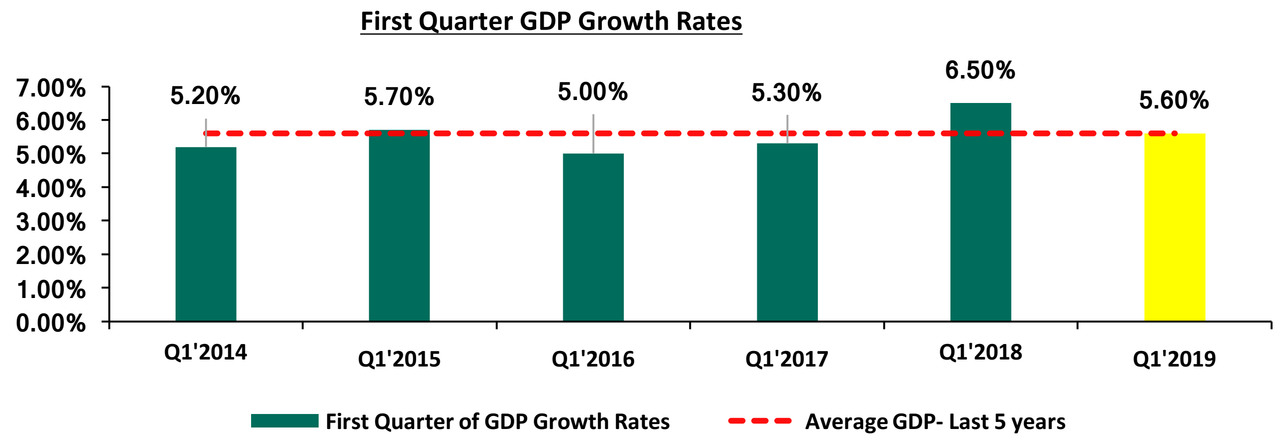
Kenya Q1'2019 GDP Growth and 2019 Outlook

During the week, the Kenya National Bureau of Statistics (KNBS) released the Q1'2019's Gross Domestic Product (GDP) report. According to the report, economic activity experienced relatively slower growth, expanding by 5.6%, in line with the 5-year average growth rate of 5.6%, but slower compared to the 6.5% growth recorded in Q1'2018.

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



The table below shows differences in y/y growth of major sectors of the economy, as we seek to look at sectoral performance in Q1'2019:

Sector	Contribution Q1'2018	Contribution Q1'2019	Q1'2018 Growth	Q1'2019 Growth	Weighted Growth Rate Q1' 2018	Weighted Growth Rate Q1'2019	Variance (% Points)
Agriculture and Forestry	26.1%	26.3%	7.5%	5.3%	2.0%	1.4%	(2.2%)
Taxes on Products	10.3%	10.2%	5.7%	5.3%	0.6%	0.5%	(0.4%)
Manufacturing	9.9%	9.7%	3.8%	3.2%	0.4%	0.3%	(0.6%)
Real estate	8.2%	8.1%	5.3%	4.2%	0.4%	0.3%	(1.1%)
Wholesale and retail trade	6.8%	6.7%	5.9%	5.3%	0.4%	0.4%	(0.6%)
Education	6.8%	6.7%	4.9%	5.4%	0.3%	0.4%	0.4%
Transport and Storage	6.1%	6.2%	8.5%	6.7%	0.5%	0.4%	(1.8%)
Financial & Insurance	5.9%	5.9%	5.2%	5.0%	0.3%	0.3%	(0.2%)
Construction	5.0%	5.0%	6.6%	5.6%	0.3%	0.3%	(1.0%)
Information and Communication	4.0%	4.2%	12.5%	10.5%	0.5%	0.4%	(2.1%)
Public administration	3.6%	3.6%	6.2%	6.5%	0.2%	0.2%	0.3%
Electricity and Water Supply	2.5%	2.5%	6.5%	6.1%	0.2%	0.2%	(0.5%)
Professional admin	2.1%	2.0%	4.0%	4.8%	0.1%	0.1%	0.8%
Health	1.5%	1.5%	4.6%	4.0%	0.1%	0.1%	(0.6%)
Accommodation & Food Services	1.4%	1.5%	13.1%	10.1%	0.2%	0.1%	(3.0%)
Other services	1.2%	1.2%	4.2%	3.2%	0.1%	0.0%	(1.1%)
Mining and quarrying	1.1%	1.1%	2.4%	2.2%	0.0%	0.0%	(0.2%)
Financial Services Indirectly Measured	(2.4%)	(2.3%)	0.2%	(3.5%)	(0.0%)	0.1%	(3.7%)
GDP at Market Prices	**100.0%**	**100.0%**	**6.5%**	**5.6%**	**6.5%**	**5.6%**	**(1.0%)**

