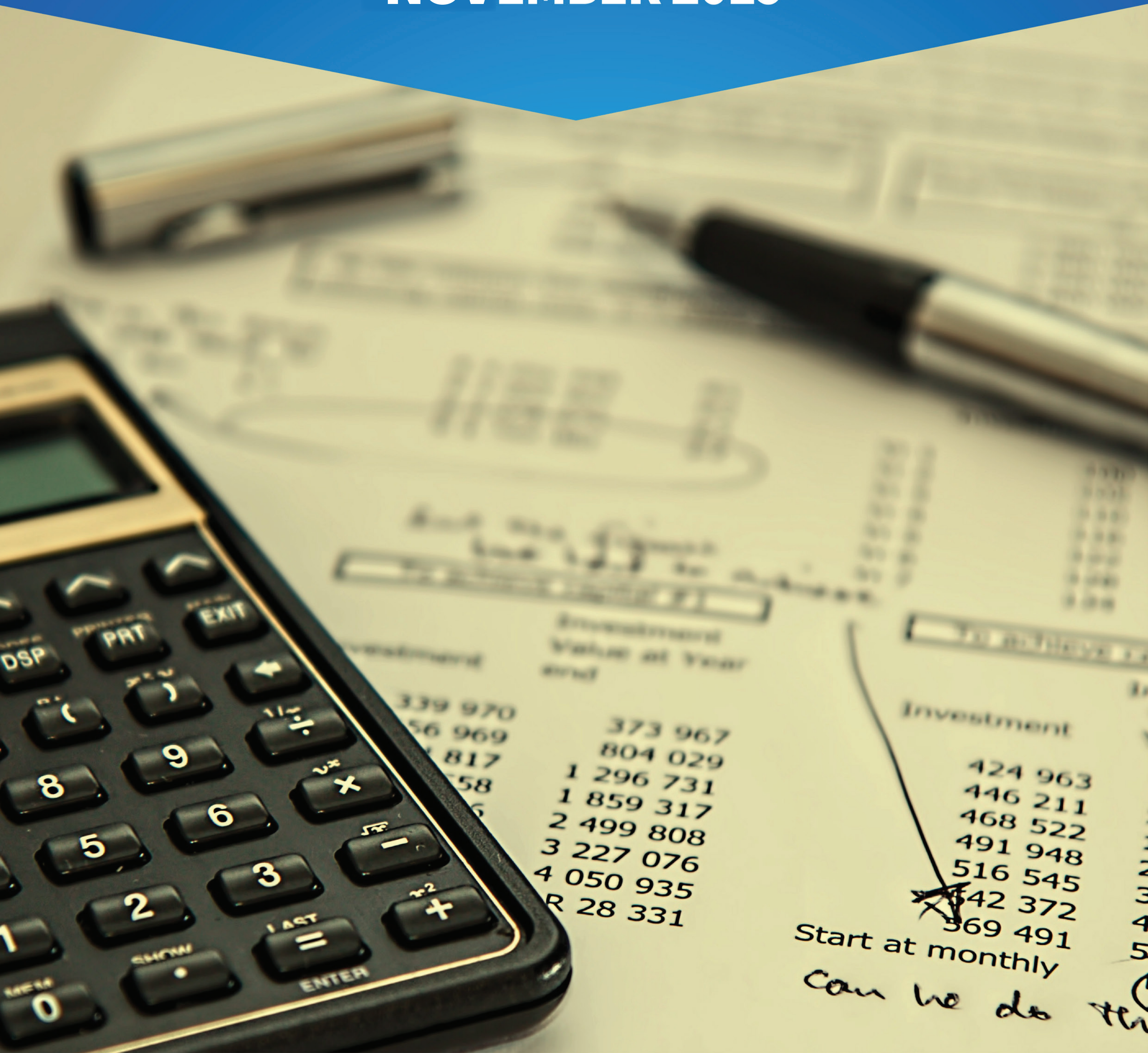
Central Bank of Kenya

REPORT OF THE MONETARY POLICY COMMITTEE MARKET PERCEPTIONS SURVEY NOVEMBER 2019



CONTENTS

BACKGROUND TO THE MARKET PERCEPTIONS SURVEYS

The Central Bank of Kenya (CBK) undertakes a Market Perceptions Survey every two months, prior to every Monetary Policy Committee (MPC) meeting to obtain perceptions of banks and non-bank private sector firms on selected economic indicators.

The Survey also enables respondents to indicate their levels of optimism in the country's economic prospects and business environment, and perspectives on the current and expected economic conditions in the country, focussing on economic activity, employment, and input prices. It also captures suggestions by private sector firms on ways to enhance the business environment.

Commercial banks, micro-finance banks, and a sample of non-bank private sector firms are included in the surveys. The sample of non-bank private firms, selected from towns across the country namely Nairobi, Mombasa, Kisumu, Eldoret, Nakuru, Nyeri and Meru, is representative of sectors that account for about 70 percent of Kenya's GDP. The sectors covered by the survey include agriculture, mining and quarrying, manufacturing, trade, hotels and restaurants, Information and Communications Technology (ICT), transport, real estate, building and construction, and finance and insurance.

The MPC Secretariat conducts sensitization engagements with respondents on an annual basis in all the regions to facilitate a better understanding of the survey questions, to enhance the quality of responses, and to increase the response rate.

1. INTRODUCTION

The November 2019 MPC Market Perceptions Survey, conducted in the first three weeks of the month, sought perceptions on the economic conditions prevailing in the two months before the MPC meeting, i.e. September and October 2019, and market expectations on economic conditions for November and December 2019, and for the next 12 months period, i.e. November 2019 – October 2020. The Survey sought from respondents their expectations with regard to overall inflation, movements of the exchange rate of the Kenya Shilling against the U.S. Dollar, demand for credit, private sector credit growth and economic growth.

Other areas interrogated included the levels of optimism in the economy's prospects, perceptions of levels of economic activity before the MPC meeting, expected levels of economic activity after the MPC meeting, and movements in production input prices before the MPC meeting.

This report provides a summary of the findings of the Survey.

2. SURVEY METHODOLOGY

The Survey was administered to the Chief Executives and other senior officers of 381 private sector firms comprising 38 operating commercial banks, 1 operating mortgage finance institution, 13 micro-finance banks (Mfbs) and 328 non-bank private firms including 45 hotels, through questionnaires sent by email and hard copy. The overall response rate to the November 2019 Survey was 66 percent of the sampled institutions. The respondents comprised 37 commercial banks, 1 mortgage finance institution, 12 micro-finance banks, 39 hotels, and 160 non-bank private sector firms.

The expectations from commercial and micro-finance banks were aggregated and analysed using weighted averages based on the market size of the bank/ microfinance bank relative to total banks/ microfinance banks, respectively, while those from the non-bank private firms were weighted using the respective sector weights based on the latest available sectoral contributions to GDP.

3. HIGHLIGHTS OF THE SURVEY

The key takeaways from the November 2019 Market Perceptions Survey included:

- Inflation expectations remained well anchored within the target range in the 2 months after the Survey, i.e. November and December, and in the 12-month period after the Survey, i.e., November 2019 – October 2020.
- Bank and non-bank respondents expected a stable Ksh/USD exchange rate for the next 2 months.
- Banks expected a further increase in Private sector credit growth in the remainder of 2019.
- Banks and non-bank private sector expected economic growth to remain strong in 2019.
- There was sustained optimism on Kenya's economic prospects by banks and the non-bank private sector.

4. CURRENT ECONOMIC CONDITIONS

4.1 Overall Economic Activity

The November 2019 Market Perceptions Survey sought bank and non-bank private sector firms' assessment of economic activity in the two months prior to the November MPC meeting, i.e. September and October 2019, to get a sense of the economic conditions prevailing before the MPC meeting.

Bank and microfinance bank respondents indicated that economic activity (volume of demand/ business activity/ production) during this period was moderate, driven by the short rains and investments in the public sector infrastructure, but was moderated by the weak access to credit by the private sector, shortfalls in revenues and delays in payments to the private sector by central and county governments. Respondents from the non-bank private sector reported moderate activity, which they attributed to the favourable weather, high tourism season, stable economy and political stability.

