KENYA ECONOMIC UPDATE

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POISED TO BOUNCE BACK?

Reviving Private Sector Credit Growth and Boosting Revenue Mobilization to Support Fiscal Consolidation

WORLD BANK GROUP

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ABBREVIATIONS

AfDB	African Development Bank
ASALs	Arid and Semi-Arid Lands
BoP	Balance of payments
CAADP	Comprehensive Africa Agriculture Development Program
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CIT	Corporate Income Tax
CMA	Capital Markets Authority
DFID	Department for International development
DTMASS	Drought Tolerant Maize for Africa Seed Scaling
EAC	East African Community
EAP	East Asia and Pacific
ECA	Eastern Europe and Central Asia
EMDE	Emerging Markets and Developing Economies
EPZ	Export Processing Zone
ETR	Effective Tax Rate
ETR-TI	Effective Tax Rate on Taxable Income
FDN	La Financiera de Desarrollo Nacional
FOMC	Federal Resource Open Market Committee
FSD-K	Financial Sector Deepening Kenya
FY	Fiscal year
GDP	Gross Domestic Product
H1, H2	First, Second Half
ICT	Information Communication Technology
IFC	International Finance Corporation
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
IFRS	International Financial Reporting Standard
IOD	Indian Ocean Dipole
KNBS	Kenya National Bureau of Statistic
KRA	Kenya Revenue Authority
LAC	Latin America and Carribean
LAPSSET	Lamu Port Southern Sudan and Ethiopia Corridor
LTO	Large Taxpayers Office
M&E	Monitoring and Evaluation
MENA	Middle East and North Africa
MFMod	Macro and Fiscal Model
MTO	Medium Taxpayers Office
NEER	Nominal Effective Exchange Rate
NPL	Non-Performing Loans
NSE	Nairobi Security Exchange
NT	National Treasury
OAG	Office of the Auditor General
PFM	Public Financial Management
PIM	Public Investment Management
PIT	Personal Income Tax
PMI	Purchasing Managers' Index
PPP	Public Private Partnership
Q1,2,3,4	Quarter One, Two, Three, Four
q-o-q	Quarter on quarter
RAPs	Resettlement Action Plans
REER	Real Effective Exchange Rate
SA	South Asia
SACCOs	Savings and Credit Cooperative Organization
SASRA	SACCO Society Regulatory Authority
SGR	Standard Gauge Railway
SME	Small and Medium Enterprises
SRC	Salaries and Remuneration Committee
SSA	Sub-Saharan Africa
T-Bill	Treasury Bill
TFP	Total Factor Productivity
USA	United States of America
VAT	Value Added Tax
WBG	World Bank Group
Y-o-Y	Year on Year
YTD	Year to Date

FOREWORD

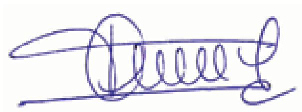
This is a critical time for Kenya, as the incoming administrations at national and devolved levels face the high expectations of ordinary Kenyans to deliver on ambitious economic development agendas and hasten the attainment of Vision 2030. Against this backdrop, it is my pleasure to present the sixteenth edition of the World Bank's Kenya Economic Update—a report which seeks to contribute to the policy discourse on pertinent economic issues. The report has three key messages.

The Kenyan economy faced multiple headwinds in 2017. A drought in the earlier half of the year, the ongoing slowdown in private sector credit growth, and a prolonged election cycle weakened private sector demand, notwithstanding an expansionary fiscal stance. Nonetheless, reflecting the relatively diverse economic structure, these headwinds were partially mitigated by the recovery in tourism, better rains in the second half of the year, still low global oil prices, and a relatively stable macroeconomic environment. Consequently, GDP growth is projected to dip to 4.9 percent in 2017—its lowest in the past five years, but still higher than the Sub-Saharan African average.

With headwinds subsiding, economic growth is projected to rebound over the medium term, reaching about 5.8 percent in 2019. However, this rebound is predicated on policy reforms needed to address downside risks that have the potential to derail medium term prospects. Two macroeconomic risks are pertinent. First, there is a need to consolidate the fiscal stance in order not to jeopardize Kenya's hard-earned macroeconomic stability—a critical ingredient to Kenya's recent robust growth performance. Second, is the need to jumpstart the recovery of credit growth to the private sector; particularly to micro, small and medium size businesses and households. Further, efforts to mitigate weather-related risks by climate proofing agriculture could be supportive of a robust and inclusive medium term growth agenda.

We are pleased to present a rich menu of policy options tabled in this edition of the Kenya Economic Update, identifying opportunities for the consolidation of the fiscal stance, both from an expenditure and revenue mobilization perspective. This is complimented with specific suggestions of macroeconomic and microeconomic reform measures that could help address the slowdown in credit growth and the broader issue of access to credit. Finally, policy options to climate proof the agriculture sector, to mitigate the worse effects of adverse weather conditions are discussed.

The World Bank remains committed to working with key Kenyan stakeholders to identify potential policy and structural issues that will enhance inclusive economic growth, keep Kenya on the path to upper middle income status, and attain Vision 2030. The semi-annual Kenya Economic Update offers a forum for such discussions. We hope that you will join us in debating topical policy issues that can contribute to fostering growth shared prosperity and poverty reduction in Kenya.



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Country Director for Kenya
World Bank

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This sixteen edition of the Kenya Economic Update was prepared by a team led by Allen Dennis. The core team included Sarah Sanya (author of Private Credit Slowdown chapter), Christine Awiti (author Revenue Mobilization chapter), Mehnaz Safavian, Caroline Cerruti, Ladisy Chengula, Leif Jensen, Moses Kajubi, Celina Mutie, and Angélique Umutesi.

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Partnership with key Kenyan policy makers was instrumental in the production of this report. The preliminary findings in this report were shared with the National Treasury, the Central Bank of Kenya, and Kenya Revenue Authority. Furthermore, in preparation for this report, the team solicited views from a broad range of private sector participants.

EXECUTIVE SUMMARY

1. **Buffeted by multiple headwinds, economic activity decelerated in 2017.** After posting a solid 5.8 percent growth in 2016, GDP growth slumped to 4.8 percent in the first half of 2017, with the third quarter showing signs of continued weakness. The slowdown in Kenya's growth momentum has been triggered by three main headwinds. First, poor rains led to a contraction in agricultural output and curtailed hydropower generation in the first half of the year. Relatedly, this led to the build-up of inflationary pressures and dampened household consumption. Second, private sector credit growth continued its trend decline, thereby further dampening aggregate demand. Third, private sector activity weakened over the first three quarters of 2017 on account of the election induced wait-and-see attitude. However, tail winds from the rebound in tourism, strong public investment, and still low oil prices partially mitigated the headwinds.

2. **Near term growth is projected to weaken, however with the easing of headwinds, economic activity is projected to rebound in the medium term.** Given ongoing headwinds, GDP growth in 2017 is expected to decelerate to 4.9 percent—its weakest growth in five years. However, predicated on the easing of headwinds and policy reforms, growth is expected to recover to 5.5 and 5.9 percent in 2018 and 2019 respectively.

3. **Nonetheless there remain significant downside risks that could scuttle the projected rebound in economic activity.** First, delays to fiscal consolidation risks jeopardizing Kenya's hard earned macroeconomic stability with adverse implications on medium term growth and the inclusivity of that growth. Second, the weakness in credit growth risks curtailing a robust recovery. Third, lingering political uncertainty can further undermine business confidence, and stunt a robust recovery.

4. **Implementing key macroeconomic and sectoral reforms can avert downside risks and contribute to a robust medium term outlook.** First, safeguarding macroeconomic stability—a foundation for robust growth—will require fiscal consolidation. Fiscal consolidation can be supported through enhancing domestic revenue mobilization and reining in of recurrent expenditures, crowding in the private sector to carry out development projects thereby reducing the burden on the public purse, and improving the efficiency of public investment spending. Second, private sector credit growth can be crowded in through fiscal consolidation as well as through the establishment of an electronic collateral registry and improvements to the credit scoring system. Third, a durable and robust growth can be supported by climate proofing agriculture through increased adoption of drought tolerant seeds, investing in water management systems and improving agronomical practices.

5. **The second part of the Kenya Economic Update focuses on two topical issues.** These are the slowdown in credit growth to the private sector and domestic revenue mobilization.

Special Focus I: Slowdown in Private Sector Credit Growth

6. **Credit growth has slowed significantly in Kenya since 2015 reflecting a series of shocks.** Private sector credit growth fell from its peak of about 25 percent in mid-2014 to 1.6 percent in August 2017—its lowest level in over a decade. The slowdown in credit is not attributable to one single event. It reflects the impact of the liquidity shock in 2015/16, the impact of the resolution of three non-systemic banks on confidence within the banking system, and the liquidity implication of a segmented interbank market. With the advent of a less supportive demand environment in 2017, regional slowdown in credit growth and supply constraints—most importantly, the rise in non-performing loans—the outlook for strong credit growth remains dim.

7. **The enactment of the interest rate caps in September 2016 made an already tough lending environment more difficult.** Although the interest rate cap was meant to reduce the cost of credit, thereby making credit accessible to a wider range of borrowers, after a year of implementation the decline in credit growth to the private sector has continued with several unintended negative consequences. First, banks have shifted lending to corporate clients and government at the expense of small and medium sized enterprises and personal household loans. Second, the proportion of new borrowers has fallen by more than half, likely impacting entrepreneurship and

new job creation. Third, the operating environment for banks has become more challenging for them to perform their financial intermediation role. Fourth, the interest rate cap has undermined monetary policy implementation with adverse implications for Central Bank's independence and ability to steer the economy.

8. **The removal of the interest rate cap is critical to preserving medium term growth prospects.** Removing the interest rate cap can help jump start domestic credit to the private sector, support the flow of funds to longer term private investments, and allow the Central Bank to effectively implement monetary policy, a key role in fostering growth.

9. **Though important, the reversal of the interest rate cap, will not be sufficient to improve access to credit.** As discussed, the weakness in credit growth started well before the enactment of the rate caps. In this regard, there is a need to carry out a deeper set of macro and microeconomic reforms to improve credit access and financial inclusion. On the macroeconomic side, a reduction in fiscal deficit and better management of public debt is key to lowering benchmark interest rates and ultimately bank lending rates. On the microeconomic front, the universal adoption of credit scoring and sharing would help counteract perennially high interest rates for borrowers and improve bank lending policies. Furthermore, accelerating the implementation of the movable collateral registry can help fast track the resolution of non-performing loans. In addition, reforms that strengthen consumer protection and increase financial literacy is essential to address predatory lending.

Special Focus II: Domestic Revenue Mobilization

10. **Improvements to domestic revenue mobilization can be supportive of the medium term fiscal consolidation plans.** Despite the robustness of GDP growth in recent years, revenues have underperformed targets by an annual average of about 3.7 percentage points of GDP since FY11/12. While a rapid rise in the expenditures has significantly contributed to the deficit, the underperformance of revenues has also played a role in the widening deficit. The Special focus section on Domestic Revenue Mobilization reviews two taxes—Corporate Income tax (CIT) and Value Added Tax (VAT), and gives policy options that could enhance revenue collection for the two taxes. Three key messages emerge from the analysis.

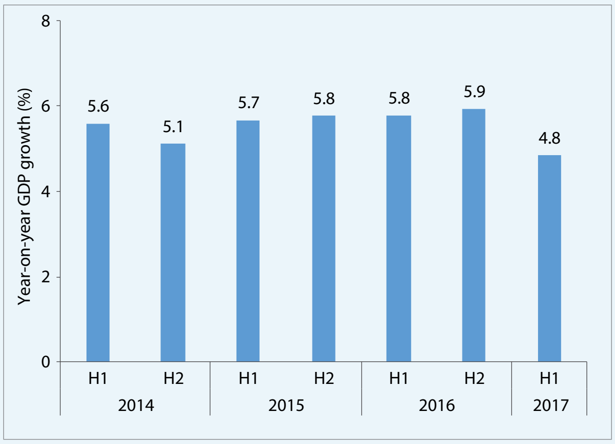
11. **First, there remains substantive scope to boost tax revenues by rationalizing exemptions.** The analysis finds that exemptions represent a significant source of forgone tax revenues. While tax exemptions may have been set for specific reasons, over time the initial objective might have lapsed. Forgone revenues from corporate income tax alone account for 1.8 percentage points of GDP with the bulk of tax exemptions concentrated in a few sub-sectors. Similarly, on VAT, the indiscriminate application of exemptions account for revenue leakages of up to 3.1 percent of GDP arising from various exemptions (over 70 percent of actual revenue).

12. **Second, there is need to enhance revenue collections in the sectors where the losses in revenue are the greatest.** The financial, manufacturing, health and social work activities, account for 88 percent of total exemptions. Any rationalization of the CIT exemptions regime therefore, should have a focus on these sectors, to the extent that the specific tax exemptions being enjoyed in these sub sectors are no longer a priority within the national development agenda. On the VAT front, taking into account international best practice, the report finds that Kenya applies a relatively liberal VAT exemptions regime on domestic supplies. This suggests that there is scope to improve VAT collection by streamlining exemptions on domestic supplies. Other areas for streamlining VAT exemptions with the potential to augment revenues include zero-rated supplies and VAT on exempt imports.

13. **Third, the tax base could be widened and compliance improved.** Measures such as cleaning up of the tax register to ensure it includes an accurate number of taxpayers as well as accurate master data could be adopted. The KRA's adoption of an electronic system is a step in the right direction and should contribute to ensuring a wider tax base coverage.

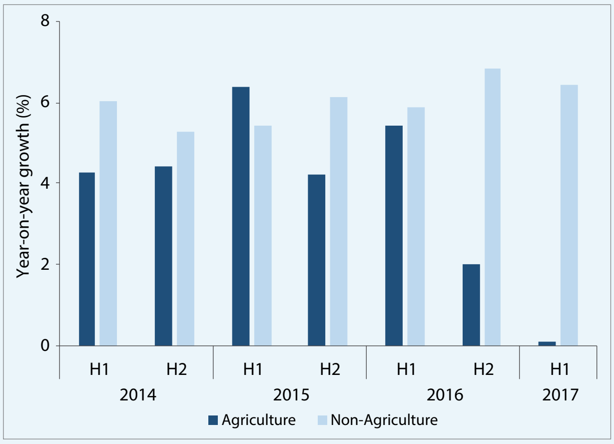
Photo: © Kenya Airports Authority

Economic growth has slowed down in 2017



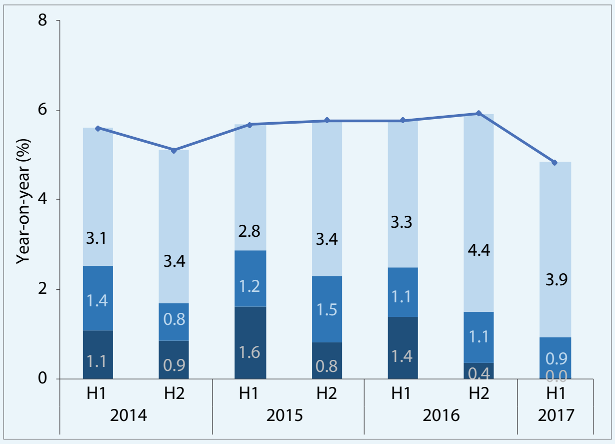
Source: Kenya National Bureau of Statistics

The moderation in growth was mainly driven by weakness in the agriculture sector



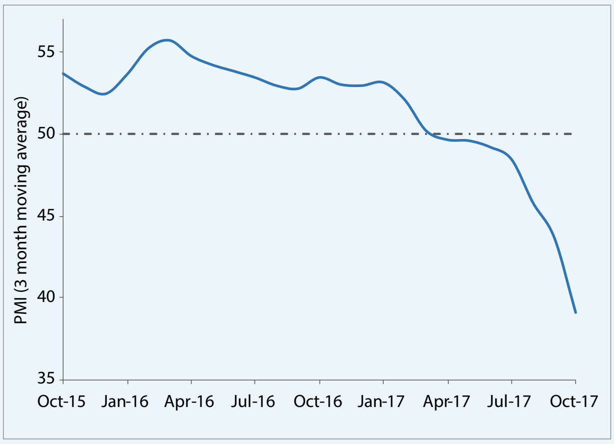
Source: World Bank computation based on data from Kenya National Bureau of Statistics

Robust activity in the services sector was strong …. helped mitigate some of the weakness from the agriculture sector



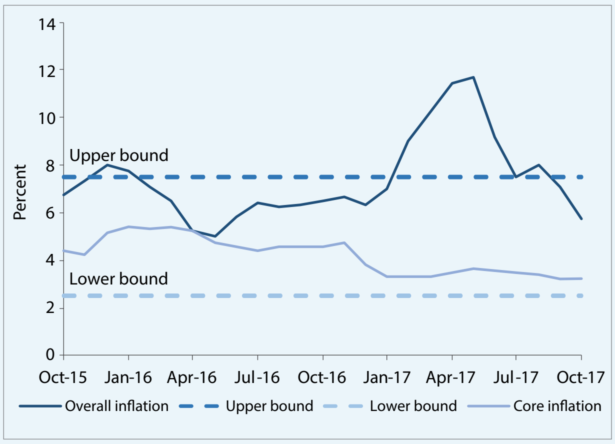
Source: World Bank computation based on data from Kenya National Bureau of Statistics

Business sentiment has weakened, with the PMI output and new orders indicators deep in contractionary territory.



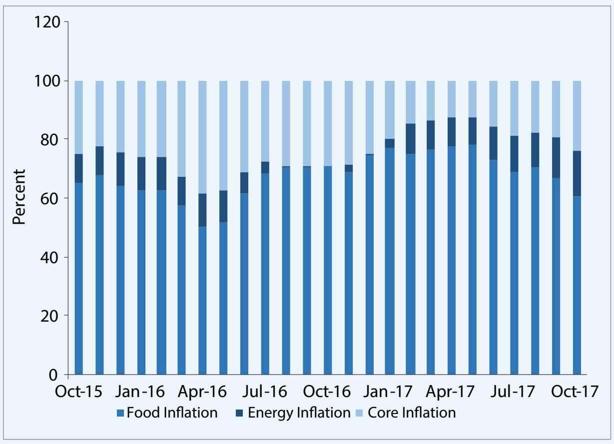
Source: CFC Stanbic and World Bank

After spiking in H1 2017, inflation has since fallen to within the target corridor. Core inflation remains subdued



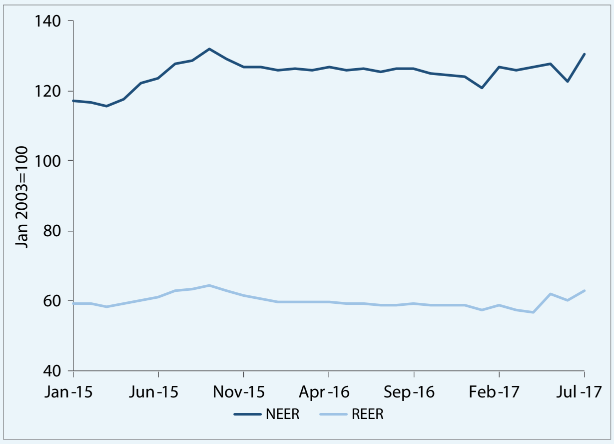
Source: Kenya National Bureau of Statistics

The recent drought and rise in oil prices contributed to the surge in inflation during the first half of the year



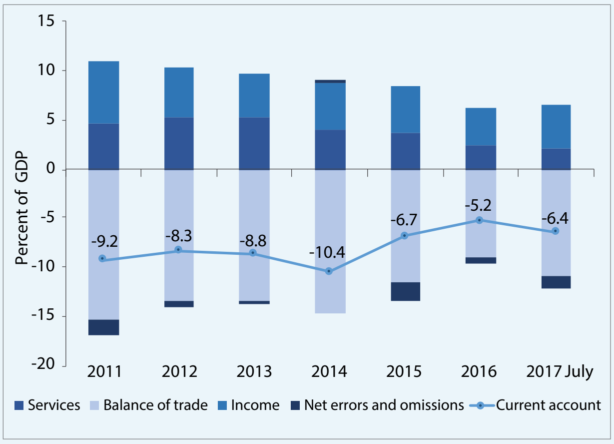
Source: World Bank computation based on data from Kenya National Bureau of Statistics

Exchange rate has remained relatively stable



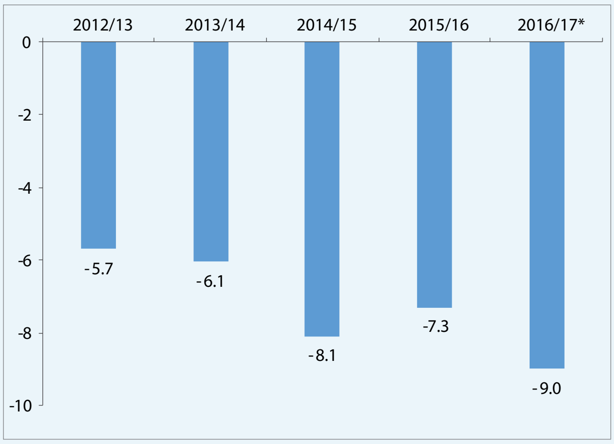
Source: Central Bank of Kenya

…however an increase in imports led to a widening of the current account deficit



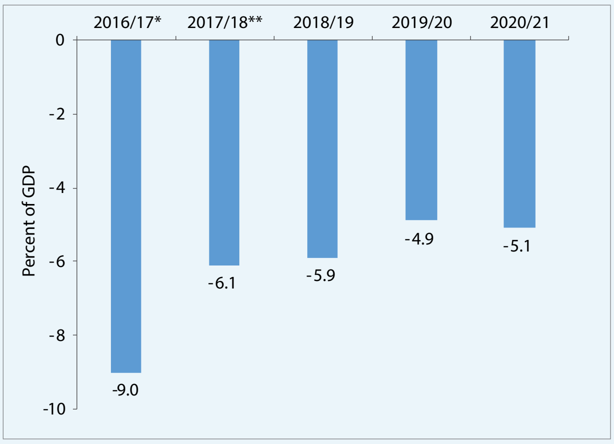
Source: Central Bank of Kenya

Fiscal consolidation is yet to commence



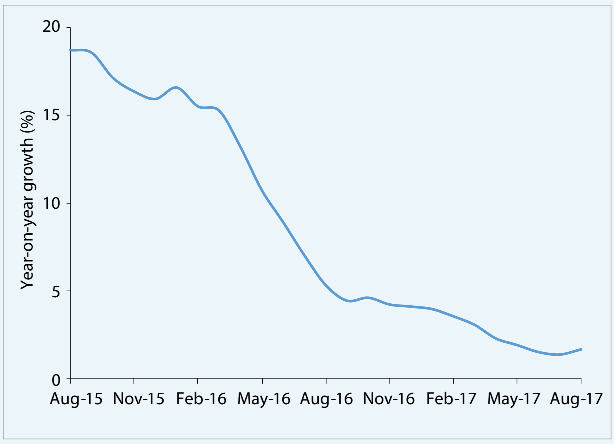
Source: The National Treasury
*Note: * indicates preliminary results*

…Medium Term Fiscal Framework points to delays in fiscal consolidation



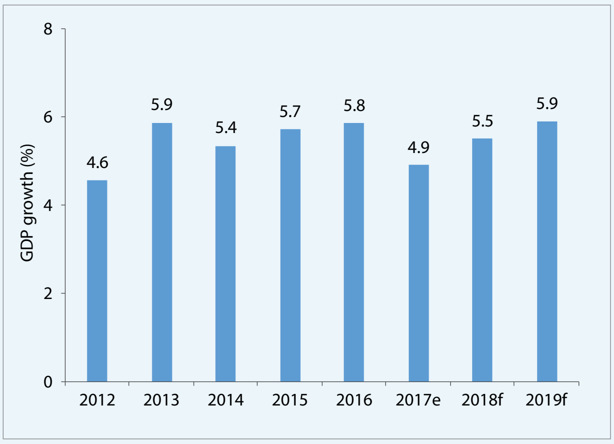
Source: The National Treasury
*Note: * indicates preliminary results, ** budget*

The deceleration in private sector credit growth has continued into 2017



Source: Central Bank of Kenya

Near term growth has moderated, however medium term growth will rebound as headwinds ease



Source: World Bank
Note: "e" denotes an estimate and "f" denotes forecast

Part 1: The State of Kenya's Economy

Photo: © Kenya National Highway Authority

1. Recent Economic Developments

1.1 The global economy is firming up

1.1.1. Global growth strengthened in the first half of 2017. The Euro Area recorded a two-year, high growth in the first half driven by a dissipating policy uncertainty, a pickup in industrial activity, and an upturn in credit growth following years of accommodative monetary policy. Supported by continued improvements in its labor market, the US economy also remains on track to strengthen in 2017, notwithstanding the marginal growth slowdown in the second quarter. At 6.9 percent growth for the first half of the year, China's economic performance was robust, driven by private consumption and a pick-up in exports (Figure 1).

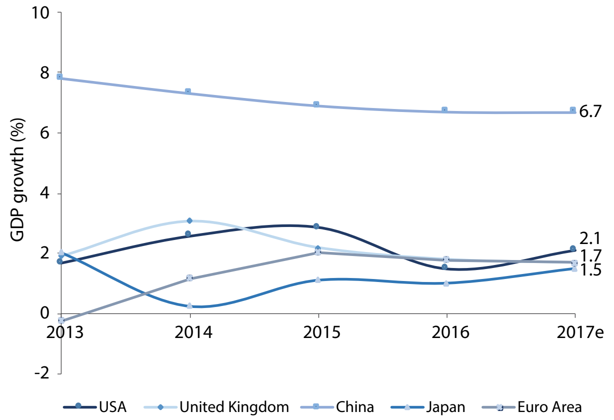
1.1.2. After recording the lowest growth in two decades in 2016, economic activity in Sub-Saharan African economies is rebounding. Among large commodity-exporting Sub-Saharan African economies such as Nigeria and Angola, the pick-up in economic activity has been supported by recovering global commodity prices and policy adjustments (Figure 2). Dented by weak domestic demand and low business confidence, South Africa entered a technical recession in Q1 2017. However, it is beginning to recover, supported by the lift in the agriculture sector. Excluding the larger economies, economic activity is also recovering in the rest of the region. The recovery in global prices of metals and minerals has been supportive of growth in these economies, as well as in other metal and mineral exporting countries (Namibia, Sierra Leone, Ghana). Further, in Southern Africa, above average rains after two years of drought are lifting agricultural output and GDP growth in Zambia and Malawi. Supported by domestic demand (including a robust public investment drive), GDP growth has remained stable in non-resource intensive economies.

1.1.3. Although still above the regional average, growth across East African economies slowed down in 2017. The prolonged effect of drought experienced in 2016 continued in 2017, dampening agricultural output and GDP growth in Uganda, Tanzania and Rwanda. In addition, there was a cyclical downturn in the credit growth across countries in the region, which has further dampened recent growth (Figure 3). Though GDP grew at a robust 7.0 percent in Tanzania in 2016, growth is expected to decline to 6.5 percent in 2017. In Uganda growth fell by 1.3 percentage points to 3.4 percent in FY 16/17, while in Rwanda the recent drop in growth has been sharper (from 8.9 percent in 2015 to 5.9 percent in 2016) on account of a tighter fiscal stance. Further, insecurity and political tensions continued to constrain economic activity in Burundi, Somalia, and South Sudan.

1.2 Similar to developments in the sub region, economic activity in Kenya moderated in 2017

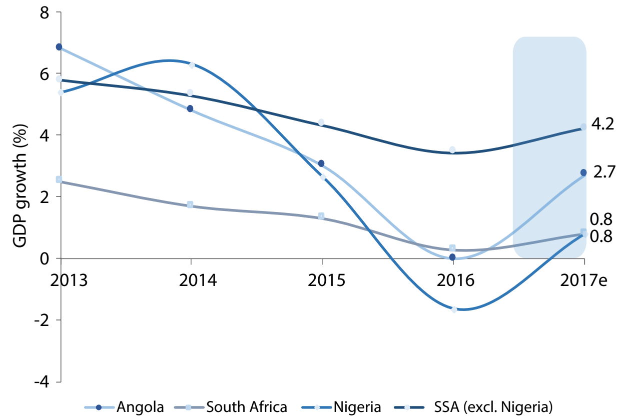
1.2.1. Buffeted by both cyclical and structural factors, economic activity in Kenya has moderated in 2017. After posting a solid 5.8 percent growth in 2016 (Figure 4), GDP growth slumped to 4.8 percent (y-o-y) in the first half of 2017 (Figure 5). The slowdown in Kenya's growth momentum has been triggered by both cyclical and

Figure 1: Global growth strengthens in 2017



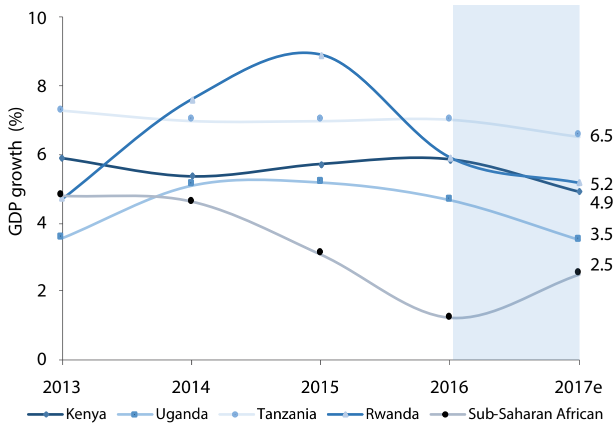
Source: World Bank (Mfmod)
Note: "e" denotes an estimate

Figure 2: After years of weakness, economic activity in Sub-Saharan Africa begins to pick-up



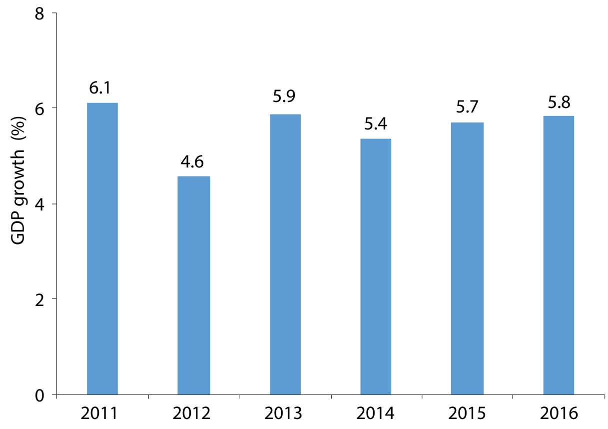
Source: World Bank (Mfmod)
Note: "e" denotes an estimate

Figure 3: Though weaker, growth across EAC economies is still above the regional average



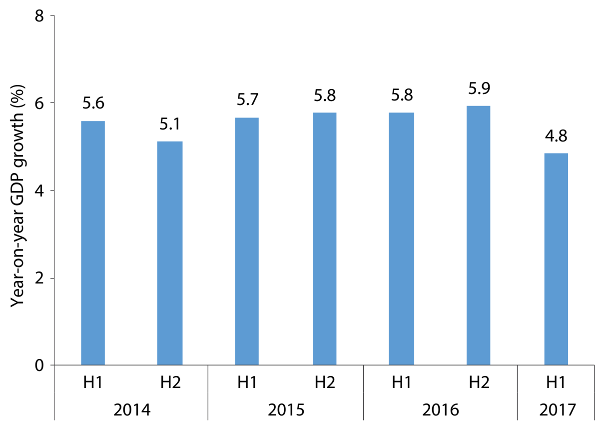
Source: World Bank (Mfmod)
Note: "e" denotes an estimate

Figure 4: Economic activity in Kenya remained robust in 2016



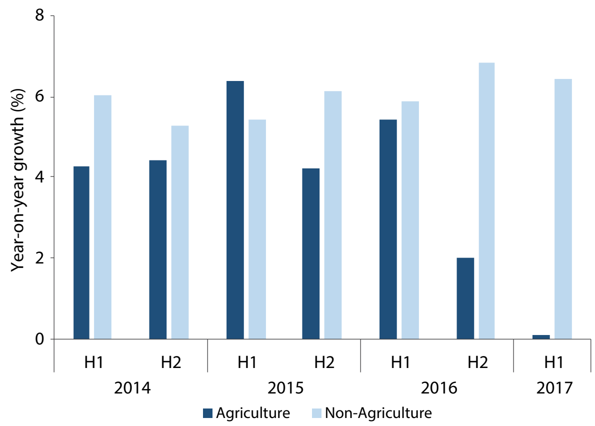
Sources: Kenya National Bureau of Statistics

Figure 5: However, Kenya's growth slowed down in the first half of 2017



Sources: Kenya National Bureau of Statistics and World Bank

Figure 6: In 2017, performance of agriculture and non-agriculture sectors in Kenya diverged



Sources: Kenya National Bureau of Statistics and World Bank

structural headwinds. First, poor rains during the short (October to November 2016) and long rains (March to May 2017) led to a contraction in agricultural output and dampened power generation, particularly hydropower. Relatedly, this led to the build-up of inflationary pressures in the first half of 2017, which dampened household consumption. Second, reflecting the trend decline in growth of credit to the private sector since 2015, private sector credit growth further weakened in 2017, from the already record low levels at the end of 2016. This has contributed to the downturn in Kenya's business cycle. Further, beyond the tightening of lending conditions by the banks, private investment also weakened over the first three quarters of 2017 on account of the election induced wait-and-see attitude adopted by the private sector. However, on the brighter side, tail winds from the rebound in tourism, strong public investment, and still low oil prices have partially mitigated some of the headwinds facing the economy.

