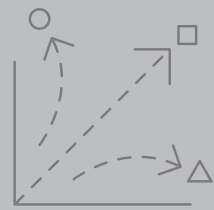
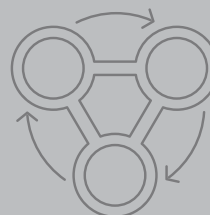
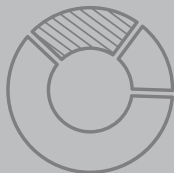




Central Bank of Kenya

QUARTERLY ECONOMIC REVIEW (QER)

*Volume 3 No 3
July - September 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

JULY - SEPTEMBER 2018

Starting with the January - March 2016 edition, the Quarterly Economic Review is available on the Internet at:

<http://www.centralbank.go.ke>

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HIGHLIGHTS

Overall inflation remained below the midpoint of the medium term target in the third quarter of 2018, largely on account of low food prices. It increased to an average of 4.7 percent in the third quarter from an average of 4.0 percent in the second quarter, mainly driven by higher fuel prices.

Broad money supply (M3) decelerated in the third quarter of 2018, to almost zero compared to an increase of 7.5 percent in the previous quarter, due to contraction in net foreign assets and net domestic assets of the banking system.

The Monetary Policy Committee (MPC) retained the Central Bank Rate (CBR) at 9.0 percent in September 2018 MPC meeting. The average interbank rate remained relatively stable at 5.2 percent in the third quarter of 2018 compared to 5.0 percent in second quarter of 2018, partly reflecting balanced liquidity conditions in the money markets.

GDP growth remained strong in the third quarter of 2018. The economy grew by 6.0 percent compared to 4.7 percent in the third quarter of 2017, largely supported by improved agricultural activities and resilience of the services sectors.

Kenya's current account deficit narrowed by 20 percent to USD 1,152 million during the third quarter of 2018 from USD 1,443 million during the second quarter of 2017. This was mainly due to improvement in the balance on goods and services.

Kenya's official international reserves position stood at USD 8,545 million by end-September 2018, equivalent to 5.6 months of imports.

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

The banking sector was stable and resilient in the third quarter of 2018. Total net assets increased by 3.5 percent while the deposit base increased by 2.5 percent between quarter two and quarter three of 2018. The system continued to be well capitalized and met the minimum capital adequacy requirements. Profitability improved supported by decrease in total expenses. Credit risk remained elevated with Gross Non-Performing Loans (NPLs) to Gross Loans ratio standing at 12.5 percent in the third quarter of 2018. Kenya Electronic Payments and Settlement System (KEPSS) used for large value Real Time Gross Settlement (RTGS) payments moved a volume of 1.17 million transaction messages worth KSh 7.38 trillion in the third quarter of 2018, compared to the second quarter of 2018 which recorded 1.16 million transactions worth KSh 7.3 trillion.

The Government's budgetary operations at the end of the first quarter of FY 2018/19 resulted in a deficit (including grants) of 0.8 per cent of GDP and was within the target of 0.6 percent of GDP. Revenue collection remained below target, as was the case with the expenditure.

Kenya's public and publicly guaranteed debt recorded a moderate increase of 2.1 percent during the first quarter of the FY 2018/19 with both domestic and external debt increasing at 1.8 percent and 2.5 percent respectively during the quarter.

The performance of the capital market declined further in the third quarter of 2018. This could be attributed to local factors such as high taxation, reduced profitability among listed firms and flight to quality by foreign investors as global markets improve. The yield on Kenya's Eurobonds declined on all the four tenors.

CHAPTER 1

Inflation

Overview

Overall inflation remained below the midpoint of the medium term target in the third quarter of 2018, largely on account of low food prices. It increased to 4.7 percent from 4.0 percent in the second quarter mainly driven by higher fuel prices (Table 1.1). Fuel inflation increased to 14.7 percent in the third quarter from 11.2 percent in the second quarter, driven by rising domestic and international energy prices. At the same time, Non-Food Non-Fuel (NFNF) inflation

increased to 4.3 percent from 3.8 percent, mainly due to the effect of excise tax indexation and other tax revisions during the quarter under review. However, food inflation declined further to 0.4 percent in the third quarter from 0.9 percent in the second quarter, following favorable weather conditions experienced across the country, which resulted to increased food supply leading to low prices.

Table 1.1: Recent Trends in Inflation (Percent)

	2017		2018					
	Q3	Q4	Q1	Q2	Q3	July	Aug	Sep
Overall inflation	7.5	5.0	4.5	4.0	4.7	4.4	4.0	5.7
Food Inflation	11.7	6.3	3.8	0.9	0.4	0.9	-0.6	0.9
Fuel Inflation	3.1	4.6	6.8	11.2	14.7	12.4	14.2	17.4
Non-Food-Non-Fuel (NFNF) Inflation	3.8	2.9	3.6	3.8	4.3	4.0	4.2	4.7
Annual Average Inflation	8.3	8.2	7.4	5.7	4.7	5.0	4.6	4.5
Three Months Annualised Inflation	-5.1	-3.1	12.6	13.1	-2.4	-3.3	-5.8	1.7

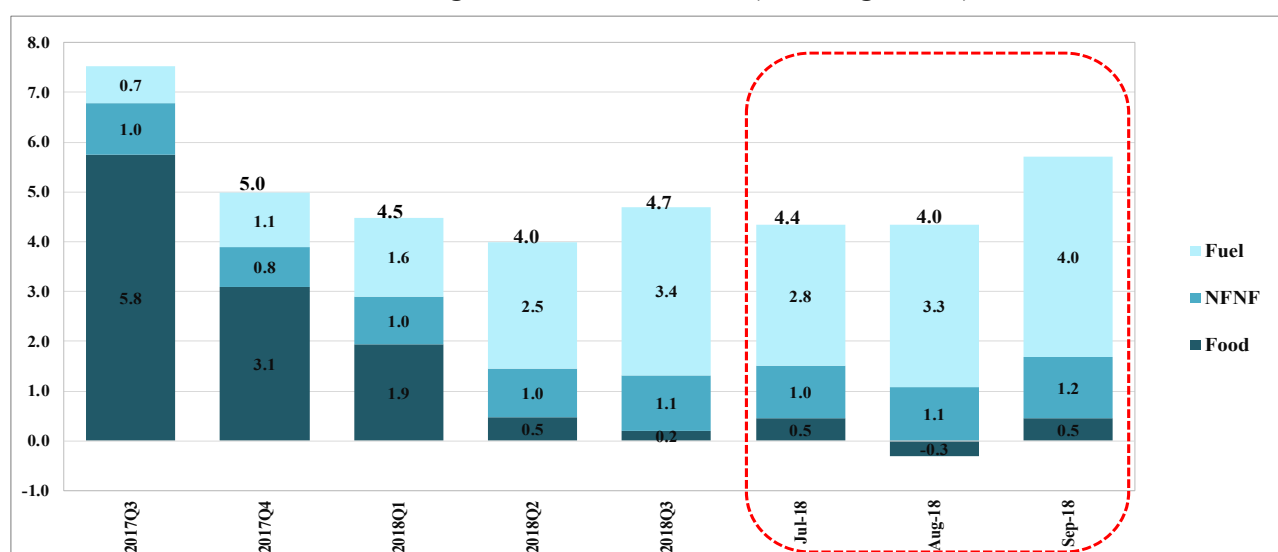
Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

Fuel inflation remained the dominant driver of inflation for two consecutive quarters and contributed 3.4 percentage points in the third quarter compared to 2.5 percentage points in the second quarter. During the quarter under review, the implementation of Value Added Tax (VAT) on fuel products in September 2018 pushed pump prices and transport costs upwards across the country. As a result, the contribution of fuel to overall inflation increased to 4.0 percentage points in September from 3.3 percentage points in

August (**Chart 1.1**).

Food inflation continued to moderate overall inflation and contributed 0.2 percentage points during the quarter under review, from 0.5 percentage points in the previous quarter. Meanwhile, the contribution of NFNF inflation to overall inflation remained relatively stable, rising marginally to 1.1 percentage points in the third quarter from 1.0 percentage points in the second 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.

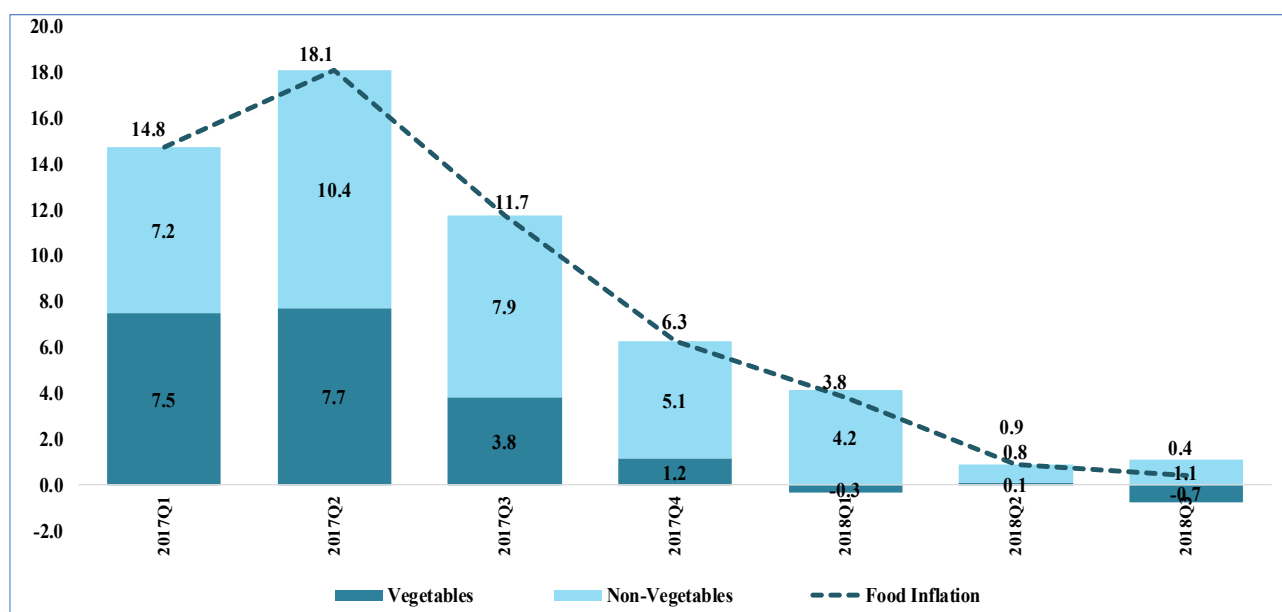
Food Inflation

Food inflation has maintained a downward trend since the second quarter of 2017. During the quarter under review, it declined to 0.4 percent from 0.9 percent in the second quarter. This decline followed a significant decline in the price of vegetables, which supported lower food inflation by 0.7 percentage points in the third quarter. Key vegetables such as tomatoes, cabbages, onions and carrots recorded significant price declines during the quarter under review owing to favorable weather conditions in food growing areas in the country (**Chart 1.2**).

Fuel Inflation

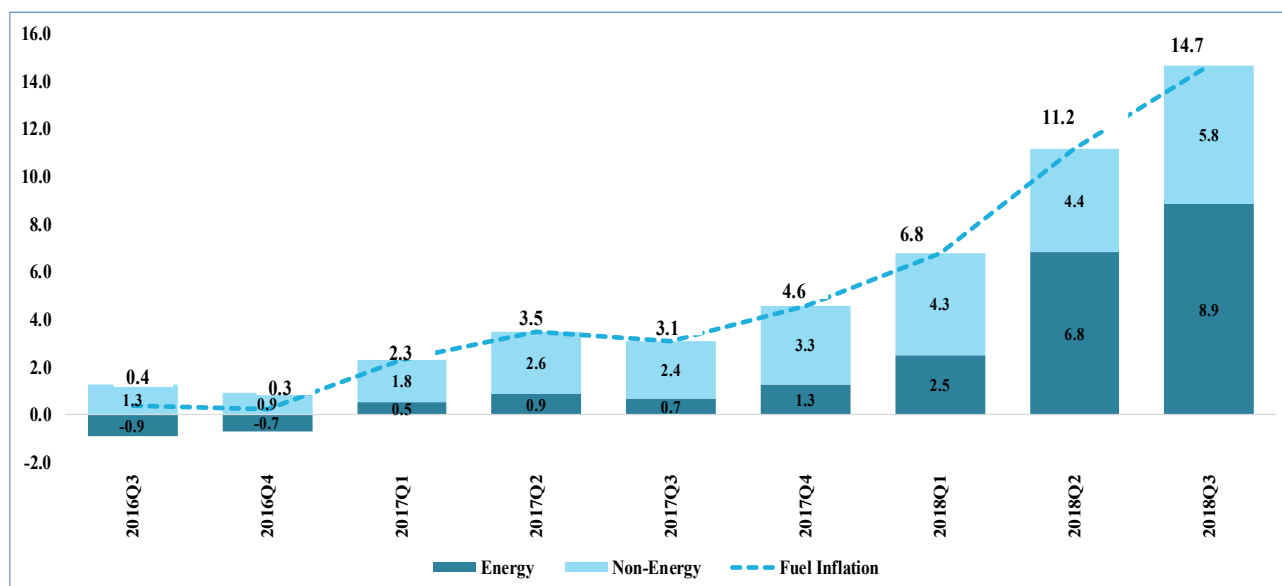
Fuel inflation increased further in the third quarter of 2018, driven by rising international oil prices and high domestic energy¹ prices. It increased to 14.7 percent in the third quarter, from 11.2 percent in the previous quarter (**Chart 1.3**). The energy component remained the dominant driver of fuel inflation for the second consecutive quarter and contributed 8.9 percentage points in the third quarter compared to 6.8 percentage points in the previous quarter.

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.

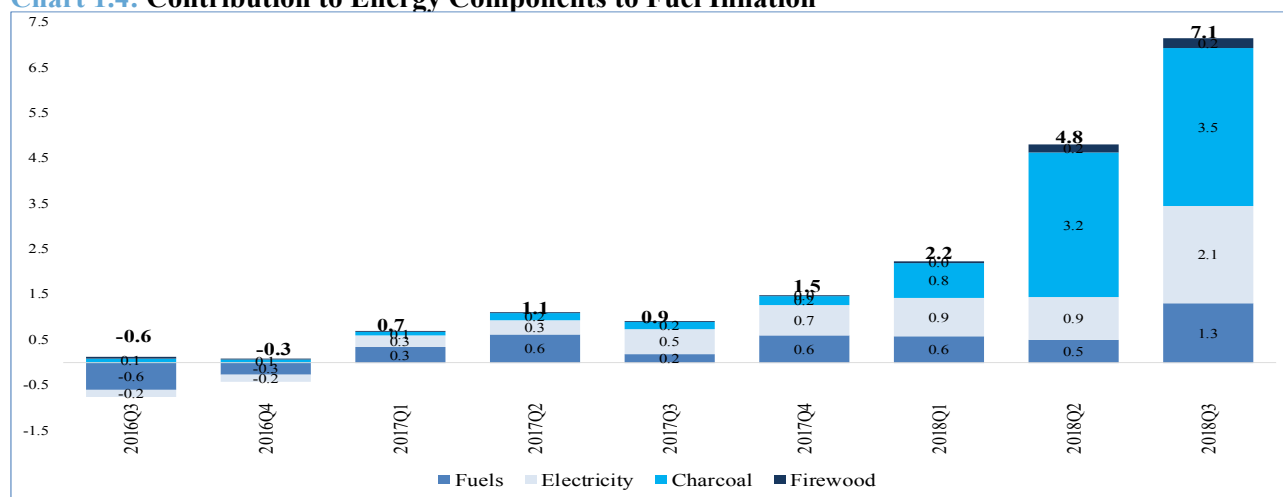
Charcoal prices remained high, following restrictions on charcoal trade and a ban on illegal logging that was imposed in March 2018. As a result, charcoal remained the dominant item exerting pressure on inflation and contributed 3.5 percentage points to fuel inflation in the quarter under review compared to 3.2 percentage points in the previous quarter (**Chart 1.4**).

Electricity prices picked up sharply in the quarter under review, following an upward review of the fixed non-fuel tariff component of consumer bills by the Energy Regulation Commission in August 2018. As a result, the contribution of electricity to fuel inflation

increased from 0.9 percentage points in the second quarter to 2.1 percentage points in the third quarter.

In addition, domestic pump prices continued to increase in line with rising international oil prices and the impact of the imposition of Value Added Tax (VAT) of 16 percent in September on the pump prices of petrol, diesel and kerosene (the VAT rate was later reduced to 8 percent). Following these developments, the contribution of fuels (petrol, diesel and kerosene) to fuel inflation increased from 0.5 percentage points in the second quarter to 1.3 percentage points in the third quarter.

Chart 1.4: Contribution to 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 modestly to 4.3 percent during the third quarter from 3.8 in the second quarter largely on account of the effect of excise tax indexation and other tax measures

mainly on, alcoholic beverages such as beer, wines and spirits, and cigarettes. Despite these tax measures, the NFNF remained low reflecting minimal demand pressures arising from appropriate monetary policy stance in place (**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
	July	2.9	4.1	4.7	6.2	0.8	1.4	5.1	4.0	4.0
	Aug	5.8	4.2	4.6	5.7	0.6	1.6	5.1	4.2	4.2
	Sep	6.5	4.6	4.9	5.9	0.6	1.6	4.9	4.3	4.7

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.

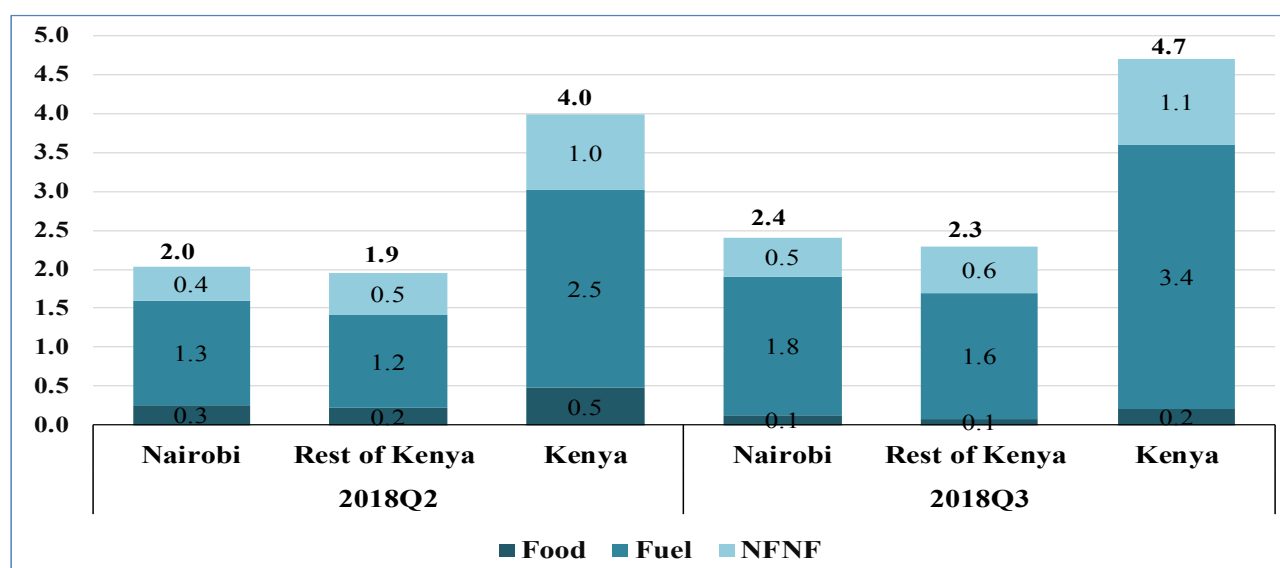
Overall Inflation across Regions

2018 (Chart 1.5).

Nairobi's contribution to overall inflation increased to 2.4 percentage points from 2.0 percentage points in the second quarter. This was mainly reflected in an increase in the contribution of fuel 1.8 percentage points from 1.3 percentage points during the period under review reflecting inflationary pressures emanating from fuel. The contribution of food inflation in Nairobi to overall inflation in Kenya declined from 0.3 percentage points in the second quarter to 0.1 percentage points during the period under review. Meanwhile, the contribution of NFNF remained stable in the second and third quarters of

In addition, inflation developments in the rest of Kenya mirrored those of the Nairobi region during the quarter under review. The contribution of inflation in this region to overall inflation increased to 2.3 percentage points from 1.9 percentage points in the second quarter. The contribution of fuel inflation in this region to overall inflation in Kenya increased to 1.6 percentage points from 1.2 percentage points in the second quarter. The contribution of food in the rest of Kenya to overall inflation in Kenya declined marginally to 0.1 percentage points from 0.2 percentage points in the previous period.

