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CENTRE FOR RESEARCH ON

FINANCIAL MARKETS AND POLICY®

About this Report

This *Bulletin* reviews Kenya's economic performance in the first quarter of 2021, drawing on the recent performance and developments to provide perspectives on the year's outlook. The *Bulletin* covers trends 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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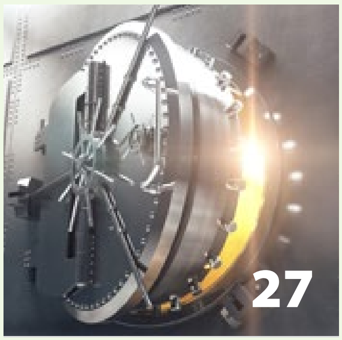


KENYA
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FOREWORD

From the CEO's Desk

It is my pleasure to present to you the 31st issue of the *Kenya Bankers Economic Bulletin*. The *Bulletin* reviews the strides that the economy made in the first quarter of 2021, emphasising the challenges that the pandemic continues 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 is the protracted effects of the pandemic, the lapse of the emergency measures that were targeted at supporting households businesses and cushioning lenders.

While this Bulletin reports on the developments in the first quarter of 2021, any outlook formed based on the data and analyses presented herein should accommodate a high degree of uncertainty underpinned by the effects of the pandemic on the economy.

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

COMMENTARY

Divergences in Economic Projections: Certainty reflecting the uncertainty

By Dr. Samuel Tiriongo

The economy in 2021 will definitely be influenced by the effects of the pandemic, that characterised its initial conditions. What is more disturbing is that the initial conditions are mutating, with the emerging variants of infections; complicating any efforts to anchor thoughts- and thus business plans- to the new normal; that is, business in an environment of COVID. But before we discuss the outlook for the economy in 2021, let's evaluate the initial conditions, particularly focusing on the impact of the pandemic on the economy, and some responses that the country deployed as mitigations to strong economic downturns.

In 2020, the economy was hit hard by the COVID-19 shock; triggering extensive disruption in global trade and travel as well as the containment measures that were deployed to limit the spread of the virus. As a result, the economy is estimated to have contracted significantly following the unprecedented school closures, imposition of dusk to dawn curfews, and restrictions on movement across critical regions as well as on public gatherings, which triggered job losses, thus depressing incomes for individuals and businesses in disproportionate measures.

Policy authorities in early 2020 took measures to mitigate the adverse effects of the pandemic particularly for the vulnerable groups, such as the low-income earners and MSMEs. These included temporary cuts in personal and corporate income taxes, a temporary reduction in the value-added tax rate from 16 percent to 14 percent, and recalibrations of the budget and its execution to accommodate additional spending on health and social protection. The central bank, for instance, instituted a

Empty Streets as a result of dusk to dawn curfew: Due to containment measures deployed to limit the spread of the COVID-19 virus, the economy is estimated to have contracted significantly.

decisive interest rate cut augmented with strong liquidity injections to support a smooth functioning of the financial system. CBK also encouraged banks to offer borrowers the chance to postpone loan payments through its emergency measures on loan restructuring, while providing some flexibility to banks on loan classification and provision for loan losses. In addition, the CBK eliminated fees for low-value mobile money transactions seeking to reduce costs for users and promote a transition from physical exchange of cash to a safer means of payment.

CBK also encouraged banks to offer borrowers the chance to postpone loan payments through its emergency measures

Against this backdrop, the focus period for this *Bulletin* happens to coincide with the end of some of the measures deployed to support the economy, thus offering a chance to evaluate the economy's readiness to organically support itself as it reels out of the effects of the pandemic. Even then, one thing is certain: policymakers and analysts remain uncertain on the extent of disruptions that the pandemic continues to cause.

1 See IMF's press release (https://www.imf.org/en/News/Articles/2021/04/02/pr2198-kenya-imf-executive-board-approves-us-billion-ecf-and-eff-arrangements), and World-Bank's report on the global economic prospects /

2 World Bank (November 2020): https://www.worldbank.org/en/news/press-release/2020/11/25/kenyas-gdp-contracts-under-weight-of-covid-19-impacting-lives-and-livelihoods

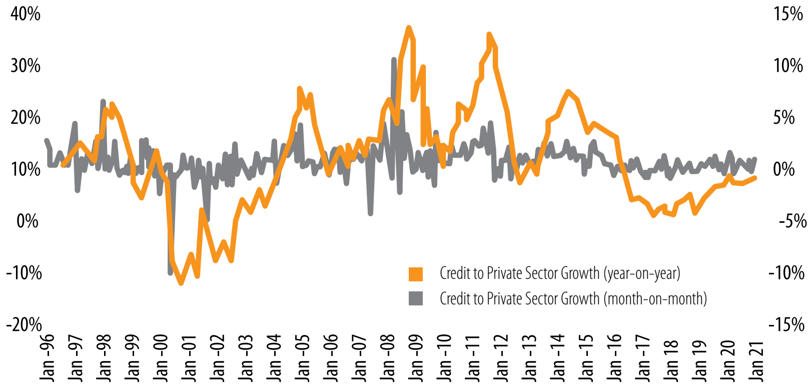
3 https://www.afdb.org/en/countries-east-africa-kenya/kenya-economic-outlook#:~:text=Recent%20macroeconomic%20and%20financial%20developments,have%20had%20a%20dampening%20effect.

4 Speech by the CS, National Treasury (available via https://www.treasury.go.ke/fy-2020-2021-growth-projection-lowered/)

5 https://www.worldbank.org/en/news/press-release/2021/06/30/kenya-s-economy-is-staging-a-partial-recovery-but-uncertainty-remains-high-and-prospects-hinge-on-the-covid-19-vaccination-drive.

6 https://www.imf.org/en/News/Articles/2021/06/23/pr21195-kenya-imf-executive-board-completes-first-reviews-extended-arrangement-eff-ecf-arrangements

Private Sector Credit Growth Dynamics



Source: CBK

But for how long will this be present, and which options will lift the hope of a stronger and sustainable recovery?. These are the critical questions that linger among many, policymakers and practitioners alike. In this space, we endeavour to paint a fairer picture of the economic effects of the pandemic, enjoying some comfort of near-full-year results for Kenya, explore the various projections for the path of the economy in 2021 and their realism.

As at end June 2021, the domestic economic activity data present covered the first three quarters of 2020. Nonetheless, various authorities had made projections on the performance of the economy. Notably, the projections varied from institution to institution, reflecting divergence in views on the impact of the pandemic, and the uncertainty that surrounded it. For instance, the IMF and the World Bank estimated the Kenyan economy to have contracted by 0.1 percent, and between 1.0 percent and 1.5 percent in 2020, respectively. On the contrary, the African Development Bank and the National Treasury (Kenya) posted more optimistic estimates of growth, at 1.4 percent and 0.6 percent, respectively.

The projections for 2021 published by end June 2021 equally varied ; from 6.3 percent by the IMF, to 4.5 percent (down from 6.9 percent estimated in January 2021) and 5.0 percent by the

7 chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/viewer.html?pdfurl=https%3A%2F%2Fwww.kbacoke%2Fdownloads%2FResearch%2520Note%2520No%25202%2520of%25202021.pdf&clen=435276&chunk=true

World Bank and the African Development Bank, respectively, as the National Treasury projected 6.4 percent growth for the same period. Indeed, the 2020 initial conditions were unanchored and the projections for 2021 heavily contingent on views about the pace of vaccination rollout, any risks of fiscal slippages, outturn on weather conditions, the pace of global economic recovery, and the evolution of credit needed to finance economic recovery.

Right at the centre of economic recovery is its financing. It was estimated that for the strong economic growth recovery to be achieved, this required growth in credit to private sector to improve from 8.4 percent in 2020 to 9.4 percent (IMF, June 2021) . Data as at the end March 2021 showed that bank lending was tapered off. The annual growth in private sector lending decelerated to 7.6 percent in March, with stronger credit growth expectations tempered by the economic uncertainty, the lapse in March 2021 of the CBK emergency measures that had supported lending to the private sector, and a deterioration in credit risk that triggered extensive tightening of credit standards by the banking sector.

In this environment, the economic recovery remained sub-optimally financed, and the realisation of the projected growth rates expected to be missed. In this case, what would have possibly been a u-shaped recovery, may see a protracted gradual and uneven recovery of the sectors of the economy even with complete easing of COVID-19 containment measures. Due to this, subsequent downward economic growth revisions would be expected, unless decisive measures are taken to revamp credit flows to the private sector. A low-hanging fruit for this, as argued in our March 2021 KBA Research Note , this would be an accommodation of pandemic-triggered risk in credit pricing, so that banks are incentivised to lend more.

"Right at the centre of economic recovery is its financing. It was estimated that for the strong economic growth recovery to be achieved, this required growth in credit to private sector to improve from 8.4 percent in 2020 to 9.4 percent (IMF, June 2021)

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

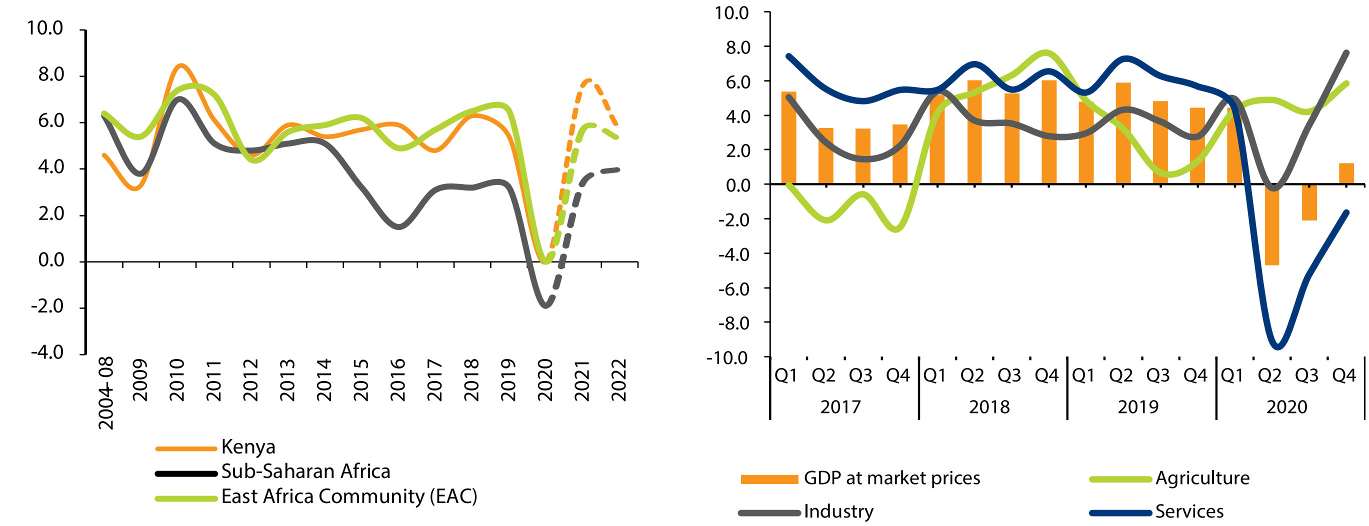
State of the Economy

The domestic economy showed signs of recovery, but the recovery was sluggish. During the first quarter of 2021, the global and domestic economy was characterised by considerable slack on account of the adverse effects of the COVID-19 pandemic, following the latter's contraction by 0.3 percent in 2020 compared to 5.0 percent growth in 2019 (**Figure 2**).

