BANKI KUU YA KENYA

Central Bank of Kenya

OCTOBER - DECEMBER 2019

CREDIT SURVEY

CENTRAL BANK OF KENYA COMMERCIAL BANKS' CREDIT OFFICER SURVEY OCTOBER - DECEMBER 2019

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 marginally from 57.66 percent in the quarter ended September 30, 2019 to 57.42 percent in the quarter ended December 31, 2019.

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 emerging developments on Commercial banks' financial position and performance.

1.2 SURVEY METHODOLOGY

Senior Credit Officers[1] responsible for credit in all operating commercial banks complete the Credit Survey questionnaire. For the quarter ended December 31, 2019, 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[2] on lending to Small and Medium sized Enterprises (SMEs), credit recovery efforts, implementation of International Financial Reporting Standard (IFRS) 9 on Financial Instruments and implementation of International Financial Reporting Standard (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 survey focused on banks' appetite for deployment of liquidity towards extension of credit, interbank lending and other forms of investment.

1.3 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan Banking Sector recorded growth in the quarter ended December 31, 2019, compared to the quarter ended September 30, 2019. Some of the sector's performance indicators are as follows: -

- The aggregate balance sheet increased by 0.7 percent from Ksh.4,798.54 billion in September 2019 to Ksh.4,832.35 billion in December 2019. The increase was attributed to increase in local currency loans and investment in government securities during the period.
- Gross loans increased by 0.29 percent from Ksh.2,766.66 billion in September 2019 to Ksh.2,774.65 billion in December 2019. The growth in gross loans was mainly due to increased advances in the Personal/Household and Mining and Quarrying sectors.

[1] *These are officers involved in most of the credit decisions hence are able to provide reasonably accurate and complete responses from their banks perspective.*

[2] *The capping of interest rates law came into effect on September 14,2016 and was repealed on November 7, 2019.*

- Total deposits increased by 1.79 percent from Ksh.3,491.9 billion in September 2019 to Ksh.3,554.42 billion in December 2019. This is attributed to increase in local currency deposits by Ksh.63.38 billion.
- The asset quality, measured by ratio of gross non-performing loans to gross loans improved from 12.38 percent in September 2019 to 12.01 percent in December 2019. This was as a result of loan repayments and write-offs.
- The total capital adequacy ratio increased from 18.31 percent in September 2019 to 18.79 percent in December 2019. The increase in the capital adequacy ratio was as a result of higher increase in total capital as compared to increase in total risk weighted assets.
- Quarterly profit before tax decreased by Ksh.4.89 billion to Ksh.34.61 billion in December 2019 from Ksh.39.50 billion in September 2019. Return on Assets decreased to 2.54 percent in December 2019 from 2.68 percent in September 2019. The total assets increased by 0.70 percent whereas quarterly profit before tax decreased by 12.38 percent during the quarter hence the decrease in return on assets.
- Return on Equity decreased to 21.23 percent in December 2019 from 22.51 percent in September 2019. This was as a result of increase in capital.
- During the quarter ended December 2019, liquidity in the banking sector marginally decreased from 50.9 percent in September 2019 to 49.7 percent. This was still above the minimum statutory ratio of 20 percent.

1.4 SUMMARY OF CREDIT OFFICER SURVEY FINDINGS

- **Demand for credit:** In the fourth quarter of 2019, the perceived demand for credit remained unchanged in ten economic sectors except Personal/ household sector where demand for credit increased during the festive season. The main sectors with unchanged demand for credit are Mining and Quarrying, Energy and Water, and Tourism, Restaurant and Hotels, except Personal/ household sector where demand for credit increased.
- **Credit Standards[3]:** In the fourth quarter of 2019, credit standards remained unchanged in all economic sectors. The main sectors with unchanged credit standards are Agriculture, Mining and Quarrying, Energy and Water, and Financial services.
- **Capping of Interest Rates:** Following the repeal of capping of interest rates effective November 7, 2019, the Central Bank of Kenya has continued to assess the impact of the repeal on demand for credit, lending to SMEs, and actual credit granted.
- 91 percent of the respondents indicated that after the repeal of interest rate capping law, the demand for credit remained unchanged while 6 percent noted that demand for credit increased.
- **Lending to Small and Medium-sized Enterprises (SMEs):** In the quarter ended December 31, 2019, 87 percent of the respondents indicated that the repeal of interest rate capping law did not negatively affect their lending to SMEs.

[3] *Credit standards are guidelines used by commercial banks in determining whether to extend a loan to an applicant.*

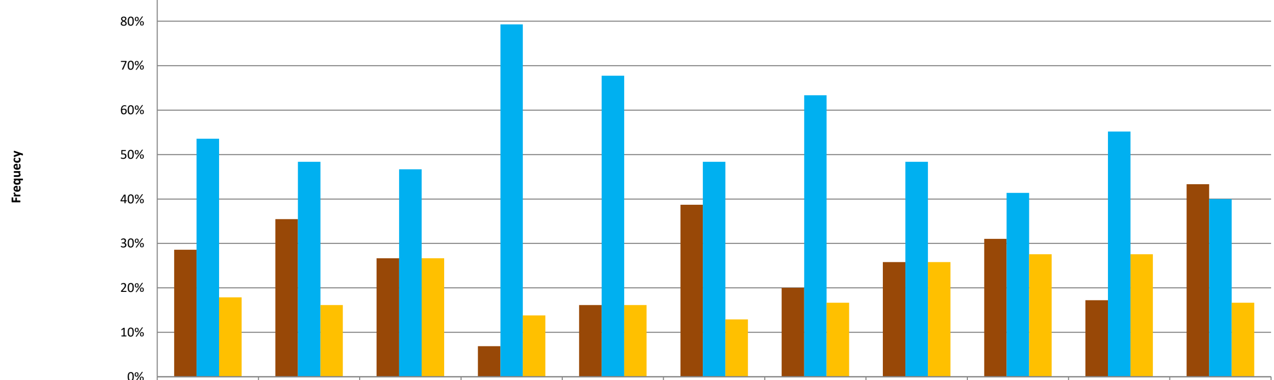
- **Non-Performing Loans:** During the quarter under review, the respondents indicated that the levels of NPLs remained unchanged in eight economic sectors. On the other hand, respondents indicated that the level of NPLs under Real Estate, Trade and Personal/ Household sectors reduced.
- **Expected Non-Performing Loans levels during the fourth quarter:** 47 percent of the respondents expect the level of NPLs to fall in the first quarter of 2020. This is attributed to enhanced recovery efforts being implemented by most banks.
- **Credit Recovery Efforts:** For the quarter ended March 31, 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 impact on commercial banks' capital adequacy due to increased provisioning. This made the commercial banks to explore injection of more capital.
- **International Financial Reporting Standard (IFRS) 16 on Leases:** Most of 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 December 2019, liquidity of the banking industry fairly remained stable.
- **Banks** indicated that they intended to deploy the additional liquidity towards credit, mostly by lending to the private sector, CBK liquidity management through repos and interbank lending. In addition, banks intend to utilize excess liquidity to invest in treasury bills and bonds.

