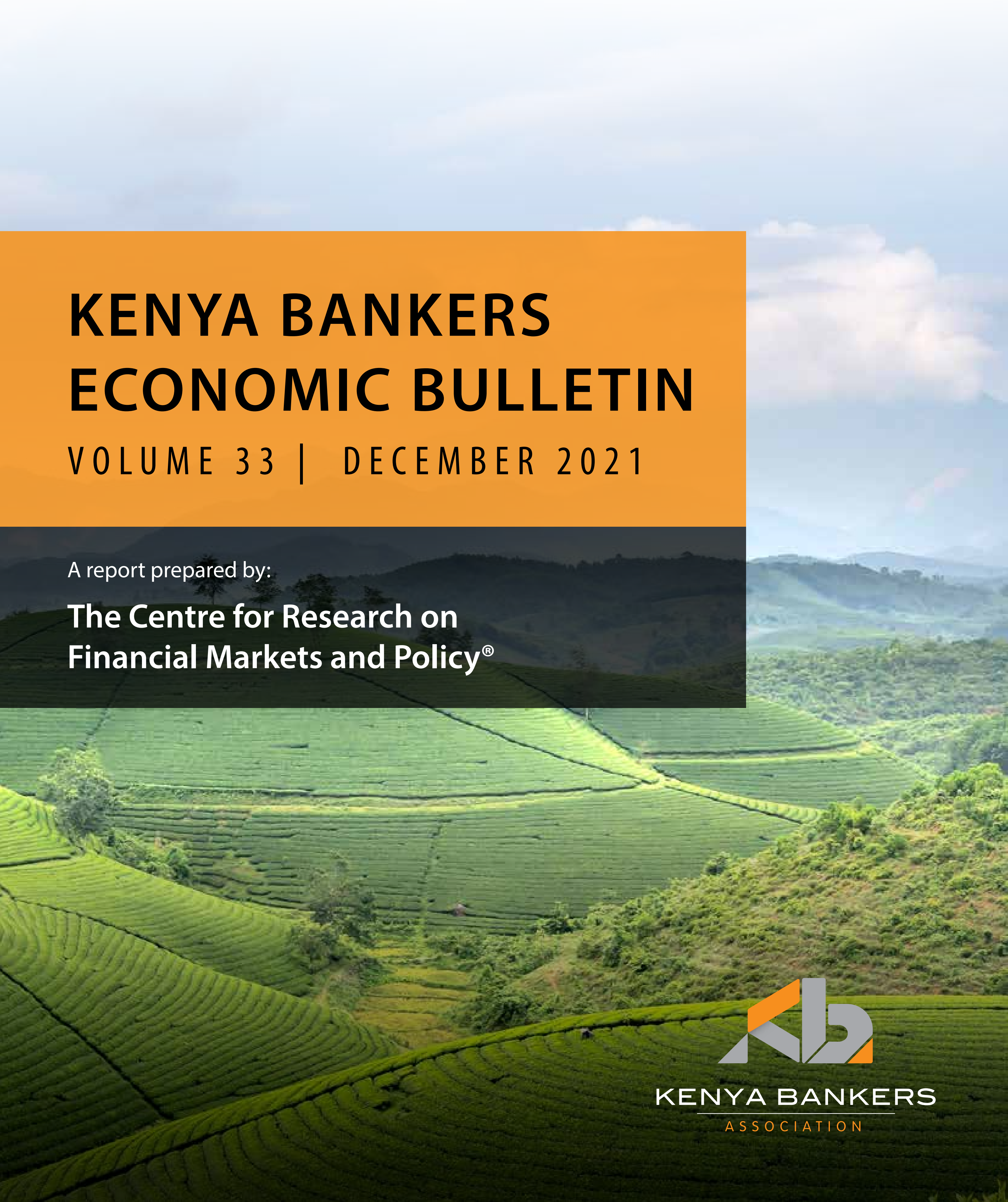

KENYA BANKERS ECONOMIC BULLETIN

VOLUME 33 | DECEMBER 2021

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 third 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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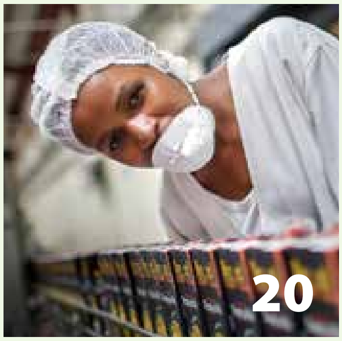

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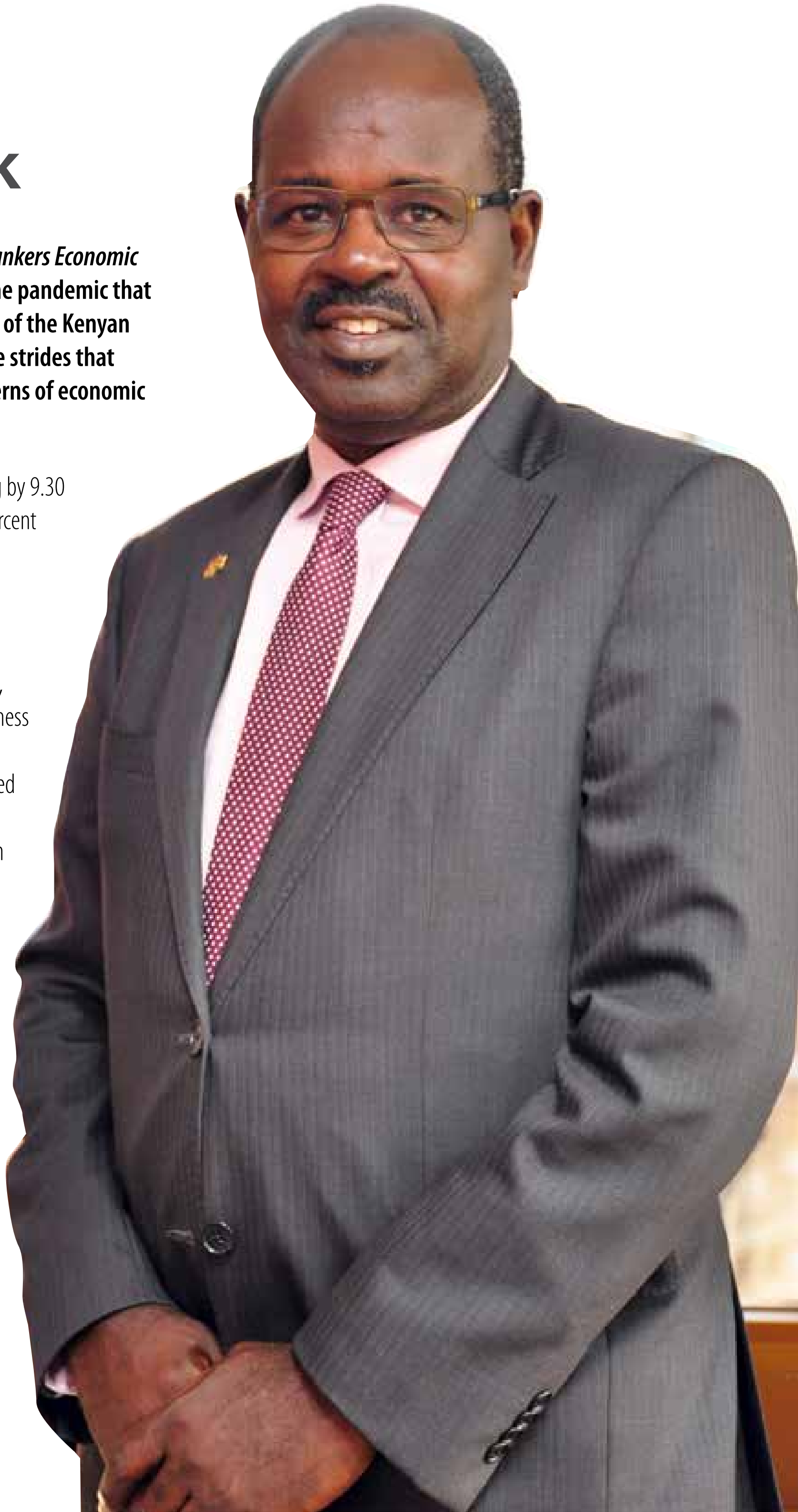
TAWASSAL

FOREWORD

From the CEO's Desk

It is my pleasure to present to you the 33rd issue of the *Kenya Bankers Economic Bulletin*. The year 2021 marked a turnaround in the effects of the pandemic that ravaged the globe from 2020. In this issue, we discuss the state of the Kenyan economy during the third quarter of 2021. The Bulletin reviews the strides that the economy made during the year, with an emphasis on the patterns of economic recoveries across sectors.



As noted in the Bulletin, the economy maintained its strong recovery, growing by 9.30 percent during the quarter under review following a strong growth of 11.0 percent in the second quarter. This was mainly driven by a strong recovery in the non-agricultural sectors as agricultural activity remained depressed on account of unfavourable weather conditions across most parts of the country.

Leading economic indicators also pointed to a strong recovery in the economy, albeit with some evident fragilities. There were notable improvements in business sales, strengthening labour market conditions, enhanced output growth even with shaky business confidence for the next 12 months on uncertainties created by the evolution of the pandemic. Amidst all, the banking sector remained strong and resilient; providing the economy with the much-needed support in terms of financing its recovery.

It is my hope that you will find this issue of the Kenya Bankers Economic Bulletin insightful and useful. While we seek to discuss specific topical issues in the economy with relevance to banking, we are open to receive and consider for publications incisive commentaries on any related topics of interest to the banking sector. For guidelines on such submissions, please get in touch with the Bulletin's Editor at ***research@kba.co.ke.***

We welcome feedback on the content of this Bulletin as we continually seek to improve its relevance to you.

Dr. Habil Olaka
Chief Executive Officer,
Kenya Bankers Association

COMMENTARY

Recovery underway, but remained fragile, bouyed down by the Shadows of the pandemic

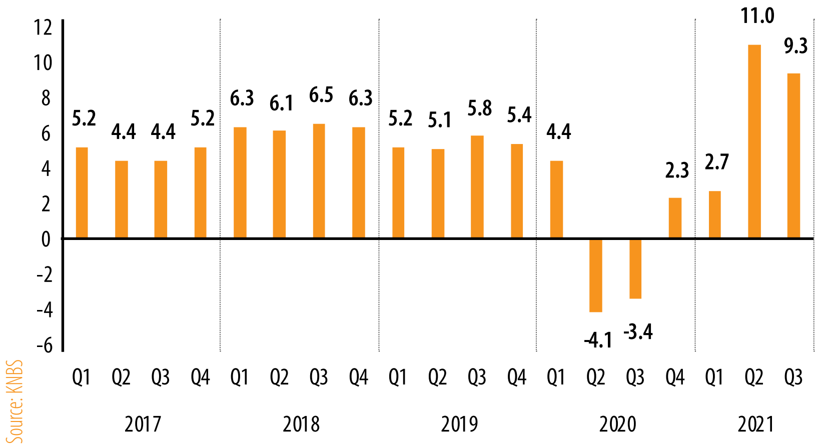
By Samuel Tiriongo, PhD

As the uncertainty created by the pandemic in 2020 and its protracted effects into 2021 waned, many policymakers were keen to support stronger economic recoveries. However, the recoveries remained unsynchronized, as many countries particularly the emerging and frontier economies, struggled with low vaccination levels to curb the spread of the pandemic, slow reopening of global trade and supply chains, and rising supply-side inflationary pressures.

