Central Bank of Kenya

REPORT OF THE MONETARY POLICY COMMITTEE MARKET PERCEPTIONS SURVEY OF MARCH 2018

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CENTRAL BANK OF KENYA 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 the expectations of banks and non-bank private sector firms on selected economic indicators. Commercial banks, micro-finance banks, as well as a sample of non-bank private sector firms are covered in the surveys. The non-bank private firms are sampled from major towns across the country including Nairobi, Mombasa, Kisumu, Eldoret, Nakuru, Nyeri and Meru, and are representative of sectors that account for about 70 percent of Kenya's GDP. The sectors covered by the survey include agriculture, mining and quarrying, manufacturing, electricity and water, trade, hotels and restaurants, transport and communications, real estate, finance and insurance, and health.

1. BACKGROUND

The March 2018 MPC Survey was conducted in the first two weeks of the month. The Survey sought market expectations with regard to overall inflation, private sector credit growth, exchange rate of the Kenya Shilling against the U.S. dollar, economic growth and levels of optimism on economic prospects and improvement in the business environment over the next two months (March-April 2018), and over the next 12 months. The expectations on economic prospects also included an analysis of forward hotel bookings over the next four months (March-June 2018).

This report provides a summary of the analyses of the responses to the Survey, based on aggregated data, received from the operating commercial banks and mortgage finance company, micro-finance banks (MFB), and a sample of non-bank private sector firms including hotels. It also gives the factors that the respondents considered as reasons behind their respective expectations.

2. SURVEY METHODOLOGY

The Survey was administered through questionnaires sent to the Chief Executives of 378 private sector firms comprising of 40 commercial banks (including 1 mortgage finance institution), 12 micro-finance banks, and 326 non bank private firms including 45 hotels. The overall response rate to the March 2018 Survey was 67 percent of the sampled institutions. The respondents comprised of all the commercial banks, 1 mortgage finance institution, 7 micro-finance banks, 29 hotels, and 178 non bank private sector firms.

The Survey questionnaires were completed by Chief Executive Officers, Finance Directors, and other senior officers from the sampled institutions who have knowledge on the economy and the business environment. The CBK conducts regular sensitizations of the respondents to the Survey in order to enhance the quality of responses, to increase the response rate in all the regions covered in the survey, and to expand the coverage of the Survey.

The expectations from commercial and micro-finance banks are compiled using weighted averages based on the size of the institution. The responses on expectations from the non bank private firms are aggregated based using simple averages.

3. HIGHLIGHTS OF THE SURVEY

The March 2018 MPC Market Perceptions Survey showed:

- Declining inflation expectations for March and April 2018, and stable inflation within the Government's target band over the next 12 months.
- The exchange rate of the Kenya Shilling against the U.S. dollar was expected to remain stable with a strengthening bias in March and April 2018.
- Private sector credit growth was expected to improve in 2018 as economic activity picks up, despite the slow start at the beginning of the year.
- Expectations of a strong recovery in Kenya's economic growth in 2018, relative to 2017.
- Increased optimism on the economic growth prospects and improvement in the business environment going forward.
- Much higher monthly forward hotel bookings between April and June 2018 relative to a similar period in 2017.

