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An Analysis of the 2017 Kenyan Election and its Potential Impact on Growth and Investor Confidence

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The Importance of the Kenyan Elections for Kenya and East Africa

General elections were held in Kenya on 8 August 2017 to elect the President, members of Parliament and devolved governments. The reported results indicated that incumbent President Uhuru Kenyatta and his Jubilee Party were re-elected with 54% of the vote.

Opposition leader Raila Amolo Odinga's five-party NASA National Super Alliance alleged that the Independent Electoral & Boundaries Commission's computer systems were tampered with and vote tallies were altered.

In a decision unprecedented in Africa, the Supreme Court ruled on 1 September that the commission *"failed, neglected or refused to conduct the election in a manner consistent with the dictates of the constitution."*

It yet has to release its detailed findings. While President Kenyatta said he'll respect the verdict, he disagreed with it and described the lawsuit that challenged the election outcome as "nothing but thuggery." The Supreme Court of Kenya nullified the August 8 election, ruling that incumbent President Uhuru Kenyatta's win by 1.4 million votes was invalid due to flaws in the tallying process.

Kenya's Supreme Court on September 1 canceled the election result, the first such ruling in Africa, and ordered a new ballot to be held. In annulling the August election result, it said the Independent Electoral and Boundaries Commission (IEBC) had not followed the constitution.

Kenyatta was declared the winner by the IEBC. The court said a new election needed to be held by 31 October 2017. The re-run election date has been moved from 17 October and has now been confirmed for 26 October.

The 26 October re-run decision has increased uncertainty in East Africa's second largest economy, where growth is already slowing. The basic issue is one of dealing with the rigging of elections, which is basically an extension of corruption. Seen from this perspective, the Kenyan Supreme Court decision was both good and bad news.

It was good news in the sense that there are checks and balances in place and that the Supreme Court is the final arbitrator. It is bad news in the sense that it could lead to uncertainty and a decline in business confidence, not only in Kenya, but also in the wider East African region.

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Odinga has demanded the electoral commission be overhauled and said he wanted guarantees on fairness before his alliance agrees to participate in the re-run. The ruling Jubilee Party, led by President Uhuru Kenyatta, who was declared the winner of the election vote, has rejected any changes to the commission.

Previous disputes over elections in Kenya have led to violence, the most serious being in 2007, when clashes left more than 1,100 people dead and forced 350,000 more to flee their homes. That resulted in growth slumping to 1.7 % in 2008 from 7.1 % a year earlier.

The real worry is that this year's election dispute is expected to have a meaningful negative impact on growth and investor confidence, as well as potentially re-creating a climate for violence.

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Odinga has said that he will not take part in the presidential election re-run slated for 26 October "***without legal and constitutional guarantees."*** Odinga wants the IEBC to strictly follow the constitution's guidance on conducting elections. NASA has begun street demonstrations to protest against a repeat presidential election without electoral reform. The reason for their demonstrations is to show a generation of Kenyans how to resist "to stop single-party dictatorship," in his words.

He also wants some of the commissioners to be sacked, alleging that they are partisan, and he is pushing for access to IEBC's electronic voting and result transmission system. Odinga criticised the IEBC for announcing the new election date, saying that opposition parties had not been consulted. While the Supreme Court didn't find any wrongdoing by any of the IEBC's staff, Odinga says commission employees, including the chairman, chief executive officer and eight others, should be removed for their complicity.

The IEBC officials have denied any wrongdoing and have refused to resign. Legal experts have warned that Kenya may be heading for a constitutional crisis if the IEBC fails to conduct an election by the court's 30 October deadline. Kenya's Attorney General has said President Kenyatta will remain in office until the next president is sworn in.

If the election on October 26 does go ahead without meeting the conditions of NASA, the opposition may resort to a constitutional clause to ensure the vote is invalidated. The constitution states that the election must take place in all 290 constituencies, and it only has to ensure the vote doesn't happen in two or three of its strongholds to seek another annulment. Odinga is of the opinion that if the IEBC pretends that it's business as usual, it would be demonstrating it is operating without due regard to the Kenyan constitution. This could be an unfortunate scenario because the stalemate could persist and could even lead to a constitutional crisis.

