Central Bank of Kenya

Monetary Policy Committee Market Perceptions Survey

May 2020

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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. In the event of any adverse shock in the economy, the MPC carries out special surveys on a monthly basis to obtain perceptions and expectations from specific sectors to shed more light into the crisis.

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 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, 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 improve the response rate.

1. INTRODUCTION

The MPC Secretariat carried out the May 2020 MPC Market Perceptions Survey in the first three weeks of the month amidst the COVID-19 pandemic. The Survey sought perceptions on the effects of the pandemic, and economic conditions prevailing in the two months before the MPC meeting, i.e. March and April 2020, and market expectations on economic conditions for May and June 2020, for the next 12 months (May 2020 – April 2021), and over the medium term (a period of 5 years).

The Survey sought from respondents their expectations with regard to overall inflation, lending rates, 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, expectations regarding employment levels, and levels of economic activity before and after 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, 14 microfinance banks (MFBs) and 328 non-bank private firms including 63 hotels, through questionnaires sent by email and hard copy. The overall response rate to the May 2020 Survey was 61 percent of the sampled institutions. The respondents comprised 37 commercial banks, 1 mortgage finance institution, 12 micro-finance banks, 51 hotels, and 132 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.

3. HIGHLIGHTS OF THE SURVEY

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

- Inflation expectations remain well anchored within the target range in the next 2 months and over the next 12 months.
- A slower economic growth expected in 2020, mainly due to the COVID-19 pandemic disruptions.
- A slower pace of increase in private sector credit growth is expected in 2020.
- Moderated optimism on Kenya's economic growth prospects going forward.

4. ECONOMIC ACTIVITY

Actual economic activity perceptions in March – April 2020

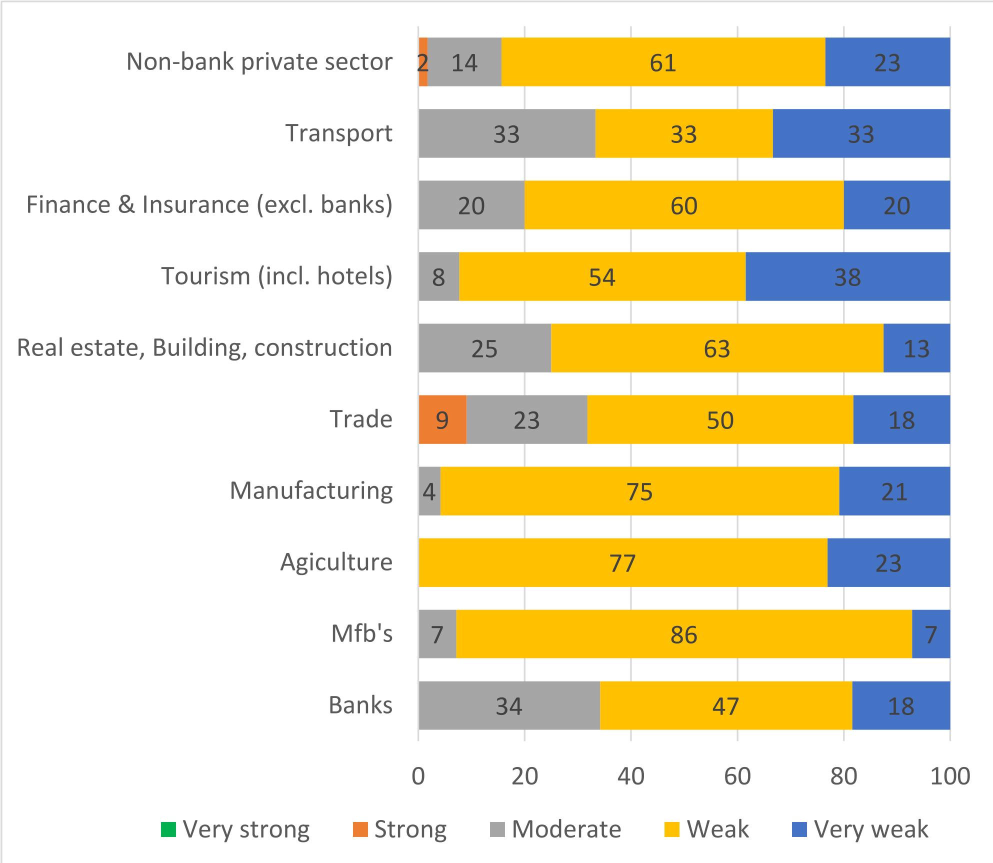
The May 2020 Market Perceptions Survey sought bank and non-bank private sector firms' assessment of economic activity in the two months prior to the May MPC meeting, i.e., March and April 2020, to get their views of the impact of the COVID-19 pandemic and other economic conditions prevailing before the MPC meeting.

The results from banks and non-bank firms revealed weak activity in March and April, due to the impact and the measures adopted to contain the COVID-19 pandemic, floods, locust invasion, and slow private sector credit growth **(Chart 1).**

Bank respondents indicated that the pandemic had negatively affected individuals and businesses, citing collapsed businesses, employment lay-offs, especially in the hotel industry, muted consumer demand and confidence, weak investment demand by firms as entrepreneurs adopted a wait and see approach to investments, lower turnovers, reduced purchasing power and muted business activity, as direct COVID-19 effects on the economy. In addition to the direct effects, efforts to contain the pandemic including the international lockdowns, curfews, movement restrictions, cessations and the diversion of government budgetary funding to fight COVID-19 also significantly contributed to the slow-down in economic activities in March and April.

Further, respondents indicated that floods and the invasion by locusts affected activity in the agricultural sector while restricted access to credit and supply chain disruptions slowed down activities in the manufacturing, construction and real estate sectors.