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

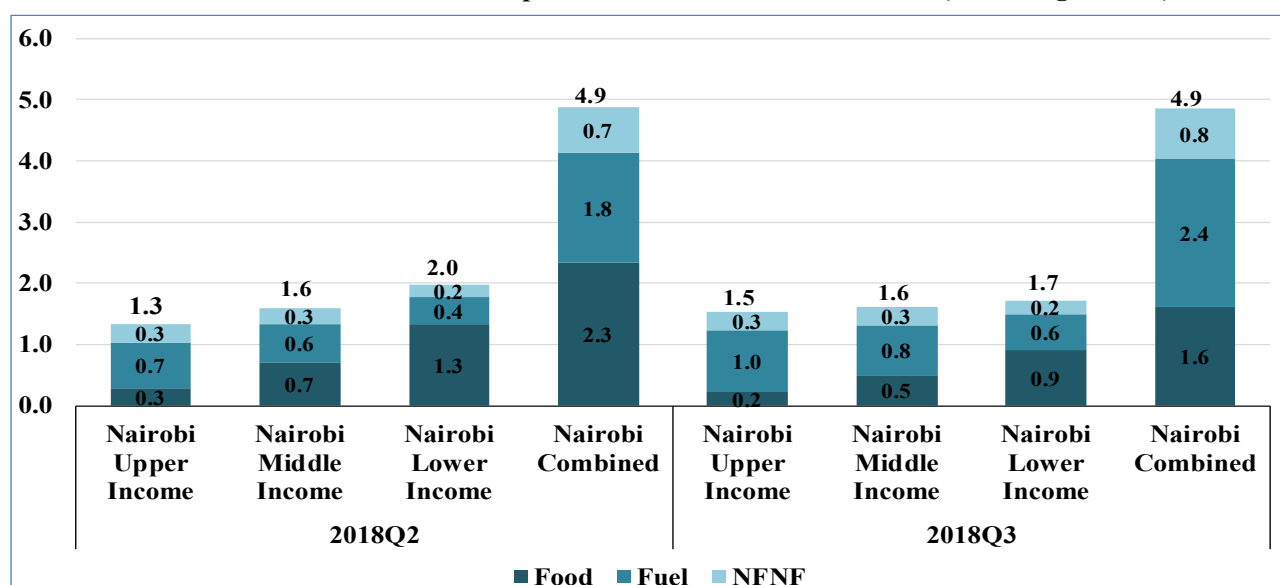


Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

Overall Inflation across Income Groups in Nairobi

The lower income group contributed 1.7 percentage points to inflation in Nairobi in the third Quarter compared with 2.0 percentage points in the previous quarter mainly on account of significant decline in food prices. The contribution of the middle income group stabilized at 1.6 percentage points as the increase in fuel prices was offset by the decline in food prices for this income group. Meanwhile, the contribution of the upper income group increased marginally to 1.5 percentage points from 1.3 percentage points mainly driven by an increase in the contribution of fuel from 0.7 percentage points to 1.0 percentage points in the period under review (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) decelerated to almost zero in the third quarter of 2018, compared to an increase of 7.5 percent in the previous quarter. The deceleration was largely reflected in reduced growth of deposits, particularly in the household sector. Household sector deposits declined by 0.5 percent in the third quarter of 2018 compared with an increase of 10.6 percent in the previous quarter reflected in foreign currency deposits, which is largely associated with developments in diaspora remittance flows. Growth in corporate sector deposits moderated to 1.4 percent in the third quarter compared to 4.0 percent in the previous quarter, largely reflected in reduced demand and, time and savings deposits (Tables 2.1 & 2.2 and Charts 1).

On 12-month basis, money supply, M3 growth moderated to 8.5 per cent in September 2018 from 10.4 percent in June 2018, largely reflecting reduction in net foreign assets of the banking system and slow growth in credit to the private sector.

Sources of Broad Money

The primary source of the decline in M3 in the third quarter of 2018 was the decrease in net foreign assets (NFA) and net domestic assets (NDA) of the banking system. The reduction in NFA of the central bank partly reflected servicing of government external debt, while the reduction in NFA of commercial banks, partly reflected deceleration in growth of their deposit holdings with non-resident banks alongside increased borrowings from non-residents. The deceleration in growth of NDA in the third quarter is due to the reduced growth in net lending to government and credit to the private sector (Table 2.1).

Table 2.1: Monetary Aggregates

	End Month Level						Quarterly Growth Rates (%)						Absolute Quarterly Changes (KSh Billions)					
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Components of M3																		
1. Money supply, M1 (1.1+1.2+1.3)	1381.1	1372.5	1387.1	1362.6	1426.7	1380.1	5.7	-0.6	1.1	-1.8	4.7	-3.3	74.1	-8.6	14.6	-24.4	64.0	-46.6
1.1 Currency outside banks	207.1	209.2	225.4	214.4	218.3	214.4	3.0	1.0	7.8	-4.9	1.8	-1.8	6.1	2.1	16.2	-11.0	3.9	-3.9
1.2 Demand deposits	1092.4	1103.2	1119.8	1083.4	1126.8	1094.6	3.8	1.0	1.5	-3.3	4.0	-2.9	40.2	10.8	16.7	-36.5	43.5	-32.2
1.3 Other deposits at CBK 1/	81.2	59.7	41.4	64.5	81.2	70.8	51.9	-26.5	-30.7	55.9	25.8	-12.9	27.7	-21.5	-18.3	23.2	16.7	-10.4
2. Money supply, M2 (1+2.1)	2494.2	2528.8	2551.8	2560.9	2681.9	2684.9	2.8	1.4	0.9	0.4	4.7	0.1	68.4	34.6	23.0	9.1	120.9	3.0
2.1 Time and saving deposits	1113.1	1156.3	1164.7	1198.3	1255.2	1304.8	-0.5	3.9	0.7	2.9	4.7	4.0	-5.7	43.2	8.5	33.6	56.9	49.6
3. Money supply, M3 (2+3.1)	2955.9	3006.2	3030.6	3035.4	3262.6	3261.1	3.1	1.7	0.8	0.2	7.5	0.0	89.4	50.2	24.5	4.7	227.2	-1.6
3.1 Foreign Currency Deposits	461.7	477.38	478.8	474.5	580.8	576.2	4.8	3.4	0.3	-0.9	22.4	-0.8	21.0	15.7	1.5	-4.4	106.3	-4.6
Sources of M3																		
1. Net foreign assets 2/	642.6	610.1	516.3	697.6	756.9	742.1	6.8	-5.1	-15.4	35.1	8.5	-2.0	41.2	-32.5	-93.7	181.3	59.3	-14.8
Central Bank	738.3	694.6	627.1	803.3	783.6	768.3	5.8	-5.9	-9.7	28.1	-2.5	-2.0	40.5	-43.7	-67.5	176.2	-19.7	-15.3
Banking Institutions	-95.8	-84.6	-110.8	-105.7	-26.7	-26.2	-0.7	-11.7	31.0	-4.6	-74.7	-1.8	0.6	11.2	-26.2	5.1	79.0	0.5
2. Net domestic assets (2.1+2.2)	2313.3	2396.1	2514.3	2337.7	2505.7	2519.0	2.1	3.6	4.9	-7.0	7.2	0.5	48.3	82.7	118.2	-176.6	168.0	13.3
2.1 Domestic credit	3035.4	3103.6	3232.6	3080.6	3237.3	3282.5	1.7	2.2	4.2	-4.7	5.1	1.4	50.8	68.2	128.9	-151.9	156.7	45.2
2.1.1 Government (net)	646.2	674.3	755.7	624.9	745.1	770.2	10.8	4.3	12.1	-17.3	19.2	3.4	62.8	28.1	81.4	-130.8	120.1	25.2
2.1.2 Private sector	2282.3	2315.6	2364.5	2343.0	2380.4	2404.0	-0.6	1.5	2.1	-0.9	1.6	1.0	-12.9	33.3	48.9	-21.5	37.4	23.6
2.1.3 Other public sector	106.9	113.7	112.4	112.7	111.9	108.3	0.9	6.4	-1.2	0.3	-0.8	-3.2	0.9	6.9	-1.3	0.3	-0.9	-3.5
2.2 Other assets net	-722.1	-707.5	-718.2	-742.9	-731.6	-763.5	0.3	-2.0	1.5	3.4	-1.5	4.4	-2.5	14.5	-10.7	-24.6	11.3	-32.0
Memorandum items																		
4. Overall liquidity, L (3+4.1)	3954.8	4032.1	4104.8	4159.2	4434.2	4465.9	3.1	2.0	1.8	1.3	6.6	0.7	118.2	77.4	72.7	54.4	275.0	31.7
4.1 Non-bank holdings of government sec	998.9	1026.0	1074.2	1123.8	1171.6	1204.8	3.0	2.7	4.7	4.6	4.3	2.8	28.8	27.1	48.2	49.6	47.8	33.2

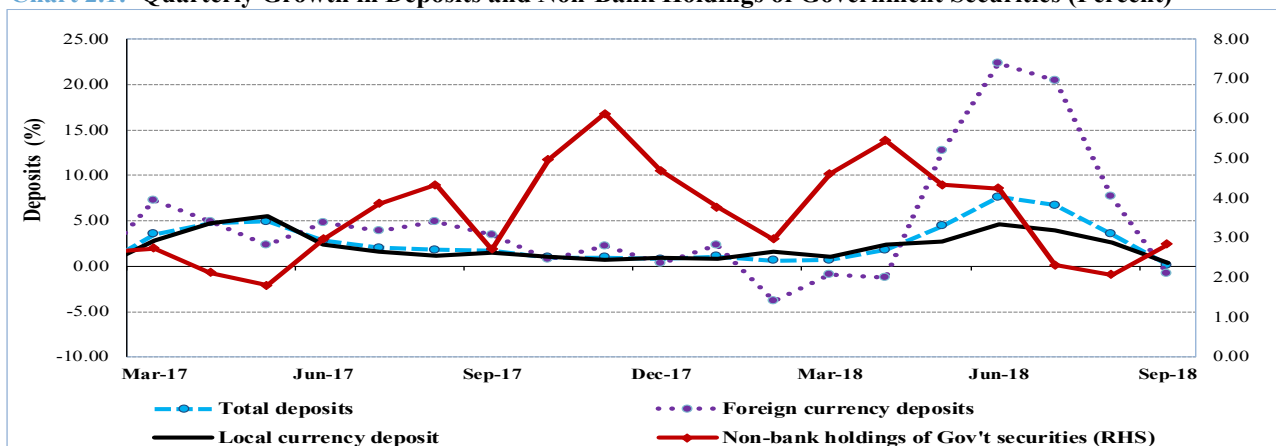
Absolute and percentage changes may not necessarily add up due to rounding

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

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

Source: Central Bank of Kenya

Developments in Domestic Credit

Growth in domestic credit decelerated to 1.4 percent in the third quarter of 2018 from 5.1 per cent in the second quarter of 2018, largely on account of decreased net lending to government and private sector credit (**Table 2.3**). The banking system net credit to government declined to KSh 25.2 billion from KSh 120.1 billion in the previous quarter on account of decreased commercial bank net lending to government and reduced utilization of the overdraft at the Central Bank by government.

Banks' lending to the private sector remained subdued in the third quarter of 2018 growing by 1.0 percent compared to 1.6 percent in the previous quarter, owing to reduced lending to the corporate sector. On the other hand, credit growth to the households' sector was relatively higher at 2.7 percent compared to 2.3 percent in the previous quarter (**Table 2.4**).

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

Source: Central Bank of Kenya

Table 2.4: Gross Bank Loans to the Private Sector Credit Growth

	End Month Level						Quarterly Growth Rates (%)						Absolute Quarterly Changes (KSh Billions)					
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
1. Household	682.4	691.7	706.3	713.4	729.8	749.4	0.9	1.4	2.1	1.0	2.3	2.7	6.0	9.3	14.6	7.0	16.5	19.6
2. Corporate	1,639.5	1,667.9	1,699.9	1,674.2	1,697.6	1,706.2	-0.8	1.7	1.9	-1.5	1.4	0.5	-13.0	28.4	32.0	-25.7	23.4	8.6
Gross Loans	2,321.9	2,359.6	2,406.3	2,387.6	2,427.4	2,455.6	-0.3	1.6	2.0	-0.8	1.7	1.2	-7.0	37.7	46.7	-18.7	39.8	28.2

Source: Central Bank of Kenya

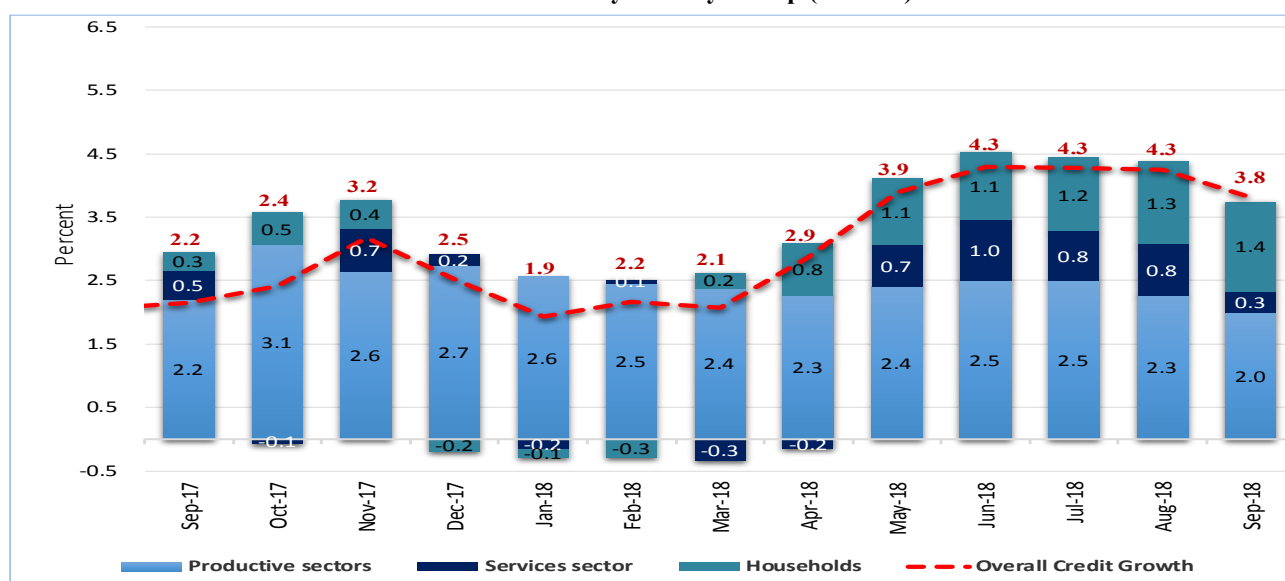
In terms of economic activities, all sectors registered positive growth rates in the third quarter of 2018, except real estate and business services. The sector with relatively stronger growth rates were manufacturing and, building and constructions, which grew by 4.3 percent and 3.7 percent, respectively (Table 2.3). Private sector credit growth continued to be supported by productive and household sectors (Table 2.5 and Chart 2.2).

On 12-month basis, private sector credit growth remained low, declining to 3.8 percent in September 2018 from 4.3 percent in June 2018. The interest rate caps and tight credit standards remained the key constraints to credit extension to the private sector.

Table 2.5: Sectoral Credit Distribution

	End Month Level										Quarterly Growth Rates (%)						Contribution to Quarterly Changes (%)					
	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
1. Productive sectors	850.3	819.8	824.1	844.0	851.2	878.0	898.1	898.7	923.9	896.0	0.9	3.1	2.3	0.1	2.8	-3.0	0.3	1.2	0.9	0.0	1.1	-1.2
Agriculture	97.5	90.6	90.1	88.4	87.1	90.5	84.7	82.9	85.0	81.3	-1.4	3.9	-6.4	-2.2	2.6	-4.4	-0.1	0.1	-0.2	-0.1	0.1	-0.2
Manufacturing	304.5	278.6	275.0	281.9	286.2	299.1	314.2	313.6	334.8	317.6	1.5	4.5	5.0	-0.2	6.8	-5.2	0.2	0.6	0.7	0.0	0.9	-0.7
Building and construction	101.5	104.8	104.8	103.3	102.8	108.8	112.0	116.3	120.9	114.4	-0.4	5.8	2.9	3.9	3.9	-5.3	0.0	0.3	0.1	0.2	0.2	-0.3
Real estate	323.2	329.6	337.4	355.0	359.9	363.0	370.7	370.8	369.1	369.4	1.4	0.9	2.1	0.0	-0.5	0.1	0.2	0.1	0.3	0.0	-0.1	0.0
Mining and quarrying	23.6	16.1	16.8	15.5	15.3	16.6	16.5	15.1	14.0	13.3	-1.5	8.8	-0.8	-8.5	-7.0	-5.3	0.0	0.1	0.0	-0.1	0.0	0.0
2. Services sector	781.3	802.9	814.3	812.9	807.0	821.5	829.2	805.0	829.1	829.4	-0.7	1.8	0.9	-2.9	3.0	0.0	-0.3	0.6	0.3	-1.0	1.0	0.0
Trade	350.6	382.4	380.7	384.3	390.6	411.1	417.4	405.1	423.9	424.5	1.6	5.3	1.5	-2.9	4.7	0.1	0.3	0.9	0.3	-0.5	0.8	0.0
Transport & communications	179.6	192.0	201.3	200.3	189.1	186.4	190.5	163.3	165.1	169.4	-5.6	-1.4	2.2	-14.3	1.1	2.6	-0.5	-0.1	0.2	-1.2	0.1	0.2
Finance & insurance	88.8	84.7	85.2	77.7	85.4	84.0	82.1	86.7	88.6	89.5	9.8	-1.7	-2.2	5.7	2.2	1.0	0.3	-0.1	-0.1	0.2	0.1	0.0
Business services	162.2	143.8	147.1	150.7	141.9	140.0	139.2	149.9	151.4	146.0	-5.8	-1.4	-0.5	7.6	1.1	-3.6	-0.4	-0.1	0.0	0.4	0.1	-0.2
3. Households	505.1	548.7	568.4	568.7	556.5	556.4	565.0	574.1	580.8	589.3	-2.1	0.0	1.6	1.6	1.2	1.5	-0.5	0.0	0.4	0.4	0.3	0.4
Private households	348.7	377.0	393.1	396.1	388.2	385.4	388.5	393.4	399.4	404.9	-2.0	-0.7	0.8	1.3	1.5	1.4	-0.3	-0.1	0.1	0.2	0.3	0.2
Consumer durables	156.5	171.7	175.3	172.6	168.3	171.0	176.5	180.6	181.4	184.4	-2.5	1.6	3.2	2.4	0.4	1.6	-0.2	0.1	0.2	0.2	0.0	0.1
4. Other activities	79.3	71.9	68.9	69.6	67.6	59.7	72.2	65.2	62.3	61.3	-2.9	-11.7	20.9	-9.6	-4.5	-1.6	-0.1	-0.3	0.5	-0.3	-0.1	0.0
5. Total Credit	2,216.1	2,243.3	2,275.7	2,295.2	2,282.3	2,315.6	2,364.5	2,343.0	2,396.1	2,376.0	-0.6	1.5	2.1	-0.9	2.3	-0.8	-0.6	1.5	2.1	-0.9	2.2	-0.8

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 (RM), comprising currency held by the non-bank public and commercial bank reserves, increased by 4.8 percent in the third quarter of 2018 compared to an increase of 2.6 percent in the previous quarter. The increase was largely reflected on bank reserves (**Table 2.6**).

The primary source of the growth in reserve money was increase in NDA of Central Bank, largely reflecting increased net lending to commercial banks due to relatively tight liquidity conditions during the quarter. Government borrowing from the Central Bank declined in third quarter as a result of decreased utilization of the overdraft facility by Government. The NFA of the Central Bank declined in the third quarter of 2018, largely reflecting servicing of government external debt.

Table 2.6: Reserve Money and Its Sources

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

Interest Rates

a. Central Bank Rate

The Monetary Policy Committee (MPC) retained the CBR at 9.0 percent in its September 2018 monetary policy meeting, to allow the impact of the previous decision of lowering the CBR by 50 basis points in March 2018 and a further 50 basis points in July 2018 to filter through the economy.

b. Interbank Rate

The average interbank rate remained relatively stable at 5.2 percent in the third quarter of 2018 compared with 5.0 percent in second quarter of 2018, partly reflecting balanced liquidity conditions in the money markets (**Table 2.7**).

c. Treasury Bill Rates

The average 91-day Treasury bill rate remained stable at 7.7 percent in the third quarter compared with 7.9 percent in the previous quarter. The interest rate on the 182-day Treasury bill rate declined to 9.1 percent from 10.2 percent (**Table 2.7**).

d. Lending and Deposit Rates

Commercial banks' interest rates remained within the interest rate limit in the third quarter of 2018. The average commercial bank lending rate declined slightly to 12.8 percent in September 2018 compared to 13.2 percent in June 2018, while the average commercial banks' deposit rate declined to 7.4 percent from 8.0 percent, partly reflecting the July 2018 reduction in CBR. The spread increased marginally to 5.4 percent from 5.2 percent in June 2018.

