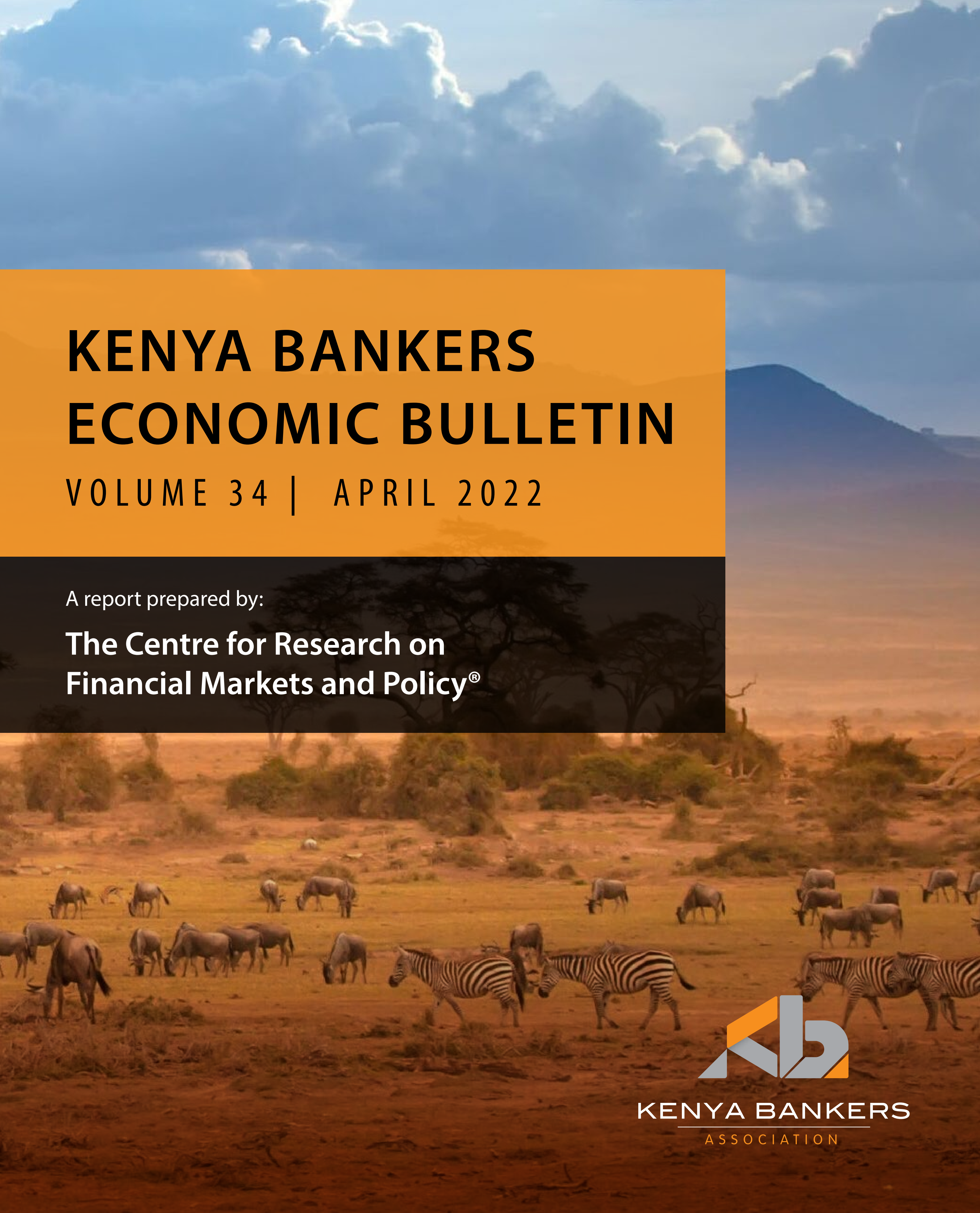

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A report prepared by:

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 fourth 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 34th issue of the *Kenya Bankers Economic Bulletin*. In this issue, we discuss the state of the Kenyan economy during the fourth quarter of 2021. The *Bulletin* reviews the strides that the global and domestic economy made during the year, their outlook and implications on the financial sector.

The global economic recovery that was projected and underway for 2021 was starting to slow down on account of forecast downgrades of growth rates for the U.S and China occasioned by rising energy prices and reimposed mobility restrictions associated with re-emergence of COVID-19 infections. In the domestic scene, economic performance for the fourth quarter of 2021 showed a growth rate of 7.4 percent , slightly down from 9.3 percent in the third quarter and 11.0 percent in the first quarter. The easing recovery of the economy was driven by moderation in agricultural activity occasioned by unfavourable weather patterns across the country, sustained from the third quarter.

Nonetheless, leading economic indicators also pointed to a strong recovery in the economy, albeit with some evident fragilities. There were notable improvements in new business orders and strengthening employment levels particularly in the manufacturing sector. This business recovery continued to support an enhanced uptake of private sector credit. Amidst all, the banking sector remained strong and resilient; depicting strong capital and liquidity positions.

As you review this report, it is my hope that you will find this issue of the *Kenya Bankers Economic Bulletin* informative, 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, EBS
Chief Executive Officer, Kenya Bankers Association

COMMENTARY

Fragile economic recovery at the centre of policy concerns, amidst energy price hikes

By Samuel Tiriongo, PhD

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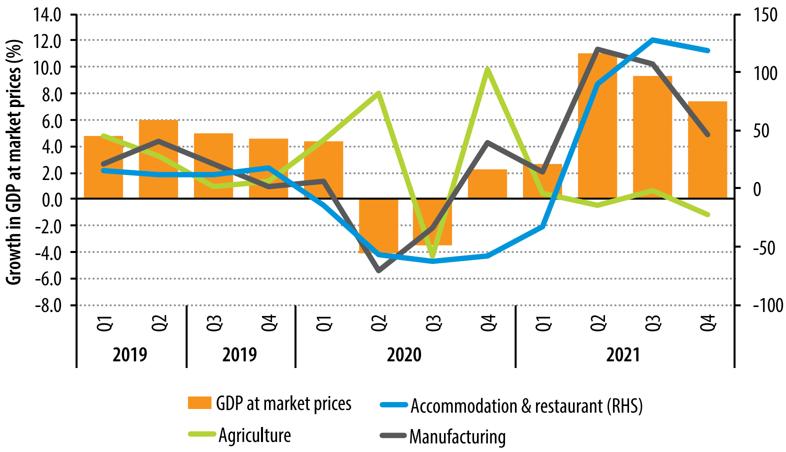
The adverse effects of the pandemic and related uncertainty around its full containment continued through 2021, but at a dissipating pace. Policymakers across the globe remained focused on deploying measures to support stronger economic recoveries. Concerns remained on the unsynchronized recoveries that were driven by unequal levels of access to vaccinations to curb new infections that continued to hinder a faster reopening of global trade and supply chains, and the emergence of new energy-driven inflationary pressures.

By the end of 2021, four critical developments continued to shape the policy debates. First, overall inflation in the country dropped to an average of 5.7 percent in December 2021 from 6.9 percent in September. This reflected a drop in food inflation that overcompensated for the escalation in fuel inflation. Even with easing reported overall inflationary pressures, there were considerable fears of a resurgence in inflation due to the rising global oil prices that was driven by both recoveries in demand and supply constraints.

Second, was a notable recovery -though at a decelerating pace - of the economy in 2021, driven by a strong resumption of activity in the services and industrial sectors attributed to the reopening of the economy from closures instigated by COVID-19 containment efforts. However, agricultural activity remained depressed on account of unfavourable weather patterns across most parts of the country, pulling down other sectors that are heavily dependent on agriculture (**Figure 1**).

Figure 1:
Domestic economic performance



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.

Uncertainty continued to linger on whether the recovery would be sustained, given the lack of a clear foresight on the containment of the pandemic, as well as reliance on a few anchors of long-term economic growth.

Third, the short-term interest rates by end 2021 had eased reflecting ample liquidity conditions. However, lending rates had remained sticky mirroring the challenges that banks continued to face with their inability to effectively price risk that were associated with delays in the approvals - and thus implementation, of risk-based pricing models. This, coupled with the suspension of listing of negative credit information announced in October 2021 that was constraining customer credit assessment by banks, continued to impede a stronger growth in credit in the economy and denying the economy of a strong and more sustainable anchor to economic recovery.

Finally, there was a reported widening of the current account deficit which, in part, continued to exert pressure on the exchange rate to weaken; a trend that had been sustained from July 2021. Such a development in a key economic fundamental posed a risk to the overall price stability in 2022 and called for a policy mitigation in the near term.

Amidst these developments, the banking industry on aggregate remained stable and resilient over the period; depicting strong capital and liquidity positions above statutory limits, sustaining trend growth in total assets and deposit base. 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 13.1 percent in December from 13.6 percent in September. Thus, banks remained cautious on the trend of credit risk and took appropriate measures to limit loss exposures generated through their credit extension services.

State of the Economy

The global economic growth landscape is expected to slow down to 4.4 percent in 2022 and 3.8 percent in 2023, down from 5.9 percent in 2021 on account of forecast downgrades for the US and China. The US and China growth forecasts for 2022 stands at 4.0 percent and 4.8 percent respectively.

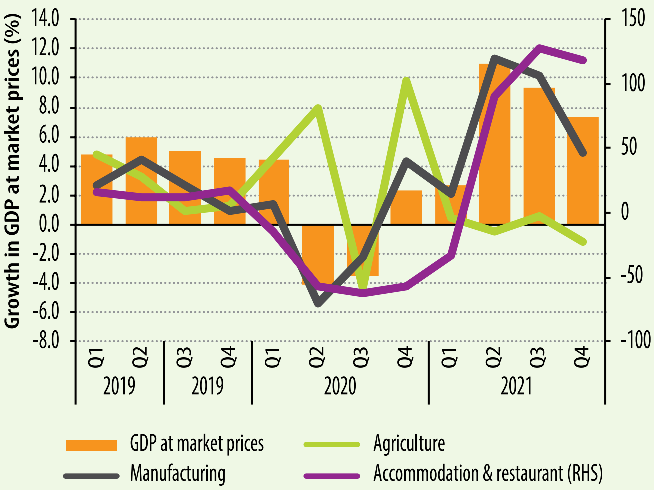
The slower global economic recovery is attributed to the waning fiscal support in Advanced Economies, rising energy prices and re-imposed mobility restrictions on account of the threat posed by Omicron variant of the COVID-19 virus, causing disruptions in the global supply chains. Additionally, the raging Russia-Ukraine war with the associated sanctions to Russian economy presents significant risks to global growth outlook in 2022.

