GLOBAL ECONOMY

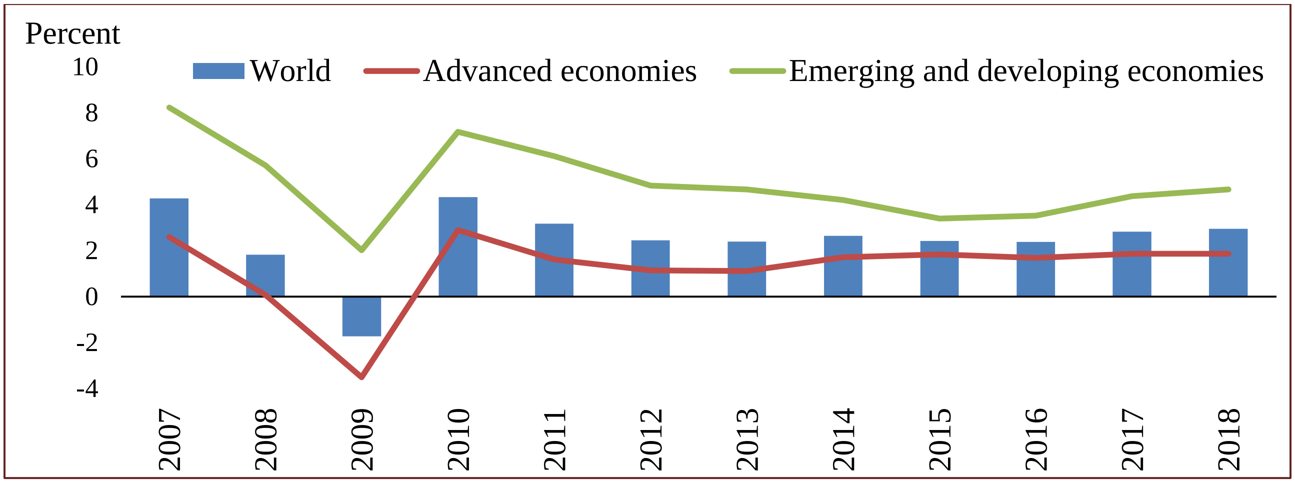
The World Bank has revised its 2016 global growth forecasts down to 2.4% from the initial 2.9% in January due to the continued sluggish growth in advanced economies, stubbornly low commodity prices, weak global trade and diminishing capital flows. Commodity exporting developing and emerging markets has struggled to adapt to lower prices for oil and other key commodities. Growth in these economies is projected to advance at a meager 0.4% pace this year, whereas growth in commodity importers has been more resilient.

World Bank GDP Growth estimates

Economies	2014	2015(es)	2016(f)
World	**2.6%**	**2.4%**	**2.4%**
Advanced economies	**1.7%**	**1.8%**	**1.7%**
US	2.4%	2.4%	1.9%
Eurozone	0.9%	1.6%	1.6%
Japan	-0.1%	0.6%	0.5%
Emerging Markets and developing economies	**4.2%**	**3.4%**	**3.5%**
Commodity exporting EMDE	2.1%	0.2%	0.4%
Other EMDE	5.9%	-5.9%	-5.8%
Other EMDE ex China	4.3%	4.7%	4.7%
East Asia & Pacific	**6.8%**	**6.5%**	**6.3%**
Europe & Central Asia	**1.8%**	**-0.1%**	**1.2%**
Latin America & the Caribbean	**1.0%**	**-0.7%**	**-1.3%**
Middle East & North Africa	**2.9%**	**2.6%**	**2.9%**
South Asia	**6.8%**	**7.0%**	**7.1%**
Sub-Saharan Africa	**4.5%**	**3.0%**	**2.5%**

Source; World Bank

Global growth

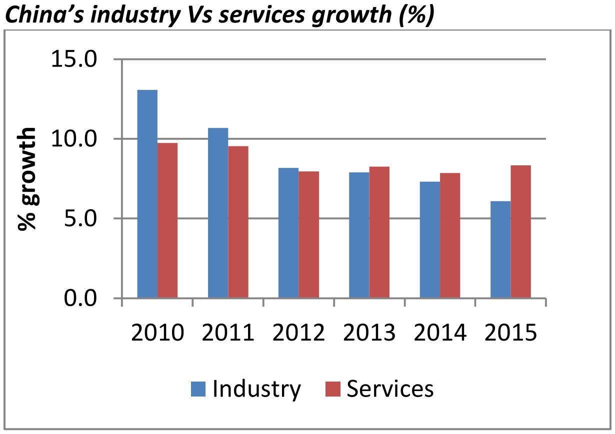


ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 15

EMERGING MARKETS

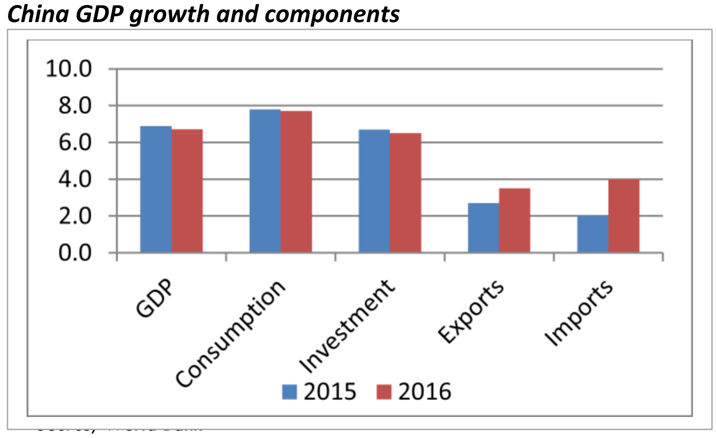
Emerging markets recorded a growth of 3.7% in 2015. That is almost half the growth registered in 2010 which stood at 7.5%. During the five years since 2010, these markets have recorded declining growth seemingly hitting the bottom in 2015. Growth in China for instance decelerated further to 6.9 per cent in 2015, and 6.7 per cent in the first quarter of 2016, reflecting weak exports and slowing investment. *World Bank*. The economy is now moving to more of a service led economy as opposed to industry led, signifying an economy whose growth rate has reached a stable phase. We do not expect to see higher growth rates as we used to experience in China in the prior years

China's industry Vs services growth (%)



