MACROECONOMIC REPORT QUARTER 1 JULY 2024

KMRC

KENYA MORTGAGE REFINANCE COMPANY

ABOUT KENYA MORTGAGE REFINANCE COMPANY

The Kenya Mortgage Refinance Company is a non-deposit taking financial institution established in 2018 under the companies Act 2015. Its mandate is to provide long-term funds to primary mortgage lenders (PMLs) for purposes of increasing availability of affordable home loans to Kenyans. KMRC provides concessional, fixed, long-term finance to the primary lenders who include Banks and Saccos so that they can transfer the same benefits to 'wananchi', making home loans more accessible to especially the moderate to low-income earners in the country.

By increasing the supply of affordable housing finance, KMRC acts as a key lever in the push to increase homeownership in Kenya. Noting that Kenya's mortgage market remains underpenetrated, relative to the potential demand for home ownership, KMRC recognizes the upside potential and the downside risks of facilitating home ownership to the moderate to low-income earners.

KMRC's vision and mission:

Vision:
To sustainably promote home ownership

Mission:
To increase affordability of home loans through refinancing

KMRC is regulated by the Central Bank of Kenya (CBK), with the Capital Markets Authority (CMA) providing oversight over its bond issuance operations.

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ABBREVIATIONS

AEs	Advanced Economies
BETA	Bottom-up Economic Transformation Agenda
CBK	Central Bank of Kenya
CBR	Central Bank Rate
EAC	East African Community
EMDEs	Emerging Markets and Developing Economies
GDP	Gross Domestic Product
IMF	International Monetary Fund
FY	Financial Year
KNBS	Kenya National Bureau of Statistics
KMRC	Kenya Mortgage Refinance Company
NHC	National Housing Corporation
NPLs	Non-Performing Loans
PMI	Purchasing Manager's Index
SDHUD	State Department for Housing & Urban Development
SSA	Sub-Saharan Africa
US	United States
WB	World Bank

ABOUT THIS REPORT

The first quarter of the 2024 edition of the KMRC Economic Report analyzes through a historical lens the macroeconomic developments in the global, regional, and domestic environment. This edition of the report specifically casts a spotlight on the economic growth, financial market developments, labor market developments as well as the fiscal and monetary policy developments.

In doing so, it provides implications of these dynamics on the economic outlook as well as the business conditions underpinning the conduct of business operations at KMRC.

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EXECUTIVE SUMMARY

- The global economy's growth remains steady with the global GDP in 2023 growing at 3.2% and is projected to steady at 3.2% in 2024 and 2025. Global trade continued to deteriorate but expected to gain momentum. A sustained worsening of global geopolitical tensions, however, portends constraints to the global economy's growth.

- Sub-Sahara Africa's growth remains resilient despite the multiple and overlapping shocks and its trajectory expected to gain momentum. Sub-Saharan Africa (SSA) registered a 3.3% growth in 2023, compared to 4.1% in 2022 and is projected to rebound back to 3.8% and 4.0% in 2024, and 2025 respectively

- Economies of the East African Community (EAC) countries registered mixed performance. The EAC economic bloc recorded a slower growth rate of 1.9% in 2023 compared to 4.5% growth recorded in 2022.

- Kenya's economic growth remained resilient, negative global spillover effects notwithstanding. Real Gross Domestic Product (GDP) expanded by 5.6% in 2023, a cyclical rebound from the 4.9% growth registered in 2022. Agriculture remained the dominant sector in 2023. The economy growth is expected to remain resilient, bolstered by strong service-sector performance and favorable agricultural output. The balance of risks to the economy's outlook is titled on the upside.

- The Construction sector has maintained steady growth over the years, but the sector's inflationary pressures continued to subdue. Annual inflation for the construction sector in 2023 stood at 4.16%, a significant decline from the 7.10% recorded in 2022. The sector's growth will further be bolstered by the rapid urbanization, population growth, increased demand for better housing and continual infrastructure development.

- Inflationary pressures have eased as monetary policy has remained tight. The monetary policy stance of the Central Bank of Kenya (CBK), in 2023, focused on taming rising inflationary pressures and anchoring inflationary expectations has paid off. The monetary policy tightening, however, has not been without trade-offs. In the real sector, the tightening has amplified domestic imbalances and fragilities but while associated with trade-offs on the domestic front, has had positive external sector effects. The current account deficit has benefited from a real exchange rate adjustment in 2023.

- Kenya's debt is growing as external debt continues to trend upwards. Kenya's public debt burden is high at 72% of GDP in 2023, with external debt at 52.2% and domestic debt at 47.8% as of March 2024. The tax revenue administration and collection continue to, but fragilities still exist. To achieve the reduction in deficit, and address the fragile fiscal situation calls for interventions on spending and revenues mobilization.

MACROECONOMIC CONTEXT

Global macroeconomic developments

• The global economy's growth remains steady, (Figure 1).
In Global GDP growth in 2023 stood at 3.2% and is projected to steady at 3.2% in 2024 and 2025, according to the International Monetary Fund (IMF). The global economy has been resilient despite the significant monetary tightening by central banks in Advanced Economies (AE) to rein on heightened inflationary pressures, restrictive credit conditions, and muted global trade and investment. World inflation eased to 6.8% in 2023 from 8.7% in 2022 partly due to lower energy prices, easing of the supply chain disruptions and a tighter monetary policy to reduce aggregate demand for goods. As a result of the elevate policy rates in the United States (US), and other Advanced Economies (AEs), interest rates have remained hinger-for-longer, and this is occasioned capital reversals across Emerging Markets and Developing Economies (EMDEs). If interest rates stay elevated this could create strains in the global financial system. Notably, in EMDEs, it could pose further challenges in their debt-servicing capacity.

• Global trade continued to deteriorate but expected to gain momentum (Figure 2).
In 2023, global trade volume decelerated to 0.4% compared to the 5.2% growth recorded in 2022. This deceleration was mainly due to base effects as the economy recovered from the COVID-19 pandemic coupled with appreciation of the US dollar and escalation of trade barriers, which further impeded the overall growth.

