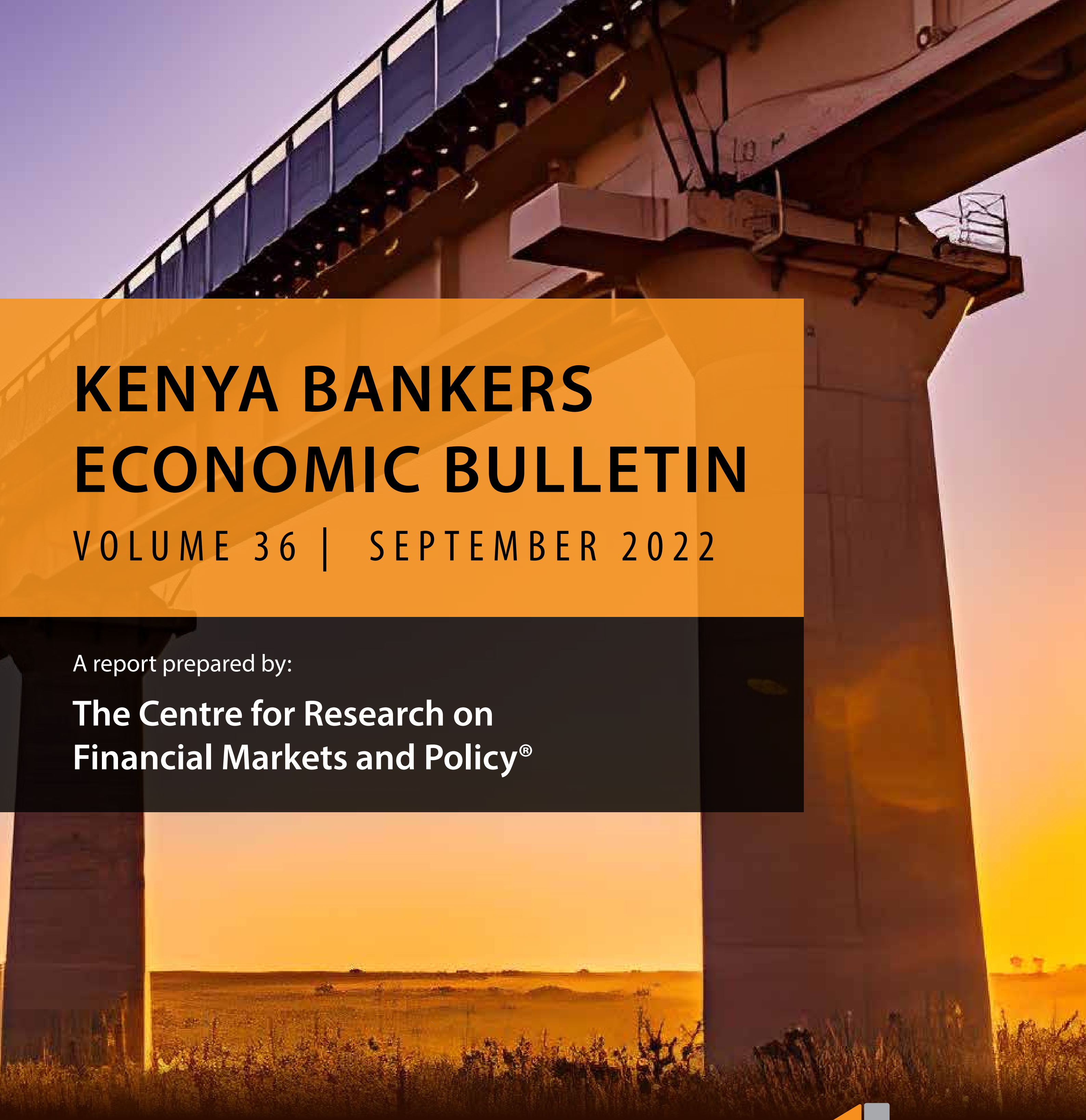

KENYA BANKERS ECONOMIC BULLETIN

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The Centre for Research on Financial Markets and Policy®

KENYA BANKERS
ASSOCIATION

CENTRE FOR RESEARCH ON

FINANCIAL MARKETS AND POLICY®

About this Report

This *Bulletin* reviews Kenya's economic performance in the second quarter of 2022, 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®

Publisher	KBA Centre for Research on Financial Markets and Policy®
KBA CEO	Dr. Habil Olaka
Chief Editor	Dr. Samuel Tiriongo
Contributor	Josea Kiplang'at Hillary Mulindi
Design & Layout	Conrad Karume
Contacts	KBA Headquarters, International Life House, 13th Floor Mama Ngina Street, Nairobi
Mailing Address	P.O. Box 73100 00200 - Nairobi
Phone	+254-20-2221704, +254-20-2217757, +254-20-2224014
E-mail	research@kba.co.ke
Web	www.kba.co.ke.
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FOREWORD

From the CEO's Desk

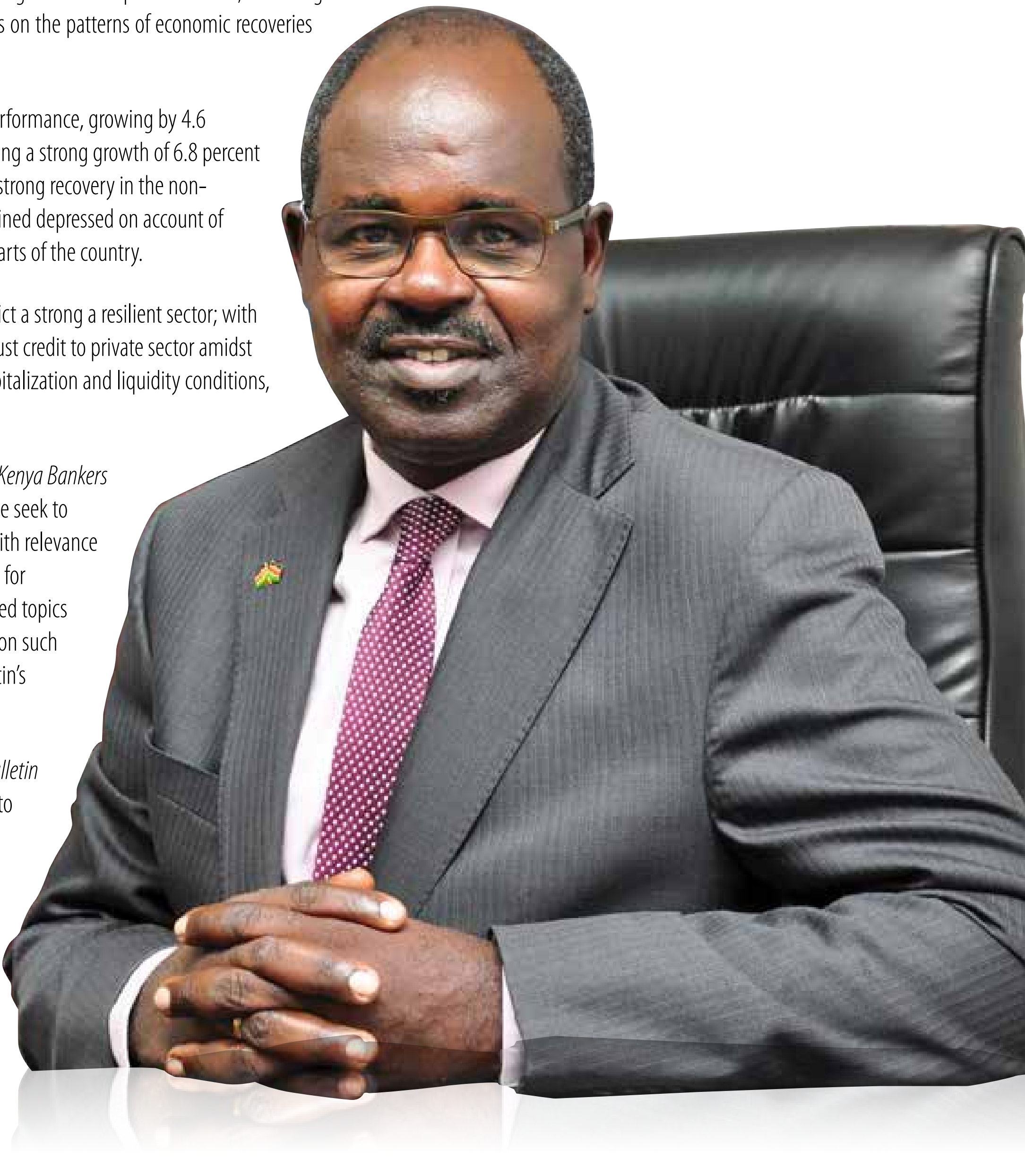
It is my pleasure to present to you the 36th issue of the *Kenya Bankers Economic Bulletin*. The year 2022 marked a notable recovery from the depressing effects of the pandemic that ravaged the globe from early 2020 through late 2021. In this issue, we discuss the state of the Kenyan economy during the second quarter of 2022, reviewing the strides made during the year, with an emphasis on the patterns of economic recoveries across sectors.

As noted in the *Bulletin*, the economy strong performance, growing by 4.6 percent during the quarter under review following a strong growth of 6.8 percent in the first 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.

Banking sector developments continued to depict a strong a resilient sector; with sustained trend growth in assets backed by robust credit to private sector amidst a slight deterioration in asset quality, strong capitalization and liquidity conditions, and trend growth in shareholders' funds.

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.



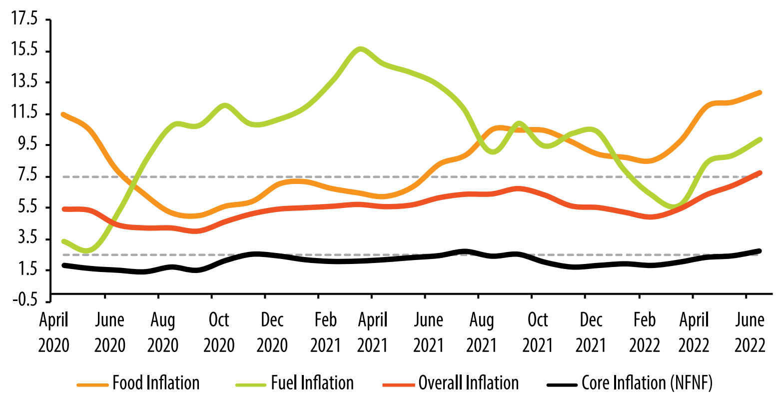
Dr. Habil Olaka, EBS
Chief Executive Officer,
Kenya Bankers Association

Inflationary Pressures Demand Stringent Monetary Policy

By Samuel Tiriongo, PhD

The policy focus during the quarter under review called for a tight balancing act. On one hand, was the increasing need to tame rising inflationary pressure and inflation expectations, and on the other, the need to protect the fragile economic recovery that was underway.

