



Central Bank of Kenya

QUARTERLY ECONOMIC REVIEW (QER)

*Volume 2 No 4
October - December 2018*



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.
- 4) 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
 - Issuing currency notes and coins.

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QUARTERLY ECONOMIC REVIEW

OCTOBER - DECEMBER 2018

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HIGHLIGHTS

Overall inflation remained around the midpoint of the medium term target in the fourth quarter of 2018. It increased to 5.6 percent from 4.7 percent in the third quarter of 2018, mainly driven by higher food and transport prices due to increased demand during the festive season.

Broad money supply (M3) grew by 2.4 percent in the fourth quarter of 2018 compared to a decline of 0.05 percent in the previous quarter. The improvement in growth of M3 was largely reflected in increased growth of deposits, particularly of the corporate sector.

The economy rebounded in 2018 and grew by 6.3 percent compared to 4.9 percent in 2017, boosted by strong agricultural activity following favourable weather conditions, resurgence in industry, and strong performance of services sectors.

Global economic growth is estimated at 3.7 percent in 2018 from 3.8 percent in 2017, following a slowdown in the second half of 2018.

Kenya's current account deficit narrowed by 9 percent to USD 913 million in the fourth quarter of 2018 from USD 1,001 million in the fourth quarter of 2017, mainly driven by an improvement in the primary and secondary income account.

Kenya's official international reserves stood at USD 8,230 million, equivalent to 5.3 months of import cover as at end December 2018.

The foreign exchange market remained steady supported by resilient inflows from tea, horticulture, diaspora remittances as well as travel receipts.

The banking sector was stable in the fourth quarter of 2018. Total net assets increased by 0.7 percent from KSh 4,414.7 million in September 2018 to KSh 4,446.1 million. The deposit base also increased by 2.8 percent from KSh 3,241.2 million to KSh 3,332.4 million between third quarter and fourth quarter of 2018. The sector was well capitalized and met the minimum capital requirements. Profitability decreased marginally due to increase in total expenses. The gross non-performing loans (NPLs) to gross loans ratio stood at 12.03 percent in the fourth quarter of 2018.

The Government's budgetary operations at the end of the first half of FY 2018/19 resulted in a deficit (including grants) of 3.1 per cent of GDP and was above the target of 2.5 percent of GDP. Revenue collection remained below target, as was the case with the expenditure.

Kenya's public and publicly guaranteed debt increased by 2.5 percent to Ksh 5,272.5 billion during the second quarter of the FY 2018/19 with both domestic and external debt increasing by 0.3 and 4.5 percent, respectively.

The capital markets registered mixed performance in the fourth quarter of 2018 compared to the third quarter. The yields on Kenya's Eurobonds edged up in the period under review, following the general trend in the international capital markets.

CHAPTER 1

Inflation

Overview

Overall inflation remained around the midpoint of the medium term target in the fourth quarter of 2018. It increased to 5.6 percent from 4.7 percent in the third quarter of 2018, mainly driven by higher food and transport prices due to increased demand during the festive season (**Table 1.1**). Fuel inflation increased marginally to 14.9 percent in the fourth quarter from 14.7 percent in the third quarter, driven by elevated domestic energy prices. Non-Food Non-Fuel (NFFN)

inflation increased to 4.5 percent from 4.3 percent, on account of excise tax indexation and other tax revisions during the quarter under review. Food inflation also increased to 1.8 percent in the fourth quarter from 0.4 percent in the third quarter, owing to higher food prices resulting from increased demand.

Table 1.1: Recent Trends in Inflation (Percent)

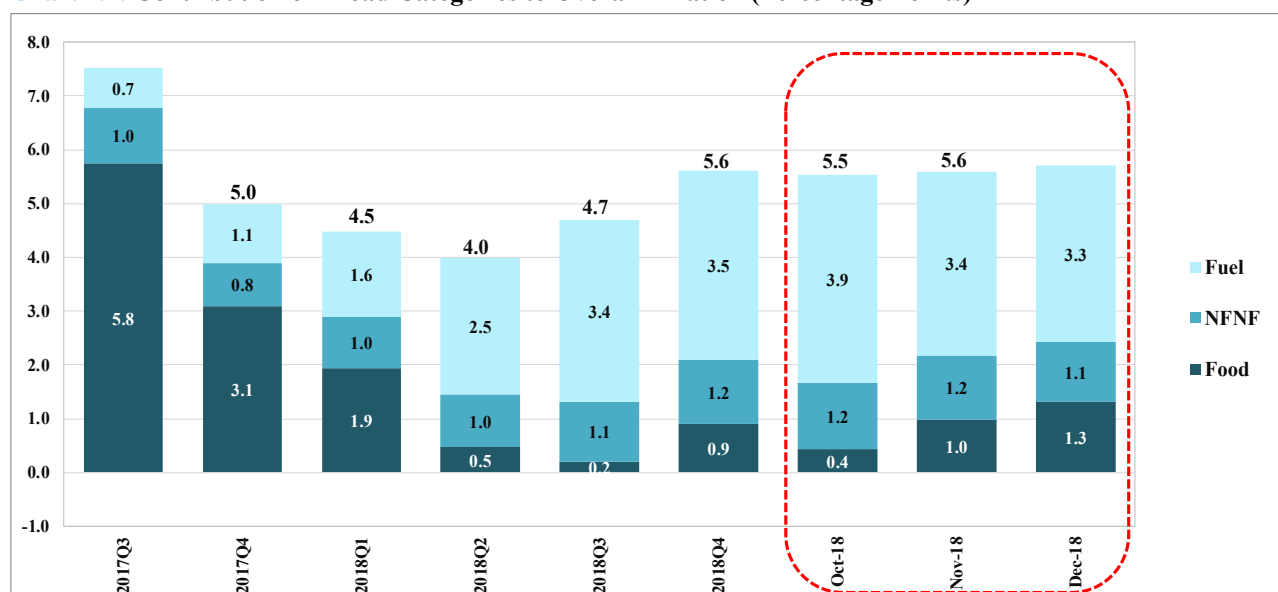
	2017				2018						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Oct	Nov	Dec
Overall inflation	8.8	10.8	7.5	5.0	4.5	4.0	4.7	5.6	5.5	5.6	5.7
Food Inflation	14.7	18.1	11.7	6.3	3.8	0.9	0.4	1.8	0.9	2.0	2.6
Fuel Inflation	2.3	3.5	3.1	4.6	6.8	11.2	14.7	14.9	16.5	14.3	13.8
Non-Food-Non-Fuel (NFFN) Inflation	4.2	4.3	3.8	2.9	3.6	3.8	4.3	4.5	4.7	4.6	4.2
Annual Average Inflation	6.5	7.7	8.3	8.2	7.4	5.7	4.7	4.6	4.5	4.6	4.7
Three Months Annualised Inflation	14.7	15.4	-5.1	-3.1	12.6	13.1	-2.4	0.3	2.1	0.1	-1.3

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

Fuel inflation remained the dominant driver of inflation and contributed 3.5 percentage points in the fourth quarter compared to 3.4 percentage points in the third quarter, reflecting the increasing pressure from energy prices. On the other hand, the contribution of food inflation to overall inflation increased to 0.9 percentage points in the fourth quarter from 0.2 percentage points in the third quarter. The

contribution of NFFN inflation to overall inflation remained relatively stable, rising marginally to 1.2 percentage points during the quarter under review from 1.1 percentage points in the previous quarter (**Chart 1.1**).

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



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

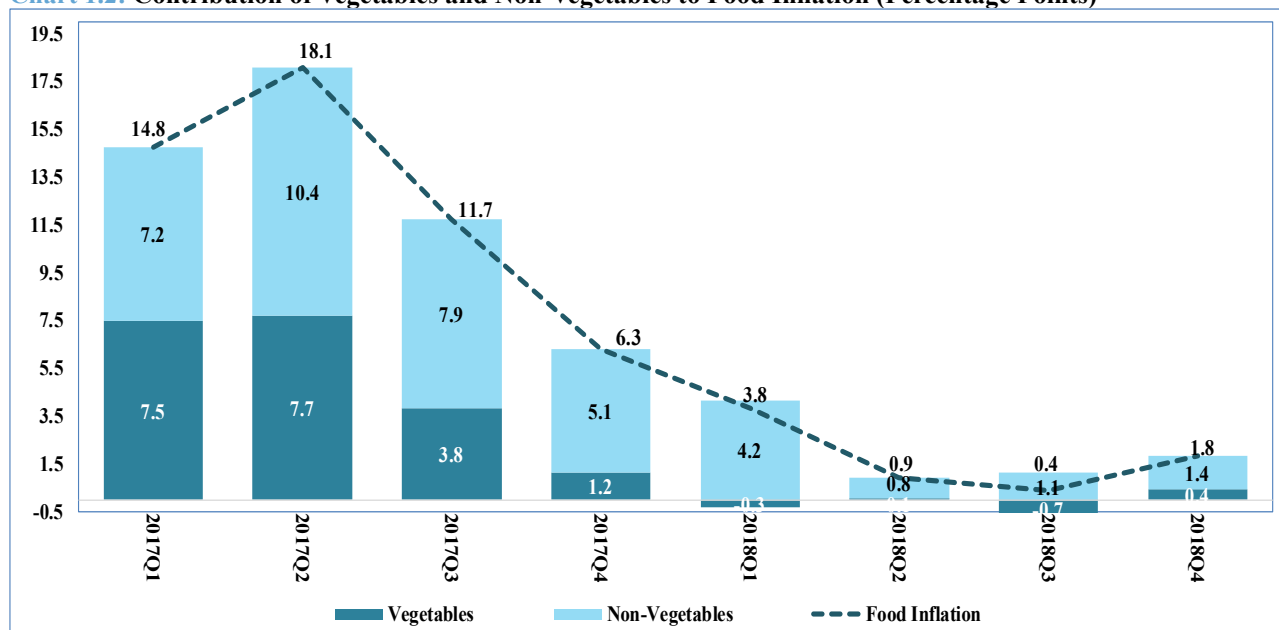
Food inflation

Food inflation reversed the downward trend observed since the second quarter of 2017, and increased to 1.8 percent in the fourth quarter of 2018 from 0.4 percent in the previous quarter. The increase was largely reflected in the vegetables category, whose contribution to food inflation increased to 0.4 percentage points in the fourth quarter, from a decline of 0.7 percentage points in the previous quarter. Key vegetables such as kale, spinach, cabbages, and Irish potatoes recorded price increases during the quarter under review owing to increased demand across the country during the festive season (**Chart 1.2**).

Fuel Inflation

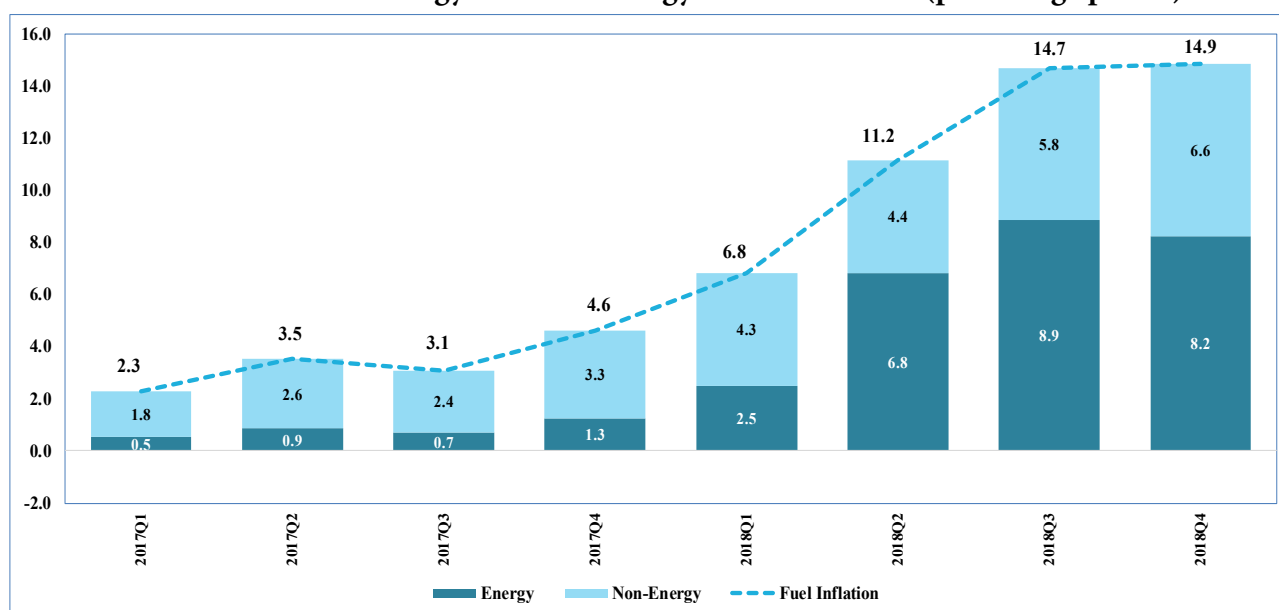
Fuel inflation increased mildly in the fourth quarter of 2018, driven by elevated high domestic energy prices. It increased to 14.9 percent in the quarter under review, from 14.7 percent in the previous quarter (**Chart 1.3**). The energy component remained the dominant driver on fuel inflation for the third consecutive quarter, though its contribution declined to 8.2 percentage points in the fourth quarter compared to 8.9 percentage points in the third quarter. The contribution of the non-energy component to fuel inflation also increased to 6.6 percentage points from 5.8 percentage points in the previous quarter (**Chart 1.3**).

Chart 1.2: Contribution of Vegetables and Non-Vegetables to Food Inflation (Percentage Points)



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

Chart 1.3: Contribution of Energy and Non-Energy to Fuel Inflation (percentage points)

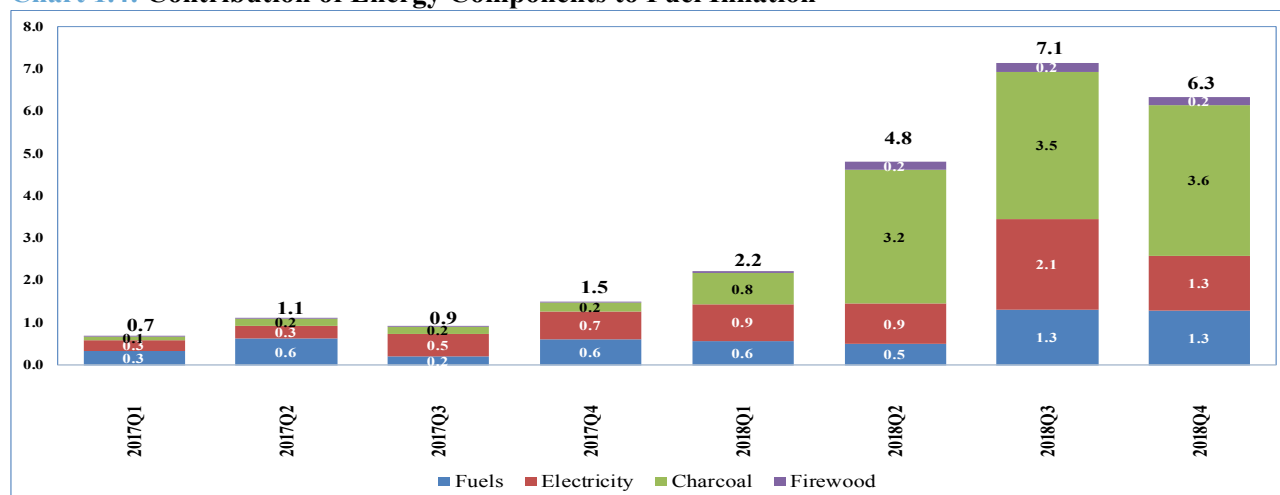


Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

Charcoal remained the dominant item exerting pressure on fuel inflation, as prices remain elevated following restrictions on charcoal trade and a ban on logging that has remained in force since March 2018. It contributed 3.6 percentage points to fuel inflation in the quarter under review compared to 3.5 percentage points in the previous quarter (**Chart 1.4**). Electricity prices increased during the quarter under review, reflecting the continued effect of an upward review of the fixed non-fuel tariff component by the Energy and Petroleum Regulatory Authority (EPRA) in August 2018. As a result, its contribution

to fuel inflation increased to 2.9 percentage points in the fourth quarter from 2.1 percentage points in the third quarter. On the other hand, domestic pump prices declined in line with declining international oil prices and the downward adjustment of the Value Added Tax (VAT) rate on petroleum products from 16 percent to 8 percent. Thus, the contribution of fuels to fuel inflation declined from 1.3 percentage points to 1.2 percentage points in the fourth quarter. Transport costs increased across the country following increased travel due to the festive season.

Chart 1.4: Contribution of Energy Components to 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 4.5 percent during the quarter under review from 4.3 in the previous quarter, reflecting the effect of excise tax indexation on the Alcoholic Beverages,

Tobacco and Narcotics category, and revised excise tax on voice call and Internet rates that affected the Communication category. However, it continued to remain low, reflecting minimal demand pressures and appropriate monetary policy stance (**Table 1.2**).

Table 1.2: Non-Food-Non-Fuel Inflation by CPI Categories (Percent)

		Alcoholic Beverages, Tobacco & Narcotics	Clothing & Footwear	Furnishings, Household Equipment and Routine Household Maintenance	Health	Communication	Recreation & Culture	Education	Miscellaneous Goods & Services	NFNF inflation
2017	Q1	3.2	4.2	3.0	3.1	0.6	2.1	2.9	3.5	4.2
	Q2	3.4	4.0	3.3	3.0	0.1	1.8	2.8	3.9	4.3
	Q3	3.0	3.8	3.2	3.1	0.3	1.2	2.9	3.6	3.8
	Q4	3.0	2.9	3.2	4.1	0.5	1.2	3.2	3.5	2.9
2018	Q1	2.9	3.8	4.1	3.6	0.7	1.6	5.2	4.4	3.6
	Q2	2.6	4.2	4.6	3.9	0.8	1.5	5.1	4.4	3.8
	Q3	5.0	4.3	4.7	5.9	0.7	1.5	5.0	4.2	4.3
	Q4	7.0	4.1	4.3	5.1	4.6	1.4	4.9	4.2	4.5
	Oct	7.0	4.7	4.7	5.9	4.3	1.7	4.8	4.4	4.7
	Nov	7.2	4.1	4.4	4.8	4.7	1.5	4.9	4.2	4.6
	Dec	6.8	3.4	3.9	4.5	4.7	1.0	4.9	3.9	4.2

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

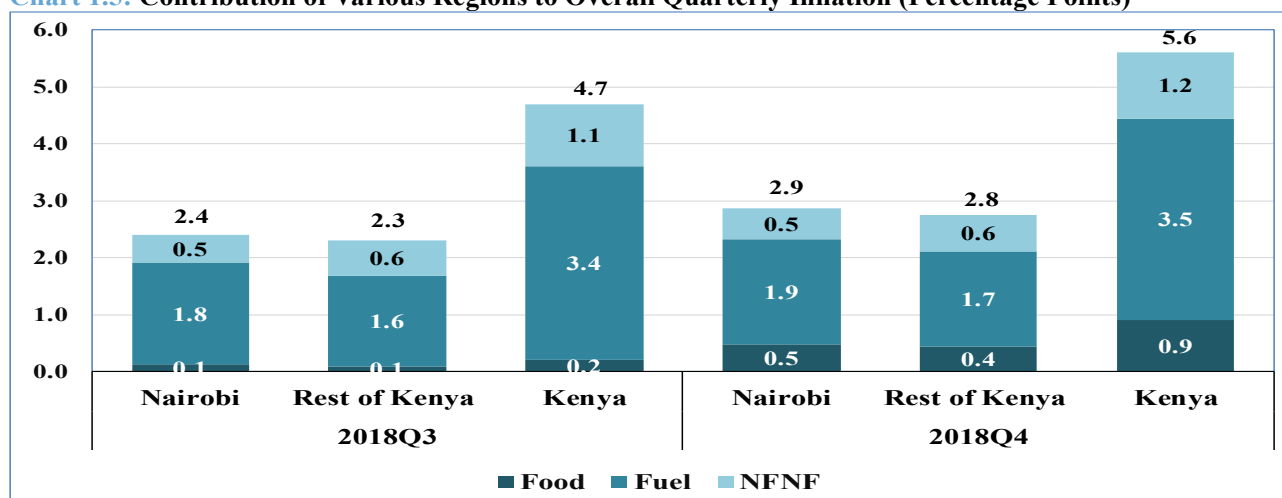
¹ Domestic energy items comprises of petrol, diesel, kerosene, Liquefied Petroleum Gas (LPG), electricity, charcoal and firewood.

Overall Inflation across Regions

The contribution of inflation in Nairobi to overall inflation in Kenya increased to 2.9 percentage points from 2.4 percentage points in the third quarter. This was reflected in increased contribution of food in Nairobi to overall inflation in Kenya to 0.5 percentage points from 0.1 percentage points during the period under review, reflecting increased demand for food inflation owing to Christmas festivities. The contribution of fuel in Nairobi region to overall inflation in Kenya increased marginally to 1.9 percentage points from 1.8 percentage points during the period under review. Meanwhile, the contribution of NFNF remained stable in the third and fourth quarters of 2018 (Chart 1.5).

In addition, inflation developments in the rest of Kenya mirrored those of the Nairobi region during the quarter under consideration, as its contribution to overall inflation increased to 2.8 percentage points from 2.3 percentage points in the third quarter. This was reflected by the increased contribution of food in the rest of Kenya to overall inflation to 0.4 percentage points from 0.1 percentage points. The contribution of fuel inflation in this region to overall inflation in Kenya increased marginally to 1.7 percentage points from 1.6 percentage points in the third quarter. Meanwhile, the contribution of NFNF remained stable.

Chart 1.5: Contribution of Various Regions to Overall Quarterly Inflation (Percentage Points)



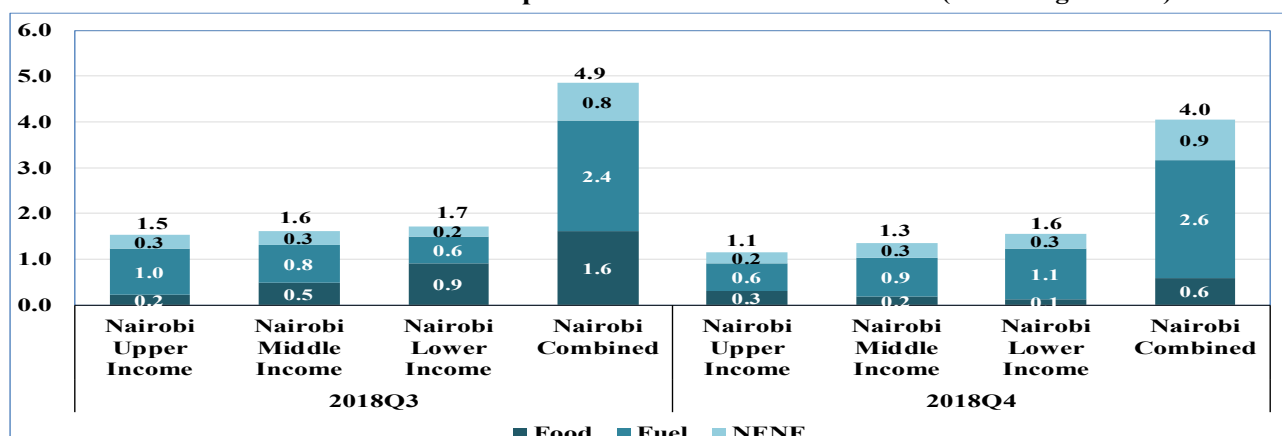
Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

Overall Inflation across Income Groups in Nairobi

The contribution of inflation in the lower income group to inflation in Nairobi declined marginally to 1.6 percentage points from 1.7 percentage points in the previous quarter, as the increase in fuel prices was offset by lower food prices. The contribution of inflation in the middle income group to inflation in Nairobi also declined to 1.3 percentage points from 1.6 percentage points in the third quarter, on account of lower food prices. Meanwhile, the contribution of inflation in the upper income group to inflation in Nairobi declined to 1.1 percentage points from 1.5 percentage points in the previous quarter on account of lower fuel prices, which occasioned a decline in the contribution of fuel to inflation in Nairobi to 0.6 percentage points from 1.0 percentage points (Chart 1.6).

