Central Bank of Kenya

REPORT OF THE MONETARY POLICY COMMITTEE MARKET PERCEPTIONS SURVEY NOVEMBER 2018

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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 the perceptions of banks and non-bank private sector firms on selected economic indicators. Commercial banks, micro-finance banks, as well as a sample of non-bank private sector firms are covered in the surveys.

The Survey also enables respondents to indicate their perspectives on the current economic conditions in the country, focussing on economic activity, employment and input prices two months before an MPC meeting. It also captures perceptions by private sector firms on how the business environment can be improved.

The non-bank private firms are sampled from selected towns across the country including Nairobi, Mombasa, Kisumu, Eldoret, Nakuru, Nyeri and Meru, and are 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, electricity and water, trade, hotels and restaurants, Information and Communications Technonoly (ICT), transport, real estate, building and construction, finance and insurance, and health.

Sensitization engagements with respondents are conducted 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 MPC Market Perceptions Survey was conducted in the first three weeks of the month. It sought perceptions on the economic conditions prevailing before the November MPC meeting, as well as market expectations for the next two months (November-December), and over the next 12 months (November 2018 – October 2019). The expectations sought covered overall inflation, exchange rate of the Kenya Shilling against the U.S. Dollar, demand for credit, ease of credit access, private sector credit growth and economic growth. Other areas interrogated included the levels of optimism in economic prospects, economic activity in the immediate period prior to the MPC meeting, the effect of the amendment on the Interest rate capping law by Parliament in September 2018 to remove the floor on deposit rates, and the responses by banks to previous MPC decisions.

This report provides a summary of the analyses of the responses to the Survey, including reasons behind the expectations, from commercial and microfinance banks (MFB's), and a sample of non-bank private sector firms.

2. SURVEY METHODOLOGY

The Survey was administered through questionnaires sent, through email and hard copy, to the Chief Executives of 377 private sector firms comprising of 39 operating commercial banks, 1 mortgage finance institution, 13 micro-finance banks, and 324 non-bank private firms including 45 hotels. The overall response rate to the November 2018 Survey was 68 percent of the sampled institutions. The respondents comprised of all the 39 commercial banks, 1 mortgage finance institution, 12 micro-finance banks, 40 hotels, and 165 non-bank private sector firms.

The Survey questionnaires were completed by either Chief Executive Officers, Finance Directors, or other senior officers from the sampled institutions who have knowledge on the economy and the business environment.

The expectations from commercial and micro-finance banks are compiled using weighted averages based on the market size of the institution, while those from the non-bank private firms are weighted using the respective sector weights based on the latest available sectoral contributions to GDP from the Economic Survey, 2018.

3. HIGHLIGHTS OF THE SURVEY

According to the November Market Perceptions Survey:

- Economic activity increased in the two months before the November MPC meeting.
- Employment levels increased in some sectors in the two months prior to the MPC meeting.
- There was a general increase in the input prices in September and October as a result of increased taxation.
- Inflation expectations for the next 2 months (November and December) and over the next 12 months remained well anchored within the target range (5 ± 2.5 percent).
- There were mixed expectations on the exchange rate of the Shilling against the U.S. dollar in November – December.
- Private sector credit growth was expected to remain slow but to increase in 2018 relative to 2017.
- Banks and non-bank private sector revised upwards their expectations on economic growth for 2018.
- There was sustained optimism on the economic growth prospects and improvement in the business environment.

4. CURRENT ECONOMIC CONDITIONS

4.1 Overall Economic Activity

Banks and non-bank private firms were asked to give an assessment of economic activity in September and October, the period before the November MPC meeting **(Chart 1a).**

Respondents reported increased overall economic activity in the two months, largely due to a pickup in spending by the National Government, festive season preparations, improved agriculture, infrastructure development, the ongoing fight against corruption and political stability.

Respondents from firms in Nairobi, especially those in the building and construction subsector, reported a strong increase in economic activity in September and October, which they attributed to increased foreign investors willing to partner with local companies and increased demand for valuations as companies sought to update their asset values as they closed their books. The respondents in the cement industry, however, reported reduced demand in September and October.

Respondents in the financial sector in Nairobi and from hotels in Mombasa and Nakuru reported a slight decrease in economic activity. The taxation measures implemented following the 2018/19 Budget, suspension of new Government projects, a higher foreign debt service, sluggish private sector credit growth and delayed national and county Government payments were cited by the financial sector respondents as reasons for the decrease in economic activity in the two months prior to the November MPC meeting. With regard to the hotel industry, a decline in activity was expected since the period September – October is traditionally a 'shoulder' or low tourism season, coming soon after the peak season in July – August during which the Mara migration takes place **(Chart 1b).**

Across the regions, Kisumu, Nyeri, Meru and Eldoret, reported increased economic activity in the two months prior to the MPC meeting. This was largely attributed to improved agricultural output due to good rains, with some tea firms in Meru reporting a 38 percent increase in production in September and October, due to sufficient rains and favourable rainfall pattern. Maize producers and millers, however, reported reduced activity in September and October mainly due to large stocks of unsold maize following increased production in the year.

Chart 1a: Economic Activity in September and October 2018 (percent)