Figure 1: Sub-Components of Inflation: Drivers of Overall Inflation



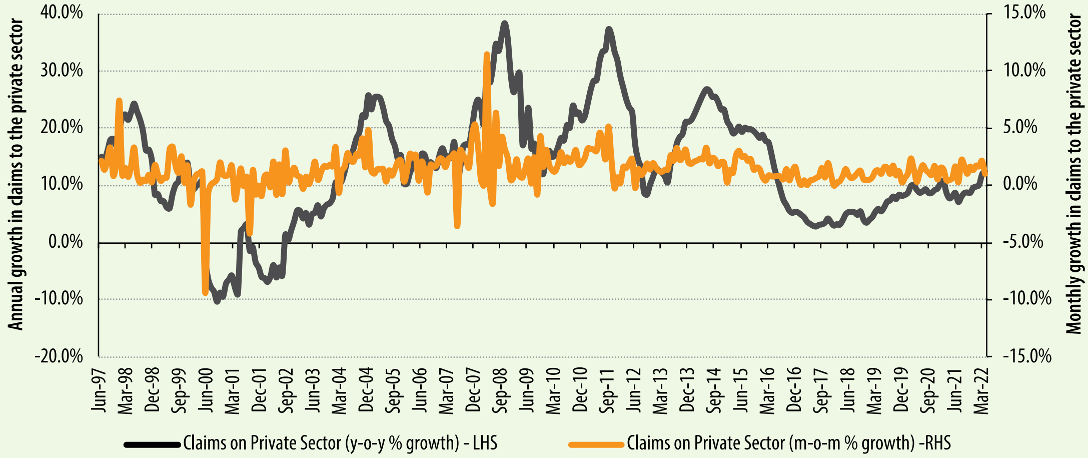
Source: CBK

First, inflation picked up, surpassing the 7.5 percent medium-term upper target. As shown in **Figure 1**, headline inflation rose from 7.1 percent in May 2022 to 7.9 percent in June and was projected to rise further in July, hitting over five-year highs, pushed up by a mix of both external and domestic factors that led to higher food and fuel prices. The rise in inflation was broad-based, with increasing pressure from both demand and supply factors. As food and fuel inflation remained elevated, core inflation was also evidently rising over the same period. The uptick in core inflation reflected emerging demand-driven inflationary pressure; of definite interest to policymakers.

While overall inflation is projected to ease to 7.3 percent by end 2022 (IMF, July 2022)[1], concerns still lingered on the impact of second-round effects of rising global oil prices. Nonetheless, episodes of rising inflation – beyond the target range – had historically triggered upward adjustments in the CBR targeted at taming inflationary expectations particularly outside the interest rate capping periods. By all means, this was unlikely to be any different; consistent with the upward revision in the CBR effected in May.

1. IMF (July 2022) publication of its Executive Board's decision after the Country's completion of the Third Review of the ECF and EFF Arrangements. Can be accessed via https://www.imf.org/en/News/Articles/2022/07/18/pr266-imf-executive-board-completes-third-reviews-ecf-eff-kenya

Figure 2: Growth in Credit to the Private Sector



> As food and fuel inflation remained elevated, core inflation was also evidently rising over the same period.

Second, economic recovery was underway, but remained fragile facing an escalation of risks, ranging from the global geopolitical disruptions to the domestic political uncertainty and unfavourable weather conditions in most parts of the country. Economic growth in the second quarter of 2022 moderated to 4.6 percent, with heterogenous sectoral performances; as activity in the agriculture sector contracted on account unfavourable weather conditions in most parts of the country, and non-agricultural sector - comprising of industry and services - provided a rebalancing, over the same period.

With the economy projected to expand by 5.7 percent in 2022 (IMF, July 2022)[2], this was not devoid of risks. At the global level, uncertainties stemming from the war in Ukraine and the unsettled global financial market conditions continued to dent the outlook, with both direct and indirect linkages to the domestic economy. On the domestic front, uncertainties also abound associated with the heightened political activities in the run up to the general elections in August that typically trigger a wait-and-see approach by investors. These factors were more likely to dim the economy's strong outlook for the year.

Third, credit growth in June - for the second month in a row -continued to register double-digit growth, breaking the 68 month long single digit growth ceiling. As **Figure 2** shows, credit to the private sector recorded an impressive growth, with June 2022 sustaining a double-digit growth momentum of 12.3 percent up from

2. https://www.imf.org/en/News/Articles/2022/07/18/pr266-imf-executive-board-completes-third-reviews-ecf-eff-kenya

11.3 percent growth in April and 10.8 percent in March. Sectoral private sector credit growth, however, depicted significant heterogeneity, with considerably robust growth in transport and communication (22.2%), manufacturing (15.2%), consumer durables (14.7%) and trade (11.6%). The overall growth in credit was aided partly by the progress made by the industry towards implementation of risk-based pricing that facilitates accommodation of borrowers previously deemed to be too risky to lend to.

Fourth, the weakening exchange rate bias- driven by a widening current account imbalance - risked fueling inflationary pressure and causing additional macro-economic instabilities. The shilling-dollar exchange rate remained on a depreciation path; driven by a relatively weaker current account deficit, and the tightening of financial conditions in advanced markets (particularly following the raise in US Fed rate). Amidst this, however, the official foreign exchange reserves, which signal the capacity of the economy to deal with any emergent instabilities in the market, though declining remained above the statutory minimum of 4 months of import cover, over the period under review.

On the back of elevated oil and non-oil commodity prices, the current account deficit was expected to deteriorate further going forward on account of faster build-up in import bill than the expansion in exports- as the global economic outlook looked bleak. In addition, the financing of the current account remained shaky, as the financial account balance risked deteriorating further on account of the slowdown of global growth and the tightening of the global financial conditions that would potentially constrain capital inflows. The stark depreciation of the shilling had only fanned additional price pressures given the country's dependence on imports that are price-inelastic such as oil, machinery and food.

The policy dilemma on a tightening bias

Amidst these developments, the policy dilemma presented two options for policymakers, both with a tightening bias. Either enhance the signal with a further CBR rate hike or support the transmission of the CBR hike effected in May. While the former would provide a stronger signal for interest rates to rise – given the challenges in the transmission process - the latter, that reflects the decision taken on July 27 - strengthens the role of the ongoing elevated efforts to enhance the rollout and implementation of risk-based credit pricing for the banking sector.

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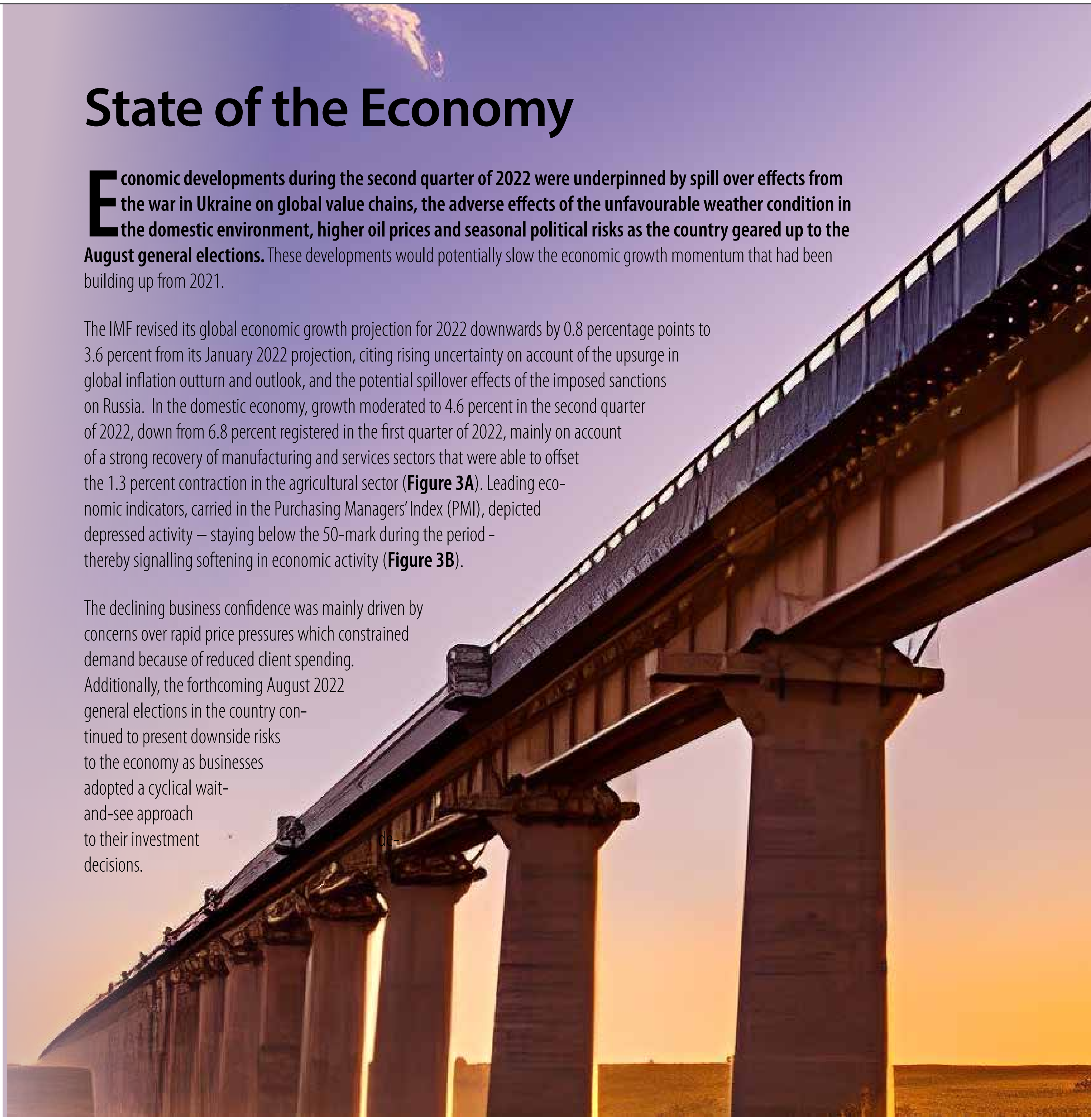


State of the Economy

Economic developments during the second quarter of 2022 were underpinned by spill over effects from the war in Ukraine on global value chains, the adverse effects of the unfavourable weather condition in the domestic environment, higher oil prices and seasonal political risks as the country geared up to the August general elections. These developments would potentially slow the economic growth momentum that had been building up from 2021.

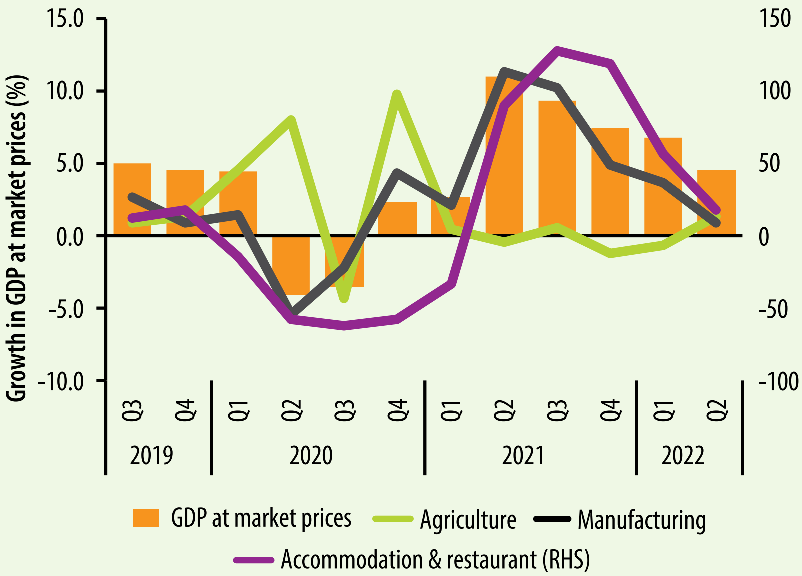
The IMF revised its global economic growth projection for 2022 downwards by 0.8 percentage points to 3.6 percent from its January 2022 projection, citing rising uncertainty on account of the upsurge in global inflation outturn and outlook, and the potential spillover effects of the imposed sanctions on Russia. In the domestic economy, growth moderated to 4.6 percent in the second quarter of 2022, down from 6.8 percent registered in the first quarter of 2022, mainly on account of a strong recovery of manufacturing and services sectors that were able to offset the 1.3 percent contraction in the agricultural sector (**Figure 3A**). Leading economic indicators, carried in the Purchasing Managers' Index (PMI), depicted depressed activity – staying below the 50-mark during the period - thereby signalling softening in economic activity (**Figure 3B**).

