CENTRAL BANK OF KENYA

CREDIT OFFICER SURVEY

JANUARY-DECEMBER 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 year ended 31st December 2015 was 62.3%, a slight increase from 59.8% reported in December 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 31st December 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 31st December 2015 included four questions that focused on:-

- Demand for Credit.
- Credit Standards.
- Interest Rates.
- Non-Performing Loans.
- Expected Non-Performing Loan Levels.
- Credit Recovery Efforts.

The survey, conducted in January 2016, 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 perceived demand for credit generally remained constant in eight economic sectors and increased in three economic sectors in the quarter ended December 2015. Issuance of equity, debt securities, political risk, internal financing, loans from non-banks and increase of CBR to 11.5% were cited as having had the least influence on the demand for credit.

1.3.2 Credit Standards

In 2015, credit standards generally remained unchanged for all the eleven economic sectors as most of the factors that influence changes on banks credit standards had little impact. This indicates that banks adopted relatively conservative credit policies in 2015 as they did in 2014.

1.3.3 Interest Rates

During the quarter under review, 60% of banks indicated that interest rates had increased. Some of the respondents cited high cost of funds and high Treasury Bill rates as the reasons that led to increased interest rates.

1.3.4 Non-Performing Loans

For the first quarter of 2016, most banks expect the levels of non-performing loans to generally remain constant across the economic sectors. However, banks foresee increasing NPLs in the Mining and Quarrying, Energy and Water and Financial Services sectors. On the other hand, NPLs are expected to drop in the Manufacturing, Tourism, Transport and Personal/Household sectors.

1.3.5 Expected Non-Performing Loan

Most of the banks expect the NPLs level to increase, with 46% of the respondents indicating so. However, 22% of the respondents feel that the NPLs level will remain unchanged while 32% of them felt that NPLs level will decrease in Q1 of 2016.

1.3.6 Credit Recovery Efforts

In Q1 of 2016, most banks intend to intensify their loan recovery efforts in all the eleven economic sectors with Mining and Quarrying, Energy and Water and Financial sectors expected to witness higher recovery efforts than the other economic sectors when compared to Q3 of 2015.

2.0 SURVEY FINDINGS

2.1 Demand for Credit

2.1.1 Observations

According to the survey, the credit officers of commercial banks perceived that the demand for credit generally remained constant in the four quarters of 2015. A comparison of the eleven economic sectors shows that the credit officers perceived that the highest growth in demand for credit was witnessed in Trade, Personal/Household and Building & Construction sectors.

During the first quarter of the year the perceived demand for credit generally remained constant in six economic sectors driven by available investment opportunities, cost of borrowing, issuance of debt securities and equity, the Kenya Bankers Reference Rate (KBRR) and retention of CBR at 8.5%. This trend was also observed in the second and third quarters of 2015.

In Q4 of 2015, perceived demand for credit generally remained constant in eight economic sectors and increased in three economic sectors. The eight economic sectors that recorded unchanged demand for credit were Agriculture, Manufacturing, Mining and Quarrying, Energy and Water, Tourism, Transport, Real Estate and Financial Services while the three economic sectors that recorded increased demand for credit were Trade, Building and Personal/Household. **Table 1** below details the reported trend in demand for credit over the four quarters of 2015.

Table 1: Demand for Credit

	Dec-15			Sep-15			Jun-15			Mar-15		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	30%	60%	10%	31%	62%	8%	44%	46%	10%	46%	41%	12%
Manufacturing	29%	54%	17%	41%	41%	17%	33%	51%	16%	36%	45%	19%
Building & Construction	41%	32%	27%	51%	27%	22%	58%	26%	16%	56%	37%	7%
Mining and Quarrying	13%	73%	15%	15%	64%	21%	10%	74%	17%	8%	68%	25%
Energy and Water	12%	68%	20%	29%	63%	7%	26%	56%	19%	26%	65%	9%
Trade	54%	37%	10%	63%	24%	12%	70%	21%	9%	60%	19%	21%
Tourism, Restaurant and Hotels	28%	55%	18%	30%	48%	23%	33%	38%	29%	18%	50%	32%
Transport and Communication	28%	50%	23%	39%	49%	12%	42%	49%	9%	49%	42%	9%
Real Estate	33%	40%	28%	45%	30%	25%	45%	43%	12%	38%	45%	17%
Financial Services	30%	58%	13%	31%	54%	15%	34%	51%	15%	21%	64%	14%
Personal/Household	48%	30%	23%	58%	28%	15%	59%	22%	20%	54%	37%	10%