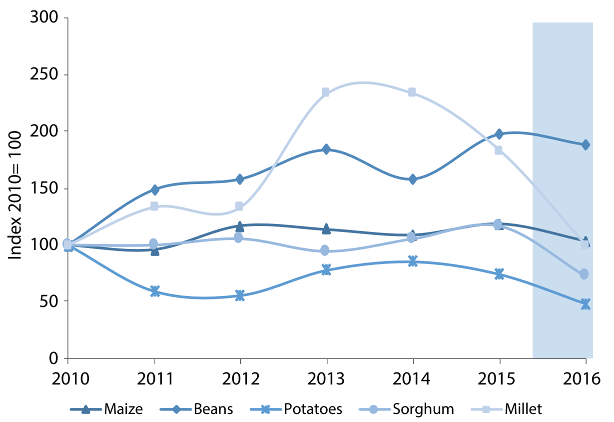
1.3 Performance of the agriculture and non-agriculture sectors diverged in the first half of 2017

1.3.1. **From the supply side, the growth deceleration was mainly driven by developments in the agriculture sector.** While the economy grew by 4.8 percent (y-o-y) in H1 2017, lower than 5.8 percent in H1 2016, a decomposition of growth suggests that most of the growth slowdown was driven by the contraction in the agriculture sector as activity in the non-agriculture sector remained healthy, growing at 6.4 percent (y-o-y) in H1 2017 (Figure 6). Poor rains and army worm infestation led to a contraction in agriculture output. With the agriculture sector being predominantly rain-dependent, the sector has been severely impacted by the drought. Agriculture output grew by 0.1 percent in the first half of 2017, and with the sector contributing almost a quarter of GDP, the sector's poor contribution in H1 2017 pulled back GDP growth by 1.0 percentage points. The poor performance of the agriculture sector in the first half of the year has been impacted by the poor short rains in Q4 2016 and the late onset of the long rains in Q2 2017. Further, the Fall Army Worm pest infestation in major food growing regions has destroyed thousands of acres of planted maize, thereby further dampening output. This has negatively impacted livestock and food production, beginning with the last quarter of 2016 (Figure 7 and Figure 8). Likewise, Kenya's main export crop, tea, contracted by 19.4 (YTD) percent in H1 2017. The contraction in output of major food crops contributed to the subsequent spike in food prices observed in the first half of the year.

1.3.2. **The dampening effect on growth emanating from the agriculture sector was mitigated by the robust performance of the services sector, particularly tourism related services.** Services sustained its growth momentum from 2016, growing at 7.0 percent (y-o-y) in the first half of 2017, higher than 5.9 percent in 2016, thus contributing some 3.9 percentage points to Kenya's growth (Figure 9). Except for the financial sector, most service subsectors recorded a solid performance (Figure 10). Accommodation and restaurants was the fastest growing sector with an acceleration of 14.8 percent in H1 2017—the fastest half-year growth since 2013. This has been supported by the improved security situation, leading to the removal of travel alerts from major tourist originating countries, the ongoing recovery of the global economy and the rise in domestic tourism.

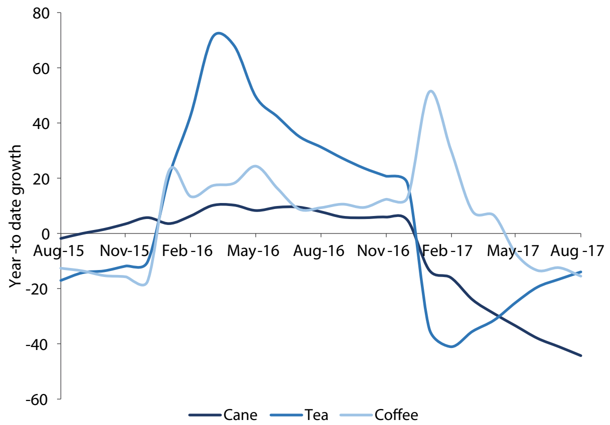
1.3.3. **Other rapidly expanding services subsectors include transport and storage, and ICT subsectors.** The transport subsector expanded by a solid 9.0 percent (y-o-y) growth in H1 2017 thanks to the provision of transport logistics services related to the boom in tourism, an expanding construction sector, ongoing public investments, and relatively low oil prices (even if prices are marginally higher than in 2016). Reflecting still strong demand (both households and firms) for telecom services, efforts by banks to lower costs by deploying new technologies and the ongoing ramping up of mobile banking operations, growth in the information and communication services maintained double-digit growth (10.4 percent y-o-y) in the first half of 2017.

Figure 7: The effects of the drought on key agriculture products commenced in 2016



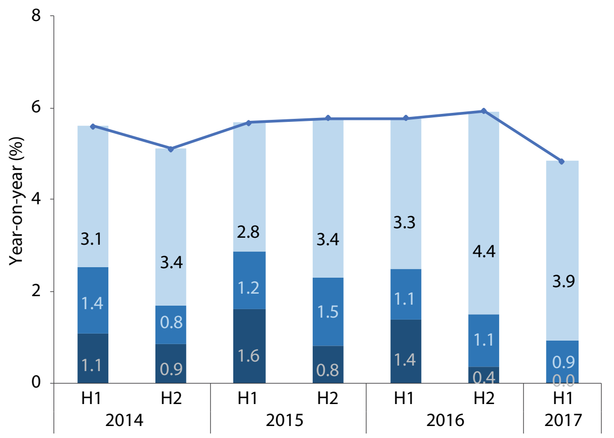
Sources: Kenya National Bureau of Statistics and World Bank

Figure 8: The impact of the drought on agricultural output worsened in 2017



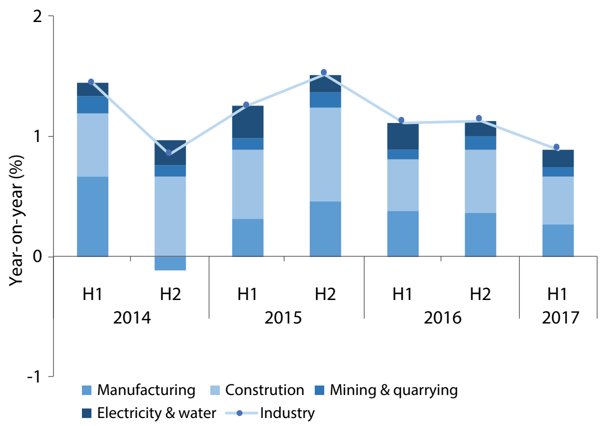
Sources: Kenya National Bureau of Statistics and World Bank

Figure 9: Services sector contribution remains robust (contribution by sector to GDP growth)



Sources: Kenya National Bureau of Statistics and World Bank

Figure 10: Performance within services was heterogeneous (contribution to GDP growth by services subsector)



Sources: Kenya National Bureau of Statistics and World Bank

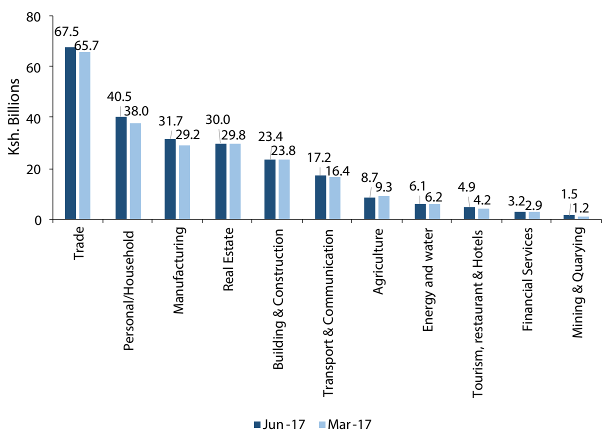
1.3.4. Financial services expanded at the lowest pace in six years, reflecting the tough environment facing banks. Kenya's financial sector has traditionally been one of the most robust subsectors of the economy, expanding at an average pace of 7.7 percent between 2010 and 2016. The challenges facing the subsector include lingering confidence effects from the earlier bank liquidation and receiverships, the rise in non-performing loans, the introduction of the interest rate caps in late 2016, the election-induced wait-and-see attitude adopted by the private sector, and insolvency challenges of certain systemically important corporates. Consequently, the sector posted a five-year low growth of 4.8 percent (y-o-y) in H1 2017 (compared to 8.2 percent during the same period in 2016). The subsector's contribution to GDP growth was some 0.3 percentage points lower in the H1 2017 compared with its five-year average of 0.5 percent. Reflecting an adaptation by banks to boost non interest incomes, the banking industry recorded increases in profitability between Q4 2016 and Q2 2017 with return on equity increasing to 22.3 percent (q-o-q) from 19.2 percent.

1.3.5. Notwithstanding the ongoing challenges, Kenya's banking sector remains on a solid footing. Capital adequacy and liquidity ratios remain above the statutory requirements. The ratio of capital to deposits reached 18.2 percent in Q2 2017, which is above the 8 percent minimum threshold; while the liquidity ratio moved from 43.8 in Q1 2017 to 44.7 in Q2 2017, which is above the statutory requirement of 20 percent. Nonetheless the quality of assets has continued to deteriorate, with the ratio of non-performing loans (NPLs) to total loans averaging 8.2 percent in H1 2017, up from 6.5 percent during the same period last year. The deterioration in NPLs continued into Q3, reaching 10.6 percent in October. All sectors except personal household and tourism, restaurant & hotels contributed to the spike in non-performing loans in recent months (Figure 11 and Figure 12).

1.3.6. Public sector construction has remained buoyant, in contrast to private sector construction. Reflecting ongoing major public and public private partnership infrastructural projects in energy, rail (including the completion of the SGR), road, and ports, the construction subsector that accounts for some 27 percent of industrial output expanded at 7.9 percent (y-o-y) in H1 2017, albeit lower than 8.8 percent in H1 2016 (Figure13). Nonetheless, reflecting election-related jitters and the tightening of lending conditions, private sector construction activity dipped as reflected in the contraction in residential and non-residential building permit approvals by 21.0 percent in the first seven months of 2017 in Nairobi.

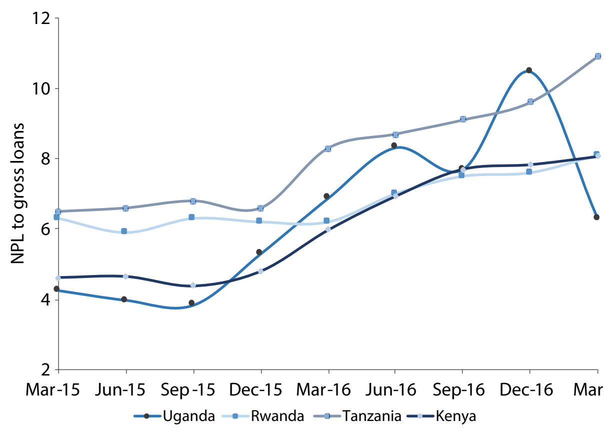
1.3.7. Manufacturing growth remains sluggish. The manufacturing sector remains an important pillar of the government's employment creation strategy. However, the sector's growth has been sluggish in recent years. The sluggishness continued in H1 2017 with manufacturing output expanding by only 2.6 percent. Given the importance of the manufacturing sector for job creation, this weak performance is at a level too low to make a dent to unemployment or absorb the yearly increase in the labor market. Though Q3 2017 data has not yet been published by Kenya National Bureau of Statistics (KNBS), business sentiment indicators suggest that manufacturing output fell significantly in that quarter, with the Purchasing Manager Index (PMI) output and new orders indicators showing deep contraction (Figure 14: PMI). In part, this

Figure 11: The stock of gross non-performing loans continued to rise across sectors in Kenya



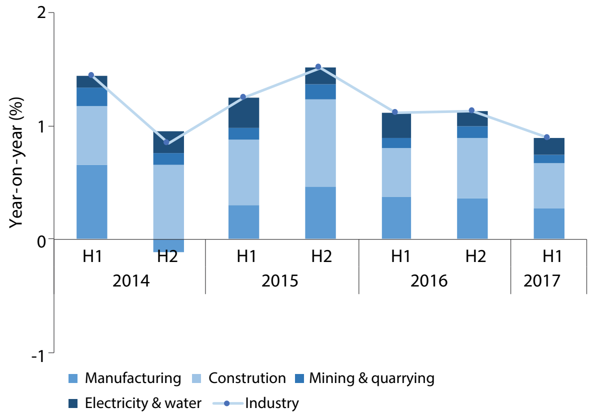
Source: Central Bank of Kenya

Figure 12: Non-performing loans have been on the rise across EAC economies in recent years



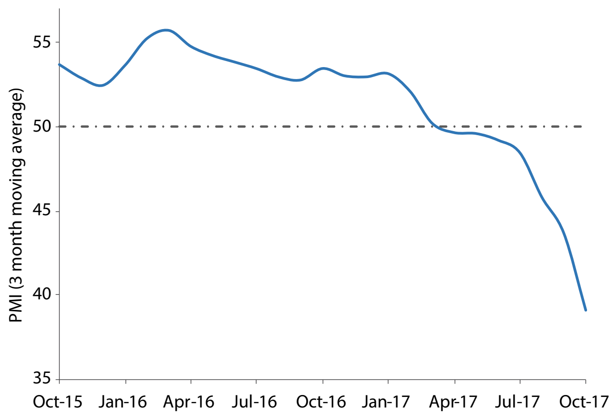
Source: Central Bank of Kenya, Bank of Tanzania, Bank of Uganda and National Bank of Rwanda

Figure 13: Within the industrial sector, output from manufacturing subsector continues to remain lethargic



Sources: Kenya National Bureau of Statistics and World Bank

Figure 14: Business sentiment has been on a steep decline in recent months (Purchasing Managers' Index)



Sources: CFC Stanbic and World Bank

reflects the slowdown in economic activity due to the general and repeat presidential elections, as well as slowdown in credit uptake in this sector.

1.3.8. **Beyond election jitters, there are structural factors affecting manufacturing output.** Output in the manufacturing sector has also been curtailed by tightening credit conditions, insufficient raw materials for certain agro-processing industries due to the drought (sugar, and maize meal) and spillover effects from the challenges facing Nakumatt—one of the largest retailers in Kenya—since many local manufacturing firms are suppliers. Further, the competitiveness of Kenya's manufactured exports in the regional market is being undermined by the influx of cheaper goods (mostly from Asia), intra-regional trade frictions, several non-tariff barriers and the upgrading of the manufacturing capabilities in neighboring countries (Uganda, Tanzania), thereby reducing their reliance on manufactured exports from Kenya.

1.4 Private sector spending moderated, whereas public sector spending held-up

1.4.1. **On the demand side, household consumption, the largest component of aggregate demand moderated in 2017.** Kenya's dynamic growth performance in recent years has been largely driven by the strong growth in private consumption (76.3 percent of GDP in the last five years), which has averaged some 5.8 percent between 2011-2016. Hence, the sustenance of a robust growth performance hinges on a continued healthy growth in private consumption. Though the aggregate demand breakdown of quarterly GDP data is not available, private consumption likely moderated in the first half of the year because of the spike in inflation, poor agricultural performance, and the recent tightening of lending conditions by the banks, which saw a contraction in credit growth to the household sector. Furthermore, the labor market, particularly in the private sector, has been less dynamic in 2017 as reflected in reported lay-offs in key sectors including the banking sector.[1] The softness in the labor market is also reflected in the weakening of revenues from personal income taxes and the drop in the employment PMI sub indicator to below 50 (contraction territory) for the first time in three years. However, the negative impact of these factors on household consumption was likely cushioned by the increase in public sector wages resulting from the many wage agitations in 2017 and robust remittance inflows (6.4 percent increase for first eight months of 2017).

1.4.2. **Notwithstanding the lull in private spending, public investment continues to stimulate economic activity.** Over the past five years, public investment has been an important driver of Kenya's GDP growth, contributing an average of some 0.7 percentage points between 2011 and 2016. Addressing Kenya's infrastructural deficit lies at the core of the government's development strategy. Consequently, the government of Kenya continues to invest heavily in improving roads, rails, ports network and the power sector (see Table 1). In FY16/17 development expenditures expanded by a solid 34.3 percent in nominal terms, with the completion of phase one of the standard gauge railway between Mombasa and Nairobi being the main flagship infrastructure project.

[1] *Kenya Bankers Association (KBA) - http://www.kba.co.ke/news59.php*

Table 1: List of ongoing major projects

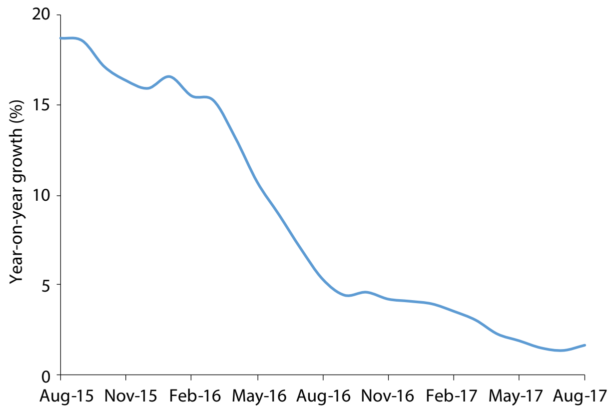
Project Name	Type	Distance	Project Value (US$ Millions)
Standard Gauge Railway Phase 2A	Railway	120 Km	1,500
Lamu Port Southern Sudan and Ethiopia Corridor (LAPSSET)	Port, Roads, Rail, Pipeline		..
Nairobi Mombasa Expressway	Road	473 Km	2300
Northern Corridor Transport Improvement Project	Roads		
Public Private Partnerships (PPP)		Capacity MW	Project Value (US$ Millions)
Thika Power	Thermal	87	146
Triumph	Thermal	82	156.5
Gulf Power	Thermal	80	108
Orpower	Geothermal	150	558
Lake Turkana	Wind	300	847
Longonot	Geothermal	140	760
Kinangop	Wind	61	150
Rabai	Heavy Fuel Oil	90	155
Kipevu	Heavy Fuel Oil	74	85
Mumias	Bagasse Co-gen	32	50

Source: Public Private Partnership (PPP) Unit, National Treasury; Kenya Railways.

1.4.3. **Unlike the resilience in public investment flows, private investment is subdued.** Although high frequency private investment data is not published, there are several indicators that point to a weakness in private investment. First, notwithstanding the drop in lending rates, overall credit growth to the private sector reached its lowest recorded level in 2017 (Figure 15, Figure 16 and Figure 17). Apart from the ICT sector, the weakness in credit growth to the productive sector has been broad-based, including: agriculture (-7.6 percent), manufacturing (-3.3 percent), mining (-7.6 percent) and construction (-1.5 percent) (Figure 18 and Figure 19). Secondly, this weakness in private investment activity is reflected in subdued imports of machinery and capital equipment imports (Figure 20: import growth by product). Thirdly, the Stanbic PMI indicator, an important barometer of business sentiment, shows business sentiment to have contracted for five successive months since April—the first time in the indicator's history.

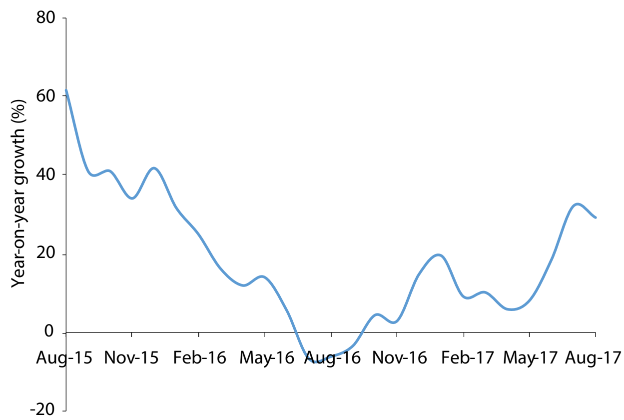
1.4.4. **Both cyclical and structural factors are depressing private investment.** Part of the weakness in investment sentiment may reflect a downturn in the business cycle related to the political cycle. However, the downturn in the business cycle has also been influenced by the weakness in credit growth, which started since Q4 2015 and was further complicated by the enactment of the caps on interest rates. Further, on account of higher inflation,

Figure 15: The deceleration in private sector credit growth has continued unabated into 2017



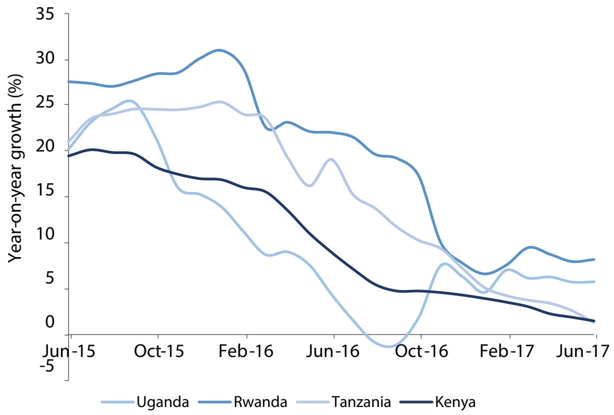
Source: Central Bank of Kenya

Figure 16: However, credit to public sector has remained strong



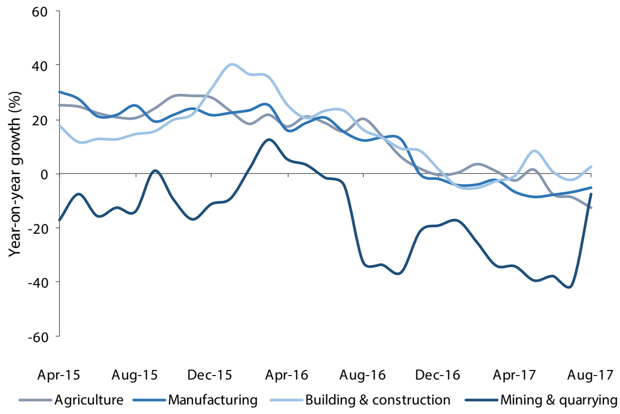
Source: Central Bank of Kenya

Figure 17: The weakness in private sector credit growth is prevalent across other East African economies



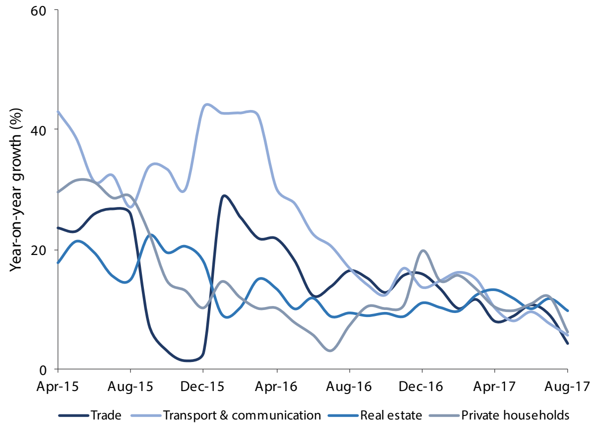
Source: Central Bank of Kenya, Bank of Tanzania, Bank of Uganda and National Bank of Rwanda

Figure 18: In Kenya, the weakness of credit to private sector is agriculture and industry broad-based



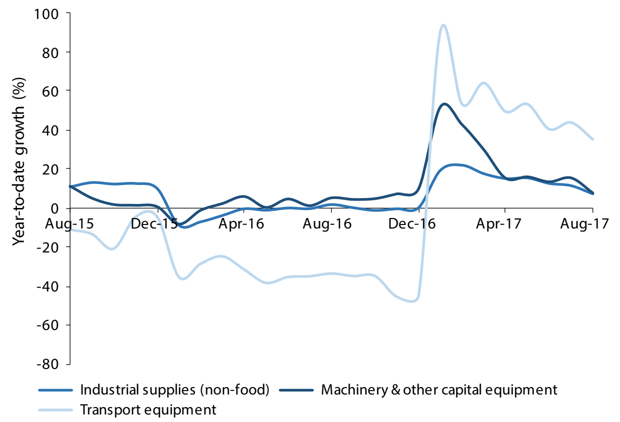
Source: Central Bank of Kenya

Figure 19: In Kenya, the weakness of credit to private sector is services and private households broad-based



Source: Central Bank of Kenya

Figure 20: Reflecting weakness in private investment, imports of key private sector driven capital goods has decelerated



Source: Kenya National Bureau of Statistics and World Bank

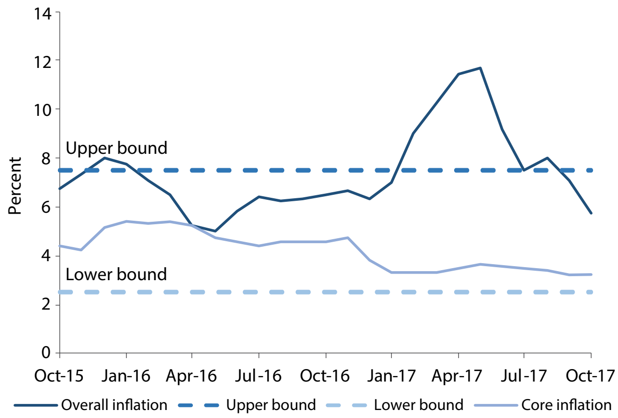
private consumption demand has been weak, in particular for durable goods, thereby depressing investment. If the factors that are depressing private investments are not sufficiently addressed, this could reduce the productivity of public investments and reduce the long-term growth potential of the Kenyan economy.

1.4.5. The contribution of net exports turned negative in 2017. Although the contribution of net exports to GDP growth was positive in 2016, net exports is serving as a drag to GDP growth thus far in 2017, owing to a contraction in exports and a moderate pick-up in imports. Despite the strengthening of the global economy and the recovery in tourism, the value of exports of goods and services in US dollars contracted by 1.7 percent in the first seven months of 2017. This has been driven by the drought-induced contraction in tea exports (3.6 percent in 2017) and a sharp drop in exports to Tanzania (due to simmering bilateral trade disputes). Kenya's export growth has also been weak on account of subdued economic activity in Uganda, Rwanda, South Sudan and Burundi. Imports of goods and services grew by 12.8 percent, driven by increased oil imports (as international oil prices rose), a ramp up in public investments, and higher food imports due to the drought-induced shortages in domestic staples.

1.5 Though relatively stable, the macroeconomic environment faced challenges in 2017

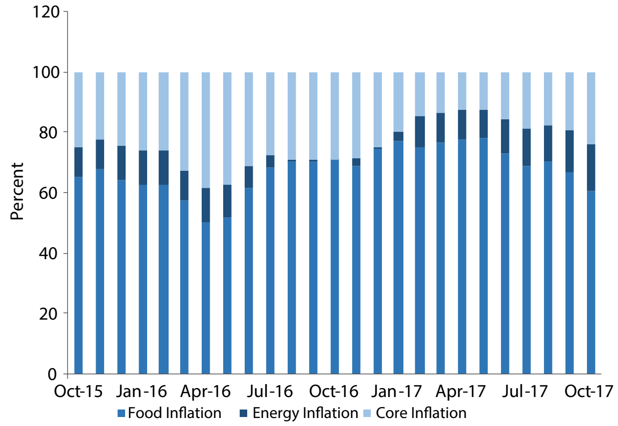
1.5.1. Inflation spiked in H1 2017. Headline inflation during the first half of the year surged to a peak of 11.7 percent in May, some 420 basis points above the maximum target level (Figure 21). This was mainly due to cost-push factors rather than a reflection of underlying demand pressures. First, insufficient rains during the short rains in 2016 and delays in importation to make up for the domestic shortfall led to a sharp rise in food prices. Secondly, a moderate increase in energy inflation, reflecting the pick-up in global oil prices and a moderate depreciation of the shilling, drove up inflation (Figure 22).

