Central Bank of Kenya

Monetary Policy Committee Market Perceptions Survey

June 2020

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. In the event of any adverse shock in the economy, the MPC carries out special surveys on a monthly basis to obtain perceptions and expectations from specific sectors to shed more light into the crisis.

The Survey 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 MPC Secretariat carried out the June 2020 MPC Market Perceptions Survey in the first three weeks of the month, at a time when the COVID-19 pandemic was spreading rapidly in the country and across the world. The Survey sought perceptions on the effects of the pandemic, and levels of economic activity in the two months before the MPC meeting, i.e. May and June 2020, and market expectations on levels of economic activity for July and August 2020.

In addition, the Survey sought from respondents their expectations with regard to overall inflation, demand for credit and levels of optimism in the economic prospects for the country.

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 by email and hard copy. The overall response rate to the June 2020 Survey was 56 percent of the sampled institutions. The respondents comprised 38 commercial banks, 1 mortgage finance institution, 13 micro-finance banks, 50 hotels, and 111 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 June 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.
- Demand for credit expected to pick up in the next 2 months.
- Economic ativity expected to pick up in the next 2 months.
- Improved optimism on Kenya's economic growth prospects.

4. INFLATION EXPECTATIONS

In the Survey, respondents were required to give their expectations of overall inflation rates for the next 2 months (June and July 2020), and the next 12 months (June 2020 to May 2021).

The results showed that respondents expected inflation to remain stable and within the target range (5 ± 2.5 percent) in June and July 2020, and over the next 12 months **(Tables 1 & 2).**

Bank respondents expected inflation to remain well anchored supported by low food prices due to good weather, low oil prices, low aggregate demand and reduction of VAT. Nevertheless, respondents indicated that some pressure on inflation could arise from increased economic activities as the economy opens up, expected increases in prices of commodities driven by the supply constraints globally and locally, possible pressure on food supplies and prices arising from locust invasion and flooding in some parts of the country, upward adjustments in local pump prices and the impact of some of the new taxes.

Non-bank firms expected inflation to remain stable supported by low food prices due to continued rainfall, low oil prices, and weak demand, but for some upward pressure to come from upward adjustments on excise duty on consumer goods and fuel, increased commodity prices due to disrupted supply chains and high cost of production due to firms not operating optimally, increased activity as economy is reopened, persistent flooding in some areas and the release of the stimulus funding.

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

Expected Inflation for:	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
Jan-Feb 2020	5.8	5.7	5.8	5.8	5.7	5.8
Mar-Apr 2020	5.8	6.4	6.4	6.0	6.5	6.5
May-Jun 2020	5.5	6.1	5.7	5.6	6.0	6.1
Jun-Jul 2020	5.6	5.9	5.6	5.6	5.5	5.9

Regarding expected inflation for the 12 months, respondents largely expected it to remain within the target range over the next 12 months supported by favourable weather and relatively low oil prices.

However, respondents cited the possibility of further increase in prices if the pandemic escalates leading to reduced production as a result of supply chain slowdowns of inputs like fertilizers, fuel, labour, machinery etc., and the final produce to markets.

Table 2: Inflation expectations for the next 12 months (%)

	January 2020 Survey	March 2020 Survey	May 2020 Survey	June 2020 Survey
All banks	5.7	6.1	5.0	5.8
Large banks	5.8	6.0	4.7	5.8
Medium banks	5.7	6.1	6.1	6.1
Small banks	5.7	6.2	5.5	5.6
MFB's	5.3	6.1	5.9	5.7
Non-bank private firms	6.0	6.3	6.5	6.1