However, some of the respondents from non-bank private firms surveyed indicated weaker economic activity due to delayed payment of pending bills by central and county governments, lower production and prices of tea and other agricultural crops, and low demand for some products. Respondents also cited limited access to credit facilities from banks, low performance by manufacturing sector, and concerns around governance issues as affecting economic activity in the two months before the November meeting **(Chart 1).**

4.2: Input prices

To assess economic conditions prevailing before the November 2019 MPC meeting, private sector firms were asked to indicate the direction of change (increase/ decrease) in the prices of various production inputs, such as energy, transportation costs, raw materials, labour, freight charges and construction materials, in September and October 2019.

Most respondents reported increases in costs related to energy, transportation, raw materials, freight charges and construction materials, while the cost of labour remained largely the same during the period **(Chart 2).**

Chart 1: Perceptions on Economic Activity for September and October 2019 (percent)

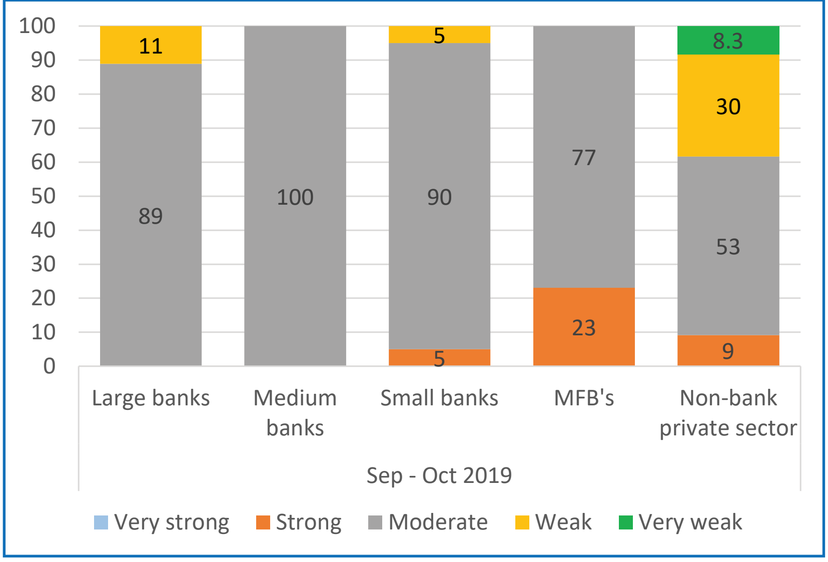
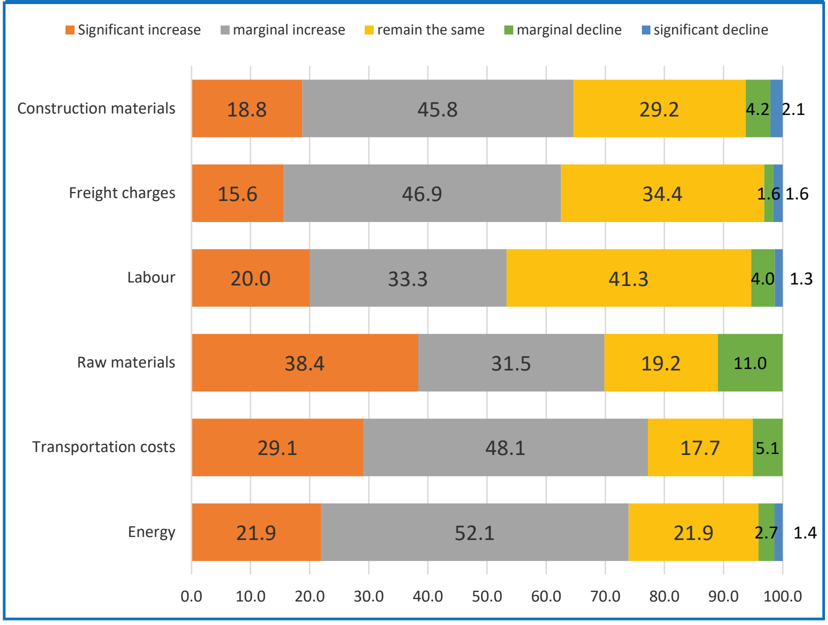


Chart 2: Perceptions on Movements in input prices in September – October 2019 (percent of respondents)



5. INFLATION EXPECTATIONS

Participants in the Survey were asked to indicate their expectations of overall inflation rates for the next 2 months (November and December 2019), and in the next 12 months (November 2019 to October 2020).

The results showed a downward revision in inflation expectations, and prospects of stability within the target range (5 ± 2.5 percent) for the next 2 months, relative to the September 2019 Survey **(Table 1).**

Table 1: Inflation expectations for the next 2 months (percent)

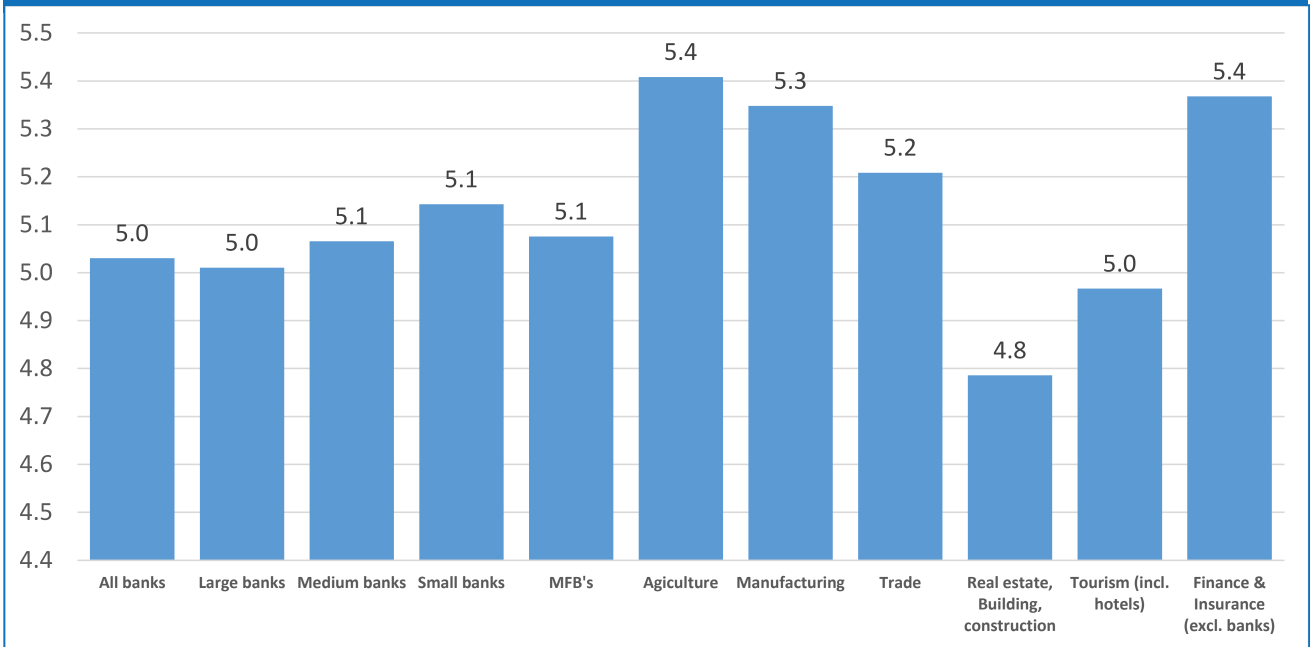
Expected Inflation for:	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
Nov-Dec 2018	5.6	5.6	5.6	5.6	5.7	5.7
Jan-Feb 2019	5.5	5.3	5.5	5.5	5.5	5.6
Mar-Apr 2019	4.2	4.2	4.1	4.2	4.2	4.3
May-Jun 2019	6.9	6.4	6.8	6.8	6.5	6.7
Jul - Aug 2019	5.9	5.8	5.8	5.9	5.9	5.8
Sep-Oct 2019	5.2	5.3	5.3	5.2	5.1	5.3
Nov-Dec 2019	5.0	5.1	5.1	5.0	5.1	5.3

Bank respondents expected the improved weather to keep food prices low, countering pressure from uncertainties related to fluctuations in fuel prices and expected increase in lending to the private sector. The non-bank private sector expected the lower food prices to reduce the impact of fuel price increases, festive season spending, tax measures and high prices of maize flour on inflation.

Respondents across the various sectors expected lower food prices due to the prevailing rains, and stable fuel prices, to support stability in inflation **(Chart 3).**

Respondents however indicated that fluctuations in fuel prices, increased cost of transport and other commodities during the festive season, recent tax revisions and a possible shortfall in maize harvest would exert upward pressure on inflation over the next 2 months.