Figure 21: Despite a H1 2017 spike in headline inflation, it has since started decelerating towards the target range



Sources: Kenya National Bureau of Statistics

Figure 22: Food inflation continues to be the main driver of headline inflation in Kenya



Sources: Kenya National Bureau of Statistics and World Bank

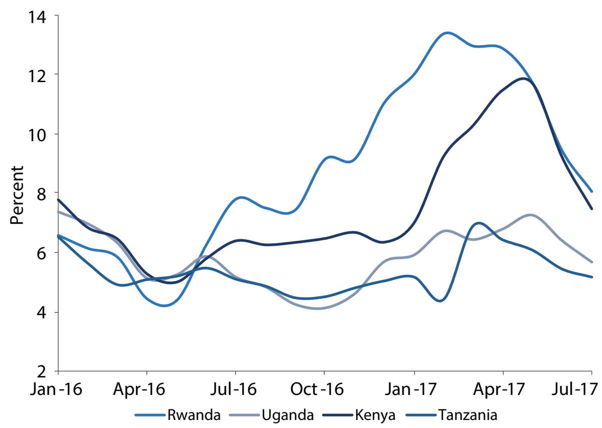
The above two factors were also responsible for the pick-up in inflation in countries in the EAC region during the first half of 2017 (Figure 23).

1.5.2. **Inflation decelerated towards the target band in H2 2017.** Since June 2017, inflationary pressures started to ease as the weather situation improved and earlier measures taken by the government to address the emerging food shortages took effect. Among these measures include allowing duty free imports of major food items (maize, wheat, sugar, and milk) and introducing a temporary subsidy on maize. As a result, headline inflation had fallen to 5.7 percent in October compared to the high of 11.7 percent in H1 2017. Further, the stability of the shilling has also served as a nominal anchor to inflationary pressures (Figure 24), contributing to the relative stability of the macroeconomic environment, and thereby counteracting some of the headwinds on economic activity.

1.5.3. **Consistent with subdued private demand, core inflation remains subdued.** Notwithstanding the rise in headline inflation, core inflation, which excludes food and energy prices, continued to decelerate through the first half of 2017. It averaged 3.4 percent over the first three quarters of the year compared with a still subdued 4.9 percent for the same period in 2016. The low level of core inflation is consistent with an economy where demand pressures are benign, as has been observed in the subdued demand from households and weaknesses in private investment.

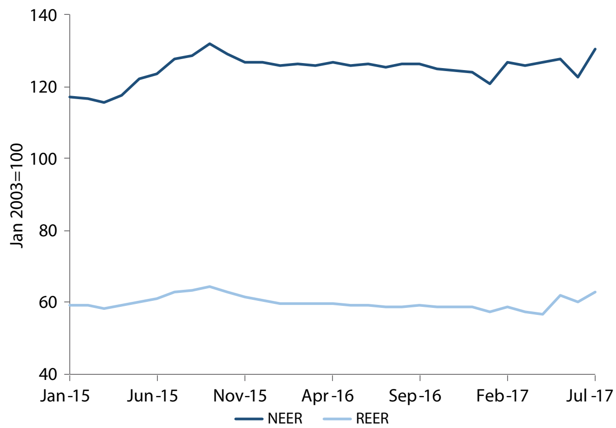
1.5.4. **Following the passage of the Banking Amendment Act (2016), monetary policy has been compromised.** With the policy rate directly linked to the level of interest rate cap, monetary policy creates perverse incentives for using the policy rate to spur or restrain economic activity. For instance, under the new regime, a lowering of the policy rate—an action often taken by

Figure 23: Inflation peaked in most EAC economies on account of the drought



Sources: Kenya National Bureau of Statistics, National Institute of Statistics Rwanda, Uganda Bureau of Statistics and Tanzania National Bureau of Statistics

Figure 24: Exchange rate has been relatively stable



Sources: Central Bank of Kenya

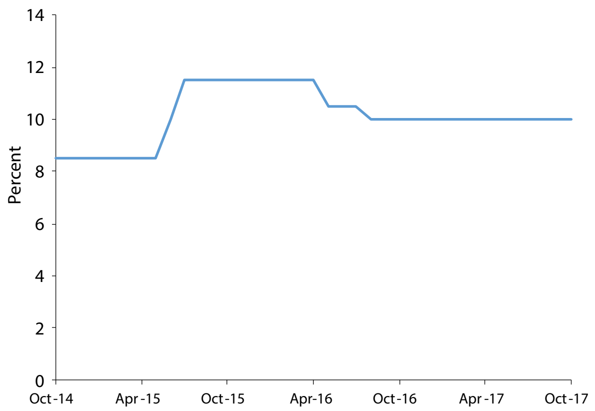
Central Banks globally if they want to stimulate economic activity—could lead to the opposite effect since the lowering of the cap further narrows the spread between yields on risk free government securities and the maximum allowed lending rates. Thus far in 2017, the policy rate has been kept stable at 10 percent (Figure 25).

1.5.5. The stock market has staged a moderate recovery in 2017. The stock exchange index (20 share) increased from 3,186.6 in December 2016 to 4,027.1 in August 2017 (Figure 26). The improvement in the first half of 2017 reflected attractive valuations, and a decline in yields on government securities. While the recovery in the stock market continued in the lead-up to general election, it took a big hit upon the announcement of the annulment of the results of the presidential results in September, with the stock market losing a record Ksh 92 billion in a single day. In general, the market was bearish in September to October, reflecting political uncertainty.

1.6 The current account widened in 2017, but remains close to recent lows

1.6.1. **Kenya's current account marginally widened.** In July 2017, the current account deficit stood at 6.4 percent of GDP compared to 5.2 percent in 2016—a five-year low (Figure 27). Kenya's trade balance worsened in 2017 despite resilience in services. Trade deficit increased to 13.2 percent of GDP in July 2017, from 10.1 percent of GDP in 2016, as uptake in merchandise imports was unmatched by exports. Despite improvements in the global commodity prices and recovery in global trade, Kenya's weak merchandise exports (9.4 percent of GDP in 2017) reflected the challenges in the real economy, and the effect of the drought. Merchandise imports on the other hand, were driven by machinery and transport equipment for ongoing public projects, oil imports following slight recovery of international oil prices, and food imports to plug shortages from the drought. The resulting merchandise imports increased to 25.1 percent of GDP

Figure 25: The Central Bank Rate has remained unchanged in 2017

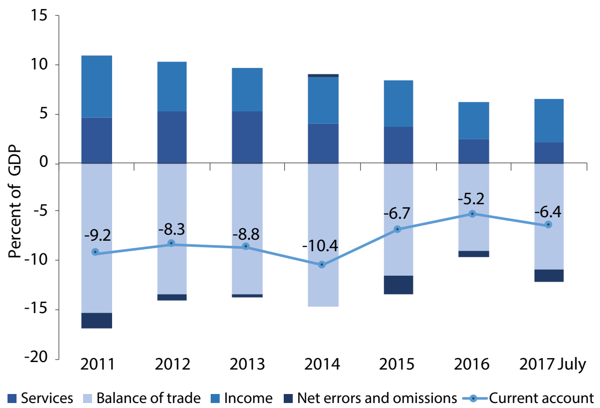


Source: Central Bank of Kenya

Figure 26: There has been a rebound in the Nairobi Securities Exchange

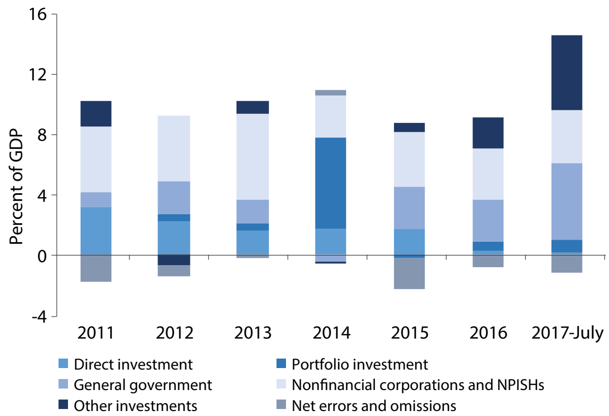
Source: Financial Times

Figure 27: The increase in imports led to widening current account deficit



Source: Central Bank of Kenya

Figure 28: Capital inflows have helped to finance the current account deficit and accumulate reserves



Source: Central Bank of Kenya

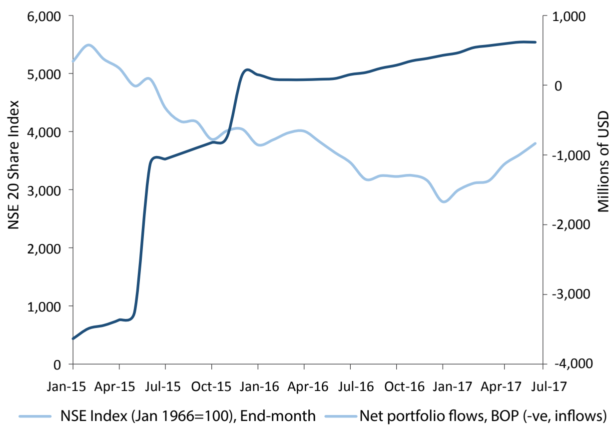
in 2017, compared to 22.2 percent of GDP in 2016. The weakness in the trade balance was somewhat mitigated by a surplus on the primary and secondary income account, including tourist receipts, and diaspora remittances.

1.6.2. Increased inflows to the financial account were sufficient to finance the current account deficit and accumulate reserves. With respect to financing of the current account, inflows to the financial account has improved to about 7.7 percent in Q2 2017 compared to about 5.9 percent of GDP in 2016 and 6.2 percent in 2015 (Figure 28). Stronger capital inflows reflect ongoing foreign investor confidence in the Kenyan economy, thereby supporting the CBK's effort to accumulate reserves, which as of end-August 2017 stood at 5.3 months of imports coverage. In terms of the breakdown of capital flows, the balance on the financial account has been driven almost entirely by other investments inflows, which tend to be shorter term and more volatile. In contrast, net foreign direct investments inflows have been subdued, and portfolio flows have reversed (outflows) since December 2015 (Figure 29). A breakdown in other investments reveals some important differences amongst sub-components: the general government and nonfinancial corporates have increased their borrowing from abroad (inflows) while banks have continued to see a decline in external financing since Q2 2015 (Figure 30), consistent with developments elsewhere in the global economy. This less supportive external financing conditions for banks suggests an increasing reliance on domestic savings to fund loan growth—a likely compounding factor to the decline in credit to the private sector.

1.7 Fiscal consolidation is yet to commence

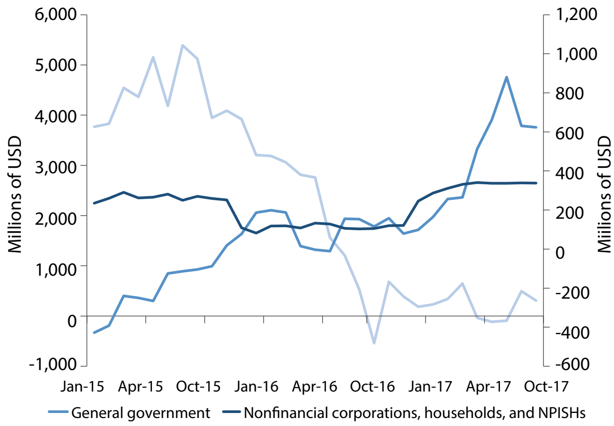
1.7.1. Driven by a combination of higher expenditure and weak revenue performance, the fiscal deficit widened in FY16/17. For FY16/17, total expenditure increased by 19.3 percent, which is above the nominal expansion in GDP growth of 14.9 percent (Figure 31 and Figure 32). As a result, the share of total government expenditure

Figure 29: Net portfolio flows (BOP) and NSE index



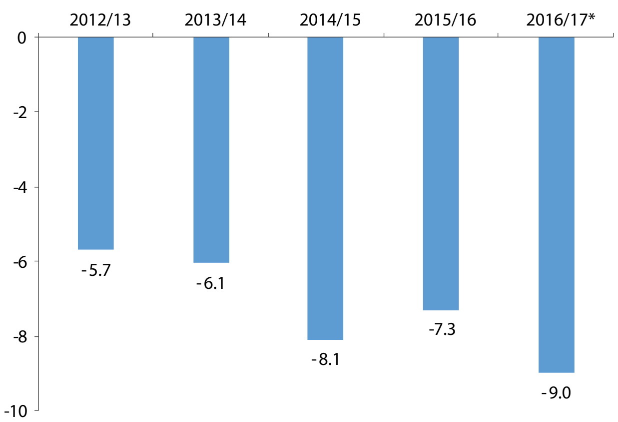
Sources: Central Bank of Kenya and World Bank

Figure 30: Capital flows to government and non-financial corporates have increased in recent months



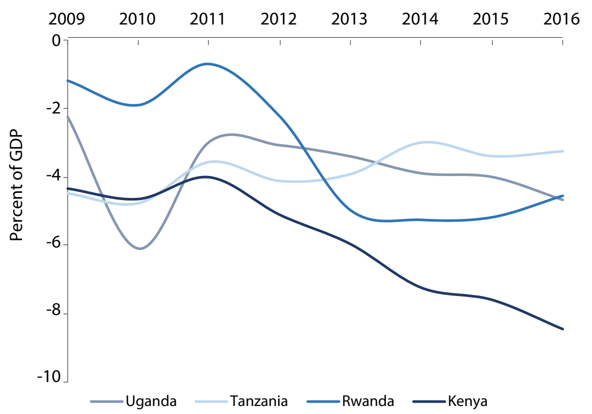
Source: Central Bank of Kenya

Figure 31: Fiscal deficit increased in FY16/17



Source: National Treasury
*Note: * indicates preliminary results*

Figure 32: Kenya's fiscal deficit remains well above other EAC countries



Source: World Bank (MFmod)
Note: Fiscal balances are in calendar years

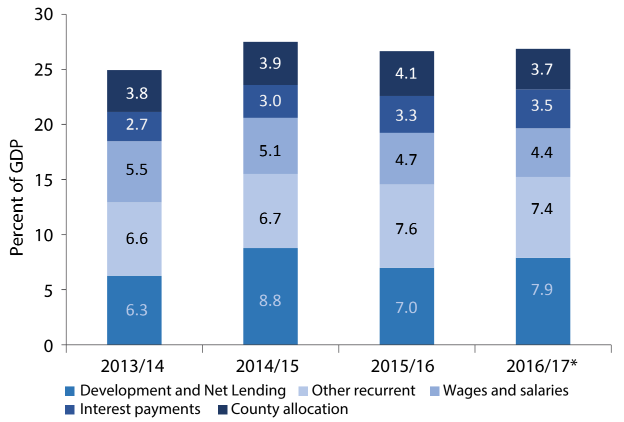
in GDP rose to 27.4 percent in FY16/17 compared to 27.2 percent in the previous year and 23.7 percent five years earlier. This represents a continuation of the rising trend of the importance of government spending in the Kenyan economy both as an important driver of growth (contributing 1.8 percentage points of GDP growth in 2016), but also as a source of fiscal risk. While development spending has been one of the main drivers of spending in recent years, transitional factors such as elections and drought response related-expenses, and structural factors such as interest payments and wage agitations has made it challenging to rein in spending. The 19.3 percent expansion in expenditure was, however, unmatched by the 13.3 percent revenue growth. Consequently, the resulting fiscal deficit widened from 7.3 percent of GDP in FY15/16 to 9.0 percent in FY16/17.

1.7.2. Recurrent expenditures absorb most of the tax revenues, leaving limited fiscal space for development spending. As a share of total revenue, recurrent expenditures remain elevated. In FY16/17, national level recurrent spending alone accounted for 90.2 percent of ordinary revenues (taxes and levies) and 15.3 percent of GDP (Figure 33). For FY16/17, transfers to the counties (which covers both county-level recurrent and development spending) accounted for an additional 21.8 percent of ordinary revenues. Hence, even before funding for any national level development project is considered, ordinary revenues are exhausted mostly by national recurrent spending as well as from county transfers. A high public sector wage bill (which according to the Salaries and Remuneration Commission accounts for 49.2 percent of tax revenues), rising interest payments from the increase in debt stock, and pension liabilities are major components of the recurrent spending. In addition, the parastatals sector also remains a drain on the public purse through, grants, loans, guarantees and contingent liabilities (see policy section for further details).

1.7.3. Increased capital expenditures in recent years, while improving competitiveness, have contributed towards a narrowing of the fiscal space. Consistent with the goal of increasing competitiveness of the Kenyan economy to foster industrialization and create jobs in order to be able to absorb the teeming new entrants to the labor market, Kenya has in recent years accelerated the pace of infrastructural development. In FY16/17, development spending increased by 34.3 percent in nominal terms (rising from 7.0 percent of GDP in FY15/16 to 7.9 percent in FY16/17). The sharp increase was directed towards various infrastructure projects including rail, roads, ports, energy, and water supply. Similarly, infrastructural spending has been increasing at the county level. However, despite the sharp increase in development spending, inefficiencies in public investment (project appraisal, selection, implementation, procurement, evaluation, and land acquisition issues) are limiting the requisite productivity gains from the development spending, and contributing to fiscal pressures.

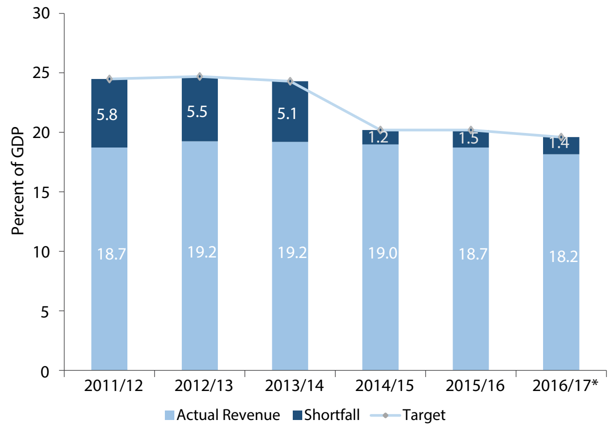
1.7.4. Nonetheless, revenues are failing to keep apace with the expansion in expenditures and the buoyancy of economic growth. Although it grew by 13.3 percent in nominal terms in FY16/17, tax revenues expanded by less than nominal GDP 14.9 percent, hence the tax-to-GDP ratio fell to 16.9 percent of GDP—its lowest level in a decade. Despite a stable VAT, excise duty, and import duty of 4.4, 2.1, and 1.2 percent of GDP respectively, the drop in tax-to GDP ratio was occasioned by subdued growth in both personal income and corporate income taxes, consistent

Figure 33: Development spending continues to be a major driver of the increase in government expenditure



Source: National Treasury
*Note: * indicates preliminary results*

Figure 34: Revenue collection continues to underperform

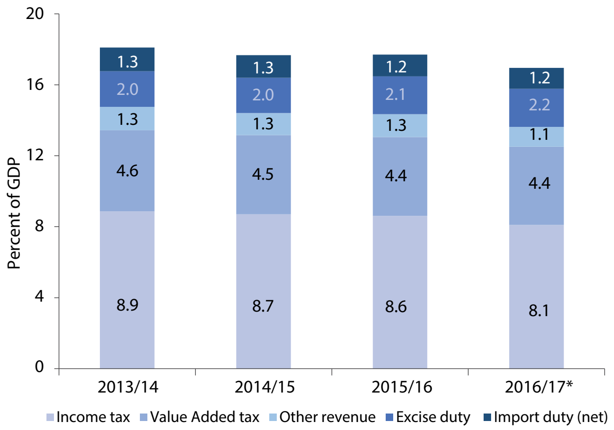


Source: National Treasury
*Note: * indicates preliminary results*

with the subdued in private sector demand, as discussed elsewhere (Figure 34 and Figure 35). For instance, over the past year, the financial sector, which is one of the largest contributors to corporate tax, experienced a slowdown following the interest rate cap—this has in turn reduced their profits margins and tax obligations. Further, beyond the election-induced slowdown in economic activity, a number of companies in the manufacturing and financial sector have laid off employees. However, not all the weaknesses in tax growth can be explained by weaknesses in economic activity, as this trend has recurred over the past five years, notwithstanding the buoyant economy, thereby suggesting the need to address administrative and policy measures to plug tax loopholes (see special focus section).

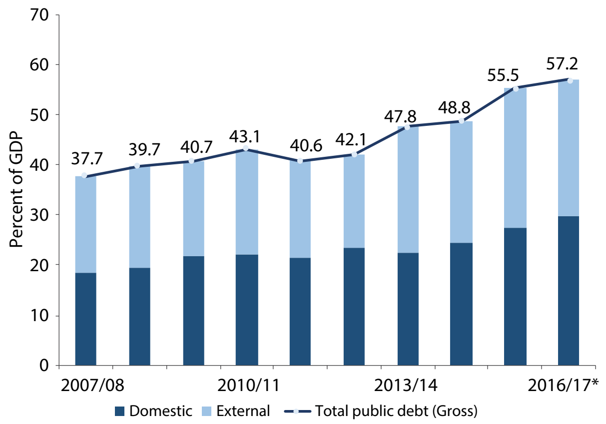
1.7.5. The expansionary fiscal stance and underperformance in revenue generation has led to a continued rise in the stock of debt. Kenya's public debt (gross) as percentage of GDP increased by 3.3 percentage points, to 57.2 percent of GDP in June 2017 from 53.8 percent of GDP during the same period in 2016 (Figure 36). The overall surge was attributed to increase of both external and domestic debt, as government borrowed to finance the fiscal deficit. External debt reached 29.8 percent of GDP in June 2017, while domestic debt stood at 27.4 percent of GDP, representing 3.0 and 0.4 percentage points higher than their level in June 2016 respectively. On the composition of external debt, the stock of debt on concessional basis continued to decline. The share of multilateral debt to total external debt declined by 7.0 percentage points to 38.0 percent in June 2017 compared to the same period in 2016 in favor of bilateral and commercial banks (which rose by 2.8 and 4.1 percentage points to 32.7 percent and 28.6 percent in June 2017 respectively). The most recent IMF/World Bank debt sustainability analysis assesses Kenya in a low risk of debt distress.

Figure 35: VAT and income tax are the largest sources of tax revenue



Source: National Treasury
*Note: * indicates preliminary results*

Figure 36: Public debt is on the rise



Source: National Treasury
*Note: * indicates preliminary results*

2. Kenya's Growth Prospects Are Favorable Over the Medium Term

2.1 As headwinds ease and reforms pick-up, growth will recover over the medium term

2.1.1. Transient headwinds are expected to ease over the medium term. First, we expect the election-induced precautionary stance taken by the private sector to relent in the post-election period, and with that the pent-up investment demand to come on-stream, boosting economic activity. Secondly, unlike the poor rains over the past year, which were influenced by La Nina conditions and a negative Indian Ocean Dipole (IOD) effect[2], international climate models suggest that currently conditions remain neutral or positive. This bodes well for favorable rainfall patterns over the short-to-medium term. The Kenya Meteorological Service forecasts enhanced rainfall for the October-December short rains. Thirdly, given the ongoing public discourse on the ineffectiveness of the Banking Amendment Act to deliver on the promise of improved credit access, particularly to the SME sector, our baseline assumes that over the medium-term measures will be taken to address the broader issue of the slowdown in credit growth and access to credit (see chapter on credit slowdown).

[2] *The Indian Ocean Dipole (IOD) is the difference in sea surface temperature between two areas. The IOD affects the climate of countries that surround the Indian Ocean Basin, and is a significant contributor to rainfall variability in these regions. http://www.bom.gov.au/climate/enso/history/ln-2010-12/IOD-what.shtml*

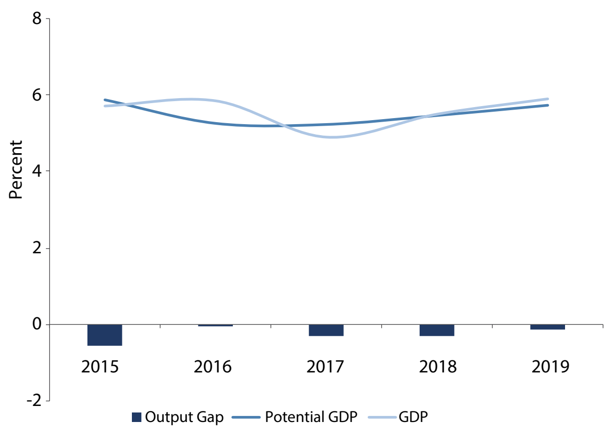
2.1.2. **Near term growth will be weak.** Growth in the second half of 2017 is likely to be supported by improvements in agriculture output, thanks to the improving weather conditions. Nonetheless, headwinds from the weakness in credit growth and more importantly the prolongation of political uncertainty will continue to significantly weigh down on aggregate demand (both household purchases and business investment), thereby limiting the lift to the economy from the agriculture sector. Against this backdrop, and a first half-year growth of 4.8 percent, GDP growth in 2017 is projected to decelerate to 4.9 percent (from 5.8 percent in 2016)—its weakest level in five years and a 0.6 percentage point markdown from earlier forecasts.

2.1.3. **The easing of the headwinds over the medium term should pave way for a rebound in growth.** Predicated on the easing of headwinds (dissipation of political uncertainty, improved rains), policy reforms to address the slowdown in credit growth, and the existing slack in the economy as reflected in the negative output gap (Figure 37), we project medium term growth to recover to 5.5 and 5.9 percent in 2018 and 2019 respectively. Domestic demand will be the main driver of growth over the medium term, with some support from the strengthening of the global economy (section 2.2). Nonetheless, risks are tilted to the downside (section 3).

2.2 Robust domestic demand will continue to be the main driver of medium term growth

2.2.1. **Private consumption expenditures are expected to rebound on dissipating inflationary pressures.** Private consumption remains the largest component of Kenya's GDP and has been one of the principal drivers of growth in Kenya, contributing some 76.3 percent of GDP growth over the past five years. However, the drought-related spike in consumer prices in the first half of 2017 dampened consumer spending, particularly for low-income households. With the deceleration in inflation in H2 2017 and expected improvements in agricultural harvests over the medium term, we expect consumer prices to be lower and to stay within the government's target range of 2.5 percent to 7.5 percent over the forecast horizon, thereby supporting a pick-up in consumption. Consumer spending will also be supported by remittance inflows, with remittances projected to reach US$2.0 billion by 2019 from an estimated US$1.7 billion in 2017. Furthermore, consumption spending will continue to benefit from the ongoing rise of the middle-class, which has grown to at least 44.9 percent of the population (AfDB, 2011).

Figure 37: GDP growth, potential output and the output gap



Source: World Bank (MFmod)

2.2.2. **Public investment will remain robust over the medium term.** Infrastructure development continues to remain an important pillar of the government's development agenda, as articulated in the medium-term plan III and Vision 2030. Major planned public investments include the second phase of Standard Gauge Railway (SGR) project and dualling of the Nairobi-Mombasa highway. These investments are expected to support growth in the short-term, and over the medium-term ease supply-side constraints, and boost the competitiveness and productivity growth of the Kenyan economy.

2.2.3. **The robust public investment pipeline will be complemented by increased private investment flows.** First, the election related wait-and-see attitude taken by investors should ease, in the post-election period. Hence, pent-up investment demand is expected to come on-stream. Secondly, under the baseline assumption, private investment will most likely be supported by the expected ease credit conditions. Furthermore, there remains a strong pipeline of PPP projects (see Table 1) particularly in the energy sector and major public investment projects. Last but not least, with a robustly growing economy and a rising middle-income, Kenya continues to remain an attractive investment destination for domestic and regional market-seeking investors (both foreign and domestic), particularly in real estate, consumer goods, health and education subsectors.

2.2.4. Medium term fiscal framework points to a tighter fiscal stance. The government's medium term fiscal consolidation suggests that recurrent spending as a share of GDP is expected to decline by about one percentage points annually over the next three to four years. Specific areas of slowdown in growth include wages and salaries, interest payments, pensions, and operations & maintenance. While the slower pace of government spending, if implemented, will serve as a drag on GDP growth in the near-term, over the medium to longer term, it will be a net positive for Kenyan economy through sustained macroeconomic stability, sending of positive signals to the market of fiscal prudence, improving Kenya's credit worthiness and thereby lowering future borrowing costs and crowding in private investment.

2.2.5. Achieving the medium term fiscal consolidation plans will require fiscal discipline. Plans to reduce the fiscal deficit below 5 percent over the medium term are commendable. However, given challenges faced, including from a strong labor lobby, rising debt payment charges, an ambitious infrastructure agenda (see Table 2), inefficiencies in public investment, vulnerability to exogenous shocks and the need to respond (security, political, weather, etc.) and historical underperformance of revenues compared to targets, fiscal discipline will be required to achieve the pace of fiscal consolidation outlined in the medium-term plan. The dropping off of one-off expenditure items (elections and drought related expenses) should be supportive of fiscal consolidation in FY18/19. However, deeper fiscal reforms will be required to achieve the medium term targets. In this regard, our baseline anticipates some fiscal consolidation over the forecast horizon, however, without the needed fiscal adjustment on both the expenditure and revenue front (see policy discussion section), the pace of fiscal consolidation over the medium term is likely to be weaker than projected.

2.2.6. The contribution of net exports will be moderate. Historically, the contribution of net exports has been negative. However, in both 2015 and 2016, its contribution has been positive, thanks to lower oil prices as well as a moderation of capital imports in 2016. Over the medium term, with oil prices projected to rise, this will dent the contribution from net exports. This is expected to be mitigated somewhat by an expanding global economy which will be supportive of Kenya's merchandise (horticulture and tea) and services (mainly tourism) exports. Hence the net exports contribution to GDP is expected to steadily decline to a neutral or a moderate negative contribution over the forecast horizon.

Table 2: Medium term growth outlook (percent, unless otherwise stated)

Project Name	2014	2015	2016	2017 e	2018 f	2019 f
Real GDP Growth	5.4	5.7	5.8	4.9	5.5	5.9
Private Consumption	4.3	5.1	4.8	4.6	4.9	5.1
Government Consumption	1.7	13.0	7.0	1.7	0.3	0.5
Gross Fixed Capital Investment	14.2	6.7	-9.3	3.9	12.7	14.6
Exports, Goods and Services	5.8	6.2	0.6	3.9	4.0	4.2
Imports, Goods and Services	10.4	1.2	-4.7	1.3	5.1	6.3
Agriculture	4.3	5.5	4.0	2.9	3.9	4.3
Industry	6.1	7.3	5.8	4.5	5.6	5.8
Services	6.3	6.1	6.5	6.0	6.2	6.6
Inflation (Consumer Price Index)	6.9	6.6	6.3	8.0	6.8	6.5
Current Account Balance (percent of GDP)	-10.4	-6.7	-5.2	-6.5	-7.0	-8.2
Fiscal Balance (percent of GDP)*	-8.1	-7.3	-9.0	-6.1	-5.9	-4.9

Source: World Bank and the National Treasury
Note: "e" denotes an estimate, "f" denotes forecast
** Fiscal Balance is sourced from National Treasury and presented as Fiscal Years*

3. Kenya's Growth Prospects are Subject to Significant Domestic and External Downside risks

3.1 Domestic risks

3.1.1. **Lingering political uncertainty.** Our baseline assumes political uncertainty will dissipate over the medium term, and with that, the wait and see attitude adopted by both businesses and consumers will wane. This should lead to a pick-up in aggregate demand over the medium term and support the projected robust rebound in economic activity. However, if political uncertainty lingers beyond the near term, its dampening effect will persist into 2018 and 2019, thereby leading to a weaker than projected growth performance. The extent of the impact will depend on the severity of the political disquiet. Indeed, the three-decade record weak growth of 0.2 percent in 2008 is a reminder of the potential calamitous impact political perturbations could have on economic activity. However, given significant improvements in institutions and major reforms carried out in recent years (including a new constitution in 2010, the devolution process, etc.) the governance framework to address political differences are in a relatively stronger position, hence the baseline assumption of dissipation in political uncertainty over the medium term.

