Central Bank of Kenya

REPORT OF THE MONETARY POLICY COMMITTEE MARKET PERCEPTIONS SURVEY OF MAY 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, building and construction, finance and insurance, and health.

Regular sensitizations of the respondents are conducted by the CBK for better understanding of the survey questions, to enhance the quality of responses, increase the response rate in all the regions covered in the survey, and to expand the coverage of the Survey.

1. BACKGROUND

The May 2018 MPC Market Perceptions Survey was conducted in the first three 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 (May-June 2018), and over the next 12 months (May 2018 to April 2019).

The expectations on economic prospects also included an analysis of forward hotel bookings over the next four months (May to August 2018).

This report provides a summary of the analyses of the responses to the Survey, based on aggregated data (weighted by size of respondent), received from the operating commercial banks and mortgage finance company, micro-finance banks (MFBs), 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, through email and hard copy, to the Chief Executives of 378 private sector firms comprising of 40 commercial banks (including 1 mortgage finance institution), 13 micro-finance banks, and 326 non-bank private firms including 45 hotels. The overall response rate to the May 2018 Survey was 65 percent of the sampled institutions. The respondents comprised of 37 out of 39 commercial banks, 1 mortgage finance institution, 7 micro-finance banks, 38 hotels, and 164 non-bank private sector firms.

The Survey questionnaires were completed by either Chief Executive Officers, Finance Directors, or other senior officers from the sampled institutions who have knowledge on the economy and the business environment.

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

3. HIGHLIGHTS OF THE SURVEY

The May 2018 MPC Market Perceptions Survey revealed that:

- Inflation expectations for the next 2 months (May and June 2018) and over the next 12 months were well anchored within the Government's target range (2.5 to 7.5 percent).
- The exchange rate of the Kenya Shilling against the U.S. dollar was expected to remain stable with a strengthening bias in May and June 2018.
- Private sector credit growth was expected to improve in 2018 on account of both supply and demand factors as economic activity picks up.
- Banks and non-bank private firms revised their economic growth expectations for 2018 upwards relative to the March 2018 Survey.
- There was sustained optimism on the economic growth prospects and improvement in the business environment going forward.

4. INFLATION EXPECTATIONS

Participants in the Survey were asked to give their expected overall inflation rates for May and June 2018, and for the next 12 months (May 2018 to April 2019).

The Survey results showed that on average, commercial banks, micro-finance banks and non-bank private firms expected overall inflation to remain well anchored within the Government target range (2.5 to 7.5 percent) in the next two months (May and June 2018), supported by lower food prices and possible lower electricity prices due to increased production of hydro-electric power (Table 1).

However, the respondents indicated the possibility of moderate inflationary pressure arising from higher international oil prices and the consequent upward adjustments in local fuel prices, as well as the impact of floods in some areas that could lower crop yields and exert pressure on food prices.

