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In Search of Fiscal Space

Government Spending and Taxation: Who Benefits?

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Government Spending and Taxation: Who Benefits?

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ABBREVIATIONS

CEQ	Commitment to Equity
CT	Cash Transfers
CT-HSNP	Cash Transfers for Hunger Safety Net Program
CT-OVC	Cash Transfers for Orphans & Vulnerable Children
CT-PwSD	Cash Transfers for Persons with Severe Disabilities
CBR	Central Bank Rate
CBK	Central Bank of Kenya
DSA	Debt Sustainability Analysis
EAC	East African Community
EMDE	Emerging Markets and Developing Economies
EU	European Union
FPE	Free Primary Education
FY	Fiscal Year
GDP	Gross Domestic Product
GoK	Government of Kenya
H1, H2	First, Second Half
ICT	Information Communication Technology
IFMIS	Integrated Financial Management Information System
LMICs	Lower Middle Income Countries
KEU	Kenya Economic Update
KMRC	Kenya Mortgage Refinance Company
KHBIS	Kenya Integrated Household Budget Survey
KNBS	Kenya National Bureau of Statistics
MFMod	Macroeconomic and Fiscal Model
NSE	Nairobi Security Exchange
NPL	Non-Performing Loans
NSNP	Kenya National Safety Net Program
NSSF	National Social Security Fund
OPCT	Older Persons Cash Transfer
PPP	Public Private Partnership
PMTs	Proxy-Means Tests
PIT	Personal Income Tax
PAYE	Pay As You Earn
PMI	Purchasing Managers' Index
Q1, Q2, Q3, Q4	Quarter One, Two, Three, Four
SRC	Salaries and Remuneration Commission
SMEs	Small and Medium Enterprises
SSA	Sub-Saharan Africa
SGR	Standard Gauge Railway
UHC	Universal Health Care
UK	United Kingdom
UFS	Urban Food Subsidy
VAT	Value Added Tax
y-o-y	Year on Year



FOREWORD

In December 2017, the government announced its Big 4 Developments Agenda, aimed at increasing delivery of affordable housing, universal health coverage, raising the share of manufacturing in the economy and improving food and nutritional security. Nonetheless, against the backdrop of fiscal consolidation, it will be important to be careful on which expenditures are contained so that the government's inclusive growth agenda is not jeopardized. This 18th Edition of the Kenya Economic Update seeks to contribute to this discussion. The report has three key messages.

First, the Kenyan economy is on a rebound in 2018. Reflecting improved rains, better business sentiment and easing of political uncertainty, real GDP growth is estimated to rebound from 4.9 percent in 2017 to 5.7 percent in 2018 and rise gradually to 6.0 percent by 2020 as the output gap closes. This growth trajectory lays a solid foundation within which the government could accelerate poverty reduction especially if accompanied by pro-poor and inclusive growth policy measures. The downside risks to this outlook arise from subdued private sector credit growth that could curtail private investment; fiscal slippages that could compromise macroeconomic stability; and an uptick in oil prices and tightening global financial markets, which could exert undue pressures to the current account balance.

Second, there is need to re-ignite private sector led growth and ensure that fiscal consolidation is growth friendly. Although private sector investment is recovering, it is well below levels needed to achieve the Big 4 Development Agenda goals. Boosting private sector investment is more important, given the waning contribution of public investment to growth due to fiscal consolidation. Furthermore, with the majority of government expenditure cuts falling on development spending, the structure of fiscal consolidation could compromise the growth potential of the economy. Additional macroeconomic and structural reforms could help crowd in the private sector and support achievement of the Big 4. For instance, it is critical to address bottlenecks against private sector credit growth, including removal of interest rates caps.

Third, the special focus section examines distributional consequences of government spending and taxes. It finds that cash transfer programs are well-targeted because a large fraction of the benefits is captured by the poor. Nonetheless, cash transfer schemes in Kenya cover only a small portion of the population. Hence, these programs could be scaled up to increase their poverty-reducing effect. However, enhanced revenue mobilization would be needed to increase coverage significantly.

The World Bank remains committed to working with key Kenyan stakeholders to identify policy and structural issues that will enhance inclusive growth and attainment of the Big 4 development agenda. The Kenya Economic Update offers a forum for such policy discussion aimed at fostering growth, reduce poverty and improve shared prosperity in Kenya.



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EXECUTIVE SUMMARY

1. The Kenyan Economy is on a rebound in 2018.

Reflecting improved rains, better business sentiment and easing of political uncertainty, economic activity is rebounding after the slowdown in activity in 2017. According to official statistics, the economy expanded from 4.7 percent in H1 of 2017 to 6.0 percent in H1 of 2018 supported by improved harvest in agriculture, steady recovery in industrial activity, and still robust performance in the services sector. As a result, real GDP growth is projected to reach 5.7 percent in 2018, an upward revision of 0.2 percentage points from the April 2018 Economic Update.

2. Growth in private consumption and investment are driving the rebound.

Private consumption picked up in 2018 fueled by rising household incomes from improved agricultural harvests, lower food prices, and strong remittance inflows. A recovery in private sector investment activity is also underway, partly reflected in increased imports of raw materials and chemicals and more positive investor sentiment with the Purchasing Managers' Index remaining in expansionary territory (above the 50-mark) for H1 2018 at 55.1 points compared to 49.7 points over the same period in 2017. The recovery in private sector activity (consumption and investment) is expected to off-set potential drag in growth due to unwinding of fiscal stimulus at a time when fiscal consolidation is gathering momentum. Net exports continued to weigh on growth owing to faster expansion in imports relative to Kenya's exports.

3. The macroeconomic environment remains broadly stable.

Inflation remains within the government's target band of 5 ± 2.5 percent. Headline inflation stood at an average rate of 4.4 percent in H1 2018 as lower food prices offset the effect of rising oil prices resulting in benign inflationary pressures. This has provided policy space for a more accommodative monetary policy stance to support growth. Nonetheless, at 4.3 percent in August 2018, private sector credit growth remains subdued and well below its historical average of about 19 percent. Notwithstanding a recent surge in oil prices, the current account deficit narrowed from 6.7 percent in 2017 to 5.3 percent in July 2018. This was adequately financed by a surplus in the financial account resulting in accumulation of official foreign reserves to 5.6 months of import cover as at September 2018.

4. Growth is projected to remain robust over the medium term.

GDP growth is projected at 5.8 percent in 2019 and 6.0 percent in 2020. The gradual pick-up is underpinned by the current slack in the economy with the output gap expected to close over the medium term. In particular, growth forecast is supported by projected recovery in agriculture and domestic demand. Further, the external balance position is expected to remain favorable, thereby supporting macroeconomic stability. This forecast remains largely consistent with those in the April 2018 Economic Update, with a slight downward revision of 0.1 percentage points for 2019 and 2020. Growth could have been higher in the absence of interest caps that remain tied to the policy rate, hence constraining the effectiveness of monetary policy to influence private sector credit access.

5. Nonetheless, there are downside risks to the outlook relating to both domestic and external developments.

On the domestic front, subdued growth in private sector credit, a recurrence of adverse drought shocks, and fiscal slippages leading to macroeconomic instability could dampen growth prospects. On the external front, an unanticipated spike in oil prices, uncertainty and rising trade tensions, and unanticipated tightening of global financial market conditions due to ongoing normalization of monetary policy in advanced economies may result in reversal of capital flows from emerging and frontier markets, including Kenya. Were any of these to materialize, this could lead to a dimmer outlook.

6. Macroeconomic policy and structural reforms are needed to boost inclusive growth and advance the government's Big 4 agenda.

Support from the public and more importantly the private sector will be required to achieve the Big 4. Macro policies could include recalibrating the quality of fiscal consolidation, improving debt management and safeguarding macroeconomic stability. Structural reforms could seek to boost private investment including through improving private sector credit access, particularly to micro and small-scale enterprises. The following areas, while not exhaustive, requires special focus from policy makers.

7. First, fiscal consolidation needs to be recalibrated towards recurrent spending.

The quality of fiscal consolidation matters for safeguarding the Kenyan

economy's long-term growth potential. A path where much of the burden of fiscal consolidation is disproportionately shouldered by development spending undermines the underlying growth potential of the Kenyan economy. In this regard, policy could take bold steps to recalibrate the balance between development and recurrent expenditures, with the latter bearing a higher share of the expenditure containment. Specific areas that could be considered to rein in recurrent spending include: lowering of transfers to state owned enterprises, cleaning and regular audit of the payroll register, keeping wages, salaries and allowance adjustments in line with recommendations from the Salaries and Remuneration Commission (SRC), and maintaining frugality in operations and maintenance expenses.

8. Second, reverse the downward trend in revenue mobilization. Raising revenue mobilization is an essential ingredient of fiscal consolidation. Domestic revenue mobilization measures could focus on rationalizing tax expenditures and putting in place a governance framework that checks the creeping-up of tax exemptions (World Bank, 2017). Further, the tax base needs to be broadened, as contemplated in the draft income tax bill. Moreover, enhanced administrative measures such as better interconnectedness between various government data management systems with iTAX (such as IFMIS and other third-party systems) could help boost efficiency of tax collection.

9. Third, improve debt management by rebalancing the mix of expensive and shorter maturity commercial loans. This could be done through taking advantage of concessional debt, which is more affordable and with longer maturity profiles. Furthermore, develop and deepen the local bond market, including initiatives to attract foreign investors to the local currency bond market. This could boost availability of low cost debt refinancing. Kenya attracts far fewer foreign investors into its local currency bond market relative to Nigeria, Egypt, Ghana and South Africa, even though its local currency bond market has grown very rapidly. Developing the local currency bond market could spur significant interest from foreign investors and potentially reduce country borrowing costs and extend the maturity profiles of local currency bonds.

10. Fourth, reprioritize and enhance efficiency of government spending to create more room for the Big 4 priority areas. For the Big 4 to succeed, this will

require some level of expenditure reprioritization. It would be equally important for there to be improvement in efficiency of spending. For instance, in the agriculture sector, a number of studies show that the lack of extension services is undermining productivity in the sector. However, the budget for agriculture continues to significantly underfund extension services. Furthermore, the efficiency of agricultural spending in input subsidy program and producer subsidies (Strategic food reserves) will need to be scrutinized with a view to improve accountability and transparency since they bear important market distortions and productivity consequences.

11. Fifth and lastly, advancing the structural reforms could help crowd in the private sector to achieve the Big

4. Since the announcement of the Big 4, the government has made progress within the affordable housing pillar by completing the legal and regulatory framework for KMRC, waiver of stamp duty for first time home buyers and the introduction of standardized forms to register a change on a property. Nonetheless, there is need for concerted effort to create the incentive structure in agriculture, universal health coverage and manufacturing. For example, in the agriculture sector, policy could focus at improving small scale farmer input access (higher yielding seeds and fertilizer), approve warehouse receipt system and access to financing.

12. In the special focus section, the fiscal incidence analysis examines the distributional consequences of Kenya's spending and taxation. This analysis is an important input for designing pro-poor policies and influencing the rate at which economic growth translates into poverty reduction. The Kenya Economic Update Edition 16 outlined options to enhance Domestic Revenue Mobilization. The Fiscal Incidence Analysis complements the DRM analysis by looking into the equity implications of government spending and taxation policy measures. The analysis covers government expenditure on cash transfer programs, education and health while revenue raising measures such as PAYE, VAT and excise taxes are examined on the revenue front. The findings from this analysis shows that:

13. Direct cash transfer programs are well-targeted, progressive and pro-poor. The analysis finds that these programs are mostly well-targeted, progressive and pro-poor. Overall, more than 60 percent of the benefits are captured by the poorest 40 percent of the population.

Nonetheless, the programs reach only a small fraction of the population, resulting in a modest effect on poverty and inequality. A cross-country comparison suggests that while government spending in cash transfers may be progressive, increasing revenue mobilization is essential for the coverage to significantly increase.

14. Public education spending is progressive in absolute terms, but progressivity declines with increasing levels of education. A disproportionately larger share of children from poor households benefit from spending on public education, in contrast with children of higher income households where the uptake of private primary education is higher. Nonetheless, the net benefits of spending at higher levels of the education system increasingly benefit the better-off.

15. Public health spending on outpatient care in lower-level facilities is progressive. Conditional on uptake, public health spending on outpatient care is pro-poor while the associated user fees and over the counter purchases are regressive. This higher uptake among the poor of outpatient care in low-level facilities compensates for lower unit costs at this level relative to government hospitals and lower uptake of outpatient care overall, resulting in a progressive impact of public spending on outpatient care.

16. On taxes, personal income tax is found to be progressive. The poorest 40 percent of Kenya's population account for, on average, 14.3 percent of market income but less than one percent of direct taxes. In contrast, 80 percent of the tax incidence is borne by the richest ten percent of the population. This result is driven by both the progressivity of the tax system and limited access to formal sector jobs among the poor.

17. Value Added Tax (VAT) is mildly progressive (close to neutral) while excise taxes are largely progressive. The analysis finds that VAT is mildly progressive with respect to consumption but close to being neutral. The burden

of VAT (with or without exemptions) is distributed almost proportionally to market income. The average share of VAT in total household expenditure is 8.4 percent if exempt items are assumed to be zero rated and 9.0 percent if they are assumed to carry 16 percent VAT. This suggests that exemptions on VAT could be benefitting the poor only marginally. Regarding excise taxes in Kenya, they are, with the exception of tobacco products, largely progressive. The bottom 40 percent, which account for 14.3 percent of market income, account for only 6.6 percent of all excise taxes, rendering the overall tax highly progressive.

18. There are three key policy recommendations from this analysis. First, the government could consider expanding direct cash transfer programs. Cash transfer programs are well-targeted so that a large fraction of the benefits are captured by the poor. These programs could further be expanded in order to increase their poverty-reducing effect. However, this will require enhancing revenue mobilization for the coverage to increase significantly.

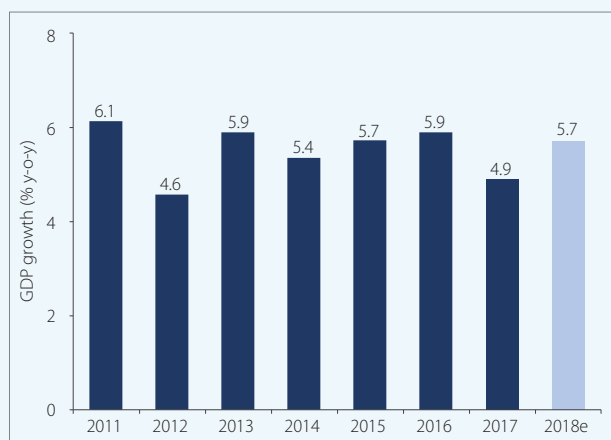
19. Second, exemptions granted within Kenya's VAT regime appear to benefit the poor only marginally. The variation in consumption shares of exempt and zero-rated items across the welfare distribution is small. A review of the VAT law might help remove exemptions and increase revenue that could then be spent in well-targeted and progressive cash transfer programs. However, a more detailed follow-up analysis of exemptions and zero-rates would be necessary to determine item-level incidence.

20. Third and finally, shifting public resources from higher-level health facilities to lower-level facilities is likely to benefit the poor. Conditional on uptake, public health spending on outpatient care is pro-poor while the associated user fees and over the counter purchases are regressive. The results suggest that redirecting spending from higher-level public health facilities to primary care facilities has the potential to benefit the poor and might increase access.



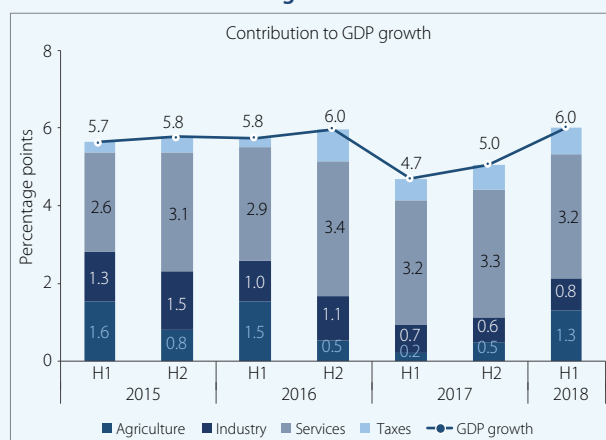
RECENT ECONOMIC TRENDS AND OUTLOOK

A rebound in economic activity is underway in 2018



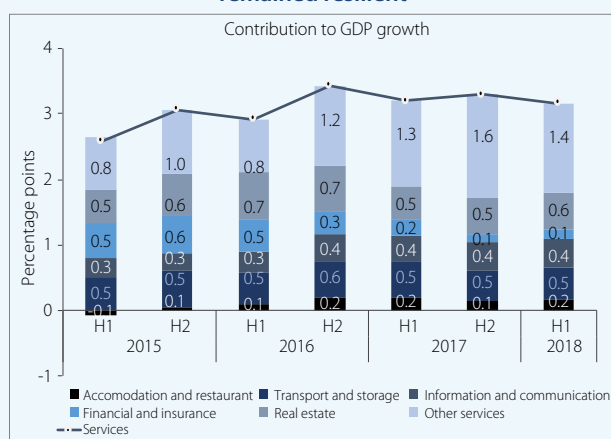
Source: Kenya National Bureau of Statistics and World Bank
Note: "e" denotes an estimate

The rebound is driven by recovery in agriculture



Source: Kenya National Bureau of Statistics and World Bank

The services contribution to GDP growth remained resilient



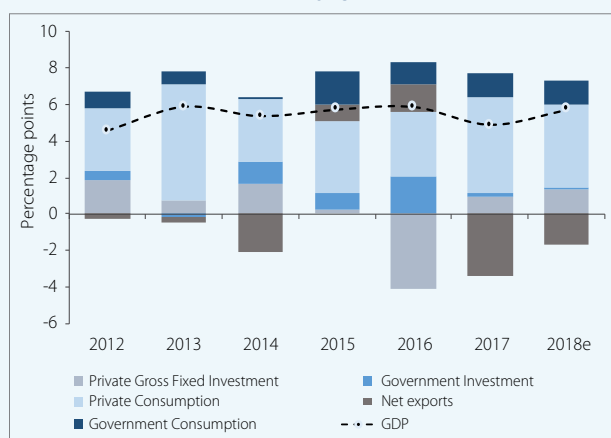
Source: Kenya National Bureau of Statistics and World Bank

The recent trend in the Purchasing Manager's Index (PMI) indicates recovery in manufacturing



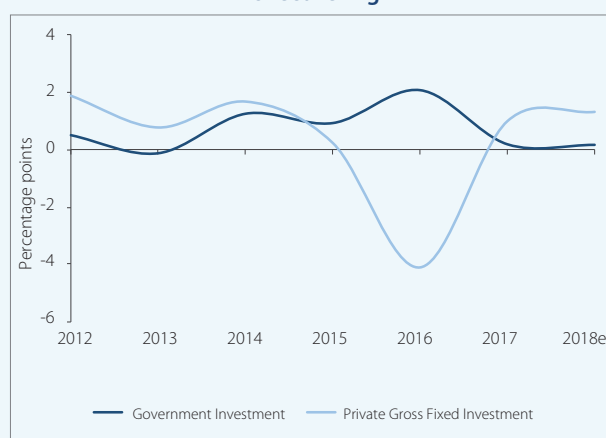
Source: CFC Stanbic and World Bank

Private consumption is aiding rebound in 2018



Source: Kenya National Bureau of Statistics and World Bank
Note: "e" denotes an estimate

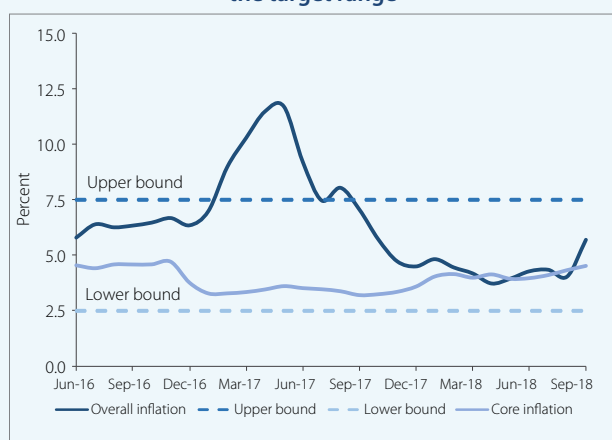
Private investment contribution to GDP is recovering



Source: Kenya National Bureau of Statistics and World Bank
Note: "e" denotes an estimate

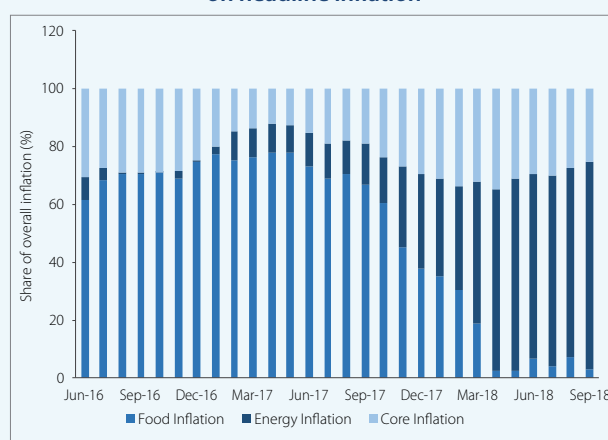
RECENT ECONOMIC TRENDS AND OUTLOOK

Inflation remains well within the target range



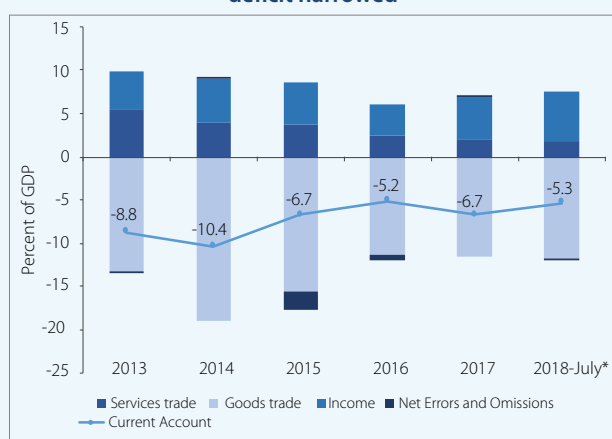
Source: Kenya National Bureau of Statistics and World Bank

Energy prices are exerting upward pressure on headline inflation



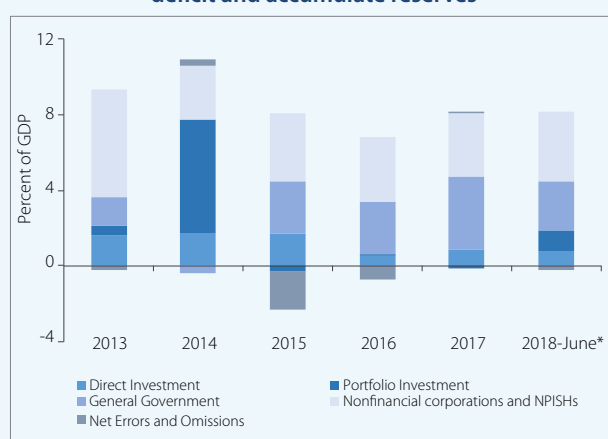
Source: Kenya National Bureau of Statistics and World Bank

Notwithstanding rising oil prices, the current account deficit narrowed



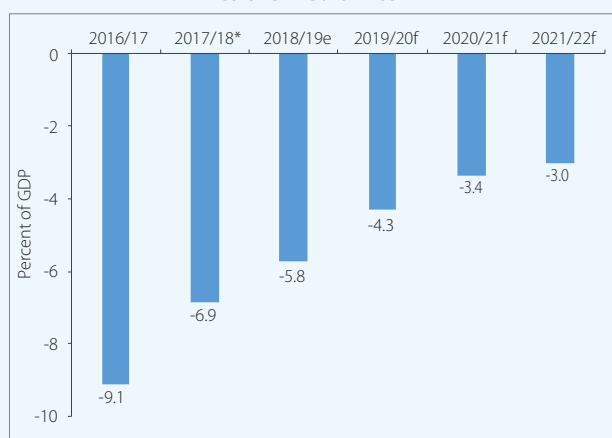
Source: Central Bank of Kenya
Notes: * indicates an estimate

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



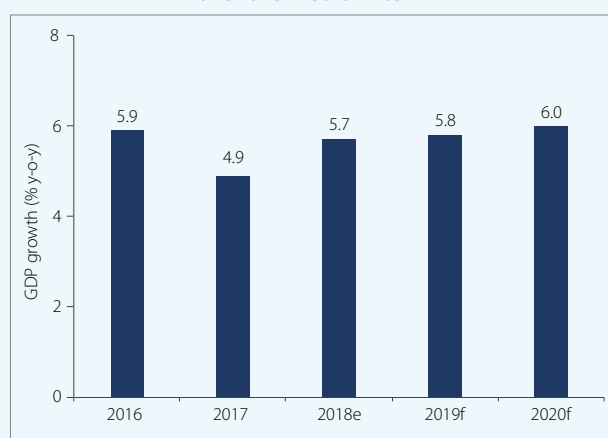
Source: Central Bank of Kenya
Notes: * indicates an estimate

The ongoing fiscal consolidation is expected to continue into the medium term



Source: The National Treasury
Notes: * indicates preliminary results, "e" denotes an estimate, "f" denotes forecast

Growth is projected to remain robust over the medium-term



Source: World Bank
Notes: "e" denotes an estimate, "f" denotes forecast.

Part 1: The State of Kenya's Economy



1. Recent Economic Developments

1.1. Global economic growth remains strong but is expected to level off in the near term

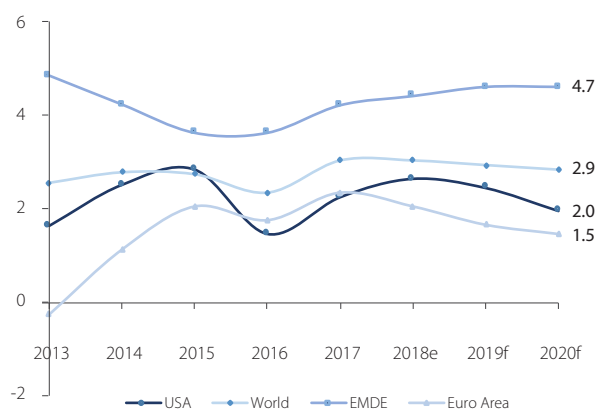
1.1.1. After a strong pick-up in 2017, growth in the global economy has eased, though still robust. Global GDP growth expanded from 2.4 percent in 2016 to 3.0 percent in 2017, driven by a synchronized recovery in both the advanced and emerging market economies. In 2018, growth is projected to reach 3.1 percent before easing to 2.9 percent in 2019. The leveling-off is driven by the closure of output gaps in advanced economies, moderation in trade and investment, and a gradual tightening of financing conditions due to ongoing withdrawal of accommodative monetary policy in advanced economies. Growth in major advanced economies is expected to decelerate from 2.3 percent in 2017 to 2.2 percent in 2018, while growth in Emerging and Developing Economies (EMDEs) will pick-up to 4.5 percent in 2018 (Figure 1). However, global growth optimism is constrained by rising trade tensions likely to have a negative impact on confidence, asset prices, global trade and investments.

