Central Bank of Kenya

REPORT OF THE MONETARY POLICY COMMITTEE MARKET PERCEPTIONS SURVEY MARCH 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 how the business environment could be improved.

Commercial banks, micro-finance banks, and a sample of non-bank private sector firms are covered in the surveys. A sample of non-bank private firms is taken from selected towns across the country namely 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 Technology (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 March 2019 MPC Market Perceptions Survey was conducted in the first three weeks of the month. It sought perceptions on the economic conditions prevailing in January and February 2019, as well as market expectations for the following two months (March and April 2019), and over the next 12 months (March 2019 – February 2020). Respondents were asked to provide their expectations with regard to overall inflation, exchange rate of the Kenya Shilling against the U.S. Dollar, demand for credit, private sector credit growth and economic growth. The Survey also sought to establish the significance of bank lending to the private sector through the mobile loan platform. Other areas interrogated included the levels of optimism in the economic prospects, perceptions of economic activity before, and expectations after the MPC meeting, as well as movements in input prices before the MPC meeting.

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

2. SURVEY METHODOLOGY

The Survey was administered through questionnaires sent by email and hard copy, to the Chief Executives of 381 private sector firms comprising of 39 operating commercial banks, 1 mortgage finance institution, 13 micro-finance banks (Mfbs) and 328 non-bank private firms including 45 hotels. The overall response rate to the March 2019 Survey was 67 percent of the sampled institutions. The respondents comprised of 39 commercial banks, 1 mortgage finance institution, 13 micro-finance banks, 38 hotels, and 164 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 analysed 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.

3. HIGHLIGHTS OF THE SURVEY

According to the March 2019 Market Perceptions Survey:

- Inflation expectations were revised downwards, and remained well anchored within the target range in the next 2 months and over the next 12 months.
- Banks and non-bank private sector firms expected the Shilling to remain stable against the U.S. Dollar in March and April 2019.
- Banks expected a stronger growth in private sector credit in 2019 relative to the January 2019 Survey.
- Respondents expected growth to be strong in 2019.
- There was sustained optimism on Kenya's economic growth prospects, going forward.

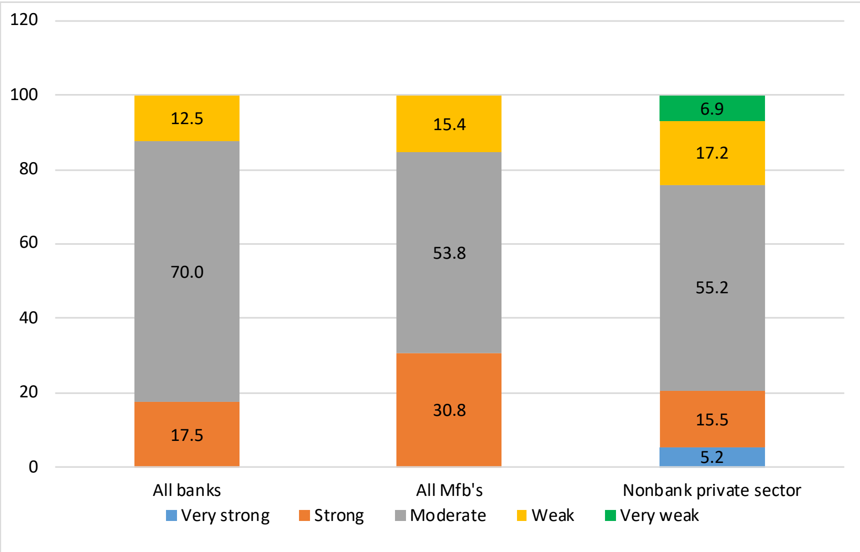
4. CURRENT ECONOMIC CONDITIONS

4.1 Overall Economic Activity

Banks and non-bank private sector firms were asked to provide their assessment of economic activity in January and February 2019. Most (53-70%) respondents indicated that economic activity during the period was moderate, characterised by modest demand partly due to seasonal factors following the December holidays **(Chart 1).** The non-bank private sector had mixed expectations ranging from very strong to very weak. Economic activity during the period was supported by the on-going investments in public infrastructure, trade, manufacturing and transport, relatively lower fuel prices, increased Government spending, improved investor confidence, and a stable macroeconomic environment.

Production levels in agriculture were, however, lower due to reduced activities occasioned by the dry weather conditions in most parts of the country, while the flower sector benefited from Valentine's day and International Women's day orders. Business activity during the period was partly constrained by slow private sector credit growth, and reduced food production due to the dry weather.

Chart 1: Perceptions on Economic Activity for January and February 2019 (percent)



4.2: Input prices

The private sector firms were asked to indicate the direction of change (increase/decrease) in the prices of various inputs such as energy, transportation costs, raw materials, labour, freight charges and construction materials, in January and February 2019. Except for freight charges, which remained largely unchanged, respondents reported marginal increases in the prices of all other inputs **(Table 1).**

Table 1: Perceptions on Movements in input prices in January – February 2019 (percent of respondents)

	Significant increase	Marginal increase	Remain the same	Marginal decline	Significant decline
Energy costs	22.2	40.0	15.6	13.3	8.9
Transportation costs	15.6	40.0	33.3	6.7	4.4
Raw materials	4.9	43.9	41.5	9.8	0.0
Labour	11.1	41.7	38.9	5.6	2.8
Freight charges	19.4	27.8	44.4	8.3	0.0
Construction materials	5.9	58.8	29.4	5.9	0.0

5. INFLATION EXPECTATIONS

Participants in the Survey were asked to indicate their expectations of overall inflation rates for the next 2 months (March and April 2019), and in the next 12 months (March 2019 to February 2020). The results showed a downward revision in the expectations for the next 2 months by banks and non-bank private sector firms **(Table 2).** Respondents expected inflation to remain within the target range (5 ± 2.5 percent).

