Central Bank of Kenya

REPORT OF THE MONETARY POLICY COMMITTEE MARKET PERCEPTIONS SURVEY SEPTEMBER 2020

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1. BACKGROUND

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 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.

2. INTRODUCTION

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

The Survey inquired about the levels of demand for credit and economic conditions prevailing in July and August 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, expectations regarding employment levels and the impact of the COVID-19 pandemic.

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 September 2020 Survey was 65 percent of the sampled institutions. The respondents comprised 38 commercial banks, 1 mortgage finance institution, 14 micro-finance banks, 56 hotels, and 140 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 September 2020 Market Perceptions Survey included:

- Optimism in the country's economic prospects increased with the continued lifting of restrictions and reopening of businesses. On average, banks and non-bank private firms increased their optimism from 58 and 48 percent in July to 81 and 62 percent, respectively in September;

- Respondents expected economic activity to increase in September and October;

- The proportion of firms expecting to lay off employees declined with improving economic activity;
- Banks expected an increase in private sector credit growth in 2020; and
- Inflation expectations remained well anchored within the target range in the next 2 months, 12 months and over the medium term.

5. ECONOMIC ACTIVITY

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

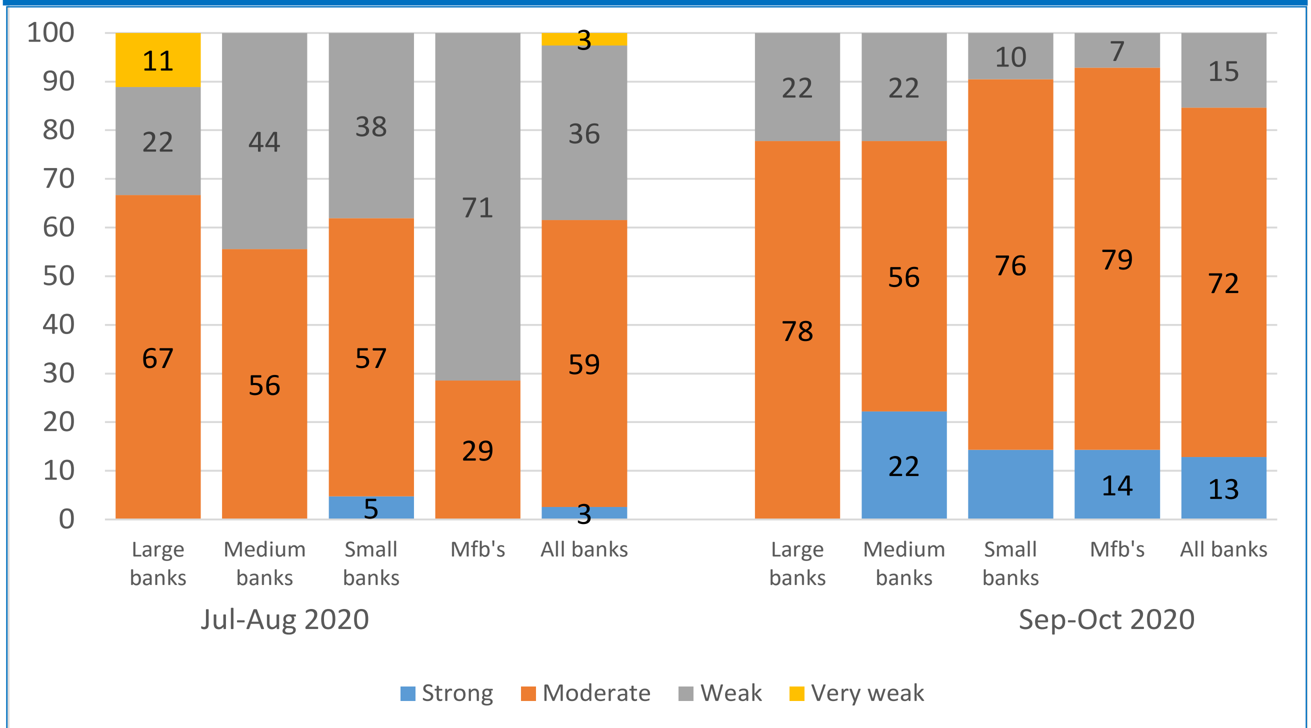
5.1 Economic activity perceptions and expectations by banks

Bank respondents expected economic activity to increase in September and October, compared to the period July and August, largely due to the flattening of the COVID-19 curve, the resultant lifting of COVID-19 restrictions and reopening of more sectors/ businesses in the economy **(Chart 1).**

Respondents also expected improved economic activity to be driven in the next two months by agricultural production due to favourable weather, implementation of the Government stimulus package meant to mitigate the effects of the pandemic and jumpstart the economy, and further spending by the Government under the *Big 4 Agenda*. In addition, respondents expected a pick-up in industrial activity and an increase in private consumption as a result of Government policies extended to cushion citizens from the extreme effects of the pandemic.

Respondents, however, pointed out that uncertainties around the pandemic, loss of jobs in the private sector due to closure or low business, slow post-COVID-19 recovery of some sectors such as tourism, a possible second wave of the pandemic were the main risks to the expected increase in economic activity.