The declining business confidence was mainly driven by concerns over rapid price pressures which constrained demand because of reduced client spending. Additionally, the forthcoming August 2022 general elections in the country continued to present downside risks to the economy as businesses adopted a cyclical wait-and-see approach to their investment decisions.

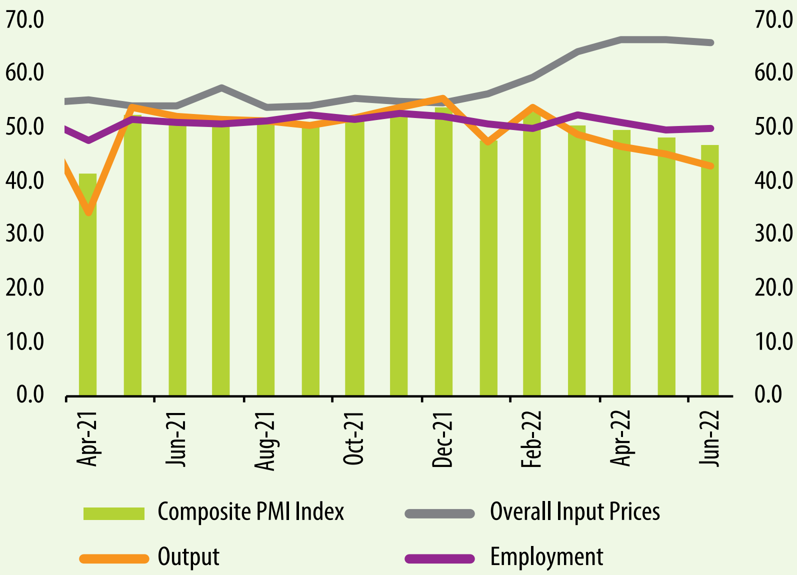
“ Growth in the domestic economy moderated to 4.6 percent in the second quarter of 2022, down from 6.8 percent registered in the first quarter of 2022.

Figure 3: **GDP Performance and Economic Outlook**

3(A) Domestic Economic performance

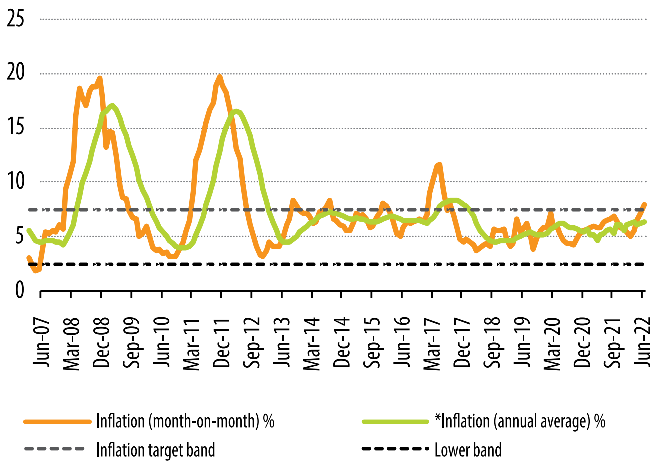


3(B) Trends in PMI



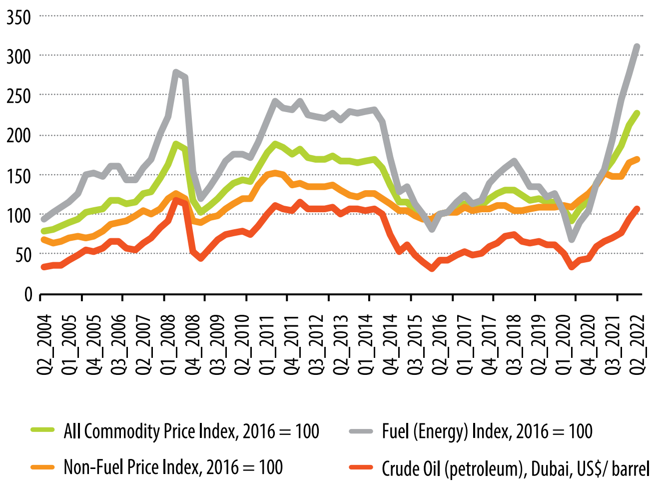
Source: KNBS and IHS Markit®

Figure 4A: Inflation trends



Source: Central bank of Kenya and IMF Global Commodity database

Figure 4B: Commodity prices

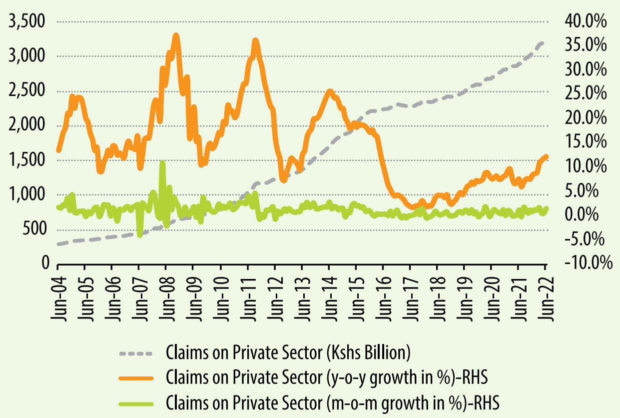


Inflation risks remained tilted on the upside during the quarter as a result of food and fuel price increases, elevated Non-Food-Non-Fuel (NFNF) inflation, as well as imported inflation as the exchange rate depicted a weakening bias. The annual headline and core inflation rose to 6.8 percent and 5.5 percent in June 2022 from 2.7 percent and 2.3 percent in January 2022, respectively (**Figure 4A**). Moreover, the price pressure continued to be exacerbated by sustained spike in global commodities prices on the back of supply-demand imbalances attributable to the Covid-19 pandemic-related disruptions in global supply chains and heightened by the Russia-Ukraine conflict (**Figure 4B)**.

Credit extension to the private sector remained upbeat with banks' increased adoption of the risk-based credit pricing framework giving renewed impetus to double-digit growth credit growth, even with elevated credit risks. At 12.3 percent year-on-year credit growth in June 2022, the credit to the private sector marked the fourth consecutive month of remaining buoyant on a double-digit growth trajectory (**Figure 5A**) and distributed heterogeneously

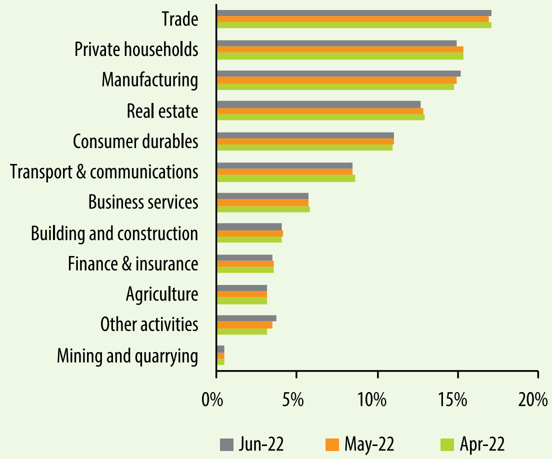
Figure 5: Private Sector Credit and Growth Dynamics

5(a) Private Sector Credit and Growth Dynamics



Source: Source: Central Bank of Kenya

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



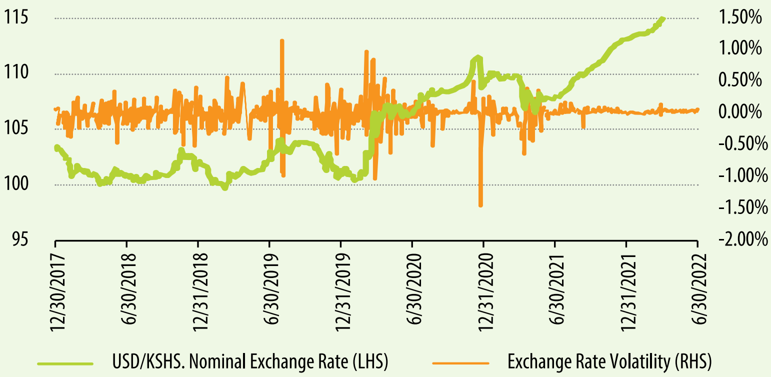
across the sectors (**Figure 5B**). In particular, credit to trade, manufacturing and consumer durables sectors registered robust growth rates moderating the slowdown to private households, transport and communication, building and construction, agriculture, business services and real estate sectors.

The Kenya Shilling weakened by 7.9 percent against the US Dollar to exchange at an average of Ksh.116.3 in the second quarter of 2022 (**Figure 6A**), reflecting pressure from higher interest rates in global markets as policy-makers in these markets tightened monetary policy to reign in on rising inflationary pressures, and foreign exchange supply constrains with the slowdown in global economic performance. However, immigrant remittances were higher compared to inflows over a similar period in 2021. This was despite posting a quantum decline from levels recorded in the first quarter of 2022; easing to USD 1,023.8 million during the first quarter to USD 1,020.8 million in the second quarter of 2022 (**Figure 6B**).

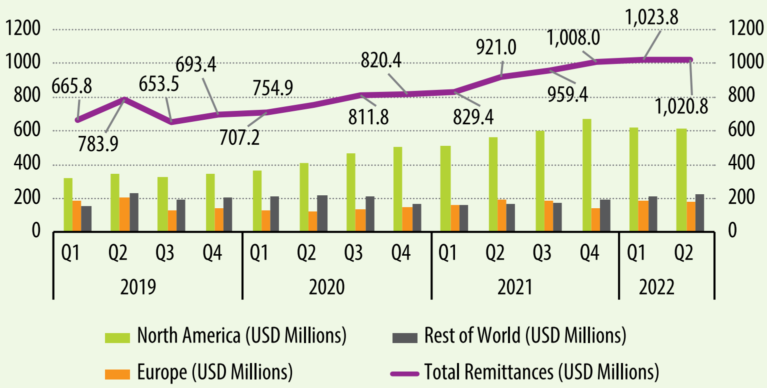
Other broader balance of payments developments showed that bilateral trade at the global and intra-Africa landscape was largely unchanged during the quarter, relative to previous quarters. For instance, Uganda and the United States of America remained the leading export destination of Kenya's exports, each constituting 10.68 percent and 11.05 percent of total exports, respectively.

