Central Bank of Kenya

REPORT OF THE MONETARY POLICY COMMITTEE MARKET PERCEPTIONS SURVEY SEPTEMBER 2019

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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.

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 September 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. July and August 2019, and market expectations on economic conditions for September and October 2019, and for the next 12 months period, i.e. September 2019 – August 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 economic 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 of 39 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 September 2019 Survey was 69 percent of the sampled institutions. The respondents comprised of 39 commercial banks, 1 mortgage finance institution, 12 micro-finance banks, 37 hotels, and 172 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 messages from the September 2019 Market Perceptions Survey included:

- Inflation expectations remained well anchored within the target range for the 2 months after the Survey, i.e. September and October, and for the 12-month period after the Survey, i.e., September 2019 – August 2020.
- There were mixed expectations by banks and non-bank private firms regarding 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 growth prospects by banks and non-bank private sector.

4. CURRENT ECONOMIC CONDITIONS

4.1 Overall Economic Activity

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

Most respondents indicated that economic activity (volume of demand/ business activity/ production) during this period was moderate, as there were no significant variations in weather, macroeconomic environment, or other dynamics **(Chart 1).** The period represented the peak season for the tourism sector, with many international visitors coming in to the country to view the wildebeest migration and other sites. In addition, respondents indicated that investments in public sector infrastructure including construction of SGR and roads, improved agricultural production and electricity generation, expected benefits of demonetization, and the fight against corruption were factors that boosted economic activity during this period.

On the other hand, respondents alluded to the period having its fair share of challenges including weak access to credit by the private sector, slow growth in sectors such as manufacturing and construction, healthcare and agriculture, delayed payments of pending bills by Government and Counties, and drought conditions in some parts of the country.

4.2: Input prices

To assess economic conditions before the September 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 July and August 2019.

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

Chart 1: Perceptions on Economic Activity for July and August 2019 (percent)

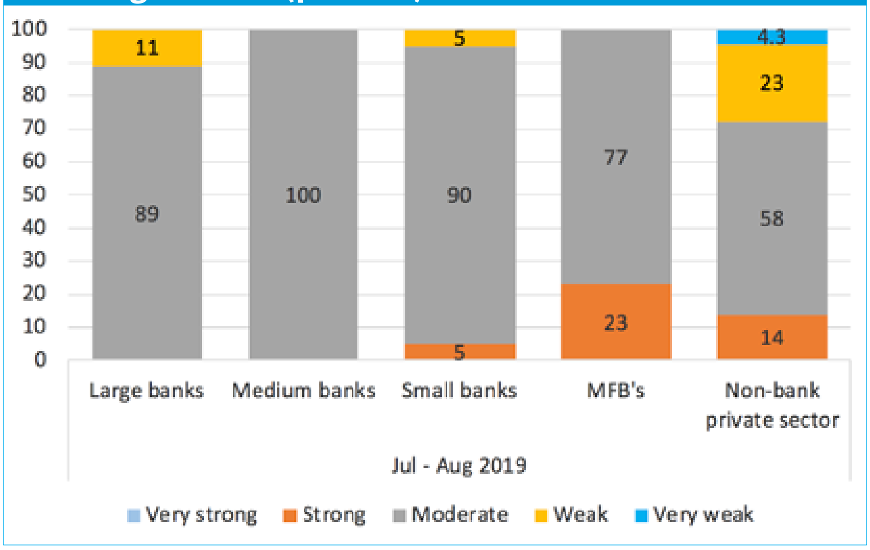
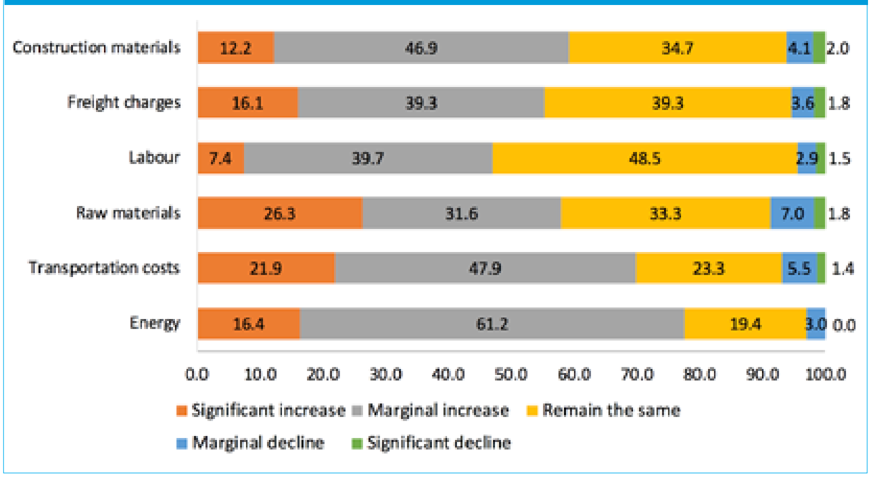


Chart 2: Perceptions on Movements in input prices in July – August 2019 (percent of respondents)



5. INFLATION EXPECTATIONS

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

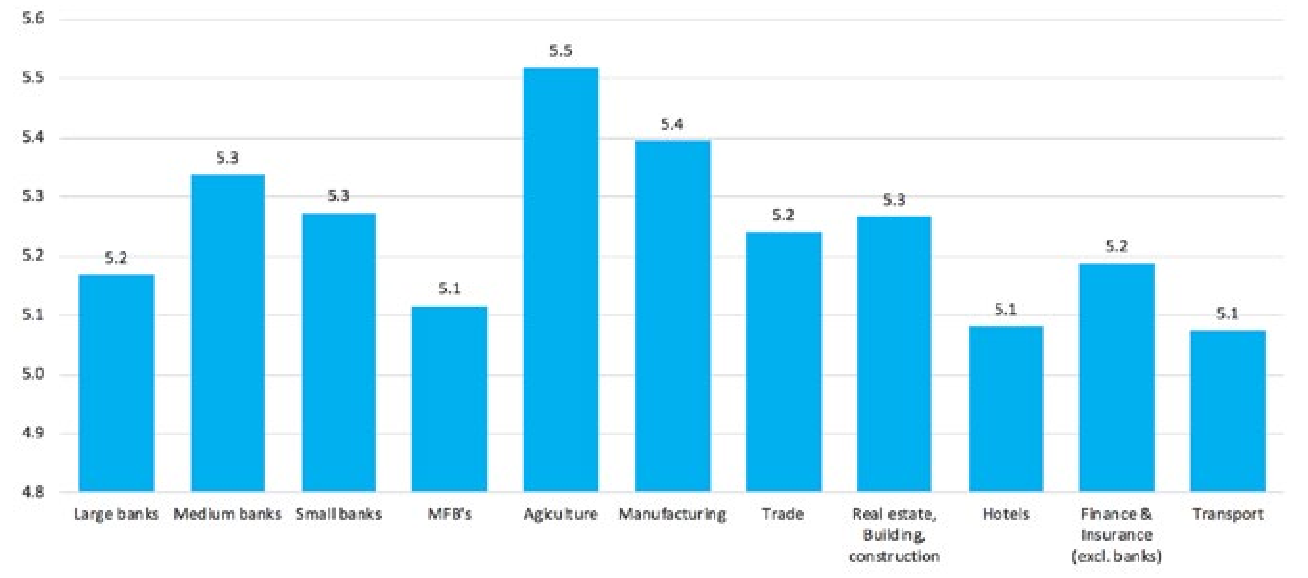
The results showed a downward revision in inflation expectations, and prospects of stability within the target range (5 ± 2.5 percent) for the next 2 months relative to the July 2019 Survey **(Table 1).**

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**
Sep-Oct 2018	5.4	5.1	5.1	5.3	4.9	5.3
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

The downward revision was attributed to decreases in food prices expected in the next 2 months as a result of enhanced food supply from the upcoming harvest season in the food basket regions, lower fuel prices , and subdued demand pressures.

