



Central Bank of Kenya

QUARTERLY ECONOMIC REVIEW (QER)

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OBJECTIVES OF THE CENTRAL BANK OF KENYA

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

- 1) To formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices;
- 2) To foster the liquidity, solvency and proper functioning of a stable, market-based financial system;
- 3) Subject to (1) and (2) above, to support the economic policy of the Government, including its objectives for growth and employment.
- 4) Without prejudice to the generality of the above, the Bank shall:
 - Formulate and implement foreign exchange policy;
 - Hold and manage Government foreign exchange reserves;
 - License and supervise authorised foreign exchange dealers;
 - Formulate and implement such policies as best promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems;
 - Act as banker and adviser to, and fiscal agent of, the Government; and
 - Issuing currency notes and coins.

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QUARTERLY ECONOMIC REVIEW

APRIL - JUNE 2018

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HIGHLIGHTS

Overall inflation remained below the midpoint of the Government medium term target band in the second quarter of 2018. It declined to 4.0 percent from 4.5 percent in the first quarter of 2018, supported by lower food prices.

Growth in broad money supply (M3) rose to 7.5 percent in the second quarter of 2018 from 0.2 percent in the first quarter, reflecting strong growth in deposits. Net domestic credit grew by 5.1 percent in the second quarter of 2018 compared to a decline of 4.1 per cent in the first quarter of 2018. Growth in credit to private sector increased by 1.6 percent compared to a decline of 0.9 percent in the first quarter of 2018. On 12-month basis, private sector credit grew 4.3 percent in June 2018 from 2.0 percent in March 2018.

The Central Bank Rate (CBR) was retained at 9.5 percent in May 2018. The interbank rate decreased to 5.04 percent in the second quarter of 2018 from 5.41 percent in first quarter of 2018, partly reflecting improved liquidity conditions. Interest rates on government securities and commercial banks' lending and deposit rates remained relatively stable in second quarter of 2018.

The economy recorded strong performance in the second quarter of 2018, and grew by 6.3 percent compared to 5.7 percent in the previous quarter, supported by recovery in agricultural activities following favourable weather conditions and resilient growth in the services sector.

Kenya's current account balance stood at US D 909 million deficit during the second quarter of 2018 from US D 1,058 million deficit during the first quarter of 2018 mainly reflecting an increase in the secondary income balance.

The position of Kenya's official international reserves was strong at US D 8,954 million by end-June 2018, equivalent to 5.9 months of imports.

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

The banking system remained resilient and stable in the second quarter of 2018. Total net assets increased by 4.5 percent, while the deposit base increased by 6.1 percent. The system continued to be well capitalized and met the minimum capital adequacy requirements. Profitability improved supported by decrease in total expenses. Credit risk remained elevated with Gross Non-Performing Loans (NPLs) to Gross Loans ratio standing at 12.0 percent in the second quarter of 2018.

Kenya Electronic Payments and Settlement System (KEPSS) used for large value Real Time Gross Settlement (RTGS) payments moved a volume of 1.16 million transaction messages worth KSh 7.3 trillion in the second quarter of 2018, compared to the first quarter of 2018 which recorded 1.05 million transactions worth KSh 6.8 trillion. Volume and value increased by 9.43 percent and 7.35 percent, respectively.

The Government's budgetary operations at the end of the fourth quarter of FY 2017/18 resulted in a deficit of 6.7 per cent of GDP and was within the target of 7.1 percent of GDP. Revenue collection improved but remained below target, as was the case with the expenditure.

Kenya's public and publicly guaranteed debt increased by 3.2 percent during the fourth quarter of the FY 2017/18 with both domestic and external debt increasing by 4.5 percent and 1.9 percent, respectively during the quarter.

The capital market recorded subdued performance in the second quarter of 2018 compared to the first quarter on account of rising profit warnings among listed firms. The yield on both Kenya's short term and long term maturing Eurobonds rose during the period under review.

CHAPTER 1

Inflation

1.1 Overview

Overall inflation remained below the midpoint of the medium term target band in the second quarter of 2018. It declined to 4.0 percent from 4.5 percent in the first quarter of 2018, supported by lower food prices (Table 1.1). Food inflation declined to 0.9 percent in the second quarter of 2018, from 3.8 percent in the first quarter, on account of abundant supply of food following favorable weather conditions experienced across the country during the quarter. The Non-Food

Non-Fuel (NFNF) inflation stabilized indicating minimal demand-driven inflationary pressures in the economy. It increased marginally to 3.8 percent in the second quarter of 2018 from 3.6 percent in the first quarter of 2018. Meanwhile, fuel inflation accelerated to 11.2 percent from 6.8 percent, owing to rising domestic and international energy prices.

The contribution of food inflation to overall inflation continued to ease due to lower food prices following increased supply owing to favorable weather

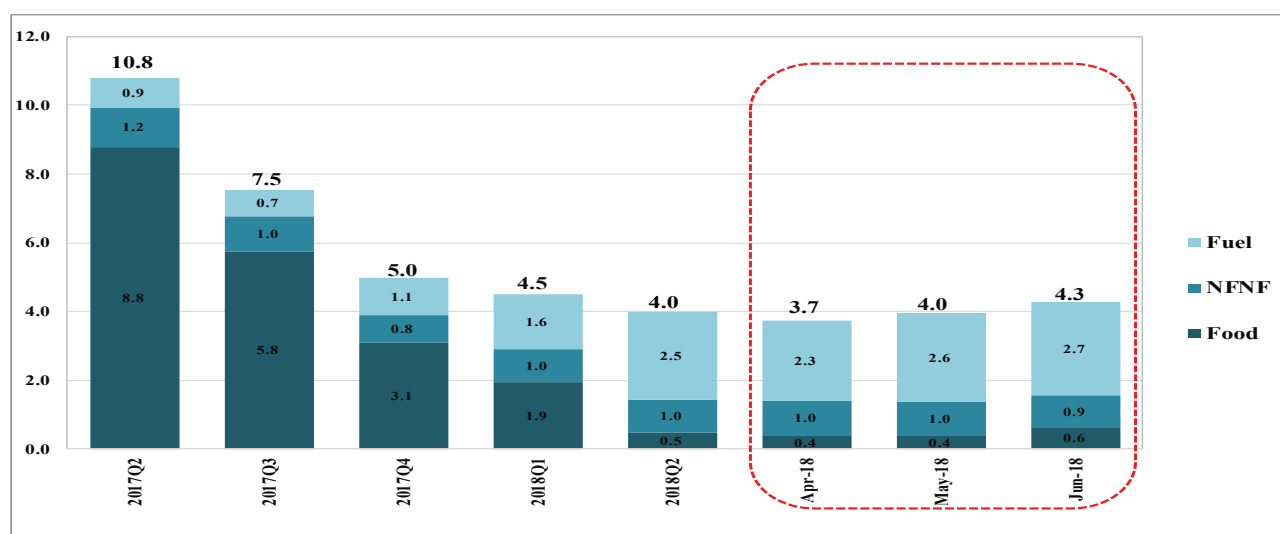
Table 1.1: Recent Developments in Inflation (Percent)

	2016		2017				2018				
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Apr	May	Jun
Overall Inflation	6.3	6.5	8.8	10.8	7.5	5.0	4.5	4.0	3.7	4.0	4.3
Food Inflation	10.3	10.6	14.7	18.1	11.7	6.3	3.9	0.9	0.8	0.7	1.2
Fuel Inflation	0.4	0.3	2.3	3.5	3.1	4.6	6.8	11.2	10.2	11.4	11.9
Non-Food Non-Fuel Inflation (NFNF)	5.0	5.2	4.2	4.3	3.8	2.9	3.6	3.8	4.0	3.9	3.6
Average annual	6.5	6.4	6.5	7.7	8.3	8.2	7.4	5.7	6.2	5.6	5.2
Three months annualised	7.0	6.6	14.7	15.4	-5.1	-3.1	12.6	13.1	17.7	15.9	5.8

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

conditions, and stood at 0.5 percentage points in the second quarter compared to 1.9 percentage points in the first quarter of 2018. On the other hand, the contribution of the fuel inflation to overall inflation increased significantly to 2.5 percentage points from 1.6 percentage points on account of elevated energy prices. However, the contribution of NFNF inflation to overall inflation remained stable at 1.0 percentage points (Chart 1.1).

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



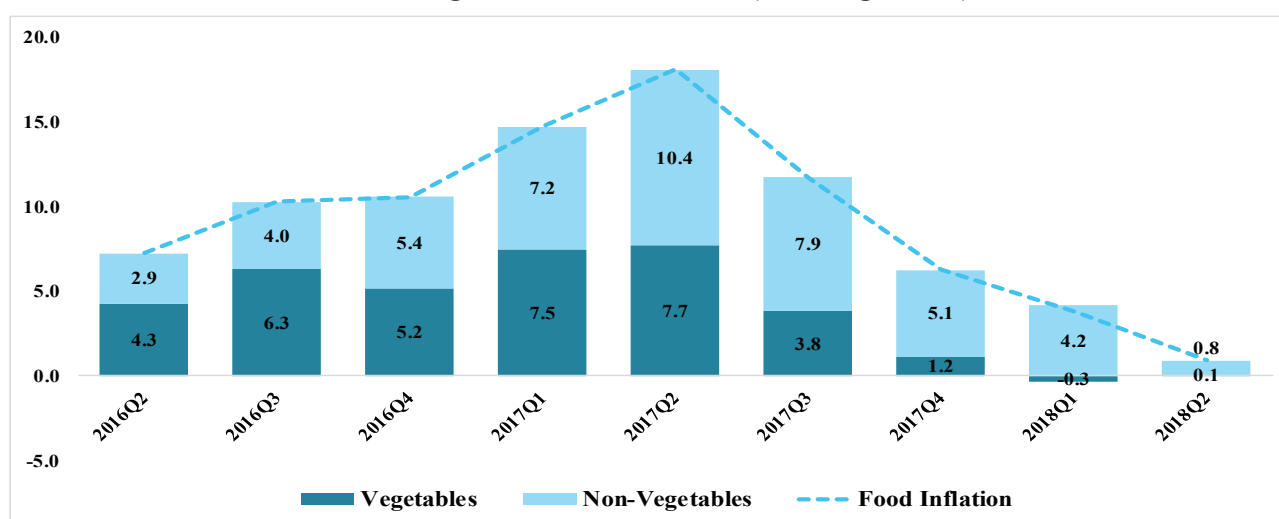
Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

1.2 Food inflation

Food inflation declined further to 0.9 percent in the second quarter of 2018 from 3.8 percent in the first quarter of 2018, largely driven by declining food prices. Food prices declined significantly compared to the same period in the previous year supported by favorable weather conditions experienced across the country during the quarter resulting in increased food production. Prices of fast growing vegetable items which had a profound effect on food inflation in the first half of 2017, declined substantially on account of abundant supply. Consequently, the contribution of vegetable items to food inflation declined significantly to 0.1 percentage points in the second quarter of 2018 from 7.7 percentage points in the second

quarter of 2017. In addition, prices of non-vegetable food items including sugar, fresh milk¹ and maize², which exerted significant pressure on food inflation in the first half of 2017 continued to decline in the second quarter of 2018. This was partly on account of favorable weather conditions and government measures to boost supply through imports of maize and sugar in 2017, whose effect moderated prices in first and second quarters of 2018. The contribution of these food items therefore declined significantly to 0.8 percentage points compared to 10.4 percentage points in the second quarter of 2017 (**Chart 1.2**).

Chart 1.2: Contribution of Broad Categories to Overall Inflation (Percentage Points)



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

1.3 Fuel Inflation

Fuel inflation increased significantly from the fourth quarter of 2017, owing to rising domestic and international energy prices, reflected in the continued increase in the contribution of energy³ prices to fuel inflation. Fuel inflation accelerated to 11.2 percent in the second quarter of 2018 from 6.8 percent in the first quarter of 2018. This is significantly higher compared to the 3.5 percent recorded in the second quarter of 2017 (**Chart 1.3**).

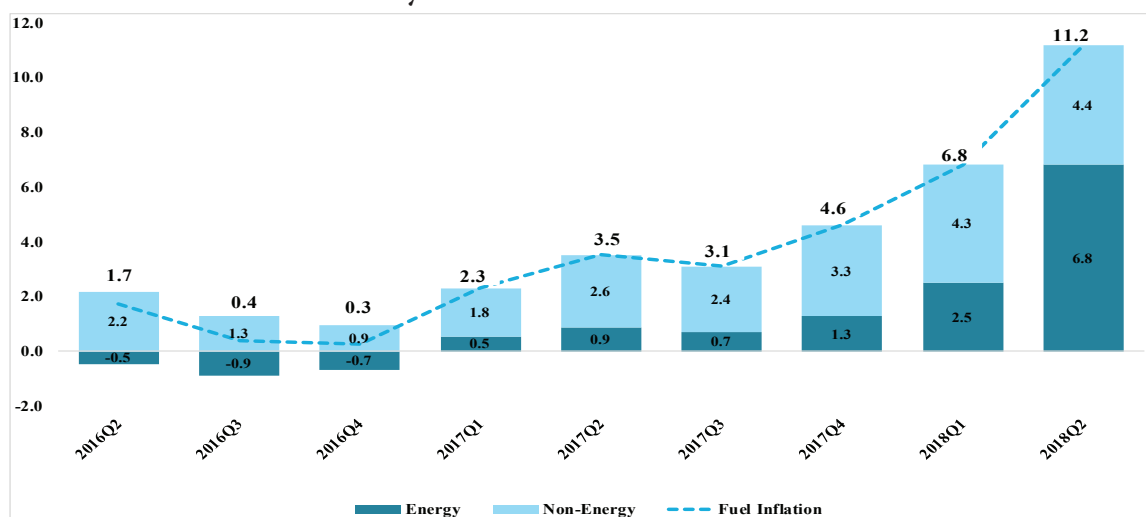
On the global scene, international oil prices continued to trend upwards and grew by 45 percent in the second quarter of 2018 compared to the same period the previous year. This has led to an upward adjustment

of domestic pump prices (petrol, diesel and kerosene) by the Energy Regulatory Commission (ERC) as well as the rising LPG gas prices. On the domestic scene, inflationary pressures emanated from charcoal prices which increased sharply in March 2018 following the ban on charcoal trade and illegal logging, in an effort to preserve forests and conserve the environment. These high prices have been sustained through the quarter under consideration, exerting high pressure on fuel inflation. Electricity prices have also remained high compared to a similar period of 2017, owing to continuous upward adjustment of the fuel cost and forex cost charges.

¹ Fresh milk comprises of fresh packeted and unpacked milk.

² Maize comprises of maize grain loose, maize flour-loose and sifted, and green maize

³ Energy items comprises of petrol, diesel, kerosene, Liquefied Petroleum Gas (LPG), electricity, charcoal and firewood.

Chart 1.3: Contribution of Key Items to Fuel Inflation

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

1.4 Non-Food Non-Fuel inflation (NFNF)

Non-Food Non-Fuel (NFNF) inflation has remained stable below the mid-point of the medium term target of 5.0 percent. It increased marginally to 3.8 percent in the second quarter of 2018, from 3.6 percent in the first quarter of 2018. This was reflected in marginal increases across the 'Clothing and Footwear', 'Furnishings, Household Equipment

and Routine Household Maintenance', 'Health' and 'Communication' categories (Table 1.2)

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

		Alcoholic Beverages, Tobacco & Narcotics	Clothing & Footwear	Furnishings, Household Equipment and Routine Household Maintenance	Health	Communication	Recreation & Culture	Education	Miscellaneous Goods & Services	Non-Food Non-Fuel Inflation
2016	Q3	14.3	3.6	3.6	3.5	1.8	4.3	4.2	3.8	5.0
	Q4	10.3	4.4	3.3	3.2	1.7	4.4	4.0	3.8	5.2
2017	Q1	3.2	4.2	3.0	3.1	0.6	2.1	2.9	3.5	4.2
	Q2	3.4	4.0	3.3	3.0	0.1	1.8	2.8	3.9	4.3
	Q3	3.0	3.8	3.2	3.1	0.3	1.2	2.9	3.6	3.8
	Q4	3.0	2.9	3.2	4.1	0.5	1.2	3.2	3.5	2.9
2018	Q1	2.9	3.8	4.1	3.6	0.7	1.6	5.2	4.4	3.6
	Q2	2.6	4.2	4.6	3.9	0.8	1.5	5.1	4.4	3.8
	Apr	2.8	4.1	4.6	3.5	0.8	1.4	5.1	4.7	4.0
	May	2.3	4.3	4.5	4.0	0.8	1.5	5.1	4.2	3.9
	Jun	2.8	4.2	4.6	4.2	0.9	1.5	5.1	4.1	3.6

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

1.5 Overall Inflation across Regions

In line with the general inflationary trend, inflation in Nairobi declined to 4.9 percent in the second quarter of 2018, from 5.8 percent in the first quarter of 2018 owing to declining food inflation. This was reflected in the decline of the contribution of food to inflation in Nairobi from 1.0 percentage points in the first quarter of 2018 to 0.3 percentage points during the period under review. The contribution of fuel to overall inflation in Nairobi increased to 1.3 percentage points from 0.8 percentage points during the period under review reflecting inflationary pressures emanating from higher fuel prices. Meanwhile, the contribution of NFNF remained stable in the first and second quarters of 2018 (**Chart 1.4**).

In addition, inflation developments in the 'Rest of Kenya' mirrored those of the Nairobi region during the quarter under consideration. Inflation in this region declined to 3.4 percent during the second quarter of 2018, from 3.6 percent in the first quarter of 2018. The contribution of food to overall inflation in the 'Rest of Kenya' region declined while that of fuel increased. At the same time, the contribution of NFNF remained stable at 0.5 percentage points.

Overall, the contribution of the 'Nairobi' region to overall inflation in Kenya declined to 2.0 percentage points from 2.3 percentage points, while that of the 'Rest of Kenya' declined to 1.9 percentage points from 2.2 percentage points.

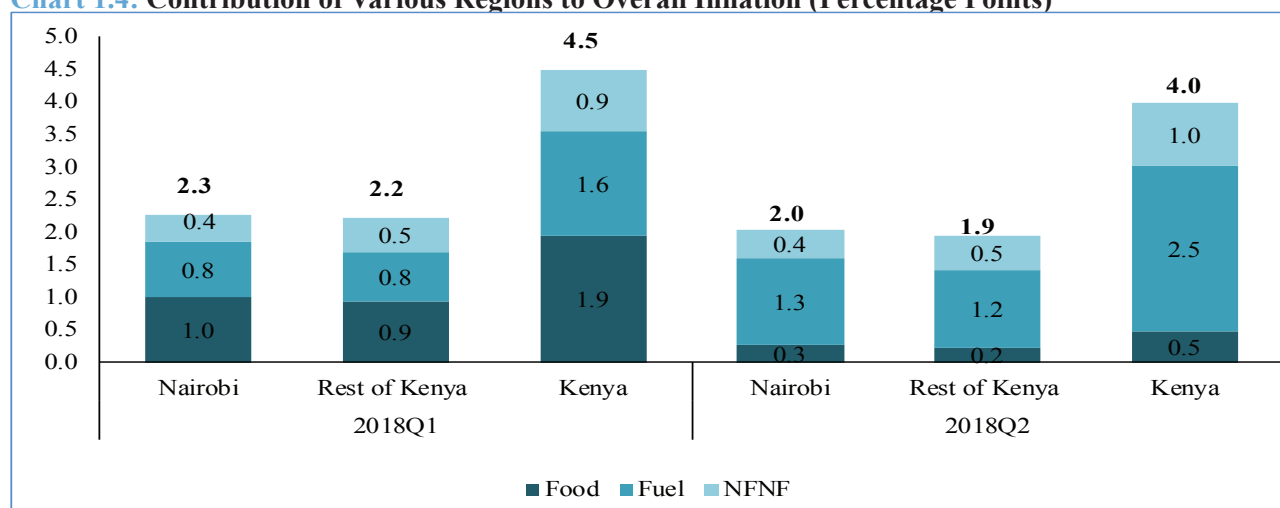
Overall Inflation across Income Groups in Nairobi

Inflation in the 'Lower Income' group declined to 4.9 percent during the quarter under review from 5.9 percent in the first quarter of 2018. The contribution of food inflation in the 'Lower Income' group to inflation in Nairobi declined during the period, while that of fuel and NFNF remained stable.

Inflation in the 'Middle Income' group during the period under consideration declined to 4.8 percent from 5.8 percent in the previous period. The contribution of food to inflation in this income group declined, while that of fuel and NFNF increased, reflecting underlying inflationary pressures.

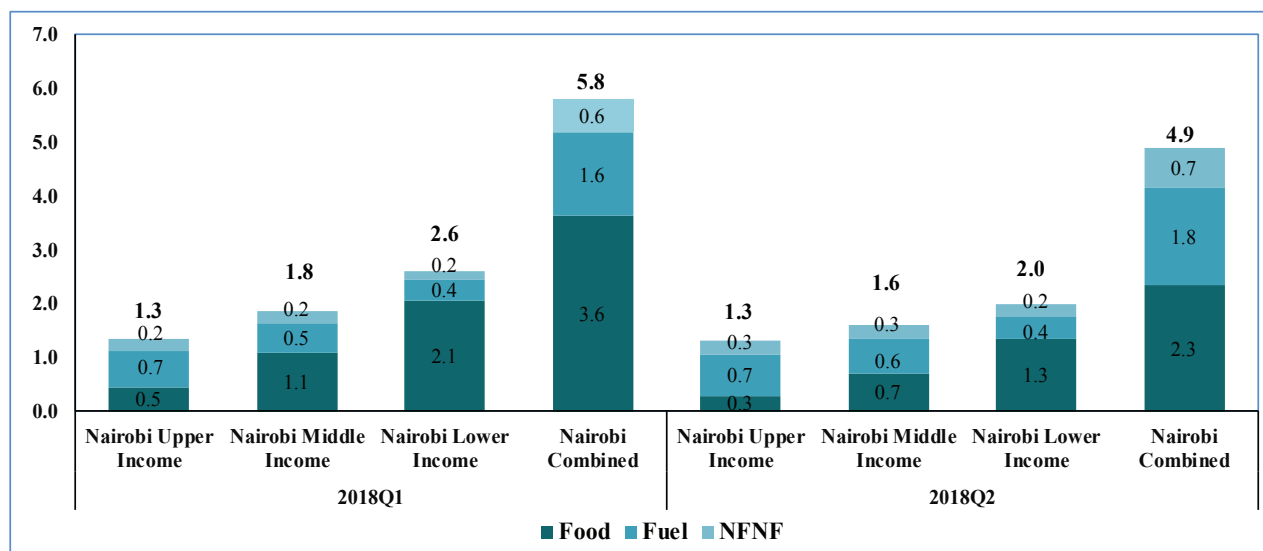
Inflation in the 'Upper Income' group exhibited a contrary trend, with inflation rising to 4.7 percent in the second quarter of 2018 from 4.1 percent in the first quarter of 2018. The contribution of food inflation in this income group declined, while that of NFNF increased. However, the contribution of fuel stabilized at 0.7 percentage points during the period (**Chart 1.5**).

