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## Economics Focus: Kenya

**Disputed election leads to political uncertainty, but long-term impact on economy probably limited**

- **Although we have concerns about the conduct of the vote count of the 27 December presidential election, we maintain that neither the opposition nor the international community will be able to force a recount. However, the re-elected president, Mwai Kibaki, may agree to reforms of the electoral system and wider talks about the need for constitutional reform.**
- **As long as the political uncertainty fades away quickly, which we expect, the impact of the political crisis on the economy is likely to be limited. This is especially the case if the impact on the tourism industry is limited.**
- **We believe if there were a sell-off of the Kenyan shilling, as a result of the political crisis in the coming weeks, then this could represent a good buying opportunity for investors, as most economic fundamentals underpinning the economy's strong performance in the last two years are unchanged despite the political uncertainty.**

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## Disputed election leads to political uncertainty, but long-term impact probably limited

### Conduct of the election depends on one's point of view

In general, African elections attract little interest in the Western media. Most pass by unnoticed unless there is some election chaos, in which case there tends to be a couple of television stories and one or two newspaper articles until the story is quickly dropped for more pressing news stories. The 27 December elections in Kenya however have proved an exception. A disputed presidential poll and a bout of election-related violence, when news stories over the Christmas and New Year holidays in the US and Europe were limited, meant that there was considerable coverage of the Kenyan elections on the main news broadcasts by all three major US television networks on 1 January.

*Much reporting of the election has been colourful*

Perhaps unsurprisingly, most of the Western media have tended to be highly colourful in their reporting of events in Kenya. For example, according to the US NBC network the election represented a “bad week for democracy in Africa” (1 January), with the violence showing “no signs of ending”. According to this view of the election, the opposition candidate, Raila Odinga, has been denied an election victory by an ageing incumbent president, Mwai Kibaki (Mr Odinga secured 4,352,993 votes compared with Mr Kibaki’s 4,584,721 votes, with the third challenger, Kalonzo Musyoka, garnering a total of 879,903). This, in turn, led to spontaneous outbreaks of violence, as the supporters of Mr Odinga’s Orange Democratic Movement (ODM), notably the poor and marginalised, felt cheated of an election victory that they had clearly won at the ballot box, with the whole process a setback for democracy.

Moreover, under this scenario a politically-weak and ageing president will preside over a divided parliament unable to push ahead with its stated programme of economic reform. In the worse case, we believe a background of simmering political discontent in the slums of Nairobi, ever-rising political pressures are likely to keep tourists away and discourage investment, leading to a sharp slowdown in economic activity, or at least the end of the country’s recent brief economic renaissance.

However, it is also possible to look at the election from another angle. In this scenario, in recent months the Kenyan opposition has become over confident with the idea that it will win an election as a result of a series of opinion polls. However, opinion polls have not always proved accurate in Africa, largely because they do not accurately capture the rural vote, which in this case swung behind the incumbent president, giving him a narrow victory. Unwilling to accept defeat, the opposition has criticised the vote as rigged, while party activists have been alleged to have engaged in acts of violence to try and enhance their political positions and give the impression that the re-elected incumbent is politically unpopular. The re-elected president has certainly pushed this line, in our view, with the president’s spokesman, Alfred Mutua, even claiming in an interview quoted in Reuters on 2 January that the “supporters of Raila Odinga are involved in ethnic cleansing” notably in relation to the violence in Eldoret and within the Rift Valley.

*We believe the reality is somewhere in between*

We believe the reality usually tends to be someone between these views. On the one hand, there does seem to have been some alleged election manipulation. This seems to be confirmed in the reports by the EU and US election observer teams (for example US State Department press statement 31 December 2007). In particular, they have expressed concerns that they were excluded from various vote counts and that in some constituencies the total number of counted votes exceeded the number of registered voters. These concerns were also supported by comments by the Chairman of the Kenyan Electoral Commission, Samuel Kivuitu, to the press that he was under pressure to announce a result quickly (East African Standard, 2 January). For example, speaking to the East African Standard on 2 January, he said that he could not provide a definitive answer as to who won the elections; he is quoted as saying “I do not know whether Kibaki won the elections”.

