Central Bank of Kenya

Monetary Policy Committee Market Perceptions Survey

January 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.

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, employment, and input prices. 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, 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 January 2020 MPC Market Perceptions Survey, conducted in the first three weeks of the month, sought perceptions on the economic conditions prevailing in the two months before the MPC meeting, i.e. November and December 2019, and market expectations on economic conditions for January and February 2020, and for the next 12 months i.e. January – December 2020. The Survey sought from respondents their expectations with regard to overall inflation, movements of the exchange rate of the Kenya Shilling against the U.S. Dollar, demand for credit, private sector credit growth and economic growth.

Other areas interrogated included the levels of optimism in the economic prospects, perceptions of levels of economic activity before the MPC meeting, expected levels of economic activity after the MPC meeting, and movements in production input prices before the MPC meeting.

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

2. SURVEY METHODOLOGY

The Survey was administered to the Chief Executives and other senior officers of 381 private sector firms comprising 38 operating commercial banks, 1 operating mortgage finance institution, 13 micro-finance banks (MFBs) and 328 non-bank private firms including 45 hotels, through questionnaires sent by email and hard copy. The overall response rate to the January 2020 Survey was 60 percent of the sampled institutions. The respondents comprised 38 commercial banks, 1 mortgage finance institution, 11 micro-finance banks, 30 hotels, and 149 other non-bank private sector firms.

The expectations from commercial and micro-finance banks were aggregated and analysed using weighted averages based on the market size of the bank/ microfinance bank relative to total banks/ microfinance banks, respectively, while those from the non-bank private firms were weighted using the respective sector weights based on the latest available sectoral contributions to GDP.

3. HIGHLIGHTS OF THE SURVEY

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

- Inflation expectations remain well anchored within the target range for the 2 months after the Survey, i.e. January and February, and for the 12-month period after the Survey, i.e., January – December 2020.
- Mixed expectations by bank and non-bank respondents with regard to the Ksh/USD exchange rate for the next 2 months.
- Expectations of an increase in private sector credit growth in 2020 relative to 2019.
- Expectations of a strong economic growth in 2020.
- Sustained optimism on Kenya’s economic prospects by banks and non-bank private sector.

4. CURRENT ECONOMIC CONDITIONS

4.1 Overall Economic Activity

The January 2020 Market Perceptions Survey sought bank and non-bank private sector firms’ assessment of economic activity in the two months prior to the January MPC meeting, i.e., November and December 2019, to get a sense of the economic conditions prevailing before the MPC meeting.

Bank respondents reported moderate to strong activity during the period **(Chart 1)**. Respondents pointed out increased activity in some sectors due to the festive season, a gradual pick-up in credit growth, settlement of most Government pending bills, improved activity in transport, trade and hotel sector, continued focus by the government on the Big 4 Agenda implementation, sound monetary policy and a stable macroeconomic environment, as factors driving economic activity in November and December 2019.

However, some respondents cited the heavy rains which affected crop production and disrupted transportation of produce to the markets, and slower business in manufacturing, construction and real estate as factors that slowed down activity in November and December .

In addition, respondents also indicated that slower Government spending on development projects, higher taxation, delayed payments to suppliers and businesses closures for the holidays were some of the challenges that affected activity during this period.

Similarly, the non-bank private firm respondents reported moderate-to-strong activity during this period driven by end of year festivities. There was an increase in the consumption of fast-moving locally produced consumer goods, due to Government's efforts to curb illicit trade particularly with regard to reducing contraband imported goods into the market. Respondents also cited the onset of rains, the resurgence in the economy experienced due to the repeal of interest rate cap and the improved business environment predicated on political stability, as reasons for the activity during the period.

The main challenges experienced during the period as cited by respondents included the slow-down due to austerity measures by the Government, the suspension of some projects, cases of layoffs in the private sector, profit warnings by some listed firms and unemployment. Respondents also cited limited access to credit as a key factor contributing to subdued economic activity**.**

4.2: Input prices

To further assess economic conditions prevailing before the January 2020 MPC meeting, private sector firms were asked to indicate the direction of change (increase/ decrease) in the prices of various production inputs, such as energy, transportation costs, raw materials, labour, freight charges and construction materials, in November and December 2019.

While respondents' views were varied depending on the particular inputs they consumed the most, the Survey showed significant increase in prices related to energy and transportation costs, mainly associated with increased pump prices and compounded by the hikes related to the festive season. Most respondents indicated that prices of raw materials, freight, construction materials and labour remained largely the same, but with a tendency to increase marginally during the period **(Chart 2).**

Chart 1: Perceptions on Economic Activity for November and December 2019 (percent)