The electoral commission has named a six-member team to run the new election - including new heads of operations, information technology and the national tallying centre - and pledged to address shortcomings identified in the court's detailed ruling.

Odinga's coalition, however, is demanding more sweeping personnel changes, including the removal of Chief Executive Officer Ezra Chiloba, and they require guarantees that the next vote will be fair before it agrees to participate. Kenyatta, on the other hand, vowed to resist all opposition attempts to achieve further management changes at the electoral body.

If both parties retain their hard-line stances, there will be a constitutional crisis and most international investors might not be prepared for this remote, but real, possibility.

Why does it matter?

The uncertainty surrounding the election outcome is impacting business confidence and could lead Kenya towards a constitutional crisis.

Both small and large businesses in Kenya are affected by uncertainty about the presidential election re-run. The impasse raises the risk that the election won't happen at all, a situation the Kenyan constitution doesn't envisage. If both parties retain their hard-line stances, there will be a constitutional crisis and most international investors might not be prepared for this remote, but real, possibility.

Some Kenyans increasingly fear that the State is reversing hard fought freedoms. The concern is a gradual erosion of the democratic gains. It seems that every five years, Kenya loses two years of government because of elections and this is creating doubts and uncertainties about the country's future.

Part of the current problem is that Kenya's electoral commission is mired in infighting over who should take the fall for the botched contest. Demands by Odinga that sweeping changes be made to the commission have also placed them at loggerheads with President Uhuru Kenyatta's ruling Jubilee Party.

While the independence of the Supreme Court of Kenya is asserted by the decision, political stability is at risk with the threat of a repeat of the 2007 post-election violence still a concern.

Odinga has warned that the election won't be allowed to proceed unless the opposition is satisfied the process will be credible. After Odinga alleged rigging, his supporters burned tires and barricaded roads in the streets of Nairobi, the capital of Kenya, and the western city of Kisumu, and clashes with the security forces ensued. The opposition said more than 100 people were killed, while the Kenya National Commission on Human Rights puts the death toll at 24.

While the court's judgment asserts the independence of the judiciary, a key pillar of Kenya's long-term development policy, it has done little to quell concerns about possible unrest around the election re-run.

Any turmoil in East Africa's second largest economy would be felt across the region, particularly in landlocked Uganda and Rwanda, which rely heavily on Kenya's ports and roads to access international markets.

Ethnic unrest that followed the disputed election vote in 2007 (referred to above), illustrated just how ugly the situation can get -- at least 1,100 people died and about 350,000 Kenyans were forced to flee their homes.

In September 2017, Kenyan business activity shrank for a fourth month as concerns about elections hit confidence in an economy that expanded at the slowest pace in more than two years in the first quarter of 2017.

Economic impact

African and global investors fear any prolonged uncertainty will weigh on growth, because it will deter business and consumer spending and delay government projects and policy decisions. The prognosis may improve when the election dust has settled, because the court's assertion of its independence is likely to be seen as proof of the soundness of Kenya's institutions and a plus when it comes to making longer-term investment decisions.

Following the 2007 Election dispute, the Kenyan economy took a downturn, made worse by the sub-prime global financial crisis, with the Kenyan growth rate slumping to 1.7% in 2008 from 7.1% a year earlier.

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Kenyan banks face declining earnings and rising bad debts as the Supreme Court's decision to order a re-run of presidential elections scuppers prospects that a limit on interest rates will be removed anytime soon.

Kenyan financial institutions have reported lower profit after the government imposed a ceiling on the interest rate they can charge on loans and have been lobbying the state to either review or remove the rule. While Kenyan banks had expected an Uhuru Kenyatta victory to lead to a policy change, with the president saying in March that the legislation needs to be revisited, that option is probably off the table after the September 1 judgment. The election re-run clouds the outlook for the policy and when it might be changed.

Reflections on Kenyatta's economic and political record

On the economic front, the big question is: Are Kenyans worse off today than they were in 2013?

Kenya's economy has expanded an average of 5.7% a year since 2013, when Kenyatta came to power, as the country reaped the benefits of lower energy prices and improved transportation links. Kenyatta's government has also spurred growth by encouraging the development of the tourism, agriculture, services and manufacturing industries, and has made some headway in improving access to education and health care.

