Central Bank of Kenya

Quarterly Economic Review

October - December 2016
Volume 1 No. 4

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.

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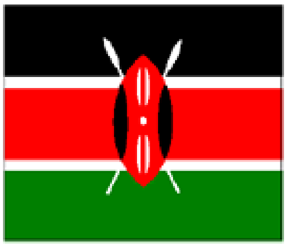

QUARTERLY ECONOMIC REVIEW

OCTOBER - DECEMBER 2016

The Quarterly Economic Review, prepared by the Central Bank of Kenya starting with the Jan - Mar 2016 edition, is available on the internet at:
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HIGHLIGHTS

Overall inflation increased by 17 basis points to 6.50 percent in the fourth quarter of 2016 from 6.33 percent in the previous quarter, largely driven by rising food inflation. Annual average inflation however, declined by 7 basis points to 6.40 percent from 6.47 percent over the same period.

Money supply (M3) changed marginally in the fourth quarter of 2016, declining by 0.3 percent compared with an increase of 0.2 percent in the previous quarter.

The Monetary Policy Committee (MPC) retained the Central Bank Rate (CBR) at 10.0 percent in their bi-monthly MPC meeting held in November 2016. The weighted average interbank interest rate decreased to 4.93 percent in fourth quarter of 2016 from 5.11 percent in third quarter of 2016. Movement in the other short term money rates more reflective of market conditions.

Overall GDP data for the fourth quarter of 2016 is not yet available. Available economic indicators for the fourth quarter of 2016 point to mixed performance.

Kenya's external position remained resilient despite a slowdown in global economic output and the worsening of the current account deficit to USD 1,169 million during the fourth quarter of 2016 from USD 1,106 million during the preceding quarter. The deterioration of the current account deficit was attributed to a drop in receipts from export of goods and services, net payments primary and secondary income, which combined more than offset the reduction in import of goods and services.

Kenya's official international reserves position was strong at USD 7,573 million by end-December 2016, equivalent to 5.3 months of imports. Kenya's Precautionary Arrangements with the IMF amounting to USD 1,500 million provided additional buffer against short term external and domestic shocks.

The banking sector profitability declined in the fourth quarter of 2016 following implementation of interest rates capping law on September 14, 2016. While the institutional structure remained unchanged, the sector's net assets declined reflecting recall of foreign currency deposits by some corporate clients for operational needs. Total bank loans increased by 2.5 percent during the quarter under review with 8 sectors recording growth in loans. The banking sector was stable with adequate capital buffers. Asset quality improved both in the proportion of net non-performing loans to gross loans and coverage ratio.

During the period under review, KEPSS availability improved to on an average of 99.95 per cent compared to 99.23 per cent in the previous quarter.

The government's budgetary operations resulted in a deficit of 1.5 per cent of GDP in the second quarter of the FY 2016/17, compared with a deficit of 1.8 per cent of GDP in the first quarter. As is typical of the first half of the financial year, budget execution was slow, thereby resulting in lower expenditures growth.

Kenya's public and publicly guaranteed debt increased by 1.9 percent during the second quarter of the FY 2016/17 largely in domestic debt.

Capital markets recorded mixed performance in the fourth quarter of 2016 with a general decline in equities and improvement in the bonds turnover.

Chapter 1
Inflation

Overview

Overall inflation increased by 17 basis points to 6.50 per cent in the fourth quarter of 2016 from 6.33 per cent in the previous quarter (**Table 1.1**). Inflation continued to be a food phenomenon across income groups and regions as food prices remained elevated in the period under review.

Food inflation increased by 27 basis points to 10.57 per cent in the fourth quarter of 2016 from 10.30 per cent in third quarter of 2016, owing to rising prices of a few but key food items. Moreover, Non-Food Non-Fuel (NFNF) rose by 19 basis points to 5.18 per cent from 4.99 per cent, largely driven by increase in prices of clothing and footwear. Fuel inflation sustained the downward trend for the fourth consecutive quarter, declining by 13 basis points to 0.27 per cent from 0.40 per cent in the period under review. The drop is largely attributed to low prices of cooking gas and international oil prices.

Annual average inflation declined by 7 basis points to 6.40 per cent from 6.47 per cent over the same period. Similarly, the three months annualized inflation declined by 35 basis points to 6.63 per cent in the fourth quarter of 2016 from 6.98 per cent in the third quarter of 2016.

Contributions of broad categories to overall inflation

The contribution of food inflation to overall inflation increased to 5.02 percentage points in the fourth quarter of 2016 from 4.87 percentage points in the third quarter of 2016. This was driven by rising food prices following low supply as most parts of the country experienced depressed rainfall (**Chart 1A**).

In a complementary role, the contribution of NFNF to overall inflation increased to 1.41 percentage points in the fourth quarter of 2016 from 1.36 percentage points in the third quarter of 2016. The contribution of fuel inflation to overall inflation however, declined to 0.07 percentage points from 0.10 percentage points over the same period, owing to fairly low international oil prices. Moreover, the sustained decline in the cost of electricity and cooking gas supported fuel inflation.

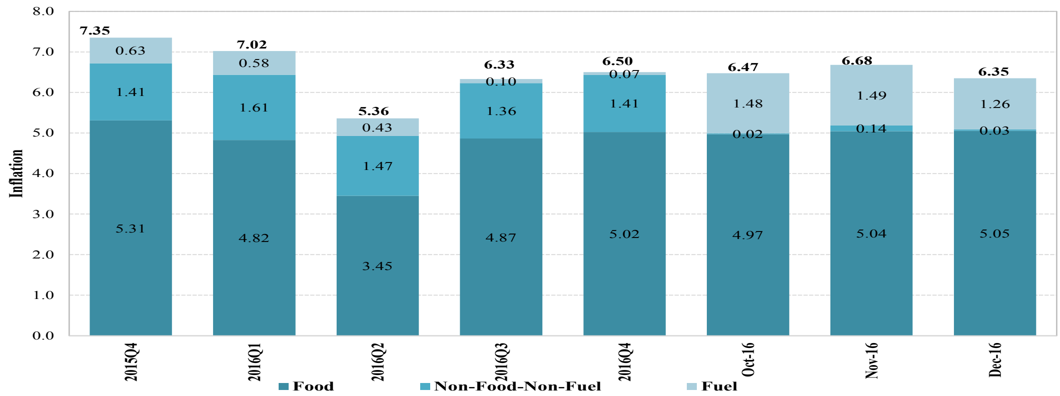
Table 1.1: Recent Developments in Inflation in Per cent[1]

	2015				2016						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Oct-16	Nov-16	Dec-16
Overall Quarterly inflation	5.82	6.99	6.14	7.35	7.02	5.36	6.33	6.50	6.47	6.68	6.35
Food Inflation	8.67	12.50	10.06	11.62	10.43	7.24	10.30	10.57	10.49	10.60	10.61
Fuel Inflation	3.57	0.68	1.04	2.39	2.25	1.73	0.40	0.27	0.10	0.57	0.14
Non-Food Non-Fuel Inflation (NFNF)	3.37	4.10	4.63	5.06	5.81	5.42	4.99	5.18	5.43	5.48	4.64
Average annual	6.66	6.66	6.39	6.44	6.84	6.58	6.47	6.40	6.48	6.43	6.30
Three months annualised	6.43	14.28	3.10	5.96	5.14	7.35	6.98	6.63	4.24	6.93	8.72

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

1 Food inflation comprise of "food and non-alcoholic beverages", and "hotels and restaurants" categories of the CPI basket; and fuel inflation comprise "transport" and "housing, water, electricity, gas and other fuels" categories of the CPI basket; NFNF excludes food and fuel inflation.

Chart 1A: Contributions of Broad Categories to Overall Inflation in Percentage Points



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

Food Inflation

Food inflation increased by 27 basis points to 10.57 per cent in the fourth quarter of 2016 compared to 10.30 per cent in the third quarter of 2016. The elevated food inflation reflected in increasing prices of some key food items, which contributed 8.1 percentage points to food inflation in the fourth quarter of 2016 (**Chart 1B**). The rise in prices of these food items was attributed to below average rainfall experienced in parts of the country as well as seasonal factors.

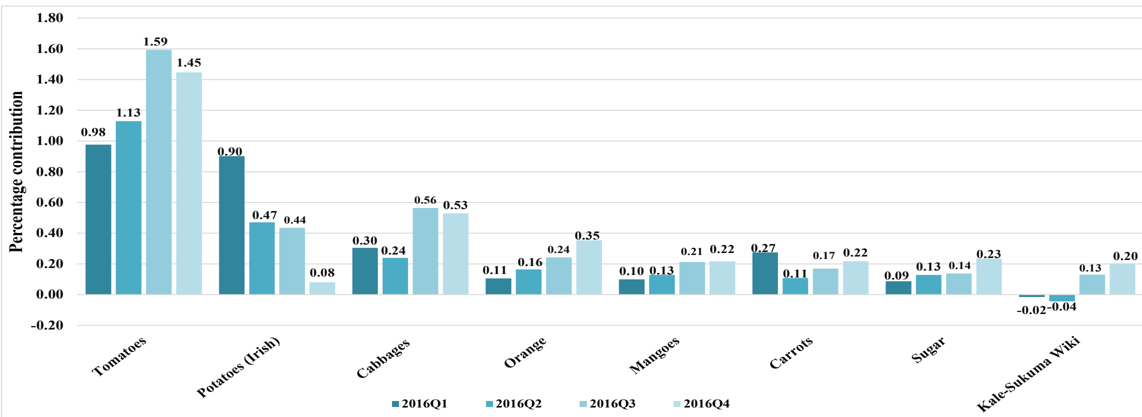
Though high, the contribution of tomatoes to food inflation declined to 1.45 percentage points in the fourth quarter of 2016 compared to 1.59 percentage points in the previous period. The contribution of sugar to food inflation increased significantly in the quarter under review reflecting the rising retail prices owing to low supply. This is attributed to falling local production as well as closure of some local factories for routine maintenance in the fourth quarter of 2016. In addition, the rising international sugar prices driven by low production of sugar in leading global suppliers, Brazil and India, following unfavorable weather conditions, pushed domestic prices up.

However, the contribution of Irish potatoes, a major driver of food inflation in the first three quarters of 2016 declined to 0.08 percentage points in the fourth quarter of 2016, from 0.44 percentage points in the third quarter of 2016.

Fuel Inflation

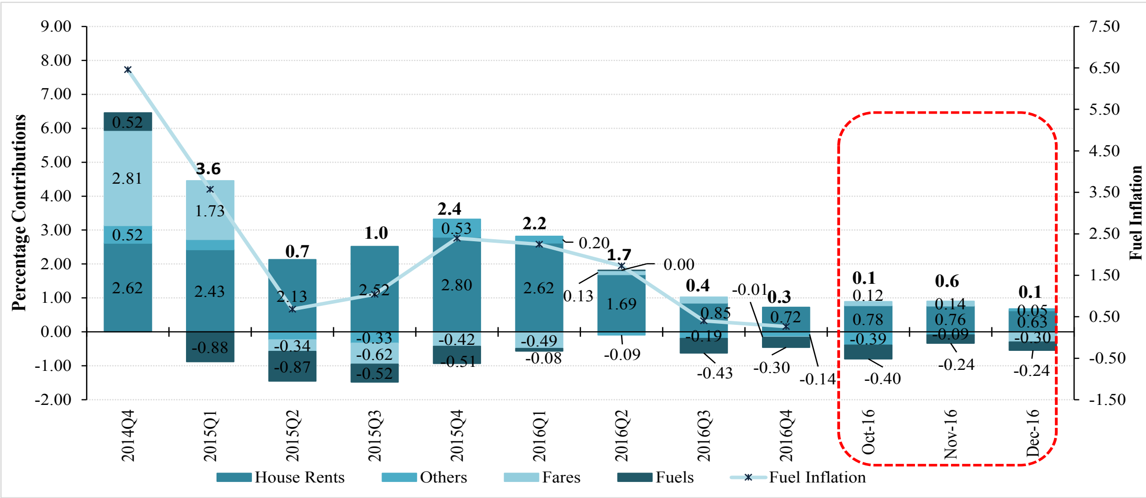
Fuel inflation moderated, having declined by 13 basis points to 0.27 per cent in the fourth quarter of 2016 from 0.40 per cent in the previous quarter (**Chart 1C**). Fuels (petrol, diesel, and kerosene and LPG gas) and other items in the fuel basket continued to dampen inflation, with their contributions declining in the fourth quarter of 2016 compared to the third quarter of 2016. The contribution of "fuels" declined to 0.4 per entage points from 0.3 percentage points in the third quarter of 2016 largely on account of low prices of cooking gas following exemption of VAT on Liquefied Petroleum Gas (LPG) and low international oil prices. Additionally, fairly low fares on account of increased competition in taxi business dampened fuel inflation. The contribution of fuel prices to inflation declined across income groups and regions over the same period.

Chart 1B: Contribution of Main Food Items to Food Inflation in Percentage Points



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

Chart 1C: Components of Fuel Inflation



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

Non-Food Non-Fuel inflation (NFNF)

Non-Food Non-Fuel (NFNF) inflation increased to 5.18 per cent in the period under review from 4.99 per cent in the third quarter of 2016 (**Table 1.2**). This was largely driven by increased prices of clothing and footwear, whose contribution to NFNF inflation increased to 1.2 percentage points from 0.96 percentage points. The push on prices for this category is attributed to price adjustments during the festive season. Moreover, minimal increases were recorded across all the other categories of NFNF inflation, except the 'Furnishings, Household Equipment and Routine Household Maintenance ' and the 'Alcoholic Beverages, Tobacco and Narcotics' categories, which recorded minimal declines in the period under review. Alcoholic Beverages, Tobacco and Narcotics category, whose contribution to NFNF inflation has been significantly high since December 2015 recorded lower contribution in the period under review following the dissipation of the effects of excise tax on cigarettes and beer.

Table 1.2: Contribution to Non-Food-Non-Fuel Inflation in Percentage Points

		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**
2015	Q1	0.08	1.00	0.82	0.40	-0.02	0.19	0.35	0.55	**3.37**
	Q2	0.18	1.13	0.89	0.49	0.07	0.25	0.38	0.72	**4.10**
	Q3	0.29	1.23	0.90	0.55	0.14	0.30	0.43	0.80	**4.63**
	Q4	0.59	1.23	1.05	0.56	0.15	0.27	0.45	0.77	**5.06**
2016	Q1	1.11	1.21	1.03	0.60	0.22	0.37	0.47	0.79	**5.81**
	Q2	1.11	1.08	0.92	0.51	0.24	0.40	0.49	0.65	**5.42**
	Q3	1.10	0.96	0.81	0.43	0.20	0.40	0.46	0.63	**4.99**
	Q4	0.87	1.20	0.79	0.45	0.24	0.46	0.50	0.67	**5.18**
	Oct	1.14	1.14	0.78	0.46	0.25	0.45	0.51	0.69	**5.43**
	Nov	1.12	1.25	0.80	0.44	0.24	0.45	0.49	0.68	**5.48**
	Dec	0.35	1.20	0.79	0.44	0.24	0.46	0.51	0.65	**4.64**

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

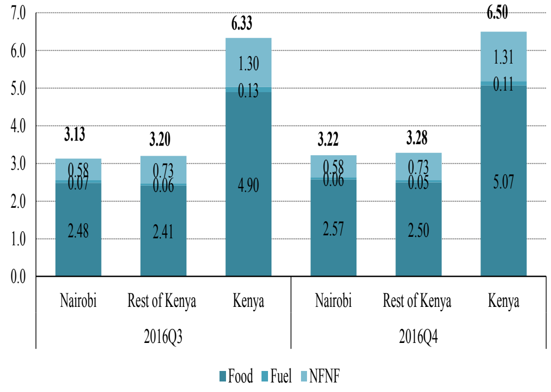
Overall Quarterly Inflation across Regions

Inflation evened out and remained stable across regions in the review period. Inflation in the 'Rest of Kenya' increased further to 6.84 per cent in the fourth quarter of 2016 from 6.39 per cent in the third quarter of 2016. However, inflation in Nairobi declined to 6.0 per cent from 6.25 per cent over the same period. The contribution of the 'Rest of Kenya' to overall inflation increased marginally to 3.28 percentage points from 3.20 percentage points while that of Nairobi increased to 3.22 percentage points from 3.13 percentage points, respectively (**Chart 1D**). Notably, inflation in both regions was largely driven by food inflation, reflecting the increased food prices during the review period as a result of the unfavorable weather conditions. Consequently, the contribution of food to inflation in Nairobi increased to 2.57 percentage points from 2.48 percentage points while that of the 'Rest of Kenya' increased to 2.50 percentage points from 2.41 percentage points.

The contribution of NFNF inflation to overall inflation remained relatively stable having recorded a marginal increase to 1.31 percentage points in the fourth quarter of 2016 from 1.30 percentage points in the third quarter of 2016. The contribution of NFNF to inflation in Nairobi and the Rest of Kenya also stabilized at 0.58 percentage points and 0.73 percentage points respectively in the period under review, signaling minimal inflationary pressures.

The contribution of fuel inflation to overall inflation declined marginally to 0.11 percentage points in the fourth quarter of 2016 from 0.13 percentage points in the third quarter of 2016. This reflected the decline in the contributions of Nairobi, from 0.07 percentage points to 0.06 percentage points, and the Rest of Kenya from 0.06 perentage points to 0.05 percentage points in the period under review.

Chart 1D: Contributions of Various Regions to Overall Quarterly Inflation in Percentage Points



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

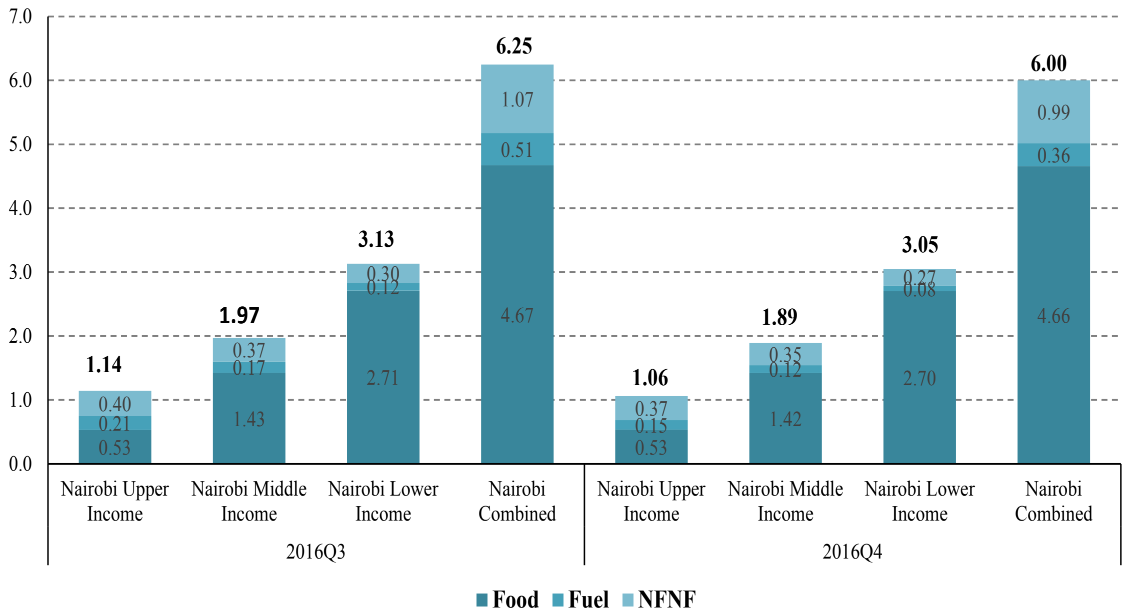
Overall Quarterly Inflation across Income Groups in Nairobi

Inflation across all income groups continued to be predominantly driven by food prices in the period under review. In Nairobi, inflation declined to 6.00 per cent in the fourth quarter of 2016 from 6.25 per cent in the second quarter of 2016. This decline was reflected across all the income groups (lower, middle and upper) and all categories (Food, Fuel and NFNF), (**Chart 1E**).