This represented the sharpest contraction in recent history, which was more pronounced in the second quarter with the economy contracting by 4.7 percent, as stiffer containment measures to curtail the spread of the virus were adopted. However, the subsequent easing of containment measures in the third and fourth quarters moderated the contraction to 2.1 percent in quarter three and supported a 1.2 percent growth in the fourth quarter. Furthermore, Kenya's Real GDP growth is projected to grow relatively faster than the average growth in Sub-Saharan Africa, at 7.6 percent in 2021 and 5.7 percent in 2022.

Further, leading economic indicators in 2021 reveal that economic recovery in the first quarter depicted some recovery, albeit remaining sluggish, as shown by Stanbic Bank's PMI index report for March 2021 (**Figure 2**). The Index (PMI), used to gauge the state of the economy from developments in the business environment, stood at 50.6 in March from 50.9 in February 2021, on account of both output and new orders slowing down in activity growth. Further, demand growth also lost traction, likely due to cash flow problems brought by the pandemic, as households limited spending on essential goods.

Figure 1:
Real GDP growth and sectoral GDP growth rates



Source: IMF, World Economic Outlook April 2021, KNBS

The subsequent easing of containment measures in the third and fourth quarters moderated the contraction to 2.1 percent in quarter three and supported a 1.2 percent growth in the fourth quarter.

Firms reported exports lost some momentum in March; As such, output grew at the slowest pace in nine months. However, employment levels continued to improve—albeit only slightly—in March. Other high-frequency indicators, especially export growth, suggests that the economic growth momentum is gaining some traction, but overall activity remains substantially below its potential. Moreover, mobility returned to pre-pandemic levels by October 2020, only to be tightened again in November 2020 and in March 2021 as Kenya faced second and third waves of COVID-19 infections (**Figure 3**).

Figure 2:
Stanbic Bank's Composite Purchasing Manager's Index

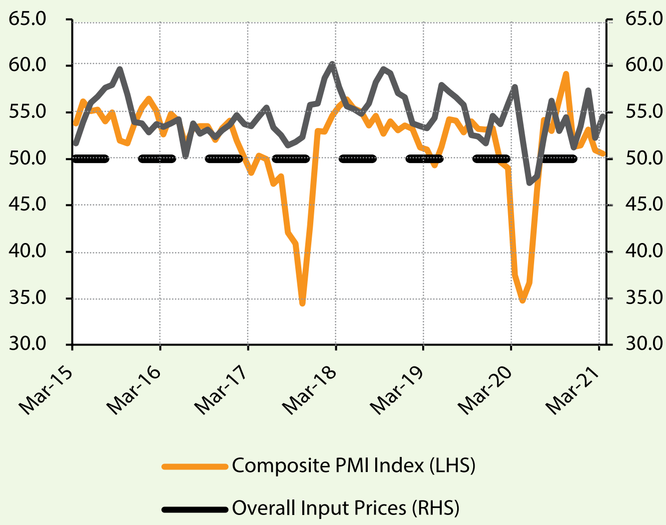


Figure 3:
Mobility Trends: percent change from pre-COVID-19 baseline

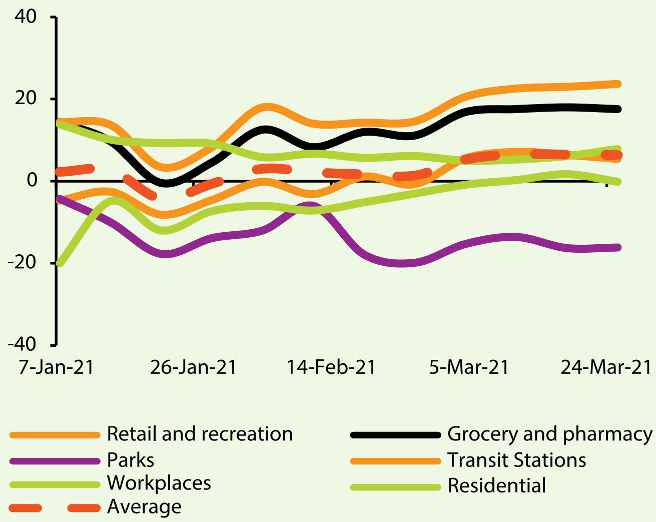
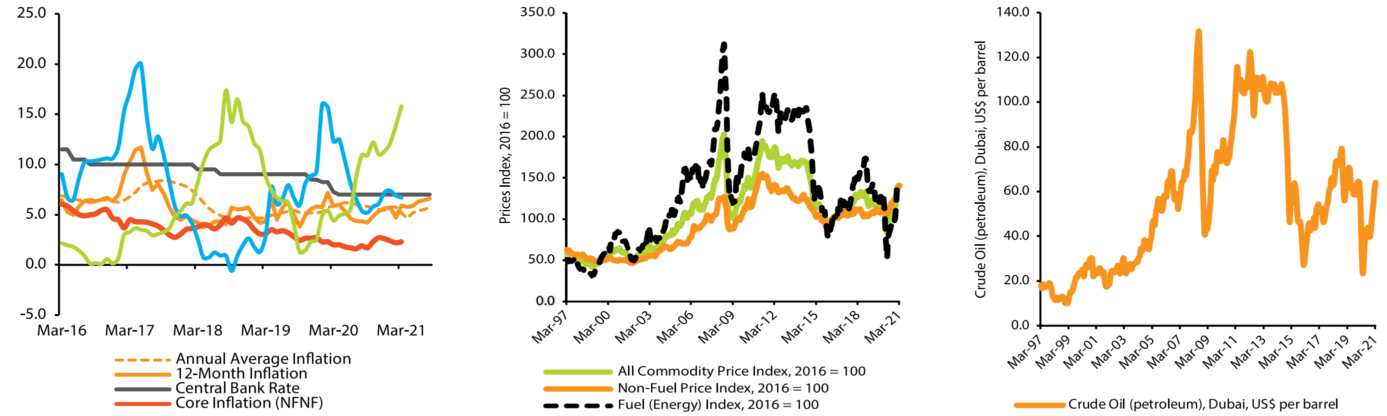


Figure 4:
Inflation and inflation drivers



Source: Central Bank of Kenya

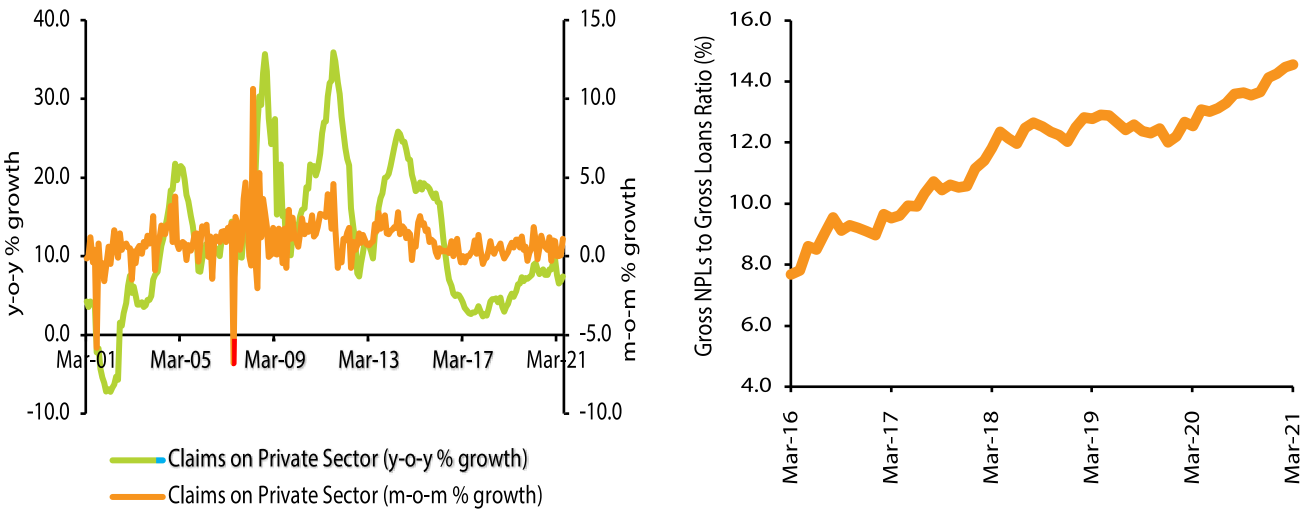
Source: IMF Global Commodity Database

Source: IMF Global Commodity Database

Consumer price inflation during the first quarter of 2021 continued to rise, with the average month-on-month inflation edging up to 5.79 percent, compared with 5.26 percent in the last quarter of 2020 (**Figure 4**). Despite the rise, the inflation remained within the target range, mainly moderated by the muted demand pressures as economic activity remained depressed, even with an accommodative monetary policy. Nonetheless, international oil prices rose (see chart 3b), with expectations of further increases in the subsequent quarters. On the basis of this, this was expected to exert upward pressure on inflation, more so with the consideration that oil remains an important intermediate input to the production of a wide range of other consumer goods.

Analyses of the evolution of private sector credit show that its trajectory has seen slight improvement since the onset of the pandemic but remains stuck at a single-digit level (Figure 5). The stock of credit in the first quarter, despite growing by 23.8 percent (or Ksh. 25.5 billion) from Ksh.2,841.60 billion in January to Ksh.2,867.10 billion in March, the growth was lower than what was recorded in the fourth quarter of 2020. The observed deceleration in credit to the private sector during the period was on the back of weakening asset quality of the banking sector, as households and businesses continued to face depressed incomes due to the adverse effects of the pandemic on economic activity.