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



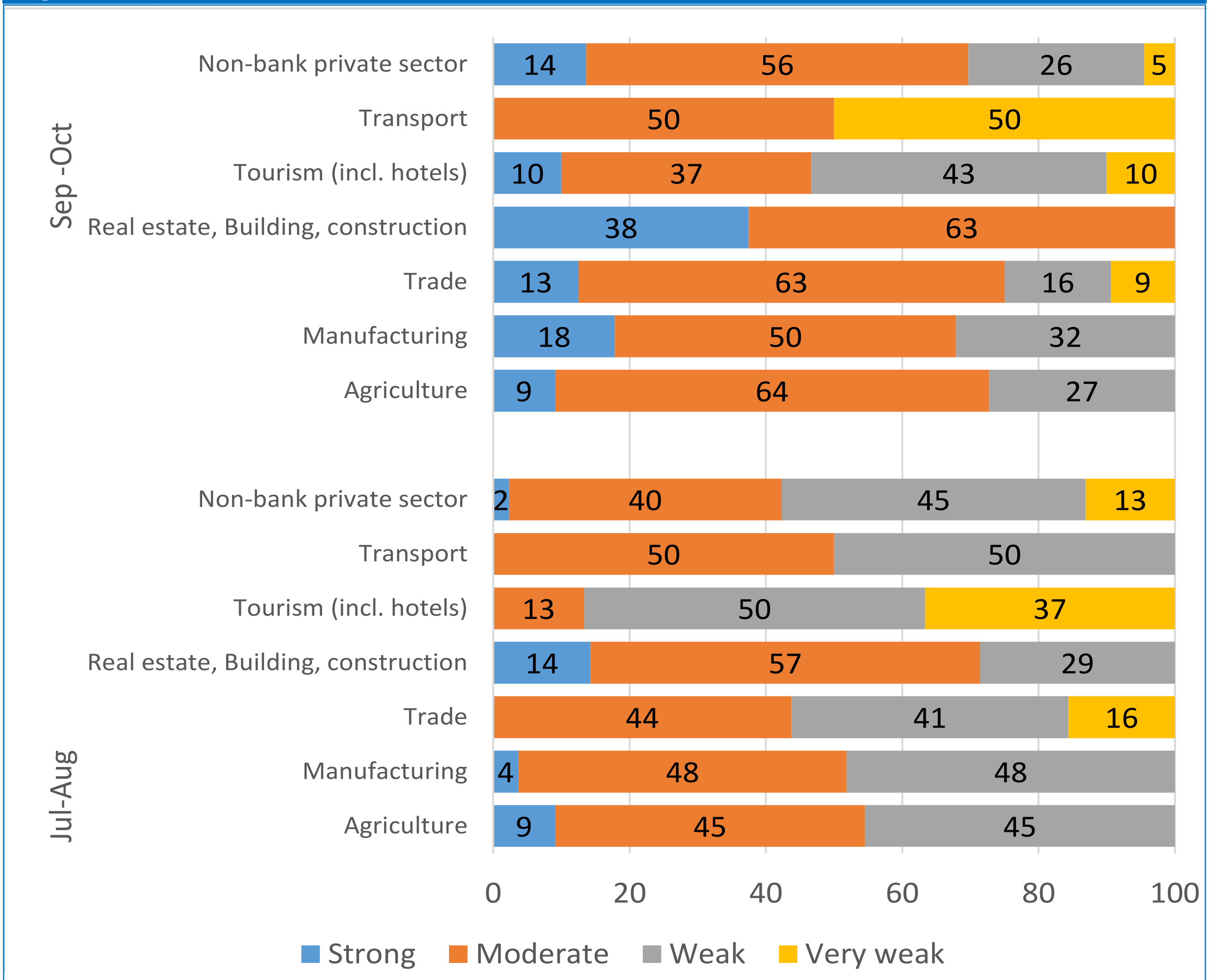
5.2 Economic activity perceptions and expectations by non-bank private firms

Non-bank private sector respondents expected improvement in economic activity in September and October largely due to the signs of flattening of the COVID-19 pandemic curve, the anticipation of further relaxation of restrictions and the reopening of more businesses **(Chart 2).**

Respondents indicated that there was evidence of increased product demand and an increase, albeit slow, in the volume of business compared to March – August of 2020, as the Government continued to handle the pandemic. Additionally, respondents expected the favourable weather condition, low inflation, the gradual relaxation of COVID-19 pandemic control measures, resumption of local and international flights, and the reopening of bars and restaurants to boost economic activity along the respective value chains. Moreover, respondents expected an increase in activity as businesses prepare to stock up for the December holiday. Respondents from the transport sector maintained their expectations of economic activity at the July levels citing the slow pace of recovery of air travel due to the pandemic's effects and second round infections in some countries, which have resulted in resluted in travel restrictions.

Risks to the expected increase in economic activity included any prolonged effects of COVID-19 and containment measures, job losses and political noise.