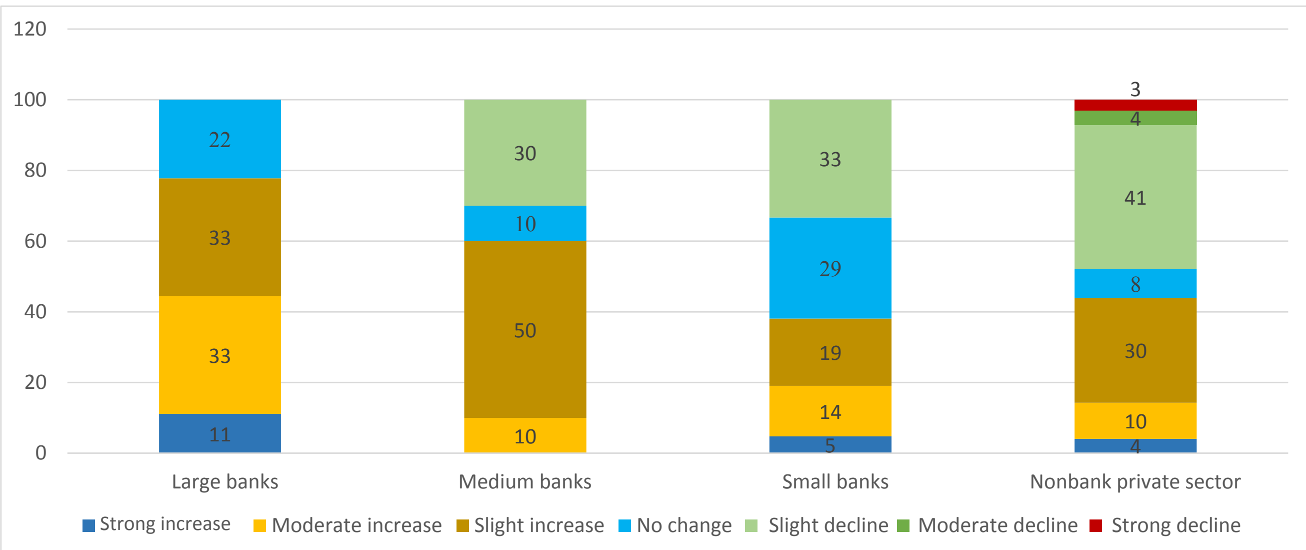
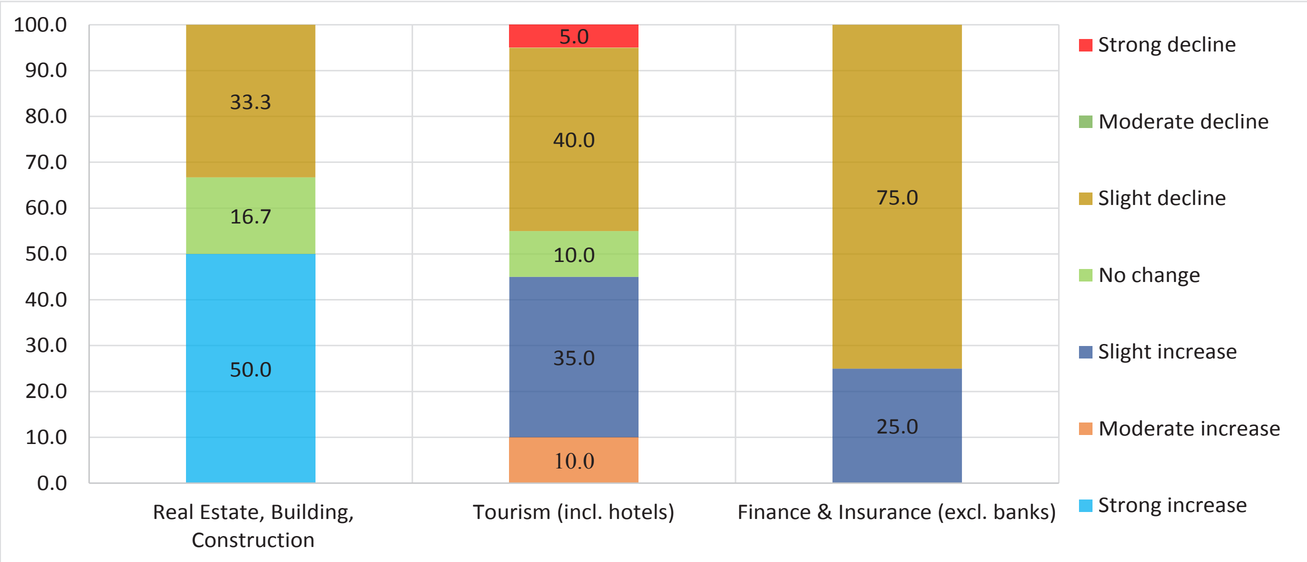


Chart 1b: Sectoral Economic Activity in September and October 2018 (percent)

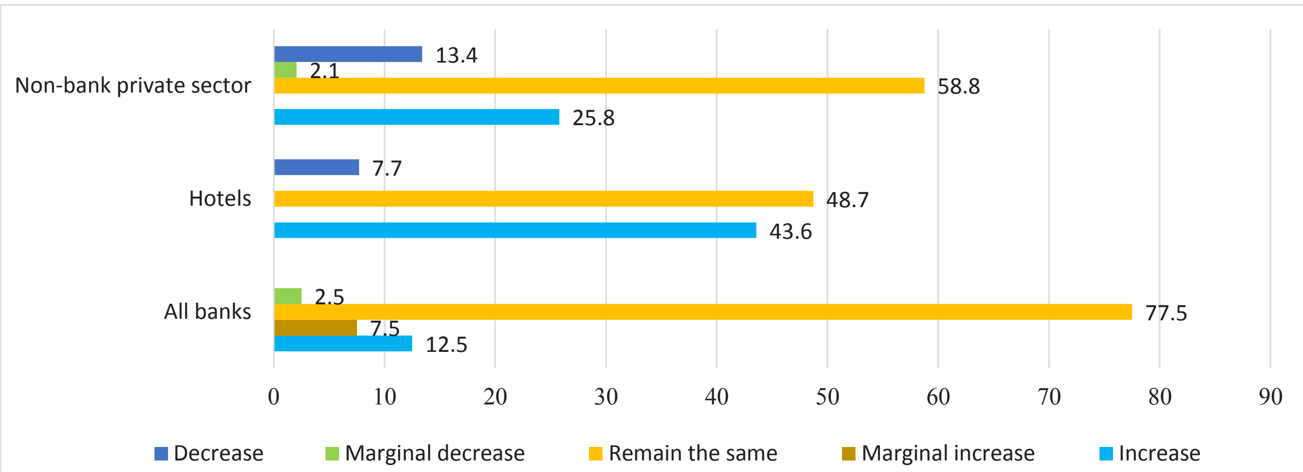


4.2: Employment

According to the Survey, respondents across different sectors indicated that employment largely remained unchanged in the two months prior to the November MPC Meeting. There were increases in employment recorded both in the banking sector and the rest of the private sector. In September and October, 20 percent of banks, with footprint across the surveyed regions hired more people, while employment levels in 78 percent of banks remained unchanged. Employment in this sector resulted from the need to invest further to grow income and from expansion of branch networks.

Approximately 44 percent of hotels polled from Nairobi, Mombasa, Naivasha and Nyeri, recorded increased employment levels during the two months prior to the MPC meeting. This increase was attributed to a higher number of tourist arrivals, preparation for the festive season and expansion projects by some hotels.