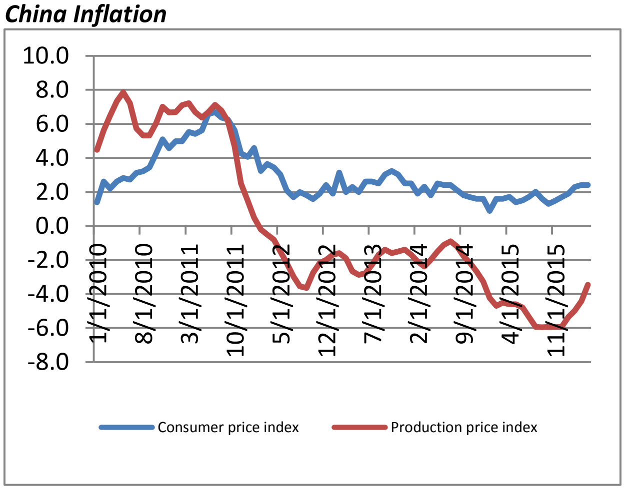
Source; World Bank

China GDP growth and components



Source; World Bank

China Inflation



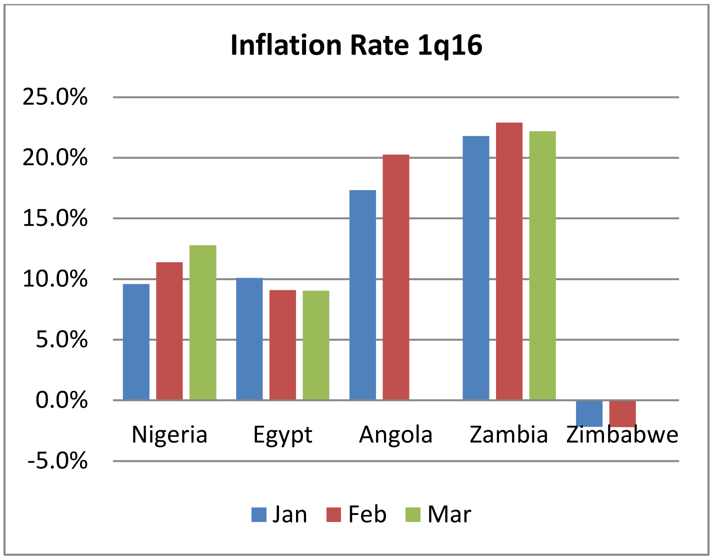
Source; World Bank

The **Brazilian** economy has also suffered from the slowdown in commodity prices. Brazil rapidly increased its exports to China over the past decade hence making the slowdown in China extra painful for them. Inflation rose to over 10%, the highest in 12 years. Inflation at 9.32% in May 2016

Growth in 2016 is expected to record some slight improvement in emerging markets due to stabilizing commodity prices.

Chinese imports have risen in the first quarter of 2016, a trend that is expected to continue hence stabilizing the economy of other emerging countries dependent on the Chinese economy. Overall growth however is expected to remain subdued.

SUB SAHARAN AFRICA



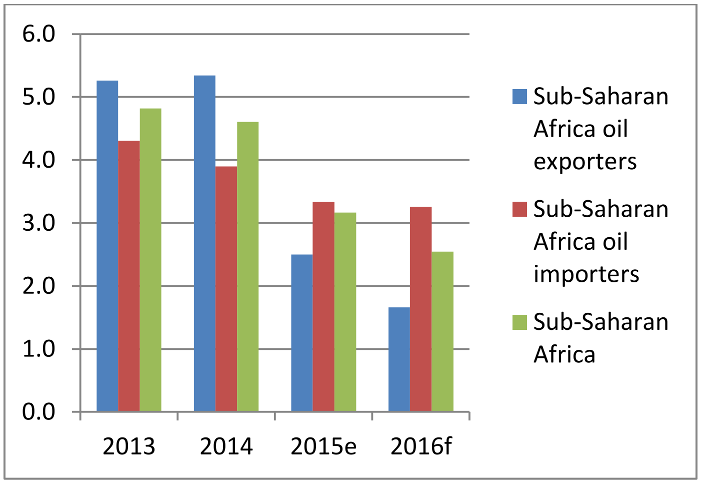
*Source: Bloomberg, AIB, *Selected countries.*

Growth in Sub-Saharan Africa will remain subdued in 2016 with the world bank forecasting a 2.5 per cent growth down from the 3 per cent growth in 2015.Low commodity prices, tightening global financial conditions will continue to weigh down growth of the region's largest economies. Drought in parts of the region is also expected to weigh down growth this year.

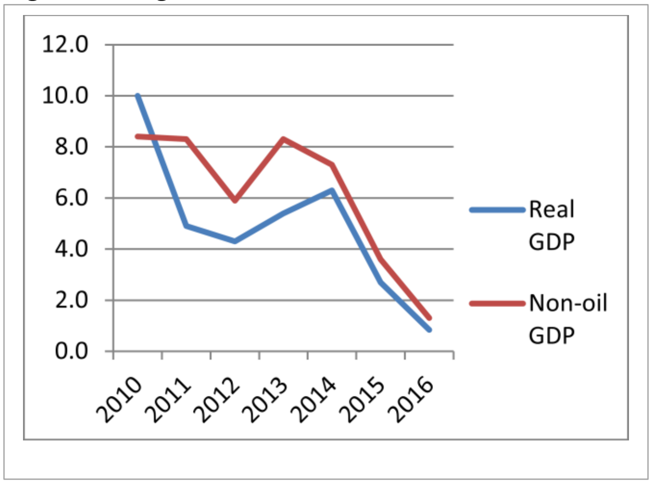
The slowdown is particularly pronounced among oil exporters (Nigeria, Angola, Republic of Congo…). Activity has also weakened substantially in non-energy mineral exporters (Botswana, South Africa, Zambia…).

The external condition affecting Sub-Saharan Africa is expected to continue in the near term as commodity prices remain low and Global financial conditions tighten. However, current stability in commodity prices may cushion against further deceleration in 2016.

