

**Central Bank of Kenya**

**JUNE 30, 2020**

# **CREDIT SURVEY**

Please rate your experience

Excellent

☒

Good

☐

Average

☐

Poor

☐

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# CENTRAL BANK OF KENYA COMMERCIAL BANKS' CREDIT OFFICER SURVEY FOR THE QUARTER ENDED JUNE 30, 2020

## 1.0 COMMERCIAL BANKS' CREDIT OFFICER SURVEY

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### 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 marginally from 56.94 percent in the quarter March 31, 2020 to 55.85 percent in the quarter ended June 30, 2020.

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, interest rates, asset quality, credit recovery efforts, deployment of liquidity and impact of implementing International Financial Reporting Standard (IFRS) 16 on Leases and IFRS 9 on financial instruments.

### 1.2 SURVEY METHODOLOGY

Senior Credit Officers<sup>1</sup> complete most of the survey and collate inputs from senior officers responsible for the other aspects. For the quarter ended June 30, 2020, 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, level of interest rates, non-performing loans, the effect of repeal of capping of interest rates<sup>2</sup> on lending to Small and Medium sized Enterprises (SMEs), 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 with regard to liquidity in the banks. The banks were required to state their appetite for deployment of liquidity towards 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 assessed the impact of the pandemic on the banking sector.

The survey included questions relating to impact of the pandemic on the banks, measures taken by banks to curb the potential impact of the pandemic and their experience in implementing the emergency measures introduced by CBK to mitigate the impact of the pandemic.

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<sup>1</sup>These are officers involved in most of the credit 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.

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<sup>2</sup>The capping of interest rates law came into effect on September 14, 2016 and was repealed on November 7, 2019.

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### 1.3 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan Banking Sector recorded growth in the quarter ended June 30, 2020, compared to the quarter ended March 31, 2020. Some of the sector's performance indicators are as follows: -

- The aggregate balance sheet increased by 4.13 percent from Ksh.5,001.16 billion in March 2020 to Ksh.5,207.82 billion in June 2020. The increase was attributed to increased investment in government securities and foreign currency loans during the period.
- Gross loans increased by 2.15 percent from Ksh. 2,847.44 billion in March 2020 to Ksh.2,908.7 billion in June 2020. The growth in gross loans was mainly due to increased advances in the Real Estate, Transport and Communication and Manufacturing sectors.
- Total deposits increased by 5.84 percent from Ksh. 3,688.08 billion in March 2020 to Ksh.3,903.62 billion in June 2020. This was as a result of increased foreign and local currency deposits.
- The asset quality, measured by ratio of gross non-performing loans to gross loans deteriorated from 12.54 percent in March 2020 to 13.14 percent in June 2020. This was attributed to a slowdown in business activities as a result of adverse effects of COVID -19 pandemic.
- The total capital adequacy ratio increased from 18.50 percent in March 2020 to 18.52 percent in June 2020. This is as a result of a higher increase in total capital as compared to increase in total risk weighted assets. The capital adequacy ratio reported in June 2020 was above the minimum statutory limits of 14.5 percent.

- Quarterly profit before tax decreased by Ksh.16.68 billion to Ksh.21.66 billion in June 2020 from Ksh.38.34 billion in March 2020. Return on Assets decreased to 2.22 percent in June 2020 from 2.33 percent in March 2020. The total assets increased by 4.13 percent whereas quarterly profit before tax decreased by 16.68 percent during the quarter hence the decrease in Return on Assets.
- Return on Equity decreased to 15.59 percent in June 2020 from 20.38 percent in March 2020. This is as a result of a drop in quarterly profit before tax in June 2020.
- During the quarter ended June 2020, liquidity in the banking sector marginally increased from 51.45 percent in March 2020 to 52.76 percent in June 2020. This was well above the minimum statutory ratio of 20 percent.

### 1.4 SUMMARY OF CREDIT OFFICER SURVEY FINDINGS

- **Demand for credit:** In the second quarter of 2020, the perceived demand for credit remained unchanged in six economic sectors whereas it decreased in five sectors.
- **Credit Standards<sup>3</sup>:** In the second quarter of 2020, credit standards remained unchanged in six economic sectors and were tightened in five sectors.

The tightening of credit standards in the five sectors is attributed to the effects of COVID – 19 pandemic.

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<sup>3</sup> Credit standards are guidelines used by commercial banks in determining whether to extend a loan to an applicant.

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- **Repeal of interest rate capping law:** 82 percent of the respondents indicated that after the repeal of interest rate capping law, the demand for credit remained unchanged, 10 percent noted that demand for credit increased while 8 percent noted that demand for credit decreased.
  - **Lending to Small and Medium-sized Enterprises (SMEs):** 20 percent indicated that the repeal had increased their lending to SMEs. In the quarter ended June 2020, 77 percent of the respondents indicated that the repeal of interest rate capping law had no effect on their lending to SMEs.
  - **Non-Performing Loans:** During the quarter under review, the respondents indicated that the levels of NPLs remained unchanged in four economic sectors and increased in seven sectors. The main sectors with the highest increase in NPLs include Tourism, Restaurant and Hotels, Transport and Communication, and Personal and Household sectors. The increase in NPLs was mainly due to a challenging business environment as a result of COVID-19 pandemic.
  - **Expected Non-Performing Loans levels during the third quarter:** 64 percent of the respondents indicated that NPLs are likely to increase in the third quarter of 2020 as a result of the global COVID-19 pandemic. The respondents indicated that all the eleven economic sectors will be affected negatively by the pandemic.
  - **Credit Recovery Efforts:** For the quarter ended September 30, 2020, banks expect to intensify their credit recovery efforts in nine of the eleven economic sectors. The intensified recovery efforts are aimed at improving the overall quality of the asset portfolio.
  - **International Financial Reporting Standard (IFRS) 9 on Financial Instruments:** Implementation of IFRS 9 had an adverse impact on commercial banks' capital adequacy due to increased provisioning. This led the commercial banks to explore injection of more capital.
  - **International Financial Reporting Standard (IFRS) 16 on Leases:** Most banks indicated that implementation of IFRS 16 increased their risk weighted assets, which has in turn negatively affected their capital adequacy ratios.
  - **Liquidity risk:** During the quarter ended June 2020, liquidity of the banking industry fairly remained stable at 52.76 percent.
  - Banks intend to deploy excess liquidity towards credit, mostly by lending to the private sector, CBK liquidity management through repos and interbank lending and investing in treasury bills and bonds.