There has also been considerable violence (it is currently estimated that around 300 people have died in various incidents (BBC, 2 January)), though this does not seem in our view to represent widespread popular protests. While it is clear to us that some of this violence does reflect apparent anger at the outcome of the elections, notably by ODM supporters, who feel they have been denied victory, or by supporters of Mr Kibaki in retribution for perceived attacks on their own supporters, it also seems to us to be driven by opportunistic efforts to settle long-standing inter-tribal scores.

### **What happens next**

*Mr Kibaki will probably stand firm, in our view*

In such a politically-charged atmosphere with events moving very rapidly, we believe it is easy to get carried away and make bold political predictions about impending chaos and unrest in the country. Such claims are often underpinned, as in this case, by claims by the opposition leaders that they would launch a programme of nationwide popular political unrest, which would bring down the government (31 December Mr Odinga called for a peaceful mass action and announced plans to hold a rally at which he would be proclaimed the people’s president (Reuters, 31 December)). While this outcome cannot be discounted, we believe it is probably unrealistic.

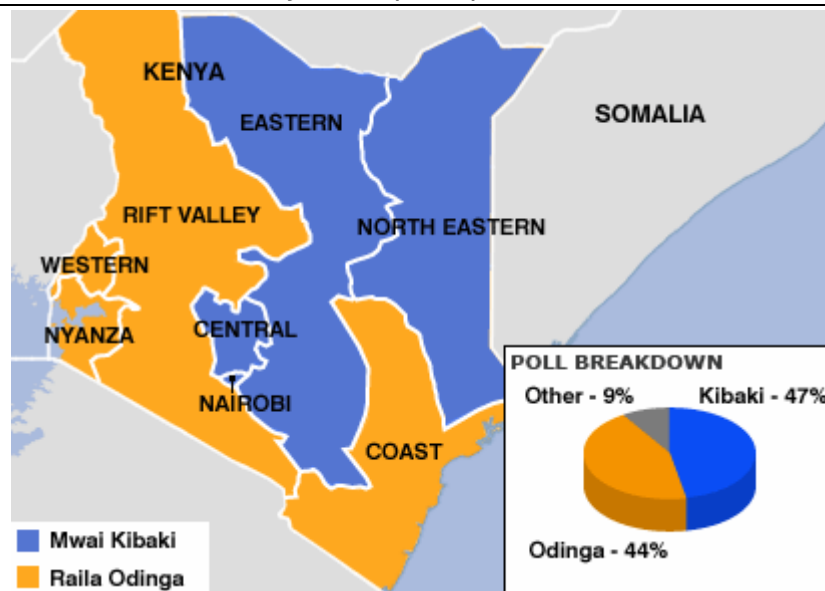
In our view the most likely outcome is that having been formally sworn into office, the re-elected Mr Kibaki will simply stand firm on the grounds that he is the country’s officially-elected president, and resorts to using the police and army to clamp down on any major widespread protests. With most Kenyans increasingly concerned about the need to get on with day-to-day living, we expect protests to probably die down naturally over the next few weeks, even if simmering resentment towards the government continues, notably in those parts of the country that voted for Mr Odinga.

*Sustained mass protests seem unlikely*

If the government does adopt this policy, Mr Odinga’s main option to challenge Mr Kibaki’s election victory would be to organise mass protests against the new president. However, these would have to be of sufficient scale and maintained for at least several weeks if they were to show that the Kenyan public is firmly in favour of political change. We believe there will be some protests, but they are unlikely to be of a sufficient scale or duration to bring about political change. Instead, in such a poor country as Kenya, people would sooner want to get back on with their lives and work. Moreover, we believe the scope for protest is likely to be limited by the police and army, although they are likely to allow some protests.

