CENTRAL BANK OF KENYA

CREDIT OFFICER SURVEY

JANUARY-MARCH 2016

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1.0 FOREWORD

1.1 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 for the quarter ended 31st March 2016 was 65.54%; a slight increase from 61.31% reported in December 2015. In order to identify the potential drivers of credit risk, the Central Bank of Kenya introduced a quarterly Credit Officer Survey in 2012.

1.2 SURVEY METHODOLOGY

The credit officer survey for the quarter ended 31st March 2016 included five questions that focused on:-

- Demand for credit.
- Credit standards.
- Interest rates.
- Non-Performing loans.
- Credit recovery efforts.

The survey, conducted in April 2016, targeted senior credit officers of all 39 operational commercial banks and 1 mortgage finance company. Charterhouse Bank Ltd, Imperial Bank Ltd and Chase Bank Ltd were excluded from the survey. Forty institutions responded.

For the quarter ended 31st March 2016, CBK received Credit Officer Survey responses from 39 operational banks and 1 mortgage finance company. The list of the responding banks is attached to this report as **Annex I**.

1.3 KEY FINDINGS

The key findings from the survey are detailed below:

1.3.1 Demand for credit

The perceived demand for credit remained constant in six economic sectors and increased in four economic sectors in the quarter ended March 2016. Increase in the demand for credit could be attributed to favorable macroeconomic environment and reduced cost of inputs such as petroleum products and electricity. Growth of credit demand in the Building and Construction sector was partly attributed to the ongoing Standard Gauge Railway construction works and construction of roads.

1.3.2 Credit Standards

Credit standards largely remained unchanged across all eleven economic sectors in Q1 of 2016. However, the credit standards were tightened in the Agriculture, Manufacturing, Tourism and Real Estate sectors as compared to Q4 of 2015. Some of the reasons cited were due to the low tourism season characterized in the first quarter of any year hence affecting both the tourism and air transport activities. Manufacturing sector, to some extent, has been constrained by a challenging business environment. On the other hand, Real Estate sector has experienced low uptake of both residential and commercial units.

1.3.3 Interest Rates

In the quarter ending 31st March 2016, 69% of the banks held their interest rates constant, 23% of the banks decreased their interest rates while 8% increased their interest rates. The respondents that increased their interest rates ascribed the increase to increased cost of funding. Respondents whose interest rates remained constant during the period under review attributed it to the stable economic environment.

1.3.4 Non-Performing Loans (NPLs)

Though most banks expect the level of NPLs to remain unchanged in Q2 of 2016, there was a significant increase in the number of respondents that foresee higher NPLs in the Personal/Household and Building and Construction sectors. Increased NPLs in the Personal/Household (35%) sector could be driven by self-employed borrowers' inability to service debt due to low business activity. Some borrowers also obtained loans at high lending rates straining their ability to pay. Increase in NPLs in the Building and Construction sector would be due to delays in payment of contractors mainly by the national and county government.

1.3.5 Credit Recovery Efforts

In the quarter ending 30th June 2016, banks forecasted an increase in credit recovery efforts in seven of the eleven economic sectors. Compared to QI of 2016, highest increase in credit recovery efforts will be in Building & Construction, Trade, Tourism, Real Estate, and Personal/Household sectors. The intensification of recovery efforts in the Personal/Household sector is in line with the banks expectations that loan defaults on consumer loans will rise while increased collection efforts in the Real Estate and Building sectors are a pointer to the industry's proactiveness in improving asset quality in these categories Further, the lenders intend to intensify credit recovery efforts in Tourism sector to tap to the expected commencement of the shoulder tourism season (Pre-Peak Season).

1.4 KENYAN BANKING SECTOR PERFORMANCE

The Kenyan Banking Sector recorded growth in the quarter ended 31st March 2016, compared to the quarter ended 31st December 2015. Some of the sector's performance indicators are as follows:

- The aggregate balance sheet increased by 2.29% from Kshs 3.49 trillion in December 2015 to Kshs 3.57 trillion in March 2016.
- Gross loans increased by 9.7% from Kshs 2.16 trillion in December 2015 to Kshs 2.37 trillion in March 2016. The growth in loans was attributed to increased demand for credit by the various economic sectors.
- The ratio of gross non-performing loans to gross loans increased from 6.8% in December 2015 to 7.8% in March 2016. The increase in gross non-performing loans was mainly attributable to delays in payments of contractors and suppliers as well as borrowers' inability to service debt due to low business activity.
- Banking sector deposits increased by 2.81% from Kshs 2.49 trillion in December 2015 to Kshs 2.56 trillion in March 2016. The growth in deposit base was supported by branch expansion, use of technological innovations for deposit mobilization and the agency banking model.

- The ratio of core capital to total risk-weighted assets remained constant at 16.0% as at December 2015 and March 2016 while the total capital to risk weighted assets increased marginally from 18.6% in December 2015 to 18.8% in March 2016. The capital adequacy ratios remained above the statutory minimum of 10.5% and 14.5% respectively.
- Cumulative unaudited pre-tax profits for 31st March 2016 stood at Kshs 38.4 billion compared to Kshs 30.7 billion for 31st December 2015 recording an increase of 25.08%. The profits were mainly attributable to the banks expanding their market niches as well as offering banking services using alternative channels, particularly digital platforms such as mobile banking, mobile loans, internet banking and cards. This alternative channels offer convenience, speed and cost effectiveness to bank customers'.