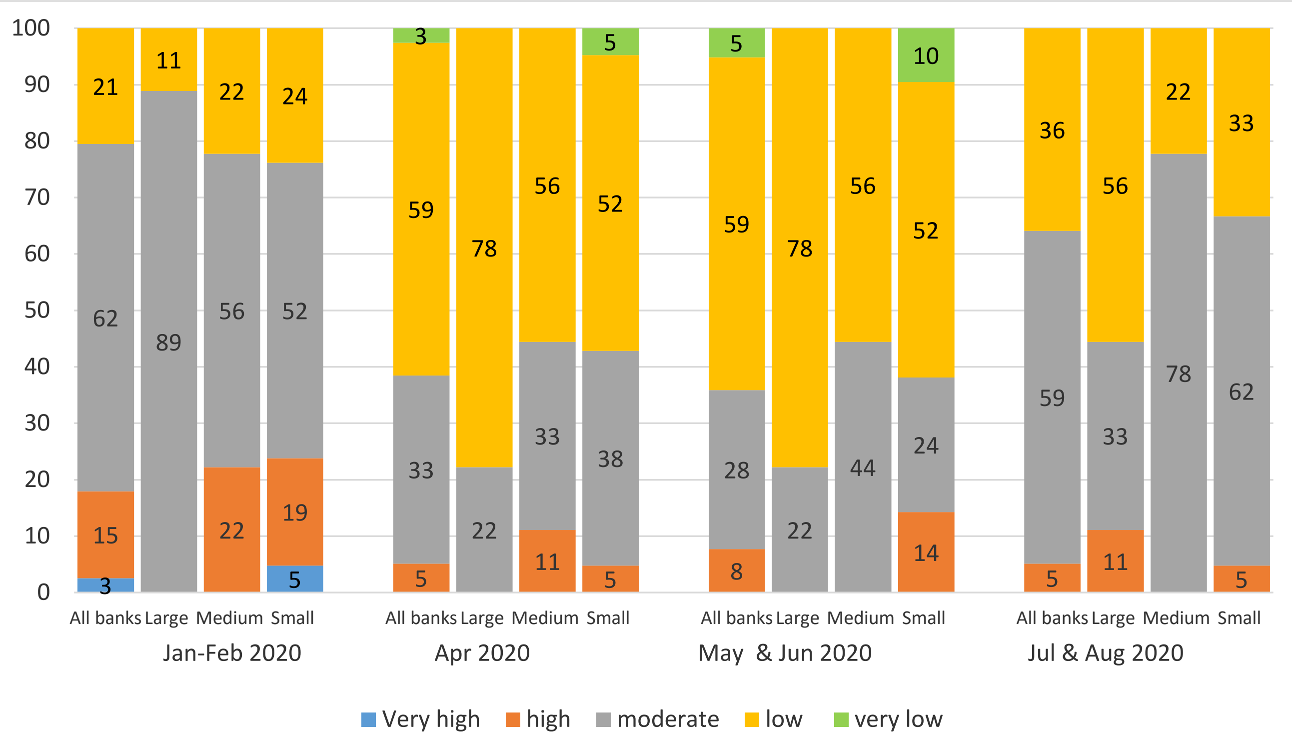
5. DEMAND FOR CREDIT EXPECTATIONS

The Survey requested bank participants 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 of the same for July and August 2020.

Bank respondents expected the gradual easing of restrictions put in place to fight the pandemic to lead to increased economic activities and trigger the need for financing, hence improved demand for credit in the next 2 months. This was in addition to the stimulus package pronounced in the Budget, expected demand for personal loans to cope with effects of the pandemic, and the need for loan moratoriums and restructuring by businesses.

However, respondents thought it unlikely that the Government would remove restrictions and cessations, indicating that the virus was yet to hit its peak, and that demand for credit would remain low as long as restrictions remained. In addition, respondents pointed out the low consumer demand and consumer confidence due to the rising unemployment, closure of businesses, reduction in household's disposable incomes, slowdown in global trade from disrupted global supply chains and the continued employment of a wait and see approach before committing to facilities, as reasons for the expected muted demand. Banks also indicated the need to exercise caution in lending especially to businesses from sectors highly affected by the pandemic, and which have a high risk of credit default.