Respondents however indicated that any depreciation of the Shilling against the US dollar, increases in prices of some staple food items such as maize flour, rice and wheat, drought in some parts of the country and pressure on oil prices due to tensions between USA and Iran could exert upward pressure on inflation. The agricultural sector respondents expressed concern about the rising prices of some food crops, especially maize, but hoped that the upcoming harvest season would moderate the price increases **(Chart 3).**

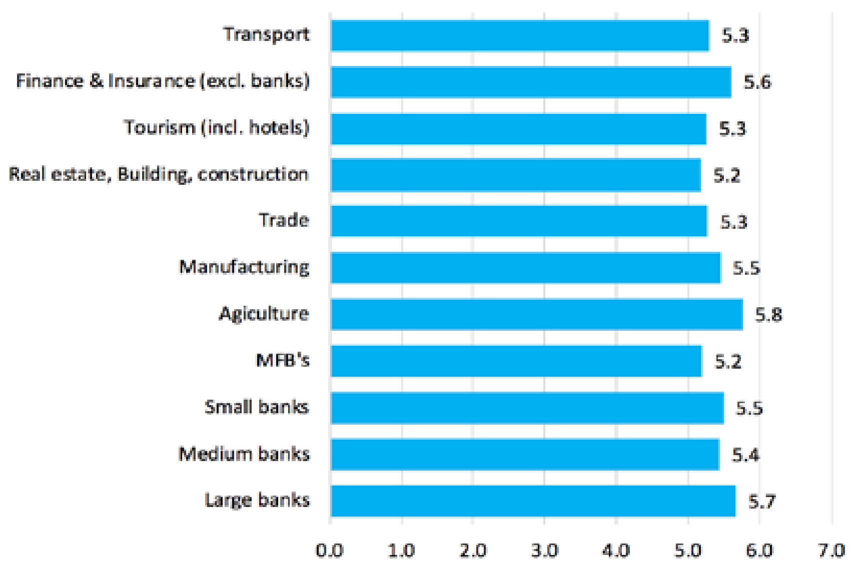
Chart 3: Sectoral inflation expectations for the next 2 months (percent)



Inflation expectations for the next 12 months (September 2019 – August 2020), across the different economic sectors remained well anchored within the target range supported by expectations of normal weather conditions which would keep food prices moderated. Other factors expected to keep inflation within the target band included expected stability of oil prices and muted demand pressures **(Chart 4).**

Nonetheless, respondents cited unpredictable weather patterns, poor supply of food in some parts of the country, and geopolitical developments that could lead to increase in crude oil prices, as risks to inflation over the next 12 months.

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



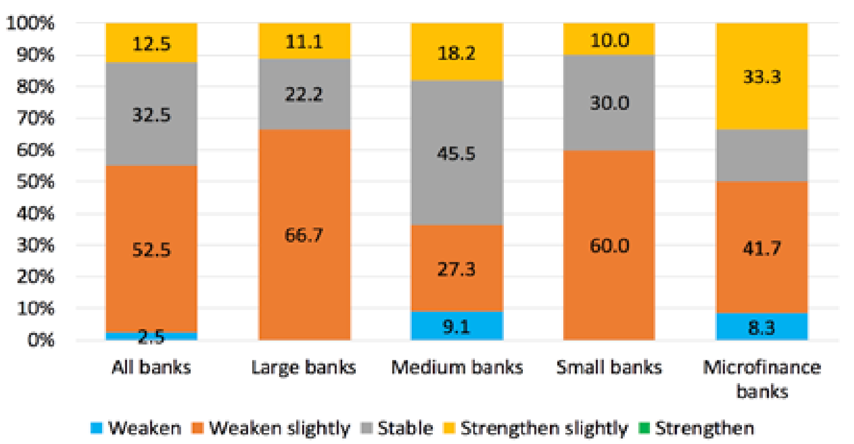
6. EXCHANGE RATE EXPECTATIONS

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 September and October 2019.

The results showed that bank respondents expected the Shilling to come under pressure against the USD in the next 2 months. They attributed this to lower inflows from tea due to the dry spell and falling prices in the international market, seasonal dividend payments, excess liquidity in the money market, importation of raw materials by industries for production activities, increased demand for USD due to demonetisation, and higher debt repayment obligations. **(Chart 5).**

Respondents, however, expected the sufficient reserves, strong diaspora flows, resilient performance of horticultural exports, strong prospects for real GDP growth and low and stable inflation to support the Shilling in September and October 2019.

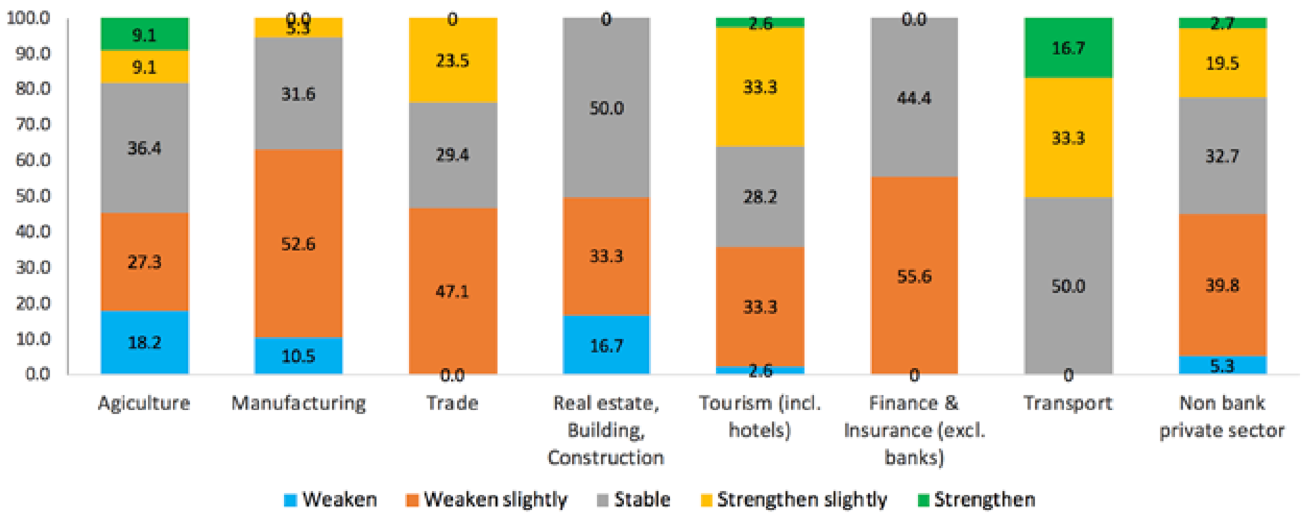
Chart 5: Banks expectations on the direction of the Shilling/ USD Exchange rate in the next 2 months (percent)



Non-bank private sector firms expected the Shilling to remain largely stable against the USD over the next 2 months supported by healthy foreign exchange reserves, strong diaspora remittances, increased inflows from tourism, improved agricultural exports due to good rains, less need for importation and a stable macroeconomic environment **(Chart 6).**

However, the non-bank private firm respondents cited increased US dollar demand by energy and manufacturing companies, lower agricultural exports due to the delayed rainfall earlier in the year, higher dollar demand as the festive season approached, and external factors, including Brexit as possible risks to the stability of the exchange rate of the Ksh against the USD.