As of October 2021, the IMF's World Economic Outlook report projected global output growth for 2021 at 5.9 percent, largely driven by increased business investments and consumer spending despite the uneven access and distribution of COVID - 19 vaccines, and differences in policy support across countries.

By the third quarter of 2021, the domestic economy was posting strong recoveries particularly in industry and services sectors. Overall, the economy in the first three quarters of the year grew by an average of 7.8 percent relative to a contraction of 0.8 percent in a similar period of 2020. Amidst this impressive performance, agricultural activity was dismal, contracting by 0.8 percent compared to a growth of 4.5 percent over a similar period in 2020, driven by unfavorable weather patterns. The strong growth in the third quarter of 2021 (**Figure 1**), mirrored a resumption of economic activity in the service sectors such as transport and storage, accommodation and restaurants, and strong performance of industry as the economy reopened (**Table 1**).

Figure 1:
Quarterly Real GDP growth



> There is some potency in monetary policy especially if it is targeted at addressing some existing structural impediments that continue to affect the credit market.

Inflationary pressure

Other developments of policy interest during the quarter included rising inflationary pressure, as overall inflation edged up to an average of 6.7 percent from 6.0 percent in the second quarter. This was driven by a dual upward pressure on food and fuel prices that respectively responded to unfavorable weather patterns and rising global oil prices. Core inflation – that reflects demand pressures in the economy- remained low and stable mirroring some negative output gap despite the impressive economic recovery during the quarter. While the buildup in inflationary pressure in the economy was largely driven by supply-side factors, a key concern was its possibility to burst the upper bound target of 7.5 percent on account of the sustained significant domestic fuel pump price hikes.

Credit market developments during the quarter depicted a market that was still at an inflection point. This, coupled with the need to support the fragile economic recovery through extension of private sector credit, meant that the overraching policy trade-off at the end of the quarter was between supporting economic recovery and mitigating any price instability threats. More than ever, the incentives for the banking sector to grow private sector loans remained low despite an elevated credit risk. The resultant built-up liquidity in the system was expected to persist in the near to medium term, unless credit pricing conditions were made more favorable.

Table 1:
Real GDP Growth by Broad Categories

	2019				2020				2021		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Overall	**5.2**	**5.1**	**5.8**	**5.4**	**4.4**	**-4.1**	**-3.4**	**2.3**	**2.7**	**11.0**	**9.3**
Agriculture	4.0	2.0	5.0	3.6	4.5	8.0	-4.3	9.8	0.4	-0.5	0.6
Services	6.4	6.7	6.7	6.8	4.3	-7.0	-4.3	0.0	3.1	15.6	11.7
o/w Accommoda-tion & Restaurant	11.0	12.1	9.9	9.0	-14.1	-57.2	-62.0	-57.7	-33.0	90.1	127.5
Transport & Storage	6.4	7.6	7.6	9.2	2.1	-16.8	-10.2	-6.2	-7.9	18.6	14.2
Industry	4.1	5.5	5.0	4.0	3.9	-1.2	2.6	7.7	4.3	9.2	8.8
o/w Construction	6.1	7.2	6.6	5.7	8.9	6.0	10.2	15.2	6.8	6.8	6.7

Source: KNBS & CBK

PEXELS/ JUHAS IMRE

The Government's fiscal operations in the quarter ending September 2021 resulted in a deficit (including grants) estimated at 0.9 percent of GDP, as revenues underperformed amidst strong expenditure pressures. Consequently, the country's total debt (public and publicly guaranteed) rose by 3.9 percent during the period, out of which domestic and external debt increased by 6.5 percent and 1.5 percent, respectively.

The stock market's overall performance improved in the third quarter of 2021 compared to the previous quarter, as both the NSE 20 share index and the NASI respectively rose by 5.9 percent and 4.3 percent, thus prompting a 2.8 percent rise in market capitalization. However, total equities turnover and the number of shares traded declined during the period.

Amidst these developments, the banking sector stood stable and resilient over the period; sustaining trend growth in total assets, and a modest bulge in deposit base. The sector was liquid and well capitalized; reporting levels strongly above statutory minimums. However, credit risk remained elevated despite recording a moderate improvement over the period, as the ratio of gross non-performing loans (NPLs) to gross loans declined to 13.6 percent in September from 14.0 percent in June.

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

State of the Economy

The wide vaccination and substantial policy support measures, particularly in advanced economies continued to anchor global economic growth during the third quarter of 2021. The IMF's *World Economic Outlook* update for July 2021 maintained growth in global GDP at 6 percent for 2021, while that of 2022 was revised upwards by 0.5 percentage points.

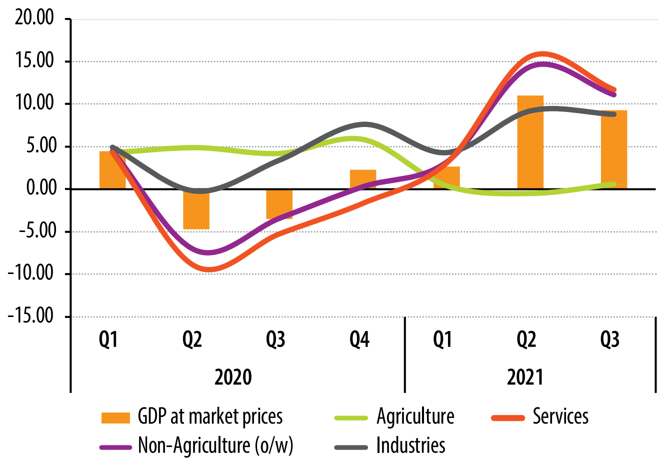
Even so, there were notable divergences in growth prospects across regions and countries largely reflecting variations in vaccinations and the extent of policy support measures. For advanced economies, growth was expected to rebound strongly in 2021, contrast to emerging market and developing economies as their growth was expected to be subdued in the year. For Sub-Saharan Africa (SSA), growth will remain positive, but among the world's lowest in 2021, reflecting slow vaccination and limited policy support measures.

Domestically, economic recovery was evident even though the adverse effects of the pandemic remained a major concern. During the quarter, the economy was characterised by a modest growth of 9.30 percent compared to a strong growth of 11.0 percent in the second quarter (**Figure 2A**). This growth was majorly driven by the services and non-agricultural sectors which grew by 11.70 percent and 11.10 percent, respectively. Equally, the leading economic indicators pointed to a recovering economy, albeit with fragility persisting. The Purchasing Managers Index (PMI) had a mixed performance during the quarter, dropping from 51.0 in June 2021 to 50.6 in July, rising to 51.1 in August before dropping to 50.4 at the end of the third quarter (**Figure 2B**). Overall, the indicator pointed to generally improving economic conditions as a result of rising sales, strengthening labour market conditions, output growth and low business confidence for the next 12 months on account of uncertainties created by the pandemic that were expected to linger for longer.

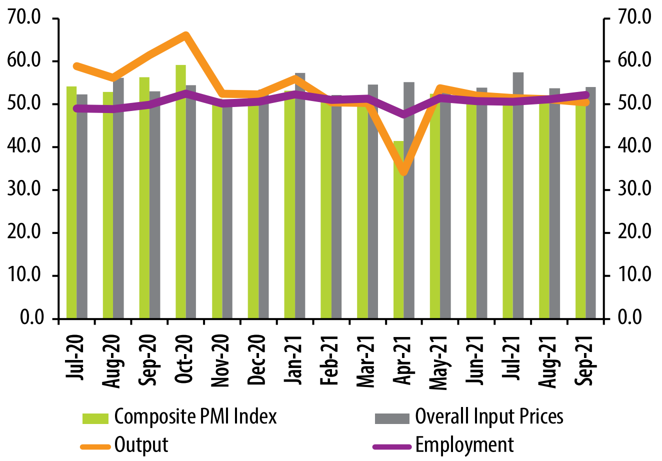
Figure 2:

GDP Performance and Economic Outlook

(2a) Domestic Economic performance



(2b) Trends in PMI



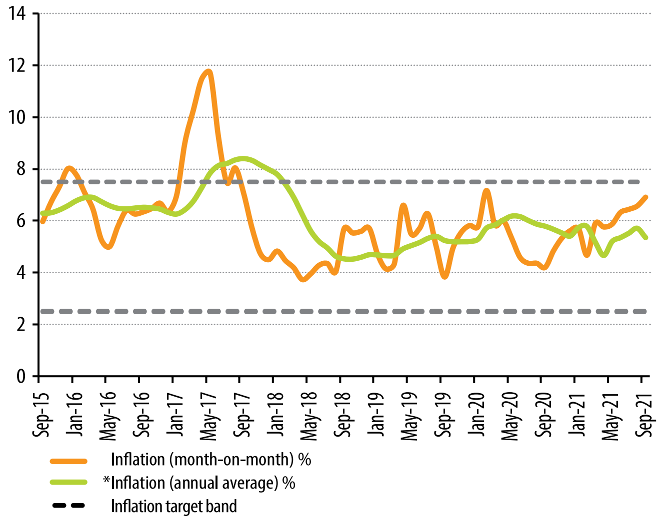
Source: KNBS and IHS Markit®

Inflationary pressure continued building up during the quarter on account of supply-side factors, to the extent of threatening to break the upper bound target of 7.5 percent. Headline inflation rate accelerated to 6.91 percent in September 2021 from 6.44 percent in July 2021 (**Figure 3A**). This was exacerbated by the significant domestic fuel pump price hikes that were attributed to the strong pass-through effects of the rising global commodities and oil prices (**Figure 3B**).

