Monthly Bulletin on Indicators on Budget and Economy
May/June 2015

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 May 2015

The 2014/2015 financial year is coming to an end. It was a difficult year for the economy, occasioned by challenges; notably insecurity which has dampened the country's tourism and investment outlook. This negatively affected foreign exchange inflow. Indeed, these downside risks have partly contributed to the deterioration of the shilling. The close of May, the shilling touched an all time high of Kshs.98 to the dollar. The currency nearly edged to the psychological mark of Kshs.100 to the dollar. Unless decisive mitigation measures are taken, the aforementioned risks, more importantly security related, will continue hurting the economy through 2015 to 2016.

For the 2015/16 financial year, the National Assembly has approved a budget amounting to Ksh. 2 trillion of which Kshs.287 billion has been earmarked for County Governments. To finance this budget, the Government is targeting to collect Ksh. 1.358 trillion in 2015/16 (approximately 20 percent of GDP). The deficit of Kshs. 570.2 billion or translating to 8.7 percent of GDP will be funded by borrowing domestically and externally.

Some of the key projects in the 2015/16 budget which are poised to propel the economy include the Standard Gauge Railway, road construction, geothermal development and investment in social and economic sectors.

Economic Growth

The National Treasury projects that the economy will grow at 7 percent in 2015; on account of a stable macroeconomic environment and ongoing major infrastructure development. However, given the uncertainties that continue to linger on such as insecurity, likelihood of food shortage, perceived stock market bubble in China and a modest economic outlook of Kenya's key trading partners, the 7 percent economic growth may not be realised. Should this be the case, then the targeted revenue collection may also not be realized and this may eventually affect budget execution in 2015/16.

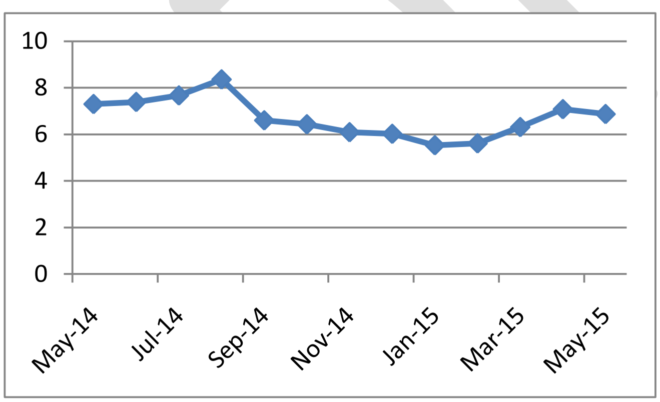
The economy grew by 5.3 percent in 2014 partly supported by increased private consumption and the escalating investments in capital. Over the same period, the National Treasury had projected that the economy would grow by 5.8 percent. Weighing in external and internal risks, we project that the economy will grow by 5.6 percent in 2015 rising to 6.0 percent in 2016 and 2017. It's important to note that over a last couple of years, the National Treasury economic growth projections have tended to be too optimistic leading under-performance of revenues mid year.

Inflation

Overall inflation eased from 7.08 per cent in April 2015 to 6.87 per cent in May 2015 but remains higher than the 5 per cent target by the National Treasury. The decline in the overall inflation in May 2015 is mainly attributed to lower food prices with increased food supply particularly for the lower income groups. Also, the transport index is reported to have declined by 1.34 per cent with decline in matatu/bus fares. During the same period, housing, water and electricity, gas and other fuels' index increased by 1.30 per cent mainly due to the observed cost increase in respect to house rent, electricity, kerosene, charcoal and other utilities.

The challenge will be to ensure that inflation does not revert to its upward trend and remains within the 5 percent target level. Significant upward pressure on inflation in the coming months stems from likelihood of increased food prices with possibility of food shortage in some regions in the coming months. Oil prices are also likely to face upward pressure in the second half of the year especially given the increment of sh. 3 per litre of fuel for the roads maintenance levy as a revenue raising measure for 2015/16. This is also likely to lead to high cost of production which will be passed on to the end user who is the consumer. Furthermore, the ERC has adjusted fuel prices upwards for the third month in a row citing global oil price increases and a weak shilling. Continued poor performance of the shilling against the dollar has also significantly contributed to the increasing cost of fuel and is likely to remain a significant factor in the coming months.

Figure 1: Trends in Inflation over the period of May 2014-May 2015



Source: Central Bank

Interest Rates

The average yield rate for the 91-day Treasury bill stood at approximately 8.2 percent for the month of May. This is slightly lower than the 8.4 average rate for the months of March and April denoting a slight reduction in government appetite for domestic borrowing. However, this trend is likely to be reversed given the request for significant additional funding in the second supplementary budget presented to parliament which will most likely be funded by domestic borrowing.

On the other hand, commercial bank lending rates declined slightly from 15.46% in March to 15.40% in April 2015 with new and existing loans from all commercial banks and microfinance banks having been converted to the KBRR framework. Conversely, the average deposit rate declined slightly from 6.63 percent to 6.60 percent over the same period. The increase in the Central Bank Rate (CBR) by 150 basis points to 10 percent will most likely lead to higher lending rates by the commercial banks. This will especially be necessitated by an increase in the KBRR base lending rate for banks which is computed as an average of the CBR rate and the 2 month weighted moving average of the KBRR. The increased cost of borrowing will adversely affect the private sector in the coming months.

