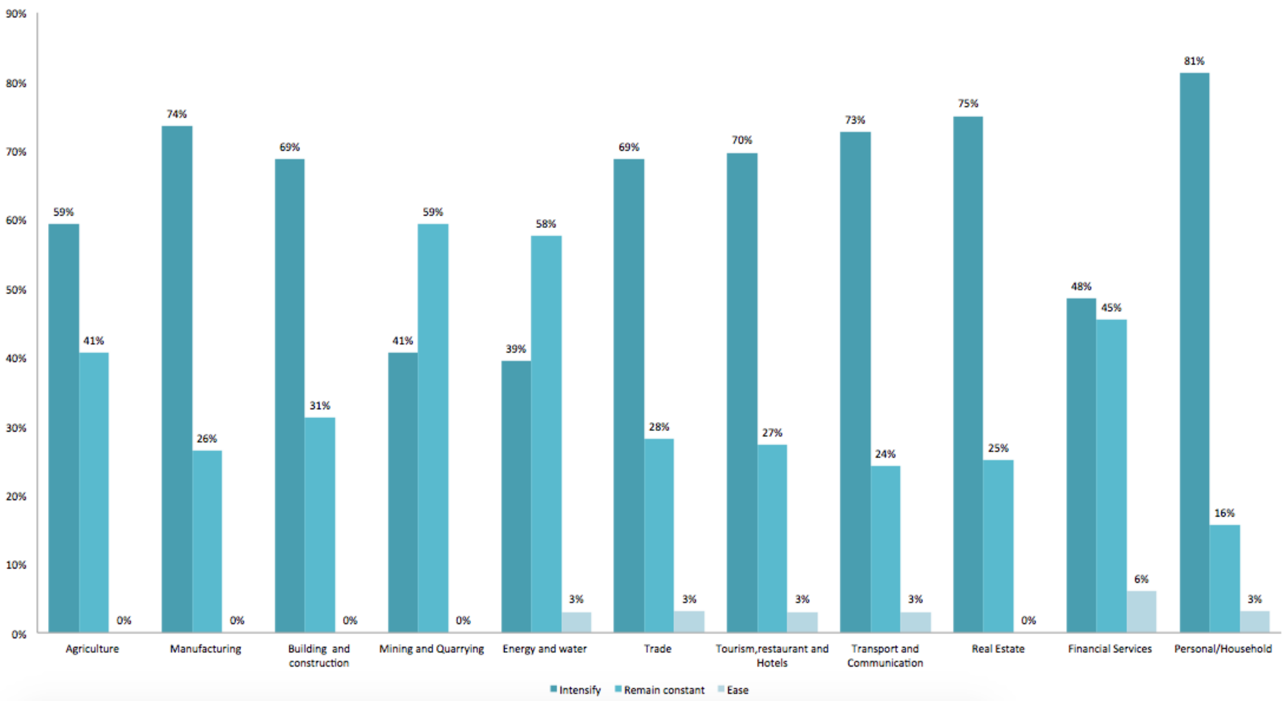
iii) The intensified recovery efforts in five sectors (Manufacturing, Trade, Transport Real Estate, and Financial Services sectors) aim at improving the overall quality of the asset portfolio in line with the banks expectations that loan defaults in these sectors will rise during second quarter of 2017.

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

Table 6: Credit Recovery Efforts

	March 2017			December 2016		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	59%	41%	0%	58%	43%	0%
Manufacturing	74%	26%	0%	70%	28%	3%
Building & construction	69%	31%	0%	80%	18%	3%
Mining and Quarrying	41%	59%	0%	45%	53%	3%
Energy and water	39%	58%	3%	51%	49%	0%
Trade	69%	28%	3%	80%	20%	0%
Tourism, Restaurant & Hotels	70%	27%	3%	70%	30%	0%
Transport & Communication	73%	24%	3%	73%	25%	3%
Real Estate	75%	25%	0%	73%	25%	3%
Financial Services	48%	45%	6%	54%	46%	0%
Personal/Household	81%	16%	3%	80%	20%	0%

Chart 14: Credit Recovery Efforts



LIST OF RESPONDENTS

1. African Banking Corporation Ltd.
2. Bank of Africa Kenya Ltd.
3. Bank of Baroda (K) Ltd.
4. Bank of India.
5. Barclays Bank of Kenya Ltd.
6. Stanbic Bank Kenya Ltd.
7. Chase Bank (K) Ltd.
8. Citibank N.A Kenya.
9. Commercial Bank of Africa Ltd.
10. Consolidated Bank of Kenya Ltd.
11. Credit Bank Ltd.
12. Co-operative Bank of Kenya Ltd.
13. Development Bank of Kenya Ltd.
14. Diamond Trust Bank (K) Ltd.
15. Ecobank Kenya Ltd.
16. Spire Bank Ltd.
17. Equity Bank Ltd.
18. Family Bank Ltd.
19. SBM Bank (Kenya) Ltd.
20. Guaranty Trust Bank (Kenya) Ltd.
21. First Community Bank Limited.
22. Guardian Bank Ltd.
23. Gulf African Bank Limited.
24. Habib Bank A.G Zurich.
25. Habib Bank Ltd.
26. I & M Bank Ltd.
27. Jamii Bora Bank Ltd.
28. KCB Bank Kenya Ltd.
29. Sidian Bank Ltd.
30. Middle East Bank (K) Ltd.
31. National Bank of Kenya Ltd.
32. NIC Bank Ltd.
33. M Oriental Bank Ltd.
34. Paramount Bank Ltd.
35. Prime Bank Ltd.
36. Standard Chartered Bank (K) Ltd.
37. Trans-National Bank Ltd.
38. Victoria Commercial Bank Ltd.
39. UBA Kenya Bank Ltd.
40. HFC Ltd.

Haile Selassie Avenue P. O. Box 60000 - 00200 Nairobi
Tel: 20 - 2860000/2861000/ 2863000 Fax: 20 - 340192