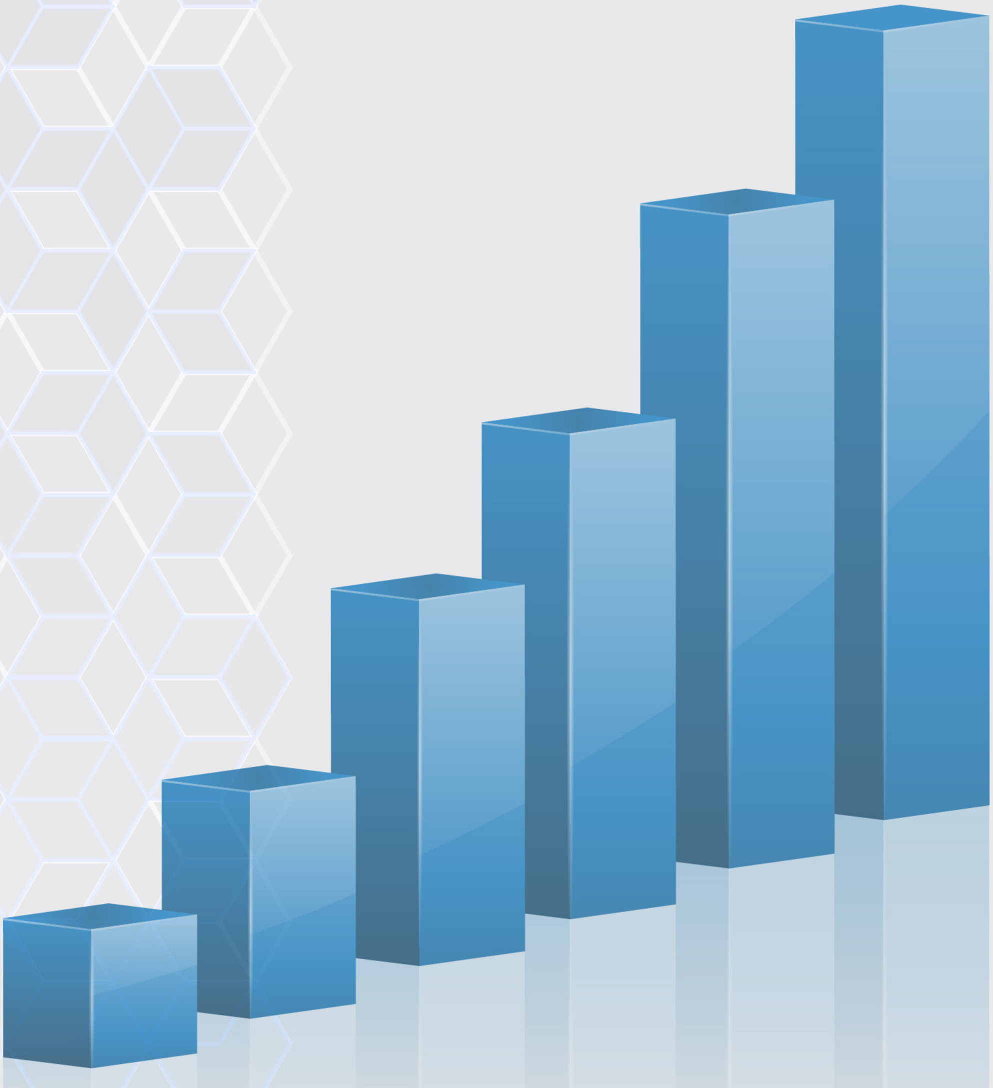
Central Bank of Kenya

Monetary Policy Committee Market Perceptions Survey

July 2021



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

The Survey also inquired about the levels of demand for credit in the next two months and expected private sector lending for 2021. In addition, the Survey interrogated market expectations on inflation, economic growth, lending rates, 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. The significance of various factors behind the expectations provided by respondents was also analysed.