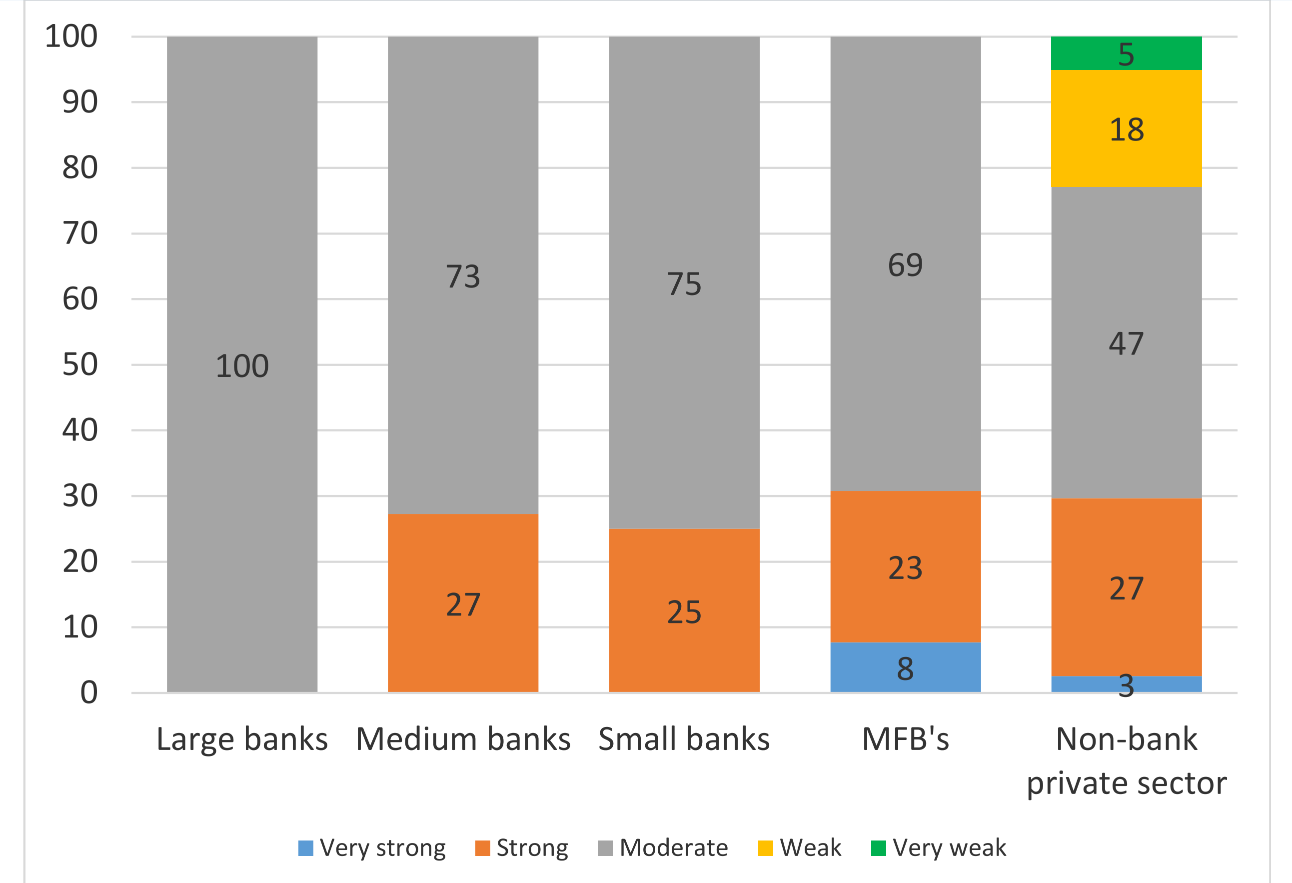
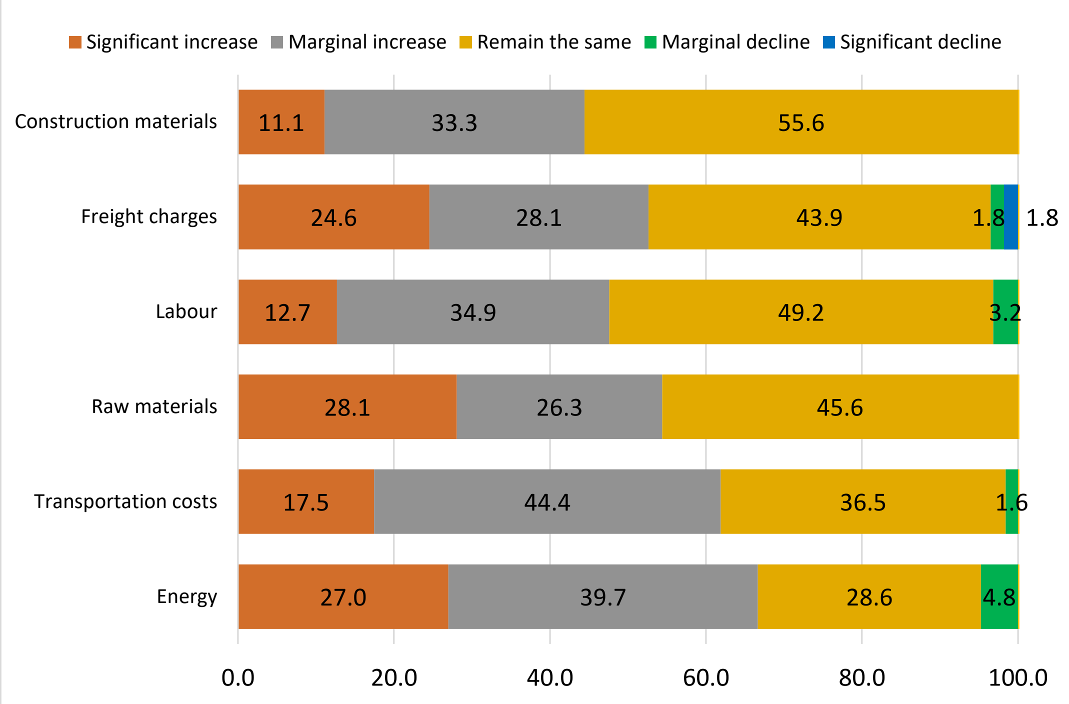


Chart 2: Perceptions on Movements in input prices in November – December 2019 (percent of respondents)



5. INFLATION EXPECTATIONS

Participants in the Survey were asked to indicate their expectations of overall inflation rates for the next 2 months (January and February 2020), and in the next 12 months (January to December 2020).

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

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

Expected Inflation for:	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
Jan-Feb 2019	5.5	5.3	5.5	5.5	5.5	5.6
Mar-Apr 2019	4.2	4.2	4.1	4.2	4.2	4.3
May-Jun 2019	6.9	6.4	6.8	6.8	6.5	6.7
Jul - Aug 2019	5.9	5.8	5.8	5.9	5.9	5.8
Sep-Oct 2019	5.2	5.3	5.3	5.2	5.1	5.3
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**

Bank respondents expected moderate upward pressure on inflation attributed to the (October-December) above normal rainfall, which led to post harvest losses, low food reserves and higher prices due to seasonal (dry) weather conditions. In addition, respondents cited the increases in fuel prices, and mild pick-up in private consumption on the back of improved liquidity as likely to put upward pressure on inflation.

However, respondents expected the above normal short rains experienced in 2019 and so far in 2020 to moderate food prices in the first quarter of 2020, despite the above listed risks.

Respondents across the non-bank sectors of the economy expected some pressure on inflation to come from rising fuel and as a result transport and consumption prices, impact of tax measures finding its way into prices of commodities, and lower harvests due to the adverse weather. However, respondents expected the ongoing rains, and a stable Shilling to moderate inflation over the next 2 months **(Table 2).**

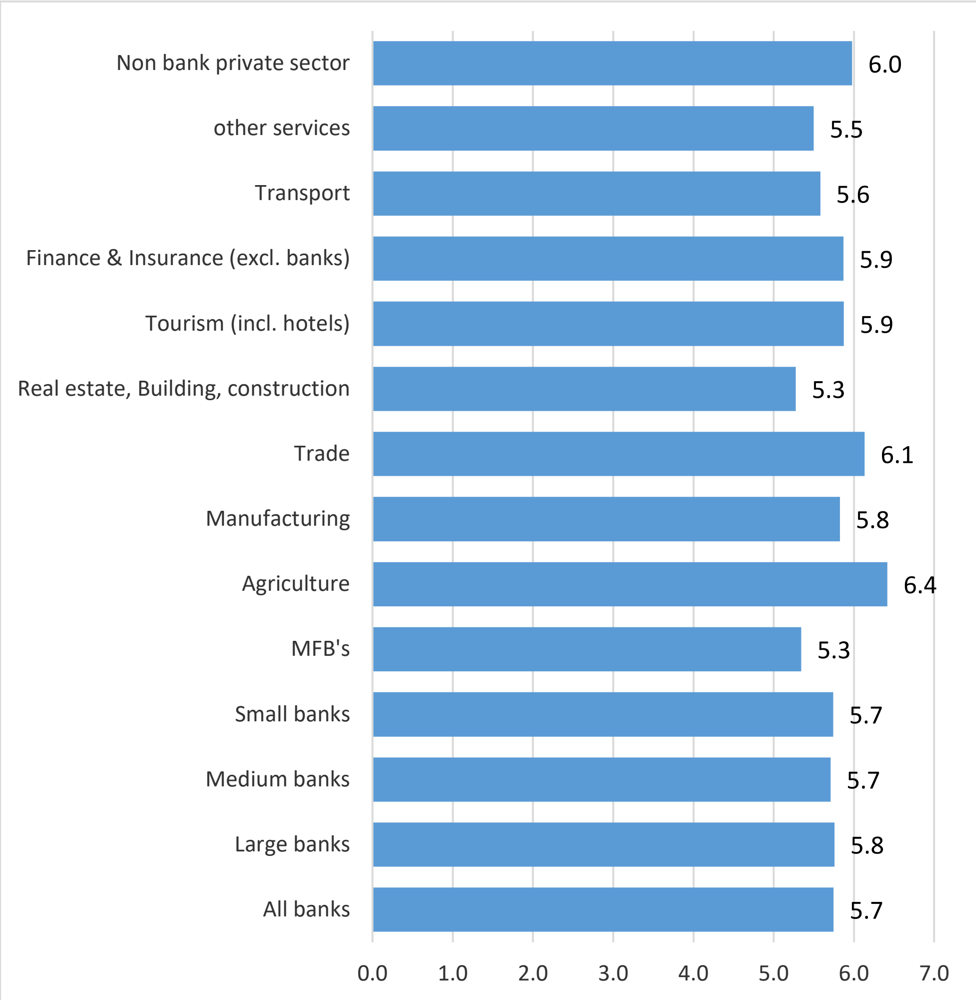
Table 2: Sectoral inflation expectations for the next 2 months (percent)

