Cytonn INVESTMENTS

Kenya Q2’2017 GDP Growth and 2017 Outlook

Cytonn Weekly

Kenya’s economy expanded by 5.0% in Q2’2017, higher than Q1’2017 growth of 4.7% but slower than 6.3% growth recorded in Q2’2016. The table below shows the sectoral contribution to the overall GDP growth, of which taxes was the main driver with agriculture, manufacturing and financial services dragging down the growth;

Sector	Contribution Q2'2016	Contribution Q2'2017	Q2'2016 Growth	Q2'2017 Growth	Weighted Growth Rate Q2'2016	Weighted Growth Rate Q2'2017	Variance
Agriculture and Forestry	24.2%	23.4%	7.1%	1.4%	1.7%	0.3%	(1.4%)
Taxes on Products	10.8%	10.9%	2.0%	6.1%	0.2%	0.7%	0.5%
Manufacturing	10.5%	10.2%	5.3%	2.3%	0.6%	0.2%	(0.3%)
Real estate	8.2%	8.6%	8.2%	9.7%	0.7%	0.8%	0.2%
Wholesale and retail trade	7.1%	7.0%	2.3%	2.8%	0.2%	0.2%	0.0%
Education	6.8%	6.9%	6.0%	5.6%	0.4%	0.4%	(0.0%)
Transport and Storage	6.6%	6.8%	7.1%	8.2%	0.5%	0.6%	0.1%
Financial & Insurance	6.1%	6.0%	8.1%	4.3%	0.5%	0.3%	(0.2%)
Construction	5.2%	5.3%	7.6%	7.5%	0.4%	0.4%	0.0%
Information and Communication	3.1%	3.2%	9.1%	9.2%	0.3%	0.3%	0.0%
Public administration	4.3%	4.3%	6.6%	6.3%	0.3%	0.3%	(0.0%)
Electricity and Water Supply	2.6%	2.6%	9.6%	6.1%	0.3%	0.2%	(0.1%)
Professional admin	2.2%	2.2%	5.4%	6.4%	0.1%	0.1%	0.0%
Health	1.8%	1.8%	6.6%	5.5%	0.1%	0.1%	(0.0%)
Accommodation & Food Services	0.9%	0.9%	15.7%	13.4%	0.1%	0.1%	(0.0%)
Other services	1.2%	1.2%	4.6%	1.2%	0.1%	0.0%	(0.0%)
Mining and quarrying	1.0%	1.0%	10.6%	5.7%	0.1%	0.1%	(0.0%)
Financial Services Indirectly Measured	(2.6%)	(2.4%)	5.2%	(0.8%)	(0.1%)	0.0%	0.2%
GDP at Market Prices	**100.0%**	**100.0%**	**6.3%**	**5.0%**	**6.3%**	**5.0%**	**(1.3%)**

The following are the key take-outs from the results;

- **Sectoral Contribution** – Agriculture is once again the biggest loser of its share of contribution to GDP, shedding 0.8%, to 23.4% from 24.2%, followed by manufacturing, which lost 0.3% to 10.2% from 10.5%. Real estate was the most improved sector, increasing its share by 0.4% y/y to 8.6% from 8.2% in Q2’2016. This is an indication that Kenya is becoming a more diversified economy, reducing its over-reliance on the traditional largest sectors;
- **Declined growth in Agriculture** –Growth in the agriculture sector slowed to 1.4%, as compared to 7.1% in Q2’2016, contributing 0.3% to GDP growth in Q2’2017, down from a contribution of 1.7% in Q2’2016. This was as a result of insufficient rainfall that was experienced during the quarter, bringing down production of food crops, as evidenced by the increase in prices which reflected in inflation shooting up to an average of 10.8% during the quarter from 8.8% in Q1’2017 and 5.4% in a similar period last year. Cash crops supported the marginal growth of the sector

this time round with tea production and the value of horticultural exports increasing by 1.0% and 7.9% to 110.8 thousand metric tonnes and Kshs 28.7 bn, respectively, from 109.7 thousand metric tonnes and Kshs 26.6 bn in Q2'2016, respectively. Coffee is the only cash crop that registered a drop in production, having recorded a 57.5% drop to 6.2 thousand metric tonnes from 14.6 thousand metric tonnes in Q2'2016;