Chart 1: Demand for Credit in 2020 Surveys (percent)



6. ECONOMIC ACTIVITY EXPECTATIONS

Economic activity perceptions and expectations by banks

The Survey sought from bank respondents an assessment of economic activity as experienced in May and June 2020, and expectations of economic activity in July and August, to get views on the effects and expected impact of the COVID-19 pandemic on the sector and the entire economy.

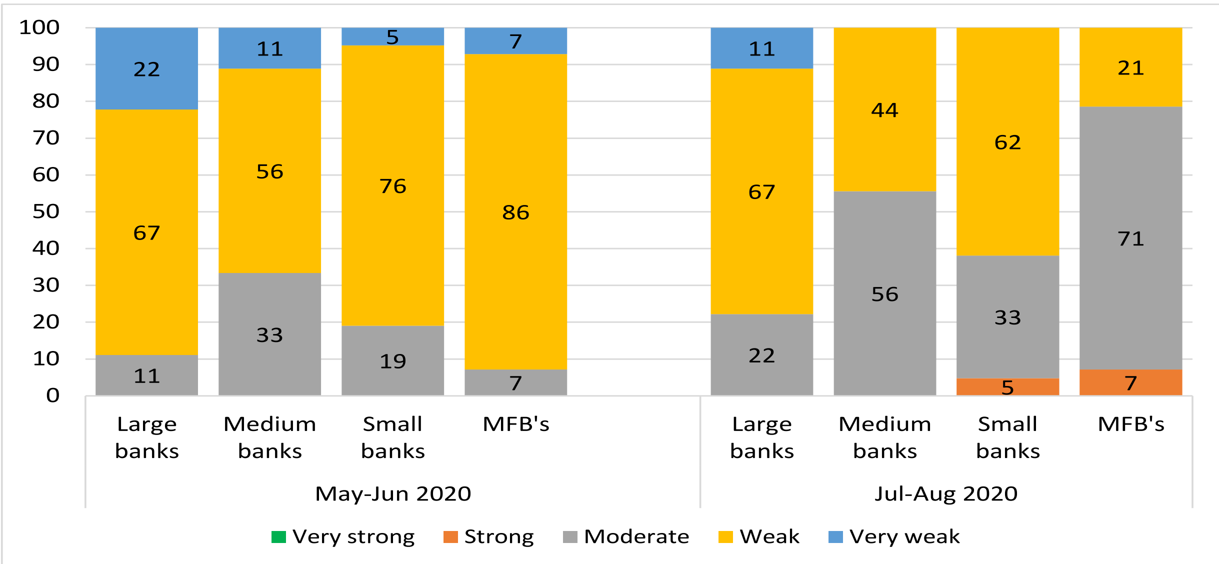
Bank respondents expected economic activity to tend to moderate in July and August from largely weak activity in May and June.

Respondents expected this shift to be driven by the economic stimulus package, support for MSMEs, stability in food prices due to favourable weather, low energy prices, lower VAT and expected payment of pending bills to suppliers by national and county governments.

However, Government measures to contain the spread of the virus, reduced household's disposable incomes due to lay-offs and furloughs, closure of businesses, muted consumer demand and confidence, weak investment demand by firms, disruption in global supply chains, locust invasion and floods and restricted access to credit were cited as some of the reasons likely to dampen activity in July and August.

In addition, respondents pointed out that the rising infections in Nairobi and Mombasa could see extended lockdowns to control the spread of the disease, although there was a fair chance that some activity could resume with strict social distancing rules.

Chart 2: Perceived and expected economic activity by banks (percent)



Similarly, non-bank private firms across the sectors indicated expectations of improved economic activity in July and August as businesses become better adapted to the new conditions and regulations in place to contain the pandemic, and with the expected gradual easing of restrictions, largely dependent on the coronavirus projections and Presidential directives. This is in addition to easing of restrictions by our trading partners, expected to restore supply chains and improve demand **(Chart 3 & 4).**

Chart 3: Perceived and expected economic activity by non-bank private firms (percent)