## 2.0 SURVEY FINDINGS

### 2.1 Demand for Credit

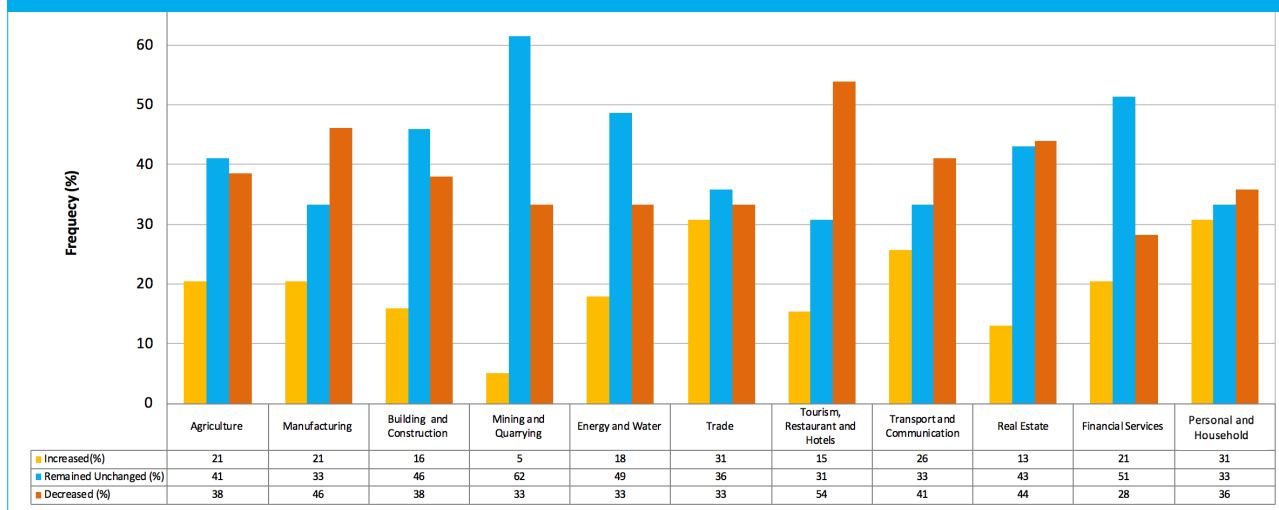
- In the second quarter of 2020, the perceived demand for credit remained unchanged in six economic sectors whereas demand for credit in five sectors decreased.
- The main sectors with unchanged demand for credit are Mining and Quarrying, Financial Services, and Energy and Water.
- Perceived demand for credit significantly decreased in the Tourism, Restaurant and Hotels, Manufacturing and Real Estate sectors. This is partly due to adverse effects of the COVID-19 pandemic.

**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 (%)	March 2020			June 2020		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	18	61	21	21	41	38
Manufacturing	31	41	28	21	33	46
Building and Construction	16	55	29	16	46	38
Mining and Quarrying	5	68	27	5	62	33
Energy and Water	15	64	21	18	49	33
Trade	46	39	15	31	36	33
Tourism, Restaurant and Hotels	26	42	32	15	31	54
Transport and Communication	16	54	30	26	33	41
Real Estate	24	45	31	13	43	44
Financial Services	21	56	23	21	51	28
Personal and Household	53	31	16	31	33	36

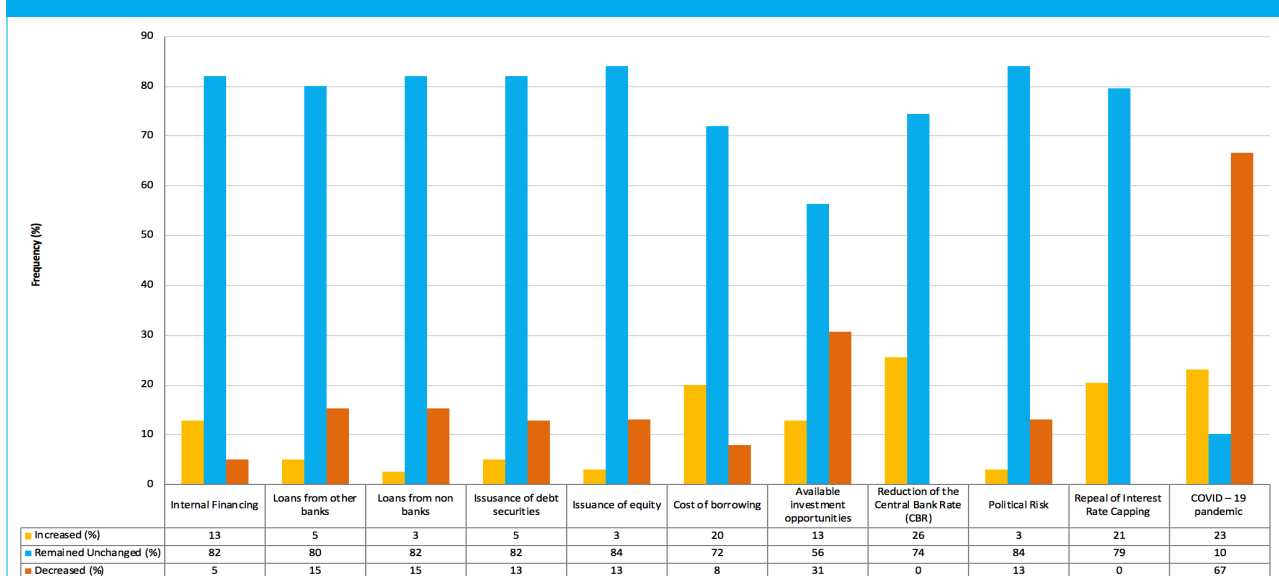
### Chart 1: Demand for Credit



## 2.2 Factors Affecting Demand for Credit

- In the quarter ended June 30, 2020, ten out of the eleven factors affecting demand for credit had no impact. However, 67 percent of the banks reported that the COVID-19 pandemic had negatively impacted the demand for credit. This is depicted in **Chart 2** and **Table 2**.
- Political risk, Issuance of equity, Issuance of debt securities and loans from non-banks were cited as having had the least impact on the demand for credit during the quarter under review. This was reported by 84 percent, 84 percent, 82 percent and 82 percent of the respondents respectively.

### Chart 2: Factors affecting Demand for Credit



**Table 2: Factors Affecting Demand for Credit**

Percentage (%)	March 2020			June 2020		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	21	71	8	13	82	5
Loans from other banks	13	71	16	5	80	15
Loans from non-banks	8	78	14	3	82	15
Issuance of debt securities	6	94	0	5	82	13
Issuance of equity	8	89	3	3	84	13
Cost of borrowing	32	65	3	20	72	8
Available investment opportunities	27	54	19	13	56	31
Reduction of the Central Bank Rate (CBR)	41	54	5	26	74	0
Political Risk	16	76	8	3	84	13
Repeal of Interest Rate Capping	33	64	3	21	79	0
COVID – 19 pandemic	24	22	54	23	10	67

