Central Bank of Kenya

QUARTERY ECONOMIC REVIEW (QER)

Volume 2 No 2
April - June 2017

OBJECTIVES OF THE CENTRAL BANK OF KENYA

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

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

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

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

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QUARTERLY ECONOMIC REVIEW

APRIL - JUNE 2017

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HIGHLIGHTS

Overall inflation rose further to 10.8 per cent in the second quarter of 2017, from 8.8 per cent in the first quarter of 2017, on account of high food prices following unfavorable weather conditions during the quarter. Similarly, annual average inflation increased by 130 basis points to 7.8 per cent from 6.5 per cent during the same period.

Recovery of growth in broad money (M3) that began in the first quarter of 2017 continued into the second quarter. Growth in M3 accelerated to 3.1 per cent in the second quarter of 2017 from 3.0 per cent in the first quarter.

The Monetary Policy Committee (MPC) decisions in May and July 2017 focused on anchoring inflation expectations. During both the May and July 2017 meetings, the Committee retained the Central Bank Rate (CBR) at 10.0 per cent. The weighted average interbank interest rate decreased to 4.8 per cent in June 2017 from 6.2 per cent in March 2017, reflecting improved market liquidity conditions.

The Kenyan economy recorded robust growth in the second quarter of 2017, despite adverse weather conditions which were experienced since late 2016 which affected agriculture. It expanded by 5.0 per cent compared to 4.7 per cent in the first quarter of 2017, largely on account of improved weather conditions, compared to the first quarter, which supported recovery in Agriculture, and Electricity and Water Supply. In addition, high Government spending on infrastructure development, low international oil prices and robust growth in tourist arrivals supported improved activity during the quarter.

Global growth is gaining momentum with a projected growth of 3.5 per cent in 2017 and 3.6 per cent in 2018 from 3.2 per cent in 2016.

Kenya's current account deficit widened by 5.4 per cent to stand at USD 1,304 million in the second quarter of 2017 from a deficit of USD 1,237 million during the first quarter of 2017 largely reflecting worsening of the trade and primary income balances.

Kenya's official international reserves position was strong at USD 8,580 million by end-June 2017, equivalent to 5.7 months of imports.

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

The banking sector continues to remain strong and vibrant despite increase in non performing loans. During the period under review, KEPSS availability improved to an average of 99.95 per cent compared to 99.23 per cent in the previous quarter.

The Government budgetary operation resulted in a deficit of 5.3 per cent of GDP in the fourth quarter of the FY 2016/17 compared with a deficit of 4.0 per cent of GDP in the third quarter. The cummulative deficit at 8.9 per cent of GDP through June 2017 was within the 10.9 per cent of GDP target for FY 2016.17.

Kenya's public and publicly guaranteed debt increased by 8.9 per cent during the fourth quarter of the FY 2016/17 mainly driven by KSh 193.3 billion increase in external debt during the quarter.

The capital markets recorded strong rally in the second quarter of 2017 as reflected in the leading market indicators for equities, domestic bond market segment and trading yields for Kenya's Eurobonds.

Chapter 1
Inflation

Overview

Overall inflation accelerated to 10.8 per cent in the second quarter of 2017, from 8.8 per cent in the first quarter of 2017, largely on account of the persistent high food prices attributable to unfavorable weather conditions during the quarter (**Table 1.1**). Food inflation increased to 18.1 per cent during the quarter under review from 14.7 per cent in the previous quarter. Fuel inflation increased to 3.5 per cent from 2.3 percent, while Non-Food Non-Fuel (NFNF) inflation increased marginally to 4.3 per cent from 4.2 per cent over the same period.

Annual average inflation increased by 130 basis points to 7.8 per cent from 6.5 per cent in the period under review, whereas the three months annualized inflation rose by 60 basis points to 15.4 per cent in the second quarter of 2017 from 14.8 per cent in the first quarter of 2017, reflective of underlying inflationary pressures in the economy.

Table 1.1: Recent Developments in Inflation in Per cent

	2016				2017				
	Q1	Q2	Q3	Q4	Q1	Q2	Apr	May	Jun
Quarterly Overall Inflation	7.02	5.36	6.33	6.50	8.77	10.79	11.48	11.70	9.21
Food Inflation	10.43	7.24	10.30	10.57	14.74	18.11	19.49	19.99	14.83
Fuel Inflation	2.25	1.73	0.40	0.27	2.31	3.52	3.67	3.49	3.39
Non-Food Non-Fuel Inflation (NFNF)	5.81	5.42	4.99	5.18	4.21	4.27	4.30	4.28	4.24
Average annual	6.84	6.58	6.47	6.40	6.48	7.75	7.28	7.84	8.13
Three months annualised	5.14	7.35	6.98	6.63	14.75	15.43	22.78	18.13	5.37

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

Contributions of broad categories to overall inflation

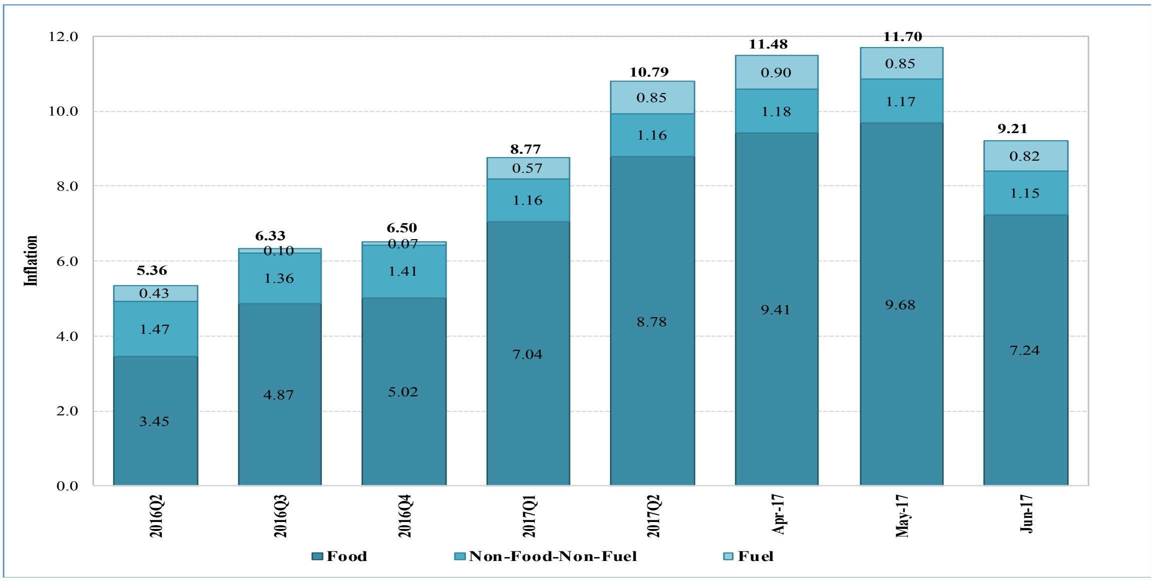
The contribution of food inflation to overall inflation accelerated to 8.8 percentage points from 7.0 percentage points in the first quarter of 2017. The increase reflects the effect of the drought conditions experienced in the first quarter of 2017. The contribution of fuel inflation to overall inflation increased to 0.9 percentage points from 0.6 percentage points in the previous quarter, partly driven by moderate recovery in international oil prices, a pick-up in Liquefied Petroleum Gas (LPG) prices occasioned by increasing international prices and low supply following ban on importation from Tanzania. In addition, the cost of electricity increased following the low hydro power generation as a result of the unfavorable weather conditions in the first quarter of 2017. Meanwhile, the contribution of NFNF stabilized at 1.2 percentage points in the first and second quarter of 2017, reflecting muted demand driven inflationary pressures (**Chart 1.1**).

Food inflation

Food inflation accelerated to 18.1 per cent in the second quarter of 2017, up from 14.7 per cent in the first quarter of 2017. The increase was occasioned by increasing prices of selected key seasonal and fast growing food items. Moreover, the shortage of sugar and maize products further exacerbated the increase in food prices. However, the government measures to curb rising prices of maize coupled with increased imports of staple food helped to ease prices of maize, milk, rice and sugar towards the end of the second quarter.

The contribution of tomatoes to overall inflation continued to be the most significant at 1.46 percentage points in the second quarter of 2017, a marginal decline from 1.47 percentage points in the first quarter of 2017. The contribution of maize increased significantly to 0.98 percentage points from 0.60 percentage points in the same period, reflective of the elevated prices of maize and maize products occasioned by the shortage experienced during the quarter under review. The contribution of sugar to overall inflation increased twofold to 0.64 percentage points from 0.33 percentage points. This was attributable to high international sugar prices and shortages arising from low cane supplies resulting from unfavorable weather

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

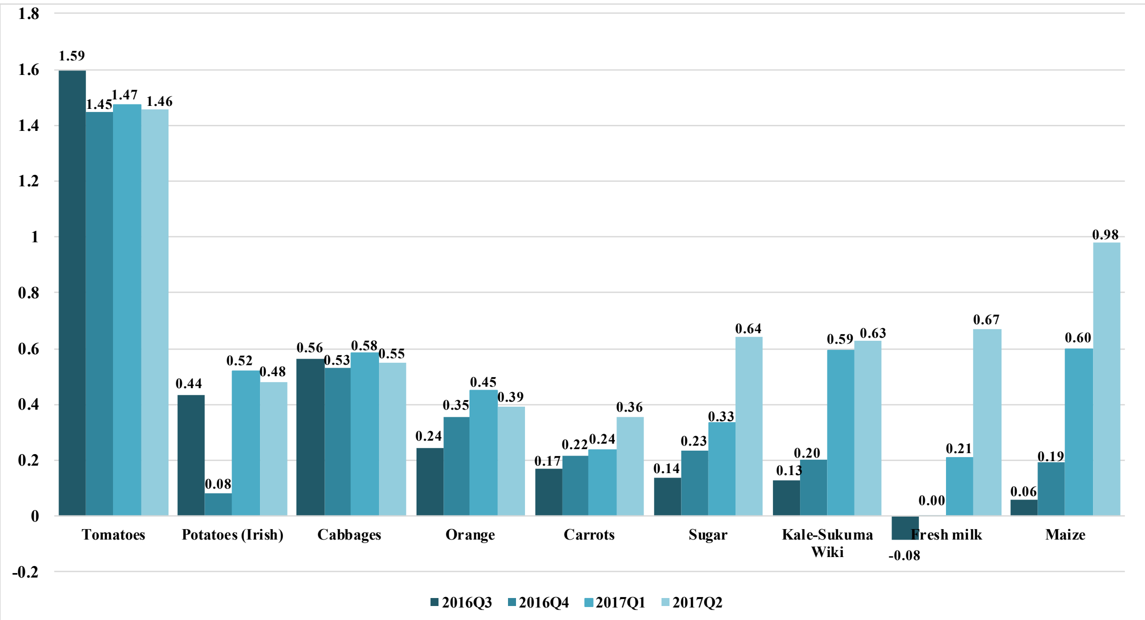


Source: Kenya National Bureau of Statistics and Central Bank of Kenya.

conditions and closure of most sugar factories in the country for maintenance. However, the Government's efforts to improve supply through increased importation helped to lower sugar prices in June 2017.

The contribution of fresh milk increased significantly for the second consecutive quarter to 0.67 percentage points from 0.21 percentage points in the first quarter of 2017. This followed decreased dairy production, occasioned by declining foliage for dairy animals, following the drought conditions experienced during the quarter. The contribution of carrots to overall inflation rose to 0.36 percentage points from 0.24 percentage points, while that of kales (sukuma wiki) increased marginally to 0.63 percentage points from 0.59 percentage points over the same period, respectively. However, Irish potatoes, cabbages and oranges, whose contribution increased in the first quarter of 2017 reversed the trend in the second quarter of 2017 as their contributions started declining.

Chart 1.2: Contribution of Main Food Items to overall Inflation in Percentage Points[1]



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

[1]Fresh milk comprises of fresh packeted and unpacketed milk.

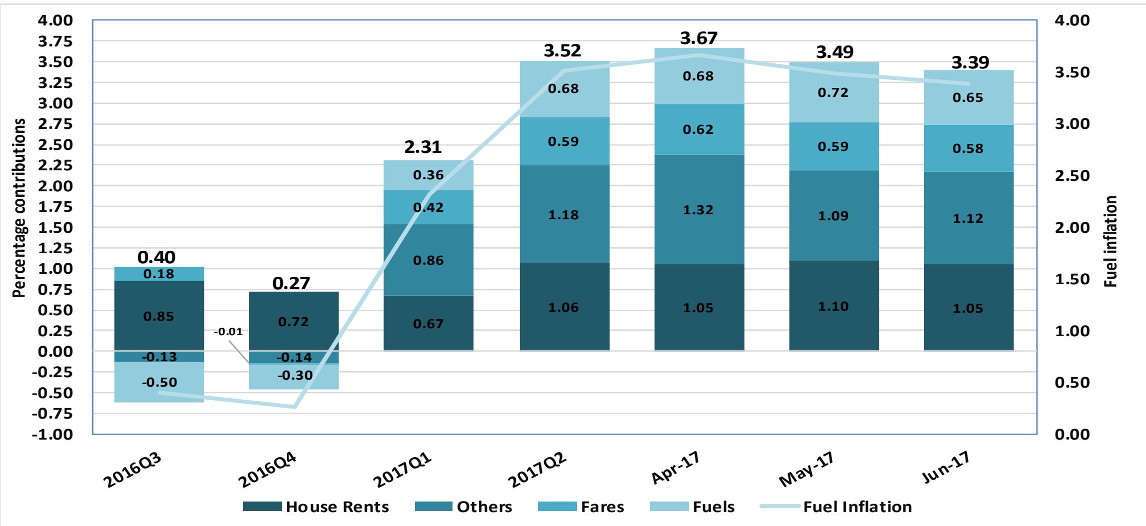
Maize comprises of green maize, loose maize grain, sifted maize flour and loose maize flour.

Fuel Inflation

Fuel inflation increased to 3.5 per cent in the second quarter of 2017 from 2.3 per cent in the first quarter (**Chart 1.3**), owing to increased prices of house rents, fuels[1], fares and other components in the fuel basket. Moreover, the cost of electricity went up during the period under review, owing to the shift in electricity generation from the less expensive hydro power to the expensive thermal sources. The shift was occasioned by lower than usual water levels, following drought conditions experienced in the country during the period. The drought also led to water shortages leading to increased cost of acquiring water services. In addition, Liquefied Petroleum Gas (LPG), which has been moderating fuel inflation since 2015 reversed its trend following increasing international prices and supply constraints following ban on importation of LPG from Tanzania during the period under consideration.

[2] Fuels comprise of Gas - (LPG), Kerosene, Petrol, Diesel, Charcoal and Firewood.

Chart 1.3: Contribution of Key Items to Fuel Inflation



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

Table 1.2: Contribution of various Baskets to Non-Food-Non-Fuel Inflation in Percentage Points

		Alcoholic Beverages, Tobacco & Narcotics	Clothing & Footwear	Furnishings, Household Equipment and Routine Household Maintenance	Health	Communication	Recreation & Culture	Education	Miscellaneous Goods & Services	**Non-Food Non-Fuel Inflation**
2016	Q2	1.11	1.08	0.92	0.51	0.24	0.40	0.49	0.65	**5.42**
	Q3	1.10	0.96	0.81	0.43	0.20	0.40	0.46	0.63	**4.99**
	Q4	0.87	1.20	0.79	0.45	0.24	0.46	0.50	0.67	**5.18**
2017	Q1	0.39	1.14	0.74	0.44	0.17	0.29	0.41	0.64	**4.21**
	Q2	0.41	1.10	0.79	0.44	0.15	0.27	0.41	0.70	**4.27**
	April	0.41	1.12	0.77	0.46	0.16	0.30	0.42	0.66	**4.30**
	May	0.42	1.09	0.79	0.44	0.14	0.27	0.40	0.72	**4.28**
	June	0.40	1.10	0.82	0.42	0.14	0.25	0.40	0.71	**4.24**

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

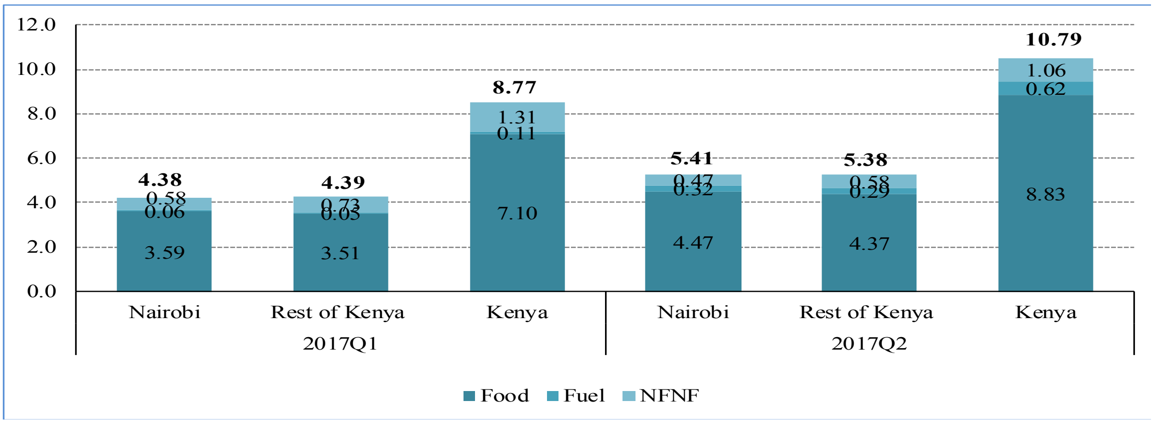
Overall Quarterly Inflation across Regions

Inflation in the Rest of Kenya accelerated to 11.3 per cent in the second quarter of 2017, from 9.2 per cent in the first quarter of 2017, whereas that of Nairobi rose to 10.1 per cent from 8.4 per cent over the same period. Consequently, the contribution of the Rest of Kenya to overall inflation increased to 5.4 percentage points from 4.4 percentage points, while the contribution of Nairobi region rose to 5.4 percentage points from 4.4 percentage points.

In both regions, food prices escalated further during the review period, reflecting the increase in the contribution of food to inflation in both Nairobi and the Rest of Kenya regions. Food inflation increased to 4.5 percentage points from 3.6 percentage points and 4.4 percentage points from 3.5 percentage points in both Nairobi and the Rest of Kenya, respectively (**Chart 1.4**). The contribution of fuel inflation to inflation in the regions was mixed. In Nairobi its contribution increased to 0.5 percentage points from 0.3 percentage points whereas in the 'Rest of Kenya' it increased to 0.4 percentage points from 0.3 percentage points.

The contribution of NFNF inflation to inflation in the two regions remained stable and unchanged across the regions. Its contribution to inflation in Nairobi and the Rest of Kenya stabilized at 0.5 percentage points and 0.6 percentage points, respectively in the first and second quarter of 2017.

Chart 1.4: Contribution of Various Regions to Quarterly Overall Inflation in Percentage Points



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

Overall Quarterly Inflation across Regions

Inflation in the Rest of Kenya accelerated to 11.3 per cent in the second quarter of 2017, from 9.2 per cent in the first quarter of 2017, whereas that of Nairobi rose to 10.1 per cent from 8.4 per cent over the same period. Consequently, the contribution of the Rest of Kenya to overall inflation increased to 5.4 percentage points from 4.4 percentage points, while the contribution of Nairobi region rose to 5.4 percentage points from 4.4 percentage points.

In both regions, food prices escalated further during the review period, reflecting the increase in the contribution of food to inflation in both Nairobi and the Rest of Kenya regions. Food inflation increased to 4.5 percentage points from 3.6 percentage points and 4.4 percentage points from 3.5 percentage points in both Nairobi and the Rest of Kenya, respectively (**Chart 1.4**). The contribution of fuel inflation to inflation in the regions was mixed. In Nairobi its contribution increased to 0.5 percentage points from 0.3 percentage points whereas in the 'Rest of Kenya' it increased to 0.4 percentage points from 0.3 percentage points.

The contribution of NFNF inflation to inflation in the two regions remained stable and unchanged across the regions. Its contribution to inflation in Nairobi and the Rest of Kenya stabilized at 0.5 percentage points and 0.6 percentage points, respectively in the first and second quarter of 2017.

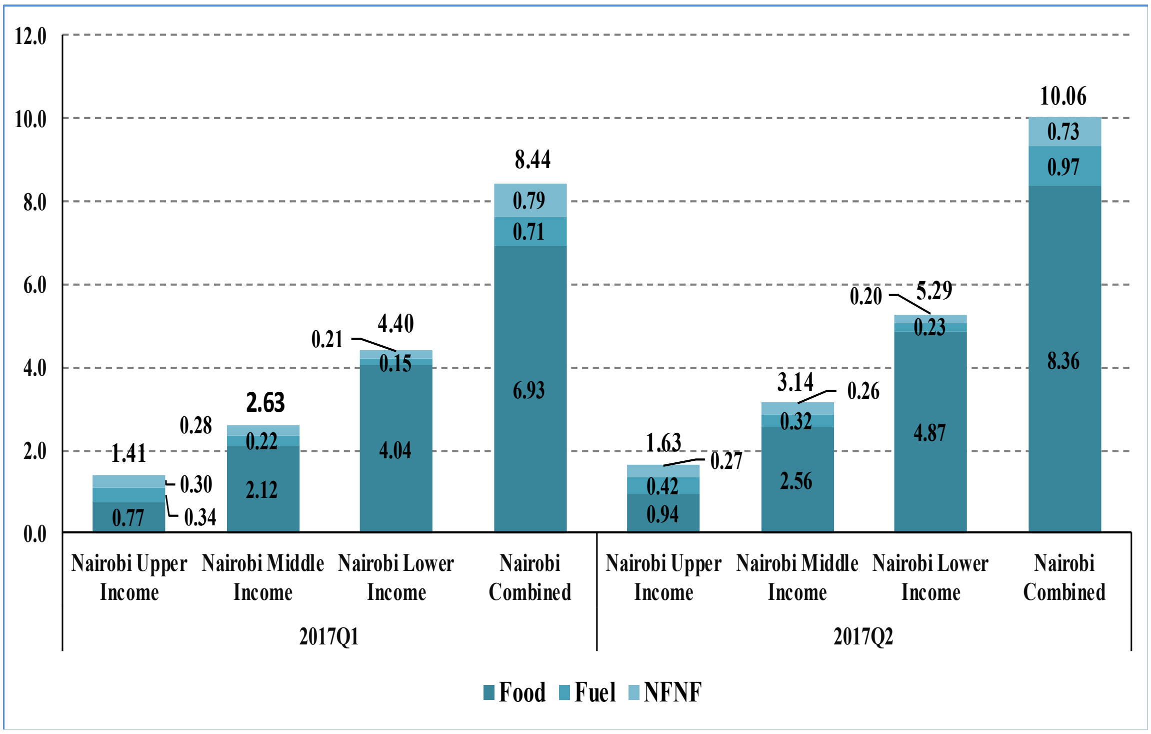
Overall Quarterly Inflation across Income Groups in Nairobi

Though varied, inflation increased across income groups in Nairobi in the second quarter of 2017 compared to the first quarter of 2017. Inflation in Nairobi increased to 10.1 per cent from 8.4 per cent in the first quarter of 2017. The increase was significant in both the lower and middle income groups, largely driven by food inflation. Inflation in the Nairobi lower income group increased to 11.2 per cent in the period under consideration, from 9.4 per cent in the previous period whereas the Nairobi middle income inflation rose to 7.2 per cent from 5.6 percent. However, inflation in the Nairobi upper income group increased marginally to 3.7 per cent from 4.6 per cent in the previous quarter (**Chart 1.5**).

