

Policy Brief



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Unravelling the Impact of the Political Impasse on the Kenyan Economy¹

Summary: *The political impasse has had a significant impact on the Kenyan economy via the uncertainty channel. This uncertainty channel has manifested itself in subdued consumption, investment, business activity, bank lending, share prices and trading on the Nairobi Stock Exchange (NSE) and increase in financial institutions' non - performing loans. At the macroeconomic level, the political impasse effects have manifested themselves in the negative impact on the fiscal budget, revenue collection, and economic growth. This policy brief brings to the fore these effects and argues for a speedy resolution of the political impasse for the country to implement its development programmes.*

1. Introduction

Kenya held its general elections on August 8, 2017 as per the Constitution of Kenya 2010 (COK 2010). This is the second election under the COK 2010. Although the August 8, 2017 elections were generally peaceful, the nullification of the Presidential election by the Supreme Court on September 1, 2017 and the repeat Presidential election scheduled for October 26, 2017 has generated political uncertainty and tension that are in turn subjecting the country into a socio-economic crisis. The political uncertainty has been exacerbated by the withdrawal of the main opposition candidate of the National Super Alliance (NASA) from the Presidential election re-run announced on 10 October 2017. The current political context is expected to increase economic uncertainty as it raises the possibility of keeping the country in political limbo for an extended duration. The election cycle, which commenced in 2014 with the installation of a new Independent Boundaries and Electoral Commission Secretariat has absorbed significant resources and most of 2017 has been spent on electioneering.

While it is constitutionally expected that elections are held every five years, anxiety among investors on the outcome of the Presidential election re-run poses a challenge vis-à-vis the development trajectory of the country; with the economy having been adversely affected by the prolonged electioneering period. Over the past couple of months, the political acrimony and rhetoric during the political campaigning, as well as uncertainty over the outcome, have negatively affected investors' confidence and caused sharp drops in industrial output as well as private sector consumption. The Kenya Private Sector Alliance (KEPSA) has indicated that most investors have postponed their investment plans decisions awaiting a political settlement. This has resulted in a slowdown in spending and private consumption of goods and services. The National Treasury has lowered its 2017 economic growth forecast to 5.5% from 5.9% due to drought and political uncertainty. This policy brief explores the impact of the political impasse on the economy. It also recommends a quick resolution to unlock Kenya's socio-economic development potential.

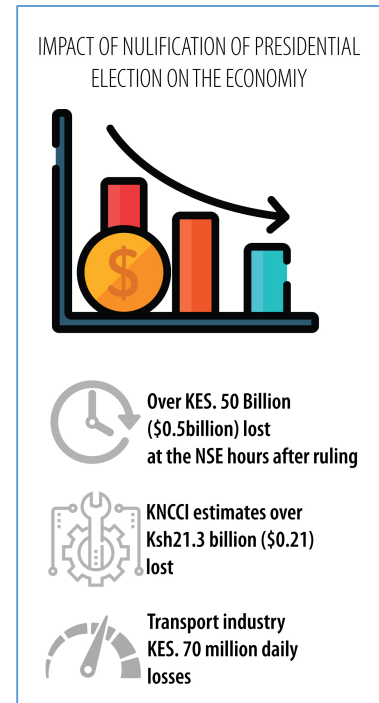
¹This policy brief is an output of the Strategic Policy Advisory Unit (SPAU) in the UNDP Kenya Country Office. The Unit focuses on upstream policy interventions in the areas of human development, pro-poor policy analysis, Agenda 2030 for Sustainable Development. It also supports the national and county governments in the design and implementation of evidence based national development plans, county integrated development plans and other relevant policy instruments.

2. Unfolding Economic Impact

The economic impact of the political impasse has been manifested in stock market pressures, slowdown in economic growth, reduced foreign direct investment, fiscal budget pressures, reduced commercial bank borrowing and increased non-performing loans, as analyzed in the following sections.