Chart 1: Perceptions on Economic Activity in March and April 2020 (percent)



Expected economic activity in May – June 2020

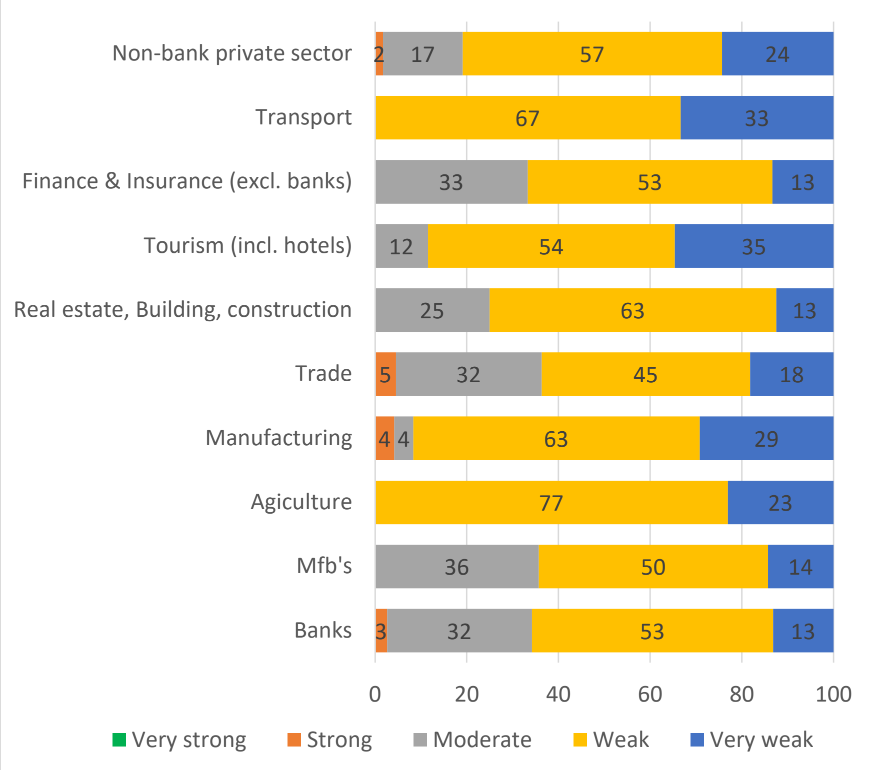
The Survey requested bank and non-bank respondents to give their expected levels of economic activity for May and June 2020, bearing in mind the presence of the pandemic that the country, and indeed the world was grappling with.

The results showed that respondents expected economic activity to remain muted around the levels experienced two months before the May MPC meeting (March and April), largely due to the COVID-19 pandemic **(Chart 2).** Respondents expected economic activity to remain subdued as conditions such as flight bans, curfews, cessations, closure of businesses and uncertainties in the market continued to affect aggregate demand in the economy.

Other reasons cited for the expected weak activity included higher unemployment rates due to lay-offs and closed businesses, interruption of supply chains for key imported inputs, closure of the hotel sector, reduction in exports, diversion of Government spending from development to fighting the pandemic, and a looming global economic recession.

Nevertheless, respondents expected economic activities to get back on track, pointing out signs of reopening in some sectors, with the lifting of the restrictions initially put in place to contain the pandemic.

Chart 2: Expectations of Economic Activity in May and June 2020 (percent)



5. INFLATION EXPECTATIONS

In the Survey, respondents were required to give their expectations of overall inflation rates for the next 2 months (May and June 2020), the next 12 months (May 2020 to April 2021), the next 2 years (May 2020 to April 2022) and the next 5 years (May 2020 to April 2025).

The results showed that respondents expected inflation to remain stable and within the target range (5 ± 2.5 percent) in May and June 2020, and over the next 1 year **(Table 1).**

Table 1: Inflation expectations (%)

Inflation expectations for:	May-20	Jun-20	Average	Next 1 year	Next 2 years	Next 5 years
Large banks	5.48	5.55	5.51	4.70	5.48	5.31
Medium banks	5.98	6.18	6.08	6.14	6.38	5.91
Small banks	5.68	5.79	5.73	5.50	6.16	5.98
All banks	5.58	5.67	5.62	5.00	5.68	5.46
MFB's	5.89	6.12	6.01	5.88	5.41	4.88
Non-banks	6.08	6.18	6.13	6.48	6.50	5.90

Bank respondents expected inflation to remain at the current levels, and to converge towards the mid-point of the Government target range over the next year supported by low food prices due to the ongoing rains, the sharp reduction in oil prices, reduced demand and tax reduction (VAT) by Government. Despite the expected stability in inflation, bank respondents pointed out the floods and locust invasion as reasons that could compromise food production and hence push prices upwards.

Non-bank respondents expected some upward pressure on inflation from expected increases in food prices arising from supply disruptions related to the ongoing floods, and locust invasion and expected increase in other commodity prices from supply disruptions, increased production and transport costs related to COVID-19. Additionally, respondents expected increase in demand as businesses reopen, and a weaker Shilling, to put upward pressure on inflation in the next 2 months and 12 months. However, respondents expected the low fuel prices, depressed economic activities, low prices of some fast growing vegetables and reduced VAT to keep prices low in the next 2 months.

Respondents expected that unpredictable weather patterns, recovery of oil prices and election related pressures would determine inflation levels in the next few years.

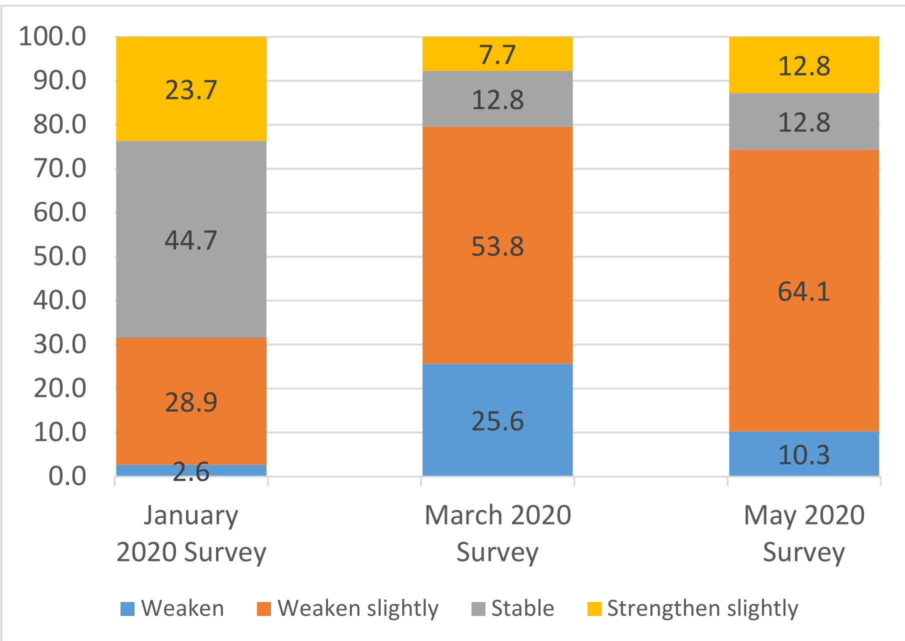
6. EXCHANGE RATE EXPECTATIONS

The Survey sought to find out from bank and non-bank private sector firms their expectations with regard to the direction of change in the exchange rate of the Shilling against the U.S. Dollar in May and June 2020.

