Central Bank of Kenya

Quarterly Economic Review

April - June 2016
Volume 1 No. 2

OBJECTIVES OF THE CENTRAL BANK OF KENYA

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

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

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

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

The Quarterly Economic Review is prepared by the Research Department of the Central Bank of Kenya.

Enquiries concerning the Review should be addressed to:
Director, Research Department,
Central Bank of Kenya,
P.O. Box 60,000 – 00200
Nairobi, Kenya
Email: Researchstat@centralbank.go.ke

QUARTERLY ECONOMIC REVIEW

APRIL - JUNE 2016

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

http://www.centralbank.go.ke

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Overview

Introduction

This Quarterly Economic Review highlights recent economic developments through April - June 2016. This includes developments in inflation, money, credit and interest rates, the real sector, balance of payments and exchange rates. It also highlights developments in the banking sector, Government budgetary operations, public debt and the stock market.

Inflation

Overall inflation declined by 166 basis points to 5.36 percent in the second quarter of 2016 from 7.02 percent in the first quarter of 2016, reflecting a decline across all the categories of inflation.

Money Supply

Money supply (M3) grew by 3.4 percent in the second quarter of 2016. This growth mainly reflected recovery in deposits, particularly time and saving and foreign currency deposits categories, which had recorded considerable decline during the previous quarter. However, the recovery in M3 growth was slightly lower than recorded in the fourth quarter of 2015.

Interest Rates

The Central Bank of Kenya eased its policy rate (CBR) in May 2016 to 10.5 percent from 11.5 percent since July 2015.

Real GDP Growth

The economy grew by 6.2 percent in the second quarter of 2016. This was an improvement from 5.9 percent growth in the first quarter of 2016. Agriculture was the lead sector, contributing 1.3 percent to growth for the second consecutive quarter.

Balance of Payments

In the year to June 2016, the current account deficit improved to 5.5 percent of GDP from 9.6 percent of GDP in a comparable period in June 2015.

Exchange Rates

The foreign exchange market has remained stable supported by a narrowing current account deficit largely due to a lower import bill, improved export earnings and resilient inflows from diaspora remittances.

Banking Sector Developments

The Kenyan banking sector recorded mixed perfromance across key indicators in the second quarter of 2016. Notably profitability improved while asset quality deteriorated.

Government Budgetary Performance

The government's budgetary operations resulted in a larger deficit at 4.6 percent of GDP in the fourth quarter of the FY 2015/16, compared with 2.8 percent of GDP in the third quarter of the FY 2015/16. Government expenditure was more pronounced in June 2016 (the end of the financial year) across the three components of recurrent, development and transfers to the Counties; indicative of a rush to expedite on outstanding programs and purchases.

Public Debt

Kenya's public and publicly guaranteed debt increased by 9.2 percent during the last quarter of the FY 2015/16 with domestic debt accounting for much of the increase. As a share of GDP, public and publicly guaranteed debt increased to 55.1 percent in the fourth quarter of 2016 from 50.4 percent in the previous quarter

Stock Market

Capital markets leading performance indicators show mixed trends in the second quarter of 2016, driven by global and domestic factors

Developments in Inflation

Overall Inflation

Overall inflation declined by 166 basis points to 5.36 percent in the second quarter of 2016 from 7.02 percent in the first quarter of 2016, on account of declining Food, Fuel and Non-Food Non-Fuel (NFNF) inflation **(Table 1.1)**. Food inflation declined by 319 basis points to 7.24 percent in the second quarter of 2016 compared to 10.43 percent in first quarter of 2016. This decline was on account of improved food supply, following favourable weather conditions experienced in food growing regions. NFNF inflation declined marginally to 5.42 percent in the period under review from 5.81 percent in the first quarter of 2016. It however remained elevated on account of the effect of excise tax imposed on beer and cigarettes in December 2015. Fuel inflation declined from 2.25 percent in the first quarter of 2016 to 1.73 percent in the second quarter of 2016 owing to fairly low international oil prices.

TABLE 1.1. RECENT DEVELOPMENTS IN INFLATION IN PERCENT[1]

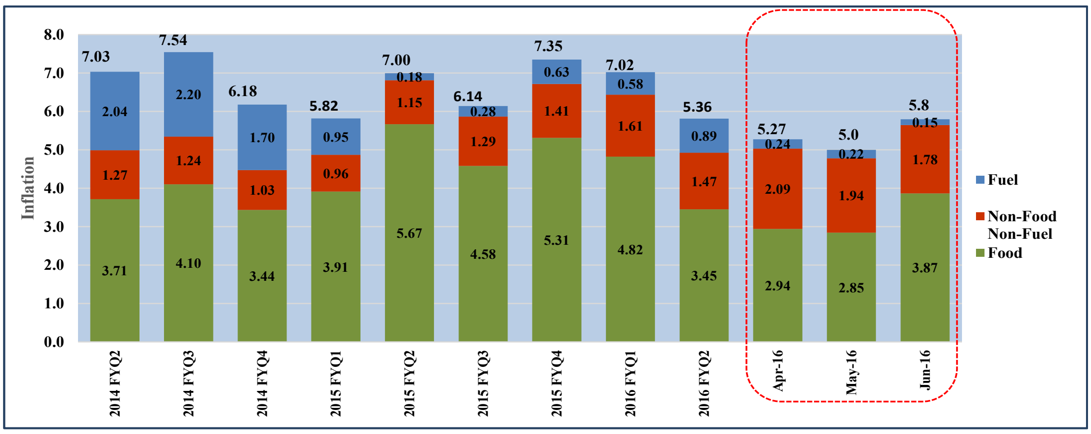
	2015				2016				
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-16	May-16	Jun-16
Overall Quarterly inflation	5.82	6.99	6.14	7.35	7.02	5.36	5.27	5.00	5.80
Food Inflation	8.67	12.50	10.06	11.62	10.43	7.24	6.70	6.45	8.56
Fuel Inflation	3.57	0.68	1.04	2.39	2.25	1.73	1.95	1.81	1.43
Non-Food Non-Fuel Inflation (NFNF)	3.37	4.10	4.63	5.06	5.81	5.42	5.85	5.41	5.01
Average annual	6.66	6.66	6.39	6.44	6.84	6.58	6.72	6.56	6.46
Three months annualised	6.43	14.28	3.10	5.96	5.14	7.35	4.18	8.29	9.58

[1] Food inflation is comprised of "food and non-alcoholic beverages", and "hotels and restaurants" categories; fuel is comprised of "transport" and "housing, water, electricity, gas and other fuels" categories; NFNF excludes food and fuel inflation

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

The contribution of food inflation to overall inflation declined to 3.45 percentage points in the second quarter of 2016 from 4.82 percentage points in the first quarter of 2016 on account of lower food prices following favourable weather conditions **(Chart 1A)**.

CHART 1A: CONTRIBUTIONS OF BROAD CATEGORIES TO OVERALL INFLATION IN PERCENT



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

NFNF inflation contributed 1.47 percentage points to overall inflation in the second quarter of 2016, a marginal decline from a contribution of 1.61 percentage points in the first quarter of 2016, reflecting the persistent effect of excise tax imposed in December 2015 **(Chart 1A)**.

The contribution of fuel inflation to overall inflation increased marginally to 0.89 percentage points in the second quarter of 2016, from 0.58 percentage points in the first quarter of 2016, reflecting the fairly low but rising international oil prices in the period under review **(Chart 1A)**.

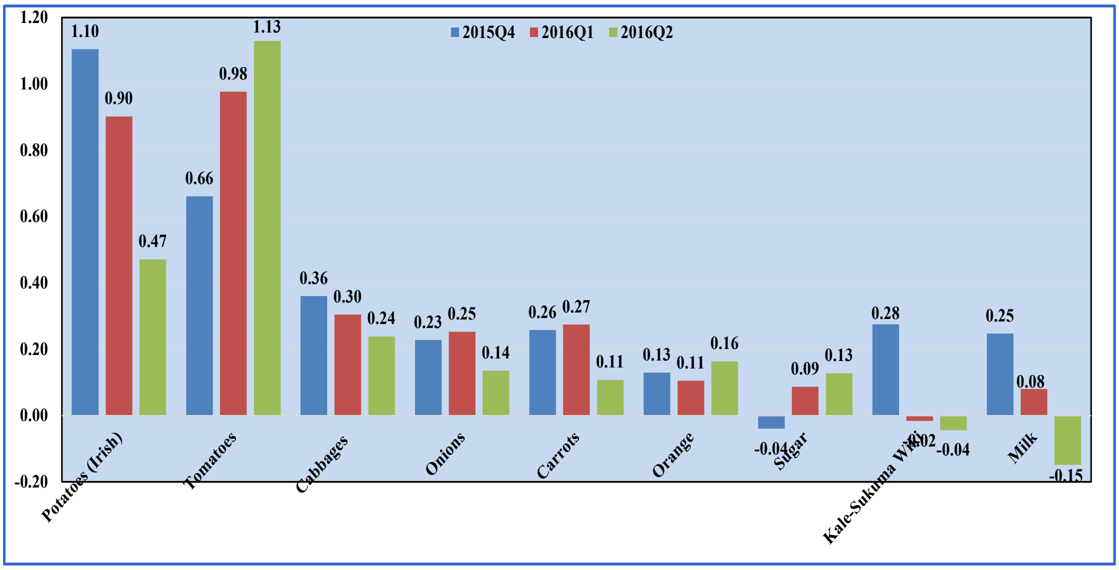
Food Inflation

Food inflation eased by 320 basis points to record 7.24 percent in the second quarter of 2016 from 10.43 percent in the first quarter of 2016. The decline is attributed to favorable weather conditions experienced in the quarter under review that boosted agricultural production.

Analysis of the food basket shows that the contribution of selected key food items to food inflation declined, except for tomatoes, sugar, and oranges **(Chart 1B)**. This includes Irish potatoes contribution that was high in recent periods but declined for the third consecutive quarter, to 0.47 percentage points in the second quarter of 2016 from 1.10 percentage points in quarter four of 2015. The contribution of tomatoes to food inflation rose by 0.15 percentage points in the second quarter of 2016 compared to 0.32 percentage points in the first quarter of 2016, whereas prices of milk and kale/sukuma wiki, dampened food inflation by 0.15 percentage points and 0.04 percentage points, respectively.

Favorable weather conditions in the Irish potato growing regions increased potatoes supply, thus lowering the prices. The same weather conditions led to water logged soils and fungal infections that reduced the harvest of tomatoes. Periods of heavy rainfall lead to lower tomato harvests as most of the crop is destroyed, reducing supply and resulting in higher prices. Overall, the impact of price increase on tomatoes, oranges and sugar were fully offset by price reduction on Irish potatoes, onions, milk, carrots, kale/sukuma wiki, among other food items, which supported lower food inflation in the quarter under review compared to first quarter of 2016.

CHART 1B: CONTRIBUTION OF MAIN FOOD ITEMS TO FOOD INFLATION IN PERCENT



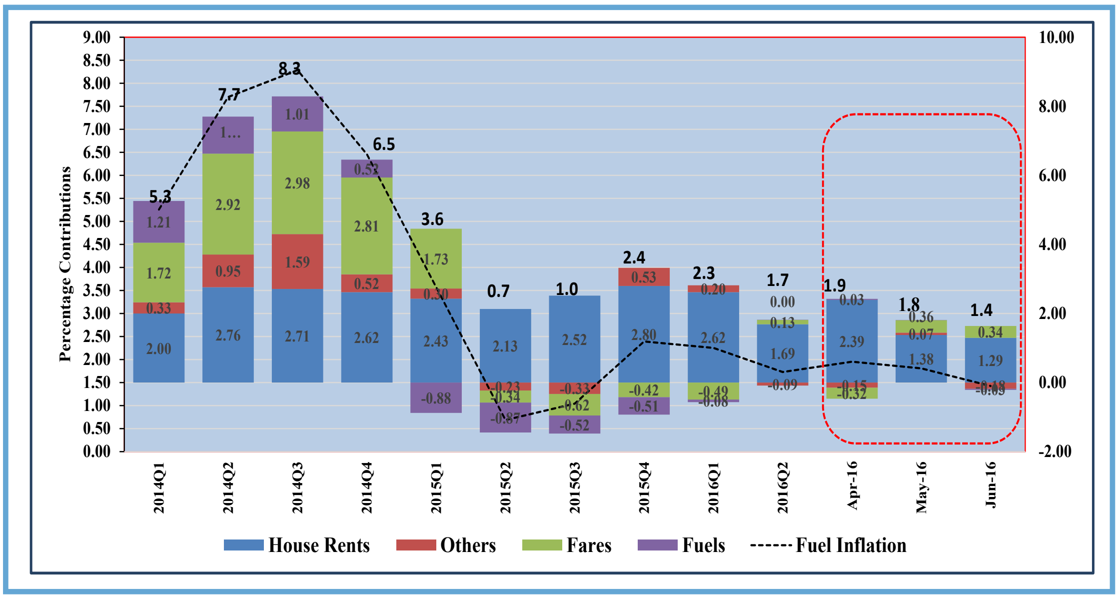
Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

Fuel Inflation

Fuel inflation declined to 1.73 percent in the second quarter of 2016 from 2.25 percent in the first quarter of 2016. This was on account of decline in the cost of items in the 'Housing, Water, Electricity, Gas and other Fuels' and 'Transport' categories **(Chart 1C)**.

The negative contribution of fuels (petrol, diesel, kerosene and LPG gas) to inflation continued to fade away reflecting a reversal of the downward trend of international oil prices that are currently on the rise. 'Fuels' reduced fuel inflation by 0.09 percentage points in the second quarter of 2016, from 0.1 percentage points in the first quarter of 2016. However, 'fares' and other items in the fuel inflation basket contributed marginally to fuel inflation in the period under review.

CHART 1C: COMPONENTS OF FUEL INFLATION



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

Non-Food Non-Fuel inflation (NFNF)

Non-Food Non-Fuel (NFNF) inflation, declined marginally to 5.42 percent in the period under review from 5.81 percent in the first quarter of 2016 **(Table 1.2)**. Significant decline in contribution to NFNF inflation was recorded in the 'Miscellaneous Goods & Services', 'Clothing & Footwear', 'Furnishings', 'Household Equipment and Routine Household Maintenance', and 'Health' categories which offset the impact of higher prices of 'Alcoholic Beverages, Tobacco and Narcotics' category to NFNF inflation.

TABLE 1.2: NON-FOOD-NON-FUEL INFLATION IN PERCENT

		Alcoholic Beverages, Tobacco & Narcotics	Clothing & Footwear	Furnishings, Household Equipment and Routine Household Maintenance	Health	Communication	Recreation & Culture	Education	Miscellaneous Goods & Services	**NFNF Inflation**
2015	Q1	0.08	1.00	0.82	0.40	-0.02	0.19	0.35	0.55	**3.37**
	Q2	0.18	1.13	0.89	0.49	0.07	0.25	0.38	0.72	**4.10**
	Q3	0.29	1.23	0.90	0.55	0.14	0.30	0.43	0.80	**4.63**
	Q4	0.59	1.23	1.05	0.56	0.15	0.27	0.45	0.77	**5.06**
2016	Q1	1.11	1.21	1.03	0.60	0.22	0.37	0.47	0.79	**5.81**
	Q2	1.11	1.08	0.92	0.51	0.24	0.40	0.49	0.65	**5.42**
	April	1.11	1.22	0.99	0.61	0.27	0.40	0.49	0.77	**5.85**
	May	1.13	1.07	0.94	0.48	0.27	0.40	0.49	0.62	**5.41**
	June	1.09	0.96	0.85	0.44	0.20	0.41	0.48	0.57	**5.01**

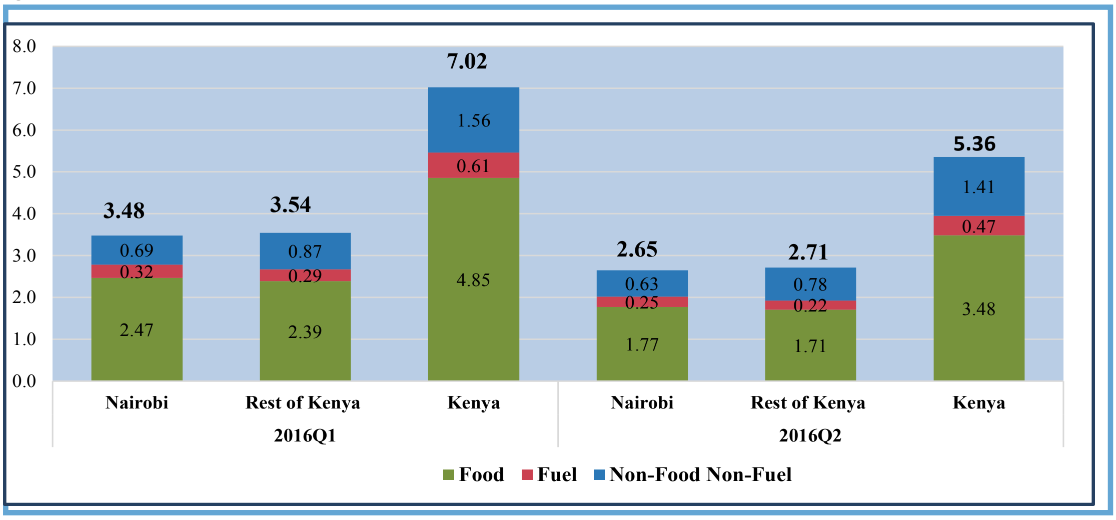
Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

Overall Quarterly Inflation Across Regions

Food inflation account for overall inflation in both Nairobi and the rest of Kenya in the second quarter of 2016. Inflation for the Rest of Kenya decelerated to 5.10 percent in the second quarter of 2016 from 7.3 percent in the first quarter of 2016, while that of Nairobi decelerated to 5.74 percent from 6.63 percent in the same period. The contribution of both the Nairobi and the Rest of Kenya to overall inflation declined by the same magnitude (0.83 percentage points) in the period under review, largely on account of decline in food prices in the regions **(Chart 1D)**. Though declining, the contribution of food inflation to overall inflation is more pronounced in Nairobi region at 1.77 percentage points than in the Rest of Kenya at 1.71 percentage points in the second quarater of 2016. This is attributed to costs incurred in transporting food items from the food growing areas to the city.

The contribution of fuel inflation in Nairobi region declined to 0.25 percentages points in the second quarter of 2016 from 0.32 percentage points in the first quarter of 2016, while that of the Rest of Kenya declined to 0.22 percentages points from 0.29 percentage points in the same period. The decline is on account of downward adjustments of fuel price by the Energy Regulation Commission (ERC) in 2016 during the second quarter. The prices of petrol and cooking gas were lowered by 3.2 percent and 2.7 percent respectively while the price of diesel remained stable, during the second quarter of 2016. The decline in the prices of these fuel items more than offset the 16.2 percent increase in Kerosene prices during the second quarter of 2016. The NFNF inflation contribution to overall inflation declined in Nairobi and the Rest of Kenya regions in the second quarter of 2016, compared to the first quarter of 2016. That of Nairobi region declined to 0.63 percentage points from 0.69 percentage points whereas, for the Rest of Kenya it declined to 0.78 percentage points from 0.87 percentage points **(Chart 1D)**.

CHART 1D: CONTRIBUTIONS OF VARIOUS REGIONS TO OVERALL QUARTERLY INFLATION IN PERCENT



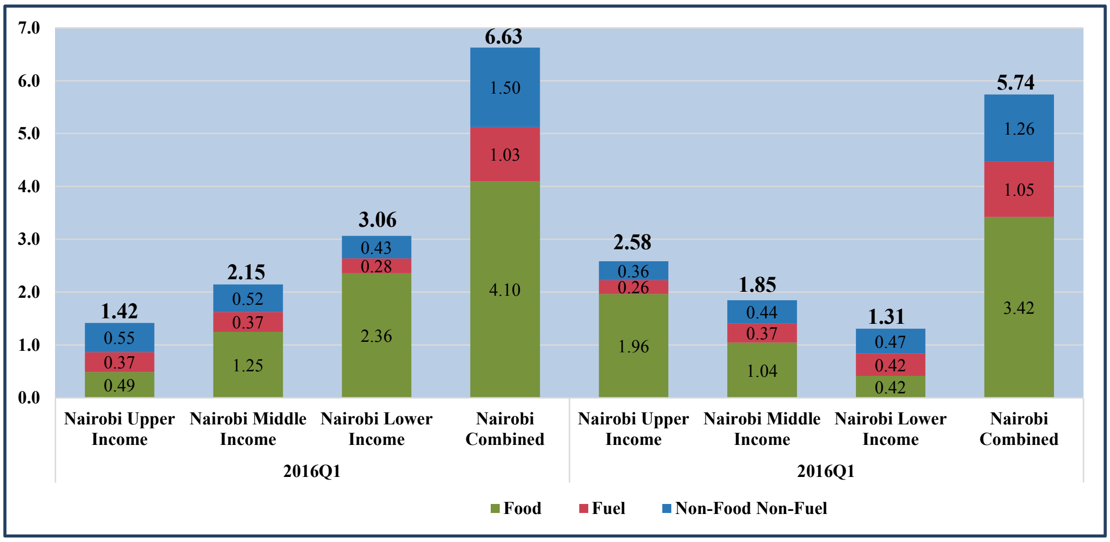
Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

Overall Quarterly Inflation Across Income Groups in Nairobi

Inflation in Nairobi eased to 5.7 percent in the second quarter of 2016 from 6.6 percent in the first quarter of 2016 on account of declining food inflation and NFNF inflation. The contribution of Food to inflation in 'Nairobi combined' declined to 3.42 percentage points from 4.10 percentage points in the period under review and impacted more on food prices for the middle and lower income groups which more than offset the increase in the upper income group. The contribution of the food inflation to overall inflation in upper income group increased to 1.96 percentage points in the second quarter of 2016 from 0.49 percentage points in the first quarter of 2016 **(Chart 1E)**.

