Kenya

2011

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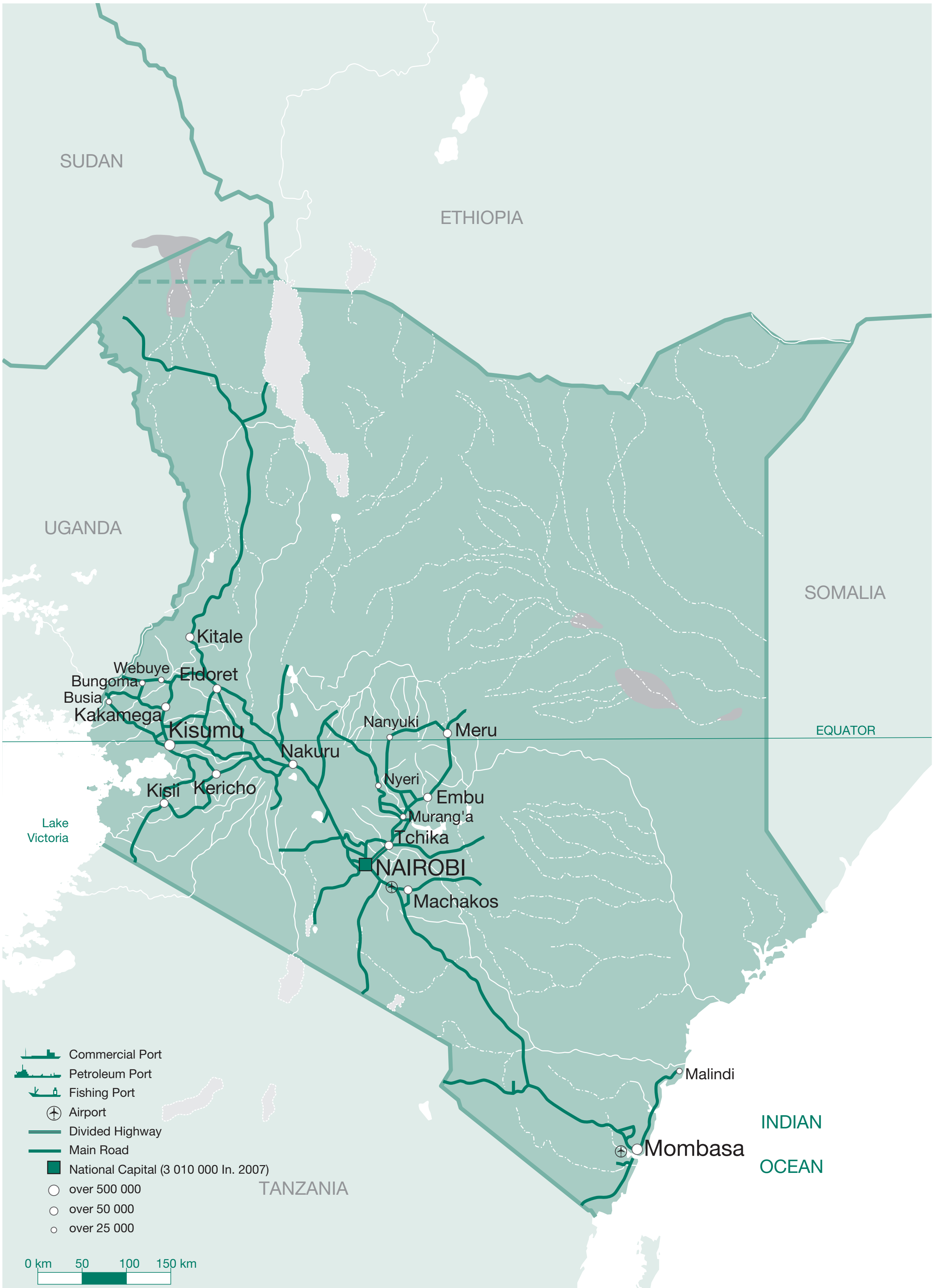

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Kenya

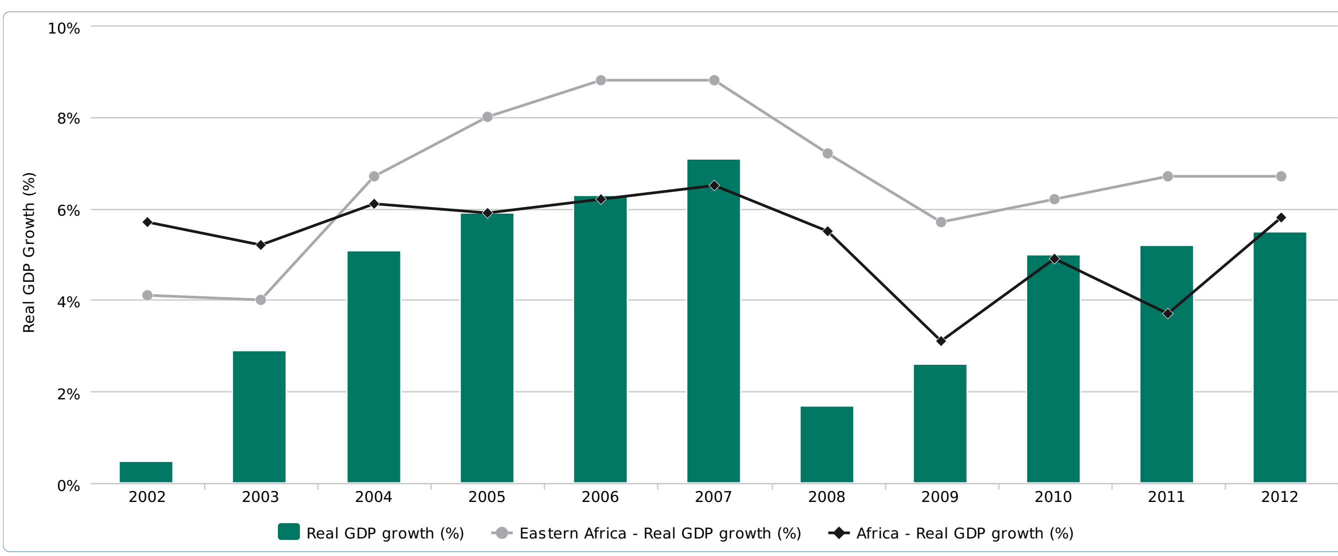
Overview

The macroeconomic performance of the Kenyan economy improved significantly in 2010 compared with 2009. While the economy grew by 2.6% in 2009, it is estimated that the growth rate of gross domestic product (GDP) nearly doubled to reach 5.0% in 2010. The increase in growth can be attributed to the good rainfall during 2010 and higher prices for Kenyan exports on world markets. The abundance of agricultural output, coupled with increased competition in some key services, helped contain inflation in 2010. However, the Kenyan economy faces two challenges: diversification and the reduction of its dependence on the vagaries of nature.