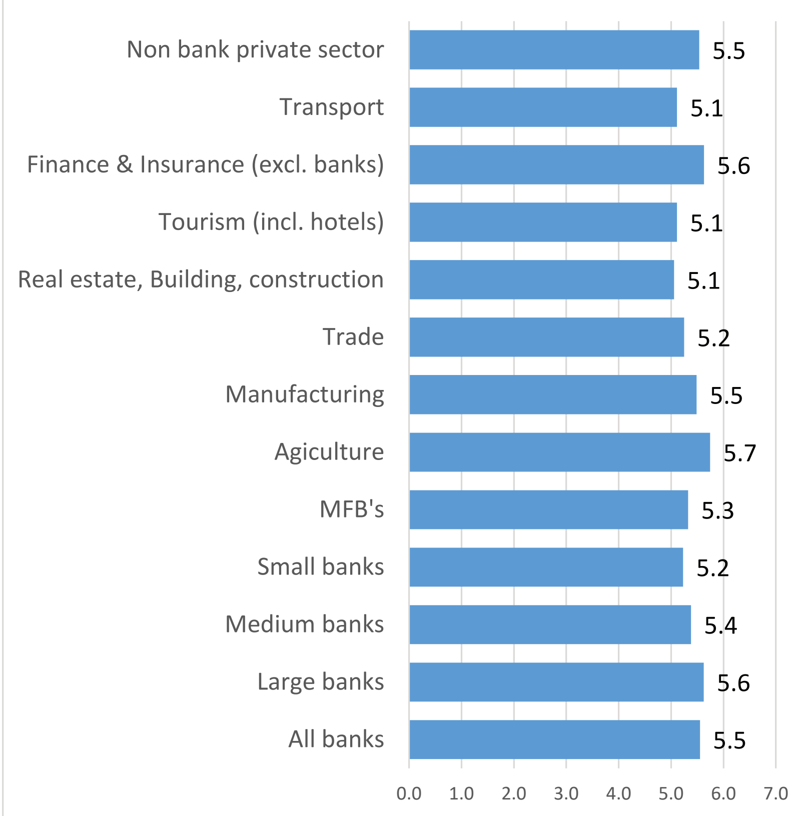
Chart 3: Sectoral inflation expectations for the next 2 months (percent)



Inflation expectations for the next 12 months (November 2019 – October 2020), across the different economic sectors remained well anchored within the target range supported by expected lower food prices due to the favourable weather **(Chart 4).**

Other factors expected to keep inflation within the target band included expected stable oil prices and muted demand pressures. However, expected pick up in private sector lending after the lifting of the interest capping law, fluctuations in international oil prices and increase in prices of foods items such as maize flour were cited as likely risks to inflation over the next 12 months.

Chart 4: Inflation expectations for the next 12 months (percent)



6. EXCHANGE RATE EXPECTATIONS

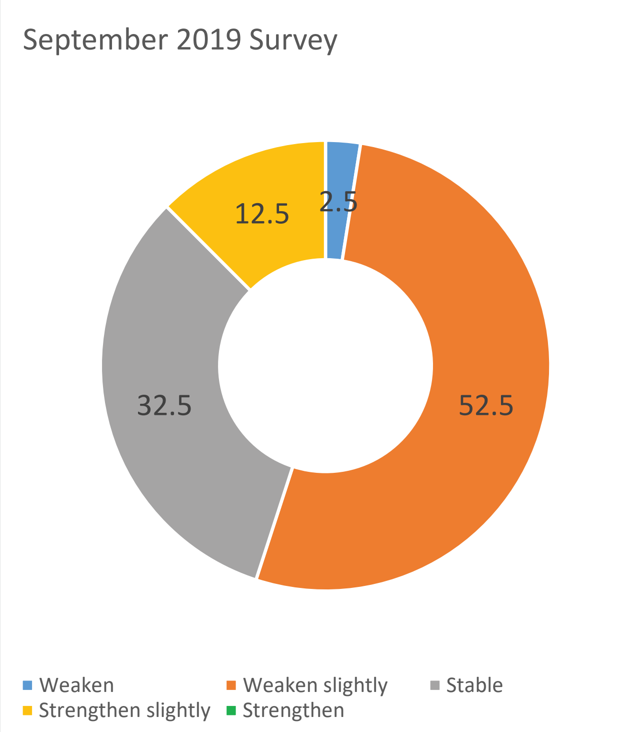
The Survey sought to find out the market expectations on the direction of change in the exchange rate of the Shilling against the U.S. Dollar in November and December 2019. The results showed that bank respondents expected the Shilling to remain stable with a strong bias to strengthen against the USD in the next 2 months, supported by adequate reserves at the CBK, strong diaspora remittances, resilient performance of exports and reduced demand for imports on manufacturing sector during the festive season **(Chart 5).**

In addition, respondents cited healthy capital inflows from the region, and from tourism, the expected USD inflows from investors following repeal of interest caps, projected stable oil prices, stable inflation, confidence among investors, narower current account deficit, and a stable political environment as reasons for the expected stability and/or strengthening of the Shilling.Risks to the Shilling in the next 2 months as cited by respondents included lower agricultural exports due to reduced production and prices, and increased dollar demand for imports as firms prepare for year-end obligations.

Non-bank private sector firms expected the Shilling to remain largely stable against the USD over the next 2 months supported by sufficient reserves, strong diaspora remittances, tourism inflows and resilient exports **(Chart 6).**

Respondents also cited the expected increase in portfolio and FDI inflows following the removal of interest rate caps, the slowdown of importation activity over the holiday season, a narrower current account deficit, the stable macroeconomic and political environment and improved security in the country as reasons for the expected stability. Risks pointed out by respondents included increased dollar demand for imports related to oil and manufacturing inputs, lower agricultural exports, and possible negative effects of the increase in the Federal Reserve Bank interest rates.

Chart 5: Banks expectations on the direction of the Shilling/ USD Exchange rate in the next 2 months (percent)