Chart 1.4: Contribution of Various Regions to Overall Inflation (Percentage Points)



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

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



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

Chapter 2

Money, Credit and Interest Rates

2.1 Monetary aggregates and its components

Broad money supply (M3) growth in the second quarter of 2018 improved to 7.5 percent from 0.2 percent in the first quarter, reflecting growth in deposits. Household sector deposits increased by 10.6 percent in the second quarter of 2018 compared with 1.6 percent in the first quarter of 2018, mainly reflected in foreign currency deposits partly due to increases in diaspora remittances mainly supported by new partnerships between commercial banks and international money remittance providers. Similarly, growth in corporate sector deposits improved to 4.0 percent in the second quarter compared with a decline of 2.0 percent in the first quarter of 2018. Notably,

there was a strong recovery in growth of time and savings deposits during the second quarter of 2018 as the growth in non-bank holdings of government securities moderated (Tables 2.1, 2.2 and Charts 2.1).

On 12-month basis, money supply, M3 growth improved to 10.5 per cent in June 2018 from 5.9 percent in March 2018 and 8.9 percent in December 2017, largely reflecting increase in net credit to government and a recovery of credit to the private sector in the second quarter of 2018.

Table 2.1: Monetary Aggregates

	End Month Level					Quarterly Growth Rates (%)					Absolute Quarterly Changes (KSh Billions)				
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Components of M3															
1. Money supply, M1 (1.1+1.2+1.3)	1391.3	1382.7	1397.3	1372.8	1436.9	5.6	-0.6	1.1	-1.7	4.7	74.1	-8.6	14.6	-24.4	64.0
1.1 Currency outside banks	206.7	208.9	225.1	214.1	217.9	3.0	1.0	7.8	-4.9	1.8	6.1	2.1	16.2	-11.0	3.9
1.2 Demand deposits	1102.9	1113.7	1130.4	1093.9	1137.3	3.8	1.0	1.5	-3.2	4.0	40.2	10.8	16.7	-36.5	43.5
1.3 Other deposits at CBK ^{1/}	81.2	59.7	41.4	64.5	81.2	51.9	-26.5	-30.7	55.9	25.8	27.7	-21.5	-18.3	23.2	16.7
2. Money supply, M2 (1+2.1)	2480.5	2515.1	2538.2	2547.3	2668.3	2.8	1.4	0.9	0.4	4.7	68.4	34.6	23.1	9.1	120.9
2.1 Time and saving deposits	1089.2	1132.4	1140.9	1174.5	1231.4	-0.5	4.0	0.8	2.9	4.8	-5.7	43.2	8.5	33.6	56.9
3. Money supply, M3 (2+3.1)	2936.1	2986.4	3010.9	3015.7	3242.9	3.1	1.7	0.8	0.2	7.5	89.5	50.2	24.6	4.7	227.2
3.1 Foreign Currency Deposits	455.6	471.27	472.7	468.4	574.7	4.8	3.4	0.3	-0.9	22.7	21.1	15.7	1.5	-4.4	106.3
Sources of M3															
1. Net foreign assets ^{2/}	644.1	611.6	517.9	699.2	758.5	6.8	-5.0	-15.3	3.5	8.5	41.1	-32.5	-93.8	181.3	59.3
Central Bank	738.3	694.6	627.1	803.3	783.6	5.8	-5.9	-9.7	2.8	-2.5	40.5	-43.7	-67.5	176.2	-19.7
Banking Institutions	-94.2	-83.0	-109.3	-104.1	-25.2	-0.7	-11.9	31.6	-0.5	-75.8	0.6	11.2	-26.2	5.1	79.0
2. Net domestic assets (2.1+2.2)	2292.0	2374.7	2493.1	2316.5	2484.5	2.2	3.6	5.0	-0.7	7.3	48.3	82.7	118.3	-176.6	168.0
2.1 Domestic credit	3002.2	3069.7	3198.3	3046.3	3203.0	1.7	2.2	4.2	-0.5	5.1	49.6	67.4	128.6	-151.9	156.7
2.1.1 Government (net)	646.2	674.3	755.7	624.9	745.1	10.8	4.3	12.1	-1.7	19.2	62.8	28.1	81.4	-130.8	120.1
2.1.2 Private sector	2249.1	2281.6	2330.2	2308.7	2346.1	-0.6	1.4	2.1	-0.1	1.6	-14.0	32.5	48.6	-21.5	37.4
2.1.3 Other public sector	106.9	113.7	112.4	112.7	111.9	0.9	6.4	-1.2	0.0	-0.8	0.9	6.9	-1.3	0.3	-0.9
2.2 Other assets net	-710.3	-694.9	-705.2	-729.9	-718.5	0.2	-2.2	1.5	0.3	-1.6	-1.3	15.3	-10.3	-24.6	11.3
Memorandum items															
4. Overall liquidity, L (3+4.1)	3935.0	4012.3	4085.1	4139.5	4414.5	3.1	2.0	1.8	1.3	6.6	118.3	77.4	72.8	54.4	275.0
4.1 Non-bank holdings of government securities	998.9	1026.0	1074.2	1123.8	1171.6	3.0	2.7	4.7	4.6	4.3	28.8	27.1	48.2	49.6	47.8

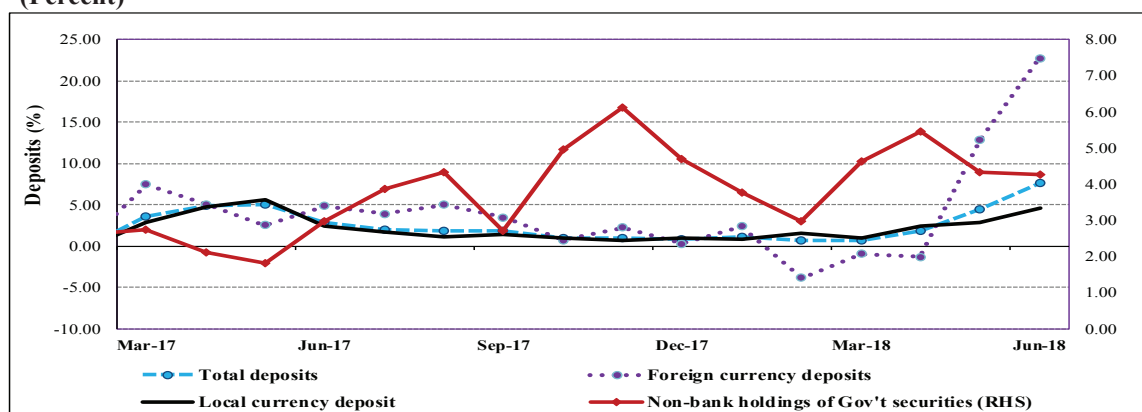
Absolute and percentage changes may not necessarily add up due to rounding

^{1/} Includes county deposits and special projects deposit

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

Source: Central Bank of Kenya

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



Source: Central Bank of Kenya

Table 2.2: Deposits Holdings of Corporates and Household Sectors

	End Month Levels (KSh Billions)					Quarterly Growth Rates (%)					Absolute Quarterly Changes (KSh Billions)				
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
1. Household Sector ^{1/}	1265.5	1300.4	1308.9	1330.0	1471.4	1.6	2.8	0.7	1.6	10.6	19.7	34.9	8.5	21.2	141.3
1.1 Demand Deposits	546.9	573.2	566.7	568.3	580.4	0.6	4.8	-1.1	0.3	2.1	3.5	26.3	-6.5	1.6	12.1
1.2 Time and Saving Deposits	580.1	590.6	601.6	616.6	646.8	2.3	1.8	1.9	2.5	4.9	13.0	10.6	11.0	14.9	30.2
1.3 Foreign Currency Deposits	138.5	136.5	140.5	145.2	244.2	2.4	-1.4	2.9	3.3	68.2	3.2	-2.0	4.0	4.7	99.0
2. Corporate Sector	1373.0	1408.4	1427.9	1398.9	1455.4	3.0	2.6	1.4	-2.0	4.0	40.4	35.4	19.5	-29.0	56.5
2.1 Time and saving deposits	549.2	534.4	558.6	519.9	542.7	8.1	-2.7	4.5	-6.9	4.4	41.2	-14.7	24.1	-38.7	22.8
2.2 Time and Saving Deposits	507.1	539.8	537.7	556.4	582.7	-3.5	6.4	-0.4	3.5	4.7	-18.5	32.7	-2.1	18.7	26.3
2.3 Foreign Currency Deposits	316.7	334.1	331.6	322.6	330.1	5.9	5.5	-0.7	-2.7	2.3	17.8	17.5	-2.5	-9.0	7.5

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

Source: Central Bank of Kenya

2.2 Sources of Broad Money

The primary source of acceleration in M3 growth in the second quarter of 2018 was the increase in Net Domestic Assets (NDA) of the banking system, largely reflected in growth of net credit to government and private sector credit (Table 2.1). The contribution of Net Foreign Assets (NFA) of the Banking system to the growth in M3 remained strong in the second quarter of 2018, but declined compared to its contribution in the first quarter of 2018. The decline was largely reflected in NFA of Central Bank partly due to government debt service. The NFA of Commercial Banks' increased in the second quarter of 2018 largely reflected in increased deposit holdings in non-resident banks and purchase of foreign securities.

2.3 Developments in Domestic Credit

Domestic credit increased by 5.1 percent in the second quarter of 2018 compared to a decline of 4.8 per cent in the first quarter of 2018, largely reflecting increased net credit flows to government and a recovery in private sector credit. The banking system net credit to government increased by KSh 120.1 billion in the second quarter of 2018, largely reflecting the utilization of the government deposits at the central bank and increase in commercial lending to the government. Growth in banks' credit to private sector increased by 1.6 percent in the second quarter of 2018 compared to a decline of 0.9 percent in the first quarter of 2018 (Table 2.3). This recovery in private sector credit was reflected in both corporate and household sectors (Table 2.4)

Table 2.3: Banking Sector Net Domestic Credit

	End Month Level					Quarterly Growth Rates (%)					Absolute Quarterly Changes (KSh Billions)				
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
1. Credit to Government	646.2	674.3	755.7	624.9	745.1	10.8	4.3	12.1	-17.3	19.2	62.8	28.1	81.4	-130.8	120.2
Central Bank	-178.9	-167.6	-67.0	-256.9	-204.4	52.6	-6.3	-60.0	283.6	-20.4	-61.7	11.3	100.6	-189.9	52.5
Commercial Banks & NBFIs	825.1	841.9	822.7	881.8	949.5	17.8	2.0	-2.3	7.2	7.7	124.4	16.7	-19.2	59.2	67.7
2. Credit to other public sector	106.9	113.7	112.4	112.7	111.9	0.9	6.4	-1.2	0.3	-0.7	0.9	6.9	-1.3	0.3	-0.8
Local government	3.9	4.2	4.0	4.2	4.4	1.2	8.1	-5.5	6.4	3.8	0.0	0.3	-0.2	0.3	0.2
Parastatals	103.0	109.5	108.4	108.5	107.5	0.9	6.3	-1.0	0.1	-0.9	0.9	6.5	-1.1	0.1	-1.0
3. Credit to private sector	2,249.1	2,281.6	2,330.2	2,308.7	2,346.1	-0.6	1.4	2.1	-0.9	1.6	-14.0	32.5	48.6	-21.5	37.4
Agriculture	85.5	88.8	83.0	81.2	81.3	-1.6	3.9	-6.5	-2.2	0.1	-1.4	3.3	-5.8	-1.8	0.1
Manufacturing	282.8	295.6	310.6	310.0	317.6	1.5	4.5	5.1	-0.2	2.4	4.1	12.8	15.1	-0.6	7.6
Trade	388.2	408.7	414.9	402.6	421.5	1.6	5.3	1.5	-3.0	4.7	6.2	20.5	6.2	-12.3	18.9
Building and construction	100.8	106.7	109.9	114.2	114.4	-0.6	5.9	2.9	3.9	0.2	-0.6	5.9	3.1	4.3	0.2
Transport & communications	185.5	182.7	186.7	159.5	161.3	-5.8	-1.5	2.2	-14.6	1.1	-11.3	-2.8	4.1	-27.2	1.8
Finance & insurance	84.9	83.5	81.6	86.2	88.1	9.9	-1.7	-2.3	5.7	2.2	7.6	-1.4	-1.9	4.6	1.9
Real estate	355.7	358.8	366.5	366.6	369.4	1.3	0.9	2.1	0.0	0.8	4.7	3.1	7.7	0.1	2.8
Mining and quarrying	14.7	16.0	15.9	14.5	13.3	-1.8	9.1	-0.8	-8.8	-8.4	-0.3	1.3	-0.1	-1.4	-1.2
Private households	386.7	384.0	387.1	392.0	397.9	-2.0	-0.7	0.8	1.3	1.5	-8.0	-2.8	3.1	4.9	5.9
Consumer durables	168.2	170.9	176.4	180.6	181.3	-2.5	1.6	3.2	2.4	0.4	-4.3	2.7	5.5	4.2	0.7
Business services	136.7	134.6	133.8	144.4	146.0	-6.2	-1.5	-0.6	7.9	1.1	-9.0	-2.0	-0.8	10.6	1.6
Other activities	59.5	51.4	63.7	56.8	53.9	-2.9	-13.6	24.1	-10.9	-5.1	-1.8	-8.1	12.4	-6.9	-2.9
4. TOTAL (1+2+3)	3,002.2	3,069.7	3,198.3	3,046.3	3,203.0	1.7	2.2	4.2	-4.8	5.1	49.6	67.4	128.6	-151.9	156.7

Source: Central Bank of Kenya

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

	End Month Level					Quarterly Growth Rates (%)					Absolute Quarterly Changes (KSh Billions)				
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
1. Household	660.1	668.8	683.2	690.2	706.6	0.7	1.3	2.2	1.0	2.4	4.6	8.7	14.4	7.0	16.4
2. Corporate	1,632.2	1,660.4	1,692.3	1,666.6	1,690.0	-0.8	1.7	1.9	-1.5	1.4	-13.4	28.2	31.9	-25.7	23.4
Gross Loans	2,292.3	2,329.2	2,375.6	2,356.8	2,396.6	-0.4	1.6	2.0	-0.8	1.7	-8.7	36.9	46.3	-18.7	39.8

Source: Central Bank of Kenya

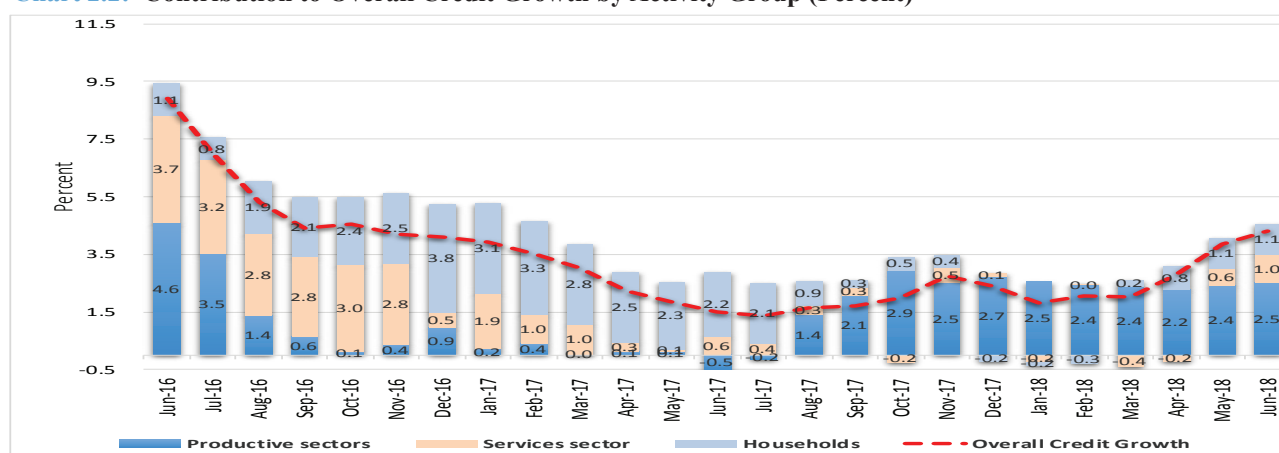
In the period under review, bank's credit growth was positive to all sectors except in mining and quarrying (Table 2.3). Credit extension mainly supported productive and service sectors which accounted for nearly 90 percent of growth of private sector credit in the second quarter of 2018. The major sub-sectors behind this recovery in private sector credit were trade, manufacturing and transport and communication which together contributed about 75 percent of the growth of private sector credit in the second quarter of 2018 (Table 2.5).

On 12-month basis, private sector credit growth improved to 4.3 percent in June 2018 from 2.0 percent in March 2018. Reasons for improved credit uptake by the private sector include strong economic growth prospects and improved business environment. As a result, the contribution of productive sectors to overall credit growth remained strong in the second quarter of 2018 (Chart 2.3). The interest rate caps however, remained a key constraint to credit extension to the private sector.

Table 2.5: Sectoral Credit Distribution

	End Month Level					Quarterly Growth Rates (%)					Contribution to Quarterly Changes (%)				
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
1. Productive sectors	839.5	865.9	885.9	886.5	896.0	0.8	3.2	2.3	0.1	1.1	0.3	1.2	0.9	0.0	0.4
Agriculture	85.5	88.8	83.0	81.2	81.3	-1.6	3.9	-6.5	-2.2	0.1	-0.1	0.1	-0.3	-0.1	0.0
Manufacturing	282.8	295.6	310.6	310.0	317.6	1.5	4.5	5.1	-0.2	2.4	0.2	0.6	0.7	0.0	0.3
Building and construction	100.8	106.7	109.9	114.2	114.4	-0.6	5.9	3.0	3.9	0.2	0.0	0.3	0.1	0.2	0.0
Real estate	355.7	358.8	366.5	366.6	369.4	1.3	0.9	2.1	0.0	0.8	0.2	0.1	0.3	0.0	0.1
Mining and quarrying	14.7	16.0	15.9	14.5	13.3	-1.8	9.1	-0.7	-8.8	-8.4	0.0	0.1	0.0	-0.1	-0.1
2. Services sector	795.2	809.4	817.0	792.7	816.9	-0.8	1.8	0.9	-3.0	3.1	-0.3	0.6	0.3	-1.0	1.0
Trade	388.2	408.7	414.9	402.6	421.5	1.6	5.3	1.5	-3.0	4.7	0.3	0.9	0.3	-0.5	0.8
Transport & communications	185.5	182.7	186.7	159.5	161.3	-5.8	-1.5	2.2	-14.6	1.1	-0.5	-0.1	0.2	-1.2	0.1
Finance & insurance	84.9	83.5	81.6	86.2	88.1	9.9	-1.7	-2.2	5.6	2.2	0.3	-0.1	-0.1	0.2	0.1
Business services	136.7	134.6	133.8	144.4	146.0	-6.2	-1.5	-0.6	7.9	1.1	-0.4	-0.1	0.0	0.5	0.1
3. Households	555.0	554.9	563.5	572.6	579.3	-2.2	0.0	1.6	1.6	1.2	-0.5	0.0	0.4	0.4	0.3
Private households	386.7	384.0	387.1	392.0	397.9	-2.0	-0.7	0.8	1.3	1.5	-0.4	-0.1	0.1	0.2	0.3
Consumer durables	168.2	170.9	176.4	180.6	181.3	-2.5	1.6	3.2	2.4	0.4	-0.2	0.1	0.2	0.2	0.0
4. Other activities	59.5	51.4	63.7	56.8	53.9	-2.9	-13.6	24.0	-10.8	-5.1	-0.1	-0.4	0.5	-0.3	-0.1
5. Total Credit	2,249.1	2,281.6	2,330.2	2,308.7	2,346.1	-0.6	1.4	2.1	-0.9	1.6	-0.6	1.4	2.1	-0.9	1.6

Source: Central Bank of Kenya

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

Source: Central Bank of Kenya

2.4 Reserve Money

Growth in reserve money (RM), which comprises currency held by the non-bank public and commercial bank reserves, increased by 2.6 percent in the second quarter of 2018 compared to a decline of 4.7 percent in the previous quarter. The increase was reflected in both bank reserves and currency outside banks (Table 2.6).

The primary source of the growth in reserve money was increase in NDA of Central Bank, largely reflecting decreased government deposits with increased spending towards the end of the 2017/2018 fiscal year. The CBK net lending to Commercial Bank declined by KSh 4.4 billion in the second quarter of 2018, partly reflecting improved liquidity conditions. Meanwhile, the NFA of the Central Bank declined in the second quarter of 2018, largely reflecting servicing of government debt.

2.5 Interest Rates

Central Bank Rate

The Monetary Policy Committee (MPC) retained the Central Bank Rate (CBR) at 9.5 percent in May 2018 to allow the impact of the previous decision of lowering the CBR by 50 basis points in March 2018 to filter through the economy. The MPC had lowered the CBR to 9.5 percent in March 2018 from 10 percent since September 2016 as there was room for easing monetary policy stance to support economic activity.

Interbank rate

The average interbank rate decreased slightly to 5.04 percent in the second quarter of 2018 from 5.41 percent in first quarter of 2018, partly reflecting improved liquidity conditions with increased government spending towards the end of the FY 2017/18. However, the volatility in the interbank rate partly reflected the impact of market segmentation along bank tiers (Table 2.7).

Treasury bill rates

The interest rates on government securities remained stable in second quarter of 2018, an indication that the implementation of government domestic borrowing program supported market stability. The average 91-day Treasury bill rate declined slightly to 7.94 percent in the second quarter of 2018 compared with 8.03 percent in the previous quarter, while the average 182-day Treasury bill rate declined to 10.18 percent from 10.48 percent (Table 2.7).

Lending and Deposit Rates

Commercial banks' interest rates remained relatively stable within the interest rate caps in the second quarter of 2018. The average commercial bank lending rate declined slightly to 13.22 percent in June 2018 compared to 13.49 percent in March 2018, while the average commercial banks' deposit rate decreased to 8.04 percent from 8.16 percent, partly reflecting the March 2018 reduction in CBR. The spread increased marginally to an average of 5.39 percent in second quarter of 2018 from 5.38 percent in the first quarter reflecting increased interest costs for time deposits.