The outlook for 2011 is promising and a combination of trends could contribute to ensure positive prospects in the short to medium term. The approval of the constitution, continued investment in infrastructure and government policies targeting development in the private sector should all enhance Kenya's business environment and reinforce a dynamic private sector. Second, deepening regional integration and the launch of the East African Community common market are creating a single trading and investment environment in which Kenyan firms to have access to a larger market. Last, prudent monetary and fiscal policy is expected to reduce inflation and keep interest rates low, creating a credible and stable macroeconomic environment. Given these prospects, the Kenyan economy is forecast to grow by 5.3% in 2011 and 5.5% in 2012.

This positive outlook may however be subject to two main challenges. First, Kenya will need to reduce its high reliance on agricultural outputs to limit its vulnerability to climate hazards by diversifying the economy. Second, Kenya may be vulnerable to another political shock as it faces 2012 elections. Contributing further to the uncertainty weighing on the political environment is the indictment of six high-level Kenyan officials – including the current finance minister and deputy prime minister – by the International Criminal Court for alleged crimes connected to the 2007 post-election violence.

Figure 1: Real GDP growth (E)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Table 1: Macroeconomic indicators

	2009	2010	2011	2012
Real GDP growth	2.6	5	5.3	5.5
CPI inflation	10.5	4.1	9.8	7.6
Budget balance % GDP	-5.4	-5.8	-6.8	-7.1
Current account % GDP	-5.3	-7.8	-8.5	-9.1

Source: National authorities' data; estimates and projections based on authors' calculations.
Figures for budget balance refer to fiscal year July (n-1)/ June (n).

Figures for 2010 are estimates; for 2011 and later are projections.

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Recent Economic Developments and Prospects

Table 2: GDP by sector (in percentage)

	2005	2009
Agriculture, forestry, fishing & hunting	24.2	23.2
Agriculture, livestock, fishery, forestry and logging	-	-
of which agriculture	-	-
of which food crops	-	-
Mining and quarrying	0.5	0.6
Mining, manufacturing and utilities	-	-
of which oil	-	-
Manufacturing	10.5	10.4
of which hydrocarbon	-	-
Electricity, gas and water	2	1.6
Electricity, water and sewerage	-	-
Construction	4	3.9
Wholesale and retail trade, hotels and restaurants	10.6	11.1
of which hotels and restaurants	-	-
Transport, storage and communication	10.3	10.5
Transport and storage, information and communication	-	-
Finance, real estate and business services	9.1	9.7
Financial intermediation, real estate services, business and other service activities	-	-
General government services	14.5	14.5
Public administration & defence; social security, education, health & social work	-	-
Public administration, education, health	-	-
Public administration, education, health & other social & personal services	-	-
Public administration, education, health & social work, community, social & personal services	-	-
Public administration, education, health & social work, community, social services	-	-
Other community, social & personal service activities	-	-
Other services	14.3	14.4
Gross domestic product at basic prices / factor cost	100	100

Source: Data from Kenya National Statistics Bureau.

Figures for 2010 are estimates; for 2011 and later are projections.

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In 2010, Kenya's economic performance continued on a positive trajectory as it recovered from past internal and external shocks. The post-election violence, drought and food and financial crises had led to a slowdown of Kenya’s normally strong economic growth. Between 2004 and 2007, the country had registered growth rates between 5.1 and 7.1%. The 2010 referendum on the constitution has now been held in a peaceful and transparent manner. A new constitution was adopted in August 2010. Favourable weather conditions, in particular good rainfall, since November 2009 have enabled Kenya to secure reliable energy supplies and to increase agricultural output. In 2010, Kenya also benefited from the global economic recovery as well as higher prices for its exports. The agriculture and manufacturing sectors became Kenya’s new growth drivers after two years of weak performances. The economy grew by 5.0%, compared with 2.6% in 2009, and 1.7% in 2008.

The rebound of agriculture, coupled with increased competition in some key services, helped contain inflation in 2010. High growth can also be attributed to increased public investment under the economic stimulus programme implemented by the government at the end of 2009. Large investments were undertaken in key sectors of the economy, namely agriculture, infrastructure, services, and health and education.

Improved and well-distributed rains starting in November 2009 and continuing into 2010 contributed to the recovery of the agricultural sector. The sector had started to recover in 2009 with the margin of decline improving from -4.1% in 2008 to -2.6%. In the third quarter of 2010, the sector continued its recovery, expanding by 6.8% compared to a contraction of 3.4% in the corresponding quarter of 2009. Despite the increase in the first three quarters of 2010, agricultural output still has not reached the pre-crisis growth levels recorded in 2007.

Kenya’s main crops, namely maize, beans, potatoes and tea, recorded significant increases in production in 2010. However, horticultural products, coffee and sugarcane recorded lower levels of output and export in 2010 compared with 2009. Flight cancellations due to the volcanic eruption in Iceland, insufficient rainfall and depressed demand from Kenya’s traditional flower markets aggravated by the global economic recession are among the main challenges faced by Kenya’s horticulture exports in 2010. As a result, horticultural exports grew only marginally, by 3.7%, while horticultural production increased by 5.7%.