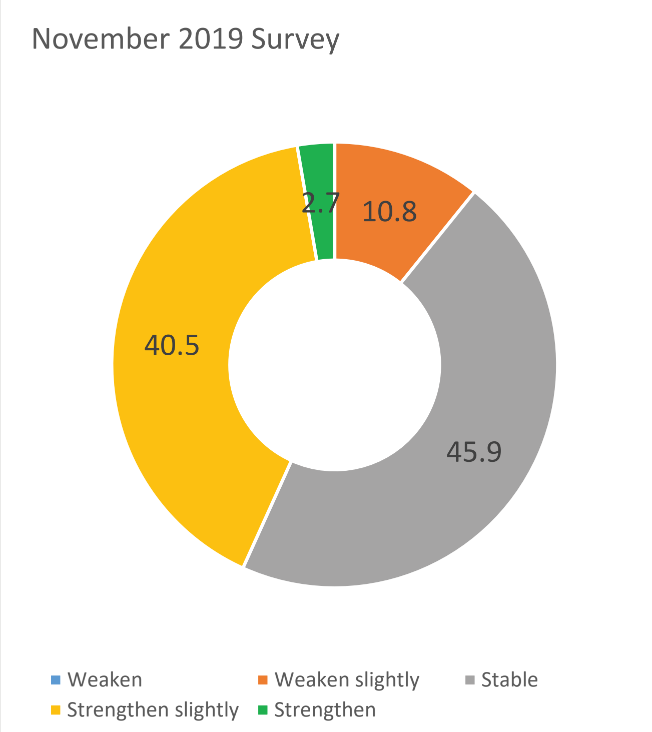
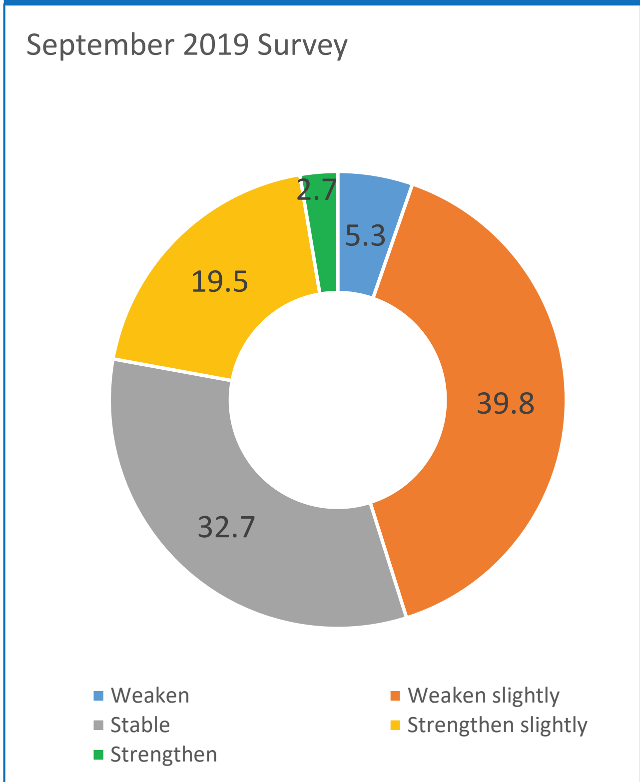
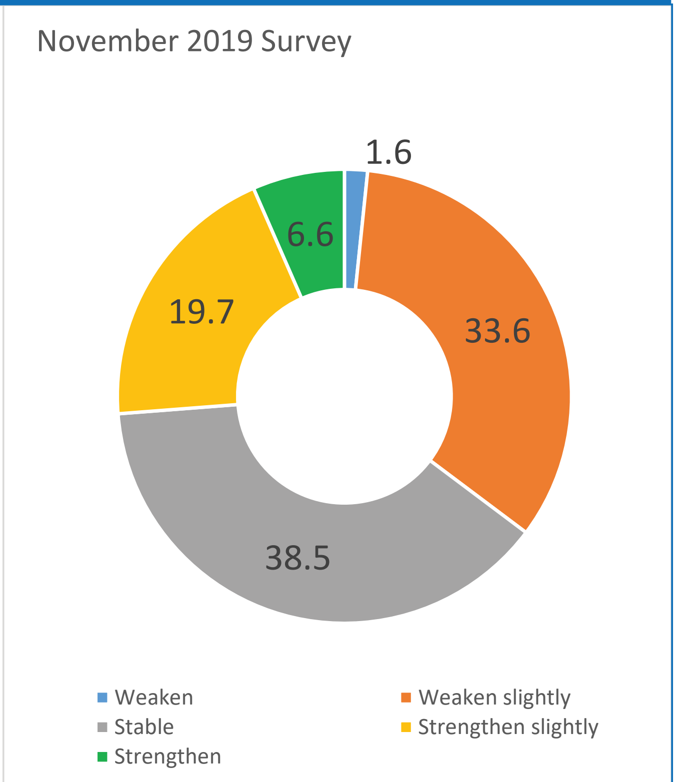


Chart 6: Non-bank private sector firms' expectations on the direction of Shilling/ USD Exchange rate in the next 2 months (percent)





7. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

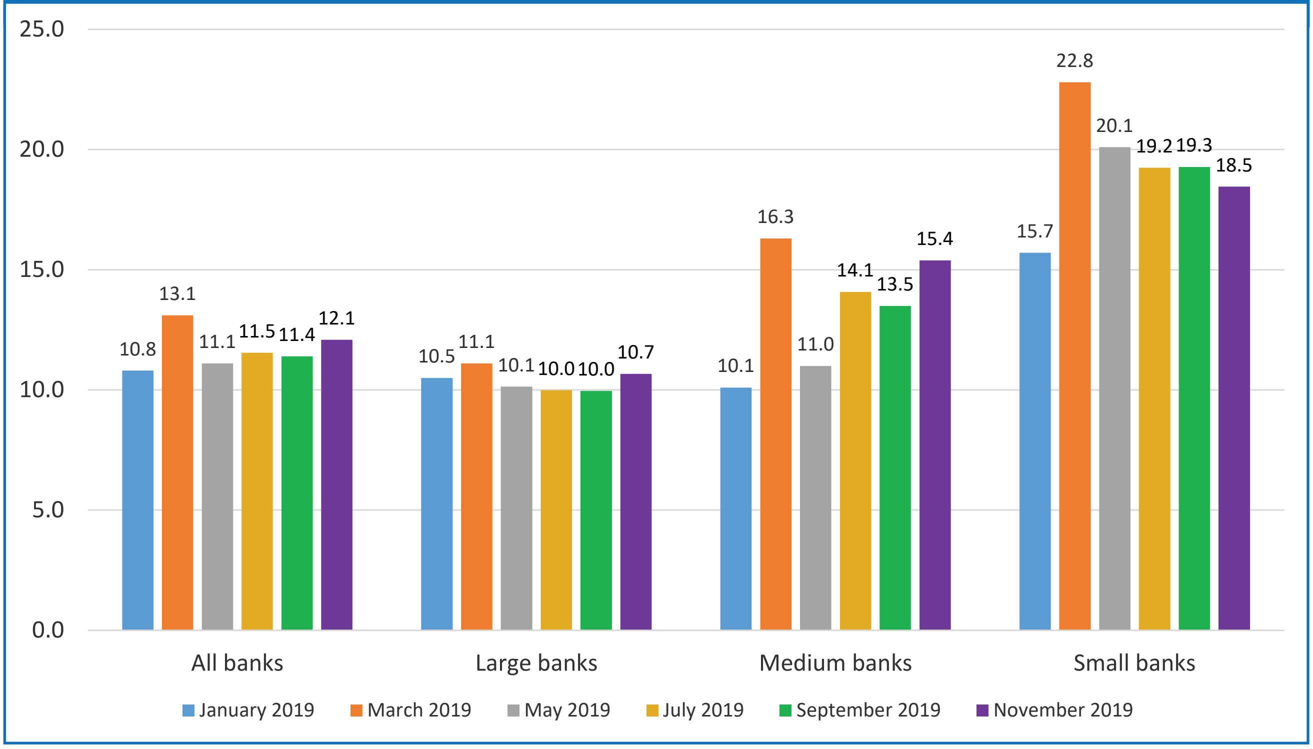
7.1 Growth in Private Sector Credit in 2019

The Survey sought to find out commercial banks' expected private sector credit growth by the end of 2019 relative to 2018.

In the November 2019 Survey, bank respondents remained consistent about their expectations of increasing private sector credit in 2019 relative to 2018 **(Chart 7).** Respondents indicated that Government's intention to accelerate payment to suppliers, more focus on lending to MSMEs including the development of innovative credit products to support the segment, increased credit demand, the expected improvement in market liquidity occasioned by the removal of the interest rate caps and the improved macro-economic environment, would support higher credit growth in 2019.

Risks to this expected private sector credit growth included the slowing demand in the property and construction sector, non-performing loans in the industry and irregular payment of outstanding bills due from central and county governments.

Chart 7: Expectations on Private Sector Credit Growth (percent)



7.2 Role of Liquidity on Private Sector Credit Growth

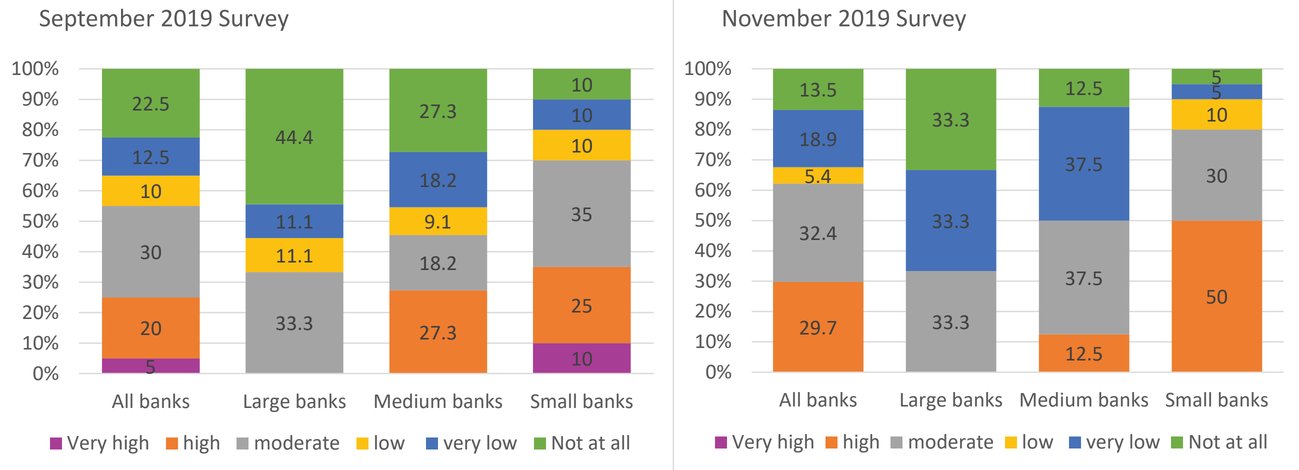
The Survey asked bank participants to indicate the extent to which liquidity was a constraint to private sector lending for their banks.