Table 2.6: Reserve Money and Its Sources

	End Month Level					Quarterly Growth Rates (%)					Absolute Quarterly Changes (KSh Billions)				
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
1. Net Foreign Assets	738.3	694.6	627.1	803.3	783.6	5.8	-43.7	-9.7	28.1	-2.4	40.5	-43.7	-67.5	176.2	-19.7
2. Net Domestic Assets	-338.7	-270.1	-188.4	-385.1	-354.4	19.7	68.6	-30.3	104.5	-8.0	-55.9	68.6	81.8	-196.8	30.7
2.1 Government Borrowing (net)	-178.9	-167.6	-67.0	-256.9	-204.4	52.6	11.3	-60.0	283.6	-20.4	-61.7	11.3	100.6	-189.9	52.5
2.2 Commercial banks (net)	23.6	63.2	28.3	33.1	28.7	-228.5	39.6	-56.1	16.9	-13.2	42.0	39.6	-36.2	4.8	-4.4
2.3 Other Domestic Assets (net)	-186.8	-169.2	-153.1	-164.7	-182.1	24.0	17.6	-10.2	7.5	10.5	-36.2	17.6	17.4	-11.5	-17.4
3. Reserve Money	399.6	424.5	438.8	418.2	429.2	-3.7	24.9	3.4	-4.7	2.6	-15.3	24.9	14.3	-20.5	11.0
3.1 Currency outside banks	206.7	208.9	225.1	214.1	217.9	3.0	2.1	7.8	-4.9	1.8	6.1	2.1	16.2	-11.0	3.8
3.2 Bank reserves	192.9	215.7	213.7	204.2	211.3	-10.0	22.8	-0.9	-4.5	3.5	-21.4	22.8	-2.0	-9.5	7.1

Table 2.7: Interest Rates (%)

	2016				2017				2018					
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Jan	Feb	Mar	Apr	May	Jun
91-day Treasury bill rate	8.72	7.25	8.06	8.44	8.69	8.42	8.13	8.01	8.04	8.03	8.02	8.00	7.96	7.87
182-day Treasury bill rate	10.83	9.56	10.85	10.55	10.53	10.38	10.32	10.53	10.64	10.42	10.39	10.30	10.26	9.99
Interbank rate	4.10	4.56	4.47	5.55	4.46	3.99	5.52	7.27	6.21	5.12	4.90	5.38	4.70	5.03
Repo rate	4.31	10.04	0.00	0.00	7.23	4.13	7.24	7.75	8.75	7.63	0.00	6.75	7.44	6.16
Reverse Repo rate	11.63	10.59	10.36	10.04	10.04	10.05	10.12	10.10	10.02	10.05	9.95	9.64	9.60	9.56
Central Bank Rate (CBR)	11.50	10.50	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	9.50	9.50	9.50	9.50
Average lending rate (1)	17.79	18.15	13.84	13.69	13.61	13.66	13.69	13.64	13.65	13.68	13.49	13.24	13.24	13.22
Overdraft rate	18.06	18.04	13.60	13.49	13.29	13.38	13.65	13.54	13.61	13.75	13.40	13.29	13.30	13.23
1-5years	18.00	18.63	13.95	13.86	13.81	13.80	13.87	13.83	13.84	13.83	13.67	13.41	13.40	13.39
Over 5years	17.31	17.64	13.83	13.59	13.55	13.64	13.51	13.46	13.45	13.45	13.31	13.03	13.03	13.00
Average deposit rate (2)	7.17	6.78	6.94	7.33	7.12	7.15	7.66	8.22	8.26	8.25	8.16	7.76	7.73	8.04
0-3months	9.78	8.80	8.21	7.16	7.28	7.76	7.71	8.43	8.52	8.50	8.48	8.46	8.53	8.39
Over 3 months deposit	10.41	9.94	8.82	8.45	8.18	8.04	8.02	8.39	8.35	8.39	8.26	8.11	8.01	8.14
Savings deposits	1.32	1.60	3.78	6.37	5.89	5.63	6.43	6.91	6.97	7.01	6.85	6.72	6.64	6.60
Spread (1-2)	10.62	11.40	6.93	6.36	6.49	6.52	6.04	5.41	5.39	5.42	5.33	5.48	5.52	5.18

Source: Central Bank of Kenya

Chapter 3

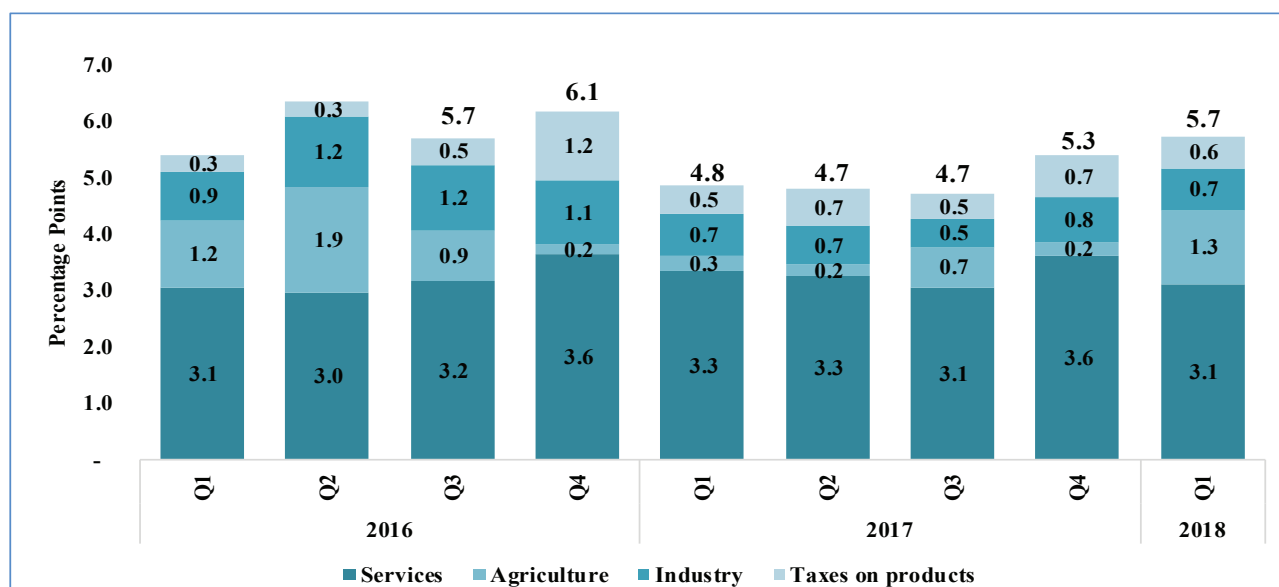
The Real Sector

3.1 Overview

In the second quarter of 2018, the economy grew by 6.3 percent compared to 4.7 percent realised in the second quarter of 2017. Real GDP growth in the second quarter of 2018 was mainly supported by improved performance of the agricultural activities following favourable weather conditions. Other sectors that supported growth include Manufacturing, Electricity and Water Supply, Wholesale and Retail Trade, Transport and Storage and Real Estate. However, other sectors such as Mining and Quarrying, and Financial and Insurance recorded subdued performance during the period (Table 3.1).

The overall strong performance was mainly driven by service-oriented sectors, which contributed 3.2 percentage points to real GDP growth in the second quarter of 2018, compared to 3.3 percentage points in the second quarter of 2017. The contribution of industry increased marginally at 0.9 percentage points compared to 0.7 percentage points in the second quarter of 2017. The contribution of agriculture to real GDP growth increased significantly to 1.3 percentage points from 0.2 percentage points in the second quarter of 2017 (Chart 3.1, Table 3.3).

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



Source: Kenya National Bureau of Statistics

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

	Annual		2017				2018	
	2016	2017	Q1	Q2	Q3	Q4	Q1	Q2
1. Agriculture	4.7	1.6	0.9	0.8	3.7	1.4	5.2	5.6
2. Non-Agriculture (o/w)	6.2	5.8	6.0	6.0	5.0	6.2	5.9	6.5
2.1 Industry	5.7	3.6	4.1	3.6	2.5	4.1	4.1	4.7
Mining & Quarrying	9.5	6.1	7.1	6.0	6.4	5.0	4.6	3.5
Manufacturing	2.7	0.2	1.3	-0.2	-0.04	-0.4	2.3	3.1
Construction	9.8	8.6	6.1	6.0	4.5	5.8	5.1	8.6
Electricity & water supply	8.3	5.6	8.3	9.5	5.6	10.9	7.2	6.1
2.2 Services	6.5	6.2	7.2	7.0	6.2	7.0	6.8	6.9
Wholesale & Retail Trade	3.4	5.7	4.3	5.6	6.7	6.5	6.2	7.7
Accommodation & restaurant	13.3	14.7	24.5	12.6	12.4	9.5	13.5	15.7
Transport & Storage	7.8	7.3	9.5	8.0	5.3	7.0	7.1	7.8
Information & Communication	9.7	11.0	12.5	10.8	10.7	10.1	12.0	12.6
Financial & Insurance	6.7	3.1	4.7	3.5	1.7	2.4	2.6	2.3
Public administration	4.8	5.3	4.6	5.3	5.0	6.1	4.6	5.8
Professional, Administration & Support Services	5.0	4.0	4.2	5.6	2.4	4.0	4.4	5.4
Real estate	8.8	6.1	6.1	6.0	6.1	6.3	6.8	6.6
Education	5.4	6.1	5.7	6.0	5.7	6.8	6.8	6.3
Health	4.8	6.0	4.0	6.8	6.4	6.3	6.1	6.1
Other services	4.1	5.0	6.6	5.2	4.5	3.7	2.4	2.5
FISIM	2.1	-5.7	-1.5	-6.4	-5.0	-7.4	-0.6	2.1
2.3 Taxes on products	4.8	5.1	4.6	6.1	4.0	6.1	5.4	7.8
Real GDP Growth	5.9	4.9	4.7	4.7	4.7	5.4	5.7	6.3

Source: Kenya National Bureau of Statistics

Table 3.2: Sectoral Shares as a Percentage of GDP

	Annual		2017				2018	
	2016	2017	Q1	Q2	Q3	Q4	Q1	Q2
1. Agriculture	21.9	21.2	25.6	23.4	19.0	16.7	25.5	23.2
2.1 Industry	19.2	19.0	18.5	19.0	19.2	19.2	18.2	18.8
Mining & Quarrying	1.1	1.1	1.1	1.0	1.1	1.1	1.1	1.0
Manufacturing	10.2	9.8	9.9	9.9	9.88	9.3	9.6	9.6
Construction	2.5	2.5	2.5	2.7	2.6	2.5	2.4	2.7
Electricity & water supply	5.4	5.6	5.0	5.4	5.7	6.2	5.1	5.4
2.2 Services	50.0	50.7	45.5	46.6	49.8	51.5	46.0	46.9
Wholesale & Retail Trade	7.5	7.6	6.9	7.1	8.6	7.7	6.9	7.2
Accommodation & restaurant	1.1	1.2	1.4	0.9	1.2	1.5	1.5	1.0
Transport & Storage	6.9	7.0	6.2	6.8	7.4	7.8	6.3	6.9
Information & Communication	3.8	4.0	4.0	3.3	3.7	5.3	4.2	3.5
Financial & Insurance	6.2	6.1	6.0	6.0	6.4	6.1	5.9	5.8
Public administration	3.8	3.9	3.6	4.3	3.7	3.8	3.6	4.3
Professional, Administration & Support Services	2.3	2.2	2.1	2.2	2.3	2.4	2.0	2.2
Real estate	8.4	8.5	8.2	8.4	8.7	8.9	8.3	8.4
Education	6.9	7.0	6.8	6.9	7.1	7.1	6.9	6.9
Health	1.8	1.8	1.6	1.8	1.9	1.9	1.6	1.8
Other services	1.3	1.3	1.2	1.2	1.3	1.3	1.2	1.2
FISIM	-2.6	-2.3	-2.4	-2.3	-2.4	-2.3	-2.3	-2.2
2.3 Taxes on products	11.4	11.5	10.4	11.0	12.0	12.6	10.4	11.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Kenya National Bureau of Statistics and CBK Staff Computations

Table 3.3: Sectoral Contributions to Real GDP Growth Rate

	Annual		2017				2018	
	2016	2017	Q1	Q2	Q3	Q4	Q1	Q2
1. Agriculture	1.0	0.3	0.2	0.2	0.7	0.2	1.3	1.3
2.1 Industry	1.1	0.7	0.7	0.7	0.5	0.8	0.7	0.9
Mining & Quarrying	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Manufacturing	0.3	0.0	0.1	0.0	0.00	0.0	0.2	0.3
Construction	0.2	0.1	0.2	0.2	0.1	0.1	0.1	0.2
Electricity & water supply	0.5	0.5	0.4	0.5	0.3	0.7	0.4	0.3
2.2 Services	3.2	3.1	3.3	3.3	3.1	3.6	3.1	3.2
Wholesale & Retail Trade	0.3	0.4	0.3	0.4	0.6	0.5	0.4	0.6
Accommodation & restaurant	0.2	0.2	0.3	0.1	0.1	0.1	0.2	0.2
Transport & Storage	0.5	0.5	0.6	0.5	0.4	0.5	0.4	0.5
Information & Communication	0.4	0.4	0.5	0.4	0.4	0.5	0.5	0.4
Financial & Insurance	0.4	0.2	0.3	0.2	0.1	0.1	0.2	0.1
Public administration	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Professional, Administration & Support Services	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Real estate	0.7	0.5	0.5	0.5	0.5	0.6	0.6	0.5
Education	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.4
Health	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other services	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
FISIM	-0.1	0.1	0.0	0.1	0.1	0.2	0.0	0.0
2.3 Taxes on products	0.6	0.6	0.5	0.7	0.5	0.8	0.6	0.9
Real GDP Growth	5.9	4.9	4.7	4.7	4.7	5.4	5.7	6.3

3.2 Performance by Sector

Economic indicators in the second quarter of 2018 pointed to a general improvement in economic activity. In particular, agriculture and electricity generation performed well following improved weather conditions experienced in the country compared to a similar quarter last year.

Agriculture

Agriculture sector recovered significantly to 5.6

percent in the second quarter of 2018 from 0.8 percent in the second quarter of 2017 (**Table 3.1**). Growth in the sector largely reflected increased output of tea, coffee, canes delivered to millers, fruits and dairy production. Consequently, the contribution of agriculture to overall GDP growth jumped to 1.3 percentage points compared to 0.2 percentage points in the second quarter of 2017 (**Table 3.3**).

Tea production increased by 31.5 percent in the second quarter of 2018 compared to the previous quarter, and was higher by 18.4 percent compared to the same quarter of 2017, mainly supported by improved weather conditions in tea growing areas during the period under review (**Table 3.4**). Consequently, average auction price of tea per kilogram decreased by 14.8 percent in the second quarter of 2018 compared to a similar quarter in 2017.

Table 3.4: Quarterly Performance of Key Agricultural Output Indicators

	2017				2018*				
	Quarterly				Quarterly		Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-18	May-18	Jun-18
Tea									
Output (Metric tonnes)	90,094	110,819	102,645	136,300	99,760	131,235	44,580	43,356	43,299
Growth (%)	-28.69	23.00	-7.38	32.79	-26.81	31.55	43.9	-2.7	-0.1
Horticulture									
Exports (Metric tonnes)	84,851	85,186	82,791	82,105	100,526	96,592	34,365	28,816	33,411
Growth (%)	8.2	0.4	-2.8	-0.8	22.4	-3.9	-8.3	-16.1	15.9
Coffee									
Sales (Metric tonnes)	16,731	6,202	5,546	5,250	15,857	8,814	4,194	4,620	N/A**
Growth (%)	198.1	-62.9	-10.6	-5.3	202.1	-44.4	-14.6	10.1	
Milk									
Output (million litres)	130.0	143.2	153.3	164.9	148.7	152.0	52.0	49.6	50.3
Growth %	-19.6	10.1	7.1	7.5	-9.8	2.2	4.3	-4.6	1.4
Sugar Cane									
Output ('000 Metric tonnes)	1,572	786	709	1,546	1,688	1,006	394	297	316
Growth (%)	-3.6	-50.0	-9.8	118.1	9.2	-40.4	-11.4	-24.7	6.6

* Provisional

** Coffee exchange was in recession hence, no trading date for June 2018

Source: Kenya National Bureau of Statistics

Coffee

Coffee sales increased by 42.1 percent in the second quarter of 2018 compared to the same period in 2017. The increase was supported by higher production of coffee following favourable weather conditions experienced in the country compared to a similar period last year. However, compared to the first quarter of 2018, coffee sales decreased by 44.4 percent (**Table 3.4**). The average auction prices decreased by 9.5 percent in the second quarter of 2018 compared to a similar period in 2017, as traders hoarded the produce as a result of tumbling down of international coffee prices.

Horticulture

Total exports of horticultural crops declined by 3.9 percent in the second quarter of 2018 compared to the previous quarter, as the decline in exports of cut flowers more than offset the higher exports of fresh vegetables, and fruits and nuts (**Table 3.4**). However, horticultural exports were higher by 13.4 percent compared to the second quarter of 2017.

3.3 Manufacturing Sector

The Manufacturing sector growth improved 3.1 percent in the second quarter of 2018 compared to a negative growth of 0.2 percent in the second quarter of 2017 (**Table 3.1**). This was largely on account

of increased agro-processing activities following recovery of the agricultural sector, increased production of galvanized sheets and increased bank credit to the sector.

Cement production declined further by 5.5 percent in the second quarter of 2018 compared to the previous quarter, and was lower by 9.8 percent compared to the same quarter of 2017. The drop in cement production is attributed to reduced activity in the construction sector and increased competition from imports. Monthly data for the quarter under review shows slowdown in production in April and May 2018 by 0.4 percent and 4.8 percent, respectively, followed by a slight increase in production by 0.5 percent in June 2018 (**Table 3.5**).

Production of **galvanized sheets** declined by 4.0 percent in the second quarter of 2018 compared to the previous quarter and was higher by 5.5 percent compared to the same quarter of 2017 (**Table 3.5**).

Table 3.5: Quarterly Production of Selected Manufactured Goods

	2017				2018*				
	Quarterly				Quarterly		Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-18	May-18	Jun-18
Cement production									
Output (MT)	1,627,269	1,531,136	1,503,449	1,500,740	1,461,459	1,381,096	474,740	452,034	454,322
Growth %	-4.5	-5.9	-1.8	-0.2	-2.6	-5.5	-0.42	-4.78	0.51
Assembled vehicles									
Output (No.)	1,499	870	1,136	1,056	1,472	1,182	409	407	366
Growth %	25.5	-42.0	30.6	-7.0	39.4	-19.7	-25.4	-0.5	-10.1
Galvanized sheets									
Output (MT)	71,888	61,730	62,124	67,107	67,857	65,139	21,434	22,271	21,434
Growth %	26.3	-14.1	0.6	8.0	1.1	-4.0	-2.8	3.9	-3.8
Processed sugar									
Output (MT)	144,403	57,589	50,423	124,711	165,800	93,935	36,682	28,933	28,320
Growth %	-2.5	-60.1	-12.4	147.3	32.9	-43.3	-25.4	-21.1	-2.1
Soft drinks									
Output ('000 litres)	144,385	133,016	123,418	156,726	150,887	129,649	45,690	40,699	43,260
Growth %	3.0	-7.9	-7.2	27.0	-3.7	-14.1	-7.0	-10.9	6.3

MT = Metric tonnes

* Provisional

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

3.4 Electricity and Water Supply Sector

Electricity and Water Supply sector recorded slow growth in the second quarter of 2018. The sector's growth decelerated to 6.1 percent compared to 9.5 percent in the second quarter of 2017, largely on account of slow growth of generation of thermal and wind energy during the period (**Table 3.1**). The sector's contribution to overall GDP growth declined marginally to 0.3 percentage points in the second quarter of 2018 compared to 0.5 percentage points a similar period in 2017 (**Table 3.3**).

Growth in electricity generation increased by 3.0 percent in the second quarter of 2018 compared to the previous quarter, and was higher by 8.1 percent compared to the same quarter in 2017. This was

attributed to a significant increase of 66.0 percent in hydroelectricity generation, following the heavy rains experienced during the quarter. Generation of geothermal electricity also increased by 3.1 percent compared to the previous quarter. Generation of thermal electricity declined significantly during the quarter (**Table 3.6**).

Consumption of electricity declined by 1.6 percent in the second quarter of 2018. Meanwhile, international oil prices increased by 11.2 percent in the second quarter compared to the previous quarter, and was 45.2 percent higher compared to the same quarter of 2017 (**Table 3.6**).

Table 3.6: Quarterly Performance in the Energy Sector

	2017				2018				
	Quarterly				Quarterly		Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-18	May-18	Jun-18
Electricity Supply (Generation)									
Output (million KWH)	2,452.6	2,515.5	2,555.4	2,617.1	2,640.4	2,718.5	886.5	917.6	914.5
Growth %	-3.7	2.6	1.6	2.4	0.9	3.0	-1.8	3.5	-0.3
Of which:									
Hydro-power Generation (million KWH)	700.6	620.3	683.3	772.6	664.8	1103.6	316.9	385.9	400.9
Growth (%)	-27.8	-11.5	10.2	13.1	-14.0	66.0	27.6	21.8	3.9
Geo-Thermal Generation (million KWH)	1,122.2	1,151.2	1,219.3	1,263.7	1,265.6	1,304.8	427.7	447.1	430.0
Growth (%)	1.6	2.6	5.9	3.6	0.2	3.1	-4.6	4.5	-3.8
Thermal Generation (million KWH)	609.1	730.8	644.1	562.2	695.8	304.0	138.7	82.9	82.4
Growth (%)	35.1	20.0	-11.9	-12.7	23.8	-56.3	-31.4	-40.2	-0.7
Wind Generation (million KWH)	20.8	13.2	8.7	18.7	14.2	6.2	3.2	1.7	1.2
Growth (%)	4.0	-36.6	-34.3	116.1	-23.9	-56.4	-21.2	-46.9	-27.9
Consumption of electricity (million KWH)									
Output	2,064.3	2,165.8	2,413.7	2,079.2	2,161.3	2,127.1	688.3	712.0	726.8
Growth %	0.4	4.9	11.4	-13.9	3.9	-1.6	-7.7	3.4	3.4
Murban crude oil average price (US \$ per barrel)									
Output	54.7	50.7	51.1	63.2	66.2	73.6	71.0	76.7	73.2
Growth %	8.2	-7.3	0.7	23.8	4.8	11.2	7.0	8.1	-4.5

Source: Kenya National Bureau of Statistics

3.5 Construction and Real Estate Sectors

Construction Sector grew by 8.6 percent in second quarter of 2018 compared to 6.0 percent in a similar quarter in 2017 supported by favourable credit to the sector, the ongoing construction of the second phase of SGR and other major public infrastructure projects (Table 3.1). The contribution of the sector to real GDP growth remained unchanged at 0.2 percentage points in the second quarter of 2017 and 2018 (Table 3.3).

