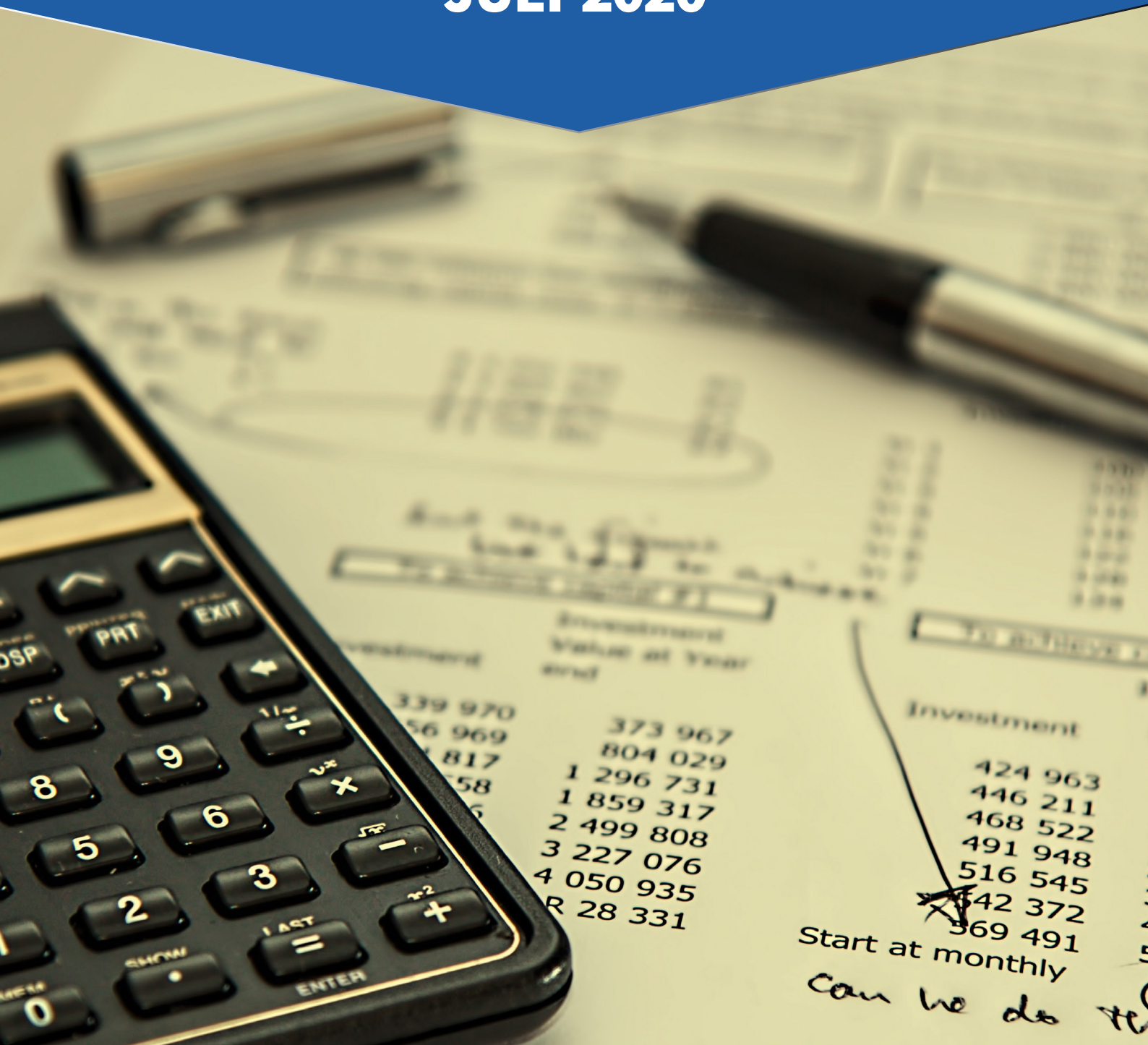




Central Bank of Kenya

REPORT OF THE MONETARY POLICY COMMITTEE MARKET PERCEPTIONS SURVEY JULY 2020



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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 perceptions of banks and non-bank private sector firms on selected economic indicators including inflation, economic growth, growth in credit to private sector and exchange rate. 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, focussing on economic activity and employment. It also captures suggestions by private sector firms on ways to improve 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 major towns across the country namely Nairobi, Mombasa, Kisumu, Eldoret, Nakuru, Nyeri and Meru, is representative of sectors that account for about 70 percent of real 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, health, building and construction, and finance and insurance.

The MPC Secretariat conducts sensitisation 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 July 2020 MPC Market Perceptions Survey was conducted in the first three weeks of the month, coinciding with the easing of movement restrictions earlier put in place particularly in and out of Nairobi and Mombasa to contain the spread of the COVID-19 (coronavirus) pandemic.

The Survey sought perceptions on the effects of the pandemic on the economy, economic conditions prevailing in the two months before the MPC meeting (i.e. May and June 2020), and market expectations on economic conditions for July and August 2020, for the next 12 months (July 2020 to June 2021), and over the medium term (over a 5 year period). The Survey also sought from respondents their expectations with regard to overall inflation, lending rates, exchange rate of the Kenya Shilling against the U.S. Dollar, demand for credit, private sector credit growth and economic growth.

Other areas surveyed included the levels of optimism in the economic prospects over the next 12 months, expectations regarding employment levels, and levels of economic activity before and after the MPC meeting in July.

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, 14 microfinance banks (MFBs) and 328 non-bank private firms including 63 hotels, through questionnaires sent in hard copy and by email. The overall response

rate to the July 2020 Survey was 64 percent of the sampled institutions. The respondents comprised 38 commercial banks, 1 mortgage finance institution, 13 micro-finance banks, 54 hotels, and 136 other non-bank private sector firms.

The expectations from commercial and microfinance 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 July 2020 Market Perceptions Survey included:

- Inflation expectations remain well anchored within the target range in the next 2 months and over the next 12 months.
- The easing of movement restrictions in and out of Nairobi and Mombasa, and further re-opening of key sectors of the economy has elicited optimism, with improved activity particularly in the transport, and hotels and restaurants sectors. A pick-up in industrial activity and an upswing in imports was also reported.
- Hotels that were still closed expected to re-open after international flights resume in August.
- Respondents acknowledged the impact of the fiscal and monetary policy measures, and private sector interventions to cushion the economy from the effects of the pandemic.
- However, uncertainties remain with regard to the increasing rate of COVID-19 infections.

4. ECONOMIC ACTIVITY

The July 2020 Market Perceptions Survey sought bank and non-bank private sector firms' assessment of economic activity in the two months prior to the MPC meeting, i.e., May and June 2020, and their expectations for July and August. The survey also assessed the extent to which the easing of movement restrictions would affect economic activity.