GDP Growth in SSA



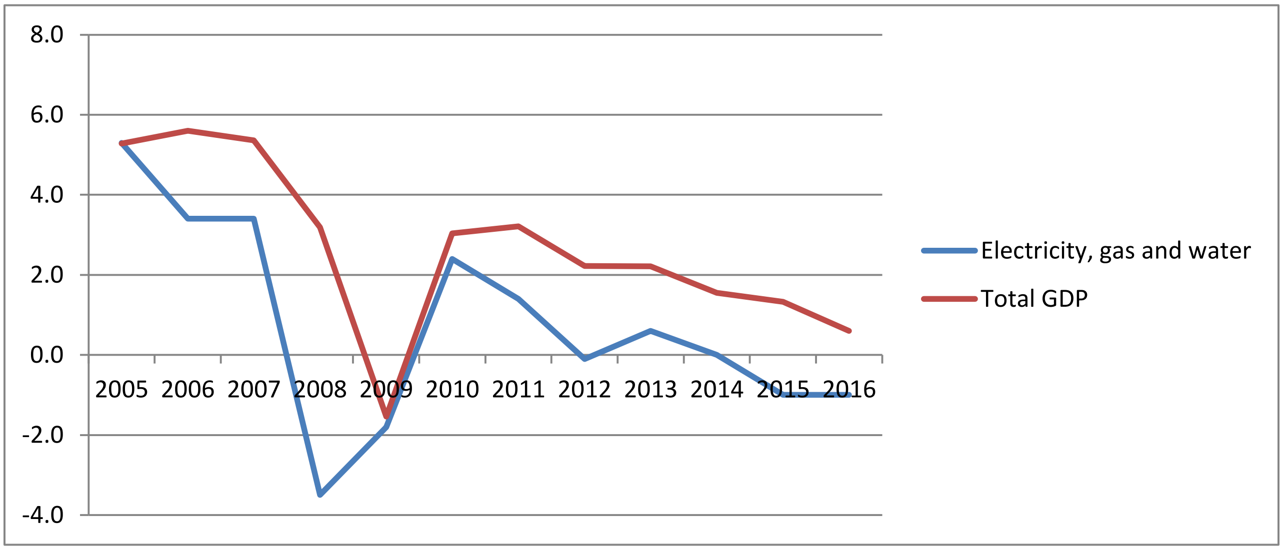
Nigeria GDP growth



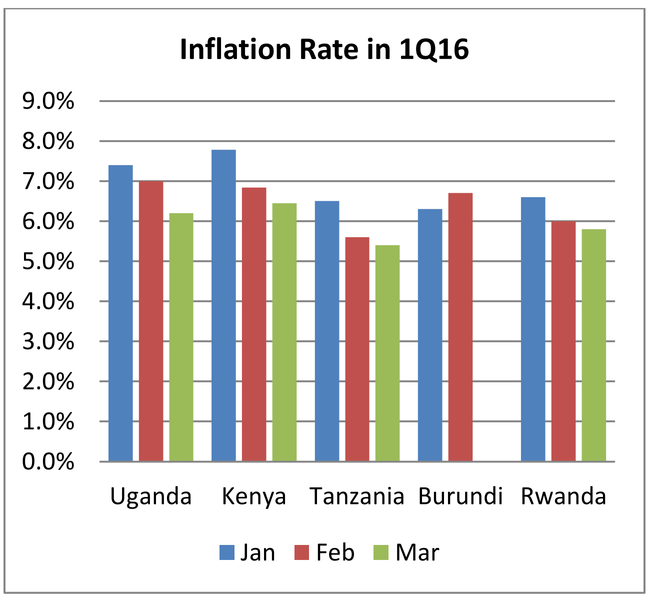
Source; World Bank

Over 90 per cent of the Nigerian economy depends on oil hence taking a big dip from the lower commodity prices. Its consumer prices went up 15.6 per cent y/y in May 2016 following a 13 per cent rise in the previous month. Egypt inflation also went up 12.3 per cent in May following a 10.3 per cent rise in April after the Central Bank devalued its currency by 13 per cent in March.

South Africa GDP growth



EAST AFRICAN ECONOMIES



Being oil importers, the East African economies are expected to remain resilient in 2016

Single digit inflation levels to continue due to low low commodity prices, especially oil prices.

GDP growth to remain strong driven by infrastructure development, increased output in Agriculture and an expanding services sector.

EAC currencies are expected to be stable in 2016 compared to 2015, though occasional currency turbulences cannot be ruled out given the differences in monetary policies in major global economies.

Continued effort by the respective governments towards economic integration in the region will also be a major boost for these economies.

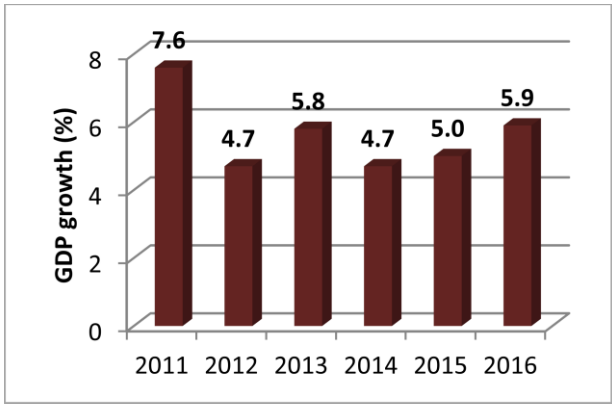
Source: Bloomberg, AIB

THE KENYAN ECONOMY

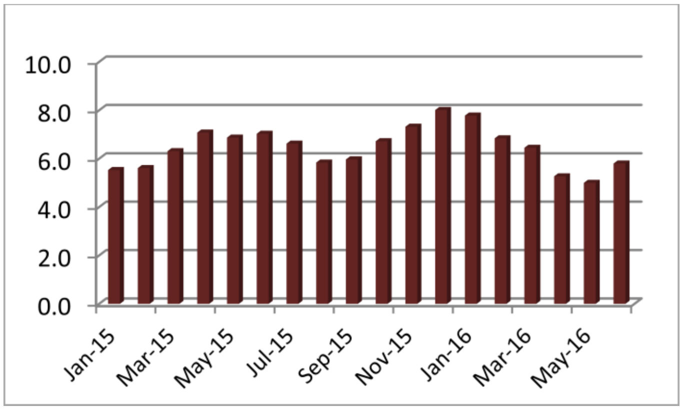
Kenya is one of the few bright spots in Sub Saharan Africa and is generally considered the economic, commercial, and logistics hub of East Africa. Kenya being an oil importer has benefited from low oil prices, which has caused the country's current account deficit to narrow to 6.8 per cent in May 2016 and also expected to further come down in the remainder of 2016. The IMF projects Kenya's economy in 2016 to expand by 5.9%, a better prospect to the 5.3% growth recorded in 2015.