Finally, in view of the closeness of the election result, we believe there are broadly as many people in favour of a Kibaki victory as an Odinga one. Therefore, the idea that there is an overwhelming majority in the country in favour of protesting for political change is clearly not the case. Instead, Mr Kibaki remains very popular in large parts of the country, notably in the central region around Nairobi, and the East and North East regions, a factor that in our view undermines the idea that there will be some sort of wave of national protest that would ultimately drive him from office.

**Figure 1. Presidential Election Result by Province (Percent)**



Source: BBC and Kenyan Electoral Commission.

*The options open to the opposition are limited*

As well as mass protests, the opposition has two other main ways to challenge the government: through the courts or through parliament. There are, however, problems with both. Using the courts to obtain a legal ruling on the election results could take years. Petitions for the last election have only just been resolved. As such, while a possible route, the outcome looks highly unpromising. In the case of parliament, although provisional results indicate to us that this is likely to be dominated by ODM, which would give the opposition some power, this should not be overstated.

Mr Kibaki's first term in the Kenyan parliament was also highly divided and fluid and the government struggled with passing much needed economic reform and clamped down significantly on corruption. Moreover, Mr Kibaki's previous governments were sidetracked, certainly in his government's first few years in office, on constitutional reform. Yet, these administrations still managed to build coalitions to pass legislation. In many ways neither the ODM nor Mr Kibaki's Party of National Unity (PNU) should really be seen as political parties in the traditional sense of the word, but loose alliances, whose members largely pursue their own interests under the banner of the party, rather than working for a party. Moreover, the offer of political office is still very alluring to many parliamentarians, in our view. In sum, we believe parliamentary opposition to the president may be important, but in the end it is likely to achieve little especially if the president makes active efforts to split the loyalty of the opposition.

*The international community can do little*

We also think that there is little that the international community can do to push the political process forward. Foreign governments are likely to continue to express their concerns over the conduct of the election vote count and the need for a solution to be found. However, in practice we believe this is likely to lead to little concrete action, while the longer Mr Kibaki remains in power the pressure is likely to grow to rebuild relations with the new president. This is especially the case as Kenya is widely seen as a crucial economy in East Africa and an important ally in the fight against Islamic extremism in the Horn of Africa. Moreover, as Kenya has only received limited aid inflows in the last few years, the threat to withhold them is likely to have only a limited impact, in our view.

In some ways, donors have also cornered themselves in recent years, limiting their ability to criticise the polls. Although they criticised the conduct of the Ethiopian elections in May 2005, those in Uganda in February 2006 and in Nigeria in April 2007, they have taken little concrete measures to show their disapproval in the end, all opting to work with the elected government rather than to isolate it. There is no clear reason why they would act differently in Kenya. Instead, we believe probably the main impact that donors could have is either to be able to press that any legal challenge is dealt within a reasonable time frame, or perhaps that some special tribunal is set up to look at the issue of the elections. This would probably rule that the Kenyan Election Commission, for example, needs reforming or that the whole electoral process needs revising, without undermining the outcome of the elections.

## **The economic implications**

*The long-term implications to the economy are likely to be limited*

In our view, assuming that the political violence fades away quickly, the overall impact of the economy is likely to be limited. The most obvious direct impact will be on the tourism sector, where we believe high profile media coverage will clearly have an impact, with bookings likely to fall. This is important, as tourism has been a key driver of economic growth in the last couple of years. Tourist arrivals in Kenya had risen to 954,335 in 2006, an increase of 14.5% from 2005, with further growth of around 13% in the first eight months of 2007 (compared with the same period in 2006). However, experience from Egypt and Morocco shows that while tourists will stay away at times of crisis, the number of visitors will quickly pick up again once the immediate crisis has passed.