Figure 6: Kenya Shilling -US Dollar Exchange Rate dynamics and Remittances inflows

6(a): Kenya Shilling -US Dollar Exchange Rate Dynamics



6(b) Trends in remittances flow by regions

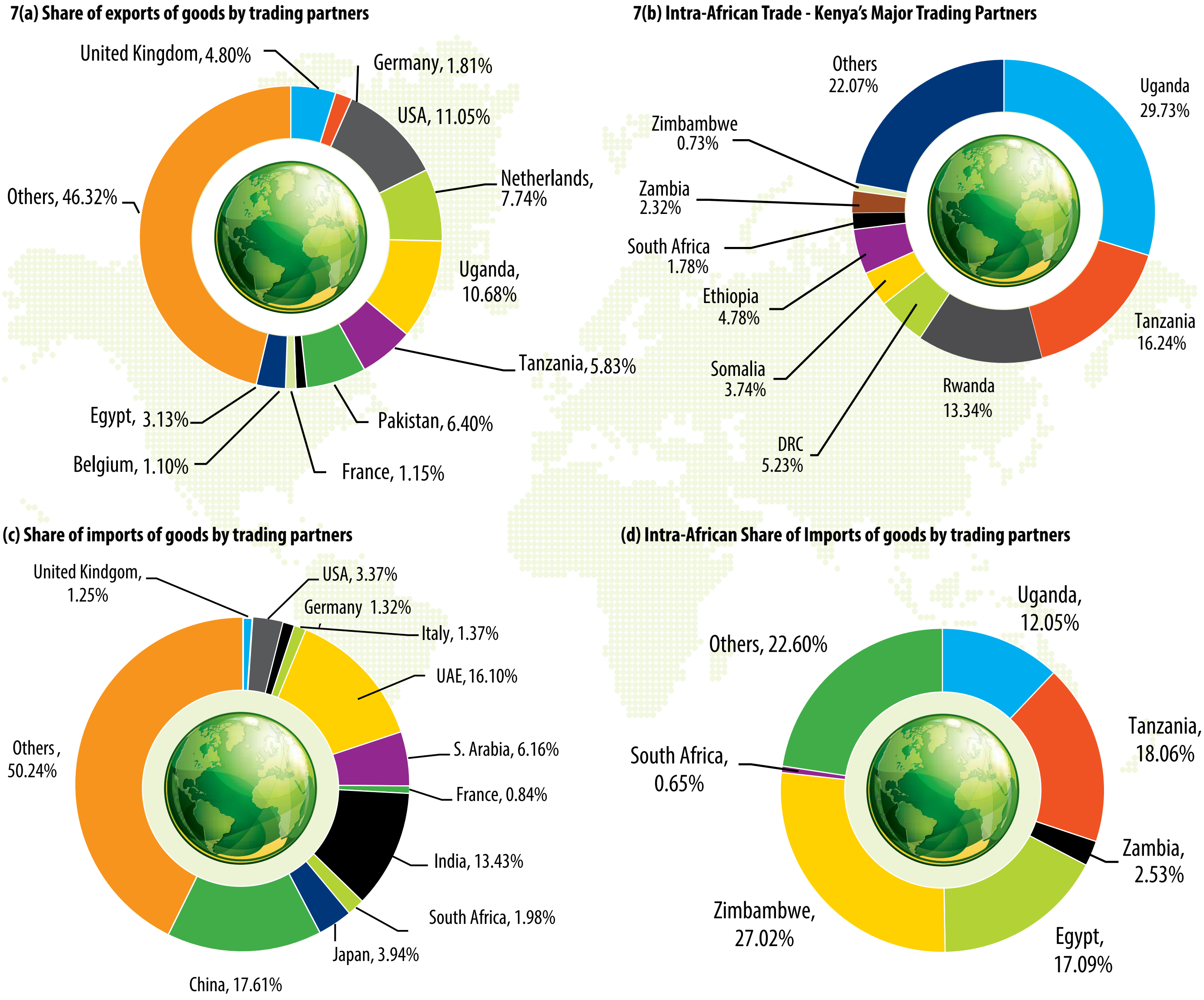


Source: Central Bank of Kenya

Analyses of intra-Africa exports data shows that three countries – that is Uganda, Tanzania and Rwanda – accounted for about 70 percent of Kenya's exports to other African countries, each country respectively absorbing 29.73 percent, 16.24 percent and 13.34 percent.

On the import side, the main source countries were China and India; accounting for a combined 33.71 percent of total imports, as Tanzania and Zimbabwe accounted for 23.70 percent and 20.21 percent of Kenya's total imports from Africa (**Figure 7**).

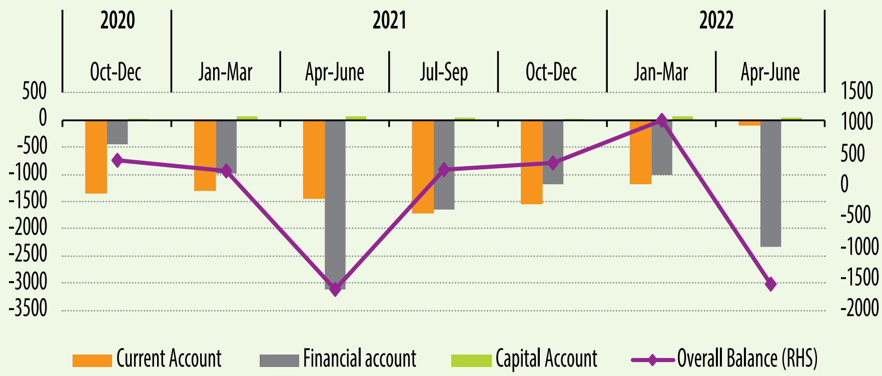
Figure 7: Kenya's Intra-African and Global Trade Developments



Source: Central Bank of Kenya

The overall balance of payments position during the quarter reflected a deficit of USD 101 million compared to a deficit of USD 1,666 million in the second quarter 2021 and a surplus of USD 1,059 million recorded during the first quarter 2022. As a building block, the current account remained weak, widening during the second quarter to USD 1,588 million compared to USD 1,462 million over a similar period in 2021. While there were minimal variations on the capital account, there was a slowdown in the net inflows on the financial account, reflecting volatilities in the global financial markets as global interest rates rose during the period (**Figure 8**).

Figure 8: Balance of the Payments Performance



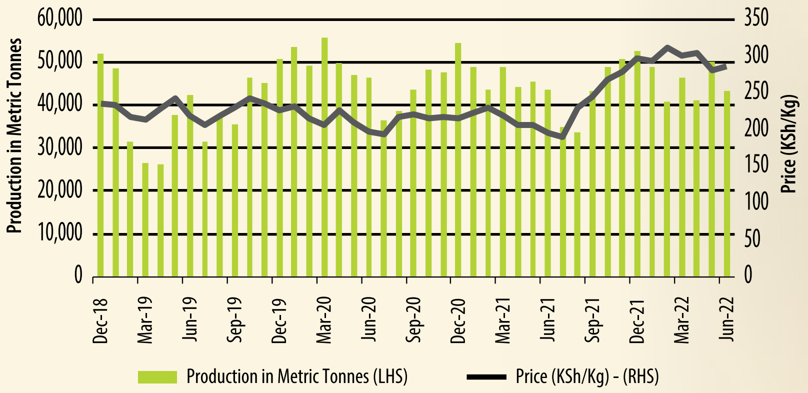
Source: CBK Quarterly Economic Review

Sectoral Performance

Agriculture

Agriculture remains the backbone of the Kenyan economy; for its direct contribution to the overall economic performance and the value added through its multiplier effects. This report highlights developments in a few agricultural products during the quarter. It is observed that tea production grew marginally (1.08 percent) during the second quarter of 2022 to 134,453 metric tonnes, compared with 133,090.05 metric tonnes produced over a similar period in 2021, even with a more erratic rainfall period during the quarter under review. Even with increased production, the auction price for tea remained high (**Figure 9**).

Figure 9: Tea production and Prices

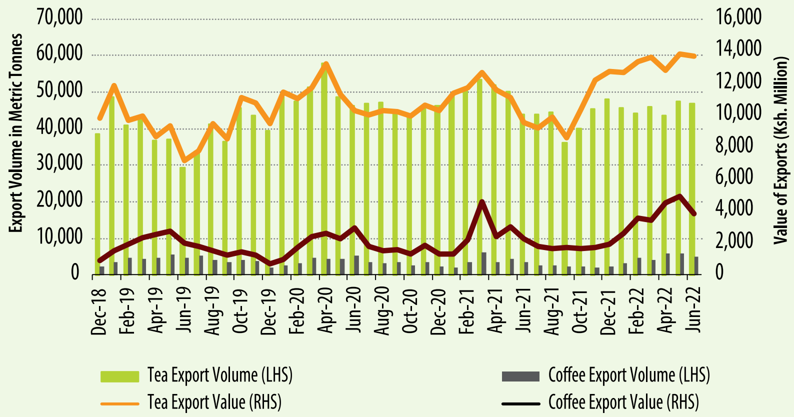


Source: KNBS

On the export side, Tea export volumes declined during the second quarter of 2022, but the higher prices resulted in a higher value being created. The total exported tea stood at 137,620.83 metric tonnes valued at Ksh. 40,232.32 million during the second quarter 2022, compared to 145,934 metric tonnes valued at Ksh. 32,194.28 million in the second quarter of 2021. The reduced tea production was compounded by reduced demand in global markets as global economic performance remained depressed and geopolitics in Ukraine adversely affected markets with declined Russia's role in the auction market.

> **"The reduced tea production was compounded by reduced demand in global markets as global economic performance remained depressed and geopolitics in Ukraine adversely affected markets**

Figure 10: Value of Tea and Coffee Exports

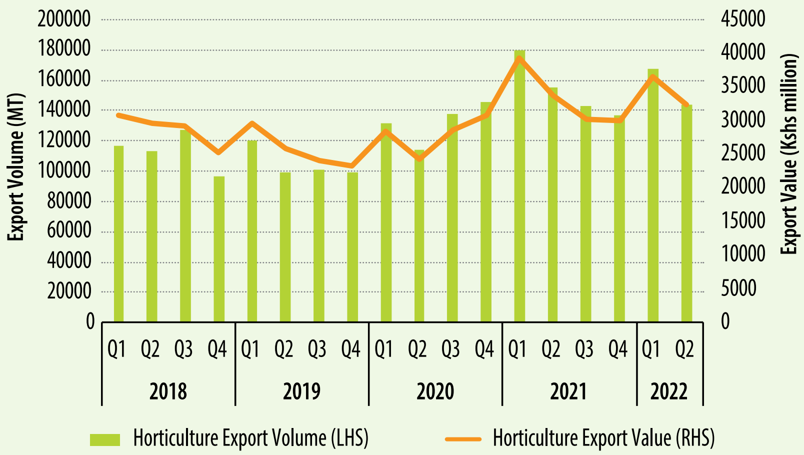


Source: KNBS

Though at lower production and earnings level, analyses of coffee exports, however, depicted some improvements, with the quantity exported rising to 16,597.39 metric tonnes (valued at Ksh. 13,162.88 million) compared to 11,485.50 metric tonnes (valued at Ksh. 7,681.99 million) over a similar quarter in 2021.

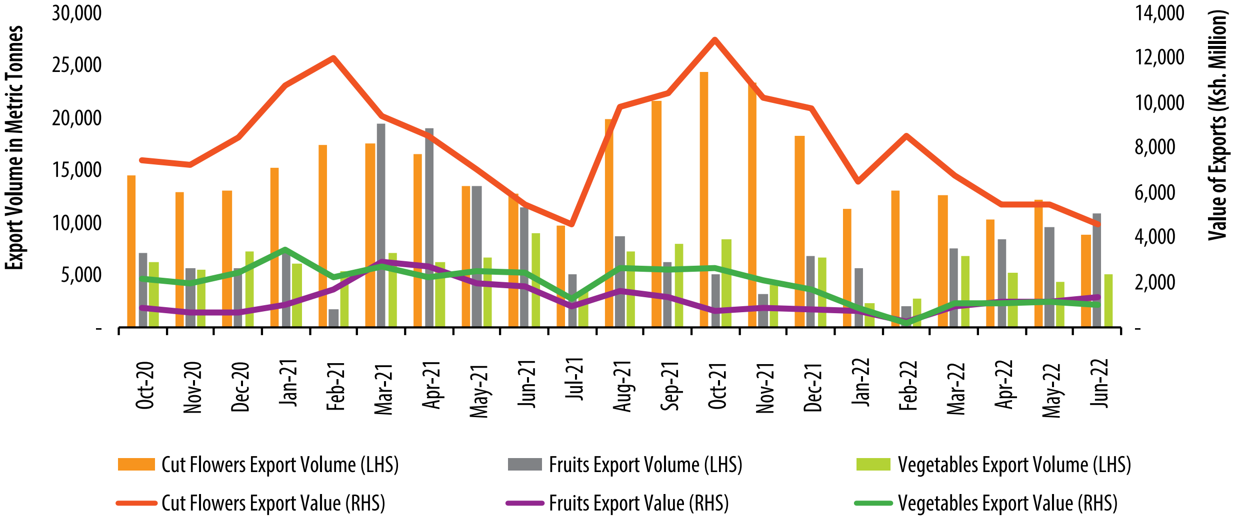
Horticultural exports, overall, declined in value by 3.83 percent during the second quarter of 2022 reflecting a decline in the value of fruits; more than offsetting the increase in exports of exotic vegetables, aromatic vegetables, and Asian vegetables (**Figure 11a**).