1.6 percentage points in the third quarter, on account of lower food prices. Meanwhile, the contribution of inflation in the upper income group to inflation in Nairobi declined to 1.1 percentage points from 1.5 percentage points in the previous quarter on account of lower fuel prices, which occasioned a decline in the contribution of fuel to inflation in Nairobi to 0.6 percentage points from 1.0 percentage points (Chart 1.6).

Chart 1.6: Contributions of Income Groups to Overall Inflation in Nairobi (Percentage Points)



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

Chapter 2

Money, Credit and Interest Rates

Monetary aggregates and its components

Broad money supply (M3) grew by 2.4 percent in the fourth quarter of 2018 compared to a decline of 0.05 percent in the previous quarter. The improvement in growth of M3 was largely reflected in increased growth of deposits, particularly in the corporate sector. The corporate sector deposits rose by 2.7 percent compared to 1.4 percent in the previous quarter, largely reflected in increased demand deposits. Similarly, the household sector deposits increased by 1.0 percent in the fourth quarter, largely

reflected in the recovery of demand deposits. Growth in currency outside banks accelerated to 7.4 percent in the fourth quarter compared to a decline of 1.8 percent in the previous quarter, largely reflecting the seasonal increased demand for cash during the end of year festivities (Tables 2.1 & 2.2 and Charts 1).

Annual growth in money supply, M3, accelerated to 10.1 percent in December 2018 from 8.5 percent in September 2018, largely reflecting increased net foreign assets of the banking system and net credit to the government.

Table 2.1: Monetary Aggregates

	End Month Level					Quarterly Growth Rates (%)					Absolute Quarterly Changes (KSh Billions)				
	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Components of M3															
1. Money supply, M1 (1.1+1.2+1.3)	1387.1	1362.6	1426.7	1380.1	1477.9	1.1	-1.8	4.7	-3.3	7.1	14.6	-24.4	64.0	-46.6	97.9
1.1 Currency outside banks	225.4	214.4	218.3	214.4	230.3	7.8	-4.9	1.8	-1.8	7.4	16.2	-11.0	3.9	-3.9	16.0
1.2 Demand deposits	1119.8	1083.4	1126.8	1094.6	1175.6	1.5	-3.3	4.0	-2.9	7.4	16.7	-36.5	43.5	-32.2	80.9
1.3 Other deposits at CBK 1/	41.4	64.5	81.2	70.8	71.7	-30.7	55.9	25.8	-12.9	1.3	-18.3	23.2	16.7	-10.4	0.9
2. Money supply, M2 (1+2.1)	2551.8	2560.9	2681.9	2684.9	2756.0	0.9	0.4	4.7	0.1	2.6	23.0	9.1	120.9	3.0	71.1
2.1 Time and saving deposits	1164.7	1198.3	1255.2	1304.8	1278.0	0.7	2.9	4.7	4.0	-2.1	8.5	33.6	56.9	49.6	-26.8
3. Money supply, M3 (2+3.1)	3030.6	3035.4	3262.6	3261.1	3337.8	0.8	0.2	7.5	0.0	2.4	24.5	4.7	227.2	-1.6	76.8
3.1 Foreign Currency Deposits	478.8	474.5	580.8	576.2	581.9	0.3	-0.9	22.4	-0.8	1.0	1.5	-4.4	106.3	-4.6	5.7
Sources of M3															
1. Net foreign assets 2/	516.3	697.6	756.9	742.1	714.1	-15.4	35.1	8.5	-2.0	-3.8	-93.7	181.3	59.3	-14.8	-28.0
Central Bank	627.1	803.3	783.6	768.3	739.5	-9.7	28.1	-2.5	-2.0	-3.8	-67.5	176.2	-19.7	-15.3	-28.8
Banking Institutions	-110.8	-105.7	-26.7	-26.2	-25.4	31.0	-4.6	-74.7	-1.8	-3.2	-26.2	5.1	79.0	0.5	0.8
2. Net domestic assets (2.1+2.2)	2514.3	2337.7	2505.7	2519.0	2623.7	4.9	-7.0	7.2	0.5	4.2	118.2	-176.6	168.0	13.3	104.7
2.1 Domestic credit	3232.6	3080.6	3237.3	3282.5	3381.1	4.2	-4.7	5.1	1.4	3.0	128.9	-151.9	156.7	45.2	98.5
2.1.1 Government (net)	755.7	624.9	745.1	770.2	858.2	12.1	-17.3	19.2	3.4	11.4	81.4	-130.8	120.1	25.2	87.9
2.1.2 Private sector	2364.5	2343.0	2380.4	2404.0	2422.0	2.1	-0.9	1.6	1.0	0.7	48.9	-21.5	37.4	23.6	18.0
2.1.3 Other public sector	112.4	112.7	111.9	108.3	100.9	-1.2	0.3	-0.8	-3.2	-6.8	-1.3	0.3	-0.9	-3.5	-7.4
2.2 Other assets net	-718.2	-742.9	-731.6	-763.5	-757.3	1.5	3.4	-1.5	4.4	-0.8	-10.7	-24.6	11.3	-32.0	6.2
Memorandum items															
4. Overall liquidity, L (3+4.1)	4104.8	4159.2	4434.2	4467.0	4551.0	1.8	1.3	6.6	0.7	1.9	72.7	54.4	275.0	32.8	84.0
4.1 Non-bank holdings of government securities	1074.2	1123.8	1171.6	1205.9	1213.1	4.7	4.6	4.3	2.9	0.6	48.2	49.6	47.8	34.3	7.3

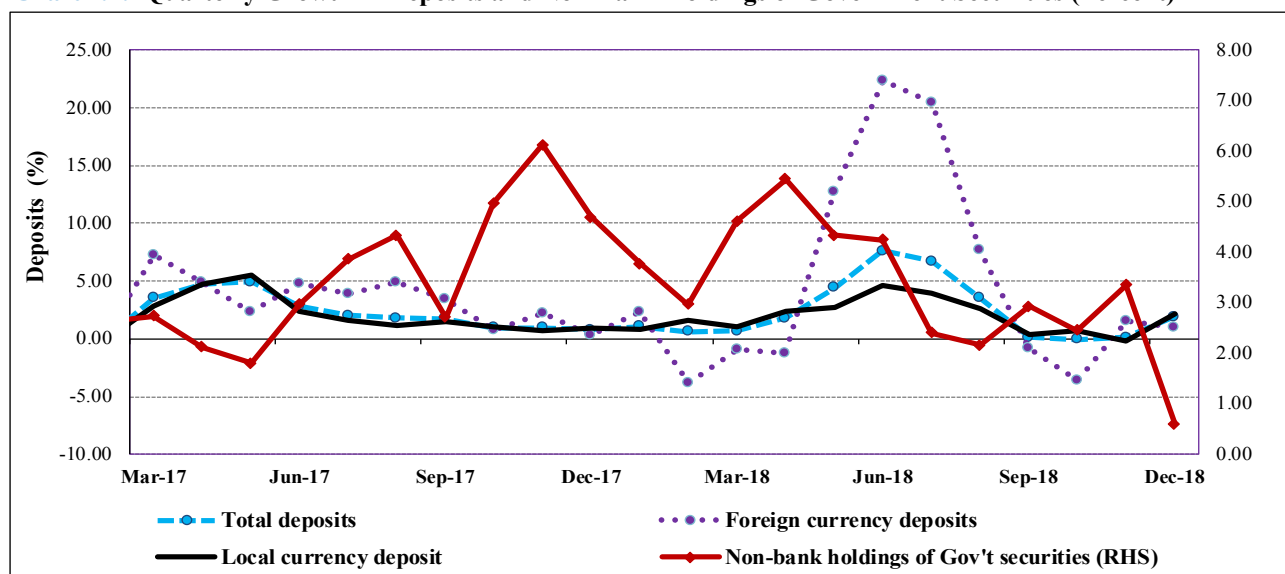
Absolute and percentage changes may not necessarily add up due to rounding

1/ Includes county deposits and special projects deposit

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

Source: Central Bank of Kenya

Chart 2.1: Quarterly Growth in Deposits and Non-Bank Holdings of Government Securities (Percent)



Source: Central Bank of Kenya

Table 2.2: Deposits Holdings of Corporates and Household Sectors

	End Month Levels (KSh Billions)							Quarterly Growth Rates (%)							Absolute Quarterly Changes (KSh Billions)						
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
1. Household Sector 1/	1279.9	1314.8	1323.2	1344.4	1485.7	1478.7	1493.4	1.6	2.7	0.6	1.6	10.5	-0.5	1.0	19.6	34.9	8.4	21.2	141.3	-7.0	14.7
1.1 Demand Deposits	540.6	566.9	560.4	562.0	574.1	560.4	562.1	0.6	4.9	-1.1	0.3	2.2	-2.4	0.3	3.5	26.3	-6.5	1.6	12.1	-13.7	1.7
1.2 Time and Saving Deposits	596.6	607.2	618.1	633.0	663.2	689.7	701.3	2.2	1.8	1.8	2.4	4.8	4.0	1.7	12.9	10.6	10.9	14.9	30.2	26.5	11.6
1.3 Foreign Currency Deposits	142.7	140.7	144.7	149.4	248.4	228.6	230.0	2.3	-1.4	2.8	3.2	66.3	-8.0	0.6	3.2	-2.0	4.0	4.7	99.0	-19.8	1.4
2. Corporate Sector	1378.0	1413.4	1432.9	1403.9	1460.4	1481.0	1520.8	3.0	2.6	1.4	-2.0	4.0	1.4	2.7	40.4	35.4	19.5	-29.0	56.5	20.5	39.8
2.1 Demand deposits	545.0	530.2	554.3	515.6	538.4	520.2	593.6	8.2	-2.7	4.5	-7.0	4.4	-3.4	14.1	41.2	-14.7	24.1	-38.7	22.8	-18.2	73.4
2.2 Time and Saving Deposits	514.5	547.2	545.0	563.8	590.0	613.6	577.5	-3.5	6.4	-0.4	3.4	4.7	4.0	-5.9	-18.5	32.7	-2.1	18.7	26.3	23.6	-36.1
2.3 Foreign Currency Deposits	318.6	336.0	333.5	324.5	332.0	347.1	349.7	5.9	5.5	-0.7	-2.7	2.3	4.6	0.7	17.8	17.5	-2.5	-9.0	7.5	15.2	2.5

1/ Household Sector includes individuals, unincorporated businesses serving households and non-profit institutions

Source: Central Bank of Kenya

Sources of Broad Money

The primary source of the growth in M3 in the fourth quarter of 2018 was the increase in net domestic assets (NDA) of the banking system. The increase in net domestic assets was largely reflected in increased net lending to government, mainly on account of utilization of government deposits at the central bank. Meanwhile, the net foreign assets (NFA) of the banking system declined in the fourth quarter; mainly reflected in the NFA of the central bank resulting from servicing of government external debt (Table 2.1).

Developments in Domestic Credit

Growth in domestic credit recovered to 3.0 percent in the fourth quarter of 2018 from 1.4 percent in the third quarter of 2018, largely reflecting increased net lending to government. The net credit to government increased by KSh 87.9 billion compared to KSh 25.2 billion in the previous quarter, largely reflecting in increased draw down of government deposits and utilization of overdraft facility. However, the commercial banks' net lending to government

decreased in the period under review, partly on account of increased redemptions of government securities (Table 2.3).

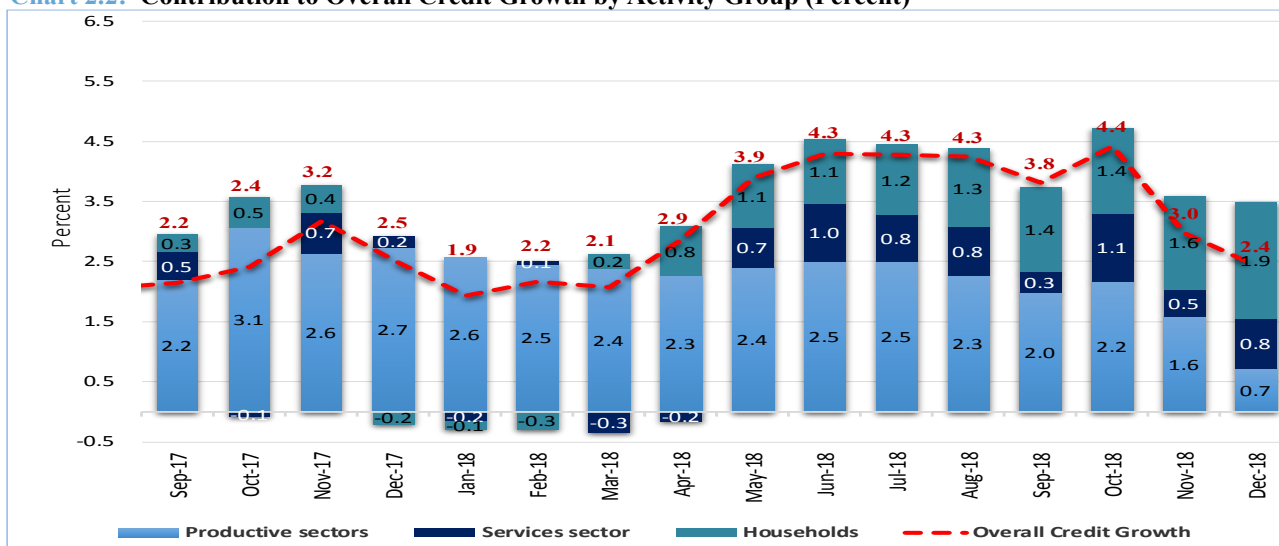
Private sector credit moderated in the fourth quarter of 2018, partly due to successful recovery efforts and loan repayments (Table 2.3 and Chart 3). Strong lending was recorded in the service sectors, including the finance and insurance, business services and trade sectors. Similarly, the private households and consumer durables registered a significant credit growth in the fourth quarter. However, lending to the building and construction, real estate and manufacturing sectors moderated in the fourth quarter of 2018, partly due to successful loans recovery efforts and loans repayments (Table 2.3).

On 12-month basis, private sector credit growth remained subdued, declining to 2.4 percent in December 2018 from 3.8 percent in September 2018 (Chart 2.2).

Table 2.3: Banking Sector Net Domestic Credit

	End Month Level							Quarterly Growth Rates (%)							Absolute Quarterly Changes (KSh Billions)						
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
1. Credit to Government	646.2	674.3	755.7	624.9	745.1	770.2	858.2	10.8	4.3	12.1	-17.3	19.2	3.4	11.4	62.8	28.1	81.4	-130.8	120.1	25.2	87.9
Central Bank	-178.9	-167.6	-67.0	-256.9	-204.4	-214.6	-95.1	52.6	-6.3	-60.0	283.6	-20.4	5.0	-55.7	-61.7	11.3	100.6	-189.9	52.4	-10.2	119.5
Commercial Banks & NBFIs	825.1	841.9	822.7	881.8	949.5	984.9	953.3	17.8	2.0	-2.3	7.2	7.7	3.7	-3.2	124.4	16.7	-19.2	59.2	67.7	35.4	-31.6
2. Credit to other public sector	106.9	113.7	112.4	112.7	111.9	108.3	100.9	0.9	6.4	-1.2	0.3	-0.8	-3.2	-6.8	0.9	6.9	-1.3	0.3	-0.9	-3.5	-7.4
Local government	3.9	4.2	4.0	4.2	4.4	4.4	4.3	1.2	8.1	-5.5	6.4	3.1	0.1	-0.4	0.0	0.3	-0.2	0.3	0.1	0.0	0.0
Parastatals	103.0	109.5	108.4	108.5	107.5	104.0	96.6	0.9	6.3	-1.0	0.1	-0.9	-3.3	-7.1	0.9	6.5	-1.1	0.1	-1.0	-3.5	-7.4
3. Credit to private sector	2,282.3	2,315.6	2,364.5	2,343.0	2,380.4	2,404.0	2,422.0	-0.6	1.5	2.1	-0.9	1.6	1.0	0.7	-12.9	33.3	48.9	-21.5	37.4	23.6	18.0
Agriculture	87.1	90.5	84.7	82.9	83.0	85.0	83.0	-1.4	3.9	-6.4	-2.2	0.2	2.5	-2.4	-1.3	3.4	-5.8	-1.8	0.1	2.1	-2.0
Manufacturing	286.2	299.1	314.2	313.6	321.1	334.8	334.6	1.5	4.5	5.0	-0.2	2.4	4.3	-0.1	4.3	12.9	15.1	-0.6	7.5	13.7	-0.2
Trade	390.6	411.1	417.4	405.1	423.9	424.5	429.3	1.6	5.3	1.5	-2.9	4.7	0.1	1.1	6.3	20.5	6.2	-12.3	18.9	0.5	4.8
Building and construction	102.8	108.8	112.0	116.3	116.5	120.9	114.0	-0.4	5.8	2.9	3.9	0.2	3.7	-5.7	-0.5	6.0	3.2	4.3	0.2	4.4	-6.9
Transport & communications	189.1	186.4	190.5	163.3	165.1	169.4	172.7	-5.6	-1.4	2.2	-14.3	1.1	2.6	1.9	-11.1	-2.7	4.1	-27.2	1.8	4.4	3.2
Finance & insurance	85.4	84.0	82.1	86.7	88.6	89.5	96.5	9.8	-1.7	-2.2	5.7	2.2	1.0	7.8	7.6	-1.4	-1.9	4.6	1.9	0.9	7.0
Real estate	359.9	363.0	370.7	370.8	373.7	369.1	368.7	1.4	0.9	2.1	0.0	0.8	-1.2	-0.1	4.9	3.2	7.7	0.1	2.8	-4.5	-0.4
Mining and quarrying	15.3	16.6	16.5	15.1	13.9	14.0	14.7	-1.5	8.8	-0.8	-8.5	-8.0	1.1	4.8	-0.2	1.3	-0.1	-1.4	-1.2	0.2	0.7
Private households	388.2	385.4	388.5	393.4	399.4	404.9	415.1	-2.0	-0.7	0.8	1.3	1.5	1.4	2.5	-8.0	-2.7	3.1	4.9	6.0	5.5	10.2
Consumer durables	168.3	171.0	176.5	180.6	181.4	184.4	195.8	-2.5	1.6	3.2	2.4	0.4	1.6	6.2	-4.3	2.7	5.5	4.2	0.7	3.0	11.5
Business services	141.9	140.0	139.2	149.9	151.4	146.0	150.4	-5.8	-1.4	-0.5	7.6	1.1	-3.6	3.0	-8.8	-1.9	-0.7	10.6	1.6	-5.4	4.4
Other activities	67.6	59.7	72.2	65.2	62.3	61.3	47.1	-2.9	-11.7	20.9	-9.6	-4.5	-1.6	-23.3	-2.0	-7.9	12.5	-6.9	-2.9	-1.0	-14.3
4. TOTAL (1+2+3)	3,035.4	3,103.6	3,232.6	3,080.6	3,237.3	3,282.5	3,381.1	1.7	2.2	4.2	-4.7	5.1	1.4	3.0	50.8	68.2	128.9	-151.9	156.7	45.2	98.5

Source: Central Bank of Kenya

Chart 2.2: Contribution to Overall Credit Growth by Activity Group (Percent)

Source: Central Bank of Kenya

Reserve Money

Growth in reserve money increased by 9.4 percent in the fourth quarter of 2018 compared to an increase of 4.8 percent in the previous quarter. The increase was reflected in the build-up in the currency outside banks and bank reserves, partly attributable to the seasonal end of year festivities (Table 2.4).

The primary source of the growth in reserve money in the fourth quarter was increase in net lending to government. The increase in net lending to government from the Central Bank was mainly attributed to a decrease in Government deposits reflecting increased spending, and coupled with increased utilization of the overdraft facility by Government. The NFA of the Central Bank declined in the fourth quarter of 2018, largely reflecting servicing of government external debt.

Table 2.4: Gross Loans to the Private Sector

	End Month Level (KSh Billions)							Quarterly Growth Rates (%)							Absolute Quarterly Changes (KSh Billions)						
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
1. Net Foreign Assets	738.3	694.6	627.1	803.3	783.6	768.3	739.5	5.8	-43.7	-9.7	28.1	-2.5	-2.0	-3.8	40.5	-43.7	-67.5	176.2	-19.7	-15.3	-28.8
2. Net Domestic Assets	-338.7	-270.1	-188.4	-385.1	-354.4	-318.4	-247.5	19.7	68.6	-30.3	104.5	-8.0	-10.2	-22.3	-55.9	68.6	81.8	-196.8	30.7	36.0	70.9
2.1 Government Borrowing (net)	-178.9	-167.6	-67.0	-256.9	-204.4	-214.6	-95.1	52.6	11.3	-60.0	283.6	-20.4	5.0	-55.7	-61.7	11.3	100.6	-189.9	52.4	-10.2	119.5
2.2 Commercial banks (net)	23.6	64.5	28.3	33.1	28.7	57.9	23.2	-228.5	40.9	-56.1	16.9	-13.2	101.7	-59.9	42.0	40.9	-36.2	4.8	-4.4	29.2	-34.7
2.3 Other Domestic Assets (net)	-186.8	-170.5	-153.1	-164.7	-182.1	-165.1	-178.9	24.0	16.3	-10.2	7.5	10.6	-9.3	8.4	-36.2	16.3	17.4	-11.5	-17.4	17.0	-13.8
3. Reserve Money	399.6	424.5	438.8	418.2	429.2	449.9	492.0	-3.7	24.9	3.4	-4.7	2.6	4.8	9.4	-15.3	24.9	14.3	-20.5	11.0	20.7	42.1
3.1 Currency outside banks	207.1	209.2	225.4	214.4	218.3	214.4	230.3	3.0	2.1	7.8	-4.9	1.8	-1.8	7.4	6.1	2.1	16.2	-11.0	3.9	-3.9	16.0
3.2 Bank reserves	192.5	215.3	213.3	203.8	210.9	235.5	261.7	-10.0	22.8	-0.9	-4.5	3.5	11.7	11.1	-21.4	22.8	-2.0	-9.5	7.1	24.6	26.1

Source: Central Bank of Kenya

Interest Rates

a. Central Bank Rate

The Monetary Policy Committee (MPC) retained the CBR at 9.0 percent in its November 2018 monetary policy meetings. The Committee noted that inflation expectations remained well anchored within the target range, and that the economy was operating close to its potential.

b. Interbank rate

The average interbank rate increased during the fourth quarter of 2018, partly reflecting tight liquidity conditions in the money market. The average interbank rate increased to 8.2 percent in December 2018 from 4.3 percent in September 2018 (Table 2.5).

c. Treasury bill rates

Interest rates on all government treasury bills tenures declined in the fourth quarter. The average 91-day

Treasury bill rate declined to 7.3 percent in December 2018 from 7.6 percent in September 2018, while the 182-day Treasury bill average rate declined to 8.4 percent from 8.8 percent (Table 2.6).

d. Lending and Deposit Rates

Commercial banks' interest rates remained within the interest rate caps in the fourth quarter of 2018. The average commercial bank lending rate declined slightly to 12.5 percent in December 2018 compared to 12.7 percent in September 2018. Similarly, the average commercial banks' deposit rate declined to 7.4 percent from 7.8 percent, partly reflecting the removal of the minimum (floor) interest rate granted on deposit through amendment of the Banking Act by Parliament in August 2018. The spread increased marginally to an average of 5.1 percent from an average of 4.9 percent in the previous quarter (Table 2.5).

