CENTRAL BANK OF KENYA

CREDIT OFFICER SURVEY

MARCH - JUNE 2015

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1.0 FOREWORD

1.1 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan Banking Sector recorded growth in the quarter ended 30th June 2015, compared to the quarter ended 31st March 2015. Some of the sector's performance indicators are as follows:

- The aggregate balance sheet increased by 6.8% from Kshs 3.37 trillion in March 2015 to Kshs 3.60 trillion in June 2015.
- Gross loans increased by 6.70% from Kshs 2.03 trillion in March 2015 to Kshs 2.16 trillion in June 2015.
- Banking sector deposits grew by 6.64% from Kshs 2.41 trillion in March 2015 to Kshs 2.57 trillion in June 2015.
- Total shareholders' funds increased by 1.76% from Kshs 533.9 billion in March 2015 to Kshs 543.32 billion in June 2015.
- Cumulative unaudited pre-tax profits for the six months ended 30th June 2015 stood at Kshs 76.90 billion compared to Kshs 71.02 billion for 30th June 2014 translating to an increase of 8.28%.

1.2 CREDIT OFFICER SURVEY

Credit risk is the single largest factor affecting the soundness of financial institutions and the financial system as a whole. Lending is also the principal business for banks. The ratio for total loans to total assets of the banking sector for the quarter ended 30th June 2015 was 59.44% a slight decrease from 59.47% reported in June 2014. In order to identify the potential causes and enhance understanding of credit risk, the Central Bank of Kenya introduced a quarterly Credit Officer Survey in 2012.

For the quarter ended 30th June 2015, CBK received Credit Officer Survey responses from 42 operational banks and 1 mortgage finance company. The list of the responding banks is attached to this report as **Annex I**.

CENTRAL BANK OF KENYA
AUGUST 2015

2.0 EXECUTIVE SUMMARY

2.1 SURVEY METHODOLOGY

The credit officer survey for the quarter ended 30th June 2015 included four questions that focused on:-

- Demand for Credit.
- Credit Standards.
- Non-Performing Loans.
- Credit Recovery Efforts.

The survey, conducted in July 2015, targeted senior credit officers of all 42 operational commercial banks and 1 mortgage finance company. Charterhouse Bank Ltd, which remains under statutory management, was excluded from the survey. All the forty three institutions responded.

2.2 KEY FINDINGS

The key findings from the survey are detailed below:

2.2.1 Demand for credit

The demand for credit generally remained constant in seven economic sectors and increased in four economic sectors in the quarter ended June 2015.

2.2.2 Credit Standards

Credit standards largely remained unchanged across all the eleven economic sectors in Q2 of 2015.

2.2.3 Non-Performing Loans

For the third quarter of 2015, most banks expect the levels of non-performing loans to generally remain constant in ten of eleven economic sectors. However, banks foresee increasing NPLs in Tourism sector. Some respondents quote spillover of delinquencies attributed to the previous spate of insecurity in the country and previous adverse travel advisories as factors for increased NPLs in Tourism Sector. On the contrary some respondents are optimistic that in the coming months Tourism is expected to recover after the lifting of adverse travel advisories by US and UK. This expectation is also supported by the fact that we are currently in the high season for Tourism sector in Kenya which runs from July to December.

2.2.4 Credit Recovery Efforts

In Q3 of 2015, most banks intend to intensify their loan recovery efforts in seven of the eleven economic sectors to improve the overall quality of their asset portfolio.

3.0 SURVEY FINDINGS

3.1 Demand for Credit

3.1.1 Observations

- In Q2 of 2015, demand for credit generally remained constant in seven economic sectors and increased in four economic sectors. The seven economic sectors that recorded unchanged demand for credit were Mining, Energy, Financial Services, Manufacturing, Transport, Agriculture and Tourism while the four economic sectors that recorded increased demand for credit were Trade, Building, Personal/Household and Real Estate. This is **depicted in Chart 1 below**.
- Compared to Q1 of 2015, Kenyan banks indicated that demand for credit:-
  - Increased in seven economic sectors in Q2 of 2015. The seven sectors were Building, Mining, Trade, Tourism, Real Estate, Financial Services and Personal/Household which went up with a margin of 2%, 2%, 10%, 15%, 7%, 13% and 5% respectively.
  - Decreased in three economic sectors namely; Building, Energy and Personal. The reasons cited for decreased demand for credit were cost of borrowing, security risks associated with the terror attacks, recent upward review of Central Bank Rate and Kenya Banks Reference Rate.

Table 1 below present the trend in the demand for credit in the quarter ended June 2015 as compared to March 2015.

