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Kenya – August BSI gains following Obama visit

- **Kenyan business sentiment recovered slightly in August, rising 2.4% m/m to 55.8**
- **This followed President Obama's visit, and the showcasing of Kenya as a regional business hub**
- **However, the 3-month average fell to 56.3 in August from 60 in July – signalling slowing momentum**

Summary

Razia Khan +44 20 7885 6914
Razia.Khan@sc.com
Chief Economist, Africa
Standard Chartered Bank

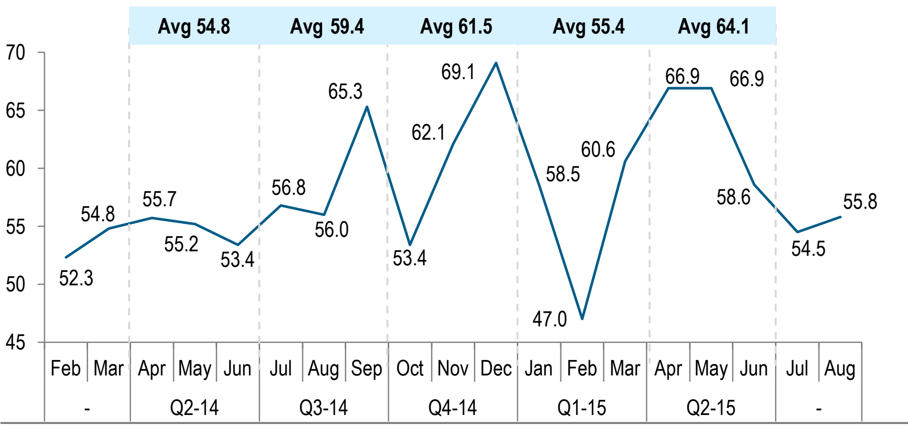
Business sentiment in Kenya, as measured by the *Standard Chartered-MNI Business Sentiment Indicator* (BSI), recovered slightly to 55.8 in August, having fallen to a five-month low in July. Gains were driven by increased production (up 2.4% m/m) and order backlogs (up 22.6% m/m from a weak base). The other components that make up the headline BSI, new orders and employment, were largely flat on the month, while supplier delivery times fell 1.7% m/m.

US President Obama's visit to Kenya in late July appears to have had a positive impact on sentiment, with the hosting of a Global Entrepreneurship Summit showcasing Kenya to foreign investors. However, many Kenya-specific factors continued to weigh on confidence. The Kenyan businesses surveyed continued to see the negative effect of the Kenyan shilling (KES) exchange rate as a constraint to business activity. Firms also remained wary of rising inflationary pressures, and reported that credit was more difficult to secure.

Although the Central Bank of Kenya (CBK) held interest rates steady at a specially scheduled meeting on 5 August – giving earlier tightening more time to feed through to the economy – the higher reset of the Kenya Banks Reference Rate (KBRR) to 9.87% (effective from August) likely influenced business sentiment. Continued KES volatility following the meeting likely made many Kenyan businesses wary of the risk of higher interest rates. In 2011, the last time Kenya faced significant FX weakness, the policy rate was raised 1,100 bps in only three months. We believe that conditions are meaningfully different this time, and we forecast a more muted tightening cycle. While the Central Bank Rate (CBR) has been raised 300bps year-to-date to 11.5%, lower oil prices should help inflation peak at a lower level than previously assumed. We see only another 100bps of policy tightening in this cycle, although more exaggerated FX weakness than we currently forecast would pose an upside risk to our CBR forecast. (For details on our latest forecast changes, see At a Glance, 12 August 2015, *'Kenya – Navigating market volatility'*.)