4.1 Economic activity perceptions and expectations by banks

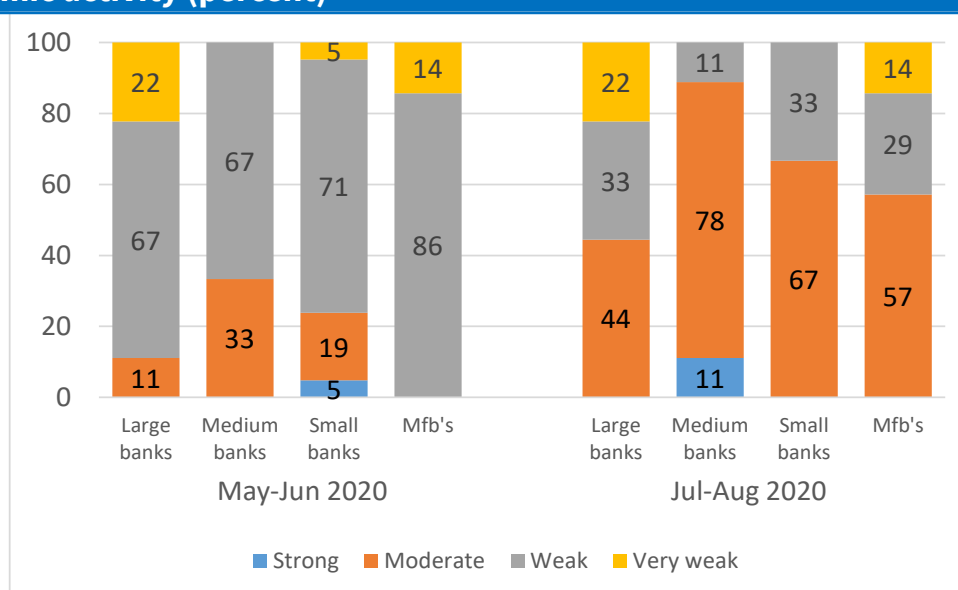
Bank respondents expected an increase in economic activity in July and August, compared to the period May and June, as the economy opened up (**Chart 1**). This expectation was attributed to the relaxation of restrictions initially put in place to contain the spread of the pandemic, particularly in the transport, tourism, accommodation and food sectors. In addition, respondents expected Government policy measures including the Economic Stimulus Programme and tax measures, improved liquidity conditions in the market, increased global travel and favourable weather to boost economic activity in July and August. Consequently, there were expectations of improved private consumption, a pick-up in industrial activity and a strong performance in the services sector.

In contrast, respondents indicated that economic

activity in the period May-June was relatively subdued, due to the impact of the COVID-19 containment measures, and uncertainty about the rising numbers of infections (**Chart 1**). Particularly, some businesses had closed, transport to and from the main cities was paralysed, there was increased unemployment, low access to credit and reduced household and business spending due to liquidity constraints. In addition, respondents indicated that supply chain disruptions due to the pandemic had caused shortages of intermediate goods used for manufacturing. Nevertheless, respondents noted some increase in economic activity in the agricultural sector, a partial reopening of restaurants and some uptick in private sector credit.

The main risks highlighted by the respondents with regard to economic activity in the period July-August included the measures still in place to control the spread of the pandemic, the uncertainty due to rising infections, any channelling of resources to the health sector at the expense of other sectors, and low access to credit especially by MSMEs. Additionally, lack of effective demand due to lost incomes and the closed education sector were cited as factors that would hinder a stronger rebound of activity in July and August.

Chart 1: Perceptions (May and June) and expectations (July and August) by banks on economic activity (percent)



4.2 Economic activity perceptions and expectations by non-bank private firms

Non-bank private sector respondents expected an improvement in economic activity in July-August, largely due to the reopening of the economy, with the easing of the restrictions put in place to contain the spread of the virus (**Chart 2**). Respondents indicated that many businesses that had closed, were reopening especially in the transport, hospitality and tourism sectors, and most of them had adopted mechanisms to cope with the new-normal environment with COVID-19. Respondents indicated that the Government Economic Stimulus Programme provided in the FY2020/21 Budget was expected to boost economic activity and enable businesses recover from the effects of the pandemic. In addition, favourable weather was expected to contribute to improved activity in July and August.

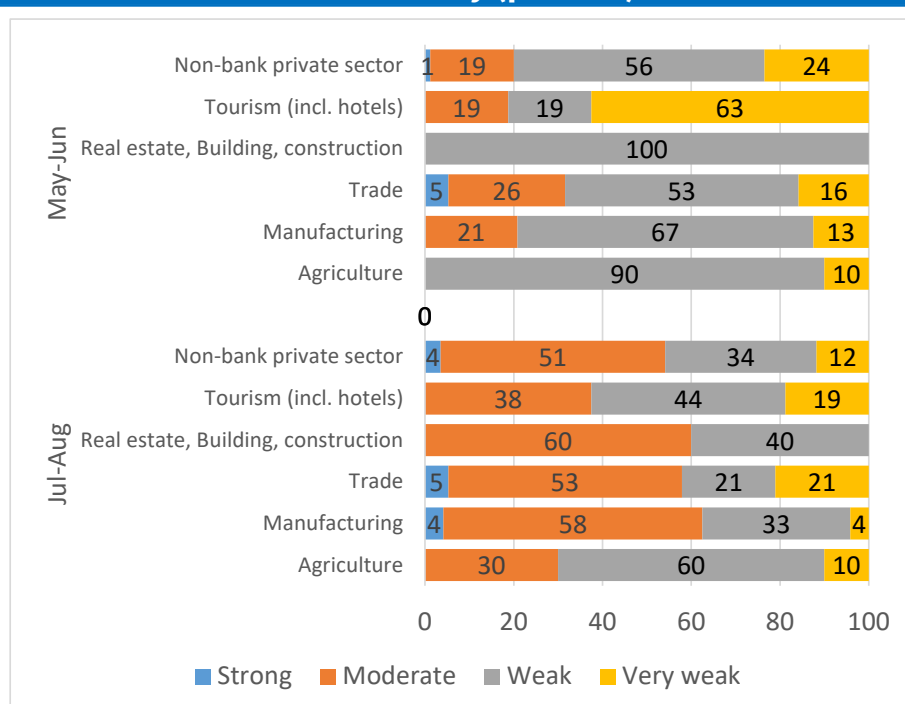
Respondents, however, cited some risks to a stronger recovery in economic activity during the period, including job losses in several sectors, and slower restoration of confidence in some sectors particularly travel and hotels. Other reasons given for a possible sluggish pick-up in activity included supply chain disruptions, reduced consumption and corporate spending, rising COVID-19 cases, caution in spending due to the uncertainty, possible diversion of funds from other sectors towards fighting the pandemic,

most institutions operating below optimal levels, increase in fuel costs and subdued activity in the education sector.

