Central Bank of Kenya

Monetary Policy Committee Market Perceptions Survey

November 2020

CONTENTS

1. BACKGROUND TO THE MARKET PERCEPTIONS SURVEYS

The Central Bank of Kenya (CBK) undertakes a Market Perceptions Survey, 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, demand for credit, 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, Meru and Kisii, is representative of sectors that account for over 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.

2. INTRODUCTION

The November 2020 MPC Market Perceptions Survey was conducted in the first three weeks of the month. It aimed at getting perceptions of respondents on selected economic indicators for the previous two months (September and October), and expectations for the next two months (November and December), the next one year (November 2020 – October 2021), two years (November 2020 – October 2022), and five years (November 2020 – October 2025).

The Survey also inquired about the levels of demand for credit and economic conditions prevailing in September and October 2020, and expectations on the same for the next two months. In addition, the Survey interrogated market expectations on inflation, economic growth, lending rates, exchange rate of the Kenya Shilling against the U.S. Dollar and private sector credit growth.

Other areas surveyed included the levels of optimism in the economic prospects over the next 12 months and expectations regarding employment levels.

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

3. SURVEY METHODOLOGY

The Survey targeted 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 November 2020 Survey was 63 percent of the sampled institutions. The respondents comprised 38 commercial banks, 1 mortgage finance institution, 13 micro-finance banks, 43 hotels, and 145 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.

4. HIGHLIGHTS OF THE SURVEY

The Key takeaways from the November 2020 Market Perceptions Survey included:

- Optimism in the country's economic prospects continued to improve with the reopening of the economy;
- Respondents expect economic activity to increase in November and December;
- The proportion of firms expecting to lay off employees declined with improving economic activity;
- Banks expect an increase in private sector credit growth in 2020; and
- Inflation expectations remain well anchored within the target range.

5. ECONOMIC ACTIVITY

The November 2020 Market Perceptions Survey sought bank and non-bank private sector firms' assessment of economic activity in September and October 2020, and their expectations for November and December.

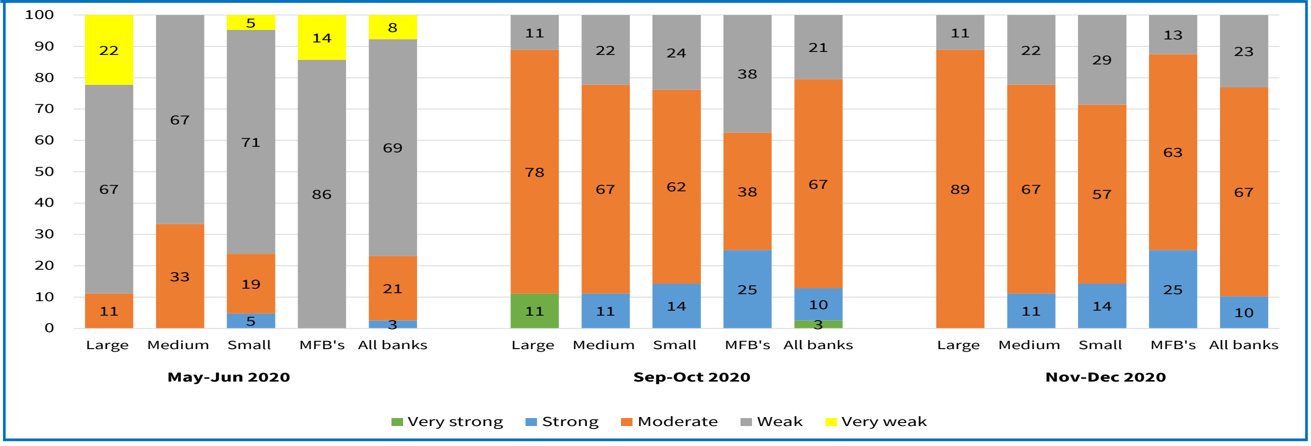
5.1 Economic activity perceptions and expectations by banks

Bank respondents expected improved economic activity in November and December **(Chart 1).**

Respondents expected a gradual improvement in the level of economic activity in most sectors with the easing of restrictions and opening up of businesses, implementation of the Government economic stimulus, strengthening external demand in Europe and Middle East, and expected higher spending during the holiday season. In addition, respondents cited high private consumption, a pick-up in industrial activity, improved performance in the services sector and announcements of the COVID-19 vaccines as reasons for the expected pick-up in economic activity.

However, respondents highlighted the renewed lockdown measures to manage the second spike in infections in some countries, slow resumption of education, travel and tourism, and weak private sector credit growth as risks to the expected increase in economic activity.