The contribution of food inflation to inflation in Nairobi in the period under consideration rose to 8.4 percentage points from 6.9 percentage points. This was largely driven by increased contribution of the lower income group which increased to 4.9 percentage points from 4.0 percentage points. Moreover, the contribution of the middle and upper income groups' increased to 2.6 percentage points and 0.9 percentage points, from 2.1 percentage points and 0.8 percentage points, respectively.

The contribution of fuel inflation to inflation in Nairobi increased to 0.97 percentage points in the second quarter of 2017 from 0.7 percentage points in the previous quarter. The increase was reflected by its increased contribution to inflation across all the income groups. On the other hand, the contribution of NFNF inflation to inflation in Nairobi declined marginally to 0.73 percentage points in the quarter under review, from 0.79 percentage points in the previous quarter, with the declines recorded across the income groups.

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



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

Chapter 2

Money, Credit and Interest Rates

i Monetary aggregates and its components

Growth in broad money, M3, accelerated to 3.1 per cent in the second quarter of 2017 from a growth of 3.0 per cent in the first quarter of 2017. The gradual recovery in M3 is largely reflected in the demand deposits which grew by 4.1 per cent in the second quarter of 2017 compared with a growth of 1.7 per cent in the first quarter of 2017. Similarly, other deposits increased by 51.9 per cent in the quarter under review compared with a decline of 3.0 per cent in the first quarter of 2017 (**Table 2.1**).

Narrow money, M1, grew by 5.9 per cent in the second quarter of 2017 compared with a growth of 0.5 per cent in the first quarter of 2017, reflecting build-up of demand deposits owing to banks' conversion of interest earning deposits to checking accounts. Government securities by nonbanks increased by 3.0 per cent during the quarter under review compared with a decline of 37.0 per cent in the first quarter of 2017 (**Table 2.1 and Chart 2.1**).

ii. Sources of Broad Money

The primary source of M3 expansion was the increase in Net Domestic Assets (NDA) of the banking system which increased by 1.9 per cent in the second quarter of 2017, reversing the decline of 1.1 per cent the previous quarter. However, growth in the Net Foreign Assets (NFA) of the Central Bank eased to 6.8 per cent in the period under review from 12.3 per cent in the first quarter of 2017, reflecting a slowdown

Table 2.1: Monetary Aggregates (KSh Billion)

	QUARTERLY LEVELS					QUARTERLY GROWTH RATES (%)					QUARTERLY CHANGE(KSh BN)				
	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
COMPONENTS OF M3															
1. Money supply, M1 (1.1+1.2+1.3)	**1,135.9**	**1,238.6**	**1,310.0**	**1,317.2**	**1,394.3**	**5.3**	**9.0**	**5.8**	**0.5**	**5.9**	**57.6**	**102.7**	**71.4**	**7.2**	**77.1**
1.1 Currency outside banks	187.9	186.6	209.5	200.6	206.7	2.5	-0.7	12.3	-4.2	3.0	4.5	-1.3	22.9	-8.9	6.1
1.2 Demand deposits	881.1	979.7	1,045.0	1,062.7	1,105.9	4.8	11.2	6.7	1.7	4.1	40.5	98.7	65.3	17.7	43.2
1.3 Other deposits at CBK 1/	66.7	71.9	55.1	53.5	81.3	23.2	7.9	-23.3	-3.0	51.9	12.5	5.2	-16.8	-1.6	27.8
2. Money supply, M2 (1+2.1)	**2,353.4**	**2,340.2**	**2,360.2**	**2,412.1**	**2,484.7**	**3.1**	**-0.6**	**0.9**	**2.2**	**3.0**	**71.8**	**-13.2**	**20.0**	**51.9**	**72.6**
2.1 Time and saving deposits	1,217.5	1,101.6	1,050.2	1,094.9	1,090.3	1.2	-9.5	-4.7	4.3	-0.4	14.3	-115.9	-51.4	44.7	-4.6
3. Money supply, M3 (2+3.1)	**2,769.0**	**2,772.7**	**2,764.5**	**2,846.6**	**2,935.3**	**3.5**	**0.1**	**-0.3**	**3.0**	**3.1**	**93.9**	**3.6**	**-8.1**	**82.1**	**88.6**
3.1 Foreign Currency Deposits	415.6	432.5	404.3	434.5	450.6	5.6	4.1	-6.5	7.5	3.7	22.0	16.9	-28.2	30.2	16.1
SOURCES OF M3															
1. Net foreign assets 2/	**562.5**	**591.9**	**495.2**	**603.0**	**649.9**	**19.2**	**5.2**	**-16.3**	**21.8**	**7.8**	**90.7**	**29.3**	**-96.7**	**107.8**	**47.0**
Central Bank	694.6	687.2	621.6	697.8	745.0	8.4	-1.1	-9.5	12.3	6.8	53.8	-7.4	-65.6	76.2	47.2
Banking Institutions	-132.0	-95.3	-126.4	-94.8	-95.1	-21.9	-27.8	32.7	-25.0	0.3	36.9	36.7	-31.1	31.6	-0.2
2. Net domestic assets (2.1+2.2)	**2,206.5**	**2,180.8**	**2,269.3**	**2,243.7**	**2,285.3**	**0.1**	**-1.2**	**4.1**	**-1.1**	**1.9**	**3.1**	**-25.7**	**88.6**	**-25.7**	**41.7**
2.1 Domestic credit	**2,855.1**	**2,858.7**	**2,973.2**	**2,953.2**	**3,005.0**	**1.1**	**0.1**	**4.0**	**-0.7**	**1.8**	**31.3**	**3.6**	**114.5**	**-20.0**	**51.8**
2.1.1 Government (net)	560.4	525.2	592.8	583.5	649.1	2.9	-6.3	12.9	-1.6	11.2	15.7	-35.2	67.5	-9.3	65.6
2.1.2 Private sector	2,216.1	2,243.3	2,275.7	2,263.8	2,249.1	0.9	1.2	1.4	-0.5	-0.6	19.1	27.2	32.4	-11.9	-14.6
2.1.3 Other public sector	78.6	90.2	104.7	105.9	106.9	-4.2	14.8	16.1	1.2	0.9	-3.5	11.6	14.5	1.2	0.9
2.2 Other assets net	**-648.6**	**-677.9**	**-703.8**	**-709.5**	**-719.7**	**4.5**	**4.5**	**3.8**	**0.8**	**1.4**	**-28.2**	**-29.3**	**-25.9**	**-5.7**	**-10.2**
MEMORANDUM ITEMS															
4. Overall liquidity, L (3+4.1)	**3,605.1**	**3,645.4**	**4,303.9**	**3,816.7**	**3,934.1**	**4.7**	**1.1**	**18.1**	**-11.3**	**3.1**	**162.5**	**40.3**	**658.4**	**-487.2**	**117.4**
4.1 Non-bank holdings of government securities	836.1	872.8	1,539.4	970.0	998.9	8.9	4.4	76.4	-37.0	3.0	68.6	36.7	666.6	-569.3	28.8

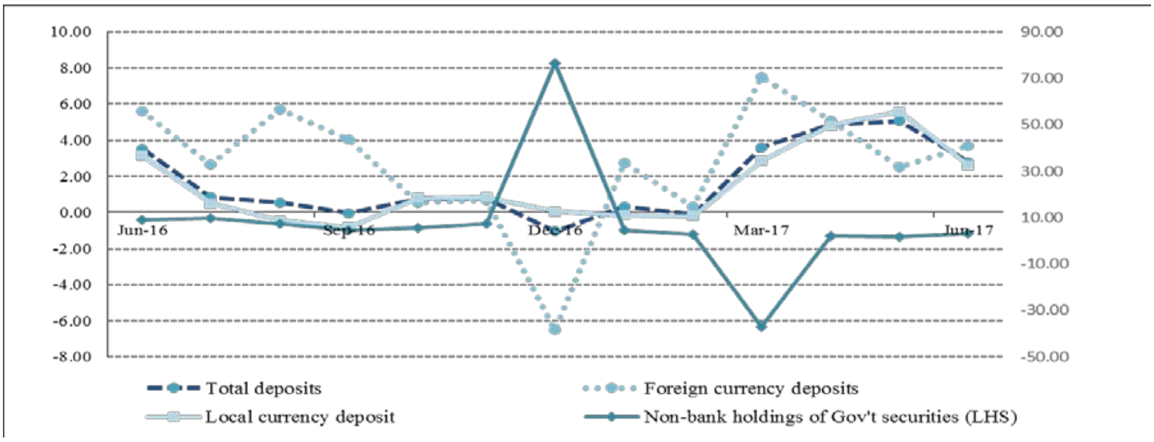
Absolute and percentage changes may not necessarily add up due to rounding

1/ Includes county deposits and special projects deposit

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

Source: Central Bank of Kenya.

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



Source: Central Bank of Kenya

in the increase of foreign exchange reserves at the CBK. The NFA of banking institutions registered an improvement of 0.3 per cent in the second quarter of 2017 compared with a decline of 25.0 per cent in the first quarter of 2017, supported by reduction in loans from non-residents and slowdown of deposits (**Table 2.1**).

iii. Developments in Domestic Credit

Net domestic credit from the banking sector increased by 1.8 per cent in the second quarter of 2017 compared with a decline of 0.7 per cent in the previous quarter. This reflected an increase in net credit to government of 11.2 per cent in second quarter of 2017 compared to a decline of 1.6 per cent in the previous quarter. Over a similar period, the 'other public sector' credit grew by 0.9 per cent compared to a growth of 1.2 per cent in the first quarter of 2017. Growth in bank credit to the private sector also declined, by 0.6 per cent in the second quarter of 2017 compared to a decline of 0.5 per cent in the previous quarter (**Table 2.1 and 2.2**).

The additional private sector credit in the second quarter of 2017 was allocated to the following activities, in order of magnitude: finance and insurance (9.9 percent); manufacturing (1.5 per cent); and trade (1.6 per cent). Meanwhile, the rest of the sectors registered loan repayments in the second quarter of 2017.

iv. Reserve Money

Reserve money (RM) which comprises currency held by the non-bank public and commercial banks reserves declined by 3.3 per cent in the second quarter of 2017 compared with a growth of 0.9 per cent in the preceding quarter. Slowdown in reserve money growth is largely reflected in banks reserves, which registered a decline of 9.3 per cent from a growth of 6.3 per cent in the previous quarter (**Table 2.3**). In the same period currency outside banks grew by 3.0 per cent from a decline of 4.2 per cent in first quarter of 2017.

Table 2.2: Banking Sector Net Domestic Credit (KSh Billion)

	END MONTH LEVEL					QUARTERLY GROWTH RATES (%)					QUARTERLY CHANGES (KSH BN)				
	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
1. Credit to Government	**560.4**	**525.2**	**592.8**	**583.5**	**649.1**	**2.9**	**-6.3**	**12.9**	**-1.6**	**11.2**	**15.7**	**-35.2**	**67.5**	**-9.3**	**65.6**
Central Bank	-156.1	-182.9	-113.9	-117.2	-176.1	93.3	17.1	-37.7	2.9	50.2	-75.4	-26.8	69.0	-3.3	-58.8
Commercial Banks & NBFIs	716.6	708.1	706.7	700.7	825.1	14.6	-1.2	-0.2	-0.8	17.8	91.1	-8.4	-1.4	-6.0	124.4
2. Credit to other public sector	**78.6**	**90.2**	**104.7**	**105.9**	**106.9**	**-4.2**	**14.8**	**16.1**	**1.2**	**0.9**	**-3.5**	**11.6**	**14.5**	**1.2**	**0.9**
Local government	3.6	3.7	3.8	3.8	3.9	2.9	3.7	2.6	1.1	1.2	0.1	0.1	0.1	0.0	0.0
Parastatals	75.0	86.5	100.9	102.1	103.0	-4.6	15.3	16.7	1.2	0.9	-3.6	11.5	14.4	1.2	0.9
3. Credit to private sector	**2,216.1**	**2,243.3**	**2,275.7**	**2,263.8**	**2,249.1**	**0.9**	**1.2**	**1.4**	**-0.5**	**-0.6**	**19.1**	**27.2**	**32.4**	**-11.9**	**-14.6**
Agriculture	97.5	90.6	90.1	86.8	85.5	3.7	-7.1	-0.6	-3.6	-1.6	3.5	-6.9	-0.5	-3.3	-1.4
Manufacturing	304.5	278.6	275.0	278.6	282.8	0.7	-8.5	-1.3	1.3	1.5	2.2	-26.0	-3.6	3.6	4.1
Trade	350.6	382.4	380.7	382.0	388.2	2.4	9.1	-0.4	0.4	1.6	8.3	31.7	-1.7	1.3	6.2
Building and construction	101.5	104.8	104.8	101.4	100.8	0.7	3.3	0.0	-3.3	-0.6	0.7	3.3	0.0	-3.5	-0.6
Transport & communications	179.6	192.0	201.3	196.8	185.5	0.0	6.9	4.8	-2.2	-5.8	0.0	12.4	9.2	-4.5	-11.3
Finance & insurance	88.8	84.7	85.2	77.3	84.9	4.3	-4.7	0.6	-9.3	9.9	3.7	-4.1	0.5	-7.9	7.6
Real estate	323.2	329.6	337.4	351.1	355.7	3.5	2.0	2.3	4.1	1.3	10.8	6.4	7.7	13.7	4.7
Mining and quarrying	23.6	16.1	16.8	14.9	14.7	4.3	-31.6	4.1	-11.0	-1.8	1.0	-7.5	0.7	-1.9	-0.3
Private households	348.7	377.0	393.1	394.8	386.7	0.1	8.1	4.3	0.4	-2.0	0.2	28.3	16.1	1.7	-8.0
Consumer durables	156.5	171.7	175.3	172.5	168.2	-0.2	9.7	2.1	-1.6	-2.5	-0.3	15.2	3.6	-2.8	-4.3
Business services	162.2	143.8	147.1	145.7	136.7	-6.0	-11.3	2.3	-1.0	-6.2	-10.3	-18.4	3.3	-1.4	-9.0
Other activities	79.3	71.9	68.9	61.9	59.5	-1.0	-9.3	-4.1	-10.2	-3.9	-0.8	-7.4	-3.0	-7.0	-2.4
4. TOTAL (1+2+3)	**2,855.1**	**2,858.7**	**2,973.2**	**2,953.2**	**3,005.0**	**1.1**	**0.1**	**4.0**	**-0.7**	**1.8**	**31.3**	**3.6**	**114.5**	**-20.0**	**51.8**

Source: Central Bank of Kenya

Table 2.3: **Reserve Money and its Sources (KSh Billion)**

	END QUARTER LEVELS					QUARTERLY % CHANGE					QUARTERLY CHANGES (KSh BN)				
	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
1. Net Foreign Assets	694.6	687.2	621.6	697.8	745.0	8.4	-1.1	-9.5	12.3	6.8	53.8	-7.4	-65.6	76.2	47.2
2. Net Domestic Assets	-304.4	-294.4	-210.4	-282.9	-343.8	27.4	-3.3	-28.5	34.4	21.5	-65.5	10.0	83.9	-72.4	-60.9
2.1 Government Borrowing (net)	-156.1	-189.9	-113.9	-117.2	-176.1	93.3	17.1	-37.7	2.9	50.2	-75.4	-26.8	69.0	-3.3	-58.8
2.2 Commercial banks (net)	3.0	42.0	43.2	-18.4	22.2	-136.4	1315.8	2.9	-142.5	-220.9	11.1	39.1	1.2	-61.6	40.6
2.3 Other Domestic Assets (net)	-154.7	-150.0	-143.2	-150.7	-193.3	0.8	1.4	-8.7	5.2	28.3	-1.2	-2.2	13.7	-7.5	-42.6
3. Reserve Money	390.2	392.8	411.1	414.9	401.2	-2.9	0.7	4.7	0.9	-3.3	-11.7	2.6	18.3	3.8	-13.7
3.1 Currency outside banks	187.9	186.6	209.5	200.6	206.7	2.5	-0.7	12.3	-4.2	3.0	4.5	-1.3	22.9	-8.9	6.1
3.2 Bank reserves	202.3	206.2	201.7	214.3	194.5	-7.4	1.9	-2.2	6.3	-9.3	-16.2	3.9	-4.6	12.7	-19.8

Source: Central Bank of Kenya

v. Interest Rates

- ***The Central Bank Rate***

The Monetary Policy Committee (MPC) retained the Central Bank Rate (CBR) at 10.0 per cent at its meetings in May and July 2017 in order to anchor inflation expectations. The Committee at its July 17, 2017 noted that the overall inflation pressures eased due to decline in prices of key food items.

- ***Short Term Interest Rates***

Short term interest rates depicted mixed performance in the second quarter of 2017 (**Table 2.4**). The weighted average interbank interest rate decreased to 3.99 per cent in June 2017 down from 4.46 per cent in March 2017, reflecting improved market liquidity conditions. The average reverse repo rate remained steady at 10.05 per cent in June 2017 barely unchanged from 10.04 in March 2017. The 91-day Treasury bill rate, which largely reflects the government's borrowing profile decreased from 8.69 per cent in March 2017 to a peak of 8.42 per cent in June 2017. The 182-day Treasury bill rate also decreased to 10.38 per cent in June 2017 from 10.53 per cent in March 2017 (**Table 2.4**).

- ***Lending and Deposit Rates***

Commercial banks' lending interest rates remained relatively stable through June 2017. The average lending rate increased marginally to 13.66 per cent by June 2017 compared to 13.61 per cent in March 2017. The marginal increase in the overall lending rate was largely reflected in the 'Overdraft' and 'Over 5 years' loan categories. Meanwhile, average commercial banks' deposit rate rose slightly to 7.15 per cent in June 2017 compared to 7.12 per cent in March 2017. The marginal increase in the average deposit rate was reflected largely in the '0-3' month category of deposits.

The change in the overall lending rate and overall deposit rate through June 2017 was minimal, thus the interest rate spread stabilized at 6.52 per cent through June 2017 compared to 6.49 per cent in March 2017 (**Table 2.4**).

Table 2.4: Interest Rates (%)

	2015				2016				2017	
	Mar	Jun	Sept	Dec	Mar	Jun	Sep	Dec	Mar	Jun
91-day Treasury bill rate	8.49	8.26	14.61	9.81	8.72	7.25	8.06	8.44	8.69	8.42
182-day Treasury bill rate	10.35	10.55	13.40	11.43	10.83	9.56	10.85	10.55	10.53	10.38
Interbank rate	6.85	11.77	19.85	7.27	4.10	4.56	4.47	5.55	4.46	3.99
Repo rate	8.08	9.70	11.50	9.23	4.31	10.04	-	-	7.23	4.13
Reverse Repo rate	-	-	-	11.92	11.63	10.59	10.36	10.04	10.04	10.05
Central Bank Rate (CBR)	8.50	10.00	11.50	11.50	11.50	10.50	10.00	10.00	10.00	10.00
Average lending rate (1)	**15.46**	**16.06**	**16.82**	**18.30**	**17.79**	**18.15**	**13.84**	**13.69**	**13.61**	**13.66**
Overdraft rate	15.68	15.65	16.65	18.48	18.06	18.04	13.60	13.49	13.29	13.38
1-5years	16.34	16.72	17.41	18.40	18.00	18.63	13.95	13.86	13.81	13.80
Over 5years	14.35	15.11	15.93	18.03	17.31	17.64	13.83	13.59	13.55	13.64
Average deposit rate (2)	**6.63**	**6.64**	**7.28**	**8.02**	**7.17**	**6.78**	**6.94**	**7.33**	**7.12**	**7.15**
0-3months	8.52	8.33	10.05	11.14	9.78	8.80	8.21	7.16	7.28	7.76
Over 3 months deposit	9.85	9.73	10.06	11.35	10.41	9.94	8.82	8.45	8.18	8.04
Savings deposits	1.53	1.85	1.71	1.56	1.32	1.60	3.78	6.37	5.89	5.63
Spread (1-2)	**8.82**	**9.42**	**9.54**	**10.28**	**10.62**	**11.40**	**6.93**	**6.36**	**6.49**	**6.52**

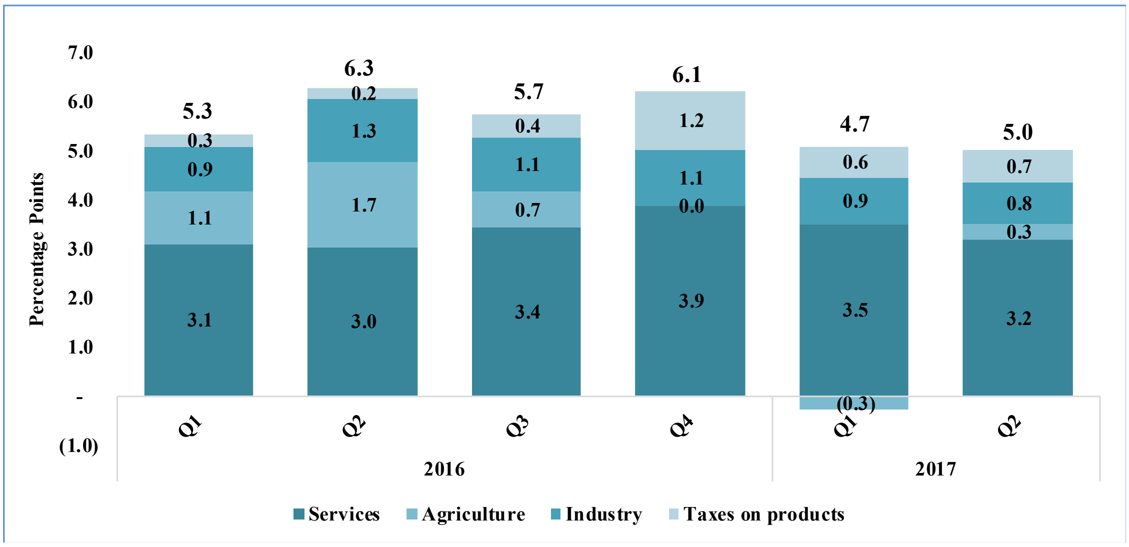
Source: Central Bank of Kenya

Chapter 3
The Real Sector

The Kenyan economy recorded robust growth of 5.0 per cent in the second quarter of 2017, despite adverse weather conditions which affected agricultural production. Though lower than the 6.2 per cent growth recorded in a similar quarter of 2016, it was an improvement compared to 4.7 per cent growth in the first quarter of 2017. The strong growth performance was largely supported by modest recovery in Agriculture Sector following improved weather conditions. In addition, the ongoing government investment in infrastructure development, low international oil prices and robust growth in tourist arrivals supported improved economic activity during the quarter.