2.0 SURVEY FINDINGS

2.1 Demand for Credit

- In the fourth quarter of 2019, the perceived demand for credit remained unchanged in ten economic sectors. The main sectors with unchanged demand for credit are Mining and Quarrying, Energy and Water, and Tourism, Restaurant and Hotels. However, there was a perceived increase in demand for credit in the Personal/ Household sector.
- **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
Increased	29%	35%	27%	7%	16%	39%	20%	26%	31%	17%	43%
Remained Unchanged	53%	48%	47%	79%	68%	48%	63%	48%	41%	55%	40%
Decreased	18%	17%	26%	14%	16%	13%	17%	26%	28%	28%	17%

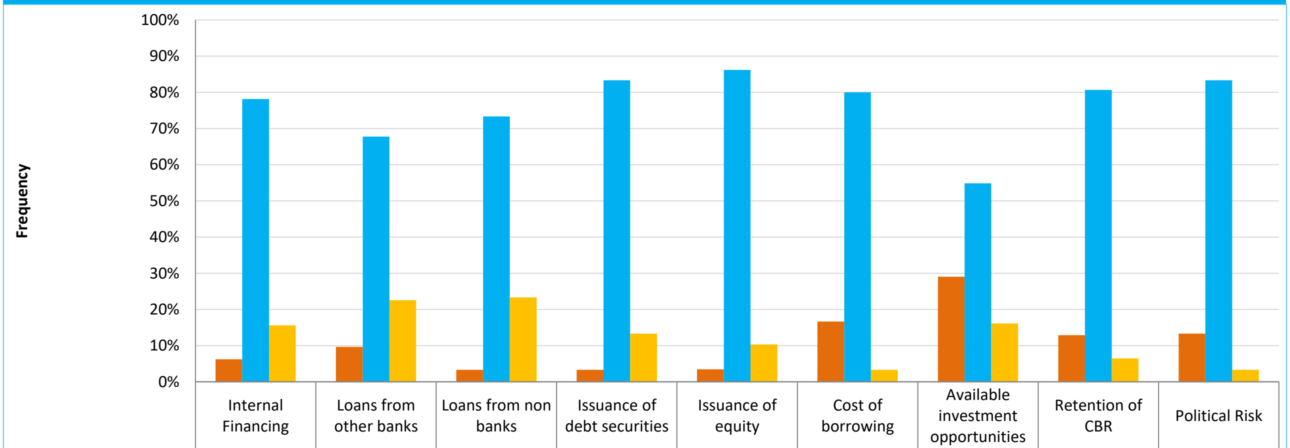
Table 1: Change in Demand for Credit

	September 2019			December 2019		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Agriculture	26%	65%	9%	29%	53%	18%
Manufacturing	26%	51%	23%	35%	48%	17%
Building and Construction	21%	62%	18%	27%	47%	26%
Mining and Quarrying	9%	76%	15%	7%	79%	14%
Energy and Water	26%	69%	6%	16%	68%	16%
Trade	54%	37%	9%	39%	48%	13%
Tourism, Restaurant and Hotels	15%	68%	18%	20%	63%	17%
Transport and Communication	29%	54%	17%	26%	48%	26%
Real Estate	29%	41%	29%	31%	41%	28%
Financial Services	14%	69%	17%	17%	55%	28%
Personal/Household	56%	35%	9%	43%	40%	17%

2.2 Factors Affecting Demand for Credit

- In the quarter ended December 31, 2019, all factors affecting demand for credit had no impact on demand for credit as indicated in **Chart 2** and **Table 2.**
- Issuance of equity, issuance of debt securities, political risk and retention of Central Bank Rate (CBR) were cited as having had the least impact on the demand for credit during the quarter under review. This was reported by 86 percent, 83 percent and 81 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 CBR	Political Risk
Increased	6%	10%	4%	4%	3%	17%	29%	13%	13%
Remained Unchanged	78%	68%	73%	83%	86%	80%	55%	81%	83%
Decreased	16%	22%	23%	13%	10%	3%	16%	6%	4%

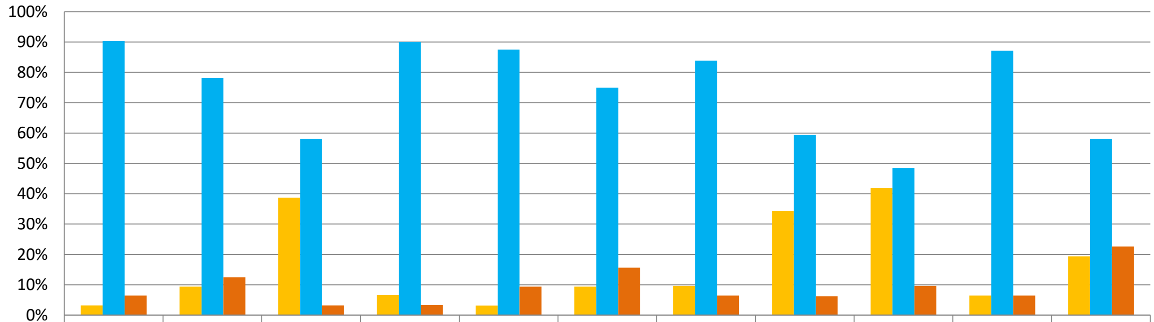
Table 2: Factors Affecting Demand for Credit