1.1.2. A cyclical upswing is underway in sub-Saharan Africa (SSA). Supported by a strong recovery in the economies of commodity-exporting countries, growth in the SSA region rebounded from a 22-year low of 1.3 percent in 2016 to 2.4 percent in 2017 and is projected to reach 3.1 percent in 2018 (Figure 2). The recovery in growth from the larger resource rich exporters (Angola, Nigeria,

and South Africa) complemented a still robust growth in the non-resource rich countries owing to strong public-sector investment in infrastructure. Growth in the resource rich economies was boosted by the steady recovery in oil, metal and mineral prices. The region's growth is projected to accelerate to 3.5 percent in 2019 and 3.6 percent in 2020, supported by still strong commodity prices.

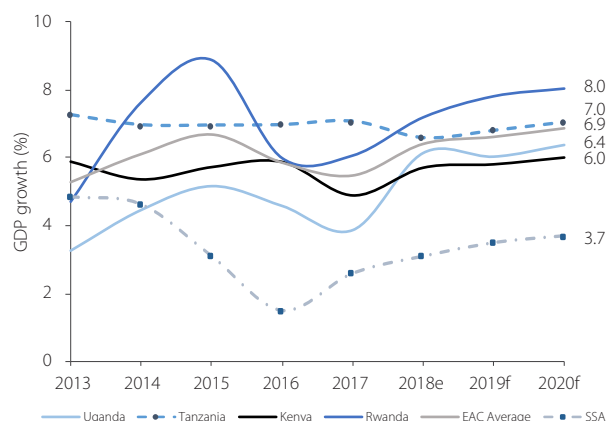
1.1.3. After decelerating in 2017 (though above the SSA average), growth in the East African Community (EAC) is expected to recover in 2018. In 2017, growth in the EAC economies dampened on account of adverse effects of drought and lower credit to the private sector, which grew at an average of 5.4 percent (Figure 2). Nonetheless, there was substantial heterogeneity in growth across member states¹. For instance, Kenya and Uganda lagged the regional average with a slower growth rate estimated at 4.9 percent and 4.0 percent, respectively, while Tanzania and Rwanda grew by 6.4 percent and 6.1 percent, respectively in 2017. In Tanzania, growth was driven by a bumper harvest in the second half of the year while in Rwanda, improved weather and a rebound in exports explained accelerated growth. In 2018, average growth for the region is projected to reach 6.1 percent, driven by a rebound in agricultural activity on the back of favorable weather conditions and a pick-up in private sector credit growth.

Figure 1: Global growth pick-up is broad-based



Source: World Bank
Notes: "e" denotes an estimate

Figure 2: Growth in the EAC countries decelerated in 2017, but is still above the SSA's average



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

¹ The average excludes the Republic of Burundi.

1.2. Led by a recovery in agriculture, a rebound in Kenya's economic activity is underway in 2018

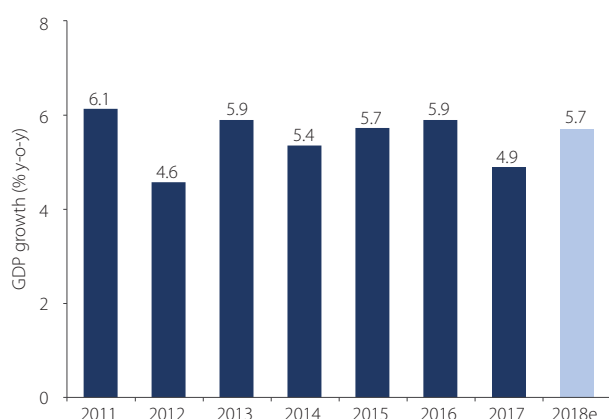
1.2.1. Kenya's economy is rebounding after the slowdown in activity in 2017. Reflecting improved rains, better business sentiment and easing of political uncertainty, a rebound in economic activity is taking root in 2018 (Figure 3). The economy expanded from 4.7 percent in H1 of 2017 to 6.0 percent in H1 of 2018. Growth was supported by a strong rebound in agricultural output, steadily recovering industrial activity, and still robust performance in the services sector.

1.2.2. Favorable weather conditions and timely receipt of the long rains in 2018 have contributed to a strong rebound in agricultural output. Agriculture accounts for about 26 percent of GDP directly and some 25 percent of GDP indirectly through its backward and forward linkages to other sectors of the economy. It also accounts for up to 60 percent of employment and 60

percent of Kenya's exports. Reflecting favorable rains, the sector recovered to an average growth rate of 5.4 percent in H1 of 2018 compared to 0.8 percent in H1 of 2017. This expansion in output enabled the agriculture sector to contribute 1.3 percentage points to GDP growth in H1 2018 compared to a meager 0.2 percentage points in 2017, when the effects of last year's drought was in full force (Figure 4). The current recovery in the agriculture sector is broad-based, reflected in the expansion of output of key food and cash crops such as tea, horticulture and sugarcane (Figure 5).

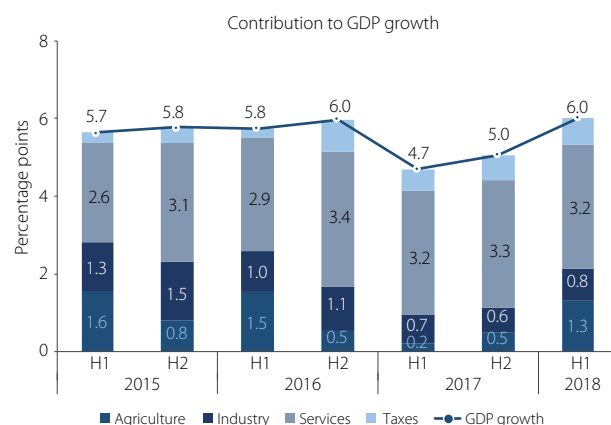
1.2.3. Manufacturing is recovering, though activity remains sluggish. The overall industrial sector (manufacturing, electricity and water and construction) accounts for approximately 9.3 percent of GDP and approximately 19.6 percent of formal sector jobs. Growth in manufacturing recovered from 0.5 percent in H1 of 2017 to 2.7 percent in H1 of 2018 but remains weak compared to a three-year average of 3.6 percent over

Figure 3: A rebound in economic activity is underway in 2018



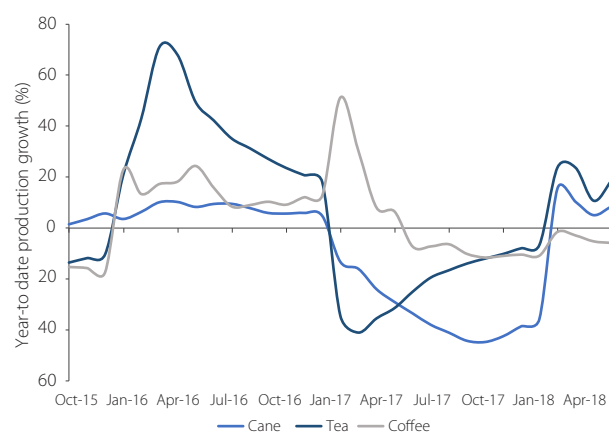
Source: Kenya National Bureau of Statistics and World Bank
Notes: "e" denotes an estimate

Figure 4: The rebound is driven by recovery in agriculture



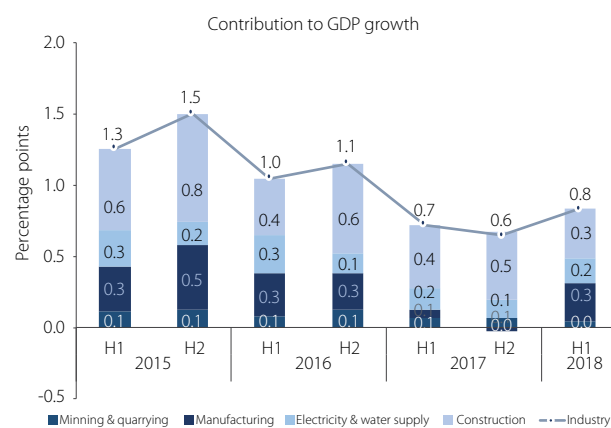
Source: Kenya National Bureau of Statistics and World Bank

Figure 5: Leading indicators show recovery of agriculture in 2018



Source: Kenya National Bureau of Statistics and World Bank

Figure 6: Industrial activity picked up after significant headwinds in 2017



Source: Kenya National Bureau of Statistics and World Bank

the 2013-2016 period (Figure 6). Recovery is supported by both increased food manufacturing (i.e. wheat and maize flour, canned fruits, soft drinks and sugar) and in non-food manufacturers such as leather, galvanized sheet (Figure 7) and chemicals. The pick-up in private sector activity is underpinned by positive investor sentiment, evidenced by the Purchasing Managers' Index remaining in expansionary territory (i.e. above the 50-mark) for H1 2018 at 55.0, compared to the same period in 2017, where it was in contractionary territory (averaging 49.7).

1.2.4. Performance in other industrial sub-sectors remains strong. Supported by stronger private sector investment in real estate, as well as ongoing government spending on infrastructure, growth in the construction sub-sector was an impressive 6.6 percent in H1 of 2018. The positive performance is reflected in the increase in the real value of approved buildings, consumption of cement, clinker, iron and steel bars. In addition, the repair of roads damaged by floods (especially in major cities) during the long rains in 2018 is expected to contribute to a healthy outcome in 2018. The abundant rainfall has also contributed to the growth in water supply to 6.9 percent in H1 of 2018 compared to 6.1 percent in H1 of 2017, thereby increasing electricity generation from hydropower, which is cheapest energy source within Kenya's energy mix (thermal, geothermal and wind).

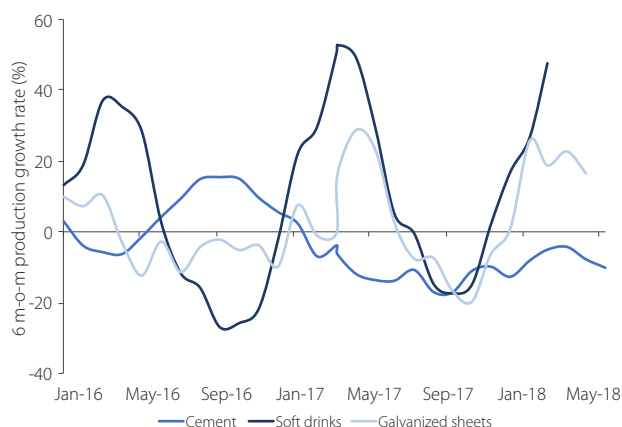
1.2.5. Services sector growth has remained resilient, despite mixed performance across the sub-sectors. The services sector grew at an average of 6.9 percent in H1 2018 compared to 7.5 percent in H1 of 2017. However, performance across the main sub-sectors was mixed (Figure 8). While wholesale and retail trade registered strong growth, activity in the accommodation and

transportation sub-sectors eased relative to 2017. In particular, growth in accommodation and restaurants (tourism) decelerated from 19.6 percent in H1 of 2017 to 14.3 percent in H1 of 2018, while growth in transport and storage services eased from 8.7 percent in H1 2017 to 7.5 percent in H1 2018. Growth in the ICT and real estate sub-sectors remained solid, spurred by the dynamism in mobile technology and steady growth in the residential real estate market. However, reflecting ongoing challenges in the banking sector, including from the interest rate caps, growth in financial services decelerated from 4.1 percent in H1 of 2017 to 2.5 percent in H1 of 2018.

1.3. Private consumption and investment are driving the recovery

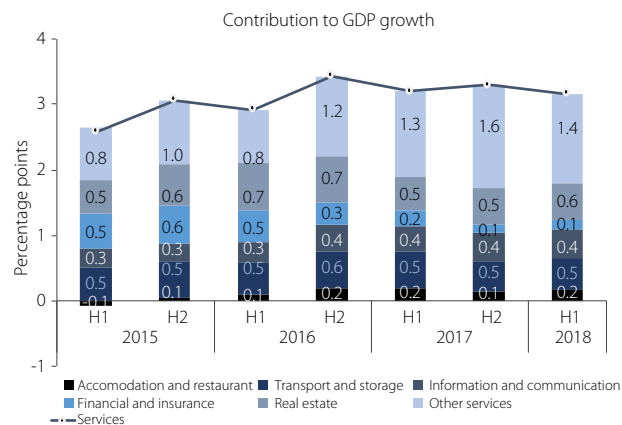
1.3.1. Favorable agricultural harvests, low inflation and remittance inflows are supportive of the recent pick-up in private consumption. Private consumption remains the largest demand component of GDP, accounting for some 75 percent of total GDP. In 2017, household consumption, particularly for poorer households, took a hit from escalating food prices, albeit mitigated by government interventions through subsidies and duty-free imports of grain and sugar. Though private consumption data for 2018 is not yet available, given the backdrop of improved agricultural harvests, lower food prices, strong remittance inflows, and improved employment opportunities from a recovering economy, private consumption is likely to be more robust in 2018 than in 2017. Nonetheless, the introduction of VAT at 8 percent on petroleum products and a specific excise tax on sugar confectionary are likely to be passed on to final consumer prices, moderating growth in private consumption in 2018.

Figure 7: Leading indicators in manufacturing shows the sector's resilience in 2018



Source: Kenya National Bureau of Statistics and World Bank

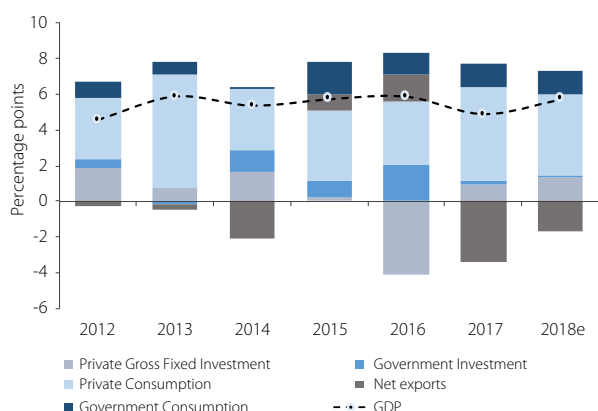
Figure 8: The services sector's contribution to GDP growth remained resilient in H1 2018



Source: Kenya National Bureau of Statistics and World Bank

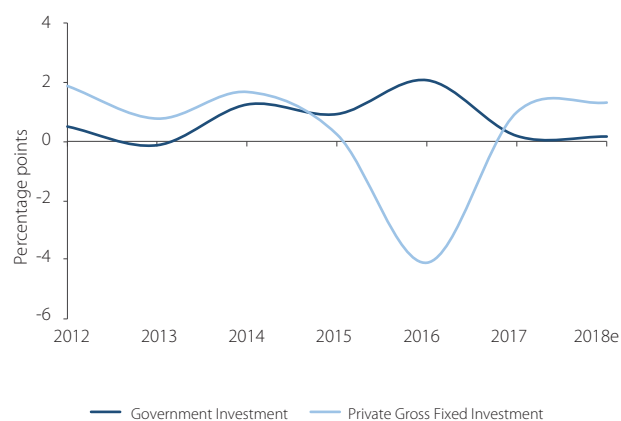
1.3.2. Private investment is recovering but is well below levels needed to achieve the Big 4. Thanks to the reduction in political uncertainty and subsequent rise in business confidence (as evidenced in the PMI improvement) and pent-up investment demand, a pick-up in private investment is underway in 2018 (Figure 9, Figure 10). This is in contrast with 2017, when much of the growth in investment came from the public sector, as private investment was shackled by political uncertainty, low access to credit and a slowdown in economic activity (Figure 11). The uptick of private investment in 2018 is reflected in increased imports of raw materials, chemicals, machinery and equipment, and recovering credit growth in H1 2018 relative to H1 2017. Nonetheless, private investment remains well below optimal levels, as reflected in the low credit growth, sluggish manufacturing activity and low productivity in the agriculture sector. Hence, there is an urgent need to accelerate the pace of recovery in private investment, particularly in areas that support inclusive growth, such as the Big 4 sectors (agriculture, housing, health care and manufacturing).

Figure 9: Private consumption is aiding rebound in 2018



Source: Kenya National Bureau of Statistics and World Bank

Figure 11: Private investment contribution to GDP is recovering



Source: World Bank
Notes: "e" denotes an estimate

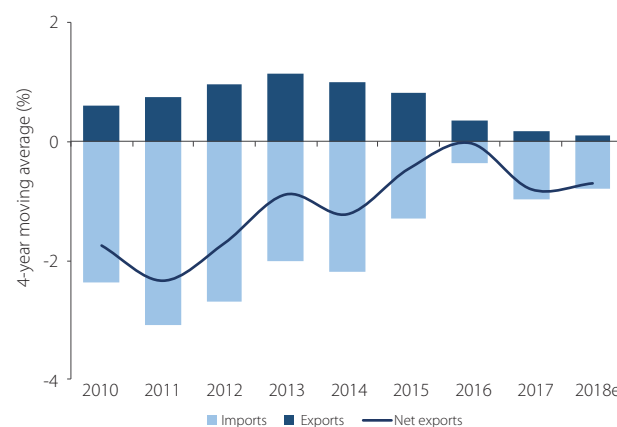
1.3.3. The need to boost private investment is all the more important, given the waning contribution of public investment to growth due to fiscal consolidation. The public sector's contribution to GDP growth more than doubled, rising from 1.1 percentage points in 2013 to 2.5 percentage points of GDP in 2017. However, in FY17/18 the expansionary fiscal stance screeched to a halt, with government spending growing at only 0.1 percent compared to an average of 17.1 percent in the previous four years. This was mainly because of a 20 percent contraction in development spending, due in part to the completion of the SGR phase one, delays in exchequer releases and low execution of the development budget. With most cuts in government expenditure falling on development spending, for gross fixed capital formation to remain healthy, thereby underpinning the growth potential of the Kenyan economy, there is an even important need for private investment growth to accelerate.

Figure 10: The recent trends in the Purchasing Managers' Index (PMI) indicates recovery in manufacturing



Source: CFC Stanbic and World Bank

Figure 12: With higher import leakage, the contribution from net exports is negative



Source: Kenya National Bureau of Statistics and World Bank Notes: "e" denotes an estimate

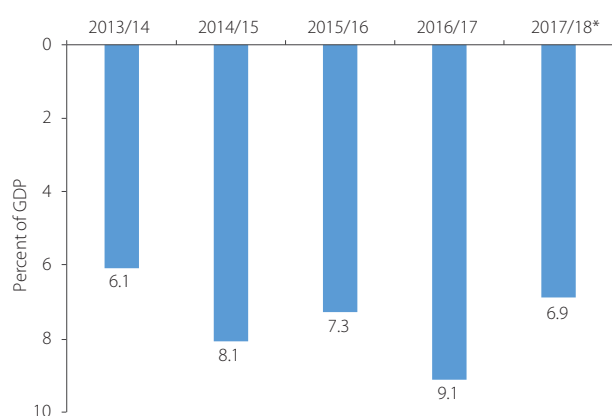
1.3.4. The contribution of net exports to growth remains negative. For H1 of 2018, net exports served as a drag to growth owing to a strong pick-up in imports that more than offset the recovery in Kenya's tea and horticultural exports, and tourism receipts (Figure 12). The faster growth in imports is driven by recovery in domestic demand. On exports, while agricultural exports, which are mostly destined for advanced economies expanded, manufactured exports, which are mostly destined to EAC countries, have remained weak. The decline in manufactured exports has persisted since 2005.

1.4. Given the narrowing of the fiscal space, the government has commenced fiscal consolidation

1.4.1. Fiscal consolidation is gathering momentum with a significant reduction in the overall fiscal deficit. Reflecting government's commitment to fiscal consolidation, the overall fiscal deficit (including grants) decreased by 2.2 percentage points to 6.9 percent of GDP in FY 2017/18 (Figure 13). This represents the fastest pace of fiscal consolidation since 2010, surpassing the targeted budget deficit of 7.2 percent of GDP. The tighter fiscal stance was achieved, notwithstanding a significant underperformance of revenues, through a significant slowdown in government spending (spending increased by only 0.1 percent). Indeed, as a share of GDP total expenditures fell by about 3.7 percentage points from 27.5 percent of GDP in FY 2016/17 to 23.9 percent in FY 2017/18.

1.4.2. The largest share of fiscal consolidation was shouldered by a contraction in development spending.

Figure 13: Starting in 2017/18, fiscal consolidation is underway

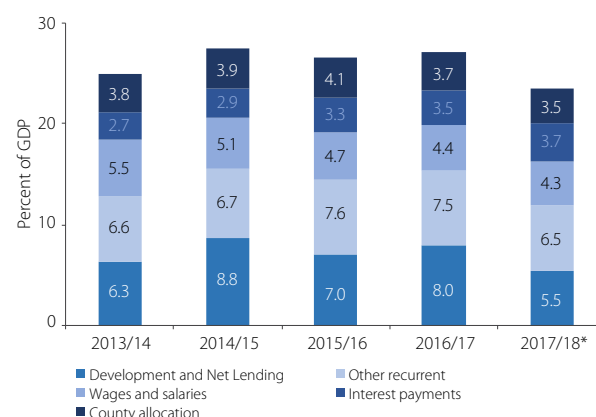


Source: The National Treasury
Notes: * indicates preliminary results

Development expenditure, contracted by 20.1 percent in FY17/18. As a share of GDP it fell from 8.0 percent in FY 2016/17 to 5.5 percent of GDP in FY 2017/18 (or by 2.5 percentage points). This decline in development spending was adequate to account for the full fiscal consolidation. The completion of SGR phase one, delays in the release of development funding and delayed implementation following a prolonged electioneering period occasioned low absorption of the development budget². With the overwhelming majority cuts to government expenditure falling on development spending, the quality of fiscal consolidation over the past year is not growth friendly.

1.4.3. The slowdown in recurrent expenditures also contributed to fiscal consolidation. Unlike the large contraction in development spending, the pace of growth of recurrent spending eased to 8.9 percent in FY17/18 compared to an average of 16.1 percent in the previous three years. However, with nominal GDP growing faster than growth in recurrent spending, as a share of GDP recurrent spending decreased by about 0.9 percentage points of GDP to 14.5 percent of GDP in FY 2017/18, notwithstanding transitional fiscal pressures in 2017/18 including additional general election expenses and food subsidies. Despite the slowdown, recurrent spending still accounted for more than 94.0 percent of total tax revenue - leaving limited room for the use of domestic resources to finance development expenditure (Figure 14). The difficulty in reining in recurrent spending, in part reflects structural rigidities from higher debt servicing payments (about 24 percent of tax revenues) and still high contribution of wages and salaries (40-50 percent of revenues). Similarly, at the county level, recurrent

Figure 14: Government spending has been elevated in recent years



Source: The National Treasury
Notes: * indicates preliminary results

² Office of the Controller of Budget, National Government Budget Implementation Review Report, PP. 65

expenditure accounted for a larger share of total county revenue (67.7 percent as at the end of Q3 2017/18), mainly driven by personnel emoluments.

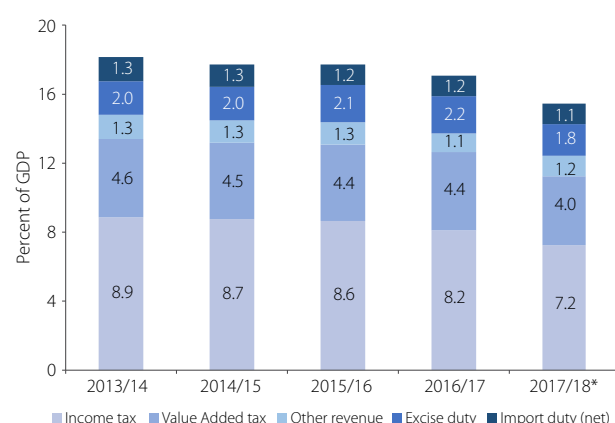
1.4.4. In contrast to expenditures, domestic revenue mobilization significantly underperformed, thereby mitigating the extent of fiscal consolidation. Total revenue as a share of GDP fell to its lowest level in a decade. Tax revenue fell to 15.4 percent of GDP in 2017/18, from 17.1 percent of GDP in 2016/17. This is attributed to underperformance in both income tax and VAT – Kenya's largest sources of tax revenue, accounting for over 70 percent of tax revenue (Figure 15). Underperformance in income tax collection could also be associated with lower profitability in the corporate and the banking sector, and inefficiencies in remitting income tax by state-run corporations experiencing cash flow difficulties. Further, the recent administrative measures to support domestic revenue mobilization including integration of iTax and IFMIS, roll out of integrated customs management, and expansion of tax bases are yet to yield the envisioned revenue increases.

1.4.5. The slower buoyancy of tax revenue relative to nominal GDP suggests that the factors associated with the shortfall are structural. A buoyant tax system has an elasticity with respect to growth in nominal GDP of at least one. However, the buoyancy of Kenya's main tax categories, namely income tax and VAT, is much weaker. Tax revenue as a percent of GDP dropped from 18.1 percent in FY 2013/14 to 17.1 percent in FY 2016/17 and preliminary results show this ratio dropping to 15.4

percent in FY 2017/18. Income tax contributed to most of that reduction (0.9 percent of GDP), accounting for almost 53 percent of the decline (Figure 16). In addition, excise duty, VAT and import duty contributed about 0.3, 0.4 and 0.1 percentage points of GDP reduction, respectively over the two periods. Given the continuous revenue decline at a time when nominal GDP is growing, the ability to raise more revenue could have plateaued and significant structural reforms may be needed to reverse this worrying trend.

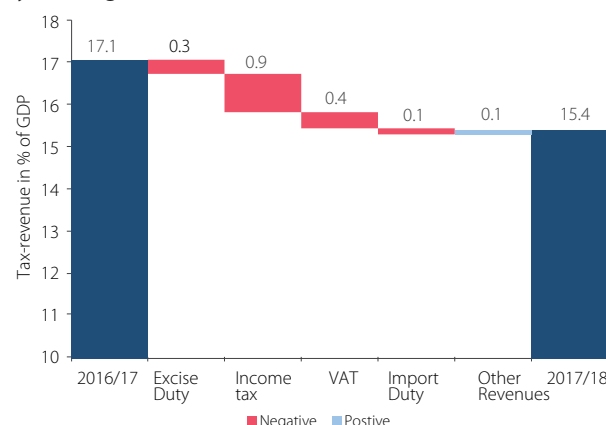
1.4.6. The upward trend in Kenya's overall public debt moderated in FY17/18. After a steady climb from about 42.1 percent of GDP in June 2013 to 57.5 percent of GDP as at June 2017, debt moderated to 57.0 percent of GDP as of June 2018 (Figure 17). The drop is partly attributed to a narrowing of the fiscal deficit in FY2017/18 but also due to resilient growth in real GDP and a relatively stable exchange rate. The drop in primary deficit from an average of 5.0 percent of GDP in 2015-16 to an average of about 3.0 percent in 2017-18 (Figure 18) contributed by slowing the pace of debt accumulation compared to recent years. Resilient GDP growth contributed to a decline in debt by some 3 percentage points of GDP and revaluation by some 4 percentage points. However, interest payments' contribution to debt stock increased from an average of 2.9 percent of GDP in 2015-2016 to an average of 3.4 percentage points of GDP over the 2017-2018 period. Kenya's debt remains below the low-income countries Debt Sustainability Analysis (DSA)³ debt thresholds of 74 percent of GDP in present value terms.

