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

Monthly Bulletin on Indicators on Budget and Economy
October/ November 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 October 2014

After rebasing of the country's GDP, Kenya joined the rank of the top ten African economies, jumping to lower middle income status and reaffirming Kenya's status as the economic powerhouse in East and Central Africa. However, whether Kenya will be able to sustain a higher growth trajectory depends to a large extent on the direction that the counties will take in relation to economic growth and policy.

Moreover, the rebasing of the country's GDP, does not mean that the lives of ordinary Kenyans have improved. The economic conditions on the ground are still the same even after the rebasing was done. Indeed there is no significant impact on the prosperity that Kenyans will experience once economic growth resulting from rebasing. **The question one has to ask is that have our lives improved?**

WHAT IS REBASING

A farmer has sacks of 10 maize sacks in a granary in 2014.

The price of maize 10sacks in 2014 using 2001 price of Kshs 100 = Kshs. 1000

The Price of the maize 10sacks in 2014 using 2009 price of Kshs. 200= Kshs 2000

*This means that there is no increase of maize sacks in 2014.**It is only the 2014 value of individual sacks but the quantity has not increased***

There is a lot that Kenya needs to do to achieve its targets set in Vision 2030 blueprint. Indeed, many policies aimed at promoting economic growth are targeted at sectors that are currently classified as county functions. For instance, the agricultural sector which remains a significant contributor to GDP is one of the five pillars under the government's broad development strategy. However, it is a county government function with the National Government's role restricted to agricultural and veterinary policies. The National Government can, however, support the agricultural sector through a conditional grant so the country realizes its targeted economic growth.

In the 2014/15 national budget, Kshs.494.9 billion (30.9% of total budget) was allocated for development expenditure. According to the exchequer releases, from July to October 2014, the Ministries, Departments and Agencies (MDAs) received Kshs. 53.60 billion for development expenditure (17 percent of the net estimates of Kshs. 320.9 billion); compared to Kshs. 48.46 billion (19 percent of net estimates) released in the same period last financial year. This indicates that absorption of development funds at the end of this financial year is likely to be low. This will eventually lead to a decline in GDP growth.

In financial year 2013/14, the initial development budget for counties was targeted at Kshs. 100.4 billion but only Kshs. 36.6 billion was actually spent. It is estimated that failure to spend the total budget as initially planned may have resulted in GDP loss by as much as 1.7% in 2013/14[1]. This translates to Kshs. 80.87 billion in economic activity that was lost due to failure of counties to absorb all funds.

[1]Simulations from Parliamentary Budget Office Macroeconomic Model

Economic Growth

The latest KNBS data after the rebasing of the GDP numbers show that the economy grew by 5.8 percent in the first half of the 2014. This has been attributed to the robust growth in the construction, manufacturing and financial and insurance sector.

This was a notable slowdown from a growth of 7.2 percent in the first half of 2013. This was attributed to a significant contraction in the Information and Communication, wholesale and retail trade, agriculture and the financial and insurance sectors. The underperformance of the agricultural sector can be attributed to a drop in the production of tea and export of vegetables and cut flowers. This was further exacerbated by low international auction prices of tea and coffee in the first half of 2014.

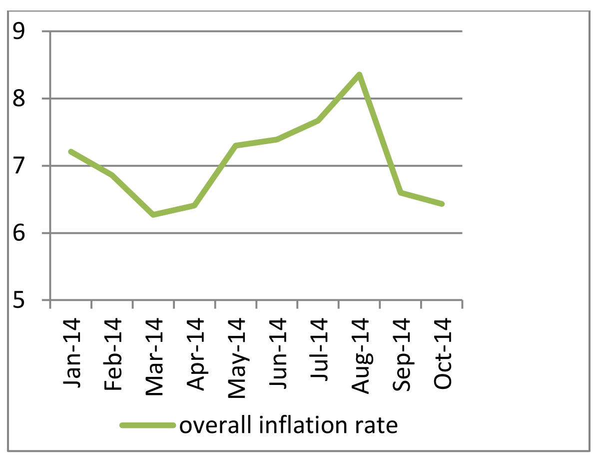
The reported growth for the first half of 2014 is far below the Vision 2030 target of 10 percent annual growth. Indeed, for the Vision 2030 to become a reality and for Kenya to become an industrialized country, economic growth must be accelerated and the contribution by the manufacturing sector to our GDP increased significantly. However, as a result of high cost of doing business and flooding of the local market with cheap counterfeit products, the contribution of manufacturing to our GDP and the growth of this important sector has remained largely subdued.