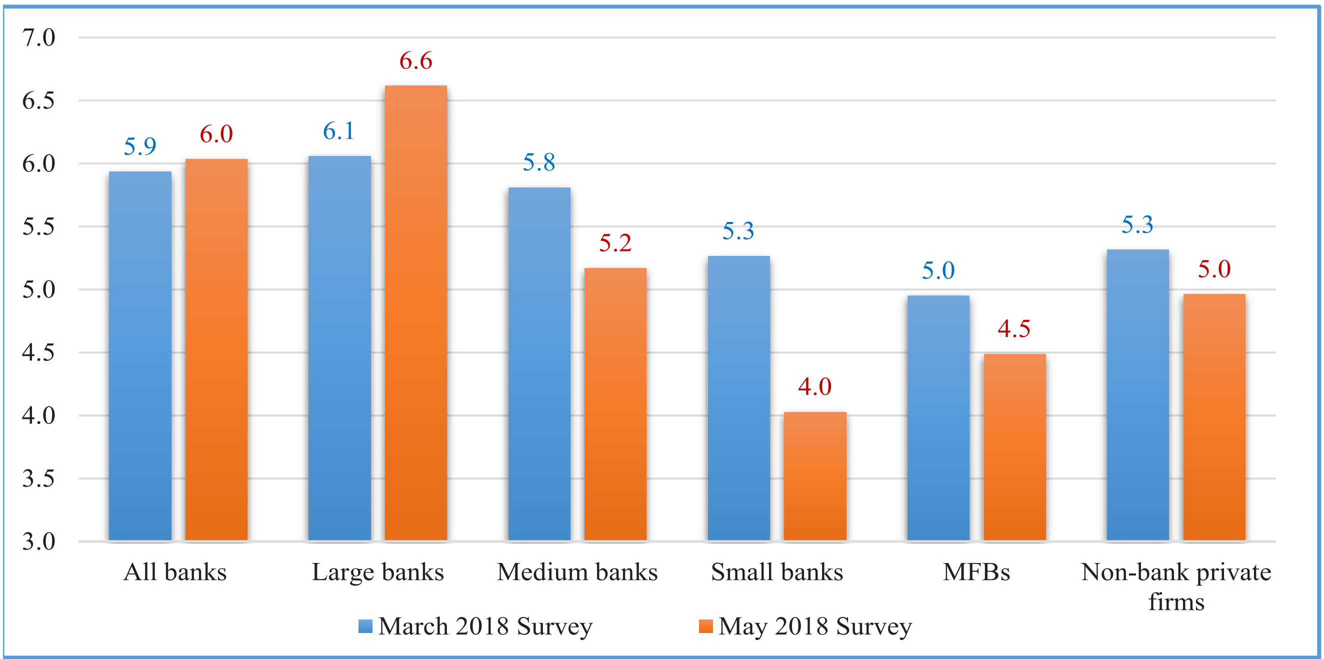
Table 1. Expected Overall Inflation over the next 2 Months (%)

Survey Month	Expected Inflation for:	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
May 2017	May–Jun 2017	12.2	11.3	11.0	11.8	11.4	11.0
Jul 2017	Jul-Aug 2017	9.8	10.2	10.3	10.0	10.4	10.1
Sep 2017	Sep-Oct 2017	7.7	7.7	8.3	7.6	8.0	8.2
Nov 2017	Nov-Dec 2017	5.9	5.8	5.9	5.9	5.5	5.7
Jan 2018	Jan-Feb 2018	5.5	5.1	4.9	5.3	5.0	5.0
Mar 2018	Mar-Apr 2018	4.4	4.8	4.6	4.5	4.6	4.8
May 2018	May-Jun 2018	4.2	3.9	3.7	4.1	3.9	3.8

Inflation expectations by banks and non-bank private sector firms for the next 12 months, May 2018 to April 2019, remained within the Government's target band (Chart 1). All respondents, except large banks, lowered their inflation expectations relative to the March 2018 survey due to expectations of lower food prices on account of improved weather conditions.

According to the large banks, risks to inflation over the next 12 months include the impact of the proposed VAT on fuel as from September 2018; higher fuel prices due to the rising international oil prices; and the above normal rainfall witnessed in most parts of the country, which could undermine crop yields with implications on food prices.

Chart 1: Expected Overall Inflation for the period May 2018 - April 2019 (%)