In contrast, the non-bank private sector respondents assessed that economic activity in May and June was subdued, largely due to the impact of the pandemic (**Chart 2**). Respondents cited the cessation of movements into and out of Nairobi and Mombasa, closure of international borders and flights, and measures to contain the virus as factors that led to loss of jobs and incomes, low business volumes in most of the economic sectors, closed businesses, reduced demand, shortage of inputs, delays in cross border trade activities due to COVID-19 testing procedures, low purchasing power, depressed sales, longer inventory holding periods, increased idle capacity for production and logistical challenges in most businesses. Other reasons cited for the subdued activity included increase in fuel prices, and reduced Government revenues.

The non-bank respondents, however, indicated that good weather and Government measures to cushion businesses, provided some stimulus to economic activity in May and June.

Chart 2: Perceptions (May and June) and expectations (July and August) by non-bank private firms on economic activity (percent)



4.3 Expected impact of easing of restrictions on economic activity

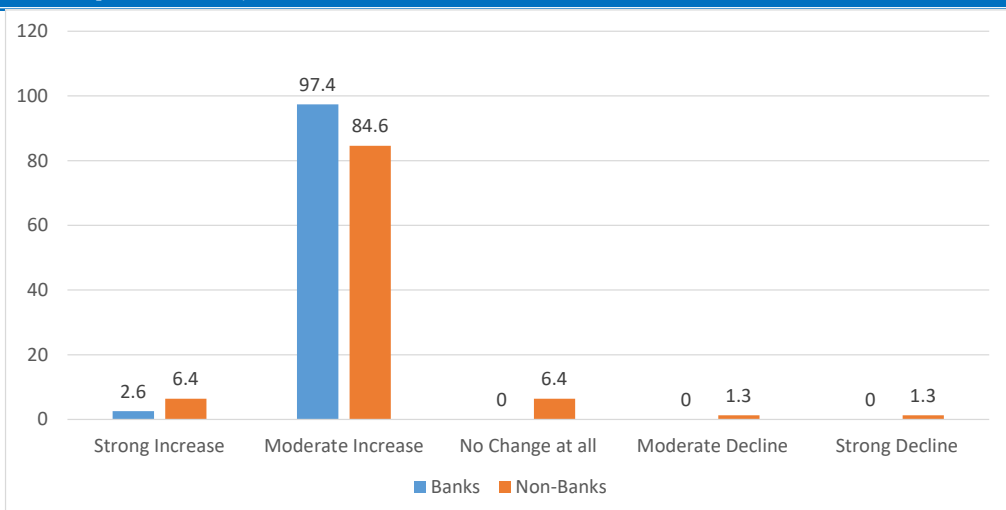
The July 2020 Survey also sought to capture views on the extent to which the easing of movement restrictions particularly for Nairobi and Mombasa, affected economic activity. Respondents expect a moderate increase in economic activity as a result of the lifting of restrictions initially in place to contain the spread of COVID-19, but were concerned about the rising cases of the pandemic **(Chart 3)**.

Particularly, bank respondents expect closed businesses to reopen, improved transport and logistics activity, increased demand for credit and

agricultural supplies, recovery in trade and tourism, a pick-up in industrial activity and an upswing in imports. Non-bank firms expect free movement of goods and services, more business operating hours, gradual pick up in the transport, airlines, hospitality and tourism sectors to support economic activity.

However, respondents were concerned about slow growth in credit to the private sector, subdued demand in the economy due to low purchasing power, and low activity due to sectors that remain closed such as education.

Chart 3: Perceptions on the impact of easing of restrictions on economic activity (percent of respondents)



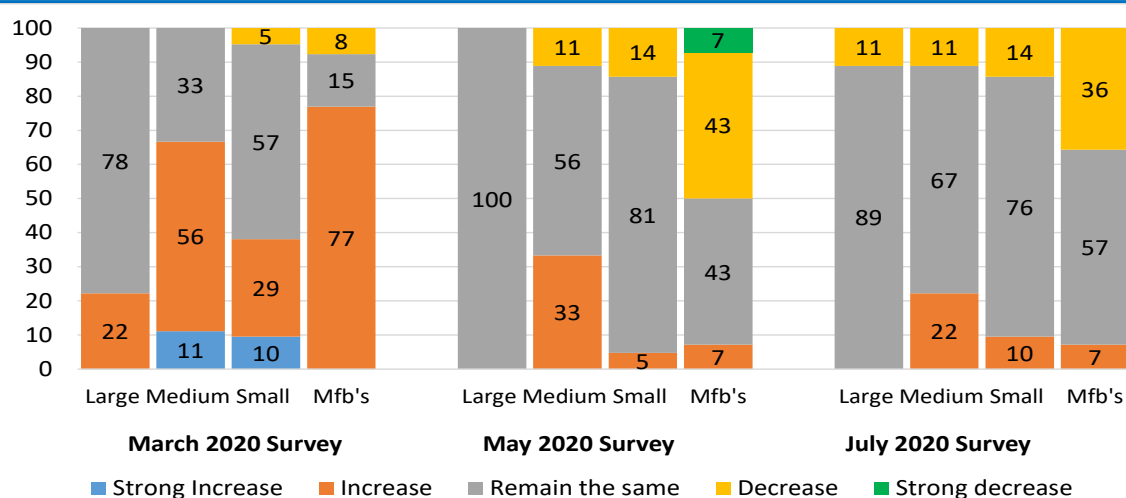
5. EXPECTED CHANGES IN EMPLOYMENT

5.1: Expected changes in employment by banks

The Survey asked bank respondents to provide their expectations with regard to the expected change in the number of employees in their respective institutions in 2020 relative to 2019. Banks largely expected to retain their workforce in 2020, with some of them reporting plans to open new branches, and hire new staff before the end of the year (**Chart 4**).

Some banks expected to reduce the number of employees within the year largely due to increased utilization of digital platforms, reduced business prospects arising from the effects of the pandemic, and rationalisation of staff costs.

