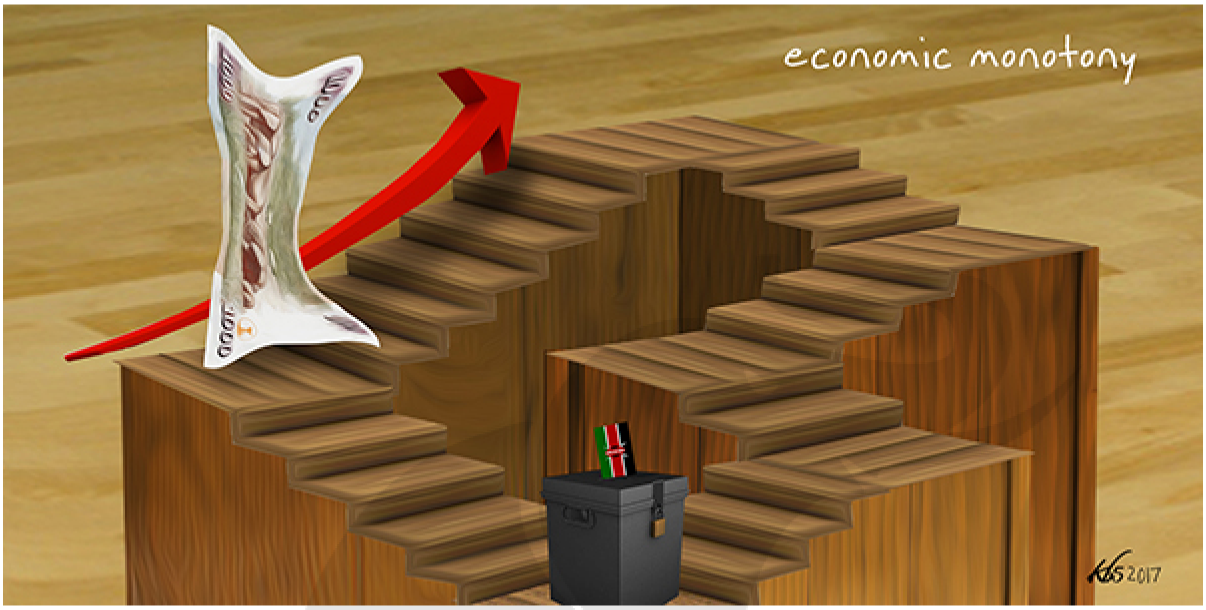
By Kwame Owino



If you read and listen to the coalition of business groups and finance pundits in Kenya, you will by now know that the nullification of the results of the August presidential elections made Kenyans $1.2 billion poorer. This narrative is driven by the view that, for some reason, Kenya's economy is supreme and that other decisions ought to be secondary to the "markets". To my mind, this is a convenient narrative for those who wish to express their views and personal political preferences by hiding under the guise of economic prudence. This narrative is troubling for several reasons, both political and for what it reflects about Kenyans' knowledge about economics and about their disposition to participate in debates on economic policy.

First, it is true that the decision by Kenya's Supreme Court on September 1, 2017 was not only unexpected but also unprecedented. For that reason, the equity markets may not have accounted for the effect of such a monumental decision, thus the abrupt reaction. However, the fact that a majority of participants in the equity markets failed to account for the small probability that the court could nullify the fake election result is neither the fault of the court nor a reflection that the decision was wrong. If any blame must be cast, it ought to fall at the doorstep of the analysts who advise market participants because their sophisticated models failed to account for a low probability result whose consequences would be enormous.

> The interpretation that the election was itself harmful to the economy is a preposterous claim reached via poor economics reasoning. Add political partisanship of business lobby groups to this inadequate understanding of economics and what will emerge is the view that politics harms Kenya's economy and so we should focus on "development", not "politicking".

So the proper way to view this market outcome is to reckon with the fact that these market participants didn't have complete knowledge to advise their clients well and, therefore, reacted in panic when an unexpected result was delivered. The interpretation that the election was itself harmful to the economy is a preposterous claim reached via poor economics reasoning. Add political partisanship of business lobby groups to this inadequate understanding of economics and what will emerge is the view that politics harms Kenya's economy and so we should focus on "development", not "politicking".

Secondly, basic knowledge of what the composite index of the Nairobi Securities Exchange (NSE) represents shows that the pundits conveniently pick numbers to illustrate their own political preferences. The NSE Index is derived from a formula that aggregates the value of the equities sold on a given day and computes the total value represented in the market, based on the latest prices of the equities. What the NSE Index shows, therefore, is what the total cost of all shares in the exchange would be if they were all sold at the latest prices. This by itself does not mean that it is an exact mirror of overall economic performance for the country.