- **Slower growth in the Manufacturing sector** – Growth in the manufacturing sector has declined to 2.3% from 5.3% in Q2'2016 and 2.9% in Q1'2017. This resulted in a decline in contribution to GDP growth at 0.2%, down from 0.6% in Q2'2016. The slower growth was driven by declining growth in (i) manufacture of food products such as sugar, edible fats, margarine and processed milk which was mainly attributed to lower supply of raw materials from the agriculture sector, and (ii) manufacture of non-food products such as cement, motor vehicle assembly and galvanized sheets;
- **Recovery of the Tourism sector**– The tourism sector continued to exhibit double digit growth, with accommodation & food services growing by 13.4% in Q2'2017 slower than 15.8% growth recorded in Q2'2016. However, the sector is growing slower than expected, having maintained its sectoral contribution and contribution to GDP growth at 0.9% and 0.1%, respectively. This growth was underpinned by a 14.4% growth in tourist arrivals to 213,543 visitors from 186,685 visitors in Q2'2016, driven by efforts to market tourism in Kenya by the Ministry of Tourism and the security that was maintained in the country throughout the quarter;
- **Growth in Real Estate -** Real Estate performance continued to improve during the quarter, having grown by 8.6% compared to 8.2% in Q2'2016. Key to note is that the sector recorded the biggest increase in contribution to GDP, gaining 0.4% of the share. The growth in the real estate sector is underpinned by strong fundamentals such as (i) the large housing deficit of over 200,000 units annually, (ii) continued improvement in infrastructure, and (iii) demographic trends such as the growing middle class, rapid urbanization, rapid population growth and the youth bulge (21 to 35 years); and
- **Continued slow-down in the Financial & Insurance sector -** Financial & insurance sector slowed down to a growth of 4.3% in Q2'2017 from 8.1% in Q2'2016, and 5.3% in Q1'2017 despite money supply increasing by 5.9% and domestic credit increasing by 7.5% during the quarter. We believe that the slow-down in the sector's growth was driven by (i) a slow-down in y/y private sector credit growth to 1.6% as at June 2017 following the enactment of the Banking (Amendment) Act, 2015, as compared to 8.6% in June 2016, and (ii) a decline in the earnings per share (EPS) growth of the Kenya listed banks by 13.8% down from the 15.5% growth recorded in Q1'2016.

Q2'2017 was characterized by the highest inflation levels witnessed during the year, hitting 11.7% in May and averaging 10.8% during the quarter, despite a stable currency, which depreciated by just 0.7% against the dollar and declining interest rates following the interest rate cap that has seen yields on government papers remain fairly stable, with the 91-day T-bill coming down 40 bps to 8.3% at the end of Q2'2017 from 8.7% at the close of the first quarter. We have seen two Institutions revise their Kenya GDP growth projections for 2017 downwards during the quarter i.e. the Kenya National Treasury and BMI Research have both downgraded to 5.5% and 5.2% from 5.7% and 5.6%, respectively, all citing poor agriculture sector performance, slow private sector credit growth and uncertainty around the presidential poll re-run.

In our view, we maintain our expectation that 2017 GDP growth will slow down and come in between 4.7% and 5.2% due to a slowdown in agriculture and finance & insurance owing to (i) slower growth of the agriculture sector, and (ii) the interest rate caps which will reduce corporate earnings for commercial banks, (iii) increased political uncertainty around the presidential poll re-run forcing investors to take a wait and see stance, and (iv) slow private sector credit growth.

We expect the 2017 GDP growth to come in between 4.7% and 5.2%, supported by (i) government continued expenditure on infrastructure, also boosting growth in the

construction sector, (ii) the continued recovery of the tourism sector, and (iii) the continued growth of the real estate sector.
