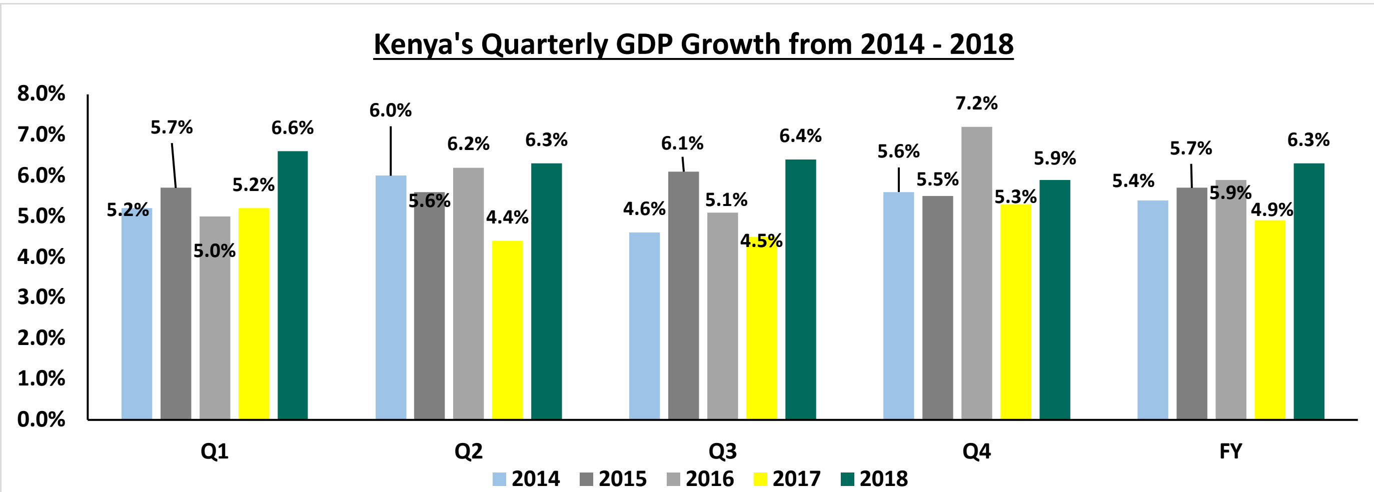
Cytonn INVESTMENTS

Kenya 2018 GDP Growth and Outlook

During the week, the Kenya National Bureau of Statistics (KNBS) released the Economic Survey 2019 indicating that the economy had expanded by 6.3% in 2018 from 4.9% recorded in 2017. This was the fastest economic growth since 8.4% recorded in 2010, and above the 5-year average GDP growth of 5.6%. This note aims to look at the economy's growth drivers, discuss the performance of major sectors and finally give our analysis, view and outlook of Kenya's projected economic growth in 2019.

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



The Kenyan economy recorded faster GDP growth in 2018 than in 2017, with growth in Q1, Q2, Q3 and Q4 coming in at 6.6%, 6.3%, 6.4% and 5.9% from 5.2%, 4.4%, 4.5% and 5.3% in 2017, respectively. Key to note the growth figures for Q1, Q2 and Q3 of 2018 were revised higher from the 5.8%, 6.2% and 6.0%, respectively, as earlier reported. The table below shows differences in y/y growth of major sectors of the economy, as we seek to look at sectoral performance in 2018:

Sector	Contribution 2017	Contribution 2018	2017 Growth	2018 Growth	Weighted Growth Rate 2017	Weighted Growth Rate 2018	Variance (% points)
Agriculture and Forestry	21.3%	21.3%	1.9%	6.4%	0.4%	1.4%	**4.5%**
Taxes on Products	11.4%	11.3%	5.4%	5.2%	0.6%	0.6%	**(0.2%)**
Manufacturing	9.8%	9.6%	0.5%	4.2%	0.0%	0.4%	**3.7%**
Real estate	8.5%	8.4%	6.1%	4.1%	0.5%	0.3%	**(2.0%)**
Wholesale and retail trade	7.6%	7.6%	5.7%	6.3%	0.4%	0.5%	**0.6%**
Transport and Storage	7.0%	7.1%	7.2%	8.8%	0.5%	0.6%	**1.6%**
Education	6.9%	6.9%	5.1%	5.8%	0.3%	0.4%	**0.8%**
Financial & Insurance	6.1%	6.1%	2.8%	5.6%	0.2%	0.3%	**2.7%**
Construction	5.6%	5.6%	8.5%	6.6%	0.5%	0.4%	**(1.9%)**
Information and Communication	4.1%	4.3%	11.0%	11.4%	0.4%	0.5%	**0.4%**
Public administration	3.9%	3.9%	6.5%	6.1%	0.3%	0.2%	**(0.4%)**
Electricity and Water Supply	2.6%	2.6%	7.0%	7.9%	0.2%	0.2%	**0.9%**
Professional admin	2.2%	2.2%	3.7%	5.9%	0.1%	0.1%	**2.2%**
Health	1.8%	1.7%	4.3%	4.5%	0.1%	0.1%	**0.2%**
Other services	1.3%	1.2%	5.1%	4.9%	0.1%	0.1%	**(0.2%)**
Accommodation & Food Services	1.2%	1.4%	14.3%	16.6%	0.2%	0.2%	**2.3%**
Mining and quarrying	1.1%	1.0%	4.5%	2.8%	0.0%	0.0%	**(1.7%)**
Financial Services Indirectly Measured	(2.4%)	(2.2%)	(3.3%)	1.1%	0.1%	0.0%	**4.3%**
GDP at Market Prices	**100.0%**	**100.0%**	**4.9%**	**6.3%**	**4.9%**	**6.3%**	**1.5%**