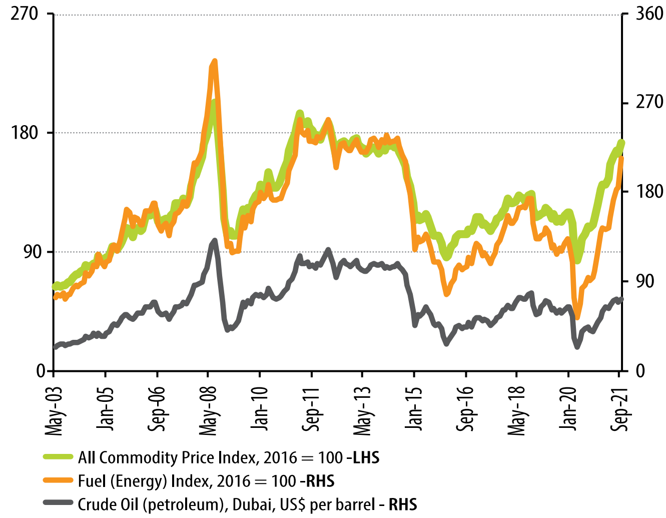
Figure 3:

Inflation trends and Global Commodity and oil price developments

(3a) Inflation Trends



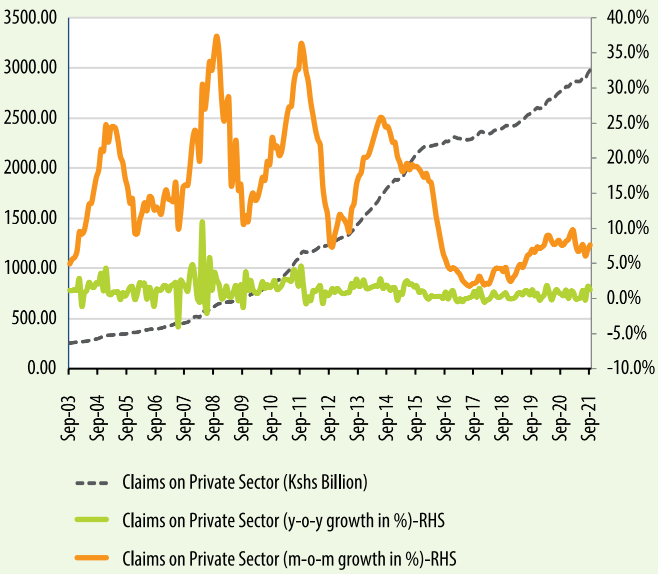
(3b) Global Commodity and oil price developments



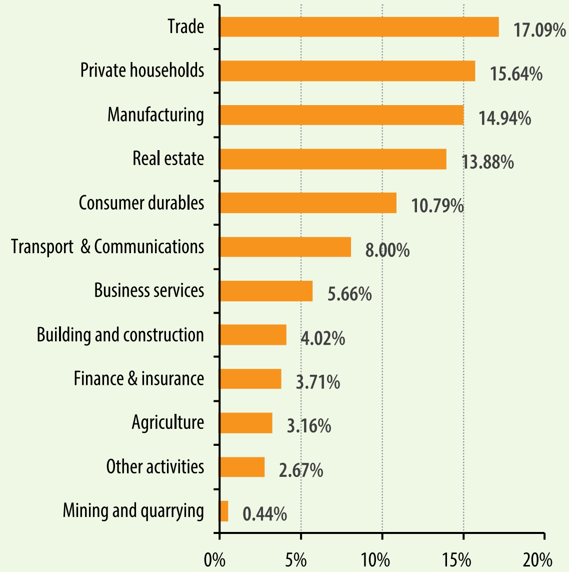
Source: Central bank of Kenya and IMF Global Commodity database

Figure 4:
Private Sector Credit and Growth Dynamics

(4a) Private Sector Credit and Growth Dynamics



(4b) Distribution of private sector credit in Q3 2021



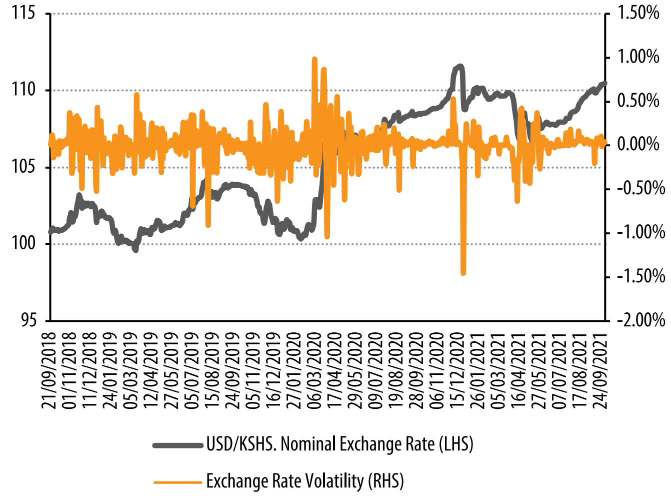
Source: Central bank of Kenya and IMF Global Commodity database

Bank credit to the private sector registered mild growth during the quarter, rising by 7.6 percent in September 2021 compared to 6.1 percent growth in July 2021 (**Figure 4A**). The bulk of credit (72.33 percent) during the quarter was absorbed by trade sector, private households, manufacturing, real estate, and consumer durables, while the agricultural sector received 3.16 percent of total credit during the quarter (**Figure 4B**).

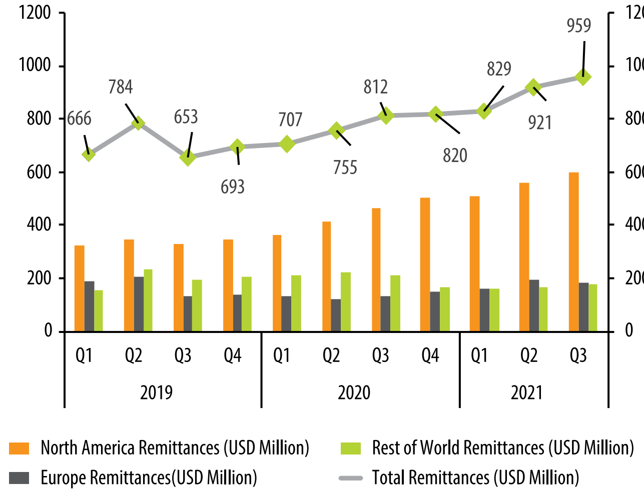
The Kenya Shilling depicted a weakening bias against the US Dollar on the account of a combination of domestic fundamentals and global economic environment. The shilling depreciated by 1 percent against the US Dollar to exchange at an average of Ksh.109.18 in the third quarter of 2021 (**Figure 5A**). Immigrant remittances remained resilient, rising from USD 920.99 million during the second quarter to USD 959.44 million in the third quarter of 2021 (**Figure 5B**) to become a steady source of foreign exchange in the country amidst global disruptions in trade.

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

(5A) Kenya Shilling -US Dollar Exchange Rate Dynamics



(5B) Trends in remittances flow by regions

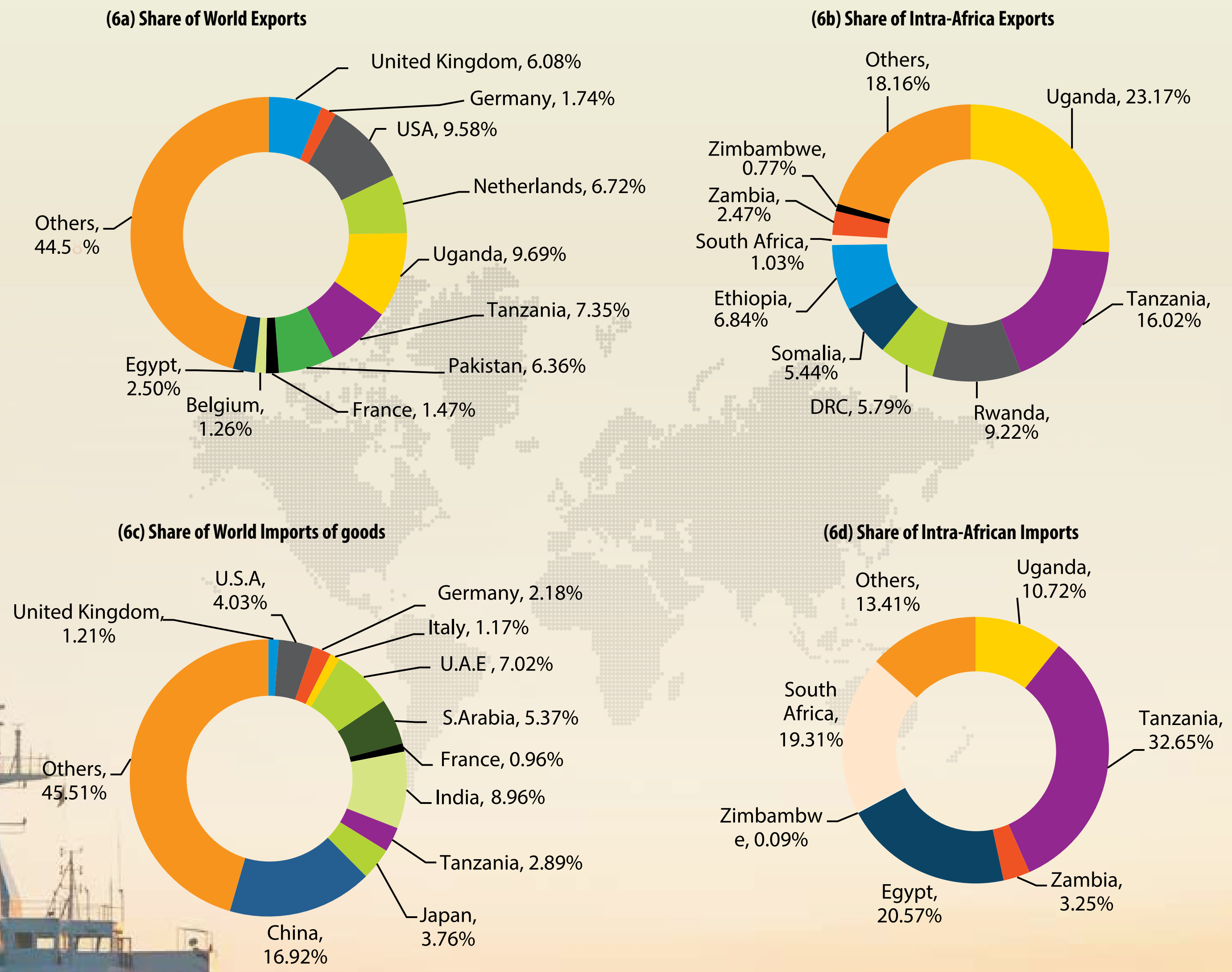


Source: Central Bank of Kenya

Analyses of trade developments show that Uganda and the United States of America remained the leading destination of Kenya's exports, respectively constituting 9.69 percent and 9.58 percent of total exports. Analyses of intra-Africa exports shows that the country's exports to the region continued to provide a rebalancing – sustaining the country's foreign exchange earnings amidst turbulence in global trade markets. During the quarter, Uganda, Tanzania and Rwanda were the leading destinations accounting for 21.3 percent, 16.02 percent and 9.22 percent, respectively. In relation to imports, China was the top source of imports to Kenya, accounting for 16.92 percent of the import expense, followed by India, 8.96 percent and UAE, 7.02 percent. Tanzania, which accounted for 2.89 percent of the total import budget during the quarter, was the leading source of imports from Africa. The share of imports from Tanzania in total intra-Africa imports stood at 32.7 percent during the quarter under review.