	Jan-20	Feb-20	Average
All banks	5.6	6.0	5.8
Large banks	5.6	6.0	5.8
Medium banks	5.6	5.8	5.7
Small banks	5.8	5.5	5.8
MFB's	5.7	5.7	5.7
Micro lenders	5.9	5.8	6.0
Agiculture	5.7	6.0	5.9
Manufacturing	5.7	5.8	5.8
Trade	6.0	6.0	6.0
Real estate, Building, construction	5.4	5.4	5.4
Tourism (incl. hotels)	5.7	6.0	5.9
Finance & Insurance (excl. banks)	5.8	5.9	5.9
Transport	5.8	5.8	5.8
other services	6.3	5.8	6.1
Non bank private sector	5.8	5.9	5.8

Inflation expectations for the next 12 months (January – December 2020), across the different economic sectors remained well anchored within the target range supported by lower food prices due to favourable weather conditions, and stable electricity prices due to the above normal short rains in the last quarter of 2019 **(Chart 3).** Bank respondents further expected that interest rates would remain stable with improved economic activity driven by a stable macroeconomic environment.

Respondents indicated that upward pressure on inflation could likely come from increased demand for credit to private sector, impact of turnover tax on prices of key commodities and possible upward pressure on food prices due to volatility in global prices.

Chart 3: Inflation expectations for the next 12 months (percent)



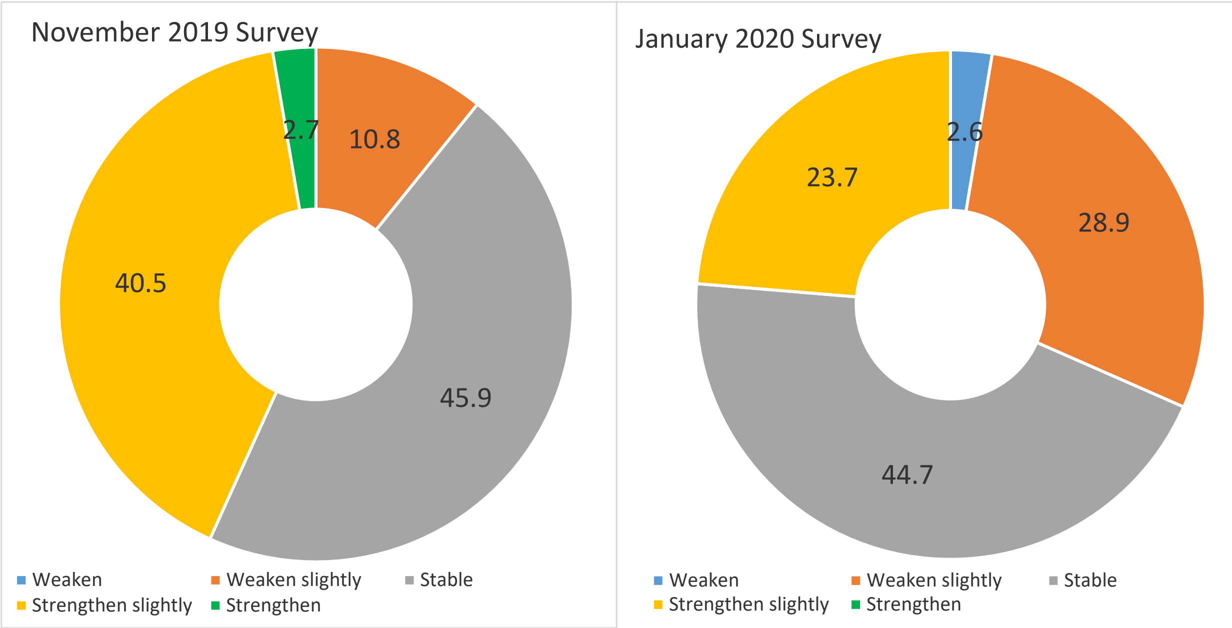
6. EXCHANGE RATE EXPECTATIONS

The Survey sought to find out the market expectations on the direction of change in the exchange rate of the Shilling against the U.S. Dollar in January and February 2020.

The results showed that bank respondents expected the Shilling to remain stable with a strengthening bias against the USD in the next 2 months, supported by sufficient foreign exchange reserves, continued strong diaspora remittances, healthy capital and tourism inflows, and political stability. In addition, bank respondents cited the resilient performance of exports, especially horticulture, with the seasonal boost expected on flower exports due to the Valentine's season, and sound monetary policy as reasons supporting the stability of the Shilling **(Chart 4).**

According to respondents, however, higher imports of raw materials for production with pick-up in economic activity, seasonal dividend remittances by global corporates, increase in oil prices and payments partly driven by geopolitical tensions, and external debt repayments obligations, were likely to exert pressure on the Shilling.

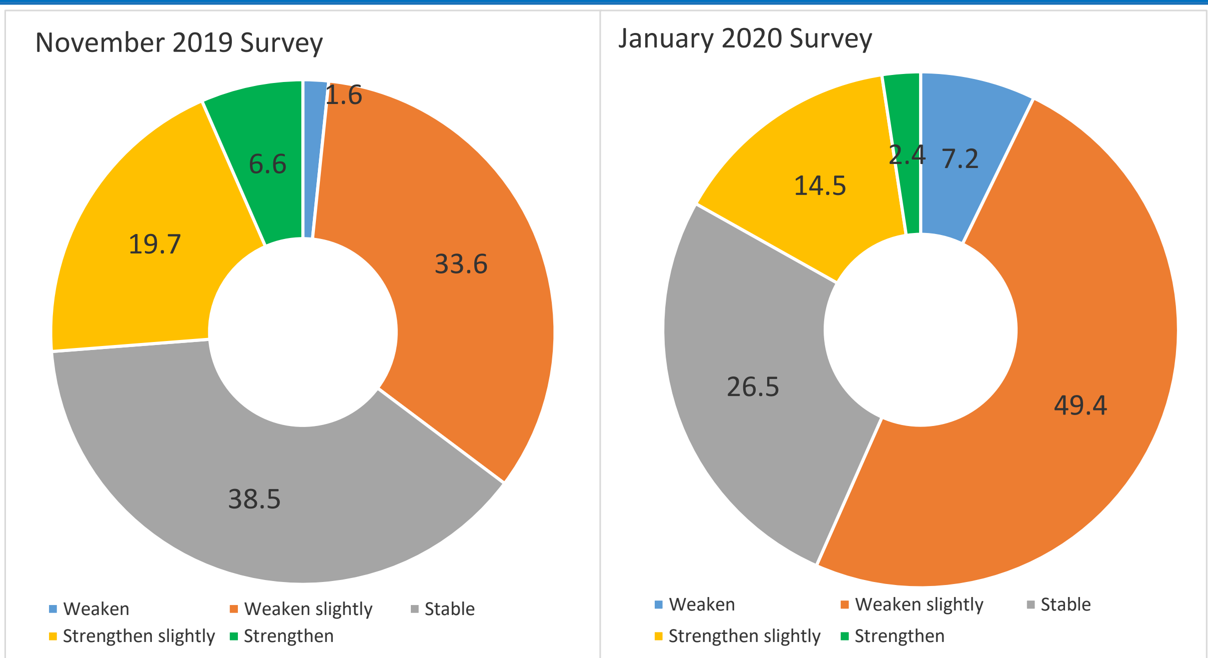
Chart 4: Banks expectations on the direction of the Shilling/ USD Exchange rate in the next 2 months (percent)



