Central Bank of Kenya

# Credit Officer Survey

March 31, 2022

# CENTRAL BANK OF KENYA COMMERCIAL BANKS' CREDIT OFFICER SURVEY FOR THE THE QUARTER ENDED MARCH 31, 2022

## 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 increased marginally from 54.1 percent in the quarter ended December 31, 2021, to 55.4 percent in the quarter ended March 31, 2022.

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

### 1.2 SURVEY METHODOLOGY

Senior Credit Officers[1] complete most of the survey and collate inputs from senior officers responsible for the other aspects. For the quarter ended March 31, 2022, 38 operating commercial banks and 1 mortgage finance company participated in the Commercial Banks Credit Officer Survey.

The survey sought to establish the lending behavior in the banking sector in respect to all the eleven economic sectors. Questions were posed on demand for credit, credit standards for approving loans, non-performing loans, credit recovery efforts, implementation of International Financial Reporting Standards (IFRS) 9 on Financial Instruments and implementation of IFRS 16 on Leases. The survey questions are generally phrased in terms of changes over the past three months or expected changes over the next three months.

The survey also included questions concerning liquidity in the banks. The banks were required to state their appetite for the deployment of liquidity towards an extension of credit, interbank lending and other forms of investment.

Following the declaration by the World Health Organization of coronavirus (COVID-19) outbreak as a pandemic in March 2020, CBK, through the credit officer survey, assesses the impact of the pandemic on the banking sector.

The survey also included questions relating to adverse impact of the pandemic on the banks and measures taken by banks to curb the adverse impact of the pandemic.

[1] *These are officers involved in most of the credit and liquidity decisions hence are able to provide reasonably accurate and complete responses from their bank's perspective. They also collate input on non-credit aspects from their counterparts.*

## 1.3 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan Banking Sector recorded growth in the quarter ended March 31, 2022, compared to the quarter ended December 31, 2021. Some of the sector's performance indicators are as follows: -

- The aggregate balance sheet increased by 1.6 percent to Ksh.6,103 billion in March 2022, from Ksh.6,008 billion in December 2021.

- Gross loans increased by 4.1 percent from Ksh. 3,248.7 billion in December 2021, to Ksh. 3,382.4 billion in March 2022. The increase in gross loans and advances was largely witnessed in the Trade, Transport and Communication, and Personal and Household sectors. The increase in gross loans was mainly due to increased credit granted for working capital purposes, and loans granted to individual borrowers.

- Total deposits increased by 0.6 percent from Ksh. 4,441.9 billion in December 2021, to Ksh. 4,466.7 billion in March 2022.

- The asset quality, measured by gross non-performing loans to gross loans ratio deteriorated from 13.1 percent in December 2021, to 14 percent in March 2022. This was due to a 11.0 percent increase in gross NPLs as compared to a 4.1 percent increase in gross loans.

- The total capital adequacy ratio decreased from 19.6 percent in December 2021, to 18.9 percent in March 2022. The decreased capital adequacy ratio was mainly due to lower increase in Total Capital of 1.1 percent as compared to 4.4 percent increase in Total Risk Weighted Assets. The capital adequacy ratios reported in the two periods were above the minimum statutory limit of 14.5 percent.

- Quarterly profit before tax increased by Ksh.7.5 billion from Ksh.49.9 billion in December 2021, to Ksh.57.3 billion in March 2022. The increase in profitability was mainly attributable to a higher decrease in quarterly expenses by Ksh.3.0 billion (9.8 percent) as compared to the decrease in quarterly income by Ksh.2.3 billion (1.4 percent) between the fourth quarter of 2021, and first quarter of 2022.

- Return on Equity (ROE) increased from 21.6 percent in December 2021, to 25.1 percent in March 2022. The increase in ROE was due to increased profit before tax between the two quarters under review.

- Liquidity in the banking sector decreased marginally from 56.2 percent in December 2021, to 55.0 percent in March 2022. This was well above the minimum statutory ratio of 20 percent.

## 1.4 SUMMARY OF CREDIT OFFICER SURVEY FINDINGS

- **Demand for credit:** In the first quarter of 2022, the perceived demand for credit remained unchanged in eight economic sectors. It increased in three sectors (Trade, Personal and Household, and Manufacturing).

- **Credit Standards[2]:** In the first quarter of 2022, credit standards remained unchanged in ten economic sectors and were tightened in one sector (Real Estate). Tightening of credit standards in Real Estate sector is attributed to the adverse effects of the pandemic.
- **Expected Non-Performing Loans levels during the next quarter:** 46 percent of the respondents indicated that NPLs are likely to fall in the second quarter of 2022. This is attributed to enhanced recovery efforts being implemented by most banks. 16 percent of the respondents expect the level of NPLs to rise in the second quarter of 2022 as a result of the continued COVID-19 pandemic. 38 percent of respondents expect NPLs to remain constant.
- **Non-Performing Loans per sector:** Respondents indicated that the level of NPLs is expected to remain constant in all economic sectors during the next quarter.
- **Credit Recovery Efforts:** For the quarter ended June 30, 2022, banks expect to intensify their credit recovery efforts in eight economic sectors and remain constant in three sectors namely Mining and Quarrying, Energy and Water, and Financial Services. The intensified recovery efforts are aimed at improving the overall quality of the asset portfolio.
- **International Financial Reporting Standard (IFRS) 9 on Financial Instruments:** Most banks have adopted a tight credit risk appraisal, ensuring that facilities are well secured and that alternative sources of repayment are available.
- **International Financial Reporting Standard (IFRS) 16 on Leases:** During the quarter ended March 31, 2022, 97 percent of the respondents had implemented IFRS 16. In the same quarter, 97 percent of the respondents had assessed the impact of IFRS 16 on their financial performance and position.
- **Liquidity risk:** During the quarter ended March 2022, 62 percent of the respondents indicated that their liquidity position had improved.
- Banks intend to deploy the additional liquidity towards lending to the private sector (26 percent), investing in Treasury Bonds (23 percent), investing in Treasury Bills (23 percent), interbank lending (15 percent), CBK liquidity management through repos (6 percent), increase their cash holdings (5 percent), and invest in other instruments including offshore (2 percent).

