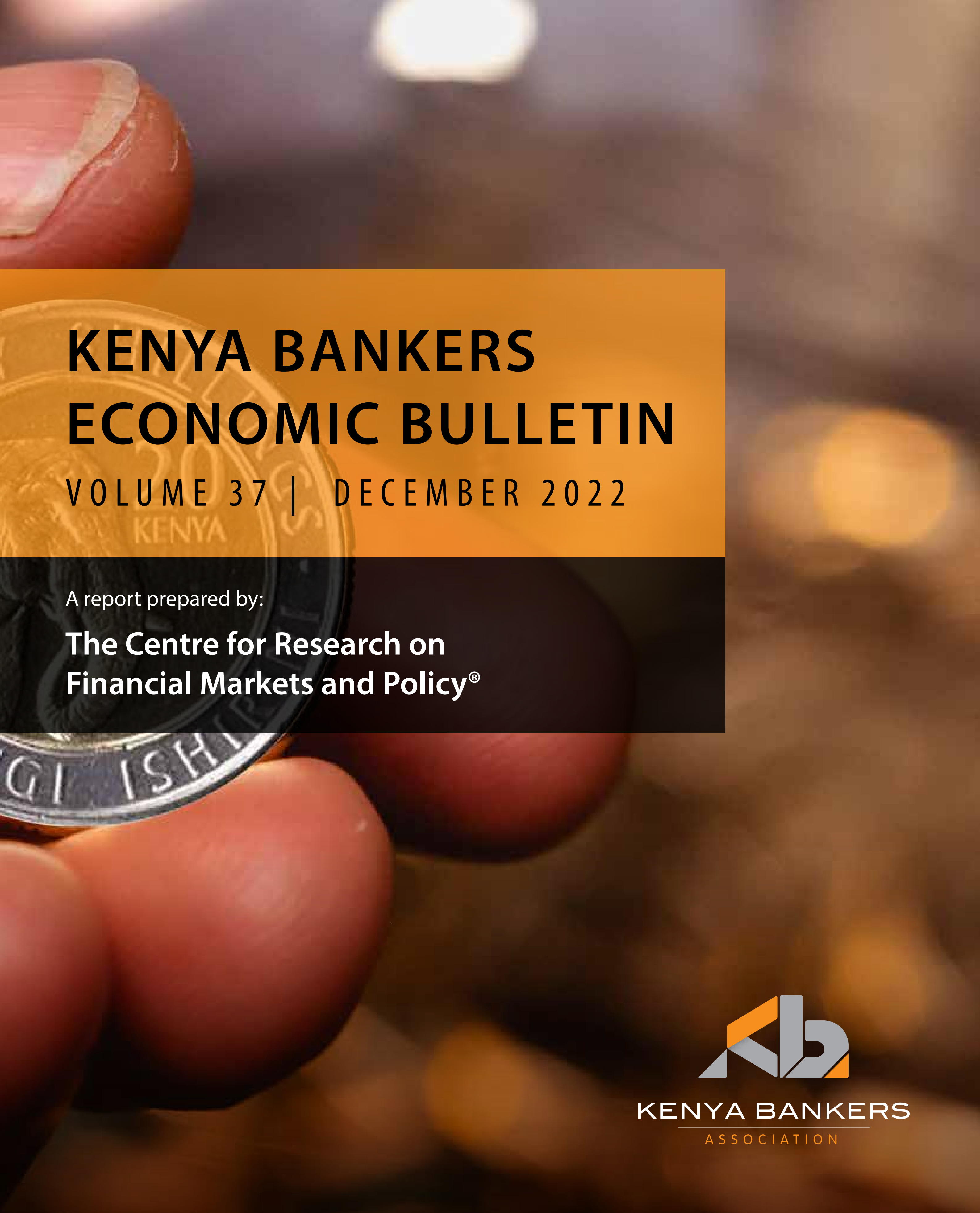

KENYA BANKERS ECONOMIC BULLETIN

VOLUME 37 | DECEMBER 2022

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 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®

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FOREWORD

From the CEO's Desk

It is my pleasure to present to you the 37th Issue of the *Kenya Bankers Economic Bulletin*. In this issue, we discuss the state of the Kenyan economy during the third quarter of 2022. The *Bulletin* reviews the strides that the economy has made during the year, with an emphasis on the opportunities and constraints that continue to shape the economy's performance at overall and sectoral level.

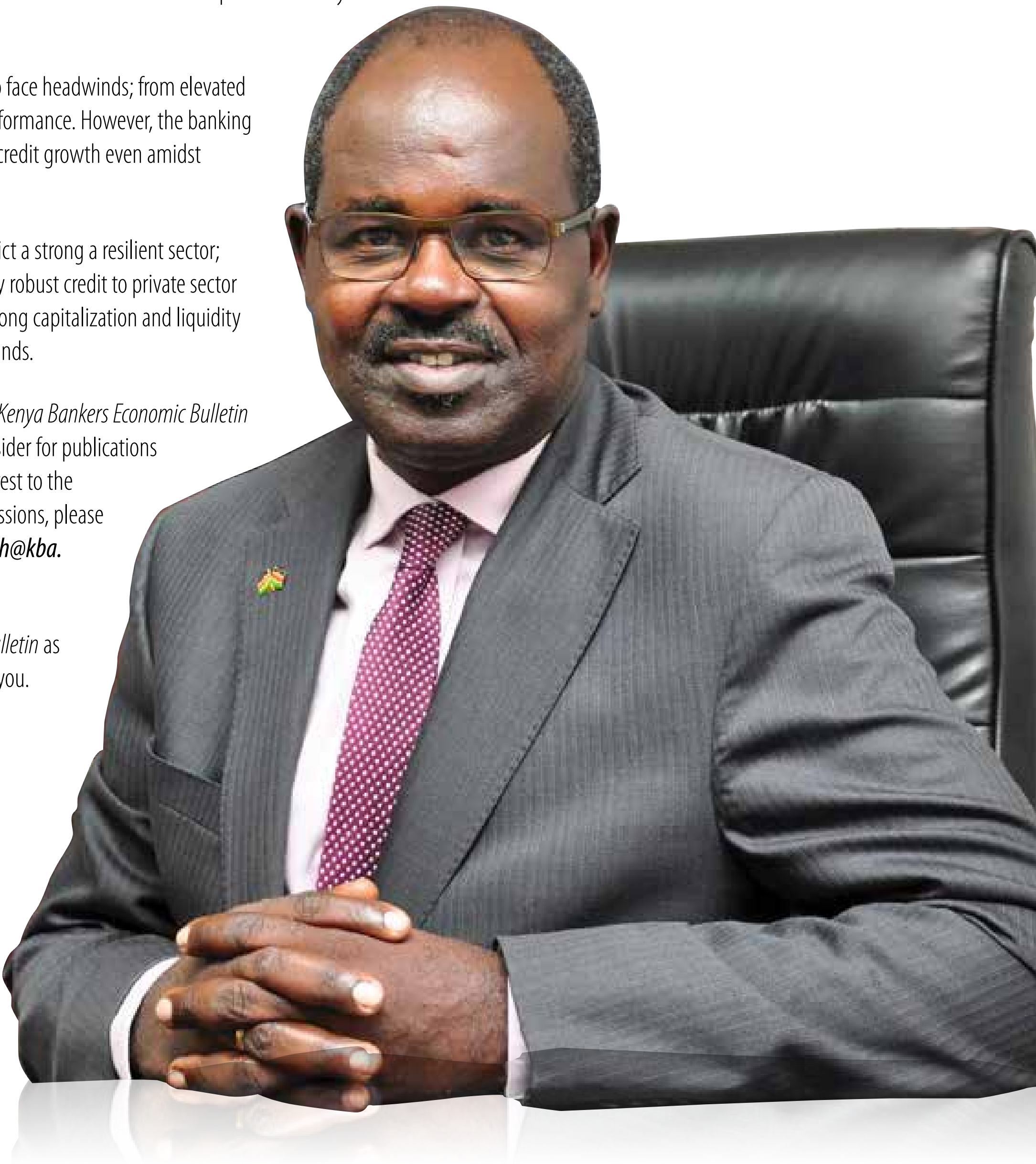
As the *Bulletin* notes, the economy continued to face headwinds; from elevated inflationary pressure to softening economic performance. However, the banking sector stood steady and resilient to post strong credit growth even amidst elevated credit risk.

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* interesting and useful. We will be happy to consider for publications incisive commentaries on a topical issue of interest to the banking industry. 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

Elevated Inflation and Softening Economic Performance Prompt Call for Policy Action

By Samuel Tiriongo, PhD

During the fourth quarter, the economy faced a number of key macroeconomic developments; from sustained higher inflationary pressure, a softening economic recovery, amidst robust growth in credit and an external sector characterized by rising interest rates that continue to exert pressure on the shilling to depreciate. From a policy front, we argued that there was scope for a further interest rate hike to provide a stronger signal and tame inflationary pressures in the economy particularly arising from a combination of strong domestic demand and a weaker Shilling.

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

From inflation standpoint, inflation continued to ease slowly, but remained considerably high above the government's upper target of 7.5% (Figure 1); bursting perceptions that inflationary pressures would be transitory. In September 2022, inflation remained elevated, with sustained increases in food and fuel inflation, increasing to 9.2 percent in September, having built on the momentum that kicked off in February 2022. Food price inflation rose, mainly driven by continued drought conditions in the country and the pass-through effects of the higher global commodities prices , as fuel inflation also rose from 7.3 percent in July to 11.7 percent in September 2022, mainly driven by the impact of the government's move to phase out the fuel subsidy program.

At the global scene, central banks in major economies such as the U.S and UK, and regional peer economies such as the South Africa, have increased their policy rates and continue to project further rate hikes in 2023 to tame inflationary pressures and expectations.

Figure 1: Trends in inflation

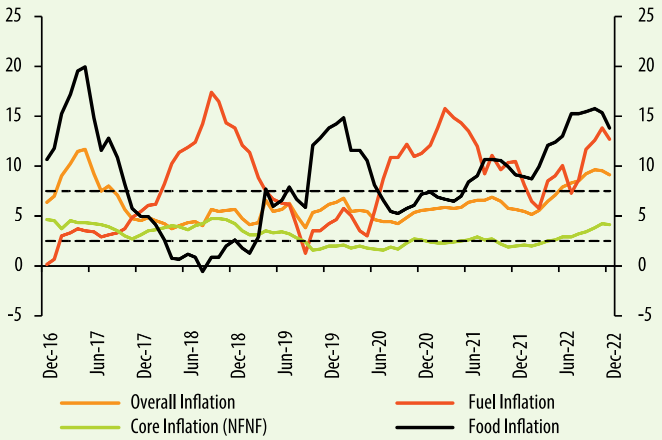
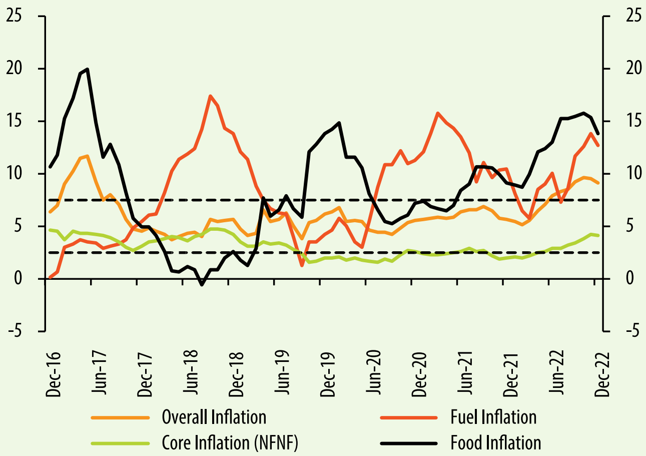
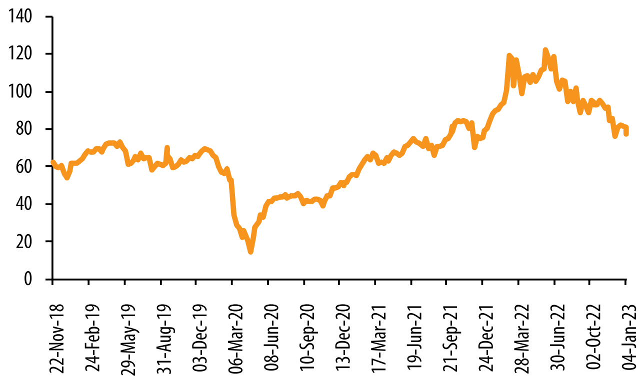


Figure 2: Trends in inflation by broad categories



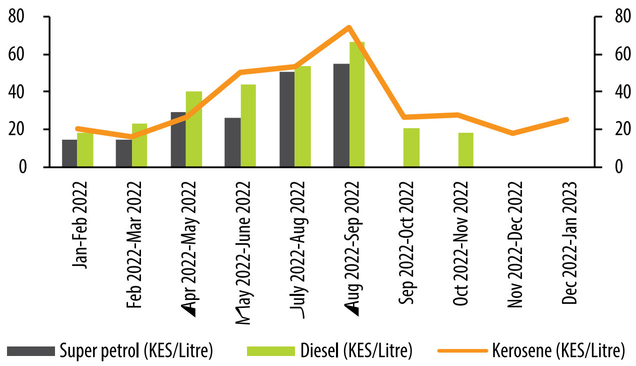
Source: CBK

Figure 3: Trends in Murban crude oil Prices



Source: Oilprice.com

Figure 4: Trends in Government subsidy on fuel



Source: EPRA

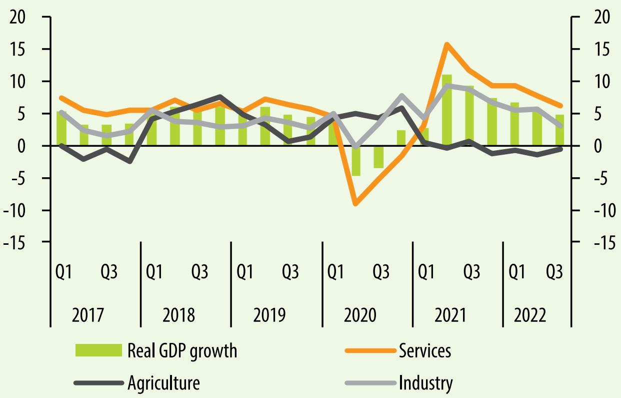
A few additional developments continue to shape the inflation outturn in the country. For instance, with the notable consistent decline in international oil prices (**Figure 3**)[1], the government's move to reduce fuel subsidy (**Figure 4**)[2] continues to keep fuel prices elevated, exerting pressure on local commodity prices given the role of oil in the production and transportation process of virtually all commodities. Nonetheless, a sustained decline in the global oil prices going forward would be translated to lower domestic fuel pump prices and provide some reprieve on the increases in prices of other consumer goods.

