KENYA BANKERS ECONOMIC BULLETIN

VOLUME 38 | MARCH 2023

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 last 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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Distributed by Kenya Bankers Association

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CREDIT

FOREWORD

From the CEO's Desk

It is my pleasure to present to you the 38th Issue of the *Kenya Bankers Economic Bulletin*. In this issue, we discuss the state of the Kenyan economy during the fourth quarter of 2022. The *Bulletin* reviews the strides that the economy made during the year, with an emphasis on the opportunities and constraints that continue to shape the economy's economic performance. Much of the discussions in this Bulletin is a reflection on the post COVID-19 pandemic recovery outturn and the risks that faced the economy, particularly drawing specific implications on the banking sector.

As the *Bulletin* notes, the economy posted resilient performance during the period despite the protracted inflationary pressure. From a policy standpoint, analyses of the macroeconomic developments and the balance of risks particularly on the financial markets, pointed to an anticipated further tightening of monetary policy stance in advanced economies in 2023. Consequently, there was scope for a further tightening of monetary policy stance in the domestic market to provide a stronger impetus in taming inflationary pressures and protect the domestic financial market stability.

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
Chief Executive Officer,
Kenya Bankers Association

COMMENTARY

Inflation Pressures and Tight Global Conditions Prompt Further Rate Hike

By Samuel Tiriongo, PhD

The monetary policy environment during the period faced persistent inflationary pressure, weakening Shilling, rising global interest rates, and waning economic recovery. Five macroeconomic developments and considerations shaped the policy options:

Figure 1: Trends in inflation

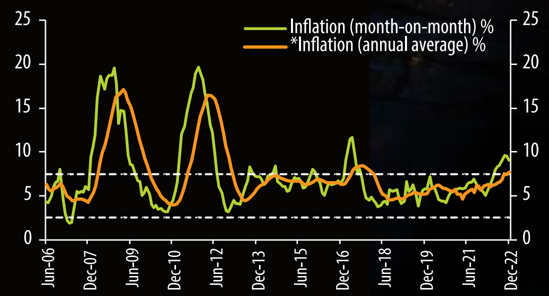
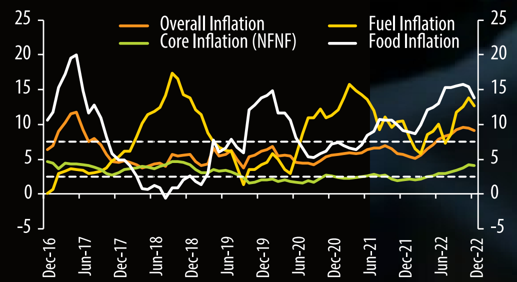


Figure 2: Trends in inflation by broad categories



Source: CBK

"The fuel subsidy reduction has kept fuel prices up, raising local commodity and production costs.

First, inflation continues to ease slowly, but remains considerably high above the government's upper target of 7.5% (Figure 1); bursting perceptions that inflationary pressures would be transitory. In December 2022, overall inflation stood at 9.1%, slightly lower than 9.5% in November and 9.6% in October 2022, driven by a broad-based decline in its sub-components (**Figure 2**). Food inflation despite remaining high, declined to 13.8% in December on increased food supplies at the end of the year, from 15.4% and 15.8% in November and October, respectively. Similarly, fuel inflation eased back to 12.7% in December, down from 13.8% in November, towards 12.6% recorded in October. Core inflation – which represents demand pressures in the economy – remained largely unchanged at 4.1% in December – relative to 4.2% in November - reflecting elevated demand pressures in the economy when compared with 3.8% in October 2022.

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

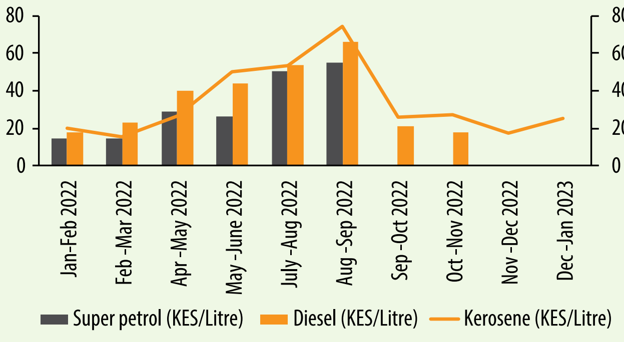
A few additional developments continue to shape the inflation outturn in the country. For instance, with the notable consistent decline in international oil prices (**Figure 3**)[1], the government's move to reduce fuel subsidy (**Figure 4**)[2] continues to keep fuel prices elevated, exerting pressure 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.

Figure 3: Trends in Murban crude oil Prices

Source: Oilprice.com

Figure 4: Trends in Government subsidy on fuel



Source: EPRA

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/).

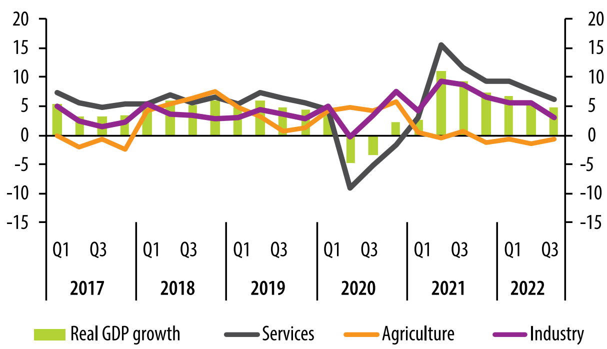
Ukrainian wheat exports to Kenya have been significantly impacted by the ongoing Russia-Ukraine war.

Second, the economy's growth momentum, both globally and on the domestic front continues to soften. According to the World Bank (2023), the global growth is 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 has been 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 is also 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 was 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 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 is estimated to have grown at 5.5% in 2022 with baseline growth further projected to soften to 5% in 2023[3].

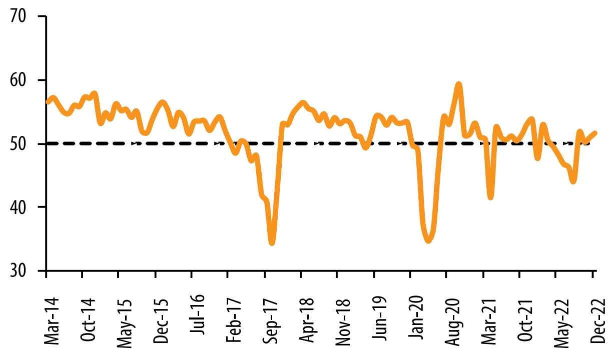
Analyses of higher frequency leading indicators of economic activity as captured by the Purchasing Managers Index (PMI) report, showed improved business conditions in the fourth quarter of 2022. The PMI index picked up to a three-month high of 51.6 in December 2022, having risen from 50.9 in November 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

Figure 5: Nominal exchange rate (KSh/USD)



Source: KNBS

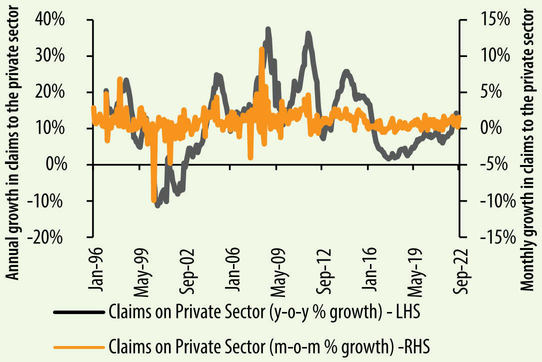
Figure 6: Remittances Inflows



Source: IHS Markit ®

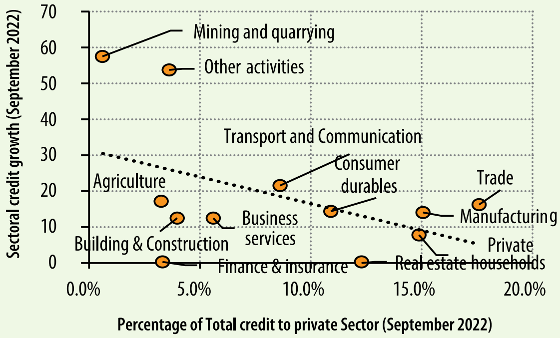
3. World Bank (2023). Global Economic Prospects. https://www.worldbank.org/en/publication/global-economic-prospects

Figure 7: Credit growth to the Private Sector (%)



Source: CBK

Figure 8: Sectoral Credit growth to the Private Sector

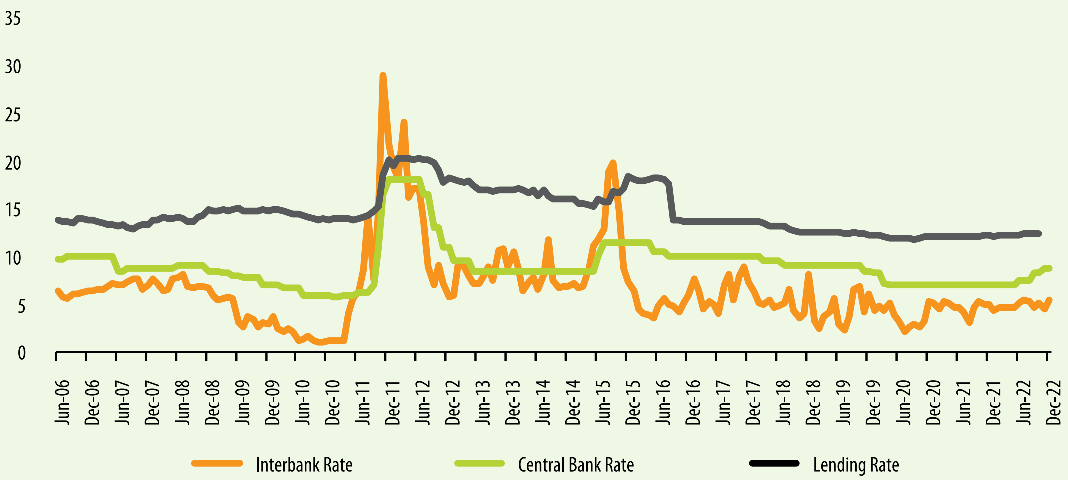


Source: CBK

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.

