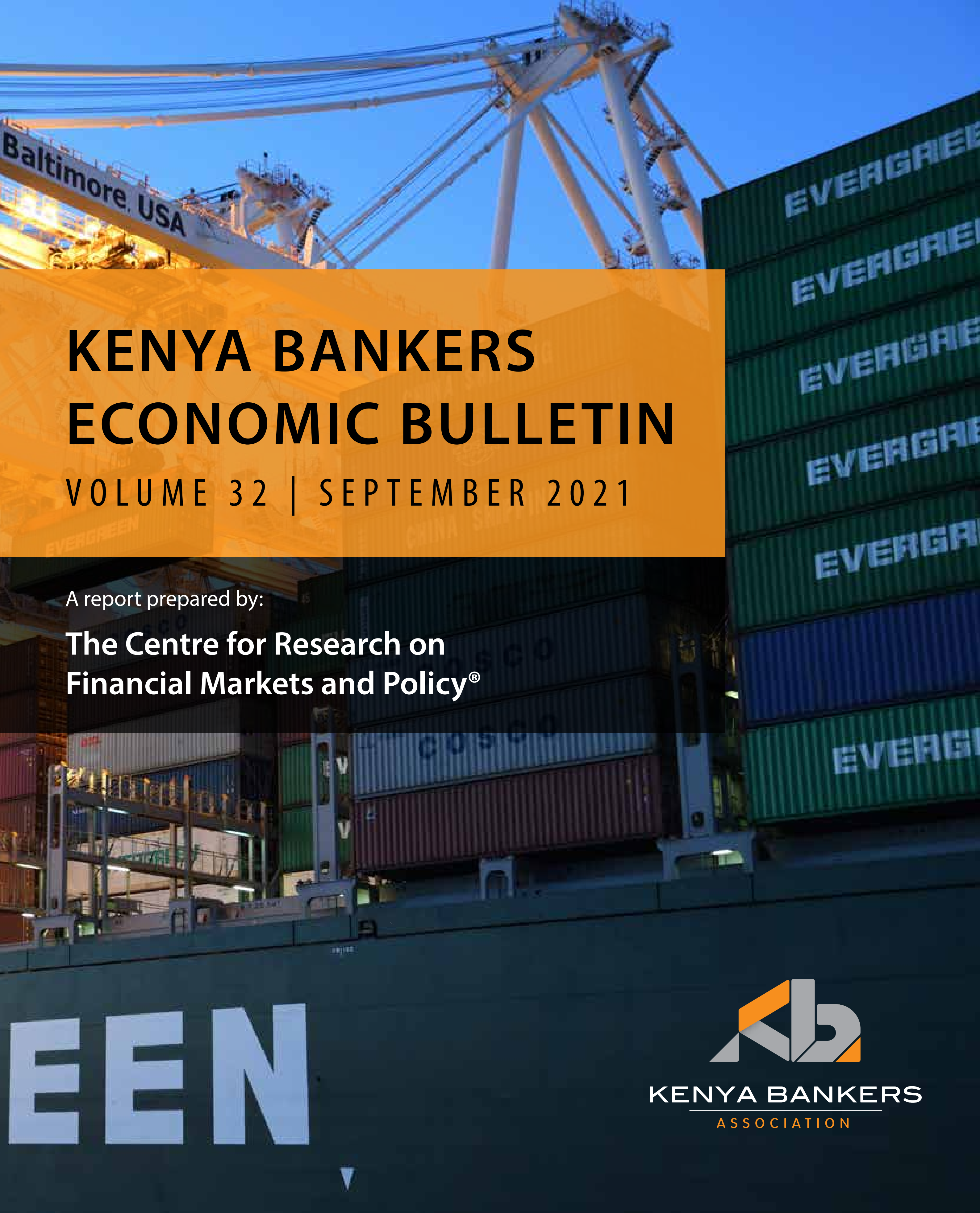

KENYA BANKERS ECONOMIC BULLETIN

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A report prepared by:

The Centre for Research on Financial Markets and Policy®

KENYA BANKERS ASSOCIATION

CENTRE FOR RESEARCH ON
FINANCIAL MARKETS AND POLICY®

About this Report

This *Bulletin* reviews Kenya's economic performance in the Second quarter of 2021, drawing on the recent performance and developments to provide perspectives on the year's outlook. The *Bulletin* covers trends in selected activities in the real economy, government fiscal operations, public debt, inflation and interest rates, the balance of payments and exchange rate, activity at the Nairobi Securities Exchange and banking sector performance..

About the Centre for Research on Financial Markets and Policy®

The Centre for Research on Financial Markets and Policy® was established by the Kenya Bankers Association in 2012 to offer an array of research, commentary, and dialogue regarding critical policy matters that impact on financial markets in Kenya. The Centre sponsors original research, provides thoughtful commentary, and hosts dialogues and conferences involving scholars and practitioners on key financial market issues. Through these activities, the Centre acts as a platform for intellectual engagement and dialogue between financial market experts, the banking sector and the policy makers in Kenya. It therefore contributes to an informed discussion that influences critical financial market debates and policies.

CENTRE FOR RESEARCH ON
FINANCIAL MARKETS AND POLICY®

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FOREWORD

From the CEO's Desk

It is my pleasure to present to you the 32nd issue of the Kenya Bankers Economic *Bulletin*. The *Bulletin* reviews the strides that the economy made in the second quarter of 2021, emphasizing the challenges that the pandemic continued to present to the economy in general and the banking sector in particular.

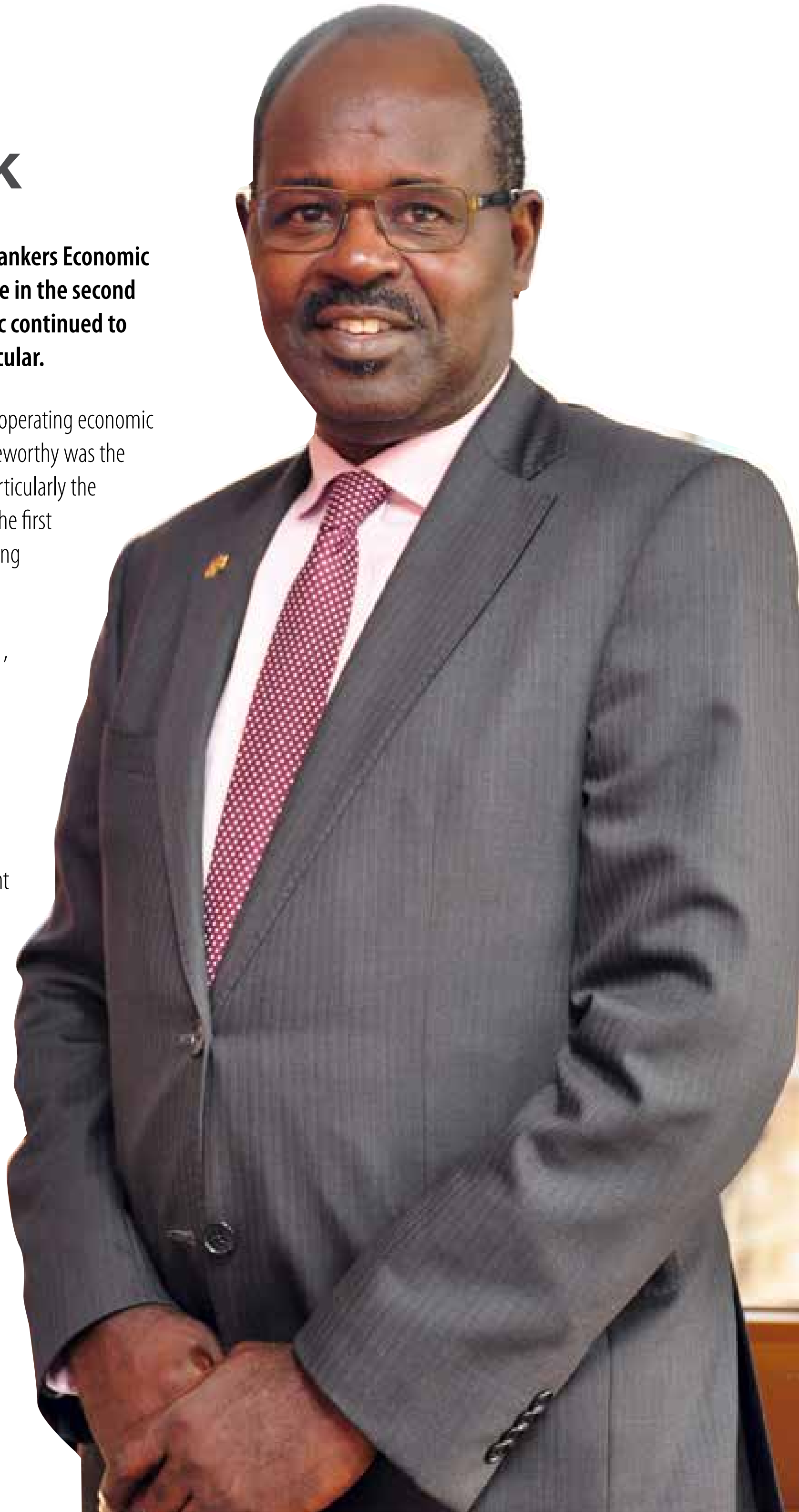
The *Bulletin* provides insights meant to support readers' understanding of the operating economic environment and its outcomes, as well as shape their near-term outlook. Noteworthy was the protracted effects of the pandemic, the developments in the economy and particularly the banking sector following the lapse of the emergency measures at the end of the first quarter that were targeted at supporting household's businesses and cushioning lenders.

While this *Bulletin* focuses on the developments in the second quarter of 2021, any outlook formed based on the data and analyses presented herein should accommodate a high degree of uncertainty underpinned by the continuing effects of the pandemic on the economy, and the proactive policy measures deployed to mitigate the effects.

It is my hope that you will find this issue of the *Kenya Bankers Economic Bulletin* interesting and useful. We welcome feedback on this Bulletin's content as we continually seek to improve its relevance to you.

You can send your feedback to the Bulletin's Editor at *research@kba.co.ke* .