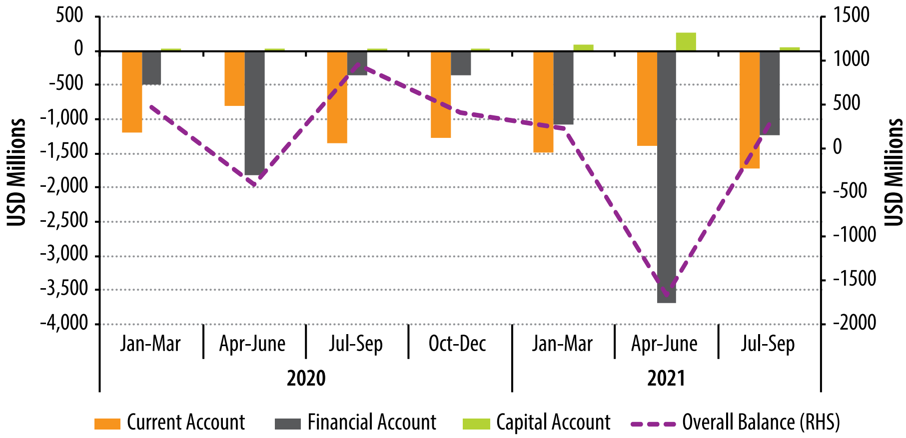
“ Analyses of intra-Africa exports shows that the country's exports to the region continued to provide a rebalancing – sustaining the country's foreign exchange earnings amidst turbulence in global trade markets.

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



Source: Central Bank of Kenya

Figure 7:
Balance of the Payments Performance



Source: CBK Quarterly Economic Review

A review of the balance of payments shows that the overall balance of the external sector recorded in the quarter was a surplus of USD 267 million; an improvement from a deficit of USD 1,665 million in the previous quarter. The net balance of the capital account declined by 80.95 percent, from USD 273 million in the second quarter to USD 52 million in the third quarter of 2021. The current account on its part widened to record a deficit of USD 1,726 million from USD 1,343 million in the third quarter, majorly catalyzed by a weaker exchange rate, lower service receipts amidst rising import bill, which more than offset the growth in receipts from agricultural exports and remittances (**Figure 7**).

Sector Performance

Agriculture

The performance of the agriculture sector remained a strong anchor to Kenya's overall economic growth trajectory, as evidenced by the latter's significant contribution to the gross domestic product (GDP).

During the quarter under review, the sector remained vulnerable to multiple shocks such as extreme and erratic weather conditions and pests that hampered crop productivity. Overall, the sector contracted by 1.8 percent in the third quarter of 2021, reflected mainly in 5.9 percent and 24.1 percent declines in tea and coffee production, respectively.

Tea production, which occurs primarily along the east and west of the Great Rift Valley, declined during the third quarter of 2021 by 16.18 percent to 111,552.90 metric tonnes, down from 133,090.05 metric tonnes produced during the previous quarter, mainly on the account of intermittent dry spells in most parts of the country (**Figure 8**). Similarly, production in the reported quarter was 5.85 percent lower compared to the corresponding period in 2020. Additionally, the average monthly auction price for Kenyan tea edged upwards on account of the minimum reserve price of 2.43 USD per kilogram that was instituted by the Ministry of Agriculture in July 2021 to support a reasonable return for smallholder farmers considering their cost of production.

In the third quarter of 2021, the export volumes and value of both tea and coffee declined (**Figure 9**). In particular, the volume of exported tea during the third quarter declined by 14.64 percent to 124,573.21 metric tonnes, from 145,934.07 metric tonnes produced in the quarter before. Consequently, the tea export value declined by 14.14 percent in the quarter. Similarly, coffee export volume during the quarter declined by 33.12 percent to an estimated 7,680.96 metric tonnes,

Figure 8:
Tea production and Prices

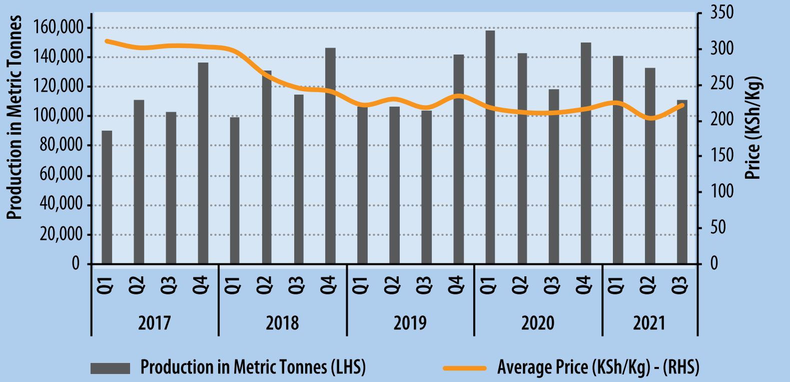


Figure 9:
Value of Tea and Coffee Exports

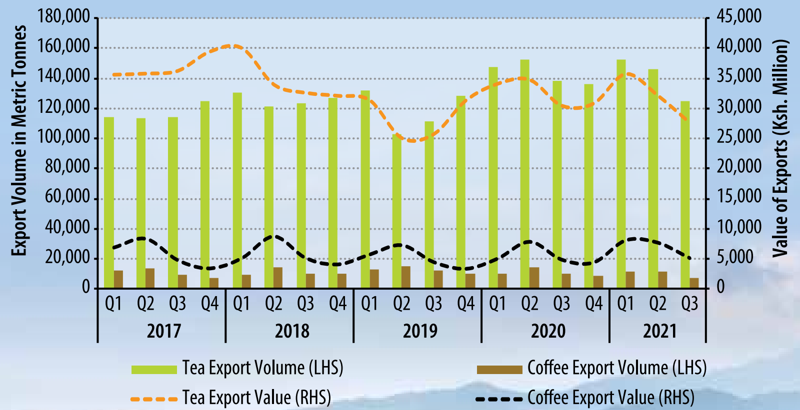
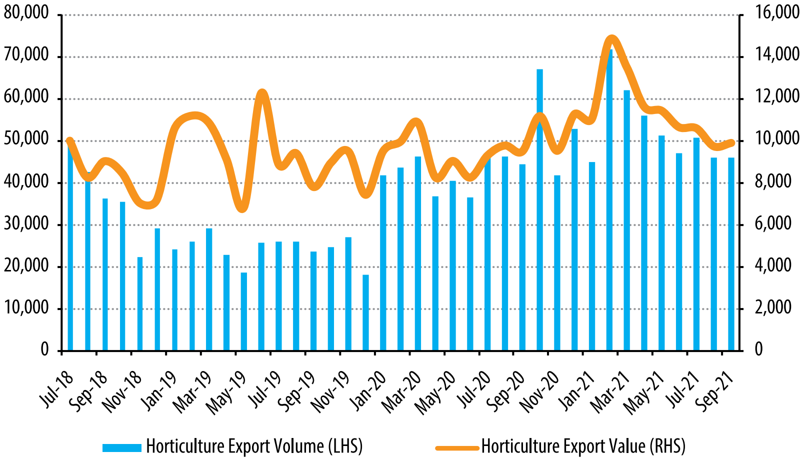


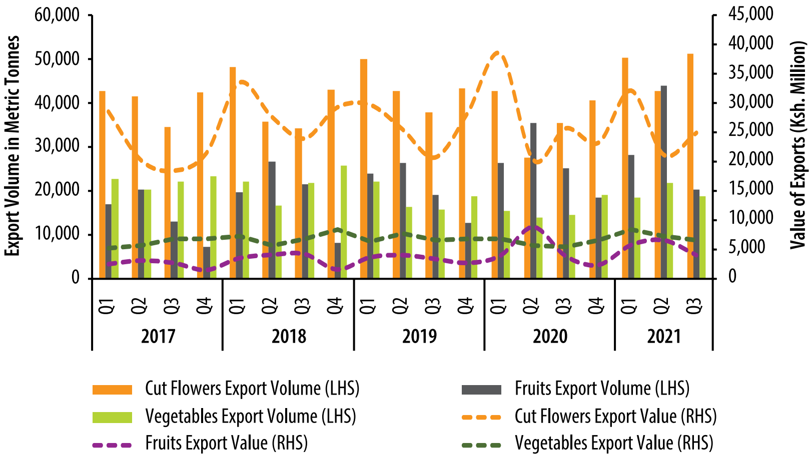
Figure 10:
Horticultural Exports



Source: CBK Quarterly Economic Review

from 11,485.5 metric tonnes reported for the previous quarter, with the decline in coffee exports is attributed to dwindling production attributed to the decline in the land under coffee – with expansion in real estate developments, outdated farming practices and unfavorable weather changes.

Figure 11:
Cut Flowers, Vegetables and Fruits



Source: CBK Quarterly Economic Review

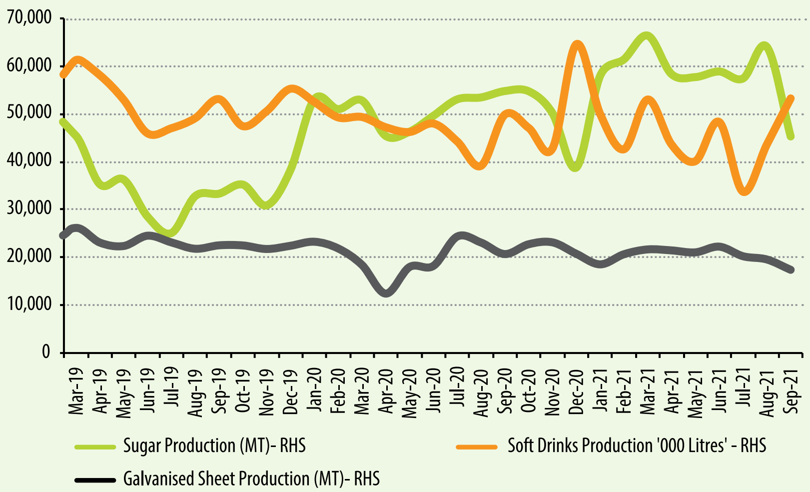
Activity in the horticultural sub sector maintained their steady growth during the quarter, with the production of vegetables, fruits, and cut flowers increasingly becoming the leading foreign exchange earners in Kenya. Nonetheless, the sub-sector experienced subdued demand for fresh produce amidst challenges with the international markets imposing bans on some products. Consequently, the declining trend of total volume and value of horticultural produce persisted during the third quarter of 2021 (**Figure 10**).

However, vegetable export volumes declined to 18,685 metric tonnes from 21,815 metric tonnes in the second quarter of 2021; a development that drove the value down from KSh. 7,149 million in the second quarter of 2021 to KSh 6,564 million in the third quarter. Similarly, the volume of fruits exported dropped by over half (54.16 percent) of the exported volume during the second quarter on account of the challenges affecting avocado and mango exports which are the leading contributors of fruit exports in Kenya.