Table 2.5: Interest Rates (%)

	2017				2018											
	Mar	Jun	Sep	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
91-day Treasury bill rate	8.69	8.42	8.13	8.01	8.04	8.03	8.02	8.00	7.96	7.87	7.69	7.64	7.64	7.56	7.36	7.34
182-day Treasury bill rate	10.53	10.38	10.32	10.53	10.64	10.42	10.39	10.30	10.26	9.99	9.35	9.00	8.82	8.51	8.30	8.40
Interbank rate	4.46	3.99	5.52	7.27	6.21	5.12	4.90	5.38	4.70	5.03	4.82	6.52	4.28	3.48	4.09	8.15
Repo rate	7.23	4.13	7.24	7.75	8.75	7.63	0.00	6.75	7.44	6.16	6.56	8.01	4.77	4.70	7.10	7.72
Reverse Repo rate	10.04	10.05	10.12	10.10	10.02	10.05	9.95	9.64	9.60	9.56	9.46	9.02	9.03	9.06	-	11.34
Central Bank Rate (CBR)	10.00	10.00	10.00	10.00	10.00	10.00	9.50	9.50	9.50	9.50	9.00	9.00	9.00	9.00	9.00	9.00
Average lending rate (1)	13.61	13.66	13.69	13.64	13.65	13.68	13.49	13.24	13.25	13.22	13.10	12.78	12.66	12.61	12.55	12.51
Overdraft rate	13.29	13.38	13.65	13.54	13.61	13.75	13.40	13.29	13.30	13.23	13.16	12.90	12.52	12.42	12.11	12.17
1-5years	13.81	13.80	13.87	13.83	13.84	13.83	13.67	13.41	13.40	13.39	13.26	12.94	12.85	12.82	12.79	12.70
Over 5years	13.55	13.64	13.51	13.46	13.45	13.45	13.31	13.03	13.03	13.00	12.88	12.53	12.51	12.46	12.50	12.47
Average deposit rate (2)	7.12	7.15	7.66	8.22	8.26	8.25	8.16	8.17	8.08	8.04	8.01	7.78	7.76	7.63	7.41	7.41
0-3months	7.28	7.76	7.71	8.43	8.52	8.50	8.48	8.46	8.53	8.41	8.41	8.28	8.22	8.03	7.85	7.83
Over 3 months deposit	8.18	8.04	8.02	8.39	8.35	8.39	8.26	8.11	8.01	8.14	8.04	7.53	7.64	7.76	7.56	7.67
Savings deposits	5.89	5.63	6.43	6.91	6.97	7.01	6.85	6.72	6.64	6.60	6.53	6.52	6.33	5.70	5.38	5.13
Spread (1-2)	6.49	6.52	6.04	5.41	5.39	5.42	5.33	5.07	5.17	5.18	5.09	5.00	4.91	4.98	5.14	5.09

Source: Central Bank of Kenya

Chapter 3

The Real Sector

Overview

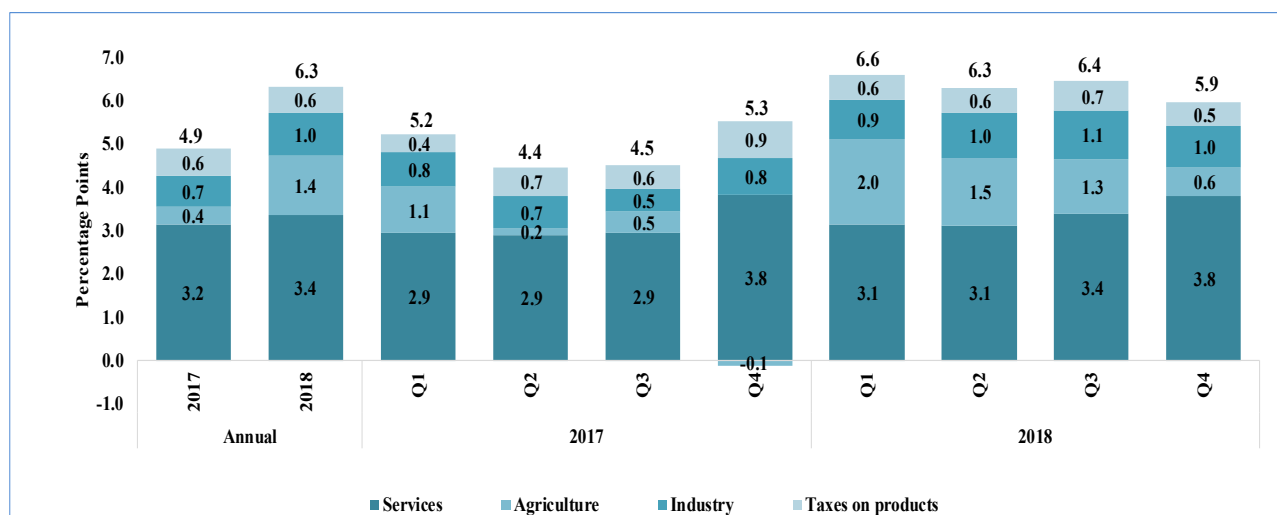
The economy rebounded in 2018 and grew by 6.3 percent compared to 4.9 percent in 2017. The strong performance of the economy was largely driven by recovery in agricultural activity following improved weather conditions experienced across the country, resurgence in industry, and strong performance of services sectors (**Chart 3.1, Table 3.1**).

Service-oriented sectors remained the key driver of growth in 2018, with their contribution to overall GDP growth increasing to 3.4 percentage points from

3.2 percentage points in 2017. The contribution of agriculture increased to 1.4 percentage points from 0.4 percentage points, while that of industry increased to 1.0 percentage point from 0.7 percentage points over the same period (**Chart 3.1, Table 3.3**).

In the fourth quarter of 2018, the economy grew by 5.9 percent, an improvement from 5.3 percent in the fourth quarter of 2017, though lower than 6.4 percent recorded in the third quarter of 2018. Growth in the quarter was largely supported by strong performance of Agriculture, Manufacturing, Electricity and Water Supply, Accommodation and Restaurant, and Finance and Insurance sectors (**Table 3.1**).

Chart 3.1: Sectoral Contributions to Real GDP Growth (Percentage Points)



Source: Kenya National Bureau of Statistics

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

	Annual		2017				2018			
	2017	2018	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1. Agriculture	1.9	6.4	4.1	0.7	2.8	-0.7	7.5	6.6	6.9	3.9
2.1 Industry	3.8	5.3	4.3	3.8	2.6	4.4	4.9	5.5	5.8	5.2
Mining & Quarrying	4.5	2.8	5.8	4.3	4.5	3.4	2.4	2.9	3.3	2.7
Manufacturing	0.5	4.2	1.6	0.0	0.10	0.2	4.0	4.9	4.8	3.1
Construction	7.0	7.9	7.9	9.1	5.5	11.3	6.6	5.4	7.0	7.3
Electricity & water supply	8.5	6.6	8.2	8.3	5.8	5.4	6.5	8.4	7.8	8.7
2.2 Services	6.5	6.9	6.5	6.3	5.9	7.5	6.9	6.7	6.8	7.3
Wholesale & Retail Trade	5.7	6.3	3.4	5.0	6.6	7.5	5.9	6.3	6.6	6.5
Accommodation & restaurant	14.3	16.6	24.2	12.3	12.0	8.9	13.1	15.4	15.7	21.3
Transport & Storage	7.2	8.8	7.3	6.5	5.1	9.7	8.5	8.4	9.0	9.3
Information & Communication	11.0	11.4	13.4	11.5	10.8	9.2	12.5	11.0	9.8	11.8
Financial & Insurance	2.8	5.6	3.8	3.3	2.3	2.0	5.2	4.6	5.4	7.0
Public administration	6.5	6.1	3.8	4.8	6.5	11.0	6.2	5.9	6.1	6.4
Professional, Administration & Support Services	3.7	5.9	3.4	5.0	2.1	4.2	6.1	7.5	6.7	3.6
Real estate	6.1	4.1	6.4	6.3	6.1	5.7	5.3	4.6	3.8	2.8
Education	5.1	5.8	5.0	4.6	4.4	6.2	4.9	5.7	5.9	6.9
Health	4.3	4.5	3.3	5.0	4.6	4.2	4.5	4.1	5.5	4.0
Other services	5.1	4.9	6.0	4.7	4.6	4.9	4.2	5.1	4.9	5.3
FISIM	-3.3	1.1	-1.2	-4.9	-1.2	-5.7	0.2	0.1	1.7	2.2
2.3 Taxes on products	5.4	5.2	4.0	6.0	4.6	6.9	5.7	5.5	5.6	4.3
Real GDP Growth	4.9	6.3	5.2	4.4	4.5	5.3	6.6	6.3	6.4	5.9

Source: Kenya National Bureau of Statistics

Table 3.2: Sectoral Shares as a Percentage of GDP

	Annual		2017				2018			
	2017	2018	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1. Agriculture	21.3	21.3	26.1	23.4	18.5	17.0	26.3	23.5	18.6	16.6
2.1 Industry	19.1	18.9	18.5	19.2	19.4	19.1	18.2	19.0	19.3	19.0
Mining & Quarrying	1.1	1.0	1.1	1.0	1.1	1.1	1.1	0.9	1.1	1.1
Manufacturing	9.8	9.6	9.9	10.0	10.01	9.4	9.7	9.9	9.9	9.1
Construction	2.6	2.6	5.0	5.4	5.7	6.2	5.0	5.4	5.8	6.3
Electricity & water supply	5.6	5.6	2.5	2.7	2.6	2.4	2.5	2.8	2.6	2.5
2.2 Services	48.2	48.5	45.1	46.5	50.0	51.4	45.3	46.6	50.1	52.1
Wholesale & Retail Trade	7.6	7.6	6.8	7.1	8.7	7.7	6.7	7.1	8.7	7.8
Accommodation & restaurant	1.2	1.4	1.4	0.9	1.2	1.5	1.5	1.0	1.3	1.7
Transport & Storage	7.0	7.1	6.1	6.7	7.3	7.8	6.2	6.8	7.5	8.0
Information & Communication	4.1	4.3	4.0	3.3	3.7	5.2	4.2	3.5	3.8	5.5
Financial & Insurance	6.1	6.1	5.9	6.0	6.4	6.2	5.9	5.9	6.4	6.2
Public administration	3.9	3.9	3.6	4.3	3.8	4.0	3.6	4.3	3.8	4.0
Professional, Administration & Support Services	2.2	2.2	2.0	2.2	2.3	2.4	2.0	2.2	2.3	2.3
Real estate	8.5	8.4	8.2	8.4	8.8	8.7	8.1	8.3	8.6	8.5
Education	6.9	6.9	6.8	6.8	7.1	7.0	6.7	6.8	7.0	7.0
Health	1.8	1.7	1.5	1.8	1.9	1.9	1.5	1.8	1.8	1.8
Other services	1.3	1.2	1.2	1.2	1.3	1.3	1.2	1.2	1.3	1.3
FISIM	-2.4	-2.2	-2.4	-2.3	-2.5	-2.3	-2.3	-2.2	-2.4	-2.2
2.3 Taxes on products	11.4	11.3	10.3	11.0	12.1	12.5	10.2	10.9	12.0	12.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Kenya National Bureau of Statistics and CBK Staff Computations

Table 3.3: Sectoral Contributions to Real GDP Growth Rate

	Annual		2017				2018			
	2016	2017	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1. Agriculture	0.4	1.4	1.1	0.2	0.5	-0.1	2.0	1.5	1.3	0.6
2. Non-Agriculture (o/w)	4.5	5.0	4.1	4.3	4.0	5.5	4.6	4.8	5.2	5.3
2.1 Industry	0.7	1.0	0.8	0.7	0.5	0.8	0.9	1.0	1.1	1.0
Mining & Quarrying	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufacturing	0.0	0.4	0.2	0.0	0.01	0.0	0.4	0.5	0.5	0.3
Construction	0.2	0.2	0.4	0.5	0.3	0.7	0.3	0.3	0.4	0.5
Electricity & water supply	0.5	0.4	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2
2.2 Services	3.2	3.4	2.9	2.9	2.9	3.8	3.1	3.1	3.4	3.8
Wholesale & Retail Trade	0.4	0.5	0.2	0.4	0.6	0.6	0.4	0.4	0.6	0.5
Accommodation & restaurant	0.2	0.2	0.3	0.1	0.1	0.1	0.2	0.2	0.2	0.4
Transport & Storage	0.5	0.6	0.4	0.4	0.4	0.8	0.5	0.6	0.7	0.8
Information & Communication	0.4	0.5	0.5	0.4	0.4	0.5	0.5	0.4	0.4	0.7
Financial & Insurance	0.2	0.3	0.2	0.2	0.1	0.1	0.3	0.3	0.3	0.4
Public administration	0.3	0.2	0.1	0.2	0.2	0.4	0.2	0.3	0.2	0.3
Professional, Administration & Support Services	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.2	0.2	0.1
Real estate	0.5	0.3	0.5	0.5	0.5	0.5	0.4	0.4	0.3	0.2
Education	0.3	0.4	0.3	0.3	0.3	0.4	0.3	0.4	0.4	0.5
Health	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other services	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
FISIM	0.1	0.0	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0
2.3 Taxes on products	0.6	0.6	0.4	0.7	0.6	0.9	0.6	0.6	0.7	0.5
Real GDP Growth	4.9	6.3	5.2	4.4	4.5	5.3	6.6	6.3	6.4	5.9

Source: Kenya National Bureau of Statistics and CBK Staff Computations

Performance by Sector

Sectoral performance was mixed in the fourth quarter of 2018, but overall the services sectors continued to drive the positive performance of the economy.

Agriculture

Agriculture sector grew by 6.4 percent compared to 1.9 percent in 2017 on account of improved weather conditions during the year. It recorded growth of 3.9 percent in the fourth quarter of 2018, which was lower than 6.9 percent recorded in the previous quarter but a significant improvement from the 0.7 percent decline in the same quarter of 2017 (Table 3.1). The sector contributed 0.6 percentage points to overall GDP growth compared to 1.3 percentage points contribution in the previous quarter, and 0.1 percentage points decline in the same quarter of 2017 (Table 3.3).

Tea

Tea production increased by 27.4 percent in the fourth quarter of 2018 compared to the previous quarter, and was higher by 7.7 percent compared to the same quarter of 2017. Monthly production increased in October and December 2018, which offset the decline in November 2018 (Table 3.4). Due to the higher production, average auction price of tea per kilogram decreased by 20.8 percent in the fourth quarter of 2018 compared to a similar quarter in 2017.

Coffee

Coffee sales increased by 11.3 percent in the fourth quarter of 2018 compared to the previous quarter, and by 22 percent compared to the same period in 2017. Monthly production was high in October 2018, which offset the declines recorded in November and December (Table 3.4). The average auction prices

Table 3.4: Quarterly Performance of Key Agricultural Output Indicators

	2017				2018*							
	Quarterly				Quarterly				Monthly			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Oct-18	Nov-18	Dec-18	
Tea												
Output (Metric tonnes)	90,094	110,819	102,645	136,300	99,760	131,235	115,242	146,762	49,284	45,649	51,830	
Growth (%)	-28.69	23.00	-7.38	32.79	-26.81	31.55	-12.19	27.35	15.9	-7.4	13.5	
Horticulture												
Exports (Metric tonnes)	84,851	85,186	82,791	82,105	100,526	96,592	108,043	76,078	27,321	24,493	24,264	
Growth (%)	8.2	0.4	-2.8	-0.8	22.4	-3.9	11.9	-29.6	-4.5	-10.4	-0.9	
Coffee												
Sales (Metric tonnes)	16,731	6,202	5,546	5,250	15,857	8,814	5,755	6,405	2,493	2,334	1,577	
Growth (%)	198.1	-62.9	-10.6	-5.3	202.1	-44.4	-34.7	11.3	8.4	-6.4	-32.4	
Milk												
Output (million litres)	130.0	143.2	153.3	164.9	148.7	152.0	162.1	180.4	55.3	57.0	68.1	
Growth %	-19.6	10.1	7.1	7.5	-9.8	2.2	6.7	11.3	-2.0	3.2	19.5	
Sugar Cane												
Output ('000 Metric tonnes)	1,572	786	709	1,546	1,689	927	1,252	1,392	498	476	419	
Growth (%)	-3.6	-50.0	-9.8	118.1	9.2	-45.1	35.2	11.2	14.5	-4.5	-11.9	

* Provisional

Source: Kenya National Bureau of Statistics

increased by 11.1 percent compared to the previous quarter, but declined by 14.7 percent compared to the same quarter of 2017.

Horticulture

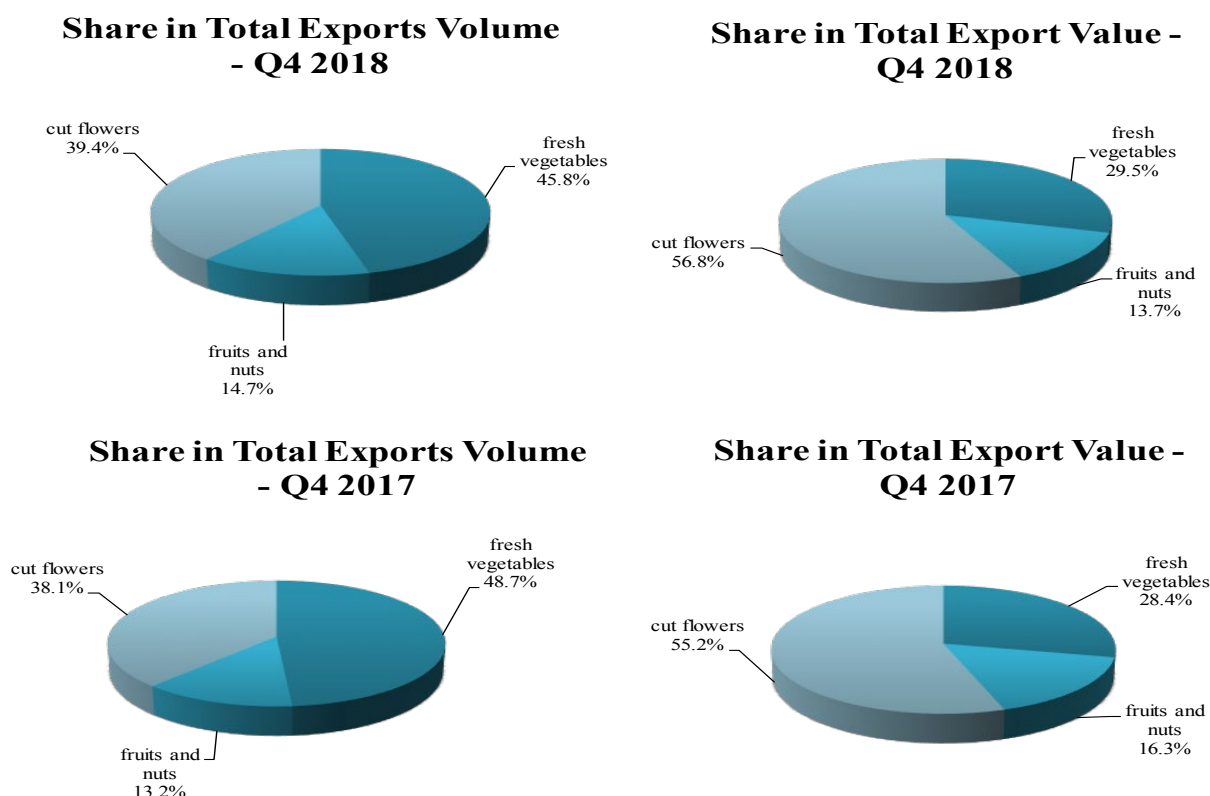
Total exports of horticultural crops declined by 29.6 percent compared to the previous quarter, and was lower by 7.3 percent compared to the same quarter of 2017 (Table 3.4). The decline was largely due to lower exports of fresh vegetables, fruits and nuts, and was recorded in all months of the quarter (Table 3.4). The value of exports also declined in the fourth quarter of 2018 compared to the same quarter of 2017 (Chart 3.2).

Milk Intake

Milk intake increased by 11.3 percent in the same quarter of 2018 compared to the previous quarter, and was higher than 9.4 percent compared to the fourth quarter of 2017 (Table 3.4). Production increased in November and December 2018, which more than offset the decline recorded in October.

Sugarcane Output

Sugarcane output was higher by 11.2 percent compared to the previous quarter. Monthly production increased in October 2018, then declined in November and December 2018 (Table 3.4). However, output declined by 9.9 percent compared to the same quarter of 2017.

Chart 3.2: Horticultural Exports

Source: Kenya National Bureau of Statistics

Manufacturing

The manufacturing sector grew by 4.2 percent in 2018 compared to 0.5 percent in 2017. It grew by 3.1 percent in the fourth quarter of 2018 compared to 0.2 percent in the fourth quarter of 2017, and 4.8 percent in the third quarter of 2018 (**Table 3.1**). The improved performance was largely driven by increased agro-processing activities following recovery of the agricultural sector, increased production of sugar and soft drinks, and increased credit advanced to the sector.

Production of processed sugar increased significantly by 18.3 percent in the fourth quarter of 2018 compared to the previous quarter, mainly driven by increased sugarcane output. Monthly production increased by 20.4 percent in October 2018, then declined by 14.5 percent and 1.3 percent in the subsequent months (**Table 3.5**). However, production was lower by 1.9 percent compared to the same quarter of 2017.

Production of **soft drinks** increased by 8.9 percent in the fourth quarter of 2018 compared to the previous quarter, following increased demand due to the festive season. The increased production was seen in all months of the quarter (**Table 3.5**). However, when compared to the fourth quarter of 2017, production

was lower by 3.8 percent during the quarter under review.

Cement production declined by 4.6 percent in the fourth quarter of 2018 compared to the previous quarter, mainly attributed to increased competition from imports. Monthly data for the quarter under review shows a slight increase of 0.3 percent in October 2018, which was offset by declines of 1.7 percent and 1.8 percent in November and December 2018, respectively (**Table 3.5**). Production was lower by 3.1 percent compared to the same quarter of 2017.

Production of **galvanized sheets** declined by 1.9 percent in the fourth quarter of 2018 compared to the previous quarter. Monthly production increased by 1.7 percent in October, then declined by 4.3 percent and 7.0 percent in November and December 2018, respectively (**Table 3.5**). When compared to the same quarter of 2017, production was higher by 1.4 percent.

Production of **assembled vehicles** declined by 15.7 percent in the fourth quarter of 2018 compared to the previous quarter, which was reflected in the monthly data as all months of the quarter recorded declined production (**Table 3.5**). However, when compared to the same quarter of 2017, production was higher by 29.9 percent.

Table 3.5: Quarterly Production of Selected Manufactured Goods

	2017				2018*							
	Quarterly				Quarterly				Monthly			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Oct-18	Nov-18	Dec-18	
Cement production												
Output (MT)	1,627,269	1,531,136	1,536,349	1,535,537	1,552,947	1,453,002	1,560,368	1,488,617	504,959	496,346	487,312	
Growth %	-4.5	-5.9	0.3	-0.1	1.1	-6.4	7.4	-4.6	0.26	-1.71	-1.82	
Assembled vehicles												
Output (No.)	1,499	870	1,136	1,056	1,472	1,182	1,627	1,372	569	476	327	
Growth %	25.5	-42.0	30.6	-7.0	39.4	-19.7	37.6	-15.7	-6.1	-16.3	-31.3	
Galvanized sheets												
Output (MT)	71,888	61,730	62,124	67,107	67,857	65,139	69,391	68,049	23,906	22,877	21,266	
Growth %	26.3	-14.1	0.6	8.0	1.1	-4.0	6.5	-1.9	1.7	-4.3	-7.0	
Processed sugar												
Output (MT)	144,403	57,589	50,423	124,711	165,800	93,935	103,403	122,360	45,324	38,768	38,268	
Growth %	-2.5	-60.1	-12.4	147.3	32.9	-43.3	10.1	18.3	20.4	-14.5	-1.3	
Soft drinks												
Output ('000 litres)	144,385	133,016	123,418	156,726	154,327	131,999	138,446	150,768	46,546	50,201	54,021	
Growth %	3.0	-7.9	-7.2	27.0	-1.5	-14.5	4.9	8.9	1.3	7.9	7.6	

MT = Metric tonnes

* Provisional

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

Electricity and Water Supply

The sector grew by 6.6 percent in 2018 compared to 8.5 percent in 2017. In the fourth quarter, it grew by 8.7 percent compared to 7.8 percent in the previous quarter, and 5.4 percent in the fourth quarter of 2017. The strong performance of the sector was largely on account of increased generation of renewable sources of electricity such as wind and solar (**Table 3.1**). The sector's contribution to overall GDP growth remained stable at 0.2 percentage points in all quarters of 2018 (**Table 3.3**).