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



7. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

7.1 Growth in Private Sector Credit in 2019

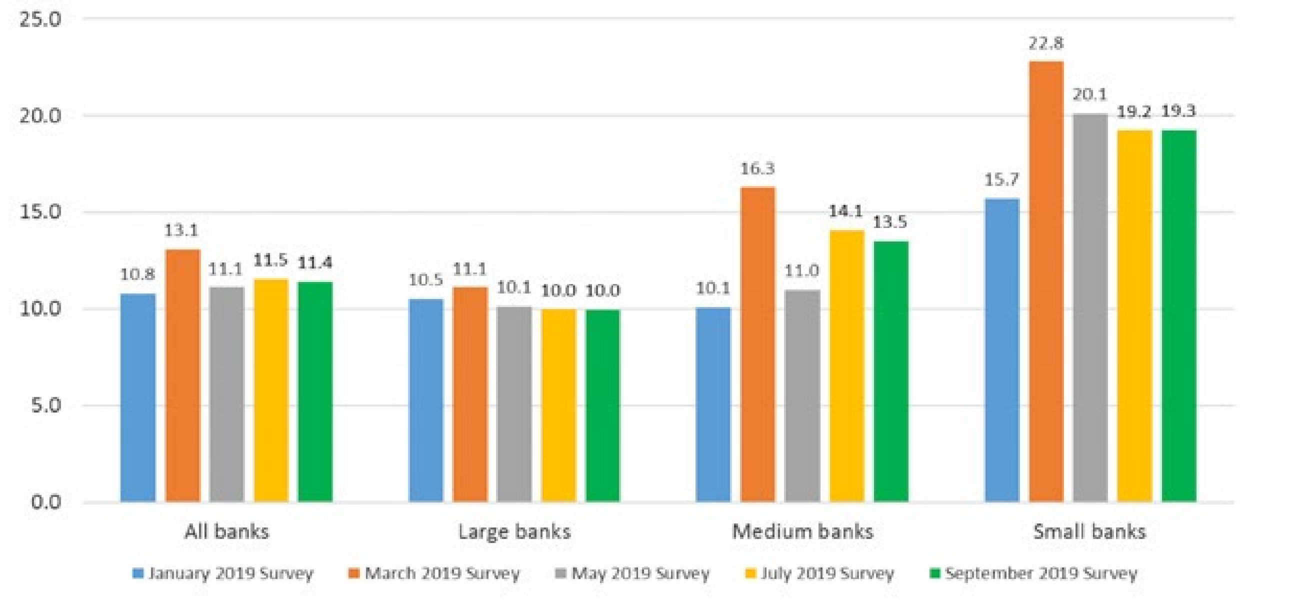
The Survey sought to find out commercial banks' expected private sector credit growth by the end of 2019 relative to 2018.

In the September 2019 Survey, just like in previous surveys of the year, respondents remained consistent about their expectations of increasing private sector credit in 2019 relative to 2018 **(Charts 7 & 8).** Respondents attributed the expected increase in private sector credit growth to the improved macroeconomic environment, characterised by increased economic activity in the private sector, Government's focus on the Big 4 Agenda, improved weather conditions and political stability.

Respondents pointed out the increasing demand for goods and services, increase in mobile lending with a focus on lending to MSMEs, improved business sentiments and investor confidence, improved risk profiling, settlement of pending bills to private sector from the public sector and ongoing public infrastructure projects as key drivers of the expected private sector credit growth.

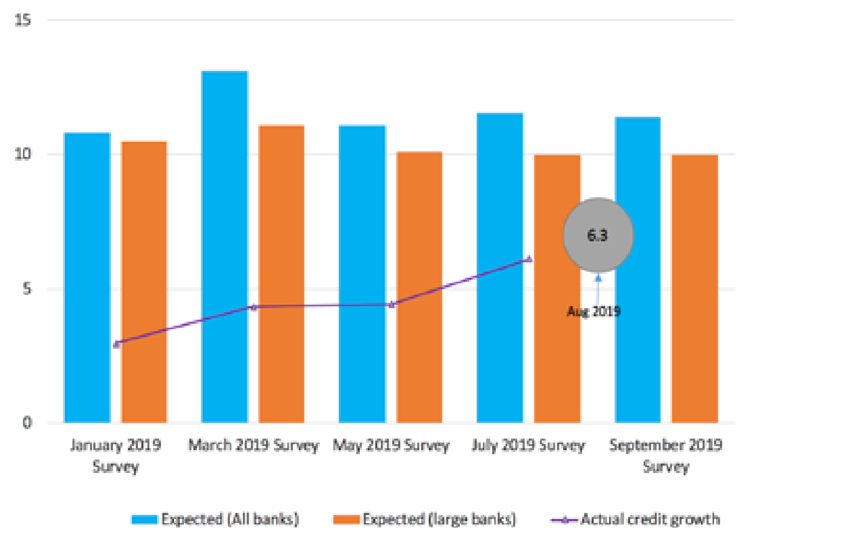
Risks to private sector credit growth as cited by respondents included the erratic weather patterns which could affect the agricultural sector, irregular payments of outstanding pending bills, increased non-performing loans, oversupply in the real estate sector, competition from Fintechs in mobile loan lending and the continued application of interest rate capping.

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



7.2. Expectations on Demand for Credit by banks

Chart 8: Expectations on Private Sector Credit Growth to December 2019 vs Actual Credit Growth Rate

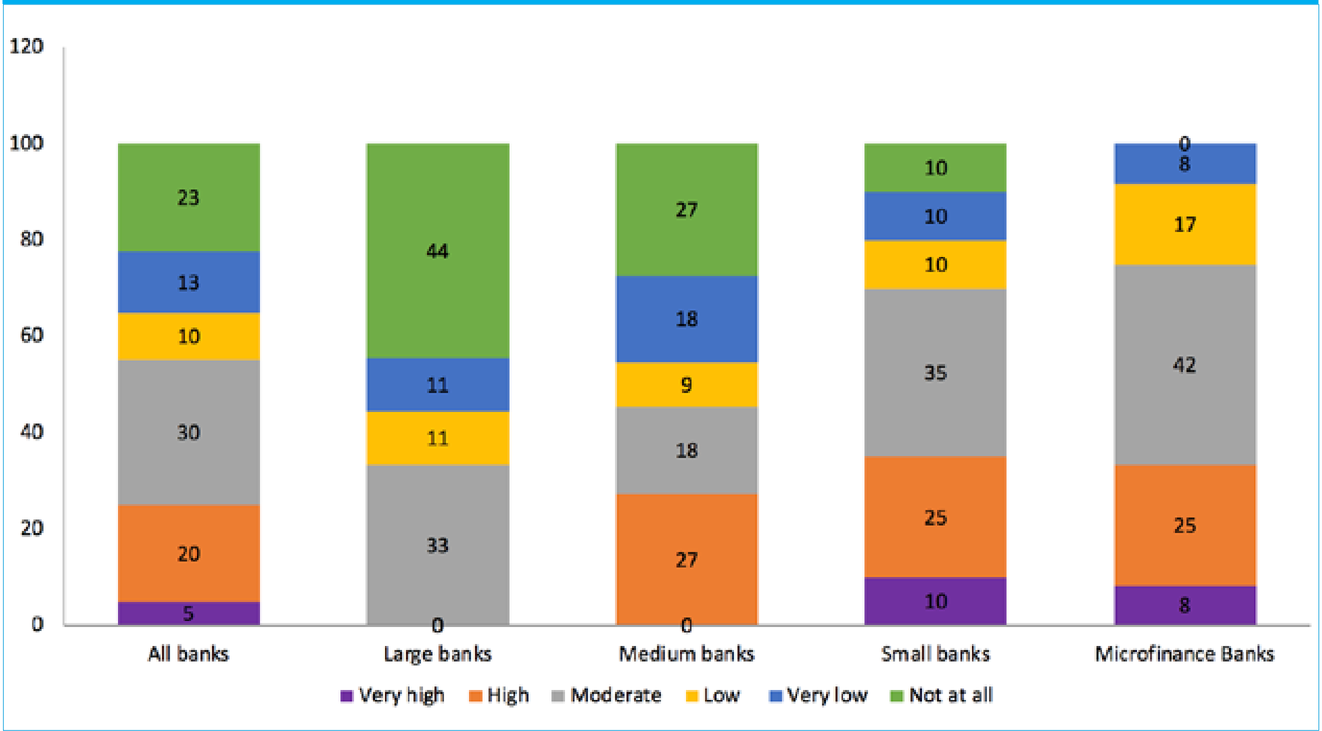


Bank respondents attributed the high levels of liquidity to interest rate capping and the inability to price risk. Most large bank respondents indicated that they had ample liquidity and a strong customer base, hence deposits, and that lending was constrained by other factors other than liquidity, maintaining that the risk premium was not sufficient to lend to the general private sector, and that their "targeted markets" were not applying for credit facilities.

