Parliamentary Budget Office
Enhancing the Legislative and Oversight Role of the Kenyan Parliament

Monthly Bulletin on Indicators on Budget and Economy
September 2014

This brief provides a summary of key recent economic and budget developments and is intended to keep stakeholders especially the legislators updated on the latest trends in the economy.

The month of September 2014

Few things have captured the imagination of Kenyans like the latest buzz word on the street – GDP rebasing. Amidst high poverty and unemployment levels, underdeveloped infrastructure, food insecurity and high cost of living, Kenyans are having a really hard time visualizing what GDP rebasing[1] is all about and more so, why it should even matter to anyone.

With the release of the new GDP figures, overnight, Kenya has been propelled to lower middle income status with the economy reported to be 25 percent larger than previously estimated. Ideally, the economy is now not only more attractive to investors due to a perception of better performance, but also provides an opportunity for expansion of the tax base as well as increased borrowing (with reduced debt to GDP ratio) which will provide additional finances for development projects. However, for any of this to make sense, prevailing economic challenges need to be addressed urgently.

The recent closure of Eveready East Africa and Cadburys Kenya is a pointer that all is not well. Many industries have relocated from Kenya due to high operating costs, preferring to import from other low cost manufacturing countries - notably, Egypt which has been favoured by both Eveready and Cadburys as the preferred country of operation - to meet local demand. This is a major blow to the already struggling manufacturing industry and is likely to adversely affect employment and economic growth. Indeed, the share of manufacturing sector to GDP has been shrinking over the last decade. Latest figures from Economic Survey 2014 indicate that the sector contributed 10.5 percent in 2005 compared to 8.9 percent in 2013.

Economic Growth

According to the figures released by the KNBS, Kenya's economy is larger by 25% and is currently valued at kshs. 4.7 trillion, up from Kshs. 3.8 billion in 2013. This implies an increase in income per capita.

However, it is worth noting that rebasing the country's GDP does not in any way mean a sudden change in the country's development indicators. Poverty levels remain persistently high, same for unemployment and the cost of living.

Indeed, the share of households below the poverty line is currently estimated at 47.8%[2]. Rural poverty is estimated at 50.4% while urban poverty is estimated at 41.6%.

For rebasing to lead to increased investment and therefore boost economic performance as envisaged, there is need to review laws and regulations which make it difficult to set up a business in the country, revamp infrastructure, lower energy costs and embrace technology in development. Currently, Kenya ranks position 129 in the Doing Business Rank 2014; a drop from position 122 in 2013. The deteriorating ranking implies that even after the previous ranking and concerns highlighted, little was done to address the situation.

[1] Rebasing simply means recalculating of the country's GDP to ensure accuracy of national account statistics by changing the base year to a more recent year to incorporate any changes in economy which have not been captured in calculation of the country's GDP

[2] Parliamentary Budget Office Macro Model (PBOM)

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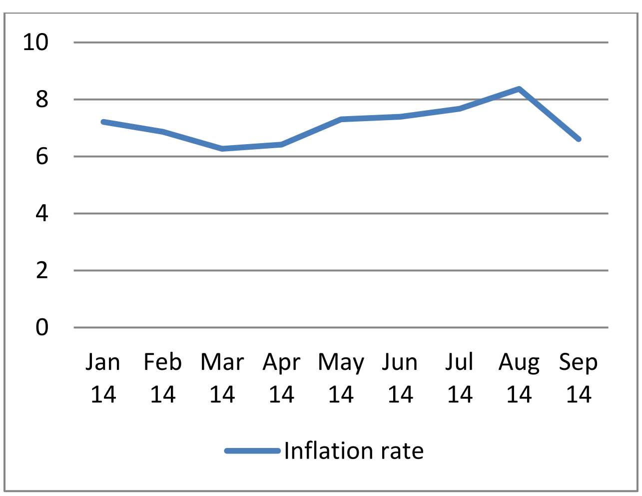
Inflation

Inflationary pressures appear to have eased in the month of September with the inflation rate standing at 6.60 percent in September, down from 8.36 percent in August. The declining inflation has been attributed to reduced kerosene and electricity prices due to reduction in fuel cost as well as forex adjustment charges.