Bank respondents expected a weakening bias of the exchange rate of the Shilling against the USD in the next 2 months due to reduced inflows from horticultural exports, tourism and diaspora remittances because of the pandemic concerns with regard to the country's debt position, credit rating and increased dollar demand by global investors and external debt service obligations **(Chart 3).**

Respondents, however expected the Shilling to be supported by sufficient reserves, reduced import demand due to the slowdown brought about by the COVID 19 pandemic, low international oil prices, and expected recovery of exports as governments gradually ease COVID-19 restrictions.

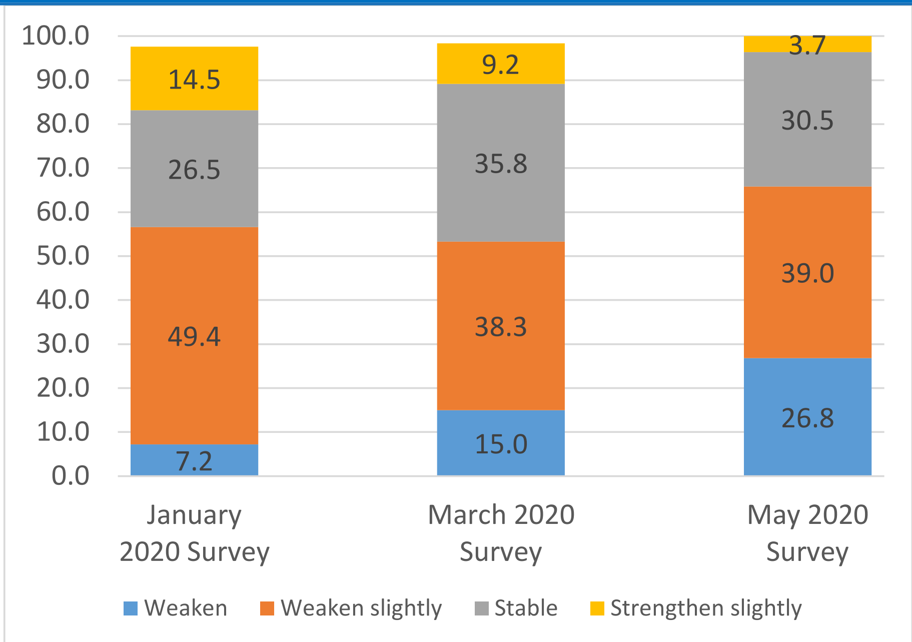
Chart 3: Banks expectations on the direction of theShilling/USD Exchange rate in the next 2 months



Similarly respondents from the non-bank private firms expected weakening bias in the exchange rate for the next 2 months due to the effects and uncertainties surrounding the pandemic including increased demand for foreign currency by foreigners selling off stocks, decline in earnings from tourism, agricultural exports and diaspora remittances, and concerns about from external debt repayments **(Chart 4).**

However, respondents expected the sufficient foreign exchange reserves, lower import bill and recovery of export earnings and diaspora remittances to support the Shilling.

Chart 4: 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

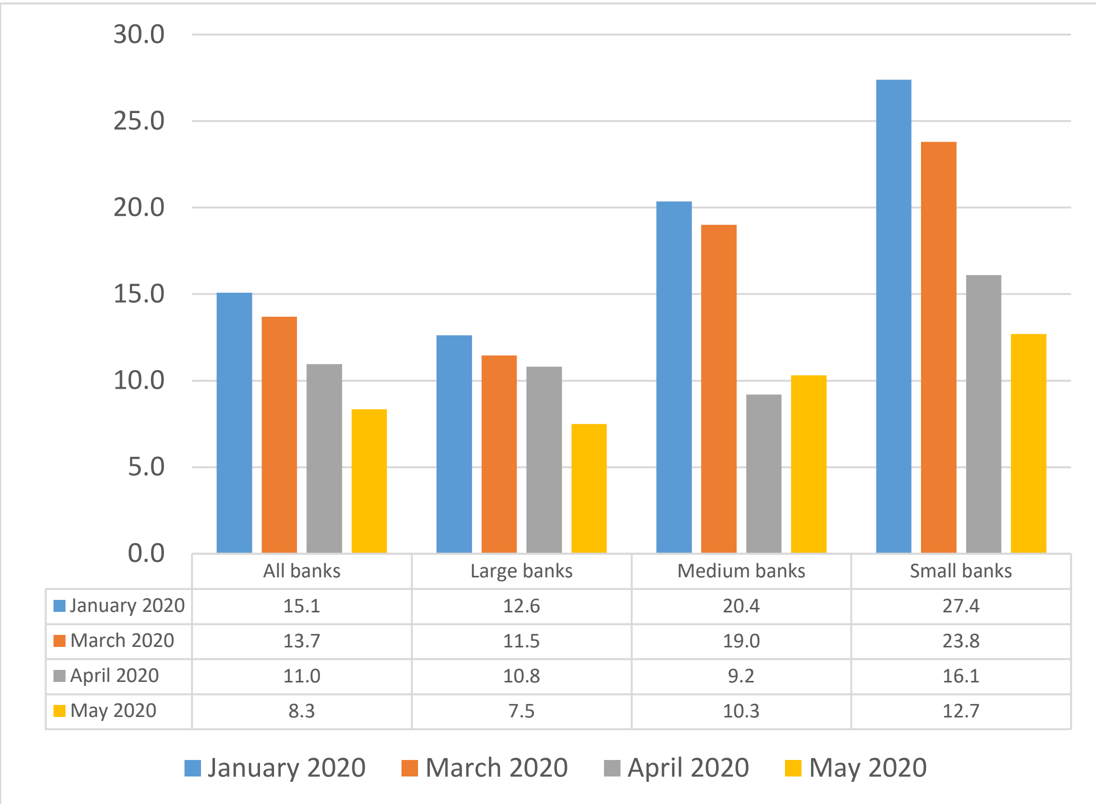
7.1 Growth in Private Sector Credit in 2020

The Survey sought to find out from commercial banks their expectations with regard to private sector credit growth by the end of 2020 relative to the position at the end of 2019.