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



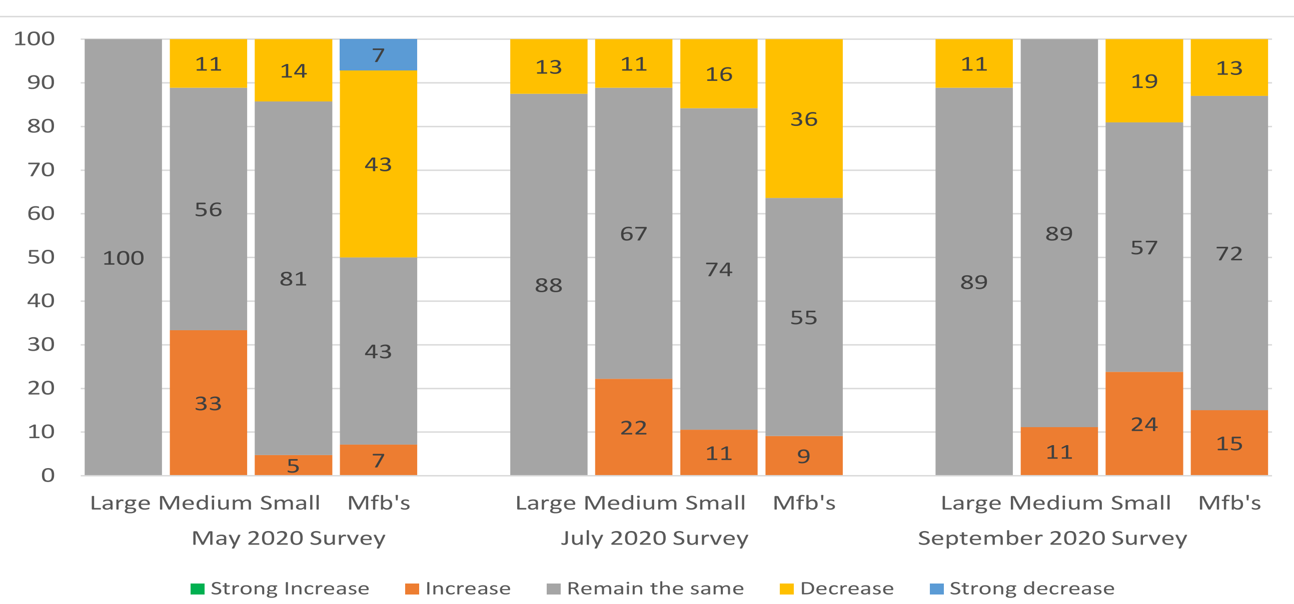
6. EXPECTED CHANGES IN EMPLOYMENT

6.1: Expected changes in employment by banks

The Survey asked bank respondents to provide their expectations with regard to change in the number of employees in their respective institutions in 2020 relative to 2019. Banks largely expected to retain their workforce in 2020, with some of them reporting plans to open new branches, and hire new staff before the end of the year **(Chart 3).**

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

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



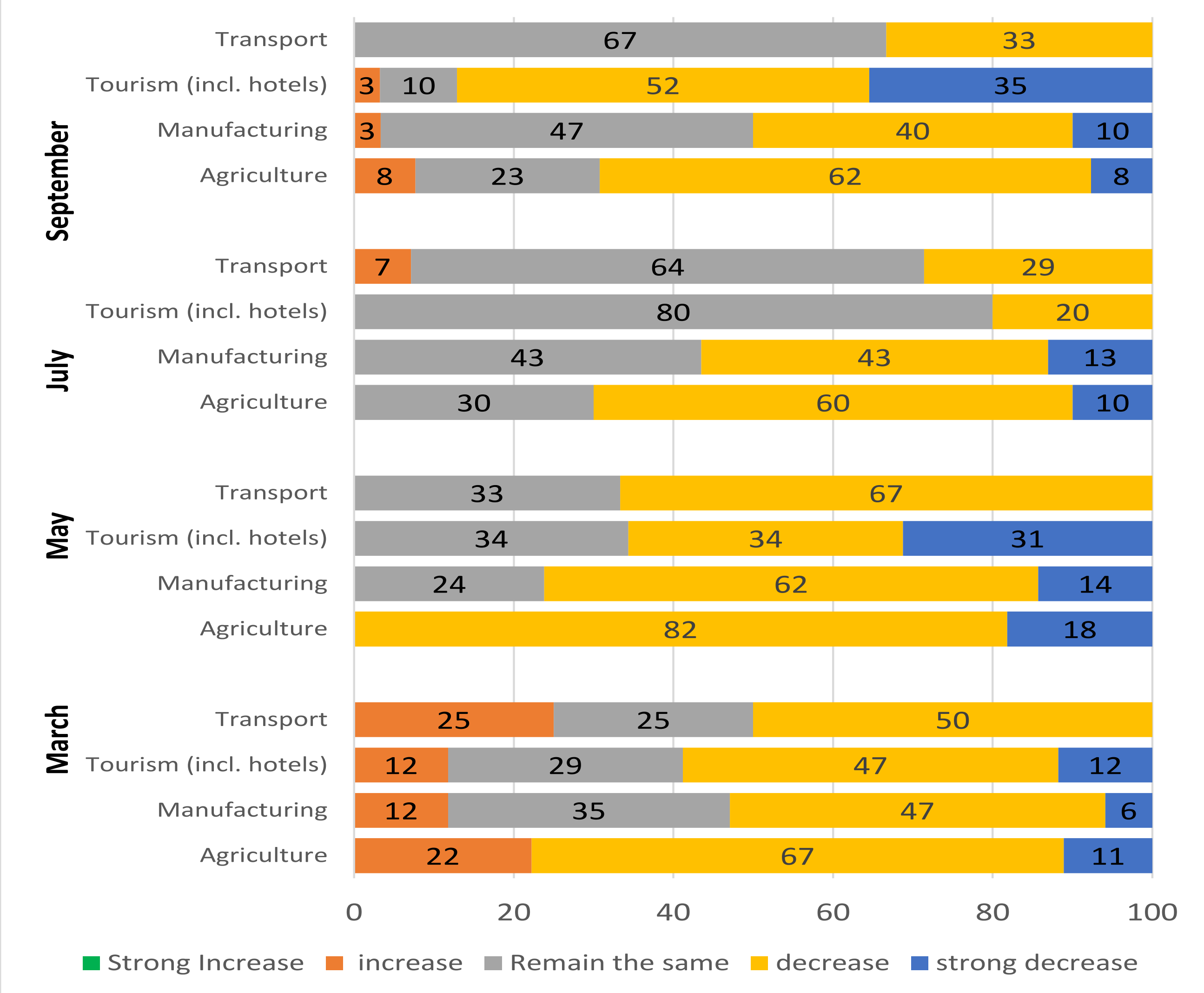
6.2: Employment expectations by non-bank private sector

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.

The Survey revealed that the non-bank private sector expected to slow down on the redundancies as economic activity picked up with the apparent flattening of the COVID-19 curve, lifting of restrictions with regard to the pandemic and reopening of businesses **(Chart 4).** Respondents from the agricultural sector, specifically flower firms, expected to rehire following good performance due to favourable weather and the easing of lockdowns in Europe. Some players in the manufacturing sector had taken advantage of new opportunities under the Government stimulus package offered to local firms and hotels, while others reported to have acquired new businesses.

However, hotel respondents expected to maintain fewer employees to cut labour costs due to low business volumes, indicating that most staff members remained on unpaid leave, while other sectors remained cautious about rehiring, preferring to maintain their numbers as they gauge the impact of the current economic situation.

