RECENT ECONOMIC DEVELOPMENTS AND MACROECONOMIC OUTLOOK: FY 2022/23-FY 2024/25 MEDIUM TERM BUDGET

Presentation at the launch of the Sector Working Groups

The National Treasury

August 5th, 2021

PRESENTATION OUTLINE

1. Background: Global and Domestic Economic Developments
2. Fiscal Performance and Outlook
3. Government's efforts to stimulate economic activity
4. Macroeconomic Outlook
5. Fiscal consolidation
6. Potential Risks to the Macroeconomic Outlook

1a. Background

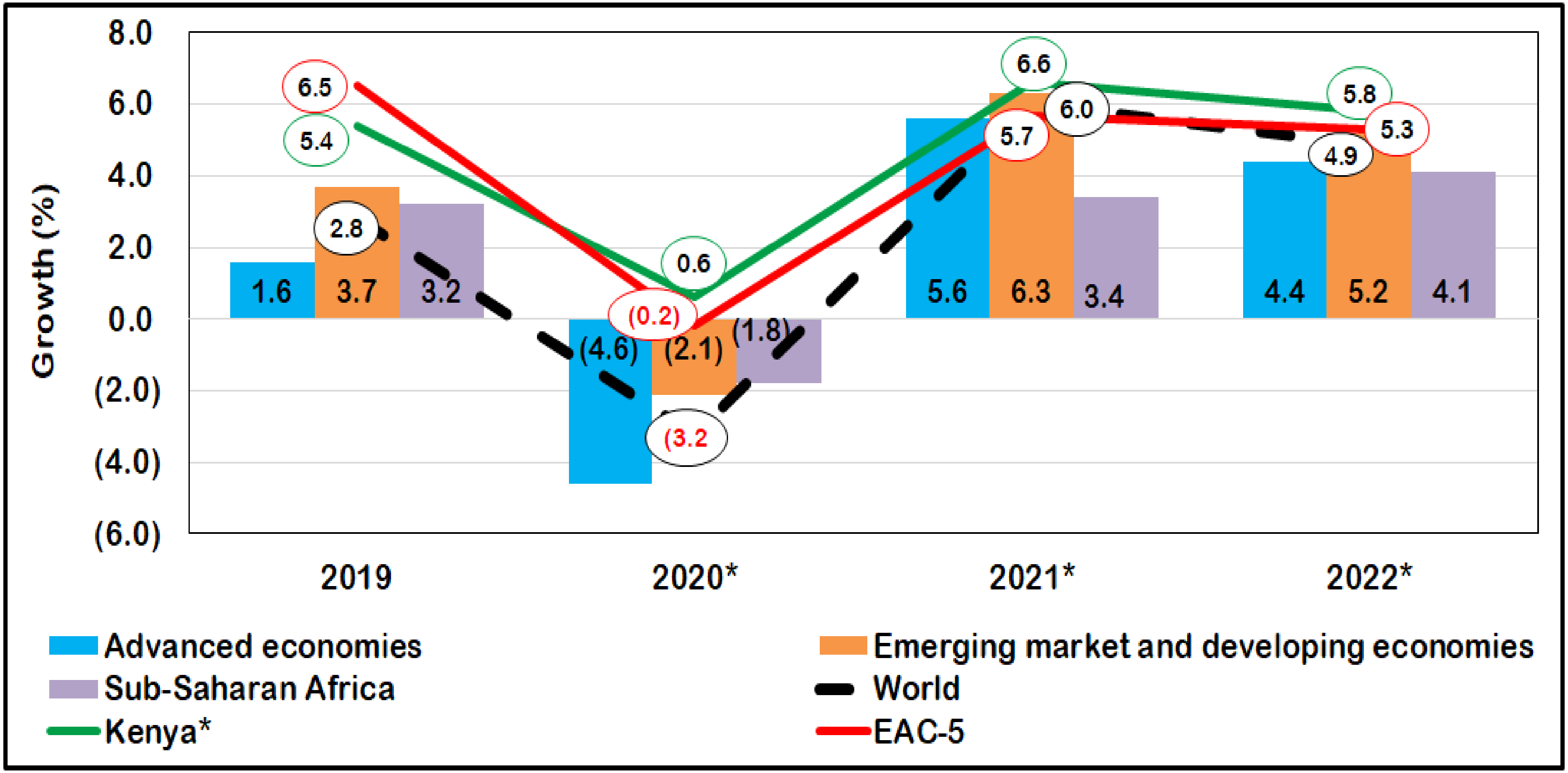
- The FY 2022/23 Budget is prepared against a background of divergent global recovery with COVID -19 Vaccine access emerging as a critical determinant to recovery. The global economy is projected to grow at 6.0 percent in 2021 and 4.9 percent in 2022.

