

Effects of ongoing rains in Kenya

“Is it Raining Profits?”

In largely agrarian economies, the prospective economic benefits of increased rainfall can be great. At the same time, the economic costs of reductions in rainfall may be equally high. Hence, depending on its intensity, increased rainfall in any season is usually a double edged sword that can either wreak havoc or be of significant benefit. Given Kenya’s high dependency on rain fed agriculture, increased rainfall often creates a positive perception about the expected performance of its economy. But is this always true?

A look at 2015

The 2015 long rains distribution was generally good over most parts of Western and Central Kenya. During the onset month of March, sunny and dry weather conditions were dominant over the entire country with rainfall being recorded during the second half of April and throughout the month of May. Increased rainfall was experienced during the October-November-December (OND) 2015 “short rains” season with majority of the meteorological stations registering rainfall well above 125.0% of their long term mean (LTM).

The GDP grew by 5.6% in 2015 compared to 5.3% in 2014, with agriculture recording 5.6% growth accounting for the biggest portion of the GDP at 30.0%. Other key sectors that contributed to the expansion were the construction sector that recorded the fastest growth at 13.6%, real estate (8.9%) and financial and insurance (8.7%).

In central highlands and south-eastern districts, the enhanced rainfall improved agricultural activities while in most parts of central rift valley, North-eastern and North-western Kenya, there was an improvement of livestock pastures. On the other hand, the cultivation of crops like potatoes and tomatoes was interrupted, but compared to the crops that were negatively impacted upon, those that were favored by the weather were more significant hence the growth of 5.6% in the agriculture sector. Heavy rains in catchment areas also led to increased water levels in the Seven Forks hydroelectric power generation dams.

2016 -Year to Date

In 2016, most parts of the country experienced sunny and dry weather conditions during the first two months with only parts of Central Rift Valley, Western Kenya and Central Highlands, Nairobi included, recording substantial amounts of rainfall.

A detailed forecast report by the Kenya Meteorological Department, reveals that during the ongoing March-April-May (MAM) long-rains season, areas likely to receive near normal rainfall include Western, Nyanza, counties in the Central and South Rift, Central Kenya, Nairobi and some counties in the Eastern region. Enhanced rainfall will be experienced in Kwale, Mombasa, Lamu and Kilifi counties, while counties in the coastal region like Taita/Taveta and Tana River, and North Eastern Counties like Mandera, Wajir and Garissa will receive depressed rainfall.

Bloomberg Ticker: **KNSMIDX**

Key Statistics:

2015 GDP (%)	5.6
GDP Per Capita (USD)	1,409.6
GNI Per Capita (USD)	1,399.7
Population (m)	44.3
Current Account Deficit to GDP (%)	6.8
Debt to GDP (%)	50.7
2015 Average Inflation (%)	6.6
<u>Inflation (May 2016)</u>	<u>5.0</u>

Rosemary Kanyoro **Research Intern**

rkanyoro@apexafrica.com
 +254 716 388584

Joy D'Souza **Head of Research**

jdsouza@apexafrica.com
 +254 723 420204

Food production. Are we on the right track?

Rainfall in Kenya is bimodal. The main season begins in March and lasts through August affecting the harvest in October while the second season begins in October and lasts through January affecting the harvest in February.

The Food and Agriculture Organization (FAO) reports that crop production for the just concluded 2015/16 short-rains harvest in bi-modal rainfall areas increased by 15.0%, above the last 5-year average. Timely and abundant rainfall has also seen farmers increase the area planted.

Being a maize deficit country, Kenya relies on cross-border business to bridge the gap of 20 million bags every year. In the period between September 2015 and March 2016, maize prices have declined by 14.0%, attributable to a bumper harvest that increased market supplies. Institutional purchases by the National Cereals and Produce Board (NCPB) in a bid to replenish the stocks of the Strategic Grain Reserve, however, had slightly increased prices in the Rift Valley region from December 2015 to February 2016. Overall, since April 2016, the two consecutive above average harvests have maintained maize prices between 5.0% and 12.0% below their levels of 12 months earlier.