Manufacturing

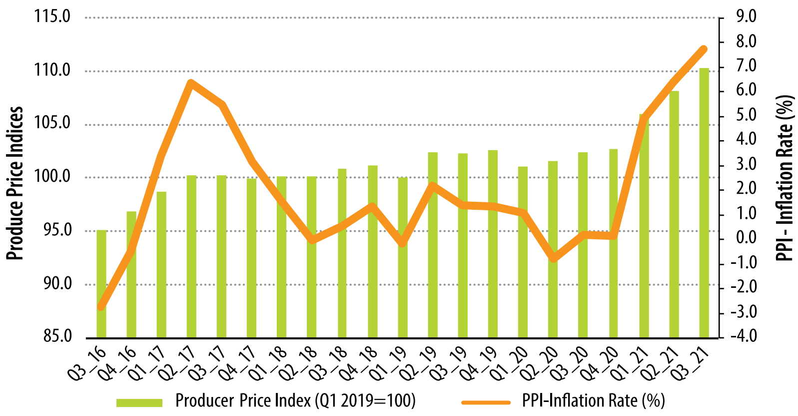
Overall, manufacturing sector expanded by 9.5 percent in the third quarter of 2021, largely driven by increased production of food that rose by 8.6 percent over the period. As depicted in **Figure 12**, however, the production of some food items declined. For instance, the production of soft drinks declined by 1.11 percent to about 131.0 million litres in the quarter, down from 132.5 million litres produced during the previous quarter. Similarly, total galvanized sheet production during the third quarter of 2021 stood at ksh 57,484 metric tonnes, pointing to a 11.70 percent decline in output compared to the preceding quarter. Sugar production during the quarter also declined to 166,994 metric tonnes, compared to 175,168 metric tonnes produced during the second quarter, on account of increased sugar imports from the COMESA region.

Figure 12:
Production in manufacturing sub-sectors



Source: CBK Quarterly Economic Review

Figure 13: Producer Price Index



Source: KNBS

Producer Price Index

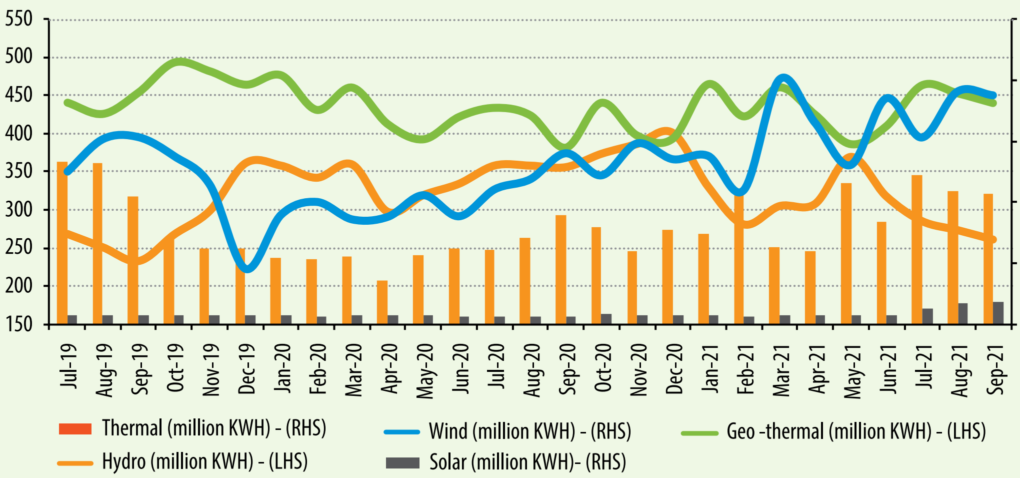
The Producer Price Index, represented in **Figure 13**, rose by 2.46 percent in the third quarter of 2021, thereby reflecting the persistent upward pressure on the product prices. On a quarter-to-quarter rate of change in producer price indices for the industrial sectors, mining and quarrying had the highest increase of 4.3 percent, while electricity followed with a 3.4 percent rise. The manufacturing sector registered an average of 1.9 percent rise in producer prices as water supply prices remained largely unchanged during the quarter.

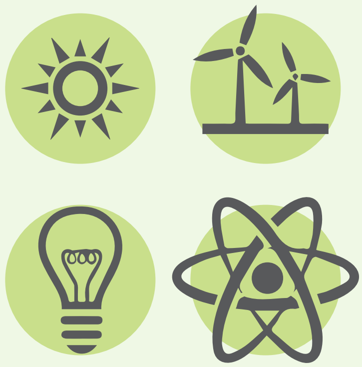
Energy

Geothermal and hydroelectric power have remained the major sources of electricity in Kenya. During the third quarter of 2021, these two sources accounted for 70.36 percent of the total electricity generated during the third quarter. Overall, electricity generation during the quarter increased to 3,094.59 million kilowatts, from 2,975.50 million kilowatts produced in the previous quarter, representing 4.00 percent rise. Significant growth in electricity generation was evident in solar energy generation (115.62 percent growth relative to the second quarter of 2021), as a result of continued investment in the sub-sector. On the contrary, the decline in hydro-electric power generation persisted during the quarter, with an overall decline of 17.43 percent being registered during the quarter (**Figure 14**).

Figure 14:

Production in manufacturing sub-sectors





Analyses of changes in crude oil prices show that the prices remained higher than their pre-pandemic levels. The Murban crude oil prices surged upwards in July 2021, reaching USD 73.5 per barrel, an increase of 2.28 percent from June 2021 (**Table 2**). In August 2021, the Murban crude oil prices moderated to an average of USD 70.3 per barrel, which was higher by USD 25.1 per barrel relative to the August 2020 level. Increases in the international commodity prices were expected to continue for the rest of 2021 driven by temporary mismatches in supply and demand. The average domestic petrol pump prices and LPG gas prices remained unchanged during the first two months of the quarter but rose in September 2021 on account of rising landing costs.

Table 2:

Average Monthly Crude Oil and Retail Fuel Prices

	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21
Murban crude oil (US$/Barrel)	40.1	42.6	49.2	54.4	61.1	64.6	63.2	66.9	71.9	73.5	70.3	73.9
Super petrol (KES/Litre)	108.0	107.0	108.0	107.9	116.0	123.7	123.7	127.2	128.0	128.0	128.0	135.5
Diesel (KES/Litre)	94.0	92.0	93.0	97.3	102.8	108.6	108.6	108.6	108.6	108.6	108.6	116.5
Kerosene (KES/Litre)	85.0	83.0	85.0	88.1	93.4	98.8	98.8	98.8	98.8	98.8	98.8	111.7
LPG (13Kgs)	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	2,394.2	2,420.7	2,445.2

Building and Construction

Building and construction sector during the third quarter of 2021 grew by 6.4 percent, driven largely by sustained government investment in infrastructure projects and strong activity in real estate developments – that supported cement production and consumption in the country. In particular, cement production during the quarter stood at 2,640,167 metric tonnes, up from 2,112,046 metric tonnes reported for the previous quarter. This represented a 25.00 percent increase in cement production (**Figure 15**).

Tourism

Analyses of tourism activities during the quarter under review show that tourists arrivals recorded an improvement. Tourists visiting the country pursued diverse reasons ranging from holiday, business, and conferences, to visiting friends and relatives and other purposes such as sports, medical related purposes, and education. The total inbound tourist arrivals during the quarter stood at 196,105; which was approximately 29.45 percent higher than the previous quarter. In particular, the inbound arrivals through JKIA terminal stood at 203,451 in the quarter compared to 106,497 in the second quarter as arrivals through Mombasa international airport (MIA) terminal stood at 14,442 in the third quarter (**Figure 16**).

Figure 15:
Cement Production and Consumption

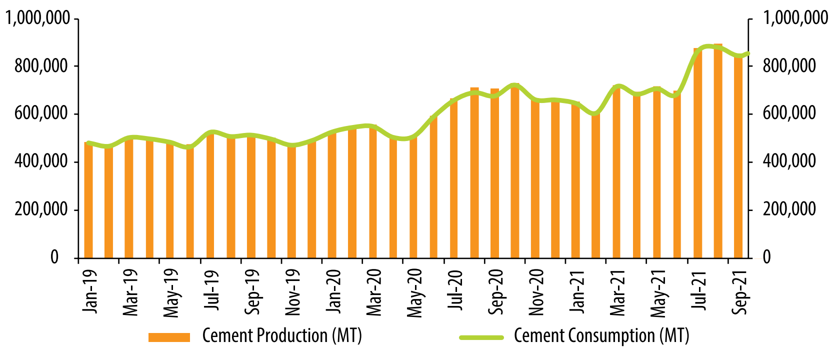
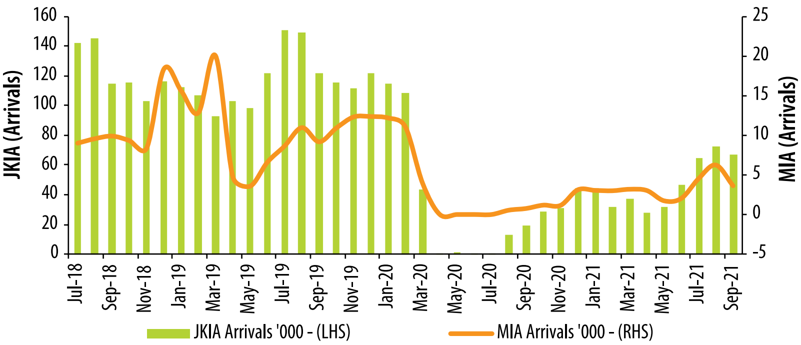
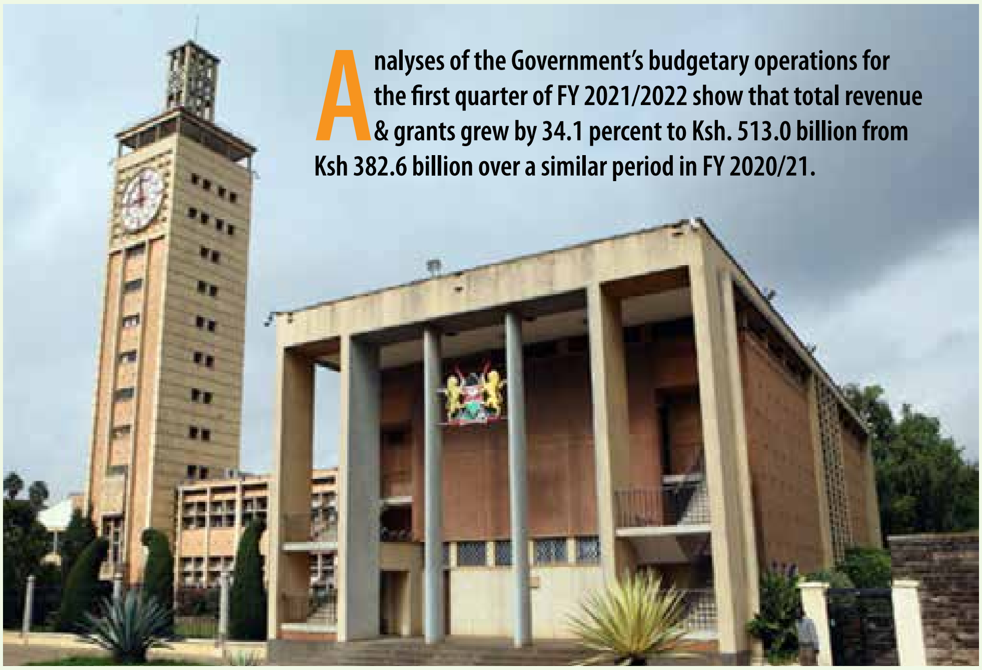