CENTRAL BANK OF KENYA
JUNE 2016

2.0 SURVEY FINDINGS

2.1 Demand for Credit

2.1.1 Observations

- In Q1 of 2016, Kenyan banks indicated that perceived demand for credit increased in four economic sectors compared to the three sectors in Q4 of 2015. This was led by Trade, Building and Construction, Personal/Household, and Real Estate sectors with 63%, 51%, 58% and 45% of the respondents reporting increased demand for credit. Increase in the perceived demand for credit could be attributed to favorable macroeconomic environment and reduced cost of inputs such as petroleum products and electricity. Growth in the Building and Construction sector was partly attributed to the ongoing Standard Gauge Railway construction works and construction of roads.
- Six economic sectors led by Mining, Energy, Financial Services, Tourism, Agriculture and Transport were reported to have recorded unchanged demand for credit. Generally, as a country nears elections the number and amount of investments channeled to a country is relatively conservative as investors adopt a wait and see strategy. Consequently, this reduces demand for credit which could have otherwise arisen with an increase in investments.
- Generally the perceived demand for credit increased in all the economic sectors in Q1 of 2016 as compared to Q4 of 2015. This aligned well with the actual demand for credit which indicated an increase in nine out of eleven economic sectors in March 2016 as compared to December 2015. The sectors that recorded decrease in actual demand for credit were Agriculture and Tourism sectors.

Chart 1 and **Table 1** below present the trend in the demand for credit in the quarter ended March 2016 as compared to December 2015.

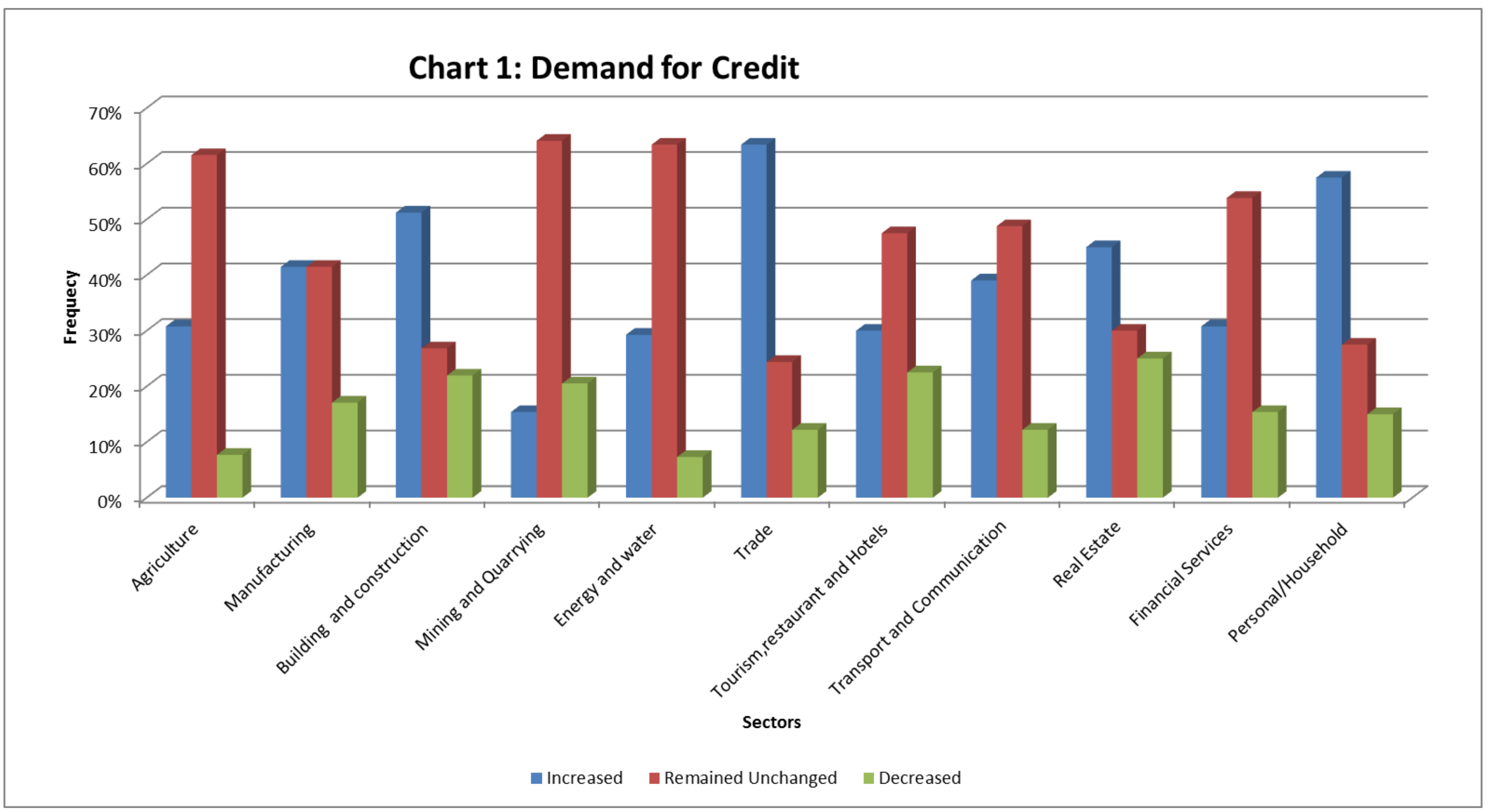


Table 1: Change in Demand for Credit

	March 2016			December 2015		
	Increased	**Remained Unchanged**	**Decreased**	**Increased**	**Remained Unchanged**	**Decreased**
Agriculture	31%	62%	8%	30%	60%	10%
Manufacturing	41%	41%	17%	29%	54%	17%
Building & Construction	51%	27%	22%	41%	32%	27%
Mining and Quarrying	15%	64%	21%	13%	73%	15%
Energy and Water	29%	63%	7%	12%	68%	20%
Trade	63%	24%	12%	54%	37%	10%
Tourism, Restaurant and Hotels	30%	48%	23%	28%	55%	18%
Transport and Communication	39%	49%	12%	28%	50%	23%
Real Estate	45%	30%	25%	33%	40%	28%
Financial Services	31%	54%	15%	30%	58%	13%
Personal/Household	58%	28%	15%	48%	30%	23%

2.2 Factors affecting demand for credit

2.2.1 Observations

- Issuance of Debt Securities, Issuance of Equity, Political Risk, Internal Financing, Loans from Non-Banks and Retention of CBR were cited by 90%, 90%, 83%, 83%, 78%, 56%, 53% and 65% of the respondents respectively, as having had the least influence on the demand for credit during the quarter under review.
- As compared to Q4 of 2015, availability of investment opportunities was cited as the factor that positively increased the demand for credit.