Growth in electricity generation increased marginally by 0.9 percent in the fourth quarter of 2018 compared

to the previous quarter, and was higher by 9.3 percent compared to the same quarter in 2017. This was attributed to a significant increase in generation of wind electricity during the quarter under review. Meanwhile, generation of hydroelectricity, geothermal electricity and thermal electricity declined by 19.6 percent, 4.0 percent and 10.5 percent, respectively, compared to the previous quarter (**Table 3.6**).

Consumption of electricity increased by 1.8 percent in the third and fourth quarters of 2018. Meanwhile, international oil prices declined by 9.1 percent in the fourth quarter of 2018 compared to the previous quarter (**Table 3.6**).

Table 3.6: Quarterly Performance in the Energy Sector

	2017				2018						
	Quarterly				Quarterly				Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Oct-18	Nov-18	Dec-18
Electricity Supply (Generation)											
Output (million KWH)	2,452.7	2,515.6	2,555.5	2,618.7	2,642.6	2,718.7	2,835.4	2,861.6	947.0	963.7	924.7
Growth %	-3.7	2.6	1.6	2.5	0.9	2.9	4.3	0.9	2.4	1.8	-4.1
Of which:											
Hydro-power Generation (million KWH)	700.6	620.3	683.3	772.6	664.8	1103.6	1229.8	988.3	420.3	417.4	392.1
Growth (%)	-27.8	-11.5	10.2	13.1	-14.0	66.0	11.4	-19.6	7.2	-0.7	-6.1
Geo-Thermal Generation (million KWH)	1,122.2	1,151.2	1,219.3	1,263.7	1,265.6	1,304.8	1,304.5	1,252.9	438.1	426.6	439.8
Growth (%)	1.6	2.6	5.9	3.6	0.2	3.1	0.0	-4.0	-0.4	-2.6	3.1
Thermal Generation (million KWH)	609.1	730.8	644.1	562.2	695.8	304.0	289.4	258.9	86.9	117.2	85.3
Growth (%)	35.1	20.0	-11.9	-12.7	23.8	-56.3	-4.8	-10.5	1.8	35.0	-27.2
Wind Generation (million KWH)	20.8	13.2	8.7	18.7	14.2	6.2	11.7	347.9	1.7	2.5	7.5
Growth (%)	4.0	-36.6	-34.3	116.1	-23.9	-56.4	88.5		-77.4	49.7	195.3
Consumption of electricity (million KWH)	2,064.3	2,165.8	2,413.7	2,079.2	2,161.3	2,127.1	2,164.9	2,203.5	737.7	751.0	714.9
Growth %	0.4	4.9	11.4	-13.9	3.9	-1.6	1.8	1.8	-0.4	1.8	-4.8
Consumption of Fuels ('000 tonnes)	1,300.8	1,314.1	1,240.8	1,146.0	1,380.1	1,324.0	1,292.3	1,192.9	418.4	400	375
Growth %	-7.0	1.0	-5.6	-7.6	20.4	-4.1	-2.4	-7.7	11.1	-4.5	-6.2
Murban crude oil average price (US \$ per barrel)	54.7	50.7	51.1	63.2	66.2	73.6	76.6	69.6	81.3	68.1	59.3
Growth %	8.2	-7.3	0.7	23.8	4.8	11.2	4.0	-9.1	3.2	-16.3	-12.8

Source: Kenya National Bureau of Statistics

Construction

The Construction sector growth remained strong at 7.9 percent in 2018 compared to 7.0 percent in 2017. In the fourth quarter, it grew by 7.3 percent compared to 7.0 percent in the previous quarter, driven by ongoing public infrastructure projects, such as construction of the second phase of the Standard Gauge Railway (SGR). However, this was lower than 11.3 percent growth recorded in the fourth quarter of 2017 (Table 3.1). The sector contributed 0.5 percentage points to real GDP growth in the fourth quarter of 2018, compared to 0.7 percentage points in the same quarter of 2017 (Table 3.3).

Indicators in the construction sector showed increased activity during the fourth quarter of 2018. Cement consumption decreased by 7.8 compared to the previous quarter, but was higher by 3.4 percent compared to the same quarter of 2017. The value of building plans approved by Nairobi City County's Planning, Compliance and Enforcement Department increased by 15.9 percent in the fourth quarter of 2018 compared to the previous quarter, and by 67 percent compared to the same quarter of 2017. The increase in value was recorded for both residential and non-residential building plans (Table 3.7).

Table 3.7: Quarterly Output of Selected Construction Indicators

	2017				2018*						
	Quarterly				Quarterly				Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Oct-18	Nov-18	Dec-18
Cement Consumption											
Output (Tonnes)	1,533,010	1,435,103	1,429,162	1,387,875	1,502,179	1,433,432	1,556,927	1,434,955	502,719	494,038	438,198
Growth %	-5.0	-6.4	-0.4	-2.9	8.2	-4.6	8.6	-7.8	-2.3	-1.7	-11.3
Value of Building Plans Approved by Nairobi City County Planning Compliance & Enforcement Department											
Residential (KSh, millions)	33,863.46	36,503.04	18,146.46	23,550.46	36,850.30	26,326.87	32,493.04	36,168.58	9,696.37	15,319.80	11,152.41
Growth (%)	-25.7	7.8	-50.3	29.8	56.5	-28.6	23.4	11.3	-12.9	58.0	-27.2
Non-residential (KSh, millions)	27,846.32	30,457.72	2,691.63	11,661.46	23,255.01	14,329.83	18,230.01	22,643.08	8,082.13	9,354.40	5,206.55
Growth (%)	-4.6	9.4	-91.2	333.2	99.4	-38.4	27.2	24.2	31.5	15.7	-44.3
Total (KSh, millions)	61,709.78	66,960.76	20,838.09	35,211.92	60,105.31	40,656.70	50,723.05	58,811.66	17,778.50	24,674.20	16,358.96
Growth (%)	-17.5	8.5	-68.9	69.0	70.7	-32.4	24.8	15.9	2.9	38.8	-33.7

Source: Kenya National Bureau of Statistics

Accommodation and Restaurants

Activity in the Accommodation and Restaurant sector rebounded to 16.6 percent in 2018 compared to 14.3 percent in 2017. In the fourth quarter of 2018, the sector grew by 21.3 percent compared to 15.7 percent in the previous quarter, and 8.9 percent in the same quarter of 2017 (Table 3.1). The resurgence of activity in the sector was attributed to growth in the aviation sector, including the introduction of direct

flights from Nairobi to New York by Kenya Airways, increased investor confidence, and removal of travel advisories.

Tourist Arrivals

Overall tourist arrivals declined by 17.2 percent in the fourth quarter of 2018 compared to the previous quarter, owing to lower arrivals through Jomo Kenyatta International Airport (JKIA) in Nairobi.

However, tourist arrivals through Moi International Airport Mombasa (MIAM) increased significantly by 35.1 percent compared to the previous quarter (**Table 3.8**). Compared to the same quarter of 2017, total tourist arrivals increased by 21.4 percent.

Total passenger flows through (JKIA) declined by 11.5 percent in the fourth quarter of 2018 compared to the previous quarter, which was reflected in both incoming and outgoing passenger flows (**Table 3.9**). However, when compared to the fourth quarter of 2017, total passenger flows increased by 10.2 percent during the quarter under review.

Table 3.8: Quarterly Tourist Arrival by Point of Entry

	2017				2018						
	Quarterly				Quarterly				Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Oct-18	Nov-18	Dec-18
Total Tourist Arrivals	306,162	301,831	368,911	319,177	353,790	332,406	467,720	387,380	125,832	125,323	136,225
Growth (%)	39.6	-1.4	22.2	-13.5	10.8	-6.0	40.7	-17.2	-3.7	-0.4	8.7
o.w. JKIA - Nairobi	271,613	287,779	341,906	285,121	207,066	298,493	434,703	342,774	113,838	110,987	117,949
Growth (%)	41.4	6.0	18.8	-16.6	-27.4	44.2	45.6	-21.1	-5.6	-2.5	6.3
MIAM - Mombasa	34,549	14,052	27,005	34,056	43,649	16,774	33,017	44,606	11,994	14,336	18,276
Growth (%)	26.7	-59.3	92.2	26.1	28.2	-61.6	96.8	35.1	19.5	19.5	27.5

Source: Kenya Tourism Board

Transport and Storage

Transport and Storage Sector recorded strong performance of 8.8 percent in 2018 compared to 7.2 percent in 2017. In the fourth quarter of 2018, it grew by 9.3 percent compared to 9.0 percent in the previous quarter, and 9.7 percent recorded in a similar period of 2017 (**Table 3.1**). The strong performance of the sector during the period under review was mainly attributed to improved activity in rail, road and air transport. Its contribution to overall GDP growth increased to 0.8 percentage points compared to 0.7 percentage points in the previous quarter (**Table 3.3**).

The volume of oil that passed through the Kenya Pipeline increased by 5.0 percent in the fourth quarter of 2018 compared to the previous quarter, and by 8.7 percent compared to the same quarter of 2017. Meanwhile, consumption of fuels declined by 7.7 percent compared to the previous quarter, but increased by 4.1 percent compared to the same quarter of 2017 (**Table 3.9**).

Table 3.9: Quarterly Performance of Selected Transport Indicators

	2017				2018						
	Quarterly				Quarterly				Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Oct-18	Nov-18	Dec-18
Number of Passengers thro' JKIA											
Total passenger flows	994,137	1,083,803	1,309,436	1,155,878	1,117,194	1,192,031	1,438,266	1,273,305	417,045	403,068	453,192
Growth (%)	-9.5	9.0	20.8	-11.7	-3.3	6.7	20.7	-11.5	-6.5	-3.4	12.4
o.w. Incoming	638,803	680,989	814,088	734,375	707,536	745,416	884,126	810,444	260,379	255,149	294,916
Growth (%)	-7.4	6.6	19.5	-9.8	-3.7	5.4	18.6	-8.3	-3.6	-2.0	15.6
Outgoing	355,334	402,814	495,348	421,503	409,658	446,615	554,140	462,861	156,666	147,919	158,276
Growth %	-13.0	13.4	23.0	-14.9	-2.8	9.0	24.1	-16.5	-11.0	-5.6	7.0
Kenya Pipeline Oil Throughput											
Output ('000 litres)	1,551,237	1,532,312	1,545,030	1,527,002	1,572,646	1,508,627	1,580,877	1,659,339	558,429	532,715	568,195
Growth %	5.7	-1.2	0.8	-1.2	3.0	-4.1	4.8	5.0	14.2	-4.6	6.7

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

Chapter 4

Global Economy

4.1 Global Economy

Global economic growth declined slightly to 3.7 percent in 2018 from 3.8 percent in 2017 after a slowdown in the second half of 2018. The global economy is expected to grow at 3.5 percent in 2019 before a slow recovery to 3.6 percent in 2020. Economic activity moderated more than expected in some large advanced economies from its strong pace in 2017 while the emerging market and developing economies continued to expand at broadly the same pace as in 2017 (**Table 4.1**). Growth in the advanced economies declined to 2.3 percent in 2018 from 2.4 percent in 2017 and is expected to slow further to 2.0 percent in 2019 reflecting a confluence of factors affecting major economies. The US economy maintained robust growth as a result of sizeable fiscal stimulus and a boost from the private sector. The slowdown in Germany followed the introduction of new automobile fuel emission standards while in Italy, concerns about sovereign and financial risks weighed on domestic demand.

There was a significant decline in growth in the Euro area from 2.4 percent in 2017 to 1.8 in 2018 and is projected at 1.6 percent in 2019. This was attributed to slower export growth after a strong surge in the final quarter of 2017. Other factors included political uncertainty, industrial action and higher energy prices which reduced demand for energy imports. Slower growth in the UK from 1.8 percent to 1.4 percent in 2018 and 1.5 percent projected in 2019 was attributed to weather disruption in the first quarter.

The emerging market and developing economy group grew at 4.6 percent in 2018 but it is expected to slow down to 4.5 percent in 2019 before improving to 4.9 percent in 2020. This reflects a lower growth in China and the recession in Turkey, with an important carryover from weaker activity in late 2018, as well as a deepening contraction in Iran. China's economy slowed down to 6.6 in 2018 from 6.9 percent in 2017 due to regulatory tightening of the property sector and non-bank financial intermediation. It is expected to slow down even further in 2019 due to combined influence of needed financial regulatory tightening

and tariff wars with the US. India's growth improved in 2018 to 7.3 percent supported by domestic demand and is expected to pick up further in 2019 due to lower oil prices and low inflation resulting in less tightening of monetary policy than previously expected.

Growth in sub-Saharan Africa picked up from 2.7 percent in 2017 to 3.0 percent in 2018. Improved growth was mostly notable in fuel-exporting economies due to higher oil prices. It is expected to improve further to 3.5 percent and 3.7 percent in 2019 and 2020, respectively. The declining oil prices may however, affect growth prospects for oil exporting countries especially Angola and Nigeria.

4.2 Risk to the global economic outlook

Risk and uncertainties to the global economic outlook have continued to intensify. The main risk to global growth remain the ongoing tariff wars between China and US and the possible effect on the global trade, investments and output. The escalation of trade tensions resulting in increase in tariff barriers may lead to higher costs of imported intermediate and capital goods, and higher final goods prices for consumers. In addition, trade policy uncertainty and concerns over escalation and retaliation would lower business investment, disrupt supply chains, and slow productivity growth.

In the UK, the possibility of a no-Brexit deal continue to increase uncertainty and may severely disrupt supply chains and raise trade costs potentially with large and long-lasting negative impacts on the economies of the United Kingdom and the rest of the world.

Risks of cyberattacks on financial infrastructure can severely disrupt cross-border payment systems and the flow of goods and services. In addition, political and geopolitical conflict in the Middle East, and tensions in East Asia remain a key threat to global growth.

Table 4.1: Global Economic Outlook

REAL GDP GROWTH IMF				
	REAL GDP GROWTH (%) IMF			
	YEAR OVER YEAR			Projections
Country/Region	2016	2017	2018	2019
World Output	3.4	3.8	3.7	3.5
Advanced economies	1.7	2.4	2.3	2
United States	1.6	2.2	2.9	2.5
Euro Area	2	2.4	1.8	1.6
Germany	2.2	2.5	1.5	1.3
France	1.2	2.3	1.5	1.5
Italy	1.1	1.6	1	0.6
Spain	3.2	3	2.5	2.2
Japan	1	1.9	0.9	1.1
United Kingdom	1.8	1.8	1.4	1.5
Emerging market and Developing economies	3.3	4.7	4.6	4.5
Russia	-0.2	1.5	1.7	1.6
China	6.7	6.9	6.6	6.2
India	7.1	6.7	7.3	7.5
Brazil	-3.5	1.1	1.3	2.5
Middle East, North Africa, Afghanistan and Pakistan	5.2	2.2	2.4	2.4
Sub-Saharan Africa	1.4	2.9	2.9	3.5

Source: IMF, World Economic Outlook (WEO), October 2018 update

Chapter 5

Balance of Payments and Exchange Rates

Balance of Payments and Exchange Rates

The current account deficit narrowed to USD 913 million in the fourth quarter of 2018 from USD 1,001 million in the fourth quarter of 2017, mainly driven

by an improvement in the primary and secondary income account (**Table 5.1**).

Table 5.1: Balance of Payments (USD Million)

ITEM	2017*	2018**							Q4 2018-Q4 2017	
	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Q4			Total	Change	%
	Q4	Q1	Q2	Q3	Oct	Nov	Dec	Q4		
1. Overall Balance	524	-2,018	333	390	-35	264	22	251	-273	-52.2
2. Current account	-1,001	-1,147	-1,208	-1,081	-415	-361	-137	-913	88	-8.8
Exports (fob)	1,456	1,600	1,584	1,510	499	477	435	1,411	-45	-3.1
Imports (fob)	3,978	4,039	4,340	4,036	1,370	1,397	1,163	3,930	-48	-1.2
Services: credit	1,128	1,285	1,367	1,365	483	483	494	1,461	333	29.5
Services: debit	622	966	983	950	346	321	298	965	343	55.0
Balance on goods and services	-2,016	-2,120	-2,372	-2,111	-733	-758	-532	-2,023	-7	0.3
Primary income: credit	148	169	185	184	60	60	61	182	33	22.5
Primary income: debit	326	296	430	381	131	75	136	342	16	5.0
Balance on goods, services, and primary income	-2,194	-2,247	-2,616	-2,308	-804	-773	-606	-2,183	10	-0.5
Secondary income: credit	1,208	1,111	1,423	1,238	393	415	474	1,282	74	6.1
o.w Remittances	565	642	737	636	186	175	204	565	0	0.0
Secondary income: debit	15	10	14	12	4	3	4	11	-4	-27.4
3. Capital Account	35	83	93	36	24	20	8	51	17	47.5
4. Financial Account	-1,383	-3,144	-195	-836	-867	-503	-1,002	-2,373	-989	71.5

* Revised

**Provisional

Fob - free on board

Source: Central Bank of Kenya

The Current Account

The trade balance widened marginally by 0.3 percent from a deficit of USD 2,016 million in the fourth quarter of 2017 to a deficit of USD 2,023 million in the fourth quarter of 2018, attributed to higher payments on services (**Table 5.1**). The value of merchandise exports decreased by 3.1 percent to USD 1,411 million in the fourth quarter of 2018 largely due to lower receipts from tea, manufactured goods and re-exports. The value of tea exports declined by 17 percent to USD 315 million, due to lower tea prices that prevailed in 2018 compared to 2017 following increased production attributed to high precipitation in tea growing areas. Receipts from horticulture exports improved by 7 percent to USD 225 million primarily due to increased earnings from cut flowers (**Table 5.2**).

The value of merchandise imports declined by 1 percent to USD 3,930 million in the fourth quarter of 2018 from USD 3,978 million, in the fourth quarter of 2017, primarily on account of lower food imports. Food imports declined by 39 percent from USD 584

million in the fourth quarter of 2017 to USD 358 million in the fourth quarter of 2018, due to improved domestic food production due to the normal weather conditions that prevailed in 2018. However, imports of oil products increased by 6 percent from USD 774 million in the fourth quarter of 2017 to USD 818 million in the fourth quarter of 2018. This was as a result of higher international crude oil prices (**Table 5.2**).

The services account recorded a 2 percent decline to USD 496 million in the fourth quarter of 2018, from USD 506 million in the fourth quarter of 2017 mainly on account of higher payments of other business services. Earnings from tourism improved by 13 percent in the fourth quarter of 2018 attributed to political stability and improved security in the country. The balance on the primary account improved by 9.7 percent from a deficit of USD 177.6 million in the fourth quarter of 2017 to deficit of USD 160.38 million in the fourth quarter of 2018. The balance on secondary income improved by 6.5 percent to USD 1,270 million due to resilient remittance inflows.

Table 5.2: Balance on Current Account (USD Million)

ITEM	2017	2018**						Q4 2018-Q4 2017		
	Oct-Dec	Jan-mar	Apr-Jun	Jul-Sep	Q4			Total	Change	%
	Q4	Q1	Q2	Q3	Oct	Nov	Dec	Q4		
CURRENT ACCOUNT	-1,001	-1,147	-1,208	-1,081	-415	-361	-137	-913	88	-9
Goods	-2,522	-2,439	-2,756	-2,525	-871	-920	-728	-2,519	3	0
Exports (fob)	1,456	1,600	1,584	1,510	499	477	435	1,411	-45	-3
o.w Coffee	34	51	67	84	15	17	9	41	7	20
Tea	382	393	346	361	112	108	96	315	-67	-17
Horticulture	210	285	297	285	83	68	74	225	15	7
Oil products	12	12	12	16	5	3	1	9	-3	-25
Manufactured Goods	98	90	97	93	33	32	33	98	-1	-1
Raw Materials	83	91	88	83	31	34	23	88	5	6
Chemicals and Related Products (n.e.s)	100	107	112	110	39	41	34	113	14	14
Miscellaneous Man. Articles	133	129	131	174	46	48	45	140	7	5
Re-exports	158	194	193	181	58	41	45	144	-14	-9
Other	245	248	243	124	79	83	75	237	-8	-3
Imports (fob)	3,978	4,039	4,340	4,036	1,370	1,397	1,163	3,930	-48	-1
o.w Oil	774	769	920	923	290	297	231	818	45	6
Chemicals	557	657	615	605	229	206	172	607	50	9
Manufactured Goods	619	749	827	835	247	233	207	688	68	11
Machinery & Transport Equipment	1,066	1,044	1,256	1,278	381	403	334	1,119	53	5
Machinery	616	646	793	715	266	290	225	781	165	27
Transport equipment	449	398	463	411	115	111	110	336	-114	-25
Other	963	820	722	394	223	257	218	698	-265	-27
o.w Food	584	536	407	379	117	131	109	358	-226	-39
Services	506	319	384	414	137	162	196	496	-10	-2
Transport Services (net)	154	89	143	143	24	63	102	189	34	22
Credit	407	444	469	491	156	191	207	554	147	36
Debit	253	355	327	348	132	128	106	365	113	45
Travel Services (net)	172	194	223	210	79	70	69	218	45	26
Credit	242	257	281	261	96	87	89	273	31	13
Debit	69	63	58	52	17	18	20	55	-14	-20
Other Services (net)	179	36	19	62	35	29	26	90	-90	-50
Primary Income	-178	-127	-245	-197	-71	-15	-75	-160	17	-10
Credit	148	169	185	184	60	60	61	182	33	23
Debit	326	296	430	381	131	75	136	342	16	5
Secondary Income	1,193	1,101	1,408	1,226	389	412	469	1,271	78	7
Credit	1,208	1,111	1,423	1,238	393	415	474	1,282	74	6
Debit	15	10	14	12	4	3	4	11	-4	-27

* Revised

**Provisional

Fob - free on board

Source: Central Bank of Kenya

Direction of Trade

Imports from China accounted for 19.1 percent of total imports to Kenya in the fourth quarter of 2018, making it the largest source of imports. In value terms, Kenya's imports from China amounted to USD 772 million, a decrease from 861 million in the fourth quarter of 2017. Imports from the European Union accounted for 13.4 percent of total imports, and decreased by 1.3 percent to USD 542 million in fourth quarter of 2018. The share of imports from Africa decreased to 11.9 percent in the fourth quarter of 2018 from 13.5 percent in the fourth quarter of 2017, reflecting a decrease in imports from the EAC and COMESA. The share of imports from India decreased to 9.6 percent from 9.8 percent, over the same period (Table 5.3).

Table 5.3: Kenya's Direction of Trade: Imports

IMPORTS (USD M)											Share of Imports (%)	
	2017*			2018**								
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Q4					
Country	Q2	Q3	Q4	Q1	Q2	Q3	October	November	December	Q4	Q4 2017	Q4 2018
Africa	475	526	537	570	504	479	167	170	145	481	13.5	11.9
<i>Of which</i>											0.0	
South Africa	166	165	132	170	171	138	55	57	48	160	3.3	4.0
Egypt	76	91	86	89	93	88	29	32	29	89	2.2	2.2
Others	234	270	319	311	240	253	83	81	68	231	8.0	5.7
											0.0	
EAC	126	139	218	213	173	156	49	51	35	134	5.5	3.3
COMESA	258	299	347	340	271	269	89	90	80	259	8.7	6.4
Rest of the World	3,456	3,635	3,442	3,467	3,835	3,860	1,254	1,224	1,077	3,554	86.5	88.1
<i>Of which</i>											0.0	
India	466	331	389	473	435	535	150	133	103	386	9.8	9.6
United Arab Emirates	284	471	362	334	469	287	158	148	61	367	9.1	9.1
China	962	855	861	867	1,136	889	266	272	234	772	21.6	19.1
Japan	211	189	207	220	203	262	87	135	79	300	5.2	7.4
USA	156	130	129	205	104	108	40	36	32	108	3.2	2.7
United Kingdom	73	71	76	76	76	81	24	27	27	79	1.9	2.0
Singapore	8	7	20	9	8	8	2	2	3	6	0.5	0.2
Germany	104	132	95	96	137	111	48	30	39	117	2.4	2.9
Saudi Arabia	225	194	337	359	424	460	171	124	167	462	8.5	11.4
Indonesia	123	157	116	106	102	112	55	36	43	135	2.9	3.3
Netherlands	38	71	43	60	45	47	11	16	12	38	1.1	1.0
France	84	68	51	53	51	62	22	27	20	70	1.3	1.7
Bahrain	26	16	19	2	8	1	0	38	3	42	0.5	1.0
Italy	52	58	44	61	75	56	20	25	17	62	1.1	1.5
Others	644	886	691	547	561	842	198	174	238	610	17.4	15.1
Total	3,932	4,160	3,979	4,036	4,338	4,338	1,420	1,393	1,221	4,035	100.0	100.0
											0.0	
EU	517	552	472	488	576	545	184	180	179	542	11.9	13.4
China	962	855	861	867	1,136	889	266	272	234	772	21.6	19.1

Source: Kenya Revenue Authority

The share of export to the rest of the world rose from 62.7 percent in the fourth quarter of 2017 to 65.9 percent in the fourth quarter of 2018 attributed to higher exports to United Arab Emirates, USA, India and Afghanistan.