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

## 2.0 SURVEY FINDINGS

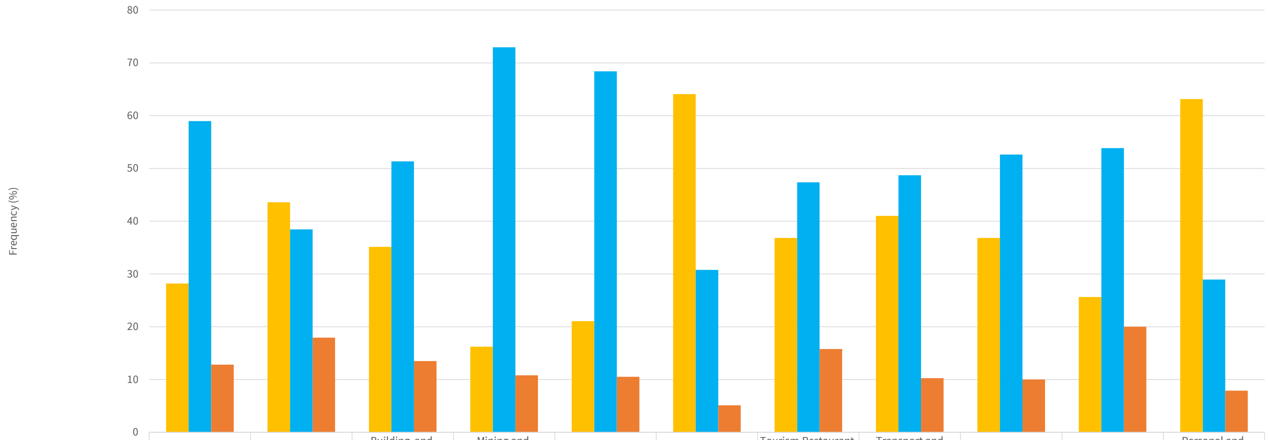
### 2.1 Demand for Credit

- In the first quarter of 2022, the perceived demand for credit remained unchanged in eight economic sectors. It increased in three sectors.
- The main sectors with unchanged demand for credit are Mining and Quarrying, Energy and Water, Agriculture and Financial Services.
- Perceived demand for credit increased in Trade, Personal and Household, and Manufacturing sectors. This is attributed to the ongoing return to normalcy of Economic activities.
- **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 (%) | December 2021 | | | March 2022 | | |
|---|---|---|---|---|---|---|
| | Increased | Remained Unchanged | Decreased | Increased | Remained Unchanged | Decreased |
| Agriculture | 21 | 62 | 18 | 28 | 59 | 13 |
| Manufacturing | 49 | 38 | 13 | 44 | 38 | 18 |
| Building and Construction | 18 | 63 | 18 | 35 | 51 | 14 |
| Mining and Quarrying | 16 | 79 | 5 | 16 | 73 | 11 |
| Energy and Water | 29 | 50 | 21 | 21 | 68 | 11 |
| Trade | 67 | 18 | 15 | 64 | 31 | 5 |
| Tourism, Restaurant and Hotels | 29 | 50 | 21 | 37 | 47 | 16 |
| Transport and Communication | 38 | 51 | 10 | 41 | 49 | 10 |
| Real Estate | 24 | 61 | 16 | 37 | 53 | 10 |
| Financial Services | 23 | 59 | 18 | 26 | 54 | 20 |
| Personal and Household | 59 | 35 | 5 | 63 | 29 | 8 |

## Chart 1: Demand for Credit

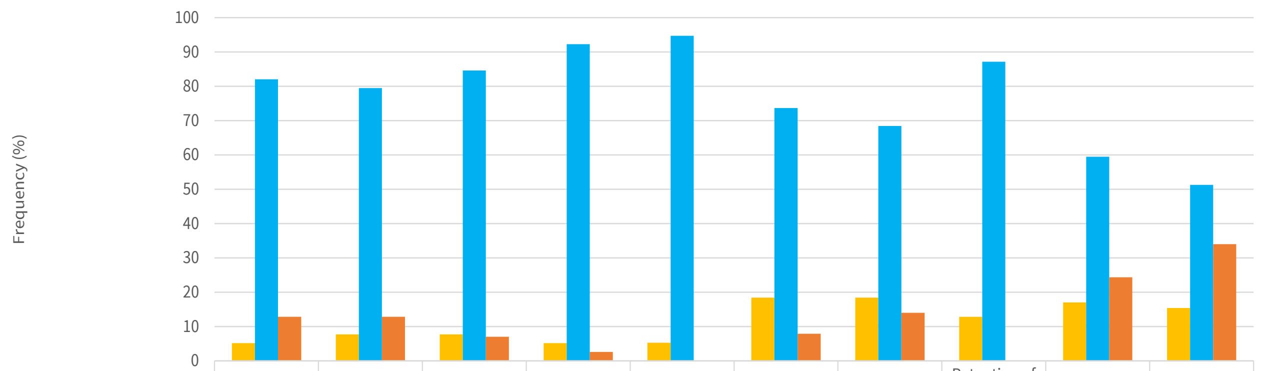



| | Agriculture | Manufacturing | Building and Construction | Mining and Quarrying | Energy and Water | Trade | Tourism,Restaurant and Hotels | Transport and Communication | Real Estate | Financial Services | Personal and Household |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Increased(%) | 28 | 44 | 35 | 16 | 21 | 64 | 37 | 41 | 37 | 26 | 63 |
| Remained Unchanged (%) | 59 | 38 | 51 | 73 | 68 | 31 | 47 | 49 | 53 | 54 | 29 |
| Decreased (%) | 13 | 18 | 14 | 11 | 11 | 5 | 16 | 10 | 10 | 20 | 8 |

## 2.2 Factors Affecting Demand for Credit

- In the quarter ended March 31, 2022, all the ten factors affecting demand for credit had no significant impact. This is depicted in **Chart 2** and **Table 2**.
- Issuance of equity, issuance of debt securities, retention of the Central Bank Rate and loans from non-banks were cited as having had the least impact on the demand for credit during the quarter under review. These were reported by 95 percent, 92 percent, 87 percent and 85 percent of the respondents respectively.