Dr. Habil Olaka
Chief Executive Officer,
Kenya Bankers Association

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COMMENTARY

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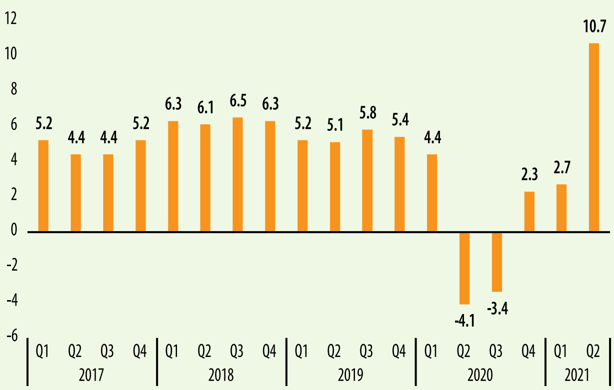
Economy on a Recovery Path:
Concerns of rising inflationary pressure and muted credit growth?

By Dr. Samuel Tiriongo

As the uncertainty created by the pandemic in 2020 and its protracted effects into early 2021 continued to linger, many commentators were looking up to a better economic outturn as economies vaccinated more and aggregate demand built up. Certainly though, policymakers and analysts remained uncertain on the extend of disruptions that the pandemic continued to cause, particularly with the unsynchronized recoveries that was being witnessed.

Nonetheless, the local economy despite recording impressive recovery in the first half of 2021, was fragile, facing material risks from the emerging COVID-19 variants and rising inflationary pressure with resumption of economic activities. At this point, the most critical question was whether it was time the policymakers lifted the supportive policy measures to ensure that the economy did not overheat and anchor a stronger and sustainable recovery. Here, we discuss the economic outcomes of the first half of 2021 and explore the potency of both fiscal and monetary policy measures to support the economy.

Figure 1:
Quarterly Real GDP growth



Source: KNBS

In the first half of 2021, and against a depressed base over a similar period in 2020, the economy grew by 11.0 percent in the second quarter up from a growth of 2.7 percent in the first quarter. The recovery mirrored a resumption of economic activity from the adverse effects of the pandemic, following the easing of COVID-19 restrictions both in the global and domestic economy. The recovery was largely supported by pickup in activity in the service-oriented sectors such as transport and storage, wholesale and retail trade, information and communication and education (**Figure 1**). The contribution of services and industry sectors to real GDP growth in the first half of 2021 averaged 5.0 percentage points and 1.1 percentage points, respectively, as that of agriculture was muted, at -0.1 percentage points.

Table 1:
Real GDP growth by broad categories

	2019				2020				2021	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Overall	**5.2**	**5.1**	**5.8**	**5.4**	**4.4**	**-4.1**	**-3.4**	**2.3**	**2.7**	**10.7**
Agriculture	4.0	2.0	5.0	3.6	4.5	8.0	-4.3	9.8	0.4	-0.5
Services	6.4	6.7	6.7	6.8	4.3	-7.0	-4.3	0.0	3.1	15.6
o/w Accommodation & Restaurant	11.0	12.1	9.9	9.0	-14.1	-57.2	-62.0	-57.7	-33.0	90.1
Transport & Storage	6.4	7.6	7.6	9.2	2.1	-16.8	-10.2	-6.2	-7.9	18.6
Industry	4.1	5.5	5.0	4.0	3.9	-1.2	2.6	7.7	4.3	9.2
o/w Construction	6.1	7.2	6.6	5.7	8.9	6.0	10.2	15.2	6.8	6.8

Source: KNBS & CBK

The notable decline in agricultural activity during the quarter, reflected adverse weather conditions which depressed tea, sugarcane, coffee and milk production, as well as livestock output. However, horticultural exports during the period recovered as global demand continued to normalize (**Table 1**). In our assessment, the economy appeared to be regaining its long-term re-orientation out of agriculture towards industry and services sectors, to anchor its medium-term growth prospects.

Other developments that had a bearing on economic recovery was the rising inflationary pressure during the period, depicted in an increase in headline inflation from 5.8 percent in April to 6.3 percent in June. This was driven by an upsurge in food prices mirroring the unfavourable weather conditions in most parts of the economy and rising global oil prices that pushed up domestic fuel pump prices.

Growth in private sector credit remained low in single digit levels through the period; raising concerns of whether the economic recovery that was underway was well-anchored. A deteriorating credit risk triggered banking sector asset portfolio reallocation as the effects of the pandemic persisted longer than was initially anticipated. The lapse of the CBK credit relief measures in March 2021 and the continued shifts in consumer expectations led banks to reprioritize lending while monitoring sectoral credit performances.

Consequently, growth in private sector credit stood at 7.7 percent in June 2021, rising only slightly from 6.8 percent in April. As

argued before, such credit outcomes are sub-optimal given that double-digit credit growth rates are required to support a strong and sustainable economic recovery going forward. *The question then is, with rising inflationary pressure, is there an opportunity to provide reprieve from a faster growth in the economy to solve supply constraints?*

Against these concerns is the need to assess the policy space, to place the economy on a strong footing through macroeconomic stability. Undoubtedly, room for fiscal policy has narrowed with the elevated debt levels and emerging concerns over its sustainability. Left with the option of re-engineering the monetary policy, the silver bullet lies in the incentives provided through the credit market, particularly in addressing its existing structural impediments.

Conventionally, to boost economic growth, monetary policy actions would involve a further cut in the interest rates. Lower interest rates would only deliver desirable outcomes if they were accompanied by actual flows of credit to the productive sectors. To this end, dealing with structural rigidities in the credit market- such as the existing pricing conditions – would be critical to unlock credit flows and support an accommodative monetary policy stance. Otherwise, additional liquidity to a system that is already liquid, may not have any desirable impact on the economy given that its marginal effects continue to approach zero.

A strong hindrance to credit flow during the quarter was its constraining price. Undoubtedly, the current mispricing would propel deadweight losses, manifested typically in inefficient allocation of resources. As such, we argue that fast-tracking the adoption and implementation of risk-based pricing in the face of elevated credit risk would deliver stronger credit growth outcomes through an accommodation of segments, deemed to be riskier, such as the Micro, Small and Medium Enterprises.

***Dr. Samuel Tiriongo is the Director of the KBA Centre for Research on Financial Markets and Policy®**

Pic/ pexels

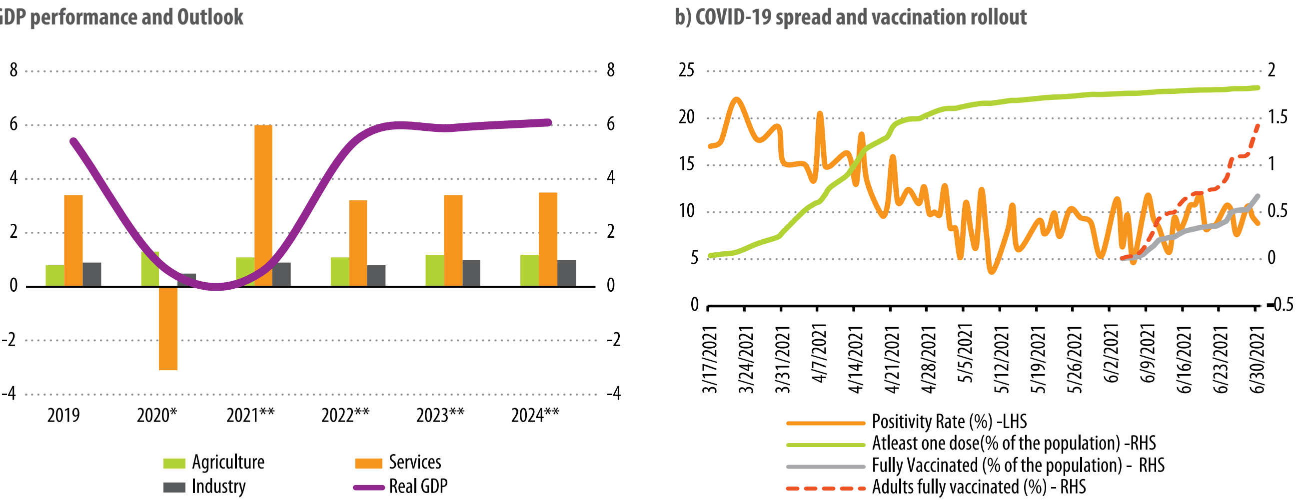
State of the Economy

The domestic economy recovered markedly during the second quarter of 2021 from the depressing effects of COVID-19 pandemic. During the quarter, the economy recovered by 10.7 percent on a year-on-year basis, supported by a strong resumption of activities in the services sector, particularly transport and storage, education, information and communication, wholesale and retail trade, and recovery in construction and manufacturing activities.

The positive economic outlook (**Figure 2a**), anchored on strides made in the vaccination program in the country (**Figure 2b**), further elevated the growth momentum that started in the previous quarter. The surge in the vaccine uptake was expected to further induce vibrancy in the service sector through strengthened demand, as more restrictions were lifted because of the easing spread of the COVID-19 virus and the attendant uncertainty. The service sector, that had been the largest contributor to GDP in the pre-covid period was projected to regain its role to contribute an average of 6.0 percent to GDP Growth in 2021 and stabilize to approximately 3.5 percent of GDP by 2024.