The key take-outs from the report are:

a. **Sectoral Contribution to Growth -** The sectoral contribution to GDP of accommodation and food services, agriculture, and transport & storage sectors increased by 0.1% points, 0.2%, and 0.1% points, respectively. Sectors whose contribution to GDP recorded declines in Q1'2019 relative to Q1'2018 include the manufacturing sector which decreased by 0.2% points, followed by information and communication, professional services, education, wholesale & retail trade, taxes on products which all decreased by 0.1%

points. The improvement in the sectoral contribution of transport and storage to GDP was supported by the increased volume of port and improved transport efficiency boosted by the Standard Gauge Railway (SGR). We note the decline in the manufacturing sector's contribution to GDP, from 9.9% in Q1'2018 to 9.7% in Q1'2019, despite the government's "Big Four" Agenda which outlines a plan to increase its contribution to 15.0% of GDP by 2022;

b. **Slowdown in agricultural activities** - Growth in the agricultural sector declined to 5.3% in Q1'2019 from 7.5% in Q1'2018. The slower growth in agriculture was attributed to a delay in the long rains in most parts of the country which led to reduced agricultural production in the country. The sector was further affected by contractions in production of coffee where the volume of coffee sales declined by 12.0% to 13.9 thousand metric tonnes in Q1'2019 from 15.9 thousand metric tonnes in Q1'2018. However, the sector's performance was supported by an increase in tea and horticulture production. The volume of tea produced recorded a growth of 6.6% from 99.8 thousand metric tonnes in Q1'2018 to 106.3 thousand metric tonnes in Q1'2019. The volume of cut flowers, fruits and vegetables grew by 3.7%, 22.2% and 0.9%, respectively, over the same period;

c. **Decline in the manufacturing sector** - The manufacturing sector recorded declines in both growth and contribution to GDP in Q1'2019. The sector recorded a growth of 3.2% in Q1'2019 compared to a growth of 3.8% in Q1'2018. The slowdown in growth was largely attributed to the decline in agro-processing activities that were subdued as a result of the delay in long rains in most parts of the country, which led to reduced agricultural production in the country. In the manufacture of foods products, growth was restrained by the manufacture of sugar, prepared and preserved fish and processing of coffee which recorded contractions in the period under review. Furthermore, in the manufacture of non-food products, growth was curtailed by the manufacture of cement and manufacture of leather products that recorded declines in the first quarter of 2019;

d. **Slowdown in financial and insurance sector** - The financial and insurance sector recorded a slower growth, which came in at 5.0% in Q1'2019, from 5.2% recorded in Q1'2018, with its contribution to GDP remaining unchanged at 5.9%. The slow-down in the sector was largely due to a slow-down in private sector credit growth as the effects of the enactment of the Banking (Amendment) Act, 2015 continue to be felt, with the private sector credit growth recording an average growth of 3.2% in Q1'2019, compared to 2.0% in Q1'2018, well below the 5-year average of 11.8%. This is despite the total domestic credit rising by 13.8% to Kshs 2,371.7 bn as at March 2019, from Kshs 2,698.5 bn as at March 2018, and broad money supply (M3) expanding by Kshs 379.9 bn from Kshs 3.0 tn as at March 2018 to Kshs 3.4 tn as at March 2019. The National Treasury proposed a repeal of the Banking (Amendment) Act 2015 in the recently read 2019/2020 Budget citing the laws' inability to meet its intended purpose, with the International Monetary Fund (IMF), highlighting in a recently released report that the law has restricted credit expansion largely to the private sector, largely made up of Micro, Small and Medium Enterprises (MSMEs), thereby negatively impacting economic growth. If repealed or reviewed, it would result in increased lending to the private sector as banks will be able to price customers differently based on their risk profiles, which would aid banks in increasing their interest revenue, and consequently improve the sector's performance and contribution to GDP;

e. **Decline in real estate sector** - The real estate sector's performance declined to record a growth of 4.2% in Q1'2019, from a growth of 5.3% in Q1'2018. The decline in performance is a result of constrained access to financing with private sector credit growth rising slightly to 3.4% in February 2019 from 2.0% in February 2018, but still below the 5-year average of 11.8%. Constrained accessibility to loans in the quarter was attributed to the banking sector's increased lending to the government rather than individuals and the private sector, evidenced by faster growth in allocations to government securities by 16.1% as at Q1'2019, relative to the 7.7% growth in loan allocations over the same period. The constrained access to credit by the real estate sector is also attributed to the high Non-Performing Loans (NPLs) the sector is having, which resultantly causes banks to shun the advancement of financing to the sector to avoid the associated costs; and,

f. **Tax** - Taxes on products growth declined by 0.4% points from 5.7% in Q1'2018 to 5.3% in Q1'2019 while its sectoral contribution to GDP declined by 0.1% over the same period. This downturn in performance is attributed to depressed revenue collection whose underperformance is attributed to income tax from corporations which recorded negative growth. However, in the Budget Policy Statement for the fiscal year 2019/20, the government has put in place measures such as strengthening tax administration, widening the tax base and overhaul of the Income Tax Act aimed at boosting revenue collection. The government has also (i) introduced a presumptive tax to target MSMEs, (ii) introduced excise duty on betting activities, and (iii) increased the excise duty rates on cigarettes, wines, and spirits, among others.

The macroeconomic growth recorded a relatively stable performance in Q1'2019 supported by the economic factors highlighted below;

i. Average inflation declined to 4.4% in Q1'2019 from 4.5% recorded in the first quarter of 2018,
ii. The Kenya Shilling strengthened against all its major trading currencies during the quarter under review compared to the same quarter of 2018. The Shilling gained strongly against the South African Rand, Euro, Pound Sterling, Japanese Yen, Ugandan and Tanzanian Shillings and marginally against the US Dollar.
iii. Weighted interest rates, on the other hand, on commercial banks' loans and deposits averaged at 12.5% in Q1 of 2019 compared to 13.6% in Q1 of 2018.

We expect the 2019 GDP growth to slow down to a range of 5.7%-5.9% from 6.3% in 2018, 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.