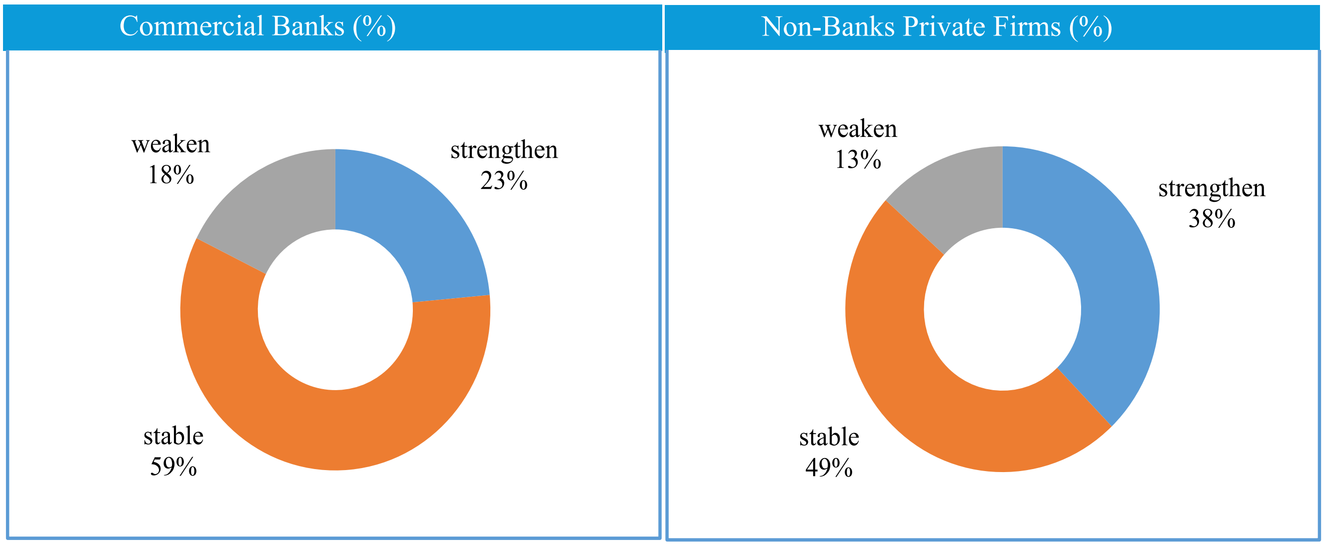
5. EXCHANGE RATE EXPECTATIONS

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 May and June 2018, and for the next 12 months.

The results showed that banks and non-bank private firms expected the Shilling to remain stable with a strengthening bias in May and June 2018, supported by: strong inflows of remittances; strong foreign exchange reserves to cushion against unforeseen shocks; increased foreign currency inflows as the tax amnesty on repatriated foreign assets deadline of end June 2018 approaches; improved investor confidence arising from the current political stability and a stable macroeconomic environment (Chart 2a).

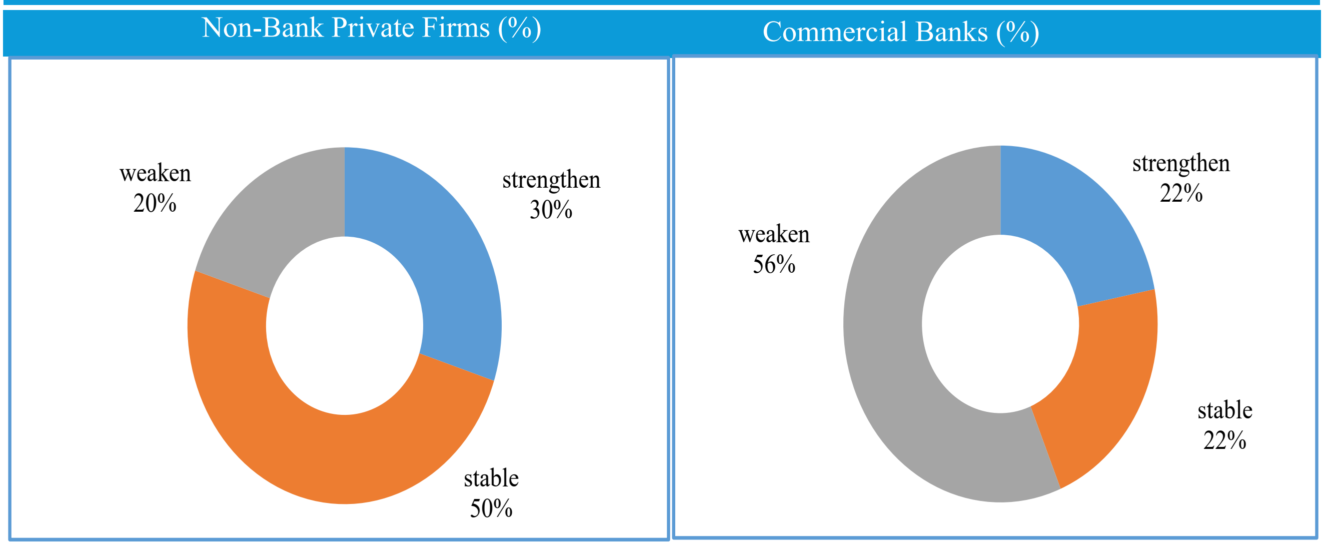
The respondents, however, cited increased U.S. dollar demand for dividends repatriation as the main risk to the stability of the KSh/USD exchange rate in the next two months.

