kenya

Demographics

Population	45 010 056 (July 2014 est.)
Population: world ranking	31 out of 240 countries (CIA)
Life expectancy (years)	Total population: 63.52; male: 62.06; female: 65.01 (2014 est.)
Main ethnic groups	Kikuyu 22%, Luhya 14%, Luo 13%, Kalenjin 12%, Kamba 11%, Kisii 6%, Meru 6%, other African 15%, non-African (Asian, European, and Arab) 1%
Business language	English (official), Kiswahili (official)
Urban population	24.4%
Population below national poverty line	45.9% (2005 est.)

Sources: CIA, World Bank

Geography

Area in sq km	580 367
Area: World ranking	49 out of 252 countries (CIA)
Climate	Varies from tropical along coast to arid in interior
Natural resources	Limestone, soda ash, salt, gemstones, fluorspar, zinc, diatomite, gypsum, wildlife, hydropower

Sources: CIA, World Bank

Sovereign ratings

S&P	B+/Stable
Fitch	B+/Stable
Moody's	B1/Stable

Source: NKC Research

Economy in 2013

Nominal GDP (US$bn)	44.77	Total government debt as % of GDP	50.02
Nominal GDP: World ranking	84 out of 188 countries (IMF)	Total external debt as % of GDP	26.35
Real GDP (% change y-o-y)	4.70	Consumer price inflation (average, %)	5.72
GDP growth: World ranking	41 out of 189 countries (IMF)	Current account balance as % of GDP	-8.18
GDP per capita (US$)	1,009.48	Equity market: Size in US$	US$23.8bn
Agriculture as % of GDP	26.81	Equity market: Listed companies	63 primary listings
Industry as % of GDP	19.26	Bond market size	US$13.1bn (end Jan-14) govt bonds outstanding in the domestic market
Services as % of GDP	53.93		

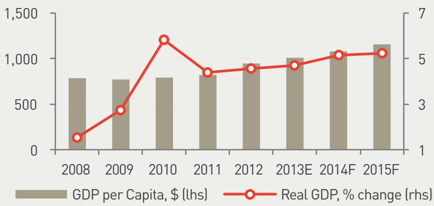
Sources: IMF, NKC Research

Political environment	
Government type	Republic
Head of state	President Uhuru Kenyatta
Head of government	President Uhuru Kenyatta
Ruling political party	Jubilee Alliance
Main opposition parties	Coalition for Reforms and Democracy, Eagle Alliance, Amani Coalition
Elections	Election last held on 4 March 2013 (next to be held in 2018)

Source: NKC Research

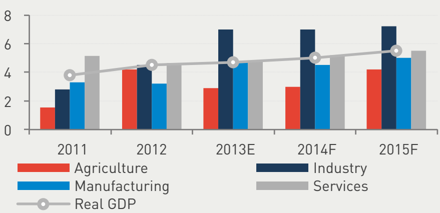
Economic outlook

GDP per capita vs real GDP



Source: NKC Research

Real GDP by sector (% change pa at factor costs)



Source: NKC Research

Kenya's economic growth performance has been fairly volatile over the past decade. Real GDP growth averaged 4.2% per annum during 2002-11.

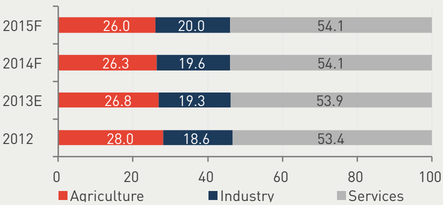
During this period, the highest growth rate was achieved in 2007 (7%), and the lowest in 2002 (0.5%). Agriculture is very important to the economy, as it is a major source of both employment and foreign exchange. Since most agricultural activities remain largely rain-fed, the sector is exposed to the vagaries of the weather.

And since a significant proportion of the population is dependent on agriculture for their livelihoods, a downturn in the sector has a noticeable and damaging effect on private consumption. Over the 2002-11 period, the correlation between growth in the agricultural sector (1.6% per annum) and overall real GDP growth was very high at 0.84. Over the same period, growth in the services sector has been impressive at an annual average of 4.8%. Some of the fastest-growing sectors in the services industry include telecommunications, hotels and restaurants, trade, and banking. Between 2002 and 2011, the industrial sector expanded at an annual average rate of 4.5%.