Non-bank private sector firms expected a marginal weakening of the Shilling against the USD over the next 2 months largely due to the uncertainty of the possible impact of weather changes on agricultural exports, low tourist season, increase in oil prices due to the conflict in Middle East including the US –Iran geopolitical tensions, and concerns around higher external debt obligations **(Chart 5).** In addition, respondents indicated that a possible increase in demand for imports with improved credit access could exert pressure on the Shilling.

Respondents, however, expected the adequate foreign exchange reserves, strong diaspora remittances, favourable weather conditions that would improve agricultural exports and a stable business and political environment, to support the Shilling over the next 2 months.

Chart 5: Non-bank private sector firms' expectations on the direction of Shilling/ USD Exchange rate in the next 2 months (percent)



7. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

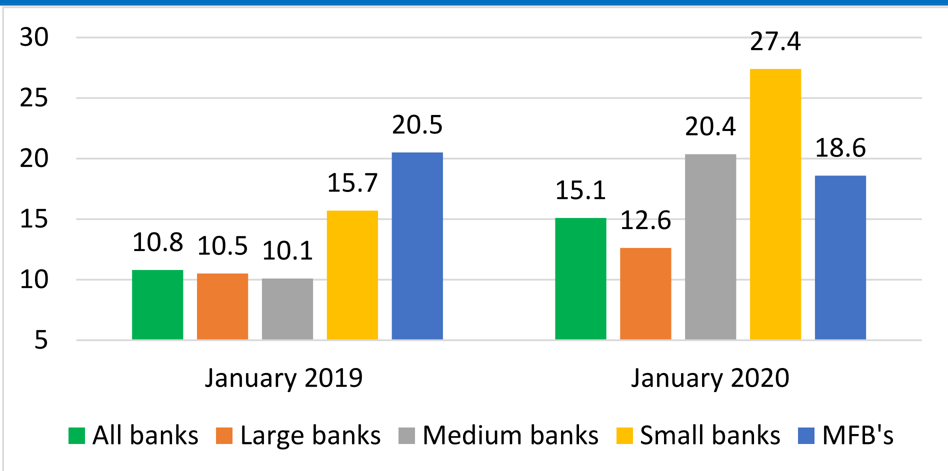
7.1 Growth in Private Sector Credit in 2020

The Survey sought to find out commercial banks' expected private sector credit growth by the end of 2020 relative to the position at the end of 2019.

Bank respondents indicated expectations of a higher growth in credit to the private sector largely driven by the repeal of interest rate caps, which was expected to ease access to credit by borrowers especially MSMEs due to adoption of risk based pricing by banks. Credit demand by farmers to purchase inputs following Government stimulus plans in agriculture and favourable weather conditions, improved business sentiments and confidence due to political stability were also expected to boost private sector credit growth in 2020 **(Chart 6).** Respondents also cited the continued support of manufacturing and agriculture under the implementation of the Big 4 Agenda, payment of pending bills by Government which was expected to unlock funds for further lending to SME's, development of innovative credit products and reduction of non-performing loans as factors that would support expansion of credit to the private sector.

According to respondents, risks to the expected private sector credit growth included any heavy Government borrowing, which could crowd out the private sector, outstanding pending bills which curtail available credit to suppliers and increase in non-performing loans in the real sector.

Chart 6: Expectations on Private Sector Credit Growth (percent)



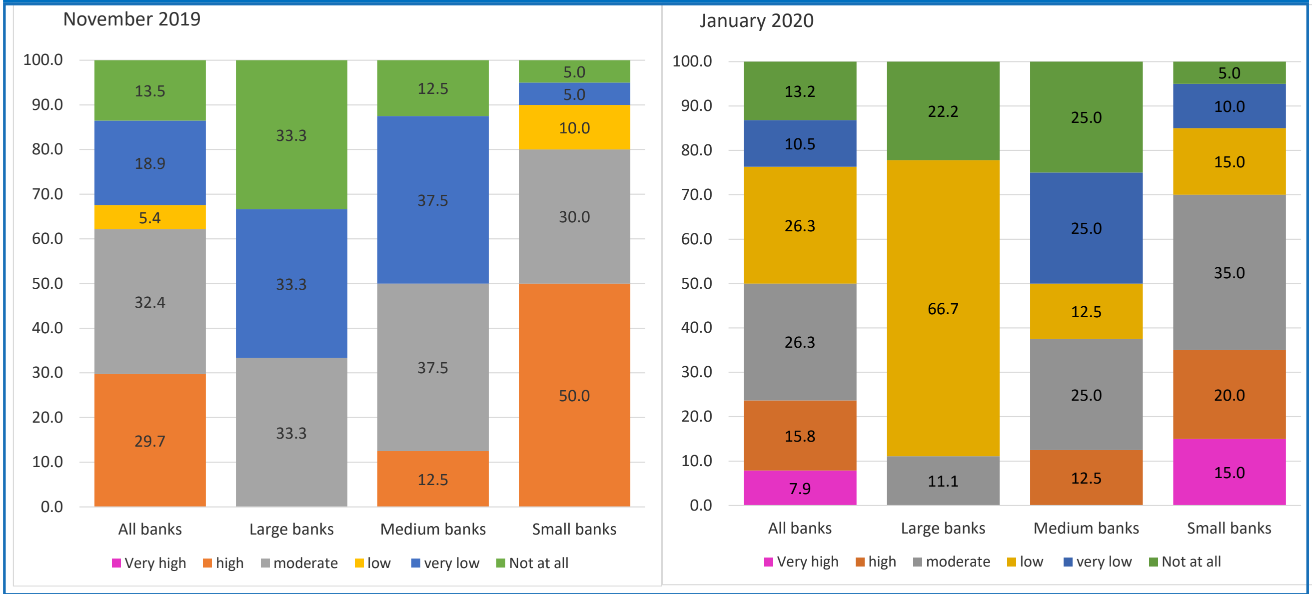
7.2 Role of Liquidity on Private Sector Credit Growth

The Survey asked bank participants to indicate the extent to which liquidity was a constraint to private sector lending for their banks.

The results showed an easing in the liquidity conditions / risk for all bank tiers particularly, small banks. Only 35 percent of the small banks indicated liquidity as a constraint to lending to the private sector in the January 2020 Survey, as opposed to 50 percent in the November 2019 Survey **(Chart 7).**

Large bank respondents indicated that strong customer deposit base and tight liquidity controls contributed to their sufficient liquidity levels. Some small and middle tier banks, however, cited high cost of funds, maturity mismatches between deposit and loan tenors, low saving culture in the economy and likely high default, as factors affecting their liquidity levels. In addition, respondents pointed out that the transfer of liquidity mainly to the tier 1 banks following the collapse of the two tier 2 banks in 2015/2016 and the channelling of most liquidity to Government paper contributed to liquidity challenges in private sector lending. Respondents, however, expected that accelerated payment to suppliers and contractors would improve liquidity and consequently lending to the private sector.