Chart 2a: Expected direction of the KSh/USD Exchange Rate – May to June 2018 (%)



Exchange rate perceptions for the next 12 months varied between banks and the non-bank private sector firms. Non-bank private sector firms expected the shilling to remain stable with a strengthening bias supported by increased agricultural exports and tourism earnings. Banks, on the other hand expected moderate pressure on the Shilling to weaken over the next 12 months on account of: the rising international oil prices; a stronger U.S. dollar in the global financial markets; a pick-up in imports and the resultant pressure on the current account as economic activity picks up; and higher U.S. dollar demand by the government to meet external obligations such as debt service payments (Chart 2b).

Chart 2b: Expected direction of the KSh/USD Exchange Rate – May 2018 to April 2019

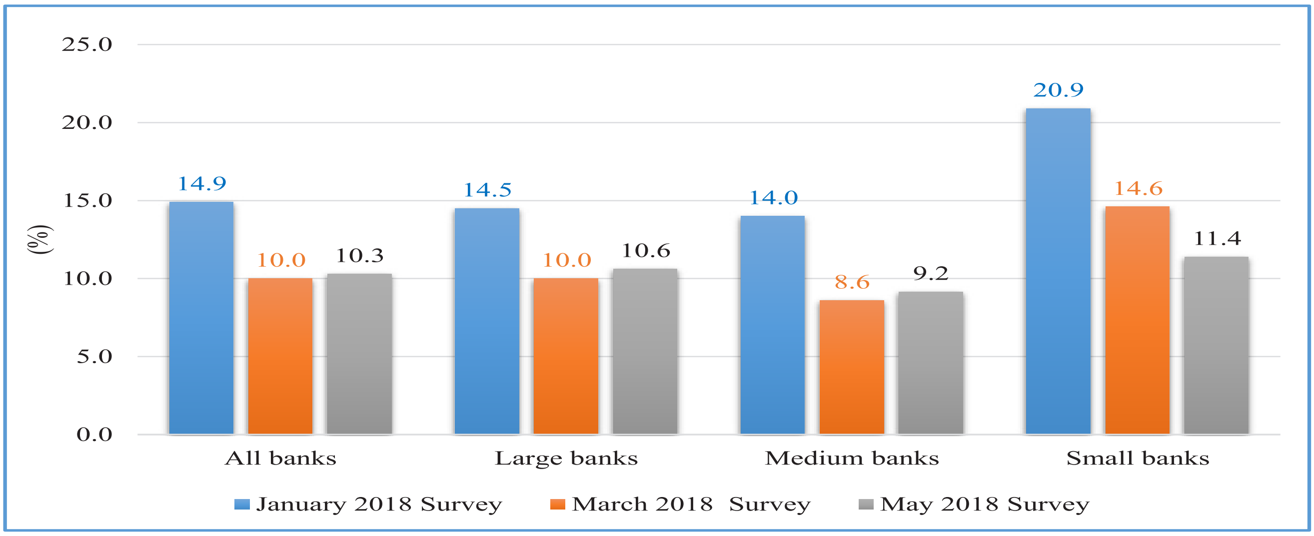


6. PRIVATE SECTOR CREDIT GROWTH EXPECTATIONS

Commercial banks were asked about their expected increase in lending for the year 2018. The May 2018 Survey showed improved lending perceptions for the year 2018, relative to the March 2018 Survey. Large and medium size banks indicated an upward revision in their expected lending to the private sector from 10.0 and 8.6 percent in the March 208 Survey to 10.6 and 9.2 percent, respectively, in the May 2018 Survey (Chart 3). The improved sentiments on credit growth were attributed to the expected increase in economic activity leading to higher demand for credit; settlement of monies owed to suppliers by central and county governments; and the expectation of the removal of interest rate caps.

The banks, however, cited their inability to effectively price risk due to the existing interest rate caps, as the most significant deterring factor to faster private sector credit growth.

Chart 3: Expectations on Private Sector Credit growth for 2018(%)



7. ECONOMIC GROWTH EXPECTATIONS

Banks and non-bank private sector firms were asked to indicate their expectations with respect to economic growth rate for 2018. According to the Survey results, commercial banks, microfinance banks (MFBs) and non-bank private sector firms indicated improved growth performance for 2018 (Table 2). The higher economic growth was expected to be supported by agriculture due to favourable weather conditions, continuing Government spending on infrastructure, focus on the *Big 4* priority areas, the positive impact of devolution, growth in foreign direct investment, sustained political stability, and its positive effect on business sentiment, and overall stability in the macroeconomic environment.