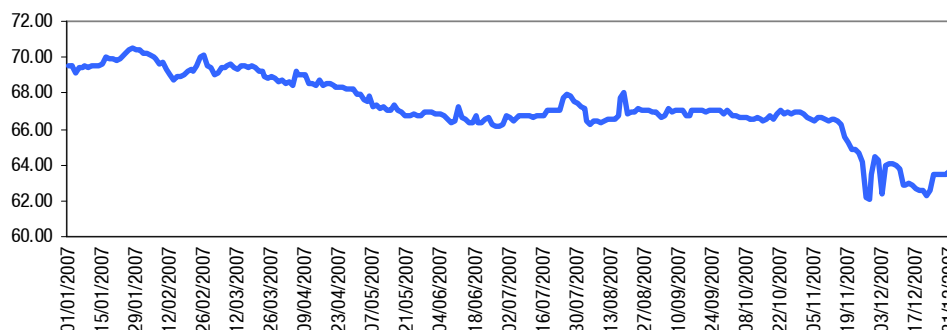
In terms of economic policy, we believe that it makes little difference who won the election in terms of the overall direction of economic policy. Moreover, we had always expected that whoever assumed the presidency would face a parliament with either a very narrow majority, or even no majority. This will clearly limit the ability to push ahead with economic reform. While we believe this is a concern, the real story of the Kenyan economy in recent years has been that the private sector has continued to drive growth despite the political situation, which has, in fact, been relatively chaotic throughout the first term of Mr Kibaki's presidency.

Moreover, and crucially in the case of Kenya, even when there are foreign investors in the private sector, most are long-term players, who are well established and will see out any political storm such as is currently under way. In recent years, despite the fact that it has a much more diversified economy, with a larger manufacturing sector, Kenya has attracted much lower levels of foreign direct investment than Tanzania and Uganda, where the flows have largely been into the mining sectors.

*If the Kenyan shilling falls, this could be a buying opportunity, in our view*

For portfolio investors the political turmoil could put some off the market, but in view of low interest rates in recent years, investor interest has been limited. However, in our view, the current crisis does create a potential opportunity. Arguably, the Kenya shilling had appreciated far more rapidly than we had expected, in the final two months 2007 it rose from around KES66.6:US\$1 at end-October to KES63.7:US\$1 at the end of 2007. Although the foreign exchange markets opened on 2 January after the political violence, trade has been limited, so no clear direction in the value of the shilling has emerged.

**Figure 2. The Kenyan Shilling against the US Dollar 2007**



Source: Reuters.

If, however, the violence and political uncertainty provokes a sell-off, the Central Bank of Kenya is likely to struggle to limit any fall in the value of the shilling given the country’s low level of foreign exchange reserves. However, once the political storm has died down, we believe that the economic fundamentals behind the shilling rally in late 2007 remain in place, though the timing of some of the capital inflows we had expected into the country will be delayed. In particular, unless there is a rapid resolution to the political crisis, we think the Safaricom IPO and the expected international eurobond issue are likely to be delayed until the middle of the year. However, once things are back on course, we think this should help drive a quick recovery in the shilling by the middle of the year.

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## Conclusion

Although we clearly have concerns about the conduct of the vote count of the 27 December presidential election, we think the likelihood of either the opposition or the international community to force a full re-count is limited. Instead, we think the most likely outcome is that the re-elected Mr Kibaki will allow some sort of investigation into the conduct of the vote count. This is likely to make broad recommendations about the need for reform of the current electoral system, but it is unlikely to demand a recount, in our view. As a further sop to the opposition, this could also be widened into a broader debate about the need for wider constitutional reform, something that occurred during Mr Kibaki's first term in office, but eventually came to nothing.

*In our view, a possible  
opportunity to enter the  
market*

Meanwhile, assuming that the political crisis runs its course fairly quickly, we expect little long-term damage to the economy, though the image of the country is likely to suffer substantially in the short run. However, even if there were a sell-off from the stock market, or of the Kenyan shilling, with the current economic fundamentals remaining unchanged, we think this may well represent an opportunity to enter a market that should continue to perform well once it has ridden over the immediate political problems.

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