2.2 Factors affecting demand for credit

2.2.1 Observations

In 2015, the main factors that had the least influence on the demand for credit during the quarter under review were internal financing, loans from other banks and non-banks, issuance of debt securities, issuance of equity, available investment opportunities, retention of CBR and KBRR as well as political risk. In the last two quarters of 2015, cost of borrowing was highlighted as the factor than lead to decrease in the demand of credit.

In Q4 of 2015, issuance of equity, debt securities, political risk, internal financing, loans from non-banks and retention of CBR were cited by 92%, 89%, 85%, 85%, 76% and 70% of the respondents respectively, as having had the least influence on the demand for credit during the quarter under review. **Table 2** below details the factors affecting demand for credit over the four quarters of 2015.

Table 2: Factors affecting demand for credit

	Dec-15			Sep-15			Jun-15			Mar-15		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	5%	85%	10%	5%	83%	13%	12%	79%	10%	12%	69%	19%
Loans from other banks	13%	59%	28%	10%	63%	27%	18%	61%	20%	12%	65%	23%
Loans from non-banks	5%	76%	18%	5%	78%	18%	5%	75%	20%	7%	71%	21%
Issuance of debt securities	0%	89%	11%	0%	90%	10%	5%	88%	7%	7%	83%	10%
Issuance of equity	0%	92%	8%	0%	90%	10%	18%	78%	4%	5%	88%	7%
Cost of borrowing	12%	22%	66%	12%	15%	73%	26%	50%	24%	40%	42%	19%
Available investment opportunities	23%	56%	21%	29%	56%	15%	16%	70%	14%	35%	53%	12%
Retention of CBR	13%	70%	18%	3%	53%	45%	14%	65%	21%	28%	67%	5%
Political Risk	5%	85%	10%	5%	83%	12%	20%	73%	7%	21%	63%	16%
Retention of KBRR	18%	56%	26%	7%	41%	51%	20%	75%	5%	44%	51%	5%

2.3 Credit Standards

2.3.1 Observations

In 2015, credit standards generally remained unchanged for all the eleven economic sectors as most of the factors that influence changes on banks credit standards had little impact. This supports the finding that credit standards to all economic sectors generally remained unchanged in the four quarters under review. This seems to indicate that banks adopted conservative credit policies in 2015 as was the case in 2014.

In 2015, access to credit was tightened for the Tourism sector by 45% (Q1) and 38% (Q2) and for the Building & Construction sector by 46% (Q3 & Q4) of the respondents. **Table 3** shows the banks' credit standards for loans to various sectors over the four quarters of 2015.

Table 3: Credit Standards for Loans to Various Sectors

	Dec-15			Sep-15			Jun-15			Mar-15		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	15%	83%	3%	20%	75%	5%	7%	83%	10%	17%	79%	5%
Manufacturing	12%	83%	5%	15%	80%	5%	5%	81%	14%	7%	81%	12%
Building & Construction	46%	51%	2%	46%	54%	0%	35%	56%	9%	33%	60%	7%
Mining and Quarrying	8%	93%	0%	8%	93%	0%	10%	88%	2%	7%	91%	2%
Energy and Water	10%	90%	0%	10%	90%	0%	7%	88%	5%	12%	84%	5%
Trade	30%	65%	5%	20%	66%	15%	9%	70%	21%	9%	72%	19%
Tourism, Restaurant and Hotels	33%	68%	0%	35%	65%	0%	38%	60%	2%	45%	55%	0%
Transport and Communication	29%	66%	5%	27%	66%	7%	21%	67%	12%	26%	63%	12%
Real Estate	38%	58%	5%	43%	53%	5%	29%	61%	10%	34%	56%	10%
Financial Services	20%	75%	5%	5%	88%	8%	5%	90%	5%	7%	90%	2%

2.4 Factors affecting credit standards

2.4.1 Observations

In Q4 of 2015, seven out of the eight factors had litle impact on banks credit standards. Bank's cost of funds and Balance sheet constraints were cited by 53% of respondents as the factor that led to the tightening of credit standards.This could be supported by the fact that towards the end of 2015, the cost of funds to banks increased due to investors preferring to invest in the more lucrative government securities. **Table 4** below shows the trend in factors influencing credit standards over the four quarters of 2015.