His opponents accuse him of not doing enough to cushion the poor from a drought and soaring food prices and failing to stamp out widespread corruption. Kenya dropped 6 places in Transparency International's Corruption Perceptions Index last year, putting it among 30 countries seen as the world's most corrupt.

Since Kenyatta took power, foreign investment increased, but many Kenyans still say they are not feeling the effect of the much-touted growth. The Kenyatta

administration has also been accused of excessive borrowing, with an estimate that it has borrowed much more than the accumulative amount borrowed by all past Kenyan governments since independence. The country's debt is currently estimated at US$26 billion. Kenya's total public debt stood at KES 3.827 trillion or 51.50% of GDP in December 2016.

The International Monetary Fund (IMF) has urged Kenya to lower the country's budget deficit in order to keep the debt at manageable levels. President Kenyatta's Jubilee government has, however, often remained defiant in the face of the warnings.

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What is Odinga promising to do differently?

Odinga made the fight against corruption and poverty the centrepiece of his campaign. His other pledges included introducing measures to assist small-scale businesses and farmers and incentives to manufacturers to help boost export-oriented growth. He also said he'd consider tax cuts to woo foreign investors and scrap a law imposed earlier by Kenyatta that prevents commercial lenders from providing loans at more than 4% above the official Central Bank of Kenya rate.

Investor concerns

The uncertainty about the election outcome is slowly starting to unnerve investors in Kenyan assets. After an initial knee jerk sell-off reaction, markets have stabilized, but longer-term Kenyan asset prices could be at risk. Scape-goating and singling out individual companies could add to increased investor concerns.

French digital-security company OT-Morpho, whose equipment was used in Kenya's presidential election, reiterated that its systems weren't tampered with to rig the outcome, calling the accusations an attempt to shift blame for a vote the nation's Supreme Court nullified.

OT-Morpho said an internal audit of its equipment, conducted after the Supreme Court annulled the August presidential election, found no foul play. The company provided 2 electronic systems that identified Kenyan voters and transmitted election results from almost 41,000 polling stations to a central tallying center. CEO Frederic Beylier said that the company does not accept that the reputation of OT-Morpho and its employees is tainted in any way by the allegations of rigged elections in Kenya.

OT-Morpho urged that the allegations must come to an end. The company is suing unidentified people in both French and Kenyan courts for damaging the company's "reputation and honour."

Odinga's NASA urged the French government to investigate Paris-based Safran SA and its relations with electoral officials, who it alleged may have "*acted in complicity and connived to undermine the will of the people of Kenya*." Safran sold its digital security unit in May to Advent International, owner of Colombes, France-based Oberthur Technologies SA, and the renamed company is called OT-Morpho.

Global investors' concerns with Odinga is that he's untested in an official capacity. If he is victorious in the October election, it will take him some time to earn the trust of investors in the country and internationally.

OT-Morpho, who provided 2 electronic systems for the ballot, wrote to the IEBC to say it was unable to provide a new results transmission system by 17 October, when the first new vote was scheduled to take place. Since then the vote has been moved to 26 October.

OT-Morpho may also be constrained by the Kenyan Supreme Court's detailed ruling on the annulment, which may comment on technical issues. The IEBC has given UAE-based Al Ghurair Printing and Publishing the green light to print ballot papers for the fresh presidential election. The IEBC resolved to return to Al Ghurair after the National Treasury blocked its bid to procure the strategic materials through a UN development agency.

While Odinga demanded that new ballot paper suppliers be selected, the commission announced it would stick with Al Ghurair, whose contract for August's vote was challenged in court before finally being allowed. The IEBC also said it was retaining the services of Paris-based OT-Morpho to provide 2 electronic systems for the re-run.

Odinga's NASA is insisting that a thorough, independent and transparent end-to-end audit and quality assurance of election technology systems is implemented before the next vote.

Market impact

The Nairobi Securities Exchange had cheered the results of the August election, which saw Kenyatta winning decisively. However, after the Supreme Court annulled the election results on 1 September, foreign investors were seen reducing their stock holdings.