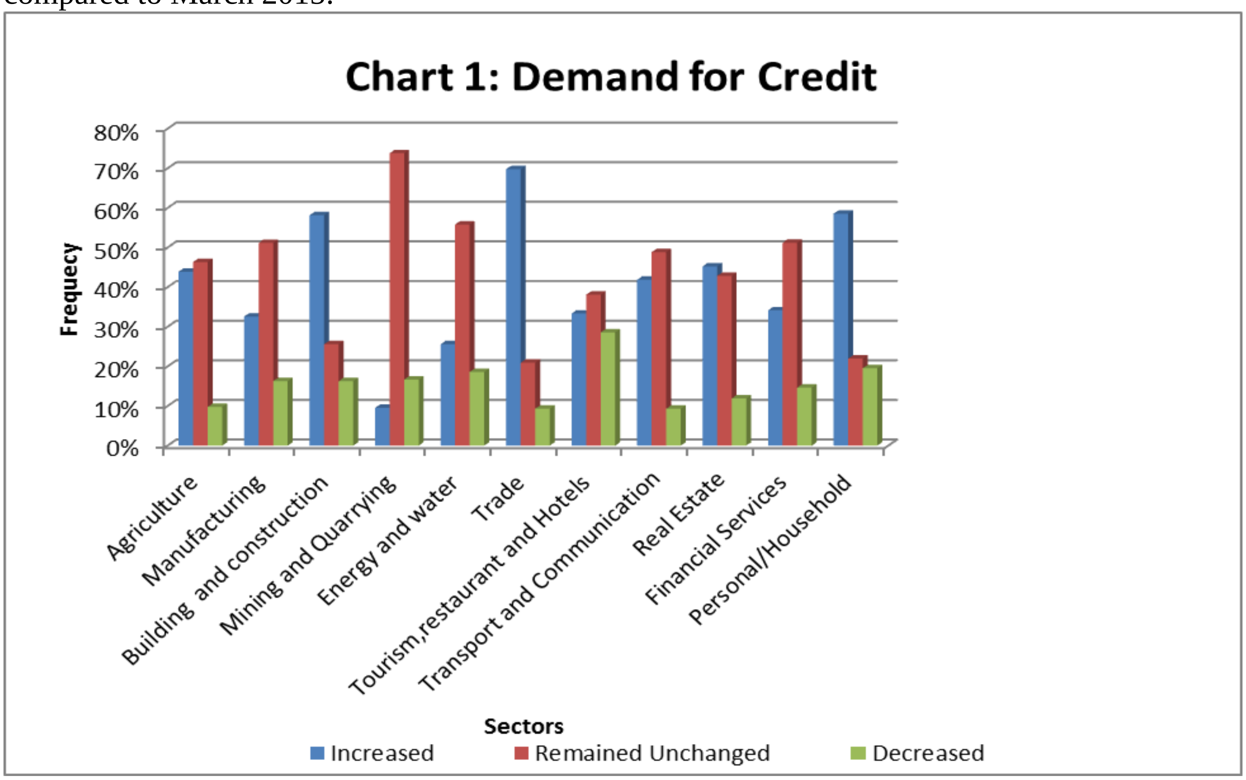

Table 1: Demand for Credit

	June 2015			March 2015		
	Increased	**Remained Unchanged**	**Decreased**	**Increased**	**Remained Unchanged**	**Decreased**
Agriculture	44%	46%	10%	46%	41%	12%
Manufacturing	33%	51%	16%	36%	45%	19%
Building & Construction	58%	26%	16%	56%	37%	7%
Mining and Quarrying	10%	74%	17%	8%	68%	25%
Energy and Water	26%	56%	19%	26%	65%	9%
Trade	70%	21%	9%	60%	19%	21%
Tourism, Restaurant and Hotels	33%	38%	29%	18%	50%	32%
Transport and Communication	42%	49%	9%	49%	42%	9%
Real Estate	45%	43%	12%	38%	45%	17%
Financial Services	34%	51%	15%	21%	64%	14%
Personal/Household	59%	22%	20%	54%	37%	10%

3.2 Factors affecting demand for credit

3.2.1 Observations

- In Q2 of 2015 credit survey, factors affecting demand for credit had no impact in all economic sectors as depicted in Chart 2 and Table 2 below.
- Some Kenyan banks indicated that cost of borrowing (24%) and recent upward review of Central Bank Rate (21%) had the most impact in reducing the demand for credit. The impact of the two aforementioned factors was however lower than in Q1 of 2015 which recorded 19% and 5% for Cost of Borrowing and Central Bank Rate respectively. This is depicted in Table 2 below.