• Labor markets globally continued to be tight (Figure 3).
In 2023, the global unemployment rate declined to 5.1% from 5.3% in 2022. The decline in the unemployment rate was a result of the expansion of employment opportunities, especially in the advanced economies.

• A sustained worsening of global geopolitical tensions, however, portends constraints to the global economy's growth.
Increased geopolitical fragmentation is detrimental to the global economy's outlook as it would lead to broad-based adverse spillovers to Emerging and Developing Economies (EMDEs). Specifically, heightened geopolitical tensions or policy uncertainty arising out of the conflict in Middle East and Russia's ongoing war against Ukraine could reduce economic activity, boost inflation, and heighten volatility in financial markets while resulting in disruptions to energy and commodity markets and global value chains.

[1] **IMF World Economic Outlook (April 2024):** Steady but Slow: Resilience amid Divergence https://www.imf.org/en/Publications/WEO/Issues/2024/04/16/world-economic-outlook-april-2024

[2] **World Bank (June 2024):** Global Economic Prospects. https://openknowledge.worldbank.org/-server/api/core/bitstreams/6feb9566-e973-4706-a4e1-b3b82a1a758d/content

Figure 1. Global growth performance is expected to be subdued

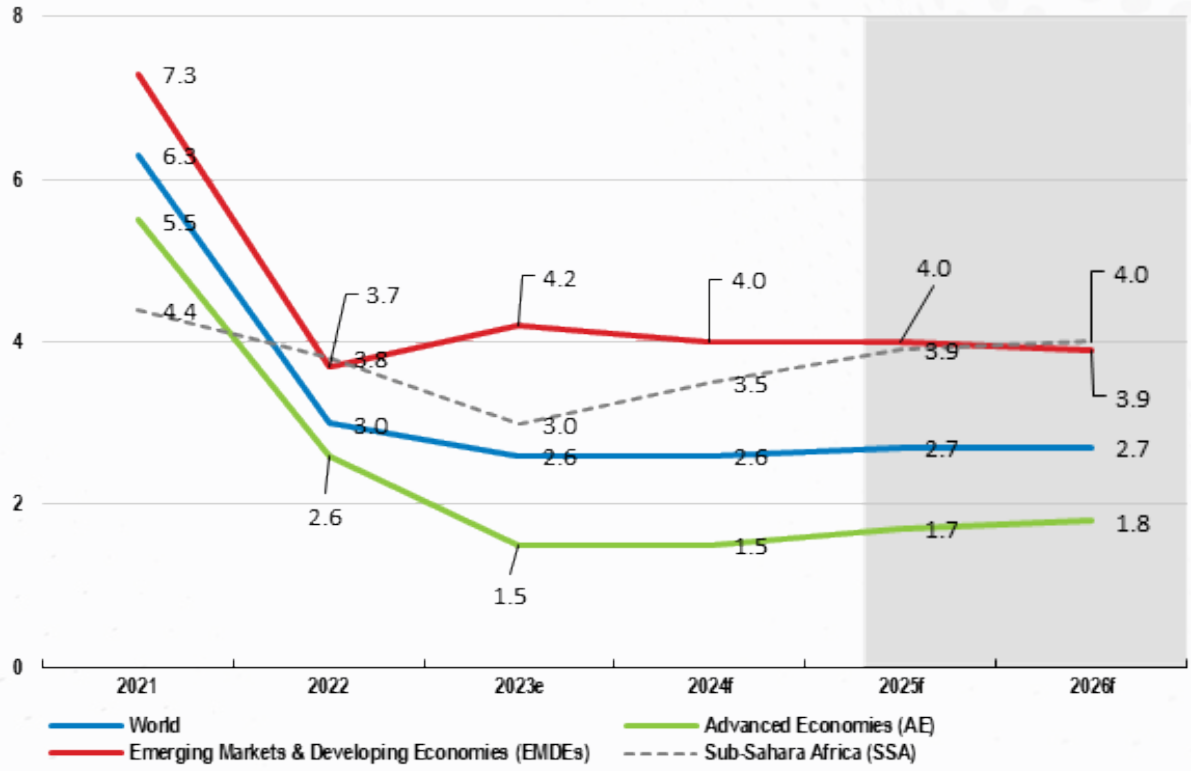
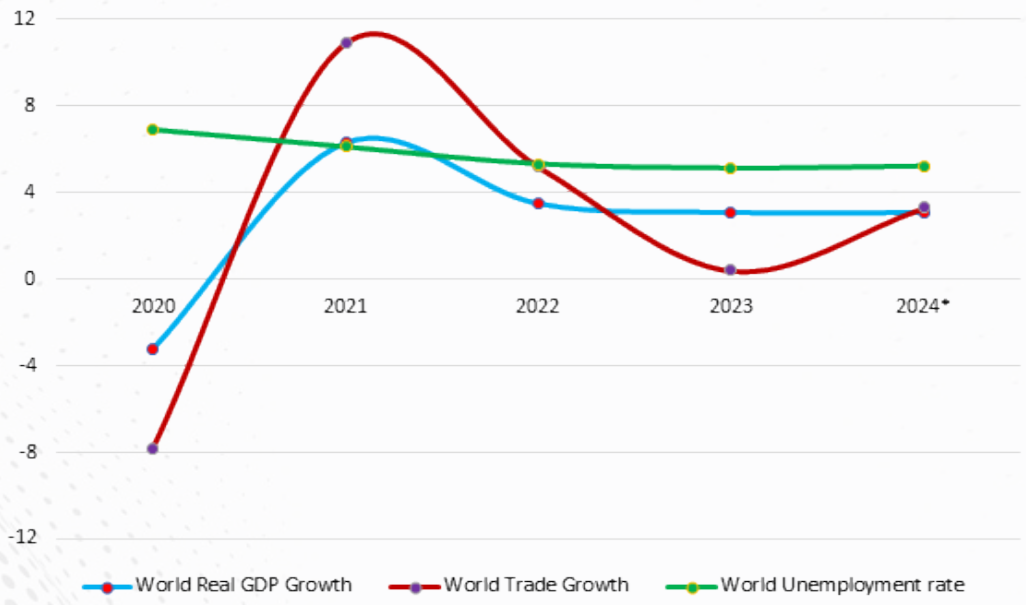