- On the domestic scene, economic growth is expected to rebound to 6.6 percent in 2021 and 5.8 percent in 2022, reinforced by the prevailing stable macroeconomic environment and the ongoing implementation of the strategic priorities of the Government under the “Big Four” Agenda and initiatives under the Economic Recovery Strategy.

- Budget execution in the FY 2020/21 progressed well. Revenue performance improved in the second half of the year from January 2021.

- Fiscal Consolidation, through revenue mobilization and expenditure rationalization, remains a Government priority to stabilize growth in public debt.

1b. The global economy is projected to grow by 6.0 percent in 2021 and 4.9 percent in 2022. Divergence in economic prospects have widened across countries since the April 2021 with access to COVID 19 Vaccine emerging as a critical determinant to recovery.



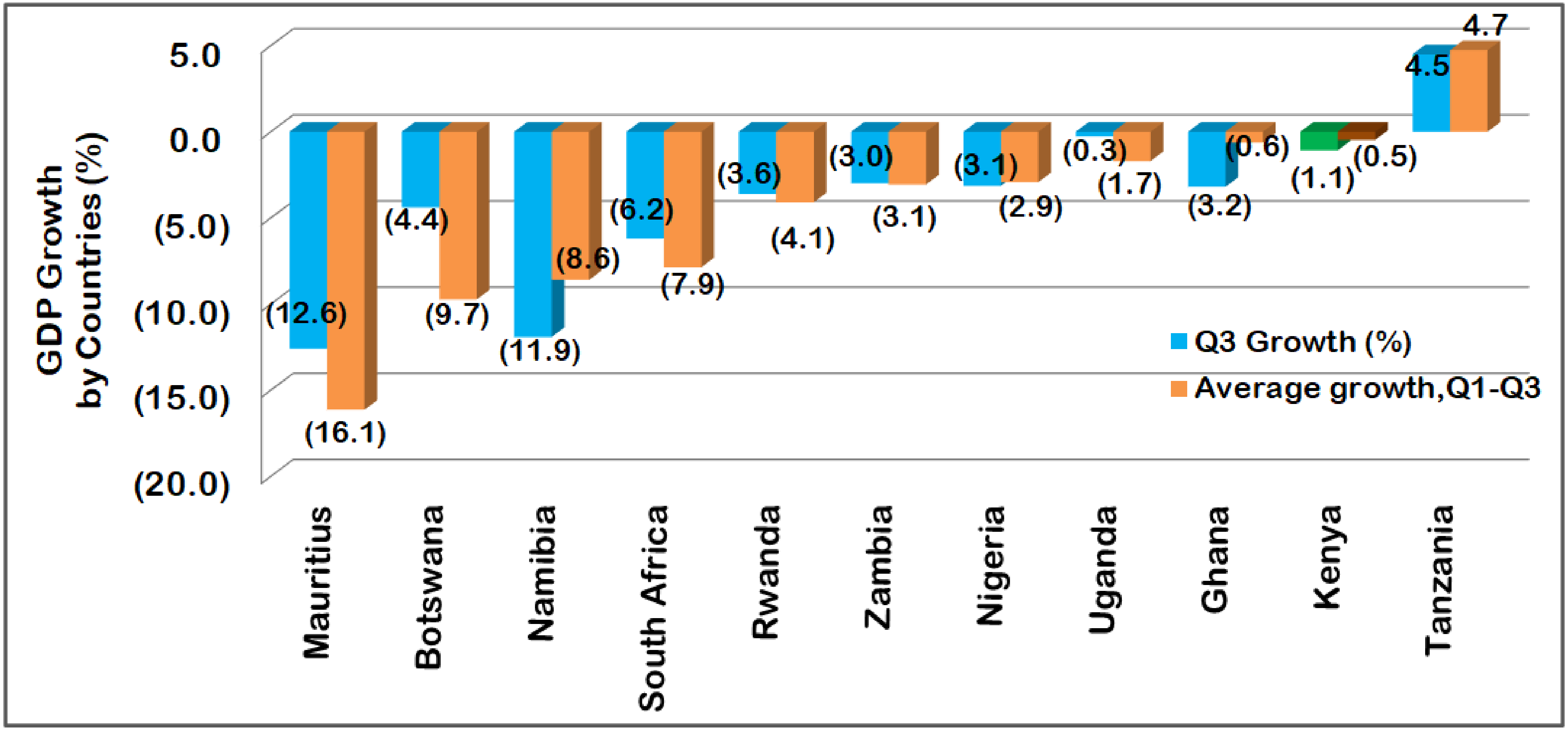
1c. Economic prospects have diverged across regions influenced by differences in the pace of vaccine rollout and policy support. Advanced economy are expected to normalize faster compared to the Emerging and developing economies as they continue facing resurgent infections and rising COVID-19 death tolls.