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

3. SURVEY METHODOLOGY

The Survey targeted Chief Executives and other senior officers of 380 private sector firms comprising 38 commercial banks, 1 mortgage finance institution, 14 microfinance banks (MFBs) and 327 non-bank private firms, including 77 hotels, through questionnaires sent in hard copy and by email. The overall response rate to the July 2021 Survey was 67 percent of the sampled institutions. The respondents comprised 38 commercial banks, 1 mortgage finance institution, 14 micro-finance banks, and 202 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 relative to total 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 July 2021 Market Perceptions Survey included:

- Respondents expect **economic activity** to increase in July-August (relative to May-June) with sustained recovery across the economic sectors. However, respondents were concerned about increased oil prices and taxation leading to high cost of goods and services.
- Respondents revised upwards their **economic growth** expectations for 2021.
- Respondents expect **employment levels** to remain moderate with a tendency to rise with increased activity in 2021 relative to 2020.
- Banks expect an increase in **private sector credit** growth in 2021 relative to 2020.
- **Optimism** in the country's economic prospects remained high, supported by the expected economic recovery, but COVID-19 uncertainties remain.
- Respondents expected **inflation** to rise in the next 2 months, but to remain within the target range.

5. ECONOMIC ACTIVITY

The July 2021 Market Perceptions Survey sought bank and non-bank private sector firms' assessment of economic activity in May and June 2021, and their expectations for July and August 2021. Respondents reported expected improvement in economic activity in July and August 2021 relative to May and June 2021, largely due to the lifting of the COVID-19 containment measures put in place in the five counties of Nairobi, Kiambu, Machakos, Kajiado and Nakuru **(Charts 1 & 2).**

In the Survey, 85 percent of respondents expected economic activity in July and August to be supported by the resumption of businesses with the easing of restrictions on the back of lower COVID-19 infections, and the acclimatisation by businesses to the new normal. Additionally, 37 percent of respondents expected economic activity to be supported by the continuing vaccinations locally and globally, increased funding towards management of the pandemic, and other Government projects in the next 2 months.

Nevertheless, COVID-19 pandemic was cited as the main risk to economic activity in July and August, with 60 percent of respondents pointing out the uncertainty, impact, mutating variants, containment measures, slow reopening of the economy and slow recovery of some sectors, as risks to activity. In addition, 36 percent of respondents cited increased taxation as likely to hamper activity through higher costs of goods and services, reducing purchasing power, and affecting businesses, especially those that were yet to recover from the impact of the pandemic.

Chart 1: Expected economic activity by banks (percent of respondents)