Figure 5:
Private Sector Credit and Growth Dynamics



Source: Central Bank of Kenya

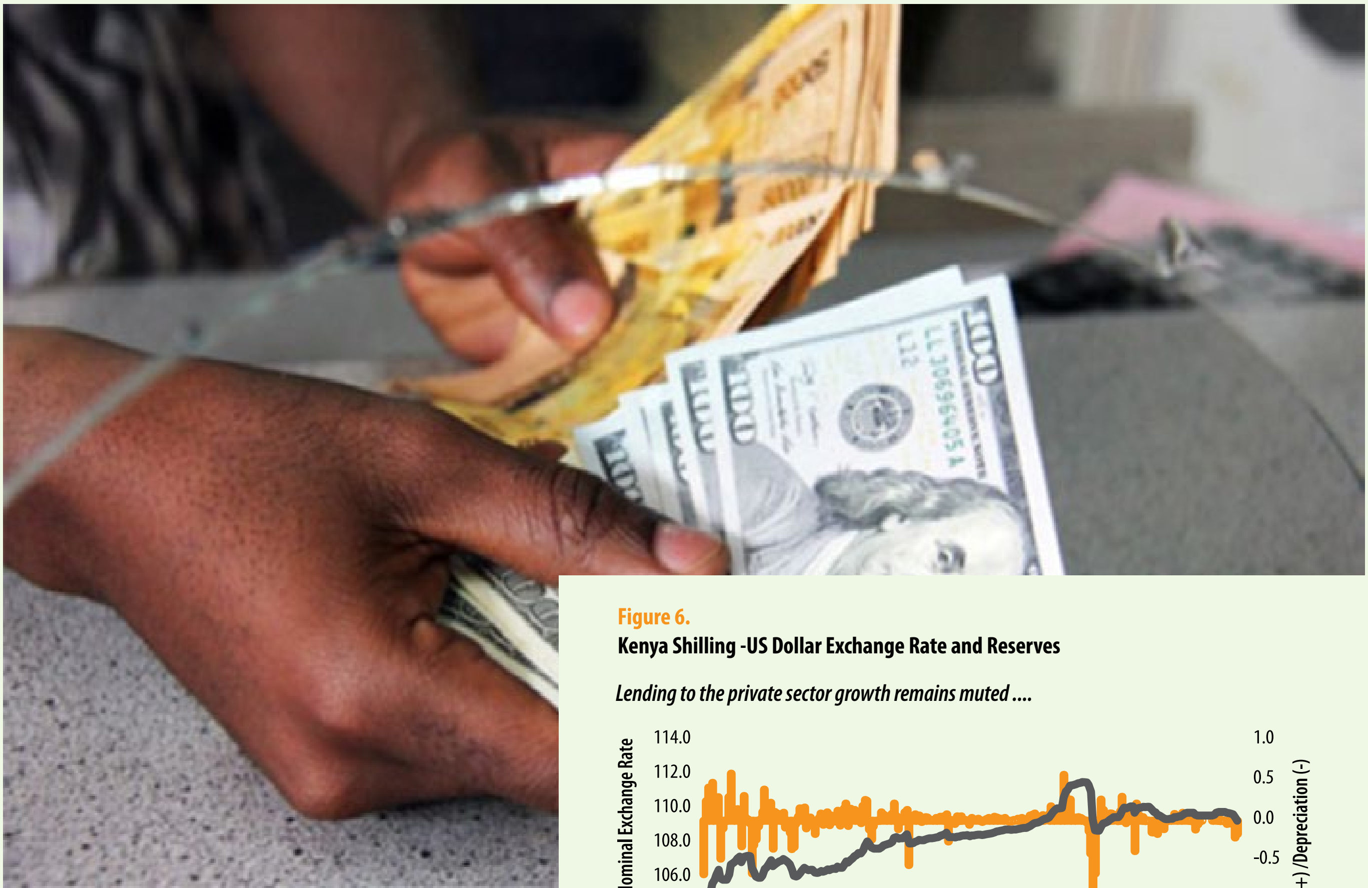
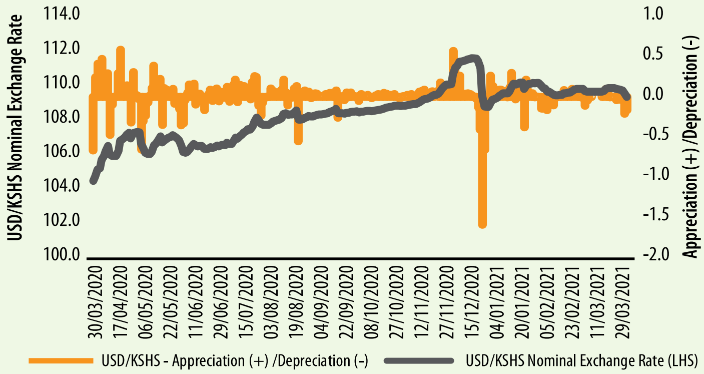
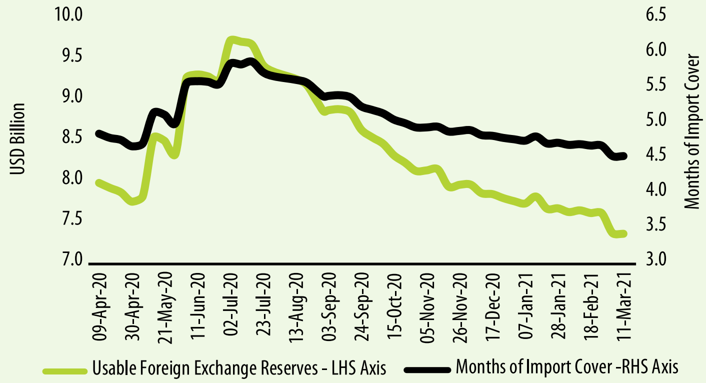


Figure 6.
Kenya Shilling -US Dollar Exchange Rate and Reserves

Lending to the private sector growth remains muted ....



....as asset quality continues to deteriorate further



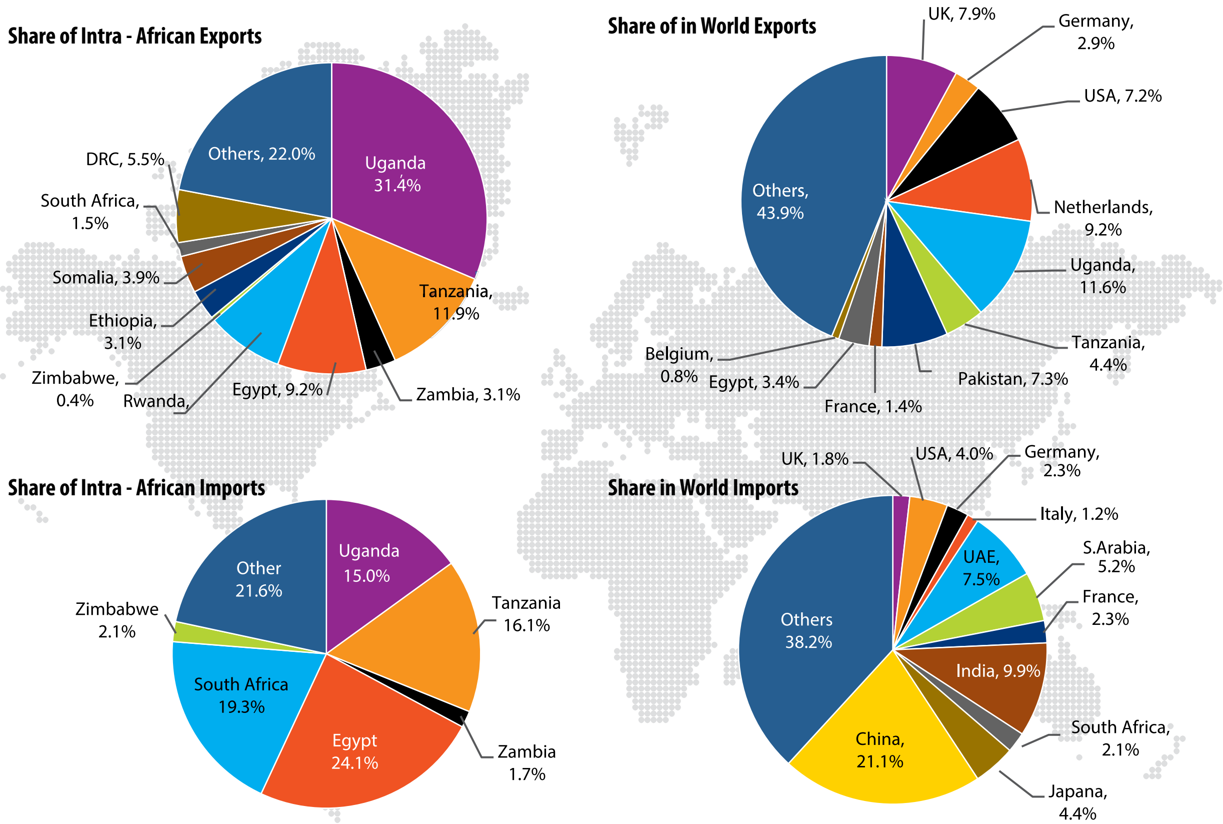
Source: Central Bank of Kenya

Notable stability was observed in the foreign exchange market during the period, supported by a fair balance between demand and supply of foreign exchange. The shilling remained stable against the US dollar as its volatility eased off, with the Shilling average exchange rate against the US dollar oscillating around Ksh.109.83, Ksh. 109.68 and Ksh.109.73 per US dollar in January, February, and March, respectively. The stability of the foreign exchange market was also anchored by the central bank's foreign exchange reserves that remained strong, at USD 7,741.2 million (or 4.7 months of import cover) as of end-March 2021, providing some buffer against any short-term shocks (**Figure 6**).

Available indicators of developments in international trade in goods and services during the quarter show that the current account deficit narrowed to about 5.1 percent of GDP in the 12 months to March 2021 compared to 5.7 percent of GDP over a similar period in 2020, mainly reflecting a lower expansion in imports than the growth in exports during the period. In particular, the increase in imports of oil, machinery and transport equipment were outpaced by the receipts from tea and horticultural exports and flows of diaspora remittances. Overall, the total exports grew by 8.92 percent as imports expanded by 17.70 percent during the quarter compared to levels registered in quarter four of 2020.

Analyses of trading partners show some selected countries continued to dominate Kenya's trade with the rest of the world during the period. As **Figure 7** shows, in the first quarter of 2021, exports to Uganda continued to dominate intra-African trade accounting for 41.4 percent of total exports, followed by Tanzania, Egypt and Rwanda at 11.9 percent, 9.2 percent and 8.0 percent, respectively. Intra-African imports, on the other hand, were mainly sourced from Egypt (24.1 percent of total intra-African imports), South Africa (19.3 percent), Tanzania (16.1 percent) and Uganda 15.0 percent) during the period. On the global front, China remained the single largest source of imports to Kenya, accounting for 21.1 percent of total imports, as exports depicted more diversified destinations; with the Netherlands, United Kingdom, Pakistan,

Figure 7:
Intra-African and Global Trade Developments



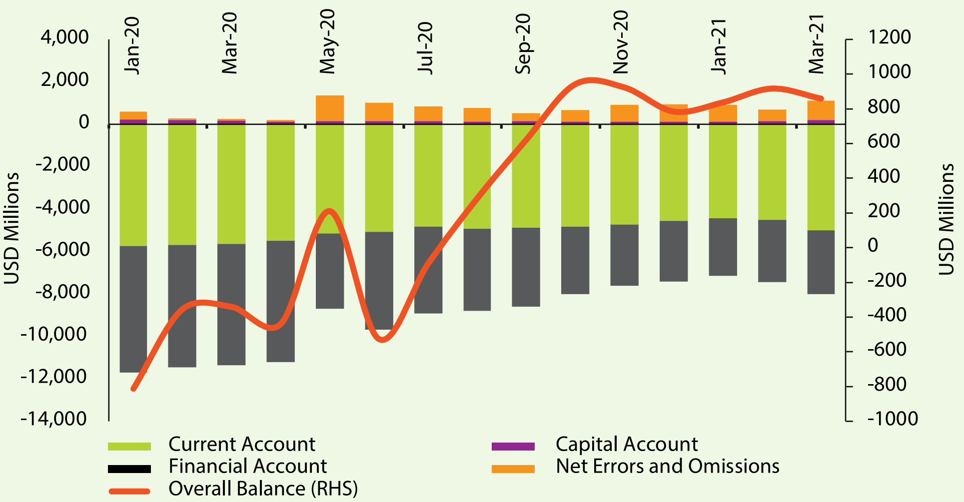
Source: Central Bank of Kenya

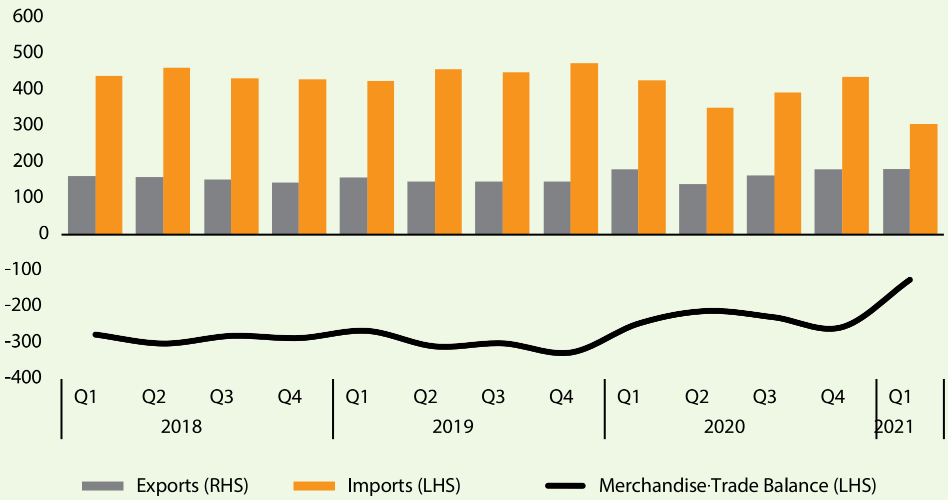
and the USA dominated, respectively, accounting for 9.20 percent, 7.90 percent, 7.3 percent and 7.2 percent during the period.