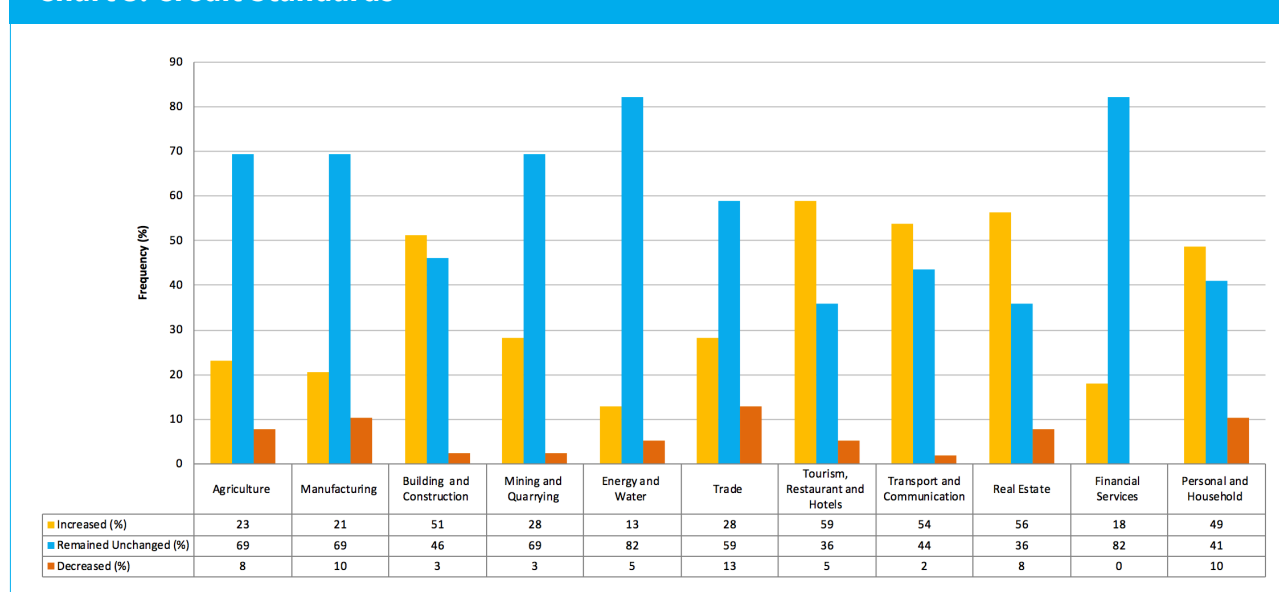
## 2.3 Credit Standards

- In the second quarter of 2020, credit standards remained unchanged in six economic sectors and tightened in five sectors.

- Tightening of credit standards in the five sectors is attributed to the effects of COVID – 19 pandemic.

This is presented in **Chart 3** and **Table 3** below.

**Chart 3: Credit Standards**





**Table 3: Credit Standards for Loans to Various Economic Sectors**

Percentage (%)	March 2020			June 2020		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	24	71	5	23	69	8
Manufacturing	26	61	13	21	69	10
Building and Construction	50	47	3	51	46	3
Mining and Quarrying	21	79	0	28	69	3
Energy and Water	18	79	3	13	82	5
Trade	31	56	13	28	59	13
Tourism, Restaurant and Hotels	58	37	5	59	36	5
Transport and Communication	46	51	3	54	44	2
Real Estate	58	34	8	56	36	8
Financial Services	23	77	0	18	82	0
Personal and Household	34	58	8	49	41	10

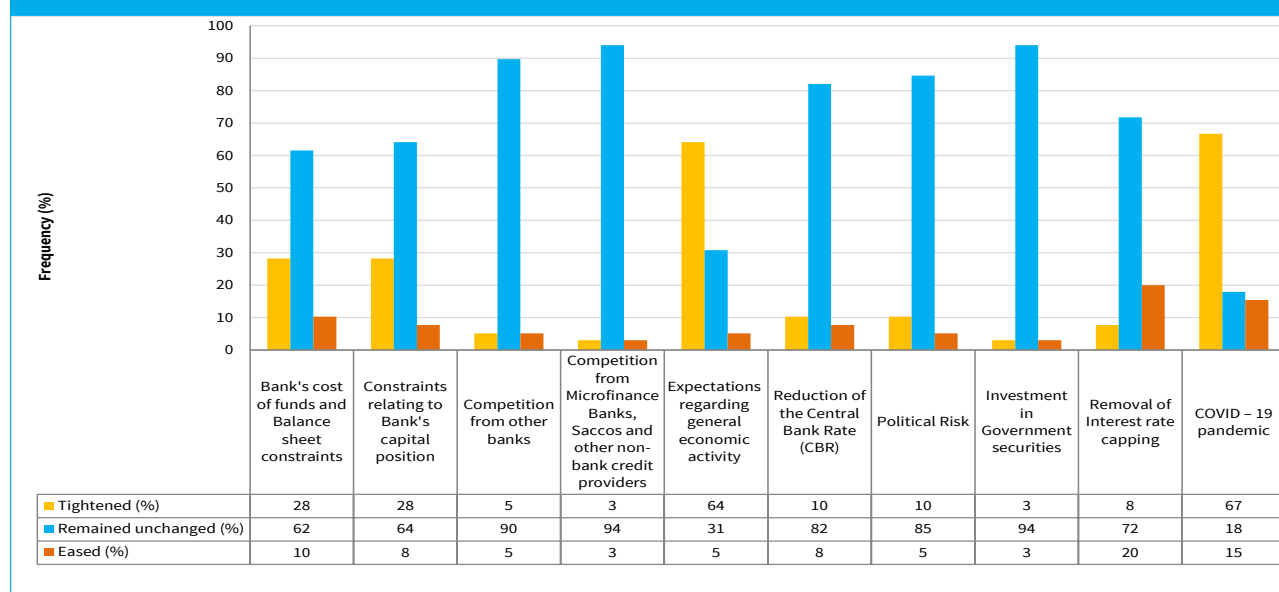
## 2.4 Factors Affecting Credit Standards

- In the quarter ended June 30, 2020, eight factors had little impact on credit standards.
- Competition from Saccos, Microfinance banks, other Credit Providers; investment in Government Securities, competition from banks, political risk and reduction of CBR are

the main factors that had no impact on credit standards. This was reported by 94 percent, 94 percent, 90 percent, 85 percent and 82 percent 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**





**Table 4: Factors affecting credit standards**

	March 2020			June 2020		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds and Balance sheet constraints	29	60	11	28	62	10
Constraints relating to Bank's capital position	26	66	8	28	64	8
Competition from other banks	8	84	8	5	90	5
Competition from DTMs, Saccos, and other Credit Providers	3	94	3	3	94	3
Expectations regarding general economic activity	57	38	5	64	31	5
Reduction of the Central Bank Rate (CBR)	8	82	10	10	82	8
Political Risk	15	80	5	10	85	5
Investment in Government Securities	3	89	8	3	94	3
Removal of Interest rate capping	10	67	23	8	72	20
COVID –19 pandemic	59	27	14	67	18	15

## 2.5 Repeal of Interest Rate Capping Law

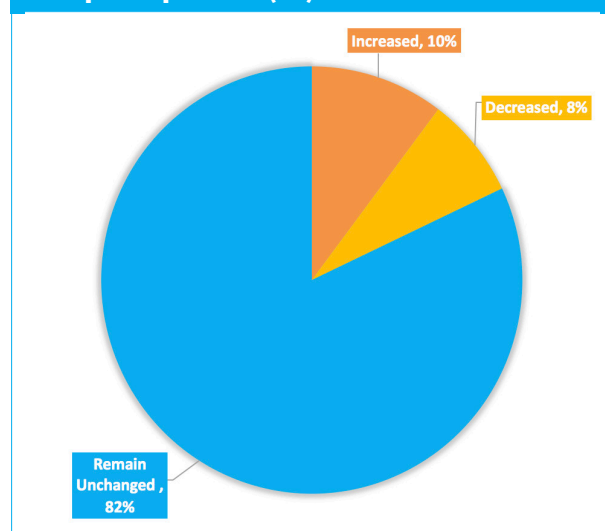
- Following the repeal of capping of interest rates effective November 7, 2019, the Central Bank of Kenya has continued to assess its impact on demand for credit, lending to SMEs, actual credit granted, and Non-Performing Loans (NPLs).