Indicators in the construction sector showed subdued activity in the second quarter of 2018. Cement consumption decreased by 5.1 percent in the second quarter compared to the previous quarter. The value of building plans approved by Nairobi City County's Planning, Compliance and Enforcement Department decreased in May-June 2018 by 9.9 percent compared to the same period in 2017. No building plans were approved in April 2018 (Table 3.7).

Table 3.7: Quarterly Output of Selected Construction Indicators

	2017				2018				
	Quarterly				Quarterly		Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-18	May-18	Jun-18
Cement Consumption Output (Tonnes)	1,533,010	1,435,103	1,429,162	1,387,875	1,410,169	1,337,695	453,538	436,776	447,381
Growth %	-5.0	-6.4	-0.4	-2.9	1.6	-5.1	-6.1	-3.7	2.4
Value of Building Plans Approved by Nairobi City County Planning Compliance & Enforcement Department									
Residential (KSh, millions)	33,863.46	36,503.04	18,146.46	23,550.46	36,850.30	26,326.87	-	12,917.29	13409.6
Growth (%)	-25.7	7.8	-50.3	29.8	56.5	-28.6	-		3.8
Non-residential (KSh, millions)	27,846.32	30,457.71	2,691.63	11,661.46	23,255.01	14,329.83	-	7,122.58	7,207.3
Growth (%)	-4.6	9.4	-91.2	333.2	99.4	-38.4	-		1.2
Total (KSh, millions)	61,709.78	66,960.75	20,838.09	35,211.92	60,105.31	40,656.70	-	20,039.87	20616.8
Growth (%)	-17.5	8.5	-68.9	69.0	70.7	-32.4	-		2.9

Source: Kenya National Bureau of Statistics

Real Estate sector grew by 6.6 percent in the second quarter of 2018 compared to 6.0 percent in the second quarter of 2017. The sector continues to benefit from Government investment in infrastructure, and increased uptake of bank credit and availability of alternative financing options (Table 3.1). However, its contribution to real GDP growth declined marginally to 0.5 percentage points in second quarter of 2018 from 0.6 percentage points recorded in the previous quarter (Table 3.2, Table 3.3).

3.6 The Accommodation and Restaurants Sector

Activity in the Accommodation and Restaurant sector continued to improve with the sector growing by

15.7 percent compared to 12.6 percent in the second quarter of 2017, largely on account of aggressive marketing by the government and improved security (Table 3.1).

3.7 Tourist Arrivals

Overall tourist arrivals declined by 12.1 percent in the second quarter of 2018 compared to the previous quarter, owing to the onset of the off-peak tourist season. The decline was reflected at the Moi International Airport Mombasa (MIAM) and Jomo Kenyatta International Airport (JKIA) in Nairobi, where tourist arrivals declined by 63.4 percent and 0.6 percent, respectively (Table 3.8).

Table 3.8: Quarterly Tourist Arrival by Point of Entry

	2017				2018				
	Quarterly				Quarterly		Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-18	May-18	Jun-18
Total Tourist Arrivals	224,170	213,543	282,463	243,026	236,273	207,677	56,041	75,028	76,608
Growth (%)	2.2	-4.7	32.3	-14.0	-2.8	-12.1	-26.2	33.9	2.1
o.w. JKIA - Nairobi	192,540	202,042	255,337	209,396	192,958	191,830	49,388	70,981	71,461
Growth (%)	0.3	4.9	26.4	-18.0	-7.9	-0.6	-19.9	43.7	0.7
MIAM - Mombasa	31,630	11,501	27,126	33,630	43,315	15,847	6,653	4,047	5,147
Growth %	16.0	-63.6	135.9	24.0	28.8	-63.4	-53.5	-39.2	27.2

Source: Kenya Tourism Board

3.8 Transport and Storage

Transport and Storage Sector recorded a strong growth of 7.8 percent in the second quarter of 2018 compared to 8.0 percent recorded in a similar period of 2017. The strong performance of the sector during the period under review was mainly attributed to improved activity in both rail and road transport (**Table 3.1**). Its contribution to overall GDP growth increased marginally to 0.5 percentage points compared to 0.4 percentage points in the previous quarter (**Table 3.3**).

Passenger flows through (JKIA) increased by 6.7 percent in the second quarter of 2018 compared to the previous quarter. The increase was reflected in both incoming and outgoing passenger flows, which was higher by 5.4 percent and 9.0 percent, respectively. Meanwhile, the volume of oil that passed through the Kenya Pipeline declined by 4.1 percent in the second quarter of 2018 compared to the previous quarter (**Table 3.9**).

Table 3.9: Quarterly Throughput of Selected Transport Companies

	2017				2018				
	Quarterly				Quarterly		Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-18	May-18	Jun-18
Number of Passengers thro' JKIA									
Total passenger flows	994,137	1,083,803	1,309,436	1,155,878	1,117,194	1,192,031	393,419	381,467	417,145
Growth (%)	- 9.50	9.02	20.82	- 11.73	- 3.35	6.70	0.99	- 3.04	9.35
o.w. Incoming	638,803	680,989	814,088	734,375	707,536	745,416	239,962	240,399	265,055
Growth (%)	- 7.42	6.60	19.54	- 9.79	- 3.65	5.35	- 0.6	0.2	10.26
Outgoing	355,334	402,814	495,348	421,503	409,658	446,615	153,457	141,068	152,090
Growth %	- 13.03	13.36	22.97	- 14.91	- 2.81	9.02	3.6	- 8.07	7.81
Kenya Pipeline Oil Throughput									
Output ('000 litres)	1,551,237	1,532,312	1,545,030	1,527,002	1,572,646	1,508,627	474,870	554,843	478,914
Growth %	5.7	- 1.2	0.8	- 1.2	3.0	- 4.1	- 9.9	16.8	- 13.7

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

Chapter 4

Global Economy

4.1 Global Economy

Global economic activity remains strong with output projected at 3.9 percent in 2018 and 2019 from 3.7 percent in 2017 on account of fiscal stimulus and accommodative monetary policies in advanced economies, stable macroeconomic environment in emerging and developing economies and recovery in global commodity prices (**Table 4.1**).

Growth in advanced economies is expected to stabilize at 2.4 percent in 2018 before moderating to 2.2 percent in 2019. This is attributed to ongoing withdrawal of monetary policy accommodation and the effects of escalating trade tensions among the advanced economies. United States economic activity is expected to strengthen in the near term, with growth projected at 2.9 percent in 2018 and 2.7 percent in 2019.

In the Euro area economy is expected to slow gradually from 2.4 percent in 2017 to 2.2 percent and 1.9 percent in 2018 and 2019, respectively. Growth forecasts for 2018 have been revised down for Germany and France due to more than expected softening of economic activity in the first quarter of the year. In Italy, slowdown is on account of wider sovereign spreads and tighter financial conditions in the wake of recent political uncertainty which is expected to weigh down on domestic demand. Japan's growth has also been marked down following a contraction in the first quarter due to weak private consumption and investments.

The overall growth forecast in the Emerging market and developing economy remain unchanged from the April WEO at 4.9 percent in 2018 and 5.1 percent in 2019. Emerging market and developing market have experienced powerful economic shocks which include rising oil prices, higher yields in the United States, dollar appreciation, trade tensions and geopolitical conflicts. The outlook therefore depends on how these global forces interact with the individual economic fundamentals.

Economic activity in China is projected to moderate to 6.6 percent and 6.4 percent in 2018 and 2019 respectively, from 6.9 percent in 2017 reflecting softening external demand and tightening of

regulatory framework in the financial sector. On the other hand, India is expected to grow at 7.3 percent in 2018 and 7.5 percent in 2019 on account of the currency exchange rate initiative and the introduction of the goods and services tax fade.

Growth in Sub-Saharan Africa (SSA) is expected to rise to 3.4 percent and 3.8 percent respectively in 2018 and 2019 supported by the rise in commodity prices and stable macroeconomic environment.

4.2 Risk to the global economic outlook

Risk and uncertainties to the global economic outlook have increased. Notably trade tensions among major advanced economies regarding imposition of tariffs on selected imports by the United States from its main trading partners particularly China and the likely retaliatory measures. The Prolonged uncertainty surrounding the North America Free Trade Agreement (NAFTA) and Brexit negotiations, and political transitions in Mexico and Venezuela will also weigh on emerging markets growth outlook for 2018. In addition, financial market volatility resulting from uncoordinated and abrupt monetary policy normalization could trigger global market volatilities with adverse consequences to the global economic prospects. Other factors include noneconomic ones such as political uncertainties and geopolitics in the Middle East and some countries in the SSA region which could erode business confidence thereby slowing down private investment and economic activity in these regions.

Table 4.1: Global Economic Outlook

REAL GDP GROWTH (%) IMF						
YEAR OVER YEAR						
			Projections		Difference from April 2018 WEO	
Country/Region	2016	2017	2018	2019	2018	2018
World Output	3.2	3.7	3.9	3.9	0.0	0.0
Advanced economies	1.7	2.4	2.4	2.2	-0.1	0.0
United States	1.5	2.3	2.9	2.7	0.0	0.0
Euro Area	1.8	2.4	2.2	1.9	-0.2	-0.1
Germany	1.9	2.5	2.2	2.1	-0.3	0.1
France	1.1	2.3	1.8	1.7	-0.3	-0.1
Italy	0.9	1.5	1.2	1.0	-0.3	-0.1
Spain	3.3	3.1	2.8	2.2	0.0	0.0
Japan	1.0	1.7	1.0	0.9	-0.2	0.0
United Kingdom	1.8	1.7	1.4	1.5	-0.2	0.0
Emerging market and Developing economies	4.4	4.7	4.9	5.1	0.0	0.0
Russia	-0.2	1.5	1.7	1.5	0.1	0.0
China	6.7	6.9	6.6	6.4	0.0	0.0
India	7.1	6.7	7.3	7.5	-0.1	-0.3
Brazil	-3.5	1.0	1.8	2.5	-0.5	0.0
Middle East, North Africa, Afghanistan and Pakistan	5.0	2.2	3.5	3.9	0.1	0.2

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

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

Chapter 5

Balance of Payments and Exchange Rates

5.1 Developments in the Balance of Payments

The current account deficit improved by 14 percent to USD 909 million in the second quarter of 2018 from USD 1,058 million in the first quarter, mainly driven

by an improvement in the secondary income account (Table 5.2).

Table 5.1: Balance of Payments (USD Million)

ITEM	2017*			2018**					Q2 2018-Q1 2018	
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Q2			Total	Change	%
	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2		
1. Overall Balance	-224	677	518	-2,025	-116	150	300	333	2,359	-116
2. Current account	-1,251	-1,443	-1,187	-1,058	-353	-383	-172	-909	149	-14
Exports (fob)	1,453	1,413	1,457	1,600	501	554	530	1,584	-15	-1
Imports (fob)	3,925	4,167	3,979	4,119	1,440	1,611	1,317	4,368	249	6
Services: credit	1,145	1,160	1,139	1,268	432	440	480	1,351	83	7
Services: debit	805	816	746	908	293	317	346	956	48	5
Balance on goods and services	-2,132	-2,410	-2,129	-2,158	-800	-934	-653	-2,387	-229	11
Primary income: credit	107	92	101	122	44	48	48	140	18	15
Primary income: debit	336	286	350	292	133	88	227	448	156	53
Balance on goods, services, and primary income	-2,360	-2,604	-2,378	-2,328	-888	-974	-833	-2,695	-367	16
Secondary income : credit	1,124	1,173	1,207	1,280	540	595	666	1,800	520	41
o.w Remittances	455	495	565	642	217	254	266	737	96	15
Secondary income: debit	14	12	16	10	4	4	5	14	4	35
3. Capital Account	22	-2	85	83	62	12	19	93	10	13
4. Financial Account	-1,298	-150	-1,085	-3,133	-322	-603	147	-778	2,356	-75

* Revised

**Provisional

Fob - free on board

Source: Central Bank of Kenya

Source: Central Bank of Kenya

5.2 The Current Account

During the second quarter of 2018, the trade balance worsened by 11 percent to USD 2,387 million from USD 2,158 million in the preceding quarter largely reflecting an increase in merchandise imports and service debit (Table 5.1).

The value of merchandise exports decreased by 1 percent to USD 1,584 million during the second quarter of 2018 mainly driven by decrease in exports of tea, horticulture, raw materials, re-exports and other exports. The value of tea exports decreased by 14 percent to USD 337 million, attributed to lower tea prices at the Mombasa Auction, following an increase in tea production and supply. Horticulture exports decreased by 1 percent to USD 255 million attributed to a decrease in cut flowers. The value of merchandise imports increased by 6 percent to USD 4,368 million from USD 4,119 million, in the second quarter, largely on account of higher importation of

oil which increased by 20 percent from USD 769 million to USD 920 million in second quarter of 2018, manufactured goods which increased by 10 percent from USD 749 million to USD 827 million and machinery and transport equipment which increased by 20 percent from USD 1,044 million to USD 1,256 million. (Table 5.2)

The services account recorded 10 percent improvement to USD 396 million in the second quarter of 2018, mainly on account of higher receipts from travel services (Table 5.2).

The balance in the primary account worsened by 81 percent from a deficit of USD 170 million in the first quarter of 2018 to deficit of USD 307 million in the second quarter of 2018, mainly on account of higher payments on foreign interest. The balance on secondary income improved by 41 percent to USD 1,786 million, on account of higher remittance inflows.

Table 5.2: Balance on Current Account (USD Million)

ITEM	2017*				2018**				Q2 2018-Q1 2018		
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-mar	Q2			Total	Change	%
	Q1	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2		
CURRENT ACCOUNT	-1,135	-1,251	-1,443	-1,187	-1,058	-353	-383	-172	-909	149	-14
Goods	-2,453	-2,472	-2,754	-2,522	-2,519	-939	-1,057	-787	-2,783	-264	10
Exports (fob)	1,470	1,453	1,413	1,457	1,600	501	554	530	1,584	-15	-1
o.w Coffee	67	81	47	34	51	29	32	27	88	37	73
Tea	345	347	351	382	393	98	116	123	337	-56	-14
Horticulture	205	213	201	210	258	85	85	85	255	-2	-1
Oil products	13	14	12	12	12	2	6	5	12	1	6
Manufactured Goods	98	94	102	98	90	33	36	30	98	8	8
Raw Materials	142	133	115	135	154	46	39	51	136	-18	-12
Chemicals and Related Products (n.e.s)	100	98	110	100	107	36	35	36	107	1	1
Miscellaneous Man. Articles	147	134	157	133	129	43	53	63	159	30	23
Re-exports	153	185	143	157	194	68	75	42	185	-9	-5
Other	199	155	175	195	211	61	76	68	205	-6	-3
Imports (fob)	3,923	3,925	4,167	3,979	4,119	1,440	1,611	1,317	4,368	249	6
o.w Oil	636	651	667	774	769	310	340	270	920	151	20
Chemicals	621	561	563	557	657	250	198	168	615	-42	-6
Manufactured Goods	619	671	615	619	749	245	315	268	827	78	10
Machinery & Transport Equipment	1,329	1,179	1,106	1,066	1,044	400	517	340	1,256	213	20
Machinery	857	764	728	616	646	246	325	223	793	148	23
Transport equipment	471	415	378	449	398	154	192	117	463	65	16
Other	604	732	1,052	802	684	180	167	217	563	-120	-18
o.w Food	372	556	857	584	536	132	124	151	407	-129	-24
Services	481	340	344	393	361	139	123	134	396	35	10
Transport Services (net)	137	135	120	200	171	81	51	25	158	-13	-8
Credit	383	396	397	446	443	161	137	148	445	2	0
Debit	246	261	277	246	273	80	85	122	287	15	5
Travel Services (net)	195	162	147	151	194	72	83	88	243	50	26
Credit	257	228	213	221	257	89	103	110	301	44	17
Debit	62	65	66	69	63	17	19	22	58	-5	-8
Other Services (net)	149	42	77	42	-4	-14	-12	20	-5	-2	51
Primary Income	-149	-228	-194	-249	-170	-88	-40	-179	-307	-138	81
Credit	99	107	92	101	122	44	48	48	140	18	15
Debit	248	336	286	350	292	133	88	227	448	156	53
Secondary Income	987	1,110	1,161	1,191	1,270	535	590	661	1,786	516	41
Credit	1,001	1,124	1,173	1,207	1,280	540	595	666	1,800	520	41
Debit	14	14	12	16	10	4	4	5	14	4	35

* Revised

**Provisional

Fob - free on board

Source: Central Bank of Kenya

5.3 Direction of Trade

Imports from China accounted for 26.0 percent of total imports to Kenya in the second quarter of 2018, making it the largest source of imports. In value terms, Kenya's imports from China amounted to USD 1,136 million, and this was mainly in the form of machinery and transport equipment for the Standard Gauge Railway. Imports from the European Union accounted for 13.2 percent of total import, and increased by 11.8 percent to USD 576 million in second quarter of 2018, mainly reflecting increased imports from Italy and Germany. The share of imports from Africa decreased to 11.5 percent in the second quarter of 2018 from 13.8 percent in the first quarter of 2018, reflecting a decrease in imports from COMESA and the EAC. The share of imports from India decreased to 10.0 percent from 11.5 percent, over the same period (**Table 5.3**).

Table 5.3: Kenya's Direction of Trade: Imports

IMPORTS (USD M)									Share of Imports (%)	
	2017			2018						
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Q2					
Country	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	Q1 2018	Q2 2018
Africa	475	526	537	570	169	167	167	504	13.8	11.5
<i>Of which</i>										
South Africa	166	165	132	170	55	54	61	171	4.1	3.9
Egypt	76	91	86	89	35	28	29	93	2.2	2.1
Others	234	270	319	311	79	84	77	240	7.5	5.5
EAC	126	139	218	213	53	64	56	173	5.2	4.0
COMESA	258	299	347	340	88	96	87	271	8.3	6.2
Rest of the World	3,450	3,641	3,442	3,549	1,271	1,443	1,149	3,864	86.2	88.5
<i>Of which</i>										
India	466	331	389	473	165	180	90	435	11.5	10.0
United Arab Emirates	284	471	362	334	222	160	87	469	8.1	10.7
China	962	855	861	867	294	483	358	1,136	21.1	26.0
Japan	211	189	207	220	75	56	73	203	5.3	4.6
USA	156	130	129	205	46	31	27	104	5.0	2.4
United Kingdom	73	71	76	76	23	26	27	76	1.8	1.7
Singapore	8	7	20	9	2	2	3	8	0.2	0.2
Germany	104	132	95	96	40	66	32	137	2.3	3.1
Saudi Arabia	225	194	337	359	103	134	187	424	8.7	9.7
Indonesia	123	157	116	106	21	33	48	102	2.6	2.3
Netherlands	38	71	43	60	13	15	18	45	1.4	1.0
France	84	68	51	53	19	16	17	51	1.3	1.2
Bahrain	26	16	19	2	0	1	7	8	0.0	0.2
Italy	52	58	44	61	25	29	21	75	1.5	1.7
Others	637	892	691	630	222	212	155	589	15.3	13.5
Total	3,925	4,167	3,979	4,119	1,440	1,611	1,317	4,368	100.0	100.0
									0.0	
EU	517	552	472	488	183	219	174	576	11.8	13.2
China	962	855	861	867	294	483	358	1,136	21.1	26.0

Source: Kenya Revenue Authority

The share of exports to Africa increased to 34.9 percent in the second quarter of 2018 from 33.2 percent in the first quarter of 2018 (Table 5.4). The improvement reflected higher exports to COMESA region (DRC) and to EAC (Tanzania, Rwanda and South Sudan). Exports to the rest of the world, however, decreased by 3.5 percent mainly on account of lower exports to the European Union, (which decreased to 21.3

percent during the first quarter of 2018). Exports to India and Pakistan also declined.

Table 5.4: Kenya's Direction of Trade: Exports

EXPORTS (USD M)									Share of Exports (%)	
	2017				2018					
	Apr-Jun	Jul-Sep	Oct-Dec		Q2					
Country	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	Q1 2018	Q2 2018
Africa	516	543	543	530	173	203	176	553	33.2	34.9
<i>Of which</i>										
Uganda	140	151	144	159	42	56	49	147	9.9	9.3
Tanzania	53	73	75	72	26	28	20	74	4.5	4.7
Egypt	35	47	60	53	10	24	19	53	3.3	3.3
Sudan	17	14	23	18	4	4	3	12	1.2	0.7
South Sudan	47	35	35	38	14	14	17	45	2.4	2.8
Somalia	46	44	42	39	13	14	14	41	2.4	2.6
DRC	45	44	46	35	13	18	11	42	2.2	2.7
Rwanda	41	48	39	38	19	18	13	50	2.4	3.2
Others	93	88	78	78	31	28	30	89	4.9	5.6
EAC	257	290	271	282	92	107	87	286	17.6	18.0
COMESA	349	368	367	359	109	140	117	366	22.4	23.1
Rest of the World	937	870	914	1,069	328	351	353	1,031	66.8	65.1
<i>Of which</i>										
United Kingdom	88	93	95	109	33	33	35	101	6.8	6.4
Netherlands	111	89	104	139	41	38	34	114	8.7	7.2
USA	121	127	105	91	36	43	45	124	5.7	7.8
Pakistan	146	152	170	183	41	45	54	139	11.4	8.8
United Arab Emirates	78	56	69	93	31	32	26	89	5.8	5.6
Germany	34	21	25	28	11	12	11	35	1.8	2.2
India	13	14	14	34	4	4	6	14	2.1	0.9
Afghanistan	11	9	4	8	1	3	4	9	0.5	0.5
Others	334	310	327	384	130	140	137	407	24.0	25.7
Total	1,453	1,413	1,457	1,600	501	554	530	1,584	100.0	100.0
EU	307	281	289	364	118	114	106	337	22.8	21.3
China	39	15	18	16	7	10	9	26	1.0	1.7

Source: Kenya Revenue Authority

5.4 Capital and Financial Account

The capital account recorded an increase of USD 10 million to USD 93 million in the second quarter of 2018.