Table 2.7: Interest Rates (%)

	2016				2017				2018								
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
91-day Treasury bill rate	8.72	7.25	8.06	8.44	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
182-day Treasury bill rate	10.83	9.56	10.85	10.55	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
Interbank rate	4.10	4.56	4.47	5.55	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
Repo rate	4.31	10.04	0.00	0.00	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
Reverse Repo rate	11.63	10.59	10.36	10.04	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
Central Bank Rate (CBR)	11.50	10.50	10.00	10.00	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
Average lending rate (1)	17.79	18.15	13.84	13.69	13.61	13.66	13.69	13.64	13.65	13.68	13.49	13.24	13.25	13.22	13.10	12.78	12.79
Overdraft rate	18.06	18.04	13.60	13.49	13.29	13.38	13.65	13.54	13.61	13.75	13.40	13.29	13.30	13.23	13.16	12.90	12.90
1-5years	18.00	18.63	13.95	13.86	13.81	13.80	13.87	13.83	13.84	13.83	13.67	13.41	13.40	13.39	13.26	12.94	12.94
Over 5years	17.31	17.64	13.83	13.59	13.55	13.64	13.51	13.46	13.45	13.45	13.31	13.03	13.03	13.00	12.88	12.53	12.53
Average deposit rate (2)	7.17	6.78	6.94	7.33	7.12	7.15	7.66	8.22	8.26	8.25	8.16	8.17	8.08	8.04	8.01	7.44	7.40
0-3months	9.78	8.80	8.21	7.16	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
Over 3 months deposit	10.41	9.94	8.82	8.45	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
Savings deposits	1.32	1.60	3.78	6.37	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
Spread (1-2)	10.62	11.40	6.93	6.36	6.49	6.52	6.04	5.41	5.39	5.42	5.33	5.07	5.17	5.18	5.09	5.34	5.39

Source: Central Bank of Kenya

Chapter 3

The Real Sector

3.1 Overview

GDP growth remained strong in the third quarter of 2018. The economy grew by 6.0 percent compared to 6.2 percent in the previous quarter and 4.7 percent in the third quarter of 2017. This was largely supported by improved agricultural activities and resilience of the services sectors.

Agriculture sector grew by 5.2 percent in the third quarter of 2018 compared to 3.7 percent in the third quarter of 2017, and contributed 1.0 percentage points to overall GDP growth compared to 0.7 percentage points, respectively. The positive performance was mainly attributed to favourable weather conditions experienced across the country, which led to increased production of key crops such as tea, coffee, sugarcane, fruits and dairy production (Table 3.1 and 3.3).

quarter of 2018, mainly supported by the services sectors. Growth in the services sectors remained strong and stable at 6.0 percent in the third quarter of 2018 compared to 6.1 percent in the third quarter of 2017, and contributed 3.0 percentage points compared to 3.1 percentage points in 2017. The strong growth was largely supported by robust growth in the wholesale and retail trade, accommodation and restaurant, information and communication, public administration, and education sectors (Table 3.1 and 3.3).

Growth of industry improved significantly to 5.3 percent in the third quarter of 2018 from 2.5 percent in the third quarter of 2017. The improved performance was attributed to recovery of the manufacturing, construction, and electricity and water supply sectors (Table 3.1 and Chart 3.1).

Non-agriculture sector grew by 6.1 in the third

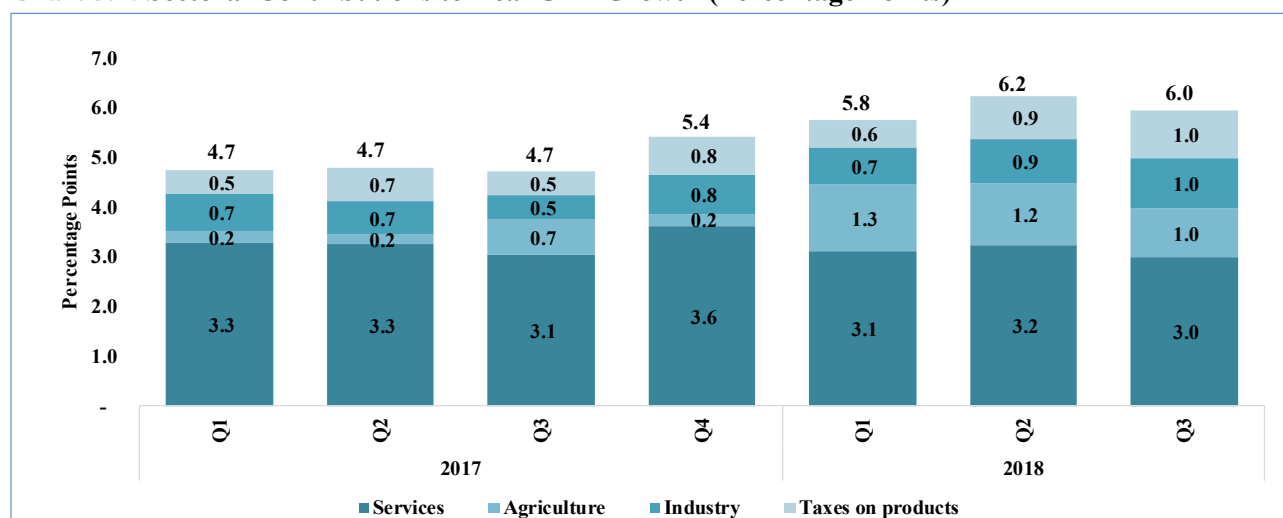
3.2 Performance by Sector

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

	Annual		2017				2018		
	2016	2017	Q1	Q2	Q3	Q4	Q1	Q2	Q3
1. Agriculture	4.7	1.6	0.9	0.8	3.7	1.5	5.3	5.4	5.2
2. Non-Agriculture (o/w)	6.2	5.8	6.1	6.0	4.9	6.2	5.9	6.5	6.1
2.1 Industry	5.7	3.6	4.1	3.6	2.5	4.1	4.1	4.7	5.3
Mining & Quarrying	9.5	6.1	7.1	6.0	6.4	5.0	4.6	3.5	8.5
Manufacturing	2.7	0.2	1.3	-0.2	-0.05	-0.4	2.3	3.1	3.2
Construction	8.3	5.6	6.1	6.0	4.5	5.8	5.1	8.6	8.5
Electricity & water supply	9.8	8.6	8.3	9.5	5.6	10.9	7.2	6.1	6.8
2.2 Services	6.7	6.9	7.2	7.0	6.1	7.0	6.8	6.9	6.0
Wholesale & Retail Trade	3.4	5.8	4.3	5.6	6.7	6.5	6.2	7.7	6.8
Accommodation & restaurant	13.3	14.7	24.5	12.6	12.4	9.5	13.5	15.7	16.0
Transport & Storage	7.8	7.4	9.5	8.0	5.3	7.0	7.1	7.8	5.4
Information & Communication	9.7	11.0	12.5	10.8	10.7	10.1	12.0	12.6	9.1
Financial & Insurance	6.7	3.1	4.7	3.5	1.7	2.4	2.6	2.3	2.6
Public administration	4.8	5.3	4.6	5.3	5.0	6.1	4.6	5.8	6.6
Professional, Administration & Support Services	5.0	4.0	4.2	5.6	2.4	4.0	4.4	5.4	4.5
Real estate	8.8	6.1	6.1	6.0	6.1	6.3	6.8	6.6	5.8
Education	5.4	6.1	5.7	6.0	5.7	6.8	6.8	6.3	6.0
Health	4.8	6.0	4.0	6.8	6.4	6.3	6.1	6.1	5.1
Other services	4.1	5.0	6.6	5.2	4.5	3.7	2.4	2.5	2.8
FISIM	2.1	-5.0	-1.8	-6.8	-3.8	-7.8	-0.1	1.9	3.5
2.3 Taxes on products	4.8	5.2	4.6	6.1	4.0	6.1	5.4	7.8	7.9
Real GDP Growth	5.9	4.9	4.7	4.7	4.7	5.4	5.8	6.2	6.0

Source: Kenya National Bureau of Statistics

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



Source: Kenya National Bureau of Statistics

Table 3.2: Sectoral Shares as a Percentage of GDP

	Annual		2017				2018		
	2016	2017	Q1	Q2	Q3	Q4	Q1	Q2	Q3
1. Agriculture	21.9	21.2	25.6	23.4	19.0	16.8	25.5	23.2	18.9
2. Non-Agriculture (o/w)	78.1	78.8	74.4	76.6	81.0	83.2	74.5	76.8	81.1
2.1 Industry	19.2	19.0	18.5	19.0	19.2	19.2	18.2	18.8	19.1
Mining & Quarrying	1.1	1.1	1.1	1.0	1.1	1.1	1.1	1.0	1.1
Manufacturing	10.2	9.8	9.9	9.9	9.9	9.3	9.6	9.6	9.6
Construction	2.5	2.5	2.5	2.7	2.6	2.4	2.4	2.7	2.6
Electricity & water supply	5.4	5.6	5.0	5.4	5.7	6.2	5.1	5.4	5.8
2.2 Services	47.4	48.3	45.5	46.6	49.7	51.5	46.0	46.9	49.8
Wholesale & Retail Trade	7.5	7.6	6.9	7.1	8.6	7.7	6.9	7.2	8.7
Accommodation & restaurant	1.1	1.2	1.4	0.9	1.2	1.5	1.5	1.0	1.3
Transport & Storage	6.9	7.0	6.2	6.8	7.4	7.8	6.3	6.9	7.3
Information & Communication	3.8	4.0	4.0	3.3	3.7	5.3	4.2	3.5	3.8
Financial & Insurance	6.2	6.1	6.0	6.0	6.4	6.1	5.9	5.8	6.2
Public administration	3.8	3.9	3.6	4.3	3.7	3.8	3.6	4.3	3.7
Professional, Administration & Support Services	2.3	2.2	2.1	2.2	2.3	2.4	2.0	2.2	2.2
Real estate	8.4	8.5	8.2	8.4	8.7	8.9	8.3	8.4	8.7
Education	6.9	7.0	6.8	6.9	7.1	7.1	6.9	6.9	7.1
Health	1.8	1.8	1.6	1.8	1.9	1.9	1.6	1.8	1.9
Other services	1.3	1.3	1.2	1.2	1.3	1.3	1.2	1.2	1.3
FISIM	-2.6	-2.4	-2.4	-2.3	-2.4	-2.3	-2.3	-2.2	-2.4
2.3 Taxes on products	11.4	11.5	10.4	11.0	12.0	12.5	10.3	11.1	12.2
Total	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
1. Agriculture	1.0	0.3	0.2	0.2	0.7	0.2	1.3	1.2	1.0
2. Non-Agriculture (o/w)	4.8	4.6	4.5	4.6	4.0	5.2	4.4	5.0	5.0
2.1 Industry	1.1	0.7	0.7	0.7	0.5	0.8	0.7	0.9	1.0
Mining & Quarrying	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.1
Manufacturing	0.3	0.0	0.1	0.0	0.0	0.0	0.2	0.3	0.3
Construction	0.2	0.1	0.2	0.2	0.1	0.1	0.1	0.2	0.2
Electricity & water supply	0.5	0.5	0.4	0.5	0.3	0.7	0.4	0.3	0.4
2.2 Services	3.2	3.3	3.3	3.3	3.1	3.6	3.1	3.2	3.0
Wholesale & Retail Trade	0.3	0.4	0.3	0.4	0.6	0.5	0.4	0.6	0.6
Accommodation & restaurant	0.2	0.2	0.3	0.1	0.1	0.1	0.2	0.2	0.2
Transport & Storage	0.5	0.5	0.6	0.5	0.4	0.6	0.4	0.5	0.4
Information & Communication	0.4	0.4	0.5	0.4	0.4	0.5	0.5	0.4	0.3
Financial & Insurance	0.4	0.2	0.3	0.2	0.1	0.1	0.2	0.1	0.2
Public administration	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Professional, Administration & Support Services	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Real estate	0.7	0.5	0.5	0.5	0.5	0.6	0.6	0.5	0.5
Education	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.4	0.4
Health	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	0.0	0.0	0.0	0.0
FISIM	-0.1	0.1	0.0	0.2	0.1	0.2	0.0	0.0	-0.1
2.3 Taxes on products	0.6	0.6	0.5	0.7	0.5	0.8	0.6	0.9	1.0
Real GDP Growth	5.9	4.9	4.7	4.7	4.7	5.4	5.8	6.2	6.0

Source: Kenya National Bureau of Statistics and CBK Staff Computations

Agriculture

The indicators for the sector show a general improvement in output in the third quarter of 2018, following improved weather conditions during the quarter.

Tea

Tea production declined by 12.2 percent in the

third quarter of 2018 compared to the previous quarter, due to cold weather conditions experienced in July. However, production increased in August and September 2018 largely attributed to the continued precipitation in tea growing areas (**Table 3.4**). Consequently, average auction price of tea per kilogram decreased by 19.5 percent in the third quarter of 2018 compared to a similar quarter in 2017.

Table 3.4: Quarterly Performance of Key Agricultural Output Indicators

	2017				2018*					
	Quarterly				Quarterly			Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jul-18	Aug-18	Sep-18
Tea										
Output (Metric tonnes)	90,094	110,819	102,645	136,300	99,760	131,235	115,242	35,278	37,433	42,531
Growth (%)	-28.69	23.00	-7.38	32.79	-26.81	31.55	-12.19	-18.5	6.1	13.6
Horticulture										
Exports (Metric tonnes)	84,851	85,186	82,791	82,105	100,526	96,592	108,043	44,355	35,073	28,615
Growth (%)	8.2	0.4	-2.8	-0.8	22.4	-3.9	11.9	32.8	-20.9	-18.4
Coffee										
Sales (Metric tonnes)	16,731	6,202	5,546	5,250	15,857	8,814	5,755	1,221	2,235	2,299
Growth (%)	198.1	-62.9	-10.6	-5.3	202.1	-44.4	-34.7		83.0	2.9
Milk										
Output (million litres)	130.0	143.2	153.3	164.9	148.7	156.4	160.4	55.5	52.8	52.2
Growth %	-19.6	10.1	7.1	7.5	-9.8	5.2	2.6	6.2	-4.9	-1.1
Sugar Cane										
Output ('000 Metric tonnes)	1,572	786	709	1,546	1,688	1,006	1,252	377	440	435
Growth (%)	-3.6	-50.0	-9.8	118.1	9.2	-40.4	24.4	19.4	16.6	-1.2

* Provisional

Source: Kenya National Bureau of Statistics

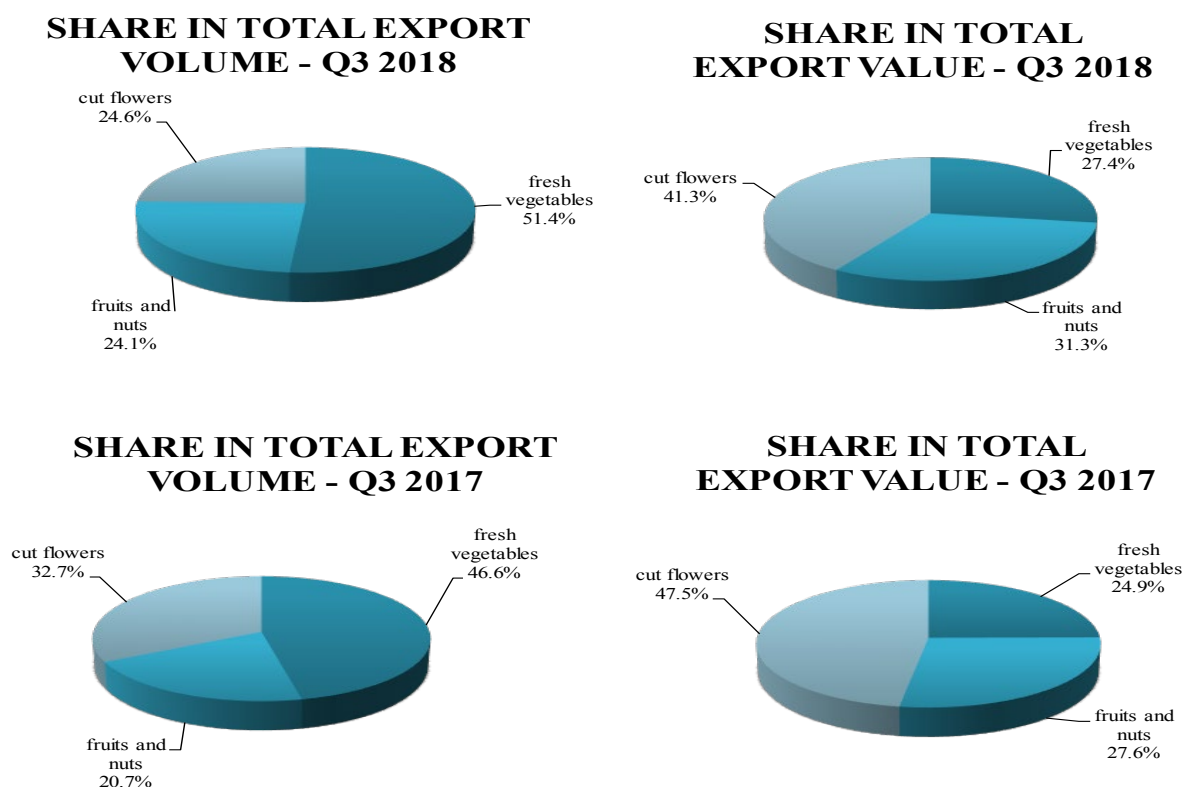
Coffee

Coffee sales declined by 34.7 percent in the third quarter of 2018 compared to the previous quarter. However, when compared to the same period in 2017, the sales increased by 9.6 percent. The increase was mainly due to higher production of coffee following favourable weather conditions experienced in the country compared to a similar period last year (**Table 3.4**). Average auction prices declined by 25.5 percent in the third quarter of 2018 compared to the same period in 2017.

Horticulture

Total exports of horticultural crops increased by 11.9 percent in the third quarter of 2018 compared to the previous quarter and by 30.5 percent compared to the same period in 2017 (**Table 3.4**).

The share of export volumes of fresh vegetables and, fruits and nuts to total horticultural exports increased to 51.4 percent and 24.1 percent, respectively, in the third quarter of 2018 from 46.6 percent and 20.7 percent, respectively, in the second quarter of 2018. The share of export volumes and values of cut flowers to total horticultural exports declined during the period under review (**Chart 3.2**).

Chart 3.2: Horticultural Exports

Source: Kenya Revenue Authority

Milk intake recorded a slow growth of 2.6 percent cumulatively in the third quarter of 2018 compared to the previous quarter. However, compared to the same period in 2017, output increased by 4.6 percent in the period under review. The improved milk output was attributed to increased pasture due to improved weather conditions (**Table 3.4**).

Sugarcane production was higher by 24.4 percent in the third quarter of 2018 compared to the previous quarter, supported by improved weather conditions (**Table 3.4**).

3.3 The Manufacturing Sector

Indicators show improved performance in the sector in the third quarter of 2018.

Sugar production increased significantly by 10.1

percent in the third quarter of 2018 compared to the previous quarter, supported by increased production of sugarcane. (**Table 3.5**).

Cement production increased by 1.4 percent in the third quarter of 2018 compared to the previous quarter, and was lower by 6.9 percent compared with the same quarter of 2017. The drop in cement production could be attributed to reduced export of cement (**Table 3.5**).

Production of **galvanized sheets** and **assembled vehicles** increased by 2.5 percent and 3.2 percent in the third quarter of 2018 compared to the previous quarter and 7.5 percent and 7.4 percent higher than a similar quarter in 2017, respectively (**Table 3.5**).

Table 3.5: Quarterly Production of Selected Manufactured Goods

	2017				2018*					
	Quarterly				Quarterly			Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jul-18	Aug-18	Sep-18
Cement production										
Output (MT)	1,627,269	1,531,136	1,503,449	1,500,740	1,461,459	1,381,096	1,399,982	465,575	473,861	460,546
Growth %	-4.5	-5.9	-1.8	-0.2	-2.6	-5.5	1.4	2.48	1.78	-2.81
Assembled vehicles										
Output (No.)	1,499	870	1,136	1,056	1,472	1,182	1,220	498	303	419
Growth %	25.5	-42.0	30.6	-7.0	39.4	-19.7	3.2	36.1	-39.2	38.3
Galvanized sheets										
Output (MT)	71,888	61,730	62,124	67,107	67,857	65,139	66,782	22,510	21,847	22,425
Growth %	26.3	-14.1	0.6	8.0	1.1	-4.0	2.5	5.0	-2.9	2.6
Processed sugar										
Output (MT)	144,403	57,589	50,423	124,711	165,800	93,935	103,403	30,105	35,646	37,652
Growth %	-2.5	-60.1	-12.4	147.3	32.9	-43.3	10.1	6.3	18.4	5.6
Soft drinks										
Output ('000 litres)	144,385	133,016	123,418	156,726	150,887	129,649	N/A	43,725	48,795	N/A
Growth %	3.0	-7.9	-7.2	27.0	-3.7	-14.1		1.1	11.6	

MT = Metric tonnes

* Provisional

N/A - Not Available

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

3.4 The Electricity and Water Supply Sector

Electricity output increased by 4.3 percent in the third quarter of 2018 compared to the previous quarter, and was higher by 11.0 percent compared to the same quarter in 2017. This was attributed to a significant increase in hydroelectricity generation by 11.4 percent, following the good rains experienced during the quarter. Wind generation increased significantly by 88.5 percent compared to the previous quarter with the generation boosted by the entry of Turkana wind power plant. However, generation of thermal and geo-thermal electricity declined during the quarter (**Table 3.6**).

Consumption of electricity increased by 1.8 percent in the third quarter of 2018. Meanwhile, international oil prices increased by 4.0 percent in the third quarter compared to the previous quarter, and were 50.0 percent higher compared to the same quarter of 2017 (**Table 3.6**).