The contribution of NFNF inflation to overall inflation in 'Nairobi combined' declined to 1.26 percentage points in the second quarter of 2016 compared to 1.50 percentage points in the first quarter. This reduction affected the upper and middle income groups. Fuel inflation, however, remained low and evenly distributed across income groups on account of low international fuel prices as well as the ERC downward adjustments of fuel prices.

CHART 1E: CONTRIBUTIONS OF INCOME GROUPS TO OVERALL INFLATION IN NAIROBI IN PERCENT.



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

DEVELOPMENTS IN MONEY, CREDIT AND INTEREST RATES

Broad Money Supply

Money supply (M3) grew by 3.4 percent in the second quarter of 2016 compared with a marginal rise of 0.2 percent in the previous quarter. This growth mainly reflect recovery in deposits, particularly time and saving and foreign currency, which had declined sharply during the previous quarter **(Table 2.1)**.

Other components of money supply, M1 grew by 5.1 percent in the second quarter of 2016, which was a marginal decrease from the 5.2 percent growth recorded in first quarter of 2016. The slowdown is attributed to demand deposits partly on account of a portfolio shift by the non-bank public from deposits to investment in government securities **(Chart 2A)**. Non-bank holding of Government securities increased by twice as much as in the first quarter of 2016. Meanwhile, other deposits at CBK recovered in the second quarter of 2016 reflecting build-up of County deposits **(Table 2.1)**.

Sources of M3

Net Foreign Assets

The Net Foreign Assets (NFA) of the banking system recovered to 18.4 percent in the second quarter of 2016 from a decline of 4.1 percent in the previous quarter, largely reflecting accumulation by the Central Bank of Kenya (CBK) and commercial banks. Net liabilities of commercial banks declined on account of an increase in banks' deposits abroad. The boost to the NFA of the Central Bank of Kenya is attributed to receipts of US$ 600 million Government commercial loan from China in end June 2016.

Net Domestic Assets

The Net Domestic Assets (NDA) of the banking system grew marginally by 0.2 percent in second quarter of 2016 compared to a growth of 1.1 percent in first quarter and zero change in the fourth quarter of 2015. The sluggish growth is reflected in lower credit uptake by the private sector which nearly counterbalanced the impact of modest pick-up in net credit to Government in the first and second quarters of 2016.

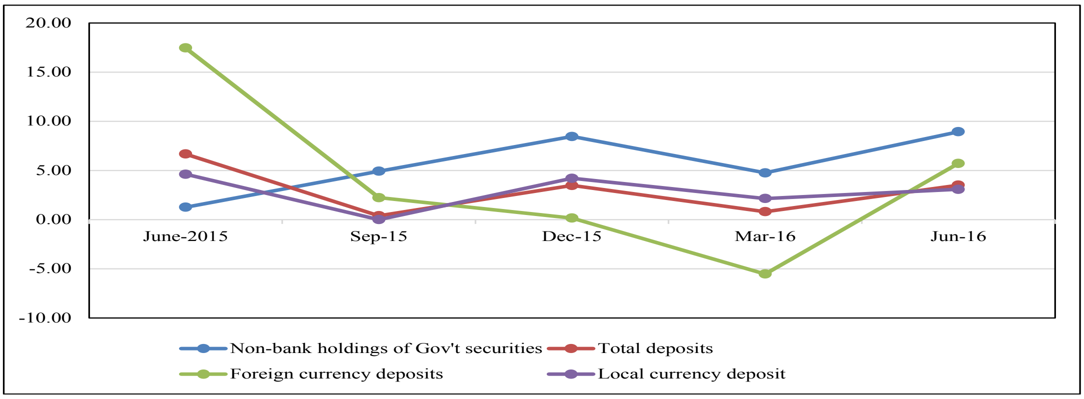
TABLE 2.1: MONETARY AGGREGATES

	END MONTH LEVEL			QUARTERLY % CHANGE			QUARTERLY ABSOLUTE CHANGE(Ksh bn)		
COMPONENTS OF M3	Dec-15	Mar-16	Jun-16	Dec-15	Mar-16	Jun-16	Dec-15	Mar-16	Jun-16
1. Money supply, M1 (1.1+1.2+1.3)	**1,023.7**	**1,076.8**	**1,131.3**	**4.5**	**5.2**	**5.1**	**43.9**	**53.1**	**54.6**
1.1 Currency outside banks	191.0	183.4	187.9	9.2	-4.0	2.5	16.1	-7.6	4.5
1.2 Demand deposits	771.7	839.0	878.9	2.1	8.7	4.8	15.6	67.3	39.9
1.3 Other deposits at CBK 1/	60.7	54.1	64.3	25.1	-10.8	18.8	12.2	-6.6	10.2
2. Money supply, M2 (1+2.1)	**2,234.8**	**2,262.7**	**2,330.7**	**4.8**	**1.2**	**3.0**	**101.4**	**27.9**	**68.1**
2.1 Time and saving deposits	1,199.4	1,175.0	1,189.8	4.7	-2.0	1.3	53.9	-24.4	14.8
3. Money supply, M3 (2+3.1)	**2,658.2**	**2,662.6**	**2,753.6**	**4.0**	**0.2**	**3.4**	**102.1**	**4.5**	**90.9**
3.1 Foreign Currency Deposits	423.4	399.9	422.8	0.2	-5.5	5.7	0.7	-23.4	22.9
SOURCES OF M3									
1. Net foreign assets 2/	**491.5**	**471.4**	**558.4**	26.2	-4.1	18.4	102.1	-20.0	86.9
Central Bank	621.4	640.8	690.4	17.4	3.1	7.7	92.1	19.4	49.6
Banking Institutions	-129.9	-169.3	-132.0	-7.2	30.3	-22.0	10.0	-39.4	37.3
2. Net domestic assets (2.1+2.2)	**2,166.7**	**2,191.2**	**2,195.2**	0.0	1.1	0.2	0.0	24.5	4.0
2.1 Domestic credit	**2,793.9**	**2,823.7**	**2,856.5**	0.3	1.1	1.2	8.6	29.8	32.8
2.1.1 Government (net)	524.0	543.6	560.8	-5.3	3.7	3.2	-29.2	19.6	17.1
2.1.2 Private sector	2,223.6	2,230.6	2,253.5	1.8	0.3	1.0	39.6	7.1	22.8
2.1.3 Other public sector	46.3	49.4	42.3	-3.6	6.7	-14.5	-1.7	3.1	-7.2
2.2 Other assets net	**-627.2**	**-632.5**	**-661.3**	1.4	0.8	4.6	-8.6	-5.3	-28.8
Memorandum items									
4. Overall liquidity, L (3+4.1)	**3,390.8**	**3,430.1**	**3,589.7**	**4.9**	**1.2**	**4.7**	**159.2**	**39.3**	**159.5**
4.1 Non-bank holdings of government securities	732.7	767.5	836.1	8.5	4.8	8.9	57.1	34.9	68.6

Absolute and percentage changes may not necessarily add up due to rounding
1/ Includes county deposits and special projects deposit
2/ Net Foreign Assets at current exchange rate to the US dollar.

Source: Central Bank of Kenya

CHART 2A : QUARTERLY GROWTH IN DEPOSITS AND NON-BANK HOLDINGS OF GOVERNMENT SECURITIES



Source: Central Bank of Kenya

Development in Domestic Credit

Net domestic credit increased by KSh 32.8bn (or 1.2 percent) in second quarter of 2016, a slight improvement from an increment of KSh 29.8billion (1.1 percent) recorded in the previous quarter **(Table 2.1)**. While net bank credit to the government recovered substantially in the first and second quarter of 2016, private sector credit uptake remained sluggish for the third consecutive quarter. The low credit uptake by the private sector is attributed to multiple factors. These include: lagged effects of monetary policy tightening in June and July 2015, dynamics in the banking sector following the placement of two banks under receivership which resulted in tightening of credit lines in the interbank market and stricter scrutiny of new loan applications by banks. Net credit to Government increased by 3.7 percent and 3.2 percent in the first and second quarters of 2016 reflecting improved performance of the government borrowing programme during the second half of FY 2015/16.

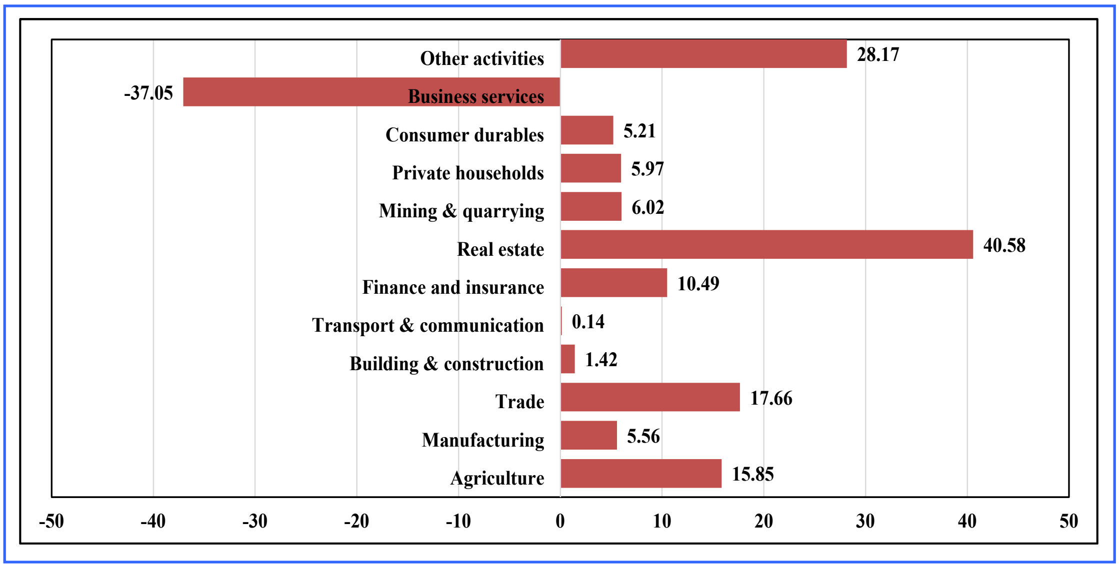
The private sector credit was channeled to the various sectors of the economy, with real estate recording the largest share at 40.6 percent. Meanwhile, reduced credit uptake was reported for business services, private households, manufacturing and trade activities.

TABLE 2.2: BANKING SECTOR NET DOMESTIC CREDIT (KSH BILLION)

	END MONTH LEVEL			QUARTERLY CHANGES (%)			QUARTERLY CHANGES (KSH BN)		
	Dec-15	Mar-16	Jun-16	DEC-2015	MAR-2016	JUN-2016	DEC-2015	MAR-2016	JUN-2016
1. Credit to Government	**524.0**	**543.6**	**560.8**	**-5.3**	**3.7**	**3.2**	**-29.2**	**19.6**	**17.1**
Central Bank	-43.6	-80.8	-154.7	-193.5	85.1	91.6	-90.3	-37.1	-74.0
Commercial Banks & NBFIs	567.7	624.4	715.5	12.0	10.0	14.6	61.0	56.7	91.1
2. Credit to other public sector	**46.3**	**49.4**	**42.3**	**-3.6**	**6.7**	**-14.5**	**-1.7**	**3.1**	**-7.2**
Local government	1.1	0.8	0.1	-1.9	-33.9	-84.8	0.0	-0.4	-0.6
Parastatals	45.2	48.7	42.1	-3.6	7.7	-13.4	-1.7	3.5	-6.5
3. Credit to private sector	**2,223.6**	**2,230.6**	**2,253.5**	**1.8**	**0.3**	**1.0**	**39.6**	**7.1**	**22.8**
Agriculture	85.9	89.6	93.2	-3.5	4.2	4.0	-3.1	3.6	3.6
Manufacturing	290.1	296.6	297.9	3.4	2.3	0.4	9.7	6.5	1.3
Trade	378.0	393.1	397.1	-0.8	4.0	1.0	-3.1	15.1	4.0
Building and construction	106.3	98.5	98.9	5.4	-7.3	0.3	5.5	-7.8	0.3
Transport & communications	171.6	169.6	169.6	10.7	-1.2	0.0	16.6	-2.0	0.0
Finance & insurance	61.0	61.7	64.1	7.3	1.1	3.9	4.2	0.7	2.4
Real estate	282.6	286.8	296.0	1.2	1.5	3.2	3.4	4.2	9.3
Mining and quarrying	20.8	22.2	23.6	-8.9	7.1	6.2	-2.0	1.5	1.4
Private households	363.9	369.2	370.5	0.5	1.5	0.4	2.0	5.3	1.4
Consumer durables	128.5	128.0	129.2	-0.3	-0.3	0.9	-0.4	-0.4	1.2
Business services	204.9	208.6	200.1	3.1	1.8	-4.1	6.1	3.6	-8.5
Other activities	129.9	106.8	113.2	0.6	-17.8	6.0	0.7	-23.2	6.4
4. TOTAL (1+2+3)	**2,793.9**	**2,823.7**	**2,856.5**	**0.3**	**1.1**	**1.2**	**8.6**	**29.8**	**32.8**

Source: Central Bank of Kenya

CHART 2B: SHARE OF CREDIT BY SECTORS (%)



Source: Central Bank of Kenya

The Central Bank Rate

The Central Bank of Kenya eased its policy rate (CBR) in May 2016 to 10.5 percent from 11.5 percent in July 2015. The reduction in the policy rate followed the easing of Inflationary pressures on account of a fall in the prices of fuel and food items. Overall inflation had declined to 5.3 percent in April from 8.0 percent in December 2015.

Interbank Rate

The weighted average interbank rate rose marginally to 4.56 percent in June from 4.1 percent in March 2016 **(Table 2.3)**. Owing to segmentation and uneven distribution of liquidity in the interbank market, the average interbank rate remained low with tier I banks trading, among themselves, high volumes at low rates.

Treasury Bill Rate

The 91-day Treasury bill rate declined to 7.25 percent in June from 8.72 percent in March 2016, while the 182-day Treasury bill rate declined to 9.56 percent from 10.83 percent **(Table 2.3)**. The decline in the Treasury bills rates was driven by over-subscription in primary auctions for government securities.

Lending and Deposit Rates

The average commercial banks' lending rate increased to 18.2 percent in June from 17.79 percent in March 2016 reflecting the effect of the monetary policy tightening in June and July 2015. The increase was mainly in the 1-5 year and over 5 years loan categories. Meanwhile, the average deposit rate declined to 6.78 percent in June from 7.17 percent in March 2016. Consequently, the interest rate spread widened to 11.37 percent in June 2016 from 10.62 percent in March 2016 **(Table 2.3)**.

TABLE 2.3: INTEREST RATES (%)

	2015							2016					
	June	**July**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**
91-day Treasury bill rate	8.26	10.57	11.54	14.61	21.65	12.34	9.81	11.36	10.63	8.72	8.92	8.15	7.25
182-day Treasury bill rate	10.55	11.99	12.06	13.40	21.52	14.02	11.43	13.46	13.19	10.83	10.87	10.25	9.56
Interbank rate	11.77	13.48	18.80	19.85	14.82	8.77	7.27	6.12	4.54	4.10	4.01	3.82	4.56
Repo rate	9.70	10.61	11.50	11.50	11.50		9.23	8.85	9.68	4.31	5.23	6.00	10.04
Reverse Repo rate	-	-	-		18.12	14.21	11.92	11.44	11.58	11.63	12.49	11.55	10.59
Central Bank Rate (CBR)	10.00	11.50	11.50	11.50	11.50	11.50	11.50	11.50	11.50	11.50	11.50	10.50	10.50
Average lending rate (1)	16.06	15.75	15.68	16.82	16.58	17.16	18.30	17.96	17.86	17.79	17.94	18.08	18.15
Overdraft rate	15.65	16.05	15.98	16.65	16.81	17.44	18.48	18.25	18.25	18.06	18.36	18.25	18.04
1-5years	16.72	16.77	16.64	17.41	16.90	17.72	18.40	18.27	18.01	18.00	18.25	18.46	18.63
Over 5years	15.11	14.44	14.43	15.93	15.87	16.26	18.03	17.33	17.41	17.31	17.20	17.53	17.64
Average deposit rate (2)	6.64	6.31	6.91	7.28	7.54	7.39	8.02	7.54	7.51	7.17	6.70	6.38	6.78
0-3months	8.33	7.89	9.22	10.05	10.55	10.50	11.14	10.32	10.00	9.78	8.68	8.54	8.80
Over 3 months deposit	9.73	9.67	10.03	10.06	10.38	10.35	11.35	10.75	11.15	10.41	10.05	8.93	9.94
Savings deposits	1.85	1.37	1.50	1.71	1.68	1.32	1.56	1.56	1.37	1.32	1.38	1.69	1.60
Spread (1-2)	**9.42**	**9.44**	**8.77**	**9.54**	**9.04**	**9.77**	**10.28**	**10.41**	**10.35**	**10.62**	**11.23**	**11.70**	**11.37**

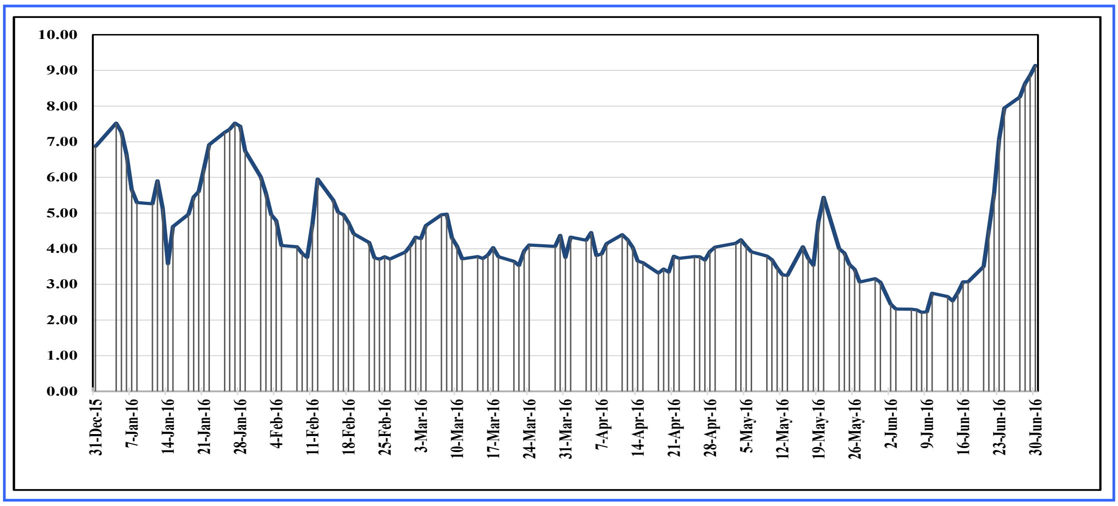
Source: Central Bank of Kenya

Liquidity and Open Market Operations

The money market was quite liquid in April and May 2016 due to accelerated government spending. Excess reserves held by commercial banks above the 5.25 percent averaging requirement increased in April and May but fell sharply by end June as banks remitted taxes **(Chart 2C)**. However, interbank liquidity distribution remained skewed in favor of a few large banks while trading remained segmented (within bank tier groups).

Central bank mopped the excess liquidity from the interbank market and also supported the liquidity distribution through reverse repo purchases.