Chart 1: Perceived and expected economic activity by banks (percent)



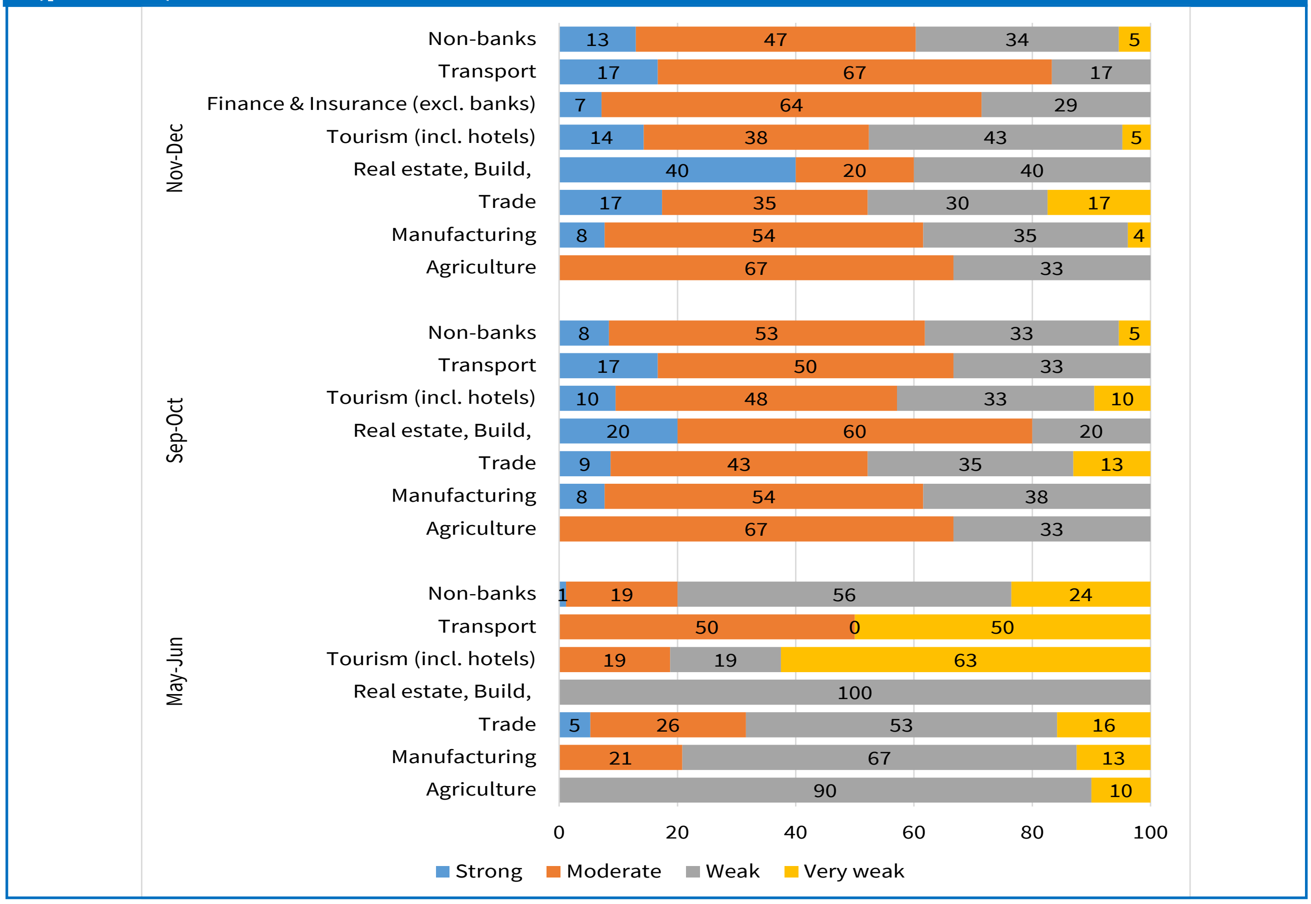
5.2 Economic activity perceptions and expectations by non-bank private firms

Non-bank private sector respondents expected an improvement in economic activity in November and December largely due to further relaxation of the COVID-19 restrictions **(Chart 2).**

In addition, respondents expected favourable weather conditions, the approaching festive season, growth in credit to the private sector, implementation of Government infrastructure projects and the recent allocation of funds to the county governments to impact positively on economic activity.

However, respondents cited challenges in access to credit, increase in fuel prices, unemployment and reduced disposable income, as risks to expected economic activity.

Chart 2: Perceived and expected economic activity by non-bank private firms (percent)



6. EXPECTED CHANGES IN EMPLOYMENT

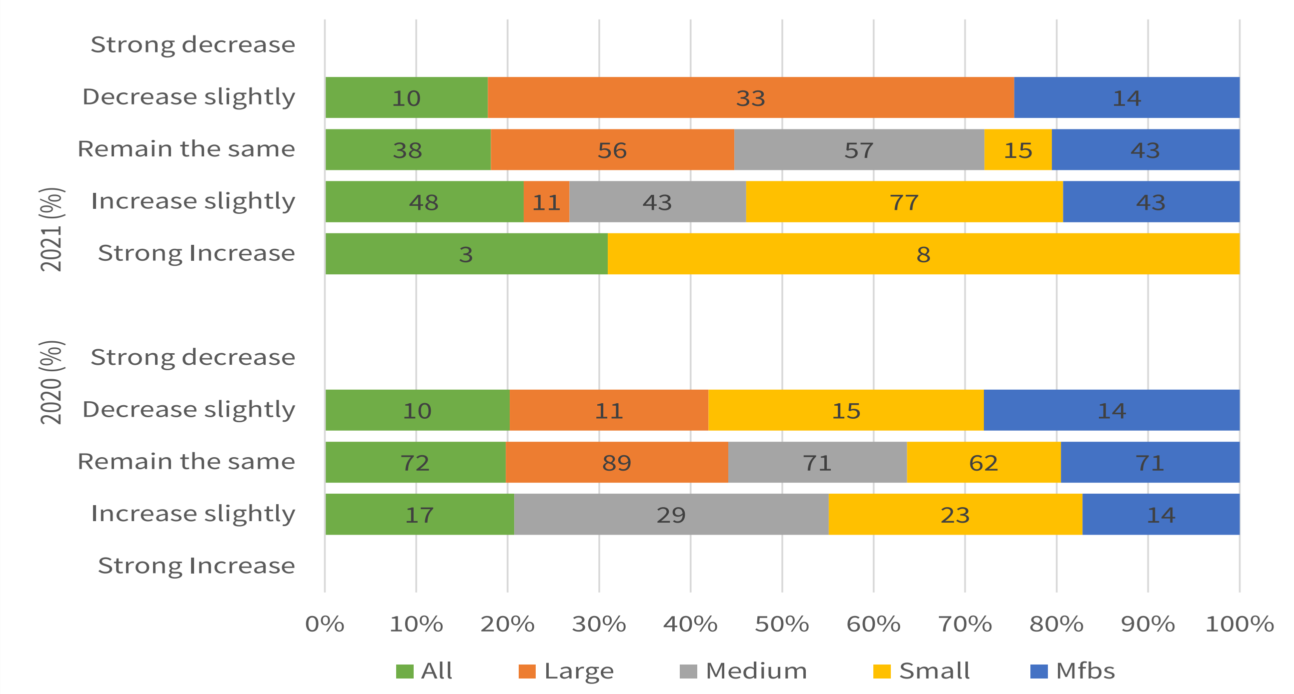
6.1. Expected changes in employment by banks