The economy's growth momentum, both globally and on the domestic front continued to soften. According to the World Bank (2023), the global growth was projected at 1.7% in 2023, described as *"the third-weakest pace in nearly three decades, overshadowed only by the 2009 and 2020 global recessions".* The softening global growth was attributed to heightened volatilities in global financial markets, the adverse effects of the war in Ukraine, and the policy measures taken to tame inflationary pressure.

On the domestic front, economic growth was similarly softening. During the third quarter of 2022, the domestic economy grew at 4.7% compared to 5.2% during the second quarter (**Figure 5**). While modest the growth reflected a broad-based expansion. During the third quarter, growth in the services sector (6.2%) was buoyed by accommodation and restaurant (22.9%), wholesale and retail trade (9.1%) and Professional, Administration & Support Services (8.7%). While the manufacturing sector grew at a modest 2.4% during the third quarter, unfavourable

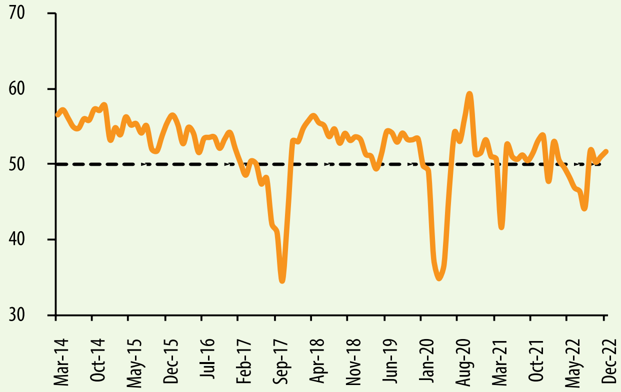
1. The Murban oil prices seemed to have stabilized at approximately USD 81.00 per barrel in December 2022, before dropping to USD 77.19 per barrel as of 5 January 2023.
2. The average landing cost of imported Super petrol, Diesel and Kerosene have been on the rise, with 2.65%, 5.65% and 6.01% increases, respectively, registered from October 2022 to November 2022 (*https://www.epra.go.ke/maximum-retail-petroleum-prices-in-kenya-for-the-period-15th-december-2022-to-14th-january-2023/*).

Figure 5: Sectoral and aggregate Real GDP growth (%)



Source: KNBS

Figure 6: Trends in PMI index



Source: IHS Markit

weather conditions in many parts of the country during the quarter continued to chock growth in the agriculture sector, consequently leading to a contraction of 0.6% in agricultural output. Overall, the Kenyan economy was estimated to have grown at 5.5% in 2022 with baseline growth further projected to soften to 5% in 2023[3].

Analyses of higher frequency leading indicators of economic activity as captured by the Purchasing Managers Index (PMI) report, showed improved business conditions in the fourth quarter of 2022. The PMI index picked up to a three-month high of 51.6 in December 2022, having risen from 50.9 in November and 50.2 in October 2022 (**Figure 6**), indicating sustained overall improvements in economic activities on a consecutive month-after-month basis supported by higher demand, favourable weather conditions and softer price pressures. Nonetheless, the PMI report revealed varied sectoral performances, with uplifts reported by firms in the agriculture, manufacturing and wholesale and retail sectors, as activity in the construction and services sectors recorded a decline.

3. World Bank (2023). Global Economic Prospects. *https://www.worldbank.org/en/publication/global-economic-prospects*

Figure 7: Annual credit to private sector remained on a double-digit growth momentum for ten months in a row......

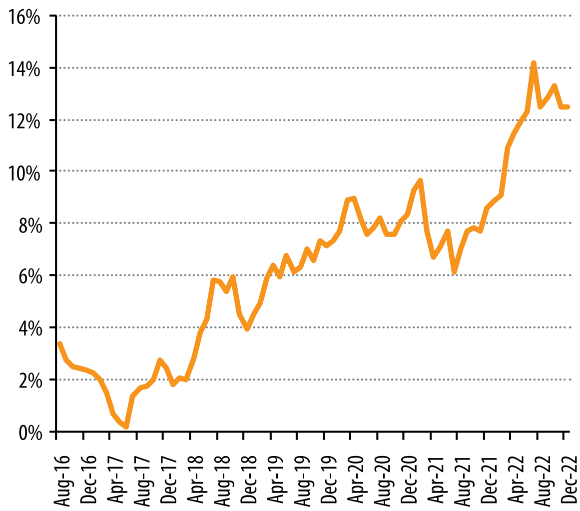


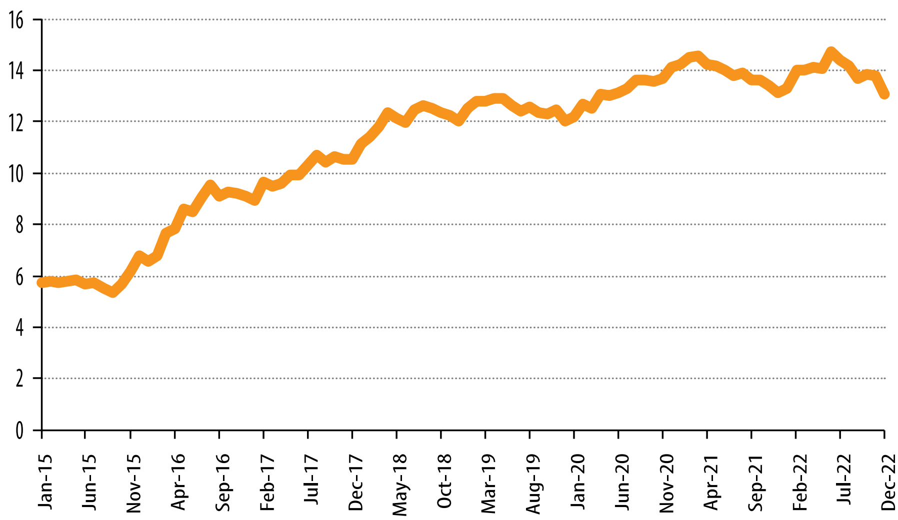
Table 1: Sectoral month-on-month credit growth (%)

	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Agriculture	3.29	0.54	7.72	12.60	17.09	22.36
Manufacturing	9.77	13.12	9.93	15.18	14.16	13.78
Trade	4.65	8.56	10.37	11.63	16.36	11.38
Building & Construction	0.50	1.84	6.39	13.99	12.52	8.20
Transport & Communications	10.95	14.24	25.06	22.15	21.54	23.48
Finance & Insurance	11.72	5.79	3.66	6.46	0.27	7.57
Real Estate	2.84	0.64	0.51	0.53	0.07	3.20
Mining & Quarrying	-8.33	42.15	-5.22	28.35	57.58	31.40
Private Household	2.60	3.73	7.56	6.10	7.75	8.19
Consumer durables	17.54	15.00	15.56	14.65	14.40	12.87
Business Services	7.59	9.49	14.71	15.21	12.51	13.68
Other activities	59.52	39.07	60.53	57.24	53.77	41.73
Credit to private sector	**7.68**	**8.60**	**10.89**	**12.26**	**12.86**	**12.46**

Growth in bank lending remained strong, despite the policy tightening, reflecting an improvement in banking sector asset quality amidst slow transition to risk-based pricing and transmission of policy signals. As **Figure 7** shows, growth in credit to the private sector, at 12.5% in 2022, was largely broad-based, but evidently stronger in mining and quarrying (having grown by 31.40%), transport and communication (23.48%), agriculture (22.36%), manufacturing (13.78%), business services (13.68%), consumer durables (12.87%), trade (11.38%), and building and construction (8.2%) (**Table 1**). The policy rate hikes effected in the second half of 2022 was ideally expected to tame demand pressures in the economy by slowing down private sector credit growth, thus minimizing its endorsement of supply-side driven inflationary pressure. The market outcome reflected challenges in the transmission of policy signals to lending rates and a slow transition of the banking industry to risk-based credit pricing environment.[4]

Amidst this, the robust growth in private sector credit was supported by an improvement in the ratio of gross non-performing loans to gross loans (asset quality) of the banking industry, with the ratio declining to 13.1% in December 2022, from 13.7% in September 2022 (**Figure 8**).

Figure 8: Improving banking sector asset quality ....



The external economic environment was strongly leaning to reflect higher interest rates as policymakers in advanced economies geared to push up efforts to rein in inflationary pressures. Recent developments in the external sector show a sustained steady

4. By mid-March, 27 banks (3 tier I; 7 tier II and 17 tier III) had received approvals of their risk-based credit pricing models, representing only up to 53% of total industry assets.

depreciation of the Shilling vis-à-vis the US dollar (**Figure 9**). This depreciation was driven by a sustained relatively larger current account deficit (as ratio of GDP particularly with the softening of economic activity) as shown in **Figure 12**, a moderation in the capital and financial account (**Figure 11**) and a reopening of the interest rate differential as advanced countries hiked their interest rates (**Figure 10**).

The sustained current account deficit is expected to continue exerting pressure on the Shilling to depreciate, particularly amidst the steady decline in the official foreign exchange reserves that continued to limit the extent to which the country could use official reserves to deal with any emerging short term foreign exchange market pressures.

Figure 9: The Kenya shilling depreciates further .....

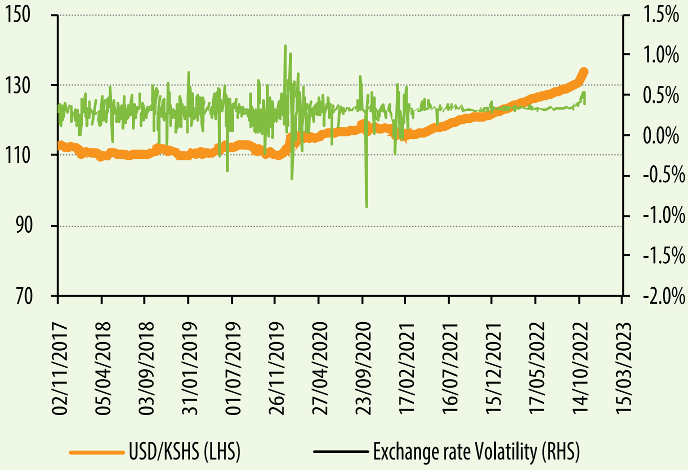


Figure 10: Federal Funds Effective Rate remains tilted upwards, exerting pressure on the Kenyan shilling....

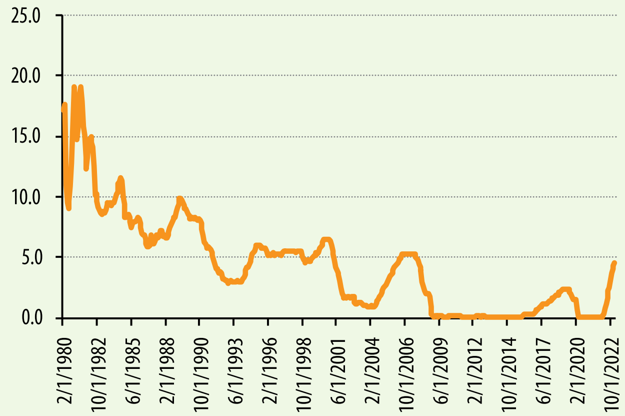


Figure 11: The overal balance of payment improved marginally.......