The economy remains resilient supported by diversification. The strong performance of the economy was supported by non-agriculture activity which grew by 6.1 per cent in the second quarter of 2017. The agriculture sector, on the other hand, posted mild recovery of 1.4 per cent during the quarter compared to a contraction of 0.3 per cent in the previous quarter.

Table 3.1: Evolution of Real GDP Growth across Quarters



Source: Kenya National Bureau of Statistics

Services remain the main source of growth. It grew by 6.8 per cent in the second quarter of 2017 compared to 6.7 per cent in the same quarter last year mainly supported by Wholesale and Retail Trade, Transport and Storage, Accommodation and Restaurants and Real Estate sectors. It contributed 3.2 percentage points to real GDP growth in second quarter of 2017 largely supported by the Real Estate (0.8 percentage points) and Transport and Storage (0.6 percentage points) (**Chart 3.1**).

The performance of Industry decelerated to 4.4 per cent in second quarter of 2017 compared to 5.0 per cent in first quarter of 2017 and 6.8 per cent in second quarter of 2016 following subdued performance of the manufacturing sector which grew by 2.3 per cent. It, however, accounted for 0.8 percentage points to growth during the quarter largely driven by the Construction Sector which contributed 0.4 percentage points to growth during the quarter (**Table 3.1 and Chart 3.1**).

Table 3.1: Gross Domestic Product Growth (%)

	2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2
1. Agriculture	**4.0**	**7.1**	**3.8**	**0.1**	**(1.1)**	**1.4**
2. Non-Agriculture (o/w)	**5.8**	**6.0**	**6.2**	**7.5**	**6.8**	**6.1**
2.1 Industry	**5.0**	**6.8**	**5.7**	**5.8**	**5.0**	**4.4**
Mining & Quarrying	6.7	10.6	9.8	11.2	9.7	5.7
Manufacturing	1.7	5.3	4.4	2.5	2.9	2.3
Construction	10.2	7.6	7.8	11.5	8.4	7.5
Electricity & water supply	8.6	9.6	5.4	4.7	5.1	6.1
2.2 Services	**7.0**	**6.7**	**7.0**	**7.6**	**7.7**	**6.8**
Wholesale & Retail Trade	3.6	2.3	4.3	5.0	6.1	2.8
Accommodation & restaurant	10.4	15.7	13.5	14.2	15.8	13.4
Transport & Storage	8.9	7.1	7.1	10.4	9.9	8.2
Information & Communication	10.9	9.1	8.8	9.8	11.4	9.2
Financial & Insurance	8.2	8.1	7.1	4.1	5.3	4.3
Public administration	5.7	6.6	5.1	3.6	5.4	6.3
Professional, Administration & Support Services	3.3	5.4	3.8	4.7	4.8	6.4
Real estate	8.8	8.2	8.5	9.5	9.3	9.7
Education	6.2	6.0	6.9	6.3	5.9	5.6
Health	5.1	6.6	7.1	4.5	4.5	5.5
FISIM	8.4	5.2	1.7	(2.7)	3.3	(0.8)
2.3 Taxes on products	**2.5**	**2.0**	**3.7**	**9.7**	**6.0**	**6.1**
Real GDP Growth	**5.3**	**6.3**	**5.7**	**6.1**	**4.7**	**5.0**

Source: Kenya National Bureau of Statistics

Table 3.2 Sectoral Share of Sectors to Real GDP (%)

	2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2
1. Agriculture	**26.5**	**24.2**	**19.1**	**17.3**	**25.0**	**23.4**
2. Non-Agriculture (of which:)	**73.5**	**75.8**	**80.9**	**82.7**	**75.0**	**76.6**
2.1 Industry	**18.6**	**19.3**	**19.6**	**19.4**	**18.7**	**19.2**
Mining & Quarrying	1.1	1.0	1.1	1.1	1.1	1.0
Manufacturing	10.3	10.5	10.4	10.0	10.1	10.2
Construction	4.9	5.2	5.6	5.9	5.0	5.3
Electricity & water supply	2.4	2.6	2.5	2.4	2.4	2.6
2.2 Services	**44.5**	**45.7**	**49.3**	**50.9**	**45.8**	**46.5**
Wholesale & Retail Trade	6.9	7.1	8.5	7.6	7.0	7.0
Accommodation & restaurant	1.2	0.9	1.1	1.4	1.3	0.9
Transport & Storage	6.0	6.6	7.4	7.7	6.3	6.8
Information & Communication	3.7	3.1	3.5	5.1	3.9	3.2
Financial & Insurance	6.0	6.1	6.6	6.3	6.1	6.0
Public administration	3.6	4.3	3.7	3.8	3.6	4.3
Professional, Administration & Support Services	2.1	2.2	2.3	2.4	2.1	2.2
Real estate	8.0	8.2	8.6	8.9	8.4	8.6
Education	6.8	6.8	7.1	7.1	6.9	6.9
Health	1.6	1.8	1.9	1.9	1.6	1.8
Other services	1.2	1.2	1.3	1.3	1.2	1.2
FISIM	(2.6)	(2.6)	(2.7)	(2.7)	(2.5)	(2.4)
2.3 Taxes on products	**10.4**	**10.8**	**12.0**	**12.4**	**10.5**	**10.9**
Total	**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 (%)

	2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2
1. Agriculture	**1.1**	**1.7**	**0.7**	**0.0**	**(0.3)**	**0.3**
2. Non-Agriculture (o/w)	**4.3**	**4.5**	**5.0**	**6.2**	**5.1**	**4.7**
2.1 Industry	**0.9**	**1.3**	**1.1**	**1.1**	**0.9**	**0.8**
Mining & Quarrying	0.1	0.1	0.1	0.1	0.1	0.1
Manufacturing	0.2	0.6	0.5	0.2	0.3	0.2
Construction	0.5	0.4	0.4	0.7	0.4	0.4
Electricity & water supply	0.2	0.3	0.1	0.1	0.1	0.2
2.2 Services	**3.1**	**3.0**	**3.4**	**3.9**	**3.5**	**3.2**
Wholesale & Retail Trade	0.3	0.2	0.4	0.4	0.4	0.2
Accommodation & restaurant	0.1	0.1	0.1	0.2	0.2	0.1
Transport & Storage	0.5	0.5	0.5	0.8	0.6	0.6
Information & Communication	0.4	0.3	0.3	0.5	0.4	0.3
Financial & Insurance	0.5	0.5	0.5	0.3	0.3	0.3
Public administration	0.2	0.3	0.2	0.1	0.2	0.3
Professional, Administration & Support Services	0.1	0.1	0.1	0.1	0.1	0.1
Real estate	0.7	0.7	0.7	0.8	0.8	0.8
Education	0.4	0.4	0.5	0.4	0.4	0.4
Health	0.1	0.1	0.1	0.1	0.1	0.1
FISIM	(0.2)	(0.1)	(0.0)	0.1	(0.1)	0.0
2.3 Taxes on products	**0.3**	**0.2**	**0.4**	**1.2**	**0.6**	**0.7**
Real GDP Growth	**5.3**	**6.3**	**5.7**	**6.1**	**4.7**	**5.0**

Source: Kenya National Bureau of Statistics

PERFORMANCE BY SECTOR

The Agriculture Sector

The agriculture sector recorded modest growth following improved weather conditions in the second quarter of 2017. The sector grew by 1.4 per cent compared to a contraction of 1.1 per cent in the first quarter of 2017, and was supported by improved production of tea during the quarter. However, compared to the same quarter of 2016, growth was significantly lower following lower crop and dairy production (**Table 3.1**).

The sectoral share to real GDP decreased to 23.4 per cent in the second quarter of 2017 compared to 25 per cent the previous quarter. However, its contribution to overall GDP growth improved to 0.3 percentage points compared to a contraction of 0.3 percentage points in the previous quarter (**Table 3.2 and Table 3.3**).

Available agricultural indicators show that production of horticulture, milk, and sugarcane declined in the second quarter of 2017, mainly on account of delayed onset of the long rains. Coffee sales also declined as the main harvest season came to an end during the quarter. However, tea production was higher in the second quarter.

Tea

Tea production increased by 23 per cent in the second quarter of 2017 compared to the previous quarter, and by 1 per cent compared to a similar quarter of 2016. The increased production was mainly attributed to increased rainfall in May 2017 following the onset of the long rains. Consequently, May 2017 recorded the highest monthly increase during the quarter (**Table 3.4**). The average auction price per kilogram of tea decreased slightly by 0.8 per cent to KSh 308.65 in the second quarter of 2017 compared to KSh 311.13 recorded in the first quarter, reflecting the increased volume of tea auctioned.

Table 3.4: **Performance of Key Agricultural Output Indicators**

	2016 Quarterly				2017* Quarterly		2017* Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-17	May-17	Jun-17
Tea									
Output (Metric tonnes)	139,607	109,747	95,532	126,349	90,094	110,819	31,458	38,822	40,538
Growth (%)	*9.0*	*-21.4*	*-13.0*	*32.26*	*-28.69*	*23.00*	*-8.8*	*23.4*	*4.4*
Horticulture									
Exports (Metric tonnes)	111,759	90,620	84,574	78,404	85,792	85,186	25,384	31,183	28,618
Growth (%)	*69.0*	*-18.9*	*-6.7*	*-7.3*	*9.4*	*-0.7*	*-16.8*	*22.8*	*-8.2*
Coffee									
Sales (Metric tonnes)	15,487	10,996	7,576	5,613	16,731	N/A	4,563	1,639	N/A
Growth (%)	*258.6*	*-29.0*	*-31.1*	*-25.9*	*198.1*		*-16.4*	*-64.1*	
Milk									
Output (million litres)	158.04	170.21	158.29	161.7	141.3	N/A	37.7	36.9	N/A
Growth %	*-13.5*	*7.7*	*-7.0*	*2.2*	*-12.6*		*-12.5*	*-2.1*	
Sugar Cane									
Output ('000 Metric tonnes)	2,068	1,721	1,742	1,630	1,572	N/A	305	232	N/A
Growth (%)	*28.2*	*-16.8*	*1.2*	*-6.5*	*-3.6*		*-35.3*	*-23.9*	

* Provisional

N/A Data not availabe

Source: Kenya Tourism Board

Coffee

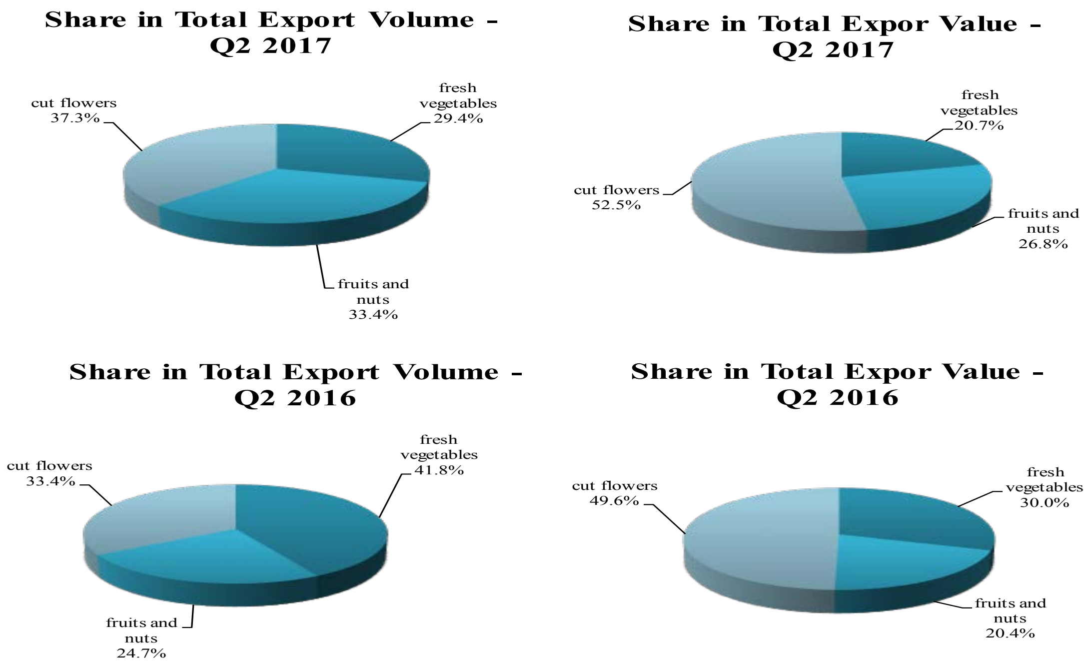
Coffee sales declined by 32.9 per cent in the period April-May 2017 compared to a similar period in 2016, on account of lower supply of coffee as the main harvest season came to an end. The decline was seen in monthly sales, which declined by 16.4 per cent and 64.1 per cent in April and May 2017, respectively (**Table 3.2**). Auction prices decreased by 4.5 per cent in the period April-May 2017 compared to a similar period in 2016 on account of increasing international coffee prices.

Horticulture

Total exports of horticultural crops declined slightly by 0.7 per cent in the second quarter of 2017 from the first quarter, and was lower by 6 per cent compared to similar quarter of 2016. The decline was attributed to low production due to the prolonged drought conditions and delayed onset of the long rains. Monthly data shows declined exports in April and June 2017, which more than offset the increased exports in May 2017 (**Table 3.4**).

The share of export volumes and value of fresh vegetables to total horticultural exports decreased to 29.4 per cent and 20.7 percent, respectively, from 41.8 per cent and 30 per cent in the same quarter of 2016. The share of export volumes and value of fruits, nuts and cut flowers increased in the second quarter of 2017 (**Chart 3.2**).

Chart 3.2: Distribution of Key Market Culture Exports



Source: Kenya Revenue Authority

Milk intake in the formal sector and **sugarcane production** declined by 28.2 per cent and 50.8 percent, respectively, in the period April-May 2017 compared to a similar period in 2016, following the prolonged drought conditions and delayed onset of the long rains season. Monthly data shows declined production in April and May 2017 (**Table 3.4**).

The Manufacturing Sector

The performance of the manufacturing sector was subdued in the second quarter of 2017. The sector recorded growth of 2.3 percent, which was lower compared to 2.9 per cent in the first quarter of 2017 and 5.3 per cent in a similar quarter of 2016 (**Table 3.1**). The subdued performance was largely on account of reduced agro-processing activity following adverse weather conditions experienced since mid-2016 which affected agricultural production. The sector was also negatively affected by reduced activity in the construction sector, which resulted in declined production of cement and galvanized sheets. The sectoral share declined slightly to 10.2 per cent from 10.5 per cent in the second quarter of 2016, while sectoral contribution to real GDP growth declined to 0.2 percentage points compared to 0.6 percentage points in the second quarter of 2016 (**Table 3.2 and Table 3.3**).

Available indicators in the manufacturing sector point to lower performance in the second quarter of 2017.

Cement production decreased by 5.8 per cent in the second quarter of 2017 compared to the previous quarter, and was lower by 9.3 per cent compared to a similar quarter of 2016. Monthly data shows that production declined in all months of the quarter (**Table 3.5**).

Production of ***sugar*** declined significantly by 60 per cent in the second quarter of 2017 compared to the previous quarter, and was lower by 50 per cent compared to the second quarter of 2016. The decline was attributed to lower production of sugarcane due to adverse weather conditions. Monthly production declined by 37.5 per cent and 41.9 percent, respectively, in April and May 2017, but improved in June 2017, as production increased by 5.9 per cent (***Table 3.5***).

Production of ***assembled vehicles*** declined by 24 per cent in the period April-May 2017 compared to the same period in 2016. Monthly data shows production declined by 3.9 per cent and 31.1 per cent in April and May 2017, respectively (**Table 3.5**).

Production of ***soft drinks*** declined by 7.7 per cent in the period April-May 2017 compared to the same period in 2016, with monthly production declining by 7.2 per cent and 12.9 per cent in April and May 2017, respectively (**Table 3.5**).

Production of ***galvanized sheets*** declined by 2.1 per cent in the period April-May 2017 compared to the same period in 2016. Monthly production decreased marginally by 0.7 per cent in April 2017, though an improvement was recorded in May 2017 (**Table 3.5**).

Table 3.5: Production of Selected Manufactured Goods

	2016				2017*				
	Quarterly				Quarterly		Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-17	May-17	Jun-17
Cement production									
Output (MT)	1,606,741	1,701,420	1,695,299	1,703,770	1,639,487	1,544,025	534,327	509,589	500,109
Growth %	*3.4*	*5.9*	*-0.4*	*0.5*	*-3.8*	*-5.8*	*-5.77*	*-4.63*	*-1.86*
Assembled vehicles									
Output (No.)	1,600	1,782	1,719	1,194	1,543	N/A	585	403	N/A
Growth %	*-38.6*	*11.4*	*-3.5*	*-30.5*	*29.2*		*-3.9*	*-31.1*	
Galvanized sheets									
Output (MT)	61,552	65,269	63,555	56,902	67,132	N/A	21,999	22,162	N/A
Growth %	*-10.4*	*6.0*	*-2.6*	*-10.5*	*18.0*		*-0.7*	*0.7*	
Processed sugar									
Output (MT)	153,750	136,459	138,136	148,144	144,101	57,620	26,230	15,246	16,144
Growth %	*-8.3*	*-11.2*	*1.2*	*7.2*	*-2.7*	*-60.0*	*-37.5*	*-41.9*	*5.9*
Soft drinks									
Output ('000 litres)	153,777	126,809	130,608	140,193	141,017	N/A	43,236	37,654	N/A
Growth %	*15.7*	*-17.5*	*3.0*	*7.3*	*0.6*		*-7.2*	*-12.9*	

MT = Metric tonnes
N/A - Not Available

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

The Electricity and Water Supply Sector

Electricity and water supply Sector growth improved to 6.1 per cent in the second quarter of 2017 compared to 5.1 per cent in the previous quarter, supported by a significant increase in generation of thermal electricity (**Table 3.1**).

Electricity generation increased by 2.6 per cent in the second quarter of 2017 compared to the previous quarter, and was higher by 2.5 per cent compared to the same quarter of 2016. The increase was attributed to increased generation of thermal and geothermal electricity, which compensated for lower generation of hydropower (**Table 3.6**). Generation of hydroelectricity declined further by 11 per cent during the second quarter of 2017 compared to the previous quarter on account of the prolonged drought conditions and delayed onset of the long rains season. On the other hand, geothermal and thermal electricity increased by 2.6 per cent and 18.3 percent, respectively, over the same period.

Table 3.6: Performance in the Energy Sector

	2016				2017				
	Quarterly				Quarterly		Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-17	May-17	Jun-17
Electricity Supply (Generation)									
Output (million KWH)	2,421.2	2,433.3	2,506.6	2,526.0	2,431.8	2,495.3	814.0	847.6	833.7
Growth %	*1.8*	*0.5*	*3.0*	*0.8*	*-3.7*	*2.6*	*-4.4*	*4.1*	*-1.6*
Of which:									
Hydro-power Generation (million KWH)	953.8	985.9	1049.2	970.9	700.6	623.4	209.9	230.2	183.3
Growth (%)	*4.0*	*3.4*	*6.4*	*-7.5*	*-27.8*	*-11.0*	*-10.4*	*9.6*	*-20.4*
Geo-Thermal Generation (million KWH)	1,166.8	1,139.9	1,073.4	1,104.2	1,122.2	1,151.2	381.1	393.8	376.2
Growth (%)	*-1.3*	*-2.3*	*-5.8*	*2.9*	*1.6*	*2.6*	*-1.7*	*3.3*	*-4.5*
Thermal (million KWH)	300.7	307.5	384.0	450.8	609.0	720.7	223.0	223.5	274.2
Growth (%)	*7.1*	*2.3*	*24.9*	*17.4*	*35.1*	*18.3*	*-2.9*	*0.3*	*22.7*
Consumption of electricity (million KWH)	1,961.5	2,059.0	2,110.7	2,181.5	2,190.5	2,292.0	731.5	778.1	782.4
Growth %	*-3.4*	*5.0*	*2.5*	*3.4*	*0.4*	*4.6*	*-2.1*	*6.4*	*0.6*
Consumption of Fuels ('000 tonnes)	1,247.1	1,227.2	1,333.9	1,398.3	1,100.7	845.7	324.7	261	260
Growth %	*12.7*	*-1.6*	*8.7*	*4.8*	*-21.3*	*-23.2*	*-18.0*	*-19.7*	*-0.1*
Murban crude oil average price (US $ per barrel)	33.7	46.1	46.3	50.6	54.7	50.7	53.4	51.5	47.3
Growth %	*-21.0*	*36.8*	*0.4*	*9.1*	*8.2*	*-7.3*	*1.5*	*-3.7*	*-8.1*

Source: Kenya National Bureau of Statistics

The Construction and Real Estate Sectors

Growth in the Construction sector remained strong despite slowdown in Standard Gauge Railway (SGR) related activities. The sector grew by 7.5 per cent in the second quarter of 2017 compared to 7.6 per cent in a similar quarter in 2016, and was supported by high public investment and private property development (**Table 3.1**). However, compared to growth of 8.4 per cent in the first quarter of 2017, growth was lower in the second quarter following reduced activity in the sector by Government, which resulted in lower consumption of cement, and volume of imports of construction materials such as iron and steel.