Domestically, the fourth quarter of 2021 registered 7.4 percent decline in the gross domestic product (GDP), down from 9.3 percent and 11 percent registered in the third and second quarters of 2021 respectively. The decline was driven by the moderating growth in the agricultural sector, accommodation and restaurants, finance and insurance, and manufacturing sector. Even so, the economic growth remained superior to what was registered in a similar period in 2020 and 2019, as it maintained the momentum towards the pre-pandemic level (**Figure 2A**).

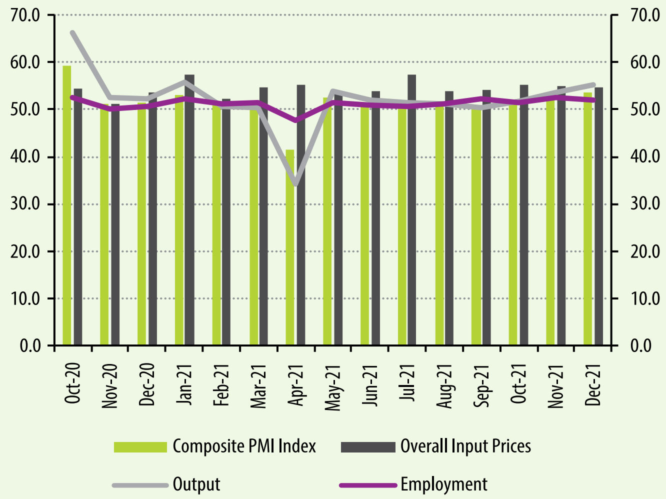
Additionally, the results of the Purchasing Managers' Index™ (PMI) in the fourth quarter pointed to the strong economic growth in the fourth quarter of 2021. The overall PMI index stood at 53.7 in December 2021, which is higher than 53.0 recorded in November 2021. The increase in the overall PMI reflects the sustained recovery of economic activity in the manufacturing sector between October 2021 and December 2021. The upturn was attributed to an increase in output as new orders picked up. In addition, the recovery in output continued to sustain growth in employment, reflecting well-anchored demand and responsive business recovery plans (**Figure 2B)**.

Figure 2:
GDP Performance and Economic Outlook

2 (A): Domestic Economic performance



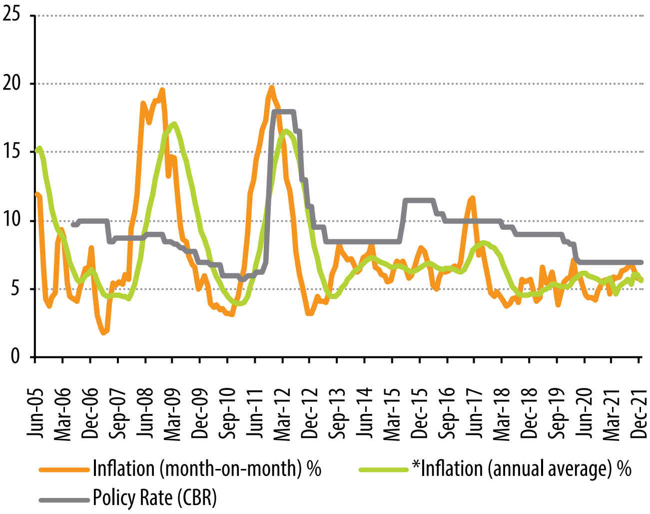
2 (B): Trends in PMI



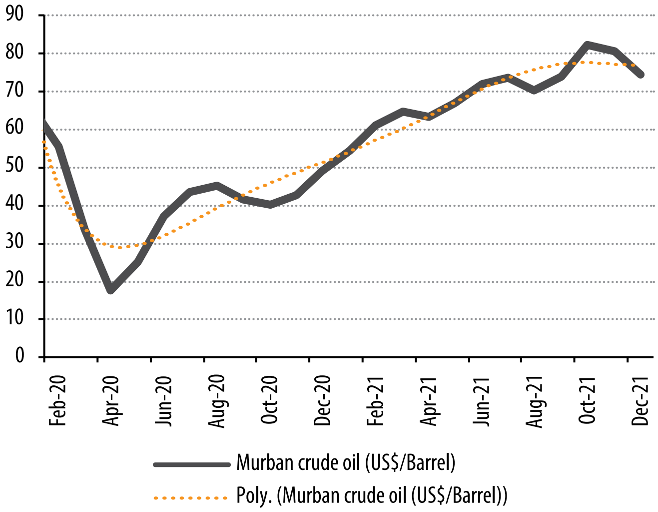
Source: KNBS and IHS Markit®

Figure 3:
Trends in Inflation and Murban Crude oil prices

3 (A): Inflation trends



3 (B): Trends in Murban oil price



Source: CBK and Oil price.com

PIC / BIGSTOCK

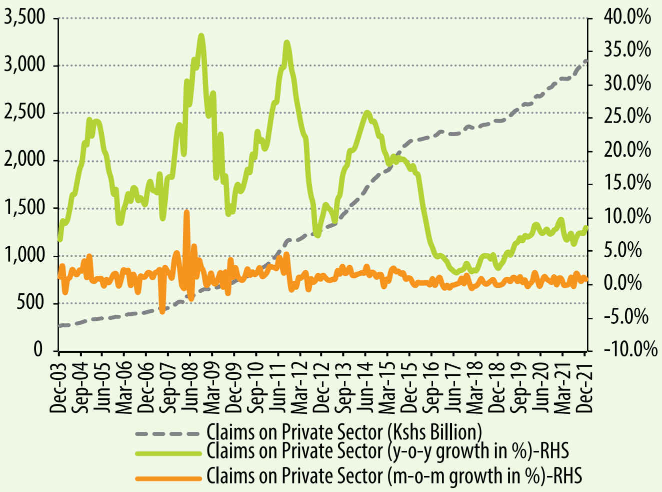
The inflationary pressure eased off during the quarter, largely driven by a slight decline in food inflation. The month-on-month inflation stood at 6.45% in October 2021, slightly easing from 6.91% in September 2021. In November and December 2021, it settled at 5.8% and 5.73% respectively (**Figure 3A**). The core inflation (non-food-non-fuel) remained below 3 percent indicative of muted demand pressures, while the food inflation declined to 9.5 percent in December 2021 from 10.6 percent in October. On the other side, fuel inflation has been on an upward trajectory, mainly driven by the high international oil prices. The Murban oil prices rose from US$73.9 per barrel in September to US$ 82.1 per barrel in October 2021 and finally moderating to US$ 74.4 per barrel in December 2021(**Figure 3B**).

The credit to the private sector persisted with its growth momentum, expanding by 8.6 percent in December 2021, up from 7.7 percent in October and November 2021, pointing to the supply and demand-side interactions. Whereas the supply-side may be willing to provide credit, the demand side remains weak (**Figure 4A**). The overall expansion of credit to the private sector is attributed to the continued build-up of activities in the manufacturing, Trade, Transport and communication, and, mining and quarrying sectors. Other sectors, including the agriculture, finance and insurance, real estate and consumer durables had a slump in credit growth, signifying to the banks risk aversion to lending in these sectors (**Figure 4B**).

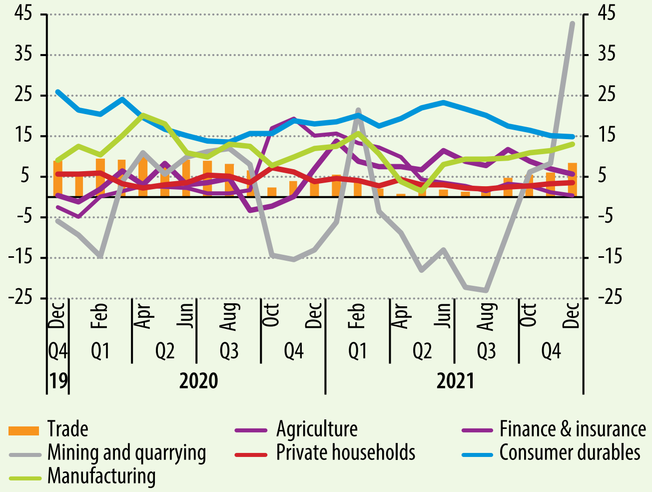
Figure 4:

Private Sector Credit and Growth Dynamics

4(A): Private Sector Credit and Growth DynamicsDynamics



4(B): Sectoral credit growth in Q4 2021



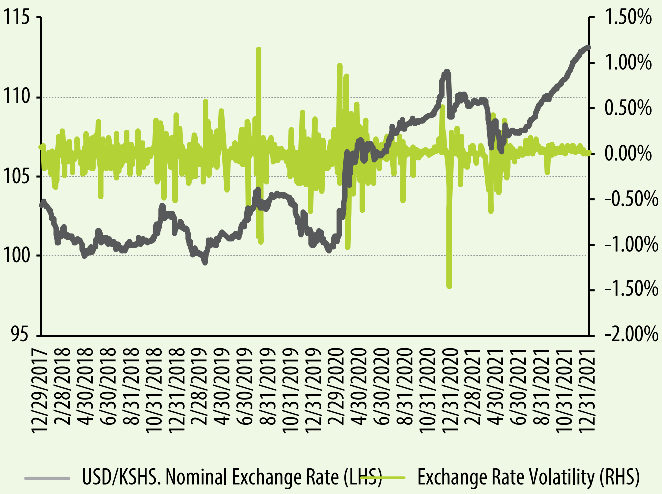
Source: Central Bank of Kenya

The Kenya Shilling depreciated by 2.51 percent against the dollar, having exchanged at an average of ksh 111.93 per dollar in the fourth quarter, relative to an average of ksh 109.187 per dollar in the third quarter of 2021 (**Figure 5 A**). Even so, the shilling remained stable during the quarter as supported by the increased diaspora remittances (**Figure 5 B)**, which rose from USD 920.99 during the second quarter of 2021 to USD 959.44 in the third quarter, despite the 6.33 percent decline of inflows from Europe) and the high export value, which rose from Ksh 178.60 billion in the third quarter to ksh. 194.64 billion in the fourth quarter, thereby narrowing the overall trade balance deficit. The modest increase in exports was attributed to exports destined to Uganda (13.36 percent), Paki-