CHART 2C: COMMERCIAL BANKS EXCESS RESERVES ABOVE 5.25 PERCENT



Source: Central Bank of Kenya

Performance of The Real Sector

Overview

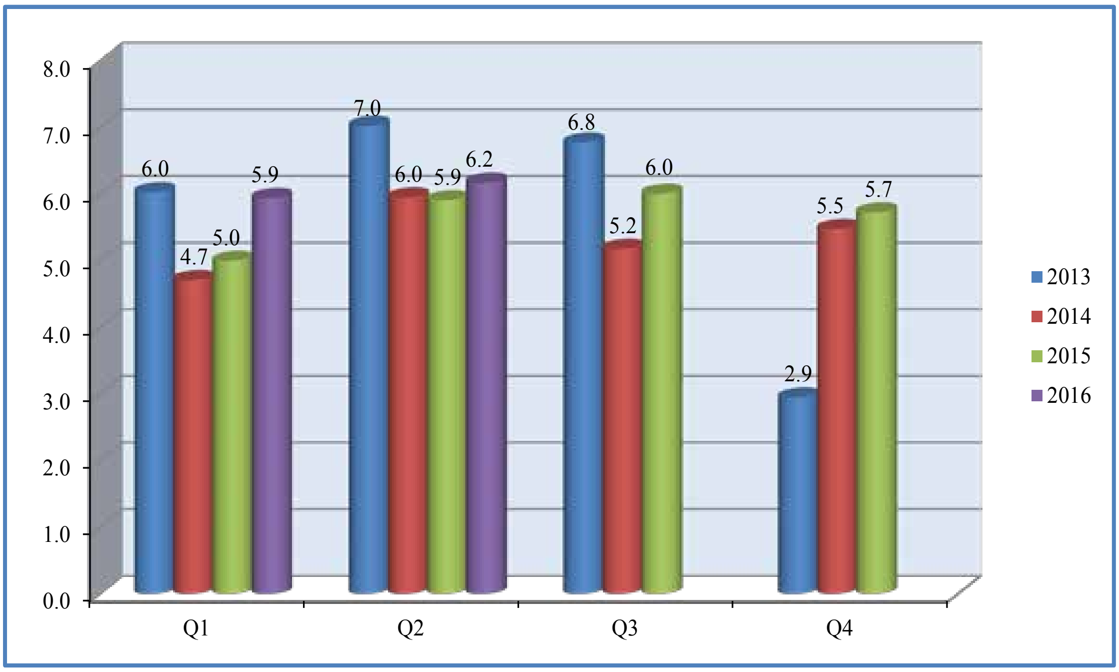
The economy maintained the higher growth trajectory, recording real Gross Domestic Product (GDP) growth of 6.2 percent in the second quarter of 2016. This was an improvement from 5.9 percent growth recorded in the first quarter of 2016 **(Table 3.1A** and **Chart 3A)**. The improved performance is attributable to favourable weather conditions which supported agricultural production, as well as low oil prices that boosted growth in the transport and storage sector. The sectors that posted improved performance include accommodation and restaurants (15.3 percent); mining and quarrying (11.5 percent); electricity and water (10.8 percent); transport and storage (8.8 percent); wholesale and retail trade (6.1 percent); and agriculture (5.5 percent).

TABLE 3.1A: GROSS DOMESTIC PRODUCT GROWTH (%)

MAIN SECTORS	Annual		Quarterly					
	2014	2015	2015				2016	
			Q1	Q2	Q3	Q4	Q1	Q2
Agriculture	3.5	5.6	2.9	4.0	5.5	11.8	5.1	5.5
Mining & Quarrying	14.5	11.0	5.7	8.6	13.7	16.3	6.9	11.5
Manufacturing	3.2	3.5	4.1	5.1	3.3	1.2	3.3	3.2
Electricity & water supply	6.2	7.1	7.4	9.2	10.0	1.8	8.5	10.8
Construction	13.1	13.6	12.6	11.2	15.6	14.9	9.9	8.2
Wholesale & Retail Trade	7.5	6.0	6.4	5.2	6.2	6.0	7.1	6.1
Accommodation & restaurant	-16.7	-1.3	-11.4	-5.0	-6.5	21.2	12.1	15.3
Transport & Storage	4.6	7.1	6.7	6.8	9.4	5.5	8.4	8.8
Information & Communication	14.6	7.3	8.6	7.0	8.2	5.9	9.7	8.6
Financial & Insurance	8.3	8.7	10.6	7.7	10.3	6.5	8.0	7.5
Public administration	5.3	5.4	8.8	6.3	3.0	3.7	5.7	6.7
Professional, Administration & Support Services	3.0	2.6	3.8	5.1	1.9	-0.1	3.5	4.8
Real estate	5.6	6.2	7.8	10.2	11.4	-4.9	6.7	8.7
Education	6.3	4.7	4.3	4.5	5.7	4.2	5.5	4.1
Health	8.1	6.6	5.8	6.4	3.2	10.6	4.2	5.3
Other services	4.2	3.8	4.6	2.8	3.8	4.1	4.5	3.3
FISIM	11.3	15.0	14.7	9.6	18.4	16.8	7.8	8.6
Taxes on products	5.3	4.2	2.9	5.8	1.9	6.5	4.5	5.1
GDP at market prices	**5.3**	**5.6**	**5.0**	**5.9**	**6.0**	**5.7**	**5.9**	**6.2**

Source: Kenya National Bureau of Statistics

CHART 3A: EVOLUTION OF GDP GROWTH ACROSS QUARTERS



Source: Kenya National Bureau of Statistics

TABLE 3.1B: SECTORAL CONTRIBUTION TO REAL GDP

Main Sectors	Annual		Quarterly					
	2014	2015	2015				2016	
			Q1	Q2	Q3	Q4	Q1	Q2
Agriculture	22.1	22.1	25.7	23.2	19.6	19.6	25.5	23.1
Mining & Quarrying	1.0	1.0	1.1	0.9	1.0	1.1	1.1	1
Manufacturing	10.9	10.6	11.1	10.7	10.6	10.2	10.8	10.4
Electricity & water supply	2.4	2.4	2.3	2.5	2.6	2.4	2.4	2.6
Construction	4.8	5.2	4.7	5.1	5.4	5.7	4.9	5.2
Wholesale & Retail Trade□	7.7	7.7	7.2	7.4	8.6	7.6	7.3	7.4
Accommodation & restaurant	1.1	1.1	1.2	0.8	1.0	1.2	1.3	0.9
Transport & Storage	6.6	6.7	5.7	6.4	7.2	7.4	5.9	6.5
Information & Communication	3.6	3.7	3.5	3.0	3.4	4.9	3.6	3
Financial & Insurance	6.0	6.2	6.0	5.9	6.3	6.5	6.1	6
Public administration	3.9	3.9	3.3	4.7	3.4	4.1	3.3	4.7
Professional, Administration & Support Services	2.3	2.3	2.2	2.1	2.3	2.4	2.2	2.1
Real estate	8.1	8.2	8.1	8.4	8.8	7.3	8.1	8.6
Education	6.9	6.8	6.6	6.8	7.1	7.0	6.5	6.6
Health	1.8	1.8	1.6	1.8	1.8	2.0	1.6	1.8
Other services	1.3	1.3	1.3	1.2	1.3	1.3	1.2	1.2
FISIM	-2.5	-2.7	-2.5	-2.5	-2.9	-3.1	-2.5	-2.6
Taxes on products	12.0	11.8	11.0	11.6	12.5	12.3	10.8	11.5

Source: Kenya National Bureau of Statistics

TABLE 3.1C: SECTORAL CONTRIBUTIONS TO GDP GROWTH RATES

MAIN SECTORS	Annual		Quarterly					
	2014	2015	2015				2016	
			Q1	Q2	Q3	Q4	Q1	Q2
Agriculture	0.8	1.2	0.8	0.9	1.1	2.3	1.3	1.3
Mining & Quarrying	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1
Manufacturing	0.3	0.4	0.4	0.5	0.3	0.1	0.4	0.3
Electricity & water supply	0.1	0.2	0.2	0.2	0.3	0.0	0.2	0.3
Construction	0.6	0.7	0.6	0.6	0.8	0.8	0.5	0.4
Wholesale & Retail Trade□	0.6	0.5	0.5	0.4	0.5	0.4	0.5	0.4
Accommodation & restaurant	-0.2	0.0	-0.1	0.0	-0.1	0.2	0.2	0.1
Transport & Storage	0.3	0.5	0.4	0.4	0.7	0.4	0.5	0.6
Information & Communication	0.5	0.3	0.3	0.2	0.3	0.3	0.4	0.3
Financial & Insurance	0.5	0.5	0.6	0.5	0.6	0.4	0.5	0.4
Public administration	0.2	0.2	0.3	0.3	0.1	0.1	0.2	0.3
Professional, Administration & Support Services	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.1
Real estate	0.4	0.5	0.6	0.9	1.0	-0.4	0.5	0.7
Education	0.4	0.3	0.3	0.3	0.4	0.3	0.4	0.3
Health	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1
Other services	0.0	0.0	0.1	0.0	0.0	0.0	0.1	0.0
FISIM	-0.3	-0.4	-0.4	-0.2	-0.5	-0.5	-0.2	-0.2
Taxes on products	0.6	0.5	0.3	0.7	0.2	0.8	0.5	0.6
GDP at market prices	**5.3**	**5.6**	**5.0**	**5.9**	**6.0**	5.7	**5.9**	**6.2**

Source: Kenya National Bureau of Statistics

Agriculture

The agriculture sector expanded by 5.5 percent in the second quarter of 2016 compared to 5.1 percent in the previous quarter and 4.0 percent in same quarter of 2015. Its contribution to real GDP growth remained high at 1.3 percentage points while its sectoral share to real GDP declined to 23.1 percent in second quarter of 2016 from 25.5 percent in the first quarter of 2016 **(Tables 3.1A** and **3.1B**). The sector's performance was boosted by adequate and well distributed rainfall that led to notable growth in the production of tea, coffee and horticultural crops for export.

Tea

Production of tea decreased by 22.1 percent in the second quarter of 2016, compared with 9.0 percent recorded in the previous quarter **(Table 3.2)**. This was due to delayed onset of the long rains. Tea auction prices declined by 11.2 percent in the second quarter of 2016 compared to the previous quarter.

TABLE 3.2: QUARTERLY PERFORMANCE OF KEY AGRICULTURAL OUTPUT INDICATORS

	2015				2016*	
	Q1	Q2	Q3	Q4	Q1	Q2
Tea						
Output (Metric tonnes)	81,617	93,646	95,836	128,112	139,607.0	108,747.0
Growth (%)	*-36.8*	*14.7*	*2.3*	*33.7*	*9.0*	*-22.1*
Horticulture						
Exports (Metric tonnes)	76,838	67,050	100,428	66,143	111,759.2	90,620.0
Growth (%)	*14.1*	*-12.7*	*49.8*	*-34.1*	*69.0*	*-18.9*
Coffee						
Sales (Metric tonnes)	13,203	6,683	8,015	4,318	15,487.0	10,996.0
Growth (%)	*92.5*	*-49.4*	*19.9*	*-46.1*	*258.6*	*-29.0*
Milk						
Output (million litres)	119.85	142.66	159.39	162.28	158.7	152.4
Growth %	*-11.4*	*19.0*	*11.7*	*1.8*	*-2.2*	*-4.0*
Sugar Cane						
Output ('000 Metric tonnes)	1,878	1,595	1,764	1,613	2,002.5	1,730.0
Growth (%)	*51.1*	*-15.1*	*10.6*	*-8.6*	*24.1*	*-13.6*

*** Provisional**

Source: Kenya National Bureau of Statistics

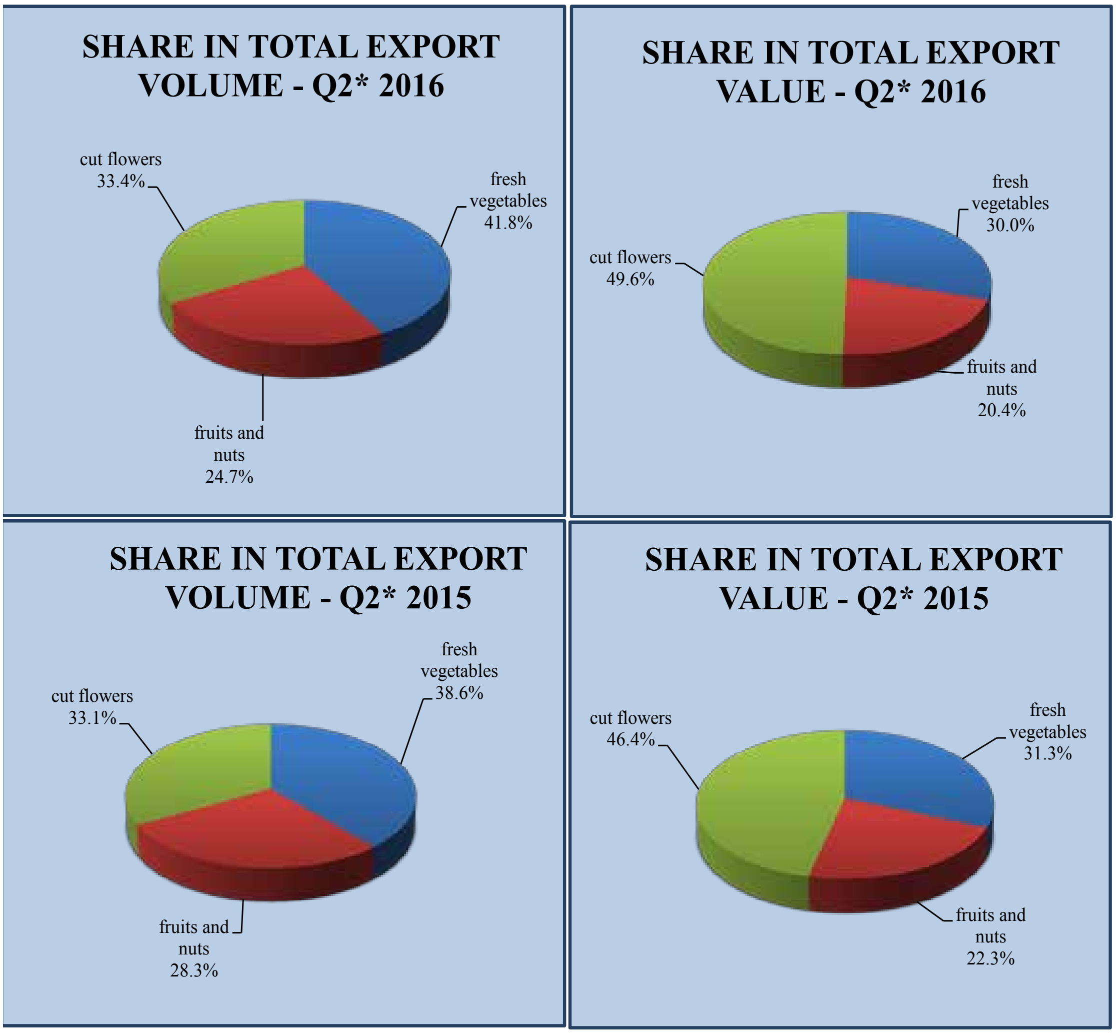
Coffee

Coffee sales decreased in the second quarter of 2016, recording a decline of 29.0 percent, while auction prices declined by 3.1 percent. However, when compared to the second quarter of 2015, coffee sales improved significantly by 64.5 percent in the period under review.

Horticulture

Horticultural exports declined in the second quarter of 2016 to record a decrease of 18.9 percent, down from an increase of 69.0 percent in the first quarter of 2016, mainly attributed to a fall in volumes of fresh vegetables arising from the delayed long rains **(Table 3.2)**. However, total export volumes increased by 35.2 percent in the second quarter of 2016 compared to the same period in 2015. Fresh vegetables recorded the largest share of export volumes, while cut flowers brought in the highest export values in April and May 2016 compared to the same period in 2015 **(Chart 3A)**.

CHART 3B: HORTICULTURAL EXPORTS



Source: Kenya Revenue Authority
****Q2 - April and May only***

Manufacturing

The manufacturing sector recorded subdued growth of 3.2 percent in the second quarter of 2016, which was slightly lower than 3.3 percent recorded in the previous quarter. Growth performance in the first half of 2016 was generally lower than that recorded in the first half of 2015. The sectoral share and contribution to overall GDP declined in the second quarter of 2016 compared to a similar quarter in 2015 **(Tables 3.1A** and **3.1B)**. Growth in the sector was mainly constrained by low activity in key subsectors such as production of soft drinks, processing of maize meal and wheat flour, and assembly of vehicles.

Cement production recorded a decline of 0.5 percent in the second quarter of 2016 compared to a growth of 3.4 percent recorded in the previous quarter. The number of assembled vehicles increased by 11.4 percent in the second quarter of 2016 compared to 3.4 percent recorded in the previous quarter **(Table 3.3)**.

TABLE 3.3: PRODUCTION OF SELECTED MANUFACTURED GOODS

	2015				2016*	
	Q1	Q2	Q3	Q4	Q1	Q2
Cement production						
Output (MT)	1,527,325	1,570,150	1,686,068	1,554,642	1,607,294	1,599,046
Growth %	*-4.0*	*2.8*	*7.4*	*-7.8*	*3.4*	*-0.5*
Assembled vehicles						
Output (No.)	2,472	2,385	2,717	2,607	1,600	1,782
Growth %	*12.5*	*-3.5*	*13.9*	*-4.0*	*-38.6*	*11.4*
Galvanized sheets						
Output (MT)	64,179	64,164	59,867	68,726	61,552	65,269.0
Growth %	*-9.7*	*-0.02*	*-6.7*	*14.8*	*-10.4*	*6.0*
Processed sugar						
Output (MT)	184,533	136,459	163,115	147,850	190,271	147,765.0
Growth %	*30.9*	*-26.1*	*19.5*	*-9.4*	*28.7*	*-22.3*
Soft drinks						
Output ('000 litres)	135691	74954	118164	125,990	119,895	107,171
Growth %	*3.7*	*-44.8*	*57.6*	*6.6*	*-4.8*	*-10.6*

MT = Metric tonnes
* Provisional

Source: Kenya National Bureau of Statistics

Construction and Real Estate

Growth in the construction industry slowed to 8.2 percent in the second quarter of 2016, compared to 9.9 percent in the first quarter of 2016 and 11.2 percent recorded in a similar quarter of 2015. The slowed growth was reflected in reduced production and consumption of cement during the quarter under review, and was mainly attributed to reduced activity related to the Standard Gauge Railway (SGR) as it nears completion.

The real estate sector recovered to record a growth of 8.7 percent in the second quarter of 2016 compared to 6.7 percent in the first quarter of 2016. This was reflected in the increased share to GDP and contribution to overall GDP growth **(Table 3.1B** and **Table 3.1C)**. Growth was enhanced by increased credit advanced to the sector.

Electricity and Water Supply Sector

The electricity and water supply sector recorded increased growth of 10.8 percent, up from 8.5 percent recorded in the first quarter of 2016. Growth in the sector was boosted by electricity generation. In particular, generation of hydro-electricity increased by 14.3 percent, while thermal electricity increased by 3.5 percent compared to second quarter of 2015.

However, hydro-power generation recorded slower growth in the second quarter of 2016 compared to the first quarter of 2016 due to delayed onset of the long rains that began in mid-April 2016. Geothermal power recorded a further decline of 2.3 percent in the second quarter of 2016 from a decline of 1.3 percent in the previous quarter. Thermal energy recorded slower growth of 2.3 percent, compared to 7.1 percent in the previous quarter **(Table 3.4)**.

TABLE 3.4: PERFORMANCE OF THE ENERGY SECTOR (QUARTERLY)

	2015				2016	
	Q1	Q2	Q3	Q4	Q1	Q2
Electricity Supply (Generation)						
Output (million KWH)	2,235.4	2,297.3	2,403.3	2,379.5	2,421.2	2,433.3
Growth %	*-2.1*	*2.8*	*4.6*	*-1.0*	*1.8*	*0.5*
Of which:						
Hydro-power Generation (million KWH)	753.8	862.6	930.2	916.7	953.8	985.9
Growth (%)	*-13.2*	*14.4*	*7.8*	*-1.5*	*4.0*	*3.4*
Geo-Thermal Generation (million KWH)	1,117.2	1,101.7	1,119.6	1,182.2	1,166.8	119.9
Growth (%)	*7.1*	*-1.4*	*1.6*	*5.6*	*-1.3*	*-2.3*
Thermal (million KWH)	364.5	333.0	353.5	280.7	300.7	307.5
Growth (%)	*-2.0*	*-8.6*	*6.2*	*-20.6*	*7.1*	*2.3*
Consumption of electricity (million KWH)	1,942.6	2,225.4	2,092.6	1,995.1	2,123.7	2,148.7
Growth %	*-3.0*	*14.6*	*-6.0*	*-4.7*	*6.4*	*1.2*
Consumption of Fuels ('000 tonnes)	1,110.2	1,111.1	1,111.9	1,106.2	1,121.7	1,294.8
Growth %	*21.2*	*0.1*	*0.1*	*-0.5*	*1.4*	*4.8*
Murban crude oil average price (US $ per barrel)	53.0	63.3	51.1	42.7	33.7	46.1
Growth %	*-29.3*	*19.5*	*-19.4*	*-16.4*	*-11.7*	*36.8*

Source: Kenya National Bureau of Statistics

The Services Sector

Performance of some of the services sectors was slower in the second quarter of 2016 compared to the previous quarter **(Table 3.1A)**. The financial and insurance sector recorded growth of 7.5 percent in the second quarter of 2016 compared to 8.0 percent reorded in the previous quarter. Its contribution to overall GDP growth remained stable at 0.4 percent over the same period **(Table 3.1C)**.

The growth performance of the information and communication sector slowed to 8.6 percent in the second quarter of 2016 compared to growth of 9.7 percent in the first quarter of 2016, with its contribution to overall GDP growth decreasing slightly to 0.3 percent from 0.4 percent.