Data released by the Kenya National Bureau of statistics (KNBS) for quarter 1 2016 shows a 5.9 per cent expansion in real GDP compared to a 5.0 per cent in a similar quarter of 2015.

Quarter One GDP growth



Inflation



Source: KNBS, AIB

The current account balance improved by 30.1% from a deficit of Kshs 101,539 million in Q1 2015 to a deficit of Kshs 71,.018 million in Q1 2016. This is mainly due to a lower import bill and growth in value of exports.

The main contributors to the growth were, according to KNBS data, Agriculture, forestry & fishing which are estimated to have expanded by 4.8 per cent in Q1 2016 compared to a 2.9 per cent growth in Q1 2015. Tea production grew by 71% owed to favorable weather conditions. Higher prices also increased the value of imports for coffee and tea (7.6% and 24.5% respectively). The horticulture sub-sector registered notable growths both in quantity and values. The quantity of cane deliveries rebounced from a decline of 4.2 per cent in first quarter of 2015 to a growth of 1.8 per cent during in Q1 2016.

Production in the sector however still remains highly traditional, small scale and mainly reliant on rains leading to fluctuations in output. The sector is the largest contributor to GDP, contributing about 29% hence key to overall growth.

Electricity and Water

Total generation of electricity increased by 8.3 per cent in the first quarter of 2016 to 2,241.18 Kwh. Generation from hydro and geothermal increased by 26.5 and 4.4 per cent; respectively while that of thermal declined by 17.5 per cent during in Q1 2016. Based on this, the sector expanded by 8.5 per cent compared to a 7.4 per cent growth recorded in Q1 2015. The sector currently contributes about 2% to the GDP; the government has in plan strategies to increase power generation to over 6000MW which will tremendously increase its growth and also the growth of other sectors facilitated by lower power costs.

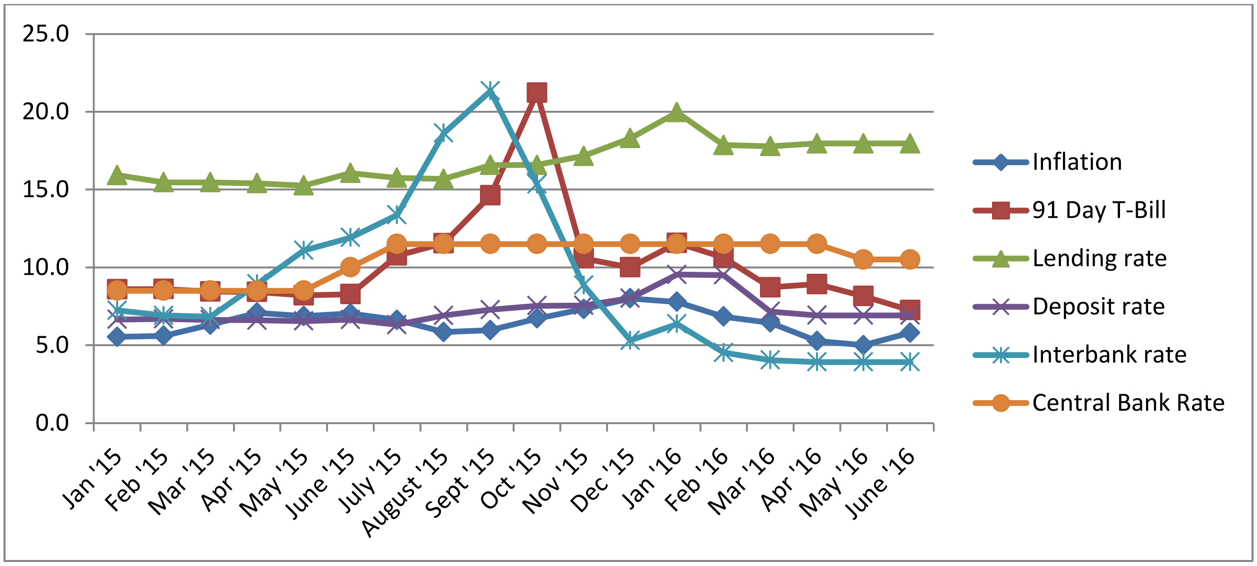
Accommodation and Food Service Activities

The sector was the biggest contributor to the Quarter growth following a recovery in the sector evidenced by the significant rise in the number of tourist arrivals at major airports from 231,038 in Q1 2015 to 261,404 in Q1 2016. It grew 12.1 per cent after a two year spell of poor performance largely occasioned by security concerns and economic downturn in some key tourist markets. The increase in arrivals is attributable to mitigation measures that were instituted to boost tourist arrivals. We expect the sector to continue the growth in 2016 as the government works to restore the sectors glory.

Transport and Storage

The Sector grew by 8.4 per cent compared to a 6.7 per cent growth in Q1 2015. The transport sub sector mainly benefited from the declining international oil prices that continued into the first quarter of 2016. The accelerated growth was mainly driven by the considerable drop in the average price of light diesel from KSh 82.87 in the first quarter of 2015 to an average of KSh 78.36 per litre. Similarly, consumption of light diesel which is a key input in the sub-sector grew by 10.7 per cent to stand at 555.4 metric tonnes. International oil prices are still low and the sector is expected to continue benefiting for the rest of 2016.