The burden of high food prices continued to be borne heavily by the low income group. The contribution of food to inflation in the lower income group marginally decreased to 2.70 per centage points in the fourth quarter from 2.71 per centage points in the third quarter of 2016. The contribution of food to inflation in the middle income group, declined negligibly to 1.42 percentage points from 1.43 percentage points, while the contribution of food to inflation in the upper income group stabilized at 0.53 percentage points.

The contribution of NFNF to inflation in Nairobi declined to 0.99 per centage points in the fourth quarter from 1.07 per centage points in the third quarter of 2016. This decline was reflected across all income groups. The Nairobi upper income group contributed 0.37 per centage points to NFNF inflation compared to 0.40 percentage points in the third quarter of 2016 whereas that of the middle income group declined to 0.35 percentage points from 0.37 per centage points. Similarly, the contribution of NFNF to inflation in the lower income group declined to 0.27 percentage points from 0.30 percentage points in the third quarter of 2016. The contribution of fuel to inflation in Nairobi declined to 0.36 percentage points in the fourth quarter of 2016 from 0.51 per entage points in the third quarter of 2016, reflecting declines across all income groups. In the upper income group, the contribution of fuel to inflation declined to 0.15 percentage points from 0.21 percentage points while that of the middle income group declined to 0.12 percentage points from 0.17 percentage points in the same period. Likewise, the contribution of fuel to inflation in the lower income group declined to 0.08 percentage points in the quarter under review from 0.12 percentage points in the preceding quarter.

Chart 1E: Contributions 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

Money supply (M3) changed marginally in the fourth quarter of 2016, declining by 0.3 per cent compared with an increase of 0.2 per cent in the previous quarter. The contraction was largely reflected in foreign currency deposits held by residents, which declined by 6.8 per cent. On the other hand, the decline in time and savings deposits slowed to 4.7 per cent in the fourth quarter of 2016 compared with 9.6 per cent decline registered in the previous quarter, which reflects continued reclassification of savings accounts into checking accounts by commercial banks' following implementation of the interest rates caps in mid-September 2016 (Table 2.1).

Narrow money, M1 declined to 5.8 per cent in the fourth quarter of 2016 from 9.1 per cent growth in the third quarter of 2016, largely reflected in the slowdown of demand deposits, to 6.8 per cent growth from 11.3 per cent. The decline was however moderated by an increase in growth of currency outside banks, largely attributable to end year festivities. However, growth in accumulation of government securities by nonbanks during the quarter under review increased to 8.2 per cent from 4.4 per cent in the third quarter of 2016, which largely explains the stagnation of money supply growth (**Table 2.1 and Chart 1**).

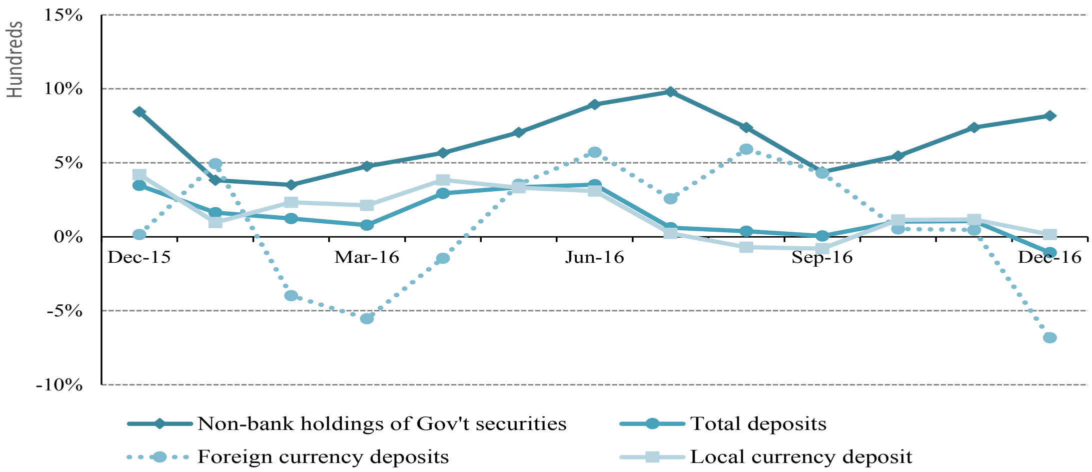
Table 2.1: Monetary Aggregates (KSh Billion)

	END MONTH LEVEL				QUARTERLY % CHANGE				QUARTERLY ABSOLUTE CHANGE(KSh BN)			
	Mar-16	Jun-16	Sep-16	Dec-16	Mar-16	Jun-16	Sep-16	Dec-16	Mar-16	Jun-16	Sep-16	Dec-16
COMPONENTS OF M3												
1. Money supply, M1 (1.1+1.2+1.3)	**1,076.77**	**1,133.71**	**1,236.72**	**1,308.93**	**5.19**	**5.29**	**9.09**	**5.84**	**53.09**	**56.94**	**103.01**	**72.20**
1.1 Currency outside banks	183.38	187.89	186.62	209.49	-3.97	2.46	-0.68	12.25	-7.58	4.51	-1.27	22.87
1.2 Demand deposits	839.00	878.86	977.84	1,043.91	8.72	4.75	11.26	6.76	67.28	39.86	98.99	66.06
1.3 Other deposits at CBK 1/	54.14	66.68	71.92	55.13	-10.81	23.16	7.86	-23.35	-6.56	12.54	5.24	-16.79
2. Money supply, M2 (1+2.1)	**2,262.26**	**2,333.11**	**2,320.83**	**2,342.62**	**1.23**	**3.13**	**-0.53**	**0.94**	**27.46**	**70.85**	**-12.28**	**21.80**
2.1 Time and saving deposits	1,185.49	1,199.40	1,084.10	1,033.70	-2.12	1.17	-9.61	-4.65	-25.63	13.90	-115.30	-50.41
3. Money supply, M3 (2+3.1)	**2,662.20**	**2,755.92**	**2,761.84**	**2,753.53**	**0.15**	**3.52**	**0.21**	**-0.30**	**4.03**	**93.73**	**5.92**	**-8.31**
3.1 Foreign Currency Deposits	399.94	422.82	441.01	410.90	-5.53	5.72	4.30	-6.83	-23.43	22.88	18.20	-30.11
SOURCES OF M3												
1. Net foreign assets 2/	**472.26**	**562.99**	**592.14**	**495.51**	**-3.91**	**19.21**	**5.18**	**-16.32**	**-19.20**	**90.73**	**29.14**	**-96.62**
Central Bank	640.77	694.58	687.19	621.58	3.12	8.40	-1.06	-9.55	19.40	53.81	-7.40	-65.60
Banking Institutions	-168.51	-131.59	-95.05	-126.07	29.71	-21.91	-27.77	32.64	-38.59	36.92	36.54	-31.02
2. Net domestic assets (2.1+2.2)	**2,189.93**	**2,192.93**	**2,169.71**	**2,258.02**	**1.07**	**0.14**	**-1.06**	**4.07**	**23.23**	**3.00**	**-23.23**	**88.31**
2.1 Domestic credit	**2,823.30**	**2,854.65**	**2,858.49**	**2,972.87**	**1.05**	**1.11**	**0.13**	**4.00**	**29.37**	**31.36**	**3.83**	**114.38**
2.1.1 Government (net)	543.62	559.34	524.16	591.72	3.74	2.89	-6.29	12.89	19.59	15.72	-35.19	67.57
2.1.2 Private sector	2,216.04	2,239.43	2,266.87	2,299.70	0.51	1.06	1.23	1.45	11.23	23.40	27.44	32.83
2.1.3 Other public sector	63.65	55.88	67.47	81.45	-2.22	-12.20	20.73	20.73	-1.45	-7.77	11.59	13.98
2.2 Other assets net	**-633.36**	**-661.72**	**-688.78**	**-714.86**	**-54.70**	**4.48**	**4.09**	**3.79**	**764.80**	**-28.36**	**-27.06**	**-26.07**
MEMORANDUM ITEMS												
4. Overall liquidity, L (3+4.1)	**3,429.71**	**3,592.05**	**3,634.62**	**3,697.72**	**1.15**	**4.73**	**1.19**	**1.74**	**38.89**	**162.34**	**42.57**	**63.09**
4.1 Non-bank holdings of government securities	767.51	836.13	872.78	944.19	4.76	8.94	4.38	8.18	34.86	68.62	36.65	71.41

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 2A: Quarterly Growth in Deposits and Non-Bank Holdings of Government Securities in Per cent



Source: Central Bank of Kenya

ii. Sources of M3

The marginal (0.3 per cent) decline in M3 in the fourth quarter of 2016 is tracked largely to a sharp fall (by 16.3 per cent) in the Banking System's net foreign assets (NFA) which fully offset improvement (by 4.1 per cent) in the System's net domestic assets (NDA) as shown in Table 2.1. The sharper decline in NFA during the quarter, compared to the third quarter of 2016 is attributed to government payments of due external debt and debt servicing. These payments are reflected largely in the NFA holdings of the Central Bank of Kenya. The decline in Banking System NFA also reflect accelerated accumulation of foreign liabilities by commercial banks.

The Net Domestic Assets (NDA) of the banking system increased by 4.1 per cent in the fourth quarter of 2016 from a deceleration of 1.1 per cent in the previous quarter. The rise in NDA mainly reflected in net credit to Government and credit to the private sector and other public sector in the fourth quarter of 2016.

iii. Developments in Domestic Credit

Net credit to government increased by 12.9 per cent in the fourth quarter from 6.3 per cent decline in the third quarter of 2016, reflecting improvement in commercial bank's holding of government securities (**Table 2.2**). Growth in bank credit to the private sector remained stable at 1.4 per cent in the fourth of quarter compared to 1.2 per cent in the previous quarter.

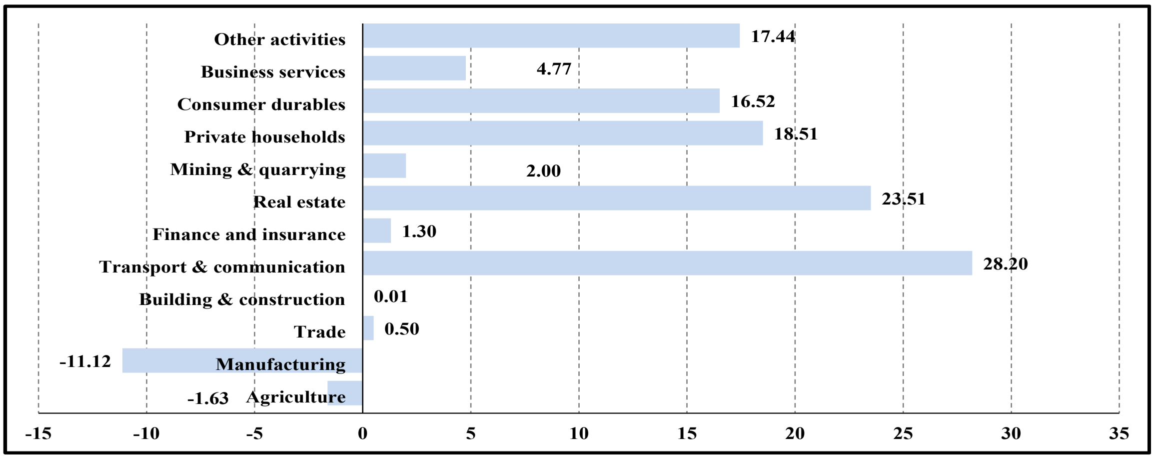
The credit distribution across activities in the private sector was more balanced in the fourth quarter of 2016 (Table 2.2). The stable flow in the last two quarters support the flattening of the 12 month decline observed since the last five quarters. This tapering and the increased monthly flows support expected recovery of private sector credit growth. In terms of shares to total net private sector credit flows, transport and communication ranked highest with a share of 28.2 per cent, followed by real estate, which recorded a share of 23.5 per cent. Meanwhile, manufacturing, business activities, and agriculture registered loan repayments in the fourth quarter of 2016 (**Chart 2B**).

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

	END MONTH LEVEL				QUARTERLY CHANGES (%)					QUARTERLY CHANGES (KSH BN)				
	Mar-16	Jun-16	Sep-16	Dec-16	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
1. Credit to Government	**543.6**	**559.3**	**524.2**	**591.7**	**-5.3**	**3.7**	**2.9**	**-6.3**	**12.9**	**-29.2**	**19.6**	**15.7**	**-35.2**	**67.6**
Central Bank	-80.8	-156.1	-182.9	-113.9	-193.5	85.1	93.3	17.1	-37.7	-90.3	-37.1	-75.4	-26.8	69.0
Commercial Banks & NBFIs	624.4	715.5	707.1	705.7	12.1	10.0	14.6	-1.2	-0.2	61.1	56.7	91.1	-8.4	-1.4
2. Credit to other public sector	**63.6**	**55.9**	**67.5**	**81.5**	**-4.3**	**-2.2**	**-12.2**	**20.7**	**20.7**	**-2.9**	**-1.4**	**-7.8**	**11.6**	**14.0**
Local government	4.1	3.5	4.6	4.6	36.4	-30.9	-13.2	28.5	0.9	1.6	-1.8	-0.5	1.0	0.0
Parastatals	59.6	52.3	62.9	76.9	-7.1	0.6	-12.1	20.2	22.2	-4.5	0.4	-7.2	10.6	13.9
3. Credit to private sector	**2,216.0**	**2,239.4**	**2,266.9**	**2,299.7**	**1.9**	**0.5**	**1.1**	**1.2**	**1.4**	**40.6**	**11.2**	**23.4**	**27.4**	**32.8**
Agriculture	94.1	97.6	90.7	90.2	-2.0	5.3	3.7	-7.0	-0.6	-1.8	4.7	3.5	-6.8	-0.5
Manufacturing	303.7	306.0	280.1	276.4	-0.9	7.2	0.8	-8.5	-1.3	-2.5	20.4	2.3	-25.9	-3.7
Trade	343.5	352.3	379.4	379.6	-1.8	10.9	2.6	7.7	0.0	-5.7	33.8	8.8	27.1	0.2
Building and construction	100.8	101.5	104.8	104.8	4.3	-6.6	0.7	3.3	0.0	4.4	-7.1	0.7	3.3	0.0
Transport & communications	183.0	183.0	195.4	204.6	3.4	2.5	0.0	6.8	4.7	5.9	4.4	0.0	12.4	9.3
Finance & insurance	84.7	88.4	84.4	84.9	-11.5	16.1	4.4	-4.5	0.5	-9.4	11.7	3.7	-3.9	0.4
Real estate	312.4	323.2	329.6	337.4	0.2	2.8	3.5	2.0	2.3	0.5	8.5	10.8	6.4	7.7
Mining and quarrying	22.6	23.6	16.1	16.8	-14.6	9.0	4.3	-31.6	4.1	-3.6	1.9	1.0	-7.5	0.7
Private households	350.4	349.6	378.2	384.3	-3.7	3.7	-0.2	8.2	1.6	-13.1	12.5	-0.8	28.7	6.1
Consumer durables	154.7	155.9	164.9	170.4	-0.5	22.6	0.8	5.8	3.3	-0.6	28.6	1.2	9.0	5.4
Business services	172.5	162.2	153.9	155.4	38.4	-29.5	-6.0	-5.2	1.0	67.8	-72.1	-10.3	-8.4	1.6
Other activities	93.8	96.2	89.2	94.9	-1.1	-27.8	2.6	-7.3	6.4	-1.4	-36.0	2.4	-7.0	5.7
4. TOTAL (1+2+3)	**2,823.3**	**2,854.7**	**2,858.5**	**2,972.9**	**0.3**	**1.1**	**1.1**	**0.1**	**4.0**	**8.5**	**29.4**	**31.4**	**3.8**	**114.4**

Source: Central Bank of Kenya

Chart 2B: Share of Credit by Sectors (%) in the Forth Quarter of 2016



Source: Central Bank of Kenya

iv. Reserve Money

Reserve money (RM) which comprises currency held by the non-bank public and commercial banks reserves improved by 4.7 per cent in the fourth quarter of 2016 from a growth of 0.7 per cent in the third quarter of 2016. Growth in reserves money was largely reflected in currency outside banks, which recovered by 12.3 per cent from 0.7 per cent decline in the third quarter of 2016 (**Table 2.3**).

The RM growth is attributable to increased utilization of Government deposits at the Central Bank of Kenya an increase in commercial banks net credit from the Central Bank of Kenya (largely through open market operations).

v. Interest Rates

a). The Central Bank Rate

.... The Monetary Policy Committee (MPC) retained the Central Bank Rate (CBR) at 10.0 per cent in their bi-monthly MPC meeting held in November 2016 in order to anchor inflation expectations.

b). Short Term Interest Rates

.... Short term interest rates depicted a mixed performance in the fourth quarter of 2016 (Table 2.4). The reverse repo rate was stable at 10.10 per cent compared with 10.49 per cent in the previous quarter. The 91-day Treasury bill rate, which largely reflects the government's borrowing profile rose to 8.14 per cent in fourth quarter of 2016 from 7.98 per cent in the third quarter, while the 182-day Treasury bill rate decreased marginally to 10.40 per cent from 10.49 per cent (**Table 2.4**)

c).Lending and Deposit Rates

.... Commercial banks' average lending interest decreased to 13.88 per cent in the fourth quarter of 2016 from 16.55 per cent in the third quarter of 2016, largely on account of the implementation of interest rate capping law effected in mid-September 2016. The decline was reflected in all loan categories. Meanwhile, the average commercial banks' deposit rate recorded an increase of 7.60 per cent from 6.67 per cent in the same period under review. The increase

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

	END QUARTER LEVELS				QUARTERLY FLOWS(KSH BN.)				QUARTERLY % CHANGE			
	Mar-16	Jun-16	Sep-16	Dec-16	Mar-16	Jun-16	Sep-16	Dec-16	Mar-16	Jun-16	Sep-16	Dec-16
1. Net Foreign Assets	640.8	694.6	687.2	621.6	19.4	53.8	-7.4	-65.6	3.1	8.4	-1.1	-9.5
2. Net Domestic Assets	-238.9	-304.4	-294.4	-210.4	-9.9	-65.5	10.0	83.9	4.3	27.4	-3.3	-28.5
2.1 Government Borrowing (net)	-80.8	-156.1	-189.9	-113.9	-37.1	-75.4	-26.8	69.0	85.1	93.3	17.1	-37.7
2.2 Commercial banks (net)	-8.2	3.0	42.0	43.2	13.5	11.1	39.1	1.2	-62.3	-136.4	1315.8	2.9
2.3 Other Domestic Assets (net)	-153.5	-154.7	-150.0	-143.2	13.8	-1.2	-2.2	13.7	-8.2	0.8	1.4	-8.7
3. Reserve Money	401.9	390.2	392.8	411.1	9.5	-11.7	2.6	18.3	2.4	-2.9	0.7	4.7
3.1 Currency outside banks	183.4	187.9	186.6	209.5	-7.6	4.5	-1.3	22.9	-4.0	2.5	-0.7	12.3
3.2 Bank reserves	218.5	202.3	206.2	201.7	17.1	-16.2	3.9	-4.6	8.5	-7.4	1.9	-2.2

Source: Central Bank of Kenya

was largely reflected in the savings category which increased by 394 basis points to 6.32 per cent from 2.38 per cent. Consequently, the interest rate spread narrowed to 6.09 per cent in the fourth quarter of 2016 from 9.89 per cent in the previous quarter of 2016 (**Table 2.4**).

