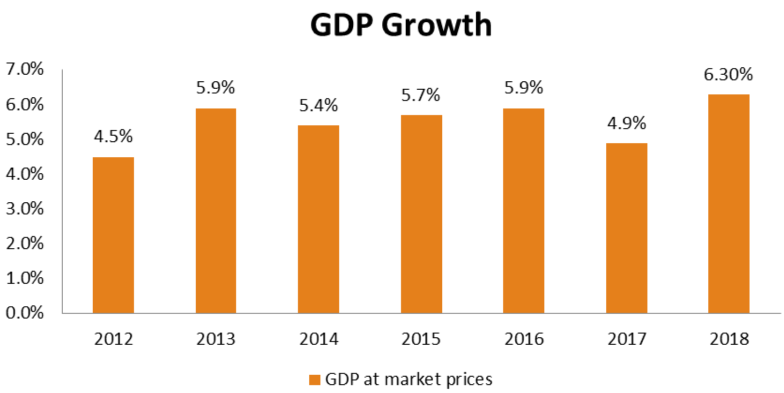
GDP growth exceeds expectations but broad-based concerns persist

Kenya's economic growth increased to 6.3% in 2018 from 4.9% in 2017. KNBS attributed this growth to higher Agricultural production, accelerated manufacturing activities, sustained growth in transportation and vibrant service sector activities.



There was a stable macroeconomic environment in 2018 as headline inflation was subdued, the current account deficit narrowed while the shilling remained stable against the USD.

GDP composition has evolved to an unfavourable mix

Since 2014, the Agricultural sector's contribution to GDP has been increasing while that of sectors (manufacturing and services) that are **essential to shift Kenya to a development path**, have declined. The situation is exasperated by the fact that other sectors have become more reliant on the agricultural sector. For instance, in 2018, increased agro-processing was the main driver for growth in the Manufacturing sector.

The reduced contribution of the Manufacturing sector is negative for the economy and may be attributed to the high cost of doing business in the country which has made it difficult for locally produced good to compete with cheap imports. The manufacturing sector is **more value-adding** and higher **labour-absorbing** thus efforts to increase its contribution would be positive for the economy.

Date: 26th April 2019

Sovereign Credit Rating (outlook):

Moody's: B2 (stable)
Fitch: B+ (stable)
S&P: B+ (stable)

March Inflation: 4.35%

91-Day T-Bill (26th Apr-19): 7.31%

182-Day T-Bill (26th Apr-19): 8.04%

364-Day T-Bill (26th Apr-19): 9.35%

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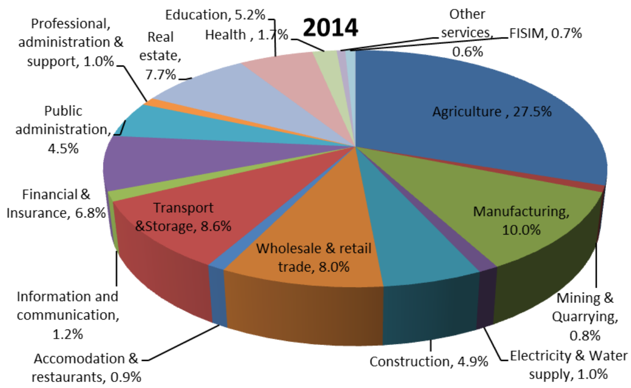
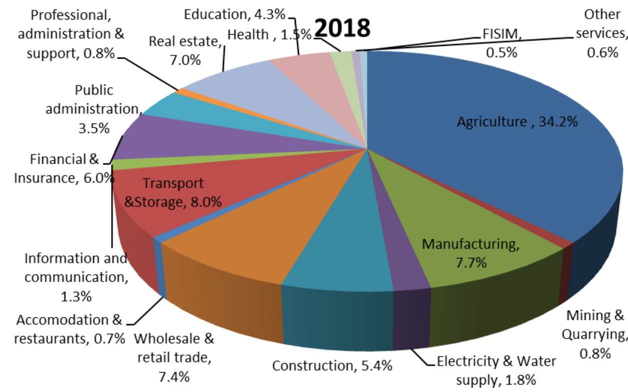
2014 GDP Composition



