Kenya – Business sentiment continues to improve

- **Kenyan business sentiment improved in October, rising 1.3%m/m to 64.7**
- **The three-month average improved to 61.5 compared to 58.1 the previous quarter**
- **Future expectations survey shows ongoing concerns about the outlook**

Summary

Business sentiment in Kenya, as measured by Standard Chartered-MNI Business Sentiment Indicator (BSI), increased by 1.3% m/m in October to 64.7. Gains were driven by order backlogs (up 10%), new orders (up 2.3%) and supplier delivery time (up 1.9%). The three-month average improved to 61.5 compared to 58.1 the previous quarter; and remains above the key 50 level, indicating economic expansion. This confirms our view that Kenya's growth momentum is robust. Indeed, increasing public investment in infrastructure as well as weaker oil prices are supportive factors (see *Country Briefing, 30 September 2015, Kenya – Rising cost of domestic borrowing*).

However, the BSI results confirm that risks to the outlook remain. Most indicators for future expectations declined (9 out of 15). Even though the Kenyan businesses surveyed were less concerned about the negative effect of the Kenyan shilling (KES) exchange rate as a constraint on business activity in October, they still saw the currency as a concern in the future. Despite hopes that a weaker exchange rate could lead to improved competitiveness, export performance has been disappointing. The infrastructure upgrade underway has yet to materialise into export growth acceleration.

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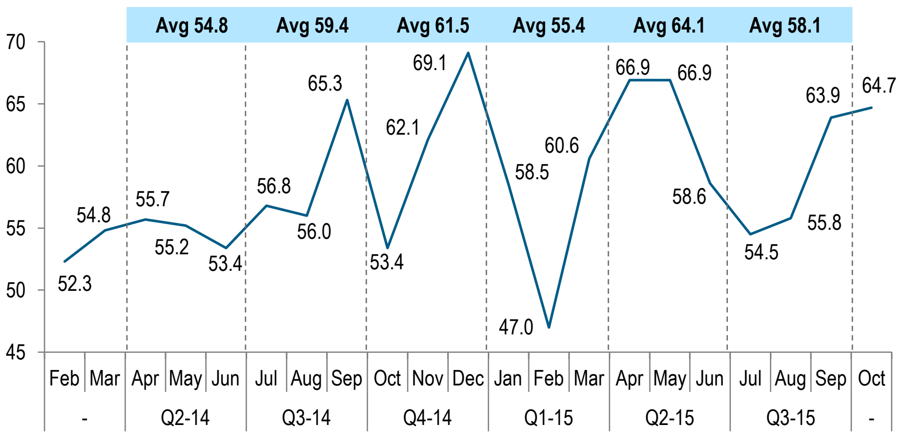
Figure 1: Kenya BSI improved to 64.7 in October

Standard Chartered-MNI Kenya Business Sentiment Indicator



Source: MNI, Standard Chartered Research

Also, in line with higher interest rates, Kenyan firms are more concerned about the availability of credit. In our view, higher market interest rates in Kenya remain a key macroeconomic concern. Earlier KES weakness necessitated aggressive tightening by the Central Bank of Kenya (CBK), which raised the policy rate a cumulative 300bps to 11.5% at two consecutive meetings in June and July. With liquidity unevenly spread within the banking system, and the government of Kenya facing a large borrowing requirement this year, market interest rates have faced increasing pressure. While high rates support the KES and are positive for the inflation outlook (we think inflation will remain in single digits, with headline inflation rising to just above 8% by end-2015), they increase the government's borrowing costs and represent a key risk to public finances. With Kenya increasing its external borrowing with a recently concluded syndicated loan, however, we expect the pressure on market interest rates to gradually dissipate.

BSI methodology – A recap

Each month, we poll c.200 businesses that represent different sectors of Kenya's economy

The Standard Chartered-MNI BSI for Kenya is a diffusion index, summarising in a single number how optimistic businesses feel about current and future economic conditions.

We partner with MNI, a well-known data provider that has long produced the Chicago PMI, among other indicators, to construct the Standard Chartered-MNI BSI. Each month, up to 200 formal-sector businesses, active in different segments of Kenya's economy, respond to questions on Kenya's current and future economic conditions. Most of the respondents polled are Nairobi-based, with some in Mombasa; the businesses that they represent are active across Kenya.