	September 2019			December 2019		
	Increased	Remained Unchanged	Decreased	Increased	Remained Unchanged	Decreased
Internal Financing	16%	65%	19%	6%	78%	16%
Loans from other banks	11%	68%	22%	10%	68%	22%
Loans from non-banks	6%	75%	19%	4%	73%	23%
Issuance of debt securities	6%	83%	11%	4%	83%	13%
Issuance of equity	6%	85%	9%	4%	86%	10%
Cost of borrowing	34%	57%	9%	17%	80%	3%
Available investment opportunities	24%	59%	16%	29%	55%	16%
Reduction of CBR	32%	63%	5%	13%	81%	6%
Political Risk	17%	80%	3%	13%	83%	4%

2.3 Credit Standards

- In the fourth quarter of 2019, credit standards remained unchanged in all the economic sectors. The main sectors with unchanged credit standards are Agriculture, Mining and Quarrying, Energy and Water, and Financial services.
- 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 /Household
Increased	4%	9%	39%	7%	3%	9%	10%	34%	42%	6%	19%
Remained Unchanged	90%	78%	58%	90%	88%	75%	84%	60%	48%	87%	58%
Decreased	6%	13%	3%	3%	9%	16%	6%	6%	10%	7%	23%

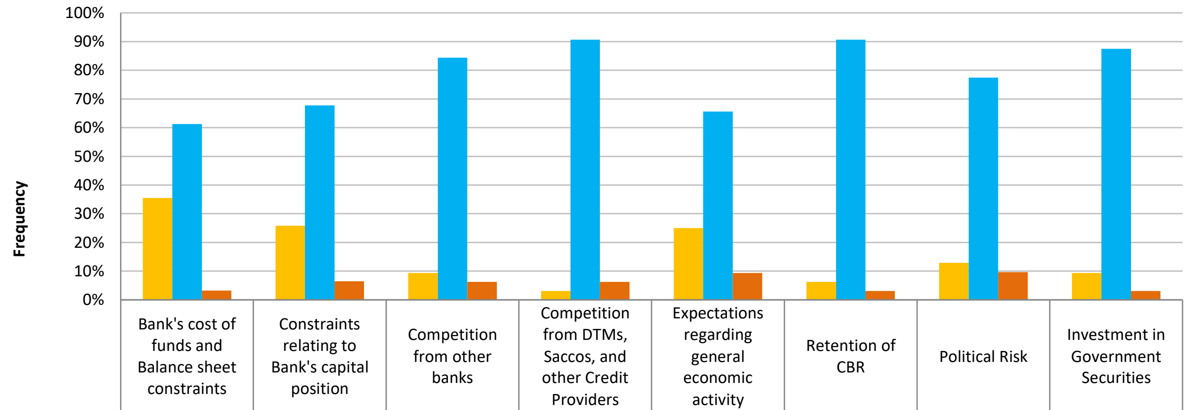
Table 3: Credit Standards for Loans to Various Economic Sectors

	September 2019			December 2019		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Agriculture	11%	81%	8%	4%	90%	6%
Manufacturing	14%	73%	14%	9%	78%	13%
Building and Construction	36%	61%	3%	39%	58%	3%
Mining and Quarrying	14%	86%	0%	7%	90%	3%
Energy and Water	8%	81%	11%	3%	88%	9%
Trade	14%	76%	11%	9%	75%	16%
Tourism, Restaurant and Hotels	22%	75%	3%	10%	84%	6%
Transport and Communication	38%	62%	0%	34%	60%	6%
Real Estate	54%	43%	3%	42%	48%	10%
Financial Services	5%	86%	8%	6%	87%	7%
Personal/Household	11%	69%	19%	19%	58%	23%

2.4 Factors Affecting Credit Standards

- In the quarter ended December 31, 2019, all eight factors had little impact on credit standards.
- Competition from Saccos, Microfinance banks, other Credit Providers; retention of CBR, Investment in Government Securities and competition from banks are the main factors that had no impact on credit standards. This was reported by 91 percent, 91 percent, 88 percent and 84 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



	Bank's cost of funds and Balance sheet constraints	Constraints relating to Bank's capital position	Competition from other banks	Competition from DTMs, Saccos, and other Credit Providers	Expectations regarding general economic activity	Retention of CBR	Political Risk	Investment in Government Securities
Tightened	35%	26%	9%	3%	25%	6%	13%	9%
Remained unchanged	61%	68%	84%	91%	66%	91%	77%	88%
Eased	3%	6%	6%	6%	9%	3%	10%	3%

Table 4: Factors affecting credit standards

	September 2019			December 2019		
	Tightened	Remained Unchanged	Eased	Tightened	Remained Unchanged	Eased
Bank's cost of funds and Balance sheet constraints	27%	65%	8%	35%	61%	3%
Constraints relating to Bank's capital position	27%	62%	11%	26%	68%	6%
Competition from other banks	3%	92%	5%	9%	84%	6%
Competition from DTMs, Saccos, and other Credit Providers	3%	92%	5%	3%	91%	6%
Expectations regarding general economic activity	24%	68%	8%	25%	66%	9%
Retention of Central Bank Rate (CBR)	11%	87%	3%	6%	91%	3%
Political Risk	11%	76%	14%	13%	77%	10%
Investment in Government Securities	8%	89%	3%	9%	88%	3%

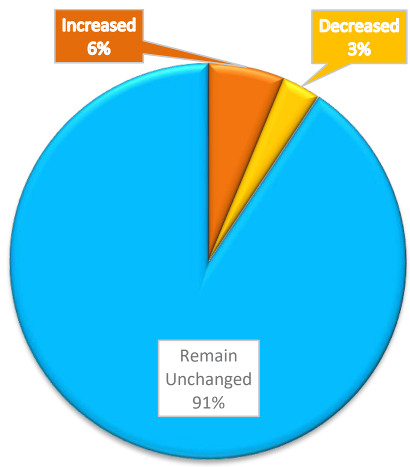
2.5 Repeal of Interest Rate Capping Law

- Following the repeal of capping of interest rates effective November 7, 2019, the Central Bank of Kenya has continued to assess the impact of the repeal of interest rate capping law on demand for credit, lending to SMEs, actual credit granted, and Non performing loans.