Inflation

Overall inflation eased further in the month of October to stand at 6.43 percent, down from 6.60 percent in September and 8.43 percent in August 2014. This was attributed to decline in the food and non- alcoholic beverages as well as transport index. The new renewable geothermal energy that was added last month will reduce Kenya's reliance on hydro generated power and reduce the cost of electricity. Although this may reduce inflationary pressures overtime, for the reduction to be fully felt, there is need to address transmission losses, which currently stand at 20 percent.

On the other hand, despite reported decline in food inflation, the food security situation remains precarious due to below average long rains as well as the Maize Lethal Necrosis Disease which resulted in reduced harvests. The short rains have been predicted to be intense with flooding expected in some areas. Furthermore, increased demand for goods and services associated with the festive season is likely to edge inflation upwards. In view of the above fundamentals, it is projected that inflation will hit the 8.0 percent mark by close of January 2015.

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



Source: KNBS

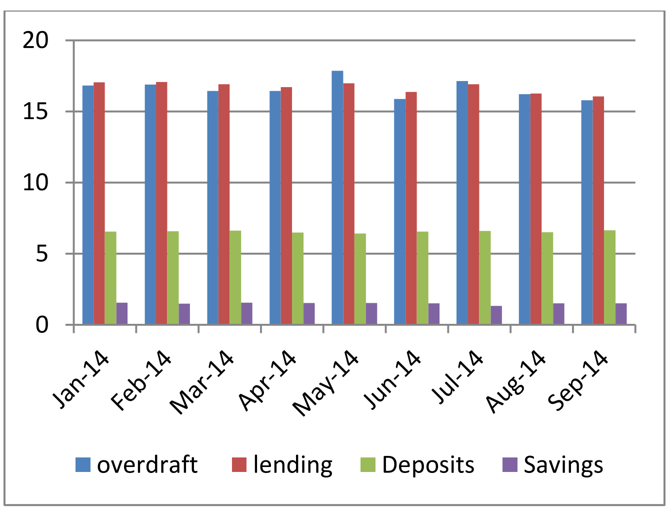
Interest Rates

The average yield rate for the 91-day Treasury bills, which is a benchmark for the general trend of interest rates, stood at 8.67 percent in the month of October. This is a slight increase from 8.65 percent in the previous month. The slight increase may have been occasioned by the issuance of infrastructure bond which pushed up the interests up.

The regulator recently announced that it shall be publishing the premium (variable K) for banks and microfinance banks which is loaded on lending rate (KBRR). This shall give borrowers information for informed decision making while seeking credit facilities and is aimed at promoting competition among banks.

There is observed increased uptake of government debt through buying of Treasury bills and Bonds by the public. This was recently witnessed when the regulator offloaded infrastructure bonds to the public at 11 percent per annum.