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

Expectations varied across banks and non-bank private sector firms, all of which expected lower economic growth in 2020 relative to 2019, largely due to the impact of the COVID-19 pandemic **(Table 1).**

Banks indicated that the worst of the COVID-19 pandemic happened in Q2, and expect a gradual improvement in economic growth from Q3. Respondents expected the agricultural sector, which continues to benefit from favourable weather, a turnaround in the key sectors of the economy driven by returning business confidence due to the lifting of restrictions, and opening up of international travel, to support growth in 2020.

In addition, Government response measures, including the stimulus package and fiscal policies meant to mitigate the negative COVID-19 impact on companies and individuals, were expected to support production and private consumption. Similarly, respondents were optimistic that payment of outstanding pending bills by county and national Government, and improved access to credit by SME's, would enable reopening of more businesses and contribute to economic growth in 2020.

In addition to the disruptions, disconnections of economic value chains, and slowdown related

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

to the pandemic, other risks to growth in 2020 included the slowdown on the development agenda due to diversion of funds to fight COVID-19, high unemployment and public debt obligations.

Non-bank respondents revised economic growth expectations slightly upwards from July on account of resilient agricultural output due to favourable weather, implementation of the Government stimulus package and other fiscal actions, expected timely payment of pending bills, improved access to credit facilities by SMEs and returning business confidence supported by a turnaround in the key sectors of the economy. Respondents expected that the above factors would partially offset the negative COVID-19 effects and support economic recovery with the resumption of economic activities.

Similarly, respondents from most sectors expressed improved sentiments with regard to economic growth in September compared with July, largely due to the lifting of most of the restrictions in place to contain the spread of the pandemic **(Charts 5a & 5b).**

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

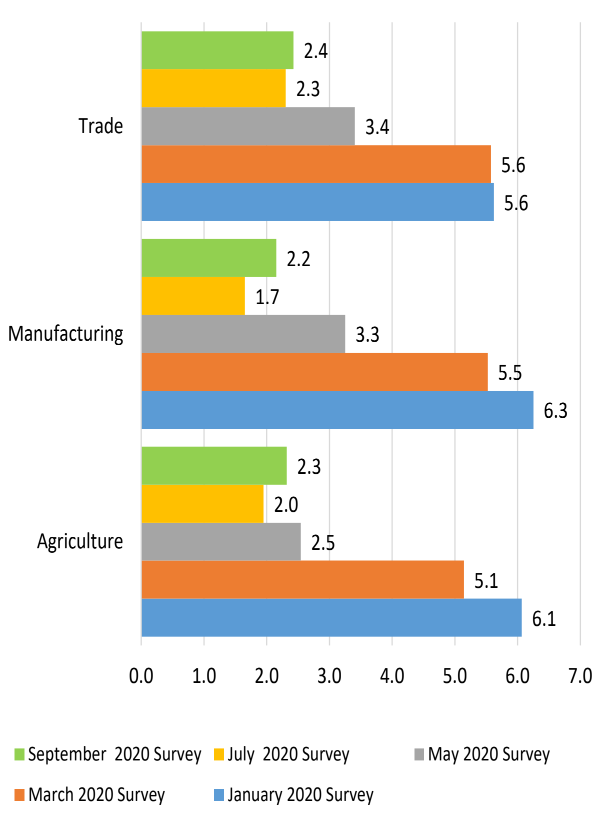
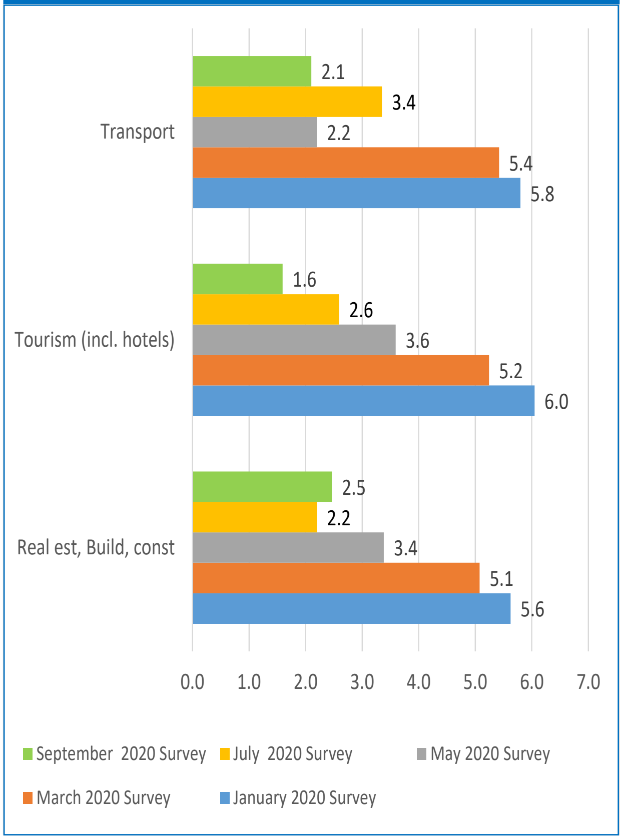


Chart 5b: Expectations on economic growth for 2020 across sectors (percent)



However, tourism and transport sector respondents revised downwards their expected growth in the September Survey relative to the July Survey due to low business following the COVID-19 impact, collapse of many establishments, job losses in the aviation and tourism sectors and severe disruptions to the global economy (source markets), due to COVID-19 impact.