Table 4:Factors affecting Credit Standards

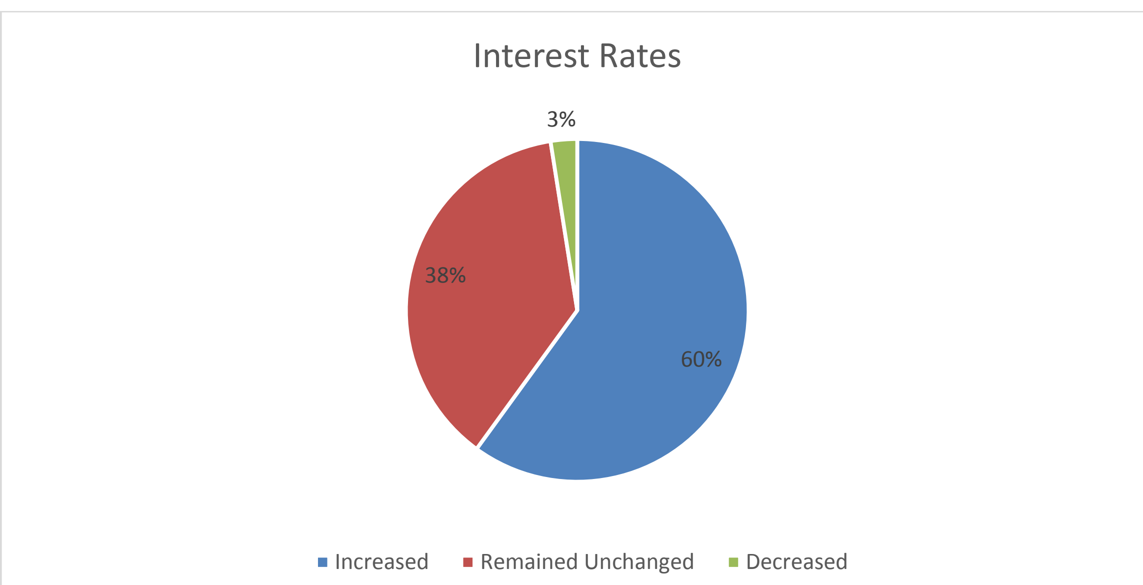
	Dec-15			Sep-15			Jun-15			Mar-15		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds & Balance sheet constraints	53%	45%	3%	63%	38%	0%	43%	55%	3%	36%	62%	2%
Constraints relating to Bank's capital position	26%	72%	3%	23%	69%	8%	24%	74%	3%	27%	63%	10%
Competition from other banks	8%	70%	23%	7%	68%	24%	9%	81%	9%	7%	62%	31%
Competition from Microfinance Banks, Saccos, & other Credit Providers	10%	85%	5%	5%	88%	8%	2%	71%	27%	0%	81%	19%
Expectations regarding general economic activity	27%	66%	7%	27%	59%	15%	21%	62%	17%	14%	67%	19%
Retention of Central Bank Rate (CBR)	13%	85%	3%	27%	66%	7%	17%	79%	5%	2%	93%	5%
Political Risk	5%	93%	3%	10%	83%	7%	14%	83%	2%	17%	78%	5%
Retention of KBRR	18%	78%	5%	24%	66%	10%	5%	90%	5%	3%	83%	15%

2.5 Interest Rates

2.5.1 Observations

During the quarter under review, 60% of the respondents indicated that interest rates had increased. Some of the respondents cited high cost of funds and high Treasury Bill rates as the reasons that led to increased interest rates. This is illustrated in **Chart 1 below.**

Chart 1: Interest Rates



2.6 Non-Performing Loans (NPLs)

2.6.1 Observations

In the first quarter of 2015, most banks forecasted an increase in NPLs in the Trade, Transport and Communication, Mining and Quarrying and Tourism sectors in Q2. However, the actual NPLs for the quarter ended 30th June 2015 increased in Building & Construction, Real Estate, Transport Trade, Manufacturing and Financial Services, Energy & Water and Tourism sectors. NPLs in the Mining and Quarrying sector remained constant.

