Central Bank of Kenya

QUARTERY ECONOMIC REVIEW (QER)

Volume 2 No 3
July September 2017

OBJECTIVES OF THE CENTRAL BANK OF KENYA

The principal objectives of the Central Bank of Kenya (CBK) as established in the CBK Act are:

1) To formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices;
2) To foster the liquidity, solvency and proper functioning of a stable, market-based, financial system;
3) Subject to (1) and (2) above, to support the economic policy of the Government, including its objectives for growth and employment.

Without prejudice to the generality of the above, the Bank shall:

- Formulate and implement foreign exchange policy;
- Hold and manage Government foreign exchange reserves;
- License and supervise authorised foreign exchange dealers;
- Formulate and implement such policies as best promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems;
- Act as banker and adviser to, and fiscal agent of, the Government; and
- Issue currency notes and coins.

The Quarterly Economic Review is prepared by the Research Department of the Central Bank of Kenya.
Information in this publication may be reproduced without restrictions provided the source is duly acknowledged.
Enquiries concerning the Review should be addressed to:
Director, Research Department,
Central Bank of Kenya,
P.O. Box 60000 – 00200
Nairobi, Kenya
Email: Researchstat@centralbank.go.ke

QUARTERLY ECONOMIC REVIEW

JULY - SEPTEMBER 2017

The Quarterly Economic Review, prepared by the Central Bank of Kenya starting with the January - March 2016 edition, is available on the internet at:
http://www.centralbank.go.ke

TABLE OF CONTENT

HIGHLIGHTS

Overall inflation declined to 7.5 percent in the third quarter of 2017, from 10.8 percent in the second quarter of 2017, on account of a decline in food inflation largely driven by declining prices of key food items following improved weather conditions and government interventions.

Growth in broad money, M3, decelerated to 1.8 per cent in the third quarter of 2017 from 3.1 per cent in the second quarter of 2017.

Monthly flows of credit to private sector showed recovery in the third quarter of 2017 with net new loans of KSh 32.5 billion compared with repayments in the previous two quarters.

The Monetary Policy Committee (MPC) retained the Central Bank Rate (CBR) at 10.0 per cent in its meetings held in July and September 2017 in order to continue anchoring following low and easing demand pressures, and inflation expectations.

The weighted average interbank interest rate increased to 6.9 per cent in the third quarter of 2017 from 4.7 per cent in the second quarter of 2017 due to tight liquidity conditions accentuated by market segmentation.

The lending, savings and Treasury bill interest rates remained relatively stable during the third quarter of 2017, with Treasury bill rates tending to decline.

The economy recorded subdued growth of 4.4 per cent in the third quarter of the year, largely on account of heightened electioneering activity which undermined the non-agriculture output.

Global growth is estimated at 3.6 per cent in 2017 and projected at 3.7 per cent in 2018, driven by strengthening global investment, recovery in international trade, manufacturing and improved business and consumer confidence.

Kenya's current account balance stood at USD 1,405 million deficit during the third quarter of 2017 from USD 1,306 million deficit during the second quarter of 2017 reflecting worsening of the trade balance.

Kenya's official international reserves position was strong at USD 7,899 million by end-September 2017, equivalent to 5.3 months of imports.

The foreign exchange market has remained stable largely on account of resilient inflows from diaspora remittances, tourism receipts, tea and horticulture exports.

The banking sector continues to remain strong and vibrant despite increase in non performing loans. During the period under review, KEPSS availability improved to an average of 99.97 per cent compared to 99.95 per cent in the previous quarter.

The government's budgetary operations improved in the first quarter of FY 2017/18 with a lower deficit of 0.7 per cent of GDP compared with a deficit of 1.0 per cent of GDP in the first quarter of FY 2016/17

Kenya's public and publicly guaranteed debt recorded moderate increase of 1.8 per cent during the first quarter of the FY 2017/18 mainly on account of KSh 64.9 billion increase in domestic debt during the quarter

The capital markets recorded gains across leading market indicators in the third quarter of 2017 for both Equities and Bonds markets segments.

CHAPTER 1
Inflation

Overview

Overall inflation declined to 7.5 percent in the third quarter of 2017, from 10.8 percent in the second quarter of 2017 (**Table 1.1**) on account of declining food inflation largely driven by declining prices of key food items attributable to favorable weather conditions and government interventions. Food inflation declined significantly to 11.7 percent from 18.1 percent in the previous quarter. Fuel inflation declined to 3.1 percent from 3.5 percent, while the Non-Food-Non-Fuel (NFNF) inflation declined to 3.8 percent from 4.3 percent in the third quarter compared to the second quarter of 2017. The three months annualized inflation declined significantly to -5.1 percent from 15.4 percent in the second quarter of 2017, reflecting diminished inflationary pressures in the economy.

Table 1.1: Recent Developments in Inflation in Per cent

	2016				2017					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	July	Aug	Sep
Quarterly Overall Inflation	7.0	5.4	6.3	6.5	8.8	10.8	7.5	7.5	8.0	7.1
Food Inflation	10.4	7.2	10.3	10.6	14.7	18.1	11.7	11.6	12.8	10.9
Fuel Inflation	2.2	1.7	0.4	0.3	2.3	3.5	3.1	2.9	3.1	3.3
Non-Food Non-Fuel Inflation (NFNF)	5.8	5.4	5.0	5.2	4.2	4.3	3.8	4.1	3.9	3.5
Average annual	6.8	6.6	6.5	6.4	6.5	7.7	8.3	8.2	8.4	8.4
Three months annualised	5.1	7.4	7.0	6.6	14.7	15.4	-5.1	-5.6	-6.1	-3.7

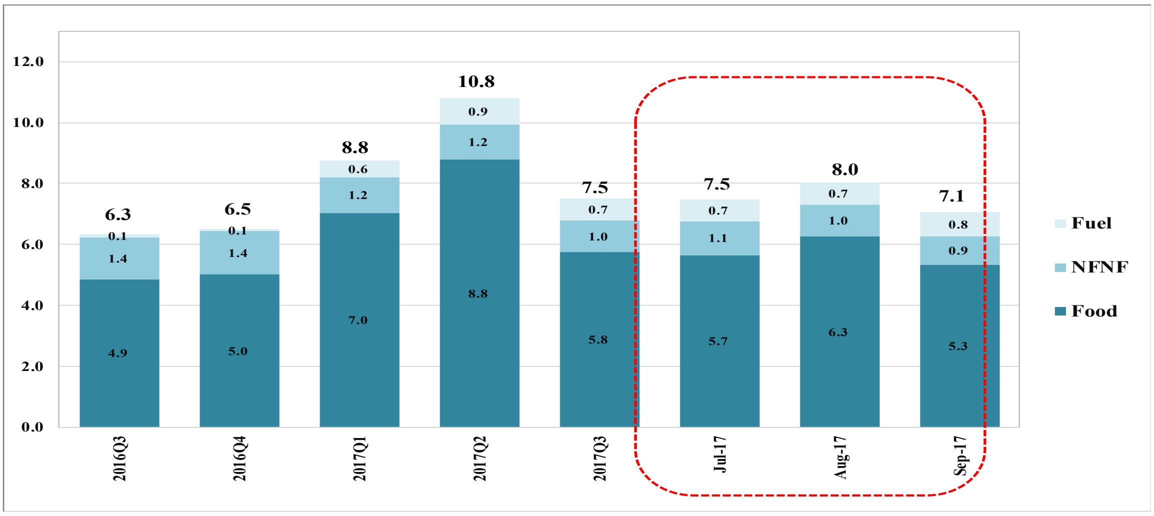
Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

Contributions of broad categories to overall inflation

Inflation continued to be a food phenomenon. The contribution of food inflation to overall inflation declined substantially to 5.8 percentage points from 8.8 percentage points in the second quarter, largely on account of increased supply of fast growing food items and milk following improved weather conditions during the quarter. In addition, government interventions through subsidies and enhanced imports supported declines in the price of maize grains, maize flour and sugar.

The easing inflation was reflected in other measures as the contribution of NFNF declined to 1.0 percentage point from 1.2 percentage points in the second quarter of 2017, and for fuel inflation to 0.7 percentage points from 0.9 percentage points over the same period (**Chart**

Chart 1.1: Contribution of Broad Categories to Overall Inflation in Percentage Points



Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

1.1).

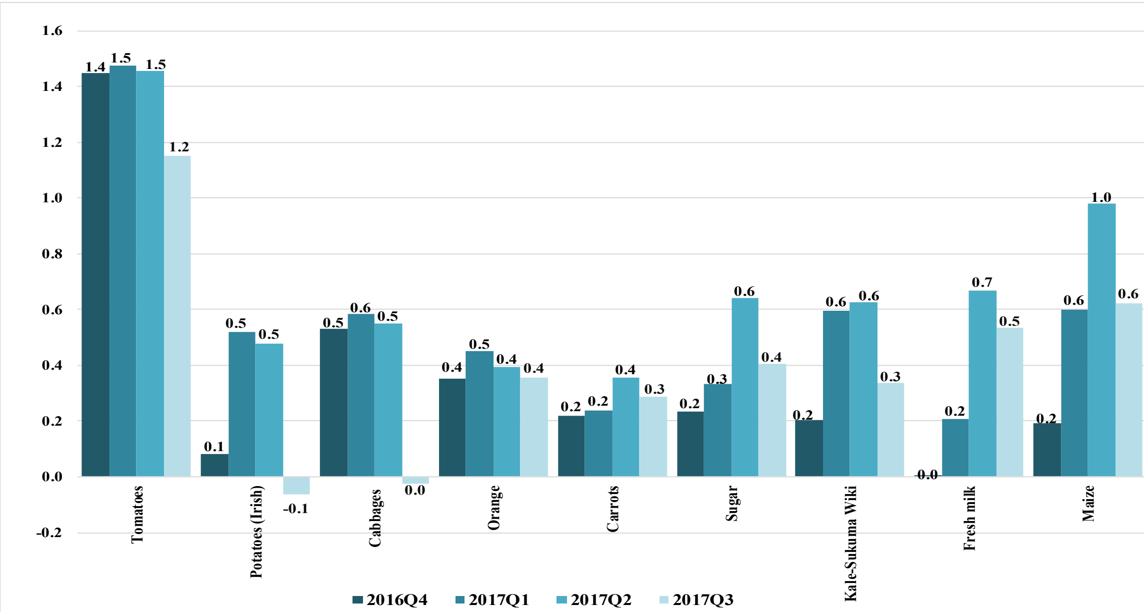
Food Inflation

Food inflation decelerated to 11.7 percent in the third quarter of 2017 from 18.1 percent in the second quarter of 2017 on account of reduced prices of key food items. This was supported by increased food supply following favorable weather conditions that enhanced agricultural production and government interventions through increased importation of sugar and price subsidy for maize flour. The supply of milk and fast maturing key food items such as vegetables improved in the period under review. Consequently, vegetables accounted for the highest contribution to the decline in overall inflation. In particular, notable price reductions were witnessed with respect to cabbages and Irish potatoes (**Chart 1.2**).

In addition, the contribution of tomatoes to overall inflation declined to 1.2 percentage points in the third quarter of 2017, from 1.5 percentage points in the second quarter of 2017, while that of kale (sukuma wiki) halved and stood at 0.3 percentage points during the period under review. Favorable weather conditions also led to improved foliage and pasture for dairy animals leading to enhanced milk production. As a result, the price of milk and its contribution to overall inflation declined during the quarter under review (**Chart 1.2**).

Government measures during the third quarter of 2017 provided significant support in moderating the prices of maize and sugar. The price of maize declined largely on account of improved supply following increased imports, the onset of the harvesting season in Kenya's food basket regions, and price subsidy on maize flour and maize grain. Consequently, the contribution of maize to overall inflation declined to 0.6 percentage points from 1.0 percentage point in the previous quarter while that of sugar declined to 0.4 percentage points

Chart 1.2: Contribution of Main Food Items to overall Inflation in Percentage Points[1]



Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

[1]Fresh milk comprises of fresh packeted and unpacketed milk.

Maize comprises of green maize, loose maize grain, sifted maize flour and loose maize flour.

from 0.6 percentage points.

Fuel Inflation

Fuel inflation declined marginally to 3.1 percent in the third quarter of 2017 from 3.5 percent in the second quarter of 2017 (**Chart 1.3**), largely on account of declining fuel prices which led to a marginal decline in fare charges. The contribution of house rents and other components in the fuel basket to overall inflation remained stable at 1.1 percentage points and 1.2 percentage points, respectively, in the period under review. The contribution of the rest of the components in the fuel basket to overall inflation remained high largely on account of the upward adjustment of fuel, forex and inflation adjustments in the cost of electricity during the period under review.

Non-Food Non-Fuel inflation (NFNF)

Non-Food Non-Fuel (NFNF) inflation declined to 3.8 percent during the period under review from 4.3 percent in the second quarter of 2017 (**Table 1.2**). The decline was reflected across most categories in the NFNF inflation basket. The low and stable NFNF inflation is reflective of minimal inflationary pressures in the economy as well as minimal second round effects of food inflation.

Chart 1.3: **Contribution of Key Items to Fuel Inflation**

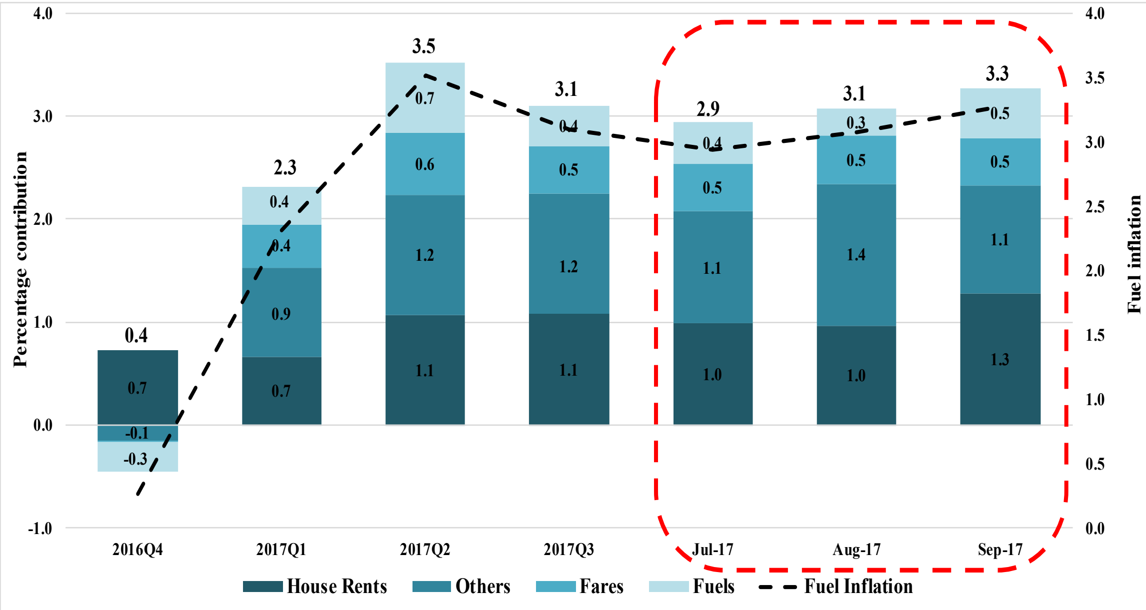


Table 1.2: **Inflation of various Baskets under Non-Food-Non-Fuel Inflation**

		Alcoholic Beverages, Tobacco & Narcotics	Clothing & Footwear	Furnishings, Household Equipment and Routine Household Maintenance	Health	Communication	Recreation & Culture	Education	Miscellaneous Goods & Services	**Non-Food Non-Fuel Inflation**
2016	Q3	14.3	3.6	3.6	3.5	1.8	4.3	4.2	3.8	**5.0**
	Q4	10.3	4.4	3.3	3.2	1.7	4.4	4.0	3.8	**5.2**
2017	Q1	3.2	4.2	3.0	3.1	0.6	2.1	2.9	3.5	**4.2**
	Q2	3.4	4.0	3.3	3.0	0.1	1.8	2.8	3.9	**4.3**
	Q3	3.0	3.8	3.2	3.1	0.3	1.2	2.9	3.6	**3.8**
	July	3.1	4.1	3.4	2.7	0.1	1.4	2.8	3.8	**4.1**
	Aug	2.9	3.8	3.2	3.4	0.3	1.2	2.8	3.5	**3.9**
	Sept	2.9	3.5	2.9	3.3	0.4	1.1	3.0	3.3	**3.5**

Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

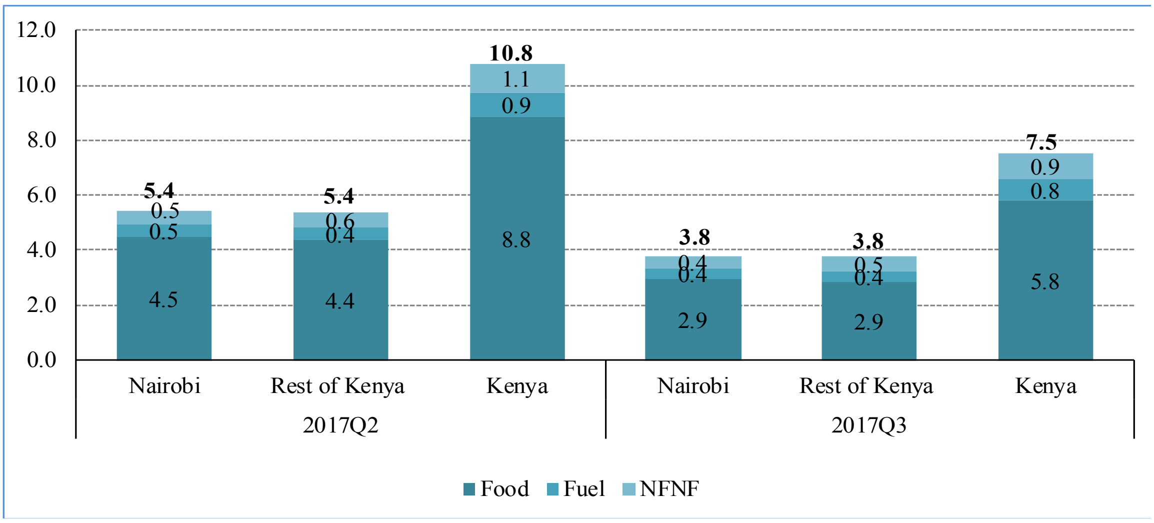
Overall Inflation across Regions

Inflation in the Rest of Kenya declined to 7.8 percent in the third quarter of 2017 from 11.3 percent in the second quarter of 2017, while that of Nairobi declined to 7.2 percent from 10.1 percent over the same period. Consequently, the contribution of both Nairobi region and the Rest of Kenya to overall inflation declined to 3.8 percentage points from 5.4 percentage points during the review period. Though it declined in the third quarter of 2017, food continued to be the main driver of inflation across the two regions and stood at 2.9 percentage points in the third quarter of 2017. The decline in the contribution of food in both regions was uniform and mirrored the decline in the contribution of regions' inflation to overall inflation in Kenya (**Chart 1.4**). The contribution of fuel and NFNF inflation in both regions to inflation in Kenya remained low and stable.

Overall Inflation across Income Groups in Nairobi

Inflation across income groups in Nairobi declined significantly to 7.2 percent in the third quarter of 2017, compared to 10.1 percent in the second quarter of 2017. The low income group, where inflation is usually affected substantially by changes in the price of basic food items, accounted for the highest decline at 7.8 percent from 11.1 percent in the second quarter of 2017. Inflation in the middle income group declined to 5.6 percent from 7.2 percent, while that of the upper income group declined to 2.5 percent from 3.7 percent in the period under review

Chart 1.4: **Contribution of Various Regions to Quarterly Overall Inflation in Percentage Points**

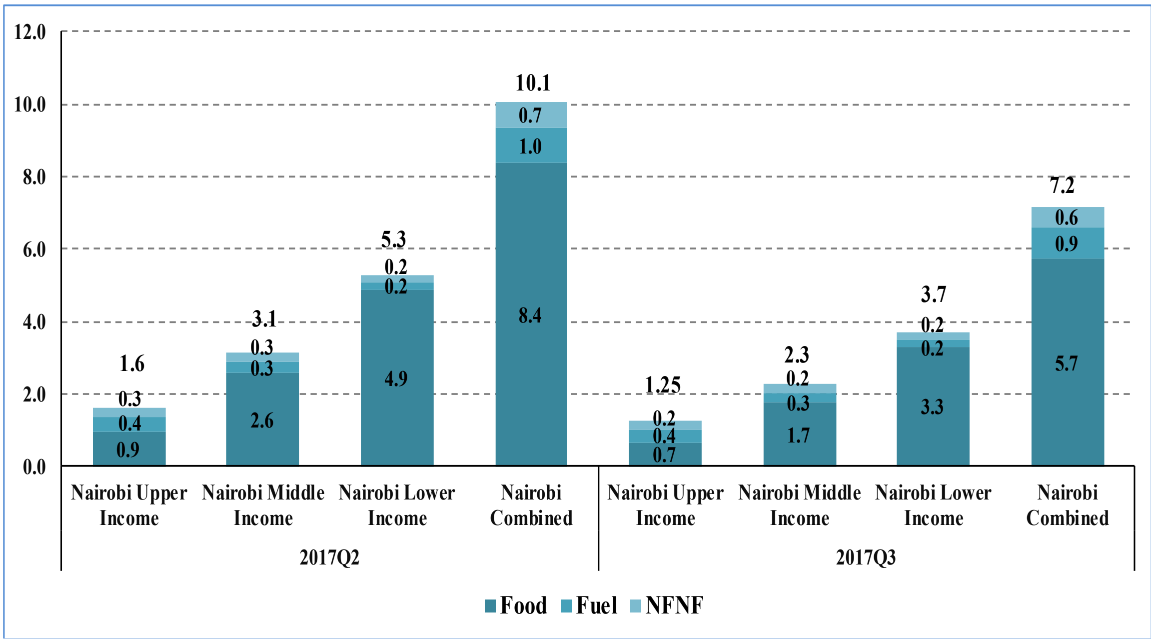


Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

(**Chart 1.5**).

In the third quarter of 2017, the contribution of food to inflation in Nairobi declined to 5.7 percentage points from 8.4 percentage points. This was reflected in the declined contribution of food in the lower income group which stood at 3.3 percentage points compared to 4.9 percentage points in the previous quarter. The contribution of food to inflation in the middle income group declined to 1.7 percentage points from 2.6 percentage points, while that of the upper income group declined to 0.7 percentage points from 0.9 percentage points over the same period. The contribution of fuel and NFNF to inflation remained low and stable, with minimal declines.

Chart 1.5: **Contribution of Income Groups to Overall Inflation in Nairobi in Percentage Points**



Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

Chapter 2

Money, Credit and Interest Rates

i Monetary aggregates and its components

The increase in money supply, M3, declined to 1.8 per cent in the third quarter of 2017 from a growth of 3.1 per cent in the second quarter (**Table 2.1 and Chart 2.1**). This deceleration is reflected in the slowdown in the growth of various M3 components except time and saving deposits. Growth in demand and foreign currency deposits decelerated in the third quarter as private enterprises cut down their demand deposits and reduced their accumulation of foreign currency deposits. Private companies however, were the key drivers of the accelerated growth in time and saving deposit holdings in quarter three of 2017, with call deposits registering the largest increase under this category. The utilization of county government deposits and delayed disbursements from the National Treasury, explain the significant decline in other deposits at the Central Bank. Overall, the third quarter of 2017 saw a reduced growth in total deposits.

