Kenya Q1'2017 GDP Growth and 2017 Outlook

Kenya's economy expanded by 4.7% in Q1'2017, slower than 5.3% growth recorded in Q1'2016. The table below shows the contributors to the overall GDP growth, of which taxes was the main driver with agriculture and financial services dragging down the growth;

Sector	Contribution Q1'2016	Contribution Q1'2017	Q1'2016 Growth	Q1'2017 Growth	Weighted Growth Rate Q1'2016	Weighted Growth Rate Q1'2017	Variance
Agriculture and Forestry	26.5%	25.0%	4.0%	(1.1%)	1.1%	(0.3%)	(1.3%)
Taxes on Products	10.4%	10.5%	2.5%	6.0%	0.3%	0.6%	0.4%
Manufacturing	10.3%	10.1%	1.7%	2.9%	0.2%	0.3%	0.1%
Real estate	8.0%	8.4%	8.7%	9.6%	0.7%	0.8%	0.1%
Wholesale and retail trade	6.9%	7.0%	3.6%	6.1%	0.3%	0.4%	0.2%
Education	6.8%	6.9%	6.2%	5.9%	0.4%	0.4%	(0.0%)
Transport and Storage	6.0%	6.3%	8.9%	9.9%	0.5%	0.6%	0.1%
Financial & Insurance	6.0%	6.1%	8.2%	5.3%	0.5%	0.3%	(0.2%)
Construction	4.9%	5.0%	10.2%	8.4%	0.5%	0.4%	(0.1%)
Information and Communication	3.7%	3.9%	10.9%	11.4%	0.4%	0.4%	0.0%
Public administration	3.6%	3.6%	5.7%	5.4%	0.2%	0.2%	(0.0%)
Electricity and Water Supply	2.4%	2.4%	8.6%	5.1%	0.2%	0.1%	(0.1%)
Professional admin	2.1%	2.1%	3.3%	4.9%	0.1%	0.1%	0.0%
Health	1.6%	1.6%	5.1%	4.5%	0.1%	0.1%	(0.0%)
Accommodation & Food Services	1.2%	1.3%	10.4%	15.8%	0.1%	0.2%	0.1%
Other services	1.2%	1.2%	5.0%	3.5%	0.1%	0.0%	(0.0%)
Mining and quarrying	1.1%	1.1%	6.7%	9.7%	0.1%	0.1%	0.0%
Financial Services Indirectly Measured	(2.6%)	(2.5%)	8.4%	3.3%	(0.2%)	(0.1%)	0.1%
GDP at Market Prices	**100.0%**	**100.0%**	**5.3%**	**4.7%**	**5.4%**	**4.9%**	**(0.5%)**

The following are the key take-outs from the results;

- **Sectoral Contribution** – Agriculture is the biggest loser of its share of contribution to GDP, shedding 1.5%, to 25.0% from 26.5%, followed by manufacturing which has lost 0.2% to 10.1% from 10.3%. Real estate was the most improved sector, increasing its share by 0.4% y/y to 8.4%. This is an indication that Kenya's is becoming a more diversified economy, reducing its over-reliance on the largest sectors;
- **Declined growth in Agriculture** – Coupled with overall contribution to GDP having declined by 1.5%, growth in the agriculture sector declined by 1.1%, contributing (0.3%) to GDP growth in Q1'2017, down from a contribution of 1.1% in Q1'2016. This was as a result of the drought experienced from the 2nd half of 2016 which led to subdued agricultural production hence reduced value of agricultural activities. Cash crop production was also affected, with tea and horticultural product production declining by 35.5% and 2.6%, respectively, and sugarcane deliveries declining by 29.8%. Horticultural production declined marginally as compared to tea as they are grown in greenhouses which enable farmers to control conditions. Coffee is the only cash crop that registered increased production of 26.6%;
- **Recovery of the tourism sector**– The tourism sector continued on its path towards recovery, with accommodation & food services growing by 15.8% in Q1'2017 up from the 10.4% growth recorded in Q1'2016. The sector contributed 0.1% to GDP growth during the quarter and gained 0.1% in its contribution to GDP. This robust growth was underpinned by a 3.1% growth in tourist arrivals and a 9.2% increase in bed occupancy, mainly driven by MICE tourism which really picked up from 2016 as the number of international conferences increased driven by Nairobi's regional hub status;
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- **Growth in Real Estate -** Real Estate performance improved during the quarter, having grown by 9.6% compared to 8.7% in Q1'2016. Key to note is that the sector recorded the biggest increase in contribution to GDP, gaining 0.4% of the share. The growth in the real estate sector is underpinned by strong fundamentals such as (i) the large housing deficit of over 200,000 units, (ii) continued improvement in infrastructure, and (iii) demographic trends such as the growing middle class, rapid urbanization, rapid population growth and the youth bulge (21 to 35 years); and
- **Continued slow-down in the financial & insurance sector -** Financial & insurance sector slowed down to a growth of 5.3% in Q1'2017 from 8.2% in Q1'2016 despite money supply increasing by 6.4% and domestic credit increasing by 5.5% during the quarter. We believe that the slow-down in the sector's growth was driven by (i) a slow-down in y/y private sector credit growth to 3.0% as at March 2017 following the enactment of the Banking (Amendment) Act, 2015, and (ii) a decline in the earnings per share (EPS) growth of the Kenya listed banks by 8.6% down from the 13.6% growth recorded in Q1'2016, with listed bank loan growth for the quarter declining to 7.1% from 15.7% recorded in Q1'2016.

The first quarter of 2017 was characterized by soaring inflation hitting 10.3% in March and increasing further in the following quarter, despite a stable currency, which depreciated by just 0.8% against the dollar and declining interest rates following the interest rate cap and the government rejecting expensive bids in the auction market given they were under no pressure to borrow. Various local international entities have also revised their Kenya GDP growth projections for 2017 downwards as shown in the table below, all citing similar reasons:

Kenya GDP Growth Projections for 2017			
Report	**Previous GDP Growth Projection**	**Current GDP Growth Projection**	**Reasons**
World Bank	6.0%	5.5%	• Ongoing drought which has led to crop failure, dying livestock. increased food insecurity and rising inflation • Slowdown in credit growth to the private sector, below the 10-year average of 19.0% • As a net oil importer, the rise in global oil prices compared to the lows of 2016 has a dampening effect on economic activity
IMF	5.7%	5.3%	• Fears of a persistent drought • Up-coming elections could make it difficult to address weakness in underlying fundamentals • Growth through high levels of product diversification • Sluggish private sector credit growth • Rising prices of oil
Kenya National Treasury	5.9%	5.7%	• The impact of the drought has negatively affected agricultural output

In our view, 2017 GDP growth is expected to slow down and come in between 4.7% and 5.2% due to a slowdown in agriculture and financial Intermediation owing to (i) the continued drought, which is expected to persist until mid-2017, and (ii) the interest rate caps which will reduce corporate earnings for commercial banks, (iii) increased political uncertainty forcing investors to take a wait and see stance, and (iv) pressure on the shilling given the strengthening of the USD in the global markets.

We expect the 2017 GDP growth to come in between 4.7% and 5.2%, supported by (i) government continued expenditure on infrastructure, (ii) the recovery of the tourism sector, and (iii) the continued growth of the construction sector.