Sectoral share to GDP increased to 5.3 per cent compared to 5.0 per cent in the previous quarter, and 5.2 per cent in the second quarter of 2016. The contribution of the sector to real GDP growth stabilized at 0.4 percentage points during the quarter under review (T**able 3.2 and Table 3.3**).

The real estate sector continues to record robust growth despite slowdown in credit, supported by robust property development across the country. The sector grew by 9.7 per cent in the second quarter of 2017, compared to 9.3 per cent in the first quarter of 2017 and 8.2 per cent in the second quarter of 2016 (**Table 3.1**). The sectoral share to GDP increased to 8.6 per cent in the second quarter of 2017, compared to 8.4 per cent in the previous quarter and 8.2 per cent in the same quarter of 2016, while its contribution to GDP growth remained stable at 0.8 percentage points (**Table 3.2 and Table 3.3**).

The Accommodation and Restaurants Sector

The Accommodation and Restaurant sector continued to recover, mainly attributable to sustained improvement in security in the country and enhanced marketing efforts by the Government and other stakeholders in the tourism sector. The sector recorded growth of 13.4 per cent in the second quarter of 2017, slightly lower than 15.8 per cent recorded both in the previous quarter and the Second Quarter of 2016 (**Table 3.1**).

Tourist Arrivals

Overall tourist arrivals declined by 6.8 per cent in the second quarter of 2017 compared to the previous quarter, owing to the low season experienced during the quarter. The decline was higher at the Moi International Airport, Mombasa (MIAM) (**Table 3.7**). However, compared to the second quarter of 2016, tourist arrivals increased by 14.4 percent. Monthly tourist arrivals declined in April 2017 compared to March 2017, then improved in May and June 2017.

Table 3.7: Tourist Arrivals by Point of Entry

	2016				2017				
	Quarterly				Quarterly		Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-17	May-17	Jun-17
Total Tourist Arrivals	206,224	186,685	262,149	219,327	224,370	213,543	67,084	67,531	78,928
Growth (%)	*6.9*	*-9.5*	*40.4*	*-16.3*	*2.3*	*-4.8*	*-6.8*	*0.7*	*16.9*
o.w. JKIA - Nairobi	178,283	175,056	236,119	192,055	192,740	202,042	62,982	64,866	74,194
Growth (%)	*4.8*	*-1.8*	*34.9*	*-18.7*	*0.4*	*4.8*	*-0.9*	*3.0*	*14.4*
MIAM - Mombasa	27,941	11,629	26,030	27,272	31,630	11,501	4,102	2,665	4,734
Growth %	*22.3*	*-58.4*	*123.8*	*4.8*	*16.0*	*-63.6*	*-51.1*	*-35.0*	*77.6*

Source: Kenya Tourism Board

Transport and Storage

Despite modest recovery in international oil prices, the transport and storage sector recorded strong performance, supported by an upsurge in passenger activity following introduction of the SGR passenger train between Nairobi and Mombasa. The sector expanded by 8.2 per cent in the second quarter of 2017 compared to 7.1 per cent in the same period last year (**Table 3.1**). The sectoral share to total GDP increased to 6.8 per cent from 6.3 per cent in the previous quarter and 6.6 per cent in the second quarter of 2017, while its contribution to overall GDP growth remained stable at 0.6 percentage points in the first and second quarters of 2017 (**Table 3.2 and Table 3.3**).

Passenger flows through Jomo Kenyatta International Airport (JKIA) in Nairobi remained relatively stable in the period April-May 2017 compared to the same period in 2016. This is reflected in monthly data for April and May 2017 (**Table 3.7**).

The volume of oil that passed through the Kenya pipeline declined slightly by 1.2 per cent in the second quarter of 2017 compared to the previous quarter, with monthly volumes decreasing in all months across the quarter (**Table 3.8**). However, the oil throughput was higher by 6.2 per cent in the Second Quarter of 2017, compared to a similar period in 2016.

Table 3.8: Throughput of Selected Transport Companies

	2016				2017				
	Quarterly				Quarterly		Monthly		
	Q1	Q2	Q3	Q4	Q1	Q2	Apr-17	May-17	Jun-17
Number of Passengers thro' JKIA									
Total passenger flows	1,082,784	1,079,762	1,079,331	1,079,503	1,079,870	N/A	359,899	360,002	N/A
Growth (%)	*0.02*	*- 0.3*	*- 0.04*	*0.02*	*0.03*		*- 0.03*	*0.03*	
o.w. Incoming	541,061	538,720	538,519	538,607	538,608	N/A	179,511	179,571	N/A
Growth (%)	*0.1*	*- 0.4*	*- 0.04*	*0.02*	*0.00*		*- 0.0*	*0.0*	
Outgoing	541,723	541,042	540,812	540,896	541,262	N/A	180,388	180,431	N/A
Growth %	*- 0.1*	*- 0.1*	*- 0.04*	*0.02*	*0.07*		*- 0.0*	*0.02*	
Kenya Pipeline Oil Throughput									
Output ('000 litres)	1,460,007	1,442,315	1,503,160	1,467,445	1,551,237	1,532,312	486,357	536,391	509,565
Growth %	*1.2*	*- 1.2*	*4.2*	*- 2.4*	*5.7*	*- 1.2*	*- 11.0*	*10.3*	*- 5.0*

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

Chapter 4
Global Economy

Global growth is gaining momentum with a projected growth of 3.5 per cent in 2017 and 3.6 per cent in 2018 up from 3.2 per cent in 2016. According to the July 2017 IMF's World Economic Outlook (WEO), economic activity in Japan, Euro area, Canada, China and India remained strong which offsets the slight slowdown in US, UK and Latin American economies **(Table 4.1)**.

Economic activity among the advanced economies is forecast at 2 per cent in 2017 and 1.9 per cent in 2018 from 1.7 per cent in 2016 reflecting strong growth outturns in key advanced economies such as Canada, France, Germany, Italy, Spain and Japan. Growth in the United States is expected to rise to 2.1 per cent in 2017 from 1.6 per cent in 2016 reflecting expectations of fiscal policy easing; a pick-up in private investment; improvement in labour market conditions and resilient financial markets. However, given the uncertainty around the timing and nature of U.S. fiscal policy changes, fiscal policy is expected to be less expansionary than previously assumed. Consequently, growth in 2018 is forecast to remain unchanged at 2.1 percent.

In the Euro Area, growth is projected to rise to 1.9 per cent in 2017 from 1.8 per cent in 2016 reflecting the continued effect of unconventional monetary policy measures taken by the European Central Bank (ECB) since 2014 to sustain domestic demand. The measures have helped stimulate credit growth, lift inflation expectations, and foster gradual economic recovery. In 2018 as the ECB gradually unwinds the exceptional policy measures, growth is expected to moderate to 1.7 percent.

Output in Japan is projected to rise to 1.3 per cent in 2017 from 1 per cent in 2016 driven by stronger than expected net exports as well as accommodative monetary and fiscal policies. Growth in 2018 is forecast to slow down to 0.6 per cent with the assumed withdrawal of fiscal support and a recovery of imports offsetting the impact of stronger anticipated foreign demand.

In emerging markets and developing economies, a sustained increase in activity is expected from 4.3 per cent in 2016 to 4.6 per cent in 2017 and a further 4.8 per cent in 2018. The development in activity largely reflects gradual improving conditions among large commodity exporters that experienced recessions in 2015–16 on account of declining commodity prices.

At 6.7 per cent in 2017, **economic activity in China** is expected to remain unchanged from 2016. Economic growth in the first quarter of 2017 turned out stronger than expected on account of supportive government policy. In 2018, growth is expected to moderate to 6.4 per cent with the gradual withdrawal of supportive policies in the form of strong credit growth and reliance on public investment to achieve growth targets. **Growth in India** is expected to increase to 7.2 per cent in 2017 and 7.7 per cent in 2018 from 7.1 per cent in 2016 primarily boosted by implementation of key reforms and appropriate fiscal and monetary policies.

Table 4.1: Global Economic Outlook

REAL GDP GROWTH (%) IMF YEAR OVER YEAR						
	Actual		Projections		Difference from April 2017 WEO Projections	
Country/Region	**2015**	**2016**	**2017**	**2018**	**2017**	**2018**
World Output	**3.4**	**3.2**	**3.5**	**3.6**	**0.0**	**0.0**
Advanced Economies	**2.1**	**1.7**	**2.0**	**1.9**	**0.0**	**-0.1**
United States	2.6	1.6	2.1	2.1	-0.2	-0.4
Euro area	2.0	1.8	1.9	1.7	0.2	0.1
Japan	1.1	1.0	1.3	0.6	0.1	0.0
United Kingdom	2.2	1.8	1.7	1.5	-0.3	0.0
Emerging Market and Developing economies	**4.3**	**4.3**	**4.6**	**4.8**	**0.1**	**0.0**
Emerging and Developing Asia	6.8	6.4	6.5	6.5	0.1	0.1
China	6.9	6.7	6.7	6.4	0.1	0.2
India	8.0	7.1	7.2	7.7	0.0	0.0
Latin America and the Caribbean	0.1	-1.0	1.0	1.9	-0.1	-0.1
Brazil	-3.8	-3.6	0.3	1.3	0.1	-0.4
Sub-Saharan Africa	3.4	1.3	2.7	3.5	0.1	0.0
South Africa	1.3	0.3	1.0	1.2	0.2	-0.4
Nigeria	2.7	-1.6	0.8	1.9	0.0	0.0
Middle East, North Africa, Afghanistan and Pakistan	2.7	5.0	2.6	3.3	0.0	-0.1

Source: IMF, World Economic Outlook, July 2017 updated

Growth in Sub-Saharan Africa (SSA) is projected to rise to 2.7 per cent in 2017 and 3.5 per cent in 2018 largely driven by specific factors in the largest SSA economies, which faced challenging macroeconomic conditions in 2016. Nigeria is projected to grow by 0.8 per cent in 2017 from a contraction of 1.6 per cent in 2016 as a result of a recovery in oil production, continued growth in agriculture, and higher public investment. **In South Africa,** modest recovery is expected, with growth forecast at 1 per cent in 2017 from 0.3 per cent in 2016 after experiencing bumper harvest due to better rainfall and an increase in mining output prompted by a moderate rebound in commodity prices.

Risks to the global economic outlook

A prolonged period of policy uncertainty would make it difficult to predict certain outcomes (for example U.S regulatory and fiscal policies; negotiations of post-Brexit arrangements, or geopolitical risks), and this could impact negatively on confidence, deter private investment and weaken growth.

Financial tensions arising from any slippage in the recent Chinese financial sector reforms aimed at curbing excessive credit growth could result in an abrupt growth slowdown with consequent adverse global spillovers. Also posing a risk to world economic outlook is a faster-than-expected monetary policy normalization in the U.S which could tighten global financial conditions and trigger reversals in capital flows to emerging and developing economies.

Other risks relate to growing appetite for **inward looking policies** in some advanced economies arising from prolonged sluggish output growth and on-inclusive economic growth. In addition, **non-economic factors** such as rising geopolitical tensions, domestic political discord in some countries as well as shocks emanating from weak governance and corruption could all dampen the growth momentum.

Chapter 5

Balance of Payments and Exchange Rates

Developments in the Balance of Payments

The current account deficit widened by 5.4 per cent to stand at USD 1,304 million in the second quarter of 2017 from USD 1,237 million in the first quarter driven by worsening of the trade and primary income account balances. The secondary income account balance, however, recorded improvement during the second quarter of 2017 (**Table 5.1 and Table 5.2**).

Table 5.1: Balance of Payments (USD Million)

ITEM	2016**			2017**					Q2 2017-Q1 2017	
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Q2			Total		%
	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	Change	Change
1. Overall Balance	**-496**	**56**	**569**	**-814**	**-333**	**124**	**-15**	**-224**	**589**	**-72.4**
2. Current account	**-1,061**	**-1,151**	**-1,184**	**-1,237**	**-422**	**-464**	**-418**	**-1,304**	**-67**	**5.4**
Exports (fob)	1,443	1,407	1,370	1,470	438	514	502	1,453	-17	-1.2
Imports (fob)	3,523	3,567	3,498	3,981	1,215	1,424	1,338	3,977	-5	-0.1
Services: credit	1,093	1,133	1,059	1,226	383	423	430	1,236	10	0.8
Services: debit	693	740	681	781	284	275	310	870	89	11.4
Balance on goods and services	-1,681	-1,767	-1,750	-2,066	-679	-762	-716	-2,157	-91	4.4
Primary income: credit	106	110	109	122	41	42	40	123	1	0.8
Primary income: debit	284	269	329	281	87	131	163	380	99	35.4
Balance on goods, services, and primary income	-1,859	-1,926	-1,970	-2,224	-725	-851	-838	-2,414	-189	8.5
Secondary income : credit	807	784	797	1,000	306	392	425	1,123	123	12.3
o.w Remittances	437	425	447	433	139	162	155	455	22	5.2
Secondary income: debit	9	10	11	14	3	6	5	14	0	1.3
3. Capital Account	**30**	**7**	**44**	**96**	**18**	**-16**	**40**	**42**	**-54**	**-56.1**
4. Financial Account	**-669**	**-284**	**-2,016**	**-2,122**	**-537**	**-723**	**-185**	**-1,445**	**678**	**-31.9**

** Revised*
***Provisional*
Fob - free on board

Source: Central Bank of Kenya

The Current Account

The trade balance worsened by 4.4 per cent in the second quarter of 2017 to stand at USD 2,157 million from USD 2,066 million in the first quarter of 2017 reflecting lower exports of goods and higher service imports (**Table 5.1**).

The value of merchandise exports decreased by 1.2 per cent to USD 1,453 million during the second quarter of 2017 generally reflecting lower global demand for exports of manufactured goods; raw materials; chemicals and related products; and miscellaneous manufactured articles. However, values of key traditional exports recorded improvement during the second quarter of 2017. The value of coffee exports increased by 21.5 percent while that of tea exports increased by 0.6 per cent reflecting higher exports volumes as well as favourable global prices. Horticulture exports increased by 3.8 per cent to USD 213 million and this was attributed to higher export volumes of fresh vegetables, fruits and nuts (**Table 5.2**).

Value of merchandise imports decreased slightly by 0.1 per cent to USD 3,977 million in the second quarter from USD 3,981 million in the first quarter largely on account of lower importation of machinery and transport equipment. However, food imports increased by 49.6 per cent to USD 556 million from USD 371 million on account of increased importation of cereals and sugar during the first half of 2017 resulting from dry weather conditions. The increase in oil imports in the second quarter of 2017 reflected relatively higher oil prices on the international market.

Net services declined by 17.7 per cent to stand at USD 367 million during the second quarter of 2017 compared to USD 445 million in the preceding quarter. This was attributed to lower net receipts from other services which reflected increased payments for insurance and pension services; and reduced earnings from telecommunications, computer and information services.

Despite the decline in net services, receipts from travel services increased by 4.9 per cent between quarter one and quarter two of 2017. Receipts from tourism are on a recovery path reflecting on-going campaigns by Government to target new markets as well as new segments, and improved security. In addition, tourist arrivals to Kenya's coast for holiday purposes have partly benefitted from the Government's Charter Incentive Programme which offers a raft of incentives to charter service providers and passengers who use them.

Meanwhile, the widening of the primary income balance by 62.1 per cent to USD 257 million was attributed to higher interest payments, while improvement in the secondary income balance by 12.4 per cent reflected increased workers' remittances and other miscellaneous current transfers **(Table 5.2)**.

Table 5.2: Balance On Current Account (USD Million)

ITEM	2016**			2017**					Q2 2017-Q1 2017	
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Q2			Total		%
	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	Change	Change
CURRENT ACCOUNT	**-1,061**	**-1,151**	**-1,184**	**-1,237**	**-422**	**-464**	**-418**	**-1,304**	**-67**	**5.4**
Goods	**-2,081**	**-2,159**	**-2,128**	**-2,511**	**-777**	**-910**	**-836**	**-2,523**	**-12**	**0.5**
Exports (fob)	**1,443**	**1,407**	**1,370**	**1,470**	**438**	**514**	**502**	**1,453**	**-17**	**-1.2**
o.w Coffee	70	48	44	67	26	31	24	81	14	21.5
Tea	325	287	290	345	97	120	130	347	2	0.6
Horticulture	205	194	192	205	64	79	70	213	8	3.8
Oil products	14	16	12	13	3	6	5	14	1	4.7
Manufactured Goods	106	112	105	98	29	34	30	94	-5	-4.9
Raw Materials	122	122	131	142	43	44	46	133	-9	-6.4
Chemicals and Related Products (n.e.s)	113	101	98	100	33	30	35	98	-2	-2.0
Miscelleneous Man. Articles	134	143	145	147	39	46	48	134	-13	-9.0
Re-exports	130	186	153	153	79	56	50	185	32	20.6
Other	222	198	200	200	25	68	62	155	-44	-22.2
Imports (fob)	**3,523**	**3,567**	**3,498**	**3,981**	**1,215**	**1,424**	**1,338**	**3,977**	**-5**	**-0.1**
o.w Oil	542	554	588	636	205	238	208	651	15	2.4
Chemicals	581	567	534	621	190	203	168	561	-60	-9.7
Manufactured Goods	645	695	604	619	217	235	219	671	52	8.4
Machinery & Transport Equipment	1,168	1,134	1,108	1,329	340	436	403	1,179	-150	-11.3
Machinery	838	783	793	857	223	254	287	764	-93	-10.9
Transport equipment	330	351	315	471	117	182	116	415	-56	-12.0
Other										
o.w Food	283	260	305	371	137	184	235	556	184	49.6
Services	**400**	**393**	**378**	**445**	**99**	**148**	**121**	**367**	**-79**	**-17.7**
Transport Services (net)	**187**	**187**	**171**	**202**	**58**	**71**	**68**	**198**	**-4**	**-2.1**
Credit	430	434	395	441	137	159	161	458	17	3.9
Debit	243	247	224	239	79	88	94	260	21	8.9
Travel Services (net)	**142**	**193**	**208**	**155**	**52**	**63**	**47**	**162**	**7**	**4.7**
Credit	175	228	230	217	72	84	71	227	11	4.9
Debit	33	35	22	62	20	22	24	65	3	5.2
Other Services (net)	**70**	**12**	**0**	**89**	**-12**	**14**	**6**	**7**	**-82**	**-92.2**
Primary Income	**-178**	**-159**	**-220**	**-159**	**-46**	**-89**	**-122**	**-257**	**-98**	**62.1**
Credit	106	110	109	122	41	42	40	**123**	**1**	**0.8**
Debit	284	269	329	281	87	131	163	**380**	**99**	**35.4**
Secondary Income	**798**	**775**	**786**	**987**	**303**	**387**	**420**	**1,109**	**123**	**12.4**
Credit	807	784	797	1,000	306	392	425	**1,123**	**123**	**12.3**
Debit	9	10	11	14	3	6	5	**14**	**0**	**1.3**

** Revised*

***Provisional*

Fob - free on board

Source: Central Bank of Kenya

Direction of Trade

China was Kenya's largest source of imports during the second quarter of 2017 but the share of imports decreased to 24.2 per cent from 27.6 per cent in the previous quarter. The share of Kenya's imports from the European Union, however, increased to 13 per cent during the second quarter of 2017 from 11.2 per cent during the previous quarter, while that from India also increased marginally to 11.7 per cent from 11.6 per cent during the first quarter of 2017. Imports from Africa accounted for 12 per cent during the second quarter of 2017 compared to 10.1 per cent during the first quarter (**Table 5.3**).

Table 5.3: Kenya's Direction of Trade: Imports

IMPORTS (USD M)									Share of Imports (%)	
	2016			2017	2017					
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Q2					
Country	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	Q1 2017	Q2 2017
Africa	**331**	**358**	**397**	**401**	**126**	**166**	**184**	**475**	**10.1**	**12.0**
Of which										
South Africa	128	137	129	136	51	48	67	166	3.4	4.2
Egypt	64	78	89	89	20	26	30	76	2.2	1.9
Others	139	143	179	177	55	91	87	234	4.4	5.9
									0.0	
EAC	**72**	**82**	**102**	**106**	**26**	**51**	**49**	**126**	**2.7**	**3.2**
COMESA	**152**	**163**	**222**	**211**	**63**	**94**	**100**	**258**	**5.3**	**6.5**
Rest of the World	**3,192**	**3,209**	**3,101**	**3,580**	**1,089**	**1,258**	**1,154**	**3,501**	**89.9**	**88.0**
Of which									0.0	
India	567	395	503	463	131	191	144	466	11.6	11.7
United Arab Emirates	237	313	210	222	86	89	109	284	5.6	7.1
China	841	971	872	1,098	255	343	365	962	27.6	24.2
Japan	195	224	191	183	73	69	69	211	4.6	5.3
USA	143	122	97	140	70	44	41	156	3.5	3.9
United Kingdom	90	80	89	71	21	29	23	73	1.8	1.8
Singapore	24	22	13	21	2	2	4	8	0.5	0.2
Germany	118	97	99	85	24	31	49	104	2.1	2.6
Saudi Arabia	167	163	224	352	85	81	58	225	8.8	5.7
Indonesia	102	121	109	153	57	31	35	123	3.9	3.1
Netherlands	37	43	45	37	6	22	9	38	0.9	1.0
France	52	58	48	56	19	34	31	84	1.4	2.1
Bahrain	2	24	43	24	16	5	4	26	0.6	0.6
Italy	59	59	68	62	20	22	10	52	1.6	1.3
Others	559	516	489	614	223	263	203	688	15.4	17.3
Total	**3,523**	**3,567**	**3,498**	**3,981**	**1,215**	**1,424**	**1,338**	**3,977**	**100.0**	**100.0**
EU	560	495	491	444	149	193	176	517	11.2	13.0
China	841	971	872	1,098	255	343	365	962	27.6	24.2

Source: Kenya Revenue Authority

Kenya's exports to Africa decreased by 8.5 per cent in the second quarter of 2017 with the decrease largely explained by the decline in exports to EAC and COMESA regions (**Table 5.4**). Exports to the rest of the world, however, increased by 3.4 per cent over the review period. The share of exports to China increased to 2.7 per cent during the second quarter of 2017, while that to the European Union decreased to 21.1 percent during the second quarter of 2017 from 22.7 per cent during the first quarter of 2017.