Table 2.1: Monetary Aggregates (KSh Billion)

	QUARTERLY LEVELS						QUARTERLY GROWTH RATES (%)						QUARTERLY CHANGE (KSh BN)					
	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
COMPONENTS OF M3																		
1. Money supply, M1 (1.1+1.2+1.3)	1,135.9	1,238.6	1,310.0	1,317.2	1,391.3	1,382.7	5.3	9.0	5.8	0.5	5.6	-0.6	57.6	102.7	71.4	7.2	74.1	-8.6
1.1 Currency outside banks	187.9	186.6	209.5	200.6	206.7	208.9	2.5	-0.7	12.3	-4.2	3.0	1.0	4.5	-1.3	22.9	-8.9	6.1	2.1
1.2 Demand deposits	881.1	979.7	1,045.0	1,062.7	1,102.9	1,113.7	4.8	11.2	6.7	1.7	3.8	1.0	40.5	98.7	65.3	17.7	40.2	10.8
1.3 Other deposits at CBK [1]/	66.7	71.9	55.1	53.5	81.2	59.7	23.2	7.9	-23.3	-3.0	51.9	-26.5	12.5	5.2	-16.8	-1.6	27.7	-21.5
2. Money supply, M2 (1+2.1)	2,353.4	2,340.2	2,360.2	2,412.1	2,480.5	2,515.1	3.1	-0.6	0.9	2.2	2.8	1.4	71.8	-13.2	20.0	51.9	68.4	34.6
2.1 Time and saving deposits	1,217.5	1,101.6	1,050.2	1,094.9	1,089.2	1,132.4	1.2	-9.5	-4.7	4.3	-0.5	4.0	14.3	-115.9	-51.4	44.7	-5.7	43.2
3. Money supply, M3 (2+3.1)	2,769.0	2,772.7	2,764.5	2,846.6	2,936.1	2,990.3	3.5	0.1	-0.3	3.0	3.1	1.8	93.9	3.6	-8.1	82.1	89.5	54.2
3.1 Foreign Currency Deposits	415.6	432.5	404.3	434.5	455.6	475.2	5.6	4.1	-6.5	7.5	4.8	4.3	22.0	16.9	-28.2	30.2	21.1	19.6
SOURCES OF M3																		
1. Net foreign assets [2]/	562.5	591.9	495.2	603.0	644.1	615.6	19.2	5.2	-16.3	21.8	6.8	-4.4	90.7	29.3	-96.7	107.8	41.1	-28.5
Central Bank	694.6	687.2	621.6	697.8	738.3	694.6	8.4	-1.1	-9.5	12.3	5.8	-5.9	53.8	-7.4	-65.6	76.2	40.5	-43.7
Banking Institutions	-132.0	-95.3	-126.4	-94.8	-94.2	-79.1	-21.9	-27.8	32.7	-25.0	-0.7	-16.1	36.9	36.7	-31.1	31.6	0.6	15.2
2. Net domestic assets (2.1+2.2)	2,206.5	2,180.8	2,269.3	2,243.7	2,292.0	2,374.7	0.1	-1.2	4.1	-1.1	2.2	3.6	3.1	-25.7	88.6	-25.7	48.3	82.7
2.1 Domestic credit	2,855.1	2,858.7	2,973.2	2,953.2	3,002.2	3,069.7	1.1	0.1	4.0	-0.7	1.7	2.2	31.3	3.6	114.5	-20.0	49.6	67.4
2.1.1 Government (net)	560.4	525.2	592.8	583.5	646.2	674.3	2.9	-6.3	12.9	-1.6	10.8	4.3	15.7	-35.2	67.5	-9.3	62.8	28.1
2.1.2 Private sector	2,216.1	2,243.3	2,275.7	2,263.8	2,249.1	2,281.6	0.9	1.2	1.4	-0.5	-0.6	1.4	19.1	27.2	32.4	-11.9	-14.0	32.5
2.1.3 Other public sector	78.6	90.2	104.7	105.9	106.9	113.7	-4.2	14.8	16.1	1.2	0.9	6.4	-3.5	11.6	14.5	1.2	0.9	6.9
2.2 Other assets net	-648.6	-677.9	-703.8	-709.5	-710.3	-694.9	4.5	4.5	3.8	0.8	0.2	-2.2	-28.2	-29.3	-25.9	-5.7	-1.3	15.3
MEMORANDUM ITEMS																		
4. Overall liquidity, L (3+4.1)	3,605.1	3,645.4	4,303.9	3,816.7	3,935.0	4,016.3	4.7	1.1	18.1	-11.3	3.1	2.1	162.5	40.3	658.4	-487.2	118.3	81.3
4.1 Non-bank holdings of Govt. securities	836.1	872.8	1,539.4	970.0	998.9	1,026.0	8.9	4.4	76.4	-37.0	3.0	2.7	68.6	36.7	666.6	-569.3	28.8	27.1

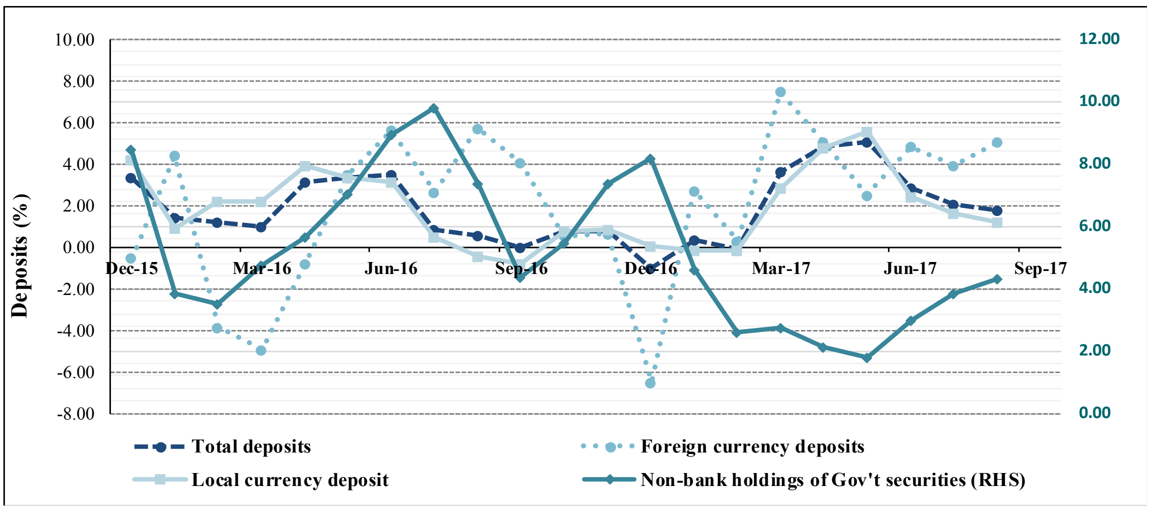
Absolute and percentage changes may not necessarily add up due to rounding

[1] */ Includes county deposits and special projects deposit*

[2] */ Net Foreign Assets at current exchange rate to the US dollar.*

Source: Central Bank of Kenya

Chart 2.1: Quarterly Growth in Deposits and Non-Bank Holdings of Government Securities in Per cent



Source: Central Bank of Kenya

ii. Sources of Broad Money

The primary source of M3 expansion in third quarter of 2017 was the increase in net domestic assets (NDA) of the banking system (**Table 2.1**), largely reflected in growth of net domestic credit to government and credit to the private sector. Meanwhile, net foreign assets of the banking sector declined, largely through payments for official debt out of holdings by the Central Bank of Kenya.

The net foreign assets of commercial banks increased as banks cut down on their non-resident deposit liabilities and external loans.

iii. Developments in Domestic Credit

Domestic credit increased by 2.2 per cent in the third quarter of 2017 compared to 1.7 per cent in the second quarter of 2017, with significant flows to the private and Government sectors. Credit to the private sector although subdued, increased by 1.4 per cent reversing repayments in the first and second quarters of 2017. On a twelve month basis, private sector credit growth edged up from 1.3 per cent in July 2017 to 1.7 per cent in September 2017 ().

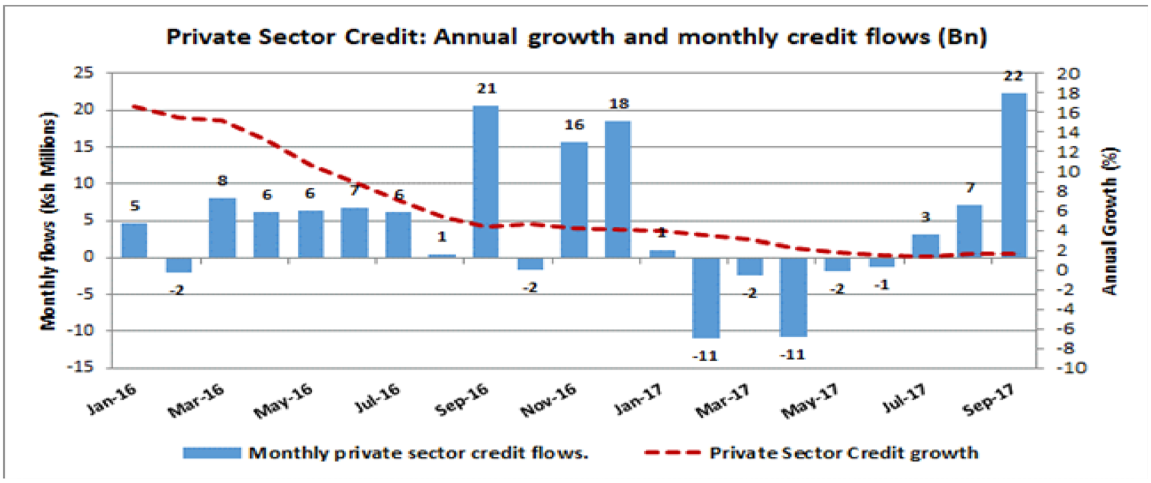
Net credit uptake by government slowed down to 4.3 per cent in the third quarter of 2017 from 10.8 per cent in the previous quarter largely reflecting reduced subscriptions to government securities by banks.

Table 2.2: Banking Sector Net Domestic Credit (KSh Billion)

	END MONTH LEVEL						QUARTERLY GROWTH RATES (%)						QUARTERLY CHANGES (KSH BN)					
	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
1. Credit to Government	**560.4**	**525.2**	**592.8**	**583.5**	**646.2**	674.3	2.9	**-6.3**	**12.9**	**-1.6**	**10.8**	**4.3**	15.7	**-35.2**	**67.5**	**-9.3**	**62.8**	**28.1**
Central Bank	-156.1	-182.9	-113.9	-117.2	-178.9	-167.6	**93.3**	17.1	-37.7	2.9	52.6	-6.3	-75.4	-26.8	69.0	-3.3	-61.7	11.3
Commercial Banks & NBFIs	716.6	708.1	706.7	700.7	825.1	841.9	14.6	-1.2	-0.2	-0.8	17.8	2.0	91.1	-8.4	-1.4	-6.0	124.4	16.7
2. Credit to other public sector	**78.6**	**90.2**	**104.7**	**105.9**	**106.9**	**113.7**	**-4.2**	**14.8**	**16.1**	**1.2**	**0.9**	**6.4**	**-3.5**	**11.6**	**14.5**	**1.2**	**0.9**	**6.9**
Local government	3.6	3.7	3.8	3.8	3.9	4.2	2.9	3.7	2.6	1.1	1.2	8.1	0.1	0.1	0.1	0.0	0.0	0.3
Parastatals	75.0	86.5	100.9	102.1	103.0	109.5	-4.6	15.3	16.7	1.2	0.9	6.3	-3.6	11.5	14.4	1.2	0.9	6.5
3. Credit to private sector	**2,216.1**	**2,243.3**	**2,275.7**	**2,263.2**	**2,249.1**	**2,281.6**	**0.9**	**1.2**	**1.4**	**-0.5**	**-0.6**	**1.4**	**19.1**	**27.2**	**32.4**	**-12.5**	**-14.0**	**32.5**
Agriculture	97.5	90.6	90.1	86.8	85.5	88.8	3.7	-7.1	-0.6	-3.6	-1.6	3.9	3.5	-6.9	-0.5	-3.3	-1.4	3.3
Manufacturing	304.5	278.6	275.0	278.6	282.8	295.6	0.7	-8.5	-1.3	1.3	1.5	4.5	2.2	-26.0	-3.6	3.6	4.1	12.8
Trade	350.6	382.4	380.7	382.0	388.2	408.7	2.4	9.1	-0.4	0.4	1.6	5.3	8.3	31.7	-1.7	1.3	6.2	20.5
Building and construction	101.5	104.8	104.8	101.4	100.8	106.7	0.7	3.3	0.0	-3.3	-0.6	5.9	0.7	3.3	0.0	-3.5	-0.6	5.9
Transport & communications	179.6	192.0	201.3	196.8	185.5	182.7	0.0	6.9	4.8	-2.2	-5.8	-1.5	0.0	12.4	9.2	-4.5	-11.3	-2.8
Finance & insurance	88.8	84.7	85.2	77.3	84.9	83.5	4.3	-4.7	0.6	-9.3	9.9	-1.7	3.7	-4.1	0.5	-7.9	7.6	-1.4
Real estate	323.2	329.6	337.4	351.1	355.7	358.8	3.5	2.0	2.3	4.1	1.3	0.9	10.8	6.4	7.7	13.7	4.7	3.1
Mining and quarrying	23.6	16.1	16.8	14.9	14.7	16.0	4.3	-31.6	4.1	-11.0	-1.8	9.1	1.0	-7.5	0.7	-1.9	-0.3	1.3
Private households	348.7	377.0	393.1	394.8	386.7	384.0	0.1	8.1	4.3	0.4	-2.0	-0.7	0.2	28.3	16.1	1.7	-8.0	-2.8
Consumer durables	156.5	171.7	175.3	172.5	168.2	170.9	-0.2	9.7	2.1	-1.6	-2.5	1.6	-0.3	15.2	3.6	-2.8	-4.3	2.7
Business services	162.2	143.8	147.1	145.7	136.7	134.6	-6.0	-11.3	2.3	-1.0	-6.2	-1.5	-10.3	-18.4	3.3	-1.4	-9.0	-2.0
Other activities	79.3	71.9	68.9	61.3	59.5	51.4	-1.0	-9.3	-4.1	-11.1	-2.9	-13.6	-0.8	-7.4	-3.0	-7.7	-1.8	-8.1
4. TOTAL (1+2+3)	**2,855.1**	**2,858.7**	**2,973.2**	**2,952.6**	**3,002.2**	**3,005.0**	**1.1**	**0.1**	**4.0**	**-0.7**	**1.7**	**2.2**	**31.3**	**3.6**	**114.5**	**-20.6**	**49.6**	**67.4**

Source: Central Bank of Kenya

Chart 2.2: Private Sector Credit Growth



Source: Central Bank of Kenya

iv. Reserve Money

Reserve money (RM), which comprises currency held by the non-bank public and commercial bank reserves, increased by 6.2 per cent in the third quarter compared to a decline of 3.7 per cent in the previous quarter. This increase largely reflected net lending to banks (through reverse repos) to mitigate tight liquidity in the money market. Consequently, bank reserves increased by KSh 22.8 billion (Table 4.3). Meanwhile, Government borrowing from Central Bank increased by KSh 11.3 billion due to government utilizing its overdraft facility at the Central Bank.

Table 2.3: Reserve Money and its Sources (KSh Billion)

	END QUARTER LEVELS						QUARTERLY % CHANGE						QUARTERLY CHANGES (KSh BN)					
	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Jun-17
1. Net Foreign Assets	694.6	687.2	621.6	697.8	738.3	694.6	8.4	-1.1	-9.5	12.3	5.8	-5.9	53.8	-7.4	-65.6	76.2	40.5	-43.7
2. Net Domestic Assets	-304.4	-294.4	-210.4	-282.9	-338.7	-270.1	27.4	-3.3	-28.5	34.4	19.7	-20.3	-65.5	10.0	83.9	-72.4	-55.9	68.6
2.1 Government Borrowing (net)	-156.1	-189.9	-113.9	-117.2	-178.9	-167.6	93.3	17.1	-37.7	2.9	52.6	-6.3	-75.4	-26.8	69.0	-3.3	-61.7	11.3
2.2 Commercial banks (net)	3.0	42.0	43.2	-18.4	23.6	63.2	-136.4	1315.8	2.9	-142.5	-228.5	167.8	11.1	39.1	1.2	-61.6	42.0	39.6
2.3 Other Domestic Assets (net)	-154.7	-150.0	-143.2	-150.7	-186.8	-169.2	0.8	1.4	-8.7	5.2	24.0	-9.4	-1.2	-2.2	13.7	-7.5	-36.2	17.6
3. Reserve Money	390.2	392.8	411.1	414.9	399.6	424.5	-2.9	0.7	4.7	0.9	-3.7	6.2	-11.7	2.6	18.3	3.8	-15.3	24.9
3.1 Currency outside banks	187.9	186.6	209.5	200.6	206.7	208.9	2.5	-0.7	12.3	-4.2	3.0	1.0	4.5	-1.3	22.9	-8.9	6.1	2.1
3.2 Bank reserves	202.3	206.2	201.7	214.3	192.9	215.7	-7.4	1.9	-2.2	6.3	-10.0	11.8	-16.2	3.9	-4.6	12.7	-21.4	22.8

Source: Central Bank of Kenya

v. Interest Rates

a. Central Bank Rate

The Monetary Policy Committee (MPC) retained the Central Bank Rate (CBR) at 10.0 per cent in the July and September 2017 meetings following given negligible demand pressures in order to continue anchoring inflation expectations. The Committee at its September meeting noted that non-food-non-fuel (NFNF) inflation remained stable and below 5 per cent medium term target, indicating that demand pressures in the economy were muted.

b. Interbank rate

The interbank rate increased to quarterly average of 6.9 per cent in the third quarter compared to an average of 4.7 per cent in the second quarter of 2017 (**Table 2.4**). This increase is attributable to the tight liquidity conditions in the money market compounded by segmentation and uneven distribution of liquidity.

c. Treasury bill rates

The average 91-day Treasury bill rate declined to 8.2 per cent in the third quarter of 2017 compared with 8.6 per cent in the previous quarter. This was due to low appetite for debt by government. The average 182-day Treasury bill rate remained more or less stable at 10.3 per cent in the third quarter of 2017, largely unchanged from 10.4 per cent in the previous quarter (**Table 2.4**).

d. Lending and Deposit Rates

Commercial banks' lending interest rates remained relatively stable through September 2017. The marginal increase in the overall lending rate was largely reflected in '1-5 years' and 'Overdraft' loan categories. In addition, the average commercial banks' deposit rate decreased to 7.6 per cent in September 2017 compared to 7.2 per cent in March 2017largely in the savings the 0-3 month's deposits categories.

Table 2.4: Interest Rates (%)

2015	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
91-day Treasury bill rate	8.49	8.42	8.26	8.26	10.57	11.54	14.61	21.65	12.34	9.81
182-day Treasury bill rate	10.35	10.26	10.37	10.55	11.99	12.06	13.40	21.52	14.02	11.43
Interbank rate	6.85	8.77	11.17	11.77	13.48	18.80	19.85	14.82	8.77	7.27
Repo rate	8.08	8.38	8.50	9.70	10.61	11.50	11.50	11.50	-	9.23
Reverse Repo rate	-	-	-	-	-	-	-	18.12	14.21	11.92
Central Bank Rate (CBR)	8.50	8.50	8.50	10.00	11.50	11.50	11.50	11.50	11.50	11.50
Average lending rate (1)	15.46	15.40	15.26	16.06	15.75	15.68	16.82	16.58	17.16	18.30
Overdraft rate	15.68	15.52	15.10	15.65	16.05	15.98	16.65	16.81	17.44	18.48
1-5years	16.34	16.37	16.39	16.72	16.77	16.64	17.41	16.90	17.72	18.40
Over 5years	14.35	14.32	14.28	15.11	14.44	14.43	15.93	15.87	16.26	18.03
Average deposit rate (2)	6.63	6.60	6.55	6.64	6.31	6.91	7.28	7.54	7.39	8.02
0-3months	8.52	8.10	8.46	8.33	7.89	9.22	10.05	10.55	10.50	11.14
Over 3 months deposit	9.85	9.81	9.72	9.73	9.67	10.03	10.06	10.38	10.35	11.35
Savings deposits	1.53	1.90	1.48	1.85	1.37	1.50	1.71	1.68	1.32	1.56
Spread (1-2)	8.82	8.80	8.70	9.42	9.44	8.77	9.54	9.04	9.77	10.28

2016	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
91-day Treasury bill rate	11.36	10.63	8.72	8.92	8.15	7.25	7.41	8.48	8.06	7.76	8.22	8.44
182-day Treasury bill rate	13.46	13.19	10.83	10.87	10.25	9.56	9.79	10.84	10.85	10.32	10.32	10.55
Interbank rate	6.12	4.54	4.10	4.01	3.82	4.56	5.88	4.98	4.47	4.12	5.11	5.55
Repo rate	8.85	9.68	4.31	5.23	6.00	10.04	9.76	7.86	-	-	7.05	-
Reverse Repo rate	11.44	11.58	11.63	12.49	11.55	10.59	10.57	10.53	10.36	10.08	10.17	10.04
Central Bank Rate (CBR)	11.50	11.50	11.50	11.50	10.50	10.50	10.50	10.50	10.00	10.00	10.00	10.00
Average lending rate (1)	17.96	17.86	17.79	17.94	18.08	18.15	18.10	17.71	13.84	13.65	14.31	13.69
Overdraft rate	18.25	18.25	18.06	18.36	18.25	18.04	17.84	17.96	13.60	13.46	13.97	13.49
1-5years	18.27	18.01	18.00	18.25	18.46	18.63	18.66	18.16	13.95	13.81	13.76	13.86
Over 5years	17.33	17.41	17.31	17.20	17.53	17.64	17.53	17.01	13.83	13.77	13.63	13.59
Average deposit rate (2)	7.54	7.51	7.17	6.70	6.38	6.78	6.64	6.42	6.94	7.82	7.65	7.33
0-3months	10.32	10.00	9.78	8.68	8.54	8.80	8.43	8.14	8.21	8.00	7.80	7.16
Over 3 months deposit	10.75	11.15	10.41	10.05	8.93	9.94	9.82	9.45	8.82	9.38	8.63	8.45
Savings deposits	1.56	1.37	1.32	1.38	1.69	1.60	1.67	1.68	3.78	6.08	6.52	6.37
Spread (1-2)	10.41	10.35	10.62	11.23	11.70	11.40	11.46	11.28	6.93	5.91	6.01	6.36

2017	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept
91-day Treasury bill rate	8.58	8.64	8.69	8.77	8.73	8.42	8.22	8.17	8.13
182-day Treasury bill rate	10.50	10.53	10.53	-	10.41	10.38	10.32	10.32	10.32
Interbank rate	7.70	6.41	4.46	5.34	4.93	3.99	6.99	8.10	5.52
Repo rate	9.95	9.88	7.23	5.32	5.29	4.13	8.29	8.90	7.24
Reverse Repo rate	10.02	10.01	10.04	10.02	10.01	10.05	10.25	10.29	10.12
Central Bank Rate (CBR)	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00
Average lending rate (1)	13.66	13.69	13.61	13.61	13.71	13.66	13.70	13.65	13.69
Overdraft rate	13.30	13.32	13.29	13.30	13.44	13.38	13.65	13.66	13.65
1-5years	13.88	13.89	13.81	13.82	13.85	13.80	13.78	13.86	13.87
Over 5years	13.60	13.66	13.55	13.52	13.68	13.64	13.62	13.39	13.51
Average deposit rate (2)	7.20	7.65	7.12	6.97	7.07	7.15	7.43	7.67	7.66
0-3months	7.19	7.32	7.28	7.22	7.25	7.76	7.83	7.80	7.71
Over 3 months deposit	8.33	8.84	8.18	8.01	8.11	8.04	8.05	8.13	8.02
Savings deposits	6.09	6.81	5.89	5.67	5.85	5.63	6.40	5.94	6.43
Spread (1-2)	6.46	6.04	6.49	6.64	6.64	6.52	6.27	5.98	6.04

Source: Central Bank of Kenya

Chapter 3

The Real Sector

OVERVIEW

The Kenyan economy recorded subdued growth of 4.4 per cent in the third quarter of 2017. This was lower than 5.0 per cent in the second quarter of 2017 and 5.7 per cent in the third quarter of 2016. The subdued performance was mainly attributed to heightened electioneering activity which undermined the non-agriculture output.