### 2.5.1 Effect of Repeal of Interest Rate Capping Law on Actual Credit Granted in Second Quarter of 2020

- 82 percent of the respondents indicated that after the repeal of interest rate capping law, the actual credit granted remained unchanged. 10 percent noted that actual credit granted increased while 8 percent noted that it decreased.

This is depicted in **Chart 5**.

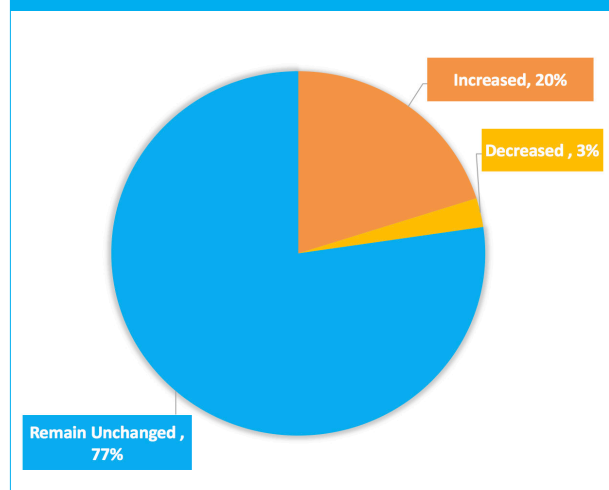
**Chart 5: Effect of Repeal of Interest Rate Cap Law on Actual Credit granted over the past quarter (%)**



### 2.5.2 Effect of repeal of Interest Rate Capping Law on Lending to SMEs in Second Quarter of 2020

- In the quarter ended June 2020, 20 percent indicated that the repeal had increased the lending to SMEs. 77 percent of the respondents indicated that the repeal of interest rate capping law had no effect on their lending to SMEs. This is indicated in **Chart 6**.
- Following the repeal of interest rate capping law, majority of the banks are on-boarding risk based pricing models. This has increased financial institution's appetite to lend to SMEs.

**Chart 6: Effect of Repeal of Interest Rate Capping Law on lending to SMEs (%)**

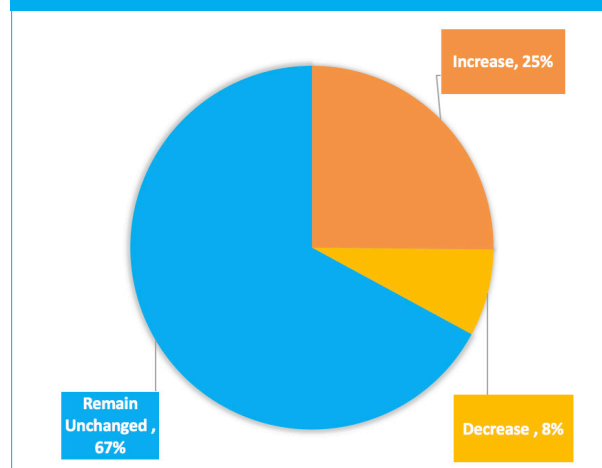


### 2.5.3 Effect of repeal of Interest Rate Cap Law on Demand for Credit in Third Quarter of 2020

- With regards to the actual new credit granted in the third quarter of 2020, 67 percent of the respondents felt that the repeal of interest capping will have little or no impact on the actual new credit granted.

- 25 percent of the respondents anticipate that repeal of interest rate capping law will lead to an increase in demand for credit while 8 percent felt that the demand for credit will decrease.
- The expected movement on demand for credit in the third quarter is shown in **Chart 7**.

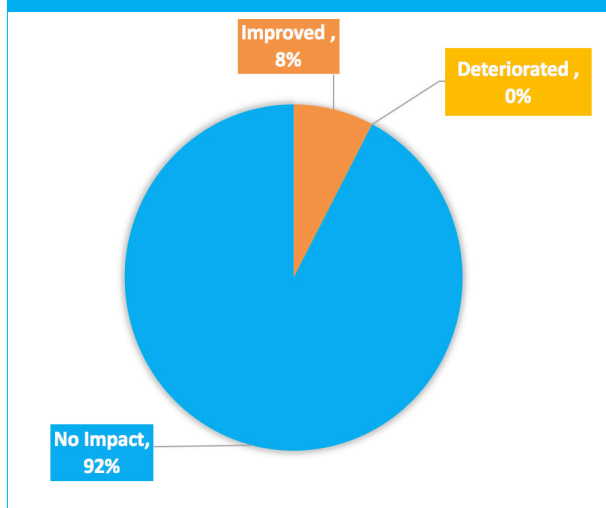
**Chart 7: Interest rate cap effect on actual new credit granted over the next three months (%)**



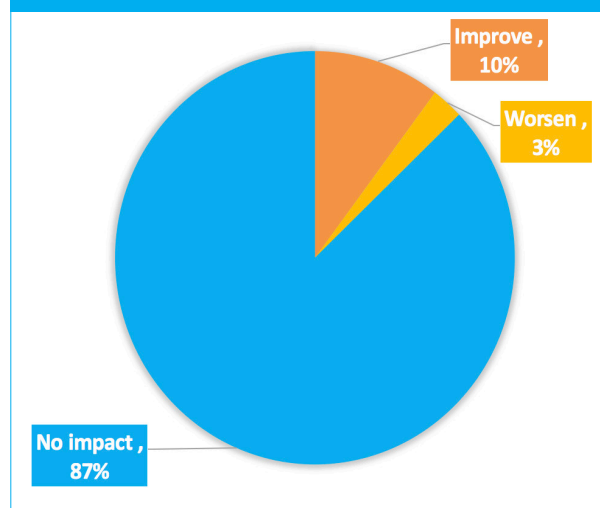
### 2.5.4 Effect of repeal of Interest Rate Capping Law on the Level of NPLs in the Second Quarter of 2020

- In the quarter ended June 30, 2020, 92 percent of the respondents indicated that repeal of interest rate capping law had no effect on level of NPLs.
- 8 percent of the respondents indicated that asset quality improved during the quarter. This trend is indicated in **Chart 8** below.

**Chart 8: Effect of repeal of interest rate capping on NPLs over the past quarter (%)**



**Chart 9: Interest rates cap effect on level of NPLs in the next quarter (%)**



### 2.5.5 Effect of repeal of Interest Rate Capping Law on the Expected Level of NPLs in the Next Quarter of 2020

- 87 percent of the respondents anticipate that repeal of interest rate capping law would have no impact on the level of NPLs in the third quarter of 2020. This is because the pricing of loans has no impact on repayment ability.
- 10 percent of the respondents expect the repeal of law on capping of interest rates to have a positive impact on NPLs.
- 3 percent expect the repeal of law on capping of interest rates to have a negative and positive impact on NPLs. This may be attributed to the uncertainties in slowdown in the economy due to the on-going global COVID-19 pandemic. This trend is as indicated in **Chart 9**.