The financial account recorded lower net inflows of USD 778 million in the second quarter of 2018, mainly reflecting a decrease in Portfolio Liabilities

in the review period. However, Direct Investment to Kenya increased to USD 269 million from USD 130 million during the period under review (**Table 5.5**).

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

ITEM	2017**				2018 **				Q2 201-Q1 2018		
	Jan-Mar	April- Jun	Jul-Sep	Oct-Dec	Jan-Mar	Q2			Total		%
	Q1	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	Change	Change
Capital account credit	79	22	-2	85	83	62	12	19	93	10	13
Capital account credit	79	22	-2	85	83	62	12	19	93	10	13
Capital account: debit				0	0						
Financial Account	-2,073	-1,298	-150	-1,085	-3,133	-322	-603	147	-777.6	2,356	-75
Direct investment: assets	74	99	49	36	12	7	6	9	21	9	76
Direct investment: liabilities	210	158	161	143	130	74	90	105	269	139	106
Portfolio investment: assets	150	177	192	145	218	73	115	128	317	99	45
Portfolio investment: liabilities	20	-22	-107	-1	1,920	-18	-40	-23	-81	-2,001	-104
Financial derivatives: net											
Other investment: assets	405	9	40	-109	195	73	73	516	662	467	240
Other investment: liabilities	2,472	1,446	377	1,015	1,508	419	747	424	1,589	81	5

* Revised

**Provisional

Source: Central Bank of Kenya

5.5 Foreign Exchange Reserves

The banking system's total foreign exchange holdings increased by 2.1 percent during the second quarter of 2018. Official reserves held by the Central Bank constituted 74 percent of gross reserves and stood at USD 8,954 million, equivalent to 5.9 months of import cover (**Table 5.6**).

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

	2017					2018				
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec						
	Q1	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	
1. Gross Reserves	10,786	10,984	10,332	9,652	11,859	12,027	11,926	12,102	12,102	
of which:										
Official	8,379	8,580	7,899	7,338	9,362	9,460	9,291	8,954	8,954	
import cover*	5.5	5.7	5.4	5.0	6.3	6.3	6.2	5.9	5.9	
Commercial Banks	2,407	2,405	2,433	2,314	2,497	2,566	2,636	3,148	3,148	
2. Residents' foreign currency deposits	4,503	4,733	5,021	4,949	4,988	4,994	5,390	5,986	5,986	

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

Source: Central Bank of Kenya

5.6 Exchange Rates

The foreign exchange market, remained relatively steady during the second quarter of 2018, was largely supported by resilient inflows from diaspora remittances and receipts from tourism, tea and horticulture exports. The Kenya Shilling strengthened by 1.09 percent against the US Dollar to exchange at an average of 100.75 during the second quarter compared with 101.86 in the first quarter of 2018. The Kenya Shilling also strengthened against the Japanese Yen, the Euro and the Pound Sterling. In the EAC region, the Kenya Shilling strengthened against all the currencies during the period under review (Table 5.7 and Chart 5A).

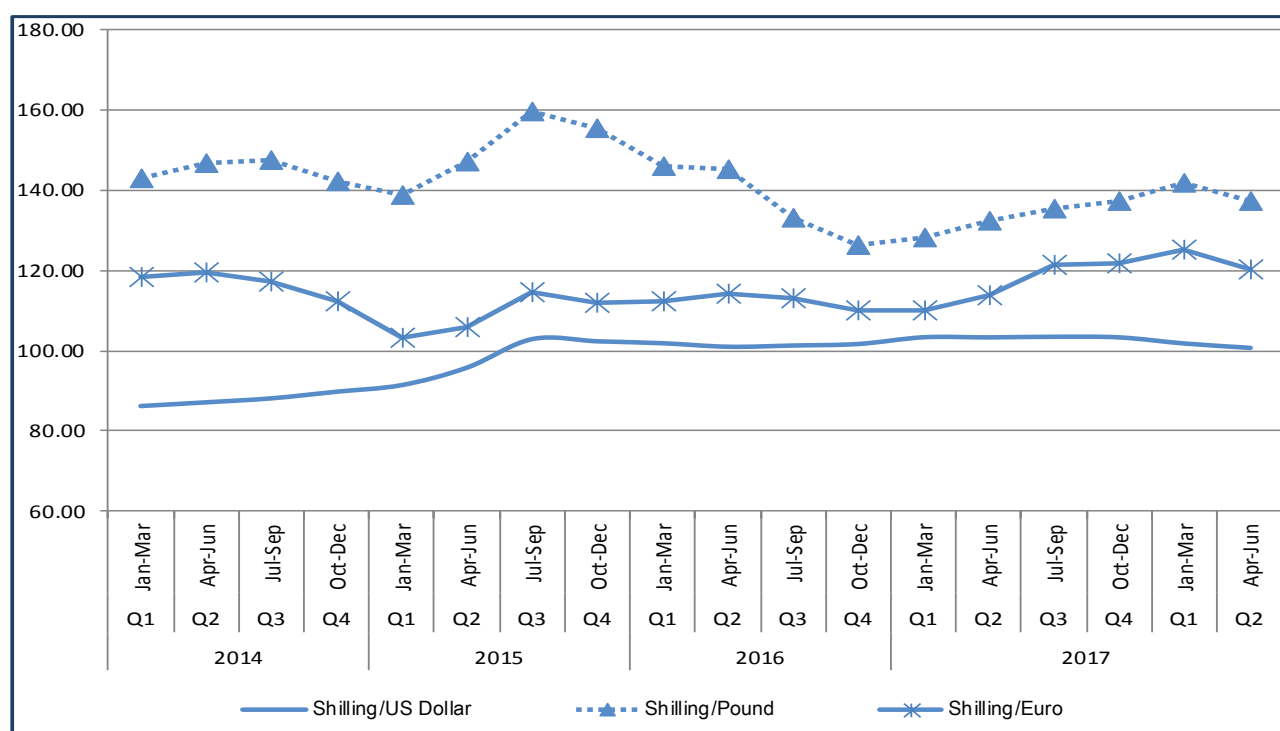
Table 5.7: Kenya Shilling Exchange Rate

	Q1	2017 Q2	Q3	2017 Q4	Q1	Apr	May	Jun	Q2	% change Q2 2018 - Q1 2018
US Dollar	103.39	103.36	103.52	103.35	101.86	100.61	100.66	101.00	100.75	-1.09
Pound Sterling	128.05	132.22	135.40	137.15	141.64	141.86	135.68	134.24	137.26	-3.09
Euro	110.12	113.75	121.50	121.66	125.11	123.65	118.96	117.97	120.19	-3.93
100 Japanese Yen	90.95	92.98	93.28	91.60	93.96	93.57	91.72	91.90	92.38	-1.67
Uganda Shilling*	34.79	34.94	34.80	35.15	35.79	36.73	37.00	38.05	37.24	4.04
Tanzania Shilling*	21.57	21.63	21.64	21.70	22.10	22.58	22.67	22.54	22.60	2.26
Rwanda Franc*	7.99	8.04	8.02	8.16	8.39	8.61	8.62	8.63	8.62	2.75
Burundi Franc*	16.35	16.56	16.79	16.99	17.32	17.52	17.52	17.45	17.50	1.01

* Units of currency per Kenya Shilling

Source: Central Bank of Kenya

Chart 5.1: Kenya Shilling Exchange Rate



Source: Central Bank of Kenya

Chapter 6

The Banking System

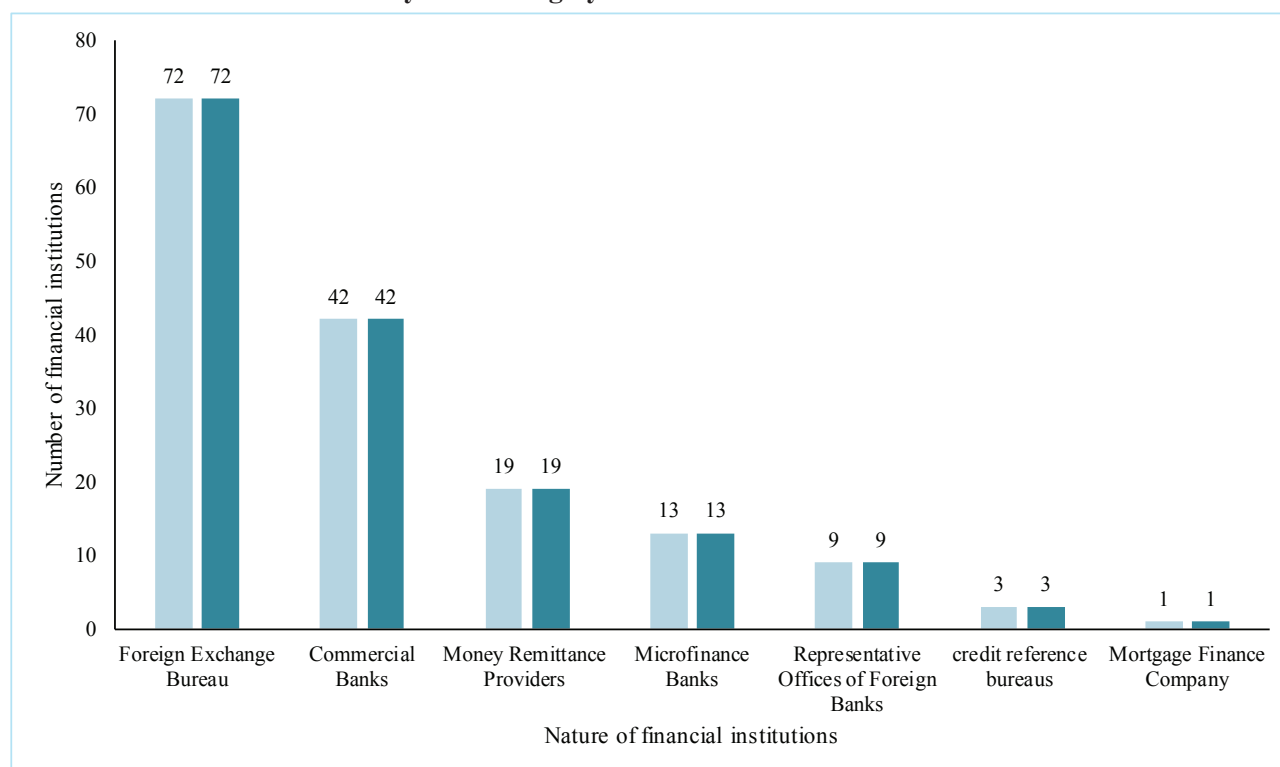
6.1 Overview

The banking sector was stable in the second quarter of 2018. Total net assets increased by 4.5 percent from KSh 4,081.9 million in March 2018 to KSh 4,266.7 million while the deposit base increased by 6.1 percent from KSh 2,979.5 million to KSh 3,161.5 million between first quarter and second quarter of 2018. The sector was well capitalized and met the minimum capital requirements. Profitability improved on account of a decline in total expenses. Credit risk remained elevated with gross non-performing loans (NPLs) to gross loans ratio at 11.97 percent in the second quarter of 2018.

6.2 Size and structure

The Kenyan banking sector comprised 42 Commercial Banks, 1 Mortgage Finance Company, 13 Microfinance Banks, 9 Representative Offices of Foreign Banks, 72 Foreign Exchange Bureaus, 19 Money Remittance Providers and 3 credit reference bureaus as at June 30, 2018. The structure of the Kenyan banking sector as at the end of the last two quarters (**Chart 6.1**).

Chart 6.1: Structure of the Kenyan Banking System



Source: Central Bank of Kenya

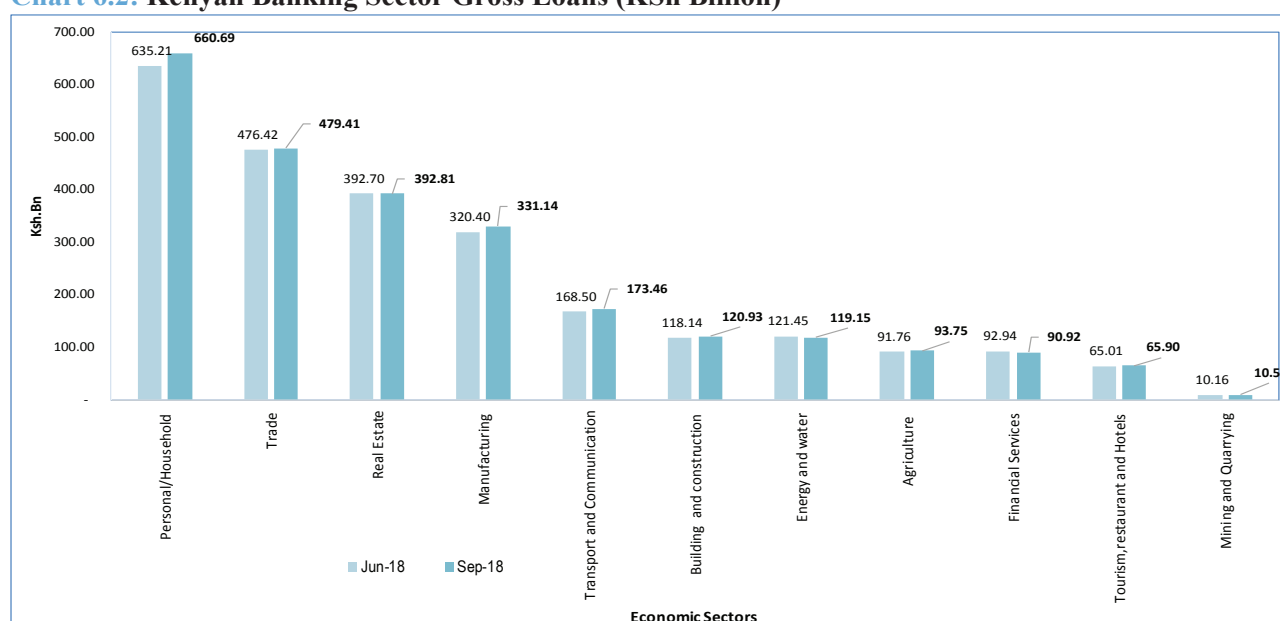
¹ Includes Charterhouse Bank Ltd., which is under Statutory Management, while Chase Bank Limited and Imperial Bank are in receivership. However, the data for the three banks have been excluded in this report.

i) Growth in banking sector assets

Total net assets increased by 4.5 percent from KSh 4,081.9 billion in the first quarter of 2018 to KSh 4,266.7 billion in the second quarter of 2018. The increase in total net assets was mainly recorded in Investment in government securities (4.4 percent) and placements (29.5 percent). However, loans and advances, which increased by 2.5 percent, remained the main component of assets, accounting for 58.5 percent in the second quarter of 2018. This was a slight increase from 54.8 percent recorded in the first quarter of 2018.

Total banking sector lending increased by 2.5 percent, from KSh 2,432.2 billion in the first quarter of 2018 to KSh 2,492.7 billion in the second quarter of 2018. The increase in gross loans and advances was largely recorded in the Trade, Personal/Household, Real Estate and Manufacturing sectors. The increase in gross was mainly due to increased loans granted to individual borrowers and credit granted for working capital purposes. See the sectoral distribution of gross loans as at June 30, 2018 (**Chart 6.2**).

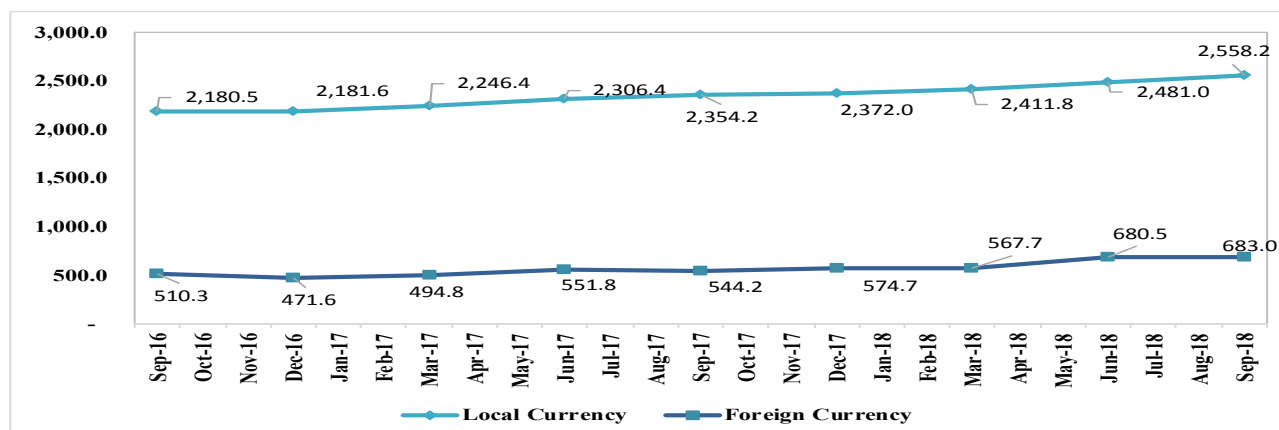
Chart 6.2: Kenyan Banking Sector Gross Loans (KSh Billion)



Source: Central Bank of Kenya

iii) Deposit Liabilities

Customer deposits remains the main source of funding to the banks accounting for 74.1 percent of the banking sector total liabilities and shareholders' funds as at the end of the second quarter of 2018. This was an increase from 73.0 percent recorded as at end of the first quarter of 2018. The customer deposit base increased by 6.1 percent from KSh 2,979.5 billion in the first quarter of 2018 to KSh 3,161.5 billion in the second quarter of 2018. Foreign currency deposits increased by KSh 182.0 billion (19.9 percent) from KSh 567.7 billion in the first quarter of 2018 to KSh 680.5 billion in the second quarter of 2018. Local currency deposits increased by KSh 69.2 billion (2.9 percent) from KSh 2,411.8 billion in the first quarter of 2018 to KSh 2,480.50 billion in the second quarter of 2018.

Chart 6.3 Customer Deposits (KSh Billion)

Source: Central Bank of Kenya

6.4 Capital Adequacy

Kenya's banking sector is well capitalized and meets the minimum capital requirements. Core capital increased slightly by 0.8 percent from KSh 540.5 billion in first quarter of 2018 to KSh 544.9 billion in the second quarter of 2018. Core capital to total risk-weighted assets ratio increased marginally from 16.2 percent in the first quarter of 2018 to 16.5 percent in the second quarter of 2018.

Total capital increased by 1.4 percent from KSh 583.4 billion in the first quarter of 2018 to KSh 591.8 billion in the second quarter of 2018. Total capital to total risk-weighted assets ratio increased from 17.4 percent to 17.9 percent over the same period.

The minimum core capital to total deposits ratio is set at 8 percent. Commercial banks maintained an adequate buffer, with the ratio standing at 17.2 percent in the second quarter of 2018 compared to 18.1 percent in the first quarter of 2018. The decrease was attributable to a higher increase of 6.1 percent in

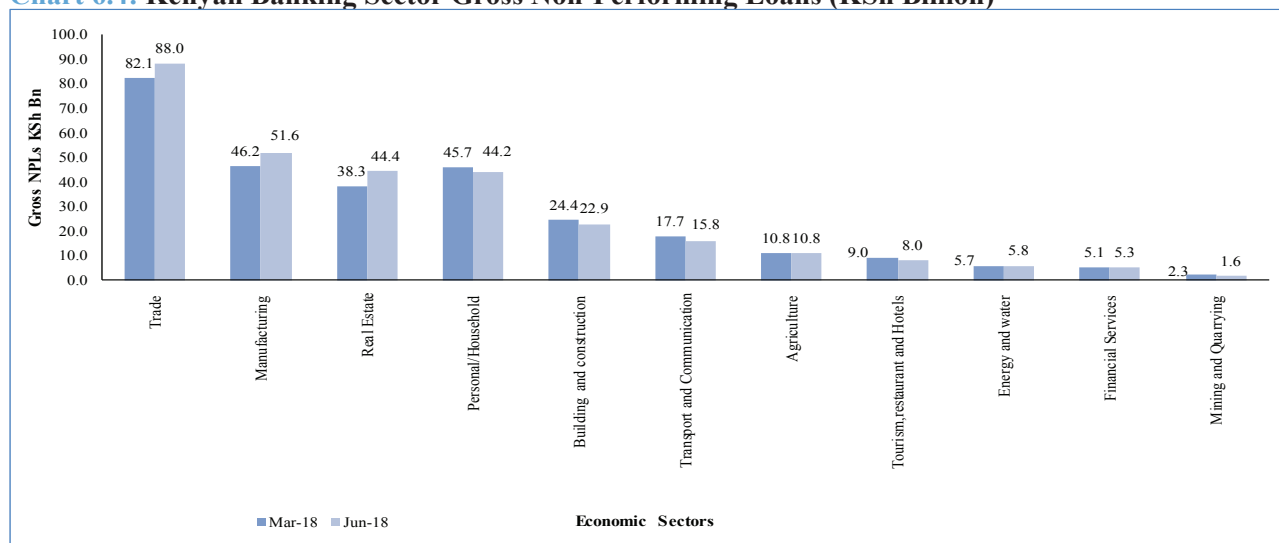
Total deposits as compared to 0.8 percent increase in Core capital between first quarter and second quarter of 2018

6.5 Asset Quality

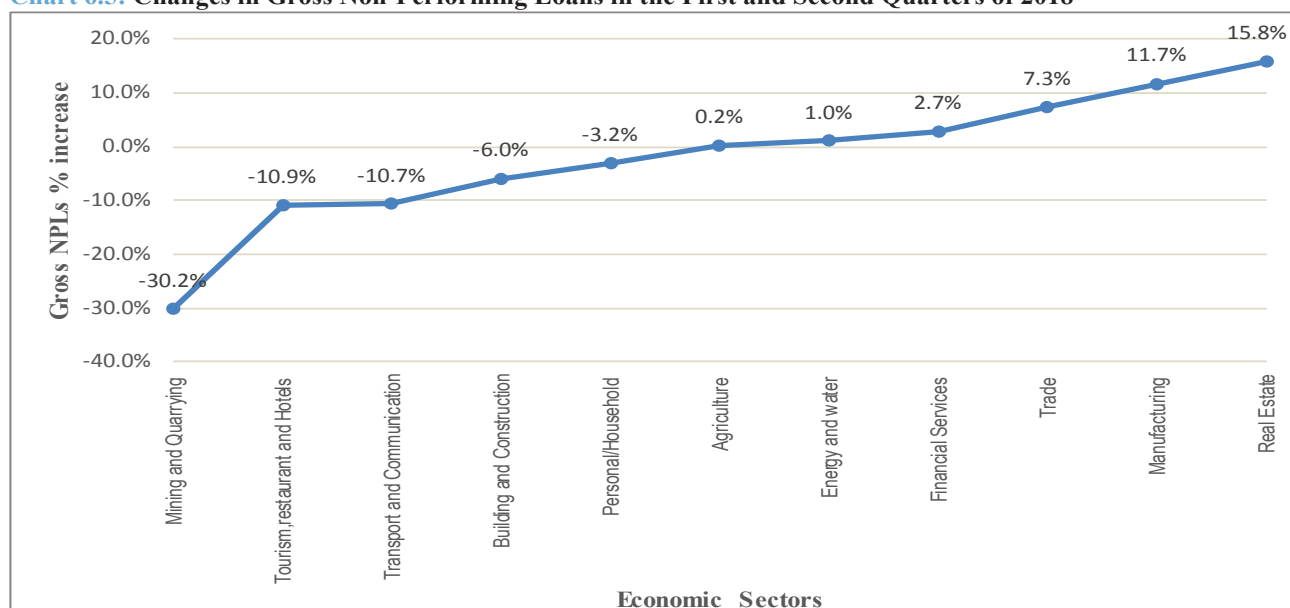
The gross non-performing loans (NPLs) increased by 3.9 percent from KSh 287.2 billion as at the end of the first quarter of 2018 to KSh 298.4 billion at the end of the second quarter of 2018.

