Central Bank of Kenya

QUARTERLY ECONOMIC REVIEW (QER)

Volume 3 No 1
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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

JANUARY - MARCH 2018

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HIGHLIGHTS

Overall inflation declined to 4.5 percent and was below the midpoint of the Government medium term target band in the first quarter of 2018. Inflation declined in the quarter under review to 4.5 percent from 5.0 percent in the fourth quarter of 2017, supported by declining food prices following favourable weather conditions.

Growth in broad money supply (M3) slowed down by 0.2 percent in the first quarter of 2018 from 0.8 percent in the fourth quarter of 2017, reflecting deceleration in the rate of increase of demand deposits and foreign currency deposits at the Central Bank of Kenya.

The economy remained resilient and grew by 4.9 percent in 2017 despite the impact of unfavourable weather conditions that undermined agricultural production and the prolonged electioneering period. In the fourth quarter of 2017, the economy grew by 5.0 percent. Available indicators show mixed performance in the first quarter of 2018.

Global economic output increased by 3.8 percent in 2017 from 3.2 percent in 2016 attributed to a rebound in global trade. The rising trend is expected to continue in 2018, with growth projected at 3.9 percent supported by strong momentum, favourable market sentiment, accommodative financial conditions, and expansionary fiscal policy.

Kenya's current account balance stood at United States Dollar (USD) 932 million deficit during the first quarter of 2018 from USD 1,187 million deficit during the fourth quarter of 2017 reflecting an improvement of the trade balance.

Kenya's official international reserves position was strong at USD 9,362 million by end-March 2018, equivalent to 6.3 months of imports.

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

The banking system remained resilient and stable in the first quarter of 2018. Total net assets increased by 0.7 percent, while the deposit base increased by 1.1 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 11.8 percent in the first quarter of 2018.

The Government's budgetary operations during the third quarter of FY 2017/18 resulted in a deficit of 1.9 per cent of GDP compared with a deficit of 1.7 per cent of GDP in the second quarter of FY 2017/18. Revenue collection improved but remained below target, as was the case with the expenditure.

Kenya's public and publicly guaranteed debt increased by 6.9 percent during the third quarter of the FY.2017/18, with both domestic and external debt increasing by 6.8 percent and 6.9 percent, respectively.

The capital market performance improved in the first quarter of 2018 due to recovery of economic activity. The yield on Kenya's short term Eurobonds increased slightly, while long term maturing yields reduced slightly.

Chapter 1
Inflation

Overview

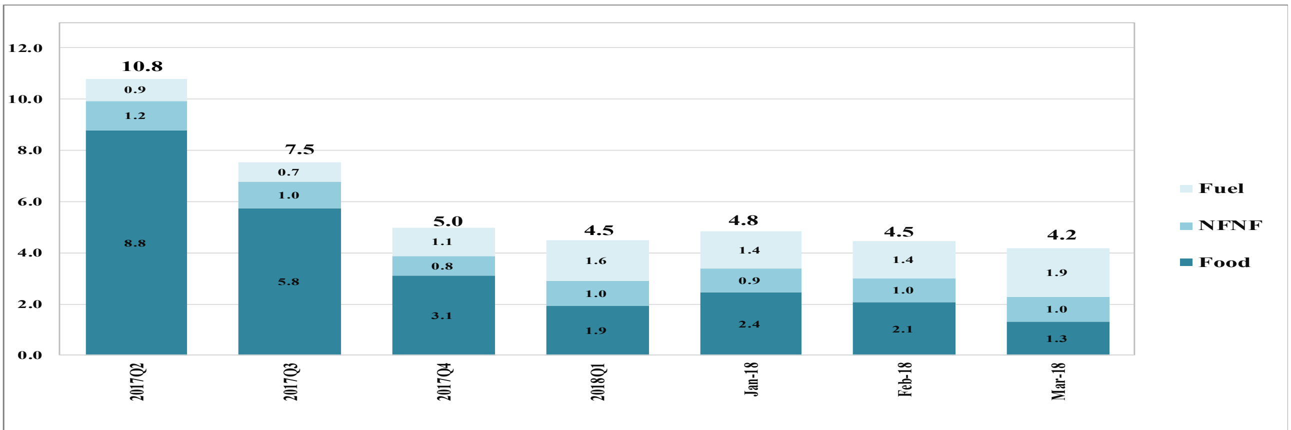
Overall inflation declined to 4.5 percent in the first quarter of 2018 from 5.0 percent in the fourth quarter of 2017, supported by declining food prices following favourable weather conditions (**Table 1.1**). Consequently, food inflation declined to 3.9 percent in the first quarter of 2018 from 6.3 percent in the fourth quarter of 2017. However, fuel inflation increased to 6.8 percent in the first quarter of 2018 from 4.6 percent, owing to the rising domestic and international energy prices. The Non-Food Non-Fuel (NFNF) inflation increased to 3.6 percent from 2.9 percent over the period under review.

Table 1.1: Recent Developments in Inflation (Percent)

	2016				2017				2018			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Jan	Feb	Mar
Overall Inflation	7.0	5.4	6.3	6.5	8.8	10.8	7.5	5.0	4.5	4.8	4.5	4.2
Food Inflation	10.4	7.2	10.3	10.6	14.7	18.1	11.7	6.3	3.9	4.9	4.1	2.6
Fuel Inflation	2.2	1.7	0.4	0.3	2.3	3.5	3.1	4.6	6.8	6.1	6.2	8.2
Non-Food Non-Fuel Inflation (NFNF)	5.8	5.4	5.0	5.2	4.2	4.3	3.8	2.9	3.6	3.5	3.6	3.8
Average annual	6.8	6.6	6.5	6.4	6.5	7.7	8.3	8.2	7.4	7.8	7.4	6.9
Three months annualised	5.1	7.4	7.0	6.6	14.7	15.4	-5.1	-3.1	12.6	6.7	13.7	17.6

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

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



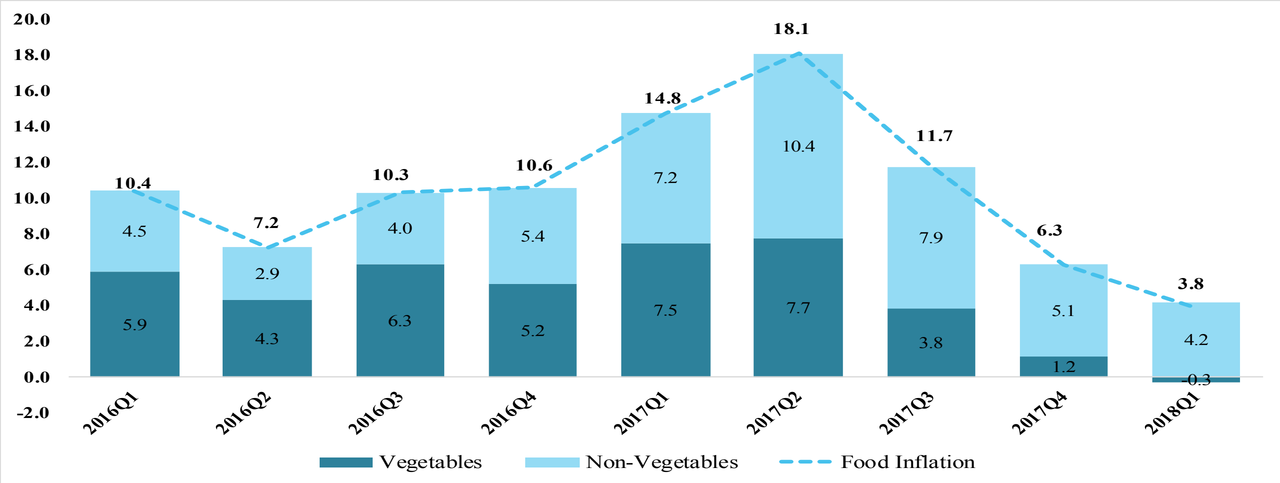
Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

In line with the above inflation outcomes, the contributions of food inflation to overall inflation declined to 1.9 percentage points from 3.1 percentage points in the fourth quarter of 2017, while that of NFNF increased to 1.0 percentage points from 0.8 percentage points over the same period. However, the contribution of fuel inflation to overall inflation increased to 1.6 percentage points from 1.1 percentage points (**Chart 1.1**).

Food inflation

Food inflation declined further to 3.9 percent in the first quarter of 2018 from 6.3 percent in the fourth quarter of 2017, the lowest since the second quarter of 2013, largely driven by decline in food prices associated with the abundant supply owing to favourable weather conditions. Prices of fast growing fresh produce such as vegetables and other staples such as milk, maize and sugar declined significantly

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



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

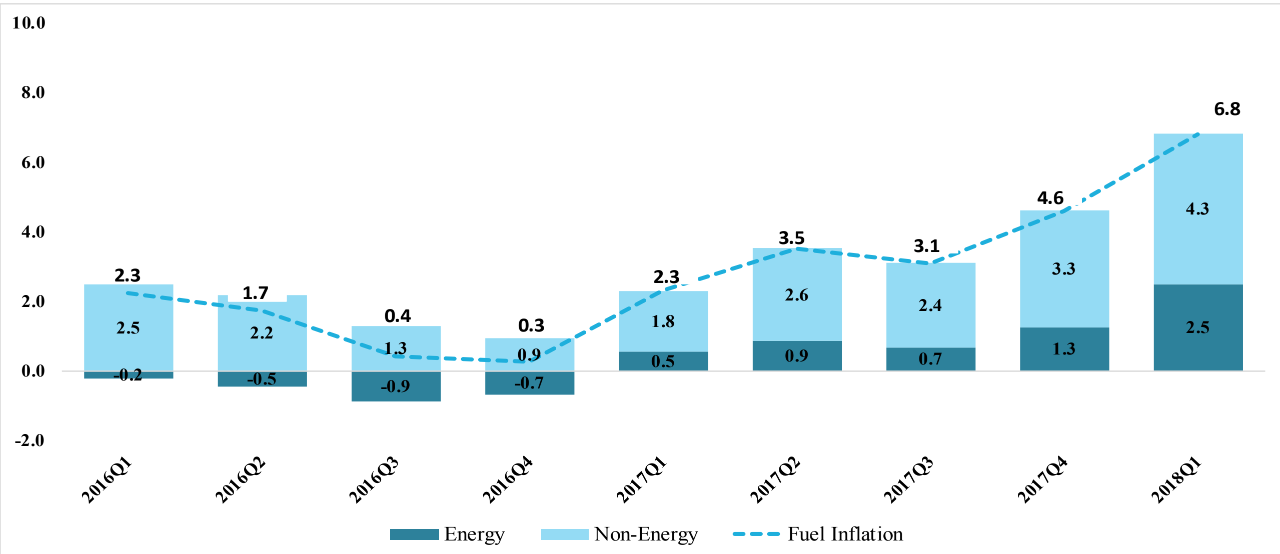
during the period under review. Consequently, the contribution of vegetables to food inflation declined further to negative 0.3 percentage points in this quarter from 1.2 percentage points in the previous quarter, the lowest since the first quarter of 2013 (**Chart 1.2**). In addition, the contribution of non-vegetable food items declined to 4.2 percentage points in the first quarter of 2018 from 5.1 percentage points in the fourth quarter of 2017.

Fuel Inflation

Fuel inflation increased significantly to 6.8 percent in the first quarter of 2018 from 4.6percent in the fourth quarter of 2017, the highest since the fourth quarter of 2014. The increase was largely on account of rising domestic and international energy prices (**Chart 1.3**). The contribution of energy items to fuel inflation increased to 2.5 percentage points from 1.3 percentage points in the previous quarter, reflecting increasing domestic prices of petrol, diesel, and Liquefied Petroleum Gas (LPG) in line with the rising international oil prices. In addition, the contribution of the non-energy items in the fuel inflation category to fuel inflation increased by 100 basis points to 4.3 percentage points in the first quarter of 2018 from 3.3 percentage points in the fourth quarter of 2017.

Pressure on fuel inflation in the first quarter of 2018 was mainly attributed to domestic energy prices as the price of charcoal accelerated following the Government ban on illegal logging and charcoal burning in March 2018. Consequently, contribution of charcoal to fuel inflation increased significantly to 1.2 percentage points in the first quarter of 2018 from 0.3 percentage points in the fourth quarter of 2017. In addition, the contribution of electricity to fuel inflation increased slightly to 0.6 percentage points from 0.5 percentage points over the same period, arising from elevated electricity cost adjustments, which increased

Chart 1.3: Contribution of Key Items to Fuel Inflation



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

to KSh.19.0 per Kilowatt hour (KwH) from KSh.16.3 per KwH in the fourth quarter of 2017. The increase was mainly on account of elevated fuel cost charges, which increased to KSh.14.2 per KwH from KSh.12.1 per KwH over the same period.

Non-Food Non-Fuel (NFNF) Inflation

Non-Food Non-Fuel (NFNF) inflation increased in the first quarter of 2018 to 3.6 percent from 2.9 percent in previous quarter, which remained below the mid-point of the Government's medium term target of 5 percent (**Table 1.2**). The increase in NFNF inflation was reflected across all the categories, except the 'Alcoholic beverages, tobacco & narcotics' and the 'Health' categories, which recorded marginal declines during the period under review.

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	Communi cation	Recreation & Culture	Education	Miscellaneous Goods & Services	Non-Food Non-Fuel Inflation
2017	Q1	3.2	4.2	3.0	3.1	0.6	2.1	2.9	3.5	**4.2**
	Q2	3.4	4.0	3.3	3.0	0.1	1.8	2.8	3.9	**4.3**
	Q3	3.0	3.8	3.2	3.1	0.3	1.2	2.9	3.6	**3.8**
	Q4	3.0	2.9	3.2	4.1	0.5	1.2	3.2	3.5	**2.9**
2018	Q1	2.9	3.8	4.1	3.6	0.7	1.6	5.2	4.4	**3.6**
	Jan	3.0	3.6	3.6	4.3	0.6	1.7	5.4	4.1	**3.5**
	Feb	3.2	3.8	4.3	3.3	0.8	1.7	5.1	4.6	**3.7**
	Mar	2.6	3.9	4.3	3.3	0.8	1.4	5.1	4.6	**3.6**

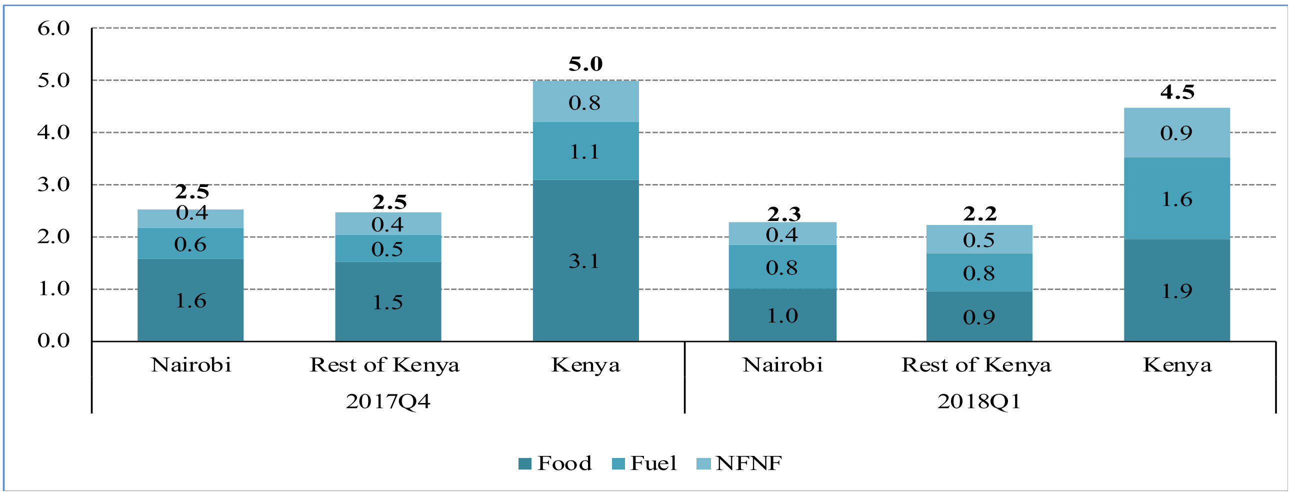
Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

Overall Inflation across Regions

Inflation in Nairobi declined to 5.8 percent in the first quarter of 2018 from 6.0 percent in the fourth quarter of 2017, largely on account of declining food inflation, whose contribution to inflation in this region declined to 1.0 percentage points from 1.6 percentage points in the previous quarter. However, the contribution of fuel to inflation in the region increased to 0.8 percentage points from 0.6 percentage points in the previous quarter. Meanwhile, the contribution of NFNF stabilized at 0.4 percentage points in the first quarter of 2018 (**Chart 1.4**).

In the Rest of Kenya, inflation declined to 3.6 percent in the first quarter of 2018 from 4.3 percent in the fourth quarter of 2017, reflecting the decline of food inflation, whose contribution decreased to 0.9 percentage points from 1.5 percentage points in the fourth quarter of 2017. However, the contribution of fuel to inflation in the region increased to 0.8 percentage points from 0.5 percentage points, while the contribution of NFNF increased marginally to 0.5 percentage points from 0.4 percentage points, respectively.
Overall, the contribution of the Nairobi region to overall inflation in Kenya declined to 2.3 percentage points from 2.5 percentage points, while that of the Rest of Kenya declined to 2.2 percentage points from 2.5 percentage points.

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



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

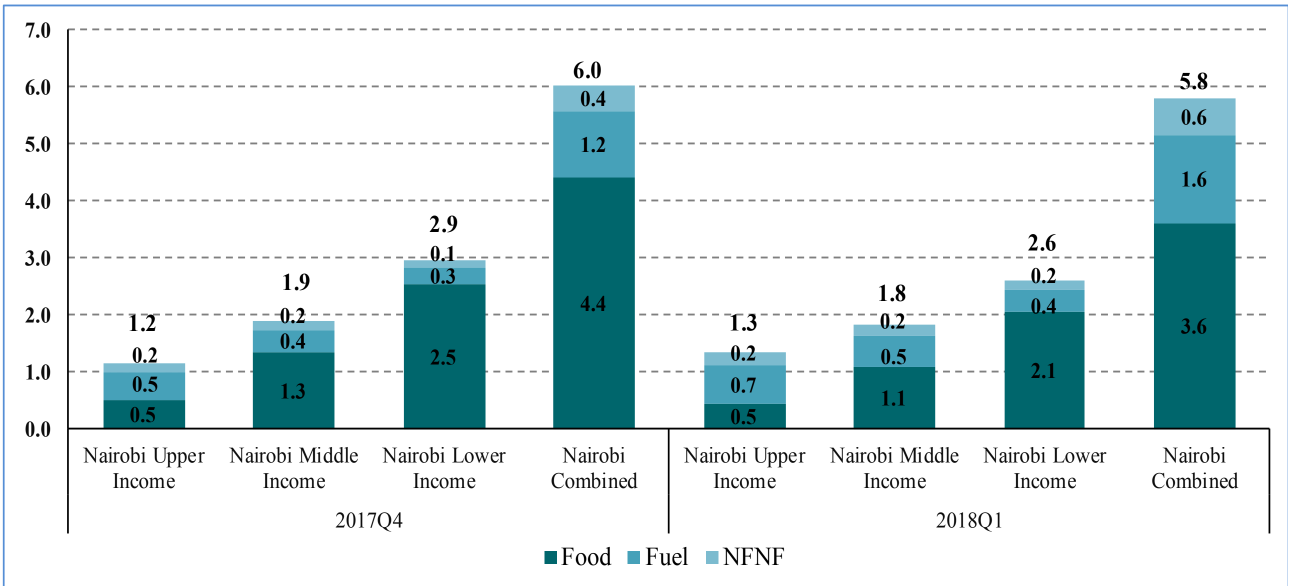
Overall Inflation across Income Groups in Nairobi

Inflation in Nairobi declined to 5.8 percent in the first quarter of 2018 from 6.0 percent in the fourth quarter of 2017. The decline was reflected in inflation for the lower income and middle income groups. Inflation in the lower income group declined to 5.9 percent from 6.2 percent in the previous quarter, largely on account of declining food inflation. However, the contribution of fuel and NFNF to inflation for lower income group increased marginally by 10 basis points each during the review period.

Inflation in the middle income group declined to 5.8 percent from 6.0 percent in the previous quarter on account of food inflation, whose contribution to inflation declined to 1.1 percentage points from 1.3 percentage points. The contribution of fuel to inflation increased marginally, while the contribution of NFNF stabilized in the first quarter of 2018 compared to the previous quarter.

Contrary to the developments in the lower and middle income groups, inflation in the upper income group increased to 4.1 percent in the first quarter of 2018, from 3.0 percent in the fourth quarter of 2017. The increase was mainly due to fuel inflation, whose contribution to overall inflation in this category increased to 0.7 percentage points from 0.5 percentage points in the fourth quarter of 2017 (**Chart 1.5**).

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

Monetary aggregates and its components

Growth in broad money supply (M3) slowed down by 0.2 percent in the first quarter of 2018 from 0.8 percent in the fourth quarter of 2017, reflecting deceleration in the rate of increase of demand deposits and foreign currency deposits at the Central Bank of Kenya. The decline in growth of demand deposits and foreign currency deposits was mainly in the corporate sector, attributed to their increased appetite for investment in government securities. Meanwhile, the household sector deposit holdings increased in the first quarter of 2018 as currency outside banks declined after the seasonal end of year festivities. Other deposits at the Central Bank increased in the first quarter of 2018 largely reflecting increased County Governments deposits on account of transfers from the National Government (**Tables 2.1 and 2.2**).

On a 12-month basis, money supply, M3 growth decelerated to 5.9 per cent in March 2018 from 8.9 percent in December 2017, largely reflecting moderation in growth of household and corporate deposits (**Chart 2.1**).