Coffee, sugarcane and milk recorded negative growth performances. Excessive drought in 2009 and unpredictable rainfall patterns in the coffee-growing area in 2010 contributed to the reduction of coffee sales from 49 498 metric tonnes in 2009 to 38 938 metric tonnes in 2010, representing a 21.3% decrease. Rising coffee prices helped to absorb the impact of lower outputs. Average annual prices for coffee sales more than doubled, from KES 195.75 (Kenyan shilling) per kilogram in 2009 to KES 396.78 per kilogram in 2010.

Domestic sugar production decreased by 4.4% in 2010. It should be noted that, despite its 11 sugar millers, Kenya imports sugar. For the year 2010/11, it is estimated that sugar demand will hit a high of 6.9 million tonnes against a projected production of 5.7 million tonnes. Imports from the Common Market for Eastern and Southern Africa (COMESA) are expected to fill the gap. Sugarcane deliveries declined by 28 217 metric tonnes during the first half of 2010, compared with deliveries over the same period in 2009.

Good weather conditions in 2010 allowed the milk production to increase from 247.5 million litres over the first half of the year 2009 to 345.5 million litres in 2010. Milk intakes in the formal milk sector increased by 25.6% between 2009 and 2010. Wet weather conditions in the tea-growing areas in the east and west Rift Valley allowed tea to continue to expand in 2010. Tea production increased by 31.1%, from 304 198 tonnes in 2009 to 399 006 tonnes in 2010.

Tourism has suffered since the December 2007 post-election violence and has yet to achieve its pre-violence performance. In 2010, however, tourism did experience significant gains. According to government estimates, Kenya will have received 1.2 million tourists in 2010, and earnings should exceed KES 100 billion. Even though the number of tourist arrivals in 2010 is still below those in 2007/08, confidence is gradually being restored and the Kenya Tourism Board (KTB) has mounted intensive marketing campaigns in European and Asian markets. The KTB has partnered with local and international travel and leisure organisations as well as the media and airlines to build a strong image for Kenya as a niche tourist destination. The promotion of scenic cities and preferred local attractions aims at increasing local tourism.

By allowing a 23.9% increase in hydro-power generation, increased rainfall in 2010 contributed to a 13.4% growth of electricity generated during the first half of 2010 compared with the similar period in 2009. Thermal power production increased by 12.3% from January to August 2010 compared with the similar period in 2009, while geo-thermal power production declined by 2.5%. Total local electricity generation for 2010 amounted to 6.4 billion Kilowatt hours, out of which 49.9% were generated by hydro-power, 22.5% by geo-thermal power and 27.6% by thermal power. During the year 2010 through August, electricity consumption increased compared to a similar period in 2009.

Kenya’s manufacturing sector contributed significantly to total output and export earnings in 2010 and has a strong potential to create employment. It is dominated by food processing. The post-election crisis had strongly impacted the manufacturing sector – it recorded a dismal growth of 3.6% in 2008 and further plummeted to 2% in 2009. These negative results were mainly attributed to the high cost of production, competition from cheap imports, high taxes and minimal credit financing. More stable energy supplies enabled the sector to rebound in 2010. It grew by 7.8% in the third quarter of 2010 compared with a decline of 0.5 percentage points in the previous year.

Growth in manufacturing was mainly attributed to the strong expansion of food manufacturing, beverages and tobacco which increased by 12% in the third quarter of 2010 compared with a decline of 1% over the same period in 2009. Cement production increased by 11.4% between 2009 and 2010. In addition, an expanding informal sector is engaged in small-scale manufacturing of household goods, motor-vehicle parts, and farm tools. In 2011, the manufacturing sector could benefit from the ongoing integration of the East African Community as Kenyan firms are considered to be more competitive than their regional counterparts.

The building and construction sector has been exemplary since 2005. The government's infrastructure development programme invested in road networks and the provision of affordable housing. The annual demand in the real estate sector, estimated at about 150 000 housing units, far exceeds the supply side, which only offers 35 000 units, leaving an annual deficit of 115 000. In spite of the significant opportunities, lending to the real estate sector stood at 8.4% of total credit by banks and mortgage finance companies in 2010, compared with a ratio of 12.2% realised in 2009. In order to facilitate provision of adequate housing to Kenya's growing population, the 2010 Finance Bill proposed to amend the Banking Act. The proposed amendment would allow mortgage finance companies to operate current accounts and banks to advance up to 40% of their total deposit liabilities for purchase, improvement or alterations of land. This last proposal would represent an increase from the actual ratio of 25%.

Table 3: Demand composition

	Percentage of GDP (current price)		**Percentage changes, volume**			**Contribution to real GDP growth**		
	2002	**2009**	**2010**	**2011**	**2012**	**2010**	**2011**	**2012**
Gross capital formation	15.2	20.9	3.4	4.1	4.9	0.9	1	1.2
Public	4.3	5.2	4.5	5.2	6	0.3	0.3	0.4
Private	10.9	15.7	3	3.8	4.5	0.6	0.7	0.8
Consumption	91.6	91.7	5.2	3.4	5.1	4.6	3	4.5
Public	17.1	16.3	3.8	3.1	3.3	0.6	0.5	0.6
Private	74.5	75.5	5.5	3.4	5.5	4	2.5	4
External sector	-6.8	-12.6	-	-	-	-0.5	1.2	-0.2
Exports	23.7	25.3	5.9	8	6	2	2.7	2.1
Imports	-30.5	-37.9	5.2	3	4.8	-2.5	-1.5	-2.2
Real GDP growth rate	-	-	-	-	-	5	5.3	5.5

Source: Data from Kenya Central Bureau of Statistics (KNBS) and Ministry of Finance; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Fiscal Policy

In 2010, the government continued to implement its economic stimulus programme, funding public projects in agriculture, services, infrastructure, health and education as well as various community-based initiatives through the Constituency Development Fund and Group funds (Youth and Women fund). To mitigate the impact of multiple shocks, the government eased its macroeconomic policies. The deficit of the primary balance increased from 3% of GDP for the fiscal year 2008/09 to 3.2% in 2009/10. It is expected to deteriorate further down to a deficit of 4.1% of GDP for fiscal year 2010/11. The overall deficit also grew from 5.4% of GDP in 2008/09 to 5.8% in 2009/10 and is forecast to increase to 6.8% in 2010/11.