Table 3.6: Quarterly Performance in the Energy Sector

	2017				2018					
	Quarterly				Quarterly			Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jul-18	Aug-18	Sep-18
Electricity Supply (Generation)										
Output (million KWH)	2,452.6	2,505.4	2,555.1	2,615.5	2,638.3	2,718.5	2,835.4	947.0	963.7	924.7
Growth %	-3.7	2.2	2.0	2.4	0.9	3.0	4.3	3.6	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	420.3	417.4	392.1
Growth (%)	-27.8	-11.5	10.2	13.1	-14.0	66.0	11.4	4.9	-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	438.1	426.6	439.8
Growth (%)	1.6	2.6	5.9	3.6	0.2	3.1	0.0	1.9	-2.6	3.1
Thermal Generation (million KWH)	609.0	720.7	644.1	560.6	693.7	304.0	289.4	86.9	117.2	85.3
Growth (%)	35.1	18.3	-10.6	-13.0	23.7	-56.2	-4.8	5.5	35.0	-27.2
Wind Generation (million KWH)	20.8	13.2	8.4	18.7	14.2	6.2	11.7	1.7	2.5	7.5
Growth (%)	4.0	-36.6	-36.3	123.0	-23.9	-56.4	88.5	36.3	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	694.0	730.0	740.9
Growth %	0.4	4.9	11.4	-13.9	3.9	-1.6	1.8	-4.5	5.2	1.5
Murban crude oil average price (US \$ per barrel)	54.7	50.7	51.1	63.2	66.2	73.6	76.6	76.0	74.9	78.8
Growth %	8.2	-7.3	0.7	23.8	4.8	11.2	4.0	3.8	-1.4	5.1

Source: Kenya National Bureau of Statistics

3.5 The Construction and Real Estate Sectors

Indicators in the construction sector show improved activity in the third quarter of 2018.

Cement consumption increased by 3.3 percent compared to the previous quarter. The value of building plans approved by Nairobi City County's Planning, Compliance & Enforcement Department also increased in the third 2018 by 24.8 percent and 143.4 percent compared to the previous quarter and the same period in 2017, respectively, indicating a significant recovery of the sector following effects of prolonged elections and economic slowdown in 2017 (Table 3.7).

Table 3.7: Quarterly Output of Selected Construction Indicators

	2017				2018*					
	Quarterly				Quarterly			Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jul-18	Aug-18	Sep-18
Cement Consumption										
Output (Tonnes)	1,533,010	1,435,103	1,429,162	1,387,875	1,410,169	1,337,731	1,381,541	458,159	466,909	456,473
Growth %	-5.0	-6.4	-0.4	-2.9	1.6	-5.1	3.3	1.6	1.9	-2.2
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	10,624.92	10,735.63	11,132.49
Growth (%)	-25.7	7.8	-50.3	29.8	56.5	-28.6	23.4	-18.0	1.0	3.7
Non-residential (KSh, millions)	27,846.32	30,457.71	2,691.63	11,661.46	23,255.01	14,329.83	18,230.01	7,201.69	4,880.78	6,147.54
Growth (%)	-4.6	9.4	-91.2	333.2	99.4	-38.4	27.2	23.2	-32.2	26.0
Total (KSh, millions)	61,709.78	66,960.75	20,838.09	35,211.92	60,105.31	40,656.70	50,723.05	17,826.61	15,616.41	17,280.03
Growth (%)	-17.5	8.5	-68.9	69.0	70.7	-32.4	24.8	-5.2	-12.4	10.7

Source: Kenya National Bureau of Statistics

3.6 The Accommodation and Restaurants Sector

Tourist Arrivals

Overall tourist arrivals increased by 60.1 percent in the third quarter of 2018 compared to the previous quarter, owing to the onset of the peak tourist season. The increase was reflected both at the Moi International Airport Mombasa (MIAM) and Jomo

Kenyatta International Airport (JKIA) Nairobi, where tourist arrivals increased by 119.4 percent and 55.2 percent, respectively (Table 3.8).

Table 3.8: Quarterly Tourist Arrival by Point of Entry

	2017				2018**					
	Quarterly				Quarterly			Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jul-18	Aug-18	Sep-18
Total Tourist Arrivals	224,370	213,543	282,463	243,026	236,273	207,677	332,426	126,797	114,989	90,640
Growth (%)	2.3	-4.8	32.3	-14.0	-2.8	-12.1	60.1	65.5	-9.3	-21.2
o.w. JKIA - Nairobi	192,740	202,042	255,337	209,396	192,958	191,830	297,658	115,908	100,698	81,052
Growth (%)	0.4	4.8	26.4	-18.0	-7.9	-0.6	55.2	62.2	-13.1	-19.5
MIAM - Mombasa	31,630	11,501	27,126	33,630	43,315	15,847	34,768	10,889	14,291	9,588
Growth %	16.0	-63.6	135.9	24.0	28.8	-63.4	119.4	111.6	31.2	-32.9

**Provisional

Source: Kenya Tourism Board

3.8 Transport and Storage

Passenger flows through (JKIA) increased by 20.7 percent in the third quarter of 2018 compared to the previous quarter. The increase was reflected in both incoming and outgoing passengers, which were higher by 18.6 percent and 24.1 percent, respectively. The volume of oil that passed through the Kenya Pipeline increased by 13.6 percent in July compared to June 2018 (Table 3.9).

Table 3.9: Quarterly Throughput of Selected Transport Companies

	2017				2018					
	Quarterly				Quarterly			Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jul-18	Aug-18	Sep-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	484,423	507,626	446,217
Growth (%)	- 9.50	9.02	20.82	- 11.73	- 3.35	6.70	20.66	16.13	4.79	- 12.10
o.w. Incoming	638,803	680,989	814,088	734,375	707,536	745,416	884,126	309,532	304,406	270,188
Growth (%)	- 7.42	6.60	19.54	- 9.79	- 3.65	5.35	18.61	16.8	- 1.7	- 11.24
Outgoing	355,334	402,814	495,348	421,503	409,658	446,615	554,140	174,891	203,220	176,029
Growth %	- 13.03	13.36	22.97	- 14.91	- 2.81	9.02	24.08	15.0	16.20	- 13.38
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	N/A	544,063	N/A	N/A
Growth %	5.7	- 1.2	0.8	- 1.2	3.0	- 4.1		13.6		

N/A - Not Available

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

Chapter 4

Global Economy

4.1 Global Economy

Global economic growth remained unchanged at 3.7 percent in 2018 as in 2017 and is projected to grow at the same level in 2019. Economic activity moderated more than expected in some large advanced economies from its strong pace last year, while the emerging market and developing economies continued to expand at broadly the same pace as in 2017 (**Table 4.1**). There have also been an increase in the downside risk. Growth in advanced economies is expected to stabilize at 2.4 percent in 2018 before moderating to 2.1 percent in 2019. There was a significant decline in growth in the Euro area from 2.4 percent in 2017 to 2.0 in 2018 and is projected at 1.9 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 1.7 percent to 1.4 percent in 2018 and 1.5 projected in 2019 was attributed to weather disruption in the first quarter. The US economy maintained robust growth as a result of sizeable fiscal stimulus and a boost from the private sector.

In the emerging markets growth is expected to stabilize at 4.7 for both 2018 and 2019 with Asia exhibiting strong growth supported by domestic demand that led to a pick-up in the Indian economy from 6.7 percent in 2017 to 7.3 and 7.4 percent in 2018 and 2019, respectively. Activity in China moderated to 6.6 in 2018 from 6.9 percent in 2017 due to regulatory tightening of the property sector and non-bank financial intermediation.

Growth in sub-Saharan Africa is expected to improve from 2.7 percent in 2017 to 3.1 percent and 3.8 percent in 2018 and 2019, respectively. Improved growth was mostly notable in fuel-exporting economies due to higher oil prices. The recovery in Latin America continued, though at a more subdued pace than anticipated as tighter financial conditions and drought weighed on growth in Argentina, and a nationwide truckers' strike disrupted production in Brazil.

4.2 Risk to the global economic outlook

Risk and uncertainties to the global economic outlook have continued to intensify. There has been an increase in policy uncertainty like in the case of China and US trade negotiation, a likely no deal Brexit for UK from EU and tightening financial condition in some parts of the world. Other factors include uncertainty surrounding renegotiations of major free trade agreements such as North American Free Trade Agreement (NAFTA), trade tensions which could influence business and financial market sentiments. There was also a reversal of capital flows to emerging market economies which are deemed to have weaker fundamentals and higher political risk.

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	3.3	3.7	3.7	3.7
Advanced economies	1.7	2.3	2.4	2.1
United States	1.6	2.2	2.9	2.5
Euro Area	1.9	2.4	2	1.9
Germany	2.2	2.5	1.9	1.9
France	1.1	2.3	1.6	1.6
Italy	0.9	1.5	1.2	1
Spain	3.2	3	2.7	2.2
Japan	1	1.7	1.1	0.9
United Kingdom	1.8	1.7	1.4	1.5
Emerging market and Developing economies	4.4	4.7	4.7	4.7
Russia	-0.2	1.5	1.7	1.8
China	6.7	6.9	6.6	6.2
India	7.1	6.7	7.3	7.4
Brazil	-3.5	1	1.4	2.4
Middle East, North Africa, Afghanistan and Pakistan	5.1	2.2	2.4	2.7

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

Chapter 5

Balance of Payments and Exchange Rates

Developments in the Balance of Payments

Provisional estimates of the current account deficit shows that it narrowed by 20 percent to USD 1,152

million in the third quarter of 2018 from USD 1,443 million in the third quarter of 2017, mainly driven by improvement in the balance on goods and services (**Table 5.1**).

Table 5.1: Balance of Payments (USD Million)

ITEM	2017*			2018**							Q3 2018-Q3 2017	
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Q3			Total			
	Q2	Q3	Q4	Q1	Q2	July	Aug	Sep	Q3	Change	%	Change
1. Overall Balance	-224	677	518	-2,018	333	-155	80	466	390	-288	-42	
2. Current account	-1,251	-1,443	-1,187	-1,202	-1,251	-494	-412	-246	-1,152	291	-20	
Exports (fob)	1,453	1,413	1,457	1,600	1,584	530	511	469	1,510	98	7	
Imports (fob)	3,925	4,167	3,979	4,036	4,338	1,420	1,393	1,221	4,035	-131	-3	
Services: credit	1,145	1,160	1,139	1,267	1,331	434	468	448	1,350	191	16	
Services: debit	805	816	746	963	983	336	335	279	950	134	16	
Balance on goods and services	-2,132	-2,410	-2,129	-2,133	-2,406	-792	-749	-583	-2,124	286	-12	
Primary income: credit	107	92	101	122	164	43	43	42	129	36	39	
Primary income: debit	336	286	350	292	417	159	134	89	383	96	34	
Balance on goods, services, and primary income	-2,360	-2,604	-2,378	-2,302	-2,659	-908	-840	-630	-2,378	226	-9	
Secondary income: credit	1,124	1,173	1,207	1,111	1,422	420	432	387	1,238	65	6	
o.w Remittances	455	495	565	642	732	214	215	205	633	138	28	
Secondary income: debit	14	12	16	10	14	5	4	3	12	0	1	
3. Capital Account	22	-2	85	83	93	12	12	12	36	38	-1,631	
4. Financial Account	-1,298	-150	-1,085	-3,149	-252	-257	-378	-208	-843	-693	462	

* Revised

**Provisional

Fob - free on board

Source: Central Bank of Kenya

The Current Account

The trade balance improved by 12 percent from a deficit of USD 2,410 million in the third quarter of 2017 to a deficit of USD 2,124 million in the third quarter of 2018, largely reflecting an increase in receipts from merchandise exports, services and secondary transfers, and, a decline in merchandise imports (**Table 5.2**).

The value of merchandise exports increased by 6.9 percent to USD 1,510 million in the third quarter of 2018 largely due to improved receipts from horticulture, chemicals and re-exports. Receipts from horticulture exports improved by 23.9 percent to USD 249 million primarily due to increased earnings from fruit. The growth in exports of fruit particularly avocados is due to improved access to the European market, as more farmers attained the Global Good Agriculture Practices (GGAP) certification. The value of tea exports however declined by 7.6 percent to USD 324 million, due to lower tea prices that prevailed in 2018 than in 2017 following increased production attributed to high precipitation in tea growing areas.

The value of merchandise imports declined by 3.2 percent to USD 4,035 million in the third quarter of 2018 from USD 4,167 million, in the third quarter of 2017, primarily on account of lower food imports. Food imports declined by 55.8 percent from USD

857 million in the third quarter of 2017 to USD 379 million in the third quarter of 2018, due to improved domestic food production as a result of normal weather conditions that prevailed in 2018. However, imports of oil products increased by 31.8 percent from USD 667 million in the third quarter of 2017 to USD 879 million in the third quarter of 2018. This was as a result of higher international crude oil prices that prevailed in the first three quarters of 2018 compared with 2017, due to tight supply conditions and uncertainty surrounding production due to losses in some of the oil producing countries such as Venezuela.

The services account recorded a 16.5 percent improvement to USD 400 million in the third quarter of 2018, from USD 344 million in the third quarter of 2017 mainly on account of higher receipts from transport services (air transport) and travel services (tourism). Improved earnings from tourism were attributed to political stability, improved security in the country, continuous marketing of Kenya by the Government as a tourist destination and gains from Kenya Airways' network expansion (**Table 5.2**).

The balance on the primary account improved by 0.4 percent from a deficit of USD 194 million in the third quarter of 2017 to deficit of USD 254 million in the third quarter of 2018. The balance on secondary income improved by 5.6 percent to USD 1,226 million due to resilient remittance inflows.

Table 5.2: Balance on Current Account (USD Million)

ITEM	2017*						2018**						Q3 2018-Q3 2017	
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-mar	Apr-Jun	Q3			Total			Change	%
	Q1	Q2	Q3	Q4	Q1	Q2	Jul	Aug	Sep	Q3				
CURRENT ACCOUNT	-1,135	-1,251	-1,443	-1,187	-1,202	-1,251	-494	-412	-246	-1,152	291	-20		
Goods	-2,453	-2,472	-2,754	-2,522	-2,436	-2,755	-890	-882	-753	-2,525	229	-8		
Exports (fob)	1,470	1,453	1,413	1,457	1,600	1,584	530	511	469	1,510	98	7		
o.w Coffee	67	81	47	34	51	88	25	16	12	52	5	11		
Tea	345	347	351	382	393	337	121	99	104	324	-27	-8		
Horticulture	205	213	201	210	258	255	94	74	81	249	48	24		
Oil products	13	14	12	12	12	12	5	2	4	11	-1	-6		
Manufactured Goods	98	94	102	98	90	98	27	35	29	91	-12	-11		
Raw Materials	142	133	115	135	154	136	32	47	46	125	10	9		
Chemicals and Related Products (n.e.s)	100	98	110	100	107	107	39	44	38	121	11	10		
Miscellaneous Man. Articles	147	134	157	133	129	159	58	54	48	160	3	2		
Re-exports	153	185	143	157	194	185	64	76	42	183	40	28		
Other	199	155	175	195	211	205	64	64	65	194	19	11		
Imports (fob)	3,923	3,925	4,167	3,979	4,036	4,338	1,420	1,393	1,221	4,035	-131	-3		
o.w Oil	636	651	667	774	769	920	313	334	233	879	212	32		
Chemicals	621	561	563	557	657	615	240	208	185	633	70	12		
Manufactured Goods	619	671	615	619	749	827	253	267	227	747	132	21		
Machinery & Transport Equipment	1,329	1,179	1,106	1,066	1,044	1,256	421	356	348	1,126	20	2		
Machinery	857	764	728	616	646	793	255	222	238	715	-13	-2		
Transport equipment	471	415	378	449	398	463	167	135	110	411	33	9		
Other	604	732	1,052	802	684	526	147	194	172	513	-539	-51		
o.w Food	372	556	857	584	536	407	130	140	108	379	-479	-56		
Services	481	340	344	393	304	348	98	133	169	400	57	17		
Transport Services (net)	137	135	120	200	102	146	39	48	61	148	28	24		
Credit	383	396	397	446	457	472	164	178	154	496	99	25		
Debit	246	261	277	246	355	326	126	130	93	348	71	26		
Travel Services (net)	195	162	147	151	194	223	62	77	71	210	62	42		
Credit	257	228	213	221	257	281	81	95	85	261	49	23		
Debit	62	65	66	69	63	58	19	18	15	52	-14	-21		
Other Services (net)	149	42	77	42	8	-20	-3	8	37	43	-34	-44		
Primary Income	-149	-228	-194	-249	-170	-253	-116	-91	-47	-254	-60	31		
Credit	99	107	92	101	122	164	43	43	42	129	36	39		
Debit	248	336	286	350	292	417	159	134	89	383	96	34		
Secondary Income	987	1,110	1,161	1,191	1,101	1,408	415	427	384	1,226	65	6		
Credit	1,001	1,124	1,173	1,207	1,111	1,422	420	432	387	1,238	65	6		
Debit	14	14	12	16	10	14	5	4	3	12	0	1		

* Revised

**Provisional

Fob - free on board

Source: Central Bank of Kenya

Direction of Trade

Imports from China accounted for 22 percent of total imports to Kenya in the third quarter of 2018, making it the largest source of imports. In value terms, Kenya's imports from China amounted to USD 889 million, an increase from 855 million in the third quarter of 2017. Imports from the European Union accounted for 13.5 percent of total imports, and decreased by 1.3 percent to USD 545 million in third quarter of 2018. The share of imports from Africa increased to 11.9 percent in the third quarter of 2018 from 12.6 percent in the third quarter of 2017, reflecting an increase in imports from the EAC. The share of imports from India increased to 13.3 percent from 7.9 percent, over the same period (Table 5.3).

Table 5.3: Kenya's Direction of Trade: Imports

IMPORTS (USD M)										Imports	
	2018**										
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Q3					
Country	Q2	Q3	Q4	Q1	Q2	July	August	September	Q3	Q2 2018	Q3 2018
Africa	475	526	537	570	504	178	157	145	479	11.6	11.9
<i>Of which</i>											
South Africa	166	165	132	170	171	59	48	32	139	3.9	3.5
Egypt	76	91	86	89	93	36	25	27	88	2.1	2.2
Others	234	270	319	311	240	82	84	86	252	5.5	6.3
										0.0	
EAC	126	139	218	213	173	59	46	51	156	4.0	3.9
COMESA	258	299	347	340	271	96	80	93	269	6.3	6.7
Rest of the World	3,450	3,641	3,442	3,467	3,835	1,243	1,237	1,077	3,556	88.4	88.1
<i>Of which</i>										0.0	
India	466	331	389	473	435	142	147	246	535	10.0	13.3
United Arab Emirates	284	471	362	334	469	81	109	96	287	10.8	7.1
China	962	855	861	867	1,136	351	289	249	889	26.2	22.0
Japan	211	189	207	220	203	91	85	88	265	4.7	6.6
USA	156	130	129	205	104	39	34	35	108	2.4	2.7
United Kingdom	73	71	76	76	76	28	31	22	81	1.8	2.0
Singapore	8	7	20	9	8	3	3	3	8	0.2	0.2
Germany	104	132	95	96	137	41	33	36	111	3.2	2.7
Saudi Arabia	225	194	337	359	424	213	201	45	460	9.8	11.4
Indonesia	123	157	116	106	102	28	52	33	113	2.4	2.8
Netherlands	38	71	43	60	45	13	19	15	47	1.0	1.2
France	84	68	51	53	51	24	18	20	62	1.2	1.5
Bahrain	26	16	19	2	8	0	1	0	1	0.2	0.0
Italy	52	58	44	61	75	15	26	15	56	1.7	1.4
Others	637	892	691	547	560	175	188	171	534	12.9	13.2
Total	3,925	4,167	3,979	4,036	4,338	1,420	1,393	1,221	4,035	100.0	100.0
										0.0	
EU	517	552	472	488	576	198	179	168	545	13.3	13.5
China	962	855	861	867	1,136	351	289	249	889	26.2	22.0

Source: Kenya Revenue Authority

Exports to the rest of the world increased with its share rising from 61.6 percent in the third quarter of 2017 to 64.5 percent in the third quarter of 2018, due to higher exports to Netherlands, United Arab Emirates, United States of America, India and Afghanistan despite decreases in the share of exports to Pakistan and the United Kingdom. The share of exports to

Africa however declined to 35.5 percent in the third quarter of 2018 from 38.4 percent in the third quarter of 2017. This reflected lower exports to the EAC region, with its share declining from 20.5 percent to 19.2 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					
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Q3					
Country	Q2	Q3	Q4	Q1	Q2	July	Aug	Sep	Q3	Q2 2018	Q3 2018
Africa	516	543	543	530	553	170	197	170	537	34.9	35.5
Of which											
Uganda	140	151	144	159	147	45	53	52	150	9.3	9.9
Tanzania	53	73	75	72	74	24	26	23	73	4.7	4.9
Egypt	35	47	60	53	53	14	15	16	45	3.4	3.0
Sudan	17	14	23	18	12	7	4	4	15	0.7	1.0
South Sudan	47	35	35	38	45	8	6	5	19	2.8	1.2
Somalia	46	44	42	39	41	11	13	12	36	2.6	2.4
DRC	45	44	46	35	42	12	12	13	38	2.7	2.5
Rwanda	41	48	39	38	50	15	18	12	45	3.2	3.0
Others	93	88	78	78	89	34	50	32	117	5.6	7.7
EAC	257	290	271	282	286	93	104	94	291	18.0	19.2
COMESA	349	368	367	359	366	118	134	120	371	23.1	24.6
Rest of the World	937	870	914	1,069	1,031	361	314	299	974	65.1	64.5
Of which											
United Kingdom	88	93	95	109	101	37	26	29	92	6.4	6.1
Netherlands	111	89	104	139	114	37	31	37	105	7.2	7.0
USA	121	127	105	91	124	53	48	41	141	7.8	9.4
Pakistan	146	152	170	183	139	53	38	46	137	8.8	9.1
United Arab Emirates	78	56	69	93	89	30	34	22	85	5.6	5.7
Germany	34	21	25	28	35	10	6	7	23	2.2	1.5
India	13	14	14	34	14	11	10	4	25	0.9	1.6
Afghanistan	11	9	4	8	9	7	4	3	14	0.5	0.9
Others	334	310	327	384	406	123	118	110	351	25.7	23.2
Total	1,453	1,413	1,457	1,600	1,584	530	511	469	1,510	100.0	100.0
EU	307	281	289	364	337	118	88	96	302	21.3	20.0
China	39	15	18	16	26	7	6	13	26	1.7	1.7

Source: Kenya Revenue Authority

Capital and Financial Account

The capital account recorded a decrease of USD 36 million in the third quarter of 2018 compared to a decline of USD 2 million in the third quarter of 2017.