Chart 7. Extent to which liquidity is a constraint to private sector lending (percent)



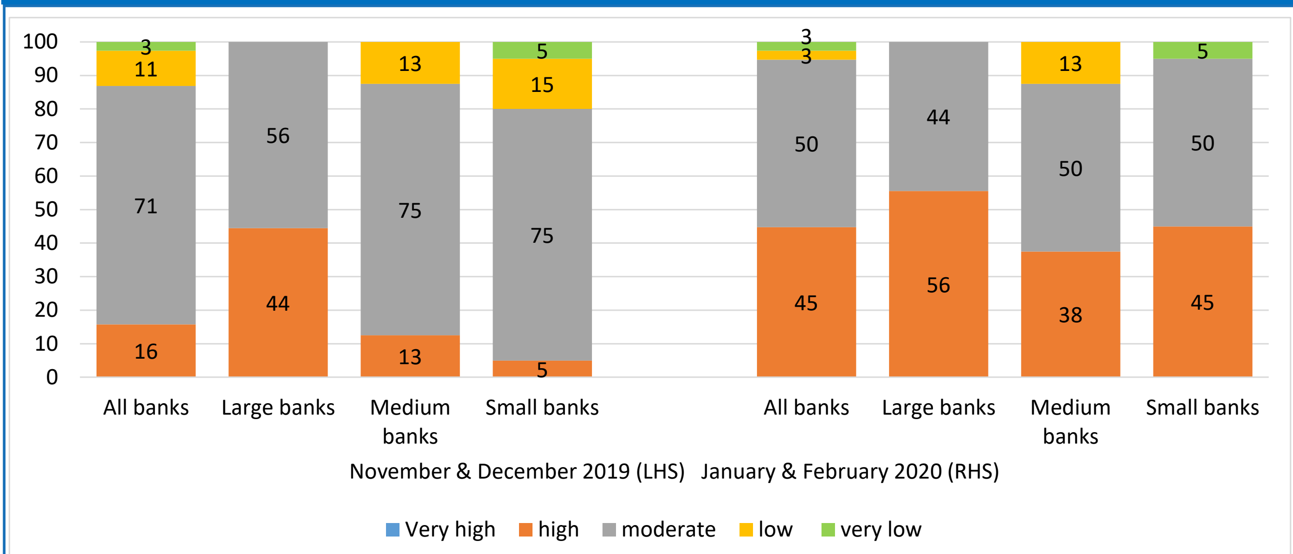
7.3 Expectations of Demand for Credit from banks

The Survey requested bank participants to give an assessment of the demand for credit experienced by their banks in the 2 months before the MPC meeting, i.e., November and December, and their expectations of the same for January and February 2020. The results showed expected increase in credit demand by all bank tiers in January and February 2020 relative to that experienced in November and December 2019 **(Chart 8).**

Banks expected higher demand for credit in January and February 2020, driven by a pick-up of economic activities in 2020, cheaper cost of credit due to the lowering of the CBR, anticipated business opportunities from the Big 4 Agenda, repeal of interest rate caps and increased demand by farmers to purchase agricultural inputs due to favourable weather conditions. In addition, bank respondents pointed out that the improved ease of doing business occasioned by a favourable macro-economic environment and the payment of pending bills to suppliers would boost liquidity flow in the market and stimulate demand for credit.

Nevertheless, respondents cited liquidity constraints and lower demand for consumer goods as factors that could slow credit demand in January and February 2020.

Chart 8: Credit demand perceptions for November and December 2019, and expectations for January and February 2020 (percent)



8. ECONOMIC ACTIVITY AND EMPLOYMENT EXPECTATIONS

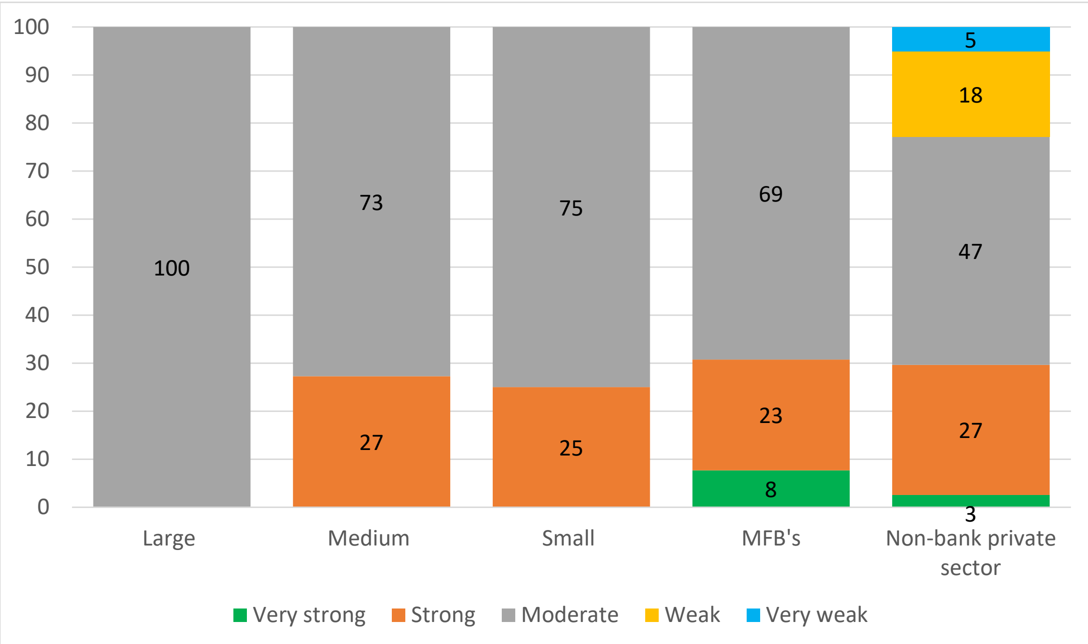
8.1. Expected Economic Activity

The Survey sought to find out expected levels of economic activity in January and February 2020 by banks and non-bank private sector firms.

Respondents expected economic activity to be largely moderate tending to strong, supported by payment of pending bills, improved food production owing to the recent good rains, expected increase in public sector activities backed by the Big 4 Agenda and increase in private sector credit which was expected to open credit to MSMEs and drive more demand for goods and services in the market. Other factors expected to boost activity included continuous efforts in supporting MSMEs through creation of innovative products, financial inclusion and access to cheap credit initiatives, continuous inflows from the diaspora, stable macro-economic environment and a stable political environment. **(Chart 9).**

Respondents, however, cited a challenging external environment, softening global growth, seasonal dry weather conditions and delays in settlement of outstanding pending bills as risks to the economic activity outlook. Additional risks mentioned included taxation measures and political noise.