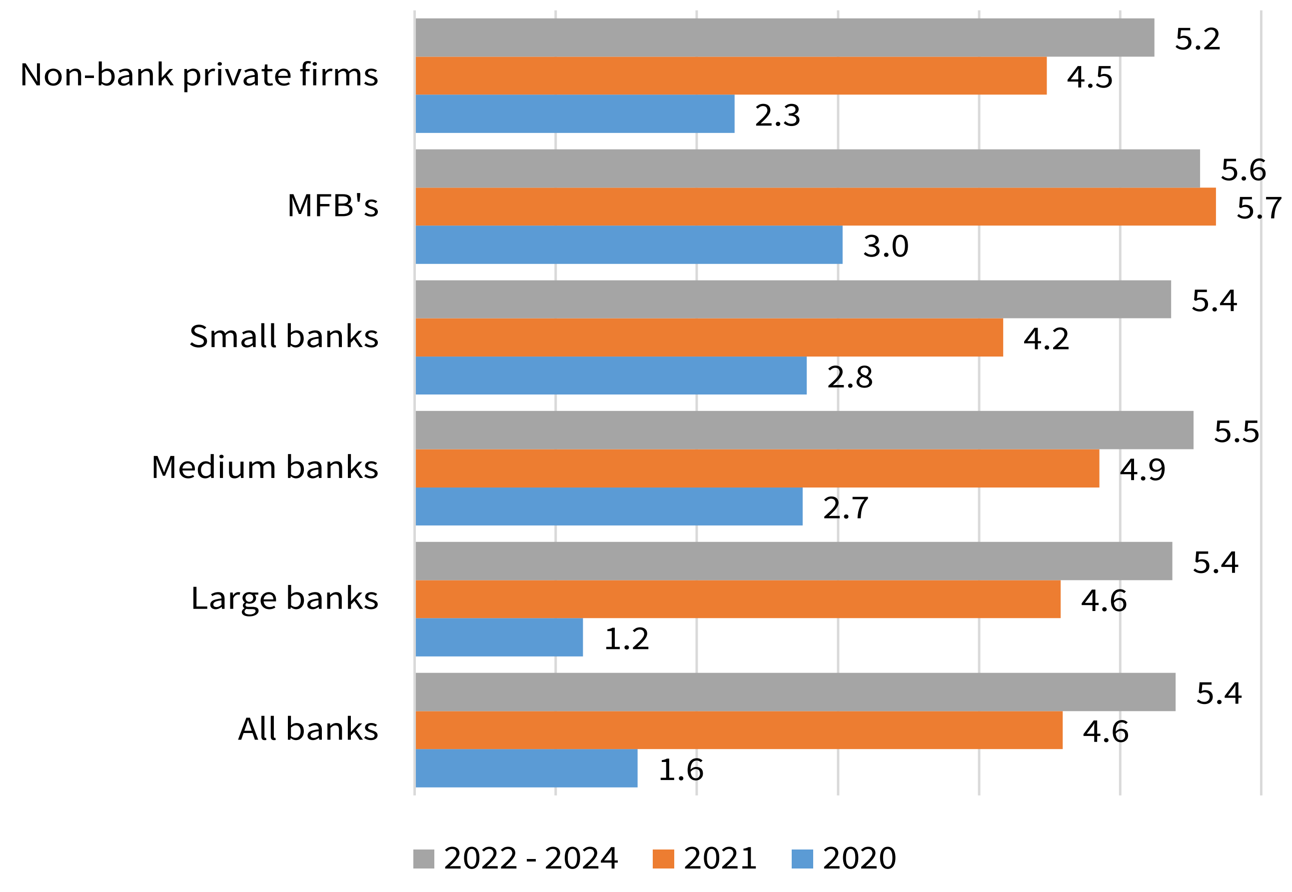
7.2. Economic growth expectations for 2020 - 2024

Bank respondents expected the economy to rebound as from 2021 as the COVID-19 impact dissipates, with high expectations of a vaccine being in place **(Chart 6).** Respondents expected economic recovery, supported by favourable weather conditions, increase in foreign exchange income, improved infrastructure, returning business confidence, improved private consumption and investment, the filtering of the Government stimulus package through the economy and a strong macro-economic environment.

Additionally, Government projects driven by the *Big 4 Agenda*, and better prospects of oil production in Turkana, are expected to encourage production and creation of job opportunities.

Risks to economic growth over the medium term included a possible resurgence of the COVID-19 pandemic, delayed discovery of a vaccine, non-performing loans, slow credit growth at the SME and individual level, and heighted political activity.