In the second quarter of 2015, most banks expected the level of NPLs to remain unchanged in Q3 of 2015 in ten of the eleven economic sectors as depicted in **Table 5**. 41% of the respondents forecasted high NPLs in the Tourism sector due to spillover of delinquencies attributed to the previous spate of insecurity in the country and previous adverse travel advisories. On the contrary some respondents were optimistic that in the coming months, Tourism Sector would recover after the lifting of adverse travel advisories by US and UK. This expectation is also supported by the annual high season for Tourism sector which runs from July to December.

In the third quarter, banks had forecasted that the level of NPLs would remain constant in Q4 of 2015 in eight of the eleven economic sectors as depicted in **Table 5**. There was a significant increase in the number of respondents that foresaw 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.

Though most of the banks expect the level of NPLs to remain unchanged in Q1 of 2016, there was a significant increase in the number of respondents that foresee higher NPLs in the Mining and Quarrying, Energy and Water and Financial Services sectors. These were 6%, 3% and 2% increase in the number of respondents respectively as compared to the quarter ended September 2015. NPLs on the other hand are expected to drop in the Manufacturing (by 3%), Tourism (by 2%), Transport (by 2%) and Personal/Household sectors (by 3%).

Table 5: Non Performing Loans

	Dec-15			Sep-15			Jun-15			Mar-15		
	Rise	Remained Constant	Fall	Rise	Remained Constant	Fall	Rise	Remained Constant	Fall	Rise	Remained Constant	Fall
Agriculture	13%	76%	11%	21%	61%	18%	8%	70%	23%	13%	73%	15%
Manufacturing	33%	54%	13%	33%	58%	10%	12%	60%	29%	7%	68%	24%
Building & construction	46%	38%	15%	46%	38%	15%	25%	55%	20%	17%	54%	29%
Mining and Quarrying	14%	84%	3%	8%	87%	5%	5%	88%	8%	8%	85%	8%
Energy and water	18%	77%	5%	15%	77%	8%	8%	86%	5%	5%	80%	15%
Trade	43%	45%	13%	43%	38%	20%	31%	50%	19%	25%	45%	30%
Tourism, Restaurant & Hotels	20%	73%	7%	28%	67%	5%	41%	30%	30%	39%	46%	15%
Transport & Communication	31%	56%	13%	37%	53%	11%	30%	50%	20%	23%	58%	20%
Real Estate	40%	53%	8%	43%	48%	10%	26%	52%	21%	19%	60%	21%
Financial Services	13%	74%	13%	11%	74%	16%	5%	78%	18%	0%	90%	10%
Personal/Household	38%	50%	13%	63%	28%	10%	31%	49%	20%	33%	50%	18%