With the relatively stable political environment coupled with easing inflation, the interest rates offered by the institutions were relatively stable in the quarter; resulting to minimum shifting of customers to alternative sources of finance.

Similarly, with the reduction of inputs such as petroleum products and electricity the cost of doing business in some sectors such as Trade have reduced resulting in industries in this sector exploring additional investments opportunities for diversification.

The responses on factors affecting demand for credit in Q1 of 2016 are presented in **Chart 2** and **Table 2** below.

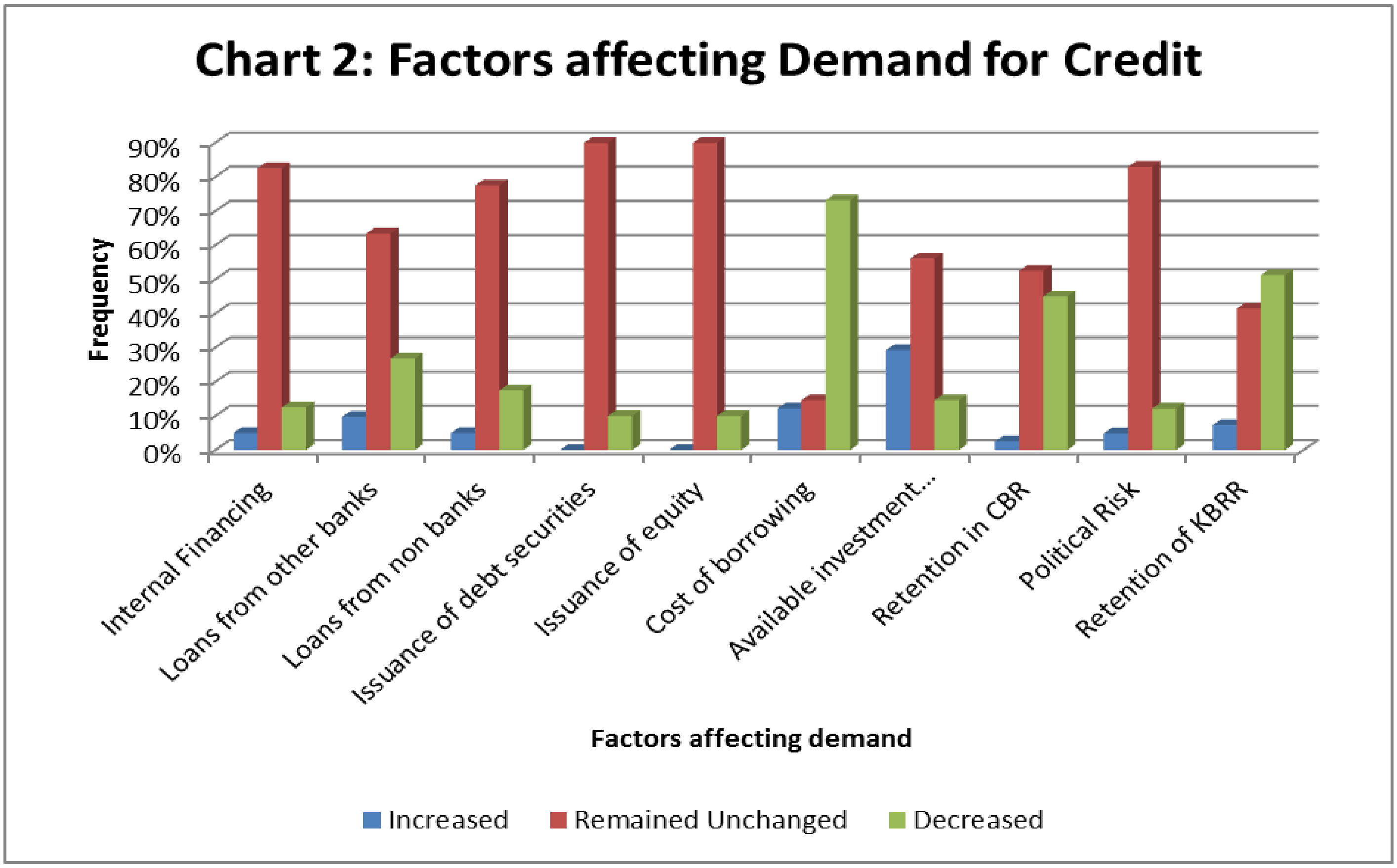


Table 2: Factors affecting Demand for credit

	March 2016			December 2015		
	Increased	**Remained Unchanged**	**Decreased**	**Increased**	**Remained Unchange d**	**Decreased**
Internal Financing	5%	83%	13%	5%	85%	10%
Loans from other banks	10%	63%	27%	13%	59%	28%
Loans from non-banks	5%	78%	18%	5%	76%	18%
Issuance of debt securities	0%	90%	10%	0%	89%	11%
Issuance of equity	0%	90%	10%	0%	92%	8%
Cost of borrowing	12%	15%	73%	12%	22%	66%
Available investment opportunities	29%	56%	15%	23%	56%	21%
Retention in CBR	3%	53%	45%	13%	70%	18%
Political Risk	5%	83%	12%	5%	85%	10%
Retention of KBRR	7%	41%	51%	18%	56%	26%

2.3 Credit Standards

2.3.1 Observations

- In all economic sectors, credit standards generally remained unchanged similar to observations made in Q4 of 2015. However, standards were eased in Trade, Transport, Financial Services and Personal/Household sectors.
- Ease of credit standards in in Q1 of 2016 compared to Q4 of 2015 could be attributed to lower retail prices for petroleum products hence improved performance in sectors such as Transport.
- Meanwhile, credit standards in Q1 of 2016 were somehow tightened for the Agriculture, Manufacturing, Tourism and Real Estate when compared to Q4 of 2015. This resonances with increase in the actual NPLs in Tourism, Manuafacturing and Real Estate sectors in Q1 of 2016 as compared to Q4 of 2015.