The overall balance of payments during the period slightly improved during the period, with the overall balance at a surplus of USD 859 million in the 12 months to March 2021 compared with a deficit of USD 340.9 million over a similar period in 2020, reflecting narrowed current account and financial deficits and increased balance on the net errors and omissions (un-apportioned flows) during the period. In particular, the current account deficit narrowed to USD 4,995.1 million in March 2021 from USD 5,635.7 million in the 12-months to March 2020. The financial account deficit also narrowed from USD 5,720.5 million to USD 3,014.0 million over the period. The trade balance in goods and services deteriorated from a deficit of USD 1,952 million in the first quarter of 2020 to a deficit of USD 2,650 million in the first quarter of 2021 (**Figure 8**).

Figure 8:

12-months Balance of the Payments developments



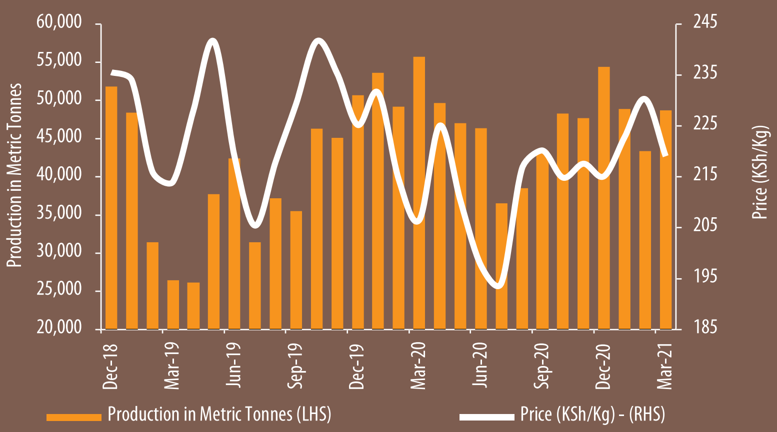


Sector Performance

Agriculture

The agricultural sector registered some mixed performance during the period, reflecting sub-sector dynamics. For instance, while tea production contracted significantly stood at 48,896 metric Tonnes in January, it declined to 43,399 metric Tonnes in February but recovered partially to 48,693 metric tons in March (**Figure 9**).

Figure 9:
Tea production and Prices



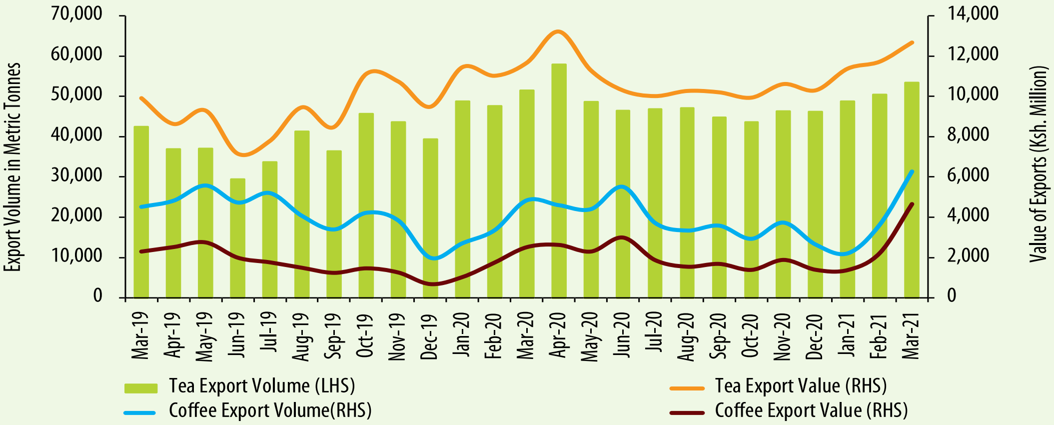
Source: KNBS

Overall, tea production in the first quarter of 2021 was lower than its levels reported for a similar period in 2020. However, tea prices during the first quarter of 2021 were higher than those reported for the previous quarter and a similar period in 2020, rising steadily from Ksh. 222.8 per kilogram in January to Ksh. 230.3 per kilogram in February, representing a 3.3 percent increase.

Despite its mixed output performance, tea continued to dominate Kenya's crop exports. As depicted in **Figure 10**, the quantity of tea exports maintained an upward trajectory, significantly increasing from 136,175 metric tonnes in quarter four of 2020 to 152,634 metric Tonnes in quarter one of 2021, which were 3.28 percent higher than the exports recorded over a similar period in 2020. As a result, in terms of value, tea exports expanded by 4.80 percent to Ksh. 35.78 billion in quarter one of 2021 from Ksh. 34.14 billion over a comparable period in 2020, but rose by 15.98 percent compared to tea exports in the fourth quarter of 2020.

Coffee export volumes edged up during the quarter by 11.12 percent to 12,117 metric Tonnes from 10,904 metric tonnes in the first quarter of 2020. This represented a 30.15 percent increase over the fourth quarter of 2020. In terms of value, coffee exports rose by 55.92 percent in the period to Ksh. 8.26 billion from Ksh. 5.30 billion in a similar quarter in 2020. This also represented a 77.1 percent increase in value compared to receipts in the fourth quarter of 2020 (**Figure 10**).

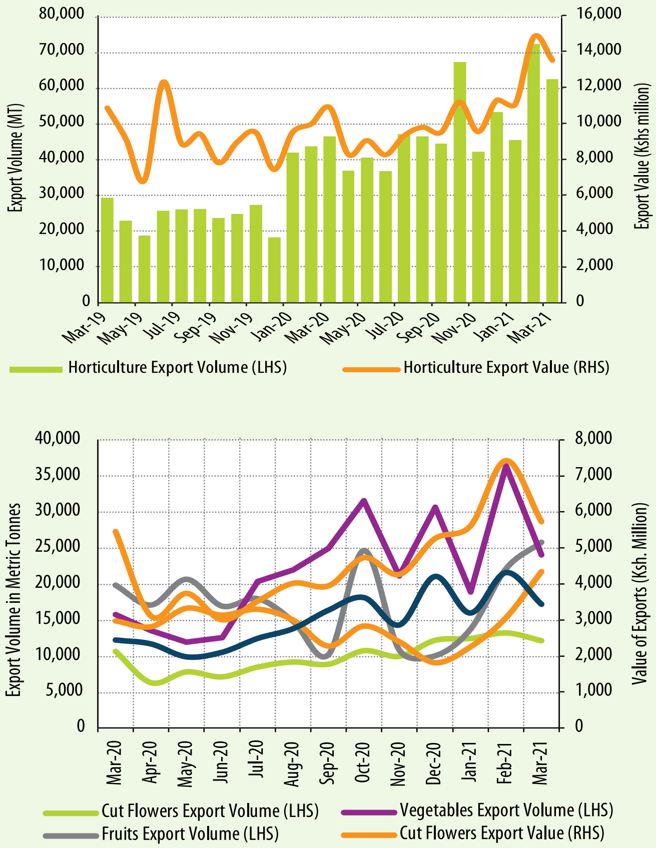
Figure 10:
Value of Tea and Coffee Exports



Source: KNBS

Horticultural exports, supported by some recovery in demand in the international market, increased in the first quarter to 179,622.6 metric Tonnes, up from 162,263.76 metric tonnes reported in quarter four of 2020, representing a 10.70 percent rise (**Figure 11**). Compared to a similar period in 2020, the first-quarter performance in export volumes was 36.1 percent higher. In terms of value, the exports rose by 29.77 percent to Ksh.39.36 billion during the first quarter of 2021 compared to a similar period in 2020 and 23.09 percent higher than the last quarter of 2020. Exports of cut flowers dominated, accounting for 47.8 per cent of the horticultural exports, as vegetables and fruits accounted for 27.8 percent and 24.4 percent, respectively. Based on granular data, other notable quarter-on-quarter developments showed that as vegetable exports declined marginally (by 4.76 percent), exports for cut flowers improved by 14.94 percent in the first quarter of 2021.

Figure 11:
Horticultural Exports

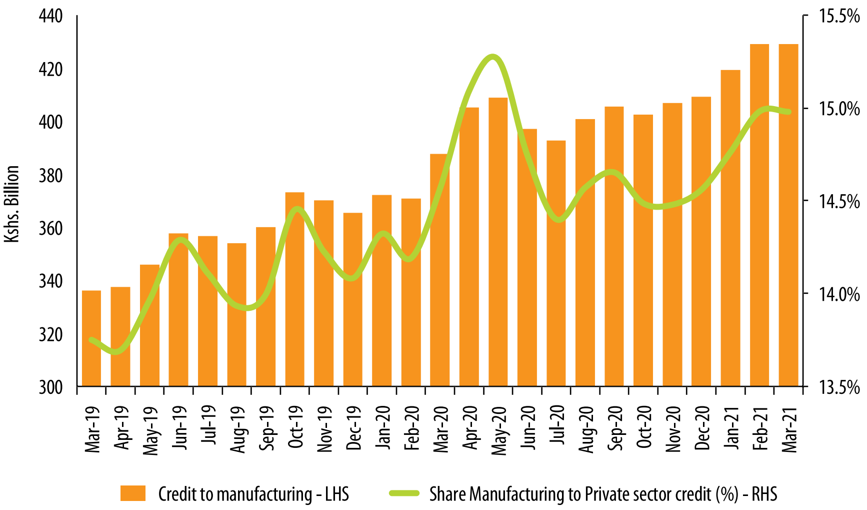


Source: KNBS

Manufacturing

Manufacturing activity rebounded slightly in the quarter, supported by the recovery in production of cement and related galvanised metal sheets and assembled motor vehicles, as well as sugar processing. The Stanbic PMI Index showed that output and new orders indices signalled a slowing in both activity and demand growth in March 2021. As a result, sales grew at the slowest rate since last November, with firms also seeing a loss of momentum from export orders. Other indicators of production and consumption in the sector showed signs of improvement. For instance, cement production edged up by 17.3 percent in the first 2-months of the quarter as production of galvanised metal sheets and assembled motor vehicles rose by 24.0 percent. Sugar processing activity also increased by 14.7 percent during the period, supported mainly by enhanced production. An additional indicator of activity in the manufacturing sector is the credit channelled to the sector. As shown in **Figure 12**, credit to the manufacturing sector maintained its growth trajectory, growing from Ksh.409.3 billion in December 2020 to 429.2 billion in March 2021, representing a credit expansion of 2.39 percent within the quarter.