Total revenue collection and grants increased to 24.9% of GDP in the fiscal year 2009/10, from 23.3% of GDP in 2008/09. Government total expenditure and net lending followed the same path, increasing from 28.7% of GDP in 2008/09 to 30.8% of GDP in 2009/10. Total government expenditure for the fiscal year 2009/10 increased by 21.7% amounting to KES 725.2 billion, against a target of KES 791.4 billion. The shortfall was attributed to lower absorption in both recurrent and development expenditures by the ministries. On the one hand, recurrent expenditure amounted to KES 510.5 billion, against a target of KES 536.3 billion, therefore representing a 95% execution rate. The lower-than-targeted recurrent expenditures mainly emanated from the operations and maintenance expenditures. On the other hand, development expenditures were executed at 84% compared with the target.

Cumulative external financing at the end of the 2009/10 fiscal year represented a net borrowing of KES 22.4 billion compared with KES 11.7 billion in 2008/09. Total disbursements including appropriations in aid amounted to KES 39.8 billion against a target of KES 66.5 billion. Public debt increased from KES 1 075.7 billion by the end of September 2009 to KES 1 294.4 billion by the end of September 2010.

From January to September 2010, domestic debt increased by 28% compared with a similar period in 2009. The stock of Treasury bills increased by 5.8% while Treasury bonds increased by 24.5%. External public debt increased from KES 525.5 billion in December 2009 to KES 589.7 billion in September 2010. The Fitch Rating for 2010 remained B+ for long-term foreign debt, B for short-term foreign debt and BB- for domestic long-term foreign debt.

Cumulative debt service payments to external agencies, as of the end of September 2010, amounted to KES 8.6 billion: 81.2% in principal and 18.8% in interest. For the first quarter of the fiscal year 2010/11, government expenditure on interest and other charges on domestic debt increased to KES 16.2 billion from KES 14.1 billion in the first quarter of the fiscal year 2009/10. For the current fiscal year 2010/11, budget estimates are that government domestic borrowing will amount to 3.8% of GDP while external borrowing shall account for 3.0% of GDP. Gross domestic debt-to-GDP ratio is projected to increase from 24.2% in June 2010 to 27.1% in June 2011.

For the fiscal year 2010/11, the government plans to contain the increase in expenditures through improved public financial management while maintaining strong revenue collection. In addition, the composition of expenditures will be shifted from recurrent to capital expenditures. For 2010/11, total government revenues and grant should represent 24.5% of GDP. Overall expenditures are projected at 31.3% of GDP. The overall recurrent expenditures are targeted at 21.3% of GDP, an increase from 20.9% of GDP recorded in fiscal year 2009/10. Current expenditures are projected at 21.9% of GDP, compared to 20.3% of GDP in 2009/10. Additional expenditures are targeted at supporting infrastructure by reducing the cost of doing business and encouraging private sector investment.

The overall fiscal deficit (after grants) is expected to worsen from the equivalent of 5.8% of GDP in 2009/10 to 6.8% of GDP in 2010/11. The government plans to cover it by net external financing of 3% of GDP and domestic borrowing of 3.8% of GDP, including domestic infrastructure bonds on 1.1% of GDP. Over the medium term, the government expects to take the fiscal deficit down to about 5% of the GDP and to bring the debt-to-GDP ratio towards 45%. The debt management strategy will aim to diversify sources of financing by emphasising long term maturities and concessional loans.

Table 4: Public finances (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Total revenue and grants	19.8	22.5	23.4	23.3	24.9	24.5	23.7
Tax revenue	17.7	19.6	20.4	20.7	21.3	21.1	20.8
Oil revenue	0	0	0	0	0	0	0
Grants	0.7	0.9	1.3	0.8	1.3	1.2	0.8
Other revenues	1.5	2	1.7	1.8	2.4	2.2	2.1
Total expenditure and net lending (a)	22	23.4	28.6	28.7	30.8	31.3	30.7
Current expenditure	19.3	18.7	21.8	21.2	20.3	21.9	21.2
Excluding interest	16.3	16.2	19.3	18.8	17.7	19.1	18.8
Wages and salaries	7.6	7.4	7.5	7.1	7	7	6.7
Goods and services	4.4	5.8	8.2	7.9	7.2	8.3	8.3
Interest	3	2.5	2.5	2.4	2.6	2.7	2.4
Capital expenditure	2.6	4.7	6.7	7.4	10.3	9.4	9.4
Primary balance	0.8	1.6	-2.7	-3	-3.2	-4.1	-4.7
Overall balance	-2.2	-0.8	-5.2	-5.4	-5.8	-6.8	-7.1

a. Only major items are reported.
Source: Data from Kenya Central Bureau of Statistics (KNBS) and Ministry of Finance; estimates (e) and projections (p) based on authors' calculations.
Fiscal year July (n-1)/June (n).

Figures for 2010 are estimates; for 2011 and later are projections.

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Monetary Policy

The Central Bank of Kenya (CBK) implemented flexible monetary policy in 2010. It aimed to keep inflation low by setting an inflation target of 5%, ensuring stable long-term interest rates and competitive exchange rates. It supported the economic activity by facilitating the private sector access to credit. The CBK has cut the Central Bank Rate (CBR) four times, amounting to a total reduction of 100 basis points in 2010, from 7% in January to 6% in July 2010. In addition, the CBK reduced the Cash Reserve Ratio from 6 to 5% in the first half of 2010.

By implementing these measures, the government expects to revive lending and stimulate the economy through increased consumer consumption. This monetary stimulus has been successful and resulted in increased access to credit for the private sector as well as recovered consumption growth. The credit allocated to the private sector grew dramatically, registering a 17% increase in the first half of 2010. The major part of this growing credit was captured by credit to households, which grew by 30% over the same period.