## Chart 2: Factors affecting Demand for Credit




| | Internal Financing | Loans from other banks | Loans from non banks | Issuance of debt securities | Issuance of equity | Cost of borrowing | Available investment opportunities | Retention of the Central Bank Rate (CBR) | Political Risk | COVID – 19 pandemic |
|---|---|---|---|---|---|---|---|---|---|---|
| Increased (%) | 5 | 8 | 8 | 5 | 5 | 18 | 18 | 13 | 17 | 15 |
| Remained Unchanged (%) | 82 | 79 | 85 | 92 | 95 | 74 | 68 | 87 | 59 | 51 |
| Decreased (%) | 13 | 13 | 7 | 3 | 0 | 8 | 14 | 0 | 24 | 34 |

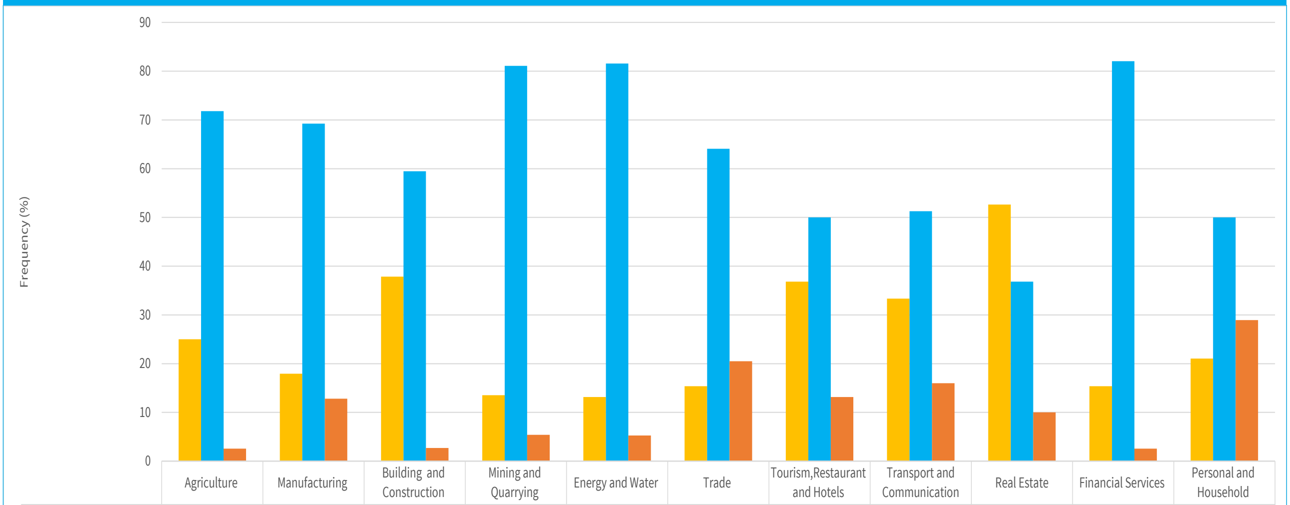
**Table 2: Factors Affecting Demand for Credit**

| Percentage (%) | December 2021 | | | March 2022 | | |
|---|---|---|---|---|---|---|
| | Increased | Remained Unchanged | Decreased | Increased | Remained Unchanged | Decreased |
| Internal Financing | 10 | 77 | 13 | 5 | 82 | 13 |
| Loans from other banks | 5 | 74 | 21 | 8 | 79 | 13 |
| Loans from non-banks | 5 | 87 | 8 | 8 | 85 | 7 |
| Issuance of debt securities | 5 | 89 | 5 | 5 | 92 | 3 |
| Issuance of equity | 3 | 89 | 8 | 5 | 95 | 0 |
| Cost of borrowing | 21 | 71 | 8 | 18 | 74 | 8 |
| Available investment opportunities | 24 | 61 | 16 | 18 | 68 | 14 |
| Reduction of the Central Bank Rate (CBR) | 18 | 82 | 0 | 13 | 87 | 0 |
| Political Risk | 5 | 79 | 16 | 17 | 59 | 24 |
| COVID – 19 pandemic | 13 | 47 | 39 | 15 | 51 | 34 |

## 2.3 Credit Standards

- In the first quarter of 2022, credit standards remained unchanged in ten economic sectors and were tightened in one sector (Real Estate).
- Tightening of credit standards in Real Estate sector is attributed to the adverse effects of COVID – 19 pandemic. This was to avoid possibility of non-performing loans as a result of the pandemic.
- This is presented in **Chart 3** and **Table 3** below.

**Chart 3: Credit Standards**




| | Agriculture | Manufacturing | Building and Construction | Mining and Quarrying | Energy and Water | Trade | Tourism,Restaurant and Hotels | Transport and Communication | Real Estate | Financial Services | Personal and Household |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Tightened (%) | 25 | 18 | 38 | 14 | 13 | 15 | 37 | 33 | 53 | 15 | 21 |
| Remained Unchanged (%) | 72 | 69 | 59 | 81 | 82 | 64 | 50 | 51 | 37 | 82 | 50 |
| Eased (%) | 3 | 13 | 3 | 5 | 5 | 21 | 13 | 16 | 10 | 3 | 29 |

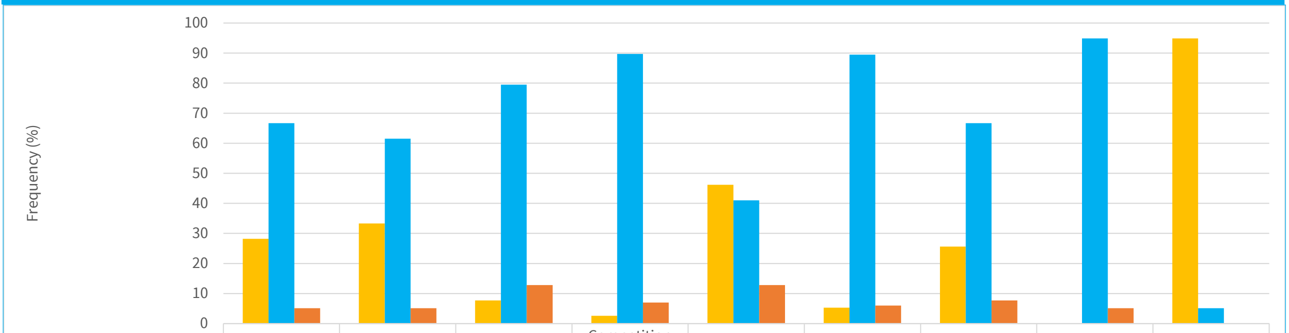
## Table 3: Credit Standards for Loans to Various Economic Sectors