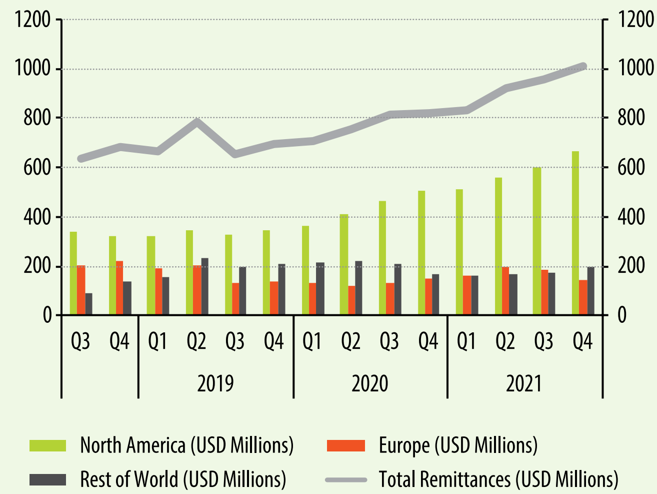
Figure 5:

Kenya Shilling -US Dollar Exchange Rate dynamics and Remittances inflow

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



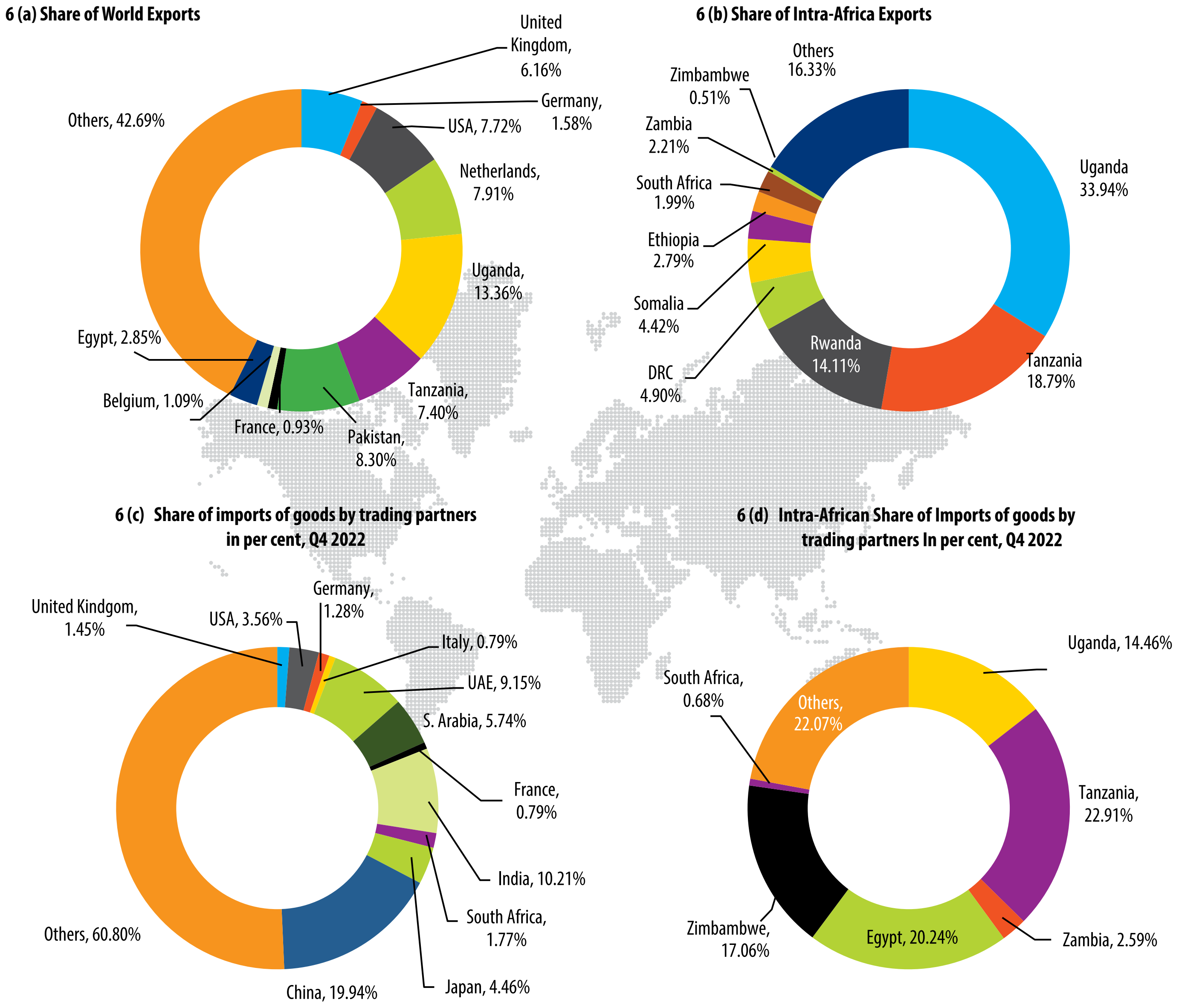
5(B): Trends in remittances flow by regions 2021



Source: Central Bank of Kenya

stan (8.30 percent), Netherlands (7.91 percent) and the United States of America (7.72 percent). The major sources of import to Kenya were China (20.36 percent), India (10.78 percent) and UAE (8.45 percent). and a modest increase in exports (Uganda and the United States of America remains the leading destination of Kenya's exports, constituting 9.69 percent and 9.58 percent of total intra-African export earnings, respectively. In the intra-African Exports, Uganda, Tanzania and Rwanda accounted for 21.3 percent, 16.02 percent and 9.22 percent, respectively) (**Figure 6**).

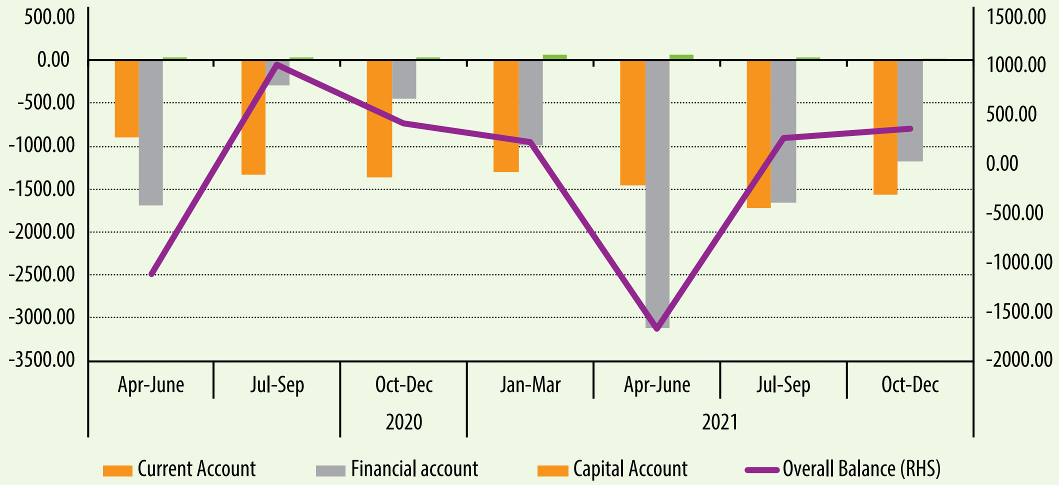
Figure 6:
Kenya's Intra-African and Global Trade Developments



Consequently, the overall balance of the external sector recorded in the quarter was a surplus of USD 402 million; an improvement from USD 271 million in the previous quarter. The net balance of the capital account declined by USD 10 million to USD 19 million in the fourth quarter of 2021.

The current account on its part deteriorated further to record a deficit of USD 2,840 million in the fourth quarter of 2021 when compared to USD 2,227 million in the fourth quarter of 2020 (**Figure 7**).

Figure 7:
Balance of the Payments Performance



Source: CBK Quarterly Economic Review

Sectoral Performance

Agriculture

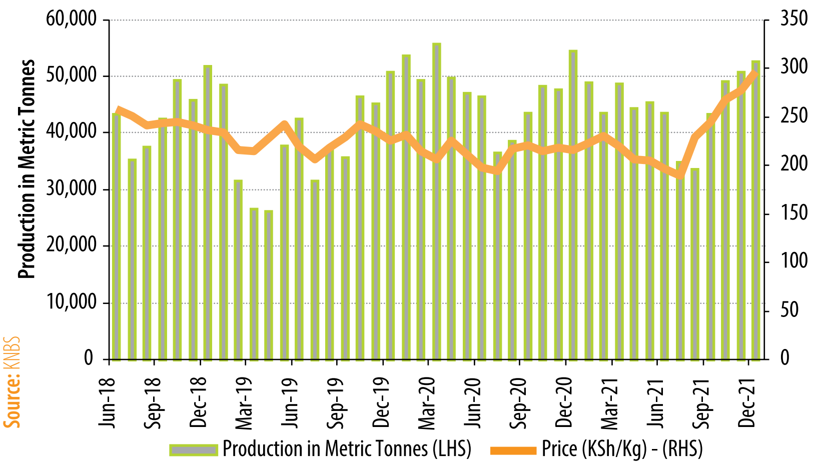
The agricultural sector remains one of the main drivers of socio-economic development in Kenya and offers great potential for growth and transformation. The sector contributes about 51 percent of Kenya's Gross Domestic Product (GDP) (26percent directly and 25 percent indirectly). The latter accounts for over 65 percent of exports and employs more than 40 percent of the total population and over 80 percent of the rural population.

> "Tea production has contributed significantly to the Kenyan economy and it remains one of the leading foreign exchange earners in the country.

Tea production has contributed significantly to the Kenyan economy and it remains one of the leading foreign exchange earners in the country. The latter's production during the fourth quarter increased from 111,552.90 metric tonnes recorded in the third quarter to 152,202.41 Metric Tonnes in the fourth quarter of 2021 (**Figure 8**), a production level that supursed 150,366.72 Metric Tonnes realized in the fourth quarter of 2020; on the account of the onset of short rains season in the country, which unlike in 2020 was delayed and marked with intermittent dry spells in most parts of the country. The average monthly auction price for Kenyan tea also increased during the fourth quarter, rising to Kshs 280.44 per kilogram against Ksh. 220.91 per kilogramme in the third quarter of 2021 and Ksh. 215.85 per kilogram during the fourth quarter of 2020. The upturn in the auction price is attributable to the minimum reserve price of 2.43 USD per kilogram that was set in July for the small holder sub-sector taking into account the cost of production the grade of tea and a reasonable return to the tea farmers.