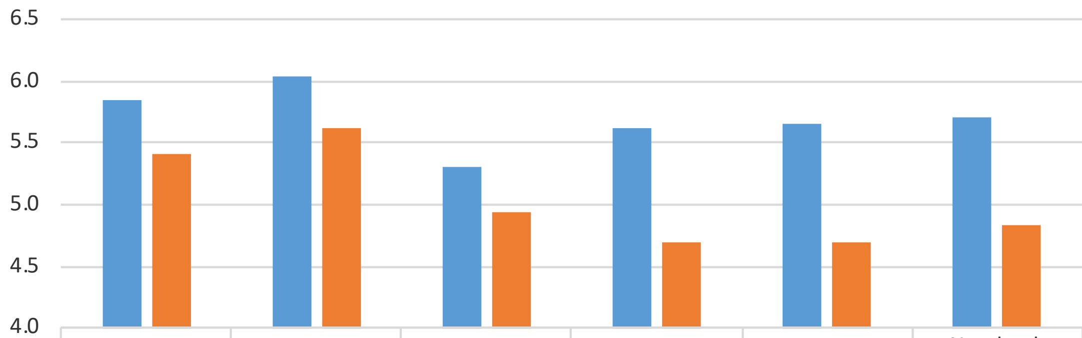
Respondents attributed the lower inflation expectations to expected stability in food prices with the anticipated long rains, and the relatively low oil prices. The long rains were also expected to boost hydro-electricity generation, thereby keeping electricity costs low. In addition, respondents indicated that the stable exchange rate in the year so far, would contribute to keeping inflation low in the next two months. According to respondents, risks to inflation in the next 2 months (March - April) included the recent upward increase in fuel prices following the rise in international oil prices, and possible delay in the onset of the long rains which could exert upward pressure on food prices.

Inflation expectations by banks and non-bank private firms over the next 12 months were also revised downwards in the March 2019 Survey **(Chart 2).** Respondents attributed the downward revision in inflation expectations to fairly stable food prices on the back of a good harvest in 2018 and predicted long rains in 2019, which are expected to support lower prices of food in the second and third quarter of the year. Other factors expected to support low inflation over the next 12 months include lower electricity prices, a stable Shilling and prudent monetary policy. Risks to inflation over the next 12 months could arise from delayed long rains, a surge in international oil prices and any demand push factors as economic activity picks momentum.

Table 2: 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
Mar-Apr 2018	4.4	4.8	4.6	4.5	4.6	4.8
May-Jun 2018	4.2	3.9	3.7	4.1	3.9	3.8
Jul-Aug 2018	4.9	4.6	4.6	4.8	4.8	4.4
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

Chart 2: Expected Overall Inflation for the next 12 months (percent)



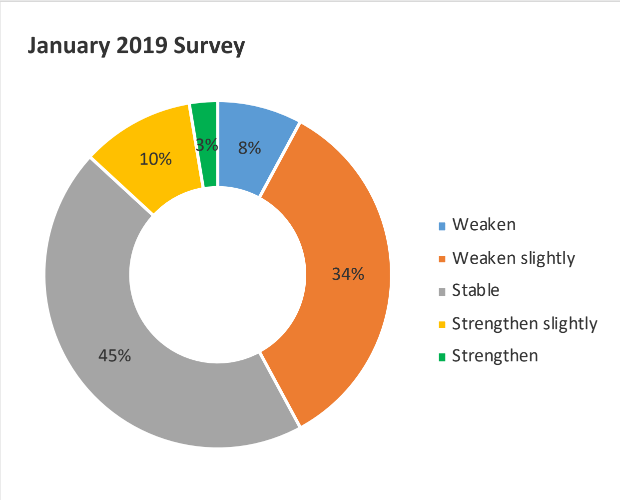
	All banks	Large banks	Medium banks	Small banks	MFB's	Non-bank private firms
January 2019 Survey	5.8	6.0	5.3	5.6	5.6	5.7
March 2019 Survey	5.4	5.6	4.9	4.7	4.7	4.8

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 March and April, 2019. The Survey results showed that banks expected the exchange rate of the Shilling against the U.S. Dollar to remain stable with a strengthening bias in the next two months supported by strong diaspora remittances, resilient tea and horticultural exports, improved investor confidence, adequate foreign exchange reserves (which are expected to provide a sufficient buffer) and expected increase in foreign direct investment inflows **(Chart 3).** Banks indicated that the main risks to the stability of the Shilling were; the strengthening of the U.S. Dollar against emerging economies' currencies, slowdown of growth in China, uncertainties around Brexit, seasonal dollar demand for dividend repatriation by global and regional corporates, rise in international oil prices, expected higher import demand as the economy picks up, and concerns over higher foreign debt repayments.

Similarly, non-bank private sector firms expected the Shilling to remain stable against the U.S. Dollar with a strengthening bias in the next 2 months supported by strong diaspora remittances, strong inflows from tea and horticultural exports, increased appetite for local infrastructural projects by international partners such as China and France, increase in foreign investments and improved tourism earnings. The strong foreign exchange reserves, and the reduction in oil import costs due to lower international oil prices are expected to provide adequate cover and buffer against short-term shocks, riding on political stability **(Chart 4).** According to the respondents, the main risks to the stability of the Shilling were a likely slow-down in agricultural exports especially tea in case of prolonged dry weather conditions, rise in international oil prices, and increased demand for with a pickup of the economy.

Chart 3: Banks expectations on the direction of the Shilling/ USD Exchange rate in the next 2 months (percent)