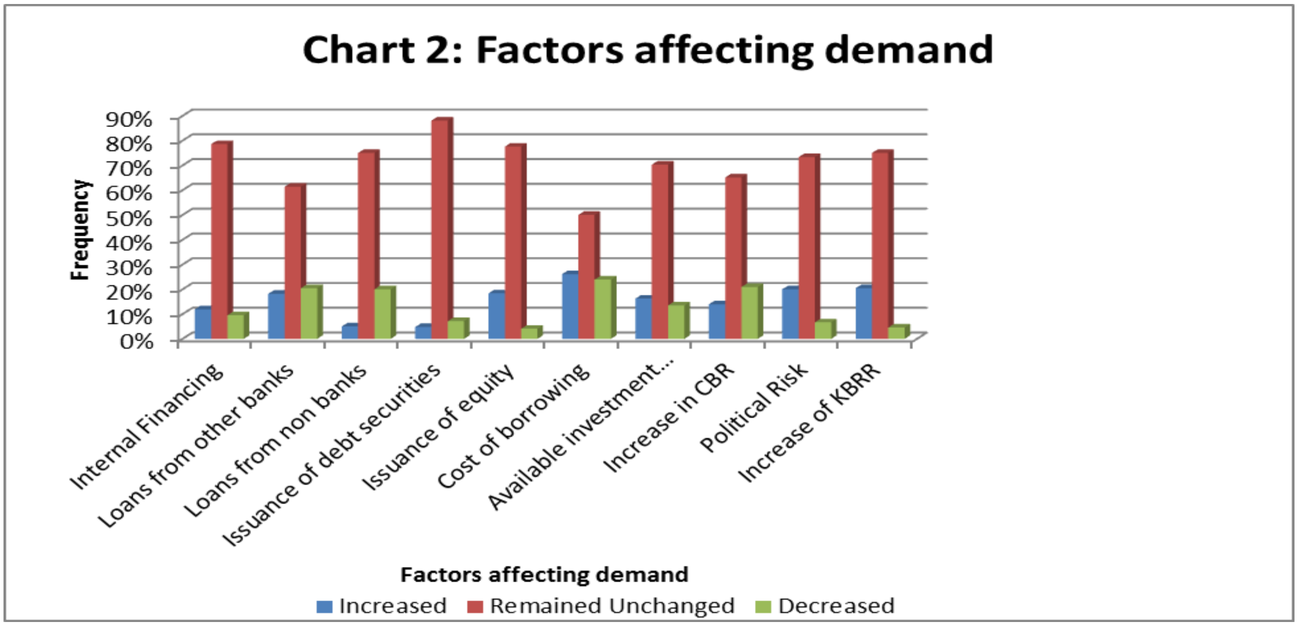

Table 2: Factors affecting Demand for credit

	June 2015			March 2015		
	Increased	**Remained Unchanged**	**Decreased**	**Increased**	**Remained Unchanged**	**Decreased**
Internal Financing	12%	79%	10%	12%	69%	19%
Loans from other banks	18%	61%	20%	12%	65%	23%
Loans from non-banks	5%	75%	20%	7%	71%	21%
Issuance of debt securities	5%	88%	7%	7%	83%	10%
Issuance of equity	18%	78%	4%	5%	88%	7%
Cost of borrowing	26%	50%	24%	40%	42%	19%
Available investment opportunities	16%	70%	14%	35%	53%	12%
Increase in CBR	14%	65%	21%	28%	67%	5%
Political Risk	20%	73%	7%	21%	63%	16%
Increase of KBRR	20%	75%	5%	44%	51%	5%

3.3 Credit Standards

3.3.1 Observations

- Similar to the last last two quarters, the survey established that credit standards generally remained unchanged for all economic sectors over the three months to 30th June 2015.
  With the increasing competition in the banking sector some banks retained their credit standards to avoid losing customers to banks with less stringent credit standards.
- Chart 3 below indicates that relatively to the other sectors, credit standards were slightly tightened for Building & Construction, Tourism, Real Estate and Transport sectors.

- Compared to Q1 of 2015, credit standards were slightly tightened for Building & Construction and Mining & Quarrying sectors by a margin of 2% and 3% respectively. This is depicted in **Table 3** below:

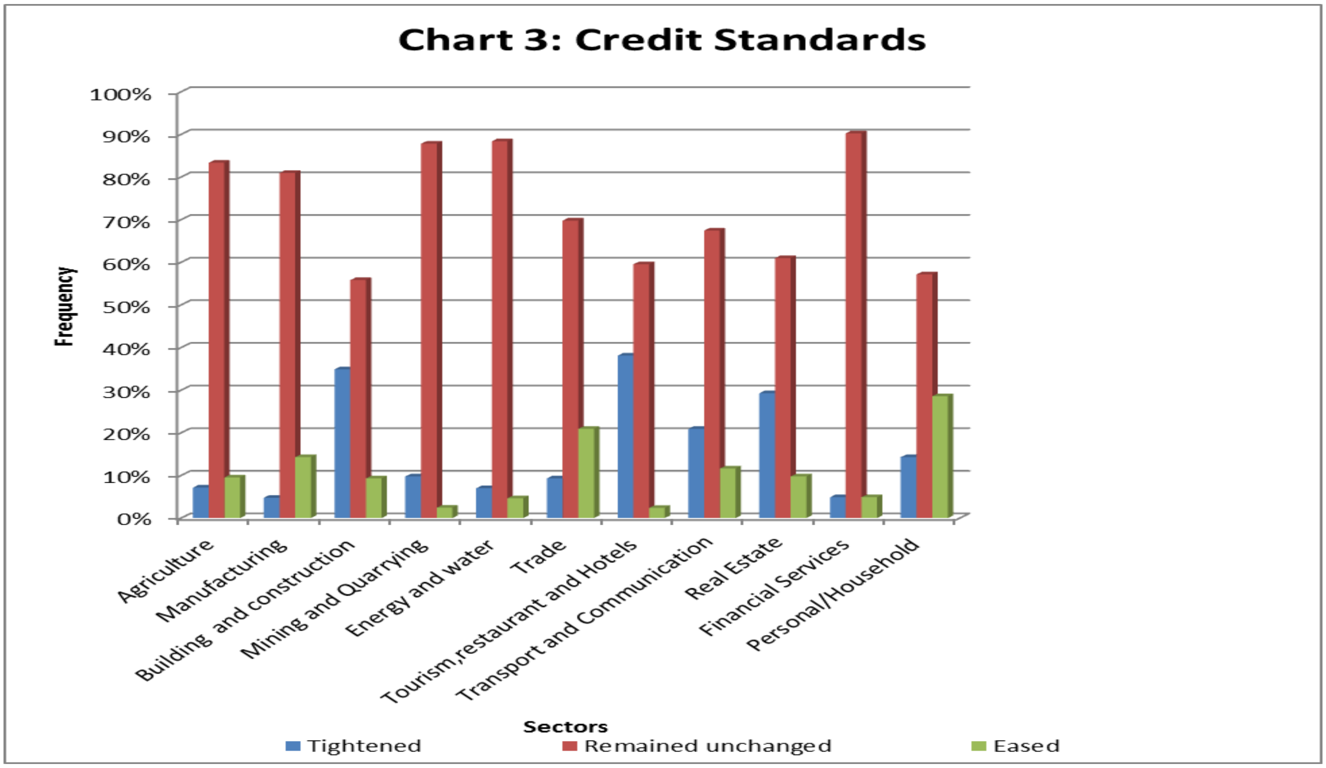

Table 3: Credit Standards

	June 2015			March 2015		
	Tightened	**Remained Unchanged**	**Eased**	**Tightened**	**Remained Unchanged**	**Eased**
Agriculture	7%	83%	10%	17%	79%	5%
Manufacturing	5%	81%	14%	7%	81%	12%
Building & Construction	35%	56%	9%	33%	60%	7%
Mining and Quarrying	10%	88%	2%	7%	91%	2%
Energy and Water	7%	88%	5%	12%	84%	5%
Trade	9%	70%	21%	9%	72%	19%
Tourism, Restaurant and Hotels	38%	60%	2%	45%	55%	0%
Transport and Communication	21%	67%	12%	26%	63%	12%
Real Estate	29%	61%	10%	34%	56%	10%
Financial Services	5%	90%	5%	7%	90%	2%
Personal/Household	14%	57%	29%	24%	62%	14%

3.4 Factors influencing credit standards

3.4.1 Observations

- In the quarter ended 30th June 2015, most of the factors that influence changes on credit standards had little impact as shown in Chart 4 below. This supports the finding that credit standards to all economic sectors generally remained unchanged in the quarter.
- 27% of the respondents reported that they eased their credit standards due to competition from Microfinance Banks, Saccos & other Credit Providers as shown in Chart 4.
- In Q2 of 2015, 43% of the banks tightened their credit standards due to Balance Sheet constraints, 24% due to constraints relating to Bank's Capital Position, 21% due to expectations regarding general economic activity, 17% due to review of Central Bank Rate and 14% due to Political Risk.
- Compared to Q1 of 2015, increase in Central Bank Rate and KBRR, Banks' Cost of Funds and Balance Sheet Constraints, Competition from other banks, Competition from microfinance banks, Saccos and Other Credit Providers and Expectations Regarding General Economic Activity were the key factors that led to tightening of credit standards as depicted in Table 4 below.