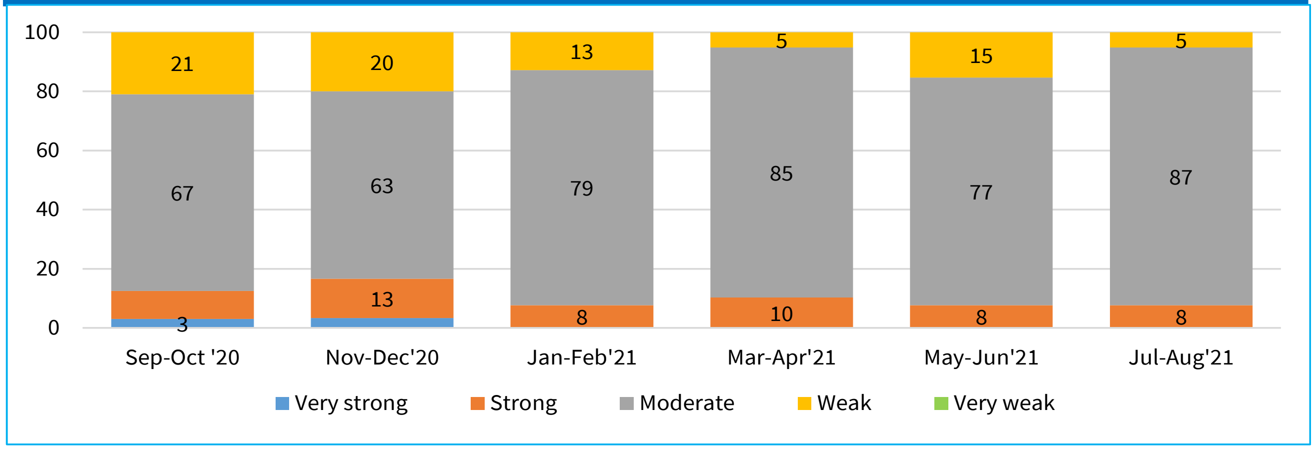
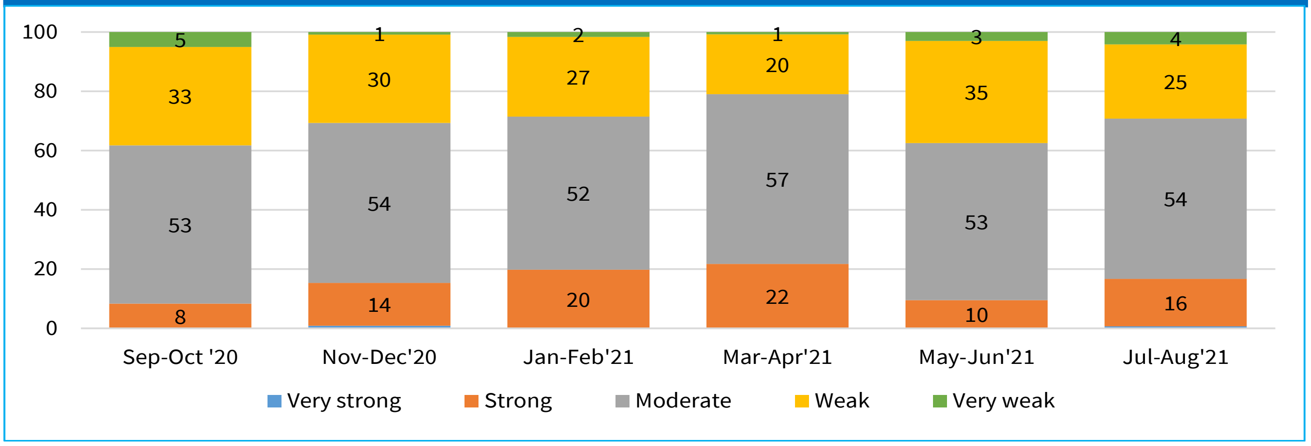


Chart 2: Expected economic activity by non-bank private firms (percent of respondents)



6. EXPECTED CHANGES IN EMPLOYMENT

The Survey asked respondents to indicate their expectations with regard to change in the number of employees in their respective institutions in 2021 relative to 2020. Expectations for employment in 2021 relative to 2020 varied according to sectors **(Chart 3)**.