Within the sector, mining activities have expanded rapidly, though from a very low base. Moreover, there has been strong growth in the construction and manufacturing sectors, although expansion in the latter has been below par in recent years, and we feel there is still significant room for development.

Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

GDP by sector (% of GDP)



Source: NKC Research

Kenya's population is expanding at a rapid pace, which necessitates an even higher real GDP growth rate to ensure that there are significant improvements in living standards. The United Nations Population Division estimates Kenya's population growth rate at around 2.7% per annum between 2000 and 2010. Over the subsequent decade, it is only expected to decline marginally. GDP per capita in current US$ prices is estimated to have exceeded US$1 000 for the first time last year, rising to US$1 009 , a 7.1% increase from the previous year. Similar growth in GDP per capita is forecast for 2014-15, reaching US$1 152 by the end of this period.

International trade

Kenya's main exports are black tea, coffee, and horticultural products, especially flowers. In addition, tourism and remittances are also important foreign exchange earners, and help to partially offset the sizeable trade deficit. Kenya does not yet produce any oil, and as a result, its oil import bill is a big drag on the current account. Kenya's forex earners have performed well over the past few years. However, imports have also expanded rapidly, resulting in a widening current account deficit. Specifically, the current account deficit widened from just 0.8% of GDP in 2004 to 9.9% of GDP in 2011. Over the same period, the trade deficit widened from 10.1% of GDP to 26.2% of GDP. Tullow Oil announced on 15 January 2014 that it had made two further oil discoveries in northern Kenya. Tullow believes that the basin has an overall potential of more than one billion barrels of oil. Further exploration activities will be undertaken over the next two years. Oil production is projected to start by 2015-16, while there are also plans for an export pipeline. The start of oil production will be very positive for Kenya. It will help to diversify and expand export earnings, and – provided the necessary refinery infrastructure is put in place – it will lower import requirements. As a result, it will help to narrow Kenya's trade deficit.

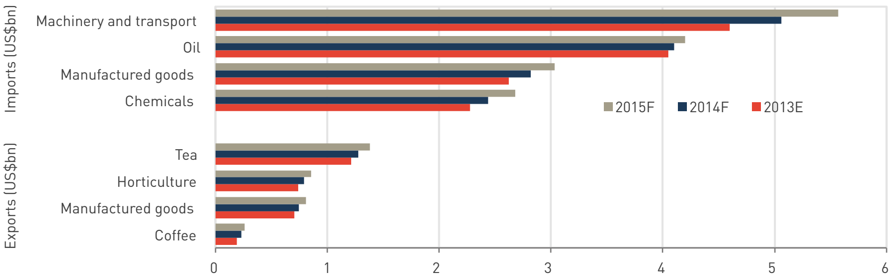
Foreign trade flows, 2013

Main exports	(US$ billion)	Main imports	(US$ billion)
Tea	1.22	Machinery and transport equipment	4.60
Horticulture	0.74	Oil	4.05
Manufactured goods	0.71	Manufactured goods	2.62
Coffee	0.19	Chemicals	2.28

Source: NKC Research

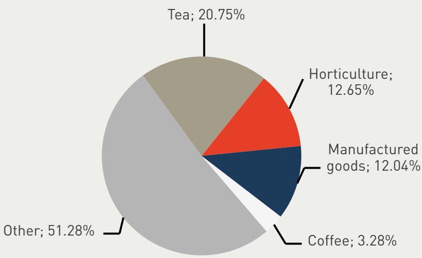
Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

Kenya top four exports and imports (US$ billion)



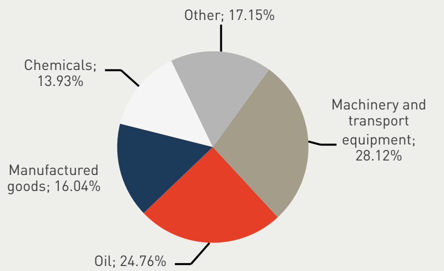
Source: NKC Research

2013 exports (% of total)



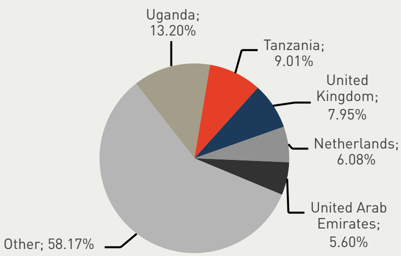
Source: NKC Research

2013 imports (% of total)