## 2.6 Non-Performing Loans (NPLs)

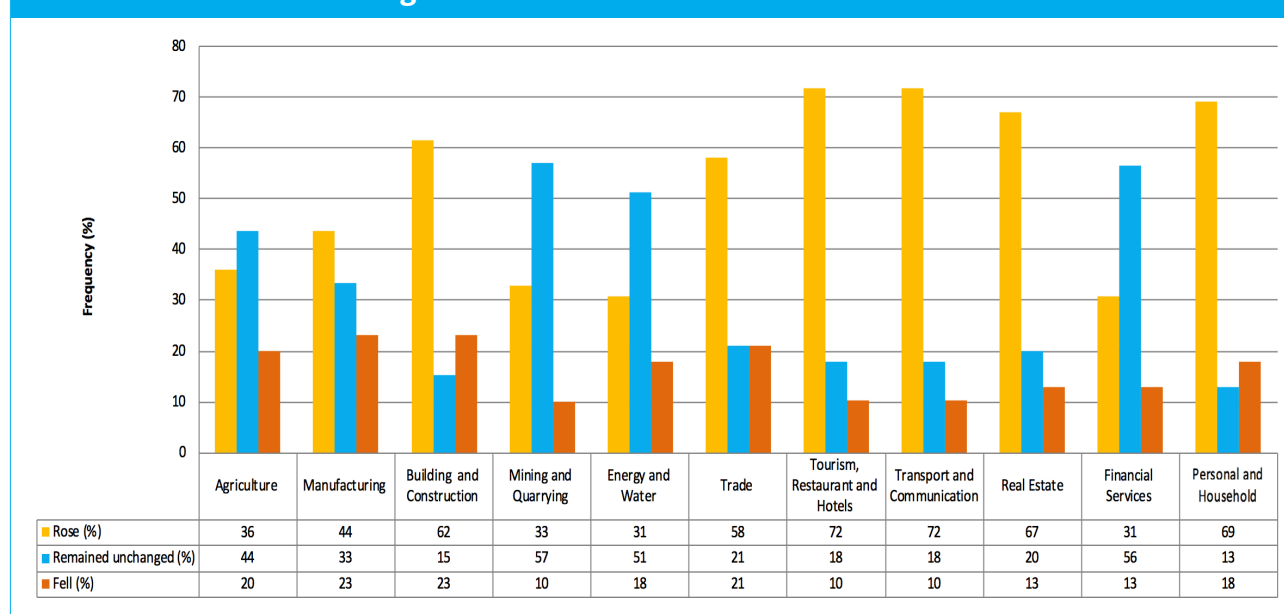
### 2.6.1 Non - Performing Loans during the quarter ended June 30, 2020

- In the quarter ending June 30, 2020, the respondents indicated that the level of NPLs increased in seven economic sectors and remained unchanged in four economic sectors (Financial Services, Mining and Quarrying, Energy and Water and Agriculture).
- NPLs increased in the Tourism, Restaurant and Hotels, Transport and Communication, Trade, Real Estate, Personal and Household, Building and Construction, and Manufacturing sectors. **Table 5** and **Chart 10** and depicts this.

**Table 5: Non-Performing Loans Trend Per Economic Sector**

Percentage (%)	March 2020			June 2020		
	Rose	Remained Unchanged	Fell	Rose	Remained Unchanged	Fell
Agriculture	38	43	19	36	44	20
Manufacturing	62	28	10	44	33	23
Building and Construction	60	29	11	62	15	23
Mining and Quarrying	33	62	5	33	57	10
Energy and Water	35	60	5	31	51	18
Trade	72	18	10	58	21	21
Tourism, Restaurant and Hotels	76	19	5	72	18	10
Transport and Communication	71	24	5	72	18	10
Real Estate	69	26	5	67	20	13
Financial Services	33	62	5	31	56	13
Personal and Household	63	29	8	69	13	18

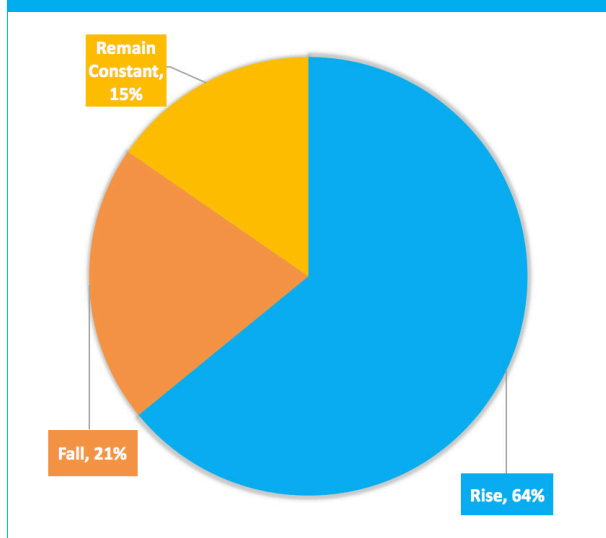
**Chart 10: Non-Performing Loans**



### 2.6.2 Expected Non-Performing Loans during the next Quarter

- 64 percent of the respondents expect the level of NPLs to rise in the third quarter of 2020. This is attributed to the challenging business environment as a result of the on-going global COVID-19 pandemic.
- 21 percent of the respondents expect the level of NPLs to fall in the third quarter of 2020. This is attributed to enhanced recovery efforts being implemented by most banks.
- 15 percent of respondents expect NPLs to remain constant. This is depicted in **Chart 11**.

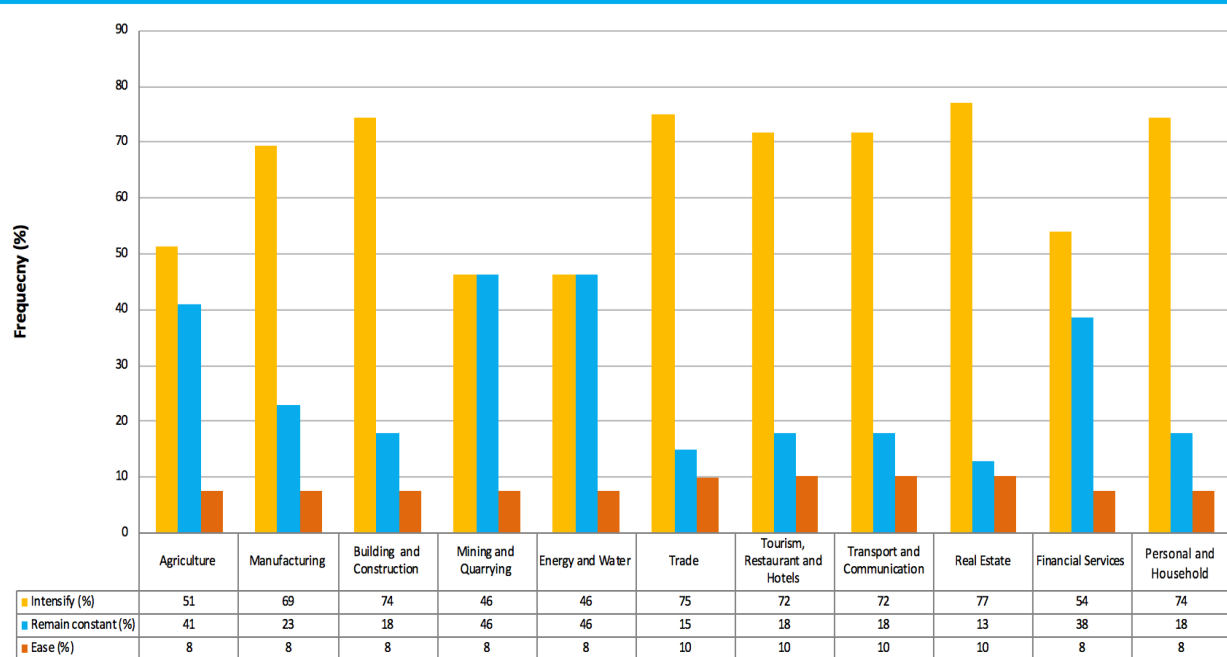
**Chart 11: Expected movements of NPLs in the next Quarter of 2020 (%)**