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



Data Source: CBK

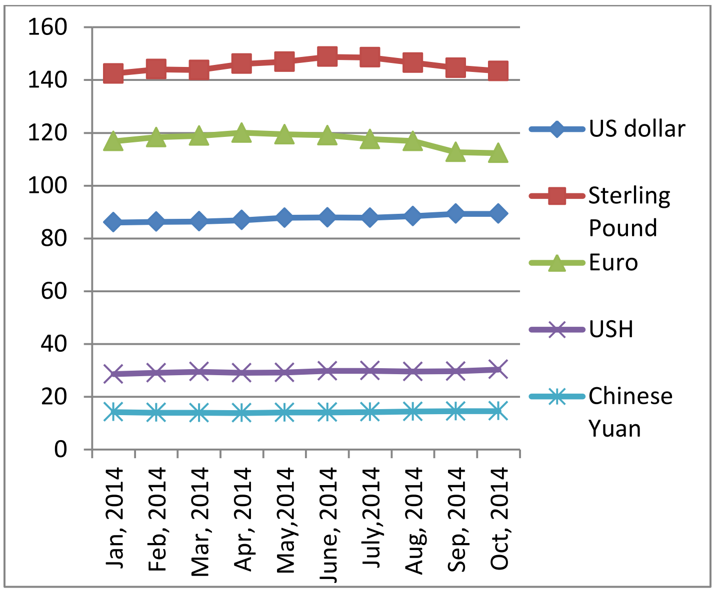
Exchange Rate

The Kenya Shilling has reported varied performance against major international currencies. It appreciated against the Euro and Sterling pound but continued its weak but fairly stable performance against the US dollar. In September, the Shilling exchanged at an average of Kshs. 89.32, Kshs. 144.6, Kshs. 112.71 and Kshs. 14.61 for the US Dollar, Sterling Pound, Euro and Chinese Yuan respectively. In October, the Kenya Shilling exchanged at an average of Kshs. 89.35, Kshs. 112.34, and Kshs. 14.55, respectively, to the US dollar, Euro, and the Chinese Yuan respectively.

In the EAC region, the Kenya shilling exchanged at an average of Kshs. 30.32 and 19.10 respectively to the Ugandan Shilling and the Tanzania Shilling in the month of October; increasing from Kshs. 29.68 and Kshs. 19.07 to the Ugandan Shilling and the Tanzania Shilling respectively in the month of September. The Kenyan shilling movement within the Ugandan and Tanzania has been a rather stable upward movement. This may be occasioned by wider trade deficits and lower alternative foreign capital inflows that Uganda and Tanzania are currently experiencing. The sale of the $2 billion Euro Bond may have helped the buoyancy of Kenya shilling. However the Kenya shilling depreciated even further by mid-November to hit the Kshs. 90 mark.

The weak performance of the shilling against the dollar could be attributed to the after effects of the decline in activity in the Tourism and Agriculture sector. On the international scene, the strength of the dollar could be a result of US Federal reserve terminating its expansionary monetary policy. This resulted to higher interest rates attracting additional capital inflows in the US.

Figure 4: Trends in Exchange Rate over the period Jan – Oct 2014



Data Source: Central Bank of Kenya

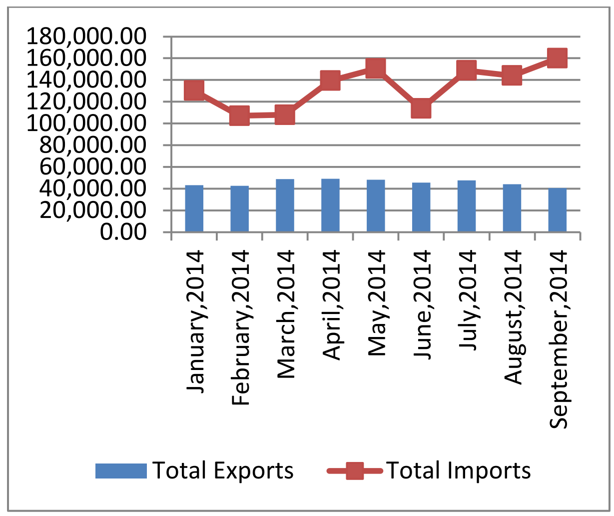
Foreign Exchange Reserves

The usable official foreign exchange reserves held by Central Bank stood at US$ 7,069 million by the end of October 2014 (4.68 months cover). This was decrease from the previous month where the foreign exchange reserves stood at US$ 7,248 (4.78 months of import cover) as at 25th September 2014. The decline could be a result of the expanding imbalance in the Balance of Payments Accounts in the month of October.

The latest figures from KNBS show that in the month of September 2014 export value declined to Kshs. 40,473.27 Million from Kshs. 43,961.71 million. On the other hand, Import value increased from Kshs. 136, 793.13 million to Kshs. 151,824.83 million.

It is also worth noting that the depreciating shilling may make exports cheaper thereby improving balance of trade and enhancing foreign exchange earnings.