The share of exports to Africa however, declined to 34.1 percent in the fourth quarter of 2018 from 37.3 percent in the fourth quarter of 2017. This reflected lower exports to the COMESA region, with its share declining from 25.2 percent to 23.6 percent during the review period (Table 5.4).

Table 5.4: Kenya's Direction of Trade: Exports

EXPORTS (USD M)											Share of Exports (%)	
	2017			2018			2018					
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Q4					
Country	Q2	Q3	Q4	Q1	Q2	Q3	Oct	Nov	Dec	Q4	Q4 2017	Q4 2018
Africa	516	543	543	530	553	537	186	172	157	515	37.3	34.1
<i>Of which</i>												
Uganda	140	151	144	159	147	150	55	51	49	155	9.9	10.2
Tanzania	53	73	75	72	74	73	26	26	22	74	5.2	4.9
Egypt	35	47	60	53	53	45	21	11	16	48	4.1	3.2
Sudan	17	14	23	18	12	15	5	7	5	16	1.6	1.1
South Sudan	47	35	35	38	45	19	10	9	8	27	2.4	1.8
Somalia	46	44	42	39	41	36	12	13	8	33	2.9	2.2
DRC	45	44	46	35	42	38	15	11	9	35	3.2	2.3
Rwanda	41	48	39	38	51	45	13	17	12	43	2.7	2.8
Others	93	88	78	78	89	117	30	27	28	84	5.3	5.6
											0.0	
EAC	257	290	271	282	286	291	100	99	87	287	18.6	19.0
COMESA	349	368	367	359	366	371	130	116	110	356	25.2	23.6
Rest of the World	937	870	914	1,070	1,030	974	314	305	278	996	62.7	65.9
<i>Of which</i>												
United Kingdom	88	93	95	109	101	92	32	31	32	95	6.5	6.3
Netherlands	111	89	104	139	114	105	37	30	33	99	7.2	6.6
USA	121	127	105	91	124	141	37	45	30	112	7.2	7.4
Pakistan	146	152	170	183	139	137	42	45	39	126	11.7	8.4
United Arab Emirates	78	56	69	93	89	85	29	26	23	78	4.7	5.2
Germany	34	21	25	28	35	23	9	9	6	24	1.7	1.6
India	13	14	14	34	14	25	6	6	5	17	1.0	1.1
Afghanistan	11	9	4	8	9	14	3	3	1	7	0.3	0.5
Others	334	310	327	384	406	351	118	111	110	438	22.5	29.0
Total	1,453	1,413	1,456	1,600	1,584	1,510	499	477	435	1,510	100.0	100.0
EU	307	281	289	364	337	294	105	92	94	291	19.9	19.3
China	39	15	18	16	26	25	18	8	16	42	1.2	2.8

Source: Kenya Revenue Authority

Capital and Financial Account

The capital account recorded a decrease of USD 17 million to a decline of USD 51 million in the fourth quarter of 2018. The financial account recorded higher net inflows of USD 2,373 million in the fourth quarter of 2018, mainly reflecting an increase in Direct Investment as well as Other Investment flows (Table 5.5).

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

	2017**				2018 **				Q4 2017-Q4 2018			
	Oct-Dec	Jan-Mar	April- Jun	Jul-Sep	Oct-Dec	Jul - Sep	Q4		Total			%
Capital account credit	44	96	39	14	35	36	24	20	8	51	17	48
Capital account credit	44	96	39	14	35	36	24	20	8	51	17	48
Capital account: debit												
Financial Account	-2,016	-2,131	-1,458	-315	-1,383	-836	-867	-503	-1,002	-2,373	-989	72
Direct investment: assets	50	56	81	33	87	18	35	37	39	111	24	27
Direct investment: liabilities	97	255	229	137	654	383	303	254	279	836	182	28
Portfolio investment: assets	157	166	166	166	167	265	147	69	66	282	115	69
Portfolio investment: liabilities	7	-30	-31	-31	-31	-66	-42	-6	-17	-65	-34	110
* Revised												
Other investment: assets	-374	401	5	35	-165	180	-201	137	53	-11	154	-94
Other investment: liabilities	1,746	2,529	1,512	443	850	983	588	498	900	1,986	1,136	134

Source: Central Bank of Kenya

Foreign Exchange Reserves

The banking system's total foreign exchange holdings increased by 42 percent during the fourth quarter of 2018. Official reserves held by the Central Bank

constituted 71 percent of gross reserves and stood at USD 8,230 million, equivalent to 5.6 months of import cover (Table 5.6).

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

	2017				2018							
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Oct	Nov	Dec	Q4	
1. Gross Reserves	10,786	10,984	10,332	9,659	11,859	12,102	11,863	11,668	11,531	11,516	11,516	
of which:												
Official	8,379	8,580	7,899	7,346	9,362	8,954	8,545	8,554	8,281	8,230	8,230	
import cover*	5.5	5.7	5.3	5.0	6.3	5.9	5.6	5.6	5.4	5.3	5.3	
Commercial Banks	2,407	2,405	2,433	2,314	2,497	3,148	3,318	3,114	3,250	3,286	3,286	
2. Residents' foreign currency deposits	4,503	4,781	4,983	4,949	4,988	5,986	5,952	5,670	5,917	6,078	6,078	

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

Source: Central Bank of Kenya

Exchange Rates

Kenya's foreign exchange market remained relatively stable during the fourth quarter of 2018, largely supported by resilient remittance inflows and receipts from tourism, horticulture exports and lower food imports. The Kenya Shilling strengthened by 1.4 percent against the US Dollar to exchange at an average of 101.91 during the fourth quarter

compared with 103.35 in the fourth quarter of 2017. The Kenya Shilling also strengthened against all other major international currencies. In the EAC region, it strengthened against the Rwanda Franc, but weakened against Uganda and Tanzania shilling and the Burundi Franc during the period under review (**Table 5.7 and Chart 5.1**).

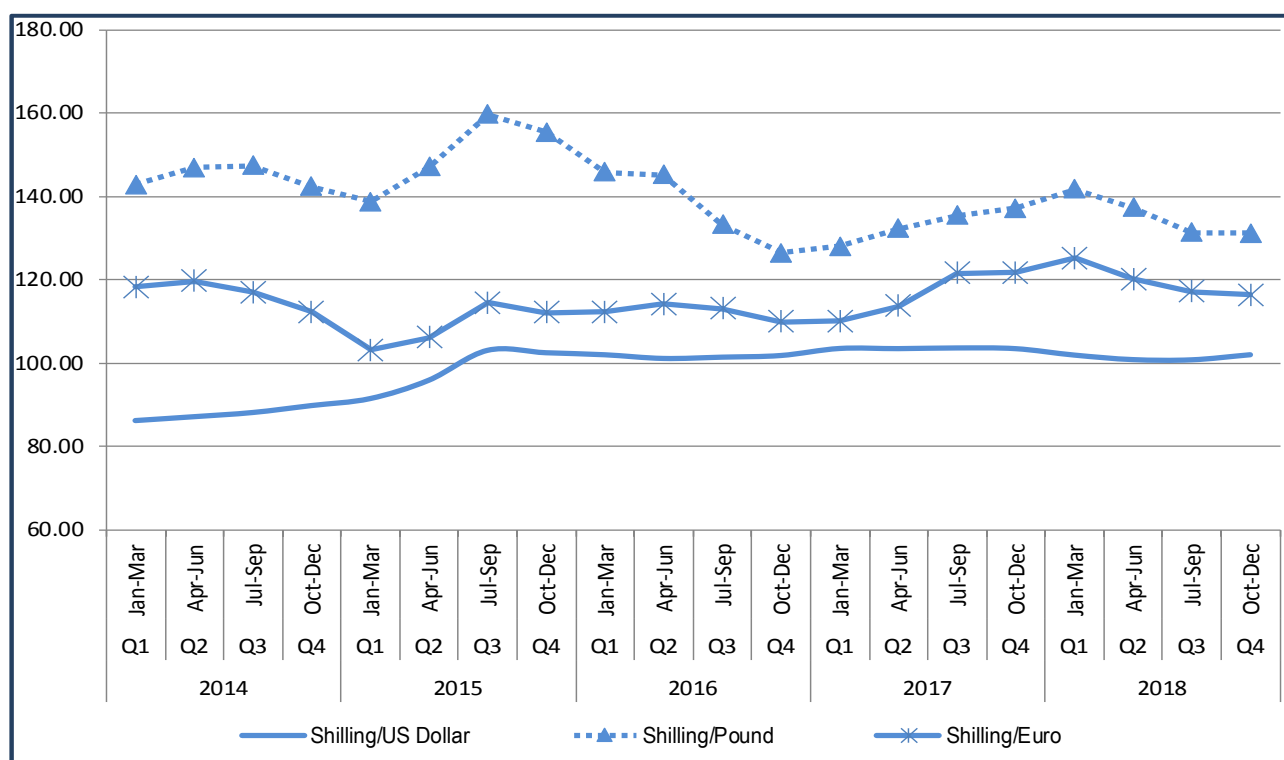
Table 5.7: Kenya Shilling Exchange Rate

		2017		2017								
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	October	November	December	Q4	% change Q4 2017 - Q4 2018
US Dollar	103.39	103.36	103.52	103.35	101.86	100.75	100.71	101.08	102.36	102.29	101.91	-1.40
Pound Sterling	128.05	132.22	135.40	137.15	141.64	137.26	131.30	131.60	132.08	129.74	131.14	-4.38
Euro	110.12	113.75	121.50	121.66	125.11	120.19	117.17	116.20	116.35	116.45	116.33	-4.38
100 Japanese Yen	90.95	92.98	93.28	91.60	93.96	92.38	90.40	89.59	90.35	90.99	90.31	-1.40
Uganda Shilling*	34.79	34.94	34.80	35.15	35.79	37.24	37.39	37.40	36.54	36.32	36.75	4.55
Tanzania Shilling*	21.57	21.63	21.64	21.70	22.10	22.60	22.67	22.66	22.46	22.49	22.54	3.87
Rwanda Franc*	7.99	8.04	8.02	8.16	8.39	8.62	8.71	8.74	8.68	8.72	8.71	6.82
Burundi Franc*	16.35	16.56	16.79	16.99	17.32	17.50	17.57	17.60	17.41	17.48	17.50	2.99

* Units of currency per Kenya Shilling

Source: Central Bank of Kenya

Chart 5.1: Kenya Shilling Exchange Rate



Source: Central Bank of Kenya

Chapter 6

The Banking System

Overview

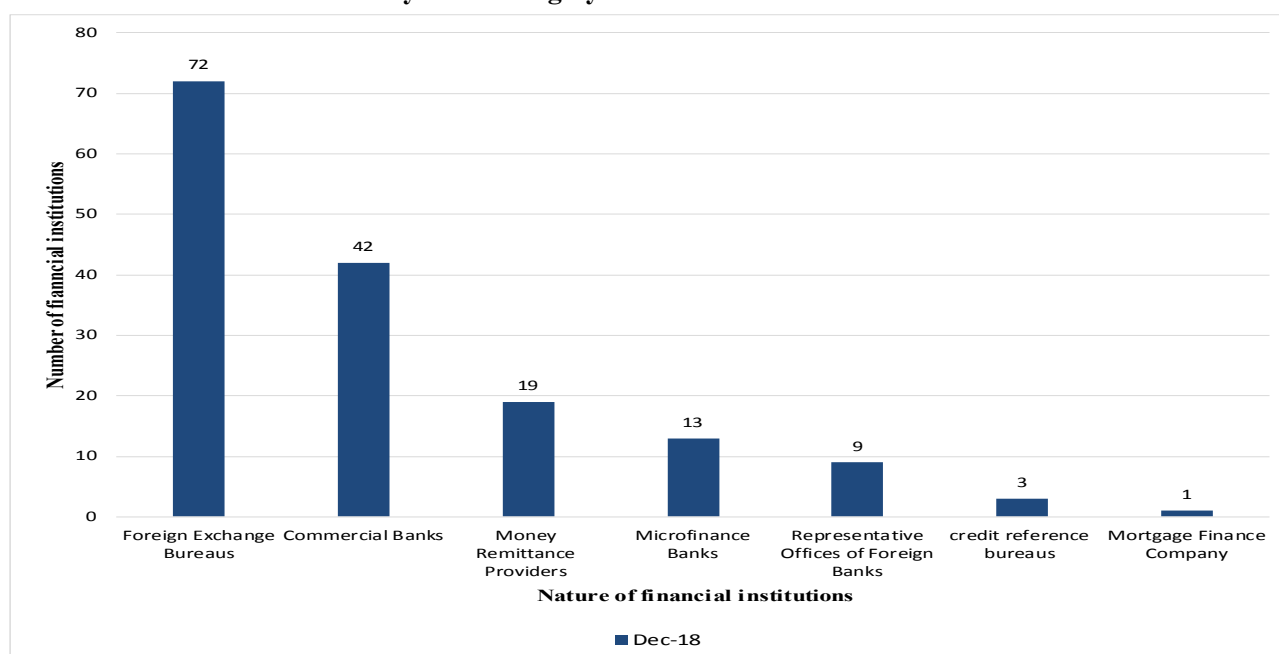
The banking sector was stable in the fourth quarter of 2018. Total net assets increased by 0.7 percent from KSh 4,414.7 million in September 2018 to KSh 4,446.1 million. The deposit base also increased by 2.8 percent from KSh 3,241.2 million to KSh 3,332.4 million between third quarter and fourth quarter of 2018. The sector was well capitalized and met the minimum capital requirements. Profitability decreased marginally due to increase in total expenses. Credit risk remained elevated with gross non-performing loans (NPLs) to gross loans ratio standing at 12.03

percent in the fourth quarter of 2018.

Size and structure

The Kenyan-banking sector comprised 42 Commercial Banks, 1 Mortgage Finance Company, 13 Microfinance Banks, 9 Representative Offices of Foreign Banks, 72 Foreign Exchange Bureaus, 19 Money Remittance Providers and 3 Credit Reference Bureaus as at December 31, 2018. **Chart 6.1** shows the structure of the Kenyan banking sector as at the end of the last two quarters.

Chart 6.1: Structure of the Kenyan Banking System



Source: Central Bank of Kenya

Structure of the Balance Sheet

i) Growth in banking sector assets

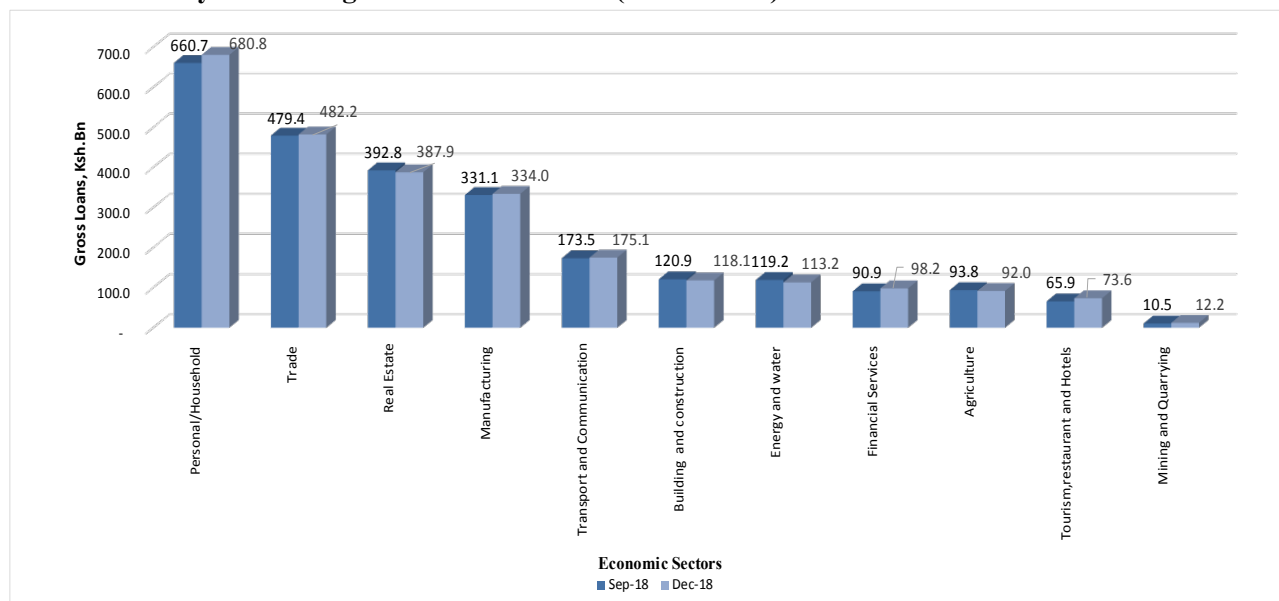
Total net assets increased by 0.7 percent from KSh 4,414.7 billion in the third quarter of 2018 to KSh 4,446.1 billion in the fourth quarter of 2018. The increase in total net assets was mainly recorded in Cash balances (24.5 percent), balances at Central Bank (13.9 percent) and foreign assets. However, loans and advances, which increased by 1.1 percent, remained the main component of assets, accounting for 53.1 percent in the fourth quarter of 2018, a slight increase from 52.7 percent recorded in the third quarter of 2018.

ii) Loans and Advances

Total banking sector lending increased by 1.1 percent, from KSh 2,538.7 billion in the third quarter of 2018 to KSh 2,567.3 billion in the fourth quarter of 2018. The increase in gross loans and advances was largely witnessed in the personal/household, tourism, restaurant, hotels, and Financial Services sectors. The increase in gross loans was mainly due to increased loans granted to individual borrowers, invoice discounting and credit granted for working capital purposes. The sectoral distribution of gross loans as at December 31, 2018 is highlighted in (**Chart 6.1**).

¹ Includes Charterhouse Bank Limited, which is under Statutory Management, Chase Bank and Imperial Bank Limited, which are in Receivership. However, the data for the two banks have been excluded in this report.

Chart 6.2: Kenyan Banking Sector Gross Loans (KSh Billion)



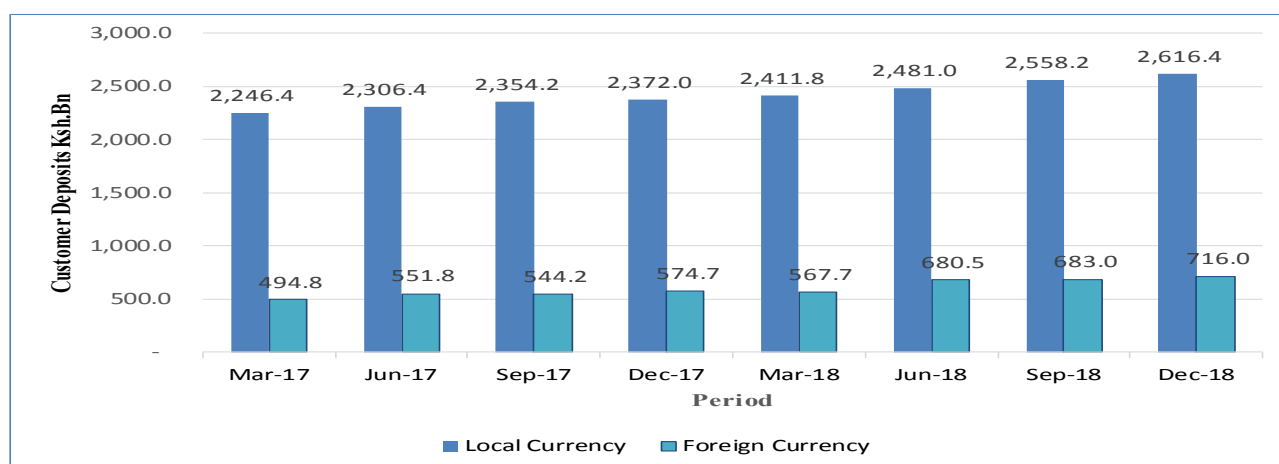
Source: Central Bank of Kenya

iii) *Deposit Liabilities*

Customer deposits remains the main source of funding to the banks accounting for 75.0 percent of the banking sector total liabilities and shareholders' funds as at the end of the fourth quarter of 2018. This was an increase from 73.4 percent recorded as at end of the third quarter of 2018. The customer deposit base increased by 2.8 percent from KSh 3,241.2 billion in the third quarter of 2018 to KSh 3,332.4 billion in the fourth quarter of 2018. Foreign currency deposits increased by KSh 33.0 billion (4.8 percent) from KSh 683.0 billion in the third quarter of 2018 to KSh 716.0 billion in the fourth quarter of 2018. Local currency deposits increased by KSh 58.2 billion (2.3 percent) from KSh 2,558.2 billion in the third quarter of 2018 to KSh 2,616.4 billion in the fourth quarter of 2018.

Chart 6.3 shows the trend of deposit liabilities.

Chart 6.3 Customers Deposit



Source: Central Bank of Kenya

Capital Adequacy

Kenya's banking sector is well capitalized and meets the minimum capital requirements. Core capital increased slightly by 0.8 percent from KSh 547.4 billion in third quarter of 2018 to KSh 603.6 billion in the fourth quarter of 2018. Total capital also increased by 10.5 percent from KSh 591.7 billion in the third quarter of 2018 to KSh 653.6 billion in the fourth quarter of 2018.

Core capital to total risk-weighted assets ratio increased marginally from 16.2 percent in the third quarter of 2018 to 17.2 percent in the fourth quarter of 2018. Total capital to total risk-weighted assets ratio also increased from 17.5 percent to 18.7 percent over the same period.