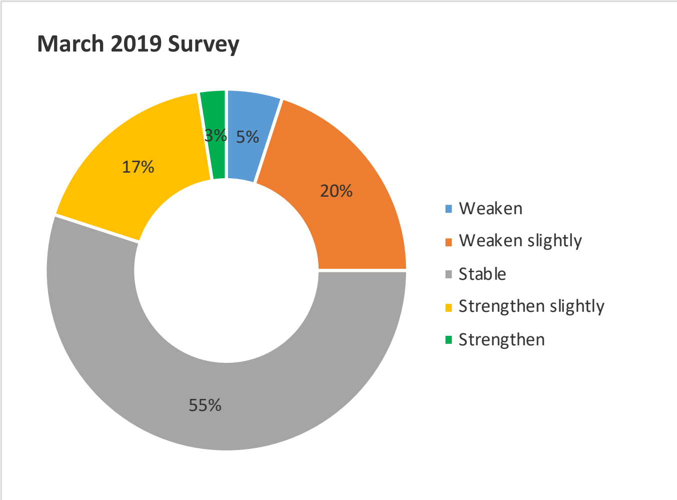
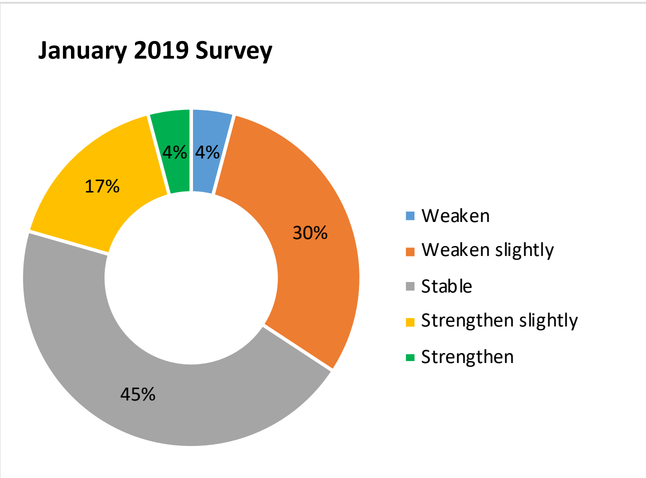
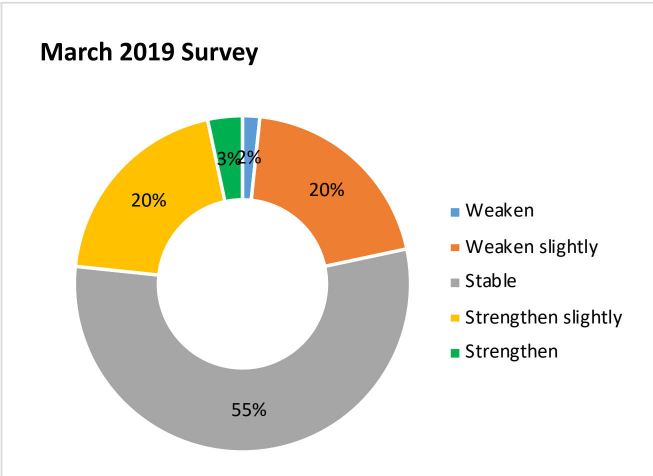


Chart 4: Non-bank private sector firms' expectations on the direction of Shilling/ USD Exchange rate in the next two months (percent)





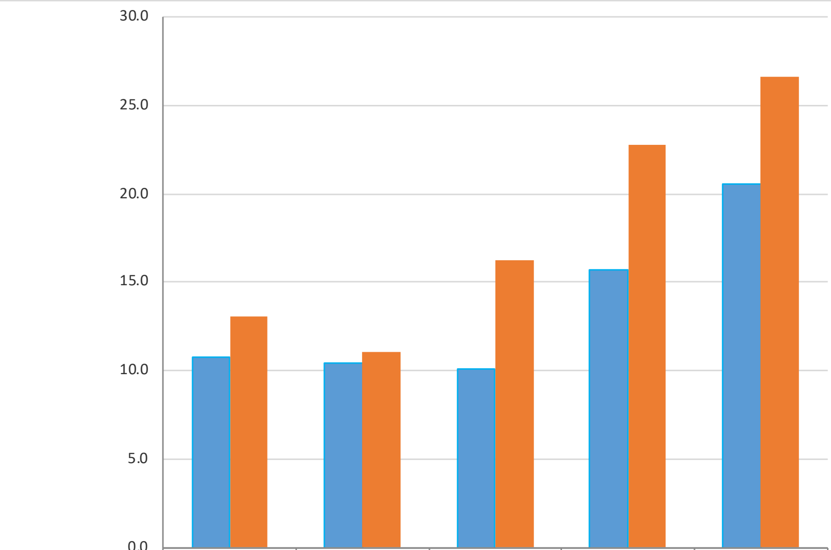
7. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

7.1 Growth in Private Sector Credit in 2019

Commercial banks were asked to indicate their expectations with regard to private sector credit growth in 2019 relative to 2018. The Survey results showed an upward revision in private sector credit growth expectations for 2019 **(Chart 5).** Respondents attributed this expected increase to, among others, increased demand to finance consumption and investment by both firms and households, opportunities offered by the Big 4 Agenda, expected settlement of accumulated private sector dues and investments in public sector development projects. The possibility of a repeal of interest rate capping, reduced cost of funds due to removal of minimum deposit interest rate, an improved business environment and stable macroeconomic environment are also expected to support enhanced economic activity and consequently growth in private sector credit.

Respondents, however, indicated that pricing risk, delayed payments to suppliers of both county and national governments, increase in the number of digital unregulated lenders, and tighter lending standards due to non-performing loans in the sector were the main risks to private sector credit growth in 2019.

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



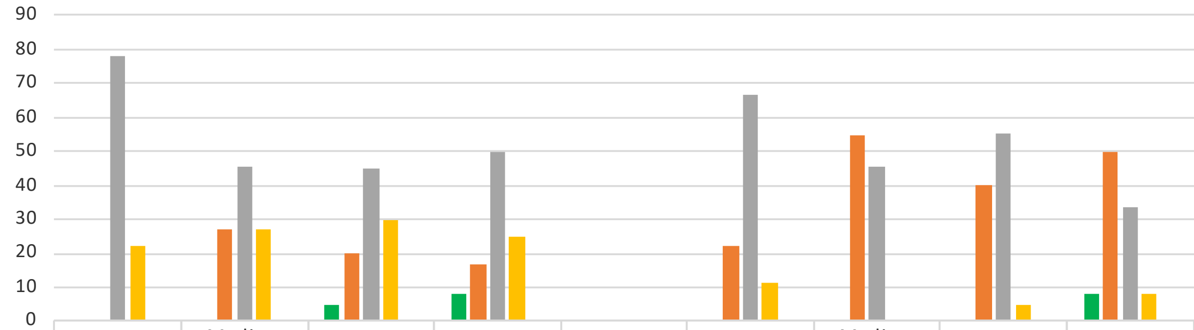
	All banks	Large banks	Medium banks	Small banks	Microfinance Banks
January 2019 Survey	10.8	10.5	10.1	15.7	20.5
March 2019 Survey	13.1	11.1	16.3	22.8	26.6