2.5.1 Effect of repeal of Interest Rate Capping Law on Demand for Credit

- 91 percent of the respondents indicated that after repeal of interest rate capping law, the demand for credit remained unchanged while 6 percent noted that demand for credit increased.
- 3 percent of the respondents noted that demand for credit decreased after repeal. This is depicted in **Chart 5** below.

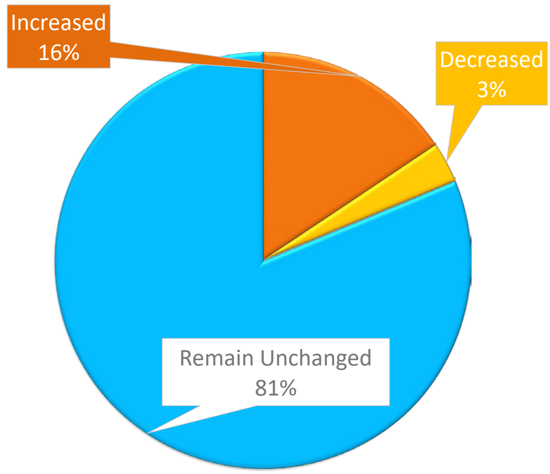
Chart 5: Interest Rate Movements



2.5.2 Impact of Repeal of Interest Rate Capping Law on Actual Credit Granted

- In the quarter ended December 31, 2019, 81 percent of the respondents were of the view that repeal of interest rate capping law had little or no effect on the actual credit granted. This is depicted in **Chart 6.**

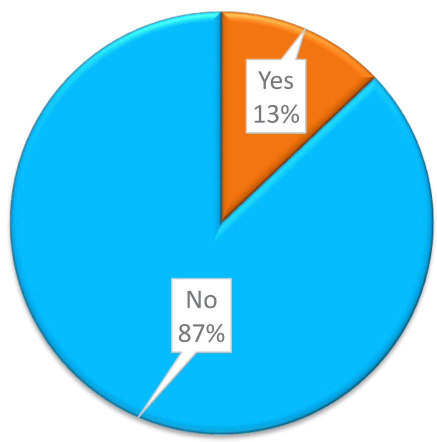
Chart 6: Interest Rate Cap Effect on Demand for Credit over the past Quarter



2.5.3 Effect of repeal of Interest Rate Capping Law on Lending to SMEs in Fourth Quarter of 2019

- In the quarter ended December 31, 2019, 87 percent of the respondents indicated lending to SMEs was not negatively affected by repeal of interest rate capping law. This is indicated in **Chart 7.**

Chart 7: Interest Rate Cap Effect on Actual New Credit Granted



- Interest rate capping compelled banks to increase their risk mitigation measures. Most banks opted to invest in government securities, which is deemed less risky as compared to lending to SMEs.
- The appetite to lend to SMEs has increased since banks are able to price risks.

2.5.4 Effect of repeal of Interest Rate Cap Law on Demand for Credit in First Quarter of 2020

- With regards to the expected demand for credit in the quarter ended March 31, 2020, 56 percent of the respondents felt that the repeal of interest capping will lead to an increase in demand for credit. However, 34 percent of the respondents anticipate that repeal of interest rate capping law will have little or no impact on the demand for credit.
- 10 percent of the respondents felt that the demand for credit will decrease. The expected movement on demand for credit in the second quarter is shown in **Chart 8**.

2.5.5 Effect of repeal of Interest Rate Capping Law on Actual New Credit in the First Quarter of 2020

- In the quarter ended March 31, 2020, 50 percent of the respondents anticipate that the repeal of interest rate capping law will have little or no impact on actual credit advanced.
- Following the repeal of interest rate capping law, 44 percent of the respondents expect increased lending in the first quarter of 2020 whereas 6 percent expect a decrease. This is depicted in **Chart 9.**

Chart 8: Interest rate cap effect on demand for credit over the next three months

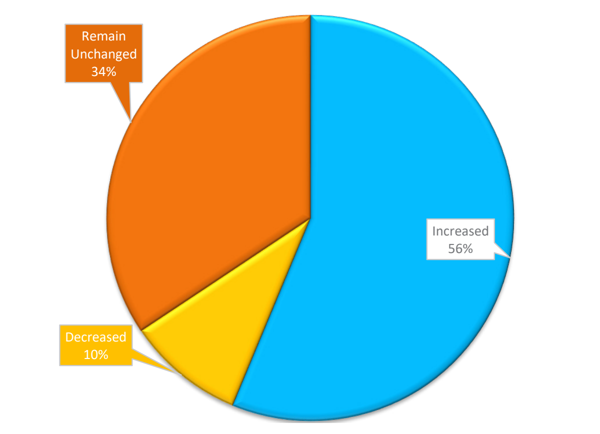
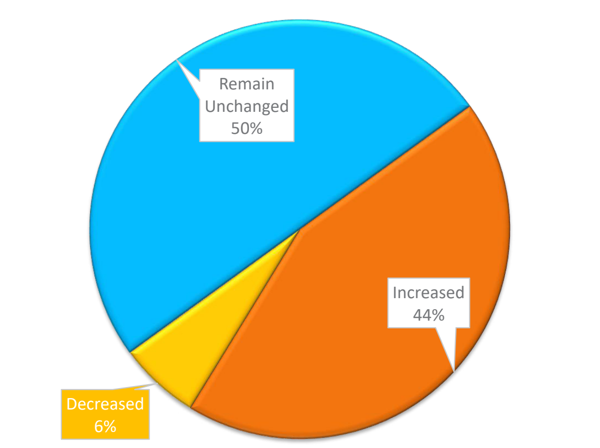


Chart 9: Interest rate cap effect on actual new credit granted over the next three months

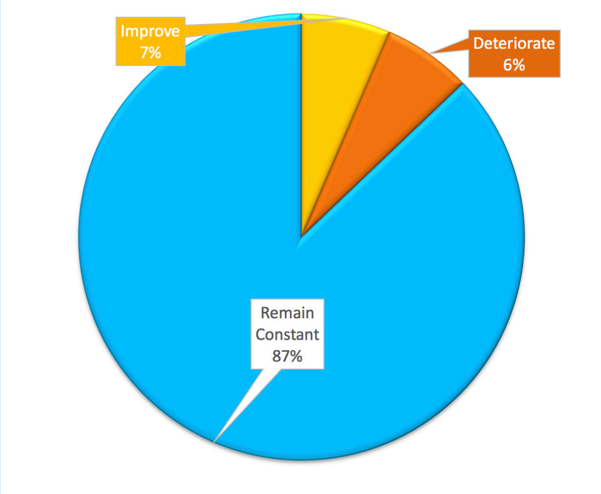


2.5.6 Effect of repeal of Interest Rate Capping Law on the Level of NPLs in the Fourth Quarter of 2019

- In the quarter ended December 31, 2019, 87 percent of the respondents indicated that repeal of interest rate capping law had no effect on level of NPLs.