The minimum core capital to total deposits ratio is set at 8 percent. Commercial banks maintained an adequate buffer, with the ratio standing at 18.1

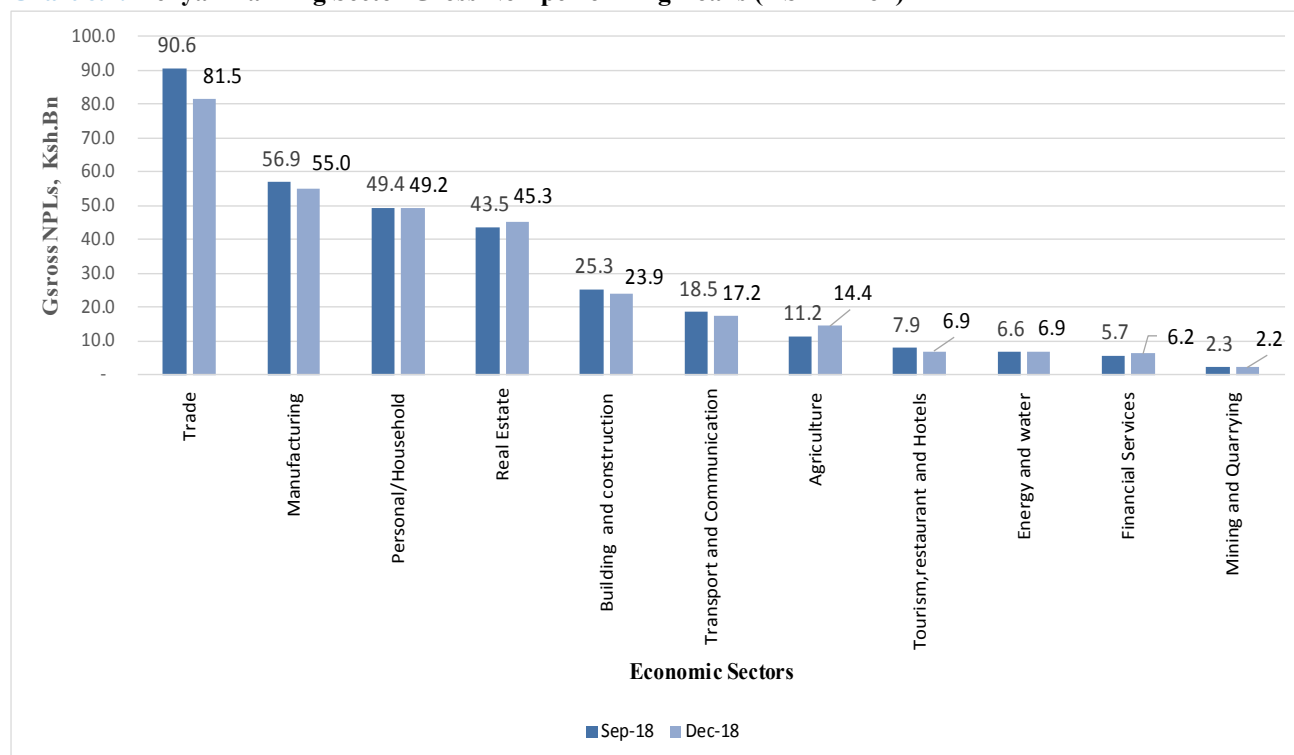
percent in the fourth quarter of 2018 compared to 16.9 percent in the third quarter of 2018. The increase was attributable to a lower increase of 2.8 percent in total deposits as compared to 10.2 percent increase in Core capital between third quarter and fourth quarter of 2018.

Asset Quality

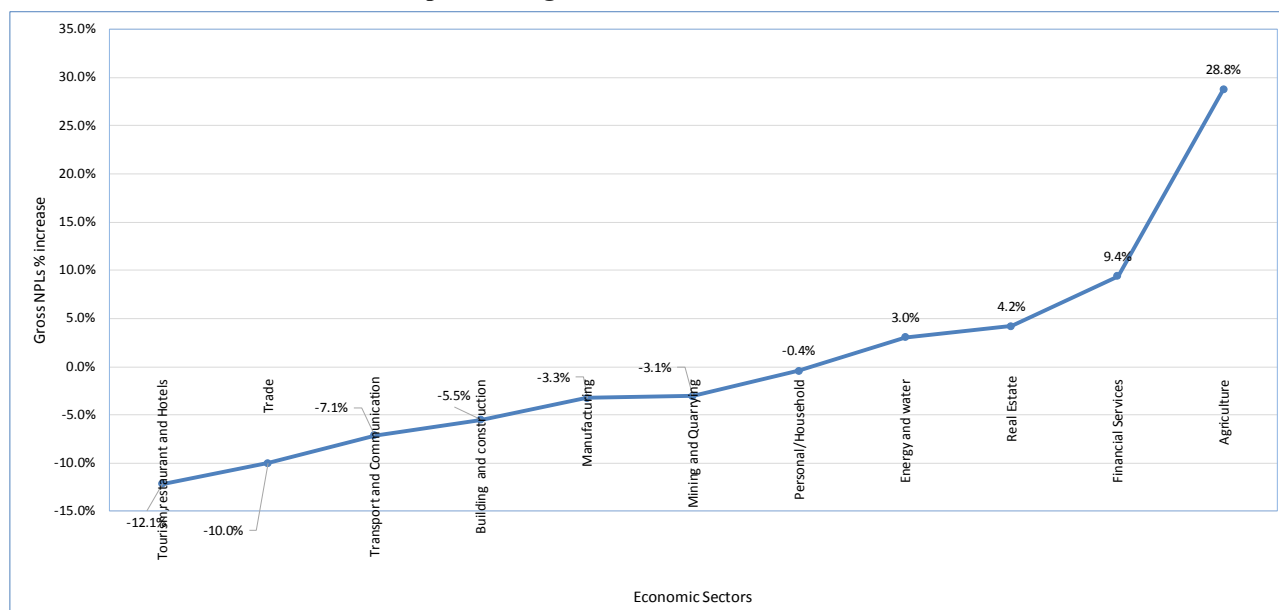
The gross non-performing loans (NPLs) decreased by 2.9 percent from KSh317.9 billion as at the end of the third quarter of 2018 to KSh 308.8 billion at the end of the fourth quarter of 2018. As a result, the gross NPLs to gross loans ratio decreased from 12.52 percent in the third quarter of 2018 to 12.03 percent in the fourth quarter of 2018. **Chart 6.4** highlights the sectoral distribution of gross NPLs.

The decrease in gross NPLS was spread across seven economic sectors as highlighted in **Chart 6.5**.

Chart 6.4: Kenyan Banking Sector Gross Non-performing Loans (KSh Billion)



Source: Central Bank of Kenya

Chart 6.5: Movement in Gross Non-performing Loans Third and Fourth Quarter of 2018

Source: Central Bank of Kenya

The Trade sector registered the highest decrease in NPLs by KSh 9.7 billion (10.0 percent) mainly due to write offs. Manufacturing and Building and Construction sectors NPLS decreased by KSh 1.9 billion (3.3 percent) and KSh 6.1 billion (1.4 percent) respectively, mainly due to repayments.

The banking sector's asset quality, as measured by the proportion of net non-performing loans to gross loans, improved slightly from 5.7 percent in the third quarter of 2018 to 5.4 percent in the fourth quarter of 2018. The coverage ratio, which is measured as

a percentage of specific provisions to total NPLs, decreased from 45.4 percent in third quarter of 2018 to 44.7 percent in fourth quarter of 2018 due to a higher decrease in specific provisions (6.1 percent) as compared to the decrease in total NPLS (4.8 percent). A summary of asset quality for the banking sector over the period (**Table 6.1**).

Table 6.1: Summary of Asset Quality

		September 2018, KSh Billion	December 2018, KSh Billion
1	Gross Loans and Advances (KSh' Bn)	2,538.7	2,567.3
2	Interest in Suspense (KSh' Bn)	54.1	57.7
3	Loans and Advances (net of interest suspended) (KSh' Bn)	2,484.6	2,509.6
4	Gross Non-Performing loans (KSh 'Bn)	317.9	308.8
5	Specific Provisions (KSh' Bn)	119.6	112.3
6	General Provisions (KSh' Bn)	37.4	36.1
7	Total Provisions (5+6) (KSh' Bn)	157.0	148.4
8	Net Advances (3-7) (KSh' Bn)	2,327.6	2,361.2
9	Total Non-Performing Loans and Advances (4-2) (KSh'Bn)	263.8	251.1
10	Net Non-Performing Loans and Advances (9-5) (KSh 'Bn)	144.1	138.8
11	Total NPLs as % of Total Advances (9/3)	10.6%	10.0%
12	Net NPLs as % of Gross Advances (10/1)	5.7%	5.4%
13	Specific Provisions as % of Total NPLs (5/9)	45.4%	44.7%
14	Gross NPLs to Gross Loans Ratio	12.5%	12.0%

Source: Central Bank of Kenya

Profitability

The banking sector recorded a decline in pre-tax profits by KSh1.9 billion (4.8 percent) from KSh 39.0 billion in the third quarter of 2018 to KSh 37.2 billion in the fourth quarter of 2018. The decrease in profitability was mainly attributable to decrease in income by KSh1.2 billion (1.0 percent) and increase in expenses by KSh 0.6 billion (0.7 percent).

Other income decreased by KSh4.5 billion (16.7 percent) while other interest income decreased by KSh 0.3 billion (6.7 percent) between third quarter of 2018 and fourth quarter of 2018. Interest on advances however increased by KSh 2.2 billion (3.5 percent) while interest on government securities increased by KSh0.4 billion (1.3 percent) between third quarter of 2018 and fourth quarter of 2018.

Total expenses increased by 0.7 percent from KSh 91.2 billion in the third quarter of 2018 to KSh 91.8 billion in the fourth quarter of 2018. The increase in expenses was largely attributable to salaries and wages and other expenses, which increased by 9.7 percent and 8.2 percent, respectively.

Interest income on loans and advances, interest on government securities and other incomes were the major sources of income accounting for 51.5 percent, 23.6 percent and 18.2 percent 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 33.1 percent, 25.0 percent and 24.6 percent of total expenses, respectively.

Return on assets (ROA) remained constant at 2.67 percent in third quarter of 2018 and fourth quarter of 2018. However, return on equity (ROE) decreased from 22.8 percent in the third quarter of 2018 to 22.5 percent in the fourth quarter of 2018. The ROE marginally decreased mainly due decline in profitability (4.8 percent) as compared to the increase in shareholders' funds (0.70 percent).

Liquidity

The banking sector's overall liquidity ratio increased from 48.0 percent in the third quarter of 2018 to 48.6 percent in the fourth quarter of 2018. The increase was driven by an increase in total foreign assets of KSh 6.6 billion (4.3 percent) from KSh 153.9 billion to KSh 160.5 billion between the two quarters under review. The increase was mainly attributed to increased balances with foreign banks. The banking sector liquidity ratio remained above the minimum statutory level of 20 percent.

Outlook of the Sector

The banking sector is projected to remain stable. Credit risk is expected to ease in the short to medium term as shown by recent declining levels of Non-Performing Loans. Liquidity risk is expected to continue easing as distribution of liquidity improves.

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 1.21 million transaction messages worth KSh 8.06 trillion in the fourth quarter of 2018, compared to the third quarter of 2018, which recorded 1.17 million transactions worth KSh 7.38 trillion. Volume and value increased by 3.27 percent and 9.17 percent, respectively. **Chart 6.6** 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.

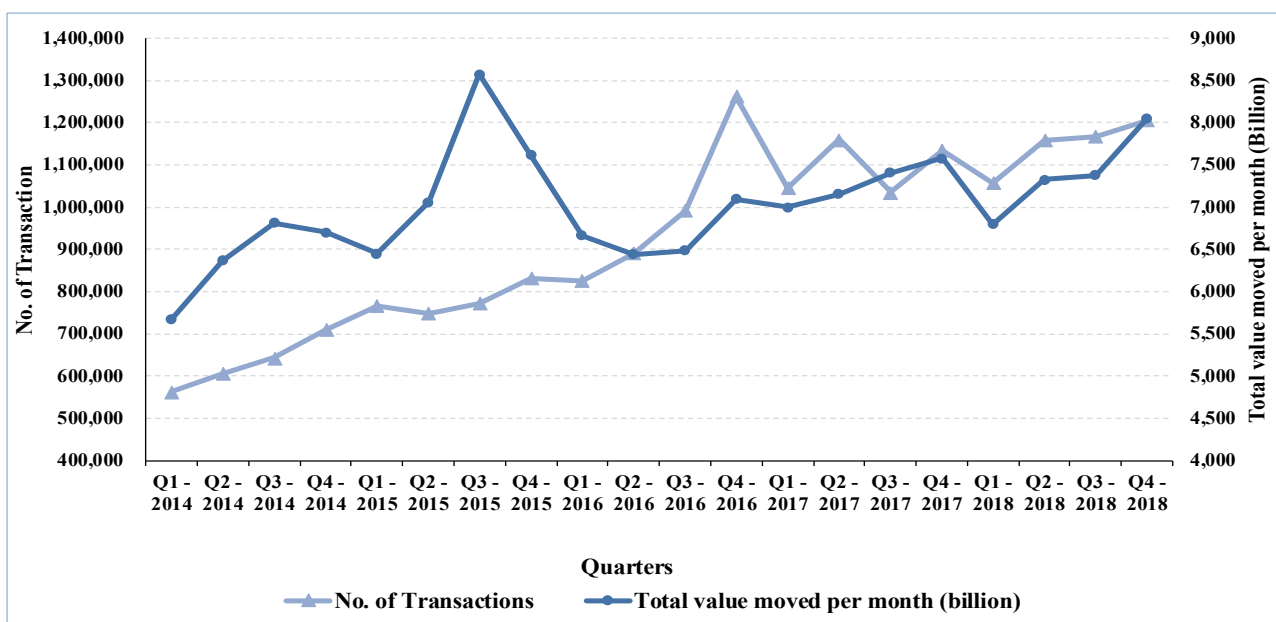
During the period under review, MT 102 usage increased by 33.13 per cent, to 40,545 messages recorded in the fourth quarter of 2018 from 30,456 messages processed in the previous quarter. The MT 103 payments decreased by 2.61 per cent, to 1,208,818 messages in the fourth quarter of 2018 from 1,178,123 messages in the previous quarter (**Chart 6.7**).

System Availability

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

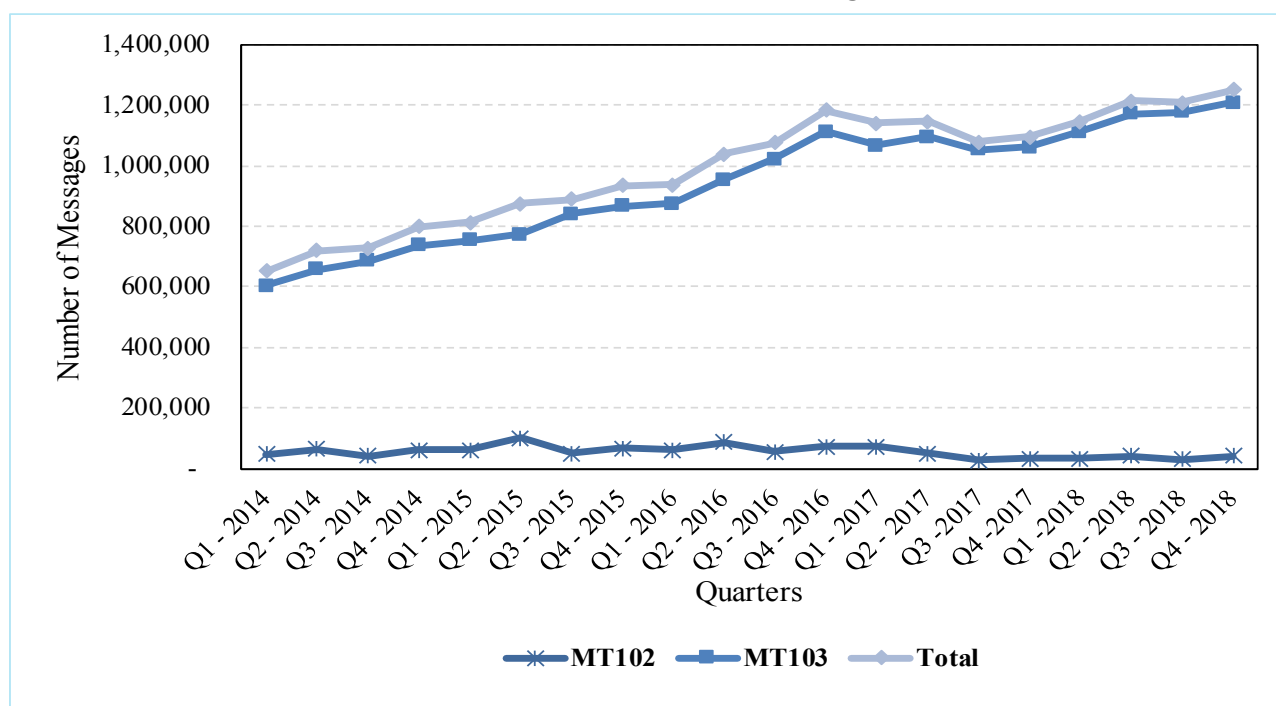
During the quarter under review, KEPSS availability maintained an average 99.23 percent during the period under review.

Chart 6.6: Trends in Monthly Flows Through KEPSS



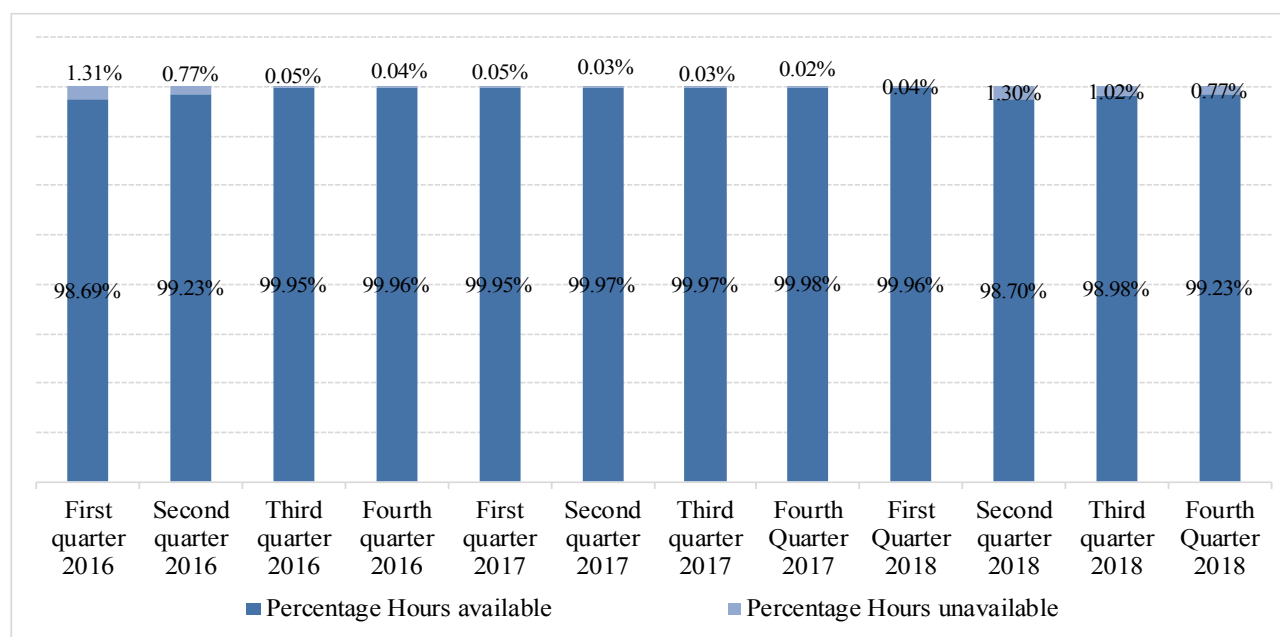
Source: Central Bank of Kenya

Chart 6.7: Trends in MT102 and MT103 Volumes Processed Through KEPSS



Source: Central Bank of Kenya

Chart 6.8: Availability of KEPSS in Kenya (%)



Source: Central Bank of Kenya

Chapter 7

Government Budgetary Performance

The Government's budgetary operations at the end of the first half of FY 2018/19 resulted in a deficit of 3.1 percent of GDP which was above the target of 2.5 percent of GDP. Both revenues and expenditures

were below their respective targets with the shortfall in total revenues and grants at 8.3 percent and total expenses and net lending at 4.9 percent.

Table 7.1: Statement of Government Operations in FY 2018/19 (KSh Billion)

	FY 2017/18		FY 2018/19				Over (+) /	%
	Q2	Cumulative to Dec-2017	Q1	Q2	Cumulative to Dec-2018	Target	Below (-) Target	Variance
1. TOTAL REVENUE & GRANTS	373.9	721.0	369.6	428.7	803.5	876.2	(72.7)	(8.3)
Ordinary Revenue	336.0	656.9	332.2	423.6	722.3	775.0	(40.2)	
Tax Revenue	313.0	630.4	329.3	351.4	680.8	762.5	(81.8)	
Non Tax Revenue	23.0	26.5	2.9	38.6	41.5	12.5	29.1	
Appropriations-in-Aid	24.7	49.3	33.8	33.5	72.4	80.7	(8.3)	
External Grants	13.2	14.8	3.6	5.1	8.8	20.5	(11.7)	
2. TOTAL EXPENSES & NET LENDING	516.7	929.0	452.5	616.0	1,075.5	1,130.7	(55.2)	(4.9)
Recurrent Expenses	334.6	634.5	345.4	317.8	643.9	768.6	(124.7)	
Development Expenses	119.1	209.8	83.6	206.6	308.9	231.9	77.0	
County Transfers	64.2	84.7	23.5	91.6	119.7	125.3	(5.6)	
Others	-	1.3	-	-	2.9	4.9	(1.9)	
3. DEFICIT (INCL. GRANTS) (1-2)	(142.8)	(208.0)	(82.9)	(187.4)	(272.0)	(254.5)	(17.5)	6.9
As percent of GDP	(1.7)	(2.4)	(0.8)	(1.9)	(3.1)	(2.5)		
4. ADJUSTMENT TO CASH BASIS	-	8.0	-	-	-	-	-	
5. DEFICIT INCL. GRANTS ON A CASH BASIS	(142.8)	(200.0)	(82.9)	(187.4)	(272.0)	(254.5)	(17.5)	
As percent of GDP	(1.7)	(2.3)	(0.8)	(1.9)	(3.1)	(2.5)		
6. DISCREPANCY: Expenditure (+) / Revenue (-)	-	-	-	-	-	-	-	
7. FINANCING	143.2	200.3	86.0	213.4	276.2	254.5	21.8	8.6
Domestic (Net)	57.9	107.1	69.2	85.6	130.8	217.7	(86.9)	
External (Net)	84.2	91.6	16.8	126.9	144.4	34.8	109.7	
Capital Receipts (domestic loan receipts)	1.0	1.0	-	1.0	1.0	2.0	(1.0)	
Others	-	0.5	-	-	-	-	-	

GDP figures from Provisional Budget Outturn-Sept 2018

Source: The National Treasury-Provisional BOT Sept 2018 published in QEBR Dec 2018 (Second Quarter)

Revenue

The Government receipts, comprising of revenue and grants rose by 16.0 percent to KSh 428.7 billion in the second quarter of FY 2018/19, compared to KSh 369.6 billion in the first quarter. The increase was reflected across both tax and non- tax revenues categories as well as external grants (**Table 7.1**).

There was a minor shift in the composition of tax revenues in the second quarter of FY 2018/19 compared with a similar period in the previous financial year (**Chart 7.1**). The composition of Value Added Tax and Excise Duty rose by 3 percentage points each, while Income tax and Import Duty decreased by 5 and 1 percentage points, respectively.

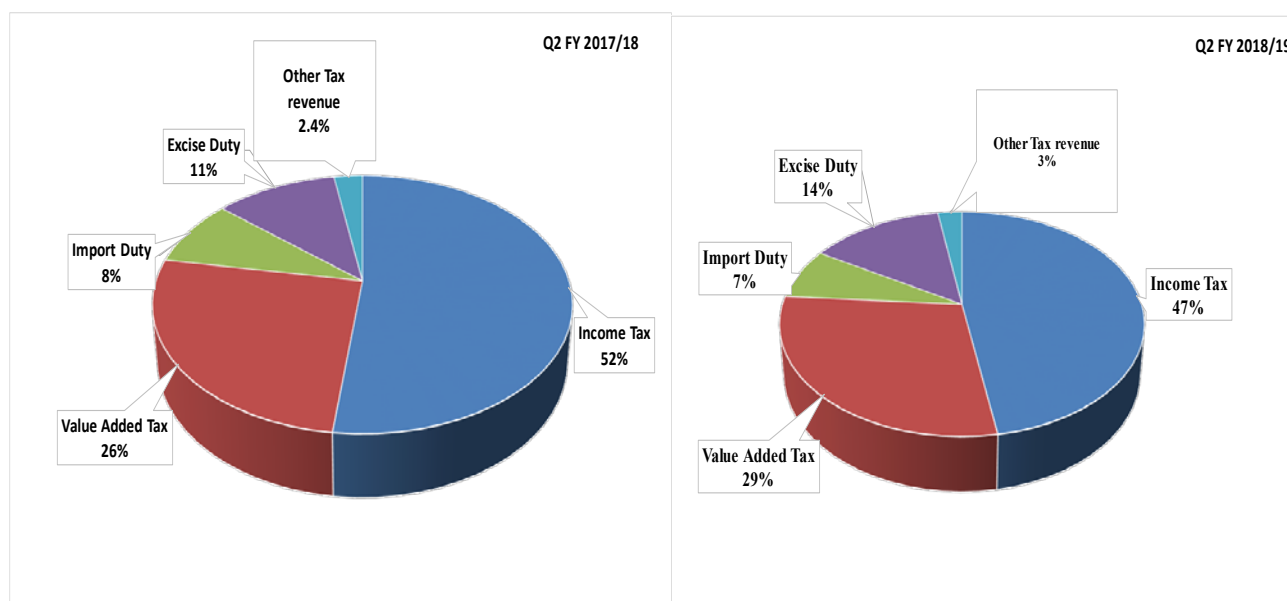
Cumulatively, the Government total revenue and grants stood at KSh 803.5 billion (8.0 percent of GDP)

in the first half of the FY 2018/19 against a target of KSh 876.2 billion (8.8 percent of GDP). All taxes fell below set targets with the shortfalls partly reflecting a slowdown in the performance of the economy which adversely affected revenue collection.