Chart 1c: Movements in employment levels in September – October 2018 (percent)

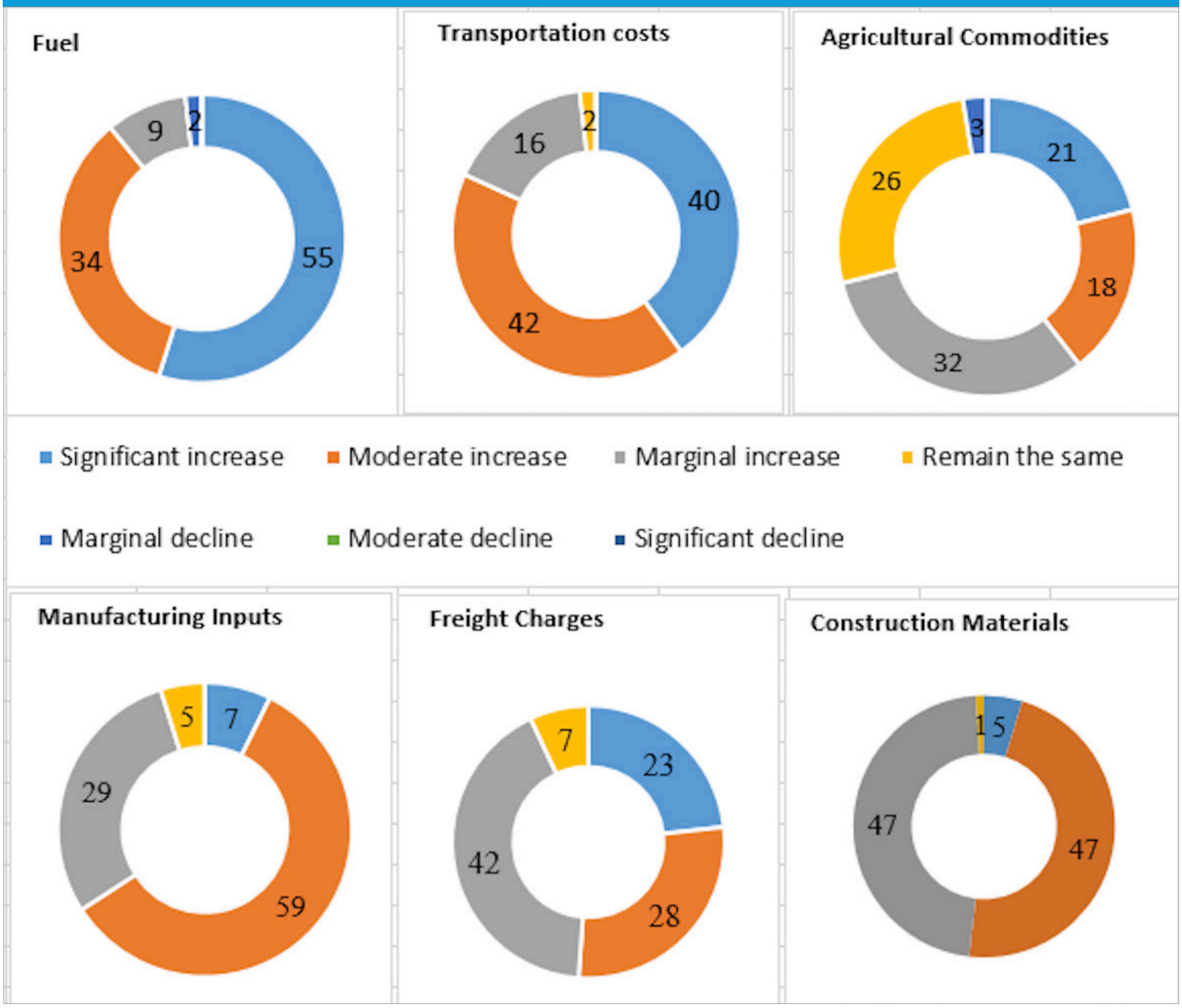


4.3: Input prices

In the November Survey, respondents were asked to indicate the direction of movement (increase/ decrease), in the prices of various inputs such as fuel, transportation costs, agricultural commodities, manufacturing inputs, freight charges and construction materials, in September and October.

Respondents from all the regions represented in the survey reported increases in prices of most inputs in the two months prior to the November MPC Meeting, largely because of the increased VAT on petroleum products in September **(Chart 2)**. Fuel and transportation costs increased significantly during the period while manufacturing and construction inputs increased moderately, as the effects of the increase in prices of petroleum products settled.

Chart 2: Movements in input prices in September – October 2018 (percent)



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), and in the next 12 months (November 2018 – October 2019).

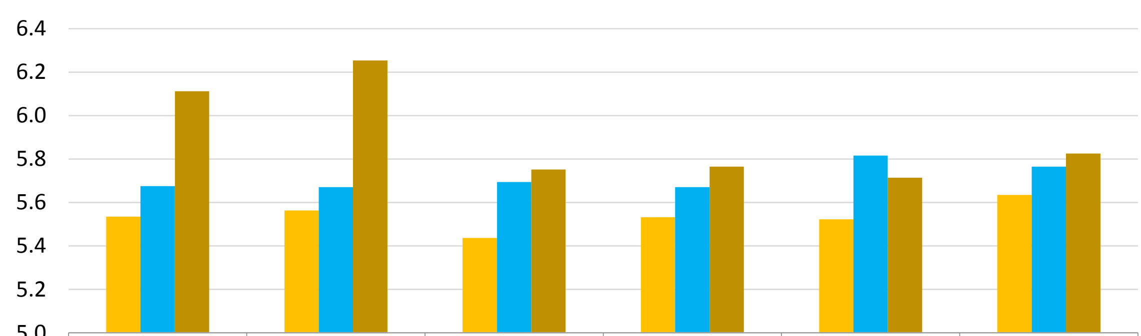
All respondents expected inflation to remain within the target range (5 ± 2.5 percent) **(Table 1)** supported by low and stable food prices and the reduction in electricity costs. Mild upward pressure on inflation was, however, expected from the increase in domestic fuel prices, the unpredictable international oil prices; and the seasonal effects of the festive season on transport and commodity prices.

The Survey showed that banks and non-bank private firms expected overall inflation to increase slightly but remain within the target range in the next 12 months, supported by stable food prices and the reduced cost of electricity **(Chart 3).** Respondents expected some upward pressure to come from increases in food prices due to the inadequate/delayed short rains, and the volatility of international oil prices.

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

Survey Month	Inflation expectations for:	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
Nov 2017	Nov-Dec 2017	5.9	5.8	5.9	5.9	5.5	5.7
Jan 2018	Jan-Feb 2018	5.5	5.1	4.9	5.3	5.0	5.0
Mar 2018	Mar-Apr 2018	4.4	4.8	4.6	4.5	4.6	4.8
May 2018	May-Jun 2018	4.2	3.9	3.7	4.1	3.9	3.8
Jul 2018	Jul-Aug 2018	4.9	4.6	4.6	4.8	4.8	4.4
Sep 2018	Sep-Oct 2018	5.4	5.1	5.1	5.3	4.9	5.3
Nov 2018	Nov-Dec 2018	5.6	5.6	5.6	5.6	5.7	5.7

Chart 3: Expected Overall Inflation for the period November 2018 to October 2019 (%)



	All banks	Large banks	Medium banks	Small banks	MFB's	Non-bank private firms
November 2018	5.5	5.6	5.4	5.5	5.5	5.6
December 2018	5.7	5.7	5.7	5.7	5.8	5.8
Next 12 months	6.1	6.3	5.8	5.8	5.7	5.8