Figure 15: Revenue growth remains weak



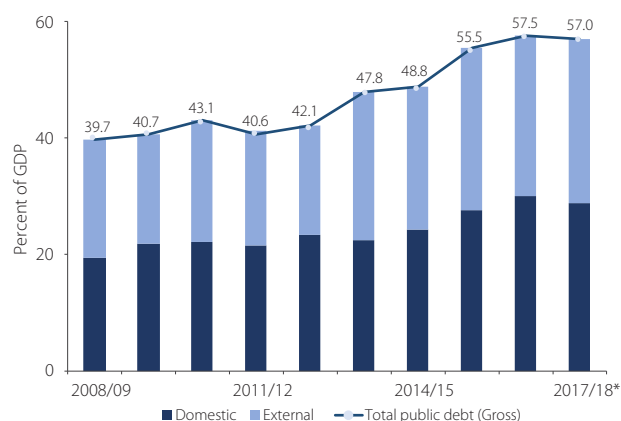
Source: The National Treasury
Notes: * indicates preliminary results

Figure 16: The decline in tax revenue is largely driven by challenges in income tax and VAT collection

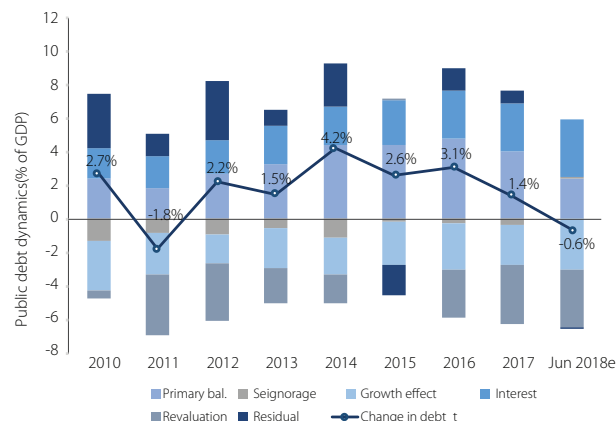


Source: The National Treasury
Notes: * indicates preliminary results

³ The thresholds are set based on the country's CPIA score. Kenya's score places it at medium range with debt-to-GDP threshold of 74 percent as an indicator of solvency.

Figure 17: Public debt moderated from a rapid rise in previous years

Source: The National Treasury
Notes: * indicates preliminary results

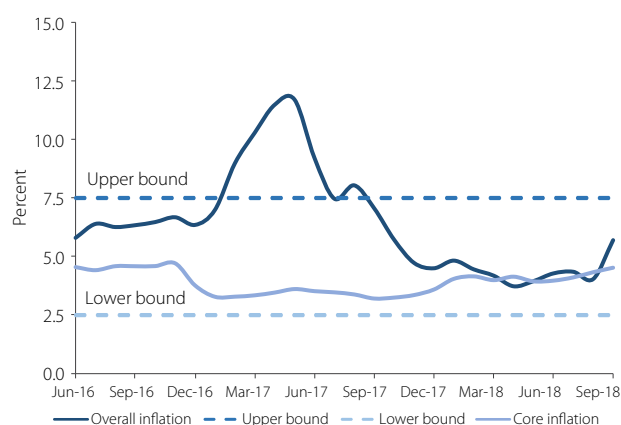
Figure 18: Debt slowdown was driven by a decrease in the primary balance

Source: The National Treasury and World Bank computations

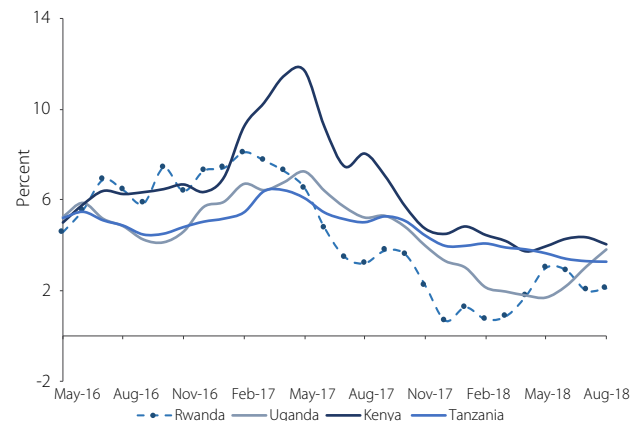
1.4.7. The composition of Kenya's debt remains balanced between external and domestic sources. As of June 2018, the total debt stock had risen to Ksh 5.0 trillion from Ksh 4.9 trillion. The split between external and domestic debt in the total debt stock was about 51:49. However, reflecting higher domestic interest rates, debt servicing charges on the domestic debt stock is about three times higher than from the external debt stock. At 28.9 percent of GDP in June 2018, external debt was 1.0 percentage point lower compared to June 2017, however, domestic debt increased by 0.4 percentage points to reach 28.0 percent in June 2018. The share of multilateral debt to total external debt declined by 5.0 percentage points to 32.0 percent in June 2018 compared to the same period in 2017, while bilateral debt's share contracted by 2.3 percentage points to 30.2 percent in June 2018. However, the share of non-concessional (commercial debt) external debt rose by 7.4 percentage points to 36 percent in June 2018.

1.5. The macroeconomic environment remains stable, however private sector credit growth remains anemic

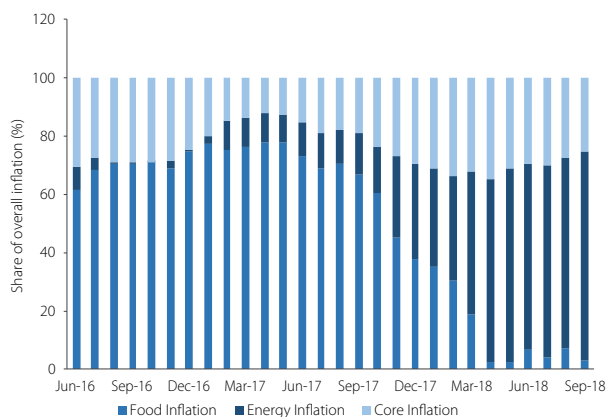
1.5.1. Although still within the government's target band of 5 ± 2.5 percent, inflation is picking up gradually. With inflation averaging 4.2 percent in H1 of 2018, inflationary pressures were broadly muted compared to an average of 9.8 percent in H1 of 2017 due to lower food prices (Figure 19). Nonetheless, Kenya's inflation, like most of its EAC counterparts (Figure 20), is gradually picking up due to base effects and the uptick in international oil prices. In addition, the phasing out of food subsidies and exemptions of VAT on petroleum products is also exerting upward pressures on domestic inflation. However, core inflation, which excludes food and energy prices, has remained below 5 percent since Q4 of 2016, reflecting an economy where underlying demand pressures are still benign (Figure 21). The stability in nominal exchange rate (Figure 22) continues to anchor inflationary expectations.

Figure 19: Inflation remains within the target range

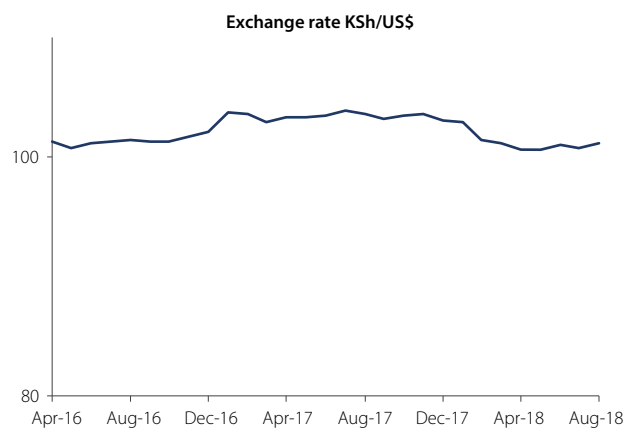
Sources: Kenya National Bureau of Statistics

Figure 20: Inflation is picking up across the EAC economies in line with rising energy prices

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

Figure 21: Energy prices are exerting upward pressure on headline inflation

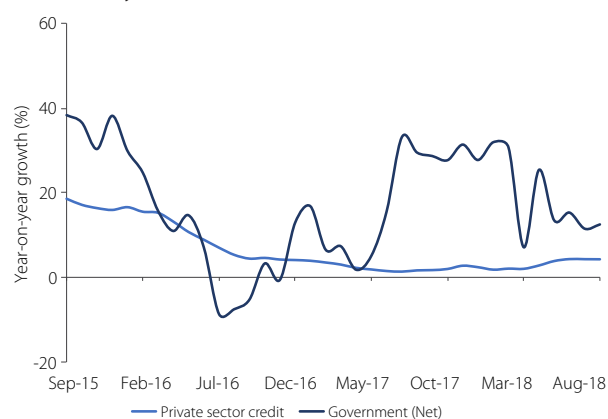
Sources: Kenya National Bureau of Statistics and World Bank

Figure 22: The stability in exchange rate continues to provide a nominal anchor to inflationary expectations

Sources: Central Bank of Kenya

1.5.2. Private sector credit growth has picked up in recent months, but still remains subdued. Like most EAC member states, Kenya's private sector credit growth collapsed from its peak of about 25 percent in mid-2014 to a low of 1.4 percent in July 2017 with credit contraction in key sectors of the economy (agriculture, private households, and transport and communication). More recently, private sector credit growth has risen from 2.0 percent in March to 4.3 percent in August 2018, signifying a slow but steady pick-up (Figure 23). Nonetheless, even though picking up, private sector credit growth remains well below its historical average of about 19 percent. While the slowdown in credit growth to private sector cannot be attributable to one single event (Figure 24), interest rate caps have derailed the recovery of credit growth in Kenya relative to the rebound witnessed elsewhere in the region, especially in the last quarter of 2017.

1.5.3. The removal of the floor could increase banks profitability without necessarily increasing lending to SMEs. The proposed amendments to interest rate caps, in place since September 2016, retains the ceiling on loans (set at policy rate plus 4 percent) but eliminates the floor on deposits (set at 70 percent of the policy rate). This partial modification lowers the cost of funding for banks thereby, improving profitability. Whether this will translate to higher lending will however be dependent on the "risk-free" rate of government securities. To the extent that yields on government securities remain high more banks will continue to be incentivized to lend to the government rather than customers perceived to be riskier (e.g. SMEs), and with lower cost of funds for the banks, return on equity could be higher. However, were yields on government securities to decline, the combination of greater spreads from the lower funding costs and diminished attractiveness of government securities could re-ignite lending to the private sector.

Figure 23: Although still weak, private sector credit growth has risen recently

Source: Central Bank of Kenya

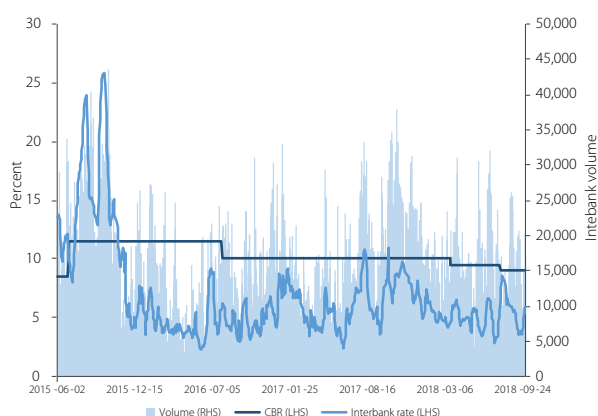
Figure 24: Synchronized collapse of credit to the private sector in the EAC region

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

1.5.4. However, with interest rate caps remaining and still tied to the policy rate the effectiveness of monetary policy to influence credit access remains constrained. With the lending rate cap still linked to the policy rate, monetary policy creates perverse incentives for using the Central Bank Policy Rate (CBR) to influence economic activity⁴. For eighteen months after the introduction of interest rate caps (September 2016 to February 2018), the policy rate remained unchanged at 10.0 percent despite core inflation falling to its lowest level of 3.2 percent in October 2017. In March 2018, the policy rate was lowered at 9.5 percent and again to 9.0 percent in August 2018 to ease liquidity conditions. The monetary easing in context of interest rate caps could have adverse impact on lending to SMEs due to lower margins for Banks.

1.5.5. Reflecting challenges among banks to price risk, there is a growing shift in lending from the private sector to the government. Growth in credit to government increased from an average of 8.8 percent in H1 of 2017 to 20.6 percent in H1 of 2018, while average growth in credit to the private sector rose marginally from 2.7 percent to 2.8 percent over the same horizon. Furthermore, liquidity segmentation in the banking system and intermittent volatility in interbank market activity (rates and transaction volumes) have further constrained the supply of credit to the private sector (Figure 25). For example, the difference in quoted interbank rates on the same day has been as high as 8 percent, with small banks facing much higher borrowing rates.

Figure 25: Interbank rates and volumes remain volatile



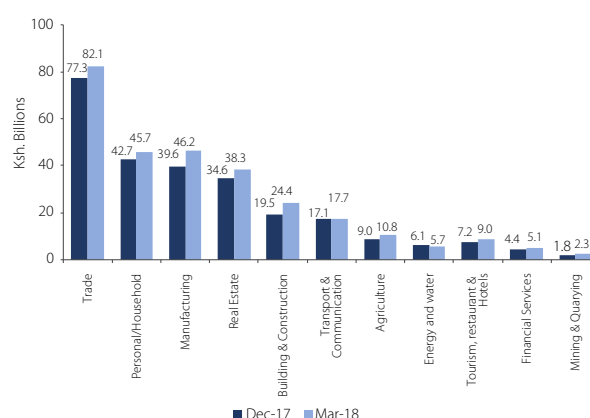
Source: Central Bank of Kenya

1.5.6. Capital adequacy ratios and profitability across the banking system remain high, but the level of non-performing loans is elevated. High levels of non-performing loans (12.7 percent in August 2018)⁵ continue to constrain lending in 2018. This spans across all the main sectors, namely trade, personal & households, manufacturing, and real estate (Figure 26). Notwithstanding concerning levels of NPLs, capital adequacy ratios remain high at 17.9 percent in August 2018. While headwinds from the low-growth environment in 2017 affected profitability, return on assets remained sizeable at 2.8 percent in June 2018. Nonetheless, risks are inherently high for smaller banks whose business model is challenged in the context of interest rate caps.

1.6. Despite rising oil prices, strong remittance inflows contributed to a narrower current account deficit

1.6.1. Notwithstanding rising oil prices, the current account deficit narrowed in the first half of 2018. In the year to July 2018, the current account deficit narrowed to 5.3 percent of GDP compared to June 2017 (Figure 27) due to stronger diaspora remittance inflows and a recovery in tourism receipts. The trade deficit increased in H1 of 2018 as the rise in the import bill outpaced increases in exports. Over the same period, exports of tea and horticulture grew at 15.4 and 14.8 percent respectively in June 2018 benefiting from a broad pick-up in global commodity prices. Reflecting the challenges underlying the competitiveness of Kenya's manufacturing sector, manufacturing exports contracted by 4.8 percent in June 2018, though less than the 14 percent contraction in June

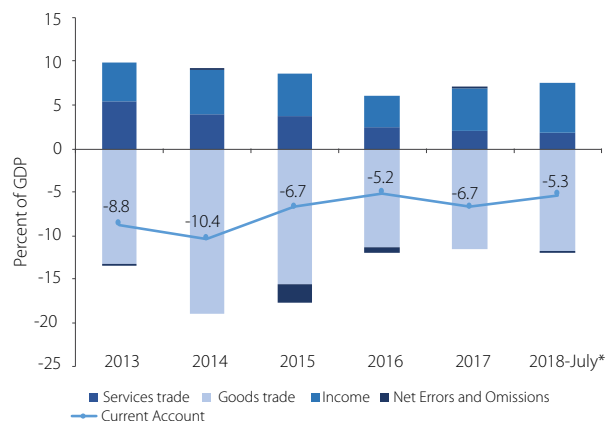
Figure 26: Higher non-performing loans constrain lending conditions



Source: Central Bank of Kenya

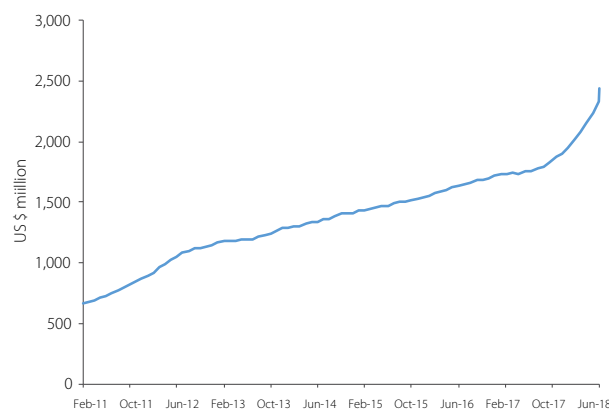
⁴ For instance, under the new regime, a lowering of the policy rate - an action often taken by Central Banks globally if they want to stimulate economic activity - could lead to the opposite effect since the lowering of the cap further narrows the spread between yields on risk free government securities and the maximum allowed lending rates.

⁵ See Monetary Policy Committee Meeting Statement (25/09/2018)- Central Bank of Kenya: https://www.centralbank.go.ke/uploads/mpc_press_release/2061124567_MPC%20Press%20Release%20-%20Meeting%20of%20September%2025,%202018.pdf

Figure 27: Notwithstanding rising oil prices, the current account deficit narrowed

Source: Central Bank of Kenya
Notes: * indicates preliminary results

2017. The weakness in the trade balance was mitigated by a strong surplus in the secondary income account due to a steady rise in remittance inflows (Figure 28).

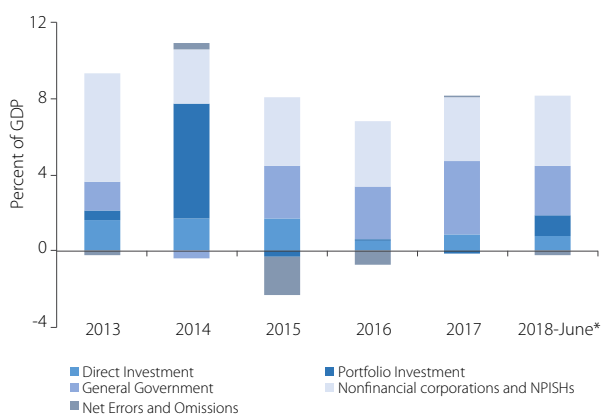
Figure 28: Improved remittance inflows contributed to the narrowing of the current account deficit

Source: Central Bank of Kenya

Resilient capital inflows reflect ongoing foreign investor confidence in the Kenyan economy and global search for yield amongst investors.

1.6.2. The financial account recorded a surplus — sufficient to finance the current account deficit and accumulate reserves. The financial account improved to 6.5 percent of GDP in the year to June 2018, compared to 6.1 percent of GDP in June 2017 (Figure 29). In terms of the breakdown of capital flows, net foreign direct investment inflows improved slightly in part reflecting the recovery of the global economy. The Eurobond proceeds supported portfolio inflows while nonfinancial corporates borrowing from abroad remained steady. Official foreign exchange reserves increased from US\$ 7,898.9 million (5.4 months of import cover) in September 2017 to US\$ 8,507.2 million (5.6 months of import cover) in September 2018, providing a comfortable buffer against external shocks.

1.6.3. Amidst softening foreign investor sentiment towards EMDEs in 2018, stock market performance has weakened. Foreign equity outflows from the Nairobi Securities Exchange (NSE) increased sharply due to uncertainty associated with the 2017 general elections but recovered towards the end of the year. However, equity outflows picked up again in 2018 with the NSE index declining by about 11.4 percent from 3,711.9 in December 2017 to 3,203.4 in August 2018 as foreign investors continued to take a net selling position (Figure 30). Recent equity outflows at the NSE are consistent with recent declines in emerging market stock valuations and compounded by the impact of interest rate caps on the valuation of bank stocks.

Figure 29: Capital inflows have helped to finance the current account deficit and accumulate reserves

Source: Central Bank of Kenya
Notes: * indicates preliminary results

Figure 30: Foreign portfolio flows have favored government bonds over equities in recent months

Source: Central Bank of Kenya

2. Outlook

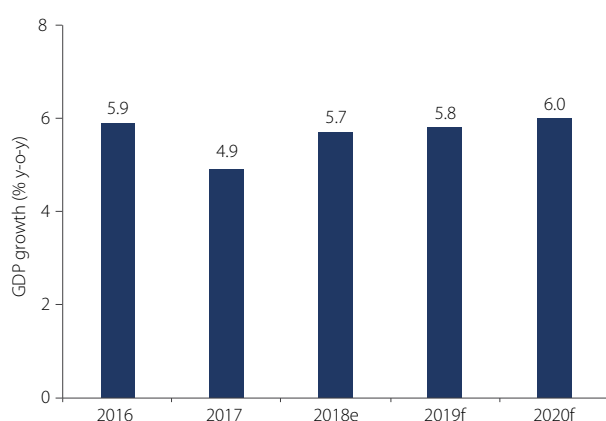
2.1. The ongoing recovery in economic activity is projected to continue over the medium term

2.1.1. The strong pick-up in economic activity that started in the first half of 2018 is expected to continue over the medium term. GDP growth is projected at 5.7 percent in 2018, rising to 5.8 and 6.0 percent, respectively for 2019 and 2020 (Table 1, Figure 31). The pickup is underpinned by the current slack in the economy with an estimated negative output gap of about -0.6 percent of GDP. As the economy rebounds the

output gap is expected to close over the medium term. In general, this forecast remains largely unchanged from the April 2018 Economic Update. The upgrade in growth for 2018 reflects a stronger than earlier projected rebound in agricultural output.

2.1.2. Near term growth is expected to be strong. Growth in the second half of 2018 is supported by recovery in agriculture owing to favorable rains and stronger domestic demand, particularly from the recovery in private consumption and investment. Further, the external balance position is expected to remain favorable, thereby supporting macroeconomic stability. However, partially mitigating the strength of the rebound will be the drag from fiscal consolidation, the recent uptick in oil prices and sub-optimal private sector credit growth (even if better than in previous years).

Figure 31: Growth is projected to remain robust over the medium-term



Source: World Bank

Notes: "e" denotes an estimate, "f" denotes forecast

2.2. Recovery in private demand could support growth while the government pursues needed fiscal restraint

2.2.1. A moderate recovery in private consumption is expected to make up for easing government consumption. The baseline assumes that favorable agricultural harvests, low inflation, and a gradual pick-up in credit to the private sector lends support to strong private consumption. In addition, while growth in the global

Table 1: Medium term growth outlook (annual percent change, unless indicated otherwise)

	2015	2016	2017	2018e	2019f	2020f
Real GDP growth, at constant market prices	5.7	5.9	4.9	5.7	5.8	6.0
Private Consumption	5.2	4.7	7.0	5.9	6.0	6.0
Government Consumption	13.7	8.5	8.4	8.5	4.2	3.5
Gross Fixed Capital Investment	5.3	-9.4	6.3	7.8	10.2	11.5
Exports, Goods and Services	6.2	-2.6	-6.2	4.9	6.8	7.1
Imports, Goods and Services	1.2	-6.3	8.4	8.7	8.9	9.0
Real GDP growth, at constant factor prices	6.1	6.0	4.9	5.7	5.8	6.0
Agriculture	5.3	4.7	1.6	4.1	4.2	4.4
Industry	7.3	5.7	3.6	4.1	4.1	5.2
Services	6.0	6.7	6.9	7.0	7.1	7.0
Inflation (Consumer Price Index)	6.6	6.3	8.0	5.2	6.0	6.5
Current Account Balance (% of GDP)	-6.7	-5.2	-6.7	-6.5	-7.0	-7.7
Fiscal Balance (% of GDP)	-7.7	-8.2	-8.0	-6.3	-5.0	-3.8
Debt (% of GDP)	52.1	56.5	57.3	57.1	56.1	53.3
Primary Balance (% of GDP)	-4.6	-4.8	-4.3	-1.8	-0.4	0.4

Sources: World Bank and the National Treasury

Notes: "e" denotes an estimate, "f" denotes forecast

* Fiscal Balance is sourced from National Treasury and presented as Fiscal Years

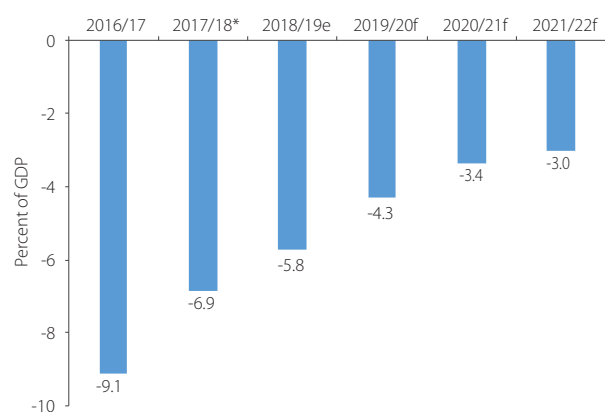
economy remains strong, remittances to the Kenyan economy are projected to be robust, thereby lending further support to household consumption. The pick-up in private consumption is expected to complement marginal growth in government consumption (salaries and wages, goods and services, transfers), translating to overall growth in final consumption. Nevertheless, on the downside, the recent VAT (of 8%) on petroleum products combined with global oil prices expected to continue its steady pick-up and with the pass-through of these prices dampening real household income, the lift to private consumption would be moderate over the medium term.

2.2.2. The recovery in private investment is expected to continue. The unwinding of pent-up investment that commenced in 2018 is projected to continue into the medium term. Our baseline assumes the recovery in private investment will be sufficient to offset a slowdown in public investment and to add to a buildup in capital stock thereby enhancing Kenya's potential output. Government investment spending is expected to decelerate in line with planned fiscal consolidation. The associated reduction of government domestic borrowing should translate into lower yields on government bonds, thereby incentivizing commercial banks to crowd in private investment. The completion of major infrastructure projects (e.g. SGR) and reforms to improve the business regulatory environment, and government efforts to attract the private sector to participate in the Big 4 (e.g. through PPPs in health, and agriculture) should help boost private investment. Nonetheless with the cap on interest rates still in play and yields on risk-free government securities still elevated, credit is unlikely to reach optimal levels, in particular credit to SMEs.