Chart 9: Expected Economic Activity in January and February 2020 (percent)



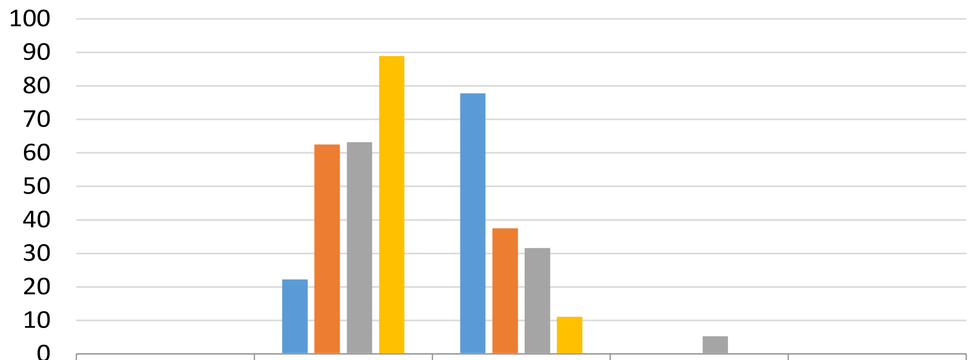
8.2: Employment Expectations

The Survey inquired from bank and non-bank respondents what their company expectations were with regard to the number of employees the company expected to retain in 2020 relative to 2019.

Large banks generally expected to retain their employment levels in 2020, while small, medium and micro-finance banks expected to hire more staff in 2020 relative to 2019, driven by the need to build new capacities and increase service levels in the area of innovation, opening of new branches and expected increases in loan books. Other reasons for expected increase in staffing levels included improved credit intake and optimistic sentiments in the market, expected rise in demand for credit **(Chart 10).** Some banks, however, indicated that they would maintain their current levels, taking a cautious approach on economic performance.

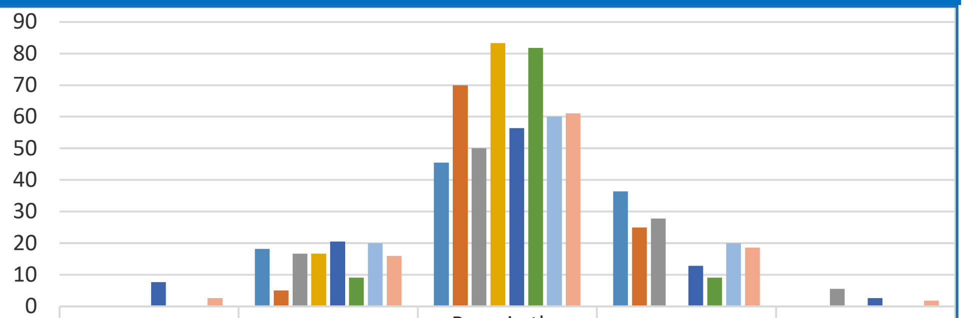
The non-bank private sector firms did not expect much difference in their staffing levels for 2020 relative to 2019 citing low business, low sales, focus on revenue maximization and leveraging on technology as reasons affecting their expectations. Hotel respondents cited increased competition and some security concerns, while respondents in the transport, cargo and logistics business claimed that transport business was relatively lower due to increased competition from SGR, compelling them to look for other business opportunities such as warehousing **(Chart 11).** Other respondents, however, indicated that planned expansions would lead to additional hires.

Chart 10: Expected changes in employment levels by banks in 2020 (percent)



	Strong increase	Increase	Remain the same	Decrease	Strong decrease
Large banks	0	22.2	77.8	0	0
Medium banks	0	62.5	37.5	0	0
Small banks	0	63.2	31.6	5.3	0
Mfb's	0	88.9	11.1	0.0	0

Chart 11: Expected changes in employment levels by non-bank private firms in 2020 (percent)



	Strong increase	Increase	Remain the same	Decrease	Strong decrease
Agriculture	0	18.2	45.5	36.4	0
Manufacturing	0	5	70	25	0
Trade	0	16.7	50.0	27.8	5.6
Real estate, Building, construction	0	16.7	83.3	0.0	0.0
Tourism (incl. hotels)	7.7	20.5	56.4	12.8	2.6
Finance & Insurance (excl. banks)	0	9.1	81.8	9.1	0
Transport	0	20.0	60.0	20.0	0
Total non-bank private sector	2.7	15.9	61.1	18.6	1.8

9. ECONOMIC GROWTH EXPECTATIONS

The Survey requested participants to indicate their expected economic growth rate for the country in 2019 and 2020.

9.1: Economic Growth Estimate for 2019

Respondents revised downwards expectations for 2019 economic growth, but expected it to remain resilient, supported by favourable weather and recovery in agriculture in the second half of the year, increased activity due to higher demand during the festive season, implementation of Big 4 Agenda and a turn-around in key sectors including food-processing, financial services and manufacturing. Respondents also cited the improved access to credit and expected growth of MSMEs following the repeal of interest rate caps, strong diaspora remittances, improving business confidence, stable macroeconomic environment and political stability as factors that would contribute to growth in 2019 **(Table 3).**

Respondents attributed the downward revision in growth to weaker performance in the agricultural sector due to adverse weather conditions earlier in the year, delayed payment of pending bills to businesses dealing with the central and county Governments and reduction of development expenditure by Government. Respondents also cited slowdown in global growth leading to lower demand for Kenya's exports, likely strain of foreign debt repayments and possible post-harvest losses expected after the disruptive rains in the fourth quarter of 2019, as factors that would dampen growth in 2019.

Table 3: Expectations on Economic Growth for 2019 (percent)

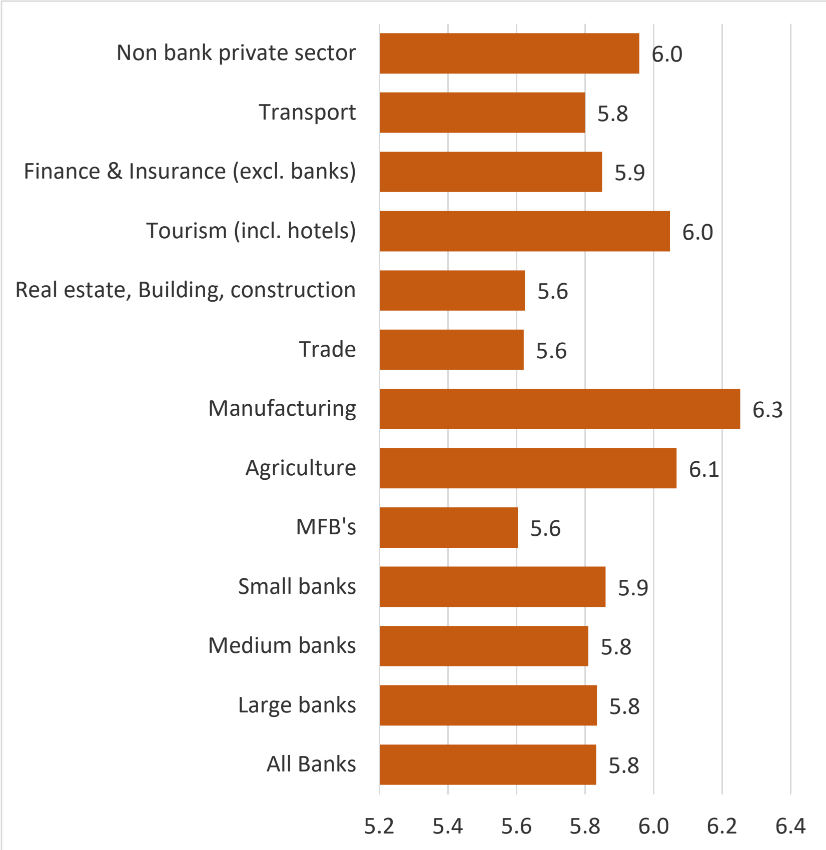
Survey month	Large banks	Medium banks	Small banks	All banks (Weighted by size of bank)	Micro-finance banks	Non-bank private firms
Jan-19	6	6	5.9	6	6	6
Mar-19	5.9	6	6.2	6	6	6.3
May-19	5.7	5.8	6.1	5.7	5.7	6
Jul-19	5.8	5.9	5.8	5.8	6.0	5.9
Sep-19	5.7	6.1	6.1	5.8	6.0	6.0
Nov-19	5.7	5.9	5.9	5.8	5.8	5.8
Jan-20	5.6	5.8	5.5	5.6	5.5	5.5