The CBK introduced agency banking in 2010 to deepen access to financing for a majority of Kenyan small entrepreneurs and to reduce the high cost of financial services. Under the Guideline on Agent Banking enacted in May 2010, banks are allowed to conduct banking business through third party agents such as petrol stations, shops, telecom companies, chemists and sole proprietors. However, services delivered by these entities exclude customer appraisal and loan approval. Information asymmetry between borrowers and banks is another factor contributing to the high premiums charged by banks. To reduce information asymmetries and promote cheaper credit, the CBK has created a credit information-sharing mechanism. The first Credit Reference Bureau was licensed in February 2010.

As a result of strong and prudent macroeconomic management combined with a favourable conjuncture (slowing international oil prices and better food supplies), inflation dramatically decreased to 3.1% in

October 2010 from a high of 19.5% in November 2008. Kenya achieved its lowest inflation performance since 2003, posting a consumer price index inflation rate of 4.1% for 2010. For 2011, the CBK will target a low inflation rate of 5% and stable interest rates. To achieve these objectives, it will need to tackle inflationary pressures arising from the rebounding economic activity as well as accelerated government spending.

Throughout 2010, the Kenyan shilling depreciated against the dollar and appreciated against the euro during the first half of 2010. For 2011, the CBK aims to ensure a competitive exchange rate that should promote private sector development.

External Position

The main exports in the first half of 2010 were tea (23.6%), horticulture (14.5%), manufactured goods (12%), raw materials (4.4%), coffee (3.9%) and oil products (2.2%). Improved commodity prices in the international markets and growing domestic production led to an increase in the value of merchandise exports of 8.4% between August 2009 and August 2010. This increase was mainly attributed to tea exports whose value increased by 37.5%. Over the same period, receipts from other exports also increased. Horticultural exports increased from USD 673 million to USD 709 million. Oil products exports increased by 21.7% from USD 91 million in August 2009 to USD 110 million in August 2010.

Almost half (46%) of Kenya's exports for the year up to August 2010 went to African countries. The main destinations for exports were Uganda (12.4%), Tanzania (8.4%), Egypt (4.5%) and Sudan (4.3%). Outside Africa, Kenya mainly exported to the United Kingdom (UK) (10.7%), the Netherlands (6.9%), the United States (US) (4.5%), Pakistan (4.5%), and United Arab Emirates (UAE) (4.4%).

The increased value of imported oil and manufactured goods raised the value of imports by 10.1% during the first half of 2010 compared to the first half of 2009. Oil imports increased by 23.6%; manufactured goods imports increased by 20% and imports of machinery and transport equipment increased by 10.8%. During the third quarter of 2010, Kenya sourced most of its imports from Far East Asia, whose share of imports accounted for 42% of the total import bill as well as from the European Union and Middle East Asia, whose shares of imports respectively amounted to 20.4% and 14.7% of the import bill.

Kenya imports crude oil and refines it for domestic use and for export. In the last five years, the quantity of imported petroleum products has grown from 3.5 million tonnes in 2004 to 4.7 million tonnes in 2009. On the other hand, the export of petroleum products increased from 37 400 tonnes in 2004 to 216 100 tonnes in 2007, fell again to 88 700 tonnes in 2008, but increased to 112 500 tonnes in 2009.

The services current account deficit improved to USD 1 787 million in the year to August 2010 from USD 1 966 million in the year to August 2009. Earnings from tourism and transportation services are the main sources of this improvement. Increased value of Kenya's imports contributed to worsening its merchandise account deficit from a deficit of USD 5 842 million in the year to August 2009 to a deficit of USD 6 509 million in the year to August 2010. As a result, the current account deficit increased from 5.3% of GDP in 2009 to 7.8% of GDP in 2010.

The main sources of foreign direct investment (FDI) were Australia (KES 16 billion), Israel (KES 4 billion), the UK (KES 738 million) and India (KES 434.3 million). On external grants, commitments amounting to KES 40.4 billion have been received for the fiscal year 2010/11. Remittances flows for 2010 are estimated at USD 642 million, from USD 609 million in 2009. These flows to Kenya are a critical source of foreign currency even if the remittances are mostly used to pay for daily needs.

Table 5: Current account (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Trade balance	-7.6	-15.7	-18.8	-19.5	-20.9	-21.5	-21.1
Exports of goods (f.o.b.)	16.5	15.2	16.8	15.2	16.4	17	16.8
Imports of goods (f.o.b.)	24.1	30.9	35.6	34.7	37.2	38.5	37.9
Services	2.6	4.6	4.6	6.6	5.4	5.5	5.4
Factor income	-1.1	-0.5	-0.2	-0.2	0	-0.1	-0.1
Current transfers	5.2	7.8	7.8	7.8	7.8	7.6	6.7
Current account balance	-0.9	-3.8	-6.6	-5.3	-7.8	-8.5	-9.1