While small and medium-sized enterprises (SMEs) are represented, so are corporates with a regional East African presence, both listed and unlisted. The responses of our panel of companies are collated to generate a single number that captures sentiment. The headline BSI (current conditions index) for Kenya is made up of a number of components with different weights: new orders (35% weight), production (25%), employment (15%), order backlogs (15%) and supplier delivery times (10%).

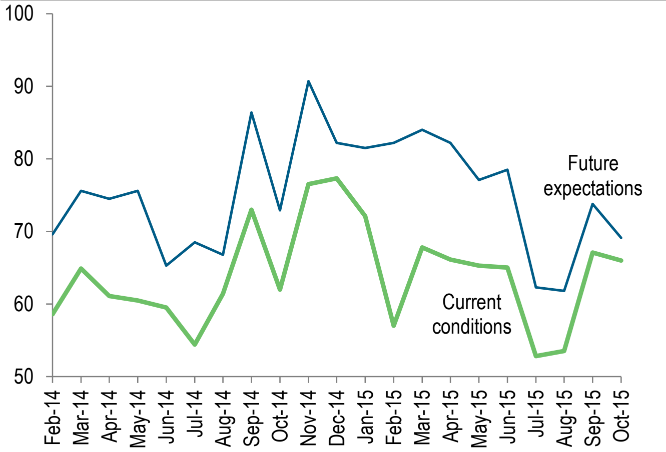
A headline BSI reading above 50 is typically consistent with economic expansion

Respondents are asked whether business activity has increased, decreased or remained the same compared with the previous month. They are also asked about their expectations for the next quarter. We use this information to calculate a diffusion indicator, by adding the percentage share of positive responses to half of the percentage of respondents reporting no change. An indicator above 50 shows an expansion. An indicator below 50 indicates a contraction. A result of 50 means no change.

Questions are asked on a number of key business metrics, including orders, production, pricing, inventories, credit availability and the impact of exchange rate trends. These questions are provided at the end of this report (Figure 17). Data collation for Kenya was initiated in February 2014. The short survey history means that it is not yet possible to adjust for seasonality. Nonetheless, we can still observe how sentiment might be changing from month to month, based on our representative panel of companies. We believe that the receipt of timely information on economic performance can help a range of stakeholders, both in the private sector and in policy circles, with their economic decision-making.

Figure 2: Overall business conditions

Current conditions fell 1.6% m/m



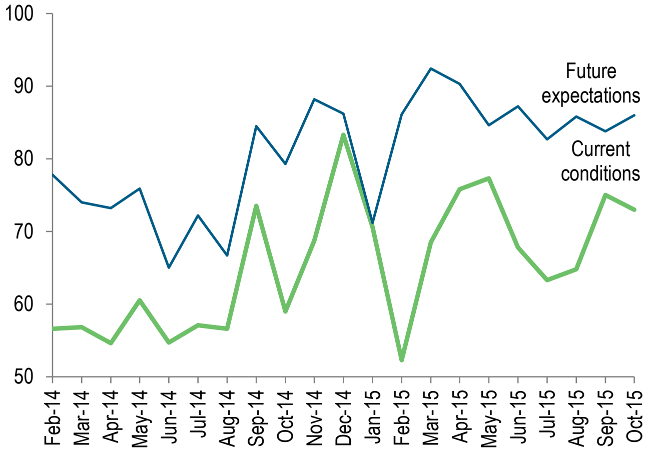
Source: MNI, Standard Chartered Research

Overall business conditions deteriorated

After a significant improvement in September, overall business conditions deteriorated in October. Current conditions declined by 1.6% m/m and future expectations fell even more – by 4.7%.

Figure 3: Production

Current conditions fell 2.7% m/m



Source: MNI, Standard Chartered Research

Production declined as firms use their stocks

Production makes up 25% of the headline BSI. Production fell as Kenyan firms have opted to use their inventories to meet higher orders. Future expectations increased slightly by 2.6%m/m, highlighting optimism among Kenyan corporates that their production will increase in the near term.