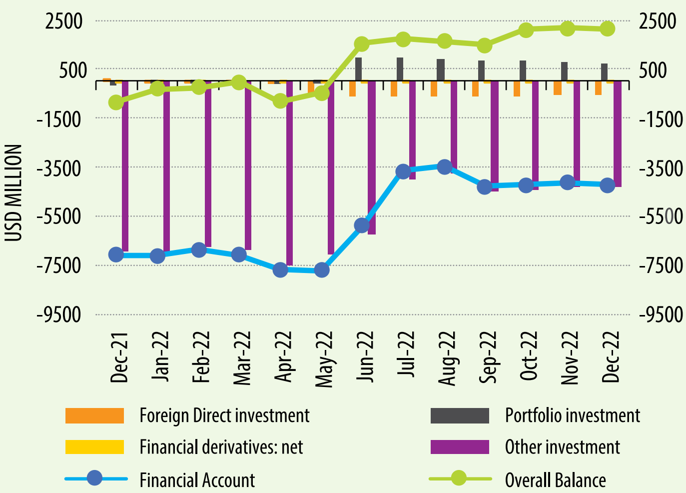
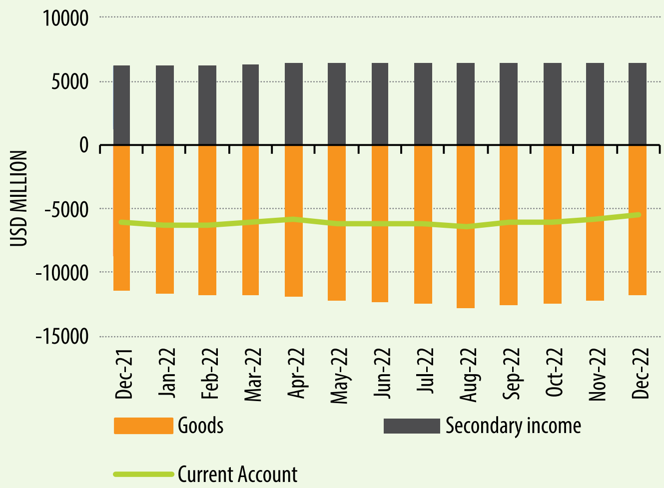


Figure 12: Current account deficit narrowed marginally..



Source: Central Bank of Kenya and Federal reserve Bank of New York[5]

5. https://www.newyorkfed.org/markets/reference-rates/effr

OUTLOOK

State of the Economy

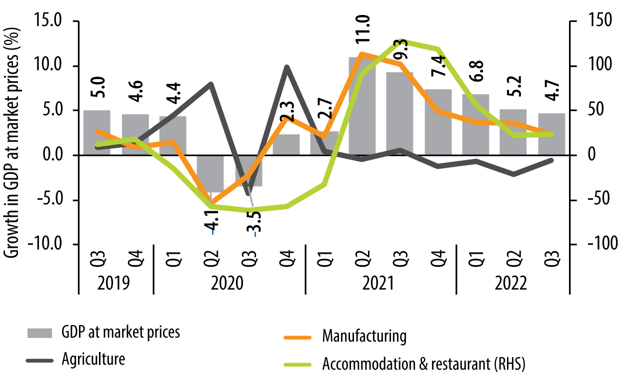
The global economic growth is expected to slowdown in 2022 to about 3.2 percent from 6.1 percent in 2021, and further decline to 2.7 percent in 2023, reflecting materialization of key downside risks highlighted in the first quarter of 2022 (IMF, October 2022).

Advanced Economies are projected to slowdown from 5.2 percent in 2021 to 2.4 percent in 2022 and further down to 1.1 percent in 2023 largely reflecting major slowdown in the US economy. In Emerging Market and Developing Economies growth is expected to decline to 3.7 percent in 2022 from 6.6 percent in 2021 and remain at that level in 2023. The slowdown largely reflects worsening growth prospects in China and India whose growth projection was lowered by 0.1 percentage points, and 0.6 percentage points to respective growth rates of 3.2 percent, and 6.8 percent in 2022. In Sub-Saharan Africa, the growth outlook for 2022 remains slightly weaker than predicted in July- 2022, declining from 4.7 percent in 2021 to 3.6 percent in 2022, but posting a modest recovery to grow by 3.7 percent in 2023.

On the domestic front, economic growth momentum has also softened. During the third quarter of 2022, the domestic economy grew at 4.7 percent compared to 5.2 percent during the second quarter (**Figure 13a**). Though modest, the growth was broad-based with significant expansion evident in the services sector (6.2 percent) driven by

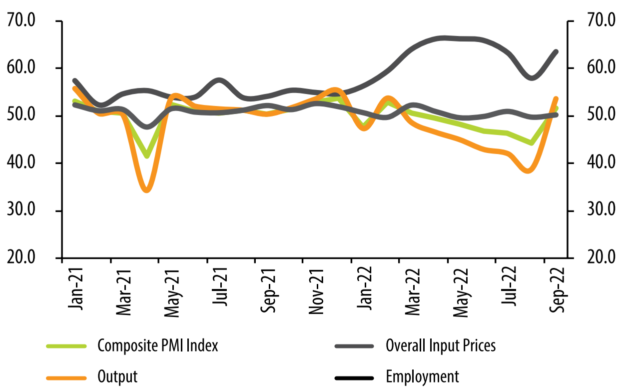
Figure 13: GDP Performance and Economic Outlook

Figure 13(a): Domestic Economic performance



Source: KNBS

Figure 13(b): Trends in PMI



Source: IHS Markit

Dhows moored at the Lamu old port: Leading economic indicators showed that investor and consumer confidence were firming up in anticipation of stronger economic growth prospects.

accommodation and restaurant services (which grew by 22.9 percent), wholesale and retail trade (9.1 percent) and Professional, Administration & Support Services (8.7 percent). The manufacturing sector grew at 2.4 percent during the period. However, unfavourable weather conditions in many parts of the country during the quarter continued to chock growth in the agriculture sector, consequently leading to a contraction of 0.6 percent in agricultural output. Overall, the Kenyan economy is estimated to have grown at 5.5 percent in 2022 with baseline growth further projected to soften to 5 percent in 2023[6].

Despite the slipping economic growth momentum, leading economic indicators published by IHS Markit's Purchasing Managers' Index (PMI) showed that investor and consumer confidence were firming up in anticipation of stronger economic growth prospects. The overall Purchasing Managers' Index (PMI) stood at 51.7 in September 2022 - above the 50 mark for the first time after five successive months – reflecting a moderate sustained monthly rise in economic activity between July and September, driven by expanding employment opportunities, growing new orders and some notable declines in input prices **(Figure 13b)**.

6. World Bank (2023). Global Economic Prospects. *https://www.worldbank.org/en/publication/global-economic-prospects*

Figure 14: **Inflation trends and Global Commodity and oil price developments**

Figure 14(a): Inflation Trends

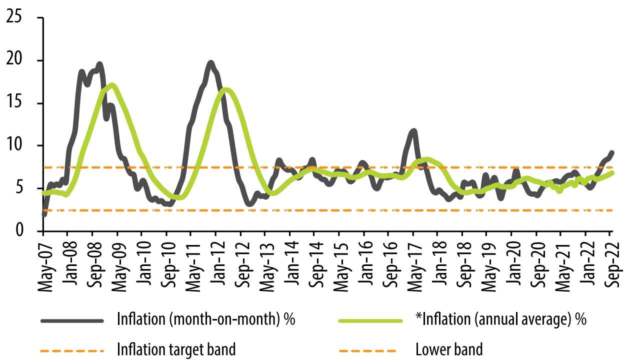
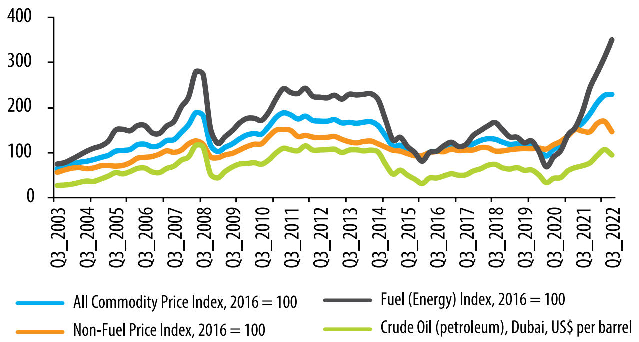


Figure 14(b): Global Commodity and oil price developments



Source: Central bank of Kenya and IMF Global Commodity database

Inflation remained elevated during the quarter, with sustained increases in food and fuel inflation. As reflected in **Figure 14a**, the overall inflation increased to 9.2 percent in September, having built on the momentum that kicked off in February 2022. Food price inflation rose, mainly driven by continued drought conditions in the country and the pass-through effects of the higher global commodities prices **(Figure 14b).** Fuel inflation also edged up from 7.3 percent in July to 11.7 percent in September 2022, mainly driven by the impact of the government's move to phase out the fuel subsidy program. This outpaced the impact of the easing global oil prices as Murban oil prices fell from USD 117.7 per barrel in June 2022 to USD 95.3 per barrel in September 2022.

The growth in private sector credit sustained double digit levels, to close the quarter at 12.9 percent year-on-year in September 2022 (**Figure 15a**), mainly attributable to strong uptake of credit by key sectors such as agriculture, manufacturing and consumer durables. In terms of credit distribution, 47.66 percent of total credit was absorbed by trade (17.62 percent), Manufacturing (15.11 percent) and private households (14.93 percent) (**Figure 15b**).

Figure 15: **Private Sector Credit and Growth Dynamics**

Figure 15(a): Private Sector Credit and Growth Dynamics

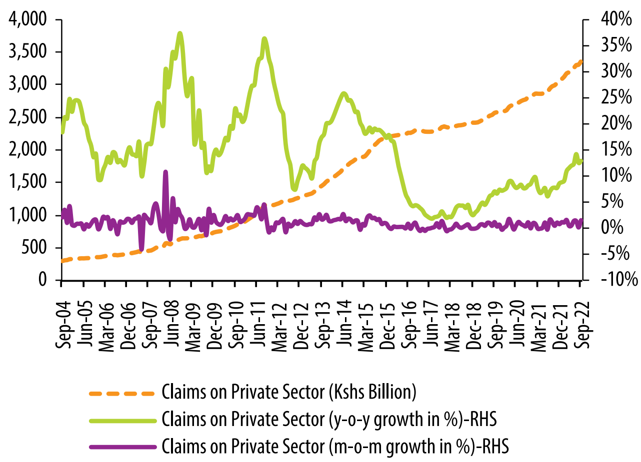
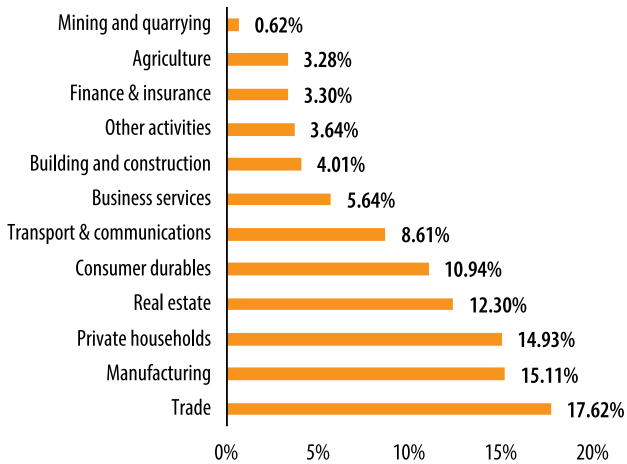


Figure 15(b): Distribution of private sector credit in Q3 2022



Source: Central bank of Kenya

Analyses of the Kenya Shilling exchange rate versus the dollar show that the exchange rate averaged Ksh 119.4 during the quarter, compared to Ksh 109.2 during the third quarter in 2021; reflecting a Shilling depreciation of 9.34 percent. Despite the notable accelerated depreciation, the exchange rate was less volatile during the period under review (**Figure 16a**). The depreciation was partly driven by less buoyant inflows of remittances, which declined by 7.14 percent from USD 1,020.78 million during the second quarter of 2022 to USD 947.89 million in the third quarter of 2022 (**Figure 16b**). While all the decline was registered across the regions, the inflows from Europe were hit most as they declined by 8.08 percent; mirroring the unsynchronized effects of the slowdown in global growth.