Agriculture sector growth recovered recording a growth of 3.1 per cent compared to 1.3 per cent in the second quarter of 2017 and 3.8 per cent in he third quarter of2 016 on account of favourable weather conditions experienced since the second quarter of the year.

Non-agriculture output declined to 4.8 per cent compared to 6.1 per cent in the second quarter of 2017.

- Growth in the Services sector was subdued. It grew by 5.6 per cent in the third quarter of 2017 compared to 6.8 per cent in the same quarter last year. The subdued performance was witnessed in Accommodation and Restaurant, Transport and Storage, Financial and Insurance, Education and Health sectors.

- The performance of Industry decelerated further to 3.4 per cent in the third quarter of 2017 compared to 4.4 per cent in the second quarter of 2017 and 5.7 per cent in the third quarter of 2016 following subdued performance of the Manufacturing, Construction, and Electricity and Water Supply sectors.

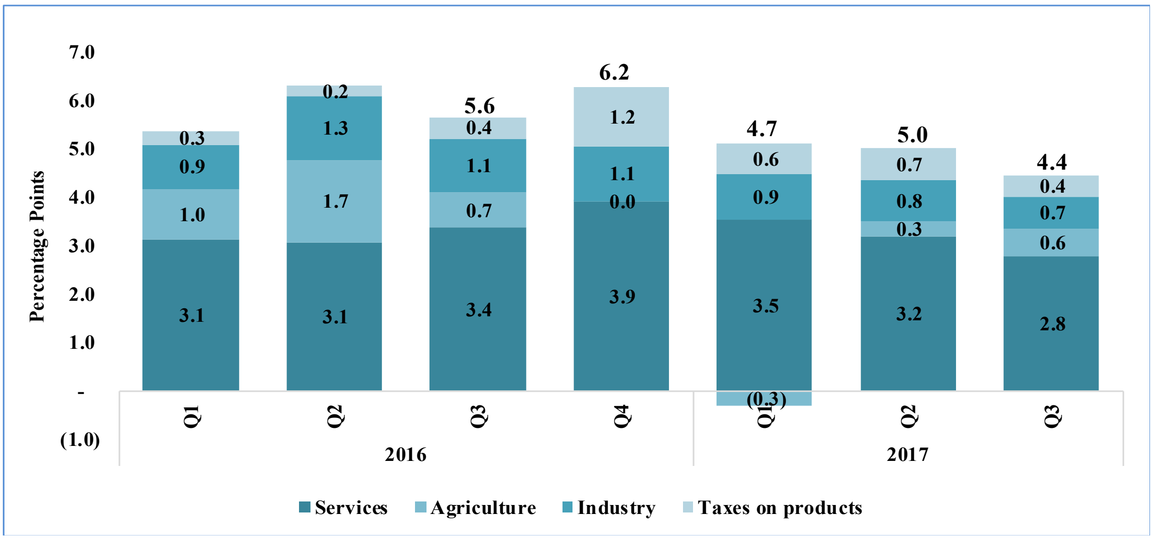
The Services sector continues to be the main source of growth. It contributed 2.8 percentage points to real GDP growth in the third quarter of 2017 largely supported by the Real Estate (0.8 percentage points), Transport and Storage (0.4 percentage points), and Information and Communication (0.3 percent). On the other hand, Industry accounted for 0.7 percentage points largely driven by the Construction sector (0.3 percentage points) while agriculture accounted for 0.6 percentage points (**Table 3.1 and Chart 3.1**).

Table 3.1:Gross Domestic Product (GDP) Growth by Activity (%)

	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
1. Agriculture	**4.0**	**7.0**	**3.8**	**0.1**	**(1.3)**	**1.3**	**3.1**
2. Non-Agriculture (o/w)	**5.8**	**6.0**	**6.1**	**7.5**	**6.8**	**6.1**	**4.8**
2.1 Industry	**5.0**	**6.8**	**5.7**	**5.8**	**5.0**	**4.4**	**3.4**
Mining & Quarrying	6.7	10.6	9.8	11.2	9.7	5.7	5.8
Manufacturing	1.7	5.3	4.4	2.5	2.9	2.3	2.1
Construction	10.2	7.6	7.8	11.5	8.4	7.5	4.9
Electricity & water supply	8.6	9.6	5.4	4.7	5.1	6.1	4.8
2.2 Services	**7.0**	**6.7**	**6.8**	**7.7**	**7.7**	**6.8**	**5.6**
Wholesale & Retail Trade	3.6	2.3	4.3	5.0	6.1	2.8	3.6
Accommodation & restaurant	10.4	15.7	13.5	14.2	15.8	13.4	7.3
Transport & Storage	9.3	7.5	6.2	10.8	10.2	8.3	5.4
Information & Communication	10.9	9.1	8.8	9.8	11.4	9.2	9.0
Financial & Insurance	8.2	8.1	7.1	4.1	5.3	4.3	2.4
Public administration	5.7	6.6	5.1	3.6	5.4	6.3	6.1
Professional, Administration & Support Services	3.3	5.4	3.8	4.7	4.8	6.4	4.9
Real estate	8.8	8.2	8.5	9.5	9.3	9.7	8.9
Education	6.2	6.0	6.9	6.3	5.9	5.6	4.8
Health	5.1	6.6	7.1	4.5	4.5	5.5	3.3
Other services	5.0	4.6	4.3	2.8	3.5	1.2	1.0
FISIM	8.4	5.2	1.7	(2.7)	3.3	(0.8)	0.8
All Industries at basic prices	**5.7**	**6.8**	**5.9**	**5.7**	**4.5**	**4.8**	**4.6**
2.3 Taxes on products	**2.5**	**2.0**	**3.7**	**9.7**	**6.0**	**6.1**	**3.6**
Real GDP Growth	**5.3**	**6.3**	**5.6**	**6.2**	**4.7**	**5.0**	**4.4**

Source: Kenya National Bureau of Statistics

Chart 3.1:Evolution of Real GDP Growth



Source: Kenya National Bureau of Statistics

Table 3.2:Sectoral Contribution as a Share of Real GDP (%)

	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
1. Agriculture	**26.4**	**24.2**	**19.1**	**17.3**	**25.0**	**23.3**	**18.8**
2. Non-Agriculture (o/w)	**73.6**	**75.8**	**80.9**	**82.7**	**75.0**	**76.7**	**81.2**
2.1 Industry	**18.6**	**19.3**	**19.6**	**19.4**	**18.7**	**19.2**	**19.4**
Mining & Quarrying	1.1	1.0	1.1	1.1	1.1	1.0	1.1
Manufacturing	10.3	10.5	10.4	10.0	10.1	10.2	10.2
Construction	4.9	5.2	5.6	5.9	5.0	5.3	5.6
Electricity & water supply	2.4	2.6	2.5	2.4	2.4	2.6	2.5
2.2 Services	**44.5**	**45.7**	**49.2**	**50.9**	**45.8**	**46.5**	**49.8**
Wholesale & Retail Trade	6.9	7.1	8.5	7.6	7.0	7.0	8.4
Accommodation & restaurant	1.2	0.9	1.1	1.4	1.3	0.9	1.1
Transport & Storage	6.0	6.6	7.4	7.8	6.3	6.8	7.4
Information & Communication	3.7	3.1	3.5	5.1	3.9	3.2	3.6
Financial & Insurance	6.0	6.1	6.6	6.3	6.1	6.0	6.4
Public administration	3.6	4.3	3.7	3.8	3.6	4.3	3.8
Professional, Administration & Support Services	2.1	2.2	2.3	2.4	2.1	2.2	2.3
Real estate	8.0	8.2	8.6	8.9	8.4	8.6	9.0
Education	6.8	6.8	7.1	7.1	6.9	6.9	7.1
Health	1.6	1.8	1.9	1.9	1.6	1.8	1.9
Other services	1.2	1.2	1.3	1.3	1.2	1.2	1.3
FISIM	(2.6)	(2.6)	(2.7)	(2.7)	(2.5)	(2.4)	(2.6)
All Industries at basic prices							**88.0**
2.3 Taxes on products	**10.4**	**10.8**	**12.1**	**12.4**	**10.5**	**10.9**	**12.0**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Kenya National Bureau of Statistics

Table 3.3: Sectoral Contribution to Real GDP Growth Rates(%)

	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
1. Agriculture	**1.0**	**1.7**	**0.7**	**0.0**	**(0.3)**	**0.3**	**0.6**
2. Non-Agriculture (o/w)	**4.3**	**4.6**	**4.9**	**6.2**	**5.1**	**4.7**	**3.9**
2.1 Industry	**0.9**	**1.3**	**1.1**	**1.1**	**0.9**	**0.8**	**0.7**
Mining & Quarrying	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Manufacturing	0.2	0.6	0.5	0.2	0.3	0.2	0.2
Construction	0.5	0.4	0.4	0.7	0.4	0.4	0.3
Electricity & water supply	0.2	0.3	0.1	0.1	0.1	0.2	0.1
2.2 Services	**3.1**	**3.1**	**3.4**	**3.9**	**3.5**	**3.2**	**2.8**
Wholesale & Retail Trade	0.3	0.2	0.4	0.4	0.4	0.2	0.3
Accommodation & restaurant	0.1	0.1	0.1	0.2	0.2	0.1	0.1
Transport & Storage	0.6	0.5	0.5	0.8	0.6	0.6	0.4
Information & Communication	0.4	0.3	0.3	0.5	0.4	0.3	0.3
Financial & Insurance	0.5	0.5	0.5	0.3	0.3	0.3	0.2
Public administration	0.2	0.3	0.2	0.1	0.2	0.3	0.2
Professional, Administration & Support Services	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Real estate	0.7	0.7	0.7	0.8	0.8	0.8	0.8
Education	0.4	0.4	0.5	0.4	0.4	0.4	0.3
Health	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other services	0.1	0.1	0.1	0.0	0.0	0.0	0.0
FISIM	(0.2)	(0.1)	(0.0)	0.1	(0.1)	0.0	(0.0)
All Industries at basic prices	-	-	-	-	-	-	**4.0**
2.3 Taxes on products	**0.3**	**0.2**	**0.4**	**1.2**	**0.6**	**0.7**	**0.4**
Real GDP Growth	**5.3**	**6.3**	**5.6**	**6.2**	**4.7**	**5.0**	**4.4**

Source: Kenya National Bureau of Statistics

PERFORMANCE BY SECTOR

Agriculture

Agriculture sector continued to recover in the third quarter of 2017. The sector grew by 3.1 per cent in the third quarter of 2017, an improvement compared to 1.3 per cent in the second quarter of 2017. Improved performance of tea, horticultural exports, and fishing sub-sectors boosted growth during the quarter under review. However, growth of the sector was lower compared to 3.8 per cent growth recorded in the third quarter of 2016, as indicators such as coffee sales, milk uptake in the formal sector, and production of key food products such as maize, beans and potatoes recorded subdued performance (**Table 3.1**).

The sectoral share to real GDP decreased to 18.8 per cent in the third quarter of 2017 compared to 23.3 per cent the previous quarter. However, its contribution to overall GDP growth improved to 0.6 percentage points compared to 0.3 percentage points in the previous quarter (**Table 3.2 and Table 3.3**).

Tea

Tea production increased by 7.4 per cent in the third quarter of 2017 compared to a similar quarter of 2016, but was 7.4 per cent lower than output in the second quarter of 2017. The improvement in production was attributed to recovery in tea production after industrial action by tea workers during the third quarter of 2016, which adversely affected the sector. Monthly production declined by 22.1 per cent in July 2017, but increased by 3.6 per cent and 17.4 per cent in August and September 2017, respectively (**Table 3.4**). Average auction price of tea per kilogram decreased by 1.3 per cent in the third quarter of 2017 compared to the second quarter of 2017, but was higher by 27.5 per cent compared to a similar quarter of 2016.

Table 3.4: Quarterly Performance of Key Agricultural Output Indicators

	2016				2017*					
	Quarterly				Quarterly			Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jul-17	Aug-17	Sep-17
Tea										
Output (Metric tonnes)	139,607	109,747	95,532	126,349	90,094	110,818	102,645	31,565	32,693	38,386
Growth (%)	*9.0*	*-21.4*	*-13.0*	*32.26*	*-28.69*	*23.00*	*-7.38*	*-22.1*	*3.6*	*17.4*
Horticulture										
Exports (Metric tonnes)	111,759	90,620	84,574	78,404	85,792	85,186	82,791	31,280	24,881	26,630
Growth (%)	*69.0*	*-18.9*	*-6.7*	*-7.3*	*9.4*	*-0.7*	*-2.8*	*9.3*	*-20.5*	*7.0*
Coffee										
Sales (Metric tonnes)	15,487	10,996	7,576	5,613	16,731	6,202	5,546	762	2,319	2,465
Growth (%)	*258.6*	*-29.0*	*-31.1*	*-25.9*	*198.1*	*-62.9*	*-10.6*		*204.1*	*6.3*
Milk										
Output (million litres)	158.04	170.21	158.29	161.7	136.6	121.78	134.17	41.77	46.16	46.24
Growth %	*-13.5*	*7.7*	*-7.0*	*2.2*	*-15.5*	*-10.8*	*10.2*	*-1.1*	*10.5*	*0.2*
Sugar Cane										
Output ('000 Metric tonnes)	2,068	1,721	1,742	1,630	1,572	786	709	245	173	291
Growth (%)	*28.2*	*-16.8*	*1.2*	*-6.5*	*-3.6*	*-50.0*	*-9.8*	*-1.7*	*-29.2*	*67.8*

* Provisional

Source: Kenya National Bureau of Statistics

Coffee

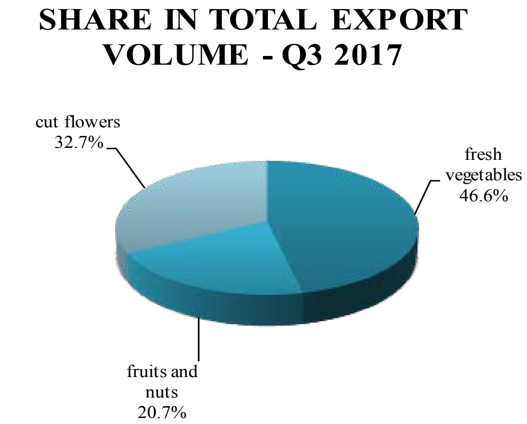
Coffee sales in the third quarter of 2017 were 10.6 per cent lower than the previous quarter and 26.8 per cent below the quantity sold in the third quarter of 2016. The Nairobi Coffee Exchange was in recess during the month of June, hence there were no coffee auctions. July 2017 saw the resumption of the coffee auctions, with 762 tonnes of coffee sold during the month. Coffee sales picked up significantly in August and September 2017 (**Table 3.4**), while average auction prices increased by 10.7 per cent in the third quarter of 2017 compared to a similar quarter of 2016.

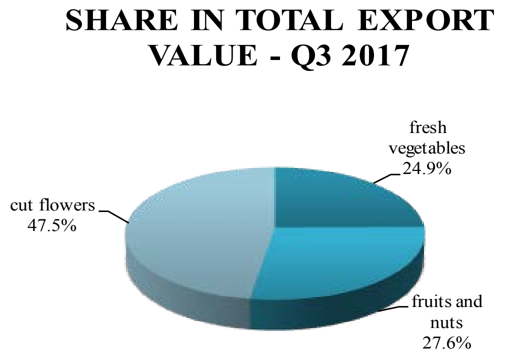
Horticulture

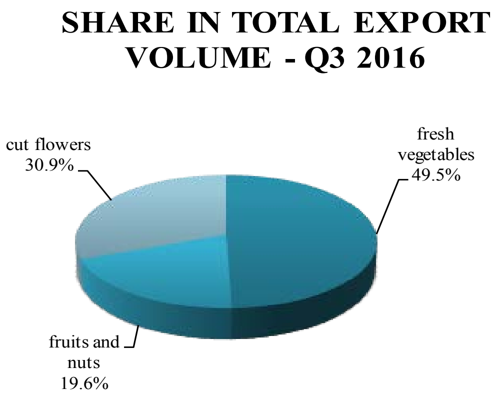
Total exports of horticultural crops declined slightly by 2.8 per cent in the third quarter of 2017, and was 2.1 per cent below the quantity exported in the third quarter of 2016. The decline reflected lower production of fresh vegetables, which has the highest share of total horticultural crop exports. Production of fruits, nuts, and cut flowers increased during the quarter under review. Monthly data shows the decline in August 2017, which more than offset the increased exports in July and September 2017 (**Table 3.1**).

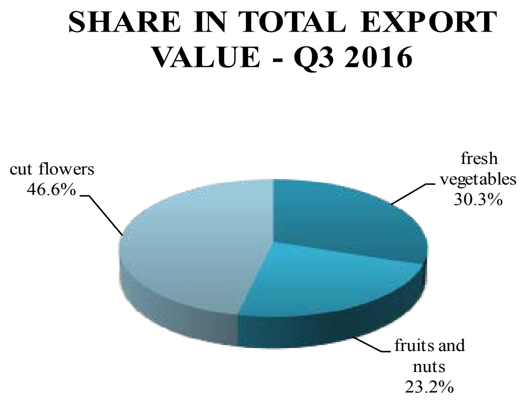
The share of export volumes and value of fresh vegetables to total horticultural exports decreased to 46.6 per cent and 24.9 percent, respectively, in the third quarter of 2017 from 49.5 per cent and 30.3 percent, respectively, in a similar quarter of 2016 (**Chart 3.4**).

Chart 3.4: **Horticultural Exports**









Source: Kenya Revenue Authorirys

Milk intake in the formal sector increased by 10.2 per cent in the third quarter of 2017, reflecting improved pasture conditions following favourable weather conditions. Monthly production declined slightly in July 2017, then improved in August and September 2017 (**Table 3.4**) However, milk intake was 15.2 per cent lower compared to the third quarter of 2016.

Sugarcane production declined by 9.8 per cent in the third quarter of 2017 compared to the previous quarter, and was lower by 59.3 per cent compared to the same quarter in 2016. The lower output reflects a switch by farmers to alternative cash crops to cut losses attributed to the structural and governance challenges affecting sugar cane production. Monthly data shows declined production in July and August 2017. However, there was a notable improvement in September 2017 (**Table 3.4**).

The Manufacturing Sector

The performance of the Manufacturing sector remained subdued in the third quarter of 2017, hampered by low activity in the non-food sub-sector following the prolonged electioneering period. It recorded a growth of 2.1 per cent in the third quarter of 2017 compared to 2.3 per cent in the second quarter of 2017 and 4.4 per cent in the third quarter of 2016. Activity in the food sub-sector increased, boosted by a significant increase in the production of maize meal, following the Government subsidy on importation of maize grain to contain maize prices. Production of soft drinks, edible oils and wheat flour also increased during the quarter under review, which supported growth of the manufacturing sector (**Table 3.1**). The sectoral share declined slightly to 10.2 per cent from 10.4 per cent in the third quarter of 2016, while sectoral contribution to real GDP growth declined to 0.2 percentage points compared to 0.5 percentage points in the third quarter of 2016 (**Table 3.2, Table 3.3**).

Sugar production declined by 12.4 per cent in the third quarter of 2017 compared to the previous quarter, and was lower by 54.6 per cent compared to the third quarter of 2016. The decline was attributed to lower production of sugarcane during the quarter. However, monthly production increased significantly in September 2017 compared to July and August 2017 (**Table 3.5**).

Cement production decreased by 3.2 per cent in the third quarter of 2017 compared to the previous quarter, and was 12.5 per cent lower compared to the same quarter of 2016. The drop in cement production which is evident from the third quarter of 2016 is attributed to reduced activity in the construction sector, as well as structural challenges facing major cement producing companies. Monthly data for the quarter under review shows a decline in August 2017, which more than offset the increases recorded in July and September 2017 (**Table 3.5**).

Production of **soft drinks** was slightly lower by 2.0 per cent in the period July-August 2017 compared to a similar period in 2016, with monthly production showing reduced output by 4.1 per cent in July 2017, then an improvement by 2.3 per cent in August 2017 (**Table 3.5**).

Production of **galvanized sheets** increased by 2.8 per cent in the period July-August 2017 compared to a similar period in 2016. Monthly production increased by 1.8 per cent in July 2017, then declined by 1.6 per cent in August 2017 (**Table 3.5**).

Table 3.5 Quarterly Production of Selected Manufactured Goods

	2016				2017*					
	Quarterly				Quarterly			Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jul-17	Aug-17	Sep-17
Cement production										
Output (MT)	1,606,741	1,701,420	1,695,299	1,703,770	1,627,269	1,531,136	1,482,853	553,631	451,651	477,571
Growth %	*3.4*	*5.9*	*-0.4*	*0.5*	*-4.5*	*-5.9*	*-3.2*	*7.85*	*-18.42*	*5.74*
Assembled vehicles										
Output (No.)	1,600	1,782	1,719	1,194	1,569	909	1,377	459	443	475
Growth %	*-38.6*	*11.4*	*-3.5*	*-30.5*	*31.4*	*-42.1*	*51.5*	*6.5*	*-3.5*	*7.2*
Galvanized sheets										
Output (MT)	61,552	65,269	63,555	56,902	67,132	65,806	N/A	22,029	21,673	N/A
Growth %	*-10.4*	*6.0*	*-2.6*	*-10.5*	*18.0*	*-2.0*		*1.8*	*-1.6*	
Processed sugar										
Output (MT)	153,750	136,459	138,136	148,144	144,403	57,589	50,423	17,882	10,892	21,649
Growth %	*-8.3*	*-11.2*	*1.2*	*7.2*	*-2.5*	*-60.1*	*-12.4*	*11.0*	*-39.1*	*98.8*
Soft drinks										
Output ('000 litres)	153,777	126,809	130,608	140,193	141,017	119,562	N/A	39,575	40,483	N/A
Growth %	*15.7*	*-17.5*	*3.0*	*7.3*	*0.6*	*-15.2*		*-4.1*	*2.3*	

MT = Metric tonnes
* Provisional
N/A - Not Available

Source: Kenya National Bureau of Statistics

The Electricity and Water Supply Sector

Electricity and Water Supply sector recorded subdued performance. The sector grew by 4.8 per cent in the third quarter of 2017 compared to 6.1 per cent in the second quarter of 2017 and 5.4 per cent in the third quarter of 2016, with the reduced performance mainly attributed to increased generation of thermal electricity, which is more expensive hence constraining value addition in the sector (**Table 3.6**).

Electricity generation increased by 1.8 per cent in the third quarter of 2017 compared to the previous quarter, and was 1.6 per cent higher compared to a similar quarter of 2016. The increase was mainly attributed to expansion of geothermal capacity in July and August 2017, and, to a lesser extent, pick up in hydroelectricity generation supported by increased rainfall. As a result, generation of thermal electricity declined during the quarter under review (**Table 3.6**).

Consumption of electricity declined by 7.6 per cent in the third quarter of 2017 compared to the previous quarter, and increased marginally by 0.3 per cent compared to the third quarter of 2016. Meanwhile, international oil prices increased marginally by 0.7 per cent in the third quarter of 2017 compared to the previous quarter, and were 10.2 per cent higher compared to the same quarter of 2016 (**Table 3.6**).

The Construction and Real Estate Sectors

The Construction sector recorded a decline in performance. The sector grew by 4.9 per cent in the third quarter of 2017, slower than 7.5 per cent in the third quarter of 2017 and 7.8 per cent growth in the third quarter of 2016, and growth was constrained as investors scaled down construction activities following the prolonged electioneering period. Key indicators in the sector such as cement consumption and import of construction materials such as cement and steel bars declined during the quarter (**Table 3.6**).