The results showed that liquidity was less of a limitation to lending in the November Survey compared with September Survey. Particularly, over 60 percent of large bank respondents indicated that liquidity was not a constraint at all, or that it ranked very low as a constraint to lending.

The survey showed improved liquidity across the bank tiers particularly the larger and medium tier banks **(Chart 8).**

Respondents indicated that Government's intention to accelerate payment to suppliers hence enabling them to pay their outstanding loans, and the removal of the interest rate caps, which would help banks compete for customers' deposits that are currently being diverted to alternative investments for lack of competitive earnings from the banks, would contribute to improving liquidity and consequently lending.

Chart 8. Extent to which liquidity is a constraint to private sector lending (percent)



7.3 Expectations of Demand for Credit from banks

The survey requested bank participants to give an assessment of the demand for credit experienced by their banks in the 2 months before the MPC meeting, i.e., September and October, and their expectations of the same for November and December. The results showed an expected improvement in credit demand in November and December relative to that experienced in September and October **(Chart 9).**

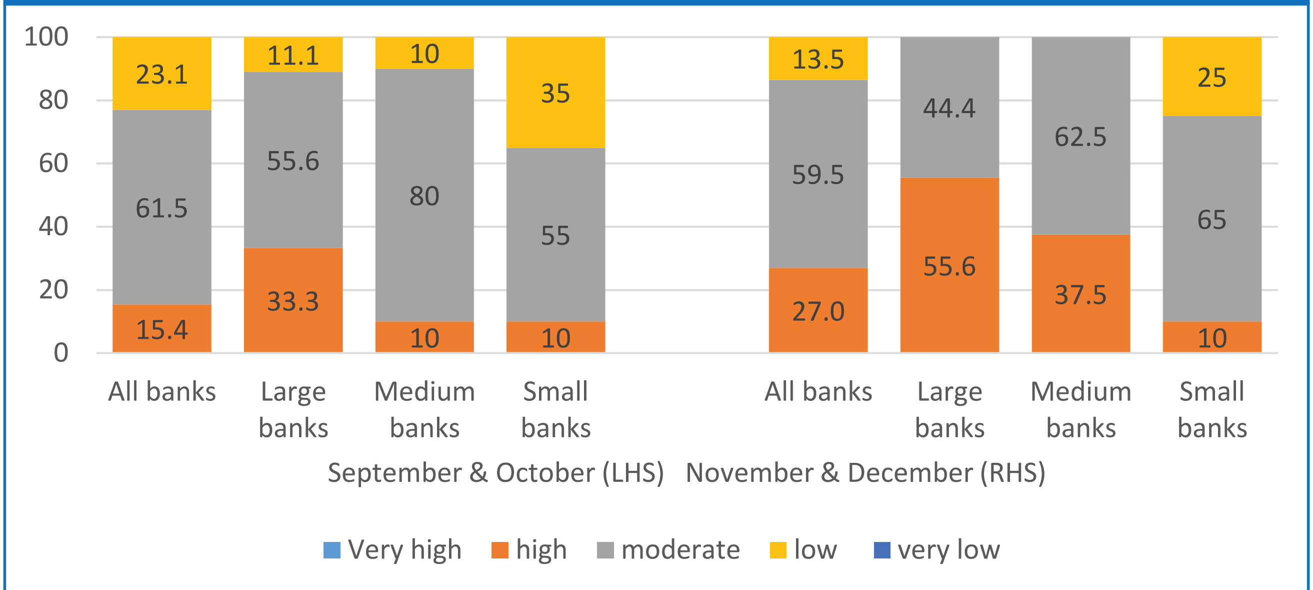
According to most respondents, demand for credit in September and October was mainly moderate, as most demand driving factors remained relatively unchanged, interest on loans remained capped and the economic outlook did not exhibit any significant shift.

Banks that experienced high demand during this period attributed it to improving economic activities that have pushed up the need for credit especially among the SME's, enhanced product propositions and sales effort by the banks, and the upcoming festive season.

Other reasons for the high demand included the cheaper cost of credit, lower inflation, implementation of the Big 4 agenda, favourable weather conditions and improvement in the macro economic environment.

Nevertheless, some banks cited challenges in the retail market and slow business activity as reasons for the low demand they experienced in September and October.

Chart 9: Credit demand perceptions for September and October, and expectations for November and December (percent)



Respondents expected an improvement in demand for credit in November and December with large banks expecting high credit demand during this period. They expected demand for credit to be driven up by the repeal of interest rate caps which would enable better pricing of risk. In addition, the improving economic activities as the festive season approaches, improvement in the ease of doing business, government payments to suppliers expected to boost liquidity flow in the market and inspire demand for credit, and a favourable macro-economic environment were cited as reasons that would drive demand during the period.

However, respondents remained cognisant of the slow -down that would arise as businesses wrapped up for the holidays.

8. ECONOMIC ACTIVITY AND EMPLOYMENT EXPECTATIONS

8.1. Expected Economic Activity

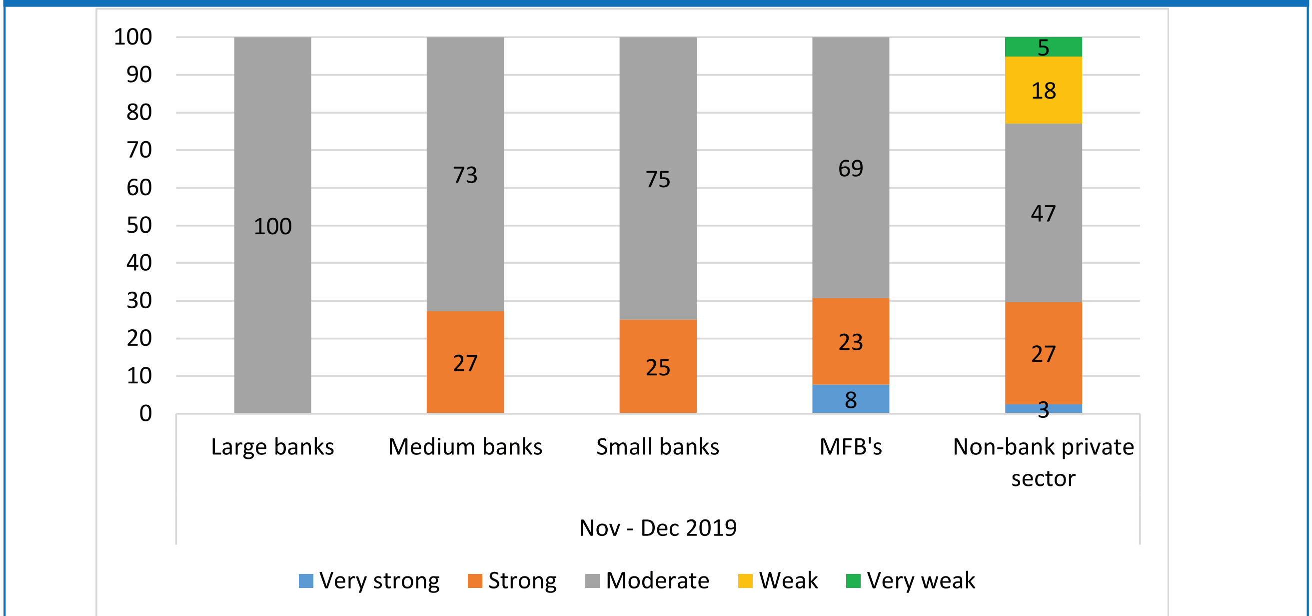
The Survey sought to find out expected levels of economic activity in November and December 2019 by banks and non-bank private sector firms.

Respondents indicated an expected pick-up in economic activity largely due to the anticipated increase in private sector credit due to the removal of the interest rate caps, and the expected payments to suppliers and contractors by the central and county governments **(Chart 10).**

Respondents pointed out that the increase in private sector lending would open up credit to MSMEs and drive more demand for goods and services in the market. In addition, respondents expect the current rains to boost agricultural production, retail trade to gain from the holiday consumption, and the public sector to experience increased activity on the back of the Big 4 agenda. Further, respondents expect diaspora remittances to increase during the festive period, and hotel bookings to increase in the peak domestic tourism season.