The tourism sector usually experiences contracted performance (low season) in the first quarter of any year hence suppressing the growth in air transport and tourism activities. Similarly, Real Estate has experienced low up take of residential and commercial units. Due to the aforementioned reasons lenders have tightened their credit standards as a precautionary measure against the reduced growth/sales from the affected sectors.

These responses are presented in **Chart 3** and **Table 3** below:

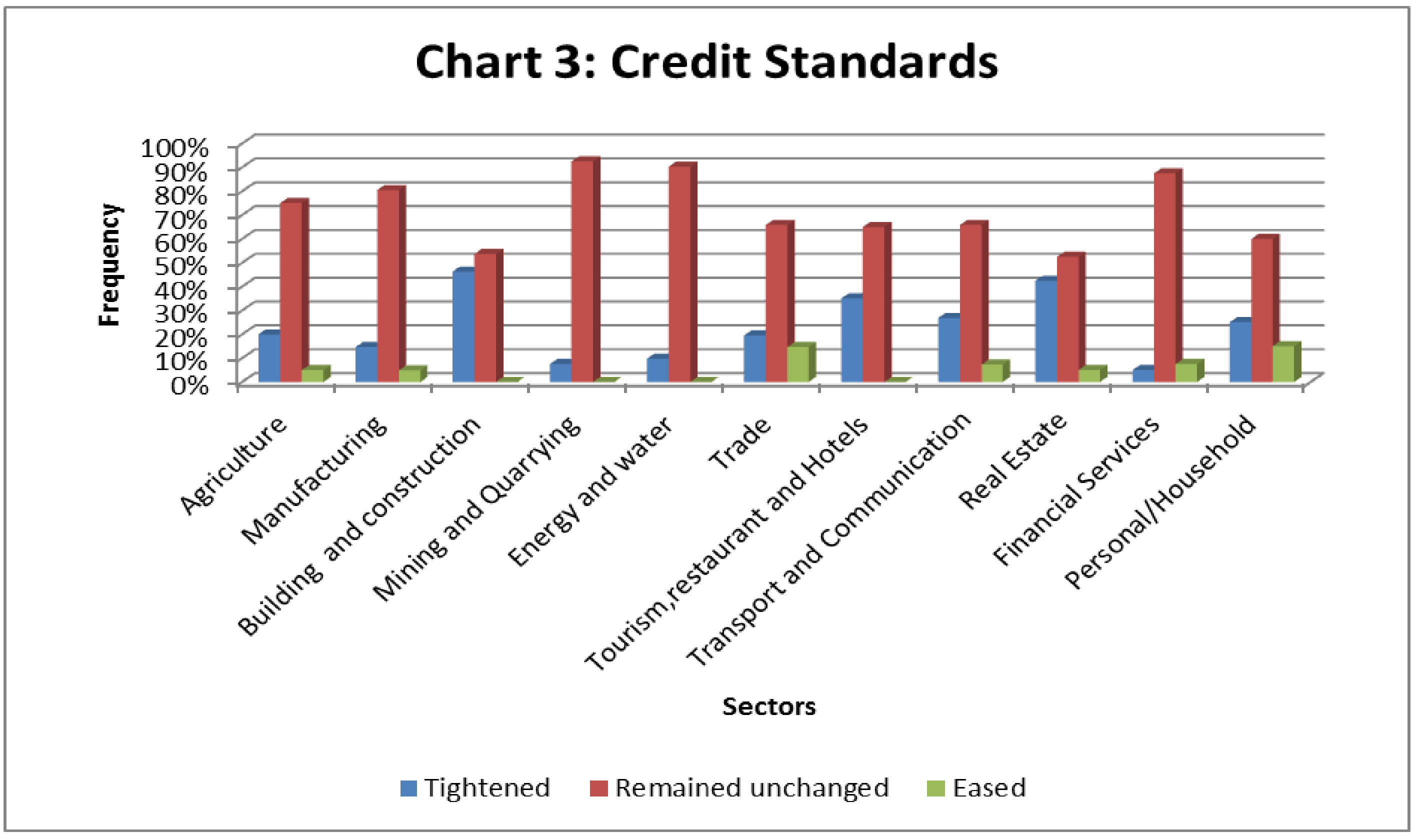


Table 3: Credit Standards for Loans to Various Economic Sectors

	March 2016			December 2015		
	Tightened	**Remained Unchanged**	**Eased**	**Tightened**	**Remained Unchanged**	**Eased**
Agriculture	20%	75%	5%	15%	83%	3%
Manufacturing	15%	80%	5%	12%	83%	5%
Building & Construction	46%	54%	0%	46%	51%	2%
Mining and Quarrying	8%	93%	0%	8%	93%	0%
Energy and Water	10%	90%	0%	10%	90%	0%
Trade	20%	66%	15%	30%	65%	5%
Tourism, Restaurant and Hotels	35%	65%	0%	33%	68%	0%
Transport and Communication	27%	66%	7%	29%	66%	5%
Real Estate	43%	53%	5%	38%	58%	5%
Financial Services	5%	88%	8%	20%	75%	5%
Personal/Household	25%	60%	15%	40%	53%	8%

2.4 Factors affecting credit standards

2.4.1 Observations

- In the quarter ended 31st March 2016, most of the factors that influence changes on credit standards had little impact. This supports the finding that credit standards to all economic sectors generally remained unchanged in the quarter.
- However, 63% of the banks tightened their credit standards in Q1 of 2016 due to Bank’s Costs of Funds & Balance Sheet constraints. This is in line with the trend of increasing interest rates in Q4 of 2015.
- When compared to Q4 of 2015, more banks cited Retention of CBR, Bank’s Costs of Funds & Balance Sheet constraints, Retention of KBRR and Political Risk as factors that contributed to their tightening of credit standards.

  In Q4 of 2015, the cost of funds to lenders increased as depositors demanded for higher return. This ultimately led to an increase in lending rates to customers. To safeguard their asset quality, some respondents intend to proactively tighten the credit standards to cushion its loan book against likely non performing loans.

A comparison of the trend in the factors affecting the banks’ credit standards are shown in **Chart 4** and **Table 4** below.