2.2.3. The medium term fiscal framework underpins a tightening fiscal stance. The government projects a decrease in overall fiscal deficit from 6.9 percent of GDP in 2017/18 to 5.7 percent of GDP in 2018/19, and a further reduction to 4.3 percent of GDP in 2019/2020 (Figure 32). Despite a marginal pick-up in 2018/19, total expenditure is projected to stabilize at 23.9 percent of GDP in the medium term, supported by a 1.2 percentage points of GDP decrease in recurrent expenditure, and a 0.2 percentage point reduction in development spending. Furthermore, budget allocations indicate a shift in resources from infrastructure to human capital development (Figure 33). Finally, tax revenue is projected to rebound to 18.2 percent of GDP in 2018/19, mainly due to recovery in economic activity, rationalization of tax exemptions, enhanced administrative measures for effective tax collection, and measures for expanding the tax base.

2.2.4. Within the context of medium term fiscal consolidation, government spending is expected to be reprioritized towards the Big 4. Reflecting the government's commitment to implement the Big 4 agenda, the FY2018/19 budget allocated about 17 percent of total public expenditure (or 4.7 percent of GDP) in support of these goals. For instance, to boost food and nutrition security, an additional Ksh 18.1 billion was allocated for strategic food reserves, cereal and crop enhancement, ongoing irrigation projects, fertilizer subsidy, crop insurance schemes, as well as Fall Army worm mitigation. In manufacturing, an additional Ksh 2.4 billion was set aside to support leather industrial parks, textiles, and dairy. To promote universal health care (UHC), Ksh 55.6 billion was allocated for free maternal healthcare, health insurance subsidy, leasing of medical

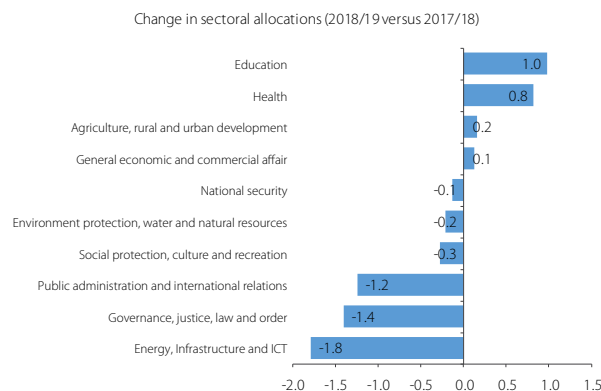
Figure 32: The ongoing fiscal consolidation is expected to continue into the medium term



Source: The National Treasury

Notes: * indicates preliminary results, "e" denotes an estimate "f" denotes forecast.

Figure 33: The share of expenditure shifted slightly towards the Big 4 sectors (health and agriculture)



Source: The National Treasury

equipment, free primary healthcare, referral hospitals, intern doctors, and nurses. Finally, Ksh 24.4 billion was allocated to affordable housing (police and civil servants) including the restructuring of the Kenya Urban Support Program to provide trunk infrastructure (water, sewerage and electricity) to crowd in private sector investment in affordable housing.

2.2.5. The external sector position is expected to remain favorable and supportive of macroeconomic stability over the medium term. Exports are projected to improve marginally over the medium term as growth in Kenya's trading partners improves and prices of its main

exports (tea, coffee, horticulture) hold steady. We also project receipts from tourism to continue to recover as there remains further scope for tourist arrivals to increase to peaks attained prior to travel advisory warnings. However, the trade balance is expected to remain negative while the current account deficit is projected to widen from 6.5 percent in 2018 to 7.0 and 7.7 percent of GDP, respectively in 2019 and 2020. The projected widening of the current account deficit will be driven by a high import bill arising from high oil prices as well as a general pick-up in domestic demand. Our baseline assumes that capital inflows will be sufficient to finance the projected current account deficit.

3. Risks are tilted to the downside

3.1. Domestic risks

3.1.1. Subdued growth of credit to the private sector, if persistent, could curtail medium term growth prospects. Our baseline assumes a strong pickup in domestic demand supported by sufficient credit flow to the private sector. However, if the expected credit growth recovery does not materialize, then the projected growth in the economy could be curtailed⁶. A lack of access to credit for the private sector presents a significant downside risk to growth prospects since it could soften the projected uptick in domestic demand, and derail business expansion plans, particularly in terms of funding for micro, small and medium-sized enterprises.

3.1.2. Slippages from the projected fiscal consolidation path could derail attainment of the needed fiscal space to fund the Big 4 agenda and potentially compromise macro-stability. The baseline assumes that the government will adhere to its medium term fiscal consolidation targets. However, fiscal slippages present a significant downside risk to the outlook because continued government borrowing is likely to outcompete the private sector in access to credit, which could adversely impact private sector investment, and could possibly lead to costly servicing of government domestic debt, erosion of fiscal buffers, and a reversal of the gains in macroeconomic stability. Further, fiscal slippages could compromise macroeconomic stability, thereby restricting government resources and its ability to catalyze the Big 4 as well as disincentivizing the private sector to invest in support of the Big 4.

3.1.3. A recurrence of adverse drought conditions could impact agricultural output, presenting a downside risk to growth prospects. The projections assume that Kenya will receive normal rains for 2018 and over the medium term, which should auger well for expansion in agricultural activity and output. However, if severe drought conditions recur, that poses a downside risk to agricultural output and medium-term growth. Nevertheless, the risk of this occurring is assessed low based on recent forecast for normal weather conditions by the Kenya Meteorological Service.

3.2. External risks

3.2.1. Unanticipated tightening of global financial conditions as a result of normalization of monetary policy in advanced economies represents a risk to financial flows to Kenya. Our baseline assumes an orderly adjustment to higher interest rates in advanced economies. However, in recent months capital outflows from emerging markets have led to significant depreciations of local currencies in emerging markets (Argentina, Turkey, Venezuela). In contrast, the Kenyan shilling has remained relatively stable and official foreign reserves remains ample (5.6 months of import cover in September 2018). Nonetheless, with continued jitteriness among global investors, emerging and frontier markets including Kenya remain vulnerable to changing sentiments and contagion. Kenya's vulnerabilities could intensify given the upcoming bullet payments for its Eurobonds and other commercial syndicated loans. These vulnerabilities could be compounded, if there are significant slippages from

⁶ Abiad, A.D., Dell'Ariccia, G. and Li, G.B., (2011), *Creditless Recoveries*, IMF Working Paper No 11/58 (Washington DC: International Monetary Fund).

its medium term fiscal consolidation pathway. However, given a comfortable level of official reserves cover and the recent commencement of fiscal consolidation, these risks are assessed low.

3.2.2. A faster and unexpected increase in oil prices presents a downside risk to the projected growth. The baseline takes into account the recent steady pick-up in oil prices. However, if a sharper and unexpected rise in oil prices occurs, this presents a significant downside risk as it could exert pressure on Kenya's terms of trade, compelling both energy prices and inflation to rise. Higher inflation could also erode purchasing power and dampen domestic demand and overall growth.

3.2.3. Uncertainty and rising trade tensions could weaken growth both globally and amongst Kenya's

major trading partners. Escalating trade tensions between larger trading powers, mounting geopolitical risks in the middle East, and the exit of the UK from the EU remain risks to the recovery in the global economy. Weaker global growth is likely to adversely impact Kenya's exports, reduce remittance inflows and tourist arrivals, thereby dampening growth prospects in Kenya beyond our projected baseline.

3.2.4. On the upside, several factors not considered in our baseline assumptions could surprise with an upswing to projected growth. These include fast-tracked structural reforms in support of the Big 4 agenda, stronger than anticipated recovery in credit to private sector and an even stronger recovery in the global economy than expected.

4. Policy options to support growth and achievement of the Big 4 Agenda

4.1.0. Further macroeconomic policy and structural reforms are needed to boost inclusive growth and advance the government's Big 4 agenda. Thanks to robust growth over the past decade, Kenya has made good progress in alleviating poverty, with the share of those living below \$1.90/day (international poverty line) declining by about ten percentage points between 2005/6 and 2015/16. Nonetheless, at 36.8 percent, poverty levels still remain elevated and is twice the average of poverty head count in low and middle-income countries (LMICs). Deep macro and structural reforms can help speed-up the pace of poverty alleviation. Macro policies could include recalibrating the quality of fiscal consolidation and improving debt management to safeguard macroeconomic stability. Structural reforms could seek to boost private investment including through improving private sector credit access, particularly to micro and small-scale enterprises.

4.1. Fiscal consolidation can be growth friendly while safeguarding macroeconomic stability

4.1.1. Fiscal consolidation needs to be recalibrated towards recurrent spending. The quality of fiscal consolidation matters for safeguarding the Kenyan

economy's long-term growth potential. A path where much of the burden of fiscal consolidation is disproportionately shouldered by development spending, as is the case in Kenya, undermines the underlying growth potential of the Kenyan economy. In this regard, there is a need to recalibrate the balance between development and recurrent expenditures, with the latter bearing a higher share of the expenditure containment. Specific measures that could be considered to rein in recurrent spending include: lowering of transfers to state owned enterprises, cleaning and regular audit of the payroll register, keeping wages, salaries and allowance adjustments in line with recommendations from the SRC, and maintaining frugality in operations and maintenance expenses⁷.

4.1.2. There is an urgent need to reverse the downward trend in revenue mobilization. Raising revenue mobilization is an essential ingredient of fiscal consolidation⁸. As a share of GDP, revenue mobilization fell to a decade low in FY 2017/18. Domestic revenue mobilization measures could focus on rationalizing tax expenditures and putting in place a governance framework that checks the creeping-up of tax exemptions (World Bank, 2017). Further, the tax base needs to be broadened, as contemplated in the draft income tax bill.

⁷ Comprehensive Public Expenditure Review 2018 (Forthcoming).

⁸ Nauschnigg (2006)

Moreover, enhanced administrative measures such as better interconnectedness between various government data management systems with ITAX (such as IFMIS and other third-party systems) could help boost efficiency of tax collection. For example, implementing GEOCRIS, a system that uses geo-spatial technology to locate property, could help boost real estate taxes, and a wider rollout of the electronic cargo tracking system could boost VAT and customs duties.

4.1.3. Reprioritize and enhance efficiency of government spending to create more room for the Big 4. For the Big 4 to succeed, some level of expenditure reprioritization will be required. Based on the FY2018/19 budget, the share of expenditure has shifted slightly in favor of health (0.8 percentage points) agriculture (0.2 percentage points) relative to their shares in FY 2017/18 (Figure 33). While this is commendable, achieving the Big 4 agenda would require much more expenditure reallocation to these critical sectors. It would be equally important for there to be improvement in efficiency of spending. For instance, in the agriculture sector, recent public expenditure review shows that the lack of extension officers is undermining productivity in the sector⁹. However, the budget for agriculture continues to significantly underfund extension services. Similarly, with 98 percent of farming being rain-fed, there needs to be more investment in support of small-scale irrigation facilities. The

efficiency of input subsidy program and producer subsidy (Strategic food reserves) also needs to be scrutinized with a view to improve accountability and transparency since they bear important market distortions and productivity consequences (Mason, N. et al. 2015; Opiyo, J. et al. 2015).

4.1.4. Increasing the level of budgetary execution remains key to realizing optimal returns to investment in the Big 4 projects. On average, over the period 2014-2016, expenditure out-turns have underperformed its allocated budget by 15 and 27 percent, respectively for the agriculture and health sectors¹⁰. Some of the constraints explaining lower absorption include limited capacity in the implementing units, lack of synchronized planning and budget execution, and slower release of funds by the exchequer. Addressing weak implementation capacity and putting in place mechanisms for faster disbursement of funds, while improving planning and budgeting remains key in raising absorption and achieving the intended objectives under the Big 4.

4.1.5. Improve debt management. Debt management could be improved by rebalancing the mix of expensive and shorter maturity commercial debt with concessional debt that is more affordable and with longer maturity profiles. Policies to develop and deepen the local bond market as well as to attract foreign investors to the local currency bond market could boost availability of low cost debt



Photo: © Dennis Nthiga and Ethan Liku/World Bank

⁹ Agriculture Public Expenditure Review (Forthcoming).

¹⁰ Comprehensive Public Expenditure Review 2018 (Forthcoming).

refinancing. Kenya attracts far fewer foreign investors into its local currency bond market relative to Nigeria, Egypt, Ghana and South Africa, even though its local currency bond market has grown very rapidly. Developing the local currency bond market could spur significant interest from foreign investors and potentially reduce country borrowing costs, extend the maturity profiles of local currency bonds, and reduce exposure to foreign exchange risk.

4.1.6. A deeper set of micro reforms are needed to tackle bottlenecks to credit access. These could include strengthening credit scoring, improving pricing transparency and strengthening consumer protection. Credit reporting can have a significant impact on the ability of commercial banks to differentiate between risky and safe borrowers thereby counteracting high uniform interest rates charged to borrowers¹¹. In addition, reforms that strengthen consumer protection and increase financial literacy are key to tackling predatory lending.

4.2. Accelerate progress in structural reforms to advance the Big 4 agenda

4.2.1. Advancing the structural reforms can help crowd in the private sector to achieve the Big 4 agenda. Government spending alone, while important, will not be sufficient to advance the Big 4 in a significant way. This

calls for a policy and institutional reform agenda that will incentivize private investment as well as public investment towards supporting the Big 4. In the previous Economic Update (KEU 17), a number of structural reforms needed to accelerate achievement of the Big 4 objectives were highlighted. Various government publications also indicate needed policy reforms to advance the Big 4. The table below reflects some of the key reforms.

4.2.2. While progress is being made, there is significant scope to fast-track the policy and institutional reform agenda that can help accelerate progress towards the Big 4. Since the announcement of the Big 4, some progress has been made in improving the policy environment (Table 2). Completed measures include the legal framework for KMRC, removal of stamp duties for first time home buyers, and the introduction of standardized forms to register a change on a property. Nonetheless, there remains several areas where progress is limited and will require a further push to advance the incentive structure in the economy to support the Big 4. These include, for example in the agriculture sector, the need to improve small scale farmer input access (higher yielding seeds and fertilizer) and financing. Given the ambitious, yet achievable, goals of the Big 4, it will be important to accelerate the pace of reforms in these areas (Table 2).



Provide 500,000 affordable houses by 2022 and achieve 100 percent Universal Health Coverage (UHC)

Photo: © Sambrian Mbaabu/World Bank and Karibu Homes

¹¹ Chi, G. and Zhang, Z. (2017): Multi-Criteria Credit Rating Model for Small Enterprise using a Nonparametric Method.

Table 2: Progress in the structural reform agenda to advance the Big 4

Progress on Structural Policy and institutional Reforms that can help Advance the Big 4	Completed	Incomplete	
		Progress	Limited Progress
Affordable Housing			
Complete the legal and regulatory framework for KMRC	X		
Waive stamp duty for first time home buyers	X		
Pass amendments to the Sectional Properties Act to allow for sub division of plots		X	
Standardize forms to register a change on property	X		
Eliminate minimal prices for professional services in housing			X
Agriculture			
Approve new seed legislation to allow equal access to public germplasm by public and private seed companies		X	
Increase the use of e-vouchers to target small holder farmers for fertilizer subsidies		X	
Approve warehouse receipt system		X	
Increase allocation of resources for better water harvesting that benefits small-scale farmers			X
Multiplicity of taxes across counties		X	
Universal Health Care			
Approve Health Financing Policy		X	
Implement action plan to reduce NHIF administrative costs			X
Increase the Share of Manufacturing			
Finalization of intellectual property rights policy		X	
Anti-counterfeit measures		X	
Finalize Kenya Investment Policy		X	
Legal framework for Micro Small Enterprises Authority			X
Finalize a framework document for national-county investment coordination			X
Finalize and enact the National Waste Management Bill 2017 and the National Water Policy		X	

Sources: World Bank compilation



Part 2: Special Focus

FISCAL INCIDENCE ANALYSIS



5. Introduction

5.1. Background

5.1.1. Kenya has been able to reduce the share of people living below the national poverty line by more than ten percentage points between 2005/06 and 2015/16, consistent with the overall robust economic growth observed. The national poverty headcount rate dropped from 46.8 percent in 2005/06 to 36.1 percent in 2015/16, which corresponds to an annualized rate of poverty reduction of 2.6 percent. Despite this successful reduction in the incidence of poverty, the absolute number of poor declined only marginally, from 16.6 million in 2005/06 to 16.4 million ten years later, due to growth of the population.

5.1.2. Inequality in Kenya has declined at the national level between 2005/06 and 2015/16, in line with a pro-poor pattern of economic growth contributing to the observed poverty reduction. The Gini index fell from 0.45 in 2005/06 to 0.39 in 2015/16, indicating that Kenya made considerable progress in terms of reducing inequality. The Gini index in rural areas declined from 0.37 to 0.33, a significant improvement for an indicator that is usually very stable over time. This suggests that redistribution contributed positively to the substantial poverty reduction observed in Kenya's rural areas during this period. The level of inequality in Kenya is moderate and comparable to inequality in Tanzania, Uganda, and Ghana.

5.1.3. This study deploys the fiscal incidence analysis to assess the distributional consequences of government spending (education and health), transfers, and taxes. The analysis of fiscal incidence and distributional consequences of the government's spending, transfers and taxes could be an important input for designing pro-poor policies and potentially for influencing the rate at which economic growth translates

into poverty reduction. By design, the analysis covers only spending, transfers and taxes that can reasonably be mapped to individual households through the recent Kenya Household Integrated Budget Survey (KHIBS) data of 2015/16. This analysis covers spending on education, public health and transfers as well as taxes (PAYE, VAT, excise taxes).

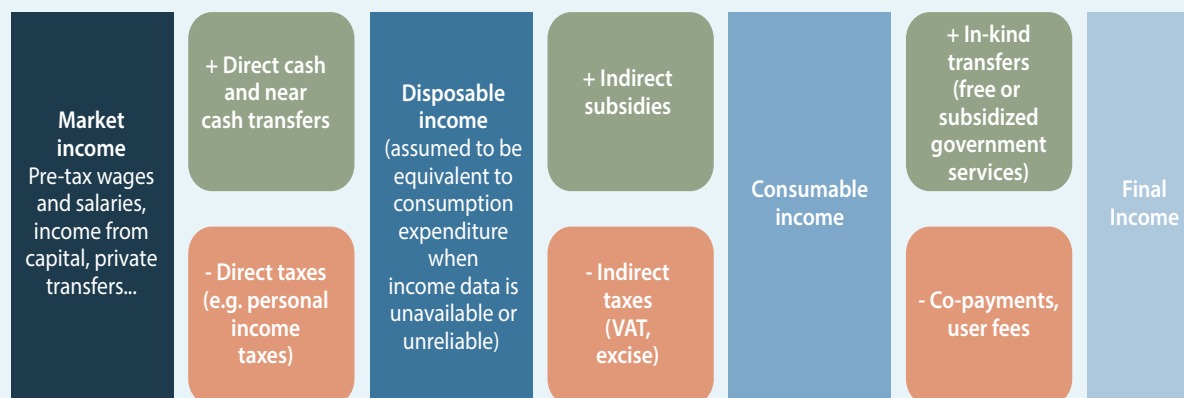
5.2. Commitment to Equity (CEQ) framework

5.2.1. The Commitment to Equity (CEQ) framework is a popular approach for analyzing the fiscal incidence of a government's system of expenditures and taxation (Lustig & Higgins, 2013; and Box 1). The framework is premised on the notion that in analyzing the impacts of taxes and transfers on poverty and inequality, it is important to consider taxation and expenditure jointly. It can be applied in both country-specific cases or across countries, with the advantage that in the latter, it provides comparable estimates of the impact of fiscal policy on inequality and poverty. The advantages of the framework include comparable results estimates and consideration of as much of the spending and transfers system that can reasonably be assigned to individual households. Nonetheless, CEQ assessments such as the one presented in this study have important limitations (Box 1).

5.2.2. Despite limitations, the CEQ framework is broad in scope and can serve as a baseline from which more narrow questions about fiscal incidence of the government's spending and taxes can be addressed. CEQ assessments are typically broad in scope, covering all taxes and transfers that can be plausibly allocated directly to households. In addition, they can be used as a baseline for further analysis such as simulation of alternative VAT regimes or changes to the parameters of transfer schemes.

Box B.1: Commitment to Equity Framework

Four income concepts in the CEQ framework



Source: Based on Lustig and Higgins (2013).

At the core of the CEQ method is the construction of income concepts and the analysis of their respective distributions.

Starting from market or pre-fiscal income, the burden and benefits of distinct components of the tax and transfer system will be added consecutively to obtain disposable income, consumable income, and final income (Figure 34). In brief, disposable income is market income less personal income taxes and employee contributions to social security plus direct cash and near-cash benefits (e.g. transfers from conditional or unconditional cash transfer programs, free food programs). Consumable income is disposable income plus indirect subsidies less indirect taxes (e.g. VAT). Final income is consumable income plus in-kind transfers (e.g. free or subsidized government services) less co-payments and user-fees. Once these income variables are constructed, the analysis tracks changes in poverty and inequality measures across the several types of income. Note that this assessment uses consumption as the underlying welfare indicator, not income.

This assessment is based on the 2015/16 KIHBS as well as administrative data from various sources. Implementing a CEQ assessment requires a comprehensive household survey as well as administrative data on taxes and transfers at the time of data collection. The CEQ framework stipulates various methods of assigning burdens and benefits to sample households (Lustig & Higgins, 2013).

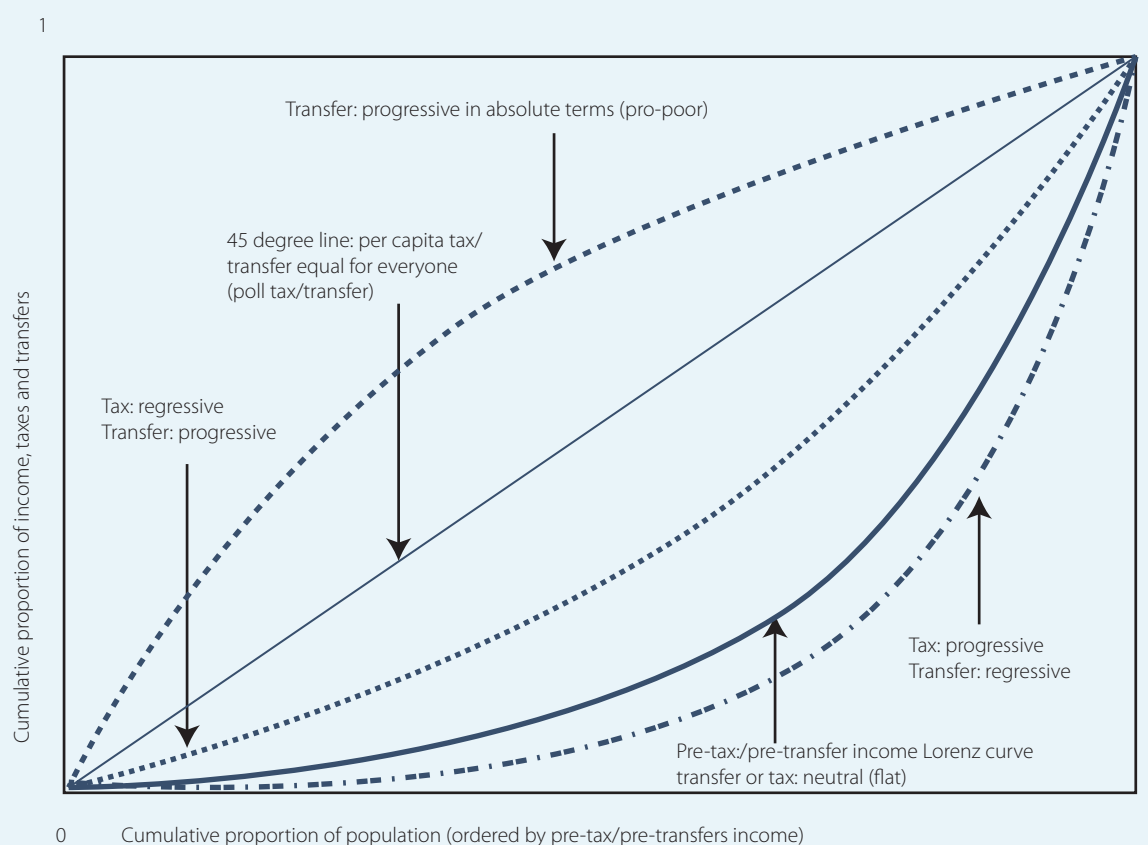
There are important limitations of the analysis that are common in this type of analysis. First, the analysis does not consider behavioral, life-cycle, or general equilibrium effects. Furthermore, the analysis provides information about the average incidence, not the incidence at the margin. Tax shifting and labor supply assumptions are strong as they imply that both consumer demand and labor supply are perfectly inelastic. Second, as in much of the literature on poverty analysis and inequality, the analysis ignores the intra-household distribution of consumption. Third, the analysis does not consider differences in the quality of education or health care services delivered by the government across income groups. Fourth, this analysis does not consider certain tax and spending items that are material to the government budget. These include taxation of corporate income and international trade, property taxes, and infrastructure spending, which are difficult to assign to individual households because of their public good nature.

Box B.2: Measuring progressivity and redistributive effects: basic concepts and definitions

When are taxes and transfers progressive? A common way to measure the progressivity of a tax (transfer) is by comparing the cumulative distribution also known as cumulative concentration shares of their burden (benefit) with the cumulative distribution of market income. This is known as the tax (transfer) redistribution approach (Duclos & Araar, 2006). In the case of spending, it is also useful to compare the cumulative distribution of benefits with the cumulative shares of total population. To illustrate, Figure A presents a Lorenz curve where the population is ranked along the horizontal axis using market (sometimes called original or reference) income, and the cumulative shares of taxes paid or transfers received is plotted along the vertical axis. The latter are concentration curves.

The report uses the following classification of taxes and transfers when referring to whether taxes or government spending are progressive or not: a tax (transfer) whose concentration curve lies everywhere below (above) the Lorenz curve for market income is globally progressive. A transfer whose concentration curve lies everywhere above the diagonal is globally progressive in absolute terms. Such a transfer is also referred to as 'pro-poor.' A tax (transfer) whose concentration curve coincides with the Lorenz curve of market income is neutral. And, finally, a tax (transfer) whose concentration curve lies everywhere above (below) the Lorenz curve is globally regressive.

Figure A: Progressivity and taxes and transfers (diagrammatic representation)



Source: Lustig and Higgins (2013).

6. Government Social Sector Spending

6.1. Is government social sector spending pro-poor?

6.1.1. Spending on education, health and social protection account for about a third of total expenditure.

Of the three types of social sector spending analyzed in this study, spending on education accounts for a large fraction of total government spending at 20.3 percent of total expenditure in FY2015/16. Spending on health accounted for 6.4 percent of total expenditure, while social protection spending accounted for about 6.4 percent of total expenditure. The three sectors combined accounted for 31.4 percent of total government expenditure in FY2015/16.