Figure 16: Kenya Shilling -US Dollar Exchange Rate dynamics and Remittances inflow

Figure 16(a): Kenya Shilling -US Dollar Exchange Rate Dynamics

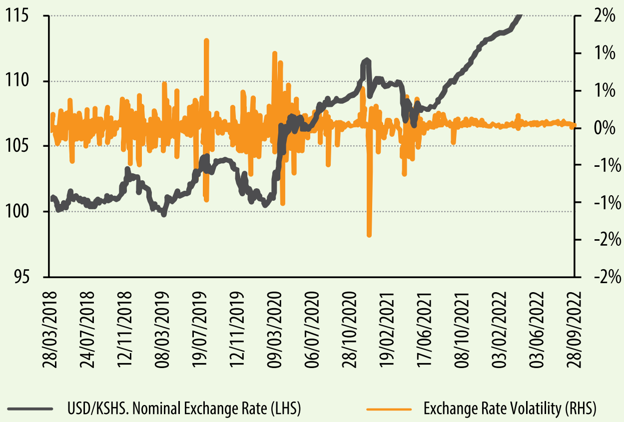
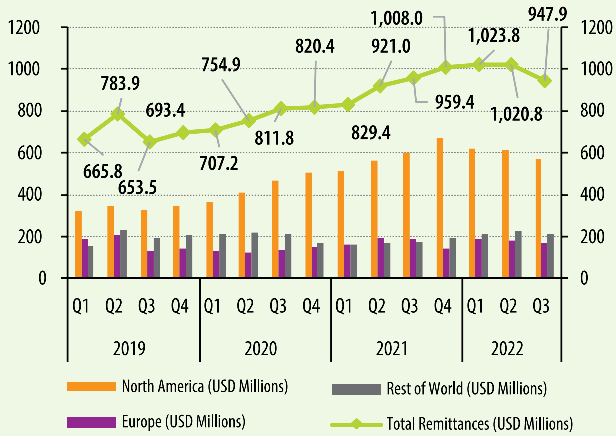


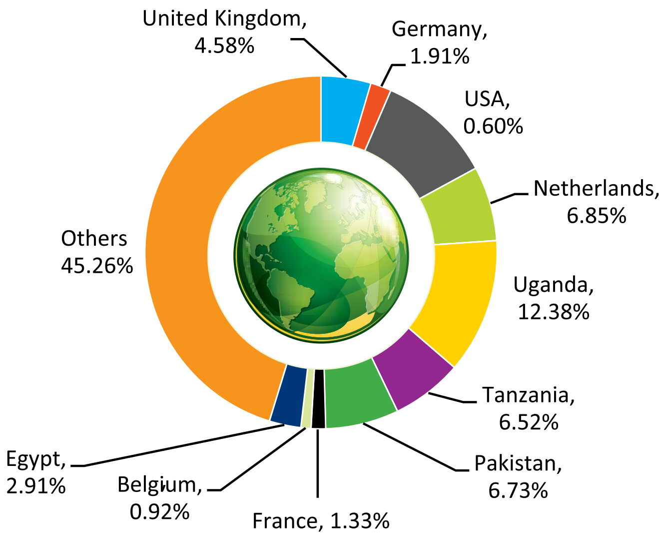
Figure 16(b) Trends in remittances flow by regions



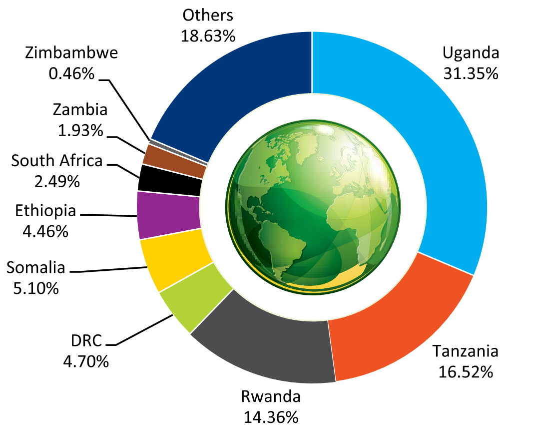
Analyses of trade patterns show that the import and export patterns with Kenya's main trading partners depicted a similar trend as the previous quarters. Uganda and the United States of America remained the leading destination of Kenya's exports, respectively constituting 12.38 percent and 10.60 percent of total exports. In the intra-Africa export front, Uganda, Tanzania and Rwanda were the leading destinations accounting for 31.35 percent, 16.52 percent and 14.36 percent, respectively. On the imports side, China was the top source of imports to Kenya, accounting for 17.31 percent of the import expense, followed by UAE at 16.86 percent and India at 7.97 percent. Intra-Africa, Tanzania remained the leading import source, and accounted for 21.82 percent of total imports from Africa.

Figure 17: Kenya's Intra-African and Global Trade Developments

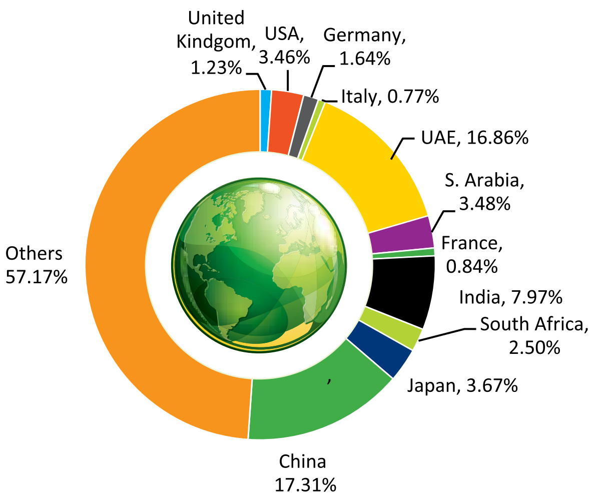
17(a) Share of exports of goods by trading partners



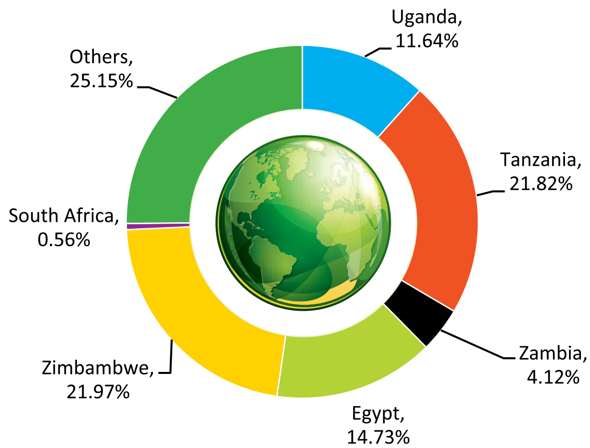
17(b) Intra-African Trade - Kenya's Major Trading Partners



17(c) Share of imports of goods by trading partners



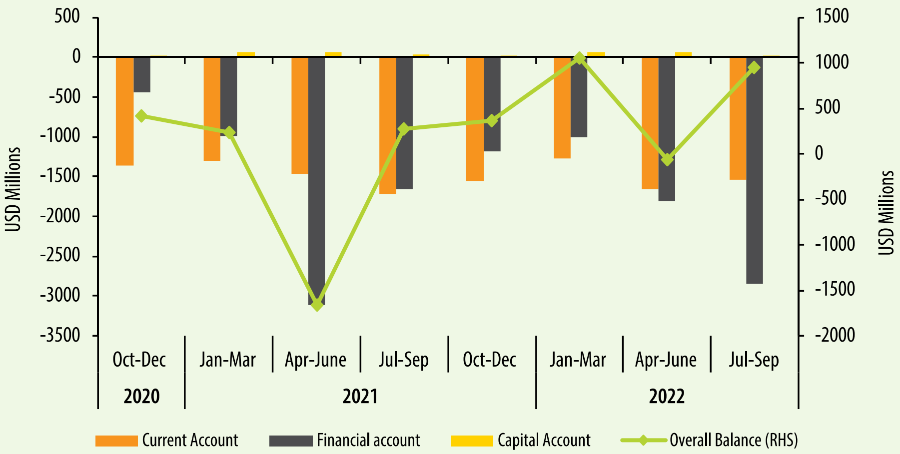
17(d) Intra-African Share of Imports of goods by trading partners



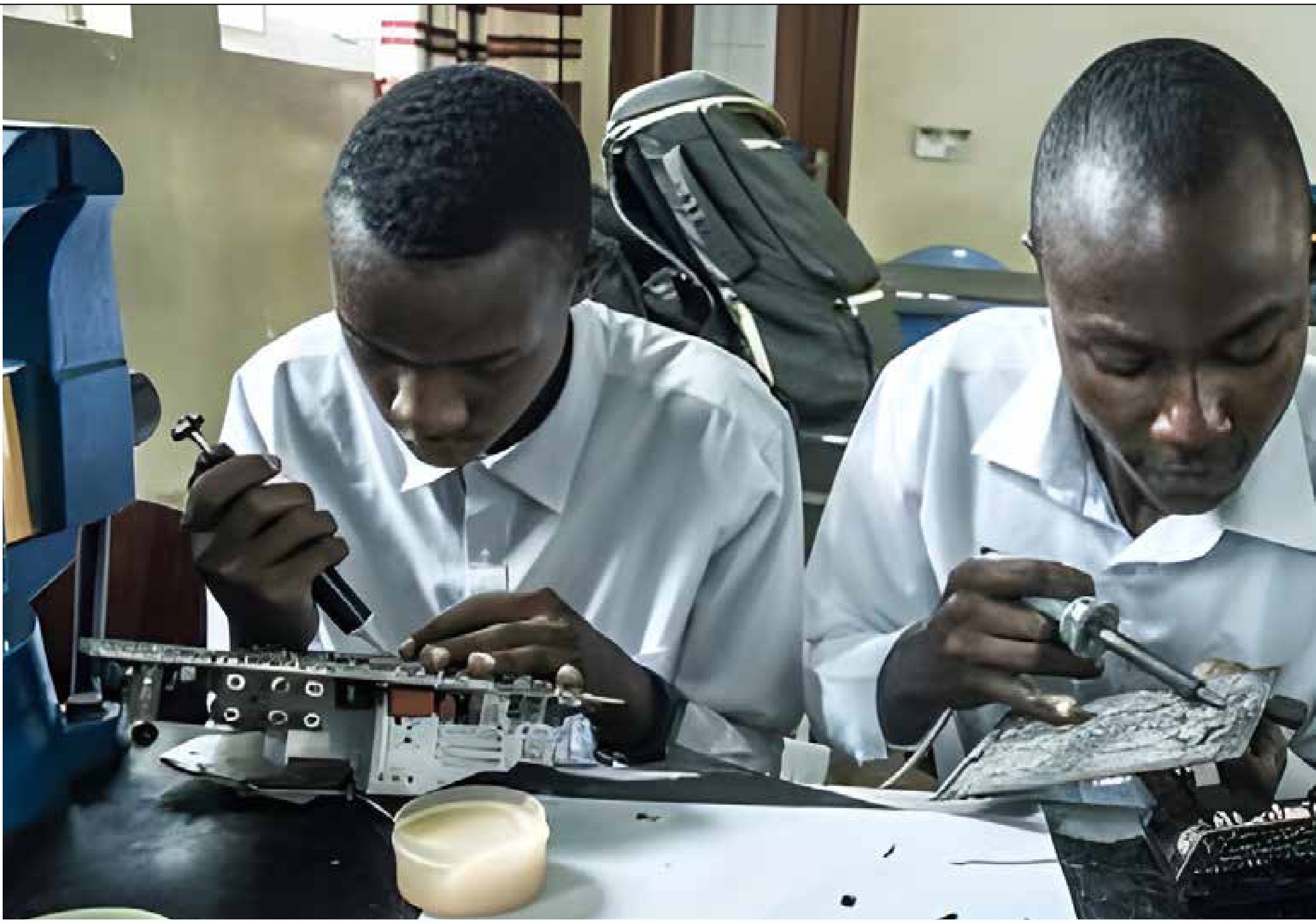
Source: Central Bank of Kenya

The overall balance of the balance of payments posted a surplus of USD 948 million; an improvement from a deficit of USD 60 million in the previous quarter. Additionally, the current account deficit narrowed to USD 1,531 million, compared to USD 1,714 million in a similar period in 2021, reflecting increased receipts from both services as well as merchandise goods, amid sustained growth in imports. While the capital account remained muted, there were some notable improvements in the financial account, with its net balance improving to USD 2,852 million in the third quarter of 2022, compared to net inflows of USD 1,654 million in the third quarter of 2021 (**Figure 18**).