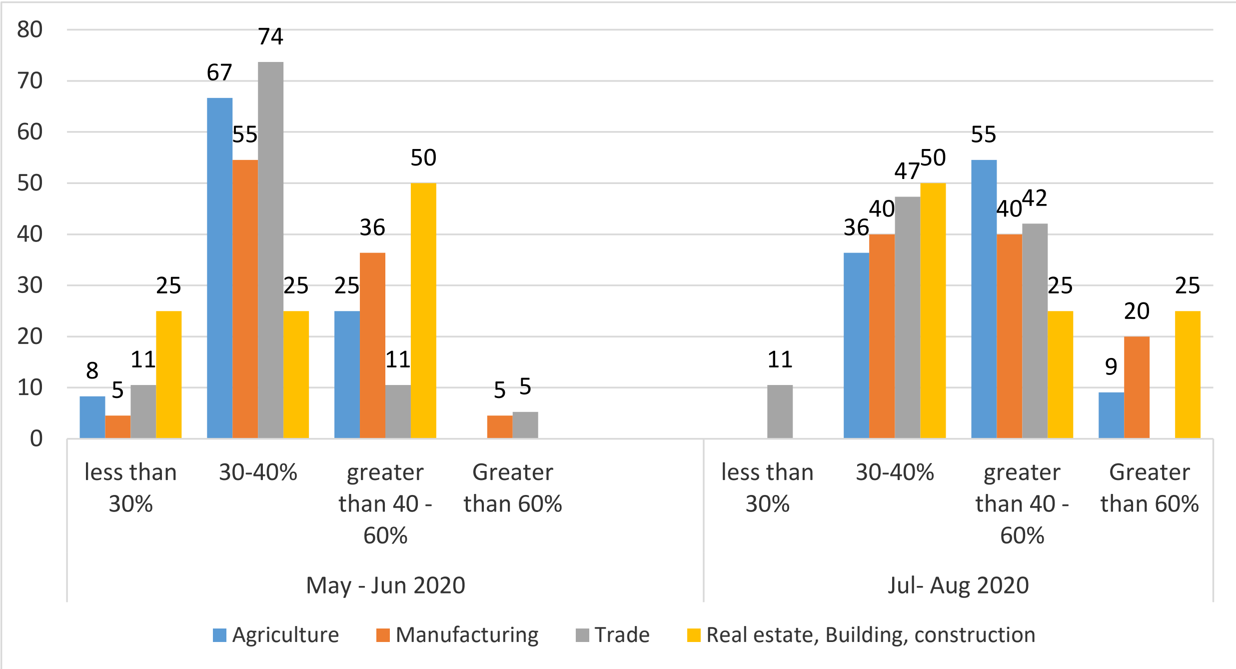
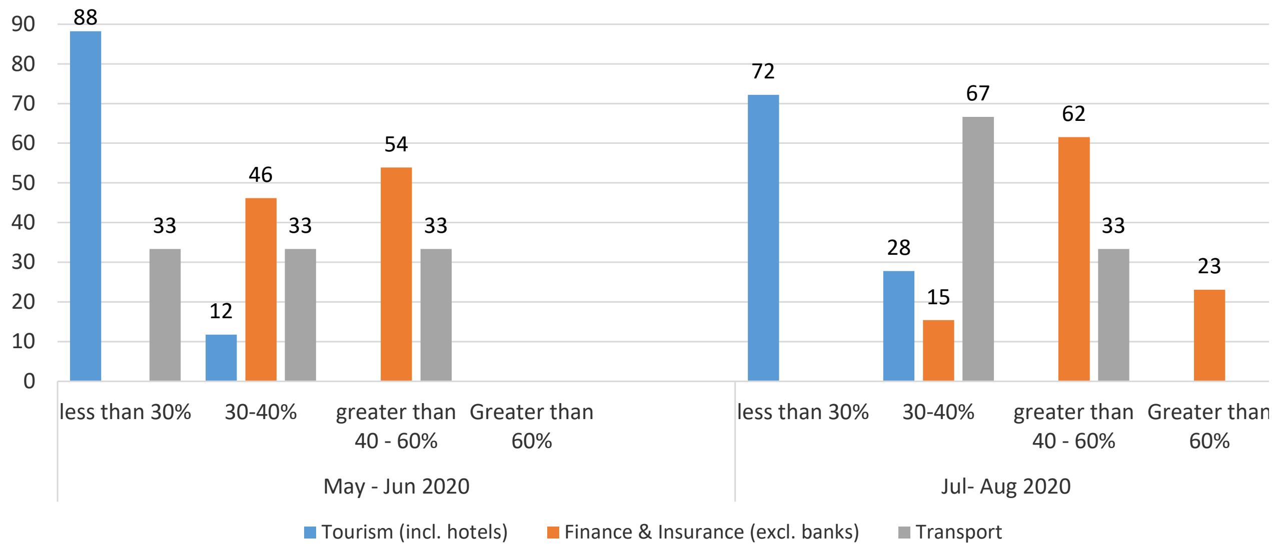