Growth in the accommodation and restaurant sector remained on an upward trend, registering growth of 15.3 percent in the second quarter of 2016 compared to 12.1 percent in the first quarter. The sector received a considerable boost from increased conference tourism as the country hosted several high profile international conferences. Security within the country was also greatly improved during the period under review.

Tourist Arrivals

Tourist arrivals recorded slowed growth in the second quarter of 2016, decreasing by 9.8 percent compared to the previous quarter **(Table 3.5**). This was attributed to the off peak tourism season. Moi International Airport in Mombasa recorded the highest decline at 58.4 percent. However, tourist arrivals increased by 9.6 percent compared to a similar quarter of 2015.

TABLE 3.5: TOURIST ARRIVALS BY POINT OF ENTRY (QUARTERLY)

	2015				2016	
	Q1	Q2	Q3	Q4	Q1	Q2
Total Tourist Arrivals	177,085	170,373	208,397	192,918	206,224	187
Growth (%)	*-8.0*	*-3.8*	*22.3*	*-7.4*	*6.9*	*-9.8*
o.w. JKIA - Nairobi	152,138	160,564	190,009	170,080	178,283	175,056
Growth (%)	*-10.2*	*5.5*	*18.3*	*-10.5*	*4.8*	*-2.2*
MIAM - Mombasa	24,947	9,809	18,388	22,838	27,941	11,629
Growth %	*8.2*	*-60.7*	*87.5*	*24.2*	*22.3*	*-58.4*

Source: Kenya Tourism Board

Transport

Transport and storage sector registered improved performance in the second quarter of 2016, growing by 8.8 percent compared to 8.4 percent recorded in the previous quarter. Growth was partly supported by low international oil prices that led to a considerable drop in the average price of light diesel. However, passenger flows at the Jomo Kenyatta International Airport, Nairobi (JKIA) declined by 0.28 percent in the second quarter of 2016, while the volume of oil that passed through the Kenya pipeline declined by 1.2 percent in the second quarter of 2016 compared to growth of 1.2 percent in the previous quarter **(Table 3.6)**.

TABLE 3.6: THROUGHPUT OF SELECTED TRANSPORT COMPANIES (QUARTERLY)

	2015				2016	
	Q1	Q2	Q3	Q4	Q1	Q2
Number of Passengers thro' JKIA						
Total passenger flows	1,093,150	1,083,521	1,082,120	1,082,533	1,082,784	1,079,762
Growth (%)	*0.4*	*-0.9*	*-0.1*	*0.0*	*0.2*	*-0.3*
o.w. Incoming	544,470	542,619	539,865	540,315	541,061	538,720
Growth (%)	*0.6*	*-0.3*	*-0.5*	*0.1*	*0.1*	*-0.40*
Outgoing	548,680	540,902	542,255	542,218	541,723	541,042
Growth %	*0.3*	*-1.4*	*0.3*	*0.0*	*-0.1*	*0.1*
Kenya Pipeline Oil Throughput						
Output ('000 litres)	1,453,716	1,412,774	1,428,822	1,442,630	1,460,007	1,442,315
Growth %	*3.2*	*-2.8*	*1.1*	*1.0*	*1.2*	*-1.2*

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

Developments in the Global Economy, Balance of Payments and Exchange Rates

Global Developments

Global economic activity remains weak projected to grow by 3.1 percent in 2016, from 3.2 percent in 2015. The global economy is expected to improve in 2017 to grow by 3.4 percent (IMF World Economic Outlook, October 2016).

Growth in advanced economies is expected to slow down to 1.6 percent in 2016 from 2.1 percent in 2015, due to lower productivity accompanied by inflation that is persistently below target. Meanwhile in emerging market and developing economies, growth momentum remains modest at a projected 4.2 percent growth in 2016 from 4 percent in 2015. This is largely due to performance of the Chinese economy which is expected to slow down to 6.6 percent in 2016 from 6.9 percent in 2015 as the country transitions from growth driven by investment and exports to growth based on consumption and services.

However, global economic activity is expected to increase with output growth projected in 2017 at 3.4 percent on account of recovery in market conditions in advanced economies as well as emerging market and developing economies.

Balance of Payments Developments

Kenya's external position remained resilient despite the worsening of the current account balance to a deficit of US$ 1,116 million during the second quarter of 2016 from a deficit of US$ 403 million in the preceding quarter. This largely follows an increase in the value of oil imports (on account of a recovery in the price of oil on the international markets following supply disruptions and seasonal demand for oil) and imports of machinery and transport equipment reflecting the ongoing expansion of Kenya's power generating capacity **(Table 4.1)**.

Kenya's overall balance of payments position worsened from US$ 254 million deficit during the first quarter of 2016 to US$ 491 million deficit during the second quarter of 2016. The deterioration was largely reflected in the current account mainly driven by increased spending on merchandise imports accompanied by lower receipts from exports of goods and services.

The current account balance worsened to a deficit of US$ 1,116 million during the second quarter of 2016 from a deficit of US$ 403 million in the preceding quarter. In particular, imports of oil, machinery and transport equipment increased by 34.7 percent and 22.2 percent, respectively in the second quarter of 2016 **(Table 4.2)**. The increase in the value of oil imports is reflected in both prices and quantities. Crude oil prices - simple average of Dated Brent, West Texas Intermediate, and the Dubai Fateh – were higher at US$ 44.8 per barrel in the second quarter of 2016 from US$ 32.8 in the first quarter of 2016. In June 2016, oil prices increased by 3.7 percent sustaining the upward trend that began in February 2016, and mainly reflects a seasonal increase in demand as well as supply disruptions in some regions. The increase in imports of machinery and transport equipment in the second quarter, mainly of power generating electrical equipment reflects the ongoing expansion of Kenya's power generating capacity.

TABLE 4.1: BALANCE OF PAYMENTS (US$ M)[1]

ITEM	2015* Q2	2015* Q3	2015* Q4	2016** Q1	2016** Apr	2016** May	2016** Jun	Q2 2016*	Q2 2016-Q1 2016 Change	Q2 2016-Q1 2016 % Change
1. Overall Balance	**504**	**504**	**-859**	**-254**	**-178**	**-53**	**-260**	**-491**	**-237**	**93.4**
2. Current account n.i.e	**-1,337**	**-912**	**-1,084**	**-403**	**-412**	**-326**	**-378**	**-1,116**	**-713**	**176.7**
Exports (fob)	1,409	1,618	1,500	1,533	466	501	483	1,450	-83	-5.4
Imports (fob)	4,062	3,836	3,911	3,025	1,178	1,103	1,201	3,481	456	15.1
Services: credit	1,140	1,099	1,101	1,073	340	288	296	924	-149	-13.9
Services: debit	520	523	543	744	247	245	242	734	-10	-1.4
Balance on goods and services	-2,174	-1,761	-1,994	-1,254	-618	-558	-665	-1,841	-587	46.8
Primary income: credit	76	78	79	91	30	29	29	88	-2	-2.7
Primary income: debit	217	197	220	181	59	59	61	178	-3	-1.5
Balance on goods, services, and primary income	-2,315	-1,880	-2,135	-1,344	-647	-588	-697	-1,931	-587	43.7
Secondary income, n. i. e.: credit	854	864	925	870	237	264	322	823	-47	-5.4
o.w Remittances	390	392	402	416	144	147	165	455	40	9.6
Secondary income: debit	16	15	14	20	2	2	3	8	-12	-60.2
3. Capital Account, n.i.e.	**75**	**59**	**60**	**100**	**17**	**14**	**20**	**51**	**-50**	**-49.5**
4. Financial Account, n.i.e.	**-952**	**-892**	**-1,774**	**-1,694**	**-232**	**-365**	**-873**	**-1,471**	**223**	**-13.2**

* Revised

**Provisional

\[1]Based on the Balance of Payments and International Investment Position Manual, 6th Edition

Source: Central Bank of Kenya

Earnings from exports of horticulture declined by 8.5 percent in the second quarter of 2016 reflecting lower seasonal demand for fresh vegetables and cut flowers. Compared with the second quarter of 2015, horticulture receipts were higher by 31 percent. The value of tea exports remained broadly unchanged in the second quarter of 2016 anchored on tea production on account of favourable weather in tea growing zones. Tea prices, however, declined from US$ 2.90 in the first quarter to US$ 2.51 during the second quarter of 2016.

The services account declined by 42.1 percent during the second quarter of 2016, mainly due to lower receipts from transport services. On the upside, travel services improved by 16.2 percent in the second quarter of 2016 in line with the recovery in tourist arrivals. Remittance inflows (secondary income) increased by 9.6 percent during the second quarter of 2016 **(Table 4.1)**.

TABLE 4.2: BALANCE ON CURRENT ACCOUNT (US$ M)

ITEM	2015* Q2	2015* Q3	2015* Q4	2016** Q1	2016** Apr	2016** May	2016** Jun	Q2 2016*	Q2 2016-Q1 2016 Change	Q2 2016-Q1 2016 % Change
2. CURRENT ACCOUNT	**- 1,337**	**- 912**	**- 1,084**	**- 403**	**- 412**	**- 326**	**- 378**	**- 1,116**	**- 713**	**176.7**
2.1 Goods	**- 2,654**	**- 2,218**	**- 2,411**	**- 1,493**	**- 712**	**- 602**	**- 718**	**- 2,032**	**- 539**	**36.1**
Exports (fob)	**1,409**	**1,618**	**1,500**	**1,533**	**466**	**501**	**483**	**1,450**	**- 83**	**- 5.4**
o.w Coffee	65	53	43	50	25	22	23	70	21	41.7
Tea	270	301	385	325	94	106	125	325	- 0	- 0.1
Horticulture	157	232	172	225	75	71	60	205	- 19	- 8.5
Oil products	19	22	11	7	5	4	6	14	7	96.8
Manufactured Goods	121	147	117	106	37	33	36	106	0	0.2
Imports (fob) of which	**4,062**	**3,836**	**3,911**	**3,025**	**1,178**	**1,103**	**1,201**	**3,481**	**456**	**15.1**
o.w Oil	698	617	598	402	172	167	203	542	140	34.7
Chemicals	629	565	546	544	226	181	175	581	37	6.9
Manufactured Goods	683	683	624	568	203	221	221	645	77	13.6
Machinery & Transport Equipment	1,431	1,330	1,518	956	414	330	424	1,168	212	22.2
2.2 Services	**620**	**576**	**558**	**329**	**93**	**43**	**54**	**191**	**- 139**	**- 42.1**
Transport Services (net)	**219**	**155**	**190**	**148**	**- 10**	**3**	**- 3**	**- 10**	**- 159**	**- 106.9**
Credit	480	417	447	400	82	94	98	274	- 126	- 31.6
Debit	262	262	257	252	93	90	101	284	32	12.9
Travel Services (net)	**136**	**127**	**105**	**137**	**48**	**52**	**59**	**159**	**22**	**16.2**
Credit	179	180	176	189	56	61	74	191	1	0.8
Debit	44	53	71	53	8	9	15	32	- 21	- 39.1
Other Services (net)	**265**	**294**	**263**	**44**	**56**	**- 12**	**- 2**	**42**	**- 2**	**- 5.0**

* Revised

**Provisional

Source: Central Bank of Kenya

Direction of Trade

Kenya sourced most imports from China during the second quarter of the year, with the share of imports from China to total imports during the review period increasing to 24 percent from 21 percent in first quarter. The surge is attributed to increase in imports related to energy investment. The share of Kenya's imports from the European Union decreased to 16 percent from 17 percent, while that from India decreased to 16 percent from 19 percent. Imports from Africa accounted for 9 percent in the second quarter of 2016 compared with 10 percent in the first quarter **(Table 4.3A)**.

TABLE 4.3A: KENYA'S DIRECTION OF TRADE IMPORTS

IMPORTS (in millions of US dollars)				2016					Share of Imports (%)	
	2015								2016	
Country	**Q2**	**Q3**	**Q4**	**Q1**	**Apr**	**May**	**Jun**	**Q2**	**Q1**	**Q2**
Africa	**393**	**377**	**358**	**296**	**101**	**112**	**117**	**330**	**10**	**9**
Of which										
South Africa	155	164	152	97	36	47	45	128	**3**	**4**
Egypt	69	62	67	65	23	19	22	64	**2**	**2**
Others	169	151	139	134	43	47	49	139	**4**	**4**
EAC	**113**	**98**	**85**	**68**	**19**	**24**	**30**	**72**	**2**	**2**
COMESA	**168**	**151**	**173**	**149**	**45**	**50**	**56**	**151**	**5**	**4**
Rest of the World	**3670**	**3459**	**3553**	**2730**	**1076**	**990**	**1084**	**3151**	**90**	**91**
Of which										
India	666	553	649	560	194	207	166	567	**19**	**16**
United Arab Emirates	264	286	232	142	71	52	115	237	**5**	**7**
China	807	929	735	640	272	247	322	841	**21**	**24**
Japan	238	235	227	201	74	60	62	195	**7**	**6**
USA	351	129	597	108	60	39	44	143	**4**	**4**
United Kingdom	114	134	88	72	28	32	31	91	**2**	**3**
Singapore	12	26	33	7	6	11	7	24	**0**	**1**
Germany	149	127	92	113	39	38	42	118	**4**	**3**
Saudi Arabia	171	111	106	128	80	30	56	167	**4**	**5**
Indonesia	118	125	97	115	30	37	35	102	**4**	**3**
Netherlands	54	65	45	38	10	20	7	37	**1**	**1**
France	53	58	58	54	17	16	19	52	**2**	**1**
Bahrain	4	30	21	11	1	0	1	2	**0**	**0**
Italy	54	63	51	48	19	19	21	59	**2**	**2**
Others	615	588	521	491	176	183	157	516	**16**	**15**
Total	**4062**	**3836**	**3911**	**3025**	**1178**	**1103**	**1201**	**3481**	**100**	**100**
EU	656	627	509	502	190	194	178	561	**17**	**16**
China	807	929	735	640	272	247	322	841	**21**	**24**

Source: Kenya Revenue Authority

Exports

Kenya's exports to Africa decreased by 5 percent in the second quarter of 2016 **(Table 4.3B)**. The decline was largely in exports to the EAC (Uganda and Tanzania), Sudan and South Sudan. In addition, exports to the rest of the world decreased by 5.7 percent in the quarter under review. The share of exports to China increased to 2 percent during the second quarter of 2016 while that to the European Union decreased to 21 percent from 23 percent in the preceding quarter.

TABLE 4.3B: KENYA'S DIRECTION OF TRADE EXPORTS

EXPORTS (in millions of US dollars)				2016					Share of Exports (%)	
	2015								2016	
Country	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	Q1	Q2
Africa	**595**	**676**	**593**	**613**	**197**	**197**	**188**	**582**	**40**	**40**
Of which										
Uganda	150	236	144	153	63	42	46	151	**10**	**10**
Tanzania	88	80	95	105	25	34	27	87	**7**	**6**
Egypt	52	51	58	53	21	18	19	58	**3**	**4**
Sudan	14	15	15	16	5	3	4	12	**1**	**1**
South Sudan	54	33	36	55	11	17	14	41	**4**	**3**
Somalia	33	36	49	39	9	19	13	40	**3**	**3**
DRC	50	50	53	46	17	15	17	49	**3**	**3**
Rwanda	43	58	40	41	16	12	16	44	**3**	**3**
Others	111	118	103	106	31	37	33	100	**7**	**7**
EAC	295	395	292	319	109	93	95	297	**21**	**20**
COMESA	385	492	370	379	143	115	124	382	**25**	**26**
Rest of the World	**814**	**942**	**907**	**919**	**269**	**304**	**294**	**867**	**60**	**60**
Of which										
United Kingdom	84	111	103	107	31	29	31	92	**7**	**6**
Netherlands	95	116	93	137	35	37	31	104	**9**	**7**
USA	96	122	101	89	30	33	37	100	**6**	**7**
Pakistan	69	81	131	73	24	31	49	105	**5**	**7**
United Arab Emirates	76	89	68	82	25	30	24	80	**5**	**6**
Germany	30	25	27	27	15	11	10	35	**2**	**2**
India	23	29	20	43	14	6	4	23	**3**	**2**
Afghanistan	30	39	40	52	9	13	13	35	**3**	**2**
Others	310	330	324	310	86	113	95	294	**20**	**20**
Total	**1409**	**1618**	**1500**	**1533**	**466**	**501**	**483**	**1450**	**100**	**100**
EU	287	344	298	349	105	101	95	300	**23**	**21**
China	24	19	19	17	7	7	11	24	**1**	**2**

Source: Kenya Revenue Authority

Capital and Financial Account

Inflows to the Capital account declined by 49.5 percent during the second quarter of 2016 reflecting a lower rate of increase of inflows from programme and project grants during the quarter.

Financial account flows in the second quarter of 2016 improved by 13.2 percent to US$ 1,471 million compared to US$ 1,694 million in the preceding quarter. Inflows were mainly in the form of other investment largely reflecting concessional Chinese bilateral funding to the Government during the financial year.

TABLE 4.4: BALANCE ON CAPITAL AND FINANCIAL ACCOUNT (US$ M)

ITEM	2015*			2016**				Q2 2016*	Q2 2016-Q1 2016	
	Q2	Q3	Q4	Q1	Apr	May	Jun		Change	% Change
B. Capital Account, n.i.e.	**75**	**59**	**60**	**100**	**17**	**14**	**20**	**51**	**-50**	**-49.5**
Capital account, n.i.e.: credit	**75**	**59**	**60**	**100**	**17**	**14**	**20**	**51**	-50	-49.5
Capital account: debit	-	-	-	-	-	-	-	-	-	-
C. Financial Account, n.i.e.	**-952**	**-892**	**-1,774**	**-1,694**	**-232**	**-365**	**-873**	**-1,471**	**223**	**-13.2**
Direct investment: assets	100	100	100	100	33	33	33	**100**	-	-
Direct investment: liabilities, n.i.e.	370	363	368	391	123	118	117	**358**	-34	-8.6
Portfolio investment: assets	80	9	26	5	3	-1	1	**3**	-3	-52.8
Portfolio investment: liabilities, n.i.e.	7	8	16	13	1	1	2	**4**	-9	-71.1
Financial derivatives: net	-	-	-	-	-	-	-	-	-	-
Other investment: assets	154	-54	84	-244	79	-4	166	**240**	485	-198.4
Other investment: liabilities, n.i.e.	908	577	1,599	1,150	223	274	954	**1,451**	301	26.2

* Revised

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Source: Central Bank of Kenya

Foreign Exchange Reserves

The banking system's total foreign exchange holdings improved by 7 percent in the second quarter of 2016. Official reserves held by the CBK constituted 79 percent of gross reserves and increased to USD 8,267 million, equivalent to 5.4 months of import cover reflecting an increase in interbank forex purchases during the month of May 2016. Foreign exchange reserves held by commercial banks increased by 11.5 percent to USD 2,232 million during the review period **(Table 4.5)**.

Meanwhile, the Precautionary Arrangements with the IMF amounting to US$ 1,500 million continue to provide additional buffer against short term external and domestic shocks.

TABLE 4.5: FOREIGN EXCHANGE RESERVES AND RESIDENTS' FOREIGN CURRENCY DEPOSITS (END OF PERIOD, US$ MILLION)

`	2015				2016				
	Q1	Q2	Q3	Q4	Q1	Apr 16	May 16	Jun 16	Q2
1. Gross Reserves	**9,834**	**9,473**	**8,899**	**9,794**	**9,809**	**10,063**	**10,102**	**10,499**	**10,499**
of which:									
Official	7,723	7,212	6,711	7,534	7,807	7,986	8,032	8,267	8,267
*import cover**	*4.9*	*4.6*	*4.3*	*4.8*	*5.1*	*5.2*	*5.3*	*5.4*	*5.4*
Commercial Banks	2,111	2,262	2,188	2,259	2,002	2,077	2,070	2,232	2,232
2. Residents' foreign currency deposits	**4,154**	**4,488**	**4,278**	**4,389**	**4,191**	**4,238**	**4,313**	**4,443**	**4,443**

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

Source: Central Bank of Kenya

Exchange Rates

The foreign exchange market has remained stable supported by a generally narrowing current account deficit and resilient inflows from diaspora remittances.

During the second quarter of 2016, the Kenya Shilling appreciated against the US Dollar and the Pound Sterling but depreciated against the Euro and the Japanese Yen. The strengthening of the Shilling against the US Dollar during the review period is largely attributed to subdued dollar demand in the domestic market and increased foreign exchange inflows from inward transfers, non-governmental organizations and the Tea Sector.

In the EAC region, the Kenya shilling strengthened against the Tanzania Shilling as well as the Rwanda and Burundi Francs but weakened against the Uganda Shilling **(Table 4.6 and Chart 4D)**.