Table 5.4: Kenya's Direction Of Trade: Exports

EXPORTS (USD M)									Share of Exports (%)	
	2016			2017	2017					
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Q2					
Country	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	Q1 2017	Q2 2017
Africa	**580**	**562**	**557**	**564**	**160**	**177**	**179**	**516**	**38.4**	**35.5**
Of which										
Uganda	150	154	155	163	46	46	47	140	**11.1**	**9.6**
Tanzania	86	70	82	75	16	19	18	53	**5.1**	**3.7**
Egypt	58	57	35	42	9	9	17	35	**2.9**	**2.4**
Sudan	12	11	13	13	5	5	7	17	**0.9**	**1.2**
South Sudan	41	25	40	45	15	13	19	47	**3.1**	**3.3**
Somalia	40	45	53	58	15	16	14	46	**4.0**	**3.1**
DRC	48	53	51	48	13	17	15	45	**3.3**	**3.1**
Rwanda	44	44	44	37	13	14	14	41	**2.5**	**2.9**
Others	100	104	83	82	28	37	28	93	**5.6**	**6.4**
EAC	**295**	**287**	**298**	**293**	**81**	**90**	**86**	**257**	**19.9**	**17.7**
COMESA	**380**	**398**	**359**	**364**	**107**	**120**	**122**	**349**	**24.8**	**24.0**
Rest of the World	**863**	**846**	**813**	**906**	**278**	**337**	**322**	**937**	**61.6**	**64.5**
Of which										
United Kingdom	92	87	85	97	25	31	32	88	**6.6**	**6.1**
Netherlands	104	89	99	119	37	40	34	111	**8.1**	**7.7**
USA	100	129	109	105	33	42	45	121	**7.1**	**8.3**
Pakistan	105	95	124	151	37	53	56	146	**10.3**	**10.0**
United Arab Emirates	80	80	63	52	23	29	26	78	**3.5**	**5.4**
Germany	35	28	27	33	13	13	9	34	**2.2**	**2.4**
India	23	33	18	16	4	5	5	13	**1.1**	**0.9**
Afghanistan	35	15	4	7	3	4	4	11	**0.5**	**0.7**
Others	289	290	285	326	102	120	111	334	**22.2**	**23.0**
Total	**1,443**	**1,407**	**1,370**	**1,470**	**438**	**514**	**502**	**1,453**	**100.0**	**100.0**
EU	298	263	280	334	96	112	99	307	**22.7**	**21.1**
China	24	27	31	24	13	13	14	39	**1.7**	**2.7**

Source: Kenya Revenue Authority

Capital and Financial Account

The capital account surplus narrowed by 56.1 per cent to USD 42 million in the second quarter of 2017 from USD96 million in the previous quarter reflecting decrease in inflows of capital transfers in form of project grants.

Inflows to the financial account decreased by 31.9 per cent to USD 1,445 million in the second quarter of 2017 from USD 2,122 million in previous quarter (**Table 5.4**). The decrease was reflected in reduced inflows of Other Investment liabilities by USD 1,004 million to USD 1,648 million in second quarter of 2017 from USD 2,652 million in first quarter 2017.

Meanwhile over the same period, resident investors increased their holdings of foreign direct investment and foreign portfolio investments by 30.4 per cent and 12.0 per cent, respectively. Resident holdings of Other Investments assets, however, declined by 97.4 per cent to USD 11 million in the second quarter reflecting decrease in foreign assets by commercial banks.

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

ITEM	2016			2017**					Q2 2017-Q1 2017	
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Q2			Total		%
	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	Change	Change
Capital account	**30**	**7**	**44**	**96**	**18**	**-16**	**40**	**42**	**-54**	**-56.1**
Capital account credit	30	7	44	96	18	-16	40	42	-54	-56.1
Capital account: debit	0	0	0	0	0	0	0	0	0	0.0
Financial Account	**-669**	**-284**	**-2,016**	**-2,122**	**-537**	**-723**	**-185**	**-1,445**	**678**	**-31.9**
Direct investment: assets	36	41	50	59	28	28	20	76	18	30.4
Direct investment: liabilities	81	72	97	156	50	45	39	134	-22	-14.2
Portfolio investment: assets	95	162	157	227	48	111	95	254	27	12.0
Portfolio investment: liabilities	5	12	7	6	2	2	0	4	-2	-35.9
Financial derivatives: net	0	0	0	0	0	0	0	0	0	0.0
Other investment: assets	241	183	-374	406	115	-170	65	11	-396	-97.4
Other investment: liabilities	955	587	1,746	2,652	677	645	326	1,648	-1,004	-37.9

** Revised*

***Provisional*

Source: Central Bank of Kenya

Foreign Exchange Reserves

The banking system's total foreign exchange holdings increased by 1.8 per cent during the second quarter of 2017 rising from USD10,786 million to USD 10,984 million between the two quarters of 2017. Official reserves held by the Central Bank of Kenya constituted 78 per cent of gross reserves and stood at USD 8,580 million, equivalent to 5.7 months of import cover (**Table 5.6**). Meanwhile, the Precautionary Arrangements with the IMF amounting to USD 1,500 million continued to provide additional buffer against short term external and domestic shocks.

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

	2015			2016				2017				
	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar				
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2
1. Gross Reserves	**9,473**	**8,899**	**9,794**	**9,809**	**10,499**	**10,602**	**9,587**	**10,786**	**11,233**	**10,934**	**10,984**	**10,984**
of which:												
Official	7,212	6,711	7,534	7,807	8,267	8,200	7,573	8,379	8,715	8,591	8,580	8,580
*import cover**	*4.5*	*4.2*	*4.8*	*5.0*	*5.4*	*5.4*	*5.0*	*5.5*	*5.8*	*5.7*	*5.7*	*5.7*
Commercial Banks	2,262	2,188	2,259	2,002	2,232	2,402	2,015	2,407	2,518	2,343	2,405	2,405
2. Residents' foreign currency deposits	**4,488**	**4,278**	**4,389**	**4,191**	**4,443**	**4,723**	**4,323**	**4,503**	**4,663**	**4,660**	**4,733**	**4,733**

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

Source: Central Bank of Kenya

Exchange Rates

The foreign exchange market has remained relatively stable supported by a generally lower current account deficit and resilient inflows from diaspora remittances. During the second quarter of 2017, the Kenya Shilling appreciated against the US Dollar but depreciated against the Pound Sterling, the Japanese Yen and the Euro when compared to its performance during the first quarter of 2017 (**Table 5.7 and Chart 5.1**). In the EAC region, the Kenya Shilling strengthened against all EAC currencies.

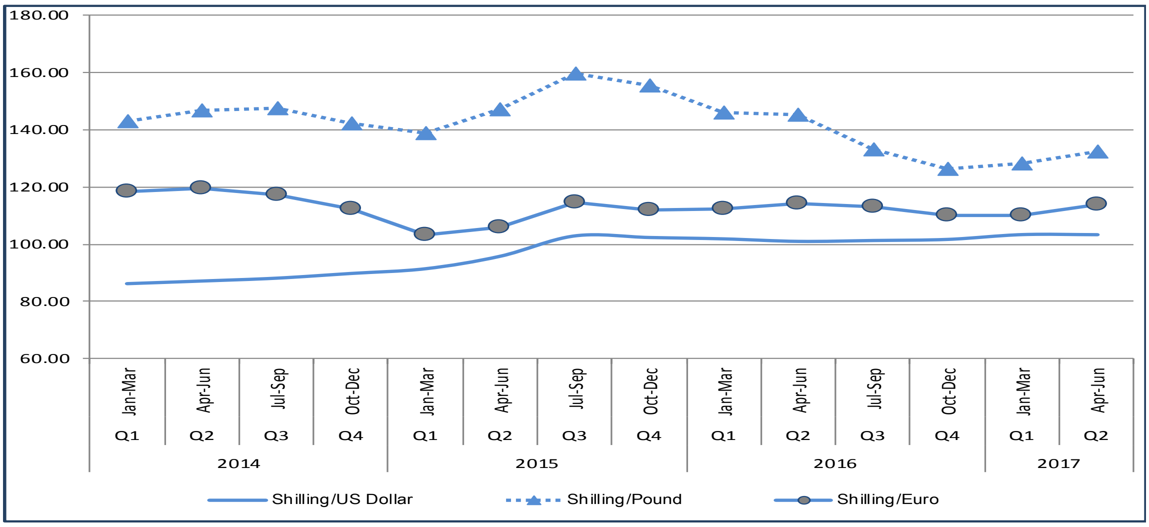
Table 5.7: Kenya Shilling Exchange Rate

	2016			2017	2017			2017	
	Q2	Q3	Q4	Q1	Apr	May	Jun	Q2	% change Q2 2017 - Q1 2017
US Dollar	101.04	101.34	101.73	**103.39**	103.33	103.26	103.49	**103.36**	**-0.03**
Pound Sterling	145.12	133.14	126.45	**128.05**	130.43	133.46	132.47	**132.22**	**3.25**
Euro	114.16	113.11	109.89	**110.12**	110.68	114.05	116.18	**113.75**	**3.29**
100 Japanese Yen	93.58	99.00	93.50	**90.95**	93.72	91.99	93.40	**92.98**	**2.24**
Uganda Shilling*	33.18	33.32	34.68	**34.79**	35.03	35.10	34.69	**34.94**	**0.43**
Tanzania Shilling*	21.69	21.58	21.44	**21.57**	21.62	21.65	21.62	**21.63**	**0.31**
Rwanda Franc*	7.55	7.56	7.83	**7.99**	8.06	8.04	8.03	**8.04**	**0.64**
Burundi Franc*	15.61	16.47	16.49	**16.35**	16.46	16.54	16.66	**16.56**	**1.30**

** 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 Sector

Structure of the Banking Sector

1. Introduction

The Kenyan banking sector comprised 42 commercial banks, 1 mortgage finance company, 13 microfinance banks, 7 representative offices of foreign banks, 74 foreign exchange bureaus, 18 money remittance providers and 3 credit reference bureaus as at June 30, 2017. Fidelity Commercial Bank Limited was acquired during the period by SBM Group and changed its name to SBM Bank Kenya Limited. DIB Bank Kenya Limited and Mayfair Bank Limited were licenced during the period. DIB Bank Kenya Ltd commenced operations in May thus increasing the number of commercial banks to 42. **Chart 6.1** below shows the structure of the Kenyan banking sector over the last two quarters.

2. Structure of the Balance Sheet

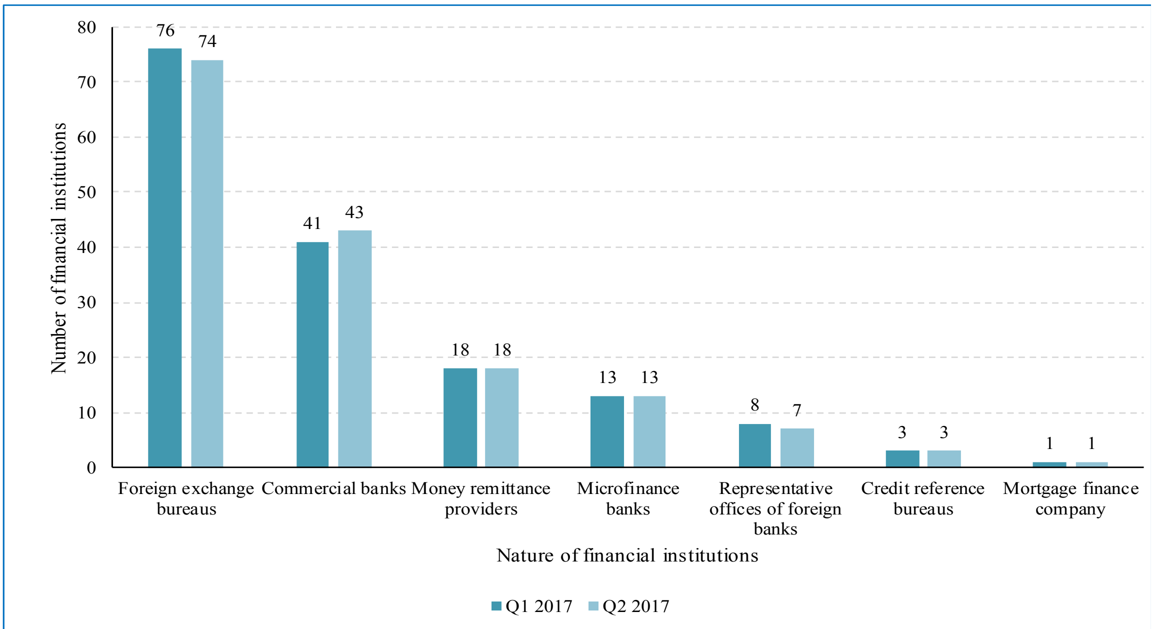
i) Growth in banking sector assets

Total net assets increased by 2.9 per cent from KSh 3,841.5 billion in the first quarter of 2017 to KSh 3,951.6 billion in the second quarter of 2017. This increase was attributable to a 15.4 per cent (KSh 134.6 billion) increase in government securities. The increase in government securities is attributable to their ease to liquidate and stability. Loans and advances remained the main component of assets accounting for 54 per cent in the second quarter of 2017, which was a slight decrease from 55 per cent recorded in the first quarter of 2017.

ii) Loans and Advances

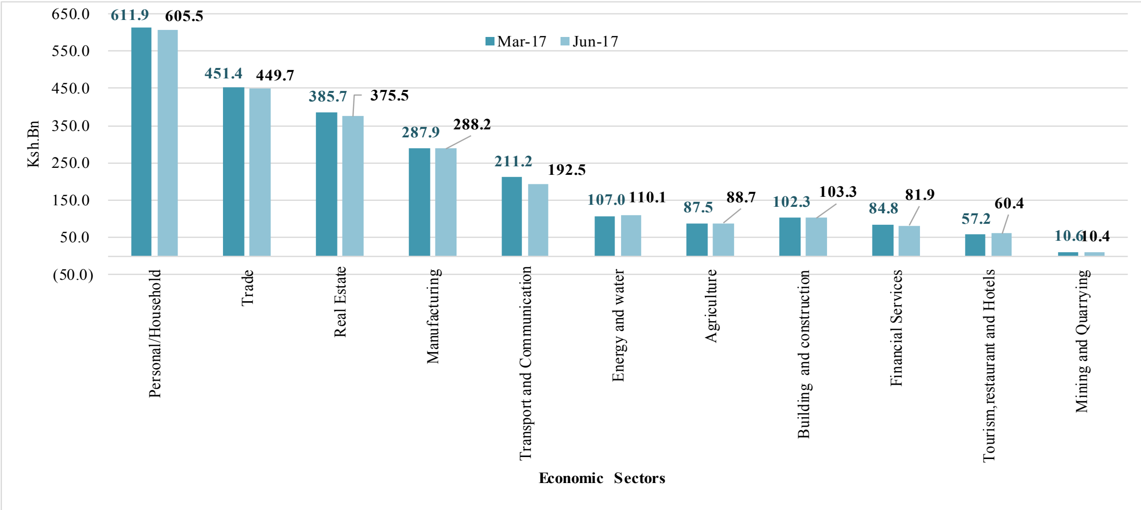
Total banking sector lending decreased by 1.3 per cent from KSh 2,381.3 billion in the first quarter, 2017 to KSh 2,366.1 billion in the second quarter of 2017. The decrease in gross loans and advances was mainly attributed to reduced lending to Transport and Communication, Financial Services and Real estate sectors. **Chart 6.2)**: Shows the changes in sectoral Gross loans between first and second quarters of 2017.

Chart 6.1: Structure of the Banking Sector in Kenya



Source: Central Bank of Kenya

Chart 6.2: Gross Loans of the Banking Sector by Economic Sector



Source: Central Bank of Kenya

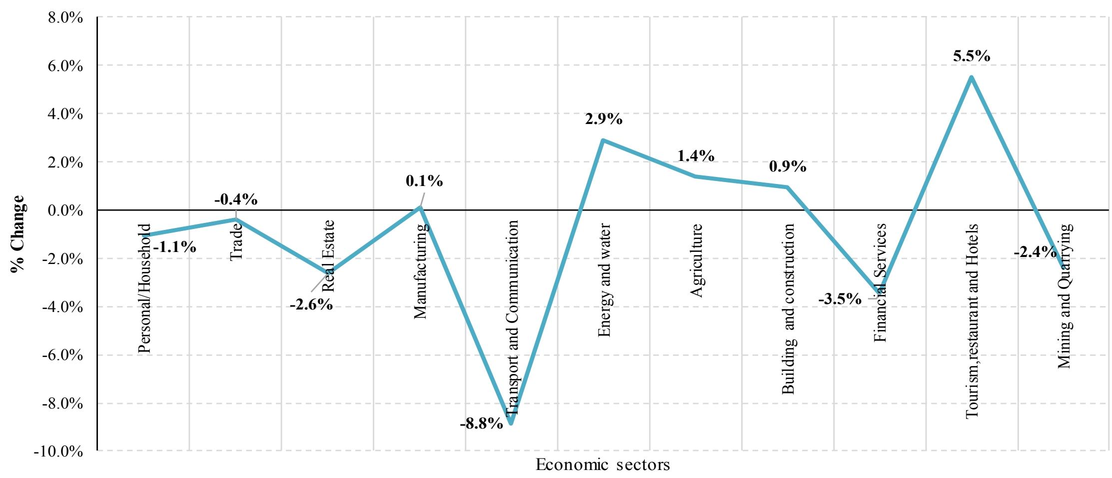
Transport and Communication sector recorded the highest decrease in lending of 8.8 per cent between the first and second quarter of 2017 attributed to higher repayments than disbursements. The sectoral distribution of gross loans as at June 30, 2017 (**Chart 6.3**).

Transport and Communication highest decrease in lending of 8.8 per cent or KSh 18.7 billion between the first quarter of 2017 and the second quarter of 2017. This was mainly attributed to repayments by some corporate clients.

iii) Deposit Liabilities

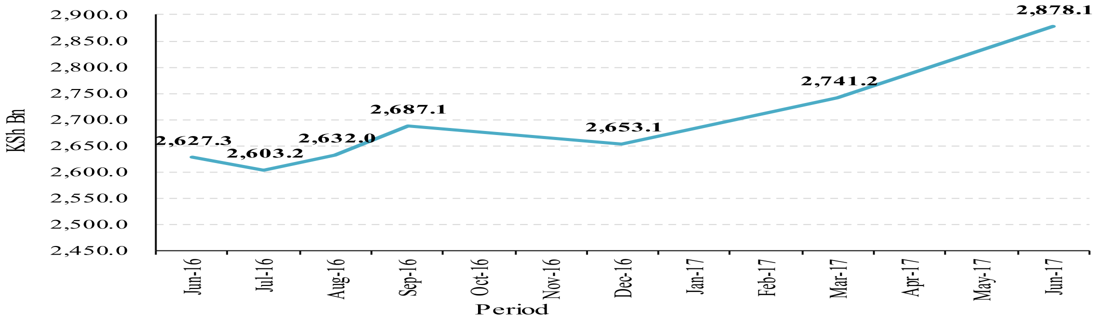
Customer deposits remains the main source of funding to the banks and accounted for 72.3 per cent of the banking sector total liabilities and shareholders' funds as at the end of the second quarter of 2017. This was an increase from 71.4 per cent recorded as at end of the first quarter of 2017. The customer deposit base increased by 4.3 per cent from KSh 2,741.21 billion in the first quarter of 2017 to KSh 2,858.0 billion in the second quarter of 2017. The increase in customer deposit base between the first quarter of 2017 and second quarter of 2017 was mainly as a result of increased foreign currency deposits made by oil supply companies, telecommunication companies and government agencies. **Chart 6.4** shows the movement in deposit liabilities from first to the second quarter of 2017.

Chart 6.3: Quarterly Changes in Gross Loans in the First Quarter of 2017



Source: Central Bank of Kenya

Chart 6.4 Customer Deposits (Ksh Billion)



Source: Central Bank of Kenya

3. Capital Adequacy

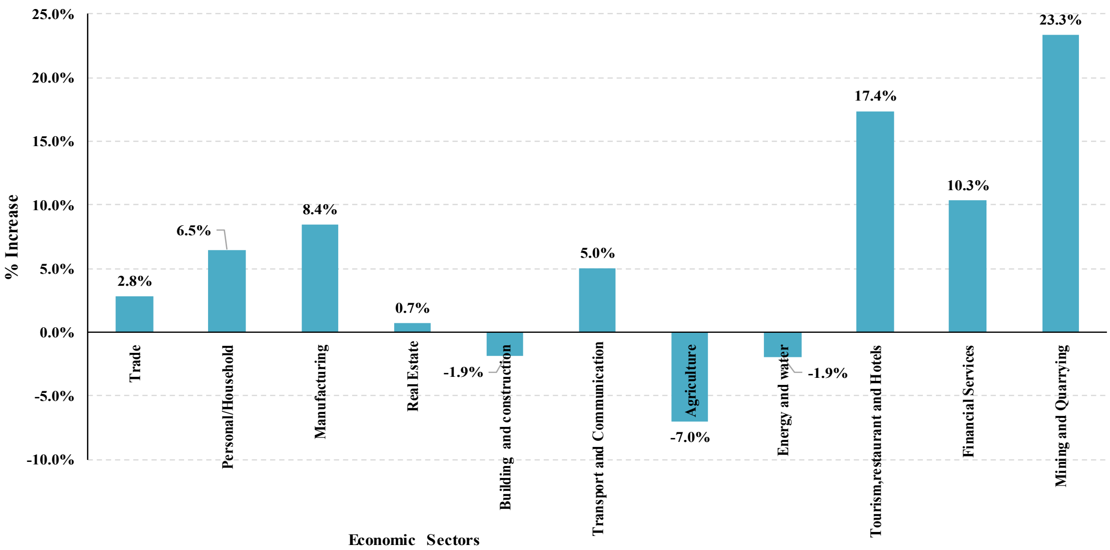
The Kenyan banking sector has continued to build up its capital levels to sustain resilience to adverse shocks. Core capital increased slightly by 0.06 per cent from KSh 526.1 billion to KSh 526.4 billion. Total capital reduced slightly by 0.2 per cent from KSh 614.5 billion to KSh 613.2 billion, between the first and the second quarter of 2017. Total capital and core capital to total risk- weighted assets ratios increased from 19.4 per cent and 16.6 per cent as at the first quarter of 2017 to 19.6 per cent and 16.8 per cent respectively as at the second quarter of 2017. This was as a result of total risk-weighted assets decreasing by 1.3 per cent over the same period.