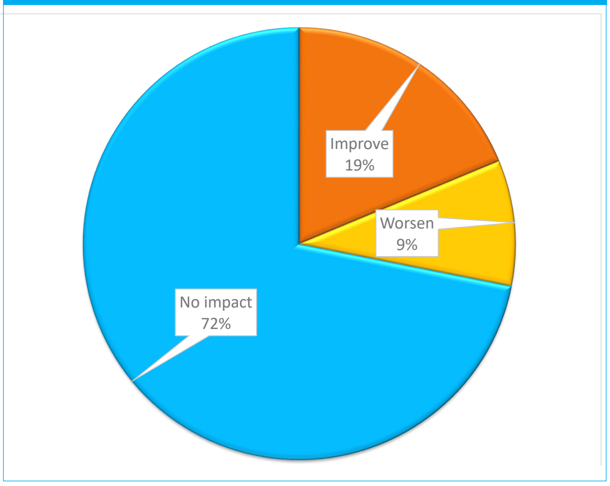
- After repeal of interest rate capping law, 7 percent of the respondents indicated that asset quality improved whereas 6 percent indicated that it deteriorated during the quarter. This trend is indicated in **Chart 10.**

Chart 10: Effect of repeal of interest rate capping law on NPLs levelover the past quarter



- 19 percent of the respondents indicated that NPLs would improve due to repeal of interest rate capping law. This trend is as indicated in **Chart 11** below.

Chart 11: Effect of repeal of interest rate capping law on NPLs in the next quarter



2.6.7 Effect of repeal of Interest Rate Capping Law on the expected Level of NPLs in the First Quarter of 2020

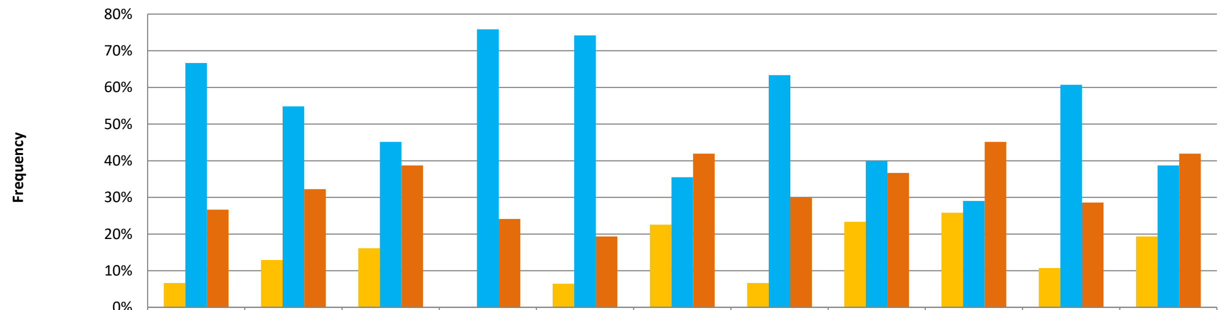
- 72 percent of the respondents anticipate that repeal of interest rate capping law would have no impact on the level of NPLs in the first quarter of 2020. This is because the pricing of loans has no impact on repayment ability.
- 9 percent of the respondents expect the repeal of Law on capping of interest rates to have a negative impact on NPLs due to sustained default owing to continued delay in payments, low realization of securities at auctions and litigations.

2.6 Non-Performing Loans (NPLs)

2.6.1 Non - Performing Loans during the quarter ended December 31, 2019

- In the quarter ending December 31, 2019, the respondents indicated that the levels of NPLs remained unchanged in eight economic sectors.
- On the other hand, respondents indicated that the level of NPLs under Real Estate, Trade and Personal/ Household sectors reduced. **Chart 12** and **Table 5** depicts this.

Chart 12: Non-Performing Loans



	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
Rose	6%	13%	16%	0%	6%	23%	7%	23%	26%	10%	19%
Remained unchanged	67%	55%	45%	76%	74%	35%	63%	40%	29%	61%	39%
Fell	27%	32%	39%	24%	19%	42%	30%	37%	45%	29%	42%

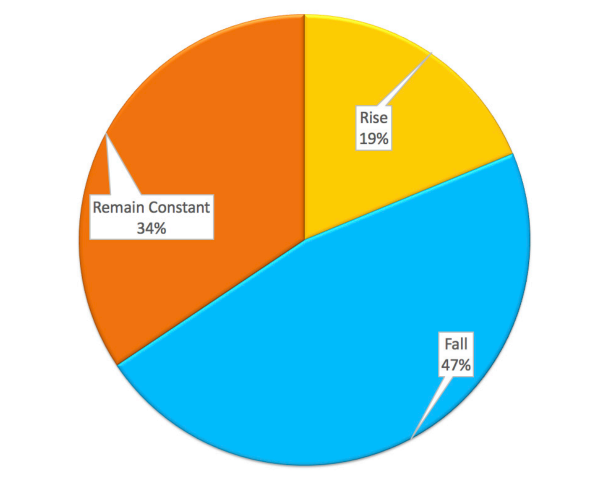
Table 5: Non Performing Loans Trend Per Economic Sector

	September 2019			December 2019		
	Rose	**Remained Unchanged**	**Fell**	**Rose**	**Remained Unchanged**	**Fell**
Agriculture	11%	57%	31%	6%	67%	27%
Manufacturing	20%	54%	26%	13%	55%	32%
Building and Construction	33%	39%	28%	16%	45%	39%
Mining and Quarrying	3%	82%	15%	0%	76%	24%
Energy and Water	3%	83%	14%	6%	74%	20%
Trade	22%	44%	33%	23%	35%	42%
Tourism, Restaurant and Hotels	9%	62%	29%	7%	63%	30%
Transport and Communication	25%	53%	22%	23%	40%	37%
Real Estate	38%	38%	24%	26%	29%	45%
Financial Services	6%	76%	18%	10%	61%	29%
Personal/Household	30%	38%	32%	19%	39%	42%

2.6.2 Expected Non Performing Loans during the next Quarter

- 47 percent of the respondents expect the level of NPLs to fall in the first quarter of 2020. This is attributed to enhanced recovery efforts being implemented by most banks.
- 34 percent of respondents expect NPLs to remain constant whereas 19 percent expect the NPL levels to rise. This is depicted in **Chart 13**.