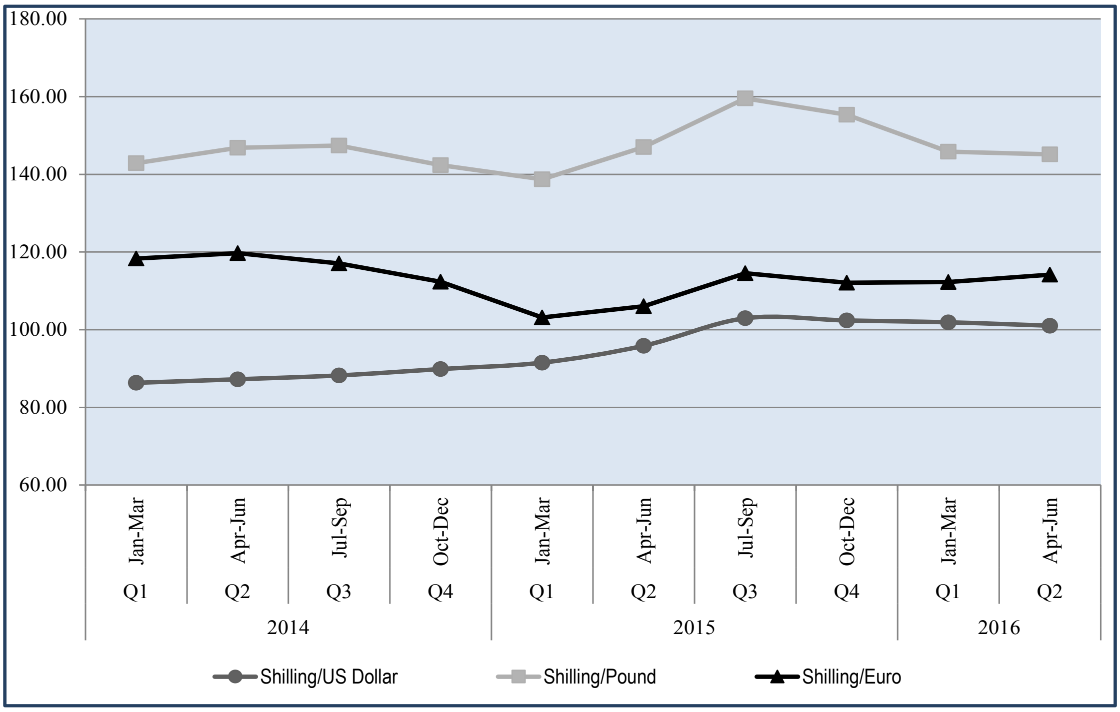
TABLE 4.6: KENYA SHILLING EXCHANGE RATE

	2015				2016					
	Q1	Q2	Q3	Q4	Q1	April	May	June	Q2	% change Q2 2016 - Q1 2016
US Dollar	91.53	95.87	102.95	102.38	101.90	101.23	100.73	101.14	101.04	-0.85
Pound Sterling	138.70	147.04	159.58	155.33	145.85	144.79	146.27	144.32	145.12	-0.50
Euro	103.15	106.05	114.52	112.10	112.26	114.84	113.96	113.69	114.16	1.69
100 Japanese Yen	76.84	79.02	84.27	84.32	88.35	92.40	92.48	95.85	93.58	5.92
Uganda Shilling*	31.62	31.97	34.21	33.95	33.51	33.04	33.21	33.27	33.18	-1.00
Tanzania Shilling*	19.80	21.27	20.73	21.13	21.44	21.65	21.74	21.67	21.69	1.13
Rwanda Franc*	7.54	7.30	7.06	7.24	7.38	7.49	7.56	7.59	7.55	2.19
Burundi Franc*	17.10	16.33	15.25	15.16	15.27	15.36	15.46	16.02	15.61	2.25

* Units of currency per Kenya Shilling

Source: Central Bank of Kenya

CHART 4B: KENYA SHILLING EXCHANGE RATE



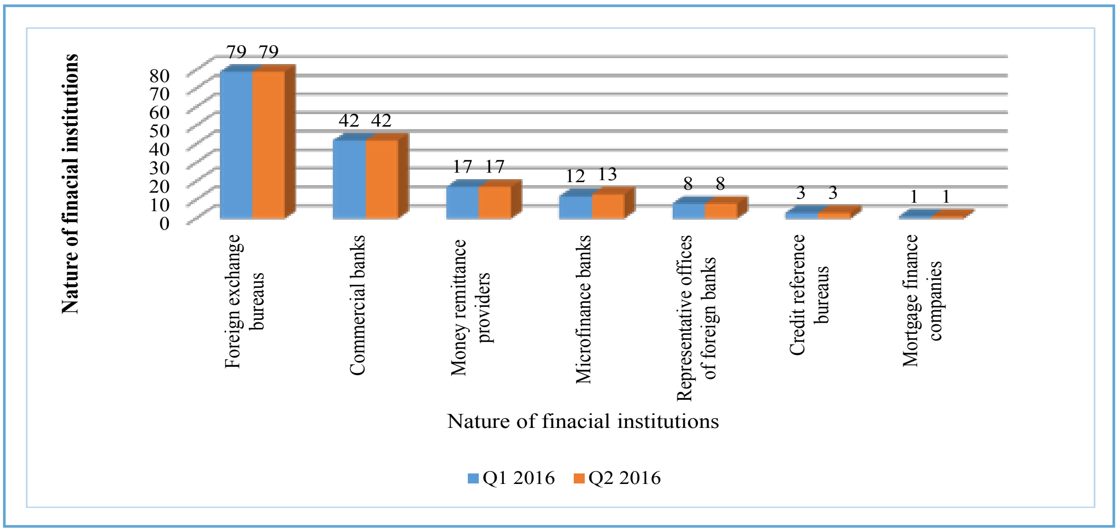
Source: Central Bank of Kenya

Developments in The Banking Sector

Introduction

The Kenyan banking sector comprised 42 commercial banks,[1] mortgage finance company, 13 microfinance banks, 8 representative offices of foreign banks, 79 foreign exchange bureaus, 17 money remittance providers and 3 credit reference bureaus as at June 30, 2016 **(Chart 5A)**

CHART 5A: STRUCTURE OF KENYAN BANKIING SECTOR



Source: Central Bank of Kenya

Maisha Microfinance Bank Limited was licensed on May 21, 2016 and this increased the number of microfinance banks to 13 as compared to 12 in quarter 1, 2016. Chase Bank Limited was placed under receivership on April 8, 2016, the second bank since Imperial Bank in October 2015.

Structure of the Balance Sheet

i) Growth in banking sector assets.

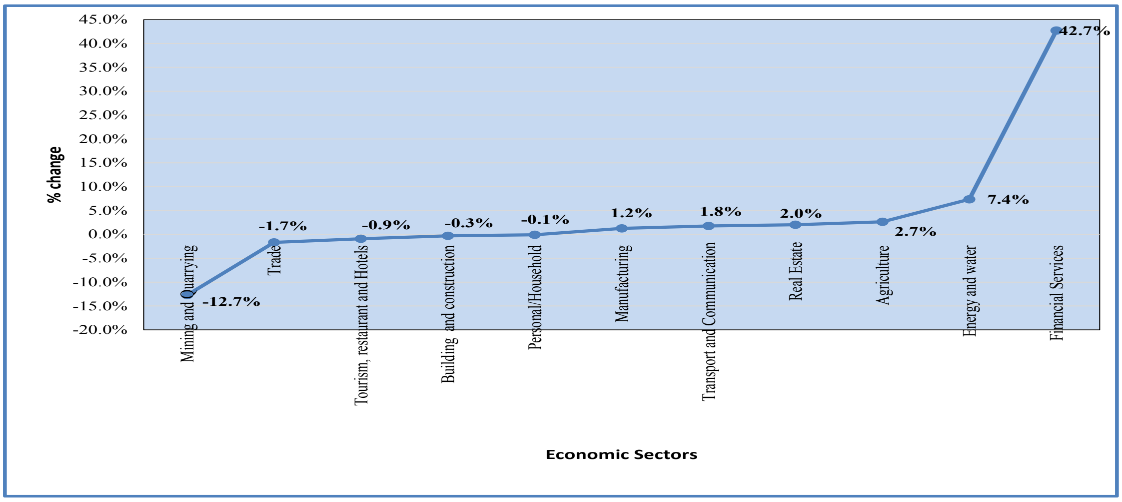
Total net assets grew by 3.0 percent from KSh 3,571.3 billion in the first quarter of 2016 to KSh 3,677.9 billion in second quarter. The growth in assets is attributed to investments in government securities which increased by 11.0 percent in the second quarter of 2016. Loans and advances were the main component of bank assets accounting for 58.7 percent in in the second quarter of 2016, compared with 59.7 percent in the previous quarter.

ii) Loans and Advances

Total banking sector lending increased by 2.1 percent from KSh 2,221.2 billion in the first quarter of 2016 to KSh 2,267.3 billion in the second quarter. Six of the twelve economic sectors, registered increase in gross loans **(Chart 5B)**.

1 Charterhouse Bank is under Statutory Management, while Chase Bank Limited and Imperial Bank are in Receivership. The three banks have been excluded in this report.

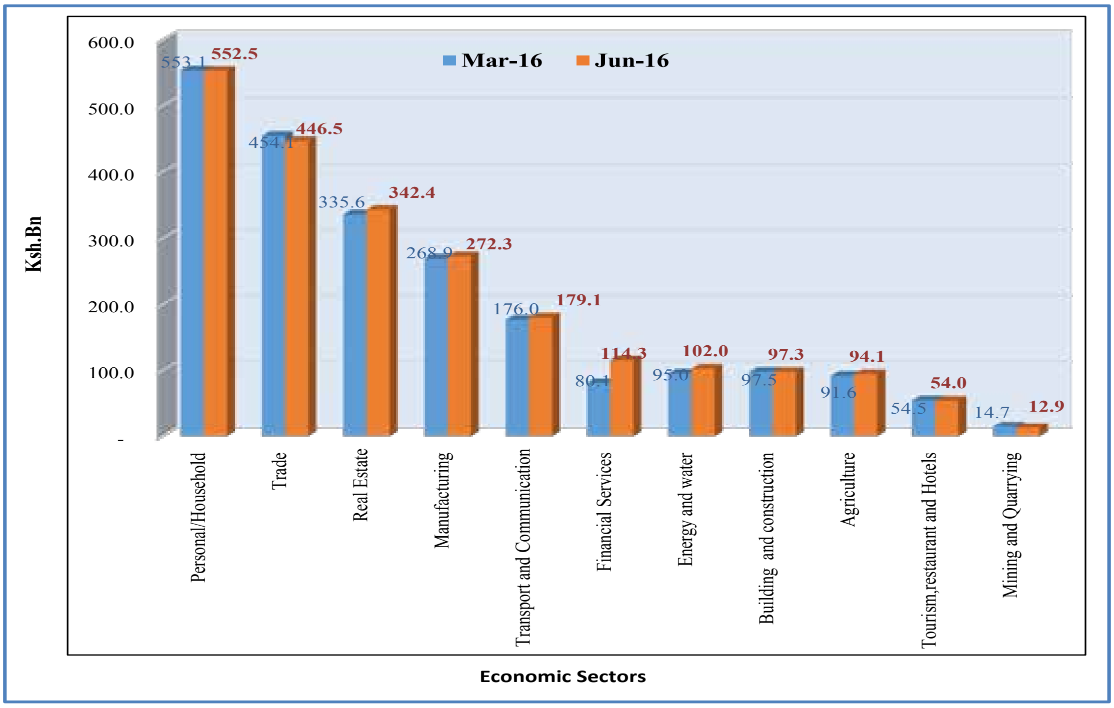
CHART 5B: CHANGE IN SECTORAL GROSS LOANS BETWEEN Q1, 2016 & Q2, 2016



Source: Central Bank of Kenya

Financial Services sector recorded the highest increase in demand for credit with an increase of KSh 34.2 billion or 42.7 percent. The surge partly reflected increased lending by banks to Microfinance banks and SACCO's to fund their activities. Credit to Energy and Water sector increased by KSh.7.0 billion or 7.4 percent largely to support distribution of electricity. Mining and Quarrying sector recorded the highest decline in gross loans at 12.7 percent on account of net repayments (**Chart 5B** and **5C**).

CHART 5C: KENYAN BANKING SECTOR GROSS LOANS (KSHS. Bn)

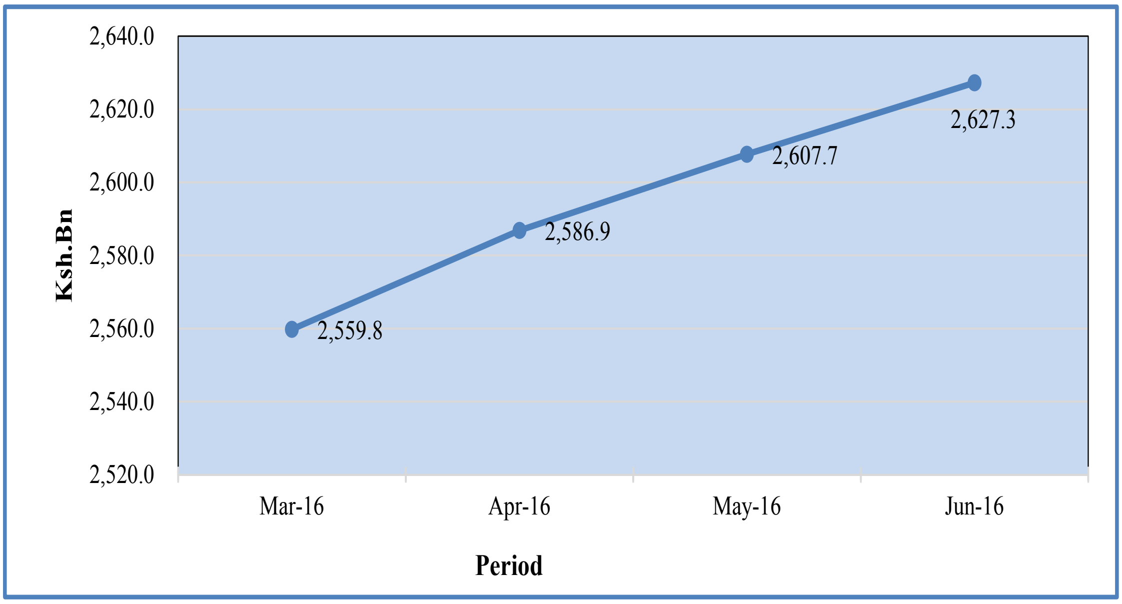


Source: Central Bank of Kenya

iii) Deposit Liabilities

Customer deposits remain the main source of funding to the banks, accounting for 71.4 percent of the banking sector entire funding activities in the second quarter of 2016 slightly changed from 71.7 percent in the previous quarter. However, customer deposits increased by 2.6 percent (**Chart 5D)**.

CHART 5D CUSTOMER DEPOSITS IN KSH BILLION



Source: Central Bank of Kenya

The growth in customer deposits through the second quarter of 2016 is attributed to:-

- Use of technological innovations for deposit mobilization- The number of commercial banks deposit accounts increased by 0.7 million, or 1.9 percent from 37.5 million in first quarter of , 2016 to 38.2 million in the second quarter. This was mainly driven by deposit accounts opened through the mobile phone platforms.
- Agency banking model- The number of all transactions through agents increased by 53.1 million in the second quarter of 2016.
- Aggressive deposit mobilization strategies adopted by several banks.

Capital Adequacy for the Sector

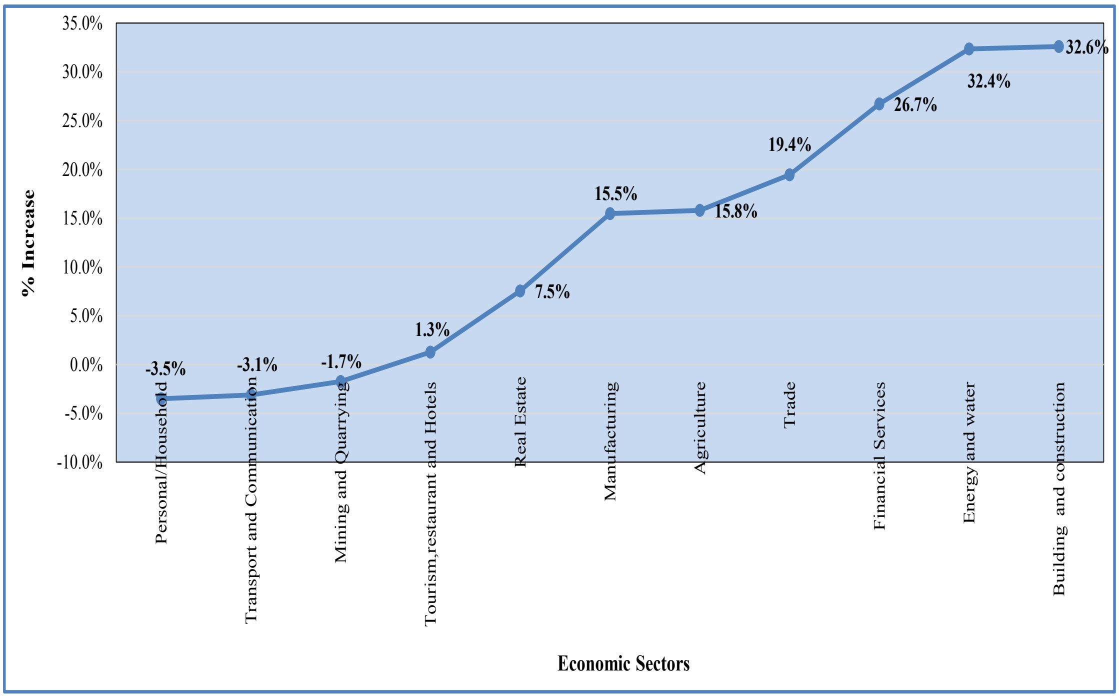
The Kenyan banking sector enhanced capital levels for resilience to adverse shocks. The core capital and total capital increased by 2.2 percent and 1.1 percent, respectively in the second quarter of 2016. However, growth in risk-weighted assets at 0.9 percent trailed that of total capital and core capital. As a result, total capital and core capital to total risk- weighted assets ratios increased from 18.8 percent and 16.0 percent in the first quarter of, 2016 to 18.9 percent and 16.3 percent, respectively in the second quarter.

The minimum core capital to total deposits ratio for banks is set at 8 percent. Banks continued to maintain high capital adequacy ratios, at 18.5 percent and 18.7 percent in the first and second quarters of 2016, respectively. The marginal reduction is attributed to a lower growth in core capital of 2.2 percent as compared to a 2.6 percent growth in customer deposits in the second quarter of 2016.

Asset Quality

Gross non-performing loans (NPLs) increased by 12.1 percent from KSh 170.6 billion as at end of first quarter of 2016 to KSh 191.2 billion by end of the second quarter 2. Eight economic sectors recorded increases in NPLs during the second quarter of 2016 as highlighted in **Chart 5E** below.

CHART 5E: SECTORAL INCREASE IN GROSS NPLS

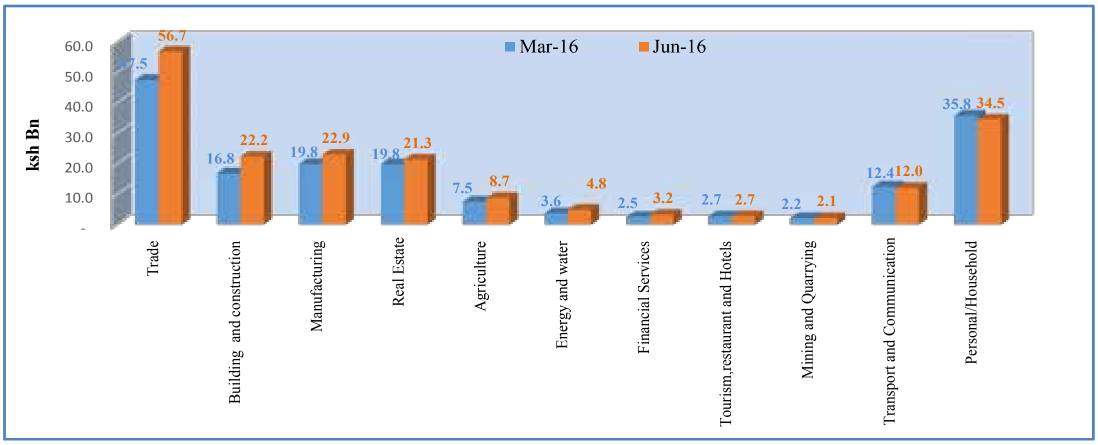


Source: Central Bank of Kenya

Personal/Household sector NPLs decreased of by KSh. 1.3 billion or 3.5 percent due to aggressive loan recovery strategies by commercial banks. Trade sector recorded the highest increase in NPLs at KSh 9.2 billion or 19.4 percent. This is attributable to business cash flow challenges and constraints. Building and Construction sector NPLs increased by KSh 5.5 billion or 32.6 percent due to delayed payments from several agencies for building and construction projects. Manufacturing sector NPLs increased by KSh 3.1 billion or 15.5 percent following reduced trading activities and cash flow constraints. The Real Estate sector NPLs increased by KSh 1.5 billion or 7.5 percent due slowdown in the uptake of housing units.

Based on the movements of NPLs highlighted above, the gross NPLs to gross loans ratio increased from 7.7 percent in the first quarter of 2016 to 8.4 percent in the second quarter. However, during the review quarter, the NPLs trend reversal is apparent following slowdown from 8.54 percent in May 2016 to 8.43 percent in June 2016 due to improved business conditions and payment of suppliers and contractors by the government. Chart 6 below highlights the sectorial distribution of gross NPLs between the two periods under review.

