Kenya Q2'2018 GDP Growth and 2018 Outlook

According to Kenya National Bureau of Statistics (KNBS), Kenya's economy expanded by 6.3% in Q2'2018, higher than 4.7% in Q2'2017. This was due to (i) recovery in agriculture, which recorded a growth of 5.6% due to improved weather conditions, (ii) improved business and consumer confidence, and (iii) increased output in the real estate, manufacturing, and wholesale & retail trade sectors, which grew by 6.6%, 3.1% and 7.7%. The table below shows the weighted sectoral contribution to the overall GDP growth, of which agriculture & forestry was the main driver:

Q2'2018 GDP Growth and Sectoral contribution to overall GDP growth							
Sector	Contribution Q2'2017	Contribution Q2'2018	Q2'2017 Growth	Q2'2018 Growth	Weighted Growth Rate Q2'2017	Weighted Growth Rate Q2'2018	Variance
Agriculture and Forestry	23.4%	23.2%	0.8%	5.6%	0.2%	1.3%	1.1%
Taxes on Products	11.0%	11.1%	6.1%	7.8%	0.7%	0.9%	0.2%
Manufacturing	9.9%	9.6%	(0.2%)	3.1%	0.0%	0.3%	0.3%
Real estate	8.4%	8.4%	6.0%	6.6%	0.5%	0.5%	0.0%
Wholesale and retail trade	7.1%	7.2%	5.6%	7.7%	0.4%	0.6%	0.2%
Education	6.9%	6.9%	6.0%	6.3%	0.4%	0.4%	0.0%
Transport and Storage	6.8%	6.9%	8.0%	7.8%	0.5%	0.5%	(0.0%)
Financial & Insurance	6.0%	5.8%	3.5%	2.3%	0.2%	0.1%	(0.1%)
Construction	5.4%	5.4%	9.5%	6.1%	0.5%	0.3%	(0.2%)
Information and Communication	3.3%	3.5%	10.8%	12.6%	0.4%	0.4%	0.1%
Public administration	4.3%	4.3%	5.3%	5.8%	0.2%	0.2%	0.0%
Electricity and Water Supply	2.7%	2.7%	6.0%	8.6%	0.2%	0.2%	0.1%
Professional admin	2.2%	2.2%	5.6%	5.4%	0.1%	0.1%	(0.0%)
Health	1.8%	1.8%	6.8%	6.1%	0.1%	0.1%	(0.0%)
Accommodation & Food Services	0.9%	1.0%	12.6%	15.7%	0.1%	0.2%	0.0%
Other services	1.2%	1.2%	5.2%	2.5%	0.1%	0.0%	(0.0%)
Mining and quarrying	1.0%	1.0%	6.0%	3.5%	0.1%	0.0%	(0.0%)
Financial Services Indirectly Measured	(2.3%)	(2.2%)	(6.4%)	2.1%	0.1%	(0.0%)	(0.2%)
GDP at Market Prices	**100.0%**	**100.0%**	**4.7%**	**6.3%**	**4.8%**	**6.3%**	**1.5%**

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

- **Sectoral Contribution** – Manufacturing and Finance & Insurance were the biggest losers in terms of sectoral contribution to GDP, losing by 0.3% points to 9.6% in Q2'2018 from 9.9% in Q2'2017 and 0.2% points to 5.8% in Q2'2018 from 6.0% in Q2'2017, respectively. Information & Communication was the most improved sector, increasing its share by 0.2% points to 3.5% in Q2'2018 from 3.3% in Q2'2017. Agriculture continued on a declining trend, marginally losing by 0.1% points on its sectoral contribution to 23.2% from 23.4%, an indication that the economy is becoming more diversified, reducing its over-reliance on agriculture, with other sectors gradually gaining ground. However, the decline in contribution of manufacturing to GDP still remains a concern, given that the government's "***Big Four***" Agenda outlines a plan to increase its contribution to 15.0% of GDP by 2022;
- **Recovery of the Agriculture sector** – Growth in the agriculture sector improved to 5.6%, as compared to 0.8% in Q2'2017, despite its contribution to GDP declining by 0.1% points to 23.2% in Q2'2018, down from 23.4% in Q2'2017. The sector contributed the largest weighted share to GDP growth at 1.3% during the quarter, attributed to the favourable weather conditions that have prevailed since Q4'

2017, and the long rains experienced in early March of 2018. Growth was mainly buoyed by an increase in output on crops and animal production. There was specifically a notable increase in production of:

i) Key crops, specifically tea production that grew by 18.4% to 131,235 tonnes in Q2'2018 from 110,819 tonnes in Q2'2017. Similarly, the volume of coffee produce rose by 44.1%. The volumes of cane also increased by 28.1% to 1.0 mn tonnes from 0.8 mn tonnes in a similar period the previous year. The horticultural sector however had a mixed performance with the value of fruits exports increasing by 30.0%, while that of vegetables and cut-flowers decreased by 17.8% and 14.7%, respectively. The total value of horticultural crop exports however grew by 29.3% to Kshs 37.1 bn from Kshs 28.7 billion in Q2'2018, and
ii) The dairy sub-sector as well remained vibrant after the rebound reported in Q1'2018. Quarter on quarter growth improved to 6.1% from a 15.9% in Q2'2017. The volume of milk delivered to processors increased by 6.1% to 152.0 mn litres in the quarter under review from 143.2 mn litres in Q2'2017;