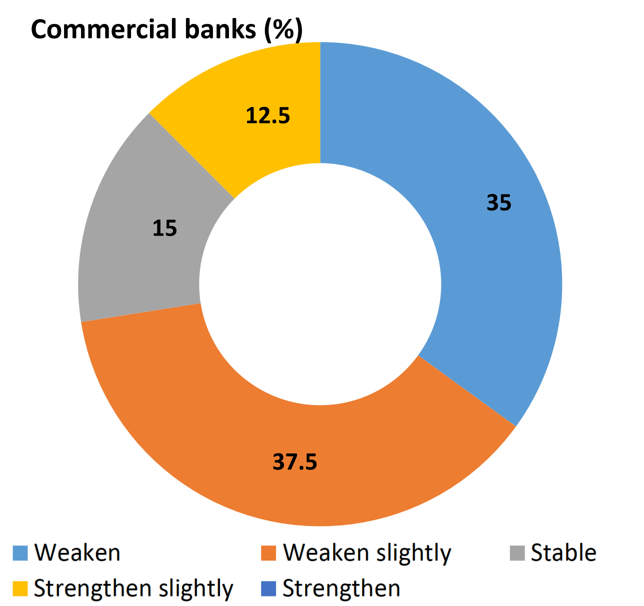
6. EXCHANGE RATE EXPECTATIONS

Participants were asked to indicate their expectations on the direction of change in the exchange rate of the Shilling against the U.S. Dollar in November and December, and in the next 12 months (November 2018 – October 2019).

Non-bank private sector firms expected the Shilling to remain relatively stable in November and December, but with a tendency to weaken (Chart 4a). Respondents expected the Shilling to be supported by improved agricultural exports, increased diaspora remittance inflows, tourism inflows and the stable macroeconomic fundamentals. However, banks expected the Shilling to weaken slightly in the next 2 months on account of the negative sentiments attributed to the IMF Report published in October 2018, a strong U.S. Dollar globally, end year payments and importation, and higher external debt service.

Over the next 12 months, respondents expected the Shilling to be supported by the inflows from tea and horticultural exports, tourism inflows, increasing diaspora inflows leading to a narrowing of the current account deficit, sound monetary policy, political stability and increased investor confidence **(Chart 4b).** However, banks and non-bank private sector firms expected moderate pressure on the Shilling to weaken slightly due to expected increase in imports as the Government implements the 'Big 4' agenda and the expected pick-up in the economy, rising U.S. Dollar demand to service external debt, expected increase in the U.S. Federal Reserve interest rate, increase in international oil prices, a stronger U.S dollar internationally, international trade tensions, and negative sentiments attributed to the IMF Report.

Chart 4a: Expected direction of the KSh/USD Exchange rate – November to December 2018 (percent)



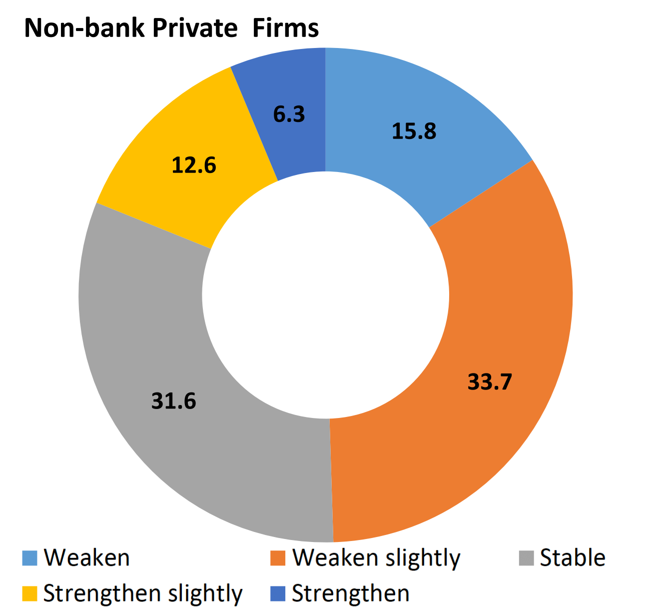
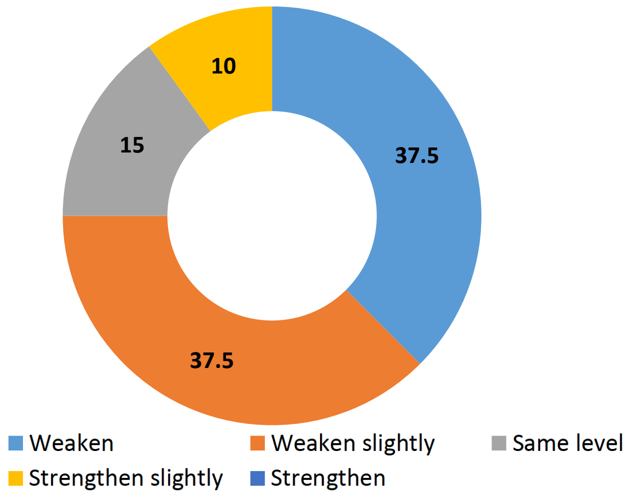
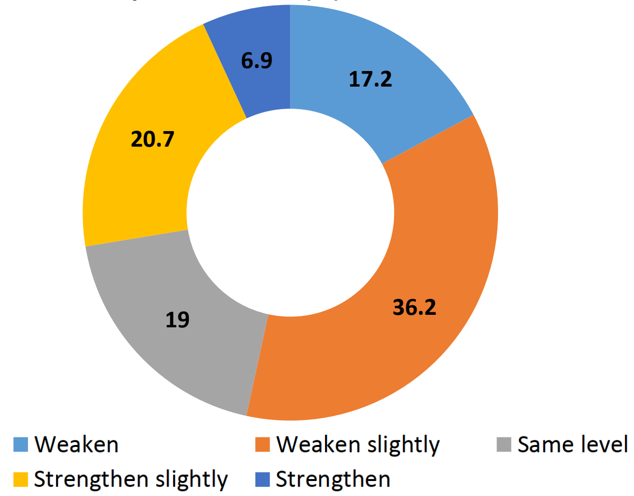


Chart 4b Expected direction of KSh/USD Exchange rate – November 2018 to October 2019 (percent)

Commercial Banks (%)



Non-bank private sector (%)



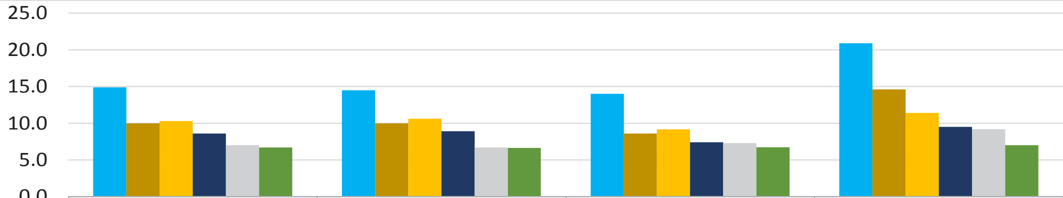
7. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