Economy	2019	2020*	2021**	2022**
World	2.8	(3.2)	6.0	4.9
Advanced Economies	1.6	(4.6)	5.6	4.4
Of which: USA	2.2	(3.5)	7.0	4.9
Emerging and Developing Economies	3.7	(2.1)	6.3	5.2
Of which: China	6.0	2.3	8.1	5.7
India	4.0	(7.3)	9.5	8.5
Sub-Saharan Africa	3.2	(1.8)	3.4	4.1
Of which: South Africa	0.2	(7.0)	4.0	2.2
Nigeria	2.2	(1.8)	2.5	2.6
EAC-5	6.5	(0.2)	5.7	5.3
Of which: Kenya***	5.4	0.6	6.6	5.8

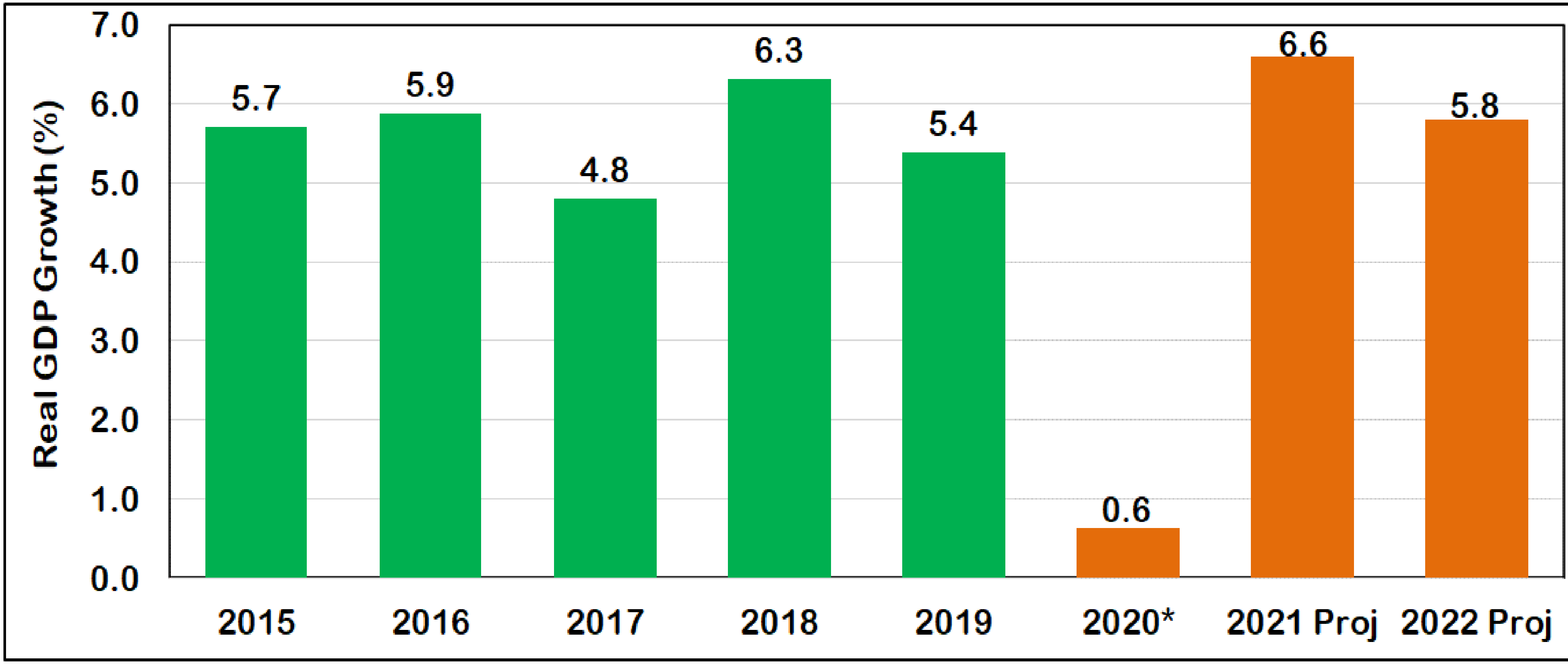
** Estimate   ** Projected   *** National Treasury Projection*

EAC-5: Burundi, Kenya, Rwanda, Tanzania and Uganda

1d. Economic performance in third quarter of 2020 shows that the Sub-Saharan region is expected to grow by 4.1% in 2022 from a contraction 1.8% in 2020. Majority of countries within the region experienced strong contractions in 2020 especially Mauritius, Botswana and South Africa among others.