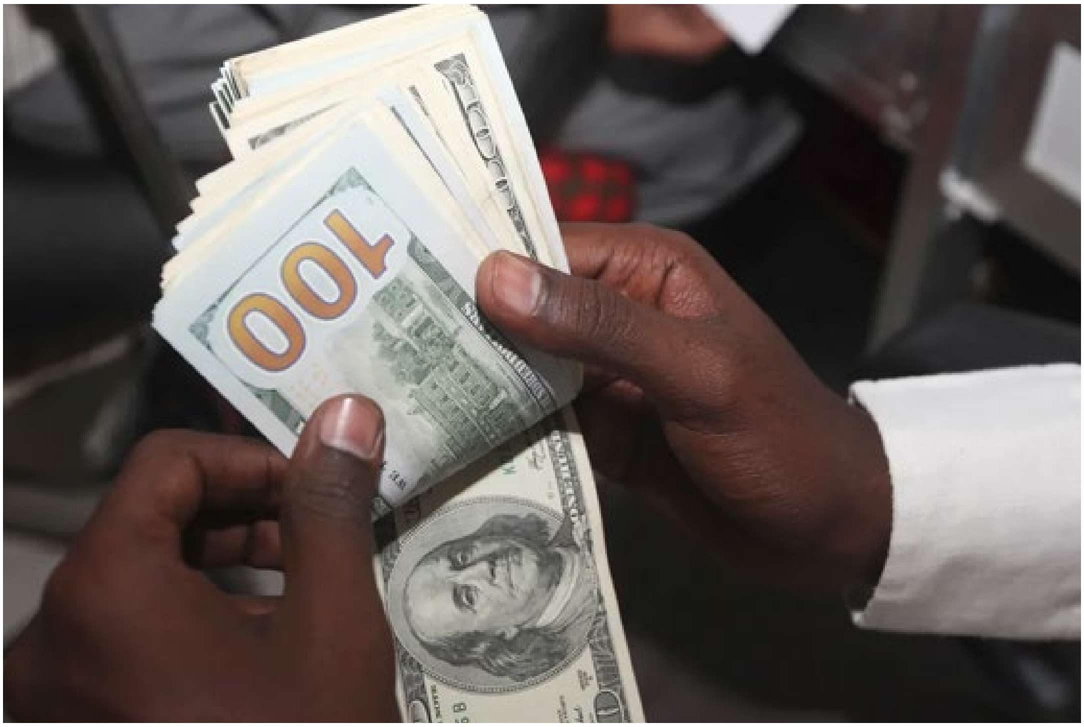
Third, private sector credit growth remained strong and within the double-digit territory for seven months in a row. The year-on-year private sector credit growth stood at 12.86% in September 2022, slightly up from 12.47% in August 2022 (**Figure 7**). An assessment of credit growth across the sectors in September 2022 reveals that strong credit growth was absorbed by transport and communication (21.54%), agriculture (17.09%), trade (16.36%), consumer durables (14.40%), manufacturing (14.16%), building and construction (12.52%) and business services (12.51%) (**Figure 8**). Going forward, it is expected that the impact of the policy tightening effected since May 2022 will start to filter through to market interest rates and moderate the growth in private sector credit in the near term. Already, there is evidence of an increase in the short-term interbank interest rates, as shown in **Figure 9,** that is expected to be followed by an increase in the longer-term interest rates. This has been supported by the considerable progress of the market in transitioning to risk-based credit pricing regime, that allows banks to price loans in line with the evolution of risk and policy signals.

Figure 9: Trends in the Interest rates (%)



Source: CBK

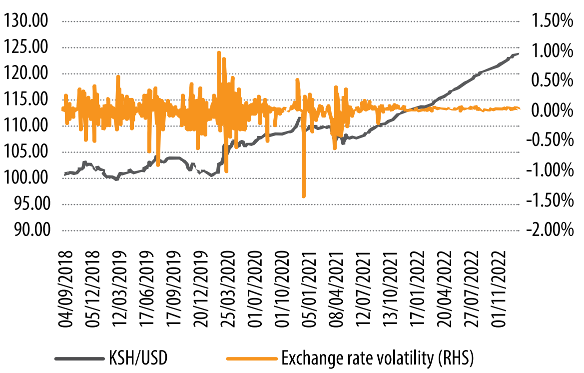
“ The usable official foreign exchange reserves position improved to stand at USD 7,415 million



Fourth, vulnerabilities on the external sector continue to persist driven by the policy measures taken to tame inflationary pressure in advanced economies as well as protracted war in Ukraine. Recent developments in the external sector show a sustained steady depreciation of the Shilling vis-à-vis the US dollar (**Figure 10**), driven largely by an elevated current account deficit, even with a slight improvement in the financial account of the balance of payments (**Figure 11**). The depreciation continues to be moderated by resilient inflows of diaspora remittances and a steady increase in tourism earnings.

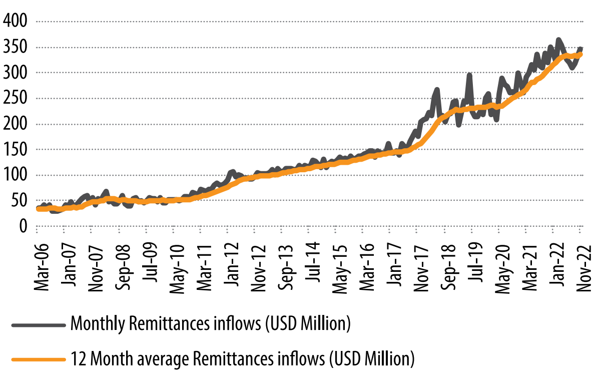
Meanwhile, the usable official foreign exchange reserves position improved to stand at USD 7,415 million (or 4.15 months of import cover) as of 12

Figure 10: Nominal exchange rate (KSh/USD))



Source: KNBS

Figure 11: Remittances Inflows



Source: IHS Markit ®

Figure 12: **FX Reserves and Import Cover**

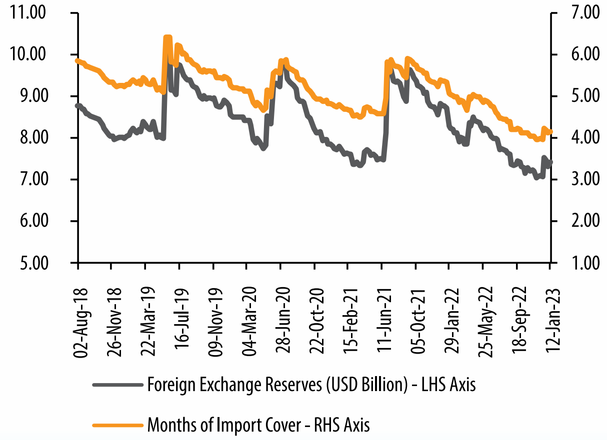
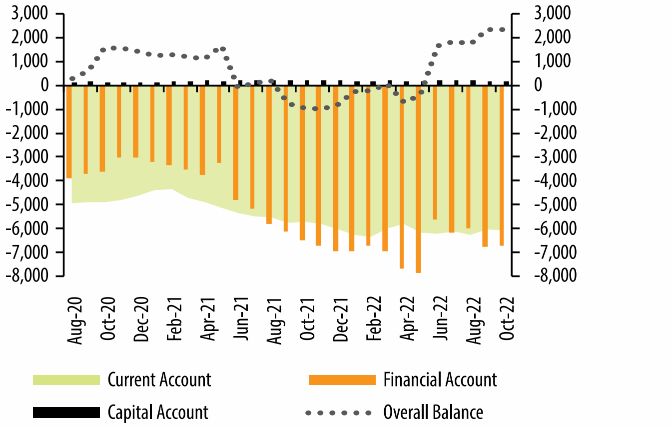


Figure 13: **Developments in the Balance of payments USD Millions (net balances)**



Source: CBK

January 2023, from USD 7,075 million (3.96 months of import cover) on 15 December 2022. This reflects a slight improvement in the country's buffers to deal with any emerging short-term shocks in the foreign exchange market. Going forward nonetheless, volatilities in the external sector are expected to be sustained with advanced countries remaining upbeat to effect interest rate hikes to tame persistent inflationary pressure. This measures would trigger a further appreciation of the US dollar in the global foreign exchange markets with direct implications on the domestic markets.

In conclusion, and from a policy standpoint, we have made an assessment of the macroeconomic developments and the balance of risks particularly on the financial markets. Against these analyses, there was an anticipated further tightening of monetary policy stance in advanced economies in 2023. Consequently, there was scope for a further tightening of monetary policy stance in the domestic market to provide a stronger impetus in taming inflationary pressures and protect the domestic financial market stability.

OUTLOOK

State of the Economy

The growth in the global economy is tilted to the downside, with various indicators pointing to slowed growth. Based on the World Economic Outlook April 2023 Report, global growth is expected to decline in 2023 to 2.9 percent, before increasing to 3.1 percent in 2024.

The slowdown is attributed to the geopolitical instabilities associated with the war in Ukraine and increase in interest rates effected to tame inflationary pressure. However, economies continued to reopen from the adverse effects of COVID-19; paving the way for a faster-than-expected recovery.

For advanced economies, the IMF projected a decline in growth to 1.3 percent in 2023, before rising slightly to 1.4 percent in 2024. This is a significant drop from the 2.6 percent growth forecast made in January 2022 for 2023. Additionally, about 90 percent of advanced economies are expected to see a decline in growth in 2023, which is likely to result in higher unemployment; projected rise by 0.5 percentage points on average from 2022 to 2024.

> **"The IMF projects stronger growth for emerging and developing economies, with 3.9% in 2023 and 4.2% in 2024.**

In contrast, emerging market and developing economies are projected by the IMF (World Economic Outlook, WEO, January 2023) to have stronger economic prospects, with an average growth of 3.9 percent in 2023 and 4.2 percent in 2024. However, there is considerable variation in growth projections across regions, and the 2023 forecast is lower than the January 2023 WEO Update and significantly below the 4.7 percent forecast made in January 2022.

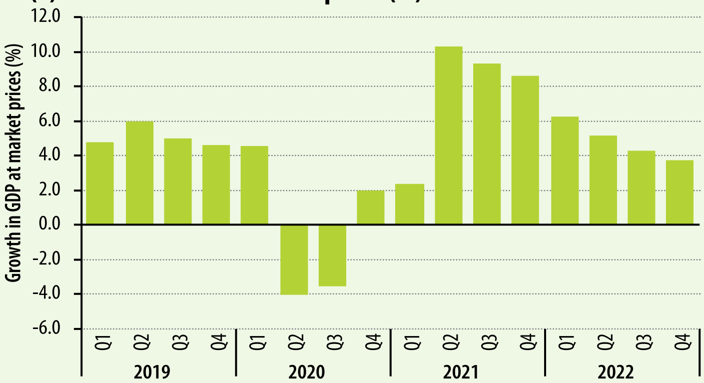
Low-income developing countries are expected to have the highest GDP growth rate, averaging 5.1 percent over 2023-24. However, projected per capita income growth averages

2.8 percent during this period, which is below the average for middle-income economies (3.2 percent) and falls short of the necessary growth rate for standards of living to converge with those in middle-income economies.

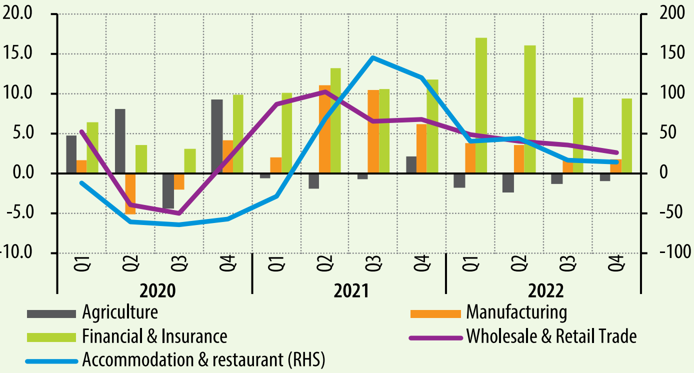
Domestically, the Kenyan economy experienced a slower growth rate in the fourth quarter of 2022 compared to the previous year. However, the growth was still positive and broad-based across all sectors of the economy, with service-oriented activities experiencing the most pronounced growth. There was a contraction in the Agriculture, Forestry, and Fishing sector; constrained by drought conditions that depressed production. However, real GDP grew by 3.8 percent

Figure 14: **GDP Performance and Economic Outlook**

14(a): Growth in GDP at market prices (%)



14(b): Sectoral GDP Growth (%)



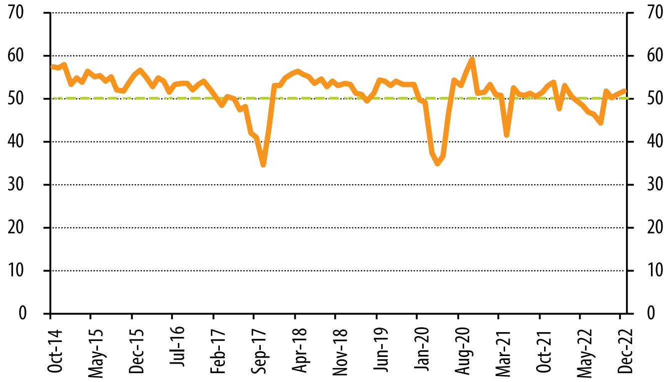
Source: KNBS

during the fourth quarter of 2022, compared to 8.6 percent growth in a similar period in 2021 **(Figure 14a)**. In particular, agriculture sector contracted by 0.9 percent, while accommodation and restaurants, financial and insurance, wholesale and retail, and the manufacturing sectors registered positive growth rates of 14.8%, 9.4%, 2.7% and 1.8% respectively **(Figure 14b)**.