Figure 1: Kenya BSI recovered slightly to 55.8 in August

Standard Chartered-MNI Kenya Business Sentiment Indicator



Source: MNI, Standard Chartered Research

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Growth considerations also influence our interest rate forecasts. Early evidence from the BSI suggests that Kenya's growth momentum is slowing. Despite the slight uptick in the headline print in August, the three-month average BSI reading declined to 56.3 in August from 60.0 in July. While current conditions remain in expansionary territory, future expectations have started to soften. In July, 10 of the 15 future expectations indicators declined m/m. This was followed by a further decline in 9 out of 15 future expectations indicators in August. This points to the need for caution ahead. Kenya's economy may be growing, but headwinds – both external and domestic – are increasingly evident.

A recap of our BSI methodology

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.

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

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%).

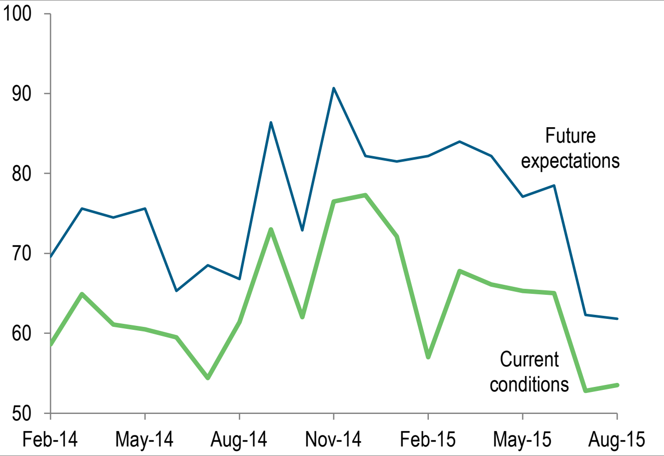
A headline BSI reading above 50 is typically consistent with economic expansion

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 rose1.3% m/m



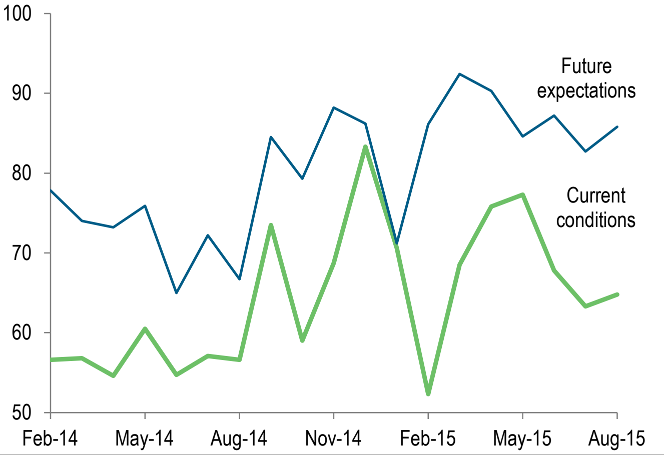
Source: MNI, Standard Chartered Research

Overall business conditions were still muted

After falling 18.8% m/m in July, overall business conditions posted a modest recovery in August, rising 1.3% m/m. However, future expectations fell even further – albeit from higher levels – declining 0.8% m/m in August. This suggests that the gains in perceptions of business conditions may be short-lived.

Figure 3: Production

Current conditions rose 2.4% m/m



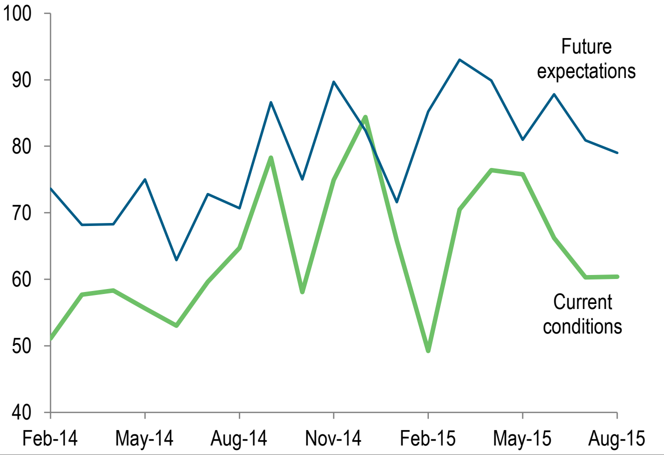
Source: MNI, Standard Chartered Research