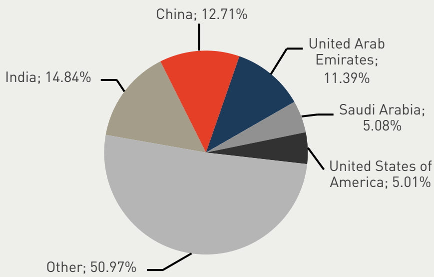
Source: NKC Research

2013 top destinations of exports (% of total)



Source: KNBS

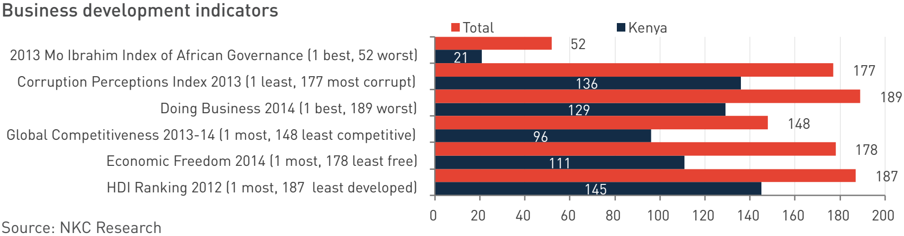
2013 top origins of imports (% of total)



Source: KNBS

Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

Business development indicators



Source: NKC Research

Policy environment

Monetary policy:

The Monetary Policy Committee (MPC) of the Central Bank of Kenya (CBK) decided during its first two meetings of 2014 (held in January and April) to keep the Central Bank Rate (CBR) unchanged at 8.5%.

The rate was last changed in May last year, when it was lowered by 100 basis points. The MPC believes that its monetary policy stance has anchored inflation expectations. This view is supported by a Market Perceptions Survey that was conducted by the bank in December 2013. Meanwhile, confidence in the economy remains strong, and has been reinforced by positive comments made by the IMF. The MPC is carefully monitoring the trend in private sector credit for signs that it might trigger an uptick in inflation.

However, the bank believes that the 'combination of declining credit risk and rising private sector [credit] growth supports private investment and growth'. A committee looking into ways to boost private sector credit and mortgage finance in the country has proposed a new formula to be used by commercial banks in calculating lending rates.

Specifically, all banks will be required to use the Kenya Banks' Reference Rate (KBRR), which will be calculated as an average of the CBR and the average 91-day treasury bill rate. The CBK will publish the KBRR, which will remain effective for six months.

Commercial banks must price their interest rates by using the following formula: KBRR + k, where k is a measure of a bank's operating costs, the borrower's credit profile, and the type of loan product. All new loans awarded from 1 July 2014 onwards must use this formula, while banks will have until 1 July 2015 to recalculate rates on existing loans. The framework will later be extended to other lenders, such as microfinance banks.

Exchange rate policy:

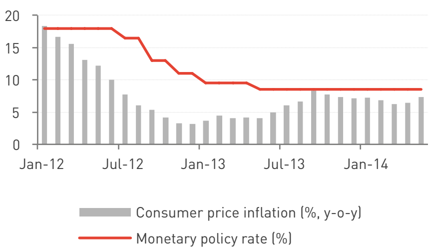
In a statement issued on its website on 26 May, the CBK noted that recent pressure on the shilling exchange rate was due to seasonal factors, and reiterated that its foreign exchange reserves 'are sufficient to provide adequate cushion against temporary shocks', while the forthcoming Eurobond will provide further support. The central bank expects a normalisation of the situation, but stands ready to act in order to dampen volatility levels. A US$600 million syndicated loan was due to be repaid by the government on 15 May. However, due to the delays in issuing its maiden Eurobond – which was supposed to finance repayment of the loan – the government decided to extend the maturity of the loan until 15 August. While the extension of the syndicated loan's maturity is not a default, it does highlight Kenya's challenges: it has sizeable current account and budget deficits, while foreign direct investment inflows are relatively small in comparison. Hence, the country is reliant on external debt to finance its shortfalls. While seasonal factors have contributed to pressure on the shilling, the negative effect on Kenya's tourism sector – an important foreign exchange earner – caused by increased terror risk cannot be denied.