Table 2.1: Monetary Aggregates

	END MONTH LEVEL					QUARTERLY GROWTH RATES (%)					QUARTERLY CHANGES (KSH BN)				
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
COMPONENTS OF M3															
1. Money supply, M1 (1.1+1.2+1.3)	**1317.2**	**1391.3**	**1382.7**	**1397.3**	**1372.8**	**0.5**	**5.6**	**-0.6**	**1.1**	**-1.7**	**7.2**	**74.1**	**-8.6**	**14.6**	**-24.4**
1.1 Currency outside banks	200.6	206.7	208.9	225.1	214.1	-4.2	3.0	1.0	7.8	-4.9	-8.9	6.1	2.1	16.2	-11.0
1.2 Demand deposits	1062.7	1102.9	1113.7	1130.4	1093.9	1.7	3.8	1.0	1.5	-3.2	17.7	40.2	10.8	16.7	-36.5
1.3 Other deposits at CBK 1/	53.5	81.2	59.7	41.4	64.5	-3.0	51.9	-26.5	-30.7	55.9	-1.6	27.7	-21.5	-18.3	23.2
2. Money supply, M2 (1+2.1)	**2412.1**	**2480.5**	**2515.1**	**2538.2**	**2547.3**	**2.2**	**2.8**	**1.4**	**0.9**	**0.4**	**51.9**	**68.4**	**34.6**	**23.1**	**9.1**
2.1 Time and saving deposits	1094.9	1089.2	1132.4	1140.9	1174.5	4.3	-0.5	4.0	0.8	2.9	44.7	-5.7	43.2	8.5	33.6
3. Money supply, M3 (2+3.1)	**2846.6**	**2936.1**	**2986.4**	**3010.9**	**3015.7**	**3.0**	**3.1**	**1.7**	**0.8**	**0.2**	**82.1**	**89.5**	**50.2**	**24.6**	**4.7**
3.1 Foreign Currency Deposits	434.5	455.6	471.27	472.7	468.4	7.5	4.8	3.4	0.3	-0.9	30.2	21.1	15.7	1.5	-4.4
SOURCES OF M3															
1. Net foreign assets 2/	**603.0**	**644.1**	**611.6**	**517.9**	**699.2**	**21.8**	**6.8**	**-5.0**	**-15.3**	**3.5**	**107.8**	**41.1**	**-32.5**	**-93.8**	**181.3**
Central Bank	697.8	738.3	694.6	627.1	803.3	12.3	5.8	-5.9	-9.7	2.8	76.2	40.5	-43.7	-67.5	176.2
Banking Institutions	-94.8	-94.2	-83.0	-109.3	-104.1	-25.0	-0.7	-11.9	31.6	-0.5	31.6	0.6	11.2	-26.2	5.1
2. Net domestic assets (2.1+2.2)	**2243.7**	**2292.0**	**2374.7**	**2493.1**	**2316.5**	**-1.1**	**2.2**	**3.6**	**5.0**	**-0.7**	**-25.7**	**48.3**	**82.7**	**118.3**	**-176.6**
2.1 Domestic credit	**2952.6**	**3002.2**	**3069.7**	**3198.3**	**3046.3**	**-0.7**	**1.7**	**2.2**	**4.2**	**-0.5**	**-20.6**	**49.6**	**67.4**	**128.6**	**-151.9**
2.1.1 Government (net)	583.5	646.2	674.3	755.7	624.9	-1.6	10.8	4.3	12.1	-1.7	-9.3	62.8	28.1	81.4	-130.8
2.1.2 Private sector	2263.2	2249.1	2281.6	2330.2	2308.7	-0.5	-0.6	1.4	2.1	-0.1	-12.5	-14.0	32.5	48.6	-21.5
2.1.3 Other public sector	105.9	106.9	113.7	112.4	112.7	1.2	0.9	6.4	-1.2	0.0	1.2	0.9	6.9	-1.3	0.3
2.2 Other assets net	**-708.9**	**-710.3**	**-694.9**	**-705.2**	**-729.9**	**0.7**	**0.2**	**-2.2**	**1.5**	**0.3**	**-5.1**	**-1.3**	**15.3**	**-10.3**	**-24.6**
MEMORANDUM ITEMS															
4. Overall liquidity, L (3+4.1)	**3816.7**	**3935.0**	**4012.3**	**4085.1**	**4139.5**	**2.9**	**3.1**	**2.0**	**1.8**	**1.3**	**108.0**	**118.3**	**77.4**	**72.8**	**54.4**
4.1 Non-bank holdings of government securities	970.0	998.9	1026.0	1074.2	1123.8	2.7	3.0	2.7	4.7	4.6	25.9	28.8	27.1	48.2	49.6

Source: Central Bank of Kenya

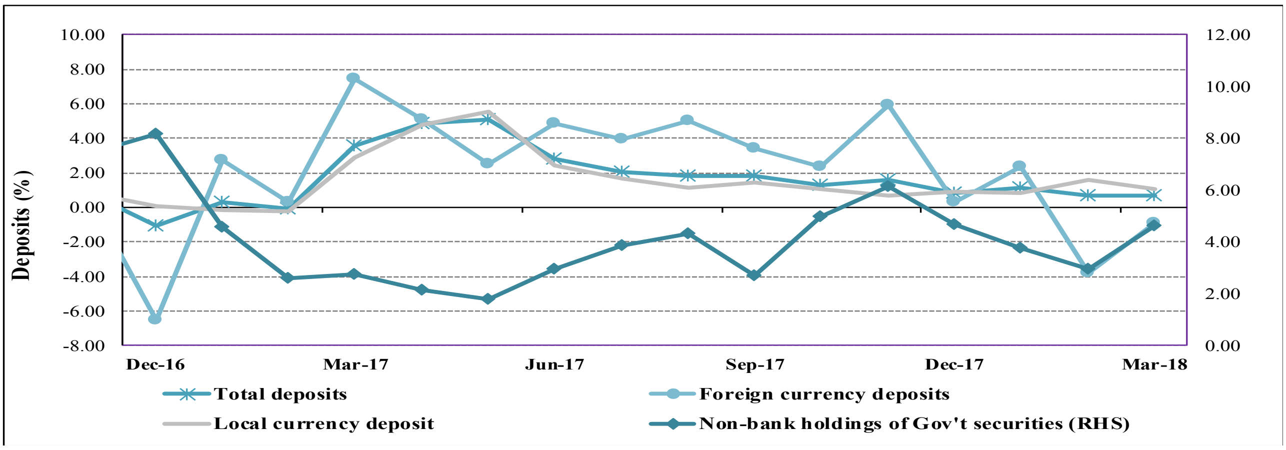
Table 2.2: Deposits Holdings of Corporates and Household Sectors

	END MONTH LEVEL					QUARTERLY GROWTH RATES (%)					QUARTERLY CHANGES (KSH BN)				
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
1. Household Sector 1/	**1245.8**	**1265.5**	**1300.4**	**1308.9**	**1330.0**	**2.2**	**1.6**	**2.8**	**0.7**	**1.6**	**27.0**	**19.7**	**34.9**	**8.5**	**21.2**
1.1 Demand Deposits	543.5	546.9	573.2	566.7	568.3	3.6	0.6	4.8	-1.1	0.3	19.1	3.5	26.3	-6.5	1.6
1.2 Time and Saving Deposits	567.1	580.1	590.6	601.6	616.6	0.1	2.3	1.8	1.9	2.5	0.6	13.0	10.6	11.0	14.9
1.3 Foreign Currency Deposits	135.3	138.5	136.5	140.5	145.2	5.7	2.4	-1.4	2.9	3.3	7.3	3.2	-2.0	4.0	4.7
2. Corporate Sector	**1332.5**	**1373.0**	**1408.4**	**1427.9**	**1398.9**	**5.0**	**3.0**	**2.6**	**1.4**	**-2.0**	**63.5**	**40.4**	**35.4**	**19.5**	**-29.0**
2.1 Time and saving deposits	508.0	549.2	534.4	558.6	519.9	-0.5	8.1	-2.7	4.5	-6.9	-2.6	41.2	-14.7	24.1	-38.7
2.2 Time and Saving Deposits	525.6	507.1	539.8	537.7	556.4	8.9	-3.5	6.4	-0.4	3.5	43.1	-18.5	32.7	-2.1	18.7
2.3 Foreign Currency Deposits	298.9	316.7	334.1	331.6	322.6	8.4	5.9	5.5	-0.7	-2.7	23.1	17.8	17.5	-2.5	-9.0

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

Source: Central Bank of Kenya

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



Source: Central Bank of Kenya

Sources of Broad Money

The primary source of deceleration in M3 growth in the first quarter of 2018 was due to the decrease in Net Domestic Assets (NDA) of the banking system, largely reflecting decrease in net credit to government resulting from increased government deposit holdings at the Central Bank of Kenya (CBK) following the Eurobond issuance as well as quarterly tax collections (**Table 2.1**). The contribution of NDA to the decrease of M3 was partly offset by an increase in the Net Foreign Assets (NFA) of the banking system. The Net Foreign Assets of the CBK increased largely due to inflows related to the Eurobond issuance in March 2018. Similarly, Commercial Banks' NFA increased in the first quarter of 2018 largely on account of increased deposit holdings in non-resident banks and lending to non-residents.

Developments in Domestic Credit

Domestic credit decreased by 4.8 per cent in the first quarter of 2018 compared to an increase of 4.2 per cent in the fourth quarter of 2017, largely reflecting reduced net credit flows to government on account of increased government deposits, resulting from the proceeds of Eurobond issuance. Similarly, growth in banks net credit to the private sector declined by 0.9 percent in the first quarter of 2018 compared with an increase of 2.1 percent in the previous quarter, largely reflecting net repayments of loans in the transport and communications sector. The slowdown in credit growth was more pronounced in the corporate sector compared with the household sector. However, strong lending was recorded by building and construction, finance and insurance, business services and private households sectors (**Table 2.3 and 2.4**). Meanwhile, commercial banks' net lending to the government improved, largely reflecting their increased investment in government securities.

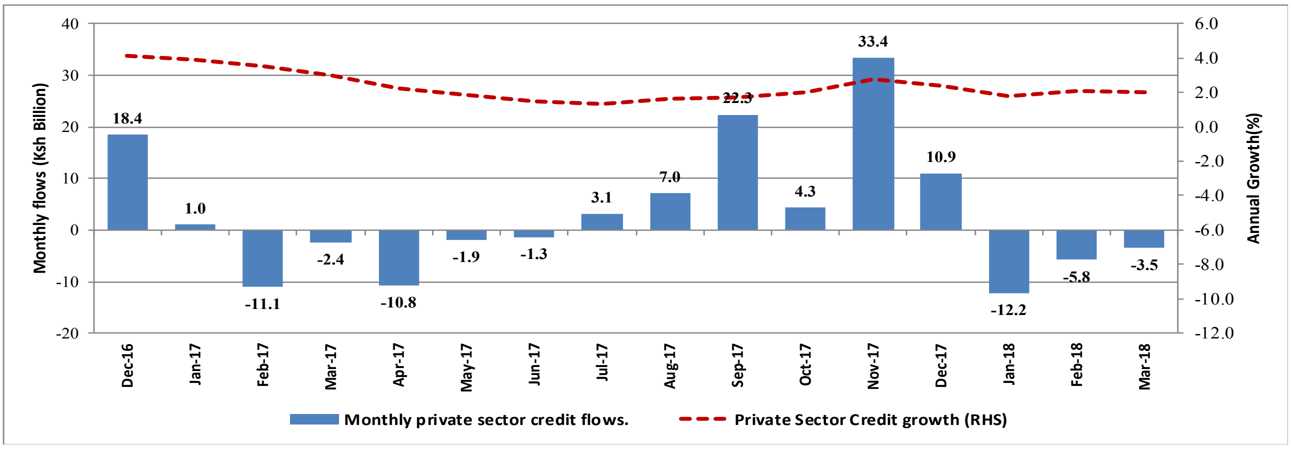
On 12-month basis, private sector credit grew by 2.0 percent in March 2018, lower than the 2.4 percent in December 2017 (**Chart 2.2**). The slowdown in credit growth was largely due to substantial loan repayments in the transport and communication sector as well as tightened banking sector's credit standards, increased alternative funding sources such as joint ventures in real estate and elevated threshold of risk attributed to the interest rate capping law.

Table 2.3: Banking Sector Net Domestic Credit

	END MONTH LEVEL					QUARTERLY GROWTH RATES (%)					QUARTERLY CHANGES (KSH BN)				
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
1. Credit to Government	**583.5**	**646.2**	**674.3**	**755.7**	**624.9**	**-1.6**	**10.8**	**4.3**	**12.1**	**-17.3**	**-9.3**	**62.8**	**28.1**	**81.4**	**-130.8**
Central Bank	-117.2	-178.9	-167.6	-67.0	-256.9	2.9	52.6	-6.3	-60.0	283.6	-3.3	-61.7	11.3	100.6	-189.9
Commercial Banks & NBFIs	700.7	825.1	841.9	822.7	881.8	-0.8	17.8	2.0	-2.3	7.2	-6.0	124.4	16.7	-19.2	59.2
2. Credit to other public sector	**105.9**	**106.9**	**113.7**	**112.4**	**112.7**	**1.2**	**0.9**	**6.4**	**-1.2**	**0.3**	**1.2**	**0.9**	**6.9**	**-1.3**	**0.3**
Local government	3.8	3.9	4.2	4.0	4.2	1.1	1.2	8.1	-5.5	6.4	0.0	0.0	0.3	-0.2	0.3
Parastatals	102.1	103.0	109.5	108.4	108.5	1.2	0.9	6.3	-1.0	0.1	1.2	0.9	6.5	-1.1	0.1
3. Credit to private sector	**2,263.2**	**2,249.1**	**2,281.6**	**2,330.2**	**2,308.7**	**-0.5**	**-0.6**	**1.4**	**2.1**	**-0.9**	**-12.5**	**-14.0**	**32.5**	**48.6**	**-21.5**
Agriculture	86.8	85.5	88.8	83.0	81.2	-3.6	-1.6	3.9	-6.5	-2.2	-3.3	-1.4	3.3	-5.8	-1.8
Manufacturing	278.6	282.8	295.6	310.6	310.0	1.3	1.5	4.5	5.1	-0.2	3.6	4.1	12.8	15.1	-0.6
Trade	382.0	388.2	408.7	414.9	402.6	0.4	1.6	5.3	1.5	-3.0	1.3	6.2	20.5	6.2	-12.3
Building and construction	101.4	100.8	106.7	109.9	114.2	-3.3	-0.6	5.9	2.9	3.9	-3.5	-0.6	5.9	3.1	4.3
Transport & communications	196.8	185.5	182.7	186.7	159.5	-2.2	-5.8	-1.5	2.2	-14.6	-4.5	-11.3	-2.8	4.1	-27.2
Finance & insurance	77.3	84.9	83.5	81.6	86.2	-9.3	9.9	-1.7	-2.3	5.7	-7.9	7.6	-1.4	-1.9	4.6
Real estate	351.1	355.7	358.8	366.5	366.6	4.1	1.3	0.9	2.1	0.0	13.7	4.7	3.1	7.7	0.1
Mining and quarrying	14.9	14.7	16.0	15.9	14.5	-11.0	-1.8	9.1	-0.8	-8.8	-1.9	-0.3	1.3	-0.1	-1.4
Private households	394.8	386.7	384.0	387.1	392.0	0.4	-2.0	-0.7	0.8	1.3	1.7	-8.0	-2.8	3.1	4.9
Consumer durables	172.5	168.2	170.9	176.4	180.6	-1.6	-2.5	1.6	3.2	2.4	-2.8	-4.3	2.7	5.5	4.2
Business services	145.7	136.7	134.6	133.8	144.4	-1.0	-6.2	-1.5	-0.6	7.9	-1.4	-9.0	-2.0	-0.8	10.6
Other activities	61.3	59.5	51.4	63.7	56.8	-11.1	-2.9	-13.6	24.1	-10.9	-7.7	-1.8	-8.1	12.4	-6.9
4. TOTAL (1+2+3)	**2,952.6**	**3,002.2**	**3,069.7**	**3,198.3**	**3,046.3**	**-0.7**	**1.7**	**2.2**	**4.2**	**-4.8**	**-20.6**	**49.6**	**67.4**	**128.6**	**-151.9**

Source: Central Bank of Kenya

Chart 2.2: Private Sector Credit Growth



Source: Central Bank of Kenya

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

	END MONTH LEVEL					QUARTERLY GROWTH RATES (%)					QUARTERLY CHANGES (KSH BN)				
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Gross Household Sector Loans [1]/	652.10	656.73	665.39	679.80	686.80	(3.25)	0.71	1.32	2.20	1.00	(21.92)	4.63	8.65	14.40	7.00
Private Sector Corporate Sector Loans	1,645.54	1,632.17	1,660.39	1,692.30	1,666.60	1.03	(0.81)	1.73	1.90	(1.50)	16.84	(13.38)	28.22	31.90	(25.70)
Gross Loans to Domestic Private Sector	**2,297.65**	**2,288.90**	**2,325.77**	**2,372.10**	**2,353.40**	**(0.22)**	**(0.38)**	**1.61**	**2.00**	**(0.80)**	**(5.08)**	**(8.75)**	**36.87**	**46.30**	**(18.70)**

Source: Central Bank of Kenya

Reserve Money

Growth in reserve money (RM), which comprises currency held by the non–bank public and commercial banks reserves declined by 4.7 percent in the first quarter of 2018 compared to an increase of 3.4 percent in the previous quarter. The decline was reflected in both bank reserves and currency outside banks (**Table 2.5**).

The primary source of the decline in reserve money was a decline in NDA of CBK, largely reflecting increased deposits by the government resulting from proceeds of Eurobond issuance as well as quarterly tax collections. Central Bank's net lending to commercial banks was relatively stable at KSh.33.1 billion in the first quarter of 2018 compared to KSh.28.3 billion in the fourth quarter of 2017, partly reflecting stability in the money market liquidity conditions. Meanwhile, NFA of the CBK, increased substantially in the first quarter of 2018, largely reflecting the proceeds of Eurobond issuance.

Table 2.5: Reserve Money and its Sources

	END MONTH LEVEL					QUARTERLY GROWTH RATES (%)					QUARTERLY CHANGES (KSh BN)				
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
1. Net Foreign Assets	697.8	738.3	694.6	627.1	803.3	12.3	5.8	-43.7	-9.7	28.1	76.2	40.5	-43.7	-67.5	176.2
2. Net Domestic Assets	-282.9	-338.7	-270.1	-188.4	-385.1	34.4	19.7	68.6	-30.3	104.5	-72.4	-55.9	68.6	81.8	-196.8
2.1 Government Borrowing (net)	-117.2	-178.9	-167.6	-67.0	-256.9	2.9	52.6	11.3	-60.0	283.6	-3.3	-61.7	11.3	100.6	-189.9
2.2 Commercial banks (net)	-18.4	23.6	63.2	28.3	33.1	-142.5	-228.5	39.6	-56.1	16.9	-61.6	42.0	39.6	-36.2	4.8
2.3 Other Domestic Assets (net)	-150.7	-186.8	-169.2	-153.1	-164.7	5.2	24.0	17.6	-10.2	7.5	-7.5	-36.2	17.6	17.4	-11.5
3. Reserve Money	414.9	399.6	424.5	438.8	418.2	0.9	-3.7	24.9	3.4	-4.7	3.8	-15.3	24.9	14.3	-20.5
3.1 Currency outside banks	200.6	206.7	208.9	225.1	214.1	-4.2	3.0	2.1	7.8	-4.9	-8.9	6.1	2.1	16.2	-11.0
3.2 Bank reserves	214.3	192.9	215.7	213.7	204.2	6.3	-10.0	22.8	-0.9	-4.5	12.7	-21.4	22.8	-2.0	-9.5

Source: Central Bank of Kenya

Interest Rates

Central Bank Rate

The Monetary Policy Committee (MPC), while noting the risk of perverse outcomes, reduced the Central Bank Rate (CBR) from 10 percent to 9.50 percent at its meetings in March 2018 in order to support economic activity (**Table 2.6**). The Committee had concluded that inflationary expectations were well anchored within the government target range, considering the increased optimism for growth prospects in the economy, and that economic output was below its potential.

Interbank rate

The interbank rate decreased to an average of 5.41 percent in the first quarter of 2018 compared to an average of 7.99 percent in the fourth quarter of 2017 (**Table 2.6**). This decrease partly reflects improved liquidity conditions in the money market.

Treasury bill rates

The interest rates on government securities were stable in first 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 8.03 percent in the first quarter of 2018 compared to 8.04 percent in the previous quarter. The average 182-day Treasury bill rate increased slightly to 10.48 percent in the first quarter of 2018, from 10.44 percent in the fourth quarter of 2017 (**Table 2.6**).

Lending and Deposit Rates

Since the introduction of interest rate caps in September 2016, Commercial banks' lending interest rates have remained relatively stable through March 2018. The review of the CBR in March, 2018 to 9.50 percent from 10.00 percent resulted in the weighted lending rate declining by 15 basis points. This is reflected in all lending categories. Deposit rates also declined albeit marginally resulting in the spread between lending rates and deposit rates narrowing marginally from 5.41 percentage points to 5.33 percentage points. Since October 2017, the spread between lending and deposit rates has been narrowing.

Table 2.6: Interest Rates (%)

	2016				2017														
	Mar	Jun	Sep	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
91-day Treasury bill rate	8.72	7.25	8.06	8.44	8.58	8.64	8.69	8.77	8.73	8.42	8.22	8.17	8.13	8.09	8.01	8.01	8.04	8.03	8.02
182-day Treasury bill rate	10.83	9.56	10.85	10.55	10.50	10.53	10.53	-	10.41	10.38	10.32	10.32	10.32	10.33	10.47	10.53	10.64	10.42	10.39
Interbank rate	4.10	4.56	4.47	5.55	7.70	6.41	4.46	5.34	4.93	3.99	6.99	8.10	5.52	7.85	8.86	7.27	6.21	5.12	4.90
Repo rate	4.31	10.04	0.00	0.00	9.95	9.88	7.23	5.32	5.29	4.13	8.29	8.90	7.24	0.00	9.21	7.75	8.75	7.63	0.00
Reverse Repo rate	11.63	10.59	10.36	10.04	10.02	10.01	10.04	10.02	10.01	10.05	10.25	10.29	10.12	10.11	10.10	10.10	10.02	10.05	9.95
Central Bank Rate (CBR)	11.50	10.50	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	9.50
Average lending rate (1)	**17.79**	**18.15**	**13.84**	**13.69**	**13.66**	**13.69**	**13.61**	**13.61**	**13.71**	**13.66**	**13.70**	**13.65**	**13.69**	**13.71**	**13.68**	**13.64**	**13.65**	**13.68**	**13.49**
Overdraft rate	18.06	18.04	13.60	13.49	13.30	13.32	13.29	13.30	13.44	13.38	13.65	13.66	13.65	13.68	13.60	13.54	13.61	13.75	13.40
1-5years	18.00	18.63	13.95	13.86	13.88	13.89	13.81	13.82	13.85	13.80	13.78	13.86	13.87	13.88	13.86	13.83	13.84	13.83	13.67
Over 5years	17.31	17.64	13.83	13.59	13.60	13.66	13.55	13.52	13.68	13.64	13.62	13.39	13.51	13.51	13.51	13.46	13.45	13.45	13.31
Average deposit rate (2)	**7.17**	**6.78**	**6.94**	**7.33**	**7.20**	**7.65**	**7.12**	**6.97**	**7.07**	**7.15**	**7.72**	**7.67**	**7.66**	**8.01**	**8.07**	**8.22**	**8.26**	**8.25**	**8.16**
0-3months	9.78	8.80	8.21	7.16	7.19	7.32	7.28	7.22	7.25	7.76	7.83	7.80	7.71	8.17	8.19	8.43	8.52	8.50	8.48
Over 3 months deposit	10.41	9.94	8.82	8.45	8.33	8.84	8.18	8.01	8.11	8.04	8.05	8.13	8.02	8.17	8.35	8.39	8.35	8.39	8.26
Savings deposits	1.32	1.60	3.78	6.37	6.09	6.81	5.89	5.67	5.85	5.63	6.40	5.94	6.43	6.92	6.93	6.91	6.97	7.01	6.85
Spread (1-2)	**10.62**	**11.40**	**6.93**	**6.36**	**6.46**	**6.04**	**6.49**	**6.64**	**6.64**	**6.52**	**5.98**	**5.98**	**6.04**	**5.70**	**5.61**	**5.41**	**5.39**	**5.42**	**5.33**

Source: Central Bank of Kenya

Chapter 3
The Real Sector

The economy remained resilient and grew by 4.9 percent in 2017 despite the unfavourable weather conditions that undermined agricultural production and the impact of the prolonged electioneering period on the economy. Economic growth was, however, lower than 5.9 percent recorded in 2016. Growth was mainly driven by the services sectors, as reflected in the improved performance of Wholesale and Retail, Trade, Real Estate, Information and Communication, Accommodation and Restaurant, Public Administration, Education, and Health sectors. However, growth in the Agriculture sector slowed down significantly to 1.6 percent in 2017 compared to 4.7 percent in 2016, owing to unfavourable weather conditions. In addition, growth in the Manufacturing sector decelerated to 0.2 percent from 2.7 percent in 2016, mainly on account of reduced activity in agro-processing due to constrained supply of agricultural raw materials and uncertainties relating to the general elections (**Table 3.1**).