7.1 Growth in Private Sector Credit in 2018

Commercial banks were asked to indicate their expected increase in lending to the private sector in 2018 relative to 2017. Though the expectations indicated improved lending in 2018 relative to 2017, banks continually revised their expectations downwards in all the MPC Surveys of 2018 **(Chart 5a).**

Bank respondents indicated that interest rate capping and the resultant inability to effectively price risk continued to constrain supply of credit as lenders diversified their portfolios to higher income and lower risk investments. According to the Survey, private sector credit growth for 2018 was expected to remain slow, but to increase in 2018 relative to 2017. The expected moderate increase in lending was attributed to increased credit to large corporate businesses by large and medium banks, the need to grow loan books by the smaller banks, improving economic conditions and better business environment.

Chart 5a: Expectations on Private Sector Credit Growth (percent)



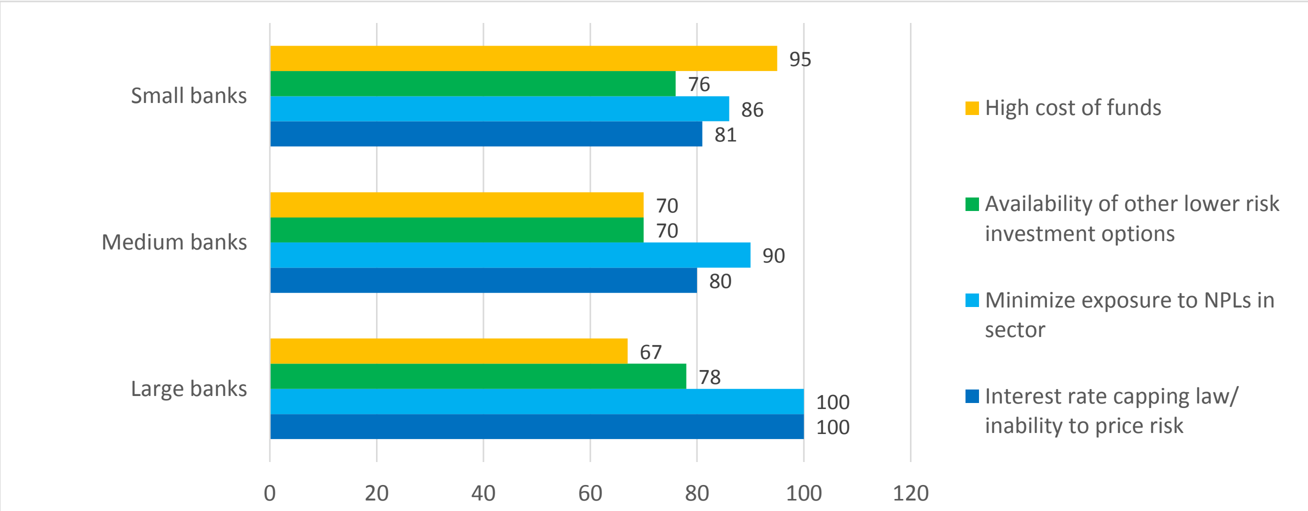
	All banks	Large banks	Medium banks	Small banks
January 2018 Survey	14.9	14.5	14.0	20.9
March 2018 Survey	10.0	10.0	8.6	14.6
May 2018 Survey	10.3	10.6	9.2	11.4
July 2018 Survey	8.6	8.9	7.4	9.5
September 2018 Survey	7.0	6.7	7.3	9.2
November 2018 Survey	6.7	6.7	6.7	7.0

7.2 Factors Limiting Credit to Private Sector Growth by banks

Banks were asked to list, in order of importance, the factors inhibiting their lending to the private sector **(Chart 5b).**

The results showed that the different bank tiers have different challenges which affect their lending to the private sector. Large and medium banks indicated that the interest rate capping law and exposure to non-performing loans were the main impediments to credit growth. For small banks, however, the high cost of funds and the need to minimize exposure to NPL's ranked high among the factors limiting their credit growth.

Chart 5b: Factors Limiting Private sector credit growth by bank tier (percent)

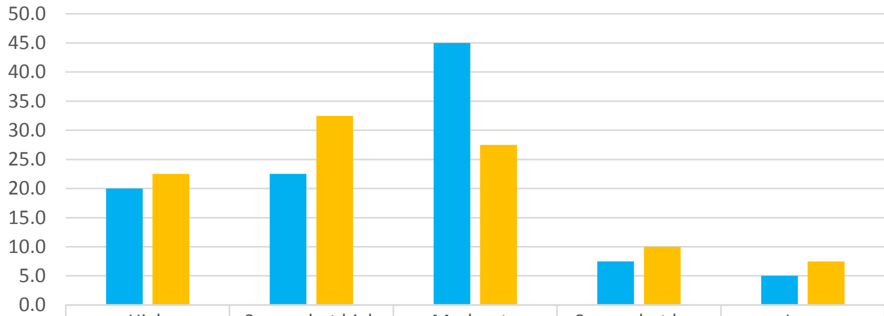


7.3 Banks expectations on Credit Demand after MPC decisions of the March and July 2018

Commercial banks were asked to indicate their expectations on credit demand following the MPC decisions to lower the Central Bank Rate (CBR) in March and July 2018. According to the banks, demand for credit has been moderate tending to high after the March and July MPC decisions. However, approval rates by banks remained low due to perceived risk factors.

In November and December, banks expected demand for credit to be relatively high in the trade, hospitality and personal sectors due to the lower interest rates, and as the festive season and new school year spending kick in. Demand from the rest of the sectors was expected to slow down as companies closed their positions at the end of the year

Chart 5c: Banks’ assessment of current and expected demand for credit (percent)

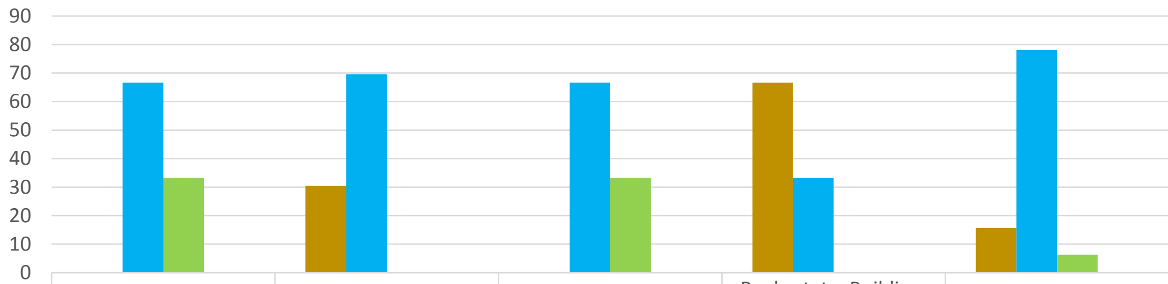


	High	Somewhat high	Moderate	Somewhat low	Low
Banks' assessment of current demand for credit	20.0	22.5	45.0	7.5	5.0
Banks' expectations for credit demand in next 2 months	22.5	32.5	27.5	10.0	7.5