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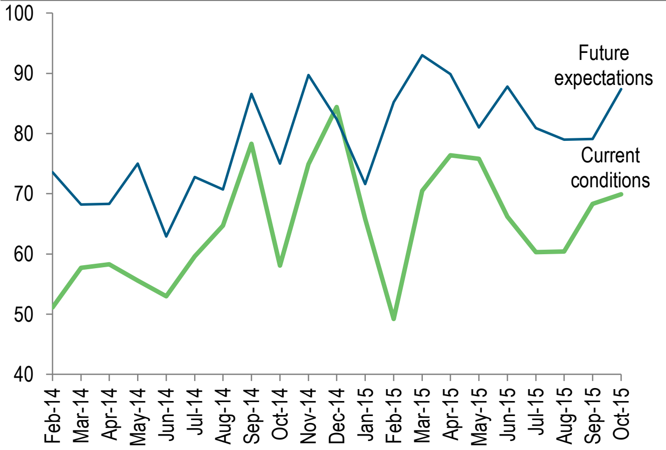
Figure 4: New orders

Current conditions increase 2.3% m/m



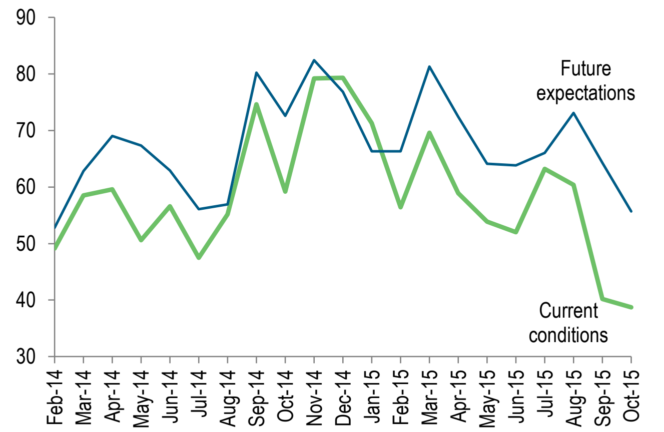
Source: MNI, Standard Chartered Research

Increased new orders

Current conditions increased by 2.3%; while future expectations rose 10.5%, highlighting increased activity.

Figure 5: Export orders

Current conditions fell 3.7% m/m



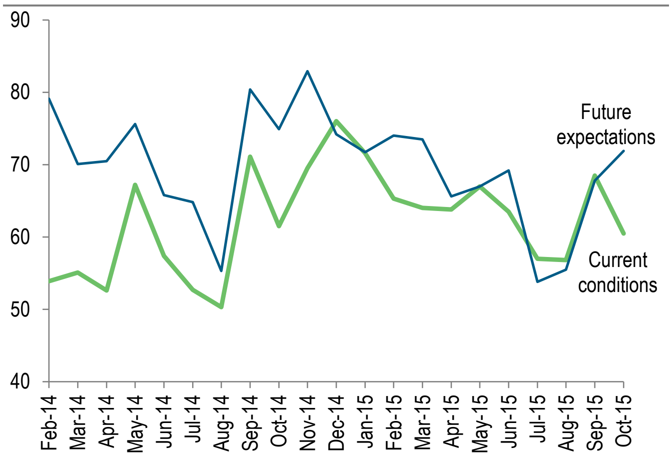
Source: MNI, Standard Chartered Research

Declining export orders

Export orders declined to their lowest level since the launch of the BSI indicators. Recent exchange rate stabilisation might have played a role in terms of Kenyan exports being less competitive– especially regionally – but this is unlikely to be the only factor. Kenya faces a number of structural issues that have limited export growth in recent years.