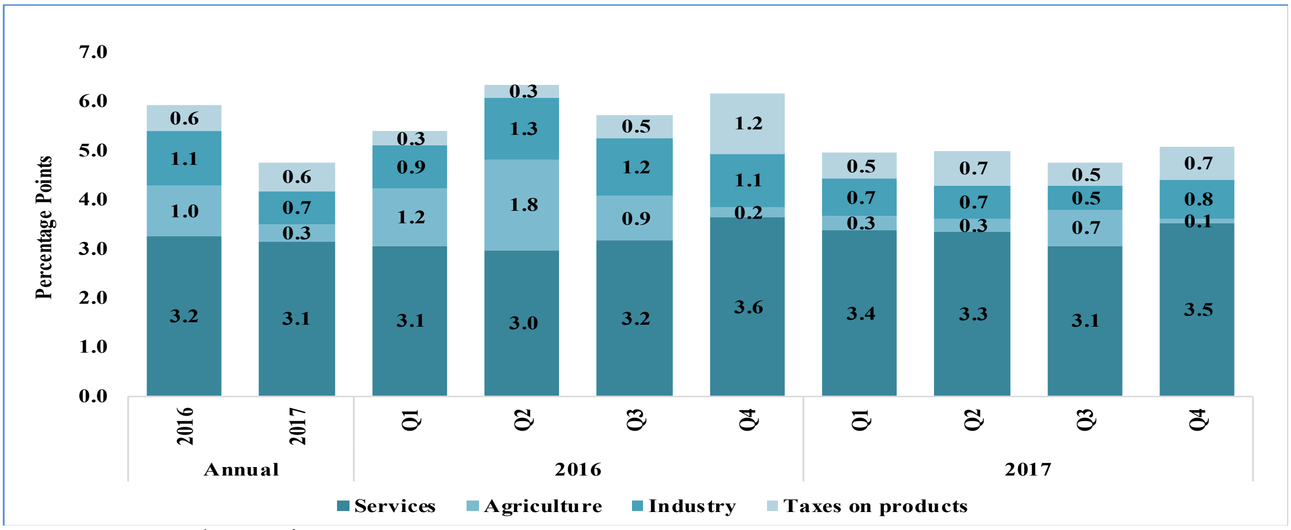
In the fourth quarter of 2017, the economy recorded 5.0 percent growth – an improvement from 4.7 percent recorded in the third quarter of 2017, but lower than 6.1 percent in the fourth quarter of 2016. Growth in the fourth quarter of 2017 was largely supported by improved performance of Construction, Electricity and Water Supply, Transport and Storage, Financial and Insurance, Public Administration, and Education sectors. However, key sectors such as Agriculture and Manufacturing recorded subdued performance during the quarter under review, which constrained overall economic growth (**Table 3.1**).

Table 3.1: Gross Domestic Product (GDP) Growth by activity(%)

	Annual		2016				2017			
	2016	2017	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1. Agriculture	**4.7**	**1.6**	**4.4**	**7.6**	**4.7**	**1.3**	**1.2**	**1.1**	**3.8**	**0.5**
2. Non-Agriculture (o/w)	**6.2**	**5.8**	**5.7**	**5.9**	**6.0**	**7.2**	**6.2**	**6.1**	**4.9**	**6.0**
2.1 Industry	**5.7**	**3.6**	**4.7**	**6.5**	**6.0**	**5.6**	**4.0**	**3.6**	**2.5**	**4.2**
Mining & Quarrying	9.5	6.1	6.6	10.6	9.8	11.2	7.3	5.6	5.8	5.7
Manufacturing	2.7	0.2	1.2	4.6	3.5	1.4	1.2	-0.1	0.01	-0.4
Construction	9.8	8.6	10.6	11.8	6.7	4.3	6.1	6.0	4.5	5.8
Electricity & water supply	8.3	5.6	9.2	7.2	9.8	13.0	8.2	9.5	5.6	10.9
2.2 Services	**6.5**	**6.2**	**6.9**	**6.5**	**6.4**	**7.1**	**7.4**	**7.2**	**6.2**	**6.8**
Wholesale & Retail Trade	3.4	5.7	3.5	2.1	3.7	4.4	4.8	5.4	6.2	6.2
Accommodation & restaurant	13.3	14.7	7.6	13.5	13.4	18.1	16.6	15.6	15.5	12.1
Transport & Storage	7.8	7.3	8.8	6.9	5.5	10.1	9.4	8.0	5.2	7.0
Information & Communication	9.7	11.0	10.6	8.9	8.8	10.2	12.5	10.8	10.7	10.1
Financial & Insurance	6.7	3.1	8.8	8.5	6.7	2.9	5.3	3.5	1.4	2.3
Public administration	4.8	5.3	5.4	6.2	4.5	2.9	4.4	5.3	5.1	6.3
Professional, Administration & Support Services	5.0	4.0	3.7	6.1	4.6	5.4	3.5	5.9	2.6	4.2
Real estate	8.8	6.1	9.4	8.7	8.4	8.5	7.2	6.9	6.0	4.6
Education	5.4	6.1	6.2	5.7	5.7	3.9	6.1	5.8	5.4	7.0
Health	4.8	6.0	4.1	5.2	5.9	3.8	4.7	6.7	6.1	6.2
Other services	4.1	5.0	4.0	3.8	4.3	4.4	6.6	5.2	4.5	3.7
FISIM	2.1	-5.7	9.8	5.9	0.4	-6.6	-1.3	-7.2	-6.3	-8.3
2.3 Taxes on products	**4.8**	**5.1**	**2.8**	**2.5**	**4.0**	**9.9**	**5.2**	**6.3**	**4.0**	**5.3**
Real GDP Growth	**5.9**	**4.9**	**5.4**	**6.3**	**5.7**	**6.1**	**4.9**	**4.9**	**4.7**	**5.0**

Source: Kenya National Bureau of Statistics

Chart 3.1: Contribution to Real GDP Growth (percentage points)



Source: Kenya National Bureau of Statistics

Growth was mainly driven by Service–oriented sectors, which contributed 3.5 percentage points to real GDP growth in the fourth quarter of 2017, up from 3.1 percentage points in the previous quarter. The contribution of Industry increased to 0.8 percentage points from 0.5 percentage points in the previous quarter, largely on account of increased growth in Electricity and Water Supply, and Construction sectors. However, the contribution of Agriculture to real GDP growth decelerated significantly to 0.1 percentage points from 0.7 percentage points, owing to unfavourable weather conditions (**Chart 3.1 and Table 3.2**).

Available economic indicators show mixed performance in the first quarter of 2018. Agricultural production, electricity generation and indicators in the construction sector point to improved performance. Meanwhile, indicators in manufacturing, tourist arrivals and transport show mixed performance.

Performance by Sector

Agriculture

Agriculture sector growth decelerated to 0.5 percent in the fourth quarter of 2017 from 3.8 percent in the previous quarter and 1.3 percent in the fourth quarter of 2016 (**Table 3.1**). Growth was constrained by declined production of key crops such as coffee, sugarcane, and milk in the fourth quarter of 2017 compared to the same quarter of 2016. Consequently, the sectoral contribution of agriculture to overall GDP growth decelerated to 0.1 percentage points compared to 0.7 percentage points in the previous quarter and 0.2 percentage points in the same quarter of 2016 (**Table 3.3**).

Available indicators show improved performance in the first quarter of 2018, as horticultural exports, coffee sales, and production of milk increased compared to the previous quarter.

Table 3.2 Sectoral Contribution as a Share of Real GDP

	Annual		2016				2017			
	2016	2017	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1. Agriculture	**21.9**	**21.2**	**26.5**	**24.3**	**19.2**	**17.5**	**25.6**	**23.4**	**19.0**	**16.7**
2. Non-Agriculture (o/w)	**78.1**	**78.8**	**73.5**	**75.7**	**80.8**	**82.5**	**74.4**	**76.6**	**81.0**	**83.3**
2.1 Industry	**19.2**	**19.0**	**18.6**	**19.2**	**19.7**	**19.4**	**18.4**	**19.0**	**19.2**	**19.2**
Mining & Quarrying	1.1	1.1	1.1	1.0	1.1	1.1	1.1	1.0	1.1	1.1
Manufacturing	10.2	9.8	10.2	10.4	10.3	9.9	9.9	9.9	9.9	9.4
Construction	2.5	2.5	2.4	2.7	2.6	2.4	2.5	2.7	2.6	2.5
Electricity & water supply	5.4	5.6	4.8	5.2	5.7	5.9	5.0	5.4	5.7	6.3
2.2 Services	**50.0**	**50.7**	**44.5**	**45.6**	**49.1**	**50.7**	**45.5**	**46.6**	**49.7**	**51.6**
Wholesale & Retail Trade	7.5	7.6	6.9	7.1	8.5	7.5	6.9	7.1	8.6	7.6
Accommodation & restaurant	1.1	1.2	1.2	0.8	1.1	1.5	1.3	0.9	1.2	1.6
Transport & Storage	6.9	7.0	6.0	6.6	7.3	7.7	6.2	6.8	7.4	7.8
Information & Communication	3.8	4.0	3.7	3.1	3.5	5.1	3.9	3.3	3.7	5.3
Financial & Insurance	6.2	6.1	6.1	6.1	6.5	6.3	6.1	6.0	6.3	6.1
Public administration	3.8	3.9	3.6	4.3	3.7	3.8	3.6	4.3	3.7	3.9
Professional, Administration & Support Services	2.3	2.2	2.1	2.2	2.3	2.5	2.0	2.2	2.3	2.4
Real estate	8.4	8.5	8.1	8.2	8.6	8.8	8.3	8.4	8.7	8.8
Education	6.9	7.0	6.8	6.8	7.0	7.0	6.9	6.9	7.1	7.1
Health	1.8	1.8	1.6	1.8	1.8	1.9	1.5	1.8	1.9	1.9
Other services	1.3	1.3	1.2	1.2	1.3	1.3	1.2	1.2	1.3	1.3
FISIM	-2.6	-2.3	-2.6	-2.6	-2.6	-2.6	-2.5	-2.3	-2.4	-2.3
2.3 Taxes on products	**11.4**	**11.5**	**10.4**	**10.9**	**12.1**	**12.4**	**10.4**	**11.0**	**12.0**	**12.5**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Kenya National Bureau of Statistics

Table 3.3: Sectoral Contributions to Real GDP Growth Rates

	Annual		2016				2017			
	2016	2017	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1. Agriculture	**1.0**	**0.3**	**1.2**	**1.8**	**0.9**	**0.2**	**0.3**	**0.3**	**0.7**	**0.1**
2. Non-Agriculture (o/w)	**4.8**	**4.6**	**4.2**	**4.5**	**4.8**	**5.9**	**4.6**	**4.7**	**4.0**	**5.0**
2.1 Industry	**1.1**	**0.7**	**0.9**	**1.3**	**1.2**	**1.1**	**0.7**	**0.7**	**0.5**	**0.8**
Mining & Quarrying	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Manufacturing	0.3	0.0	0.1	0.5	0.4	0.1	0.1	0.0	0.0	0.0
Construction	0.2	0.1	0.3	0.3	0.2	0.1	0.1	0.2	0.1	0.1
Electricity & water supply	0.5	0.5	0.4	0.4	0.6	0.8	0.4	0.5	0.3	0.7
2.2 Services	**3.2**	**3.1**	**3.1**	**3.0**	**3.2**	**3.6**	**3.4**	**3.3**	**3.1**	**3.5**
Wholesale & Retail Trade	0.3	0.4	0.2	0.2	0.3	0.3	0.3	0.4	0.5	0.5
Accommodation & restaurant	0.2	0.2	0.1	0.1	0.1	0.3	0.2	0.1	0.2	0.2
Transport & Storage	0.5	0.5	0.5	0.5	0.4	0.8	0.6	0.5	0.4	0.5
Information & Communication	0.4	0.4	0.4	0.3	0.3	0.5	0.5	0.4	0.4	0.5
Financial & Insurance	0.4	0.2	0.5	0.5	0.4	0.2	0.3	0.2	0.1	0.1
Public administration	0.2	0.2	0.2	0.3	0.2	0.1	0.2	0.2	0.2	0.2
Professional, Administration & Support Services	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Real estate	0.7	0.5	0.8	0.7	0.7	0.7	0.6	0.6	0.5	0.4
Education	0.4	0.4	0.4	0.4	0.4	0.3	0.4	0.4	0.4	0.5
Health	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other services	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.0
FISIM	-0.1	0.1	-0.3	-0.2	0.0	0.2	0.0	0.2	0.1	0.2
2.3 Taxes on products	**0.6**	**0.6**	**0.3**	**0.3**	**0.5**	**1.2**	**0.5**	**0.7**	**0.5**	**0.7**
Real GDP Growth	**5.9**	**4.9**	**5.4**	**6.3**	**5.7**	**6.1**	**4.9**	**4.9**	**4.7**	**5.0**

Source: Kenya National Bureau of Statistics

Table 3.4: Quarterly Performance of Key Agricultural Output Indicators

	2017				2018*			
	Quarterly				Quarterly	Monthly		
	Q1	Q2	Q3	Q4	Q1	Jan-18	Feb-18	Mar-18
Tea								
Output (Metric tonnes)	90,094	110,818	102,645	136,300	N/A	40,834	27,939	N/A
Growth (%)	*-28.69*	*23.00*	*-7.38*	*32.79*		*-14.0*	*-31.6*	
Horticulture								
Exports (Metric tonnes)	85,792	85,186	82,791	82,105	100,526	27,278	35,773	37,475
Growth (%)	*9.4*	*-0.7*	*-2.8*	*-0.8*	*22.4*	*12.2*	*31.1*	*4.8*
Coffee								
Sales (Metric tonnes)	16,731	6,202	5,546	5,250	15,857	5,112	5,832	4,913
Growth (%)	*198.1*	*-62.9*	*-10.6*	*-5.3*	*202.1*	*287.3*	*14.1*	*-15.8*
Milk								
Output (million litres)	94.6	122.2	134.0	143.0	167.7	47.9	59.4	60.3
Growth %	*-41.5*	*29.2*	*9.6*	*6.7*	*17.3*	*0.3*	*24.0*	*1.4*
Sugar Cane								
Output ('000 Metric tonnes)	1,572	786	709	1,546	N/A	640	N/A	N/A
Growth (%)	*-3.6*	*-50.0*	*-9.8*	*118.1*		*22.6*		

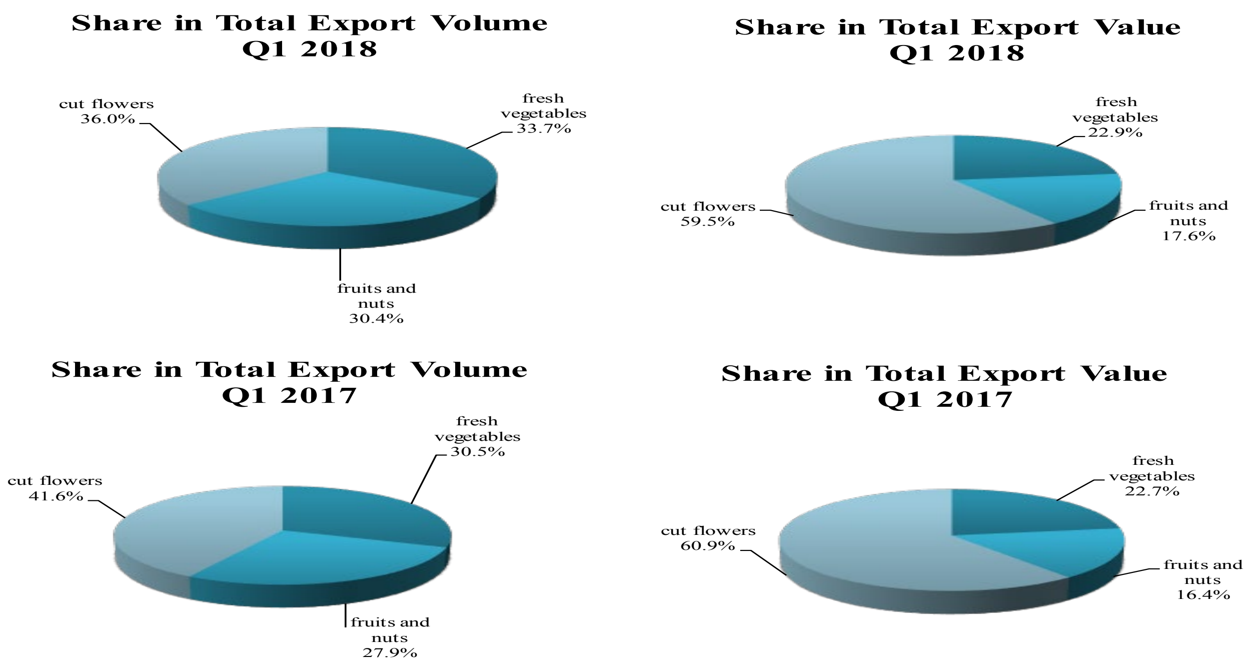
Source: Kenya Tourism Board

Tea: Tea production increased by 32.8 percent in the fourth quarter of 2017 compared to the previous quarter, and was higher by 7.9 percent compared to the same quarter of 2016, mainly supported by improved weather conditions in tea growing areas during the fourth quarter of 2017. Production was higher by 23.4 percent in the period January–February 2018 compared to a similar period in 2017. However, monthly production declined in both January and February 2018 by 14.0 percent and 31.6 percent, respectively (**Table 3.4**). Average auction price of tea per kilogram decreased by 4.1 percent in the period January–February 2018 compared to a similar period in 2017.

Coffee: Coffee sales declined by 5.3 percent in the fourth quarter of 2017 compared to the previous quarter, and were lower by 6.5 compared to the same quarter of 2016. The decline was on account of suspension of the coffee auction in October 2017 owing to insufficient quantities of coffee for auction, and recess of the Nairobi Coffee Exchange in December 2017 on account of the festive season.

However, coffee sales increased significantly by 202.1 percent in the first quarter of 2018, compared to the previous quarter, owing to increased quantity of coffee auctioned after the November–December harvest period. Monthly coffee sales increased by 287.3 percent in January 2018 following resumption of coffee auctions, and increased further by 14.1 percent in February 2018 before declining by 15.8 percent in March 2018 (**Table 3.4**). Average auction prices increased by 23.5 percent in the first quarter of 2018 compared to the previous quarter, but were lower by 7.1 percent compared to the same quarter of 2017.

Chart 3.2: Horticultural Exports



Source: Kenya Revenue Authority

Horticulture: Total exports of horticultural crops declined slightly by 0.8 percent in the fourth quarter of 2017 compared to the previous quarter, but were higher by 4.7 percent compared to a similar quarter of 2016. Exports of fruits and nuts declined in the fourth quarter of 2017 compared to the previous quarter, which more than offset the increased exports of fresh vegetables and cut flowers. In the first quarter of 2018, horticultural exports increased by 22.4 percent compared to the fourth quarter of 2017, and were higher by 17.2 percent compared to a similar quarter in 2017. The increase is attributable to higher exports of fruits, nuts, and cut flowers (**Table 3.4**).

The share of export volumes of fresh vegetables, and fruits and nuts to total horticultural exports increased to 33.7 percent and 30.4 percent, respectively, in the first quarter of 2018 from 30.5 percent and 27.9 percent, respectively, in the first quarter of 2017. However, the share of export volumes and values of cut flowers to total horticultural exports declined during the period under review. (**Chart 3.2**).

Milk: Milk intake in the formal sector increased by 17.3 percent in the first quarter of 2018 from 6.7 percent in the fourth quarter of 2017, and was higher by 22.8 percent compared to the first quarter of 2017. The improved milk output was attributed to increased pasture following improved weather conditions. Monthly production increased in all months of the quarter, with the most significant increase recorded in February 2018 at 24.0 percent (**Table 3.4**).

Sugarcane: Sugarcane production improved by 22.6 percent in January 2018 compared to December 2017, and was higher by 10.0 percent compared to January 2017. The increased production was mainly attributed to improved weather conditions (**Table 3.4**).

The Manufacturing Sector

The Manufacturing sector contracted by 0.4 percent in the fourth quarter of 2017 compared to 1.4 percent growth in the fourth quarter of 2016 (**Table 3.1**). The sector was affected by uncertainties associated with the prolonged electioneering, as well as subdued performance of agriculture, which undermined agro-based processing industries. The few indicators available point to mixed performance in the first quarter of 2018 compared to the previous quarter, as production of assembled vehicles increased, while the output of cement declined (**Table 3.5**).

Sugar production increased by 147.3 percent in the fourth quarter of 2017. Monthly production increased by 15.5 percent in January 2018. The higher output was mainly supported by increased production of sugarcane (**Table 3.5**).

Cement production declined in the first quarter of 2018 by 2.7 percent compared to a decline of 0.2 percent in the previous quarter, and was lower by 10.2 percent compared to the same quarter of 2016. The drop in cement production is attributed to reduced activity in the construction sector, as well as structural challenges facing major cement producing companies. Monthly data for the quarter under review shows declined production in January and February 2018, by 5.4 percent and 3.2 percent, respectively, followed by improved production of 4.5 percent in March 2018 (**Table 3.5**).

Galvanized sheets production decreased by 7.4 percent in the period January–February 2018 compared to a similar period in 2017. Monthly production increased by 11.3 percent in January 2018, before declining by 8.5 percent in February 2018 (**Table 3.5**).

Table 3.5: Quarterly Production of Selected Manufactured Goods

	2017				2018*			
	Quarterly				Quarterly	Monthly		
	Q1	Q2	Q3	Q4	Q1	Jan-18	Feb-18	Mar-18
Cement production								
Output (MT)	1,627,269	1,531,136	1,503,449	1,500,740	1,460,935	490,524	474,618	495,793
Growth %	*-4.5*	*-5.9*	*-1.8*	*-0.2*	*-2.7*	*-5.38*	*-3.24*	*4.46*
Assembled vehicles								
Output (No.)	1,499	870	1,136	1,056	1,472	395	529	548
Growth %	*25.5*	*-42.0*	*30.6*	*-7.0*	*39.4*	*22.7*	*33.9*	*3.6*
Galvanized sheets								
Output (MT)	71,888	61,730	62,124	67,107	N/A	23,858	21,830	N/A
Growth %	*26.3*	*-14.1*	*0.6*	*8.0*		*11.3*	*-8.5*	
Processed sugar								
Output (MT)	144,403	57,589	50,423	124,711	N/A	56,860	N/A	N/A
Growth %	*-2.5*	*-60.1*	*-12.4*	*147.3*		*15.5*		
Soft drinks								
Output ('000 litres)	144,385	133,016	123,418	156,726	N/A	39,905	39,033	N/A
Growth %	*3.0*	*-7.9*	*-7.2*			*-39.9*	*-2.2*	

MT = Metric tonnes
* Provisional
N/A - Not Available

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

Assembled vehicles production increased by 39.4 percent in the first quarter of 2018 compared to a decline of 7.0 percent in the fourth quarter of 2017. The increase is mainly attributable to the re-entry of vehicle manufacturers such as Volkswagen and Peugeot (**Table 3.5**). However, production was lower by 1.8 percent compared to a similar quarter of 2017.

The Electricity and Water Supply Sector

Electricity and Water Supply sector recorded improved performance in the fourth quarter of 2017, and grew by 10.9 percent compared to 5.6 percent in the third quarter of 2017 and 13.0 percent in the fourth quarter of 2016 (**Table 3.1**). The improved performance was mainly attributed to increased production of hydro-electricity following increased rainfall experienced during the quarter. The sector's contribution to overall GDP growth increased to 0.7 percentage points from 0.3 percentage points in the previous quarter (**Table 3.3**).

Growth in electricity generation decreased to 0.9 percent in the first quarter of 2018 compared to 2.4 percent growth recorded in the previous quarter, owing to declined generation of hydro-electricity and wind electricity by 14.0 percent and 23.9 percent, respectively, in the first quarter of 2018 compared to the previous quarter. Growth in generation of geothermal electricity also slowed to 0.2 percent compared to the previous quarter. Consequently, generation of thermal electricity increased by 23.8 percent during the quarter (**Table 3.6**). However, total electricity generation was 7.7 percent higher in the first quarter of 2018 compared to a similar quarter of 2017.

Consumption of electricity increased by 3.9 percent in the first quarter of 2018 indicative of increased economic activity. Meanwhile, international oil prices increased by 4.8 percent in the first quarter of 2018, and were 21.1 percent higher compared to the same quarter of 2017 (**Table 3.6**).

The Construction and Real Estate Sectors

The Construction sector grew by 5.8 percent, an improvement compared to 4.5 percent growth in the previous quarter and 4.3 percent growth in a similar quarter in 2016 (**Table 3.1**). The contribution of the sector to real GDP growth stabilized at 0.1 percentage points in the third and fourth quarters of 2017 (**Table 3.3**).

Indicators in the sector showed increased activity in the first quarter of 2018. Cement consumption increased by 1.6 percent compared to the previous quarter, with the increase mainly reflected in monthly consumption in January and March 2018. Meanwhile, the value of building plans approved by the Nairobi City County Planning, Compliance & Enforcement Department increased in both January and February 2018, pointing to increased activity in the sector (**Table 3.7**).