Bank respondents revised downwards their expected lending to the private sector, largely due to the impact and uncertainty of the COVID-19 pandemic on economic activity in 2020 **(Chart 5).** Respondents indicated that the decline in household and business spending due to the COVID-19 pandemic, closure of MSMEs due to restrictions and cessations, partial closure of Government registry, reduced demand from trading partners and resultant impact on domestic production, supply chain disruptions and cautious borrowing approach taken by clients would slow down growth in credit to the private sector. In addition, respondents cited the need to minimize NPLs, the weak economic activity, delayed payments to suppliers by Government, low disposable incomes and restrictions on foreign trade as reasons for the downward revision in expected growth in credit to private sector.

Respondents, however, expected the interventions by Government and by CBK, coupled with development of innovative credit products, to cushion and support the SME sector, and boost demand for credit. In addition, respondents cited improved risk profiling, restructuring of loans under the COVID-19 emergency relief measures and payment of pending bills by national and county Governments to facilitate liquidity and reduce levels of industry non-performing assets, as reasons that would contribute to private sector credit growth. Respondents also pointed out that the Government initiative to support MSMEs through reduced duties and other subsidies would boost growth in the sector and consequently demand for credit, the reduced energy prices would likely spur lending in most of industrial sectors, and expectations of continued favourable weather conditions would increase demand in the agricultural sector.

Credit Growth (percent)



	All banks	Large banks	Medium banks	Small banks
January 2020	15.1	12.6	20.4	27.4
March 2020	13.7	11.5	19.0	23.8
April 2020	11.0	10.8	9.2	16.1
May 2020	8.3	7.5	10.3	12.7

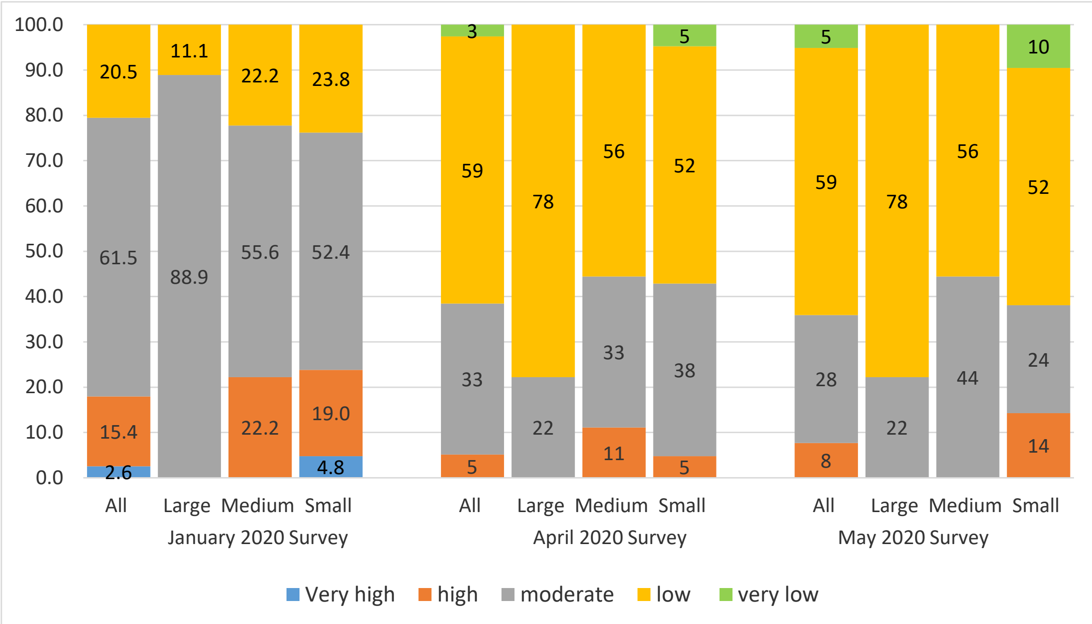
7.2 Expected Demand for Credit

The Survey requested bank participants for an assessment of credit demand from their perspective, during the 2 months before the MPC meeting, i.e., March and April, and their expectations of the same for May and June 2020.

Just like in April, bank respondents expected demand for credit in May and June to remain low due to the effects of COVID-19 pandemic on the economy **(Chart 6).** Respondents pointed out lower demand from sectors such as transport, hotels and restaurants, SMEs, tea, coffee, floriculture and horticulture, mainly attributed to closures and lockdowns due to the pandemic.

Respondents indicated that large corporate demand had significantly dropped due to elevated business risks and uncertainties, forcing investors to take a wait and see approach to investment decisions. However, respondents expected demand for short-term credit for bridging working capital, and demand by households, to increase.

Chart 6: Expected Demand for Credit in 2020 (percent)



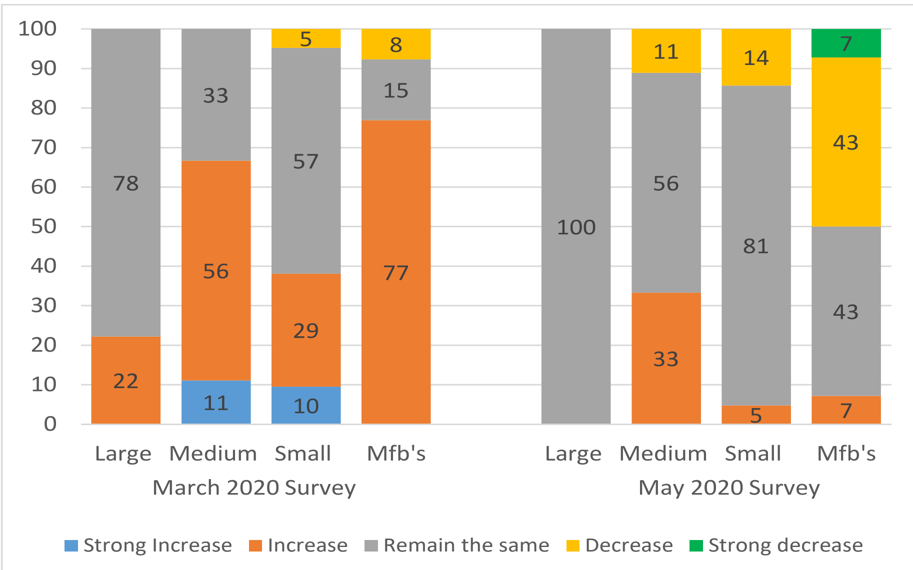
8. EMPLOYMENT EXPECTATIONS

8.2: Expected changes in employment by banks

The Survey inquired from bank respondents their expectations with regard to the number of employees their respective banks expected to retain in 2020 relative to 2019.