Bank respondents were asked to indicate their expectations with regard to changes in the number of employees in their respective institutions in 2020 relative to 2019, and employment expectations for 2021. Banks largely expected to retain their workforce in 2020, with some reporting plans to open new branches, and hire new staff before the end of the year, and increase employment levels in 2021 with economic recovery post- COVID-19 **(Chart 3).**

Respondents expected to increase employment levels in 2021 to support the anticipated increase in demand for credit after containment of the pandemic, for their respective banks to grow in tandem with expected economic growth, and the need for manpower to manage new products and business reorganizations that were delayed in 2020 due to the pandemic.

However, some banks did not expect new hires in light of the negative business impact of the COVID-19 pandemic and continued investment in automation and widening of digitally anchored customer service channels, with focus on improving efficiency.

Chart 3: Expected changes in employment levels by banks in 2020 and 2021 (percent)



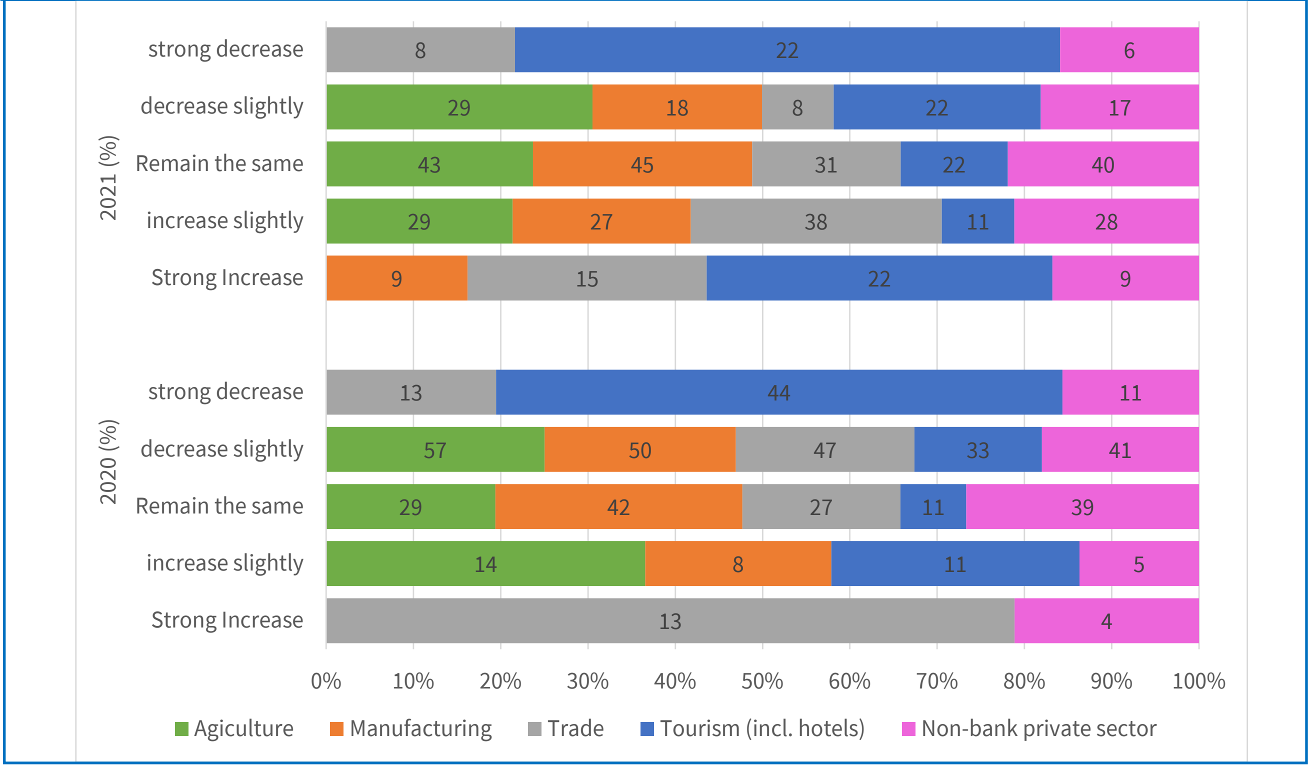
6.2: Employment expectations by non-bank private sector

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, and expectations for 2021 **(Chart 4).**

Respondents from the different sectors expected to increase employment levels with increased business and product demand as the economy recovered from the impact of the COVID-19 pandemic.