> Even if we rely on the impressive performance of some of the corporations listed on the NSE, collectively these corporations do not account for the largest share of Kenya's economy and are a poor reflection of Kenya's economic profile.

Yes, one could argue that because the firms listed in the NSE are based in Kenya, their performance should be correlated to overall economic performance. But for the NSE Index to become a perfect measure of overall economic performance would require that all slices of Kenyan enterprises be represented in the exchange and that they be included according to their real economic sizes and sectors. These enterprises are not included in the NSE Index; the fact that the telecommunications giant Safaricom's value alone is about 20 per cent of the total of the NSE's Index shows the folly of relying on the NSE exclusively as a measure of overall economic performance in the country. Even if we rely on the impressive performance of some of the corporations listed on the NSE, collectively these corporations do not account for the largest share of Kenya's economy and are a poor reflection of Kenya's economic profile.

Thirdly, even if the NSE Index could be weighted to perfectly reflect the depth and breadth of Kenyan enterprises, the price movements downwards should not be taken to mean that real wealth is lost. The nature of the trade in equities is such that when prices decline, it often means that one person is buying what another is disposing of. For instance, a price rise today for a share in Safaricom does not create wealth by itself because the buyer is paying for it by replacing the seller as an equity owner. What the buyer of a stock is betting on is that the corporation will make profits through the years and that those profits will be reflected in the prices over time. The price of equities at any moment reflects the view of the future performance of the corporations and that is already incorporated in that price.

If the court decision suddenly shows that some enterprises must have discount value, then we must ask why these corporations are overly invested in a particular political result. It was a mistake for these corporations to bet on Kenyan courts not nullifying an election; if they made this mistake, then they should take their losses and move on.

> The one day price change, which Kenyans attributed to the Supreme Court decision, cannot be used as a measure of the state of the economy but rather of the state of mind of the investors in the corporations whose equities were traded.

The one day price change, which Kenyans attributed to the Supreme Court decision, cannot be used as a measure of the state of the economy but rather of the state of mind of the investors in the corporations whose equities were traded. We should not take a normative view that because the equity markets reacted "negatively" to the news from the Supreme Court, then that decision and whatever drove it is necessarily bad. As I have argued here, it may be a signal that the new reality shows that the expectation that some firms will thrive has changed and that's what market indices are supposed to do.

Extending the few days of performance to make the point that politics and court decisions are harming the economy shows both inadequate knowledge about the role of equity markets in an economy and misinterpretation of what the price changes mean. The primary lesson is that a competent person will ignore the overreaction from a few days performance, especially since the equity prices incorporate several years' worth of expected performance.

So far I have argued that day-to-day changes in equity prices do not reflect real changes in overall wealth and so the losses and gains are largely notional, and that the NSE is not equivalent to the Kenyan economy. Therefore, no normative conclusion on economic policy can be made from a drastic change in the index. The relevant question then is why Kenyans are being led to believe that the Supreme Court decision led to economic harm. The answer is that it is convenient for some people to believe that politics invariably has a negative effect on the economy.

> The idea that elections hurt the economy is convenient when one doesn't want to explore the sound and solid reasons for the nullification of the election results.

Even if we accept that the perceived loss of wealth in the movement of the NSE Index is harmful to the entire economy, it is a stretch to argue that politicians and the judiciary are primarily to blame. To my mind, the fact that many participants at the NSE were blindsided means that they have political preferences that they expected the Supreme Court to confirm. Hence the shock and gnashing of teeth because the court made a different decision. The idea that elections hurt the economy is convenient when one doesn't want to explore the sound and solid reasons for the nullification of the election results.

Given that the administration of elections by the Independent Electoral and Boundaries Commission (IEBC) was deemed shambolic, if not altogether fraudulent, the decision demonstrated that there is a cost to society when public institutions are incompetent. A court decision ought to be made irrespective of its temporal effect on the prices of equities. It is not about the failure of an election, but rather the underperformance of the IEBC. As an independent arm of government, the Supreme Court underscored this underperformance, even though the executive branch of government is the one most hurt by its decision.

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Thus the claim that the nullification of elections is hurting Kenya's economy is an argument derived from political preference rather than from economic logic. The NSE is an important part of Kenya's economic environment but do not be fooled that it is the economy, because it is not.

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