Chart 4: Expected changes in employment levels by banks in 2020 (percent)

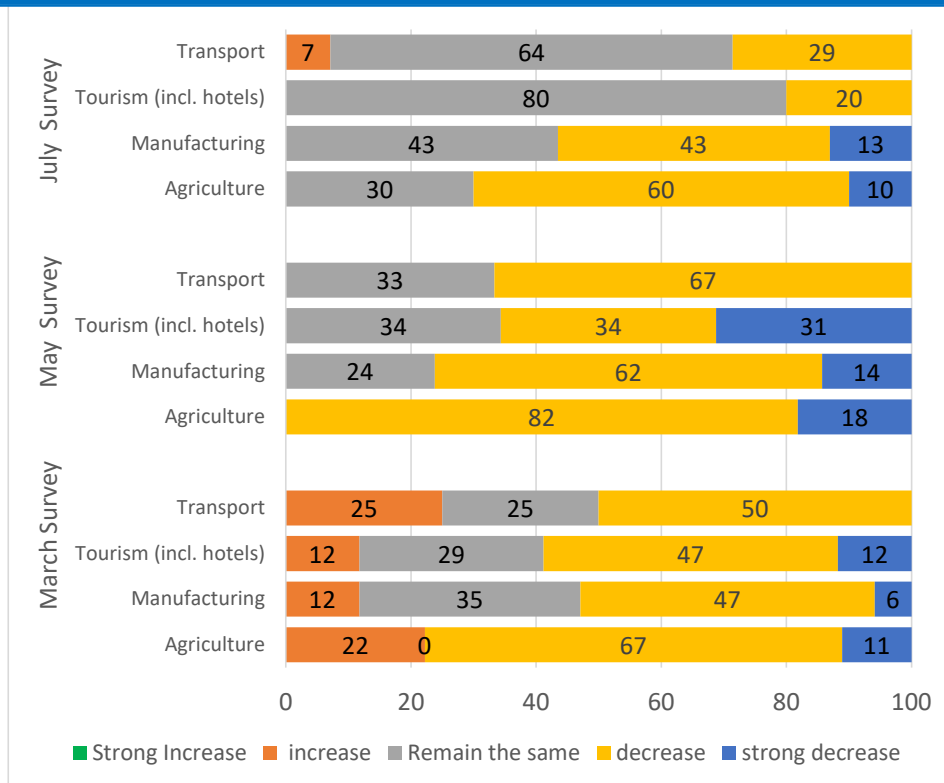


5.2: Employment expectations by non-bank private sector

The Survey inquired from non-bank private sector respondents, their expectations with regard to the change in the number of employees in their respective companies in 2020 relative to 2019 (**Chart 5**). The respondents indicated that their activities were severely affected by the measures put in place to contain the spread of the pandemic, and that they had to make adjustments in their staffing levels in the immediate period following the pandemic.

However, the July 2020 Survey shows a slowdown in further lay-offs, with some respondents indicating that they were keen on taking advantage of new opportunities and the stimulus package offered to local firms, such as motor vehicle assemblers and hotels. Hotel respondents indicated that most of their workers were out of employment due to prolonged effects of the pandemic.

Chart 5: Expected changes in employment levels by non-bank private firms in 2020 (percent)



6. EXPECTED ECONOMIC GROWTH

The Survey requested participants to indicate their expected economic growth rate for the country for the current year 2020, and in the next two and five years.

6.1. Economic growth expectations for 2020

Growth expectations for 2020 varied across banks and non-banks private sector firms (**Table 1**). Banks expected growth in 2020 to be supported by the reopening of the economy, the fiscal and monetary policy stimuli, favourable weather, Government interventions and support of business community. This was in addition to returning business confidence mainly due to easing of travel restrictions, transportation/distribution of raw materials, improving private consumption, and pickup in industrial activity.

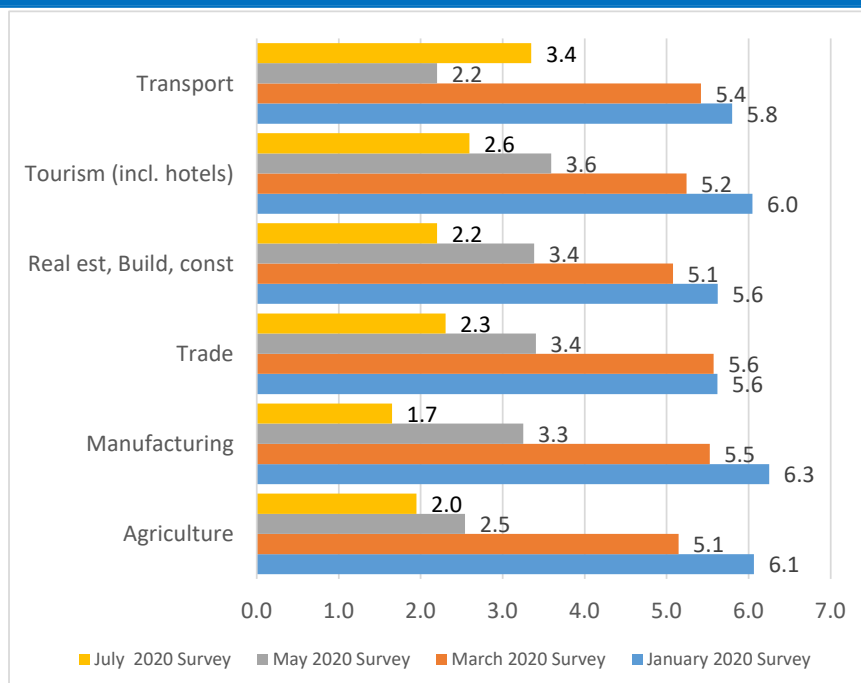
However, respondents expected the full impact of the pandemic to be felt in the second and third quarter, with the second quarter being the hardest hit by the COVID-19 containment measures. Respondents expected key sectors, except agriculture, to be affected by the containment measures mainly due to supply chain disruptions, uncertainty with the evolution of the impact of COVID-19, a depressed business environment, concerns over the concentration of spending on COVID-19 containment, unemployment, and low credit flow to the private sector.

Non-bank respondents across the sectors expected the fiscal stimulus to cushion the effects of COVID-19 on economic growth, and encourage business and spending (**Table 1 and Chart 6**). All sectors expected lower growth in 2020 due to Covid-19.

Table 1: Expectations on economic growth for 2020 (percent)

Survey month	Large banks	Medium banks	Small banks	All banks (Weighted by size of bank)	Micro-finance banks	Non-bank private firms
Jan-20	5.6	5.8	5.5	5.6	5.5	5.5
Mar-20	5.2	5.3	5.3	5.2	5.6	5.3
May-20	1.4	1.6	2.8	1.6	2.7	2.9
Jul-20	1.2	2.7	2.9	1.7	3.6	2.0

Chart 6: Expectations on economic growth for 2020 across sectors (percent)