The rainy season has also triggered an oversupply of milk, way beyond the absorption capacity of the processors in the country. While the consumption remains unchanged, milk supply continues to increase, a situation expected to persist until the rain subsides

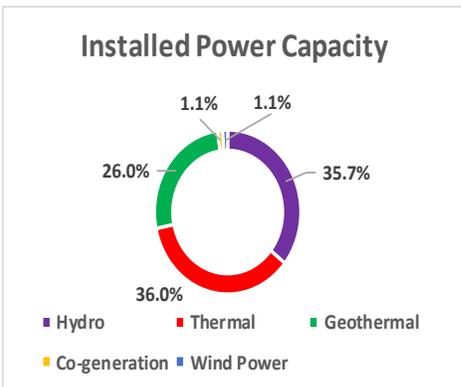
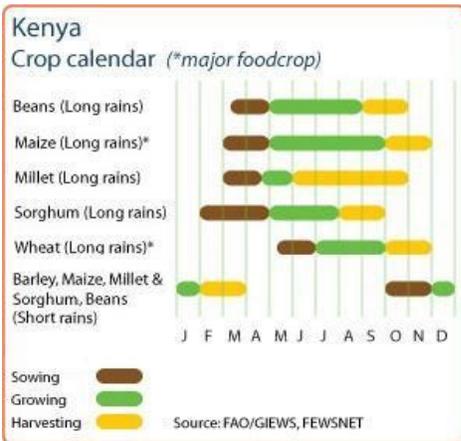
Electricity production: The light at the end of the tunnel

The rains are bound to facilitate cheaper hydropower generation in the Seven Forks and other hydroelectric power generation dams, which will cut the use of expensive thermal and ultimately reduce the monthly adjustable fuel cost charge in electricity power bills.

In 2015, the energy sector recorded an accelerated growth of 9.7% compared to a growth of 7.3% in 2014. Hydro and geothermal power accounted for 79.4% of the total power generated in 2015 from 67.3% in 2014. Generation from geothermal plants doubled to 4,059GWh owing to the commissioning of Kengen’s 280MW Olkaria IV plant in December 2014.

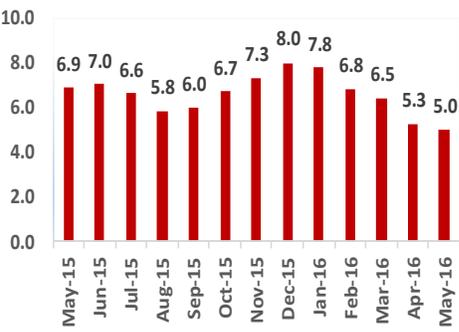
In 2015, The installed power capacity stood at 2,320MW. Hydro power accounted for 35.7% of installed capacity, with thermal and geothermal accounting for 36.0% and 26.0% respectively. The remaining portion was mainly from co-generation (1.1%), wind power (1.1%).

The Energy Regulatory Commission (ERC) confirmed that in May 2016, hydro plants were generating at peak and that the fuel costs charge linked to the amount of power generated from expensive diesel had remained unchanged since the start of 2016 at KES 2.31 KWH. Kengen’s power dams were also full, an indication that hydro production will possibly increase further in 2016, further lowering contribution from thermal power and easing inflationary pressures.



Source: KNBS

Overall Rate of Inflation

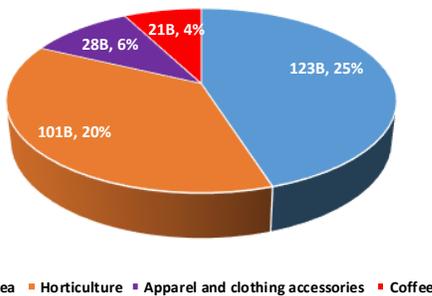


Transport and Storage

As can be expected, this sector has borne the brunt of the heavy rains. Flash floods experienced during the day render certain roads impassable leaving behind a trail of death and destruction. Roads and buildings have been destroyed, property damaged and huge traffic snarl ups experienced especially in the capital. The Kenya Roads Board estimates a total funding backlog of KES 400B required to carry out road maintenance across the country.

The storage sector has not been spared. In Mombasa, the flow of the key input to farms has been interrupted by persistent rains at a time when farmers needed it most. The demand for fertilizer rises sharply at this time of the year, which coincides with the onset of the long rains that slowed the offloading of fertilizer. On April 14th for instance, only 220 tonnes of fertilizer were offloaded compared to 3300 tonnes that can be offloaded in a normal day.

Top Exports 2015

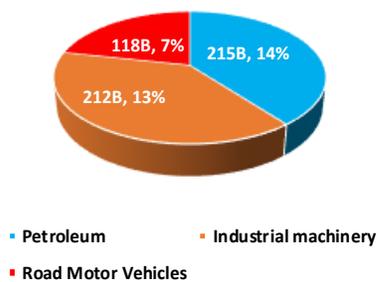


What this means for inflation

In Kenya, food alone accounts for 36.0% of items used to calculate monthly inflation figures, while transport, housing, water, electricity, gas and other fuels account for a further 27.0% of the consumer basket.