Interest Rates and Inflation Trend



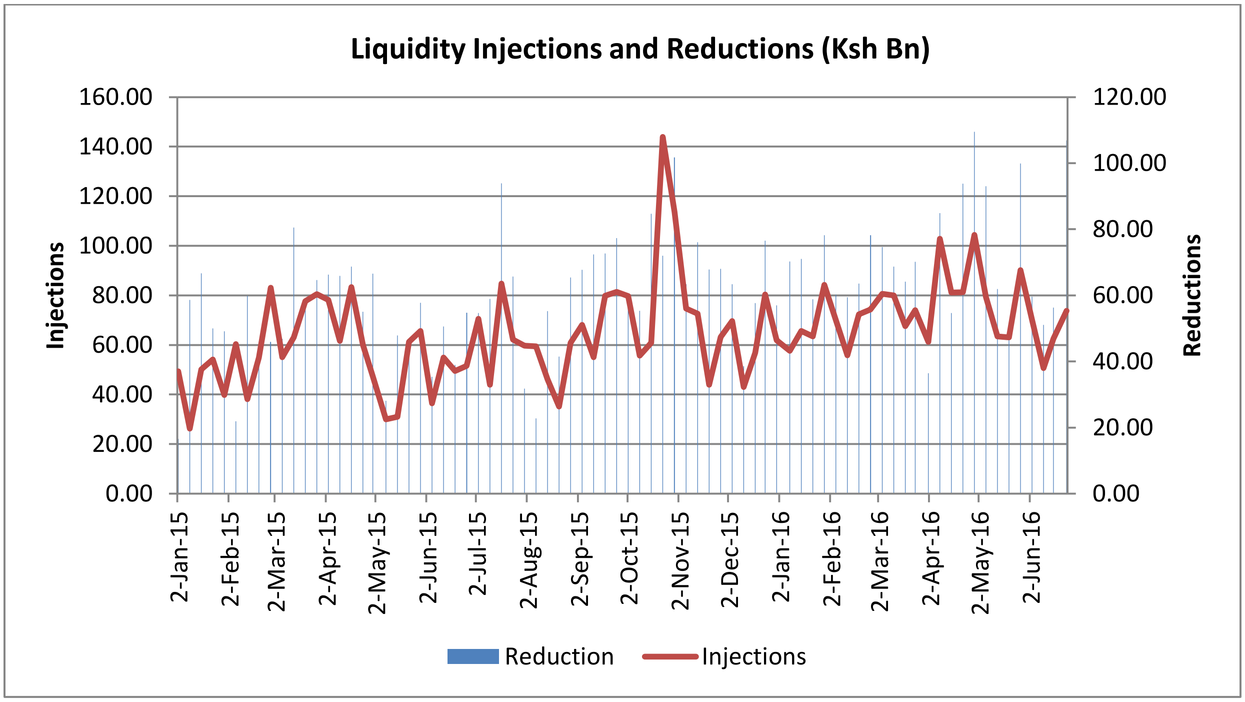
The figure above shows the trend of various interest rates for the period January 2015 to June 2016. Over the first quarter of 2016, the average interest rate on 91-day treasury bills stood at 10.24 per cent, compared to an average of 8.56 per cent recorded in a similar period in 2015. Over the same period, lending interest rates rose to 17.87 per cent. Into the second quarter of 2016, the 91-day T-bill rate has reduced to 8.10%, hitting 7.05% in July 2016, lower than the rates in Q2 2015 where the stood at 8.30%. Lending interest rates are however much higher at 18.08% compared to 15.42% in Q2 2015 respectively.

The interbank rate also dropped from an average of 6.9 per cent in Q1 2015 to 4.9 per cent in Q1 2016 and averaged at 4.3% in Q2 2016. The average savings deposit rate dropped from 1.55 per cent in March 2015 to 1.42 per cent in March, the rate further dropped to 3.92% in Q2 2016 from 10.64 in Q2 2015.The Central Bank rate (CBR currently stands at 10.50% from 11.50 per cent.

Inflation has been maintained in single digits and within the CBK range mainly due to lower fuel, electricity and food prices in the one year period.

Liquidity

The money market has been very liquid on the back of higher maturities with the interbank rate averaging 4.5% in the month of June 2016.



Source; CBK, AIB

Currency

The Kenyan Shilling has remained resilient against the US dollar; it has however gained against the Sterling Pound following the BREXIT shock. We view the situation however as temporary and it will be reverting back to its normal levels. Global strengthening of the US dollar due to capital flows may lead to weakening of the Kenya shilling against the US dollar. The Kenya shilling has also slightly lost against the East African currencies.

The decline in global fuel prices has significantly reduced the import bill thus easing pressure on the shilling. Fuel prices are expected to remain in the current levels in 2016 hence sustaining the lower import bill. We therefore expect the shilling to remain stable in 2016.

	31-Mar	30-Apr	31-May	30-Jun	q-on-q	YTD
USD/KES	101.53	101.14	100.83	101.10	-0.42%	-1.18%
EUR/KES	113.31	114.50	112.37	112.30	-0.89%	0.46%
GBP/KES	143.44	147.52	147.40	136.44	-4.88%	-10.11%
JPY/KES	89.40	93.14	90.71	98.40	10.07%	15.81%
YUAN/KES	15.59	15.61	15.32	15.21	-2.45%	-3.43%
RUPEE/KES	1.52	1.52	1.50	1.50	-1.87%	-2.89%
KES/UGX	33.24	32.95	33.35	33.68	1.32%	2.10%
KES/TZS	21.54	21.65	21.73	21.66	0.56%	2.60%
RAND/KES	6.57	7.38	6.37	6.77	3.03%	2.93%

Source: Central Bank, AIB

Being a net importer and now that the country is spending more on the ongoing infrastructure; the fundamental pressure still remains. The Current account deficit has however dropped to the levels of 6.8% of GDP and is expected to drop further on the back of increased foreign inflows and the lower import bill. Central Bank of Kenya reserves currently stand at Usd 7.6 billion, an equivalent of 5 months of import cover which is above the required 4 months hence ready to cushion the shilling against any temporary shocks.

Balance of Trade

Data from KNBS shows that in the first quarter of 2016, international merchandise trade balance improved by 25.4 per cent to a deficit of KSh 167,251 million in the first quarter of 2016 from a deficit of Kshs 224,137 million in Q1. Domestic export earnings increased by 13.4 per cent to KSh 130,650 million in the quarter under review boosted by growth in earnings from horticulture and tea exports. See balance of trade data on table below

Balance of trade --Kshs millions

Year	Period	Domestic Exports	Re-exports	Total Exports	Imports	Balance of trade	Vol of trade
2013	Q1	121,910	10,063	131,973	355,998	(224,025)	487,971
	Q2	114,470	10,363	124,833	329,426	(204,593)	454,260
	Q3	111,682	11,956	123,638	356,169	(232,531)	479,806
	Q4	109,640	14,216	123,856	367,214	(243,358)	491,070
2014	Q1	115,406	19,137	134,543	345,179	(210,636)	479,722
	Q2	115,473	25,549	141,022	403,453	(262,431)	544,474
	Q3	118,632	14,847	133,479	452,638	(319,159)	586,117
	Q4	111,061	17,132	128,192	417,055	(288,862)	545,247
2015	Q1	115,226	16,290	131,516	355,653	(224,138)	487,169
	Q2	114,075	19,513	133,588	402,014	(268,426)	535,602
	Q3	139,595	24,827	164,421	408,592	(244,171)	573,013
	Q4	137,288	20,283	157,570	414,156	(256,586)	571,726
2016	Q1	130,650	23,846	154,497	321,748	(167,251)	476,244

Source; KNBS

The current account balance improved by 30.1 per cent from a deficit of KSh 101,539 million in the first quarter of 2015 to a deficit of KSh 71,018 million in Q1 2016 which can be explained by the decline in import expenditure and a significant increase in the value of exports.