The trend in factors affecting the banks' credit standards are indicated in **Chart 4** and **Table 4** below.

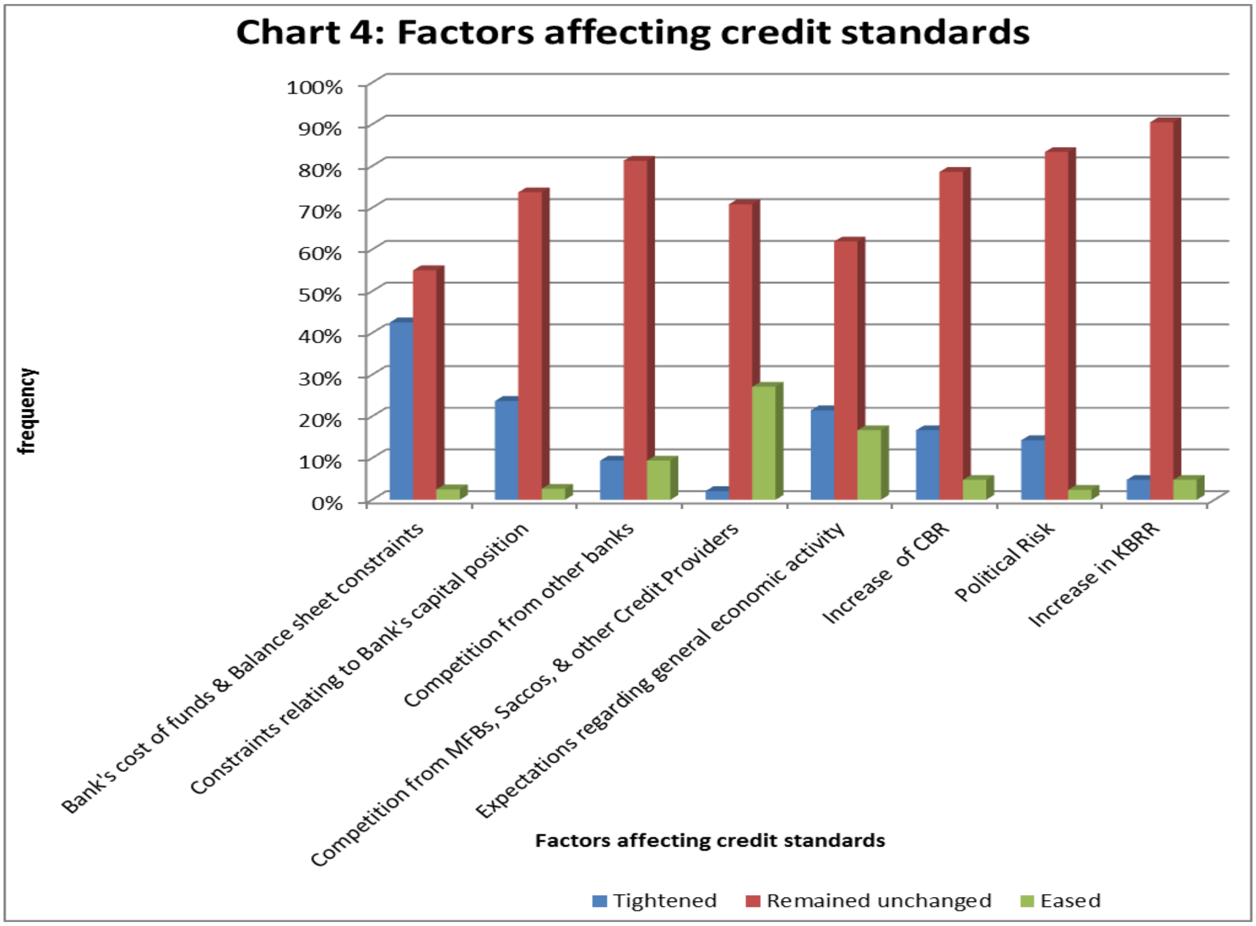

Table 4: Factors affecting credit standards

	June 2015			March 2015		
	Tightened	**Remained Unchanged**	**Eased**	**Tightened**	**Remained Unchanged**	**Eased**
Bank's cost of funds & Balance sheet constraints	43%	55%	3%	36%	62%	2%
Constraints relating to Bank's capital position	24%	74%	3%	27%	63%	10%
Competition from other banks	9%	81%	9%	7%	62%	31%
Competition from Microfinance Banks, Saccos, & other Credit Providers	2%	71%	27%	0%	81%	19%
Expectations regarding general economic activity	21%	62%	17%	14%	67%	19%
Increase of Central Bank Rate (CBR)	17%	79%	5%	2%	93%	5%
Political Risk	14%	83%	2%	17%	78%	5%
KBRR	5%	90%	5%	3%	83%	15%