PIC / Twiga Foods

Figure 8:
Tea production and Prices



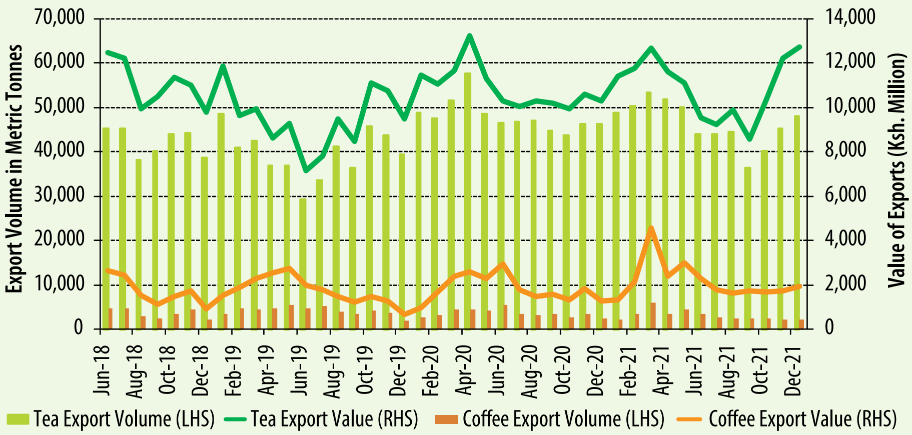
Enhanced demand for tea in most markets pulled the export volume upwards, rising from 36,308 metric tonnes in September 2021 to 47,922 metric tonnes in December 2021 (**Figure 9**). However, when compared to a similar period, the total export volume for the fourth quarter of 2021 was 2.10 percent lower at 133,318 metric tonnes, compared to 136,175 metric tonnes recorded in the same period in 2020. On the other hand,

PIC / TELEMMGLPIC

the performance of coffee sub-sector took a hit, as the volume of coffee exports was on a plummeting path; declining from 2,480 metric tonnes in September to 2,170 metric tonnes in November 2021, and then it edged upwards to 2,314 metric tonnes in December 2021.

The horticultural sector weathered through the fourth quarter, registering a slight decline in the total volume and value of exports. The total volume of horticulture exports in the fourth quarter of 2021 was 136,538.1 metric tonnes with an equivalent value of Kshs 29.93 billion, both of which were lower than horticultural produce exported in a similar period of 2020, albeit higher than the third quarter of 2021 **(Figure 10)**.

Figure 9:
Tea production and Prices



Source: KNBS

> **"The horticultural sector weathered through the fourth quarter, registering a slight decline in the total volume and value of exports.**

Figure 10 (a):
Horticultural Exports

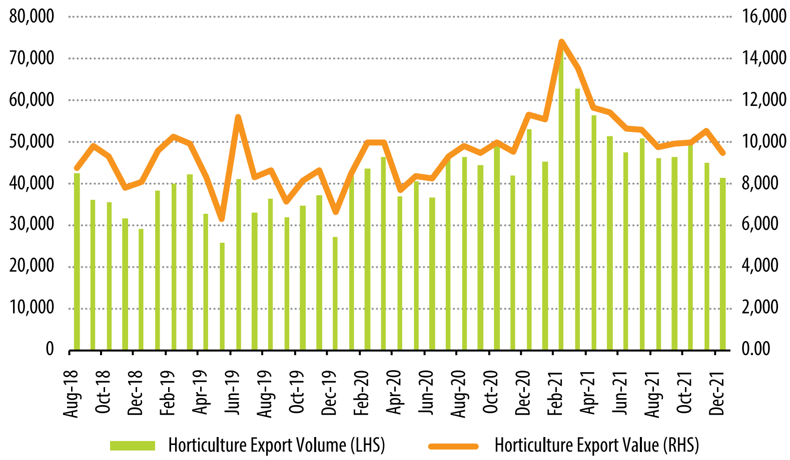
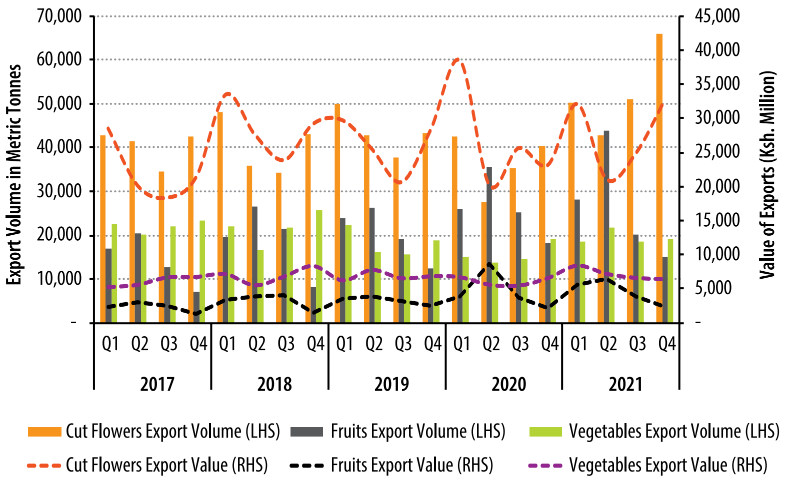


Figure 10 (b):
Cut Flowers, Vegetables and Fruits



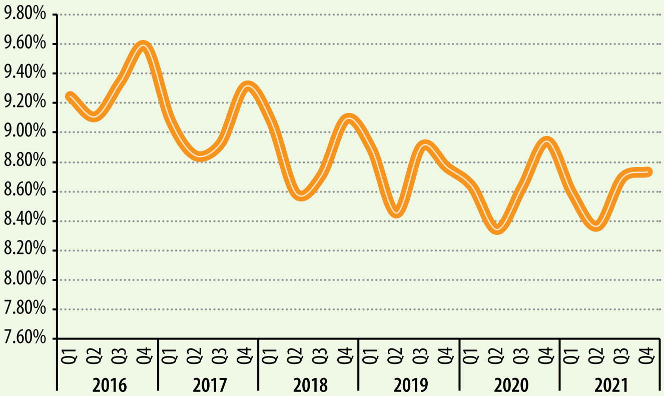
Source: KNBS

On the other hand, the volume of flowers exports also increased during the fourth quarter, rising to 66,046 metric tonnes, relative to 51,115 metric tonnes registered in the third quarter of 2021, as Netherlands, the United Kingdom, Germany and Norway emerged the leading export destinations. The fruit exports volume declined from a total of 18,268 metric tonnes that was recorded in a similar period in 2020 to 15,096 metric tonnes in 2021, however, there was a corresponding 9.66 percent increase in value. Vegetable exports volumes dropped from 8,435 metric tonnes in October 2021 to 4,002 metric tonnes in November 2021, thereafter, rising to 6,644 metric tonnes in December 2021. The leading vegetable export destinations were the United Kingdom, Holland and France. The volume and value of fruits exported continued with the declining trend that were evident as from February 2021, on the account of the challenges affecting avocado and mango exports which are the leading contributors of fruits exports. While issues associated with the mango was successfully resolved and its exportation to the European Union resumed, avocado still experienced a number of challenges. The hass avocado and fuerte avocado harvesting season for the 2021/2022 fiscal year was closed with effect on the 15th November 2021 and the export of jumbo variety was limited to a minimum size code 20 (184g) to ensure maturity is observed. Additionally, the allowable offseason sizes was limited to a maximum size code 22 and 24 for fuerte and hass avocado varieties respectively.

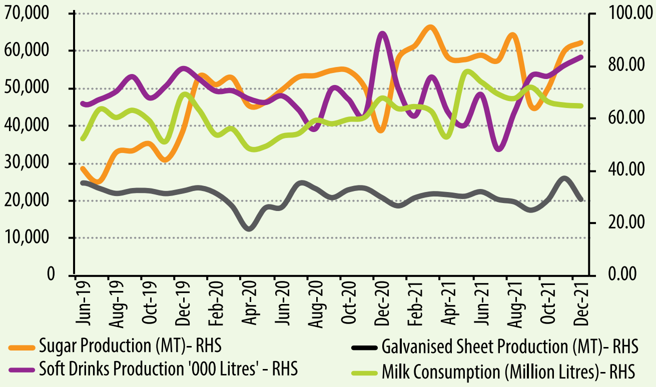
Figure 11:

Production in manufacturing Sectors

11 (a): Manufacturing Sector as a percentage of GDP



11 (b): Production in Manufacturing sub-sectors



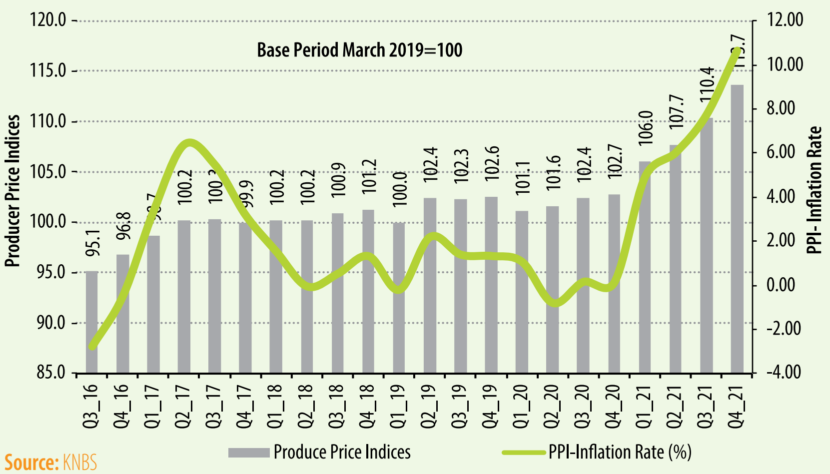
Source: KNBS

Manufacturing

Manufacturing is key sector in Kenya's economic development, in both its contribution to national output and exports, and for job creation. The role of the manufacturing sector in Vision 2030 is to create employment and wealth. The sector, as reflected in **Figure 11 A**, continues to punch below its overall goal in the Medium-Term Plan (MTP) where it is envisaged to increase its contribution to the GDP by at least 10% per annum as envisioned in the Vision 2030. Production of cement has been on a decline, dropping from 892,975 metric tonnes in October to 807,553 metric tonnes in December 2021. Contrarily, month-on-month sugar production has expanded from 49,899 metric tonnes in October 2021 to 62,333 metric tonnes in December 2021. Milk uptake in the formal sector dropped from 66.59 million litres in October 2021 to 64.89 million litres in December 2021. The proportion credit to the sector edged upwards, signaling heightened activities during the fourth quarter of 2021. The total credit to the manufacturing sector rose to 1,362.98 billion from 1,312.50 billion registered in the third quarter of 2021.

Figure 12:

Producer Price Index



Source: KNBS

Producer Price Index

The producer price index (PPI) remained on an upward trajectory in 2021, to peak in the fourth quarter of 2021 by rising to 113.7. In comparison to the last quarter of 2020, this represented a 10.64 percent rise persistent during the final quarter of 2021 (**Figure 12**). Relative to the previous quarter, the highest price increases was registered in mining and quarrying sector (2.8 percent) and manufacturing (1.6 percent).