Table 3.6: Quarterly Performance in the Energy Sector

	2016				2017					
	Quarterly				Quarterly			Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jul-17	Aug-17	Sep-17
Electricity Supply (Generation)										
Output (million KWH)	2,421.2	2,433.3	2,506.6	2,526.0	2,431.9	2,502.3	2,546.8	865.5	825.8	855.5
Growth %	*1.8*	*0.5*	*3.0*	*0.8*	*-3.7*	*2.9*	*1.8*	*4.2*	*-4.6*	*3.6*
Of which:										
Hydro-power Generation (million KWH)	953.8	985.9	1049.2	970.9	700.6	620.3	683.3	192.6	251.3	239.5
Growth (%)	*4.0*	*3.4*	*6.4*	*-7.5*	*-27.8*	*-11.5*	*10.2*	*6.8*	*30.5*	*-4.7*
Geo-Thermal Generation (million KWH)	1,166.8	1,139.9	1,073.4	1,104.2	1,122.2	1,151.2	1,219.3	401.7	415.0	402.7
Growth (%)	*-1.3*	*-2.3*	*-5.8*	*2.9*	*1.6*	*2.6*	*5.9*	*6.8*	*3.3*	*-3.0*
Thermal (million KWH)	300.7	307.5	384.0	450.8	609.1	730.8	644.1	271.3	159.5	213.3
Growth (%)	*7.1*	*2.3*	*24.9*	*17.4*	*35.1*	*20.0*	*-11.9*	*-1.1*	*-41.2*	*33.8*
Consumption of electricity (million KWH)	1,961.5	2,059.0	2,110.7	2,181.5	2,186.9	2,292.0	2,117.1	721.3	684.5	711.4
Growth %	*-3.4*	*5.0*	*2.5*	*3.4*	*0.2*	*4.8*	*-7.6*	*-7.8*	*-5.1*	*3.9*
Consumption of Fuels ('000 tonnes)	1,247.1	1,227.2	1,333.9	1,398.3	1,100.7	1,174.4	N/A	294.6	N/A	N/A
Growth %	*12.7*	*-1.6*	*8.7*	*4.8*	*-21.3*	*6.7*		*-31.0*		
Murban crude oil average price (US $ per barrel)	33.7	46.1	46.3	50.6	54.7	50.7	51.1	48.6	48.9	55.7
Growth %	*-21.0*	*36.8*	*0.4*	*9.1*	*8.2*	*-7.3*	*0.7*	*2.7*	*0.5*	*14.0*

N/A - Not Available

Source: Kenya National Bureau of Statistics

Sectoral share to GDP increased to 5.6 per cent compared to 5.3 per cent in the previous quarter but was stable compared to the third quarter of 2016. The contribution of the sector to real GDP growth reduced marginally to 0.3 percentage points compared to 0.4 percentage points in the previous quarter and the third quarter of 2016 (**Table 3.2 and Table 3.3**).

The real estate sector continues to record robust growth despite slowdown in credit, supported by robust property development across the country. The sector grew by 8.9 per cent in the third quarter of 2017, compared to 9.7 per cent in the second quarter of 2017 and 8.5 per cent in the third quarter of 2016 (**Table 3.1**). The sectoral share to GDP increased to 9.0 per cent in the third quarter of 2017, compared to 8.6 per cent in the previous quarter and the same quarter of 2016, while its contribution to GDP growth remained stable at 0.8 percentage points (**Table 3.2 and Table 3.3**).

The Accommodation and Restaurants Sector

Growth in the Accommodation and Restaurant sector remained strong, supported by higher tourist arrivals. The sector grew by 7.3 per cent in the third quarter of 2017. However, growth was lower compared to 13.4 per cent in the second quarter of 2017 and 13.5 per cent in the third quarter of 2016, following reduced hotel bed occupancy following political uncertainty experienced during the quarter (**Table 3.1**).

Tourist Arrivals

Overall tourist arrivals increased by 32.3 per cent in the third quarter of 2017 compared to the previous quarter. The highest inflow of tourists during the quarter was recorded in July 2017 as Kenya hosted the IAAF World Under-18 Championships in Nairobi. Monthly tourist arrivals at Jomo Kenyatta International Airport (JKIA), in Nairobi and the Moi International Airport Mombasa (MIAM) increased in July 2017, but declined in September 2017 (**Table 3.6**). When compared to the third quarter of 2016, overall tourist arrivals increased by 7.3 percent, pointing to continued recovery of the tourism sector.

Table 3.7: Quarterly Tourist Arrivals by Point of Entry

	2016				2017					
	Quarterly				Quarterly			Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jul-17	Aug-17	Sep-17
Total Tourist Arrivals	206,224	186,685	262,149	219,327	224,370	213,543	282,463	105,241	89,782	87,440
Growth (%)	*6.9*	*-9.5*	*40.4*	*-16.3*	*2.3*	*-4.8*	*32.3*	*33.3*	*-14.7*	*-2.6*
o.w. JKIA - Nairobi	178,283	175,056	236,119	192,055	192,740	202,042	255,337	97,955	79,053	78,329
Growth (%)	*4.8*	*-1.8*	*34.9*	*-18.7*	*0.4*	*4.8*	*26.4*	*32.0*	*-19.3*	*-0.9*
MIAM - Mombasa	27,941	11,629	26,030	27,272	31,630	11,501	27,126	7,286	10,729	9,111
Growth %	*22.3*	*-58.4*	*123.8*	*4.8*	*16.0*	*-63.6*	*135.9*	*53.9*	*47.3*	*-15.1*

Source: Kenya Tourism Board

Transport and Storage

The Transport and Storage sector recorded slower growth in the third quarter of 2017, following reduced growth in road transport. The sector expanded by 5.4 per cent in the third quarter of 2017, which was lower than 8.2 per cent in the previous quarter and 6.2 per cent in the third quarter of 2016. Consumption of diesel reduced during the quarter, while international oil prices recovered by 10.2 per cent compared to the third quarter of 2016 (**Table 3.1**). The sectoral share to total GDP increased to 7.4 per cent from 6.8 per cent in the previous quarter but remained stable compared to the third quarter of 2017, while its contribution to overall GDP growth declined to 0.4 percentage points in the third quarter compared to 0.6 percentage points in the previous quarter and 0.5 percentage point in the third quarter of 2016 (**Table 3.2 and Table 3.3**).

Passenger flows through Jomo Kenyatta International Airport (JKIA) increased marginally by 0.1 per cent in the July and August 2017 compared to the same months in 2016. Passenger flows have stabilized since the second quarter of 2016 (**Table 3.8**).

Table 3.8: Quarterly Throughput of Selected Trasport Companies

	2016				2017			
	Quarterly				Quarterly		Monthly	
	Q1	Q2	Q3	Q4	Q1	Q2	Jul-17	Aug-17
Number of Passengers thro' JKIA								
Total passenger flows	1,082,784	1,079,762	1,079,331	1,079,503	1,079,870	1,079,812	360,000	359,911
Growth (%)	*0.02*	*-0.3*	*-0.04*	*0.02*	*0.03*	*-0.01*	*0.02*	*-0.02*
o.w. Incoming	541,061	538,720	538,519	538,607	538,608	538,599	179,548	179,511
Growth (%)	*0.1*	*-0.4*	*-0.04*	*0.02*	*0.00*	*-0.00*	*0.0*	*-0.0*
Outgoing	541,723	541,042	540,812	540,896	541,262	541,213	180,452	180,400
Growth %	*-0.1*	*-0.1*	*-0.04*	*0.02*	*0.07*	*-0.01*	*0.0*	*-0.03*

Source: Kenya National Bureau of Statistics and Kenya Pipeline Company Limited

Chapter 4

Global Economy

All the major multilateral institutions, including the International Monetary Fund (IMF), the World Bank and the Organisation for Economic Cooperation and Development (OECD) have predicted stronger global performance in 2017 and 2018 compared to 2016. The IMF projects global growth at 3.6 per cent in 2017 and 3.7 per cent in 2018 up from 3.2 per cent realized in 2016. These forecasts are 0.1 percentage points higher than what the Fund had forecasted in the April and July 2017 World Economic Outlook (WEO). This positive global outlook is explained by strengthening global investments, recovery in international trade and industrial production, easing global monetary conditions, stabilization of commodity prices, and rising business and consumer confidence. Improvements in growth outcomes in the euro area, Japan, China, Eastern Europe and Russia outweigh the marginal declines in growth forecast in the US, UK and India (**Table 4.1**).

Economic activity among the major advanced economies improved in the first half of 2017 and therefore output growth in these economies is projected to improve from 1.7 per cent in 2016 to 2.2 per cent in 2017 and 2.0 per cent in 2018. Strengthening business investment, private consumption and external demand account for the improved performance in these economies. Growth in the United States is expected to increase to 2.2 per cent in 2017 and 2.3 per cent in 2018, from 1.5 per cent in 2016. The projected growth reflects supportive financial conditions and strong business and consumer confidence. The downward revision in October 2017 relative to the April WEO forecast is due to a major correction in US fiscal policy assumptions.

In the Euro Area, the growth is more broad-based driven by rising employment, accommodative monetary policy, reduced political uncertainty and export growth. Thus growth is expected to rise to 2.1 per cent in 2017 from 1.8 per cent in 2016 and then moderate at 1.9 in 2018. Economic activity in the UK is slowing on account of easing consumption, investment and uncertainty over the outcome of Brexit negotiations. Output in Japan is projected to rise to 1.5 per cent in 2017 from 1.0 per cent in 2016. This momentum is attributed to the strengthening of global demand and policy actions to sustain private consumption. However, growth in 2018 is projected to weaken to 0.7 per cent on account of reduced fiscal support, lower private consumption, higher imports and slower growth in foreign demand.

In emerging markets and developing economies, output is projected to grow at 4.6 per cent in 2017 and 4.9 per cent in 2018 from a growth of 4.3 per cent recorded in 2016, reflecting improvement in commodity prices and increased economic growth in commodity dependent economies. Economic activity in China is expected to increase marginally to 6.8 per cent in 2017 from 6.7 per cent in 2016. In 2018, Chinese growth is projected to slow down to 6.5 per cent on account of easing stimulus measures and re-balancing of the economy. The upward revision in 2017 reflects the stronger than expected out turn in the first half of the year underpinned by previous policy easing and supply side reforms. Growth in India is also expected to slow down to 6.7 per cent in 2017 due to persistent disruptions associated with the currency reforms introduced in November 2016, as well as transition costs associated with the launch of the national Goods and Services Tax in July 2017.

Economic activity in Sub-Saharan Africa (SSA) is projected to grow at 2.6 per cent in 2017 and 3.4 per cent in 2018 driven largely by easing macroeconomic challenges, recovery in oil production in Nigeria, easing of drought conditions in Eastern and Southern Africa and improving external commodity demand. Nigeria's economy is projected to grow by 0.8 per cent in 2017 as a result of recovery in oil production, growth in agriculture, and higher public investment. In South Africa, growth is projected to be subdued at 0.7 per cent in 2017 and 1.1 per cent in 2018 largely because of waning consumer and business confidence as a result of heightened political uncertainty.

Table 4.1: **Global Economic Outlook**

REAL GDP GROWTH (%) IMF YEAR OVER YEAR						
			Projections		Difference from July 2017 WEO update	
Country/Region	**2015**	**2016**	**2017**	**2018**	**2017**	**2018**
World Output	**3.4**	**3.2**	**3.6**	**3.7**	**0.1**	**0.1**
Advanced economies	**2.2**	**1.7**	**2.2**	**2.0**	**0.2**	**0.1**
United States	2.9	1.5	2.2	2.3	0.1	0.2
Euro Area	2.0	1.8	2.1	1.9	0.2	0.2
Germany	1.5	1.9	2.0	1.8	0.2	0.2
France	1.1	1.2	1.6	1.8	0.1	0.1
Italy	0.8	0.9	1.5	1.1	0.2	0.1
Spain	3.2	3.2	3.1	2.5	0.0	0.1
Japan	1.1	1.0	1.5	0.7	0.2	0.1
United Kingdom	2.2	1.8	1.7	1.5	0.0	0.0
Emerging market and Developing economies	**4.3**	**4.3**	**4.6**	**4.9**	**0.0**	**0.1**
Russia	-2.8	-0.2	1.8	1.6	0.4	0.2
China	6.9	6.7	6.8	6.5	0.1	0.1
India	8.0	7.1	6.7	7.4	-0.5	-0.3
Brazil	-3.8	-3.6	0.7	1.5	0.4	0.2
Middle East, North Africa, Afghanistan and Pakistan	**2.7**	**5.0**	**2.6**	**3.5**	**0.0**	**0.2**

Source: IMF, World Economic Outlook, October 2017 updated

Downside risks to global economic outlook

Despite the relatively strong global economic outlook outlined above, downside risks do exist. Chief among them is the policy uncertainty in advanced economies arising from threats of escalation of trade restrictions, which could derail recovery in international trade and investment. The prolonged US regulations and fiscal policy uncertainty, the potential adoption of trade restrictions, the outcome of the protracted Brexit negotiations, and the elevated geopolitical risks could dampen global investment and business confidence.

Another potential downside risk relates to financial tensions likely to be triggered by, among other things, less than optimal re-balancing of the Chinese economy, rising debt levels and diminishing fiscal space in many emerging and developing economies. If China does not counter the associated risks by accelerating recent efforts to curb the expansion of credit, these factors could imply a heightened risk of a sharp slowdown in China's growth. A slowdown in Chinese growth could have repercussions to other economies through weaker trade, low commodity prices, and fall in business and consumer confidence.

Normalization of monetary policy in advanced economies, especially in the US could lead to tightening of global financial conditions which could in turn usher in financial market volatilities in emerging and developing economies through capital flow reversals. If these risk materialize, then they could cause a dent on the global economic recovery.

It is important to add that despite the slowdown in both global and Sub-Saharan economies, Kenya's growth has proved resilient and has sustained a strong growth trajectory in the recent past. Kenya's growth is projected at 5.0 per cent and 5.5 per cent in 2017 and 2018, respectively, against a SSA average of 2.6 per cent and 3.4 per cent over the same period. That notwithstanding, if the above downside risks materialize, it could affect external demand which could adversely affect Kenya's external environment.

Chapter 5

Balance of Payments and Exchange Rates

Developments in the Balance of Payments

The current account deficit deteriorated by 7.6 percent to stand at USD 1,405 million in the third quarter of 2017 from USD 1,306 million in the second quarter driven by worsening of the balance on goods and services. The primary and secondary income balances, however, recorded improvement during the third quarter of 2017 (**Table 5.1**).

Table 5.1: Balance of Payments (USD Million)

ITEM			2017**						Q3 2017-Q2 2017	
	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Q3			Total		%
	Q3	Q4	Q1	Q2	Jul	Aug	Sep	Q3	Change	Change
1. Overall Balance	**56**	**569**	**-814**	**-224**	**446**	**222**	**9**	**677**	**902**	**-401.9**
2. Current account	**-1,151**	**-1,184**	**-1,193**	**-1,306**	**-564**	**-502**	**-339**	**-1,405**	**-98**	**7.5**
Exports (fob)	1,407	1,370	1,470	1,453	516	405	492	1,413	**-40**	**-2.8**
Imports (fob)	3,567	3,498	3,979	3,977	1,545	1,342	1,323	4,211	**234**	**5.9**
Services: credit	1,133	1,059	1,270	1,238	477	416	425	1,318	**80**	**6.5**
Services: debit	740	681	783	863	288	324	275	887	**23**	**2.7**
Balance on goods and services	-1,767	-1,750	-2,023	-2,149	-840	-845	-682	-2,366	**-217**	**10.1**
Primary income: credit	110	109	122	130	38	39	39	115	**-15**	**-11.4**
Primary income: debit	269	329	279	372	119	55	141	315	**-57**	**-15.4**
Balance on goods, services, and primary income	-1,926	-1,970	-2,180	-2,391	-921	-861	-784	-2,566	**-175**	**7.3**
Secondary income : credit	784	797	1,000	1,123	360	362	451	1,173	**50**	**4.4**
o.w Remittances	425	447	433	455	153	166	176	495	**40**	**8.8**
Secondary income: debit	10	11	14	39	5	4	5	14	**-25**	**-63.3**
3. Capital Account	**7**	**44**	**96**	**39**	**1**	**8**	**6**	**14**	**-24**	**-62.7**
4. Financial Account	**-284**	**-2,016**	**-2,388**	**-1,267**	**69**	**-81**	**-258**	**-270**	**997**	**-78.7**

** Revised*

***Provisional*

Fob - free on board

Source: Central Bank of Kenya

The Current Account

The current account comprises the balance on goods and services (trade balance) as well as the primary and secondary income balances. During the third quarter of 2017, the trade balance worsened by 10.1 per cent to USD 2,366 million from USD 2,149 million in the second quarter of 2017 reflecting lower exports of goods and an increase in imports (mainly food and oil) (**Table 5.2**).

The value of merchandise exports decreased slightly by 2.8 per cent to USD 1,413 million during the third quarter of 2017 generally reflecting lower global demand for exports of coffee; horticulture; oil products; raw materials and re-exports. However, values of tea, manufactured goods, miscellaneous manufactured articles, chemicals and related products recorded an improvement during the third quarter of 2017. The value of coffee exports decreased by 42.1 per cent to USD 47 million while the value of tea exports increased by 1.1 per cent to USD 351 million supported by higher production volumes due to favorable weather conditions and favorable global tea prices (**Table 5.2**). Horticulture exports decreased by 5.4 per cent to USD 201 million, attributed largely to lower export volumes of cut flowers.

Payments for imports of goods increased by 5.9 per cent to USD 4,211 million from USD 3,977 million largely on account of increased spending on imports of food following the Government duty waiver on imports of maize, oil and chemicals. Food imports increased by 52.9 per cent between quarter two and three of 2017. The 2.5 per cent increase in oil imports in the third quarter of 2017 reflected relatively higher oil prices on the international market attributed to reduced supply by OPEC countries, accelerated pace of inventory declines in the US as well as reduced refinery capacity following the hurricane season. Payments for imports of manufactured goods, machinery and transport equipment also decreased during the quarter.

Net services recorded a 15.2 per cent increase between quarter two and three to stand at USD 432 million in the third quarter of 2017 compared to USD 375 million in the preceding quarter (**Table 5.2**). This was on account of higher inflows from transport and other services. Meanwhile, the deficit in the primary income balance narrowed from USD 242 million to USD 199 million in the third quarter of 2017 on account of lower interest payments on investment income while improvement in the secondary income balance to USD 1,161 million reflected increased workers' remittances.

Table 5.2: Balance On Current Account (USD Million)

ITEM	Jul-Sep	Oct-Dec	2017** Jan-Mar	Apri-Jun	Q3			Total	Q3 2017-Q2 2017	%
	Q3	Q4	Q1	Q2	Jul	Aug	Sep	Q3	Change	Change
CURRENT ACCOUNT	**-1,151**	**-1,184**	**-1,193**	**-1,306**	**-564**	**-502**	**-339**	**-1,405**	**-98**	**7.5**
Goods	**-2,159**	**-2,128**	**-2,509**	**-2,524**	**-1,029**	**-937**	**-831**	**-2,798**	**-274**	**10.9**
Exports (fob)	**1,407**	**1,370**	**1,470**	**1,453**	**516**	**405**	**492**	**1,413**	**-40**	**-2.8**
o.w Coffee	48	44	67	81	19	13	15	47	-34	-42.1
Tea	287	290	345	347	129	90	132	351	4	1.1
Horticulture	194	192	205	213	74	65	62	201	-11	-5.4
Oil products	16	12	13	14	3	4	5	12	-2	-12.9
Manufactured Goods	112	105	98	94	36	29	38	102	9	9.3
Raw Materials	122	131	142	133	39	34	41	115	-19	-14.0
Chemicals and Related Products (n.e.s)	101	98	100	98	39	35	35	110	12	12.0
Miscelleneous Man. Articles	143	145	147	134	57	46	54	157	23	17.3
Re-exports	186	153	153	185	53	43	46	143	-42	-22.6
Other	198	200	199	155	66	46	63	175	20	12.9
Imports (fob)	**3,567**	**3,498**	**3,979**	**3,977**	**1,545**	**1,342**	**1,323**	**4,211**	**234**	**5.9**
o.w Oil	554	588	636	651	236	210	221	667	16	2.5
Chemicals	567	534	621	561	197	186	180	563	3	0.5
Manufactured Goods	695	604	619	671	221	157	237	615	-56	-8.4
Machinery & Transport Equipment	1,134	1,108	1,329	1,179	462	293	351	1,106	-73	-6.2
Machinery	783	793	604	732	275	205	248	728	-4	-0.5
Transport equipment	351	315	94	94	187	88	103	378	284	302.9
Other										
o.w Food	260	305	371	556	267	388	195.3	850	294.3	53.0
Services	**393**	**378**	**487**	**375**	**190**	**92**	**150**	**432**	**57**	**15.2**
Transport Services (net)	**187**	**171**	**200**	**204**	**89**	**56**	**81**	**226**	**22**	**10.7**
Credit	434	395	440	459	186	150	169	504	45	9.8
Debit	247	224	241	255	97	94	87	278	23	9.0
Travel Services (net)	**193**	**208**	**199**	**162**	**55**	**46**	**50**	**151**	**-12**	**-7.2**
Credit	228	230	262	227	78	65	73	216	-11	-5.1
Debit	35	22	62	65	23	19	23	65	0	0.2
Other Services (net)	**12**	**0**	**87**	**8**	**46**	**-10**	**19**	**55**	**47**	**578.2**
Primary Income	**-159**	**-220**	**-157**	**-242**	**-81**	**-16**	**-102**	**-199**	**43**	**-17.6**
Credit	110	109	122	130	38	39	39	115	-15	-11.4
Debit	269	329	279	372	119	55	141	315	-57	-15.4
Secondary Income	**775**	**786**	**987**	**1,085**	**357**	**359**	**445**	**1,161**	**76**	**7.1**
Credit	784	797	1,000	1,123	360	362	451	1,173	50	4.4
Debit	10	11	14	39	4	3	5	12	-27	-69.4

** Revised*

***Provisional*

Fob - free on board

Source: Central Bank of Kenya

Direction of Trade

China remains Kenya's largest source of imports accounting for 20.3 per cent of total imports in quarter three of 2017. However, this is lower than the 24.2 per cent share recorded in preceding quarter. The share of Kenya's imports from the European Union increased marginally to 13.1 per cent during the third quarter of 2017 compared with 13.0 per cent in the second quarter, while that from India decreased to 7.9 per cent from 11.7 per cent over the same period. Imports from Africa accounted for 12.3 per cent during the third quarter of 2017 compared to 12.0 per cent in the second quarter of 2017 (**Table 5.3**).

Table 5.3: Kenya's Direction of Trade: Imports

IMPORTS (USD M)								Share of Imports (%)	
		2017		2017					
	Oct-Dec	Jan-Mar	Apri-Jun	Q3					
Country	**Q4**	**Q1**	**Q2**	**July**	**Aug**	**Sep**	**Q3**	**Q2 2017**	**Q3 2017**
Africa	**397**	**401**	**475**	**168**	**188**	**162**	**518**	**12.0**	**12.3**
Of which									
South Africa	129	136	166	55	56	54	165	4.2	3.9
Egypt	89	89	76	30	29	31	91	1.9	2.2
Others	179	177	234	83	103	77	262	5.9	6.2
EAC	**102**	**106**	**126**	**43**	**41**	**48**	**132**	**3.2**	**3.1**
COMESA	**222**	**211**	**258**	**91**	**111**	**90**	**293**	**6.5**	**7.0**
Rest of the World	**3,101**	**3,578**	**3,501**	**1,377**	**1,155**	**1,161**	**3,693**	**88.0**	**87.7**
Of which									
India	503	463	466	99	104	128	331	11.7	7.9
United Arab Emirates	210	222	284	172	140	158	471	7.1	11.2
China	872	1,098	962	367	211	277	855	24.2	20.3
Japan	191	183	211	81	53	55	189	5.3	4.5
USA	97	140	156	60	34	36	130	3.9	3.1
United Kingdom	89	71	73	22	23	26	71	1.8	1.7
Singapore	13	21	8	2	2	3	7	0.2	0.2
Germany	99	85	104	56	24	52	132	2.6	3.1
Saudi Arabia	224	352	225	72	98	25	194	5.7	4.6
Indonesia	109	153	123	54	50	53	157	3.1	3.7
Netherlands	45	37	38	31	16	23	71	1.0	1.7
France	48	56	84	19	27	22	68	2.1	1.6
Bahrain	43	24	26	9	4	4	16	0.6	0.4
Italy	68	62	52	21	22	16	58	1.3	1.4
Others	489	612	688	312	347	284	943	17.3	22.4
Total	**3,498**	**3,979**	**3,977**	**1,545**	**1,342**	**1,323**	**4,211**	**100.0**	**100.0**
EU	491	444	517	217	149	186	552	13.0	13.1
China	872	1,098	962	367	211	277	855	24.2	20.3

Source: Kenya Revenue Authority

Kenya's exports to Africa increased by 5.2 per cent in the third quarter of 2017 and as a share of total exports, this represents 38.4 percent, an improvement compared with 35.5 per cent in the second quarter (**Table 5.4**). The increase was largely in exports to the EAC (Uganda, Rwanda and Tanzania) and COMESA regions. Exports to the rest of the world, however, decreased by 7.2 per cent. The share of exports to China decreased to 1.1 per cent during the third quarter of 2017, while that to the European Union decreased to 19.9 per cent from 21.1 per cent during the second quarter of 2017.