Table 3.6: Quarterly Performance in the Energy Sector

	2017				2018			
	Quarterly				Quarterly	Monthly		
	Q1	Q2	Q3	Q4	Q1	Jan-18	Feb-18	Mar-18
Electricity Supply (Generation)								
Output (million KWH)	2,452.6	2,505.5	2,555.2	2,617.1	2,640.4	900.5	837.1	902.9
Growth %	*-3.7*	*2.2*	*2.0*	*2.4*	*0.9*	*2.4*	*-7.0*	*7.9*
Of which:								
Hydro-power Generation (million KWH)	700.6	620.3	683.3	772.6	664.8	223.0	193.4	248.4
Growth (%)	*-27.8*	*-11.5*	*10.2*	*13.1*	*-14.0*	*-11.0*	*-13.2*	*28.4*
Geo-Thermal Generation (million KWH)	1,122.2	1,151.2	1,219.3	1,263.7	1,265.6	430.5	387.0	448.1
Growth (%)	*1.6*	*2.6*	*5.9*	*3.6*	*0.2*	*-1.3*	*-10.1*	*15.8*
Thermal Generation (million KWH)	609.1	720.8	644.1	*562.2*	*695.8*	*243.8*	*249.8*	*202.3*
Growth (%)	*35.1*	*18.3*	*-10.6*	*-12.7*	*23.8*	*31.6*	*2.4*	*-19.0*
Wind Generation (million KWH)	20.8	13.2	8.4	18.7	14.2	3.3	6.9	4.1
Growth (%)	*4.0*	*-36.6*	*-36.3*	*123.0*	*-23.9*	*-55.2*	*110.4*	*-40.1*
Consumption of electricity (million KWH)	2,064.3	2,165.8	2,413.7	2,079.2	2,161.3	731.1	684.6	745.6
Growth %	*0.4*	*4.9*	*11.4*	*-13.9*	*3.9*	*5.9*	*-6.4*	*8.9*
Murban crude oil average price (US $ per barrel)	54.7	50.7	51.1	63.2	66.2	66.3	66.0	66.3
Growth %	*8.2*	*-7.3*	*0.7*	*23.8*	*4.8*	*6.8*	*-0.5*	*0.5*

Source: Kenya National Bureau of Statistics

Table 3.7: Quarterly Output of Selected Construction Indicators

	2017				2018			
	Quarterly				Quarterly	Monthly		
	Q1	Q2	Q3	Q4	Q1	Jan-18	Feb-18	Mar-18
Cement Consumption								
Output (Tonnes)	1,533,010	1,435,103	1,429,162	1,387,875	1,410,169	466,160	461,099	482,910
Growth %	*-5.0*	*-6.4*	*-0.4*	*-2.9*	*1.6*	*3.4*	*-1.1*	*4.7*
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	N/A	13,122.47	10,917.29	N/A
Growth (%)	*-25.7*	*7.8*	*-50.3*	*29.8*		*1.2*	*-16.8*	
Non-residential (KSh, millions)	27,846.32	30,457.71	2,691.63	11,661.46	N/A	6,824.92	9,822.84	N/A
Growth (%)	*-4.6*	*9.4*	*-91.2*	*333.2*		*16.7*	*43.9*	
Total (KSh, millions)	61,709.78	66,960.75	20,838.09	35,211.92	N/A	19,947.39	20,740.13	N/A
Growth (%)	*-17.5*	*8.5*	*-68.9*	*69.0*		*6.1*	*4.0*	

N/A - Not Available

Source: Kenya National Bureau of Statistics

Growth in the real estate sector slowed to 4.6 percent in the fourth quarter of 2017 compared to 6.0 percent growth in the previous quarter and 8.5 percent growth in the fourth quarter of 2016 (**Table 3.1**). Consequently, the sectoral contribution to real GDP growth declined to 0.4 percentage points from 0.5 percentage points recorded in the previous quarter (**Tables 3.2 and 3.3**).

Accommodation and Restaurant Sector

The performance of the Accommodation and Restaurant sector remained strong at 12.1 percent growth in the fourth quarter of 2017. However, this was slightly lower compared to 15.5 percent in the previous quarter and 18.1 percent in a similar quarter of 2016. The slowdown could be attributed to political uncertainty due to the prolonged electioneering period (**Table 3.1**).

Tourist Arrivals

Overall, tourist arrivals declined by 2.8 percent in the first quarter of 2018 compared to the previous quarter, owing to the onset of the off-peak tourist season. The decline was mainly reflected at the Jomo Kenyatta International Airport (JKIA), Nairobi, where arrivals declined by 7.9 percent. However, at the Moi International Airport Mombasa (MIAM) arrivals increased by 28.8 percent (**Table 3.8**). When compared to the first quarter of 2017, overall tourist arrivals increased by 5.3 percent.

Table 3.8: Quarterly Tourist Arrival by Point of Entry

	2017				2018			
	Quarterly				Quarterly	Monthly		
	Q1	Q2	Q3	Q4	Q1	Jan-18	Feb-18	Mar-18
Total Tourist Arrivals	224,370	213,543	282,463	243,026	236,273	76,649	83,651	75,973
Growth (%)	*2.3*	*-4.8*	*32.3*	*-14.0*	*-2.8*	*-27.6*	*9.1*	*-9.2*
o.w. JKIA - Nairobi	192,740	202,042	255,337	209,396	192,958	61,137	70,169	61,652
Growth (%)	*0.4*	*4.8*	*26.4*	*-18.0*	*-7.9*	*-32.6*	*14.8*	*-12.1*
MIAM - Mombasa	31,630	11,501	27,126	33,630	43,315	15,512	13,482	14,321
Growth %	*16.0*	*-63.6*	*135.9*	*24.0*	*28.8*	*2.6*	*-13.1*	*6.2*

Source: Kenya Tourism Board

Transport and Storage Sector

The Transport and Storage sector expanded by 7.0 percent in the third quarter of 2017, an improvement compared to 5.2 percent in the previous quarter, but lower than 10.1 percent in the fourth quarter of 2016 (**Table 3.1**). The sector contribution to overall GDP growth increased marginally to 0.5 percentage points in the fourth quarter of 2017 compared to 0.4 percentage points in the previous quarter (**Table 3.3**).

Passenger flows through Jomo Kenyatta International Airport (JKIA) declined by 3.3 percent in the first quarter of 2018 compared to the previous quarter. The decline was reflected in both incoming and outgoing passenger flows, which declined by 3.7 percent and 2.8 percent, respectively (**Table 3.9**). However, when compared to the first quarter of 2017, passenger flows increased by 15.3 percent in the first quarter of 2018.

Meanwhile, the volume of oil that passed through the Kenya Pipeline increased by 3.0 percent in the first 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	Jan-18	Feb-18	Mar-18
Number of Passengers thro' JKIA								
Total passenger flows	994,137	1,083,803	1,309,436	1,155,878	1,117,194	388,194	339,423	389,577
Growth (%)	*-9.50*	*9.02*	*20.82*	*-11.73*	*-3.35*	*-8.93*	*-12.56*	*14.78*
o.w. Incoming	638,803	680,989	814,088	734,375	707,536	247,565	218,571	241,400
Growth (%)	*-7.42*	*6.60*	*19.54*	*-9.79*	*-3.65*	*-9.50*	*-11.71*	*10.44*
Outgoing	355,334	402,814	495,348	421,503	409,658	140,629	120,852	148,177
Growth %	*-13.03*	*13.36*	*22.97*	*-14.91*	*-2.81*	*-7.90*	*-14.06*	*22.61*
Kenya Pipeline Oil Throughput								
Output ('000 litres)	1,551,237	1,532,312	1,545,030	1,527,002	1,572,646	537,475	508,234	526,937
Growth %	*5.71*	*-1.22*	*0.83*	*-1.17*	*2.99*	*1.50*	*-5.44*	*3.68*

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

Chapter 4

Global Economy

Global economic output increased by 3.8 percent in 2017 from 3.2 percent in 2016 attributed to a rebound in global trade. The rising trend is expected to continue in 2018, with growth projected at 3.9 percent supported by strong momentum, favourable market sentiment, accommodative financial conditions, and expansionary fiscal policy in the United States (**Table 4.1**).

Growth in advanced economies is expected to improve to 2.5 percent in 2018 from 2.3 in 2017 and 1.7 percent in 2016, largely on account of improved investment activities, consumer spending and strong external demand.

In the Euro Area, output improved by 2.3 percent in 2017 from 1.8 percent in 2016 and is forecast at 2.4 percent in 2018. Increased growth in 2018 is attributed to stronger than expected domestic demand, supportive monetary policy, and prospects of improved external demand. However, growth in the United Kingdom is projected to slow down to 1.6 percent in 2018 from 1.8 percent in 2017 and 1.9 percent in 2016, reflecting the after–effects of Brexit. Output in Japan is estimated to have risen to 1.7 percent in 2017 from 0.9 percent in 2016. This momentum is attributed to the strengthening global demand and policy actions to sustain private consumption. However, growth in 2018 is projected to moderate to 1.2 percent due to a cyclical slowdown in business fixed investments, and the effects of the scheduled consumption tax hike.

Growth in emerging market and developing economies is estimated to have increased by 4.8 percent in 2017 compared with 4.4 percent in 2016, largely attributed to acceleration in private consumption. Output is projected at 4.9 percent in 2018 with the sustained recovery reflecting improved prospects for commodity based economies. Economic activity in China increased to 6.9 percent in 2017 from 6.7 percent in 2016, supported by resurgent net exports and strong private consumption. However, the growth is projected to slow down to 6.6 percent in 2018 on account of continued re-balancing away from investment toward private consumption and from industry to services. Growth in India is expected to pick-up to 7.4 percent in 2018 from 6.7 percent in 2017 and 7.1 percent in 2016 on account of strong private consumption as well as fading transitory effects of the currency exchange initiative.

In Sub-Saharan Africa (SSA), growth picked up from 1.4 percent in 2016 to an estimated 2.8 percent in 2017, and is expected to rise further to 3.4 percent in 2018 driven largely by improvement in output among major commodity exporters. Recovery is expected to continue in 2018 with economic activity projected at 2.1 percent in 2018. Output in South Africa in 2017 improved to 1.3 percent from 0.6 percent in 2016. Growth in 2018 is forecast at 1.5 percent attributed to gradual firming up of business confidence with the change in the political leadership.

Downside risks to global economic outlook

In spite of this reasonably satisfactory outlook, risks to the global economic growth outlook at a global level are still high. Notably, tighter financial conditions in the United States (US) would have spill overs to other economies, including a reduction in capital flows to emerging markets. Similarly, changes in US tax policies are expected to aggravate income polarization, which could affect the political and investment climate for policy choices in the future.

In addition, anxiety about technological change and globalization is on the rise and this could foster a shift towards inward–looking policies, therefore, disrupting trade and investment. Climate change, geopolitical tensions, and cyber-security breaches pose additional threats to the global growth outlook.

Table 4.1: **Global Economic Outlook**

			Projections		Difference from October 2017 WEO	
Country/Region	**2016**	**2017**	**2018**	**2019**	**2018**	**2018**
World Output	**3.2**	**3.8**	**3.9**	**3.9**	**0.2**	**0.2**
Advanced economies	**1.7**	**2.3**	**2.5**	**2.2**	**0.3**	**0.4**
United States	1.5	2.3	2.9	2.5	0.4	0.6
Euro Area	1.8	2.3	2.4	2.0	0.3	0.3
Germany	1.9	2.5	2.5	2.0	0.5	0.5
France	1.2	1.8	2.1	1.9	0.1	0.0
Italy	0.9	1.5	1.5	1.1	0.3	0.2
Spain	3.3	3.1	2.8	2.1	-0.1	0.1
Japan	0.9	1.7	1.2	0.9	0.5	0.1
United Kingdom	1.9	1.8	1.6	1.5	0.0	-0.1
Emerging market and Developing economies	**4.4**	**4.8**	**4.9**	**5.0**	**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	0.1	0.1
India	7.1	6.7	7.4	7.8	0.0	0.0
Brazil	-3.5	1.0	2.3	2.1	0.4	0.1
Middle East, North Africa, Afghanistan and Pakistan	**4.9**	**2.6**	**3.4**	**3.5**	**0.1**	**0.0**
Sub-saharan Africa	**1.4**	**2.8**	**3.4**	**3.7**	**0.1**	**0.2**
Nigeria	-1.6	0.8	2.1	1.9	0.0	0.0
South Africa	0.6	1.3	1.5	1.7	0.6	0.8

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

Chapter 5

Balance of Payments and Exchange Rates

Developments in the Balance of Payments

The current account deficit narrowed by 10.9 percent to USD 1,057 million in the first quarter of 2018 from USD 1,187 million in the fourth quarter, driven by an increase in exports of goods and services; and improvement in the primary and the secondary income account (**Table 5.1**).

Table 5.1: **Balance of Payments (USD Million)**

ITEM	2017*				2018**				Q4 2017-Q1 2018	
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Q1			Total		%
	Q1	Q2	Q3	Q4	Jan	Feb	March	Q1	Change	Change
1. Overall Balance	**-814**	**-224**	**677**	**518**	**-162**	**-37**	**-1,826.4**	**-2,025**	**-2,544**	**-490.9**
2. Current account	**-1,135**	**-1,251**	**-1,443**	**-1,187**	**-549**	**-191**	**-317.4**	**-1,057**	**130**	**-10.9**
Exports (fob)	1,470	1,453	1,413	1,457	523	569	508.1	1,600	143	9.8
Imports (fob)	3,923	3,925	4,167	3,979	1,472	1,208	1,438.5	4,118	139	3.5
Services: credit	1,207	1,145	1,160	1,139	370	398	500.7	1,268	129	11.3
Services: debit	726	805	816	746	275	320	313.3	908	161	21.6
Balance on goods and services	-1,973	-2,132	-2,410	-2,129	-853	-561	-743.0	-2,158	-29	1.3
Primary income: credit	99	107	92	101	45	36	40.6	122	22	21.4
Primary income: debit	248	336	286	350	142	62	88.2	292	-58	-16.6
Balance on goods, services, and primary income	-2,122	-2,360	-2,604	-2,378	-950	-587	-790.6	-2,327	51	-2.1
Secondary income : credit	1,001	1,124	1,173	1,207	404	399	477.4	1,280	74	6.1
o.w Remittances	433	455	495	565	209	210	222.2	642	77	13.6
Secondary income: debit	14	14	12	16	3	3	4.2	10	-5	-33.6
3. Capital Account	**79**	**22**	**-2**	**85**	**24**	**42**	**16.6**	**83**	**-3**	**-3.2**
4. Financial Account	**-2,073**	**-1,298**	**-150**	**-1,085**	**-318**	**-658**	**-2,157.9**	**-3,133**	**-2,048**	**188.7**

** Revised*

***Provisional*

Fob - free on board

Source: Central Bank of Kenya

The Current Account

The current account comprises the balance on goods and services (trade balance), and the balance on primary and secondary income. During first quarter of 2018, the trade balance worsened by 1.3 percent to USD 2,158 million from USD 2,129 million in the preceding quarter largely reflecting an increase in merchandise imports.

The value of merchandise exports increased by 9.8 percent to USD 1600 million during the first quarter of 2018 mainly driven by increases in exports of raw materials, tea, horticulture, coffee, chemical products, re-exports and other exports. The value of tea exports increased by 3 percent to USD 393 million supported by higher production (attributed to favourable weather) and higher exports demand (**Table 5.2**). Horticulture exports increased by 23 percent to USD 258 million, attributed to increased export volumes of fruits and nuts; and cut flowers. The value of merchandise imports increased by 4 percent to USD 4,118 million from USD 3,979 million, over the same period, largely on account of higher importation of manufactured goods which increased by 21 percent from USD 619 million to USD 749 million and chemicals which increased by 18 percent from USD 557 million to USD 657 million. Imports of oil and transport equipment declined.

The services account recorded a decline of 8 percent and decreased to USD 361 million in the first quarter of 2018, mainly on account of higher payments of transport and other services (financial, telecommunications and insurance services).

The balance in the primary account improved by 32 percent from a deficit of USD 249 million in the fourth quarter of 2017 to deficit of USD170 million in the first quarter of 2018, mainly on account of lower payments on foreign interest. The balance on secondary income also improved by USD 79million to USD 1,270million, on account of higher remittance inflows.

Table 5.2: Balance on Current Account (USD Million)

ITEM	2017*				2018**			
	Jan-Mar	Apri-Jun	Jul-Sep	Oct-Dec	Q1			Total
	Q1	Q2	Q3	Q4	Jan	Feb	March	Q1
CURRENT ACCOUNT	**-1,135**	**-1,251**	**-1,443**	**-1,187**	**-549**	**-191**	**-317**	**-1,057**
Goods	**-2,453**	**-2,472**	**-2,754**	**-2,522**	**-949**	**-639**	**-930**	**-2,518**
Exports (fob)	**1,470**	**1,453**	**1,413**	**1,457**	**523**	**569**	**508**	**1,600**
o.w Coffee	67	81	47	34	13	16	22	51
Tea	345	347	351	382	145	145	103	393
Horticulture	205	213	201	210	71	93	94	258
Oil products	13	14	12	12	2	5	5	12
Manufactured Goods	98	94	102	98	26	29	36	90
Raw Materials	142	133	115	135	58	51	46	154
Chemicals and Related Products (n.e.s)	100	98	110	100	31	37	38	107
Miscelleneous Man. Articles	147	134	157	133	42	42	46	129
Re-exports	153	185	143	157	70	78	46	194
Other	199	155	175	195	65	75	71	211
Imports (fob)	**3,923**	**3,925**	**4,167**	**3,979**	**1,472**	**1,208**	**1,438**	**4,118**
o.w Oil	636	651	667	774	248	211	310	769
Chemicals	621	561	563	557	243	189	225	657
Manufactured Goods	619	671	615	619	245	227	277	749
Machinery & Transport Equipment	1,329	1,179	1,106	1,066	394	300	350	1,044
Machinery	857	764	728	616	273	187	186	646
Transport equipment	471	415	378	449	121	113	164	398
Other								
o.w Food	372	556	857	786	203	167	165	535
Services	**481**	**340**	**344**	**393**	**95**	**78**	**187**	**361**
Transport Services (net)	**137**	**135**	**120**	**200**	**46**	**50**	**75**	**171**
Credit	383	396	397	446	130	140	173	443
Debit	246	261	277	246	84	91	98	273
Travel Services (net)	**195**	**162**	**147**	**151**	**54**	**65**	**75**	**194**
Credit	257	228	213	221	73	91	93	257
Debit	62	65	66	69	20	25	19	63
Other Services (net)	**149**	**42**	**77**	**42**	**-4**	**-37**	**37**	**-4**
Primary Income	**-149**	**-228**	**-194**	**-249**	**-97**	**-25**	**-48**	**-170**
Credit	99	107	92	101	45	36	41	122
Debit	248	336	286	350	142	62	88	292
Secondary Income	**987**	**1,110**	**1,161**	**1,191**	**401**	**396**	**473**	**1,270**
Credit	1,001	1,124	1,173	1,207	404	399	477	1,280
Debit	14	14	12	16	3	3	4	10

** Revised*

***Provisional*

Fob - free on board

Source: Central Bank of Kenya

Table 5.3: Kenya's Direction of Trade: Imports

IMPORTS (USD M)	2017				2018				Share of Imports (%)	
	Jan-Mar	Apri-Jun	Jul-Sep	Oct-Dec	Q1					
Country	**Q1**	**Q2**	**Q3**	**Q4**	**Jan**	**Feb**	**Mar**	**Q1**	**Q4 2017**	**Q1 2018**
Africa	**401**	**475**	**526**	**537**	**214**	**184**	**171**	**569**	**13.5**	**13.8**
Of which									**0.0**	
South Africa	136	166	165	132	58	48	64	170	3.3	4.1
Egypt	89	76	91	86	30	34	25	89	2.2	2.2
Others	177	234	270	319	126	102	82	310	8.0	7.5
EAC	**106**	**126**	**139**	**218**	**85**	**73**	**56**	**213**	**5.5**	**5.2**
COMESA	**211**	**258**	**299**	**347**	**130**	**117**	**93**	**339**	**8.7**	**8.2**
Rest of the World	**3,522**	**3,450**	**3,641**	**3,442**	**1,258**	**1,024**	**1,267**	**3,549**	**86.5**	**86.2**
Of which									0.0	
India	463	466	331	389	209	151	114	473	9.8	11.5
United Arab Emirates	222	284	471	362	52	98	184	334	9.1	8.1
China	1,098	962	855	861	267	249	352	867	21.7	21.1
Japan	183	211	189	207	82	60	78	220	5.2	5.3
USA	140	156	130	129	82	58	66	205	3.2	5.0
United Kingdom	71	73	71	76	31	23	22	76	1.9	1.8
Singapore	21	8	7	20	3	2	4	9	0.5	0.2
Germany	85	104	132	95	29	29	37	96	2.4	2.3
Saudi Arabia	352	225	194	337	125	95	139	359	8.5	8.7
Indonesia	153	123	157	116	51	26	29	106	2.9	2.6
Netherlands	37	38	71	43	32	13	15	60	1.1	1.4
France	56	84	68	51	19	21	14	53	1.3	1.3
Bahrain	24	26	16	19	1	1	1	2	0.5	0.0
Italy	62	52	58	44	20	25	16	61	1.1	1.5
Others	556	637	892	691	256	174	198	629	17.4	15.3
Total	**3,923**	**3,925**	**4,167**	**3,979**	**1,472**	**1,208**	**1,438**	**4,118**	**100.0**	**100.0**
EU	444	517	552	472	175	156	157	488	11.9	11.9
China	1,098	962	855	861	267	249	352	867	21.7	21.1

Source: Kenya Revenue Authority

Direction of Trade

Imports from China accounted for 21.1 percent of total imports to Kenya in the first quarter of 2018, making it the largest source of imports. In value terms, Kenya's imports from China was USD 867 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 11.9 percent of total import, and increased by 3.4 percent to USD 488 million in first quarter of 2018, mainly reflecting increased imports from Italy, France, Germany and Netherlands. The share of imports from Africa increased to 13.8 percent in the first quarter of 2018 from 13.5 percent in the fourth quarter of 2017, reflecting increased imports from both South Africa and Egypt. Share of imports from India also increased to 11.5 percent from 9.8 percent, over the same period (**Table 5.3**).

The share of exports to Africa dropped to 33.2 percent in the first quarter of 2018 from 37.2 percent in the fourth quarter of 2017 (**Table 5.4**). The decline reflected lower exports to COMESA region (Egypt, DRC and Sudan). Exports to the rest of the world, however, increased by 16.8 percent mainly on account of higher exports to the European Union, which increased to 22.8 percent during the first quarter of 2018 from 19.9 percent during the fourth quarter of 2017.

Capital and Financial Account

The capital account recorded a decrease of USD 3 million to USD 83 million in the first quarter of 2018. The financial account recorded higher net inflows of USD 3134 million in the first quarter of 2018, mainly reflecting an increase in Portfolio Liabilities on account of government uptake of the Eurobond in March 2018. However, Direct Investment to Kenya remained minimal and declined by USD 13 million to USD 130 million during the period under review (**Table 5.5**).