| Percentage (%) | December 2021 | | | March 2022 | | |
|---|---|---|---|---|---|---|
| | Tightened | Remained Unchanged | Eased | Tightened | Remained Unchanged | Eased |
| Agriculture | 15 | 82 | 3 | 25 | 72 | 3 |
| Manufacturing | 15 | 67 | 18 | 18 | 69 | 13 |
| Building and Construction | 34 | 61 | 5 | 38 | 59 | 3 |
| Mining and Quarrying | 14 | 81 | 5 | 14 | 81 | 5 |
| Energy and Water | 13 | 76 | 11 | 13 | 82 | 5 |
| Trade | 21 | 64 | 15 | 15 | 64 | 21 |
| Tourism, Restaurant and Hotels | 45 | 42 | 13 | 37 | 50 | 13 |
| Transport and Communication | 31 | 51 | 18 | 33 | 51 | 16 |
| Real Estate | 50 | 45 | 5 | 53 | 37 | 10 |
| Financial Services | 10 | 87 | 3 | 15 | 82 | 3 |
| Personal and Household | 26 | 47 | 26 | 21 | 50 | 29 |

### 2.4 Factors Influencing Credit Standards

- In the quarter ended March 31, 2022, seven factors had little impact on credit standards whereas COVID-19 and expectations regarding general economic activities led to tightening of credit standards.
- Investment in Government Securities, Competition from Saccos, Microfinance banks, and other Credit Providers, Retention of the Central Bank Rate (CBR), and Competition from other banks are the main factors that had no impact on credit standards. These were reported by 96 percent, 90 percent, 89 percent and 79 percent of the respondents respectively.
- A comparison of the trend in the factors affecting the banks' credit standards are shown in **Chart 4** and **Table 4**.

**Chart 4: Factors affecting Credit Standards**




| | Bank's cost of funds and Balance sheet constraints | Constraints relating to Bank's capital position | Competition from other banks | Competition from Microfinance Banks, Saccos and other non-bank credit providers | Expectations regarding general economic activity | Retention of the Central Bank Rate (CBR) | Political Risk | Investment in Government securities | Covid 19 |
|---|---|---|---|---|---|---|---|---|---|
| Tightened (%) | 28 | 33 | 8 | 3 | 46 | 5 | 26 | 0 | 95 |
| Remained unchanged (%) | 67 | 62 | 79 | 90 | 41 | 89 | 67 | 95 | 5 |
| Eased (%) | 5 | 5 | 13 | 7 | 13 | 6 | 8 | 5 | 0 |

### Table 4: Factors affecting credit standards

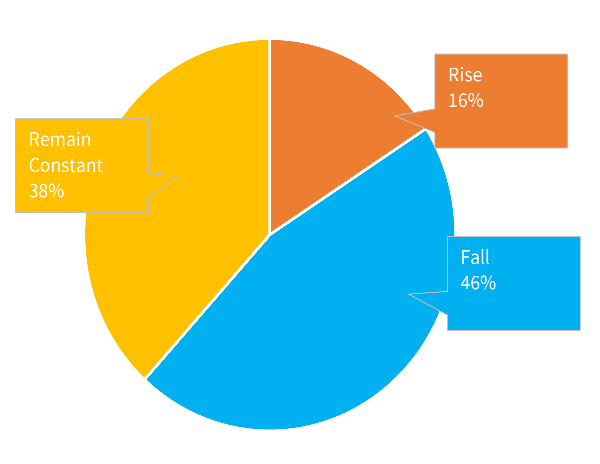
| | December 2021 | | | March 2022 | | |
|---|---|---|---|---|---|---|
| | Tightened | Remained Unchanged | Eased | Tightened | Remained Unchanged | Eased |
| Bank's cost of funds and Balance sheet constraints | 21 | 74 | 5 | 28 | 67 | 5 |
| Constraints relating to Bank's capital position | 28 | 67 | 5 | 33 | 62 | 5 |
| Competition from other banks | 8 | 77 | 15 | 8 | 79 | 13 |
| Competition from DTMs, Saccos, and other Credit Providers | 3 | 87 | 10 | 3 | 90 | 7 |
| Expectations regarding general economic activity | 38 | 41 | 21 | 46 | 41 | 13 |
| Retention of the Central Bank Rate (CBR) | 8 | 87 | 5 | 5 | 89 | 6 |
| Political Risk | 15 | 85 | 0 | 26 | 67 | 8 |
| Investment in Government Securities | 8 | 92 | 0 | 0 | 95 | 5 |
| COVID-19 | - | - | - | 95 | 5 | 0 |

## 2.5. Non-Performing Loans (NPLs)

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

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

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



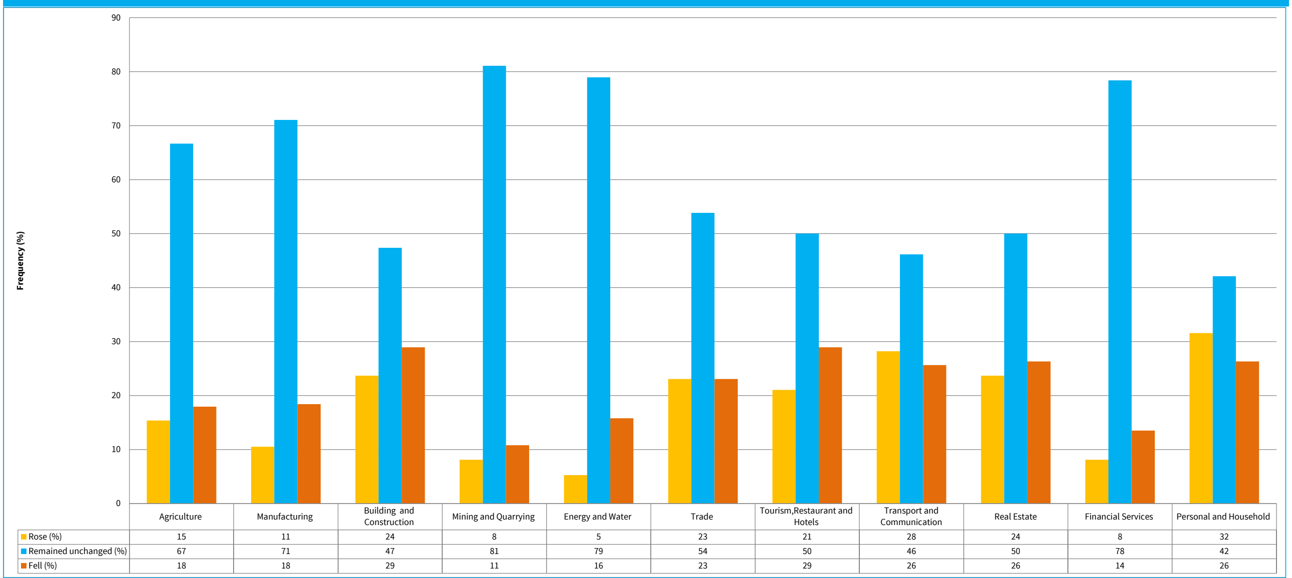
### 2.5.2 Expected Non-Performing Loans per sector during the next Quarter

- Respondents indicated that the level of NPLs is expected to remain constant in all economic sectors during the next quarter.
- **Table 5** and **Chart 6** depicts this.