Figure 18: Balance of the Payments Performance



Source: CBK Quarterly Economic Review



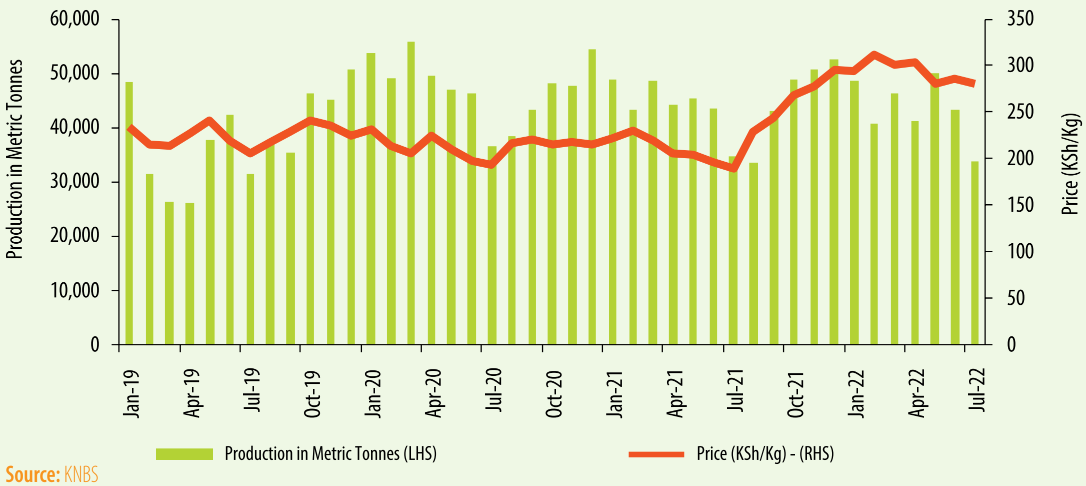
Sectoral Performance

Agriculture

The agriculture sector performance during the quarter was low, depressed by continued drought conditions across most parts of the country. The sector contracted by 0.6 percent, which was a stronger performance relative to the 1.8 percent contraction in a similar period in 2021. However, there was revamped optimism in the sector as the Government announced new subsidized fertilizer prices on 20th September 2022 coupled with a supply of 71,000 metric tonnes (1.4 million - 50kg bags).

Sub-sector performance mimicked declined production during the quarter. In particular, tea production declined by 19.8 percent to 107,945.27 metric tonnes during the third quarter of 2022 from 134,532.86 metric tonnes produced during the previous quarter **(Figure 19)**. Similarly, production in the reported quarter was 3.23 percent lower compared to the corresponding period in 2021.

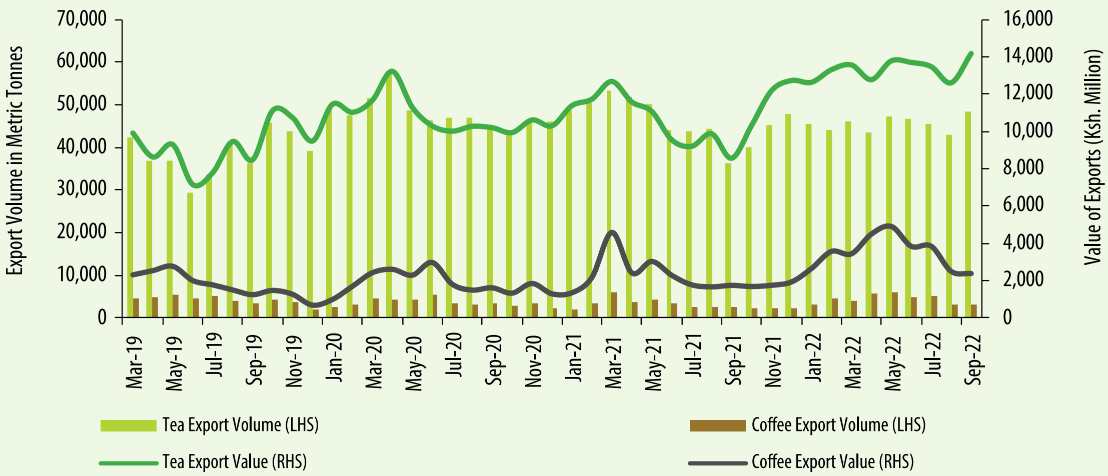
Figure 19: Tea production and Prices



Source: KNBS

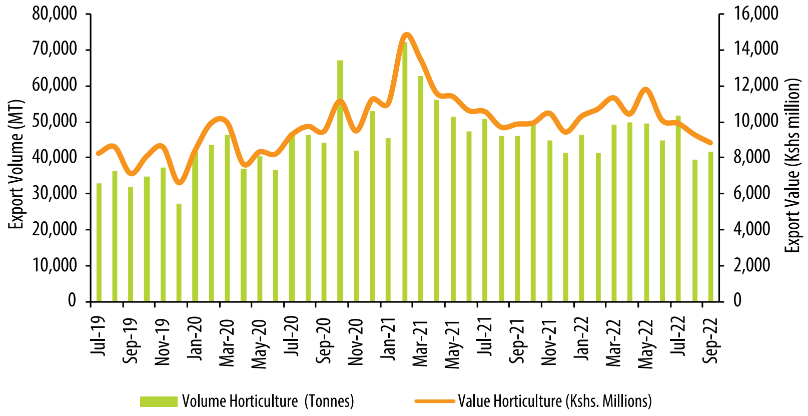
Despite this, the export volume of tea were higher when compared to what was recorded in a similar period in 2021 (**Figure 20**). In particular, the volume of exported tea during the third quarter was 9.8 percent higher than levels recorded over a similar period in 2021; rising from 124,573.21 metric tonnes in the third quarter of 2021 to 136,837.70 metric tonnes produced in the third quarter of 2022. Consequently, export earning on tea rose by 45.6 percent, in part supported by the exchange rate depreciation witnessed during the period. Similarly, coffee export volume during the quarter was up by 50.6 percent to an estimated 11,564.39 metric tonnes, from 7,680.96 metric tonnes reported in a similar period in 2021.

Figure 20: Value of Tea and Coffee Exports



Source: KNBS

Figure 21: Horticultural Exports

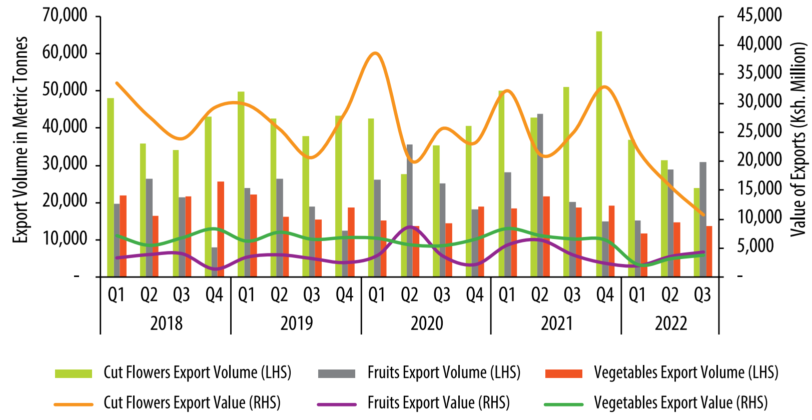


Source: KNBS

The horticultural sub sector also registered a depressed performance mainly driven by a decline in export volumes of cut flowers and vegetables (**Figure 21**). The volume of cut flowers exports declined from 51,115 metric tonnes in the third quarter of 2021 to 23,818 metric tonnes in the third quarter of 2022; reflecting slightly over 50 percent drop in export volume, leading to a significant decline in the export value (by 57.0 percent), as cut flower export value dropped to KSh.10,686 million in the period under review from KSh.24, 862 million recorded in the third quarter of 2021 (**Figure 22**).

Vegetable export volumes also declined during the period, to 13,808 metric tonnes from 18,685 metric tonnes over a similar period 2021. The export earnings also declined but by a larger margin than the volumes, dropping by 41.9 percent over the period compared 26.1 percent decline in volumes. However, volumes of exports of fruits rose by 53.9 percent and the export value grew by 12.7 percent. The rise in export volume and value of the fruits was buoyed by the rising demand of avocado and mango exports following the removal of export restrictions.

Figure 22: Cut Flowers, Vegetables and Fruits



> **"The volume of cut flowers exports declined from 51,115 metric tonnes in the third quarter of 2021 to 23,818 metric tonnes in the third quarter of 2022.**

Manufacturing

The manufacturing sector activity registered marginal expansion, growing by 2.4 percent in the third quarter of 2022 **(Figure 23),** but with mixed performance in key sub-sector activities. In particular, while sugar production recovered to 177,126 metric tonnes in the quarter under review compared with 166,994 metric tonnes in the third quarter of 2021 , there was a 12.78 percent decline in cement production to 2,302,658 metric tonnes over the period under review. On the consumption side, milk and cement consumption declined by 10.66 percent and 14.64 percent, respectively; largely reflecting low production levels during the period.

Producer Price Index

The Producer Price Index, represented in **Figure 24,** representing changes in producer prices, shows that producer prices during the quarter rose relative to prices over a similar period in 2021. This reflected a persistent upward pressure on the product prices. The PPI inflation rate stood at 15.78 percent compared to 7.72 percent in a similar period in 2021, as the produce Price index was up from 110.34 in the third quarter 2021 to 127.76 in the quarter under review. The rise was majorly catalyzed by an increase in producer prices in the mining and quarrying sector, whose producer price inflation edged up to 40.0 percent.

Energy

The drought conditions recorded across the country during the quarter continued to constrain activity in the energy sector. Consequently, the quarter posted a dip in hydroelectric production; pushing supply to rely more on other sources of energy. For instance, geothermal power production increased as hydroelectric generation dwindled. Despite this, two sources of energy remained the major sources of energy accounting for 69.23 percent during the quarter under review; marginally declining from 70.36 percent in the third quarter of 2021. Overall, nonetheless, total electricity generation during the quarter increased to 3,285.97 million kilowatts from 3,094.59 million kilowatts (6.18 percent rise) produced over a similar period the year before **(Figure 25).**

Figure 23: Production in manufacturing sub-sectors

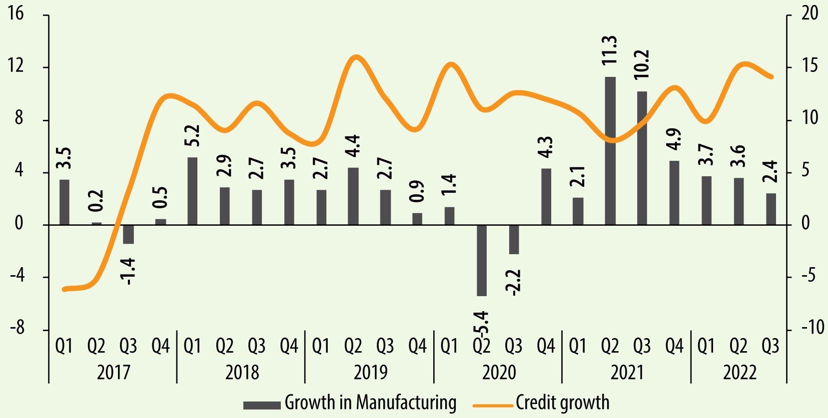


Figure 24: Producer Price Index

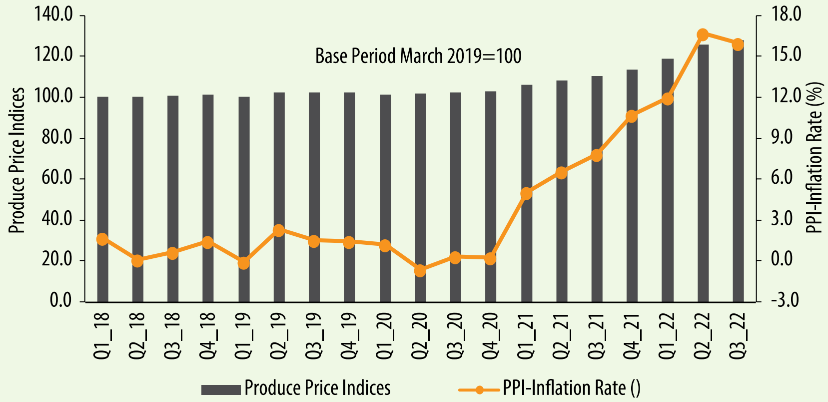
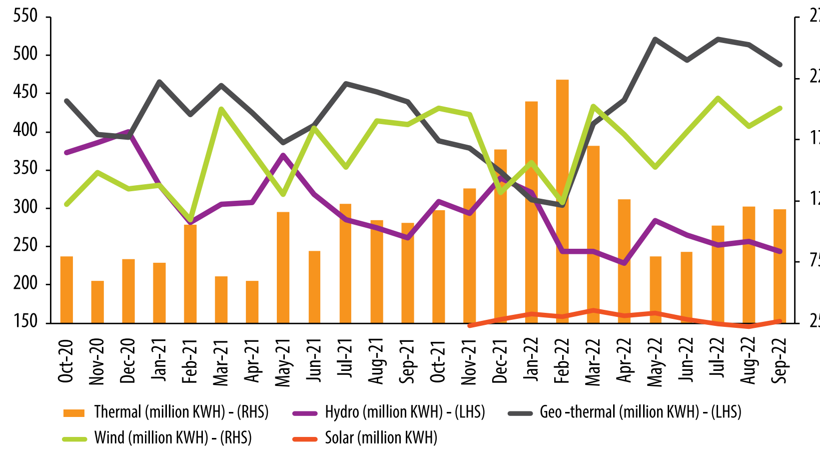