- **Further decline in the Financial & Insurance sector growth –** The Financial & insurance sector slowed down further, recording a growth of 2.3% in Q2'2018 from 3.5% in Q2'2017. The sector's contribution to GDP declined as well by 0.2% points to 5.8% in Q2'2018 from 6.0% Q2' 2017. The slow-down in the sector can be attributed to the continued low private sector credit growth despite recording an improvement in Q2'2018 to an average of 3.7% compared to 1.9% in Q2'2017, as the effects of the enactment of the Banking (Amendment) Act, 2015 continue to be felt. This is despite the lending rate declining to 13.2% in June from 13.7% in June 2017, and broad money supply (M3) expanding by 10.4% to Kshs 3.2 tn in Q2'2018 from Kshs 2.9 tn in Q2'2017. Following the assent of the Finance Bill 2018, that retained the status quo on lending rates citing that banks had not shown concerted efforts to address the issue of high credit pricing only removing the floor rate on deposits, we expect credit to the private sector to remain low. The increment on excise duty fees charged for money transfer services by banks, agencies and other financial services providers to 20.0% from the earlier 10.0% and excise duty on other fees charged by financial institutions to 20.0% from the earlier 10.0% could also slow down consumption of these services and effectively hurting corporate earnings on the financial sector;
- **Accelerated growth in the Manufacturing sector, despite a decline in sectoral contribution to GDP** – Growth in the manufacturing sector continued to improve recording a 3.1% growth in Q2'2018 from the 0.2% contraction in Q2'2017. Contribution of the sector to total GDP however declined slightly to 9.6% from 9.9% in Q2'2017. Improved growth in the sector was driven by agro-processing activities that improved due to the increased agricultural production during the quarter which saw milk processing as well as butter production increase by 12.2% and 48.4%, respectively. Food manufacturing and processing of beverages also improved, supported by processing of bread, beer and stout, biscuits and sugar. Growth in the sector was however hindered by the decline in assembly of motor vehicles and finished leather. The manufacturing sector was further supported by the improved access to credit which rose by 11.5% in Q2'2018 compared to a 6.8% decline recorded in Q2'2017. 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 of which housing is one of the key agendas which will also enhance the manufacturing of cement;
- **Growth in the Real Estate sector –** The Real Estate sector performance improved during Q2'2018, having grown by 6.6% compared to 6.0% in Q2'2017. The sector's contribution to GDP remained flat at 8.4% in Q2'2018. Real estate is expected to drive growth in 2018 and in the next 5 years, with the government's plan to construct 500,000 new affordable housing units under the big four agenda in the next 5 years through injecting low-cost capital into the housing sector which has seen the amendment to the employment Act that will see employees contribute 1.5% of the monthly basic salary while the employer will match the same amount provided that the sum of the employer and

employee contributions do not exceed Kshs 5000 monthly, payable to the National Housing Development Fund; and

- **Improved growth in the Tourism sector**– During the quarter, growth in accommodation and food service activities improved to 15.7% from 12.6% recorded in Q2'2017, which can be attributed to improved security, stable political environment following the completion of the prolonged electioneering period in 2017 and aggressive marketing strategies undertaken by the government. The sector has continued to stabilize having grown at an average rate of 14.0% with growth in Q2'2018 being evidenced by growth in the number of airport arrivals in Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) by 7.1% to 231,757 in Q2'2018 from 216,480 in Q2'2017. This, in our view, indicates that growth is now stabilizing in the sector, and will continue to grow steadily going forward should better security and ongoing reforms continue to prevail and bear fruit.

The macroeconomic environment in Kenya remained relatively stable in Q2'2018, supported by,

i. A stable interest rate environment with the CBK rejecting higher yields on treasury securities, and the MPC reducing the CBR to 9.0% in July from 9.5% and retaining it at 9.0% in their September meeting,
ii. A relatively stable currency, despite depreciating marginally by 0.2% to Kshs 101.1 from Kshs 100.8 as at the end of Q1'2018,
iii. improved business confidence and strong private consumption as evidenced by an average Stanbic PMI of 55.6 in Q2'2018 up from 49.2 in Q2'2017, and,
iv. declined inflation, with the average inflation rate for Q2'2018 declining to 4.0% from 10.8% in Q2'2017. We expect inflation in H2'2018 to experience upward pressure but at a lower rate following the reduction in the rate of VAT charge to 8.0% from 16.0%, affirming the expectations of inflation for the year averaging within the government's set target of 2.5%-7.5%. Having said this, 2018 is set to be a better year in terms of the macroeconomic environment and economic growth, as we have seen reflected in the second quarter growth, and we expect similar improvements going forward.

Going forward, we are of the view that imposition of some of the tax measures as introduced in the Finance Bill raise a concern in the country's economic growth, especially on corporate earnings this year with the main focus being on the Telecommunication and Financial services industry due to the increased excise tax on both money transfers and internet charges which could slow down consumption of these services. In other sectors, consumers will also be faced with the additional taxes on fuel as well as the housing levy, which we believe will put a strain on overall consumption. This is because consumers will have to rationalize their consumption on goods and services due to the dilution of their purchasing power, which effectively means a reduction in the quantity of goods and services a single unit of currency can buy. This will lead to reduced demand of goods and services across various economic 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 following improved weather conditions set to boost agricultural productivity, water supply and electricity that will in turn favour the manufacturing sector, and continued growth in tourism, real estate and construction sectors.