Capital Markets

The Equities market remained subdued in Q2 2016 with turnover only increasing by 1% from Q1 2016 and has dropped 9% from the turnover in Q2 2015. Consequently, the NSE 20 share index declined from 4906.07 points in June 2015 to 3640.61 points in June 2016 while the NASI has dropped to 140.64 in June 2016 from 164.41 in June 2015 continuing as bear run that started in 2015. Foreign investor participation dropped to 71% in Q2 2016 from 75% in Q2 2015.

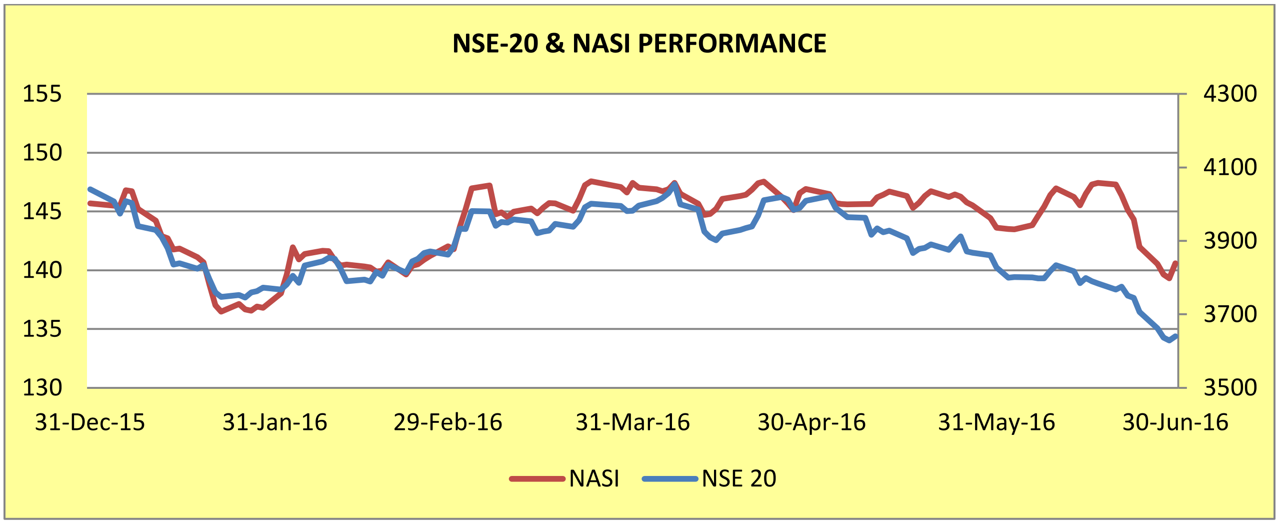
Key market statistics

	31-Mar	29-Apr	31-May	30-Jun	q-on-q 2016	YTD
Market Cap (KES)	2,078.28	2,071.04	2,024.83	1,994.81	-4.02%	-1.50%
NSE 20 share Index	3,982.09	4,009.26	3,827.80	3,640.61	-8.58%	-9.10%
NSE All share Index	147.44	146.93	143.61	140.6	-4.64%	-2.34%
FTSE NSE Kenya 15 index	186.21	187.74	181.81	176.12	-5.42%	-3.52%
FTSE NSE Kenya 25 index	186.57	187.81	182.67	177.5	-4.86%	-2.53%

	Q2 2015	Q1 2016	Q2 2016	Q/Q 2016	Q/Q 2015/2016
Equity+I Reit Turnover (KES billion)	40.770	36.609	37.044	1.19%	-9.14%
Total Volume Traded (billions)	1.853	1.300	1.413	8.70%	-23.77%
Foreign buys	37.396	24.046	27.198	13.11%	-27.27%
Foreign sales	23.624	23.550	25.735	9.28%	8.93%
Bond Turnover (KES billion)	59.45	114.53	146.05	27.52%	145.67%

Source: NSE, AIB database

Performance Trend



Source; NSE, AIB database

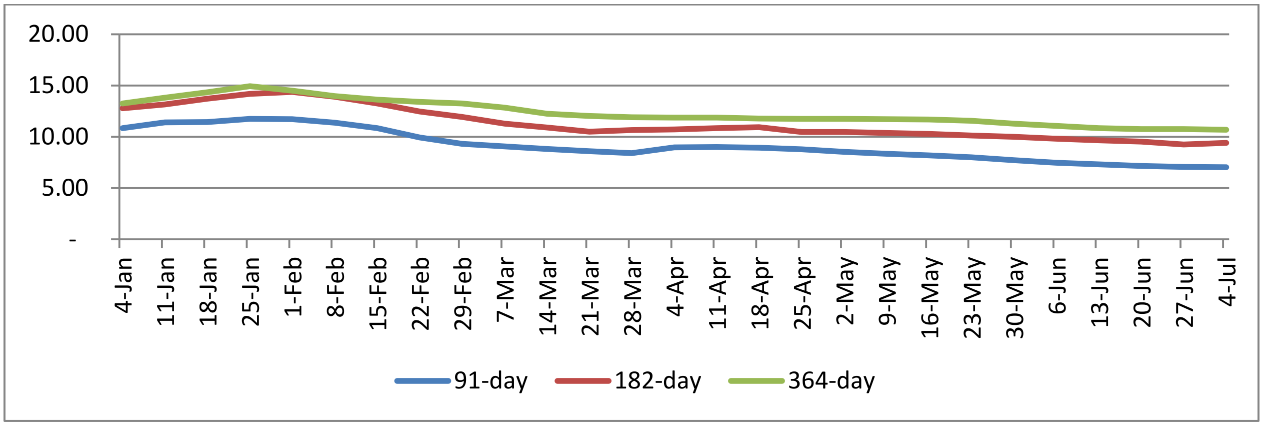
The Equities market is 80% foreign dominated trading in about just 5 counters which are the most liquid and most visible stocks in the market. Any external shock that causes uncertainty therefore leads to foreign exits which in turn negatively affect the market. We therefore do not expect to see a major upturn in Q3 2016 as local investors' also layback with their funds diverted to fixed income, however, the improving economy, stable macro environment and lower interest rates in fixed income support a rebound. Most of the counters are trading on very attractive valuations hence giving good entry points.