Figure 11a: Horticultural Exports

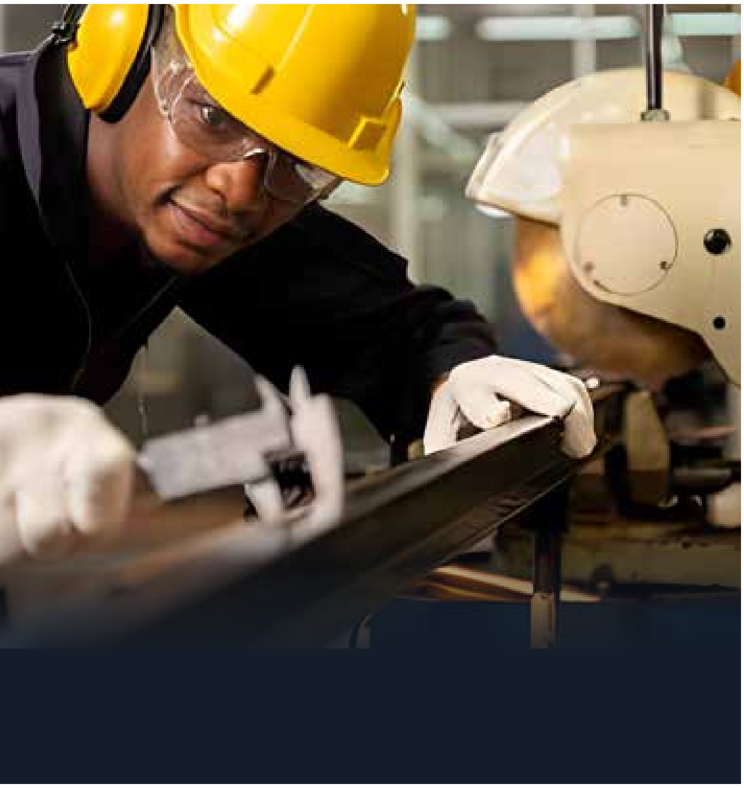


Source: KNBS

Figure 11b: Cut Flowers, Vegetables and Fruits



Source: KNBS



The volume of horticultural exports declined by a larger margin; 6.92 percent from 155,045.08 metric tonnes in the second quarter in 2021 to 144,310.17 metric tonnes over the period under review (**Figure 11b**). In particular, vegetable export volumes also declined to 14,626.72 metric tonnes over the period compared with 21,814.86 metric tonnes recorded in the second quarter of 2021; a development that drove the value down by more than half from Ksh. 7,149.17 million in the second quarter of 2021 to KSh 3,221.61 million in the second quarter of 2022. Similarly, the volume of fruits exported dropped to 28,863.30 metric tonnes from 43,895.04 metric tonnes over a similar period in 2021 to 28,863.30 metric tonnes under the review period. The export of cut flowers also decreased by 11,513.38 metric tonnes, while its value decreased by Ksh 5,516.42 million, over the second quarter of 2022 when compared to the value achieved in a similar quarter in 2021.

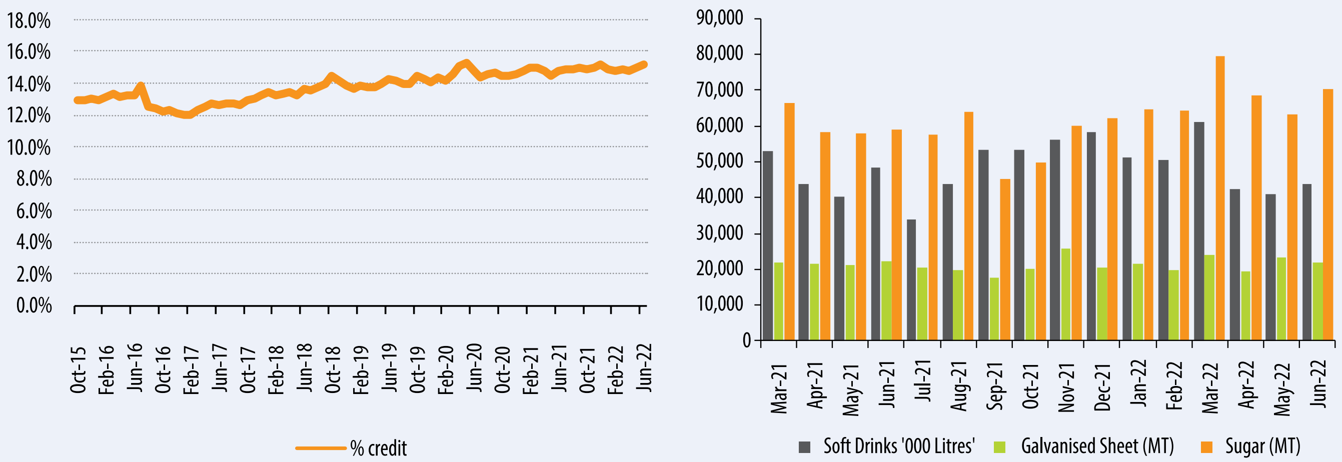
Manufacturing

Activity in the manufacturing sector expanded during the second quarter of 2022; driving a stronger uptake of credit by the sector (**Figure 12a**). In particular, the share of credit to the manufacturing sector grew to 15.0 percent during the quarter, up from 14.7 percent in a similar period in 2021 and 14.8 percent in the first quarter 2022. Notable drivers of manufacturing sector activity during the quarter included production of soft drinks and galvanized iron sheets, with the latter reflecting a strong pick up in the construction sector (**Figure 12b**).

Figure 12: **Production in manufacturing sub-sectors**

12(a) Credit to the manufacturing sector as a percentage of total credit

12(b) Production in manufacturing sub-sectors



Source: KNBS

Producer Price Index

The Producer Price Index (PPI), based on March 2019 prices, reflected a price inflation of 16.7 percent year-on-year in the second quarter 2022, from 108.1 in the second quarter of 2021 (**Figure 13**). The uptick in producer prices was on trend, reflecting the escalating costs of production, attributed largely to the growing global supply constraints on account of the Russia-Ukraine war. The second quarter year on year producer inflation represented a sharp increase in producer prices from a producer price inflation of 6.4 percent recorded in June 2021.

Figure 13: **Producer Price Index**

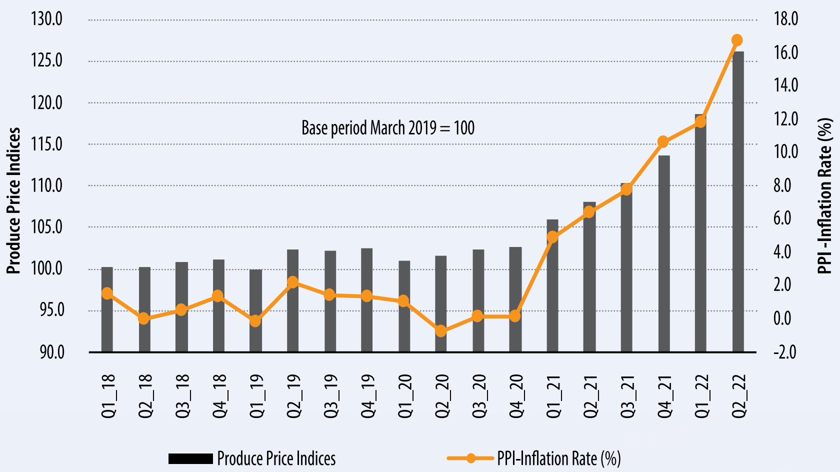
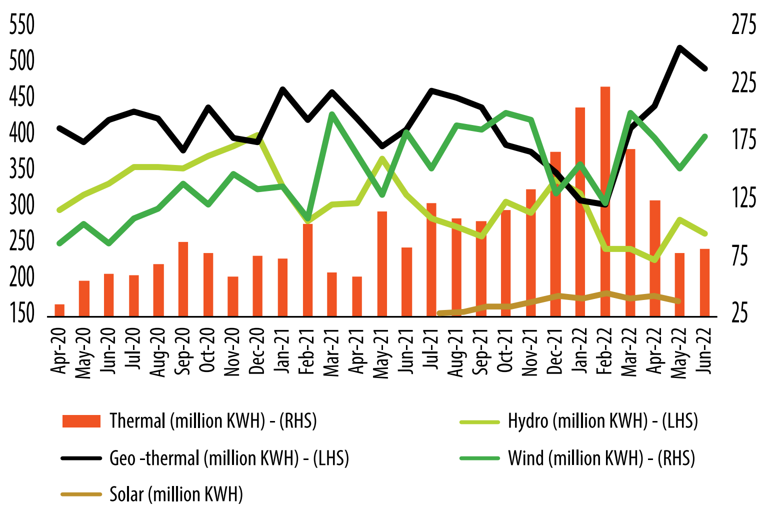


Figure 14: Monthly Electricity Generation by Source



Source: KNBS

Energy

Analyses of energy generation during the quarter, depicted a 5.13 percent growth to 3,128.59 million kilowatts relative to levels recorded over a similar period in 2021(**Figure 14**). It is also observed that the dominance of geothermal and hydroelectric power was strengthened, as the two sources of energy accounted for 71.42 percent of the total electricity generated during the quarter, majorly driven by a 19.5 percentage growth in geothermal electricity production.

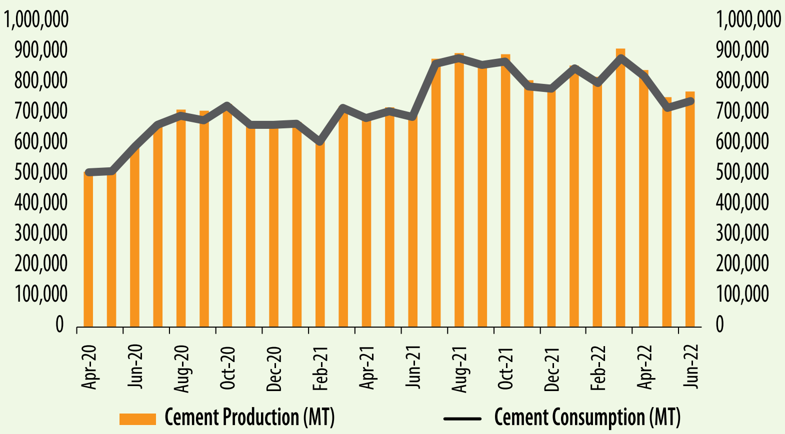
Movements in crude oil prices depict elevated prices, driven by supply bottlenecks that were compounded by the Russia-Ukraine conflict. In particular, Murban crude oil prices during the period rose to USD 117.7 per barrel by the end of the quarter (**Table 1**). Consequently, the average domestic petrol pump prices and LPG gas prices edged upwards, mimicking a strong pass-through of global oil prices to the domestic pump prices.