7.3. 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. Analysis of the results over the last three surveys showed that large banks maintained high liquidity levels relative to the smaller banks **(Chart 9).**

Chart 9: Extent to which liquidity is a constraint to private sector lending (percent)



7.2 Expectations of Demand for Credit from banks

The survey requested bank participants to give an assessment of the demand for credit their banks experienced from customers in the 2 months before the MPC meeting, i.e., July and August, and their expectations of the same for the 2 months after the September MPC, i.e., September and October **(Chart 10a & 10b).** Respondents indicated that credit demand in July and August was largely moderate, but they expected increased demand in September and October.

According to the respondents, in July and August, there was stability in the macroeconomic and political environment, and lower cost of credit, factors that contributed to an enabling business environment. Some banks experienced increased demand for credit from SMEs and individuals for personal loans. Government infrastructure projects related to roads and the promise to lower energy costs seems to have encouraged borrowings from manufacturing and other production sectors. Investor optimism was high in the tourism and trade sectors. Bank respondents attributed part of this demand to the attractiveness of products developed to support clients' needs.

However, factors such as slow uptake of credit due to delayed payments by both the National and County governments, credit lending risk and non- performing loans moderated the demand of credit in July and August.

Respondents attributed the expected increase in demand for credit in September and October to expectation of increased in economic activities and an improved business environment. They cited the increase in available borrowing channels, renewed efforts to support MSMEs by providing credit for their businesses, increased appetite for mobile-based loans and for investments/ stocking up for the festive season as factors likely to increase demand in September and October. Other factors pointed out included the lower cost of credit, higher liquidity in the banking sector, on-set of the short rains and release of funds to counties by the government.

Chart 10a: Credit demand Perceptions (July and August) (percent)

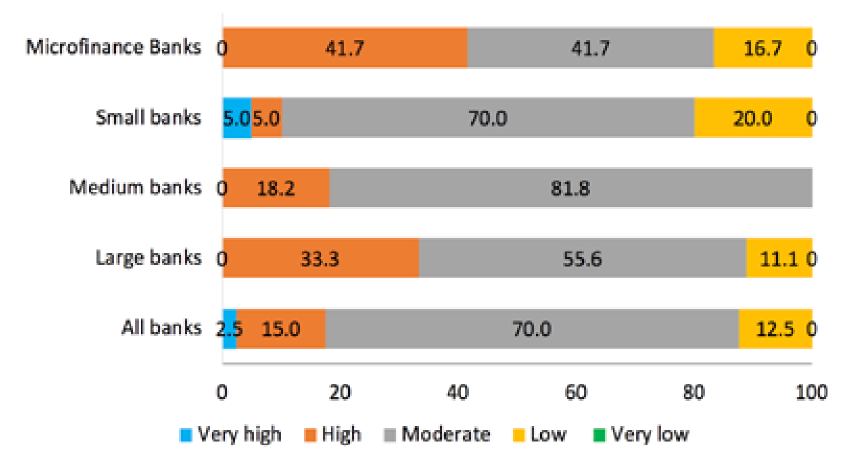
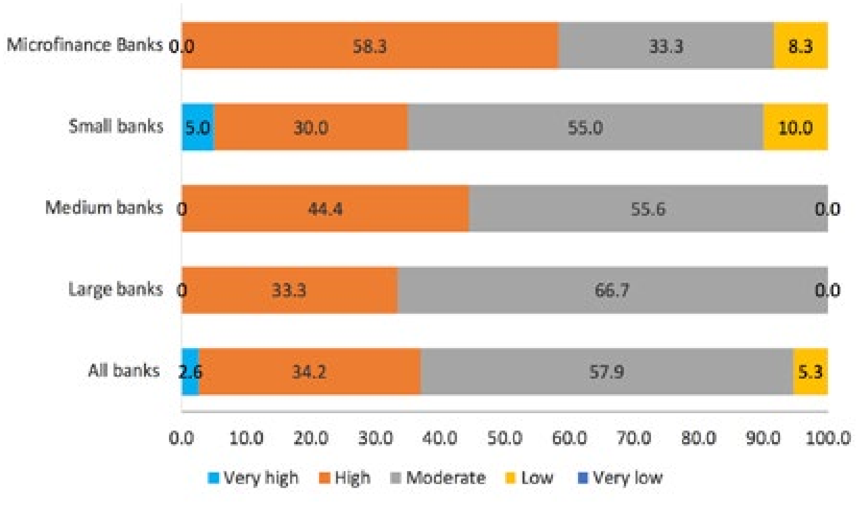


Chart 10b: Credit demand Expectations (September and October) by banks (percent)



8. ECONOMIC ACTIVITY AND EMPLOYMENT

8.1. Expected Economic Activity

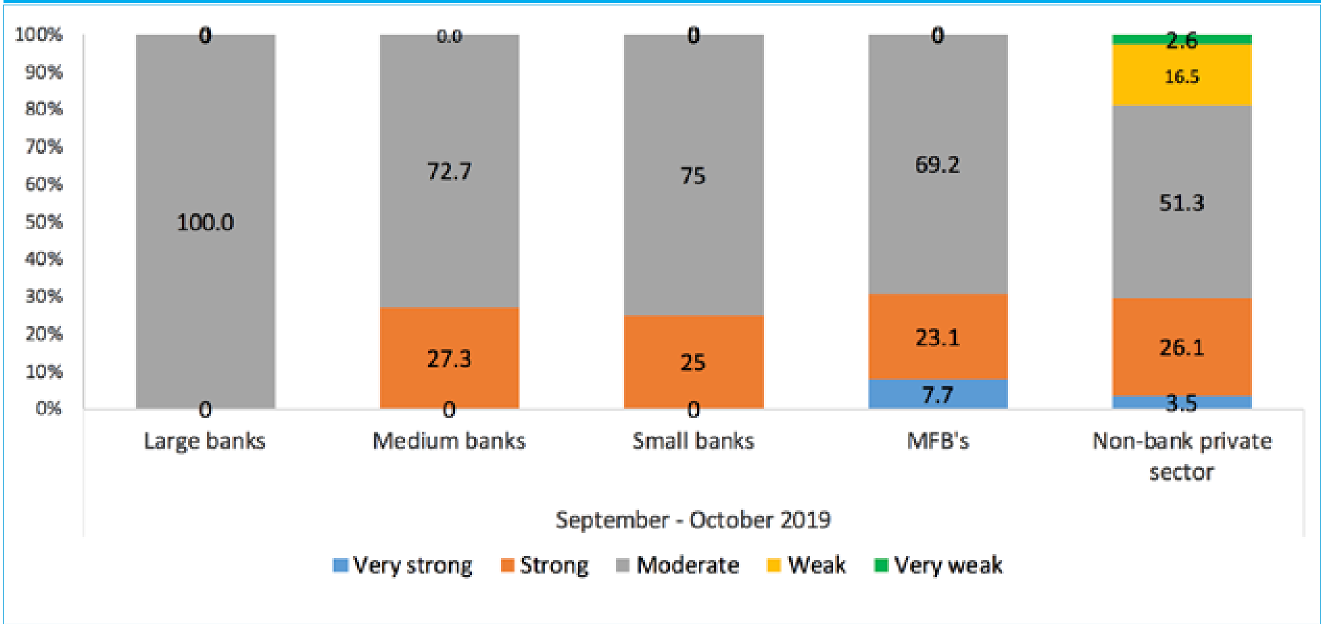
The Survey sought to find out expected levels of economic activity in September and October 2019 by banks and non-bank private sector firms.