Figure 16:
Monthly Inbound Tourist Arrivals



Government Revenue & Expenditure

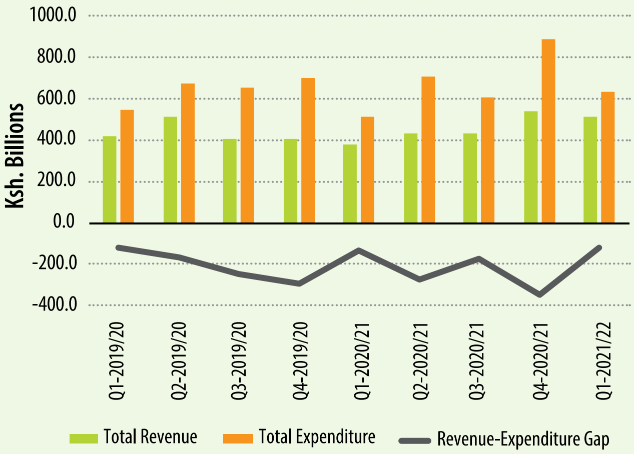


Analyses of the Government's budgetary operations for the first quarter of FY 2021/2022 show that total revenue & grants grew by 34.1 percent to Ksh. 513.0 billion from Ksh 382.6 billion over a similar period in FY 2020/21.

Total expenditures over the period also grew, but by a lower margin of 23.8 percent, to Ksh 631.7 billion in FY 2021/2022. This implied a narrower revenue – expenditure gap of Ksh. 118.7 billion, that was estimated at 0.9 percent against a target of 1.4 percent of GDP (**Figure 17**).

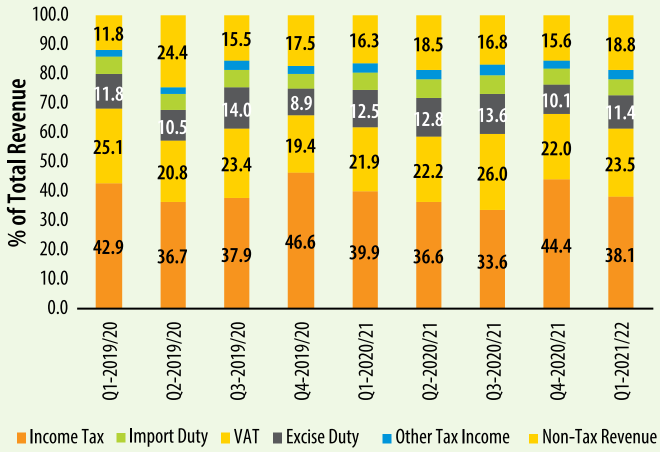
Revenue performance during the quarter was above target by 4.4 percent, as total expenditures were below target by 5.1 percent. The strong revenue performance was supported by an increase In the contribution of VAT, whose share in the total revenue grew to 23.5 percent as shares of other revenue sources declined marginally when compared to a similar period in FY 2020/21 (**Figure 18**).

Figure 17:
Quarterly Revenue-Expenditure Gap



Source: CBK Quarterly Economic Review

Figure 18:
Quarterly Revenue Structure

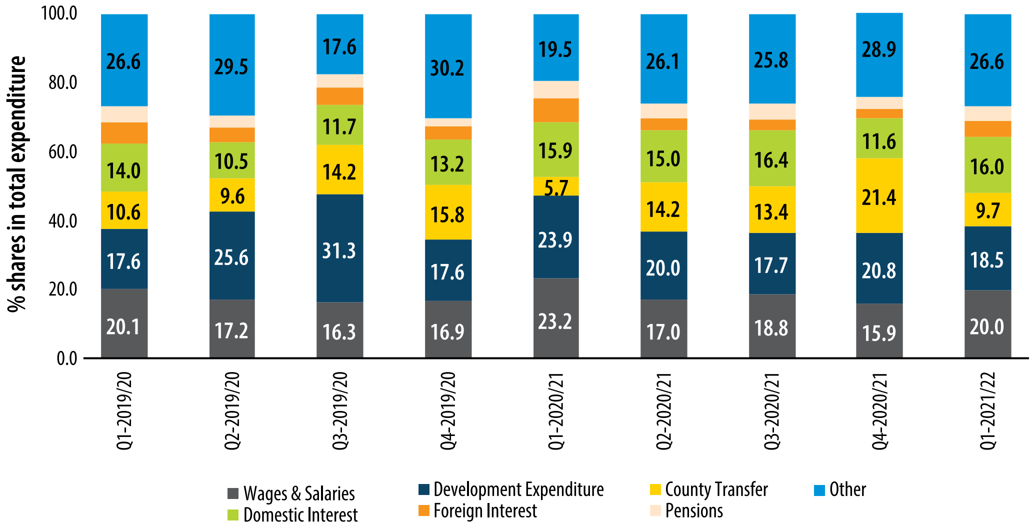


Source: CBK Quarterly Economic Review

Figure 19 shows a breakdown of total expenditure during the first quarter of FY 2021/22. It is evident that during the quarter, wages and salaries accounted for the largest share of expenditures, at 20.0 percent despite the share declining from 23.2 percent over the first quarter of FY 2020/21. The second largest expenditure item was development spending – attributed to the heavy government investment in infrastructure developments. It is also noted that the share of transfers to the counties rose during the quarter compared to a similar period in the previous financial year, reflecting enhanced allocations to support county government operations. The share of domestic and foreign debt interest payments in total expenditures – declined from 22.6 percent in the first quarter of FY 2020/21 to 20.8 percent in FY 2021/22, reflecting some reprieve in debt burden on government revenues.

> **The second largest expenditure item was development spending – attributed to the heavy government investment in infrastructure developments**

Figure 19:
Quarterly Expenditure Structure



Source: CBK Quarterly Economic Review

Government Deficit Financing & Public Debt

Total public debt as at end September 2021 stood at Ksh. 8.00 trillion having grown from Ksh. 7.1 trillion in September 2020. The ratio of domestic to external debt as at September 2021 was 49.2%: 50.8% compared with 48.9%: 51.1% in September 2020 **(Figure 20).** Domestic debt accumulation was largely supported by enhanced investments by insurance companies and pension funds, as commercial banks' share marginally declined. External sector debt accumulation over the period was driven by multilateral debt as the Government was keen to ease cost of borrowing and reduce foreign interest payments in its effort to enhance debt sustainability.

Figure 20:
Quarterly Revenue-Expenditure Gap (Domestic Debt)

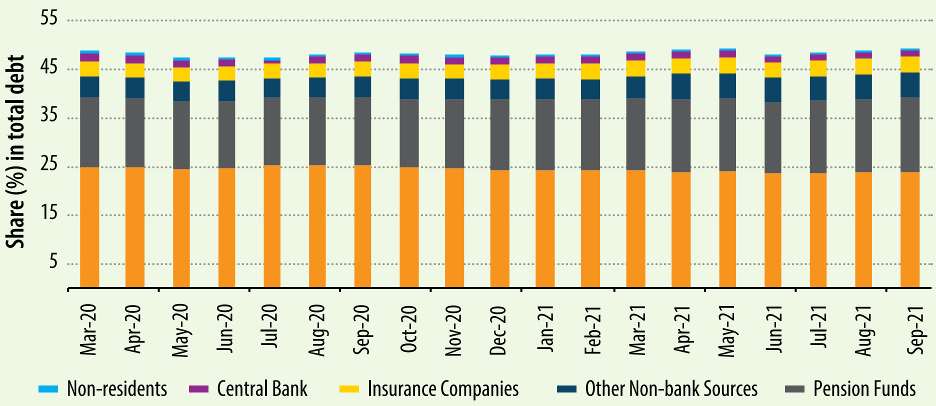
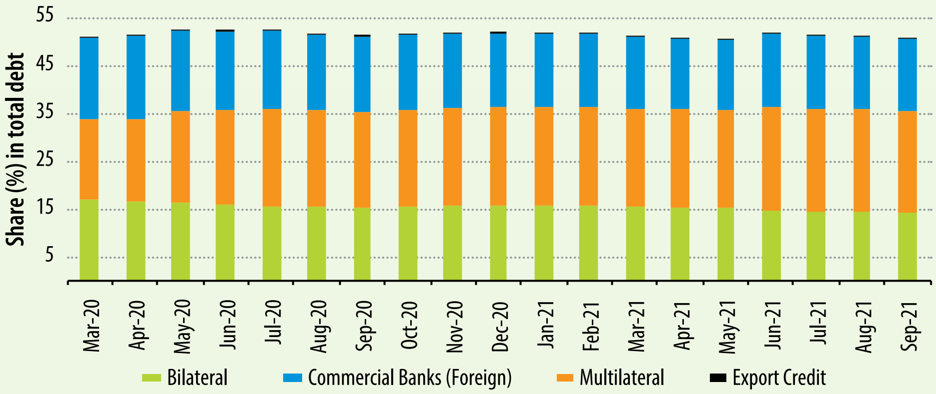


Figure 20:
Quarterly Revenue-Expenditure Gap (External Debt)