Table 2.4: Interest Rates (%)

	2015				2016			
	Mar	**June**	**Sept**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**
91-day Treasury bill rate	8.56	8.31	12.24	14.60	10.24	8.11	7.98	8.14
182-day Treasury bill rate	10.30	10.39	12.48	15.65	12.49	10.23	10.49	10.40
Interbank rate	6.92	10.57	17.38	10.29	4.92	4.13	5.11	4.93
Repo rate	8.01	8.86	11.20	10.37	7.61	7.09	8.81	7.05
Reverse Repo rate	-	-	-	14.75	11.55	11.54	10.49	10.10
Central Bank Rate (CBR)	8.50	9.00	11.50	11.50	11.50	10.50	10.00	10.00
Average lending rate (1)	**15.62**	**15.57**	**16.09**	**17.35**	**17.87**	**18.06**	**16.55**	**13.88**
Overdraft rate	15.77	15.42	16.23	17.58	18.19	18.22	16.47	13.64
1-5years	16.42	16.49	16.94	17.68	18.09	18.45	16.92	13.81
Over 5years	14.66	14.57	14.93	16.72	17.35	17.46	16.12	13.66
Average deposit rate (2)	**6.66**	**6.60**	**6.83**	**7.65**	**7.41**	**6.62**	**6.67**	**7.60**
0-3months	8.56	8.30	9.05	10.73	10.03	8.67	8.26	7.65
Over 3 months deposit	9.86	9.75	9.92	10.69	10.77	9.64	9.36	8.82
Savings deposits	1.55	1.74	1.53	1.52	1.42	1.56	2.38	6.32
Spread (1-2)	**8.96**	**8.98**	**9.25**	**9.70**	**10.46**	**11.45**	**9.89**	**6.09**

Source: Central Bank of Kenya

Chapter 3

The Real Sector

Overall GDP data for the fourth quarter of 2016 is not yet available.

Available economic indicators for the fourth quarter of 2016 point to mixed performance, with lower production recorded in agriculture and electricity generation which was attributed to depressed rainfall experienced during the quarter. However, available indicators for the manufacturing, tourism, and transport and storage sectors point to generally improved performance during the quarter under review.

The Agriculture Sector

Production in the sector was varied, with production of tea, sugarcane, and milk intake in the formal sector increasing in the fourth quarter of 2016. Meanwhile coffee sales and horticulture production declined during the fourth quarter of 2016.

Tea

Tea production increased by 32.3 per cent in the fourth quarter of 2016 compared to the previous quarter, boosted by increased monthly production in December 2016 that fully offset declined output in November 2016 (**Table 3.1**). However, tea production declined by 1.4 per cent compared to the same quarter of 2015, with the Tea Directorate attributing the decline to drought conditions that begun during the quarter under review. The average auction price per kilogram of tea increased by 9.97 per cent to KSh 262.69 in the fourth quarter of 2016 compared to KSh 238.88 recorded in the previous quarter on account of rising international tea prices.

Coffee

Coffee sales declined by 25.9 per cent in the fourth quarter of 2016 compared to the third quarter. Monthly sales were mixed, with a decline of 29.8 per cent recorded in December 2016 compared to a significant improvement of 50.9 per cent in November 2016. The decline recorded in December 2016 was mainly attributed to reduced activity at the Nairobi Coffee Exchange during the month owing to the festive season (**Table 3.1**). However, compared to the fourth quarter of 2015, coffee sales increased by 30.0 per cent in the fourth quarter of 2016. Auction prices increased by 16.8 per cent in the fourth quarter of 2016 compared to the previous quarter, in tandem with increasing international coffee prices.

Horticulture

Production of horticultural crops for export declined by 7.3 per cent in the fourth quarter of 2016 from the third quarter, largely attributed to unfavorable weather conditions due to depressed rainfall experienced during the fourth quarter of 2016 (**Table 3.1**). However, production was higher by 18.5 per cent when compared to the same quarter of 2015, on account of increased production of fresh vegetables, fruits and nuts. The share of export volumes of fresh vegetables to total horticultural exports increased to 43.6 per cent in the fourth quarter of 2016 from 40.4 per cent in the same quarter of 2015, while the share of export value of cut flowers declined slightly to 53.4 per cent compared with 54.6 per cent in the same quarter of 2015 (**Chart 3A**).

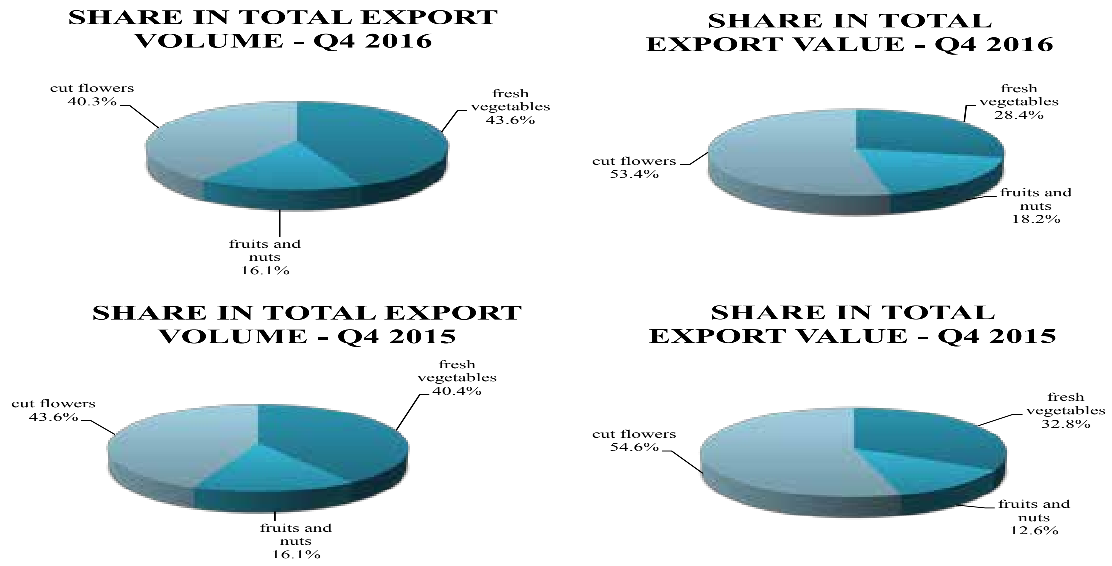
Table 3.1: Quarterly Performance of Key Agricultural Output Indicators

	2015		2016*						
	Quarterly		Quarterly				Monthly		
	Q3	Q4	Q1	Q2	Q3	Q4	Oct-16	Nov-16	Dec-16
Tea									
Output (Metric tonnes)	95,836	128,112	139,607	108,747	95,532	126,348	41,342	39,903	45,103
Growth (%)	*2.3*	*33.7*	*9.0*	*-22.1*	*-12.2*	*32.26*	*12.4*	*-3.5*	*13.0*
Horticulture									
Exports (Metric tonnes)	100,428	66,143	111,759	90,620	84,574	78,404	24,155	30,781	23,467
Growth (%)	*49.8*	*-34.1*	*69.0*	*-18.9*	*-6.7*	*-7.3*	*-17.8*	*27.4*	*-23.8*
Coffee									
Sales (Metric tonnes)	8,015	4,318	15,487	10,996	7,576	5,613	1,573	2,374	1,666
Growth (%)	*20.0*	*-46.1*	*258.6*	*-29.0*	*-31.1*	*-25.9*	*-52.1*	*50.9*	*-29.8*
Milk									
Output (million litres)	158.2	182.6	158	170.3	158.3	163.7	59.4	54.9	49.4
Growth %	*13.3*	*15.4*	*-13.5*	*7.8*	*-7.0*	*3.4*	*35.9*	*-7.6*	*-10.0*
Sugar Cane									
Output ('000 Metric tonnes)	1,764	1,613	2,068	1,721	1,742	1,630	569	541	520
Growth (%)	*10.6*	*-8.6*	*28.2*	*-16.8*	*1.2*	*-6.5*	*0.1*	*-4.9*	*-3.8*

* Provisional

Source:* *Kenya National Bureau of Statistics

Chart 3A: **Horticultural Exports**



Source: Kenya Revenue Authority

Other indicators in the agriculture sector recorded mixed performance.

Milk intake in the formal sector increased by 3.4 per cent in the fourth quarter of 2016 from the decline of 7.0 per cent seen during the previous quarter.

Sugarcane production declined by 6.5 per cent in the fourth quarter of 2016 compared to the previous quarter, with the decline recorded in monthly production in November and December 2016 (**Table 3.1**).

The Manufacturing Sector[1]

Available indicators in the manufacturing sector point to a slight improvement in performance in the fourth quarter of 2016.

[1] There is a long time lag of data availability on some indicators for the manufacturing sector.

Cement production increased marginally by 0.5 per cent in the fourth quarter of 2016 compared to the previous quarter (**Table 3.2**), and was higher by 9.6 per cent compared to the fourth quarter of 2015. Monthly production of cement in December 2016, however, declined by 4.6 per cent as activity in the construction sector slowed ahead of end of year holidays.

Production of ***soft drinks*** increased further by 7.3 per cent in the fourth quarter of 2016 compared to 3.0 per cent increase in the previous quarter. Monthly production increased significantly by 24.6 per cent in December 2016, following increased demand due to end of year festivities (**Table 3.2**).

Production of ***sugar*** increased by 7.2 per cent in the fourth quarter of 2016 from the previous quarter, supported by increased monthly production in October and November 2016 (**Table 3.2**).

Table 3.2 **Quarterly Production of Selected Manufactured Goods**

	2015		2016*						
	Quarterly		Quarterly				Monthly		
	Q3	Q4	Q1	Q2	Q3	Q4	Oct-16	Nov-16	Dec-16
Cement production									
Output (MT)	1,686,068	1,554,642	1,606,741	1,701,420	1,695,299	1,703,770	573,034	584,780	545,956
Growth %	*7.4*	*-7.8*	*3.4*	*5.9*	*-0.4*	*0.5*	*8.43*	*2.05*	*-6.64*
Assembled vehicles									
Output (No.)	2,717	2,607	1,600	1,782	1,719	N/A	357	461	N/A
Growth %	*13.9*	*-4.0*	*-38.6*	*11.4*	*-3.5*		*-42.7*	*29.1*	
Galvanized sheets									
Output (MT)	59,867	68,726	61,552	65,269	63,555	N/A	18,328	23,099	N/A
Growth %	*-6.7*	*14.8*	*-10.4*	*6.0*	*-2.6*		*-12.9*	*26.0*	
Processed sugar									
Output (MT)	184,533	167,586	153,750	136,459	138,136	148,144	48,929	51,298	46,422
Growth %	*35.2*	*-9.2*	*-8.3*	*-11.2*	*1.2*	*7.2*	*9.5*	*4.8*	*-9.5*
Soft drinks									
Output ('000 litres)	110,694	132,927	153,777	126,809	130,608	140,193	46,131	41,877	52,185
Growth %	*-4.0*	*20.1*	*15.7*	*-17.5*	*3.0*	*7.3*	*-5.6*	*-9.2*	*24.6*

MT = Metric tonnes

* Provisional

N/A - Not Available

Source: Kenya National Bureau of Statistics

Monthly production of ***galvanized sheets*** improved, increasing by 26.0 per cent in November 2016 from the decline of 12.9 per cent recorded in October 2016 (**Table 3.2**). Cumulatively, however, production of galvanized sheets in the period October-November 2016 was lower by 20.0 per cent compared to a similar period in 2015. The slowdown is largely attributed to the increasing use of alternative roofing materials such as solar tiles and shingles.

Monthly production of ***assembled vehicles*** increased by 29.1 per cent in November 2016 compared to a decline of 42.7 per cent in October 2016 (**Table 3.2**). However, cumulative production for the period October-November 2016 was significantly lower when compared to the same period in 2015, by 61.3 per cent.

The Electricity and Water Supply Sector

Electricity generation increased marginally by 0.8 per cent in the fourth quarter of 2016 compared to the previous quarter, with the decline in hydroelectricity generation fully offset by increased geothermal and thermal electricity (**Table 3.3**). When compared to the fourth quarter of 2015, total electricity generation increased by 6.1 per cent in the fourth quarter of 2016. Nevertheless, monthly data on overall electricity generation shows a decline in November and December 2016 of 1.7 per cent and 1.6 per cent, respectively, on the back of depressed rainfall that resulted in reduced generation of hydroelectricity during both months, by 11.8 per cent and 5.0 per cent, respectively. However, generation of geothermal reversed the trend of previous quarters and increased by 2.9 per cent in the fourth quarter of 2016, while thermal electricity generation was higher by 17.4 per cent during the period under review to compensate for the decline in generation of hydroelectricity.

Table 3.3: Quarterly Performance in the Energy Sector

	2015		2016						
	Quarterly		Quarterly				Monthly		
	Q3	Q4	Q1	Q2	Q3	Q4	Oct-16	Nov-16	Dec-16
Electricity Supply (Generation)									
Output (million KWH)	2,403.3	2,379.5	2,421.2	2,433.3	2,506.6	2,526.0	856.0	841.9	828.1
Growth %	*4.6*	*-1.0*	*1.8*	*0.5*	*3.0*	*0.8*	*4.3*	*-1.7*	*-1.6*
Of which:									
Hydro-power Generation (million KWH)	930.2	916.7	953.8	985.9	1049.2	970.9	356.9	314.9	299.1
Growth (%)	*7.8*	*-1.5*	*4.0*	*3.4*	*6.4*	*-7.5*	*2.4*	*-11.8*	*-5.0*
Geo-Thermal Generation (million KWH)	1,119.6	1,182.2	1,166.8	1,139.9	1,073.4	1,104.2	363.9	369.1	371.2
Growth (%)	*1.6*	*5.6*	*-1.3*	*-2.3*	*-5.8*	*2.9*	*8.5*	*1.4*	*0.6*
Thermal (million KWH)	353.5	280.7	300.7	307.5	384.0	450.8	135.2	157.9	157.7
Growth (%)	*6.2*	*-20.6*	*7.1*	*2.3*	*24.9*	*17.4*	*-1.1*	*16.8*	*-0.1*
Consumption of electricity (million KWH)	2,077.3	2,031.5	1,961.5	2,059.0	1,977.0	2,055.7	688.2	689.5	678.1
Growth %	*-6.7*	*-2.2*	*-3.4*	*5.0*	*-4.0*	*4.0*	*8.4*	*0.2*	*-1.7*
Consumption of Fuels ('000 tonnes)	1,111.9	1,106.2	1,247.1	1,227.2	1,333.9	1,398.3	478.6	433	486
Growth %	*0.1*	*-0.5*	*12.7*	*-1.6*	*8.7*	*4.8*	*-6.4*	*-9.5*	*12.3*
Murban crude oil average price (US $ per barrel)	51.1	42.7	33.7	46.1	46.3	50.6	51.4	46.2	54.2
Growth %	*-19.4*	*-16.4*	*-21.0*	*36.8*	*0.4*	*9.1*	*12.9*	*-10.1*	*17.3*

Source: Kenya National Bureau of Statistics

Tourist Arrivals

Tourist arrivals in the fourth quarter of 2016 decreased by 16.7 per cent compared to the third quarter (Table 3.4). There was increased activity in the third quarter of 2016 on account of increased conference tourism. However, when compared to the fourth quarter of 2015, tourist arrivals increased by 13.7 per cent in the fourth quarter of 2016, which points to continued recovery of the tourism sector. Monthly data on overall tourist arrivals shows an increase of 12.5 per cent in December 2016, which was reflected in the major points of entry: Jomo Kenyatta International Airport (JKIA) in Nairobi recorded 10.4 per cent increase, while Moi International Airport, Mombasa (MIAM) recorded a significant increase of 28.5 per cent .

Table 3.4: Quarterly Tourist Arrivals by Point of Entry

	2015		2016						
	Quarterly		Quarterly				Monthly		
	Q3	Q4	Q1	Q2	Q3	Q4	Oct-16	Nov-16	Dec-16
Total Tourist Arrivals	208,397	192,915	206,224	186,685	263,149	219,327	72,244	69,214	77,869
Growth (%)	*22.3*	*-7.4*	*6.9*	*-9.5*	*41.0*	*-16.7*	*-5.7*	*-4.2*	*12.5*
o.w. JKIA - Nairobi	190,009	170,078	178,283	175,056	236,119	192,055	63,229	61,224	67,602
Growth (%)	*18.3*	*-10.5*	*4.8*	*-1.8*	*34.9*	*-18.7*	*-6.0*	*-3.2*	*10.4*
MIAM - Mombasa	18,388	22,837	27,941	11,629	27,030	27,272	9,015	7,990	10,267
Growth %	*87.4*	*24.2*	*22.3*	*-58.4*	*132.4*	*0.9*	*-3.9*	*-11.4*	*28.5*

Source: Kenya Tourism Board

Transport and Storage

Passenger flows through the Jomo Kenyatta International Airport, Nairobi (JKIA) increased marginally by 0.02 per cent in the fourth quarter of 2016 compared to the previous quarter. The marginal increase was recorded in both incoming and outgoing passengers (**Table 3.5**). When compared to the fourth quarter of 2015, however, total passenger flows were marginally lower by 0.3 per cent in the fourth quarter of 2016.

On the other hand, the volume of oil that passed through the Kenya pipeline decreased by 2.4 per cent in the fourth quarter of 2016 compared to the previous quarter, with the largest decline recorded in October 2016 (**Table 3.5**). However, oil volumes were slightly higher in the fourth quarter of 2016 by 1.7 per cent compared to the same quarter in 2015.

Table 3.5: Quarterly Throughput of Selected Transport Companies

	2015		2016*						
	Quarterly		Quarterly				Monthly		
	Q3	Q4	Q1	Q2	Q3	Q4	Oct-16	Nov-16	Dec-16
Number of Passengers thro' JKIA									
Total passenger flows	1,082,120	1,082,533	1,082,784	1,079,762	1,079,331	1,079,503	359,724	359,875	359,904
Growth (%)	*-0.1*	*0.04*	*0.02*	*-0.3*	*-0.04*	*0.02*	*0.03*	*0.04*	*0.01*
o.w. Incoming	539,865	540,315	541,061	538,720	538,519	538,607	179,429	179,601	179,577
Growth (%)	*-0.5*	*0.1*	*0.1*	*-0.4*	*-0.04*	*0.02*	*0.1*	*0.1*	*-0.01*
Outgoing	542,255	542,218	541,723	541,042	540,812	540,896	180,295	180,274	180,327
Growth %	*0.3*	*-0.01*	*-0.1*	*-0.1*	*-0.04*	*0.02*	*-0.1*	*-0.01*	*0.03*
Kenya Pipeline Oil Throughput									
Output ('000 litres)	1,428,822	1,442,630	1,460,007	1,442,315	1,503,160	1,467,445	481,770	496,026	489,650
Growth %	*1.1*	*1.0*	*1.2*	*-1.2*	*4.2*	*-2.4*	*-4.0*	*3.0*	*-1.3*

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

Chapter 4

Global Economy, Balance of Payments And Exchange Rates

Global Economy

Growth in global economic output slowed to 3.1 per cent in 2016 from 3.2 per cent in 2015 (IMF, WEO January 2017 update) with subdued activity largely attributed to weak performance among the advanced economies with major economies registering declines in growth ranging between 0.2-1 percentage points. The largest decline however, was registered by the United States of America (US) on account of poor export performance and low private investment. Despite a slowdown in economic performance within the Euro Area driven by subdued domestic demand and weak export performance, individual countries such as Germany and Italy registered improvements in activity while performance in others such as France and Spain remained unchanged in 2016.

Among the emerging markets and developing economies (EMDEs), improved economic performance by the Middle East, North Africa, Afghanistan and Pakistan; and the Commonwealth and Independent States (mainly Russia) balanced out deterioration in performance by Emerging and Developing Asia (largely China and India); Emerging and Developing Europe, Latin America and the Caribbean; and Sub Saharan Africa (mainly Nigeria and South Africa). Consequently, output growth in the EMDEs stabilised at 4.1 per cent in 2016 as in 2015.