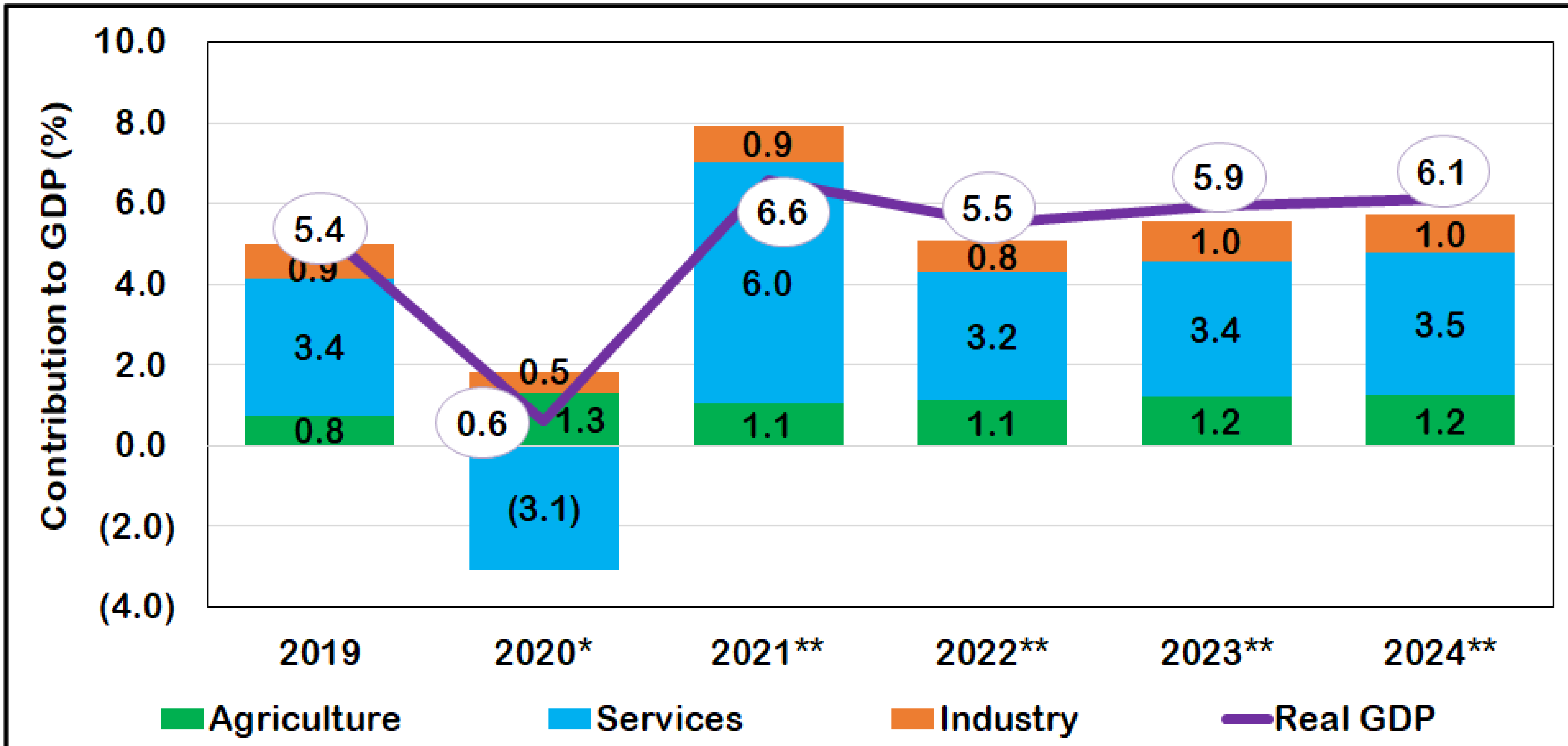


1e: Leading indicators for the Kenyan economy point to a relatively strong recovery in the first quarter of 2021. As such, the economy is projected to recover to 6.6% in 2021, partly reflecting the lower 2020 base effect