### 2.7 Credit Recovery Efforts in the Second Quarter of 2020

- For the quarter ended June 30, 2020, banks expect to intensify their credit recovery efforts in nine of the eleven economic 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. 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) Real Estate (77 percent).
  - ii) Trade (75 percent).
  - iii) Personal and Household and Building and Construction (74 percent).
  - iv) Tourism, Restaurant and Hotels, and Transport and Communication (72 percent).
- Credit recovery efforts are expected to remain unchanged in the Mining and Quarrying, and Energy and Water since the level of bad debts in these sectors is low. The responses on the expected credit recovery efforts by the banks are depicted in **Chart 12** and **Table 6**.

**Chart 12: Credit Recovery Efforts**



**Table 6: Credit Recovery Efforts**

	March 2020			June 2020		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	58	37	5	51	41	8
Manufacturing	69	26	5	69	23	8
Building and Construction	63	29	8	74	18	8
Mining and Quarrying	45	50	5	46	46	8
Energy and Water	49	46	5	46	46	8
Trade	66	26	8	75	15	10
Tourism, Restaurant and Hotels	66	29	5	72	18	10
Transport and Communication	69	26	5	72	18	10
Real Estate	63	29	8	77	13	10
Financial Services	54	43	3	54	38	8
Personal and Household	63	29	8	74	18	8

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## 2.8 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.
- Central Bank of Kenya assesses : -
  - i). The challenges the banks have experienced 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;
  - iii). What the bank have done to ensure that the assumptions are more reliable.

### 2.8.1 Challenges experienced in the Implementation of IFRS 9 and Mitigation Measures

It is worth noting that most banks have adopted a tight credit risk appraisal, ensuring that facilities are well secured and that alternative sources of repayment are available. In addition, banks have changed their lending policies to align them with IFRS 9.

However, implementation of IFRS 9 has had some challenges. These include: -

- i. Negative impact on capital adequacy due to increased provisioning.
  - ii. Challenges in getting reliable macro-economic indicators.
  - iii. Commercial banks are also not able to predict which other macro-economic data are likely to affect the economy.
  - iv. Cost implication for the relevant technology, consultants and personnel training.
  - v. Negative impact on profitability.
  - vi. Continuous improvement of the business model.
- As a mitigation measure, banks have indicated that: -
    - i. They have injected additional capital to accommodate the expected rise in credit losses.
    - ii. They are continuously improving their business models to incorporate forward-looking credit risk assessment models in compliance with IFRS 9 requirements.
    - iii. Some banks have developed internal rating models to assess credit risks across the board including for SMEs. Banks have therefore introduced unsecured credit products for SMEs.
    - iv. Banks have engaged consultants to validate the assumptions to ensure that they are reliable.
    - v. The focus of banks is now more on secured lending.
    - vi. Banks have revamped their credit recovery efforts.
    - vii. Banks are enhancing staff capacity through training as well as reviewing their policies and procedures to ensure full compliance with IFRS 9.
    - viii. Banks focus on high yielding assets.



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

- The use of forward-looking information is a key component of the Expected Credit Loss (ECL) impairment approach. Commercial banks are now required to consider historic, current and forward-looking information (including macro-economic data).

This aims at ensuring that credit losses are recognized at an early stage, rather than waiting for an incurred loss event to have occurred before credit losses are recognized.

- ECLs are measured in a way that is not just determined by evaluating a range of possible outcomes, adjusted for the time value of money, but also taking into account 'reasonable and supportable' information about past, present and future events and economic conditions.
- During the quarter under review, the survey revealed the following:-
  - i. Some of the respondents indicated that they have updated their assumptions to include the current macro-economic indicators.
  - ii. Banks are facing challenges in modeling data related to the global COVID-19 pandemic and its predicted impact on loan performance.

Banks are still assessing the effects of COVID-19 to generate different assumptions that will need to be included in the model.
  - iii. Some banks have conducted various stress tests to isolate industries that are most vulnerable and are being monitored in order to incorporate them into their various models.

### 2.8.3 Actions by the commercial banks to ensure that the assumptions are reliable

Some of the respondents have indicated that they are currently reviewing their assumptions on a quarterly basis to ensure that they are reliable. This aims at ensuring that losses in different sectors are reflected accurately in the model.

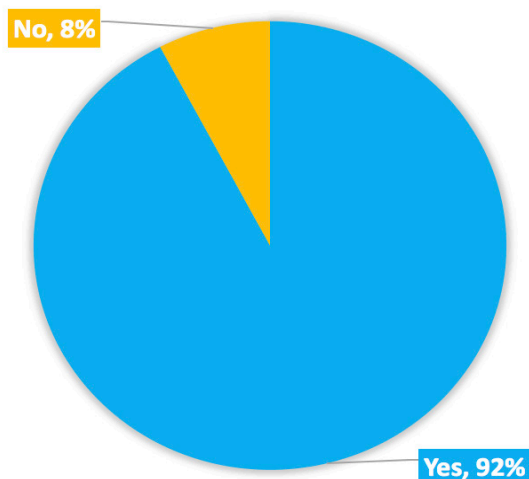
Some banks have also indicated that their model parameters (probability of default and Loss Given Default) are updated twice yearly to ensure all parameters are up to date and relevant.

## 2.9 International Financial Reporting Standard (IFRS) 16 on Leases

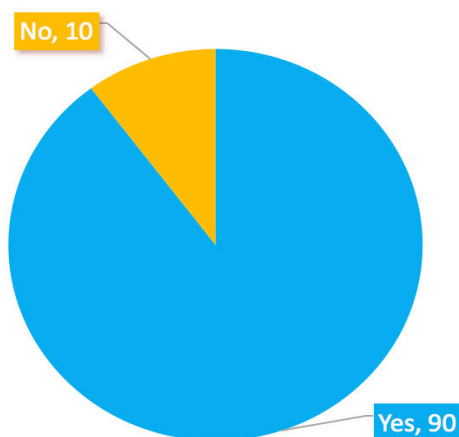
- The International Financial Reporting Standard (IFRS) 16 on Leases became effective from January 1, 2019. This standard replaced International Accounting Standard (IAS) 17 on Leases.
- The main difference between IAS 17 and IFRS 16 is the treatment of operating leases by lessees. Under IAS 17, a lessee 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. However, financial institutions have been facing challenges with the implementation of IFRS 16.

- During the quarter ended June 30, 2020, 92 percent of the respondents had implemented IFRS 16 and 90 percent of the respondents had assessed the likely impact of IFRS 16 on their financial performance and position. This is depicted in **Chart 13** and **Chart 14** below.

**Chart 13: Banks that have implemented IFRS 16 on Leases (%)**



**Chart 14: Banks that assessed the likely impact of IFRS 16 (%)**



### 2.9.1 Impact of IFRS 16 on Banks' Financial performance and position

- Most banks indicated that implementation of IFRS 16 increased their risk weighted assets, which has in turn decreased their capital adequacy ratios.
- This may call for capital injection to strengthen the banks' capital adequacy.