The global economic output is forecast to grow at 3.4 per cent in 2017 on account of improved output in both advanced economies and the EMDEs (IMF, WEO January 2017 update). Performance amongst the advanced economies in 2017 will largely be driven by projected acceleration of economic growth in the US to 2.3 per cent from 1.6 per cent in 2016 on the assumption of fiscal stimulus in 2017. A modest slowdown in activity within the Euro area by 0.1 percentage points to a forecast 1.6 per cent growth in 2017 with the deceleration associated with the rebound in global oil prices, increased policy uncertainties and lingering bank sector concerns about bank profitability amidst low global interest rates. Uncertainty about the Brexit process is expected to impact on growth in the United Kingdom in 2017. As a result, output growth is forecast at 1.5 per cent in 2017 from 2 per cent in 2016.

A projected pick-up in economic growth among the EMDEs is forecast at 4.5 per cent in 2017 largely reflecting expected recovery in commodity exporting EMDEs. Growth in China is projected to slow down to 6.5 per cent in 2017 from 6.7 per cent in 2016 on account of softer external demand, heightened uncertainty about global trade prospects and slower private investment. India is projected to maintain its growth momentum at 7.2 per cent in 2017 from 6.6 per cent in 2016. In Sub Saharan Africa, growth is forecast to increase to 2.8 per cent in 2017 from 1.6 per cent in 2016 on the expectation of stabilization of commodity prices.

Balance of Payments Developments

Kenya's overall balance of payments position improved from a surplus of USD 56 million during the third quarter of 2016 to a surplus of USD 569 million in the fourth quarter of 2016 (**Table 4.1**).

Table 4.1: Balance Of Payments (USD Million)

	2016**							Q4 2016-Q3 2016	
	Jan-Mar	Apr-Jun	Jul-Sep	Q4			Q4		%
ITEM	Q1	Q2	Q3	Oct	Nov	Dec	2016*	Change	Change
1. Overall Balance	**-258**	**-496**	**56**	**27**	**266**	**276**	**569**	**512**	**909.1**
2. Current account n.i.e	**-377**	**-1,165**	**-1,106**	**-346**	**-393**	**-501**	**-1,239**	**-133**	**12.0**
Exports (fob)	1,531	1,447	1,410	420	493	461	1,374	-36	-2.5
Imports (fob)	3,046	3,520	3,563	1,101	1,230	1,163	3,494	-69	-1.9
Services: credit	1,043	924	1,073	320	333	355	1,007	-65	-6.1
Services: debit	708	678	726	219	210	235	665	-61	-8.4
Balance on goods and services	-1,180	-1,827	-1,807	-581	-614	-583	-1,778	29	-1.6
Primary income: credit	90	88	91	30	30	30	90	-1	-1.4
Primary income: debit	135	199	183	38	64	223	324	141	76.9
Balance on goods, services, and primary income	-1,224	-1,939	-1,899	-589	-648	-775	-2,012	-113	6.0
Secondary income, n. i. e.: credit	867	782	802	246	258	278	783	-19	-2.3
o.w Remittances	416	437	425	143	144	161	447	23	5.3
Secondary income: debit	20	8	9	3	3	4	10	1	15.8
3. Capital Account, n.i.e.	**130**	**35**	**12**	**7**	**51**	**2**	**60**	**48**	**400.4**
4. Financial Account, n.i.e.	**-1,746**	**-1,331**	**-1,443**	**-852**	**-765**	**-1,436**	**-3,053**	**-1,610**	**111.6**

** Revised*
***Provisional*
n.i.e - not included elsewhere
fob - free on board
[1] /Based on the Balance of Payments and International Investment Position Manual 6th Edition

Source: Central Bank of Kenya

The Current Account

The current account deficit worsened to USD 1,169 million during the fourth quarter of 2016 from USD 1,106 million during the preceding quarter (**Table 4.2**). The widening reflects a drop in receipts from export of goods and services, net payments primary and secondary income, which combined more than offset the reduction in import of goods and services.

The balance on goods and services registered 1.1 per cent improvement largely driven by lower payments for imports of machinery and transport equipment (on account of a slowdown in the importation of Standard Gauge Railway (SGR) related equipment due to the winding down of phase 1 of the project) and a reduction in payments for transport, travel and other services (insurance, pension and financial services). However, payments for imports of oil increased by 6.1 per cent during the fourth quarter of 2016 mainly on account of the rebound in international oil prices. A projected pickup in oil prices is expected in 2017 (IMF, WEO January 2017 update).

Net export of goods and services declined by 4.1 per cent during the fourth quarter of 2016 on account of lower exports of goods (mainly coffee, horticulture, oil products, manufactured goods, chemicals and related products) and a reduction in receipts from transport, travel and other services (financial services; Government goods and services). The decline in horticulture exports was largely driven by lower global demand for exports of fresh vegetables as well as fruits and nuts, while the decline in receipts from travel services was mainly due to lower tourist arrivals for holiday purposes during the quarter compared to arrivals during the preceding quarter. However, the lifting of travel advisories by key Western markets, Kenya Government promotional initiatives which include substantial investment in security, aggressive marketing and charter incentive programs that began in January 2016, have had a positive impact on tourism as reflected in increased tourist arrivals for conference and business purposes during the fourth quarter of 2016. Receipts from tea exports increased supported by favourable international prices over the review period.

In the meantime, the primary income balance deteriorated by 54.6 per cent during the fourth quarter of 2016 largely reflecting an increase in debits in respect of foreign interest payments.

The balance on the secondary income account also deteriorated by 4.1 per cent during the fourth quarter of 2016 mainly on account of lower income receipts by Non-Governmental Organisations. However, remittance inflows – under personal transfers in the secondary income account – increased by 5.3 per cent during the fourth quarter of 2016.

Table 4.2: Balance On Current Account (USD Million)

ITEM	2016**							Q4 2016-Q3 2016	
	Jan-Mar	Apr-Jun	Jul-Sep	Q4			Q4		%
	Q1	Q2	Q3	Oct	Nov	Dec	2016*	Change	Change
2. CURRENT ACCOUNT	-377	-1,165	-1,106	-346	-393	-501	-1,239	-133	12.0
2.1 Goods	-1,514	-2,073	-2,154	-681	-737	-703	-2,120	33	-1.6
Exports (fob)	1,531	1,447	1,410	420	493	461	1,374	-36	-2.5
o.w Coffee	50	70	48	15	17	13	44	-4	-7.9
Tea	325	325	287	74	109	106	290	2	0.8
Horticulture	225	205	194	54	80	59	192	-2	-1.0
Oil products	7	14	16	4	4	4	12	-4	-25.8
Manufactured Goods	106	106	112	32	37	36	105	-7	-5.9
Raw Materials	119	122	122	36	49	46	131	9	7.6
Chemicals and Related Products (n.e.s)	112	113	101	30	34	34	98	-3	-3.3
Miscelleneous Man. Articles	144	134	143	43	50	52	145	3	1.8
Re-exports	234	130	186	64	48	41	153	-33	-18.0
Other	210	226	200	66	66	71	204	4	1.8
Imports (fob) of which	3,046	3,520	3,563	1,101	1,230	1,163	3,494	-69	-1.9
o.w Oil	402	542	554	196	207	185	588	34	6.1
Chemicals	544	581	567	178	180	175	534	-34	-5.9
Manufactured Goods	568	645	695	194	225	185	604	-92	-13.2
Machinery & Transport Equipment	956	1,168	1,134	321	388	398	1,108	-26	-2.3
2.2 Services	334	246	347	100	122	120	342	-4	-1.2
Transport Services (net)	183	77	77	22	22	28	72	-5	-6.9
Credit	403	308	312	91	95	98	284	-28	-8.9
Debit	220	231	235	69	73	70	213	-22	-9.5
Travel Services (net)	130	150	255	80	92	92	264	9	3.5
Credit	184	183	290	89	97	100	286	-4	-1.4
Debit	54	33	35	9	5	8	22	-13	-36.8
Other Services (net)	22	19	15	-1	8	0	7	-8	-53.8

** Revised*
***Provisional*
fob - free on board

Source: Central Bank of Kenya

Direction of Trade

China was Kenya's largest source of imports during the fourth quarter of 2016 despite a decline in the share of imports during the review period to 25 per cent from 27.3 per cent in the third quarter of 2016. The share of Kenya's imports from the European Union increased to 14.1 per cent from 13.9 per cent, while that from India rose to 14.4 per cent from 11.1 per cent. Imports from Africa accounted for 11.4 per cent during the fourth quarter of 2016 compared to 10 per cent during the third quarter (**Table 4.3A**).

Kenya's exports to Africa decreased by 1.5 per cent in the fourth quarter of 2016 (**Table 4.3B**). The decline was largely in exports to COMESA (Uganda, Egypt, DRC and Rwanda) while those to EAC increased. Exports to the rest of the world declined by 3.2 per cent. The share of exports to China increased to 2.3 per cent during the fourth quarter of 2016 compared with 1.5 per cent in the previous quarter, while that to the European Union decreased to 20.3 per cent from 21.5 per cent during the third quarter of 2016.

Table 4.3A: Kenya's Direction of Trade Imports

IMPORTS (in millions of US dollars)								Share of Imports (%)	
	2016							2016	
	Jan-Mar	Apr-Jun	Jul-Sep	Q4					
Country	**Q1**	**Q2**	**Q3**	**Oct**	**Nov**	**Dec**	**Q4**	**Q3**	**Q4**
Africa	**296**	**330**	**357**	**118**	**144**	**136**	**397**	**10.0**	**11.4**
Of which									
South Africa	97	128	137	38	44	47	129	3.8	3.7
Egypt	65	64	78	24	34	32	89	2.2	2.6
Others	134	139	142	56	67	57	179	4.0	5.1
EAC	**68**	**72**	**82**	**33**	**43**	**26**	**102**	**2.3**	**2.9**
COMESA	**149**	**151**	**163**	**66**	**85**	**71**	**222**	**4.6**	**6.4**
Rest of the World	**2,750**	**3,189**	**3,206**	**983**	**1,086**	**1,027**	**3,097**	**90.0**	**88.6**
Of which									
India	560	567	395	164	161	179	503	11.1	14.4
United Arab Emirates	142	237	313	93	72	45	210	8.8	6.0
China	640	841	971	260	309	303	873	27.3	25.0
Japan	201	195	224	50	72	70	192	6.3	5.5
USA	108	143	122	26	33	39	98	3.4	2.8
United Kingdom	72	91	80	30	28	31	89	2.2	2.6
Singapore	7	24	22	8	3	2	13	0.6	0.4
Germany	113	118	97	28	36	35	99	2.7	2.8
Saudi Arabia	128	167	163	93	68	63	224	4.6	6.4
Indonesia	115	102	121	29	41	38	109	3.4	3.1
Netherlands	38	37	43	8	23	14	45	1.2	1.3
France	54	52	58	16	17	16	48	1.6	1.4
Bahrain	11	2	24	6	13	24	43	0.7	1.2
Italy	48	59	59	21	23	24	68	1.7	1.9
Others	511	555	511	151	187	145	483	14.4	13.8
Total	**3,046**	**3,520**	**3,563**	**1,101**	**1,230**	**1,163**	**3,494**	**100.0**	**100.0**
EU	502	561	495	137	179	176	492	13.9	14.1
China	640	841	971	260	309	303	873	27.3	25.0

Source: Kenya Revenue Authority

Table 4.3B: Kenya's Direction Of Trade Exports

EXPORTS (in millions of US dollars)								Share of Exports (%)	
	2016							2016	
	Jan-Mar	Apr-Jun	Jul-Sep	Q4					
Country	**Q1**	**Q2**	**Q3**	**Oct**	**Nov**	**Dec**	**Q4**	**Q3**	**Q4**
Africa	**613**	**582**	**566**	**178**	**184**	**196**	**558**	**40.2**	**40.6**
Of which									
Uganda	153	151	157	53	52	50	155	**11.1**	**11.3**
Tanzania	105	87	70	24	31	27	82	**5.0**	**6.0**
Egypt	53	58	57	11	7	17	35	**4.0**	**2.6**
Sudan	16	12	11	4	6	3	13	**0.8**	**0.9**
South Sudan	55	41	25	14	11	14	40	**1.8**	**2.9**
Somalia	39	40	45	15	17	21	53	**3.2**	**3.9**
DRC	46	49	53	18	18	14	51	**3.8**	**3.7**
Rwanda	*41*	*44*	*45*	11	12	21	44	**3.2**	**3.2**
Others	106	100	104	27	29	27	84	**7.4**	**6.1**
EAC	**319**	**297**	**292**	**94**	**101**	**104**	**298**	**20.7**	**21.7**
COMESA	**379**	**382**	**402**	**116**	**116**	**127**	**359**	**28.6**	**26.2**
Rest of the World	**918**	**864**	**843**	**242**	**309**	**264**	**816**	**59.8**	**59.4**
Of which									
United Kingdom	107	92	91	21	33	31	85	**6.5**	**6.2**
Netherlands	137	104	110	26	42	31	99	**7.8**	**7.2**
USA	89	100	111	33	43	33	109	**7.9**	**7.9**
Pakistan	73	105	85	29	53	42	124	**6.0**	**9.0**
United Arab Emirates	82	80	79	23	23	18	63	**5.6**	**4.6**
Germany	27	35	31	8	10	9	27	**2.2**	**2.0**
India	43	23	36	9	5	5	18	**2.5**	**1.3**
Afghanistan	52	35	17	1	1	2	4	**1.2**	**0.3**
Others	309	291	283	94	100	95	288	**20.1**	**21.0**
Total	**1,531**	**1,447**	**1,410**	**420**	**493**	**461**	**1,374**	**100.0**	**100.0**
EU	349	300	303	74	110	96	280	**21.5**	**20.3**
China	17	24	21	15	7	9	31	**1.5**	**2.3**

Source: Kenya Revenue Authority

Capital and Financial Account

The capital account surplus improved by USD 48 million in the fourth quarter of 2016, to USD 60 million reflecting increase in inflows largely from project grants and aid towards development projects.

Net inflows to the financial account at USD 2,387 million in the fourth quarter of 2016 were 65.4 per cent higher than flows in the third quarter of 2016. The surplus reflected higher liabilities compared to assets during the fourth quarter of 2016. Other Investment liabilities, increased by USD 631 million to USD 2,065 million, reflecting higher uptake of loans by General Government mostly in the form of project and commercial loans over the review period. Inflows of Foreign Direct Investment also increased by USD 23 million to USD 85 million in the fourth quarter of 2016. However, inflows of Portfolio Investment declined by USD 193 million to USD 117 million.

Table 4.4: Balance on Capital and Financial Account (USD Million)

ITEM	2016** Jan-Mar Q1	Apr-Jun Q2	Jul-Sep Q3	Q4 Oct	Nov	Dec	Q4 2016*	Q4 2016-Q3 2016 Change	% Change
3. Capital Account, n.i.e.	**130**	**35**	**12**	**7**	**51**	**2**	**60**	**48**	**400.4**
Capital account, n.i.e.: credit	130	35	12	7	51	2	**60**	48	400.4
Capital account: debit	0	0	0	0	0	0	**0**	0	0.0
4. Financial Account, n.i.e.	**-1,746**	**-1,331**	**-1,443**	**-852**	**-765**	**-1,436**	**-3,053**	**-1,610**	**111.6**
Direct investment: assets	54	62	70	25	26	31	82	**12**	**16.7**
Direct investment: liabilities, n.i.e.	244	72	62	13	27	44	85	23	36.9
Portfolio investment: assets	9	6	107	67	102	2	170	64	59.9
Portfolio investment: liabilities, n.i.e.	181	132	310	50	67	0	117	-193	-62.3
Financial derivatives: net	0	0	0	0	0	0	0	**0**	**0.0**
Other investment: assets	-235	248	187	-111	173	-434	-372	-559	-298.4
Other investment: liabilities, n.i.e.	1,149	1,443	1,435	769	972	990	2,731	1,297	90.4

** Revised*
***Provisional*
n.i.e - not included elsewhere
Source: Central Bank of Kenya

Foreign Exchange Reserves

The banking system's total foreign exchange holdings decreased by 9.6 per cent during the fourth quarter of 2016. Official reserves held by the Central Bank of Kenya (CBK) constituted 79 per cent of gross reserves and stood at USD 7,573 million, equivalent to 5.3 months of import cover (**Table 4.5**). 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 4.5: Foreign Exchange Reserves and Residents' Foreign Currency Deposits (End of Period, USD Million)

`	2015 Jan-Mar Q1	Apr-Jun Q2	Jul-Sep Q3	Oct-Dec Q4	2016 Jan-Mar Q1	Apr-Jun Q2	Jul-Sep Q3	Oct 16	Nov 16	Dec 16	Q4
1. Gross Reserves	**9,834**	**9,473**	**8,899**	**9,794**	**9,809**	**10,499**	**10,602**	**10,442**	**10,327**	**9,587**	**9,587**
of which:											
Official	7,723	7,212	6,711	7,534	7,807	8,267	8,200	8,155	7,872	7,573	7,573
*import cover**	*4.8*	*4.5*	*4.2*	*4.8*	*5.0*	*5.5*	*5.6*	*5.7*	*5.5*	*5.3*	*5.3*
Commercial Banks	2,111	2,262	2,188	2,259	2,002	2,232	2,402	2,287	2,455	2,015	2,015
2. Residents' foreign currency deposits	**4,154**	**4,488**	**4,278**	**4,389**	**4,191**	**4,443**	**4,723**	**4,439**	**4,606**	**4,323**	**4,323**

*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 stable supported by a lower current account deficit and resilient inflows from diaspora remittances. The Kenya Shilling depicts relative stability against the USD since the fourth quarter of 2015 (**Table 4.6 and Chart 4A**). During the fourth quarter of 2016, the Kenya Shilling appreciated against the Pound Sterling, the Euro and the Japanese Yen but depreciated against the US Dollar. The weakening of the Shilling against the US Dollar is largely attributed to developments on the international markets – appreciation of the US Dollar against most major currencies anchored on positive US economic data during the review period.

In the EAC region, the Kenya Shilling strengthened against the Uganda Shilling, and the Rwanda and Burundi Francs but weakened against the Tanzania Shilling.