Figure 12: Credit to the Manufacturing Sector

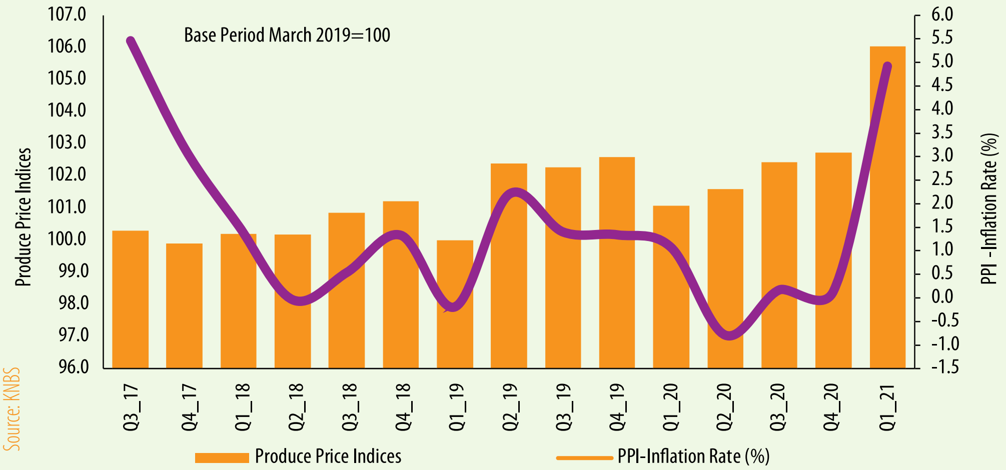


Source: KNBS

Producer price developments

The producer price index (PPI), a measure of the average changes in prices received by producers for their output, continued on an upward trajectory, with the first quarter of 2021 registering the highest value of producer price inflation in recent months (Figure 13). The producer price inflation rose to 4.92 percent in March 2021 compared to 1.07 per cent in March 2020, with the rise attributed to changes in prices for the manufacturing sector that reflect a strong pass-through to producer prices. As a result, manufacturing sector producer prices edged up by the highest margins, by 5.1 percent in March 2021, followed by electricity, gas, steam and air conditioning supply, whose producer prices rose by 3.6 percent. Further, the Stanbic Bank's PMI index, the manufacturing input prices continued their upward trend due to higher fuel prices. Similarly, output prices rose for the third month running, albeit at a more moderate pace than input costs.

Figure 13:
Producer Price Developments



Energy

Total energy generated during the quarter declined to 2,977.3 million kilowatts, from 3,032.62 million kilowatts produced in quarter four of 2020, reflecting a 1.82 percent contraction. However, the energy produced during the first quarter was 3.08 percent higher than that generated over a similar period in 2020 (**Figure 14**). During the quarter, the decrease in energy generation was a 20.91 percent decline in hydropower generation as the energy sector depended largely on geothermal power, accounting for the highest source of energy (45.26 percent). Hydropower, wind and thermal energy accounted for 30.79 percent, 15.03 percent and 8.17 percent, respectively. Solar energy contributed a minuscule 0.74 percent to the total energy production during the quarter.

The crude oil prices in the international market continued to escalate, mainly due to the limited supply in the global market attributed to production restraints by OPEC and its partners (OPEC+) producers. Consequently, this pushed up the domestic pump prices during the period. The Murban crude oil prices rose from US$ 54.0 in January to US$ 64.6 per barrel in March 2021, representing an 18.72 percent rise. The average domestic fuel pump prices shot up drastically, with the super petrol prices reflecting the highest increase, from Ksh.108.0 /litre in January to Ksh.123.7 /litre in March 2021 (representing a 14.65 percent change). Diesel and kerosene prices also rose during the quarter, by 11.56 percent and 12.16 percent, respectively, as the price of 13-kg Liquified Petroleum Gas (LPG) rose marginally from Kshs. 2,018.9 in January to Ksh. 2,031 in February and further to Ksh. 2,074.2 at the end of the quarter, representing a 2.74 percent overall increase during the quarter (**Table 1**). The persistent fuel cost increases were expected to exert upward pressure on inflation from its direct contribution through fuel inflation and indirectly via fuel's role in the production of other consumer goods.

> **"Crude oil prices in the international market continued to escalate, mainly due to the limited supply.**

Figure 14:
Monthly Electricity Generation by Source

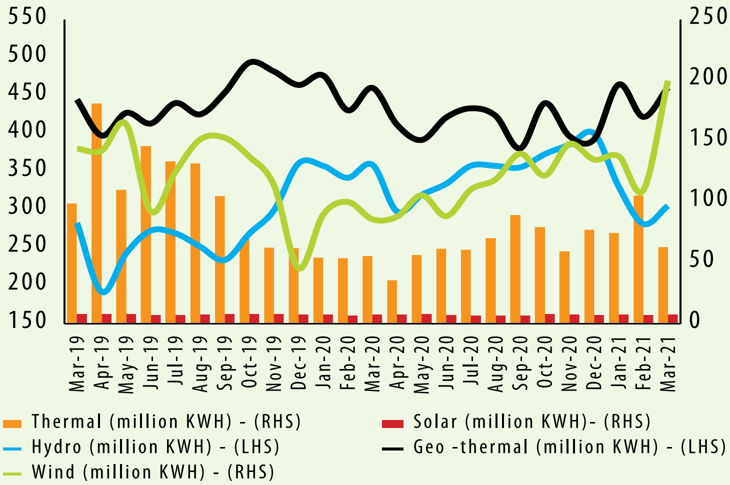


Table 2:
Average Monthly Crude Oil and Retail Fuel Prices

	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Feb-21	Mar-21
Murban crude oil (US$/Barrel)	37.1	43.4	45.2	41.5	40.0	43.0	49.0	61.1	64.6
Super petrol (KES/Litre)	90.3	101.4	104.8	106.3	108.0	107.0	108.0	116.0	123.7
Diesel (KES/Litre)	75.9	92.8	95.6	95.5	94.0	92.0	93.0	102.8	108.6
Kerosene (KES/Litre)	63.8	66.4	84.6	84.1	85.0	83.0	85.0	93.4	98.8
LPG (13Kgs)	2078.5	2075.0	2060.2	2033.6	2018.0	2020.0	1977.0	2,031.2	2,074.2

Source: ADNOC oil prices and KNBS

Table 1:

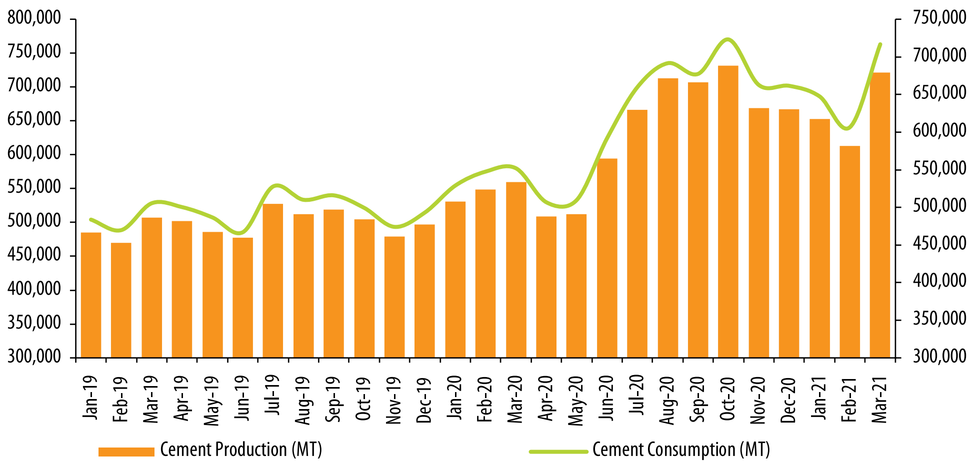
Building and Construction

Building and construction sector experienced some improvement in activity during the first quarter of 2021, as indicated by increased cement consumption primarily driven by the Government's infrastructure projects. The overall demand for cement rose by 8.35 percent, from 661,504 MT in December 2020 to 716,740 metric Tonnes in March 2021. As a result, the production-consumption gap narrowed by 14.70 percent, from 19,378 metric tonnes in the last quarter of 2020 to 16,529 metric tonnes. Compared to a similar period in 2020, which posted a production-consumption gap of 10, 285 metric Tonnes, the gap in the first quarter of 2020 was 61.13 percent smaller than the gap recorded in the first quarter of 2021 (**Figure 15**). The ongoing government infrastructure projects, most of which will be completed at the end of 2021 or early 2022, will continue to support cement consumption and building and construction activity.

Transport and Storage

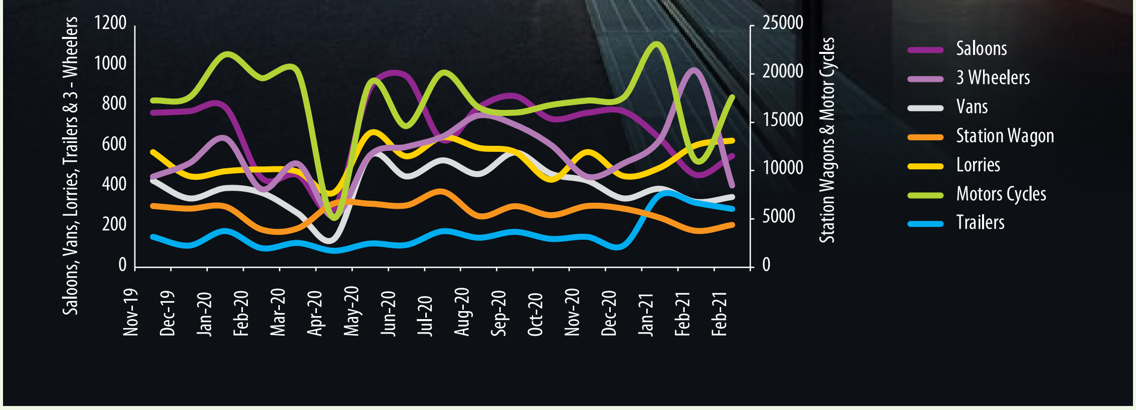
Activity in transport and storage services during the quarter remained sluggish, depicted by slow passenger flows, near-zero growth in motor vehicle registrations and depressed oil deliveries. During the quarter, passenger throughput via JKIA for the first two months of 2021 stood at 313,045, which was 68.8 percent lower than levels reported over a similar period in 2020, reflecting the impact of travel restrictions by the pandemic. Over the same period, motor vehicle registrations remained flat. The number of saloon cars registered stood at 1,652, Station wagons at 13,291, vans at 1,064, lorries at 1,729, trailers at 968, and motorcycles and 3-wheelers at 51,564, and 2,013, respectively. These figures were not substantially different from what was recorded in the first two months of 2020, indicating that the supply of motor vehicles was relatively less disrupted by the pandemic (**Figure 16**). In addition, Kenya pipeline's oil throughput in January was depressed, declining by 8.6 percent to 624,236 thousand litres compared to levels reported for January 2020.