In the bonds market, we do not expect to see any increases in rates as liquidity remains high. The 91-day T-bill is now at 7 per cent, we see it coming further down to about 6 per cent which could necessitate a further downward movement in the short term rates (1-5 years).

Fixed income market

Following the bearish equity market, funds have been shifted to the bonds market as investors look for risk free assets for their funds. Rates in the primary market have dropped to a more than 6 moth low. The 91 day T-bill traded at an average rate of 7.25% in June 2016 from the highs of 21% in October 2015 and 11% in Feb 2016. The rates averaged 8.15% in May 2016.

T-bill rates



Source; CBK, AIB

Treasury Bonds

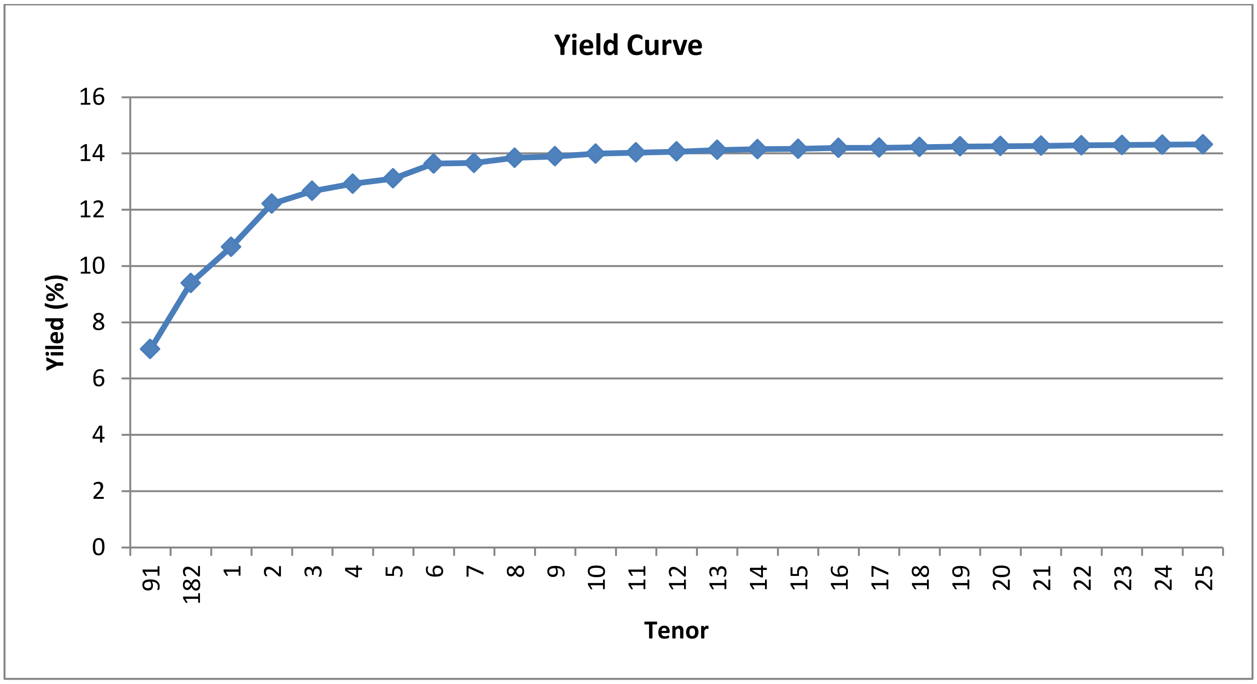
Q2 2016 T. Bond issued

	Offered (Billion)	Performance Rate	bids (Billion)	Weighted Average of Successful Bids	Last Auction Rate (%)
June					
2 Year	30	169.36%	34.703	11.51%	12.02%
15 Year			16.105	14.34%	14.98%
May					
2-Year	30	269.80%	34.7	12.02%	15.76%
9-Year			39.43	13.34%	14.75%
April					
5-Year	20	181.73%	36.35	14.33%	13.95%

Source: Central Bank, AIB

Bond strategy

We are of the opinion that investors should still trade on the lower end of the yield curve (1 - 5 years) as there is no incentive for holding the longer term bonds (10 - 30 year). Rates in this segment are almost on the same level for different maturity bonds, meaning the investor is not sufficiently compensated for exposing themselves to higher risk associated with longer term bonds. Moreover, with the lower rate on the 91 day T-bill (7.045%) and more funds coming to the bonds markets as investors seek for safety havens and the yield curve also continuing to take a normal shape, we see rates on the lower end coming further down hence booking capital gains for investors.



Source: NSE, AIB

The short term trading nature is a conviction that rates direction is still not that clear. When rates decline investors will start moving out of the yield curve booking in rates that will compensate them for holding the long term bonds.

Outlook

The Economy, Q3/Q4

The performance of Kenya's economy in Q3 and Q4 2016 is likely to be no different from Q1 and Q2, largely determined by internal factors. All the sectors of the economy are expected to continue in their growth trajectory.

The Agricultural sector may experience some reduced growth due to the depressed long rains, the sectors' output is therefore likely to slow down but will still record a moderate positive growth.

The financial intermediation sector is likely to remain robust despite the recent takeover of three commercial banks by the Central Bank of Kenya due to financial impropriety. The expected sustenance of growth momentum by most of the economic activities is likely to boost credit uptake and therefore favor the financial and insurance activities.

The construction industry is also expected to maintain an increased role in the creation of value addition due to the ongoing public infrastructure development and continued investment in fixed assets by the private and public sector.