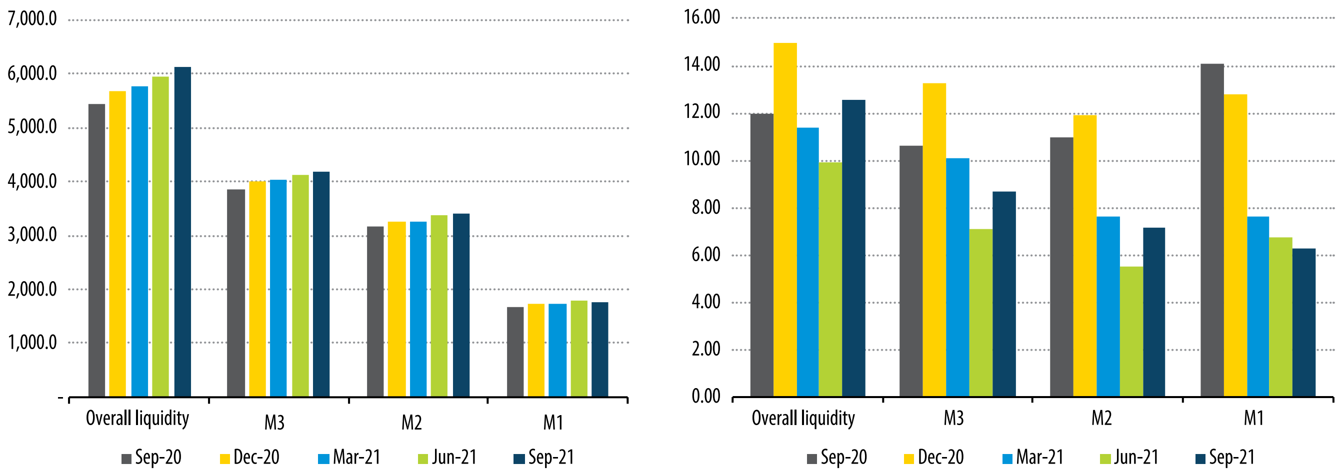


Money Supply

Overall liquidity in the economy grew by 12.54 percent on a year-on year basis by the end of September 2021 to close at Ksh. 6129.7 billion. This was mainly driven by an expansion in broad money supply (M3) which grew by 8.70 percent and a 21.7 percent increase in the stock of non-bank holdings of government securities over the period **(Figure 21).** Investments by individuals in government securities rose as yields on the securities increased during the period. However, there were moderate growth in M1 and M2 monetary aggregates in September 2021 reflecting a steady trend growth in demand, time and savings deposits during the period.

Figure 21:
Trends in Monetary Aggregates

(21a) Volumes, Ksh Billions **(21b) Year-on-Year growth rates, %**

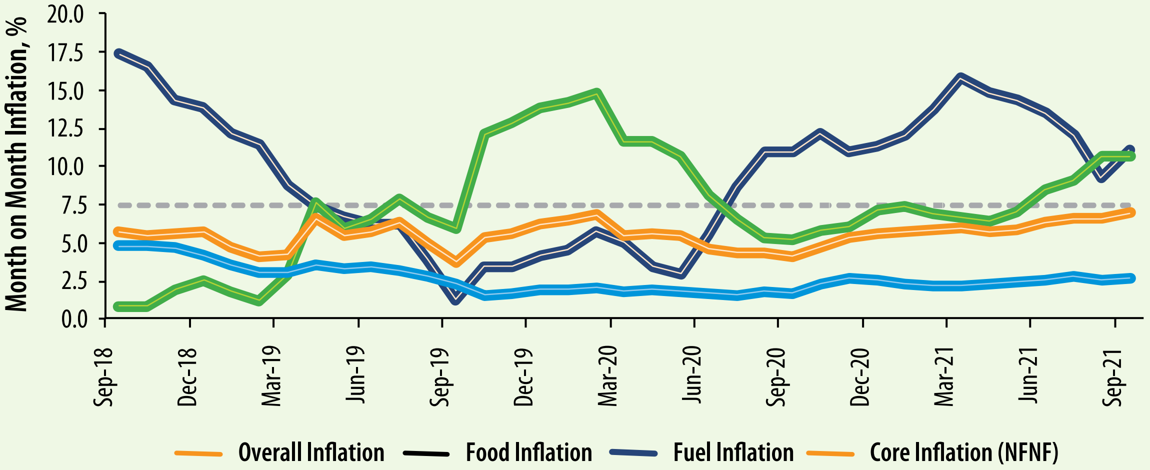


Source: Central Bank of Kenya

Inflation

Inflationary pressures remained benign during the third quarter; staying within the official target range of between 2.5 percent and 7.5 percent **(Figure 22).** This was despite an increase in food and fuel inflation to 10.6 percent and 11.1 percent in September, respectively, on account of unfavorable weather conditions in most parts of the country and an elevated global crude oil prices during the period. Core inflation, however, remained stable at 2.7 percent by September reflecting the existence of spare capacity in the economy and thus muted demand pressures even with the strong recovery of the economy noted over most of 2021.

Figure 22:
Inflation Dynamics



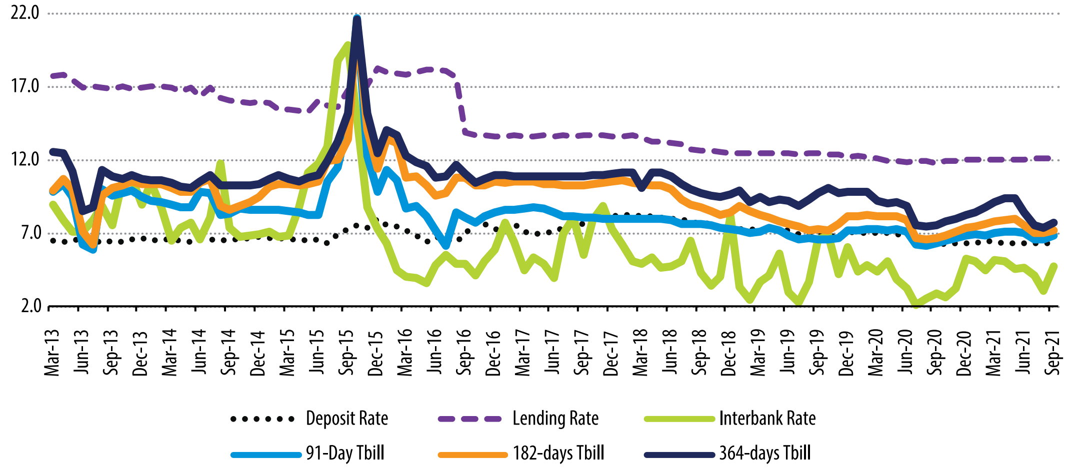
Source: Central Bank of Kenya

Interest Rates

As the Central Bank Rate (CBR) was kept unchanged at 7.0 percent during the third quarter of 2021, market interest rates were largely stable during the period. The average banking industry lending interest rate in September 2021 stood at 12.1 percent, and reflected some stickiness despite market conditions calling for adjustments; an outcome that was attributed to the slow rollout of risk-based pricing frameworks in the banking sector. The banking sector average cost of funds declined marginally -with the average deposit rate in September dropping to 6.3 percent from 6.4 percent in September 2020.

The short-term interest rates however depicted some volatility overtime in response to temporary market liquidity changes. In September 2021, the average overnight interbank rate stood at 4.7 percent compared despite adjustments in the policy rate. Yields on government securities in September also edged up, though marginally, to 6.8 percent, 7.3 percent and 7.8 percent for the 91-day, 182-day and 364-day treasury bills, respectively **(Figure 23).**

Figure 23:
Interest Rates Dynamics

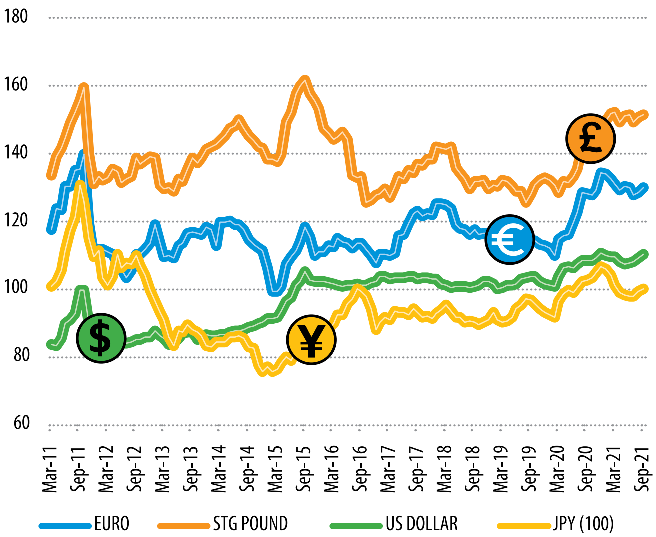


Exchange Rates

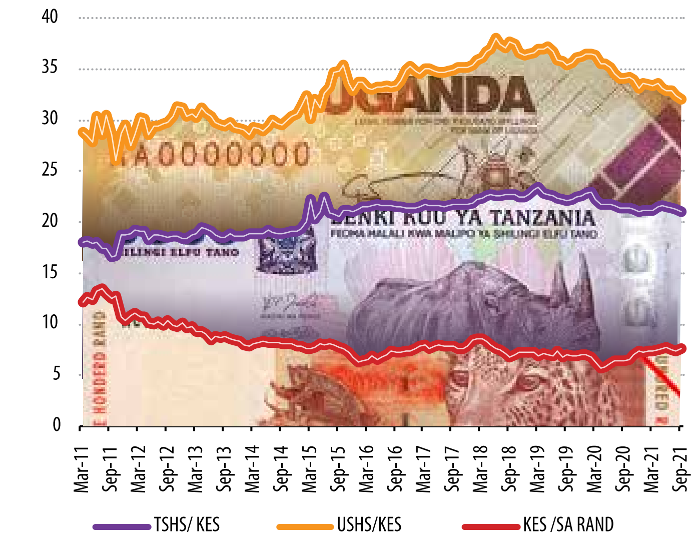
The Kenya Shilling sustained a weakening bias during the third quarter of 2021 against the major global currencies but remained steady against the currencies of countries in the region. As reflected in **Figure 24**, the Kenya Shilling exchange rate weakened against strongly against the Sterling pound and the Euro, but moderately against the US dollar and the Japanese Yen. When compared to its regional counterparts, the Shilling depicted some mixed performance; slightly weakening against the Uganda and Tanzania shilling, but gaining ground against the South African Rand.