Figure 6: Production capacity

Current conditions fell 11.7% m/m



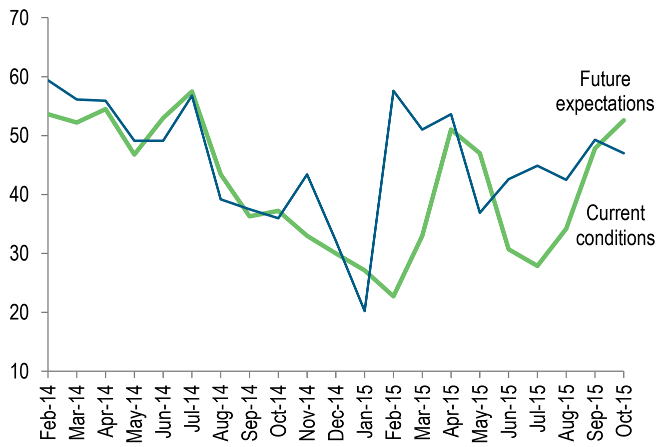
Source: MNI, Standard Chartered Research

Production capacity – More negative responses

The number of companies planning to increase production capacity declined 11.7%, which might be linked to less affordability of credit but may also be a sign that growth is slowing. However, future conditions continued their rebound.

Figure 7: Order backlogs

Current conditions increase 10% m/m



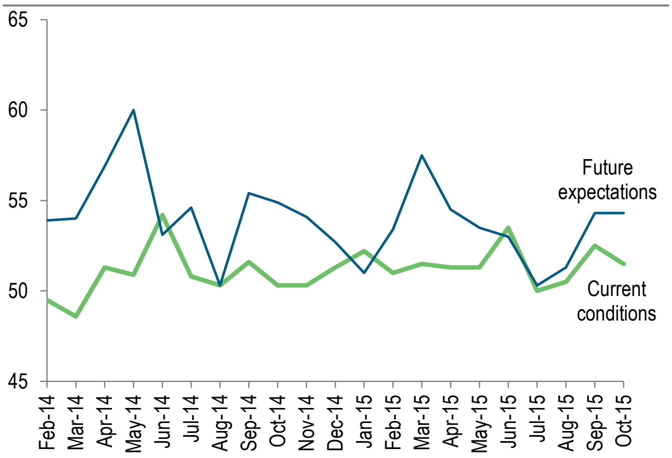
Source: MNI, Standard Chartered Research

Order backlogs surged

Current conditions increased by 10%m/m in October helping to drive the BSI improvement (order backlogs contribute 15% of the headline BSI).

Figure 8: Employment

Current conditions fell 1.9% m/m



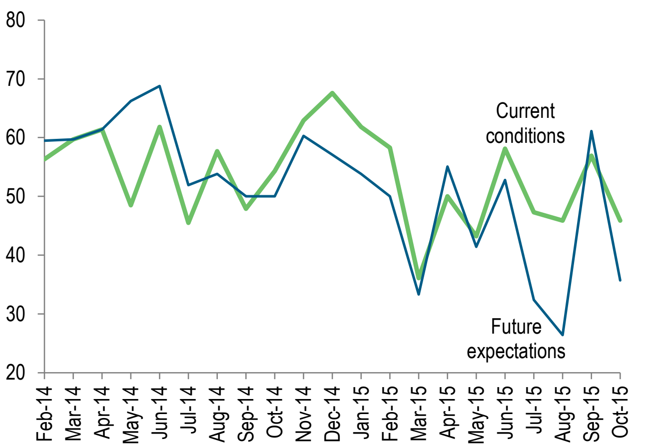
Source: MNI, Standard Chartered Research

Employment intentions remained subdued

Current conditions for employment fell by 1.9%m/m in October. While business confidence has remained in expansionary territory for most of the series history, it has rarely indicated robust employment gains.

Figure 9: Inventories

Current conditions fell 19.3% m/m



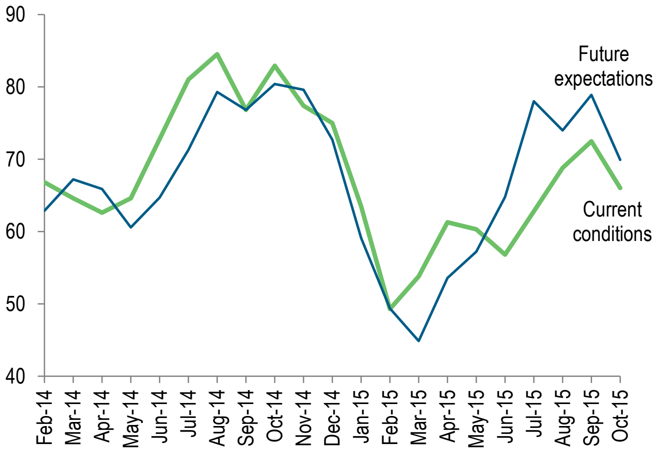
Source: MNI, Standard Chartered Research

Inventories declined

Current conditions for inventories declined 19.3%m/m in October. Kenyan firms reported lower inventories of finished goods, in line with lower production and the rise in order backlogs.