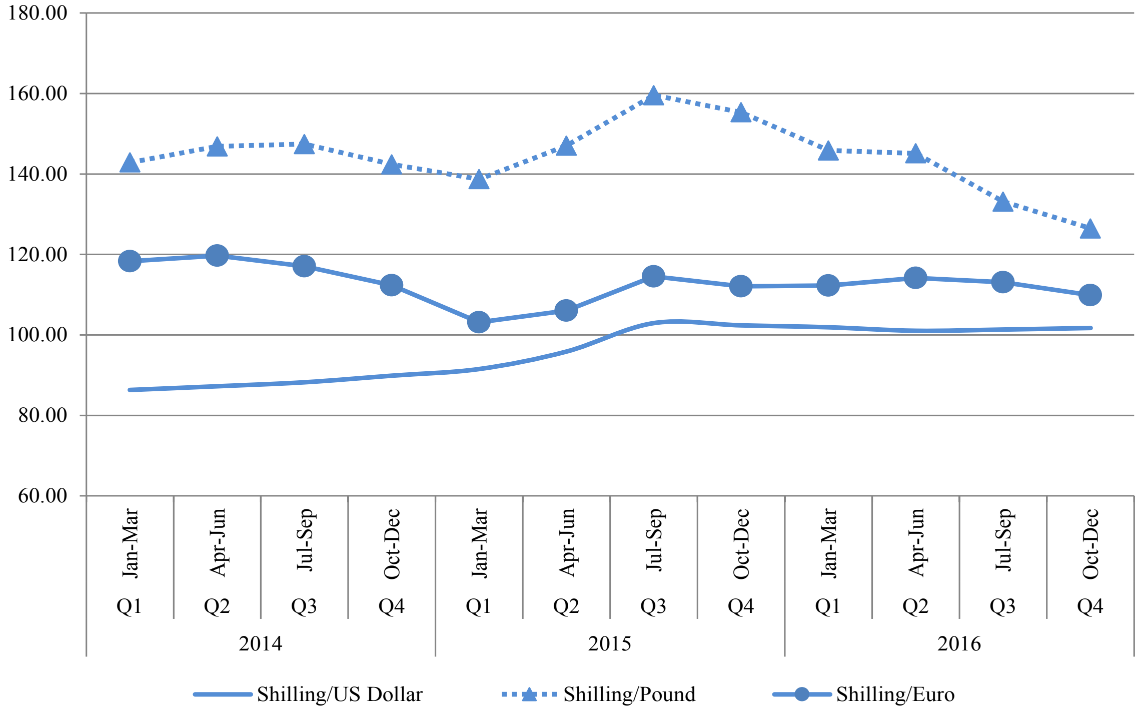
Table 4.6: Kenya Shilling Exchange Rate

	2015				2016							
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	October	November	December	Q4	% change Q4 2016 - Q3 2016
US Dollar	91.53	95.87	102.95	102.38	101.90	101.04	101.34	101.32	101.75	102.13	101.73	0.38
Pound Sterling	138.70	147.04	159.58	155.33	145.85	145.12	133.14	125.47	126.29	127.68	126.45	-5.02
Euro	103.15	106.05	114.52	112.10	112.26	114.16	113.11	111.88	109.98	107.67	109.89	-2.85
100 Japanese Yen	76.84	79.02	84.27	84.32	88.35	93.58	99.00	97.78	94.27	88.10	93.50	-5.56
Uganda Shilling*	31.62	31.97	34.21	33.95	33.51	33.18	33.32	33.88	34.93	35.25	34.68	4.08
Tanzania Shilling*	19.80	21.27	20.73	21.13	21.44	21.69	21.58	21.54	21.44	21.34	21.44	-0.63
Rwanda Franc*	7.54	7.30	7.06	7.24	7.38	7.55	7.56	7.60	7.90	7.99	7.83	3.54
Burundi Franc*	17.10	16.33	15.25	15.16	15.27	15.61	16.47	16.51	16.49	16.44	16.49	0.08

** Units of currency per Kenya Shilling*

Source: Central Bank of Kenya

Chart 4A: Kenya Shilling Exchange Rate



Source: Central Bank of Kenya

Chapter 5

The Banking Sector

Structure of the Banking Sector

The Kenyan banking sector comprised 42 commercial banks, 1 mortgage finance company, 13 microfinance banks, 8 representative offices of foreign banks, 77 foreign exchange bureaus, 17 money remittance providers and 3 credit reference bureaus as at December 31, 2016. There were no changes in the composition of the banking sector between the third quarter and fourth quarter of 2016 (**Chart 5A**).

Chart 5A: Structure of Kenyan Banking Sector

Structure of the Balance Sheet

i) Growth in banking sector assets

Total net assets dropped by 0.7 per cent to KSh 3,762.5 billion in the fourth quarter of 2016 from KSh 3,789.6 billion in the third quarter of 2016. The drop in assets is attributable to a 23 per cent decrease in placements, mainly with banks abroad following withdrawal of foreign currency deposits by some corporate clients for operational purposes. Loans and advances remained the main component of assets, and accounted for 58.8 per cent in the fourth quarter, 2016, which was an increase from 57.1 per cent recorded in third quarter, 2016.

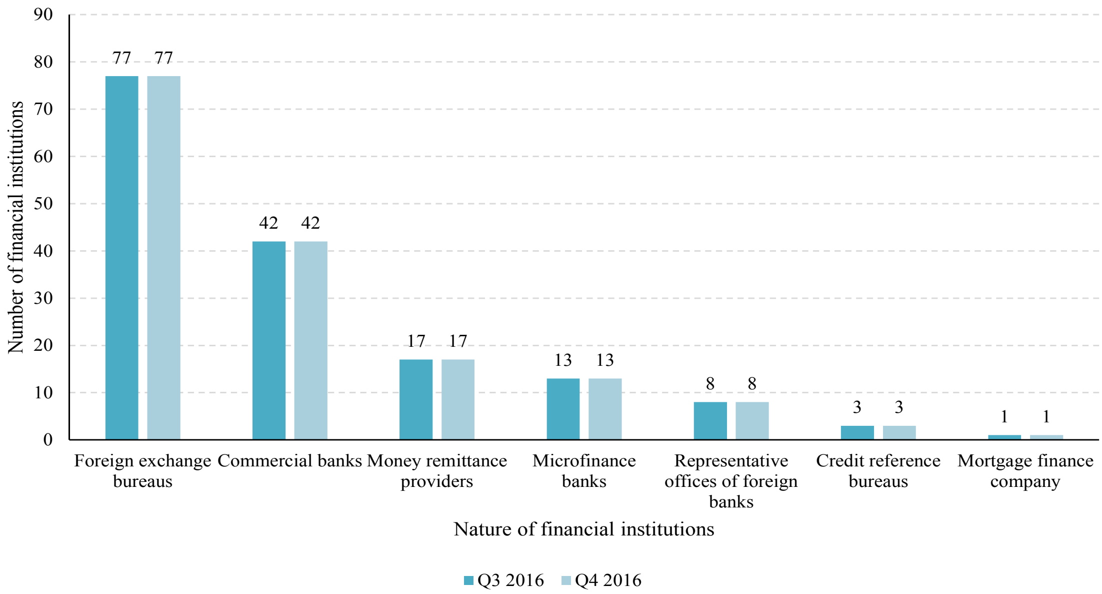
ii) Loans and Advances

Total banking sector lending increased by 2.5 per cent to KSh 2,327.4 billion in the fourth quarter of 2016 from KSh 2,271.5 billion in the previous quarter. Eight of the eleven economic sectors registered increases in gross loans (**Chart 5B**). This was an increase from six economic sectors which registered increases in the third quarter of 2016.

Chart 5B: Change in Gross Loans in the fourth Quarter of 2016

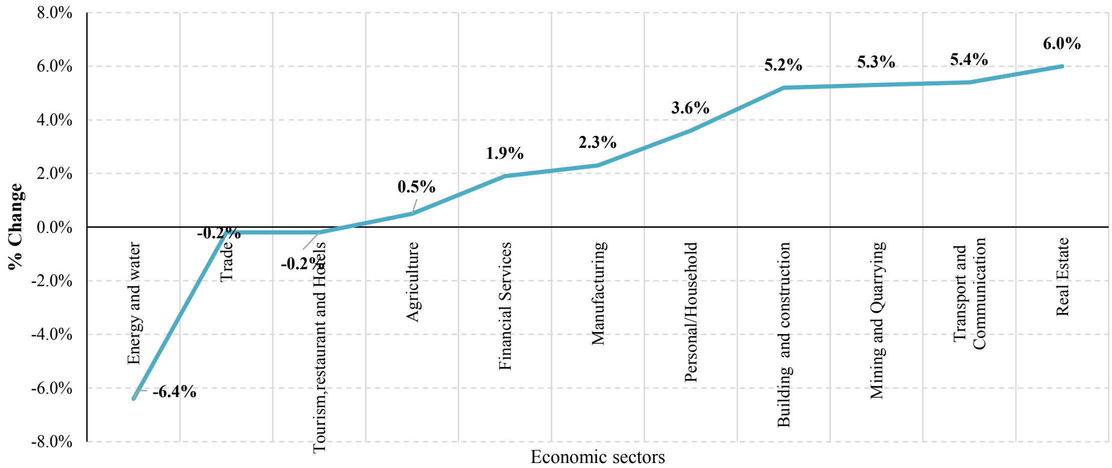
The Real Estate sector recorded the highest growth in credit at 6.0 per cent in the fourth quarter of 2016. The Energy and Water sector registered the highest decrease in lending of 6.4 per cent or KSh 7.2 billion in the fourth quarter of 2016 on the back of relatively higher loan repayment. The sectoral distribution of gross loans as at 31st December 2016 is shown in **Chart 5C**.

Chart 5A: Structure of Kenyan Banking Sector



Source: Central Bank of Kenya

Chart 5B: Change in Sectoral Gross Loans Between Q3, 2016 & Q4, 2016



Source: Central Bank of Kenya

iii) Deposit Liabilities

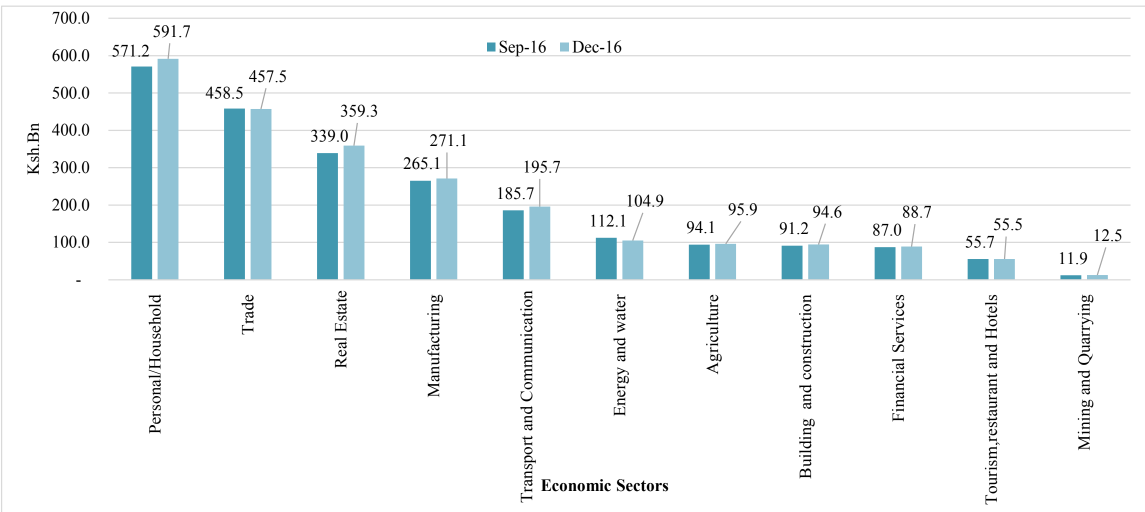
Customer deposits were the main source of funding to the banks and accounted for 70.5 per cent of the banking sector total liabilities and shareholders' funds as at the end of the fourth quarter, 2016. The customer deposits base dropped by 1.3 per cent to KSh 2,653.1 billion in the fourth quarter of 2016 from KSh 2,687.1 billion in the previous quarter. This decline reflected largely utilization of deposits by some corporate clients for operational purposes. The trend movement in deposit liabilities is shown in (**Chart 5D**).

Capital Adequacy

The Kenyan banking sector has continued to build adequate capital buffers to sustain resilience to adverse shocks. Banks are required to maintain a core capital to total deposits ratio of not less than 8 per cent. While the observed ratio during the fourth quarter of 2016 was high at 17.4 per cent, it was marginally lower than 18.4 per cent registered in the previous quarter. Core capital had declined relatively more sharply (by 7.2 per cent) than customer deposits which declined at 1.3 per cent.

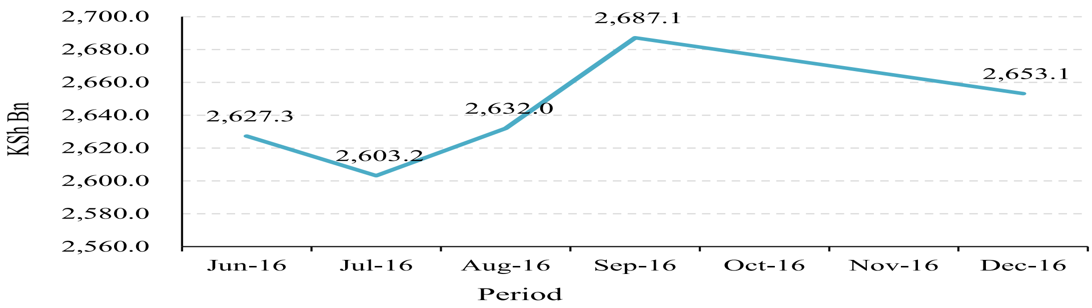
Assessed against the total risk weighted assets, total capital and core capital to total risk-weighted asset ratios decreased to 18.7 per cent and 15.8 per cent in the fourth quarter of 2016 from 19.0 per cent and 16.3 per cent, respectively in the previous quarter. Core capital and total capital decreased by 7.2 per cent and 5.5 per cent to KSh 460.4 billion and KSh 544.9 billion, respectively in the fourth

Chart 5C: Kenyan Banking Sector Gross Loans (KSh Billion)



Source: Central Bank of Kenya

Chart 5D **Customer Deposits (Ksh Billion)**



Source: Central Bank of Kenya

quarter, from KSh 496.3 billion and KSh 576.4 billion respectively in the previous quarter. Total risk-weighted assets declined by 4.1 per cent in the review period. This decline in risk weighted assets was lower than that of total capital and core capital.

Asset Quality

The gross non-performing loans (NPLs) increased by 6.7 per cent to KSh 212.6 billion as at the end of the fourth quarter of 2016 from KSh 199.2 billion in end of third quarter of 2016. Nine economic sectors recorded increased NPLs in the fourth quarter of 2016 (**Chart 5E**).

Tourism, Restaurant and Hotels sector recorded the highest increase in NPLs in the fourth quarter of 2016 at 32.2 per cent or KSh 1.1 billion. This is mainly attributable to business cash flow challenges due to low business sales/ turnovers.

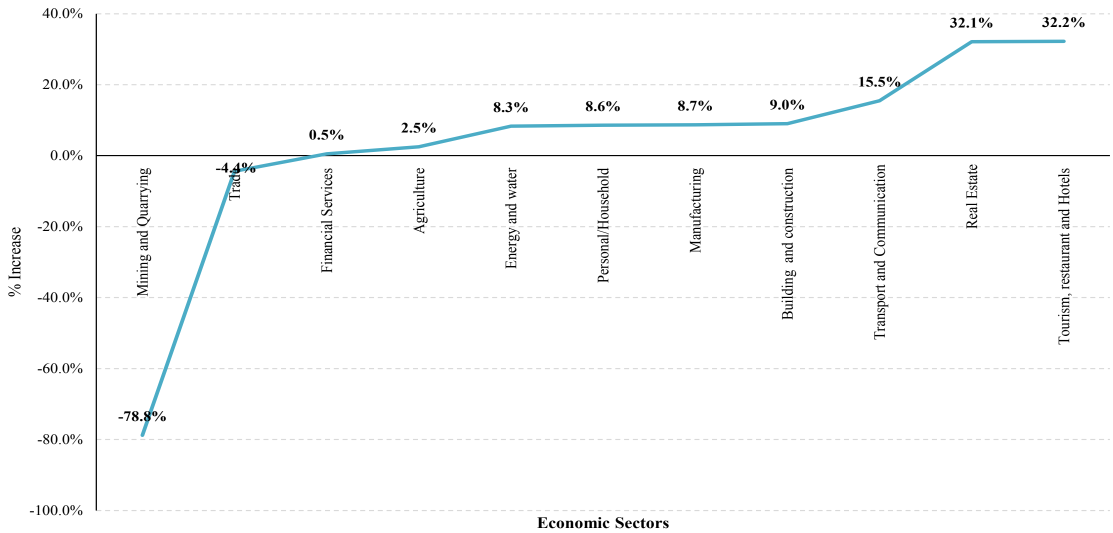
Real Estate sector registered an increase in NPLs of 32.1 per cent or KSh 6.9 billion due to low uptake of housing units constructed which affected loan repayments for the sector. Transport and Communication sector recorded an increase in NPLs of KSh 2.1 billion or 15.5 per cent. This is attributable to challenges in the business environment.

Mining and Quarrying sector registered the highest decrease in NPLs of 78.8 per cent, or KSh 1.6 billion in the fourth quarter of 2016. This was attributed to major accounts which were regularized due to favorable environment for business operations.

Trade sector NPLs declined by KSh 2.7 billion or 4.4 per cent in the fourth quarter of 2016 reflecting repayments associated with favourable business environment in the sector.

Based on the movements of NPLs highlighted above, the gross NPLs to gross loans ratio increased marginally to 9.1 per cent in fourth

Chart 5E: **Change in Gross NPLS**



Source: Central Bank of Kenya

quarter of 2016 from 8.9 per cent in third quarter of 2016. The detailed sectoral distribution of gross NPLs in the fourth quarter of 2016 is shown in **Chart 5F**.

The banking sector's asset quality measured by the proportion of net non-performing loans to gross loans improved to 4.6 per cent in fourth quarter of 2016 from 4.7 per cent in third quarter of 2016. Similarly, the coverage ratio, which measure total NPLs as a percentage of specific provisions increased to 37.7 per cent in fourth quarter of 2016 from 35.3 per cent in third quarter of 2016 due to a higher increase in specific provisions as compared to increase in NPLs between the two periods.

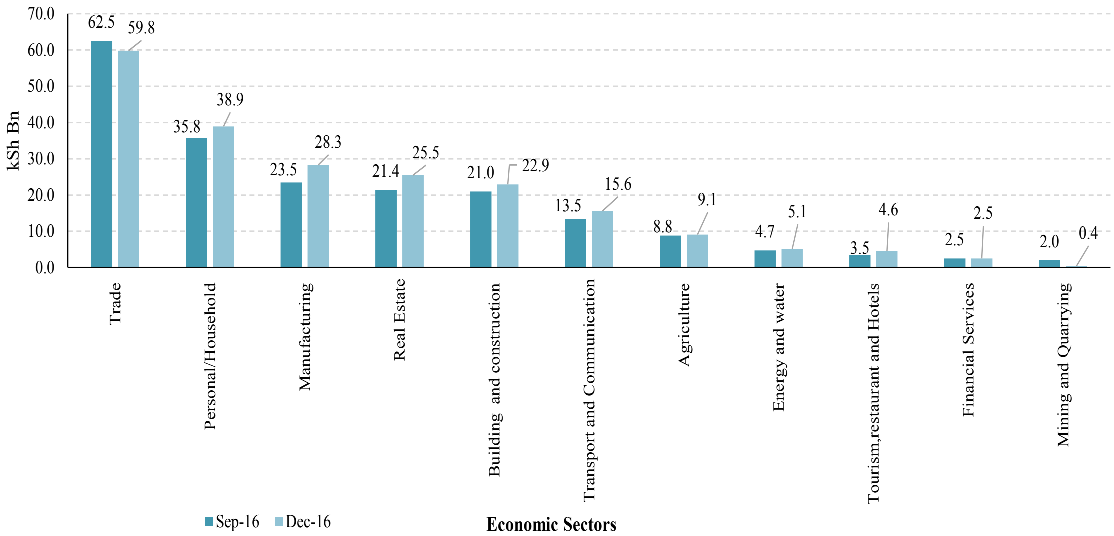
A summary of asset quality for the banking sector over the period is shown in **Table 5.1**.

Profitability

The banking sector pre-tax profits decreased by 27.3 per cent to KSh 29.1 billion in fourth quarter of 2016 from KSh 40.0 billion in the previous quarter. The decline was mainly attributable to a decrease in income and increase in expenses during the quarter under review. Total income declined by 6.8 per cent to KSh 117.9 billion from KSh 126.5 billion in the third quarter, while total expenses increased by 2.4 per cent to KSh 88.8 billion from KSh 86.7 billion in the third quarter of 2016.

The lower income reflects in interest on loans which decreased by 14.5 per cent or KSh 11.1 billion. The increase in expenses was largely attributable to a 29.0 per cent (KSh 25.8 billion) increase in interest on deposits. These developments are attributed to interest capping on deposits which took effect from September 14, 2016.