However, some respondents expected to keep the number of active employees lower than the optimal levels citing prolonged effects of the pandemic, deferment of expansion plans until after 2021, lack of funds to engage new employees, digitization, which has enabled more work to be done by fewer people, poor business performance and lower consumer spending.

Chart 4: Expected changes in employment levels by non-bank private firms in 2020 and 2021 (percent)



7. EXPECTED ECONOMIC GROWTH

The Survey requested participants to indicate their expected economic growth rate for the country for the years 2020, 2021, and 2022-2024.

7.1. Economic growth expectations for 2020

Respondents expected economic growth to be low in 2020. Banks maintained their growth expectations from the previous survey while non-bank respondents revised their economic growth expectations slightly downwards **(Table 1).**

Bank respondents expected 2020 growth in most sectors to be impacted adversely by the COVID-19 pandemic, through supply chain disruptions, closures due to restrictions to contain the pandemic, reduced demand and potential change towards risk averseness in consumer behaviour. Additionally, respondents expected the slow credit growth to affect economic growth in 2020.

Nevertheless, respondents expect robust agricultural production, the gradual lifting of COVID-19 restrictions, implementation of the Economic Stimulus Package and other fiscal measures, and returning business confidence supported by a turnaround in key sectors of the economy to support growth in 2020.

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
Sep-20	1.2	2.7	2.8	1.6	3.1	2.3
Nov-20	1.2	3.2	2.4	1.6	2.3	2.1

Similarly, non-bank respondents expected economic growth in 2020 to be negatively impacted by the pandemic. Respondents indicated that the pandemic had caused significant supply and demand shocks in key sectors of the economy, especially tourism related industries (aviation, hospitality) due to the containment measures locally and internationally. Other negative outcomes which respondents expected to negatively impact growth, included low business, loss of jobs and livelihoods, low Government spending and reduced disposable income. In addition, respondents cited slow private sector lending, business closures and profit warnings by some companies due to reduced activities, as reasons for the lower economic growth in 2020.

However, respondents expected strong agricultural growth and gradual reopening of businesses to offset negative COVID-19 effects **(Charts 5a & 5b).**

Chart 5a: Expectations on economic growth for 2020 across sectors (percent)

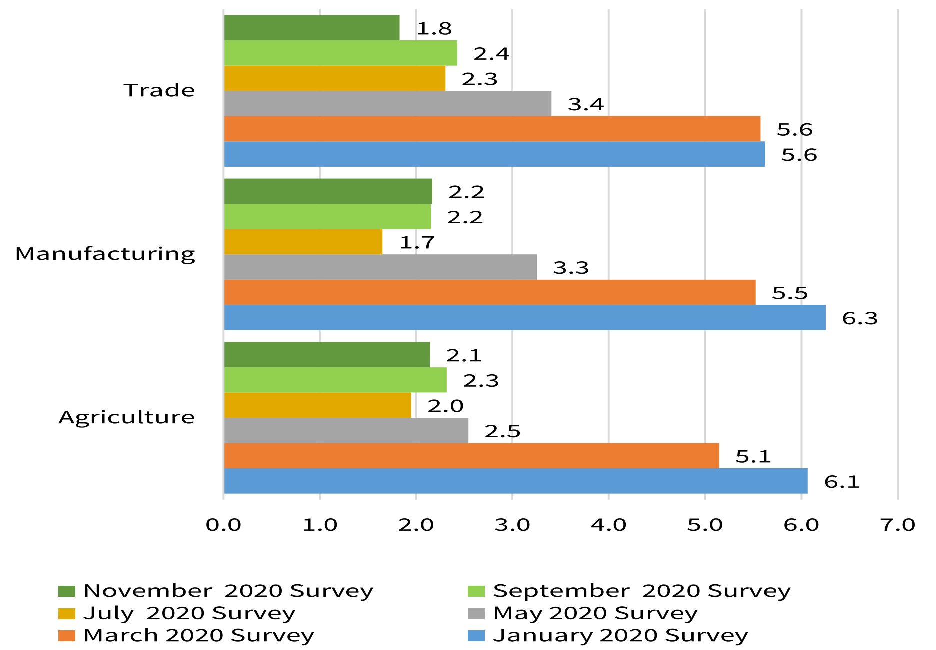
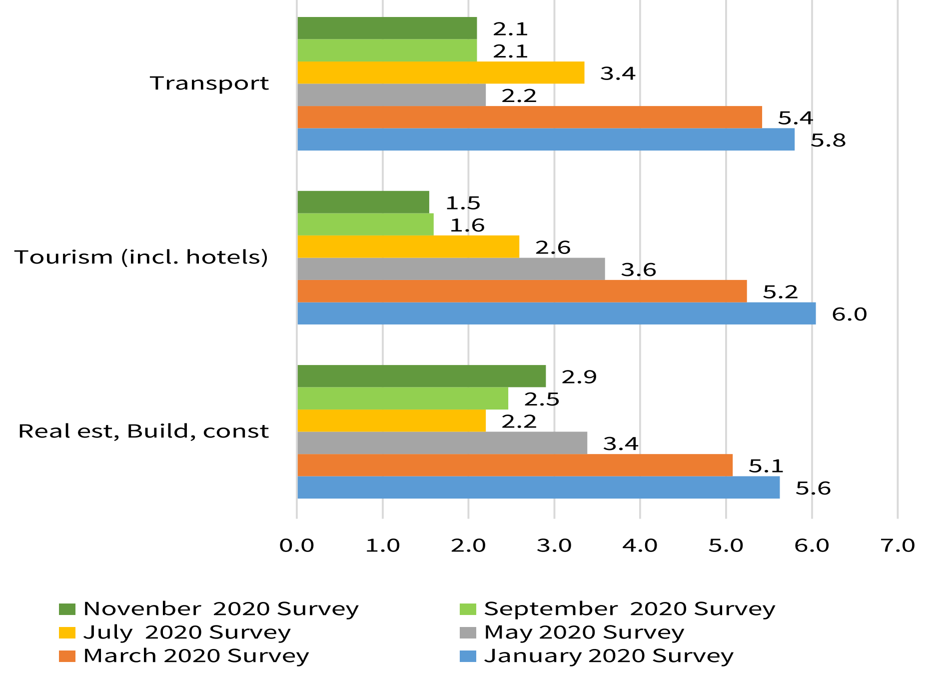