3.1.2. **The projected rebound in economic activity could be scuttled if the ongoing weakness in private sector credit growth is not reversed.** For Kenya's robust growth to be sustained over the medium term, it is imperative for private investment to rebound, particularly within an environment of projected medium term fiscal consolidation. The robust medium term growth projections are predicated on the assumption that policy makers will act to alleviate the weakness in credit growth to the private sector. If this does not occur, it presents a significant downside risk to growth prospects since weak credit growth will dampen effective demand by households, stunt business expansion plans, and lower the growth potential of the Kenyan economy over the long-run.

3.1.3. **Delays in fiscal consolidation can jeopardize Kenya's hard-earned macroeconomic stability and undo some of the gains of recent years.** Fiscal slippages represent a risk to medium term growth projections through its impact on macroeconomic stability—a foundational necessity recognized in the Medium-Term Plan. Given pressures from recurrent expenditures, vulnerability to exogenous shocks (e.g. weather and security-related) an ambitious public investment agenda (see Table 1), and a track record of underperformance of revenues vis-a-vis targets (subsection 1.7), fiscal pressures could exacerbate if the planned fiscal consolidation is not adhered to. This could have adverse implications for government borrowing cost, crowding out of the private sector, exchange rate stability, inflation, and financial sector stability, thereby potentially reversing some of Kenya's recent hard-earned gains (macro-stability, robust growth, poverty reduction). Unfortunately, for a variety of reasons (decline in commodity prices, growth decline, weak revenues, fiscal indiscipline etc.), this fate has in recent years befallen several Sub-Saharan African countries (e.g. Angola, Burundi, Ghana, Cameroon, Chad, Gabon, Guinea, Malawi, Nigeria, Nigeria and Zambia), thereby forcing them into fiscal adjustment. Recent World Bank studies point to a further rise in fiscal sustainability gaps in the sub region. By adhering to its medium term fiscal consolidation plan, this downside risk can be averted for Kenya.[3] Indeed, recent studies confirm that fiscal stabilization enhances medium-term growth (Choi et al., 2017) and governments that delivered on fiscal consolidation plans are rewarded by financial markets and not penalized by voters (Gupta et al., 2017).[4]

3.1.4. **Inadequate or unpredictable rains present significant downside risks.** Our forecast assumes normal rains over the medium term. This may, however, not materialize. The poor rains of the past year have accounted for at least a 1.1 percentage point decline in GDP growth for the first half of the year. Hence, if normal or near normal rains does not materialize, they pose a significant risk to agricultural output, with downside risks to medium term growth.

3.2 External risks

3.2.1. **Spillovers from global markets represent a risk to Kenya's medium term prospects.** We observe three potential sources of external risks. First, destabilizing capital outflows from emerging and frontier markets triggered by

3 *http://pubdocs.worldbank.org/en/752761493655512338/Global-Economic-Prospects-June-2017-Topical-Issue-Debt-dynamics.pdf ; and "World Bank Group. 2017. Africa's Pulse, No. 16, October 2017. World Bank, Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/28483 License: CC BY 3.0 IGO."*

4 *http://www.imf.org/en/Publications/WP/Issues/2017/02/23/Governments-and-Promised-Fiscal-Consolidations-Do-They-Mean-What-They-Say-44690)*

the tightening of global financing conditions could be detrimental to Kenya. Median projections by the United States Federal Reserve Open Market Committee (FOMC) members point to one more interest rate hike by year end, and another three next year, bringing policy rates to 2.1 percent by end-2018. If rising U.S. yields are supported by prospects of strengthening U.S. growth, then for frontier markets such as Kenya, borrowing conditions could remain benign and positive trade spillovers could lift growth. However, if rising U.S. yields are not accompanied by stronger U.S. growth prospects, borrowing cost for frontier and emerging markets such as Kenya could rise and capital flows could slow sharply. The loss of Ksh 92 billion at the NSE in one day (due mostly to withdrawals from foreign portfolio investors), after the recent annulment of the Presidential elections is a stark reminder of the potential for destabilizing capital outflows in Kenya. However, this risk is assessed low given healthy reserve levels of US dollar 7.9 billion (equivalent to 5.3 months of import cover).

3.2.2. **Weaker global growth.** Secondly, the baseline assumes a further strengthening of the global economy, which should in turn be supportive of Kenya's growth prospects. Nonetheless, escalating tensions in global trade, adversarial geopolitical developments, and an increase in policy uncertainty among high-income countries (including from ongoing Brexit negotiations) could mark down global growth. If this were to occur, support to growth from the global economy through trade, tourism, investment and remittances would be weaker than assumed in the baseline, thereby presenting a downside risk to Kenya's growth prospects.

3.2.3. **Sharper than expected recovery in oil prices.** Last but not least, the projected moderate increase in global oil prices that underpins the forecast may not hold. Indeed, if the increase is much stronger than expected, net-oil importing countries such as Kenya (that have continued to benefit from the windfall of low oil prices) could see their growth prospects curtailed as domestic demand is dampened on account of higher energy inflation. This, however, remains a tail risk event given that higher oil prices are likely to induce a supply response, especially from US shale oil producers.

4. Accelerating Growth Will Require Structural and Sectoral Reforms

4.1 Further structural reforms are needed to achieve the Vision 2030 growth target

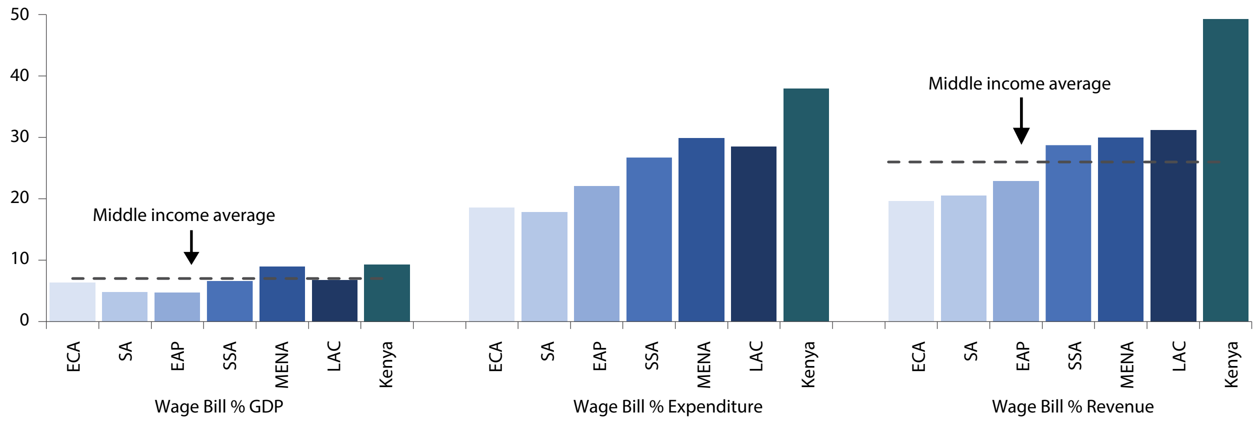
4.1.1 **Under Vision 2030, the target GDP growth is 10 percent.** This pace of growth will be consistent with making significant inroads into reducing unemployment and alleviating poverty. Based on recent developments discussed, this section focuses on a subset of structural (section 4.2) and sectoral reforms (Box 1) that will be pertinent to safeguarding Kenya's robust growth performance and could contribute towards accelerating inclusive growth and job creation.

4.2 Consolidate the fiscal stance to safeguard macroeconomic stability

4.2.1. **Strengthening revenue mobilization can support fiscal consolidation.** While Kenya's GDP growth has remained robust in recent years, tax revenues have not kept a pace with economic activity. A World Bank study finds a tax gap of about 5 percent of GDP mostly arising from exemptions. Measures to plug this gap will enhance domestic revenue mobilization and support the fiscal consolidation process. Indeed, had revenues from taxes and levies been sustained at the FY13/14 levels of 18.1 percent of GDP, the fiscal deficit in FY16/17 would have been lower by 1.2 percentage points. The special focus chapter provides extensive policy recommendations on policy and administrative measures to enhance domestic revenue mobilization.

4.2.2. **Rationalize public sector wages and salaries.** Over the past ten years, average public sector wages have increased by 10.2 percent compared to an increase of 11.4 percent for the private sector. Further, reflecting new institutions at the national and county levels required under the 2010 constitution, the public sector work force has increased. A recent Capacity Assessment and Rationalization of Public Service (CARP) audit report has recommended rationalization of staff levels to a more optimal size. Further, according to the Salaries and Remunerations Commission, the public sector wage bill accounted for some 49.2 percent of total ordinary revenues and 9.3 percent of GDP—much higher than in comparable countries and regions (Figure 38). The large public sector wage bill makes it more difficult to rein in the fiscal deficit, thereby increasing the risk of macroeconomic stability. Ongoing, efforts by the Salaries and Remuneration

Figure 38: Compared to other regions the Government wage bill in Kenya is elevated



Note: 1/ Kenya's data is for 2016/17, while regional averages corresponds to 2000-2013
2/ ECA - Eastern Europe and Central Asia; SA - South Asia; EAP - East Asia & Pacific; SSA - Sub-Saharan Africa; MENA - Middle East& North Africa; LAC - Latin America & Caribbean
Source: World Bank (2015) and Salaries and Remuneration Commission (2017)

Commission (SRC) to tame the wage bill through rationalization and streamlining of public service payroll, hiring freezes and carrying out job evaluation for State and other public officers are commendable.

4.3 Improve the efficiency of public investment and reforms in state-owned enterprise sector

4.3.1. **Despite increased spending on infrastructure to boost productivity, efficiency of public investment has been declining.** The contribution of net investment to GDP growth declined to 0.7 percentage points in 2013-16 compared to 1.9 percentage points in 2008-12. Furthermore, growth in Kenya's total factor productivity (TFP), though rising, is at about 1.3 percent, well short of productivity growth in other Sub-Saharan economies such as Rwanda, Ethiopia and Ghana (Kenya Economic Update Edition 14). Causes of low efficiency of investment can be attributed to weakness in the system of public investment management (PIM), particularly project appraisal, selection and management. Furthermore, the process of land acquisition poses a unique challenge (see Box 3 for detailed catalogue of policy recommendations).

4.3.2. **Re-invigorate reforms in government-owned enterprises to reduce the drain on the public purse.** There are over 200 Government Owned Entities (GOE) (State Corporation Advisory Committee, 2013) in Kenya. For FY15/16, grants to SOE's accounted for some 10 percent of government recurrent spending, with a 100 of them making losses to the tune of Ksh 15 billion while receiving Ksh39 billion in grants. Loans and guarantees to parastatals constitute a potential source of fiscal risk. As of June 2016, the outstanding balance of national government loans to parastatals was Ksh 572 billion, comparable in size to the development budget. Outstanding parastatals loans also pose a risk to financial sector stability. For instance, in 2017, Kenya Airways had to restructure Ksh24 billion in loans from the banking sector, with several banks taking a significant haircut. Steps to implement a revised legal and regulatory framework governing the parastatal sector have stalled in Parliament. The Government Owned Entities Bill, 2015, if passed, will support a framework for the merging and dissolution of government owned enterprises, and transformation into leaner and efficient GOE's that help crowd in private investment. Efforts to reinvigorate such reforms will help protect the public purse, reduce contingent fiscal liabilities, and leverage government resources for market and private solutions that can accelerate Kenya's growth in the medium term.

4.4 Crowd in the private sector to undertake infrastructural projects

4.4.1. **Recalibrate the financing of critical infrastructural projects, by crowding in private investment and reducing the burden on public finances.** Infrastructure needs in Kenya are vast, and the resources required to provide them through the public space are insufficient. Addressing Kenya's infrastructure deficit will require sustained expenditures of almost US$ 4 billion per year in the medium-term, which is about 6.1-7 percent of Kenya's GDP. Given a narrowing fiscal space, the public sector cannot sustainably meet these needs, yet addressing the infrastructure gap remains critical to improving the competitiveness of the Kenyan economy. Fortunately, Kenya's capital markets are the most developed in East Africa with assets under management of institutional investors representing 18 percent of GDP. Her capital markets also enjoy significant interest and participation of foreign investors in the domestic capital market as well as in the independent power production sector through PPPs. Hence, there exists significant potential to scale-up the participation of the private sector in the provision of infrastructural needs, including in social sectors such as housing, education and the provision of health care.

4.4.2. The private sector could be incentivized to participate in the provision of infrastructural development through (see Colombia Case study—Box 3):

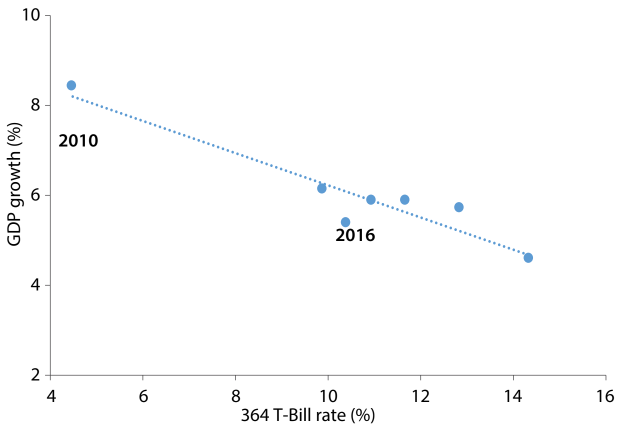
- Pension industry reforms to create greater flexibility in their investment process, limit the ability of members to withdraw and reduce trustee rotation.
- Tax reform to incentivize institutional investors and banks to invest in infrastructure assets (e.g. by providing similar tax incentives as currently exist on infrastructure bonds).
- Regulatory reform to ensure that infrastructure assets are within the permissible investment categories of institutional investors.
- Prompt payment of contractors of ongoing infrastructure projects.
- Reduction in the higher end of the yield curve to make other asset classes (including longer term infrastructure projects) relatively attractive to incentivize banks and institutional investors in alternative investments.

4.5 Macro and micro economic policy interventions can improve credit access

4.5.1. A reduction in government borrowing on the domestic market can contribute to lowering borrowing costs. Given that Kenyan banks price loans off equivalent government securities, a reduction in benchmark T-bill rates should help bring down the cost of credit to the private sector. In general, lower T-bill rates are associated with better economic performance including GDP growth and private investment (Figure 39 & Figure 40). For instance, in 2010, a year in which the Kenyan economy attained an enviable growth rate of 8.4 percent, its highest in three decades, the 364 and 184-day T-bill rates registered an average of 4.5 and 3.8 percent. Hence, at an average coupon rate of 10.9 and 10.3 percent for the 364 and 184-day T-Bills in 2017 respectively, there remains significant scope for a reduction. Lower fiscal deficits should help reduce government borrowing requirements, thereby putting downward pressure on yields of government securities, as was the case in 2010, when the fiscal deficit and 364-day T-bill rate were at multi-year lows of 3.4 and 4.5 percent respectively.

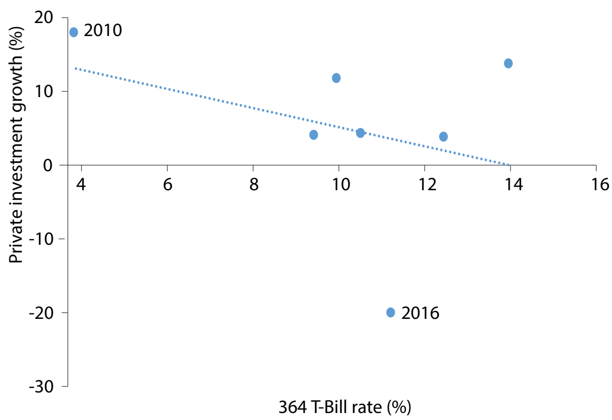
4.5.2. The regulatory environment for banks could be relaxed to allow them competitively price risks associated with different borrowers. With risk-free 364-day treasury bills and five-year government bonds at about 10.9 and 12.5 percent respectively, on a risk adjusted basis a cap of 14 percent, effectively prices out several borrowers and disincentivizes banks to offer longer maturity loans. This is because apart from the "risk free" and relative "costless" nature of lending to government, extending new credit to private entities often involves cost associated with legal fees, insurance, government levies, stamp duty, valuation fees, security registration and other third party costs. Further, different borrowers present different risk profiles hence attracting different risk premiums. Thus, taking these factors into account, on a risk-adjusted basis, under the current regime where margins have been compressed, the operating environment supports the extension of

Figure 39: Higher government security yields are associated with lower GDP growth



Sources: Kenya National Bureau of Statistics, Central Bank of Kenya and World Bank
Note: Each dot represents a year. The sample period is 2010-2016.

Figure 40: Higher government security yields are associated with lower private investment



Sources: Kenya National Bureau of Statistics, Central Bank of Kenya and World Bank
Note: Each dot represents a year. The sample period is 2010-2016.

Photo: © Sarah Farhat

Microeconomic frictions to accessing credit need to be addressed

credit to only a limited number of borrowers—the lowest risk borrowers. Accommodating credit worthy borrowers with a higher risk profile, including personal unsecured loans and loans to SMEs—the back bone of the Kenyan economy- thereby calls for a more flexible pricing regime that allows banks to competitively determine loan prices. Further, there needs to be improvements in the institutional environment to prohibit predatory lending, through stronger consumer protections.

4.5.3. Microeconomic frictions to accessing credit need to be addressed. Recent efforts to reduce the transactional cost in accessing credit including the Moveable Property and Securities Right Act and a new website allowing potential borrowers to compare cost of credit across banks[5] are commendable. Nonetheless more could be done, specifically relating to the establishment of a publicly available electronic collateral registry, digital lands registry, and improvements to the information content provided to the credit reference bureaus to help lenders better identify credit worthy borrowers. In Ghana, reforms under the Borrowers and Lenders Act (2012) and the establishment of the collateral registry has led to over 77,500 loans registered, and an extension of over US$12 billion in financing to in excess of 8,000 SMEs and 30,000 Micro loans (see Special Focus I for further policy recommendations).

[5] *(http://www.costofcredit.co.ke/)*

BOXES

Box B.1: Climate proofing agriculture in Kenya

1. **Kenya is highly vulnerable to the impacts of climate change.** Extreme weather events, largely droughts and to a lesser extent floods, have been the principal source of volatility in the performance of agriculture in Kenya. The Center for Global Development ranks Kenya 13th out of 233 countries for direct risks arising from extreme weather. The frequency and intensity of severe weather events has recently increased, and this trend will be further amplified in the future as temperatures rise due to climate change. In Kenya, about 83 percent of land area is in the Arid and Semi-Arid Lands (80 percent of the population lives in the remaining 17 percent of land), and two-thirds of the country receives less than 500 mm of rainfall per year.

2. **Yet, agriculture in Kenya remains predominantly rain-fed.** The agriculture sector accounts for the livelihood of 60 percent of the workforce, generates two-thirds of (65 percent) of merchandise exports, and roughly 60 percent of foreign exchange. While rainfall patterns will inevitably continue to influence agricultural sector output for a foreseeable future, some measures need to be taken to reduce the extreme vulnerability of Kenya's agriculture sector to the vagaries of the weather. Investing in climate-smart agriculture (increased productivity, enhanced resilience, and reduced greenhouse gases) can help to mitigate some of the worse effects of increasing temperatures and droughts, such as occurred in recent years.

Policies

3. **Increase the adoption of drought tolerant varieties.** Advances in biotechnology has led to the development of seeds that can grow bigger and longer roots allowing them to capture more water from the soil, and thereby making them more drought tolerant. According to the Drought Tolerant Maize for Africa Seed Scaling project (DTMASS)[6], the adoption of such varieties has led to yield increases of some 20-30 percent compared to non-drought tolerant varieties in 13 African countries over a five-year period. While Kenyan farmers have adopted drought tolerant maize varieties, they are yet to do so at a scale that would make a dent in mitigating severe downturns in agricultural output. Beyond the adoption of drought tolerant seeds, there may be the need to switch to dryland crops, such as millet, sorghum, and cassava. For instance, maize, which is the most widely grown food crop in Kenya is very sensitive to water stress; and even when rains are adequate it is sensitive to the timing of rains. Further, a significant share of the maize is also grown in marginal lands, thus making it every susceptible to droughts. Switching to dryland crops would increase food crops production by building resilience to climate change and variability, and thereby boost food security. Hence, the need to provide adequate extension services and incentives to switch from maize to dryland crops. However, with the current bias towards maize production, through various production and marketing subsidies, farmers may not be sufficiently incentivized.

4. **Invest in better water management systems.** Virtually all (98 percent) agriculture in Kenya is rain-fed and extremely vulnerable to increasing temperatures and droughts. Studies in Kenya find that by 2030, under business-as-usual scenario, climate change will reduce yields of staples (maize by 12 percent, rice by 23 percent, wheat by 13 percent) as well as prospects for cropland to sustain maize and wheat production. Depending on the region and type of production system, water scarcity due to climate change will result in less productive pasture, lower dairy yields, and higher risks that crop and livestock diseases will spread. Reducing this risk will require investments in irrigation infrastructure to build resilience to drought shocks. Droughts cannot be stopped. However, they can be managed. A historical review of Kenya's drought history shows some degree of predictability that droughts occur every three-four years, interspersed with years of abundant rain (even floods). Yet the requisite infrastructure to harvest rainwaters for the inevitable drought years remains highly inadequate. Notwithstanding ongoing efforts, to help mitigate the worse effects of drought (and flood years) will require a radical overhaul of the investment to the agriculture sector, including into efficient surface irrigation, precision irrigation (drip technology), and sustainably harvesting ground aquifers. While spending on infrastructure has significantly increased in recent years, expenditure on specific agriculture infrastructure remains weak. Spending on agriculture in Kenya, like many countries in Sub-Saharan Africa, is significantly below the African Union Comprehensive Africa Agriculture Development Program (CAADP) target of 10 percent of national budgets.

5. **Make relevant and timely information available to farmers to improve agronomical practices.** To help farmers address the challenges of climate change and variability, and to enhance their resilience amid those challenges, it is imperative that Kenya develops and use agro-weather forecasting, monitoring and dissemination tools, as well as market information systems (input/output prices and quantities). Adopting these measures will

[6] *http://www.cimmyt.org/project-profile/drought-tolerant-maize-for-africa-seed-scaling-dtmass/*

improve the capacity of smallholder farmers to adopt climate-smart agriculture technologies, innovations, and management practices. In other words, developing "big data" for climate smart agriculture will help farmers and pastoralists make informed decisions on what, when, where and how to produce and market their commodities. Recent advances in information technology can be deployed to further climate proof agriculture production, including the adoption of sensors, and satellite imagery to gather important information including on soil moisture, soil type, and weather forecasts; and can therefore, provide a more predictable basis for undertaking the best agronomical practices. For instance, information on soil analysis can guide farmers on knowing the crops and fertilizers suitable for specific soils types. Further, the provision of information on advanced weather patterns by locality can also help farmers make an informed decision on the right planting time, thereby avoiding the failed harvests that several farmers have faced due to untimely planting.

Box B.2: Improving the efficiency of public investments

A recent World Bank study points out that Kenya can enhance the efficiency of its public investments by undertaking reforms in two broad areas: improving public investment management and the process of land management.

Policies on Public Investment Management

Quick-win, high-priority actions include:

- Establishing minimum criteria for project preparation, appraisal and inclusion of a project in the budget;
- Gradually strengthening the role of National Treasury as an independent reviewer of project proposals before selection for funding; while enhancing the capacity to undertake this role;
- Improving transparency and accountability for management of the portfolio of public investment projects.

A more comprehensive and longer term reform action plan and effort could include:

- **Strategic guidance:** ensure that investment proposals are more stringently reviewed for alignment with the strategies of the Vision 2030 and related Medium Term Plans.
- **Project design and appraisal:** draft project appraisal guidelines with minimum standards for technical design, costing and economic analysis.
- **Project selection and budgeting:** strengthen the role and capacity of the National Treasury to review and challenge proposals by line Ministries as part of the annual budget cycle.
- **Project implementation:** strengthen core public financial management systems: procurement, contract management, cash management, and improving IFMIS functionality and compliance.
- **Procurement:** ensuring competition in public procurement and strengthening the antitrust enforcement to prevent bid rigging and reduce the cost of delivering public infrastructure.
- **Audit and Monitoring and Evaluation:** continuation of reforms at the Office of the Auditor General (OAG), and supplement the existing indicator-based approach to M&E at national level with a focus on project and program evaluation.
- **Transparency and disclosure:** the National Treasury could initiate a cleaning up of the data in e-Promis and use the database to improve information and transparency.

Policies on Land management:

Mitigating the delays related to land acquisition requires legislative and administration reform which include protecting the public land currently available and strengthening the legislation that governs compulsory land acquisition and involuntary resettlement. Some quick wins in the regard include:

- Providing payment assurance (such as via an escrow account at the National Treasury) for financing land acquisition and resettlement to ensure immediate availability of funds for compensation when needed.
- Preparing and periodically updating comprehensive public land inventory. Strengthen administrative systems to safeguard public land by registering and titling all public land parcels in the name of the county or the appropriate national authority.
- Developing a policy on involuntary resettlement, with supporting legislation, which reflects the principles of international good practice.

Source: World Bank. (2016). Kenya Economic Update, Edition 14.

Box B.3: Crowding in Private Investment: What can Kenya learn from Colombia?

The Colombian 4G Toll Road Program Infrastructure Debt Fund

In 2014, the Government of Colombia launched a USD 20 billion PPP Toll Road Program (7 percent of GDP), one of the largest in the world, covering 40 road transactions. Through WBG engagement:

1. Close to 50 percent of the projects have been awarded (equivalent to USD10 billion of investment mobilization) of which 10 projects have reached financial close.
2. Out of two of the 10 projects awarded, a dominant share of the debt was provided by pension funds through the creation of infrastructure debt funds and project bonds.

The WBG supported this endeavor with a comprehensive approach, including:

1. Policy and regulatory reforms, to allow pension funds to invest in infrastructure assets.
2. Strengthening of the PPP framework to enable a pipeline of bankable projects.
3. Investing USD 50 million seed IFC investment in a local infrastructure debt fund that helped mobilize over USD 400 million from pension funds; USD 70 million IFC equity investment in the local infrastructure development bank (FDN).
4. Technical support to strengthen their ability to address market gaps by supporting in the design of financial guarantees.

The newly created infrastructure debt fund, provided many advantages:

1. Allowed local pension funds to participate in the bank syndicate with the same terms and conditions.
2. Benefited from the participation of banks and engagement of a fund manager to ensure proper due-diligence, monitoring and management of the project(s) and fund.
3. Matching of investment tenures: whilst banks provided medium term funding (10-12 years), the provision of longer tenured financing (19 years) was well suited for pension-funds long-term investment horizon.
4. The structure benefited from a 15 percent partial credit guarantee from the local infrastructure development bank (FDN).

A key factor contributing to the success of WBG's efforts in Colombia was the early engagement of the Government alongside the institutional investors. This enabled the introduction of amendments to the structure of the PPP road projects. Such changes included, notably:

1. Increase in the share of availability payments in USD from 15 percent to 30 percent.
2. Increase in the frequency of top-up payments related to traffic shortfall.
3. Allocation of specific construction risk to the Government, pertaining to more geologically challenging sections of the road.

To date, two more debt funds have been created with private funding, illustrating that this modality is not only successful to crowd in long-term local currency infrastructure finance, but can be easily replicated for future projects, and possibly other markets.

PART 2: SPECIAL FOCUS I

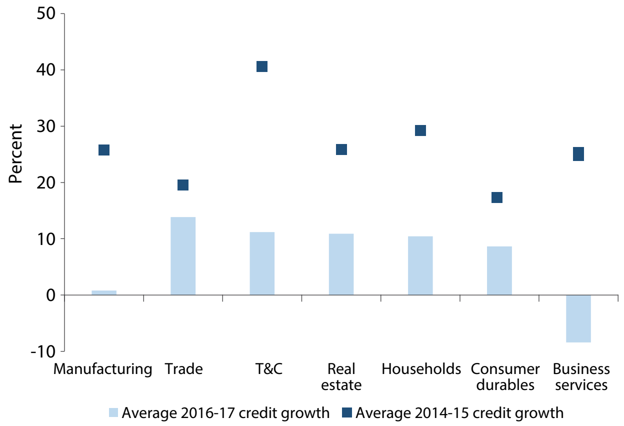
Photo: © World Bank

5. The Slowdown in Private Sector Credit Growth in Kenya: A Confluence of Multiple Shocks?

5.1 Introduction

5.1.1. **Credit growth has slowed significantly in Kenya.** Private sector credit growth fell from its peak of about 25 percent in mid-2014 to 2 percent in October 2017—its lowest level in over a decade. Limited credit availability, can hinder robust economic recovery, as has been observed in several economies in Europe and elsewhere after the global financial crisis. This box seeks to investigate the driving forces behind the recent broad-based slowdown in credit growth in Kenya (Figure 41).

Figure 41: Credit growth to private sector



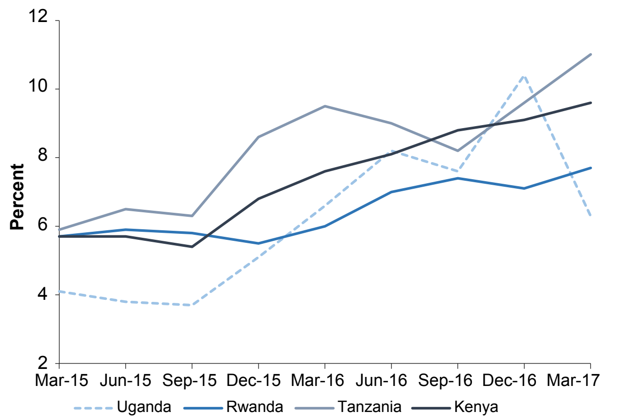
Source: Central Bank of Kenya and World Bank
Note: T&C - Transport & Communication

5.1.2. **Kenya's slowdown in credit growth is partly a sub-regional phenomenon linked to the rise in non-performing loans and adverse macro-financial shocks.** The credit slowdown has also been observed in Uganda, Rwanda, and Tanzania (Figure 42 and 43). The synchronization of the credit slowdown in part reflects trade and financial interlinkages between these countries, decline in economic growth, and the deterioration in the quality of bank assets and rise in non-performing loans. Nonetheless, there remains significant idiosyncratic factors driving the increase in NPL's in each of these economies, including for instance the deterioration of business sentiments in Tanzania and a bank failure in Uganda. Furthermore, the CBK's stepped up oversight of banks since 2015 underscored the need for higher loan loss provisioning for several banks in Kenya.