3.5 Non-Performing Loans (NPLs)

3.5.1 Observations

- Most banks expect the level of NPLs to remain unchanged in Q3 of 2015 in ten of the eleven economic sectors as depicted in Chart 5 below.
- 41% of the respondents foresee that higher NPLs will be recorded in the Tourism sector due to spillover of delinquencies attributed to the previous spate of insecurity in the country and previous adverse travel advisories. On the contrary some respondents are optimistic that in the coming months, Tourism Sector is expected to recover after the lifting of adverse travel advisories by US and UK. This expectation is also supported by the fact that we are currently in the annual high season for Tourism sector which runs from July to December.
- Some respondents predicted that the increase of the Central Bank Rate and Kenya Banks Reference Rate as likely factors to increase the risk of financial distress going forward.
- Other respondents envisioned that due to depreciating Kenya Shilling, importers will probably reduce their merchandise or raw materials importation resulting in reduction in profit which would lead to rise in NPLs.
- Loans in Agriculture sector are expected to perform well due to the expected improved harvest in Q3 of 2015.
- Compared to feedback from Q1 of 2015 there was rise in NPLs in Manufacturing, Building & Construction, Energy & Water, Trade, Tourism, Transport, Real Estate and Financial Services sectors as depicted in Table 5 below.

Chart 5 and **Table 5** below indicate respondents' expectations on NPL trend in Q3 of 2015.