Table 5.4: Kenya's Direction Of Trade: Exports

EXPORTS (USD M)								Share of Exports (%)	
		2017		2017					
	Oct-Dec	Jan-Mar	Apr-Jun	Q3					
Country	**Q4**	**Q1**	**Q2**	**July**	**Aug**	**Sep**	**Q3**	**Q2 2017**	**Q3 2017**
Africa	**557**	**564**	**516**	**191**	**157**	**194**	**543**	**35.5**	**38.4**
Of which									
Uganda	155	163	140	52	43	56	151	**9.6**	**10.7**
Tanzania	82	75	53	22	25	26	73	**3.7**	**5.1**
Egypt	35	42	35	13	12	22	47	**2.4**	**3.3**
Sudan	13	13	17	5	5	4	14	**1.2**	**1.0**
South Sudan	40	45	47	17	7	11	35	**3.3**	**2.5**
Somalia	53	58	46	18	13	13	44	**3.1**	**3.1**
DRC	51	48	45	16	13	15	44	**3.1**	**3.1**
Rwanda	44	37	41	18	13	16	48	**2.9**	**3.4**
Others	83	82	93	31	27	31	88	**6.4**	**6.2**
EAC	**298**	**293**	**257**	**98**	**88**	**105**	**290**	**17.7**	**20.5**
COMESA	**359**	**364**	**349**	**125**	**105**	**137**	**368**	**24.0**	**26.0**
Rest of the World	**813**	**906**	**937**	**325**	**248**	**297**	**870**	**64.5**	**61.6**
Of which								**0.0**	
United Kingdom	85	97	88	35	28	30	93	**6.1**	**6.6**
Netherlands	99	119	111	31	26	33	89	**7.7**	**6.3**
USA	109	105	121	49	39	38	127	**8.3**	**9.0**
Pakistan	124	151	146	59	39	55	152	**10.0**	**10.8**
United Arab Emirates	63	52	78	22	12	22	56	**5.4**	**4.0**
Germany	27	33	34	8	6	7	21	**2.4**	**1.5**
India	18	16	13	5	4	5	14	**0.9**	**1.0**
Afghanistan	4	7	11	5	1	3	9	**0.7**	**0.6**
Others	285	325	334	111	93	105	310	**23.0**	**21.9**
Total	**1,370**	**1,470**	**1,453**	**516**	**405**	**492**	**1,413**	**100.0**	**100.0**
EU	280	334	307	103	85	93	281	**21.1**	**19.9**
China	31	24	39	5	4	7	15	**2.7**	**1.1**

Source: Kenya Revenue Authority

Capital and Financial Account

The capital account surplus narrowed by USD 24 million in the third quarter of 2017 to USD 15 million from USD 39 million in the previous quarter of 2017, reflecting a decrease in inflows of capital transfers in form of project grants.

During the quarter under review, inflows to the financial account decreased by 79 per cent to USD 270 million, from USD 1,267 million in quarter two of 2017 (**Table 5.5**). The decrease was reflected in 'other investment' liabilities which decreased to USD 467 million from USD 1,476 million in the previous quarter. Lower inflows of 'other liabilities' reflected lower net incurrence of liabilities by Government; commercial loans; and debt repayment.

Meanwhile over the same period, resident investors decreased their holdings of foreign direct investment and foreign portfolio investments to USD 33 million and USD 268 million, respectively. Resident holdings of 'other' foreign investments however, increased to USD 41 million reflecting increase in net foreign assets by commercial banks.

Table 5.5: Balance on Capital and Financial Account (USD Million)

ITEM			2017**						Q2 2017-Q1 2017	
	Jul-Sep	Oct-Dec	Jan-Mar		Q3			Total		%
	Q3	Q4	Q1	Q2	July	August	September	Q3	Change	Change
Capital account credit	**7**	**44**	**96**	**39**	**1**	**8**	**6**	**15**	**-24**	**-61**
Capital account credit	7	44	96	39	1	8	6	15	-24	-61
Capital account: debit					0	0	0			
Financial Account	**-284**	**-2,016**	**-2,122**	**-1,267**	**69**	**-81**	**-258**	**-270**	**997**	**-79**
Direct investment: assets	41	50	59	82	14	11	8	33	-49	-60
Direct investment: liabilities	72	97	156	134	37	43	56	136	2	2
Portfolio investment: assets	162	157	227	254	86	83	99	268	14	6
Portfolio investment: liabilities	12	7	6	4	3	2	4	9	5	134
Financial derivatives: net										
Other investment: assets	183	-374	406	11	15	57	-31	41	30	287
Other investment: liabilities	587	1,746	2,652	1,476	6	186	275	467	-1,009	-68

** Revised*

***Provisional*

Source: Central Bank of Kenya

Foreign Exchange Reserves

The banking system's total foreign exchange holdings decreased by 5.9 per cent during the third quarter of 2017. Official reserves held by the Central Bank constituted 76 per cent of gross reserves and stood at USD 7,899 million, equivalent to 5.3 months of import cover **(Table 5.5).** Meanwhile, the Precautionary Arrangements with the IMF amounting to USD 1,500 million continued to provide additional buffer against short term external and domestic shocks.

Table 5.6: Foreign Exchange Reserves and Residents' Foreign Currency Deposits (End of Period, USD Million)

`	2016			2017					
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apri-Jun				
	Q2	Q3	Q4	Q1	Q2	Jul	Aug	Sep	Q3
1. Gross Reserves	**10,499**	**10,602**	**9,587**	**10,786**	**10,984**	**10,550**	**10,378**	**10,332**	**10,332**
of which:									
Official	8,267	8,200	7,573	8,379	8,580	8,135	7,910	7,899	7,899
*import cover**	*5.4*	*5.4*	*5.0*	*5.5*	*5.7*	*5.4*	*5.3*	*5.3*	*5.3*
Commercial Banks	2,232	2,402	2,015	2,407	2,405	2,415	2,468	2,433	2,433
2. Residents' foreign currency deposits	**4,443**	**4,723**	**4,323**	**4,503**	**4,733**	**4,871**	**4,896**	**5,021**	**5,021**

*Based on 36 month average of imports of goods and non-factor services

Source: Central Bank of Kenya

Exchange Rates.

The foreign exchange market has remained relatively steady during the third quarter of 2017, which was largely supported by resilient inflows from diaspora remittances, tourism receipts, tea and horticulture exports. The shilling depreciated marginally by 0.16 per cent against the US Dollar to exchange at an average of 103/52 during the third quarter compared with 103.39 in the second quarter. The Kenya Shilling also depreciated against other major international currencies when compared to its performance during the second quarter of 2017 (**Table 5.6 and Chart 5.1**). The weakening of the Kenya Shilling against the US Dollar over the review period was influenced by domestic and international factors notably an increase in dollar demand mainly from local importers and positive sentiment surrounding strong US economic data.

In the EAC region, the Kenya Shilling strengthened against the Tanzania Shilling and the Burundi Franc but weakened against the Uganda Shilling and the Rwanda Franc during the period under review.

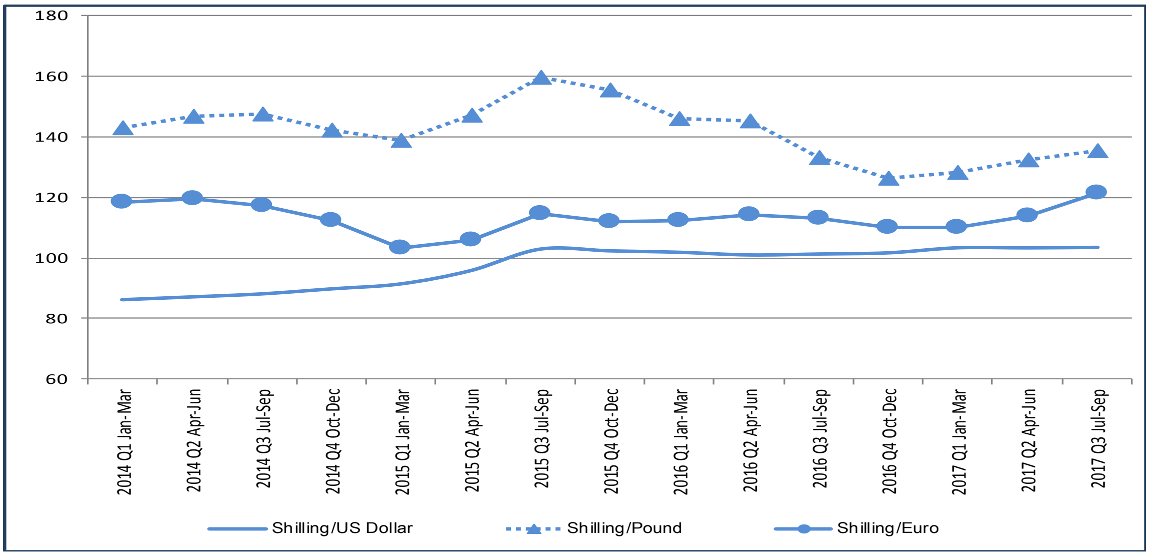
Table 5.7: Kenya Shilling Exchange Rate

	2016			2017		2017			2017	
	Q2	Q3	Q4	Q1	Q2	July	August	September	Q3	% change Q3 2017 - Q2 2017
US Dollar	101.04	101.34	101.73	**103.39**	**103.36**	103.88	103.56	103.12	**103.52**	**0.16**
Pound Sterling	145.12	133.14	126.45	**128.05**	**132.22**	134.86	134.24	137.09	**135.40**	**2.40**
Euro	114.16	113.11	109.89	**110.12**	**113.75**	119.40	122.24	122.86	**121.50**	**6.82**
100 Japanese Yen	93.58	99.00	93.50	**90.95**	**92.98**	92.30	94.30	93.23	**93.28**	**0.32**
Uganda Shilling*	33.18	33.32	34.68	**34.79**	**34.94**	34.67	34.82	34.91	**34.80**	**-0.41**
Tanzania Shilling*	21.69	21.58	21.44	**21.57**	**21.63**	21.55	21.62	21.75	**21.64**	**0.03**
Rwanda Franc*	7.55	7.56	7.83	**7.99**	**8.04**	7.97	8.01	8.07	**8.02**	**-0.35**
Burundi Franc*	15.61	16.47	16.49	**16.35**	**16.56**	16.66	16.79	16.92	**16.79**	**1.40**

** Units of currency per Kenya Shilling*

Source: Central Bank of Kenya

Chart 5.1: Kenya Shilling Exchange Rate



Source: Central Bank of Kenya

Chapter 6

The Banking Sector

Structure of the Banking Sector

1. Introduction

The Kenyan banking sector comprised 42 Commercial Banks, 1 Mortgage Finance Company, 13 Microfinance Banks, 8 Representative Offices of Foreign Banks, 74 Foreign Exchange Bureaus, 18 Money Remittance Providers and 3 credit reference bureaus as at September 30, 2017. During the period, the key developments include acquisition of Habib Bank Limited by Diamond Trust Bank, licensing of Société Générale of France to open a representative office in Kenya and the licensing of Airtel Money Transfers Limited as a money remittance provider. Chart 6.1 shows the structure of the Kenyan banking sector as at the end of the last two quarters.

2. Structure of the Balance Sheet

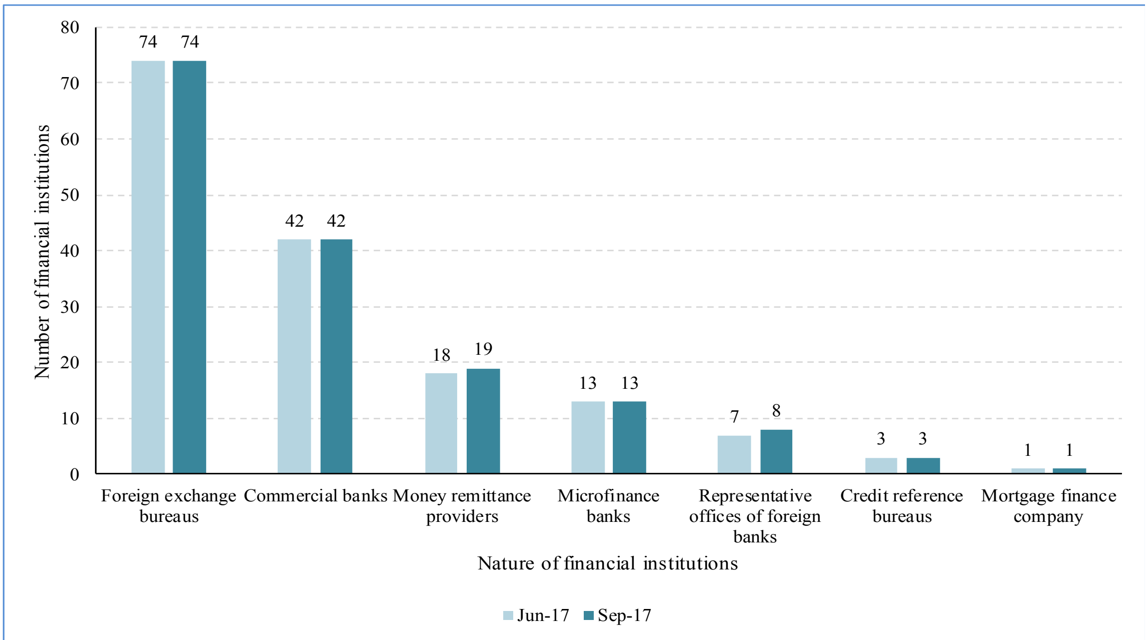
i) Growth in banking sector assets

Total net assets increased by 4.8 per cent from KSh 3,951.6 billion in the second quarter of 2017 to KSh 4,140.1 billion in the third quarter of 2017. This increase was attributable to increased investment in government securities, and loans and advances by 1.7 per cent and 1.6 per cent, respectively. Loans and advances remained the main component of assets accounting for 55 per cent in the third quarter of 2017, which was a slight decrease from 56 per cent recorded in the second quarter of 2017.

ii) Loans and Advances

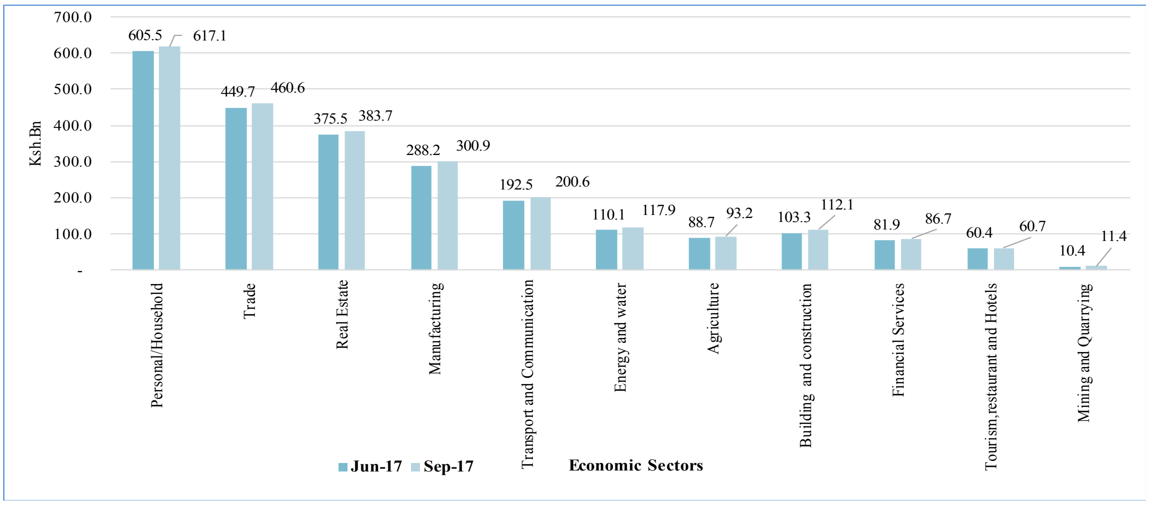
Total banking sector lending increased by 0.44 per cent, from KSh 2,380.0 billion in the second quarter of 2017 to KSh 2,390.4 billion in the third quarter of 2017. The increase in gross loans and advances was mainly attributed to increased lending to Mining and Quarry, Building and Construction, and Energy and Water sectors. The sectoral distribution of gross loans as at September 30, 2017 is highlighted in **Chart 6.2**.

Chart 6.1: Structure of the Banking Sector in Kenya



Source: Central Bank of Kenya

Chart 6.2: Gross Loans of the Banking Sector by Economic Sector



Source: Central Bank of Kenya

Mining and Quarrying sector recorded the highest increase of 10 per cent in lending, followed by Building and Construction sector with an increase of 8.6 per cent and Energy and Water sector with an increase of 7.0 per cent between the second and third quarters of 2017. The changes in sectoral gross loans between second and third quarters of 2017 are depicted in **Chart 6.2**. All the economic sectors recorded increases in lending between second and third quarter of 2017.

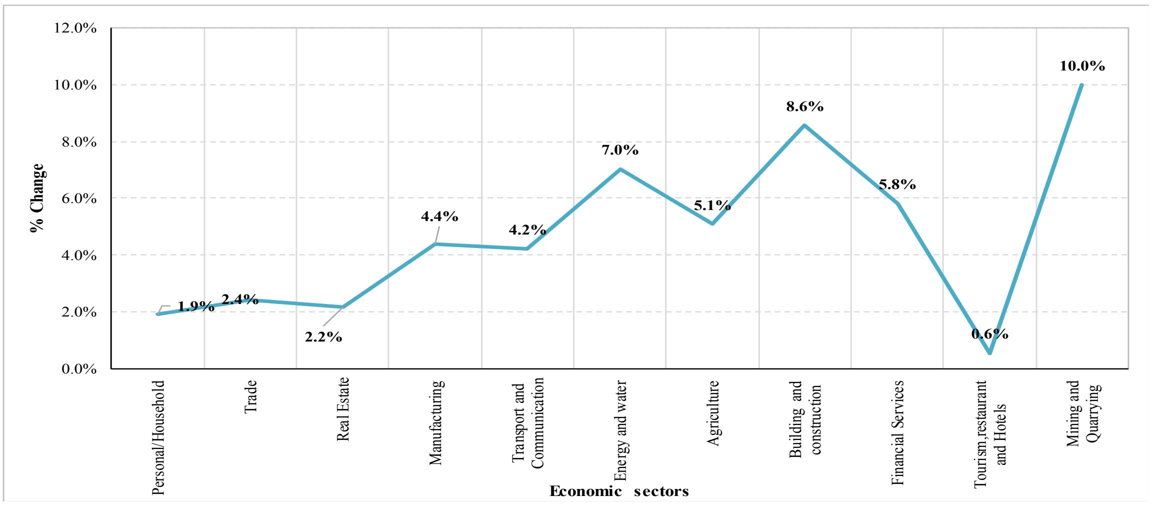
iii) Deposit Liabilities

Customer deposits remain the main source of funding to the banks and accounted for 71.9 per cent of the banking sector total liabilities and shareholders' funds as at the end of the third quarter of 2017. This was a slight decrease from 72.3 per cent recorded as at end of the second quarter of 2017. The customer deposit base increased slightly by 0.02 per cent from KSh 2,977.6 billion in the second quarter of 2017 to KSh 2,978.2 billion in the third quarter of 2017. The increase in customer deposit base was mainly as a result of increase in foreign currency deposits made by oil supply companies, telecommunication companies and government agencies. **Chart 6.4** shows the movement in deposit liabilities between the second and the third quarter of 2017.

3. Capital Adequacy

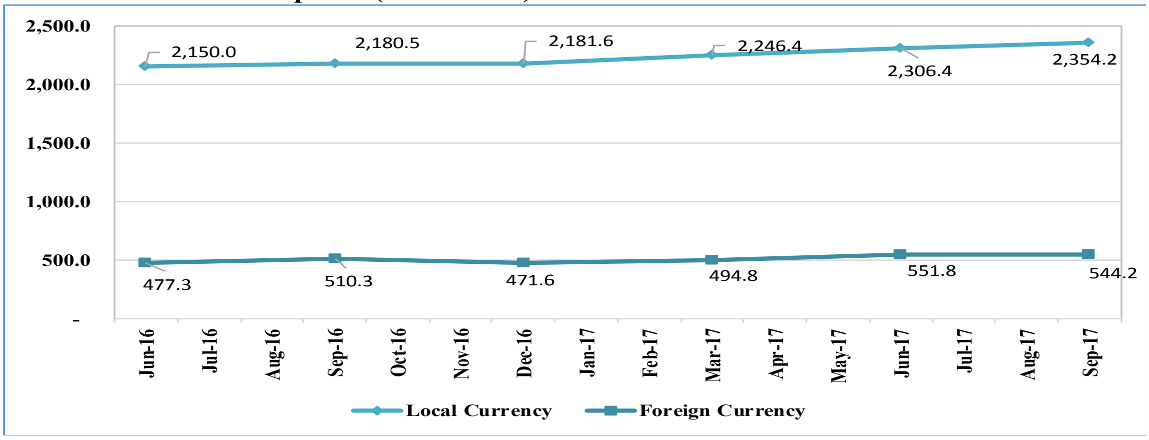
Kenya's banking sector is well capitalized and meets the minimum capital requirements:-

Chart 6.3: Quarterly Changes in Gross Loans in the First Quarter of 2017



Source: Central Bank of Kenya

Chart 6.4 **Customer Deposits (Ksh Billion)**



Source: Central Bank of Kenya

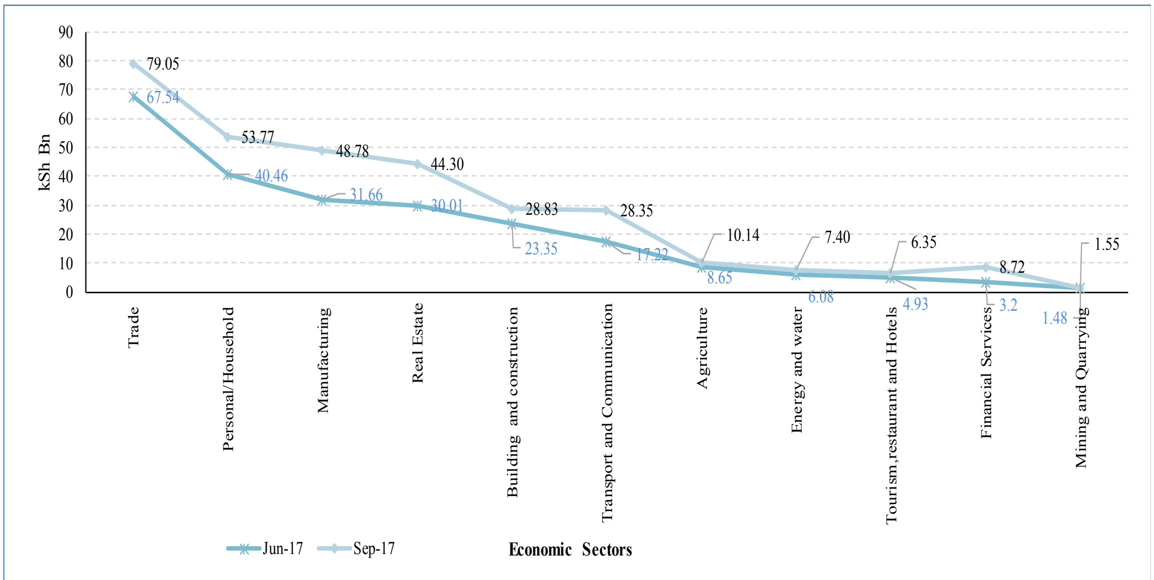
- Core capital increased slightly by 1.2 per cent from KSh 526.4 billion in the second quarter of 2017 to KSh 532.7 billion in the third quarter of 2017.
- Total capital increased slightly by 0.29 per cent from KSh 613.2 billion to KSh 615.0 billion, over the same period
- Core capital to total risk-weighted assets ratio decreased from 16.8 per cent as at the second quarter of 2017 to 16.2 per cent as at the third quarter of 2017.
- Total capital to total risk-weighted assets ratio decreased from 19.6 per cent as at the second quarter of 2017 to 18.8 per cent as at the third quarter of 2017.

o The decrease in capital ratios was as a result of a higher increase in total risk-weighted assets as compared to the increase in both core and total capital.

