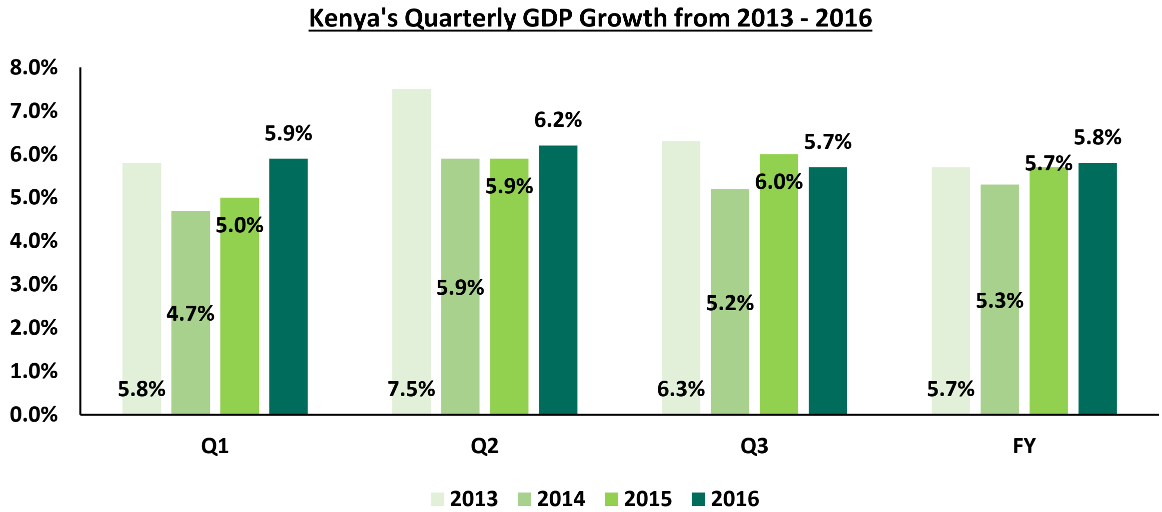
Kenya 2016 GDP Growth and Outlook

At the beginning of 2016, our outlook was that 2016 GDP would grow at between 5.7% - 6.0% underpinned by strong performance in key sectors among them energy, construction, real estate, information and communication and the recovery of the tourism sector. We were however of the view that agriculture and financial intermediation sectors would grow at a slower pace than in 2015. We saw the expected drought, which usually follows El-Nino, as the main hindrance to growth in the agricultural sector while financial intermediation sector was expected to be affected by anticipated interest rate volatility and later the interest rate capping in the fourth quarter. During the week, the Kenya National Bureau of Statistics (KNBS) released the Economic Survey 2017 indicating that GDP is estimated to have grown by 5.8% in 2016 from 5.7% in 2015; in line with our expectation. This note aims to summarize the survey, discuss the performance of major sectors and finally give our analysis, view and outlook of economic growth in 2017.

The graph below shows the GDP growth progression over the last 4 years:



The Kenyan economy recorded stronger GDP growth in 2016 than in 2015, with growth in Q1, Q2 and Q3 coming in at 5.9%, 6.2% and 5.7% from 5.0%, 5.9% and 5.7% in 2015, respectively. The last quarter of 2016, however, suffered from subdued growth in agriculture and financial intermediation sectors hence rendering the overall 2016 GDP growth lower than had been anticipated by the National Treasury at 5.9%. The table below shows differences in y/y growth of major sectors of the economy as we seek to look at sectoral performance in 2016:

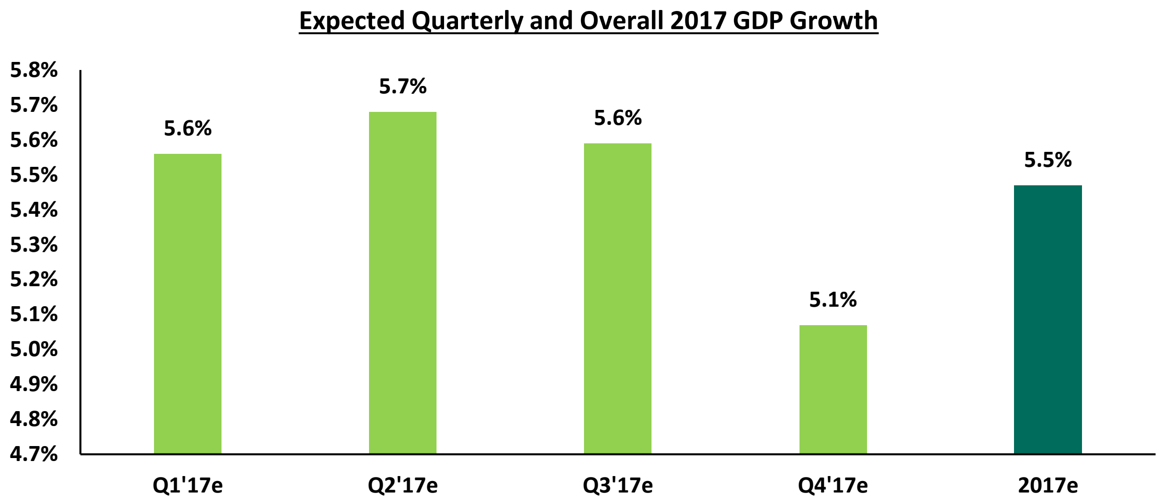
Sector	Contribution FY'2015	Contribution FY'2016	FY'2015 Growth	FY'2016 Growth	Weighted Growth Rate FY'2015	Weighted Growth Rate FY'2016	Variance
Agriculture and Forestry	22.2%	21.8%	5.5%	4.0%	1.2%	0.9%	(0.3%)
Taxes on Products	11.5%	11.4%	2.8%	4.5%	0.3%	0.5%	0.2%
Manufacturing	10.5%	10.3%	3.6%	3.5%	0.4%	0.4%	(0.0%)
Real estate	8.2%	8.4%	7.2%	8.8%	0.6%	0.7%	0.1%
Wholesale and retail trade	7.7%	7.5%	5.9%	3.8%	0.5%	0.3%	(0.2%)
Education	6.9%	6.9%	4.5%	6.3%	0.3%	0.4%	0.1%
Transport and Storage	6.8%	6.9%	8.0%	8.4%	0.5%	0.6%	0.0%
Financial Intermediation	6.2%	6.2%	9.4%	6.9%	0.6%	0.4%	(0.2%)
Construction	5.2%	5.4%	13.9%	9.2%	0.7%	0.5%	(0.2%)
Public administration	3.9%	3.9%	5.5%	5.3%	0.2%	0.2%	(0.0%)
Information and Communication	3.7%	3.8%	7.4%	9.7%	0.3%	0.4%	0.1%
Electricity and Water Supply	2.5%	2.5%	8.5%	7.1%	0.2%	0.2%	(0.0%)
Professional admin	2.3%	2.2%	2.5%	4.3%	0.1%	0.1%	0.0%
Health	1.8%	1.8%	6.1%	5.8%	0.1%	0.1%	(0.0%)
Other services	1.3%	1.3%	3.9%	4.2%	0.0%	0.1%	0.0%
Accommodation & Food Services	1.1%	1.1%	(1.3%)	13.3%	(0.0%)	0.2%	0.2%

Mining and quarrying	1.0%	1.1%	12.4%	9.5%	0.1%	0.1%	(0.0%)
Financial Services Indirectly Measured	(2.7%)	(2.6%)	13.5%	3.0%	(0.4%)	(0.1%)	0.3%
GDP at Market Prices	**100.0%**	**100.0%**	**5.7%**	**5.8%**	**5.8%**	**5.9%**	**0.1%**