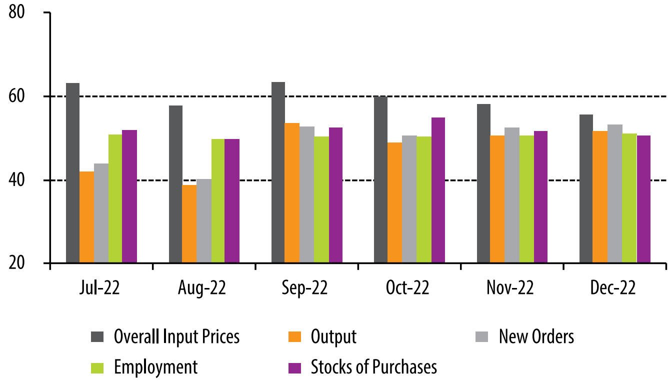
The Kenya Purchasing Managers' Index™ (PMI™) pointed to strong growth momentum in 2022, despite challenges such as intermittent rains and drought conditions in several parts of the country. The index remained above the 50-mark particularly in the second half of the year; a good indicator of economic recovery. However, input prices continued to rise month after month over the period reflecting build up in inflationary pressures. As output rose, driven by factors such as improved business and consumer confidence, government policies and interventions, and an overall positive economic outlook, there was a notable increase in new orders of products pushing up employment levels **(Figure 15)**.

"The Kenya Purchasing Managers' Index™ pointed to strong growth momentum in 2022, despite challenges such as intermittent rains and drought conditions in several parts of the country.

15(a): Composite PMI index



15(b): Selected PMI sub-indices



Source: IHS Markit®

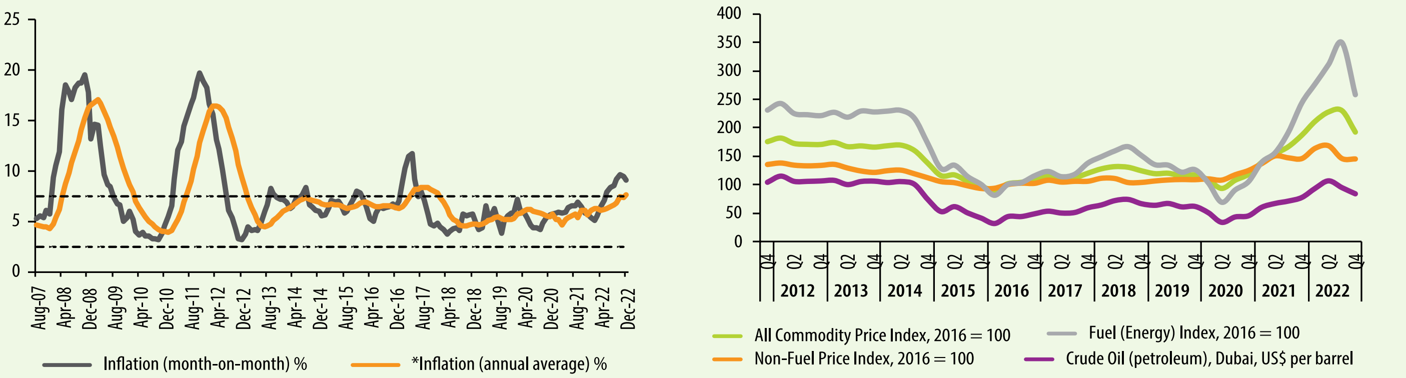
The persistently high inflation in Kenya, driven mainly by the lagged impact of the drought conditions in most parts of the country, remained a cause for concern during the quarter. As a consequence, food inflation remained at double-digit level during the fourth quarter, particularly at 13.8 percent in December 2022. In addition, fuel inflation at 12.7 percent by end December 2022 **(Figure 16a),** exerted further pressure on overall inflation to rise; with the fuel price increases driven by withdrawal of fuel subsidies by the Government. Although core inflation was low and stable, the outlook remained uncertain and surrounded by upside risks emanating from the possibility of higher global energy prices, a faster global economic recovery pushing up global demand, and protracted supply side-driven inflationary pressures trickling through to core inflation.

However, it is positive to note that commodity prices, particularly of crude oil, moderated during the quarter **(figure 16b);** declining to USD 84.22 per barrel in the fourth quarter of 2022, which was 11.58 percent lower than the prices recorded in the third quarter of 2022, and maintaining a similar trend is the global commodity prices and the Fuel (Energy) index.

Credit to the private sector continued to grow at a double-digit levels during the quarter, largely buoyed by the rebound in consumption and increased economic activities. In particular,

Figure 16: Inflation trends and Global Commodity and oil price developments

(a): Inflation Trends **(b): Global Commodity and oil price developments**



Source: Central bank of Kenya and IMF Global Commodity database

total private sector credit growth improved to a growth of 12.46 percent in 2022 as all economic sectors registered positive growth rates **(Figure 17).**

A sectoral disaggregation of commercial banks' credit to the private sector as of December 2022 showed that growth of credit to agriculture (22.36 percent), manufacturing (13.78 percent), trade (11.38 percent), transport and communication (23.48 percent), and building and construction (8.20 percent) sectors remained notably robust **(Table 1).** These outcomes were anchored on strong optimism on the recovery of the economy.

Figure 17: Private Sector Credit and Growth Dynamics

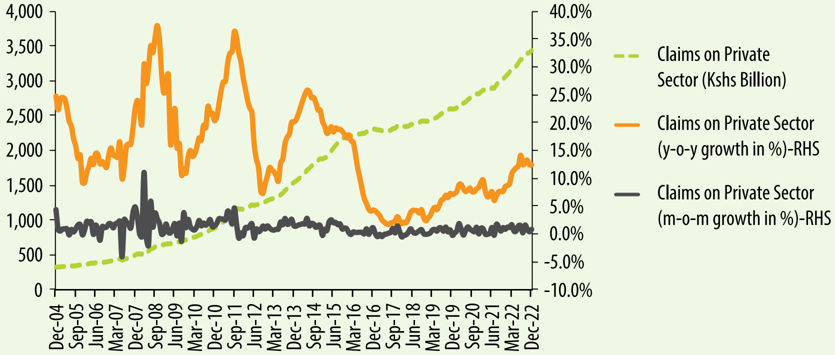
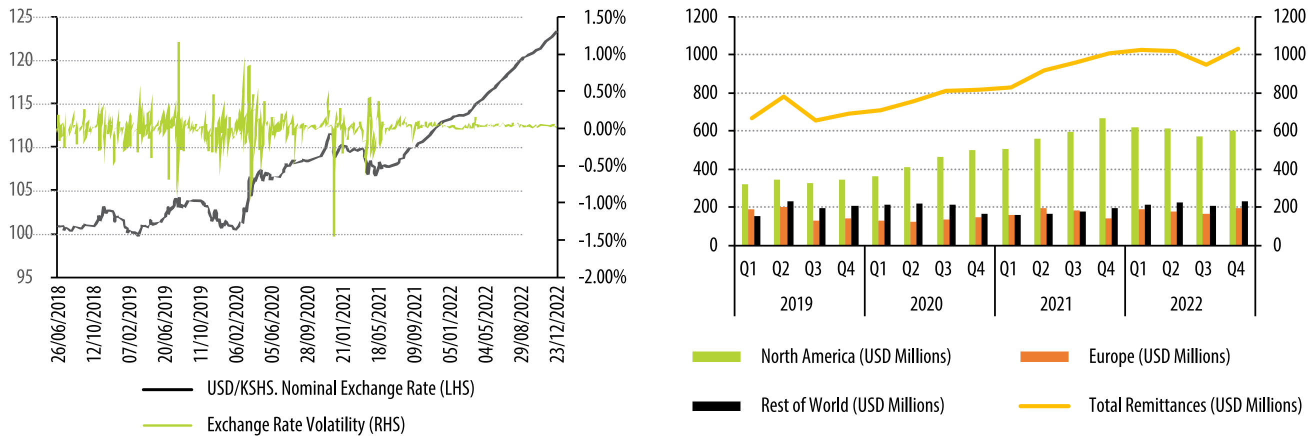


Table 1: Commercial banks Sectoral private sector credit growth

	Sept - 21	Dec - 21	Mar - 22	Jun - 22	Sept - 22	Dec - 22
Agriculture	3.29	0.54	7.72	12.60	17.06	22.36
Manufacturing	9.77	13.12	9.93	15.18	14.16	18.78
Trade	4.65	6.56	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 Households	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

Source: Central bank of Kenya

Figure 18: Kenya Shilling -US Dollar Exchange and Remittances flow



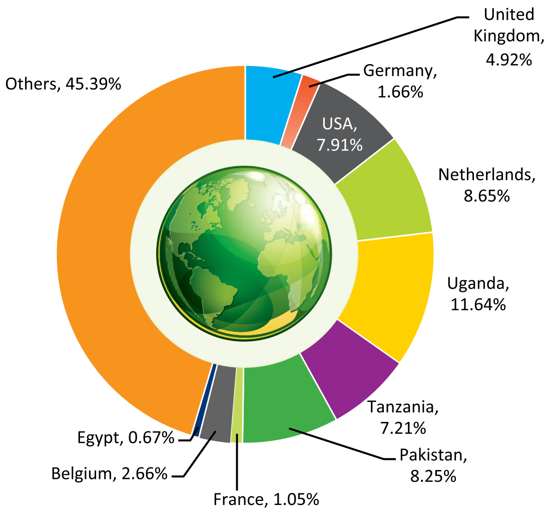
Source: CBK

The Kenya shilling, as depicted in **Figure 18a,** weakened by 9.0 percent against the US dollar in the quarter, mainly as a result of increased demand for dollars and the unfavourable interest rate and inflation differential between Kenya and its major trading partners. Consequently, one US dollar exchanged for an average of 122.0 Kenya shillings during the quarter. Despite the weakening, the foreign exchange reserves held by the Central Bank remained strong and above the required minimum of 4.0 months of imports cover, thereby providing adequate buffer against short-term shocks in the foreign exchange market. In addition, the inflows in remittances remained resilient; increasingly steadily by 3 percent to USD 1,047 million during the quarter **(Figure 19b).**