However, respondents cited that the slow down and/or holiday closures by businesses, depressed activities in the construction sector and weaker liquidity among consumers due to delayed payments of pending bills could negatively affect activity during the period.

Chart 10: Expected Economic Activity in November and December 2019 (percent)

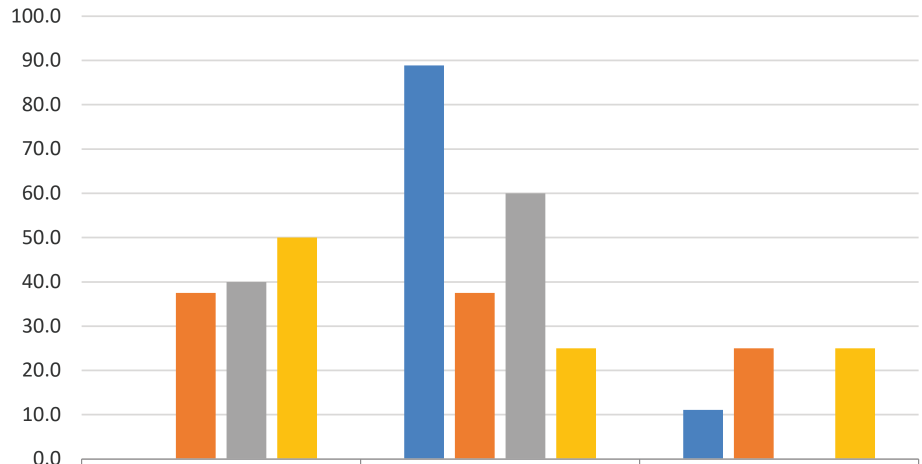


8.2: Employment Expectations

The Survey inquired about expected movements in employment levels for 2019 from bank and non-bank respondents. Large banks expected to retain their employment levels in 2019, while small banks and micro-finance banks expect to have higher staffing numbers in 2019 relative to 2018 **(Chart 11).**

The non-bank private sector firms did not expect much change in their staffing levels for 2019 relative to 2018 **(Chart 12).**

Chart 11: Expected changes in employment levels by banks in 2019 (percent)

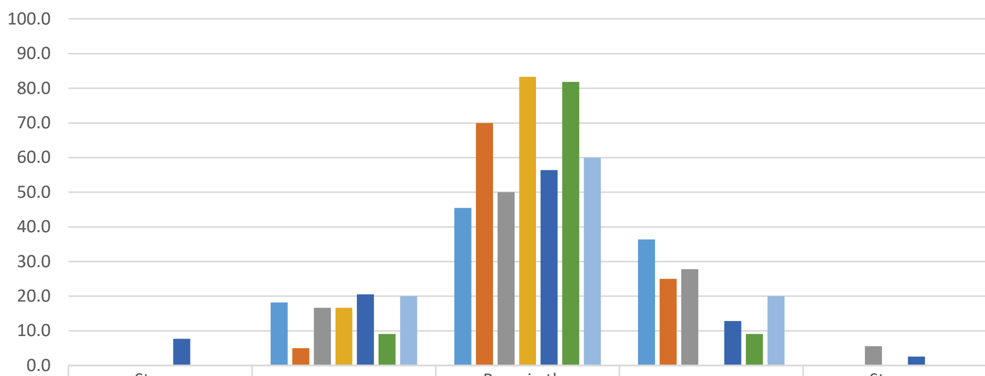


	Increase	Remain the same	Decrease
Large banks	0.0	88.9	11.1
Medium banks	37.5	37.5	25.0
Small banks	40.0	60.0	0.0
Mfb's	50.0	25.0	25.0

Bank respondents cited mergers, expansions of branch networks, increased product range and the need to support businesses and improve efficiency as reasons for expected increase in employment levels in 2019. However, respondents cited the leveraging on automation of banking services and continuous use of digital solutions, pressure on return on assets and stagnated business volumes as reasons for reduction in staffing levels in 2019.

Hotel respondents indicated that increased bookings would require engaging more employees for longer, hence increased employment. However, respondents cited low levels of business, high labour costs, high costs of inputs, and the need to remain afloat while competing with cheap substitutes as reasons for laying off staff in 2019.

Chart 12: Expected changes in employment levels by non-bank private firms in 2019 (percent)



	Strong Increase	Increase	Remain the same	Decrease	Strong decrease
Agiculture	0.0	18.2	45.5	36.4	0.0
Manufacturing	0.0	5.0	70.0	25.0	0.0
Trade	0.0	16.7	50.0	27.8	5.6
Real estate, Building, construction	0.0	16.7	83.3	0.0	0.0
Tourism (incl. hotels)	7.7	20.5	56.4	12.8	2.6
Finance & Insurance (excl. banks)	0.0	9.1	81.8	9.1	0.0
Transport	0.0	20.0	60.0	20.0	0.0

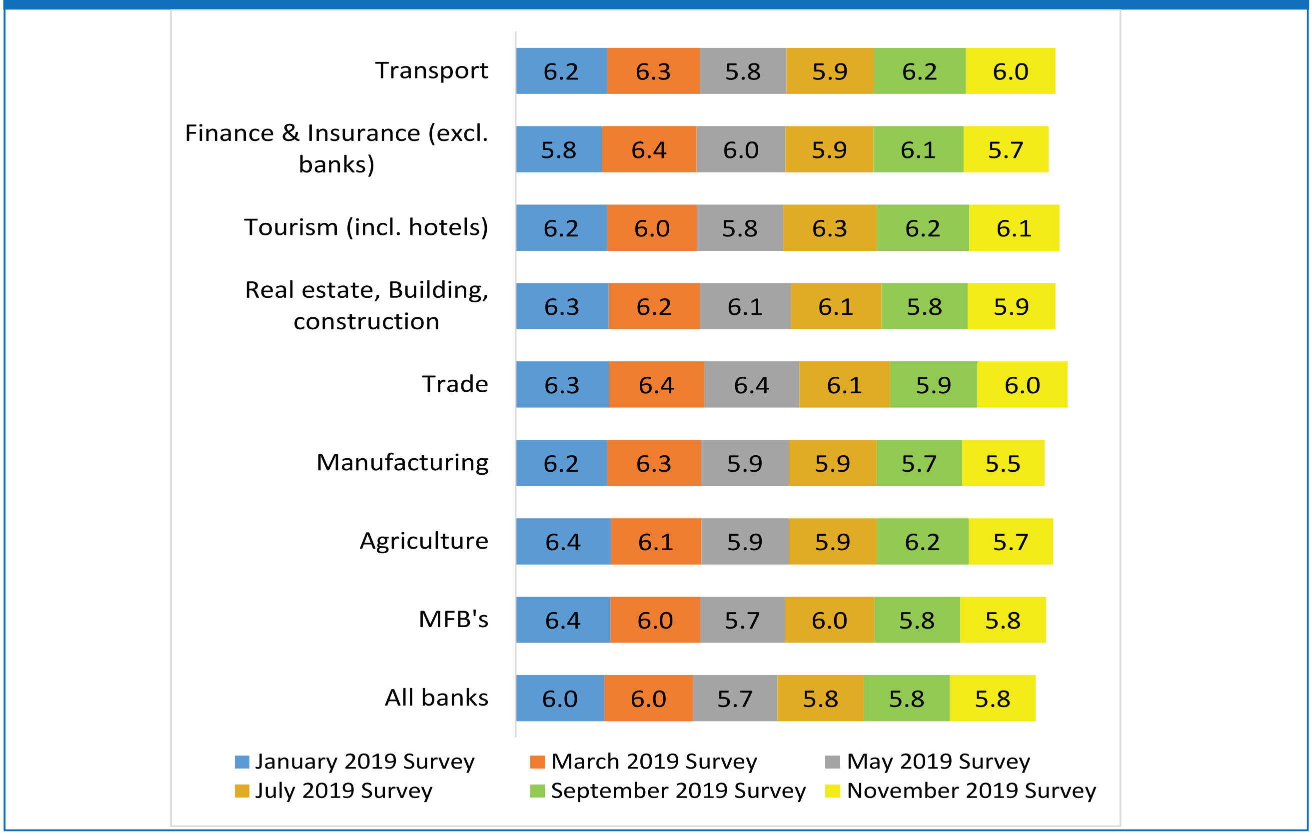
9. ECONOMIC GROWTH EXPECTATIONS

The Survey requested participants to indicate their expected economic growth rate for the country in 2019. Respondents expressed expectations of strong growth in 2019, supported by Government investments in the Big 4 priority sectors, continued investments in public infrastructure, upgrade of existing infrastructure in the country, a turnaround in sectors such as agriculture, services and tourism, improved business confidence, sustained fight against corruption, and a stable macroeconomic environment **(Table 2).** Other factors included expected improvement in access to credit by the private sector following the removal of interest rate caps, improved tourism and political stability.