The gross NPLs to gross loans ratio increased from 11.8 percent in the first quarter of 2018 to 11.97 percent in the second quarter of 2018. **Chart 6.4** highlights the detailed sectoral distribution of gross NPLs.

The increase in gross NPLS was spread across six economic sectors. Five economic sectors registered decreases in gross NPLs as highlighted in **Chart 6.5**

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

Source: Central Bank of Kenya

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

Source: Central Bank of Kenya

The Real Estate sector registered the highest increase in NPLs by KSh 6.1 billion (15.8 percent) due to slow uptake of housing units. Manufacturing and Trade sector's NPLS increased by KSh 5.4 billion (11.7 percent) and KSh 6.1 billion (15.8 percent) respectively, mainly due to delayed payments from public and private sectors.

The banking sector's asset quality, as measured by the proportion of net non-performing loans to gross loans, deteriorated slightly from 5.5 percent in the first quarter of 2018 to 5.6 percent in the second quarter

of 2018. The coverage ratio, which is measured as a percentage of specific provisions to total NPLs, decreased from 44.4 percent in first quarter of 2018 to 44.2 percent in second quarter of 2018.

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

Table 6.1: Summary of Asset Quality

		March 2018, KSh Billion	June 2018, KSh Billion
1	Gross Loans and Advances (KSh' Bn)	2,432.2	2,492.7
2	Interest in Suspense (KSh' Bn)	47.4	49.2
3	Loans and Advances (net of interest suspended) (KSh' Bn)	2,384.7	2,443.5
4	Gross Non-Performing loans (KSh 'Bn)	287.2	298.4
5	Specific Provisions (KSh' Bn)	106.5	110.1
6	General Provisions (KSh' Bn)	39.7	37.4
7	Total Provisions (5+6) (KSh' Bn)	146.1	147.5
8	Net Advances (3-7) (KSh' Bn)	2,238.6	2,296.0
9	Total Non-Performing Loans and Advances (4-2) (KSh'Bn)	239.8	249.1
10	Net Non-Performing Loans and Advances (9-5) (KSh 'Bn)	133.3	139.0
11	Total NPLs as % of Total Advances (9/3)	10.10%	10.20%
12	Net NPLs as % of Gross Advances (10/1)	5.50%	5.60%
13	Specific Provisions as % of Total NPLs (5/9)	44.40%	44.20%
14	Gross NPLs to Gross Loans Ratio (4/1)	11.80%	12.00%

Source: Central Bank of Kenya

6.6 Profitability

The banking sector recorded growth in pre-tax profits by KSh 0.8 billion (2.1 percent) from KSh 37.7 billion in the first quarter of 2018 to KSh 38.5 billion in the second quarter of 2018. The growth in profitability was mainly attributable to increased income by KSh 3.1 billion (2.3 percent) as compared to the increase in expenses by KSh 2.3 billion (2.8 percent).

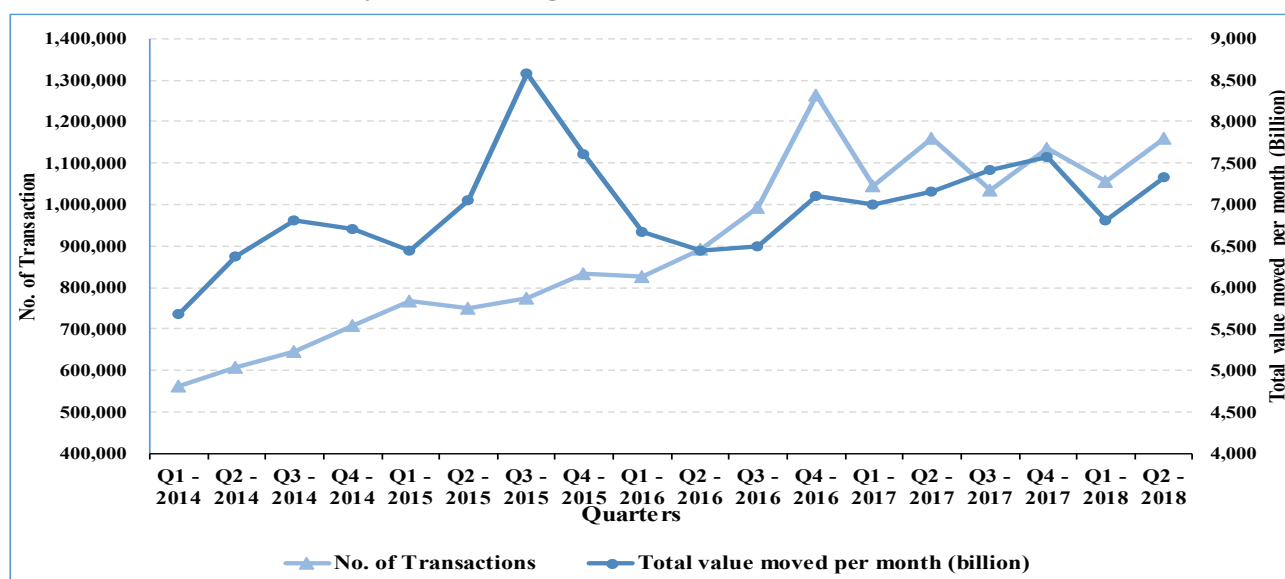
Interest on advances decreased by KSh 46.2 billion (0.1 percent) while interest on government securities increased by KSh 2.5 billion (9.2 percent) between first quarter of 2018 and second quarter of 2018.

Total expenses increased by 2.8 percent from KSh 84.2 billion in the first quarter of 2018 to KSh 86.5 billion in the second quarter of 2018. The increase in expenses was largely attributable to interest on deposits and bad debts charge, which increased by 1.8 percent and 1.7 percent.

Interest income on loans and advances, interest on government securities and other incomes were the major sources of income accounting for 52.4 percent, 23.1 percent and 17.2 percent of total income respectively. On the other hand, interest on deposits, salaries and wages, and other expenses were the key components of expenses, accounting for 33.4 percent, 25.3 percent and 23.7 percent of total expenses, respectively.

Return on assets (ROA) decreased from 2.9 percent in first quarter of 2018 to 2.8 percent in the second quarter of 2018. Similarly, return on equity (ROE) decreased from 23.9 percent in the first quarter of 2018 to 23.7 percent in the second quarter of 2018. The decline in ratios is mainly due to a higher increase in assets (4.5 percent) compared to the increase in shareholders' funds (2.0 percent).

Chart 6.6: Trends in Monthly Flows Through KEPSS



Source: Central Bank of Kenya

6.7 Liquidity

The banking sector's overall liquidity ratio increased from 45.8 percent in the first quarter of 2018 to 48.0 percent in the second quarter of 2018. The increase was driven by a significant increase in Total Foreign Assets of KSh 90.6 billion (135 percent) from KSh 67.1 billion to KSh 157.7 billion between the two quarters under review. The banking sector liquidity ratio remained above the minimum statutory level of 20 percent.

6.8 Outlook of the Sector

The banking sector is projected to remain stable in third quarter of 2018. Credit risk is expected to remain elevated as banks put in place measures to mitigate the high level of non-performing loans. Liquidity risk is expected to continue easing.

6.9 Kenya Shilling Flows In KEPSS

Kenya Electronic Payments and Settlement System (KEPSS) used for large value Real Time Gross Settlement (RTGS) payments moved a volume of 1.16 million transaction messages worth KSh 7.3 trillion in the second quarter of 2018, compared to the first quarter of 2018 which recorded 1.05 million transactions worth KSh 6.8 trillion. Volume and value increased by 9.43 percent and 7.35 percent, respectively. **Chart 6.6** below highlights recent trends in KEPSS transactions.

Bank Customer Payments Processed Through KEPSS

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

third party Message Type (MT 103) used for single credit transfers.

During the period under review, MT 102 usage increased by 22.51 per cent, to 40,889 messages recorded in the second quarter of 2018 from 33,375 messages processed in the previous quarter. The MT 103 payments increased by 5.35 per cent, to 1,172,258 messages in the first quarter of 2018 from 1,112,760 messages in the previous quarter (**Chart 6.8**).

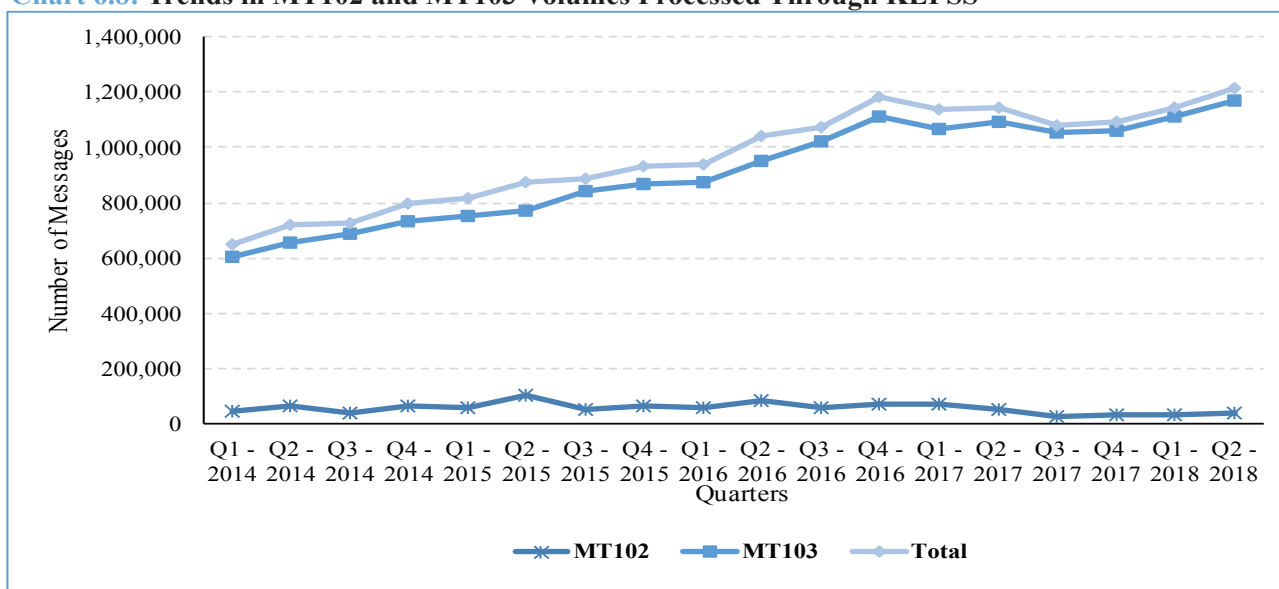
settle their obligations and fund their accounts.

During the quarter under review, KEPSS availability maintained an average 98.7 percent during the period under review (**Chart 6.9**).

System Availability

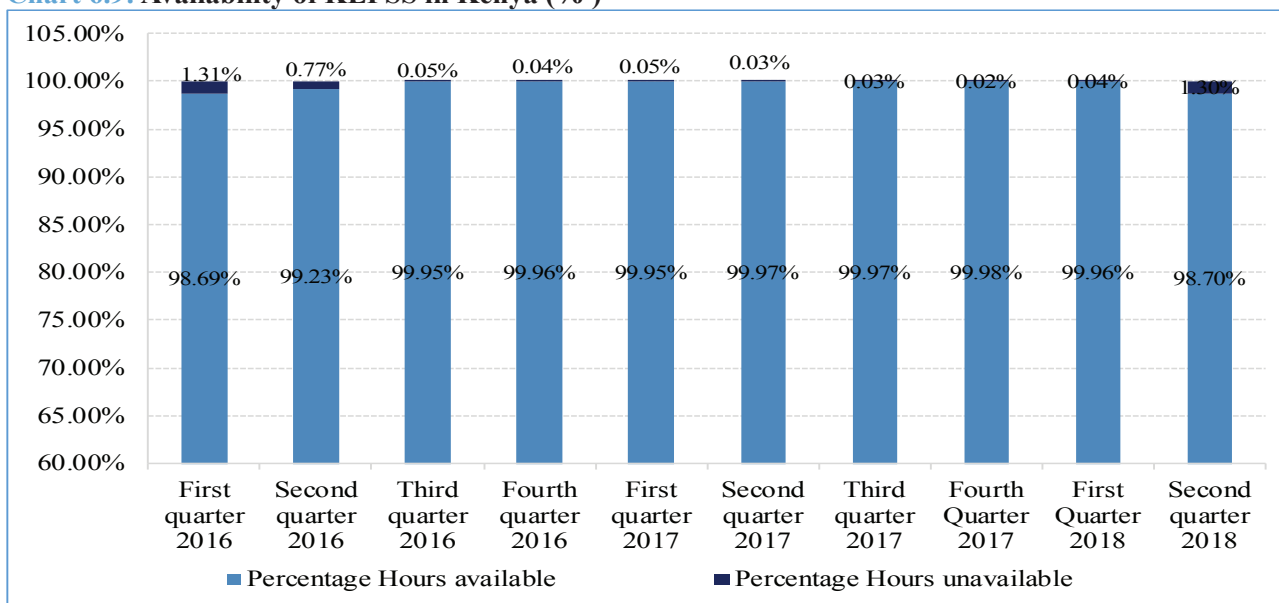
The KEPSS system is available to the commercial banks and other participants for 8 hours per day. The system runs from 8.30 AM to 4.30 PM but the operating time can be extended to enable participants

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



Source: Central Bank of Kenya

Chart 6.9: Availability of KEPSS in Kenya (%)



Source: Central Bank of Kenya

Chapter 7

Government Budget

7.1 Overview

The Government's budgetary operations at the end of the fourth quarter of FY 2017/18 resulted in a deficit of 6.7 per cent of GDP which was within the target of

7.1 per cent of GDP. Both revenues and expenditures were below their respective targets with the shortfall in total revenues and grants at 11.03 per cent and total expenses and net lending at 9.38 per cent.

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

Statement of Government Operations in FY 2017/18 (RSD Billion)											Over (+) /	%
	(FY 2017/18)								Cumulative to June-18	Target	Below (-) Target	Variance
	Jan	Feb	Mar	Q3	April	May	June	Q4				
1. TOTAL REVENUE & GRANTS	135.9	95.7	118.5	350.1	126.1	132.7	179.7	438.6	1,514.8	1,702.6	(187.7)	(11.0)
Ordinary Revenue	126.6	85.7	106.2	318.5	119.5	123.2	147.0	389.7	1,365.1	1,659.6	(294.5)	
Tax Revenue	124.0	80.2	102.5	306.8	117.5	113.5	141.4	372.3	1,282.9	1,428.0	(145.0)	
Non Tax Revenue	2.6	5.5	3.6	11.7	2.1	9.7	5.6	17.3	82.1	61.7	20.5	
Appropriations-in-Aid	7.8	7.2	8.1	23.1	6.2	7.6	30.8	44.6	122.2	170.0	(47.8)	
External Grants	1.5	2.8	4.2	8.5	0.4	2.0	1.9	4.3	27.6	43.0	(15.4)	
2. TOTAL EXPENSES & NET LENDING	137.3	170.6	208.8	516.7	176.7	240.3	342.0	759.0	2,111.5	2,330.0	(218.5)	(9.4)
Recurrent Expenses	122.7	96.8	115.1	334.5	132.7	166.6	182.9	482.2	1,319.6	1,453.0	(133.4)	
Development Expenses	35.4	67.2	64.0	166.7	25.0	26.9	92.7	144.6	485.7	584.8	(99.1)	
County Transfers	22.8	19.4	47.6	89.8	18.5	46.7	66.4	131.7	306.2	292.2	14.0	
Others	-	-	1.5	1.5	0.5	-	-	0.5	-	-	-	
3. DEFICIT (INCL. GRANTS) (1-2)	(1.4)	(75.0)	(90.3)	(166.6)	(50.6)	(107.5)	(162.3)	(320.4)	(596.6)	(627.4)	30.8	(4.9)
As percent of GDP	(0.0)	(0.8)	(1.0)	(1.9)	(0.6)	(1.2)	(1.8)	(3.6)	(6.7)	(7.1)		
4. ADJUSTMENT TO CASH BASIS				-				-			-	
5. DEFICIT INCL. GRANTS ON A CASH BASIS	(1.4)	(75.0)	(90.3)	(166.6)	(50.6)	(107.5)	(162.3)	(320.4)	(596.6)	(627.4)	30.8	
As percent of GDP	(0.0)	(0.8)	(1.0)	(1.9)	(0.6)	(1.2)	(1.8)	(3.6)	(6.7)	(7.1)		
6. DISCREPANCY: Expenditure (+) / Revenue (-)				-				-			-	
7. FINANCING	32.3	115.3	115.3	262.9	39.9	49.4	91.6	180.9	608.0	627.4	(19.4)	(3.1)
Domestic (Net)	23.0	87.9	32.5	143.4	42.5	(87.2)	68.7	24.0	273.7	248.7	25.0	
External (Net)	9.3	27.2	82.8	119.3	(2.6)	136.6	22.1	156.1	331.6	374.6	(43.0)	
Capital Receipts (domestic loan receipts)	-	-	-	-	-	0.0	0.8	0.8	-	3.8	(3.8)	
Others	-	0.2	-	0.2	-	-	-	-	2.6	0.2	2.4	

GDP figures from Provisional Budget Outturn-June 2018

Sources: The National Treasury: Provisional Budget Out Turn June 2018 published in the Quarterly Economic Budget Review June 2018 (Fourth Quarter)

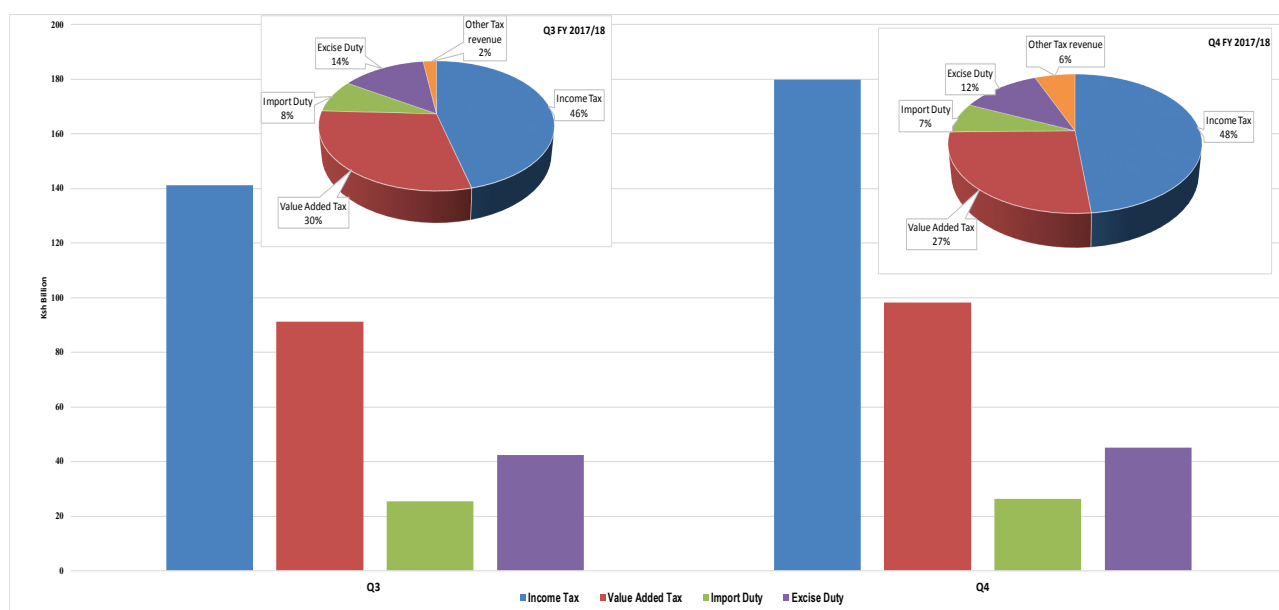
7.2 Revenue

The Government receipts, comprising revenue and grants rose by 25.3 percent to KSh 438.6 billion in the fourth quarter of FY 2017/18, from KSh 350.1 billion in the third quarter of the FY 2017/18. The increase was reflected across all revenue categories.

There was a shift in the composition of tax revenues in the fourth quarter of FY 2017/18 compared with the third quarter (**Chart 7.1**). The composition of income tax and other taxes rose by 2 percentage points and 4 percentage points, respectively, while Value Added Tax and excise duty decreased by 3 percentage points and 2 percentage points, respectively. The composition of import duty remained relatively unchanged during the period under review.

Cumulatively, the Government total revenue and grants stood at KSh 1,514.8 billion (17.5 percent of GDP) in the FY2017/18 against a target of KSh 1,702.6 billion (19.2 percent of GDP). All taxes fell below set targets with the shortfalls partly reflecting a slowdown in the performance of the economy which adversely affected revenue collection.