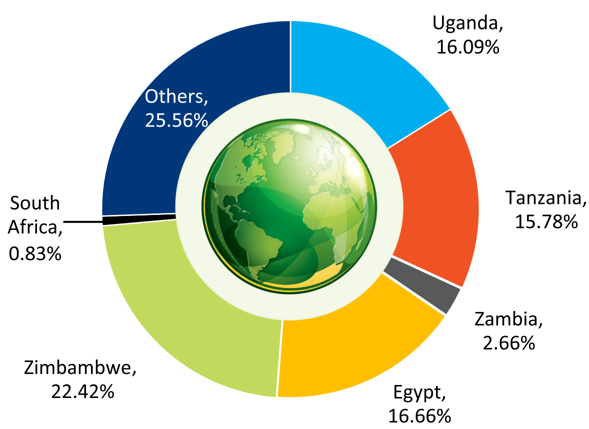
Kenya's external sector performance analyses showed that the total export earnings during the period stood at USD 1,762 million, which was 3.16 percent increase compared to the same period in the previous year. The top three leading destinations for Kenya's exports were Uganda, Netherlands and Pakistan, which cumulatively constituted 27.54 percent of Kenya's total exports. In contrast, the import bill declined to USD 4,334 million in the final quarter of 2022, which was a 14.43 percent drop compared to the same period in the previous year. In terms of source countries, the UAE overtook China as the main source of imports, accounting for 20.27 percent of total imports, compared to China's 18.82 percent **(Figure 20).**

Figure 19: Kenya's Intra-African and Global Trade Developments

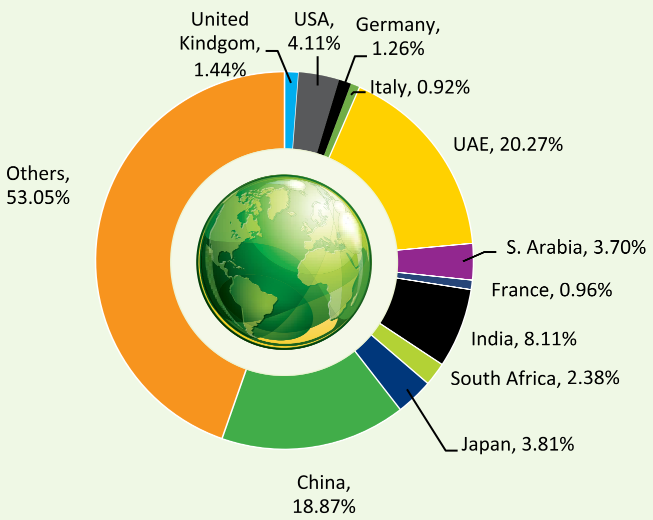
(a) Share of exports of goods by trading partners



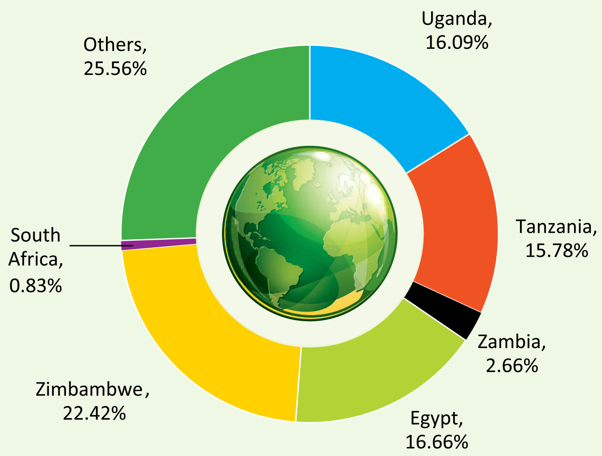
(b) Intra-African Trade - Kenya's Major Trading Partners



(c) Share of imports of goods by trading partners



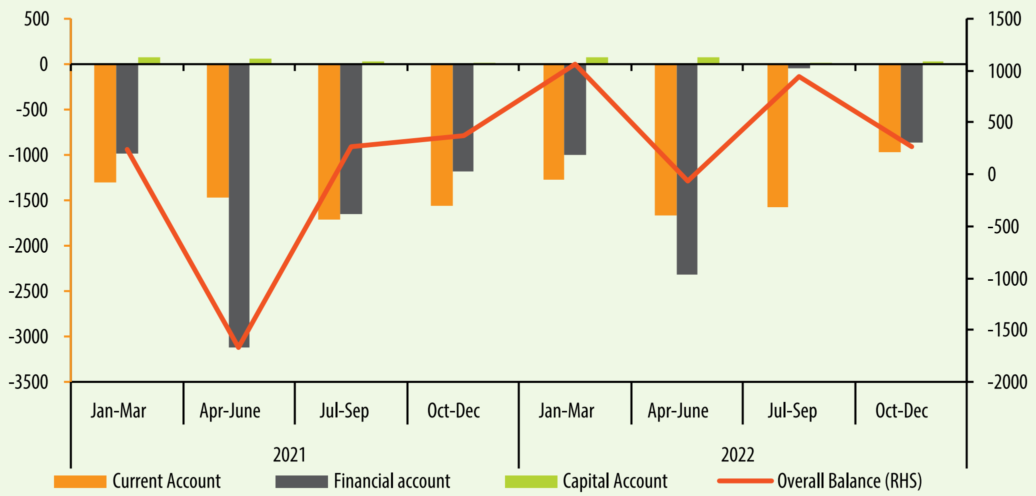
(d) Intra-African Share of Imports of goods by trading partners



Source: Central Bank of Kenya

In December 2022, the overall balance of payments position recorded a surplus of USD 274 million, which was an improvement from a deficit of USD 431 million recorded in a similar period in 2021. This was mainly due to an improvement in the capital and financial accounts, and a narrowing of the current account deficit on account of improvements in the services account and the net secondary income balance (**Figure 20**).

Figure 20: Balance of the Payments Performance



Sectoral Performance

Agriculture

Despite the persistent drought conditions in Kenya, the agricultural sector registered some improvement; thereby moderating its contraction to 0.6 percent in the third quarter of 2022. Government interventions during the quarter targeted at reducing production costs included deployment of subsidies on fertilizers, injecting KSh 3.55 billion into the sector.

Figure 21: Tea production and Price Movements

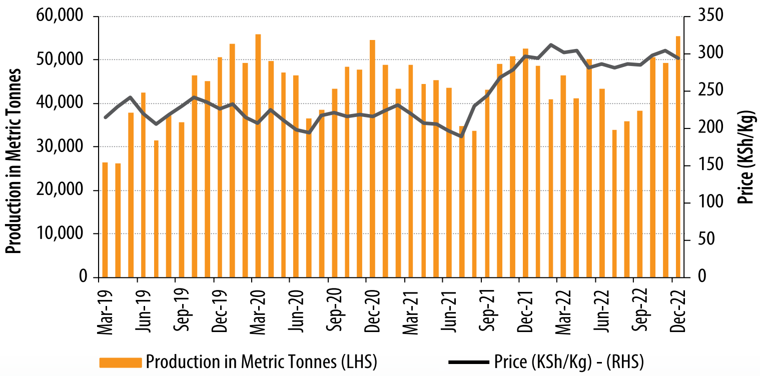
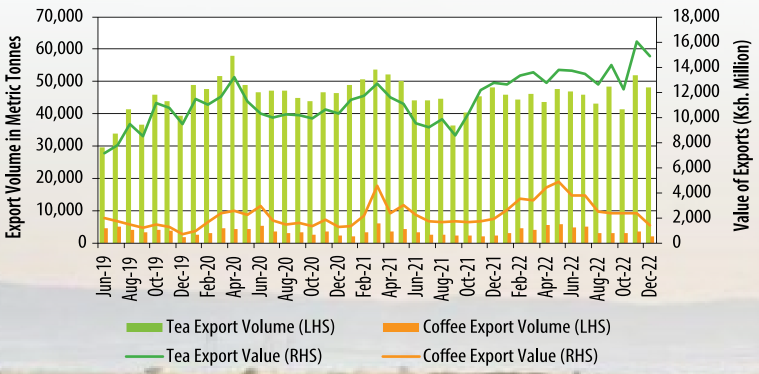


Figure 22: Value of Tea and Coffee Exports



Production of Tea - one of Kenya's leading cash crops - increased by 1.84 percent in the fourth quarter of 2022, mainly driven by earlier commencement of short-rains and enhanced rainfall in December in the core production zones . Production during the quarter increased to 155,009.25 metric tonnes from 152,202.41 metric tonnes recorded in a similar period in 2021 (**Figure 21**). From the earnings side, the average monthly auction price for Kenyan tea also increased during the quarter, rising to KSh 298.47 per kilogram, compared to KSh 280.44 per kilogram registered in a similar period in 2021.

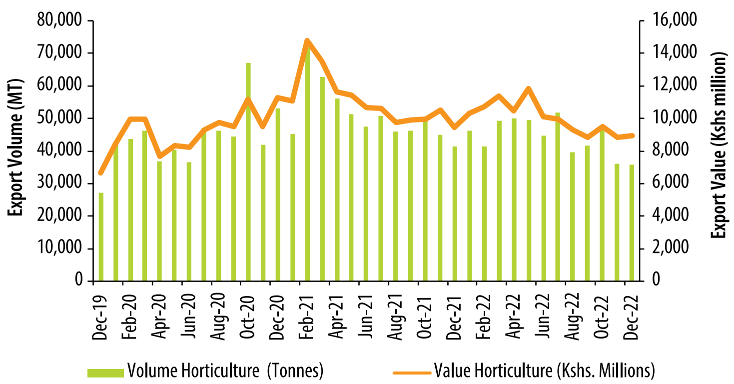
Despite global economic challenges, the fourth quarter of 2022 saw a surge in tea and coffee exports, with volume and value surpassing the previous year's records **(Figure 22).** Pakistan maintained its position as the leading importer of Kenyan tea, while the UK, Russia, and Egypt also ranked high on the list. However, traditional markets like India, the USA, and the Netherlands recorded lower imports, while frontier and emerging markets like Burkina Faso and Chile witnessed growth. With winter season demand projected to drive exports of tea and coffee, its impact will be against enhanced economic uncertainty.

The horticultural sub-sector has long been on a strong and steady growth path, generating significant foreign exchange earnings year after year.

However, recent years have seen an overall decline in performance. The volume and value of horticulture exported has decreased quarter on quarter from 136,538.05 tonnes in the fourth quarter of 2021 to 118,467.57 tonnes in the quarter under review **(Figure 23)**.