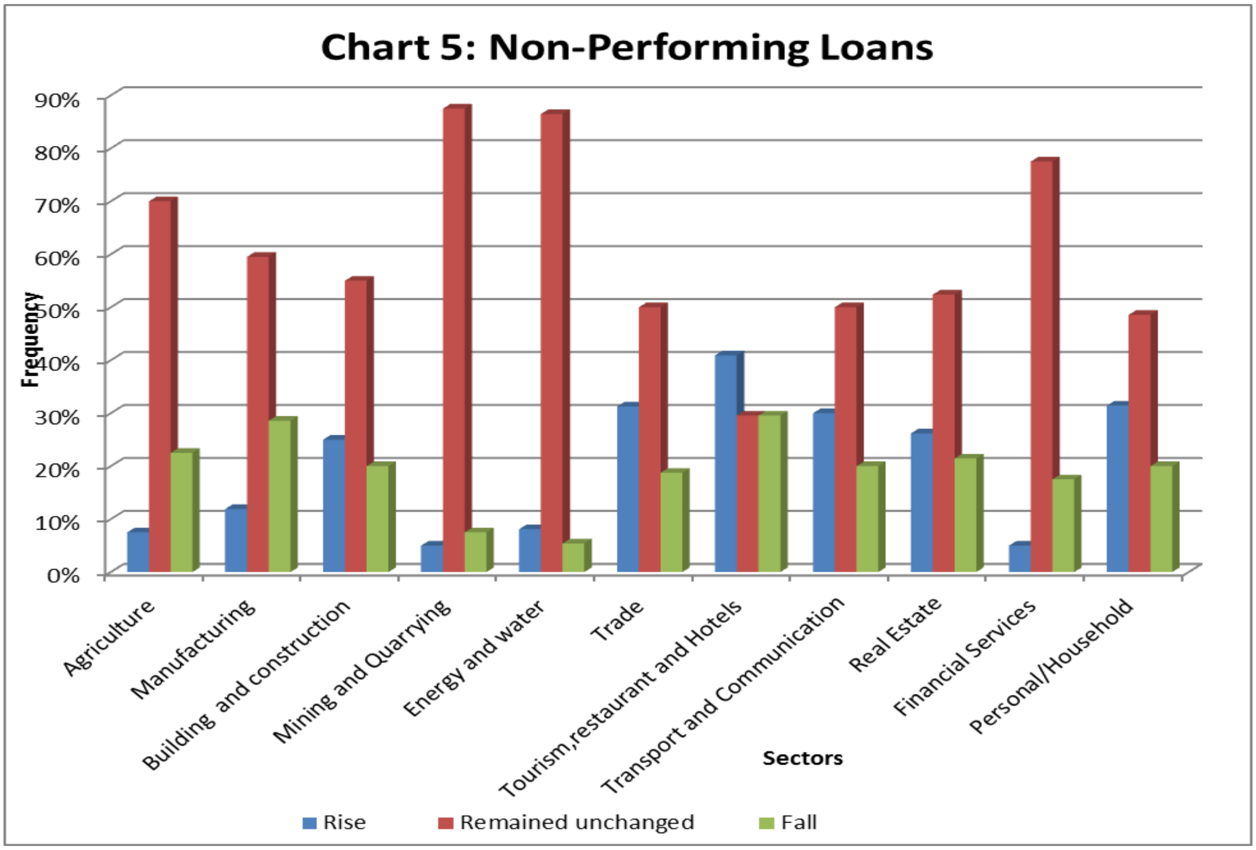

Table 5: Non Performing Loans Trend

	June 2015			March 2015		
	Rise	**Remained Constant**	**Fall**	**Rise**	**Remained Constant**	**Fall**
Agriculture	8%	70%	23%	13%	73%	15%
Manufacturing	12%	60%	29%	7%	68%	24%
Building & construction	25%	55%	20%	17%	54%	29%
Mining and Quarrying	5%	88%	8%	8%	85%	8%
Energy and water	8%	86%	5%	5%	80%	15%
Trade	31%	50%	19%	25%	45%	30%
Tourism, Restaurant & Hotels	41%	30%	30%	39%	46%	15%
Transport & Communication	30%	50%	20%	23%	58%	20%
Real Estate	26%	52%	21%	19%	60%	21%
Financial Services	5%	78%	18%	0%	90%	10%
Personal/Household	31%	49%	20%	33%	50%	18%

3.6 Credit Recovery Efforts

3.6.1 Observations

- For the quarter ending 30th September 2015, banks predict that credit recovery efforts will be intensified in seven of eleven sectors. The banks expect to intensify their credit recovery efforts in Personal/Household, Building & Construction, Tourism, Real Estate, Trade, Manufacturing, Transport and Communication economic sectors. Credit recovery efforts towards Agriculture, Mining and Quarrying, Energy and Water and Financial Service sectors are expected to generally remain constant. This is depicted in Chart 6 below.

- Banks indicated that they intend to intensify credit recovery efforts so as to mitigate the likely increase in non-performing loans due to increase in interest rates and to improve their overall quality of asset portfolio.
- For sectors, such as Tourism, which experience seasonal fluctuations of cash flows, banks intend to intensify recovery efforts so as to collect amounts due during the boom season.
- Some banks cited the growth in retail loan book portfolio as a trigger of intensified credit recovery efforts to counter any possible non-performing loans in the Personal/Household Sector. In this regard, some banks aim at intensifying monitoring of loan accounts through regular review of accounts and customer visits to enable banks detect early warning signs and address them.
- Compared to Q1 of 2015 Credit Survey, this survey indicates that banks intend to intensify their credit recovery efforts for Manufacturing, Building, Energy, Financial Services, Trade, Tourism, Transport, Personal/Household and Real Estate sectors. This is majorly attributable to the increase in the interest rates charged by banks following the upward revision of the CBR and KBRR by the CBK. This is depicted in Table 6 below.

The responses on the expected credit recovery efforts by the banks during the quarter ending 30th June 2015 are depicted in **Chart 6** and **Table 6** below.