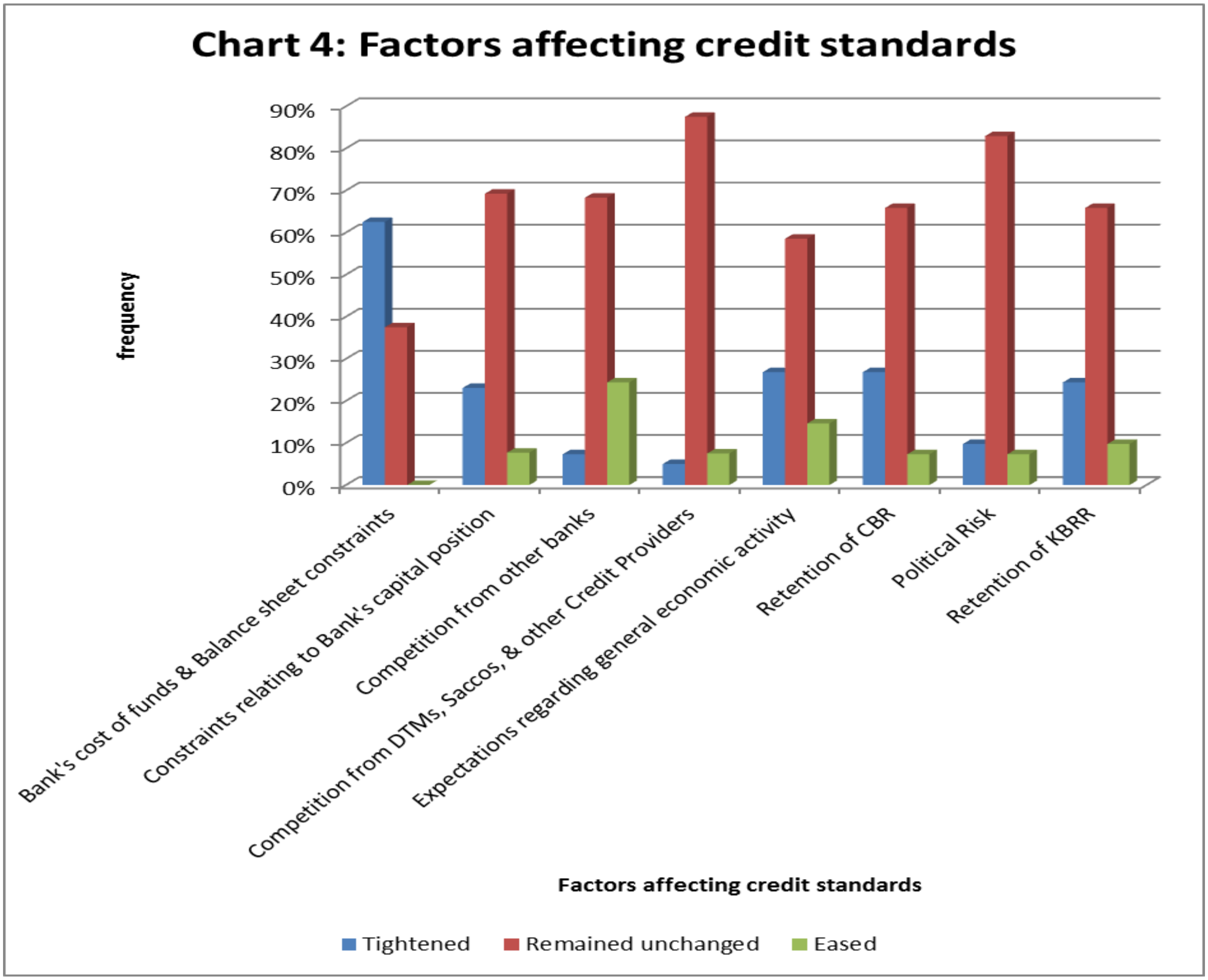


Chart 4: Factors affecting credit standards
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
frequency
Bank's cost of funds & Balance sheet constraints
Constraints relating to Bank's capital position
Competition from other banks
Competition from DTMs, Saccos, & other Credit Providers
Expectations regarding general economic activity
Retention of CBR
Political Risk
Retention of KBRR
Factors affecting credit standards
Tightened
Remained unchanged
Eased

Table 4: Impact of factors affecting credit standards

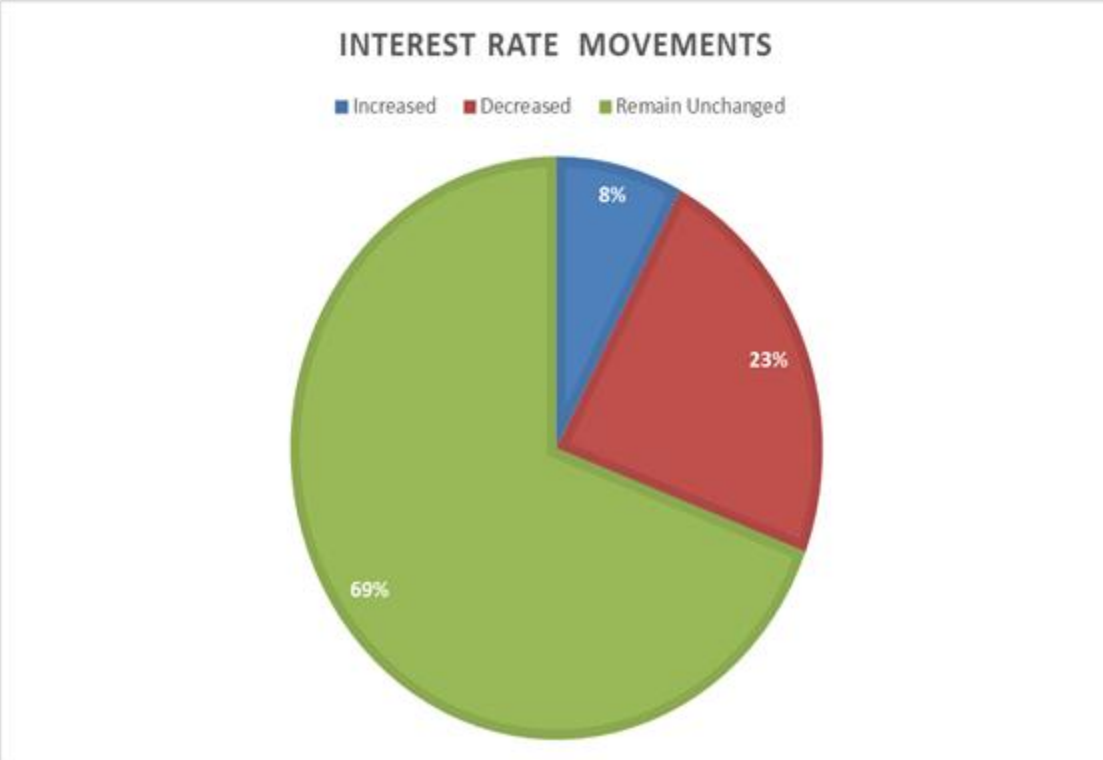
	March 2016			December 2015		
	Tightened	**Remained Unchanged**	**Eased**	**Tightened**	**Remained Unchanged**	**Eased**
Bank's cost of funds & Balance sheet constraints	63%	38%	0%	53%	45%	3%
Constraints relating to Bank's capital position	23%	69%	8%	26%	72%	3%
Competition from other banks	7%	68%	24%	8%	70%	23%
Competition from DTMs, Saccos, & other Credit Providers	5%	88%	8%	10%	85%	5%
Expectations regarding general economic activity	27%	59%	15%	27%	66%	7%
Retention of Central Bank Rate (CBR)	27%	66%	7%	13%	85%	3%
Political Risk	10%	83%	7%	5%	93%	3%
Retention of KBRR	24%	66%	10%	18%	78%	5%