5.1.3. **This chapter focuses on a chronological sequence of events that contributed to the decline in private sector credit growth, and makes policy recommendations for reversing this trend.** In Kenya, credit slowdown reflects several factors including exogenous factors such as the external financing shock in 2015, and endogenous events, most notably the interest rate caps introduced in 2016 and the elevated risk free rate of return due to high levels of government borrowing in the domestic market[7]. It is useful to clarify at the outset that the slowdown in credit cannot be attributed to one single event.

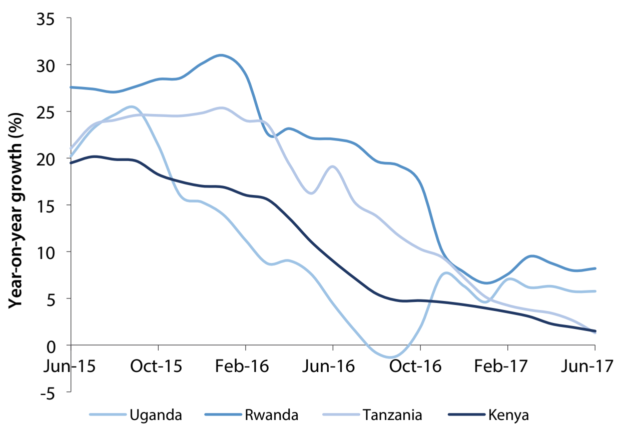
5.1.4. **From a theoretical perspective, both demand and supply factors are significant in explaining credit cycles.**[8] Private sector credit to GDP varies widely across

Figure 42: EAC: ratio of non-performing loans to gross loans



Source: Central Bank of Kenya, Bank of Tanzania, Bank of Uganda and National Bank of Rwanda

Figure 43: EAC: annual credit growth



Source: Central Bank of Kenya, Bank of Tanzania, Bank of Uganda and National Bank of Rwanda

7 *The slowdown in credit growth may also reflect a correction of the strong credit growth between 2010-13 when external financing conditions very favorable.*

8 *Akhtar (1994) in the study of the 1989-92 credit slowdown in the U.S highlights the challenge with separating shifts in the supply schedule from developments on the demand side. As the extent of lenders' response depends not only on the degree of perceived economic weakness and its effects on borrowers' credit quality but also on the state of their own balance sheets.*

countries and it correlates strongly with income level as well as long-term economic growth and poverty reduction[9]. On the demand side, strong economic growth, stable macro policies, and low debt burden in the private sector support the expansion of credit and vice versa. On the supply side, credit growth is mostly affected by the strength of banks' balance sheet, with capital and NPLs being the main factors that influence the supply of credit, while access to cheap wholesale funding facilitated by foreign-owned subsidiaries can also play a role.[10] Changes in the regulatory environment—higher provisions and tighter capital buffers—can further affect the supply of credit.[11]

5.2 Kenya's slowdown in credit growth can be attributed to exogenous events beginning in 2015

5.2.1. **The slowdown in credit growth reflects a series of shocks that have hit the economy since 2015.**[12] Private sector credit growth in Kenya has been on a consistent downward trend since the second half of 2015. However, the triggers for the downturn in the credit cycle can be traced to the first half of 2015, when the economy was hit by unfavorable external developments and certain domestic shocks coalescing to put pressure on the exchange rate and domestic prices.

5.2.2. External financing shock

5.2.2.1. **Like several other emerging and frontier markets in 2015, the Kenyan economy experienced large capital outflows.** Large outflows, including from the banking sector, were due to changing investor sentiment towards emerging and frontier markets. The situation in Kenya was accentuated by reduced tourism receipts, following adverse travel advisories after the Garissa attack in April 2015.

5.2.2.2. **The external financing shock put pressure on the exchange rate and liquidity in the banking sector.** The shilling depreciated by 15.2 percent in the first quarter of 2015 compared to a depreciation of 3.0 percent during the same period in 2014. Along with an increase in food prices, exchange rate depreciation and its pass-through effects on inflation contributed to a spike in inflation from 7.0 percent in June 2015 to 8.0 percent in December 2015. The CBK increased the policy interest rate (CBR) by 300 bps between May and July 2015, intervened in the foreign exchange market and restricted banks' access to the overnight discount window. The resulting liquidity squeeze curbed the exchange rate depreciation, and together with the failure of a very small bank, contributed to a significant increase in interbank rates (up to 23 percent in September 2015) and segmentation of the interbank market.

5.2.2.3. **The CBK acted to ease bank's access to liquidity and stepped up its oversight of the banking sector.** Against this backdrop of liquidity concerns particularly for smaller banks, the CBK injected liquidity—purchased foreign exchange, reopened the discount window, and engaged in reverse repo operations to support banks experiencing liquidity pressures. The CBK's strengthened oversight of bank's compliance with prudential guidelines, led to a higher loan loss provisioning coverage ratio for several banks.[13] By September 2015, private sector credit growth had begun to decline (Figure 44).

5.2.3. Bank liquidation and receiverships

5.2.3.1. **Even as demand conditions stabilized, under continuing difficult financial conditions, bank balance sheets weakened and credit supply indicators tightened for most of 2016 (Figure 44 and 45).** Foreign exchange market pressures eased and the economy recovered with real GDP growth of 5.7 and 5.8 percent in 2015 and 2016 respectively (up from 5.4 percent in 2014). However, risks appear to have rotated from the real to the financial sector and by April 2016 three non-systemic banks were under receivership for liquidity and capital deficiencies reasons. There was "flight-to quality", as smaller-size banks suffered loss of wholesale deposits, and bank lending to the public sector increased even as private credit growth fell precipitously for most of 2016 (Figure 44 and 45). Furthermore, increased segmentation of the interbank market also intensified the liquidity stress in smaller banks and their ability to extend credit.

5.2.3.2. **The deceleration of credit growth continued as banks cut back their lending to improve balance sheets hit by a growing number of nonperforming loans (NPLs)**

9 *Čihák et al. 2012.*

10 *Holmstrom and Tirole 1997, CESEE monitor, May 2016.*

11 *Griffith Jones and Ocampo 2009.*

12 *Credit growth also declined in 2014, stabilized in the first half of 2015, and began a persistent downward trend shortly after. This section focuses on the drivers of credit decline since 2015.*

13 *Studies have shown that increased emphasis by the regulators on bank capital and asset quality can weigh negatively on the supply of credit—a standard argument for counter cyclical regulations put forward in the literature (Lown and Wenninger 1994 and McCoy 2016).*

(Figure 46 and 47). While Banks remain well capitalized, bank asset quality and profitability indicators deteriorated. At the same time, non-performing loans increased significantly as credit growth fell. In studies of countries in Central, Eastern and Southeastern Europe, it was similarly found that sharp increases in NPL's reduces bank capital and, hence, their lending capacity.

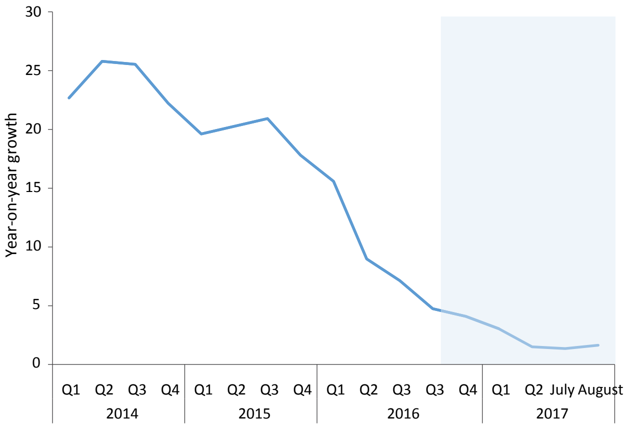
5.2.3.3. These shocks highlight the relative strength of supply conditions in explaining the decline in credit growth—a situation that is not unique to Kenya. For example, empirical research shows interest rate in Jordan to be largely affected by shifts in credit supply as the elasticity of credit demand with respect to the lending rate is relatively smaller than the elasticity of credit supply. While supply factors also played a major role in the decline of bank credit in Namibia during 1996-2000.

5.2.4. More recently, subdued domestic demand in 2017 has been both a cause and contributor to the weakness in credit growth. Real GDP growth, although robust, has weakened markedly in recent months. Growth in Q1 2017 fell to 4.7 percent—well below the 2013-16 average of 5.7 percent because of drought, election related uncertainty and the deceleration of credit growth. Furthermore, inflation spiked in H1 2017 (up to 11.7 percent in May), reflecting mainly renewed spikes in food prices. Taken together, demand for credit is likely to have declined as firm and households cut output and consumption respectively.[14] The less supportive demand environment in 2017, and supply constraints—most importantly, the impaired balance sheet of banks, the outlook for strong credit growth remains difficult and clouded by downside risks.

5.3 Interest rate caps made an already tough lending environment even more difficult

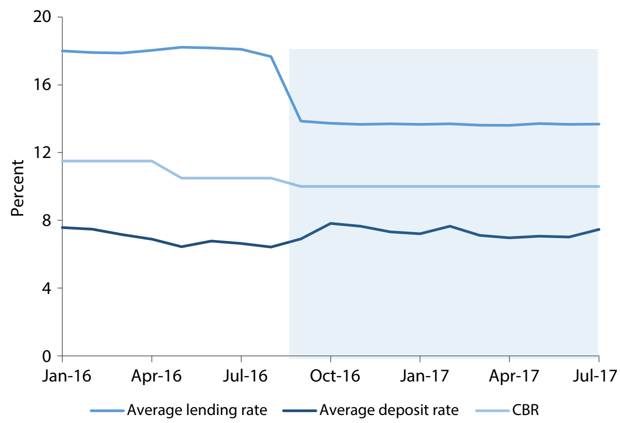
5.3.1. The new law capping interest rates became effective in September 2016—complicating the recovery of credit supply. The law puts a ceiling on lending rates by banks and financial institutions at 4 percentage points above the Central Bank Rate (CBR), with a floor on term-deposit rates equal to 70 percent of the CBR. This new legislation was in response to the public view that lending

Figure 44: Growth in private sector credit



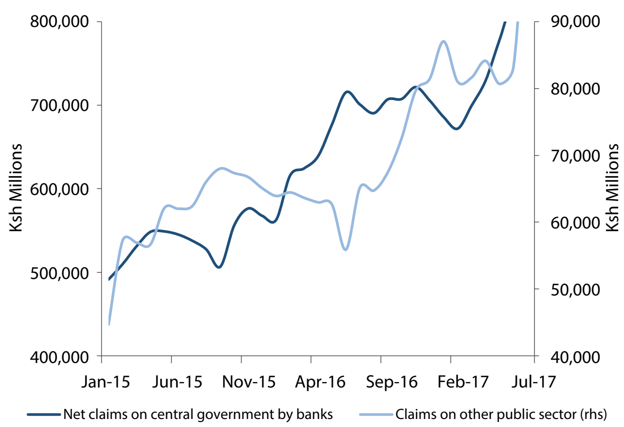
Source: Central Bank of Kenya

Figure 45: Interest rates before and after the cap



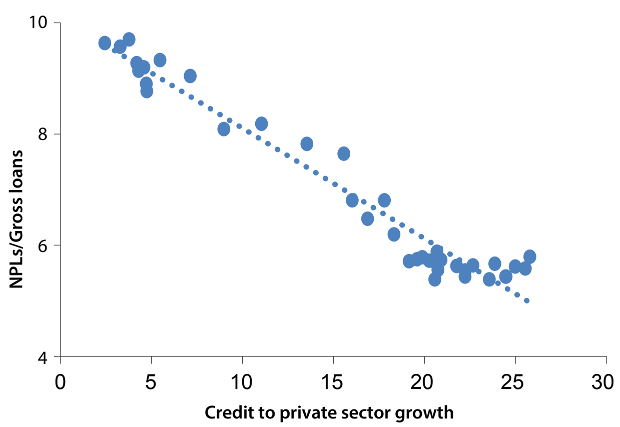
Source: Central Bank of Kenya

Figure 46: Lending to the public sector



Source: Central Bank of Kenya

Figure 47: Private credit growth and NPLs/Gross loans (2014-2017)



Source: Central Bank of Kenya and World Bank

[14] The lack of bank lending surveys makes it difficult to make definitive statements about the extent of the decline in credit demand.

rates in Kenya were too high, and that banks were engaging in predatory lending behavior.[15] Although the interest rate cap was meant to reduce the cost of credit, thereby making credit accessible to a wider range of borrowers, after a year of implementation weakness in private sector credit growth remains.

5.3.2. **Evidence on the effectiveness of interest rate caps around the world is mixed.** While more than 70 countries worldwide have enacted interest rates caps to some degree, their various forms and modes of implementation make definitive conclusions on their net impact difficult to assess. In theory, interest rate caps can help reduce the cost of borrowing for consumers and are often used by governments to protect unsophisticated borrowers from predatory lending. In practice, however, the impact depends also on how banks adjust credit supply when faced with interest caps.[16]

5.4 Interest rate caps has had unintended negative consequences in Kenya

5.4.1. **The interest rate cap has negatively affected small borrowers and SMEs'.** In response to the caps, banks have shifted lending to corporate clients whenever possible impacting the allocation of credit to smaller borrowers. Unable to properly price riskier loans, banks have generally adjusted their portfolios to less risky asset classes and rationing out riskier borrowers including SME's and micro borrowers. Our data analysis confirms that commercial banks indeed responded to the interest rate caps by shifting lending to their corporate clients to the extent possible. Specifically, both tier 1 and tier 2 banks exhibited a significant shift towards corporate clients, and away from small businesses or individual borrowers following the interest rate caps.

5.4.2. **The proportion of new borrowers has fallen by more than half from a peak of 13 percent in March of 2016, to roughly 6 percent after the caps, likely impacting entrepreneurship and new job creation.**[17] Smaller banks, who do not have a large corporate client base, are forced to maintain their portfolios in SME and consumer lending, but have stopped lending to new and unknown customers. All of this has led to a statistically significant decrease in consumer and unsecured loans since the cap was introduced. The shift in bank portfolios away from smaller and riskier borrowers is particularly impactful in Kenya, where riskier SME and micro borrowers make up roughly 4/5^{ths} of all borrowers.

5.4.3. **The interest cap has also affected Kenya's savers' access to interest-bearing deposit accounts, as banks are reclassifying interest bearing accounts to non-interest bearing accounts.** Empirical evidence suggests some re-classification of deposit accounts within banks—from interest to non-interest-bearing accounts—is happening to avoid higher deposit interest charges. This reclassification has contributed to the shorter duration of deposits and bank liabilities, which has helped stabilize the liquidity coverage ratio of smaller banks albeit at the expense of banks' willingness and capacity to make longer term loans.

5.4.4. **Another effect of the interest cap is that banks have re-allocated credit from the private to the public sector (Figure 48).** Since the introduction of the caps, credit to the government has increased significantly even as credit to the private sector continues to fall. So far in 2017, growth in credit to the government has averaged about 15 percent compared to the 2.3 percent to the private sector. With risk-free 364-day treasury bills and five-year government bonds at about 11 percent and 12.5 percent respectively, on a risk adjusted basis a cap of 14 percent effectively prices out several borrowers and encourages investment in government securities at the expense of lending to the private sector (Figure 49).

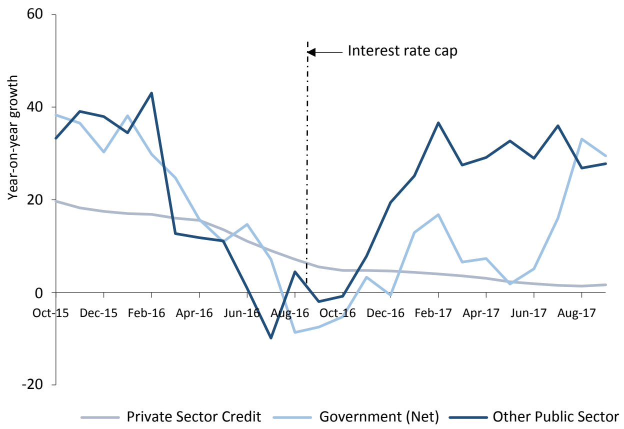
5.4.5. **The interest rate cap has had a dampening effect on overall economic activity.** Compared to earlier forecasts, GDP growth for Kenya has been downgraded by about 1.1 percentage points from 6.1 to 4.9 percent for 2017. While part of that growth downgrade is undoubtedly linked to the effects of the drought as well as the political jitters (see chapter one) the continued slowed down in

[15] *Interest rate spreads in Kenya averaged 10.1 percent between 2001 and 2015, with profits (48 percent) and overheads (40 percent) accounting for a large portion of these margins.*

[16] *At the request of the Central Bank of Kenya, and with strong support from the National Treasury, a World Bank mission visited Nairobi from March 13th-20th, 2017, to assess the impact of the interest rate cap on the real economy. The objective of the mission was to i) engage with counterparts and stakeholders affected by the interest cap to understand their perspectives on how the caps are affecting financial institutions and credit growth to the economy; ii) secure commitments from banks, microfinance institutions, and SACCOs to provide micro-level data to undertake the analysis; and iii) to initiate a research design and analysis initiative to provide a full analysis based on robust data collection and analysis. Meetings were held with key financial sector regulators including the Central Bank of Kenya (CBK), National Treasury (NT), Capital Markets Authority (CMA), and SACCOS Society Regulatory Authority (SASRA). In addition, the mission met with financial institutions, including tier 1, 2, and 3 commercial banks, deposit taking microfinance banks, and SACCOs. Finally, the mission met with development partners including Financial Sector Deepening Kenya (FSD-K) and DFID. Data requests were submitted to commercial banks for an independent empirical analysis. This section is a summary of the insights from mission meetings and analysis of data provided by the CBK. It is part of a more detailed report shared with the authorities on the impact of the interest rate cap so far.*

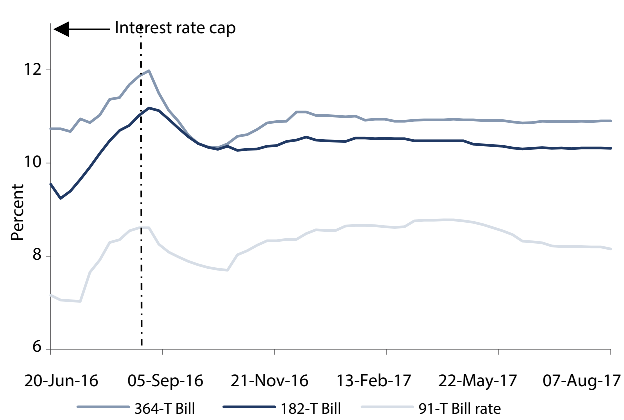
[17] *Paligorova and Santos (2014) show that supply induced maturity shortening by banks can have implications for financial stability. Forcing borrowers to revisit banks within shorter periods of time exposes them to "own" and "bank" refinancing risks. This potential synchronization of banks' and borrowers' rollover risk may be a source of financial instability.*

Figure 48: Changes in domestic credit



Source: Central Bank of Kenya

Figure 49: Government treasury bill rates



Source: Central Bank of Kenya

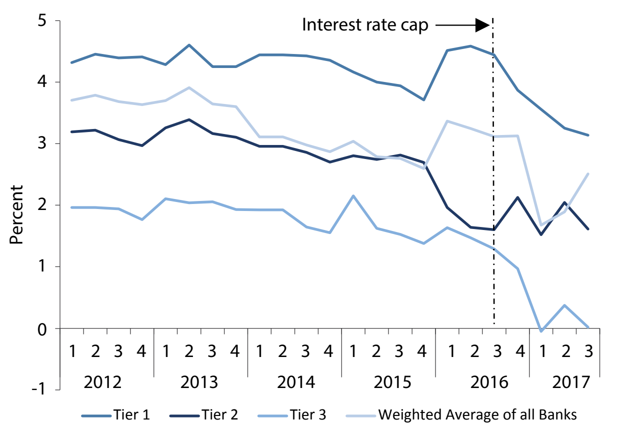
credit growth in the aftermath of the rate cap has also been a contributing factor. The dampening effects on growth are likely to be more pronounced in the medium term if the rate cap persists, since the drought and political jitter factors are expected to be transient. Beyond the growth impact, given the importance of the segment of borrowers that have been worst hit by the cap—the SME's and personal loans—the impact on employment and job creation is likely to be more pronounced, well beyond the announced lay-offs in the banking sector.

5.5 The interest rate cap is undermining confidence in the banking system

5.5.1. **Narrower interest margins have translated to declining bank profits which could affect capital.** On a weighted average basis, return on assets declined following the introduction of the caps, particularly in tier 3 banks where return on assets hovering around zero since January 2017 (Figure 50). More recently, profitability indicators have staged a modest recovery as banks adjust their strategies to the decline in net interest income to remain profitable in the near term. This recovery is in part driven by increases in non-interest income generating activities to counter lower lending margins and the reorientation of banks' portfolio towards government securities. Capital to asset ratios remain adequate at about 18% since the introduction of the caps; however, persistent declines in profitability could have a knock on effect on capitalization and further weaken the outlook for credit recovery (Figure 51).

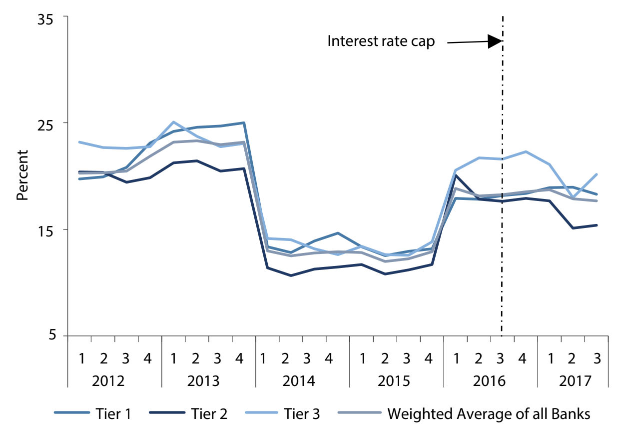
5.5.2. **Deposit migration from smaller banks adversely impacts the already weak liquidity position of these banks.** The evidence shows that the growth in deposits fell, on a weighted average basis, after the caps were introduced and remains subdued. However, this aggregate trend masks significant volatility in bank funding across different types of banks. On one hand, growth in deposit account holders is broadly unchanged across all tiers of banks (flat at less than 2 percent). On the other hand, the caps have exacerbated the migration of deposits from tier 3 banks to tier 1 and 2 banks, thereby adversely impacting the liquidity position of these banks and their ability to further mobilize deposits (Figure 52 & Figure 53).

Figure 50: Quarterly returns on assets



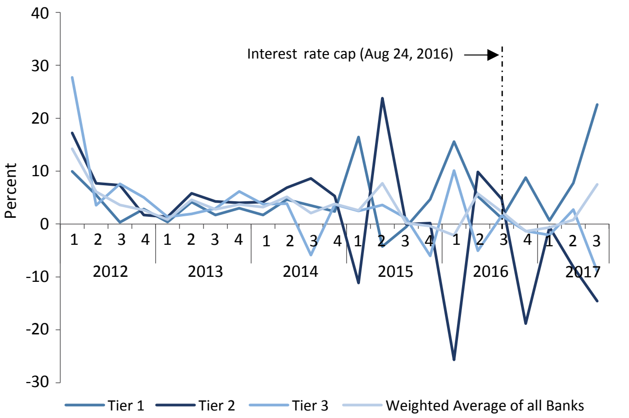
Source: Central Bank of Kenya

Figure 51: Quarterly capital to assets



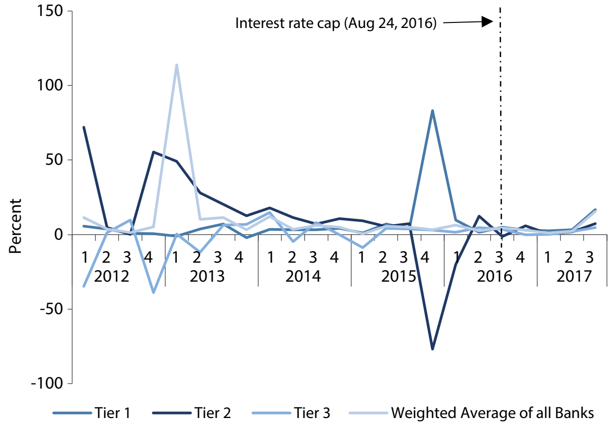
Source: Central Bank of Kenya

Figure 52: Quarterly growth in deposits



Source: Central Bank of Kenya

Figure 53: Quarterly growth in deposit account holders



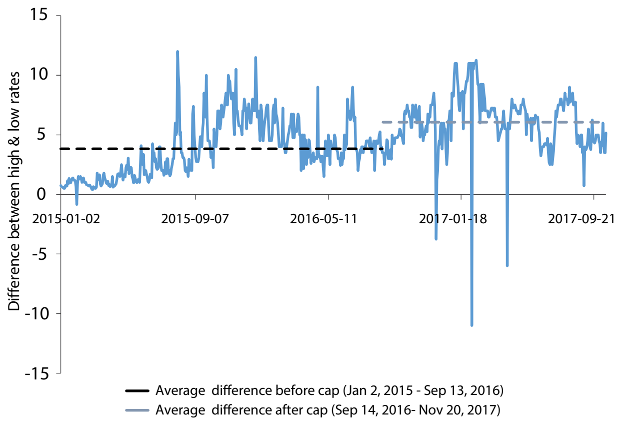
Source: Central Bank of Kenya

5.5.3. **In addition, the segmentation in the interbank market has persisted, with large banks reluctant to provide liquidity to smaller banks (Figure 54).** Transaction volumes and liquidity have improved since the liquidity crisis that lasted well into Q1 2016—reflecting liquidity provisions by the CBK to smaller banks. However, risk aversion in the interbank market persists due to ongoing concerns about the liquidity position and solvency of smaller banks. The segmentation in the interbank market and its attendant effects on competition between banks also exacerbates the negative effect of the interest rate caps on credit supply in smaller banks. There is also an underlying concern about the disproportionate impact of the caps on smaller banks and the likelihood that they would need a major change in strategy to remain competitive in this setting. These concerns have been reflected in wider gaps between interbank lending rates for large and small banks as well as greater volatility of interbank rates in the post cap period.[18]

5.5.4. **Foreign participation in the stock market also continues to be weak following the cap.** The stock market is often a good indicator of foreign investor sentiments towards the economy. The NSE declined in the immediate aftermath of the cap, driven mainly by withdrawal of foreign participation in the stock market. While the overall index has staged an impressive recovery in 2017, this rally masks some negative underlying trends. First, foreign purchases have remained subdued (Figure 55). Second, the volumes of bank stocks traded is more volatile and prices have not recovered in some cases.

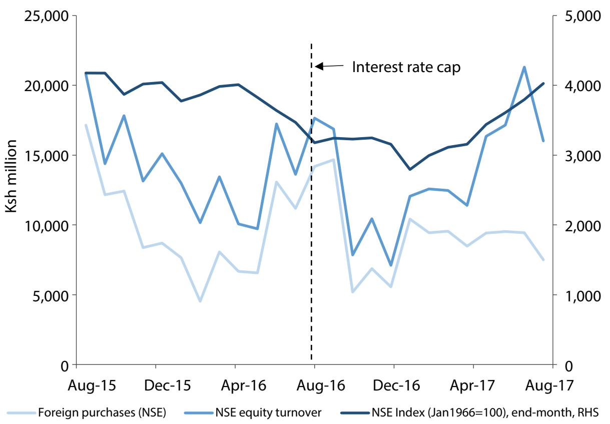
5.5.5. **Outside the banking system, interest rate caps also undermine monetary policy transmission and implementation, with implications for CBK's independence and its ability to steer the economy**. With caps linked to the CBR (policy rate), changes in the policy rates could be counterproductive. For example, if the CBK were to loosen its monetary policy stance to stimulate

Figure 54: Interbank market segmentation



Source: Central Bank of Kenya

Figure 55: Stock market activity



Source: Central Bank of Kenya

18 *The average gap between the CBR and the weighted average interbank rates has widened since the cap was introduced (6.25 in the period January 2016-September 13 (2016) vs. 4.38). the difference between the two periods is statistically significant*

the economy through a policy rate cut, there would be a decline in the interest rate ceiling. This in turn would make it less profitable for banks to lend, particularly to smaller or higher risk customers, thus potentially offsetting the impact of the rate cut. The CBR has been changed once since the implementation of the cap.

5.6 The recovery of credit growth faces further headwinds

5.6.1. **The new International Financial Reporting standards (IFRS 9) could pose further challenges to the recovery of credit growth in the near term.** Specifically, the expected-loss impairment framework in IFRS 9 requires banks to account for expected credit losses on loans from the moment of its origination or acquisition and adjust throughout the life of the loan. Previously, credit losses were recognized only once there has been an incurred loss event. In the context of slow credit growth and elevated non-performing loans, provisioning will likely increase, further tightening bank's ability to allocate credit to the private sector, particularly for higher risk borrowers.

5.6.2. **Deteriorating domestic and regional economic cycles could further impact bank performance and increase NPLs—impacting the recovery of credit growth in the near term.** The expected weaker domestic and regional growth prospects are likely to affect bank performance, specifically, asset quality, profitability, credit supply and in some cases solvency. More generally, economic downturns are often accompanied by higher unemployment, which affect the ability of debtors to service their debt, ultimately leading to an increase in NPL's and deterioration in bank performance.[19]

5.7 Policy recommendations

5.7.1. **Removing the interest rate cap can help re-boost domestic credit to the private sector and allow for the Central Bank to effectively implement monetary policy, a key role in fostering growth.** While the interest rate cap policy was an attempt to make credit less costly and therefore more accessible to borrowers, this policy objective has not been achieved. Our analysis confirms significant credit rationing to small and medium enterprises and for unsecured personal loans, while lending to the government and lower risk large corporates has increased. Access to longer term loans have also been curtailed with potential deleterious consequences for private capital investment and long-run economic growth. Since the cap was introduced, total credit growth to the private sector has been weak, while the composition of lending has shifted in favor of large corporate clients. Furthermore, pegging the interest rate cap to the Central Bank Rate (CBR) has fundamentally affected the effectiveness of monetary policy, and the signaling and relevance of the CBR. Addressing this issue is even more important at this current juncture given the slack in the economy. Aggregate demand remains weak as reflected in low business sentiment, weakness in private investment, and

Photo: © Sarah Farhat

Reforms that strengthen consumer protection and increase financial literacy are essential to tackling predatory lending

[19] *Grigoli et al. 2016.*

subdued core inflation. By unhinging the interest cap from the policy rate, this could allow the lowering of the policy rate to have the intended effect on boosting credit growth, aggregate demand and overall economic activity.