Chart 5F: Kenyan Banking Sector Gross Non-Perfoming Loans (KSh Billion)



Source: Central Bank of Kenya

Table 5.1: Summary of Asset Quality

		Sept-16, KSh'Bn	Dec-16, KSh'Bn
1	Gross Loans and Advances (KSh 'Bn)	2271.5	2327.4
2	Interest in Suspense (KSh 'Bn)	34.11	42.3
3	Loans and advances (net of interest suspended) (KSh'Bn)	2237.4	2285.1
4	Gross non-performing loans (KSh 'Bn)	199.2	212.6
5	Specific Provisions (KSh 'Bn)	58.3	64.1
6	General Provisions (KSh 'Bn)	19	20.1
7	Total Provisions (5+6) (KSh 'Bn)	77.3	84.2
8	Net Advances (3-7) (KSh 'Bn)	2160	2200.9
9	Total Non-Performing Loans and Advances (4-2) (KSh 'Bn)	165.1	170.3
10	Net Non-Performing Loans and Advances (9-5) (KSh 'Bn)	106.8	106.1
11	Total NPLs as % of Total Advances (9/3)	7.40%	7.50%
12	Net NPLs as % of Gross Advances (10/1)	4.70%	4.60%
13	Specific Provisions as % of Total NPLs (5/9)	35.30%	37.70%

Source: Central Bank of Kenya

Interest on loans and advances, interest on government securities and other incomes were the major sources of income and accounted for 59.7 per cent, 18.3 per cent and 15.8 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 32.7 per cent, 24.2 per cent and 22.1 per cent of total expenses, respectively.

The return on assets remained constant at 3.3 per cent in third quarter of 2016 and fourth quarter of 2016 while return on shareholders' funds decreased to 24.8 per cent in the fourth quarter of 2016 from 27.0 per cent in the third quarter of 2016. The decrease was as a result of reduced profitability.

Liquidity

The banking sector's overall liquidity ratio decreased to 41.4 per cent in the fourth quarter, 2016 from 42.9 per cent recorded in the third quarter, 2016. The decrease was mainly attributed to a relatively slower growth in liquid assets compared to the increase in short term liabilities. The banking sector liquidity ratio recorded was above the minimum statutory level of 20 per cent.

Outlook of the Sector

The Kenyan banking sector is expected to remain stable in 2017. Credit risk is expected to remain elevated but will be mitigated by improvements in the business environment. Liquidity risk is expected to be mitigated by improved distribution of liquidity across the banking sector.

KENYA SHILLING FLOWS IN KEPSS

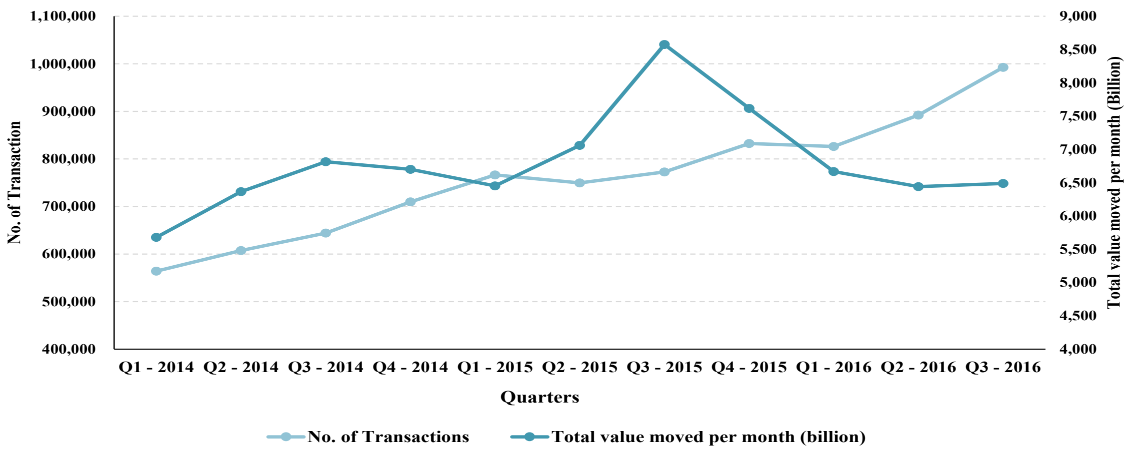
Kenya Electronic Payments and Settlement System (KEPSS) used for large value Real Time Gross Settlement (RTGS) payments moved a volume of 1.26 million transaction messages worth KSh 7.1 trillion in the fourth quarter of 2016, compared to the third quarter of 2016 which recorded 0.99 million transactions worth KSh 6.5 trillion. Volume and value moved increased by 27.3 per cent and 9.2 per cent, respectively. **Chart 5G** 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.

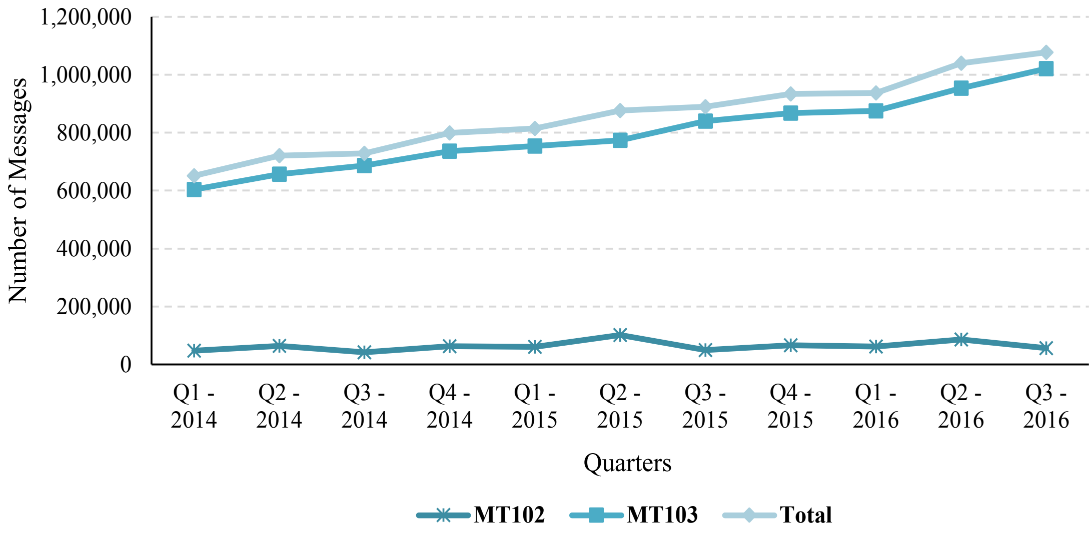
During the period under review, MT 102 usage increased by 28.7 per cent, to 71,829 messages recorded in the fourth quarter of 2016 from 55,812 messages processed in the previous quarter. The MT 103 payments increased 8.8 per cent, to 1,111,036 messages in the fourth quarter of 2016 from 1,020,792 messages in the previous quarter (**Chart 5H**). The sustained growth of KEPSS is an indicator of its popularity as a safe, secure, and reliable platform for conducting banking transactions.

Chart5G: Trends in Monthly Flows Through KEPSS



Source: Central Bank of Kenya

Chart 5H: Trends in MT102 and MT103 Volumes Processed Through KEPSS

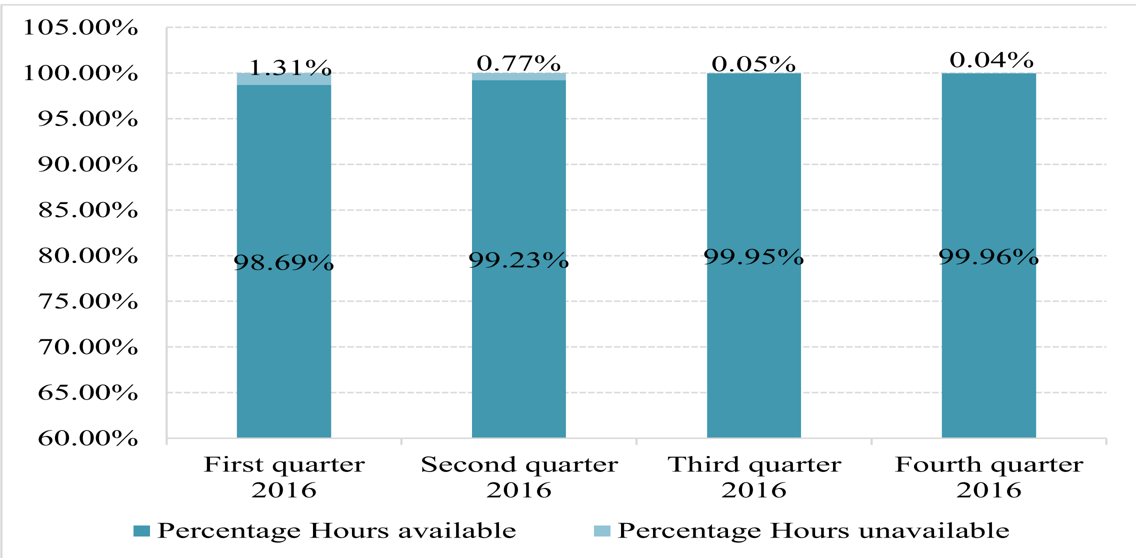


Source: Central Bank of Kenya

The KEPSS system has been available to the commercial banks and other participants for 8 hours per day as agreed by the stakeholders. The system operates from 8.30 AM to 4.30 PM in two 'windows'. However, the 'windows' can be extended to enable participants settle their obligations and fund their accounts before the system is closed.

During the period under review, KEPSS availability improved to on an average of 99.95 per cent compared to 99.23 per cent in the previous quarter (**Chart 5I**).

Chart 5I: KEPSS Availability January to September 2016



Source: Central Bank of Kenya

Chapter 6

Government Budgetary Performance

The government's budgetary operations resulted in a deficit of 1.5 per cent of GDP in the second quarter of the FY 2016/17, compared with a deficit of 1.8 per cent of GDP in the first quarter. As is typical of the first half of the financial year, budget execution was slow, thereby resulting in lower expenditures growth (**Table 6.1**).

Revenue

Cumulatively, Government receipts (comprising tax revenue and grants) were KSh 675.8 billion in the first half of FY 2016/17, equivalent to 10.9 per cent of GDP. Cumulative tax revenue alone stood at KSh 591.2 billion (9.5 per cent of GDP) and was KSh 31.4 billion below target. Tax revenue in the second quarter of 2016/17 was 4.5 per cent higher than KSh 280.9 billion collected in the first quarter of the FY 2016/17. The shortfall in the second quarter of 2016/17 reflected in PAYE, Import Duty and VAT on imports collection.

External grants in the latter half of the year to December 2016 stood at KSh 6.4 billion, which was KSh 28.3 billion lower than target due to a low absorption of donor funds at the start of the Fiscal Year.

Ministerial Appropriations in Aid (A-in-A) collected in the first half of the FY 2016/17 was KSh 45.6 billion. This represented a shortfall of KSh 12.2 billion due to under reporting in the ministry expenditure returns. The shortfall in ministerial A-in-A collections was also observed in the first quarter of 2016/17 for similar reasons.

Excise tax, VAT on local goods and other income tax performed above their targets. As observed in previous years, the collection of revenues is usually slow at the start of the fiscal year but picks up in the second quarter of the year. The outlook for revenue collection remains optimistic, especially with implementation of various legal and administrative measures to address tax leakages.

Expenditure and Net Lending

Government expenditure and net lending in the first half of the FY 2016/17 stood at KSh 904.4 billion (14.5 per cent of GDP) against a target of KSh 1,110.9 billion (17.8 per cent of GDP). The shortfall of KSh 206.4 billion can be attributed to lower recurrent and development expenditures by the National and County governments. Expenditures in the second quarter under review were much higher than in the first quarter in the FY2016/17.

In terms of broad categories of expenditure, recurrent expenditure was below target by KSh 46.5 billion. Domestic interest payments for the first half of the FY 2016/17 amounted to KSh 64.0 billion compared to KSh 36.1 billion in the first quarter of the FY 2016/17. Foreign

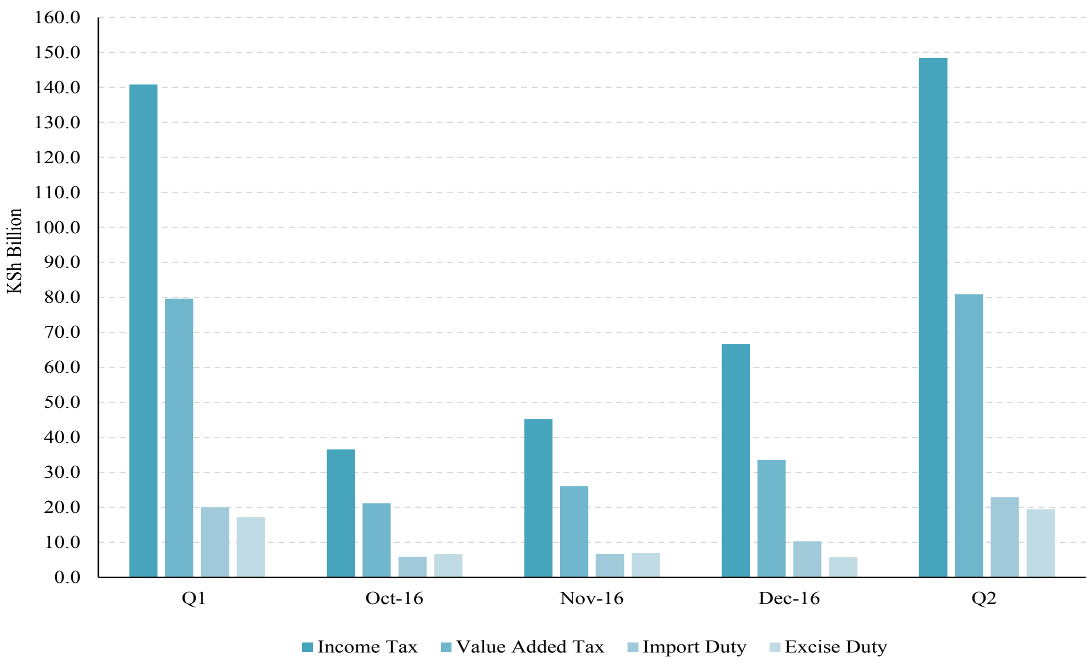
Table 6.1: Statement of Government Operations in FY 2015/16 (Ksh Billion)

	(FY 2016/17)					Cumulative to Dec 2016	Target	Over (+) / Below (-) Target
	Q1	Oct	Nov	Dec	Q2			
1. TOTAL REVENUE & GRANTS	**317.6**	**89.9**	**112.6**	**155.7**	**358.2**	**675.8**	**736.4**	**(60.7)**
Ordinary Revenue	**298.9**	**82.4**	**100.4**	**150.9**	**333.7**	**669.3**	**701.7**	**(32.3)**
Tax Revenue	280.9	76.1	85.4	131.9	293.5	591.2	622.5	(31.4)
Non Tax Revenue	18.0	6.3	15.0	18.9	40.3	32.5	21.3	11.2
Appropriations-in-Aid	17.2	6.7	7.0	5.7	19.4	45.6	57.8	(12.2)
External Grants	1.4	0.7	5.2	(0.9)	5.0	6.4	34.7	(28.3)
2. TOTAL EXPENSES & NET LENDING	**430.9**	**175.2**	**236.3**	**41.1**	**452.6**	**904.4**	**1,110.9**	**(206.4)**
Recurrent Expenses	293.8	99.0	120.9	131.2	351.0	536.6	583.1	(46.5)
Development Expenses	81.8	49.0	94.7	26.2	169.9	251.6	376.1	(124.5)
County Transfers	55.3	12.9	27.3	20.7	60.9	116.3	149.2	(32.9)
Others	-	-	-	-	-	-	2.5	**(2.5)**
3. DEFICIT ON A COMMITMENT BASIS (1-2)	**(113.3)**	**(85.4)**	**(123.6)**	**114.6**	**(94.4)**	**(228.7)**	**(409.2)**	**180.5**
As percent of GDP	(1.8)	(1.4)	(2.0)	1.8	(1.5)	(3.7)	(6.6)	2.9
4. ADJUSTMENT TO CASH BASIS	-	-	-	-	-	-	-	-
5. DEFICIT ON A CASH BASIS	**(113.3)**	**(85.4)**	**(123.6)**	**114.6**	**(94.4)**	**(228.7)**	**(409.2)**	**180.5**
As percent of GDP	(1.8)	(1.4)	(2.0)	1.8	(1.5)	(3.7)	(6.6)	2.9
6. DISCREPANCY: Expenditure (+) / Revenue (-)	257.8	270.3	-	-	270.3	-	-	-
7. FINANCING	**86.0**	**43.6**	**59.0**	**81.7**	**184.4**	**270.3**	**374.4**	**(104.1)**
Domestic (Net)	49.7	31.7	9.6	73.9	115.2	164.6	198.6	(33.9)
External (Net)	36.3	11.9	49.4	7.9	69.2	105.5	174.6	(69.1)
Capital Receipts (domestic loan receipts)	0.2	-	-	-	-	239.1	1.3	237.8
Others(Euro Bond sale proceeds)	-	-	-	-	-	-	-	-

NB: using the new re-based GDP figures as per 2016 economic survey

Sources: Provisional Budget Outrun from the National Treasury

Chart 6A: Composition of Government Revenue (Ksh Billion)



Source: Provisional Budget Outrun from the National Treasury

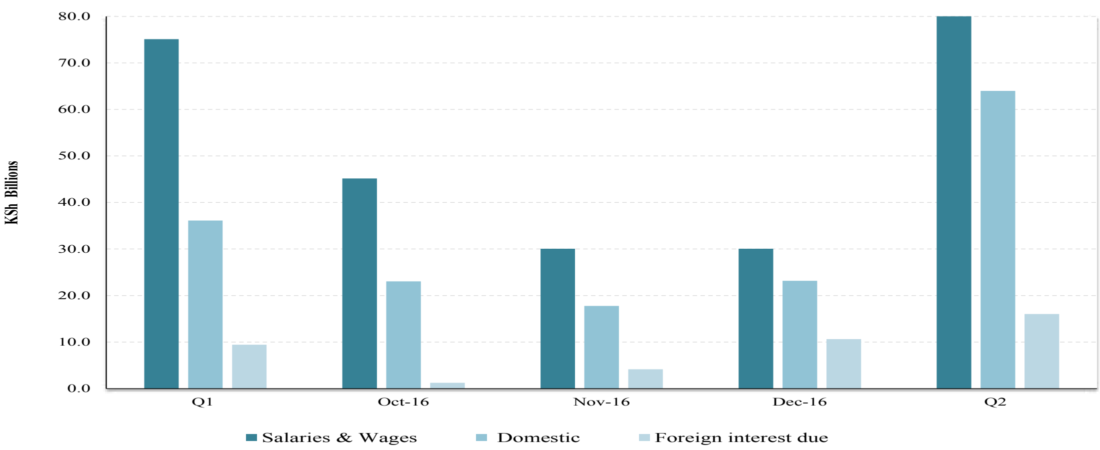
interest payments were KSh 16.0 billion, 58.7 per cent or KSh 9.4 billion higher than payment in the first quarter of the FY 2016/17 (**Chart 6B**). Cumulative Development expenditure was below target by KSh 124.5 billion. Development expenditure performed below the target on account of non-inclusion of County expenditures.

With respect to composition, the share of recurrent expenditure in total government spending was 77.6 per cent in the second quarter while the contribution of development expenditure to total government expenditure was 37.5 per cent. Development expenditures were largely channeled into infrastructure and energy and petroleum ministries for implementation of key infrastructure projects. The share of county transfers was 13.5 per cent of government spending (**Table 6.1**).

Financing

External financing in the first half of 2016/17 was KSh 105.5 billion against a target of KSh 174.6 billion. Net domestic borrowing amounted to KSh 164.6 billion over the review period. The borrowing comprised KSh 18.9 billion from commercial banks, KSh 106.8 billion from Non-banking financial institutions, KSh 37.8 billion from the CBK and KSh 1,087 million from Non-Residents (**Table 6.2**). Net domestic borrowing at KSh 49.4 billion in the first quarter of the FY 2016/17 was relatively small.