Figure 10: Input prices

Current conditions declined 9% m/m



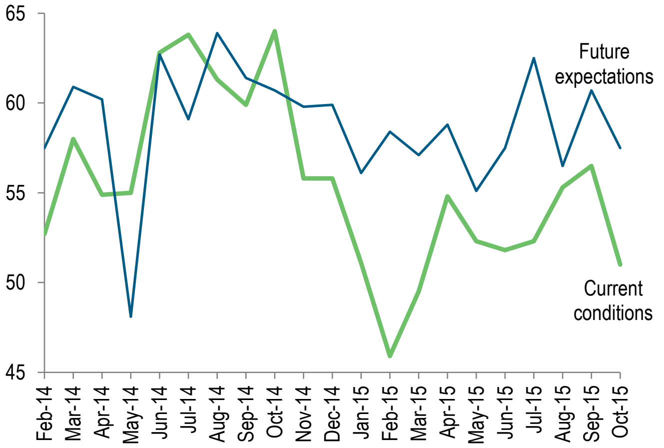
Source: MNI, Standard Chartered Research

Firms expected lower input prices

Current conditions for input prices declined 9% in October and future conditions declined by 11.4%, which highlights the belief that the exchange rate should remain stable. Cheaper imported fuel is also likely to be a factor in declining input cost expectations.

Figure 11: Prices received

Current conditions declined 9.7% m/m



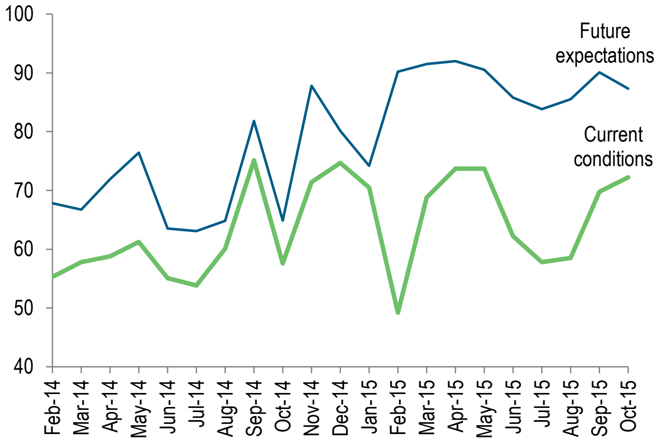
Source: MNI, Standard Chartered Research

Kenyan firms were not able to pass price rises on

Current conditions for prices received decreased 9.7%m/m in October. This is in line with lessening inflation concerns

Figure 12: Financial position of your company

Current conditions increased 3.4% m/m



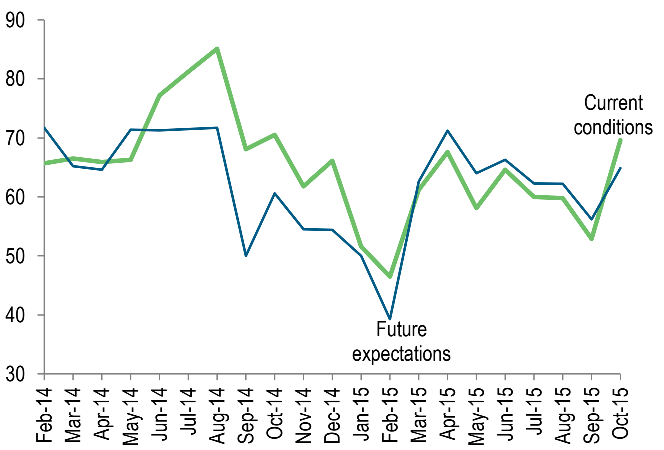
Source: MNI, Standard Chartered Research

Corporates still positive on their financial situations

Companies remain relatively upbeat about their financial positions. The current conditions indicator increased by 3.4% in October. However, future conditions declined by 3.1%, probably because firms wonder about the impact of higher interest rates.