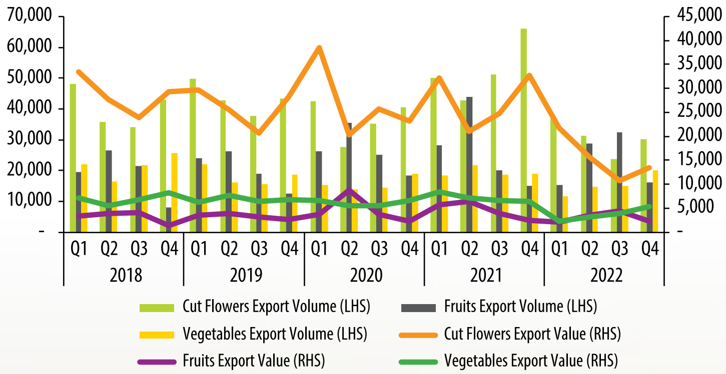
The volume and value of cut flowers exported declined to stand at 30,281 tonnes and KSh 13,432 million, respectively in the final quarter of 2022. Fruit export volume and value also declined, to 16,120 tonnes and KSh 2,340 million, respectively. In contrast, the volume and value of vegetable export increased marginally during the quarter **(Figure 24).**

Figure 23: Horticultural Exports



Source: KNBS

Figure 24: Cut Flowers, Vegetables and Fruits



Source: KNBS

Figure 25a: Trends in the Manufacturing sector

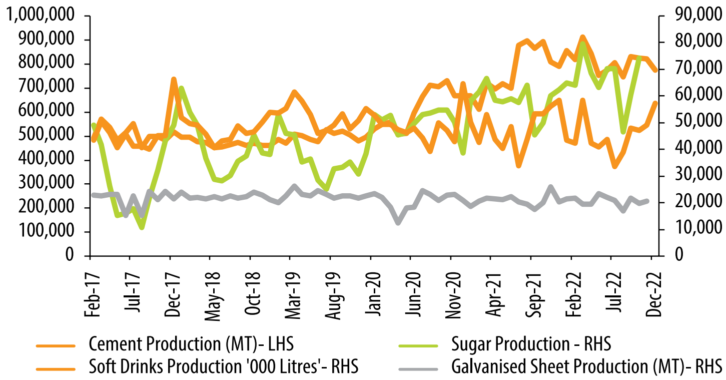
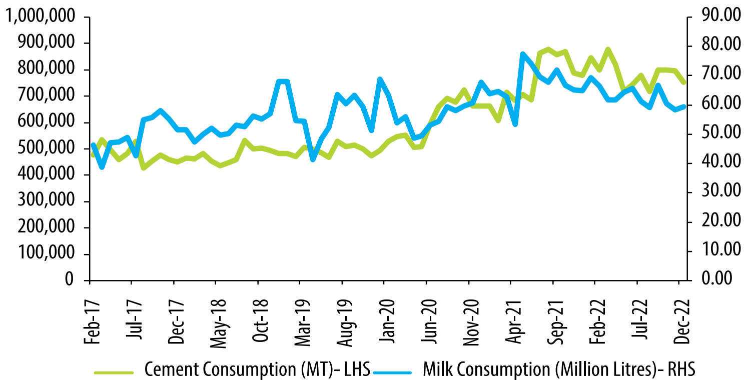


Figure 25b: Trends in the Milk and Cement Consumption



Source: KNBS

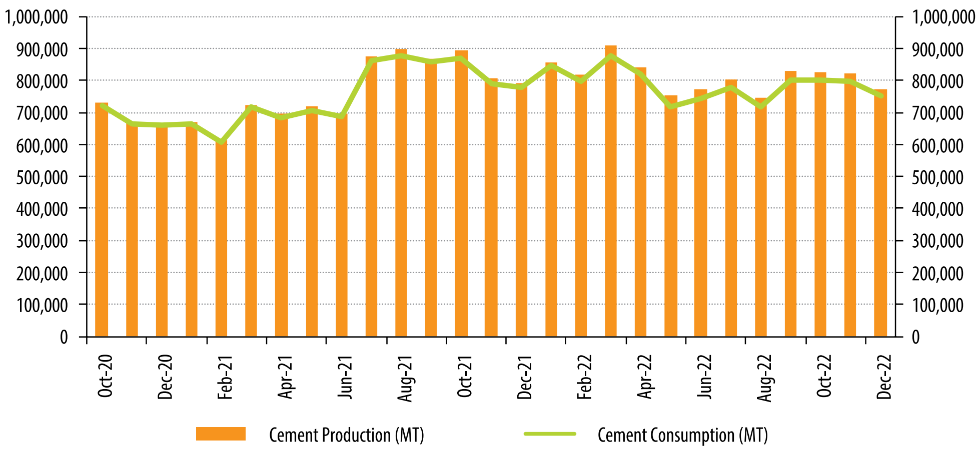
Manufacturing

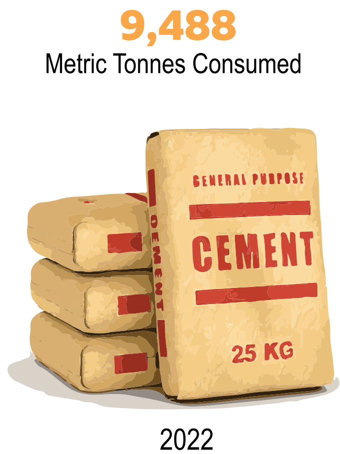
The production levels in manufacturing sector depicted a mixed performance in various key sub-sectors. While sugar and soft drinks production increased, there was a mild decline in cement production. Supported by more favorable weather patterns, Sugar production in December 2022 grew to 63,968 metric tonnes compared to 62,333 metric tonnes registered in December 2021. However, as demand eased with consumption declining by 3.50 percent, Cement production declined to 2,420,366 metric tonnes in the fourth quarter of 2022, reflecting a 2.86 percent decline in production relative to a similar period in 2021. Milk consumption also saw a decline by 9.46 percent over the period **(Figures 25a & 25b).**

Building and Construction

Activity in the building and construction sector reflected reduced demand in cement production and consumption, and the broader economic performance. Despite depicting moderation in activity during the fourth quarter of 2022, the building and construction industry in Kenya has shown remarkable growth, as bolstered by the government's investment in infrastructure development, and prioritization of affordable housing. There was a decrease in the demand for cement between October 2022 and December 2022 - reflected by a 5.8 percent decline in cement consumption, which resulted in a 6.7 percent reduction in cement production (**Figure 26).**

Figure 26: Cement Consumption





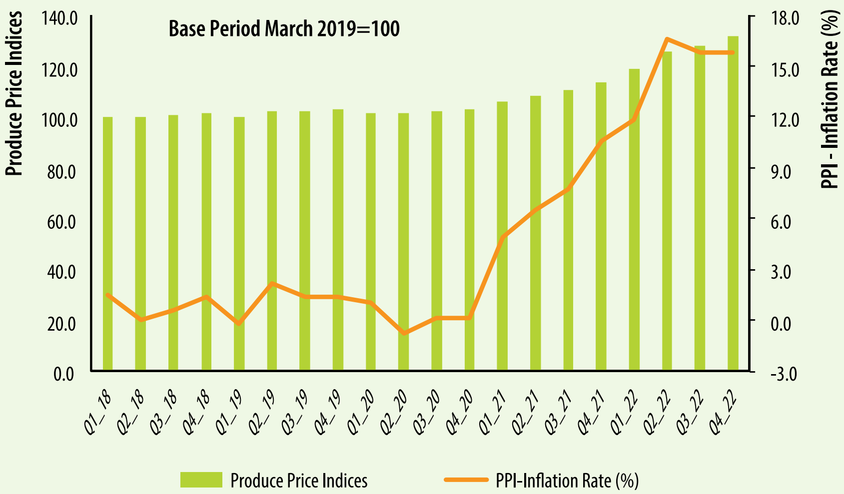
Source: KNBS

Producer Price Index

The Producer Price Index for the manufacturing sector in Kenya has maintained an upward trajectory since the first quarter 2020, when it stood at 101.07. In the fourth quarter 2022, the index increased by 30.21 percent over the period; driven by rapid price increases in the quarrying and mining sector (by 22.7 %) and the manufacturing sector (16.9 %) largely on account of rising global commodity input prices.

Notably, the Electricity sub-index increased by 6.2 percent in the fourth quarter of 2022, marking an upturn following three successive quarterly declines. Consequently, the annual producer price inflation increased slightly to 15.84 percent in the fourth quarter of 2022 from 10.59 percent in a similar period in 2021 **(Figure 27).**

Figure 27: **Producer Price Index**



Source: KNBS

Energy

The energy sector remains a critical component of the economy, and the ongoing transition to cleaner energy sources presents both challenges and opportunities for companies in the sector. The renewable energy sector has continued to grow, driven by increasing demand for clean energy with the implementation of supportive government policies. Solar and wind power have continued to post stellar performance. In fact, wind and solar energy generation was up by 11.89 percent in the last quarter of 2022 compared to a similar period in 2021, out of which 61.45 percent growth was in solar energy as Wind energy generation grew by a modest 4.91 percent.

Overall, the total energy generation during the quarter increased to 3,241.55 million kilowatts from 3,078.68 million kilowatts in the third quarter, which reflects a 5.29 percent growth. Even so, the drought in some parts of the country resulted in a 25.52 percent decline in hydroelectric power generation; more than offsetting the growth registered in other electricity generation sub-sectors **(Figure 28).**

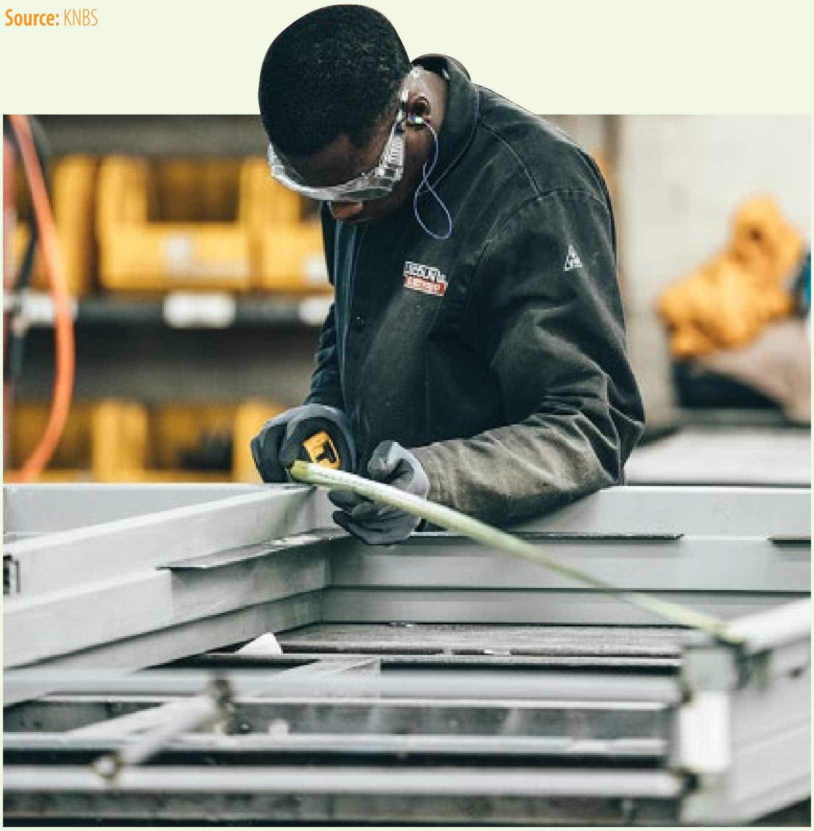
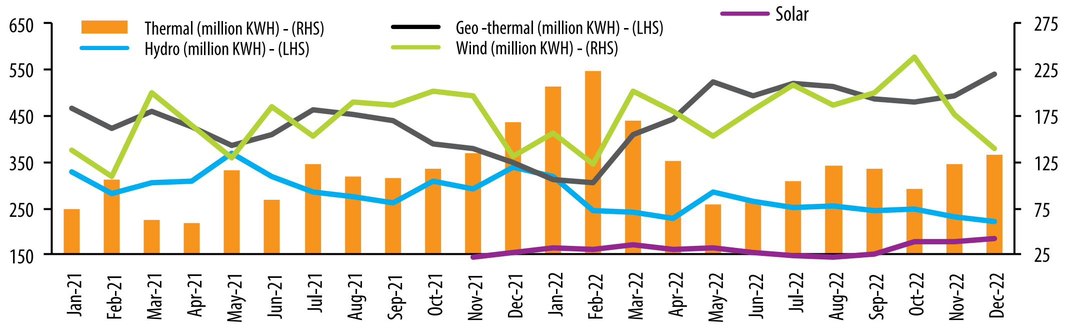


Figure 28: Monthly Electricity Generation by Source (Million KwH)



Electricity Generation by Source (Gigawatt Hours)

In the international markets, crude oil prices moderated during the quarter. The Murban crude oil prices declined gradually to close the quarter at USD 79.6 per barrel in December 2022, from USD 95.3 per barrel in September 2022, as reported in **Table 2**. Domestic pump prices remained elevated during the period, with the average super petrol prices recorded at KSh 179.1 in October 2022 before declining to KSh 178.1 per litre in November and December 2022 as set by the Energy and Petroleum Regulatory Authority (EPRA). Diesel and Kerosene prices also dropped marginally by KSh 1 per litre from the October 2022 prices, as prices of LPG (13 kgs) gas registered substantial decline during the quarter; notably falling below KSh 3,000 in December.