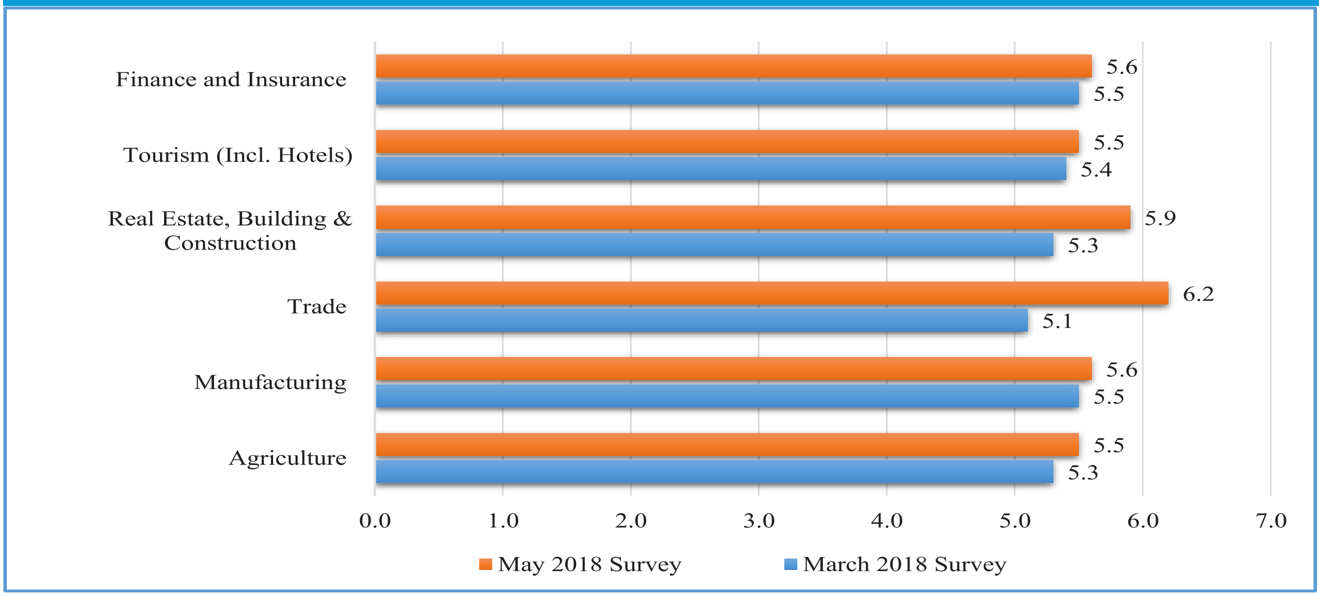
Respondents, however, pointed out that weak private sector lending due to the interest rate capping, excessive rains that may affect agriculture and game tourism in the short term, and concerns over the relatively high foreign debt level, may constrain the 2018 economic growth.

Table 2. Expectations on Economic Growth (%)

Survey Month	Large banks	Medium banks	Small banks	All banks (weighted by size of bank)	MFBs	Non-bank private firms
Jan-2018	5.5	5.5	5.4	5.5	5.6	5.4
Mar-2018	5.4	5.3	5.4	5.4	5.5	5.4
May-2018	5.5	5.6	5.4	5.5	5.6	5.6

The expectations on economic growth were also analysed by grouping respondents by their respective economic sectors (Chart 4). The results showed an upward revision in economic growth expectations for 2018 by the private sector firms in the May 2018 Survey relative to the March 2018 Survey. Most respondents, particularly those from the trade sector, attributed their perceptions for higher growth in 2018 to the existing political stability, and favourable weather conditions in most parts of the country.

Chart 4. Expectations on Economic Growth by Respondent Sectors (%)



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 sustained optimism about the economy in 2018. Optimism levels remained high in the third survey of 2018 as the economy recovered from the effects of the prolonged elections and drought in 2017 (Chart 5a). The reasons cited for this increased optimism included, among other factors, the improved political environment; the expected pick-up in economic activity driven by both Government and private sector activities; improved weather conditions; stable macroeconomic fundamentals and the prospect of interest rate cap review.