External grants for the first half of the FY 2018/19 stood at KSh 8.8 billion, which was KSh 11.7 billion lower than expected, due to slow absorption of donor funds which is common in the first half of every year

Meanwhile, ministerial Appropriations in Aid (A-in-A) collected during the first half of FY 2018/19 amounted to KSh 72.4 billion, which was KSh 8.3 billion lower than target due to under reporting in ministerial expenditure returns. Ministerial A-in-A collections were also low in the first quarter of FY 2018/19 for similar reasons.

Chart 7.1: Composition of Government Revenue FY 2018/19 (Ksh Billion)



Source: Provisional Budget Out-turn from The National Treasury

Expenditure and Net Lending

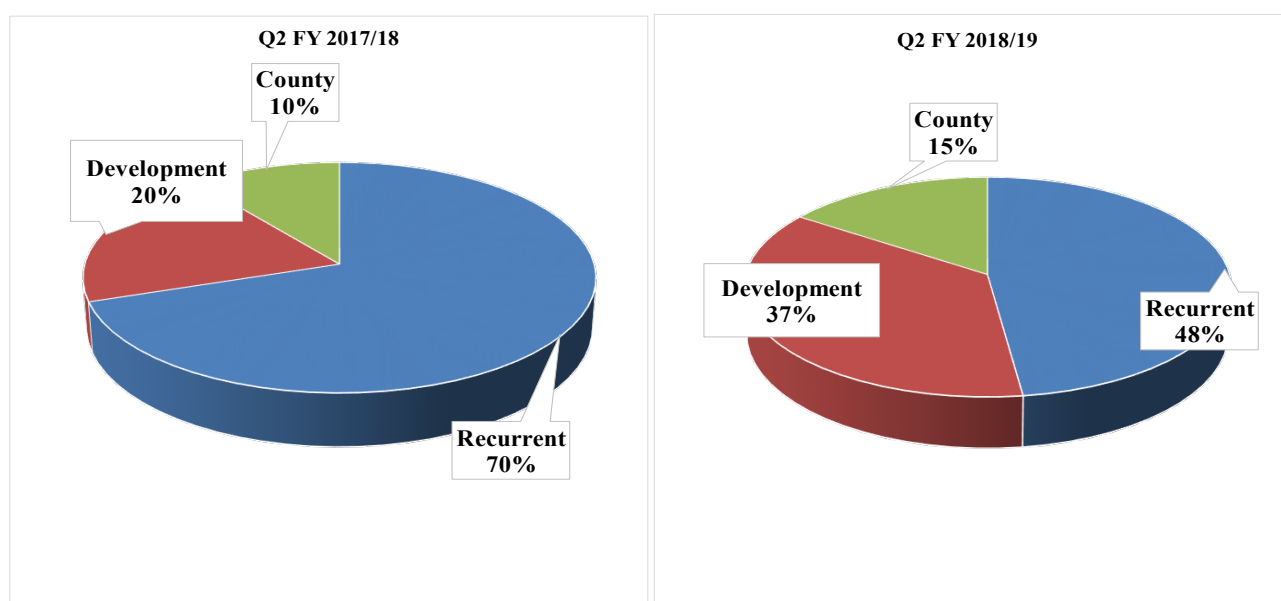
Government expenditure and net lending rose by 36.1 percent to KSh 616.0 billion in the second quarter of the FY 2018/19 compared with KSh 452.5 billion in the first quarter of the FY 2018/19. The increase in expenditures reflected development expenditures and county transfers. National government recurrent expenditures declined by 8.0 percent in the second quarter of FY 2018/19 compared to the first quarter (**Table 7.1**).

In terms of composition, recurrent expenditure remained the largest share in total government expenditure accounting for 48 percent in the second

quarter of FY 2018/19, which was 22 percentage points lower than the level recorded in a similar quarter the previous fiscal year. Conversely, the share of development expenditure rose by 17 percentage points, in the period under review (**Chart 7.2**).

Cumulatively, expenditure and net lending in the first half FY 2018/19 amounted to KSh 1075.5 billion (10.8 percent of GDP), against a target of KSh 1130.7 billion (11.3 percent of GDP). The shortfall of KSh 55.2 billion was attributed to lower absorption of both recurrent and development expenditures by the National Government and transfers to the County Governments, as is typical of the first half in past fiscal years (**Table 7.1**).

Chart 7.2: Composition of Recurrent Expenses



Sources: Provisional Budget Outturn from The National Treasury

Financing

The budget deficit including grants amounted to KSh 272.0 billion or 3.1 percent of GDP at the end of the first half of FY 2018/19. The deficit financing mix was 47.4 percent and 52.3 percent domestic and external resources, respectively. The domestic borrowing comprised KSh 93.7 billion draw-down in Government deposits held at the Central Bank,

a repayment of KSh 5.0 billion to commercial banks, KSh 41.2 billion from Non-banking financial institutions and KSh 1.0 billion from Non-Residents (**Table 7.2**). Net domestic borrowing at the end of the first half of FY 2018/19 was below target by KSh 86.9 billion, while external financing was KSh 109.7 billion above the expected target.

Table 7.2 Domestic Financing up to December 2018

	FY 2017/18				FY 2018/19					
	Q1	Q2	Q3	Q4			Q1		Nov-18	Q2
	Sep-17	Dec-17	Mar-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18
1. From CBK	8.3	108.9	(80.2)	(26.3)	(30.8)	11.4	(10.4)	47.5	46.8	93.7
2. From commercial banks	12.6	(2.9)	77.5	124.3	52.0	44.7	45.7	50.7	44.2	(5.0)
4. From Non-banks	26.3	74.4	125.1	172.8	5.1	7.2	33.7	33.3	47.6	41.2
5. From Non-Residents	1.9	3.2	3.2	3.0	0.6	0.6	0.2	0.9	1.0	1.0
Change in Credit from banks (From 30th June 2018)	20.9	106.0	(2.7)	97.9	21.1	56.2	35.4	98.3	91.0	88.7
Change in Credit from non-banks (From 30th June 2018)	26.3	74.4	125.1	172.8	5.1	7.2	33.7	33.3	47.6	41.2
Change in Credit from non-residents (From 30th June 2018)	1.9	3.2	3.2	3.0	0.6	0.6	0.2	0.9	1.0	1.0
6. Total Change in Dom. Credit (From 30th June 2018)	49.2	183.6	125.6	273.7	26.8	64.0	69.2	132.4	139.6	130.8

NB: Treasury Bills are reflected at cost

Source: Central Bank of Kenya

Outlook for FY 2018/19

In the revised budget estimates detailed in the Budget Policy Statement (BPS) February 2019 for the FY 2018/19, total revenue is projected at KSh 1,879 billion (18.7 percent of GDP) while external grants are projected at KSh 47 billion. Government expenditure is projected at KSh 2,514 billion (25.1 percent of GDP), of which KSh 1,513 billion will be for recurrent expenses, KSh 365 billion for transfers to county governments, and KSh 631 billion for development expenses.

The overall budget deficit including grants on commitment basis is, therefore, projected at KSh 635 billion (6.3 percent of GDP) in 2018/19, to be financed through net external borrowing of KSh 321 billion and net domestic borrowing of KSh 310 billion.

Table 7.3: Budget Estimates for the Fiscal Year 2018/19 (KSh Billion)

	Ksh (Billion)	%age of GDP	%age of GDP
1. TOTAL REVENUE (Including Grants)	1,879	18.7	21.1
Total Revenue	1,831	18.3	20.6
Appropriations-in-Aid	180	1.8	2.0
External Grants	47	0.5	0.5
2. TOTAL EXPENSES & NET LENDING	2,514	25.1	28.2
Recurrent Expenses	1,513	15.1	17.0
Development Expenses	631	6.3	7.1
County Transfer	365	3.6	4.1
Contingency Fund	5	0.0	0.1
3. DEFICIT INCL. GRANTS (1-2)	-635	-6.3	-7.1
			0.0
4. FINANCING	635	6.3	7.1
Domestic (Net)	310	3.1	3.5
External (Net)	321	3.2	3.6
Domestic loan repayments(receipts)	4	0.0	0.0

Source: National Treasury: BPS -February 2019

Chapter 8

Public Debt

Overall Public Debt

Kenya's public and publicly guaranteed debt recorded a moderate increase of 2.5 percent during the second quarter of the FY 2018/19 with both domestic and external debt increasing at 0.3 percent and 4.5 percent respectively. The public debt consisted of 51.7 percent and 48.3 percent external and domestic debt, respectively. The ratio of publicly and publicly

guaranteed debt to GDP remained constant at 59.2 percent in the two quarters of the FY 2018/2019. External debt to GDP ratio rose by 0.5 percentage points while the ration of domestic debt to GDP decreased by 0.6 percentage points (**Table 7.1**).

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

	2017/18			2018/19				Change Q on Q
	Q2	Q3	Q4	Q1	Oct-18	Nov-18	Q2	
EXTERNAL								
Bilateral	782.6	800.9	815.4	812.5	837.2	850.3	894.0	81.5
Multilateral	841.8	836.8	829.8	877.7	894.9	902.7	874.7	-3.1
Commercial Banks	707.8	858.1	906.4	898.3	905.8	939.0	938.2	39.8
Supplier Credits	17.1	16.7	16.7	16.7	16.9	17.0	16.9	0.1
Sub-Total	2,349.3	2,512.4	2,568.4	2,605.3	2,654.7	2,709.0	2,723.7	118.4
(As a % of GDP)	28.8	30.1	31.5	30.0	29.8	30.4	30.6	
(As a % of total debt)	51.4	51.4	50.9	50.6	51.1	51.4	51.7	
DOMESTIC								
Banks	1,221.7	1,320.4	1,377.2	1,405.5	1,400.8	1,414.7	1,407.8	2.2
Central Bank	96.8	93.6	110.8	90.2	78.5	98.3	118.2	28.0
Commercial Banks	1,124.9	1,226.9	1,266.5	1,315.3	1,322.2	1,316.4	1,289.6	-25.8
Non-banks	973.2	1,025.7	1,076.3	1,109.8	1,108.9	1,122.5	1,114.8	5.1
Pension Funds	611.2	641.8	671.5	689.1	686.6	696.1	694.3	5.1
Insurance Companies	142.7	150.9	154.5	154.1	154.4	152.5	154.3	0.1
Other Non-bank Sources	219.3	232.9	250.2	266.5	267.9	273.9	266.3	-0.2
Non-residents	25.4	25.5	25.3	25.4	26.1	26.2	26.2	0.8
Sub-Total	2,220.3	2,371.7	2,478.8	2,540.7	2,535.8	2,563.4	2,548.8	8.1
(As a % of GDP)	27.3	28.5	30.4	29.2	28.5	28.8	28.6	-0.6
(As a % of total debt)	48.6	48.6	49.1	49.4	48.9	48.6	48.3	-1.0
GRAND TOTAL	4,569.6	4,884.1	5,047.2	5,146.0	5,190.4	5,272.4	5,272.5	126.5
(As a % of GDP)	55.7	58.6	59.3	59.2	58.3	59.2	59.2	

Source: The National Treasury and Central Bank of Kenya

Domestic Debt

Total domestic debt build-up during the quarter under review registered a growth of 0.3 percent compared to 1.9 percent in the previous quarter. Investor's preferences shifted to longer dated securities increasing the uptake of Treasury bonds by 1.6 percent while Treasury bills uptake reduced by 4.7 percent. The proportion of debt securities to total domestic debt decreased by 1.1 percentage points during the quarter under review. As the share of debt securities to total domestic debt decreased, the utilization of the government overdraft facility at the Central Bank increased from Ksh 36.3 billion in September 2018 to Ksh 64.8 billion in December 2018 (**Table 7.2**).

Treasury Bills

Treasury bill holdings excluding those held by the CBK for open market operations (Repos) recorded 4.7 percent decrease during the second quarter of the FY 2018/19 as investors' preference shifted to longer dated securities. Similarly, the proportion of Treasury bills to total domestic debt decreased by 1.9 percentage points during the period under review. The dominance of Commercial banks in Treasury bills market persisted with their holdings standing at 58.6 percent of the total amount of outstanding Treasury Bills by the end of the second quarter of the FY 2018/19. Other significant holders of Treasury bills included Pension funds (17.9 percent) and parastatals included in other holders (13.3 percent) (**Table 7.2**).

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

Table 8.2: Government Gross Domestic Debt (KSh Billion)

	Ksh (Billion)							Change: Q on Q		Proportions						
	2017/18			2018/19						2017/18			2018/19			
	Q2	Q3	Q4	Q1	Oct-18	Nov-18	Q2	Ksh (Bn)	%	Q2	Q3	Q4	Q1	Oct-18	Nov-18	Q2
Total Stock of Domestic Debt (A+B)	2,220.3	2,371.7	2,478.8	2,540.7	2,535.8	2,563.4	2,548.8	8.1	0.3	100.0	100.0	100.0	100.0	100.0	100.0	100.0
A. Government Securities	2,146.0	2,300.5	2,390.5	2,472.9	2,479.6	2,486.9	2,452.3	-20.5	-0.8	96.7	97.0	96.4	97.3	97.8	97.0	96.2
1. Treasury Bills (excluding Repo Bills)	684.7	772.7	878.6	944.1	952.0	950.1	899.4	-44.7	-4.7	30.8	32.6	35.4	37.2	37.5	37.1	35.3
Banking institutions	363.9	436.2	502.6	558.1	570.4	567.6	547.8	-10.3	-1.8	16.4	18.4	20.3	22.0	22.5	22.1	21.5
The Central Bank	20.6	20.6	20.6	20.6	20.6	20.6	20.6	0.0	0.0	0.9	0.9	0.8	0.8	0.8	0.8	0.8
Commercial Banks	343.3	415.6	482.0	537.5	549.8	547.0	527.2	-10.3	-1.9	15.5	17.5	19.4	21.2	21.7	21.3	20.7
Pension Funds	159.2	159.2	180.1	187.4	174.7	175.3	161.1	-26.2	-14.0	7.2	6.7	7.3	7.4	6.9	6.8	6.3
Insurance Companies	18.2	20.5	21.2	20.0	19.4	17.3	16.4	-3.6	-17.9	0.8	0.9	0.9	0.8	0.8	0.7	0.6
Others	143.4	156.8	174.7	178.6	187.6	189.9	174.1	-4.5	-2.5	6.5	6.6	7.0	7.0	7.4	7.4	6.8
2. Treasury Bonds	1,461.2	1,527.8	1,511.9	1,528.8	1,527.6	1,536.8	1,552.9	24.1	1.6	65.8	64.4	61.0	60.2	60.2	60.0	60.9
Banking institutions	783.5	813.2	786.4	779.6	774.3	770.7	763.6	-16.1	-2.1	35.3	34.3	31.7	30.7	30.5	30.1	30.0
The Central Bank	9.4	9.4	9.4	9.4	9.4	9.4	9.4	0.0	0.0	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Commercial Banks	774.1	803.8	776.9	770.2	764.9	761.2	754.2	-16.1	-2.1	34.9	33.9	31.3	30.3	30.2	29.7	29.6
Insurance Companies	124.4	130.4	133.3	134.2	135.1	135.2	137.9	3.7	2.8	5.6	5.5	5.4	5.3	5.3	5.3	5.4
Pension Funds	452.1	482.6	491.4	510.1	511.9	520.8	533.1	23.1	4.5	20.4	20.3	19.8	20.1	20.2	20.3	20.9
Others	101.2	101.6	100.8	104.9	106.3	110.2	118.3	13.4	12.8	4.6	4.3	4.1	4.1	4.2	4.3	4.6
3. Long Term Stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Banking institutions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4. Frozen account	24.4	23.9	23.9	23.9	23.3	23.3	23.3	-0.6	-2.3	1.1	1.0	1.0	0.9	0.9	0.9	0.9
Of which: Repo T/Bills	23.8	23.3	23.3	23.3	22.7	22.7	22.7	-0.6	-2.4	1.1	1.0	0.9	0.9	0.9	0.9	0.9
B. Others:	49.9	47.2	64.4	44.0	32.8	53.2	73.1	29.1	66.3	2.2	2.0	2.6	1.7	1.3	2.1	2.9
Of which CBK overdraft to Government	42.3	39.7	56.8	36.3	25.2	44.9	64.8	28.5	78.6	1.9	1.7	2.3	1.4	1.0	1.8	

Source: Central Bank of Kenya

Treasury Bonds

Treasury bond holdings increased by 1.6 percent during the second quarter of the FY 2018/19, a faster build up compared to the 1.1 percent increase observed in the previous quarter due to the shift in investor preference towards longer dated securities. The largest component of this buildup was the uptake of the 20-year fixed rate Treasury bond in line with government objective to reduce the refinancing risk by lengthening the average time to maturity of government securities. The dominant holders of Treasury bonds by the end of the period under review were commercial banks, pension funds and Insurance companies. Commercial bank holdings accounted for about half of the total Treasury Bonds outstanding.

Domestic Debt by Tenor and the Maturity Structure

The government floated 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 underscoring the Public Debt Management Office goal of reducing the refinancing risk. The benchmark Treasury Bonds; 2-year, 5-year, 10-year, 15-year and 20-year Treasury Bonds accounted for 77.4 percent of the total outstanding Treasury Bonds, which is 0.6 percentage point increase from the previous quarter. Other domestic debt consists of uncleared effects, advances from commercial banks and Tax Reserve Certificates.

The average time to maturity of existing domestic debt remained stable at 4 years 2 months in the second quarter of the FY 2018/19. The refinancing risk reduced as the Treasury bills share in the domestic debt profile decreased to 35.3 percent from 35.4 percent in September 2018.

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

		Kshs (Billions)							Change Q on Q		Proportions						
		2017/18			2018/19				Q2 2018/19		2017/18			2018/19			
		Q2	Q3	Q4	Q1	Oct-18	Nov-18	Q2	Kshs(Bn)	%	Q2	Q3	Q4	Q1	Oct-18	Nov-18	Q2
Treasury bills	91-Day	46.0	48.5	46.9	49.8	58.6	65.1	54.9	5.1	10.2	2.1	2.0	1.9	2.0	2.3	2.5	2.2
	182-Day	190.9	202.1	258.3	216.9	191.1	167.2	135.2	-81.7	-37.7	8.6	8.5	10.4	8.5	7.5	6.5	5.3
	364-Day	447.8	522.1	573.5	677.4	702.3	717.8	709.3	31.9	4.7	20.2	22.0	23.1	26.7	27.7	28.0	27.8
Treasury Bond	1-Year	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	2-Year	113.9	93.8	63.6	63.6	63.6	63.6	38.1	-25.5	-40.1	5.1	4.0	2.6	2.5	2.5	2.5	1.5
	3-Year	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	4-Year	4.8	4.8	4.8	4.8	4.8	4.8	4.8	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2
	5-Year	323.0	346.1	307.2	307.2	307.2	272.6	272.6	-34.6	-11.3	14.5	14.6	12.4	12.1	12.1	10.6	10.7
	6-Year	8.5	8.5	8.5	8.5	8.5	8.5	8.5	0.0	0.0	0.4	0.4	0.3	0.3	0.3	0.3	0.3
	7-Year	50.1	50.1	50.1	50.1	50.1	50.1	50.1	0.0	0.0	2.3	2.1	2.0	2.0	2.0	2.0	2.0
	8-Year	33.7	33.7	33.7	33.7	33.7	33.7	33.7	0.0	0.0	1.5	1.4	1.4	1.3	1.3	1.3	1.3
	9-Year	76.5	76.5	76.5	76.5	76.5	71.2	71.2	-5.4	-7.0	3.4	3.2	3.1	3.0	3.0	2.8	2.8
	10-Year	272.5	265.5	265.5	270.4	270.4	270.4	303.2	32.8	12.1	12.3	11.2	10.7	10.6	10.7	10.5	11.9
	11-Year	0.0	0.0	0.0	0.0	0.0	0.0	8.8	8.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
	12-Year	133.2	133.2	133.2	129.3	120.3	120.3	120.3	-9.0	-7.0	6.0	5.6	5.4	5.1	4.7	4.7	4.7
	15-Year	291.4	353.6	386.8	386.8	394.7	415.9	415.9	29.1	7.5	13.1	14.9	15.6	15.2	15.6	16.2	16.3
	20-Year	104.9	113.4	128.1	144.0	171.9	171.9	171.9	27.9	19.4	4.7	4.8	5.2	5.7	5.7	6.7	6.7
	25-Year	20.2	20.2	25.3	25.3	25.3	25.3	25.3	0.0	0.0	0.9	0.9	1.0	1.0	1.0	1.0	1.0
	30-Year	28.1	28.1	28.1	28.1	28.1	28.1	28.1	0.0	0.0	1.3	1.2	1.1	1.1	1.1	1.1	1.1
Other Domestic debt	Repo T bills	23.8	23.3	23.3	23.3	22.7	22.7	22.7	-0.6	-2.4	1.1	1.0	0.9	0.9	0.9	0.9	0.9
	Overdraft	42.3	39.7	56.8	36.3	25.2	44.9	64.8	28.5	100.0	1.9	1.7	2.3	1.4	1.0	1.8	2.5
	Other Domestic debt	8.2	8.2	8.2	8.3	8.2	8.9	8.9	0.6	7.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Total Debt		2,220.3	2,371.7	2,478.8	2,540.7	2,535.8	2,563.4	2,548.8	8.1	0.3	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Kenya

External Debt

Public and publicly guaranteed debt increased by 4.5 percent to Ksh 2,723.7 billion in quarter two of FY 2018/2019. External debt accumulation during the quarter under review was mainly driven by disbursements of US dollar 700 million semi-concessional debt from the Chinese government to finance the Nairobi-Naivasha Standard Gauge Railway. Foreign exchange risk on external debt was low due to relatively stable exchange rate during the quarter under review.

Composition of External Debt by Creditor

With increased access to international financial markets, Kenya continues to record dwindling levels of concessional debt and build-up of commercial and semi-concessional borrowing. During the quarter under review, the share of outstanding debt from official multilateral and bilateral lenders (who provide both concessional and semi-concessional loans) remained similar to the proportion held in the previous quarter. The concessionality of external debt declined as the proportion of debt held by multilateral lenders who lend on concessional terms declined and that held by bilateral lenders who lend on semi concessional terms increased by 1.6 percentage points by the end of the second quarter of the FY 2018/19 (**Chart 8.1**).

Debt owed to the International Development Association (IDA), Kenya's largest multilateral lender, amounted to USD 5.3 billion or 19.9 percent of total external debt while that owed to China, Kenya's

largest bilateral lender, amounted to USD 6.2 billion, or 23.2 percent of the total external debt in the second quarter of the FY 2018/19 (**Chart 8.2**).