Respondents expected a pick-up in economic activity with the release of money to counties and the payment of suppliers by the national and county Governments **(Chart 11).** Other reasons for the expected increase in economic activities included the beginning of short rains which were expected to boost agriculture, improving tourism, Government's promise to lower cost of energy expected to spur high investments by private sector, Government's Big 4 implementation, increased diaspora remittances, a stable macroeconomic environment and political stability. The agricultural sector expected improved economic activity due to expected early rains in October 2019 to boost production, while the wholesale and retail trade sectors were gearing up for the festive season spending **(Chart 12)**.

Respondents in the tourism sector expected that the high season would extend to end of October, and that conferencing and meetings would pick up with the release of county funds, even as they headed to the domestic peak season. The manufacturing sector expected that release of cash to counties, production for the festive season, good rains and Big 4 agenda funding would provide for increased activity in September and October.

Respondents, however, indicated that erratic weather conditions could affect the agricultural sector and subdued private sector credit growth could affect manufacturing, construction and real estate sectors.

Chart 11: Expected Economic Activity in September and October 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 mostly expected to retain their employment levels in 2019, while medium and small banks expected to either increase or retain their staffing levels in 2019. The non-bank private sector firms on their part indicated that they would retain their staffing levels as they stand. **(Charts 13 and 14).**

Bank respondents cited the ongoing mergers, expansions of branch networks and the need to support business as reasons for expected increase in employment levels in 2019. However, respondents pointed out that the focus on organic growth and the need to leverage on technology could moderate new hires.

The non-bank private sector respondents indicated that the anticipation of improved business levels, expansions, and other seasonal factors depending on the sector, would support the expected growth in employment.

Hotels, however, cited competition from the international brands coming into the Kenyan market and closure of more rooms for refurbishments as reasons prohibiting employment growth in 2019, while other non-bank private sector firms cited decrease in sales, high operational costs and adoption of new technology in running daily business as reasons for not increasing staffing levels in 2019.

Chart 12: Perceptions (July/August) and Expectations (September/October) of Economic activity (percent of respondents)

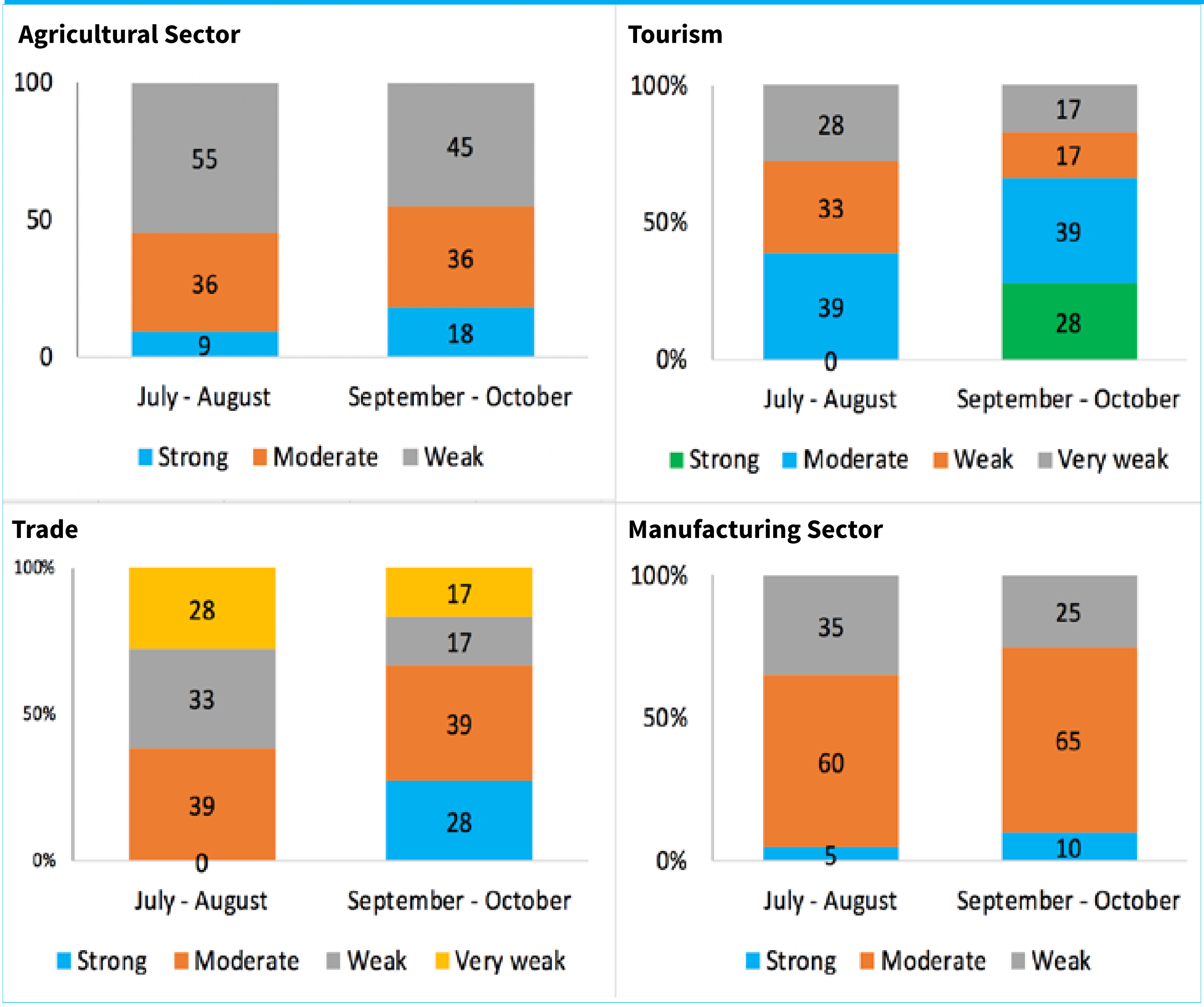


Chart 13: Expected changes in employment levels by banks in 2019 (percent)