7.2. Expectations on Demand for Credit by banks

Commercial banks were asked to give an assessment of the demand for credit by the private sector in January and February 2019, and their expectations for credit demand in March and April. According to the respondents, credit demand in January and February was moderate, driven by funding needs related to the commencement of the school calendar, opportunities offered by the Big 4 Agenda and an improved business environment which was enhanced by lower political risk and an improved economic outlook **(Chart 6).**

Respondents expected a higher demand of credit in March and April, supported by increased Government spending as the financial year progresses, opportunities presented by the Big 4 agenda, expectations for higher economic growth, lower interest rates, lower political risk, and expected demand for loans by farmers in March and April which coincides with the long rains. In addition, respondents pointed out that most businesses actualised their budgets in March and April and indicated the need to supplement their capital with bank loans, and that credit demand from the manufacturing sector was expected to pick up as the sector continued to benefit from lower energy costs. These factors, together with the high appetite for credit by Micro, Small and Medium Sized Enterprises (MSMEs) and the stable macro-economic environment were expected to support an increase in the demand for credit in March and April.

Chart 6: Credit demand perceptions (January and February) and expectations (March and April) by banks (percent)



	Perceptions on credit demand in Jan-Feb					Expectations on credit demand for Mar - Apr			
	Large banks	Medium banks	Small banks	MFB's		Large banks	Medium banks	Small banks	MFB's
Very high	0	0	5.0	8.3		0	0	0	8.3
High	0	27.3	20.0	16.7		22.2	54.5	40.0	50.0
Moderate	77.8	45.5	45.0	50.0		66.7	45.5	55.0	33.3
Low	22.2	27.3	30.0	25.0		11.1	0	5	8.3
Very low	0	0	0	0		0	0	0	0

7.3. Non-bank private sector expectations on demand for credit (percent)

Non-bank private sector firms were asked to indicate their level of demand for credit in 2019, and also provide an indication of the proportion of their demand for credit that is met/satisfied every year **(Chart 7).**

The results showed that the expected credit demand from hotels was rated as high to very high which was attributed to the need to finance expansion, refurbishment and upgrading of facilities, in addition to running operations as hotels endeavoured to match competition from new upcoming hotels. Wholesale and retail trade sector respondents reported a high demand for credit mainly through supplier's credits and loans from financial institutions to finance their operations. Manufacturers indicated moderate demand for credit which was largely to finance their operations, undertake maintenance, and expand their operations. Respondents in the financial (excluding commercial and Microfinance banks) and insurance sectors indicated lower demand for credit as they relied mainly on internally generated funds.

According to the Survey, the proportion of credit demand met every year by the non-bank private sector varied according to sectors **(Chart 8).** Respondents from finance and insurance (excluding banks) and manufacturing sectors indicated that they are able to get about 80 percent of their credit demand from banks, while hotels, real estate and agriculture sectors recorded a lower percentage of their credit demand met mainly due to their higher risk perceptions by lenders.

Chart 7: Credit demand by Non bank private sector firms for 2019 (percent)

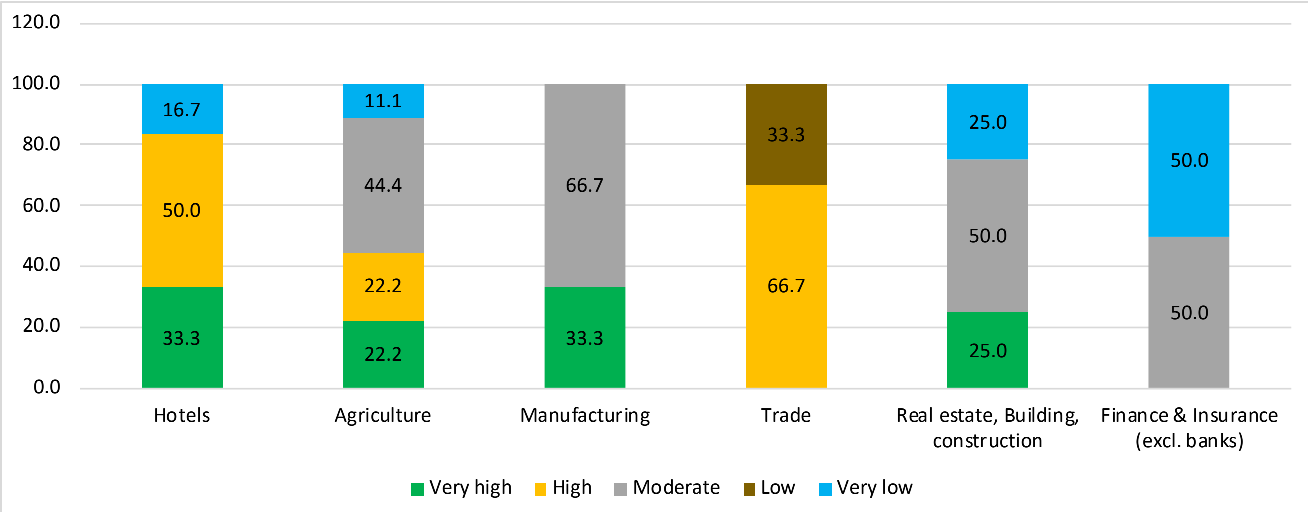
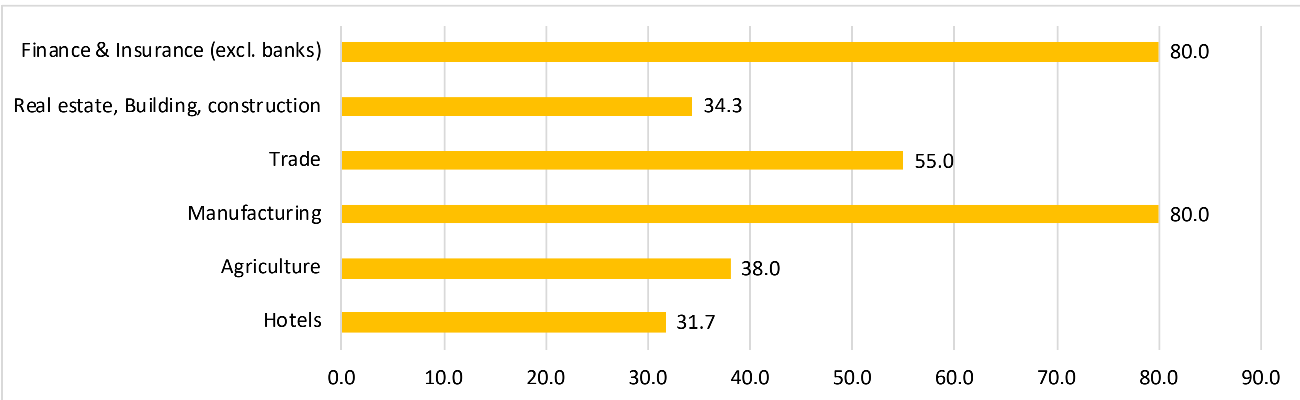