Table 2: Average Monthly Crude Oil and Retail Fuel Prices

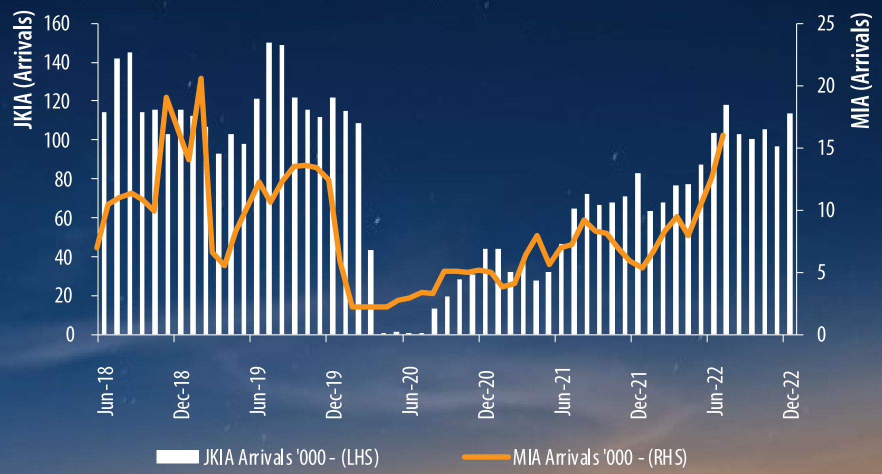
	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22
Murban crude oil (US$/Barrel)	85.4	94.0	113.5	105.6	113.9	117.7	108.6	101.9	95.3	93.6	89.7	79.6
Super petrol (KSh/Litre)	130.5	130.5	135.5	145.4	150.9	159.9	159.9	159.9	180.1	179.1	178.1	178.1
Diesel (KSh/Litre)	111.5	111.5	116.5	126.4	131.9	140.9	140.9	140.9	165.9	163.9	162.9	162.9
LPG (13Kgs)	2659.2	2659.7	2866.2	2924.6	3176.9	3218.2	3100.7	3103.2	3106.7	3084.0	3004.8	2980.8

Source: ADNOC oil prices and KNBS

Tourism

The tourism sector experienced growth during the quarter, with a significant increase in inbound tourist arrivals compared to a similar period in the previous year. The increase can be attributed to the continued easing of travel restrictions by many countries across the globe. The total inbound tourist arrivals during the fourth quarter of 2022 stood at 350,551; which is 2.23 percent higher than 342,904 inbound tourists reported in the previous quarter and 46.05 percent more than the total inbound tourists reported in a similar period in 2021 (**Figure 29**).

Figure 29: Monthly Inbound Tourist Arrivals by entry point

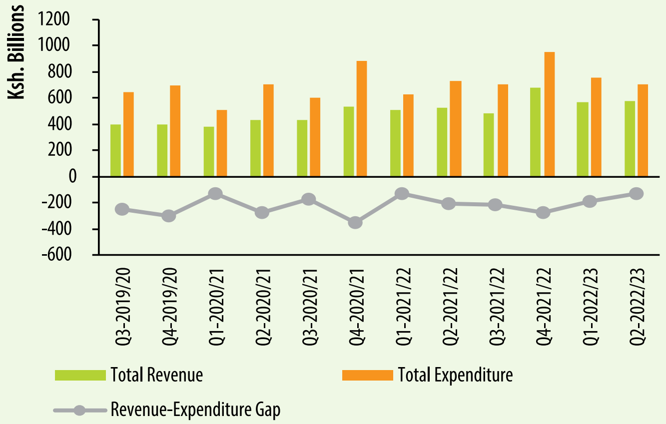


Government Revenue & Expenditure

Fiscal performance has been a key indicator and driver of the state of aggregate economic activity. Data for the quarter under review show that Kenya's fiscal performance, particularly government spending and taxation outcomes, continued to reflect a fiscal consolidation regime. On one hand and in disaggregate terms, government expenditure decreased to KSh 580.8 billion in the second quarter of the FY 2022/23 compared to KSh 733.2 billion in the second quarter of the FY 2021/22, mainly driven by a decline in national government recurrent and development expenditures, and county transfers by 18.9 percent, 33.0 percent, and 15.7 percent, respectively.

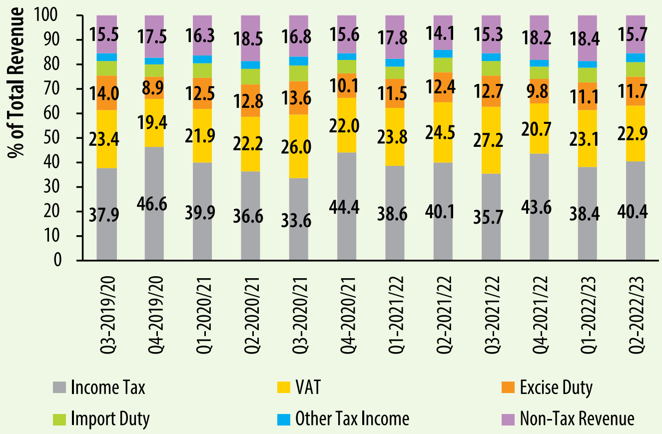
On the other hand, total government revenue and grants increased to KSh 540.5 billion in the second quarter of FY 2022/23, compared to KSh 531.3 billion over a similar period in FY 2021/22. The growth in tax revenue was supported mainly by direct taxes which posted an impressive growth of 10.18 percent during the quarter to KSh 2,316.94 billion. However, there was a significant shift in the composition of total revenue, as the share of Value Added Tax (VAT) and Excise Taxes respectively declined by 1.4 and 0.6 percentage points. The proportion of income tax, import tax and other taxes over the period went up by 1.2 percent, 0.3 percent, and 0.5 percent respectively. The revenue-expenditure gap declined to KSh 131.9 billion, compared to KSh 207.4 billion the same period in FY 2021/2022; reflecting a quantum reduction in the primary fiscal deficit.

Figure 30: Quarterly Revenue-Expenditure Gap



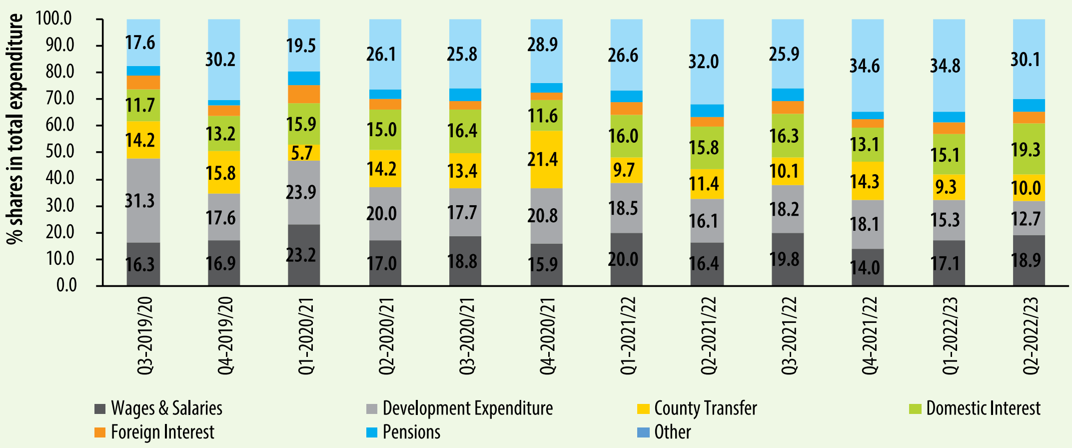
Source: CBK

Figure 31: Quarterly Revenue Structure



The government's expenditure during the second quarter of FY 2022/23 as outlined in **Figure 32**, reflects a continuation of a trend from the previous period. The largest share of expenditure was allocated to wages and salaries, accounting for 18.9 percent; which is an increase from 16.4 percent that had been registered in a similar period in the previous year. Development spending remained the second largest expenditure item, representing 12.7 percent of the total expenditure during the quarter. Furthermore, there was a slight increase in the share of transfers to counties relative to the previous quarter. Notably, domestic and foreign debt interest payments increased to account respectively for 19.3 percent and 4.4 percent up from 15.8 percent and 3.7 percent in a similar period in FY 2021/2022; indicating a growing debt burden from a financing cost perspective.

Figure 32: Quarterly Expenditure Structure



Source: CBK

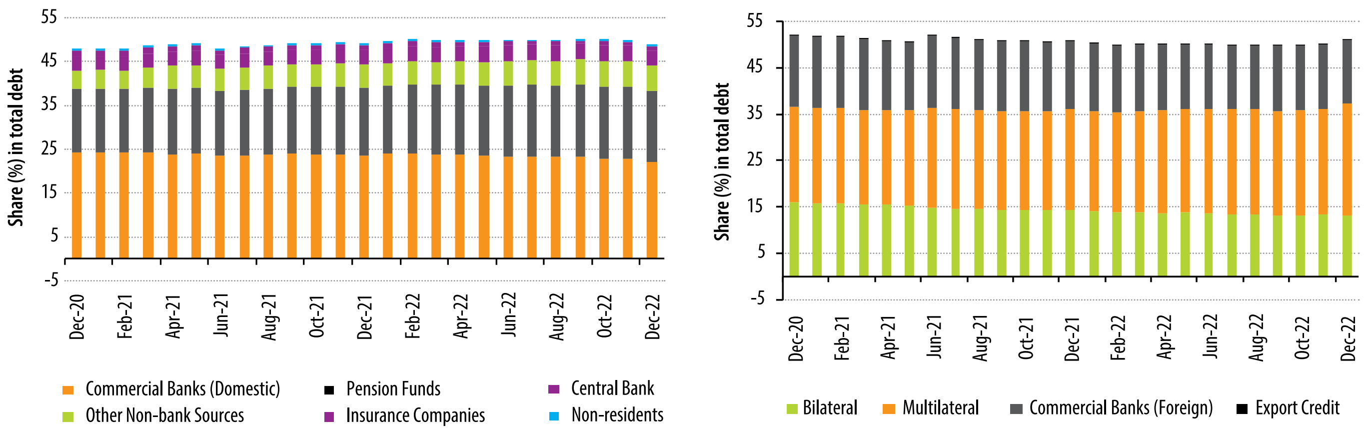
Government Deficit Financing & Public Debt

The Kenya's public and publicly guaranteed debt increased by 5.1 percent during the second quarter of 2022/23, resulting in the public debt to GDP ratio rising to 69.1 percent from 66.9 percent in the previous quarter.

The increase was evident in both the domestic and the external debt, with the increase in domestic debt being driven by increased uptake of Treasury bonds – that consequently raised the proportion of debt securities to total domestic debt to 98.4 percent. There was also evident growth in external debt largely due to disbursements from multilateral lenders and exchange rate movements, and the shift in the composition of external debt towards concessional loans from official multilateral lenders is a positive development (**Figure 33**).