Figure 25: Monthly Electricity Generation by Source



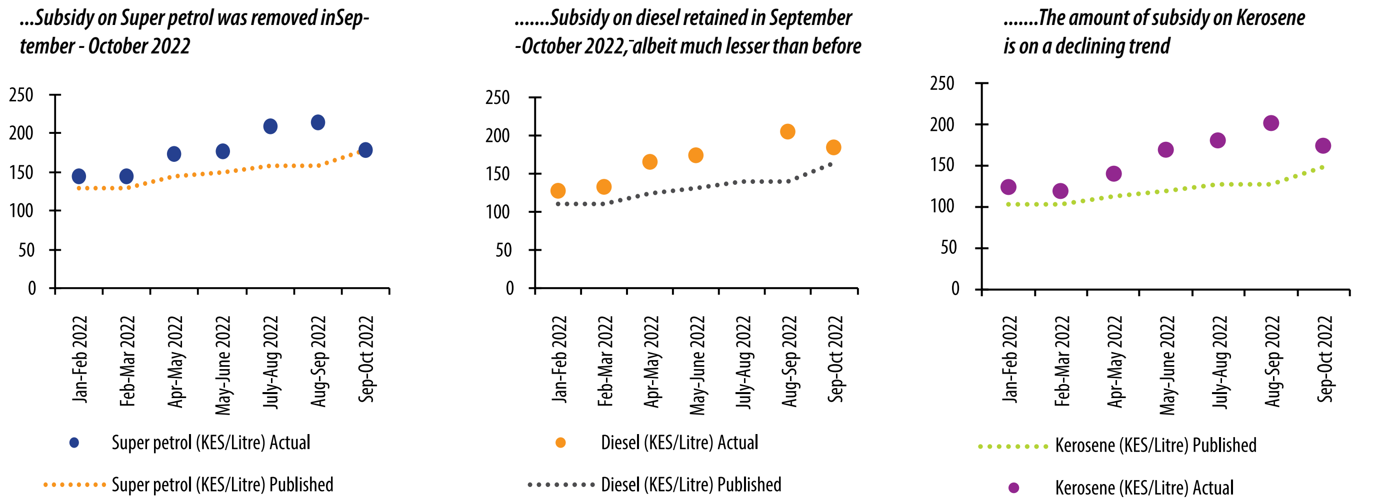
Crude oil prices declined during the quarter, but they were generally high in part due to the global constrained the are linked to the Russia-Ukraine geopolitical tensions. The global benchmark crude oil prices, that is the Murban crude oil prices, dropped to USD 95.3 per barrel in September 2022, from USD 117.7 per barrel in June 2022 **(Table 2)**. In the domestic front, the retail fuel prices increased in September 2022, following the removal of subsidy **(Figure 26)**. The average super petrol prices increased to Kes 180.1 per litre, that of diesel and kerosene increased to Kes 165.9 and Kes 148.9 per litre, respectively. The LPG (13 kgs) rose to Kes 3,106.7 in September 2022.

Table 2: Average Monthly Crude Oil and Retail Fuel Prices

	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22
Murban crude oil (US$/Barrel)	82.1	80.4	74.4	85.4	94.0	113.5	105.6	113.9	117.7	108.6	101.9	95.3
Super petrol (KES/Litre)	130.5	130.5	130.5	130.5	130.5	135.5	145.4	150.9	159.9	159.9	159.9	180.1
Diesel (KES/Litre)	111.5	111.5	111.5	111.5	111.5	116.5	126.4	131.9	140.9	140.9	140.9	165.9
Kerosene (KES/Litre)	104.5	105.5	106.5	106.5	106.5	104.5	114.4	119.9	128.9	128.9	128.9	148.9
LPG (13Kgs)	2513.7	2611.2	2638.8	2659.2	2659.7	2866.2	2924.6	3176.9	3218.2	3100.7	3103.2	3106.7

Source: ADNOC oil prices and KNBS

Figure 26: Trends in fuel subsidy program



Source: EPRA

**The gap between the actual and published prices reflects the level of subsidy

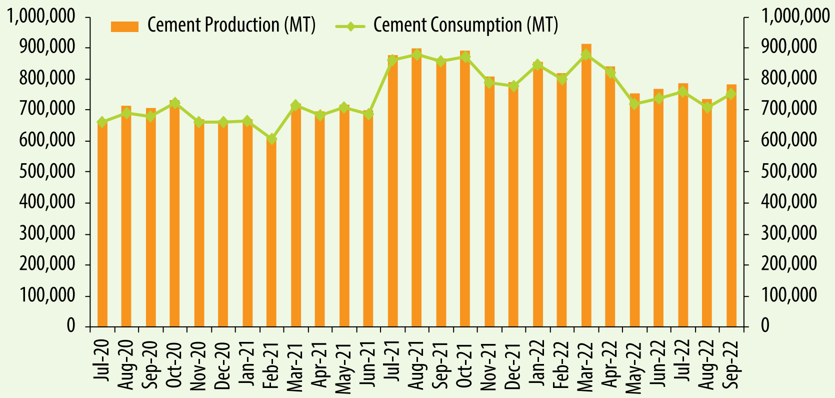
Building and Construction

Building and construction sector grew much slower in the third quarter of 2022. In 2021, the third quarter grew by 6.7 percent compared to the 4.3 percent growth in the current quarter. The slow growth was equally reflected by declining trend in cement production and consumption. In particular, cement production during the quarter stood at 2,302,658 metric tonnes, up from 2,640,167 metric tonnes reported in a similar quarter in 2021, representing 12.78 percent drop in cement production. The cement consumption reduced by 14.6 percent, with an overall implication of widening the cement production-consumption gap to 84,909 metric tonnes during the third quarter of 2022 (**Figure 27**).

Tourism

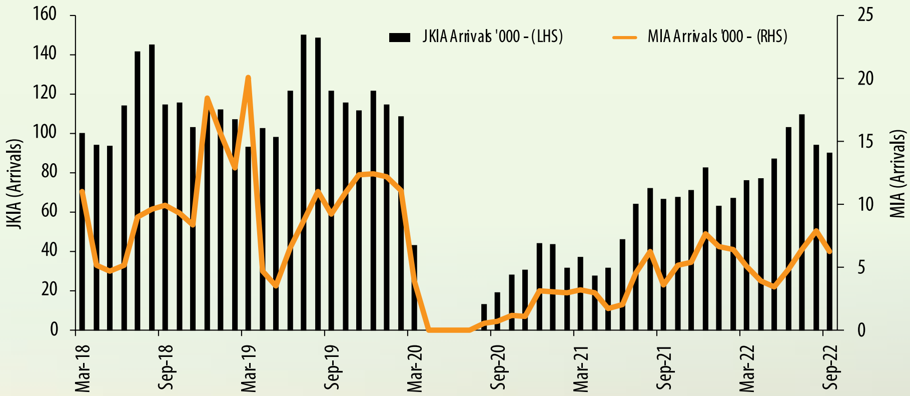
Tourists inflow, majorly driven to have a view of Kenya's scenic landscapes, vast wildlife preserves and conferences, ticked up during the quarter thereby signaling the continued economic expansion. In return, the earned foreign currency from the tourists arrival play a significant role in stabilizing the Kenya shilling. The total inbound tourist arrivals during the quarter stood at 315,112, JKIA terminal received 294,499 inbound tourists as 20,613 got in through Mombasa international airport (MIA) terminal (**Figure 28**).

Figure 27: Cement Production and Consumption



Source: KNBS

Figure 28: Monthly Inbound Tourist Arrivals



Source: KNBS

Government Revenue and Expenditure

The total revenue & grants in the first quarter of FY 2022/2023 grew by 5.7 percent to Ksh. 542.1 billion, compared to Ksh 513.0 billion over a similar period in FY 2021/22. Mirroring the same trend, total expenditures was up by 5.3 percent, to Ksh 664.8 billion in FY 2022/2023 mainly as a result of 9.3 percent increase in recurrent expenditure and 15.8 percent in county transfer.

In a similar period in FY 2021/2022, the total expenditure was Ksh 631.7 billion. The revenue – expenditure gap rose to Ksh. 122.7 billion, which was wider than the Ksh. 118.7 billion recorded in a similar period in the FY 2021/2022 (**Figure 29**). Growth in the share of import taxes (0.4 percent) and other taxes (4.2 percent) were evident, contrary to a plunge in Value Added Tax (VAT) (1.9 percent), income tax (1.7 percent), and excise taxes (1.0 percent) (**Figure 30**).

Figure 29: Quarterly Revenue-Expenditure Gap

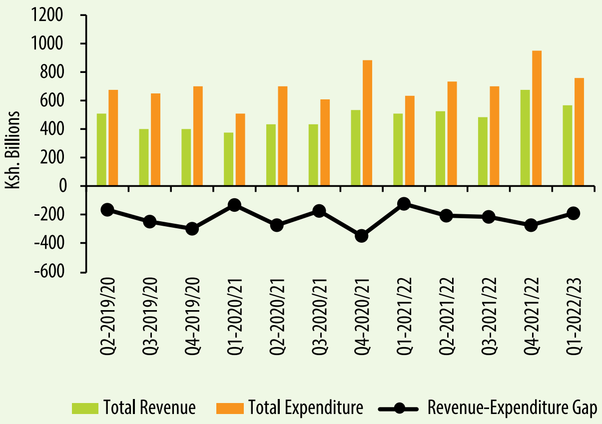
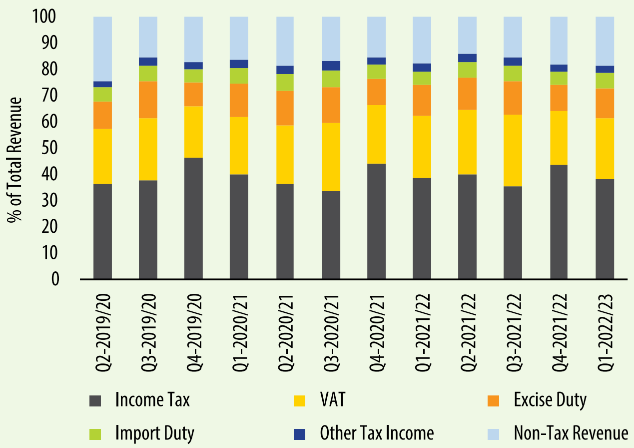


Figure 30: Quarterly Revenue Structure



Source: Central Bank of Kenya

Figure 31: Quarterly Expenditure Structure

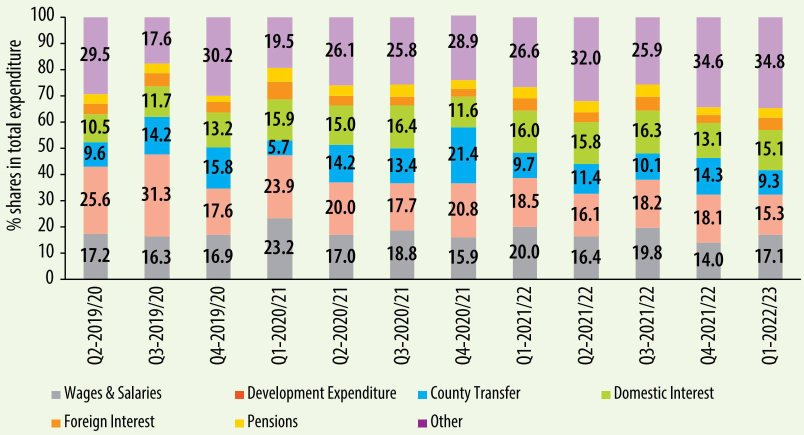


Figure 31 shows a breakdown of total expenditure during the first quarter of FY 2022/23. It is evident that during the quarter, wages and salaries accounted for the largest share of expenditures, at 17.1 percent despite the share declining from 20.0 percent in the first quarter of FY 2021/22. The second largest expenditure item was development spending, standing at 15.3 percent. The share of transfers to the counties rose during the quarter compared to a similar period in the previous fiscal year, reflecting enhanced allocations to support county government operations. The share of domestic and foreign debt interest payments in total expenditures remained largely unchanged in comparison to the first quarter in FY 2021/22.

Government Deficit Financing and Public Debt

Total public debt as at end September 2022 stood at Ksh. 8.70 trillion having grown from Ksh. 8.0 trillion in September 2021. The ratio of domestic to external debt as of September 2021 was 50.18% : 49.82% compared to 49.2% : 50.8% in September 2021. The proportion of debt securities to total domestic debt stood at 98.6 percent by the end of the first quarter of FY 2022/23 which was 0.8 percentage points higher than the previous quarter (**Figure 32**). The exchange rate movements, coupled with disbursements from the International Monetary Fund (IMF) resulted in a 0.9 percent increase in external debt during the first quarter of FY 2022/23.