Source: Data from CBK data; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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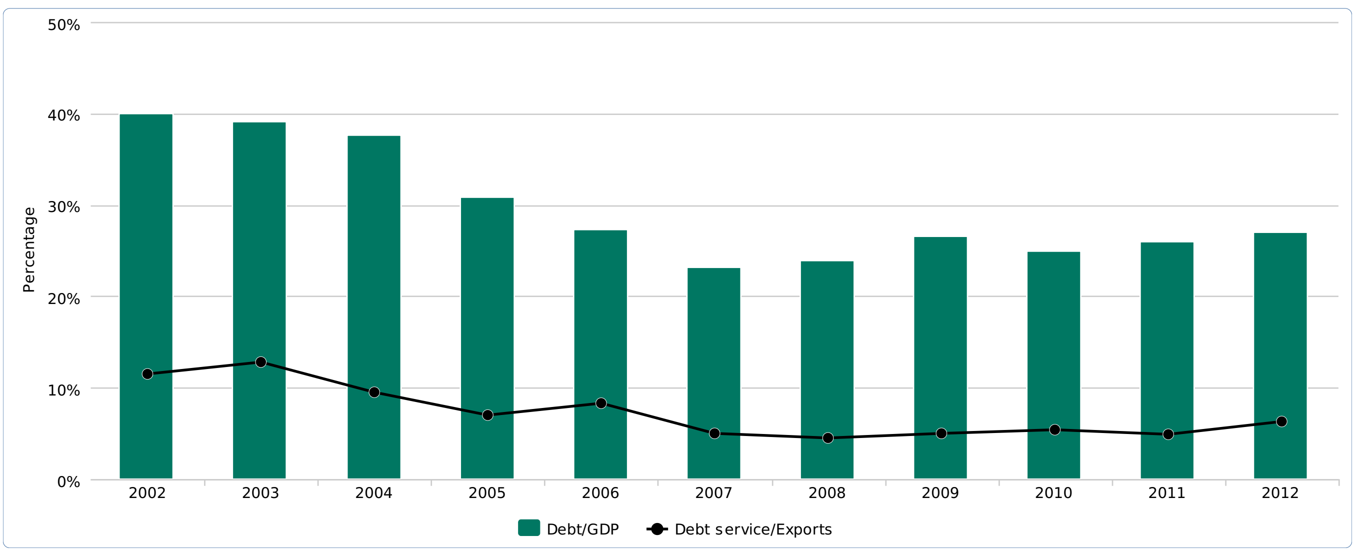
Figure 2: Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Structural Issues

Private Sector Development

In 2010, the World Bank *Doing Business* report ranked Kenya 98th out of 183 economies in the "Ease of doing business", three places below its 2009 ranking. Poor infrastructure, political risk, finding the right quality of staff, and access to adequate credit and financing were among the major constraints faced by small and medium enterprises (SMEs) in 2010. The government's Economic Stimulus Programme played an important part in boosting infrastructure projects and creating credit for SMEs. The government streamlined the financial sector by regulating microfinance institutions. The 2010/11 budget included a Business Regulation Bill to prevent the regulatory authorities from setting arbitrary charges and fees. It is meant to address the main constraints faced by businesses and promote growth in the private sector.

The Kenyan banking sector performed well in 2010. Total assets of the banking sector rose by 22.6% between June 2009 and June 2010. Growth in asset base was due to growth in deposits, retained profits and capital injections. From June 2009 to June 2010, non-performing loans decreased by 7.9%, total deposits increased by 27.8%, capital and reserves of the banking sector grew by 25.6%. In the meantime, total capital to risk weighted assets ratio only decreased marginally from 19.8% to 19.6%. The banking sector pre-tax profits increased by 41.9% over the same period.

The good performance of the Kenyan economy and the gradual recovery of the global economy in 2010 contributed to the rebound in trading activities at the Nairobi Stock Exchange (NSE). The NSE 20 share index rose by 55% between September 2009 and October 2010. Market capitalisation increased by 58.3% over the same period. Bond turnover for the year up to November 2010 stood at KES 460 billion compared with the annual turnover of KES 110 billion in 2009, representing a 316% increase.

2010 was dubbed the year of Rights Issue. Up to October 2010, KES 16 billion had been raised through rights issues at the NSE as listed firms raised additional capital. This represented 56% of the total amount raised since 1988, which stands at KES 28 billion. During the year, TPS Serena, Kenya Commercial Bank Group, Standard Chartered Bank and KPLC raised capital through rights issues. TPS Serena raised KES 1.60 billion out of the planned KES 1.18 billion while KCB raised KES 12.50 billion out of the targeted KES 15.00 billion. Standard Chartered Bank raised KES 2.50 billion – more than the target of KES 1.88 billion. The funds were raised to complete the buyout of a planned custodial business from rival Barclays Bank. The bank used the excess proceeds to support its balance sheet.

Other Recent Developments

The 2010/11 budget emphasises agricultural and rural development, in recognition of agriculture's major contribution to GDP (23%), as well as employment and exports. The strategy's main objectives are to secure livelihoods in rural areas and ensure food security and employment. The government plans to promote agriculture through improving agro-business, value-addition and market access; increasing access to credit and to affordable inputs; and promoting research and training. Key infrastructure facilities were also given major attention in the 2010/11 budget. The government will continue to scale up investments in transport networks, both roads and ports. and energy supply. The development budget for constructing the road network was allocated KES 78.6 billion. KES 34.1 billion were dedicated to diversifying energy sources mainly through the expansion of the national transmission system and the development of geothermal energy.

The Information and Communication Technologies (ICT) sector is vibrant and has actively contributed to economic growth in recent years. Telkom Kenya is the main fixed line telephone service provider in Kenya. Because of intense competition, the company has diversified to other services including enhanced voice and data services. In 2010, Telkom Kenya had a client base of about 460 000 on both fixed line and CDMA wireless. During the year up to June 2010, the number of fixed lines was 234 522, representing a 5.4% decline compared with the similar period in 2009. In the same period, the number of fixed wireless subscriptions declined by 46.2%. The decline in fixed network subscriptions is an indication of the increased availability of more convenient and affordable mobile phones.

As at the end of June 2010, the penetration of mobile phone services was reported at 51.2 per 100 inhabitants, still below the world average of 67.0 per 100 inhabitants. Mobile phone money transfer service is a Kenyan innovation that has performed outstandingly well over time. Safaricom and Airtel have been the major providers of this service through M-pesa and Zap respectively. Orange Kenya started its money transfer service – Orange Money – in 2010. The mobile phone money service subscribers increased to 7.7 million by December 2009 from 5.5 million by December the previous year. It is estimated that the service had attracted over 13.5 million subscribers by November 2010.

The Internet market continued to expand in 2010. From January to June 2010, there were an estimated

7.8 million Internet users in the country, up from 3.6 million users in the same period of the previous year. The increase in the number of Internet users was mainly attributed to increased access of Internet services through mobile phones. In the first half of 2010, there were 3.1 million Internet subscriptions in the country compared with 1.8 million subscriptions reported over a similar period in 2009, representing a 69.8% increase. The increase in the number of Internet subscriptions continued to be dominated by mobile data. Internet subscriptions through GPRS/EDGE and 3G accounted for 99% of total subscriptions. Orange Kenya was granted a 3G licence by Communications Commission of Kenya in 2010. The number of subscribers therefore increased because of innovations in Internet access by operators from the standard personal computer to mobile handset and portable broadband Internet modems. The effect of the Seacom cable on Internet prices is lagging as investors recoup their investment before bringing down prices.