Production rose, driving BSI gains

Production makes up 25% of the headline BSI. Current conditions and future expectations both rose in August, by 2.4% m/m and 3.7% m/m, respectively, helping to drive BSI gains. At 64.8, current conditions remain firmly in expansionary territory. Kenyan companies remain optimistic that they will increase production in the near future.

Figure 4: New orders

Current conditions rose 0.2% m/m



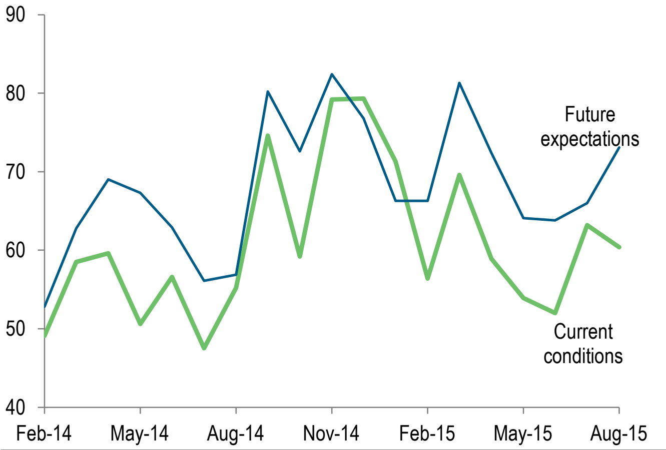
Source: MNI, Standard Chartered Research

New orders – A negligible increase

New orders rose a marginal 0.2% m/m in August, while future expectations declined 2.3% m/m. Expectations were down from robust levels, so the correction in expectations may not signal anything meaningful – yet.

Figure 5: Export orders

Current conditions fell 4.4% m/m



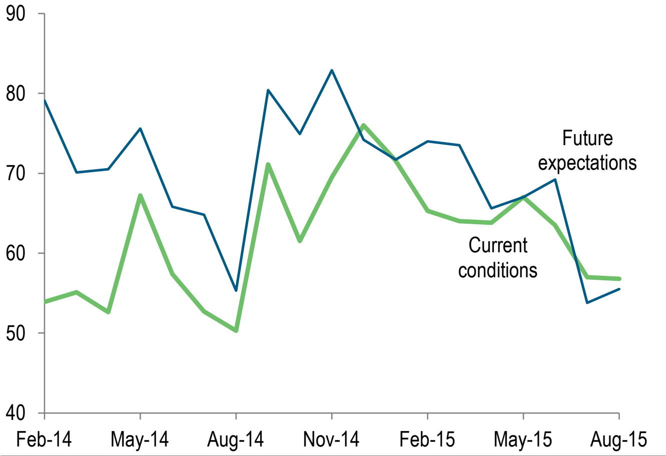
Source: MNI, Standard Chartered Research

Future expectations of export orders rose strongly

Despite recent KES weakness, current conditions for export orders fell in August to 60.4. However, future expectations were much stronger – companies believe that KES weakness, perhaps combined with future infrastructure improvements, will lift export orders further out. Future expectations rose 10.8% m/m in August. This followed a rise of 3.4% m/m in July. At 73.1, future expectations for export orders were at their highest level since March 2015.