6.1.2. Devolution of certain functions means that spending on health and education vary at the national and county level.

In FY2015/16 spending on education at the national level accounted for 17.6 percent of total spending, while spending at the county level was about 6.8 percent of total county spending. Devolution of early childhood education, with all other levels of education executed at the national level, explains the large variation in education spending. Similarly, a fully devolved health function meant that health spending at the county level accounted for 22.3 percent of total county spending in FY2015/16. Health spending at the national level was about 1.9 percent of total government spending.

6.1.3. The Government of Kenya (GoK) recently introduced a series of direct cash transfer (CT) programs whose fiscal incidence is analyzed here.

The direct cash transfer programs considered here are the Cash Transfer for Hunger Safety Net Program (CT-HSNP), the Cash Transfer for Orphans & Vulnerable Children (CT-OVC), the Older Persons Cash Transfer (OPCT), and the Cash Transfer for Persons with Severe Disabilities (CT-PwSD). Transfer programs not considered in this analysis include the Urban Food Subsidy (UFS) program and bursary fund programs. The following section assesses the distributional consequences of Kenya's spending and taxes.

6.2. Cash Transfers

6.2.1. Cash transfer programs have different objectives but are unified administratively under a common operating framework.

CT-PwSD aim at reducing poverty among specific demographic groups, namely the elderly and persons with severe disabilities. The CT-HSNP aims to reduce hunger and vulnerability in specific geographic areas and the CT-OVC aims to build human capital among orphans and vulnerable children and to encourage civil registration. In 2013, the Kenya National Safety Net Program (NSNP) was established to improve and coordinate social protection delivery providing a common operating framework for the government's cash transfer programs including a unified beneficiary registry.

6.2.2. Cash transfer programs differ in terms of coverage, payouts, and their targeting mechanism.

Three of the four programs considered here are unrestricted in terms of their geographic coverage. The HSNP is targeted exclusively at households in Mandera, Marsabit, Turkana, and Wajir. Both the HSNP and the CT-OVC use proxy-means tests (PMTs) for targeting while the OPCT and the CT-PwSD are targeted based on a combination of poverty status and demographic characteristics, and old-age and disability status, respectively. Payout amounts are similar in all four programs (Table 4), ranging from Ksh 2,000 monthly per household for the CT-OVC, the OPCT, and the CT-PwSD, to Ksh 2,550 per month for the HSNP.

6.2.3. All four cash transfer programs are progressive and pro-poor.

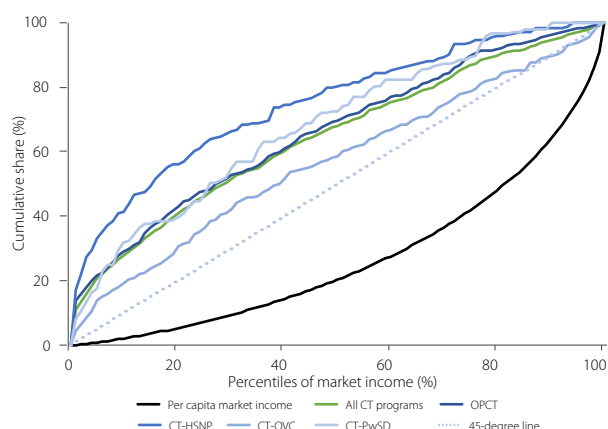
The four cash transfer programs appear well-targeted to the poor. Overall, 60.2 percent of the benefits are captured by the poorest 40 percent of the population (Figure 34a). There is some variation across programs. CT-HSNP, which uses a combination of geographic targeting and a PMT, directs 74.3 percent of the benefits distributed to the poorest 40 percent and is thus the best-targeted program among the four. It is followed by the CT-PwSD with 64.5 percent targeted to the bottom 40 percent, the OPCT with 60.8 percent, and finally the CT-OVC with 51.6 percent.

6.2.4. The targeting performance of Kenya's cash transfer programs is comparable or slightly better than the targeting performance of similar programs elsewhere.

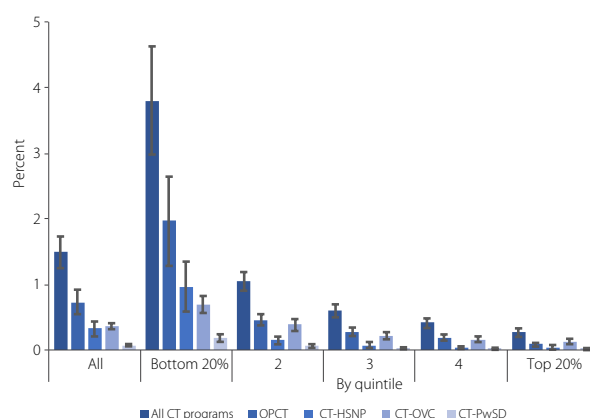
One study that assembles a dataset of 122 interventions finds that the mean and median among

Figure 34: Lorenz and concentration curves (ranked by real market income per adult) for market income and cash transfer programs and share in total expenditure by quintile

(a) Lorenz- and concentration curves for cash transfer receipts and market income (%)



(b) Share of cash transfer receipts in total expenditure by quintile



Source: World Bank based on KIHBS 2015/16 and administrative data.

68 programs for which this indicator is available are 59.2 and 52.5 percent captured by the bottom 40 percent, respectively, and a similar—56.3 and 61.8 percent—among the eight programs in that sample that are based on PMTs (Coady, Grosh, & Hoddinott, 2004). Hence, the targeting performance of Kenya's cash transfer programs seems typical or even slightly above-average among programs of this type.

6.2.5. Because of its size, the OPCT is the most important program for the poor. Because the OPCT was the largest program in terms of coverage in 2016 and given its good targeting performance, the transfers appear to have a greater impact on poor household income than the other CT programs. Transfers account for, on average, almost two percent of total household expenditure among the poorest quintile, decreasing to 1.0 and 0.6 percent among the second and third quintiles (Figure 34b). The HSNP program is also marginally significant to the poor with an average budget share of around one percent among the poorest 20 percent. Overall and on average, cash transfers account for close to 1.5 percent of household expenditure across the entire population and 3.8 percent among the bottom 20 percent.

6.3. Public Education Spending

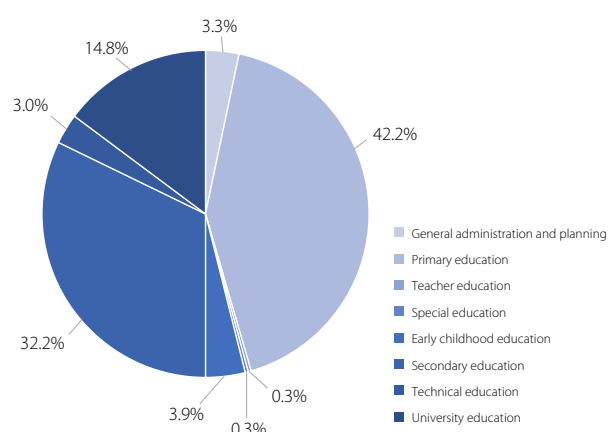
6.3.1. Close to three quarters of the Government's recurrent public education spending is directed to primary and secondary education. Kenya's education system comprises eight years of primary, four years of secondary, and four years of tertiary education. Early childhood education and some aspects of vocational

education have recently been devolved to the counties, while public primary, secondary, and tertiary education remains under the national government. Public primary and public secondary account for 42.2 percent and 32.2 percent of total recurrent spending on education, respectively (Figure 35). Tertiary education also accounts for a significant portion, around 14.8 percent.

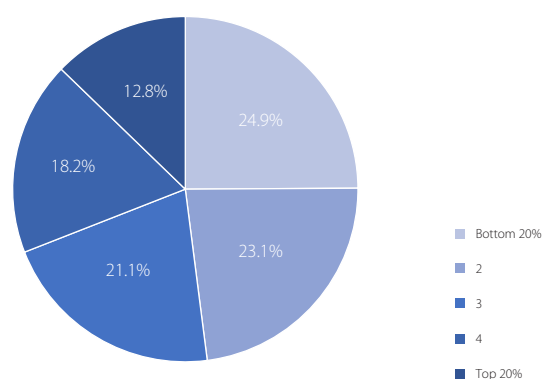
6.3.2. Public education spending is expected to be pro-poor in Kenya for three reasons. The first is related to demographics: the share of school-age children is higher among the poor, with nearly half of all children between the ages of 6 and 17 among the bottom 40 percent (Figure 36). Even without differences in public school enrollment, the poor would therefore stand to benefit disproportionately from public education spending. Second, the poor are more likely to be enrolled in public schools than their wealthier counterparts, particularly at the primary level (Figure 36a). The trend towards higher uptake of private education at the primary level is well documented and has been linked to the introduction of Free Primary Education (FPE) in 2003. Differences in overall enrollment rates only materialize at post-primary levels, especially in tertiary education (World Bank, 2018b). The final reason relates to school financing. Public primary education is fully subsidized while post-primary education often requires substantial co-payments, even for public provision (World Bank, 2018b). This arrangement is expected to further increase the effect of higher uptake of primary public education among the poor and to mitigate the benefits of public secondary that would otherwise accrue to richer families.

Figure 35: Distribution of recurrent public education spending by education level

(a) Distribution of recurrent public education spending by level



(b) Share of children age 6-17 by quintile



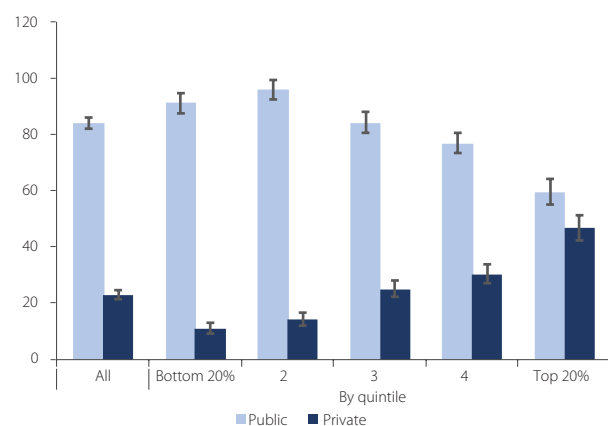
Source: World Bank based on education sector reports (panel (a)) and KIHBS 2015/16 (panel (b)).

6.3.3. While enrollment rates are declining, public (per-student) spending is increasing across the education system. Kenya spends significant public resources on all major levels of the education system. More than 40 percent of total recurrent spending is allocated to primary, more than 30 percent to secondary, and about 15 percent to university education (Figure 35a). However, the total number of students enrolled decreases drastically across these levels, partly due to the 8-4-4 structure with its focus on eight years of primary education and partly because of decreasing enrollment rates. This results in escalating levels of per student spending: the average net benefit to public primary school students is around Ksh 14,600, increasing sharply to Ksh 24,500 in secondary, and Ksh 53,000 in university.

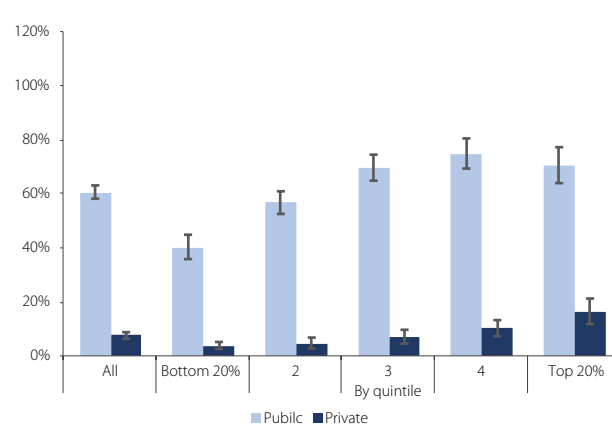
6.3.4. The combined net benefits of public education expenditure are progressive in absolute terms but become regressive at higher levels of education. The bottom 40 percent capture 14.3 percent of per capita market income but 51.7 percent of the net benefits of public education spending (Figure 37). This result is driven by early childhood education and primary education spending, of which the poorest 40 percent capture 67.8 and 58.2 percent, respectively. While public spending on early childhood education and primary and special education are progressive in absolute terms, spending on secondary public education and technical and teacher education is progressive only in relative terms. Spending on public universities, on the other hand, is regressive, due to low levels of enrollment among the poor (World Bank, 2018b).

Figure 36: Distribution of school-age children and gross enrollment, 2015/16

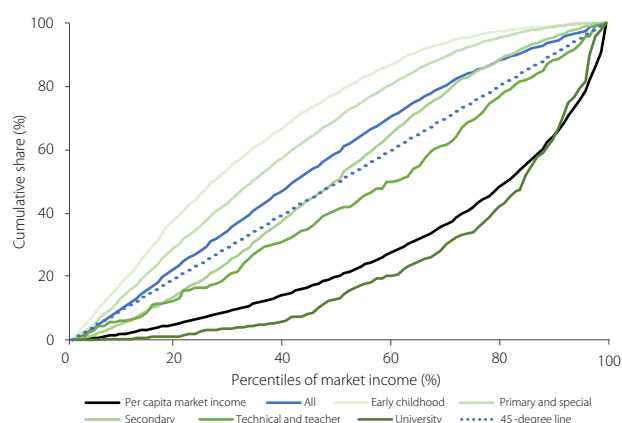
(a) Gross enrollment ratios in primary by type of provider



(b) Gross enrollment ratios in secondary by type of provider



Source: World Bank based on KIHBS 2015/16.

Figure 37: Per capita market income and net benefit of public education expenditure

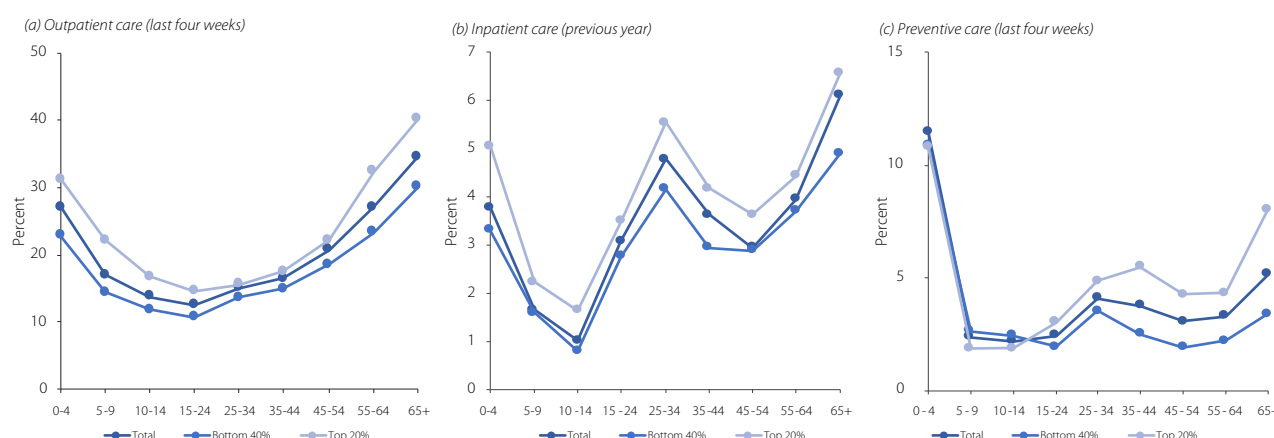
Source: World Bank based on KIHBS 2015/16 and administrative data.

6.4. Public Health Spending

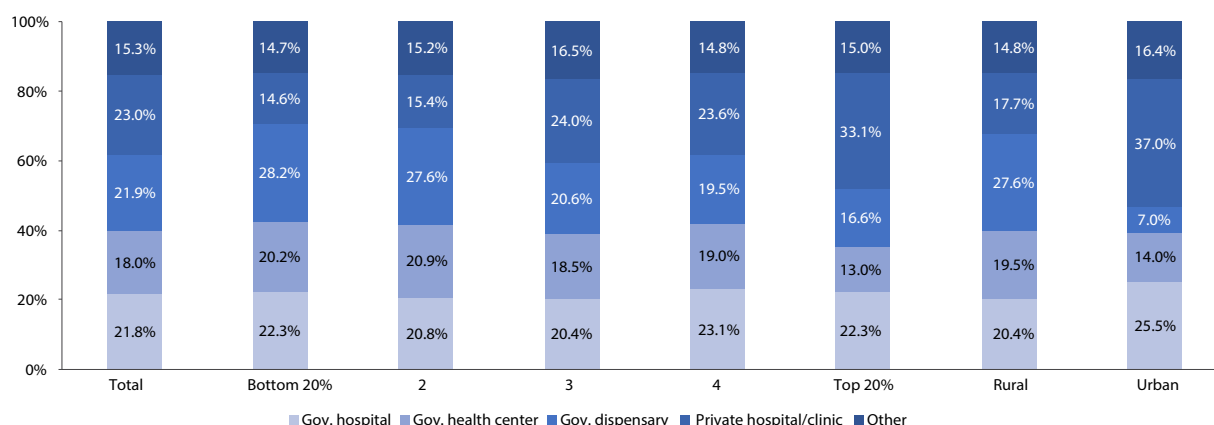
6.4.1. While the poor are less likely to seek health services in general, they are more likely to consult with public providers. As in the case of public education spending, there are several factors that determine the incidence of public health spending in Kenya. One is simply the difference in the propensity to seek care. The poor are typically less likely to seek care and this holds for all types of care; curative outpatient visits, inpatient care and preventive care. The sole exception is preventive care for children below 15 years—across all age groups (Figure 38c). But conditional on uptake, the poor are more likely to consult government-run facilities. This is true for

health centers and dispensaries, but not for government hospitals (Figure 38). Reliance on public services is high in rural areas and less so in urban areas.

6.4.2. Public spending on outpatient care in lower-level facilities is pro-poor, while user fees and over-the-counter purchases associated with outpatient care in public facilities are regressive. The overall incidence of public spending on outpatient care is nearly neutral: the bottom 40 percent account for 36.6 percent of the benefits (Figure 40a). The result follows from a combination of effects. The poor are less likely to consult health providers. But conditional on uptake, they are more likely to consult public facilities, particularly lower-level facilities such as dispensaries and health centers. Consequently, the bottom 40 percent capture 41.2 and 50.3 percent of the gross benefits associated with health centers and dispensaries but only 30.6 percent of the gross benefits associated with government hospitals. Globally, public spending on outpatient care in health centers and dispensaries is progressive in absolute terms while public spending on outpatient care in government hospitals is still progressive. However, the poorest 40 percent have a share of 16.1 percent in market income but account for 25.9 percent of all fees and over-the-counter purchases associated with public outpatient health services (Figure 40b).

Figure 38: Uptake of outpatient, inpatient, and preventive care by age group and quintile, 2015/16

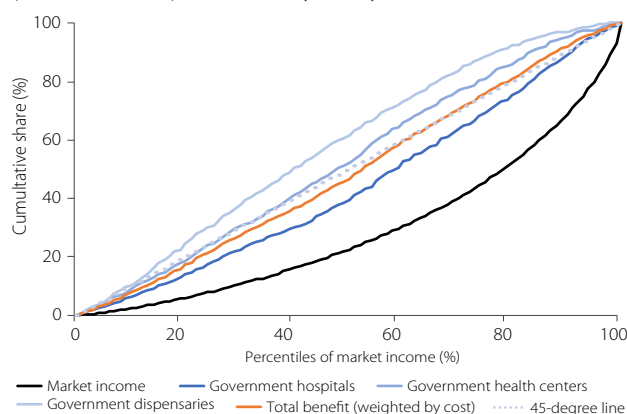
Source: World Bank based on KIHBS 2015/16.

Figure 39: Provider choice for outpatient care by quintile and locality, 2015/16

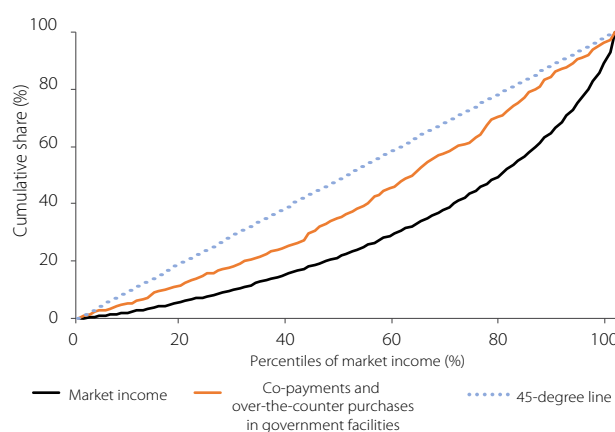
Source: World Bank based on KIHBS 2015/16.

Figure 40: Incidence of outpatient visits, public expenditure on outpatient visits, and user fees by facility

(a) Incidence of outpatient visits and gross benefits of public expenditure on outpatient visits by facility



(b) Incidence of user fees (fees and over-the-counter purchases)



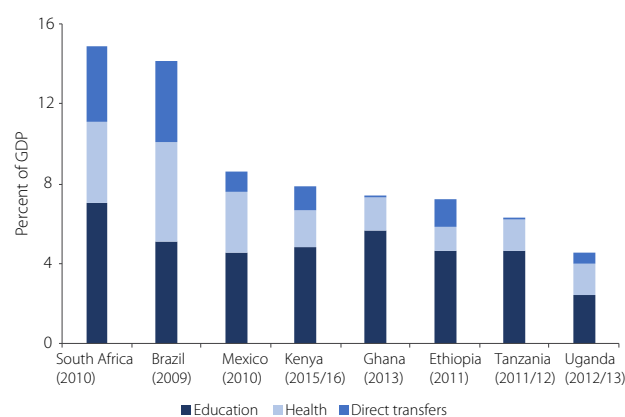
Source: World Bank based on KIHBS 2015/16 and information tabulated in Flessa, et al (2011).

6.5. Benchmarking Kenya's Social Spending

6.5.1. Across the main neighboring countries, spending on direct transfers, education and health were found to be broadly progressive. Fiscal Incidence Analysis using the CEQ methodology was carried out for Ethiopia (2011), Tanzania (2011/12) and Uganda (2012/13). The analyses find that government social sector spending on direct transfers and in-kind spending are broadly progressive, poverty reducing and have a positive but only small effect on inequality. However, subsidies such as electricity subsidies in Ethiopia and Tanzania are found to be regressive, with most of the benefits accruing to richer households who are more likely to use electricity. For all three countries, like in Kenya, direct transfers are found to be progressive when they are well targeted.

6.5.2. Education sector spending was the most pro-poor for those neighboring countries. Just as enrollment rates for poor households are high at lower levels, so are the drop-out rates at higher levels of education. Secondly,

education is the sector with the highest spending in Ethiopia, Tanzania, Kenya and Uganda. Kenya had the highest expenditure on education at 4.8 percent of GDP, followed by Ethiopia and Tanzania at 4.6 percent of GDP each. Education expenditure in Uganda was less than half of the other three EAC countries at 2.4 percent of GDP (Figure 41).

Figure 41: Social sector spending as a percent of GDP for selected countries

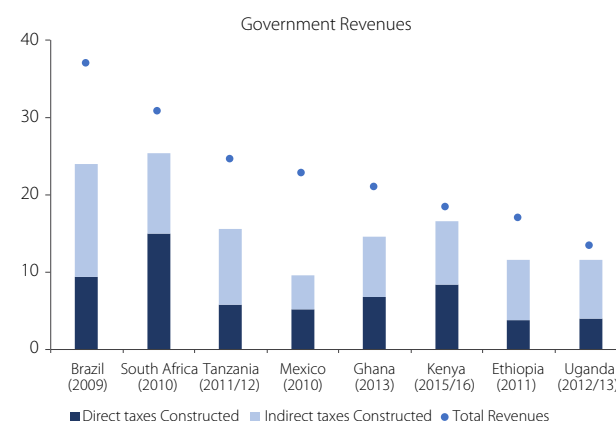
Source: The CEQ Institute and World Bank calculations

6.5.3. In general, social spending in middle income countries tends to reduce market income inequality substantially if direct transfers are well targeted. The CEQ analysis for South Africa found social sector spending on direct and in-kind transfers to be progressive, with the direct transfer programs being large and well targeted. Similarly, social sector spending in Mexico was found to be progressive with the expansion of direct transfer programs found to be pro-poor. This is also the case in Brazil where direct transfer programs such as Bolsa Familia are progressive.

6.5.4. Even though social sector spending is usually largely progressive, scaling up coverage requires a higher revenue base. The CEQ fiscal analysis on Mexico notes that benefits gained from tax exemptions are muted in comparison to foregone benefits from expenditure. In contrast, the combined redistributive effects from revenue and spending in South Africa has had a positive effect on inequality. South Africa's tax revenue in 2010 was 25.4 percent of GDP, with indirect taxes making up 10.4 percent

of GDP. Comparatively, Kenya's tax to GDP ratio was 16.7 percent in FY2015/16, with indirect taxes accounting for 8.3 percent of GDP (Figure 42). This suggests that while government spending on social protection is progressive, increasing revenue mobilization and expanding the tax base is essential before coverage can be increased significantly.

Figure 42: Government revenue as a percent of GDP for selected countries that have completed the CEQ



Source: CEQ Institute and World Bank

7. Taxes in Kenya

7.1. How does Kenya compare to her peers?

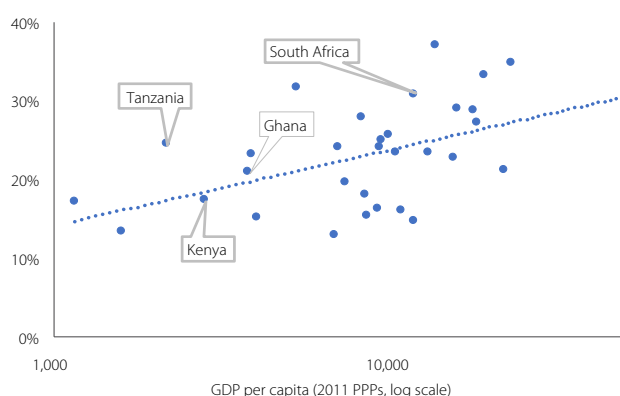
7.1.1. In 2015/16, Kenya's total government revenue was in line with peer countries, but with a relatively higher share of tax revenues. A cross-country sample of 31 low- and middle-income countries reveals that revenues as a percent of GDP averages 23 percent. In Kenya, however, total revenue represented only 18 percent of GDP, which is more typical of lower-income countries (Figure 43a). Taxes accounted for 90 percent of

government revenue, pointing to the importance of taxes relative to other sources of revenue (Figure 43b).