Figure 2. Growth of real GDP, unemployment and trade performance, 2020–24



Source: IMF WEO, KNBS Economic Survey 2024, KMRC Research 2024, *Projections

REGIONAL MACROECONOMIC DEVELOPMENT

Sub-Sahara Africa's growth remains resilient despite the multiple and overlapping shocks and its trajectory expected to gain momentum. Sub-Saharan Africa (SSA) registered a 3.3% growth in 2023, compared to 4.1% in 2022 . Underlying the decline the region's growth in 2023 was on account of the slower growth rate in the region's three largest economies: Nigeria, South Africa, and Angola owing to the muted global growth, unfavorable weather conditions, and the supply chain disruptions. Even so, more than half of African countries (31) had higher real GDP growth rates in 2023 than in 2022. SSA's growth is, however, projected to rebound back to 3.8% and 4.0% in 2024, and 2025 respectively highlighting the strong resilience of African economies. The outturn, nonetheless, will be significant heterogeneity across the respective economies reflecting the structural divergences of the African countries.

Inflation pressures remain elevated in Sub-Sahara Africa. The inflation rate, in SSA, is estimated to have increased by 300 basis points to 17% in 2023 from 14% in 2022 on account of higher food prices, liquidity constraints and the pass-through effects of currency depreciations against the dollar.

Some large economies in the region such as Ghana, Ethiopia and Nigeria had high inflation rate which led to an increase in the overall inflation rate in the region. Although the inflation rate increased in the SSA region, over 40 % of the countries in the region witnessed a decline in inflation.

Economies of the East African Community (EAC) countries registered mixed performance. As a bloc, the EAC recorded a slower growth rate of 1.9% in 2023 compared to 4.5% growth recorded in 2022. This deceleration was partly attributed to a combination of external factors, such as fluctuations in commodity prices and budget challenges as well as a larger-than-expected contractions in Sudan and South Sudan due to the ongoing conflict in the former. However, the East African Community's economy is projected to accelerate bounce back to grow at 4.9% in 2024 and further to 5.7% in 2025 thus becoming Africa's faster growing region. In the East African Community (EAC), inflationary pressures have subdued. The Inflation rate eased from 7.1% in 2022 to 6.8% in 2023.

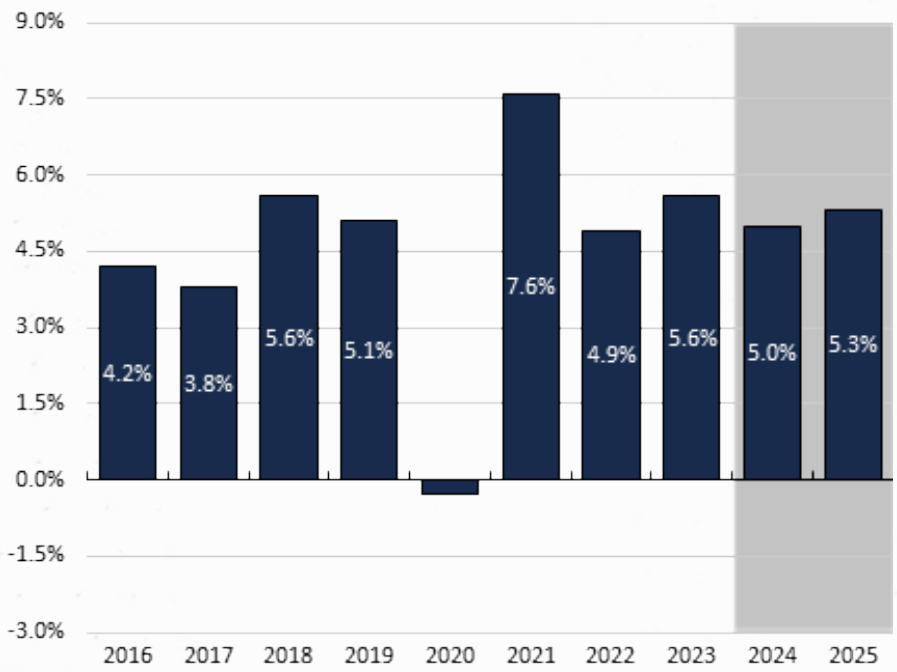
[3] **AfDB African Economic Outlook (AEO) 2024**
https://www.afdb.org/en/documents/african-economic-outlook-2024

KENYA'S ECONOMIC GROWTH TRAJECTORY

Kenya's economic growth remained resilient, negative global spillover effects notwithstanding. Real Gross Domestic Product (GDP) expanded by 5.6% in 2023, a cyclical rebound from the 4.9% growth registered in 2022 **(Figure 3)**.

Nominal GDP grew by 12.0%, reaching KES. 15,108.8 billion in 2023, from KES. 13,489.6 billion in 2022. The growth was broad based, as most sectors of the economy registered robust growth.

Figure 3. Kenya's economic growth has proved resilient



Source: KNBS Economic Survey 2024, KMRC Research 2024

Agriculture remained the dominant sector in 2023. Notably, this growth was supported by growth in the agriculture and services sector but dampened by the contraction of the industrial sector due to low investments and productivity in the sector **(Figure 4)**. The agricultural sector accounted for 21.8% of the total GDP. The services sector contributed 61.3% of the GDP while industry-related sector comprised 16.9% of the GDP. At a granular sectoral perspective, the key drivers of the growth included information & communication(9.3%), transportation and storage (6.2%), financial and insurance (10.1%), real estate (7.3%) and accommodation and food service activities (33.6%) sectors. However, the mining and quarrying sector recorded a 6.5% contraction. Further, private and government final consumption significantly accounted for more than three-quarters of the total GDP **(Figure 5)**. The latter, however, is projected to decrease, aligning with the government's efforts for more significant fiscal consolidation to stabilize the overall public debt-to-GDP ratio in 2024

[4]**KNBS (May 2024). Kenya Economic Survey 2024:** https://www.knbs.or.ke/wp-content/uploads/2024/05/2024-Economic-Survey.pdf