9.2: Economic Growth expectations for 2020

In the January 2020 Survey, respondents expected a stronger economic growth in 2020 relative to 2019. Respondents across the sectors expected increased agricultural production, infrastructural developments, continued implementation of the Big 4 Agenda, growth in credit to private sector with improved access, healthy Government spending despite the fiscal consolidation, payment of pending bills by Government, an improved manufacturing sector, and a stable macroeconomic environment to support growth in 2020. In addition, respondents cited the harnessing of renewable sources of power, improvement in tourism, enhanced business confidence, renewed fight against corruption and political stability as key to growth expectations in 2020 **(Chart 12).**

However, respondents mentioned, delayed payment to government suppliers, Government austerity measures put in place, continued downsizing of businesses due to pricing, dwindling disposable incomes and political noise as the main risks to growth in 2020. Additionally, respondents pointed out shortages in cash flows affecting private sector, geo-political tensions and Brexit as factors likely to affect 2020 economic growth.

Chart 12: Expectations on Economic Growth for 2020 across Sectors (percent)



10. OPTIMISM ON THE ECONOMIC PROSPECTS

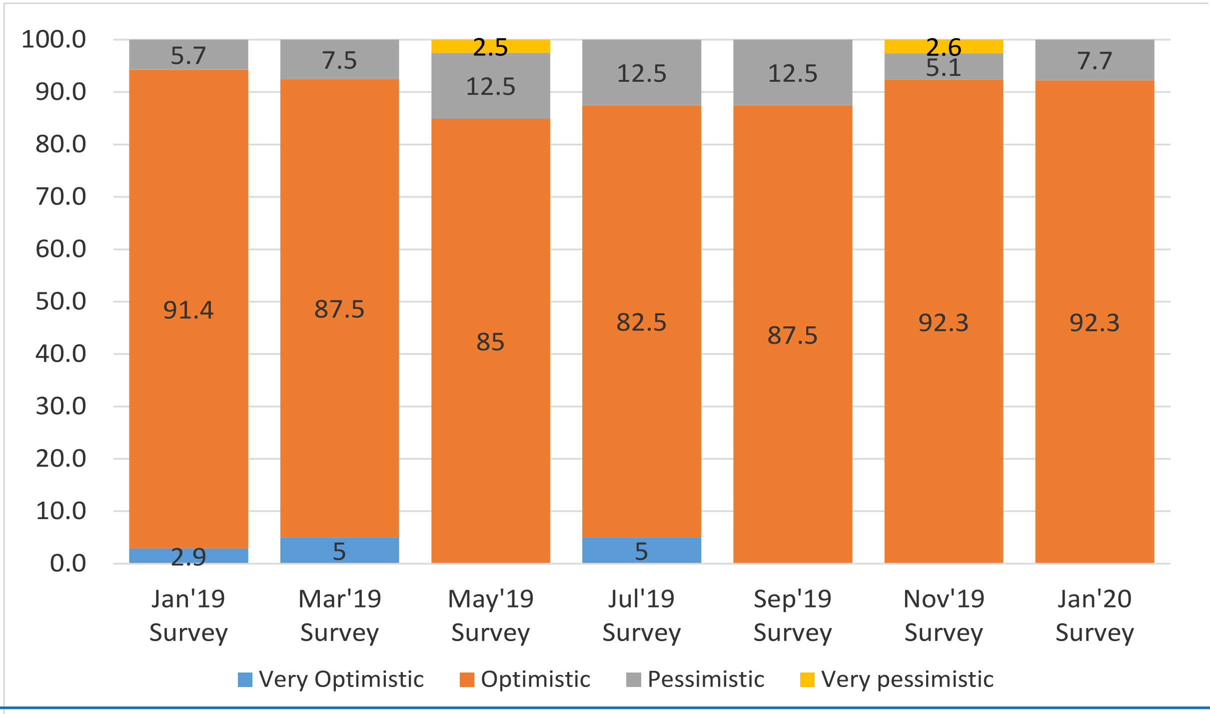
10.1. Economic Prospects

In the January 2020 Survey, banks and non-bank private sector firms were asked how optimistic/ pessimistic they were regarding the country's economic prospects. The results showed sustained optimism by respondents across banks and nonbank private sector firms **(Charts 13 and 14).**

Bank respondents were optimistic about the country's economic prospects, citing sentiments and actions by the President at the beginning of the year 2020, which indicated strong commitment to drive the economy forward, settlement of outstanding pending bills, implementation of the Big 4 Agenda projects and Government investment in infrastructure as reasons for their optimism. In addition, respondents pointed out the ability to price risk following the lifting of the interest rate caps which is expected to unlock credit to deserving sectors and increase private sector credit, and improved weather conditions expected to support agricultural output as key to this optimism. Other reasons given for this optimism included strong diaspora inflows, expected lower cost of electricity due to improved rainfall, stable macroeconomic environment and political stability.

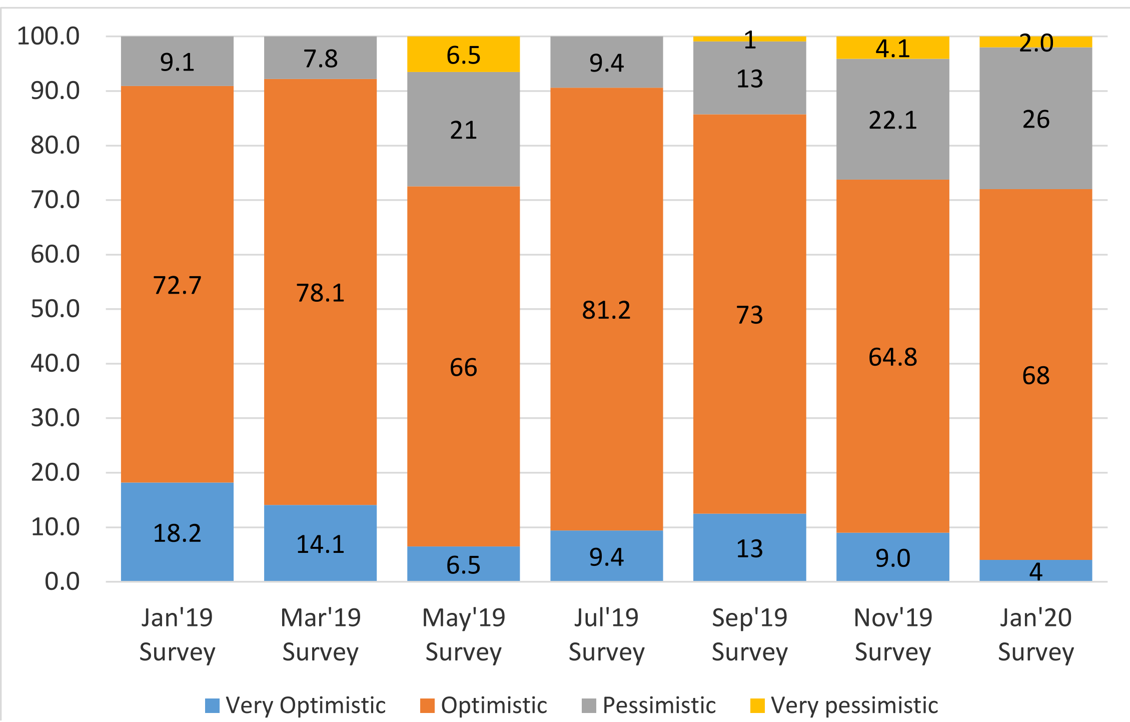
Risks to the optimism by bank respondents included perceived higher tax burden on the public, concerns over little room for Treasury to support growth due to debt obligations, and political noise.