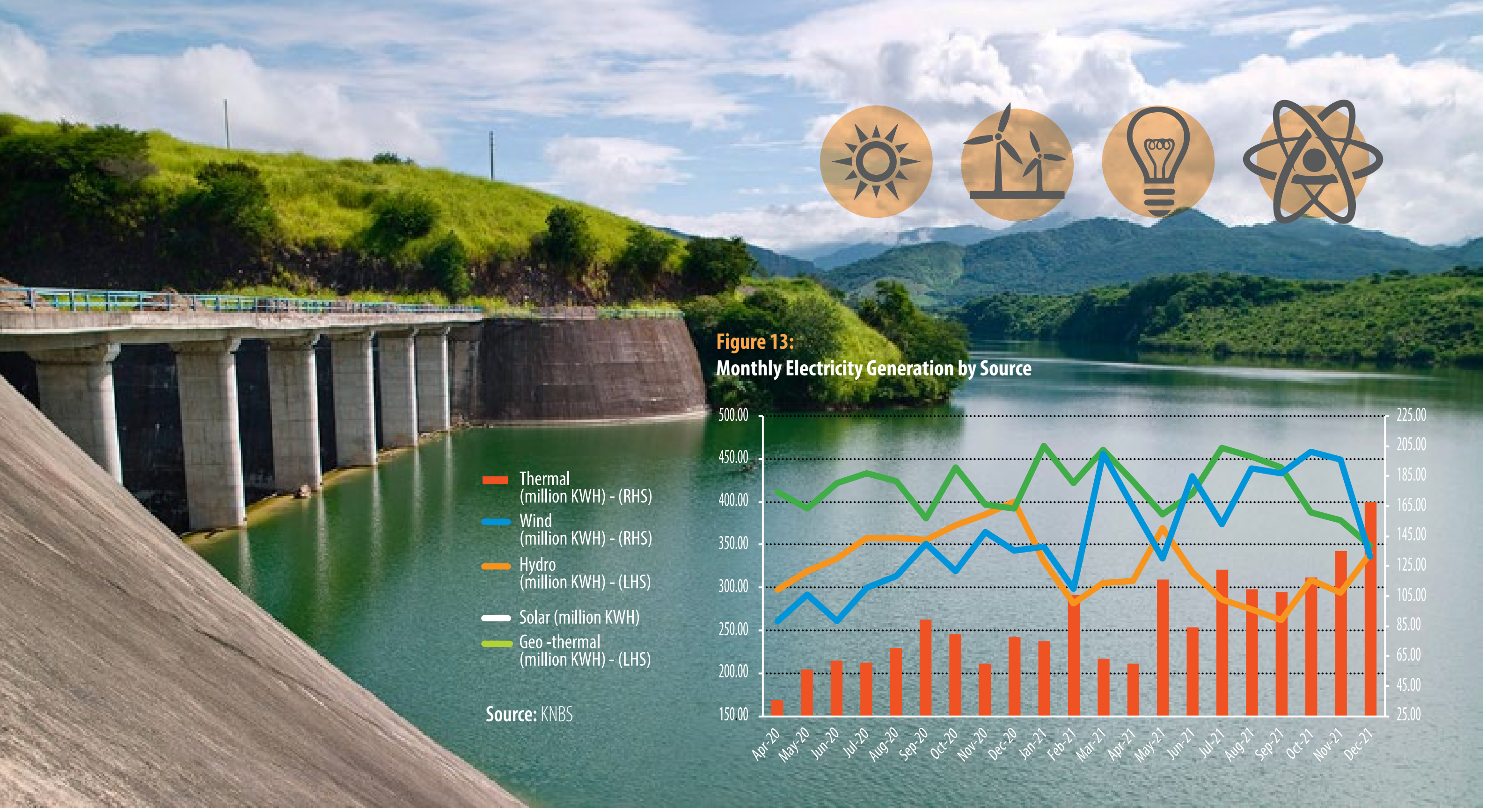


Figure 13:
Monthly Electricity Generation by Source

Source: KNBS

Energy

The energy sector propels foward Kenya's economic progression, since reliable supply of fuels to the transportation industry, electricity to households and businesses, and other sources of energy are integral to growth and production across the country. Total energy generation produced in the last quarter of 2021 decreased marginally to 3,078.68 million kilowatts from 3,094.59 million kilowatts produced in the third quarter of 2021. This represents 0.51 percent contraction from the previous quarter, but it is 1.78 percent higher than the 3,024.77 million kilowatts generated in a similar period in 2020 (**Figure 13**).

The crude oil prices in the international market declined during the quarter (**Table 1**). The Murban crude oil prices declined from US$ 82.1 in September 2021 to US$ 74.4 per barrel in December 2021, representing a 9.4 percent decline during the quarter. The average domestic fuel pump and Diesel prices remained unchanged during the quarter, despite the increase in landing costs on the account of increased government subsidy to cushion consumers. However, both kerosene and 13-kg Liquified Petroleum Gas (LPG) prices were on an upward trend.

Table 1: Average Monthly Crude Oil and Retail Fuel Prices

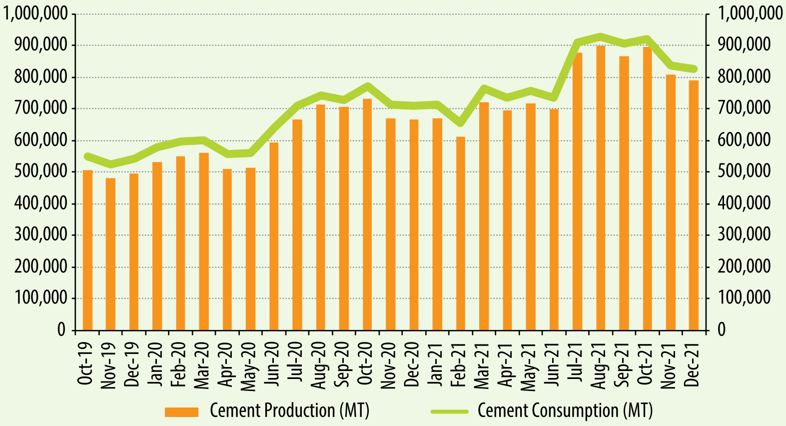
	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21
Murban crude oil (US$/Barrel)	54.4	61.1	64.6	63.2	66.9	71.9	73.5	70.3	73.9	82.1	80.4	74.4
Super petrol (KES/Litre)	107.9	116.0	123.7	123.7	127.2	128.0	128.0	128.0	135.5	130.5	130.5	130.5
Diesel (KES/Litre)	97.3	102.8	108.6	108.6	108.6	108.6	108.6	108.6	116.5	111.5	111.5	111.5
Kerosene (KES/Litre)	88.1	93.4	98.8	98.8	98.8	98.8	98.8	98.8	111.7	104.5	105.5	106.5
LPG (13Kgs)	2018.9	2031.2	2074.2	2074.2	2074.2	2074.2	2394.2	2420.7	2445.2	2513.7	2611.2	2638.8

Source: ADNOC oil prices and KNBS

Building and Construction

Activity in the building and construction sector moderated during the final quarter of 2021. The demand for cement shrank by 10.6 percent, dropping from 892,975 metric tonnes in October 2021 to 807,553 metric tonnes in December 2021. This was accompanied by a subsequent reduction in cement production (**Figure 14**).

Figure 14: Cement Production and Consumption

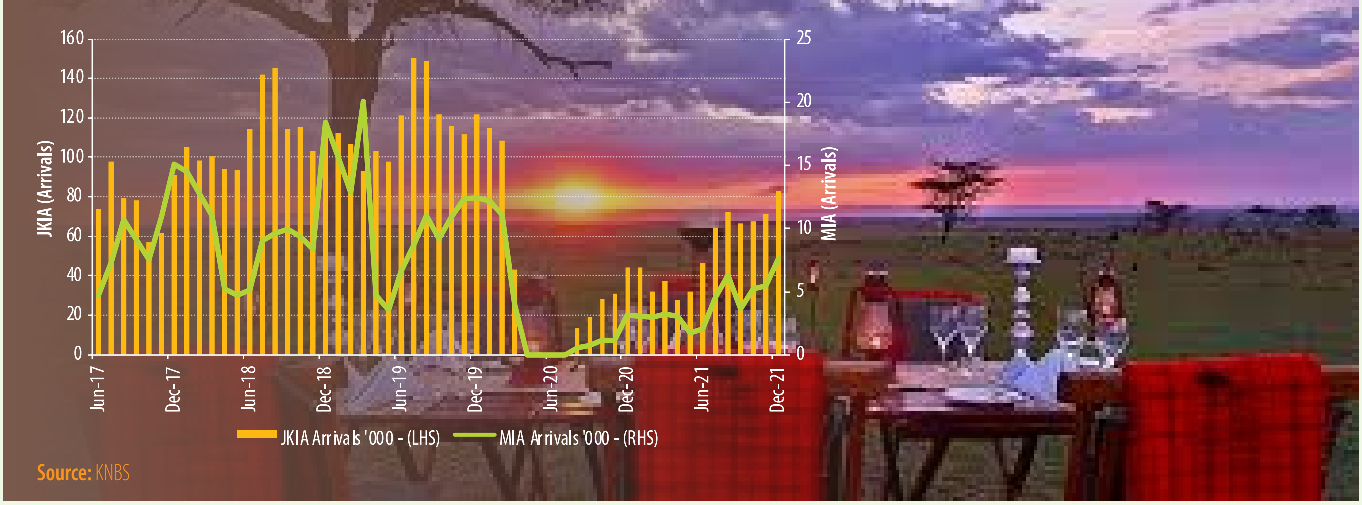


Source: KNBS

Tourism

An impressive uptick in activities in the fourth quarter continue to propel the tourism sector much closer to the performance registered during the pre-pandemic era. There was a month-on-month growth in the number of inbound tourists. The total inbound tourist arrivals during the fourth quarter of 2021 stood at 240,019; a greater than 217,873 reported in the previous quarter and 108,916 reported in a similar period in 2020 (**Figure 15**).

Figure 15: Monthly Inbound Tourist Arrivals

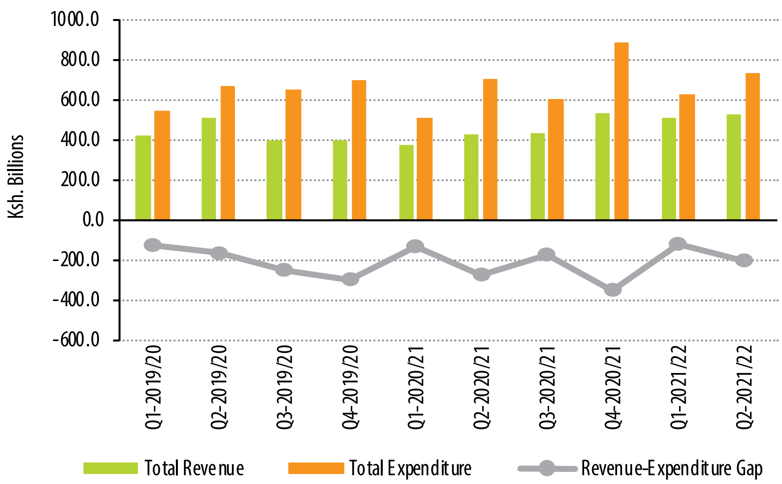


Source: KNBS

Government Revenue & Expenditure

The government fiscal space remains tight, however it slightly eased of during the second quarter of FY 2021/2022 (Figure 16). Even so, constrained expenditures and elevated government debt levels continue to constrain the fiscal position.