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



Source: Provisional Budget Out-turn from The National Treasury

7.3 Expenditure and Net Lending

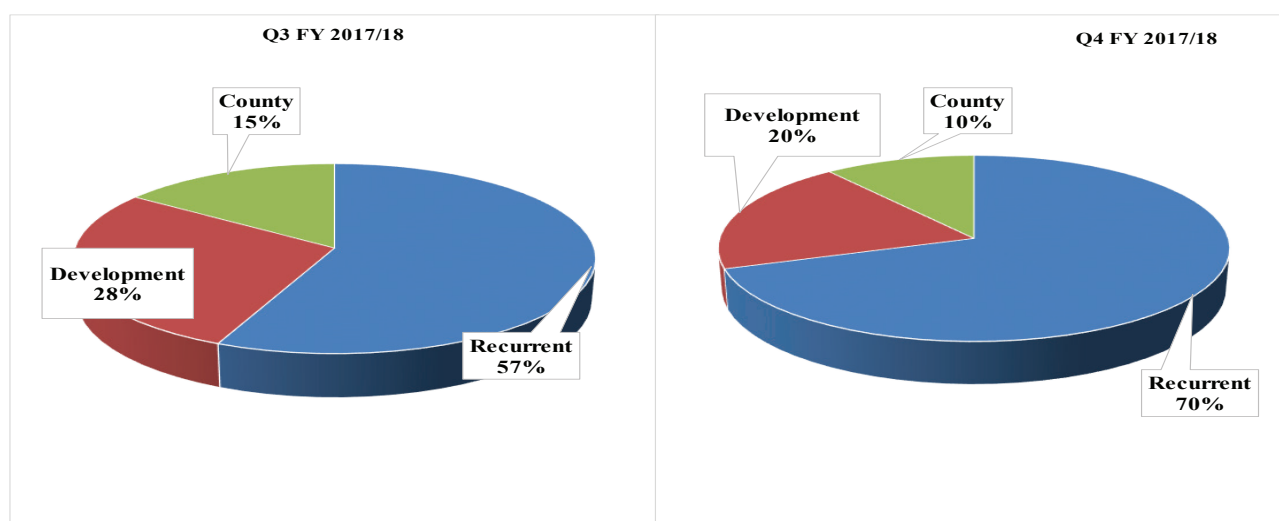
Government expenditure and net lending rose by 46.9 percent to KSh 759 billion in the fourth quarter of the FY 2017/18 compared with KSh 517 billion in the third quarter of the FY 2017/18. The increase in expenditures reflected national government recurrent expenditures and County transfers which rose by 44.1 percent and 46.6 percent, respectively. Development expenditure declined by 13.2 percent in the fourth quarter of FY 2017/18 compared to the third quarter.

In terms of composition, recurrent expenditure remained the largest share in total government expenditure accounting for 70 percent in the fourth quarter of FY 2017/18, which was 13 percentage points higher than the level recorded in the previous quarter. Conversely, the share of development expenditure

and county transfers declined by 8.0 percentage points and 5.0 percentage points, respectively (**Chart 7.2**). Development expenditures were largely channeled to infrastructure and energy and petroleum ministries for implementation of key infrastructure projects.

Cumulatively, expenditure and net lending in the FY 2017/18 amounted to KSh 2,111.5 billion (24.4 percent of GDP), against a target of KSh 2,330.0 billion (26.3 percent of GDP). The shortfall of KSh 218.5 billion was attributed to lower absorption of both recurrent and development expenditures by the National Government and County Governments.

Chart 7.2: Composition of Recurrent Expenses FY 2017/18



Sources: Provisional Budget Outturn from The National Treasury

7.4 Financing

The budget deficit including grants amounted to KSh 596.6 billion or 6.7 percent of GDP at the end of FY 2017/18. The deficit financing mix was 45.0 percent and 54.5 percent domestic and external resources, respectively. The domestic borrowing comprised KSh 26.3 billion draw down of Government deposits held at the Central Bank, KSh 124.3 billion from commercial

banks, KSh 172.8 billion from Non-banking financial institutions and KSh 3.0 billion from Non-Residents (**Table 7.2**). Net domestic borrowing at the end of the fourth quarter of FY 2017/18 was above target by KSh 25.0 billion while, external financing had a shortfall of KSh 43.0 billion against the expected target.

Table 7.2 Domestic Financing

	NET CREDIT TO GOVERNMENT (Ksh Bn)											
	2017/18											
	Jul-17	Aug-17	Q1	Oct-17	Nov-17	Q2	Jan-18	Feb-18	Q3	Apr-18	May-18	Q4
			Sep-17			Dec-17			Mar-18			Jun-18
1. From CBK	57.9	60.9	8.3	60.6	77.4	108.9	29.3	45.6	(80.2)	(32.5)	(62.0)	(26.3)
2. From commercial banks	(3.8)	(14.8)	12.6	9.8	2.9	(2.9)	7.3	61.7	77.5	93.2	115.0	124.3
4. From Non-banks	2.6	14.2	26.3	51.2	75.7	74.4	90.4	108.2	125.1	150.3	155.8	172.8
5. From Non-Residents	0.4	1.0	1.9	2.8	2.7	3.2	2.6	3.2	3.2	3.5	3.3	3.0
Change in Credit from banks (From 30th June 2017)	54.0	46.1	20.9	70.4	80.4	106.0	36.6	107.3	(2.7)	60.6	53.0	97.9
Change in Credit from non-banks (From 30th June 2017)	2.6	14.2	26.3	51.2	75.7	74.4	90.4	108.2	125.1	150.3	155.8	172.8
Change in Credit from non-residents (From 30th June 2017)	0.4	1.0	1.9	2.8	2.7	3.2	2.6	2.7	3.2	3.5	3.3	3.0
6. Total Change in Dom. Credit (From 30th June 2017)	57.1	61.3	49.2	124.4	158.8	183.6	129.6	218.2	125.6	214.4	212.1	273.7

NB: Treasury Bills are reflected at cost

Source: Central Bank of Kenya

7.5 Outlook for FY 2018/19

In the budget estimates for the FY 2018/19, total revenue is projected at KSh 1,949.2 billion (20.0 per cent of GDP) while external grants are projected at KSh 48.5 billion. Government expenditure is projected at KSh 2,556.6 billion (26.3 per cent of GDP), of which KSh 1,550.0 billion will be for recurrent expenses, KSh 376.4 billion for transfers to county governments, and KSh 625.1 billion for development expenses.

The overall budget deficit including grants on commitment basis is, therefore, projected at KSh 558.9 billion (5.7 per cent of GDP) in 2018/19, to

be financed through net external borrowing of KSh 287.0 billion and net domestic borrowing of KSh 271.9 billion.

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

	Ksh (Billion)	%age of GDP
1. TOTAL REVENUE (Including Grants)	1,997.7	20.5
Total Revenue	1,949.2	20.0
Appropriations-in-Aid	180.0	1.9
External Grants	48.5	0.5
2. TOTAL EXPENSES & NET LENDING	2,556.5	26.3
Recurrent Expenses	1,550.0	15.9
Development Expenses	625.1	6.4
County Transfer	376.4	3.9
Contingency Fund	5.0	0.1
3. DEFICIT INCL. GRANTS (1-2)	558.9	5.7
4. FINANCING	558.9	5.7
Domestic (Net)	271.9	2.8
External (Net)	287.0	3.0

Source: The National Treasury : Budget Policy Statement February 2018

Chapter 8

Public Debt

8.1 Overall Public Debt

Kenya's public and publicly guaranteed debt increased by 3.2 percent during the fourth quarter of the FY 2017/18 with both domestic and external debt increasing by 4.5 percent and 1.9 percent respectively during the quarter. The buildup in public debt was slower than the projected rate of economic expansion, hence the decline in the ratio of public

and publicly guaranteed debt to GDP to 57.0 percent compared with 61.2 percent in the previous quarter. Correspondingly, the ratio of external debt to GDP decreased from 31.5 percent to 29.5 percent while that of domestic debt decreased from 29.7 percent to 28.6 percent, in the fourth quarter of the FY 2017/18 (**Table 8.1**).

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

	2016/17				2017/18								
	Q1	Q2	Q3	Q4	Q1	Oct-17	Nov-17	Q2	Q3	Apr-18	May-18	Q4	Change Q on Q
EXTERNAL													
Bilateral	580.4	577.8	689.1	722.6	742.1	787.1	792.5	782.6	800.9	824.9	827.5	821.0	20.1
Multilateral	799.7	781.3	806.9	844.4	842.8	838.1	839.8	841.8	836.8	827.4	824.9	816.1	-20.6
Commercial Banks	442.8	458.1	594.1	712.1	708.2	710.8	707.9	707.8	858.1	893.3	903.9	906.4	48.3
Supplier Credits	15.5	15.3	11.2	15.3	17.1	17.2	17.1	17.1	16.7	16.6	16.8	16.7	0.0
Sub-Total	1,838.4	1,832.4	2,101.4	2,294.4	2,310.2	2,353.1	2,357.2	2,349.3	2,512.4	2,562.2	2,573.1	2,560.2	47.8
(As a % of GDP)	26.1	25.5	28.4	29.8	30.1	29.1	30.6	30.3	31.5	29.0	29.1	28.9	
(As a % of total debt)	49.8	48.7	51.9	52.1	51.5	51.8	51.4	51.4	51.4	51.5	51.3	50.8	
DOMESTIC													
Banks	1,028.7	1,032.6	1,061.1	1,196.4	1,223.5	1,213.1	1,228.6	1,221.7	1,320.4	1,337.4	1,363.6	1,377.2	56.8
Central Bank	58.9	85.5	85.3	54.5	79.2	71.9	95.1	96.8	93.6	98.0	98.3	110.8	17.2
Commercial Banks	969.8	947.0	975.8	1,141.9	1,148.3	1,141.3	1,133.5	1,124.9	1,226.9	1,239.5	1,265.3	1,266.5	39.6
Non-banks	813.8	884.8	862.3	893.2	925.0	950.4	974.9	973.2	1,025.7	1,051.9	1,058.3	1,076.3	50.6
Pension Funds	493.8	544.9	549.2	593.5	592.7	609.2	615.8	611.2	641.8	658.5	659.6	671.5	29.7
Insurance Companies	136.4	143.2	138.9	138.9	134.7	136.4	139.5	142.7	150.9	153.3	156.1	154.5	3.6
Other Non-bank Sources	183.6	196.7	174.2	160.8	197.5	204.9	219.6	219.3	232.9	240.2	242.6	250.2	17.3
Non-residents	12.0	13.6	21.5	22.1	24.1	25.0	24.9	25.4	25.5	25.9	25.7	25.3	-0.2
Sub-Total	1,854.6	1,931.0	1,945.0	2,111.7	2,176.6	2,188.5	2,228.4	2,220.3	2,371.7	2,415.3	2,447.6	2,478.8	107.2
(As a % of GDP)	26.4	26.8	26.2	27.4	28.4	27.0	28.9	28.7	29.7	27.3	27.7	28.0	
(As a % of total debt)	50.2	51.3	48.1	47.9	48.5	48.2	48.6	48.6	48.6	48.5	48.7	49.2	
GRAND TOTAL	3,693.0	3,763.4	4,046.3	4,406.1	4,486.8	4,541.6	4,585.7	4,569.6	4,884.1	4,977.4	5,020.7	5,039.0	155.0
(As a % of GDP)	52.5	52.3	54.6	57.3	58.4	56.1	59.5	59.0	61.2	56.3	56.8	57.0	

Source: The National Treasury and Central Bank of Kenya

8.2 Domestic Debt

Total domestic debt increased by 4.5 percent during the quarter and this was slightly lower than the 6.8 percent increase observed in the previous quarter as the government edged closer to its borrowing target for the FY 2017/18. The share of domestic debt to total debt increased by 0.6 percent to 49.2 percent by the end of the fourth quarter of the FY 2017/18. Investors' preference shifted to shorter dated securities hence the 13.7 percent increase in the uptake of Treasury bills. Conversely, the proportion of debt securities to total domestic debt decreased by 0.6 percentage points during the quarter under review. The decrease in the share of debt securities to total domestic debt was on account of an offsetting effect arising from 97.9 percent utilization of the government overdraft facility at the Central Bank.

Table 8.2: Government Gross Domestic Debt (KSh Billion)

	Ksh (Billion)							Change: Q on Q		Proportions						
	2016/17	2017/18						Ksh (Bn)	%	2016/17	2017/18					
	Q4	Q1	Q2	Q3	Apr-18	May-18	Q4			Q4	Q1	Q2	Q3	Apr-18	May-18	Q4
Total Stock of Domestic Debt (A+B)	2,111.7	2,176.6	2,220.3	2,371.7	2,415.3	2,447.6	2,478.8	107.2	4.5	100.0	100.0	100.0	100.0	100.0	100.0	100.0
A. Government Securities	2,076.1	2,111.4	2,146.0	2,300.5	2,339.7	2,371.8	2,390.5	90.0	3.9	98.3	97.0	96.7	97.0	96.9	96.9	96.4
1. Treasury Bills (excluding Repo Bills)	744.2	724.8	684.7	772.7	789.7	838.7	878.6	105.9	13.7	35.2	33.3	30.8	32.6	32.7	34.3	35.4
Banking institutions	436.5	412.5	363.9	436.2	440.4	481.7	502.6	66.4	15.2	20.7	19.0	16.4	18.4	18.2	19.7	20.3
The Central Bank	20.6	20.6	20.6	20.6	20.6	20.6	20.6	0.0	0.0	1.0	0.9	0.9	0.9	0.9	0.8	0.8
Commercial Banks	415.9	391.9	343.3	415.6	419.8	461.1	482.0	66.4	16.0	19.7	18.0	15.5	17.5	17.4	18.8	19.4
Pension Funds	179.5	171.4	159.2	159.2	165.2	166.8	180.1	20.9	13.1	8.5	7.9	7.2	6.7	6.8	6.8	7.3
Insurance Companies	13.7	15.0	18.2	20.5	20.5	22.7	21.2	0.7	3.3	0.7	0.7	0.8	0.9	0.9	0.9	0.9
Others	114.4	125.9	143.4	156.8	163.6	167.6	174.7	17.9	11.4	5.4	5.8	6.5	6.6	6.8	6.8	7.0
2. Treasury Bonds	1,332.0	1,386.6	1,461.2	1,527.8	1,550.1	1,533.1	1,511.9	-16.0	-1.0	63.1	63.7	65.8	64.4	64.2	62.6	61.0
Banking institutions	724.5	749.8	783.5	813.2	821.6	806.2	786.4	-26.9	-3.3	34.3	34.5	35.3	34.3	34.0	32.9	31.7
The Central Bank	9.4	9.4	9.4	9.4	9.4	9.4	9.4	0.0	0.0	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Commercial Banks	715.1	740.4	774.1	803.8	812.2	796.8	776.9	-26.9	-3.3	33.9	34.0	34.9	33.9	33.6	32.6	31.3
Insurance Companies	138.9	119.7	124.4	130.4	132.7	133.4	133.3	2.9	2.2	6.6	5.5	5.6	5.5	5.5	5.5	5.4
Pension Funds	414.1	421.4	452.1	482.6	493.4	492.8	491.4	8.8	1.8	19.6	19.4	20.4	20.3	20.4	20.1	19.8
Others	54.5	95.7	101.2	101.6	102.4	100.7	100.8	-0.8	-0.8	2.6	4.4	4.6	4.3	4.2	4.1	4.1
3. Long Term Stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Banking institutions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4. Frozen account	25.0	24.4	24.4	23.9	23.9	23.9	23.9	0.0	0.0	1.2	1.1	1.1	1.0	1.0	1.0	1.0
Of which: Repo T/Bills	23.8	23.8	23.8	23.3	23.3	23.3	23.3	0.0	0.0	1.1	1.1	1.1	1.0	1.0	1.0	0.9
B. Others:	10.6	40.8	49.9	47.2	51.6	51.9	64.4	17.2	36.5	0.5	1.9	2.2	2.0	2.1	2.1	2.6
Of which CBK overdraft to Government	0.0	24.7	42.3	39.7	44.0	44.4	56.8	17.2	43.4	0.0	1.1	1.9	1.7	1.8	1.8	2.3

Source: Central Bank of Kenya

Treasury Bills

Treasury bill holdings, excluding those held by the CBK for open market operations (Repos) recorded 13.7 percent increase during the fourth quarter of the FY 2017/18 as investors' appetite for shorter dated securities increased. Similarly, the proportion of Treasury bills to total domestic debt increased by 2.8 percent during the period under review. The dominance of Commercial banks in Treasury bills market persisted with their holdings standing at 54.9 percent of the total amount of outstanding Treasury Bills by the end of the fourth quarter of the FY 2017/18. Other significant holders of Treasury bills included Pension funds (20.5 percent) and parastatals included in other holders (16.6 percent). The dominance of commercial banks in the government securities' market characterizes moderate under representation

of other institutional investors (pension funds, foreign investors and insurance companies).

Treasury Bonds

Treasury bond holdings decreased by 1.0 percent during the fourth quarter of the FY 2017/18, partly reflecting significant maturities of Treasury bonds and a shift in investor preference towards shorter dated securities. The dominant holders of Treasury bonds by the end of the period under review were commercial banks, pension funds and Insurance companies. Commercial bank holdings accounted for about half of the total Treasury Bonds outstanding.

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

		Kshs (Billions)						Change Q on Q		Proportions						
		2016/17	2017/18					Q4 2017/18		2016/17	2017/18					
		Q4	Q2	Q3	Apr-18	May-18	Q4	Kshs(Bn)	%	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Treasury bills	91-Day	92.2	46.0	48.5	41.5	44.1	46.9	-1.6	-3.4	4.4	1.6	2.1	2.0	1.7	1.8	1.9
	182-Day	234.3	190.9	202.1	228.9	241.0	258.3	56.2	27.8	11.1	11.7	8.6	8.5	9.5	9.8	10.4
	364-Day	417.7	447.8	522.1	519.2	553.6	573.5	51.4	9.8	19.8	19.9	20.2	22.0	21.5	22.6	23.1
Treasury Bond	1-Year	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	2-Year	82.1	113.9	93.8	93.8	63.6	63.6	-30.2	-32.2	3.9	4.7	5.1	4.0	3.9	2.6	2.6
	3-Year	0.2	0.4	0.4	0.4	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	4-Year	2.3	4.8	4.8	4.8	4.8	4.8	0.0	0.0	0.1	0.2	0.2	0.2	0.2	0.2	0.2
	5-Year	272.7	323.0	346.1	333.6	333.6	307.2	-38.8	-11.2	12.9	13.9	14.5	14.6	13.8	13.6	12.4
	6-Year	8.5	8.5	8.5	8.5	8.5	8.5	0.0	0.0	0.4	0.4	0.4	0.4	0.4	0.3	0.3
	7-Year	8.7	50.1	50.1	50.1	50.1	50.1	0.0	0.0	0.4	0.4	2.3	2.1	2.1	2.0	2.0
	8-Year	33.7	33.7	33.7	33.7	33.7	33.7	0.0	0.0	1.6	1.5	1.5	1.4	1.4	1.4	1.4
	9-Year	76.5	76.5	76.5	76.5	76.5	76.5	0.0	0.0	3.6	3.5	3.4	3.2	3.2	3.1	3.1
	10-Year	256.9	272.5	265.5	265.5	265.5	265.5	0.0	0.0	12.2	12.9	12.3	11.2	11.0	10.8	10.7
	11-Year	4.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
	12-Year	146.4	133.2	133.2	133.2	133.2	133.2	0.0	0.0	6.9	6.1	6.0	5.6	5.5	5.4	5.4
	15-Year	286.7	291.4	353.6	373.6	386.8	386.8	33.2	9.4	13.6	13.2	13.1	14.9	15.5	15.8	15.6
	20-Year	104.9	104.9	113.4	128.1	128.1	128.1	14.7	13.0	5.0	4.8	4.7	4.8	5.3	5.2	5.2
	25-Year	20.2	20.2	20.2	20.2	20.2	25.3	5.2	25.5	1.0	0.9	0.9	0.9	0.8	0.8	1.0
	30-Year	28.1	28.1	28.1	28.1	28.1	28.1	0.0	0.0	1.3	1.3	1.3	1.2	1.2	1.1	1.1
Repo T bills		23.8	23.8	23.3	23.3	23.3	23.3	0.0	0.0	1.1	1.1	1.1	1.0	1.0	1.0	0.9
Overdraft		0.0	42.3	39.7	44.0	44.4	56.8	17.2	100.0	0.0	1.1	1.9	1.7	1.8	1.8	2.3
Other Domestic debt		11.7	8.2	8.2	8.2	8.2	8.2	0.0	0.4	0.6	0.5	0.4	0.3	0.3	0.3	0.3
Total Debt		2,111.7	2,220.3	2,371.7	2,415.3	2,447.6	2,478.8	107.2	4.5	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Kenya

Domestic Debt by Tenor and the Maturity Structure

The government majorly floated shorter dated securities during the period under review. Nevertheless, the current debt securities portfolio is dominated by medium and long term debt securities underscoring the Public Debt Management Office's goal of reducing the refinancing risk. The benchmark Treasury Bonds comprising 2-year, 5-year, 10-year, 15-year and 20-year Treasury Bonds accounted for 76.1 percent of the total of outstanding Treasury Bonds, a 0.4 percent increase from the position in the previous quarter. Other domestic debt consists of uncleared effects, advances from commercial banks and Tax Reserve Certificates.

Domestic debt maturity structure improved with the average time to maturity of existing domestic debt increasing slightly to 4 years and 2 months in the fourth quarter of the FY 2017/18 from 4 years and 1 months in the third quarter of FY 2017/18, respectively. Nonetheless, the refinancing risk worsened (35.4 percent from 32.6 percent in March 2018).