7.4 Ease of Credit access to the private sector (percent)

Respondents from the non-bank private sector firms were asked to give an assessment of the ease of access to credit from commercial banks **(Chart 5d).** Respondents from the large corporates indicated that they found it easy to access loans from commercial banks, while those representing the smaller businesses still found it difficult to get financing. Manufacturing and real estate/construction firms reported significant ease in accessing loans from commercial banks. Players in sectors such as agriculture and trade found it more difficult to access bank loans due to the perceived higher risks in their businesses, particularly after the implementation of interest rate capping.

Chart 5d: Banks’ assessment of ease of access of credit from banks (percent)



	Agiculture	Manufacturing	Trade	Real estate, Building, construction	Tourism (incl. hotels)
Easy	0	30	0	67	16
Moderate	67	70	67	33	78
difficult	33	0	33	0	6
very difficult	0	0	0	0	0

8. ECONOMIC GROWTH EXPECTATIONS

Participants were asked to indicate their expectations with respect to country's economic growth rate for 2018. All respondents revised their growth expectations upwards, and expected the growth momentum for the first half of the year to be maintained for the rest of the year **(Table 2).**

According to the Survey results, growth in 2018 was expected to be largely supported by the rebound in agriculture, infrastructure investments, increased activity in construction and manufacturing, improvement in tourism/hospitality sector, increased diaspora remittances/ investments and strong performance in other sectors despite the weak private sector credit growth. In addition, the supportive economic reforms, improved foreign investor confidence, favourable business environment, stable macroeconomic environment and a stable political environment are expected to impact positively on growth.

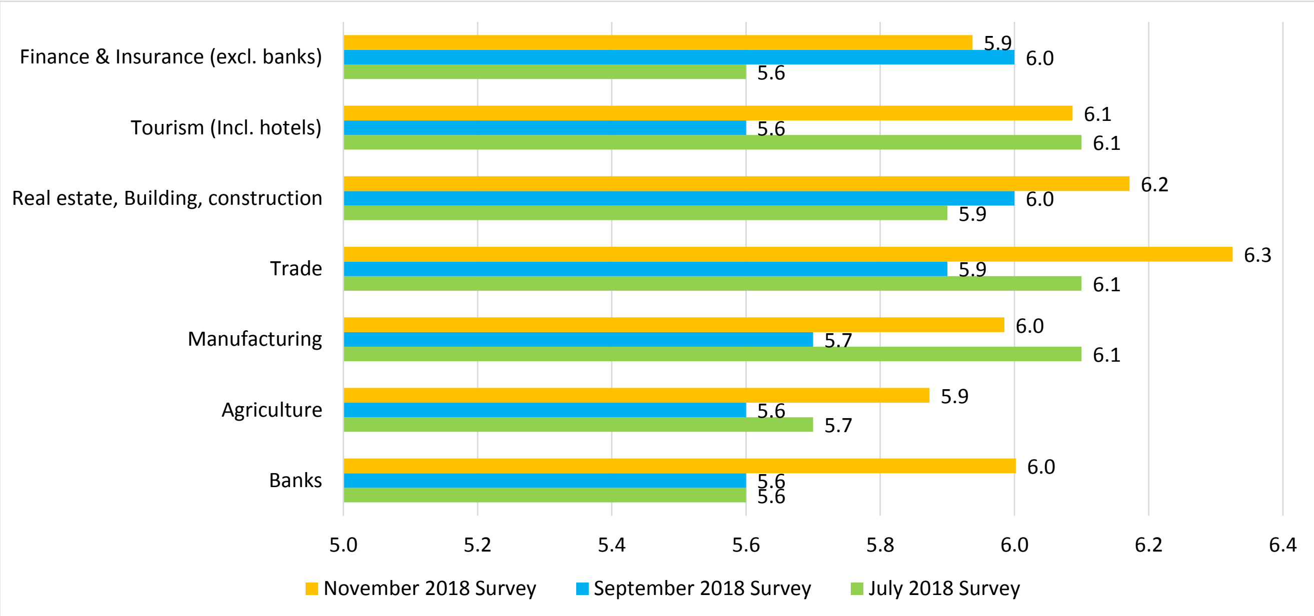
The Survey showed improved economic growth expectations across the different sectors relative to the previous survey, a shift which was partly informed by the release of the second quarter growth numbers by the Kenya National Bureau of Statistics **(Chart 6).** Hotels cited the positive implications of the newly introduced Kenya Airways (KQ) direct flights to the USA, the direct charter flights to Mombasa, increased tourist arrivals and the good weather as factors likely to boost growth in the industry. In the agriculture sector, the tea industry was particularly upbeat on account of the good weather, both rainfall quantity and pattern, which has led to increased production in the year. The wholesale and retail sector was stocking up in anticipation of the festive season.

Respondents, however, cited delays in Government payments, the impact of the newly introduced taxes, reduction in Government spending, higher oil prices, weak private sector credit growth, higher public debt and insufficiently funded MSMEs as the main risks to growth.

Table 2: Expectations on Economic Growth for 2018 (percent)

Survey Month	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
Jan –2018	5.5	5.5	5.4	5.5	5.6	5.4
Mar–2018	5.4	5.3	5.4	5.4	5.5	5.4
May–2018	5.5	5.6	5.4	5.5	5.6	5.6
Jul–2018	5.5	5.6	5.8	5.6	5.6	5.9
Sep–2018	5.6	5.4	5.4	5.6	6.0	5.7
Nov–2018	6.1	5.8	6.0	6.0	6.0	6.0

Chart 6: Expectations on Economic Growth for 2018 across Sectors (percent)