Respondents cited concerns on the weak private sector credit growth due to interest rate capping law, the rising international and local oil prices and the level of public debt as risks to this robust outlook.

Similarly, the non-bank private sector firms remained optimistic about the country's economic prospects and improvement in the business environment going forward (Chart 5b). Respondents cited the improved political environment and the expected investments in strategic areas under the *Big 4* initiative as key to economic growth and hence the optimism. Hotels were optimistic on improved tourism performance particularly with the start of direct flights to the USA and Germany, and improved security in the country. However, the non-bank private sector firms expressed their concern about the relatively high foreign debt repayments and the rise in international oil prices and their possible adverse effects on the economy.

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

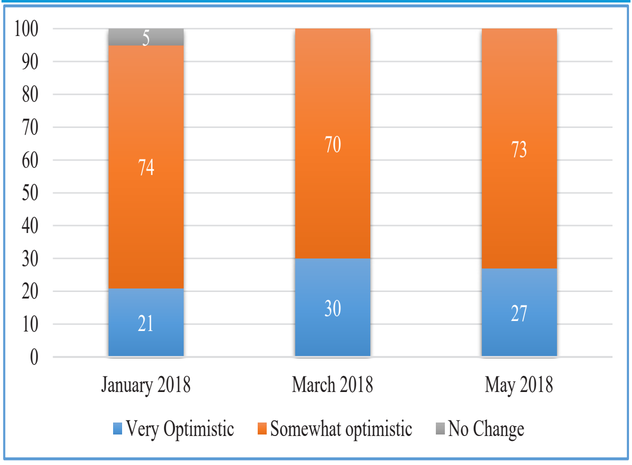
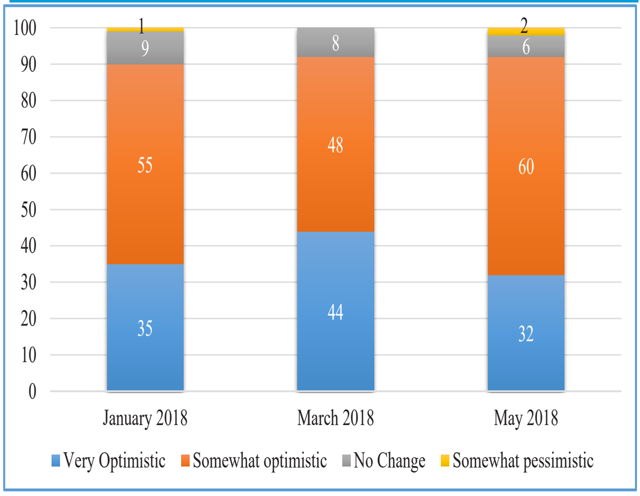


Chart 5b: Optimism by Non-Bank Private Firms on Economic Prospects and Improvement in the Business Environment Going Forward (%)



8.2 Forward Hotel Bookings

As part of assessing perceptions on Kenya's business environment and economic outlook, hotels were requested to provide the levels of monthly forward bookings for the period May to August 2018, expressed as a percentage of their total capacity. The results showed an increase in the monthly bookings for June, July and August 2018 compared to forward bookings over a similar period in 2017 (Charts 6a and 6b). Respondents attributed this trend to the onset of the peak season for foreign tourists from June to September, the upcoming annual wildebeest migration which is expected to attract tourists, and the calm political environment in 2018. Respondents further indicated their optimism for a further pick-up in forward hotel bookings soon after the heavy rains and flooding ceases.