Fiscal policy:

The finance ministry projects total fiscal expenditure at KSh1.58 trillion in the 2014/15 fiscal year (FY, starting in July), and total revenue is forecast at KSh1.24 trillion. The budget deficit is projected at KSh342.4 billion, which, according to our estimates, is equivalent to 7.4% of GDP. External financing will amount to KSh149.2 billion, or 3.2% of GDP, while domestic borrowing would cover KSh190.8 billion, or 4.1% of GDP. The remaining KSh2 billion will be covered by loan repayment receipts. Kenya's fiscal deficit has widened in recent years due to higher wages and increased infrastructure spending. The fiscal deficit in the coming FY may once again fall short of the target due to implementation capacity constraints, but even so, consecutive large budget deficits may start to crowd out credit to the private sector.

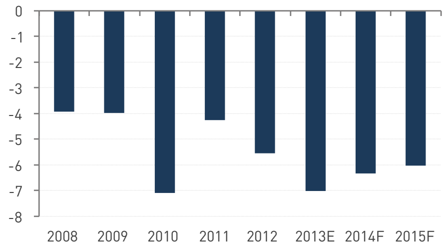
Kenya's public debt is forecast to reach 50.9% of GDP by the end of June 2014, compared to 44.4% of GDP at the end of June 2008. Infrastructure spending received considerable attention in the latest budget. The finance minister stated that the government would finalise financing for the second stage of a new standard gauge railway between Nairobi and the Ugandan border. Building of the first stage from the coast to Nairobi has already begun. In addition, the government plans to build three new airports: at Malindi on the coast, Mandera in the north and Suneka in the western part of the country.

Consumer price inflation and monetary policy rate



Source: Central Bank of Kenya, National Bureau of Statistics

Budget balance (% of GDP)



Source: NKC Research

Regulatory and tax environment:

Although Kenya is still one of the easier countries to do business in – compared to other countries in Africa – its progress in terms of reforms has been mixed. After Kenya boasted being one of the top-10 reformers on a global basis in the World Bank's Doing Business 2008 index, the country has moved down the scale since. Kenya is ranked 129th out of 189 countries in the 2014 edition of the index, down seven places from the previous edition. The corporate income tax rate is 30% of profit. There is also a 2.67% tax on gross salaries for social security contributions. The value added tax rate is 16%, while interest is taxed at 15%. There is no capital gains tax, although the Kenya Revenue Authority wants it to be reintroduced. (Capital gains legislation has been suspended since 1985.)

Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

Political environment

Kenya can be considered a low-risk country since the success of the 2013 elections under the new constitution. Most recent news from Kenya has been about insecurity resulting from terror attacks by members or sympathisers of Somalia's Al-Shabaab, which killed more than 150 people in the first six months of 2014. There definitely has been an increase in terrorism since the beginning of the year, and the tourism business (especially in Coast Province) has already suffered, but it is not yet serious enough to threaten overall political stability.

President Uhuru Kenyatta and Deputy President William Ruto's trials in the International Criminal Court (ICC) are progressing very limply, and it looks probable that both will be acquitted. Ultimately, the trials' effect on politics in Kenya will, if this outcome materialises, turn out to have been minimal, and will mostly amount to a surge of defensive nationalism, which has been to the advantage of the government.

The main political risks are economic ones: the indirect threat that terror may affect investment and business in general (in addition to the tourism industry), and the danger that a leaky and bloated bureaucracy, now growing because of the devolution of power to county-level governments, may hamper investment and affect Kenya's fiscal profile. These dangers are still only potential ones.

Economic environment

Ratings:

Kenya has the same rating on its sovereign debt from all three major rating agencies. Standard & Poor's (S&P) affirmed its sovereign credit rating on Kenya at 'B+' with a stable outlook on 8 November 2013. The stable outlook reflects S&P's view that economic growth will remain resilient, and that despite sporadic unrest, political stability will be maintained. Meanwhile, Fitch Ratings affirmed Kenya's long-term foreign currency sovereign credit rating on 31 January 2014 at 'B+', also with a stable outlook. The rating continues to be constrained by weak governance, low income per capita, and relatively poor human development indicators and business environment. Moody's Investors Service affirmed Kenya's credit rating at 'B1' with a stable outlook on 13 November 2013.