Banks are required to maintain a core capital to total deposits ratio of not less than 8 per cent. As at the end of the second quarter of 2017, this ratio decreased to 18.4 per cent from 19.2 per cent registered in the first quarter of 2017.

4. Asset Quality

The gross non-performing loans (NPLs) increased by 3.5 per cent from KSh 226.6 billion as at the end of the first quarter of 2017 to KSh 234.6 billion in end of the second quarter of 2017. Eight economic sectors recorded increases in the NPLs between first quarter of 2017 and second quarter of 2017 as shown in **Chart 6.5**.

Chart 6.5: Changes in Gross NPLS in the First and Second Quarters of 2017



Source: Central Bank of Kenya

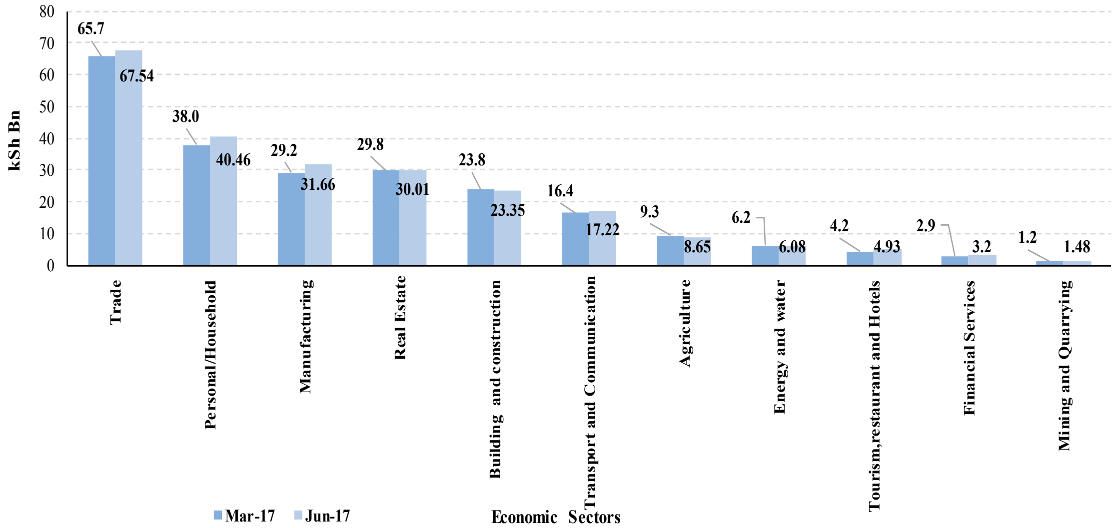
Mining and Quarrying sector registered the highest increase in NPLs of 23.3 per cent (KSh 280 million) between first and the second quarters of 2017. This was attributed to business cash flow challenges due to low turnovers which affected the serviceability of loans during the period under review.

Tourism, Restaurant and Hotels sector registered an increase in NPLs of 17.4 per cent (KSh 730 million) due to slow down in business which led to delayed and partial loan re payments.

Agriculture sector recorded the highest decrease in NPLs of 7 per cent between the first and the second quarter of 2017 of 7.0 per cent (KSh 650 million). This is mainly attributable to increased business sales/turnovers and improved weather conditions.

Based on the movements of NPLs highlighted above, the gross NPLs to gross loans ratio increased from 9.5 per cent in first quarter of 2017 to 9.9 per cent in the second quarter of 2017. **Chart 6.6** highlights the detailed sectoral distribution of gross NPLs between the two periods under review.

Chart 6.6: Kenyan Banking Sector Gross Non-Perfoming Loans



Source: Central Bank of Kenya

The banking sector's asset quality as measured by the proportion of net non-performing loans to gross loans, deteriorated slightly from 4.7 per cent in the first quarter of 2017 to 4.8 per cent in the second quarter of 2017. Coverage ratio, which is measured as a percentage of specific provisions to total NPLs recorded a positive increase from 36.6 per cent in first quarter of 2017 to 38.4 per cent in the second quarter of 2017 due to a lower increase in specific provisions as compared to increase in NPLs between the two periods.

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

Table 6.1: **Summary of Asset Quality**

		March-17, KSh Billion	June-17, KSh Billion
1	Gross Loans and Advances (KSh'Bn)	2,381.3	2,366.1
2	Interest in Suspense (KSh'Bn)	47.0	49.9
3	Loans and advances (net of interest suspended) (KSh'Bn)	2,334.3	2,316.2
4	Gross non-performing loans (KSh'Bn)	226.6	234.6
5	Specific Provisions (KSh'Bn)	65.8	71.0
6	General Provisions (KSh'Bn)	19.8	20.5
7	Total Provisions (5+6) (KSh'Bn)	85.6	91.5
8	Net Advances (3-7) (KSh'Bn)	2,248.7	2,224.7
9	Total Non-Performing Loans and Advances (4-2) (KSh'Bn)	179.6	184.7
10	Net Non-Performing Loans and Advances (9-5) (KSh'Bn)	110.8	113.7
11	Total NPLs as percent of Total Advances (9/3)	0.1	0.1
12	Net NPLs as percent of Gross Advances (10/1)	0.1	0.1
13	Specific Provisions as percent of Total NPLs (5/9)	0.4	0.4

Source: Central Bank of Kenya

5. Profitability

i) Profit and Loss

The banking sector registered improved performance in pre-tax profits by 2.0 per cent from KSh 34.4 billion in first quarter of 2017 to KSh 35.1 billion in the second quarter of 2017. The increase in profitability is attributed to a higher increase in income compared to the rise in expenses.

ii) Income

Total income for the banking sector grew by 7.5 per cent from KSh 79.5 million in the first quarter to KSh 165.2 million in the second quarter of 2017.

The increase in income was largely attributed to increased investments in government securities which increased by 15 per cent from 875.2 billion in the first quarter of 2017 to KSh 1,009.8 billion in the second quarter of 2017.

Interest income on loans and advances, interest on government securities and other incomes were the major sources of income accounting for 54 percent, 20 per cent and 18 per cent 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 31.1 percent, 25.4 per cent and 22.3 per cent of total expenses respectively.

The return on assets (ROA) decreased from 2.9 per cent in the first quarter of 2017 to 2.8 per cent in the second quarter of 2017 while return on equity (ROE) increased from 22.2 per cent in the first quarter of 2017 to 22.3 per cent in the second quarter of 2017. The decrease in ROA and increase in ROE were as a result of increase in profitability between the two quarters.

6. Liquidity

The banking sector's overall liquidity ratio increased from 43.8 per cent in the first quarter of 2017 to 44.7 per cent recorded in the second quarter of 2017. This is evidenced by a 4.0 per cent decrease in Loans to deposit ratio from 86.9 per cent in the first quarter of 2017 to 82.9 per cent in the second quarter of 2017. The banking sector liquidity ratio recorded was above the minimum statutory level of 20 percent.

7. Outlook of the Sector

The Kenyan banking sector is expected to remain stable in the second half of 2017. Credit risk is expected to remain elevated but will be mitigated by improvements in the business environment, improved weather conditions, changes in political environment.

KENYA SHILLING FLOWS IN KEPSS

Kenya Electronic Payments and Settlement System (KEPSS) used for large value Real Time Gross Settlement (RTGS) payments moved a volume of 1.6 million transaction messages worth KSh 7.2 trillion in the first quarter of 2017, compared to the first quarter of 2017 which recorded 1.05 million transactions worth KSh 7 trillion. Volume and value moved increased by 2.20 per cent and 10.95 per cent, respectively. **Chart 6.7** below highlights recent trends in KEPSS transactions.

Bank Customer Payments Processed Through KEPSS

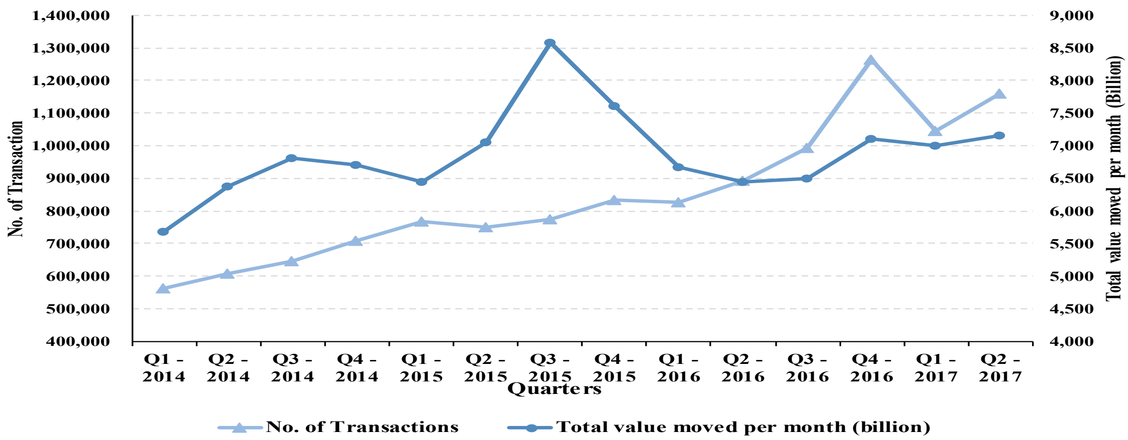
In transmitting payments through the RTGS for customers, commercial banks submit the payment instructions vide multiple third party Message Type (MT 102) used for several credit transfers and single third party Message Type (MT 103) used for single credit transfers.

During the period under review, MT 102 usage decreased by 32.4 per cent, to 49,364 messages recorded in the second quarter of 2017 from 73,022 messages processed in the previous quarter. The MT 103 payments increased by 2.62 per cent, to 1,095,797 messages in the second quarter of 2017 from 1,067,868 messages in the previous quarter (**Chart 6.8**). The sustained growth of KEPSS is an indicator of its continued preference by the Payment Service Providers for real time settlements.

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

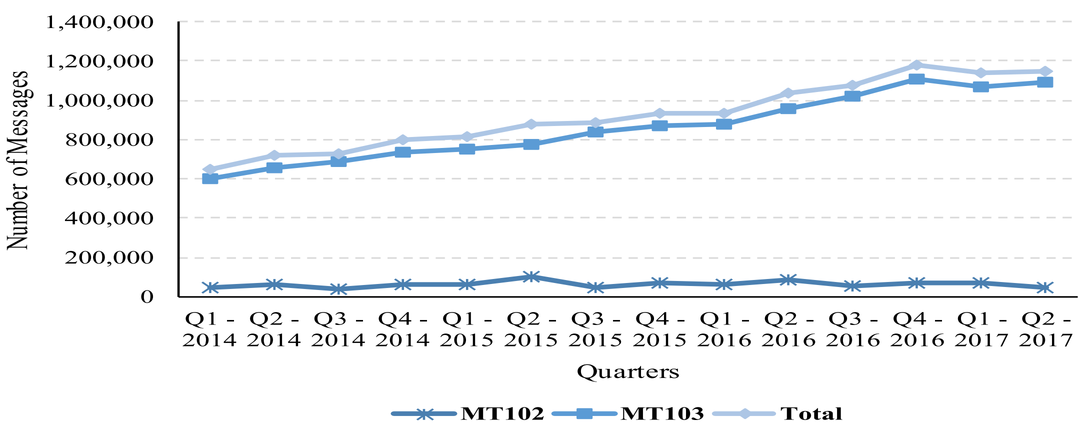
During the quarter under review, KEPSS availability declined marginally to record an average of 99.97 per cent compared to 99.95 per cent in the previous quarter (**Chart 6.9**)

Chart 6.7: Trends in Monthly Flows Through KEPSS



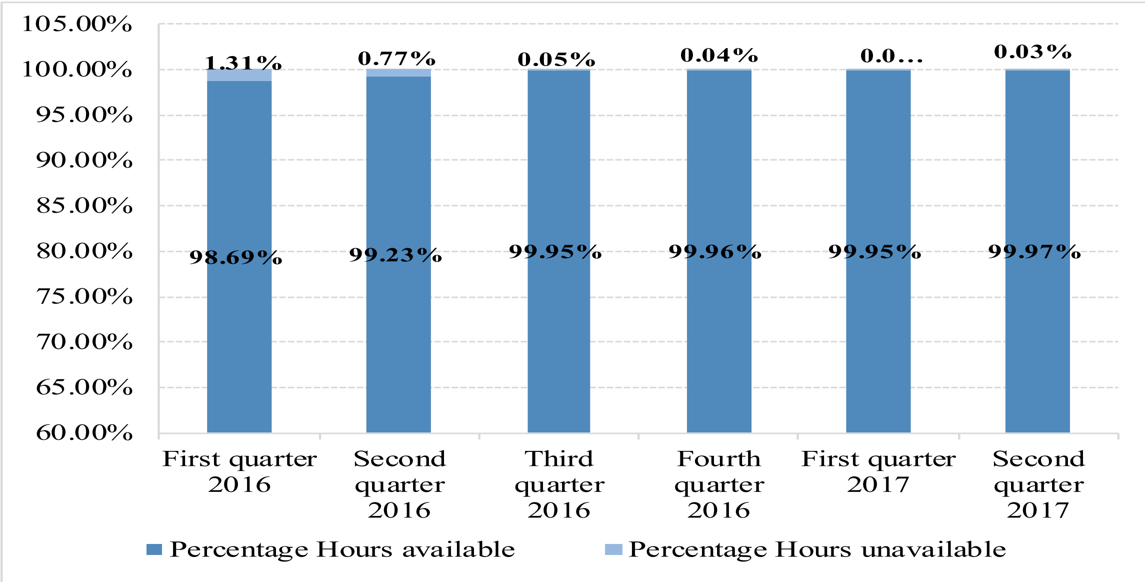
Source: Central Bank of Kenya

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



Source: Central Bank of Kenya

Chart 6.9: Availability of KEPSS in Kenya (%)



Source: Central Bank of Kenya

Chapter 7

Government Budgetary Performance

The government's budgetary operations resulted in a deficit of 5.3 per cent of GDP in the fourth quarter of the FY 2016/17 compared with a deficit of 4.0 per cent of GDP in the third quarter (**Table 7.1**). The operations resulted in a cumulative deficit of 8.9 per cent of GDP by end June 2017 which was within the 10.9 per cent of GDP target set for the FY 2016/2017. Both cumulative total revenues and grants, and total expenses and net lending were marginally lower than respective targets for end June 2017.

Table 7.1: Statement of Government Operations in FY 2016/17 (KSh Billion)

	(FY 2016/17)					Cumulative to June 2017	Target	Over (+) / Below (-) Target
	Q3	April	May	June	Q4			
1. TOTAL REVENUE & GRANTS	**321.0**	**130.9**	**133.8**	**163.0**	**427.8**	**1,426.9**	**1,514.1**	**(87.2)**
Ordinary Revenue	**290.0**	**124.6**	**126.4**	**150.9**	**401.9**	**1,305.8**	**1,455.4**	**(149.6)**
Tax Revenue	271.1	118.9	119.5	135.6	374.0	1,219.5	1,220.9	(1.4)
Non Tax Revenue	18.9	5.8	6.9	15.3	27.9	86.3	90.4	(4.1)
Appropriations-in-Aid	16.9	4.9	6.7	7.0	18.5	94.8	144.0	(49.2)
External Grants	14.1	1.4	0.7	5.2	7.3	26.3	58.8	(32.5)
2. TOTAL EXPENSES & NET LENDING	**607.6**	**247.1**	**212.0**	**346.6**	**805.7**	**2,110.0**	**2,326.9**	**(216.9)**
Recurrent Expenses	348.9	132.8	147.0	210.8	490.6	1,179.5	1,238.3	(58.8)
Development Expenses	189.7	89.4	28.7	94.6	212.6	639.8	797.9	(158.1)
County Transfers	69.0	25.0	35.3	39.2	99.5	284.7	284.7	(0.0)
Others	-	-	-	-	-	**6.0**	6.0	
3. DEFICIT ON A COMMITMENT BASIS (1-2)	**(286.7)**	**(116.2)**	**(78.1)**	**(183.6)**	**(377.9)**	**(683.1)**	**(812.8)**	-
As percent of GDP	(4.0)	(1.6)	(1.1)	(2.6)	(5.3)	8.9	10.9	
4. ADJUSTMENT TO CASH BASIS						-	-	**(2.0)**
5. DEFICIT ON A CASH BASIS	**(286.7)**	**(116.2)**	**(78.1)**	**(183.6)**	**(377.9)**	**(683.1)**	**(812.8)**	-
As percent of GDP	(4.0)	(1.6)	(1.1)	(2.6)	(5.3)	8.9	10.9	
6. DISCREPANCY: Expenditure (+) / Revenue (-)	105.6	49.1	8.4	53.2	110.7	14.2	0.0	(2.0)
7. FINANCING	**181.0**	**67.1**	**69.7**	**130.4**	**267.2**	**697.3**	**812.8**	**14.2**
Domestic (Net)	(9.3)	10.7	38.1	109.9	158.7	309.8	346.8	(115.5)
External (Net)	190.3	56.4	31.6	20.5	108.5	385.7	463.9	(37.1)
Capital Receipts (domestic loan receipts)	0.7	0.6	0.2	0.0	0.9	1.8	-	(78.1)
Others(Euro Bond sale proceeds)	-	-	-	-	-	-	-	1.8

NB: using the new re-based GDP figures as per 2017 Economic Survey

Sources: The National Treasury

Revenue

Cumulatively, government receipts - revenue and grants - amounted to KSh 1,426.9 billion or 18.5 per cent of GDP, in the FY 2016/17. Cumulative tax revenue alone stood at KSh 1,219.5 billion (15.8 per cent of GDP) and was KSh 1.4 billion below target of KSh 1,220.9 billion. Tax revenue in the fourth quarter of FY 2016/17 stood at KSh 374 billion which was much higher than the KSh 271.1 billion collected in the third quarter of the FY 2016/17. The increase reflected improved performance in Import Duty, Income tax and VAT on imports.

Cumulative external grants for the FY 2016/17 stood at KSh 26.3 billion, which was KSh 32.5 billion below target on account of slow absorption of donor funds.

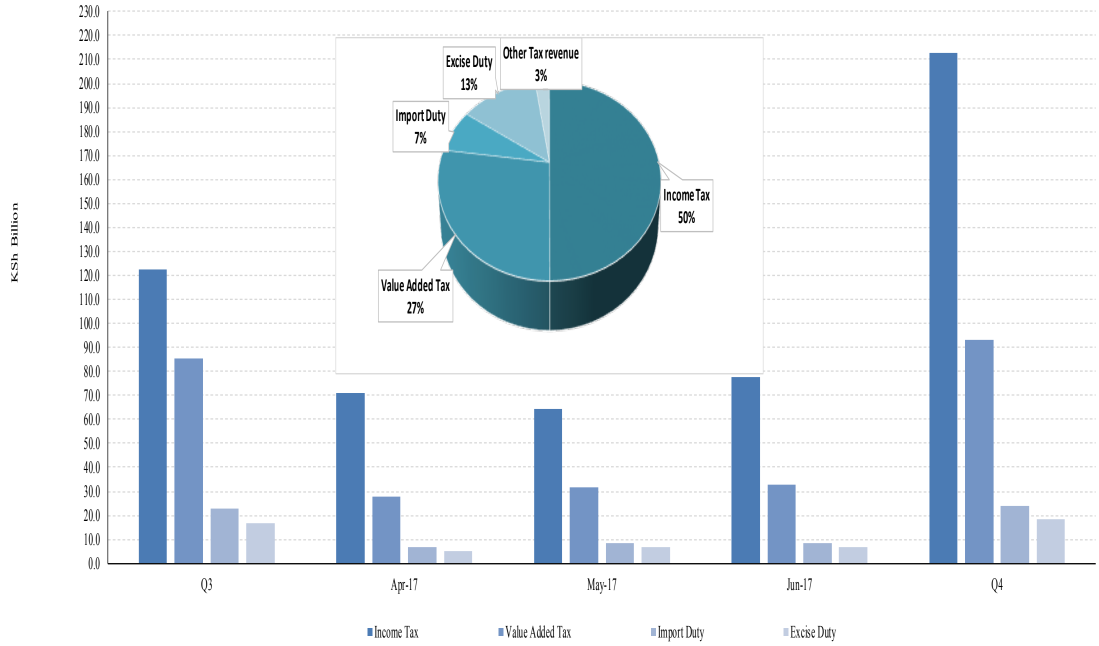
Meanwhile, ministerial Appropriations in Aid (A-in-A) collected during the FY 2016/17 amounted to KSh 94.8 billion, which was KSh 49.2 billion lower than target due to under reporting by public universities. Ministerial A-in-A collections fell below target for the fourth consecutive quarter of the FY 2016/17.

Income tax, Import Duty and VAT performed above respective targets (**Chart 7.1**). As observed in previous years, the collection of revenues started to pick up in the third quarter of the year.

Expenditure and Net Lending

Government expenditure and net lending for the FY 2016/17 stood at KSh 2,110.0 billion (27.3 per cent of GDP) against a target of 2,326.9 billion. The shortfall of KSh 216.9 billion reflects lower recurrent and development expenditures by the National and County governments. However, the expenditures in the fourth quarter alone stood at KSh 805.7 billion and were 32.6 per cent higher than the KSh 607.6 billion spent in the third quarter of FY 2016/17 (**Chart 7.1**).