Figure 15:
Cement Production and Consumption



Source: KNBS

Figure 16:
Quarterly Motor Vehicles Registration

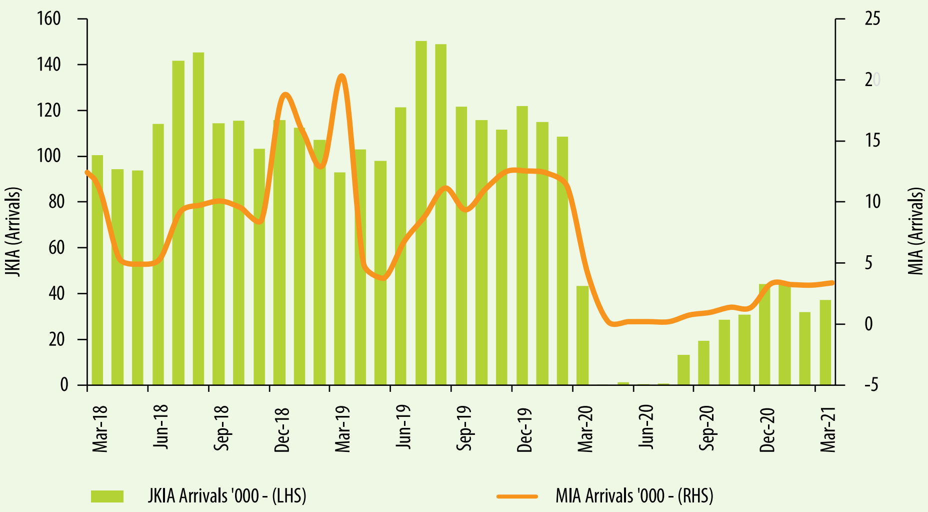


Source: KNBS

Tourism

Tourism activity remained low during the period, travel restrictions imposed by the pandemic and its containment measures persisted. During the quarter, total inbound tourist arrivals stood at 122,498, about 57.6 percent lower than the arrivals in the first quarter of 2020. Nonetheless, the inbound arrivals through JKIA – the main terminal in the country- that stood at 113,249 in the quarter reflected a slight improvement from 103,449 in quarter four of 2020. Arrivals through Mombasa international airport (MIA) remained somewhat flat, reported at 9,249 in the first quarter of 2021 (**Figure 17**).

Figure 17:
Monthly Inbound Tourist Arrivals



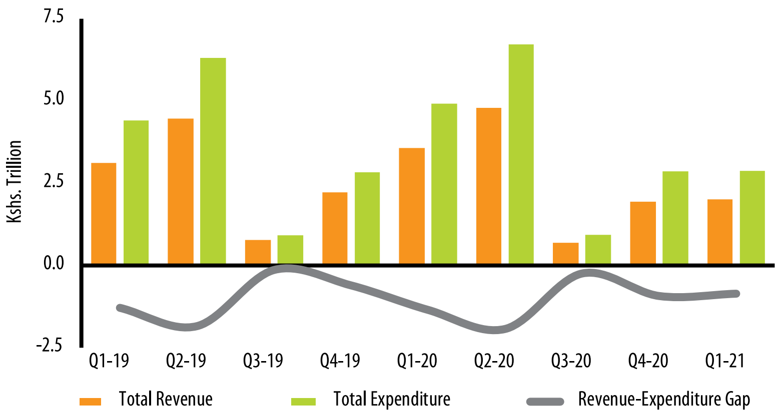
Source: KNBS

Financing of Government

The fiscal space during the first quarter of 2021 widened slightly as the revenue-expenditure gap narrowed from the last quarter of 2020 (Figure 18), driven by a stronger improvement in revenue than the growth in expenditure. As a result, total cumulative government revenue in the fiscal year to the end of the first quarter of 2021 stood at Ksh 3.26 trillion, reflecting a -8.62 percent contraction compared to cumulative revenue in the three quarters to March 2020, which stood at Ksh 3.57 trillion.

Figure 18.

Cumulative Government Revenue and Expenditure



Source: Central Bank of Kenya

On the other hand, Cumulative expenditure stood at Ksh 4.69 trillion in the first quarter of 2021 compared to Ksh 4.92 trillion in the first quarter of 2020, representing a 4.57 percent contraction on an annual basis. As a result, the deficit in the first quarter of 2021 rose by 6.15 percent to settle at Kshs. 1.43 trillion, from the deficit of Kshs. 1.35 trillion in a similar period in 2020. The build-up of the fiscal deficit may appear inconsistent with the government's pursuit of fiscal consolidation. Still, the slowdown in debt build-up may support reducing the public debt-to-GDP ratio to 50 percent in the medium term.

Analyses of the portfolio of revenue sources in quarter one of 2021 mirrored the last quarter of 2020, as both income tax and value-added tax (VAT) dominated, just as in the previous quarter. As shown in **Figure 19**, income tax was the top-most important government revenue source, accounting for 37.2 percent of total revenue in the first quarter of 2021. Value-added tax (VAT) was the second most important source of revenue and contributed 23.2 percent as excise duty, and import duty accounted for 13.3 percent and 6.4 percent, respectively. During the same period, non-tax revenues accounted for 16.7 percent.

Figure 19.
Quarterly Revenue Structure

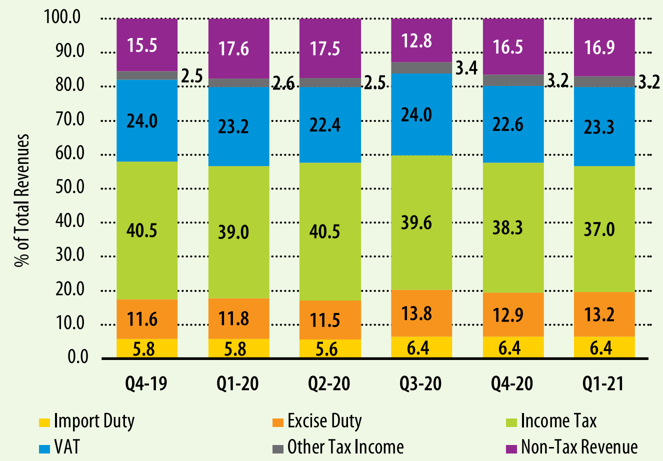
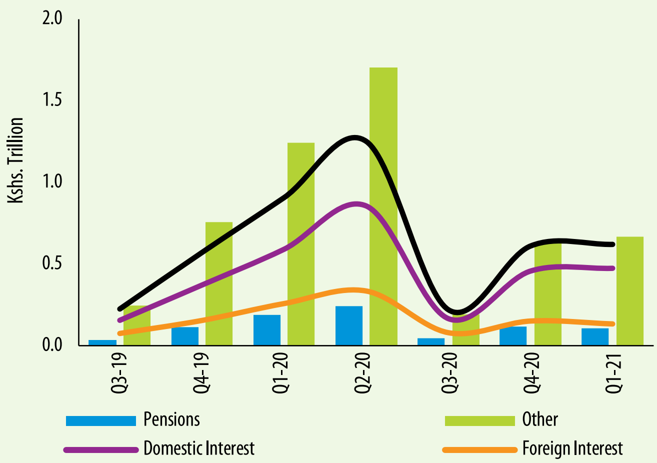


Figure 20.
Quarterly Expenditure Structure



Source: Central Bank of Kenya

The expenditure dynamics had slight deviations from the previous quarter. At the top of the expenditure was wages and salaries which stood at Kshs. 0.6 trillion, thereby accounting for 31.1 percent of the total expenditures in the quarter. Foreign and domestic interest expenses during the period were Kshs. 0.13 trillion and Ksh. 0.47 trillion, respectively, accounting for 30.7 percent in the first quarter of 2021, marginally lower than 31.1 percent in the previous quarter. Expenditure on pensions declined by 9.6 percent to settle at Ksh. 0.10 trillion, consequently slowing down the three-fold growth experienced in the previous quarter (**Figure 20**).

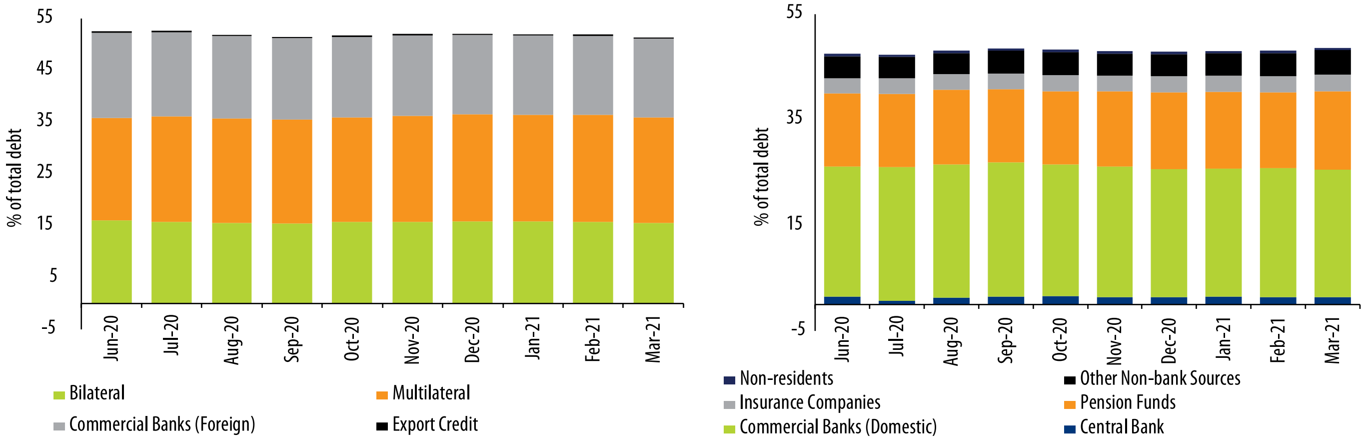
Public Debt

Kenya's stock of debt grew marginally by 0.79% in the period under review from Kshs. 7.2 trillion in December 2020, to Kshs. 7.3 trillion by March 2021. Out of the total stock of debt, the proportion contributed by external lenders remained largely unchanged in comparison to the previous quarter, as the multilateral debt accounted for 20.38 percent, bilateral and commercial debt accounted for 15.57 percent and 15.17 percent, respectively. In addition, the proportion of export credit during the period remained largely unchanged, accounting for 0.25 percent of the total debt by the end of the quarter (**Figure 21**).

A disaggregation of the domestic debt by lender showed that commercial banks accounted for the largest share of government

Figure 21:
External and Domestic Debt and its Composition

A. External debt as a percentage of total debt *B. Domestic debt as a percentage of total debt*

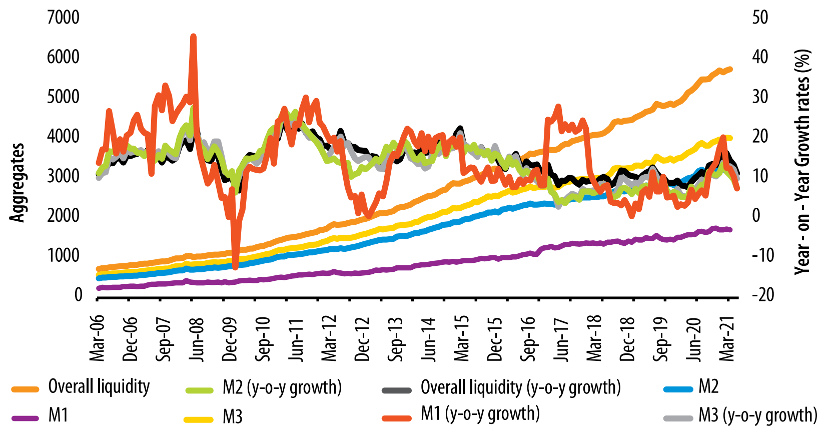


debt, holding 24.21 percent, followed by pension funds, insurance companies and other entities, as well as the Central Bank, which, respectively, accounted for 14.82 percent, 3.20 percent, 4.63 percent and 1.36 percent of total debt during the period (**Figure 21**).