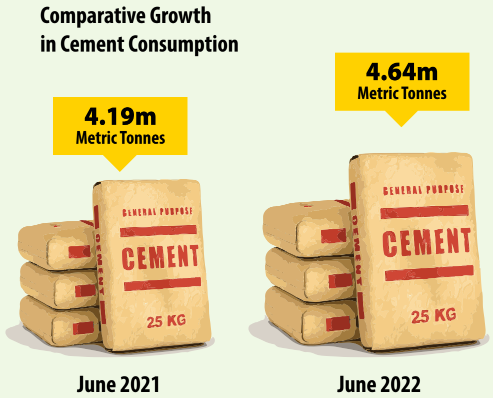
Table 1: Table 1. Average Monthly Crude Oil and Retail Fuel Prices

	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22
Murban crude oil (US$/Barrel)	73.5	70.3	73.9	82.1	80.4	74.4	85.4	94.0	113.5	105.6	113.9	117.7
Super petrol (KES/Litre)	128.0	128.0	135.5	130.5	130.5	130.5	130.5	130.5	135.5	145.4	150.9	159.9
Diesel (KES/Litre)	108.6	108.6	116.5	111.5	111.5	111.5	111.5	111.5	116.5	126.4	131.9	140.9
Kerosene (KES/Litre)	98.8	98.8	111.7	104.5	105.5	106.5	106.5	106.5	104.5	114.4	119.9	128.9
LPG (13Kgs)	2,394.2	2,420.7	2,445.2	2,513.7	2,611.2	2,638.8	2,659.2	2,659.7	2,866.2	2,924.6	3,176.9	3,218.2

Source: KNBS

Figure 15: Cement Production and Consumption





Source: KNBS

Building and Construction

Building and construction activities moderated during the quarter relative to the three previous quarters. However, it was higher than a similar period in 2021. Cement production during the quarter slowed-down from levels recorded in the first quarter but remained higher at 2,363,653 metric tonnes during second quarter compared with 2,112,046 metric tonnes reported for a similar period in 2021. Cement consumption, on its part stood at 4,639,627 metric tonnes during the quarter, up from 4,189,776 metric tonnes reported in a similar period in 2021 (**Figure 15**).

Tourism

Tourists' arrivals accelerated during the quarter, rising to 279,981 during the second quarter. Out of this, the inbound arrivals through the Nairobi JKIA terminal stood at 267,769 in the quarter compared to 106,497 in a similar period in 2021, reflecting a stronger recovery of the tourism sector from the depressing effects of COVID-19 pandemic. The arrivals through Mombasa international airport (MIA) terminal was at 12,212; also reflected growth when compared to a similar period in 2021 (**Figure 16**).

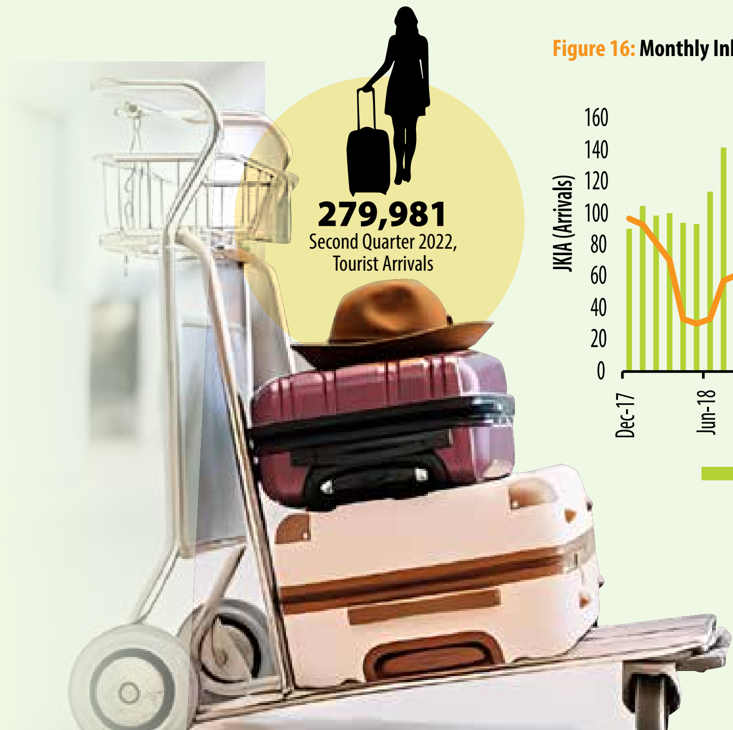
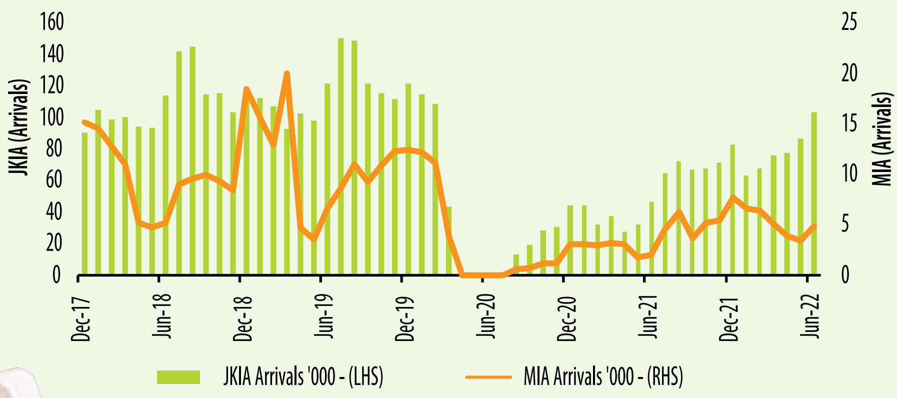


Figure 16: Monthly Inbound Tourist Arrivals (in thousands)



Government Revenue and Expenditure

Analyses of the Government's budgetary operations for the final quarter of FY 2021/2022 show that total revenue and grants grew by 15.5 percent to Ksh. 636.9 billion from Ksh 551.4 billion over a similar period in FY 2020/21.

Total expenditure and net lending decreased to Ksh 885.9 billion, relative to Ksh 891.6 billion in a similar period in the FY 2020/2021 (**Figure 17**), consistent with the government's fiscal consolidation path. However, the growth in revenue was lower than the decline in expenditure thus leading to an expansion in the primary deficit within the quarter.

During the period, income tax remained the top source of government revenue, accounting for 42.9 percent of total revenue, followed by value added tax that accounted for 20.4 percent, as excise duty and import duty came in third and fourth at 9.6 percent and 4.8 percent, respectively (**Figure 18**).

The total government expenditure, illustrated by **Figure 19**, indicates that during the final quarter of FY 2021/2022, recurrent expenditure accounted for 81.9 percent, while development expenditure accounted for 18.1 percent of the total government expenditure. The breakdown of the recurrent expenditure revealed that Salaries and wages accounted for 14.1 percent with county transfers and domestic interest payments accounting for 14.3 percent and 13.1 percent, respectively. Foreign interest repayments and pension payments each accounted for 3.0 percent of the total recurrent expenditure.

Figure 17: Quarterly Revenue-Expenditure Gap

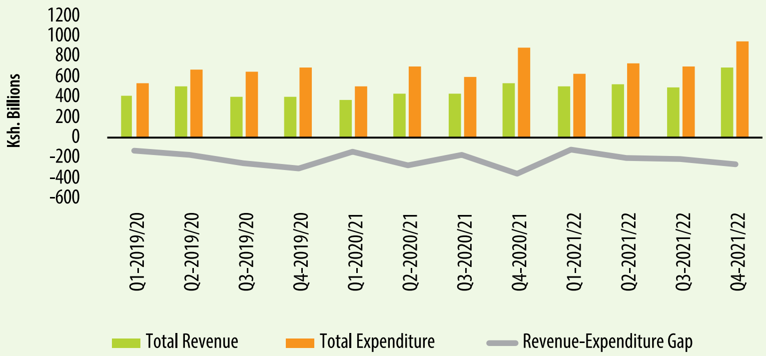


Figure 18: Quarterly Revenue Structure

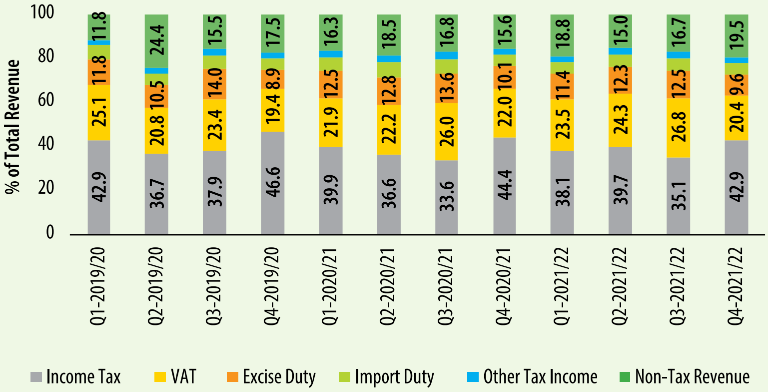
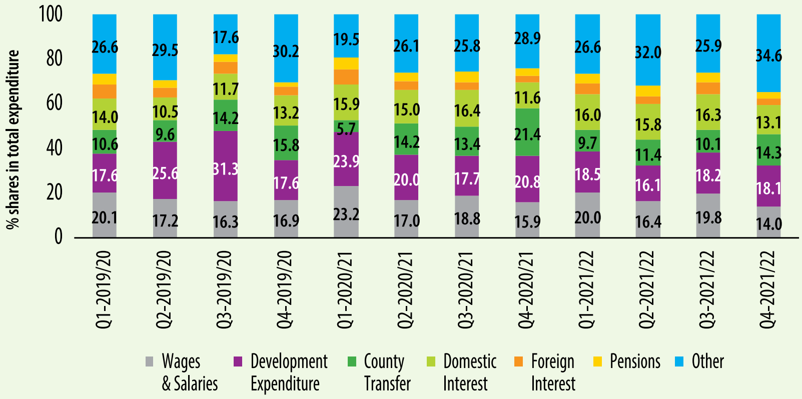


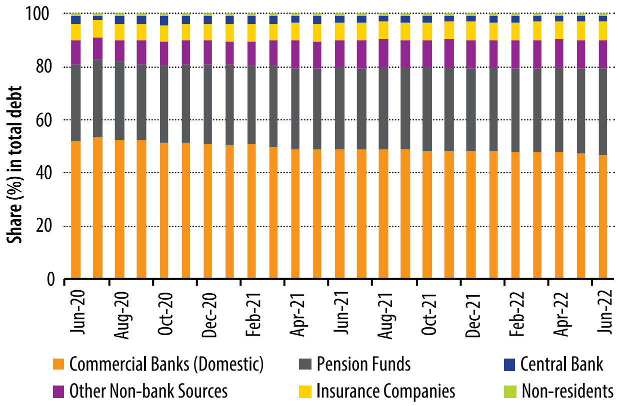
Figure 19: Quarterly Revenue Structure



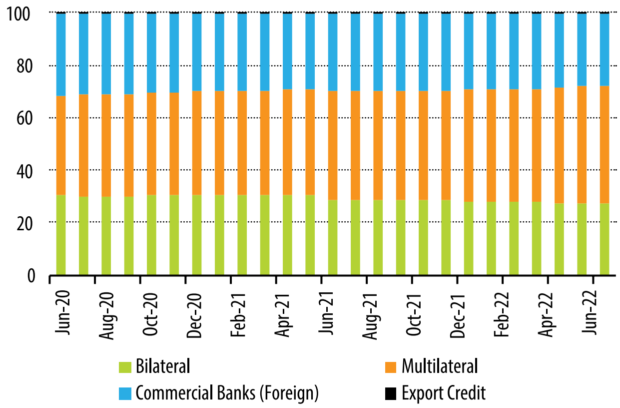
Government Deficit Financing & Public Debt

Figure 20: **External and Domestic Debt and its Composition**

(a) Domestic Debt



(b) External Debt

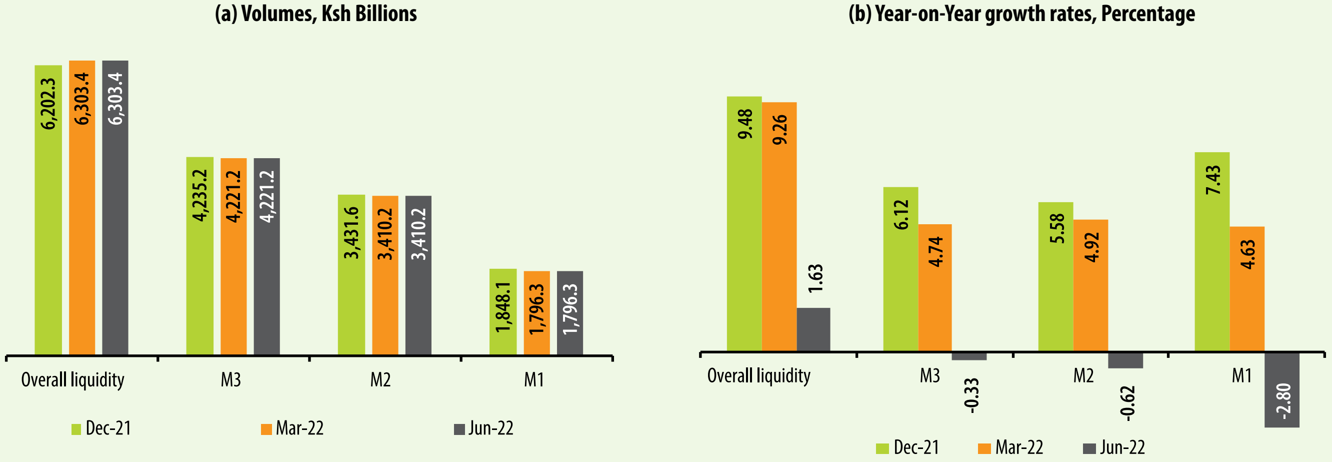


Analyses of deficit financing shows that the total public debt by the final quarter of the financial year 2021/2022 stood at Ksh. 8.58 trillion, with growth evident in both the domestic and external debt (Figure 20). The domestic debt and, public and publicly-guaranteed external debt increased by 2.3 percent and 2.0 percent, respectively during the fourth quarter of FY 2021/22.