Figure 4. Sectoral Drivers of Economic Growth

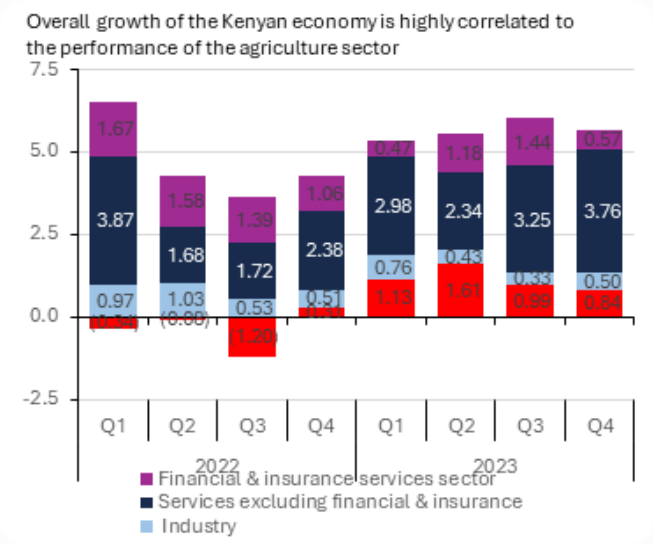
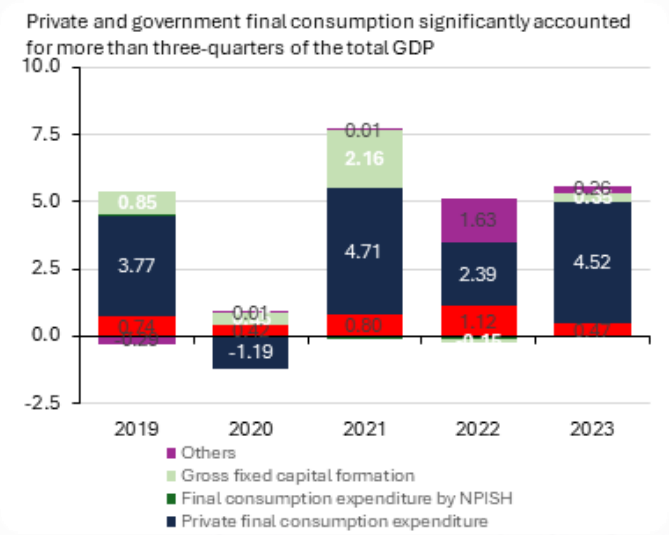


Figure 5. Drivers of Economic Growth



Source: KNBS Economic Survey 2024, KMRC Research 2024

The economy growth is expected to remain resilient, bolstered by strong service-sector performance and favorable agricultural output. The economy is projected to grow at 5.0%, according to the World Bank and the IMF . Moreover, the leading economic indicators, particularly the Purchasing Manager's Index (PMI) further indicates a continued sustenance of the strong performance of the economy in the first quarter of 2024, on account of robust activities in the agriculture and service sectors, particularly accommodation and food services, as well as information and communication . The PMI reading for May 2024 stood at 51.8 compared to 50.1 in April, the highest since January 2023.

The balance of risks to the economy's outlook is titled on the upside. Downside risks to the outlook could stem primarily from a lackluster global economic performance and adverse domestic agricultural conditions, low private-sector credit growth, and the threat of uneven weather patterns on agricultural output. Moreover, the tight fiscal stance being pursued by the Government may also lead to tight liquidity affecting aggregate demand. Externally, escalation of geopolitical tensions conflicts could result in higher commodity prices which would pose a risk to domestic inflation outcomes. Similarly, the volatile global financial markets, and external trade uncertainties potentially pose downside risks to the outlook.

[5] **World Bank (June 2024).** Kenya Economic Update - Fostering Trade for Robust Growth and Dynamic Job Creation (English). Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/099060424051072317/P1797691bf301a04d1a4b6114cf28701d1e

[6] **IMF (June 2024).** Staff-Level Agreement with Kenya on Seventh Reviews of the Extended Fund Facility and Extended Credit Facility Arrangements and the Second Review Under the Resilience and Sustainability Facility https://www.imf.org/en/News/Articles/2024/06/10/pr-24213-kenya-agreement-on-7th-reviews-of-eff-and-ecf-arrangements-and-2nd-review-under-rsf

[7] **Stanbic Bank & IHS Markit (June 2024):** Purchasing Manager's Index Report for May 2024 https://www.stanbicbank.co.ke/kenya/personal/news-and-insights/stanbic_kenya_pmi_may_2024

2.1. CONSTRUCTION SECTOR PERFORMANCE

The Construction sector has maintained steady growth over the years. The construction sector registered a growth of 3.0% in 2023 compared to a growth of 4.1% in 2022 602.7 billion in 2023 **(Figure 6).** Credit to construction sector increased by 7.2% to KES. 602.7 billion in 2023. The growth was supported in part by an increase in government expenditure on roads and the number of residential buildings completed by the State Department for Housing and Urban Development (SDHUD). The growth, however, was suppressed by the deceleration in the consumption of key inputs in the construction industry such as cement consumption and volume of imported iron and steel, cement clinkers and non-ferrous metals. The sector's inflationary pressures continued to subdue.

Annual inflation for the construction sector in 2023 stood at 4.16%, a significant decline from the 7.10% recorded in 2022.

The number of residential buildings continues to increase sizably but lags the demand. The supply of residential buildings completed in Nairobi County increased to 18,084 **(Figure 7).** On the other hand, the State Department of Housing and Urban Development (SDHUD) completed 3,357 residential housing units in 2023. As a result, the value of completed residential housing units by the SDH increased from KES.1,761.0 million in 2022 to KES. 11,000.3 million in 2023. Moreover, the National Housing Corporation (NHC) completed 164 residential buildings in 2023.