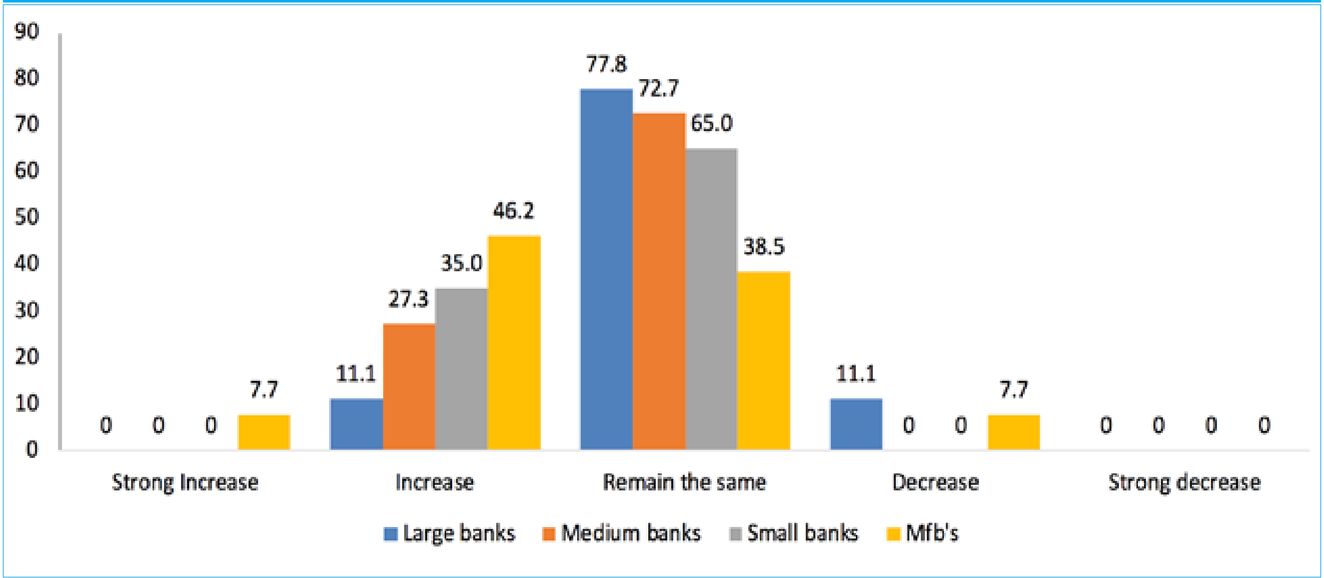
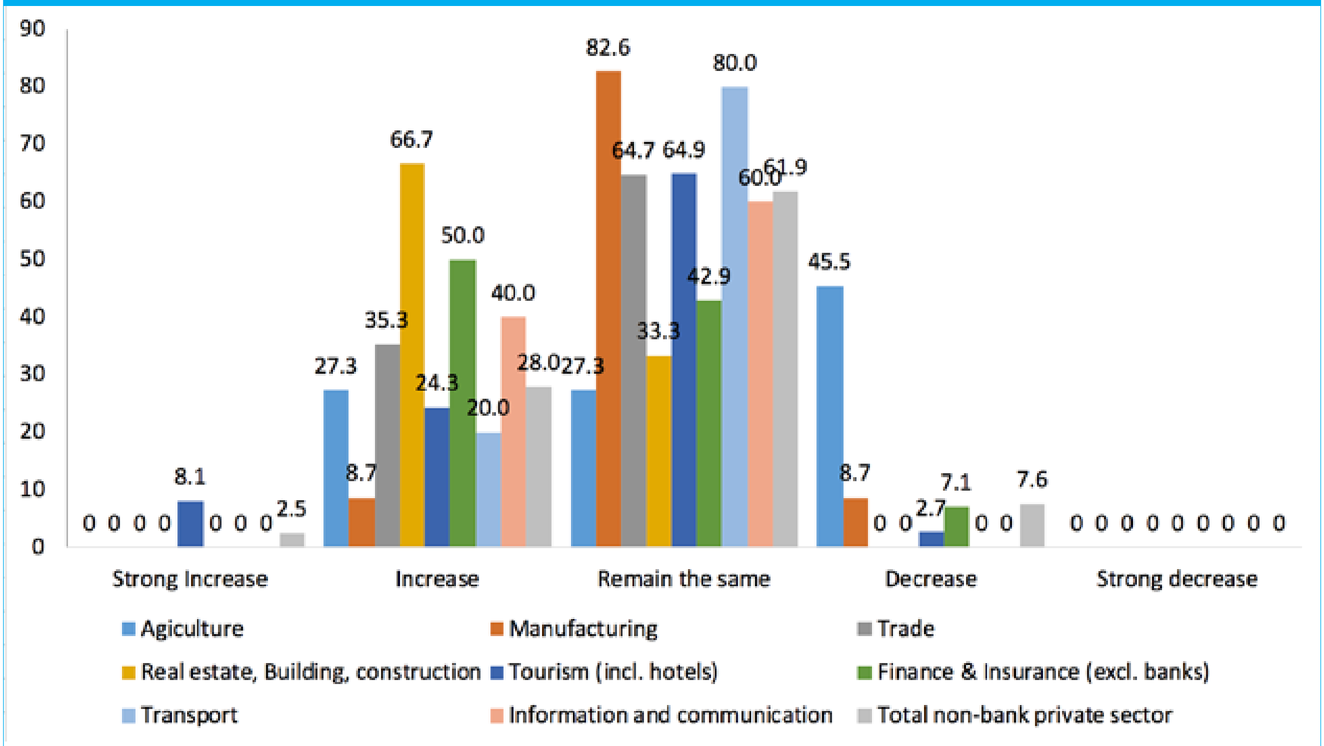


Chart 14: Expected changes in employment levels by non-bank private firms in 2019 (percent)



9. ECONOMIC GROWTH EXPECTATIONS

The Survey requested the participants to indicate their expected economic growth rate for the country in 2019. Respondents expressed expectations of strong growth in 2019, supported by Government investment in enabling Big 4 agenda, sustained growth in manufacturing, recovery in agriculture, infrastructure developments and construction, expansions in telecommunication and transport **(Table 2).** Other factors included diversification of export base, driven by onset of blue economy, innovation among the youth, returning business confidence, regional integration, stable macroeconomic environment, political stability and sustained fight against corruption,.

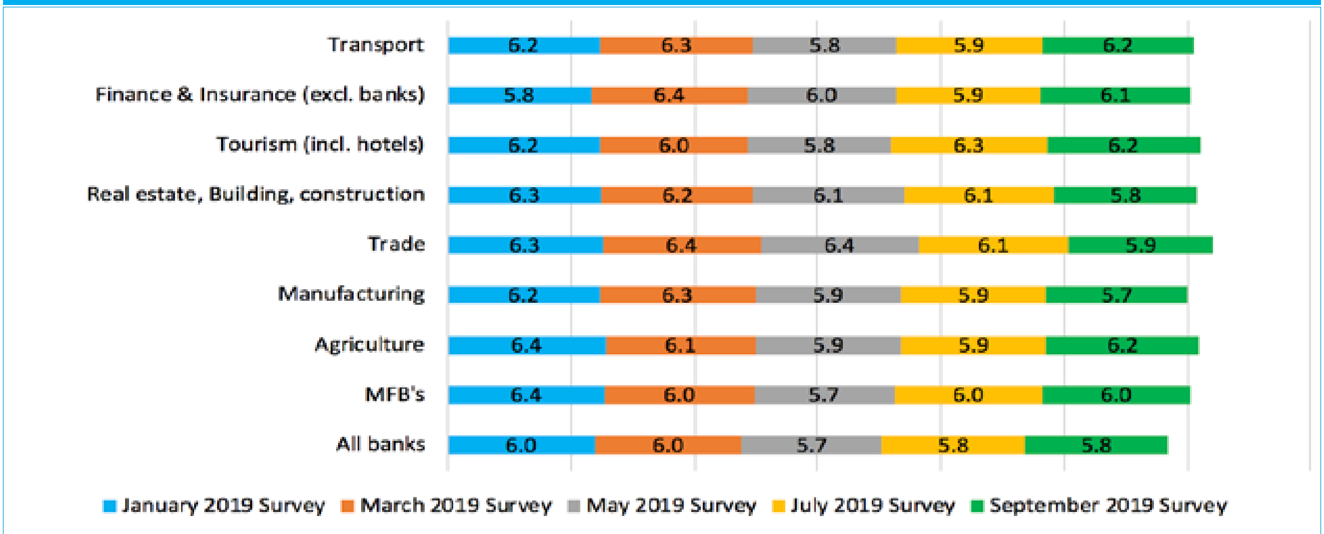
However, respondents indicated that lower growth in the first quarter of 2019, low credit flows to private sector, reduced export earnings due to lower prices internationally, a slow industrial sector, uncertainties with regard to the short rains, fiscal consolidation and delayed payments to private sector by Government, could slow down growth in 2019.