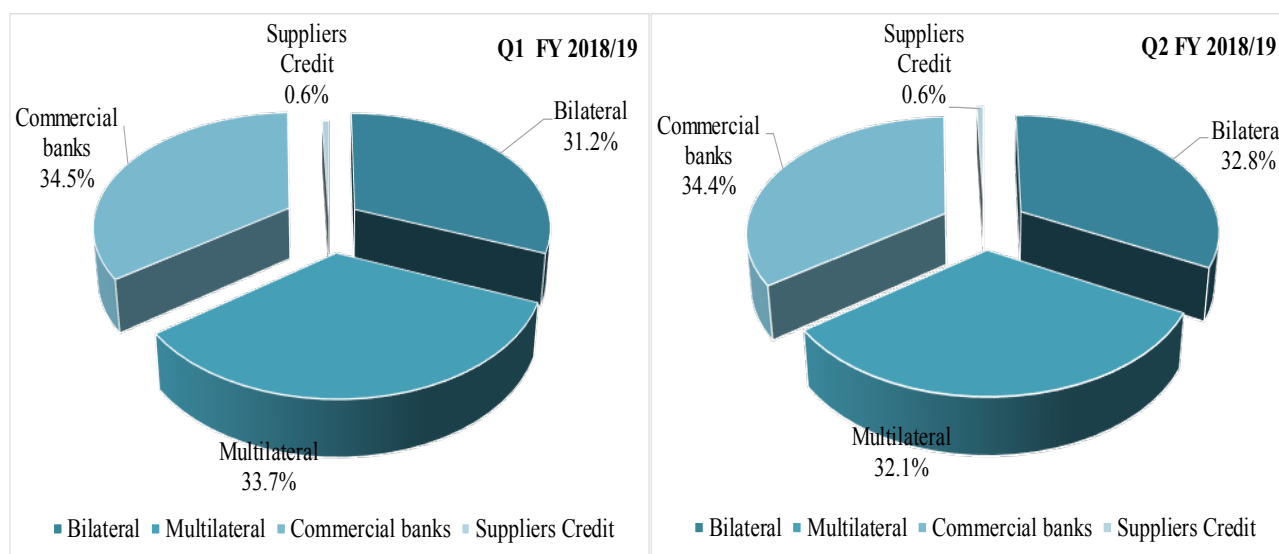
Currency Composition of External Debt

Kenya's public and publicly guaranteed external debt is denominated in various currencies to mitigate against the currency risk. The dominant currencies included the US dollar and the Euro which accounted for 85.2 percent of the total currency composition at the end of the second quarter of the FY 2018/19. This was partly consistent with the currency composition of the Central Bank's forex reserve holdings. The proportion held in the US dollar increased by 2.1 percentage points mainly on account disbursements of dollar- denominated loan advanced by the Chinese government to finance Nairobi-Naivasha Standard Gauge Railway (**Chart 8.3**).

Public Debt Service

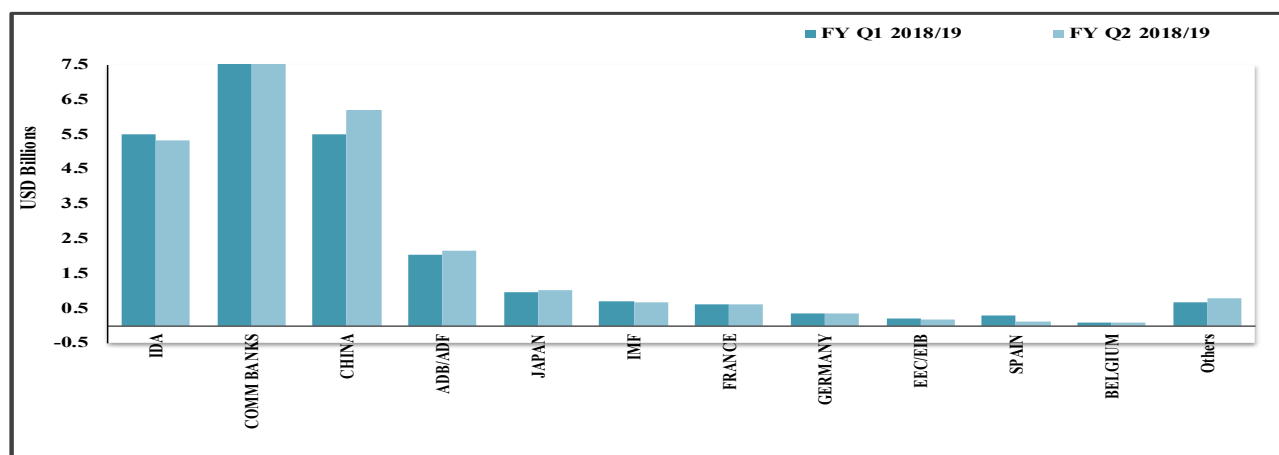
The ratio of domestic interest payments to revenues stood at 16.9 percent in the second quarter of the FY 2018/19. The largest component of domestic interest payments was coupon interest on Treasury Bonds which was consistent with the proportion of debt held in Treasury bonds. External debt service for the second quarter of the FY 2018/19 amounted to Ksh 69.9 billion and was within sustainable levels. Debt service ratios to flow resource bases such as revenues and exports are liquidity indicators of the level of indebtedness. Liquidity indicators of external indebtedness improved and edged further below the

Chart 8.1: Composition of External Debt by Lender



Source: The National Treasury

Chart 8.2: External Debt By Creditor



Source: The National Treasury

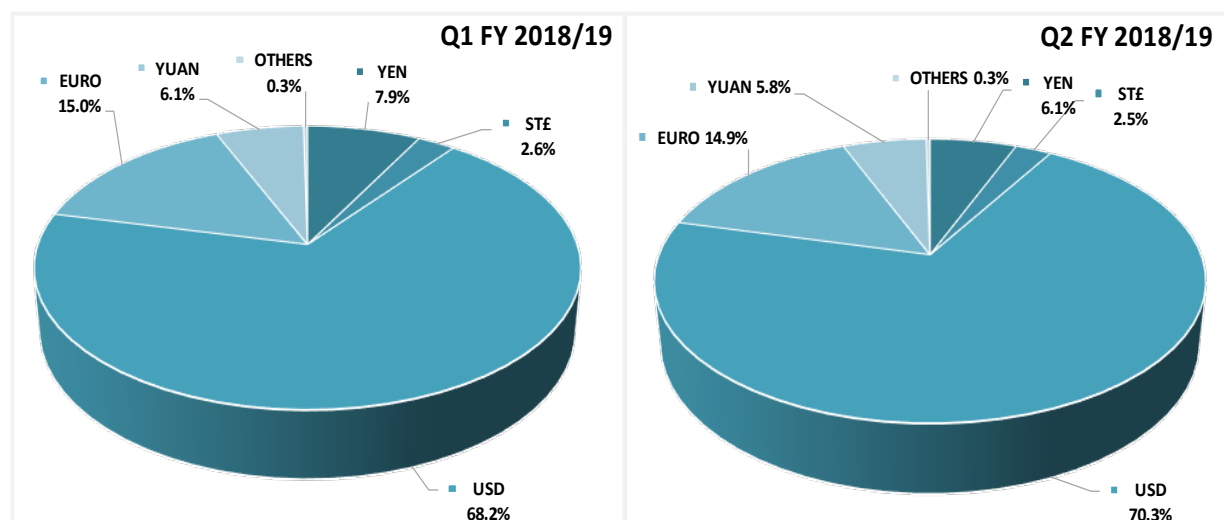
Debt Sustainability Analysis liquidity indicative thresholds (23 percent of revenues and 21 percent of exports) implying improving debt dynamics (Table 8.4).

Debt Sustainability Analysis

The October 2018 Debt sustainability update showed deteriorating debt dynamics with a downgrade from low risk of external debt distress to moderate risk of external debt distress. All the liquidity and solvency

debt burden indicators were below the composite indicator based thresholds in the baseline scenarios but there were prolonged breaches in the alternative scenarios. Public DSA sensitivity analysis show that if primary deficit were to remain at the current levels, public debt would take an upward trajectory and rise above the debt sustainability benchmark for strong policy performers. This points to the need for immediate fiscal consolidation.

Chart 8.3: Debt Composition by Currency



Source: The National Treasury

Outlook for Fiscal Year 2018/19

Total public and publicly guaranteed external debt is estimated at 2,881.7 billion (28.7 percent of GDP), while gross and net domestic debt are expected to close the financial year 2018/19 at KSh 2,788.9 billion (27.8 percent of GDP) and KSh 2,279.9 billion (22.7 percent of GDP), respectively (BPS 2019) billion (27.8 percent of GDP) and KSh 2,279.9 billion (22.7 percent of GDP), respectively (BPS 2019).

Table 8.4: Liquidity Indicators of External Debt Sustainability

	Q2 FY 2017/18	Q3 FY 2017/18	Q4 FY 2017/18	Q1 FY 2018/19	Q2 FY 2018/19
Debt service to Revenues (23%)	11.4	8.5	14.7	10.1	7.9
Debt service to Exports (21%)	14.8	10.5	20.4	12.5	10.9

Source: Central Bank of Kenya

Chapter 9

The Capital Markets

Equities Market

The equities market share prices declined in the fourth quarter of 2018 compared to the third quarter of 2018 as reflected by 2.6 percent, 5.1 percent and 4.9 percent decline in the NSE 20 share index, NASI

and Market Capitalization, respectively. The volume of shares traded and total Equity turnover however, grew by 59.8 percent and 11 percent, respectively (Table 9.1).

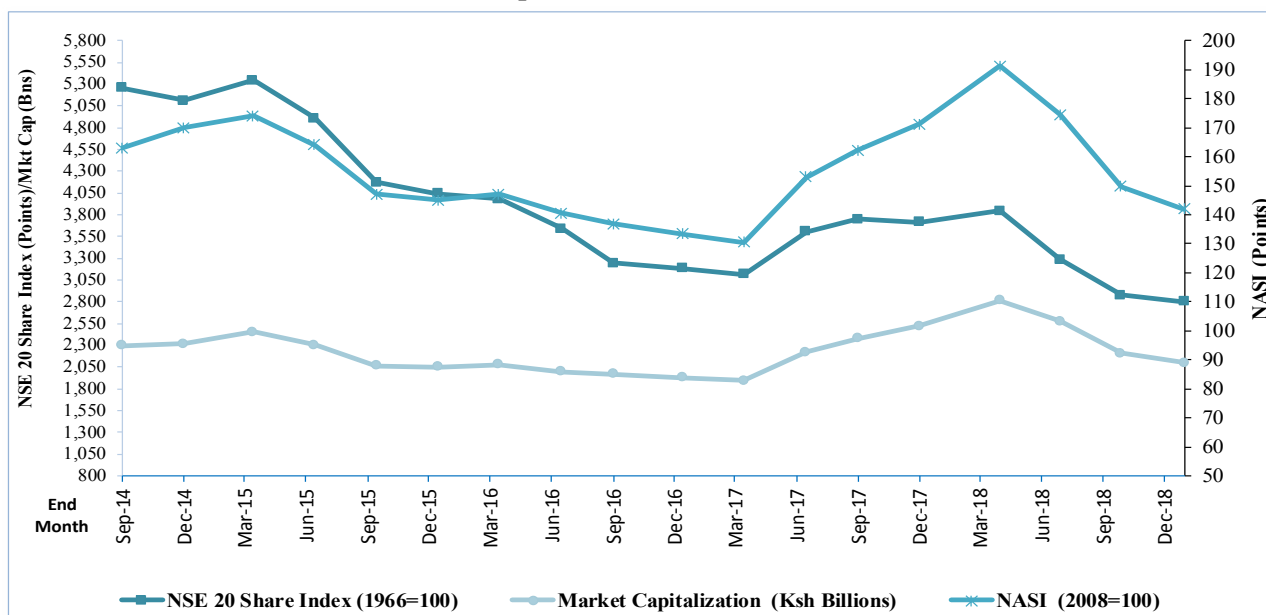
Table 9.1: Selected Stock Market Indicators

INDICATOR	2017			2018				% CHANGE (2018Q4-2018Q3)
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
NSE 20 Share Index (1966=100)	3607.2	3751.5	3711.9	3845.3	3285.7	2875.5	2801.0	-2.59
NASI (2008=100)	152.92	162.21	171.20	191.23	174.36	149.67	142.00	-5.12
Number of Shares Traded (Millions)	1892.06	2019.72	1291.155	2138.96	1580.04	983.14	1570.53	59.75
Equities Turnover (Ksh Millions)	44,902	53,577	36,019	61,150	47,142	31,930	35,435	10.98
Market Capitalization (Ksh Billions)	2,224	2,377	2,522	2,817	2,576	2,211	2,102	-4.94
Foreign Purchase (Ksh Millions)	27,424	23,099	22,760	31,065	24,618	17,336	23,323	34.54
Foreign Sales (Ksh Millions)	29,692	34,219	22,941	39,149	32,794	24,041	29,994	24.76
Ave. Foreign Investor Participation to Equity Turnover (%)	63.60	53.49	63.44	57.41	60.89	64.84	75.12	15.85
Bond Turnover (Ksh Millions)	134,633	108,168	89,120	152,338	158,523	133,683	118,171	-11.60
FTSE NSE Kenya Govt. Bond Index (Points)	91.54	91.67	92.83	93.58	95.00	94.85	95.40	0.58
5-Year Eurobond Yield (%)	4.47	4.28	3.76	3.83	5.74	4.52	5.87	*1.35
10-Year Eurobond Yield (%) -2024	6.64	6.46	5.67	6.24	7.18	6.86	8.35	*1.49
10-Year Eurobond Yield (%) -2028				6.86	7.89	7.65	9.00	*1.35
30-Year Eurobond Yield (%) -2048				7.81	8.90	8.59	9.75	*1.16

* Percentage points

Source: Nairobi Securities Exchange

Chart 9.1: NSE 20, NASI and Market Capitalization



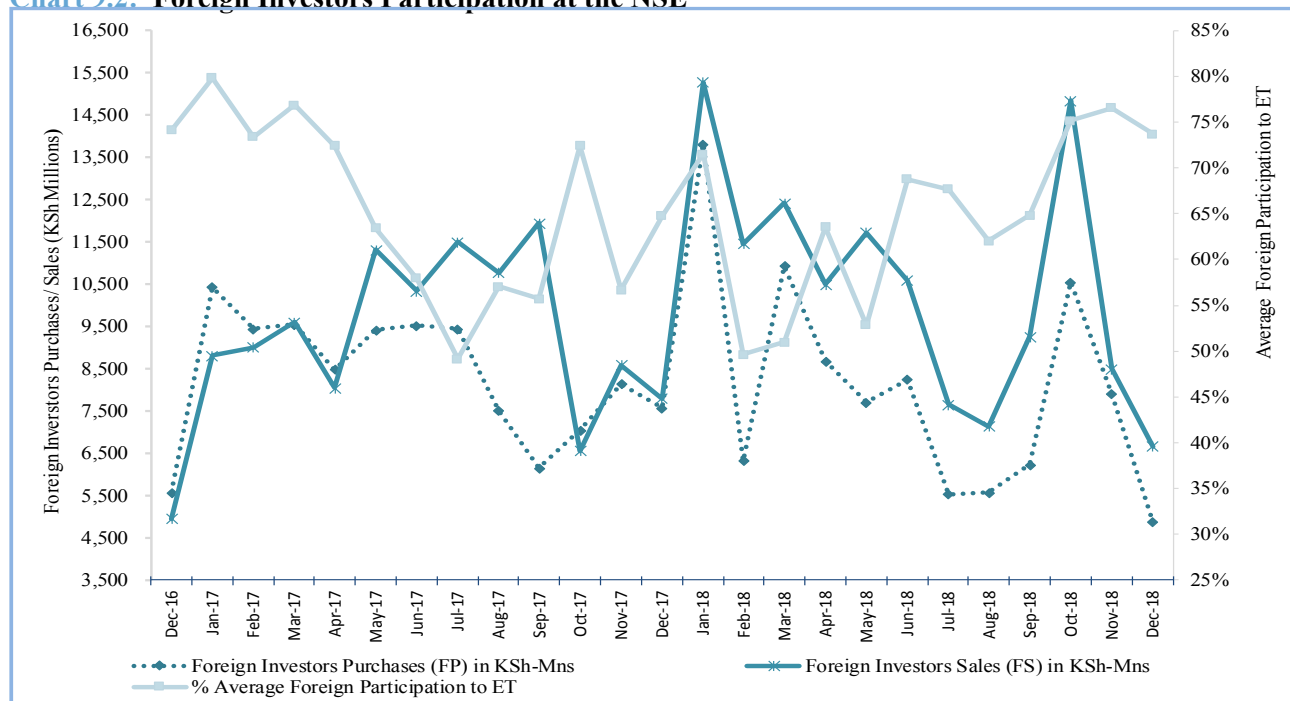
Source: Nairobi Securities Exchange

Foreign Investors' Participation

quarter of 2018 compared to 64.8 percent in the third quarter of 2018 (Chart 9.2 and Table 9.1).

The value of shares bought by foreign investors at the NSE increased by 34.5 percent against foreign investors' sales increase of 24.8 percent. The average net foreign investors' participation at the NSE relative to equity turnover was 75.1 percent, in the fourth

Chart 9.2: Foreign Investors Participation at the NSE



Source: Nairobi Securities Exchange

Bonds Market

The volume of bonds traded in the domestic secondary market declined by 11.6 percent in the fourth quarter of 2018, reflecting less appetite for fixed income securities. The FTSE NSE Kenyan Government Bond Index rose by 0.58 percent in the period under review, reflecting a marginal decline in the market yields. The yields on the 5– year, 10–year (2024), 10–year (2028)–and 30–year (2048) Kenya Eurobonds edged up by 1.35 percentage points, 1.49 percentage points, 1.35 percentage points and 1.16 percentage points respectively on the last trading day of the fourth quarter of 2018.

Chapter 10

Statement of Financial Position of the Central Bank of Kenya (Kenya Shillings Million)

1.0	ASSETS	2018				Absolute Quarterly Changes (KSh Million)				Quarterly Growth Rates (%)			
		MAR	JUN	SEPT	DEC	Q4, 2018	Q3, 2018	Q2, 2018	Q1, 2018	Q4, 2018	Q3, 2018	Q2, 2018	Q1, 2018
1.1	Reserves and Gold Holdings	929,848	923,391	879,688	847,323	(32,365)	(43,704)	(6,457)	176,498	(3.7)	(4.7)	(0.7)	23.4
1.2	Funds Held with IMF	2,678	2,012	5,393	2,577	(2,816)	3,380	(665)	1,191	(5)	168.0	(24.8)	80.1
1.21	Investment in Equity (Swift Shares)	10	9	9	9	(0)	0	(1)	0	(1.2)	0.9	(6.3)	1.2
1.3	Items in the Course of Collection	21	25	11	19	8	(14)	4	2	70.5	(55.6)	18.8	12.6
1.4	Advances to Commercial Banks	43,604	38,503	67,812	77,477	9,665	29,308	(5,101)	3,960	14.3	76.1	(11.7)	10.0
1.5	Loans and Other Advances	2,551	2,585	2,597	2,603	6	12	35	(94)	0.2	0.4	1.4	(3.6)
1.6	Other Assets	2,284	2,298	2,412	2,589	177	114	14	(69)	7.3	5.0	0.6	(2.9)
1.7	Retirement Benefit Asset	8,197	6,585	6,585	6,585	-	-	(1,613)	-	-	-	(19.7)	-
1.8	Property and Equipment	22,324	27,153	25,472	26,500	1,028	(1,681)	4,829	321	4.0	(6.2)	21.6	1.5
1.81	Intangible Assets	117	165	507	641	134	342	47	71	26.4	207.8	40.2	150.9
1.9	Due from Government of Kenya	63,609	80,188	59,746	88,399	28,653	(20,442)	16,579	(3,278)	48.0	(25.5)	26.1	(4.9)
	TOTAL ASSETS	1,075,244	1,082,915	1,050,231	1,054,720	4,490	(32,684)	7,671	178,600	0.4	(3.0)	0.7	19.9
2.0	LIABILITIES												
2.1	Currency in Circulation	262,622	262,439	257,695	288,299	30,604	(4,744)	(183)	(16,537)	11.9	(1.8)	(0.1)	(6)
2.2	Investments by Banks -Repos						-						
2.3	Deposits	571,657	584,287	565,910	531,808	(34,103)	(18,377)	12,630	207,331	(6.0)	(3.1)	2.2	57
2.4	International Monetary Fund	109,129	100,284	98,453	92,244	(6,210)	(1,830)	(8,845)	(1,287)	(6.3)	(1.8)	(8.1)	(1)
2.5	Other Liabilities	1,661	6,123	(4,582)	4,173	8,755	(10,705)	4,462	165	(191.1)	(174.8)	268.6	11
	TOTAL LIABILITIES	945,068	953,132	917,476	916,523	(953)	(35,656)	8,064	189,671	(0.1)	(3.7)	0.9	25
3.0	EQUITY AND RESERVES	130,175	129,782	132,755	138,197	5,442	2,972	(393)	(11,071)	4.1	2.3	(0.3)	(7.8)
	Share Capital	5,000	5,000	5,000	5,000					-	-	-	-
	General reserve fund -Unrealized	65,195	44,432	44,432	44,432	-	-	(20,763)	-	-	-	(31.8)	-
	-Realized	23,690	30,692	30,692	30,692	-	-	7,002	-	-	-	29.6	-
	-Capital Projects	17,189	24,473	24,473	24,473	-	-	7,284	-	-	-	42.4	-
	Period surplus/(Deficit)	(3,886)	-	2,972	9,215	6,242	2,972	3,886	-	210	-	-	-
	Asset Revaluation	14,790	17,801	17,801	17,801		-	3,011	-	-	-	20.4	-
	Retirement Benefit Asset Reserves	8,197	6,584	6,584	6,584		-	(1,613)	-	-	-	(19.7)	-
	Consolidated Fund		800	800		(800)	-						
4	TOTAL LIABILITIES AND EQUITY	1,075,244	1,082,915	1,050,231	1,054,720	4,490	(32,684)	7,671	178,600	0	(3.0)	0.7	20

Source: Central Bank of Kenya

Notes on the Financial Position

Assets

The Central Bank of Kenya (CBK) balance sheet increased marginally by 0.4 percent in the fourth quarter of 2018, largely reflecting KSh 28.7 billion increase in debt due from government. Debt due from government comprise of Government utilization of the overdraft facility at the Central Bank, overdrawn accounts which were converted to a long term debt with effect from 1 November 1997.

Reserve and gold holdings comprise of foreign reserves held in external current accounts, deposits and special/projects accounts, domestic foreign currency clearing accounts, gold, special drawing rights and Reserves Advisory and Management Program (RAMP) securities invested with the World Bank. Reserve and gold holdings decreased by KSh 32.4 billion in the fourth quarter of 2018, largely on account of government debt service and central bank operations.

Advances to commercial banks, largely for liquidity management, increased by KSh 9.7 billion in the fourth quarter of 2018. Funds held with the IMF decreased by KSh 2.8 billion, while the retirement benefit asset remained unchanged at KSh 6.6 billion.

Items in the course of collection, which represent the value of clearing instruments held by the CBK while awaiting clearing by respective commercial banks,

increased by KSh 8.0 million compared to a decrease of KSh 14.0 million in the third quarter of 2018.

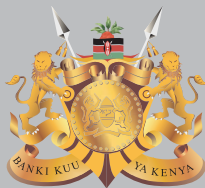
Growth of Loans and other advances include outstanding balances on advances to commercial banks under the Overnight Loan Facility (OLF), and IMF funds on lent to Government, decelerated to 0.2 percent in the fourth quarter of 2018 compared to an increase of 0.4 percent in the previous quarter.

Other assets, which largely consist of prepayments and sundry debtors, and deferred currency expense increased by 7.3 percent in the fourth quarter of 2018.

Liabilities

Currency in circulation increased by 11.9 percent in the fourth quarter of 2018 compared to a decline of 1.8 percent in the previous quarter.

Deposits at the Central Bank by Government of Kenya, local commercial banks, other public entities and project accounts and local banks' forex settlement accounts declined by 6.0 percent compared to a decrease of 3.1 percent in the previous quarter.



Central Bank of Kenya

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