Figure 5: Trends in Exports and Imports (Kshs. Millions)



Source: KNBS

Domestic Debt

The domestic debt increased from Kshs. 1228.13 billion in the month of September to Kshs. 1254.80 billion by the end of October. This steady increase was due to the ever increasing uptake of government securities in the domestic market. The bank overdraft has increased to Kshs. 20.99 billion by end of October, from a low of Kshs. 18.90 billion in mid-October.

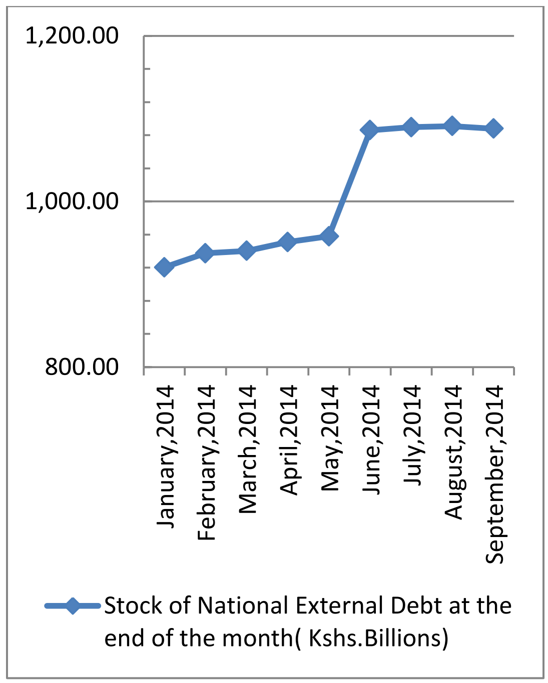
The overall external debt has slightly reduced from Kshs. 1090.98 billion in the month of August 2014 to Kshs. 1087.8 billion by the end of September 2014.The decrease was attributed to repayment made to the syndicate loan of USD 600 million.

The currency composition of external debt, shows that the US Dollar forms the largest share of the external debt portfolio followed by the Euro. This is a worrisome trend because it means that in the coming months the country would pay higher premium due to the depreciation of the Kenya Shilling against the dollar.

It is worth noting that the country is slowly approaching the approved statutory external debt ceiling of Kshs. 1.2 trillion set by Parliament in January 2013.The government is seeking to raise the external debt ceiling to Kshs. 2.5 Trillion. However increasing the ceiling will need to take into consideration the following:

a) National Treasury to clearly state whether the total estimated amount required for external debt stock is for the FY 2014/15 or beyond. The external borrowing must be in line with Art. 201 (c) of the Constitution
b) National Treasury to carry out a new debt sustainability analysis in the view of the rebased GDP figures
c) National Treasury to address the low absorption capacity of development expenditure. This would enable Kenyans enjoy the benefits of the development partner funds.

Figure 6: Trends in Stock of National Debt



Memorandum Items[2]		
Category	Estimate for 2014/15	Current Actual/Provisional
Exchequer releases	Kshs. 1,182 billion	
	Recurrent	Kshs.186.36 Billion (29.78 % of the target) As at 31st October 2014
	Development	Kshs.53.60 Billion (16.70% Of The Target) at 31st October 2014
CFS	*Kshs.415.5 billion*	Kshs. 208.43 Billion(50.16% of the Target) (31st October 2014)
Transfers to Counties	*Kshs.226.66 billion*	Kshs. 50.72 Billion(22.17% of the Target) (31st October 2014)
Revenue Target (excluding external grants)	Kshs.1,087.1 billion	Kshs.312.68 billion(28.76 percent of the Target)(As at 31st October 2014)
Stock of Debt	Kshs.2,200 billion	
Of which: Domestic		Kshs. 1254.80 Billion(24th October 2014)
External		Kshs.1087.8 billion (September 2014)
CBK Overdraft		Kshs. 20.99 Billion (24th October 2014)
GDP Growth rate	5.0% (Nat. Treasury 2014)	5.7% (2013)(After Rebasing)

Main data sources are Central Bank, KNBS, KRA, Treasury and PBO