Chart 5b: Expectations on economic growth for 2020 across sectors (percent)



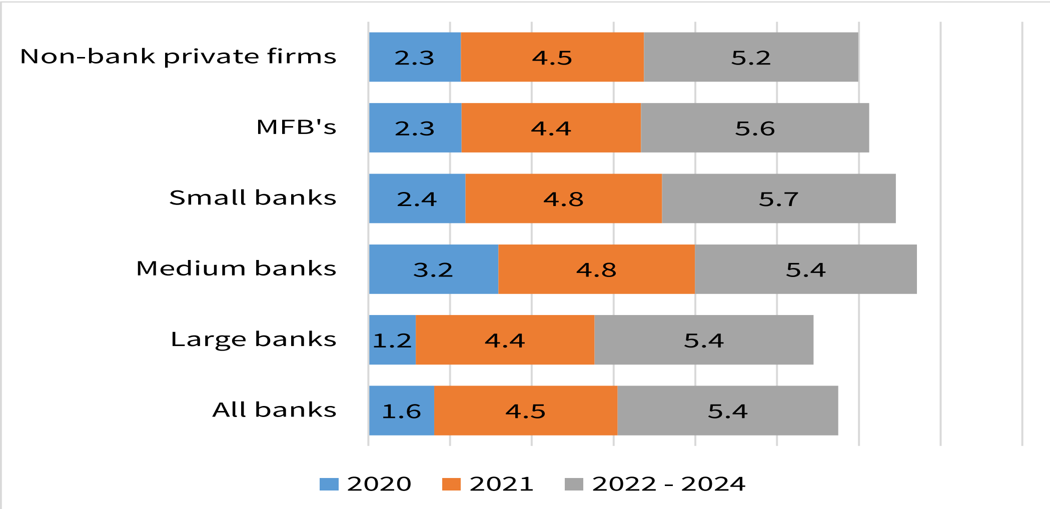
7.2. Economic growth expectations for 2020 - 2024

Bank respondents expected the economy to rebound as from 2021 with the hope of a vaccine being in place and international borders opened **(Chart 6).**

Respondents expected economic growth as a result of recovery in activity supported by eased containment measures, Government spending to support demand, favourable weather conditions, increased foreign exchange income and improved infrastructure. In addition, respondents cited returning business confidence supported by a turnaround in the key sectors of the economy, monetary and fiscal stimulus feeding through to stronger private consumption and investment, improved external and domestic demand, improving business environment, prospects of a COVID-19 vaccine and a stable macro-economic environment as factors expected to support growth in the medium term.

However, respondents cited the second wave of COVID-19 infections, slow credit growth at the SME and Individual level, challenges in non-performing facilities recoveries, low business due to the pandemic and the upcoming electioneering period as possible downside risks to growth in the medium term.

Chart 6: Expectations on economic growth 2020 – 2024 (percent)



8. OPTIMISM ON THE ECONOMIC PROSPECTS

Economic Prospects in the next 12 months

The November 2020 Survey asked bank and nonbank private sector firms to indicate how optimistic/ pessimistic they were regarding the country's economic prospects in the next 12 months.