4. INFLATION EXPECTATIONS

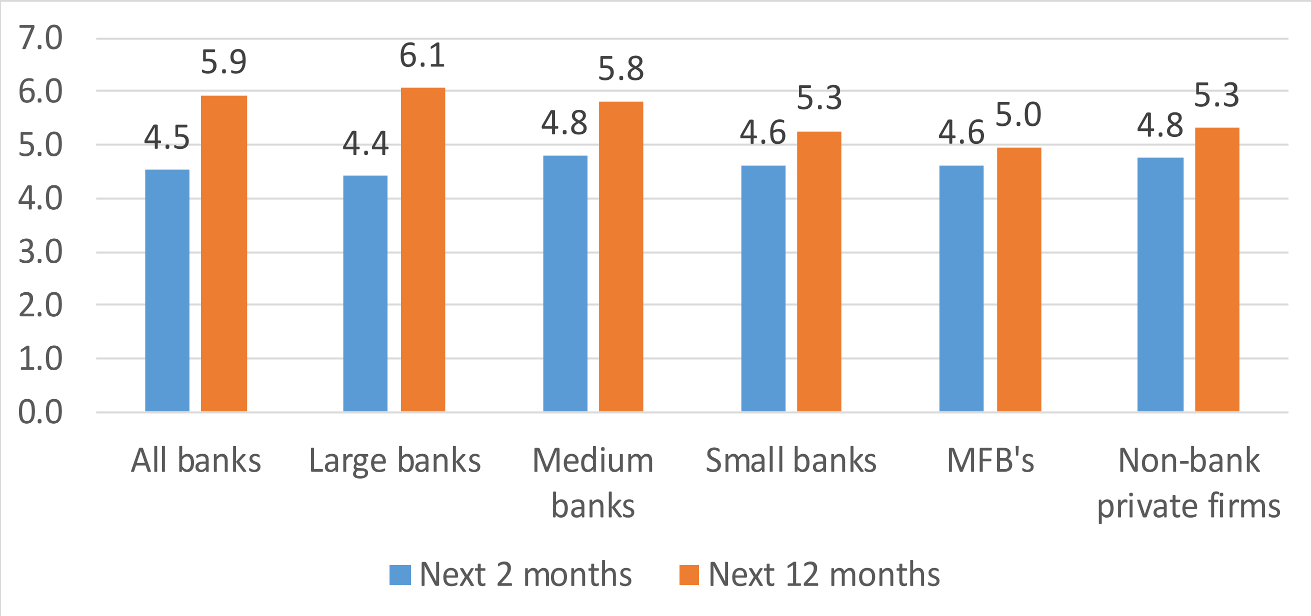
Participants in the Survey were asked to give their expected overall inflation rates for March and April 2018, and for the next 12 months (March 2018 – February 2019). The Survey results showed that commercial banks, micro-finance banks and non-bank private firms expected inflation to decline in the next two months (March and April 2018), largely due to lower food prices, compared with those of a similar period in 2017 (Table 1). The respondents, however, indicated the possibility of inflationary pressure arising from higher fuel prices due to the expected increase in international oil prices.

Table 1. Expected Overall Inflation Over the next 2 months (%)

Survey Month	Expected Inflation for:	Large banks	Medium banks	Small banks	All banks	MFBs	Non-bank private firms
March 2017	Mar–Apr 2017	9.9	9.5	9.5	9.7	9.6	9.7
May 2017	May–Jun 2017	12.2	11.3	11.0	11.8	11.4	11.0
July 2017	Jul-Aug 2017	9.8	10.2	10.3	10.0	10.4	10.1
September 2017	Sep-Oct 2017	7.7	7.7	8.3	7.6	8.0	8.2
November 2017	Nov-Dec 2017	5.9	5.8	5.9	5.9	5.5	5.7
January 2018	Jan-Feb 2018	5.5	5.1	4.9	5.3	5.0	5.0
March 2018	Mar-Apr 2018	4.4	4.8	4.6	4.5	4.6	4.8

At the same time, all respondents indicated that they expected inflation to increase marginally in the next one year but to remain within the Government's target range (2.5 to 7.5 percent) as shown in chart 1. The main reason for this expected stability in inflation is the anticipation of normal rains and consequent moderation of food prices within the year. Respondents attributed the expected marginal upward pressure on inflation in the course of the year to higher international oil prices, and the likely impact of VAT on petroleum products which is expected to be introduced in September 2018.