- The core capital to total deposits ratio as at the end of the third quarter of 2017 increased to 22.1 per cent from 21.8 per cent in the second quarter of 2017. This is as a result of a lower increase in deposits (0.02 percent) as compared to a1.2 per cent increase in core capital.

Banks are required to maintain a core capital to total deposits ratio of not less than 8 per cent. As at the end of the second quarter of 2017, this ratio decreased to 18.4 per cent from 19.2 per cent registered in the first quarter of 2017.

Chart 6.5: **Kenyan Banking Sector Gross Non-Performing Loans**



Source: Central Bank of Kenya

4. Asset Quality

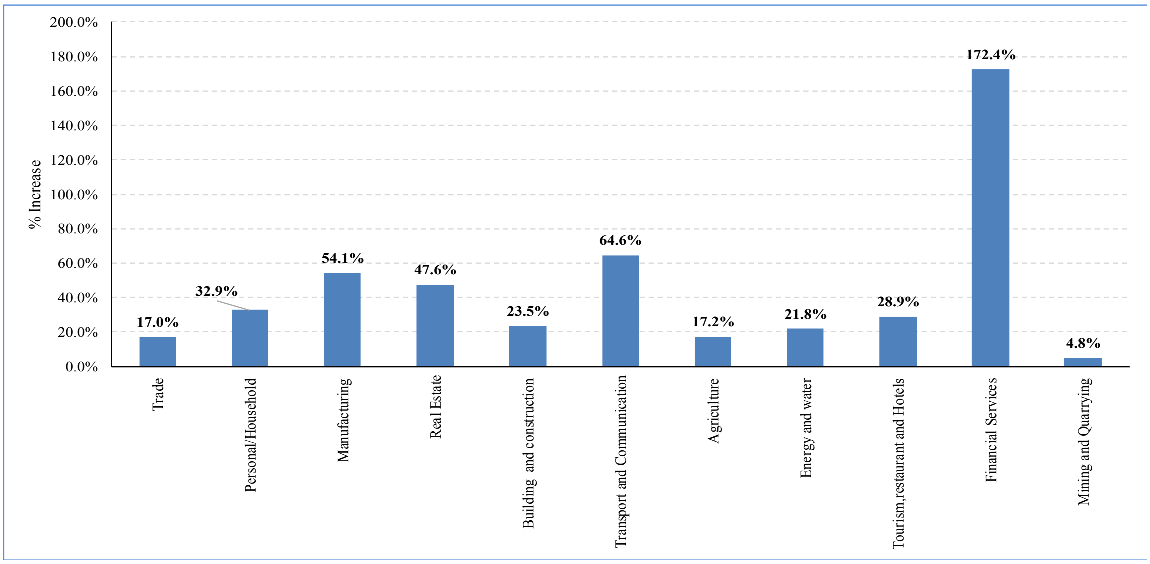
The gross non-performing loans (NPLs) increased by 6.3 per cent from KSh 234.9 billion as at the end of the second quarter of 2017 to KSh 249.7 billion at the end of the third quarter of 2017.

All the economic sectors recorded increases in the NPLs between the second quarter of 2017 and third quarter of 2017 as shown in **Chart 6.5**.

Financial services sector registered the highest increase in NPLs of 172.4 per cent (KSh 552 million) between second and third quarter of 2017. This was attributed to business cash flow challenges due to low turnovers as a result of a challenging business environment, which affected the serviceability of loans during the period under review.

Transport and communication sector registered an increase in NPLs of 64.6 per cent (KSh 1,130 million) due to slow down in business which led to delayed and partial loan re-payments.

Chart 6.6: Movement in Gross NPLs - Second and Third Quarter of 2017



Source: Central Bank of Kenya

The banking sector's asset quality, as measured by the proportion of net non-performing loans to gross loans, deteriorated slightly from 4.8 per cent in the second quarter of 2017 to 5.6 per cent in the third quarter of 2017.

The coverage ratio, which is measured as a percentage of specific provisions to total NPLs, recorded a decrease, from 38.4 per cent in second quarter of 2017 to 34.5 per cent in the third quarter of 2017 due to a decrease in specific provisions.

A summary of asset quality for the banking sector over the period is provided in **Table 6.1**.

Table 6.1: **Summary of Asset Quality**

		June-17, KSh Billion	Sept-17, KSh Billion
1	Gross Loans and Advances (KSh'Bn)	2,366.1	2,390.4
2	Interest in Suspense (KSh'Bn)	49.9	43.6
3	Loans and advances (net of interest suspended) (KSh'Bn)	2,316.2	2,346.8
4	Gross non-performing loans (KSh'Bn)	234.6	249.7
5	Specific Provisions (KSh'Bn)	71.0	71.2
6	General Provisions (KSh'Bn)	20.5	21.3
7	Total Provisions (5+6) (KSh'Bn)	91.5	92.5
8	Net Advances (3-7) (KSh'Bn)	2,224.7	2,254.4
9	Total Non-Performing Loans and Advances (4-2) (KSh'Bn)	184.7	206.1
10	Net Non-Performing Loans and Advances (9-5) (KSh'Bn)	113.7	134.9
11	Total NPLs as percent of Total Advances (9/3)	0.08	0.09
12	Net NPLs as percent of Gross Advances (10/1)	0.05	0.06
13	Specific Provisions as percent of Total NPLs (5/9)	0.38	0.35

Source: Central Bank of Kenya

5. Profitability

i) Profit and Loss

The banking sector registered a decline in performance, pre-tax profits declined by 0.19 per cent from KSh 35.1 billion in the second quarter of 2017 to KSh 29.6 billion in the third quarter of 2017. The decrease in profitability is attributed to a decrease in income by 9.2 percent, while expenses increased by 4.5 percent.

ii) Income

Total income for the banking sector dropped by 9.2 per cent from KSh 120.7 billion in the second quarter to KSh 109.6 billion in the third quarter of 2017. The decrease in income was largely attributed to decrease in interest from investment in government securities and loans and advances which decreased by 5.8 per cent and 9.0 per cent, respectively.

Interest income on loans and advances, interest on government securities and other incomes were the major sources of income accounting for 54.2 percent, 20.9 per cent and 18.1 per cent of total income respectively. On the other hand, interest on deposits, salaries and wages, and other expenses were the key components of expenses, accounting for 30.8 percent, 25.6 per cent and 22.4 per cent of total expenses respectively.

The return on assets (ROA) decreased from 2.8 per cent to 2.6 per cent in the third quarter of 2017. Return on equity (ROE) decreased from 22.3 per cent to 20.6 per cent over the same period. The decrease in ROA and ROE were as a result of decreased profitability between the two quarters.

6. Liquidity

The banking sector's overall liquidity ratio increased from 44.7 per cent in the second quarter of 2017 to 45.4 per cent recorded in the third quarter of 2017. This is evidenced by a 0.4 per cent decrease in loans to deposit ratio from 82.9 per cent in the second quarter of 2017 to 82.5 per cent in the third quarter of 2017. The banking sector liquidity ratio recorded was above the minimum statutory level of 20 percent.

7. Outlook of the Sector

The banking sector is projected to remain stable and maintain an upward growth trend in the near term. The growth momentum will be underpinned by on-going efforts by the Central Bank of Kenya and National Treasury to ensure a stable macro-economic environment.

KENYA SHILLING FLOWS IN KEPSS

Kenya Electronic Payments and Settlement System (KEPSS) used for large value Real Time Gross Settlement (RTGS) payments moved a volume of 1.03 million transaction messages worth KSh 7.4 trillion in the third quarter of 2017, compared to the second quarter of 2017 which recorded 1.16 million transactions worth KSh 7.2 trillion. Volume decreased by 11.21 per cent and value increased by 2.78 per cent, respectively. **Chart 6.7** below highlights recent trends in KEPSS transactions.

Bank Customer Payments Processed through KEPSS

In transmitting payments through the RTGS for customers, commercial banks submit the payment instructions vide multiple third party Message Type (MT 102) used for several credit transfers and single third party Message Type (MT 103) used for single credit transfers.

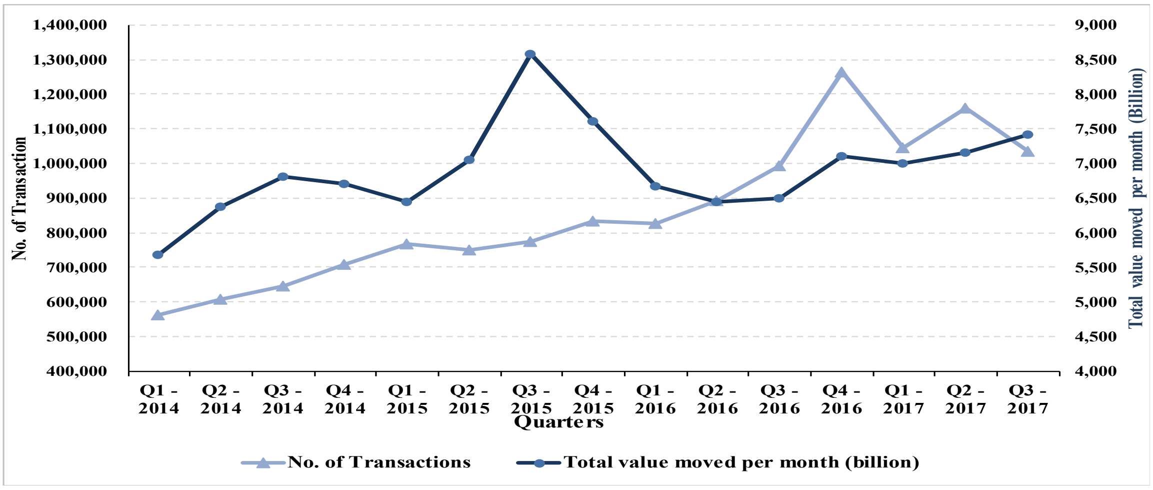
During the period under review, MT 102 usage decreased by 46.01 per cent, to 26,654 messages recorded in the third quarter of 2017 from 49,364 messages processed in the previous quarter. The MT 103 payments decreased by 3.92 per cent, to 1,052,828 messages from 1,095,797 messages in the previous quarter (**Chart 6.8**).

System Availability

The KEPSS system is available to the commercial banks and other participants for 8 hours per day. The system runs from 8.30 AM to 4.30 PM but the operating time can be extended to enable participants settle their obligations and fund their accounts.

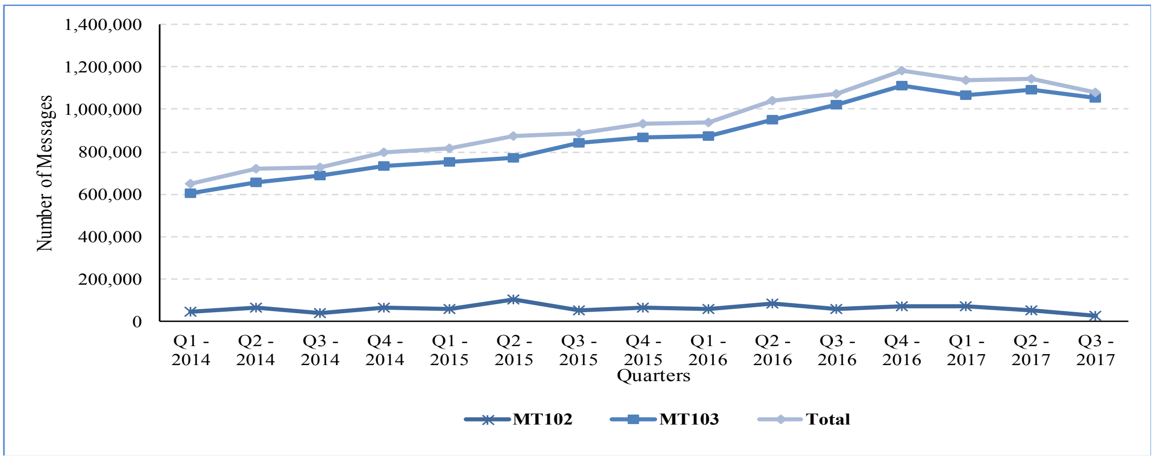
During the quarter under review, KEPSS availability maintained an average 99.97 per cent during the period under review.

Chart 6.7: Trends in Monthly Flows Through KEPSS



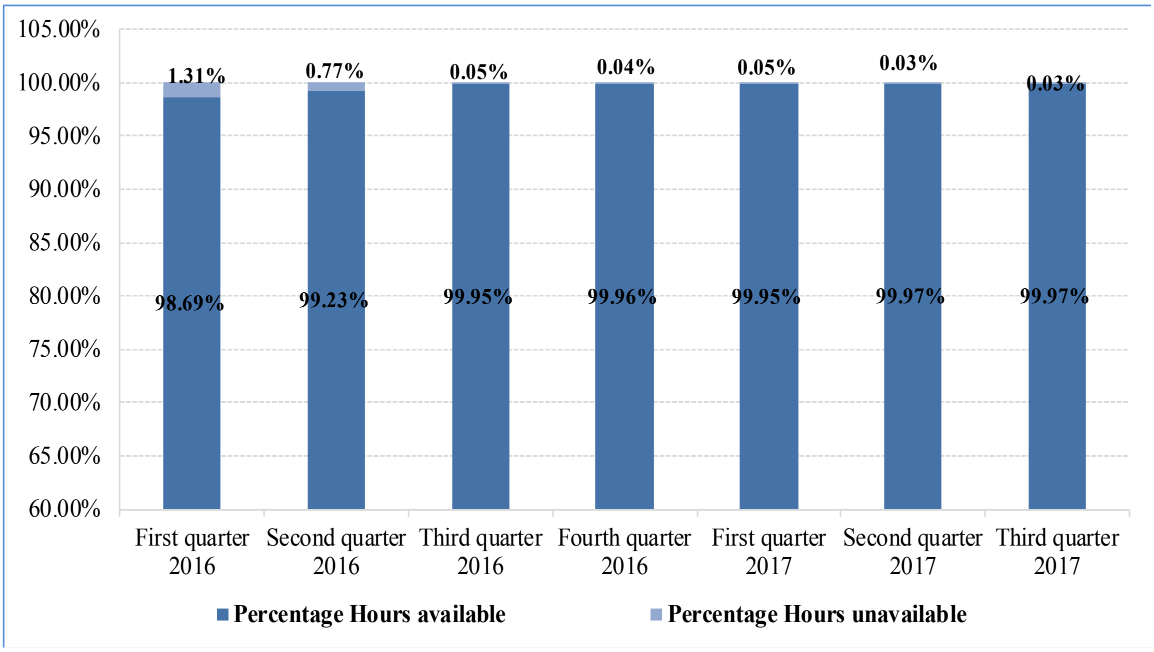
Source: Central Bank of Kenya

Chart 6.8: Trends in MT102 and MT103 Volumes Processed Through KEPSS



Source: Central Bank of Kenya

Chart 6.9: Availability of KEPSS in Kenya (%)



Source: Central Bank of Kenya

Chapter 7

Government Budgetary Performance

The government's budgetary operations improved in the first quarter of FY 2017/18 with a lower deficit of 0.7 per cent of GDP compared with a deficit of 1.0 per cent of GDP in the first quarter of FY 2016/17 (**Table 7.1**). The deficit was within the target of 0.6 per cent of GDP. The total revenues and grants for the quarter were 12.9 per cent below the target and the shortfall in total expenses and net lending 9.5 per cent below target.

Table 7.1: Statement of Government Operations in FY 2016/17 (KSh Billion)

	(FY 2016/17)		(FY 2017/18)					Over (+) /	%
	Q1	Cumulative to June '2017	July	Aug	Sept	Q1	Target	Below (-) Target	Variance
1. TOTAL REVENUE & GRANTS	**315.1**	**1,426.9**	**95.5**	**110.2**	**145.4**	**347.2**	**398.8**	**(51.6)**	**(12.95)**
Ordinary Revenue	294.5	1,305.8	**87.9**	**101.8**	**131.2**	**320.9**	**350.8**	**(29.9)**	
Tax Revenue	286.8	1,219.5	87.8	100.0	129.7	317.4	344.8	(27.4)	
Non Tax Revenue	7.7	86.3	0.1	1.8	1.6	3.5	6.1	(2.5)	
Appropriations-in-Aid	19.2	94.8	7.5	6.8	9.6	24.6	37.2	(12.6)	
External Grants	**1.5**	**26.3**	0.1	1.6	4.6	1.6	10.8	(9.2)	
2. TOTAL EXPENSES & NET LENDING	387.6	2,110.0	**84.0**	**145.5**	**147.0**	**412.3**	**455.6**	**(43.4)**	**(9.52)**
Recurrent Expenses	237.7	1,179.5	69.5	117.9	109.8	299.9	292.8	7.2	
Development Expenses	94.6	639.8	5.7	18.5	33.4	90.7	88.1	2.5	
County Transfers	**55.3**	**284.7**	8.8	9.1	2.5	20.4	73.5	(53.1)	
Others	-	**6.0**	-	-	**1.3**	**1.3**	**1.3**	0.0	
3. DEFICIT (INCL. GRANTS) (1-2)	(72.5)	(683.1)	**11.5**	**(35.3)**	**(1.6)**	**(65.1)**	**(56.8)**	**(8.3)**	**14.59**
As percent of GDP	**(1.0)**	**8.9**	0.1	(0.4)	(0.0)	(0.7)	(0.6)	(0.1)	
4. ADJUSTMENT TO CASH BASIS	**(16.3)**	-	-	-	-	**8.0**	-	**8.0**	
5. DEFICIT INCL .GRANTS ON A CASH BASIS	(88.8)	(683.1)	**11.5**	**(35.3)**	**(1.6)**	**(57.2)**	**(56.8)**	**(0.3)**	
As percent of GDP	(1.2)	8.9	0.1	(0.4)	(0.0)	(0.6)	(0.6)	(0.0)	
6. DISCREPANCY: Expenditure (+) / Revenue (-)		**14.2**	-	-	-	-	-	-	
7. FINANCING	88.8	697.3	**1,801.7**	**(1,760.2)**	**3.6**	**57.2**	**56.8**	**0.3**	**0.58**
Domestic (Net)	49.4	309.8	1,801.8	(1,761.4)	1.8	49.2	39.3	9.9	
External (Net)	39.2	385.7	(3.9)	4.5	1.8	7.5	17.0	(9.6)	
Capital Receipts (domestic loan receipts)	-	**1.8**	-	-	-	-	-	-	
Others	**0.2**	**0.0**	**3.8**	**(3.3)**	-	0.5	0.5	0.1	

GDP figures from the Budget Review and Outlook Paper (BROP)-September 2017

Sources: The National Treasury

Revenue

Government receipts comprising revenue and grants amounted to KSh 347.2 billion or 3.9 per cent of GDP, in the first quarter of FY 2017/18. All revenue components and grants fell below target during the quarter. Tax revenue which is the largest component stood at KSh 317.4 billion (3.6 per cent of GDP) and was KSh 27.4 billion below the target set or the first quarter of FY 2017/18. The tax revenue for the quarter under review was however, 10.7 percent higher than in the first quarter of FY 2016/17. The increase reflected improved performance in import duty, income tax and VAT on imports.

External grants for the first quarter of the FY 2017/18 stood at KSh 1.6 billion, which was KSh 9.2 billion lower than expected due to slow absorption of donor funds.

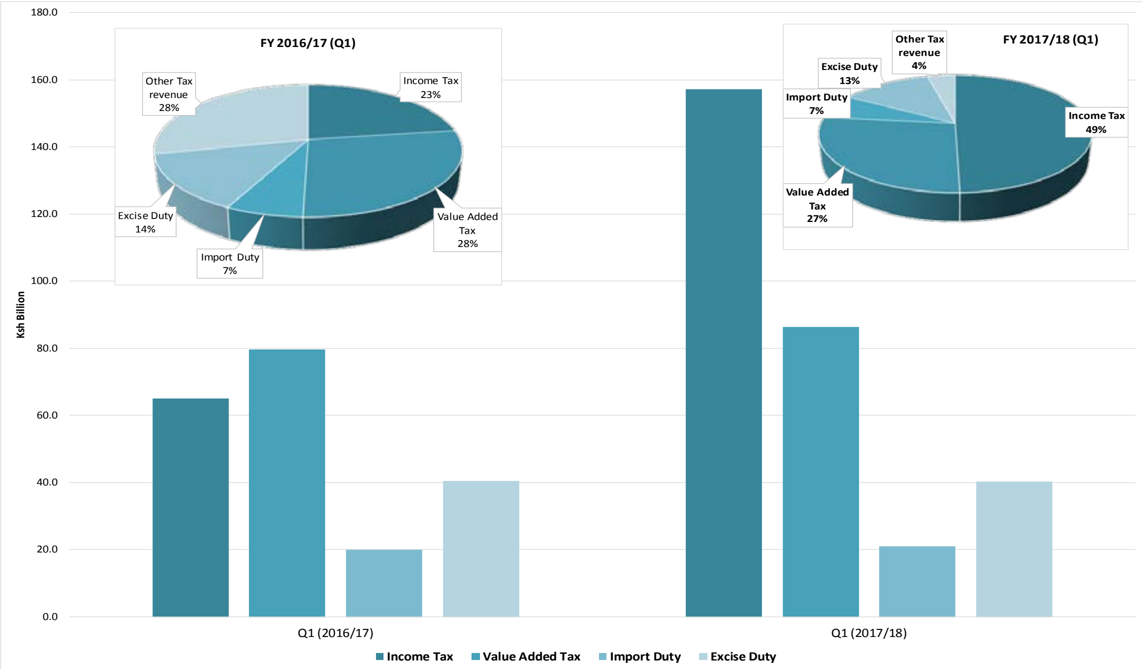
Meanwhile, ministerial Appropriations in Aid (A-in-A) collected during the first quarter of FY 2017/18 amounted to KSh 24.6 billion, which was KSh 12.6 billion (33.8 percent) lower than target due to under reporting in ministry expenditure returns. Ministerial A-in-A collections were also low in the first quarter of FY 2016/17 for similar reasons.