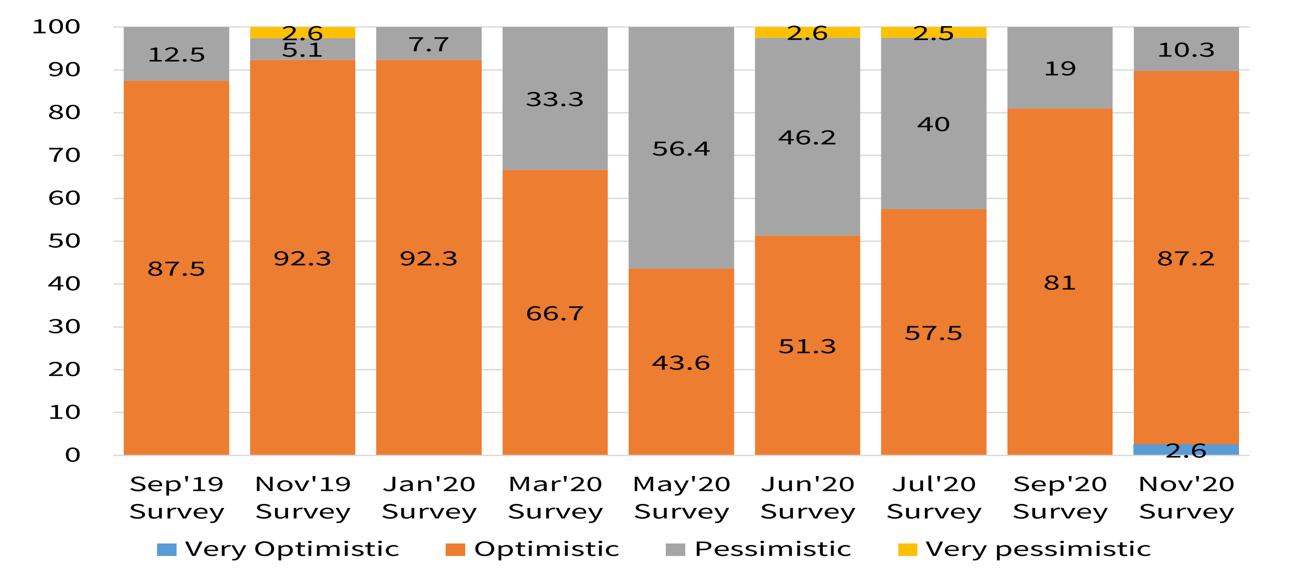
The results showed improved optimism by respondents across banks and nonbank private sector firms, largely due to expectations that the COVID-19 containment measures would manage the pandemic and result in increasing economic activity over time **(Charts 7 and 8).**

Bank respondents expected agricultural production to increase with the favourable weather, key sectors most affected by the pandemic, such as tourism, to recover following Government support, and citizens to get relief from the stimulus package and tax measures by the Government. Other factors contributing to this optimism included proposals in the Budget by National Treasury to help reduce unemployment by allocating funds for youth ***kazi mtaani*** program and other initiatives to support women and people living with disability, credit guarantee schemes, County and National Government's commitment to settle pending bills to MSMEs/suppliers, adoption of digital ecommerce, logistics and payments by Kenyans, and diversification of the Kenyan economy.

Additionally, respondents cited the monetary and fiscal measures, increased focus on infrastructural developments and the hope of a vaccine as reasons for their optimism and increased confidence.

However, respondents pointed out the second COVID-19 wave and rise in foreign debt obligations as risks to this optimism.

Chart 7: Optimism by Banks on Economic Prospects (percent)

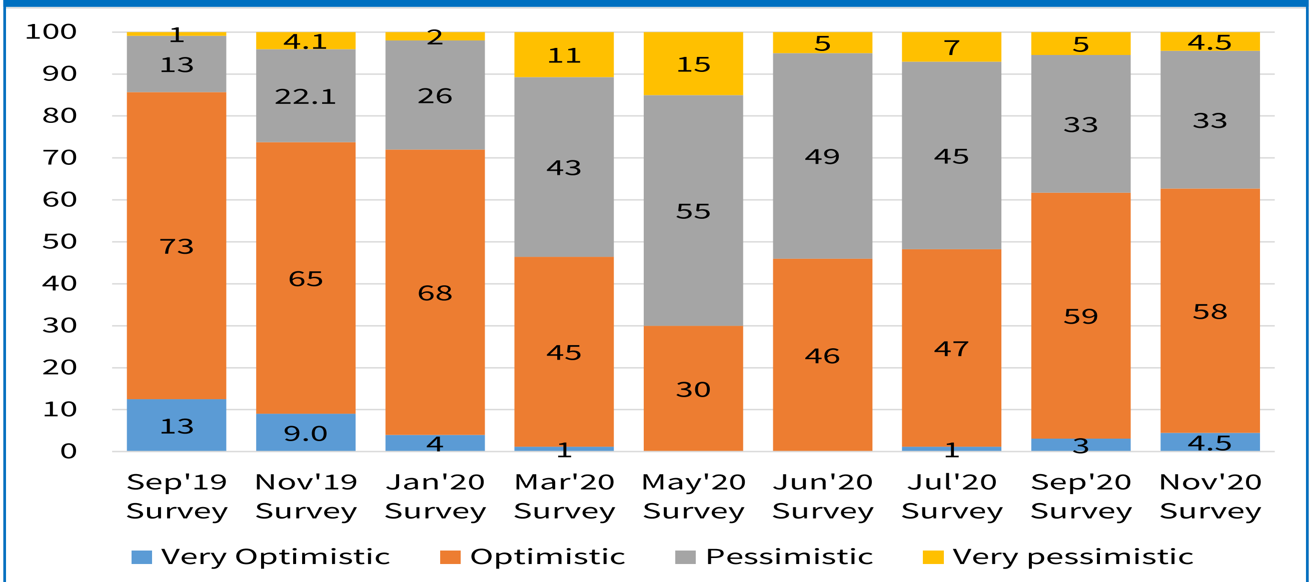


Similarly, non-bank private sector respondents expressed improved optimism in the November Survey largely due to good harvests throughout the year, the easing of restrictions put in place to control the spread of COVID-19, and the prospects of a vaccine in the near future.