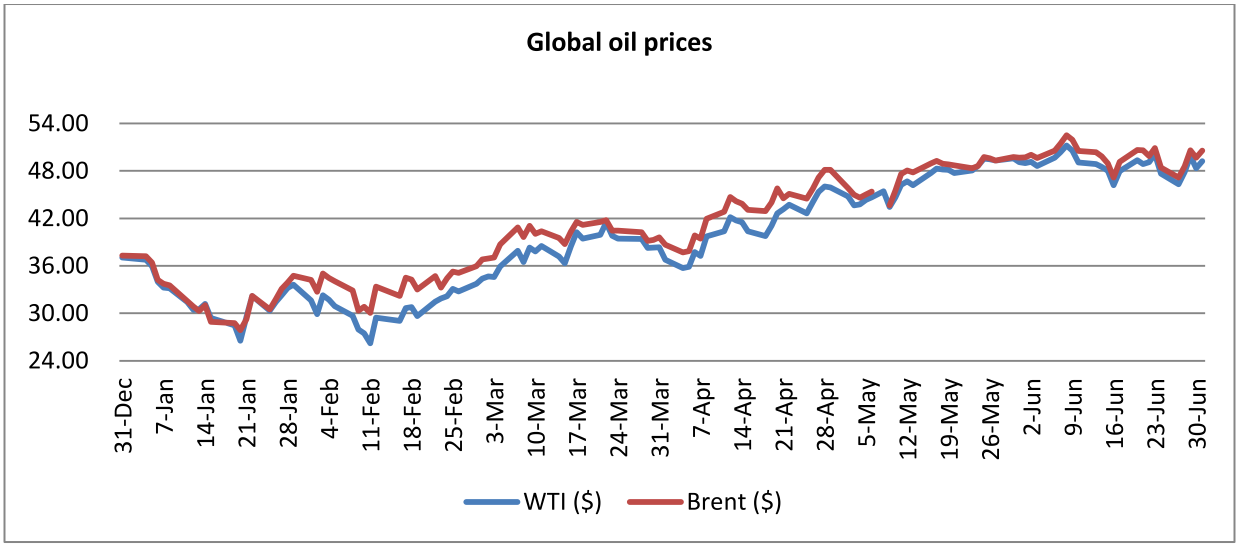
The tourism sector is also on a recovery path with the government on the forefront putting in place measures to revamp the sector. Positive growth from the sector will be a major boost to the overall GDP growth in 2016 considering the poor performance recorded in 2015.

We expect to see a higher growth in Q2 2016 compared to the 5.5% recorded in Q2 2015 with the main driver being the accommodation and restaurants sector. The sector recorded a 0.8% contraction last year; it however posted a 12.1% growth in Q1 2016 owing to a recovery and increase in the number of tourist. Though Q2 was marred by the un conducive political environment that led to slight reductions in the number of tourists as reported by the government, we still expect the sector to record some good growth.

The transport sub sector will continue posting its current growth trajectory as fuel prices are still low. Increase in Hydro electricity generation is also expected to have reduced costs of electricity in the manufacturing sector.

Oil Prices

Fuel prices, though having risen to the levels of $ 50 per barrel in July, we do not see it continuing to trade above the $ 50 due to increased oil production across the world, rising fuel efficiency and collapsed consensus among oil producers . This will help contain inflation within the Central Bank's target. The Kenya shilling is likely to remain stable against its major trading currencies similar to all other key macroeconomic indicators.



Source; bloom berg

Inflation

Inflation figures for June 2016 released by the KNBS shows that the CPI increased by 1.05 per cent from 167.99 in May 2016 to 169.76 in June 2016. The overall inflation rate in June 2016 stood at 5.80 per cent from 5 per cent in May 2016.

Main increase was from the food basket where the prices of vegetables mainly tomatoes, cabbages, onions and carrots went up both on a month on month and yearly basis. The prices of sifted maize flour went up between May and June, the prices were however lower than the previous years' prices.

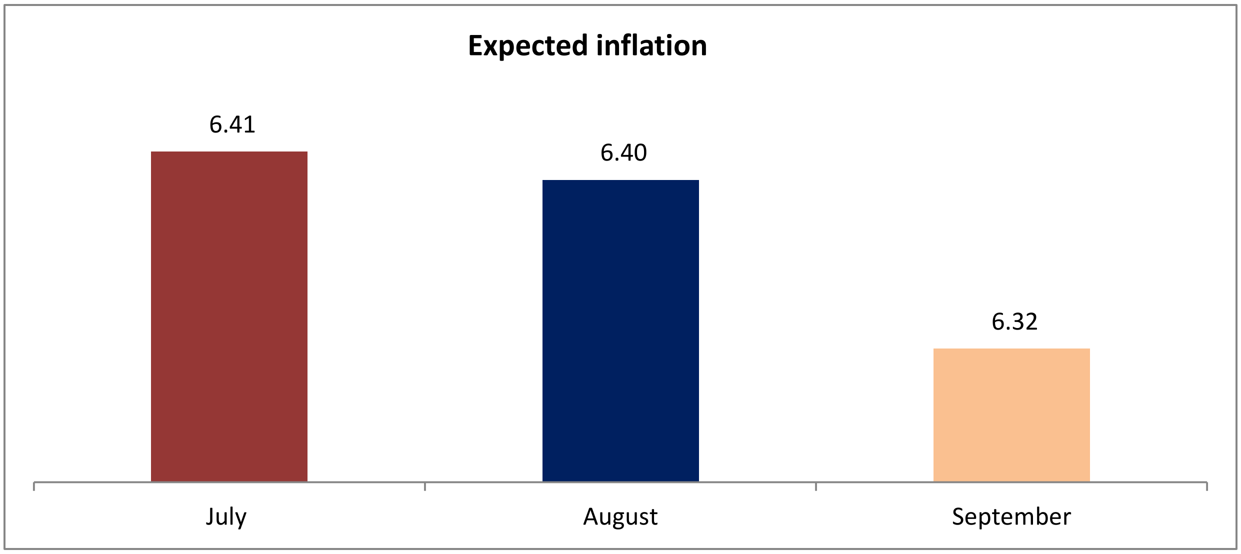
Fuel and gas prices also went up in June 2016 but were still lower than the last year's prices.

The new road maintenance levy rates gazetted by the transport secretary are expected to take effect this July. A litre of petrol is expected to increase by Kshs 6 after the levy was increased from Kshs 12 to Kshs 18. Home owners are expected to get a reprieve from lower cooking gas prices which dropped 7 per cent to Kshs 2,252.86 for the 13 Kg LPG gas. Gas prices are expected to further come down.

Food security report from the ministry of agriculture indicates that maize yields will this year fall to 32.2 million bags from 36.8 million bags in 2015 due to the poor long rains experienced. This is expected to spark an increase in maize prices.

We expect vegetable prices to remain stable at the current levels in July 2016 hence still exert pressure on inflation due to the lower prices last year. Pressure on prices of maize flour will be gradual with a spike expected in September if the yield is much lower.

We therefore expect to see an increase a slight increase in inflation this July due to the higher vegetable prices in the food basket which take up 36% of the total weight. Inflation will however remain within the CBK target range of 2.5%-7.5% on the back of lower fuel prices and electricity costs compared to the same time last year.



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