Chart 6B: Composition of Recurrent Expenses



Sources: Provisional Budget Outrun from the National Treasury

Table 6.2 Domestic Financing Ending Sept 30, 2016

	FY 2015/16	FY 2016/17					
	Q4			Q1			Q2
NET CREDIT TO GOVERNMENT 2015/2016 (Ksh Bn)	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16
1. From CBK	(111.11)	(29.30)	3.77	(24.58)	12.03	0.61	37.83
2.From commercial banks	187.15	6.25	3.12	37.36	34.73	38.93	18.86
4.From Non-banks	139.44	19.91	30.35	37.53	70.23	92.45	106.82
5. From Non-Residents	4.58	(0.71)	(1.00)	(0.87)	(0.21)	0.70	1.09
Change in Credit from banks (From 30th June 2015)*	76.05	(23.05)	6.89	12.77	46.77	39.54	56.69
Change in Credit from non-banks(From 30th June 2015)*	139.44	19.91	30.35	37.53	70.23	92.45	106.82
Change in Credit from non-residents(From 30th June 2015)*	4.58	(0.71)	(1.00)	(0.87)	(0.21)	0.70	1.09
6.Total Change in Dom. Credit (From 30th June 2015)	220.06	(3.84)	36.24	49.43	116.78	132.69	164.60

NB. Treasury Bills are reflected at Cost

** the changes in credit for each quarter, reflect the changes within the Fiscal Year 2016/2017*

Source: Central Bank of Kenya

Domestic financing in the first half of the FY 2016/17 performed well compared to a similar period in FY 2015/16 when borrowing was constrained due to tight liquidity conditions in the money market. The performance of the government's domestic borrowing programme is consistent with thresholds set in the Medium Term Debt Management Strategy.

Outlook for FY 2016/17

In the budget estimates for the FY 2016/17, total revenue is estimated at KSh 1,500.6 billion (21.3 per cent of GDP) while external grants are estimated at KSh 72.7 billion (1.0 per cent of GDP). Government expenditure is estimated at KSh 2,265 billion (30.6 per cent of GDP), of which KSh 1,164.9 billion (15.8 per cent of GDP) will be for recurrent expenses, KSh 280.3 billion for transfers to county governments, and KSh 817 billion for development expenses (**Table 6.3**).

The overall budget deficit including grants on commitment basis is therefore estimated at KSh 691.5 billion (9.4 per cent of GDP) in 2016/17. The deficit is expected to be financed through net external borrowing of KSh 462.3 billion and net domestic borrowing of KSh 229.2 billion.

Table 6.3: Budget Estimates for the Fiscal Year 2016/17 (Ksh Billion)

	Ksh (Billion)	%age of GDP
1. TOTAL REVENUE (Including Grants)	**1,573.3**	**21.3**
Ordinary Revenue	1,376.4	18.6
Appropriations-in-Aid	124.2	1.7
External Grants	72.7	1.0
2. TOTAL EXPENSES & NET LENDING	**2,264.5**	**30.6**
Recurrent Expenses	1,164.9	15.8
Development Expenses	817.0	11.1
County Transfer	280.3	3.8
3. DEFICIT ON A COMMITMENT BASIS (1-2)	**-691.2**	**-9.4**
4. ADJUSTMENT TO CASH BASIS	**0.0**	**0.0**
5. DEFICIT ON A CASH BASIS	**-691.20**	**-9.4**
6. DISCREPANCY: Expenditure (+) / Revenue (-)	**0.0**	**0.0**
7. FINANCING	**691.50**	**9.4**
Domestic (Net)	229.2	3.1
External (Net)	462.3	6.3

Source: National Treasury Budget Summary for 2016/17

Chapter 7
Public Debt

Overall Public Debt

Kenya's public and publicly guaranteed debt increased by 1.9 per cent during the second quarter of the FY 2016/17 reflecting an increase in domestic debt. As a percentage of GDP, total debt stock at the end of the quarter under review was 54.6 per cent, 100 basis points above the previous quarter. The domestic debt ratio to GDP increased by 110 basis points while the ratio of external debt to GDP declined by 10 basis points during the second quarter of the FY 2016/17 (**Table 7.1**).

Domestic Debt

Total domestic debt increased by 4.1 per cent during the second quarter of the FY 2016/17, an accelerating over the 2.2 per cent growth in the previous quarter (**Table 7.2**). The share of domestic debt to total debt rose from 50.2 per cent at the end of the first quarter to 51.3 per cent by the end of the second quarter of the FY 2016/17. This increase in domestic debt reflected Government borrowing through Treasury Bonds, Treasury bills and its overdraft facility at the Central Bank. Reflecting investor portfolio reallocation, the accumulation of domestic was biased to Treasury bonds, the relatively longer dated securities following a more normalized debt securities yield curve. Nonetheless, the share of debt securities to total domestic debt declined on account of large maturities during the quarter under review. Following improved execution of the budget and the subsequent decline of the government deposits at the Central Bank, the government utilized the overdraft window up to 57.4 per cent of its statutory limit. Consequently, the share of the government overdraft to total domestic debt increased by 140 basis points to 1.6 per cent.

Treasury Bills

Treasury bill holdings, excluding those held by the Central Bank for open market operations (Repos) increased by 0.3 per cent during the second quarter of the FY 2016/17. Conversely, the proportion of Treasury bills to total domestic debt decreased by 120 basis points during the period under review reflective of investors' preferences for longer dated securities during periods of stable interest rates. Although the dominance of commercial banks in Treasury bills market eased, the holdings of commercial banks stood at more than half (53 per cent) of the total amount of outstanding Treasury Bills by the end of the second quarter of the FY

Table 7.1: Kenya's Public And Publicly Guaranteed Debt (Ksh Billion)[1]

	FY 2015/16				2016/17						
	Q1	Q2	Q3	Q4	Jul-16	Aug-16	Q1	Oct-16	Nov-16	Q2	Change Q on Q
EXTERNAL**											
Bilateral	477.5	481.3	522.4	539.1	551.6	557.2	580.4	593.0	585.5	577.8	-2.7
Multilateral	759.3	751.2	766.6	812.3	793.9	793.9	799.7	792.5	788.8	781.3	-18.4
Commercial Banks	295.6	366.2	360.2	442.6	443.7	443.6	442.8	443.6	445.3	458.1	15.3
Supplier Credits	17.8	16.5	16.4	9.2	8.5	8.5	15.5	15.4	15.3	15.3	-0.2
Sub-Total	**1,550.2**	**1,615.2**	**1,665.6**	**1,803.2**	**1,797.7**	**1,803.3**	**1,838.4**	**1,844.5**	**1,834.9**	**1,832.4**	**-6.0**
(As a % of GDP)	22.5	23.4	24.2	26.2	26.1	26.2	26.7	26.8	26.6	26.6	
(As a % of total debt)	52.8	51.2	50.3	49.8	49.8	49.8	49.8	49.6	48.9	48.7	
DOMESTIC											
Banks	**790.3**	**865.8**	**932.3**	**1,027.2**	**1,001.6**	**998.4**	**1,028.7**	**1,018.7**	**1,035.4**	**1,032.6**	**3.8**
Central Bank	107.6	101.4	102.6	99.9	69.6	68.9	58.9	55.6	68.3	85.5	26.6
Commercial Banks	682.7	764.4	829.7	927.3	932.0	929.5	969.8	963.1	967.2	947.0	-22.8
Non-banks	**586.1**	**661.7**	**702.2**	**774.9**	**795.4**	**805.6**	**813.8**	**846.7**	**813.8**	**884.8**	**71.0**
Pension Funds	345.4	389.0	417.0	468.9	484.3	486.3	493.8	518.7	531.1	544.9	51.0
Insurance Companies	121.1	129.1	133.0	134.4	137.9	134.1	136.4	137.0	141.4	143.2	6.8
Other Non-bank Sources	119.6	143.6	152.2	171.6	173.3	185.2	183.6	191.1	141.4	196.7	13.1
Non-residents	**11.5**	**12.6**	**12.0**	**13.0**	**12.3**	**11.9**	**12.0**	**12.3**	**13.2**	**13.6**	**1.6**
Sub-Total	**1,388.0**	**1,540.0**	**1,646.5**	**1,815.1**	**1,809.3**	**1,816.0**	**1,854.6**	**1,877.7**	**1,918.7**	**1,931.0**	**76.4**
(As a % of GDP)	20.1	22.4	23.9	26.4	26.3	26.4	26.9	27.3	27.9	28.0	
(As a % of total debt)	47.2	48.8	49.7	50.2	50.2	50.2	50.2	50.4	51.1	51.3	
GRAND TOTAL	**2,938.2**	**3,155.2**	**3,312.1**	**3,618.3**	**3,607.0**	**3,619.2**	**3,693.0**	**3,722.2**	**3,753.6**	**3,763.4**	**70.5**
(As a % of GDP)	42.7	45.8	48.1	52.5	52.4	52.5	53.6	54.0	54.5	54.6	

Ratios computed using Treasury GDP estimate from the Budget Review Outlook Paper (BROP)
** External debt is inclusive of guaranteed debt

Sources: National Treasury and Central Bank of Kenya

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

Table 7.2: Government Gross Domestic Debt (Ksh Billion)

	Q4	%	Q1	%	Oct-16	%	Nov-16	%	Q2	%	Change: Q on Q
Total Stock of Domestic Debt (A+B)	**1,815.1**	**100.0**	**1,854.6**	**100.0**	**1,877.7**	**100.0**	**1,918.7**	**100.0**	**1,931.0**	**100.0**	**76.4**
A. Government Securities	**1,740.1**	**95.9**	**1,820.0**	**98.1**	**1,845.6**	**98.3**	**1,874.6**	**97.7**	**1,869.5**	**96.8**	**49.5**
1. Treasury Bills (excluding Repo Bills)	**588.1**	**32.4**	**618.2**	**33.3**	**616.7**	**32.8**	**620.0**	**32.3**	**620.2**	**32.1**	**1.9**
Banking institutions	361.9	19.9	384.2	20.7	366.7	19.5	360.2	18.8	349.5	18.1	-34.6
The Central Bank	20.6	1.1	20.6	1.1	20.6	1.1	20.6	1.1	20.6	1.1	0.0
Commercial Banks	341.3	18.8	363.6	19.6	346.1	18.4	339.6	17.7	329.0	17.0	-34.6
Pension Funds	117.9	6.5	120.3	6.5	132.0	7.0	135.4	7.1	147.8	7.7	27.5
Insurance Companies	18.4	1.0	16.3	0.9	14.0	0.7	14.2	0.7	14.7	0.8	-1.6
Others	89.9	5.0	97.5	5.3	104.1	5.5	110.2	5.7	108.1	5.6	10.6
2. Treasury Bonds	**1,152.0**	**63.5**	**1,201.8**	**64.8**	**1,228.9**	**65.4**	**1,254.6**	**65.4**	**1,249.3**	**64.7**	**47.6**
Banking institutions	569.9	31.4	591.6	31.9	599.4	31.9	610.6	31.8	601.1	31.1	9.5
The Central Bank	9.4	0.5	9.4	0.5	9.4	0.5	9.4	0.5	9.4	0.5	0.0
Commercial Banks	560.5	30.9	582.1	31.4	590.0	31.4	601.2	31.3	591.6	30.6	9.5
Insurance Companies	116.0	6.4	120.1	6.5	123.0	6.6	127.2	6.6	128.5	6.7	8.4
Pension Funds	351.0	19.3	373.5	20.1	386.7	20.6	395.7	20.6	397.1	20.6	23.5
Others	115.1	6.3	116.6	6.3	119.8	6.4	121.1	6.3	122.8	6.4	6.2
3. Long Term Stocks		**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
Others		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**	**1.4**	**25.6**	**1.4**	**25.6**	**1.4**	**25.6**	**1.3**	**25.6**	**1.3**	**0.0**
Of which: Repo T/Bills	25.0	1.4	25.0	1.3	25.0	1.3	25.0	1.3	25.0	1.3	0.0
B. Others:	**49.4**	**2.7**	**9.0**	**0.5**	**6.5**	**0.3**	**18.5**	**1.0**	**35.9**	**1.9**	**26.9**
Of which CBK overdraft to Government	44.2	2.4	3.3	0.2	0.0	0.0	12.7	0.7	29.9	1.6	26.6

Source: Central Bank of Kenya

2016/17. Other significant holders of Treasury bills included pension funds (23.8 per cent) and parastatals-included in other holders (11.3 per cent).

Treasury Bonds

Treasury bonds holdings increased by 4 per cent during the second quarter of the FY 2016/17, reflecting proceeds from the issuance of a 15- year infrastructure Treasury bond. The increase was partially offset by the KSh 29.5 billion maturity of a two- year fixed rate Treasury bond. The dominant holders of Treasury bonds by the end of the period under review were commercial banks, pension funds and Insurance companies. Commercial banks holdings accounted for about half of the total Treasury Bonds outstanding.

Domestic Debt by Tenor and the Maturity Structure

Government issued both short and long dated securities during the period under review. The current debt securities portfolio is dominated by medium and long term debt securities. The benchmark Treasury Bonds; 2-year, 5-year, 10-year, 15-year and 20-year Treasury Bonds accounted for 74.5 per cent of the total of outstanding Treasury Bonds by the end of the quarter under review. Other domestic debt consists of uncleared effects, advances from commercial banks and Tax Reserve Certificates.

In terms of the maturity structure, the average length to maturity of existing domestic debt increased to 4 years and 6 months in the second quarter compared with 4 years and 5 months in the preceding quarter. This increase was reflective in the stock of longer-dated debt securities in the domestic debt securities portfolio during the

TABLE 7.3: OUTSTANDING DOMESTIC DEBT BY TENOR (Ksh billion)

		Q4	%	Q1	%	Oct-16	%	Nov-16	%	Q2	%	Change Quarter on Quarter
Treasury bills	91-Day	81.8	4.5	59.9	3.2	67.4	3.6	56.6	3.0	51.1	2.6	-8.8
	182-Day	191.8	10.6	185.0	10.0	194.4	10.4	200.8	10.5	201.1	10.4	16.1
	364-Day	314.5	17.3	373.4	20.1	354.9	18.9	362.5	18.9	368.0	19.1	-5.3
Treasury Bond	1-Year	34.5	1.9	10.2	0.6	0.0	0.0	0.0	0.0	0.0	0.0	-10.2
	2-Year	122.1	6.7	122.1	6.6	122.1	6.5	122.1	6.4	116.8	6.1	-5.3
	3-Year	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	4-Year	2.3	0.1	2.3	0.1	2.3	0.1	2.3	0.1	2.3	0.1	0.0
	5-Year	215.9	11.9	263.4	14.2	263.4	14.0	263.4	13.7	263.4	13.6	0.0
	6-Year	22.7	1.2	8.5	0.5	8.5	0.5	8.5	0.4	8.5	0.4	0.0
	7-Year	8.7	0.5	8.7	0.5	8.7	0.5	8.7	0.5	8.7	0.5	0.0
	8-Year	38.2	2.1	38.2	2.1	38.2	2.0	38.2	2.0	38.2	2.0	0.0
	9-Year	76.5	4.2	76.5	4.1	76.5	4.1	76.5	4.0	76.5	4.0	0.0
	10-Year	188.5	10.4	206.8	11.2	206.8	11.0	206.8	10.8	206.8	10.7	0.0
	11-Year	4.0	0.2	4.0	0.2	4.0	0.2	4.0	0.2	4.0	0.2	0.0
	12-Year	132.1	7.3	132.1	7.1	132.1	7.0	132.1	6.9	132.1	6.8	0.0
	15-Year	183.8	10.1	183.8	9.9	216.5	11.5	238.8	12.4	238.8	12.4	55.0
	20-Year	74.3	4.1	96.8	5.2	96.8	5.2	104.9	5.5	104.9	5.4	8.1
	25-Year	20.2	1.1	20.2	1.1	20.2	1.1	20.2	1.1	20.2	1.0	0.0
	30-Year	28.1	1.6	28.1	1.5	28.1	1.5	28.1	1.5	28.1	1.5	0.0
	Repo T bills	25.0	1.4	25.0	1.3	25.0	1.3	25.0	1.3	25.0	1.3	0.0
	Overdraft	44.2	2.4	3.3	0.2	0.0	0.0	12.7	0.7	29.9	1.6	26.6
	Other Domestic debt	5.8	0.3	6.3	0.3	11.8	0.6	6.4	0.3	6.6	0.3	0.3
Total Debt		**1,815.1**	**100.0**	**1,854.6**	**100.0**	**1,877.7**	**100.0**	**1,918.7**	**100.0**	**1,931.0**	**100.0**	**76.4**

Source: Central Bank of Kenya

review period. Subsequently, the refinancing risk decreased to 32.1 per cent from 33.3 per cent in September 2016.

External Debt

Public and publicly guaranteed external debt registered a marginal decline of 0.3 per cent during the second quarter of the FY 2016/17 mainly due to currency revaluation. The shilling appreciated significantly against the Sterling Pound, Japanese Yen, the Euro and the Chinese Yuan, the –the major currencies besides the USD, in the multilateral debt currency basket. In addition, the repayments of principal to the International Development Association (IDA) and the Japanese Government were partially offset by new disbursements of USD 200 million from the Chinese government on semi-concessional terms, and, USD 100 million from the Preferential Trade Area Bank on commercial terms.

Composition of External Debt by Creditor

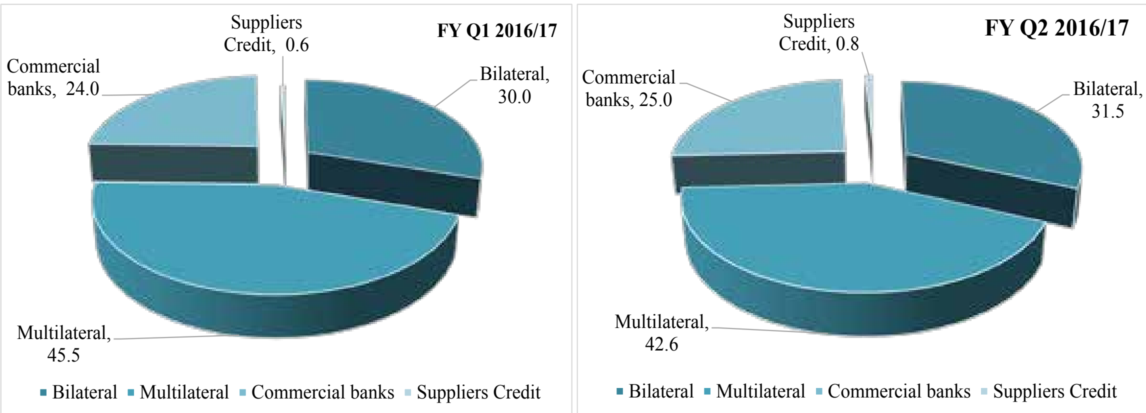
Following Kenya's elevation to lower middle income economy status in September 2014, recourse to borrowing on commercial and semi-concessional terms has increased while that on concessional terms has declined. Reflecting this trend, the share of outstanding debt from official multilateral and bilateral lenders – who provide both concessional and semi-concessional loans– decreased by 40 basis points from the 75.5 per cent in the previous quarter to 75.1 per cent by the end of the second quarter of the FY 2016/17. The share of commercial debt in total external debt increased by 100 basis points to 25 per cent in the second quarter of FY 2016/17 (**Chart 7A**).

Debt owed to the International Development Association (IDA), Kenya's largest multilateral lender, amounted to USD 4.7 billion or 26.5 per cent of total external debt, while that owed to China, Kenya's largest bilateral lender, amounted to USD 3.5 billion, or 19.4 per cent of the total external debt in the second quarter of the FY 2016/17 (**Chart 7B**).