Chart 1: Expected Overall Inflation for the period March 2018 – February 2019 (%)

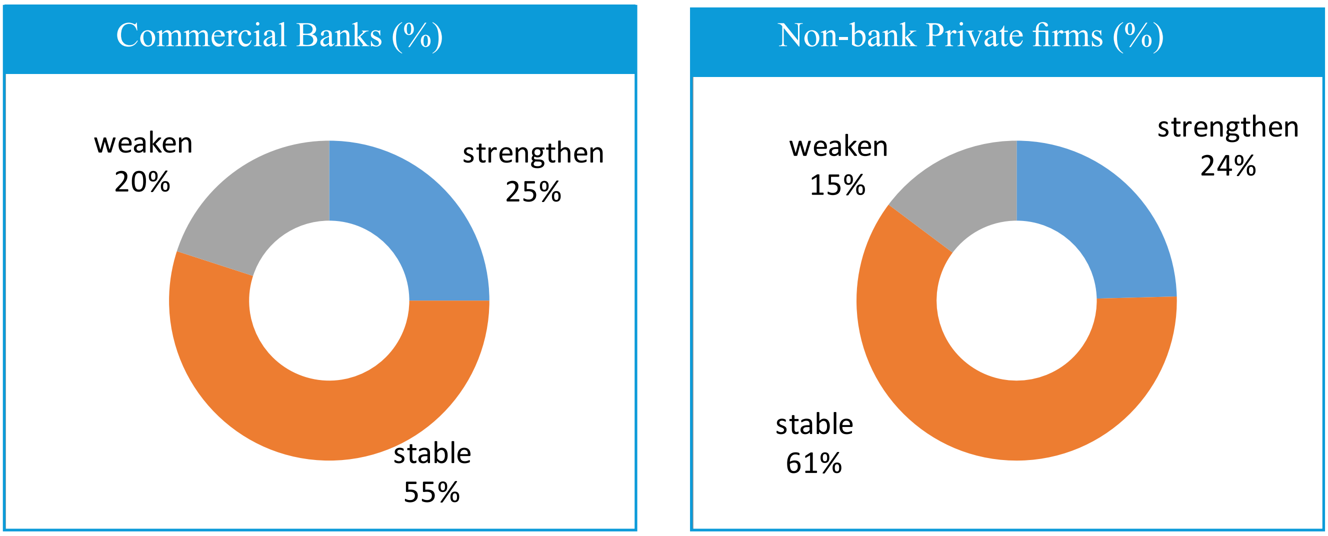


5. EXCHANGE RATE EXPECTATIONS

Participants were asked to indicate their expectations on the direction of change in the exchange rate of the Kenya Shilling against the U.S. dollar in March and April 2018, and for the next 12 months. Banks and non-bank private firms expected the exchange rate in March and April 2018 to either strengthen or remain stable on account of low and stable inflation, sufficient foreign exchange reserves boosted by the recent Eurobond proceeds, increased diaspora remittances, strong inflows from exports, and strong macroeconomic fundamentals (Chart 2a).

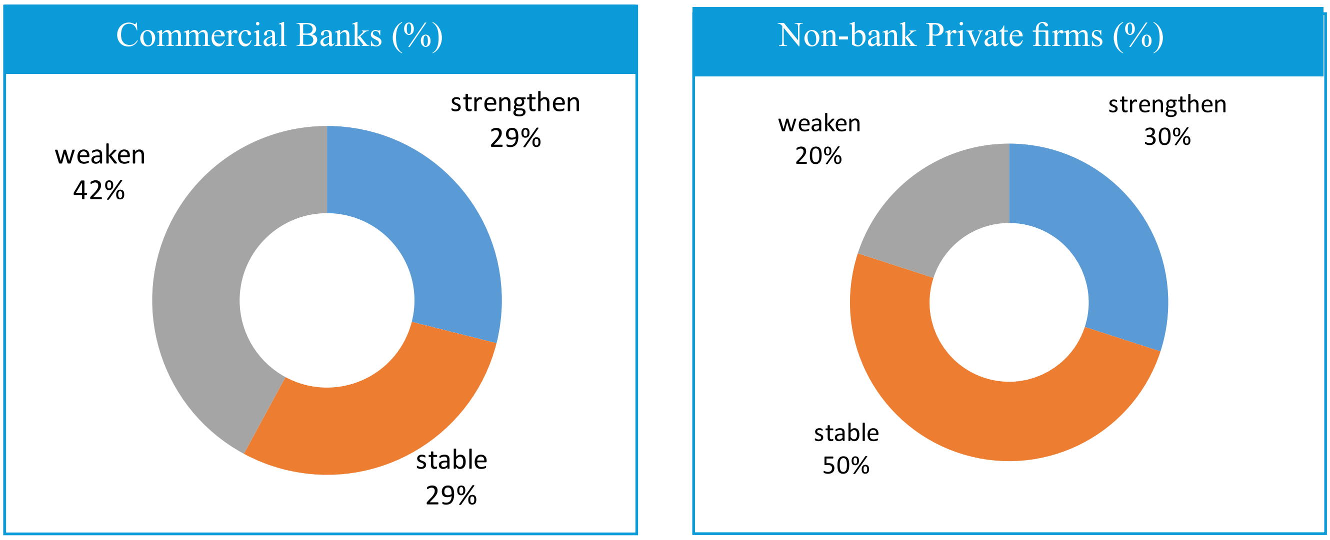
Short term risks to the stability of the exchange rate according to the Survey included: seasonal pressure arising from dollar demand for dividends repatriation, and expected increase in the import bill due to higher international oil prices.