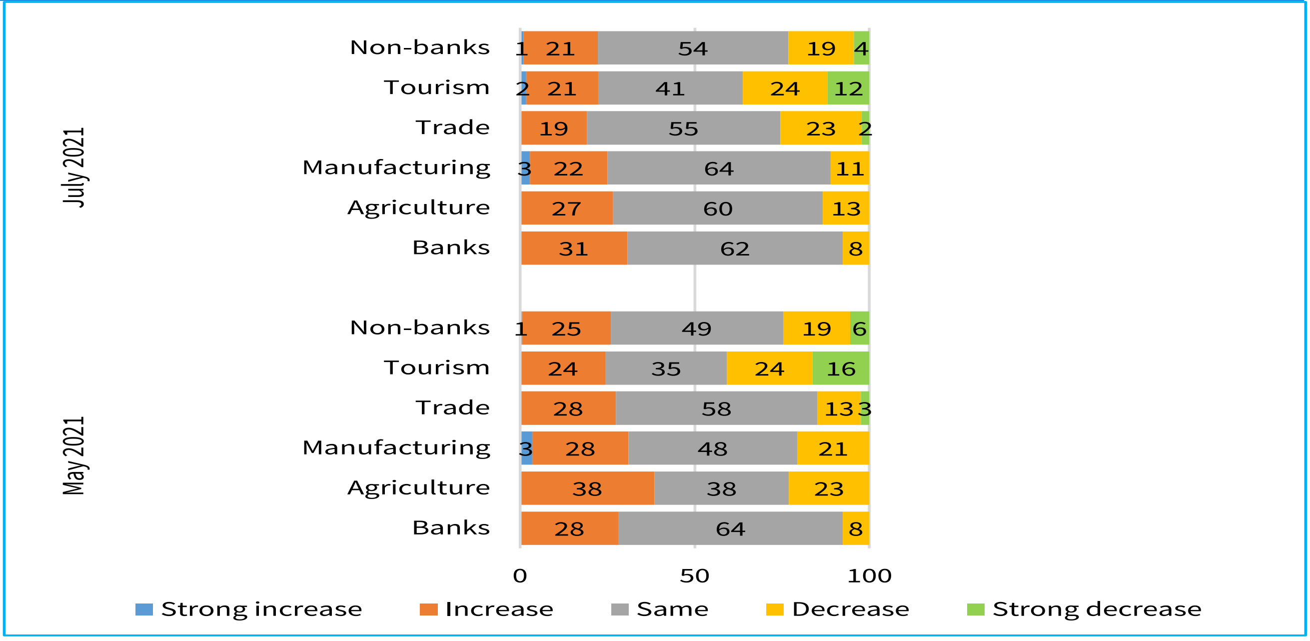
Most banks expected to maintain their current workforce, though some expected expansions in the course of the year that would require more staff, while others did not plan to replace any exiting staff.

Hotels indicated expectations of increased business, hence employment, with the arrival of the vaccine, while others reported that low business prevented them from recalling all the employees after the COVID-19 closures, and that they had resorted to multi-skilling to cut costs.

Agriculture sector respondents reported improved demand and expected hiring in 2021 compared to 2020, while others cited reduced production, and those in the tea sector cited the new Tea Act, which requires restructuring and cutting labour costs through outsourcing strategies.

Respondents from the manufacturing sector expected to maintain the current levels of employees. Some, however, expected to reduce the workforce in order to cut costs due to higher production costs and low demand.

Chart 3: Expectations on employment levels for 2021 relative to 2020 (percent of respondents)



7. EXPECTED ECONOMIC GROWTH

The Survey requested participants to indicate their estimated economic growth rate for the country in 2021. Respondents revised upwards their growth rates expectations, suggesting optimism on economic growth prospects **(Table 1).**

On average, 96 percent of respondents expected economic growth to be boosted by a rebound in sectors that had been adversely affected at the onset of the pandemic such as education, trade and manufacturing, the easing of COVID-19 restrictions both locally and globally expected to boost tourism and transportation and spur economic activity as business operations resume to near 2019 levels, and implementation of the Economic Recovery Strategy, and availability of vaccines. In addition, 42 percent of respondents expected the focus on infrastructure spending and completion of major Government projects to support growth in 2021.

The COVID-19 pandemic, however, was cited by respondents as the main risk to the expected pick-up in growth due to the uncertainty both locally and globally, the slow vaccine rollout, containment measures that could dent economic prospects, mutations of the virus, and subdued activity in some sectors such as tourism (78 percent respondents).

Table 1: Expectations on economic growth for 2021 (percent)

	SURVEY MONTH			
	Jan-21	Mar-21	May-21	Jul-21
Banks	3.5	5.1	5.5	5.6
Agriculture	4.7	5.4	6.1	5.9
Manufacturing	5.1	5.1	5.4	5.4
Trade	4.5	5.0	5.4	5.6
Real estate, Building, construction	4.7	5.1	5.2	5.8
Finance & Insurance (excl. banks)	5.1	5.1	5.2	5.3
Transport & Services	4.6	4.5	5.2	5.9
Tourism(hotels &restaurants)	4.7	4.7	5.3	5.5
Non-bank private sector	4.7	5.2	5.6	5.7

8. OPTIMISM ON THE ECONOMIC PROSPECTS

The July 2021 Survey requested bank and nonbank private sector firms to indicate how optimistic or pessimistic they were regarding the country's economic prospects in the next 12 months.