The respondents expected the number of employees within their banks to remain largely the same, with a tendency to decrease in 2020 due to COVID-19, which had slowed down planned expansions and increases in the range of products. In addition, respondents pointed out that automation and digitization projects could potentially reduce the overall number of employees **(Chart 7)**.

Chart 7: Expected changes in employment levels by banks in 2020 (percent)



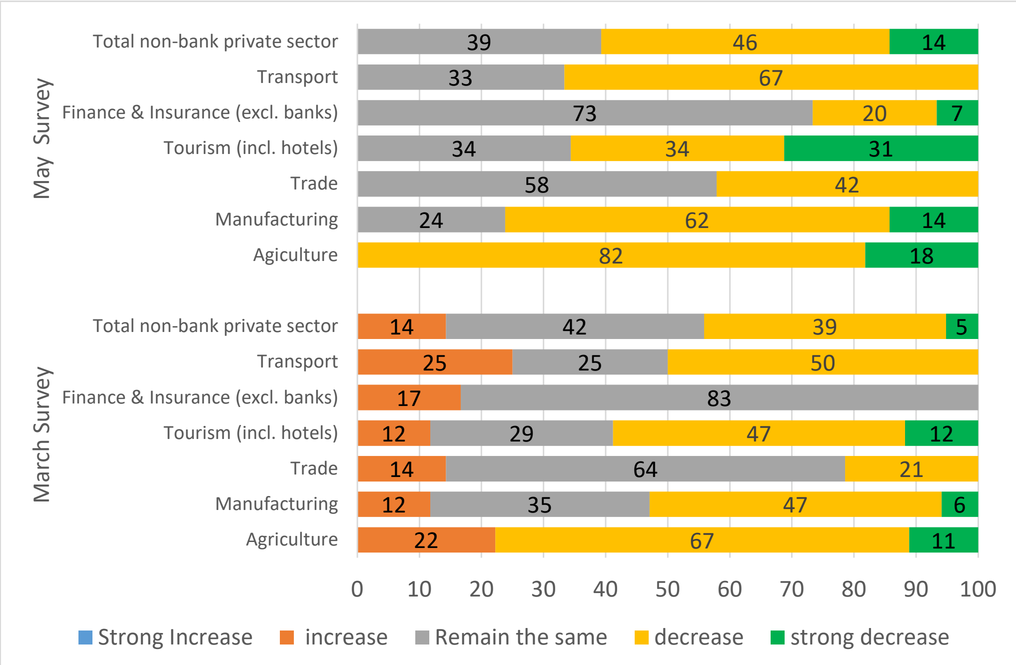
8.3: Employment Expectations by non-bank private sector (percent)

The Survey inquired from non-bank private sector respondents, expectations with regard to the number of employees their respective companies expected to retain in 2020 relative to 2019.

Respondents from the non-bank private sector expected the employment levels within their establishments to decrease following the low business levels and revenue generation, which were unable to sustain the current numbers of employees, in addition to the closures and uncertainties and supply chain interruptions brought about by the pandemic (Chart 8).

However, some companies have resolved to take all possible measures to maintain their employees, and resort to salary cuts, if necessary.

Chart 8: Expected changes in employment levels by non-bank private firms in 2020 (percent)



9. EXPECTED ECONOMIC GROWTH

The Survey requested participants to indicate their expected economic growth rate for the country for the current year 2020, and the next two and five years, respectively.

9.1: Economic Growth Expectations for 2020

Respondents made significant downward revisions to their expectations on economic growth largely due to the impact of COVID-19 pandemic on the economy. Respondents indicated that, travel and tourism, hotels and restaurants, export and imports, and the education sector were hard-hit by the pandemic and were unlikely to recover within the year. In addition, respondents cited muted consumer demand and confidence, rise in unemployment, and pending bills, which have slowed down private sector credit growth, as factors likely to affect growth negatively. In addition to the effects associated with the pandemic, respondents cited the ongoing floods and locust invasion, indicating that these would affect agricultural output in 2020.

However, respondents expected some relief from falling international oil prices and gradual easing of restrictions, that had been put in place to curb the spread of the virus. In addition, respondents expected the economy to rebound in 2021 as economic activity picked up and with the pandemic under control, favourable weather conditions, lower oil prices, and the expansionary fiscal and monetary policies, which are expected to provided an economic stimulus to private sector and households.

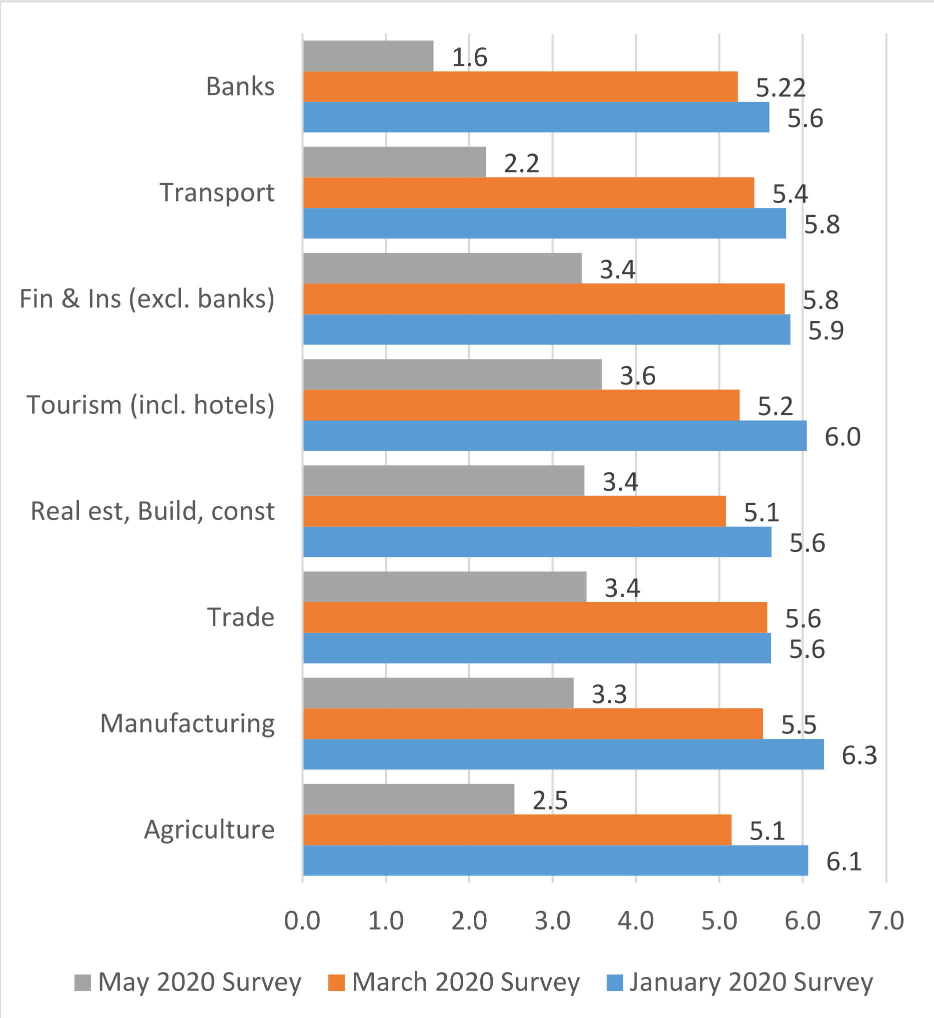
Table 2: Expectations on Economic Growth for 2020 (percent)