Chart 2a: Expected direction of the KSh/USD Exchange rate – March to April 2018 (%)



Over the next 12 months, 58 percent of commercial banks and 80 percent of non-bank private firms expected the Kenya Shilling to either strengthen or remain stable (Chart 2b). This expectation was attributed to sufficient reserves, improved export earnings, increasing diaspora remittances, improving tourism receipts and a stable political and economic environment. Risks to the stability of the exchange rate over the next 12 months were cited as ; expected pressure from a possible increase in the import bill as a result of a pick-up in capital imports as activity builds up with economic recovery, rising international oil prices, possible increases in foreign interest rates and, consequently, prospects of a stronger U.S. dollar.

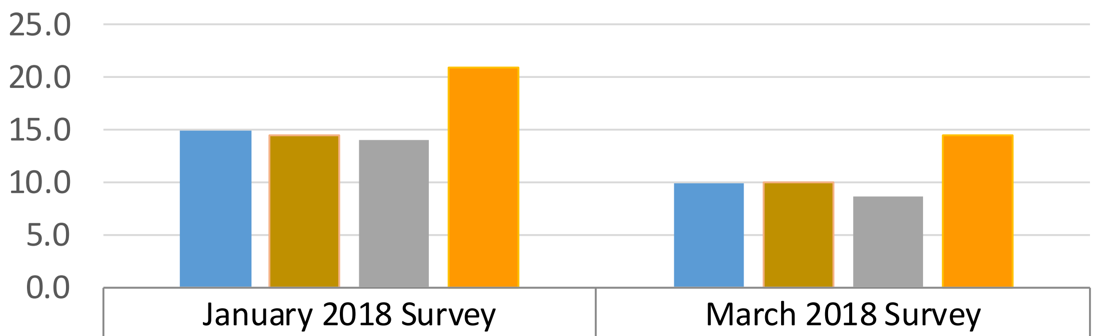
Chart 2b: Expected direction of KSh/USD Exchange rate – March 2018 to February 2019 (%)



6. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

Regarding private sector credit growth, commercial banks were asked about the direction and proportion of their expected lending in the second quarter (Q2) of 2018 and in the entire 2018. A total of 34 out of 40 banks expected to increase their lending to the private sector while the remaining banks expected to maintain their current levels. The results however showed a downward revision in commercial bank expectations of private sector credit growth in the March 2018 Survey relative to the January 2018 Survey as shown in Chart 3.