Chart 8: Proportion of Credit demand realised every year (percent)



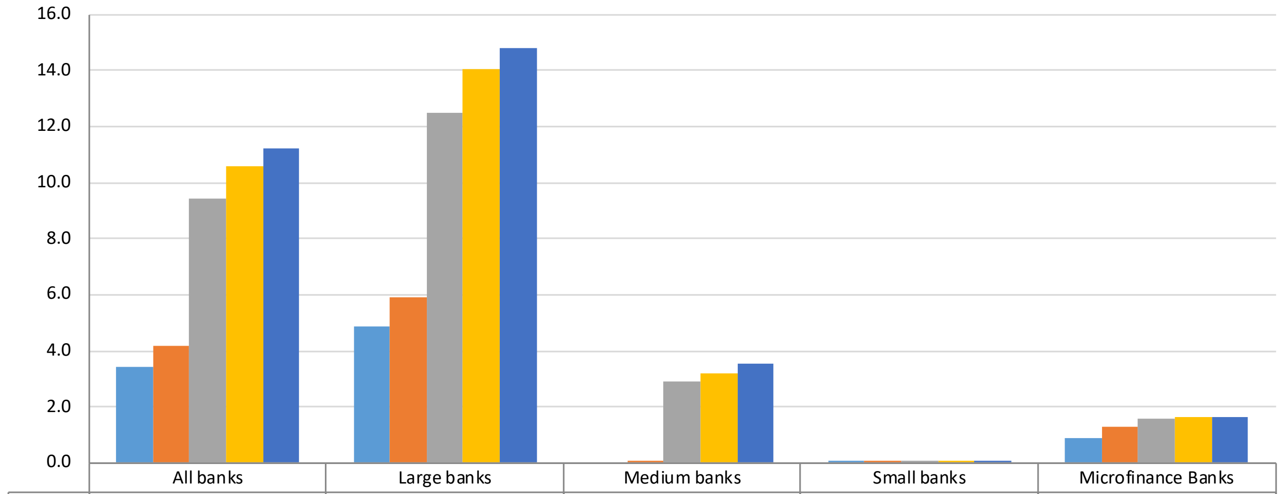
7.4. Evolution of bank lending via the mobile loan platform

Banks were asked to indicate the proportion of their lending to the private sector extended through the mobile loan platform. The results showed a significant increase in the proportion of mobile loans to total loans by banks in 2018 **(Chart 9).** The increase was primarily driven by four banks (3 large and 1 medium). According to the respondents, the increase in digital lending was enabled by the introduction of new digital products with features that appealed to borrowers such as top-up loans, borrow and repay within a day, roll-over up to 60 days, and the convenience both in terms of time taken and ability for borrowers to access loans anywhere and anytime.

Respondents pointed out that digital lending was driven by credit scoring models that leverage on data from multiple sources including banking history, mobile transactions, repayment history, fulfilment of promises to pay from collections systems data and Credit Reference Bureau scores.

Respondents from medium and small banks, however, indicated that the uptake of mobile loans has been slow, attributing it to the competitive market positions held by the digital lending market leaders. Microfinance banks proportion of mobile to total lending remained flat during the period. Banks, however, expected mobile loans to remain key in their business going forward.

Chart 9: Mobile loan lending platform (percent of total lending)



	All banks	Large banks	Medium banks	Small banks	Microfinance Banks
Dec-16	3.4	4.9	0.0	0.0	0.9
Dec-17	4.2	5.9	0.0	0.0	1.3
Dec-18	9.5	12.5	2.9	0.0	1.6
Jan-19	10.6	14.0	3.2	0.0	1.6
Feb-19	11.2	14.8	3.5	0.0	1.6