The financial account recorded higher net inflows of USD 843 million in the third quarter of 2018, mainly reflecting an increase in Foreign Direct Investment and Other Investment (Table 5.5).

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

ITEM	April- Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Q3			Total		%
	Q2	Q3	Q4	Q1	Q2	Jul	August	September	Q3	Change	Change
Capital account credit	22	-2	85	83	93	12	12	12	36	-58	-62
Capital account credit	22	-2	85	83	93	12	12	12	36	-58	-62
Capital account: debit			0	0	0	0	0	0	0	0	0
Financial Account	-1,298	-150	-1,085	-3,133	-252	-257	-378	-208	-843	-591	234
Direct investment: assets	99	49	36	12	23	5	8	7	19	-4	-16
Direct investment: liabilities	158	161	143	130	270	54	62	267	383	113	42
Portfolio investment: assets	177	192	145	218	317	114	58	94	265	-51	-16
Portfolio investment: liabilities	-22	-107	-1	1,920	-81	-21	-15	-30	-66	15	-18
Financial derivatives: net											
Other investment: assets	9	40	-109	195	662	18	-72	235	182	-480	-73
Other investment: liabilities	1,446	377	1,015	1,508	1,065	360	326	307	993	-72	-7

Source: Central Bank of Kenya

Foreign Exchange Reserves

The banking system's total foreign exchange holdings decreased by 2.0 percent during the third quarter of 2018. Official reserves held by the Central Bank constituted 72 percent of gross reserves and stood at USD 8,545 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-Jul				
	Q1	Q2	Q3	Q4	Q1	Q2	July	August	September	Q3
1. Gross Reserves	10,786	10,984	10,332	9,652	11,859	12,102	12,264	12,099	11,863	11,863
of which:										
Official	8,379	8,580	7,899	7,338	9,362	8,954	9,103	9,013	8,545	8,545
import cover*	5.5	5.7	5.4	5.0	6.3	5.9	6.0	5.9	5.6	5.6
Commercial Banks	2,407	2,405	2,433	2,314	2,497	3,148	3,161	3,086	3,318	3,318
2. Residents' foreign currency deposits	4,503	4,733	5,021	4,949	4,988	5,986	5,959	5,858	5,952	5,952

*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 third quarter of 2018, largely supported by resilient inflows from diaspora remittances and receipts from tourism, tea and horticulture exports. The Kenya Shilling strengthened by 0.1 percent against the US Dollar to exchange at an average of 100.71 during the third quarter compared with 100.75 in the second quarter of 2018. The Kenya Shilling also strengthened against all other major international currencies as well as the EAC Region currencies during the period under review (**Table 5.7 and Chart 5.1**).

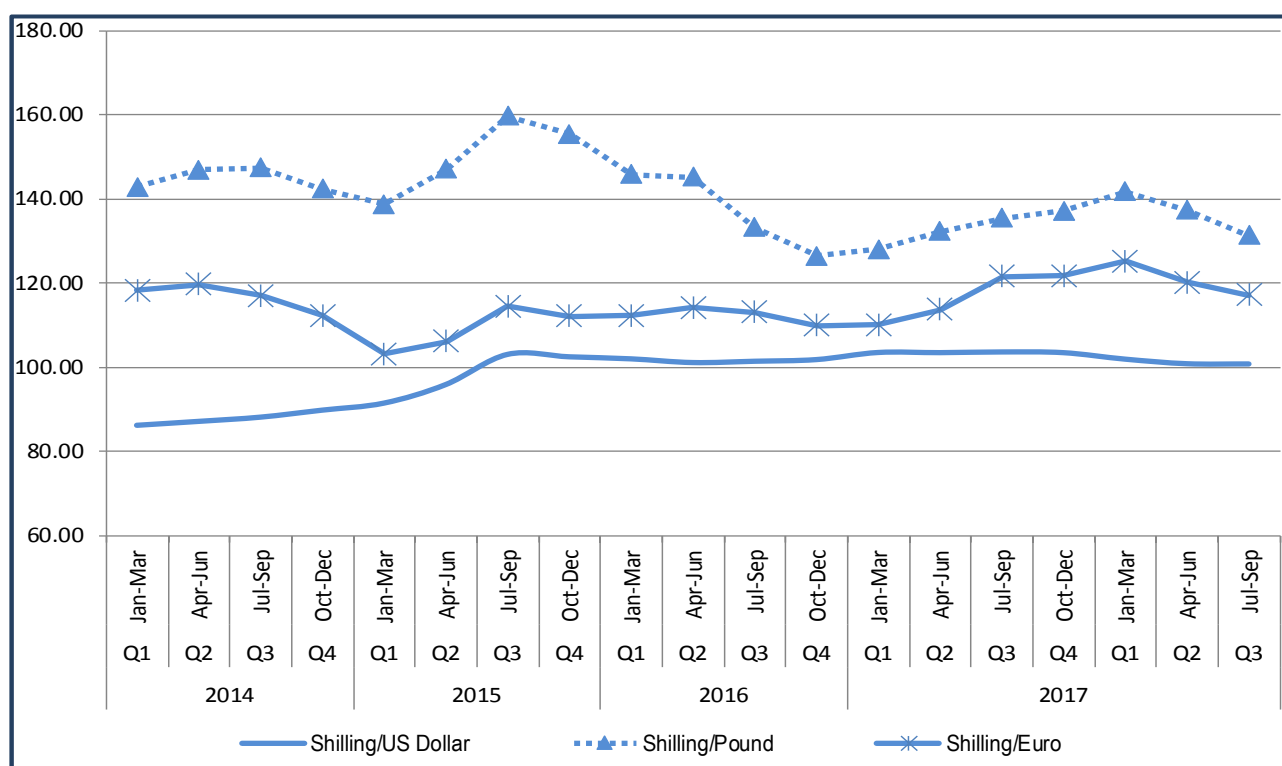
Table 5.7: Kenya Shilling Exchange Rate

		2017		2017							
	Q1	Q2	Q3	Q4	Q1	Q2	July	August	September	Q3	% change Q3 2018 - Q2 2018
US Dollar	103.39	103.36	103.52	103.35	101.86	100.75	100.67	100.61	100.83	100.71	-0.05
Pound Sterling	128.05	132.22	135.40	137.15	141.64	137.26	132.58	129.68	131.65	131.30	-4.34
Euro	110.12	113.75	121.50	121.66	125.11	120.19	117.60	116.25	117.66	117.17	-2.52
100 Japanese Yen	90.95	92.98	93.28	91.60	93.96	92.38	90.35	90.67	90.17	90.40	-2.15
Uganda Shilling*	34.79	34.94	34.80	35.15	35.79	37.24	37.41	37.06	37.70	37.39	0.40
Tanzania Shilling*	21.57	21.63	21.64	21.70	22.10	22.60	22.61	22.71	22.67	22.67	0.29
Rwanda Franc*	7.99	8.04	8.02	8.16	8.39	8.62	8.69	8.72	8.72	8.71	1.09
Burundi Franc*	16.35	16.56	16.79	16.99	17.32	17.50	17.52	17.58	17.60	17.57	0.39

* 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

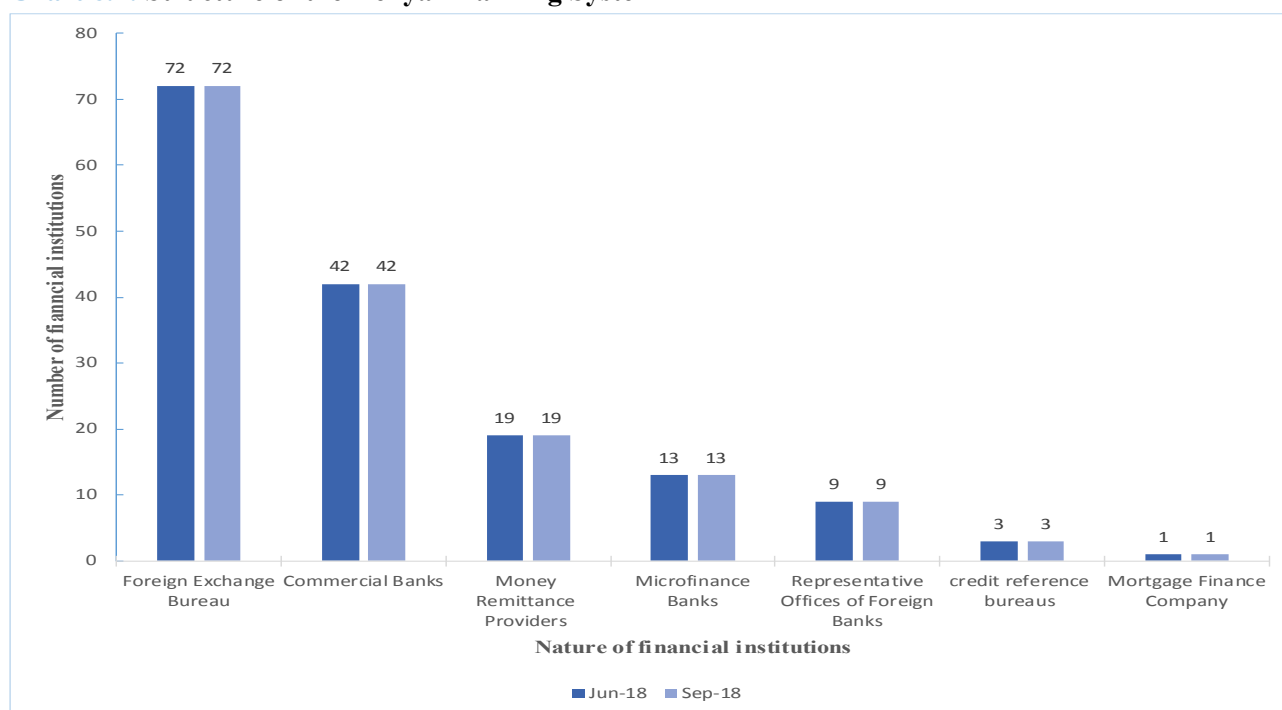
1. Overview

The banking sector was stable and resilient in the third quarter of 2018. Total net assets increased by 3.5 percent while the deposit base increased by 2.5 percent between quarter two and quarter three of 2018. The sector was well capitalized and met the minimum capital requirements. Profitability improved supported by increased total income. Credit risk remained elevated with gross Non-Performing Loans (NPLs) to Gross Loans ratio standing at 12.5 percent in the third quarter of 2018.

2. Size and Structure

The Kenyan banking sector comprised 42 Commercial Banks¹, Mortgage Finance Company, 13 Micro-finance Banks, 9 Representative Offices of Foreign Banks, 72 Foreign Exchange Bureaus, 19 Money Remittance Providers and 3 Credit Reference Bureaus as at September 30, 2018. The structure of the banking sector remained unchanged over the last two quarters (**Chart 6.1**).

Chart 6.1: Structure of the Kenyan Banking System



Source: Central Bank of Kenya

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

3. Structure of the Balance Sheet

i) Growth in banking sector assets

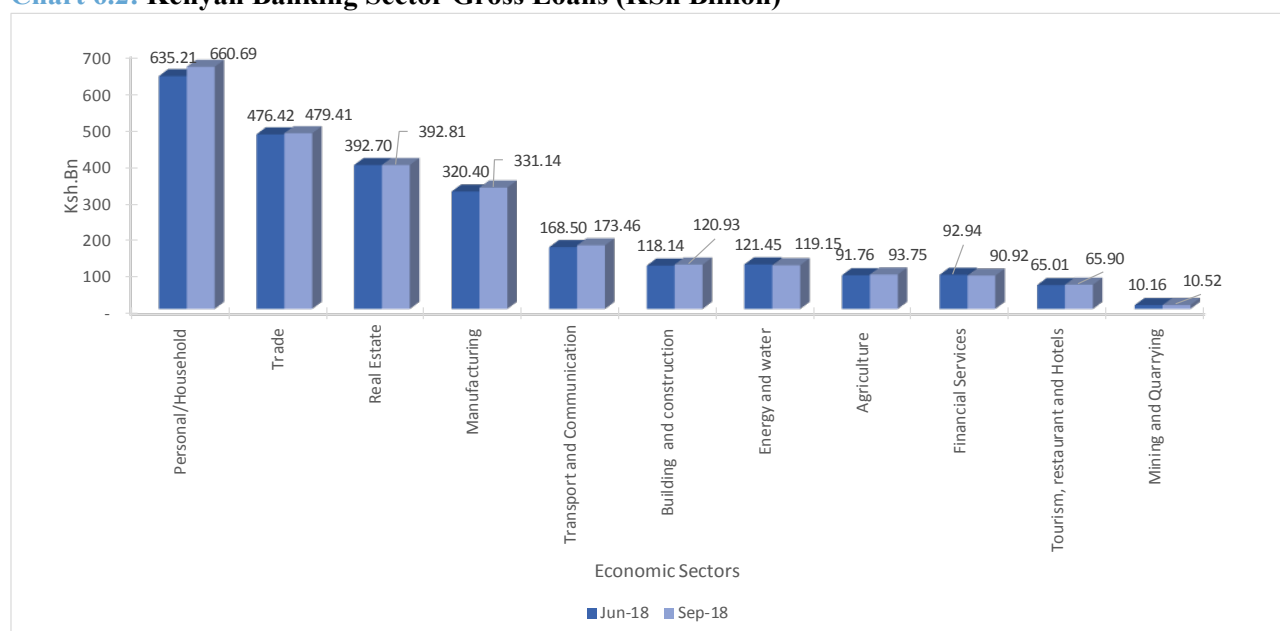
Total net assets increased by 3.5 percent to KSh 4,414.7 billion in the third quarter of 2018 from KSh 4,266.7 billion in the second quarter of 2018. Asset categories that recorded increases are balances at Central Bank (13.91 percent) and placements (10.35 percent). Loans and advances remained as the main component of assets, accounting for 52.72 percent in the third quarter of 2018, a decrease from 53.81 percent recorded in the second quarter of 2018.

Credit Risk

ii) Loans and Advances

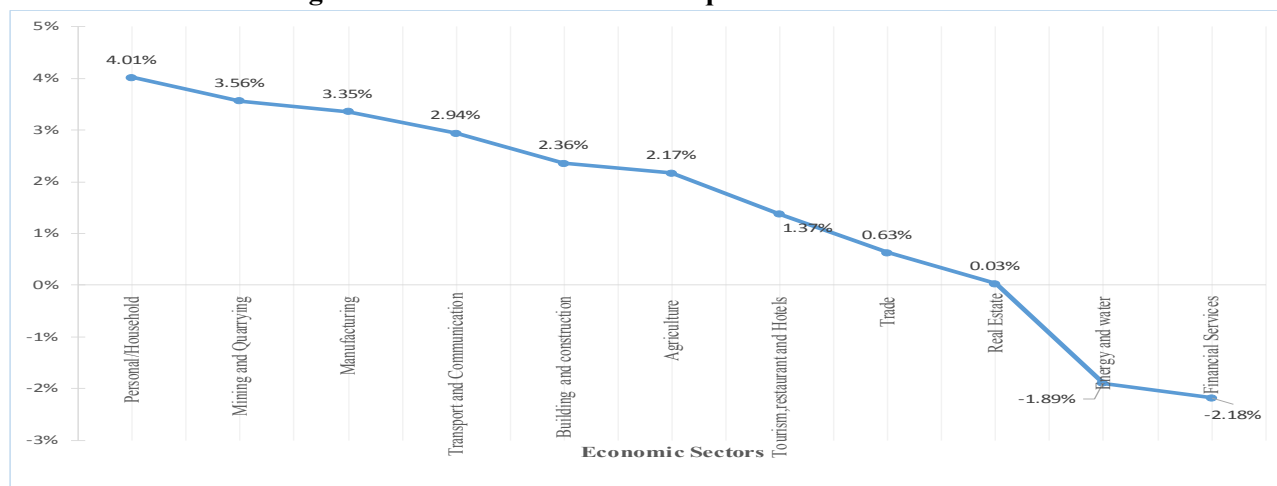
Total banking sector lending increased by 1.8 percent, to KSh 2,538.7 billion in the third quarter of 2018 from KSh 2,492.7 billion in the second quarter of 2018. The increase in gross loans and advances was largely witnessed in the Personal/Household, Manufacturing and Transport and Communication sectors. The sectoral distribution of gross loans as at June 31, 2018 and September 30, 2018 (**Chart 6.2**).

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



Source: Central Bank of Kenya

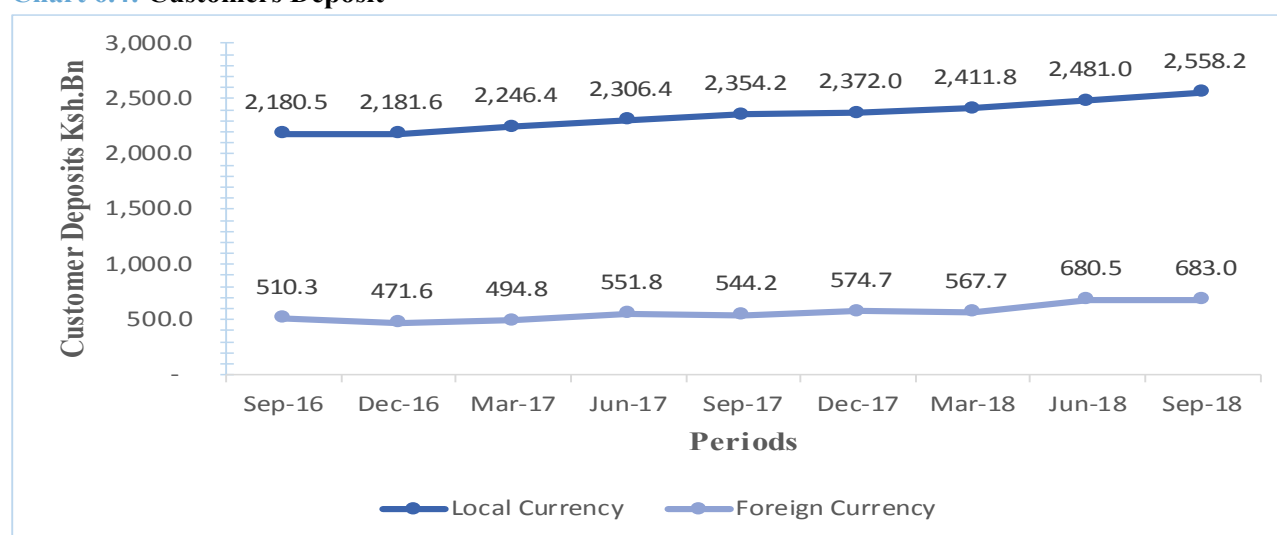
The changes in sectoral gross loans between second quarter of 2018 and third quarter of 2018 are depicted in **Chart 6.3**. The Personal/Household sector recorded the highest increase in lending of KSh 25.49 billion (4.01 percent) during the period under review due to increased loans granted to individual borrowers.

Chart 6.3 Movement in gross loans between 2nd and 3rd quarter of 2018

Source: Central Bank of Kenya

iii) Deposit Liabilities

Customer deposits remained the main source of funding to the banks accounting for 73.4 percent of the banking sector total liabilities and shareholders' funds as at the end of the third quarter of 2018. This was a decrease from 74.1 percent recorded as at the end of the second quarter of 2018. The customer deposit base increased by 2.5 percent to KSh 3,241.2 billion in the third quarter of 2018 from KSh 3,161.5 billion in the second quarter of 2018. **Chart 6.4** shows the trend of deposit liabilities.

Chart 6.4: Customers Deposit

Source: Central Bank of Kenya

4. Capital Adequacy

Kenya's banking sector is well capitalized and meets the minimum capital requirements. Core capital increased by 2.6 percent to KSh 559.2 billion in third quarter of 2018 from KSh 544.9 billion in the second quarter of 2018. Total capital increased by 2.3 percent to KSh 605.7 billion to KSh 591.8 billion over the same period.

Core capital to total risk-weighted assets ratio decreased marginally to 16.2 percent in the third quarter of 2018 from 16.5 percent in the second quarter of 2018. Similarly, total capital to total risk-weighted assets ratio decreased to 17.5 percent from 17.8 percent over the same period.