Chart 3: Expected direction/percentage increase in Private Sector Credit growth for 2018 (%)

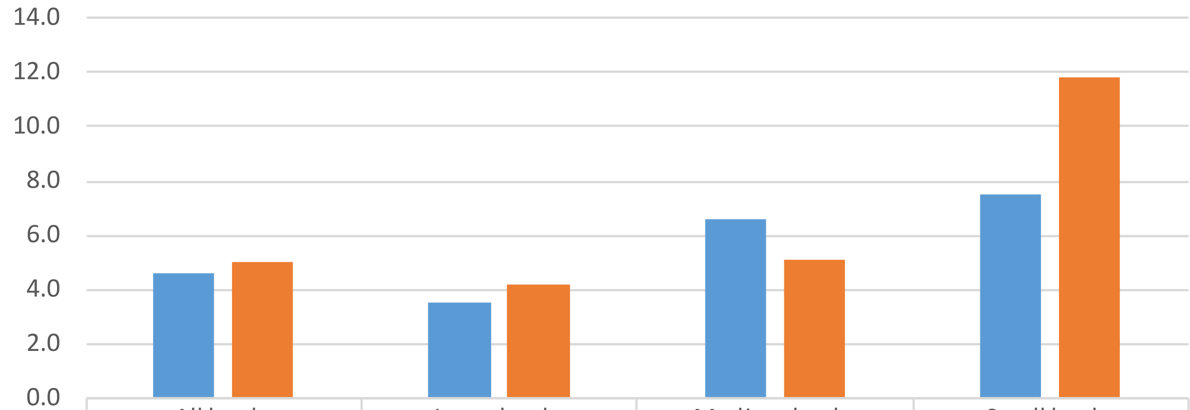


	January 2018 Survey	March 2018 Survey
All banks	14.9	10.0
Large banks	14.5	10.0
Medium banks	14.0	8.6
Small banks	20.9	14.6

Respondents attributed this downward revision to new information with regard to the likely timing for the removal of interest rate caps, which Banks had factored into their expected credit growth in the January 2018 Survey. Other factors cited include a slow start at the beginning of the year, difficulties in pricing of risk due to interest rate capping and low advances to deposits ratio to support increased lending to the private sector. Credit to the private sector was, however, expected to improve as economic activity picked up and as Government spending increases.

An analysis of the quarterly credit growth expectations showed that large and small banks expected to increase lending to the private sector in Q2 (Chart 4). Reasons cited for the expected increase in private sector credit in Q2 included an expected pick up in economic activity as Government spending increases, renewed business confidence by the private sector, Government's focus on spending under the 'BIG 4' plan, a positive economic outlook and a stable political environment. Medium size banks expected a slower growth in credit to the private sector in Q2 compared to Q1 due to difficulties in pricing risk on account of interest rate caps, and a higher cost of funds.

Chart 4: Expected increase in Private Sector Credit growth per Quarter in 2018 (%)



	All banks	Large banks	Medium banks	Small banks
Q1 2018	4.6	3.6	6.6	7.5
Q2 2018	5.0	4.2	5.1	11.8

7. ECONOMIC GROWTH EXPECTATIONS

Banks and non-bank private sector firms were asked to indicate their expectations with respect to economic growth rates for 2018. According to the Survey results, all respondents indicated expectations of better economic performance in 2018 relative to 2017 (Table 2). Respondents expected economic growth to be supported by agriculture due to favourable weather conditions, continuing infrastructure investments, a stable political environment, positive business sentiments, increase in private sector activities, the Government's 'BIG 4' development agenda, and a stable macroeconomic outlook. Respondents, however, pointed out that weak private sector lending due to interest rate capping, and a tighter fiscal policy stance, may constrain economic growth in 2018.

Table 2: Expectations on Economic growth (%)

Expected growth in:	Survey Month	Large banks	Medium banks	Small banks	All banks	Micro-finance banks	Non-bank private firms
2017	November 2017	4.7	4.9	4.8	4.8	4.9	4.7
2018	January 2018	5.5	5.5	5.4	5.5	5.6	5.4
	March 2018	5.4	5.3	5.4	5.4	5.5	5.4