Figure 32: External and Domestic Debt and its Composition

Figure 32(a): Domestic Debt

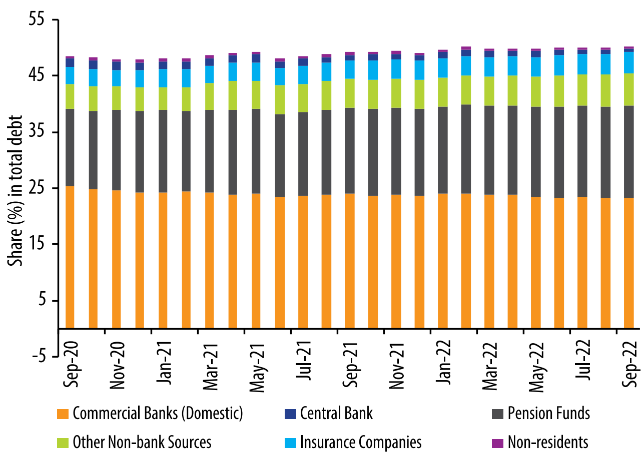
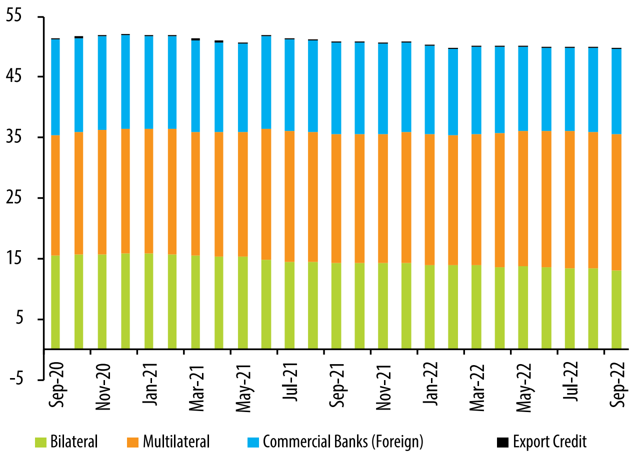


Figure 32(b): External Debt



Source: Central Bank of Kenya

Figure 33: Trends in Monetary Aggregates

Figure 33(a): Volumes , Ksh Billions

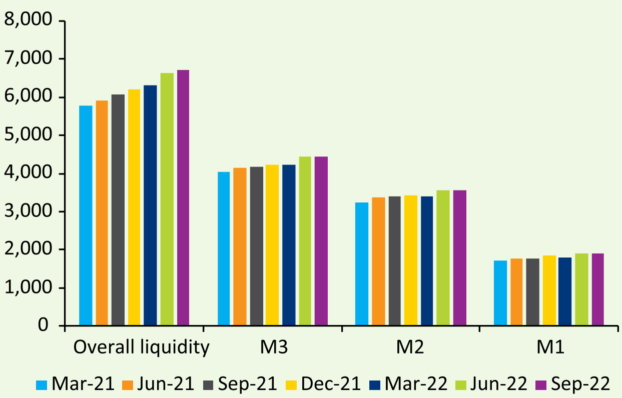
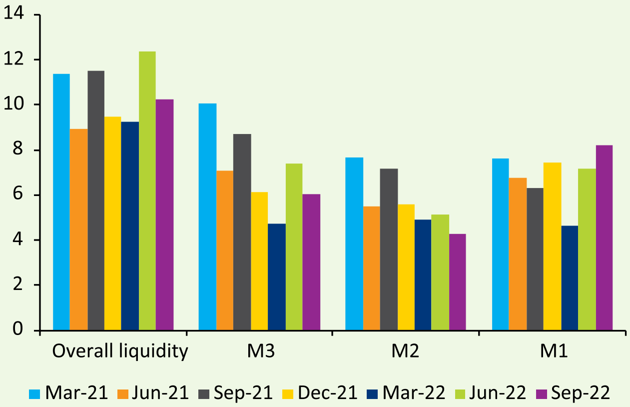


Figure 33(b): Year-on-year growth rates, %



Source: Central Bank of Kenya

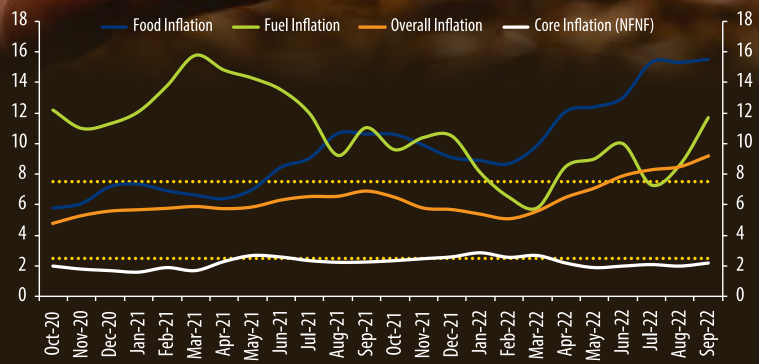
Money Supply

Overall liquidity in the economy grew by 10.23 percent on a year-on year basis by the end of September 2022 to close at Ksh. 6,694.5 billion. Broad money supply (M3) slightly contracted by 0.3 percent in the third quarter of 2022, mainly reflecting reduction in deposits. The decline in deposits was mainly on account of household deposits and other deposits at the Central Bank. Household deposits declined by 1.4 percent compared to an increase of 4.7 percent in the previous quarter, mainly reflected in demand deposit holdings. The 12-month growth in broad money supply (M3) decreased to 6.1 percent in September 2022 from 7.4 percent in June 2022, largely reflecting reduced net foreign assets of the banking system **(Figure 33).**

Inflation

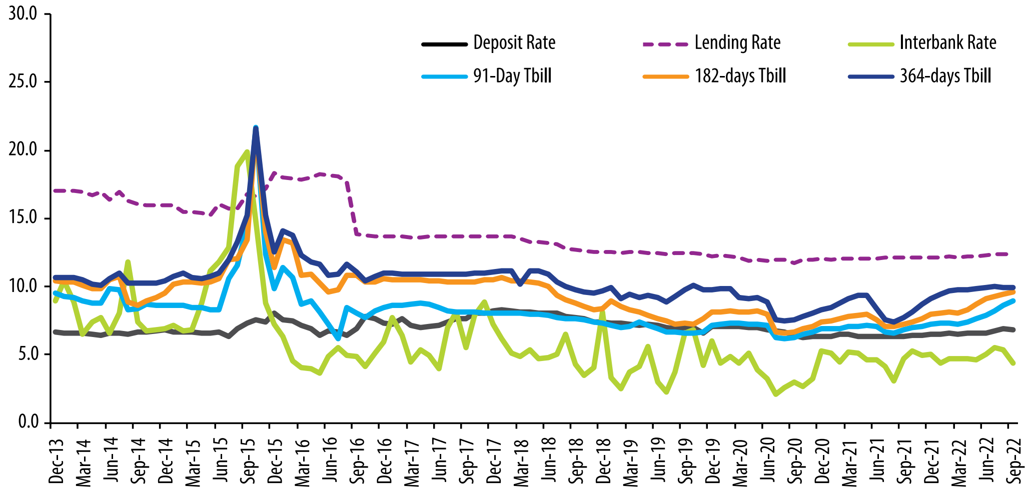
Inflationary pressure remained tilted to the upperside with overall inflation rising further to 9.2 percent by September 2022, mainly driven by sustained increases in fuel prices amidst high food prices. In particular, food inflation remained elevated, at 15.3 percent, throughout the quarter. In addition, fuel inflation rose to 11.7 percent by September 2022 on account of a sustained increase in global oil prices. Core inflation equally edged up, rising to 3.40 percent by September 2022, thereby pointing to sustained build-up in demand from the relatively depressed economy **(Figure 34)**.

Figure 34: Inflation Dynamics



Source: Central Bank of Kenya

Figure 35: Interest Rates Dynamics



Source: Central Bank of Kenya

"On 29 May 2022, the CBR was raised to 7.5 percent, and it was further raised to 8.25 percent on 29 September 2022.

Interest Rates

The Central Bank Rate (CBR) was raised twice during the quarter with the implication of rise filtering through the market interest rates. On 29 May 2022, the CBR was raised to 7.5 percent, and it was further raised to 8.25 percent on 29 September 2022. In response, interbank and lending interest rates depicted marginal increases, albeit at a less-than proportionate rate when compared to the rise in the benchmark lending rates. The weighted average lending rate increased marginally to 12.41 percent in September 2022 from 12.27 percent in June 2022. The average interbank interest rates declined to 4.36 percent in September 2022 from 5.06 percent in June 2022, partly reflecting improved liquidity conditions in the money markets following seasonal increased government payments towards the end- of the fiscal year. The average 91-day Treasury bill rate increased to 8.92 percent from 7.90 percent in June, while the average 182-day Treasury bill rate increased to 9.60 percent from to 9.07 percent **(Figure 35).**

Exchange Rates

The exchange rate pressure on the Kenya Shilling against the US dollar was sustained during the quarter, but at a much softer pace, on account of the improvements in the market fundamentals. As reflected in **Figure 36**, the Kenya Shilling weakened by 9.4 percent against the US Dollar to exchange at an average of Ksh.119. 4 per US dollar in the third quarter of 2022 compared with Ksh 109.2 in a similar quarter in 2021. It, however, strengthened against the Sterling Pound, the Euro, and the Japanese Yen. When compared to its regional counterparts, the Kenya Shilling weakened against the Tanzania shilling and the south Africa Rand but strengthened against the Uganda shilling.

Figure 36: Exchange Rate Developments

Figure 36(a): Major currencies

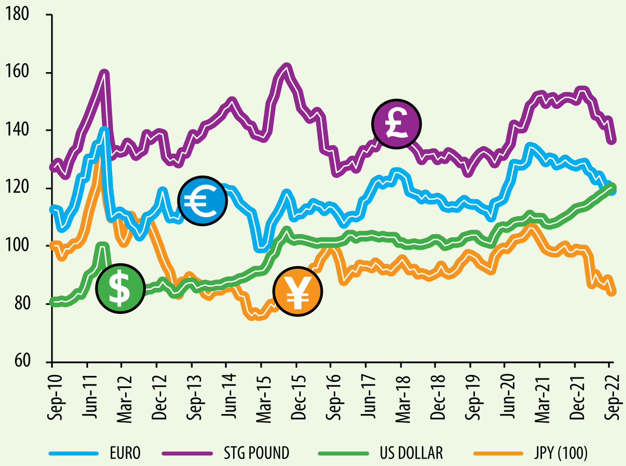
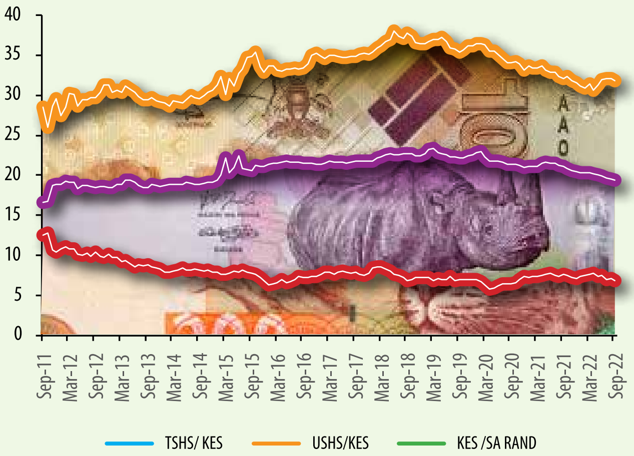


Figure 36(b): EAC region currencies



Source: Central Bank of Kenya

Capital Markets

The capital market sector was bearish during the quarter with the benchmark indices declining. The NASI dropped gradually from 141.05 in July 2022 to 128.41 in September 2022, while the NSE-25 equally dropped from 3474.84 in July 2022 to 3102.05 in September 2022. NSE-20 closed the quarter at 1717.68 as market capitalization dropped by 8.98 percent from Ksh. 2,198.26 billion in July 2022 to Ksh. 2,000.82 billion at the end of the previous quarter.

However, equity turnover was on an upward trajectory. The total number of shares traded dropped from 870.20 million in the second quarter 2022 to 823.34 million in the third quarter of 2022, which is equivalent to a 5.39 percent decline. The volume of contracts traded in the derivative markets picked up, thereby reversing the downward trend that began in the third quarter of 2021. The volume traded rose from 1,001 in the second quarter 2022 to 1,114 contracts in the third quarter of 2022, which is equivalent to an 11.29 percent increase.