2.5 Interest rates

- In the Q1 of 2016, 69% of the banks held their interest rates constant, 23% of the banks decreased their interest rates while 8% increased their interest rates.
- The respondents that increased their interest rates indicated that the increase was due to increased cost of funding.
- Respondents whose interest rates remained constant during the period under review attributed it to stable economic environment. Further, some respondents indicated that interest rates generally remained unchanged to cushion customers from the high rates that could result to defaults occasioned by higher installments than earlier budgeted.
- The respondents that have reduced their interest rates attribute this to maintanance of Central Bank Rate and Kenya Bankers Reference Rate at 11.5% and 9.87% respectively as well as a generally stable inflation rate in Q4 of 2015.

Responses on the movement of interest rates in Q1 of 2016 is depicted in **Chart 5** below.

Chart 5: Interest Rate Movements



3.6 Non-Performing Loans (NPLs)

3.6.1 Observations

- In the December 2015 Credit Survey, the respondents forecasted:
  - higher NPLs in the Mining and Quarrying, Energy and Water and Financial Services economic sectors.
  - a drop in NPLs in the Manufacturing, Tourism, Transport and Personal/Household economic sectors.

However, comparison between actual NPLs in Q1 of 2016 and Q4 of 2015 indicate that NPLs increased with the largest margin in Real Estate, Personal/Household, Trade and Manufacturing sectors. The increase in NPLs in Real Estate was mainly attributed to low uptake of residential and commercial units leading to the contractors' inability to service loans obtained for construction. Personal/ Household sector was affected by borrowers' inability to service debt due to increased lending rates.

On the other hand, actual NPLs declined in Transport and Communication, Agriculture and Mining sectors in Q1 of 2016 as compared to Q4 of 2015. The customers in these sectors repaid their loans in time due to: adequate rainfall hence boosting the Agriculture sector, lower retail prices for petroleum products hence improved performance in the Transport sector, demand for credit in the Mining sector did not significantly increase hence the NPLs followed the trend.

- Though most of the banks expect level of NPLs to remain unchanged in Q2 of 2016, there was a significant increase in the number of respondents that foresee higher NPLs in the Personal/Household and Building and Construction sectors as depicted in Chart 5 below.
  - ❖ Increased NPLs in the Personal/Household (35%) sector could be driven by borrowers' inability to service debt due to low business activity for self-employed borrowers and high lending rates for loans extended from September 2015 to March 2016.
  - ❖ Construction sector NPLs would be due to delays in payment of contractors mainly by the government. Some respondents also quoted frustrations in the recovery efforts from pledged collateral due to delay in the litigation process.
- Prediction of decreased NPLs in Q2 of 2016 in Agriculture, Mining, Energy, Trade, Real Estate and Financial Services sectors would be due to the enhanced credit recovery efforts adopted by respondents. In addition, some respondents have indicated intention to tighten credit appraisal processes as an effort towards improving asset quality.

Chart 5 and **Table 5** below indicate respondents' expectations on NPL trend in Q2 of 2016.