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



8. OPTIMISM ON THE ECONOMIC PROSPECTS

8.1. Economic prospects in the next 12 months

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

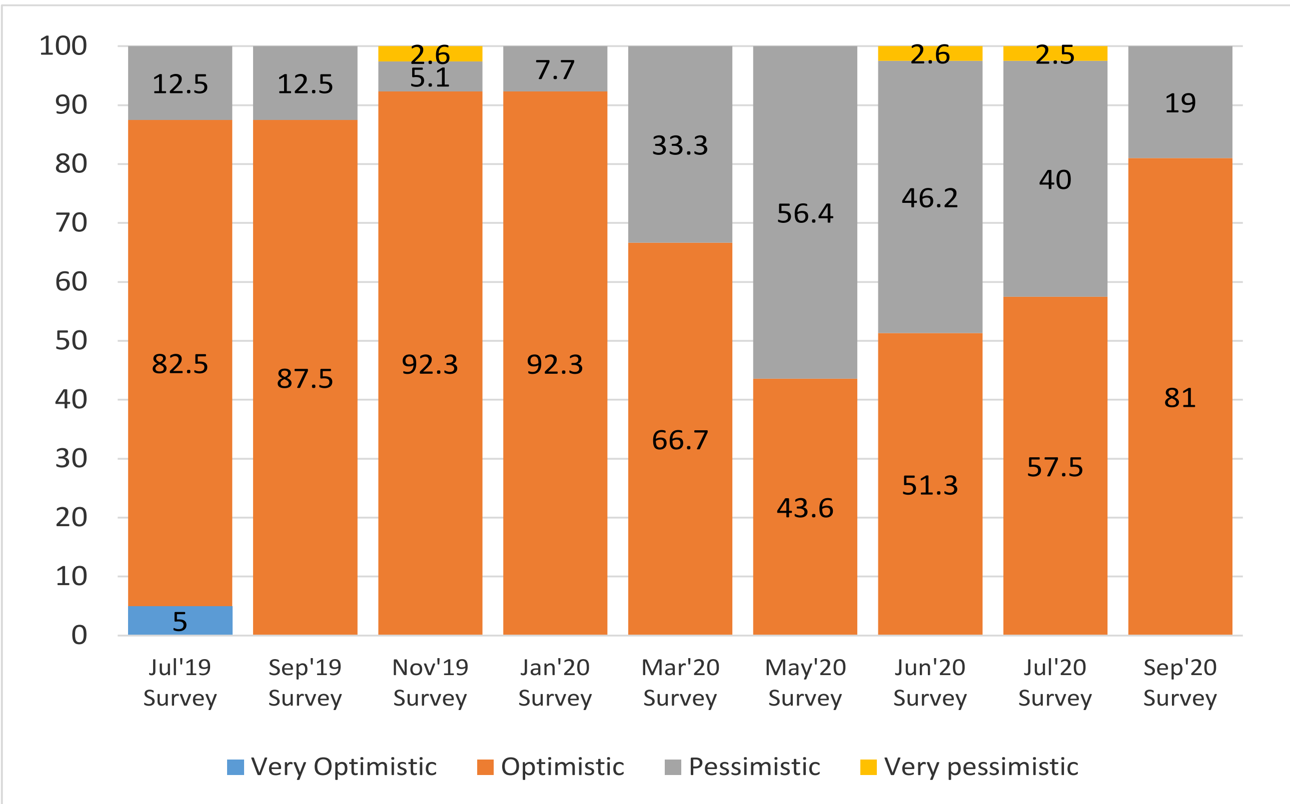
The results showed improved optimism by respondents across banks and nonbank private sector firms, largely as a result of the strides made in fighting COVID-19 pandemic, continued lifting of restrictions initially put in place to contain the spread of the pandemic and the reopening of more sectors of the economy **(Charts 7 and 8).**

Bank respondents revised their optimism upwards for a number of reasons including Government to support key sectors affected by the pandemic by allocating funds to help in their recovery e.g. tourism through the Kenya Tourism Fund, and the Government stimulus package and tax measures implemented to support citizens and businesses affected by the pandemic. Other reasons given included the proposal to help reduce unemployment by allocating funds for the youth, i.e. *kazi mtaani* programme, and other initiatives to support women and people living with disability, proposal to help unlock finances for small and medium enterprises through a Credit Guarantee Scheme, and Government's commitment to settle pending bills.

Furthermore, the rise in adoption of digital ecommerce, favourable weather, lower imports bill as a result of lower global oil prices, resilient diaspora remittances, increased focus on the *Big 4 Agenda,* and easing of travel and movement restrictions, were expected to support recovery in the economy.

Risks to this optimism included uncertainty around the containment of the virus, Government revenue under-performance, reduction in Government-

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



led infrastructure development initiatives due to diversion of funds towards the containment of COVID-19, increased unemployment, closed down education sector and political noise.

Similarly, non-bank private sector respondents expressed improved optimism in the September Survey largely due to Government efforts in containing COVID-19 at both national and county levels, resumption of business activities, recovery of tourism sector as borders re-open, anticipated short rains season and prioritization of economic revival by key Government players.

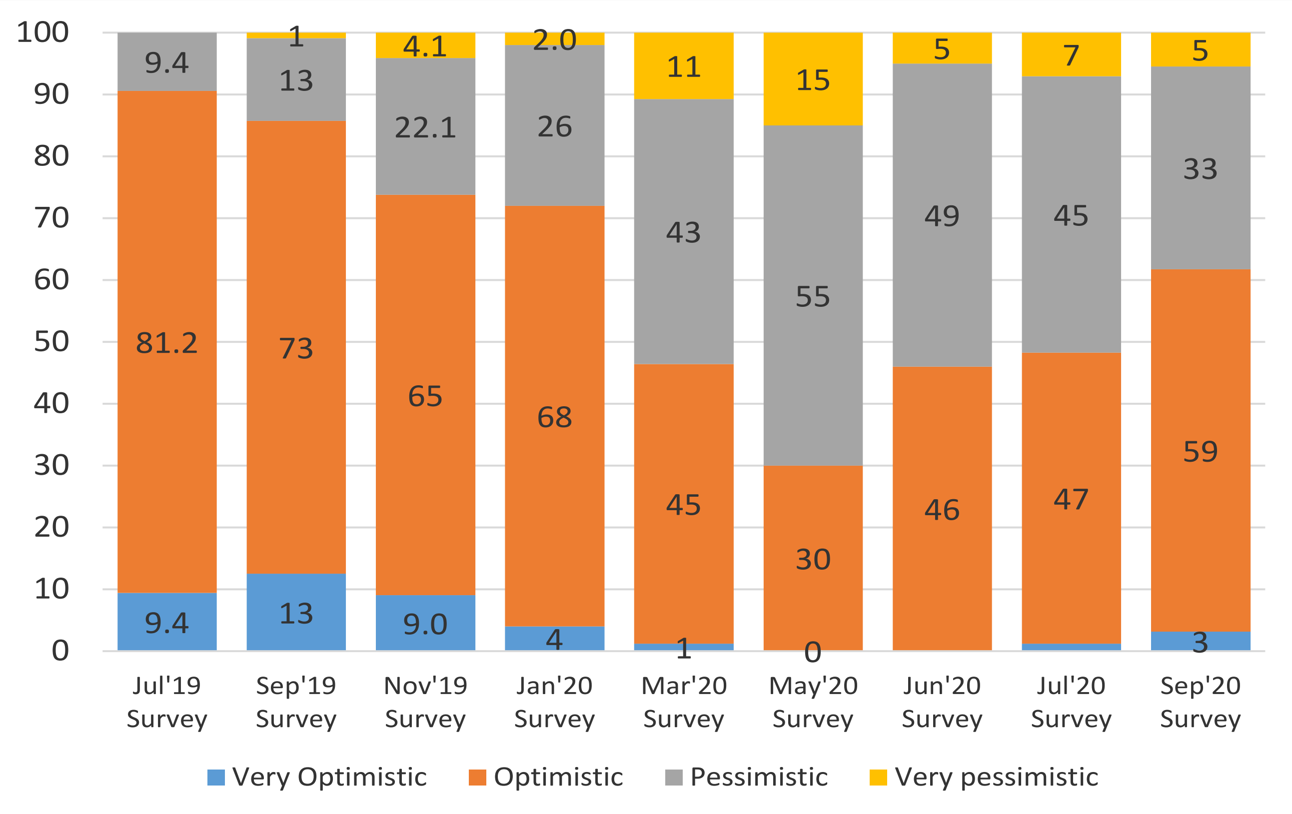
Additionally, respondents cited the proactive Government interventions in the economy, tax measures in place to cushion Kenyans against COVID-19 impact, proposed fund to support MSME's, and improved access to credit by individuals and corporates as reasons informing the optimism.