Figure 6. Construction Sector Growth Rate

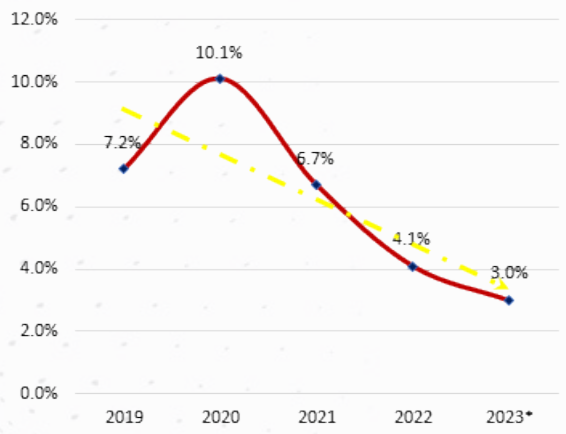
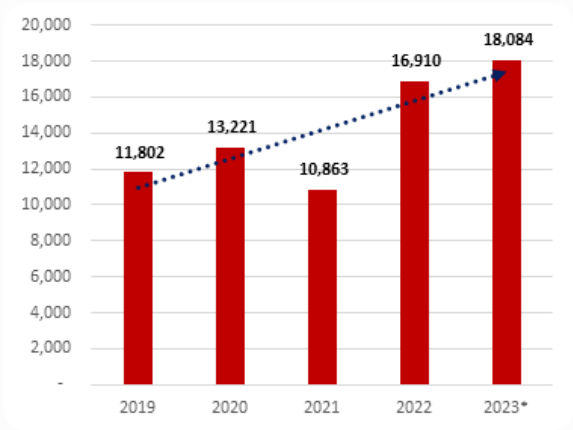


Figure 7. No of Residential Buildings



Source: KNBS Economic Survey 2024, KMRC Research 2024

The sector's growth will further be bolstered by the rapid urbanization, population growth, increased demand for better housing and continual infrastructure development. The growth trajectory of the construction sector is expected to remain below the average growth rate of 8.2% observed during 2019–21. With the ongoing implementation of the Bottom-up Economic Transformation Agenda (BETA) and the focus on the Affordable Housing Program, notable milestones in the construction of residential buildings can be discerned. However, following sluggish performance in 2023 attributed to a decline in building permits, construction activity is projected to modestly increase in 2024.

[8] **CBK (June 2024). Monetary Policy Communique**
https://www.centralbank.go.ke/uploads/mpc_press_release/32649240_MPC%20Press%20Release%20-%20Meeting%20of%20June%205%202024.pdf

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The Best-Kept Secret about Home Loans in Kenya.

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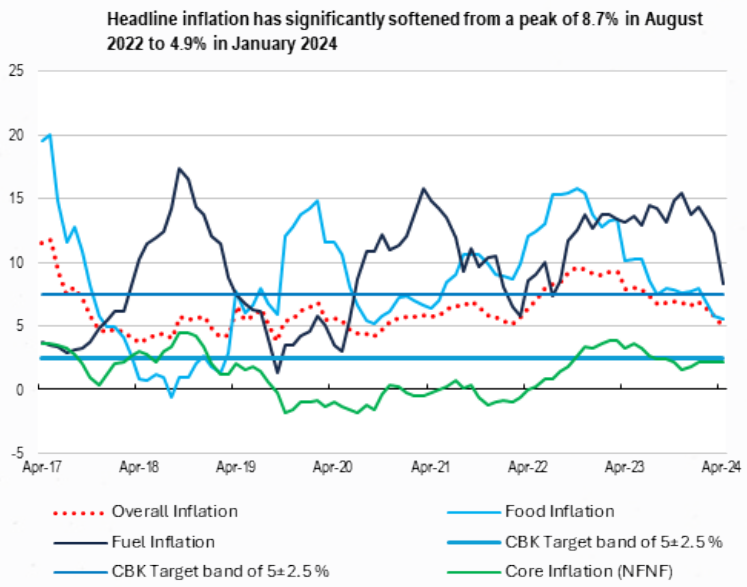
3. INFLATION, INTEREST RATES & MONETARY POLICY DYNAMICS

Inflationary pressures have eased as monetary policy has remained tight. The monetary policy stance of the Central Bank of Kenya (CBK), in 2023, focused on taming rising inflationary pressures and anchoring inflationary expectations has paid off **(Figure 8).** With the Central Bank Rate (CBR) increased by a cumulative 425 basis point increase from 8.75% in January 2023 to 13% currently, the highest level in more than 10 years, inflation receded to a two-year low of 5.7% in March 2024, and further subsided to 5.0% and 5.1% in April and May 2024, respectively. The deceleration of headline inflations has been on account of a significant decline in both food and fuel inflation which declined to 6.2% and 7.8% in May 2024 from 5.6% and 8.3% in April 2024 respectively. Core inflation, however, remains sticky. In May 2024, inflation waned to 3.4% from 3.6% in April, reflecting muted demand pressures and continued impact of monetary policy action.

Figure 8. Inflation and monetary policy dynamics, 2017-2024



Source: Central Bank of Kenya (CBK), KMRC Research 2024

The monetary policy tightening, however, has not been without trade-offs.
In the real sector, the tightening has amplified domestic imbalances and fragilities.

- First, financial market interest rates have risen significantly as monetary policy transmits through the economy. The average commercial bank's interest rate for loans and advances rose to 14.63% in 2023, from 12.67% as of December 2022 **(Figure 9).**
- Second, and related to the first, the growth in credit to the private sector is subdued. In 2023, the total domestic credit recorded a growth of 12.7% to KES. 7,041.1 billion compared to a growth of 12.2% in 2022 **(Figure 10).** As of April 2024, the growth in bank lending to the private sector had shrunk further to 6.6% on account of the reflecting exchange rate valuation effects on foreign currency denominated . Whereas growth of the local currency denominated loans remained resilient to grow at 14.3% in April 2024, foreign currency denominated loans which accounts for 26% of the total banking sector loans contracted by 14.2%.