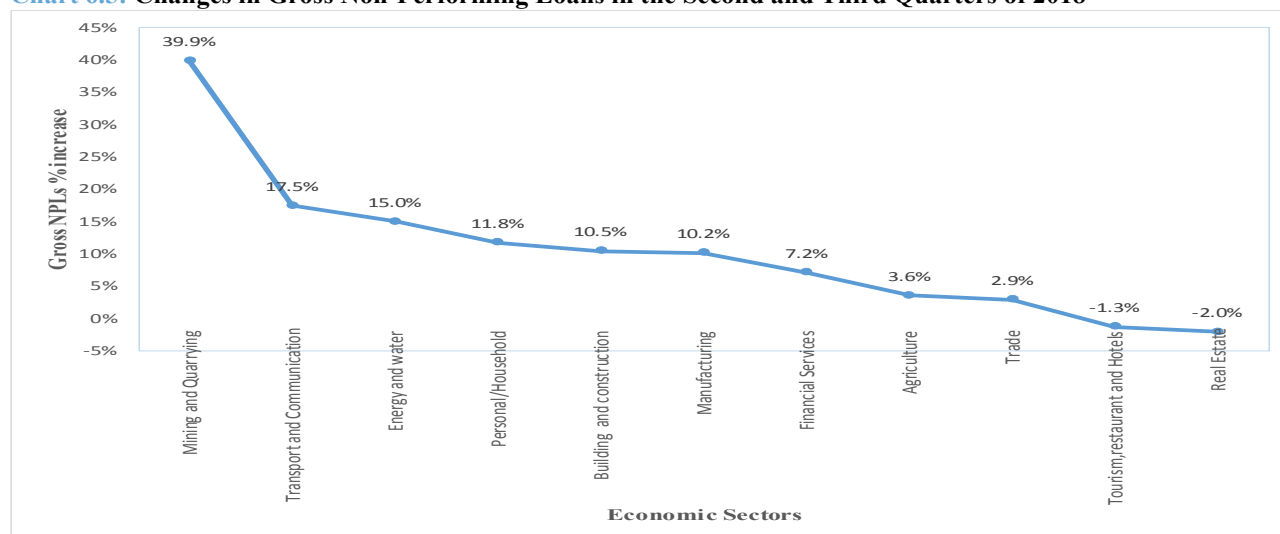
The minimum core capital to total deposits ratio is set at 8 percent. Commercial banks maintained

an adequate buffer, with the ratio standing at 17.3 percent in the third quarter of 2018 compared to 17.2 percent in the second quarter of 2018. The increase was attributable to a higher increase of 2.6 percent in core capital compared to 2.5 percent increase in total deposits between second and third quarters of 2018

5. Asset Quality

The gross non-performing loans (NPLs) increased by 6.5 percent to KSh 317.9 billion as at the end of the third quarter of 2018 from KSh 298.4 billion at the end of the second quarter of 2018. The increase was spread across nine economic sectors as highlighted in Chart 6.5.

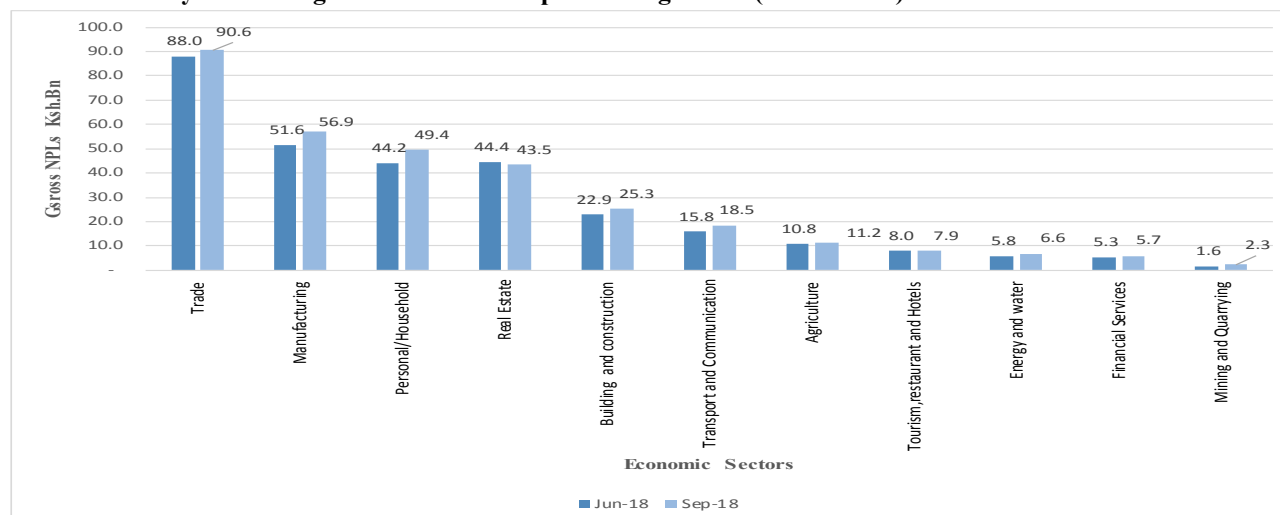
Chart 6.5: Changes in Gross Non-Performing Loans in the Second and Third Quarters of 2018



Source: Central Bank of Kenya

The Mining and Quarrying sector registered the highest percentage in increase in NPLs by Ksh.0.65 billion (39.9 percent) attributable to low business turnover that led to delayed and partial loan repayments. The gross NPLs to gross loans ratio increased to 12.5 percent in the third quarter of 2018 from 11.9 percent in the second quarter of 2018. Chart 6.6 below highlights the detailed sectoral distribution of gross NPLs.

Chart 6.6: Kenyan Banking Sector Gross Non-performing Loans (KSh Billion)



Source: Central Bank of Kenya

The banking sector's asset quality, as measured by the proportion of net non-performing loans to gross loans, improved to 4.2 percent in the third quarter of 2018 from 5.6 percent in the second quarter of 2018. The coverage ratio, which is measured as a percentage of specific provisions to total NPLs, increased to 45.4 percent in third quarter of 2018 from 44.2 percent in second quarter of 2018.

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

Table 6.1: Summary of Asset Quality

		June 2018, KSh Billion	September 2018, KSh Billion
1	Gross Loans and Advances (KSh' Bn)	2,492.7	2,538.7
2	Interest in Suspense (KSh' Bn)	49.2	54.1
3	Loans and Advances (net of interest suspended) (KSh' Bn)	2,443.5	2,484.6
4	Gross Non-Performing loans (KSh 'Bn)	298.4	317.9
5	Specific Provisions (KSh' Bn)	110.1	119.6
6	General Provisions (KSh' Bn)	37.4	37.4
7	Total Provisions (5+6) (KSh' Bn)	147.5	157.0
8	Net Advances (3-7) (KSh' Bn)	2,296.0	2,327.6
9	Total Non-Performing Loans and Advances (4-2) (KSh'Bn)	249.1	263.8
10	Net Non-Performing Loans and Advances (9-5) (KSh 'Bn)	139.0	106.8
11	Total NPLs as % of Total Advances (9/3)	10.2%	10.6%
12	Net NPLs as % of Gross Advances (10/1)	5.6%	4.2%
13	Specific Provisions as % of Total NPLs (5/9)	44.2%	45.4%

Source: Central Bank of Kenya

6. Profitability

The banking sector recorded an increase in pre-tax profits of KSh 0.5 billion (1.3 percent) to KSh 39.0 billion in the third quarter of 2018 from KSh 38.5 billion in the second quarter of 2018. The growth in profitability was mainly attributable to an increase in income of KSh 5.2 billion as compared to an increase in expenses of KSh 4.7 billion.

Interest income on loans and advances, interest on government securities and other incomes were the major sources of income accounting for 51.4 percent, 23.3 percent and 18.4 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 33.4 percent, 24.8 percent and 24.0 percent of total expenses, respectively.

The Return on Assets (ROA) decreased to 2.7 percent in the third quarter of 2018 from 2.8 percent in the second quarter of 2018. Return on Equity (ROE) decreased to 22.8 percent in the third quarter of 2018 from 23.7 percent in the second quarter of 2018. The decreases in ROA and ROE are attributable to a lower increase in profitability compared to the increase in total assets and shareholders' funds. Profitability increased by 1.3 percent, while total assets and

shareholders' funds increased by 3.5 percent and 4.7 percent, respectively.

7. Liquidity

The banking sector's overall liquidity ratio increased to 49.3 percent in the third quarter of 2018 from 48.0 percent recorded in the second quarter of 2018. This was well above the minimum statutory level of 20 percent.

8. Outlook of the Sector

The banking sector is projected to remain stable. Credit risk is expected to remain elevated in the short to medium term as banks put in place measures to mitigate the high level of non-performing loans. Liquidity risk is expected to continue easing as shown by the continued increase in liquidity ratio.

9. 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 1.17 million transaction messages worth KSh 7.38 trillion in the third quarter of 2018, compared to the second quarter of 2018 which recorded 1.16 million transactions worth KSh 7.3 trillion. Volume and value increased by 0.84 percent and 0.68 per cent, respectively. **Chart 6.7** highlights recent trends in KEPSS transactions.

Bank Customer Payments Processed Through KEPSS

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

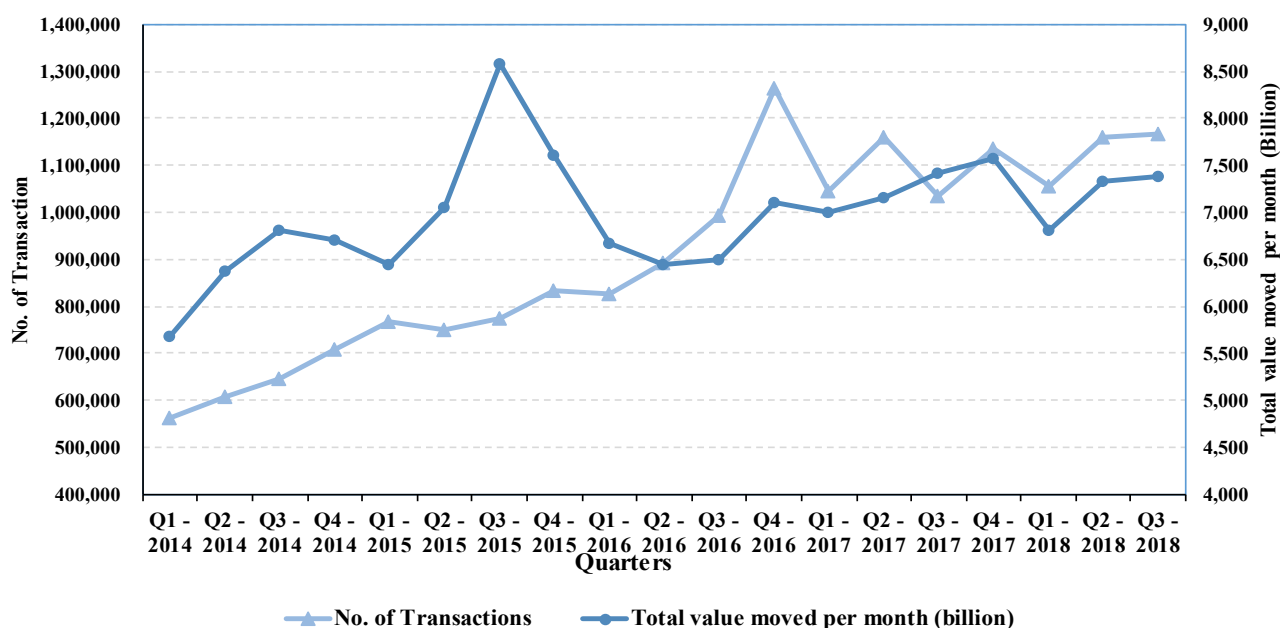
During the period under review, MT 102 usage decreased by 25.52 per cent, to 30,456 messages recorded in the third quarter of 2018 from 40,889 messages processed in the previous quarter. The MT 103 payments increased by 0.50 per cent, to 1,178,123 messages in the third quarter of 2018 from 1,172,258 messages in the previous quarter (**Chart 6.8**).

System Availability

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

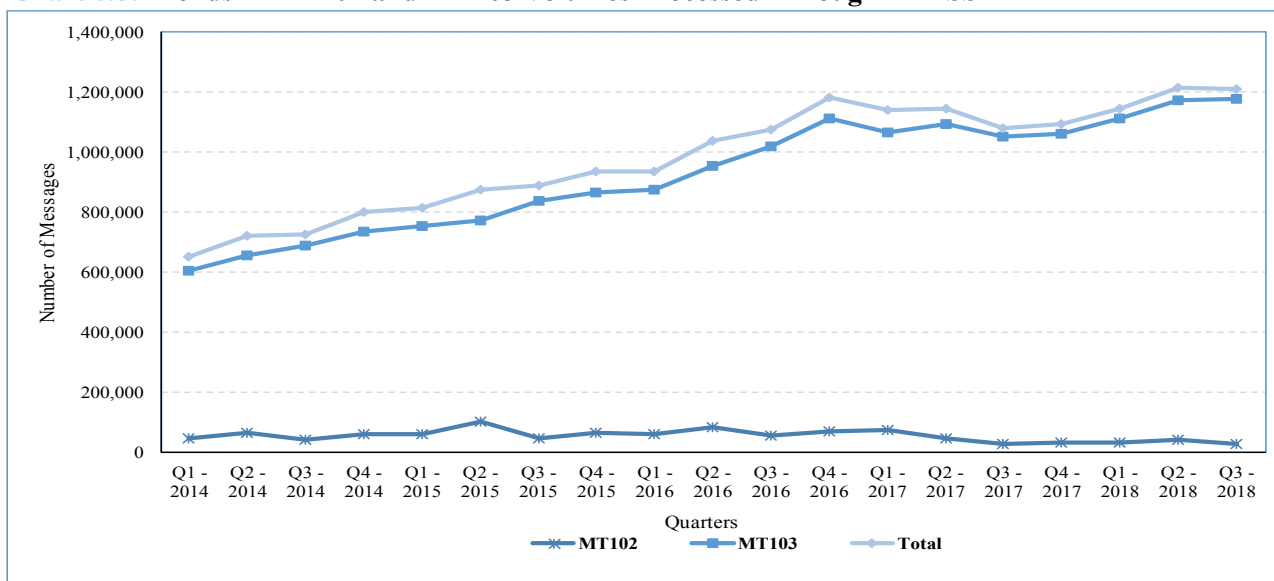
During the quarter under review, KEPSS availability maintained an average 98.98 percent (**Chart 6.9**).

Chart 6.7: Trends in Monthly Flows Through KEPSS



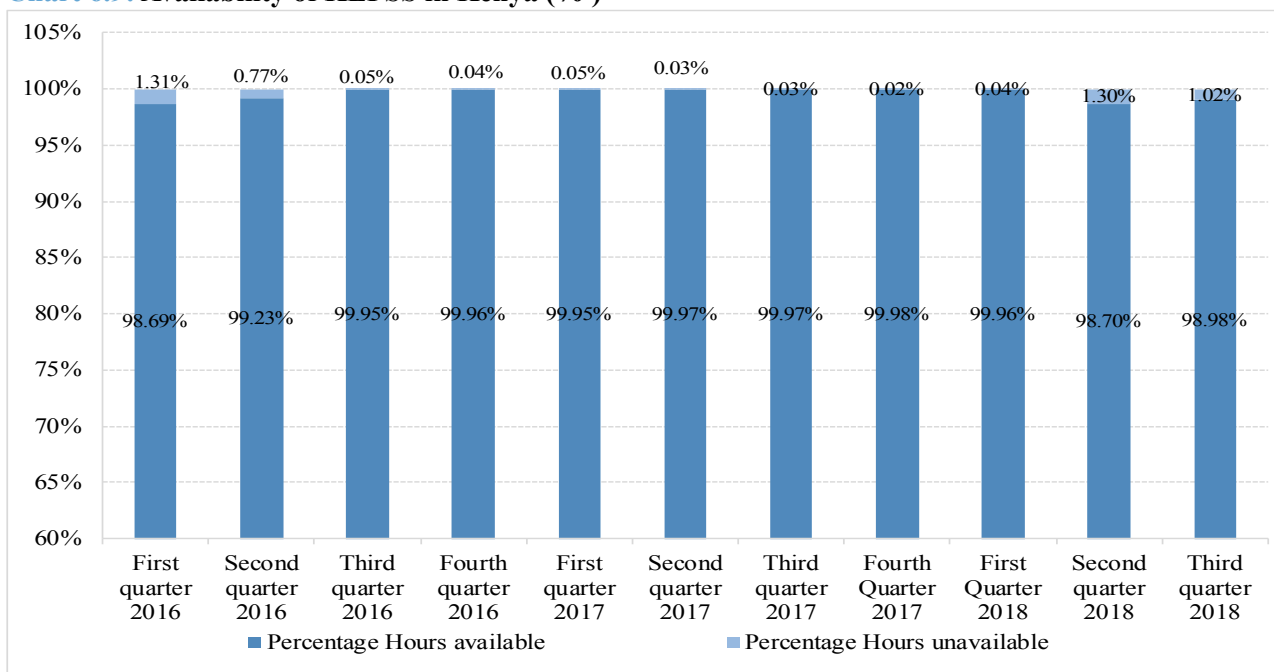
Source: Central Bank of Kenya

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



Source: Central Bank of Kenya

Chart 6.9: Availability of KEPSS in Kenya (%)



Source: Central Bank of Kenya

Chapter 7

Government Budgetary Performance

The Government's budgetary operations at the end of the first quarter of FY 2018/19 resulted in a deficit of 0.8 percent of GDP which was within the target of 0.6 percent of GDP. Both revenues and expenditures were below their respective targets with the shortfall

in total revenues and grants at 17.2 percent and total expenses and net lending at 10.0 percent. Total revenues and grants, total expenses and net lending were below the respective targets by 17.2 percent and 10.0 percent, respectively.

Table 7.1: Statement of Government Operations in FY 2017/18 (KSh Billion)

	FY 2017/18		FY 2018/19						Over (+) / Below (-) Target	% Variance
	Q1	Cumulative to June-18	July	Aug	Sept	Q1	Cumulative to Sept-2018	Target		
1. TOTAL REVENUE & GRANTS	347.2	1,514.8	108.2	116.6	139.4	369.6	369.6	446.4	(76.8)	(17.2)
Ordinary Revenue	320.9	1,365.1	99.0	108.6	124.6	332.2	332.2	400.9	(62.7)	
Tax Revenue	317.4	1,282.9	98.8	106.4	124.2	329.3	329.3	394.9	(65.6)	
Non Tax Revenue	3.5	82.1	0.2	2.3	0.3	2.9	2.9	6.0	(3.1)	
Appropriations-in-Aid	24.6	122.2	9.1	6.4	12.8	33.8	33.8	37.4	(3.7)	
External Grants	1.6	27.6	-	1.5	2.1	3.6	3.6	8.1	(4.5)	
2. TOTAL EXPENSES & NET LENDING	412.3	2,111.5	91.7	161.3	199.5	452.5	452.5	502.9	(50.5)	(10.0)
Recurrent Expenses	299.9	1,319.6	89.5	123.4	132.5	345.4	345.4	360.0	(14.6)	
Development Expenses	90.7	485.7	2.2	33.9	47.5	83.6	83.6	87.8	(4.2)	
County Transfers	20.4	306.2	-	4.0	19.5	23.5	23.5	53.9	(30.4)	
Others	1.3	-	-	-	-	-	-	1.3	(1.3)	
3. DEFICIT (INCL. GRANTS) (1-2)	(65.1)	(596.6)	16.5	(44.7)	(60.1)	(82.9)	(82.9)	(56.6)	(26.3)	46.6
As percent of GDP	(0.8)	(6.7)	0.2	(0.4)	(0.6)	(0.8)	(0.8)	(0.6)		
4. ADJUSTMENT TO CASH BASIS	8.0									
5. DEFICIT INCL. GRANTS ON A CASH BASIS	(57.2)	(596.6)	16.5	(44.7)	(60.1)	(82.9)	(82.9)	(56.6)	(26.3)	
As percent of GDP	(0.7)	(6.7)	0.2	(0.4)	(0.6)	(0.8)	(0.8)	(0.6)		
6. DISCREPANCY: Expenditure (+) / Revenue (-)	-									
7. FINANCING	57.2	608.0	26.8	52.7	6.6	86.0	86.0	56.6	29.5	52.2
Domestic (Net)	49.2	273.7	28.3	33.6	7.4	69.2	69.2	40.7	28.5	
External (Net)	7.5	331.6	(1.5)	19.1	(0.8)	16.8	16.8	14.9	1.9	
Capital Receipts (domestic loan receipts)	-	-	-	-	-	-	-	1.0	(1.0)	
Others	0.5	2.6	-	-	-	-	-	-	-	

GDP figures from Provisional Budget Outturn-Sept 2018

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

Revenue

The Government receipts, comprising of revenue and grants rose by 6.5 percent to KSh 369.6 billion in the first quarter of FY 2018/19, compared to KSh 347.2 billion in the first quarter of the FY 2017/18. The increase was reflected across all revenue categories.

There was a minor shift in the composition of tax revenues in the first quarter of FY 2018/19 compared with a similar quarter in the previous financial year (**Chart 7.1**). The composition of Value Added Tax, Import Duty and Excise Duty rose marginally by 0.9 percentage points, 1.2 percentage points and 0.3 percentage points respectively, while Income tax and Other taxes decreased by 1.2 percentage points each.