Table 2: Expectations on Economic Growth for 2019 (percent)

Survey month	Large banks	Medium banks	Small banks	All banks (Weighted by size of bank)	Micro-finance banks	Non-bank private firms
Jan-19	6.0	6.0	5.9	6.0	6.0	6.0
Mar-19	5.9	6.0	6.2	6.0	6.0	6.3
May-19	5.7	5.8	6.1	5.7	5.7	6.0
Jul-19	5.8	5.9	5.8	5.8	6.0	5.9
Sep-19	5.7	6.1	6.1	5.8	6.0	6.0
Nov-19	5.7	5.9	5.9	5.8	5.8	5.8

Chart 13: Expectations on Economic Growth for 2019 across Sectors (percent)



However, respondents cited weaker agricultural output in Q1, reduction in Government projects in 2019, delayed payment to businesses dealing with the Government and counties, cash-flow constraints linked to the interest rate cap for most of the year and continued slowdown in manufacturing and real estate as factors that would negatively affect economic growth in 2019.

A sectoral analysis of economic growth expectations showed that respondents across the different sectors expected economic growth to remain strong in 2019 **(Chart 13).** Hotels cited political stability as a key factor for the expected growth, while the finance sector lauded the removal of interest rate caps. Respondents cited delayed payments by the national and county governments, difficulty in obtaining credit, and political noise as risks to their growth expectations.

10. OPTIMISM ON THE ECONOMIC PROSPECTS

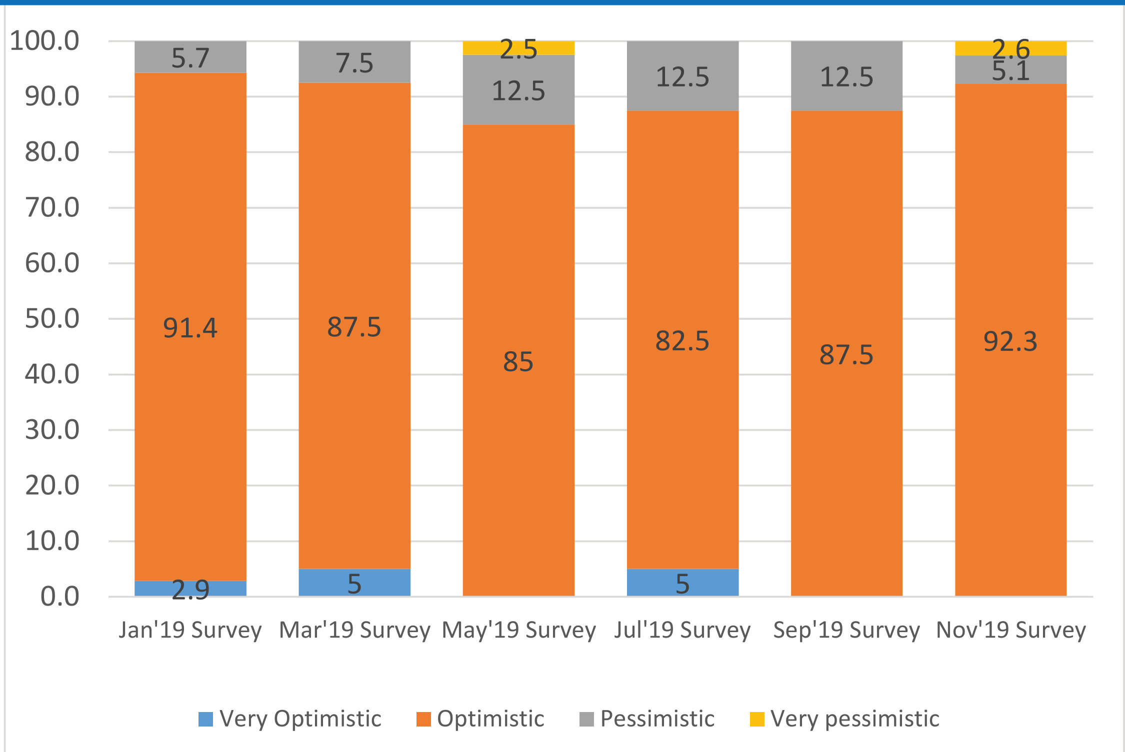
10.1. Economic Prospects

In the November 2019 Survey, banks and non-bank private sector firms were asked how optimistic/ pessimistic they were regarding the country's economic prospects **(Charts 14 and 15).** The results showed sustained optimism by respondents across banks and nonbank private sector firms.

Banks remained optimistic in the country's economic prospects in all surveys carried out in 2019. In the November Survey, banks cited expected increase in private sector lending and opening up of credit to MSMEs following the removal of interest rate caps, implementation of the Big 4 agenda projects, ongoing infrastructure developments, favourable weather, Government's commitment to settle pending bills, stable macroeconomic environment and political stability as reasons for this optimism.

However, respondents pointed out that the delay in settling pending bills, concerns around foreign debt obligations, fears of a slowdown in global growth and political noise that is gaining momentum could affect growth negatively to some extent.

Chart 14: Optimism by Banks on Economic Prospects, Going Forward (percent)

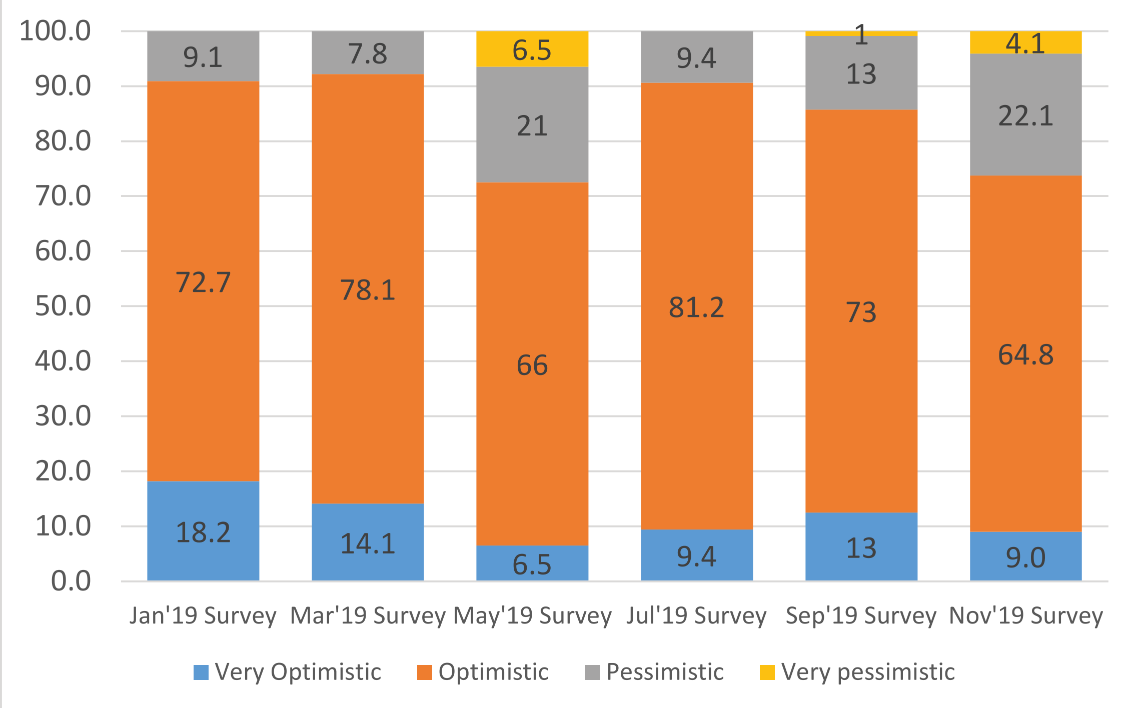


The non-bank private sector firms remained optimistic about the country's prospects in 2019, but revised downwards their optimism levels in the November Survey.