9. OPTIMISM ON THE ECONOMY

9.1. Economic Prospects and Improvement in the Business Environment

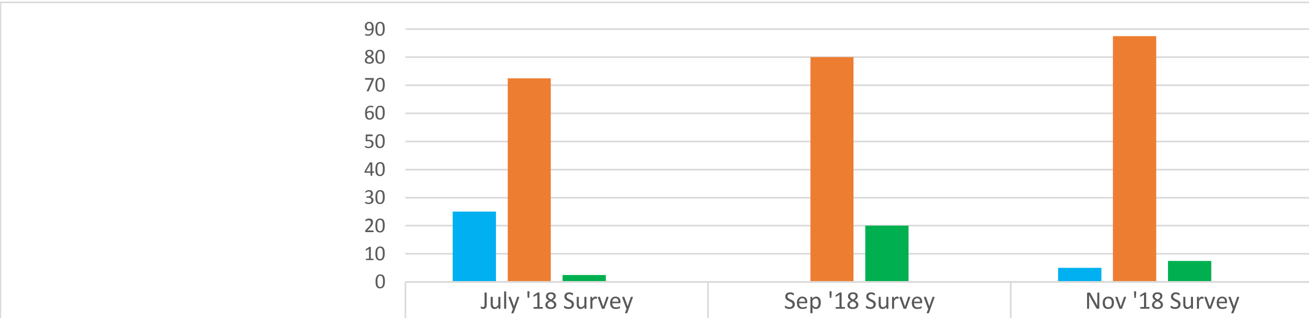
Banks and non-bank private sector firms were asked to indicate their levels of optimism on the country's economic prospects and improvements in the business environment going forward. The results of the Survey showed improved optimism by banks and the non-bank private sector firms with regard to the country's economic prospects and improvement in the business environment **(Chart 7a and 7b).**

According to respondents in the banking sector, the favourable weather conditions and strong agricultural performance, infrastructure development focus on the *'Big 4'* priority areas, increase in foreign investments, improved ease of doing business, Government's efforts in the fight against corruption, the stable political environment and expectations of a resolution of slow credit growth through a review of the interest rates capping law were cited as reasons for the renewed optimism. The optimism was, however, tempered by concerns about the recent increase in pump and international oil prices, increased taxation, delays in Government spending, high levels of corruption and the sluggish private sector credit growth.

Similarly, respondents from the non-bank private firms expressed improved optimism about the country's economic prospects and improvements in the business environment. Respondents cited continued Government spending on infrastructure with focus on the 'Big 4' priority areas, improved agricultural production due to favourable weather, expected improvement in cargo clearing at the port of Mombasa, direct flights to the USA and France, heightened fight on corruption, political stability and stable macroeconomic conditions as reasons for the renewed optimism. According to the non-bank private firms respondents, risks to this optimism included the increased taxation which they thought would dampen consumer spending hence corporate profits, rising external debt service, slow growth in credit to private sector, increased fuel prices and high levels of corruption.

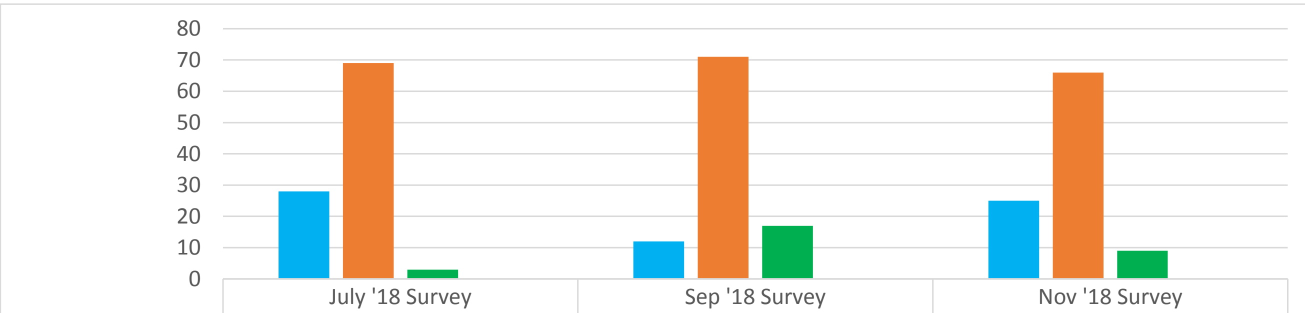
The Survey results on optimism by the non-bank private sector showed the specific sectors driving the overall improved optimism, and the variations in the levels of optimism in the different sectors. **(Chart 7c).** The improved optimism by the non-bank private sector firms was largely driven by the hotel, wholesale and retail, real estate, building and construction, agriculture and manufacturing sectors. The sector-specific reasons cited for the improved optimism included the expected benefits related to the new flights to the USA by the hotel industry, expectations for increased sales by the retail and wholesale sector as the country prepares for the end year festivities and new school year, increased activities in the real estate and construction industry, improved agricultural output, especially tea, and Government's expected support to the manufacturing sector as part of the *'Big 4'* agenda.

Chart 7a: Optimism by Banks on Economic Prospects and Improvement in the Business Environment Going Forward (percent)



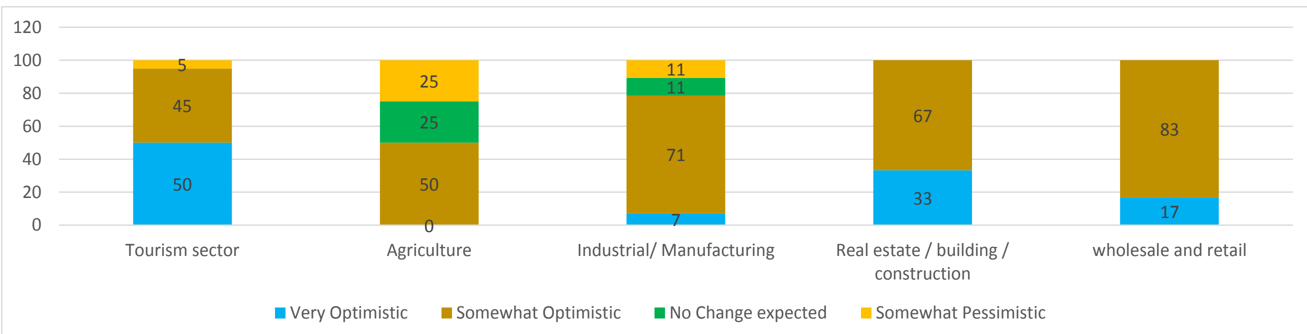
	July '18 Survey	Sep '18 Survey	Nov '18 Survey
Very Optimistic	25	0	5
Optimistic	72.5	80	87.5
Pessimistic	2.5	20	7.5
Very Pessimistic	0	0	0

Chart 7b: Optimism by Non-Bank Private Firms on Economic Prospects and Improvement in the Business Environment Going Forward (percent)



	July '18 Survey	Sep '18 Survey	Nov '18 Survey
Very Optimistic	28	12	25
Optimistic	69	71	66
Pessimistic	3	17	9
Very pessimistic	0	0	0

Chart 7c: Non-bank private Firms optimism for Economic prospects and Improvement in the business environment by sector (percent)



9.2 Forward Hotel Bookings

Hotels were requested to provide the levels of monthly forward bookings received so far for the period November 2018 to February 2019. The Survey showed a slight increase in average forward bookings compared to a similar period in 2017 **(Chart 8a and 8b).**

The trend in forward bookings was explained by the fact that November is traditionally a low month for tourism and that January and February, which previously represented the peak leisure season, have been slow in the recent past. However, the last week of December and the first week of the new year represent a peak period for domestic tourists, with most domestic bookings taking place at the last minute. Respondents cited the improved security, political stability and the new flight to USA as factors expected to impact positively on hotel forward bookings.