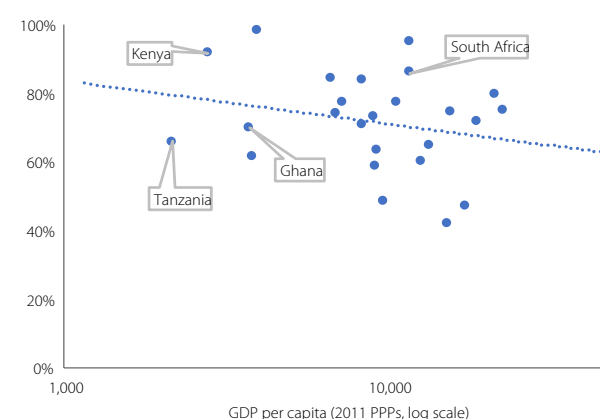
7.1.2. Both direct and indirect taxes account for about eight percent of GDP. Kenya has come to rely on direct taxes more than other countries at similar levels of economic development while the proportion of tax revenue raised from indirect taxes is comparable to regional peers (Figure 44). In 2015/16, direct taxes were

Figure 43: Total revenue and share of taxes of total revenue against GDP per capita (2011 PPPs, log scale)

(a) Total revenue as percent of GDP



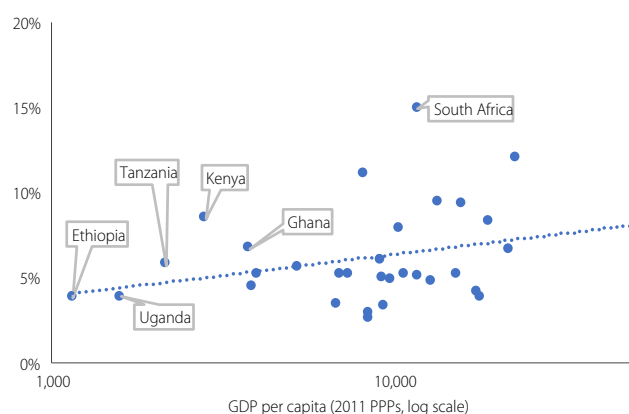
(b) Taxes as percent of total government revenue



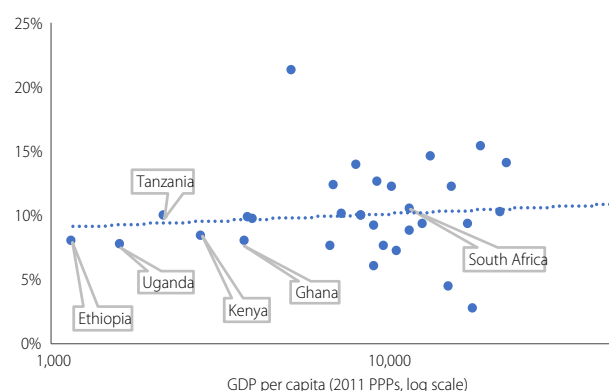
Source: Kenya Economic Survey 2017, World Development Indicators, and CEQ Institute.

Figure 44: Share of direct and indirect taxes in GDP against GDP per capita (2011 PPPs, log scale)

(a) Direct taxes as percent of GDP



(b) Indirect taxes as percent of total government revenue



Source: Kenya Economic Survey 2017, World Development Indicators, and CEQ Institute.

roughly equally split between income tax from individuals and corporate income tax. VAT contributed about 25.4 percent of the total tax revenue while excise taxes contributed about 12.3 percent. Taxes on international trade accounted for about 9.2 percent of total tax revenue.

7.1.3. Among indirect taxes, VAT in Kenya accounts for about a quarter of total tax revenue. This is a lower share than in other low- and middle-income countries. The standard rate of VAT in Kenya is 16 percent. However, a considerable number of goods and services are either

zero-rated or exempt. As a result, the share of VAT in Kenya's total tax revenue is lower relative to low- and middle-income countries, (where it accounts for around 60 percent). The number of VAT exempt categories in Kenya recently increased to more than 30, with a resulting loss in tax revenue of about two percent of GDP in 2015 (World Bank, 2017). Excise taxes account for one fourth of indirect taxes, a larger share than typically seen in low- and middle-income countries. Excise taxes are applied to tobacco products, alcoholic and non-alcoholic beverages, airtime, and some other goods and services.



Overall, exempt and zero-rated items within Kenya's VAT regime benefit the poor only marginally.

7.2. Direct Taxes – Personal Income Tax

7.2.1. Personal income is taxed based on a progressive rate structure with six tax brackets. Income tax in Kenya is imposed inter alia on business income, employment income (including benefits), rental income, pensions, and investment income. Personal income tax (PIT) is governed by the Income Tax Act (Kenya Revenue Authority, 2014). Marginal tax rates on income increase progressively from ten percent to 30 percent. In addition, every individual is entitled to an allowance, known as ‘personal relief,’ which was Ksh 13,944 in 2015/16. The present analysis uses the tax brackets as applied in 2015 and 2016.

7.2.2. The relationship between structural progressivity, changes in the average or marginal tax rate along the income distribution and observed progressivity of PIT is empirically ambiguous. Efficiency considerations aside, higher top tax rates and the resulting increase in structural progressivity imply that the rich pay a relatively larger share of their pre-tax income in taxes. The inequality-improving effect may further be strengthened if the additional revenue is progressively redistributed. While this may seem intuitive, responses to taxation of personal income such as tax evasion and tax avoidance imply that the empirical relationship between structural progressivity and actual inequality is ambiguous.

7.2.3. Direct taxes are progressive. The poorest 40 percent of Kenya’s population in terms of per capita market income accounts for 14.3 percent of market income but less than one percent of direct taxes (Figure 45a). In contrast, 80 percent of direct taxation incidence is borne by the richest ten percent of the population. On average, direct individual taxes account for only 1.2 percent of

total household expenditure among the poorest quintile, (Figure 45b) but their share increases to 4.5 percent in the fourth quintile and to more than eight percent in the top quintile. This is a result of both the progressivity of the tax system and limited access to formal-sector jobs among the poor. Less than five percent of all formal sector jobs are held by individuals in the bottom 20 percent while 48 percent are held by individuals in the top 20 percent.

7.2.4. The distribution of taxpayers across tax brackets suggests that a large share—one third—of those that pay income tax end up paying the highest marginal tax rate of 30 percent. Only 2.8 percent of individuals report employer contributions to the NSSF whose taxable income falls below the personal relief threshold. Around 20 percent fall into the two subsequent tax brackets, with marginal tax rates of 10 and 15 percent, respectively. On average, they pay 7.4 and 9.4 percent of their gross income in taxes, respectively. Almost one in three individuals that are assumed to pay income tax in the analysis are in the top tax bracket with a marginal tax rate of 30 percent. The estimated average tax rate in this bracket is 18 percent.

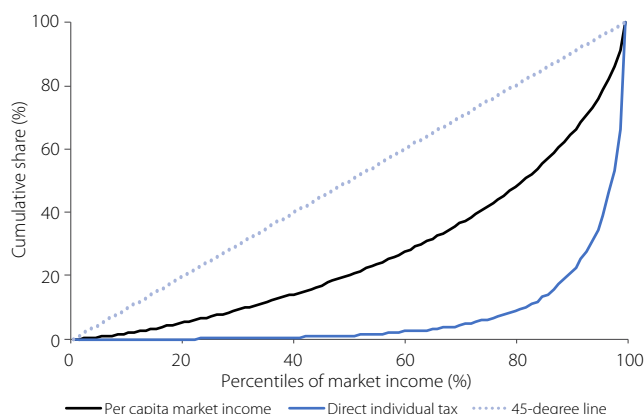
7.3. Indirect Taxes

Value Added Tax

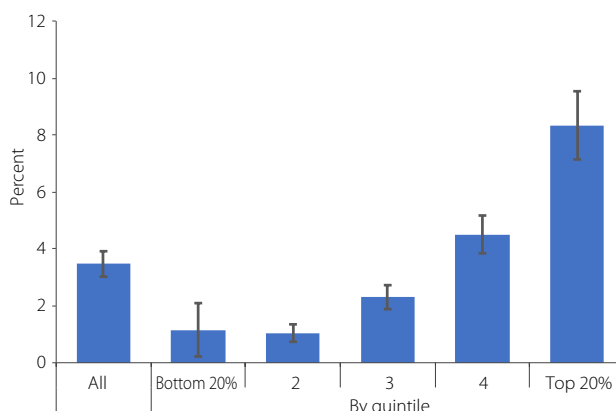
7.3.1. Goods and services in Kenya’s VAT regime are either standard-rated, zero-rated, or exempt. The standard VAT rate in Kenya is 16 percent. Exclusion from VAT appears in two different ways, zero-ratings and exemptions. Of the 460 items for which expenditure was recorded in the survey data, 311 were taxed at 16 percent, 29 were zero-rated, and 120 were exempt. Most exempt goods and services were found in the agricultural sector.

Figure 45: Lorenz and concentration curves for per capita market income and direct taxes on individual income and share in total expenditure by quintile

(a) Lorenz- and concentration curve for direct taxes and market income



(b) Share of personal income tax in total expenditure by quintile



Source: World Bank based on KIHBS 2015/16.

Note: 95-percent confidence intervals indicated in panel (b).

The exemption also extends to agricultural inputs such as seeds, fertilizers, and tractors (World Bank, 2017). Two alternative assumptions were made regarding exempt goods in this analysis. Exempt items were either (1) treated as taxed at the 16-percent rate or (2) treated as zero-rated items. While the actual tax rate will typically fall somewhere in-between, it turned out that the distributional implications of these assumptions do not differ substantially. Given that many exempt items in the data pertained to the agricultural sector, in which inputs are often also exempt, it was decided to proceed with the assumption that exempt goods carry no VAT.

7.3.2. VAT is mildly progressive but close to neutral, regardless of how exempt goods are treated. The burden of VAT is distributed almost proportionally to market income (Figure 46). For instance, the bottom-40 percent account for between 12.4 and 14.1 percent of the VAT burden, depending on whether exempt items are treated as zero-rated or taxed at 16 percent, compared to a share in market income of 14.3 percent. The average share of VAT in total household expenditure is 8.4 percent if exempt items are assumed to be zero-rated and 9.0 percent if they are assumed to carry 16 percent VAT. The expenditure share among the bottom 20 percent increases from 7.2 to 8.4 percent in going from zero-rates to the full 16-percent tax rate and falls from 10.3 to 9.7 among the richest 20 percent.

7.3.3. Exemptions could be eliminated or replaced by zero-rates for merit goods without major distributional consequences. Exemptions do not have a large effect on the relative distribution of welfare because they are both applied to merit goods and other goods that could

be considered luxury goods and services, such as air ticketing services supplied by travel agents. The removal of exemptions would boost tax collection without major impacts at least on the relative distribution of welfare. A revenue-neutral removal of some exemptions for luxury items and a concomitant shift of merit goods into the category of zero-rated goods would have positive effects for the poor. Alternatively, additional revenue from the removal of exemptions and zero rates could be redistributed in ways that are less distortive, e.g. through cash transfers. However, greater in-depth analysis of this question is called for to identify exemption and zero-rates that appear poorly targeted to the bottom of the distribution.

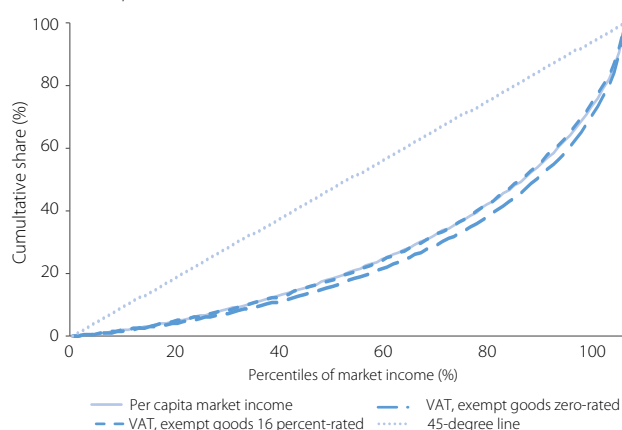
Excise Tax

7.3.4. The analysis of excise tax in this report accounts for more than 80 percent of revenue from this tax. Beverages and cigarettes are taxed based on quantities whereas consumption of airtime is taxed at ten percent. Excise tax on financial transactions and other commodities (jewelry, cosmetics, and locally assembled vehicles) is not considered. However, the items included in the analysis account for 87 and 82 percent of total revenue from excise tax in 2015 and 2016, respectively.

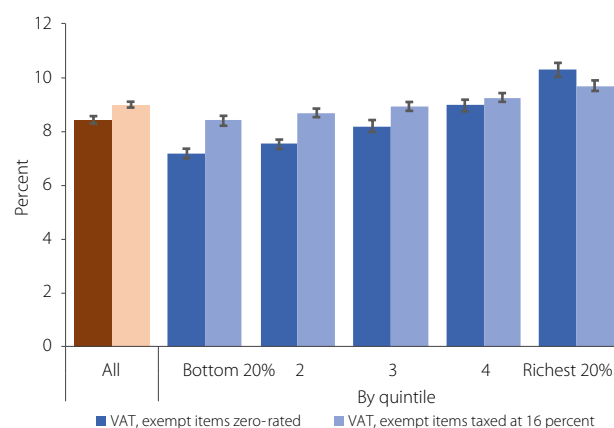
7.3.5. Excise taxes are progressive except for tobacco products. The bottom 40 percent, which account for 14.3 percent of market income, account for only 6.6 percent of all excise taxes, rendering the overall tax highly progressive (Figure 48a). This is driven mainly by excise taxes on beer (3.9 percent), wine and spirits (4.4), non-alcoholic beverages (3.9), and air time (6.6). Excise duty on tobacco is initially mildly progressive but then

Figure 46: Lorenz and concentration curves for market income and VAT under different assumptions about exempt items and share in total expenditure by quintile

(a) Lorenz and concentration curve for market income and VAT (under different assumptions)



(b) Share of VAT in total expenditure by quintile



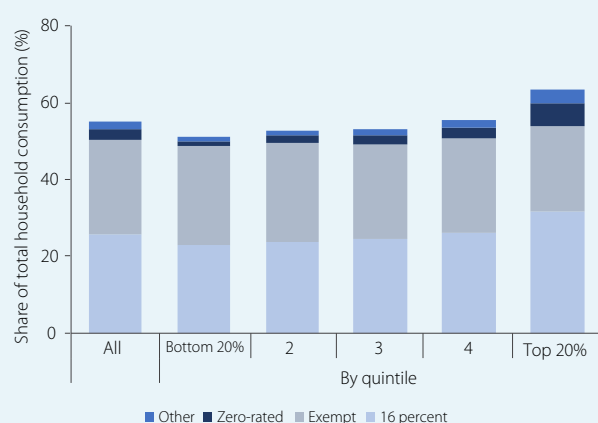
Source: World Bank based on KIHBS 2015/16 and administrative data (KNBS, 2017).

Box B.3: Can VAT be progressive?

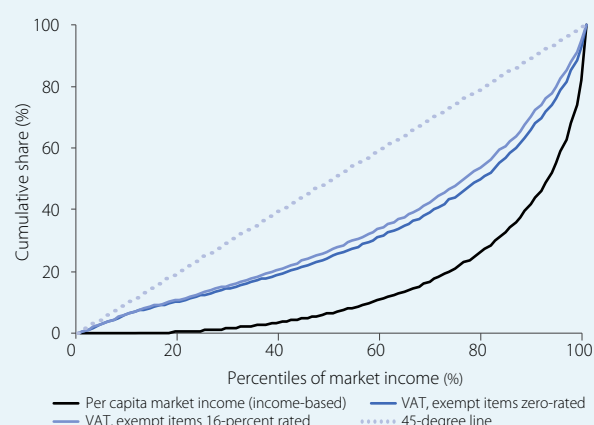
VAT usually disproportionately affects the poor. Why not in Kenya? Exempt and zero-rated items may be disproportionately consumed by the poor, contributing to a mildly progressive impact of VAT. Is this also true for Kenya? Expenditure shares (in total expenditure) of zero-rated goods are generally too small to make much of a difference, increasing from only 3.1 percent in the bottom quintile to 6.2 percent in the top quintile. But the share of exempt items falls from 46.9 percent among the poorest 20 percent to 37.2 percent among the richest 20 percent. Hence, while exemptions are not particularly well-targeted to the poor, they do benefit from them somewhat. Also, the poor typically have lower shares of expenditure in consumption because they rely more heavily on auto-consumption or transfers. In Kenya, the share of expenditure in total consumption increases from 49.2 percent among the bottom 20 percent to 62.9 percent among the richest 20 percent (Figure 47a).

Figure 47: Share of expenditure in total consumption of items differentiated by type of VAT

(a) Share of expenditure in total consumption by VAT type



(b) Lorenz and concentration curve for (income-based) market income and VAT (under alternative assumptions) by VAT type



Source: World Bank based on KIHBS 2015/16.

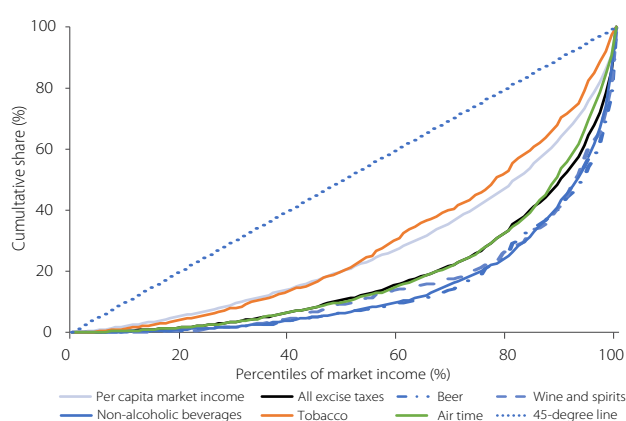
The use of consumption as the relevant welfare indicator makes the result of progressive VAT more likely. VAT is foremost a tax on consumption. It is often assumed to be regressive as the share of consumption in income is lower for the rich than for the poor, the difference being savings. Here, however, consumption is used as the relevant welfare indicator instead of income. This implies that even if expenditure were equal to consumption and there were no exemptions, VAT could at most be neutral. If progressivity would be measured against a welfare indicator based on actual household income, VAT would clearly be regressive (Figure 47b). Hence, differences in the method used to assess economic welfare are largely responsible for this result.

turns regressive around the median household. The bottom ten percent account for only 2.2 percent of per capita market income yet 1.4 percent of tobacco excise tax. However, the concentration curve for tobacco excise duties eventually crosses the Lorenz curve so that the poorest 60 percent already account for 30.7 percent of tobacco excise tax, a larger share than their 27.5 percent in market income. This suggests lower relative spending among the poor and higher relative spending among the middle quintiles. The expenditure shares of excise taxes are small (Figure 48b). Across the entire population, excise tax duty accounts for little more than one percent of total household expenditure. The share rises from 0.6 percent among the poorest quintile to 2.3 percent among the richest 20 percent of the population.

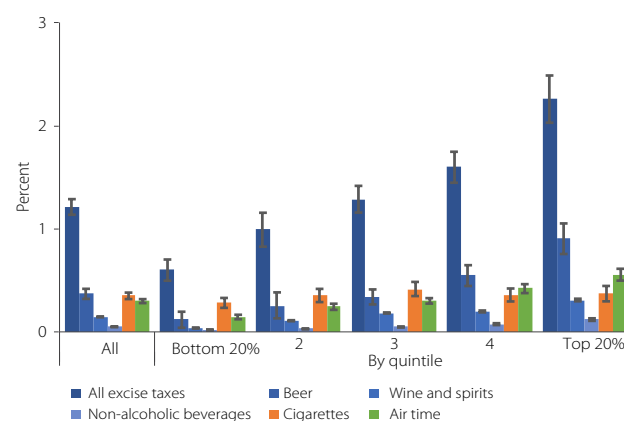
7.3.6. Adverse economic effects of tobacco consumption that arise only in the medium- and long-term have the potential to alter the assessment of the progressivity of excise duty on tobacco. Tobacco taxes are often assessed as regressive as low-income households tend to allocate a larger share of their budgets to the purchase of tobacco products. On the other hand, because tobacco consumption is associated with shorter life expectancy, higher medical expenses, added years of disability, and negative externalities through secondhand smoke, tobacco taxes are considered an effective policy tool to reduce tobacco consumption (Lewit & Coate, 1982). To the extent that tobacco consumption is price-elastic, higher duties have the potential to reduce these adverse economic effects. Recent evidence from extended cost-

Figure 48: Lorenz and concentration curves for market income and excise taxes and share in total expenditure by quintile

a) Lorenz and concentration for market income and excise taxes



(b) Share of excise taxes in total expenditure by quintile



Source: World Bank based on KIHBS 2015/16.

benefit analyses in developing countries suggest that the aggregate net effect of immediate negative income variations and long-term benefits of reduced uptake can result in positive benefits that can be more pronounced

among low-income households (Fuchs & Meneses, 2017a; Fuchs & Meneses, 2017b; Fuchs, Del Carmen, & Kechia Mukong, 2018).

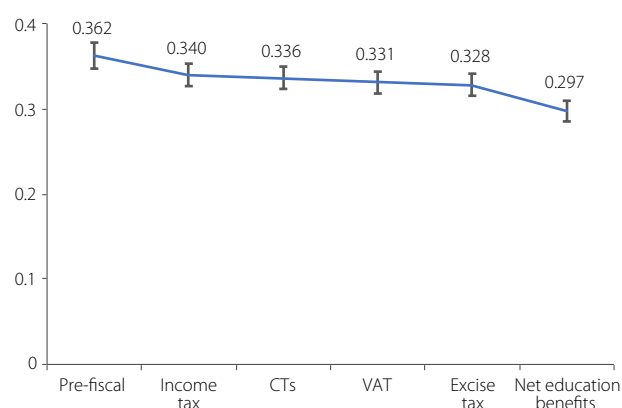
8. Effects on Poverty and Inequality

8.1.1. Direct taxes and transfers have virtually no correlation with poverty but a negative relationship with inequality. The poverty headcount ratio tends to increase with direct taxes by around 0.6 percentage points and decreases with direct transfers by almost the same amount (Figure 49). While the correlations between these interventions and poverty headcount are small, the Gini index decreases by 2.3 percentage points with direct taxes and by another one third of a percentage point with cash transfers (Figure 49a). The analysis suggests that the top ten percent account for 80 percent of the income tax burden which is reflected here in a sharp drop in their share in income (Figure 49b).

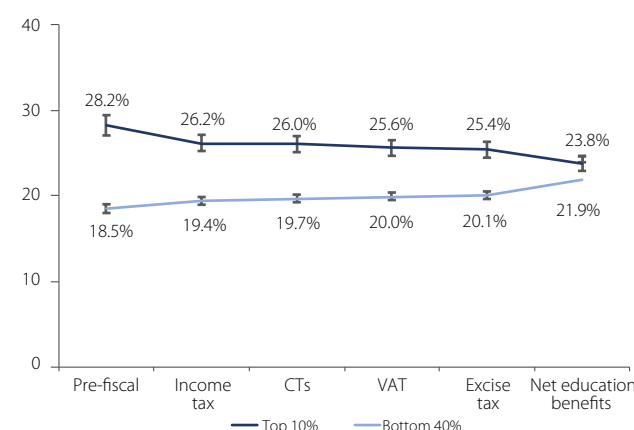
8.1.2. Increases in VAT and excise taxes are positively associated with poverty and have a small, negative relationship with inequality. The poverty rate increases by more than five percentage points after VAT is accounted for. However, because VAT is mildly progressive and its burden is shared across all income groups, it also has a sizable, negative relationship with the Gini index (0.6 percentage points; Figure 15a). Excise taxes, which generate only half of the revenue that VAT generates, have a similar effect on poverty and inequality. They further increase poverty, by about one percentage point, and lower the Gini index by 0.3 percentage points (Figure 49a).

Figure 49: Combined effects of taxes and transfers on inequality – Gini index and income shares of top 10 percent and bottom 40 percent

(a) Gini index



(b) Income shares



Source: World Bank based on KIHBS 2015/16 and administrative data as detailed in the text.

8.1.3. The net benefits of public education spending have a large, negative relationship with inequality.

Public education spending is large and progressive in absolute terms, primarily through spending on pre-primary, primary, and secondary. Inequality measured by the Gini index drops to only 0.297 after the net benefits of public education spending are accounted for, causing the income shares of the top ten percent and the bottom 40 percent to converge significantly (Figure 49). This result should be interpreted carefully. The production cost of education is not necessarily equal to households' willingness-to-pay for public education, particularly in the Kenyan context in which there is evidence of large rents earned by civil-service teachers.

8.1.4. As in other countries in Sub-Saharan Africa, the effects of direct transfers and taxes on poverty are moderate in Kenya. Cross-country comparisons suggest that poverty headcount ratios in SSA, using the World Bank's \$1.25-poverty line based on 2005 PPPs, do not change much in going from market income to disposable income (Figure 50a). Such changes range from a reduction by only a tenth of a percentage point in Tanzania to one percentage point in Ethiopia. Kenya falls roughly in the middle of this range with a reduction in the poverty headcount by half a percentage point. Using the \$2.50-poverty line, the positive effect on poverty of direct taxes even dominates the poverty-reducing effect of direct transfers in Ghana, Uganda, Kenya, and Tanzania but the overall effect remains small (Figure 50b). It seems plausible that the same factors are at play that are also observed in Kenya, namely a small effective tax base due to high levels of informality and direct transfer programs that are small in terms of coverage. The major exception

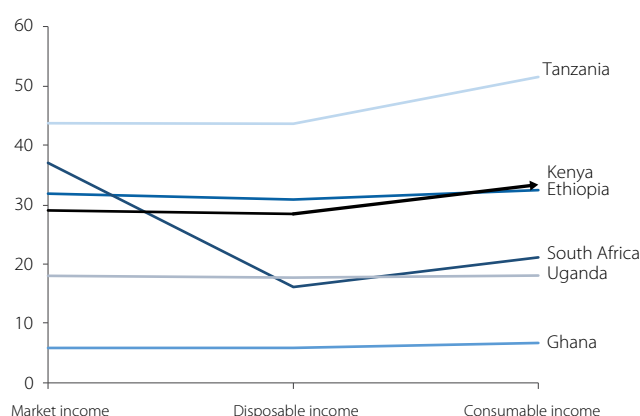
to this pattern is South Africa, which achieves significant poverty reduction in going from market to disposable income, mainly as a result of large direct transfer programs.

8.1.5. As in Kenya, indirect taxes are often associated with an increase in poverty in Sub-Saharan Africa. In going from disposable to consumable income, poverty rates increase in most countries, including those in Sub-Saharan Africa. The increase in poverty headcount using the \$1.25-poverty line ranges from three tenths of a percentage points in Uganda to 7.9 percentage points in Tanzania. With an increase in poverty of 5.9 percentage points, Kenya is close to the upper end of this range. However, it should be noted again that indirect subsidies in Kenya, while likely negligible, were not included in this study.