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

Respondents across the sectors expected 2020 economic growth to shrink due to the impact of COVID-19 pandemic on all sectors of the economy. Respondents cited closures, movement restrictions, declines in domestic and foreign demand, decreased production in manufacturing and services sectors, heavy borrowing and low consumption, as reasons for the downward revision of expected economic growth.

However, respondents indicated that 2020 growth was very dependent on how soon the virus was contained, as it would take some time for some sectors to recover.

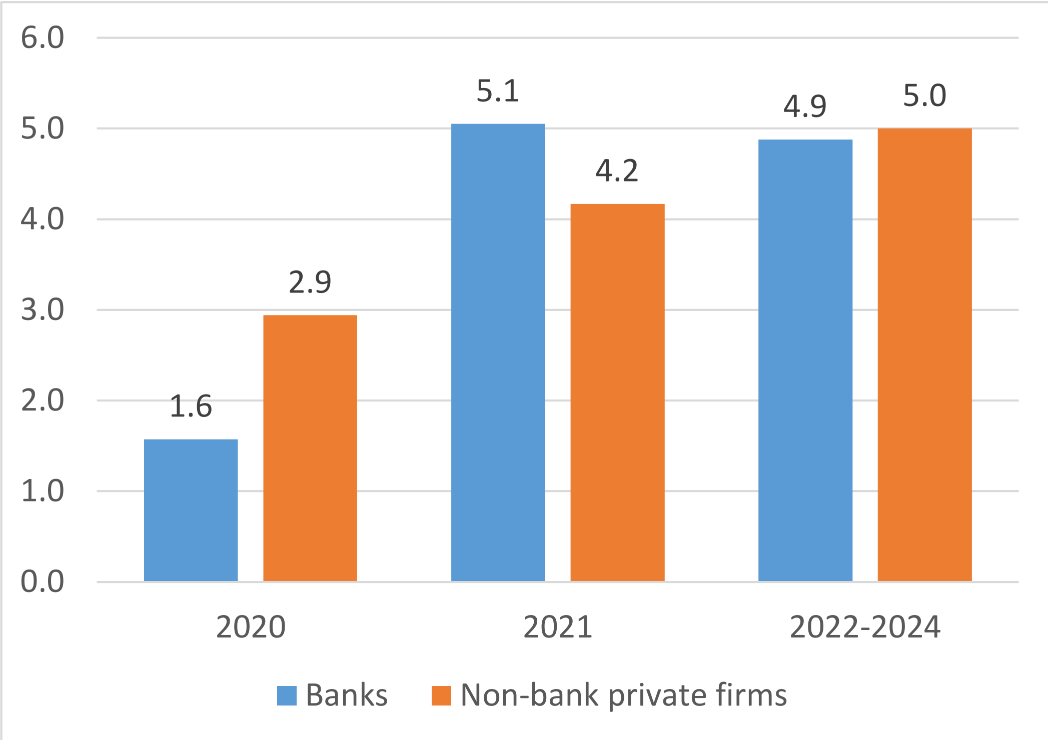
Chart 9: Expectations on Economic Growth for 2020 across Sectors (percent)



9.2: Economic Growth expectations for 2021 - 2024

Respondents expected improvement in economic growth in 2021, as businesses and countries recover from the pandemic **(Chart 10).**

Chart 10: Expectations on Economic Growth 2020 – 2024 (Percent)