Figure 6: Productive capacity

Current conditions fell -0.4%m/m



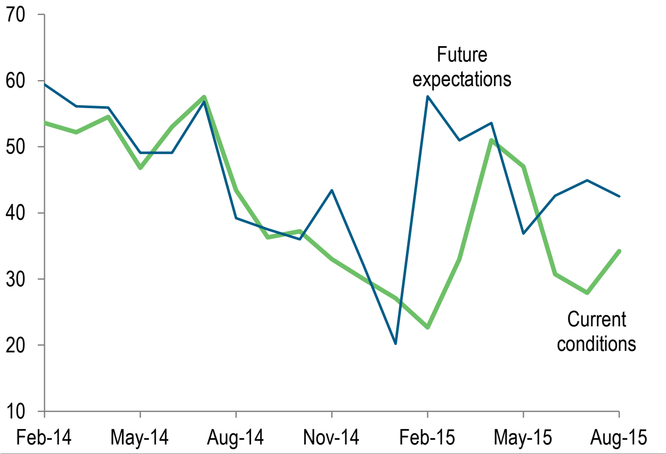
Source: MNI, Standard Chartered Research

Productive capacity – More negative responses

When asked what is happening to their productive capacity, an increasing number of companies provided negative responses in August. Although both current conditions and future expectations for this indicator are still above the 50 level – suggesting that more firms expect productive capacity to improve than not – these readings are nonetheless down from the highs of over 60 seen earlier in the series. The number of companies planning to increase production capacity has been declining for some time. This could reflect expectations of more subdued growth ahead and/or concerns about the affordability of credit to support expansion plans.

Figure 7: Order backlogs

Current conditions rose 22.6% m/m



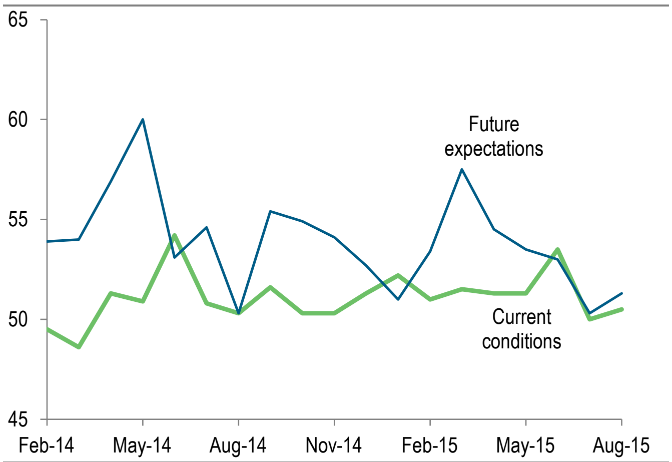
Source: MNI, Standard Chartered Research

Order backlogs surged

Current conditions for this indicator surged 22.6% in August, helping to drive BSI gains (order backlogs contribute 15% of the headline BSI). Nonetheless, the rise was off a low base. The current conditions indicator was still sub-50, at only 34.2 – suggesting that order backlogs are not widespread.

Figure 8: Employment

Current conditions rose 1.0% m/m



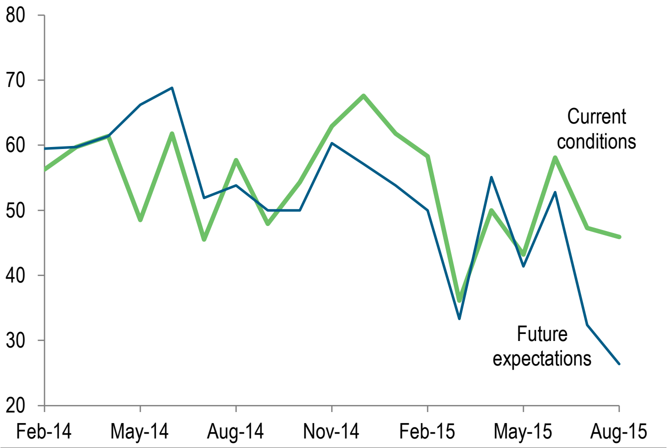
Source: MNI, Standard Chartered Research

Little change to employment intentions

Current conditions for employment have flatlined for much of the series history, although future expectations have shown more volatility. A key question is whether Kenya's economic upswing will continue for long enough to make a meaningful difference to job creation. Our BSI, which has been running since February last year, has rarely indicated robust employment gains, even though business confidence has remained in expansionary territory for most of the series history (February 2015, when the index dipped below 50, was the only exception).