Income tax, import duty and VAT performed below their respective targets (**Chart 7.1**). As observed in previous years, the collection of revenues is usually slow at the start of the fiscal year. The outlook for revenue has been revised downwards cognizant of the challenges of prolonged drought and a repeat Presidential election, which affected revenue collection in the first quarter

Expenditure and Net Lending

Government expenditure and net lending in the first quarter of the FY 2017/18 stood at KSh 412.3 billion (4.7 per cent of GDP) compared to 455.6 billion (5.2 per cent of GDP) target. The

Chart 7.1: Composition of Government Revenue (Ksh Billion)



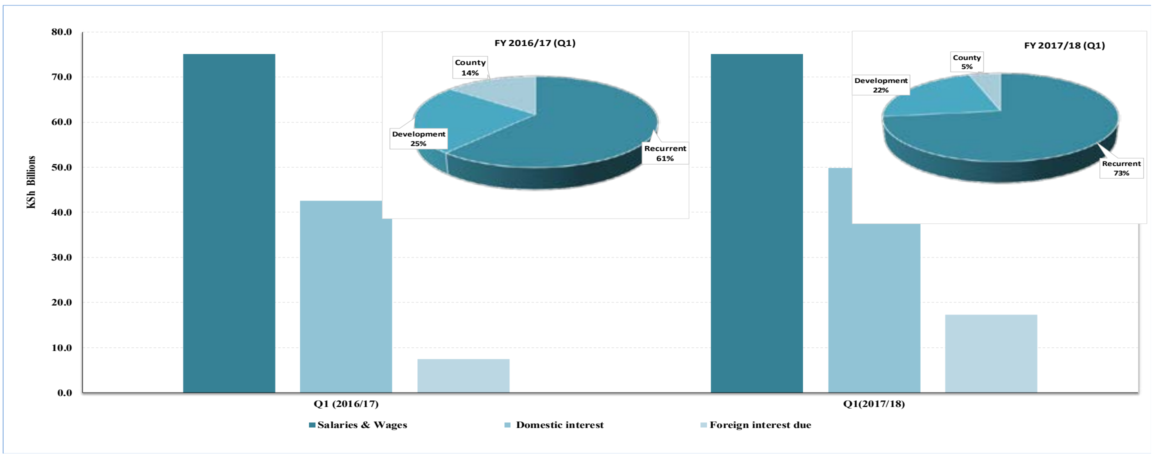
Source: The National Treasury

shortfall of KSh 43.4 billion can be attributed to lower absorption recorded in both county expenditures and development expenditures. Expenditures in the first quarter under review, were 6.4 per cent higher than the outlay in a similar quarter in the FY2016/17

In terms of broad categories of expenditure, recurrent exceeded target by KSh 7.2 billion (2.4 percent) in the first quarter of FY 2017/18, while domestic interest payments at KSh 49.9 billion were 17.3 percent higher than KSh 42.5 billion in a similar quarter in the FY 2016/17. Foreign interest payments which stood at KSh 17.3 billion were also 133.3 percent higher than KSh 7.4 billion paid in the first quarter of the FY 2016/17 (**Chart 7.2**), indicating that the cost of debt service have risen both for domestic and external debt. Development expenditure was above target by KSh 2.5 billion.

With respect to composition, the share of recurrent expenditure in total government spending dominated at 72.7 per cent in the first quarter, while the contribution of development expenditure to total government expenditure 22.0 per cent. Development expenditures were largely channeled to infrastructure and energy and petroleum ministries for implementation of key infrastructure projects. County transfers constituted 5.0 per cent of government spending (**Table 7.1**).

Chart 7.2: Composition of Recurrent Expenses



Sources: The National Treasury

Table 7.2 Domestic Financing Ending June 30, 2017

	NET CREDIT TO GOVERNMENT (Ksh Bn)						
	2016/17				2017/18		
	Q1	Q2	Q3	Q4			Q1
	Sep-16	Dec-16	Mar-17	Jun-17	Jul-17	Aug-17	Sep-17
1. From CBK	(24.6)	37.8	35.8	(22.4)	57.9	60.9	8.3
2.From commercial banks	37.4	18.9	12.5	169.5	(3.8)	(14.8)	12.6
4.From Non-banks	37.5	106.8	132.4	160.7	2.6	14.2	26.3
5. From Non-Residents	(0.9)	1.1	1.4	1.9	0.4	1.0	1.9
Change in Credit from banks (From 30th June 2016)	12.8	56.7	48.4	147.2	54.0	46.1	20.9
Change in Credit from non-banks(From 30th June 2016)	37.5	106.8	132.4	160.7	2.6	14.2	26.3
Change in Credit from non-residents(From 30th June 2016)	(0.9)	1.1	1.4	1.9	0.4	1.0	1.9
6.Total Change in Dom. Credit (From 30th June 2016)	49.4	164.6	182.1	309.8	57.1	61.3	49.2

NB: Treasury Bills are reflected at cost

Source: Central Bank of Kenya

Financing

The budget deficit in the first quarter of FY 2017/18 amounted to KSh 57.2 billion or 0.6 percent of GDP. It was financed largely from domestic sources, by KSh 49.2 billion (or 86.0 percent share). The borrowing comprised KSh 8.30 billion from the Central Bank, KSh 12.62 billion from commercial banks, KSh 26.32 billion from Non-banking financial institutions and KSh1.94 billion from non-residents (**Table 7.2**). Net domestic borrowing in the first quarter of FY 2017/18 stabilized at the same level recorded in the first quarter of FY 2016/17. Meanwhile, external financing in the first quarter of the FY 2017/18 amounted to KSh 7.5 billion (or 13.0 percent share) against a target of KSh 17.0 billion.

The uptake for government securities was low during the first quarter of FY 2017/18, reflected in the under-performance of government security auctions, with investors having adopted a wait and see attitude in view of the repeat Presidential elections on October 26, 2017. In addition, the government's reluctance to accept higher interest rates has also constrained domestic borrowing. However, the performance of the government's domestic borrowing programme has been consistent with thresholds set in the Medium Term Debt Management Strategy.

Outlook for FY 2017/18

In the budget estimates for the FY 2017/18, total revenue including grants is projected at KSh 1,706.8 billion (19.4 per cent of GDP), while external grants are projected at KSh 59.6 billion (0.7 per cent of GDP). Government expenditure is projected at KSh 2,358.6 billion (26.8 per cent of GDP), of which KSh 1436.5 billion (16.3 per cent of GDP) is for recurrent expenses, KSh 306.2 billion (3.5 per cent of GDP) for transfers to county governments, and KSh 610.9 billion (6.9 per cent of GDP) for development expenses (**Table 7.3**). GDP) will be for recurrent expenses, KSh 295.3 billion for transfers to county governments, and KSh 640.3 billion for development expenses (**Table 7.3**).

The overall budget deficit including grants on commitment basis is, therefore, projected to be KSh 524.6 billion (6.0 per cent of GDP) in 2017/18. The deficit is expected to be financed through net external borrowing of KSh 256.0 billion and net domestic borrowing of KSh 268.6 billion.

Table 7.3: Budget Estimates for the Fiscal Year 2017/18 (KSh Billion)

	Ksh (Billion)	%age of GDP
1. TOTAL REVENUE (Including Grants)	**1,706.8**	**19.4**
Ordinary Revenue	1,490.4	16.9
Appropriations-in-Aid	135.6	1.5
External Grants	59.6	0.7
2. TOTAL EXPENSES & NET LENDING	**2,358.6**	**26.8**
Recurrent Expenses	1,436.5	16.3
Development Expenses	610.9	6.9
County Transfer	306.2	3.5
Contigency Fund	5.0	
3. DEFICIT INCL. GRANTS (1-2)	-651.8	**-7.4**
4. DEFICIT INCL. GRANTS ON A CASH BASIS	**-651.8**	**-7.4**
5. FINANCING	**524.6**	**6.0**
Domestic (Net)	315.7	3.6
External (Net)	268.6	3.1

Source: The National Treasury : Budget Review and Outturn Paper (BROP), September 2017

Chapter 8
Public Debt

Overall Public Debt

Kenya's public and publicly guaranteed debt recorded moderate increase of 1.8 per cent during the first quarter of the FY 2017/18 mainly on account of KSh 64.9 billion increase in domestic debt during the quarter. The increase in public debt was slower than the estimated GDP growth. Consequently, the ratio of public and publicly guaranteed debt to GDP declined to an estimated 56.2 per cent by the end of September 2017, from 56.8 per cent at the end of the previous quarter. The external debt to GDP ratio decreased by 64 basis points, while domestic debt to GDP ratio increased marginally by 4 basis points during the first quarter of the FY 2017/18 **(Table 8.1)[1].**

[1] The quarterly analysis is based on the Fiscal year quarters; Q1: July- September, Q2: October- December, Q3: January-March Q4: April- June

Domestic Debt

Total domestic debt registered a faster growth relative to the estimated nominal GDP growth rate. However, the 3.1 per cent build up during the quarter under review was lower than the 8.6 per cent increase observed in the previous quarter. The depressed uptake of government securities was associated with low budget execution experienced in the quarter following the long electioneering period. However, despite the aforementioned uncertainty, investors' preference shifted to longer dated securities, hence the 4.1 per cent increase in the uptake of Treasury bonds. The share of domestic debt to total debt increased from 47.9 per cent at the end of June 2017, to 48.5 per cent by the end of September 2017. Conversely, the proportion of debt securities to total domestic debt increased by 1.3 per cent during the quarter under review.

Table 8.1: Kenya's Public and Publicly Guaranteed Debt (KSh Billion)[1]

	2015/16	2016/17				2017/18			
	Q4	Q1	Q2	Q3	Q4	Jul-17	Aug-17	Q1	Change Q on Q
EXTERNAL**									
Bilateral	548.4	580.4	577.8	689.1	722.6	744.5	742.0	742.1	19.5
Multilateral	798.8	799.7	781.3	806.9	844.4	831.7	842.5	842.8	-1.6
Commercial Banks	432.4	442.8	458.1	594.1	712.1	712.1	708.2	708.2	-3.9
Supplier Credits	16.6	15.5	15.3	11.2	15.3	17.2	17.1	17.1	1.8
Sub-Total	**1,796.2**	**1,838.4**	**1,832.4**	**2,101.4**	**2,294.4**	**2,305.5**	**2,309.8**	**2,310.2**	**15.8**
(As a % of GDP)	26.9	26.4	25.6	28.0	29.6	29.7	29.3	28.9	
(As a % of total debt)	49.7	49.8	48.7	51.9	52.1	52.1	52.0	51.5	
DOMESTIC									
Banks	**1,027.2**	**1,028.7**	**1,032.6**	**1,061.1**	**1,196.4**	**1,205.1**	**1,200.4**	**1,223.5**	**27.1**
Central Bank	99.9	58.9	85.5	85.3	54.5	63.7	75.7	79.2	24.7
Commercial Banks	927.3	969.8	947.0	975.8	1,141.9	1,141.4	1,124.7	1,148.3	6.4
Non-banks	**774.9**	**813.8**	**884.8**	**862.3**	**893.2**	**896.1**	**912.4**	**925.0**	**31.7**
Pension Funds	468.9	493.8	544.9	549.2	593.5	575.7	586.1	592.7	-0.8
Insurance Companies	134.4	136.4	143.2	138.9	138.9	130.1	133.3	134.7	-4.2
Other Non-bank Sources	171.6	183.6	196.7	174.2	160.8	190.3	193.1	197.5	36.8
Non-residents	**13.0**	**12.0**	**13.6**	**21.5**	**22.1**	**22.6**	**23.1**	**24.1**	**2.0**
Sub-Total	**1,815.1**	**1,854.6**	**1,931.0**	**1,945.0**	**2,111.7**	**2,123.8**	**2,135.9**	**2,176.6**	**64.9**
(As a % of GDP)	27.2	26.6	27.0	26.0	27.2	27.4	27.1	27.3	
(As a % of total debt)	50.3	50.2	51.3	48.1	47.9	47.9	48.0	48.5	
GRAND TOTAL	**3,611.3**	**3,693.0**	**3,763.4**	**4,046.3**	**4,406.1**	**4,429.3**	**4,445.7**	**4,486.8**	**80.7**
((As a % of GDP)	54.0	53.0	52.6	54.0	56.8	57.1	56.5	56.2	

Sources: The National Treasury and Central Bank ofKenya

[1] The quarterly analysis is based on the Fiscal year quarters; Q1: June- September, Q2: October- December, Q3: January-March Q4: April- June

Table 8.2: Government Gross Domestic Debt (KSh Billion)

	Kshs (Billion)							Change: Q on Q		Proportions						
	2016/17				2017/18					2016/17				2017/18		
	Q1	Q2	Q3	Q4	Jul-17	Aug-17	Q1	Kshs (Bn)	%	Q1	Q2	Q3	Q4	Jul-17	Aug-17	Q1
Total Stock of Domestic Debt (A+B)	**1,854.6**	**1,931.0**	**1,945.0**	**2,111.7**	**2,123.8**	**2,135.9**	**2,176.6**	**64.9**	**3.1**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
A. Government Securities	**1,820.0**	**1,869.5**	**1,883.9**	**2,076.1**	**2,077.9**	**2,078.3**	**2,111.4**	**35.2**	**1.7**	**98.1**	**96.8**	**96.9**	**98.3**	**97.8**	**97.3**	**97.0**
1. Treasury Bills (excluding Repo Bills)	**618.2**	**620.2**	**615.8**	**744.2**	**740.7**	**721.6**	**724.8**	**-19.4**	**-2.6**	**33.3**	**32.1**	**31.7**	**35.2**	**34.9**	**33.8**	**33.3**
Banking institutions	384.2	349.5	328.6	436.5	433.6	413.9	412.5	-24.0	-5.5	20.7	18.1	16.9	20.7	20.4	19.4	19.0
The Central Bank	20.6	20.6	20.6	20.6	20.6	20.6	20.6	0.0	0.0	1.1	1.1	1.1	1.0	1.0	1.0	0.9
Commercial Banks	363.6	329.0	308.0	415.9	413.0	393.3	391.9	-24.0	-5.8	19.6	17.0	15.8	19.7	19.4	18.4	18.0
Pension Funds	120.3	147.8	152.6	179.5	172.8	173.2	171.4	-8.1	-4.5	6.5	7.7	7.8	8.5	8.1	8.1	7.9
Insurance Companies	16.3	14.7	16.0	13.7	15.2	14.6	15.0	1.3	9.3	0.9	0.8	0.8	0.7	0.7	0.7	0.7
Others	97.5	108.1	118.5	114.4	119.2	120.0	125.9	11.5	10.0	5.3	5.6	6.1	5.4	5.6	5.6	5.8
2. Treasury Bonds	**1,201.8**	**1,249.3**	**1,268.2**	**1,332.0**	1,337.2	1,356.6	1,386.6	**54.6**	**4.1**	**64.8**	**64.7**	**65.2**	**63.1**	**63.0**	**63.5**	**63.7**
Banking institutions	591.6	601.1	650.9	724.5	725.7	728.9	749.8	25.3	3.5	31.9	31.1	33.5	34.3	34.2	34.1	34.5
The Central Bank	9.4	9.4	9.4	9.4	9.4	9.4	9.4	0.0	0.0	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Commercial Banks	582.1	591.6	641.5	715.1	716.2	719.4	740.4	25.3	3.5	31.4	30.6	33.0	33.9	33.7	33.7	34.0
Insurance Companies	120.1	128.5	122.9	138.9	115.0	118.7	119.7	-19.2	-13.8	6.5	6.7	6.3	6.6	5.4	5.6	5.5
Pension Funds	373.5	397.1	396.5	414.1	403.0	412.9	421.4	7.3	1.8	20.1	20.6	20.4	19.6	19.0	19.3	19.4
Others	116.6	122.8	97.8	54.5	93.6	96.2	95.7	41.2	75.6	6.3	6.4	5.0	2.6	4.4	4.5	4.4
3. Long Term Stocks	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Banking institutions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4. Frozen account	**25.6**	**25.6**	**25.0**	**25.0**	**24.4**	**24.4**	**24.4**	**-0.6**	**-2.2**	**1.4**	**1.3**	**1.3**	**1.2**	**1.2**	**1.1**	**1.1**
Of which: Repo T/Bills	25.0	25.0	24.4	23.8	23.8	23.8	23.8	0.0	0.0	1.3	1.3	1.3	1.1	1.1	1.1	1.1
B. Others:	**9.0**	**35.9**	**36.0**	**10.6**	**0.0**	**0.0**	**0.0**	**-10.6**	**-100.0**	**0.5**	**1.9**	**1.9**	**0.5**	**0.0**	**0.0**	**0.0**
Of which CBK overdraft to Government	3.3	29.9	26.0	0.0	9.2	21.2	24.7	24.7	100.0	0.2	1.6	1.3	0.0	0.4	1.0	1.1

Source: Central Bank of Kenya

The increase in the share of debt securities to total domestic debt was on account of a lower utilization of the government overdraft facility at the Central Bank.

Treasury Bills

Treasury bill holdings, excluding those held by the Central Bank for open market operations (Repos) recorded 2.6 per cent decline during the first quarter of the FY 2017/18 as investors' appetite for longer dated securities increased confirming a stable near term view given the uncertainties associated with the August 2017 general elections and the repeat presidential election. Similarly, the proportion of Treasury bills to total domestic debt decreased by 190 basis points during the period under review. The dominance of commercial banks in Treasury bills market persisted with their holdings standing at 54.2 per cent of the total amount of outstanding Treasury Bills by the end of the first quarter of the FY 2017/18. Other significant holders of Treasury bills included pension funds (23.6 percent) and parastatals included in other holders (13.3 percent). The persistent dominance of commercial banks in the government securities market partly underscores moderate underdevelopment of other institutional investors' sectors such as pension funds, and insurance companies.

Treasury Bonds

Treasury bond holdings increased by 4.1 per cent during the first quarter of the FY 2017/18, a slower build up compared to 5.0 growth observed in the previous quarter. This increase was driven by the shift in investor preference towards longer dated securities despite the uncertainties associated with the prevailing political situation during the quarter under review. The largest component of this buildup was proceeds from a 5- year Fixed rate Treasury

Table 8.3: Outstanding Domestic Debt by Tenor (KSh Bllion)

		Kshs (Billions)							Change Q on Q		Proportions						
		2016/17				2017/18			Q1 2017/18		2016/17				2017/18		
		Q1	Q2	Q3	Q4	Jul-17	Aug-17	Q1	shs(Bn)	%	Q1	Q2	Q3	Q4	Jul-17	Aug-17	Q1
	91-Day	59.9	51.1	48.7	92.2	58.2	53.6	35.9	-56.3	-61.1	3.2	2.6	2.5	4.4	2.7	2.5	1.6
Treasury	182-Day	185.0	201.1	212.4	234.3	258.9	230.0	254.9	20.6	8.8	10.0	10.4	10.9	11.1	12.2	10.8	11.7
bills	364-Day	373.4	368.0	354.7	417.7	423.6	438.0	434.0	16.3	3.9	20.1	19.1	18.2	19.8	19.9	20.5	19.9
	1-Year	10.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0
	2-Year	122.1	116.8	100.9	82.1	82.1	82.1	102.8	20.7	25.2	6.6	6.1	5.2	3.9	3.9	3.8	4.7
	3-Year	0.0	0.0	0.0	0.2	0.2	0.2	0.4	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	4-Year	2.3	2.3	2.3	2.3	10.8	10.8	4.8	2.5	108.8	0.1	0.1	0.1	0.1	0.5	0.5	0.2
	5-Year	263.4	263.4	288.3	272.7	272.7	284.8	302.3	29.6	10.9	14.2	13.6	14.8	12.9	12.8	13.3	13.9
	6-Year	8.5	8.5	8.5	8.5	8.5	8.5	8.5	0.0	0.0	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Treasury	7-Year	8.7	8.7	8.7	8.7	8.7	8.7	8.7	0.0	0.0	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Bond	8-Year	38.2	38.2	33.7	33.7	33.7	33.7	33.7	0.0	0.0	2.1	2.0	1.7	1.6	1.6	1.6	1.5
	9-Year	76.5	76.5	76.5	76.5	76.5	76.5	76.5	0.0	0.0	4.1	4.0	3.9	3.6	3.6	3.6	3.5
	10-Year	206.8	206.8	206.8	256.9	262.1	274.6	280.9	24.0	9.3	11.2	10.7	10.6	12.2	12.3	12.9	12.9
	11-Year	4.0	4.0	4.0	4.0	4.0	4.0	0.0	-4.0	-100.0	0.2	0.2	0.2	0.2	0.2	0.2	0.0
	12-Year	132.1	132.1	146.4	146.4	137.9	137.9	133.2	-13.3	-9.1	7.1	6.8	7.5	6.9	6.5	6.5	6.1
	15-Year	183.8	238.8	238.8	286.7	286.7	286.7	286.7	0.0	0.0	9.9	12.4	12.3	13.6	13.5	13.4	13.2
	20-Year	96.8	104.9	104.9	104.9	104.9	104.9	104.9	0.0	0.0	5.2	5.4	5.4	5.0	4.9	4.9	4.8
	25-Year	20.2	20.2	20.2	20.2	20.2	20.2	20.2	0.0	0.0	1.1	1.0	1.0	1.0	1.0	0.9	0.9
	30-Year	28.1	28.1	28.1	28.1	28.1	28.1	28.1	0.0	0.0	1.5	1.5	1.4	1.3	1.3	1.3	1.3
	Repo T bills	25.0	25.0	24.4	23.8	23.8	23.8	23.8	0.0	0.0	1.3	1.3	1.3	1.1	1.1	1.1	1.1
	Overdraft	3.3	29.9	30.3	0.0	9.2	21.2	24.7	24.7	100.0	0.2	1.6	1.6	0.0	0.4	1.0	1.1
	Other Domestic debt	6.3	6.6	6.4	11.7	12.9	7.5	11.5	-0.2	-1.7	0.3	0.3	0.3	0.6	0.6	0.4	0.5
Total Debt		**1,854.6**	**1,931.0**	**1,945.0**	**2,111.7**	**2,123.8**	**2,135.9**	**2,176.6**	**64.9**	**3.1**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Central Bank of Kenya

bond. The dominant holder of Treasury bonds by the end of the period under review was commercial banks, accounting for about half of the total Treasury Bonds outstanding. Other holders included pension funds and insurance companies

Domestic Debt by Tenor and the Maturity Structure

The current debt securities portfolio is dominated by medium and long term debt, which underscores the Government's strategy of reducing the refinancing risk. The benchmark Treasury Bonds of 2-year, 5-year, 10-year, 15-year and 20-years accounted for 77.7 per cent of the total of outstanding Treasury Bonds at the end of September 2017, a 2.4 per cent increase from June 2017. Treasury bills accounted for 2.6 percent while other domestic debt: consisting of uncleared effects, advances from commercial banks and Tax Reserve Certificates, declined by 1.7 per cent during the quarter.

Domestic debt maturity structure weakened marginally with the average time to maturity of existing domestic debt decreasing to 4 years and 1 month in the first quarter of the FY 2017/18 from 4 years and 2 months and 4 years 5 months in the fourth and third quarter of the FY 2016/17, respectively. This marginal decline was attributed to the issuance of more short term Treasury bonds during the first quarter of 2017/18 as compared to the issuance of medium term Treasury bonds during the third and the fourth quarters of the FY 2016/17. The refinancing risk declined to 33.3 per cent from 35.2 per cent in June 2017.

