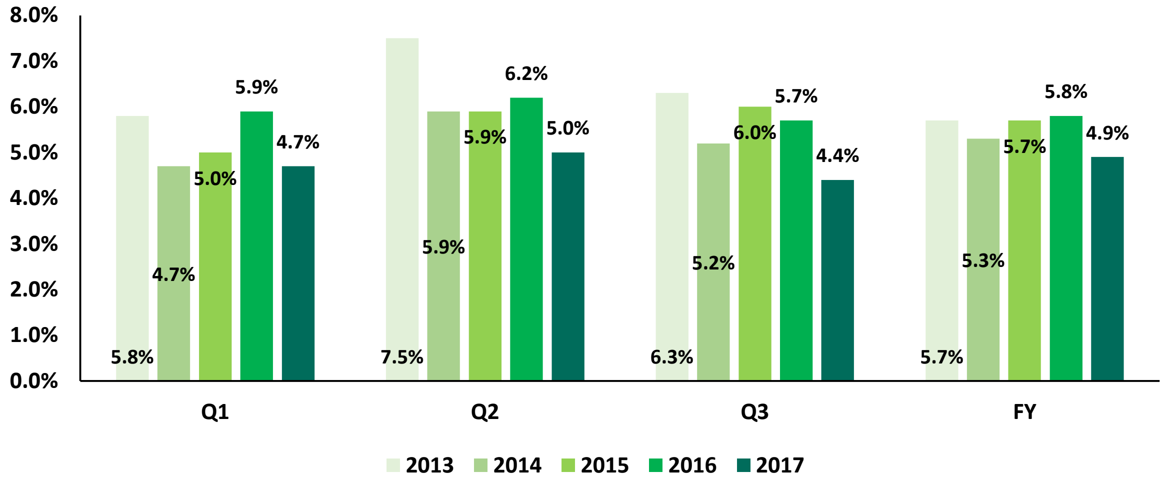
Kenya 2017 GDP Growth and Outlook

At the beginning of 2017, our outlook was that 2017 GDP growth would slow down and come in between 5.4% and 5.7% due to a slowdown in agriculture and financial Intermediation owing to (i) the continued drought, which was expected to persist until mid-2017, and (ii) the interest rate caps which will reduce corporate earnings for commercial banks and also negatively affect private sector credit growth. Increased political uncertainty was also expected to force investors to take a wait and see stance. Despite these challenges, we expected growth to be supported by (i) government continued expenditure on infrastructure, (ii) the recovery of the tourism sector, and (iii) the continued growth of the construction sector. However, as the year progressed, we revised our projection downwards to a range of 4.7% - 5.2% as GDP growth for the first three quarters came in below our expectations, averaging 4.7%.

During the week, the Kenya National Bureau of Statistics (KNBS) released the Economic Survey 2018 indicating that GDP is estimated to have grown by 4.9% in 2017 from 5.9% in 2016; in line with our expectation of between 4.7% - 5.2%. This note aims to summarize the survey, discuss the performance of major sectors and finally give our analysis, view and outlook of projected economic growth in 2018.

The table below shows the GDP growth progression over the last 5 years:

Kenya's Quarterly GDP Growth from 2013 - 2017



The Kenyan economy recorded slower GDP growth in 2017 than in 2016, with growth in Q1, Q2 and Q3 coming in at 4.7%, 5.0% and 4.4% from 5.9%, 6.2% and 5.7% in 2016, respectively. The first quarter of 2017, suffered from subdued growth in agriculture due to the effects of the 2016/17 drought, while the third quarter's growth suffered the negative effects of uncertainty in the political environment brought about by the prolonged election period. The table below shows differences in y/y growth of major sectors of the economy, as we seek to look at sectoral performance in 2017:

Sector	Contribution 2016	Contribution 2017	2016 Growth	2017 Growth	Weighted Growth Rate 2016	Weighted Growth Rate 2017	Variance
Agriculture and Forestry	21.9%	21.2%	4.7%	1.6%	1.0%	0.3%	(0.7%)
Taxes on Products	11.4%	11.5%	4.8%	5.1%	0.6%	0.6%	0.0%
Manufacturing	10.2%	9.8%	2.7%	0.2%	0.3%	0.0%	(0.3%)
Real estate	8.4%	8.5%	8.8%	6.1%	0.7%	0.5%	(0.2%)
Wholesale and retail trade	7.5%	7.6%	3.4%	5.7%	0.3%	0.4%	0.2%
Transport and Storage	6.9%	7.0%	7.8%	7.3%	0.5%	0.5%	(0.0%)
Education	6.9%	7.0%	5.4%	6.1%	0.4%	0.4%	0.1%
Financial & Insurance	6.2%	6.1%	6.7%	3.1%	0.4%	0.2%	(0.2%)
Construction	5.4%	5.6%	9.8%	8.6%	0.5%	0.5%	(0.1%)
Information and Communication	3.8%	4.0%	9.7%	11.0%	0.4%	0.4%	0.1%
Public administration	3.8%	3.9%	4.8%	5.3%	0.2%	0.2%	0.0%
Electricity and Water Supply	2.5%	2.5%	8.3%	5.6%	0.2%	0.1%	(0.1%)