However, the easing inflation may be temporary especially with a looming food shortage. The food security situation has been worsening due to the Maize Lethal Necrosis Disease which has affected crops in various parts of Rift valley, Central, Western and Eastern Kenya. As a result, FAO projects a 10 percent decline in cereal production compared to the previous year. Going forward, this may result in increased food inflation as well as increased importation of cereals.

However, with reduction in energy costs over the next three months due to increased electricity production as has been reported, then inflation may remain below the double digit for this year.

Figure 2: Trends in Inflation over the period Jan 2014-September 2014



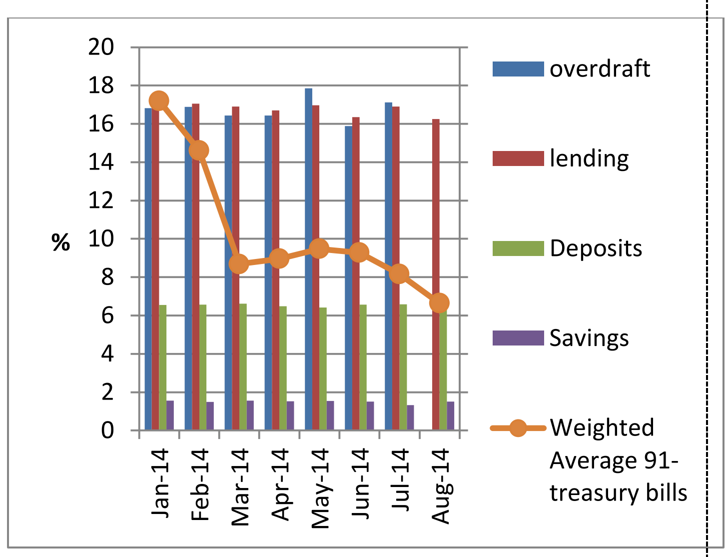
Source: KNBS

Interest Rates

The average yield rate for the 91-day Treasury bills stood at 8.65 percent for the month of September; up from 8.475 percent in July 2014 and 8.64 percent in August 2014. This denotes an increase in appetite for money by government.

It is worth noting that commercial bank lending rates stood at 16.26 percent in August. The introduction of the KBRR rate which currently stands at 9.13 percent appears to have had little or no impact to the lending rate of commercial banks to the private sector.

Figure 3: Trends in Interest rates over the period Jan 2014-August 2014



Data Source: CBK

Exchange Rate

The Kenya shilling has had a mixed performance in the month of September. The shilling strengthened against the Euro and the Sterling Pound but weakened against the dollar.

The Kenya shilling exchanged at an average of Kshs. 145.16, Kshs. 114.65, Kshs. 88.39 and

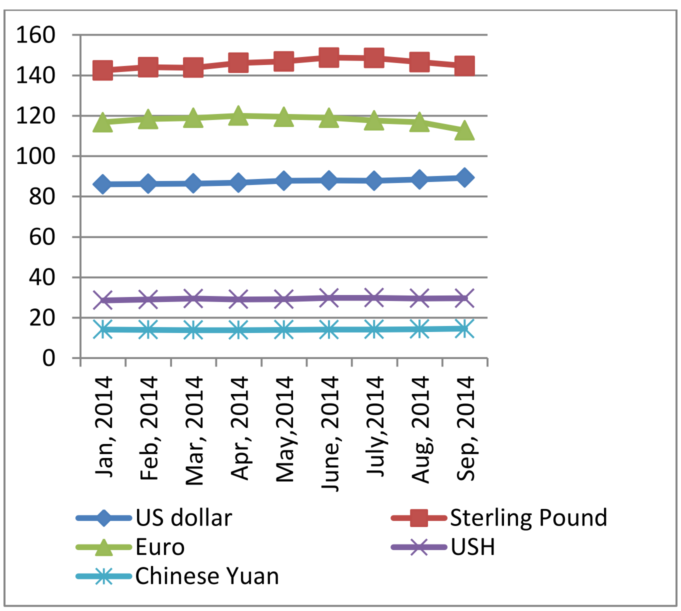
Kshs.14.38 to the Sterling Pound, Euro, Dollar and Chinese Yuan respectively.

The fall of the shilling against the US dollar was occasioned by increased demand from importers due to increased volume of imports and decreased inflow of dollars from declining volumes of exports especially in the agriculture sector as well as decreased tourist arrivals in the country.