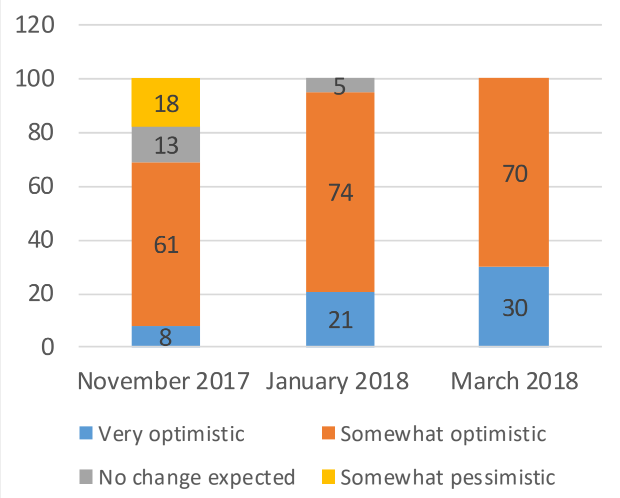
8. OPTIMISM ON THE ECONOMY

8.1. Economic Prospects and Improvement in the Business Environment

Banks and non-bank private sector firms were asked to indicate their levels of optimism on the country's economic prospects and improvements in the business environment going forward. The results showed an upsurge in optimism by banks in the March 2018 Survey, compared with the previous Surveys (Chart 5a). The reasons cited for this increased optimism included, among other factors, the expected removal of interest rate caps, lower inflation expectations, the stable political environment, increasing business confidence, favourable weather conditions, continuing infrastructure development and increased private sector activities.

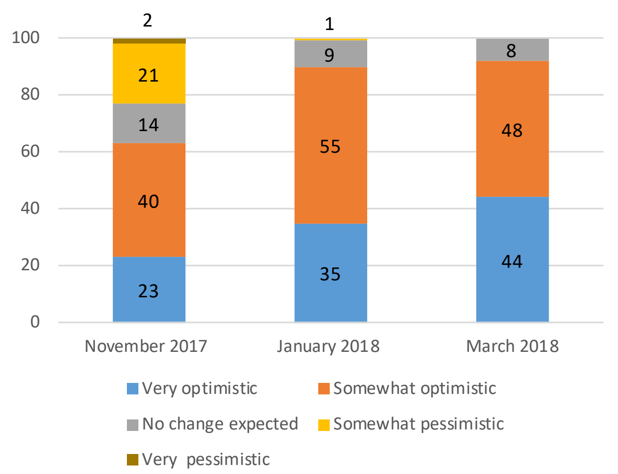
The respondents, however, noted some risks to the robust outlook which included concerns on the weak private sector credit growth due to interest rate capping, and the level of public debt.

Chart 5a: Optimism by Banks on Economic Prospects and Improvement in the Business Environment Going Forward (%)



Similarly, the non-bank private sector firms expressed optimism about the country's economic prospects and improvement in the business environment going forward, in the March 2018 Survey, relative to the January 2018 Survey (Chart 5b). Factors cited to be contributing to this optimism included the prospect of new markets for exports due to the expected direct flights to the USA and Germany, improved security especially for the hotel industry, favourable weather conditions, continuing infrastructure investment, stable macroeconomic environment and political stability. The respondents, however, cited the high cost of production as a result of increasing fuel prices, and higher foreign debt repayments as risks to the country's economic prospects and improvement in the business environment.

Chart 5b: Optimism by Non-Bank Private Firms on Economic Prospects and Improvement in the Business Environment Going Forward (%)



8.2 Forward Hotel Bookings

In the March 2018 Survey, hotels were requested to provide the prevailing levels of monthly forward bookings for the period March to June 2018, expressed as a percentage of their total capacity. Compared to forward bookings over a similar period in 2017, the results showed an increase in the monthly bookings for April, May and June 2018 (Charts 6a and 6b). The respondents attributed the significant rise in forward bookings in April 2018 to seasonality with respect to the Easter holidays. The general increase in forward bookings in 2018 was attributed to reduced uncertainties compared to 2017, which was an election year. In addition, respondents observed that the commencement of direct flights between Kenya and the U.S. in October 2018 will boost tourism performance going forward.