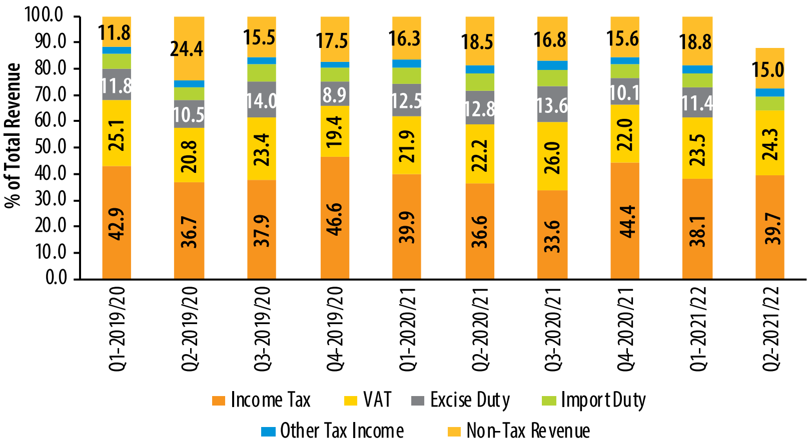
Figure 16:
Quarterly Revenue-Expenditure Gap



A review of government revenue sources points to overdependence to tax revenue sources (84 percent), while the non-tax revenue accounts for less than 16 percent of the total revenue base. Disaggregating the tax revenue by source during the quarter, income tax accounts for over 38.3 percent of the total tax revenues, underscoring its importance in funding government expenditures.

With the income tax already saturated, this suggests that the government's ability to raise additional revenue is constrained and to contain the rising fiscal deficits it must cut back on its spending. On the other hand, the Value added tax (VAT) accounts for 24.2 percentage of with excise duty accounting for 11.9 percent and import duty accounts for 5.4 percent, as other tax incomes and non-tax revenues account for 3.1 percent and 16 percent respectively (**Figure 17**).

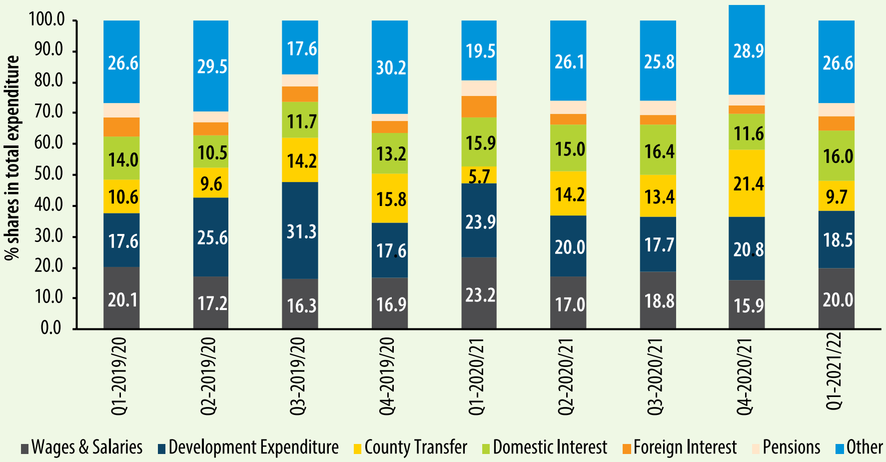
Figure 17:
Quarterly Revenue Structure

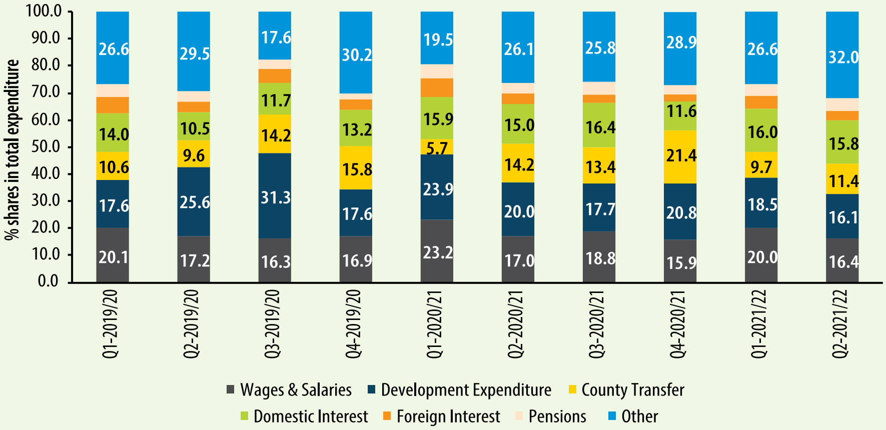


On the expenditure side, **Figure 18** shows that the recurrent expenses comprise a large portion of government spending during the fourth quarter to account for 72.03 percent of government spending and 17.48 percent of the spending is on development expenditure. Among the components of recurrent expenditure, 27.00 percent is on wages and salaries, approximately 23.09 percent on domestic interest payments, 5.85 percent on foreign interest payments, with pensions accounting for 5.1 percent of the total current expenditure.

“ The recurrent expenses comprise a large portion of government spending during the fourth quarter to account for 72.03 percent of government spending and 17.48 percent of the spending is on development expenditure.

Figure 18: Quarterly Expenditure Structure





Source: Central Bank of Kenya

Banki Kuu ya
Central Bank of
Kenya
AA2507250
for One Thousand Shillings
Elfu Moja
1000
Kenya
AA2342250
Legal Tender for Two Hundred Sh
Shilingi Mia Mbili

Deficit Financing and Public Debt

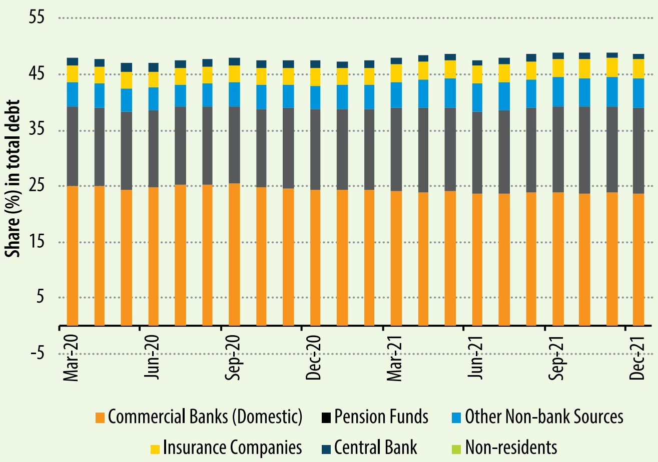
Kenya's public debt stock has been on the rise, but more importantly, the recent trends has seen the government increased commitment to fiscal consolidation.

For instance, it was estimated that the ratio of public debt to GDP would decline from 68.2 percent by the end of the first quarter of the FY 2021/22 to 67.9 percent by the end of second quarter of the FY 2021/22. In terms of its composition, the domestic debt and external debt stand at approximately 50:50 ratio **(Figure 19)**. The external debt has tended to rely on expensive commercial debt rather than concessional debt. More eminently, the debt is being contracted from non-Paris Club creditors, notably China, raising concerns about debt transparency as well as debt collateralization.

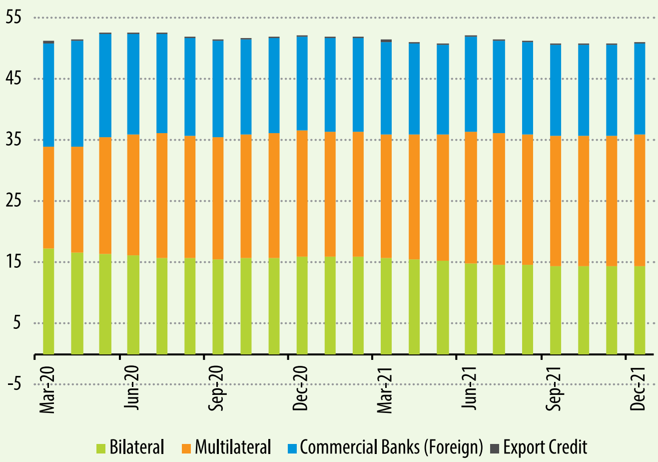
On the domestic front, treasury bonds accounted for 64.19 percent of the total domestic debt while treasury bills accounted for 33.25 percent of the total domestic debt while overdrafts at the Central bank accounted for 2.39 percent of the total domestic debt. Similarly, advances from commercial banks and other domestic debt accounted for 0.12 percent and 0.04 percent of the total domestic debt respectively. The high government debt has several downside implications to the economy. First, it could potentially erode investor confidence, thus requiring the government to pay a rising risk premium on its debt. Second, it reduces the effectiveness of the fiscal policy. More specifically, high government debt can reduce the size of fiscal multipliers through the Ricardian channel and investor sentiment channel. Third, the high debt slows growth and investment.