Table 5.4: Kenya's Direction of Trade: Exports

EXPORTS (USD M)										Share of Exports (%)	
	2017					2018					
	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Q4					
Country	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Jan**	**Feb**	**Mar**	**Q4**	**Q4 2017**	**Q1 2018**
Africa	**557**	**564**	**516**	**543**	**543**	**168**	**189**	**174**	**530**	**37.2**	**33.2**
Of which											
Uganda	155	163	140	151	144	46	58	55	159	**9.9**	**9.9**
Tanzania	82	75	53	73	75	19	30	23	72	**5.2**	**4.5**
Egypt	35	42	35	47	60	21	20	12	53	**4.1**	**3.3**
Sudan	13	13	17	14	23	6	6	6	18	**1.6**	**1.2**
South Sudan	40	45	47	35	35	15	12	11	38	**2.4**	**2.4**
Somalia	53	58	46	44	42	13	14	12	39	**2.9**	**2.4**
DRC	51	48	45	44	46	11	11	13	35	**3.2**	**2.2**
Rwanda	44	37	41	48	39	13	11	14	38	**2.7**	**2.4**
Others	83	82	93	88	78	23	27	28	78	**5.3**	**4.9**
EAC	**298**	**293**	**257**	**290**	**271**	**82**	**103**	**97**	**282**	**18.6**	**17.6**
COMESA	**359**	**364**	**349**	**368**	**367**	**116**	**125**	**118**	**359**	**25.2**	**22.4**
Rest of the World	**813**	**906**	**937**	**870**	**914**	**355**	**380**	**334**	**1,069**	**62.8**	**66.8**
Of which											
United Kingdom	85	97	88	93	95	34	42	33	109	**6.5**	**6.8**
Netherlands	99	119	111	89	104	42	46	51	139	**7.2**	**8.7**
USA	109	105	121	127	105	25	30	36	91	**7.2**	**5.7**
Pakistan	124	151	146	152	170	71	69	42	183	**11.7**	**11.4**
United Arab Emirates	63	52	78	56	69	31	37	25	93	**4.7**	**5.8**
Germany	27	33	34	21	25	8	10	11	28	**1.7**	**1.8**
India	18	16	13	14	14	9	16	10	34	**1.0**	**2.1**
Afghanistan	4	7	11	9	4	3	3	2	8	**0.3**	**0.5**
Others	285	325	334	310	327	133	127	124	383	**22.5**	**24.0**
Total	**1,370**	**1,470**	**1,453**	**1,413**	**1,457**	**523**	**569**	**508**	**1,599**	**100.0**	**100.0**
EU	280	334	307	281	289	116	125	123	364	**19.9**	**22.8**
China	31	24	39	15	18	6	7	3	16	**1.2**	**1.0**

Source: Kenya Revenue Authority

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

ITEM	2017*				2018 **				Q4 2017-Q1 2018	
	Jan-Mar	April- Jun	Jul-Sep	Oct-Dec	Q1			Total		%
	Q1	Q2	Q3	Q4	Jan	Feb	Mar	Q1	Change	Change
Capital account credit	**79**	**22**	**-2**	**85**	**24**	**42**	**17**	**83**	**-3**	**-3**
Capital account credit	79	22	-2	85	24	42	17	83	-3	-3
Capital account: debit				0						
Financial Account	**-2,073**	**-1,298**	**-150**	**-1,085**	**-318**	**-658**	**-2,158**	**-3,133.5**	**-2,048**	**188.7**
Direct investment: assets	74	99	49	36	3	3	5	12	-24	-66
Direct investment: liabilities	210	158	161	143	58	40	33	130	-13	-9
Portfolio investment: assets	150	177	192	145	64	67	88	218	73	50
Portfolio investment: liabilities	20	-22	-107	-1	-14	-50	1,985	1,920	1,921	-128,763
Financial derivatives: net										
Other investment: assets	405	9	40	-109	-144	65	274	195	304	-278
Other investment: liabilities	2,472	1,446	377	1,015	198	803	508	1,508	493	49

** Revised*

***Provisional*

Source: Central Bank of Kenya

Foreign Exchange Reserves

The banking system's total foreign exchange holdings increased by 7.9 percent during the first quarter of 2018. Official reserves held by the Central Bank constituted 79 percent of gross reserves and stood at USD 9,362 million, equivalent to 6.3 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	Apri-Jun	Jul-Sep	Oct- Dec				
	Q1	Q2	Q3	Q4	Jan	Feb	Mar	Q1
1. Gross Reserves	**10,786**	**10,984**	**10,332**	**9,652**	**9,676**	**9,758**	**11,859**	**11,859**
of which:								
Official	8,379	8,580	7,899	7,338	7,510	7,532	9,362	9,362
*import cover**	*5.5*	*5.7*	*5.4*	*5.0*	*5.1*	*5.1*	*6.3*	*6.3*
Commercial Banks	2,407	2,405	2,433	2,314	2,166	2,226	2,497	2,497
2. Residents' foreign currency deposits	**4,503**	**4,733**	**5,021**	**4,949**	**5,147**	**4,867**	**4,988**	**4,988**

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

Source: Central Bank of Kenya

Exchange Rates

The foreign exchange market, which remained relatively steady during the first 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 1.47 percent against the US Dollar to exchange at an average of 101.18 during the first quarter compared with 103.35 in the fourth quarter of 2017. The Kenya Shilling weakened 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 5.1**).

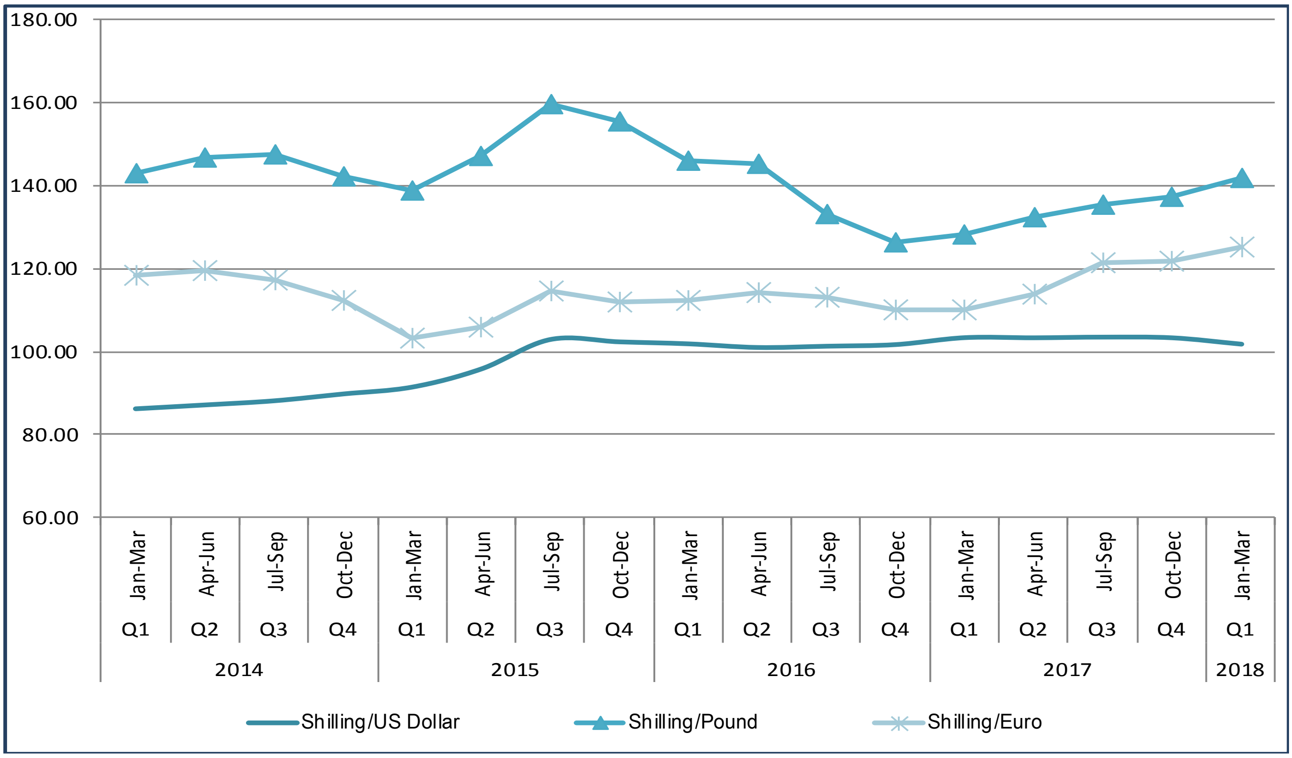
Table 5.7: Kenya Shilling Exchange Rate

	2017				2018			2018	
	Q1	Q2	Q3	Q4	Jan	Feb	March	Q1	% change Q1 2018 - Q4 2017
US Dollar	103.39	103.36	103.52	**103.35**	**102.92**	**101.40**	**101.18**	**101.83**	**-1.47**
Pound Sterling	128.05	132.22	135.40	**137.15**	**141.95**	**141.72**	**141.24**	**141.64**	**3.27**
Euro	110.12	113.75	121.50	**121.66**	**125.37**	**125.29**	**124.68**	**125.11**	**2.84**
100 Japanese Yen	90.95	92.98	93.28	**91.60**	**92.73**	**93.86**	**95.33**	**93.97**	**2.60**
Uganda Shilling*	34.79	34.94	34.80	**35.15**	**35.37**	**35.87**	**36.16**	**35.80**	**1.85**
Tanzania Shilling*	21.57	21.63	21.64	**21.70**	**21.81**	**22.20**	**22.31**	**22.11**	**1.88**
Rwanda Franc*	7.99	8.04	8.02	**8.16**	**8.23**	**8.44**	**8.49**	**8.39**	**2.84**
Burundi Franc*	16.35	16.56	16.79	**16.99**	**17.13**	**17.40**	**17.45**	**17.33**	**1.98**

** Units of currency per Kenya Shilling*

Source: Central Bank of Kenya

Chart 5.1: Kenya Shilling Exchange Rate



Source: Central Bank of Kenya

Chapter 6

The Banking System

1. Size and Structure

The structure of the Kenyan banking system comprised of 42 Commercial Banks[1], 1 Mortgage Finance Company, 13 Microfinance Banks, 8 Representative Offices of Foreign Banks, 74 Foreign Exchange Bureaus, 18 Money Remittance Providers and 3 Credit Reference Bureaus (CRBs) as at March 31, 2018 (**Chart 6.1**).

2. Structure of the Balance Sheet

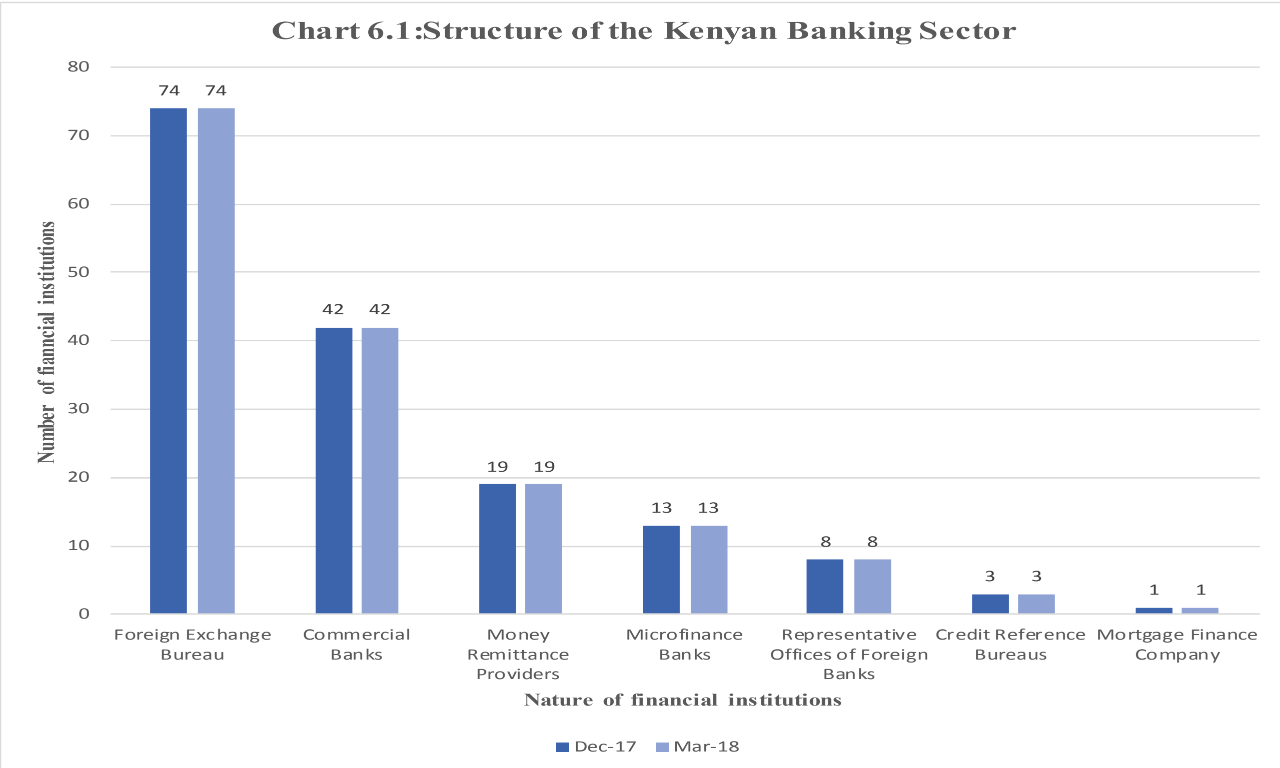
i) Growth in Banking System Assets

Total net assets increased by 0.74 percent from KSh.4, 051.8 billion in the fourth quarter of 2017 to KSh. 4,081.9 billion in the first quarter of 2018. Asset categories that recorded increases include investment in government securities (9.3 percent) and investments (12.5 percent). Meanwhile, loans and advances remained the main component of assets, accounting for 54.8 percent in the first quarter of 2018, a slight decrease from 57.1 percent recorded in the fourth quarter of 2017.

ii) Loans and Advances

Total banking system lending decreased by 0.84 percent, from KSh 2, 452.7 billion in the fourth quarter of 2017 to KSh 2, 432.2 billion in the first quarter of 2018. The decrease in gross loans and advances was largely witnessed in the Transport and Communication, Trade and Real Estate sectors due to repayments made during the period under review. The sectoral distribution of gross loans as at March 31, 2018 is mainly in peronal/Household, Trade, Real Estate and Manufacturing Sectors (**Chart 6.2**).

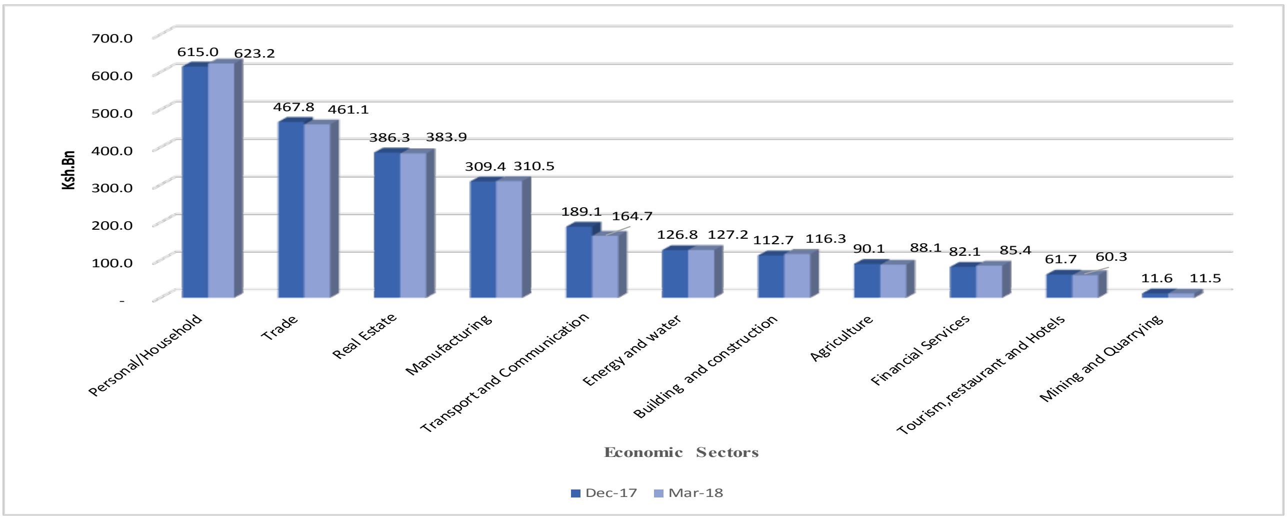
Chart 6.1: **Structure of the Kenyan Banking System**



Source: Central Bank of Kenya

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

Chart 6.2: Kenyan Banking System Gross Loans and Advances (KSh Billion)



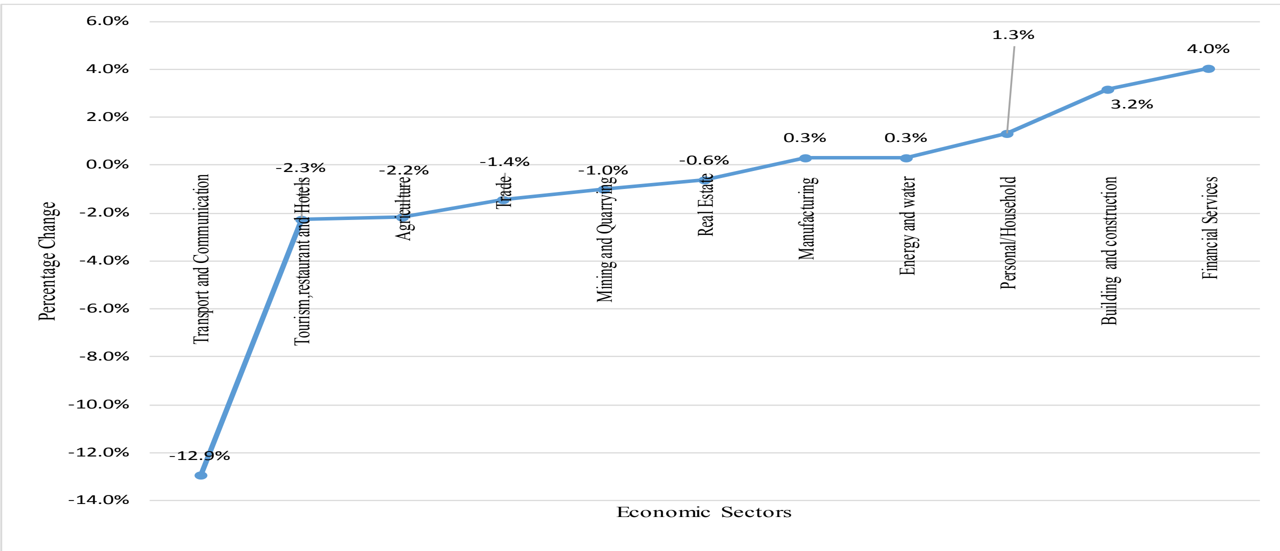
Source: Central Bank of Kenya

The Transport and Communication Sector recorded the highest decrease in lending of KSh.24.4 billion (12.9 percent) followed by the Trade sector which recorded a decrease of KSh.6.8 billion (1.4 percent) and the Real Estate sector with a decrease of KSh.2.3 billion (0.6 percent) between the fourth quarter of 2017 and first quarter of 2018. The decreases were attributable to loan repayments during the period under review. The changes in sectoral gross loans between the fourth quarter of 2017 and first quarter of 2018 (**Chart 6.3**). The Personal/ Household sector recorded an increased in lending by KSh.8.2 billion (1.3 percent) during the period under review due to increase in loans granted to individual borrowers.

iii) Deposit Liabilities

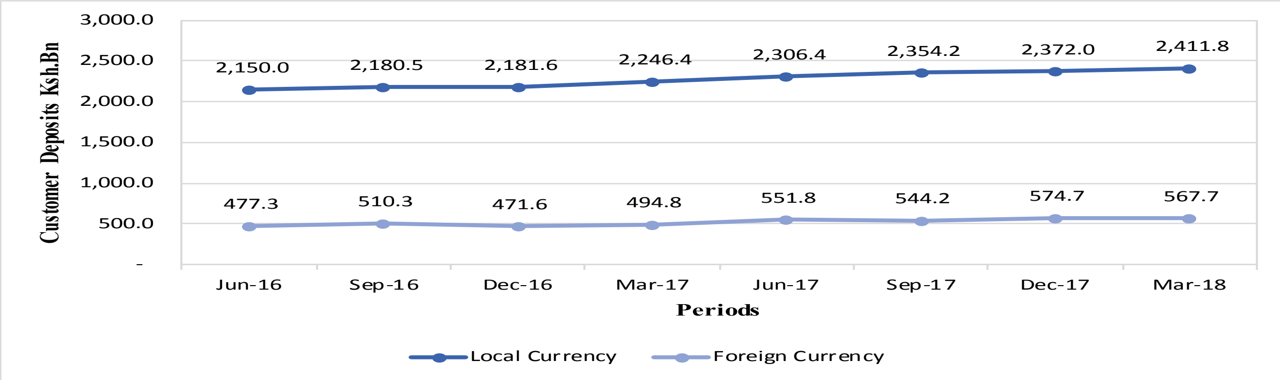
Customer deposits remained the main source of banks' funding accounting for 73.0 percent of the banking system total liabilities and shareholders' funds as at the end of the first quarter of 2018. This was an increase from 72.7 percent recorded as at end of the fourth quarter of 2017. The customer deposit base increased by 1.1 percent from KSh.2, 946.7 billion in the fourth quarter of 2017 to KSh.2, 979.5 billion in the first quarter of 2018 (**Chart 6.4**).

Chart 6.3: Quarterly Changes in Gross Loans in the First Quarter of 2018



Source: Central Bank of Kenya

Chart 6.4 **Customer Deposits (KSh Billion)**



Source: Central Bank of Kenya

3. Capital Adequacy

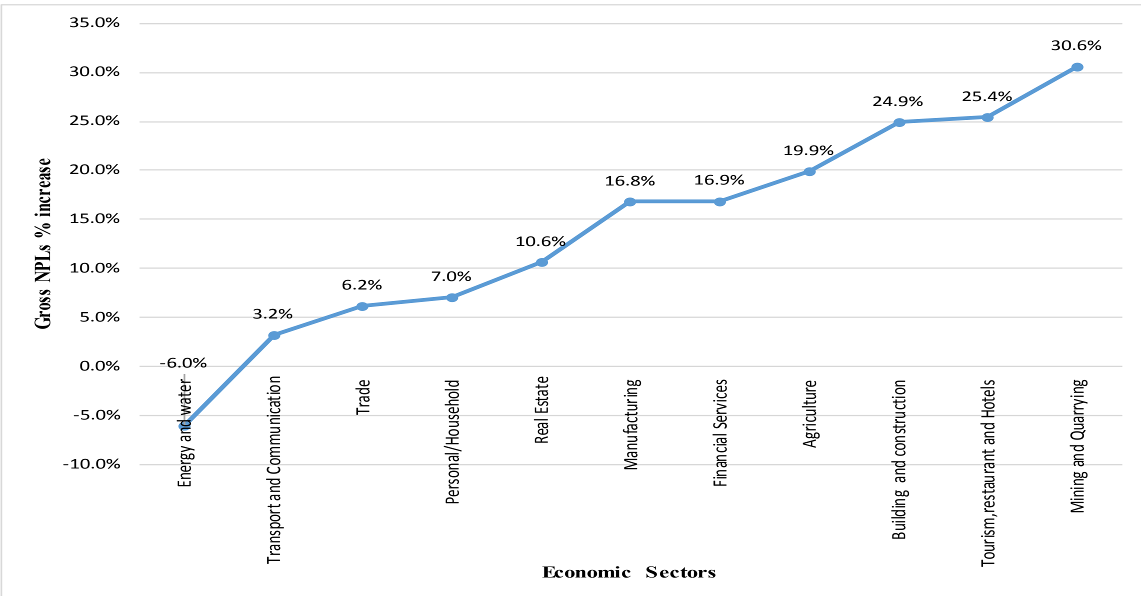
Kenya's banking system remain well capitalized with capitalization levels above the minimum statutory capital adequacy requirements. The banking system core capital increased slightly by 0.2 percent from KSh.539.6 billion in the fourth quarter of 2017 to KSh.540.5 billion in the first quarter of 2018. Total capital decreased by 6.0 percent from KSh.620.9 billion in the fourth quarter of 2017 to KSh.583.4 billion in the first quarter in 2018.

Core capital to total risk-weighted assets ratio increased marginally from 16.0 percent in the fourth quarter of 2017 to 16.2 percent in the first quarter of 2018. Total capital to total risk-weighted assets ratio decreased from 18.5 percent to 17.4 percent over the same period. The decline was due to a larger decrease in total capital of 6.0 percent compared to 0.5 percent decrease in total risk weighted assets in the first quarter of 2018.
The minimum statutory core capital to total deposits ratio is set at 8 percent. Banks maintained adequate buffers with the ratio standing at 18.1 percent in the first quarter of 2018 compared to 18.3 percent in the fourth quarter of 2017. The decrease was on account of a higher increase of 1.1 percent in total deposits compared to 0.2 percent increase in core capital between the fourth quarter of 2017 and first quarter of 2018.