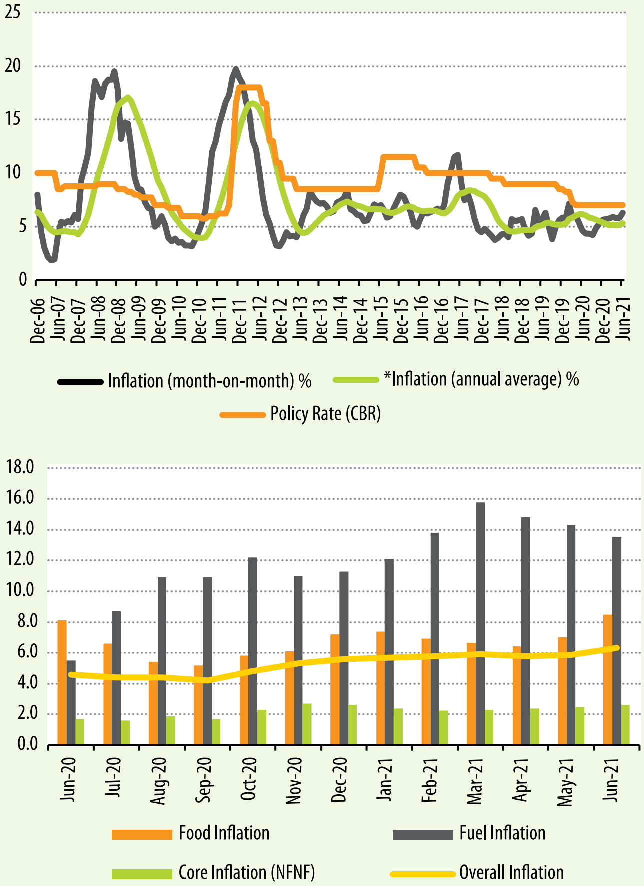
Pic/ Red Charlie - Unsplash

Figure 2: GDP Performance and Outlook, Covid-19 Spread and Vaccination program



Source: National Treasury & Ministry of Health

Figure 3:
Inflation trends

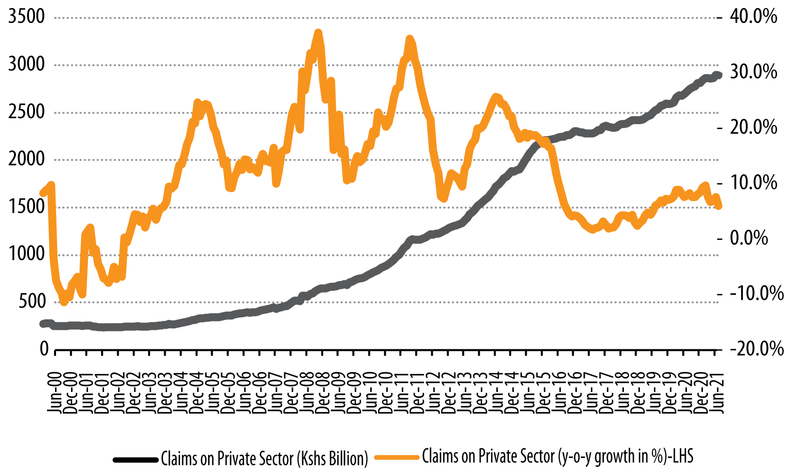


Source: KNBS & CBK

Nonetheless, the economy while still characterised as fragile and the scarring effects of the Covid-19 pandemic lingering, its recovery was facing risks from rising inflationary pressures (**Figure 3**). The month-on-month headline inflation rose from 5.76 percent in April to close the quarter in June at 6.32 percent, as the annual average inflation rate rose to 5.35 percent in June up from 5.15 percent in April. The rise in headline inflation was driven by a surge in both fuel and food prices, as core inflationary pressures remained muted.

“ The surge in the vaccine uptake was expected to further induce vibrancy in the service sector through strengthened demand, as more restrictions were lifted because of the easing spread of the COVID-19 virus and the attendant uncertainty.

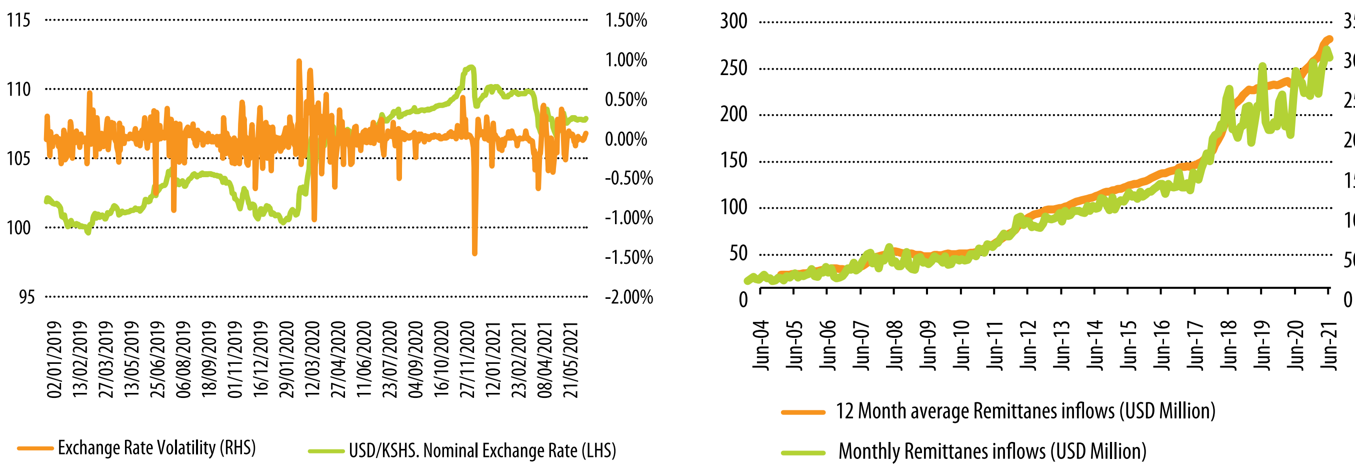
Figure 4:
Private Sector Credit and Growth Dynamics



The trajectory of credit to the private sector growth little changed since the onset of the pandemic and remained stuck at a single-digit level (**Figure 4**), largely on the back of a weakening asset quality base and banks readjustment in the loan portfolios as COVID-19 impact on economic activities materialized. In addition, there were notable changes regulatory requirements – follow the lapse of the credit relief measures issued by CBK - and shifts in consumer expectations with the protracted impact of the pandemic. As a result, growth in private sector credit stood at to 7.7 percent in June 2021, slightly up from 6.8 percent in April 2021, with the improved growth observed in manufacturing (that grew by 8.1 percent in June), transport and communications (11.8 percent), and consumer durables (23.4 percent). This reflected enhanced loan applications consistent with economic recovery.

The shilling exchange rate against the US-dollar manifested less volatility during the quarter, largely underpinned by a sustained inflows of foreign exchange particularly in form of diaspora remittances. The volume of remittances rose from USD 790.35 million in the first quarter to 837.94 USD million in the second quarter (**Figure 5**).

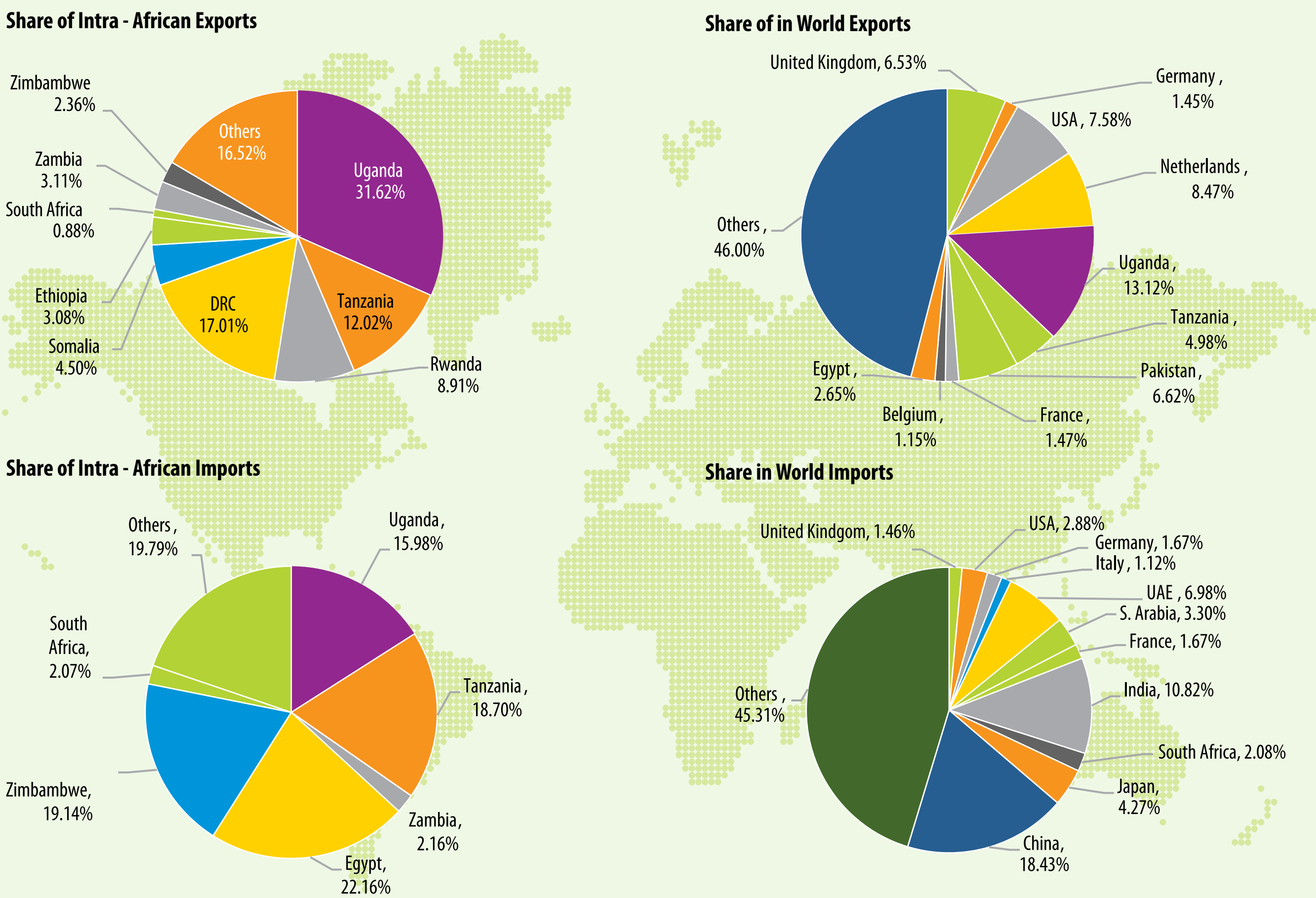
Figure 5: Kenya Shilling -US Dollar Exchange Rate dynamics and Remittances inflow



Source: Central Bank of Kenya

The indicators of trade with the rest of the world reveal that there was an 8.92 percent growth in imports from major destinations across the world during the quarter, while the volume of exports declined by 5.95 percent from the previous quarter. The dominance in terms of flow of goods among the key trading partners largely remained unchanged when compared to the previous quarter (**Figure 6**).