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

- **Sectoral Contribution** - There were no significant changes in sectoral contribution to GDP with Agriculture, which is the top contributor to GDP remaining unchanged at 21.3% from the previous year. The manufacturing and real estate sectors lost their share by 0.2% points and 0.1% points, to 9.6% and 8.4% from 9.8% and 8.5% in 2017, respectively. Information & communication was the biggest gainer in contribution to GDP by 0.2% points, y/y to 4.3% from 4.1%, mainly driven by growth in the digital economy. Mobile cellular penetration rate per 100 inhabitants for instance improved to 103.5 in 2018 from 91.9 in 2017. Cable TV and Direct to home satellite subscriptions also increased significantly to 169,700, and 1,100,000 in 2018, respectively. This is an indication that Kenya is becoming a more diversified economy, shedding its over-reliance on specific sectors. A key concern was however on the decline in the manufacturing sector despite the government's plan to increase its share of GDP to 15.0%, according to the '***Big Four Agenda***';
- **Rebound in the Agriculture sector** – There was a rebound recorded in the Agriculture sector, which recorded a growth of 6.4% in 2018 from a growth of 1.9% in 2017, which was revised higher from the initial reported growth of 1.6%. Despite the rebound in growth, the sectors' contribution remained unchanged at 21.3%. Growth was mainly driven by marked improvement in crops and animal production anchored by favourable weather conditions that characterized the year under review. Increased supply of food crops led to a significant drop in prices of key food crops during the review period. Cash crops also witnessed increased supply, with coffee and tea production rising by 7.3% and 12.1% to 41,400 tonnes and 493,000 tonnes from 38,600 tonnes and 439,785.9 tonnes in 2017, respectively. As a consequence of improved agricultural production, inflation remained low at 4.7% in the year of review compared to 8.0% in 2017, majorly due to considerable declines in prices of food after the shortage experienced in 2017;
- **Accelerated growth in the Manufacturing sector, despite a marginal decline in sectoral contribution to GDP** – Growth in the manufacturing sector was robust in 2018 recording a 4.2% growth, up from the 0.5% growth recorded in 2017. Contribution of the sector to total GDP however declined slightly to 9.6% from 9.8% in 2017. Improved growth in the sector was driven by agro-processing activities that improved due to the increased agricultural production during the year. Under manufacturing of food and beverages, the highest growth was recorded in the manufacture of sugar at 30.3% and liquid milk at 18.5%. Growth in the sector was however hindered by a 2.6% and 2.5% decline in the manufacture of cement and clinker, respectively, which was as a result of a declined growth in the construction sector. The manufacturing sector was further supported by the improved access to credit which rose by 6.5% to Kshs 336.0 bn from Kshs 315.5 bn in 2017. We expect growth in this sector to improve driven by ongoing government infrastructural projects such as phase two of the Standard Gauge Railway and roads as well as the development in real estate with the expected implementation of the ***"Big 4 Agenda"*** of which housing is one of the key agendas, which will enhance the manufacturing of cement and clinker. Furthermore, with government initiatives like reducing the cost of energy, that are aimed towards supporting various industries, such as textile, leather and agro-business, we expect growth to pick up in the sector;
- **Continued Recovery of the Tourism Sector**– During the year, growth in accommodation and food service activities improved to 16.6% from 14.3% recorded in 2017, which can be attributed to

enhanced security in the country, and a pick up in the MICE tourism sector, with Kenya being one of the top Meetings, Incentive Group Travel, Conferences and Exhibitions destination in Africa. Growth was further boosted with the visits by heads of states and dignitaries, as well as various international conferences held during the year. These coupled with the withdrawal and relaxation of travel advisories, introduction of charter flights from key cities in Europe, increased flight frequency and routes, and the inauguration of the Nairobi-New York route in October 2018 saw international visitor arrivals rising by 14.0% to 2,027,700 from 1,778,400 in 2017. Growth in the sector is now stabilizing with its contribution to GDP increasing to 1.4% from 1.2% in 2017, and we expect the trend to be sustained going forward, should better security and ongoing reforms continue to prevail and bear fruit;