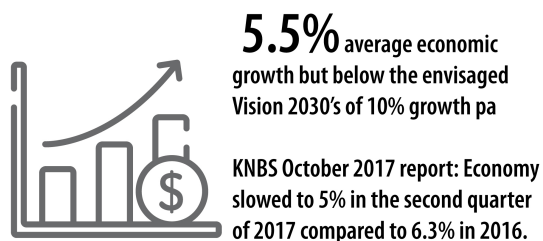
Stock Market Pressures

On September 1, 2017, the Kenya's Supreme Court annulled the presidential elections citing "illegalities and irregularities." The Court ordered fresh elections within 60 days, scheduled for October 26, 2017 although the opposition has since withdrawn from the repeat Presidential election. The political uncertainty has negatively affected the business environment as business owners have been counting losses since the beginning of the electioneering period in May 2017. [Immediately after the 1 September 2017 Supreme Court ruling, the Nairobi Securities Exchange \(NSE\), the largest stock market in East and Central Africa halted trade due to a sharp fall in share prices.](#) Over Ksh50 billion (US\$0.5 billion) was lost within a few hours at the bourse, which can be attributed in large part to political uncertainty brought about by the ruling. The public transport industry has claimed making a loss of Ksh75 million everyday nationally since the 1 September 2017 Supreme Court ruling, while the Kenya National Chamber of Commerce and Industry (KNCCI) estimates that the country has lost Presidential elections.



Slow Down in Economic Growth

Past data indicates that the country has been relatively stable prior to elections despite tensions and security threats since the last general elections held in 2013. Economic growth has averaged 5.5% over the period but is still below the envisaged Vision 2030's of over 10% growth per annum. The [Kenya National Bureau of Statistics](#) (KNBS) data released in early October 2017 shows the economy slowed to 5% in the second quarter of 2017 as compared to 6.3% over a

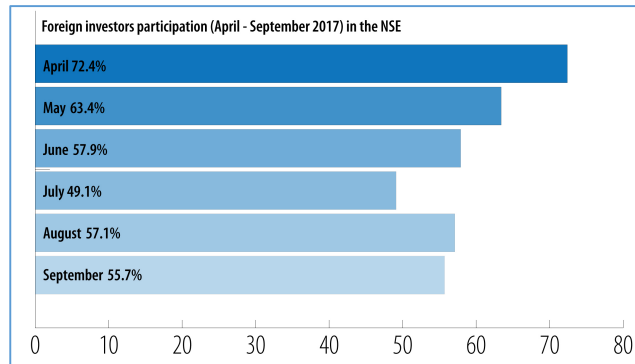


similar period in 2016 (see figure 2). At the same time, the National Treasury is grappling with a US\$276.2 million shortfall in the revenue target for the first quarter of the 2017/18, with the second quarter already predicted to be even lower. Even though the real extent of the fiscal and economic effects is still to be determined, key sectors are being negatively affected by political uncertainty.

Reduced Foreign Direct Investment (FDI)

Data from the [Capital Markets Authority](#) (CMA) shows that the participation of foreign investors in the NSE has remained stuck below the 60% since June 2017 due to growing jitters. The CMA put the level of participation at the NSE by the foreigners at 57.9% in June 2017, 49.1% in July and 57.1% in August and 55.7% in September compared to 63.4% in May and 72.4% in April. The decline in participation is associated with investor jitters due to political uncertainties surrounding the Presidential election re-run. The data also shows there was a marked slowdown in foreign investor purchases in the third quarter of the year. The CMA data shows that most of

the foreign investors cashed out of the NSE between July and September 2017. Over the same period, shares worth Ksh23.1 billion were purchased, leading to a net foreign equity outflow of Ksh11.1 billion. In addition, foreigners, who ordinarily command most of activities on the Nairobi bourse, have cut their participation to an average of 54%.



The [Kenya Association of Manufactures'](#) (KAM) third quarter Barometer report released in Mid-October 2017 indicates that political uncertainty will adversely affect industries, where profits will dip with a further negative impact expected from the rise in the cost of raw materials. The



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report indicates that 47% of factories plan to shed jobs over the next six months following sales that were lower than expected and led to reduction in production. While the political impasse continues, KAM indicates that 64% of industrial manufactures forecast zero or negative revenue growth in the next six months.

Fiscal Budget Pressures

The political uncertainty has also had an impact on the fiscal budget of the country, resulting in the suspension of National Government funds transfers to County Governments since July 2017. To accommodate the IEBC request of Ksh12 billion for the fresh presidential election and other government commitments, the National Treasury has presented a supplementary budget cutting development spending for the current fiscal year by Ksh30 billion. This means that Kenya is already in a compromised fiscal position where recurrent expenditure accounts for 58.8% of the 2017/2018 budget.