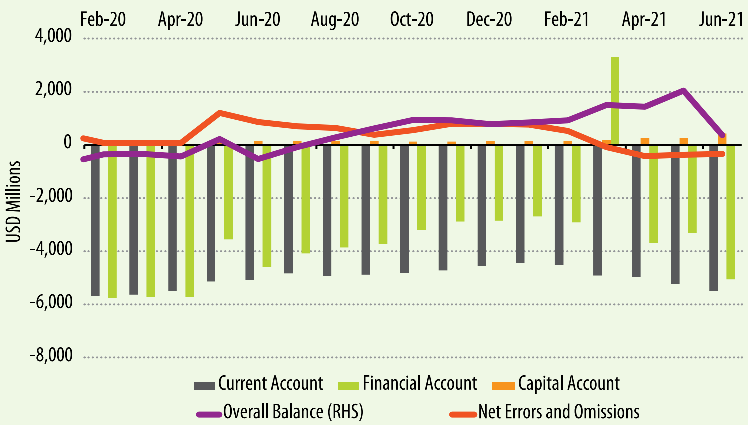
Figure 6: Kenya's Intra-African and Global Trade Developments



Source: Central Bank of Kenya

The overall balance of payment improved slightly, when compared to a similar period in 2020. The current account deficit was estimated at USD 5,503.5 Million which was 5.4 percent of GDP in the 12 months to June 2021. As at June 2021, the overall balance (surplus) stood at USD 361.5 million, despite narrowing slightly, reflected a favorable performance in the capital and financial accounts that more-than-offset the expansion in the current account deficit (**Figure 7**). Going forward, concerns would be on the pace with which the current account deficit would expand given uncertainty in global markets that may dwindle financial and capital flows to the country.

Figure 7: Balance of the Payments Performance



Source: KNBS

Pic/ Beks-uZYZ0BH / unsplash

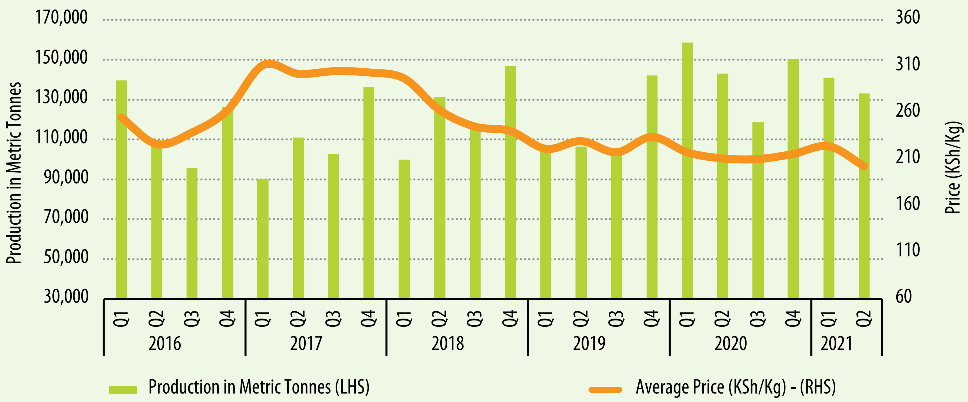
Sector Performance

Agriculture

The agricultural sector, which is considered the backborn of Kenya's economy, experienced significant slack in both the output produced and the value created. Total volume of tea production in the second quarter dropped by about 5.00 percent to 133,090 metric tonnes compared to levels recorded in the first quarter, largely reflecting unfavorable weather conditions.

The quarter reported a decline in the average tea prices to Ksh. 202.62 per kilogram, which turned out to be the lowest in the last six years. Tea prices declined from Kshs. 230.27 per kilogram in March 2021 to Kshs. 206.58 in April 2021 and 206.58 per kilogram in May 2021; overall representing 6.31 percent decline in tea prices in three consecutive months (**Figure 8**).

Figure 8: Tea production and Prices

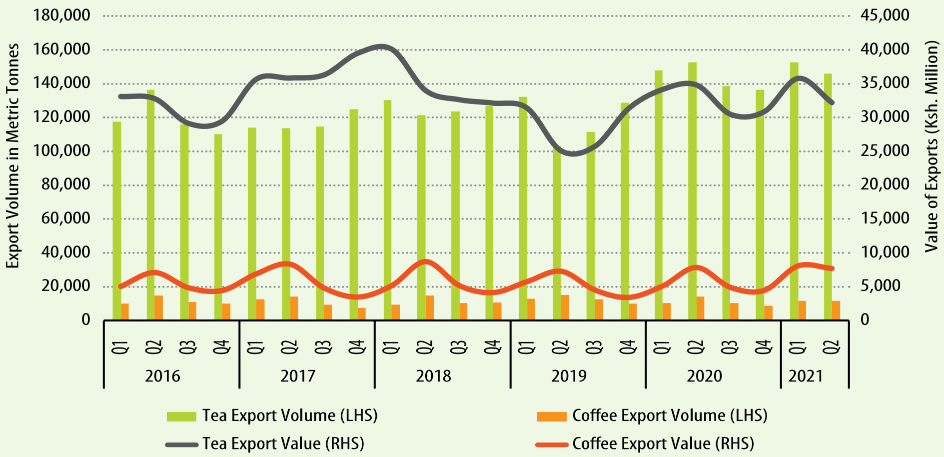


Source: KNBS

Consequently, and as depicted in **Figure 9**, the quantity of tea exports declined from 152,634 metric tonnes in quarter one of 2021 to 145,934 metric tonnes in quarter two. The export volume was 4.44 percent lower than levels recorded at a similar period in 2020. As a result of the decline in both volume and price, there was 10.01 percent drop in the value of tea exports from the previous quarter to settle at Ksh. 33.19 billion. Relative to the levels reported over a similar period in 2020, this was 7.49 percent lower.

Decline in output performance was also registered in coffee sub-sector. The volume of coffee exports dropped from 11,676 metric tonnes in the first quarter to 11,486 metric tonnes in the second quarter: representing 1.62 percent decline. Comparing with performance in the second quarter of 2020, this volume represented 18.67 percent reduction in coffee exports. In terms of value, coffee exports plummeted by 4.70 percent from Ksh. 8.06 billion reported in the first quarter of 2021, to Ksh. 7.682 billion in the second quarter.

Figure 9: Value of Tea and Coffee Exports

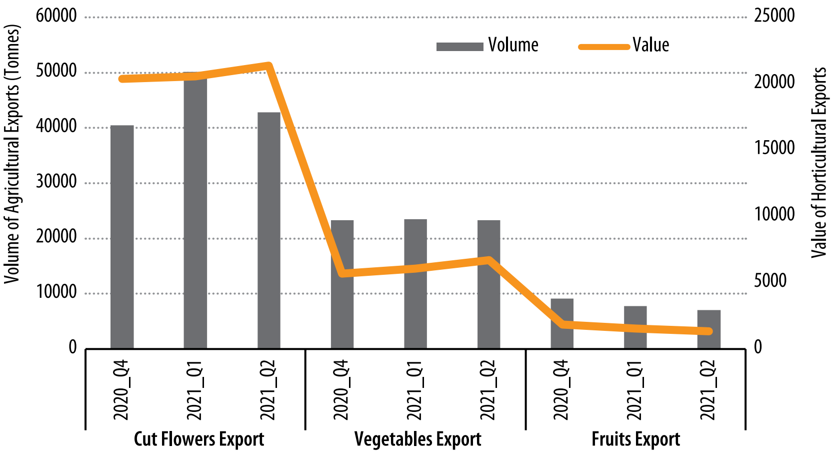


Source: KNBS

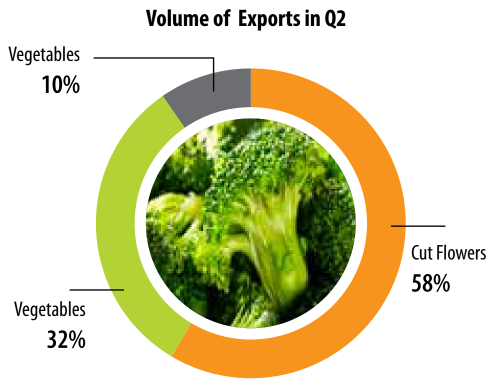
Pic/Georgina Smith

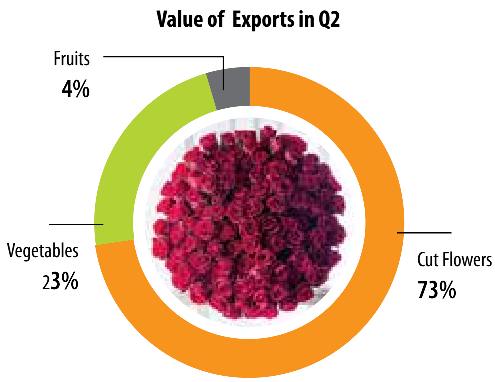
Cut flowers continue to dominate in both the volume and the value of horticultural exports (**Figure 11**). During the quarter, they accounted for 58.54 percent of horticultural export volume, as vegetables and fruits accounted for 31.82 percent and 9.6 percent, respectively. In terms of value, cut flowers exports accounted for 72.66 percent of total value horticultural exports, while exports of vegetables and fruits accounted for 22.79 percent, and 4.55 percent of the total value of horticultural exports.

Figure 11: Horticultural Exports



Source: KNBS





> **"The the growth in the volume of credit absorbed by the sector eased to 14.80 percent in June 2021 from 14.98 reflecting continued uncertainty in the recovery of the global and domestic economies from the disruptive effects of the pandemic on global supply chains**

Manufacturing

Credit to manufacturing sector reflects the level of activity in the sector. During the second quarter of 2021, the manufacturing sector activity tapered off compared to levels recorded in the first quarter. In particular, the growth in the volume of credit absorbed by the sector eased to 14.80 percent in June 2021 from 14.98 reflecting continued uncertainty in the recovery of the global and domestic economies from the disruptive effects of the pandemic on global supply chains (**Figure 12**).

Producer Price Index

The upward trajectory of the producer price index (PPI) was maintained during the second quarter of 2021, rising from 106.0 in the previous quarter to 107.7 (**Figure 13**). Relative to the previous quarter, the highest price increases were registered in mining and quarrying sector (2.8 percent) and manufacturing (1.6 percent) that was largely accounted for by delayed recoveries in production volumes in these sectors.