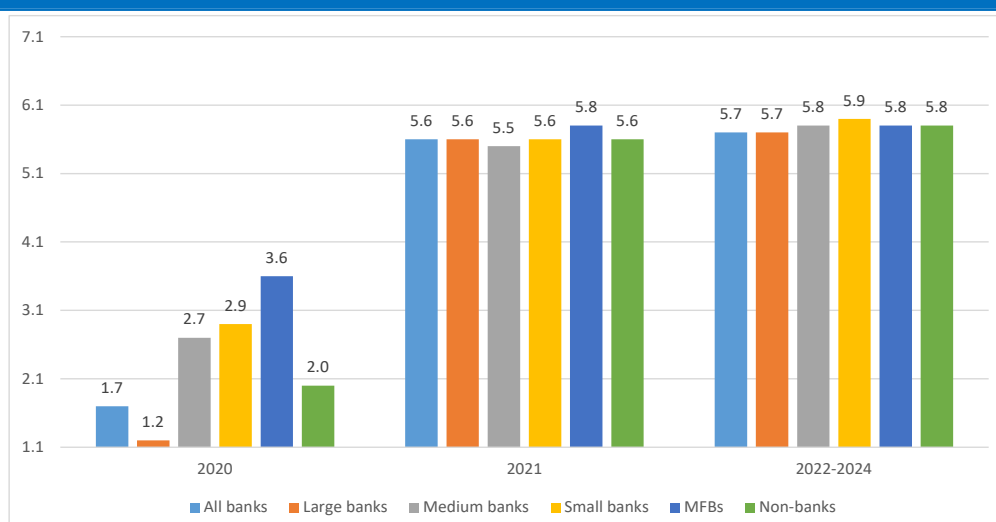


6.2. Economic growth expectations for 2020 - 2024

Respondents expected the economy to rebound as from 2021 (**Chart 7**). This expectation is pegged on the ability of Kenya and other world economies to flatten the COVID-19 curve through the containment measures deployed, as well as potential discovery of vaccines and treatments. Respondents expected favourable weather, lower oil prices, pick-up in economic activities, monetary and fiscal stimuli, returning business confidence supported by a

turnaround in the key sectors of the economy to play a big role in contributing to economic growth in the medium term. In addition, the opening up of international travel and investments in the Big 4 were expected to boost growth in 2021-2024. However, in the case of prolonged impact of Covid-19, containment measures could take longer than expected and dampen growth in the medium term, in addition to slow credit growth to MSMEs.

Chart 7: Expectations on economic growth 2020 – 2024 (percent)



7. OPTIMISM ON THE ECONOMIC PROSPECTS

7.1. Economic prospects in the next 12 months

The July 2020 Survey requested bank and non-bank private sector firm respondents to indicate how optimistic/ pessimistic they were regarding the country's economic prospects in the next 12 months. The results showed improved optimism by respondents across banks and nonbank private sector firms largely as a result of the lifting of restrictions initially put in place to contain the spread of the pandemic **(Charts 8 and 9)**.

Bank respondents revised their optimism upwards largely due to the reopening of the economy, in addition to the fiscal stimulus and monetary policy measures put in place, soundness and stability of the banking system, other targeted state interventions to cushion the economy from shocks and effects of the pandemic including funds for Kazi Mtaani Program and other initiatives to support women and people living with disability. Respondents also cited favourable weather, steady diaspora remittances, relatively low oil prices, Government efforts to clear pending bills, and support to the tea and dairy sectors as reasons for the improved optimism.

However, the limited activity in the education sector, concerns over debt obligations, and reduced development spending were cited as risks to this optimism.

Similarly, the non-bank private sector firms revised their optimism upwards largely due to the opening up of the economy through lifting of COVID-19 containment restrictions. Respondents expected economic activity to pick up gradually citing positivity in efforts to develop a vaccine globally, and curbing the spread locally, Government stimulus package, payment of pending bills, increased demand and tax measures put in place to cushion businesses.

However, the optimism was tempered by the uncertainties with regard to the impact of COVID-19 on businesses, rising cases of the pandemic, and reduced development expenditure.

Chart 8: Optimism by banks on economic prospects (percent)

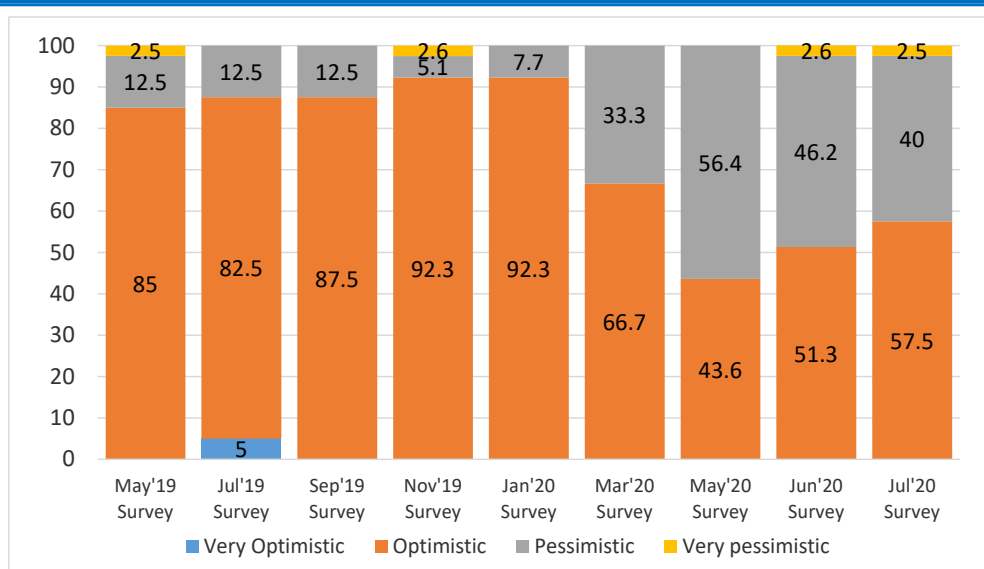
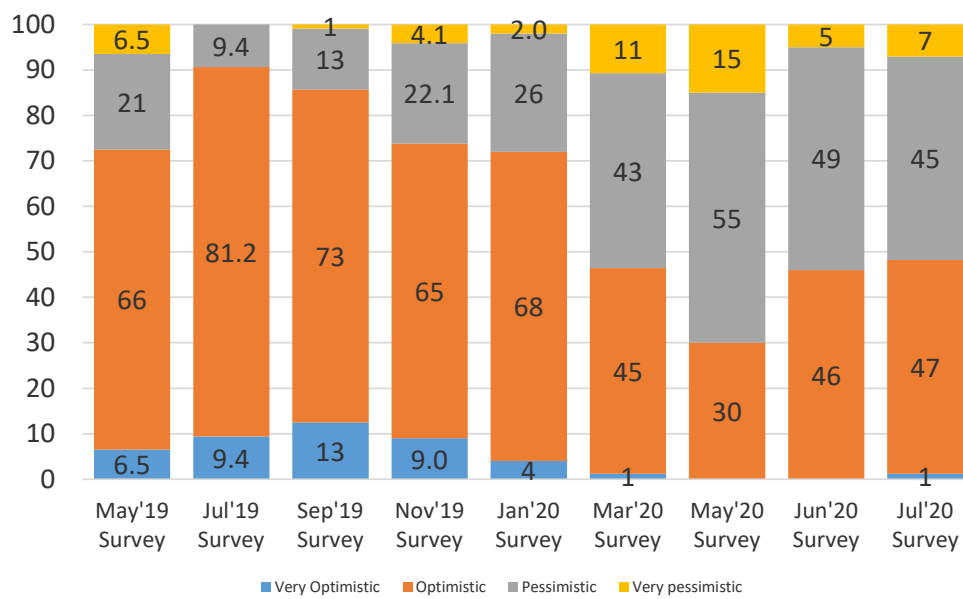


Chart 9: Optimism by non-bank private firms on economic prospects (percent)



7.2. Average hotel occupancy and forward hotel bookings

In the July Survey, hotel respondents reported an improvement in the forward bookings (**Chart 10**). Particularly, about 60 percent of hotels indicated that they would open when international travel resumes in August. Large hotel chains had only a few (1 or 2)

outlets opened while they awaited the resumption of international flights. A comparative analysis of hotel bookings in the July 2020 and July 2019 is shown in **Charts 11a and 11b**.