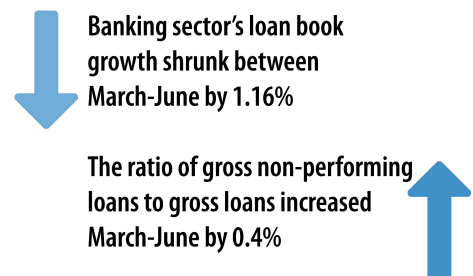
12Billion for the October 2017 fresh presidential election

30 billion supplementary budget cut for development spending for current fiscal year (58.8% of the 2017/2018 budget)

Less money is being channeled to productive spending with the bulk of the funds spent in non-productive recurrent spending. The reduction in development spending will skew the development-recurrent ratio even further, pushing Kenya into a position where government spending will have an even more muted impact on economic growth. Additionally, the government's revenue collection for the fiscal year starting July was below target by Ksh29 billion. Experiences have demonstrated that it is prudent to have as much money as possible spent on development expenditure to spur economic growth as this increases fiscal space to address a country's development challenges. The policy implication is that the reduction in development expenditure will have an adverse impact on economic growth and fiscal space in Kenya going forward. Furthermore, the reduced spending is occurring in a context of muted economic growth due to a combination of elections, [the declaration of a national drought](#) and commercial bank interest rate caps. The development spending cut will exacerbate an already difficult year for many businesses, and further compromise economic growth.

Reduced Commercial Bank Borrowing and Increased Non-Performing Loans

From the banking sector, [data from the Central Bank of Kenya's \(CBK\) Credit Survey](#) released September 2017 paints a gloomy picture as commercial banks lament how political uncertainty has led to a tightening of credit and is negatively affecting all sectors of the economy. Already, the banking sector's loan book growth shrunk by 0.84% in June from March's 2%, while the ratio of gross non-performing loans to gross loans increased from 9.5% in March to 9.9% in June, due to the challenging business environment. The CBK attributes the decrease in gross loans mainly to a reduction in loans granted to support the transport and communication, trade, agriculture, real estate, mining and quarrying sectors. Commercial banks expect an increase in the levels of non-performing loans (NPLs) in the third quarter of 2017 with 42% of this expected rise in NPLs attributed to the industry's perceiving increased political risk ahead of the Presidential election rerun.



3. Conclusion

Political uncertainty will remain high because of the Presidential election re-run, which will continue to dampen business activities. The continued political impasse will heighten political tension and instability, disrupt businesses as demonstrations are intensified, violent clashes between security agencies and demonstrators occur, and ethnic groupings fight against each other among other things. This will further create insecurity and increased opportunistic crime or resurgence of organized crimes. Productive sectors such as agriculture, energy, manufacturing etc. will be interrupted. Food supplies from the rural areas to markets in urban centers will be interrupted leading to increased food prices and reduced standard of living for many Kenyans.

Currently, little attention has been given to the economy which is expected to contract sharply as no development strategy is vigorously implemented. While lip service is given to the MTP II implementation due to political stalemate, it is unlikely that MTP III (2018-2022) and CIDPs (2018-2022) - expected to spur Kenya's development agenda in the next five years - will provide a much-needed roadmap in terms of priorities in the already ethnically polarized country. No meaningful development will take place in the next six months even if the political stalemate is resolved as processes must be put in place for meaningful policy execution. During the 2007/8 political instability, key sectors witnessed a sharp slowdown of economic activity, due mainly to displacement of labour; disruption of input supply chains and trading routes; rapid decline in tourism arrivals and destruction of assets due to looting and arson. Based on 2007/8 figures, where the economy contracted sharply from a 7.1% growth rate to 1.5%, 2017 and 2018 data will also witness a sharp decline in GDP growth. The situation may get worse if external factors such as increasing oil prices, recurring drought, reduced exports and impact of reduced external support is considered.

Already Kenya Private Sector Alliance (KEPSA) has for instance cautioned that the political tension could lead to unprecedented inflation and an unpredictable impact on the economy. The negative impact on the economy calls for the need for politicians to strike a quick deal to end the political impasse over the repeat Presidential election. Resolving the stalemate will reverse

the waning investor confidence, and facilitate a conducive business environment to unlock the potential of various sectors to contribute positively to the development in the country.

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The views expressed in this policy brief are those of the SPAU, and do not represent the views of UNDP, the United Nations or any of its affiliate organizations

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