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

A sectoral analysis of economic growth expectations showed that respondents across the different sectors expected economic growth to remain strong in 2019 (Chart 15). Hotels reported increased bookings in the first half of the year and expected the trend to continue for the remainder of the year with increased international arrivals. Respondents from the transport sector lauded the improvement in infrastructure.

Chart 15: Expectations on Economic Growth for 2019 across Sectors (percent)



10. OPTIMISM ON THE ECONOMIC PROSPECTS

10.1. Economic Prospects

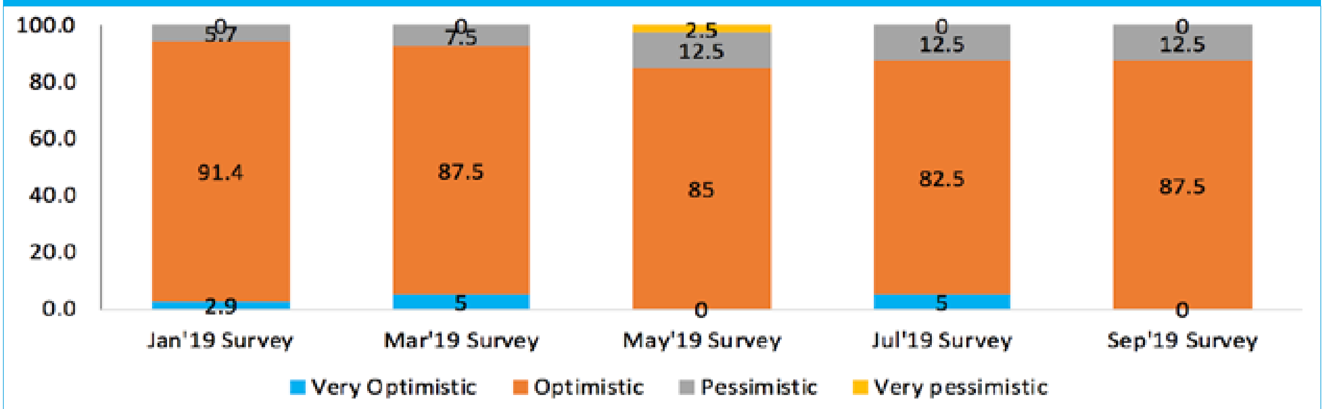
In the September 2019 Survey, banks and non-bank private sector firms' were asked how optimistic/ pessimistic they were regarding country's economic prospects **(Charts 16 and 17).** The results showed sustained optimism by respondents across banks and nonbank private sector firms.

Banks remained optimistic about the country's economic prospects, citing the implementation of the Big 4 agenda projects, ongoing infrastructure developments, commitment to settling pending bills by the Government, improved current account deficit and improved weather conditions as reasons for their optimism. In addition, inflows of foreign currency from diaspora, improved private sector credit growth, improvement in Kenya's ranking in the World Bank Doing Business Indicators, a diversified economy, a stable macroeconomic environment, political stability and fight against corruption were expected to contribute positively towards economic growth in the country.

However, respondents cited interest rate capping law, trade wars between USA and China unpredictable weather patterns, delayed payments of pending bills and weak private sector lending as risks to this optimism. Among reasons given by some banks for their pessimism was the effect of the delayed long rains in Q1 and fiscal consolidation

The non-bank private sector firms' optimism about the country's prospects was based on the Government's commitment to the implementation of the Big 4 Agenda, which is expected to spur development in the country, infrastructure development, improved agricultural exports and manufacturing, which is projected to grow with the Rebate Program which so far has seen industries save up on energy costs. Respondents cited the commercial mining of oil, intra-Africa integration, low interest rates, direct flights to the US and France and improved tourism, stable macroeconomic environment, political stability and the sustained fight against corruption, as key to the private sector's optimism on the economy.

Chart 16: Optimism by Banks on Economic Prospects, Going Forward (percent)



Risks to the optimism expressed by the non-bank private firms included the slower than anticipated roll out of Government projects, relatively low private sector credit growth, a weak performance of a number of companies, high taxation in some counties, high rate of corruption, interest rate capping and increased external debt obligations,

The Trade sector respondents cited the increase in operational costs and numerous taxes, especially in counties, as informing their pessimism, while those from the real estate sector were concerned about higher energy costs and delays in Government funds disbursements to projects affecting consumption of key inputs **(Chart 18).**

Chart 17: Optimism by Non-Bank Private Firms on Economic Prospects Going Forward (percent)

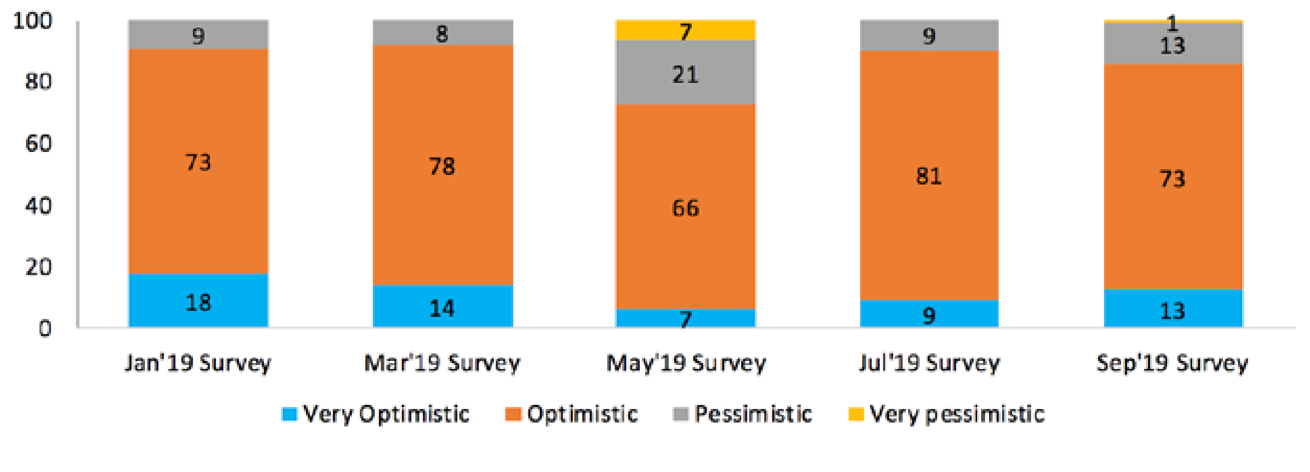
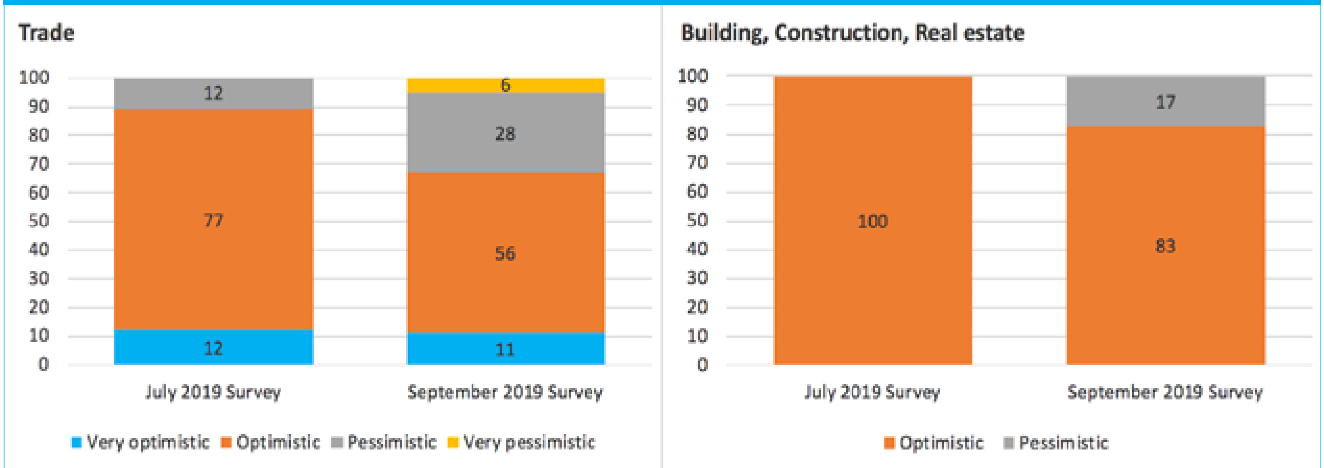