4. Asset Quality

The Gross Non-Performing Loans (NPLs) increased by 10.8 percent from KSh.259.2 billion as at the end of the fourth quarter of 2017 to KSh.287.2 billion at the end of the first quarter of 2018. The increase was spread across most economic sectors (**Chart 6.5**).

Chart 6.5: **Changes in Gross Non-Performing Loans in the 4th Quarter of 2017 & 1st Quarter of 2018**

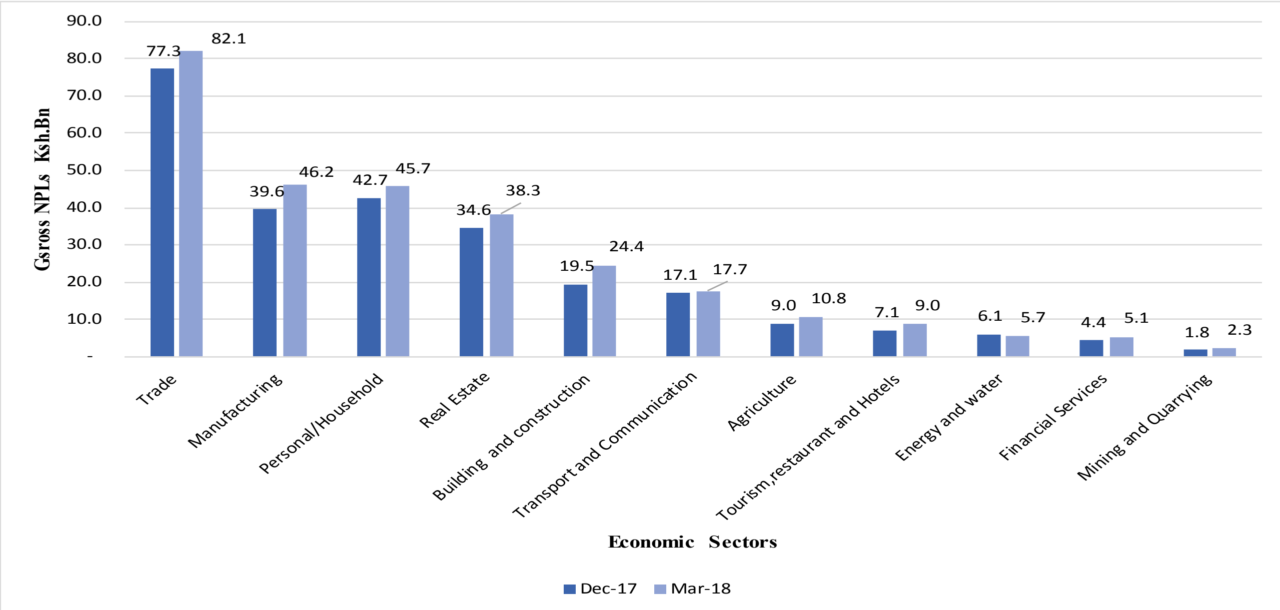


Source: Central Bank of Kenya

The Manufacturing sector registered the highest increase in NPLs, by KSh.6.4 billion (16.8 percent) due to slow down in business, which led to delayed in loan re-payments. The Building and Construction sector registered an increase in NPLs of KSh.4.9 billion (24.9 percent) in the first quarter of 2018, attributed to delayed payments by the Governments and private sector to contractors and suppliers. Gross NPLs to total gross loans ratio increased from 10.6 percent in the fourth quarter of 2017 to 11.8 percent in the first quarter of 2018 with varied sectoral distribution of gross NPLs (**Chart 6.6**).

The banking system's asset quality, as measured by the proportion of net non-performing loans to gross loans, improved slightly from 5.7 percent in the fourth quarter of 2017 to 5.5 percent in the first quarter of 2018 (**Table 6.1**). The coverage ratio, which is measured as a percentage of specific provisions to total NPLs, increased from 34.5 percent in fourth quarter of 2017 to 44.4 percent in first quarter of 2018.

Chart 6.6: Sectorial Distribution of the Kenyan Banking System Gross NPLs (KSh Billion)



Source: Central Bank of Kenya

The increase was due to increase in specific provisions by KSh.32.2 billion (43.7 percent) as compared to an increase of Net NPLs by KSh.24.8 billion or 11.6 percent in the period under review.

5. Profitability

The banking system recorded growth in pre-tax profits by KSh.1.2 billion (3.2 percent) from KSh.36.5 billion in the fourth quarter of 2017 to KSh.37.7 billion in the first quarter of 2018. The growth in profitability was mainly attributable to decreased expenses by KSh.16.9 billion (16.6 percent).This is despite a decrease in total income of KSh.15.6 billion (11.4 percent) between fourth quarter of 2017 and first quarter of 2018.

Interest on loans and advances decreased by KSh.11.2 billion (14.7 percent), while interest on government securities decreased by KSh.3.7 billion (12.0 percent) between the fourth quarter of 2017 and first quarter of 2018.

Total expenses decreased by 16.6 percent from KSh.101.0 billion in the fourth quarter of 2017 to KSh.84.2 billion in the first quarter of 2018. The decrease in expenses was largely attributed to interest expense on deposits and bad debts charge, which decreased by 11.5 percent and 45.7 percent, respectively, in the first quarter of 2018.

Interest income on loans and advances, interest on government securities and other incomes were the major sources of income accounting for 53.1 percent, 22.4 percent and 18.4 percent of total income, respectively. On the other hand, interest on deposits, salaries and wages, and other expenses were the key components of expenses, accounting for 33.6 percent, 26.0 percent and 22.9 percent of total expenses, respectively.

The Return on Assets (ROA) increased from 2.7 percent in fourth quarter of 2017 to 2.9 percent in the first quarter of 2018. Return on Equity (ROE) increased from 20.8 percent in the fourth quarter of 2017 to 23.9 percent in the first quarter of 2018.

Table 6.1: Summary of Asset Quality

		December 2017, KSh Billion	March 2018, KSh Billion
1	Gross Loans and Advances (KShs' Bn)	2,452.7	2,432.2
2	Interest in Suspense (KShs' Bn)	44.3	47.4
3	Loans and Advances (net of interest suspended) (KShs' Bn)	2,408.4	2,384.7
4	Gross Non-Performing loans (KShs 'Bn)	259.2	287.2
5	Specific Provisions (KShs' Bn)	74.1	106.5
6	General Provisions (KShs' Bn)	19.5	39.7
7	Total Provisions (5+6) (KShs' Bn)	93.6	146.1
8	Net Advances (3-7) (KShs' Bn)	2,314.8	2,238.6
9	Total Non-Performing Loans and Advances (4-2) (KShs'Bn)	214.9	239.8
10	Net Non-Performing Loans and Advances (9-5) (KShs 'Bn)	140.9	133.3
11	Total NPLs as % of Total Advances (9/3)	8.9%	10.1%
12	Net NPLs as % of Gross Advances (10/1)	5.7%	5.5%
13	Specific Provisions as % of Total NPLs (5/9)	34.5%	44.4%

Source: Central Bank of Kenya

6. Liquidity

The banking system's overall liquidity ratio remained well above the minimum statutory level of 20 percent. It increased from 43.7 percent in the fourth quarter of 2017 to 45.8 percent recorded in the first quarter of 2018.

7. Banking System Outlook

The banking system is projected to remain resilient and stable. Credit risk is expected to remain elevated in the short to medium term, while liquidity risk is expected to ease.

KEPSS KENYA SHILLING THROUGHPUT

Kenya Electronic Payments and Settlement System (KEPSS) used for large value Real Time Gross Settlement (RTGS) payments moved a volume of 1.06 million transaction messages worth KSh 6.8 trillion in the first quarter of 2018, compared to 1.17 million transactions messages worth KSh.7.6 trillion recorded in the fourth quarter of 2017 (**Chart 6.7**). Volume and value decreased by 10.24 percent and 6.87 per cent, respectively.

Bank Customer Payments Processed Through KEPSS

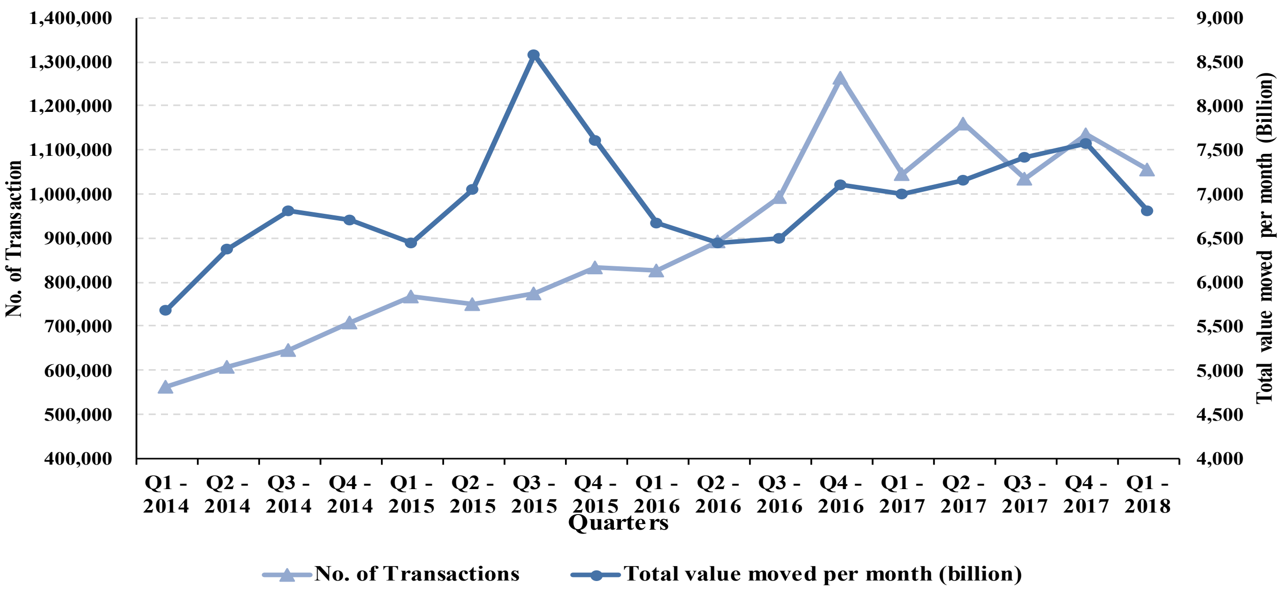
In transmitting payments through the RTGS for customers, commercial banks submit the payment instructions vide multiple third party Message Type (MT 102) used for several credit transfers and single third party Message Type (MT 103) used for single credit transfers.

During the period under review, MT 102 increased by 1.32 per cent, to 33,375 messages recorded in the first quarter of 2018 from 32,940 messages processed in the fourth quarter of 2017. The MT 103 payments increased by 4.74 per cent, to 1,112,760 messages in the first quarter of 2018 from 1,062,433 messages in the previous quarter (**Chart 6.8**).

System Availability

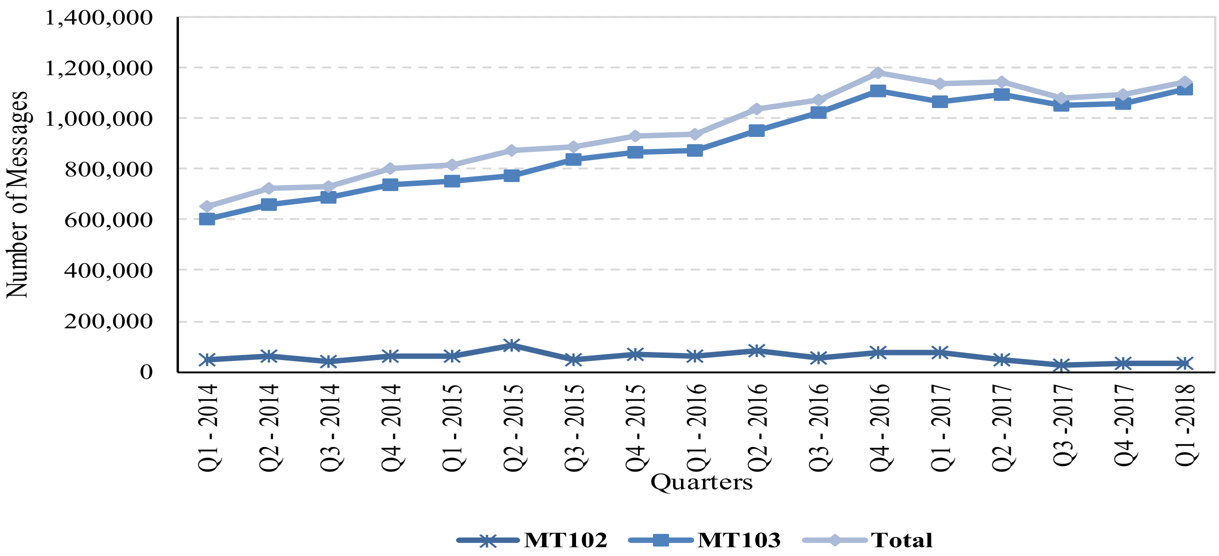
KEPSS system availability to banks and other participants for 8 hours per day maintained an average of 99.96 percent KEPSS availability during the first quarter of 2018 (**Chart 6.9**). The system runs from 8.30 AM to 4.30 PM, but the operating time can be extended to enable participants settle their obligations and fund their accounts.

Chart 6.7: **Trends in Monthly Flows Through KEPSS**



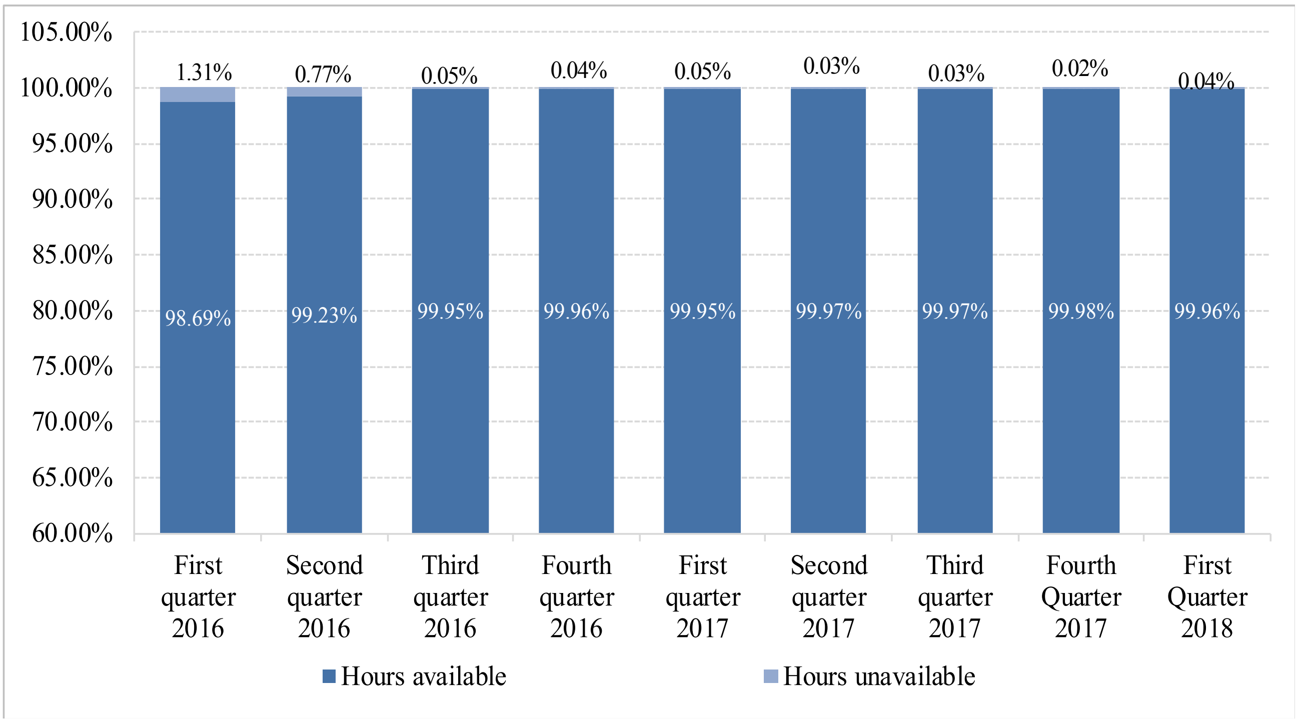
Source: Central Bank of Kenya

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



Source: Central Bank of Kenya

Chart 6.9: Availability of KEPSS in Kenya



Source: Central Bank of Kenya

Chapter 7

Government Budgetary Performance

The Government's budgetary operations during the third quarter of FY 2017/18 resulted in a deficit of 1.9 per cent of GDP compared with a deficit of 1.7 per cent of GDP in the second quarter of FY 2017/18. Revenue collection improved but remained below target, as was the case with the expenditure (**Table 7.1**).

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

	(FY 2017/18)										Over (+) /	%
	Oct	Nov	Dec	Q2	Jan	Feb	Mar	Q3	Cumulative to Mar' 2018	Target	Below (-) Target	Variance
1. TOTAL REVENUE & GRANTS	**101.6**	**119.6**	**152.7**	**373.9**	**135.9**	**95.7**	**118.5**	**350.1**	**1,071.1**	**1,202.0**	**-130.9**	**-10.9**
Ordinary Revenue	**91.1**	**105.0**	**139.8**	**336.0**	**126.6**	**85.7**	**106.2**	**318.5**	**975.4**	**1,040.6**	**-65.2**	
Tax Revenue	87.8	103.5	121.7	313.0	124.0	80.2	102.5	306.8	929.6	994.6	-64.9	
Non Tax Revenue	3.3	1.5	18.2	23.0	2.6	5.5	3.6	11.7	45.8	46.0	-0.2	
Appropriations-in-Aid	7.4	9.3	8.0	24.7	7.8	7.2	8.1	23.1	72.4	116.0	-43.6	
External Grants	3.1	5.3	4.9	13.2	1.5	2.8	4.2	8.5	23.3	45.5	-22.2	
2. TOTAL EXPENSES & NET LENDING	**137.3**	**170.6**	**208.8**	**516.7**	**137.3**	**170.6**	**208.8**	**592.5**	**1,488.7**	**1,616.5**	**-127.8**	**-7.9**
Recurrent Expenses	91.3	119.0	124.3	334.6	122.7	96.8	115.1	334.5	969.1	932.8	36.2	
Development Expenses	31.1	21.5	66.5	119.1	35.4	67.2	64.0	166.7	341.1	454.7	-113.6	
County Transfers	14.9	30.1	19.2	64.2	22.8	19.4	47.6	89.8	174.5	225.0	-50.5	
Others	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	1.5	1.5	4.0	4.0	0.0	
3. DEFICIT (INCL. GRANTS) (1-2)	**-35.7**	**-51.0**	**-56.1**	**-142.8**	**-1.4**	**-75.0**	**-90.3**	**-166.6**	**-417.6**	**-414.4**	**-3.1**	**0.8**
As percent of GDP	-0.4	-0.6	-0.6	-1.7	0.0	-0.9	-1.0	-1.9	-4.8	-4.8		
4. ADJUSTMENT TO CASH BASIS				**0.0**				**0.0**			**0.0**	
5. DEFICIT INCL .GRANTS ON A CASH BASIS	**-35.7**	**-51.0**	**-56.1**	**-142.8**	**-1.4**	**-75.0**	**-90.3**	**-166.6**	**-417.6**	**-414.4**	**-3.1**	
As percent of GDP	-0.4	-0.6	-0.6	-1.7	0.0	-0.9	-1.0	-1.9	-4.8	-4.8		
6. DISCREPANCY: Expenditure (+) / Revenue (-)				0.0				0.0			0.0	
7. FINANCING	**65.1**	**41.8**	**36.3**	**143.2**	**32.3**	**115.3**	**115.3**	**262.9**	**427.9**	**291.7**	**136.2**	**46.7**
Domestic (Net)	27.6	37.1	-6.8	57.9	23.0	87.9	32.5	143.4	250.5	101.9	148.6	
External (Net)	37.5	4.7	42.0	84.2	9.3	27.2	82.8	119.3	175.6	310.0	-134.5	
Capital Receipts (domestic loan receipts)	0.0	0.0	1.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Others	-	-	-	-	-	0.2	-	0.2	1.8	2.5	-0.7	

GDP figures from the Budget Policy Statement(BPS)-March 2018

Sources: Provisional Budget Out-turn from The National Treasury (as at March 2018)

Revenue

The Government receipts, comprising revenue and grants declined by 6.4 percent to KSh 350.1 billion in the third quarter of FY 2017/18, from KSh 373.9 billion in the second quarter of the FY 2017/18. All revenue categories declined during the third quarter of the FY 2017/18. The largest decline in revenues and grants was in non-tax revenue of from KSh 23.0 billion during the second quarter to KSh 11.7 billion recorded in the third quarter of the FY 2017/18 mainly on account of investment income.

Ministerial Appropriations in Aid (A-in-A) collected in the third quarter of the FY 2017/18 declined to KSh 23.1 billion from KSh 24.7 billion collected in the second quarter.

There was a shift in the composition of tax revenues from the second quarter to the third quarter of FY 2017/18 (**Chart 7.1**). Value Added Tax (VAT) and excise duty increased by 3.8 percentage points and 2.7 percentage points, respectively, while income tax declined by 5.9 percentage points during the third quarter of the FY 2017/18. The composition of import duty and other tax revenue in the total tax revenues remained unchanged during the period under review.

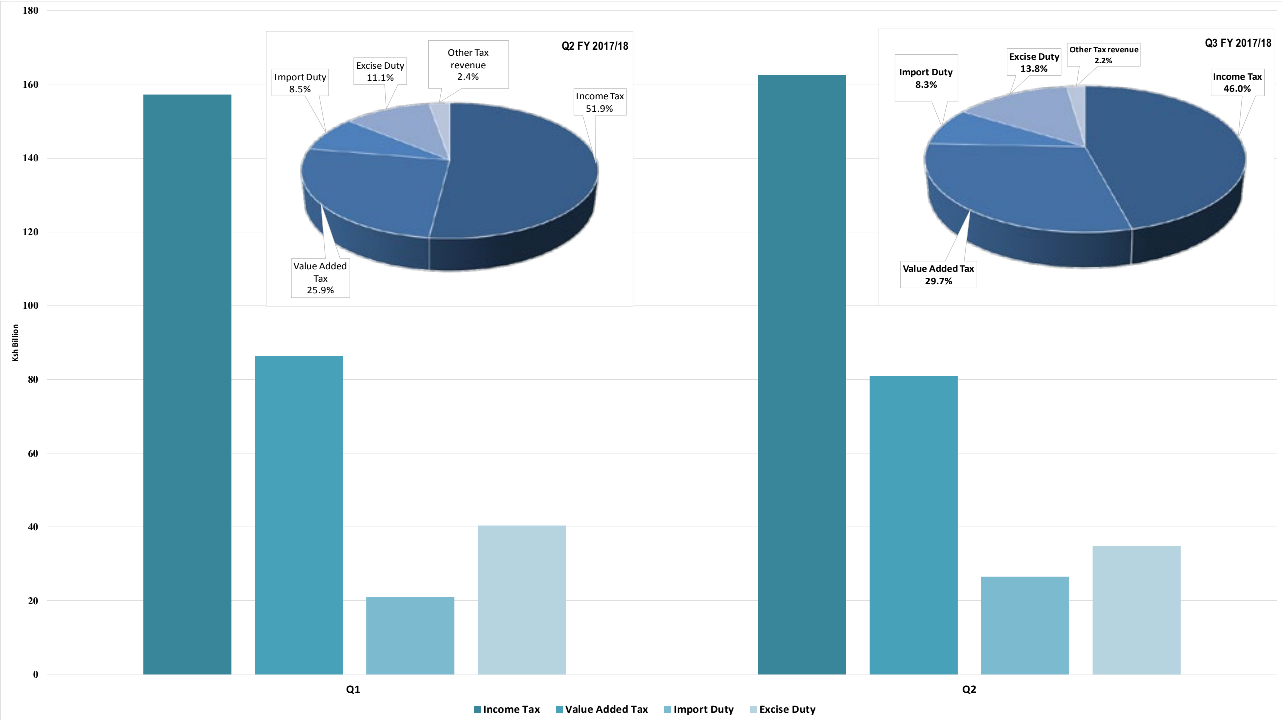
Cumulatively, the Government receipts, were KSh 1,071.1 billion (12.4 percent of GDP) to the end of the third quarter of the FY2017/18 against a target of KSh 1,202.0 billion (13.9 percent of GDP). All taxes fell below set targets except corporate tax that surpassed target by KSh 2.7 billion in the third quarter of the FY2017/18. The shortfalls were due to a slowdown in the economy, which affected revenue collection adversely.