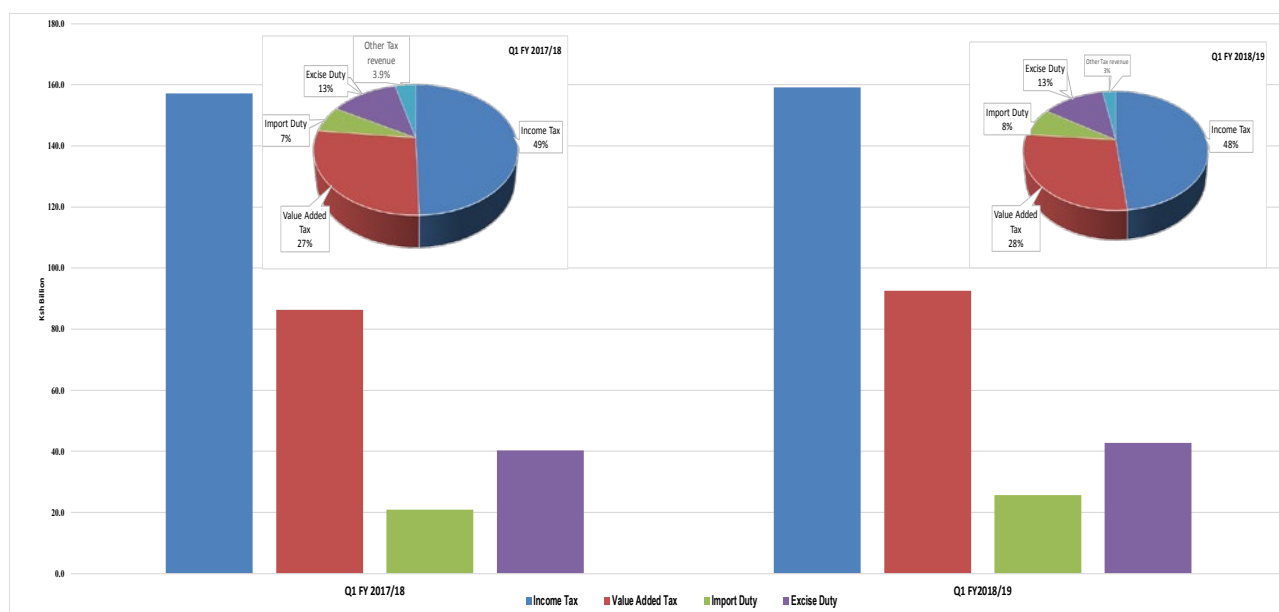
Cumulatively, total government revenue and grants was KSh 369.6 billion (3.7 percent of GDP) in the

FY2017/18 against a target of KSh 446.4 billion (4.5 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 quarter of the FY 2018/19 amounted to KSh 3.6 billion, which was KSh 4.5 billion lower than expected, due to slow absorption of donor funds which is common in the first quarter of every year

Meanwhile, ministerial Appropriations in Aid (A-in-A) collected during the first quarter of FY 2017/18 amounted to KSh 33.8 billion, which was KSh 3.7 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 2017/18 for similar reasons.

Chart 7.1: Composition of Government Revenue FY 2017/18 (Ksh Billion)



Source: Provisional Budget Out-turn from The National Treasury

Expenditure and Net Lending

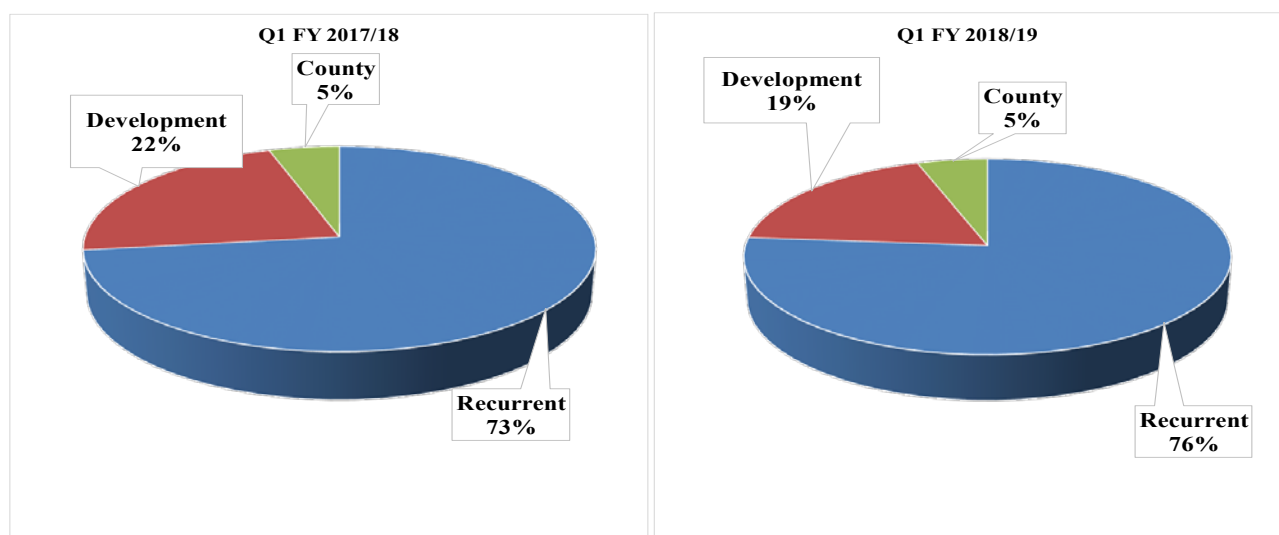
Government expenditure and net lending increased by 9.7 percent to KSh 452.5 billion in the first quarter of the FY 2018/19 compared to KSh 412.3 billion in the first quarter of the FY 2017/18. The increase in expenditures reflected National Government recurrent expenditures and county transfers which increased by 15.2 each, respectively in the quarter under review. Development expenditure declined by 7.9 percent in the first quarter of FY 2018/19 compared to a similar period in previous year.

In terms of composition, recurrent expenditure accounted for 76 percent of total government expenditure in the first quarter of FY 2018/19, which is 3 percentage points higher than the level recorded

in a similar quarter in the previous year. Conversely, the share of development expenditure declined by 3 percentage points (**Chart 7.2**).

Cumulatively, expenditure and net lending in the first quarter FY 2018/19 amounted to KSh 452.5 billion (4.5 percent of GDP), against a target of KSh 502.9 billion (5.0 percent of GDP). The shortfall of KSh 50.5 billion was attributed to lower absorption of both recurrent and development expenditures by the National Government and County Governments, as is typical of the first quarter in past fiscal years.

Chart 7.2: Composition of Recurrent Expenses FY 2017/18



Sources: Provisional Budget Outturn from The National Treasury

Financing

The budget deficit including grants amounted to KSh 82.9 billion or 0.8 percent of GDP at the end of the first quarter of FY 2018/19. The deficit financing mix was 80 percent and 20 percent domestic and external resources, respectively. The domestic borrowing comprised KSh 10.4 billion draw down of Government deposits held at the Central Bank,

KSh 45.7 billion from commercial banks, KSh 33.7 billion from Non-banking financial institutions and KSh 0.2 billion from Non-Residents (**Table 7.2**). Net domestic borrowing at the end of the first quarter of FY 2018/19 was above target by KSh 28.5 billion and external financing was also KSh 1.9 billion above the expected target.

Table 7.2 Domestic Financing up to September 2018

	FY 2017/18												FY 2018/19		
	Q1			Q2			Q3			Q4					
	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18		
1. From CBK	8.3	60.6	77.4	108.9	29.3	45.6	(80.2)	(32.5)	(62.0)	(26.3)	(30.8)	11.4	(10.4)		
2. From commercial banks	12.6	9.8	2.9	(2.9)	7.3	61.7	77.5	93.2	115.0	124.3	52.0	44.7	45.7		
4. From Non-banks	26.3	51.2	75.7	74.4	90.4	108.2	125.1	150.3	155.8	172.8	5.1	7.2	33.7		
5. From Non-Residents	1.9	2.8	2.7	3.2	2.6	3.2	3.2	3.5	3.3	3.0	0.6	0.6	0.2		
Change in Credit from banks (From 30th June 2018)	20.9	70.4	80.4	106.0	36.6	107.3	(2.7)	60.6	53.0	97.9	21.1	56.2	35.4		
Change in Credit from non-banks (From 30th June 2018)	26.3	51.2	75.7	74.4	90.4	108.2	125.1	150.3	155.8	172.8	5.1	7.2	33.7		
Change in Credit from non-residents (From 30th June 2018)	1.9	2.8	2.7	3.2	2.6	2.7	3.2	3.5	3.3	3.0	0.6	0.6	0.2		
6. Total Change in Dom. Credit (From 30th June 2018)	49.2	124.4	158.8	183.6	129.6	218.2	125.6	214.4	212.1	273.7	26.8	64.0	69.2		

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 Review and Outlook Paper (BROP) 2018 for the FY 2018/19, total revenue is projected to be KSh 1,899 billion (19.0 percent of GDP) while external grants are projected at KSh 46 billion. Government expenditure is projected at KSh 2,474 billion (24.8 percent of GDP), of which KSh 1,541 billion will be for recurrent expenses, KSh 305 billion for transfers to county governments, and KSh 623 billion for development expenses.

The overall budget deficit including grants on commitment basis is, therefore, projected to be KSh 576 billion (5.8 percent of GDP) in 2018/19, to be financed through net external borrowing of KSh 272.0 billion and net domestic borrowing of KSh 300 billion.

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

	Ksh (Billion)	%age of GDP
1. TOTAL REVENUE (Including Grants)	1,899	19.0
Total Revenue	1,853	18.5
Appropriations-in-Aid	180	1.8
External Grants	46	0.5
2. TOTAL EXPENSES & NET LENDING	2,474	24.8
Recurrent Expenses	1,541	15.4
Development Expenses	623	6.2
County Transfer	305	3.1
Contingency Fund	5	0.1
3. DEFICIT INCL. GRANTS (1-2)	576	5.8
4. FINANCING	576	5.8
Domestic (Net)	300	3.0
External (Net)	272	2.7
Domestic loan repayments(receipts)	4	0.0

Budget Review and Outlook Paper -September 2018

Source: The National Treasury

Chapter 8

Public Debt

Overall Public Debt

Kenya's public and publicly guaranteed debt recorded moderate increase of 2.1 percent during the first quarter of the FY 2018/19 with both domestic and external debt increasing at 1.8 percent and 2.5 percent respectively during the quarter. The buildup in public debt was slower relative to the projected rate of economic expansion, hence the decline in the

ratio of publicly and publicly guaranteed debt to GDP by 0.5 percentage points to 56.5 percent compared with the previous quarter. Correspondingly, external debt and domestic debt ratio to GDP decreased by 0.3 percentage points and 0.2 percentage points, respectively, in the first quarter of the FY 2018/19. (Table 8.1)¹.

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

	2016/17				2017/18				2018/19			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Jul-18	Aug-18	Q1	Change Q on Q
EXTERNAL												
Bilateral	580.4	577.8	689.1	722.6	742.1	782.6	800.9	821.0	811.6	813.3	812.5	-8.4
Multilateral	799.7	781.3	806.9	844.4	842.8	841.8	836.8	816.1	857.1	860.1	877.7	61.6
Commercial Banks	442.8	458.1	594.1	712.1	708.2	707.8	858.1	906.4	915.7	921.3	898.3	-8.0
Supplier Credits	15.5	15.3	11.2	15.3	17.1	17.1	16.7	16.7	16.6	16.7	16.7	0.0
Sub-Total	1,838.4	1,832.4	2,101.4	2,294.4	2,310.2	2,349.3	2,512.4	2,560.2	2,601.1	2,611.4	2,605.3	45.1
(As a % of GDP)	26.1	25.5	28.4	29.8	30.1	30.3	31.5	28.9	28.6	28.7	28.6	
(As a % of total debt)	49.8	48.7	51.9	52.1	51.5	51.4	51.4	50.8	50.9	51.2	50.6	
DOMESTIC												
Banks	1,028.7	1,032.6	1,061.1	1,196.4	1,223.5	1,221.7	1,320.4	1,377.2	1,406.2	1,384.2	1,405.5	28.3
Central Bank	58.9	85.5	85.3	54.5	79.2	96.8	93.6	110.8	80.3	69.0	90.2	-20.6
Commercial Banks	969.8	947.0	975.8	1,141.9	1,148.3	1,124.9	1,226.9	1,266.5	1,325.9	1,315.3	1,315.3	48.9
Non-banks	813.8	884.8	862.3	893.2	925.0	973.2	1,025.7	1,076.3	1,081.5	1,083.5	1,109.8	33.5
Pension Funds	493.8	544.9	549.2	593.5	592.7	611.2	641.8	671.5	671.4	675.3	689.1	17.6
Insurance Companies	136.4	143.2	138.9	138.9	134.7	142.7	150.9	154.5	154.5	154.1	154.1	-0.4
Other Non-bank Sources	183.6	196.7	174.2	160.8	197.5	219.3	232.9	250.2	255.6	254.1	266.5	16.2
Non-residents	12.0	13.6	21.5	22.1	24.1	25.4	25.5	25.3	26.0	26.0	25.4	0.1
Sub-Total	1,854.6	1,931.0	1,945.0	2,111.7	2,176.6	2,220.3	2,371.7	2,478.8	2,513.6	2,493.7	2,540.7	61.9
(As a % of GDP)	26.4	26.8	26.2	27.4	28.4	28.7	29.7	28.0	27.6	27.4	27.9	
(As a % of total debt)	50.2	51.3	48.1	47.9	48.5	48.6	48.6	49.2	49.1	48.8	49.4	
GRAND TOTAL	3,693.0	3,763.4	4,046.3	4,406.1	4,486.8	4,569.6	4,884.1	5,039.0	5,114.7	5,105.1	5,146.0	107.0
(As a % of GDP)	52.5	52.3	54.6	57.3	58.4	59.0	61.2	57.0	56.2	56.1	56.5	

Source: The National Treasury and Central Bank of Kenya

Domestic Debt

Total domestic debt build up during the quarter under review registered a lower growth relative to the 4.5 percent build up in the previous quarter. This depressed uptake of government securities was associated with low budget execution synonymous with first quarter of the financial year. Consequently, investor's preferences shifted to shorter dated securities hence the 7.5 percent increase in the uptake of Treasury bills. The share of domestic debt to total debt increased from 49.2 percent at the end of the fourth quarter to 49.4 percent by the end of the first

quarter of the FY 2018/19. The proportion of debt securities to total domestic debt increased by 0.9 percentage points during the quarter under review. The increase in the share of debt securities to total domestic debt was majorly on account of an offsetting effect arising from the slowdown in the utilization of the government overdraft facility at the Central Bank from 86.5 percent in June 2018 to 55.3 percent in September 2018.

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		Proportions			Proportions								
	FY 2017/18			FY 2018/19			Ksh (Bn)	%	Q4	Jul-16	Aug-16	FY 2017/18				FY 2018/19				
	Q2	Q3	Q4	Jul-18	Aug-18	Q1						Q1	Q2	Q3	Q4	Jul-18	Aug-18	Q1		
Total Stock of Domestic Debt (A+B)	2,220.3	2,371.7	2,478.8	2,513.6	2,493.7	2,540.7	61.9	2.5	100.0	100.0	100.0	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	2,455.2	2,446.9	2,472.9	82.4	3.4	95.9	97.5	97.5	97.0	96.7	97.0	96.4	97.7	98.1	97.3		
1. Treasury Bills (excluding Repo Bills)	684.7	772.7	878.6	946.2	922.5	944.1	65.5	7.5	32.4	31.9	32.0	33.3	30.8	32.6	35.4	37.6	37.0	37.2		
Banking institutions	363.9	436.2	502.6	565.1	551.5	558.1	55.5	11.0	19.9	19.5	19.2	19.0	16.4	18.4	20.3	22.5	22.1	22.0		
The Central Bank	20.6	20.6	20.6	20.6	20.6	20.6	0.0	0.0	1.1	1.1	1.1	0.9	0.9	0.9	0.8	0.8	0.8	0.8		
Commercial Banks	343.3	415.6	482.0	544.5	530.9	537.5	55.5	11.5	18.8	18.3	18.0	18.0	15.5	17.5	19.4	21.7	21.3	21.2		
Pension Funds	159.2	159.2	180.1	178.5	170.2	187.4	7.2	4.0	6.5	6.6	6.6	7.9	7.2	6.7	7.3	7.1	6.8	7.4		
Insurance Companies	18.2	20.5	21.2	21.8	21.2	20.0	-1.2	-5.6	1.0	1.0	0.8	0.7	0.8	0.9	0.9	0.9	0.9	0.8		
Others	143.4	156.8	174.7	180.8	179.5	178.6	3.9	2.2	5.0	4.9	5.4	5.8	6.5	6.6	7.0	7.2	7.2	7.0		
2. Treasury Bonds	1,461.2	1,527.8	1,511.9	1,509.0	1,524.5	1,528.8	16.9	1.1	63.5	65.6	65.5	63.7	65.8	64.4	61.0	60.0	61.1	60.2		
Banking institutions	783.5	813.2	786.4	782.7	786.0	779.6	-6.7	-0.9	31.4	32.4	32.3	34.5	35.3	34.3	31.7	31.1	31.5	30.7		
The Central Bank	9.4	9.4	9.4	9.4	9.4	9.4	0.0	0.0	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4		
Commercial Banks	774.1	803.8	776.9	773.3	776.6	770.2	-6.7	-0.9	30.9	31.8	31.8	34.0	34.9	33.9	31.3	30.8	31.1	30.3		
Insurance Companies	124.4	130.4	133.3	132.8	132.8	134.2	0.8	0.6	6.4	6.6	6.6	5.5	5.6	5.5	5.4	5.3	5.3	5.3		
Pension Funds	452.1	482.6	491.4	492.9	501.2	510.1	18.6	3.8	19.3	20.2	20.2	19.4	20.4	20.3	19.8	19.6	20.1	20.1		
Others	101.2	101.6	100.8	100.6	104.4	104.9	4.2	4.1	6.3	6.4	6.5	4.4	4.6	4.3	4.1	4.0	4.2	4.1		
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	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	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	0.0	0.0		
4. Frozen account	24.4	23.9	23.9	23.9	23.9	23.9	0.0	0.0	1.4	1.4	1.4	1.1	1.1	1.0	1.0	1.0	1.0	0.9		
Of which: Repo T/Bills	23.8	23.3	23.3	23.3	23.3	23.3	0.0	0.0	1.4	1.4	1.4	1.1	1.1	1.0	0.9	0.9	0.9	0.9		
B. Others:	49.9	47.2	64.4	34.5	22.9	44.0	-20.5	-31.8	2.7	1.1	1.1	1.9	2.2	2.0	2.6	1.4	0.9	1.7		
Of which CBK overdraft to Government	42.3	39.7	56.8	26.3	15.1	36.3	17.2	30.2	2.4	0.8	0.7	1.1	1.9	1.7	2.3	1.0	0.6	1.4		

Source: Central Bank of Kenya

Treasury Bills

Treasury bill holdings, excluding those held by the CBK for open market operations (Repos) recorded 7.5 percent increase during the first quarter of the FY 2018/19 due to increased investors' preference for short-term tenor securities. Similarly, the proportion of Treasury bills to total domestic debt increased by 1.8 percentage points during the period under review. The dominance of Commercial banks in Treasury bills market persisted with their holdings standing at 56.9 percent of the total amount of outstanding Treasury Bills by the end of the first quarter of the FY 2018/19. Other significant holders of Treasury bills included Pension funds (19.8percent) and parastatals-included in other holders (13.3 percent). The persistent dominance of commercial banks in the government securities' market characterizes moderate underdevelopment of other institutional investors' sectors (Pension funds, foreign investors and insurance companies).

Treasury Bonds

Treasury bond holdings increased by 1.1 percent during the first quarter of the FY 2018/19, compared to the 1.0 percent decline in the previous quarter despite the shift in investor preference towards shorter tenor securities. The largest component of this accumulation was the proceeds from a 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.