Figure 12: Share of Manufacturing to private sector Credit (%)

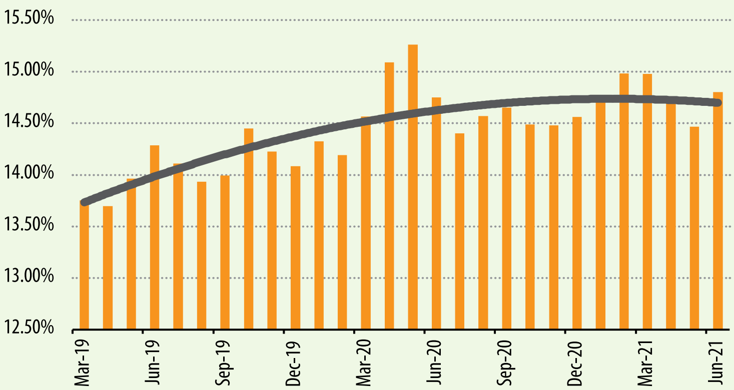
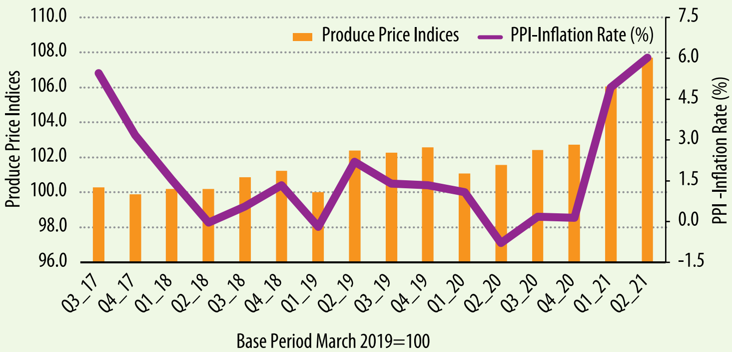


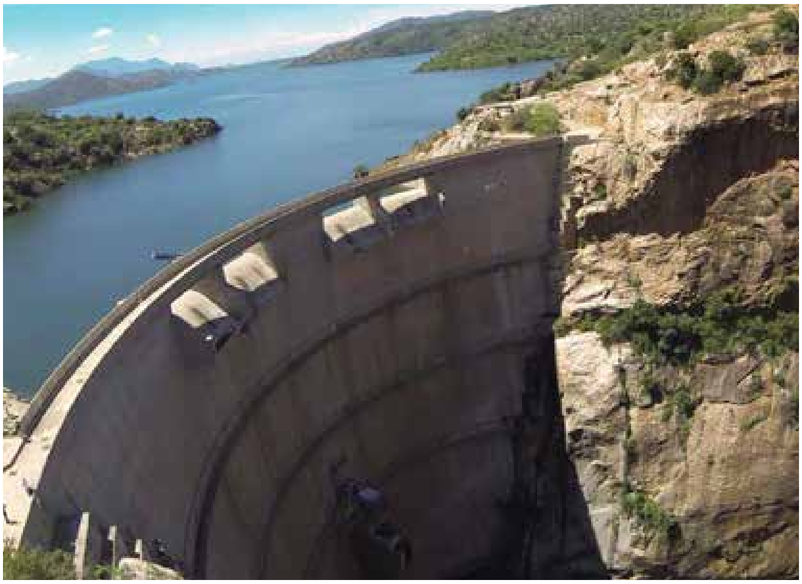
Figure 13: Producer Price Index



Source: KNBS

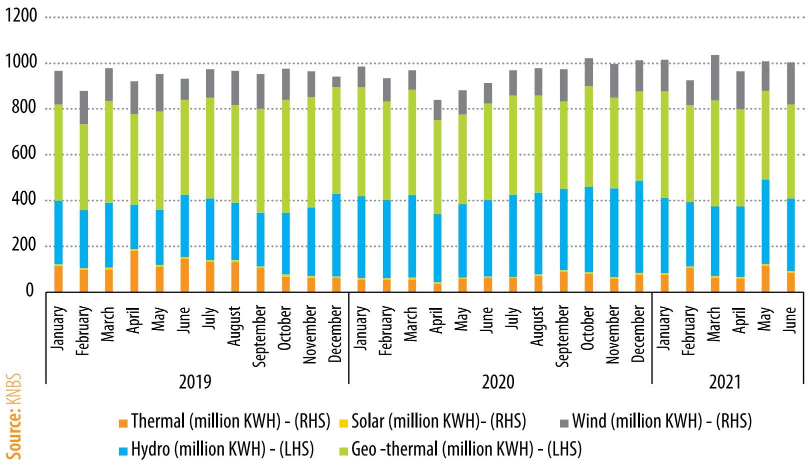
Energy

Total energy generated during the second quarter of 2021 declined marginally to 2,975.7 million kilowatts from 2,977.3 million kilowatts produced in the previous quarter, representing 1.82 percent contraction. However, the energy production during the period under review was 12.93 percent higher than the 2,634.88 million kilowatts generated in a similar period in 2020 (**Figure 14**). Overall, hydro-power and geothermal power continued to account for the largest proportion of energy produced in the country, respectively at 33.4 percent and 40.9 percent during the quarter. Consequently, the pass-through effects of international crude oil price changes on domestic energy production -particularly with the large geothermal power contribution, would have direct implications on energy supply and consumption in the country.



Pic/ KENGEN

Figure 14: Monthly Electricity Generation by Source



Source: KNBS

The crude oil prices in the international market remained on an upward trend during the quarter (**Table 1**). The Murban crude oil prices rose from US$ 63.24 in April 2021 to US$ 71.89 per barrel in June 2021, representing a 13.67 percent rise. The average domestic petrol pump prices were revised upwards by 3.49 percent, from 123.7 Kes/ litre in April 2021 to close at 128 KES/Litre in June 2021. Diesel, Kerosene, and Liquified Petroleum Gas (13-kg container) prices stood at Kes 108.6, Kes 98.8 and Kes 2,074.2, respectively, during the entire quarter. Changes in energy prices would typically be directly transmitted to the cost of all consumer goods via the role of energy in the production process of virtually all commodities.

Table 1:
Average Monthly Crude Oil and Retail Fuel Prices

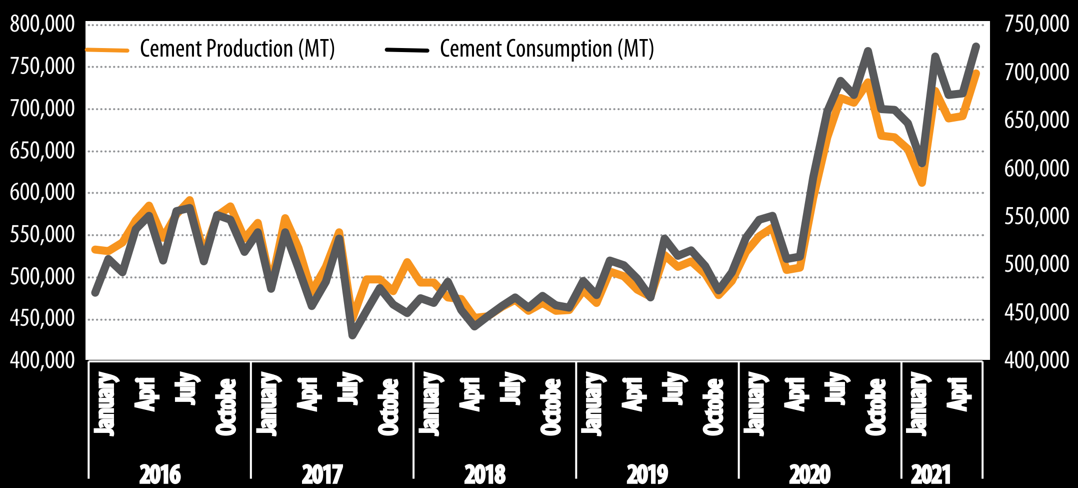
	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21
Murban crude oil (US$/Barrel)	41.5	40.1	42.6	49.2	54.4	61.1	64.6	63.2	66.9	71.9
Super petrol (KES/Litre)	106.3	108.0	107.0	108.0	107.9	116.0	123.7	123.7	127.2	128.0
Diesel (KES/Litre)	95.5	94.0	92.0	93.0	97.3	102.8	108.6	108.6	108.6	108.6
Kerosene (KES/Litre)	84.1	85.0	83.0	85.0	88.1	93.4	98.8	98.8	98.8	98.8
LPG (13Kgs)	2,033.6	2,018.0	2,020.0	1,977.0	2,018.9	2,031.2	2,074.2	2,074.2	2,074.2	2,074.2

Source: ADNOC oil prices and KNBS

Building and Construction

There was a notable increase in activity in the building and construction sector during the quarter. The demand for cement grew by 7.39 percent, from 677,411 metric tonnes in April 2021 to 727,478 metric tonnes in June 2021. Despite a stronger increase in demand, cement production recorded 7.80 percent growth during the quarter, resulting in a widening of the cement production-consumption gap from 11,101 metric tonnes in April 2021 to 12,400 metric tonnes and 14,774 metric tonnes in May and June, respectively (**Figure 15**).

Figure 15: Cement Production and Consumption



Pic/ Sutirta Budiman/unsplash.jpg / unsplash

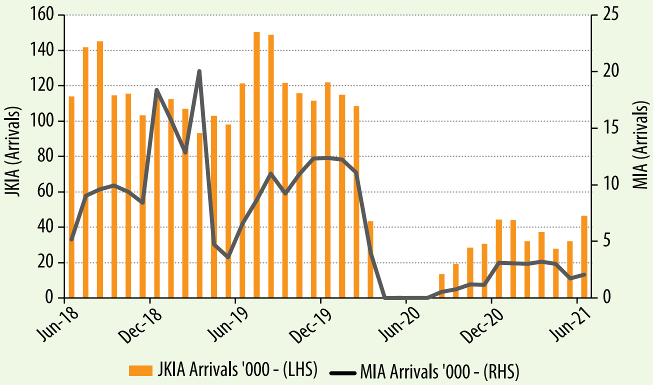

Pic/ Voo Qqq/ unsplash

Tourism

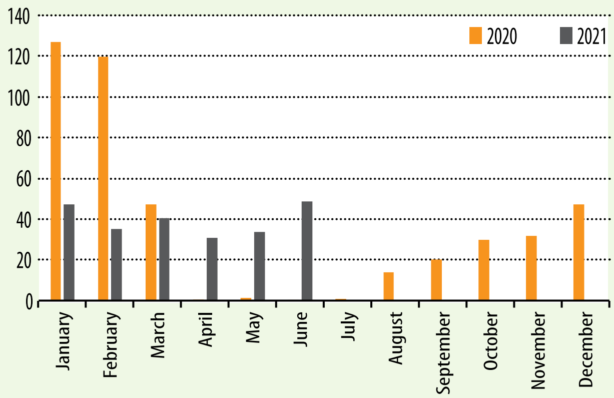
Tourism activity depicted continued recovery, from the adverse effects of the pandemic that disrupted transport channels, with the easing of restrictions. The total inbound tourist arrivals during the second quarter stood at 113, 307- less than 122,498 reported in the previous quarter but reflecting a rise on month-on-month basis (**Figure 16**).