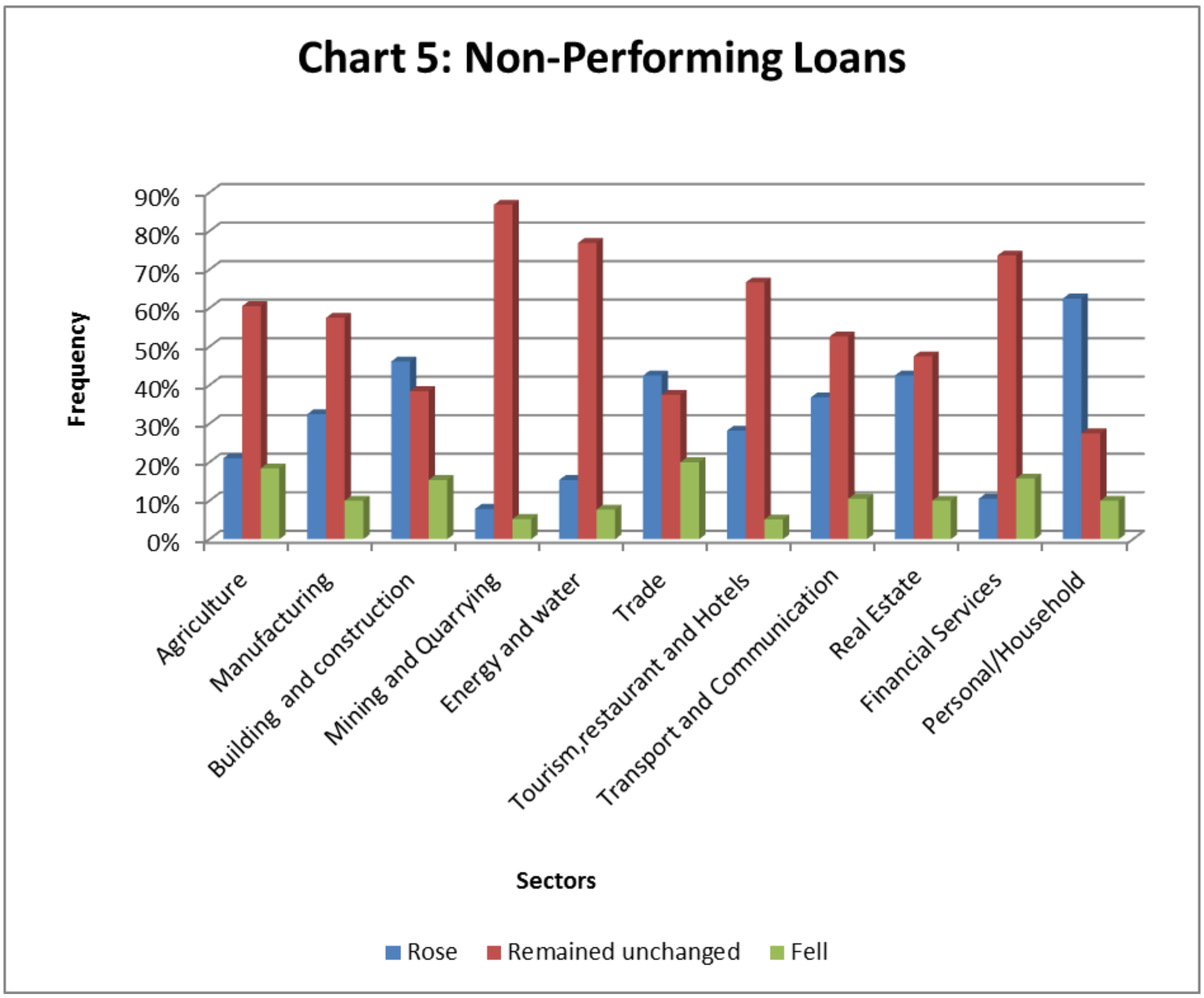
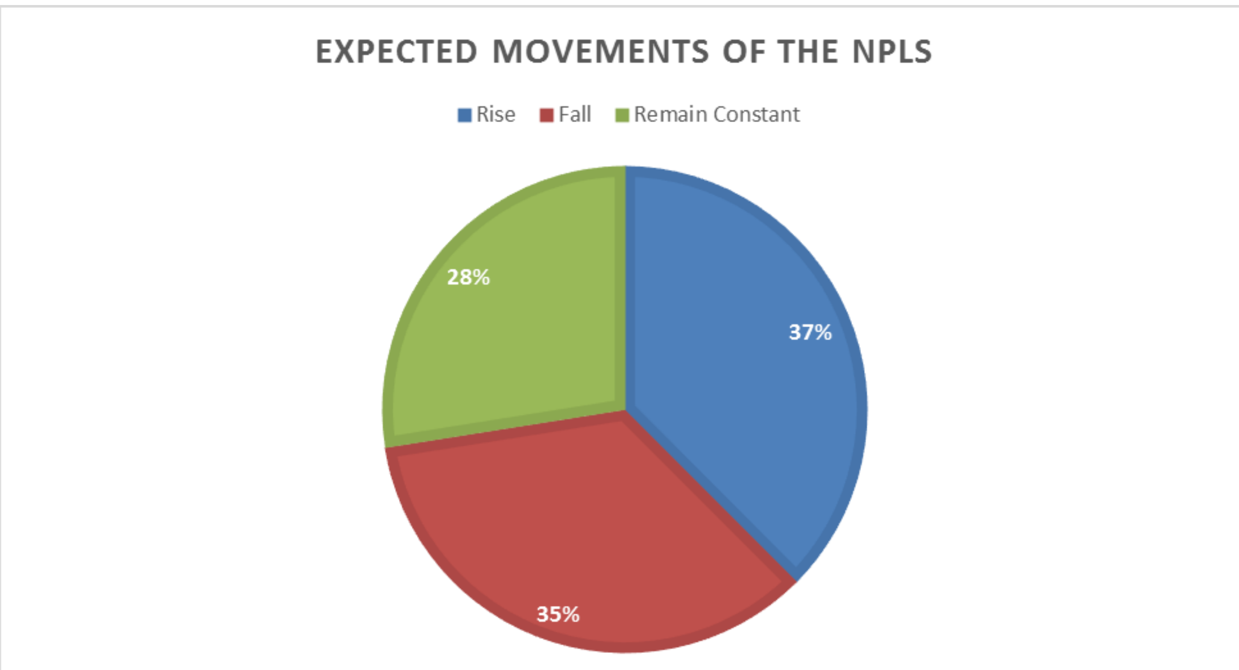


Table 5: Non Performing Loans Expectation Trend Per Economic Sector

	March 2016			December 2015		
	Rose	**Remained Unchanged**	**Fell**	**Rose**	**Remained Unchanged**	**Fell**
Agriculture	21%	61%	18%	13%	76%	11%
Manufacturing	33%	58%	10%	33%	54%	13%
Building & construction	46%	38%	15%	46%	38%	15%
Mining and Quarrying	8%	87%	5%	14%	84%	3%
Energy and water	15%	77%	8%	18%	77%	5%
Trade	43%	38%	20%	43%	45%	13%
Tourism, Restaurant & Hotels	28%	67%	5%	20%	73%	7%
Transport & Communication	37%	53%	11%	31%	56%	13%
Real Estate	43%	48%	10%	40%	53%	8%
Financial Services	11%	74%	16%	13%	74%	13%
Personal/Household	63%	28%	10%	38%	50%	13%

Chart 6: Expected Movements of the NPLs Across All the Economic Sectors



2.6 Credit Recovery Efforts

2.6.1 Observations

- In Q2 of 2016, banks forecasted an increase in credit recovery efforts in seven out of the eleven sectors. In Q2 of 2016, the highest increase in credit recovery efforts will be in Personal/Household, Building & Construction, Real Estate, Tourism and Trade sectors.