- **Slower Real Estate Sector Growth –** The real estate sector performance slowed down in 2018, having grown by 4.1% compared to 6.1% in 2017. This was due to a decline in demand for property despite the growing supply, evidenced by the 3.0% decline in the residential sector occupancy rates, and the 4.8% increase in supply of mall space in the retail sector to 6.5 mn SQFT in 2018 from 6.2 mn SQFT in 2017, as per Cytonn's research. The sector's contribution to GDP also declined marginally to 8.4% from 8.5% in 2017. Credit advanced to the sector also recorded a marginal decline of 0.5% to Kshs 368.7 bn as at end of 2018 from Kshs 370.7 bn as at end of 2017. Despite this, real estate is still one of the sectors expected to drive growth in 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. The implementation of the affordable housing initiative however is still in contention, after the Labour court issued orders temporarily stopping the government from implementing the 1.5% levy for the housing fund that was to take effect from the end of March 2019; and

- **Recovery in the Financial & Insurance Sector –** The financial & insurance sector grew by 5.6% in 2018, up from the slow 2.8% growth recorded in 2017, which had been as a result of banks feeling the impact of the introduction of the capping of interest rates. 2018's improved performance was driven by improved banking sector earnings growth, with interest income earned by commercial banks rising by 30.7% to Kshs 379.6 bn from Kshs 368.2 bn in 2017. Of note is that total domestic credit grew by 4.6% in 2018 compared to 8.7% in 2017, with a decline being recorded in credit growth to the National Government which came in at 13.6% in 2018 compared to 27.5% in 2017 as well as credit to the private sector which came in at 1.9% compared to 4.1% in 2017. The continued decline in credit growth is mainly attributable to effects of the interest rate cap. 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 legislators, claiming that collusion by commercial banks and the Central Bank has led to the frustration of the Act's intended purpose. In Q1'2019, a ruling by a three-Judge High Court Bench in Nairobi declared the Banking (Amendment) Act 2016 to be unconstitutional. Noting that the implementation of this rule would come with a lot of disruption to the Financial Services sector, the High Court suspended the effect of the declaration for 12-months, thus allowing Parliament time to reconsider sections that were declared unconstitutional by the High Court. In our view, repealing the Act while putting in place measures to make credit available to the private sector will be key in driving credit growth;

2019 is a year that so far has been characterized by:

i. Growth prospects uncertainty with the World Bank's and International Monetary Fund (IMF) revising their GDP growth projections downwards to 5.7% and 5.8% from 5.8% and 6.1%, previously, due to risks emanating from the delayed start to the March-May 2019 long rains,
ii. As a consequence of the delayed long rains and the continued rise in global oil prices, there are expectations of moderate inflationary pressure, but the inflation rate is still expected to remain within the government set target of 2.5%-7.5%,
iii. A stable shilling currently having appreciated by 0.3% against the dollar year to date, and a stable interest rate environment with the CBK maintaining yields on treasury instruments stable, and the MPC maintaining the CBR at 9.0% in the 2 meetings held in 2019.

We expect the 2019 GDP growth to slow down to a range of 5.7%-5.9%, due to the delayed long rains with most parts of the country expected to experience depressed rainfall that is set to lead to a decline in agricultural production. Consequently, this will have an adverse effect on the manufacturing sector, as the major growth driver in the sector is Agro-processing. In addition, ongoing emergency intervention to address food shortages in several counties could impose fiscal pressure constraining capital spending, which has also been a major driver of economic growth especially in the construction sector.

Below is a table showing average projected GDP growth for Kenya in 2019, updated with the World Bank's and International Monetary Fund (IMF) downward revision to 5.7% and 5.8% from 5.8% and 6.1%, respectively; noteworthy being that the highest projection is by the Central Bank of Kenya at 6.3%, but recently the Central Bank of Kenya (CBK) Governor hinted on a possible downward revision by 1.0% points in the event that the country experiences a severe drought due to the delayed long rains.

	Kenya 2019 Annual GDP Growth Outlook	**Q1'2019**	**Q2'2019**
1	Central Bank of Kenya	6.3%	6.3%
2	International Monetary Fund (IMF)	6.1%	5.8%
3	Citigroup Global Markets	6.1%	6.1%
4	African Development Bank (AfDB)	6.0%	6.0%
5	PNB Paribas	6.0%	6.0%
6	UK HSBC	6.0%	6.0%
7	Euromonitor International	5.9%	5.9%
8	World Bank	5.8%	5.7%
9	**Cytonn Investments Management Plc**	5.8%	5.8%
10	Focus Economics	5.8%	5.8%
11	JPMorgan	5.7%	5.7%
12	Euler Hermes	5.7%	5.7%
13	Oxford Economics	5.6%	5.6%
14	Standard Chartered	5.6%	5.6%
15	Capital Economics	5.5%	5.5%
16	Fitch Solutions	5.2%	5.2%
	Average	**5.8%**	**5.8%**