Figure 19:
External and Domestic Debt and its Composition

19 (A) Domestic Debt



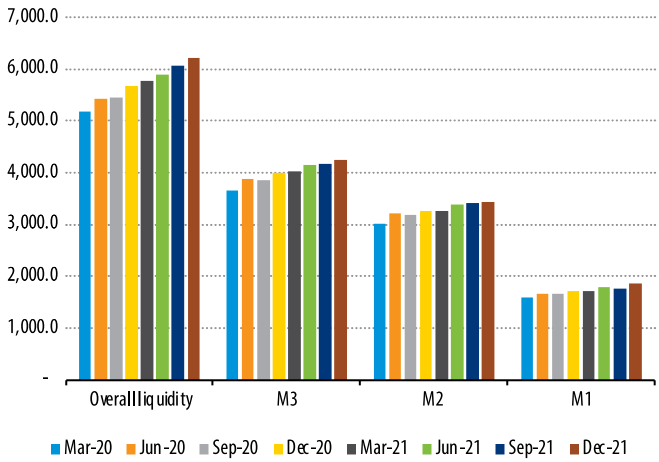
19 (B) External Debt



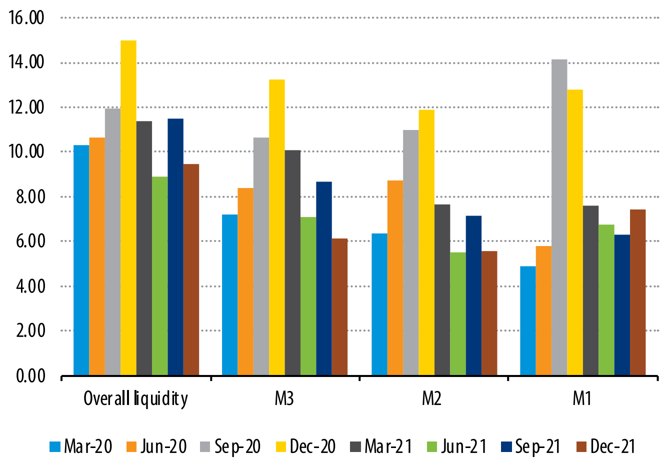
Source: CBK

Figure 20: **Trends in Monetary Aggregates**

20 (A): Volumes, Ksh Billions



20 (B): Year-on-Year growth rates, %



Source: Central Bank of Kenya

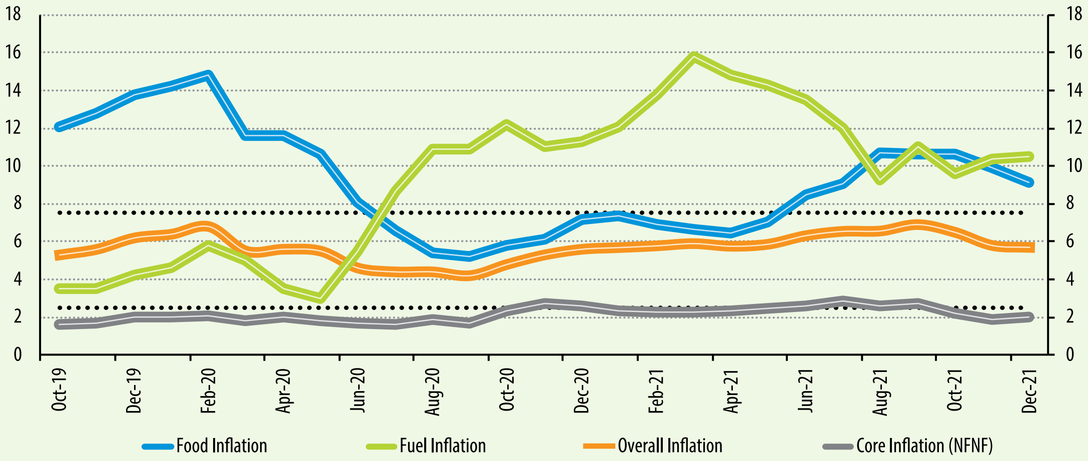
Money Supply

The monetary aggregates, especially quasi money (M1) and broad money (M3), were on a modest ascent **(Figure 20)** during the fourth quarter of 2021. Broad money supply (M3), a key indicator for monetary policy formulation, rose from Kshs. 4,210.90 million in October 2021 to Kshs. 4,235.20 million in December 2021. The overall liquidity in the economy grew by 10.42 percent on a year-on year basis by the end of December 2021 to close at Kshs. 6,255.70 billion.

Inflation

Overall inflation remained stable within the target range during the quarter. However, it dropped to 5.7 percent in December 2021 down from 6.45 percent registered in October 2021. The core inflation declined during the quarter, thus reflecting the muted demand pressures in the economy. In a similar trend, food inflation declined progressively during the quarter; from 10.63 percent at the end of third quarter to 9.1 percent at the end of December 2021.In contrast, there was an upsurge in fuel inflation; rising to 10.5 in December 2021, up from 9.6 percent in October 2021 **(Figure 21)**.

Figure 21: **Inflation Dynamics**

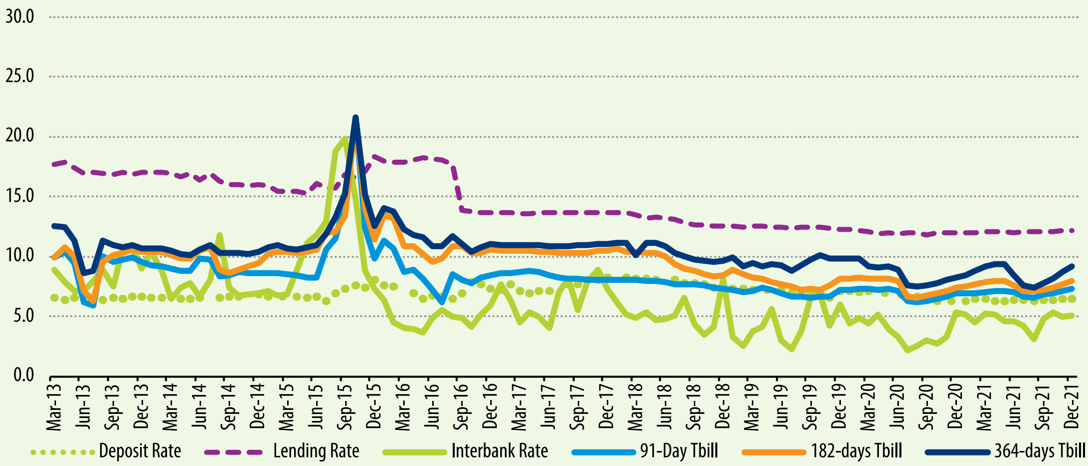


Interest Rates

The money market rates have been characterised by broad stability **(Figure 22)**, majorly on the account of the accommodative monetary policy during the quarter[1]. Both the interbank market and short-term government securities rates which largely reflects the government's borrowing profile trended upwards suggesting a tightening liquidity position in the market. The interbank market rate rose from 5.3 percent in October to 5.02 percent in December 2021.

Similarly, the average yield rate for short-term government securities was on the rise. The 91-day treasury bill rate rose from 6.95 percent in October to 7.26 percent in December. The 182-day treasury bill rate rose from 7.36 percent to 7.95 percent while the 364-day treasury bill rate rose from 8.14 percent to 9.13 percent over the same period. Both the weighted average deposit and lending rate were stable, albeit sticky as a result of slow approvals of the banks risk-based pricing models.

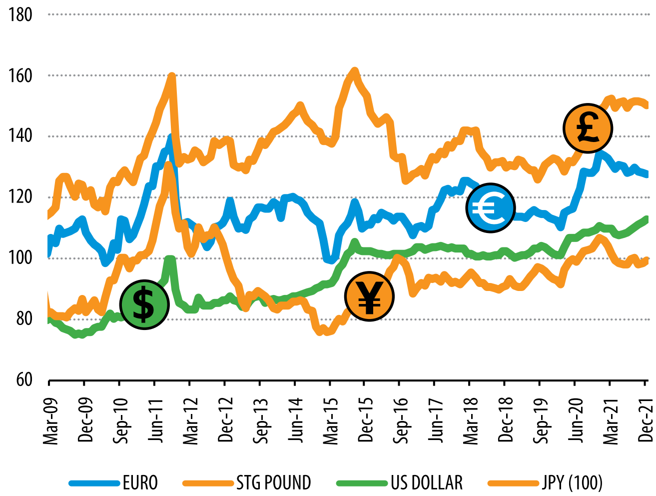
Figure 22: **Interest Rates Dynamics**



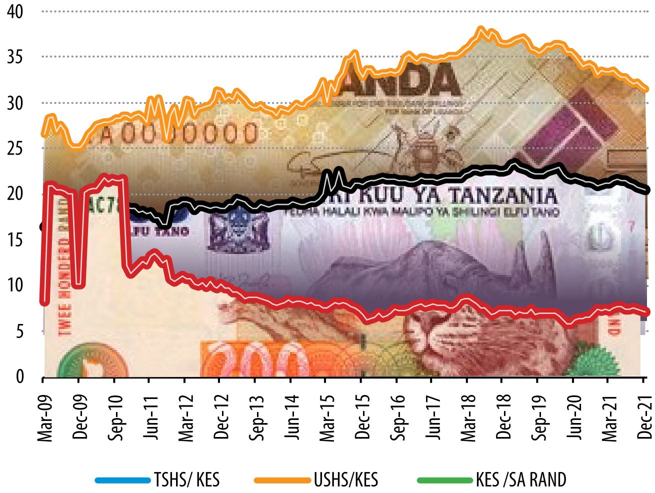
1 The central bank rate was maintained at 7.0 percent during the fourth quarter of 2021.

Figure 23: Exchange Rate Developments

23 (a): Major currencies



23 (b): EAC region currencies



Source: Central Bank of Kenya

Exchange Rates

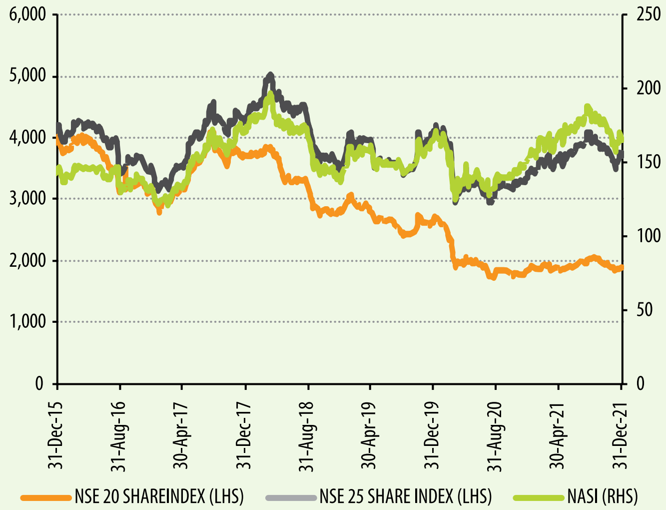
The shilling was relatively stable during the quarter, however, while it slightly depreciated against the US Dollar and the sterling pound, it equally strengthened against the Euro and Japanese Yen. The Kenya Shilling exchanged at an average of 111.90 against the US Dollar in the fourth quarter of 2021 compared with 109.49 in a similar quarter in 2020, while against the STG pound, the Kenya Shilling exchanged at an average of 150.90 in the fourth quarter of 2021 compared with 144.50 in a similar quarter in 2020. Against the Euro, the Kenya Shilling exchanged at an average of 128.06 in the fourth quarter of 2021 compared with 130.45 in a similar quarter in 2020. Against the Japanese Yen, the Kenya Shilling exchanged at an average of 98.45 in the fourth quarter of 2021 compared with 104.81 in a similar quarter in 2020 (**Figure 23A**). On the regional front, the shilling weakened slightly against the Tanzania and Uganda shilling, but strengthened against the South African rand (**Figure 23B**).