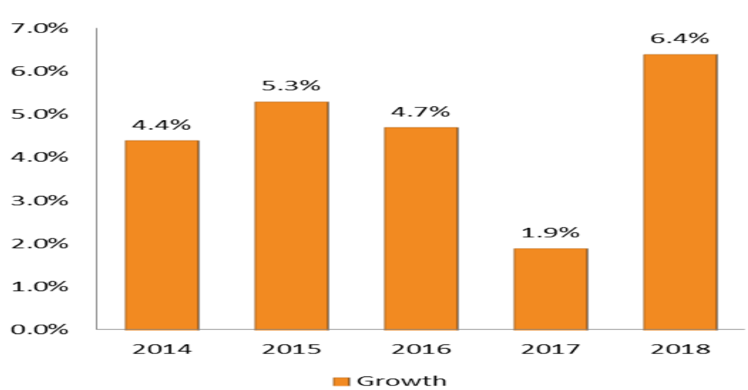
2018 GDP Composition



Agricultural sector relies on volumes to drive growth even as prices decline

In 2019, favourable weather conditions supported the growth in the Agricultural sector as it accelerated from 1.9% in 2017 to 6.4% in 2018. This growth was mainly supported by increased crop production. The marketed value of all major food crops, save coffee and pyrethrum, increased. The value of coffee was affected by lower prices while earnings from pyrethrum has been declining since 2015. Meanwhile, an increase in the volume of tea produced was able to offset the lower prices thus leading to the higher tea earnings.

Agriculture Sector Growth

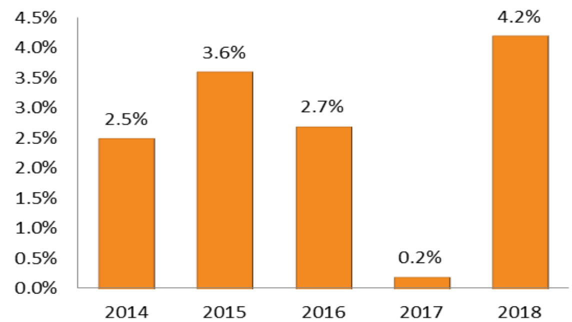


Manufacturing sector growth driven by lower value adding agro-processing activities

The manufacturing sector expanded by 4.2% compared to a revised growth of 0.5% in 2017 mainly buoyed by increased agro-processing during the review period. This emphases the increased correlation between growth in this and the agricultural sector. In a year where unfavourable weather leads to reduced agricultural activities, growth in the manufacturing sector is also likely decline.

Despite the increased growth rate, the sector's contribution to formal employment marginally decreased. The sector now accounts for 11.1% of total formal employment versus 11.4% in 2017.

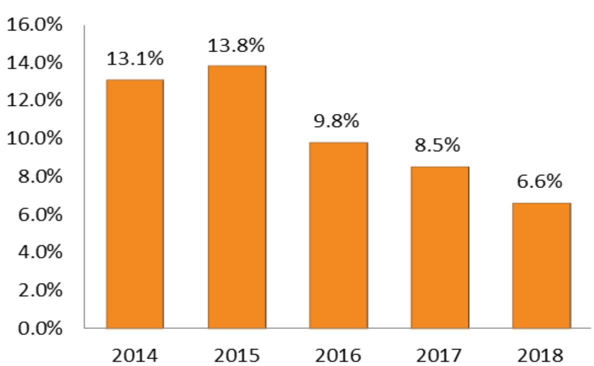
Manufacturing Sector Growth



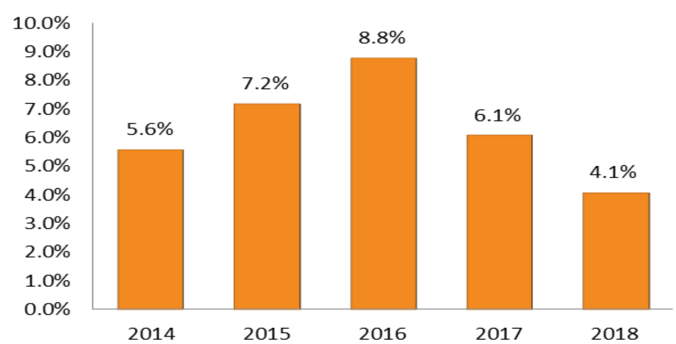
A slowdown in the property sector affects growth in the Construction and Real Estate Sectors

Growth in the construction sector reduced on account of lower government expenditure on roads and reduced household construction while the Real estate sector recorded its lowest growth since 2013.

Construction Sector Growth



Real Estate Sector Growth



2019 Outlook

Kenya's economy is heavily dependent on Agriculture as it is 34% of the country's GDP. Unfavourable weather conditions experienced in 1H19 are likely to negatively affect the growth and could lead to an uptick in inflation. However, the sucessful implementation of the 'Big four' agenda could help spur growth. The World Bank and CBK have revised their projections downwards to 5.7% and 5.3% respectively.

Relatively lower rainfall is likely to affect growth in the agriculture and manufacturing sectors while higher inflation is expected to reduce consumers' purchasing power.

In 2019, interest rates are expected to remain subdued due to the elevated demand for government paper while CBK is likely to maintain an accommodative monetary policy stance.

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