Emerging Economic Partnerships

Kenya's historical trade partners are mainly located in Europe (the UK, Germany and the Netherlands) and East Africa (Uganda and Tanzania). The US seems to have played a minor role in trade relations prior to 1999. Pakistan and India have persistently increased their share of trade over time. For its exports, Kenya has concentrated on the African markets with Rwanda and Egypt as key targets. For imports, Kenya has of late increased its trade relations with the US, South Africa, Saudi Arabia, the UAE, Iran, Japan, Singapore and China. Regarding investment, the country has had one of the most open regimes for FDI in Africa since its independence. The main historical sources of investment have been the UK, Germany and India as well as other European countries such as Italy, the Netherlands and France.

India's relations with Kenya started before independence with the voyages of merchants. Indira Gandhi participated in the country's independence celebrations in 1963. In 1981, the two countries granted each other Most Favoured Nation status under an India-Kenya trade agreement. In 1989, an India-Kenya Double Taxation Avoidance Agreement was signed. Recently, investment and trade partnerships between the two countries have culminated in a wave of new investment. Petrochemicals and chemicals, telecommunications and floriculture are the sectors in which Indian firms have been investing the most. Recent investments by Indian firms include Bharti Airtel (telecom), Essar (telecom and refining), Tata Africa (cars, pharmaceuticals, information technologies, etc.) and Reliance (petroleum products).

In 2010, India is Kenya's sixth largest trading partner. Kenya mainly exports vegetables, soda ash, tea, metal and leather to India and imports pharmaceuticals, machinery, steel products, automobiles and power transmission devices. Indian official development assistance (ODA) is limited and comes in the form of loans and credit. A loan of INR 50 million (Indian rupees) was granted to the government of Kenya in 1982 in addition to lines of credit offered by EXIM Bank of India to the Industrial Development Bank. In November 2010, during the visit of the Kenyan prime minister to India, an agreement granting a line of credit of USD 61.6 million from EXIM Bank of India to the government of Kenya to be utilised in the power transmission sector was signed. As part of the Indian co-operation, more than 100 scholarships are offered by the government of India each year to Kenyan nationals.

Since the early 2000s, Kenya has been building new economic partnerships with African, Middle Eastern and Far Eastern countries. Since the Narc government took over in January 2003, its policy has targeted the intensification of trade relations with Eastern countries. The government has entered into trade and economic partnerships with five countries in the Middle East and Asia (China, Iran, UAE, Japan and Singapore) but the key economic partner is China.

China was the fourth country to recognise Kenya's independence in 1963. It considers Kenya as a gateway to Africa. New enhanced economic relations between Kenya and China began in 2005 with President Kibaki's visit to China. The trip culminated with a five-part agreement covering: ODA for infrastructure and energy, extended aviation services, technical assistance for assessment and industrial products' classification and standards, and modernisation of equipment at the Kenya Broadcasting Corporation (KBC). As a direct consequence of these agreements, Kenya's imports from China grew by 224.5%, from KES 23.0 billion in 2005 to KES 74.5 billion in 2009. Imports from China between January and November 2010 amounted to KES 110.1 billion making China the first origin of imports before the UAE (KES 108.4 billion) and India (KES 82.9 billion).

Chinese direct investments in Kenya also escalated. Between 2004 and 2007, China invested a capital of KES 2.5 billion. In 2009, FDI from China culminated to KES 530 million up from KES 53.4 million in 2008. Chinese companies are active in construction, tourism and manufacturing. There are currently 96 investment projects undertaken by the Chinese, mainly road construction projects, employing a workforce of about 9 000 Kenyans. An increasing number of small to medium-sized Chinese firms specialising in auto repair and maintenance, home furnishings, construction equipment and agricultural machinery have also settled in Kenya.

China provides monetary and non-monetary aid to Kenya, exclusively on a project basis. It supports infrastructure, equipment and plants, academic and technical training, human relief and tariff exemption. The share of Chinese aid became significant in 2002 when it exceeded 1% of total development assistance received by Kenya. In 2005, the share of Chinese development assistance rose to 8.25%, placing China second among bilateral donors. China's development aid policy differs from Kenya's traditional partners by its greater flexibility in accommodating internal political constraints. No pre-conditions are imposed on the attribution of aid. The assistance is only tied to the formal recognition of Chinese Taipei under the One China Principle and to the use of Chinese companies and procurement of material.

Trade between the UAE and Kenya is growing very fast. Between 2004 and 2009, Kenyan exports to the UAE have increased from KES 2.4 billion to KES 10.7 billion, representing a 347% increase. However, most of the trade favours the UAE since Kenya imports significantly more. Between 2005 and 2009, imports from the UAE increased by 42.8% from KES 62.8 billion to KES 89.7 billion. In addition to being Kenya's major supplier of oil, the UAE has emerged as a favoured shopping destination. Kenyans travel there regularly to purchase household and office electronic appliances, automobile spare parts and motor vehicles. Even though the UAE largely contributes to imports and exports, it does not contribute at all to foreign direct investments.

Israel is a notable emerging investment partner. While foreign direct investments coming from Israel amounted to KES 800 million between 2004 and 2008, and to only KES 78 million in 2009, these flows increased dramatically in 2010 – approaching KES 4 billion. Overall, Israel contributed to the creation of 701 local jobs between 2004 and 2010. It has continually invested in the agricultural sector over the years, mainly in agricultural machinery and irrigation.