Professional admin	2.3%	2.2%	5.0%	4.0%	0.1%	0.1%	(0.0%)
Health	1.8%	1.8%	4.8%	6.0%	0.1%	0.1%	0.0%
Other services	1.3%	1.3%	4.1%	5.0%	0.1%	0.1%	0.0%
Accommodation & Food Services	1.1%	1.2%	13.3%	14.7%	0.2%	0.2%	0.0%
Mining and quarrying	1.1%	1.1%	9.5%	6.1%	0.1%	0.1%	(0.0%)
Financial Services Indirectly Measured	(2.6%)	(2.3%)	2.1%	(5.7%)	(0.1%)	0.1%	0.2%
GDP at Market Prices	**100.0%**	**100.0%**	**5.9%**	**4.9%**	**5.9%**	**4.9%**	**(1.0%)**

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

- **Sectoral Contribution** - There were some significant changes in sectoral contribution to GDP with some of the top 3 contributors, agriculture and manufacturing lost their share by 0.7% and 0.5% to 21.2% and 9.8%, respectively. Construction and information & communication, each increased their shares by 0.2% y/y to 5.6% and 4.0% from 5.4% and 3.8%, respectively. This is an indication that Kenya is becoming a more diversified economy, shedding its over-reliance on specific sectors. The increase in share of the construction sector was mainly due to government infrastructure spending. Manufacturing however lost its share due to the challenging operating environment caused by the prolonged election period. Manufacturing is however expected to pick up in the next 5 years with the government's plan to increase its share of GDP to 15.0%, according to the '***Big Four Agenda***';
- **Declined growth in Agriculture** – Coupled with overall contribution to GDP having declined by 0.7% to 21.1%, the lower growth of 1.6% from 4.7% in 2016 led to agriculture contributing 0.3% to 2017 GDP growth, a 0.7% point decline from its 1.0% contribution in 2016. This was attributed to the effects of the 2016/17 drought, which rendered the weather conditions unfavourable for agricultural activities. This time round, cash crops were not spared, with coffee and tea production declining by 11.5% and 7.5% to 40,800 tonnes and 439,800 tonnes from 45,492 tonnes and 472,785 tonnes in 2016, respectively. Only horticultural produce beat the drought, with volumes produced increasing by 16.4% to 304,100 tonnes from 261,200 tonnes in 2016. Staple food crops like maize also suffered the effects of the drought, with volumes produced declining by 6.3% to 35.4 mn bags from 37.8 mn bags in 2016; which then resulted in a rise in inflation, hitting highs of 11.7% in May 2017;
- **Continued Recovery of the Tourism Sector**– The tourism sector remained resilient despite travel bans by various western countries and the prolonged election period that brought along with it uncertainty in the political environment and security concerns. Accommodation & food services maintained double-digit growth, growing by 14.7%, up from 13.3%, and increasing its share of GDP to 1.2% from 1.1% in 2016. This robust growth was underpinned by a 20.3% growth in tourism earnings, a 8.1% growth in international arrivals and a 11.3% increase in bed occupancy. We expect the sector to exhibit better growth this year, now with direct flights to the USA and travel bans being lifted by various countries;
- **Slower Real Estate Sector Growth –** The real estate sector performance dipped in 2017, having grown by 6.1% compared to 8.8% in 2016. Growth was seen in the 10.2% rise in the estimated value of new private buildings issued with certificate of occupancy in Nairobi to Kshs 85.6 bn from Kshs 77.7 bn in 2016. Real estate is one of the sectors expected to drive growth in 2018 and in the next 5 years with the government's plan to construct 1,000,000 units by 2022, with 80.0% being affordable housing and 20.0% being social developments that fall under the slum upgrade programme; and
- **Slow-down in Growth in the Financial & Insurance Sector –** The financial & insurance sector grew by 3.1% in 2017, a slowdown from 6.7% growth in 2016 and 9.4% in 2015, driven by (i) slow banking sector earnings growth, with listed banks earnings growth coming in at a market cap weighted average of 1.0%, compared to 4.4% in FY'2016, and (ii) a slow-down in private sector credit growth to 2.4% from 4.1% in 2016. Of note is that total domestic credit grew by 7.9% compared to 6.4% in 2016, primarily due to a 12.1% growth in credit to the national government, compared to the decline in private sector credit growth, indicating increased lending to the government. The slower growth in the financial & insurance sector is mainly attributed to effects of the interest rate cap, eroding interest income earned by banks in 2017. There have been calls by the IMF, World Bank,

African Development Bank and other local institutions to repeal the cap, with the National Treasury and the President endorsing this. However, repealing of the cap has since seen opposition from the very legislators who are responsible for passing a bill to revise it, claiming that collusion by commercial banks and the Central Bank has led to the frustration of the Act's intended purpose. We expect the Treasury to table a Bill in Parliament, proposing a revision or total overhaul of the Act. In our view, repealing the Act while putting in place measures to make credit available to the private sector will be key driving growth in 2018.

2018 is a year that so far has been characterized by declining inflation, hitting 4.2% in March, a stable shilling currently having appreciated by 2.8% against the dollar year to date, and a stable interest rate environment with the CBK maintaining yields on treasury instruments stable, and the MPC lowering the CBR to 9.5% from 10.0%. The average projection for GDP growth in 2018 was at 5.4% by 14 Organizations that we track as at Q1'2018, and so far with revisions as at Q2'2018, the average comes to 5.5%. We have since revised our GDP growth projection to a range of 5.4% - 5.6%, from 5.3% - 5.5% previously, driven by a recovery in the agriculture and manufacturing sectors, and continued growth in tourism, real estate and construction sectors.

We expect the 2018 GDP growth to come in between 5.4% and 5.6%, supported by recovery in the agriculture and manufacturing sectors, and continued growth in tourism, real estate and construction sectors.