5.7.2. **Removing the interest rate cap must be accompanied by a deeper set of structural reforms to improve credit access and financial inclusion.** Though important, the reversal of the interest rate cap, will not be sufficient to improve access to credit. Indeed, as discussed earlier, the weakness in credit growth started well before the enactment of the rate caps. In this regard, there is the need to carry out a deeper set of macro and microeconomic reforms to tackle bottle necks to credit access and improvements in financial inclusion.

5.7.3. **On the macroeconomic side, a reduction in fiscal deficit and better management of public debt is key to lowering benchmark interest rates and ultimately bank lending rates.** Elevated fiscal deficit levels in recent years has increased domestic borrowing by the government. For instance, in 2010, a year in which the Kenyan economy attained an enviable growth rate of 8.4 percent, its highest in three decades, the 364 and 184-day T-bill rates registered an average of 4.5 and 3.8 percent, whereas in 2017 the coupon rates have averaged 10.9 and 10.3 percent for the 364 and 184-day respectively. The higher domestic borrowing has thereby contributed to the increase in the "risk free" interest rate and, ultimately, the rate at which banks lend to the private sector. This crowding out has a significant adverse effect on private investments and potential growth. Hence by consolidating on the fiscal stance—rationalizing expenditures (see chapter 1) and enhancing domestic revenue mobilization (see special focus chapter)—the government can reduce its domestic borrowing requirement, and the cost of credit, thereby crowding in the private sector.

5.7.4. **On the microeconomic front, the universal adoption of credit scoring and sharing would help counteract perennially high interest rates for borrowers and improve bank lending policies.** Credit reporting can have a sizable impact on the ability of banks to differentiate between risky borrowers, and offer financing that is priced per the risk of the borrower. To strengthen credit reporting in Kenya, the CBK is already working with commercial banks on increasing the quality of their consumer data and to include credit reporting data in lending decisions. However, overall credit bureau data and products can be significantly improved, and other lenders can be supported to also participate in the credit reporting system, such as SACCOs and microfinance institutions. This reform, coupled with a well-functioning credit bureau, will improve pricing transparency among banks, and broadly lower interest rates.

5.7.5. **Accelerating the implementation of the movable collateral registry will help fast track the NPL resolution process.** The National Treasury has recently passed a reform making it possible for borrowers to use movable property as collateral which can lower the cost of longer term credit. However, the reform to date has only been partially implemented, with the passage of the Movable Property Security Rights Bill. The second phase of the reform, setting up a movable property registry, currently remains unfinished and is a source of systemic vulnerability.

5.7.6. **Reforms that strengthen consumer protection and increase financial literacy are essential to tackling predatory lending.** For example, establishing a consumer protection bureau, could equip borrowers with greater bargaining power vis-à-vis banks and other lenders; promote a more transparent pricing practices; increase financial literacy and allow for more effective dispute mechanisms.

PART 3: SPECIAL FOCUS II

Photo: © Kenya Revenue Authority

6. Enhancing Revenue Mobilization to Support Fiscal Consolidation

6.1 Growth in revenues have not kept pace with robust GDP growth

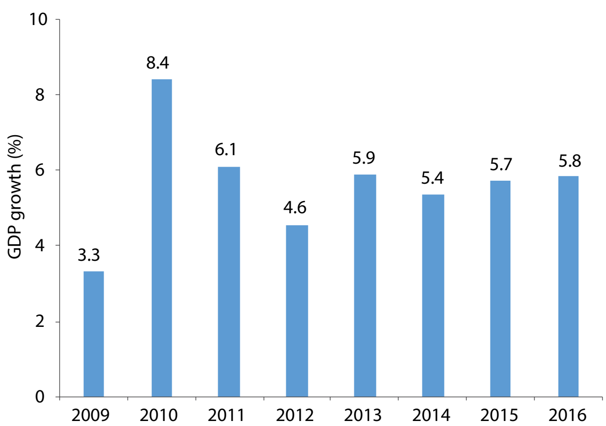
6.1.1. Economic growth in Kenya has been resilient. Over the last decade, economic growth in Kenya averaged 5.6 percent, higher than the global economic growth rate of 2.3 percent (Figure 56). GDP growth over this period was broad-based. The services sector which accounts for the largest component of GDP, grew by 6.2 percent while industry grew at 6.0 percent. The agriculture sector expanded by 4.1 percent. On the demand side, public infrastructure spending and consumption, driven by increased access to credit, propelled growth. Ceteris paribus, this broad-based growth should be supportive of increased tax revenues from both production and consumption sources.

6.1.2. Despite the robustness of GDP, revenue growth has remained volatile and underperformed targets. As a share of GDP tax revenues increased to a high of 16.8 percent in FY13/14, but declined by 0.5 percentage points by FY15/16, before rebounding in FY16/17 (Figure 57). While Kenya compares favorably to several Sub-Saharan African economies in terms of its taxes collected as a share of GDP, it lags several middle-income country peers including South Africa (27.3 percent), Botswana (25.6 percent), Jamaica (26.8 percent), Mozambique (23.1 percent) Senegal (19.8 percent), and Vietnam (19.1 percent). Since FY11/12, revenues have underperformed targets by an annual average of about 3.7 percentage points of GDP.

6.1.3. The weakness in revenue performance has exacerbated fiscal pressures. Expenditures have expanded at the pace of 26.5 percent between FY10/11 and FY15/16—increasing by 3.9 percentage points of GDP. This expansion has been fueled by an ambitious infrastructure drive to improve the competitiveness of the Kenyan economy, and new institutions emanating from the Constitution of Kenya, 2010. However, revenues have not kept apace. Consequently, the fiscal deficits have widened from -3.5 percent in FY16/17 to -8.9 percent of GDP in FY16/17, and with that debt levels have steadily climbed to 57.2 percent of GDP in 2017 from 37 percent in FY10/11. In recognition of the erosion of the fiscal space, the government's fiscal framework seeks to embark on a steady fiscal consolidation over the medium term, reducing deficits to about 4.9 percent of GDP by FY19/20.

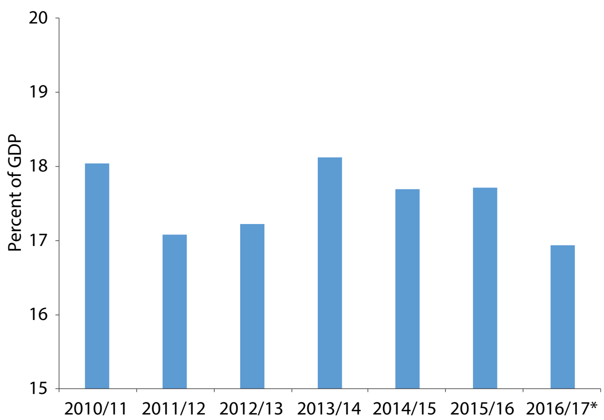
6.1.4. Improvements to domestic revenue mobilization can be supportive of the medium term fiscal consolidation plans. Rationalization of spending, in particular recurrent spending, (see chapter one), will remain core to medium term fiscal consolidation. Nevertheless, increased domestic revenue mobilization can allow for a softer fiscal adjustment process. If Kenya improves tax collection from the current average performance, among its middle-income peers, to the 75th percentile mark, (about 20-22 percent of GDP—which is consistent with the target set in the Budget Policy Statement 2017), it will reach lower levels of deficits than currently envisaged. This will signal Kenya's fiscal prudence credentials to markets and elicit lower borrowing costs domestically and externally.

Figure 56: Kenya's GDP growth, 2009-2016



Source: Kenya National Bureau of Statistics

Figure 57: Revenue performance



Source: The National Treasury
*Note: * denotes preliminary results*

6.1.5. To improve revenue performance, reforms to domestic revenue mobilization are required. Revenue performance has moderated in recent years. This chapter considers the opportunities available for expanding revenue collection through tax policy and administration reforms. The bulk of the analysis in this chapter, is based on two more detailed World Bank tax studies on corporate income tax (CIT) and value-added tax (VAT) where further details can be found.[20] Kenya faces a number of challenges in enhancing revenue yield on property taxation, the CIT and VAT. Yet, these three tax sources offer the best opportunities in the tax mix for substantial revenue improvements. Indeed, CIT and VAT alone, accounted for 49.4 percent of tax revenues in 2015. The revenue performance of personal income taxes and Excise in Kenya is much better aligned with the tax potential. The revenue yield as share to GDP on Personal Income Tax (PIT) and Excise stood at 4.8 percent and 2.0 percent respectively in FY14/15, as seen against the EAC average of 2.4 percent and 2.1 percent respectively. The Sub-Saharan Africa (SSA) average for excise in 2015 was 1.7 percent, indicating revenue collection in Kenya around 20 percent higher on Excises taxes than in SSA. The detailed analysis of CIT and VAT reform opportunities provide broader lessons applicable to the overall domestic resource mobilization agenda.

6.1.6. Three key messages emerge from the analysis. First, there remains a substantive scope for boosting revenue by rationalizing exemptions. Secondly, there is need to enhance revenue collections in the sectors where the losses in revenue are the greatest. Thirdly, efforts to widen the tax base, and improve compliance through various administrative measures could significantly boost revenues. Further details are discussed below.

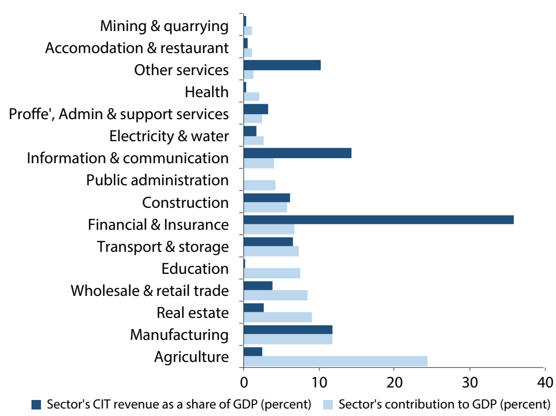
6.2 Improving Corporate Income Tax (CIT) collection in Kenya

6.2.1. Corporate income taxes are widely used globally. The corporate income tax (CIT), is one of the main taxes on business profits, a tax policy instrument affecting the costs of capital. Empirical evidence shows that higher corporate income tax rates reduce business density and entrepreneurship entry rates and increases the capital size of new firms. The progressivity of tax rates increases entrepreneurship entry rates, whereas highly complex tax codes reduce them.[21] Unlike in higher income countries, which have tended to decrease statutory CIT rates, countries in SSA have maintained statutory rates while decreasing effective rates through tax incentives.

6.2.2. CIT is governed by the Income Tax Act, Cap 470 of the Laws of Kenya. CIT is levied on the income of legal entities such as; Limited Companies, Trusts, and Co-operatives. Resident companies are taxable at a rate of 30 percent, while non-resident companies at 37.5 percent. The rate applicable to resident legal entities (30 percent) is aligned to the maximum marginal personal income tax rate for individuals. Some companies, such as those on the stock exchange or in EPZs, have received preferential treatment through lower tax rates.

6.2.3. The CIT response to economic growth remained moderate between 2010 and 2015. During this period, growth in job creation and business investment, particularly foreign direct investment, suggest potential for significant increase in corporate income tax revenues. Nonetheless, the response has been relatively muted. Our analysis shows a significant variation between sectoral contributions to GDP and their contributions to corporate income tax revenues. Only a few sectors, mostly those with a higher share of large tax payers, contribute a disproportionately higher share of corporate income tax revenues. On the other hand, certain sectors such as; agriculture, wholesale and retail trade, education and real estate, whose contribution to the total corporate income tax is disproportionately lower than their share in GDP. This suggests that there remains scope for improvement in CIT revenues (Figure 58).

Figure 58: Main sectors as percentage of total GDP and CIT revenue, 2015



Source: World Bank based on KRA data

[20] See Kenya Tax Policy Studies: Value Added Tax and Corporate Income Tax. World Bank Report 2017.

[21] https://wol.iza.org/articles/corporate-income-taxes-and-entrepreneurship/long

6.3 CIT findings and policy options

Findings

6.3.1. **Exemptions represent a significant source of the tax gap to CIT revenues.** Measures such as the effective tax rate and the magnitude of exempted income in each sector are widely used approaches in estimating the CIT tax gap.[22] Applying this tax gap methodology, the analysis shows that holding tax rates constant, CIT revenues could increase by 24 percent or Ksh 33.3 billion if all CIT exemptions for businesses were eliminated (Table 3). Taking into consideration the fact that there are legitimate socio-economic reasons for the application of differentiated tax rates by sector (for instance lower rates in health and education), the tax gap analysis reveals a still significant Ksh 26.2 billion shortfall in corporate income tax revenues. In other words, there remains about 19 percent potential for the increase in CIT revenues, after adjusting for reduced rates on account of various socioeconomic factors—an extra revenue loss of 1.9 percent of GDP.[23] Compared to other middle-income countries such as South Africa and Mauritius, this magnitude of tax gap remains considerable.

6.3.2. **The bulk of tax exemptions are concentrated in a few sub-sectors.** Four subsectors; financial services, information and communication technology, health, and manufacturing, account for about three-quarters of the losses in corporate income tax. This reflects the relatively large size of these subsectors in GDP. Indeed, reflecting higher levels of formalization, the actual contributions of the financial and banking sectors to the total corporate income tax revenues is disproportionately higher.

Table 3: The cost of tax exemptions from sample, by sectors*

	Taxable income *(KSh, millions)*	Taxable income w/o exemptions *(KSh, millions)*	Cost of exemptions with ETR-TI *(KSh, millions)*	Cost of exemptions with uniform 30 percent rate *(KSh, millions)*	Potential CIT revenue increase if all exemptions eliminated* *(Percent)*
Agriculture, Forestry & Fishing	14,458	16,992	527	760	18
Mining & Quarrying	2,187	3,083	188	269	41
Manufacturing	63,039	73,804	2,459	3,229	17
Electricity, Gas, Steam & Air Conditioning	7,265	7,428	42	49	2
Water Supply; Waste management, Sewerage	533	541	2	2	2
Construction	20,391	21,338	347	284	5
Wholesale, Retail Trade & Vehicle Repair	16,801	16,994	53	58	1
Transportation & Storage	22,880	24,003	395	337	5
Accommodation & Food Services	3,389	3,487	20	29	3
Information & Communication	57,023	61,849	1,487	1,448	8
Financial & Insurance Activities	171,801	218,328	11,897	13,958	27
Real Estate Activities	12,164	14,437	596	682	19
Administrative & Support Services	13,946	15,139	336	358	9
Public Admin, Defence & Social Security	76	121	8	14	60
Education	1,525	9,754	755	2,469	540
Human Health and Social Work Activities	2,845	14,176	1,581	3,399	398
Arts, Entertainment & Recreation	310	350	11	12	13
Other Services	12,164	18,074	1,766	1,773	49
Activities of Extraterritorial Orgs.	115	209	20	28	82
Other Income (not defined, employee & null)	33,689	47,746	3,690	4,217	42
TOTAL	**456,600**	**567,852**	**26,181**	**33,376**	**24**

Source: World Bank computation based on data from Kenya Revenue Authority(KRA)
*Note: *Observed figures for the sample. Furthermore, the table assumes the current effective rates on taxable income are applied (not a uniform 30 percent rate).*

[22] *The Effective Tax Rate is calculated as actual tax levied on a company's profits. The ETR can be higher or lower than the statutory tax rate. See the Kenya Tax Policy Studies 2017 Reports for a more detailed discussion on the ETR.*

[23] *The estimate of revenues forgone on CIT is unfortunately based only on one year—2014/15 data. Furthermore, as discussed in Section IV, the information and data is incomplete and, consequently, the estimate of revenue forgone is most likely too low.*

6.3.3. Exemptions are higher in several tax stations compared with the performance of Large Taxpayers Office (LTO). The LTO, Medium Taxpayers Office (MTO), and tax stations in Nairobi and Mombasa collect most of Kenya's CIT revenue. In 2015, the LTO collected about 80.1 percent of CIT tax while accounting for only 41.7 percent of the loss in CIT revenues arising from exemptions. This contrasts with several other tax stations where the share of foregone revenues due to exemptions is proportionately higher than the share of corporate income taxes collected. In Nairobi West for instance, the share of corporate income taxes collected amount to 3.3 percent, while the cost of exemptions is at a disproportionately larger share of 15.5 percent (Table 4). The current data set did not allow for further identification of the reasons behind these variations, and substantive differences in tax declarations of enterprises across tax stations cannot explain the full variation.

Policy options

6.3.4. Tax expenditures may prove efficient when applied targeted and used sparingly. Examples include promotion of export-oriented economic sectors by incentives on the cost side, such as accelerated depreciation, rather than providing enterprises with global tax holidays. Similarly, the attraction of highly-skilled workers in the Research and Development activities may prove successful when using specific tax exemptions over a fixed period. The analysis on Kenya, however, shows that, even after adjusting for such situations that could justify the provision of preferential treatments, due to too generous and general application of preferential treatments, significant scope to plug in losses from corporate income taxes remain. This section identifies three key measures that can help reduce forgone revenues without compromising development priorities.

Table 4: CIT collections by tax station, from sample

Tax station	Taxable income *(KSh, millions)*	Taxable income w/o exemption *(KSh, millions)*	CIT Rev. 2015 *(KSh, millions)*	Effective Tax Rate on Taxable Income *(Percent)*	Structure of CIT (2015) *(Percent)*	Cost of exemption with uniform 30% rate *(KSh, millions)*	Cost of exemption *(Percent)*
LTO	367,944	414,334	98,115	27	80.12	13,917	41.70
MTO	25,873	41,486	7,252	28	5.92	4,684	14.00
West Nairobi	16,162	33,407	4,035	25	3.29	5,173	15.50
East Nairobi	14,502	19,534	3,672	25	3.00	1,510	4.50
North Nairobi	10,967	23,798	2,642	24	2.16	3,849	11.50
South Nairobi	6,382	11,478	1,689	26	1.38	1,529	4.60
Machakos	898	1,518	1,628	181	1.33	186	0.60
Mombasa North	3,393	3,818	887	26	0.72	128	0.40
Mombasa South	2,143	3,459	839	39	0.69	395	1.20
Thika	3,242	5,541	611	19	0.50	690	2.10
Nakuru	1,563	3,147	345	22	0.28	475	1.40
Nyeri	752	1,246	203	27	0.17	148	0.40
Eldoret	722	900	134	19	0.11	53	0.20
Kisumu	578	1,025	105	18	0.09	134	0.40
Meru	392	703	90	23	0.07	93	0.30
Malindi	244	419	89	36	0.07	53	0.20
Embu	141	218	45	32	0.04	23	0.10
Other	363	1,340	35	10	0.03	293	0.90
Garissa	112	113	26	23	0.02	0.4	0.00
Kakamega	228	366	24	11	0.02	41	0.10
TOTAL	**456,600**	**567,852**	**122,464**	**27**	**100**	**33,376**	**100**

Source: World Bank computation based on data from Kenya Revenue Authority (KRA)

6.3.5. Carry out a comprehensive review of the corporate income tax exemptions regime with a view to rationalize it. There exist over 30 tax exempt income categories in Kenya. The more exemptions and differentiated rates exist in any country, both within and across sectors, the more complicated the tax regime. This increases the risk of non-compliance. International best practice recommends a simplified tax regime. In this regard, several countries are moving towards a tax regime with lower statutory rates, to a large extent financed through rationalization of exemptions and preferential rates. Compared to its East African peers, statutory corporate income tax rates in Kenya remain competitive at 30 percent, similar to that of Ethiopia, Tanzania, Uganda and Rwanda. However, Kenya can focus on limiting exemptions to simplify the tax regime, and thereby reduce the slowdown in revenue growth. A comprehensive review of all existing exemptions by policy makers to examine to what extent each existing exemption and or preferential rate is still consistent with the current medium term development plan. This is all the more important as several of the tax exemptions may have outlived their objectives. In reviewing the CIT, specific measures to limit revenue gaps include modifying reduced preferential CIT rates for new companies and negotiating fade out schemes for established companies; as well as limiting accelerated depreciation to 100 percent of acquisition costs.

6.3.6. There remains significant scope to increase corporate income tax revenues by widening the tax base. Our analysis shows a significant variation between sectoral contributions to GDP and their contributions to corporate income tax revenues. Only a few sectors, mostly those with a higher share of large tax payers, contribute a disproportionately higher share of corporate income tax revenues. Given the degree of CIT revenue concentration in certain sectors, there remains significant scope to widen the tax base. The tax base could be enlarged by expanding the definition of business income, since this would bring more income streams and businesses into the tax net. Secondly, the tax base can also be widened by clarifying and introducing prohibitions to deductible expenses. Wider usage of the KRA electronic filing system could enhance compliance, and increase the tax base and revenues.

6.3.7. Enhance tax revenue in areas where the tax gap is the greatest. While opportunities to widen the tax base remain, it is important to recognize that current levels of tax exemptions are skewed in favor of a few sectors. The financial, manufacturing, health and social work activities, account for 88 percent of total exemptions. Any rationalization of the exemptions regime therefore, should have a focus on these sectors, to the extent that the specific tax exemptions being enjoyed in these subsectors are no longer a priority within the national development agenda. Similarly, the level of tax exemptions is also skewed in favor of a few tax stations, hence the need to focus on these areas to minimize leakages. These include the Medium Taxpayers Office, West Nairobi and North Nairobi, which jointly account for 41 percent of all exemptions yet contribute only 11.4 percent to CIT revenues (Table 4).

6.3.8. A fiscal governance framework is required to prevent the future burgeoning of exemptions. Tighter approval processes are required for introducing new exemptions, regular monitoring of existing exemptions and the introduction of sunset clauses to ensure they do not persist beyond their utility period. Further, a systematic approach to regularly monitoring the cost and benefits of tax expenditures to inform the discontinuation of benefits when the costs exceed benefits. Other measures could include the promotion of a unified authorizing environment; a review of the practice of granting tax expenditures by administrative decree, and strengthening advisory and monitoring functions. Further fiscal transparency could be strengthened by reporting on tax expenditures and including tax expenditure estimates in the annual budget preparation and budget document.

6.3.9. Strengthen tax administration. Administrative measures that could further boost CIT revenues include: ensuring regular updates of taxpayer data (tax liabilities, filing, payment and economic sector), improving risk-based audits, and validating the CIT database with third party sources. Regular verification exercises could be conducted by matching the largest importers with the largest tax payers and checking if the largest government contractors are paying reasonable taxes.

6.4 Improving Value Added Tax collection in Kenya

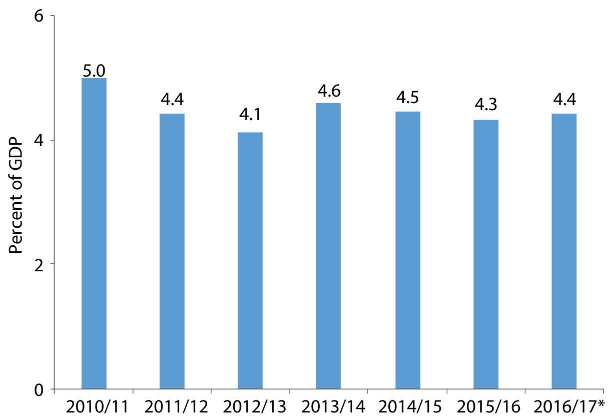
6.4.1. The Value-Added Tax (VAT) Act governs VAT in Kenya. VAT is chargeable on goods and services supplied in and imported into Kenya. Liability falls on the person making the supplies of goods and services. The applicable VAT rate is 16 percent, with a nil rate applicable to zero-rated goods. Zero-rated goods are determined by the Minister of Finance, and are specified in the VAT Act.

Additionally, the applicable VAT rate is deductible from goods that are exempt as specified by law. Kenya's VAT rate of 16 percent is lower than that of; Rwanda, Uganda and Tanzania respectively whose VAT rate is 18 percent. It is however higher than Ghana, Nigeria and South Africa at 15, 5 and 14 percent respectively.

6.4.2. **Kenya operates a VAT withholding system by ensuring 6 percent of the value of taxable supply is withheld by a VAT agent and remitted directly to the KRA.** Most taxpayers subject to withholding tax are below the VAT threshold, which leads them to accumulate significant credits carried forward, thereby creating contingent liabilities on the Treasury. The government reintroduced VAT withholding in response to compliance gaps. However, Kenya's new Tax Procedures Law repealed the authority of the VAT Act to impose and collect withholding tax without adding a replacement provision in the new law. The KRA has nonetheless continued to administer withholding tax, with amendments in the June 2016 Budget anticipated to resolve the policy gap.

6.4.3. **Overall, the performance of VAT revenue declined in recent years.** Revenue from VAT moderated between FY10/11 and FY12/13 (5.0 to 4.1 percent of GDP). Coinciding with the twin policy and administration reforms of 2013, (elimination of VAT exemptions and introduction of the online tax administration system), VAT revenue increased by 0.5 percentage points to 4.6 percent of GDP in FY13/14. Since then however, VAT revenue has taken a downward trend to settle at 4.4 percent of GDP in FY16/17, which is low compared to SSA peers.

Figure 59: VAT performance



Source: National Treasury
*Note: * denotes preliminary results*

6.5 Options for enhancing VAT collections

Findings

6.5.1. **There are substantial forgone revenues in VAT revenues arising from the indiscriminate application of exemptions.** Using the foregone revenue approach to quantify VAT revenue losses[24], our analysis shows that there is a leakage of up to 3.1 percent in VAT revenues arising from various exemptions. Given that VAT collections are 4.3 percent of GDP, the forgone revenue is to more than 70 percent of actual revenue. Exemptions on domestic supplies was estimated at 1.36 percent of GDP after including an adjustment for standard exempt supplies. A second significant source of foregone revenue was the zero-rated supplies at 1.06 percent of GDP. The third significantly important source of forgone VAT revenues is from exempt imports which is estimated at 0.49 percent of GDP (Table 5).

Table 5: Revenue foregone from exemptions, 2015

Summary of VAT exemptions	Forgone revenue *(KSh, millions)*	Forgone revenue *(Percent, GDP)*
VAT on Exempt Imports	30,804	0.49
VAT on Supply to EPZ & SEZ Units at Zero-Rate	1,410	0.02
VAT on Supply from EPZs to Domestic Economy	287	0.01
VAT on declared Domestic Exempt Supplies (Adjusted for Standard Exempt Items)*	84,516	1.36
Remissions and Waivers	11,429	0.18
Zero-rated Supplies**	66,141	1.06
Total	**194,588**	**3.13**
Total GDP (for Comparison)	**6,224,400**	**6,224,400**

Source: Kenya Revenue Authority databases, EPZ Authority Report 2015 and World Bank

[24] *The foregone revenue approach calculates VAT on exemptions to determine foregone revenue. See the Kenya Tax Policy Studies: VAT 2017 for a more detailed discussion on the foregone revenue approach.*

6.5.2. The largest VAT refunds were claimed by smaller taxpayers below the registration threshold. Data from 2015 indicates that nearly 98 percent of tax payers are below the VAT registration threshold of Ksh 5 million (Table 6). Unfortunately, this segment of taxpayers declared the most VAT refund claims and VAT credit carried forward, representing 75 percent and 61 percent, respectively of total VAT refunds and credit carried forward.

Policy Options

6.5.3. VAT revenues can be boosted by streamlining the exemptions regime. Tax exemptions are set for specific reasons. However, overtime, the initial objective may become redundant yet the exemption may still be in place leading to a loss of revenues. While exemptions lower the effective tax rate, if applied correctly they need not lead to lower revenues since the boost in consumption that the effective tax rate engenders could promote higher revenues. Against this backdrop, it is important to undertake a comprehensive review of the VAT exemption regime with a view to eliminating exemptions that have: (i) already served their original intended purposes; (ii) not been effective in achieving their intended purpose; (iii) are no longer consistent with national development priorities; and (iv) have led to significant revenue losses.

6.5.4. VAT exemptions may not be the most efficient way to achieve equity considerations. VAT exemptions are often put in place with reference to reducing living costs on basic items for low-income households. Empirical evidence suggests that the VAT is inefficient in achieving such equity concerns given that the absolute subsidy to the middle and higher income brackets is often much higher than to low-income groups, and the revenue loss is hence substantive in achieving minor subsidies to lowest income. Excises taxes are much more efficient in targeting equity objectives, as are compensatory transfers on the expenditure budget. Specific measures to rationalize VAT exemptions could include repealing domestic exempt or zero-rated supplies incurring a loss of revenue, and requiring firms in export processing zones to file income tax returns indicating forgone taxes.

6.5.5. To maximize the revenue generation potential, it is important to focus on areas where the tax gaps from the exemptions is the highest. One of the areas of greatest VAT revenue losses stems from VAT on domestic exempt supplies. Taking into consideration international best practice, the study finds that Kenya applies a relatively liberal VAT exemptions policy on domestic supplies. There is an additional 1.4 percent for VAT exemption provided on these supplies. After adjusting for exemptions on goods in which exemptions are normally granted. This suggest that there are opportunities to improve VAT collection by streamlining exemptions on domestic supplies. Other areas for streamlining VAT exemptions with the potential to augment revenues include zero-rated supplies and VAT on exempt imports. It will be important to raise the risk level for audit purposes in sectors where high input tax claims exist (see Box B.4 below).

6.5.6. Intensify tax administration to address compliance gaps and broaden the tax base. To overcome the problem of a large number of VAT refund claimants, the VAT tax register could be cleaned to ensure that it includes an accurate number of taxpayers, accurate master data, and confirm that only tax payers declaring turnovers above Ksh 5 million are on the VAT register, or that those below the threshold are generating revenue and are not net refund claimants. The KRA's adoption of an electronic system is a step in the right direction and should contribute to ensuring a wider base coverage.

Table 6: VAT details by turnover, 2015 (Ksh Millions)

Band	Taxpayers number	Tax payable	Input VAT	Output VAT	VAT withholding tax	Credit brought forward	Refund claim
0 - 5m	106,376	25,205	312,546	333,881	6,224	652,177	8,157
5 - 7.5m	550	6,797	8,652	15,228	184	442	0
7.5 - 10m	300	5,015	5,854	10,705	94	391	63
10 - 15m	257	6,834	7,015	13,732	99	796	138
15 - 20m	158	4,954	5,911	10,761	235	257	0.093
> 20m	190	54,347	57,850	111,517	1,603	1,350	49
Total	**107,831**	**103,153**	**397,829**	**495,824**	**8,439**	**655,412**	**8,407**

Source: Kenya Revenue Authority (KRA)

[25] *A World Bank Staff analysis of consumption tax for the Kenyan economy shows that at high levels of consumption tax, individuals substitute saving for consumption thereby increasing consumption with a consequent decline in savings and investments in the economy. The utility of exemptions is thus important as it can be applied to different groups to encourage consumption while ensuring that savings remain intact.*

Photo: © Kenya Revenue Authority

Intensify tax administration to address compliance gaps and broaden the tax base.