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

| Percentage (%) | December 2021 | | | March 2022 | | |
|---|---|---|---|---|---|---|
| | Rose | Remained Unchanged | Fell | Rose | Remained Unchanged | Fell |
| Agriculture | 10 | 74 | 15 | 15 | 67 | 18 |
| Manufacturing | 13 | 58 | 29 | 11 | 71 | 18 |
| Building and Construction | 32 | 37 | 32 | 24 | 47 | 29 |
| Mining and Quarrying | 5 | 84 | 11 | 8 | 81 | 11 |
| Energy and Water | 8 | 74 | 18 | 5 | 79 | 16 |
| Trade | 21 | 36 | 44 | 23 | 54 | 23 |
| Tourism, Restaurant and Hotels | 29 | 42 | 29 | 21 | 50 | 29 |
| Transport and Communication | 26 | 46 | 28 | 28 | 46 | 26 |
| Real Estate | 32 | 37 | 32 | 24 | 50 | 26 |
| Financial Services | 8 | 70 | 22 | 8 | 78 | 14 |
| Personal and Household | 26 | 37 | 37 | 32 | 42 | 26 |

**Chart 6: Non-Performing Loans**



## 2.6 Credit Recovery Efforts in the Second Quarter of 2022

- For the quarter ended June 30, 2022, banks expect to intensify their credit recovery efforts in eight economic sectors and remain constant in three sectors namely Mining and Quarrying, Energy and Water, and Financial Services. The intensified recovery efforts are aimed at improving the overall quality of the asset portfolio.
- The main sectors that banks intend to intensify credit recovery efforts, in order to enhance reduction of NPLs therefore improving the overall quality of their asset portfolio, are: -

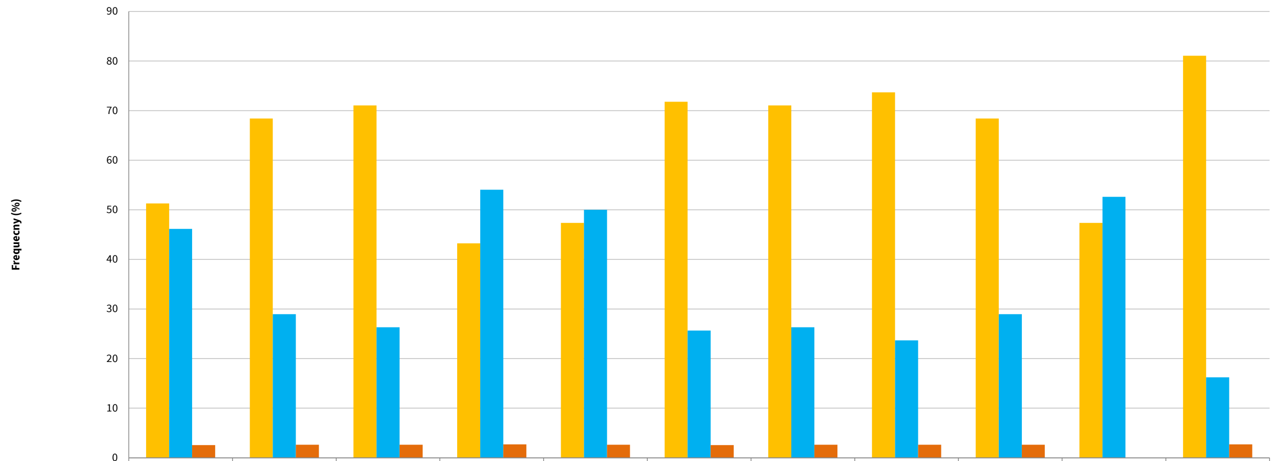
  i. Personal and Household (81 percent).
  ii. Transport and Communication (74 percent).
  iii. Trade (72 percent).
  iv. Building and Construction (71 percent).
  v. Tourism, Restaurants and Hotels (71 percent).

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

### Table 6: Credit Recovery Efforts

| | December 2021 | | | March 2022 | | |
|---|---|---|---|---|---|---|
| | Intensified | Remained Unchanged | Eased | Intensified | Remained Unchanged | Eased |
| Agriculture | 51 | 46 | 3 | 51 | 46 | 3 |
| Manufacturing | 71 | 26 | 3 | 68 | 29 | 3 |
| Building and Construction | 79 | 18 | 3 | 71 | 26 | 3 |
| Mining and Quarrying | 47 | 50 | 3 | 43 | 54 | 3 |
| Energy and Water | 45 | 53 | 3 | 47 | 50 | 3 |
| Trade | 82 | 16 | 3 | 72 | 26 | 3 |
| Tourism, Restaurant and Hotels | 82 | 13 | 5 | 71 | 26 | 3 |
| Transport and Communication | 74 | 23 | 3 | 74 | 24 | 3 |
| Real Estate | 71 | 26 | 3 | 68 | 29 | 3 |
| Financial Services | 53 | 47 | 0 | 47 | 53 | 0 |
| Personal and Household | 84 | 13 | 3 | 81 | 16 | 3 |

## Chart 7: Credit Recovery Efforts




| | Agriculture | Manufacturing | Building and Construction | Mining and Quarrying | Energy and Water | Trade | Tourism,Restaurant and Hotels | Transport and Communication | Real Estate | Financial Services | Personal and Household |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Intensify (%) | 51 | 68 | 71 | 43 | 47 | 72 | 71 | 74 | 68 | 47 | 81 |
| Remain constant (%) | 46 | 29 | 26 | 54 | 50 | 26 | 26 | 24 | 29 | 53 | 16 |
| Ease (%) | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 0 | 3 |

## 2.7 International Financial Reporting Standard (IFRS) 9 on Financial Instruments

- The International Financial Reporting Standard (IFRS) 9 on Financial Instruments became effective from January 1, 2018. This standard replaced International Accounting Standard (IAS) 39 on Financial Instruments (Recognition and Measurement).
- IFRS 9 introduced a new method of determining provisions for expected losses on loans extended by lending institutions.
- Institutions are required to recognize expected credit losses at all times and to update the amount of expected credit losses recognized at each reporting date to reflect changes in the credit risk of financial instruments.
- The Central Bank of Kenya assesses: -

  i. The challenges that banks still experience in the implementation of IFRS 9 and mitigation measures implemented.

  ii. Whether the banks have made any changes in the assumptions used in IFRS 9 and if they are more reliable.