2.7 Expected Non-Performing Loan Levels

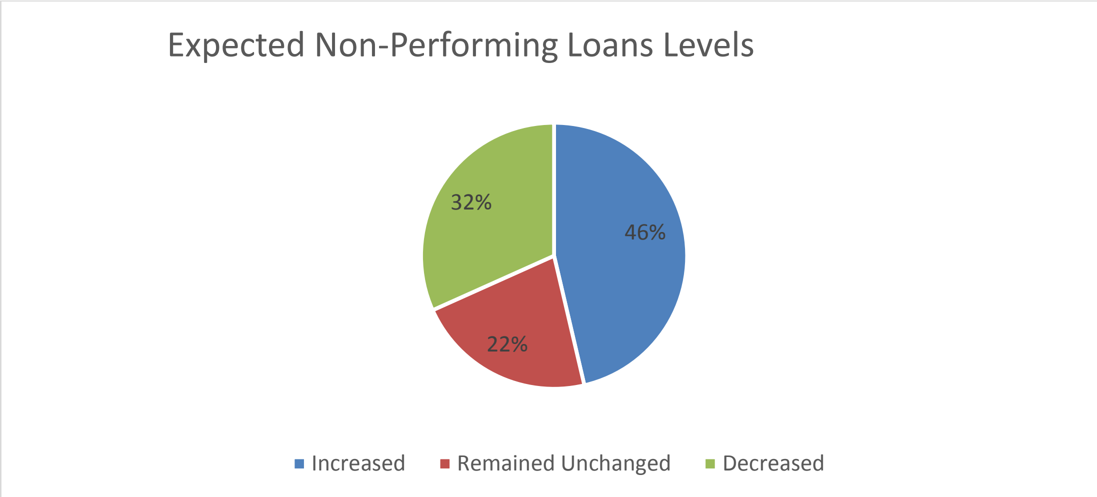
2.7.1 Observations

Most of the respondents expect the NPLs level to increase with 46% of the respondents indicating so. However, 22% of the respondents feel that the NPLs level will remain unchanged while 32% of them felt that NPLs level will decrease in Q1 of 2016. This is depicted in **Chart 2** below.

The expected increase in NPLs in Q1 of 2016 may be attributed to various factors:

- The expected increase in NPLs in the Mining and Quarrying sector may be attributed to the pending Mining Bill in parliament.
- Some respondents predicted that the perceived poor business environment, low liquidity in the economy, high interest rates/residual effect of the interest rise in the previous year and government cash flow constraints.
- Other respondents cited high cost of funds resulting to higher financing costs coupled with a slump in economic activity which may hamper performance of companies.
- 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.
- 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 2: Expected Non-Performing Loan Levels



2.8 Credit Recovery Efforts

2.8.1 Observations

In year 2015, credit recovery efforts were intensified in all the eleven economic sectors. The increase was mainly driven by banks seeking to recover NPLs which had consistently built up in the year. Manufacturing, Energy and Water, Mining and Quarrying and Financial Services sectors are expected to witness the greatest recovery efforts in Q1 of 2016, with 7%, 7%, 5% and 3% more banks intensifying their recovery efforts compared to Q3 of 2015.

Banks intend to intensify their loan recovery efforts in all the eleven economic sectors with Mining and Quarrying, Energy and Water and Financial Services sectors expected to witness higher recovery efforts than other economic sectors. This aims at improving the overall quality of banks' asset portfolio in line with the banks expectations that loan defaults in these sectors will rise during Q1 of 2016.

Banks cite increased cost of funds, perceived poor business environment, delayed government payments, inflation and pending Mining Bill in parliament as reasons for them to intensify credit recovery efforts in Mining and Quarrying, Energy and Water and Financial Services sectors. The trend on credit recovery efforts is shown in **Table 6**.

Table 6: Credit Recovery Efforts

	Dec-15			Sep-15			Jun-15			Mar-15		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	42%	55%	3%	44%	56%	0%	44%	54%	2%	48%	50%	3%
Manufacturing	61%	37%	2%	54%	46%	0%	51%	47%	2%	43%	50%	7%
Building & construction	70%	25%	5%	80%	20%	0%	69%	29%	2%	52%	45%	2%
Mining and Quarrying	33%	64%	3%	28%	72%	0%	25%	75%	0%	27%	73%	0%
Energy and water	38%	60%	3%	31%	69%	0%	33%	64%	2%	31%	69%	0%
Trade	70%	28%	3%	75%	25%	0%	63%	34%	2%	61%	34%	5%
Tourism, Restaurant & Hotels	50%	48%	3%	58%	43%	0%	67%	33%	0%	66%	34%	0%
Transport & Communication	65%	30%	5%	65%	35%	0%	62%	38%	0%	61%	39%	0%
Real Estate	60%	38%	3%	68%	33%	0%	64%	36%	0%	52%	48%	0%
Financial Services	41%	54%	5%	38%	59%	3%	38%	63%	0%	34%	66%	0%
Personal/Household	63%	33%	5%	80%	20%	0%	74%	24%	2%	68%	32%	0%

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.