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

		Kshs (Billions)						Change Q on Q		Proportions							
		2017/18			2018/19			Q1 2018/19		2017/18				2018/19			
		Q1	Q2	Q3	Q4	Jul-18	Aug-18	Q1	Kshs(Bn)	%	Q1	Q2	Q3	Q4	Jul-18	Aug-18	Q1
Treasury bills	91-Day	35.9	46.0	48.5	46.9	50.2	39.9	49.8	3.0	6.4	1.6	2.1	2.0	1.9	2.0	1.6	2.0
	182-Day	254.9	190.9	202.1	258.3	245.7	223.8	216.9	-41.4	-16.0	11.7	8.6	8.5	10.4	9.8	9.0	8.5
	364-Day	434.0	447.8	522.1	573.5	650.3	658.8	677.4	103.9	18.1	19.9	20.2	22.0	23.1	25.9	26.4	26.7
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	102.8	113.9	93.8	63.6	63.6	63.6	63.6	0.0	0.0	4.7	5.1	4.0	2.6	2.5	2.5	2.5
	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	302.3	323.0	346.1	307.2	307.2	307.2	307.2	0.0	0.0	13.9	14.5	14.6	12.4	12.2	12.3	12.1
	6-Year	8.5	8.5	8.5	8.5	8.5	8.5	8.5	0.0	0.0	0.4	0.4	0.4	0.3	0.3	0.3	0.3
	7-Year	8.7	50.1	50.1	50.1	50.1	50.1	50.1	0.0	0.0	0.4	2.3	2.1	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	1.5	1.4	1.4	1.3	1.4	1.3
	9-Year	76.5	76.5	76.5	76.5	76.5	76.5	76.5	0.0	0.0	3.5	3.4	3.2	3.1	3.0	3.1	3.0
	10-Year	280.9	272.5	265.5	265.5	252.0	271.3	270.4	5.0	1.9	12.9	12.3	11.2	10.7	10.0	10.9	10.6
	11-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
	12-Year	133.2	133.2	133.2	133.2	133.2	129.3	129.3	-3.9	-2.9	6.1	6.0	5.6	5.4	5.3	5.2	5.1
	15-Year	286.7	291.4	353.6	386.8	386.8	386.8	386.8	0.0	0.0	13.2	13.1	14.9	15.6	15.4	15.5	15.2
	20-Year	104.9	104.9	113.4	128.1	138.8	138.8	144.0	15.8	12.4	4.8	4.7	4.8	5.2	5.5	5.6	5.7
	25-Year	20.2	20.2	20.2	25.3	25.3	25.3	25.3	0.0	0.0	0.9	0.9	0.9	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	1.3	1.2	1.1	1.1	1.1	1.1
Repo T bills	Repo T bills	23.8	23.8	23.3	23.3	23.3	23.3	23.3	0.0	0.0	1.1	1.1	1.0	0.9	0.9	0.9	0.9
	Overdraft	24.7	42.3	39.7	56.8	26.3	15.1	36.3	-20.6	100.0	1.1	1.9	1.7	2.3	1.0	0.6	1.4
Other Domestic debt		11.5	8.2	8.2	8.2	8.8	8.4	8.3	0.1	0.9	0.5	0.4	0.3	0.3	0.3	0.3	0.3
Total Debt		2,176.6	2,220.3	2,371.7	2,478.8	2,513.6	2,493.7	2,540.7	61.9	2.5	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Kenya

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 76.7 percent of the total of outstanding Treasury Bonds, a 0.6 percentage points increase from the position in 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 and 2 months in the first quarter of the FY 2018/19. The refinancing risk worsened as the Treasury bills component in the domestic debt profile increased (37.2 percent from 35.4 percent in June 2018).

External Debt

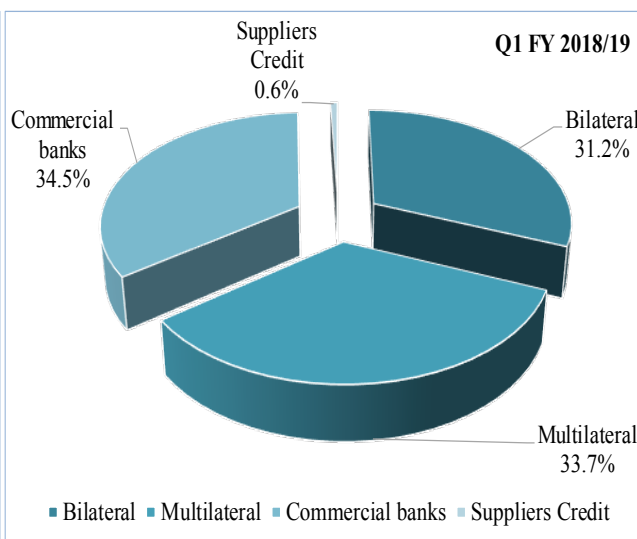
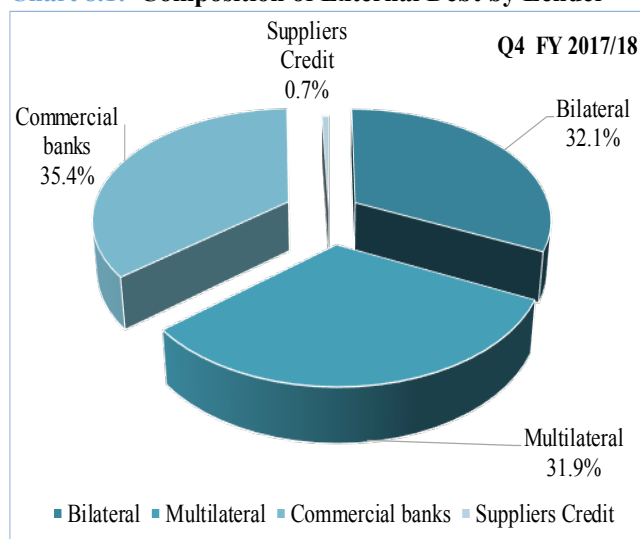
Public and publicly guaranteed external debt increased by 2.5 percentage points during the first quarter of the FY 2018/19. External debt accumulation during the quarter under review was mainly driven by disbursements of concessional debt from International Development Association (IDA) to finance several projects in the energy and roads sectors. 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 reduce the amount of concessional debt and increase in commercial and semi-concessional loans. During the quarter under review, this trend was reversed with the share of outstanding debt from official multilateral and bilateral lenders (who provide both concessional and semi-concessional loans) increasing by 0.9 percentage points from the 64.0 percent in the previous quarter to 64.9 percent by the end of the first quarter of the FY 2018/19. Consequently, the share of commercial debt decreased by 0.9 percentage points to 34.5 percent. This shift in the composition of external debt was mainly on account of loan disbursements from International Development Association (IDA) (**Chart 8.1**).

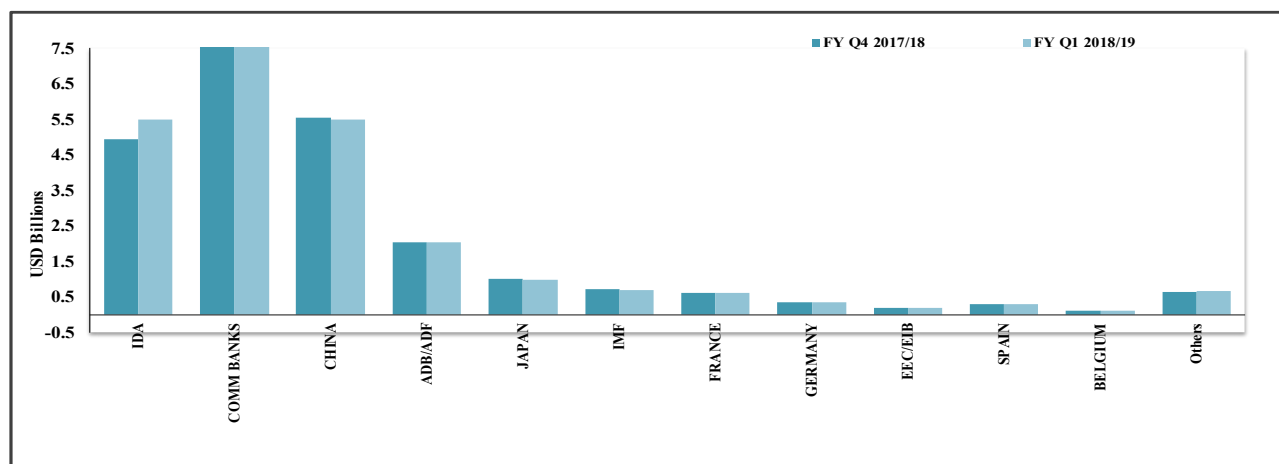
Debt owed to the International Development Association (IDA), Kenya's largest multilateral lender, amounted to US D 5.499 billion or 21.3 percent of total external debt while that owed to China, Kenya's largest bilateral lender, amounted to US D 5.497 billion, or 21.2 percent of the total external debt in the first quarter of the FY 2018/19 (**Chart 8.2**). The increase in the proportion of external debt held by leading multilateral and bilateral lenders underscores government's commitment to ensuring sustainable debt levels.

Chart 8.1: Composition of External Debt by Lender



Source: The National Treasury

Chart 8.2: External Debt By Creditor



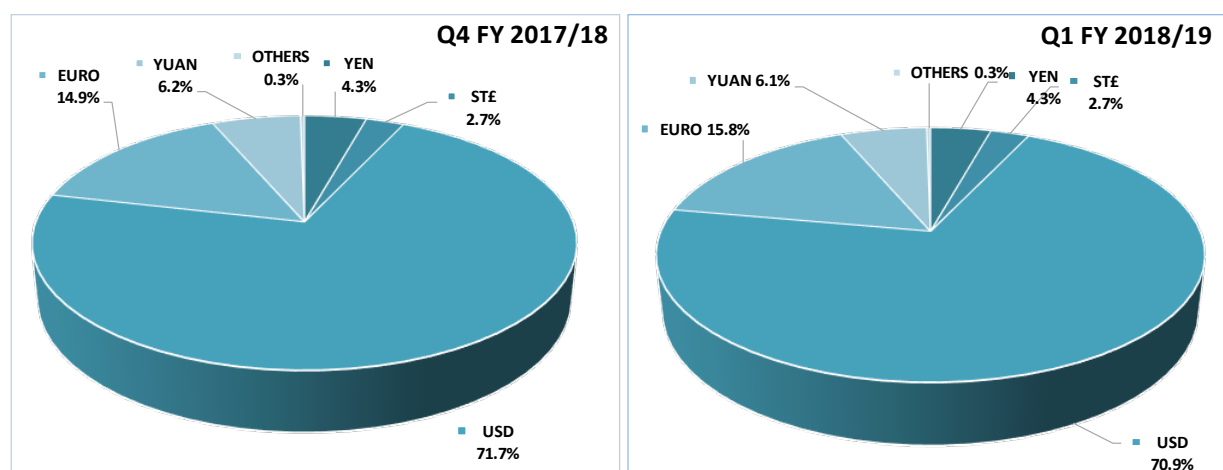
Source: The National Treasury

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 86.7 percent of the total currency composition at the end of the first 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 Euro increased mainly on account disbursements of Euro-denominated loan advanced by the International Development

Association (IDA) to finance projects in the energy and roads sectors (**Chart 8.1**).

Chart 8.3: Debt Composition by Currency



Source: The National Treasury

Public Debt Service

The ratio of domestic interest payments to revenues increased to 16.8 percent in the first quarter of the FY 2018/19 compared to the previous quarter (4.9 percent). The largest component of domestic interest payments was coupon interest on Treasury Bonds which was consistent with the proportion of debt held in Treasury bonds. External debt service for the first quarter of the FY 2018/19 amounted to KSh 25.3 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 Country Policy and Institutional assessment (CPIA) determined liquidity indicative thresholds (21 percent of exports and 23 percent of revenues) implying improving debt dynamics (**Table 8.4**).

Table 8.4: Liquidity Indicators of External Debt Sustainability

	Q1 FY 2017/18	Q2 FY 2017/18	Q3 FY 2017/18	Q4 FY 2017/18	Q1 FY 2018/19
Debt service to Revenues (23%)	7.2	11.4	8.5	14.7	10.1
Debt service to Exports (21%)	9.1	14.8	10.5	20.4	12.5

Source: Central Bank of Kenya

Debt Sustainability Analysis

The March 2018 Debt sustainability update indicate 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 CPIA 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 way above the debt sustainability benchmark for strong policy performers. This justifies the need for the ongoing fiscal consolidation.

Outlook for Fiscal Year 2018/19

Total public and publicly guaranteed external debt is estimated at 2,832.7 billion (28.9 percent of GDP), while gross and net domestic debt are expected to close the financial year 2018/19 at KSh 2,775.6 billion (28.3 percent of GDP) and KSh 2,341.2 billion (23.9 percent of GDP), respectively (BPS 2018).

Chapter 9

The Capital Markets

Equities Market

The equities market performance was lower in the third quarter of 2018 compared to performance in the second quarter of 2018 as reflected across all the market indicators. The decline in performance could be attributed to developments in global financial markets leading to flight to quality, and local factors including the less-impressive financial results of some

listed companies and increased taxes on the financial markets transactions (**Table 9.1**).

Table 9.1: Selected Stock Market Indicators

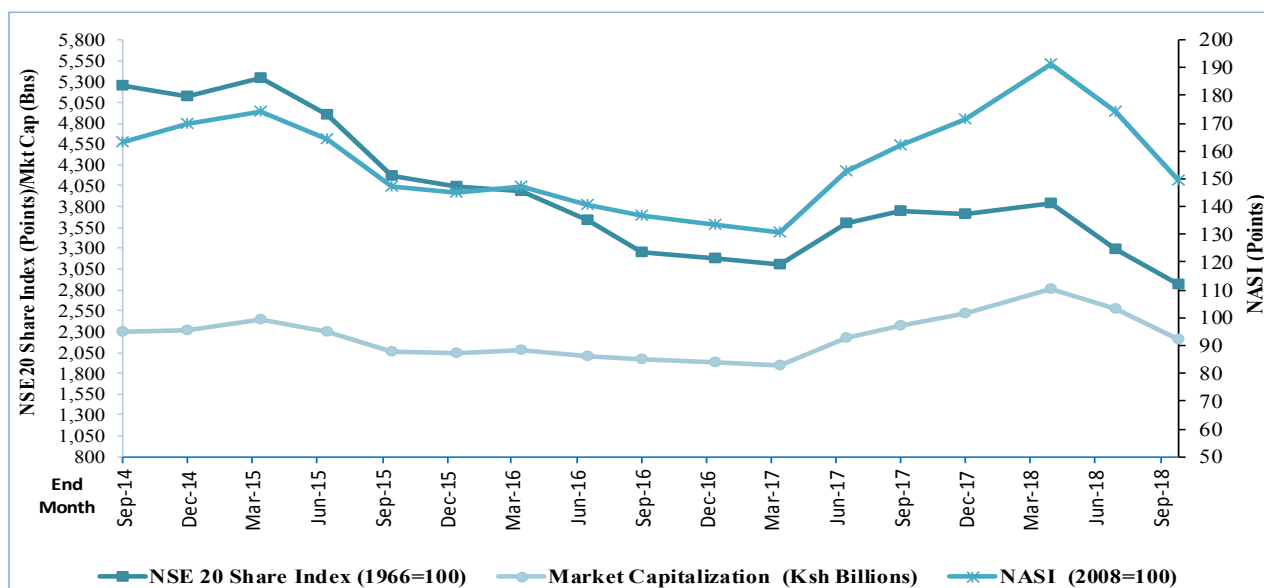
INDICATOR	2017				2018			% CHANGE (2018Q3-2018Q2)
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
NSE 20 Share Index (1966=100)	3112.5	3607.2	3751.5	3711.9	3845.3	3285.7	2875.5	-12.48
NASI (2008=100)	130.51	152.92	162.21	171.20	191.23	174.36	149.67	-14.16
Number of Shares Traded (Millions)	1859.82	1892.06	2019.72	1291.155	2138.96	1580.04	983.14	-37.78
Equities Turnover (Ksh Millions)	37,095	44,902	53,577	36,019	61,150	47,142	31,930	-32.27
Market Capitalization (Ksh Billions)	1,894	2,224	2,377	2,522	2,817	2,576	2,211	-14.16
Foreign Purchase (Ksh Millions)	29,421	27,424	23,099	22,760	31,065	24,618	17,336	-29.58
Foreign Sales (Ksh Millions)	27,433	29,692	34,219	22,941	39,149	32,794	24,041	-26.69
Ave. Foreign Investor Participation to Equity Turnover (%)	76.64	63.60	53.49	63.44	57.41	60.89	64.84	3.95
Bond Turnover (Ksh Millions)	103,997	134,633	108,168	89,120	152,338	158,523	133,683	-15.67
FTSE NSE Kenya Govt. Bond Index (Points)	89.73	91.54	91.67	92.83	93.58	95.00	94.85	-0.16
5-Year Eurobond Yield (%)	4.20	4.47	4.28	3.76	3.83	5.74	4.52	*-1.22
10-Year Eurobond Yield (%) -2024	7.10	6.64	6.46	5.67	6.24	7.18	6.86	*-0.32
10-Year Eurobond Yield (%) -2028					6.86	7.89	7.65	*-0.24
30-Year Eurobond Yield (%) -2048					7.81	8.90	8.59	*-0.31

* Percentage points

Source: Nairobi Securities Exchange

The decline in equity prices reduced the shareholder's wealth, measured by market capitalization, in the third quarter of 2018 by 14.16 percent compared to the 8.56 percent decline in the second quarter of 2018 (**Chart 9.1**).

Chart 9.1: NSE 20, NASI and Market Capitalization

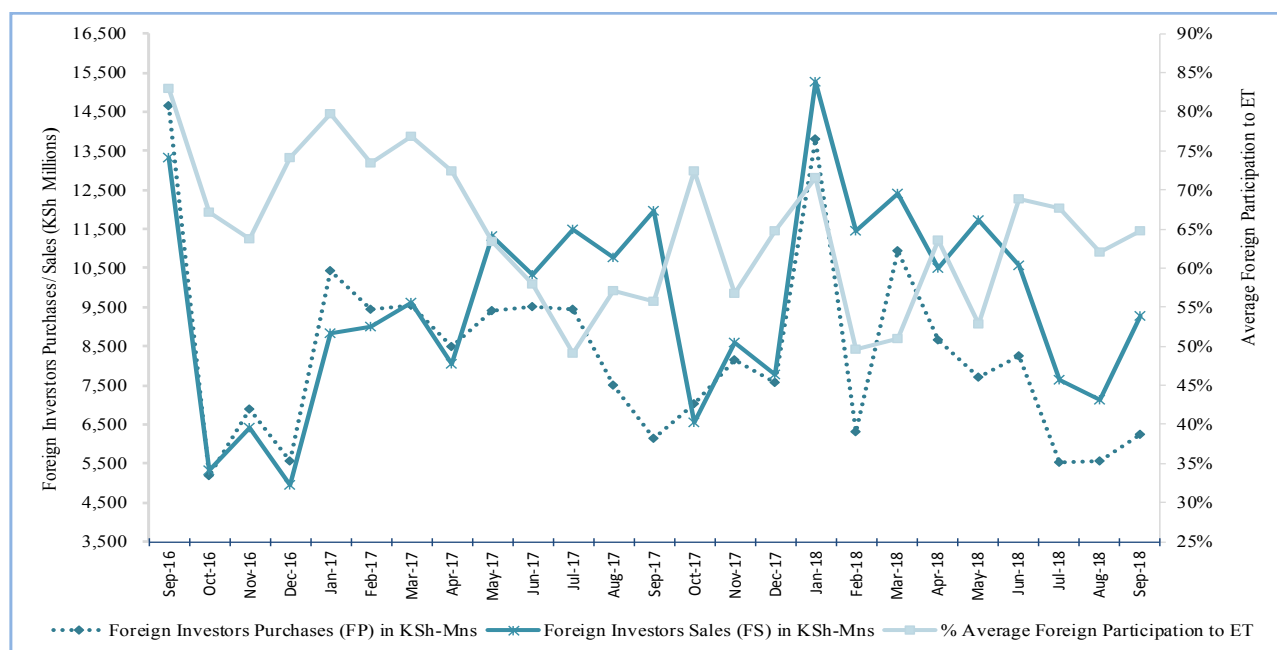


Source: Nairobi Securities Exchange

Foreign Investors' Participation

Foreign investors dominated trading at NSE in the third quarter of 2018 accounting for an average of 64.84 percent of total equity turnover, compared to 61.72 percent in the second quarter of 2018. Their participation was more on the sale side, implying a net outflow, explained by either profit-taking or divestiture from the NSE on increased taxes or both (Chart 9.2 and Table 9.1).

Chart 9.2: Foreign Investors Participation at the NSE



Source: Nairobi Securities Exchange

Bond Market

The volume of bonds traded at NSE declined by 15.67 percent in the third quarter of 2018, reflecting less propensity to invest in long-term fixed income securities. This poor performance was also reflected in the primary market, where all bonds issued in July, August and September 2018 were under-subscribed at 34.65 percent, 74.56 percent and 81.17 percent respectively. The FTSE NSE Kenyan Government Bond Index declined by 0.16 percent in the period under review, reflecting a marginal increase in secondary market yields. All the yields on the 5-year, 10-year (2024), 10-year (2028)-and 30-year (2048) Kenya Eurobonds declined by 1.22 percentage points, 0.32 percentage points, 0.24 percentage points and 0.31 percentage points respectively on the last trading day of the third quarter of 2018. This reflects increased appetite for fixed income in global markets as investors sought to minimize their exposure to volatility in equities markets that characterised the third quarter.

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

Source: Central Bank of Kenya

Notes on the Financial Position

Assets

The Central Bank of Kenya (CBK) balance sheet decreased by 3.0 percent in the third quarter of 2018, largely reflecting KSh 20.4 billion decrease in debt due from government. Debt due from government comprise of Government utilization of the overdraft facility at the Central bank and overdrawn accounts which were converted to a long term debt with effect from 1 November 1997.

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 43.7 billion in the third 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 29.3 billion in the third quarter of 2018. Funds held with the IMF increased by KSh 3.4 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, declined by KSh 14.0 billion compared to an increase of KSh 4.0 billion in the second quarter of 2018.

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, increased by 0.4 percent in the third quarter of 2018 compared to an increase of 1.4 percent in the previous quarter.

Other assets, which largely consist of prepayments and sundry debtors, and deferred currency expense increased by 5.0 percent in the third quarter of 2018.

Liabilities

Currency in circulation declined by 1.8 percent in the third quarter of 2018 compared to a decline of 0.1 percent in the previous quarter.

Deposits at the CBK by Government of Kenya, local commercial banks, other public entities and project accounts and local banks' forex settlement accounts declined by 3.1 percent compared to an increase of 0.1 percent in the previous quarter.

Equity and reserves increased by 2.3 percent in the third quarter of 2018 compared to a decline of 0.3 percent in the previous quarter.



Central Bank of Kenya

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