CHART 5F: KENYAN BANKING SECTOR GROSS NON-PERFOMING LOANS (KSH BILLION)



Source: Central Bank of Kenya

The banking sector's asset quality measured as a proportion of net non-performing loans to gross loans deteriorated from 3.95 percent in the first quarter of 2016 to 4.41 percent in the second quarter. Similarly, the coverage ratio, which is measured as a percentage of specific provisions to total NPLs decreased from 36.3 percent to 35.7 percent due to the higher increase in NPLs as compared to increase in specific provisions between the two periods.

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

TABLE 5.1: SUMMARY OF ASSET QUALITY

		Mar-16 (Kshs'Bn)	June-16 (Kshs'Bn)
1	Gross Loans and Advances (Kshs'Bn)	2,221.20	2,267.25
2	Interest in Suspense (Kshs'Bn)	32.85	35.72
3	Loans and advances (net of interest suspended) (Kshs'Bn)	2,188.36	2,231.53
4	Gross non-performing loans (Kshs'Bn)	170.58	191.24
5	Specific Provisions (Kshs'Bn)	50.03	55.59
6	General Provisions (Kshs'Bn)	16.68	18.00
7	Total Provisions (5+6) (Kshs'Bn)	66.71	73.58
8	Net Advances (3-7) (Kshs'Bn)	2,121.65	2,157.95
9	Total Non-Performing Loans and Advances (4-2) (Kshs'Bn)	137.73	155.52
10	Net Non-Performing Loans and Advances (9-5) (Kshs'Bn)	87.70	99.93
11	Total NPLs as % of Total Advances (9/3)	6.29%	6.97%
12	Net NPLs as % of Gross Advances (10/1)	3.95%	4.41%
13	Specific Provisions as % of Total NPLs (5/9)	36.33%	35.74%

Source: Central Bank of Kenya

Profitability

The banking sector pre-tax profits increased by 11.7 percent from KSh 38.4 billion in the first quarter of 2016 to KSh 42.8 billion in the second quarter. The profitability in the second quarter of 2016 is mainly reflected in interest on government securities and interest on advances which increased by 11.7 percent and 1.2 percent. This was attributable to increase investment in government securities (11 percent) in the second quarter of 2016 and the increase in lending rates from an average of 17.8 percent in the first quarter of 2016 to an average of 18.1 percent in the second quarter.

Total income increased by 2.6 percent, from KSh 126.5 billion to KSh 129.7 billion, while total expenses decreased by 1.3 percent, from KSh 88.1 billion to KSh 86.9 billion over the same period. The decrease in expenses was largely in interest on deposits which decreased by 14.6 percent due to a fall in the weighted deposit rate from 7.2 percent to 6.4 percent.

Interest on loans and advances, other incomes and interest on government securities were the major sources of income accounting for 61.1 percent, 15.4 percent and 17.1 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 35.3 percent, 23.2 percent and 20.6 percent of total expenses, respectively.

The return on assets increased from 3.4 percent in the first quarter of 2016 to 4.2 percent in second quarter 2016 while return on shareholders' funds increased from 27.7 percent to 33.8 percent following accelerated growth in the sector's profitability in the second quarter of2016.

Liquidity

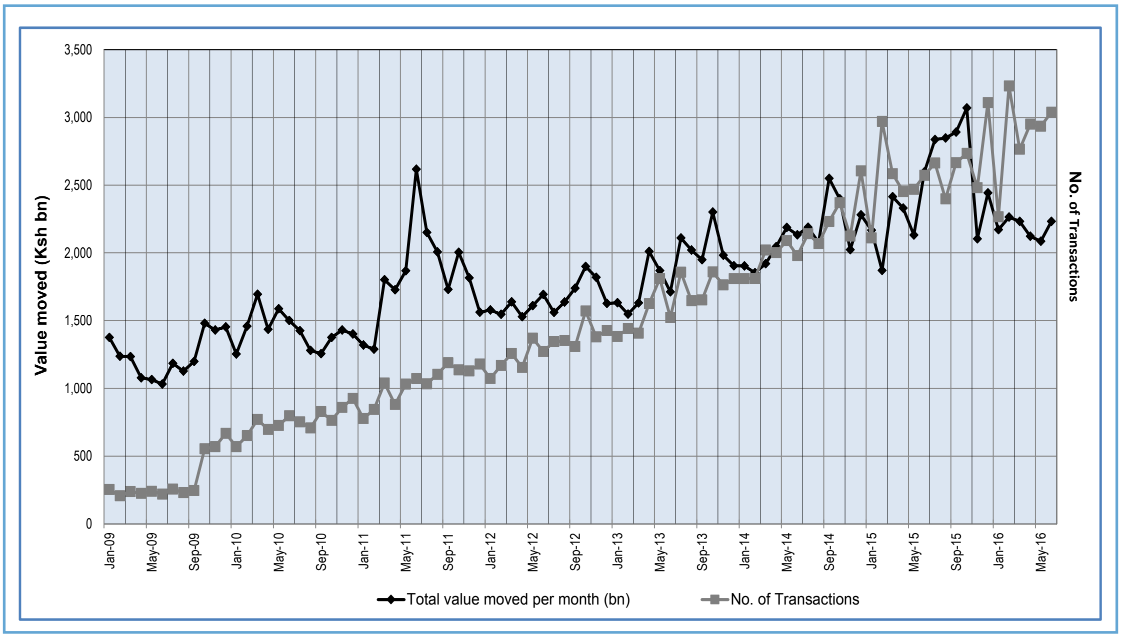
The banking sector's overall liquidity ratio changed marginally in the second quarter of 2016. It stood at 40.4 percent in June compared to 39.9 percent recorded in March. The banking sector liquidity ratio recorded was above the minimum statutory level of 20 percent.

The placement of Chase Bank Limited in receivership on April 8, 2016, affected the liquidity distribution which accelerated segmentation in the interbank market and reduction of interbank lines. However, the Central Bank of Kenya provided support to the affected banks through reverse repos.

KENYA SHILLING FLOWS IN KEPSS

The Kenya Electronic Payments and Settlement System (KEPSS) used for large value Real Time Gross Settlement (RTGS) payments moved a volume of 892,067 Transaction messages worth KSh 6.4 trillion compared to 839,890 transactions worth KSh 6.8 trillion recorded in the first quarter of 2016. This represented an increase of 6.2 percent in volume and a decline of 5.9 percent in value.

CHART5G: TRENDS IN MONTHLY FLOWS THROUGH KEPSS



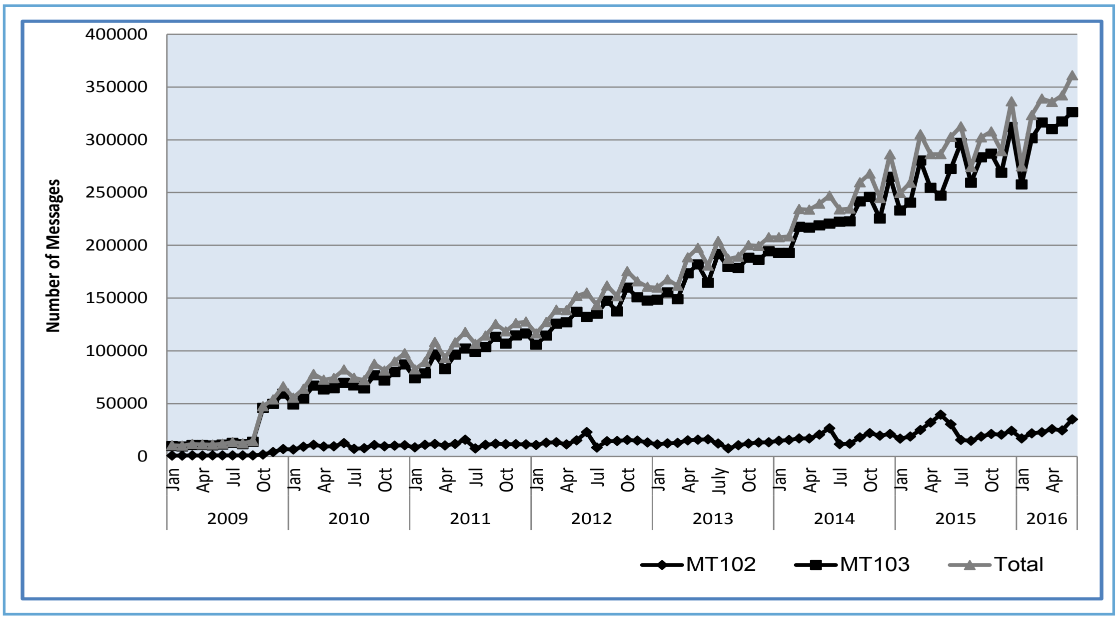
Source: Central Bank of Kenya

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 from 61,634 messages processed in the first quarter of 2016 to 85,650 messages recorded. However, MT 103 payments increased from 875,631 messages to 953,810 messages over the same period.

CHART 5H: TRENDS IN MT102 AND MT103 VOLUMES PROCESSED THROUGH KEPSS



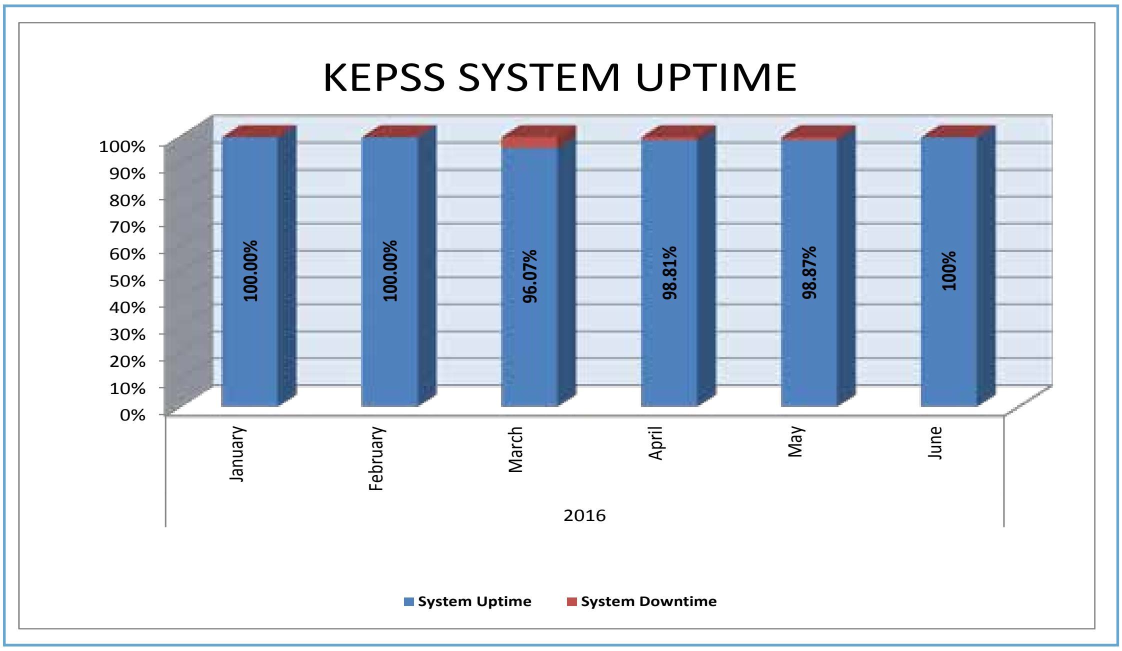
Source: Central Bank of Kenya

KEPSS System Availability

The KEPSS system operates from 8.30 AM to 4.30 PM to enable participants transmit customer payment requests and participants to settle their obligations and fund their accounts.

During the period under review, KEPSS was available on an average of 99.23 percent compared to 98.69 percent availability in the first quarter of 2016. This has been due to enhanced oversight and continuous monitoring of the system by both the Bank and the participants.

CHART 5I: KEPSS AVAILABILITY FOR THE PERIOD TO JUNE 2016



Source: Central Bank of Kenya

Government Budget Performance

The government's budgetary operations resulted in a deficit of 4.6 percent of GDP in the fourth quarter of the FY 2015/16, which was higher than the deficit of 2.8 percent of GDP in the third quarter. Government expenditure was more pronounced in June 2016 (the end of the financial year) across the three components of recurrent, development and transfers to the Counties; indicative of a rush to expedite on outstanding programs and purchases before the closure of the year.

The cumulative Government's budgetary operations in the FY 2015/16 resulted in a deficit of 8.4 percent of GDP including grants on a commitment basis, which was within the 10.1 percent of GDP deficit programmed for the period **(Table 6.1)**.

TABLE 6.1: STATEMENT OF GOVERNMENT OPERATIONS IN FY 2015/16 (KSh Billion)

	Q3				Q4				Cumulative to June 2016	Target	Over (+) / Below (-) Target
	Jan	Feb	March		April	May	June				
1. TOTAL REVENUE & GRANTS	107.3	13.4	171.7	292.4	122.5	112.0	138.7	373.2	1,250.0	1,431.5	(181.4)
Ordinary Revenue	91.5	6.5	166.7	264.7	116.4	106.8	132.9	356.1	1,222.0	1,358.0	(136.0)
Tax Revenue	80.4	4.7	156.6	241.6	109.4	100.3	117.0	326.7	1,112.0	1,216.0	(104.0)
Non Tax Revenue	11.1	1.8	10.2	23.1	7.0	6.4	16.0	29.4	44.7	38.9	5.8
Appropriations-in-Aid	4.2	3.4	4.8	12.4	4.5	4.8	4.2	13.6	65.3	103.2	(37.9)
External Grants	11.6	3.4	0.2	15.2	1.6	0.4	1.5	3.5	28.0	73.4	(45.4)
2. TOTAL EXPENSES & NET LENDING	142.4	63.5	262.3	468.3	184.3	153.1	320.8	658.1	1,771.8	1,953.8	(182.0)
Recurrent Expenses	88.6	16.8	190.9	296.2	128.7	126.6	160.5	415.8	1,024.1	1,013.0	11.2
Development Expenses	31.1	22.1	51.0	104.2	40.6	26.0	113.3	179.9	483.6	676.6	(193.0)
County Transfers	22.8	24.6	20.4	67.8	15.0	0.5	46.9	62.4	264.0	264.2	(0.2)
Others	-	-	-	-	-	-	-	-	-	-	-
3. DEFICIT ON A COMMITMENT BASIS (1-2)	(35.2)	(50.1)	(90.6)	(175.9)	(61.8)	(41.1)	(182.1)	(285.0)	(521.7)	(626.4)	104.6
As percent of GDP	(0.6)	(0.8)	(1.5)	(2.8)	(1.0)	(0.7)	(2.9)	(4.6)	(8.4)	(10.1)	1.7
4. ADJUSTMENT TO CASH BASIS	-	-	-	-	-	-	-	-	-	-	-
5. DEFICIT ON A CASH BASIS	(35.2)	(50.1)	(90.6)	(175.9)	(61.8)	(41.1)	(182.1)	(285.0)	(626.4)	104.6	(731.0)
As percent of GDP	(0.6)	(0.8)	(1.5)	(2.8)	(1.0)	(0.7)	(2.9)	(4.6)	(10.1)	-	(10.1)
6. DISCREPANCY: Expenditure (+) / Revenue (-)	0.4	58.3	(29.9)	28.9	(40.5)	10.1	(41.5)	(71.9)	(99.0)	51.6	(150.6)
7. FINANCING	12.0	83.9	40.3	136.2	6.3	50.7	93.7	150.7	527.4	(53.0)	580.4
Domestic (Net)	4.2	69.1	29.5	102.8	2.8	48.3	18.6	69.7	179.7	40.4	139.2
External (Net)	7.8	14.8	10.9	33.4	3.5	2.4	75.1	80.9	340.5	(88.7)	429.2
Capital Receipts (domestic loan receipts)	0.5	-	19.3	19.8	(18.6)	-	0.4	(18.2)	2.2	0.2	2.0
Others(Euro Bond sale proceeds)	-	-	-	-	-	-	-	-	-	-	-

Source: Provisional Budget Outturn from the National Treasury

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

Revenue

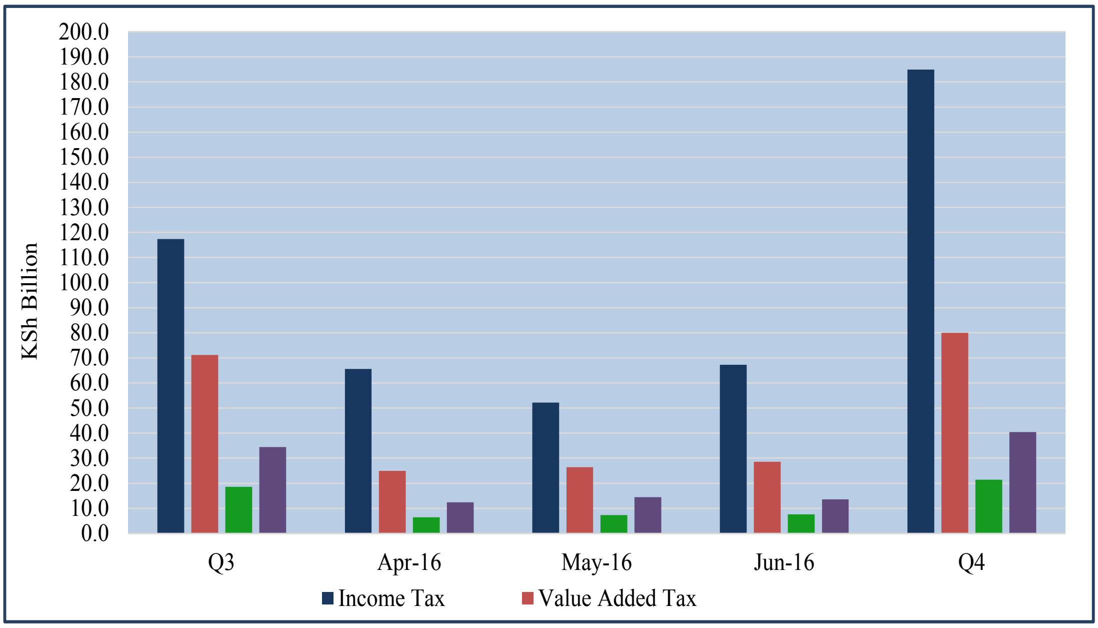
Total Government receipts (that is tax revenue and grants) increased by 27.6 percent to KSh 373.2 billion in the fourth quarter of FY 2015/16, from KSh 292.4 billion in the third quarter. Tax revenue alone rose by 35.2 percent to KSh 326.7 billion compared to KSh 241.6 billion collected in the third quarter. Cumulatively, tax revenue was KSh 1112.0 billion in the FY 2015/16, which although higher than the previous year's, was 10 percent or KSh 104 billion lower than target. The shortfall reflected an under-performance of PAYE and VAT collection. There were some challenges with the collection of VAT owing to slowdown in some sectors of the economy and government policy on exemptions and taxation of state corporations. PAYE also fell short of target due to a slowdown in some sectors like manufacturing and construction which may have affected employment.

External grants in the fourth quarter of the FY 2015/16 reduced to KSh 3.5 billion from KSh 15.2 billion recorded in the previous quarter. Cumulatively, external grants during the FY were KSh 45.4 billion below target due to a low absorption of donor funds.

Ministerial Appropriations in Aid (A-in-A) collected in the fourth quarter of the FY 2015/16 was KSh 13.6 billion compared to KSh 12.4 billion collected in the third quarter. The cumulative shortfall during the year amounted to KSh 49.4 billion and is attributed to under reporting in the ministry expenditure returns. This collection was, however, 12.8 percent higher than the previous year.

By June 2016, the government had collected revenues including grants of KSh 1,250.0 billion on a cumulative basis against a target of KSh 1,431.4 billion. As a proportion of GDP, revenue and grants collected through the fourth quarter of the FY 2015/16 amounted to 20.08 percent.