Figure 9. **Evolution of Commercial Bank Rates, 2000-24**

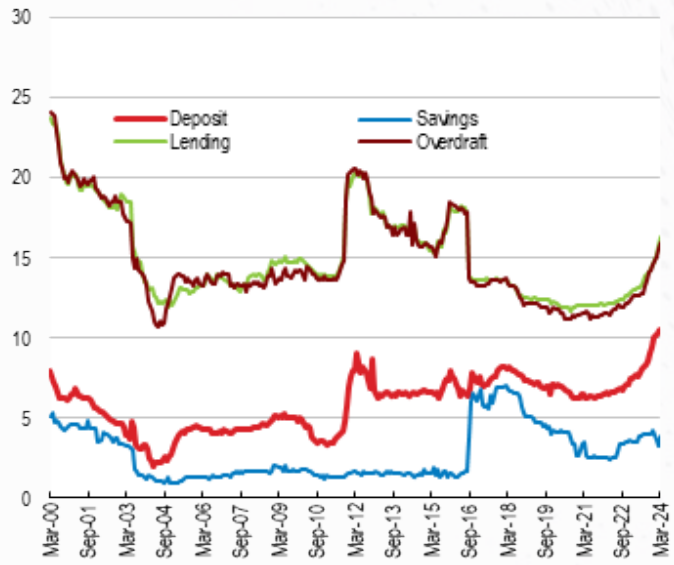
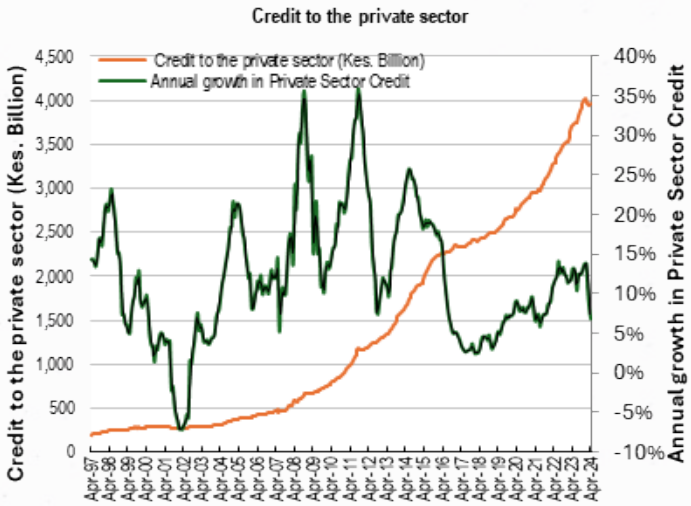


Figure 10. **Evolution of Credit to the Private Sector, 1997-24**

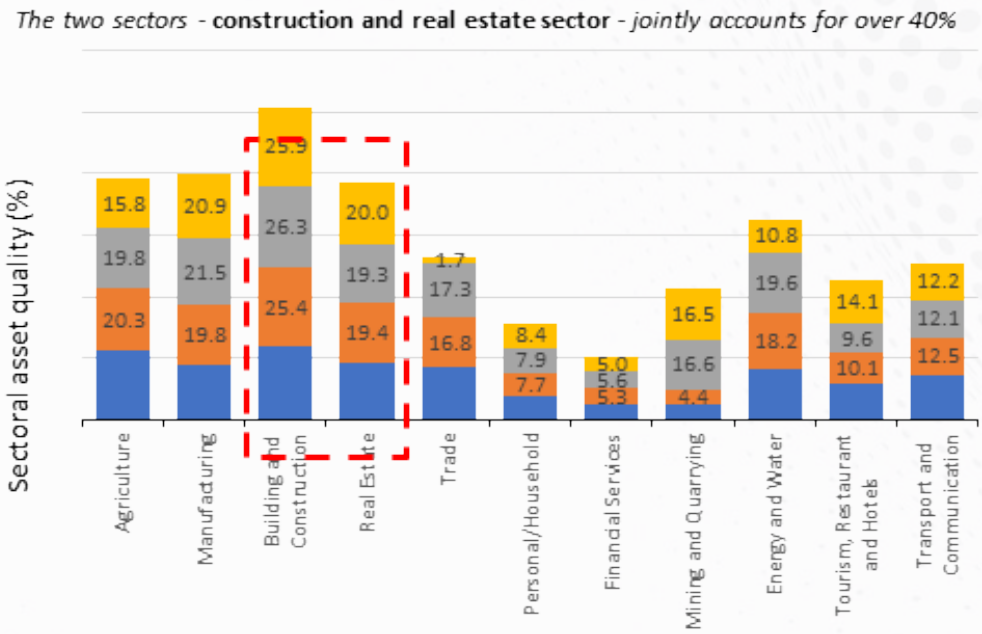


Source: KNBS Economic Survey 2024, KMRC Research 2024

Third, asset quality has deteriorated further. Asset quality has remained elevated with the ratio of gross non-performing loans (NPLs) to gross loans at 16.1% in April 2024 compared to 15.5% in February. The credit quality weakening has been driven by increases in non-performing loans in several sectors, notably, agriculture, real estate, tourism, restaurant and hotels, trade and building and construction sectors. Based on the latest available sectoral asset quality data, the construction and real estate sector is the significant driver of asset quality deterioration. The two sectors jointly account for over 40% of the banking sectors stock of non-performing loans **(Figure 11).**

[8] **CBK (June 2024). Monetary Policy Communique**
https://www.centralbank.go.ke/uploads/mpc_press_release/32649240_MPC%20Press%20Release%20-%20Meeting%20of%20June%205%202024.pdf

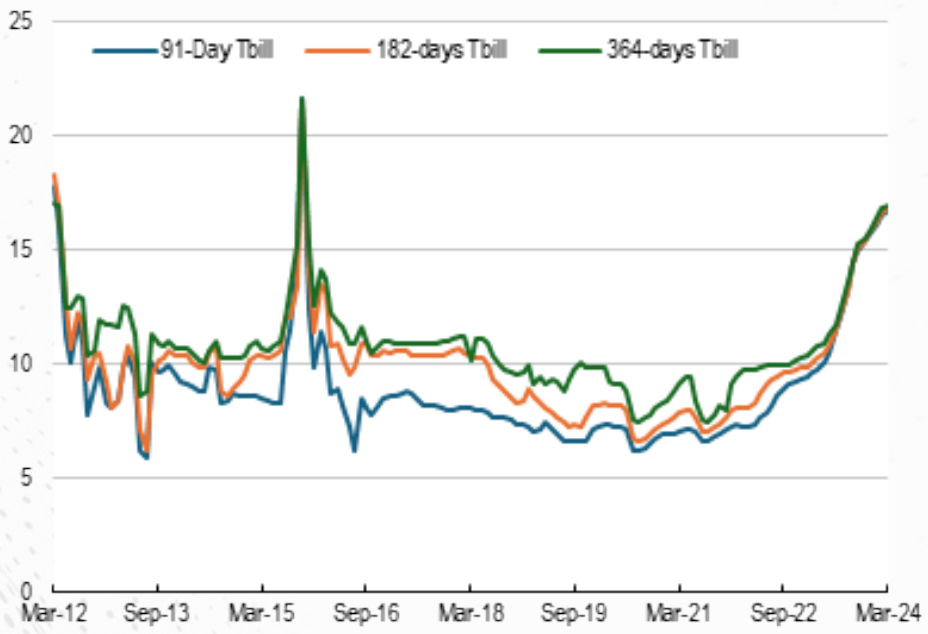
Figure 11. **Sectoral evolution of asset quality, 2023**