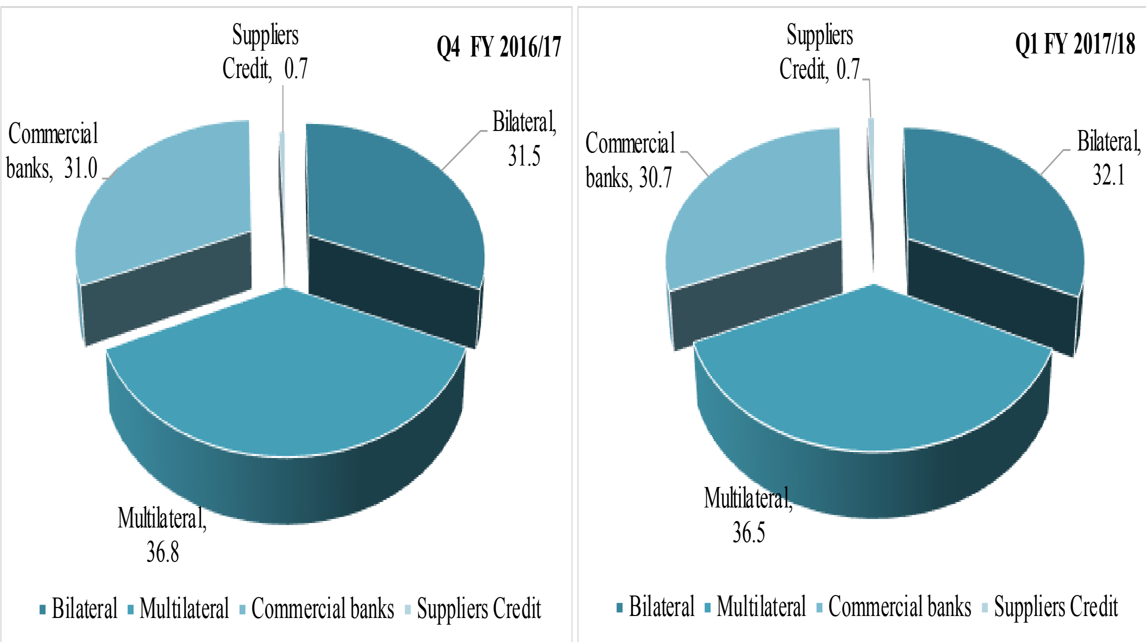
External Debt

Public and publicly guaranteed external debt increased by 0.7 per cent during the first quarter of the FY 2017/18. External debt accumulation reflected mainly disbursements of bilateral debt from China to finance phase II of the Standard Gauge railway and France to finance several projects in the energy sector. Principal amortization of debt owed to International Development Association (IDA) had an offsetting effect on the overall external debt build up. Foreign exchange risk on external debt was low due to relatively stable exchange rate during the quarter under review.

Composition of External Debt by Creditor

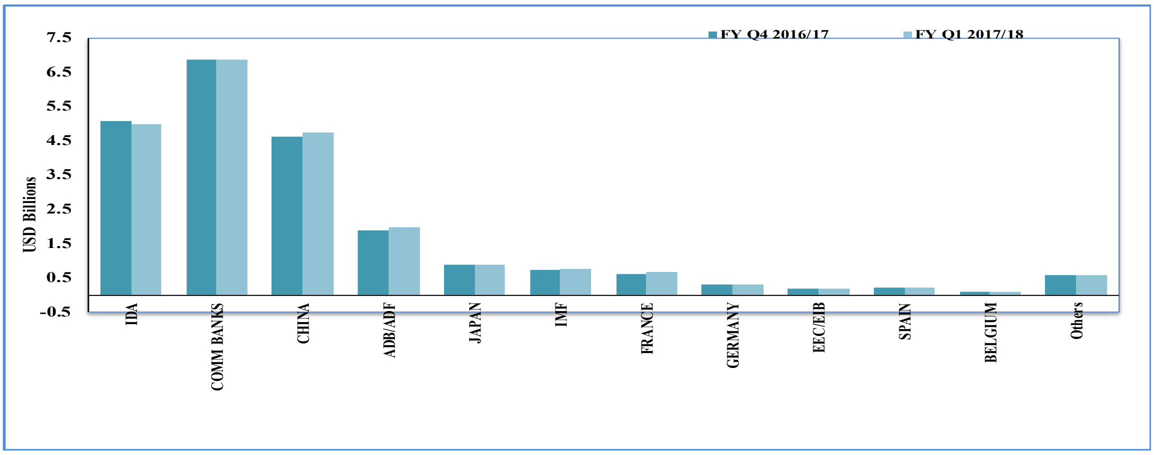
Kenya continues to record declining levels of concessional debt and build-up of commercial and semi-concessional borrowing since its elevation to a lower middle income economy status in September 2014. The share of outstanding debt from official multilateral and bilateral lenders (who provide both concessional and semi-concessional loans) increased from the 68.3 per cent in June 2017, to 68.6 per cent by the end of September 2017. Consequently, the share of commercial debt decreased by 30 basis points during the review period. The shift in the composition of external debt was mainly

Chart 8.1: Composition of External Debt by Lender Classification



Source: The National Treasury

Chart 8.2: External Debt By Creditor



Source: The National Treasury

due to disbursements from France and China (**Chart 8.1**).

Debt owed to IDA, Kenya's largest multilateral lender, amounted to USD 5.0 billion or 22.3 per cent (22.9 per cent in the previous quarter) of total external debt while that owed to China, Kenya's largest bilateral lender, amounted to USD 4.6 billion, or 21.2 per cent (20.9 per cent in the previous quarter) of the total external debt in the fourth quarter of the FY 2016/17 (**Chart 8.2**).

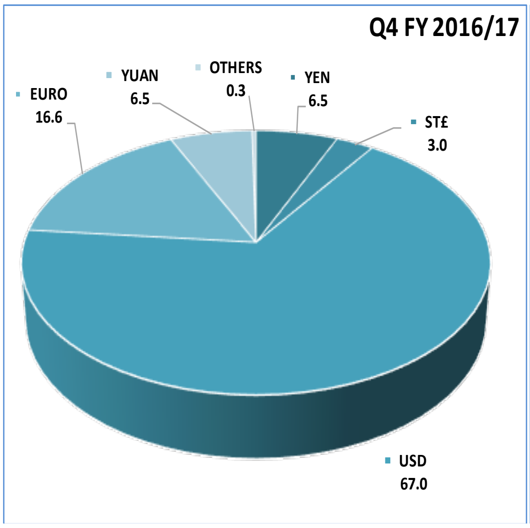
Currency Composition of External Debt

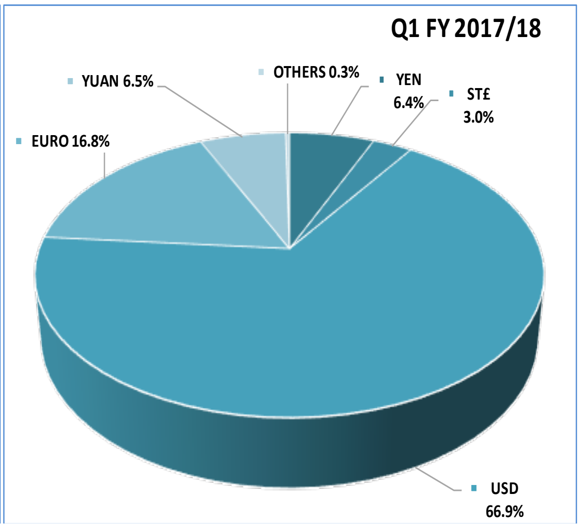
Kenya's public and publicly guaranteed external debt is denominated in various currencies to mitigate currency risk. The dominant currencies include the US dollar and the Euro which accounted for 66.9 per cent and 16.8 percent of the total external debt, respectively, at the end of the first quarter of the FY 2017/18. This was partly consistent with the currency composition of the Central Bank's forex reserve holdings. The proportion held in the Euro increased mainly on account of disbursements of Euro-denominated loan advanced by the French Government to finance projects in the energy and roads sectors (**Chart 8.3**).

Public Debt Service

The ratio of domestic interest payments to revenues stood at 14.2 per cent in the first quarter of the FY 2017/18 which was lower than the previous quarter (15.0 percent). The largest component of domestic interest payments was interest on Treasury Bonds which was consistent with the proportion of debt held in Treasury bonds. External debt service for the first quarter of the FY 2017/18 amounted to KSh 25.3 billion. Analysis of the liquidity indicators of external indebtedness, such as debt service to revenues and debt service to exports show that Kenya faces low exposure to external debt

Chart 8.3: Debt Composition by Currency





Source: The National Treasury

Table 8.4: Liquidity External Debt Sustainability Indicators

	FY 2015/16	Q1 FY 2016/17	Q2 FY 2016/17	Q3 FY 2016/17	Q4 FY 2016/17	Q1 FY 2017/18
Debt service to Revenues (23%)	6.2	4.9	7.0	7.3	7.3	7.2
Debt service to Exports (21%)	7.4	10.8	10.3	8.3	8.3	9.1

Quartely debt service as a ratio of resource flows in similar quarters

Source: Central Bank of Kenya

service default as the ratios are below the CPIA determined liquidity thresholds (21 per cent of exports and 23 per cent of revenues) **(Table 8.4).**

Debt Sustainability Analysis (DSA)

The December 2016 debt sustainability update by the IMF showed that Kenya faces a low risk of external debt distress. All the liquidity and solvency debt burden indicators were below the CPIA[2] based thresholds both in the baseline and alternative scenarios. However, there is a temporary breach of debt service to exports ratio under standardized stress tests. Public DSA sensitivity analysis show that if primary deficit were to remain at the current levels, public debt would take an upward trajectory and reach levels that are way above the EAC convergence criterion. However, the debt ratios are expected to improve in the medium term due to ongoing fiscal consolidation.

Outlook for Fiscal Year 2017/18

Total public and publicly guaranteed external debt is estimated at 2,627.6 billion (29.8 per cent of GDP), while gross and net domestic debt are expected to close the financial year 2017/18 at KSh 2,427.9 billion (27.6 per cent of GDP) and KSh 1,993.4 billion (22.6 per cent of GDP), respectively (BROP 2017).

[2]The EAC public debt convergence criterion for PV of Debt/GDP is 50 percent
CPIA stands for Country Policies and Institutions Assessment
The primary deficit is the non-interest budget balance, an increase in the primary deficit leads into an increase in public debt through the debt and deficit vicious cycle

Chapter 9

The Capital Markets

Equities Market

The equities market recorded gains across all indices, equity turnover and market capitalization in the third quarter of 2017 (**Table 9.1**). The improved performance indicates continued recovery from a bear run experienced in the fourth quarter of 2016 and first quarter of 2017 and resilience to the prolonged electioneering period.

The overall increase in equities prices reflected by gains NASI and all other indices, led to 6.87 per cent growth in shareholders' wealth measured by Market Capitalization **(Chart 9.1).**

Foreign Investors' Participation at the NSE

The value of share purchased by foreign investors at the NSE declined by 15.77 per cent, while their total sales increased by 15.25 per cent in the third quarter of 2017 compared to the second quarter of 2017. Overall, net foreign investors participation at the NSE averaged 53.49 per cent in the quarter under review, down from 63.60 per cent in the previous quarter. This reduced activity by foreign investors at the NSE could be explained by increased risks perception surrounding the electioneering period **(Chart 9.2 and Table 9.1).**

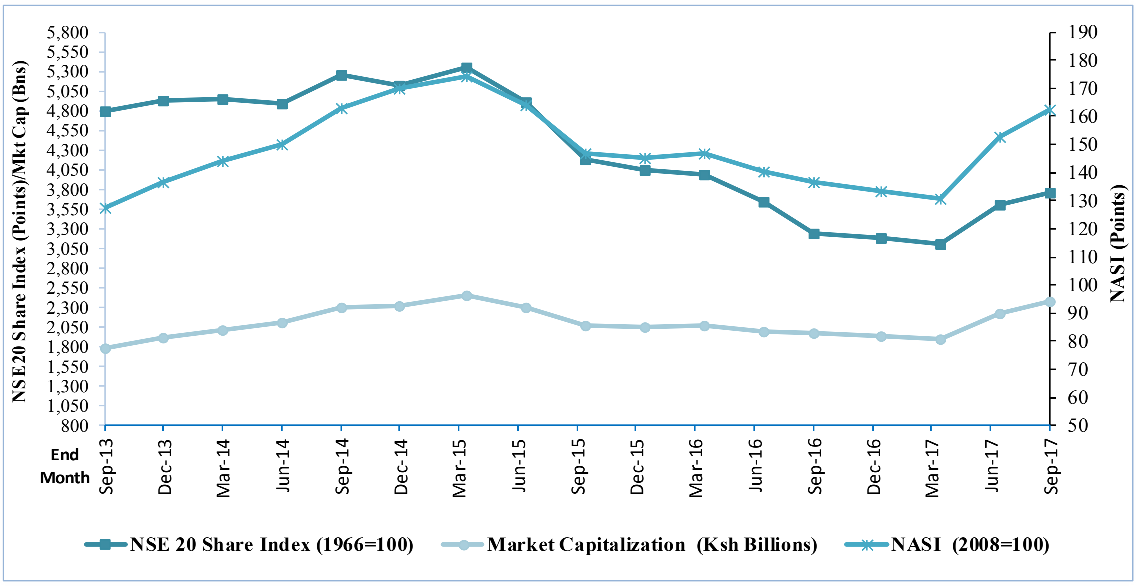
Table 9.1: Selected Stock Market Indicators

INDICATOR	2015	2015		2016				2017			% QUARTERLY CHANGE (2017Q3-2017Q2)
		Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
NSE 20 Share Index (1966=100)	4,040	4173.00	4040.00	3982.00	3640.61	3243.21	3186.00	3112.52	3607.18	3751.46	4.00
NASI (2008=100)	145.00	147.00	145.00	147.00	140.60	136.75	133.30	130.51	152.92	162.21	6.08
FTSE NSE Kenya 15 Index	182.55	195.09	182.55	185.17	175.70	160.96	159.07	161.43	189.83	204.43	7.69
FTSE NSE Kenya 25 Index	182.11	194.81	182.11	185.47	176.47	166.62	164.30	164.02	195.93	208.93	6.64
Number of Shares Traded (Millions)	6,812	1,883	1,456	1,300	1,411	1,999	1,101	1,860	1,892	2,020	6.75
Equities Turnover (Ksh Millions)	209,382	56,722	46,095	36,609	37,034	48,141	25,392	37,095	44,902	53,577	19.32
Market Capitalization (Ksh Billions)	2,049	2,064	2,054	2,078	1,998	1,972	1,931	1,894	2,224	2,377	6.87
Foreign Purchase (Ksh Millions)	132,495	43,856	29,500	20,258	26,322	40,038	17,652	29,421	27,424	23,099	(15.77)
Foreign Sales (Ksh Millions)	131,579	37,300	29,439	21,844	19,339	34,018	16,703	27,433	29,692	34,219	15.25
Average Foreign Investor Participation to Equity Turnover (%)	63.06	71.54	63.93	57.50	61.65	76.92	67.65	76.64	63.60	53.49	*(10.11)
Bond Turnover (Ksh Millions)	305,099	44,511	71,321	113,400	149,809	74,809	94,367	103,997	134,633	108,168	(19.66)
FTSE NSE Kenya Govt. Bond Index	90.04	90.41	90.04	89.28	87.98	89.11	90.05	89.73	91.54	91.67	0.14
I-REIT Turnover in (KSh Million)				19.50	14.55	16.13	9.12	39.40	7.43	20.04	169.77
I-REIT in Units - Total Deals	-10.11			185.0	151.0	151.0	310.0	281.0	309.0	493.0	59.55
5-Year Eurobond Yield (%)	7.93	7.27	7.93	6.48	6.23	4.59	4.95	4.20	4.47	4.28	*(0.19)
10-Year Eurobond Yield (%)	9.05	8.11	9.05	7.81	8.13	7.19	7.86	7.10	6.64	6.46	*(0.18)

* Percentage points

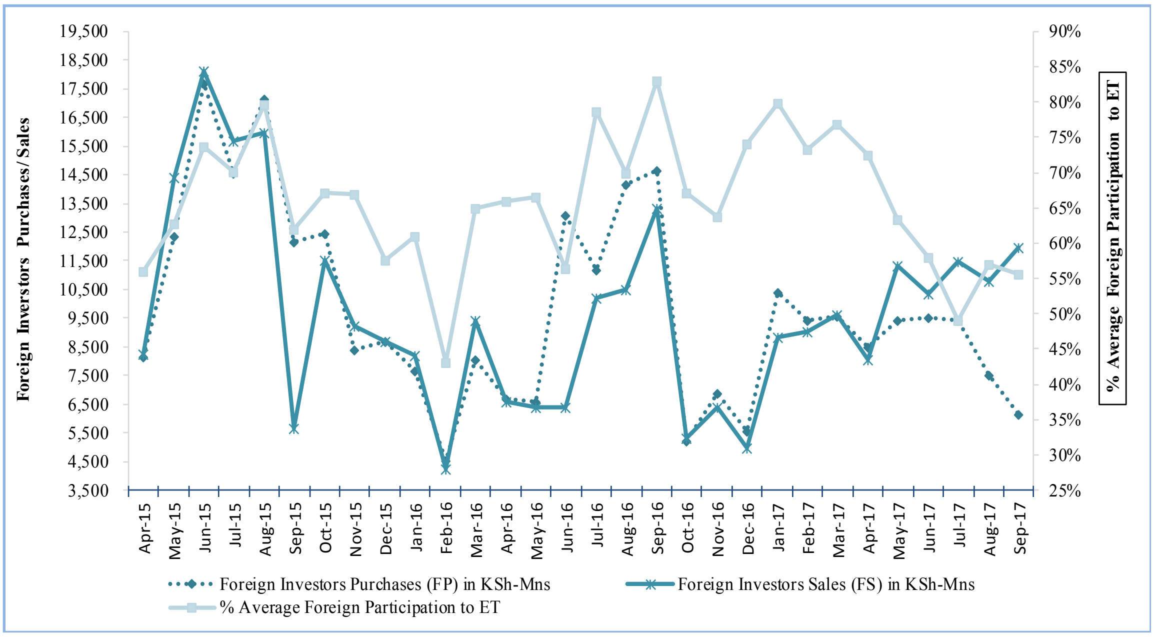
Source: Nairobi Securities Exchange

Chart 9.1: NSE 20 NASI and Market Capitalization



Source: Nairobi Securities Exchange

Chart 9.2: Foreign Participation



Source: Nairobi Securities Exchange

Bond Market

The bonds trading activity in the third quarter of 2017 fell below the second quarter of 2017 with the volume traded declining by 19.66 percent. The FTSE NSE Kenyan Government Bond Index increased by 0.14 per cent in the period under review, further underlining the effects of elections on the increase in secondary yields. The 5-and 10-Year Kenya Euro bonds yields declined marginally by 0.19 percentage points and 0.18 percentage points, respectively, reflecting positive investor sentiments or liquidity in the market.

Chapter 10

Statement of Financial Position of the Central Bank of Kenya

(Kenya Shillings Million)

BANKI KUU YA KENYA

STATEMENT OF FINANCIAL POSITION AS AT THE THIRD QUARTER OF 2017

(AMOUNTS IN KSHS. MILLION)

		2017			Q3, 2017	Q2, 2017	Q1 2017	Q3, 2017	Q2, 2017	Q1, 2017
1.0	**ASSETS**	**MAR**	**JUNE**	**SEPT**	**Change**	**Change**	**Change**	**% change**	**% change**	**% change**
1.1	RESERVES AND GOLD HOLDINGS	835,899	870,325	830,309	(40,016)	34,426	87,744	(4.6)	4.1	11.7
1.2	FUNDS HELD WITH IMF	1,199	1,877	253	(1,624)	679	(2,548)	(86.5)	56.6	(68.0)
1.21	INVESTMENT IN EQUITY (SWIFT SHARES	9	9	10	0	1	0	2.8	7.0	3.3
1.3	ITEMS IN THE COURSE OF COLLECTION	28	43	22	(21)	15	5	(48.9)	52.1	21.8
1.4	ADVANCES TO COMMERCIAL BANKS	41,870	34,870	75,773	40,903	(7,000)	(13,964)	117.3	(16.7)	(25.0)
1.5	LOANS AND OTHER ADVANCES	2,531	2,575	2,650	74	44	(61)	2.9	1.8	(2.3)
1.6	OTHER ASSETS	2,480	2,923	2,486	(437)	443	(1,250)	(15.0)	17.9	(33.5)
1.7	RETIREMENT BENEFIT ASSET	7,776	8,197	8,197	-	421	-	-	5.4	-
1.8	PROPERTY AND EQUIPMENT	22,430	22,703	21,983	(720)	273	611	(3.2)	1.2	2.8
1.81	INTANGIBLE ASSETS	(72)	52	49	(3)	124	(133)	(6.6)	173.3	(217.3)
1.9	DUE FROM GOVERNMENT OF KENYA	55,395	24,449	49,350	24,902	(30,946)	(224)	101.9	(55.9)	(0.4)
	TOTAL ASSETS	**969,545**	**968,024**	**991,081**	**23,057**	**(1,521)**	**70,180**	**2.4**	**(0.2)**	**7.8**
2.0	**LIABILITIES**									
2.1	CURRENCY IN CIRCULATION	245,513	253,787	250,695	(3,092)	8,274	(17,221)	(1.2)	3.4	(6.6)
2.2	INVESTMENTS BY BANKS - REPOS	14,164	-	-	-	(14,164)	14,164		(100.0)	-
2.3	DEPOSITS	465,079	470,109	483,815	13,706	5,029	64,977	2.9	1.1	16.2
2.4	INTERNATIONAL MONETARY FUND	116,168	115,125	114,659	(466)	(1,043)	49	(0.4)	(0.9)	0.0
2.5	OTHER LIABILITIES	3,329	(5,059)	1,859	6,918	(8,388)	1,214	(136.7)	(252.0)	57.4
	TOTAL LIABILITIES	844,254	833,962	851,029	17,066	(10,291)	63,184	2.0	(1.2)	8.1
3.0	EQUITY AND RESERVES	125,292	134,062	140,053	5,991	8,770	6,997	4.5	7.0	5.9
	Share Capital	5,000	5,000	5,000					-	-
	General reserve fund -Unrealized	57,550	57,550	65,195	7,645	-	-	13.3	-	-
	-Realized	16,909	16,909	23,690	6,782			40.1	-	0.0
	-Capital Projects	15,047	15,047	17,189	2,142	-	-	14.2	-	-
	Period surplus/(Deficit)	8,219	16,569	5,991	(10,578)	8,349	6,996	(63.8)	101.6	571.9
	Asset Revaluation	14,790	14,790	14,790	-	-	-	-	-	-
	Retirment Benefit Asset Reserves	7,776	8,197	8,197	-	421	-		5.4	-
4.0	**TOTAL LIABILITIES AND EQUITY**	**969,545**	**968,024**	**991,081**	**23,057**	**(1,521)**	**70,181**	**2.4**	**(0.2)**	**7.8**

Source: Central Bank of Kenya

Notes on the Financial Position

Assets

The balance sheet of the Central Bank, grew by 2.4 per cent compared to a marginal decline of 0.2 per cent in the previous quarter. The increase was due to advances to commercial banks and dues from the government. Advances to commercial banks, largely for liquidity management, increased by 117.3 per cent in the third quarter of 2017 compared to a decline of 16.7 per cent in the previous quarter. This followed an increase in liquidity injection through reverse Repo securities.

Debt due from Government of Kenya, including Government utilization of the overdraft facility at the Central Bank and overdrawn accounts which were converted to a long term debt with effect from November 1, 1997 increased in third quarter compared to a decline in the previous quarter. The increase was a result of the government utilizing the overdraft facility.

Reserves and Gold holdings category decreased by 4.6 per cent in the third quarter of 2017 compared to a growth of 4.1 per cent in the second quarter of 2017. These comprise foreign reserves held in external current accounts, deposits and special/projects accounts, domestic foreign currency clearing accounts, gold, special drawing rights and RAMP securities invested with the World Bank.

Items in the course of collection, which represent the value of clearing instruments held by the Central Bank, while awaiting clearing by respective commercial banks, decreased by 48.9 per cent, compared to the growth of 52.1 per cent in the second quarter of 2017.

Other assets, which largely consist of prepayments and sundry debtors, and deferred currency expense decreased by 15.0 per cent compared to an increase of 17.9 per cent in the second quarter of 2017.

Liabilities

Currency in circulation decreased by 1.2 per cent in the third quarter of 2017 compared to an increase of 3.4 per cent in the previous quarter.

Deposits by Government of Kenya, local commercial banks, other public entities and project accounts and local banks' forex settlement accounts grew by 2.9 per cent compared to a growth of 1.1 per cent in the previous quarter.

Equity and reserves increased by 4.5 per cent in the third quarter of 2017 compared to a growth of 7. 0 per cent in the previous quarter, reflecting an increase in the period's surplus.

Central Bank of Kenya

Haile Selassie Avenue P. O. Box 60000 - 00200 Nairobi
Tel: 20 - 2860000/2861000/ 2863000 Fax: 20 - 340192

www.centralbank.go.ke | www.facebook.com/CentralBankKenya | @CbkKenya