Chart 4: Perceived and expected economic activity by non-bank private firms (percent)



Hotel respondents pointed out the existence of forward bookings awaiting resumption of flights, while the financial sector expected better performance in the second half of 2020, as the economy gradually opened up. Horticultural firm respondents expected improved activity with the building up of demand and reopening of markets in Europe.

Nonetheless, respondents expected that extensions of closures, restrictions, curfews and cessations would keep economic activities at low levels over the next 2 months, and were doubtful of there being any change in the mitigation strategies, at least in the short term, given the rising cases of new infections.

7. OPTIMISM ON ECONOMIC PROSPECTS

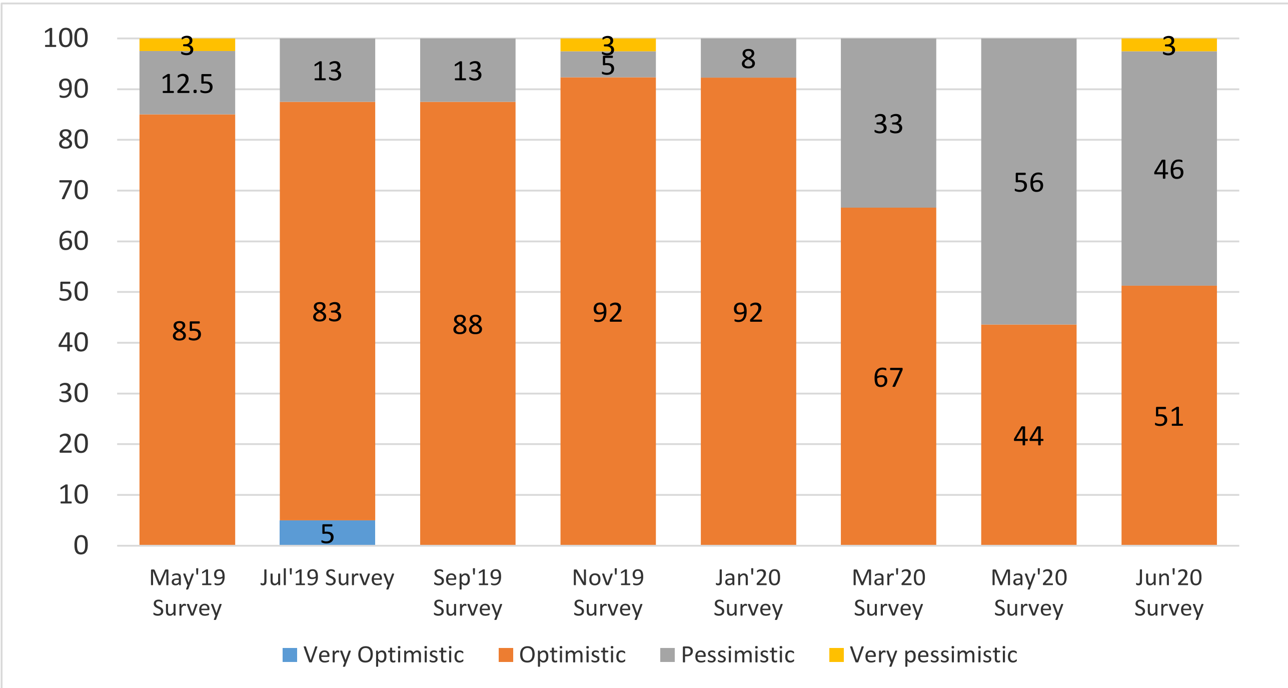
7.1. Economic Prospects

The June 2020 Survey requested bank and non-bank private sector firm respondents to indicate how optimistic/ pessimistic they were regarding the country's economic prospects. The results showed upward revisions in optimism by respondents across banks and nonbank private sector firms largely due to expectations of opening up of the economy through easing of restrictions initially put in place by the Governemnt to control the pandemic's spread **(Charts 5 and 6).**