Chart 13: Expected movements of NPLs in the next Quarter of 2019



2.7 Credit Recovery Efforts in the First Quarter of 2020

- For the quarter ended March 31, 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 (90 percent),
ii) Trade (81 percent),
iii) Transport and Communication (77 percent),
iv) Personal/Household (77 percent), and
v) Building and Construction (77 percent).

- The sector whose Credit recovery efforts is expected to remain unchanged is Mining and Quarrying since the level of bad debts in this sector is low. Energy and water sector has mixed reactions with equal respondents whose recovery efforts will be intensified and retained. The responses on the expected credit recovery efforts by the banks are depicted in **Chart 15** and **Table 6.**

Chart 15: Credit Recovery Efforts

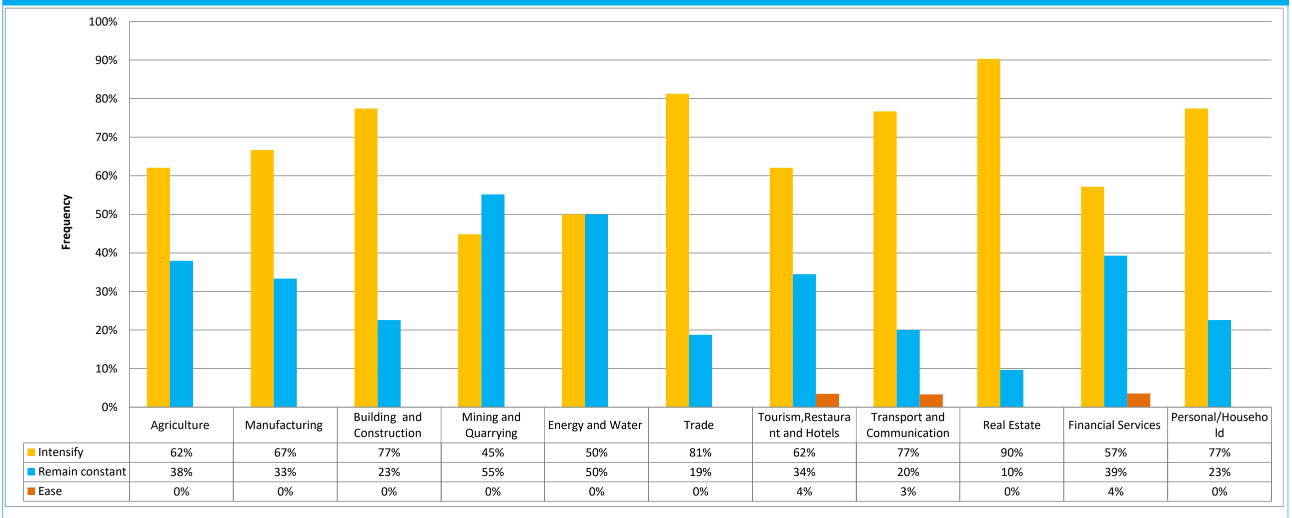


Table 6: Credit Recovery Efforts

	September 2019			December 2019		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	60%	40%	0%	62%	38%	0%
Manufacturing	66%	34%	0%	67%	33%	0%
Building and Construction	81%	19%	0%	77%	23%	0%
Mining and Quarrying	43%	54%	3%	45%	55%	0%
Energy and Water	51%	49%	0%	50%	50%	0%
Trade	83%	17%	0%	81%	19%	0%
Tourism, Restaurant and Hotels	63%	34%	3%	62%	34%	4%
Transport and Communication	86%	11%	3%	77%	20%	3%
Real Estate	86%	14%	0%	90%	10%	0%
Financial Services	58%	39%	3%	57%	39%	4%
Personal/Household	83%	17%	0%	77%	23%	0%

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.
- Following implementation of IFRS 9 beginning January 1, 2018, the Central Bank of Kenya has continued to assess: -

    i). How the implementation of IFRS 9 has impacted the commercial banks' business model;

    ii). Credit risk appetite; and

    iii). The challenges the banks have experienced in the implementation of IFRS 9 and their mitigation measures on the impact.

2.8.1 Impact of IFRS 9 on Credit Risk Appetite

- Most of banks are now prioritizing lending to low risk ventures and they have changed their lending policies to align them with IFRS 9.
- Most banks have adopted a tight credit risk appraisal, ensuring that facilities are well secured and that alternative sources of repayment are available.

2.8.2 Impact of IFRS 9 on Business Model

- Most of the respondents have indicated that implementation of IFRS 9 has resulted in banks:

    i). revamping their credit risk rating tools for various sectors,

    ii). prioritizing lending to low risk segments,

    iii). tightening their credit risk appraisal requirements, and

    iv). lending to customers with alternative income streams to ensure repayment from multiple sources.

2.8.3 Challenges experienced in the Implementation of IFRS 9

The respondents have highlighted the challenges they have experienced since the implementation of IFRS 9 came into effect.

- Impact on capital adequacy due to increased provisioning.
- Continuous improvement of their business model.
- Inadequate technical skills and modeling capabilities.
- Cost implication for the relevant technology and personnel training.
- Unavailability of reliable macroeconomic data and less historical data to rely on to prepare the models required for economic overlay and sector specific.
- Impact on profitability.

As a mitigation measure, banks have indicated that: -

i). they are exploring injection of additional capital.

ii). focus on secured lending.

iii). revamp their recovery mechanisms and efforts.

iv). enhancing staff capacity through training as well as reviewing their policies and procedures to ensure full compliance with IFRS 9.