Figure 33: External and Domestic Debt and its Composition

(a): Domestic Debt **(b): External Debt**



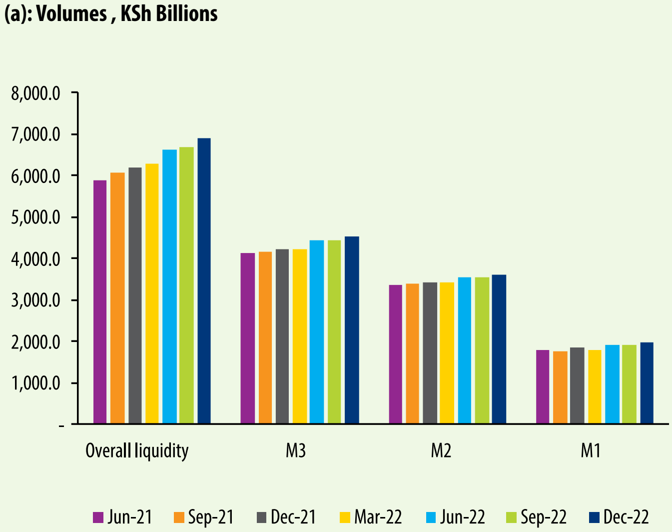
Source: CBK

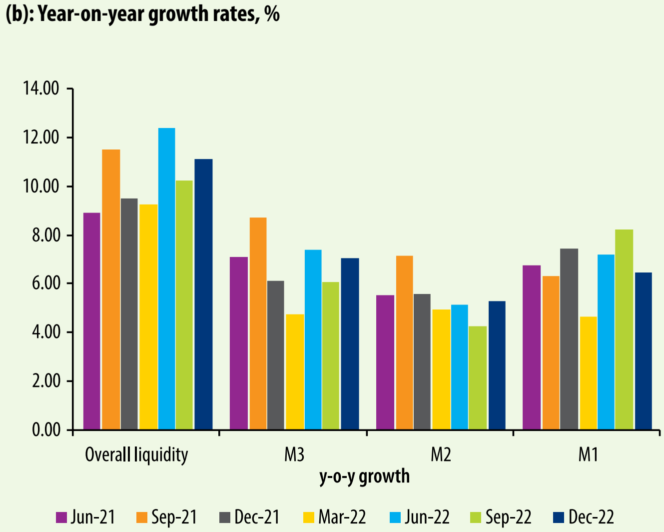
Money Supply

As depicted in **Figure 34,** broad money supply (M3) increased by 2.3 percent in the fourth quarter of 2022, reflecting a significant rebound from the 0.3 percent contraction in the previous quarter. The growth was mainly driven by increased deposits, particularly in the corporate sector, which benefited from some recovery in economic activities. Household deposits also increased slightly, mainly reflected in demand deposit holdings due to increased demand for liquidity during the end-of-year festivities.

The 12-month growth in broad money supply (M3) edged up slightly to 7.1 percent in December 2022 from 6.1 percent in September 2022, partially due to increased net domestic assets of the banking system. Resilient private sector credit partly supported the growth in net domestic assets of the banking system, offsetting the contraction in net foreign assets. The decline in net foreign assets largely reflected a reduction in the official foreign exchange reserves at the Central Bank of Kenya during the period.

Figure 34: Trends in Monetary Aggregates





Source: CBK

9.6%
Overall inflation as at Dec 2022

Inflation

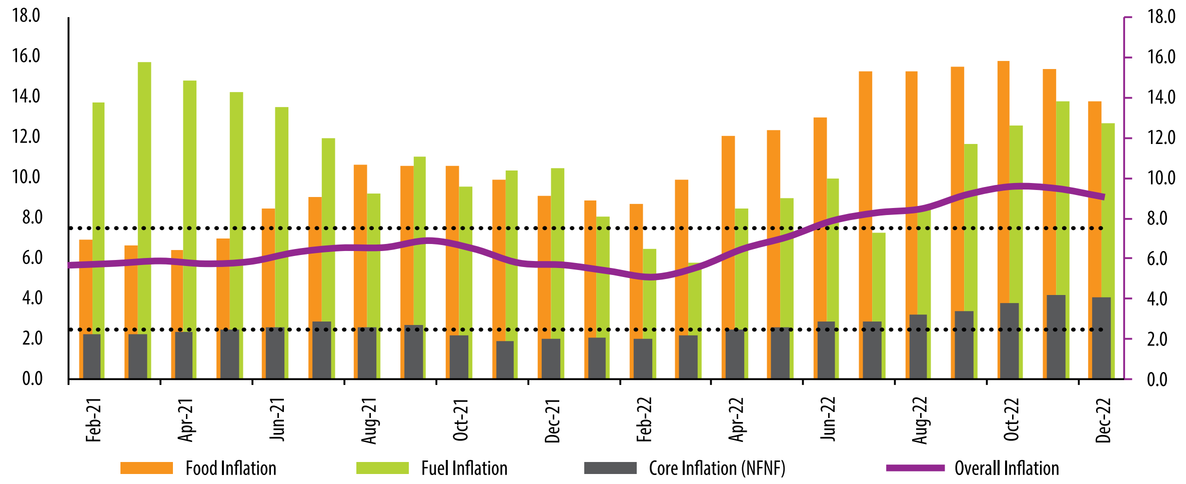
Inflation peaked in October, to stand at 9.6 percent - driven by increased food, fuel and core inflation - before moderating in November and December 2022 (**Figure 35**). As Food prices edged up of prolonged drought conditions across most parts of the country, fuel prices responded to the removal of government subsidy on petroleum domestic retail prices effected in the quarter. Demand pressures were also evident – pushing up core inflation – as private sector credit growth remained strong in double digit levels during the period.

Interest Rates

The Central Bank of Kenya tightened the monetary policy stance in the second half of 2022, triggering an increase in interbank money market interest rates in the fourth quarter of 2022.

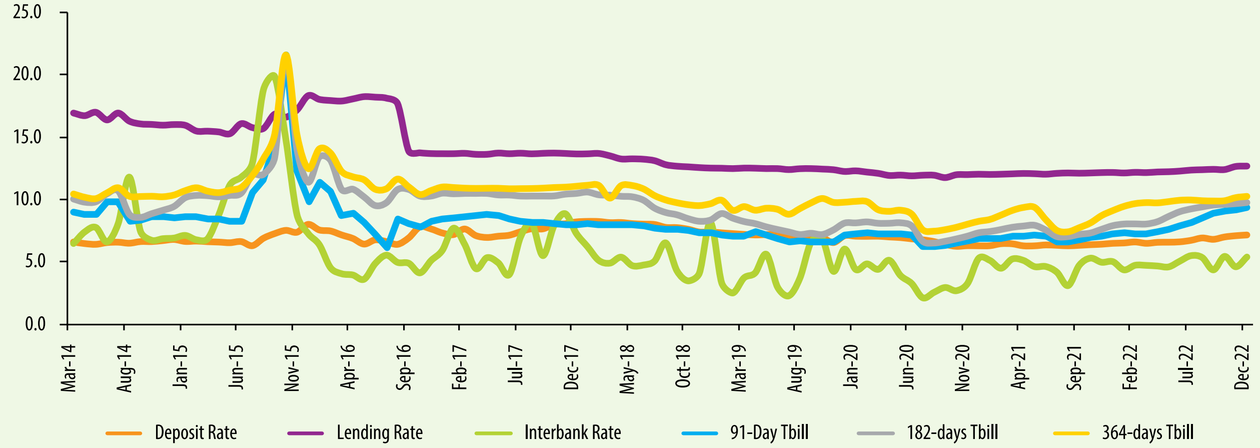
The tight liquidity conditions that ensued in the domestic financial system resulted in a higher cost of funds for banks and borrowing cost on loan rates **(Figure 36)**, thereby slowing down credit to private sector.

Figure 35: Inflation Dynamics



Source: CBK

Figure 36: Interest Rates Dynamics



Source: CBK

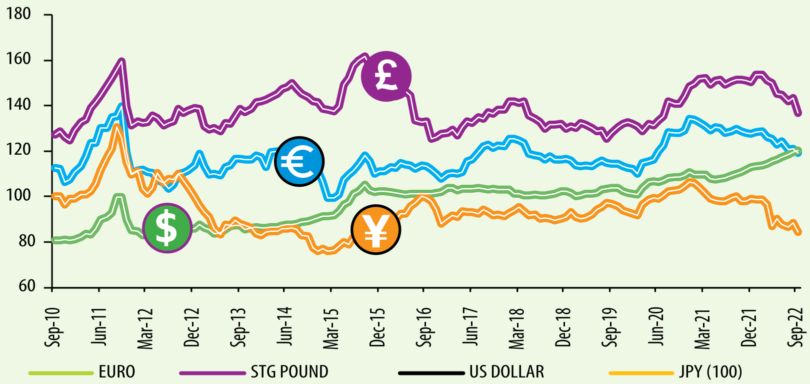
Exchange Rates

The Kenyan shilling faced increased pressure to weaken against the US dollar during the period under review, amidst the high global demand for the dollar as the US federal reserve maintained a tight monetary policy stance during the period. Consequently, the shilling weakened to exchange at an average of KSh 121.95 during the quarter, compared to KSh 119.40 per US dollar in the third quarter of 2022 and KSh 111.9 per US dollar in the fourth quarter of 2021. However, the shilling strengthened against other international currencies. It exchanged against the Sterling pound, the euro, and the Japanese yen, to trade at an average of KSh 143.12, KSh 124.40 and KSh 86.28, respectively, up from KSh 150.90, KSh 128.06 and KSh 98.47 recorded in a similar quarter in 2021 **(Figure 37a).**

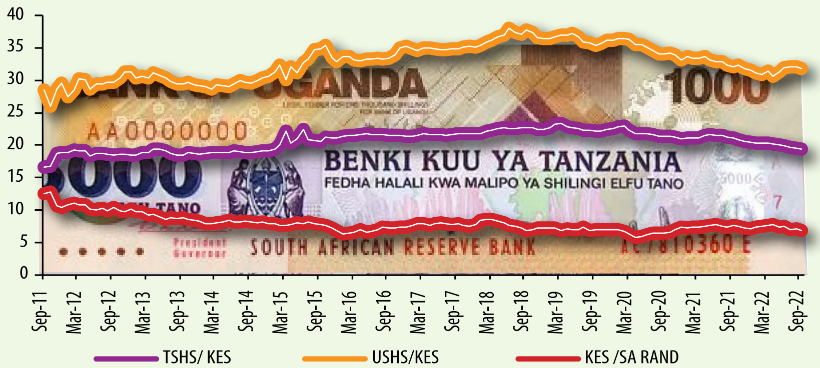
At the regional front, the Kenyan shilling strengthened slightly against the Ugandan shilling to exchange at UGsh 30.82 compared to UGsh 31.84 per Kenya Shilling the fourth quarter of 2021. In contrast, it weakened against the Tanzanian shilling, the Burundi Franc, Rwanda Franc and the South African rand during the period **(Figure 37b)**, reflecting demand -supply and trade relations dynamics between the countries during the period.