### 2.7.1 Challenges experienced in the Implementation of IFRS 9

- Most banks have adopted a tight credit risk appraisal, ensuring that facilities are well secured and that alternative sources of repayment are available.

  However, implementation of IFRS 9 has had some challenges.

  i. Macroeconomic data is not readily available and there is little historical data to rely on to prepare the models required for economic cover and sector specific.

  ii. Aligning the model with emerging trends that are affecting the economy globally.

  iii. Integrating credit-grading scores to the IFRS 9 Point in Time (PIT) Probabilities of default (PDs).

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

- Banks have implemented the following mitigation measures: -

    i. Some banks are part of the ongoing financial institutions discussions championed by external rating agencies such as Moody's and Fitch.

    ii. Some banks are in the process of aligning credit grading scores to the IFRS 9 PDs.

    iii. Seeking for additional capital injection to accommodate the expected rise in Credit Losses.

    iv. Focusing on robust acquisition strategies to acquire better performing clients as well as redesigning the collection strategies to enhance portfolio performance.

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

- Banks have stressed the macroeconomic factor to focus on the worst-case scenario.
- Some banks have updated the segmentation of the loan book to be more relevant in this COVID-19 environment. The segmentation has moved away from the size of the loans and is now based on the industry of their customers.

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

- Some banks use sensitivity analysis to assess the impacts of various assumptions to ensure reasonability.
- Ensuring that all risk components used in the measurement of expected credit losses (ECL) reflect the current economic conditions and credit risk behavior of customers in the bank.
- Realignment of business models to minimize credit losses on unutilized limits and to enhance efficiency in internal operations.
- Bank emphasize on good quality security in all borrowings to help minimize provisions.
- Banks investment in credit scoring system.
- Regular refresh of the macro-economic variables based on the current economic environment and of the risk parameters driven by the portfolio performance.

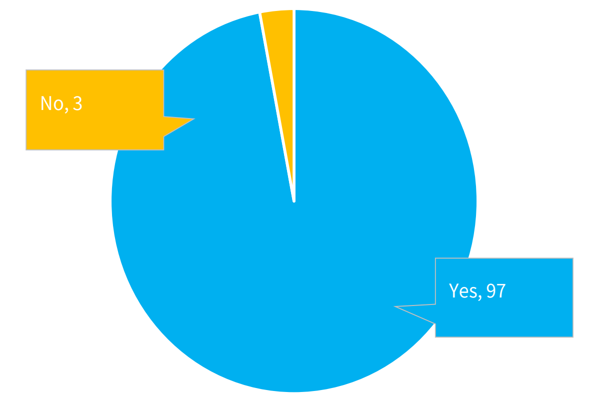
## 2.8. International Financial Reporting Standard (IFRS) 16 on Leases

- The International Financial Reporting Standard (IFRS) 16 on Leases became effective from January 1, 2019. This standard replaced International Accounting Standard (IAS) 17 on Leases.
- The main difference between IAS 17 and IFRS 16 is the treatment of operating leases by lessees. Under IAS 17, a lessee was not obligated to report assets and liabilities from operating leases on their balance sheet but instead report the leases as off-balance sheet items. IFRS 16 changes this by requiring lessees to recognize operating leases right of use (ROU) assets and lease liabilities on the balance sheet.
- IFRS 16 aims to improve the quality of financial reporting for companies with material off balance sheet leases.
- During the quarter ended March 31, 2022, CBK assessed the level of implementation of IFRS 16 in the banking industry and its impact.

### 2.8.1 Implementation of IFRS 16

- During the quarter ended March 31, 2022, 97 percent of the respondents had implemented IFRS 16. This is depicted in **Chart 8**.

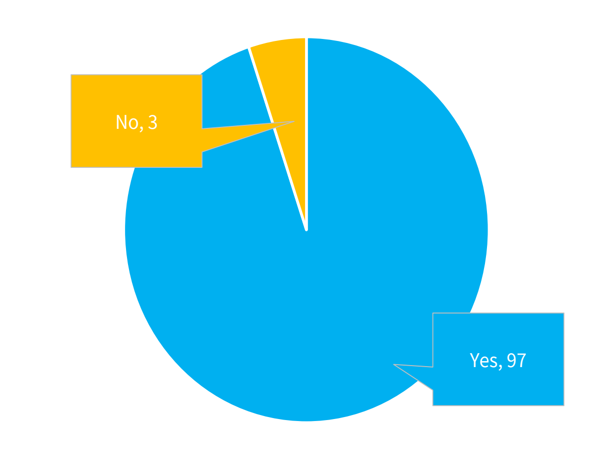
**Chart 8: Banks that have implemented IFRS 16 on Leases (%)**




### 2.8.2 Assessment of the Impact of IFRS 16

- During the quarter ended March 31, 2022, 97 percent of the respondents had assessed the impact of IFRS 16 on their financial performance and position. This is depicted in **Chart 9**.

**Chart 9: Banks that assessed the likely impact of IFRS 16 (%)**




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

Most banks indicated that implementation of IFRS 16 :-

- Increased their risk weighted assets, which has in turn decreased their capital adequacy ratios.
- It also had a negative impact on the banks' retained earnings.
- The adoption of IFRS 16 resulted into additional expenses on account of deprecation on right of use assets and interest expense on lease liabilities held by banks.

### 2.8.4 Financial indicators for Leases

- Following the implementation of IFRS 16 on January 1, 2019, the value of the financial indicators for leases in the banking industry as at March 31, 2022 are indicated in **Table 7**.