Figure 16: Monthly Inbound Tourist Arrivals

Total Inbound tourists by Port of Entry



Total Inbound tourists '000, 2020 and 2021



Source: KNBS

Financing of Government

The government budget deficit widened slightly in the second quarter, despite an improvement in the revenue collected when compared to the previous three quarters (Figure 17). The improvement in revenue is attributed to the rebound in economic activities following the easing of covid-19 containment measures. The cumulative revenue-expenditure gap in the second quarter of 2021 widened from Kshs 1.43 trillion reported in the previous quarter to Kshs 2.26 trillion.

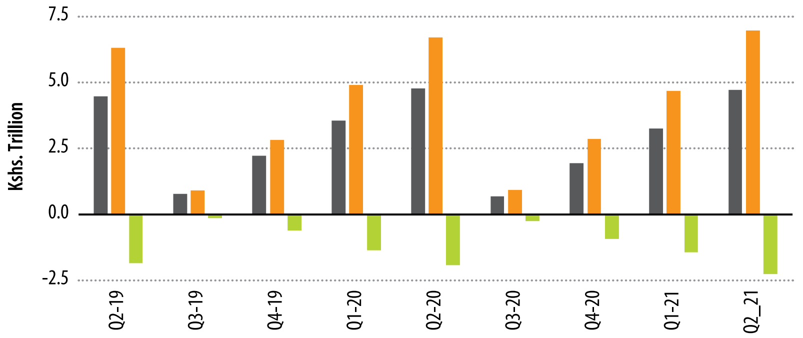
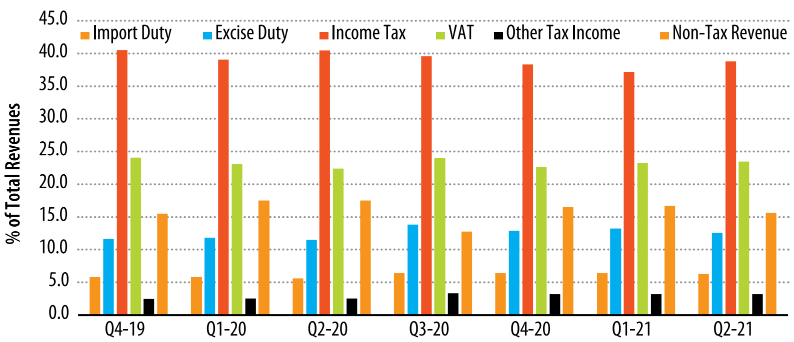


Figure 17: Quarterly Revenue-Expenditure Gap

The cumulative revenue-expenditure gap in the second quarter of 2021 widened from Kshs 1.43 trillion reported in the previous quarter to Kshs 2.26 trillion.

Figure 18: Quarterly Revenue Structure

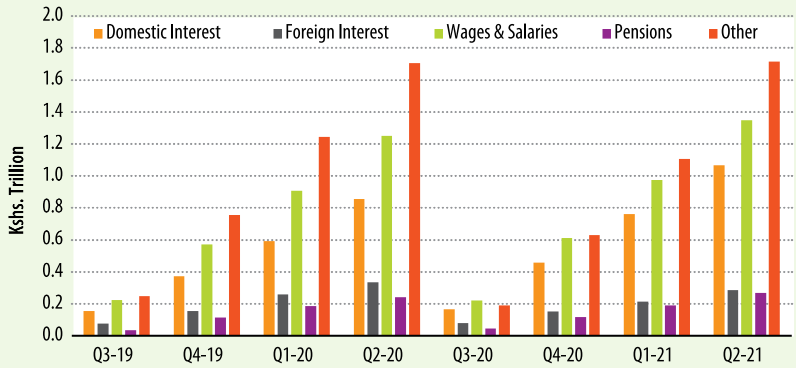


Source: Central Bank of Kenya

Analyses of the government revenue shows that the revenue structure remained largely unchanged, as Income tax and Value-added tax (VAT) dominated the sources of revenue; both accounting for 62.25 percent of the revenue during the second quarter as shown on **Figure 18**.

On the other side, government expenditure rose during the period, on account of increases in wages and salaries which stood at Kshs. 1.35 trillion compared to Kshs. 0.6 trillion in the previous quarter. Other significant expenses included foreign and domestic interest expenses which accounted for 22.8 percent and 6.1 percent of total expenses respectively, while pensions during the period which accounted for 5.7 percent of the total expenditure **(Figure 19)**.

Figure 19: Quarterly Expenditure

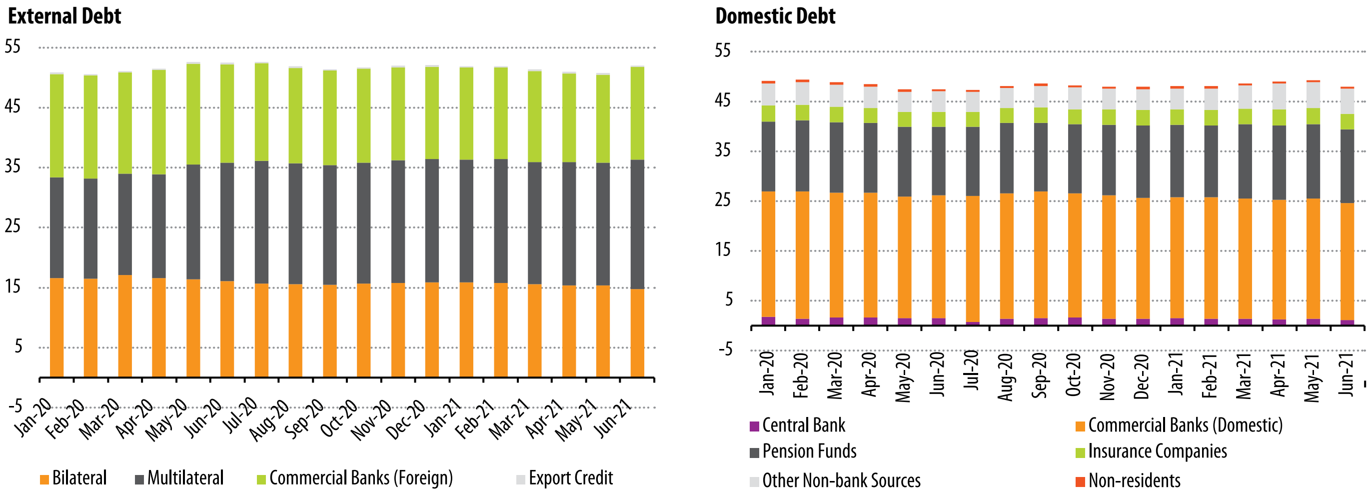


Source: Central Bank of Kenya

Public Debt

The stock of debt remained on an upwards trajectory, growing by 5.08 percent to Kshs. 7.7 trillion by June 2021 from Kshs. 7.3 trillion in March 2021, and the split between external and domestic lenders was largely unchanged. Among the external lenders, 20.54 percent of the debt was accounted for by multilateral debt, while bilateral and commercial banks' external debt accounted for 15.18 percent and 14.82 percent in total debt, respectively. Export credit accounted for 0.24 percent of the total debt (**Figure 20**). Among the domestic lenders, commercial banks held the largest share, accounting for approximately a quarter of debt raised domestically, followed by pension funds that accounted for 14.86 percent of the domestic debt.

Figure 20: External and Domestic Debt and its Composition

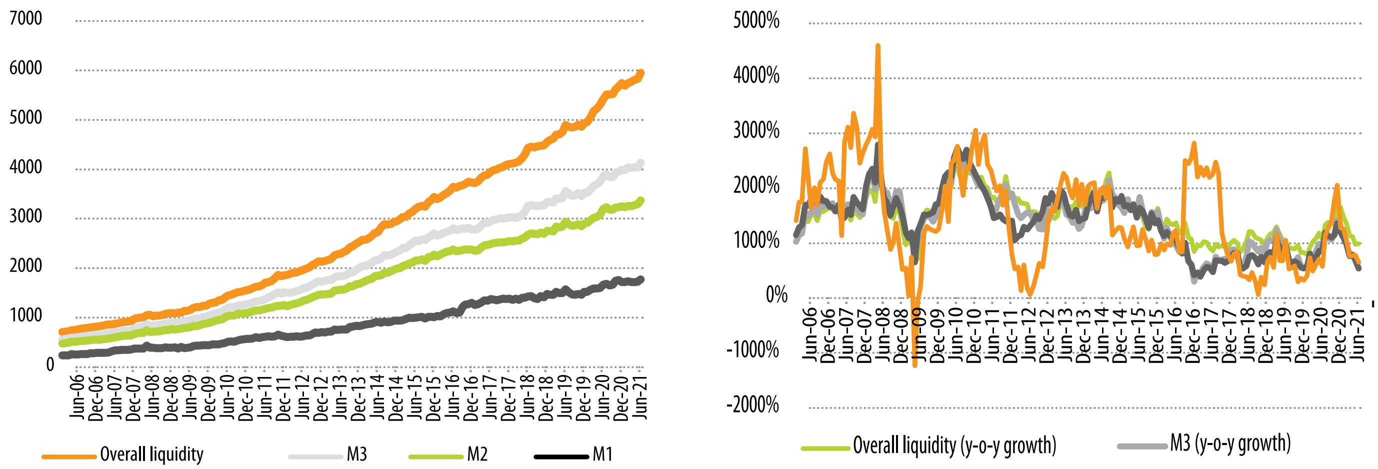


Source: Central Bank of Kenya

Money Supply

The growth in broad money moderated further during the second quarter, with its year-on-year growth rate declining from its peak of 14.16 percent in November 2020, to 10.08 percent in March, 9.33 percent in April to 6.99 percent in June 2021. This in part reflected a marked negative base effect linked to the exceptionally high liquidity conditions in the banking sector at the start of Covid-19 pandemic in the first quarter of 2020. The short-run dynamics of broad money imply a robust pace of money creation on the back of the support provided by monetary and fiscal policies. The main driver of broad money growth was a strong expansion in the narrow money M1, at 7.74 percent in March, 7.78 percent in April, before moderating to 6.52 percent in June 2021 (**Figure 21**). The growth in overall liquidity was also supported by build up in foreign currency deposits in the banking sector during the period.