Figure 9: Inventories

Current conditions fell 3% m/m



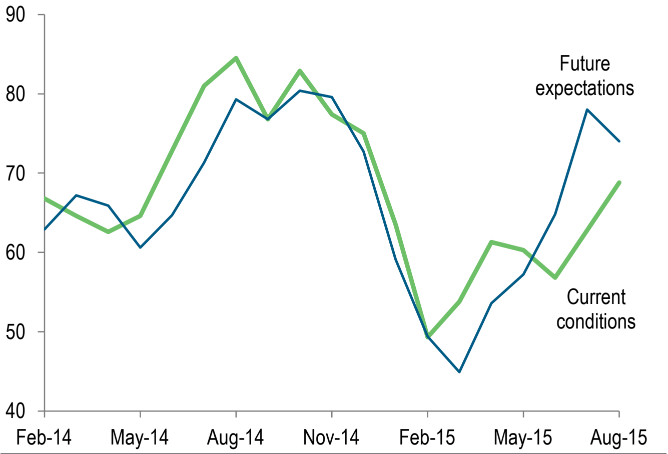
Source: MNI, Standard Chartered Research

Businesses ran down inventories

In sync with the rise in order backlogs, companies reported lower inventories of finished goods.

Figure 10: Input prices

Current conditions rose 9.6% m/m



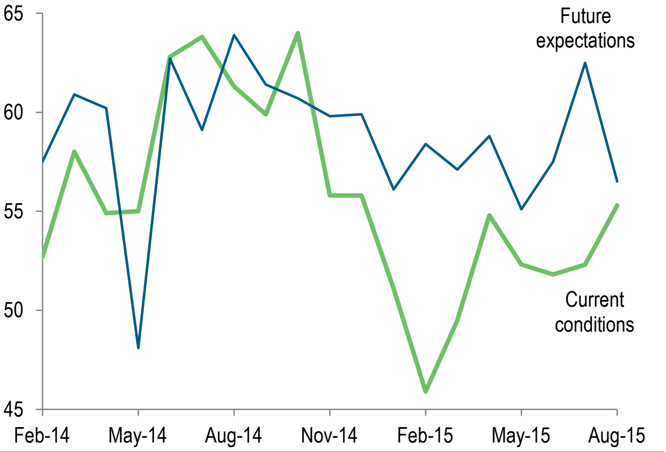
Source: MNI, Standard Chartered Research

Input prices rose

Current conditions for input prices rose almost 10% as companies felt the impact of a weaker FX rate. However, future expectations declined 5.1% m/m, perhaps reflecting the belief that the pressure would not be long-lived, or that cheaper imported fuel might compensate for FX weakness.

Figure 11: Prices received

Current conditions rose 5.7% m/m



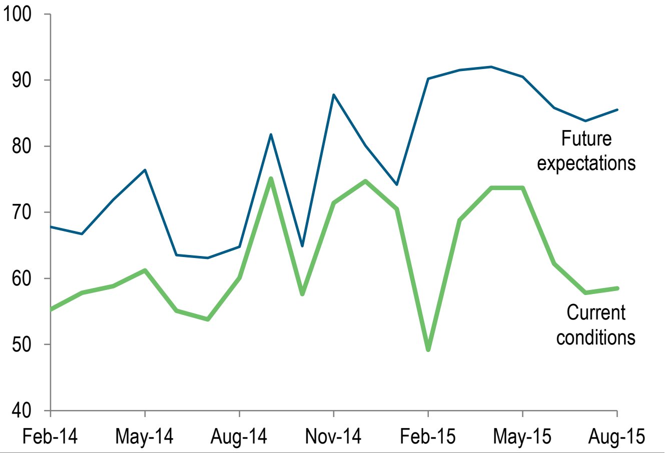
Source: MNI, Standard Chartered Research

Kenyan firms were able to pass price rises on

Current conditions for the 'prices received' indicator increased c.6% in August, indicating an environment where companies can still pass on price increases. However, there are new doubts about their ability to be able to do so in the future, given the sharp decline in future expectations.