Figure 37: Exchange Rate Developments

(a) Major currencies



(b) EAC region currencies



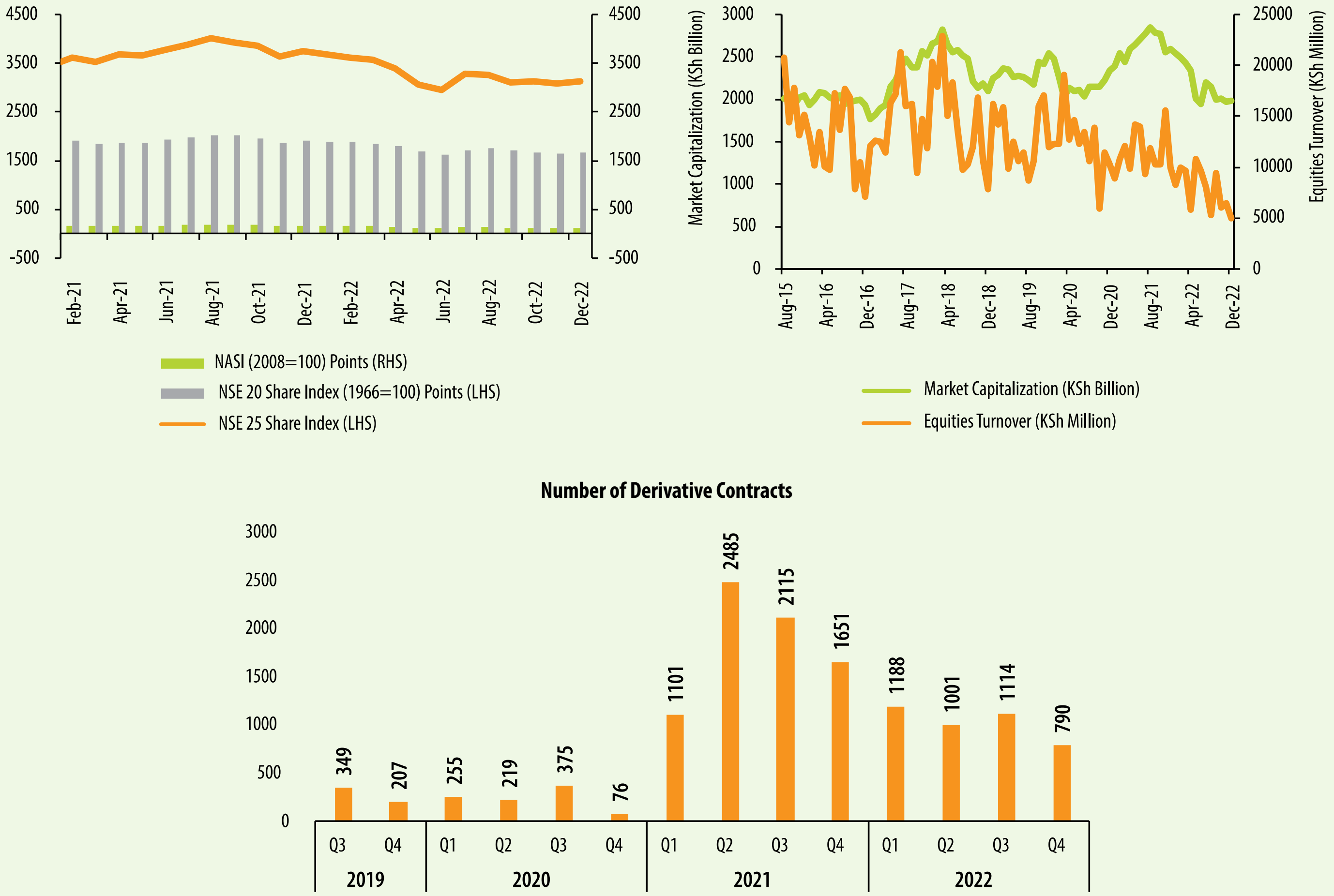
Source: CBK

Capital Markets

The capital markets remained bearish during the last quarter of 2022, in part due to the lagged effects of the general election that was held on 8th August 2022. During the period, 634.17 million shares were traded, which was lower than the 993.89 million shares registered in a similar quarter in 2021 but higher than the 823.34 million shares recorded in the third quarter of 2022. The equities turnover declined to KSh 17,452.41 million during the quarter relative to KSh 35,787.66 million registered in a similar quarter in 2021. Consequently, there was a drop in all the trading indices on a month-on-month basis during the quarter; with the NSE-25 and NSE-20 ending the quarter at 3133.64 and 1676.10, respectively.

Similarly, market capitalization declined by 9.65 percent to KSh 1,986.08 billion in December 2022. Additionally, the volume of derivative contracts traded declined by more than half to 790 in the quarter, down from 1,651 contracts traded in a similar quarter in 2021 **(Figure 38).**

Figure 38: Trends in Nairobi Securities Exchange Leading Indicators



Source: Nairobi Securities Exchange

Banking Sector Performance

Kenya's banking sector continues to bolster strong performance, with growth being witnessed across various indicators.

Kenya's banking sector continues to bolster strong performance, with growth being witnessed across various indicators. The sector's total assets **(Figure 39)** registered a trend growth, by 2.8 percent in the quarter to KSh 6,596.6 billion by December 2022, with loans and advances, placements, and other assets contributing significantly to the growth. Net loans and advances remained the main component of total assets, accounting for 51.0 percent. The sector's liquidity levels were ample with total liquidity ratio remaining above its statutory minimum of 20 percent, despite declining slightly to 50.8 percent during the quarter **(Figure 40)**, driven by a faster increase in total short-term liabilities than the increase in liquid assets.

Figure 39: Total assets

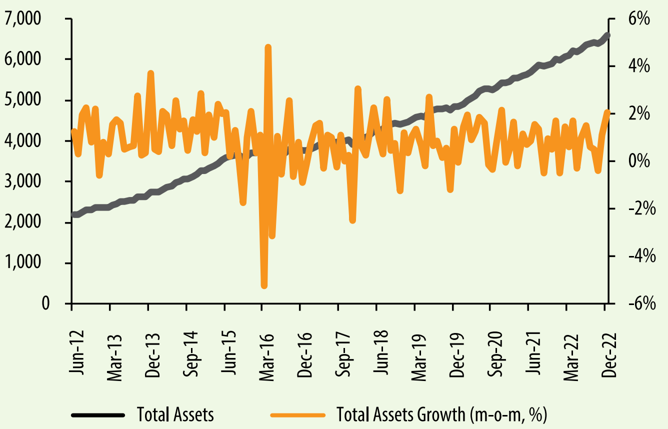
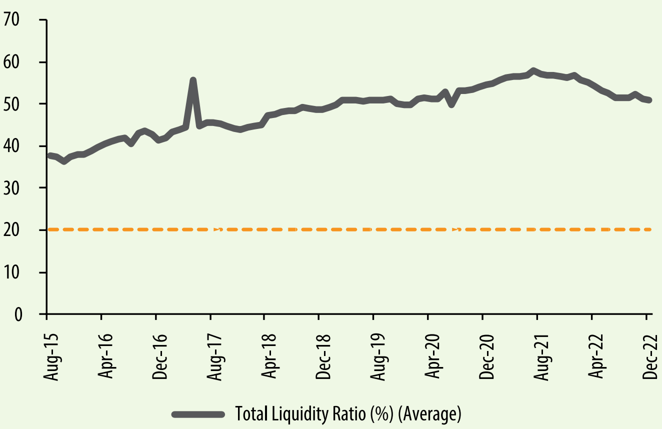


Figure 40: Liquidity ratio



The asset quality, represented in **Figure 41**, strengthened during the quarter, driven by a decline in total gross non-performing loans (NPLs) (by 0.8 percent) amidst an increase in gross loans, leading to a drop in the NPLs ratio to 13.3 percent. The decrease in gross NPLs was broad-based, spreading mainly across five economic sectors, i.e. Tourism, Restaurant and Hotels, Building and Construction, Transport and Communication and Trade sectors. Notably, real estate, manufacturing, energy and water, and personal and household sectors recorded significant build up in NPLs. The total shareholders' funds in the industry remained on a steady trend growth during the quarter to KSh 952.6 billion in December 2022 (**Figure 42**), mainly driven by a 3.3 percent increase in the industry's total risk-weighted assets.

Figure 41: Asset Quality

a) Gross loans **b) Gross non-performing loans**

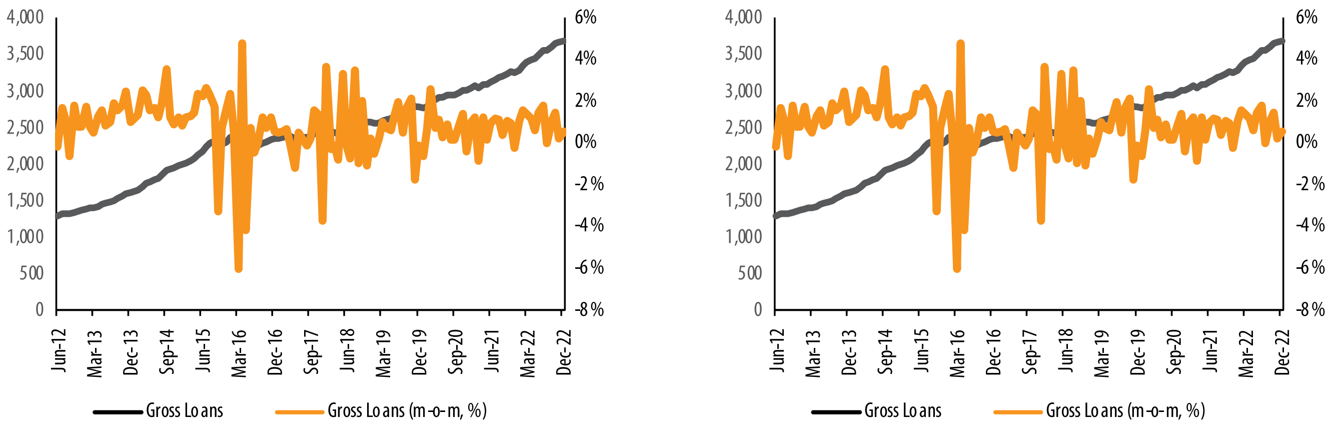
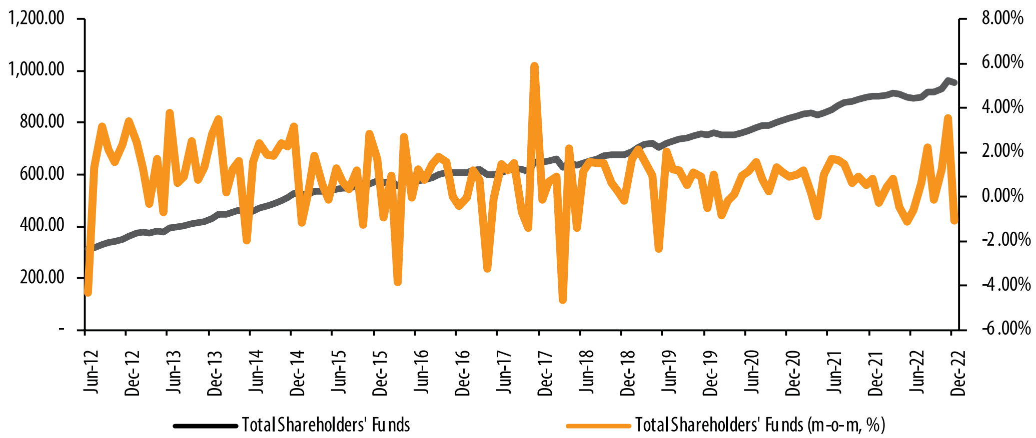


Figure 42: Total shareholders' funds



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