This can be considered an indication of their faith in the incumbent president, and could signal further gains in the Kenyan financial markets if the results of the August election are repeated in October. As far as Odinga is concerned, he has seized many popular platforms in his campaign regarding his fight against poverty and corruption, as well as supporting small businesses, manufacturers, and farmers.

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One of the most significant post-election events being measured in Kenya has been the violence associated with the results. This is a major factor to be considered by international investors.

The Nairobi Securities Exchange All Share Index is up 28% in YTD 2017, according to total returns, and the MSCI country index is also up by the same percentage.

Drawing on historical precedent, it is the occurrence of violence that can be one of the biggest red flags for international investors.

Going into the Kenyan election in August, there was an air of optimism among investors in the region that the elections will be largely peaceful, with very few taking up political risk and violence insurance covers.

Election controversies have become routine in Kenya since it became a multiparty democracy in 1991, but 2017 could be a defining moment in Kenyan politics.

According to Pan-African insurer African Trade Insurance Agency (ATI), only a few investors were considering taking up political risk and political violence cover, compared with 2013 when Kenyans last voted. Investor complacency comes at a time when foreign direct investment inflows in East Africa and economic growth are on a decline, blamed on various shocks.

A report by audit and consulting firm Ernst and Young (E&Y) indicates that FDI inflows into the region significantly plunged last year, with Kenya recording the biggest drop. E&Y's Africa Attractiveness Report 2017 shows that last year, Kenya experienced an investment decline after a bumper year in 2015, following a 57.9% decline in FDI projects. Capital investment declined by 55.5%.

Financial markets and the Kenyan shilling were sharply impacted by the election, but they seem to have already recovered. Kenyan equities and bonds took a dive in the wake of the court verdict, but are holding up. The rebound has been seen because of the firm message that the Supreme Court sent with its unprecedented ruling, which in turn gave a big boost to faith in the judicial system of the country.

Importantly, this bounce back also indicates confidence amongst foreign investors, given that foreign investors were the biggest participants in the sell-off following the Supreme Court ruling.

The CEO of the IEBC said that the re-run will cost an estimated 12 billion Kenyan shillings (US$117 million). As a point of reference, the August 8 election had cost about US$480 million.

With a per capita income of less than US$3,000 (adjusted for purchasing-power-parity) in 2016, according to World Bank data, the election will cost the equivalent of the annual income of 40,000 people. Unadjusted for PPP, this number is equal to the annual income of over 102,000 people. Next to pressure on government finances, investors have additional concerns, and some stem from history.

Election controversies have become routine in Kenya since it became a multiparty democracy in 1991, but 2017 could be a defining moment in Kenyan politics. The European Union urged Kenya's ruling Jubilee Party and the main opposition alliance to be prepared to compromise hard-line positions to allow for a credible rerun of presidential elections.

Strategic long-term investors therefore will want to wait until the October 26th election re-run is out of the way before re-balancing portfolios and implementing investment decisions.

Kenya's central bank tried to reassure the market and global investors by communicating a sense of normalcy and continuity amid uncertainty about the country's protracted elections. However, the Central Bank may lower its 2017 economic growth forecast slightly to reflect uncertainty about the elections. The growth rate for 2018 could be below 5.5%, but definitely above 5%.

Two months after Kenya staged its presidential election, the East African nation's political future remains a guessing game. The latest news seems to imply that

Odinga is challenging the October 26th election and this could lead to a constitutional crisis. While the electoral commission says the vote will go ahead on 26 October, the opposition says it won't. The uncertainty has prompted Kenyan stocks to fall the most in Africa since the annulment of the results on 1 September and yields on its Eurobonds to jump. Traders and investors are therefore seen to be deserting Kenya's stock market, as the unresolved crisis around the country's presidential election discourages foreign investment.

Kenya's benchmark index, which gained 26% in the 12 months to 31 August, has slumped to become the worst-performer in Africa and the second-biggest decliner globally since the Supreme Court ordered that a new vote be held.

If the election doesn't happen, Kenya could be in a real constitutional crisis, with all its negative side effects. Investors beware.

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