The results showed sustained optimism by respondents across banks and nonbank private sector firms **(Charts 4 & 5).** Respondents remained optimistic about the country's economic prospects largely on account of expected economic recovery and increased economic activity arising from improved confidence and reopening of the economy, following the decline in the spread of the virus due to effective management and continued vaccination, and subsequent easing of containment measures (78 percent of respondents). In addition, 48 percent of respondents expected implementation of the FY2021/2022 Budget, including the Economic Stimulus Programme, increased Government expenditures, expected increase in revenue collection, renewed focus on infrastructure, and the completion of development projects under the Big 4 Agenda, to boost economic growth in 2021.

Risks to this optimism, however, included the uncertainty around the COVID-19 pandemic, slow vaccine rollout, emergence of new variants and subsequent lockdowns as the biggest challenge to economic recovery, which were cited by 38 percent of respondents. Political activity was expected to be elevated with the onset of the 2022 election cycle (32 percent respondents), while higher taxes were cited as likely to affect businesses operating in the country and erode consumers' disposable income (21 percent respondents).

Chart 4: Optimism by Banks on Economic Prospects (percent of respondents)

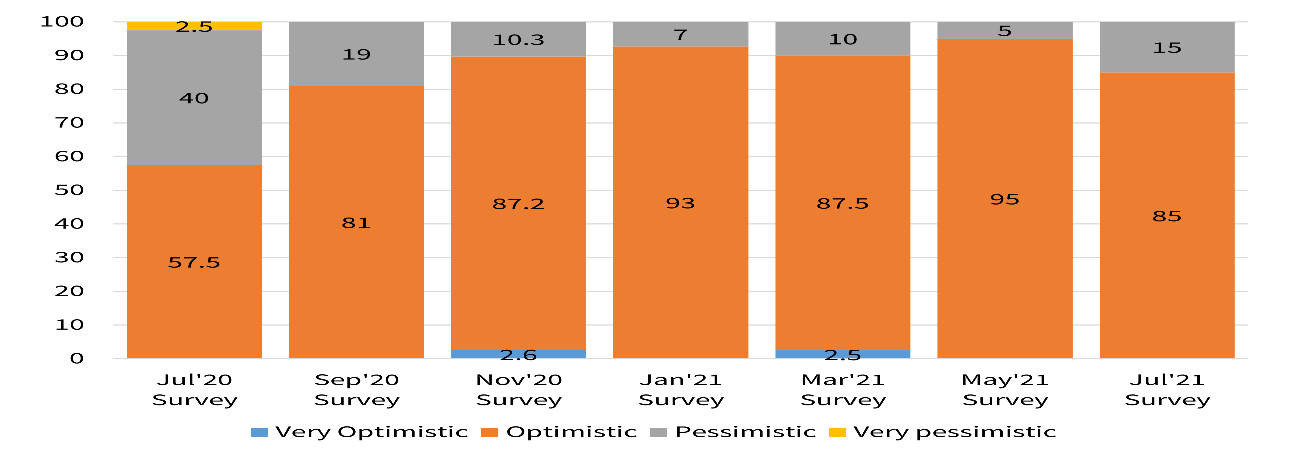
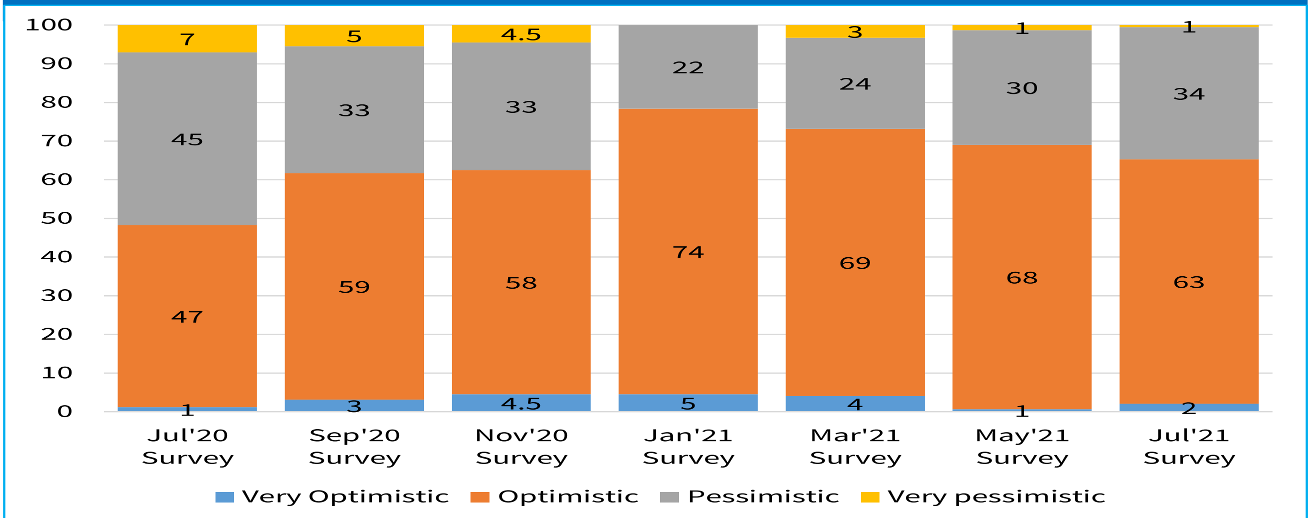