10. OPTIMISM ON THE ECONOMIC PROSPECTS

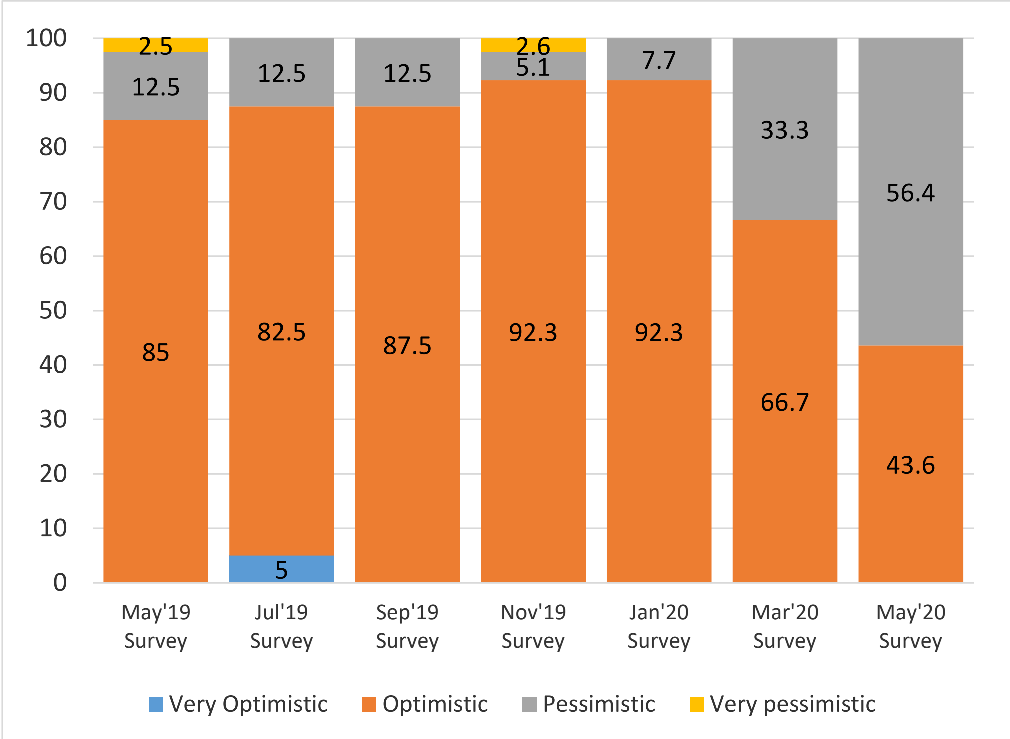
10.1. Economic Prospects

The May 2020 Survey requested bank and non-bank private sector firm respondents to indicate how optimistic/ pessimistic they were regarding the country's economic prospects. The results showed downward revisions in optimism by respondents across banks and nonbank private sector firms largely due to the COVID-19 pandemic **(Charts 11 and 12).**

Bank respondents revised downwards their optimism for the country's economic prospects due to the coronavirus pandemic, which had led to closures and uncertainties in the economy, resulting in job losses and negatively affecting livelihoods. In addition, respondents cited slowdown in business activity, deferred investment decisions, increase in the cost of doing business, restrictions instituted by the Government to curb the spread of the virus and movement of focus from development to fighting the pandemic as reasons for the downward revision.

However, respondents pointed out the pro-active expansionary fiscal policy interventions to stem the COVID-19 pandemic spread, the support to MSMEs and households by reducing taxes, CBK's monetary policy interventions to protect liquidity, soundness and stability of the banking system from a financial crisis, debt relief and renegotiation of public debt as reasons for their optimism.

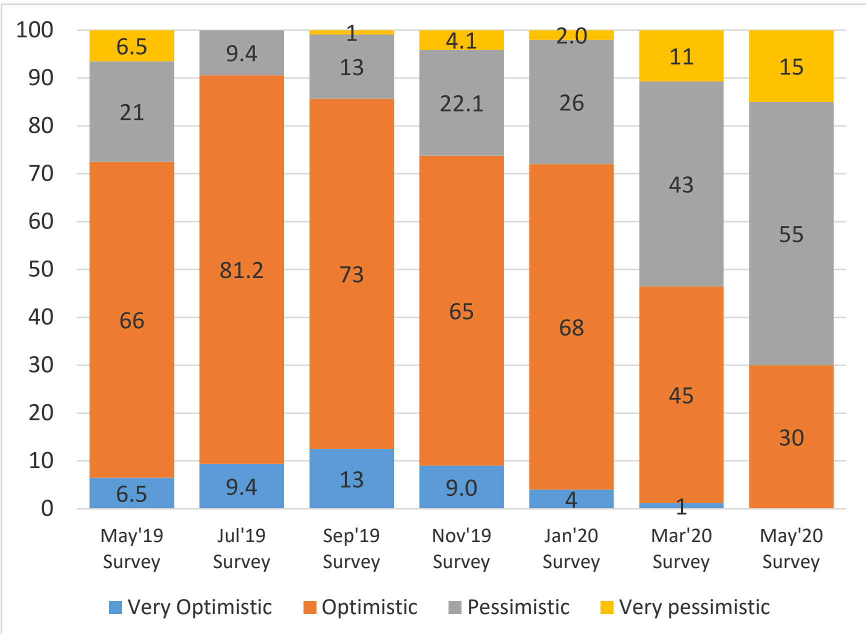
Chart 11: Optimism by Banks on Economic Prospects (percent)



The non-bank private sector firms revised downwards their optimism levels about the country's economic prospects due to the effects and uncertainty around the COVID-19 pandemic amid debt servicing obligations and potential effects of locust invasion on agriculture. In addition, respondents cited slowdown in economic activities, stalled development projects and slowdown in business growth as reasons for their downward revision.

Respondents, however, expected the economy to recover in time, with additional supportive measures put in place by Government.

Chart 12: Optimism by Non-bank private firms on Economic Prospects (percent)



10.2. Forward Hotel Bookings

In an attempt to assess optimism in economic prospects of the country in the midst of a pandemic, the Survey requested hotel sector respondents to indicate monthly forward hotel bookings, if any, received so far for the period May – August 2020.

Results showed that most hotels had all their bookings cancelled or suspended indefinitely with the onset of COVID-19 **(Chart 13 & 14).** Out of hotels that responded, 75 percent were in the process of reopening, i.e., complying with the Government's requirements for reopening, 19 percent had reopened, but with zero forward bookings and only 5 percent had forward bookings for the period. Respondents, however, pointed out that reopening with curfews and lockdowns in Nairobi and Mombasa, and with airports closed would not be cost- effective.

Chart 13: Forward Hotel Bookings for May–August 2020 (percent of total capacity)