Figure 12: Financial position of your company

Current conditions rose 1.2 m/m



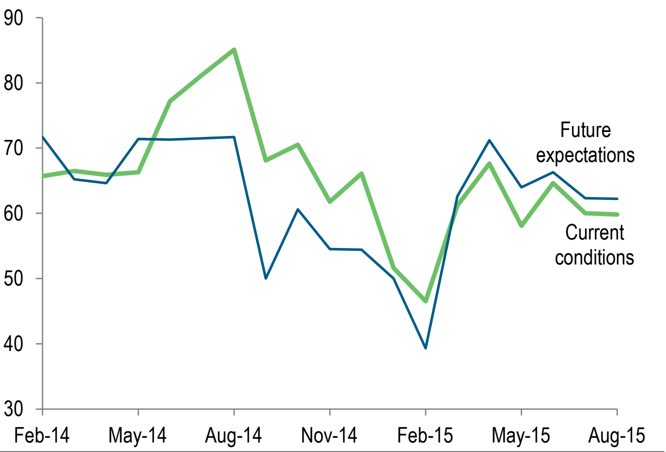
Source: MNI, Standard Chartered Research

Companies still upbeat about financial positions

Companies remained relatively upbeat about their financial positions, with both current conditions and future expectations rising in August.

Figure 13: Interest rates paid

Current conditions fell 0.3% m/m



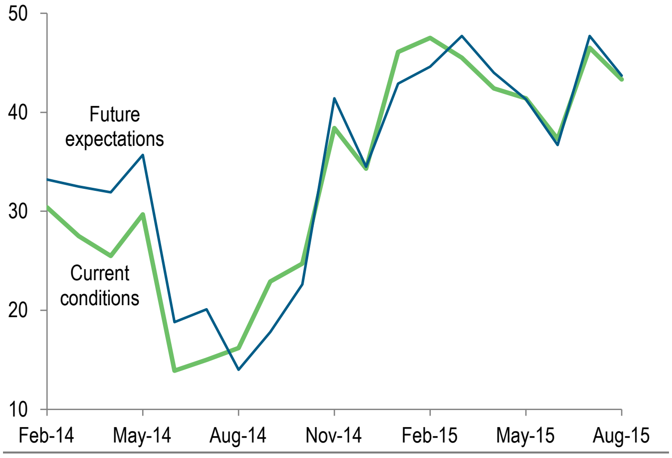
Source: MNI, Standard Chartered Research

Firms were more negative about interest rates paid

Both future expectations and current conditions for this indicator declined; this is perhaps unsurprising given the 300bps of policy tightening so far and the higher KBRR in August. Despite high interbank rates in August, the authorities stepped back from further policy tightening.

Figure 14: Effect of the KES exchange rate

Current conditions fell 6.9% m/m



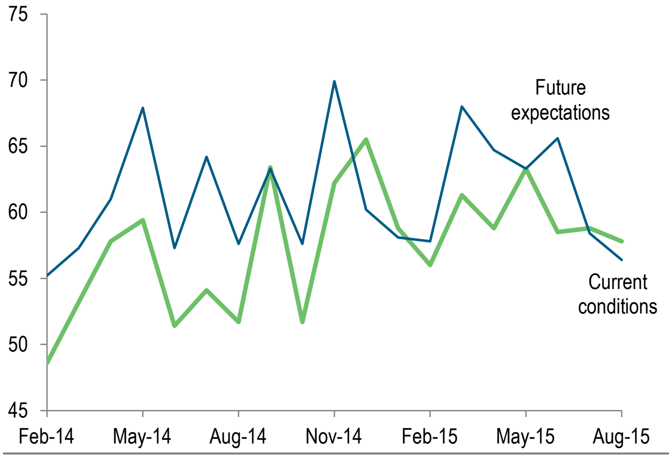
Source: MNI, Standard Chartered Research