Key indicators to watch

Exchange rate	The shilling has been fairly stable over the past two years, but remains exposed to weather and external demand-related shocks.
Forex reserves	The central bank uses its forex reserves to support the local unit from time to time. Kenya's foreign reserve position has strengthened over the past few years, despite a wide current account deficit and meagre official net FDI.
Monetary policy and inflation	The central bank has in the past been slow to raise interest rates pre-emptively to combat rising inflation. The real policy rate has declined from a peak of 10.4% in August 2012 to 4.5% in May this year.

Source: NKC Research

Key vulnerabilities	What is the government doing to address this?
Terrorism is the most serious impediment to foreign investment and tourism.	While terrorism is difficult to contain, Kenya needs to implement strategies and tactics designed to prevent what is currently a relatively containable issue sliding out of control.

Key vulnerabilities	What is the government doing to address this?
Dependent on hydroelectricity; oil-importing region.	New power plants using a combination of geothermal energy, co-generation, coal, and liquefied natural gas will become operational over the next few years, thereby reducing Kenya's reliance on hydropower. Oil production is to start within a few years.
Dependence on Europe for trade, remittances, and tourism earnings.	Kenya's exports to other countries within the EAC grouping have increased more than five-fold in the period between 2001 and 2011, and comprises over 75% of intra-regional exports.

Source: NKC Research

Market participation	
Foreign investors	All foreign-owned commercial banks operating in the country participate in both the government and corporate debt market. Foreign ownership of equity may not exceed 60%. Repatriation of capital, dividends, and interest is guaranteed by the Foreign Investment Protection Act (FIPA).
Local investors	All domestic-owned commercial banks and mortgage companies. The pension sector has become an increasingly important player since the enactment of the Retirement Benefits Act.

Source: NKC Research

Financial market

Foreign exchange

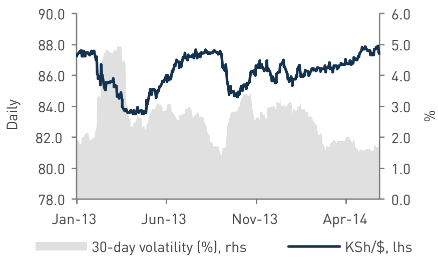
Security	Average size of a single transaction	Average daily turnover range	Bid/offer spread	Tenor/ maturity	Quotation/ settlement	Reuters page	Additional information
Spot	US$0.5m to US$2m	US$20m to US$50m	10 bps for US$0.5m to US$1m	-	T+2	KES=	Main cross is US$/KES
Forwards (deliverable)	US$0m to US$2m	US$10m and above	200 bps to 400 bps	Liquid up to 1 year	T+2	KES-FWD=	Main benchmark is US$/KES
Forwards (non-deliverable)	US$1m to US$2m	US$0m to US$5m	200 bps to 400 bps	Liquid up to 1 year	T+2	-	Main benchmark is US$/KES
Swaps	US$0.5m to US$2m	US$20m to US$50m	200 bps to 400 bps	Liquid up to 1 year	T+2	-	Main benchmark is US$/KES

Sources: Bloomberg, Reuters, NKC Research

The shilling depreciated sharply during 2011 to reach a low of KSh106/US$ in October of that year. This was caused by a combination of higher international oil prices; a drought, which resulted in lower agricultural export earnings, higher food imports, and lower supply of hydropower; and loose monetary policy. The shilling recovered strongly subsequent to reaching its low point in October 2011, supported by tighter monetary policy, funding from the IMF, and inflows of foreign investment into the debt and equity markets. Since then, the shilling has again depreciated, although at only a gradual pace. The shilling averaged KSh84.4/US$ in 2012 (from KSh88.7/US$ in 2011), and depreciated to an average of KSh86/US$ last year. The local unit has come under some pressure since 2013 Q4, but it has not nearly been as sharply affected as a number of emerging and frontier market currencies in 2014 to date. This is mainly due to foreign investors not making up as large a share of the bond and equity markets, combined with a favourable macroeconomic outlook. Moreover, forex reserves are currently at a healthy level, so the central bank does have some scope to support the shilling exchange rate.

The shilling is expected to average around KSh88.3/US$ in 2014, before weakening to an average of KSh90.1/US$ next year. This will be driven by the large current account and budget deficits, higher inflation than that of trading partners, and the possibility of seeing larger portfolio investment outflows than in recent years.