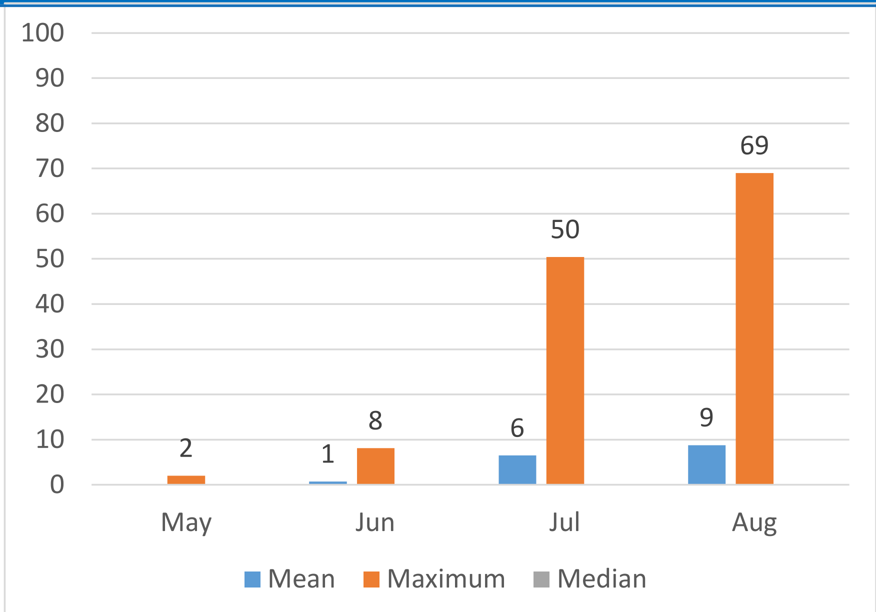
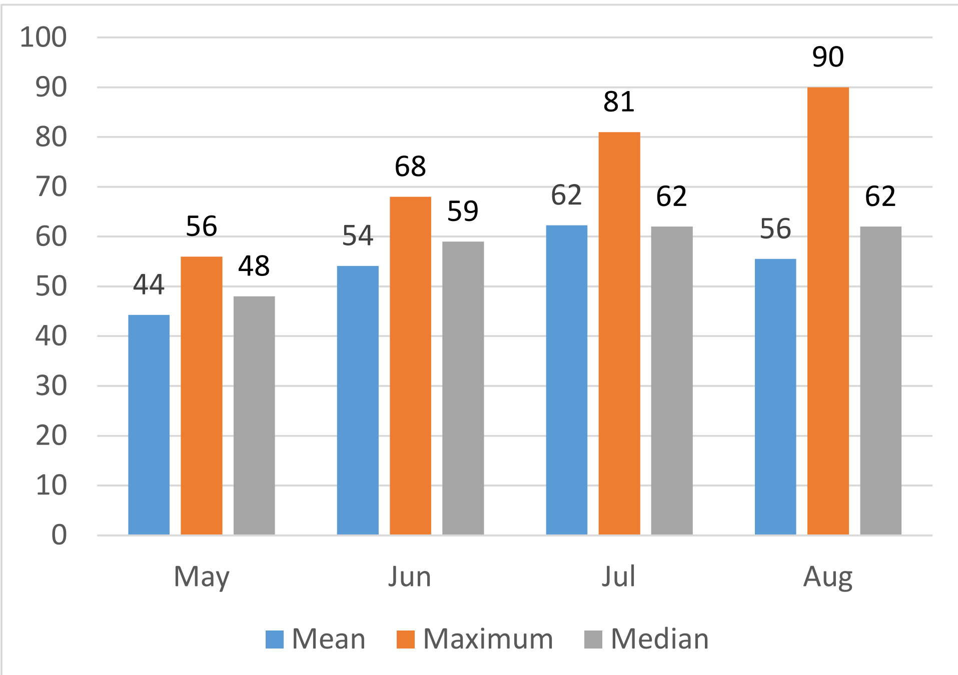


Chart 14: Forward Hotel Bookings for May–August 2019 (percent of total capacity)



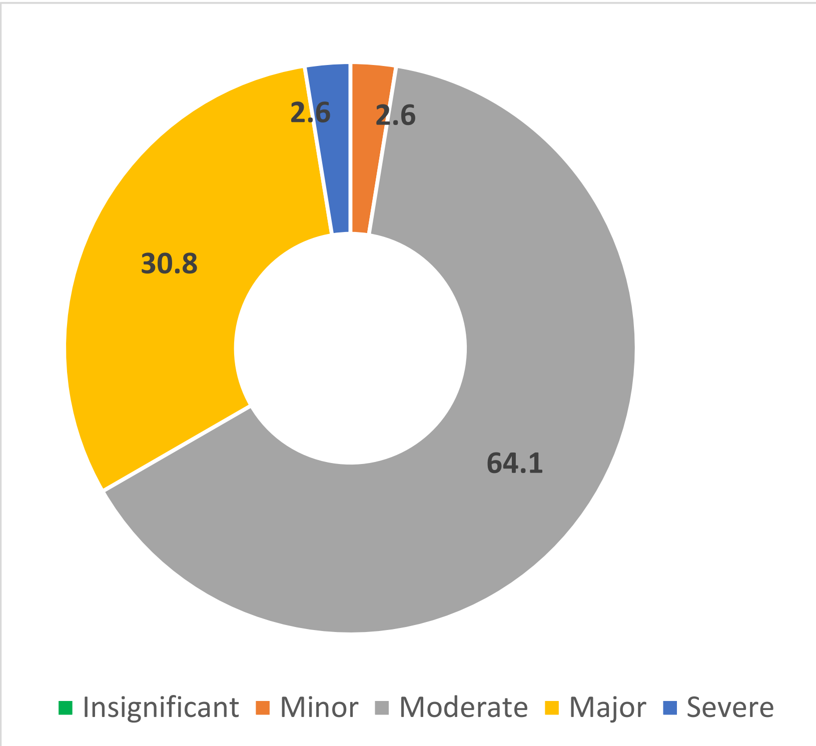
11. IMPACT OF COVID-19

The Survey requested banks and non-bank private firms for their perceived impact of the coronavirus on their sectors so far.

11.1 Impact of COVID-19 on the Financial sector

In the May Survey, bank respondents described the impact of COVID-19 to the sector as moderate with a tendency to worsen, if the pandemic was not contained soon **(Chart 15)**. Respondents cited the lower lending rates, reduced demand for credit especially from the corporate segment, increased use of digital transactions, reduced employee productivity due to working from home, shifted focus by customers to essentials/necessities, leading to a reduction of loan applications and reduced risk appetite by MSMEs as some of the pandemic's effects already felt in the sector.

Chart 15: Impact of COVID-19 on Financial Sector (percent)



Bank respondents cited increase in loan impairment and provisions, increased caution in lending to businesses that rely on imports, high risk of credit default, rise in non- performing Loans and applications for restructuring, reduced business cash flows and a drop in transactions related income due to low transaction volumes as further effects of the pandemic on the sector.

In addition, respondents pointed out that most customers were unable to service their facilities due to job losses, and that most banks had experienced increased operations cost due to adoption of various safety measures put in place to curb spread of the virus.

11.1 Impact of COVID-19 on Non-bank Private Sector

Non-bank private sector respondents indicated that the COVID-19 impact had been severe, as seen in declining trade, supply disruptions, lower demand and delayed payments. In addition, respondents cited delayed projects, expensive imports and cancelled exports as some of the effects of the virus.

Respondents from the tourism sector reported sharp reductions in the number of international tourist arrivals in Q1 of 2020, and projected the trend to remain for the rest of 2020. In addition, respondents indicated that domestic tourism had come to a halt due to the restriction of movements to limit the spread of the virus. Respondents, however, expected the sector to pick up at a slower pace, with the lifting of restrictions.

Other sectors cited supply chain disruptions, slowdown in the growth of inflows, higher input costs, slowdown in construction activities, slower trade, lower staff productivity and general slowdown of operations with a lot more focus on personnel safety.

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