

Kenya Business Forecast Report Q3 2014

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Abstracts

Core Views

A wave of small-scale terrorist attacks shows that the Kenyan security services are unable to prevent Somali-based al-Shabaab from operating in Mombasa. Another large-scale attack, especially in Nairobi, would have a devastating effect on investor confidence.

Over the longer term, sharp ethnic divisions pose a serious threat to political stability in Kenya. Political parties are mostly organised along ethnic lines, and it remains possible that future elections could lead to a crisis such as the one seen in 2007-2008.

Economic growth in Kenya is still accelerating, but rising headwinds have caused us to lower our 2014 real GDP growth forecast from 6.0% to 5.7%. Economic expansion will average 6.0% between 2014 and 2018, faster than in recent years but slower than in many African countries.

Inflation has remained constrained in the first half of 2014, but we expect it to pick up in the second half of the year due to rising food prices. Price growth will likely remain relatively moderate, but a worse-than-expected harvest could cause inflation to spike.

Questions regarding the accuracy of Kenyan official data have led us to revise our 2014 current account deficit forecast from 8.7% of GDP to 7.6%. Lower oil prices and strong export growth will see the shortfall shrink, though a poor harvest could boost imports and prevent this.

Faster economic growth and lower capital spending will cause Kenya's fiscal deficit to narrow over the coming years. We predict that the country's budget shortfall will be equivalent to 7.5% of GDP in 2013/14.

Kenya's GDP will double in US dollar terms between 2014 and 2023 as growth accelerates and the currency remains relatively stable. The country will benefit greatly from its role as the economic and commercial hub of the fast-growing East African Community.

Major Forecast Changes

We have downwardly revised our real GDP growth forecasts due to poor figures from Q3 2013, the last period for which official data is available.

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Security Situation Will Remain Tense

Kenya's anti-terrorism efforts remain weak and poorly coordinated, and we doubt that the country's security services would be capable of preventing another spectacular attack by al-Shabaab, which would have significant negative implications for tourism and foreign investment. A draconian crackdown also risks further alienating the country's Muslim population.

Table: Political Overview

Long-Term Political Outlook

Ethnic Polarisation Remains Key Challenge

Despite the terrorist attack on the Westgate shopping centre, the politicisation of sharp ethnic divisions remains the key threat to Kenya's long-term political stability. Although the 2013 elections were peaceful, voting patterns show that the electorate continues to cast ballots according to ethnicity. Meanwhile, President Uhuru Kenyatta, elected in 2013, is facing charges at the International Criminal Court. This will complicate the country's relations with the West. Terrorism linked to Kenya's military involvement in Somalia is likely to remain a risk, but it does not pose a systemic threat to political stability.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Accelerating Growth Faces Significant Headwinds

Real GDP growth is accelerating in Kenya, but the speed of the country's economic recovery is slowing due to weaker consumption growth and a persistent trade deficit.

We have downgraded our 2013 economic growth estimate from 5.4% to 5.2% and our

2014 forecast from 6.0% to 5.7%, but stress that even this slower rate of growth is a significant improvement compared to the performance seen in recent years.

Table: GDP BY EXPENDITURE

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Inflation To Pick Up In H214

March 2014 consumer price inflation figures show that price growth in Kenya is slowing, in line with our view that inflation will remain constrained in the first half of the year. We maintain the view, however, that higher food prices will pull inflation higher in H2 2014.

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Balance Of Payments

Data Revisions, Lower Oil Imports Drive Narrower Current Account Deficit

Concerns over the accuracy of Kenyan official data have led us to revise our 2012 and 2013 balance of payments figures, narrowing the current account deficit in both years. These changes do not affect our core view, which is that lower oil import bill will reduce Kenya's trade deficit over the coming years, leading to a smaller current account shortfall.

Table: CURENT ACOUNT

Fiscal Policy

Accelerating Economy, Lower Capital Spending To Trim Deficit

Kenya's fiscal deficit will narrow over the coming years, from 7.5% of GDP in 2013/14 to 7.0% in 2018/19. This forecast assumes that economic growth accelerates and that the president succeeds in restraining wage costs; risks are weighted towards a slower fiscal adjustment.

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Solid Foundations Spur Broad-Based Economic Growth

We expect that Kenya's economy will more than double in US dollar terms between 2014 and 2023, with annual real GDP growth averaging 6.0%. The economy is highly diversified, and serves as the commercial core of the fast-growing East African Community.

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