Chart 5: Optimism by Non-bank private firms on Economic Prospects (percent of respondents)



9. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

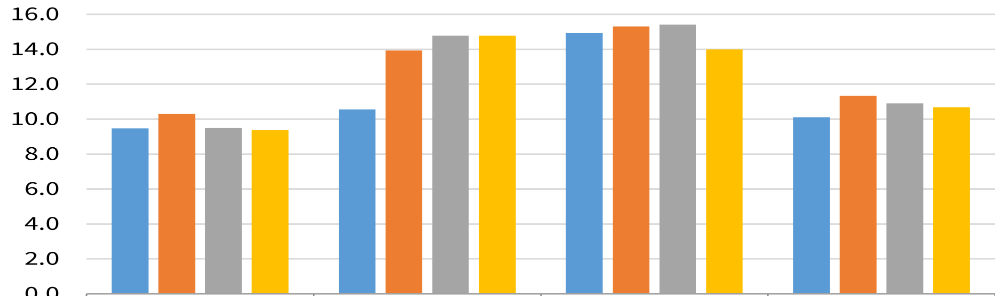
9.1. Growth in private sector credit in 2021

The Survey sought to find out from commercial banks by what percentage they expected to grow credit to private sector in 2021 relative to 2020 **(Chart 6).**

About 88 percent of respondents expected increased private sector credit growth largely pegged on recovery in economic activity in key sectors such as manufacturing, transport and trade. This was attributed to the easing of COVID-19 restrictions, and continued rollout of vaccinations, and expectations of lower credit risk as business operations improved. In addition, 37 percent of respondents expected introduction of new products and digital solutions targeted at new customers as banks seek to expand their portfolios, while 31 percent of respondents expected continued implementation of the Government's Big 4 Agenda and budgetary allocations to major developments some of which would be actualized through MSME/SME funding, to boost private sector credit growth in 2021.

However, uncertainty due to COVID-19 mutation, containment measures, slow recovery of some sectors, low orders and employment rates in some sectors, were cited as the main risks to economic activity and hence credit uptake in the country in 2021. In addition, the risk of a rise in inflation due to rising oil prices and higher taxes were expected to push the cost of living upwards and reduce the disposable income, and consequently the ability to service loans.