Chart 13: Optimism by Banks on Economic Prospects, Going Forward (percent)



The non-bank private sector firms maintained their optimism levels about the country's economic prospects going forward citing increased government funding in the implementation of the Big 4 Agenda, renewed focus on agriculture and MSMEs, expected payment of suppliers by Government and Government's investments in infrastructure development **(Chart 14).** Respondents also expected the removal of interest caps to lead to increase in credit growth to MSMEs and economic activity and as a result spur growth. Other reasons for this optimism included the renewed focus on agriculture and MSMEs sector, the fight against corruption and a stable political environment.

Chart 14: Optimism by Non-Bank Private Firms on Economic Prospects, Going Forward (percent)



10.2. Forward Hotel Bookings

To further assess optimism in the economy, the January Survey requested hotel sector respondents to indicate monthly forward hotel bookings received so far for the period January – April 2020.

Average forward hotel bookings were strong but lower for January and February 2020 relative to a similar period in the previous year. Respondents attributed this mainly to the effect of security threats in Lamu and the Northern parts of the country, and changes in booking habits, where international guests appear to be booking closer to the date of visit **(Charts 15 and 16).** Other reasons given for the lower bookings included high competition due to increased bed capacity in the country, ocassional challenges with the ferry services at the coast and traffic congestion in Nairobi.

Chart 15: Forward Hotel Bookings for January–April 2020 (percent of total capacity)

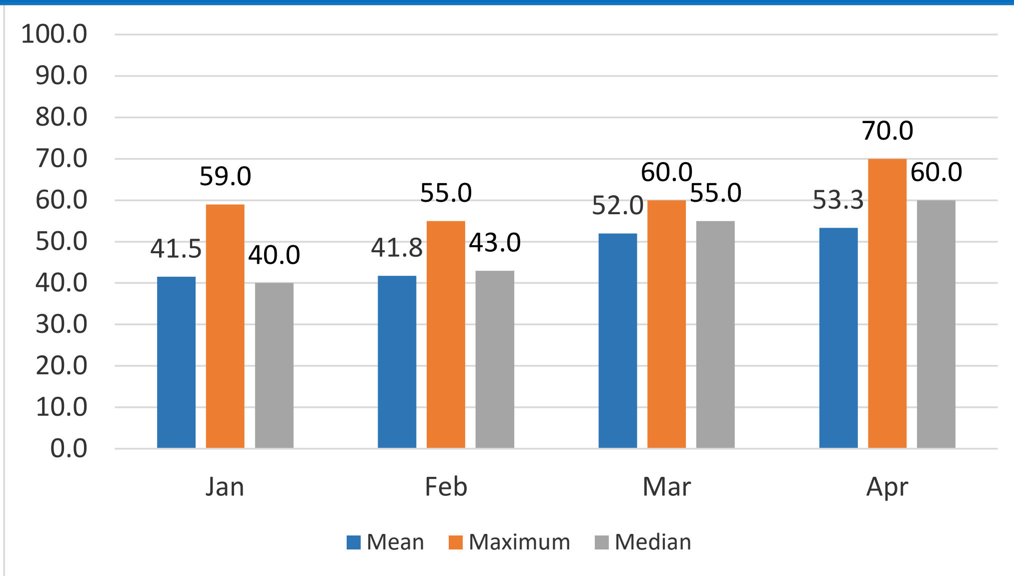
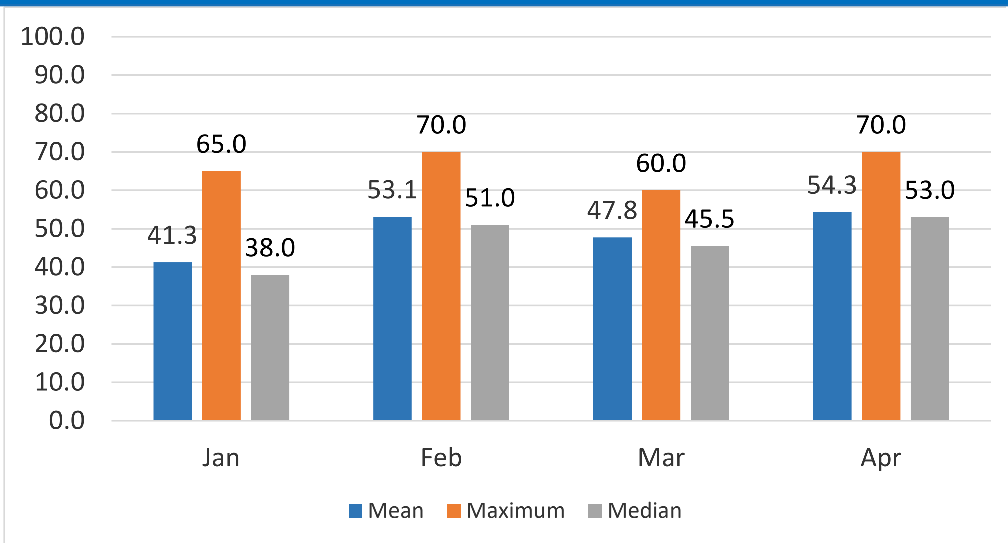


Chart 16: Forward Hotel Bookings for January-April 2019 (percent of total capacity)



11. SUGGESTIONS ON HOW THE BUSINESS ENVIRONMENT COULD BE IMPROVED

Banks and non-bank private firms were asked to indicate the challenges that they were currently encountering and suggest how the business environment could be improved, going forward.

Bank respondents indicated the need for improvement of security to boost tourism, acceleration of any payments of any pending bills, ease of collateral and land registration process, support to local manufacturing and trade activities, reduction in Government borrowing from domestic market, exploration of mechanisms to improve liquidity distribution in the banking sector and review of the impact of turnover tax on MSMEs. Bank respondents also suggested the setting up of a fund for microfinance banks to enable them reduce the cost of funds and thus extend cheap loans to clients and the need to check on unhealthy competition from unregulated players. Finally, respondents indicated that provision of tax incentives to MSMEs would encourage investment in manufacturing and technology.

The non-bank private firm respondents suggested that the Government allocates additional marketing budget for tourism promotion abroad, improves security, lowers the cost of doing business by reducing taxes and licences and makes timely payments to suppliers. Other suggestions included an improved regulatory environment and support for the MSMEs, review and/or enactment of Government policies that are pro-capital markets, policy support especially on import substitution strategy to help local manufacturers generate local demand for their products, and restructuring of external debts to allow for comfortable payment terms.

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