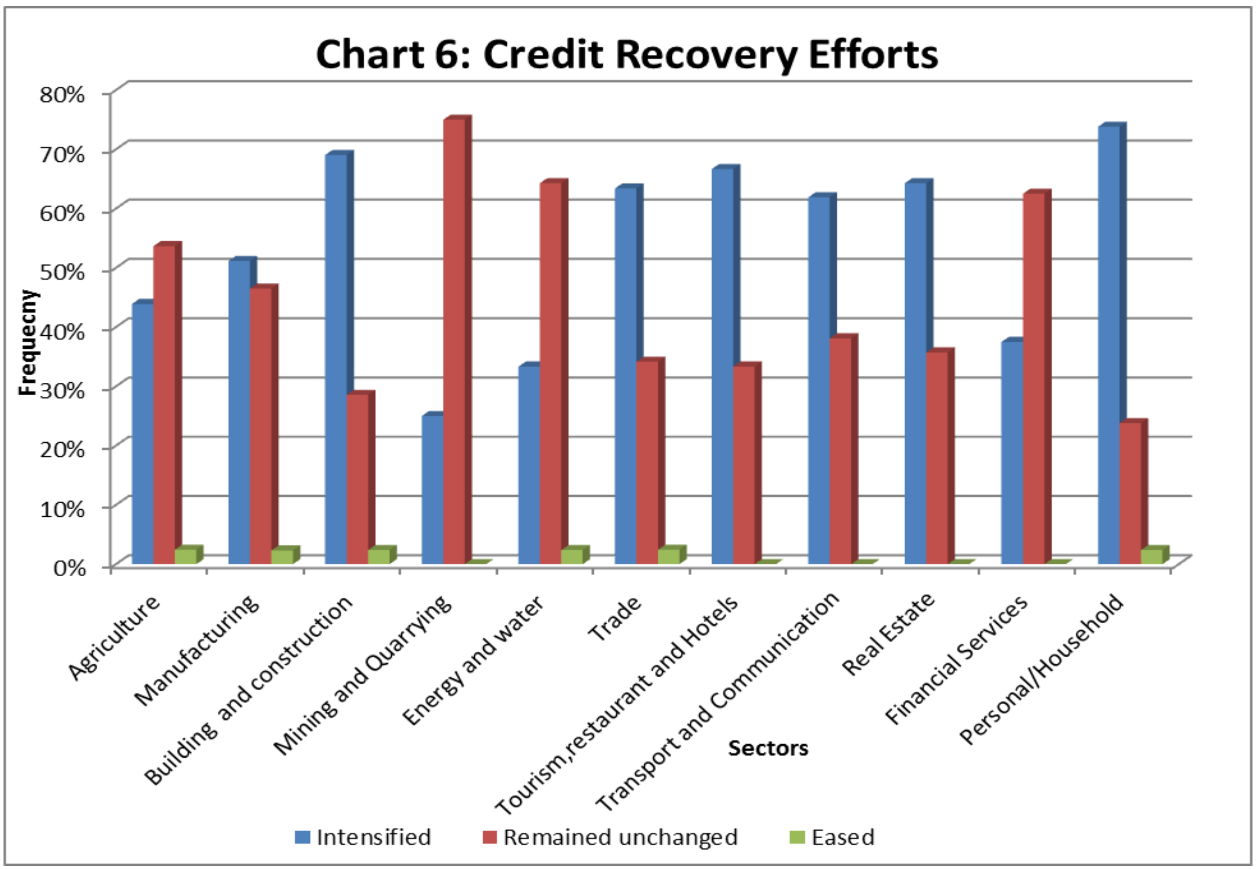

Table 6: Credit Recovery Efforts

	June 2015			March 2015		
	Intensified	Remained Unchanged	Eased	Intensified	Remained Unchanged	Eased
Agriculture	44%	54%	2%	48%	50%	3%
Manufacturing	51%	47%	2%	43%	50%	7%
Building & construction	69%	29%	2%	52%	45%	2%
Mining and Quarrying	25%	75%	0%	27%	73%	0%
Energy and water	33%	64%	2%	31%	69%	0%
Trade	63%	34%	2%	61%	34%	5%
Tourism, Restaurant & Hotels	67%	33%	0%	66%	34%	0%
Transport & Communication	62%	38%	0%	61%	39%	0%
Real Estate	64%	36%	0%	52%	48%	0%
Financial Services	38%	63%	0%	34%	66%	0%
Personal/Household	74%	24%	2%	68%	32%	0%

Annex I (List of Respondents)

1. African Banking Corporation Ltd.
2. Bank of Africa Kenya Ltd.
3. Bank of Baroda
4. Bank of India
5. Barclays Bank of Kenya Ltd.
6. CfC Stanbic Bank Ltd.
7. Chase Bank (K) Ltd.
8. Citibank N.A Kenya.
9. Commercial Bank of Africa Ltd.
10. Consolidated Bank of Kenya Ltd.
11. Co-operative Bank of Kenya Ltd.
12. Credit Bank Ltd.
13. Development Bank of Kenya Ltd.
14. Diamond Trust Bank (K) Ltd.
15. Dubai Bank Kenya Ltd.
16. Ecobank Kenya Ltd.
17. Equatorial Commercial Bank Ltd.
18. Equity Bank Ltd.
19. Family Bank Ltd.
20. Fidelity Commercial Bank Ltd.
21. Guaranty Trust Bank (Kenya) Ltd.
22. First Community Bank Limited.
23. Giro Commercial Bank Ltd.
24. Guardian Bank Ltd.
25. Gulf African Bank Limited.
26. Habib Bank A.G Zurich.
27. Habib Bank Ltd.
28. I & M Bank Ltd.
29. Imperial Bank Ltd.
30. Jamii Bora Bank Ltd.
31. Kenya Commercial Bank Ltd.
32. K-Rep Bank Ltd.
33. Middle East Bank (K) Ltd.
34. National Bank of Kenya Ltd.
35. NIC Bank Ltd.
36. Oriental Commercial Bank Ltd.
37. Paramount Universal Bank Ltd.
38. Prime Bank Ltd.
39. Standard Chartered Bank (K) Ltd.
40. Trans-National Bank Ltd.
41. Victoria Commercial Bank Ltd.
42. UBA Kenya Bank Ltd.
43. Housing Finance Ltd.