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

- **Sectoral Contribution** - There was no significant change in sectoral contribution to GDP but key to note is that the top 3 contributors, agriculture, taxes and manufacturing have all lost their share by 0.4%, 0.1% and 0.2% to 21.8%, 11.4% and 10.3%, respectively since FY'2015. Construction was the most improved, increasing its share by 0.2% y/y to 5.4%. This is an indication that Kenya's is becoming a more diversified economy, shedding its over-reliance on specific sectors;
- **Declined growth in Agriculture** – Coupled with overall contribution to GDP having declined by 0.4% to 21.8%, the growth of 4.0% from 5.5% in FY'2015 led to agriculture contributing (0.3%) to FY'2016 GDP growth. This was attributed to the drought experienced from the 2nd half of the year which rendered the weather conditions unfavourable for agricultural activities. However, cash crops did well with tea and coffee production increasing by 18.5% and 10.8%, respectively; while food crop production declined with maize, beans and sugarcane production declining by 12.7%, 4.7% and 1.3%, respectively, alongside declines in sorghum and millet which are supposed to be drought-resistant. Horticultural crops which are another major export also did well, with fresh horticultural exports growing by 12.3%. This goes to emphasize the concentration of cash crops and negligence of food crops which boosts Kenya's exports but in turn neglects food security and worsens the inflationary situation in the country;
- **Recovery of the tourism sector**– Recovery of tourism sector resulted in a growth of 13.3% in accommodation and food services compared to a contraction of 1.3% recorded in a similar period last year. This robust growth was underpinned by a 36.8% growth in tourism earnings, a 13.5% growth in international arrivals and a 9.7% increase in bed occupancy. MICE tourism really picked up in 2016 as the number of international conferences increased driven by Nairobi's regional hub status;
- **Growth in Real Estate -** Real Estate performance improved this year having grown by 8.8% compared to 7.2% in FY'2015. Growth was seen in (i) the 7.5% rise in the estimated value of completed buildings in Nairobi to Kshs 76.2 bn from Kshs 70.9 bn in 2015, (ii) the 10.5% increase in new private buildings in Nairobi to 10,002 from 9,054 in 2015, and (iii) the 2,260.0% rise in construction of new public residential buildings to 1,062 from 45 in 2015. The growth in the real estate sector explains the increase in cement consumption by 10.4% to 6.3 mn tonnes from 5.7 mn tonnes in 2015; and
- **Slow-down in Financial Intermediation -** Financial Intermediation grew by 6.9% in 2016 from 9.4% in 2015, in line with our expectation of a 6.5% growth, driven by (i) slow banking sector earnings growth of an estimate 6.7% for the whole industry and 4.4% for the listed banks, (ii) slow M3 money supply growth of 3.6% in 2016 from 14.1% in 2015, (iii) a slump in domestic credit growth to 6.4% from 20.8% in 2015, and (iv) a slow-down in public sector credit growth to 9.1% from 24.5% in 2015. While this is disheartening given the progress Kenya has made over the years to grow the financial intermediation sector, having hit highs of 9.4% growth in 2015, the Kenya Bankers Association in conjunction with the Central Bank of Kenya (CBK) are set to carry out an assessment of the impact of the Banking (Amendment) Act, 2015 on the private sector credit growth and economic growth, as per the 2017/18 Budget Policy Statement. We believe that the government has been made aware of the current financial mediation slump in the country and that this is one of the measures being taken to revamp the sector.

2017 is a year that so far has been characterized by soaring inflation hitting 10.3% in March, a stable shilling currently having lost only 0.8% against the dollar year to date and fairly stable interest rates with the CBK maintaining T-bill yields and rejecting higher bids. Last week, the World Bank revised its 2017 GDP projection downwards to 5.5% from 6.0% previously basing this on the slow-down in private sector credit growth and the effects of the prevailing drought on the agricultural sector and on electricity supply. The table below shows our projections for GDP growth in 2017:



The GDP growth is expected to 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 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, (iv) pressure on the shilling given the strengthening of the USD in the global markets, and (v) high oil prices, which will increase the import bill.

We expect the 2017 GDP growth to come in between 5.4% and 5.7%, supported by (i) government continued expenditure on infrastructure, (ii) the recovery of the tourism sector, and (iii) the continued growth of the construction sector.