Chart 10: Average hotel occupancy and average forward bookings (%)

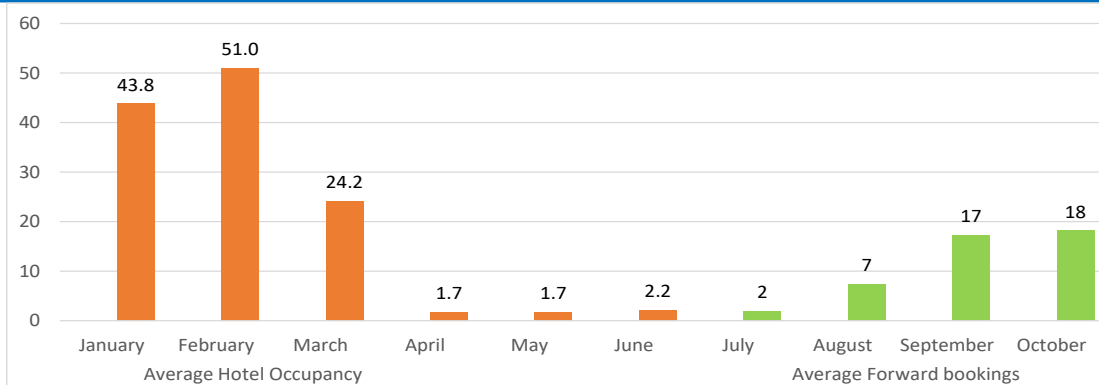


Chart 11a: forward hotel bookings for July – October 2020 (percent of total capacity)

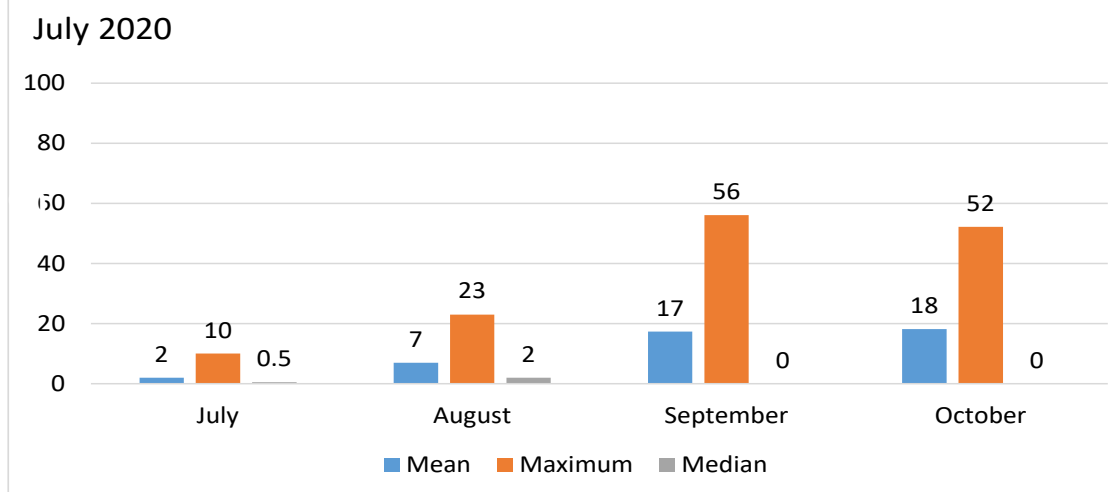
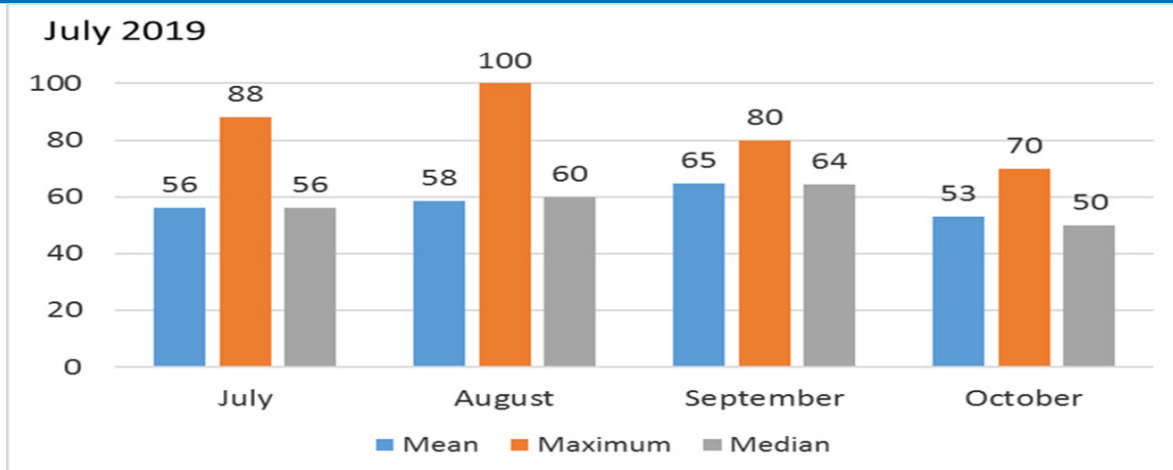


Chart 11b: forward hotel bookings for July – October 2019 (percent of total capacity)



8. INFLATION EXPECTATIONS

8.1 Inflation expectations for July and August

In the Survey, respondents were required to give their expectations of overall inflation rates for the next 2 months (July and August 2020), the next 12 months (July 2020 to June 2021), the next 2 years (July 2020 to June 2022) and the next 5 years (July 2020 to June 2025). The results showed that inflation expectations remained anchored, with respondents expecting inflation to remain within the target range (5 ± 2.5 percent) in July and August 2020 (**Table 2**).