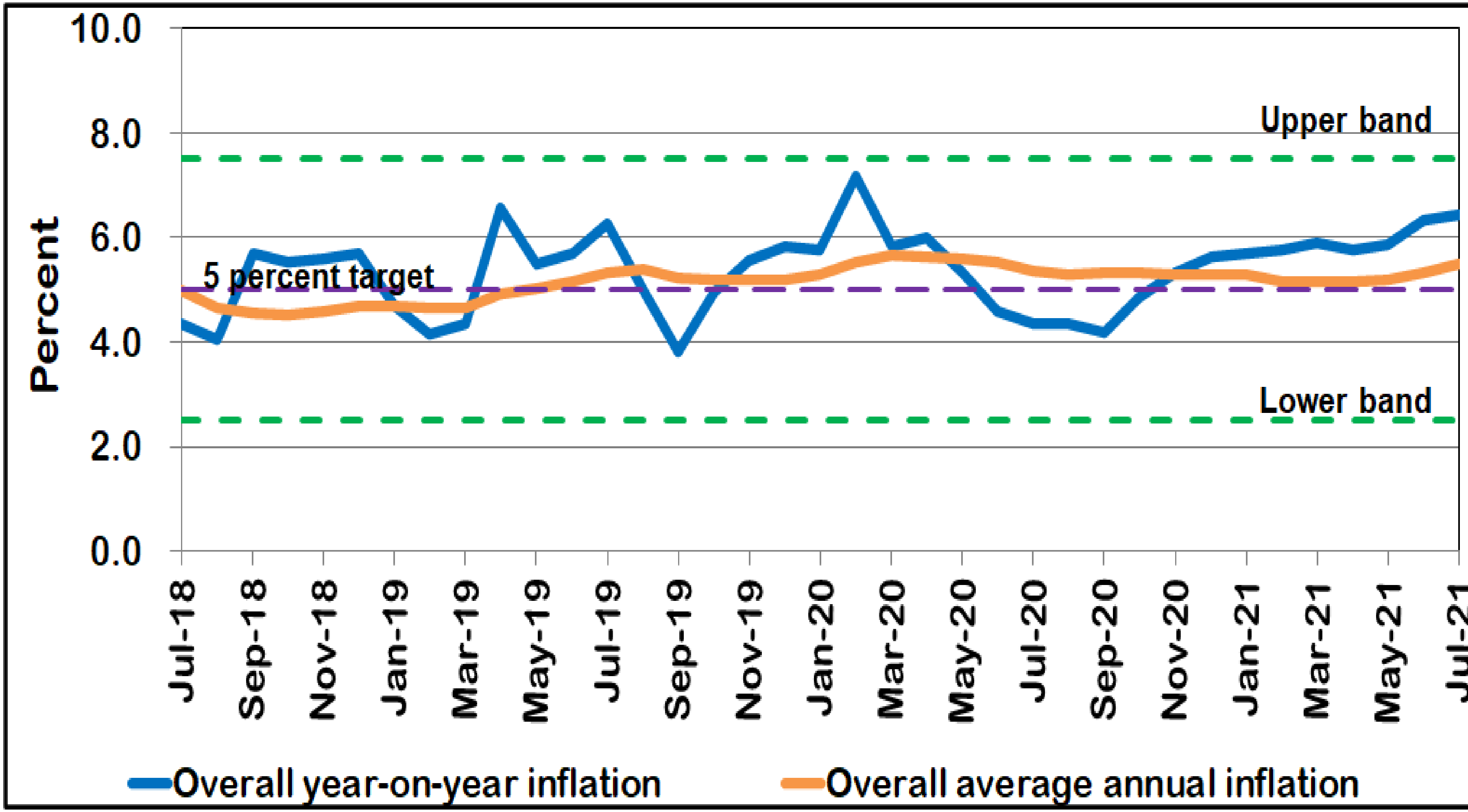


- The economy is projected to stabilize at **5.8% in 2022**.