The number of shares traded fell by 5.39%, from 870.20 million in Q2 2022 to 823.34 million in Q3 2022

Figure 38: Market Capitalization vs Equities turnover

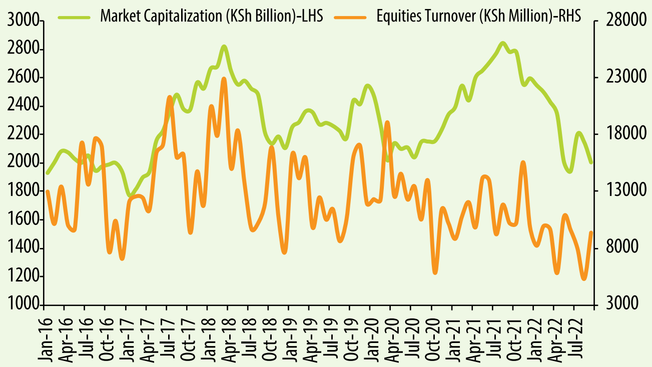


Figure 39: Number of shares Traded

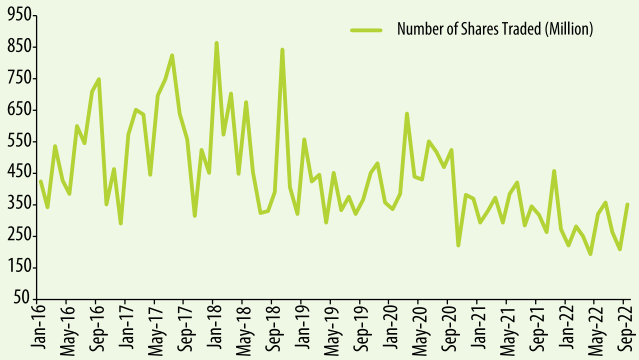


Figure 40: Number of Contracts

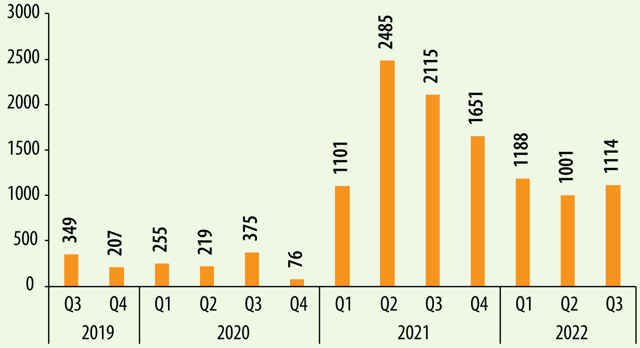
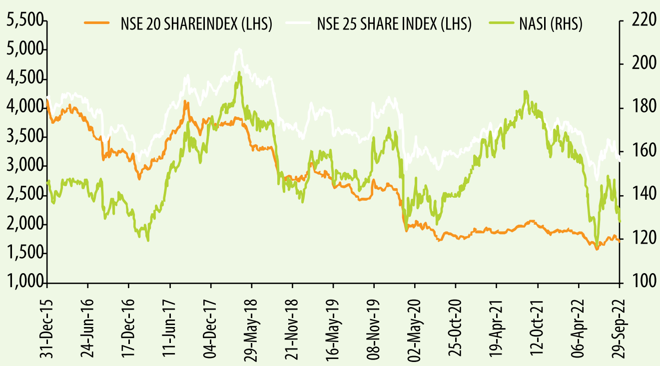
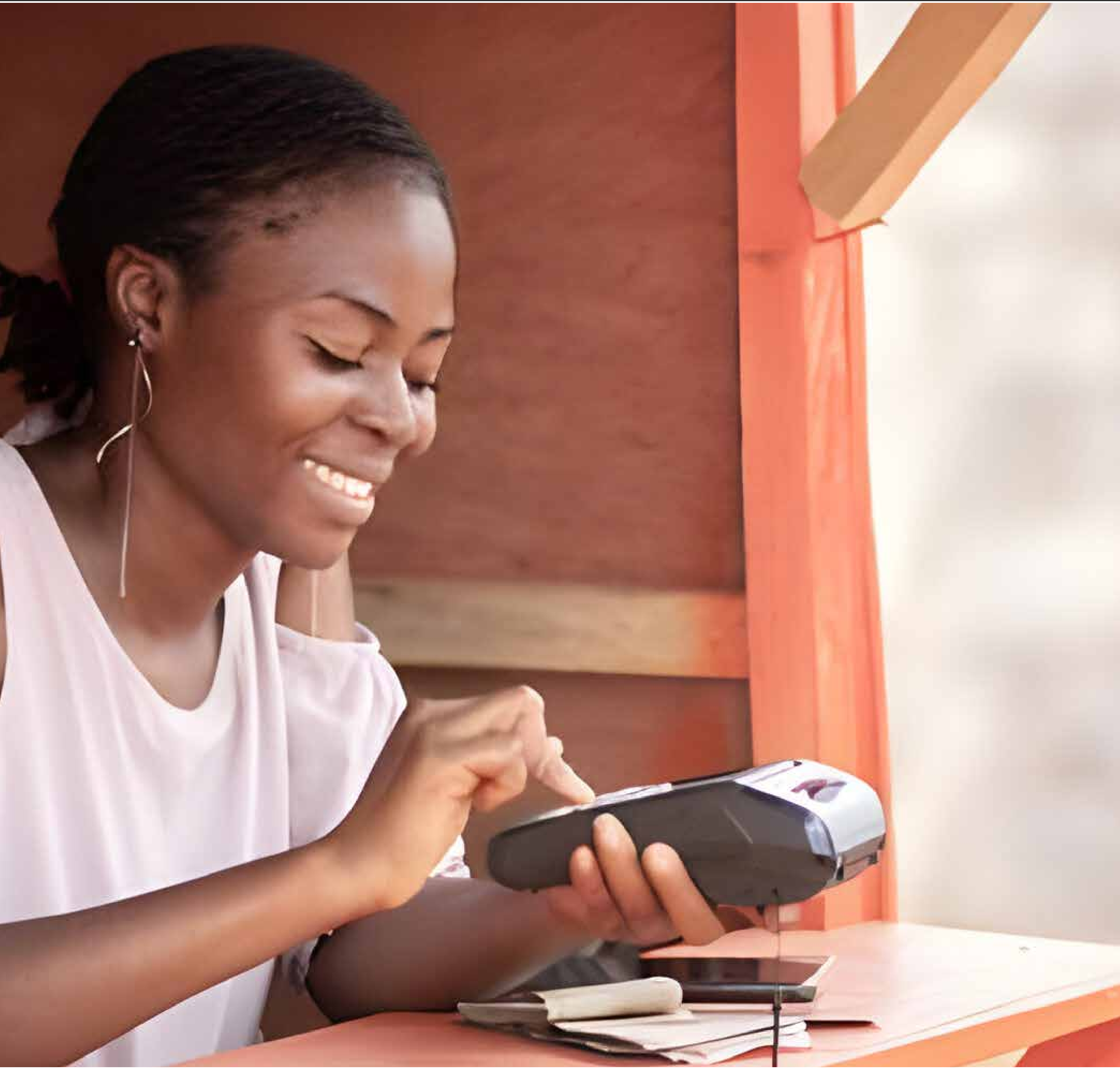


Figure 37: Trends in Nairobi Securities Exchange Leading Indicators





Banking Sector Performance

The continued stability and robustness of the banking sector, as pointed of by various indicators during the third quarter 2022, bestows confidence that the sector will continue supporting economy's growth momentum. The capital adequacy ratio, for instance, remained above the minimum capital requirement of 14.5 percent as it stood at 19.0 percent. In addition, the sectors asset base continued to grow, by 2.6 percent in September 2022, from Ksh6,249.7 billion in June 2022 to Ksh 6,415.2 billion (**Figure 41**).

The overall liquidity ratio, despite remaining strong above the minimum threshold of 20 percent, decreased to 51.5 percent in the third quarter of 2022, from 52.5 percent in the second quarter of 2022. The decrease was driven by an increase in total short-term liabilities (0.3 percent) as compared to a 1.5 percent decrease in total liquid assets between the two quarters (**Figure 41**).

The gross loans increased to Ksh 3,594.7 billion in the third quarter of 2022, mainly due to credit expansion to trade, personal and household, transport and communication, and agricultural sectors **(Figure 42)**. This was contrary to expectations as overall asset quality continued to deteriorate, thereby signalling the elevated credit risk. The Gross Non-performing Loans (NPLs) to Gross Loans Ratio stood at 13.7 percent at the end of the third quarter of 2022. The upward trajectory of the total shareholder's funds persisted during the quarter, rising from Kshs. 893.0 billion in June 2022 to Kshs. 917.5 billion in September 2022 **(Figure 43)**.

Figure 41: Total assets

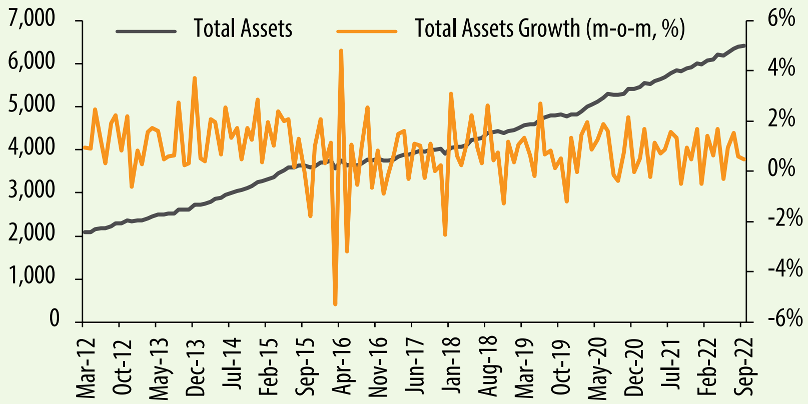


Figure 42: Liquidity ratio

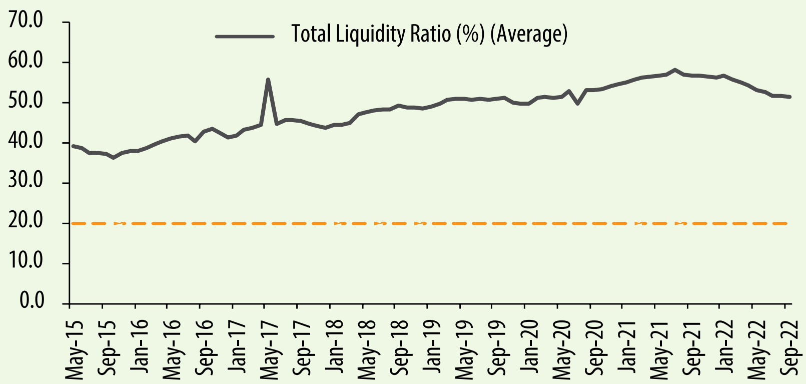


Figure 43: Gross loan

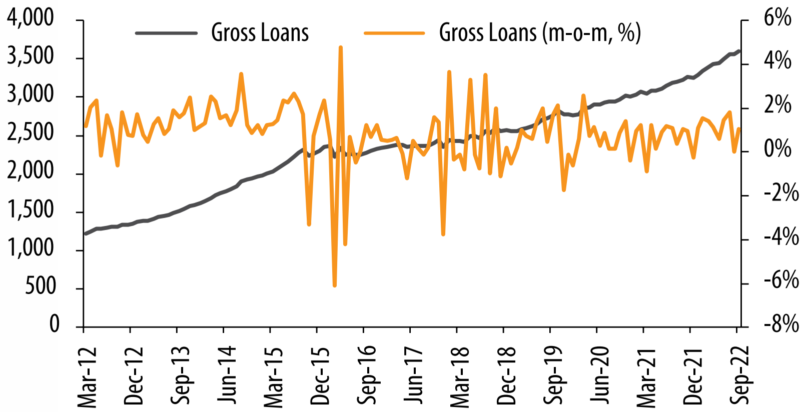


Figure 44: Gross non-performing loans

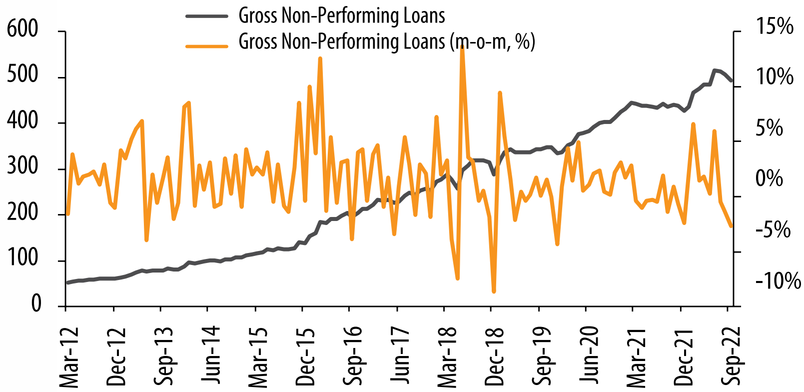
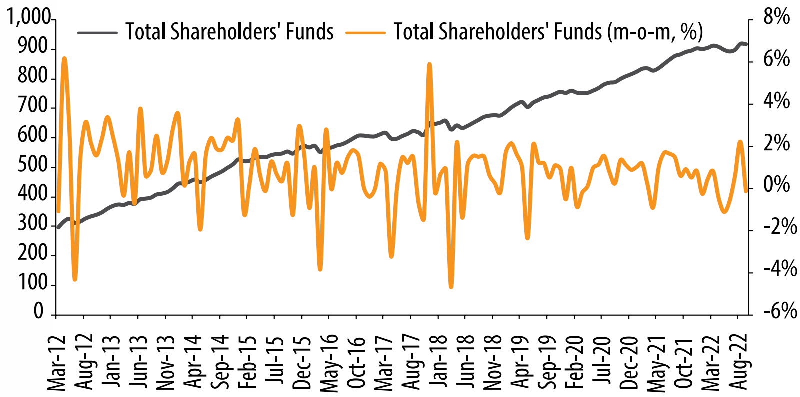


Figure 45: Total shareholders' fund



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