Source: Central Bank of Kenya (CBK), KMRC Research 2024

Fourth, treasury yields have substantially increased, albeit signs of easing are evident. The overall interest rates increased for the 91-day Treasury Bill rates stood at 15.97% as of June 13th, 2024, easing slightly compared to 16.68% in March 2024. Similarly, the 182-day Treasury Bill rates at 16.7% as of June 13th, 2024, have also eased compared to 16.9% in March 2024. The longer-tenor Treasury Bill rates, that is one-year (i.e. 364-days) stood at 16.98% in March 2024, and has further stabilized 16.8% as of June 13th, 2024 **(Figure 12).**

Figure 12. **Yields on Government Securities, 2012-24**



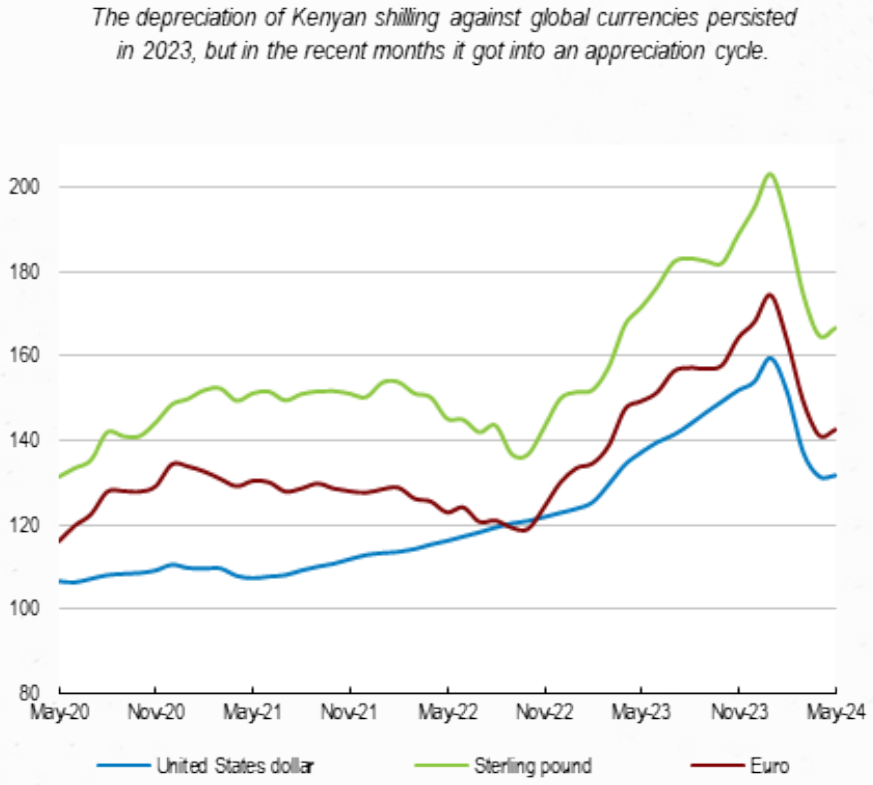
Source: Central Bank of Kenya (CBK), KMRC Research 2024

The monetary policy, while associated with trade-offs on the domestic front, has had positive external sector effects. The tightening has also played a significant role in stabilizing the foreign exchange, and therefore reducing the current account deficit position.

•The Kenyan shilling exchanging at KES. 130.2 as at May 2024 **(Figure 13),** and this has been critical in reducing the pass-through effects of depreciation on inflation, and management of the elevated debt to be rebuilt.

positions. In addition, the foreign exchange reserves, which stood at USD 7,012 million (3.7 months of import cover) as of June 13, 2024 as Kenya secured financial resources to manage its maturing debt in 2024. The stock of reserves continues to provide buffer against any short-term shocks in the foreign exchange market and they continue to bolster confidence in Kenya's currency. However, it falls short of the 4-months imports cover and therefore calls for buffers to be rebuilt.