CHART 6A: COMPOSITION OF GOVERNMENT REVENUE (KSH BILLION)



Sources: Provisional Budget Outrun from the National Treasury

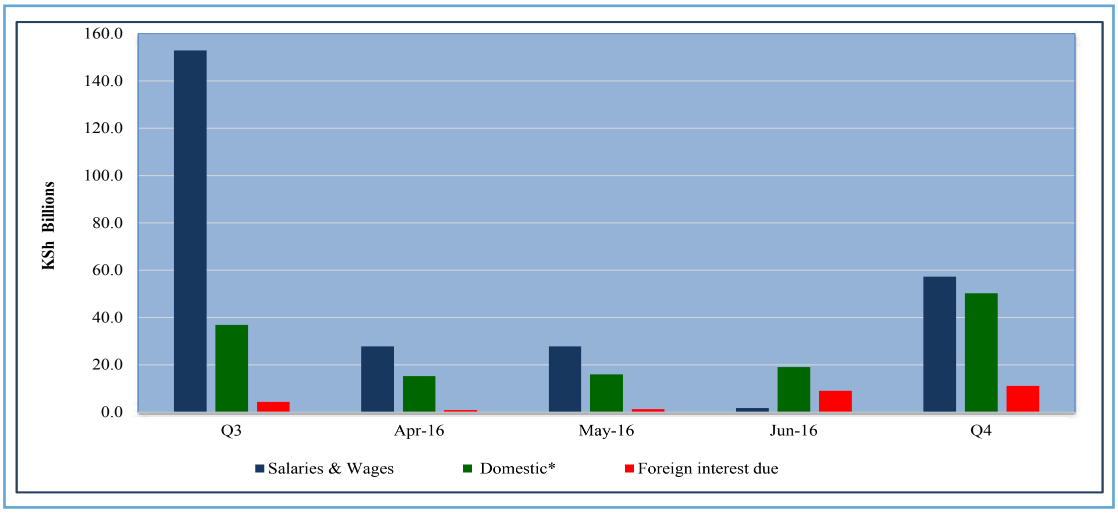
All tax revenue categories recorded significant increase in the fourth quarter of FY 2015/16. Revenues from income tax rose by 57.6 percent, excise import duties by 17.5 percent and 14.9 percent, respectively; and VAT proceeds by 12.3 percent **(Chart 6A)**. The outlook for revenue collection is optimistic especially with implementation of various legal and administrative measures to seal tax leakages.

Expenditure and Net Lending

Government expenditure and net lending rose by 40.5 percent in the fourth quarter of the FY 2015/16 over the previous quarter. In terms of broad categories of expenditure, recurrent and development expenditure increased by 40.3 percent and 72.6 percent, respectively. With respect to composition, the share of recurrent expenditure in total government spending was unchanged at 63.2 percent that was recorded in the third quarter. The contribution of development expenditure to total government expenditure increased to 27.3 percent in the fourth quarter of FY 2015/16 from 22.3 percent in the third quarter. Development expenditure were largely channeled into infrastructure and energy and petroleum ministries. The development expenditures performed below the target on account of non-inclusion of expenditures from the districts and some donor funded projects in large ministries. The share of county transfers declined to 9.5 percent in quarter four of FY 2015/16 from 14.5 percent in the third quarter **(Table 6.1)**.

Cumulatively, expenditure and net lending for the FY 2015/16 amounted to KSh 1,771.8 billion, against a target of KSh 1,953.8 billion. The shortfall is attributed to lower absorption of development expenditures by the National Government and County Governments. Recurrent expenditure rose by 40.3 percent between the third and fourth quarter of the FY 2015/16. In terms of components, total interest payments rose by 48.9 percent. In particular, domestic interest payments for the fourth quarter of the FY 2015/16 amounted to KSh 172.9 billion, compared to KSh 36.9 billion in the third quarter. Foreign interest payments were KSh 30.5 billion, which was lower than KSh 4.3 billion paid in the third quarter of the FY 2015/16 **(Chart 6B)**. Expenditures on salaries and wages declined by 62.5 percent in the fourth quarter of the FY 2015/16. This slowdown is against a backdrop of higher salaries paid out in the third quarter, following delayed teachers' salaries due to arrears agreed on in the industrial dispute between their union and Teachers Service Commission in the first quarter of the FY 2015/16. Additionally, the discrepancy between actual and target expenditures partly reflects the non-capture of the district expenditures and hence under reporting by ministries.

CHART 6B: COMPOSITION OF RECURRENT EXPENSES



Sources: Provisional Budget Outrun from the National Treasury

Financing

External financing in the fourth quarter of the FY 2015/16 was KSh 80.9 billion compared to KSh 33.4 billion in the third quarter of the FY 2015/16 **(Table 6.1)**. The higher external borrowing reflects proceeds of the commercial loan of US$ 600 million from China Development Bank received in June 2016.

Net domestic borrowing amounted to KSh 220.1 billion at the end of the FY 2015/2016. It comprised KSh 187.2 billion credit from commercial banks, KSh 139.4 billion from Non-Banking Financial Institutions and KSh 4.6 billion from Non-Residents. A repayment of KSh 111.1 billion was made to the Central Bank **(Table 6.2)**.

Domestic financing, which was constrained during the first quarter of the year (July –September 2015) following tight liquidity conditions in the domestic money market improved in the second, third and fourth quarters of the FY 2015/16 as liquidity conditions stabilized. However, the performance of the government's domestic borrowing programme was consistent with thresholds set in the Medium Term Debt Management Strategy.

TABLE 6.2 DOMESTIC FINANCING ENDING JUNE 30, 2016

	Q1	Q2	Q3			Q4
NET CREDIT TO GOVERNMENT 2015/2016 (Ksh Million)	Sep-16	Dec-15	Mar-16	Apr-16	May-16	Jun-16
1. From CBK	**67**	**-22,452**	**-34,917**	**-57,867**	**-65,118**	**-111,107**
2.From commercial banks	**-36**	**27,925**	**88,402**	**118,250**	**150,487**	**187,152**
4.From Non-banks	**-29**	**37,673**	**73,248**	**83,989**	**108,673**	**139,440**
5. From Non-Residents	**1**	**1,820**	**1,106**	**1,757**	**4,049**	**4,576**
Change in Credit from banks (From 30th June 2015)	31,573	5,473	53,485	60,383	85,369	76,045
Change in Credit from non-banks(From 30th June 2015)	-29,467	37,673	73,248	83,989	108,673	139,440
Change in Credit from non-residents(From 30th June 2015)	743	1,820	1,106	1,757	4,049	4,576
6.Total Change in Dom. Credit (From 30th June 2015)	**2,849**	**44,967**	**127,839**	**146,129**	**198,091**	**220,061**

NB. Treasury Bills are reflected at Cost

Source: Central Bank of Kenya

Outlook for FY 2016/17

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

TABLE 6.3: BUDGET ESTIMATES FOR THE FISCAL YEAR 2016/17 (KSH BILLION)

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

Source: National Treasury Budget Summary for 2016/17

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

Developments in Public Debt

Overall Debt Kenya's public and publicly guaranteed debt increased by 9.2 percent in the fourth quarter of the FY 2015/16, with domestic debt accounting for much of the increase. As a percentage of GDP, total debt stock at the fourth quarter was 55.1 percent, a 470 basis points increase compared with the third quarter of the FY 2015/16. Domestic and external debt to GDP ratios increased by 250 basis points and 210 basis points respectively, during the fourth quarter of the FY 2015/16 **(Table 7.1)**.

TABLE 7.1: KENYA'S PUBLIC AND PUBLICLY GUARANTEED DEBT (Ksh billion)

	FY 2015/16							
	Q4	Q1	Q2	Q3	Apr-16	May-16	Q4	Change Q on Q
EXTERNAL**								
Bilateral	430.4	477.5	481.3	522.4	551.0	553.1	539.1	16.7
Multilateral	684.6	759.3	751.2	766.6	772.4	766.9	812.3	45.6
Commercial Banks	276.9	295.6	366.2	360.2	361.8	360.7	442.6	82.4
Supplier Credits	16.6	17.8	16.5	16.4	8.6	8.5	9.2	-7.2
Sub-Total	**1408.6**	**1,550.2**	**1,615.2**	**1,665.6**	**1,693.8**	**1,689.1**	**1,803.2**	**137.6**
(As a % of GDP)	22.6	23.6	24.6	25.4	25.8	25.7	27.5	
(As a % of total debt)	49.8	52.8	51.2	50.3	50.1	49.1	49.8	
DOMESTIC								
Banks	**793.8**	**790.3**	**865.8**	**932.3**	**963.2**	**995.8**	**1,027.2**	**94.8**
Central Bank	63.3	107.6	101.4	102.6	101.0	100.4	99.9	-2.8
Commercial Banks	730.4	682.7	764.4	829.7	862.2	895.4	927.3	97.6
Non-banks	**616.0**	**586.1**	**661.7**	**702.2**	**713.2**	**742.1**	**774.9**	**72.7**
Pension Funds	352.7	345.4	389.0	417.0	426.0	448.9	468.9	51.9
Insurance Companies	127.9	121.1	129.1	133.0	133.8	133.4	134.4	1.4
Other Non-bank Sources	135.4	119.6	143.6	152.2	153.4	159.8	171.6	19.4
Non-residents	**10.7**	**11.5**	**12.6**	**12.0**	**12.6**	**12.5**	**13.0**	**1.1**
Sub-Total	**1420.4**	**1,388.0**	**1,540.0**	**1,646.5**	**1,689.0**	**1,750.3**	**1,815.1**	**168.6**
(As a % of GDP)	22.8	21.1	23.5	25.1	25.7	26.7	27.6	
(As a % of total debt)	50.2	47.2	48.8	49.7	49.9	50.9	50.2	
GRAND TOTAL	**2829.1**	**2,938.2**	**3,155.2**	**3,312.1**	**3,382.9**	**3,439.4**	**3,618.3**	**306.2**
((As a % of GDP)	45.5	44.7	48.1	50.4	51.5	52.4	55.1	

Ratios computed using Treasury GDP figures from the Budget Summary 2016/17
** External debt is inclusive of guaranteed debt

Sources: National Treasury and Central Bank of Kenya

Domestic Debt Total domestic debt[1] increased by 10.2 percent during the fourth quarter of the FY 2015/16, a faster acceleration over the 6.9 percent growth observed in the previous quarter. Treasury Bills accounted for 68.3 percent of the increase in domestic debt during the review period. However, the increase in Treasury bills slowed relative to 77.1 percent in the third quarter as investors' appetite shifted towards the relatively longer dated securities following a more normalized debt securities yield curve. The share of domestic debt to total debt increased from 49.5 percent at the end of the third quarter to 50.2 percent at the end of the fourth quarter of the FY 2015/16 reflecting improved performance of the government's borrowing programme.

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

TABLE 7.2: GOVERNMENT GROSS DOMESTIC DEBT (Ksh billion)

	Q1	%	Q2	%	Q3	%	Apr-16	%	May-16	%	Q4	%	Change: Q on Q
Total Stock of Domestic Debt (A+B)	**1,388.0**	**100.0**	**1,540.0**	**100.0**	**1,646.5**	**100.0**	**1,689.0**	**100.0**	**1,750.3**	**100.0**	**1,815.1**	**100.0**	**168.6**
A. Government Securities	**1,313.5**	**94.6**	**1,463.1**	**95.0**	**1,568.3**	**95.2**	**1,612.6**	**95.5**	**1,674.4**	**95.7**	**1,740.1**	**95.9**	**171.9**
1. Treasury Bills (excluding Repo Bills)	**266.6**	**19.2**	**390.8**	**25.4**	**472.9**	**28.7**	**507.9**	**30.1**	**553.9**	**31.6**	**588.1**	**32.4**	**115.2**
Banking institutions	159.3	11.5	269.7	17.5	316.0	19.2	324.9	19.2	350.5	20.0	361.9	19.9	45.9
The Central Bank	25.5	1.8	20.6	1.3	20.6	1.3	20.6	1.2	20.6	1.2	20.6	1.1	0.0
Commercial Banks	133.7	9.6	249.1	16.2	295.4	17.9	304.3	18.0	329.9	18.8	341.3	18.8	45.9
Pension Funds	33.2	2.4	65.0	4.2	85.6	5.2	89.8	5.3	106.3	6.1	117.9	6.5	32.3
Insurance Companies	13.5	1.0	17.6	1.1	18.1	1.1	19.1	1.1	18.6	1.1	18.4	1.0	0.3
Others	60.6	4.4	38.5	2.5	53.2	3.2	74.2	4.4	78.5	4.5	89.9	5.0	36.7
2. Treasury Bonds	**1,046.9**	**75.4**	**1,072.3**	**69.6**	**1,095.4**	**66.5**	**1,104.7**	**65.4**	**1,120.5**	**64.0**	**1,152.0**	**63.5**	**56.7**
Banking institutions	518.1	37.3	524.3	34.0	537.2	32.6	541.5	32.1	549.0	31.4	569.9	31.4	32.7
The Central Bank	9.4	0.7	9.4	0.6	9.4	0.6	9.4	0.6	9.4	0.5	9.4	0.5	0.0
Commercial Banks	508.6	36.6	514.9	33.4	527.8	32.1	532.1	31.5	539.6	30.8	560.5	30.9	32.7
Insurance Companies	107.6	7.8	111.4	7.2	114.9	7.0	114.7	6.8	114.8	6.6	116.0	6.4	1.2
Pension Funds	312.2	22.5	324.1	21.0	331.4	20.1	336.2	19.9	342.6	19.6	351.0	19.3	19.6
Others	109.1	7.9	112.5	7.3	111.9	6.8	112.3	6.8	114.1	6.5	115.1	6.3	3.2
3. Long Term Stocks		-		**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
Others		-		0.0		0.0		0.0		0.0		0.0	0.0
4. Frozen account	**26.7**	**1.9**	**26.1**	**1.7**	**26.1**	**1.6**	**26.1**	**1.5**	**26.1**	**1.5**	**25.6**	**1.4**	**-0.6**
Of which: Repo T/Bills	26.6	1.9	25.5	1.7	25.5	1.5	25.5	1.5	25.5	1.5	25.0	1.4	-0.6
B. Others:	**47.8**	**3.4**	**50.8**	**3.3**	**52.1**	**3.2**	**50.4**	**3.0**	**49.8**	**2.8**	**49.4**	**2.7**	**-2.7**
Of which CBK overdraft to Government	45.9	3.3	45.2	2.9	46.5	2.8	44.9	2.7	44.2	2.5	44.2	2.4	-2.2

Source: Central Bank of Kenya

Treasury Bills

Treasury bill holdings, excluding those held by the CBK for open market operations (Repos) increased by 24.4 percent during the fourth quarter of the FY 2015/16. This increase was reflective of improved performance of the government's borrowing plan as pension funds' and commercial banks' appetite for short dated securities increased. Correspondingly, the proportion of Treasury bills to total domestic debt increased by 370 basis points during the fourth quarter of the FY 2015/16. The dominant investors of Treasury Bills were commercial banks (with a share of 58 percent) and pension funds (with a share of 20 percent) by the end of the last quarter of the FY 2015/16. The persistent dominance of commercial banks in the securities market characterizes moderate underdevelopment of institutional investors' sectors.

Treasury Bonds

The Treasury bond yield curve normalized in the fourth quarter of the FY 2015/16 due to further stabilization of interest rates, thus the quarter under review recorded a faster build up in the stock of Treasury Bonds relative to the previous quarter. Outstanding Treasury bonds recorded a 5.2 percent increase reflecting issuance of a nine year Infrastructure Treasury bond. The dominant holders of Treasury bonds by the end of the period under review were commercial banks, pension funds and Insurance companies. Commercial banks holdings accounted for about half of the total Treasury Bonds outstanding. The perpetual dominance of commercial banks in the debt securities market reflects the underdevelopment of institutional investor sectors that is insurance, pension funds and foreign investors.

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

		Q1	%	Q2	%	Q3	%	Apr-16	%	May-16	%	Q4	%	Change Q on Q
Treasury bills	91-Day	33.0	2.4	103.3	6.7	62.8	3.8	76.5	4.5	82.5	4.7	81.8	4.5	19.0
	182-Day	41.8	3.0	79.6	5.2	163.6	9.9	173.9	10.3	178.4	10.2	191.8	10.6	28.3
	364-Day	191.8	13.8	207.9	13.5	246.5	15.0	257.4	15.2	293.0	16.7	314.5	17.3	67.9
Treasury Bonds	1-Year	24.3	1.75	44.7	2.9	44.7	2.7	34.5	2.0	34.5	2.0	34.5	1.9	-10.2
	2-Year	137.1	9.9	111.8	7.3	132.0	8.0	112.0	6.6	96.6	5.5	122.1	6.7	-9.9
	3-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
	4-Year	2.3	0.2	2.3	0.1	2.3	0.1	2.3	0.1	2.3	0.1	2.3	0.1	0.0
	5-Year	189.8	13.7	205.5	13.3	196.4	11.9	215.9	12.8	215.9	12.3	215.9	11.9	19.5
	6-Year	40.7	2.9	31.5	2.0	31.5	1.9	22.7	1.3	22.7	1.3	22.7	1.2	-8.8
	7-Year	8.7	0.6	8.7	0.6	8.7	0.5	8.7	0.5	8.7	0.5	8.7	0.5	0.0
	8-Year	38.2	2.8	38.2	2.5	29.4	1.8	38.2	2.3	38.2	2.2	38.2	2.1	8.8
	9-Year	15.1	1.1	38.8	2.5	40.2	2.4	40.2	2.4	76.5	4.4	76.5	4.2	36.3
	10-Year	163.9	11.8	163.9	10.6	183.6	11.2	193.6	11.5	188.5	10.8	188.5	10.4	4.9
	11-Year	4.0	0.3	4.0	0.3	4.0	0.2	4.0	0.2	4.0	0.2	4.0	0.2	0.0
	12-Year	132.1	9.5	132.1	8.6	132.1	8.0	132.1	7.8	132.1	7.5	132.1	7.3	0.0
	15-Year	168.2	12.1	168.2	10.9	168.2	10.2	177.8	10.5	177.8	10.2	183.8	10.1	15.6
	20-Year	74.3	5.4	74.3	4.8	74.3	4.5	74.3	4.4	74.3	4.2	74.3	4.1	0.0
	25-Year	20.2	1.5	20.2	1.3	20.2	1.2	20.2	1.2	20.2	1.2	20.2	1.1	0.0
	30-Year	28.1	2.0	28.1	1.8	28.1	1.7	28.1	1.7	28.1	1.6	28.1	1.6	0.0
	Repo T bills	26.6	1.9	25.5	1.7	25.5	1.5	25.5	1.5	25.5	1.5	25.0	1.4	-0.6
	Overdraft	45.9	3.3	45.2	2.9	46.5	2.8	44.9	2.7	44.2	2.5	44.2	2.4	-2.2
	Other Domestic debt	1.9	0.1	6.2	0.4	5.9	0.4	6.1	0.4	6.2	0.4	5.8	0.3	-0.1
Total Debt		**1,388.0**	**100.0**	**1,540.0**	**100.0**	**1,646.5**	**100.0**	**1,689.0**	**100.0**	**1,750.3**	**100.0**	**1,815.1**	**100.0**	**168.6**

Source: Central Bank of Kenya

Domestic Debt by Tenor and the Maturity Structure

Government issued both short and medium term dated securities during the period under review. The current debt securities portfolio is dominated by short and medium term domestic debt. The benchmark Treasury Bonds; 2-year, 5-year, 10-year, 15-year and 20-year Treasury Bonds accounted for 68.1 percent of the total of outstanding Treasury Bonds by the end of the last quarter of the FY 2015/16. Other domestic debt consists of uncleared effects, advances from commercial banks and Tax Reserve Certificates.

In terms of the maturity structure, the average length to maturity of existing domestic debt declined to 4 years and 3 months in the fourth quarter of the FY 2015/16 from 4 years and 7 months reported in the third quarter. This decline was reflective of the increase in the proportion of short-dated debt securities in the domestic debt portfolio during the review period.

This decline was reflective of the increase in the proportion of short-dated debt securities in the domestic debt portfolio during the review period thereby worsening the refinancing risk (32.4 percent from 28.7 percent in March 2016).

External Debt

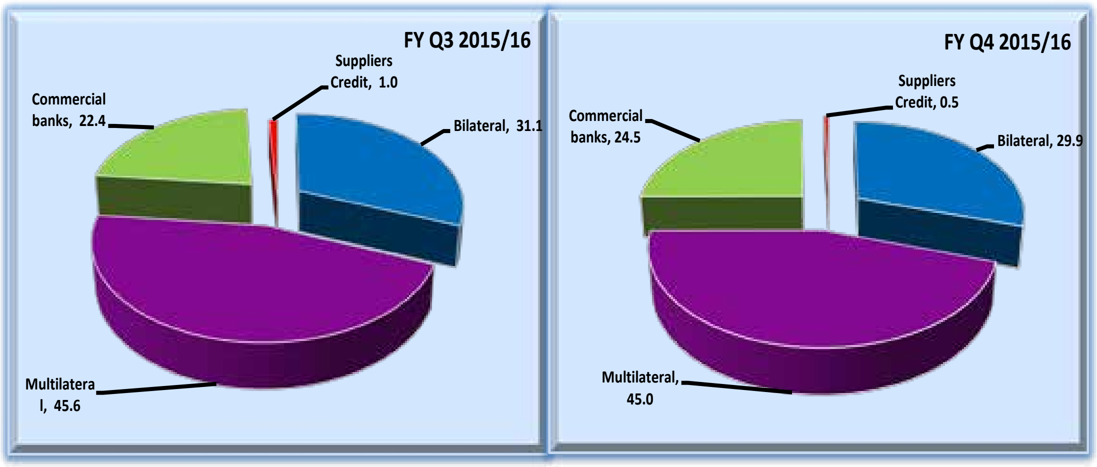
Public and publicly guaranteed external debt increased by 8.3 percent during the fourth quarter of the FY 2015/16, a slower build up in local currency terms than the previous quarter mainly on account of the strengthening of the Kenyan shilling against the US dollar during the review period. External debt accumulation during fourth quarter reflects disbursement of USD 600 million from China Development Bank.