Exchange rate
Kenyan shilling



Source: Reuters

Equities

Stock market	Listed companies	Liquidity	Total market capitalisation	Settlement	Most liquid sector	Daily trading volume
Nairobi Stock Exchange	63 primary listings	Very liquid in African context	US$23.8bn	T+3	Banking, telecommunications	38 million shares

Source: Bloomberg

The Nairobi Stock Exchange (NSE) has performed very well since the beginning of 2012. The recovery was partly driven by investors shifting from Kenyan debt markets into the stock market. The loosening of monetary policy, with interest rate cuts in July, September, and November of 2012, and in January and, most recently, in May 2013, also proved to be supportive. The bourse came under some pressure during May-August last year, which may have been linked to the generally weaker sentiment towards emerging and frontier asset markets following the US Federal Reserve's indication that it will start to taper its bond-buying programme earlier than was previously expected.

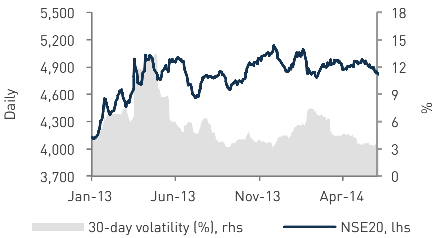
An increase in Kenya's domestic bond yields since mid-June may also have led to a marginal shift in investment from the equity to the debt market, as investors would want to lock in the higher returns on offer. The bourse has recovered strongly since September. Foreign ownership of shares in the NSE reached a seven-year high in November 2013, with a proportion of around 25%. However, in the first quarter of 2014, foreign investors were net sellers on the bourse to the value of KSh2.78 billion, compared to net purchases of KSh25.6 billion during the whole of last year. Telecoms operator Safaricom has the biggest market capitalisation on the bourse, at around

US$5.9 billion or 24.8% of the total. The company's share price soared last year, reaching an all-time high. The NSE's overall market capitalisation stood at US$23.8 billion at the end of May, an increase of 19.2% y-o-y. Monthly equity market turnover averaged KSh13 billion last year, up from KSh7.2 billion in 2012 and KSh6.5 billion in 2011. Turnover increased by 27.4% y-o-y in the first quarter of this year. The stock exchange is therefore quite liquid in an African context.

Top-five listed companies	Market capitalisation
Safaricom Limited	US$5.9bn
East African Breweries Limited	US$2.4bn
Equity Bank Limited	US$1.7bn
Kenya Commercial Bank Limited	US$1.6bn
Standard Chartered Bank Kenya	US$1.1bn

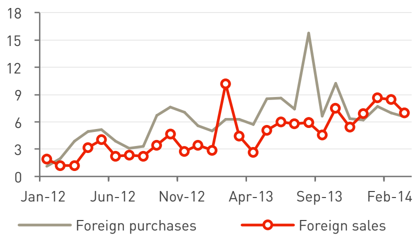
Source: Bloomberg

Nairobi Stock Exchange - NSE20



Source: Reuters

Foreign investor participation (KSh' billion)



Source: NSE

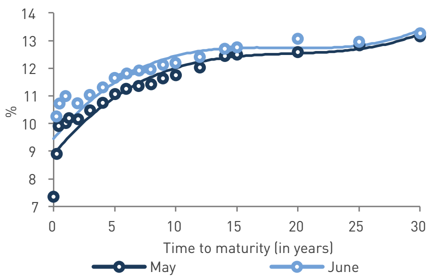
Fixed income

Security	Tenor/ maturity	Auction frequency	Liquidity	Quotation/ settlement	Auction participation	Bid/offer spread
Treasury bill	91, 182 and 364 day	91 and 182 day sold weekly 364 day sold monthly	Good	T+1 (primary market) T+3 (secondary market)	Open to all market participants	N/A
Treasury bonds	1 to 30 years	Monthly or as set out in provisional auction calendar	Good	T+1 (primary market) T+3 (secondary market)	Foreign banks are prohibited from obtaining funding of less than 1 year directly through the local market	50 bps - 100 bps