Figure 13: Interest rates paid

Current conditions rose 31.6% m/m



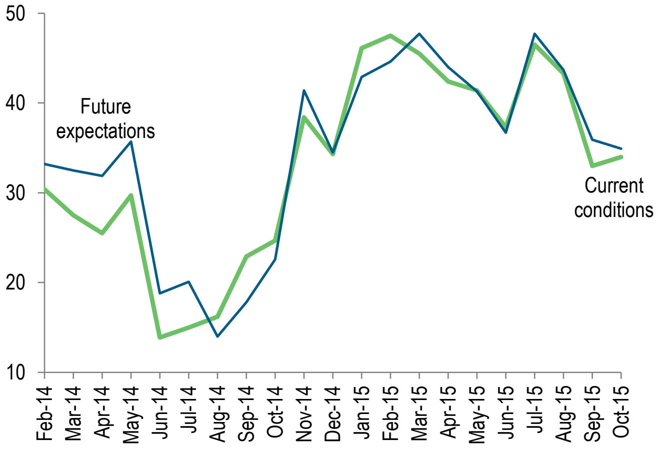
Source: MNI, Standard Chartered Research

More firms reported higher interest rate paid

Both current conditions and future expectations for interest rates paid increased in October, reflecting more firms indicating that interest rates paid had increased. This is unsurprising given the extent of monetary tightening so far this year.

Figure 14: Effect of the KES exchange rate

Current conditions rose 3% m/m



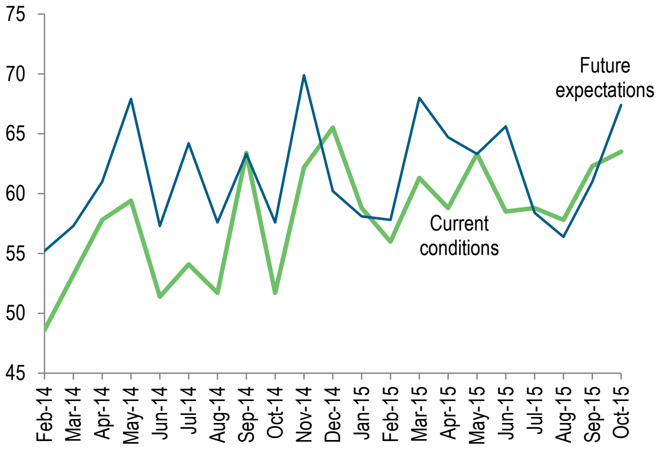
Source: MNI, Standard Chartered Research

The KES was a lesser concern

In line with recent KES stabilisation, fewer Kenyan firms reported that the currency was a source of concern in October. Current conditions increased by 3%m/m. But future expectations continued to decline (by 2.8% in October) highlighting that FX pressure remains a concern in the near term, and that businesses are wary of the risk of further depreciation.

Figure 15: Supplier delivery times

Current conditions rose 1.9% m/m



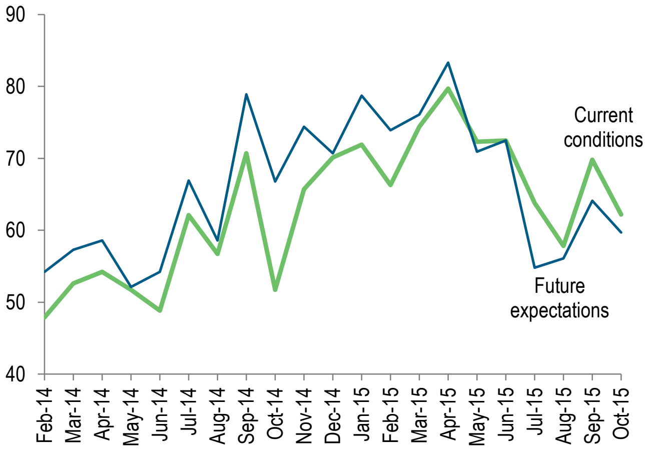
Source: MNI, Standard Chartered Research

Supplier delivery times rose

Supplier delivery times makes up 10% of the headline BSI. Current conditions and future expectations both rose in October. This suggests stronger economic momentum overall, but note that this series has traditionally been very volatile.