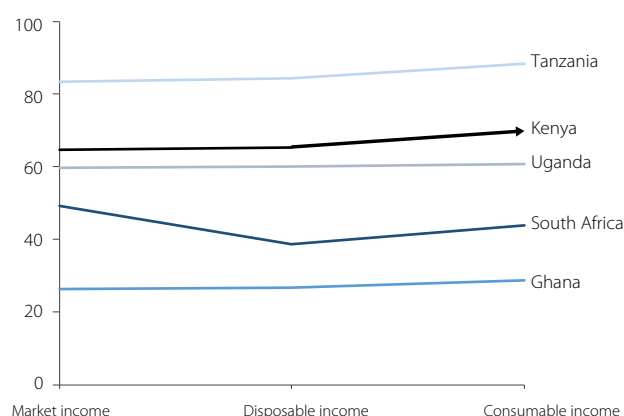
8.1.6. Kenya achieves little poverty reduction through direct taxes and transfers while indirect taxes are associated with increase in poverty. Among countries for which similar distributional impact analyses have been completed, poverty reduction (based on the \$1.25-poverty line) in going from market income to disposable income varies widely (Figure 51a). For instance, almost one fifth of South Africa's population is initially lifted out of poverty at this stage, compared to almost basically no one in Ghana and Armenia. While South Africa is an outlier here, countries like Brazil and Mexico, which were among the first to adopt large-scale cash transfer programs, are also among those that achieve significant reductions in extreme poverty at this stage. Kenya's reduction of half a percentage point ranks among the upper end of the distribution. Only seven out of a total of 29 countries in the dataset achieve less poverty reduction. On the other hand,

Figure 50: Poverty headcount ratios (using the World Bank's \$1.25 and \$2.50-poverty lines based on 2005 PPPs) across countries and income concepts

(a) Poverty rates (\$1.25 2005 PPPs)



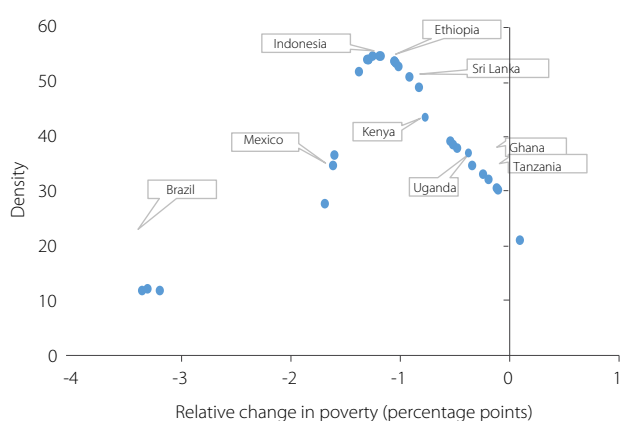
(b) Poverty rates (\$2.50 2005 PPPs)



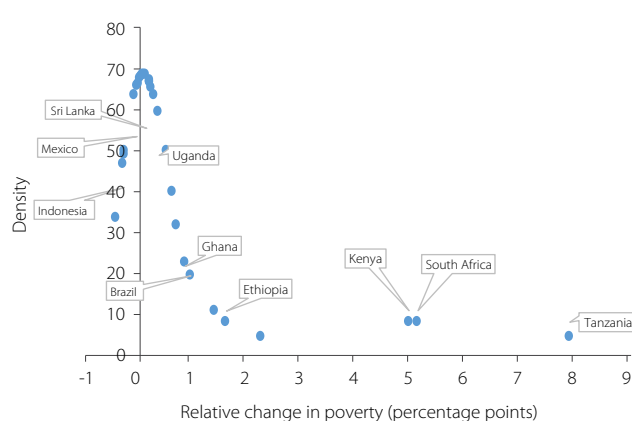
Source: World Bank based on KIHBS 2015/16 and administrative data as detailed in text as well as data from the CEQ institute.

Figure 51: Density distribution of poverty effects in going from market to disposable and from disposable to consumable income (based on the World Bank's \$1.25-poverty line using 2005 PPPs)

(a) Density of change in poverty rate: market to disposable income



(b) Density of change in poverty rate: disposable to consumable income



Source: World Bank based on KIHBS 2015/16 and administrative data as detailed in text as well as data from the CEQ institute.

Note: The observation for South Africa is removed from panel (a) as an outlier (see text).

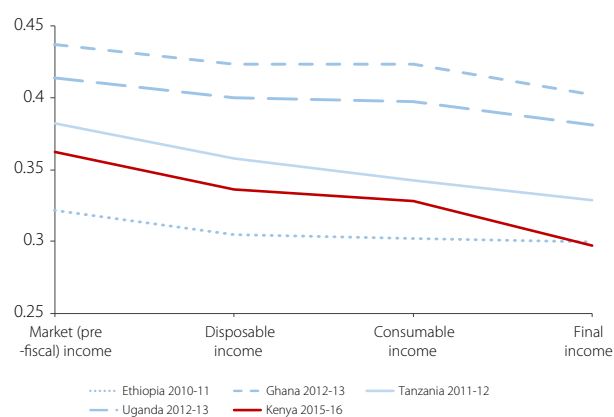
only two countries, Tanzania and South Africa, register a larger effect on poverty of indirect taxes and transfers (Figure 51b). Results are qualitatively similar when the \$2.50-poverty line is used.

8.1.7. The inequality-reducing effect of direct taxes and transfers between market income and consumable income in Kenya is similar to other countries in the region. Ethiopia, Ghana, Tanzania, and Uganda all reduce inequality through direct taxation and transfers, ranging from a decline in the Gini by 1.3 percentage points in Ghana and Uganda to 2.5 percentage points in Tanzania (Figure 52). With 2.6 percentage points, the reduction in Kenya is at the upper end of this range but not very different from that of Tanzania. As in Kenya, inequality barely changes in these countries between disposable income and consumable income. Only Tanzania achieves a reduction by 1.5 percentage points.

8.1.8. The negative effect of public education spending on poverty and inequality is substantially more pronounced in Kenya relative to benchmark

countries. The effect of public education spending on inequality is pronounced in Ghana, Tanzania, and Uganda, at 2.1, 1.3, and 1.7 percent. However, it is much larger in Kenya, at 3.1 percent. It should be noted that the estimates for Kenya do not include public health spending. Again, there are major concerns about allocating public education spending to households based on the production-cost approach, maybe more so than in other countries.

Figure 52: Gini coefficient by CEQ income concepts and country



Source: World Bank based on KIHBS 2015/16 and administrative data as well as data from the CEQ institute.

9. Summary and Policy Implications

9.1.1. Overall, taxes and transfers have mostly an attenuating effect on inequality while their effect on poverty is more mixed. This report considers the combined effect of taxes and transfers in Kenya on poverty and inequality. Direct taxes and transfers reduce inequality and are almost exactly off-setting in their effect on poverty. Indirect taxes, while positively associated

with poverty, are progressive and thus reduce inequality. Additionally, while public spending on education is pro-poor, the analysis underlying this assertion relies on strong assumptions. Overall, Kenyan spending and taxation policies are associated with a change in inequality and poverty to a degree similar to what is observed regionally.

9.1.2. The Government of Kenya could consider further expanding direct cash transfer programs, but this will also require enhanced revenue mobilization.

Cash transfer programs are well-targeted so that a large fraction of the benefits is captured by the poor. However, cash transfer schemes in Kenya cover only a small portion of the population. These programs, which have been introduced only recently, could further be expanded in order to increase their poverty-reducing effect. However, more robust revenue mobilization is needed to increase coverage significantly.

9.1.3. Overall, exempt and zero-rated items within Kenya's VAT regime benefit the poor only marginally.

The report finds that the variation in consumption shares of exempt and zero-rated items across the welfare distribution is small. A review of the VAT law might help to make VAT more progressive or, alternatively, increase revenue that could then be employed in progressive cash transfer programs, while also addressing other concerns

about exemptions. However, a more detailed follow-up analysis of exemptions and zero-rates would be necessary to determine item-level incidence, including the recent removal of exemptions on petroleum products.

9.1.4. Shifting public resources from higher-level health facilities to lower-level facilities is likely to benefit the poor.

The results suggest that redirecting spending from higher-level public health facilities to primary care facilities has the potential to benefit the poor and might increase access. However, it is important in this case to also assess the absorptive capacities of these facilities. This is less clear for public spending on tertiary education. The immediate benefits, calculated as the cost of producing public tertiary education, are captured overwhelmingly by the top 20 percent. But higher education has also been linked to an economy's prospect of achieving high rates of growth through fostering technological convergence (Bloom, Canning, Chan, & Luca, 2014).



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STATISTICAL TABLES

Table 1: Macroeconomic environment

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018e
GDP growth Rates (percent)	3.3	8.4	6.1	4.6	5.9	5.4	5.7	5.9	4.9	5.7
Agriculture	-2.3	10.1	2.4	3.1	5.4	4.3	5.3	4.7	1.6	4.3
Industry	3.7	8.7	7.2	4.2	5.3	6.1	7.3	5.7	3.6	4.0
Manufacturing	-1.1	4.5	7.2	-0.6	5.6	2.5	3.6	2.7	0.2	
Services	6.2	7.3	6.1	4.7	5.4	6.0	6.0	6.7	6.9	7.3
Fiscal Framework (percent of GDP)/ ¹										
Total revenue	19.4	19.1	18.7	19.2	19.2	19.0	18.7	18.3	16.8	20.0
Total expenditure	24.0	23.8	23.7	25.1	25.6	28.1	27.2	27.5	23.9	26.3
Grants	1.0	0.6	0.4	0.5	0.5	0.5	0.5	0.3	0.3	0.5
Budget deficit (including grants)	-5.8	-3.5	-4.5	-5.7	-6.1	-8.1	-7.3	-9.1	-6.9	-5.8
Total debt (net)	40.7	43.1	40.6	42.1	47.8	48.8	55.5	57.5	57.0	57.2
External Account (percent of GDP)										
Exports (fob)	12.2	13.1	13.9	12.3	10.6	10.1	9.4	8.2	7.7	7.6
Imports (cif)	25.6	28.7	33.8	30.8	29.2	28.6	24.5	19.1	21.3	21.1
Current account balance	-4.6	-5.9	-9.1	-8.3	-8.8	-9.8	-6.8	-5.3	-6.7	-6.2
Financial account	-10.2	-8.1	-8.2	-11.0	-9.4	-11.4	-8.0	-5.9	-6.1	-6.5
Capital account	0.7	0.6	0.6	0.5	0.3	0.4	0.4	0.3	0.2	0.3
Overall balance	-3.0	-0.4	2.1	-2.4	-0.7	-2.4	0.4	-0.2	0.2	-0.6
Prices										
Inflation	9.2	4.0	14.0	9.4	5.7	6.9	6.6	6.3	8.0	5.2
Exchange rate (average Ksh/\$)	77.4	79.2	88.8	84.5	86.1	87.9	98.2	101.5	103.4	105.0

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 2017 are actuals for 2017/18

Table 2: GDP growth rates for Kenya and EAC (2011-2017)

	2011	2012	2013	2014	2015	2016	2017	2018e
Kenya	6.1	4.6	5.9	5.4	5.7	5.9	4.9	5.7
Uganda	9.4	3.8	3.6	5.1	5.2	4.7	4.0	5.5
Tanzania	7.9	5.1	7.3	6.9	7.0	7.0	6.4	6.6
Rwanda	7.8	8.7	4.7	7.6	8.8	6.0	6.1	6.5
Average	7.8	5.6	5.3	6.2	6.7	5.9	5.3	6.1

Source: World Bank
Note: "e" denotes an estimate

Table 3: Kenya annual GDP

Years	GDP, current prices	GDP, 2009 constant prices	GDP/capita, current prices	GDP growth
	Ksh millions	Ksh millions	US\$	Percent
2007	2,151,349	2,765,595	839	6.9
2008	2,483,058	2,772,019	917	0.2
2009	2,863,688	2,863,688	920	3.3
2010	3,169,301	3,104,303	967	8.4
2011	3,725,918	3,294,026	987	6.1
2012	4,261,370	3,444,339	1,155	4.6
2013	4,745,594	3,646,821	1,229	5.9
2014	5,403,471	3,842,186	1,335	5.4
2015	6,284,191	4,061,901	1,355	5.7
2016	7,194,163	4,300,302	1,463	5.9
2017	7,749,435	4,510,390	1,508	4.9

Source: Kenya National Bureau of Statistics and World Development Indicators



Table 4: Broad sector growth (y-o-y, Percent)

Year	Quarterly	Agriculture	Industry	Services	GDP
2012	Q1	3.1	5.2	4.3	4.1
	Q2	2.2	2.1	5.3	4.2
	Q3	3.1	5.2	4.4	5.2
	Q4	4.2	4.2	4.9	4.7
2013	Q1	5.3	9.4	4.0	6.1
	Q2	6.8	6.9	6.7	7.5
	Q3	5.8	6.2	5.8	6.4
	Q4	3.6	-0.6	5.2	3.5
2014	Q1	4.2	5.8	5.6	5.2
	Q2	4.4	9.9	5.8	6.0
	Q3	7.1	3.5	5.1	4.6
	Q4	1.8	5.3	7.5	5.6
2015	Q1	7.8	6.4	5.2	5.7
	Q2	4.4	7.0	6.3	5.6
	Q3	4.0	9.1	7.0	6.1
	Q4	4.5	6.6	5.5	5.5
2016	Q1	4.5	4.6	6.9	5.3
	Q2	7.7	6.4	6.5	6.2
	Q3	4.7	5.9	6.4	5.7
	Q4	1.1	5.8	7.2	6.3
2017	Q1	0.9	4.1	7.2	4.7
	Q2	0.8	3.6	7.0	4.7
	Q3	3.7	2.5	6.2	4.7
	Q4	1.4	4.1	7.0	5.4
2018	Q1	5.2	4.1	6.8	5.7
	Q2	5.6	4.7	6.9	6.3

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 = Wholesale and retail trade + Accommodation and restaurant + Transport and storage + Information and communication + Financial and insurance + Public administration + Professional administration and support services + Real estate + Education + Health + Other services + FISIM + Taxes on products

Table 5: Contribution by Broad sub-sectors (percentage points)

	Quarterly	Agriculture contribution to GDP	Industry by sub sector contribution				Industries	Service by sub sector contribution						Services
			Mining and quarrying	Manufacturing	Electricity and water supply	Construction		Accommodation and restaurant	Transport and storage	Real estate	Information and communication	Financial and insurance	Other	
2012	Q1	0.8	0.1	-0.1	0.2	0.7	0.9	0.2	0.5	0.4	0.4	0.0	0.5	1.9
	Q2	0.5	0.2	-0.2	0.1	0.3	0.4	0.0	0.5	0.3	-0.2	0.3	1.4	2.4
	Q3	0.6	0.2	0.1	0.2	0.5	1.0	0.0	-0.1	0.3	-0.4	0.4	2.0	2.1
	Q4	0.8	0.2	0.0	0.2	0.4	0.9	0.1	-0.1	0.3	0.5	0.6	0.9	2.4
2013	Q1	1.4	0.2	1.0	0.1	0.4	1.7	-0.5	-0.6	0.3	0.4	0.6	1.5	1.8
	Q2	1.7	-0.2	0.8	0.2	0.4	1.3	0.0	0.1	0.3	0.3	0.6	1.7	3.0
	Q3	1.1	0.0	0.6	0.2	0.4	1.2	0.2	0.2	0.4	0.4	0.4	1.3	2.8
	Q4	0.7	-0.1	0.1	0.1	-0.1	-0.1	0.0	0.7	0.4	0.5	0.3	0.7	2.5
2014	Q1	1.1	0.1	0.5	0.1	0.3	1.1	-0.3	0.2	0.4	0.4	0.4	1.4	2.5
	Q2	1.1	0.2	0.8	0.1	0.7	1.8	-0.3	0.4	0.4	0.3	0.4	1.4	2.6
	Q3	1.4	0.0	0.1	0.2	0.4	0.7	-0.4	0.6	0.5	0.6	0.5	0.7	2.5
	Q4	0.3	0.2	-0.3	0.2	0.9	1.0	0.0	0.3	0.5	0.7	0.6	1.6	3.7
2015	Q1	2.0	0.1	0.3	0.2	0.6	1.2	-0.1	0.5	0.5	0.3	0.6	0.6	2.3
	Q2	1.1	0.1	0.3	0.3	0.6	1.3	0.0	0.6	0.5	0.2	0.5	1.0	2.8
	Q3	0.8	0.2	0.5	0.2	0.8	1.7	0.0	0.7	0.6	0.2	0.7	1.1	3.4
	Q4	0.8	0.1	0.4	0.1	0.7	1.3	0.1	0.4	0.7	0.3	0.5	0.8	2.8
2016	Q1	1.2	0.1	0.1	0.2	0.4	0.9	0.1	0.5	0.7	0.4	0.5	0.8	3.0
	Q2	1.8	0.1	0.5	0.3	0.4	1.2	0.1	0.5	0.7	0.3	0.5	0.9	3.0
	Q3	0.9	0.1	0.4	0.2	0.5	1.2	0.1	0.4	0.7	0.3	0.4	1.2	3.1
	Q4	0.2	0.2	0.1	0.1	0.7	1.1	0.2	0.7	0.7	0.5	0.2	1.2	3.6
2017	Q1	0.2	0.1	0.1	0.1	0.4	0.8	0.3	0.6	0.5	0.5	0.3	1.1	3.2
	Q2	0.2	0.1	0.0	0.2	0.5	0.7	0.1	0.5	0.5	0.3	0.2	1.5	3.2
	Q3	0.7	0.1	0.0	0.1	0.3	0.5	0.1	0.4	0.5	0.4	0.1	1.5	3.0
	Q4	0.2	0.1	0.0	0.1	0.6	0.8	0.1	0.5	0.6	0.5	0.2	1.7	3.6
2018	Q1	1.3	0.1	0.2	0.1	0.4	0.8	0.2	0.4	0.6	0.5	0.2	1.3	3.1
	Q2	1.3	0.0	0.3	0.2	0.3	0.9	0.1	0.5	0.5	0.4	0.1	1.4	3.2

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

Note: Other = Wholesale and retail trade + Public administration + Professional, administration and support services + Education + Health + Other services + FISIM

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	2.6	-4.6	5.8	6.7	-1.0	4.4	5.2	7.5	4.7	5.4
	Q2	-10.2	2.2	2.3	-1.2	2.0	4.6	-1.3	5.3	5.2	-3.5	4.3	4.8
	Q3	-21.9	3.1	1.9	3.8	4.6	4.7	5.2	4.5	4.8	-1.5	4.5	4.5
	Q4	0.3	4.2	2.9	6.7	4.4	4.2	1.9	4.8	4.7	2.5	4.7	4.6
2013	Q1	49.8	5.3	3.3	-0.6	8.8	4.9	-1.8	3.9	4.6	8.3	5.5	4.8
	Q2	-8.9	6.8	4.7	-2.8	7.0	6.2	1.3	6.7	4.9	-1.8	7.0	5.6
	Q3	-22.7	5.8	5.7	3.7	6.8	6.7	4.3	5.8	5.3	-1.7	7.2	6.2
	Q4	-1.9	3.6	5.6	-0.8	-0.7	5.3	1.5	5.3	5.4	-1.1	3.5	5.9
2014	Q1	50.7	4.2	5.4	5.9	5.8	4.6	-1.6	5.6	5.8	10.1	5.2	5.8
	Q2	-8.7	4.4	4.7	0.9	9.9	5.4	1.6	5.8	5.6	-1.0	6.0	5.5
	Q3	-20.7	7.1	4.8	-2.4	3.5	4.6	3.6	5.1	5.5	-2.9	4.6	4.9
	Q4	-6.6	1.8	4.4	0.9	5.3	6.1	3.8	7.5	6.0	-0.2	5.6	5.4
2015	Q1	59.8	7.8	5.5	7.0	6.4	6.2	-3.7	5.2	5.9	10.3	5.7	5.5
	Q2	-11.5	4.4	5.5	1.4	7.0	5.6	2.6	6.3	6.1	-1.2	5.6	5.4
	Q3	-21.1	4.0	4.8	-0.4	9.1	7.0	4.3	7.0	6.5	-2.5	6.1	5.7
	Q4	-6.4	4.5	5.3	-1.4	6.6	7.3	2.3	5.4	6.0	-0.7	5.5	5.7
2016	Q1	59.7	4.5	4.4	5.1	4.6	6.8	-2.5	6.7	6.4	10.1	5.3	5.6
	Q2	-8.9	7.7	5.3	3.2	6.4	6.6	2.3	6.4	6.4	-0.3	6.2	5.8
	Q3	-23.3	4.7	5.4	-0.9	5.9	5.9	4.4	6.4	6.2	-3.0	5.7	5.7
	Q4	-9.5	1.0	4.7	-1.5	5.8	5.7	3.2	7.4	6.7	-0.2	6.3	5.9
2017	Q1	59.5	0.9	3.5	3.3	4.1	5.6	-2.7	7.2	6.9	8.4	4.7	5.7
	Q2	-9.0	0.8	1.7	2.8	3.6	4.8	2.1	7.0	7.0	-0.3	4.7	5.3
	Q3	-21.0	3.7	1.5	-1.9	2.5	4.0	3.6	6.2	6.9	-3.0	4.7	5.1
	Q4	-11.6	1.4	1.6	0.0	4.1	3.6	4.0	7.0	6.9	0.4	5.4	4.9
2018	Q1	65.5	5.2	2.9	3.3	4.1	3.6	-2.9	6.8	6.8	8.8	5.7	5.2
	Q2	-8.6	5.6	4.3	3.4	4.7	3.9	2.2	6.9	6.7	0.2	6.3	5.6

Source: World Bank and Kenya National Bureau of Statistics

Table 7: Growth Outlook

Annual growth (percent)	2014	2015	2016	2017e	2018f	2019f	2020f
BASELINE							
GDP	5.4	5.7	5.9	4.9	5.7	5.8	6.0
Revised projections	5.4	5.7	5.8	4.8	5.5	5.9	6.1
Revised projections (KEU 17)	5.4	5.7	5.8	4.8	5.5	5.9	6.1
Revised projections (KEU 16)	5.4	5.7	5.8	4.9	5.5	5.9	
Private consumption	4.3	5.2	4.7	7.0	5.9	6.0	6.0
Government consumption	1.1	13.7	8.5	8.4	8.5	4.2	3.5
Gross fixed capital investment	14.5	5.3	-9.4	6.3	7.8	10.2	11.5
Exports, goods and services	5.8	6.2	-2.6	-6.2	4.9	6.8	7.1
Imports, good and services	10.4	1.2	-6.3	8.4	8.7	8.9	9.0
Agriculture	4.4	5.3	4.7	1.6	4.1	4.2	4.4
Industry	6.1	7.3	5.7	3.6	4.1	4.1	5.2
Services	6.0	6.0	6.7	6.9	7.0	7.1	7.0
Inflation (Consumer Price Index)	6.9	6.6	6.3	8.0	5.2	6.0	6.5
Current Account Balance, % of GDP	8.1	10.0	8.1	2.7	6.6	6.7	6.0
Fiscal balance, % of GDP	-7.1	-7.7	-8.2	-8.0	-6.3	-5.0	-3.8
Debt (% of GDP)	48.3	52.1	56.5	57.3	57.1	56.1	53.3
Primary Balance (% of GDP)	-4.3	-4.6	-4.8	-4.3	-1.8	-0.4	0.4

Sources: World Bank and the National Treasury

Notes: "e" denotes and estimate, "f" denotes forecast

* Fiscal Balance is sourced from National Treasury and presented as Fiscal Years

Table 8: National Fiscal position

Actual (percent of GDP)	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Revenue and Grants	19.7	19.1	19.7	19.7	19.5	19.2	18.6	17.1	20.5
Total Revenue	19.1	18.7	19.2	19.2	19.0	18.7	18.3	16.8	20.0
Tax revenue	18.0	17.1	17.2	18.1	17.7	17.7	17.1	15.4	18.2
Income tax	7.9	7.8	8.3	8.9	8.7	8.6	8.2	7.2	8.6
VAT	5.0	4.4	4.1	4.6	4.5	4.4	4.4	4.0	4.8
Import Duty	1.3	1.3	1.3	1.3	1.3	1.2	1.2	1.1	1.2
Excise Duty	2.3	2.0	1.9	2.0	2.0	2.1	2.2	1.8	2.3
Other Revenues	1.5	1.6	1.7	1.3	1.3	1.3	1.1	1.2	1.3
Railway Levy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Appropriation in Aid	1.1	1.7	2.0	1.1	1.3	1.0	1.2	1.4	1.9
Grants	0.6	0.4	0.5	0.5	0.5	0.5	0.3	0.3	0.5
Expenditure and Net Lending	23.8	23.7	25.1	25.6	28.1	27.2	27.5	23.9	26.3
Recurrent	16.9	16.3	18.1	14.8	14.8	15.6	15.4	14.5	15.5
Wages and salaries	5.7	5.5	6.1	5.5	5.1	4.7	4.4	4.3	4.6
Interest Payments	2.3	2.1	2.7	2.7	2.9	3.3	3.5	3.7	4.1
Other recurrent	8.9	8.8	9.3	6.6	6.7	7.5	7.5	6.5	6.8
Development and net lending	6.8	7.4	6.8	6.3	8.7	7.0	8.0	5.5	6.8
County allocation			0.2	3.8	3.9	4.1	3.7	3.5	3.3
Contingencies	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	
Parliamentary Service				0.4	0.4	0.3	0.3	0.3	0.4
Judicial Service				0.3	0.2	0.2	0.2	0.1	0.1
Fiscal balance									
Deficit including grants (cash basis)	-3.5	-4.5	-5.7	-6.1	-8.1	-7.3	-9.1	-6.9	-5.8
Financing	3.5	4.5	5.7	6.1	8.1	7.3	9.1	6.9	5.8
Foreign Financing	0.8	2.8	1.9	2.1	3.7	4.1	5.0	3.7	3.0
Domestic Financing	2.7	1.6	3.8	4.0	4.4	3.1	4.1	3.1	2.8
Total Public Debt(net)	43.1	40.6	42.1	47.8	48.8	55.5	57.5	57.0	57.2
External Debt	21.0	19.6	18.7	22.4	24.4	27.6	30.0	28.9	28.9
Domestic Debt (net)	22.2	21.5	23.3	25.3	24.4	27.9	27.6	28.0	28.3
Memo:									
GDP (Fiscal year current market prices, Ksh bn)	3,447,610	3,994,393	4,503,257	5,073,777	5,828,115	6,508,084	7,658,100	8845853.96	9726649.41

Source: 2017 Budget Review Outlook Paper (BROP) and Quarterly Budgetary Economic Review (Fourth Quarter, Financial Year 2016/2017), National Treasury