### 2.9.2 Challenges experienced in the Implementation of IFRS 16

- Most banks indicated that the major challenge they face in implementation of IFRS 16 is cost of training their staff for compliance with the standard.
- As a mitigation measure, banks have indicated that they are: -
  - training their staff on the job, and
  - changing their business models and risk management tools.

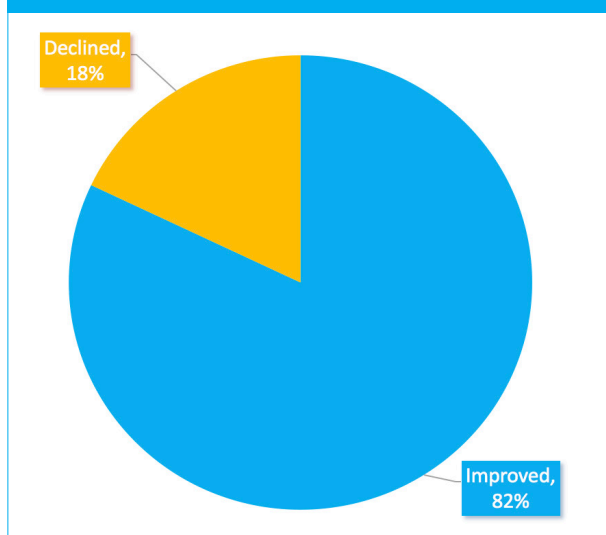
### 2.10 Liquidity Risk

- During the quarter ended June 30, 2020, liquidity in the banking sector increased from 51.45 percent in March 2020 to 52.76 percent in June 2020. This remained above the minimum statutory ratio of 20 percent.
- Banks whose liquidity deteriorated in the last two quarters intend to solve this by: -
  - Mobilizing deposits from the general public.
  - Enhanced loan collections and recoveries.
  - Sourcing for strategic investment partners.

## 2.11 Commercial Banks' liquidity positions

- During the quarter ended June 2020, 82 percent of the respondents indicated that their liquidity position had improved as indicated in **Chart 15**.

**Chart 15: Movement in liquidity risk (%)**

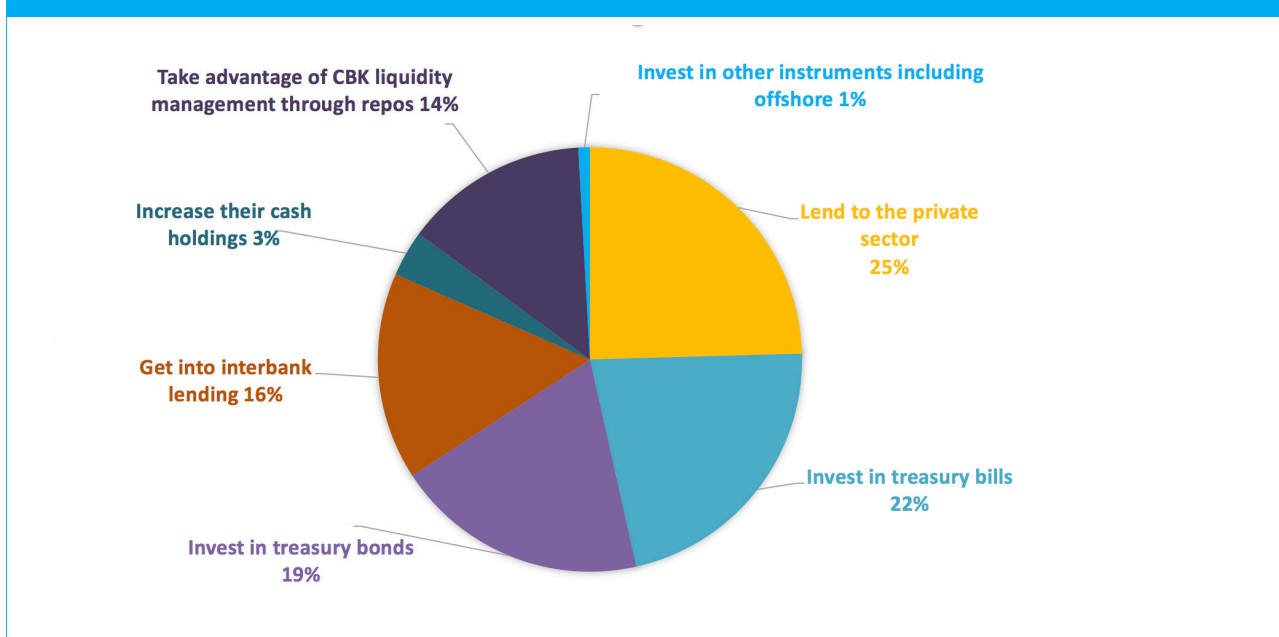


- As indicated in **Chart 16**, with the improved liquidity, it is expected that in the next quarter, issuance of credit will increase as most banks intend to deploy the additional liquidity towards lending to the private sector (28 percent), investing in treasury bills and bonds (20 percent), CBK liquidity management through repos (17 percent) and interbank lending (12 percent). This is similar to the previous quarter.

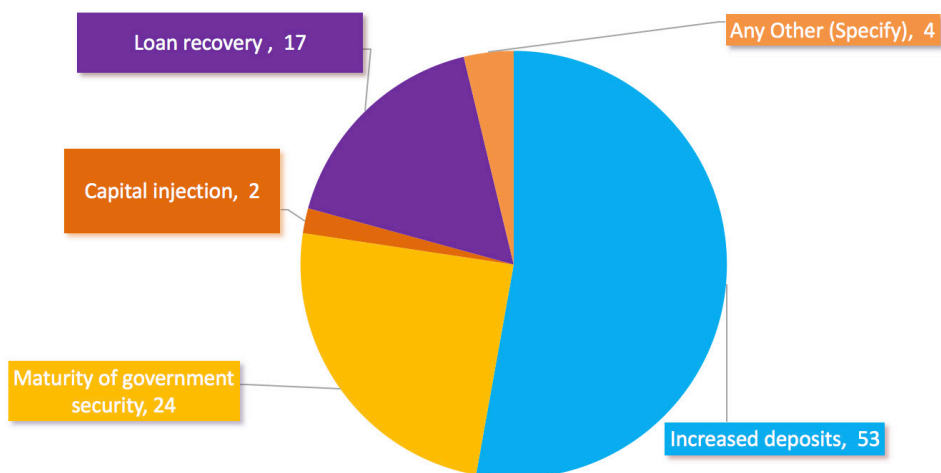
## 2.12 Factors that led to improved liquidity over the past quarter

- During the quarter ended June 2020, liquidity improved mainly as a result of: -
  - Increased deposits (53 percent).
  - Maturity of government securities (24 percent).
  - Loan recovery (17 percent).
- The drivers of improved liquidity are indicated in **Chart 17** below.