Figure 16: Availability of credit

Current conditions fell 10.9% m/m



Source: MNI, Standard Chartered Research

Availability of credit declined sharply

The current conditions and future expectations indicators both fell sharply in October. Overall, Kenyan companies saw credit availability as more constrained compared with the reading in September.

Figure 17: Understanding the questions

In order to aid comprehension of the survey, we reproduce the questions asked of respondents below

Productive capacity	Compared with a month ago, is the productive capacity of your company higher, the same or lower? Questions will also address the three-month outlook.
Production	Questions address what is happening to actual production – higher, the same, or lower? What about the three-month outlook?
Interest rates paid	How do the interest rates that you pay compare with a year ago? How do you expect the interest rate you pay to change in three months' time?
New orders	Compared with a month ago, are new orders higher, the same or lower? Do you think that new orders will be higher, the same or lower in three months?
New export orders	Compared with a month ago, are new export orders higher, the same or lower? Do you think new export orders in three months' time will be the same, higher or lower?
Exchange rate	Compared with a month ago, how is the FX rate affecting your business – helping, no impact or hurting? How do you think it will be affecting your business in three months' time?
Suppliers' delivery times	Compared with a month ago, are your suppliers' delivery times (of raw materials, consumables, etc.) higher, the same or lower? Do you think your suppliers' delivery times (of raw materials, consumables, etc.) in three months' time will be higher, the same or lower?
Number of employees	Compared with a month ago, is the number of your employees not enough, just right or too many? What do you expect it to be in three months' time?
Financial position of your company	An assessment of whether this is better, the same or worse.
Order backlogs	(For agricultural companies, there are no questions about order backlogs.)
Input prices	How do they compare with a month ago? Where are they expected to be in three months' time?
Prices you charge for your products	How do they compare with a month ago? Where are they expected to be in three months' time?
Availability of credit	Is it better, the same or worse than a year ago? Do you expect the availability of credit in three months to be better, the same or worse?
Inventory of finished goods	(For agricultural companies, there are no questions about inventories of finished goods.)
Overall business conditions	Are these improving, the same or worsening? What do you expect over the next quarter?

Source: Standard Chartered Global Research, MNI

A selection of comments from the Kenya panel of businesses

"Shortage of raw material this month meant we had to scale back our production."

"While my company is looking to expand its operations, we will have delay our plans until there is a reduction in the level of interest charged on loans."

"New advertisement campaign has helped push up sales."

"Suppliers aren't always so quick to dispatch goods so we place orders early to ensure they arrive on time."

"Short-staffed this month as we are finding it difficult to find experienced individuals."

"We now only accept US dollars for export orders since the shilling is so weak, a decision that has pushed away some of our overseas clients."

"Better cost management has left our finances in a healthier state."

"Our machines broke fairly frequently this month and so we have amassed backlogs."

"Fuel prices are falling. Since this is our biggest cost, we have been able to keep our own prices competitive."

"Banks were less willing to lend to us as we were a little late on a few repayments earlier on in the year."

"El Niño could disrupt delivery times over the coming months."

"Our output was slightly lower on account of employee attrition. We are currently training their replacements and should be back up to speed next month."

"Opening of a new office in Mombasa has brought in more business from there."

"Volatility of the shilling makes it difficult to plan for the future."

"We are in a better financial position after appointing a new accountant who has helped us cut down on our tax bill."

"Number of unfulfilled orders has risen after the introduction of a new product slowed down output.

Staff will become more adept once they become more familiar with the production process which will clear any backlogs."

"Suppliers are raising their prices as Christmas approaches. Too late to seek out new ones and so we have had no choice but to absorb these higher costs."

"Government support has given us access to sizable loans at a reasonable rate."

Source: MNI, Standard Chartered Research

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