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 was expected 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.
- Implementation of IFRS 16 has led to institutions increasing their Risk weighted Assets thus affecting their Capital to Risk Weighted Assets ratio.
- Training costs is the other challenge the institutions are facing in implementation of IFRS 16.
- During the quarter ended December 2019, 84 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 16** and **Chart 17** below.

Chart 16: Banks that assessed IFRS 16 on Leases

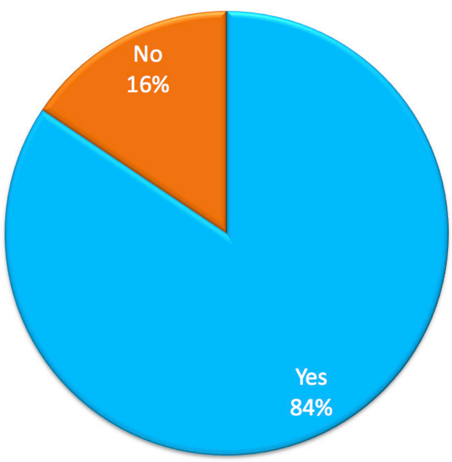
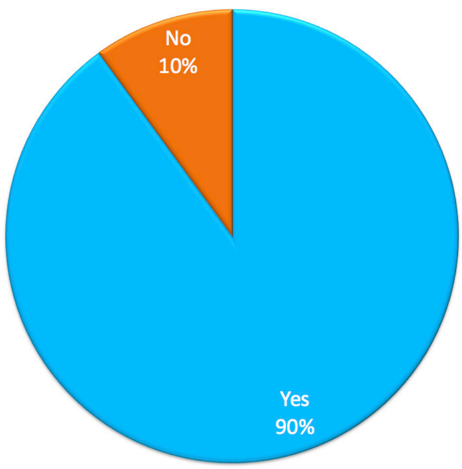


Chart 17: Banks that assessed the likely impact of IFRS 16



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

- Most of banks indicated that implementation of IFRS 16 increased their risk weighted assets, which has in turn decreased their capital adequacy ratios.
- This would 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 entire staff for compliance with the standard.
- As a mitigation measure, banks have indicated that they are: -

i). training their staff on the job; and

ii). changing their business models and risk management tools.

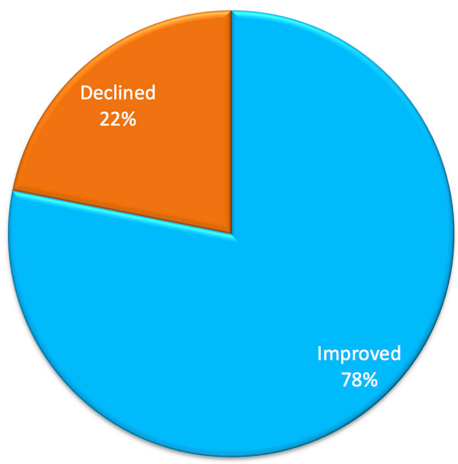
2.10 Liquidity Risk

- During the quarter ended December 2019, liquidity in the banking sector marginally decreased from 50.9 percent in September 2019 to 49.7 percent in December 2019. This remained above the minimum statutory ratio of 20 percent.

2.11 Commercial Banks' liquidity positions

- During the quarter ended December 2019, 78 percent of the respondents indicated that their liquidity position had improved as indicated in **Chart 18** below.

Chart 18: Movement in liquidity risk



- As indicated in **Chart 19**, 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 (35%), investing in treasury bonds (27%), interbank lending (16%) and CBK liquidity management through repos (14%).
- In the previous quarter, issuance of credit was expected to increase as most banks intended to deploy the additional liquidity towards lending to the private sector (35%), CBK liquidity management through repos (15%) and interbank lending (13%).

2.12 Factors that led to improved liquidity over the past quarter

- During the quarter ended December 2019, liquidity improved mainly as a result of: -

  i). Increased deposits (52%),

  ii). Maturity of government securities (23%), and

  iii). Disposal of fixed assets (19%).

- The drivers of improved liquidity are indicated in **Chart 20** below.