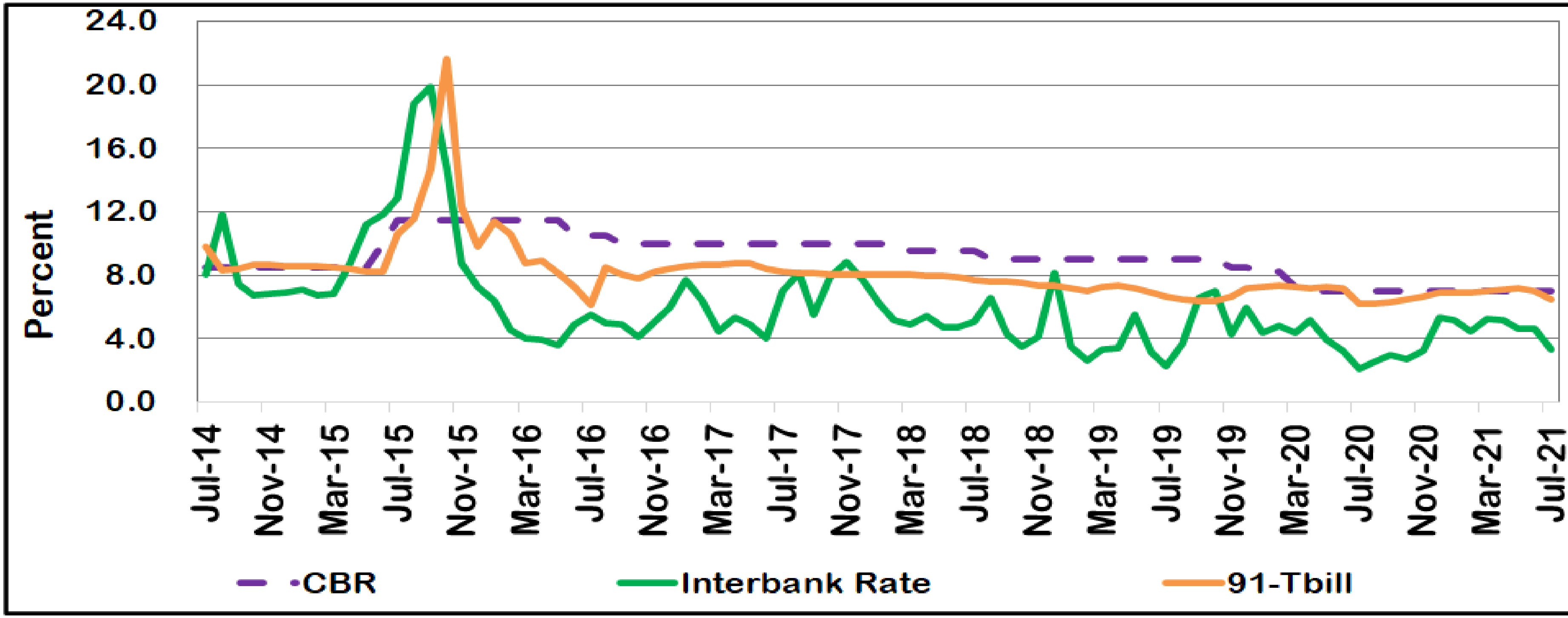
1g. The service sector has generally been the largest contributor to GDP and will contribute an average of 6.0% to GDP Growth in 2021 (due to in part to recovery from the 2020 contraction) from a negative contribution of 3.1% in 2020. The contribution is expected to stabilise at 3.2% in 2022.



1h. Inflation has largely been within the government target range of 5+/-2.5%. Overall inflation rate remained within the target range at 6.4% in July 2021 supported by subdued demand pressure.