The intensified credit recovery efforts in the:

- Personal/Household sector is in line with the banks expectations that loan defaults on consumer loans will rise following high lending rates extended to borrowers in prior period. Lending rates averaged 16.8 %, 18.3% and 17.8% for Q3 of 2015, Q4 of 2015 and Q1 of 2016 respectively.
- Real Estate and Building sectors are a pointer to the industry's proactiveness in improving asset quality in these categories.
- Tourism sector aims at gaining from the expected positive returns from commencement of the shoulder tourism season (Pre-Peak Season).

- Agriculture, Mining, Energy and Financial Services sectors are expected to witness neither intensified nor eased credit recovery efforts in Q2 of 2016, as per 56%, 72%, 69% and 59% of the respondents respectively.
- In line with the objective of intensifying credit efforts, some respondents have indicated adopting timely collection and recovery procedures, engaging external debt collectors and training their staff on problem loan management.

The responses on the expected credit recovery efforts by the banks during the quarter ending 31st March 2016 are depicted in **Chart 6** and **Table 6** below.

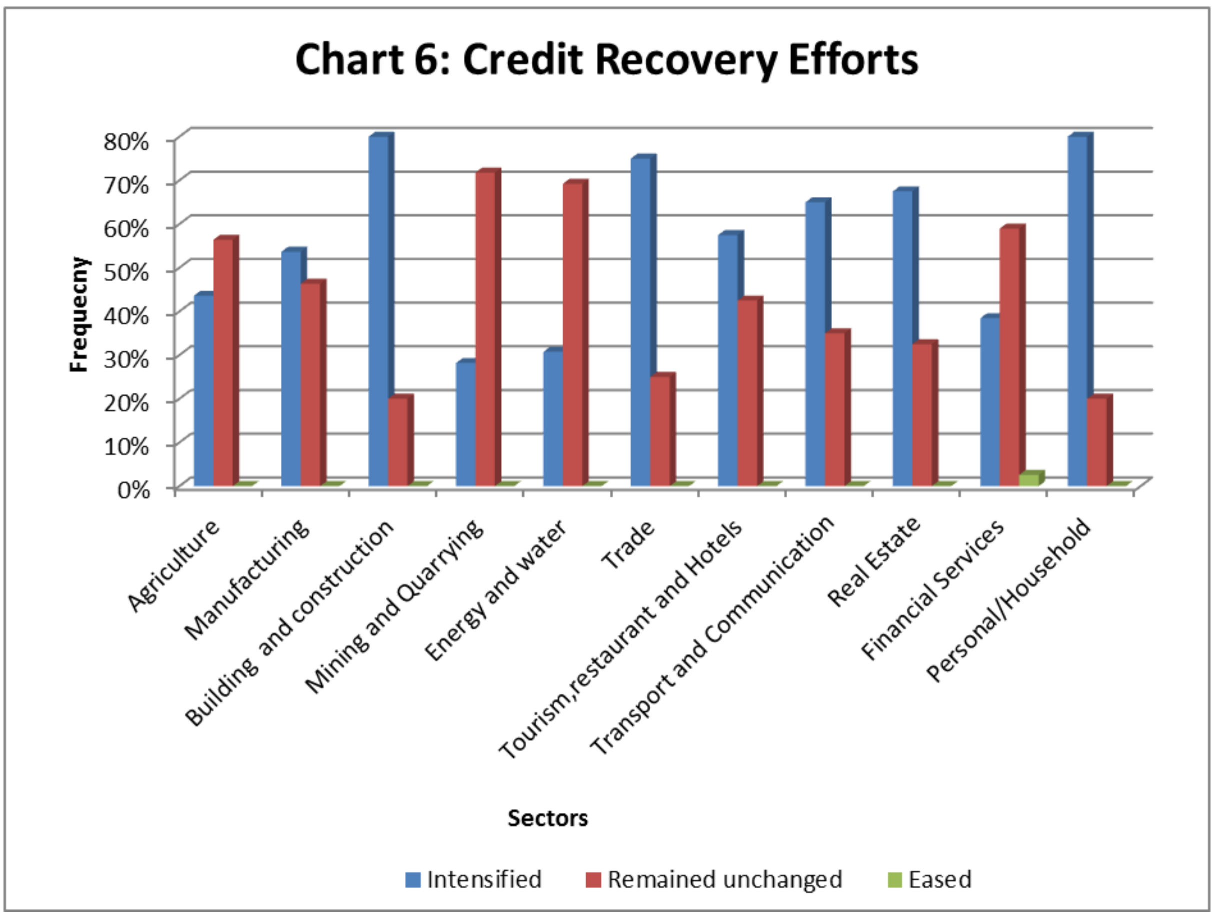


Table 6: Credit Recovery Efforts

	March 2016			December 2015		
	Intensified	**Remained Unchanged**	**Eased**	**Intensified**	**Remained Unchanged**	**Eased**
Agriculture	44%	56%	0%	42%	55%	3%
Manufacturing	54%	46%	0%	61%	37%	2%
Building & construction	80%	20%	0%	70%	25%	5%
Mining and Quarrying	28%	72%	0%	33%	64%	3%
Energy and water	31%	69%	0%	38%	60%	3%
Trade	75%	25%	0%	70%	28%	3%
Tourism, Restaurant & Hotels	58%	43%	0%	50%	48%	3%
Transport & Communication	65%	35%	0%	65%	30%	5%
Real Estate	68%	33%	0%	60%	38%	3%
Financial Services	38%	59%	3%	41%	54%	5%
Personal/Household	80%	20%	0%	63%	33%	5%

Annex I (List of Respondents)

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