Chart 8a: Forward Hotel Bookings in the November 2018 Survey (percent of total capacity)

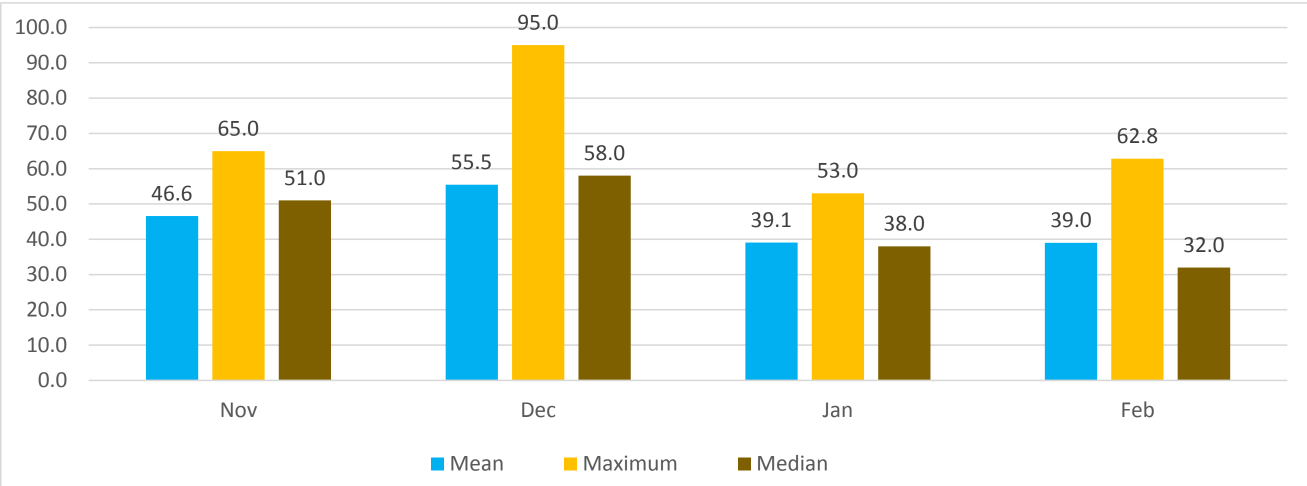
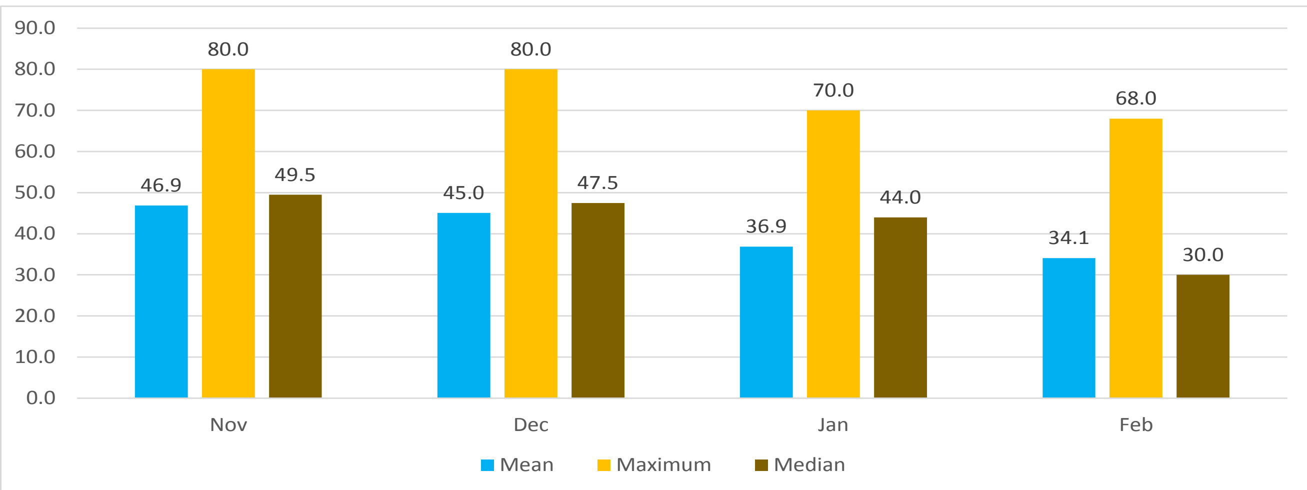


Chart 8b: Forward Hotel Bookings in the November 2017 Survey (percent of total capacity)



10. PERCEPTIONS ON IMPROVING THE BUSINESS ENVIRONMENT

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.

Banks indicated that there was need for, among others, to: complete the digitalization of the lands records in order to speed up the collateral perfection process and also weed out duplicate titling; reduce the cost of recovery on distressed facilities through speedier resolution in the courts; review the interest rate capping law in order to enable banks to price for risk and differentiate secured and unsecured lending; timely payments to public sector suppliers by both the county and national governments; review some of the taxation measures which may result in a higher cost of doing business; enhanced regulation for mobile and financial technology leaders to promote fairness in the industry; reduction in government domestic borrowing in order to lower the risk of crowding out of private sector borrowing; and to provide tax incentives for banks that finance risky sectors such as agriculture and MSMEs.

Respondents from the non-bank private sector across the surveyed regions indicated that there was need to: speed processing of tax refunds; reduced public domestic borrowing in order to lower interest rates on loans; consideration of alternative credit scoring metrics targeting the SME borrowers to facilitate their loan uptake; to facilitate financial education particularly for the young borrowers before contracting the first loan; deal with corruption; reconsider tax measures which increase the cost of doing business; introduce a government backed incentive for banks to lend to the tourism sector against their revenues and for all new flights to and from USA, that would make the cost of flying more affordable.

Non-bank private firms also highlighted the need for the banking industry and the government to reach a mutual agreement with regards to the interest rate caps law. They observed that following the introduction of the interest rate caps, banks were reluctant to lend to MSMEs which was depriving them of adequate funding to develop themselves and grow. Respondents also indicated that there was need to implement tax incentives to the manufacturing sector especially, on cost of inputs such as electricity and fuel, provide additional incentives for exporters through competitive inland freight costs, easing congestion at the port, as well as efficient export documentation process. Additionally, respondents also suggested the need to continue to address the cost of doing business through innovative ways such as easing legal and regulatory requirements.

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