Bank respondents expected inflation to remain low and stable in the next 2 months on account of lower food prices following favourable weather conditions, weak demand and expectations of lower international crude oil prices. In addition, the lifting of restrictions was expected to gradually address the supply chain issues. Respondents expected these factors to

more than offset any effects of higher oil prices, supply disruptions.

Similarly, non-bank respondents similarly expected inflation to remain within target in the next 2 months due to low food and relatively low global oil prices. Respondents expected some upward pressure on inflation from the recent increase in pump prices, a weaker Shilling, and progressive recovery of economic activity.

However, respondents, expected the lifting of cessations and the recent increase in pump prices to exert some upward pressure on inflation through increased economic activity, higher demand for fuel, costs of production and transport. In addition, respondents expected some pressure on inflation to arise from the tax measures in FY2020/21 which would ultimately see the increased costs passed to consumers.

Table 2: Inflation expectations for July and August (%)

Expected Inflation for:	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
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	5.1	5.1	5	5.1	5.3
Jan-Feb 2020	5.8	5.7	5.8	5.8	5.7	5.8
Mar-Apr 2020	6.0	5.8	6.4	6.4	6.5	6.0
May-Jun 2020	5.5	6.1	5.7	5.6	6.0	6.1
Jul-Aug 2020	4.8	4.9	4.8	4.8	4.6	4.7

8.2. Inflation expectations for the next 1, 2 and 5 years

Respondents expected inflation to remain stable in the next 1, 2 and 5 years, largely supported by moderate demand pressure, and anticipated stability of oil price (**Table 3**).

However, respondents indicated that the main

risks to the inflation outlook included higher fuel prices as economies recover from the pandemic, and any weather fluctuations that could possibly put upward pressure on inflation in the medium term.

Table 3: Inflation expectations for the next 1, 2 and 5 years (%)

	All banks	Large banks	Medium banks	Small banks	MFB's	Micro lenders	Non-bank private firms
July 2020 - June 2021	5.3	5.3	5.3	5.1	4.7	5.5	5.2
July 2020 - June 2022	5.5	5.5	5.6	5.2	5.0	5.6	5.5
July 2020 - June 2025	5.3	5.2	5.5	5.3	5.4	5.9	5.3

9. EXCHANGE RATE EXPECTATIONS

The Survey sought to find out from bank and non-bank private sector firms their expectations with regard to the direction of change in the exchange rate of the Shilling against the U.S. Dollar in July and August 2020. There were varied expectations across banks and non-banks on the direction of the Shilling to US. dollar exchange rate.

Bank respondents expected the Shilling to be supported by sufficient foreign exchange reserves, strong diaspora remittances, exports growth and muted dollar demand. However, respondents expected a weakening bias for the Shilling against the US Dollar in the next 2 months as a result of expected increased demand for the USD for imports including as the

economy reopens, liquidity currently prevailing in the money markets, increased uncertainty, risk aversion by global investors, subdued tourism receipts, lower capital inflows and extended lockdowns abroad **(Chart 12)**.

Non-bank private firm respondents had mixed expectations with regard to the direction of the Shilling in the next 2 months **(Chart 13)**. Respondents expected the Shilling to be supported by the sufficient foreign exchange reserves, relatively low global oil prices, receipts from agricultural exports and sustained diaspora remittances. However, some respondents expected pressure on the Shilling to arise from increased imports, concerns on external debt obligations and the uncertainty brought about by the pandemic.

Chart 12: Banks expectations on the direction of the Shilling/ US dollar exchange rate in the next 2 months (percent)

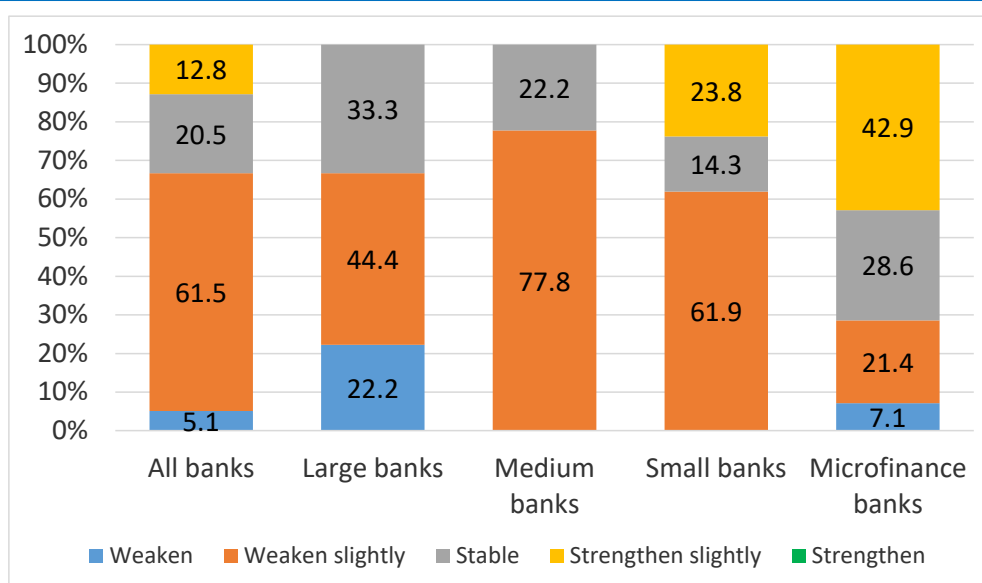
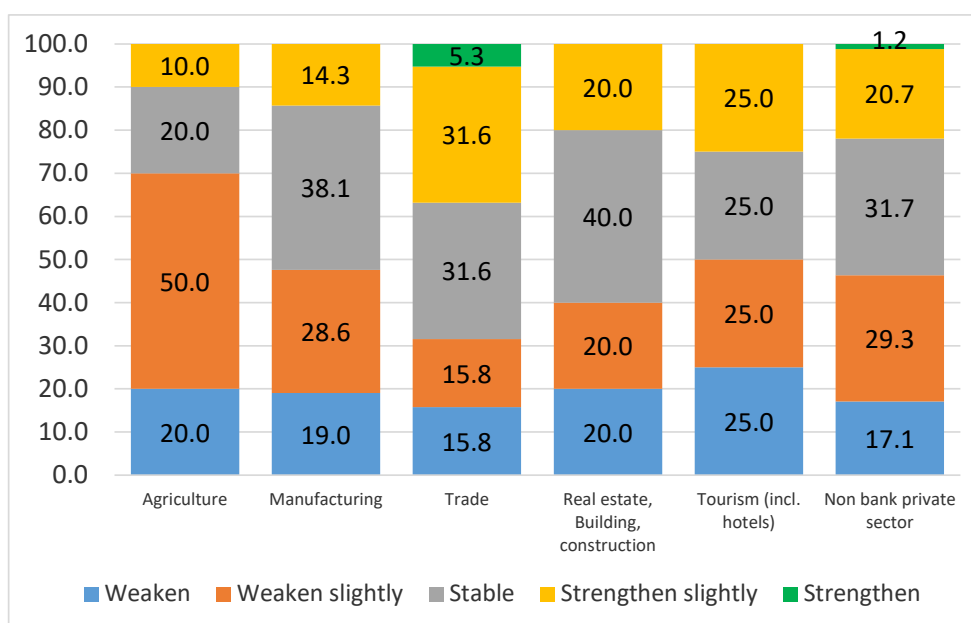