Currency Composition of External Debt

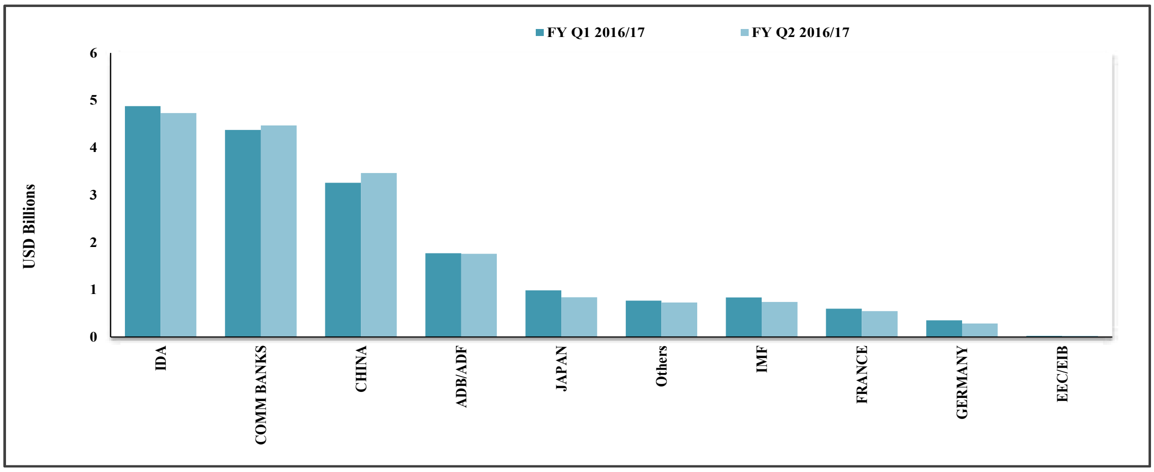
Kenya's public and publicly guaranteed external debt is denominated in various currencies, partly to mitigate currency risk. The dominant currencies included the US dollar and the Euro which accounted for 81.9 per cent of the total debt by currency at the end of the second quarter of the FY 2016/17. This was consistent with the currency composition of the Central Bank's forex reserve holdings. The proportion held in the Chinese Yuan and the US dollar increased mainly on account of the of USD 100 million disbursement from the Preferential Trade Area Bank and Chinese

Chart 7A: Composition of External Debt by Lender Classification



Source: The National Treasury

Chart 7B: **External Debt By Creditor**



Source: The National Treasury

Yuan denominated disbursement (equivalent to US dollar 200 million) from the Chinese Government (**Chart 7C**).

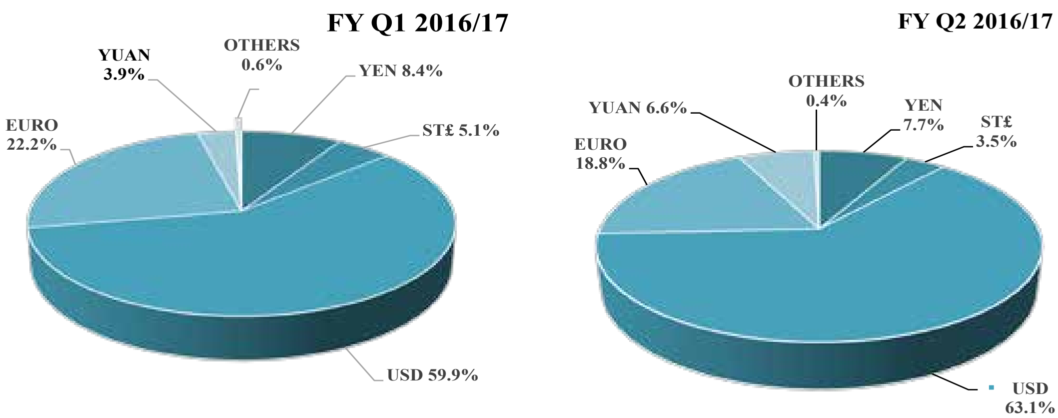
Public Debt Service

The ratio of domestic interest payments to revenues stood at 18.1 per cent in the second quarter of the FY 2016/17, which was higher than the previous quarter (13.4 per cent) due to increased interest payments. The largest component of domestic interest payments was coupon interest on Treasury Bonds which was consistent with the proportion of debt held in Treasury bonds. External debt service for the first half of the FY 2016/17 amounted to KSh 40.0 billion and was within sustainable levels. Analysis of the liquidity indicators of external indebtedness (debt service ratios to revenues and exports) show that Kenya faces low exposure to external debt service default as the ratios were way below the CPIA determined liquidity indicators (25 per cent of exports and 22 per cent of revenues) (**Table 7.4**).

Debt Sustainability Analysis

The December 2016 Debt sustainability update showed that Kenya faces a low risk of external debt distress. All the liquidity and solvency debt burden indicators were below the CPIA based thresholds. However, there is a temporary breach of debt service to exports ratio under standardized stress tests. Public DSA sensitivity analysis shows that if the primary deficit were to remain at the current levels, public debt would take an upward trajectory to way above the EAC convergence criterion. The fiscal consolidation underway will however mitigate this risk in the medium term.

Chart 7C: **Debt Composition by Currency**



Source: The National Treasury

Table 7.4: Liquidity External Debt Sustainability Indicators

	Q2 2015/16	Q3 2015/16	Q4 2015/16	FY 2015/16	Q1 FY 2016/17	Q2 FY 2016/17
Debt services to Revenues (22%)	6.9	5.7	6.9	6.2	4.9	7.0
Debt services to Exports (25%)	7.9	6.5	10.2	7.4	10.8	17.6

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

Source: Central Bank of Kenya

Outlook for Fiscal Year 2016/17

Total public and publicly guaranteed external debt is estimated at 1,926.5 billion (26.5 percent of GDP), while gross and net domestic debt is expected to close the year at KSh 2, 053.8 billion (28.3 percent of GDP) and KSh 1,645.5 billion (22.6 percent of GDP), respectively (BROP 2016). [2]

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[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 8

The Capital Markets

Equity Market

All performance indicators in the equities market segment declined in the fourth quarter of 2016 relative to the previous quarter. The four equity price indices tracked declined in fourth quarter of 2016. Equity turnover and number of shares traded decreased by 47.2 percent and 44.9 percent, respectively. This partly underscores the shift by investors from the equity market to Government securities to minimize risk due to stock prices volatility associated with unfavourable financial results of listed companies and market jitters associated with August 2017 General Elections. Shareholders' wealth, measured by market capitalization edged down 2.07 percent, or KSh 41 billion loss (**Table 8.1 and Chart 8A**).

FTSE NSE Kenya 15 Index, which measures performance of the 15 largest stocks by market capitalization, dropped by 2 points, and the FTSE NSE Kenya 25 Index, which measures performance of 25 most liquid stocks, declined by 3 points at the end of fourth quarter of 2016 relative to the previous quarter.

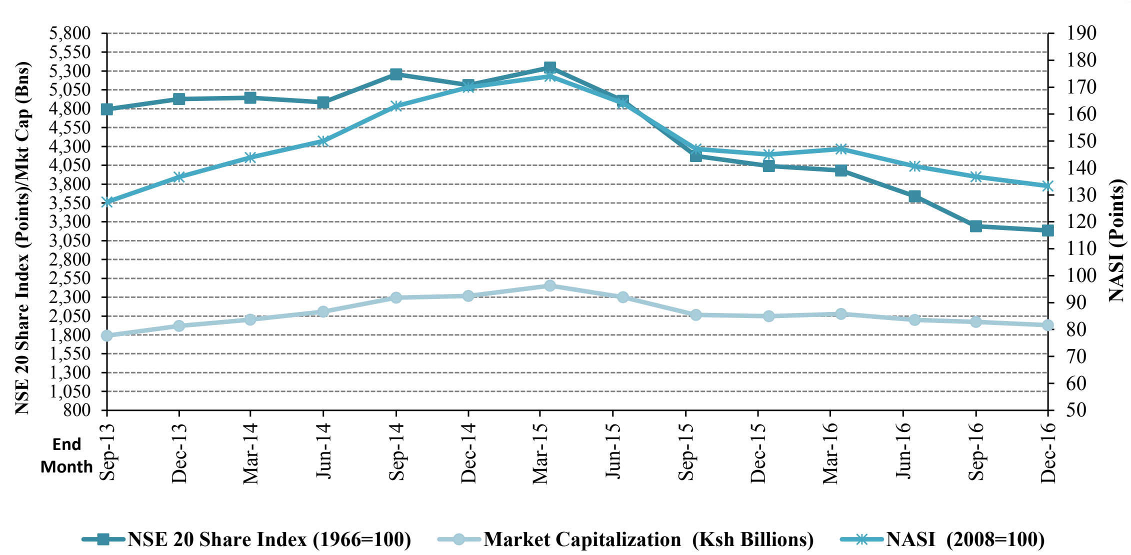
Telecommunication and Technology, Banking and Energy and Petroleum sectors accounted for 78.5 percent of all shares traded in the fourth quarter of 2016 Q4, highlighting sectoral concentration risks.

Table 8.1: Selected Stock Market Indicators

INDICATOR	2015	2015				2016				% QUARTERLY CHANGE (Q4-Q3)
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
NSE 20 Share Index (1966=100)	4,040	5,346	4,906	4,173	4,040	3,982	3,641	3,243	3,186	-1.76
NASI (2008=100)	145	174	164	147	145	147	141	137	133	-2.52
FTSE NSE Kenya 15 Index	183	232	216	195	183	185	176	161	159	-1.17
FTSE NSE Kenya 25 Index	182	232	215	195	182	185	176	167	164	-1.39
Number of Shares Traded (Millions)	6,812	1,622	1,852	1,883	1,456	1,300	1,411	1,999	1,101	-44.92
Equities Turnover (Ksh Millions)	209,382	46,341	60,224	56,722	46,095	36,609	37,034	48,141	25,392	-47.25
Market Capitalization (Ksh Billions)	2,049	2,452	2,302	2,064	2,054	2,078	1,998	1,972	1,931	-2.07
Foreign Purchase (Ksh Millions)	132,495	20,945	38,194	43,856	29,500	20,258	26,322	40,038	17,652	-55.91
Foreign Sales (Ksh Millions)	131,579	24,102	40,738	37,300	29,439	21,844	19,339	34,018	16,703	-50.90
Average Foreign Investor Participation to Equity Turnover (%)	63	49	66	72	64	58	62	77	68	-12.05
Bond Turnover (Ksh Millions)	305,099	129,370	59,897	44,511	71,321	113,400	149,809	74,809	94,367	26.14
FTSE NSE Kenya Govt. Bond Index	90	93	92	90	90	89	88	89	90	1.05

Source: Nairobi Securities Exchange

Chart 8A: Nse 20 Share Index, Nasi And Market Capitalization

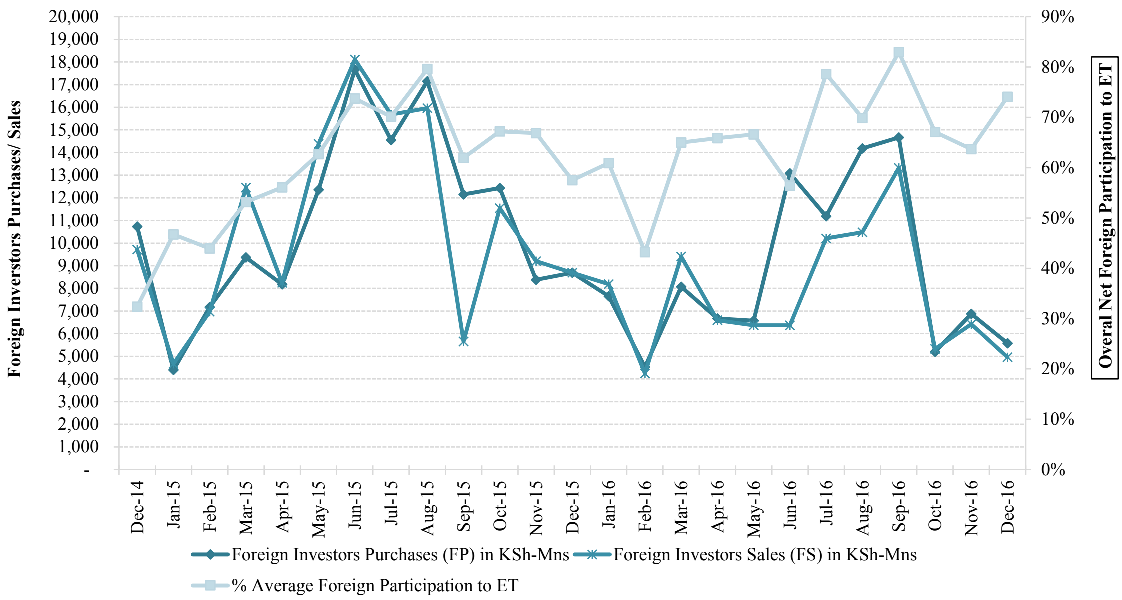


Source: Nairobi Securities Exchange

Foreign Investor Participation

Foreign investors' participation at the NSE as a proportion of total equity turnover decreased from 77 percent in third quarter of 2016 to 68 percent in the fourth quarter of 2016 (**Table 8.1**). The combined value of foreign purchases and sales declined by 53.6 percent in the fourth quarter of 2016 compared with the value in previous quarter, indicating reduced foreign investor appetite (**Chart 8B**). The improvement in average foreign participation to ET in December 2016 compared November 2016 could be explained by portfolio investors targeting expected capital gains on share price increase following release of listed companies financials .

Chart 8B: Foreign Participation



Source: Nairobi Securities Exchange

Bond Market

The volume of bonds traded in the secondary market increased by 26.14 percent (**Table 8.1**), to transact a total of KSh 9.4 billion worth of bonds in 2016Q4 up from KSh 7.5 billion in 2016Q3. The FTSE NSE Kenyan Government Bond Index increased by 1.05 points, reflecting price gains on bonds or decline in secondary market yields. Similarly, the primary market recorded good performance, with 103 percent subscription rate for KSh 102 billion offered in bonds in the quarter under review.

Chapter 9

Statement of Financial Position of the Central Bank of Kenya

(Kenya shillings million)

		2016				Dec-Sept	Sept-June	Dec-Sept	Sept-June
1.0	ASSETS	MARCH	JUNE	SEP	DEC	Change	Change	% change	% change
1.1	RESERVES AND GOLD HOLDINGS	786,202	826,788	820,608	748,156	(72,452)	(6,180)	(8.8)	(0.7)
1.2	FUNDS HELD WITH IMF	1,958	1,923	4,028	3,747	(281)	2,105	(7.0)	109.4
1.21	INVESTMENT IN EQUITY (SWIFT SHARES	9	9	9	9	(1)	0	(5.8)	1.2
1.3	ITEMS IN THE COURSE OF COLLECTION	65	80	52	23	(29)	(27)	(56.0)	(34.2)
1.4	ADVANCES TO COMMERCIAL BANKS	25,076	44,679	47,895	55,834	7,939	3,216	16.6	7.2
1.5	LOANS AND OTHER ADVANCES	2,584	2,483	2,540	2,591	52	57	2.0	2.3
1.6	OTHER ASSETS	3,129	3,227	3,681	3,730	49	454	1.3	14.1
1.7	RETIREMENT BENEFIT ASSET	4,668	5,455	7,776	7,776	-	2,321	-	42.6
1.8	PROPERTY AND EQUIPMENT	20,638	22,404	22,916	21,818	(1,098)	512	(4.8)	2.3
1.81	INTANGIBLE ASSETS	191	207	140	61	(79)	(67)	(56.5)	(32.4)
1.9	DUE FROM GOVERNMENT OF KENYA	72,636	69,762	29,006	55,620	26,613	(40,756)	91.8	(58.4)
	TOTAL ASSETS	**917,147**	**977,018**	**938,652**	**899,365**	**(39,287)**	**(38,367)**	**(4.2)**	**(3.9)**
2.0	LIABILITIES								
2.1	CURRENCY IN CIRCULATION	231,976	234,751	232,685	262,734	30,049	(2,066)	12.9	(0.9)
2.2	INVESTMENTS BY BANKS - REPOS		7,834	-	-	-	(7,834)	-	(100.0)
2.3	DEPOSITS	432,203	494,125	464,875	400,102	(64,773)	(29,250)	(13.9)	(5.9)
2.4	INTERNATIONAL MONETARY FUND	126,426	122,438	122,836	116,119	(6,717)	398	(5.5)	0.3
2.5	OTHER LIABILITIES	1,753	3,117	2,112	2,114	2	(1,005)	0.1	(32.2)
	TOTAL LIABILITIES	792,358	862,265	822,509	781,070	(41,439)	(39,756)	(5.0)	(4.6)
3.0	EQUITY AND RESERVES	124,789	114,753	116,143	118,295	2,151	1,390	1.9	1.2
	Share Capital	5,000	5,000	5,000	5,000	-	-	-	-
	General reserve fund -Unrealized	77,171	77,171	57,550	57,550	-	(19,621)	-	(25.4)
	-Realized	12,555	5,679	16,909	16,908	(1)	11,229	(0.0)	197.7
	-Capital Projects	7,445	7,445	15,047	15,047	-	7,602	-	102.1
	Period surplus/(Deficit)	3,160	-	(929)	1,223	2,152	(929)	(231.7)	-
	Asset Revaluation	14,790	14,790	14,790	14,790	-	-	-	-
	Retirment Benefit Asset Reserves	4,668	4,668	7,776	7,776	-	3,108	-	66.6
4.0	**TOTAL LIABILITIES AND EQUITY**	**917,147**	**977,018**	**938,652**	**899,365**	**(39,288)**	**(38,366)**	**(4.2)**	**(3.9)**

Source: Central Bank of Kenya

Notes on the Financial Position

Assets

The balance sheet of the Central Bank of Kenya (CBK), declined further by 4.2 per cent in the fourth quarter of 2016, compared to 3.9 per cent in the previous quarter. The decline largely reflected in the foreign assets held by CBK.

Reserves and Gold holdings category comprise of 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. These foreign exchange reserves balance declined by 8.8 per cent in the fourth quarter of 2016 compared to with 0.7 per cent in the third quarter of 2016. The CBK applied the reserves largely in repaying Government's external debt due and debt service

Items in course of collection represent the value of clearing instruments held by the CBK, while awaiting clearing by respective commercial banks. The items declined by 56.0 per cent, representing further improvement to a decrease of 34.2 per cent in the third quarter of 2016.

Advances to commercial banks, used by CBK for liquidity management, grew by 16.6 per cent in the fourth quarter compared to a growth of 7.2 per cent in the previous quarter. This reflects an increase in the uptake of reverse repo sales by banks.

Loans and other advances include outstanding balances on advances to commercial banks under the Overnight Loan Facility (OLF), and IMF funds on-lent to Government. The outstanding balance grew by 2.0 per cent in the fourth quarter of 2016 compared with a growth of 2.3 per cent in the previous quarter.

Other assets, which largely consist of prepayments and sundry debtors, and deferred currency expense decreased by 4.8 per cent compared to 14.1 per cent in the third quarter of 2016.

Debt due from Government of Kenya, includes Government utilization of the overdraft facility at the Central bank and overdrawn accounts which were converted to a long term debt with effect from 1 November 1997. The government total outstanding overdraft at CBK rose by 91.4 per cent in the fourth quarter of 2016, compared with a repayment of 58.4 per cent in the previous quarter.

Liabilities.

Currency in circulation grew by 12.9 per cent in the fourth quarter of 2016 compared to a decline of 0.9 per cent in the previous quarter.

Deposits held by CBK for the Government of Kenya, local commercial banks deposit, other public entities and project accounts and local banks' forex settlement accounts declined by 13.9 per cent compared to a decline of 5.9 per cent in the previous quarter.

Equity and reserves increased by 1.9 per cent in fourth quarter of 2016 compared to 1.2 per cent growth in the previous quarter, reflecting a slight increase in period's surplus.