Source: NKC Research

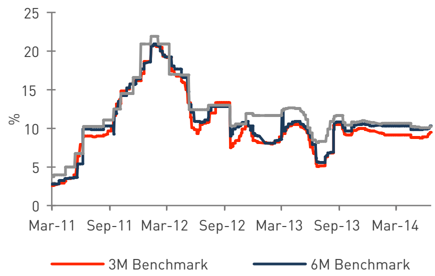
Kenya's domestic debt market is well developed and liquid by African standards. Maturities range from 91 days to 30 years. In June this year, the Kenyan sovereign finally issued its maiden Eurobond after many delays. The US$500 million five-year tranche priced at a yield of 5.875%, while the US$1.5 billion 10-year tranche attained a yield of 6.875%. The final yields both came in at the tighter end of initial guidance, which was 6% on the five-year tranche and 7% on the 10-year offering. The order book on the five-year tranche reached US$2.5 billion while the longer-dated tranche raked in US$5.5 billion in tenders. The proceeds are earmarked for infrastructural development as well as the repayment of a US$600 million syndicated loan. Kenya illustrated shrewdness in weighing market conditions and offering a dual-tranche instrument to widen the capital base and lower aggregate borrowing costs. Still, we remain circumspect about such a large issue; the combined US$2 billion issue amounts to around 30% of foreign exchange reserves, which is quite high relative to other recent African issuers.

Kenya (benchmark) yield curve



Sources: NKC Research, Reuters

Kenya treasury bills (secondary market)



Sources: NKC Research, Reuters

The sovereign's maiden Eurobond issue is expected to contribute to increased international bond issuances from the private sector and parastatals. As a result, external debt is forecast to increase by 12.7% this year, taking the ratio to GDP to 27.7%, from 26.8% in 2013. Kenya Power has announced that it plans to issue Eurobonds to help finance its expansion plans after it has obtained a credit rating. Meanwhile, ARM Cement has also announced that it may sell Eurobonds to help fund its US$300 million expansion programme. Housing Finance, Kenya's second-largest mortgage lender, has also announced that it will issue a seven-year KSh20 billion corporate bond once the government has issued its Eurobond, in order to take advantage of potentially lower borrowing costs. A key concern we have is that the increased appetite for taking on debt (by the public and private sector), spurred by the easy global monetary conditions, could backfire once liquidity dries up. It is therefore crucial that business plans are not reliant on interest rates remaining at current low levels.

Macroeconomic data and forecasts

Key annual economic data	2009	2010	2011	2012E	2013E	2014F	2015F
Real GDP (% change)	2.74	5.80	4.38	4.56	4.70	5.14	5.22
Nominal GDP (US$bn)	30.60	32.23	34.33	40.70	44.77	49.17	53.85
Consumer price inflation (average, %)	9.23	3.96	14.02	9.38	5.72	6.95	7.41
Budget balance, incl grants (% of GDP)	-3.98	-7.09	-4.26	-5.55	-7.01	-6.33	-6.01
- Revenue (% of GDP)	22.44	25.13	24.63	23.54	23.85	25.09	26.02
- Expenditure (% of GDP)	26.41	32.21	28.89	29.09	30.87	31.43	32.04
Government debt (% of GDP)	46.72	49.87	53.36	50.26	50.02	50.92	51.39
Current account balance (% of GDP)	-5.31	-7.35	-9.89	-9.50	-8.18	-8.17	-8.34
Trade balance (% of GDP)	-16.24	-19.33	-26.24	-25.90	-23.46	-22.83	-22.38
KES/US$	77.35	79.23	88.81	84.53	85.98	88.16	92.00
Short-term interest rate (%)	14.81	14.37	15.05	19.67	17.31	17.20	17.90
Foreign reserves (US$bn)	3.85	4.07	4.25	5.70	6.56	6.77	7.19
Months of import cover	4.11	3.61	3.12	3.78	4.36	4.27	4.20

Source: NKC Research

Key monthly indicators	End-10	End-11	End-12	End-13	Mar-14	Apr-14	May-14
Consumer price inflation (% y-o-y)	4.51	18.93	3.20	7.15	6.27	6.41	7.30
Monetary policy rate (%)	6.00	18.00	11.00	8.50	8.50	8.50	8.50
Foreign reserves (US$bn)	4.07	4.25	5.70	6.56	N/A	N/A	N/A
91-day treasury bill rate (% eop)	2.28	18.66	8.17	9.63	9.16	8.83	8.89
KES/US$ (eop)	80.50	84.95	85.75	86.20	86.30	86.96	87.60
Brent crude oil (US$/barrel eop)	94.23	109.19	111.60	110.50	106.40	108.98	110.01

Sources: NKC Research, Reuters, Central Bank of Kenya, Kenya National Bureau of Statistics

Note: In the table above, E and F are the abbreviations for estimate and forecast respectively.