Chart 13: Non-bank private sector firms' expectations on the direction of Shilling/ US dollar exchange rate in the next 2 months (percent)



10. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

10.1 Growth in private sector credit in 2020

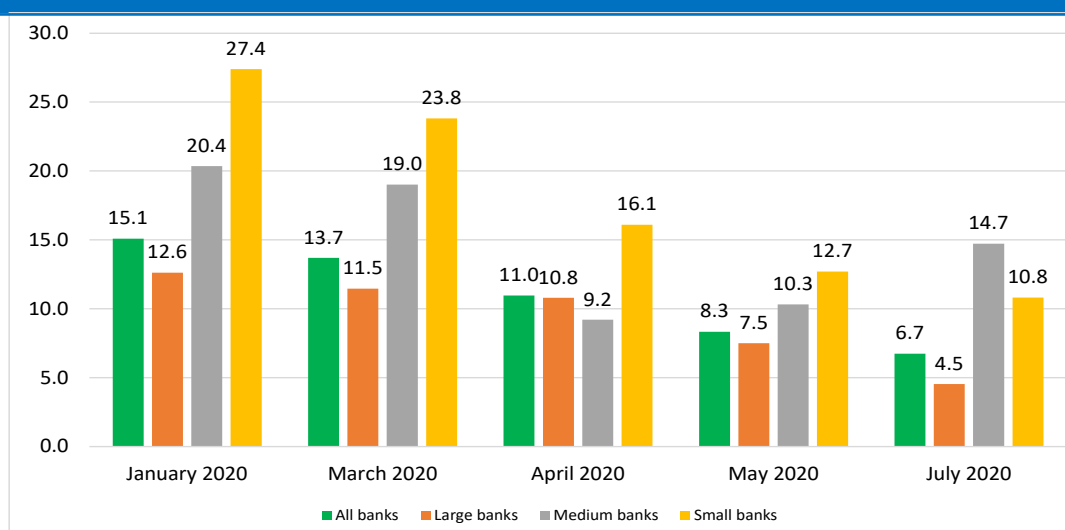
The Survey sought to find out from commercial banks their expectations with regard to private sector credit growth by the end of 2020 relative to the position at the end of 2019 (**Chart 14**).

Respondents expected private sector credit growth in 2020 to be supported by increased demand by businesses following the gradual reopening of the economy, reduction of CBR and CRR, Government interventions to support MSMEs from COVID-19, improved risk profiling, payment of pending bills by national and county

governments, favourable weather conditions, and increased liquidity in the banking system. In addition, anticipated business opportunities from the Big 4 related projects and demand for short term working capital requirements to meet immediate business needs are expected to support growth in credit to the private sector.

However, some respondents revised downwards their expected credit growth to the private sector for 2020, relative to 2019, indicating uncertainties of the COVID-19 pandemic on economic activities and growth in 2020.

Chart 14: Expectations on private sector credit growth (percent)



10.2 Expected demand for credit in 2020

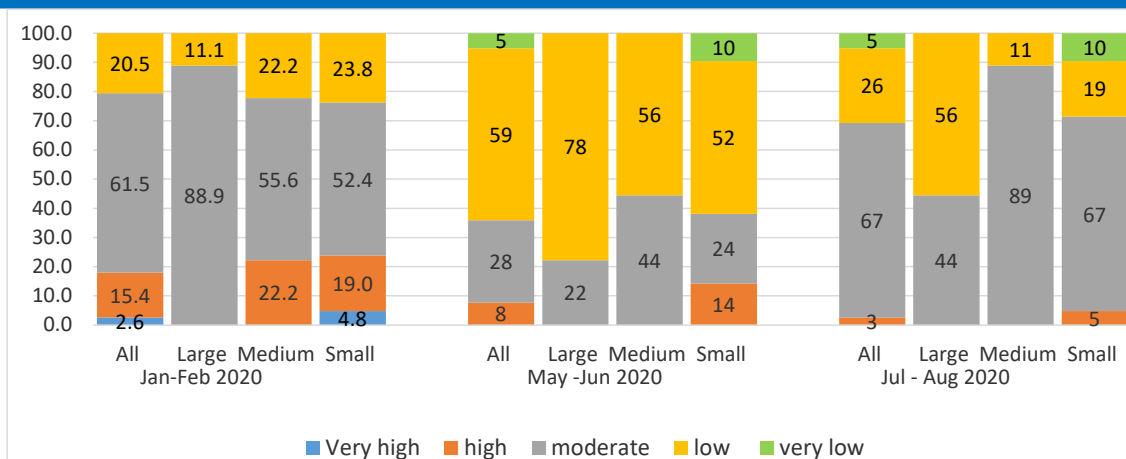
The Survey requested bank respondents for an assessment of credit demand from their perspective, during the 2 months before the MPC meeting (i.e. May and June), and their expectations for July and August 2020 (**Chart 15**).

Bank respondents expected a pick-up in demand for credit in July and August due to the opening up of the economy as businesses

looked for money to revamp their operations, Government's commitment to pay suppliers, increase in economic activity albeit at a slower pace, ability to price risk by banks and Government led infrastructure development initiatives from the Big 4 priority areas.

However, some respondents indicated that the demand for credit may remain moderate largely due to uncertainties with the rising COVID-19 cases, and credit risk.

Chart 15: Demand for credit in 2020 surveys (percent)



11. HOW THE BUSINESS ENVIRONMENT COULD BE ENHANCED

The survey asked respondents to indicate how the business environment could be enhanced going forward. Bank respondents indicated that continued settlement of pending bills will spur economic activity and lower non-performing loans, while improved digital security, and increased effectiveness in the Judicial System on contract enforcement would improve their business environment. Other suggestions included implementation of guarantee schemes for vulnerable borrowers, VAT refunds to assist businesses with managing their cash flow and provision of a business stabilization fund to

mitigate the impact of COVID-19 especially for MSMEs.

Non-bank private firms on the other hand suggested more support to the MSMEs segment, and the need to provide incentives to the tourism industry to reduce the cost of doing business so that there would be reasonable rates to attract domestic tourists and still break even. Other suggestion related to the need to improve speed of COVID-19 testing of hotel employees, release of VAT refunds on time and provide enough incentives to help the local informal sector and the MSMEs.



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