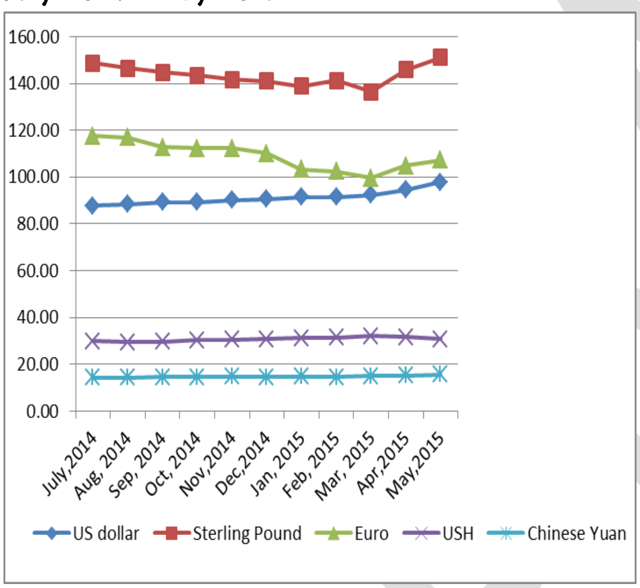
Exchange Rate

In the month of May, the Kenya shilling depreciated even further against the dollar to reach the Kshs. 98 mark against the dollar. For other major world currencies, the Kenya shilling exchanged at Ksh. 151.03, Ksh. 107.29 and Ksh. 79.98 for the Sterling Pound, Euro and Japanese Yen respectively. In the East African Community, the Ugandan and Tanzanian Shilling exchanged to the Kenyan shilling at a mean rate of Kshs.30.82 and Kshs.21.11 respectively.

The continued weakening of the Kenya Shilling against the dollar is occasioned by high dollar demands for foreign exchange, the widening current account deficit and a strong dollar in the global currency market, especially with the increase in the US interest rates.

The effect of the depreciating shilling against the dollar has ripple effects on the manufacturing sector. Most of the industries usually import the larger percentage of their raw materials, thus their import bill has risen significantly.

Figure 3: Trends in Exchange Rate over the period July 2014 - May 2015



Data Source: KNBS

The Central Bank of Kenya Monetary Policy Committee retained the Central Bank Rate (CBR) at 8.50 per cent during the month of May. However, it intervened in early June by increasing the Central Bank Rate (CBR) by 150 basis points to 10 percent, citing "*emerging aggregate demand pressures and persistent volatility in the global foreign exchange markets coupled with projected recovery in international oil prices which have implications on inflationary expectations and the potential of the pass-through of the past exchange rate movements on consumer price inflation.*"

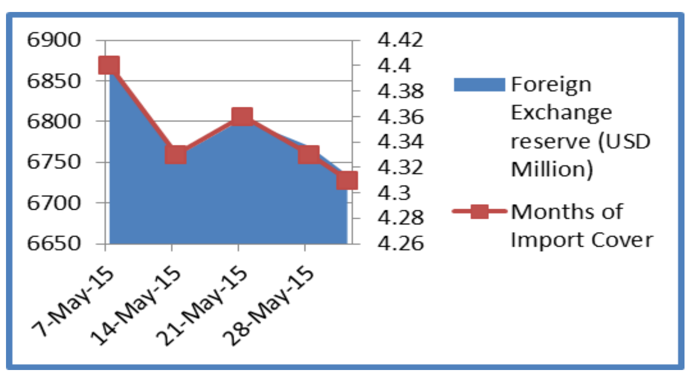
This is the first time in two years that the policy rate has been increased.

Foreign Exchange Reserves

The Foreign Exchange reserves increased during the first week of May 2015 to stand at 4.4 months of import cover, up from 4.39 months in the preceding period. This was followed by a sharp decline to 4.33 months of import cover as shown in figure 4. On average the import cover declined to 4.36 months in May 2015 from 4.45 months of import cover in April 2015. The decline in import cover can be attributed to the intervention by Central Bank, during the month, to stabilize the depreciating shilling against the dollar by releasing the dollar currency into the financial market.

Although the import cover has remained within the Central Bank's threshold of 4 months import cover, care should be taken to ensure that it does not decline beyond the statutory level.

Figure 4: Foreign Exchange reserves & Months of Import cover for May 2015



Data Source: Central Bank of Kenya

Domestic Debt

At the end of the month of May, domestic debt rose to Ksh. 1,407.73 billion. This is slightly less than the domestic debt by end of April which stood at Ksh. 1,415.84 billion. Domestic debt levels are occasioned by continued uptake of government securities to meet revenue shortfalls and finance government expenditure.

As the financial year comes to an end, the latest KRA data shows that there is a shortfall of revenue collection estimated at Ksh. 70 billion (8 percent of total revenue estimates). Yet the government requested for additional expenditure through the Supplementary II Estimates.

The risk associated with high government domestic debt in the economy, is that it drives up lending rates hence crowding out the private sector.

Memorandum Items[1]

Category	Estimate for 2014/2015	Current Actual/Provisional
GDP Growth rate		5.3% in 2014
Revenue	Ksh. 1,523 Billion	Kshs.1,328 billion(May 2015)
Debt	Ksh. 3.78 trillion	Ksh. 2.685 Trillion
Of which: Domestic		Ksh. 1,407 billion(May 2015)
External		Ksh.1.278 Billion(March, 2015)
CBK Overdraft		Ksh. 29.52 Billion (May, 2015)
Exchequer releases		Ksh 1,280 Billion (May, 2015)
Of which: CFS		Ksh. 370.78 Million (May, 2015)
Transfers to Counties	*Ksh. 229 billion*	Ksh. 172,338 Million(May 2015)

[1] Source: National Treasury, Central Bank