Going forward, the import pressure may increase due to the need to import food as some areas of the country still suffer from the effects of drought. However, this may be countered by declining global cereal prices as reported by FAO.[3]

A mild El Nino (enhanced rainfall) during the Oct – Dec Short rains can also boost agriculture with proper water harvesting. However, low investment in agriculture will negate this benefit.

Figure 5: Trends in Exchange Rate over the period January - September 2014



Data Source: Central Bank of Kenya

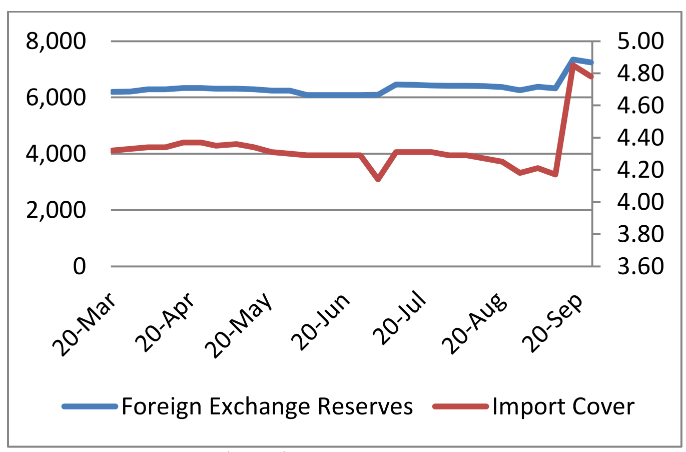
[3] GIEWS Food Price Monitor, 10 September 2014

Foreign Exchange Reserves

The official foreign exchange reserves held by Central Bank stood at US$ 7,248 million by the end of August 2014 (4.78 months cover). This was an increase from the previous month where the foreign reserves stood at US$ 6,257 million by 28th August 2014.

The improving foreign exchange reserves are a positive trend. However, should Kenya's import bill continue to be high and with reduced inflows from Tourism and Tea, this trend may be reversed in the future. Near conclusion of the EPA talks may turn around the earlier expectation of Kenya being exposed to a higher tax regime for produce exported to EU markets with adverse effect on forex reserves. Higher tax would've made Kenya's produce relatively more expensive in the EU market thereby reducing demand and therefore foreign exchange inflows.

Figure 6: Trends in Forex Reserves in March- Sept 2014



Data Source: Central Bank of Kenya

Domestic Debt

The stock of gross domestic debt which is composed of Treasury bills and bonds as well as overdraft at the Central Bank decreased to 1.228

trillion (as at 26th September 2014) from Kshs. 1.297 trillion at the end of August 2014. This has been attributed to maturing of a number of debt instruments.

Notably, the government overdraft has declined to 17.1 billion by end of September, from a high of 38.3 billion in mid September. Increasing use of the overdraft facility in the recent past has implied a precarious cash position for the government necessitating the use of this facility to meet funding shortfalls.

The delay in implementation of the Treasury Single Account continues to hamper effective management of state resources which means that while various government entities hold idle balances in various bank accounts, the government is forced to borrow to meet funding shortfalls. Implementation of the TSA will reduce government borrowing as the government will now have access to the previous idle balances for its operations thereby avoiding unnecessary borrowing costs.

It is also worth noting that the maturing of debt instruments at the end of September which led to a decline in domestic debt can be counterproductive in the sense that the government may have to revert to the overdraft facility to stay afloat.

Memorandum Items[4]

Category	Estimate for 2014/15	Current Actual/Provisional
Stock of Debt	Kshs.2,200 billion	
Of which: Domestic		Kshs. 1228.1 billion (26th September, 2014)
External		Kshs. 1085.3 billion (July, 2014)
CBK Overdraft		Kshs. 17.1 billion (As at 26th September, 2014)
Exchequer releases	Kshs. 1,182 billion	Kshs. 208.71 billion (As at 29th August, 2014)
Of which: CFS	*Kshs.415.5 billion*	Kshs.104.9 billion (As at 29th August, 2014)
Transfers to Counties	*Kshs.226.66 billion*	Kshs.28.5 billion (As at 29th August, 2014

Main Sources are Central Bank, KNBS, KRA, Treasury and PBO