6.6 Conclusion

6.6.1. **There is potential for Kenya to increase its domestic revenue mobilization to levels observed in other middle income countries.** With forgone revenues of about 5 percent of GDP, Kenya has the potential to increase its tax to GDP ratio from about 17-18 percent to 20-22 percent, consistent with the experience in other middle income countries. This will provide support to the government of Kenya's medium term fiscal consolidation plans while maintaining its strong focus on bridging the infrastructural deficit to improve upon the competitiveness of the economy.

6.6.2. **The analysis finds that there are opportunities to significantly reduce forgone CIT and VAT revenues.** There are significant revenue potential losses due to extensive and generous use of tax exemptions, and preferential CIT rates. The estimated loss of revenue stemming from CIT and VAT only amount to 5 percent of GDP. Further in-depth review of specific solutions is required in clarifying alignment with the Vision 2030 plan with the view to suppress inefficient and generous schemes of tax expenditures, towards achieving revenue improvements in the amount of 2-4 percent to GDP just in CIT and VAT areas. In this context, careful considerations on impact on equity should be taken, when tax expenditures related to items consumed by the poorest are considered suppressed. In many cases, a better targeted and less costly solution on the expenditure side of the budget can be made, in the form of subsidization of social services or targeted entitlement programs, such as lump-sum transfers.

6.6.3. **Beyond streamlining exemptions, the fiscal governance framework on the provision of tax expenditures could be enhanced to avert future revenue losses.** The nature of tax expenditures—to reduce tax obligations for certain groups of taxpayers and/or on certain products and economic activities—implies that a fiscal gap is created by not collecting the tax revenues as accrued, had the tax code been applied equally. However, the fiscal scrutiny on the utility of tax expenditures and evidence of value-added is much less developed in Kenya compared to spending on the other expenditure items in the budget. Similarly, the accountability and fiscal transparency of tax expenditures is less developed, given that there is no repository that provides an overview on level and composition of tax expenditures (or forgone revenues). Hence, fiscal governance solutions are required to ensure efficiency, including suppressing generous exemptions in order to increase domestic revenue mobilization.

Box B.4: Potential sectors to further streamline VAT tax exemptions

Gaps in VAT performance are prevalent in specific sectors. The following sectors were identified as having gaps in VAT performance: i) Water supply; sewerage and waste management; ii) Agriculture, forestry and fishing; ii) Activities of households as employers; iii) Financial and insurance activities; iv) Mining and quarrying activities; and v) Human health and social work services. Sectors with VAT gaps were also identified as the refund oriented sectors, in addition to being the sectors with highest ratios of zero-rated or exempt supplies. In 2016, the agriculture sector was reported to have a ratio of refunds to VAT of -236 percent, with the water supply sector reporting -109 percent.

A sectoral review of the tax exemption policy may enhance VAT revenue collection. Exemptions essentially lower the tax rate and maybe justifiable for disadvantaged groups who would otherwise not be able to afford certain goods and services. In addition, exemptions can have behavioral change effects that are income enhancing. Sector specific examples include:

I. **Water Supply:** The zero-rated VAT in the water sector is meant to benefit final consumption for the poor. However, since the exemptions are not specifically defined as for final consumption, the industrial sector also benefit from zero-rated water supply as an intermediate input, which creates a distortion in the VAT chain, in addition to increasing the administrative burden for processing VAT refunds.

II. **Agriculture, Forestry and Fishing:** Where the legal framework does not clearly define a farmer by the activities that a farmer undertakes, but offers exemptions on equipment deemed to be used in farming, then individuals who use such equipment but are not farmers may make refund claims in error.

III. **Education Services:** Broadly, the education sector is exempt in Kenya. However, in 2015, the claims for input tax exceeded tax charged in the sector. The likely factors for excess input tax are weak reliability of registration data and failure to apply proper apportionment rules where mixed (exempt and standard rate) supplies are made.

IV. **Financial and Insurance Services:** The financial and insurance services sector in Kenya supports Islamic banking which has a broadly exempt status. With no clear definition of exempt products, banks can apply exemptions at their discretion on their Islamic product offerings. To enhance revenue in this sector, clear guidelines on exempt products would be beneficial.

Beyond tax expenditures rationalization, the following policy recommendations could enhance VAT revenue performance for the sectors with significant tax gaps:

- Draft regulations providing an inclusive definition of farmers, and clean the tax register;
- Consider raising risk levels in sectors such as education, and investigate causes of high input tax claims, and confirm registration validity; and
- Concerning VAT Withholding, the GoK should carry out analysis of the optimum rate that may not cause refund and cash flow problems in economic sectors.

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STATISTICAL TABLES

Table 1: Macroeconomic environment

	2009	2010	2011	2012	2013	2014	2015	2016
GDP growth rates (percent)	3.3	8.4	6.1	4.6	5.9	5.4	5.7	5.8
Agriculture	-2.3	10.1	2.4	3.1	5.4	4.3	5.5	4.0
Industry	3.7	8.7	7.2	4.2	5.3	6.1	7.3	5.8
Manufacturing	-1.1	4.5	7.2	-0.6	5.6	2.5	3.6	3.5
Services	6.2	7.3	6.1	4.7	5.4	6.0	5.9	7.1
Fiscal Framework (percent of GDP)/[1]								
Total revenue	19.4	19.1	18.7	19.2	19.2	19.0	18.4	18.2
Total expenditure	24.0	23.8	23.7	25.1	25.6	28.1	26.6	27.4
Grants	1.0	0.6	0.4	0.5	0.5	0.5	0.4	0.3
Budget deficit (including grants)	-5.8	-3.5	-4.5	-5.7	-6.1	-8.4	-7.4	-8.9
Total debt (net)	36.6	39.1	37.0	38.5	43.7	44.6	47.9	51.5
External Account (percent of GDP)								
Exports (fob)	12.2	13.1	13.6	12.5	10.6	10.4	9.8	8.2
Imports (cif)	25.6	28.7	33.0	31.3	29.3	28.3	23.4	19.5
Current account balance	-4.6	-6.0	-9.2	-8.3	-8.8	-10.4	-6.7	-5.2
Financial account	-10.2	-8.1	-8.2	-11.0	-9.4	-11.4	-8.0	-5.9
Capital account	0.7	0.6	0.6	0.5	0.3	0.4	0.4	0.3
Overall balance	-3.0	-0.4	2.1	-2.4	-0.7	-2.4	0.4	-0.2
Prices								
Inflation	10.5	4.1	14.0	9.6	5.7	6.9	6.6	6.3
Exchange rate (average Ksh/US$)	77.4	79.2	88.8	84.5	86.1	87.9	98.2	101.5

Source: Kenya National Bureau of Statistics, National Treasury, Central Bank of Kenya and World Bank
End of FY in June (e.g 2009 = 2009/2010)
1/Figures for 2015 are actuals for 2015/16

Table 2: GDP growth rates for Kenya and EAC (2014-2019)

	2010	2011	2012	2013	2014	2015	2016
Kenya	8.4	6.1	4.6	5.9	5.4	5.7	5.8
Uganda	5.7	9.4	3.8	3.6	5.1	5.2	4.7
Tanzania	6.4	7.9	5.1	7.3	7.0	7.0	7.0
Rwanda	7.3	7.9	8.8	4.7	7.6	8.9	5.9
Average EAC	6.9	7.8	5.6	5.3	6.2	6.6	5.9

Source: World Bank (MfMod)

Table 3: Kenya annual GDP

Year	GDP, current prices *(Ksh Billions)*	GDP, 2009 constant prices *(Ksh Billions)*	GDP/capita, current prices *(US$)*	GDP growth *(Percent)*
2007	2,151	2,766	839	6.9
2008	2,483	2,772	917	0.2
2009	2,864	2,864	920	3.3
2010	3,169	3,104	967	8.4
2011	3,726	3,294	987	6.1
2012	4,261	3,444	1,155	4.6
2013	4,745	3,647	1,229	5.9
2014	5,402	3,842	1,335	5.4
2015	6,261	4,062	1,350	5.7
2016	7,159	4,299	1,455	5.8

Source: Kenya National Bureau of Stastics and World Development Indicators

Table 4: Broad sector contribution to GDP growth (Quarterly, percent)

Year	Quarterly	Agriculture	Industry	Services	GDP
2012	Q1	0.8	0.7	2.6	4.1
	Q2	0.5	1.2	2.5	4.2
	Q3	0.6	2.3	2.3	5.2
	Q4	0.8	1.0	2.9	4.7
2013	Q1	1.4	2.7	2.0	6.1
	Q2	1.7	2.1	3.7	7.5
	Q3	1.1	1.7	3.6	6.4
	Q4	0.7	0.1	2.7	3.5
2014	Q1	1.1	1.7	2.4	5.2
	Q2	1.1	2.2	2.8	6.0
		1.4	1.1	2.1	4.6
	Q4	0.3	1.7	3.6	5.6
2015	Q1	2.1	1.6	2.1	5.8
	Q2	1.1	1.7	2.8	5.6
		0.8	2.3	2.9	6.1
	Q4	0.8	1.8	2.9	5.5
2016	Q1	1.1	1.2	3.1	5.3
	Q2	1.7	1.5	3.1	6.3
	Q3	0.7	1.5	3.5	5.7
	Q4	0.0	1.5	4.6	6.1
2017	Q1	-0.3	1.4	3.6	4.7
	Q2	0.3	1.0	3.6	5.0

Source: World Bank, based on data from Kenya National Bureau of Statistics

Note: Agriculture = Agriculture, forestry and fishing
Industry = Mining and quarrying + Manufacturing+Electricity and water supply+Construction
Services = Whole sale and retail trade + Accomodation and restaurant + Transport and storage + Information and communication + Financial and insurance + Public administration + Proffessional administration and support services + Real estate + Education + Health + Other services +FISIM +Taxes on products

Table 5: Contribution by Broad sub-sectors (Quarterly, percent)

	Quarterly	Agriculture contribution to GDP	Industry by sub sector contribution				Industries	Service by sub sector contribution					Other	Services
			Mining and quarrying	Manufacturing	Electricity and water supply	Construction		Accomodation and restaurant	Transport and storage	Real estate	Information and communication	Financial and insurance		
2012	Q1	0.8	0.1	-0.1	0.2	0.7	0.9	0.2	0.5	0.4	0.4	0.0	1.0	2.4
	Q2	0.5	0.2	-0.2	0.1	0.3	0.4	0.0	0.5	0.3	-0.2	0.3	2.3	3.3
	Q3	0.6	0.2	0.1	0.2	0.5	1.0	0.0	-0.1	0.3	-0.4	0.4	3.5	3.6
	Q4	0.8	0.2	0.0	0.2	0.4	0.9	0.1	-0.1	0.3	0.5	0.6	1.6	3.0
2013	Q1	1.4	0.2	1.0	0.1	0.4	1.7	-0.5	-0.6	0.3	0.4	0.6	2.7	3.0
	Q2	1.7	-0.2	0.8	0.2	0.4	1.3	0.0	0.1	0.3	0.3	0.6	3.3	4.6
	Q3	1.1	0.0	0.6	0.2	0.4	1.2	0.2	0.2	0.4	0.4	0.4	2.6	4.1
	Q4	0.7	-0.1	0.1	0.1	-0.1	-0.1	0.0	0.7	0.4	0.5	0.3	1.1	2.9
2014	Q1	1.1	0.1	0.5	0.1	0.3	1.1	-0.3	0.2	0.4	0.4	0.4	1.9	3.0
	Q2	1.1	0.2	0.8	0.1	0.7	1.8	-0.3	0.4	0.4	0.3	0.4	1.9	3.1
	Q3	1.4	0.0	0.1	0.2	0.4	0.7	-0.4	0.6	0.5	0.6	0.5	0.8	2.6
	Q4	0.3	0.2	-0.3	0.2	0.9	1.0	0.0	0.3	0.5	0.7	0.6	2.1	4.2
2015	Q1	2.1	0.1	0.3	0.2	0.6	1.2	-0.1	0.5	0.5	0.3	0.6	0.8	2.5
	Q2	1.1	0.1	0.3	0.3	0.6	1.3	0.0	0.6	0.6	0.2	0.5	1.3	3.1
	Q3	0.8	0.2	0.5	0.2	0.8	1.7	0.0	0.7	0.6	0.2	0.7	1.3	3.5
	Q4	0.8	0.1	0.4	0.1	0.7	1.3	0.1	0.4	0.7	0.3	0.5	1.4	3.4
2016	Q1	1.1	0.1	0.2	0.2	0.5	0.9	0.1	0.5	0.7	0.4	0.5	1.1	3.3
	Q2	1.7	0.1	0.6	0.2	0.4	1.3	0.1	0.5	0.7	0.3	0.5	1.2	3.3
	Q3	0.7	0.1	0.5	0.1	0.4	1.1	0.1	0.5	0.7	0.3	0.5	1.7	3.9
	Q4	0.0	0.1	0.3	0.1	0.6	1.1	0.2	0.8	0.8	0.5	0.3	2.5	5.0
2017	Q1	-0.3	0.1	0.3	0.1	0.4	0.9	0.2	0.6	0.7	0.4	0.3	1.8	4.0
	Q2	0.3	0.1	0.2	0.2	0.4	0.8	0.1	0.5	0.8	0.3	0.3	1.8	3.8

Source: World Bank, based on data from Kenya National Bureau of Statistics

Note: Other = Whole sale and retail trade + Public admistration +Proffessional, admistration and support services + Education + Health +Other services +FISIM + Taxes on products

Table 6: Quarterly growth rates (percent)

Year	Quarter	Agriculture			Industry			Services			GDP		
		Quarter-on-Quarter	Year-on-Year	Four Quarter Moving Average	Quarter-on-Quarter	Year-on-Year	Four Quarter Moving Average	Quarter-on-Quarter	Year-on-Year	Four Quarter Moving Average	Quarter-on-Quarter	Year-on-Year	Four Quarter Moving Average
2012	Q1	48.2	3.1	2.4	-5.1	5.2	6.6	-1.1	4.3	5.2	6.9	4.1	5.2
	Q2	-10.2	2.2	2.1	-0.6	2.1	4.5	-1.2	5.3	5.2	-3.1	4.3	4.6
	Q3	-21.9	3.1	2.0	4.3	5.2	4.7	5.1	4.4	4.8	-0.7	5.2	4.5
	Q4	0.3	4.2	3.1	6.0	4.2	4.2	2.1	4.9	4.7	1.7	4.7	4.6
2013	Q1	49.8	5.3	3.8	-0.5	9.4	5.2	-2.0	4.0	4.6	8.3	6.1	5.1
	Q2	-8.9	6.8	5.0	-2.8	6.9	6.4	1.3	6.7	5.0	-1.8	7.0	5.9
	Q3	-22.7	5.8	5.6	3.7	6.2	6.6	4.3	5.8	5.3	-1.7	6.4	6.2
	Q4	-1.9	3.6	5.4	-0.8	-0.6	5.3	1.5	5.2	5.4	-1.1	3.5	5.9
2014	Q1	50.7	4.2	5.1	5.9	5.8	4.5	-1.6	5.6	5.8	10.1	5.2	5.6
	Q2	-8.7	4.4	4.4	0.9	9.9	5.3	1.6	5.8	5.6	-1.0	6.0	5.3
	Q3	-20.7	7.0	4.7	-2.4	3.5	4.6	3.6	5.1	5.4	-2.9	4.6	4.8
	Q4	-6.6	1.8	4.3	0.9	5.3	6.1	3.8	7.5	6.0	-0.2	5.6	5.4
2015	Q1	59.8	8.0	5.5	7.0	6.4	6.2	-3.8	5.2	5.9	10.3	5.8	5.5
	Q2	-11.5	4.6	5.6	1.5	6.9	5.6	2.6	6.2	6.0	-1.2	5.6	5.4
	Q3	-21.1	4.1	5.0	-0.4	9.1	6.9	4.3	6.9	6.5	-2.5	6.1	5.7
	Q4	-6.4	4.3	5.5	-1.4	6.7	7.3	2.4	5.4	5.9	-0.7	5.5	5.7
2016	Q1	59.2	4.0	4.2	5.3	5.0	6.9	-2.4	7.0	6.4	10.1	5.3	5.6
	Q2	-8.9	7.1	4.9	3.2	6.8	6.8	2.3	6.7	6.5	-0.3	6.3	5.8
	Q3	-23.5	3.8	4.9	-1.3	5.7	6.0	4.6	7.0	6.5	-3.0	5.7	5.7
	Q4	-9.8	0.1	4.0	-1.3	5.8	5.8	3.0	7.6	7.1	-0.3	6.1	5.8
2017	Q1	57.3	-1.1	2.4	4.5	5.0	5.8	-2.3	7.7	7.2	8.6	4.7	5.7
	Q2	-6.5	1.4	0.9	2.6	4.4	5.2	1.5	6.8	7.3	0.0	5.0	5.3

Source: World Bank and Kenya National Bureau of Statistics

Table 7: Growth outlook

Annual growth (percent)	2014	2015	2016	2017e	2018f	2019f
BASELINE						
GDP						
Revised projections	5.4	5.7	5.8	4.9	5.5	5.9
Previous projections (KEU 15)	5.4	5.7	5.8	5.5	5.8	6.1
Previous projections (KEU 14)	5.3	5.6	5.9	6.0	6.1	
Private consumption	4.3	5.1	4.8	4.6	4.9	5.1
Government consumption	1.7	13.0	7.0	1.7	0.3	0.5
Gross fixed capital investment	14.2	6.7	-9.3	3.9	12.7	14.6
Exports, goods and services	5.8	6.2	0.6	3.9	4.0	4.2
Imports, good and services	10.4	1.2	-4.7	1.3	5.1	6.3
Agriculture	4.3	5.5	4	2.9	3.9	4.3
Industry	6.1	7.3	5.8	4.5	5.6	5.8
Services	6.3	6.1	6.5	6	6.2	6.6
Inflation (Consumer Price Index)	6.9	6.6	6.3	8	6.8	6.5
Current Account Balance, % of GDP	-10.4	-6.7	-5.2	-6.5	-7.0	-8.2
Fiscal balance, % of GDP	-8.1	-7.3	-9.0	-6.1	-5.9	-4.9
Debt (% of GDP)	48.8	51.3	55.6	54.9	52.9	53.3
Primary Balance (% of GDP)	-4.4	-4.5	-5.1	-5.0	-2.5	-1.9

Source: World Bank and the National Treasury; Fiscal Balance is sourced from National Treasury and presented as Fiscal Years.
Note: "e" denotes an estimate, "f" denotes forecast.

Table 8: National fiscal position

Actual (percent of GDP)	2007/ 08	2008/ 09	2009/ 10	2010/ 11	2011/ 12	2012/ 13	2013/ 14	2014/ 15	2015/ 16	2016/ 17*
Revenue and Grants	19.7	18.9	20.6	19.7	19.1	19.7	19.7	19.5	19.2	18.5
Total Revenue	18.6	18.2	19.6	19.2	18.7	19.2	19.2	19.3	19.0	18.5
Tax revenue	15.7	15.6	16.0	16.6	15.5	15.6	16.8	16.5	16.4	15.8
Income tax	6.8	6.9	7.2	7.9	7.8	8.3	8.9	8.7	8.6	8.1
VAT	4.8	4.7	4.9	5.0	4.4	4.1	4.6	4.5	4.4	4.4
Import Duty	1.4	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.2	1.2
Excise Duty	2.7	2.6	2.5	2.3	2.0	1.9	2.0	2.0	2.1	2.2
Other Revenues	1.4	1.4	2.0	1.5	1.6	1.7	1.3	1.3	1.3	1.1
Railway Levy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.3
Appropriation in Aid	1.5	1.2	1.6	1.1	1.7	2.0	1.1	1.3	1.0	1.2
Grants	1.1	0.7	1.0	0.6	0.4	0.5	0.5	0.5	0.5	0.3
Expenditure and Net Lending	23.1	22.3	24.0	23.8	23.7	25.1	25.6	28.1	27.2	27.4
Recurrent	17.4	16.3	16.9	16.9	16.3	18.1	14.8	14.8	15.6	15.3
Wages and salaries	6.3	5.8	5.7	5.7	5.5	6.1	5.5	5.1	4.6	4.4
Interest Payments	2.1	1.9	2.1	2.3	2.1	2.7	2.7	2.9	3.2	3.5
Other recurrent	9.0	8.6	9.1	8.9	8.8	9.3	6.6	7.4	7.5	7.4
Development and net lending	5.7	6.0	7.1	6.8	7.4	6.8	6.3	8.8	7.0	7.9
County allocation	0.0	0.0	0.0	0	0	0.22	3.81	3.9	4.1	3.7
Contigecies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Parliamentary Service	0.0	0.0	0.0	0.0	0.0	0.0	0.44	0.39	0.3	0.31
Judicial Service	0.0	0.0	0.0	0.0	0.0	0.0	0.26	0.2	0.18	0.15
Fiscal balance										
Deficit excluding grants (commitment basis)	-4.4	-4.0	-4.6	-4.7	-4.9	-5.9	-6.4	-9.1	-8.4	-9.2
Deficit including grants (commitment basis)	-3.3	-3.4	-3.6	-4.1	-4.5	-5.4	-5.9	-8.7	-8.0	-8.9
Deficit including grants (cash basis)	-0.3	-4.4	-5.8	-3.5	-4.5	-5.7	-6.1	-8.1	-7.3	-9.0
Financing										
Foreign Financing	0.3	1.5	0.8	0.8	2.8	1.9	2.1	3.7	4.2	5.0
Domestic Financing	-0.6	2.8	5.0	2.6	1.6	3.8	4.0	4.3	3.1	4.0
Total Public Debt (net)	33.4	35.4	36.6	39.1	37.0	38.5	43.7	44.8	47.9	51.5
External Debt	19.1	20.0	18.9	21.0	19.6	18.7	25.3	24.4	26.8	29.8
Domestic Debt (net)	14.3	15.4	17.7	18.1	17.4	19.8	21.5	20.2	21.1	21.8
Memo:										
GDP (Calender year current market prices, Ksh bn)	2,483	2,864	3,169	3,726	4,261	4,745	5,402	6,261	7,159	
GDP (Fiscal year current market prices, Ksh bn)	2,317	2,673	3,017	3,448	3,994	4,503	5,074	5,828	6,508	7,711

Source: 2017 Budget Review Outlook Paper (BROP) and Quarterly Budgetary Economic Review (First Quarter, Financial Year 2017/2018), National Treasury
*Note: *indicate preliminary results*

Table 9: Kenya's public and publicly guaranteed debt, June 2014 to June 2017

	14-Dec	15-Mar	15-Jun	15-Sept	15-Dec	16-Mar	16-Jun	16-Sept	16-Dec	17-Mar	17-Jun*	17-Sept*
TOTAL PUBLIC DEBT (Net)	2,275,952	2394450	2,601,432	2,723,628	2,844,004	2,938,291	3,210,775	3,276,654	3,448,699	3,675,734	3,972,526	4,048,978
Lending	-5,701	-5,701	-5,701	-5,701	-5701	-5,701	-5,701	-5,701	-5,701	-5,701	-5,701	-5701
Government Deposits	-298,879	-275,083	-236,565	-208,869	-305496	-320,041	-394,856	-426,911	373,016	364,909	428,774	(432,113)
Total Public Debt (Gross)	2,580,532	2,675,234	2,843,698	2,938,199	3,155,200	3,264,033	3,611,331	3,709,266	3,827,417	4,046,344	4,407,001	4,486,793
External Debt	1,272,583	1,278,108	1,423,253	1,550,233	1,615,183	1,617,506	1,796,198	1,854,711	1,896,443	2,101,391	2,294,736	2,310,198
Bilateral	389,083	384,607	445,057	482,203	481,282	478,883	548,351	545,652	641,763	689,119	724,823	742,064
Multilateral	612,353	618,456	684,631	754,599	751,154	762,089	798,842	839,936	781,256	806,922	841,899	842,814
Commercial Bank & Supplier Credit	271,147	275,044	293,565	313,430	382,747	376,534	449,005	469,123	473,424	605,350	728,014	725320
Commercial Banks	255,188	259,746	276,937	295,642	366,231	360,175	432,377	452,495	458,122	594,140	712,100	708,231
Suppliers Credit	15,959	15,298	16,628	17,788	16,516	16,359	16,628	16,628	15,302	11,210	15,914	17,089
Domestic Debt	1,307,949	1,397,126	1,420,444	1,387,966	1,540,017	1,646,527	1,815,133	1,854,555	1,930,973	1,944,953	2,112,265	2,176,595
Central Bank	58,286	64,835	63,335	107,637	101,386	102,648	99,856	58,945	85,528	85,316	55,061	79,201
Commercial Banks	649,940	715,011	730,419	682,694	764,399	829,688	927,307	969,790	947,030	975,803	1,141,889	1,148,296
Non Banks & Nonresidents	599,723	617,280	626,689	597,635	674,232	714,192	787,970	825,820	898,415	883,834	915,316	949,098
(%) of Total public debt(gross)												
External Debt	49.3	47.8	50.0	52.8	51.2	49.6	49.7	50.0	49.5	51.9	52.1	51.5
Domestic Debt	50.7	52.2	50.0	47.2	48.8	50.4	50.3	50.0	50.5	48.1	47.9	48.5
% of External debt												
Bilateral	30.6	30.1	31.3	31.1	29.8	29.6	30.5	29.4	33.8	32.8	31.6	32.1
Multilateral	48.1	48.4	48.1	48.7	46.5	47.1	44.5	45.3	41.2	38.4	36.7	36.5
Commercial Bank & Supplier Credit	21.3	21.5	20.6	20.2	23.7	23.3	25.0	25.3	25.0	28.8	31.7	31.4
Commercial Banks	20.1	20.3	19.5	19.1	22.7	22.3	24.1	24.4	24.2	28.3	31.0	30.7
Suppliers Credit	1.3	1.2	1.2	1.1	1.0	1.0	0.9	0.9	0.8	0.5	0.7	0.7
% of Domestic debt												
Central Bank	4.5	4.6	4.5	7.8	6.6	6.2	5.5	3.2	4.4	4.4	2.6	3.6
Commercial Banks	49.7	51.2	51.4	49.2	49.6	50.4	51.1	52.3	49.0	50.2	54.1	52.8
Non Banks & Nonresidents	45.9	44.2	44.1	43.1	43.8	43.4	43.4	44.5	46.5	45.4	43.3	43.6

Source: National Treasury (Quarterly Economic Budgetary Review, November 2017)
*Note: *Provisional*

Table 10: 12-months cumulative balance of payments BPM6 Concept (US$ million)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017-July
A. Current Account, n.i.e.	-505	-796	-1,821	-1,713	-2,371	-3,821	-4,205	-4,838	-5,98	-4,322	-3,653	-4,792
Merchandise A/C	-3,243	-4,222	-5,593	-4,952	-6,216	-8,355	-9,315	-10,243	-11,319	-9,577	-7,890	-9,653
Goods: exports f.o.b.	3,509	4,153	5,067	4,526	5,248	5,834	6,212	5,846	6,219	5,985	5,747	5,781
Goods: imports f.o.b.	6,752	8,375	10,659	9,479	11,464	14,189	15,527	16,089	17,538	15,563	13,637	15,434
Oil	1,745	1,919	3,051	2,192	2,673	4,082	4,081	3,838	4,026	2,500	2,087	2,489
Services	1,013	1,263	1,377	1,084	1,744	1,994	2,602	2,926	2,405	2,329	1,689	1,560
Services: credit	2,431	2,938	3,260	2,904	3,789	4,131	4,990	5,130	5,066	4,496	4,526	4,612
Services: debit	1,418	1,675	1,883	1,820	2,045	2,138	2,387	2,204	2,662	2,167	2,837	3,052
Income	1,725	2,162	2,395	2,156	2,101	2,540	2,507	2,479	2,889	2,795	2,548	3,301
B. Capital Account, n.i.e.	168	157	94	261	240	235	235	158	275	257	206	186
C. Financial Account, n.i.e.	-677	-22,47	-1,423	-3,782	-3,252	-3,425	-5542	-5183	-7008	-5,070	-4,137	-5,487
Direct investment: net	-27	-1,001	-384	-1,452	-1,117	-1,364	-1142	-920	-1045	-1,088	-235.1	-1,35.1
Portfolio investment: net	21	16	25	-81	-156	1	-218	-273	-3716	156	384.5	616.5
Financial derivatives: net	0	0	0	0	0	0	0	0	0	0	0	0
Other investment: net	-671	-1,262	-1,064	-2,249	-1,979	-2,062	-4182	-3990	-2248	-4,139	-4,287	-5,968.1
D. Net Errors and Omissions	235	-805	-189	-1215	-947	-734	-348	-134	168	-1,260	-561	-815
E. Overall Balance	-575	-802	493	-1115	-174	896	-1223	-369	-1453	255	-129	-66
F. Reserves and Related Items	575	802	-493	1115	174	-896	1223	369	1453	-255	129	66
Reserve assets	618	941	-480	1322	154	246	1455	859	1333	-361	38	-30
Credit and loans from the IMF	-6	116	-17	199	-34	284	193	177	-119	-107	-91	-96
Exceptional financing	48	23	30	8	13	858	38	312	0	0	0	0
Gross Reserves (USD Million)	3,331	4,557	4,641	5,064	5,123	6,045	7,160	8,483	9,738	9,794	9,588	10,550
Official	2,415	3,355	2,875	3,847	4,002	4,248	5,702	6,560	7,895	7,534	7,573	8,135
Commercial Banks	916	1,202	1,765	1,217	1,121	1,797	1,458	1,923	1,843	2,259	2,015	2,415
Imports cover (36 mnths import)	3.9	4.4	3.1	3.9	3.9	3.4	4.0	4.3	4.9	4.8	5.0	5.4
Memo:												
Annual GDP at Current prices (USD Million)	25,826	31,958	35,895	37,022	40,000	41,953	50,411	55,101	61,395	63,398	70,092	74,496