Figure 13. Bilateral exchange rates against the KES. for selected currencies



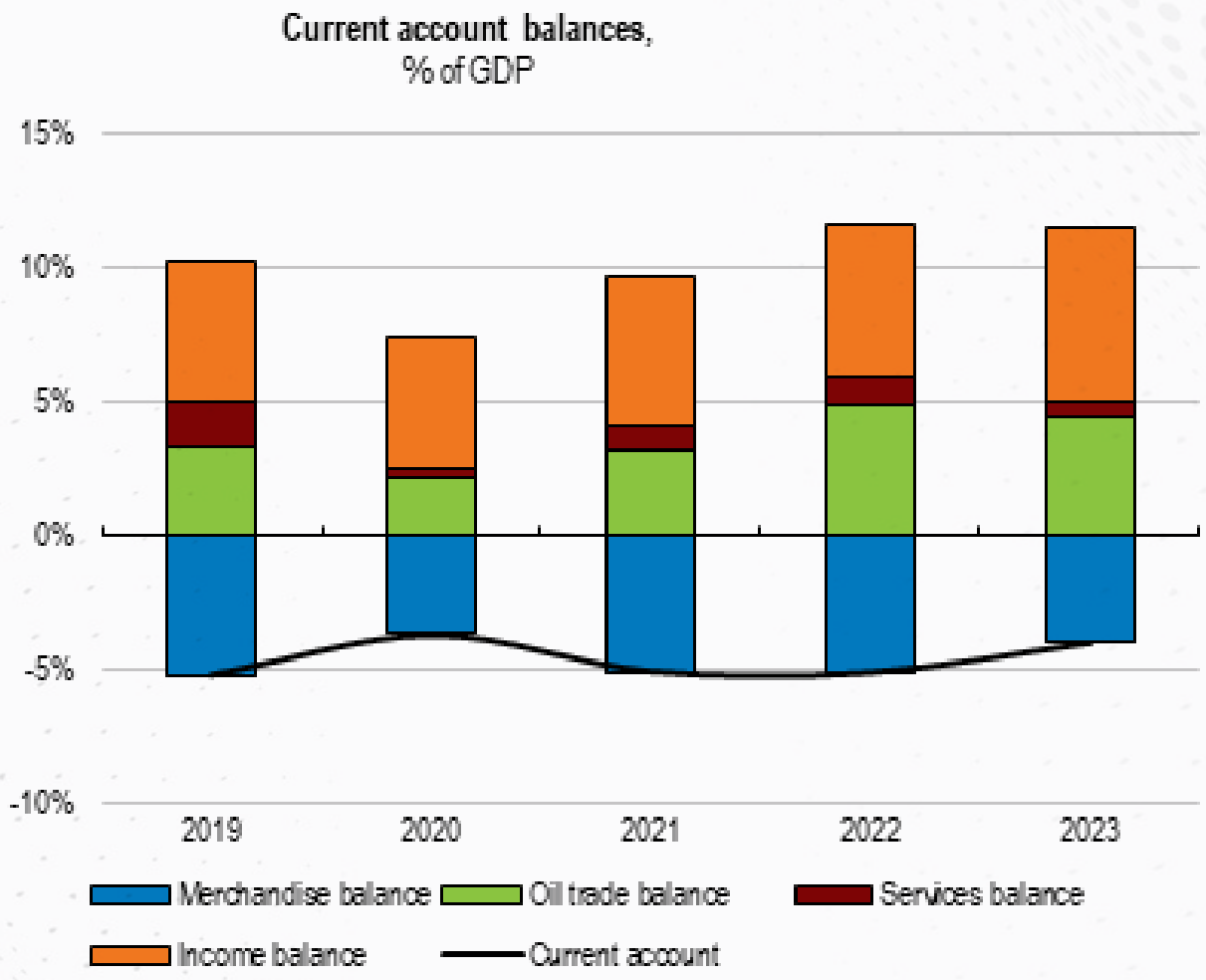
Source: Central Bank of Kenya (CBK), KMRC Research 2024

The current-account deficit has benefited from a real exchange-rate adjustment in 2023.

According to the CBK, the current account deficit in April 2024 stood at 4.1% of GDP down from 4.8% in a similar period of 2023 **(Figure 14)** and is expected to stabilize at 4.0% of GDP in 2024. The faster growth in merchandise exports compared to imports played and is expected to continue playing a crucial role in narrowing the current account deficit.

[9] **CBK Bulletin June 14, 2024.**
https://www.centralbank.go.ke/uploads/weekly_bulletin/1491790769_Weekly%20CBK%20Bulletin%20June%2014,%202024%20V2.3.pdf

Figure 14. **Current account balances, 2019–23**



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4. FISCAL POLICY, AND PUBLIC DEBT DYNAMICS

• **Kenya's debt is growing as external debt continues to trend upwards.** Kenya's public debt burden is high at 72% of GDP in 2023, with external debt at 52.2% and domestic debt at 47.8% as of March 2024.
The external debt structure is 51.4% multilateral, 22.9% bilateral and 25.4% commercial, leading to a high debt-servicing ratio; interest payments constitute 32% of revenue in 2024. Navigating the debt constraints calls for proactive liability management operations and is pegged on adherence to fiscal consolidation strategy.

• **The tax revenue administration and collection continue to, but fragilities still exist.** The tax-to-GDP ratio in Kenya increased to 18.9% in the FY 2023/24, a 2.4% increase from the 16.5% in FY 2022/23. In FY 2021/22, the tax-to-GDP ratio stood at 17.3% slightly higher than the 15.9% in FY 2020/21. In the H1 of FY2023/24, revenues have grown moderately, expanding by 13.4% in the first nine months of FY2023/24 compared to 10.6% growth in a similar period in FY2022/23. Income tax and VAT remained the major source of government revenue, accounting for 61.7% of total revenue including grants during this period. As a share of GDP, non-tax revenue experienced the largest increase reaching 2.1% of GDP against a target of 1.8% of GDP and previous year's level of 1.7%.

The fiscal deficit in FY 2023/24 stood at 5.6% of GDP, however, for the first time a primary surplus of 0.8% of GDP was recorded since FY 2022/23 supportive of the government's fiscal consolidation path. The fiscal deficit is expected to reduce from 5.7% of GDP in FY 2023/24 to 3.3% of GDP in FY 2024/25. Its success, however, is heavily dependent on the tax and spending reforms, along with measures that ensure a robust fiscal framework, given substantial fiscal pressures ahead. The fiscal deficit will be funded mostly by foreign borrowing and less domestic borrowing, and therefore this is expected to ease the domestic financial conditions.

• **To achieve the reduction in deficit, and address the fragile fiscal situation calls for interventions on spending and revenues mobilization.** Government seeks to put in place measures to broaden the revenue base and rationalize expenditures to reduce the fiscal deficits. The implementation of the reforms on revenue and expenditure is expected to result in reduction in the fiscal deficit including grants of 4.9% of GDP in the FY 2023/24 to 3.1% of GDP in the FY 2027/28. An approved expenditure of 3.914 trillion Kenyan shillings (22.6% of GDP) in FY 2024/25, up from 18% of GDP in the previous year with recurring spending consuming around 90% of revenue, limiting funds for development projects. Going forward, revenue collections are expected to rise to 20.2% of GDP in FY 2027/28 from 19.0% of GDP in FY 2023/24 while total expenditures are projected to reduce to 23.7% of GDP from 24.2% of GDP over the same period. However, tax revenues as of April 2024 (just three months prior to the end of the FY) are lagging government projections.

KMRC

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