In 2015 drought conditions that were experienced during the first quarter, pushed up the prices of items such as potatoes, tomatoes, milk, cabbages, beans and onions. However, enhanced rainfall during the second half of the year increased supplies resulting in decreases in prices of several food items.

Top Imports 2015

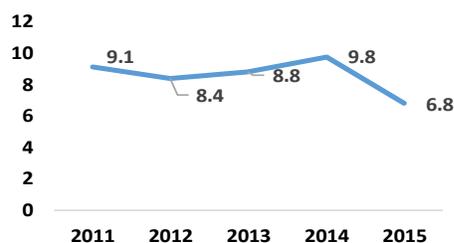


In 2016, bumper harvest expected from staple foods like maize and beans, will ease their prices and contribute to reduced food inflation. Inflation for the month of May, for instance, declined 27bps to 5.00% mainly driven by containment of food inflation which stood at 6.54% coupled with slow growth in electricity, fuels and transport owing to electricity and fuel prices remaining significantly low compared to last year.

The current account deficit

The leading export earners in 2015 were tea (KES 123B, 25%); horticulture (KES 101B, 20%); articles of apparel and clothing accessories (KES 28B, 6%); and coffee (KES 21B, 4%), collectively accounting for 54.6% of the total export merchandise. Leading exports were petroleum products which amounted to KES 215B (14% of the total imports), industrial machinery (KES 212B, 13%) and road motor vehicles (KES 118B, 7%).

Current Account to GDP Ratio



Favorable weather conditions in 2016 may drive an increase in tea and horticultural exports, the two top revenue earners, which coupled with subdued crude oil prices may lead to further narrowing of the current account deficit. The government estimates that the current account deficit to GDP will decline to 6.2% in 2016. In 2015, the ratio stood at 6.8% from 9.8% in 2014 driven by an 8.2% increase in total exports to KES 581B, and a 2.5% reduction in the import bill to KES 1,578B. The ratio in 2013, 2012 and 2013 was 8.8%, 8.4% and 9.1% respectively.

Outlook for the rest of the year

Average rainfall performance is expected in the agricultural counties of Western, Nyanza, Rift Valley, central highlands and the Coastal strip, which will continue to improve crop yield if land use is well managed. In Arid and Semi-Arid Lands (ASALs) that are mostly pastoral, the expected poor rainfall performance might impact negatively on the livestock sector because pastures and browse for animals may not regenerate to optimum levels.

In the tea sector, a much better performance in the course of the year is expected as the Shilling continues to favor the sector, countering the effect of a decline in global prices. Tea producing companies might see improved top line performance in light of this. Half year results announced by Sasini Limited for instance revealed a 25.1% y/y increased in revenues driven by improved weather conditions that boosted production volumes.

Coffee sales might improve because better quality coffee is expected from Eastern Kenya from July. The four-year coffee productivity project funded by the European Union (EU) also continues to promote the planting of two new varieties: Batian and Ruiru 11, which are resistant to two main coffee diseases. The proposed launch of a mark of origin for Kenyan coffee could also diversify international markets increasing export volumes.

Judging from the last milk glut in 2011 the market situation could get worse as the rains continue due to excess milk production. We hope the Ministry of Agriculture keeps its promise to buy excessive milk from farmers for processing into powdered form for storage. Plans are also in place to include milk in the strategic food reserve which currently comprises maize, beans, rice, fish and canned beef.

The Government has been keen on its commitment to keeping power costs down and has rejected a number of proposals by electricity distributor Kenya Power seeking to revise tariffs upwards. Also, next year being an election year, we expect the government to take a stance that will keep them in good standing with the citizen! This, coupled with the substitution of expensive thermal power with hydropower due to high water levels, is bound to lower electricity bills for consumers. The water resources management sector also benefits significantly from the good rainfall due increased water resources for drinking, sanitation and industrial use.

Conclusion

For increased rainfall to substantially influence economic performance, the country has to be adequately prepared to take advantage of the temporary opportunities that are bound to arise. In the agricultural sector especially, the rains can only fully translate to profits if mechanisms are put in place to minimize gluts that are brought about by supply that is in excess of demand, avoiding wastage. Since repercussions are unpredictable, the costs of inaction in such seasons, therefore, is what could easily change a much anticipated 'blessing' to the economy into an outright curse.

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ApexAfrica Capital Ltd

A The Riverfront, 1st Floor, Prof. David Wasawo Drive, Off Riverside Drive | P.O. Box 43676-00100 | Nairobi | Kenya |

T: +254-20-2226440 | **Fax:** +254-20-2319092 | **Cell:** +254-723-420204 | **W :**

www.apexafrica.com