Figure 21: Trends in Monetary Aggregates

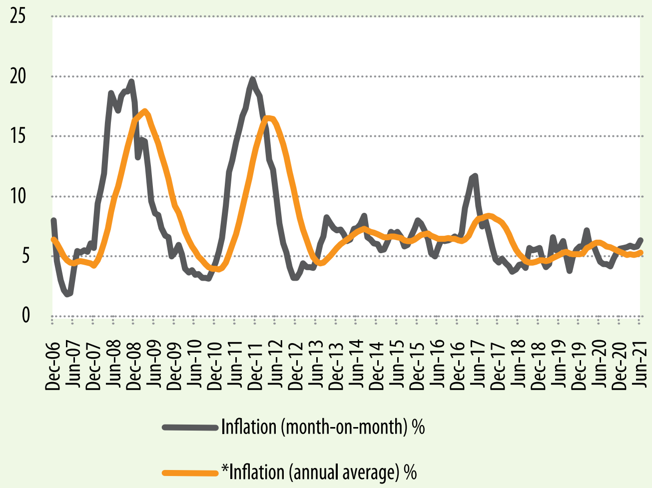


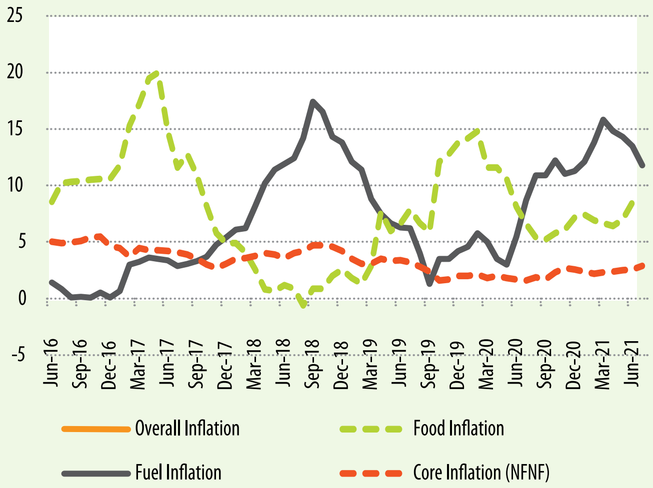
Source: Central Bank of Kenya

Inflation

Inflation sustained an increase during the second quarter of 2021 from the previous three quarters. Overall inflation rate and core inflation rate, despite being within the Government target range, edged up to stand at 6.3 percent and 2.6 percent in June, respectively. The high inflationary pressure was attributed to an upsurge in food prices and core inflation, as fuel inflation remained elevated (**Figure 22**). The rise in core inflation reflected a gradual recovery in demand for consumer goods and services, particularly with the easing of COVID-19 restrictions and containment measures.

Figure 22: Inflation Dynamics



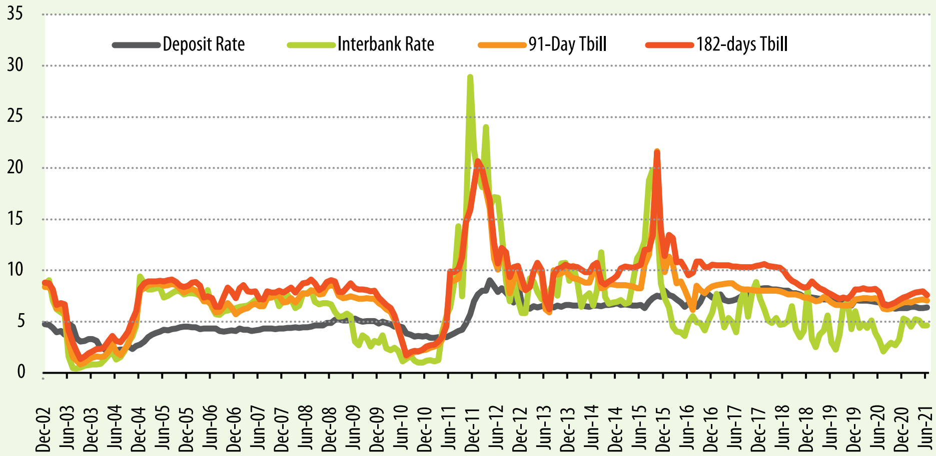


Source: Central Bank of Kenya

Interest Rates

The evolution of the Interest rates during the quarter depicted mixed trends. While the interbank rate declined in response to policy-driven enhanced liquidity in the market, both 91-day and 182-day Treasury bills moderately edged up; a characteristic typical of the end of the fiscal year (**Figure 23**).

Figure 23: Interest Rates Dynamics

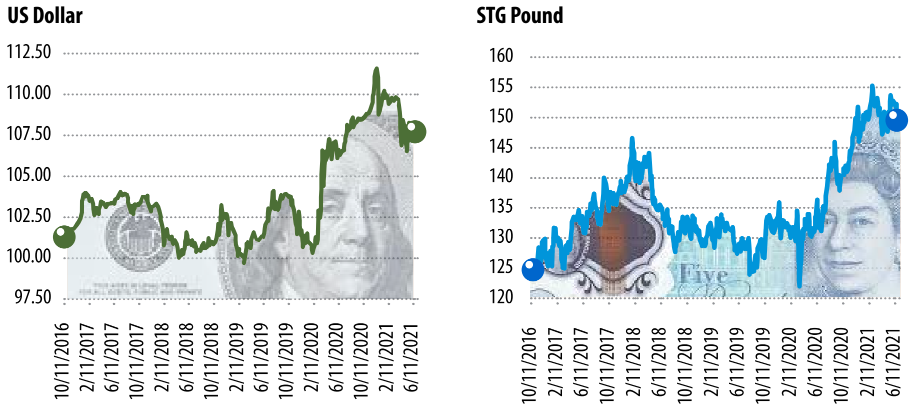


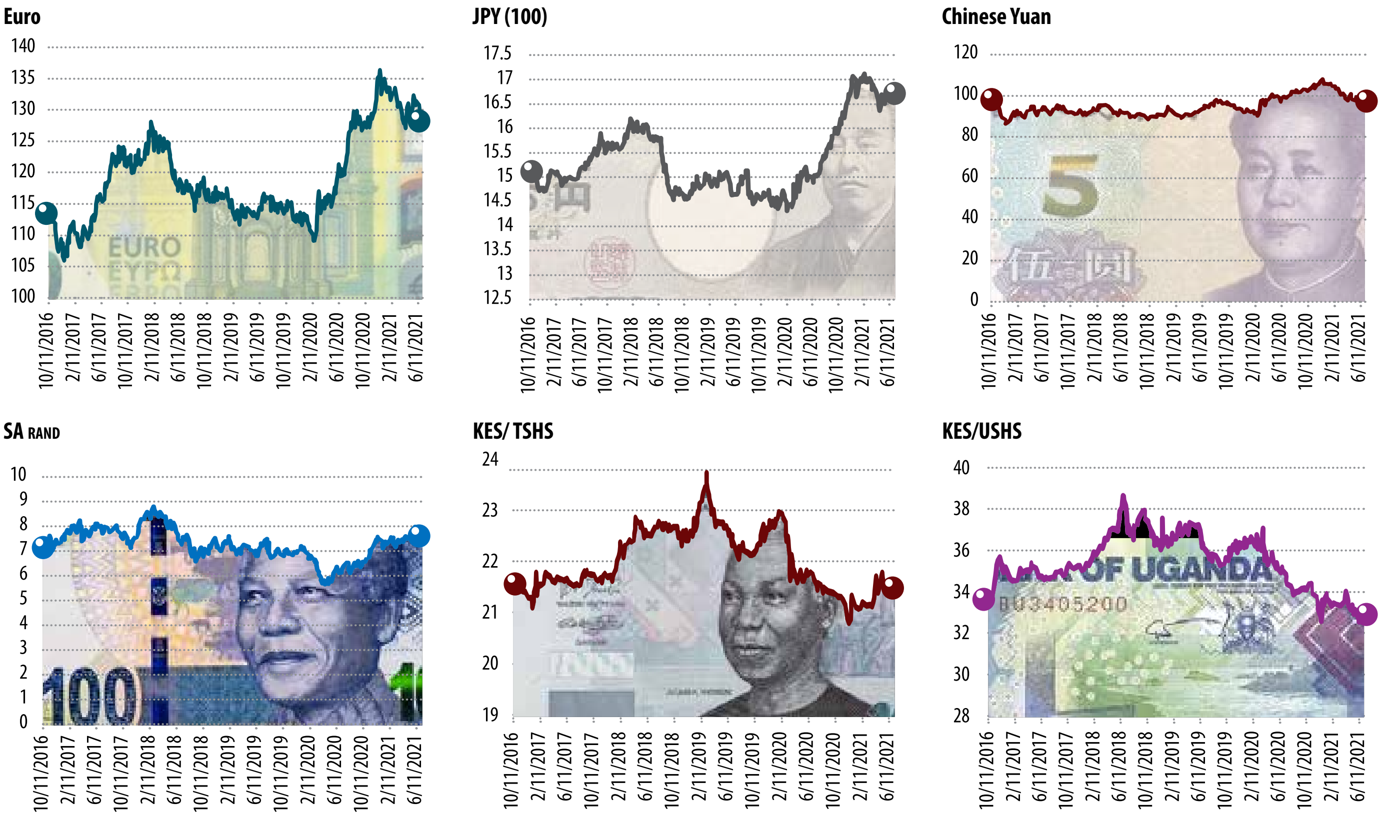
Source: Central Bank of Kenya

Exchange Rates

The Kenya Shilling exchange rate, despite remaining less volatile, exhibited mixed performance against the major currencies during the quarter. In April, the average exchange rate of the Shilling against the US dollar stood at Ksh 107.9, strengthened slightly in May to Ksh 107.4 before edging up to Ksh 107.8 in June. A similar pattern was reflected by the Sterling Pound and the Euro. However, the Shilling sustained a strengthening bias against the Yen (**Figure 24**).