Respondents attributed their optimism to Government's investments in infrastructural development, Government's commitment to the implementation of the Big 4 agenda, incentives to improve business environment, suspension of interest rate caps, tourism growth, the commercial mining of oil, supportive weather conditions, the continued fight against corruption, political stability and stable macroeconomic environment.

The weaker optimism was largely attributed to concerns around the country's debt levels and political noise. In addition, respondents cited increased costs of production, reduced demand for some products, delays in payment of VAT claims, loss of jobs in some companies, delays in Government funds disbursements to projects impacting consumption of key inputs, and challenges in some companies struggling to stay afloat.

Chart 15: Optimism by Non-Bank Private Firms on Economic Prospects Going Forward (percent)



10.2. Forward Hotel Bookings

The Survey requested respondents from the hotel sector to indicate monthly forward hotel bookings received so far for the period November 2019 to February 2020.

Average forward hotel bookings reflected the mixed expectations by other non-bank private sector firms **(Chart 16).**

Business hotels indicated low projections as most local and international companies were in the process of winding up for the year.

Leisure hotels and resorts anticipated an increase in bookings as the festive season approaches.

Chart 16: Forward Hotel Bookings for November 2019 – February 2020 (percent of total capacity)

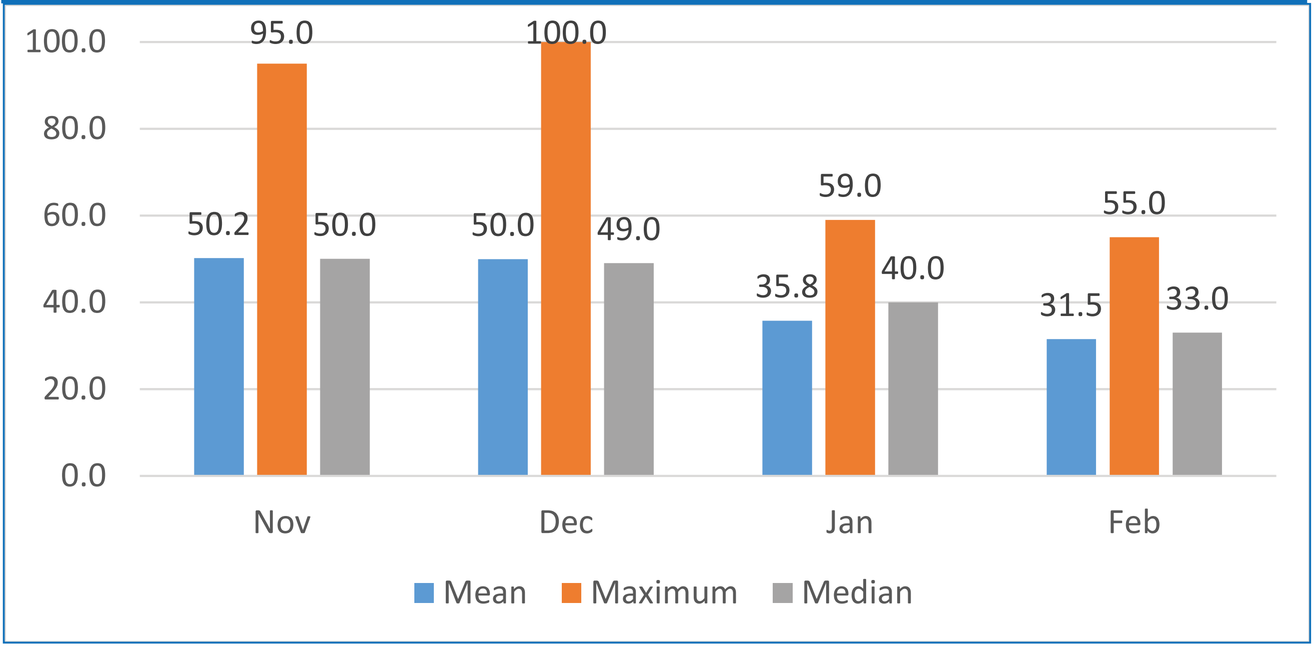
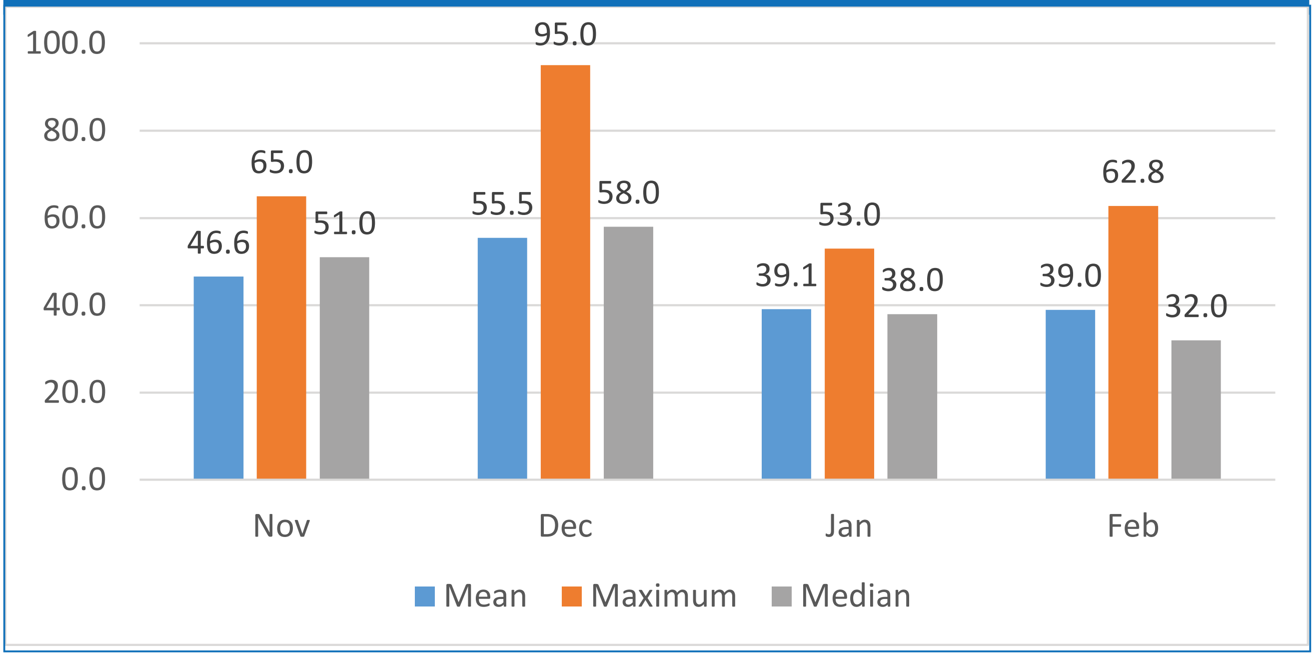


Chart 17: Forward Hotel Bookings for November 2018-February 2019 (percent of total capacity)



11. SUGGESTIONS ON HOW THE BUSINESS ENVIRONMENT COULD BE IMPROVED

Banks and non-bank private firms were asked to indicate the challenges that they were currently encountering, and suggest how the business environment could be improved going forward.

Bank respondents indicated the need for introduction of priority sector lending to boost the MSME sector and increase credit to the private sector. They also highlighted the need for reduction of the cost of doing business, particularly that of recovery of distressed facilities through speedier resolution in courts. Bank respondents further indicated that acceleration in settlement of government arrears, improvement in tax collection, reduction of government borrowing internally and externally and improvement in liquidity distribution in the banking sector would contribute to improving the business environment. In addition, the scaling up of agro-processing and value addition would increase returns on agriculture, support SMEs and spur growth in the country. Finally, respondents maintained that there should be continued effort in the fight against corruption.

The non-bank private firm respondents suggested that the Government should put in place measures to reduce cheap imports, lower energy costs and encourage value addition to support manufacturing, urgent release of VAT refunds, slow down on acquiring debt and enhance the fight against corruption.

Haile Selassie Avenue P. O. Box 60000 - 00200 Nairobi
Tel: 20 - 286 0000/286 1000/ 286 3000 Fax: 20 - 34 0192