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

| Banking Industry (Ksh '000) | December 2021 | March 2022 |
|---|---|---|
| Right of use (ROU) assets | 35,292,160.80 | 35,381,434.30 |
| Lease liabilities | 30,950,491.09 | 30,212,023.60 |
| Depreciation of the right of use asset | 8,697,785.27 | 6,536,178.26 |
| The finance charge associated with the lease liability | 2,751,059.69 | 1,126,251.05 |

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

- Most banks indicated that the major challenge they faced in implementation of IFRS 16 include: -
  - i. The adoption resulted into additional expenses on account of deprecation on right of use assets and interest expense on lease liabilities held by banks.
  - ii. Determining the most appropriate discounting rate for lease payment.
  - iii. Clarity of lease agreement especially the issues related to restoration cost and possible maximum period of extension

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

- As a mitigation measure, banks have indicated that they are: -
  - i. Banks are keener on lease terms at the point of entry due to the immediate impact on the financials.
  - ii. Banks have automated the IFRS 16 computations for more efficiency.
  - iii. Continuous training of Finance staff on the computations and impact of IFRS 16.

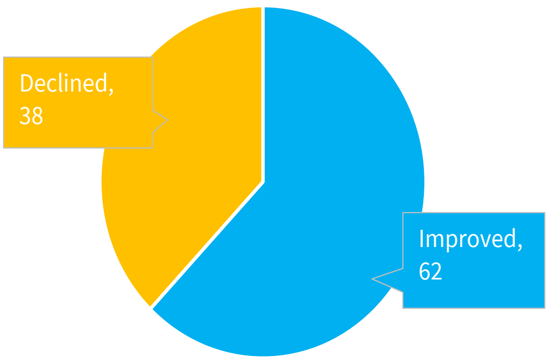
## 2.9 Liquidity Risk

- Banks were required to state the status of their liquidity positions, factors that led to improved liquidity, their plans with improved liquidity, measures being taken with deteriorated liquidity and their involvement in interbank activities during the quarter ended March 31, 2022.

### 2.9.1 Commercial Banks' liquidity positions

- During the quarter ended March 2022, 62 percent of the respondents indicated that their liquidity position had improved as indicated in **Chart 10**.

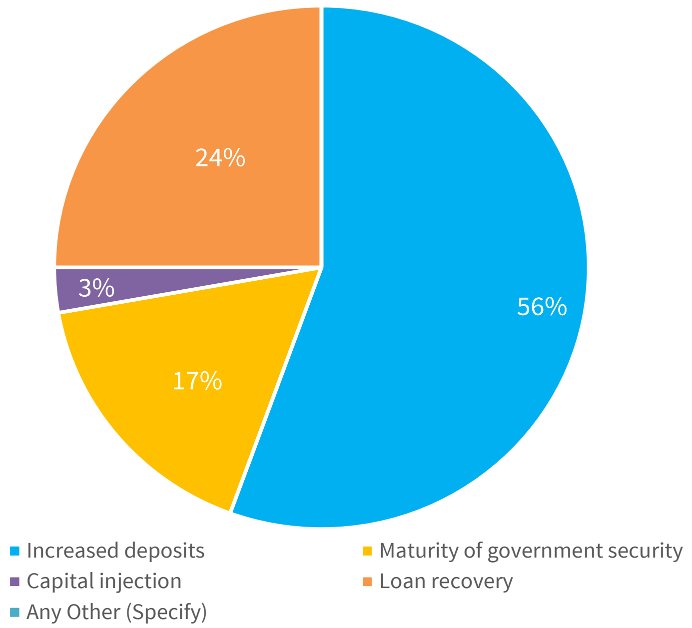
**Chart 10: Movement in liquidity risk (%)**




### 2.9.2 Factors that led to improved liquidity in the quarter ended March 31, 2022

- During the quarter ended March 31, 2022, liquidity improved mainly as a result of: -
  i). Increased deposits (56 percent).
  ii). Loan recovery (24 percent).
  iii). Maturity of government securities (17 percent).
  iv). Capital injection (3 percent).
- The drivers of improved liquidity are indicated in **Chart 11** below.

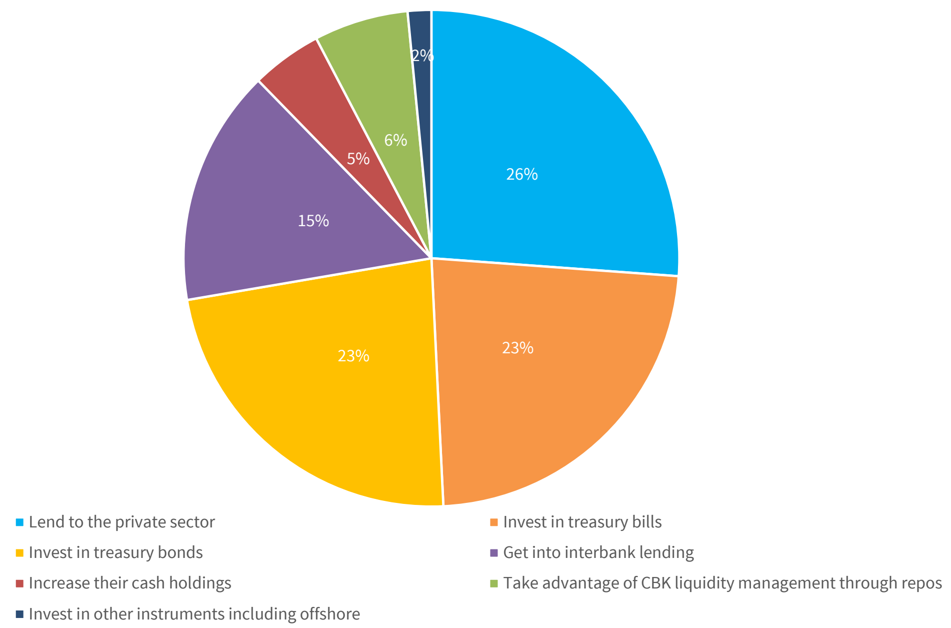
**Chart 11: Reasons for improved liquidity (%)**



### 2.9.3 Commercial Banks' plans with improved liquidity

- As indicated in **Chart 12**, with the improved liquidity, it is expected that in the second quarter of 2022, credit to private sector will increase as several banks intend to deploy the additional liquidity towards lending to the private sector (26 percent), investing in Treasury Bonds (23 percent), investing in Treasury Bills (23 percent), interbank lending (15 percent), increase their cash holdings (5 percent), CBK liquidity management through repos (6 percent), and invest in other instruments including offshore (2 percent).