8. ECONOMIC ACTIVITY AND EMPLOYMENT

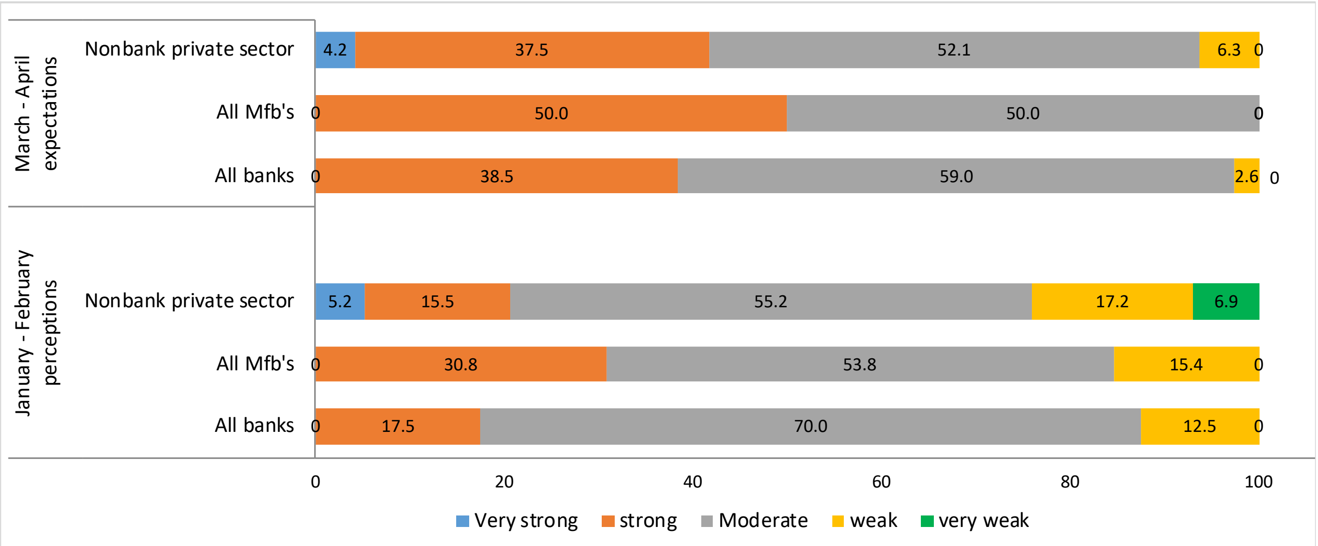
8.1. Expected Economic Activity

Banks and non-bank private sector firms were asked to indicate their expected levels of economic activity in March and April 2019. The Survey results showed expectations of increased economic activity in March and April, compared to that in January and February **(Chart 10).** Respondents expect moderate to strong economic activity in the period driven by loan growth and deposit mobilization by banks, implementation of business budgets by bank customers, activities around the Government's Big 4 Agenda which are expected to provide investment opportunities in manufacturing, housing, agriculture and health care, the anticipated long rains which were expected to support agriculture, and expected disbursement of funds to suppliers by county and national governments and the private sector.

In addition, the Government is expected to enhance implementation of its policies and projects as the end of the financial year approaches, while growth in most service sector activities was expected to be supported by the strong consumer demand, a conducive business environment, stable macroeconomic and political environment.

Respondents indicated that while economic activity was expected to pick up, low access to credit, delayed payment of outstanding obligations by both national and county governments and other private sector players, and concerns with regard to corruption continued to constrain business activity in the economy.

Chart 10: Perceptions (January and February) and Expectations (March and April) on Economic Activity (percent)

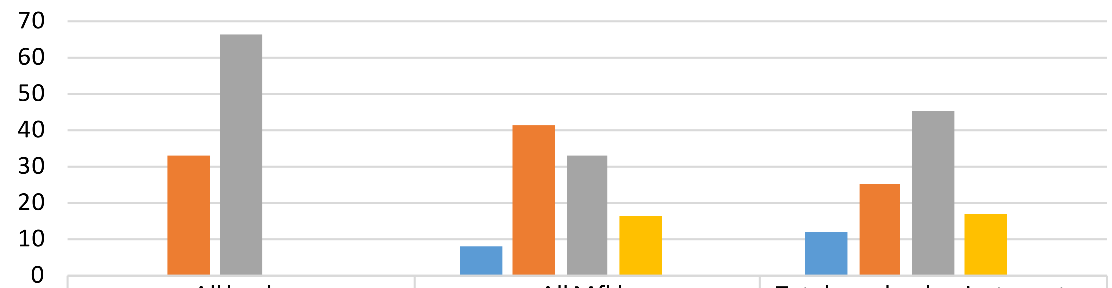


8.2: Employment Expectations

On their institutional employment prospects in 2019, close to 70% of the banks and non-bank private sector firms indicated that employment was expected to either remain at the current staffing levels, or increase in 2019 **(Chart 11).**

According to the respondents, growth in employment levels were expected to be driven by the opening up of new branches, the need to enhance service delivery, the need to increase capacity to manage the increased portfolios in banks, and the anticipated increase in business levels with improving infrastructure and economic growth by the non-bank private firms. Bank respondents, however, pointed out that the digitization of banking industry products, processes and business models were expected to enhance efficiency and hence dampen the demand for new hires.

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



	All banks	All Mfb's	Total non-bank private sector
Strong Increase	0	8.3	11.9
Increase	33.3	41.7	25.4
Remain the same	66.7	33.3	45.8
Decrease	0	16.7	16.9
Strong decrease	0	0	0

9. ECONOMIC GROWTH EXPECTATIONS

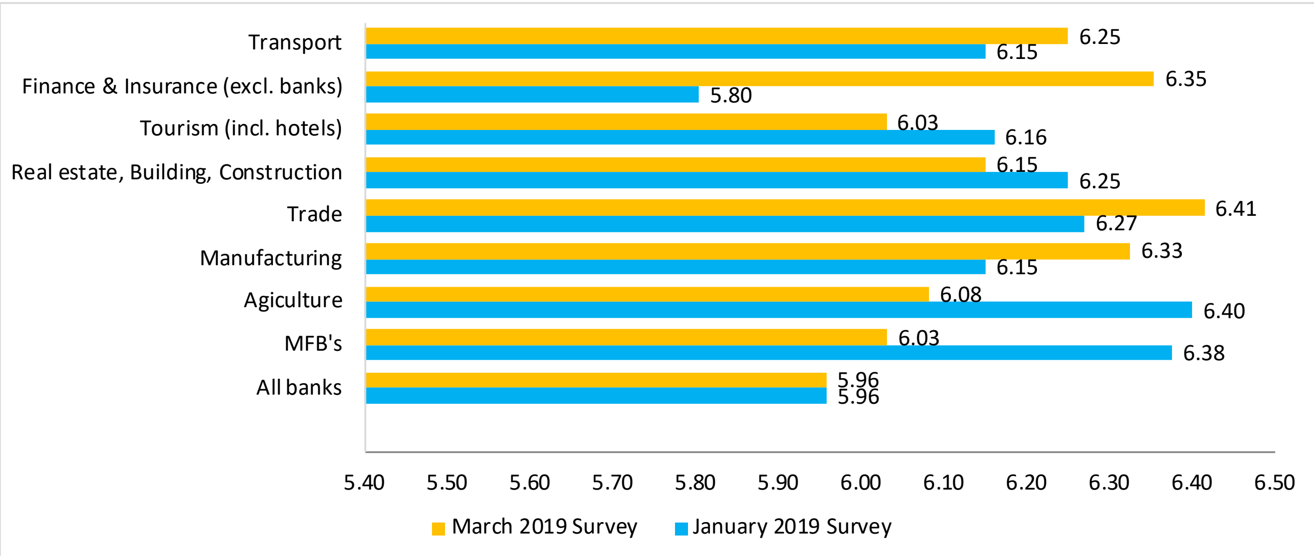
Participants were asked to indicate their expected economic growth rate for the country in 2019. Respondents remained positive on the growth prospects for the country **(Table 4 and Chart 12).** They expected economic growth to remain strong, supported by a boost in agricultural output due to expectations of favourable weather, public infrastructure investments, implementation of the Big 4 Agenda, a resilient services sector and improvement in the tourism industry. Furthermore, the relatively low international oil prices, benefits from diversification of the country's export base partly driven by onset of investments in the Blue Economy, expected strengthening of economies in Sub-Saharan Africa, improved business confidence, political stability and a stable macroeconomic environment were expected to contribute to robust growth in 2019. Respondents in the manufacturing, transport, finance and insurance sectors excluding banks, and trade sectors revised upwards their growth expectations for 2019 in the March 2019 Survey.