Chart 19: Plans with improved liquidity

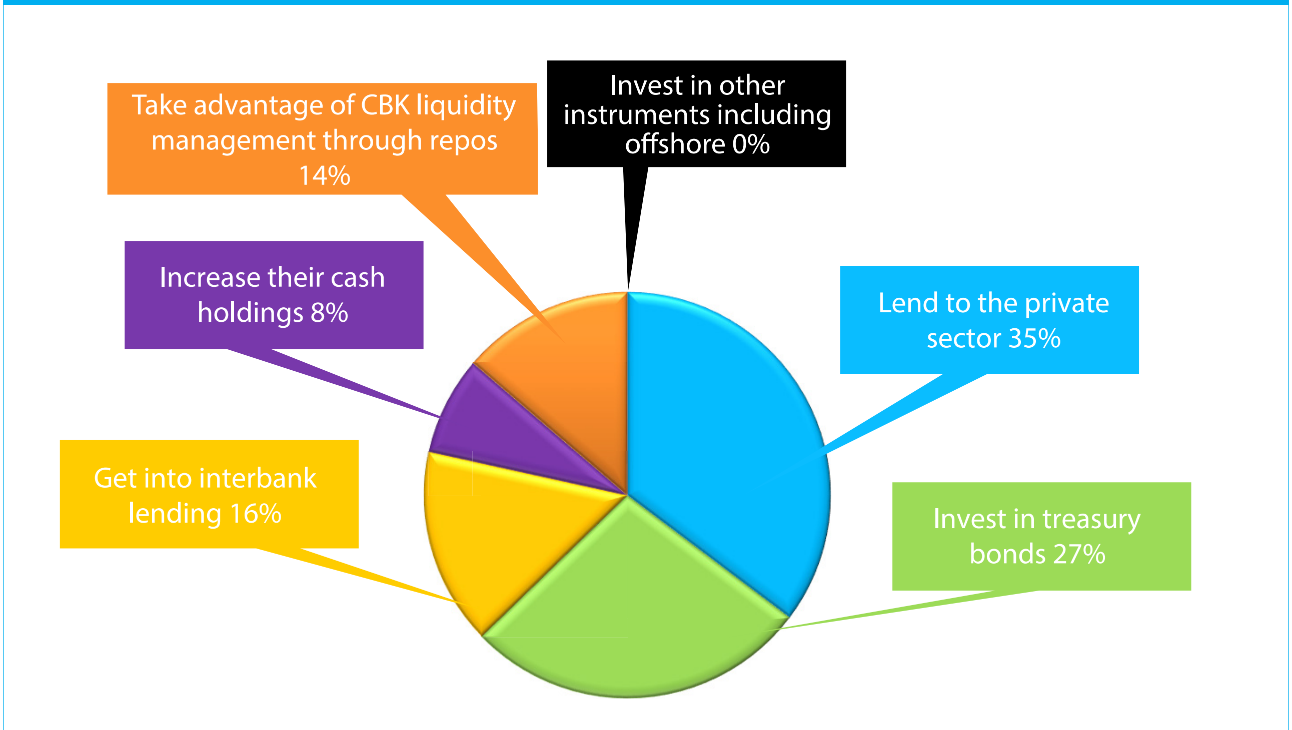
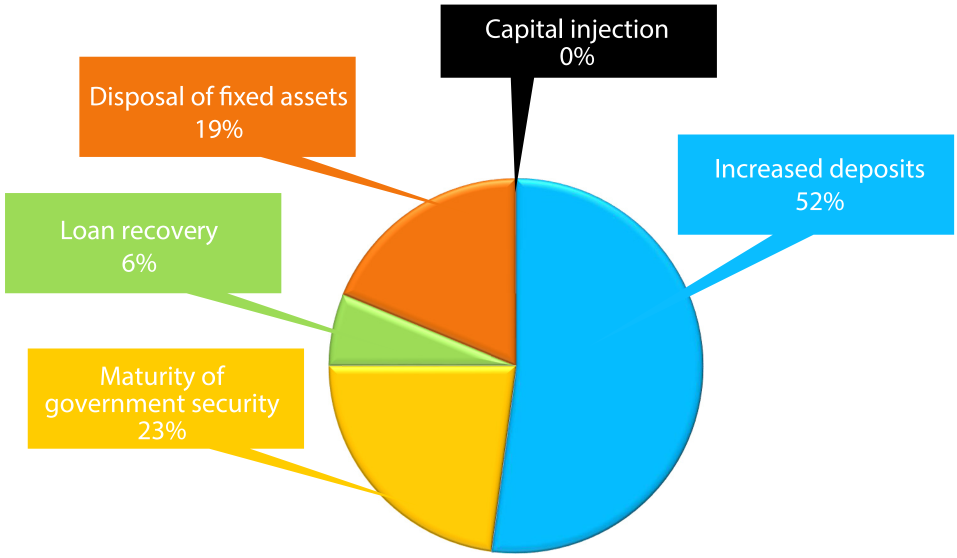


Chart 20: Reasons for improved liquidity



2.13 Commercial Banks' plans for the next quarter Banks

- Banks whose liquidity deteriorated in the last two quarters intend to solve this by: -

  i). Mobilizing deposits from the general public.
  ii). Increasing focus on loan collections and recoveries.
  iii). Sourcing for strategic investment partners.

2.14 Commercial Banks' interbank activities during the quarter

- During the quarter ended December 2019, 57 percent of the banking industry increased their interbank lending activities. This is indicated in **Chart 21** below.
- 68 percent of the banking industry indicated that their interbank borrowing decreased. This is indicated in **Chart 22** below.

Chart 21: Increase in interbank lending

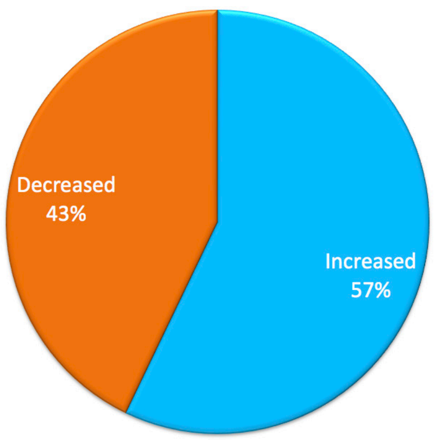
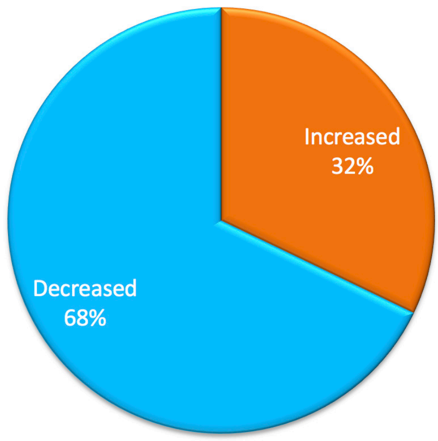


Chart 22: Increase in Interbank borrowing



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. Citibank N.A Kenya.
7. Consolidated Bank of Kenya Ltd.
8. Credit Bank Ltd.
9. Co-operative Bank of Kenya Ltd.
10. Development Bank of Kenya Ltd.
11. Diamond Trust Bank (K) Ltd.
12. DIB Bank Kenya Ltd.
13. Ecobank Kenya Ltd.
14. Equity Bank Ltd.
15. Family Bank Ltd.
16. Guaranty Trust Bank (Kenya) Ltd.
17. First Community Bank Ltd.
18. Guardian Bank Ltd.
19. Gulf African Bank Ltd.
20. Habib Bank A.G Zurich.
21. I & M Bank Ltd.
22. Jamii Bora Bank Ltd.
23. KCB Bank Kenya Ltd.
24. Middle East Bank (K) Ltd.
25. Mayfair Bank Ltd.
26. National Bank of Kenya Ltd.
27. NCBA Bank Kenya Plc.
28. M Oriental Bank Ltd.
29. Paramount Bank Ltd.
30. Prime Bank Ltd.
31. Standard Chartered Bank (K) Ltd.
32. SBM Bank Kenya Ltd.
33. Spire Bank Ltd.
34. Sidian Bank Ltd.
35. Stanbic Bank Kenya Ltd.
36. Transnational Bank Ltd.
37. Victoria Commercial Bank Ltd.
38. UBA Kenya Bank Ltd.
39. HFC Ltd.

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