Chart 18: Optimism for Kenya's economic prospects by Non-bank private firms (percentage)



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 September to December 2019. The Survey results showed higher average forward hotel bookings for September to December 2019 compared to a similar period in 2018 **(Charts 19 & 20).** According to respondents, the forward bookings are likely to increase because most locals book very close to the travelling dates. The bookings consisted of leisure bookings over the peak season by residents and foreigners. Bookings were, however affected by unfavourable weather (rains) for tourists in some areas and high competition due to increased bed capacity.

Chart 19: Forward Hotel Bookings for September-December 2019 Survey (percent of total capacity)

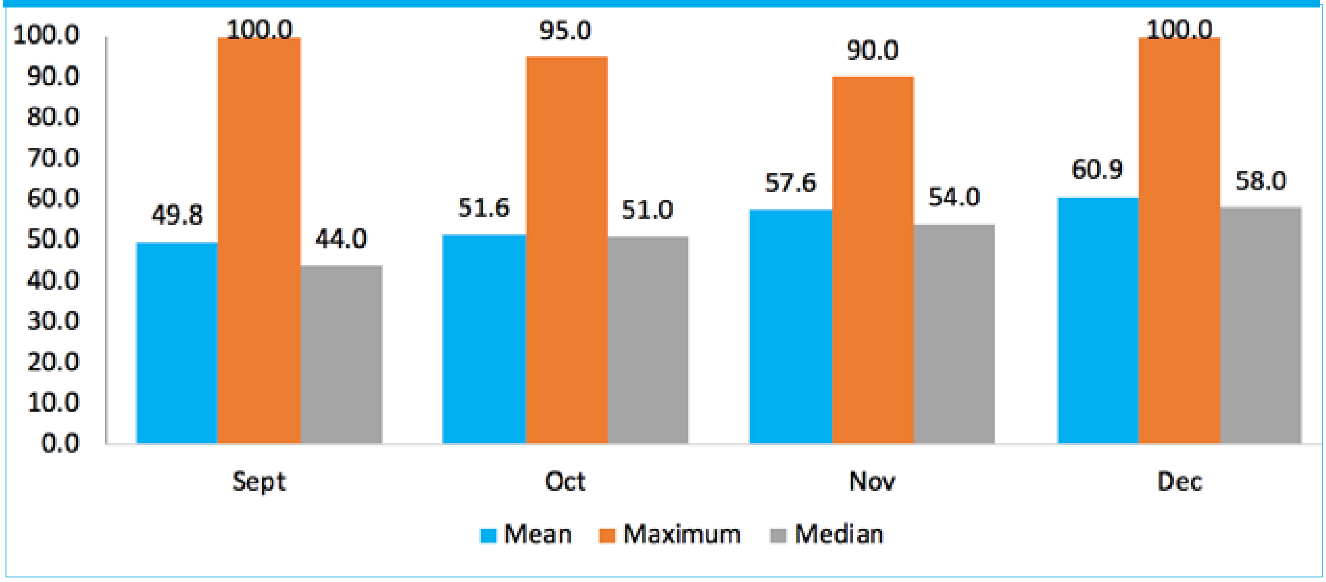
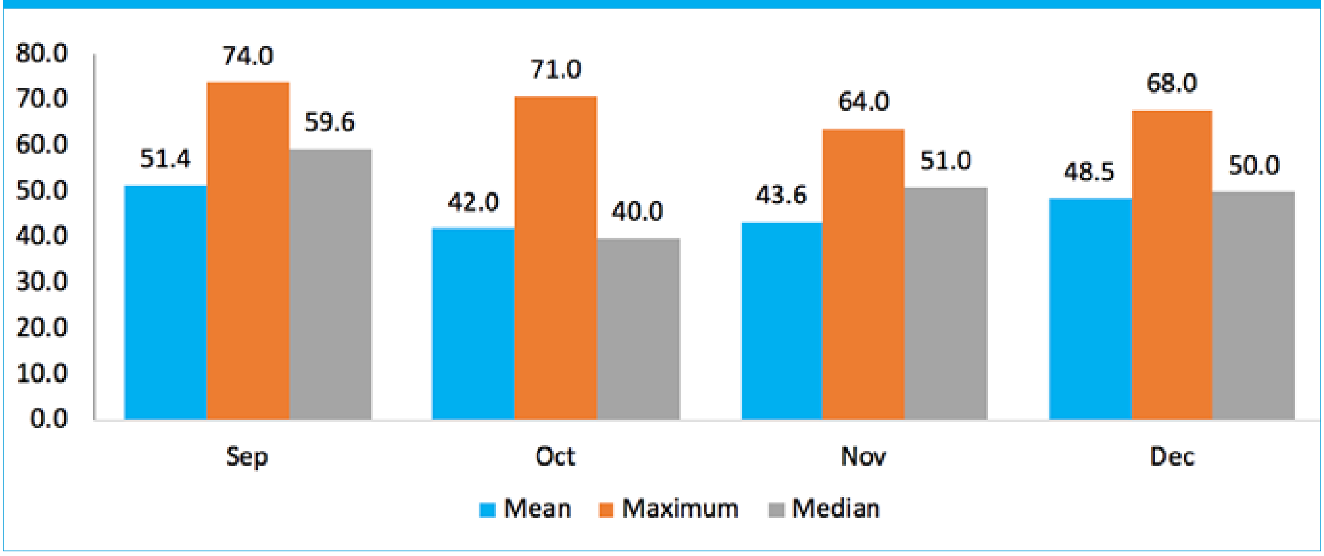


Chart 20: Forward Hotel Bookings for September-December 2018 Survey (percent of total capacity)



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 to review the interest rate capping law to enhance access to credit by small businesses, to put in place supportive credit policies to increase private sector lending and timely payments of public sector suppliers by the Government. In addition, reduction of the cost of doing business, especially the cost of recovery on distressed facilities through speedier resolution in courts and bringing in house legal work, and the sustained fight against corruption were mentioned as actions that would go a long way in improving the business environment. Other suggestions included efforts to improve security to support tourism, reduce congestion at the Port and reduction of the budget deficit.

The non-bank private firm respondents suggested that lower interest rates would allow more access to loans for investments, especially for SMES, hence reducing the cost of finance. They suggested that the Government should encourage the youth to take up agriculture through promoting it as a viable alternative, encourage the use of new technologies in production, improve security and involve corporate engagements through public, private partnerships. Additionally, respondents cited that increased tourism marketing by Government, payment of pending bills by Government to contractors, enhancing tax revenue mobilization to support government spending, blocking/ stopping cheap counterfeit exports and sustained fight against corruption would go far in improving the business environment.

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