Respondents cited the reopening of schools in January, expected to boost confidence and spur growth in economic activities, firms beginning to rehire to meet the rising demand for goods and services, rising business confidence due to easing of containment measures, rebound in consumer and Government expenditure as it enacts its 8-point stimulus and expected increase in credit growth as banks loan pricing models are approved by CBK, as some of the reasons for their optimism.

However, the extent of the second COVID-19 wave in the country remaining uncertain, with the possibility of regional lockdowns and enforcing of containment measures was cited as a downside risk which could further dampen the prospects of economic recovery especially in the service and education sector.

Chart 8: Optimism by Non-bank private firms on Economic Prospects (percent)



9. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

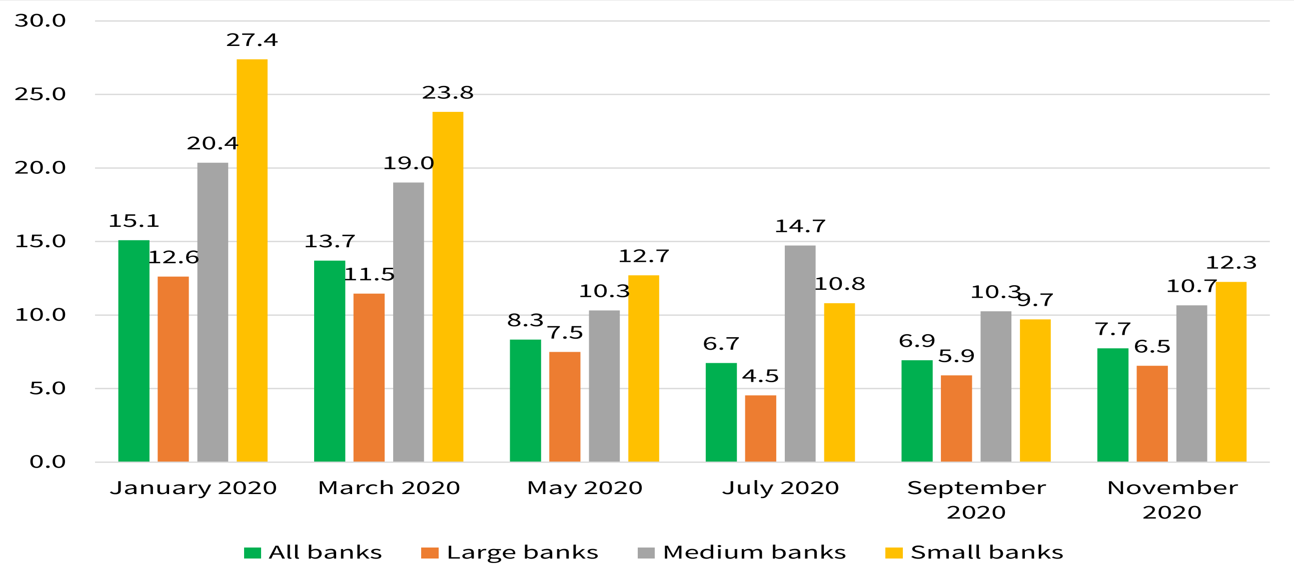
9.1. Growth in private sector credit in 2020

The Survey sought to find out from commercial banks by what percentage they expected to grow credit to private sector in 2020 relative to 2019 (Chart 9).

Respondents expected increase in aggregate demand in the economy as the economy opens up, reduction of CBR and Cash Reserve Ratio, Government fiscal policy interventions to support MSMEs, continued implementation of the Government's Big 4 Agenda, favourable weather conditions expected to increase demand from the agricultural sector, improved risk profiling and lower credit risk as business operations resume, to support credit to the private sector in 2020.

However, some respondents cited uncertainty in business environment due to the emergence of a second wave of the pandemic, unemployment, Job losses and pay cuts which have affected the uptake of credit, reduced credit appetite due to shelving of growth plans by businesses due to COVID-19 disruptions, increased credit risk, and slow down in economic activity due to COVID-19 pandemic, as risks to private sector credit growth in 2020.

Chart 9: Expectations on private sector credit growth (percent)