Expenditure and Net Lending

Government expenditure and net lending rose by 14.7 percent to KSh 592.5 billion in the third quarter of the FY 2017/18 compared with KSh 516.7 billion in the second quarter of the FY 2017/18. The increase in expenditures reflected national government development expenditures and County governments transfers each of which rose by 39.9 percent. Recurrent expenditure remained unchanged in the third quarter of FY 2017/18.

In terms of composition, recurrent expenditure remained the largest share in total government expenditure accounting for 56.6 percent in the third quarter of the FY2017/18. However, this was lower than the 64.8 percent recorded in the previous quarter. Conversely, the share of development expenditure and County governments transfers increased by 8.6 percentage points and 4.6 percentage points,

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



Source: Provisional Budget Out-turn from The National Treasury

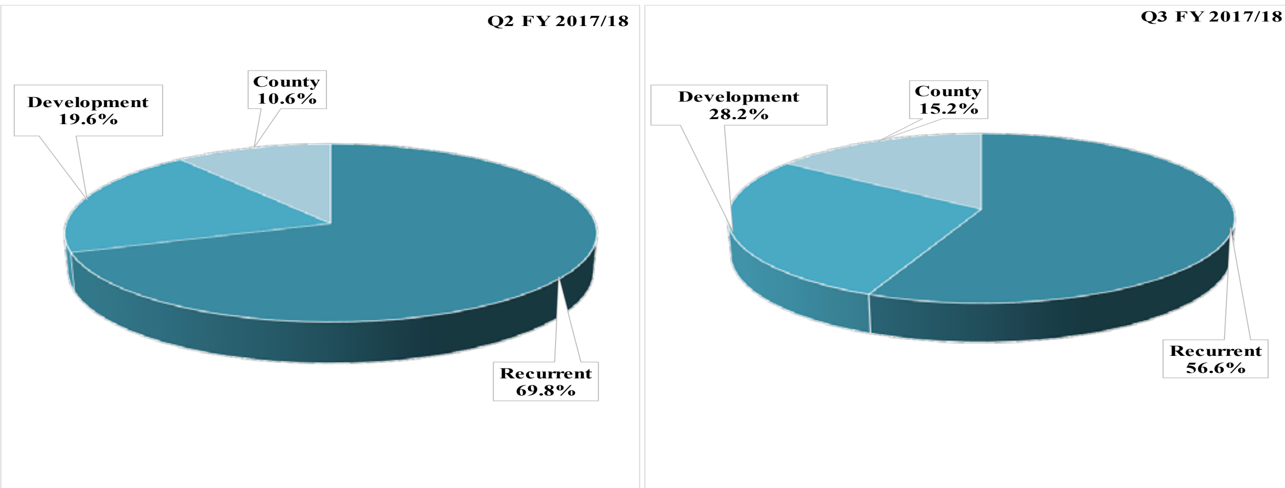
respectively (**Chart 7.2**). Development expenditures were largely channeled to infrastructure and energy and petroleum ministries for implementation of key infrastructure projects.

Cumulatively, expenditure and net lending to the third quarter of the FY 2017/18 amounted to KSh 1,488.7 billion (17.2 percent of GDP), against a target of KSh 1,616.5 billion (18.7 percent of GDP). The shortfall of KSh 127.8 billion was attributed to lower absorption of development expenditures by the National Government and County Governments. Meanwhile, the recurrent expenditures were above target by KSh 36.2 billion to the third quarter of the FY 2017/18, largely reflecting higher than projected domestic interest payments. In terms of components of recurrent expenditures, wages and salaries, domestic interest and foreign interest decreased by 6.1 percent, 22.8 percent and 40.3 percent, respectively during the third quarter of the FY 2017/18 compared with the spending in the previous quarter. On the other hand, pensions and other recurrent expenditures increased by 42.9 percent and 162.3 percent, respectively, during the quarter under review.

Financing

The budget deficit to the third quarter FY 2017/18 amounted to KSh 417.6 billion or 4.8 percent of GDP. The deficit financing mix was 59.0 percent and 41.0 percent domestic and external resources, respectively. The domestic borrowing comprised KSh 39.1 billion draw down of Government deposits held at CBK, KSh 83.1 billion from commercial banks, Ksh 125.1

Chart 7.2: Composition of Recurrent Expenses FY 2017/18



Sources: Provisional Budget Outturn from The National Treasury

Table 7.2 Domestic Financing

	NET CREDIT TO GOVERNMENT (Ksh Bn)								
	2017/18								
			Q1			Q2			Q3
	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18
1. From CBK	57.9	60.9	8.3	60.6	77.4	108.9	29.3	45.6	39.1
2.From commercial banks	(3.8)	(14.8)	12.6	9.8	2.9	(2.9)	7.3	61.7	83.1
4.From Non-banks	2.6	14.2	26.3	51.2	75.7	74.4	90.4	108.2	125.1
5. From Non-Residents	0.4	1.0	1.9	2.8	2.7	3.2	2.6	3.2	3.2
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	122.1
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
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
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	250.4

NB: Treasury Bills are reflected at cost

Source: Central Bank of Kenya

billion from Non-banking financial institutions and KSh 3.2 billion from Non-Residents (**Table 7.2**). Net domestic borrowing in the third quarter of FY 2017/18 was higher by 36.4 percent compared to the level recorded in the second quarter, and was above target. Meanwhile, external financing in the third quarter of the FY 2017/18 amounted to KSh 175.6 billion against a target of KSh 310.0 billion.

Outlook for FY 2017/18

In the budget estimates for the FY 2017/18, total revenue including grants is projected at KSh 1,702.3 billion (19.7 per cent of GDP), while external grants are projected at KSh 59.2 billion (0.7 per cent of GDP). Government expenditure is projected at KSh 2,323.1 billion (26.8 per cent of GDP), of which KSh 1,392.8 billion (16.1 per cent of GDP) is for recurrent expenses, KSh 345.7 billion (4.0 per cent of GDP) for transfers to county governments, and KSh 579.6 billion (6.7 per cent of GDP) for development expenses (**Table 7.3**).

The overall budget deficit including grants on commitment basis is projected at KSh 620.8 billion (7.2 per cent of GDP) in FY 2017/18. The deficit is expected to be financed through net external borrowing of KSh 323.2 billion and net domestic borrowing of KSh 293.8 billion.

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

	Ksh (Billion)	%age of GDP
1. TOTAL REVENUE (Including Grants)	**1,702.3**	**19.7**
Total Revenue	1,643.1	19.0
Appropriations-in-Aid	135.6	1.6
External Grants	59.2	0.7
2. TOTAL EXPENSES & NET LENDING	**2,323.1**	**26.8**
Recurrent Expenses	1,392.8	16.1
Development Expenses	579.6	6.7
County Transfer	345.7	4.0
Contigency Fund	5.0	
3. DEFICIT INCL. GRANTS (1-2)	-620.8	**-7.2**
4. FINANCING	**620.8**	**7.2**
Domestic (Net)	293.8	3.4
External (Net)	323.2	3.7

Source: The National Treasury : Budget Policy Statement February 2018

Chapter 8
Public Debt

Overall Public Debt

Kenya's public and publicly guaranteed debt increased by 6.9 percent during the third quarter of the FY.2017/18, with both domestic and external debt increasing by 6.8 percent and 6.9 percent, respectively. The ratio of public and publicly guaranteed debt to GDP increased to 59.5 percent compared with 59.0 percent in the previous quarter, implying a faster build up in public debt than the projected rate of economic expansion. Correspondingly, the ratio of domestic debt to GDP increased from 28.7 percent to 28.9 percent, while the ratio of external debt to GDP increased from 30.3 percent to 30.6 percent in the third quarter of the FY.2017/18 (**Table 8.1**)[1].

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

Domestic Debt

Total domestic debt increased by 6.8 percent during the third quarter of FY.2017/18, which was higher than the 2.1 percent build up observed in the previous quarter (**Table 8.2**). The increase in the pace of accumulation of domestic debt was as a result of increased uptake of government securities in the primary market during the quarter under review. Investors' preference shifted to short dated securities, hence the 12.8 percent increase in the uptake of Treasury bills. The share of domestic debt to total debt remained unchanged by the end of the third quarter compared to the second quarter in the FY.2017/18. The proportion of debt securities to total domestic debt increased slightly by 0.3 percent during the quarter under review.

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

	2016/17				2017/18							
	Sep-16	Dec-16	Mar-17	Jun-17	Jul-17	Aug-17	Sep-17	Dec-17	Jan-18	Feb-18	Mar-18	Change Q on Q
EXTERNAL												
Bilateral	580.4	577.8	689.1	722.6	744.5	742.0	742.1	782.6	805.2	804.4	800.9	18.3
Multilateral	799.7	781.3	806.9	844.4	831.7	842.5	842.8	841.8	853.5	841.8	836.8	-5.1
Commercial Banks	442.8	458.1	594.1	712.1	712.1	708.2	708.2	707.8	701.9	900.1	858.1	150.3
Supplier Credits	15.5	15.3	11.2	15.3	17.2	17.1	17.1	17.1	16.9	16.8	16.7	-0.4
Sub-Total	**1,838.4**	**1,832.4**	**2,101.4**	**2,294.4**	**2,305.5**	**2,309.8**	**2,310.2**	**2,349.3**	**2,377.5**	**2,563.1**	**2,512.4**	**163.1**
(As a % of GDP)	26.1	25.5	28.4	30.4	30.5	30.6	30.1	30.3	29.0	31.2	30.6	
(As a % of total debt)	49.8	48.7	51.9	52.1	52.1	52.0	51.5	51.4	51.4	52.3	51.4	
DOMESTIC												
Banks	**1,028.7**	**1,032.6**	**1,061.1**	**1,196.4**	**1,205.1**	**1,200.4**	**1,223.5**	**1,221.7**	**1,232.3**	**1,305.1**	**1,320.4**	**98.7**
Central Bank	58.9	85.5	85.3	54.5	63.7	75.7	79.2	96.8	83.8	100.1	93.6	-3.2
Commercial Banks	969.8	947.0	975.8	1,141.9	1,141.4	1,124.7	1,148.3	1,124.9	1,148.5	1,205.0	1,226.9	101.9
Non-banks	**813.8**	**884.8**	**862.3**	**893.2**	**896.1**	**912.4**	**925.0**	**973.2**	**990.1**	**1,008.1**	**1,025.7**	**52.5**
Pension Funds	493.8	544.9	549.2	593.5	575.7	586.1	592.7	611.2	624.8	633.2	641.8	30.6
Insurance Companies	136.4	143.2	138.9	138.9	130.1	133.3	134.7	142.7	143.2	146.5	150.9	8.3
Other Non-bank Sources	183.6	196.7	174.2	160.8	190.3	193.1	197.5	219.3	222.1	228.4	232.9	13.7
Non-residents	**12.0**	**13.6**	**21.5**	**22.1**	**22.6**	**23.1**	**24.1**	**25.4**	**24.8**	**25.0**	**25.5**	**0.1**
Sub-Total	**1,854.6**	**1,931.0**	**1,945.0**	**2,111.7**	**2,123.8**	**2,135.9**	**2,176.6**	**2,220.3**	**2,247.3**	**2,338.2**	**2,371.7**	**151.3**
(As a % of GDP)	26.4	26.8	26.2	27.9	28.1	28.3	28.4	28.7	27.4	28.5	28.9	
(As a % of total debt)	50.2	51.3	48.1	47.9	47.9	48.0	48.5	48.6	48.6	47.7	48.6	
GRAND TOTAL	**3,693.0**	**3,763.4**	**4,046.3**	**4,406.1**	**4,429.3**	**4,445.7**	**4,486.8**	**4,569.6**	**4,624.8**	**4,901.3**	**4,884.1**	**314.5**
(As a % of GDP)	52.5	52.3	54.6	58.3	58.6	58.9	58.4	59.0	56.4	59.8	59.5	

Source: The National Treasury and Central Bank of Kenya

Table 8.2: Government Gross Domestic Debt (KSh Billion)

	Ksh (Billion)							Change: Q on Q		Proportions						
	2016/17		2017/18							2016/17		2017/18				
	Q3	Q4	Q1	Q2	Jan-18	Feb-18	Q3	Ksh (Bn)	%	Q3	Q4	Q1	Q2	Jan-18	Feb-18	Q3
Total Stock of Domestic Debt (A+B)	**1,945.0**	**2,111.7**	**2,176.6**	**2,220.3**	**2,247.3**	**2,338.2**	**2,371.7**	**151.3**	**6.8**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
A. Government Securities	**1,883.9**	**2,076.1**	**2,111.4**	**2,146.0**	**2,186.0**	**2,260.5**	**2,300.5**	**154.6**	**7.2**	**96.9**	**98.3**	**97.0**	**96.7**	**97.3**	**96.7**	**97.0**
1. Treasury Bills (excluding Repo Bills)	**615.8**	**744.2**	**724.8**	**684.7**	**732.0**	**768.3**	**772.7**	**88.0**	**12.8**	**31.7**	**35.2**	**33.3**	**30.8**	**32.6**	**32.9**	**32.6**
Banking institutions	328.6	436.5	412.5	363.9	397.7	434.5	436.2	72.3	19.9	16.9	20.7	19.0	16.4	17.7	18.6	18.4
The Central Bank	20.6	20.6	20.6	20.6	20.6	20.6	20.6	0.0	0.0	1.1	1.0	0.9	0.9	0.9	0.9	0.9
Commercial Banks	308.0	415.9	391.9	343.3	377.1	413.9	415.6	72.3	21.0	15.8	19.7	18.0	15.5	16.8	17.7	17.5
Pension Funds	152.6	179.5	171.4	159.2	170.9	160.5	159.2	0.1	0.0	7.8	8.5	7.9	7.2	7.6	6.9	6.7
Insurance Companies	16.0	13.7	15.0	18.2	18.4	20.1	20.5	2.3	12.4	0.8	0.7	0.7	0.8	0.8	0.9	0.9
Others	118.5	114.4	125.9	143.4	145.1	153.2	156.8	13.4	9.3	6.1	5.4	5.8	6.5	6.5	6.6	6.6
2. Treasury Bonds	**1,268.2**	**1,332.0**	**1,386.6**	**1,461.2**	**1,453.9**	**1,492.2**	**1,527.8**	**66.6**	**4.6**	**65.2**	**63.1**	**63.7**	**65.8**	**64.7**	**63.8**	**64.4**
Banking institutions	650.9	724.5	749.8	783.5	773.4	793.0	813.2	29.7	3.8	33.5	34.3	34.5	35.3	34.4	33.9	34.3
The Central Bank	9.4	9.4	9.4	9.4	9.4	9.4	9.4	0.0	0.0	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Commercial Banks	641.5	715.1	740.4	774.1	763.9	783.5	803.8	29.7	3.8	33.0	33.9	34.0	34.9	34.0	33.5	33.9
Insurance Companies	122.9	138.9	119.7	124.4	124.9	126.4	130.4	6.0	4.8	6.3	6.6	5.5	5.6	5.6	5.4	5.5
Pension Funds	396.5	414.1	421.4	452.1	453.8	472.7	482.6	30.5	6.8	20.4	19.6	19.4	20.4	20.2	20.2	20.3
Others	97.8	54.5	95.7	101.2	101.8	100.2	101.6	0.4	0.4	5.0	2.6	4.4	4.6	4.5	4.3	4.3
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**	**25.0**	**24.4**	**24.4**	**23.9**	**23.9**	**23.9**	**-0.6**	**-2.3**	**1.3**	**1.2**	**1.1**	**1.1**	**1.1**	**1.0**	**1.0**
Of which: Repo T/Bills	24.4	23.8	23.8	23.8	23.3	23.3	23.3	-0.6	-2.3	1.3	1.1	1.1	1.1	1.0	1.0	1.0
B. Others:	**36.0**	**10.6**	**40.8**	**49.9**	**37.5**	**53.8**	**47.2**	**-2.7**	**-5.4**	**1.9**	**0.5**	**1.9**	**2.2**	**1.7**	**2.3**	**2.0**
Of which CBK overdraft to Government	26.0	0.0	24.7	42.3	29.9	46.2	39.7	-2.7	-6.3	1.3	0.0	1.1	1.9	1.3	2.0	1.7

Source: Central Bank of Kenya

Treasury Bills

Treasury bill holdings, excluding those held by the CBK for Open Market Operations (Repos) increased by 12.8 percent during the third quarter of the FY.2017/18, reflecting increased investors' appetite for shorter dated securities. Similarly, the proportion of Treasury bills to total domestic debt increased by 1.8 percent during the period under review. The dominance of commercial banks in the Treasury bills market persisted with banks accounting for 53.8 percent of the total amount of outstanding Treasury Bills by the end of the third quarter. Other significant holders of Treasury bills include Pension funds (20.6 percent) and parastatals – included in other holders (15.8 percent). The persistent dominance of commercial banks in the government securities' market characterizes under representation of other institutional investors (pension funds, foreign investors and insurance companies) (**Table 8.3**).

Treasury Bonds

Treasury bond holdings increased by 4.6 percent during the third quarter of the FY.2017/18, a slower build up compared to the 5.4 growth observed in the previous quarter. The deceleration was driven by the shift in investor preference towards shorter dated government securities. The largest component of the increase was the proceeds from the 15- year fixed rate bond. The dominant holders of Treasury bonds by the end of the period under review were commercial banks, pension funds and insurance companies. Commercial banks holdings accounted for about half of the total Treasury Bonds outstanding.

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

		Kshs (Billions)						Change Q on Q		Proportions						
		2016/17		2017/18				Q2 2017/18		2016/17		2017/18				
		Q3	Q4	Q2	Jan-18	Feb-18	Q3	Kshs(Bn)	%	Q3	Q4	Q1	Q2	Jan-18	Feb-18	Q3
Treasury bills	91-Day	48.7	92.2	46.0	49.7	49.7	48.5	2.5	5.4	2.5	4.4	1.6	2.1	2.2	2.1	2.0
	182-Day	212.4	234.3	190.9	202.0	206.3	202.1	11.2	5.9	10.9	11.1	11.7	8.6	9.0	8.8	8.5
	364-Day	354.7	417.7	447.8	480.3	512.3	522.1	74.3	16.6	18.2	19.8	19.9	20.2	21.4	21.9	22.0
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	100.9	82.1	113.9	93.8	93.8	93.8	-20.2	-17.7	5.2	3.9	4.7	5.1	4.2	4.0	4.0
	3-Year	0.0	0.2	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	2.3	4.8	4.8	4.8	4.8	0.0	0.0	0.1	0.1	0.2	0.2	0.2	0.2	0.2
	5-Year	288.3	272.7	323.0	323.0	323.0	346.1	23.1	7.1	14.8	12.9	13.9	14.5	14.4	13.8	14.6
	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	0.4	0.4
	7-Year	8.7	8.7	50.1	50.1	50.1	50.1	0.0	0.0	0.4	0.4	0.4	2.3	2.2	2.1	2.1
	8-Year	33.7	33.7	33.7	33.7	33.7	33.7	0.0	0.0	1.7	1.6	1.5	1.5	1.5	1.4	1.4
	9-Year	76.5	76.5	76.5	76.5	76.5	76.5	0.0	0.0	3.9	3.6	3.5	3.4	3.4	3.3	3.2
	10-Year	206.8	256.9	272.5	277.6	265.5	265.5	-7.0	-2.6	10.6	12.2	12.9	12.3	12.4	11.4	11.2
	11-Year	4.0	4.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.0	0.0	0.0	0.0	0.0
	12-Year	146.4	146.4	133.2	133.2	133.2	133.2	0.0	0.0	7.5	6.9	6.1	6.0	5.9	5.7	5.6
	15-Year	238.8	286.7	291.4	299.1	349.5	353.6	62.1	21.3	12.3	13.6	13.2	13.1	13.3	14.9	14.9
	20-Year	104.9	104.9	104.9	104.9	104.9	113.4	8.6	8.2	5.4	5.0	4.8	4.7	4.7	4.5	4.8
	25-Year	20.2	20.2	20.2	20.2	20.2	20.2	0.0	0.0	1.0	1.0	0.9	0.9	0.9	0.9	0.9
	30-Year	28.1	28.1	28.1	28.1	28.1	28.1	0.0	0.0	1.4	1.3	1.3	1.3	1.3	1.2	1.2
	Repo T bills	24.4	23.8	23.8	23.3	23.3	23.3	-0.6	-2.3	1.3	1.1	1.1	1.1	1.0	1.0	1.0
	Overdraft	30.3	0.0	42.3	29.9	46.2	39.7	-2.7	100.0	1.6	0.0	1.1	1.9	1.3	2.0	1.7
	Other Domestic debt	6.4	11.7	8.2	8.2	8.2	8.2	0.0	-0.6	0.3	0.6	0.5	0.4	0.4	0.4	0.3
Total Debt		**1,945.0**	**2,111.7**	**2,220.3**	**2,247.3**	**2,338.2**	**2,371.7**	**151.3**	**6.8**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Central Bank of Kenya

Domestic Debt by Tenor and Maturity Structure

The government floated both short and long dated securities during the period under review. The current debt securities portfolio is dominated by medium and long term debt securities, underscoring the government's Public Debt Management Strategy 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 75.7 percent of the total of outstanding Treasury Bonds, a 2.0 percent decline from the position in the previous quarter. Other domestic debt consists of uncleared effects, advances from commercial banks and Tax Reserve Certificates.

The average time to maturity of existing domestic debt increased to 4 years and 1 month in the third quarter of the FY 2017/18 from 4 years in the second quarter of FY 2017/18. This marginal increase was attributed to the issuance of more long term Treasury bonds during the third quarter of FY 2017/18 as compared to the issuance of short and medium term Treasury bonds during the second quarter of FY 2017/18.

External Debt

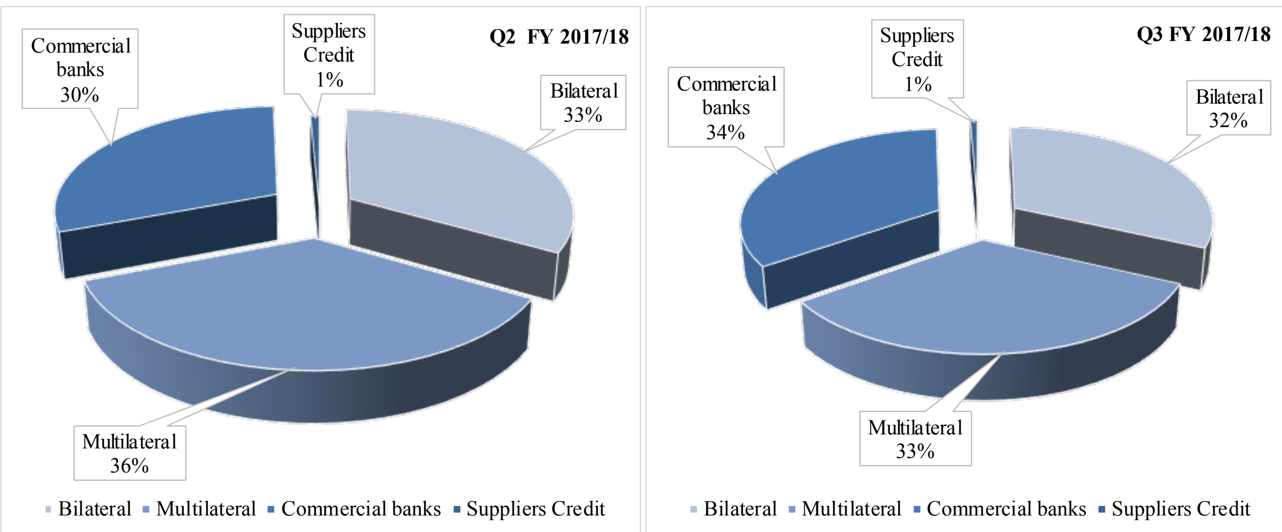
Public and publicly guaranteed external debt increased by 6.9 percent during the third quarter of the FY.2017/18, largely reflecting the US D 2.0 billion disbursements of commercial debt from the March 2018 international sovereign bond. Principal amortization of debt owed to International Development Association (IDA) and China, and the repayment of the 2015 syndicated loan had an off-setting effect on the overall external debt build up. Foreign exchange risk on external debt remained low due to relatively stable exchange rate during the quarter under review.