Bank respondents expressed improvement in optimism in economic prospects due to, among others, the fiscal policy interventions to stem Covid-19 impact, support to MSMEs & households by reducing corporate tax, VAT & PAYE, allocation of funds to support sectors most affected by the pandemic, CBK interventions to protect liquidity, soundness and stability of the banking system, gradual reopening of the economy, Government's commitment to settle pending bills and the rise in adoption of digital ecommerce, logistics and payments by Kenyans. In addition, respondents cited good weather, low global oil prices, diaspora remittances holding steady despite rising unemployment in source markets and the opening up of trading partners as reasons for this optimism.

This optimism was, however, tempered by the impact of the Covid-19 pandemic on virtually all sectors of the economy, and the uncertainty of its recovery path both locally and globally, fiscal deficit and loan obligations, the impact of the multiplier effect of people who have been laid off or taken salary cuts, global recession due to the pandemic, continued underperformance of tax revenues, redirection of investment funds to fighting the pandemic, floods in some parts of the country, locusts invasion, and the fact that most of the measures put in place to fight the pandemic would take time to be felt.

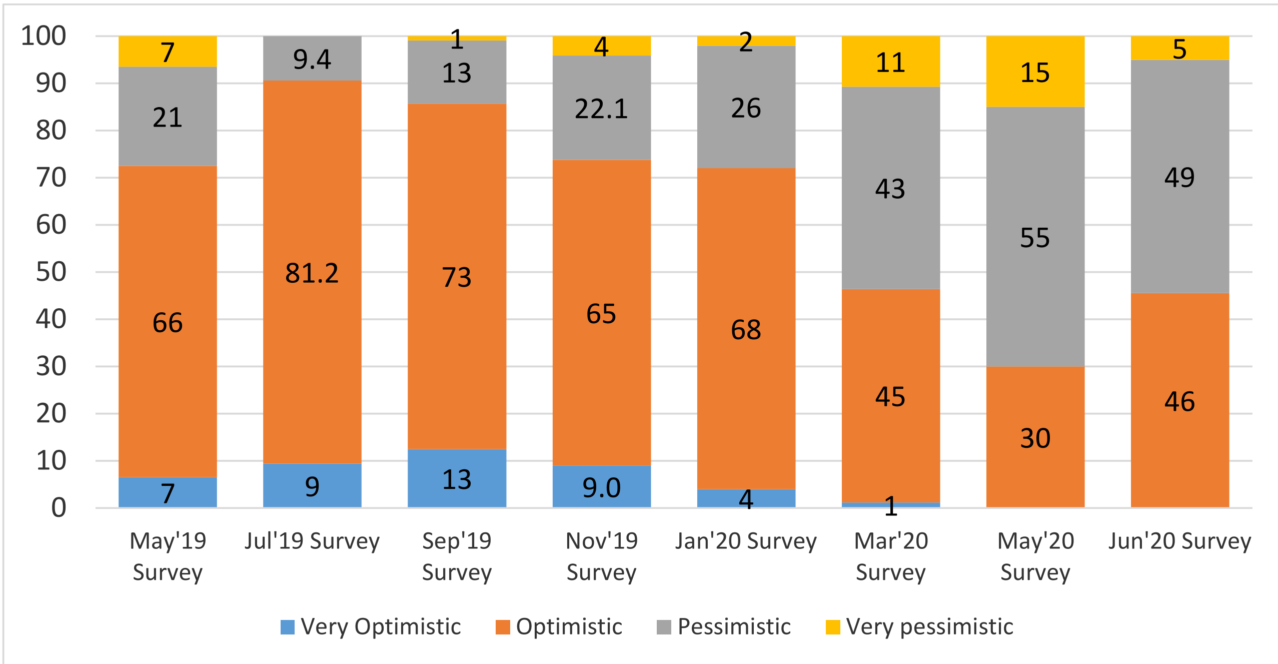
Chart 5: Optimism by Banks on Economic Prospects (percent)