According to respondents, the downside risks to economic growth included the delay/insufficient rainfall in the long rain season, effects of the fiscal consolidation, the external investor sentiment arising from the USA/China trade tensions, slowdown of growth in China, fears of a global recession in 2019, uncertainties around Brexit, a slow private sector credit growth, and delays in payment of suppliers.

Table 4: 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

Chart 12: Expectations on Economic Growth for 2019 across Sectors (percent)



10. OPTIMISM ON THE ECONOMY

10.1. Economic Prospects and Improvement in the Business Environment

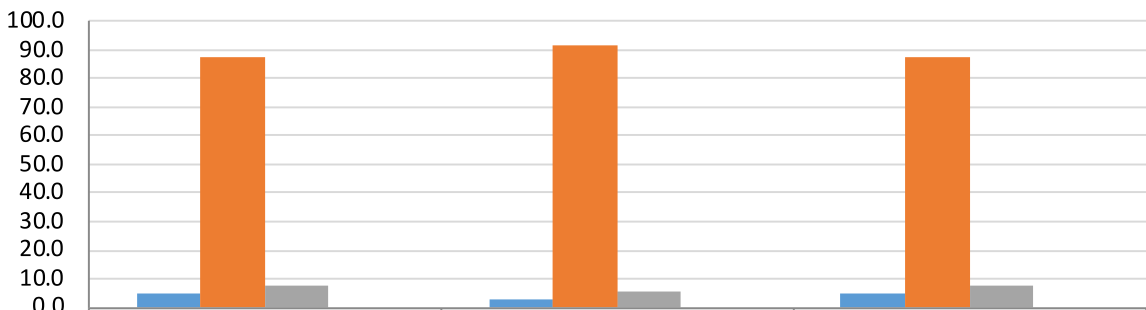
Analysis of banks and non-bank private sector firms' responses on levels of optimism on the country's economic prospects and improvements in the business environment are presented in **Charts 13 and 14.** The results showed sustained optimism by respondents across banks and non-bank private sector firms.

Bank respondents expected increased agricultural output as a result of the predicted favourable weather conditions, and re-energized economic growth momentum arising from the public infrastructure investments and the implementation of the Big 4 Agenda, which was expected to support recovery of manufacturing, housing, health and transport sectors. Additionally, the steady export flows from tea and horticulture products, stable energy prices, improved tourism, increase in foreign investments due to improved investor confidence, and political stability, were cited as reasons for the optimism. Bank respondents also indicated that expectations of a review of the interest rates capping law, ongoing fight against corruption and the stable macroeconomic environment was a source of the optimism.

Risks to the optimism included the possibility of a delay or insufficient rains, possible slowdown of economic growth due to fiscal consolidation, delays in payment of overdue invoices by central and county Governments, subdued credit expansion to the private sector, and political noise. External risks cited included fears of a slowdown in global growth, slower growth in China and the uncertainties around Brexit.

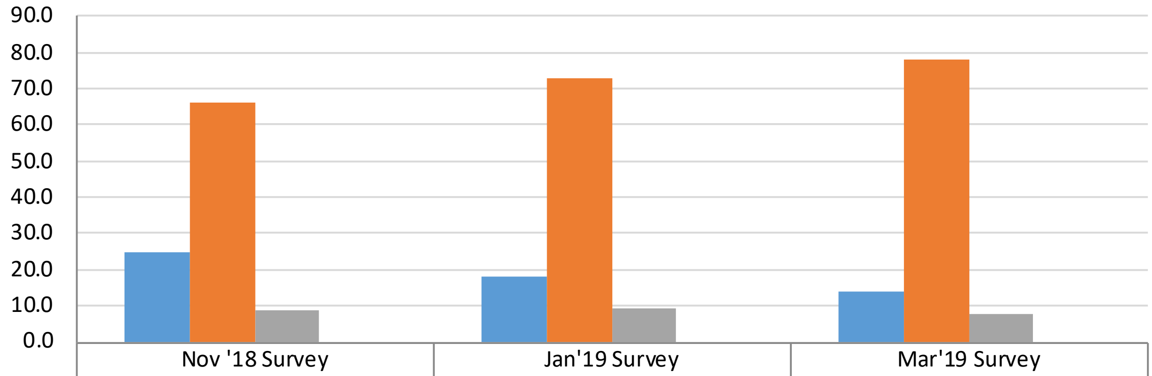
Non-bank private firms also remained optimistic about Kenya's economic prospects and improvements in the business environment, citing favourable weather conditions, realization of infrastructure development projects including railway, energy and airstrips in the counties, expected growth in the tourism sector boosted by direct flights to the USA and France, increase in foreign direct investments and improved investor confidence as key to their optimism. Development of new products leveraging on technology, expected improved access to credit by MSMEs, political stability, the renewed fight against corruption, stable macroeconomic environment and a positive economic outlook were also mentioned as reasons for their optimism. According to respondents, risks to their optimism included the unpredictable weather patterns, delays by the central and county governments in paying suppliers, and lack of access to credit by MSME's due to interest rate capping.

Chart 13: Optimism by Banks on Economic Prospects and Improvement in the Business Environment Going Forward (percent)



	Nov '18 Survey	Jan'19 Survey	Mar'19 Survey
Very Optimistic	5.0	2.9	5.0
Optimistic	87.5	91.4	87.5
Pessimistic	7.5	5.7	7.5
Very pessimistic	0	0	0

Chart 14: Optimism by Non-Bank Private Firms on Economic Prospects and Improvement in the Business Environment Going Forward (percent)



	Nov '18 Survey	Jan'19 Survey	Mar'19 Survey
Very Optimistic	25.0	18.2	14.1
Optimistic	66.0	72.7	78.1
Pessimistic	9.0	9.1	7.8
Very pessimistic			

10.2. Forward Hotel Bookings

Hotels were requested to provide levels of monthly forward bookings received so far for the period March to June 2019. Forward hotel bookings remained largely stable relative to a similar period in 2018, due to increased bed capacity with establishment of new hotels in addition to the upcoming mid- to - high - booking season (Charts 15 and 16). The bookings represented mostly local and international conference bookings.