Figure 24: Exchange Rate Developments

(24a) Major currencies

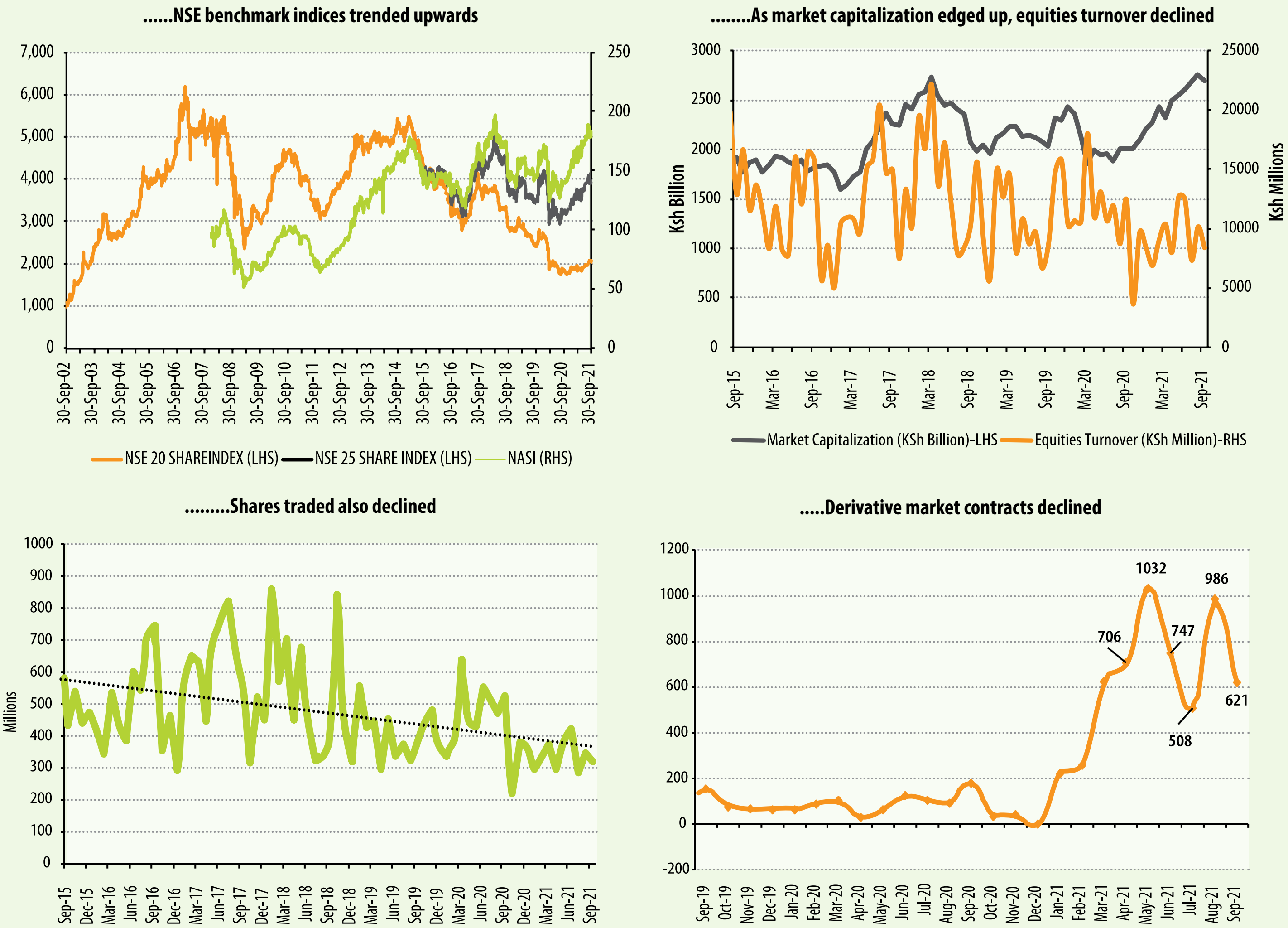


(24b) EAC region currencies



Source: Central Bank of Kenya

Figure 25:
Trends in Nairobi Securities Exchange Leading Indicators



Source: Nairobi Securities Exchange

Capital Markets

The capital market sector exuded impressive performance during the quarter, reflecting some level of recovery in the securities markets from the depressing effects of the pandemic. Notably, all the benchmark indices edged upwards, with the NASI rising by 4.28 percent from 173.53 in June 2021 to 178.31 in September 2021, while the NSE-25 and NSE-20 were up by 3.77 percent and 5.88 percent, respectively over the period. Market capitalization also edged up by 2.83 percent from the close of the second quarter of 2021 to Ksh. 2,778.65 billion at the end of the third quarter. However, there were notable declines in the cumulative number of shares traded and equity turnover, which respectively declined by 2.91 percent and 13.35 percent in the third quarter from levels recorded in the second quarter of 2021. The volume of contracts traded in the derivative markets[1] also declined during the quarter, reflecting continued uncertainty in the markets, from 2,445 in the second quarter to 2,115 contracts in the third quarter of 2021.

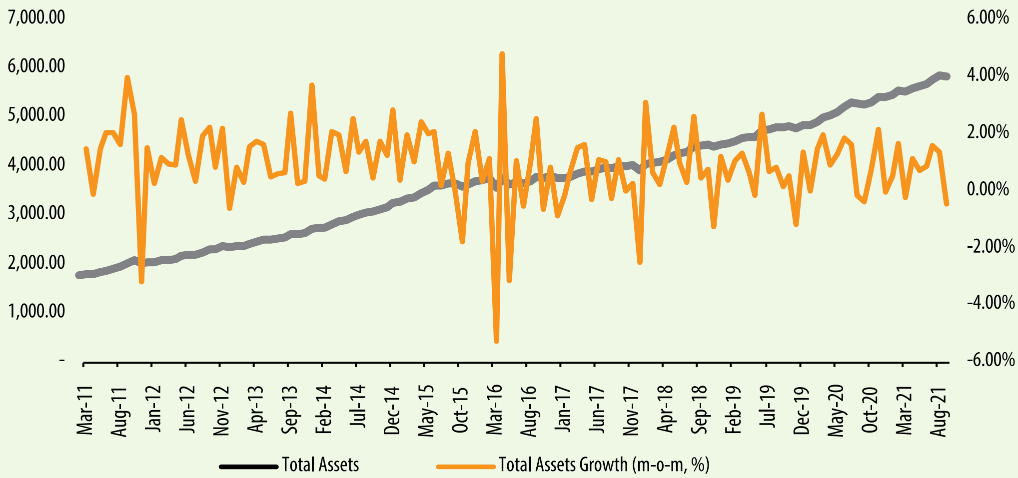
1 The derivatives market, that was launched in April 2019, trades equity index futures based on the NSE-25 index and the single stock futures for Safaricom, Equity Group, KCB Group, EABL and BAT.

Banking Sector Performance

The banking industry continued to depict strong and resilient performance as the economy reeled from the effects of COVID-19 pandemic that occasioned some changes in balance sheets of banks. The sector sustained trend growth in assets, posted an improvement in asset quality and strong liquidity positions.

During the third quarter of 2021, total assets maintained its long-term growth trajectory, to stand at Ksh.5,822.1 billion by end September 2021, having grown by 2.5 percent from Ksh.5,680.0 billion reported in June 2021 **(Figure 26).** The growth in the total assets was attributed to the growth in investments in government securities during the period as banks were cautious to grow the private sector loan book on account of the protracted uncertainties in the recoveries of economies from the effects of the pandemic.

Figure 26: Total Assets



Ksh **5,680 bn**
Total assets as at June 2021

Ksh **5,822 bn**
Total assets as at Sept. 2021

Source: Nairobi Securities Exchange

Similarly, and as depicted in **Figure 27,** the overall liquidity ratio in the banking sector despite recording a slight decline from 56.8 percent in June 2021 to 56.7 percent by September 2021 remained above the statutory minimum limit of 20 percent. The slight moderation in the liquidity ratio reflected an increase in the total liquid assets by 2.3 percent that was more-than-offset by a 2.5 percent growth in the total short-term liabilities.

The sector also noted further improvements in the asset quality during the quarter, as the ratio of total NPLs to gross loans declined to 13.64 percent in September from 14.00 percent in June 2021. The strengthening asset quality was supported by a 2.7 percent increase in gross loans compared to a 0.1 percent increase in NPLs in the quarter **(Figure 28)**.

The total shareholder's funds remained on a mild upward trajectory, rising by 3.81%; from Kshs. 850.80 Billion in June 2022 to Kshs. 883.20 Billion in september 2021 **(Figure 29)**. Even so, the month-on-month growth was on a declining trend; in July 2021 it grew by 1.64%, then 1.47% in August and finally closed the quarter by registering 0.60% growth in September 2021.

Figure 27: Liquidity Ratio

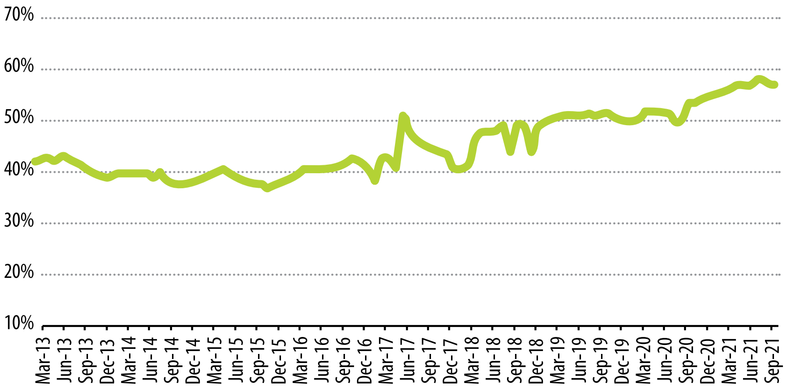


Figure 28: Asset Quality

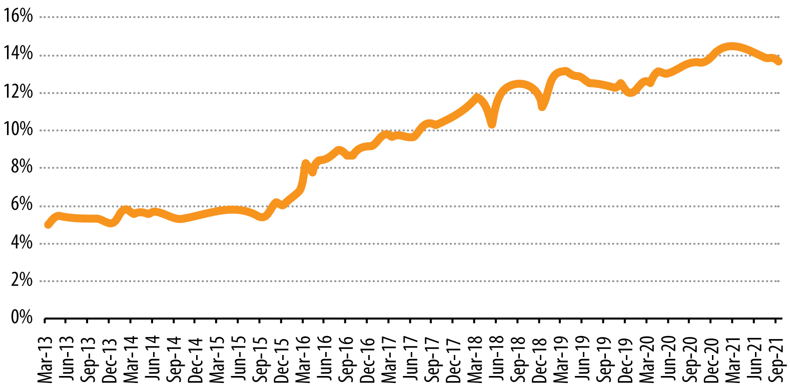
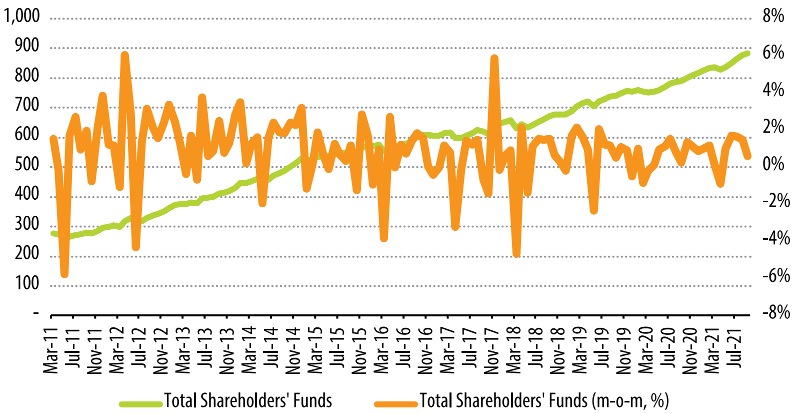


Figure 29: Total shareholder Funds



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