Chart 6: Expectations on private sector credit growth (percent)



	Large banks	Medium banks	Small banks	All banks
Jan-21	9.5	10.6	14.9	10.1
Mar-21	10.3	13.9	15.3	11.3
May-21	9.5	14.8	15.4	10.9
Jul-21	9.4	14.8	14.0	10.7

Jan-21 Mar-21 May-21 Jul-21

10. INFLATION EXPECTATIONS

In the Survey, respondents were requested to give their expectations of overall inflation rates for the next 2 months, July and August 2021, and for the next 12 months (July 2021 – June 2022) **(Table 2).**

Respondents expected an increase in inflation in the next 2 and 12 months, manly driven by the increase in global oil prices and subsequently local pump prices. This was expected to exert upward pressure on inflation directly and indirectly through increased prices of manufactured goods, imported goods through rising shipping costs, transport and electricity costs (51 percent respondents). The recently implemented taxes were expected to affect commodity prices including food and fuel products (43 percent respondents), while depressed rainfall during the first half of the year was expected to exert upward pressure on food prices (24 percent respondents).

Table 2: Inflation expectations for July and August 2021, and for the next 12 months (percent)

Expected Inflation for:	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
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
Jan-Feb 2021	5.9	5.7	5.7	5.8	5.6	5.8
Mar-Apr 2021	6.1	6.0	5.9	6.0	5.6	5.9
May-Jun 2021	5.9	5.9	5.7	5.9	5.5	5.8
Jul-Aug 2021	6.9	6.7	6.5	6.8	6.7	6.5
INFLATION EXPECTATIONS FOR THE NEXT 12 MONTHS						
Mar '21 Survey	6.1	5.9	5.8	6.0	5.4	6.0
May '21 Survey	5.7	5.9	5.8	5.8	5.5	6.0
Jul '21 Survey	6.5	6.2	6.3	6.4	6.4	6.4

11. EXCHANGE RATE EXPECTATIONS

The Survey sought to find out from bank and nonbank private sector firms their expectations regarding the direction of change in the exchange rate of the Shilling against the US Dollar in July and August 2021. 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 higher volumes of exports especially floriculture as our export destinations re-open from COVID-19 lockdowns, increasing global economic activity due to widespread vaccinations, resumption of business operations locally, increased diaspora remittances and expected increase in economic growth.

However, respondents indicated that receipts from tourism were expected to remain low due to the ongoing pandemic. Respondents were also concerned about heightened political activity which may affect investment, and the increase in the import bill due to the rise in global oil prices.

12. HOW THE BUSINESS ENVIRONMENT COULD BE ENHANCED

The Survey asked respondents to indicate how the business environment could be enhanced. Bank respondents pointed out the need for continued settlement of pending bills by national and county governments to unlock liquidity, as well as the need for additional economic stimulus packages and tax incentives to support business continuity post COVID. Other suggestions included a quicker roll out of COVID-19 vaccination programme, support for public- private partnerships to enable creation of investment opportunities across all economic sectors, setting up of a centralized collateral registry to improve efficiency, and the need to address cases of over regulation, which increases the cost of doing business through compliance costs. Banks also highlighted the need to settle pending bills to spur demand for credit and lower credit risk, improved security to deal with cyber-crime, and increased efforts to win the fight against corruption. In addition, respondents indicated the need to review taxation on financial services to reduce the cost of credit, quicker roll out of COVID 19 vaccination programme to contain the spread, speeding up of conclusion of court cases, and need to improve the ease of doing business by automating all government processes.

Non-bank private firms on the other hand suggested that COVID restrictions be eased, the need to increase vaccination efforts, reduce county government license fees and provision of tax incentives particularly to SMEs by national / county government. Respondents also recommended timely release of funds to county governments to support clearance of pending bills and payment to SMEs for services and goods supplied. Further, respondents indicated the need to improve the licencing process, reduce power costs, and put in place measures to speed up dispute resolutions.

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