Composition of External Debt by Creditor

Kenya continues to record lower levels of concessional debt and build-up of commercial and semi-concessional borrowing since her elevation to lower middle income economy status in September 2014. The share of outstanding debt from official multilateral and bilateral lenders, who provide both concessional and semi-concessional loans, declined by 180 basis points from the 76.7 percent in the third quarter of the FY 2015/16 to 74.9

percent by the end of review period . Conversely, the share of commercial debt increased by 210 basis points during the review period and largely on account of the disbursements from China Development Bank by end June 2016 **(Chart 7A).**

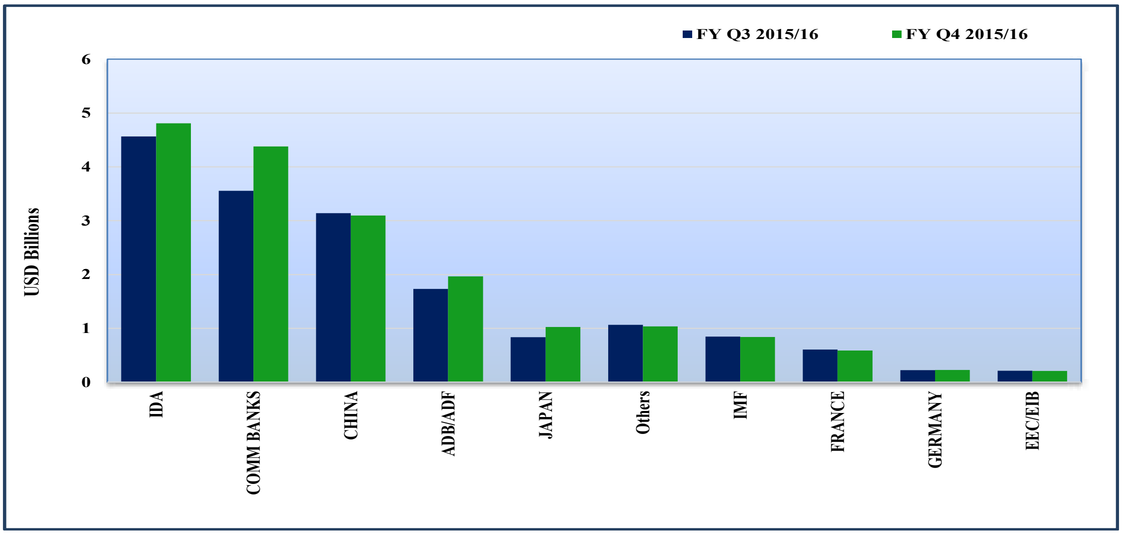
CHART 7A: COMPOSITION OF EXTERNAL DEBT BY LENDER CLASSIFICATION



Source: The National Treasury

Debt owed to the International Development Association (IDA), Kenya's largest multilateral lender, amounted to USD 4.8 billion or 27 percent of total external debt while that owed to China, Kenya's largest bilateral lender, amounted to USD 3.1 billion, or 17.4 percent of the total external debt in the fourth quarter of the FY 2015/16 **(Chart 7B)**. The main sources of the build-up of external debt were, China Development Bank, International Development Association (IDA), Japan and the African Development Bank (ADB).

CHART 7B: EXTERNAL DEBT BY CREDITOR

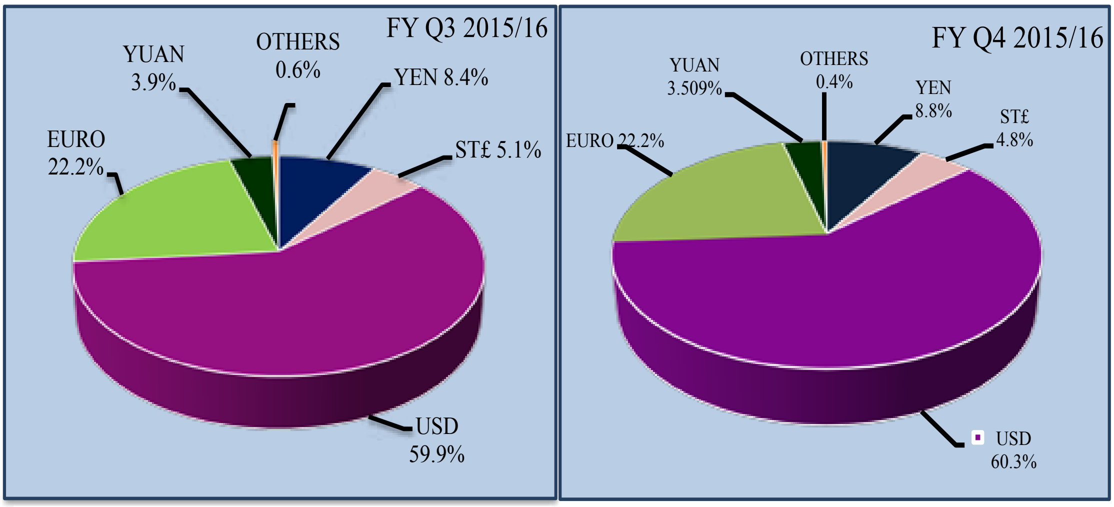


Source: The National Treasury

Currency Composition of External Debt

Kenya's public and publicly guaranteed external debt is denominated in various currencies partly to mitigate against currency risk. The dominant currencies included the US dollar and the Euro which accounted for 82.5 percent of the total currency composition at the end of the fourth quarter of the FY 2015/16. This was partly consistent with the currency composition of the Central Bank's forex reserve holdings. The proportion held in the US dollar and the Japanese Yen increased mainly on account of the dollar denominated loan disbursements from China Development Bank , Internal Development Association, and African Development Bank as well as disbursements from the Government of Japan denominated in the Japanese Yen **(Chart 7C)**.

CHART 7C: DEBT COMPOSITION BY CURRENCY



Source: The National Treasury

Public Debt Service

The ratio of domestic interest payments to revenues stood at 13.8 percent in the fourth quarter of the FY 2015/16. 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 stood at Ksh 78.6 billion and was within sustainable levels.

Debt service ratios to a flow resource base such as revenues and exports is a liquidity indicator of the level of indebtedness. Analysis of the liquidity indicators of external indebtedness show that Kenya faces low exposure to external debt service default as the ratios were way below the country policies and institution assessment (CPIA) determined liquidity indicators (25 percent of exports and 22 percent of revenues) **(Table 7.4)**.

TABLE 7.4: LIQUIDITY EXTERNAL DEBT SUSTAINABILITY INDICATORS

	Q2 2015/16	Q3 2015/16	Q4 2015/16	FY 2015/16
Debt services to Revenues (22%)	6.9	5.7	6.9	6.2
Debt services to Exports (25%)	7.9	6.5	10.2	7.4

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

Source: Central Bank of Kenya

Debt Sustainability Analysis

The March 2016 Debt sustainability update showed that Kenya faces a low risk of external debt distress. All the liquidity and solvency debt burden indicators were below the CPIA based thresholds both in the baseline and stress scenario. The update lays emphasis on the need to strengthen debt management capacity owing to the bunched repayments in the coming years (USD 750 million in 2017, USD 750 million in 2019 and USD 2 billion in 2024).

Outlook for FY 2016/17

Total public and publicly guaranteed external debt is estimated at KSh 1,788.8 billion (24.6 percent of GDP), of which gross and net domestic debt amount to KSh1, 688.8 billion (23.3 percent of GDP) and KSh 1,446.5 billion (19.9 percent of GDP), respectively[2].

2 The EAC public debt convergence criterion for PV of Debt/GDP is 50 percent CPIA stands for Country Policies and Institutions Assessment

Activity in the Stock Market

Equity Market Segment

All the four equity market price indices declined in the second quarter of 2016 compared with the previous quarter. Shareholders' wealth, measured by market capitalization, posted KSh.80.28 billion drop in value in the second quarter of 2016 compared to first quarter **(Table 8.1** and **Chart 8A)**.

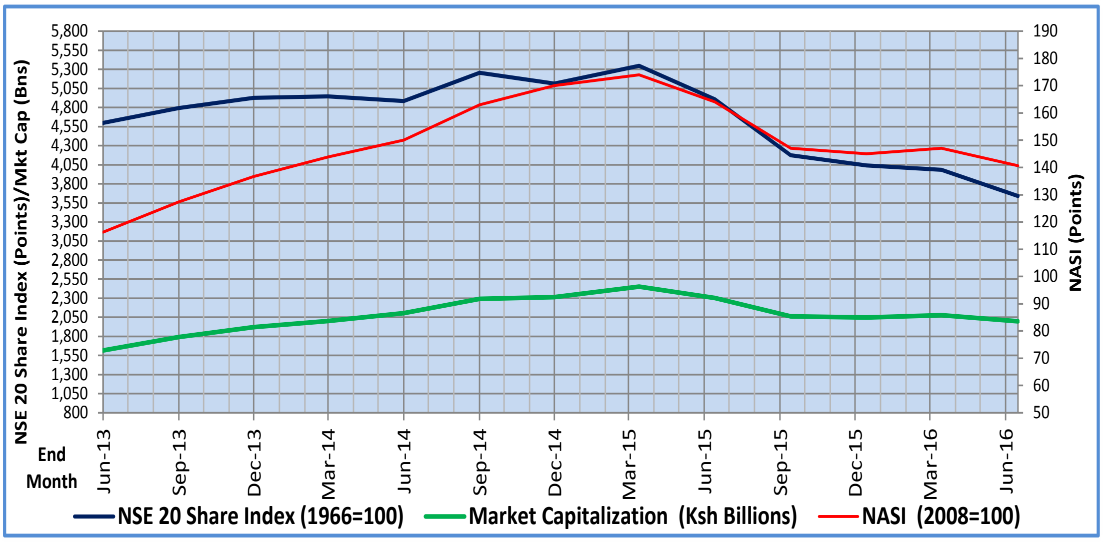
TABLE 8.1: SELECTED STOCK MARKET INDICATORS

INDICATOR	2013	2014	2015	2015				2016	
				Q1	Q2	Q3	Q4	Q1	Q2
NSE 20 Share Index (1966=100)	4926.97	5113.00	4040.00	5346.00	4906.00	4173.00	4040.00	3982.00	3640.61
NASI (2008=100)	136.65	170.00	145.00	174.00	164.00	147.00	145.00	147.00	140.60
FTSE NSE Kenya 15 Index	172.40	217.76	182.55	231.56	216.07	195.09	182.55	185.17	175.70
FTSE NSE Kenya 25 Index	174.27	218.70	182.11	231.87	215.28	194.81	182.11	185.47	176.47
Number of Shares Traded (Millions)	7,665.92	8,133.65	6,812.14	1,621.72	1,852.31	1,882.60	1,455.51	1,299.70	1,411.00
Equities Turnover (Ksh Millions)	155,746.00	215,725.83	209,381.86	46,340.84	60,223.86	56,721.90	46,095.26	36,609.27	37,034.00
Market Capitalization (Ksh Billions)	1,920.72	2,316.32	2,049.00	2,452.47	2,302.00	2,063.64	2,053.52	2,078.28	1,998.00
Foreign Purchase (Ksh Millions)	92,978.00	109,230.00	132,495.00	20,945.00	38,194.00	43,856.00	29,500.00	20,258.00	26,322.00
Foreign Sales (Ksh Millions)	67,415.00	105,700.00	131,579.00	24,102.00	40,738.00	37,300.00	29,439.00	21,844.00	19,339.00
Average FPa to Equity Turnover	51.49%	49.82%	63.06%	48.60%	65.53%	71.54%	63.93%	57.50%	62.95%
Bond Turnover (Ksh Millions)	452,459.86	506,050.22	305,099.19	129,369.95	59,897.16	44,511.49	71,320.60	113,400.10	149,808.73
FTSE NSE Kenya Govt. Bond Index	91.28	93.31	90.04	93.11	92.03	90.41	90.04	89.28	87.98

Source: Nairobi Securities Exchange

The factors underpinning the increased market uncertainties following the 'Brexit' referendum vote, placement of three banks under receivership and underperforming NSE listed companies' profitability in 2015 reflected by increased profits warnings. Cognisant of these factors and events, Local investors offloaded their shares, while foreign investors increased participation with increased purchases relative to sales. This led to depressed share prices and increased volume of shares traded by 8.6 percent in the second quarter of 2016.

CHART 8A: NSE 20 SHARE INDEX, NASI AND MARKET CAPITALIZATION



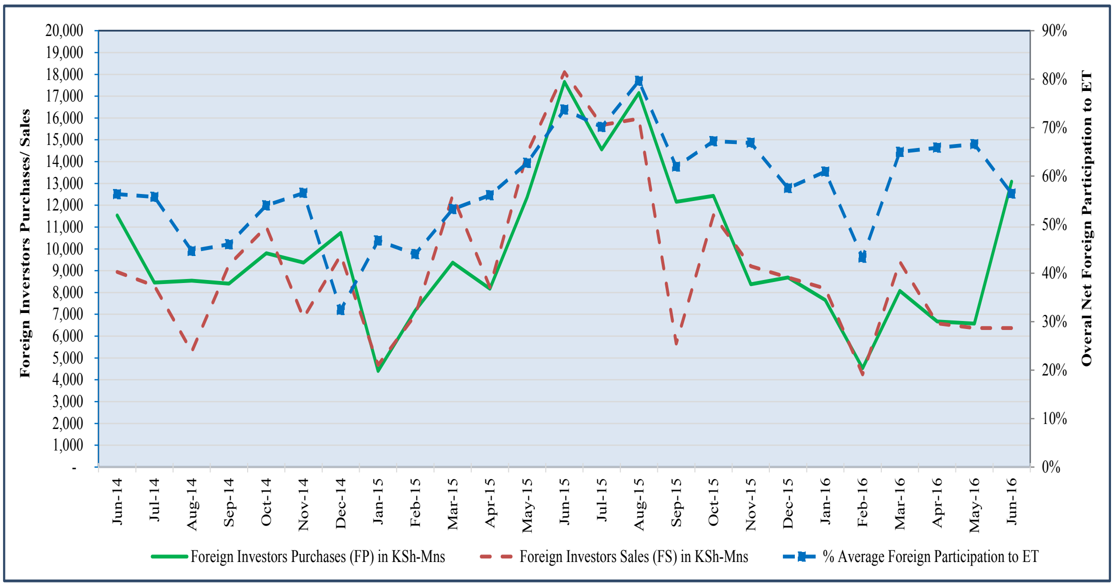
Source: Nairobi Securities Exchange

The most traded sectors were the Telecommunication & Technology, Banking, and Energy & Petroleum, which accounted for 38.03 percent, 32.52 percent and 11.31 percent, respectively, of all shares traded in the second quarter of 2016. Real Estate Investment Trust (REIT) was least traded, with 12,800 shares.

Foreign Investors Participation

NSE foreign investors' activity increased, with foreign investors' purchases higher than sales in the second quarter of 2016, attributed to local investors retreat and global financial markets uncertainty **(Chart 8B)**.

CHART 8B: FOREIGN PARTICIPATION



Source: Nairobi Securities Exchange

Bond Market

The bond market performance improved in the second quarter of 2016 over the previous quarter. The volume of bonds traded in the secondary market increased by 32.11 percent. Similar strong performance was noted in the primary market where all bonds offered for sale were oversubscribed. The government issued bonds to raise KSh.80 billion and received bids worth KSh.158.2 billion (implying 197.7 percent subscription rate). This was higher compared to KSh.85 billion offered in the first quarter of 2016 that attracted bids worth KSh.119.1 billion or 140.1 percent subscription rate. The strong investor appetite reflect investors' preference for 'safer' assets rather than equities, considered more risky.

The FTSE NSE Kenyan Government Bond Index declined to 87.98 points in the second quarter of 2016 from 89.28 points in the first quarter.

Statement of Financial Position Of The Central Bank of Kenya
(Kenya shillings million)

1.0 ASSETS	Mar-16	Apr-16	May-16	Jun-16	Change Jan-Mar	%	Change Apr-Jun	%
1.1 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS	786,202	802,502	796,130	826,672	22,564	3.0	40,471	5.1
1.2 FUNDS HELD WITH IMF	1,958	1,429	3,853	1,923	469	31.5	(35)	(1.8)
1.3 ITEMS IN THE COURSE OF COLLECTION	65	30	32	80	40	154.7	14	22.0
1.4 ADVANCES TO COMMERCIAL BANKS	25,076	42,205	46,545	44,679	(20,106)	(44.5)	19,603	78.2
1.5 LOANS AND OTHER ADVANCES	2,584	2,579	2,550	2,538	(64)	(2.4)	(46)	(1.8)
1.6 OTHER ASSETS	3,129	10,372	3,219	3,064	(62)	(2.0)	(65)	(2.1)
1.7 RETIREMENT BENEFIT ASSET	4,668	4,668	4,668	4,668	-	-	-	-
1.8 PROPERTY AND EQUIPMENT	20,638	20,759	21,037	20,957	373	1.8	318	1.5
1.81 INTANGIBLE ASSETS	191	173	188	165	(29)	(13.0)	(26)	(13.8)
1.9 DUE FROM GOVERNMENT OF KENYA	72,636	71,052	70,480	69,762	952	1.3	(2,873)	(4.0)
TOTAL ASSETS	**917,147**	**955,768**	**948,703**	**974,509**	**4,136.9**	**0.5**	**57,361.5**	**6.3**
2.0 LIABILITIES								
2.1 CURRENCY IN CIRCULATION	231,976	236,080	231,584	234,751	(8,955)	(4)	2,775	1
2.2 INVESTMENTS BY BANKS	-	-	-	7,834	(26,256)	(100)	7,834	na
2.3 DEPOSITS	432,203	466,077	467,448	494,125	47,556	12	61,922	14
2.4 INTERNATIONAL MONETARY FUND	126,426	126,261	124,685	122,438	554	0	(3,987)	(3)
2.5 OTHER LIABILITIES	1,753	787	1,031	1,287	941	116	(466)	(27)
TOTAL LIABILITIES	792,358	829,205	824,748	860,436	13,840	2	68,078	9
3.0 EQUITY AND RESERVES	124,789	126,563	123,955	114,073	(9,704)	(7)	(10,716)	(9)
Share Capital	5,000	5,000	5,000	5,000	-	-	-	-
General reserve fund -Unrealized	77,171	77,171	77,171	77,171	(1,271)	(2)	-	-
-Realized	12,555	12,555	12,555	12,562	1,424	13	7	0
-Capital Projects	7,445	7,445	7,445	7,445	-	-	-	-
Period surplus	3,160	4,934	2,326	(7,563)	(9,857)	(76)	(10,723)	(339)
Asset Revaluation	14,790	14,790	14,790	14,790	-	-	-	-
Retirment Benefit Asset Reserves	4,668	4,668	4,668	4,668	-	-	-	-
4.0 TOTAL LIABILITIES AND EQUITY	**917,147**	**955,768**	**948,703**	974,509	4,137	0	57,361	6

Source: Central Bank of Kenya

Notes on the Financial Position

The balance sheet of the Central Bank of Kenya increased by 6.3 percent in the second quarter of 2016 compared with 0.5 percent growth in the previous quarter. The expansion reflects largely in accumulation of foreign exchange reserves and advances to commercial banks and associated deposit liabilities.

Assets

Balances due from Banking institutions and Gold holdings category comprise of foreign reserves held in external current accounts, deposits and special/projects accounts, domestic foreign currency clearing accounts, gold, special drawing rights and RAMP securities invested with the World Bank. These foreign exchange reserves balance increased by 5.1 percent in the second quarter of 2016 from 3.1 percent growth in the first quarter.

Items in course of collection represent the value of clearing instruments held by the Central Bank of Kenya, while awaiting clearing by respective commercial banks. The clearance improved with accumulation of this item slowing down to 22 percent from 154.7 percent in the first quarter of 2016.

Advances to commercial banks, largely provided in the management of interbank liquidity, increased by 78.2 percent in the second quarter of 2016 compared with 44.5 percent repayment in the previous quarter.

Loans and other advances include outstanding balances on advances to commercial banks under the Overnight Loan Facility (OLF), and IMF funds on-lent to Government. The outstanding balance declined by 1.8 percent in the second quarter of 2016, largely due to loan repayments.

Other assets, that largely consist of prepayments and sundry debtors, and deferred currency expense declined by 2.1 percent in second quarter of 2016, unchanged from the previous quarter.

Debt due from Government of Kenya, which includes Government utilization of the overdraft facility at the Central bank and overdrawn accounts which were converted to a long term debt with effect from 1 November 1997, recorded 4 percent repayment in the June 2016 quarter in contrast to 1.3 percent growth in the previous quarter.

Liabilities

Currency in circulation increased marginally, by 1 percent compared to 4 percent decline in the first quarter of 2016.

Deposits held by CBK for the Government of Kenya, local commercial banks deposit, other public entities and project accounts and local banks' forex settlement accounts, increased by 14 percent and was largely the main source of expansion in Central Bank of Kenya liabilities.

Equity and reserves category declined by 9 percent largely on account a fall in the period surplus.