Money Supply

Monetary aggregates registered slight growth in the first quarter of 2021, supporting an overall improvement in the liquidity conditions. The stock of overall liquidity in the 12 months to March 2021 rose by 11.37 percent to Kshs. 5,769.05 billion, compared with a growth of 10.29 percent in the 12 months to March 2020. Compared to the stock of liquidity at the end of December 2020, the March 2021 levels were 0.5 percent higher, implying some enhanced liquidity conditions in the market, consistent with the accommodative monetary policy measures adopted since March 2020. Out of the overall liquidity, a disaggregation shows that broad money (M3) was the main contributor to the liquidity improvement, having increased by 10.08 percent over the 12 months to March 2021, as changes in quasi-money (M2) and narrow money were lower (7.69 percent and 0.21 percent, respectively) during the period (**Figure 22**).

Figure 22.
Trends in Monetary Aggregates



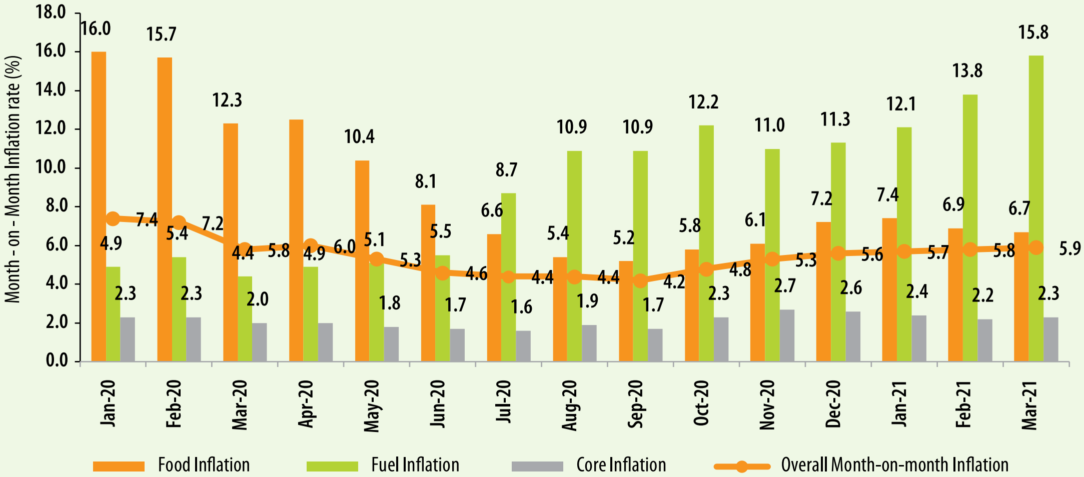
Source: Central Bank of Kenya

Inflation

Inflationary pressures edged up slightly in the quarter ending March 2021, reflecting an upsurge in fuel inflation that was less-than-compensated by the moderation in food inflation. The overall 12-months inflation rate rose steadily from 5.3 percent in December to 5.9 percent in March, mainly on account of fuel inflation that increased from 11.3 percent to 15.8 percent over the period as the rise in global oil prices triggered an upward adjustment in local pump prices. Food inflation, however, moderated from 7.2 percent to 6.7 percent over the period. As a result, core inflation (non-food-non-fuel inflation) that reflects the demand side driven inflationary pressures remained largely muted, slightly declining to 2.3 percent in March 2021 from 2.6 percent in December 2020 (**Figure 23**).

Figure 21:

External and Domestic Debt and its Composition



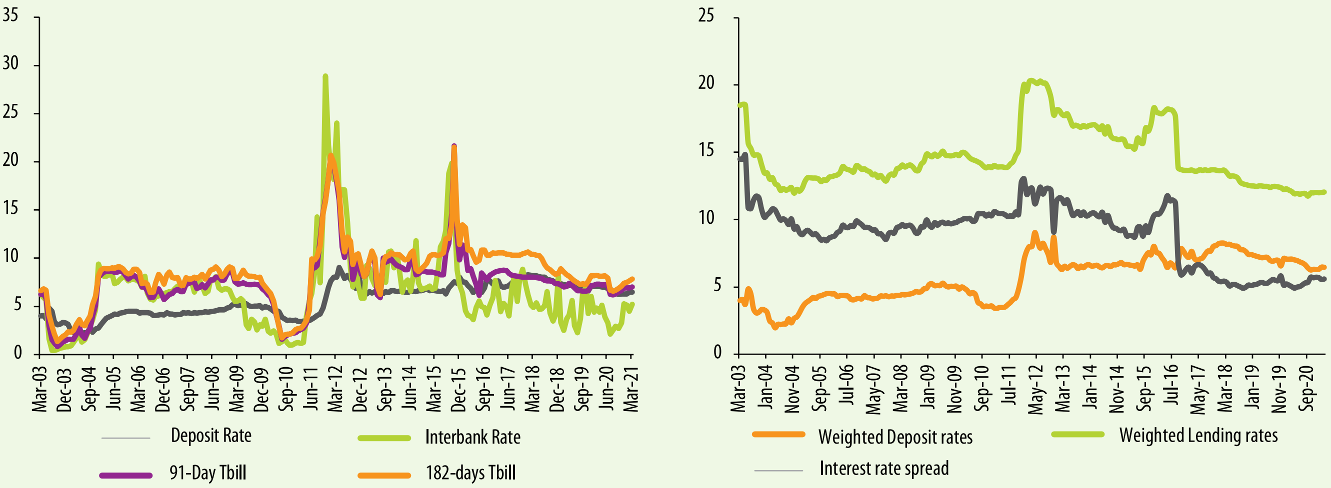
Source: Central Bank of Kenya

Interest Rates

The market interest rates exhibited relatively low volatility, buoyed by ample liquidity in the system consistent with the sustained accommodative monetary policy stance during the period. As the central bank rate (CBR) remained at 7 percent through the period, other key short-term market interest rates generally depicted marginal increases. The average yield rate for the 91-day Treasury bills - the market benchmark rate - rose marginally from 6.92 per cent in January 2021 to 7.03 per cent in March 2021. The average overnight inter-bank rate also increased from 5.12 percent to 5.23 percent over the period, as the average 182-day Treasury bills rate edged up from 7.48 percent to 7.82 percent (**Figure 24**). Over the same period, the average weighted deposit rates rose from 6.30 percent in December 2020 to 6.45 percent in March. The average weighted lending rates for the banking sector remained largely unchanged, rising marginally from 12.02 percent in December 2020 to 12.05 percent in March (**Figure 24b**). This 'stickiness' in lending rates, even amidst the rising average cost of funds (deposit rates), reflects the existing challenges that banks continue to face with their inability to effectively price risk.

Figure 24:

Short term Interest Rates Dynamics



Source: Central Bank of Kenya

Table 2:
Nairobi Securities Exchange Leading Indicators

	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Feb-21	Mar-21
NASI (2008=100) Points	137.68	133.23	139.68	139.89	140.04	145.20	152.11	165.39	158.62
NSE 25 Share Index	3217.11	3059.56	3223.79	3258.78	3170.87	3264.15	3415.24	3624.96	3531.58
NSE 20 Share Index (1966=100) Points	1942.12	1804.10	1794.85	1852.29	1783.68	1759.93	1868.39	1915.68	1846.41
Number of Shares Traded (Million)	552.55	517.07	470.56	524.53	219.42	381.00	369.13	330.68	373.00
Equities Turnover (KSh Million)	12301.61	13469.60	10543.37	13923.59	5880.91	11393.00	10236.93	10819.73	12064.00
Market Capitalization (KSh Billion)	2105.36	2036.04	2144.43	2147.74	2150.06	2229.00	2336.70	2541.16	2437.00

Source: NSE

"Total market capitalisation rose by 4.29 percent from the close of the fourth quarter of 2020 to Ksh. 2,437 billion at the end of the first quarter of 2021.

Capital Markets

The equity market continued to record recovery, as vibrancy rebounded at the Nairobi Securities Exchange (Table 2). Total market capitalisation rose by 4.29 percent from the close of the fourth quarter of 2020 to Ksh. 2,437 billion at the end of the first quarter of 2021, signalling an increase in trading activity. In addition, the activity indices edged upwards with NASI, NSE-25 and NSE-20 indices closing the first quarter at 158.62, 3531.58 and 1846.41 points, respectively, with all except the NSE-20, depicting improvements from levels recorded in December 2020. Comparative to the preceding quarter, the number of shares traded increased by 2.90 percent to 997.68 million in the first quarter of 2021, while the value of equity turnover rose from Ksh. 27,510.84 million in the quarter ending December 2020 to Ksh. 31,735.29 million, representing a 15.36 percent surge.

The primary bond market registered increased subscriptions for the government bonds compared to the previous quarter. During the quarter, the government issued bonds seeking to raise a total of KSh.193.0 billion and received subscriptions worth KSh.288.4 billion, out of which KShs. 228.25 billion were accepted. This represented an average subscription rate of 149.4 percent over the period. In January, the average subscription rate was the highest at 248.83 percent, while subscriptions rates in February and March 2021 stood at 62.42 percent and 97.41 percent, respectively. The stronger investor appetite for bonds reflected investors' preference for bonds over equities during the quarter.

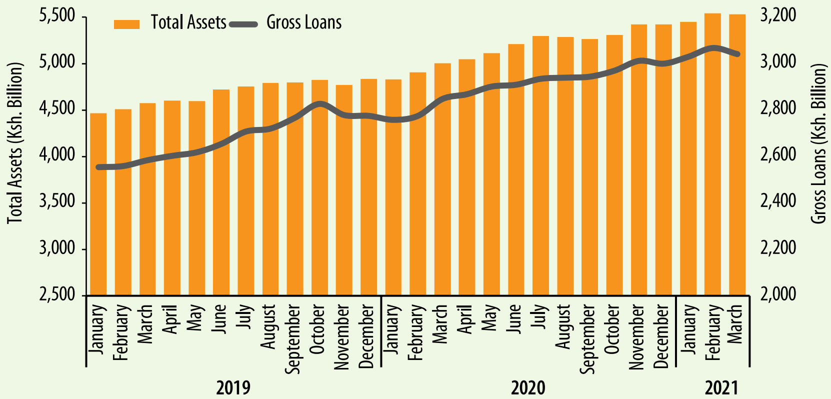
The secondary bond market, especially of government bonds and securities, was characterised by mixed performance. On the one hand, the FTSE NSE Kenya Government Bond Index was on a downward trend, closing at 97.9 points in January, 97.3 points in February, and 97.0 points in March. On the other hand, the bond volumes transacted in the first quarter grew by 27.23 percent from the previous quarter, while the number of deals undertaken rose from 4,037 in the last quarter of 2020 to 5,852, reflecting a 44.96 percent increase. During the quarter, the most trade bond was the 16-year infrastructure bond issued in January 2021.

Banking Sector Developments

During the quarter under review, the banking sector remained strong, supported by an expanded asset base as lending to the private sector increased despite a deterioration in credit risk. The sector's net assets expanded by 2.0 percent, from KSh.5,420.1 billion in December 2020 to KSh.5,528.4 billion in March 2021, largely on account of an 8.1 percent growth in placements. The sector's gross loans increased from KSh.2,999.5 billion in the fourth quarter of 2020 to KSh. 3,040.6 billion in the first quarter of 2021, reflecting a 0.7 percent increase (**Figure 27**). The growth in gross loans and advances was driven by increased credit to both businesses to support their working capital requirements and individual borrowers.