**Chart 12: Plans with improved liquidity (%)**




### 2.9.4 Measures being taken by Commercial banks to enhance deteriorated liquidity

- During the quarter ended March 2022, 38 percent of the respondents indicated that their liquidity position had deteriorated as indicated in **Chart 10**.
- The affected banks are enhancing their deposit mobilization campaigns to enhance their liquidity positions.

### 2.9.5 Commercial Banks' interbank activities

- During the quarter ended March 31, 2022, 51 percent of the respondents indicated that their interbank lending activities increased. This is indicated in **Chart 13** below.
- 54 percent of the respondents indicated that their interbank borrowing decreased. This is indicated in **Chart 14** below.
- Interbank borrowing has generally decreased due to tightening of credit standards by institutions for all categories of facilities.

**Chart 13: Increase in interbank lending (%)**

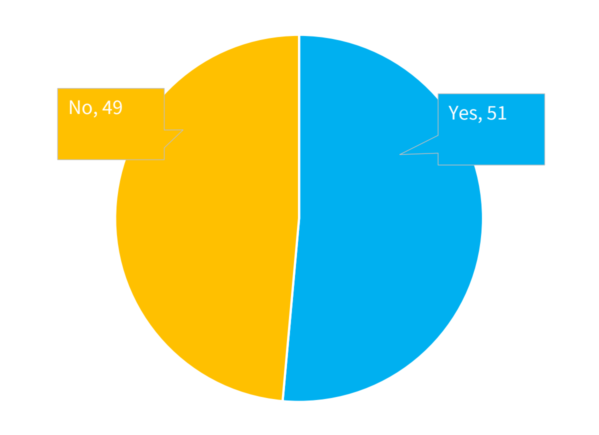
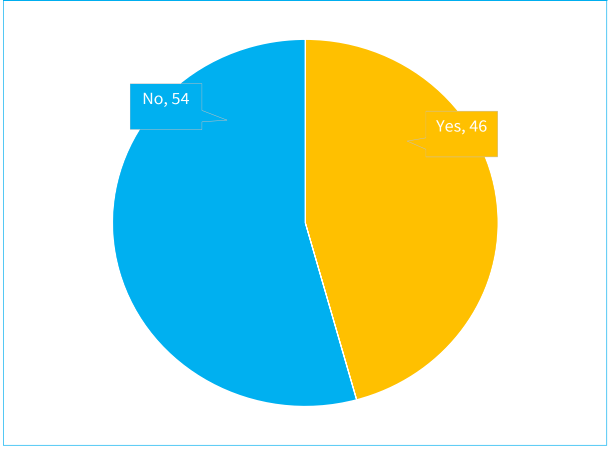



**Chart 14: Increase in Interbank borrowing (%)**




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

- With the ongoing COVID-19 pandemic, the global economic outlook has been highly uncertain, with unprecedented volatility in the financial markets.
- The adverse effects of the pandemic on the Kenyan economy points that the impact has been severe. In this regard, CBK through the credit survey assessed the impact of the pandemic on the banking sector. The survey covered areas relating to: -

  i) Adverse impact of the pandemic on the banks.
  ii) Opportunities that have arisen from the pandemic.
  iii) The key risks that have been increased by the pandemic.
  iv) Measures banks are taking to curb the adverse impact of the pandemic on banks' business.
  v) Banks' experience after the expiry of the emergency measures on restructured loans introduced by CBK to mitigate the impact of the pandemic.

### 2.10.1 Adverse Impact of Coronavirus (COVID-19) pandemic on the banks

The commercial banks have indicated that the pandemic has had an adverse impact on their business including:-

- Delay in loan repayments in some key sectors even after moratoriums issued expired as many sectors in the economy are yet to recover from COVID-19 effects with 2022 projections seeming worse especially with the new variants during the year.
- Cases of staff contracting the virus and as such resulting in reduction in productivity.

- Decreased lending, because of slowdown in the economy and emerging risks associated with COVID-19 pandemic.
- Reduction in earnings due to low revenue from lending due as a result of defaults as customers struggle with the effects of the pandemic.

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

Some of the opportunities arising from the pandemic include:

- Increased digital transactions as clients access bank products and services through digital channels.
- Increase in the use of debit/credit cards to transact as opposed to cash.
- The pandemic has led to use of technology for meetings which reduced the cost of travelling and hosting of meetings.
- Emergent opportunities in certain industry segments like Health, Manufacturing, Fast-Moving Consumer Goods (FMCG) and Information Communication Technology (ICT) which have continued to expand.

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

Some of the key risks increased by the pandemic include:

- **Credit risk**: Due to the adverse effect of the pandemic on the economy hence affecting customers' ability to meet their financial obligations. There is also uncertainty on customer incomes and employment coupled with reducing collateral values.
- **Operational risk**:This can occur in case of mass infection among the staff.
- **Cyber security risk**: Due to increased use of digital banking and staff working remotely.

### 2.10.4 Measures taken by banks to curb the potential impact of coronavirus pandemic

Commercial banks have put in place the following measures to curb the adverse impact of the pandemic: -

- Digitizing transactions to enable clients access bank products through their digital channels hence reducing face to face contacts.
- Granting moratorium and other forms of relief to clients who will be unable to make their loan repayments.
- Increase in provisions as a cautionary measure to mitigate the uncertainty caused by the pandemic.
- Borrowings from DFIs to cushion the Bank from any liquidity pressures that may arise from the accommodation of loans.
- The bank has taken guarantees with institutions to mitigate credit risk as a result of the adverse effects of covid 19.

### 2.10.5 Respondents experiences after the expiry of the emergency measures on restructured loans by CBK to mitigate the impact of COVID-19

The respondents indicated their experiences after the expiry of the emergency measures on restructured loans as outlined below;

i. Increase in NPLs due to reclassification of facilities, which have been restructured but were still not able to meet their obligations as their businesses are yet to fully recover.
ii. Reduction in profits due to increase in NPLs and provisions from the restructured facilities.
iii. Banks are using robust relationship management to ensure the loans whose moratoriums have expired are being repaid based on new contractual terms.

## LIST OF RESPONDENTS

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

Central Bank of Kenya

Haile Selassie Avenue P.O. Box 60000 - 00200 Nairobi |Tel: (+254) 20 - 286 0000 / 286 1000 / 286 3000

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