While the growth in domestic debt was largely driven by 4.0 percent increased uptake of Treasury bonds, the growth in external debt during the quarter mainly reflected the exchange rate movements, as the Kenya shilling continued to depreciate against the dollar.

During the period, while commercial banks and pension funds were the majority holders of domestic public debt – accounting for 46.72 percent and 36.39 percent, respectively, while multilateral (accounting for 44.84 percent), bilateral (27.34 percent) and commercial banks (27.53 percent) dominated the external public debt during the quarter.

Figure 21: Trends in Monetary Aggregates



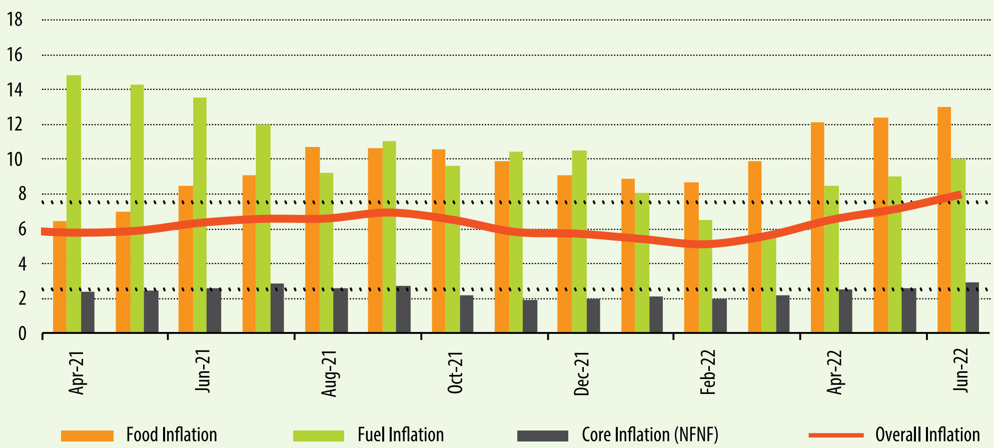
Money Supply

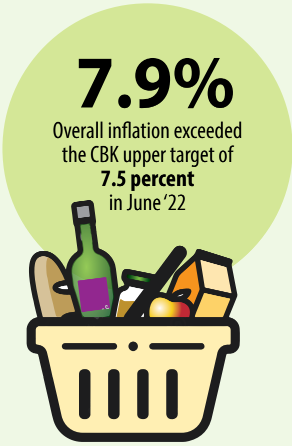
Overall liquidity was up by 12.32 percent on a year-on-year basis to close the quarter at Ksh. 6,626.2 billion, compared with Ksh. 5,899.5 billion recorded in a similar period in 2021. This was mainly driven by an expansion in broad money supply (M3) which grew by 5.2 percent during the quarter as a result of increased deposits driven by the recovery in economic activities; that led to an increase in private sector credit and net lending to government. Narrower monetary aggregates; M1 and M2, increased by 5.15 percent and 7.17 percent respectively in June 2022 from 4.92 percent and 4.63 percent, respectively, in March 2022 (**Figure 21**).

Inflation

Inflationary pressure build-up persisted during the quarter largely driven by increases in food and fuel prices (**Figure 22**). In particular, in June 2022, the overall inflation exceeded the official target upper band of 7.5 percent, to stand at 7.9 percent as food and fuel inflation rose to 13 percent and 10 percent, respectively. Core inflation; the non-food-non-fuel inflation also edged up during the period to 2.9 percent in June 2022, reflecting the pass-through effects of sustained fuel and food price increases and rising demand as growth in credit to private sector remained robust.

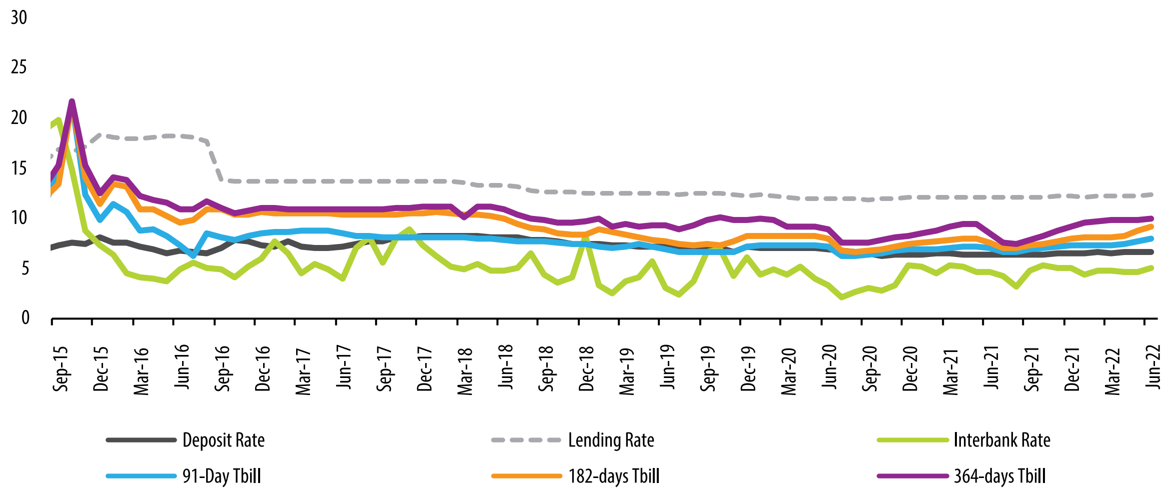
Figure 22: Inflation Dynamics





Source: Central Bank of Kenya

Figure 23: Interest Rates Dynamics



Source: Central Bank of Kenya

Interest Rates

Analyses of interest rate trends shows that interest rates generally remained on an increasing trajectory. The significant rise in the interbank rate reflected the transmission of the Central Bank Rate (CBR) hike to 7.5 percent in June, from 7.0 percent in May. Consequently, the interbank rate rose to 5.06 percent in June 2022, up from 4.6 percent in May 2022. The other market rates equally inched up, but the rise was significantly lower in comparison to the interbank rates (**Figure 23**); mirroring the structural challenges that continue to impede the transmission of policy rates to longer term market rates.

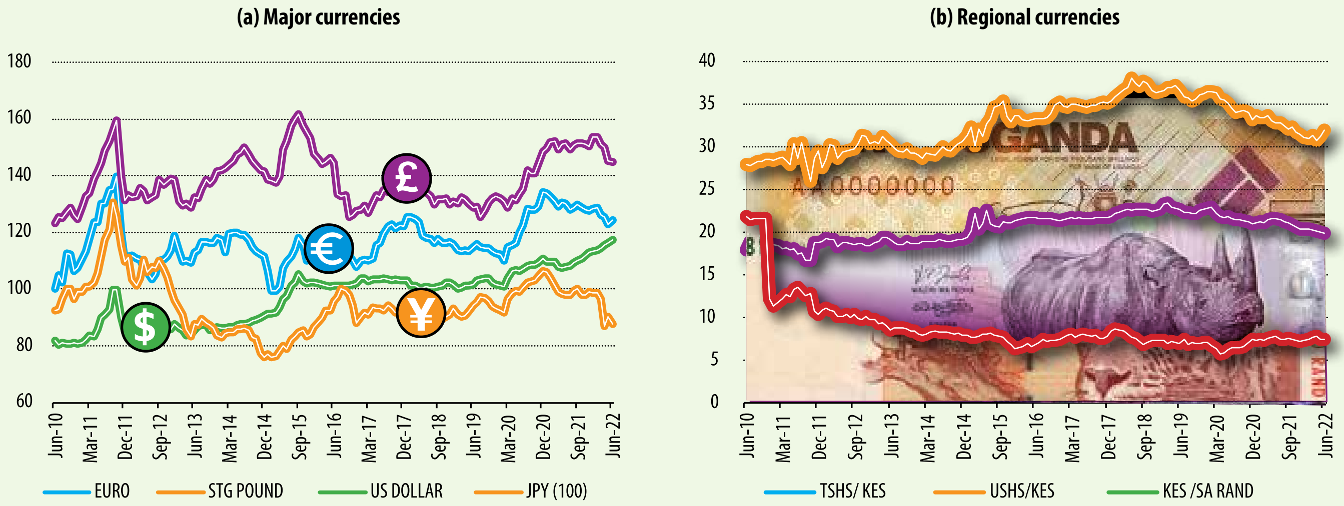
Exchange Rates

The foreign exchange market came under intense pressure, evidenced by the strong depreciation of the Shilling against the US dollar; the main reserve and trading currency. The shilling weakened by 7.9 percent against the US dollar when compared to its level in the second quarter of 2021, to exchange at an average of Ksh 116.3 in the second quarter of 2022 on the back of bearish sentiments

occasioned by tightening of monetary policy by the Federal Reserve Board leading to offshore investors adjusting their portfolio holdings in Kenya.

In addition, the widened current account deficit triggered a faster build-up in import costs than the receipts on exports pushed up the demand for US dollars in the market, adding to the weakening pressure on the Shilling. Relative to other major currencies, however, the shilling strengthened against the Sterling Pound, the Euro, and the Japanese Yen **(Figure 24 a)**. In the EAC region, it depreciated against the Uganda shilling and the Tanzania Shilling to exchange at an average of UGsh. 31.31, and Tsh.19.99 per Kenya shilling, but remained somewhat steady against the South African Rand exchanging at an average of Ksh 7.49 per unit of Rand.