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

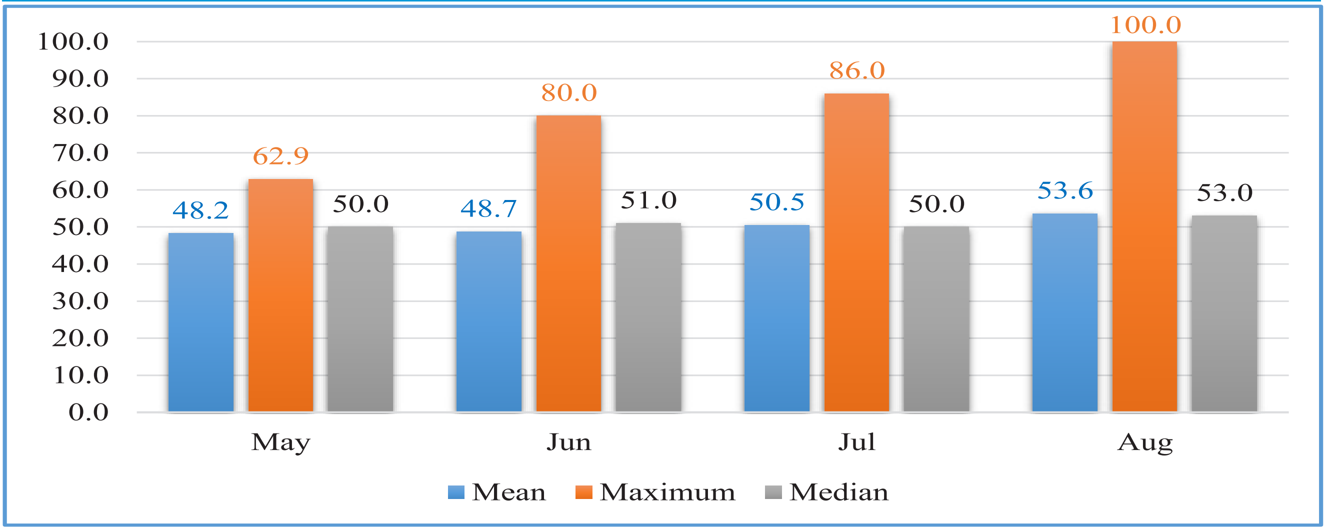
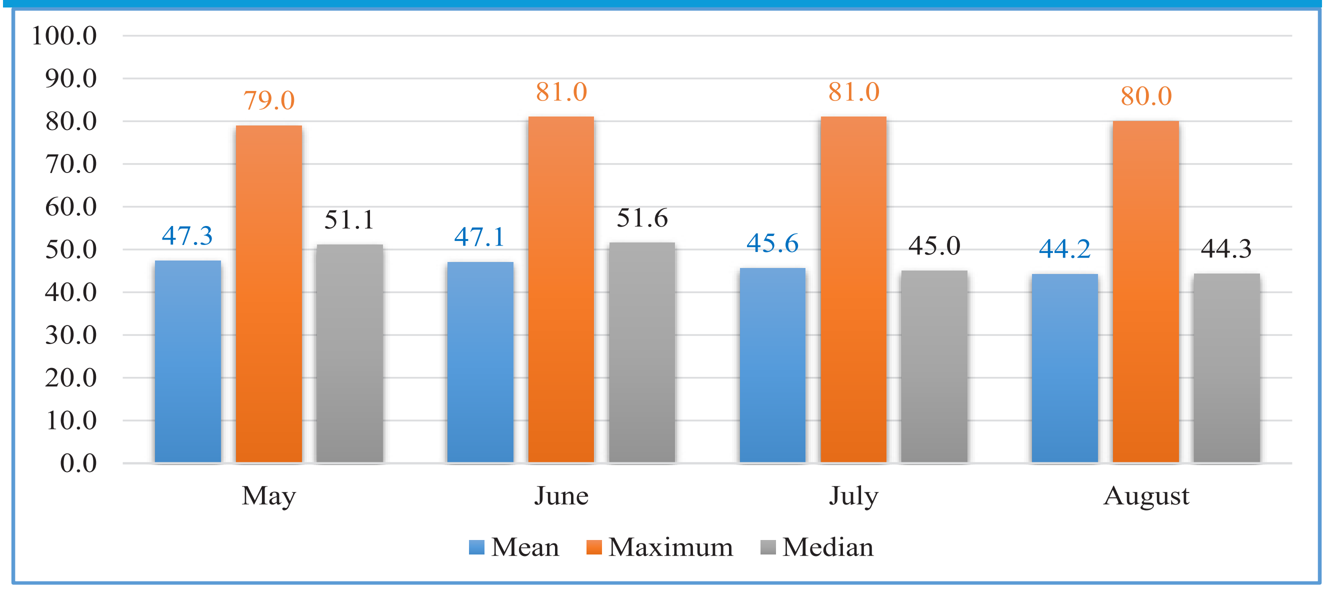


Chart 6b: Forward Hotel Bookings in the May 2017 Survey (percent of total capacity)



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