Source: Central Bank of Kenya

Table 11: Inflation

Year	Month	Overall Inflation	Food Inflation	Energy Inflation	Core Inflation
2015	January	5.5	7.7	4.5	4.1
	February	5.6	8.7	3.3	4.1
	March	6.3	11.0	2.9	3.9
	April	7.1	13.4	1.5	4.0
	May	6.9	13.2	0.3	4.2
	June	7.0	13.4	0.2	4.4
	July	6.6	12.1	0.6	4.4
	August	5.8	9.9	1.1	4.3
	September	6.0	9.8	1.5	4.4
	October	6.7	11.3	2.0	4.4
	November	7.3	12.7	2.3	4.2
	December	8.0	13.3	2.9	5.1
2016	January	7.8	12.7	2.9	5.4
	February	7.1	10.8	1.7	5.4
	March	6.5	9.4	2.1	5.4
	April	5.3	6.8	2.0	5.2
	May	5.0	6.6	1.8	4.7
	June	5.8	8.9	1.4	4.5
	July	6.4	10.8	0.9	4.4
	August	6.3	10.9	0.1	4.6
	September	6.3	10.9	0.2	4.6
	October	6.5	11.0	0.1	4.6
	November	6.7	11.1	0.6	4.7
	December	6.3	11.2	0.1	3.8
2017	January	7.0	12.5	0.7	3.3
	February	9.2	16.7	3.0	3.3
	March	10.3	18.8	3.3	3.3
	April	11.5	21.0	3.7	3.5
	May	11.7	21.5	3.5	3.6
	June	9.2	15.8	3.4	3.5
	July	7.5	12.2	2.9	3.5
	August	8.0	13.6	3.1	3.4
	September	7.1	11.5	3.3	3.2
	October	5.7	8.5	3.0	3.2

Source: World Bank, based on data from Kenya National Bureau of Statistics

Table 12: Credit to private sector

Year	Month	Total Private sector annual growth rates	Agriculture	Mafuctuirng	Trade	Building and construction	Transport and communication	Finance and insurance	Real estate	Mining and quarrying	Private households	Consumer durables	Business services	Other activities
2015	January	21.8	25.2	30.1	19.8	17.6	43.0	76.1	33.4	-3.8	35.2	14.2	24.8	-31.3
	February	20.7	24.7	27.5	21.5	11.6	38.6	79.6	29.1	-16.2	38.7	15.3	19.3	-31.4
	March	19.6	22.3	21.1	18.8	12.7	31.3	47.5	19.6	-20.1	28.0	12.4	27.8	-8.9
	April	19.9	20.8	21.6	23.6	12.6	32.3	49.2	17.7	-17.1	29.5	13.1	19.7	-8.9
	May	20.9	20.5	25.8	23.0	14.5	27.0	50.8	21.3	-13.7	31.5	11.6	16.4	-3.9
	June	20.5	24.0	20.0	25.9	15.5	33.8	43.3	19.4	-22.1	31.2	21.6	15.8	-11.1
	July	21.2	28.5	22.3	26.7	19.8	33.4	46.8	15.5	-17.9	28.6	21.5	25.3	-12.6
	August	21.0	28.7	25.3	25.9	22.1	30.0	50.5	15.0	-18.0	28.5	21.0	22.5	-14.2
	September	20.8	21.4	19.3	29.7	27.9	29.0	45.7	12.5	-5.4	26.6	19.0	15.9	-0.9
	October	19.5	17.2	20.2	23.6	37.6	32.1	26.4	9.8	-15.5	18.2	18.0	24.1	8.6
	November	18.7	12.5	20.8	22.2	34.0	32.3	28.5	10.6	-22.8	16.7	15.3	19.3	14.6
	December	18.0	14.1	16.2	21.3	30.7	26.5	0.0	6.2	-11.3	9.1	14.3	63.5	-1.0
2016	January	16.6	17.3	15.9	28.4	25.3	30.2	12.2	9.1	-9.3	14.6	12.8	13.8	4.1
	February	15.5	21.0	18.7	25.4	20.5	27.7	11.1	10.2	1.7	12.0	7.3	16.2	-3.8
	March	15.2	18.6	20.6	21.8	23.2	22.6	10.8	15.0	12.5	10.1	10.0	13.4	-8.6
	April	13.2	15.5	15.2	21.8	23.1	20.5	13.4	13.4	5.3	10.2	7.5	7.8	-15.5
	May	10.7	20.2	12.2	18.1	16.1	16.9	8.1	10.1	3.2	7.8	9.5	8.5	-18.7
	June	8.9	13.7	13.3	12.3	13.2	14.1	9.1	11.9	-1.6	5.7	2.5	5.1	-11.8
	July	7.0	6.1	12.5	13.8	9.2	12.4	13.5	8.8	-4.5	3.1	4.3	-4.4	-12.9
	August	5.3	1.8	-0.3	16.4	8.3	16.8	-2.5	9.4	-32.8	7.2	9.2	-11.1	-17.1
	September	4.4	-0.5	-2.0	15.2	1.3	13.6	2.7	8.9	-33.7	10.5	5.6	-10.2	-24.3
	October	4.6	0.4	-4.3	12.8	-4.9	14.7	1.2	9.3	-36.4	10.1	10.1	-2.0	-20.1
	November	4.2	3.5	-4.1	15.7	-5.3	16.1	0.1	8.8	-21.3	10.6	10.6	-11.7	-30.6
	December	4.1	0.9	-2.4	15.9	-2.8	14.9	16.7	11.0	-19.1	19.7	11.3	-34.8	-27.0
2017	January	3.9	-2.6	-6.8	13.4	-0.8	10.2	-0.6	10.3	-17.5	14.7	11.1	-13.0	-30.7
	February	3.5	1.4	-8.6	10.1	8.3	8.0	-4.6	9.7	-25.5	15.6	11.1	-13.7	-28.5
	March	3.0	-7.7	-7.8	11.6	0.6	9.6	-9.2	12.4	-34.0	13.3	10.1	-15.5	-22.7
	April	2.3	-8.8	-6.8	8.0	-2.3	7.6	-11.9	13.2	-34.2	10.4	11.9	-15.1	-19.0
	May	1.9	-12.6	-5.2	8.8	2.5	5.6	-2.8	11.8	-39.5	9.8	11.3	-21.8	-19.2
	June	1.5	-12.3	-7.1	10.7	-0.7	3.2	-4.4	10.1	-37.8	10.9	7.5	-15.8	-25.0
	July	1.4	-11.6	-6.6	9.0	0.5	0.6	-8.5	11.8	-41.0	12.1	3.3	-10.8	-28.1
	August	1.6	-7.6	3.3	4.3	-1.5	-2.3	5.4	9.7	-7.6	6.2	-1.6	-6.5	-27.4

Source: Central Bank of Kenya

Table 13: Mobile payments

	Month	Number of agents	Number of customers (Millions)	Number of transactions (Millions)	Value of transactions (Billions)
2015	January	125,826	25.4	81.7	210.5
	February	127,187	25.5	80.7	208.1
	March	128,591	25.7	90.3	231.8
	April	129,218	26.1	84.9	213.7
	May	129,735	26.5	89.9	230.2
	June	131,761	26.5	90.7	227.9
	July	133,989	26.7	94.0	238.9
	August	136,042	27.0	94.1	248.2
	September	138,131	27.3	96.3	247.5
	October	140,612	27.5	102.8	255.8
	November	142,386	28.1	101.3	236.4
	December	143,946	28.6	107.4	267.1
2016	January	146,710	29.1	108.1	243.4
	February	148,982	29.5	114.1	257.2
	March	150,987	30.7	121.7	273.6
	April	153,762	31.4	120.2	269.8
	May	156,349	31.3	122.6	277.9
	June	162,465	31.4	121.8	271.0
	July	167,072	32.3	127.0	281.9
	August	173,774	32.8	131.5	296.9
	September	173,731	33.4	130.7	283.9
	October	181,456	34.0	141.4	292.1
	November	162,441	34.3	140.8	291.2
	December	165,908	35.0	146.2	316.8
2017	January	152,547	33.3	143.8	299.5
	February	154,908	33.3	140.3	279.4
	March	157,855	33.9	147.2	320.2
	April	160,076	34.3	143.6	297.4
	May	164,674	34.2	156.9	315.4
	June	165,109	34.2	150.3	299.8
	July	169,480	34.6	153.1	308.9
	August	167,353	35.3	145.9	286.3
	September	167,775	35.6	146.6	300.9

Source: Central Bank of Kenya

Table 14: Exchange rate

	Month	USD	UK Pound	Euro
2015	January	91.4	138.5	106.3
	February	91.5	140.2	103.9
	March	91.7	137.5	99.4
	April	93.4	139.6	100.7
	May	96.4	149.1	107.5
	June	97.7	152.2	109.7
	July	101.2	157.5	111.4
	August	102.4	159.8	114.1
	September	105.3	161.5	118.2
	October	102.8	157.5	115.4
	November	102.2	155.4	109.8
	December	102.2	153.3	111.1
2016	January	102.3	147.5	111.1
	February	101.9	145.9	113.0
	March	101.5	144.2	112.6
	April	101.2	144.8	114.8
	May	100.7	146.3	114.0
	June	101.1	144.3	113.7
	July	101.3	133.4	112.1
	August	101.4	132.9	113.7
	September	101.3	133.2	113.5
	October	101.3	125.4	111.9
	November	101.7	126.3	110.0
	December	102.1	127.7	107.7
2017	January	103.7	128.0	110.2
	February	103.6	129.5	130.4
	March	102.9	126.9	109.9
	April	103.3	130.4	110.7
	May	103.3	133.5	114.8
	June	103.5	132.5	116.2
	July	103.9	134.9	119.4
	August	103.6	134.2	122.2
	September	103.1	137.1	122.9

Source: Central Bank of Kenya

Table 15: Exchange rate (Index January 2016 = 100)

Year	Month	NEER	REER	USD
2015	January	93.0	99.6	89.3
	February	92.7	99.2	89.4
	March	91.8	97.8	89.7
	April	93.4	99.2	91.3
	May	97.0	101.3	94.2
	June	98.1	102.4	95.5
	July	101.2	105.7	98.9
	August	102.1	106.2	100.1
	September	104.8	108.3	102.9
	October	102.4	105.8	100.5
	November	100.7	103.4	99.9
	December	100.5	101.9	99.9
2016	January	100.0	100.0	100.0
	February	100.1	100.5	99.6
	March	100.0	100.3	99.2
	April	100.6	100.7	98.9
	May	99.9	99.7	98.5
	June	100.2	99.5	98.9
	July	99.7	98.5	99.0
	August	100.3	99.1	99.1
	September	100.3	99.8	99.0
	October	99.3	98.9	99.0
	November	99.0	98.5	99.4
	December	98.5	98.8	99.8
2017	January	95.8	96.7	101.4
	February	100.5	98.5	101.3
	March	99.9	96.5	100.5
	April	100.6	95.3	101.0
	May	101.2	104.3	100.9
	June	97.5	101.1	101.2
	July	103.6	106.0	101.5
	August			101.2
	September			100.8

Source: World Bank, based on data from Central Bank of Kenya

Table 16: Nairobi Securities Exchange (NSE 20 Share Index)

Year	Month	NSE 20 Share Index
2015	January	4,856
	February	4,933
	March	4,946
	April	4,949
	May	4,882
	June	4,885
	July	4,906
	August	5,139
	September	5,256
	October	5,195
	November	5,156
	December	5,113
	January	5,212
	February	5,491
	March	5,248
	April	5,091
	May	4,787
	June	4,906
	July	4,405
	August	4,177
	September	4,174
	October	3,869
2016	November	4,016
	December	4,041
	January	3,773
	February	3,862
	March	3,982
	April	4,009
	May	3,828
	June	3,641
	July	3,489
	August	3,179
	September	3,243
	October	3,229
2017	November	3,247
	December	3,186
	January	2,794
	February	2,995
	March	3,113
	April	3,158
	May	3,441
	June	3,607
	July	3,798
	August	4,027
	September	3,751

Source: Financial Times

Table 17: Central Bank Rate and Treasury Bills

Year	Month	Central Bank rate	91-Treasury Bill	182-Treasury Bill	364-Treasury Bill
2015	January	8.5	8.6	9.6	12.1
	February	8.5	8.6	10.0	11.0
	March	8.5	8.5	10.3	10.7
	April	8.5	8.4	10.3	10.6
	May	8.5	8.3	10.3	10.7
	June	10	8.3	10.4	11.0
	July	11.5	10.6	11.0	11.6
	August	11.5	11.5	11.5	13.3
	September	11.5	14.0	12.5	15.2
	October	11.5	21.0	15.7	21.5
	November	11.5	12.3	16.3	15.2
	December	11.5	9.7	15.7	12.5
2016	January	11.5	11.2	13.0	14.1
	February	11.5	10.6	12.8	13.7
	March	11.5	8.7	12.6	12.3
	April	11.5	8.9	11.7	11.8
	May	10.5	8.2	10.7	11.6
	June	10.5	7.3	10.2	10.8
	July	10.5	7.4	9.9	10.9
	August	10.0	8.5	10.8	11.7
	September	10.0	8.1	10.8	11.0
	October	10.0	7.8	10.3	10.4
	November	10.0	8.2	10.3	10.8
	December	10.0	8.4	10.5	10.6
2017	January	10.0	8.6	10.5	11.0
	February	10.0	8.6	10.5	10.9
	March	10.0	8.6	10.5	10.9
	April	10.0	8.8	10.5	10.9
	May	10.0	8.7	10.4	10.9
	June	10.0	8.4	10.3	10.9
	July	10.0	8.2	10.3	10.9
	August	10.0	8.2	10.4	10.9
	September	10.0	8.1	10.4	10.9
	October	10.0	8.1	10.3	11.0

Source: Central Bank of Kenya

Table 18: Interest rates

Year	Month	Short-term			Long-term			Interest Rate Spread
		Interbank	91-Treasury Bill	Central Bank Rate	Average deposit rate	Savings	Overall weigheted lending rate	
2015	January	7.2	8.6	8.5	6.7	1.6	15.9	9.3
	February	6.9	8.6	8.5	6.7	1.5	15.5	8.8
	March	6.8	8.5	8.5	6.6	1.5	15.5	8.8
	April	8.9	8.4	8.5	6.6	1.9	15.4	8.8
	May	11.1	8.3	8.5	6.6	1.5	15.3	8.7
	June	11.9	8.3	10.0	6.6	1.9	16.1	9.4
	July	13.4	10.6	11.5	6.3	1.4	15.8	9.4
	August	18.6	11.5	11.5	6.9	1.5	15.7	8.8
	September	21.3	14.0	11.5	7.3	1.7	16.8	9.5
	October	15.3	21.0	11.5	7.5	1.7	16.6	9.0
	November	8.9	12.3	11.5	7.4	1.3	17.2	9.8
	December	5.3	9.7	11.5	8.0	1.6	18.3	10.3
2016	January	6.4	11.2	11.5	7.6	1.6	18.0	10.4
	February	4.5	10.6	11.5	7.5	1.4	17.9	10.4
	March	4.0	8.7	11.5	7.2	1.4	17.9	10.7
	April	3.9	8.9	11.5	6.9	1.5	18.0	11.1
	May	3.6	8.2	10.5	6.4	1.6	18.2	11.8
	June	4.9	7.3	10.5	6.8	1.6	18.2	11.4
	July	5.5	7.4	10.5	6.6	1.7	18.1	11.5
	August	5.0	8.5	10.0	6.4	1.7	17.7	11.2
	September	4.9	8.1	10.0	6.9	3.8	13.9	7.0
	October	4.1	7.8	10.0	7.8	6.1	13.7	5.9
	November	5.1	8.2	10.0	7.6	6.5	13.7	6.0
	December	5.9	8.4	10.0	7.3	6.4	13.7	6.4
2017	January	7.7	8.6	10.0	7.2	6.1	13.7	6.5
	February	6.4	8.6	10.0	7.7	6.8	13.7	6.0
	March	4.5	8.7	10.0	7.1	5.9	13.6	6.5
	April	5.3	8.8	10.0	7.0	5.7	13.6	6.6
	May	4.9	8.7	10.0	7.1	5.9	13.7	6.6
	June	4.0	8.4	10.0	7.0	5.7	13.7	6.7
	July	6.8	8.2	10.0	7.5	6.4	13.7	6.2
	August	8.1	8.2	10.0				
	September	5.5	8.1	10.0				
	October		8.1	10.0				

Source: Central Bank of Kenya

Table 19: Money aggregate growth rates (y-o-y)

Year	Month	Money supply, M1	Money supply, M2	Money supply, M3	Reserve money
2015	January	11.4	17.0	16.0	15.8
	February	10.0	17.2	18.6	11.5
	March	11.9	16.4	16.4	11.8
	April	13.4	17.2	17.3	12.0
	May	10.0	14.8	16.5	15.0
	June	9.6	16.4	18.6	14.9
	July	13.0	16.0	16.4	25.8
	August	10.5	14.3	14.0	2.9
	September	8.5	12.7	13.5	16.7
	October	10.8	13.6	13.6	24.5
	November	7.9	11.6	13.0	13.0
	December	8.5	12.4	13.7	3.3
2016	January	10.9	10.8	11.1	9.1
	February	9.9	10.0	9.3	9.2
	March	10.9	10.7	11.2	16.1
	April	10.6	9.9	9.5	9.0
	May	12.8	9.8	8.6	7.6
	June	13.4	9.2	8.1	4.9
	July	9.4	7.8	6.9	4.3
	August	9.5	6.9	6.8	6.8
	September	26.1	8.8	8.0	4.3
	October	24.3	6.8	6.8	-7.4
	November	25.3	6.2	6.2	0.5
	December	28.1	4.8	3.7	4.8
2017	January	21.9	5.3	5.2	5.1
	February	23.7	4.5	5.4	2.9
	March	22.1	5.7	6.4	3.2
	April	23.6	6.3	7.1	9.0
	May	21.8	6.2	6.7	5.2
	June	22.7	5.6	6.0	2.9
	July	24.6	7.5	8.3	5.0
	August	22.5	7.5	7.7	7.7

Source: Central Bank of Kenya

Table 20: Coffee production and exports

Year	Month	Production (MT)	Price (Ksh/Kg)	Exports (MT)	Exports value (Ksh Million)
2015	January	2,795	412	2,844	1,307
	February	4,837	489	2,884	1,339
	March	5,571	378	4,290	2,025
	April	3,714	310	3,948	1,901
	May	2,969	289	4,383	2,236
	June	0	0	4,220	2,068
	July	2,086	339	3,938	1,943
	August	3,286	371	3,991	1,790
	September	2,643	364	3,405	1,617
	October	1,768	320	4,400	2,019
	November	1,268	337	2,769	1,244
	December	1,282	435	2,528	1,092
2016	January	3,432	462	2,449	1,184
	February	5,220	486	3,277	1,636
	March	6,835	437	4,169	2,206
	April	4,513	340	4,804	2,540
	May	4,735	263	4,814	2,170
	June	1,747	268	4,983	2,369
	July	569	324	3,987	1,798
	August	3,723	431	3,719	1,637
	September	3,284	437	3,173	1,399
	October	1,573	410	3,116	1,489
	November	2,374	468	3,929	1,691
	December	1,666	514	2,886	1,252
2017	January	5,190	590	3,214	1,553
	February	6,081	606	3,868	2,094
	March	5,460	507	5,447	3,231
	April	4,563	299	4,201	2,698
	May	1,639	276	5,424	3,117
	June	-	-	4,443	2,501
	July	762	420	3,598	1,971
	August	2,319	443	2,649	1,311

Source: Kenya National Bureau of Statistics

Table 21: Tea production and exports

Year	Month	Production (MT)	Price (Ksh/Kg)	Exports (MT)	Exports value (Ksh Million)
2015	January	41,653	212	40,970	8,485
	February	24,276	221	41,086	9,313
	March	15,688	250	35,700	8,796
	April	23,837	258	28,262	7,189
	May	37,523	297	27,016	7,506
	June	32,286	319	35,915	11,263
	July	30,942	344	30,623	10,146
	August	28,410	330	27,687	9,481
	September	36,484	327	33,528	11,413
	October	41,343	333	40,246	13,538
	November	40,382	313	36,714	12,126
	December	46,387	309	42,779	13,768
2016	January	50,308	279	36,575	11,013
	February	43,969	253	43,292	12,200
	March	45,330	234	37,571	9,887
	April	37,571	214	39,313	9,517
	May	36,573	223	44,901	10,658
	June	35,603	243	52,175	12,613
	July	29,285	246	42,751	10,679
	August	29,462	234	39,673	9,993
	September	36,785	236	33,528	8,454
	October	41,342	243	29,656	7,548
	November	39,903	273	41,138	11,123
	December	45,103	273	39,396	10,811
2017	January	32,991	316	46,434	14,072
	February	22,605	317	33,898	10,880
	March	34,498	300	33,662	10,693
	April	31,458	297	32,091	9,991
	May	38,822	304	39,329	12,354
	June	40,538	325	42,370	13,485
	July	31,565	310	41,437	13,442
	August	32,693	300	29,628	9,269

Source: Kenya National Bureau of Statistics

Table 22: Horticulture exports

Year	Month	Exports (MT)	Exports value (Ksh Million)
2015	January	18,170	6,413
	February	20,599	7,892
	March	21,259	10,510
	April	21,410	6,223
	May	19,160	6,300
	June	16,904	5,140
	July	17,359	8,551
	August	16,175	5,824
	September	25,188	8,187
	October	22,179	9,905
	November	19,428	8,095
	December	20,179	7,399
2016	January	20,160	10,927
	February	22,337	10,151
	March	24,314	11,140
	April	25,931	8,611
	May	21,260	7,004
	June	20,157	10,293
	July	17,981	5,577
	August	19,650	7,293
	September	20,924	6,659
	October	23,327	8,312
	November	22,772	7,641
	December	22,294	7,906
2017	January	27,033	11,555
	February	27,452	10,934
	March	27,892	13,606
	April	25,658	8,977
	May	30,007	10,291
	June	26,362	9,395
	August	23,357	9,237

Source: Kenya National Bureau of Statistics

Table 23: Leading economic indicators year to date growth rates (Percent)

Year	Month	Horticulture	Coffee	Tea
2014	January	0.5	13.6	-3.8
	February	-4.6	-7.4	-3.5
	March	-4.7	9.1	2.3
	April	-2.6	12.8	4.5
	May	0.7	6.3	0.9
	June	3.3	2.3	1.3
	July	4.5	4.6	0.5
	August	5.0	-0.3	1.1
	September	5.0	-2.5	1.6
	October	4.1	-2.9	2.5
	November	3.4	-2.9	1.9
	December	3.0	-3.0	2.3
2015	January	-1.8	-10.3	6.0
	February	1.7	-8.3	13.7
	March	5.4	-7.5	7.2
	April	5.0	-11.0	-0.8
	May	3.3	-9.5	-5.7
	June	1.6	-9.3	-6.1
	July	1.6	-12.5	-9.6
	August	1.2	-9.3	-11.8
	September	5.1	-9.7	-11.3
	October	5.9	-7.0	-9.4
	November	6.6	-8.5	-8.9
	December	8.1	-8.1	-7.9
2016	January	11.0	-13.9	-10.7
	February	9.6	0.0	-2.7
	March	11.3	-1.2	-0.3
	April	13.9	5.3	7.4
	May	13.3	6.3	16.5
	June	14.2	8.5	21.5
	July	12.8	7.5	23.8
	August	13.7	5.6	25.8
	September	9.4	4.3	22.9
	October	8.9	0.5	17.1
	November	9.6	3.3	16.6
	December	9.7	3.9	14.1
2017	January	34.1	31.2	27.0
	February	28.2	23.7	0.6
	March	23.3	26.6	-2.9
	April	16.5	13.8	-6.8
	May	21.1	13.5	-8.1
	June	22.5	8.6	-10.3
	July	23.0	6.0	-9.2
	August	22.5	2.0	-11.1

Source: World Bank, based on data from Kenya National Bureau of Statistics

Table 24: Local electricity generation by source

Year	Month	Hydro (KWh million)	Geo-thermal (KWh million)	Thermal (KWh million)	Total (KWh million)
2015	January	278	388	109	776
	February	230	352	121	703
	March	246	377	134	757
	April	264	359	121	744
	May	301	380	103	784
	June	297	362	109	769
	July	305	353	143	801
	August	319	378	112	808
	September	306	389	99	794
	October	310	402	100	812
	November	300	393	89	782
	December	307	387	92	786
2016	January	322	392	93	808
	February	297	392	95	784
	March	335	383	112	830
	April	303	394	102	800
	May	334	403	92	830
	June	348	342	113	803
	July	337	393	110	842
	August	364	345	138	850
	September	349	335	137	824
	October	357	364	135	862
	November	315	369	158	848
	December	299	371	158	836
2017	January	252	380	197	837
	February	214	354	182	758
	March	234	388	230	858
	April	212	381	223	822
	May	229	394	224	849
	June	180	376	274	834
	July	193	402	271	867
	August	251	415	159	829

Source: Kenya National Bureau of Statistics

Table 25: Soft drinks, sugar, galvanized sheets and cement production

Year	Month	Soft drinks Litres (thousands)	Sugar (MT)	Galvanized sheets (MT)	Cement (MT)
2015	January	41,348	63,227	21,304	511,298
	February	41,440	57,917	20,078	465,471
	March	48,865	63,389	22,797	550,556
	April	42,148	46,280	20,674	537,452
	May	36,874	44,081	23,132	516,513
	June	36,274	46,098	20,358	516,185
	July	32,086	47,957	18,415	570,904
	August	38,432	54,089	20,871	553,929
	September	40,176	61,069	20,581	561,235
	October	42,936	56,360	26,024	557,589
	November	40,025	43,401	25,764	510,747
	December	49,966	48,089	16,938	486,306
2016	January	50,502	41,348	21,330	533,490
	February	45,237	41,440	20,102	531,813
	March	58,038	48,865	20,120	541,438
	April	44,429	42,148	23,109	568,253
	May	43,189	36,874	21,980	585,929
	June	39,191	36,202	20,180	547,238
	July	42,393	32,158	18,320	575,193
	August	39,331	38,508	24,190	591,612
	September	48,884	40,291	21,045	528,494
	October	46,131	43,203	18,328	573,034
	November	41,877	40,141	19,143	584,780
	December	52,185	49,966	19,431	545,956
2017	January	50,491	53,071	23,271	565,440
	February	43,941	49,094	21,696	491,307
	March	46,585	41,936	22,165	570,522
	April	41,814	26,230	21,999	535,061
	May	36,483	15,246	22,162	482,762
	June	41,265	16,144	21,645	513,313
	July	39,575		22,029	553,631
	August				451,651

Source: Kenya National Bureau of Statistics

Table 26: Tourism arrivals

Year	Month	JKIA	MIA	Total
2015	January	40,846	10,107	50,952
	February	45,141	7,882	53,053
	March	66,121	6,958	73,079
	April	49,933	4,020	53,953
	May	50,764	2,511	53,275
	June	59,867	3,218	63,146
	July	72,515	5,728	78,243
	August	63,332	7,546	70,878
	September	54,162	5,114	59,276
	October	66,441	6,049	72,490
	November	53,622	7,718	61,340
	December	50,015	9,070	59,085
2016	January	65,431	9,407	74,838
	February	62,856	9,983	72,839
	March	49,996	8,551	58,547
	April	51,311	3,869	55,180
	May	59,294	3,578	62,872
	June	64,451	4,182	68,633
	July	81,729	7,832	89,561
	August	87,141	9,817	96,958
	September	67,249	8,381	75,630
	October	63,229	9,015	72,244
	November	61,224	7,990	69,214
	December	67,602	10,267	77,869
2017	January	67,053	12,637	79,690
	February	62,119	10,611	72,730
	March	63,568	8,382	71,950
	April	62,982	4,102	67,084
	May	64,866	2,665	67,531
	June	74,194	4,734	78,928
	July	97,955	7,286	105,241
	August	79,053	10,729	89,782

Source: Kenya National Bureau of Statistics

Table 27: New vehicle registration

Year	Month	All body types (Numbers)
2015	January	15,366
	February	17,409
	March	25,067
	April	20,730
	May	22,837
	June	25,070
	July	21,132
	August	17,360
	September	18,596
	October	18,740
	November	23,209
	December	22,308
2016	January	14,652
	February	12,771
	March	10,280
	April	13,699
	May	11,855
	June	22,428
	July	23,442
	August	18,288
	September	18,527
	October	13,018
	November	27,286
	December	27,431
2017	January	23,889
	February	20,748
	March	27,720
	April	23,074
	May	24,720
	June	24,509
	July	29,346
	September	21,137

Source: Kenya National Bureau of Statistics

POISED TO BOUNCE BACK?

Reviving Private Sector Credit Growth and Boosting Revenue Mobilization to Support Fiscal Consolidation

This is a critical time for Kenya, as the incoming administrations at national and devolved levels face the high expectations of ordinary Kenyans to deliver on ambitious economic development agendas and hasten the attainment of Vision 2030. Against this backdrop, it is my pleasure to present the sixteenth edition of the World Bank's Kenya Economic Update—a report which seeks to contribute to the policy discourse on pertinent economic issues. The report has three key messages.

The Kenyan economy faced multiple headwinds in 2017. A drought in the earlier half of the year, the ongoing slowdown in private sector credit growth, and a prolonged election cycle weakened private sector demand, notwithstanding an expansionary fiscal stance. Nonetheless, reflecting the relatively diverse economic structure, these headwinds were partially mitigated by the recovery in tourism, better rains in the second half of the year, still low global oil prices, and a relatively stable macroeconomic environment. Consequently, GDP growth is projected to dip to 4.9 percent in 2017—its lowest in the past five years, but still higher than the Sub-Saharan African average.

With headwinds subsiding, economic growth is projected to rebound over the medium term, reaching about 5.8 percent in 2019. However, this rebound is predicated on policy reforms needed to address downside risks that have the potential to derail medium term prospects. Two macroeconomic risks are pertinent. First, there is a need to consolidate the fiscal stance in order not to jeopardize Kenya's hard-earned macroeconomic stability—a critical ingredient to Kenya's recent robust growth performance. Second, is the need to jumpstart the recovery of credit growth to the private sector; particularly to micro, small and medium size businesses and households. Further, efforts to mitigate weather-related risks by climate proofing agriculture could be supportive of a robust and inclusive medium term growth agenda.

We are pleased to present a rich menu of policy options tabled in this edition of the Kenya Economic Update, identifying opportunities for the consolidation of the fiscal stance, both from an expenditure and revenue mobilization perspective. This is complimented with specific suggestions of macroeconomic and microeconomic reform measures that could help address the slowdown in credit growth and the broader issue of access to credit. Finally, policy options to climate proof the agriculture sector, to mitigate the worse effects of adverse weather conditions are discussed.

The World Bank remains committed to working with key Kenyan stakeholders to identify potential policy and structural issues that will enhance inclusive economic growth, keep Kenya on the path to upper middle income status, and attain Vision 2030. The semi-annual Kenya Economic Update offers a forum for such discussions. We hope that you will join us in debating topical policy issues that can contribute to fostering growth shared prosperity and poverty reduction in Kenya.

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