8.3 External Debt

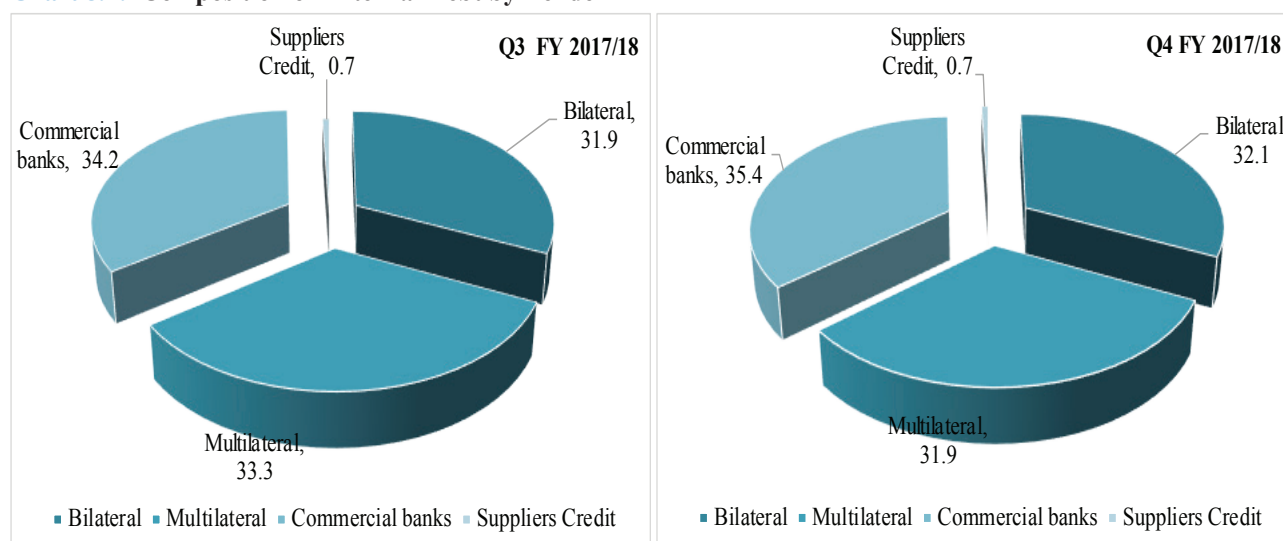
Public and publicly guaranteed external debt increased by 1.9 percent during the fourth quarter of the FY 2017/18. External debt accumulation during the quarter under review was mainly driven by disbursements of bilateral debt from China to finance

infrastructural projects in roads and energy and commercial debt from the Trade Development Bank. Principal amortization of debt owed to International Development Association (IDA) and Japan and the repayment of the 2015 syndicated loan had an offsetting effect on the overall external debt build up. Foreign exchange risk on external debt was low due to relatively stable exchange rate during the quarter under review.

Composition of External Debt by Creditor

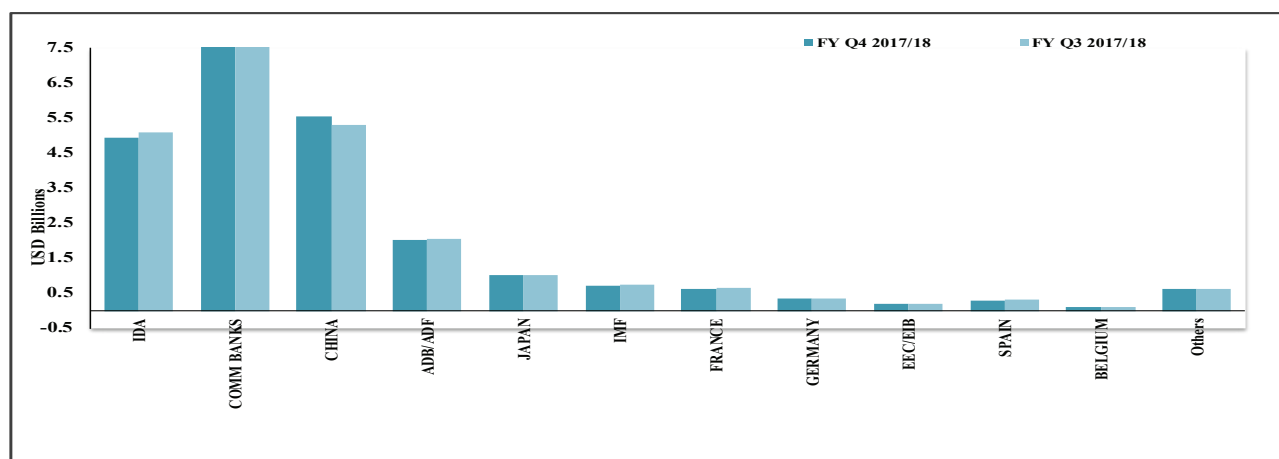
With increased access to international financial markets, Kenya continues to record dwindling levels of concessional debt and a build-up of commercial and semi-concessional borrowing. During the quarter under review, this trend persisted with the share of outstanding debt from official multilateral and bilateral lenders (who provide both concessional and semi-concessional loans) decreasing by 1.2 percentage from the 65.2 percent in the previous quarter to 64.0 percent by the end of the fourth quarter of the FY 2017/18. Consequently, the share of commercial debt decreased by 2.2 percentage points to 35.4 percent. This shift in the composition of external debt was mainly on account of disbursements from Trade Development Bank (**Chart 8.1**).

Chart 8.1: Composition of External Debt by Lender



Source: The National Treasury

Chart 8.2: External Debt By Creditor



Source: The National Treasury

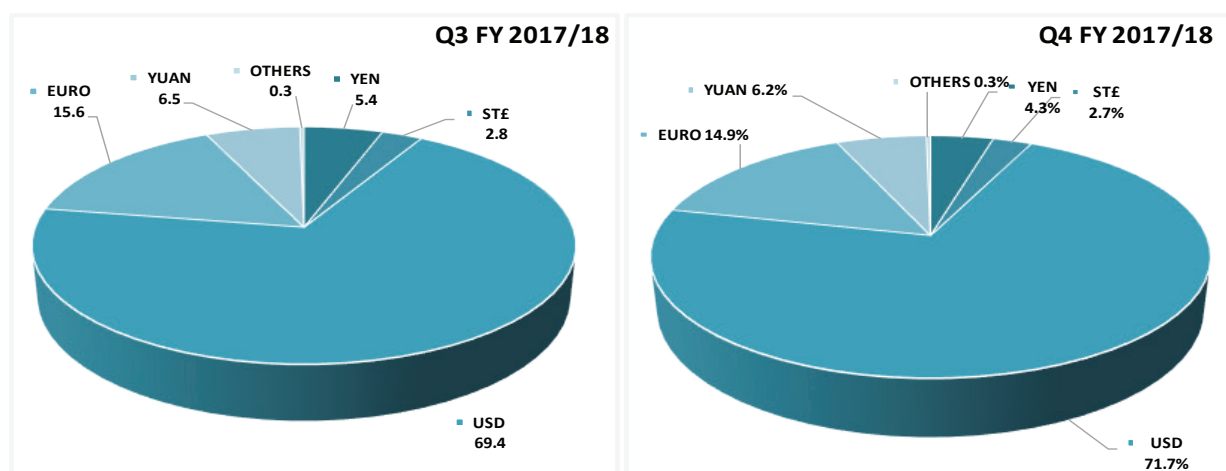
International Development Association (IDA), was overtaken by Commercial banks as the largest external lender to Kenya, at USD 9.0 billion or 35.4 percent of total external debt. While debt owed to China, Kenya's largest bilateral lender, amounted to USD 5.5 billion, or 21.8 of the total external debt in the fourth quarter of the FY 2017/18 (Chart 8.2).

Currency Composition of External Debt

Kenya's public and publicly guaranteed external debt is denominated in various currencies to mitigate against the currency risk. The dominant currencies

included the US dollar and the Euro which accounted for 86.6 percent of the total currency composition at the end of the fourth quarter of the FY 2017/18. This was majorly consistent with the currency composition of the Central Bank's forex reserve holdings. The proportion held in the US dollar increased mainly on account disbursements of dollar- denominated loan advanced by the Chinese government to and disbursements from Trade Development Bank (Chart 8.3).

Chart 8.3: Debt Composition by Currency



Source: The National Treasury

8.4 Public Debt Service

The ratio of domestic interest payments to revenues stood at 4.9 percent in the fourth quarter of the FY 2017/18 which was significantly lower than the previous quarter (17.3 percent) implying improving domestic debt sustainability dynamics. 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 ratios to flow resource bases

such as revenues and exports are liquidity indicators of the level of indebtedness. Liquidity indicators of external indebtedness deteriorated and edged closer to the Country Policies and Institutions Assessment (CPIA) determined liquidity indicators thresholds (21 percent of exports and 23 percent of revenues) implying increased risk to external debt sustainability (Table 8.4).

Table 8.4: Liquidity Indicators of External Debt Sustainability

	Q4 FY 2016/17	Q1 FY 2017/18	Q2 FY 2017/18	Q3 FY 2017/18	Q4 FY 2017/18
Debt service to Revenues (23%)	7.3	7.2	11.4	8.5	14.7
Debt service to Exports (21%)	8.3	9.1	14.8	10.5	20.4

Source: Central Bank of Kenya

Chapter 9

The Capital Markets

9.1 Equities Market

The equities market performance recorded reduced activity in the second quarter of 2018 compared to performance in the first quarter of 2018 as reflected across all the market indicators. The reduced performance could be attributed to developments in global financial markets and local factors including less-impressive financial results characterised by

increased profit warnings of select listed companies (Table 9.1).

Table 9.1: Selected Stock Market Indicators

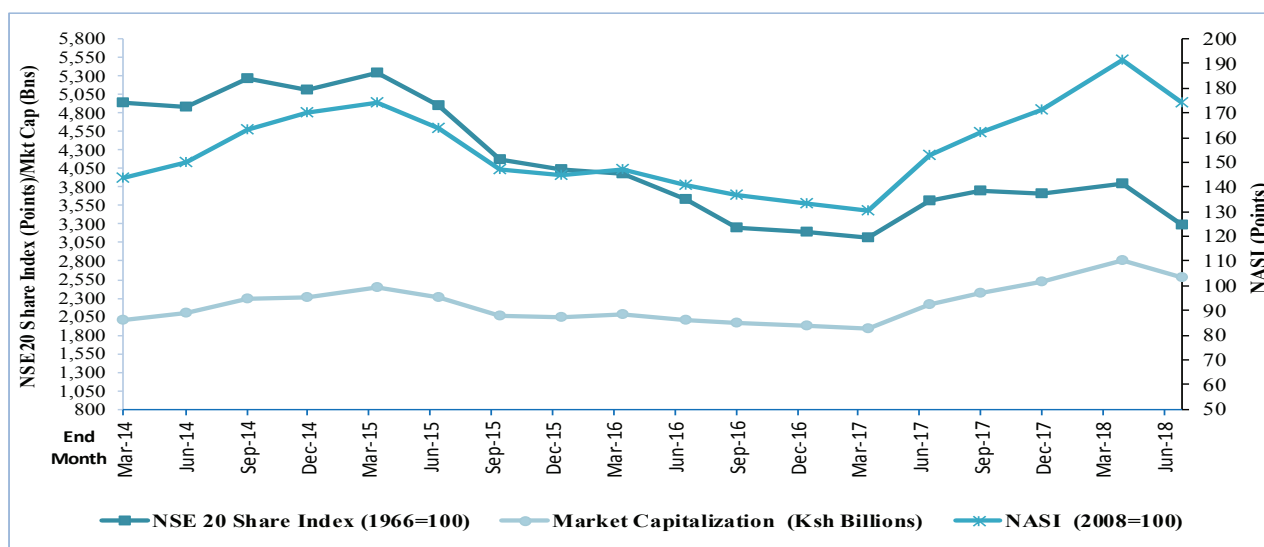
INDICATOR	2017				2018		% QUARTERLY CHANGE (2018Q2-2018Q1)
	Q1	Q2	Q3	Q4	Q1	Q2	
NSE 20 Share Index (1966=100)	3112.5	3607.2	3751.5	3711.9	3845.3	3285.7	-14.55
NASI (2008=100)	130.51	152.92	162.21	171.20	191.23	174.36	-8.82
Number of Shares Traded (Millions)	1859.82	1892.06	2019.72	1291.155	2138.96	1580.04	-26.13
Equities Turnover (Ksh Millions)	37,095	44,902	53,577	36,019	61,150	47,142	-22.91
Market Capitalization (Ksh Billions)	1,894	2,224	2,377	2,522	2,817	2,576	-8.56
Foreign Purchase (Ksh Millions)	29,421	27,424	23,099	22,760	31,065	24,618	-20.75
Foreign Sales (Ksh Millions)	27,433	29,692	34,219	22,941	39,149	32,794	-16.23
Ave. Foreign Investor Participation to Equity Turnover (%)	76.64	63.60	53.49	63.44	57.41	60.89	3.48*
Bond Turnover (Ksh Millions)	103,997	134,633	108,168	89,120	152,338	158,523	4.06
FTSE NSE Kenya Govt. Bond Index (Points)	89.73	91.54	91.67	92.83	93.58	95.00	1.52
5-Year Eurobond Yield (%)	4.20	4.47	4.28	3.76	3.83	5.74	1.91*
10-Year Eurobond Yield (%) -2024	7.10	6.64	6.46	5.67	6.24	7.18	0.94*
10-Year Eurobond Yield (%) -2028					6.86	7.89	1.02*
30-Year Eurobond Yield (%) -2048					7.81	8.90	1.08*

* Percentage points

Source: Nairobi Securities Exchange

The decline in equity prices reduced the shareholder's wealth, measured by market capitalization, in the second quarter of 2018 by 8.56 percent compared to an increase of 70.65 percent the first quarter of 2018 (Chart 9.1).

Chart 9.1: NSE 20, NASI and Market Capitalization

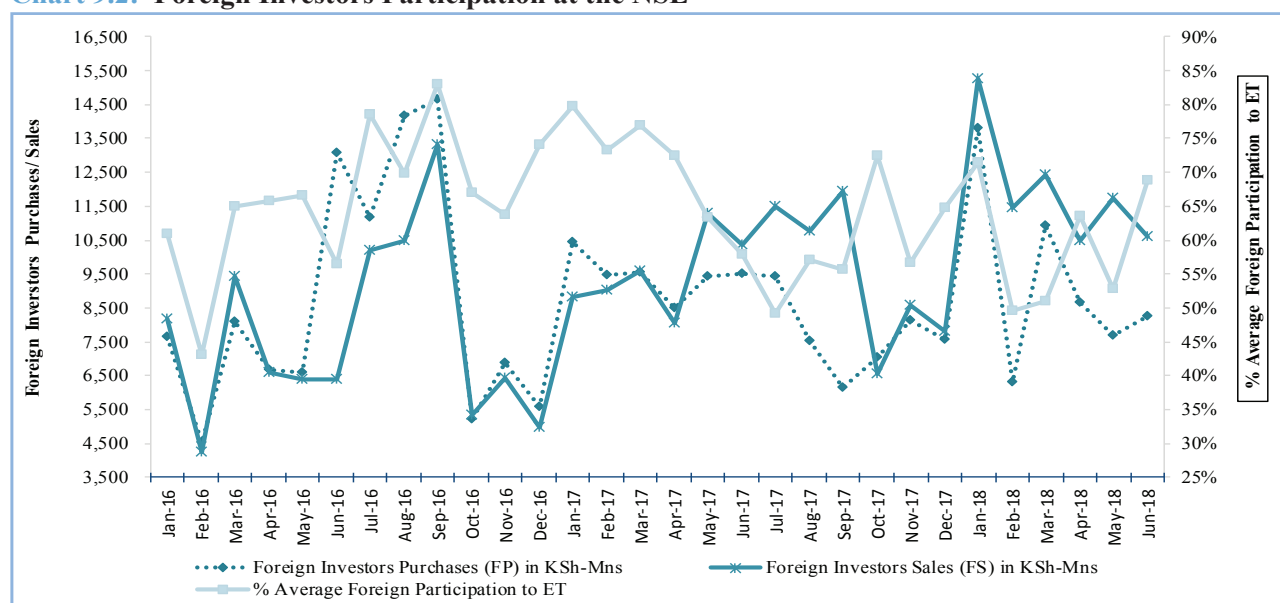


Source: Nairobi Securities Exchange

9.2 Foreign Investors' Participation

The value of shares bought by foreign investors at the NSE declined by 20.75 percent against foreign investors' sales decline of 16.23 percent. The average net foreign investors' participation at the NSE relative to equity turnover was 61.72 percent, which is slightly above the first quarter of 2018 at 57.37 percent, reflecting increased participation. Foreign investors' sales have exceeded purchases since the second quarter of 2017, reflecting profit-taking and divesture from the NSE (**Chart 9.2 and Table 9.1**).

Chart 9.2: Foreign Investors Participation at the NSE



Source: Nairobi Securities Exchange

9.3 Bond Market

The volume of bonds traded at NSE rose by 4.06 percent in the second quarter of 2018 compared to the first quarter of 2018, reflecting investors' improved appetite for less risky assets. The FTSE NSE Kenyan Government Bond Index increased by 1.52 percent in the period under review, reflecting a marginal decline in secondary market yields. The 5- and 10-year Kenya Eurobonds yields increased by 1.91 percentage points and 0.94 percentage points, respectively while the yields on the 10- and 30-year Eurobonds also increased by 1.02 percentage points and 1.08 percentage points, respectively by the end of the second quarter of 2018. This reflects investor sentiments in global financial markets conditions.

Chapter 10

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

1.0	ASSETS	2017			2018		Absolute Quarterly Changes (KSh Million)			Quarterly Growth Rates (%)		
		JUNE	SEPT	DEC	MARCH	JUNE	Q2, 2018	Q1, 2018	Q4, 2017	Q2, 2018	Q1, 2018	Q4, 2017
1.1	Reserves and Gold Holdings	870,325	830,309	753,350	929,848	923,391	(6,457)	176,498	(76,959)	(0.7)	23.4	(9.3)
1.2	Funds Held with IMF	1,877	253	1,487	2,678	2,012	(665)	1,191	1,234	(24.8)	80.1	488
1.21	Investment in Equity (Swift Shares)	9	10	10	10	9	(0.6)	0	0	(6.3)	1.2	1.3
1.3	Items in the Course of Collection	43	22	19	21	25	4	2	(3)	18.8	12.6	(14.7)
1.4	Advances to Commercial Banks	34,870	75,773	39,645	43,604	38,503	(5,101)	3,960	(36,128)	(11.7)	10.0	(47.7)
1.5	Loans and Other Advances	2,575	2,650	2,645	2,551	2,585	35	(94)	(4)	1.4	(3.6)	(0.2)
1.6	Other Assets	2,923	2,486	2,354	2,284	2,298	14	(69)	(132)	0.6	(2.9)	(5.3)
1.7	Retirement Benefit Asset	8,197	8,197	8,197	8,197	6,585	(1,613)	-	-	(19.7)	0.0	-
1.8	Property and Equipment	22,703	21,983	22,003	22,324	27,153	4,829	321	20	21.6	1.5	0.1
1.81	Intangible Assets	52	49	47	117	165	47	71	(2)	40.2	150.9	(4.4)
1.9	Due from Government of Kenya	24,449	49,350	66,887	63,609	80,188	16,579	(3,278)	17,537	26.1	(4.9)	35.5
	TOTAL ASSETS	968,024	991,081	896,643	1,075,244	1,082,915	7,671	178,600	(94,438)	0.7	19.9	(9.5)
2.0	LIABILITIES											
2.1	Currency in Circulation	253,787	250,695	279,159	262,622	262,439	(183)	(16,537)	28,464	(0.1)	(5.9)	11.4
2.2	Investments by Banks -Repos	-	-				-					
2.3	Deposits	470,109	483,815	364,325	571,657	584,287	12,630	207,331	(119,489)	2.2	56.9	(24.7)
2.4	International Monetary Fund	115,125	114,659	110,416	109,129	100,284	(8,845)	(1,287)	(4,243)	(8.1)	(1.2)	(3.7)
2.5	Other Liabilities	(5,059)	1,859	1,497	1,661	6,123	4,462	165	(363)	268.6	11.0	(19.5)
	TOTAL LIABILITIES	833,962	851,029	755,397	945,068	953,132	8,064	189,671	(95,632)	0.9	25.1	(11.2)
3.0	EQUITY AND RESERVES	134,062	140,053	141,246	130,175	129,782	(393)	(11,071)	1,193	(0.3)	(7.8)	0.9
	Share Capital	5,000	5,000	5,000	5,000	5,000						
	General reserve fund -Unrealized	57,550	65,195	65,195	65,195	65,195		-	-	-	0.0	-
	-Realized	16,909	23,690	23,690	23,690	22,890	(800)		(0.4)	(3.4)	0.0	
	-Capital Projects	15,047	17,189	17,189	17,189	17,189	-		0.0	-	0.0	-
	Period surplus/(Deficit)	16,569	5,991	7,185	(3,886)	(4,279)	(393)	(11,071)	1,194	10.1	(154.1)	19.9
	Asset Revaluation	14,790	14,790	14,790	14,790	14,790	-		-	-	0.0	
	Retirement Benefit Asset Reserves	8,197	8,197	8,197	8,197	8,197			(0.02)	0.0	0.0	-
4.0	TOTAL LIABILITIES AND EQUITY	968,024	991,081	896,643	1,075,244	1,082,915	7,671	178,600	(94,438)	0.7	19.9	(9.5)

Source: Central Bank of Kenya

Notes on the Financial Position

Assets

The Central Bank of Kenya (CBK) balanced sheet increased marginally by 0.7 percent in the second quarter of 2018, largely reflecting KSh 16.6 billion increase in debt due from government. Debt due from government comprise utilization of the overdraft facility at the Central bank and overdrawn accounts which were converted to a long term debt with effect from November 1, 1997.

Reserve and gold holdings which comprise foreign reserves held in external current accounts, deposits and special/projects accounts, domestic foreign currency clearing accounts, gold, special drawing rights and RAMP securities invested with the World Bank decreased by KSh 6.5 billion, partly reflecting servicing of government debt and central bank operations.

Advances to commercial banks, largely for liquidity management, decreased by KSh 5.1 billion in the second quarter of 2018, partly reflecting improved liquidity conditions resulting from increased government spending towards the end of 2017/2018 fiscal year. Funds held with the IMF declined by KSh 0.7 billion while the retirement benefit asset declined by KSh 1.6 billion.

Items in the course of collection, which represent the value of clearing instruments held by the CBK while awaiting clearing by respective commercial banks, increased by KSh 4 million compared to KSh 2 million in the first quarter of 2018.

Loans and other advances include outstanding balances on advances to commercial banks under the Overnight Loan Facility (OLF), and IMF funds on-lent to Government, increased by 1.4 percent in the second quarter of 2018 compared to a decline of 3.6 percent in the previous quarter.

Other assets, which largely consist of prepayments and sundry debtors, and deferred currency expense increased marginally by 0.6 percent in the second quarter of 2018.

Liabilities

Currency in circulation declined marginally by 0.1 percent in the second quarter of 2018 compared to a decline of 5.9 percent in the previous quarter.

Deposits by Government of Kenya, local commercial banks, other public entities and project accounts and local banks' forex settlement accounts increased by 2.2 percent compared to a strong growth of 56.9 percent in the previous quarter, largely reflecting utilization of government deposits.

Equity and reserves decreased by 0.3 percent in the second quarter of 2018 compared to a decline of 7.8 percent in the previous quarter, reflecting reduction in growth of period's deficit.



Central Bank of Kenya

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