The non-bank private sector respondents expressed improved optimism in the June Survey largely due to expectations of economic recovery with the gradual opening up of the economy. Respondents indicated that the measures put in place to contain the pandemic, the economic stimulus package to support the sectors hardest hit by the pandemic and the implementation of various budget proposals with regard to local manufacturing, youth empowerment, etc., would contribute to economic recovery. Other reasons for the improved optimism included good weather hence lower inflation, Government commitment in settling pending bills and pending hotel bookings awaiting resumption of flights.

Respondents, however, pointed out that the Covid19 pandemic's negative impact on all major sectors of the economy, the closures, job losses, reduced activity, etc., was the main reason affecting their optimism in the country's economic prospects.

Chart 6: Optimism by Non-bank private firms on Economic Prospects (percent)



7.2. Forward Hotel Bookings

The Survey requested hotel sector respondents to indicate monthly forward hotel bookings, if any, received so far for the period June - October 2020. Results showed that at the time of the June survey, more hotels had re-opened compared with the May Survey, and of those that responded, 33 percent had forward bookings compared with 5 percent in May.Respondents indicated that hotels expected guests to arrive after easing of cessations and curfews and resumption of international flights.

Chart 7: Forward Hotel Bookings for June–October 2020 (percent of total capacity)

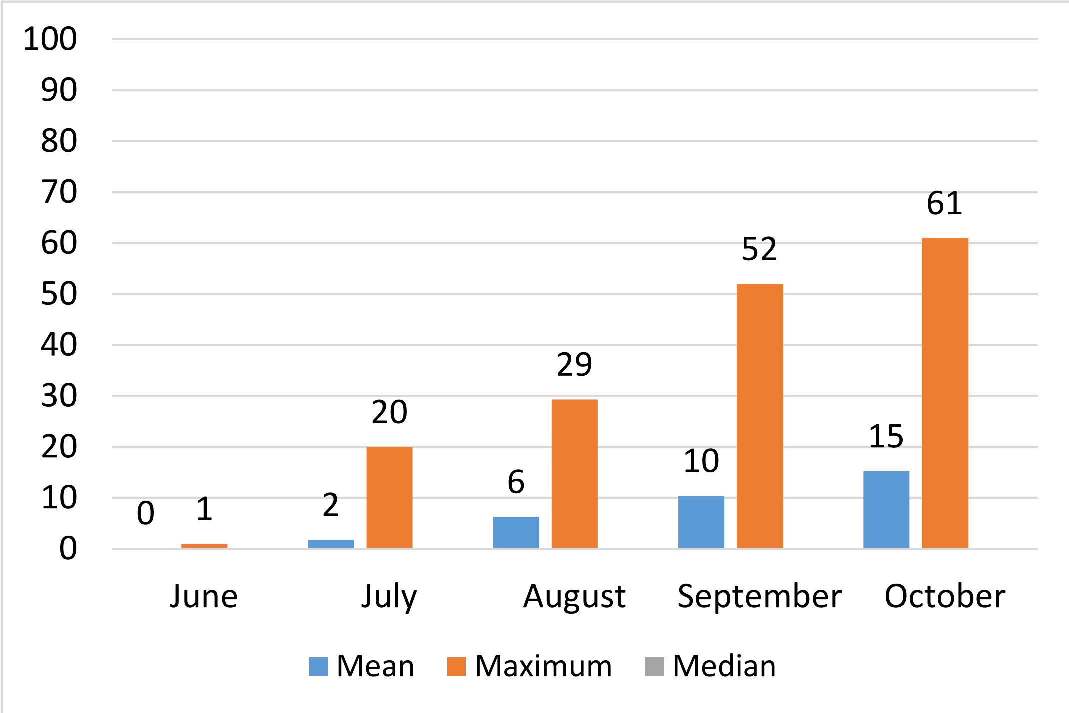
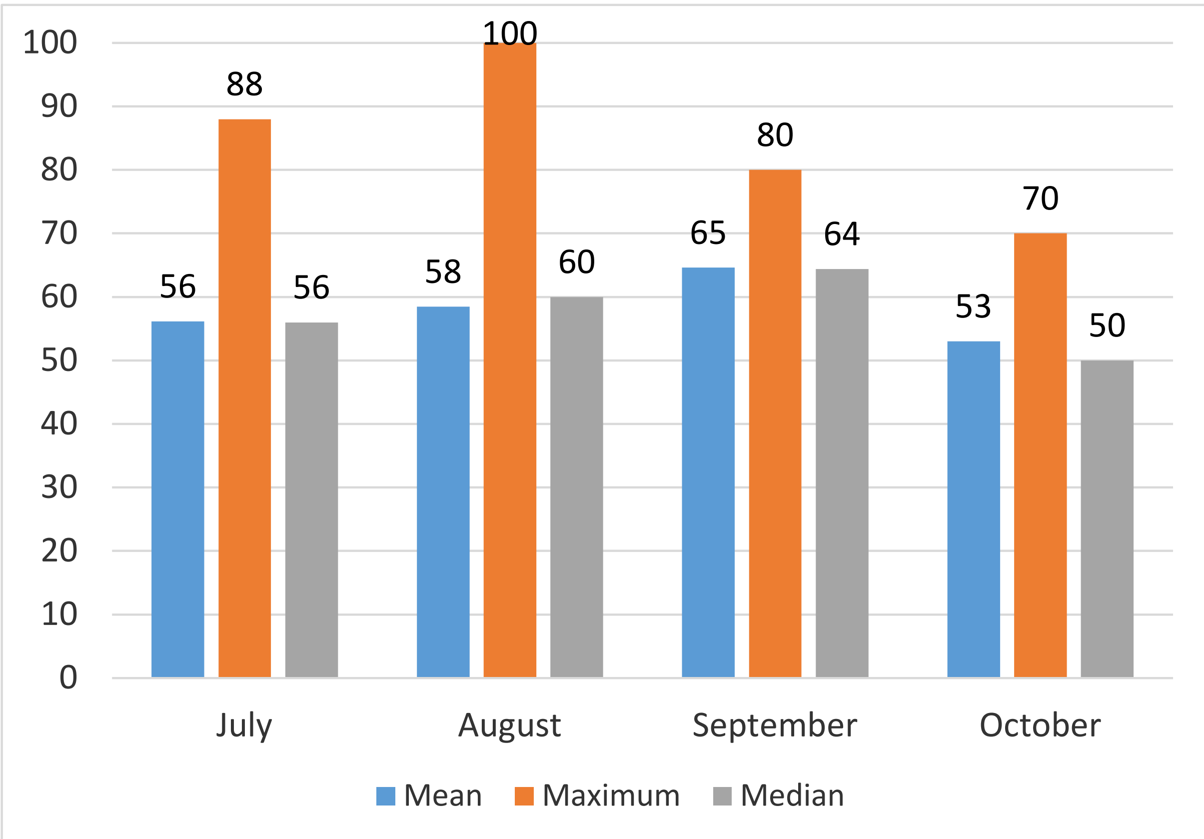


Chart 8: Forward Hotel Bookings for July–October 2019 (percent of total capacity)



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