Other reasons included increased diaspora remittances, rebound in consumer and Government spending expected with the 8-point stimulus, low inflation, implementation of the *Big 4 Agenda*, ease of travel restrictions, and Government's commitment in settling pending bills.

However, the optimism was tempered by the effect of the containment measures of COVID-19, slow pace of recovery of some sectors such as tourism, with low traveller confidence due to the effect of the pandemic in the tourism source markets, and high unemployment.

Other reasons moderating the optimism included uncertainty about re-opening of schools, increasing borrowing needs to finance Government budget deficits and maturing debt obligations, slowing down of development expenditure, closure of some businesses, delays in government payments to suppliers, governance issues and the possibility of a COVID-19 resurgence.

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



9. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

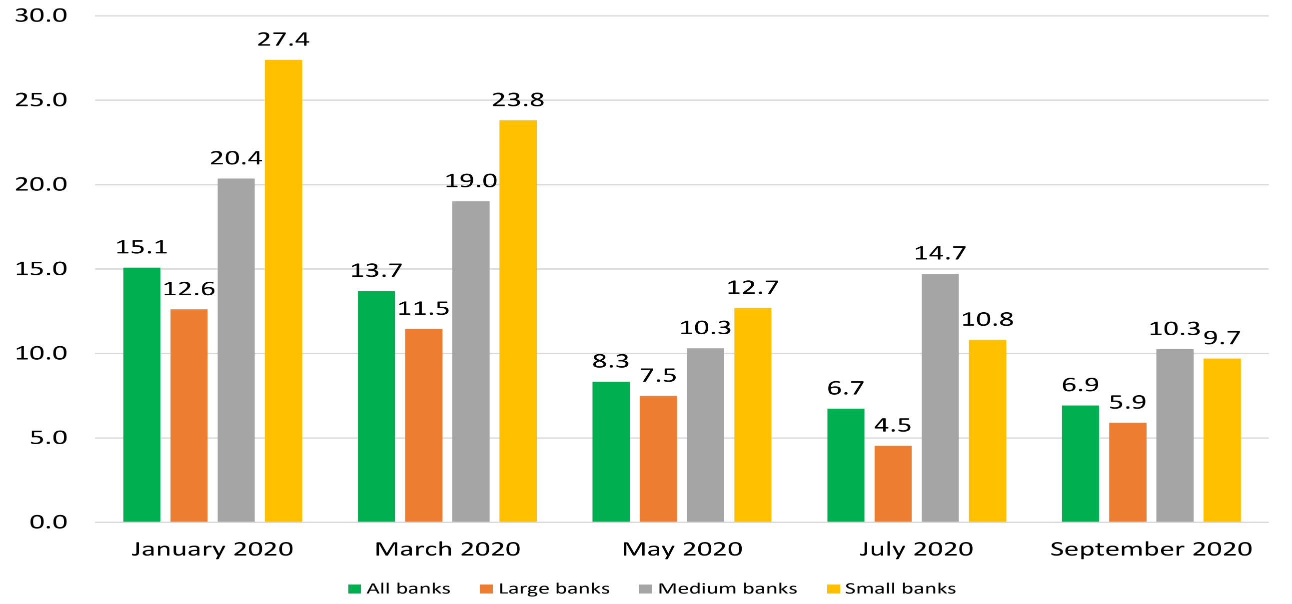
9.1. Growth in private sector credit in 2020

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 the opening up of more businesses with the lifting of more COVID-19 related restrictions, increasing aggregate demand in the economy following the build-up of economic activities and Government's support to economic sectors through the stimulus package, improved risk profiling, favourable weather conditions and timely payments to suppliers, to support private sector credit growth in 2020. In addition, anticipated business opportunities from the *Big 4 Agenda* related projects and demand for short-term working capital requirements to meet immediate business needs were expected to support growth in credit to the private sector.

However, some respondents revised downwards their expected credit growth to the private sector for 2020, relative to 2019 due to effects of uncertainties of the pandemic on economic activities, lower economic growth in 2020, delayed payment of pending bills, elevated credit risk, increased non-performing loans in the industry, and increased and unemployment.