Figure 27.

Total Assets and Gross loans



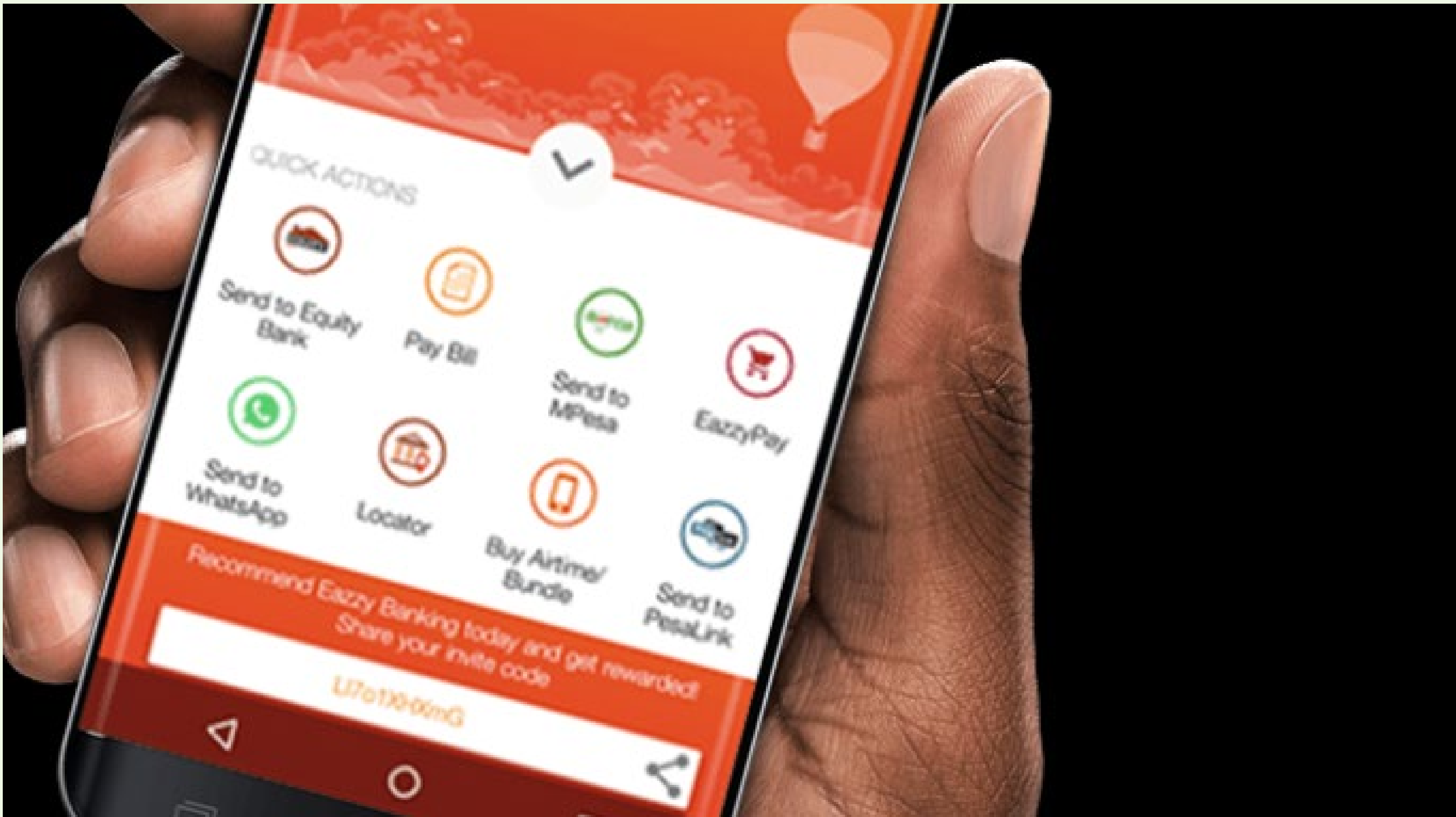


Figure 28:
Liquidity Ratio on an upward trajectory

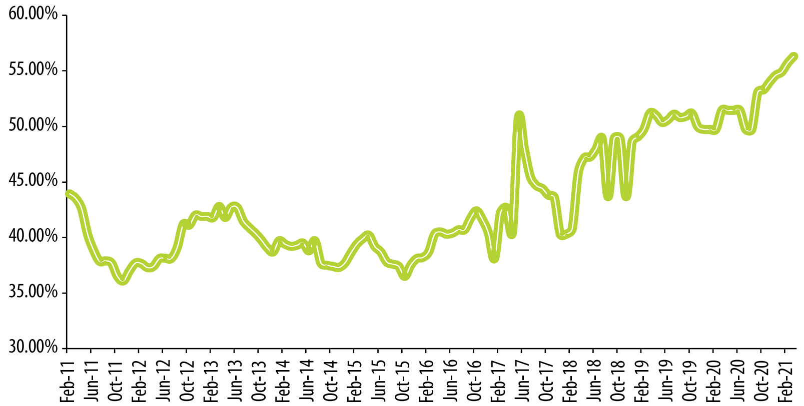
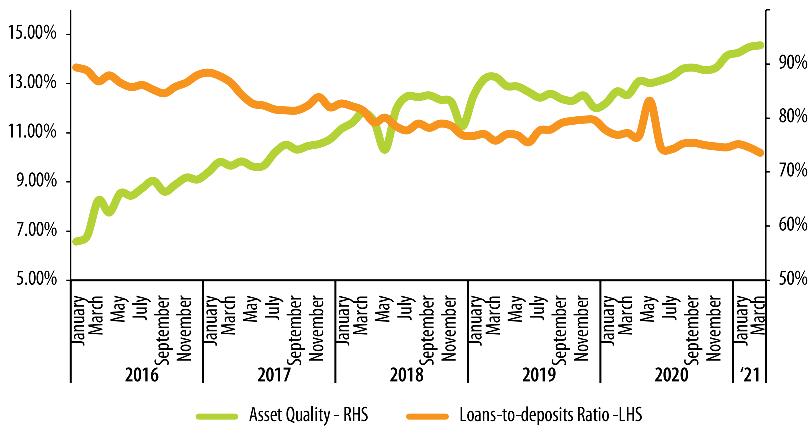


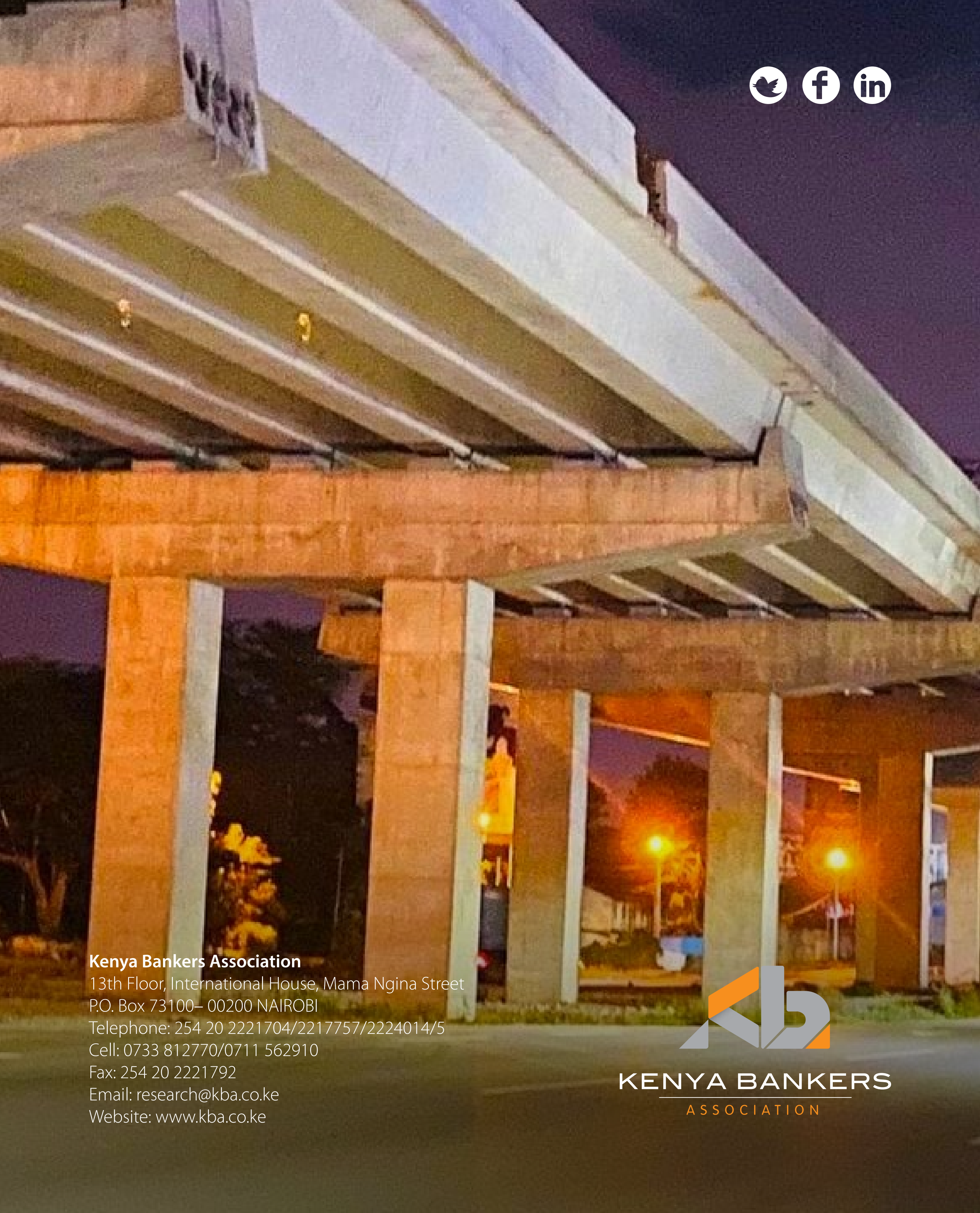
Figure 29: Asset Quality and Loan-to-deposit ratio



Source: Central Bank of Kenya

The industry average liquidity ratio remained above the statutory minimum limit of 20 percent (Figure 28). The industry liquidity ratio edged to 56.30 percent in March 2021, up from 54.60 percent in December 2020, on account of a faster accumulation of short-term liquid assets (mainly investments in government securities) than the growth in short term liquid liabilities.

The industry, however, saw a deterioration in the quality of assets held, with the ratio of gross NPLs rising to 14.6 percent in March 2021 from 14.1 percent in December 2020, as the build-up in NPLS outpaced that of loans (Figure 29). As a result, in terms of volumes, gross non-performing loans (NPLs) increased to KSh.442.6 billion at the end of the first quarter of 2021 from KSh 424.1 billion recorded at the end of the fourth quarter of 2020. This growth in NPLS was largely on account of the adverse of the pandemic won economic activity that depressed loanee income and thus constrained their ability to service loans. At the same time, the banking sector's conversion of deposits to loans, as reflected in the loans-to-deposit ratio, continued on a downward trend as banks exercised tighter credit standards following increased credit risk.



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