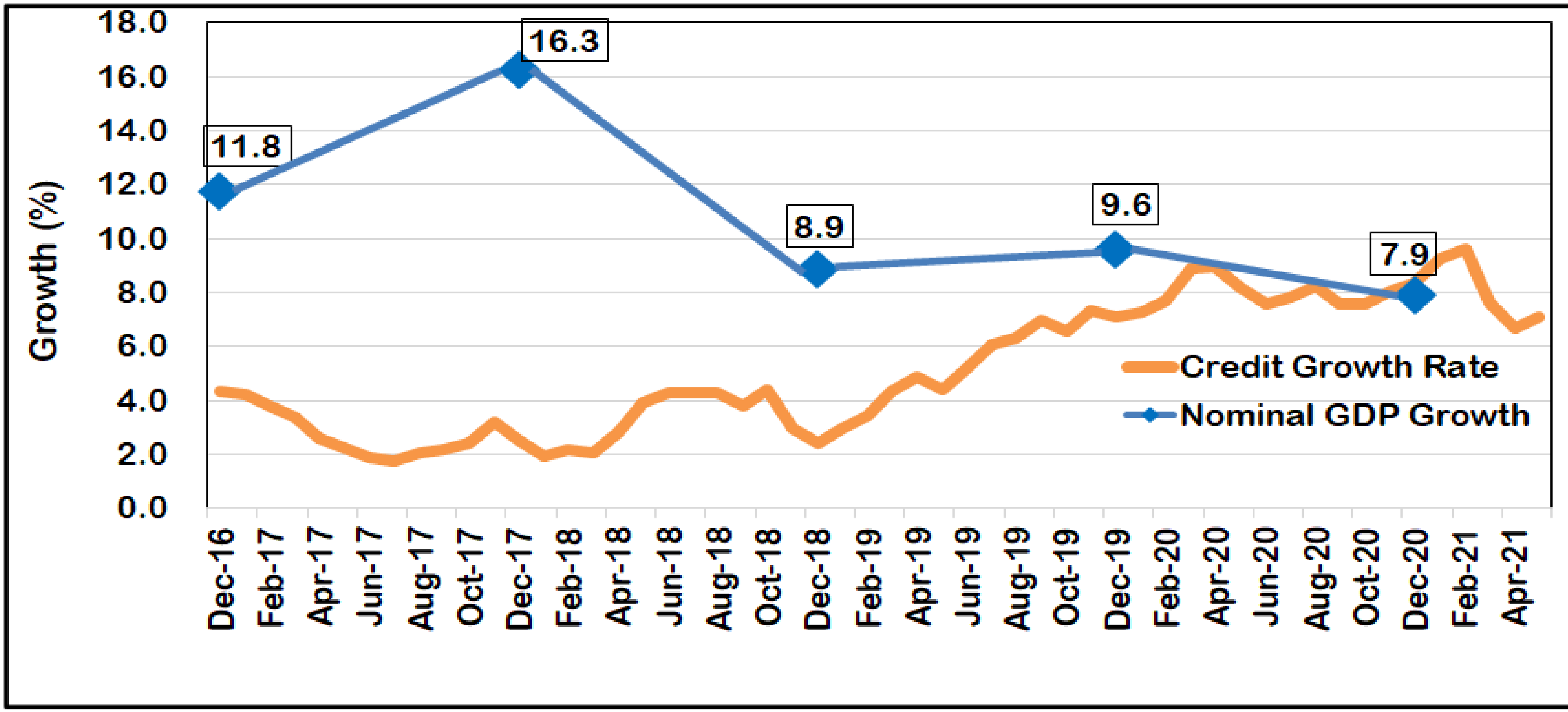


1i. Interest rates have been fairly low and stable (below 10% from 2016), due to prudent monetary and fiscal stance



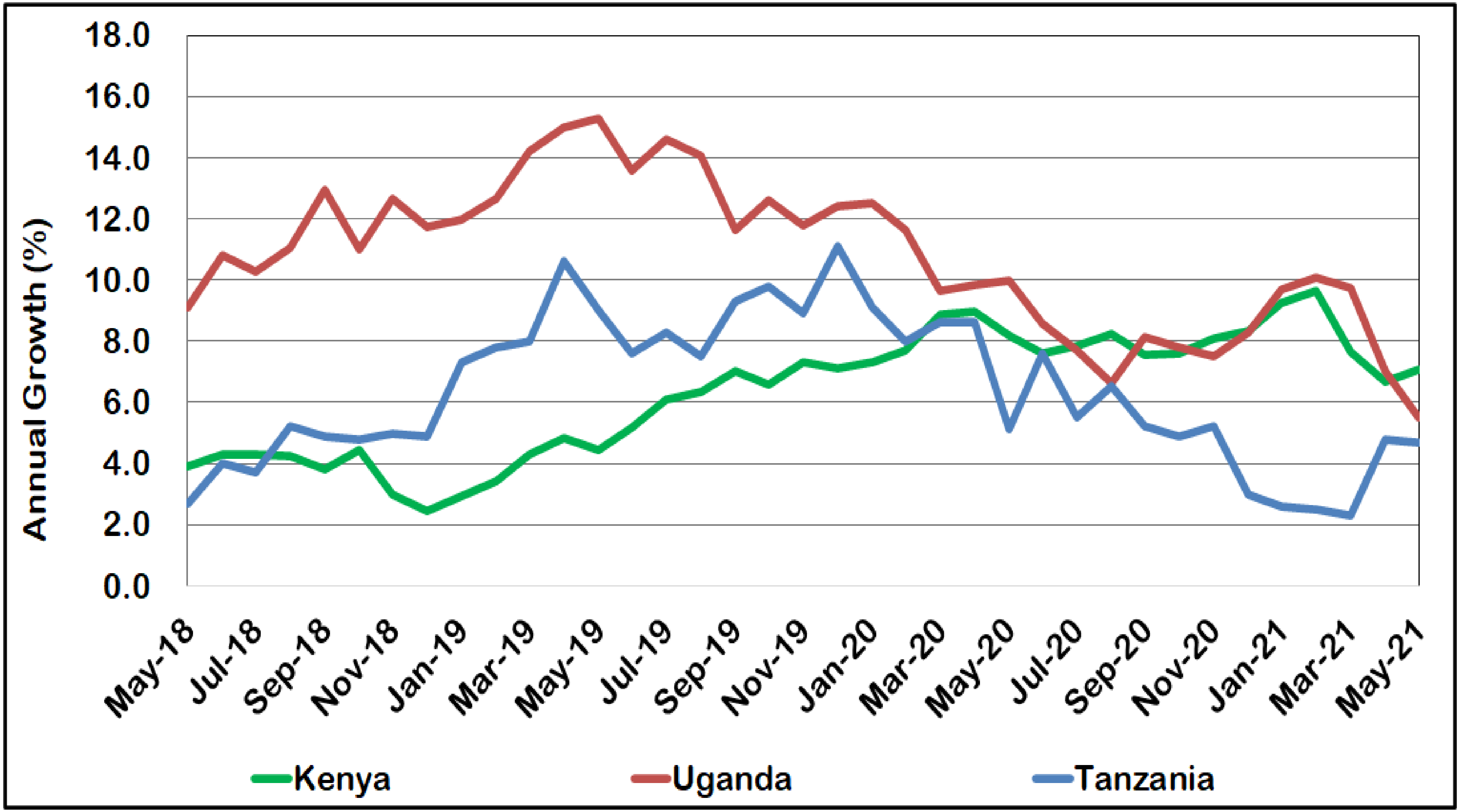
- The Central Bank Rate remained unchanged at 7.0% in July 2021 to signal lower lending rates in order to support credit access by borrowers especially the Small and Medium Enterprises distressed by COVID-19 pandemic.
- Interbank rate has generally been low at 3.9% in July 2021 due to enhanced liquidity in money market