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



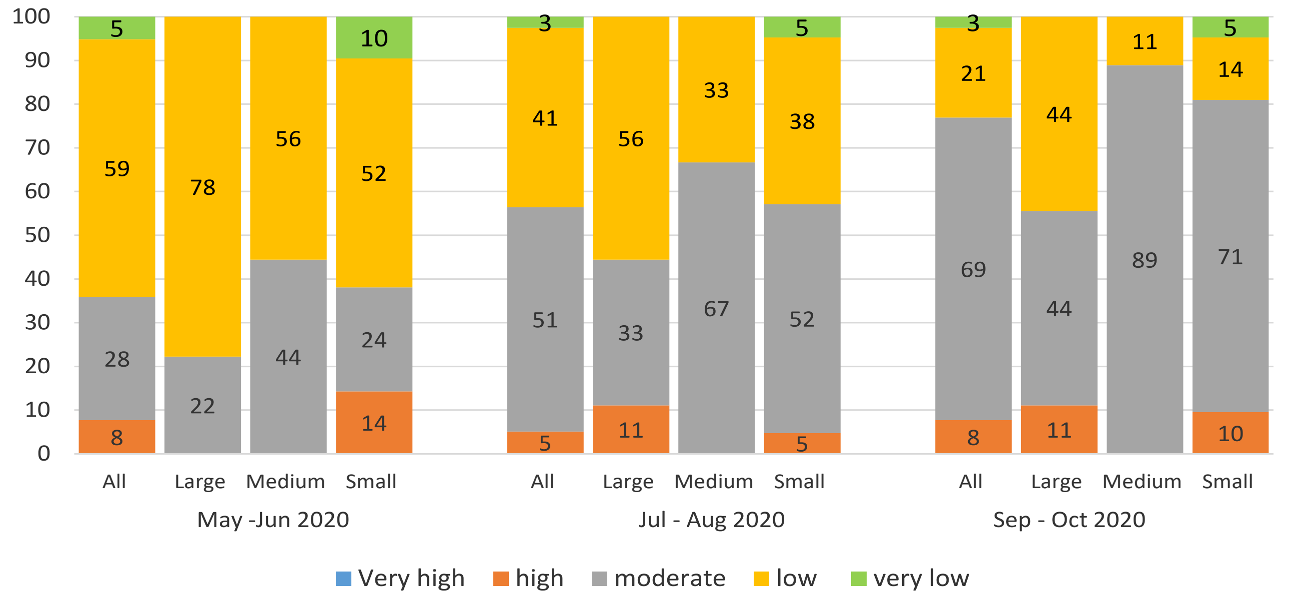
9.2. Expected demand for credit in 2020

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

Respondents expected slightly higher demand for credit by their customers in September and October, driven by improving economic activity, reopening of more businesses, and improving business confidence, following the reduction in the pandemic's infection rate and lifting of the COVID-19 restrictions. Other reasons for expected increased demand for credit included the commitment by Government to pay suppliers, and the need for financing by businesses to resume operations or for working capital support.

Nevertheless, respondents expected slow economic recovery, increased levels of unemployment, slow payment of suppliers and contractors, credit risk and COVID-19 uncertainties, to dampen demand for credit in September and October.

Chart 13: Demand for credit (percent)



10. INFLATION EXPECTATIONS

10.1. Inflation expectations for September and October

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

The results showed that inflation expectations remained anchored, with respondents expecting inflation to remain within the target range (5 ± 2.5 percent) in September and October 2020 **(Table 2).**

Bank respondents expected inflation to remain low and stable in the next 2 months due to lower food prices following favourable weather conditions and ongoing harvest season, subdued demand pressure and expectations of lower international crude oil prices.

Similarly, non-bank respondents expected inflation to remain within the target range in the next 2 months due to low food and relatively low global oil prices.

However, respondents expected some upward pressure on inflation mainly through increased demand due to economic activity, higher demand for fuel, and costs of production and transport.

Table 2: Inflation expectations for September and October (percent)

Expected Inflation for:	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
Sep-Oct 2019	5.2	5.3	5.3	5.2	5.1	5.3
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**

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 low food prices due to favourable weather, muted demand pressures on the back of low consumer demand, and expected macroeconomic stability **(Table 3).**

Inflation over the mid-term was expected to remain within the target range supported by increased food security to minimise food inflation and continued macro-economic stability. Respondents expected the economy to have recovered from all the economic, social and political shocks including COVID-19 pandemic and the general elections, in the medium term.

Nevertheless, respondents cited possible volatility in food prices due to weather fluctuations, increases in oil prices as global demand recovers, and general increased spending prior to the general elections, as risks to the inflation outlook .

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
September 2020 - August 2021	5.1	5.2	5.1	4.9	4.5	5.0
September 2020 - August 2022	5.4	5.4	5.4	5.7	5.5	5.4
September 2020 - August 2025	5.1	5.1	5.3	5.3	4.9	5.1

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 September and October 2020. Expectations were varied across banks and nonbanks on the direction of the Shilling to US Dollar exchange rate.

Bank respondents expected the Shilling to be supported by sufficient foreign exchange reserves, strong diaspora remittances, recovery in agricultural exports, and a possible weakening on the US Dollar as we head into the US elections in November. However, respondents expected some pressure to arise from increased Dollar demand as more businesses reopen following the easing of containment measures by the Government, lower capital flows and tourism earnings, and effects of excess liquidity currently prevailing in the money markets.

Similarly, non-bank private firm respondents expected the Shilling to be supported by the sufficient foreign exchange reserves, low inflation and improving exports as economic activities resumed with the opening of the economy. However, some respondents expected some pressure to arise from increased imports, concerns on external debt obligations and the continued uncertainty brought about by the pandemic.

12. HOW THE BUSINESS ENVIRONMENT COULD BE ENHANCED

The Survey asked respondents to indicate how the business environment could be enhanced. Bank respondents indicated that continued settlement of pending bills would spur economic activity and lower non-performing loans, while improved digital security and increased effectiveness in the Judicial System on contract enforcement would improve their business environment. Other suggestions included, implementation of guarantee schemes for vulnerable borrowers, continued CBK communication to the Kenyan population on the usefulness and safety of adopting usage of digital channels, and provision of a business stabilization fund to mitigate the impact of COVID-19 especially for MSMEs.

Non-bank private firms on the other hand suggested more support in terms of subsidies to the MSMEs segment, low interest rate loans for business especially those in the tourism sector, additional fiscal measures to facilitate the business recovery, beside reduction of taxes, and interventions to reduce cross-border trade bottlenecks and facilitate seamless movement of the raw material across borders.

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