Chart 6a: Forward Hotel Bookings in the March 2018 Survey (percent of total capacity)

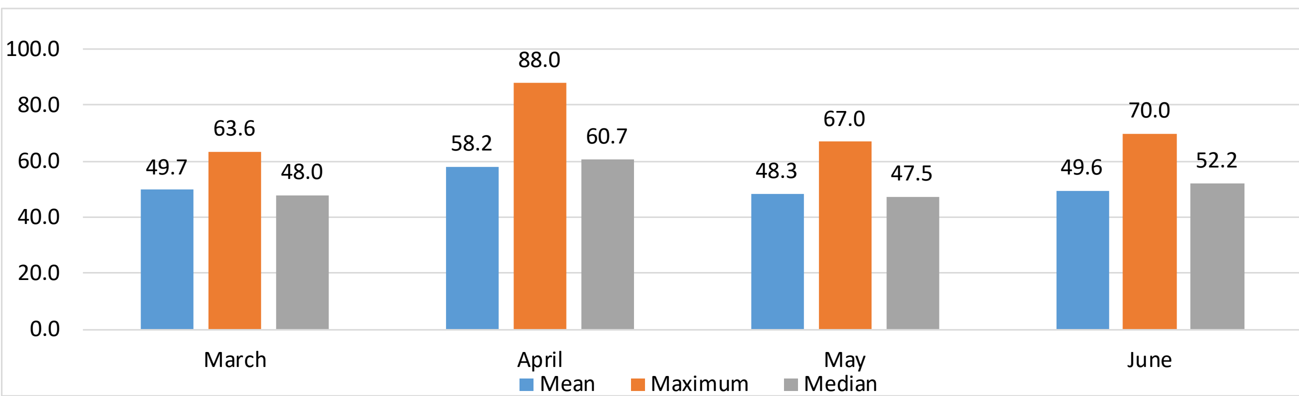
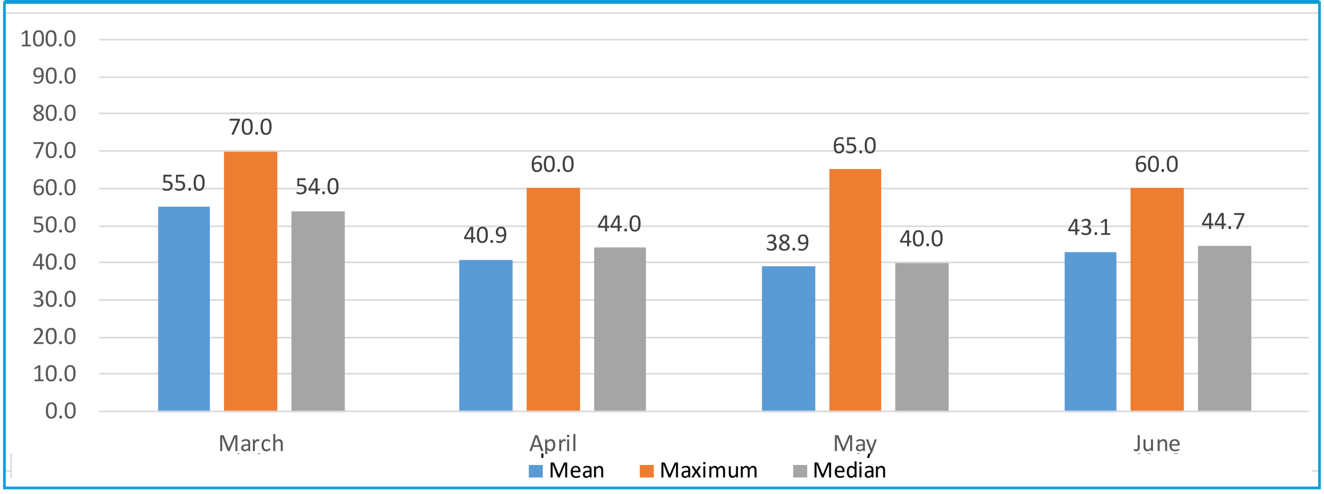


Chart 6b: Forward Hotel Bookings in the March 2017 Survey (percent of total capacity)



Haile Selassie Avenue P. O. Box 60000 - 00200 Nairobi
Tel: 20 - 2860000/2861000/ 2863000 Fax: 20 - 340192