**Chart 16: Plans with improved liquidity (%)**



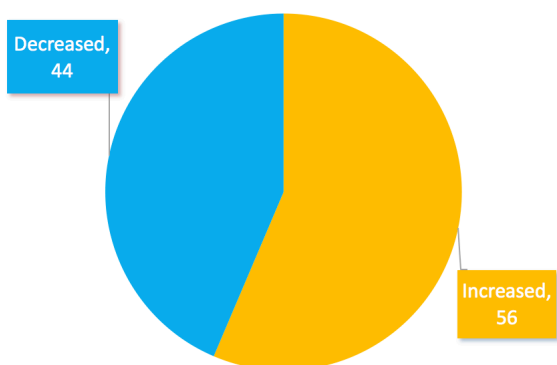
**Chart 17: Reasons for improved liquidity (%)**



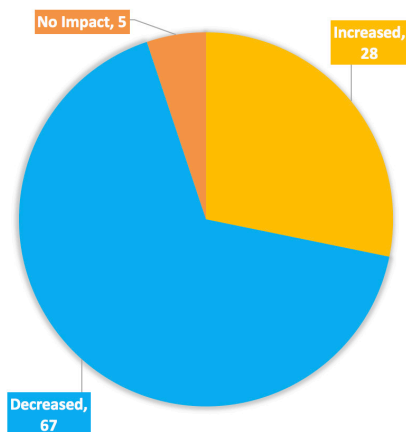
### 2.13 Commercial Banks' interbank activities during the quarter

- During the quarter ended June 2020, 56 percent of the respondents indicated that their interbank lending activities decreased. This is indicated in **Chart 18** below.
- 67 percent of the respondents indicated that their interbank borrowing decreased. This is indicated in **Chart 19** below.

**Chart 18: Increase in interbank lending(%)**



**Chart 19: Increase in Interbank borrowing (%)**



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## 2.14 Impact of the Global Coronavirus Pandemic on the Banking Sector

The ongoing COVID-19 pandemic has devastated many countries, with significant human, economic and social costs. The global economic outlook has been highly uncertain, with unprecedented volatility in the financial markets.

While the extent of the adverse effects of the pandemic on the Kenyan economy is still evolving, it is already evident that the impact may be 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) Measures taken by banks to curb the potential impact of the pandemic; and
- iii) Banks' experience in implementing the emergency measures introduced by CBK to mitigate the impact of the pandemic.

### 2.14.1 Impact of Coronavirus pandemic expected by the banks

The commercial banks have indicated that they expect the pandemic to have a negative impact on their business.

Some positive impacts include:

- Increased use of digital platforms (Mobile and internet banking).
- Increased demand for lending to Fast Moving Consumer Goods (FMCG), health and technology companies.

Some of the adverse effects include:

- Decrease in profitability because of slowdown in business.
- Increased expenditure. Banks have been compelled to purchase Personal Protective Equipment (PPE) for staff as well as ensuring that their premises are well fumigated.

- Increases in Non-Performing Loans which may be attributed to slowdown in business, business closures and job losses.
- Decrease in loans advanced to customers as bank become more cautious due to the high risk of credit default.
- 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.

### 2.14.2 Measures taken by banks to curb the potential impact of coronavirus pandemic on its business

The commercial banks have put in place the following measures to curb the potential impact of the pandemic:-

- Banks have implemented their Business Continuity Plans (identification of critical processes critical staff and their back-ups).
- Sensitization and enhanced awareness of staff through regular e-mails and phone text messages.
- Banks have put in place work rotation plans for all staff members and automated their processes to ensure social distancing.
- Banks have assessed the various industries and the expected impacts thereon and are reaching out to the affected customers to discuss restructures and moratoriums to manage the situation.
- Banks have tightened their credit standards on granting of new loans to enable the assessment of the impact of the pandemic in each industry.
- Banks are actively reaching out and working with customers to understand their constraints caused by the pandemic and offering a number of reliefs including restructuring of facilities and providing moratoriums on both interest and principal where necessary.

- Giving 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 their businesses.
- Supporting customers with working capital financing to cover the increase in working capital requirements (payments to suppliers and fixed costs) attributed to slowdown in sales revenue/no revenue.
- Continuous portfolio monitoring for early warning signs to ensure quality of the asset book

### 2.14.3 Impact of implementing the emergency measures introduced by CBK to mitigate the impact of the Coronavirus Pandemic

The emergency measures issued by CBK along with their impact on the banking sector include:-

- Review and extension of personal loans for up to one year:** Banks have received and processed several requests from clients for restructuring of their loans and moratorium for payment of the principal amounts.
- Assessment and restructuring of loans to Medium sized enterprises and corporate borrowers :** Banks have indicated that:-
  - They expect a reduction in interest income as a result of restructurings.
  - They have received several restructuring requests. However, the biggest challenge is that the customers are quoting CBK emergency measures as a blanket approval with the assumption that the grace period applies to all.
  - There is a challenge in getting rational projected financials for each business to determine the likely pandemic impact on each business.

- Currently, the assessment is done on a case by case basis. Allowing moratorium on both principle and interest is mainly for customers severely affected by the pandemic.

- meeting all loan extension and restructuring costs.** However, this will put a strain on the bank's operations hence necessitating measures to reduce/cut costs as much as possible for sustainability.
- Waiving of digital charges:** Banks have waived all charges for digital platforms balance enquiries and transfers between mobile money wallets and bank accounts. This has led to increased usage of mobile banking platforms.
- Lowering the Central Bank Rate to 7.25 percent:** Whereas the intention was to encourage lending, due to disruption of the country's economy by the pandemic, there is less appetite for borrowing and lending.
- Majority of the banks indicated that **lowering the Cash Reserve ratio to 4.25 percent** has availed more funds to be used for onward lending to MSMEs. Further, the funds will also assist in balancing the banks liquidity position now that most clients are asking for relief and moratorium.
- Flexibility on loan classification and provisioning for loans** that were performing as at March 2, 2020 but restructured due to the pandemic will improve the quality of the banks' loan books. It is expected that lower provisioning in the coming months will protect the bank against further losses and eroding of capital.
- Extension of maximum tenor of repos to 91 days** will come in handy if the situation persists as banks will be able to accommodate customers for longer periods of moratorium.

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#### **2.14.4 Suggested proposals to further mitigate the impact the Coronavirus Pandemic**

- The respondents made proposals for CBK to consider to further mitigate the impact of COVID-19. In summary, the banks have noted that there is need for CBK in conjunction with the National Treasury to come up with other specific measures that particularly cushion institutions. This could be in form of the following:-
  - i. Credit Guarantee Schemes<sup>4</sup>.
  - ii. Additional funding to be offered at concessionary rates to the commercial banks.
  - iii. Encourage use of discount window at minimal rate and without the stigma that is associated with use of discount window.

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<sup>4</sup>A credit guarantee scheme provides third-party credit risk mitigation to lenders through the absorption of a portion of the lender's losses on the loans made to SMEs in case of default, typically in return for a fee.



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## LIST OF RESPONDENTS

1. Absa Bank Kenya Plc
2. Access Bank Ltd.
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. Credit Bank Ltd.
10. Co-operative Bank of Kenya Ltd.
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. Middle East Bank (K) Ltd.
27. Mayfair CIB Bank 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. Standard Chartered Bank (K) Ltd.
34. SBM Bank Kenya Ltd.
35. Spire Bank Ltd.
36. Sidian Bank Ltd.
37. Stanbic Bank Kenya Ltd.
38. Victoria Commercial Bank Ltd.
39. UBA Kenya Bank Ltd.



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