Note: *indicate Preliminary results

Table 9: Kenya's Public and Publicly Guaranteed Debt, June 2014 to June 2018

KShs. Millions	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
TOTAL PUBLIC DEBT (Net)	2,394,450	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	4,045,218	4,217,535	4,304,497	4,529,996
Lending	(5,701)	(5,701)	(5,701)	(5,701)	(5,701)	(5,701)	(5,701)	(5,701)	(5,701)	(5,701)	(5,701)	-5701	-5701	-5701
Government Deposits	(275,083)	(236,565)	(208,869)	(305,496)	(320,041)	(394,856)	(426,911)	(373,016)	(364,909)	(428,774)	(432,113)	(350,924)	(573,884)	(503,337)
Total Public Debt (Gross)	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	4,483,032	4,574,160	4,884,082	5,039,034
External Debt	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	2,310,197	2,353,795	2,512,431	2,560,199
Bilateral	384,607	445,057	482,203	481,282	478,883	548,351	545,652	641,763	689,119	724,823	742,063	782,588	800,912	816,119
Multilateral	618,456	684,631	754,599	751,154	762,089	798,842	839,936	781,256	806,922	841,899	842,814	841,847	836,766	820,966
Commercial Bank & Supplier Credit	275,044	293,565	313,430	382,747	376,534	449,005	469,123	473,424	605,350	728,014	725,320	729,360	874,753	923,114
Commercial Banks	259,746	276,937	295,642	366,231	360,175	432,377	452,495	458,122	594,140	712,100	708,231	712,274	858,062	906,389
Suppliers Credit	15,298	16,628	17,788	16,516	16,359	16,628	16,628	15,302	11,210	15,914	17,089	17,086	16,691	16,725
Domestic Debt	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	2,172,835	2,220,365	2,371,651	2,478,835
Central Bank	64,835	63,335	107,637	101,386	102,648	99,856	58,945	85,528	85,316	55,061	79,201	96,797	93,583	110,782
Commercial Banks	715,011	730,419	682,694	764,399	829,688	927,307	969,790	947,030	975,803	1,141,889	1,144,536	1,124,950	1,226,866	1,266,457
Non Banks & Nonresidents	617,280	626,689	597,635	674,232	714,192	787,970	825,820	898,415	883,834	915,316	949,098	998,618	1,051,202	1,101,596
(%) of Total public debt(gross)														
External Debt	47.8	50.0	52.8	51.2	49.6	49.7	50.0	49.5	51.9	52.1	51.5	51.5	51.4	50.8
Domestic Debt	52.2	50.0	47.2	48.8	50.4	50.3	50.0	50.5	48.1	47.9	48.5	48.5	48.6	49.2
% of External debt														
Bilateral	30.1	31.3	31.1	29.8	29.6	30.5	29.4	33.8	32.8	31.6	32.1	33.2	31.9	31.9
Multilateral	48.4	48.1	48.7	46.5	47.1	44.5	45.3	41.2	38.4	36.7	36.5	35.8	33.3	32.1
Commercial Bank & Supplier Credit	21.5	20.6	20.2	23.7	23.3	25.0	25.3	25.0	28.8	31.7	31.4	31.0	34.8	36.1
Commercial Banks	20.3	19.5	19.1	22.7	22.3	24.1	24.4	24.2	28.3	31.0	30.7	30.3	34.2	35.4
Suppliers Credit	1.2	1.2	1.1	1.0	1.0	0.9	0.9	0.8	0.5	0.7	0.7	0.7	0.7	0.7
% of Domestic debt														
Central Bank	4.6	4.5	7.8	6.6	6.2	5.5	3.2	4.4	4.4	2.6	3.6	4.4	3.9	4.5
Commercial Banks	51.2	51.4	49.2	49.6	50.4	51.1	52.3	49.0	50.2	54.1	52.7	50.7	51.7	51.1
Non Banks & Nonresidents	44.2	44.1	43.1	43.8	43.4	43.4	44.5	46.5	45.4	43.3	43.7	45.0	44.3	44.4

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	Jun-18
A. Current Account, n.i.e.	(505)	(796)	(1,821)	(1,713)	(2,371)	(3,821)	(4,205)	(4,838)	(5,998)	(4,322)	(3,697)	(5,016)	(4,821)
Merchandise A/C	(3,243)	(4,222)	(5,593)	(4,952)	(6,216)	(8,355)	(9,315)	(10,243)	(11,319)	(9,577)	(7,665)	(10,201)	(10,813)
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	5,748	5,792	6,043
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	13,413	15,994	16,856
Oil	1,745	1,919	3,051	2,192	2,673	4,082	4,081	3,838	4,026	2,500	2,087	2,728	3,131
Services	1,013	1,263	1,377	1,084	1,744	1,994	2,602	2,926	2,405	2,329	1,421	1,558	1,476
Services: credit	2,431	2,938	3,260	2,904	3,789	4,131	4,990	5,130	5,066	4,496	4,154	4,651	4,902
Services: debit	1,418	1,675	1,883	1,820	2,045	2,138	2,387	2,204	2,662	2,167	2,733	3,093	3,426
Income	1,725	2,162	2,395	2,156	2,101	2,540	2,507	2,479	2,889	2,795	2,547	3,627	4,516
B. Capital Account, n.i.e.	168	157	94	261	240	235	235	158	275	257	206	185	273
C. Financial Account, n.i.e.	(677)	(2,247)	(1,423)	(3,782)	(3,252)	(3,425)	(5,542)	(5,183)	(7,008)	(5,070)	(4,137)	(4,606)	(5,202)
Direct investment: net	(27)	(1,001)	(384)	(1,452)	(1,117)	(1,364)	(1,142)	(920)	(1,045)	(1,088)	(235)	(415)	(585)
Portfolio investment: net	21	16	25	(81)	(156)	1	(218)	(273)	(3,716)	156	385	775	(859)
Financial derivatives: net	-	-	-	-	-	-	-	-	-	-	-	-	-
Other investment: net	(671)	(1,262)	(1,064)	(2,249)	(1,979)	(2,062)	(4,182)	(3,990)	(2,248)	(4,139)	(4,286)	(4,966)	(3,758)
D. Net Errors and Omissions	235	(805)	(189)	(1,215)	(947)	(734)	(348)	(134)	168	(1,260)	(516)	68	(157)
E. Overall Balance	(575)	(802)	493	(1,115)	(174)	896	(1,223)	(369)	(1,453)	255	(129)	157	(497)
F. Reserves and Related Items	575	802	(493)	1,115	174	(896)	1,223	369	1,453	(255)	129	(157)	497
Reserve assets	618	941	(480)	1,322	154	246	1,455	859	1,333	(361)	38	(235)	375
Credit and loans from the IMF	(6)	116	(17)	199	(34)	284	193	177	(119)	(107)	(91)	(77)	(122)
Exceptional financing	48	23	30	8	13	858	38	312	-	-	-	-	-
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	9,646	12,102
Official	2,415	3,355	2,875	3,847	4,002	4,248	5,702	6,560	7,895	7,534	7,573	7,332	8,954
Commercial Banks	916	1,202	1,765	1,217	1,121	1,797	1,458	1,923	1,843	2,259	2,015	2,314	3,148
Imports cover (36 mths import)	4	4	3	4	4	3	4	4	5	5	5	5	6
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	75,168	79,822

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	9.0	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
	November	4.7	5.8	4.8	3.4
	December	4.5	4.7	5.4	3.6
2018	January	4.8	4.7	6.1	4.0
	February	4.5	3.8	6.2	4.2
	March	4.2	2.4	8.2	4.0
	April	3.7	0.3	10.2	4.1
	May	4.0	0.3	11.4	3.9
	June	4.3	0.9	11.9	4.0
	July	4.4	0.5	12.4	4.1
	August	4.0	-1.2	14.2	4.3
	September	5.7	0.5	17.4	4.5

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

Table 12: Credit to Private Sector Growth (%)

Year	Month	Total Private sector annual growth rates	Agriculture	Manufacturing	Trade	Building and construction	Transport and communication	Finance and insurance	Real estate	Mining and quarrying	Private households	Consumer durables	Business services	Other activities
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	-31.3
	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	-29.2
	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	-23.5
	April	2.2	-8.8	-6.8	8.0	-2.3	7.6	-11.9	13.2	-34.2	10.4	11.9	-15.1	-19.8
	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	-20.0
	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
	September	1.7	-2.0	6.1	6.9	1.8	-4.9	-1.4	8.9	-0.8	1.9	-0.5	-6.4	-28.6
	October	2.0	-1.1	10.2	11.5	4.0	-8.2	-1.3	10.0	9.2	2.9	0.1	-19.2	-35.0
	November	2.7	-7.7	10.6	10.0	3.1	-8.0	1.5	9.3	-3.2	2.7	-0.4	-7.6	-23.1
	December	2.4	-7.9	13.0	9.0	4.8	-7.2	-4.3	8.6	-5.5	-1.5	-1.6	-6.4	-7.5
2018	January	1.8	-7.9	12.0	5.0	5.3	-11.3	-1.3	8.2	-7.3	-1.5	1.4	-0.4	-12.5
	February	2.1	-13.3	13.1	6.8	4.7	-14.4	4.8	8.3	-7.3	-2.7	2.3	-0.8	-2.9
	March	2.0	-6.5	11.3	5.4	12.7	-18.9	11.6	4.4	-3.1	-0.7	4.7	-0.9	-7.3
	April	2.8	-4.7	10.1	5.0	14.4	-18.2	10.1	3.6	-4.9	2.6	5.0	2.6	-2.6
	May	3.8	-3.6	12.2	6.8	9.2	-15.3	2.6	3.7	-3.9	3.8	5.5	11.1	-8.6
	June	4.3	-4.9	12.3	8.6	13.5	-13.0	3.8	3.8	-9.5	2.9	7.8	6.9	-9.4
	July	4.3	-6.7	11.6	6.5	13.7	-11.0	8.5	4.3	0.1	2.9	9.1	3.3	-7.1
	August	4.3	-4.5	13.3	7.0	14.9	-11.3	3.5	0.9	-9.6	2.7	11.5	6.6	-5.8

Source: Central Bank of Kenya

Table 13: Mobile payments

Year	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	95.5	243.4
	February	148,982	29.5	101.0	257.2
	March	150,987	30.7	107.9	273.6
	April	153,762	31.4	105.5	269.8
	May	156,349	31.3	107.8	277.9
	June	162,465	31.4	106.3	271.0
	July	167,072	32.3	110.5	281.9
	August	173,774	32.8	114.2	296.9
	September	173,731	33.4	112.6	283.9
	October	181,456	34.0	122.5	292.1
	November	162,441	34.3	120.9	291.2
	December	165,908	35.0	126.3	316.8
2017	January	152,547	33.3	122.0	299.5
	February	154,908	33.3	117.5	279.4
	March	157,855	33.9	133.3	320.2
	April	160,076	34.3	128.9	297.4
	May	164,674	34.2	132.5	315.4
	June	165,109	34.2	125.9	299.8
	July	169,480	34.6	128.1	308.9
	August	167,353	35.3	120.6	286.3
	September	167,775	35.5	128.5	300.9
	October	170,389	36.0	134.2	299.0
	November	176,986	36.4	131.7	299.0
	December	182,472	37.4	139.9	332.6
2018	January	188,029	37.8	136.7	323.0
	February	192,117	38.4	132.3	300.9
	March	196,002	39.3	147.5	337.1
	April	201,795	40.3	142.1	313.0
	May	202,387	41.7	141.0	329.0
	June	197,286	42.6	137.4	317.7
	July	200,227	42.6	143.1	332.4

Source: Central Bank of Kenya

Table 14: Exchange rate

Year	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
	October	103.4	136.4	121.6
	November	103.6	136.8	121.4
	December	103.1	138.2	122.0
2018	January	102.9	141.9	125.4
	February	101.4	141.7	125.3
	March	101.2	141.2	124.7
	April	100.6	141.9	123.7
	May	100.7	135.7	119.0
	June	101.0	134.2	118.0
	July	100.7	132.6	117.5
	August	100.6	129.7	116.2

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	100.2	99.2
	April	100.6	100.5	98.9
	May	99.9	99.5	98.5
	June	100.2	99.3	98.9
	July	99.7	98.2	99.0
	August	100.3	99.1	99.1
	September	100.3	99.2	99.0
	October	99.3	98.1	99.0
	November	99.0	97.7	99.4
	December	98.5	97.8	99.8
2017	January	87.3	84.5	101.4
	February	87.5	83.8	101.3
	March	87.0	82.2	100.5
	April	87.8	81.5	101.0
	May	88.3	81.3	100.9
	June	88.9	82.9	101.2
	July	89.6	84.5	101.5
	August	90.1	84.9	101.2
	September	90.0	86.3	100.8
	October	89.6	85.8	101.1
	November	89.7	86.3	101.2
	December	89.7	85.7	103.1
2018	January	90.7	85.5	102.9
	February	89.9	84.1	101.4
	March	89.6	82.7	101.2
	April	84.1	77.6	100.6
	May	83.0	76.3	100.7
	June	82.8	77.1	101.0
	July	86.7	80.5	100.7
	August			101.2

Source: Central Bank of Kenya and World Bank

Table 16: Nairobi Securities Exchange

(NSE 20 Share Index, Jan 1966=100, End - month)

Year	Month	NSE 20 Share Index
2015	June	4,906
	July	4,405
	August	4,177
	September	4,174
	October	3,869
	November	4,016
	December	4,041
2016	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
	November	3,247
	December	3,186
2017	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
	October	3,730
	November	3,805
	December	3,712
2018	January	3,737
	February	3,751
	March	3,845
	April	3,705
	May	3,353
	June	3,286
	July	3,297
	August	3,203

Source: Central Bank of Kenya



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
	November	10.0	8.0	10.5	11.0
	December	10.0	8.0	10.5	11.1
2018	January	10.0	8.0	10.6	11.2
	February	10.0	8.0	10.4	11.2
	March	9.5	8.0	10.4	11.1
	April	9.5	8.0	10.3	11.1
	May	9.5	8.0	10.3	11.1
	June	9.5	7.8	9.9	10.8
	July	9.0	7.7	9.3	10.3
	August	9.0	7.6	9.0	10.0
	September	9.0	7.6	8.8	9.8

Source: Central Bank of Kenya

Table 18: Interest rates

Year	Month	Short-term			Long-term			
		Interbank	91-Treasury Bill	Central Bank Rate	Average deposit rate	Savings	Overall weighted lending rate	Interest Rate Spread
2015	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	8.6	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	7.2	5.6	13.7	6.5
	July	6.8	8.2	10.0	7.4	6.4	13.7	6.3
	August	8.1	8.2	10.0	7.7	5.9	13.7	6.0
	September	5.5	8.1	10.0	7.7	6.4	13.7	6.0
	October	7.8	8.1	10.0	8.0	6.9	13.7	5.7
	November	8.9	8.0	10.0	8.1	6.9	13.7	5.6
	December	7.3	8.0	10.0	8.2	6.9	13.6	5.4
2018	January	6.2	8.0	10.0	8.3	7.0	13.7	5.4
	February	5.1	8.0	10.0	8.3	7.0	13.7	5.4
	March	4.9	8.0	9.5	8.2	6.8	13.5	5.3
	April	5.4	8.0	9.5	8.1	6.7	13.2	5.0
	May	4.9	8.0	9.5	8.1	6.6	13.3	5.2
	June	5.0	7.8	9.5	8.0	6.6	13.2	5.2
	July	4.8	7.7	9.0				
	August	6.6	7.6	9.0				
	September		7.6	9.0				

Source: Central Bank of Kenya

Table 19: Money aggregate

Year	Growth rates (yoy)	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	22.5	5.4	6.0	2.9
	July	24.6	7.5	8.3	5.0
	August	22.5	7.5	7.7	7.7
	September	11.6	7.5	7.7	8.1
	October	9.5	7.0	7.9	3.8
	November	7.8	7.4	7.8	6.2
	December	6.7	7.5	8.9	6.7
2018	January	8.0	8.3	9.0	8.3
	February	8.4	8.4	8.0	6.3
	March	4.2	5.6	5.9	0.8
	April	3.9	5.5	5.5	-0.1
	May	3.9	5.9	7.6	5.5
	June	3.3	7.6	10.5	7.0
	July	4.6	7.8	10.2	2.1
	August	2.9	7.3	9.2	6.6

Source: Central Bank of Kenya and World Bank

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
	September	2,465	457	3,134	1,516
	October	1,619	409	2,335	1,121
	November	2,310	419	3,196	1,566
	December	1,320	453	1,955	775
2018	January	5,112	527	2,509	1,286
	February	5,832	577	2,834	1,612
	March	4,913	478	3,936	2,237
	April	4,194	305	4,550	2,822
	May	4,620	217	5,573	3,209
	June	-	-	4,649	2,664
	July	1,221	357	4,683	2,457

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
	September	38,386	305	43,469	13,570
	October	43,420	316	41,173	13,147
	November	45,374	309	39,128	12,713
	December	47,507	285	44,413	13,634
2018	January	40,834	304	48,447	14,964
	February	27,939	302	47,357	14,657
	March	30,987	284	34,488	10,471
	April	44,580	268	33,565	9,830
	May	43,356	263	42,533	11,703
	June	43,299	257	45,182	12,463
	July	35,278	251	45,242	12,226

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	27,045	11,559
	February	27,461	10,942
	March	27,892	9,094
	April	25,658	8,977
	May	30,549	10,292
	June	26,271	9,395
	July	22,179	8,660
	August	23,357	9,237
	September	23,818	8,962
	October	24,337	9,059
	November	21,676	8,275
	December	23,905	10,871
2018	January	27,131	14,899
	February	29,603	16,454
	March	32,902	12,610
	April	29,589	12,870
	May		
	June		

Source: Kenya National Bureau of Statistics



Table 23: Leading Economic Indicators year to date growth rates (Exports MT, Percent)

Year	Month	Horticulture	Coffee	Tea
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	28.3	23.7	0.6
	March	23.3	26.6	-2.9
	April	16.5	13.8	-6.8
	May	21.6	13.5	-8.1
	June	22.9	8.6	-10.3
	July	22.9	6.0	-9.2
	August	22.5	2.0	-11.1
	September	21.5	1.7	-7.4
	October	19.7	-0.5	-4.0
	November	17.3	-2.1	-4.1
	December	16.5	-4.1	-2.7
2018	January	0.3	-21.9	4.3
	February	4.1	-24.5	19.3
	March	8.8	-25.9	14.3
	April	10.3	-17.3	12.2
	May		-12.4	11.3
	June		-9.6	10.4
	July		-4.8	10.2

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
	September	239	403	213	859
	October	217	416	224	861
	November	305	411	153	877
	December	250	436	184	879
2018	January	223	430	242	900
	February	193	387	249	837
	March	248	448	202	903
	April	317	428	139	887
	May	386	447	83	918
	June	401	430	82	914
	July	420	438.1	86.9	947.0

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	50,409	53,071	26,230	565,440
	February	43,353	49,094	22,994	491,307
	March	50,623	41,936	22,574	570,522
	April	46,399	26,230	23,225	535,061
	May	40,742	15,246	23,081	482,762
	June	45,875	16,113	15,424	513,313
	July	41,980	17,882	22,640	553,631
	August	41,217	10,892	15,296	451,651
	September	40,221	21,649	24,188	498,167
	October	45,275	32,296	21,312	498,374
	November	45,073	43,175	24,357	483,956
	December	66,378	49,240	21,438	518,410
2018	January	52,617	54,907	23,919	494,709
	February	50,806	50,758	21,890	490,020
	March	51,419	40,918	22,048	476,730
	April		38,573	21,434	474,740
	May			22,271	452,034
	June				454,322

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
	September	78,329	9,111	87,440
	October	57,034	7,557	64,591
	November	61,617	10,956	72,573
	December	90,745	15,117	105,862
2018	January	61,137	15,512	76,649
	February	70,169	13,482	83,651
	March	61,652	14,321	75,973
	April	49,388	6,653	56,041
	May	70,981	4,047	75,028
	June	71,461	5,147	76,608

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
	August	22,422
	September	21,137
	October	18,889
	November	22,954
	December	23,264
2018	January	23,676
	February	24,123
	March	23,290
	April	21,920
	May	23,729
	June	21,011
	July	24,232

Source: Kenya National Bureau of Statistics

SPECIAL FOCUS: ANNEX

Table 3: Tax revenue by source, 2015/16

	Ksh million	Share in total revenue	Share in GDP
Taxes on income, profits, and capital gains	569,811.18	50.1%	8.5%
Income tax from individuals (PAYE)	286,166.16	25.2%	4.3%
Income tax from corporations	279,834.49	24.6%	4.2%
Capital gains tax	3,810.54	0.3%	0.1%
Taxes on property	88.26	0.0%	0.0%
Immovable property	0.00	0.0%	0.0%
Financial and capital transactions	88.26	0.0%	0.0%
Value-added tax (VAT)	289,213.47	25.4%	4.3%
VAT on domestic goods and services	160,389.01	14.1%	2.4%
VAT on imported goods and services	128,824.45	11.3%	1.9%
Taxes on other goods and services	162,593.81	14.3%	2.4%
Excise taxes	139,540.34	12.3%	2.1%
Taxes on use of goods and on permission to use goods or to perform services and activities	5,780.10	0.5%	0.1%
Taxes on goods and services collected as AIA	17,273.37	1.5%	0.3%
Taxes on international trade transactions	104,433.27	9.2%	1.6%
Custom duties	79,187.93	7.0%	1.2%
Other taxes on international trade and transactions	25,245.33	2.2%	0.4%
Other taxes not elsewhere classified	10,423.54	0.9%	0.2%
Total tax revenue	1,136,563.52	100.0%	17.0%

Source: Kenya Economic Survey 2017. Note: GDP in the last column is calculated as the geometric mean of GDP in market prices in 2015 and 2016.

Table 4: Personal income tax rates, 2016 tax calendar year.

Annual taxable income	Marginal tax rate (percent)	Tax bracket as share of GDP per capita in 2016
On first Ksh121,968	10	0.86
On next Ksh114,912	15	1.59
On next Ksh114,912	20	2.32
On next Ksh114,912	25	3.05
On taxable income in excess of Ksh466,704	30	3.78

Source: Kenya Economic Survey 2017. Note: GDP in the last column is calculated as the geometric mean of GDP in market prices in 2015 and 2016.

Table 5: Simulation results for personal income tax – taxpayers and average tax rate by bracket

Tax brackets	Taxpayers	Share in total taxpayers (payroll and business income)	Average tax rate
< Ksh13,944	68,482	2.8%	0.0%
Ksh13,944 - Ksh135,912	502,667	20.9%	7.4%
Ksh135,912 - Ksh250,824	487,235	20.3%	9.4%
Ksh250,824 - Ksh365,736	355,683	14.8%	11.4%
Ksh365,736 - Ksh480,648	227,561	9.5%	13.3%
Ksh480,648 and above	761,263	31.7%	18.0%
All	2,402,891	100.0%	12.3%

Source: World Bank based on KIHBS 2015/16 and using income tax brackets as applied in 2015 and 2016 (see text)

Table 6: Description of four main cash transfer programs

Program	Geographic coverage (2015)	Households covered (2015)	Transfer (Ksh per household)	Targeting
Hunger Safety Net Program (CT-HSNP)	4 counties	84,340	2,550 monthly	PMT
Orphans and Vulnerable Children (CT-OVC)	47 counties	255,643	2,000 monthly	PMT, OVCs
Older People (OPCT)	47 counties	162,695	2,000 monthly	Poor and older than 65 years
Persons with Severe Disability (CT-PwSD)	47 counties	25,471	2,000 monthly	Poor and disabled
Total		519,878		

Source: Ministry of Labour and East African Affairs (2016).

Table 7: Excise tax revenue by item, 2015 and 2016

	Ksh million		Share in total	
	2015	2016	2015	2016
Beer	19,526	24,443	31.2%	30.4%
Wine and spirits	6,148	10,681	9.8%	13.3%
Mineral water, soft drinks, and juices	2,515	3,319	4.0%	4.1%
Cigarettes	12,230	12,441	19.5%	15.5%
Airtime	14,139	15,541	22.6%	19.3%
Financial transactions	7,222	11,313	11.5%	14.1%
Other commodities	902	2,642	1.4%	3.3%
Total	62,682	80,380	100.0%	100.0%

Source: World Bank based on KES 2017 (KNBS, 2017).

Table 8: Tuition, gross, and net benefits of public education expenditure, 2015/16

	Average tuition			Gross benefit allocated per student in public	Average net benefit per student in public	Net benefit as share of gross benefit
	Public	Private	Ratio			
Early childhood education	917	5,685	16.1%	6,024	5,107	84.8%
Primary and special education	456	10,466	4.4%	15,074	14,619	97.0%
Secondary education	14,553	27,451	53.0%	39,013	24,460	62.7%
Technical and teacher education	29,780	36,228	82.2%	31,823	2,043	6.4%
University education	58,921	107,709	54.7%	111,921	52,999	47.4%

Source: World Bank based on KIHBS 2015/16 and various issues of the education sector reports.

In Search of Fiscal Space

Government Spending and Taxation: Who Benefits?

In December 2017, the government announced its Big 4 Developments Agenda, aimed at increasing delivery of affordable housing, universal health coverage, raising the share of manufacturing in the economy and improving food and nutritional security. Nonetheless, against the backdrop of fiscal consolidation, it will be important to be careful on which expenditures are contained so that the government's inclusive growth agenda is not jeopardized. This 18th Edition of the Kenya Economic Update seeks to contribute to this discussion. The report has three key messages.

First, the Kenyan economy is on a rebound in 2018. Reflecting improved rains, better business sentiment and easing of political uncertainty, real GDP growth is estimated to rebound from 4.9 percent in 2017 to 5.7 percent in 2018 and rise gradually to 6.0 percent by 2020 as the output gap closes. This growth trajectory lays a solid foundation within which the government could accelerate poverty reduction especially if accompanied by pro-poor and inclusive growth policy measures. The downside risks to this outlook arise from subdued private sector credit growth that could curtail private investment; fiscal slippages that could compromise macroeconomic stability; and an uptick in oil prices and tightening global financial markets, which could exert undue pressures to the current account balance.

Second, there is need to re-ignite private sector led growth and ensure that fiscal consolidation is growth friendly. Although private sector investment is recovering, it is well below levels needed to achieve the Big 4 Development Agenda goals. Boosting private sector investment is more important, given the waning contribution of public investment to growth due to fiscal consolidation. Furthermore, with the majority of government expenditure cuts falling on development spending, the structure of fiscal consolidation could compromise the growth potential of the economy. Additional macroeconomic and structural reforms could help crowd in the private sector and support achievement of the Big 4. For instance, it is critical to address bottlenecks against private sector credit growth, including removal of interest rates caps.

Third, the special focus section examines distributional consequences of government spending and taxes. It finds that cash transfer programs are well-targeted because a large fraction of the benefits is captured by the poor. Nonetheless, cash transfer schemes in Kenya cover only a small portion of the population. Hence, these programs could be scaled up to increase their poverty-reducing effect. However, enhanced revenue mobilization would be needed to increase coverage significantly.

The World Bank remains committed to working with key Kenyan stakeholders to identify policy and structural issues that will enhance inclusive growth and attainment of the Big 4 development agenda. The Kenya Economic Update offers a forum for such policy discussion aimed at fostering growth, reduce poverty and improve shared prosperity in Kenya.

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