Chart 15: Forward Hotel Bookings for March-June 2019 Survey (percent of total capacity)

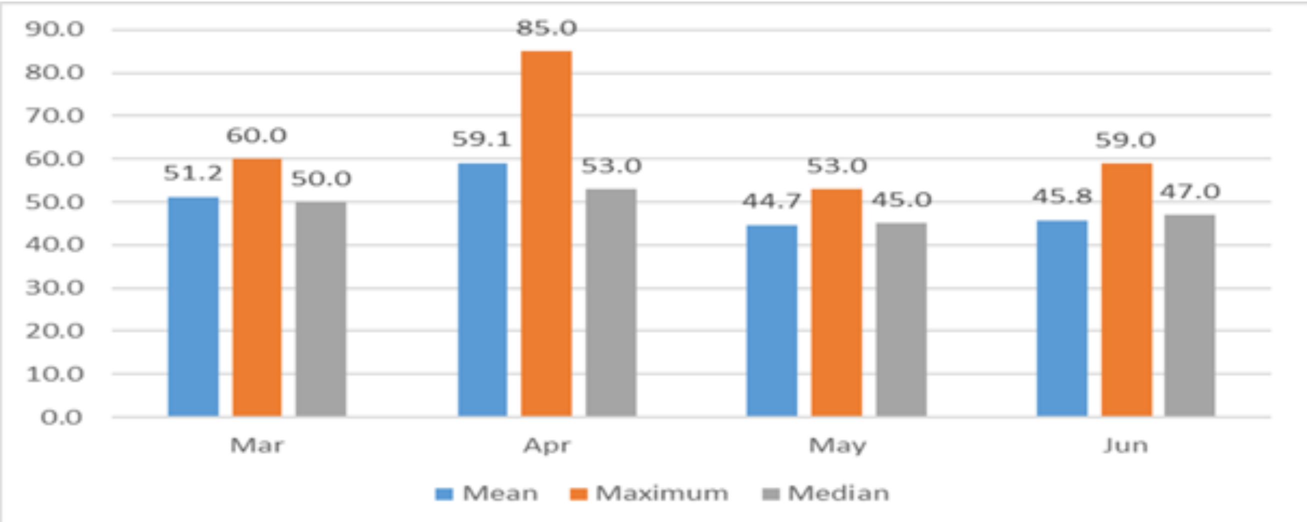
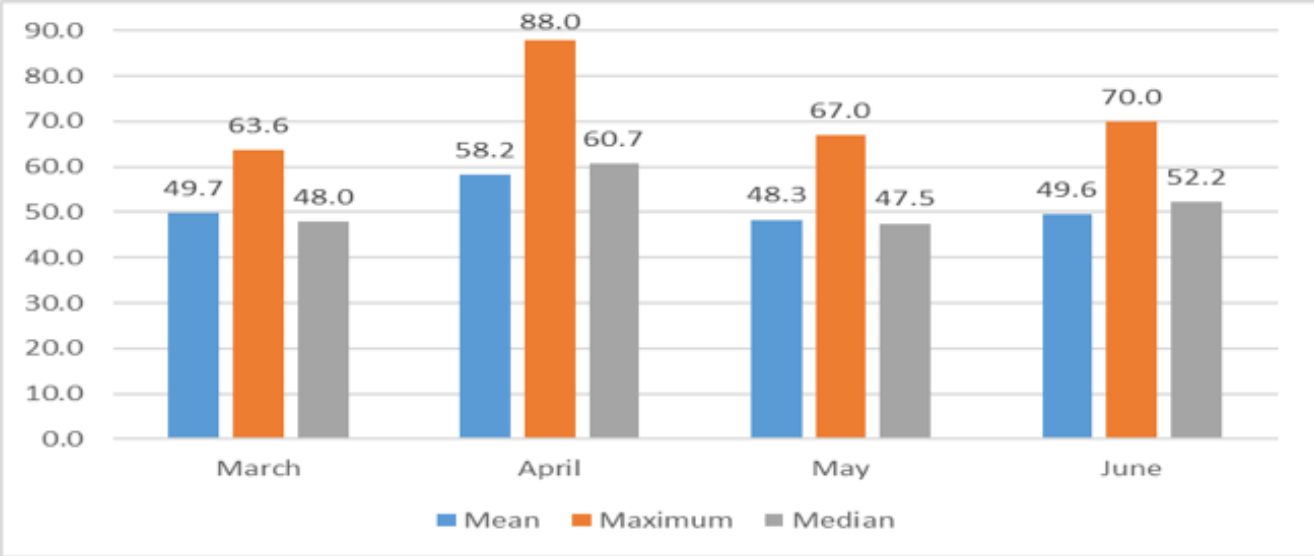


Chart 16: Forward Hotel Bookings for March-June 2018 Survey (percent of total capacity)



11. 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.

Bank respondents raised concerns on the need to review the law capping interest rates to facilitate effective pricing of risk and increase credit access by small businesses, and the need for coordinated efforts to address cybercrime in order to engender trust and confidence in the financial system. Other concerns included the need to broaden the tax base to cover MSMEs in order to grow tax revenues, timely payments to public sector suppliers by county and national governments as well as the private sector, expedite implementation of Movable Property Security Rights Act, 2017 which would be key to private sector credit lending by providing alternative collaterals for securing loans. Other suggestions included fast-tracking the implementation of the Commodities Exchange to spur rapid agrarian transformation from peasant and subsistence farming to commercial agriculture, offer guarantees on funding to key economic sectors like agriculture and manufacturing, and reduction in government borrowing from domestic market.

The non-bank private firms' respondents indicated the need to review the interest rate capping law in order to support increased access to bank credit. The non-bank private sector respondents indicated that the empowerment of development finance institutions would increase lending to the unreachable sectors of the economy.

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