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| A picture of a winding road and trees  financial statement  [Document subtitle] | DAVID KAIRU KURIA - HSB214-0090/2022  EDWIN WAITHAKA MAINA -HSB212-0002/2022 |

# NEW FINANCIAL STATEMENT

The 2022 Financial Stability Report discusses key developments and risks in Kenya’s economy and financial sector in 2022 and first half of 2023. Globally, the period under review was characterised by elevated inflationary pressures in advanced countries triggering strong monetary policy responses. This came on the backdrop of a reversal from a long period of very low interest rates, low volatility, and ample liquidity, associated with persistent expansionary monetary policy in the advanced economies. Emergence of inflationary risks in advanced economies triggered monetary policy tightening, which increased interest rates.

This resulted in unexpected and unintended impact on financial institutions, especially banks, that had large exposures in bonds and relied on debt and money market for liquidity. Accumulation of bonds and reliance on market funding exposes these institutions to liquidity, duration, and credit risks. Climate change risks to the financial sector and overall economy have increased. Several countries are now experiencing longer and severe droughts, floods and mudslides, and severe storms including typhoons and hurricanes. These have come with significant physical, transition and/or liability risks to the financial sector. With limited fiscal space to mitigate the effects and/ or adaptation, vulnerabilities in these countries have increased. Kenya’s economy was resilient in 2022 to multiple shocks domestic and global sources. It expanded by 4.8 percent in 2022, compared to 7.6 percent in 2021. The expansion was supported by robust growth of service sectors, mainly transport and storage, financial and insurance, information and communication, and accommodation and food services.

However, agriculture sector contracted further by 1.6 percent in 2022 due to drought. Other factors included

* Poverty
* Shortage of capital
* Land fragmentation
* Banditry

The economy is projected to grow by 5.7 percent in 2023 on rebound in agriculture and other key sectors. The real Estate and building and construction sectors, however, remain subdued on changing consumer behaviour, especially for commercial real estate. The narrow fiscal space, high debt level, tightening monetary policy and liquidity conditions in the international market, unpredictable weather patterns and political risks, could impact growth in 2023. Additionally, tightening lending standards by banks may slowdown credit uptake, thus growth and financial sector stability. Kenya’s financial sector was stable and resilient to multiple shocks in 2022. Banking sector was sound and stable supported by strong capital and liquidity buffers.

There is however elevated credit, interest rate and operational risks as indicated by the 2023 Banking Sector Stress Test report. The microfinance banks remain weak, thinly capitalised, and loss making, diminishing their credit intermediation role. Capital markets face flight to safety by investors, characterised by excess volatility, reduced liquidity and high concentration risk. Corporate bonds segment recorded some act in the primary market, while there were no new issuances in the market and equities market segments are yet to record new issuances. The capital, return on investment and gross premium increased. However, insurance industry paid more claims then premiums received, while fraud incidents increased.

However, technology related incidences such as fraud increase. In addition, the sector paid more claims than premium received, imply risks mispricing. Pension sector face low returns on investment due to decline in equity and bond prices and member contributions. The asset quality and profitability of Saccos improved in 2022 despite slow economic growth and high cost of living experienced by members. Overall, a careful policy balancing between stemming inflation through monetary tightening, undertaking fiscal consolidation to enhance public debt sustainability and deploying fiscal and financial policies to support vulnerable firms and households is needed for sustained economic recovery and macro-financial stability. The Central banks also need to deploy appropriate tools to address financial stability concerns separate from those targeting monetary policy objectives.

The East African Community (EAC) economies grew slower in 2022 by an average of 2.4 percent from an average growth of 6.9 percent in 2021. The moderation is on account of depressed agricultural output, constrained fiscal space on account of rising public debt and lower revenues, inflationary risks, and monetary policy tightening to curb rising prices. The region’s growth is projected at an average of 5.1 percent in 2023, supported by rebound in Agriculture, global economic recovery, easing inflationary pressures, and improved financial conditions. Downside risks to the projected growth include elevated food and energy prices, thus maintaining inflation high, and in turn delaying the Partner States Central Banks to ease their respective monetary policies stance. The regional national currencies also remain under pressure against international currencies, thus impacting households and firms negatively. This is through

1. Foreign policy
2. Shortage of money
3. High import bills
4. High cost of fuels
5. Rise in debt risks

The banking sector in the EAC region remains resilient to credit and interest rate shocks due to sufficient capital and liquidity buffers-built overtime through retained earnings. In addition, regulators have implemented a wide range of regulatory measures to ensure the sector is well prepared to weather emerging risks. However, strains to household income as a result of high inflation due to supply disruptions of energy, food and fertilizer attributed to the Russia – Ukraine War, continue to weigh in on credit risk for banks. The NPLs ratios for Rwanda, Uganda, Kenya and Burundi and South Sudan have risen significantly. A further increase in interest rates if monetary policy tightening is sustained, could worsen financial conditions, intensify financial markets volatility and reduce access to liquidity by banks.

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| SECTORS | | Sep 30 | Oct -30 |
| Agriculture | Fruits | 7.7 | 97.6 |
| Manufacturing | Automotive | 10.4 | 34.89 |
| Trade | Exports | 9.6 | 32.7 |
| Business | Banking | 67.8 | 45.7 |
| Households | Electronics | 45.2 | 67.2 |
| Real estate | Shares | 8.2 | 98.8 |