Figure 24: Exchange Rate Developments





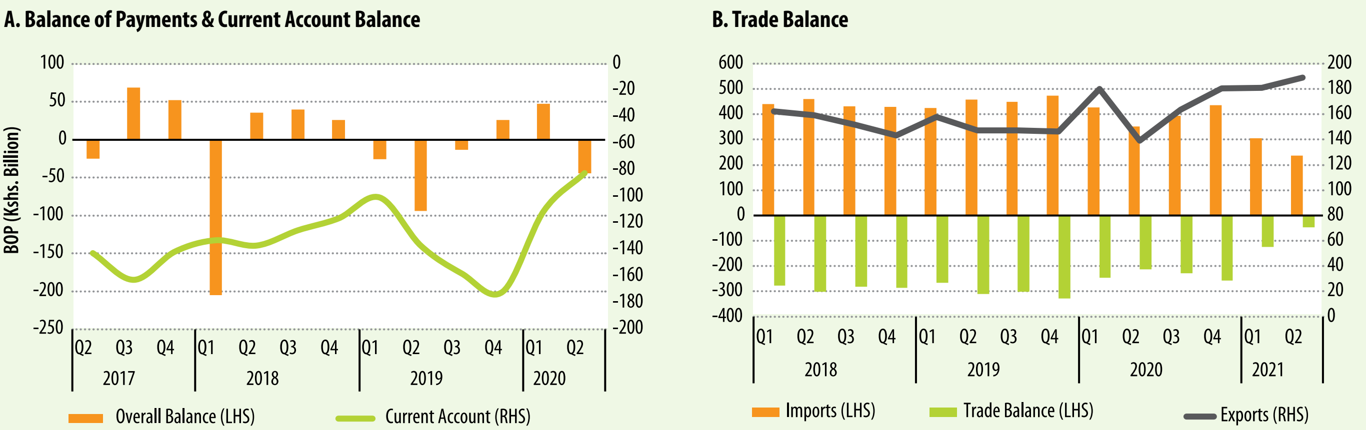
Source: Central Bank of Kenya

Balance of Payments

The overall balance of payment position improved slightly, when compared to a similar period in 2020. The current account deficit is estimated to have widened to USD 1,381 million in the second quarter of 2021 from USD 782 million in the second quarter of 2020 reflecting increased imports of intermediate goods which more than offset improved earnings from strong agricultural exports, and resilient diaspora remittances. The trade balance in goods and services is estimated to have deteriorated by 49 percent from a deficit of USD 1,705 million in the second quarter of 2020 to a deficit of USD 2,545 million in the second quarter of 2021, largely on account of increased imports of intermediate goods (**Figure 25**).

Pic/William William / unsplash

Figure 25: Balance of Payments

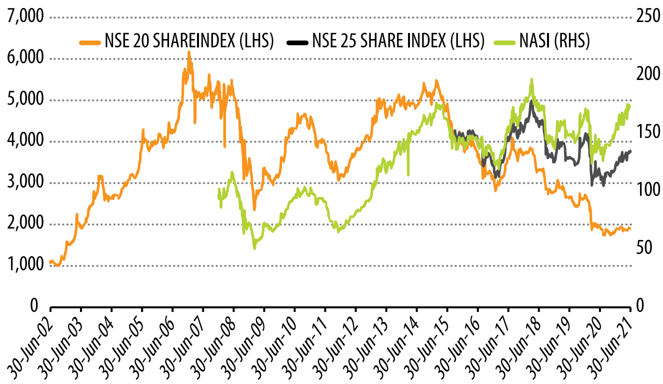


Source: KNBS

Capital Markets

The stock market indices edged upwards during the quarter as NSE listed firms reported better-than-expected earnings during the period (**Figure 26**). The NASI index rose by 9.40%, to peak at 177.52 in June, from levels reported in March; reflecting the highest increase since May 2018. Similarly, the NSE-25 and NSE-20 rose albeit at a lower margin compared to the NASI, respectively by 6.81 percent and 4.39 percent during the quarter. The total market capitalization was up by 10.88 percent from the close of the first quarter of 2021, to settle at Ksh. 2,766.28 from Ksh. 2,437 billion at the end of the first quarter **(Table 2)**. Relative to the previous quarter, the number of shares traded, and equity turnover increased by 12.79 percent and 15.65 percent, respectively. The enhanced activity at the equity market was consistent with easing of the pandemic-related containment measures as well as the resumption of economic activities that ignited confidence in the markets.

Figure 26: Trends in NASI, NSE-25 and NSE-20



Source: NSE

Table 2:
Nairobi Securities Exchange Leading Indicators

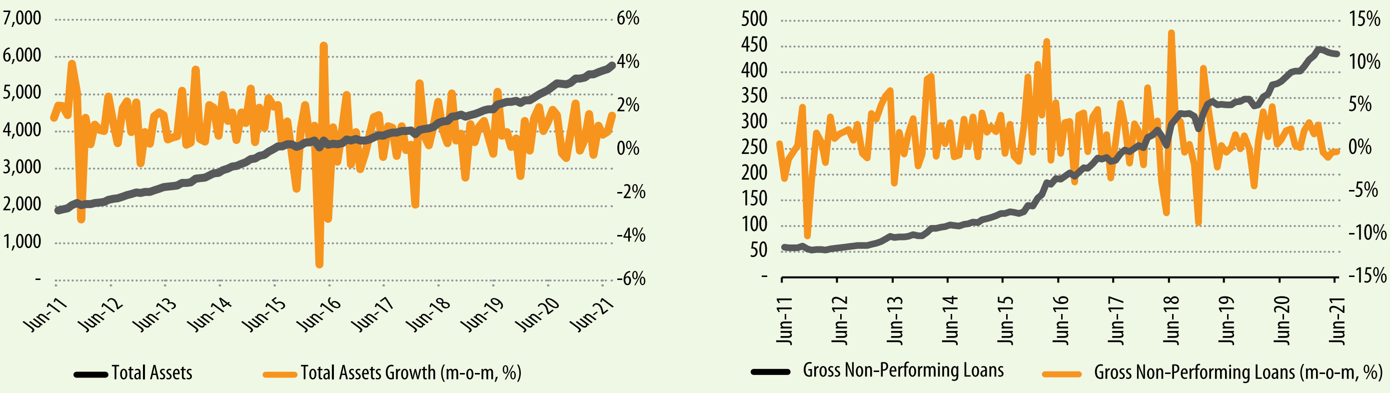
	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21
Number of Shares Traded (Million)	524.53	219.42	381.00	369.13	294.00	330.68	373.00	293.00	385.94	420.71
Equities Turnover (KSh Million)	13923.59	5880.91	11393.00	10236.93	8851.56	10819.73	12064.00	9877.58	14161.67	13952.58
Market Capitalization (KSh Billion)	2147.74	2150.06	2229.00	2336.70	2390.29	2541.16	2437.00	2599.05	2646.71	2702.22

Source: NSE

Banking Sector Developments

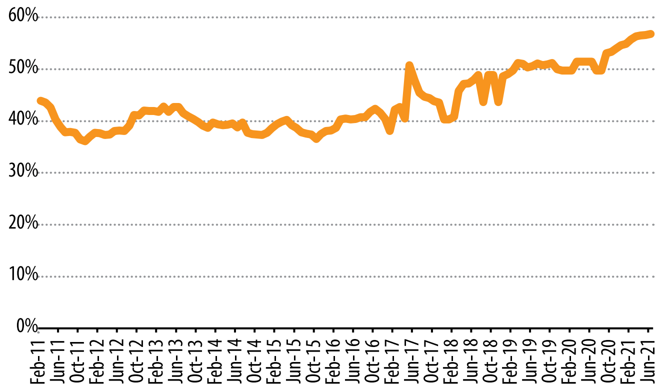
The sector registered strong performance during the second quarter, as the total net assets expanded from KSh 5,528.4 billion in March 2021 to KSh 5,680 billion in June 2021, representing a 2.7 percent growth. Gross loans increased from KSh 9,136.1 billion in the first quarter of 2021 to KSh 9,269.3 billion in the second quarter of 2021, a 1.46 percent increase (Figure 27).

Figure 27: Total Assets and Gross loans



Source: KNBS

Figure 28: Liquidity Ratio on an upward trajectory

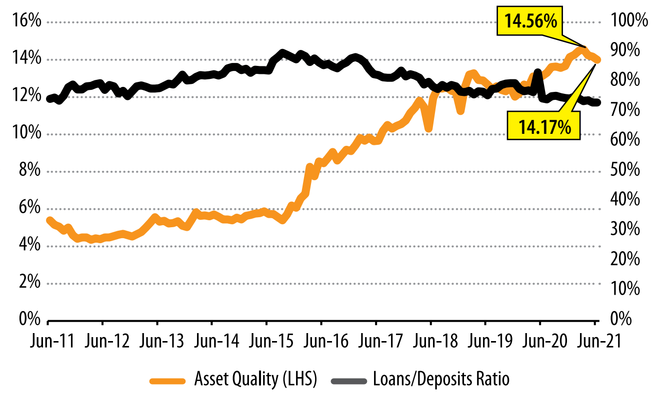


Source: Central Bank of Kenya

The liquidity levels were on the rise, despite being way above the minimum regulatory limits. In April, the sector liquidity ratio stood at 56.50 percent in liquidity, rising slightly to 56.60 percent in May before closing the quarter at 56.80 percent in June (**Figure 28**). Enhanced liquidity ratios were supported by the maintenance of an easing monetary policy stance adopted by the Central Bank of Kenya since April 2020, and increased investments in government securities by banks, as private sector credit risk remained elevated.

There was, however, a slight improvement in the banking sector asset quality during the second quarter, as the ratio of gross non-performing loans (NPLs) to gross loans dropped to 14.1 percent in June from 14.6 percent at the end of March (**Figure 29**). In quantum terms, however, gross NPLs during the period declined from Ksh. 438.30 billion in April, to Ksh. 436.60 billion in May and further to Ksh. 435.30 billion in June. This implies a more-than proportionate easing in private sector credit than the decline in the gross NPLs. An additional measure of the conversion of loans to deposits, remained steady at approximately 73 percent during the quarter, reflecting minimal changes in the intermediation structure in the banking sector.

Figure 29: Asset Quality and Loan-to-deposit ratio



Source: Central Bank of Kenya

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