Figure 24: Exchange Rate Developments



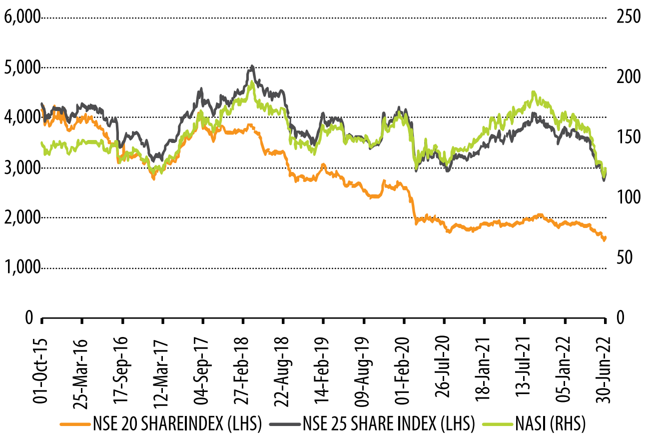
Source: Central Bank of Kenya

Capital Markets

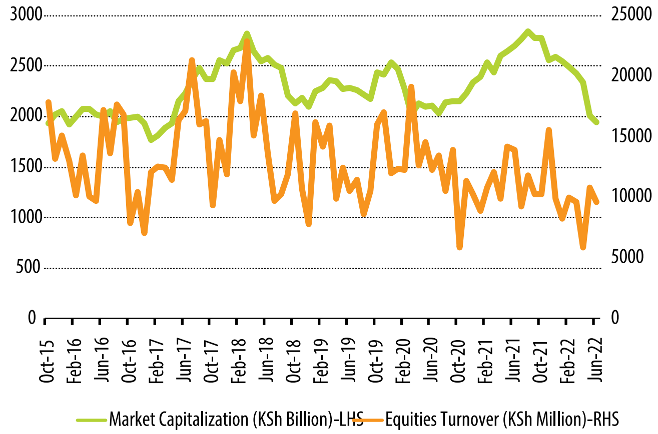
The capital market witnessed reduced activity during the second quarter of 2022, as all the benchmark indices declined (**Figure 25a**). The NASI declined from 158.08 in April 2022 to 124.47 in June 2022; representing 21.3 percent slide, while the NSE-25 and NSE-20 were up by 16.8 percent and 12.5 percent, respectively over the period. This reflected some mixed performance across the market driven by investor preferences of certain counters. Total market capitalization – in tandem with the overall decline of market activity- also dropped by 20.05 percent from Ksh. 2,425.53 billion at the close of the first quarter of 2022 to Ksh. 1,939.21 billion at the end of the second quarter 2022 (**Figure 25b**). However, the cumulative number of shares traded rose by almost half by the second quarter (42.24 percent) (**Figure 25c**). Equity turnover, declined marginally from Ksh. 9,641.00 in April 2022 to Ksh. 9,607.73 in June 2022. The trend decline in the volume of contracts traded in the derivatives market was sustained during the quarter (**Figure 25d**).

Figure 25: Trends in Nairobi Securities Exchange Leading Indicators

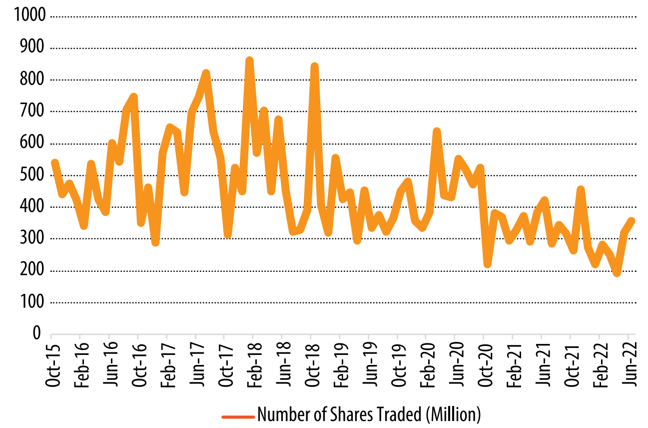
(a) Trends in the NSE 20 Share Index, NSE 25 Share index and NASI



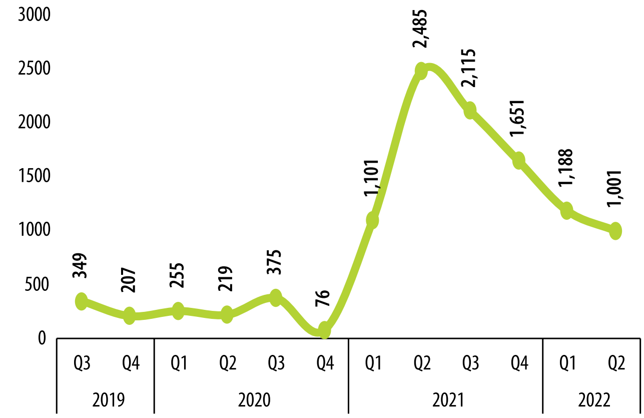
(b) Trends in market capitalization and Equities turnover



(c) Number of Shares Traded (Million)



(d) Trends in the number of derivative contracts

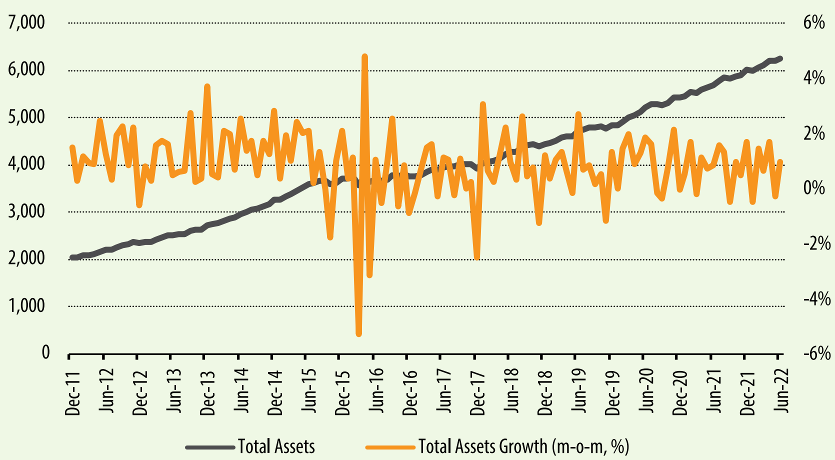


Source: Nairobi Securities Exchange

Banking Sector Performance

The banking sector continued to register robust performance. The total assets registered a year-on-year growth of 10.0 percent, rising to KSh 6,249.7 billion in June 2022 compared with Ksh 5,680 billion in June 2021 (Figure 26), mainly on account of the 12.3 percent growth in loans and advances.

Figure 26: Total Assets



The net loans and advances for the sector edged up to Ksh 3,492.8 billion in the second quarter of 2022; a significant portion of which was absorbed by personal and household loans (whose cumulative book stood at Ksh 950 billion), trade (Ksh 629 billion), Manufacturing (KSh 492 billion), energy and water (KSh 140 billion), and transport and communication (KSh 293 billion) sectors.

Comparative growth in Total Assets

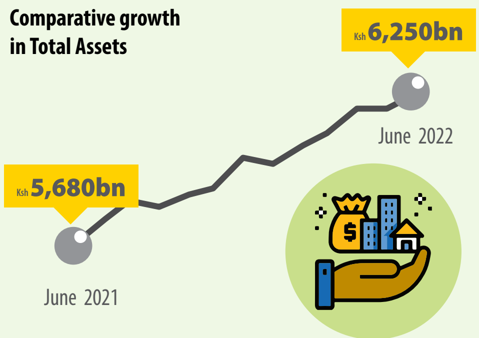


Figure 27: Industry Average Liquidity Ratio

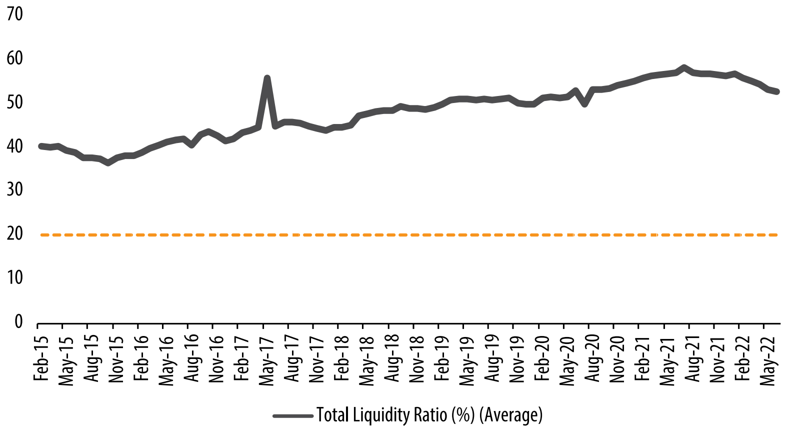


Figure 28: Asset Quality

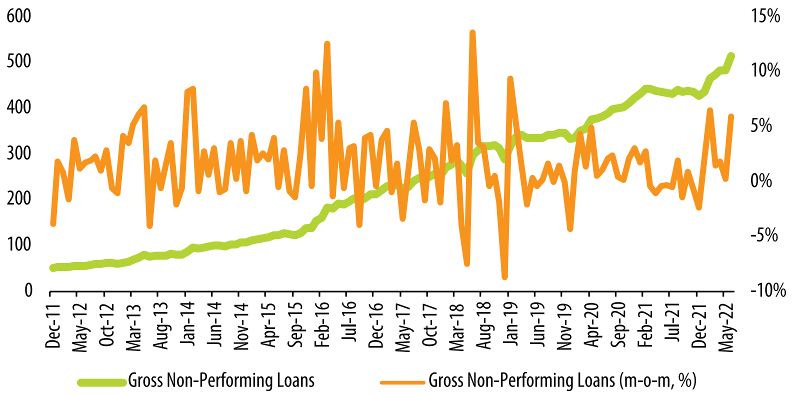
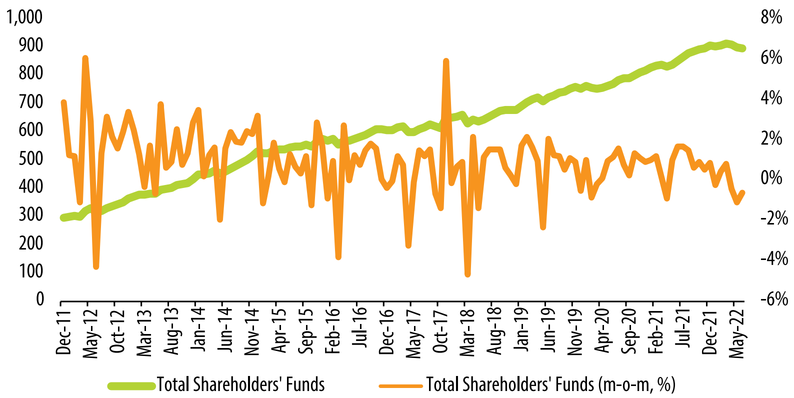


Figure 29: Total shareholders' Funds



The banking sector's overall liquidity ratio, despite posting a slight decline to 52.5 percent in the second quarter of 2022, down from 56.8 percent in the second quarter of 2021, remained well above the statutory limit of 20 percent.

The industry's asset quality deteriorated slightly, with the ratio of gross non-performing loans (NPLs) to total loans edging up during the quarter. In particular, gross NPLs rose from Ksh 435.3 billion during the second quarter of 2021, to KSh 514.4 billion at the end of the second quarter of 2022 (**Figure 28**). As a ratio to total loans, the NPLs ratio rose to 14.73 percent in the second quarter of 2022, from 13.99 percent in the second quarter of 2021 due to a faster growth in gross non-performing loans (18.17 percent) that outpaced a 12.31 percent increase in gross loans.

The banking industry total shareholders' funds remained largely on its strong growth trajectory, increasing to Ksh 893.0 billion at the end of the second quarter of 2022 compared to Ksh 850.80 billion during the second quarter of 2021 (**Figure 29**).

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13th Floor, International House, Mama Ngina Street
P.O. Box 73100– 00200 NAIROBI
Telephone: 254 20 2221704/2217757/2224014/5
Cell: 0733 812770/0711 562910
Fax: 254 20 2221792
Email: research@kba.co.ke
Website: www.kba.co.ke

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Kenya Bankers Association
13th Floor, International House, Mama Ngina Street
P.O. Box 73100 – 00200 NAIROBI
Telephone: 254 20 2221704/2217757/2224014/5
Cell: 0733 812770/0711 562910
Fax: 254 20 2221792
Email: research@kba.co.ke
Website: www.kba.co.ke

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