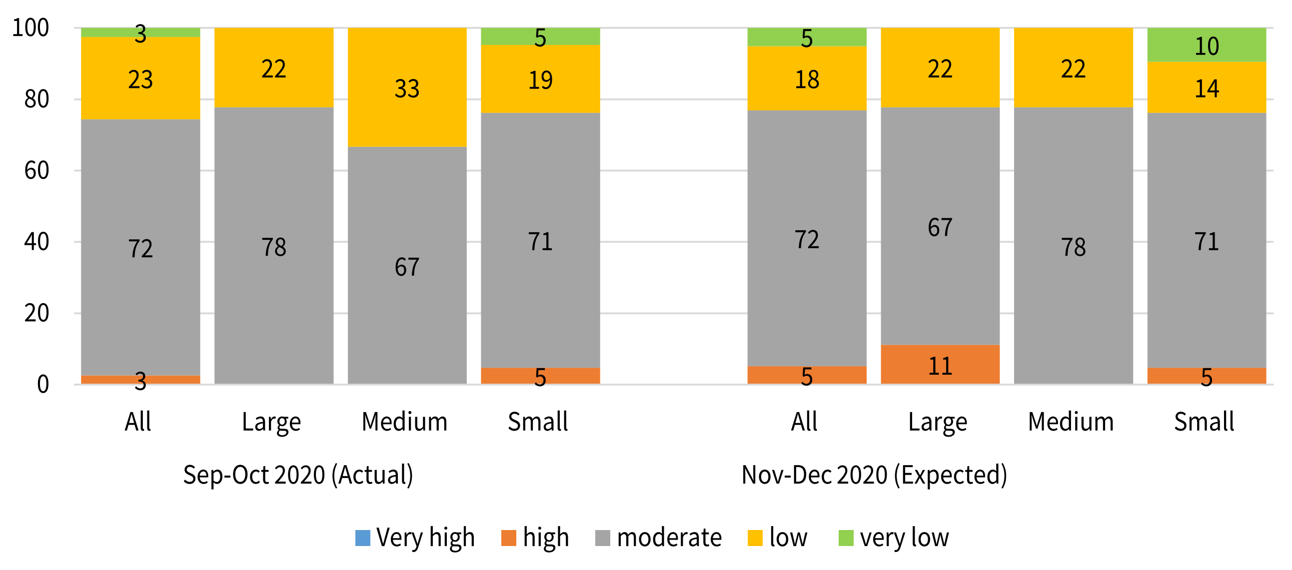
9.2. Expected demand for credit in 2020

The Survey requested bank respondents for an assessment of credit demand from their perspective, during the 2 months before the MPC meeting (i.e. September and October), and their expectations for November and December 2020 **(Chart 10).**

Respondents expected moderate demand for credit in November and December to be driven by the need for working capital to enable businesses recover from the impact of COVID-19, businesses restocking in anticipation of the festive season's expected increase in demand for goods and services, banks' ability to lend to higher risk customers and favourable weather conditions.

However, respondents expected demand for credit to be dampened by the impact of the second wave of COVID-19 infections and renewed global lock down measures that could disrupt supply chains and local activity, businesses still not focusing on expansion or new projects, due to elevated liquidity risks and delayed payments from Government agencies and counties.

Chart 10: Demand for credit in 2020 surveys (percent)



10. INFLATION EXPECTATIONS

10.1. Inflation expectations for November and December

In the Survey, respondents were requested to give their expectations of overall inflation rates for the next 2 months (November and December 2020), the next 12 months (November 2020 to October 2021), the next 2 years (November 2020 to October 2022) and the next 5 years (November 2020 to October 2025).

The results showed that inflation expectations remained anchored, with respondents expecting inflation to remain within the target range (5 ± 2.5 percent) in November and December 2020 (Table 2) supported by low food prices, stable oil prices in the global market and muted demand pressures.

However, respondents expected some upside risk from the increase in activity with the reopening of the economy.

Table 2: Inflation expectations for November and December (percent)

Expected Inflation for:	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
Nov-Dec 2019	5.0	5.1	5.1	5.0	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
Sep-Oct 2020	4.6	4.6	4.5	4.6	4.6	4.8
Nov-Dec 2020	**4.8**	**5.0**	**4.8**	**4.9**	**4.3**	**4.9**

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

Respondents expected inflation to remain well anchored in the next one, two and five years, supported by stable food prices due to favourable weather, relatively low and stable oil prices and muted demand pressures on the back of low consumer demand **(Table 3).**

However, respondents expected some pressure from pick up in demand post COVID-19 and the pressure that could arise from the likelihood of VAT reverting back to 16 percent in July 2021.

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

	All banks	Large banks	Medium banks	Small banks	MFB's	Non-bank private firms
November 2020 - October 2021	5.2	5.2	5.2	5.0	4.1	5.3
November 2020 - October 2022	5.4	5.4	5.5	5.4	4.8	5.9
November 2020 - October 2025	5.1	5.1	5.2	4.9	4.1	5.4

11. EXCHANGE RATE EXPECTATIONS

The Survey sought to find out from bank and non-bank private sector firms their expectations regarding the direction of change in the exchange rate of the Shilling against the US Dollar in November and December 2020. Expectations were varied across banks and nonbanks on the direction of the Shilling to US Dollar exchange rate.

Respondents expected the Shilling to be supported by increase in horticultural exports, diaspora remittances, and tourism inflows as the holiday season kicks in.

However, respondents expected increase in imports and elevated demand for dollars consistent with recovery in activity during the period to exert some pressure on the shilling.

12. HOW THE BUSINESS ENVIRONMENT COULD BE ENHANCED

The Survey asked respondents to indicate how the business environment could be enhanced.

Banks requested for support to embrace new products within the new operating environment, highlighted the need for both National and county governments to settle their pending bills in order to spur demand for credit, and lauded the increased efforts in the fight against corruption.

Non-bank private firms on the other hand suggested that Government considers providing grants to support industries and sectors affected by COVID-19, the need to fast-track implementation of measures increase access to credit, and fast-tracking of VAT Refunds to help improve the business cash flow.

Central Bank of Kenya

Haile Selassie Avenue P.O. Box 60000 - 00200 Nairobi |Tel: (+254) 20 - 286 0000 / 286 1000 / 286 3000

www.centralbank.go.ke | www.facebook.com/CentralBankKenya | @CbkKenya