Chart 7.1: Composition of Government Revenue (Ksh Billion)



Source: The National Treasury

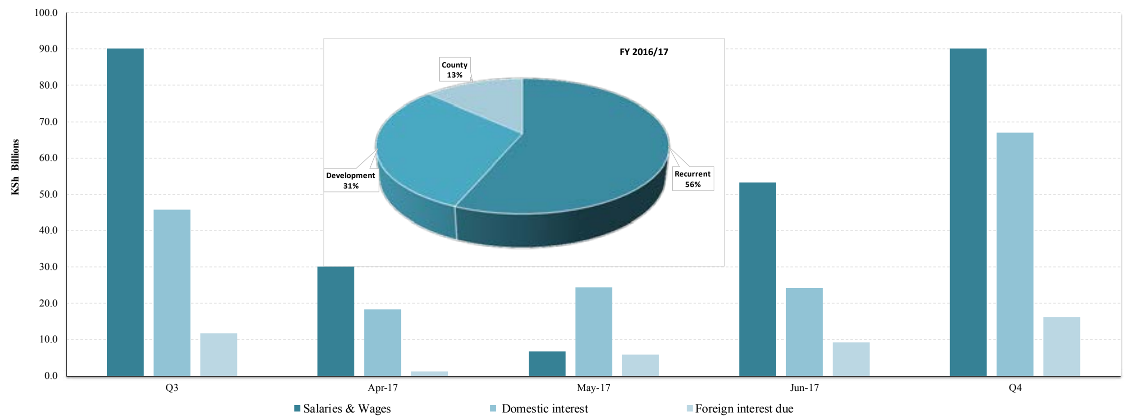
In terms of broad categories of expenditure, recurrent was below target by KSh 19.4 billion, and largely in foreign interest payments. Domestic interest payments for the fourth quarter increased to KSh 67.1 billion from KSh 45.7 billion in the third quarter of the FY 2016/17. Foreign interest payments which stood at KSh 16.2 billion were also higher than KSh 11.8 billion paid in the third quarter (**Chart 7.2**). Cumulatively, development expenditure was below target by KSh 158.1 billion largely attributed to non-capture of some National Sub-County expenditures following under reporting by ministries.

With respect to composition, the share of recurrent expenditure in total government spending dominated at 60.9 per cent in the fourth quarter, while the contribution of development expenditure to total government expenditure was 26.4 percent. Development expenditures were largely channeled into infrastructure and energy and petroleum ministries for implementation of key infrastructure projects. The share of county transfers was 12.3 per cent of government spending (**Table 7.1**).

Financing

External financing for FY 2016/17 amounted to KSh 385.7 billion against a target of KSh 463.9 billion. Net domestic borrowing amounted to KSh 309.8 billion over the same period. The

Chart 7.2: Composition of Recurrent Expenses



Sources: The National Treasury

Table 7.2 Domestic Financing Ending June 30, 2017

	NET CREDIT TO GOVERNMENT 2016/17 (Ksh Bn)											
			Q1			Q2			Q3			Q4
	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17
1. From CBK	(29.30)	3.77	(24.58)	12.03	0.61	37.83	44.90	83.19	35.84	(38.11)	(36.17)	(22.37)
2.From commercial banks	6.25	3.12	37.36	34.73	38.93	18.86	(6.79)	(9.70)	12.53	75.61	135.66	169.54
4.From Non-banks	19.91	30.35	37.53	70.23	92.45	106.82	107.16	117.29	132.40	125.96	133.17	160.68
5. From Non-Residents	(0.71)	(1.00)	(0.87)	(0.21)	0.70	1.09	1.23	1.29	1.37	1.29	1.48	1.92
Change in Credit from banks (From 30th June 2016)	(23.05)	6.89	12.77	46.77	39.54	56.69	38.11	73.50	48.37	37.50	99.48	147.17
Change in Credit from non-banks(From 30th June 2016)	19.91	30.35	37.53	70.23	92.45	106.82	107.16	117.29	132.40	125.96	133.17	160.68
Change in Credit from non-residents(From 30th June 2016)	(0.71)	(1.00)	(0.87)	(0.21)	0.70	1.09	1.23	1.29	1.37	1.29	1.48	1.92
6.Total Change in Dom. Credit (From 30th June 2016)	(3.84)	36.24	49.43	116.78	132.69	164.60	146.49	192.08	182.13	164.75	234.14	309.76

NB. Treasury Bills are reflected at Cost

Source: Central Bank of Kenya

borrowing comprised KSh 169.5 billion from commercial banks, KSh 160.7 billion from Non-banking financial institutions and KSh 1.9 billion from Non-Residents. There was also a repayment of KSh 22.4 billion to the CBK (**Table 7.2**). Net domestic borrowing in the FY 2016/17 increased by 55 per cent compared to KSh 202.3 billion in a similar period in the FY 2015/16.

Domestic financing in the FY 2016/17 performed well compared to FY 2015/16. In the FY 2015/16 liquidity constraints coupled with government's reluctance to accept higher interest rates constrained domestic borrowing. The performance of the government's domestic borrowing programme has been consistent with thresholds set in the Medium Term Debt Management Strategy.

Outlook for FY 2017/18

In the budget estimates for the FY 2017/18, total revenue is projected at KSh 1,763.3 billion (20.0 per cent of GDP) while external grants are projected at KSh 58.8 billion (0.7 per cent of GDP). Government expenditure is projected at KSh 2,287.9 billion (26.0 per cent of GDP), of which KSh 1,347.3 billion (15.3 per cent of GDP) will be for recurrent expenses, KSh 295.3 billion for transfers to county governments, and KSh 640.3 billion for development expenses (**Table 7.3**).

The overall budget deficit including grants on commitment basis is, therefore, projected to be KSh 524.6 billion (6.0 per cent of GDP) in 2017/18. The deficit is expected to be financed through net external borrowing of KSh 256.0 billion and net domestic borrowing of KSh 268.6 billion.

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

	Ksh (Billion)	%age of GDP
1. TOTAL REVENUE (Including Grants)	**1,763.3**	**20.0**
Ordinary Revenue	1,549.4	17.6
Appropriations-in-Aid	155.1	1.8
External Grants	58.8	0.7
2. TOTAL EXPENSES & NET LENDING	**2,287.9**	**26.0**
Recurrent Expenses	1,347.3	15.3
Development Expenses	640.3	7.3
County Transfer	295.3	3.4
Contigency Fund	5.0	
3. DEFICIT ON A COMMITMENT BASIS (1-2)	**-524.6**	**-6.0**
4. ADJUSTMENT TO CASH BASIS	**0.0**	**0.0**
5. DEFICIT ON A CASH BASIS	**-524.6**	**-6.0**
6. DISCREPANCY: Expenditure (+) / Revenue (-)	**0.0**	**0.0**
7. FINANCING	**524.60**	**6.0**
Domestic (Net)	268.6	3.1
External (Net)	256.0	2.9

Source: The National Treasury

Chapter 8
Public Debt

Overall Public Debt

Kenya's public and publicly guaranteed debt increased by 8.9 per cent during the fourth quarter of the FY 2016/17 mainly driven by an increase in external debt. Consequently, total debt stock at the end of June 2017 was 57.1 per cent, a 460 basis points increase compared with the previous quarter. External and domestic debt ratio to GDP increased by 250 basis points and 220 basis points, respectively during the fourth quarter of the FY 2016/17 (**Table 8.1**).

Domestic Debt

Total domestic debt increased by 8.6 per cent during the fourth quarter of the FY 2016/17, a faster build up as compared to the 0.7 per cent growth observed in the previous quarter. Conversely, the share of domestic debt to total debt decreased from 48.1 per cent at the end of the third quarter to 47.9 per cent by the end of the fourth quarter of the FY 2016/17. The government increased its uptake of the Treasury bills and bonds (Mainly Treasury bills) in the primary market as its execution of budgetary obligations improved. Consequently, the proportion of debt securities to total domestic debt increased by 110 basis points during the quarter under review. The increase in the share of debt securities to total domestic debt was on account of an offsetting effect arising from government's fulfilment of its statutory requirement of full repayment of the overdraft facility at the Central Bank by the close of the financial year.

Table 8.1: Kenya's Public and Publicly Guaranteed Debt (KSh Billion)[1]

	Q4	Q1	Q2	Q3	Apr-17	May-17	Q4	Change Q on Q
EXTERNAL**								
Bilateral	548.4	580.4	577.8	689.1	701.7	723.8	722.6	33.5
Multilateral	798.8	799.7	781.3	806.9	818.8	833.4	844.4	37.5
Commercial Banks	432.4	442.8	458.1	594.1	631.1	632.2	712.1	118.0
Supplier Credits	16.6	15.5	15.3	11.2	15.6	15.8	15.3	4.1
Sub-Total	**1,796.2**	**1,838.4**	**1,832.4**	**2,101.4**	**2,167.3**	**2,205.2**	**2,294.4**	**193.0**
(As a % of GDP)	26.8	25.7	25.6	27.3	28.1	28.6	29.8	
(As a % of total debt)	49.7	49.8	48.7	51.9	52.3	51.9	52.1	
DOMESTIC								
Banks	**1,027.2**	**1,028.7**	**1,032.6**	**1,061.1**	**1,102.9**	**1,159.2**	**1,196.4**	**135.3**
Central Bank	99.9	58.9	85.5	85.3	55.0	55.0	54.5	-30.8
Commercial Banks	927.3	969.8	947.0	975.8	1,047.9	1,104.1	1,141.9	166.1
Non-banks	**774.9**	**813.8**	**884.8**	**862.3**	**855.5**	**864.6**	**893.2**	**30.9**
Pension Funds	468.9	493.8	544.9	549.2	543.5	574.0	593.5	44.3
Insurance Companies	134.4	136.4	143.2	138.9	137.5	140.9	138.9	0.0
Other Non-bank Sources	171.6	183.6	196.7	174.2	174.4	149.7	160.8	-13.4
Non-residents	**13.0**	**12.0**	**13.6**	**21.5**	**18.0**	**18.2**	**22.1**	**0.6**
Sub-Total	**1,815.1**	**1,854.6**	**1,931.0**	**1,945.0**	**1,979.9**	**2,045.5**	**2,111.7**	**166.8**
(As a % of GDP)	27.1	25.9	27.0	25.2	25.7	26.5	27.4	
(As a % of total debt)	50.3	50.2	51.3	48.1	47.7	48.1	47.9	
GRAND TOTAL	**3,611.3**	**3,693.0**	**3,763.4**	**4,046.3**	**4,147.1**	**4,250.7**	**4,406.1**	**359.8**
((As a % of GDP)	53.8	51.6	52.6	52.5	53.8	55.1	57.1	

Sources: The National Treasury and Central Bank ofKenya

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

Table 8.2: Government Gross Domestic Debt (KSh Billion)

	Kshs (Billion)							Change: Q on Q		Proportions						
	Q4	Q1	Q2	Q3	Apr-17	May-17	Q4	Kshs (Bn)	%	Q4	Q1	Q2	Q3	Apr-17	May-17	Q4
Total Stock of Domestic Debt (A+B)	**1,815.1**	**1,854.6**	**1,931.0**	**1,945.0**	**1,979.9**	**2,045.5**	**2,111.7**	**166.8**	**8.6**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
A. Government Securities	**1,740.1**	**1,820.0**	**1,869.5**	**1,883.9**	**1,943.9**	**2,009.4**	**2,076.1**	**192.2**	**10.2**	**95.9**	**98.1**	**96.8**	**96.9**	**98.2**	**98.2**	**98.3**
1. Treasury Bills (excluding Repo Bills)	**588.1**	**618.2**	**620.2**	**615.8**	**626.9**	**684.1**	**744.2**	**128.4**	**20.9**	**32.4**	**33.3**	**32.1**	**31.7**	**31.7**	**33.4**	**35.2**
Banking institutions	361.9	384.2	349.5	328.6	373.0	404.2	436.5	107.9	32.8	19.9	20.7	18.1	16.9	18.8	19.8	20.7
The Central Bank	20.6	20.6	20.6	20.6	20.6	20.6	20.6	0.0	0.0	1.1	1.1	1.1	1.1	1.0	1.0	1.0
Commercial Banks	341.3	363.6	329.0	308.0	352.4	383.6	415.9	107.9	35.0	18.8	19.6	17.0	15.8	17.8	18.8	19.7
Pension Funds	117.9	120.3	147.8	152.6	143.0	164.1	179.5	26.8	17.6	6.5	6.5	7.7	7.8	7.2	8.0	8.5
Insurance Companies	18.4	16.3	14.7	16.0	13.5	13.2	13.7	-2.3	-14.1	1.0	0.9	0.8	0.8	0.7	0.6	0.7
Others	89.9	97.5	108.1	118.5	97.3	102.5	114.4	-4.1	-3.4	5.0	5.3	5.6	6.1	4.9	5.0	5.4
2. Treasury Bonds	**1,152.0**	**1,201.8**	**1,249.3**	**1,268.2**	**1,317.0**	**1,325.3**	**1,332.0**	**63.8**	**5.0**	**63.5**	**64.8**	**64.7**	**65.2**	**66.5**	**64.8**	**63.1**
Banking institutions	569.9	591.6	601.1	650.9	694.2	719.0	724.5	73.6	11.3	31.4	31.9	31.1	33.5	35.1	35.2	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	0.5	0.5	0.5	0.5	0.5	0.4
Commercial Banks	560.5	582.1	591.6	641.5	684.8	709.6	715.1	73.6	11.5	30.9	31.4	30.6	33.0	34.6	34.7	33.9
Insurance Companies	116.0	120.1	128.5	122.9	137.5	140.9	138.9	16.0	13.0	6.4	6.5	6.7	6.3	6.9	6.9	6.6
Pension Funds	351.0	373.5	397.1	396.5	400.5	409.9	414.1	17.5	4.4	19.3	20.1	20.6	20.4	20.2	20.0	19.6
Others	115.1	116.6	122.8	97.8	84.9	55.4	54.5	-43.3	-44.3	6.3	6.3	6.4	5.0	4.3	2.7	2.6
3. Long Term Stocks	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Banking institutions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4. Frozen account	**25.6**	**25.6**	**25.6**	**25.0**	**25.0**	**25.0**	**25.0**	**0.0**	**0.0**	**1.4**	**1.4**	**1.3**	**1.3**	**1.3**	**1.2**	**1.2**
Of which: Repo T/Bills	25.0	25.0	25.0	24.4	24.4	24.4	23.8	-0.6	-2.3	1.4	1.3	1.3	1.3	1.2	1.2	1.1
B. Others:	**49.4**	**9.0**	**35.9**	**36.0**	**10.9**	**11.1**	**10.6**	**-25.4**	**-70.6**	**2.7**	**0.5**	**1.9**	**1.9**	**0.6**	**0.5**	**0.5**
Of which CBK overdraft to Government	44.2	3.3	29.9	26.0	30.3	0.0	0.0	-26.0	-100.0	2.4	0.2	1.6	1.3	1.5	0.0	0.0

Source: Central Bank of Kenya

Treasury Bills

Treasury bill holdings, excluding those held by the CBK for open market operations (Repos) increased by 20.9 per cent during the fourth quarter of the FY 2016/17 due to improved liquidity in the money market and an increased investors' appetite for shorter dated securities due to uncertainties associated with the August 2017 general elections. Similarly, the proportion of Treasury bills to total domestic debt increased by 350 basis points during the period under review. The dominance of Commercial banks in Treasury bills market persisted with their holdings standing at 55.9 per cent of the total amount of outstanding Treasury Bills by the end of the fourth quarter of the FY 2016/17. Other significant holders of Treasury bills included Pension funds (24.1 per cent) and parastatals-included in other holders (12.0 per cent). The persistent dominance of commercial banks in the government securities' market characterizes moderate underdevelopment of other institutional investors' sectors (Pension funds, foreign investors and insurance companies).

Treasury Bonds

Treasury bond holdings increased by 5.0 per cent during the fourth quarter of the FY 2016/17, a faster build up compared to the 1.5 growth observed in the previous quarter. This increase was driven by increased liquidity and government's commitment to mitigating the refinancing risk. The buildup was mainly on account of the proceeds from the reopened 10-year Fixed rate Treasury bond. The dominant holders of Treasury bonds by the end of the period under review were commercial banks, pension funds and Insurance companies. Commercial bank holdings accounted for about half of the total Treasury Bonds outstanding.

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

		Kshs (Billions)							Change Q on Q		Proportions						
		Q4	Q1	Q2	Q3	Apr-17	May-17	Q4	Kshs(Bn)	%	Q4	Q1	Q2	Q3	Apr-17	May-17	Q4
Treasury bills	91-Day	81.8	59.9	51.1	48.7	69.8	83.6	92.2	43.5	89.4	4.5	3.2	2.6	2.5	3.5	4.1	4.4
	182-Day	191.8	185.0	201.1	212.4	174.1	200.2	234.3	21.9	10.3	10.6	10.0	10.4	10.9	8.8	9.8	11.1
	364-Day	314.5	373.4	368.0	354.7	383.0	400.2	417.7	63.0	17.8	17.3	20.1	19.1	18.2	19.3	19.6	19.8
Treasury Bond	1-Year	34.5	10.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.9	0.6	0.0	0.0	0.0	0.0	0.0
	2-Year	122.1	122.1	116.8	100.9	100.9	100.9	82.1	-18.7	-18.6	6.7	6.6	6.1	5.2	5.1	4.9	3.9
	3-Year	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	4-Year	2.3	2.3	2.3	2.3	2.3	2.3	2.3	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
	5-Year	215.9	263.4	263.4	288.3	303.8	272.7	272.7	-15.6	-5.4	11.9	14.2	13.6	14.8	15.3	13.3	12.9
	6-Year	22.7	8.5	8.5	8.5	8.5	8.5	8.5	0.0	0.0	1.2	0.5	0.4	0.4	0.4	0.4	0.4
	7-Year	8.7	8.7	8.7	8.7	8.7	8.7	8.7	0.0	0.0	0.5	0.5	0.5	0.4	0.4	0.4	0.4
	8-Year	38.2	38.2	38.2	33.7	33.7	33.7	33.7	0.0	0.0	2.1	2.1	2.0	1.7	1.7	1.6	1.6
	9-Year	76.5	76.5	76.5	76.5	76.5	76.5	76.5	0.0	0.0	4.2	4.1	4.0	3.9	3.9	3.7	3.6
	10-Year	188.5	206.8	206.8	206.8	240.1	256.9	256.9	50.1	24.2	10.4	11.2	10.7	10.6	12.1	12.6	12.2
	11-Year	4.0	4.0	4.0	4.0	4.0	4.0	4.0	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2
	12-Year	132.1	132.1	132.1	146.4	146.4	146.4	146.4	0.0	0.0	7.3	7.1	6.8	7.5	7.4	7.2	6.9
	15-Year	183.8	183.8	238.8	238.8	238.8	261.3	286.7	48.0	20.1	10.1	9.9	12.4	12.3	12.1	12.8	13.6
	20-Year	74.3	96.8	104.9	104.9	104.9	104.9	104.9	0.0	0.0	4.1	5.2	5.4	5.4	5.3	5.1	5.0
	25-Year	20.2	20.2	20.2	20.2	20.2	20.2	20.2	0.0	0.0	1.1	1.1	1.0	1.0	1.0	1.0	1.0
	30-Year	28.1	28.1	28.1	28.1	28.1	28.1	28.1	0.0	0.0	1.6	1.5	1.5	1.4	1.4	1.4	1.3
	Repo T bills	25.0	25.0	25.0	24.4	24.4	24.4	23.8	-0.6	-2.3	1.4	1.3	1.3	1.3	1.2	1.2	1.1
	Overdraft	44.2	3.3	29.9	30.3	0.0	0.0	0.0	-30.3	-100.0	2.4	0.2	1.6	1.6	0.0	0.0	0.0
	Other Domestic debt	5.8	6.3	6.6	6.4	11.5	11.7	11.7	5.9	93.2	0.3	0.3	0.3	0.3	0.6	0.6	0.6
Total Debt		**1,815.1**	**1,854.6**	**1,931.0**	**1,945.0**	**1,979.9**	**2,045.5**	**2,111.7**	**167.3**	**8.6**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Central Bank of Kenya

Domestic Debt by Tenor and the Maturity Structure

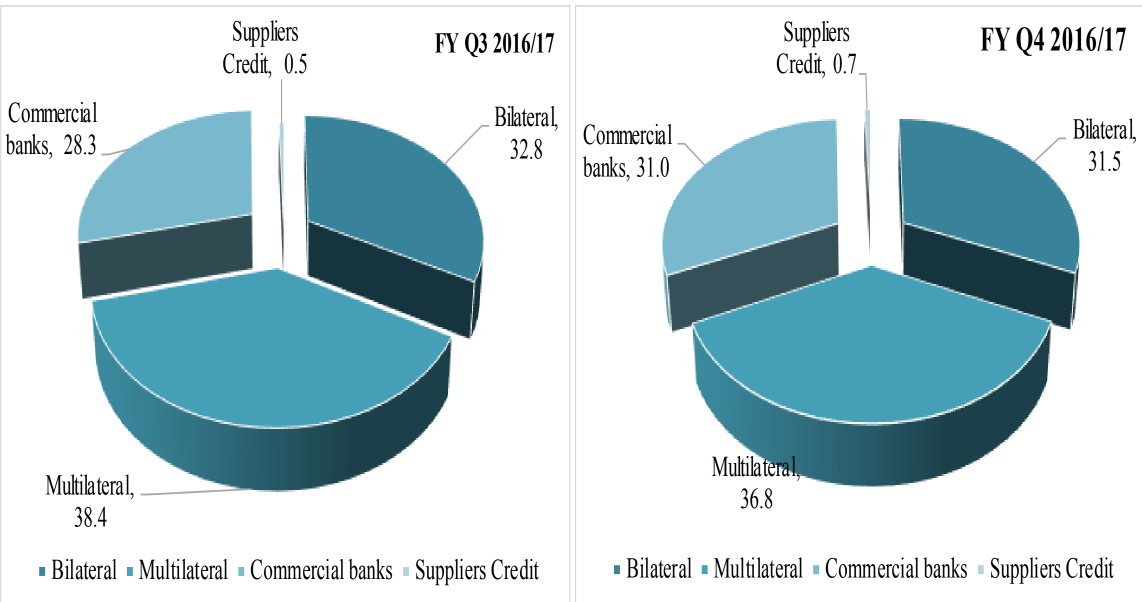
Government issued both short and long dated securities during the period under review. The current debt securities portfolio is dominated by medium and long term debt securities. The benchmark Treasury Bonds; 2-year, 5-year, 10-year, 15-year and 20-year Treasury Bonds accounted for 75.3 per cent of the total of outstanding Treasury Bonds by the end of the fourth quarter of the FY 2016/17. Other domestic debt consists of uncleared effects, advances from commercial banks and Tax Reserve Certificates.

In terms of the maturity structure, the average time to maturity of existing domestic debt decreased to 4 years and 2 months in the fourth quarter of the FY 2016/17 from 4 years and 5 months reported in the third quarter of the FY 2016/17. This decrease was reflective of the significant increase in shorter-dated debt securities in the domestic debt securities portfolio during the review period. Subsequently, the refinancing risk worsened (35.2 per cent from 31.7 per cent in March 2017).