FX market trends hurt business sentiment

More Kenyan companies reported that the effect of the KES exchange rate was hurting their business prospects. The decline in both current conditions and future expectations in August undid some of the optimism seen in July. This indicator has been consistently below 50 throughout the survey history, although it was less negative in August than it was in May 2014. This may suggest that some businesses are benefiting from KES weakness versus the USD; alternatively, it may suggest that KES appreciation versus regional trading-partner currencies (which have typically weakened even more against the USD than the KES has) is helping a subset of Kenyan businesses.

Figure 15: Supplier delivery times

Current conditions fell 1.7% m/m



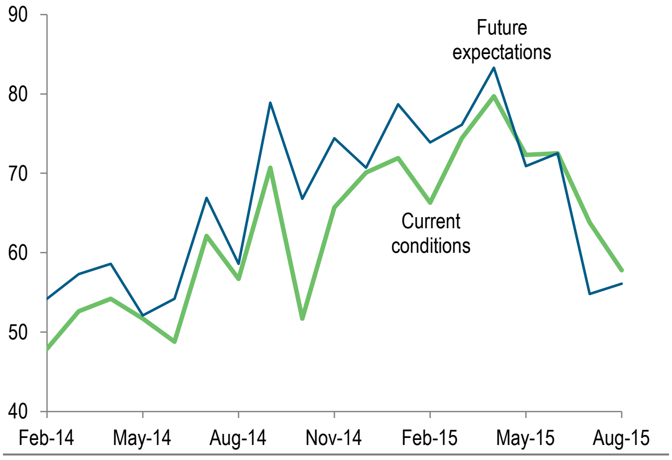
Source: MNI, Standard Chartered Research

Supplier delivery times fell

Supplier delivery times – both current conditions and future expectations – were reported lower in August. This may suggest slowing economic momentum, although it is difficult to read too much into a single indicator. The series has been volatile.

Figure 16: Availability of credit

Current conditions fell 9.4% m/m



Source: MNI, Standard Chartered Research

Availability of credit seen to be more constrained

Both current conditions and future expectations for this indicator declined in August. Kenyan companies expect credit availability to worsen, perhaps reflecting their concerns over persistent FX volatility and the need for further tightening. Given higher T-bill yields since the last KBRR reset (calculated in July but effective in August), companies that borrow at a floating rate are likely to face higher interest rates in the new year, when the KBRR is next reset. High interbank rates may also prompt banks to place surplus liquidity with other financial institutions in the interim, earning higher returns than they might by lending to corporates.

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

Better business conditions; security situation is better now. Hotels have business.

Heightened activity from diplomatic travel schedules.

Higher order backlogs; we have not reached all potential areas of market.

Higher backlogs; government bureaucracy in processing some transactions.

[We expect higher backlogs]. Slow process of land transactions with government departments.

Higher backlogs; increased orders will stretch our capacity.

There was a serious bad effect from countrywide crackdown on illicit brews. It affects legitimate producers.

Impending US president visit spurred more business.

Imports and exports shot up.

High prices of fuel and electricity tariffs.

Input prices are higher since the dollar strengthened against shilling.

Shilling dropped very much in value against strong world currencies.

Depreciation caused a rise in prices, discouraging customers to buy our products.

Higher prices received; we charged the tax burden to customers.

Banks are still charging the same interest rates as last month, but rates in the market have increased.

Source: MNI, Standard Chartered Research

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Document approved by
David Mann
Chief Economist, Asia

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