Trade and investment relations between Australia and Kenya have been limited but Australia began to show an interest in Kenyan minerals and petroleum resources industry in 2010. Flow Energy Limited entered the Kenyan coast to explore the possibility of oil and gas in Lamu. This represented a large part of Australia's investment in Kenya in 2010, which amounted overall to KES 16 billion. With the prospect of oil, Australia is posed to be a major investor in Kenya. An oil agreement between Kenya and Iran, in which Iran offered to sell oil to Kenya at better prices, caused an upward leap in trade in 2007.

Political Context

The irregularities of the 2007 elections caused a wave of violence throughout the country. In 2008, a power-sharing agreement was signed between President Kibaki and the opposition. In April 2008, a 42-member coalition cabinet was sworn in that included new ministries for co-operative development, Northern Kenya development and Nairobi metropolitan development. A reform agenda was part of the power-sharing agreement. The aim of the constitutional reform is to reinforce the effectiveness of the system of checks and balances. The Constitutional Review Act of December 2008 launched the process of constitution drafting. In August 2010, Kenyans voted on a referendum for the new constitution. The constitution received broad support and was approved by 66.9% of the voters.

The new constitution maintains Kenya's presidential system but establishes additional checks and balances on executive power and envisions a process of decentralisation. The decentralisation process as well as the implementation of check and balances will take place progressively through the passage of further acts over the five coming years. The International Criminal Court (ICC) is investigating alleged crimes committed during the 2007 post-election violence. On 15 December 2010, the ICC indicted six high-level Kenyan officials, including the current finance minister and deputy prime minister. The outcome of these indictments, as well as the 2012 elections, poses risks for Kenya's economic outlook.

On the governance side, the country ranked 26th on the 2010 Ibrahim Index of African Governance published by the Mo Ibrahim Foundation. It scored poorly on personal safety, accountability and corruption, and infrastructure. There have been numerous calls for improved transparency in the public sphere. The finance ministry has acknowledged that corruption diverts a large share – about one third – of the national budget, leaving fewer resources for the targeted communities. The country scored 2.1 out 10 on a scale from 10 (highly clean) to 0 (highly corrupt) on the 2010 Corruption Perception Index calculated by Transparency International. Kenya ranks 154th out of 178 countries.

Social Context and Human Resource Development

Modest progress has been made towards achieving most of the Millennium Development Goals (MDGs). The country is considered off-track when it comes to eradicating extreme poverty (MDG 1) by 2015 though the percentage of population below the poverty line did drop from 56.0% in 2000 to 46.9% in 2008/09. High inflation rates between 2003 and 2009 have eroded the purchasing power of the population, dramatically affecting the poor and most vulnerable. Persistent poverty and unemployment, particularly among youth, remain major challenges.

Kenya's Human Development Index (HDI), where 0 is the lowest score and 1 the highest, has increased from 0.464 in 2009 to 0.470 in 2010, compared with 0.389 in sub-Saharan Africa and 0.624 in the world. The country belongs to the group of those where human development is low ranking, 128th out of 169 countries. The Youth Development Index (YDI) evaluates the degree of inclusion and social integration of youth in education, health and income. Kenya's YDI is slightly above its HDI at 0.5817 in 2009. Looking at the composition of this index, income appears to be the major challenge with Kenya's Youth Income Index at 0.44. To address the issue of youth being unemployed and lacking skills, the government has formulated the National Youth Policy and established the National Youth Council.

Kenya is very likely to achieve universal primary education (MDG 2) by 2015 with an adult literacy rate of 73.6% in 2010 and a combined gross enrolment ratio in education of 59.6%. The number of mean years of schooling for adults is 7 years and expected years of schooling of children is 9.6 years. To improve access to quality education, the government invested in free primary education and free tuition in secondary schools in 2009/10 and plans to allocate an additional KES 2 billion to these programmes in 2010/11. Kenya could possibly achieve MDG 3 – to promote gender equality and empower women – if some changes are made. The new constitution affirms the right for men and women to be treated equally and benefit from equal opportunities. As part of the new constitution, each one of the 47 counties will elect a woman MP. As a result, at least 16% of all members of parliament will be women. This represents an improvement from the 2007 elections where only 15 women were elected as members of parliament.

Kenya made progress towards reducing child mortality (MDG 4) even though it probably will not be sufficient to achieve this goal fully by 2015. Infant mortality has been significantly reduced – from 77 per 1 000 live births in 2003 to 52 per 1 000 in 2009 – and immunisation coverage increased to 77% in 2008/09 from 57% in 2003. When it comes to improving maternal health (MDG 5), Kenya's maternal mortality rates actually worsened between 2003 and 2008/09, reaching 488 per 100 000 in 2008/09. Major progress is needed to get Kenya back on track.

Despite the progress achieved towards combating HIV/AIDS and malaria (MDG 6), these diseases remain major issues for Kenya. The overall prevalence of HIV in Kenya was estimated to stand at 7.4% among persons aged 15-64 in 2008. Prevalence among women in this group was 8.7% while among men the rate was 5.6%. It was estimated that Kenya has 1.33 million Kenyan adults infected with HIV. Since 2007, malaria has remained the most common and severe ailment in terms of morbidity and mortality. It currently accounts for 20% of all admissions to health facilities in Kenya. Malaria was estimated to cause 20% of all deaths in children under the age of 5 in 2010. Out of a population of 39 million Kenyans, 25 million are currently at risk of getting malaria.

Health care provision in Kenya is a central theme in the government's social sector expenditure. Public expenditure on health has increased significantly since the fiscal year 2007/08. It increased from KES 23.8 billion in 2007/08 to KES 30.5 billion in 2009/10. However, the provision of health services in Kenya remains generally suboptimal. It is currently estimated that 50% of health facilities lack electrical power, water and sanitation services. The doctor-patient ratio is 17 per 1 000 while the nurse-patient ratio is 120 per 1 000. Preliminary results for the Kenya health and demographic survey (KHDS), released in 2009, indicated that the total fertility rate for Kenyan women aged between 15 and 49 declined from 8.1 in 1975 to 4.6 in 2008. In its 2010/11 budget, the government planned to allocate KES 1 billion for the recruitment of 15 additional nurses and 5 public health technicians in each constituency.