External Debt

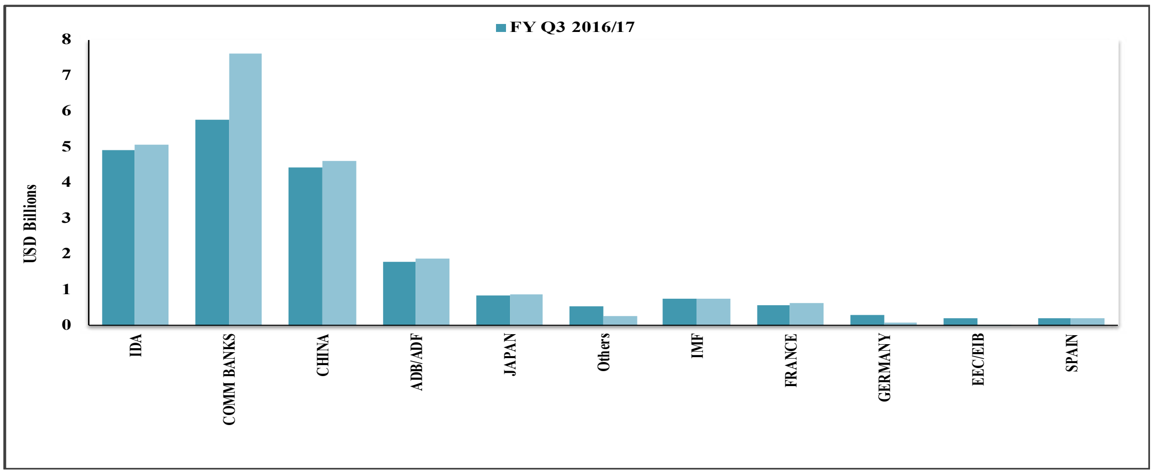
Public and publicly guaranteed external debt registered an increase of 9.2 per cent during the fourth quarter of the FY 2016/17. External debt accumulation during the quarter under review was mainly on account of disbursements of commercial debt from Trade and Development Bank of US dollar 300 million and syndicated loan of US dollar 200 million, semi-concessional and concessional loans from china of US dollar 200 million and International Development association of US dollar 200 million, respectively. Additionally, the government extended an explicit guarantee to Kenya airways on a US dollar 750 million procured from Exim Bank USA. The Chinese loans were used to finance the completion of Phase I and the onset of Phase II of the Standard Gauge Railway while the commercial debt was used for budget support. Furthermore, depreciation of major currencies in Kenya's external debt basket (the US dollar, the Sterling Pound, Japanese Yen, the Euro and the Chinese Yuan) as compared to the previous quarter also led to the buildup in external debt in local currency terms.

Chart 8.1: Composition of External Debt by Lender Classification



Source: The National Treasury

Chart 8.2: External Debt By Creditor



Source: The National Treasury

Composition of External Debt by Creditor

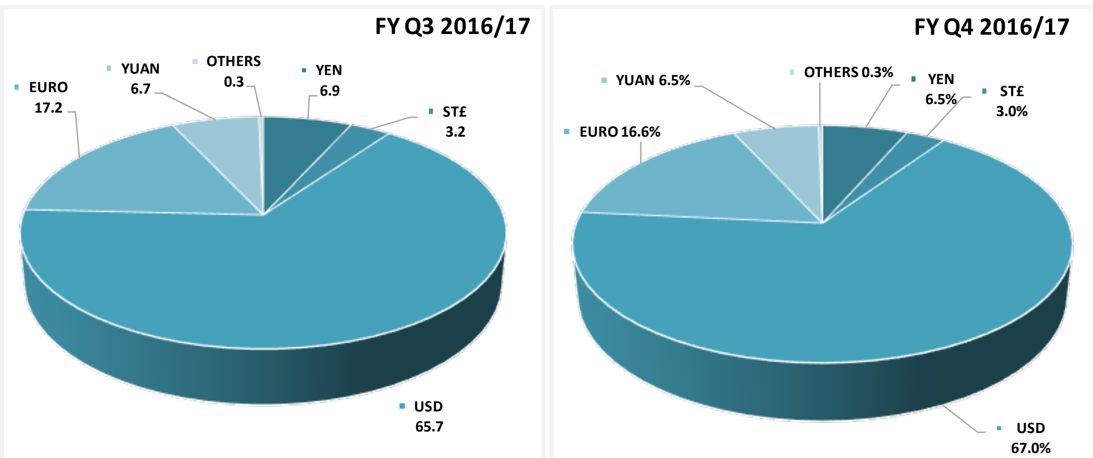
Kenya continues to record lower levels of concessional debt and build-up of commercial and semi-concessional borrowing since her elevation to a lower middle income economy status in September 2014. Reflecting this trend, the share of outstanding debt from official multilateral and bilateral lenders (who provide both concessional and semi-concessional loans) decreased by 290 basis points from the 71.2 per cent in the previous quarter to 68.3 per cent by the end of the fourth quarter of the FY 2016/17 . Consequently, the share of commercial debt increased by 270 basis points during the review period. This shift in the composition of external debt was mainly on account of disbursement of US dollar 1.3 million from the syndicated loan and the Trade and Development Bank and African Export Import Bank and the explicit guarantee to Kenya Airways (**Chart 8.1**).

Debt owed to the International Development Association (IDA), Kenya's largest multilateral lender, amounted to USD 5.1 billion or 22.9 per cent (24 per cent in the previous quarter) of total external debt while that owed to China, Kenya's largest bilateral lender, amounted to USD 4.6 billion, or 20.9 per cent (21.4 per cent in the previous quarter) of the total external debt in the fourth quarter of the FY 2016/17 (**Chart 8.2**). The decline observed in the proportion of external debt held by leading multilateral and bilateral lenders implies decline in the concessionality of Kenya's public and publicly guaranteed external debt.

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 included the US dollar and the Euro which accounted for 83.6 per cent of the total

Chart 8.3: Debt Composition by Currency



Source: The National Treasury

Table 8.4: Liquidity External Debt Sustainability Indicators

	Q3 2015/16	Q4 2015/16	FY 2015/16	Q1 FY 2016/17	Q2 FY 2016/17	Q3 FY 2016/17	Q4 FY 2016/17
Debt services to Revenues (23%)	5.7	6.9	6.2	4.9	7.0	7.3	7.3
Debt services to Exports (21%)	6.5	10.2	7.4	10.8	10.3	8.3	8.3

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

Source: Central Bank of Kenya

currency composition at the end of the fourth quarter of the FY 2016/17. This was partly consistent with the currency composition of the Central Bank's forex reserve holdings. The proportion held in the US dollar increased mainly on account of the Kenya Airways explicit guarantee and US dollar denominated 900 million loan disbursements from Trade and Development Bank Bank., International Development Association and the syndicated loan (**Chart 8.3**).

Public Debt Service

The ratio of domestic interest payments to revenues stood at 15.0 per cent in the fourth quarter of the FY 2016/17 which was lower than the previous quarter (16.0 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 FY 2016/17 amounted to KSh 94.3 billion and was within sustainable levels. Debt service ratios to flow resource bases such as revenues and exports are liquidity indicators of the level of indebtedness. Analysis of the liquidity indicators of external indebtedness show that Kenya faces low exposure to external debt service default as the ratios were way below the CPIA determined liquidity indicators (21 per cent of exports and 23 per cent of revenues) (**Table 8.4**).

Debt Sustainability Analysis

The December 2016 Debt sustainability update showed that Kenya faces a low risk of external debt distress. All the liquidity and solvency debt burden indicators were below the[1] CPIA based thresholds both in the baseline and alternative scenarios. However there is a temporary breach of debt service to exports ratio under standardized stress tests. Public DSA sensitivity analysis show that if primary deficit were to remain at the current levels, public debt would take an upward trajectory and way above the EAC convergence criterion. This is expected to improve in the medium term due to ongoing fiscal consolidation.

Outlook for Fiscal Year 2017/18

Total public and publicly guaranteed external debt is estimated at KSh 2026.6 billion (24.5 per cent of GDP), while gross and net domestic debt are expected to close the financial year 2017/18 at KSh 2,306.8 billion (27.8 per cent of GDP) and KSh 1,898.4 billion (22.9 per cent of GDP), respectively (BPS 2017).

[1]The EAC public debt convergence criterion for PV of Debt/GDP is 50 per cent

CPIA stands for Country Policies and Institutions Assessment. The primary deficit is the non-interest budget balance, an increase in the primary deficit leads into an increase in public debt through the debt and deficit vicious cycle

Chapter 9

The Capital Markets

Equities Market

The equities market recorded strong gains in the second quarter of 2017 across leading market indicators, with exception of the purchases by foreign investors and average foreign investors' participation as a ratio of total equity turnover. This strong rally reflects a recovery from bear run experienced in the prior two quarters. (**Table 9.1 and Chart 9.1**).

Foreign Investors' Participation

The value of shares bought by foreign investors at the NSE declined by 6.79 per cent while total sales rose by 8.23 per cent in the second quarter of 2017, indicating net outflow. As a proportion of total equity turnover, foreign investor purchases averaged at 55.56 per cent while sales averaged averaged 60.31 percent. Overall, net foreign investors participation at the NSE averaged 66.31 per cent in the second quarter of 2017 down from 76.65 per cent and 77.09 per cent in the first quarter of 2017 respoectively. (**Chart 9.2 and Table 9.1**). The decline in avergae foreign investors particitapation to total equity turnover from 76.87 per cent in March 2017 to 57.94 per cent in June 2017 could be explained profit-taking by foreign portfolio investors and increased appetite from local investors.

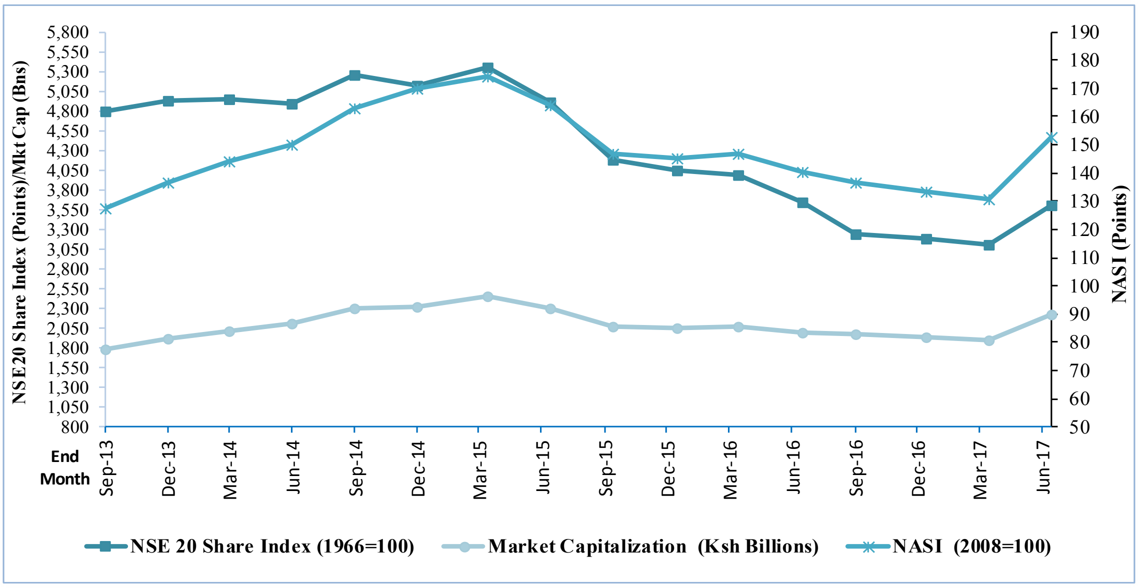
Table 9.1: Selected Stock Market Indicators

INDICATOR	2015	2015			2016				2017		% QUARTERLY CHANGE (2017Q1-2016Q4)
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	
NSE 20 Share Index (1966=100)	4,040	4,906	4,173	4,040	3,982	3,641	3,243	3,186	3,113	3,607	15.89
NASI (2008=100)	145.00	164.00	147.00	145.00	147.00	140.60	136.75	133.30	130.51	152.92	17.17
FTSE NSE Kenya 15 Index	182.55	216.07	195.09	182.55	185.17	175.70	160.96	159.07	161.43	189.83	17.59
FTSE NSE Kenya 25 Index	182.11	215.28	194.81	182.11	185.47	176.47	166.62	164.30	164.02	195.93	19.45
Number of Shares Traded (Millions)	6,812	1,852	1,883	1,456	1,300	1,411	1,999	1,101	1,860	1,892	1.73
Equities Turnover (Ksh Millions)	209,382	60,224	56,722	46,095	36,609	37,034	48,141	25,392	37,095	44,902	21.05
Market Capitalization (Ksh Billions)	2,049	2,302	2,064	2,054	2,078	1,998	1,972	1,931	1,894	2,224	17.40
Foreign Purchase (Ksh Millions)	132,495	38,194	43,856	29,500	20,258	26,322	40,038	17,652	29,421	27,424	-6.79
Foreign Sales (Ksh Millions)	131,579	40,738	37,300	29,439	21,844	19,339	34,018	16,703	27,433	29,692	8.23
Average Foreign Investor Participation to Equity Turnover (%)	63	66	72	64	58	62	77	68	76.68	66.66	*-10.02
Bond Turnover (Ksh Millions)	305,099	59,897	44,511	71,321	113,400	149,809	74,809	94,367	103,997	134,633	29.46
FTSE NSE Kenya Govt. Bond Index	90.04	92.03	90.41	90.04	89.28	87.98	89.11	90.05	89.73	91.54	2.02
I-REIT Turnover in (KSh Million)					19.50	14.55	16.13	9.12	39.40	7.43	-81.14
I-REIT in Units - Total Deals					185.0	151.0	151.0	310.0	281.0	309.0	9.96

* Percentage points

Source: Nairobi Securities Exchange

Chart 9.1: Nse 20 Share Index, Nasi And Market Capitalization

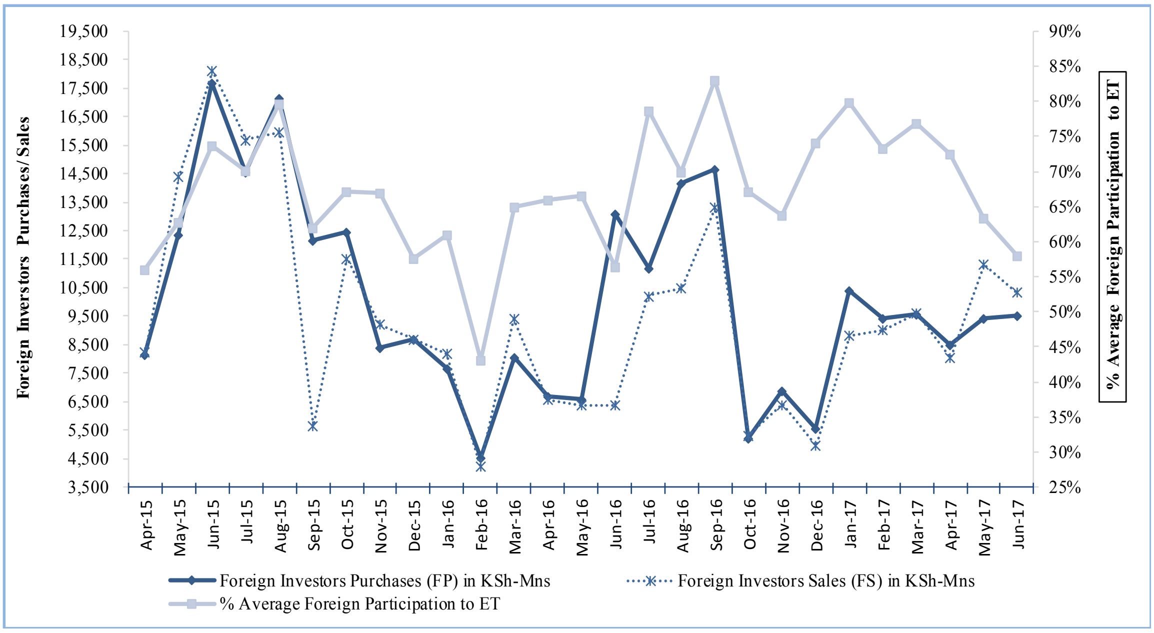


Source: Nairobi Securities Exchange

Domestic Bond and Kenya's Eurobond Markets

The volume bonds traded rose by 29.46 per cent in second quarter of 2017 compared to the first quarter trading. This may signal investors' search for yield on fixed income following a decline in secondary yields as shown by increase in the FTSE NSE Kenyan Government Bond Index. The end quarter trading yields on Kenya's 5-and 10-year Eurobonds declined by 26 basis points and 45 basis points respectively by end June 2017, reflecting high investor appetite and confidence in the securities.

Chart 9.2: Foreign Participation



Source: Nairobi Securities Exchange

Chapter 10

Statement of Financial Position of the Central Bank of Kenya

(Kenya Shillings Million)

1.0	ASSETS	2016 DEC	2017 MAR	JUNE	Q2, 2017 Change	Q1 2017 Change	Q2, 2017 % change	Q1, 2017 % change
1.1	RESERVES AND GOLD HOLDINGS	748,156	835,899	870,325	34,426	87,744	4.1	11.7
1.2	FUNDS HELD WITH IMF	3,747	1,199	1,877	679	(2,548)	56.6	(68.0)
1.21	INVESTMENT IN EQUITY (SWIFT SHARES	9	9	9	1	0	7.0	3.3
1.3	ITEMS IN THE COURSE OF COLLECTION	23	28	43	15	5	52.1	21.8
1.4	ADVANCES TO COMMERCIAL BANKS	55,834	41,870	34,870	(7,000)	(13,964)	(16.7)	(25.0)
1.5	LOANS AND OTHER ADVANCES	2,591	2,531	2,575	44	(61)	1.8	(2.3)
1.6	OTHER ASSETS	3,730	2,480	2,923	443	(1,250)	17.9	(33.5)
1.7	RETIREMENT BENEFIT ASSET	7,776	7,776	8,197	421	-	5.4	-
1.8	PROPERTY AND EQUIPMENT	21,818	22,430	22,703	273	611	1.2	2.8
1.81	INTANGIBLE ASSETS	61	(72)	52	124	(133)	173.3	(217.3)
1.9	DUE FROM GOVERNMENT OF KENYA	55,620	55,395	24,449	(30,946)	(224)	(55.9)	(0.4)
	TOTAL ASSETS	**899,365**	**969,545**	**968,024**	**(1,521)**	**70,180**	**(0.2)**	**7.8**
2.0	**LIABILITIES**							
2.1	CURRENCY IN CIRCULATION	262,734	245,513	253,787	8,274	(17,221)	3.4	(6.6)
					-	-		
2.2	INVESTMENTS BY BANKS - REPOS	-	14,164	-	(14,164)	14,164	(100.0)	-
					-	-		
2.3	DEPOSITS	400,102	465,079	470,109	5,029	64,977	1.1	16.2
					-	-		
2.4	INTERNATIONAL MONETARY FUND	116,119	116,168	115,125	(1,043)	49	(0.9)	0.0
					-	-		
2.5	OTHER LIABILITIES	2,114	3,329	(5,059)	(8,388)	1,214	(252.0)	57.4
					-	-		
	TOTAL LIABILITIES	781,070	844,254	833,962	(10,291)	63,184	(1.2)	8.1
					-	-		
3.0	EQUITY AND RESERVES	118,295	125,292	134,062	8,770	6,997	7.0	5.9
	Share Capital	5,000	5,000	5,000	-	-	-	-
	General reserve fund -Unrealized	57,550	57,550	57,550	-	-	-	-
	-Realized	16,908	16,909	16,909	-	1	-	0.0
	-Capital Projects	15,047	15,047	15,047	-	-	-	-
	Period surplus/(Deficit)	1,223	8,219	16,569	8,349	6,996	101.6	571.9
	Asset Revaluation	14,790	14,790	14,790	-	-	-	-
	Retirment Benefit Asset Reserves	7,776	7,776	8,197	421	-	5.4	-
4.0	**TOTAL LIABILITIES AND EQUITY**	**899,365**	**969,545**	**968,024**	**(1,521)**	**70,181**	**(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), remained virtually the same in the second quarter of 2017, compared to a growth of 7.8 per cent in the previous quarter. There was a marginal decline attributable mainly to a 55.9 per cent decline in debt due from the Government of Kenya, mainly through the overdraft account. This is in line with the legal requirement for the government to clear its overdraft balances before the end of the fiscal year.

Reserves and Gold holdings category grew by 4.1 per cent in the second quarter of 2017 compared to a growth of 11.7 per cent in the first quarter of 2017. These 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.

Items in the course of collection, which represent the value of clearing instruments held by the CBK while awaiting clearing by respective commercial banks, increased by 52.1 percent, representing further improvement compared to the growth of 21.8 per cent in the first quarter of 2017.

Advances to commercial banks, largely for liquidity management, declined by 16.7 per cent in the second quarter of 2017 compared to a decline of 25.0 per cent in the previous quarter. This followed an increase in liquidity absorption through repo securities and Term Auction Deposits.

Loans and other advances include outstanding balances on advances to commercial banks under the Overnight Loan Facility (OLF), and IMF funds on-lent to Government, grew by 1.8 per cent in the second quarter of 2017 compared to a decline of 2.3 per cent in the previous quarter.

Other assets, which largely consist of prepayments and sundry debtors, and deferred currency expense rose by 17.9 per cent compared to a decline of 33.5 per cent in the first quarter of 2017.

Debt due from Government of Kenya, including Government utilization of the overdraft facility at the Central bank and overdrawn accounts which were converted to a long term debt with effect from 1 November 1997 declined in the second quarter. The government outstanding overdraft at CBK declined by 55.9 per cent in the second quarter of 2017, compared to a decline of 0.4 per cent in the previous quarter.

Liabilities

Currency in circulation rose by 3.4 per cent in the second quarter of 2017 compared to a decline of 6.6 per cent in the previous quarter.

Deposits by Government of Kenya, local commercial banks, other public entities and project accounts and local banks' forex settlement accounts grew by 1.1 per cent compared to a growth of 16.2 per cent in the previous quarter.

Equity and reserves increased by 7.0 per cent in the second quarter of 2017 compared to a growth of 5.9 per cent in the previous quarter, reflecting an increase in the period's surplus.

Central Bank of Kenya

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