Capital Markets

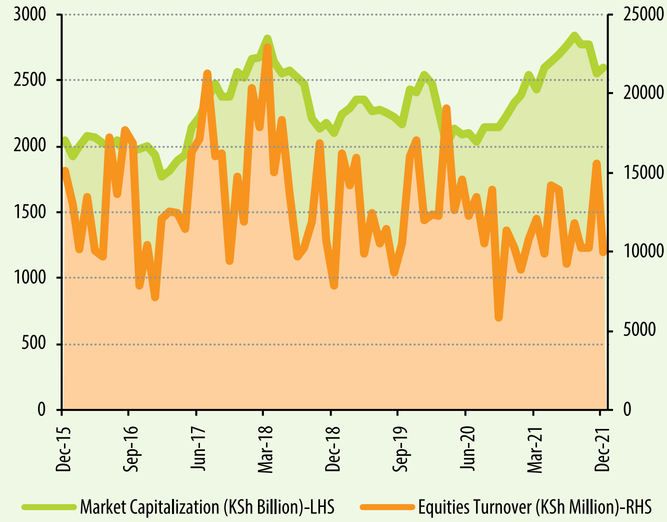
The capital market sector was bearish with all the benchmark indices and performance indicators tilted downwards. The NASI declined from 181.23 in October 2021 to 166.46 in December 2021, while the NSE 25 and NSE 20 equally took to a declining trend, dropping to 1,902.57 and 3,743.90 at the end of the quarter, down from 2,038.08 and 3,952.12 in October 2021, respectively. The market capitalization rose from 2,777.07 in October to 2,552.93 in November before declining to 2592.2 in December 2021. The number of shares traded and equity turnover increased by 5.00 percent and 14.12 percent respectively, relative to the third quarter of 2021. The volume of contracts traded in the derivative markets declined during the quarter, from 2,115 contracts in the third quarter to 1,651 contracts in the fourth quarter of 2021.

Figure 24:
Trends in Nairobi Securities Exchange Leading Indicators

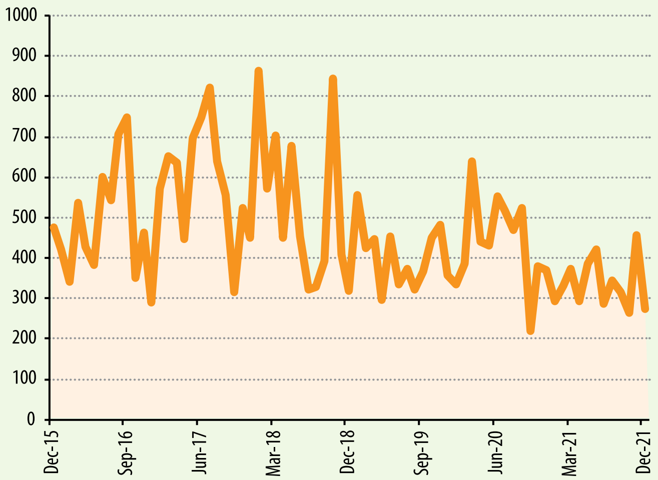
24 (A): All the NSE indices tilted downwards during the fourth quarter



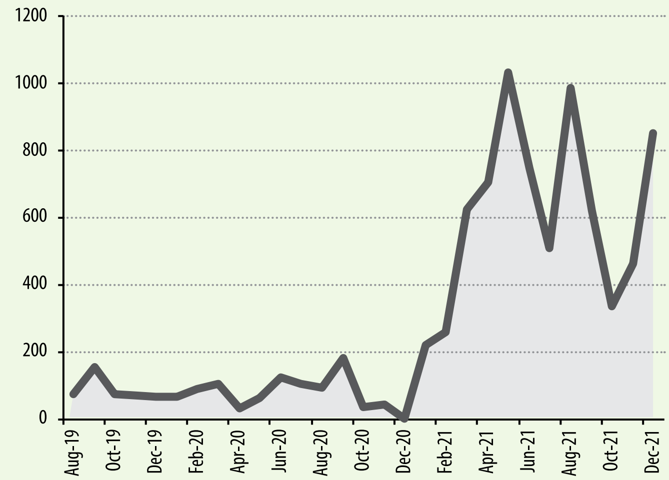
24 (B): EAC region currencies



24 (C): Number of Shares Traded (Million)



24 (D): Volume of derivative Contracts traded



Source: Nairobi Securities Exchange

"The sector's overall liquidity ratio, which has remained above the 20 percent regulatory threshold, declined from 56.7 percent in Q3 of 2021, to 56.2 at the end of Q4.

Banking Sector Performance

Figure 25 depicts that the banking sector remained stable and resilient during the fourth quarter of 2021. The total assets rose to Ksh 6,008.0 billion in December 2021, up from Ksh 5,822.1 billion at the end of the third quarter of 2021.

Nonetheless, the elevated credit risk resulted in a mild deterioration in the asset quality. The gross non-performing loans (NPLs) stood at Ksh 426.8 billion at the end of the fourth quarter of 2021, while the ratio of gross NPLs to gross loans stood at 13.1 percent as at the end of December 2021, which was slightly lower than the 13.6 percent recorded at the end of September 2021 as a result of declining gross NPLs. The banking sector's overall liquidity ratio, which has consistently remained above the 20 percent regulatory threshold, declined from 56.7 percent in the third quarter of 2021, to 56.2 at the end of the fourth quarter as a result of escalating short-term liabilities.

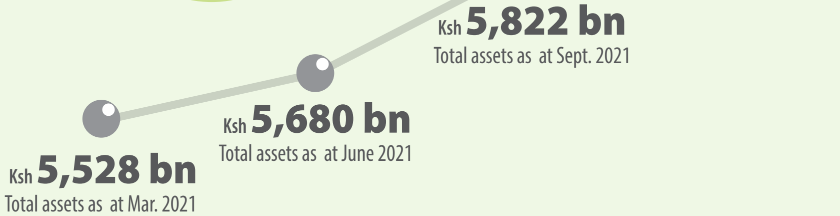
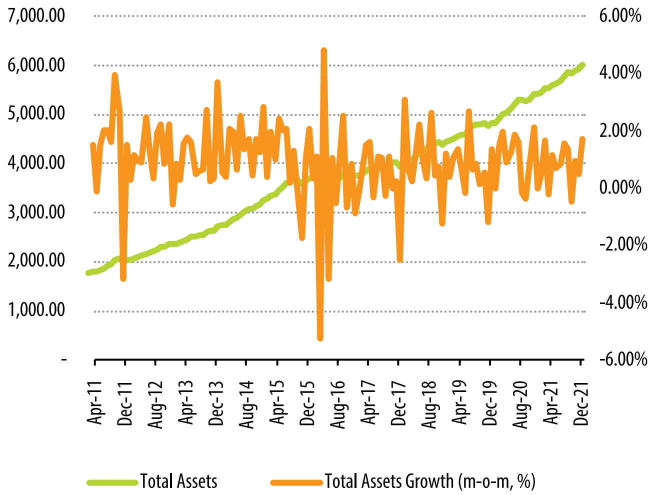
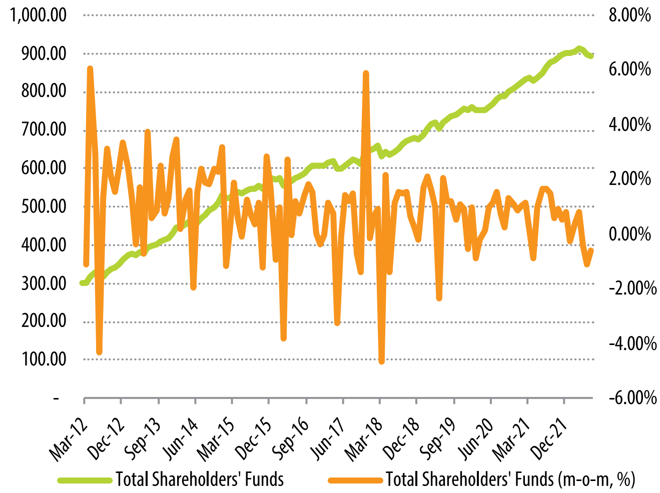


Figure 25:
The performance of the banking sector

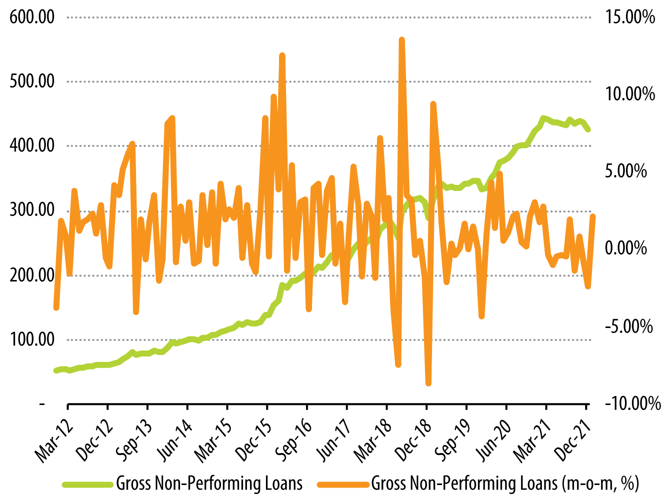
......The total assets rose to Ksh 6,008.0 billion in December 2021



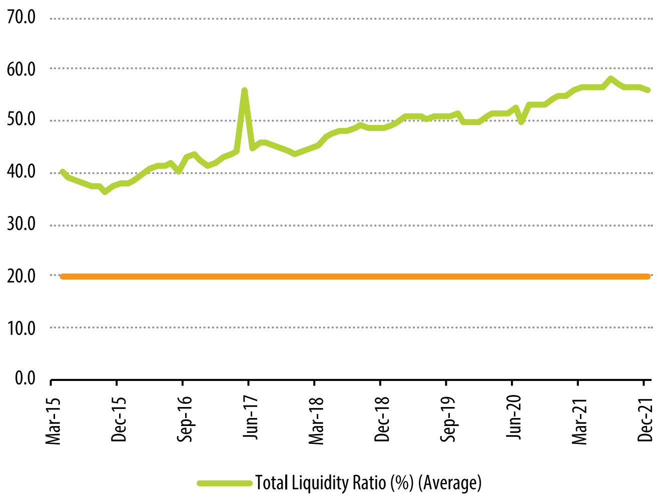
......The shareholders funds rose to Ksh 903.4 billion in December 2021



......The Gross Non-performing loans declined slighly



..... Increased short-term liabilities contributed to declining liquidity ratio



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