Composition of External Debt by Creditor

Kenya's proportion of concessional debt declined as a result of increased commercial and semi-concessional borrowing, mainly driven by the US D 2.0.billion international sovereign bond. Consequently, the share of commercial debt increased by 4.1 percentage points during the review period. The share of outstanding debt from official multilateral and bilateral lenders (who provide both concessional and semi-concessional loans) decreased from 69.1 percent in the previous quarter to 65.2 percent by the end of the third quarter of the FY 2017/18 (**Chart 8.1**).

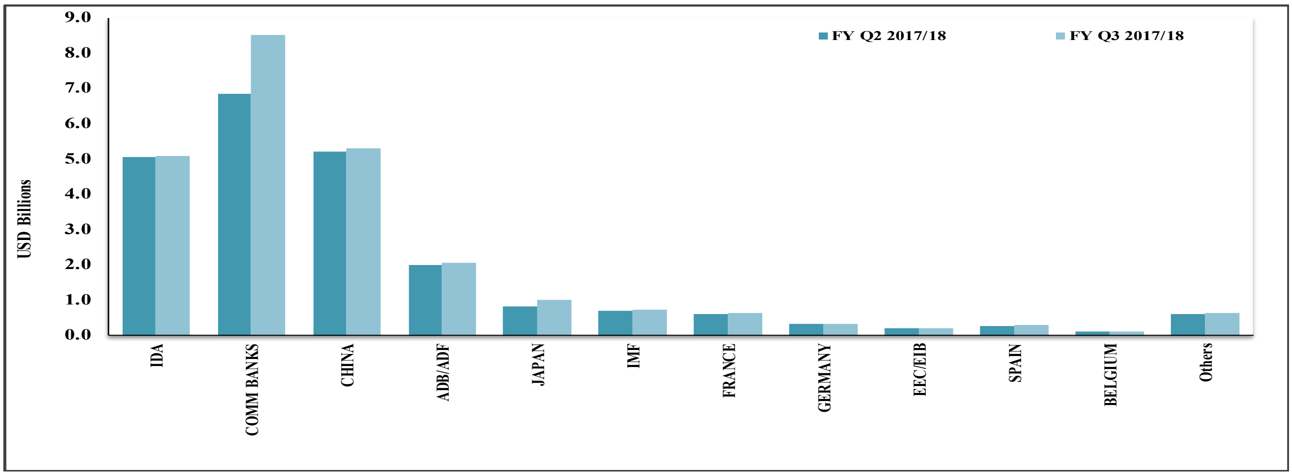
Debt owed to the International Development Association (IDA), Kenya's largest multilateral lender, amounted to US D 5.1 billion or 20.4 percent (compared to 22.8 percent in the previous quarter) of total external debt; while that owed to China, Kenya's largest bilateral lender, amounted to US D 5.3 billion, or 21.3 percent compared to 22.9 percent in the previous quarter of the total external debt in the third quarter of the FY 2017/18 (**Chart 8.2**).

Chart 8.1: Composition of External Debt by Lender



Source: The National Treasury

Chart 8.2: **External Debt By Creditor**



Source: The National Treasury

Currency Composition of External Debt

Kenya's public and publicly guaranteed external debt is denominated in various currencies to mitigate against currency risk. The dominant currencies include the USD, Euro, Yuan and Yen, which accounted for 96.9 percent of the total currency composition at the end of the third quarter of the FY.2017/18. This was consistent with the currency composition of the CBK's forex reserve holdings. The proportion held in US Dollar increased mainly on account of disbursements of dollar–denominated loans from the international sovereign bond (**Chart 8.3**).

Public Debt Service

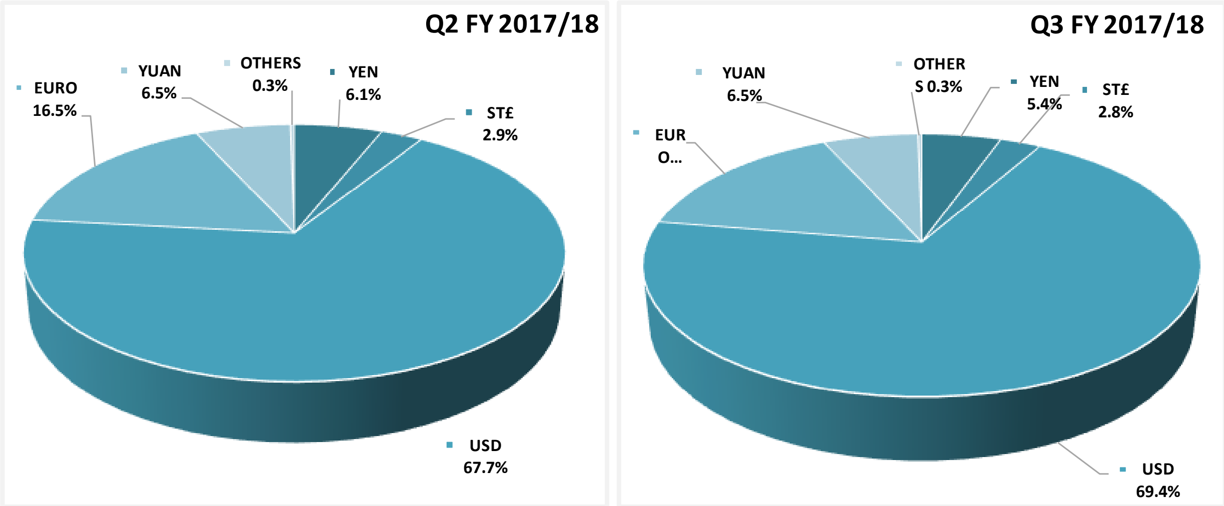
The ratio of domestic interest payments to tax revenues stood at 13.7 percent in the third quarter of the FY.2017/18, which was lower than the previous quarter (17.3 percent). The largest component of domestic interest payments was coupon interest on Treasury Bonds, which was consistent with the proportion of debt held in Treasury bonds. External debt service for the third quarter of the FY.2017/18 amounted to KSh 45.2 billion and was within debt sustainable levels. Analysis of the liquidity indicators of external indebtedness show that Kenya faces low exposure to external debt service default as the ratios were below the Country Policies and Institutional Assessment (CPIA) determined liquidity indicators (21 percent of exports and 23 percent of revenues) (**Table 8.4**).

Debt Sustainability Analysis

However, stress testing showed heightening vulnerabilities to debt distress. The March 2018 Debt Sustainability Analysis (DSA)update showed deteriorating debt dynamics. All the liquidity and solvency debt burden indicators were below the[2] CPIA based thresholds in the baseline scenarios but there were breaches in the alternative scenarios. Public DSA sensitivity analysis shows that if primary deficit were to remain at the current levels, public debt would take an upward trajectory way above the debt sustainability benchmark for strong policy performers. This points to the need for fiscal consolidation in the medium term.

[2] CPIA stands for Country Policies and Institutional Assessment

Chart 8.3: Debt Composition by Currency



Source: The National Treasury

Table 8.4: Liquidity Indicators of External Debt Sustainability

	Q2 FY 2016/17	Q3 FY 2016/17	Q4 FY 2016/17	Q1 FY 2017/18	Q2 FY 2017/18	Q3 FY 2017/18
Debt service to Revenues (23%)	7.0	7.3	7.3	7.2	11.4	8.5
Debt service to Exports (21%)	10.3	8.3	8.3	9.1	14.8	10.5

Source: Central Bank of Kenya

Chapter 9
The Capital Markets

Equities Market

The equities market performance improved in the first quarter of 2018. The NSE 20 and NASI Share Indices increased by 3.84 percent and 11.57 percent, respectively, compared to the fourth quarter of 2017. The number of shares traded increased 65.66 percent, while turnover increased by 69.77 percent, indicating improved liquidity conditions in the equities market **(Table 9.1).**

The improvement in the equity prices and shares traded increased shareholder's wealth, measured by market capitalization, by 11.71 percent in the first quarter of 2018 compared to the fourth quarter of 2017 **(Figure 9.1).** The improvement in the performance of the equities market is on account of the rebound of economic activities in the first quarter of 2018.

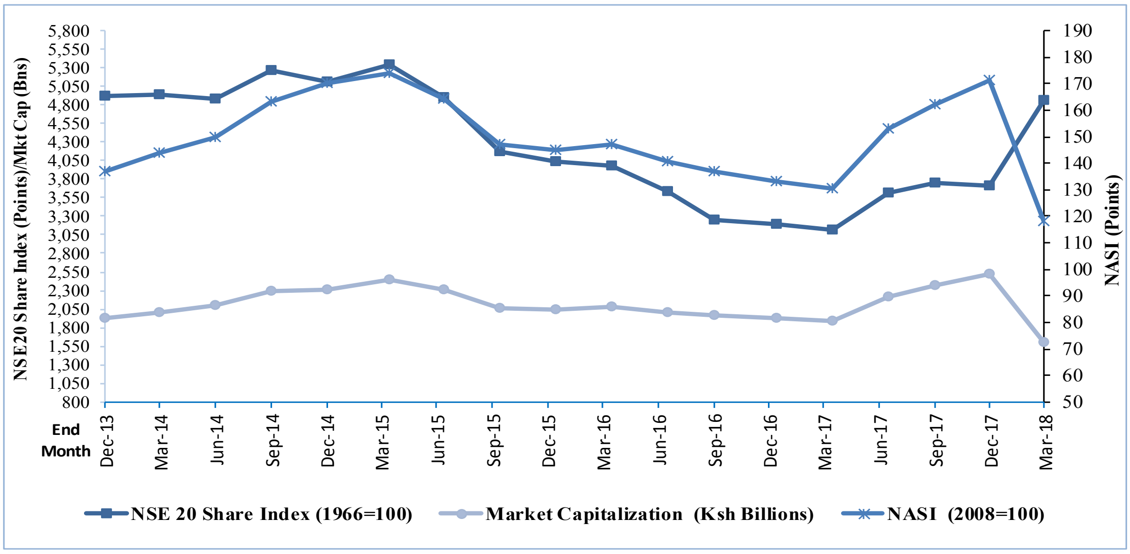
Table 9.1: Selected Stock Market Indicators

INDICATOR	2015	2016				2017				2018	% QUARTERLY CHANGE (2017Q4-2017Q3)
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	
NSE 20 Share Index (1966=100)	4,040	3,982	3,641	3,243	3,186	3,113	3,607	3,751	3711.9	3854.3	3.84
NASI (2008=100)	145.00	147.00	140.60	136.75	133.30	130.51	152.92	162.21	171.20	191.00	11.57
Number of Shares Traded (Millions)	1,456	1,300	1,411	1,999	1,101	1,860	1,892	557	2,522	2,817	11.71
Equities Turnover (Ksh Millions)	46,095	36,609	37,034	48,141	25,392	37,095	44,902	16,248	22,760	31,065	36.49
Market Capitalization (Ksh Billions)	2,054	2,078	1,998	1,972	1,931	1,894	2,224	2,377	22,941	39,149	70.65
Foreign Purchase (Ksh Millions)	29,500	20,258	26,322	40,038	17,652	29,421	27,424	6,149	13,347	18,381	37.71
Foreign Sales (Ksh Millions)	29,439	21,844	19,339	34,018	16,703	27,433	29,692	11,947	89,120	152,338	70.94
Average Foreign Investor Participation to Equity Turnover (%)	64	58	62	77	68	76.68	66.66	55.69	92.83	93.58	0.81
Bond Turnover (Ksh Millions)	71,321	113,400	149,809	74,809	94,367	103,997	134,633	108,168	89.12	152.34	70.94
FTSE NSE Kenya Govt. Bond Index	90.04	89.28	87.98	89.11	90.05	89.73	91.54	91.67	92.83	93.58	0.81
5-Year Eurobond Yield (%)	7.93	6.48	6.23	4.59	4.95	4.20	4.465	4.276	3.76	3.83	0.07*
10-Year Eurobond Yield (%)	9.05	7.81	8.31	6.84	7.86	7.10	6.64	6.46	5.67	6.24	0.57*
10-Year Eurobond Yield (%)-2028										6.862	0
30-Year Eurobond Yield (%)-2048										7.81	0

* Percentage points

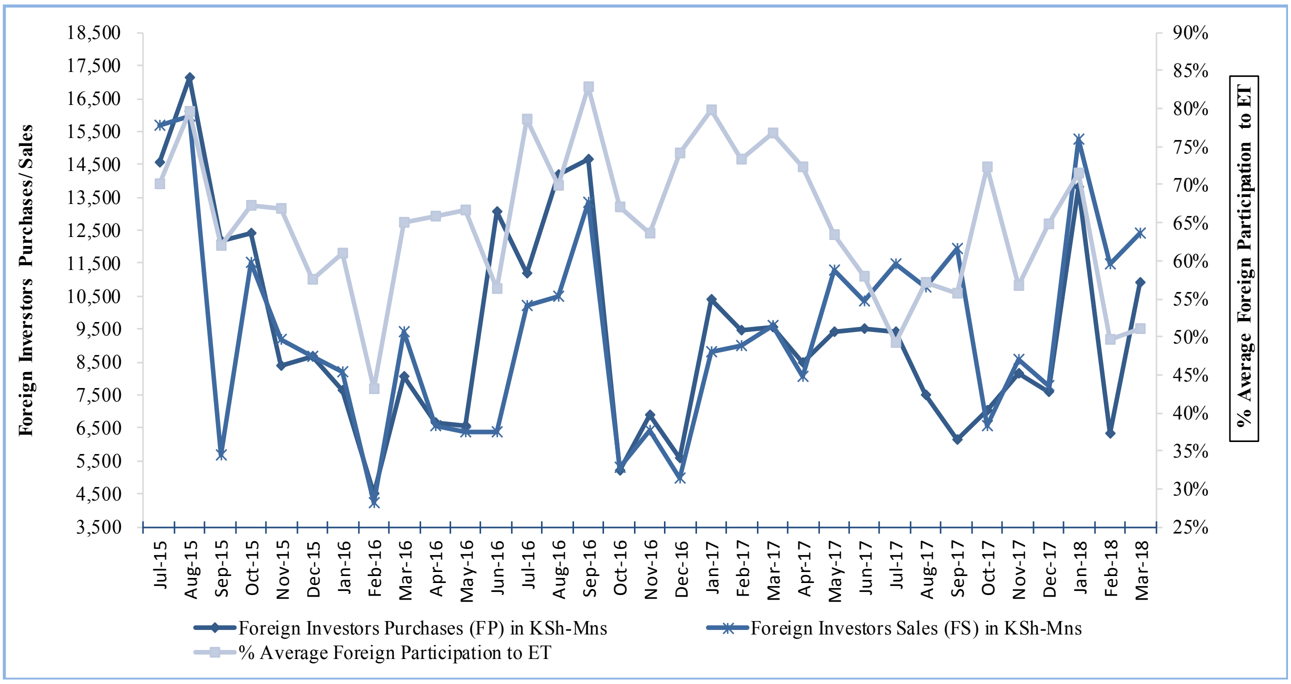
Source: Nairobi Securities Exchange

Chart 9.1: NSE 20, NASI and Market Capitalization



Source: Nairobi Securities Exchange

Chart 9.2: Foreign Investors Participation at the NSE



Source: Nairobi Securities Exchange

Foreign Investors' Participation

The value of shares purchased by foreign investors at the Nairobi Securities Exchange (NSE) increased by 36.49 percent in the first quarter of 2018, while the value of shares sold by foreign investors increased by 70.65 percent compared to the fourth quarter of 2017. The net foreign investors' participation at the NSE relative to equity turnover averaged 57.41 percent, which is lower compared to the fourth quarter of 2017 of 63.44 percent, reflecting a higher participation by local investors relative to foreign investors **(Figure 9.2 and Table 9.1).**

Bond Market

The value of bonds traded in the first quarter of 2018 increased by 70.94 percent compared to the fourth quarter of 2017 due to increase sales of government bonds with higher coupon rates on the primary market. The FTSE NSE Kenyan Government Bond Index increased by 0.81 percent in the period under review, reflecting a marginal decline in secondary market yields. The 5– and 10– year Kenya Eurobonds yields increased by 0.07 percentage points and 0.57 percentage points, respectively, reflecting investor sentiments about Kenya's elevated risk profile. The Government of Kenya issued 10 year and 30 year Eurobonds with coupon rates of 7.25 percent and 8.25 percent, respectively, in the first quarter of 2018. The yields on the two bonds reduced to 6.86 and 7.81 by the end of the first quarter of 2018.

Chapter 10

Statement of Financial Position of the Central Bank of Kenya

(Kenya Shillings Million)

				2017			2018				QUARTERLY CHANGES (%)
1.0	ASSETS	JUNE	SEPT	DEC	MARCH	Q1, 2018	Q1, 2018	Q4, 2017	Q3, 2017	Q2, 2017	Q1, 2017
1.1	RESERVES AND GOLD HOLDINGS	870,324.9	830,309.2	753,349.8	929,848.0	176,498.2	23.4	-9.3	-4.6	4.1	11.7
1.2	FUNDS HELD WITH IMF	1,877.3	253.0	1,486.8	2,677.6	1,190.9	80.1	487.7	-86.5	56.6	-68.0
1.21	INVESTMENT IN EQUITY (SWIFT SHARES)	9.5	9.8	9.9	10.0	0.1	1.2	1.3	2.8	7.0	3.3
1.3	ITEMS IN THE COURSE OF COLLECTION	42.8	21.9	18.7	21.0	2.3	12.6	-14.7	-48.9	52.1	21.8
1.4	ADVANCES TO COMMERCIAL BANKS	34,869.9	75,772.6	39,644.7	43,604.4	3,959.7	10.0	-47.7	117.3	-16.7	-25.0
1.5	LOANS AND OTHER ADVANCES	2,575.1	2,649.5	2,645.1	2,550.6	-94.5	-3.6	-0.2	2.9	1.8	-2.3
1.6	OTHER ASSETS	2,923.1	2,485.7	2,353.8	2,284.5	-69.3	-2.9	-5.3	-15.0	17.9	-33.5
1.7	RETIREMENT BENEFIT ASSET	8,197.5	8,197.5	8,197.5	8,197.5	0.0	0.0	0.0	0.0	5.4	0.0
1.8	PROPERTY AND EQUIPMENT	22,702.7	21,982.9	22,002.9	22,323.6	320.7	1.5	0.1	-3.2	1.2	2.8
1.81	INTANGIBLE ASSETS	52.5	49.0	46.8	117.5	70.6	150.9	-4.4	-6.6	173.3	-217.3
1.9	DUE FROM GOVERNMENT OF KENYA	24,448.8	49,350.3	66,887.5	63,609.3	-3,278.2	-4.9	35.5	101.9	-55.9	-0.4
	TOTAL ASSETS	**968,024.1**	**991,081.3**	**896,643.4**	**1,075,243.5**	**178,600.1**	**19.9**	**-9.5**	**2.4**	**-0.2**	**7.8**
2.0	**LIABILITIES**										
2.1	CURRENCY IN CIRCULATION	253,787.1	250,695.5	279,159.0	262,621.6	-16,537.4	-5.9	11.4	-1.2	3.4	-6.6
2.2	INVESTMENTS BY BANKS - REPOS	0.0	0.0							-100.0	0.0
2.3	DEPOSITS	470,108.8	483,814.8	364,325.3	571,656.6	207,331.2	56.9	-24.7	2.9	1.1	16.2
2.4	INTERNATIONAL MONETARY FUND	115,125.4	114,659.4	110,416.3	109,128.9	-1,287.3	-1.2	-3.7	-0.4	-0.9	0.0
2.5	OTHER LIABILITIES	-5,058.9	1,859.0	1,496.5	1,661.0	164.5	11.0	-19.5	-136.7	-252.0	57.4
	TOTAL LIABILITIES	833,962.4	851,028.7	755,397.2	945,068.2	189,671.0	25.1	-11.2	2.0	-1.2	8.1
3.0	EQUITY AND RESERVES	134,061.7	140,052.8	141,246.3	130,175.4	-11,070.9	-7.8	0.9	4.5	7.0	5.9
	Share Capital	5,000.0	5,000.0	5,000.0	5,000.0		0.0			0.0	0.0
	General reserve fund -Unrealized	57,550.3	65,195.3	65,195.3	65,195.3	0.0	0.0	0.0	13.3	0.0	0.0
	-Realized	16,908.5	23,690.2	23,689.8	23,689.8		0.0		40.1	0.0	0.0
	-Capital Projects	15,047.4	17,189.4	17,189.4	17,189.4		0.0	0.0	14.2	0.0	0.0
	Period surplus/(Deficit)	16,568.6	5,990.7	7,184.5	-3,886.4	-11,070.9	-154.1	19.9	-63.8	101.6	571.9
	Asset Revaluation	14,790.0	14,790.0	14,790.0	14,790.0		0.0		-	0.0	0.0
	Retirment Benefit Asset Reserves	8,196.9	8,197.3	8,197.2	8,197.2		0.0	0.0		5.4	0.0
4.0	**TOTAL LIABILITIES AND EQUITY**	**968,024.1**	**991,081.5**	**896,643.4**	**1,075,243.5**	**178,600.1**	**19.9**	**-9.5**	**2.4**	**-0.2**	**7.8**

Source: Central Bank of Kenya

Notes on the Financial Position

Assets

The balance sheet of the Central Bank of Kenya (CBK), increased by 19.9 percent in the first quarter of 2018 compared to a decline of 9.5 percent in the previous quarter. This growth is attributed to an increase in reserves and gold holdings, which increased by KSh.76.5 billion. Reserve and gold holdings 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.

Other items that contributed to an increase in assets of the CBK include advances to commercial banks, largely for liquidity management, which increased by 10.0 percent in the first quarter of 2018 compared to a decline of 47.7 percent in the previous quarter. The increase in advances to commercial banks was on account of relatively tight liquidity conditions in the banking system, necessitating liquidity injections through Reverse Repos.

Items in the course of collection, which represent the value of clearing instruments held by CBK while awaiting clearing by respective commercial banks increased by 12.6 percent in the first quarter of 2018, compared to a decline of 14.7 percent in the fourth quarter of 2017.

Loans and other advances include outstanding balances on advances to commercial banks under the Overnight Loan Facility (OLF), and IMF funds on-lent to the Government, that declined by 3.6 percent in the first quarter of 2018 compared to a decline by 0.2 percent in the previous quarter.

Other assets, which largely consist of prepayments and sundry debtors, and deferred currency expense declined further by 2.9percent in the First quarter of 2018.

Debt due from Government of Kenya, including Government utilization of the overdraft facility at the CBK and overdrawn accounts, which were converted to a long term debt with effect from November 1, 1997 declined in the first quarter of 2018. The government outstanding overdraft at CBK declined by 4.9 percent in the first quarter of 2018 compared to an increase of 35.5 percent in the previous quarter.

Liabilities

Currency in circulation declined by 5.9 percent in the first quarter of 2018 compared to an increase of 11.4 percent in the previous quarter.

Deposits by the Government of Kenya, local commercial banks, other public entities and project accounts and local banks' foreign exchange settlement accounts grew by 56.9 percent in the first quarter of 2018 compared to a decline of 24.7 percent in the previous quarter.

CBK equity and reserves decreased by 7.8 percent in the first quarter of 2018 compared to a growth of 0.9 percent in the previous quarter, reflecting an increase in the period's deficit.

Central Bank of Kenya

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