1j. Credit extension by the banking sector has been rising since 2018 following removal of interest rate caps and implementation of various initiatives to support lending

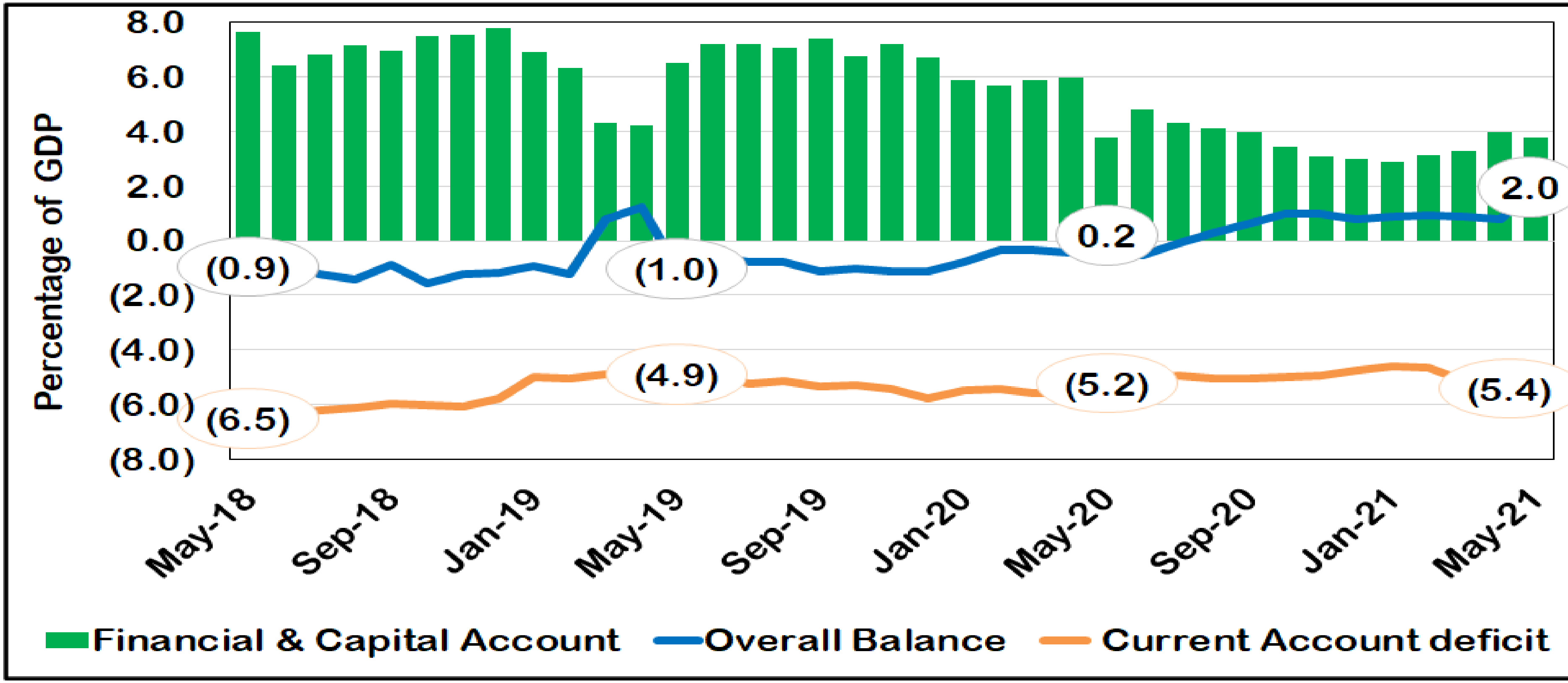


- ❑ Credit stock to private sector grew by 7.1% in July 2021 and is expected to improve further by the end of the year.

1k. Private sector credit in Kenya has been growing faster compared to Tanzania since September 2020 and catching up with Uganda in May 2021

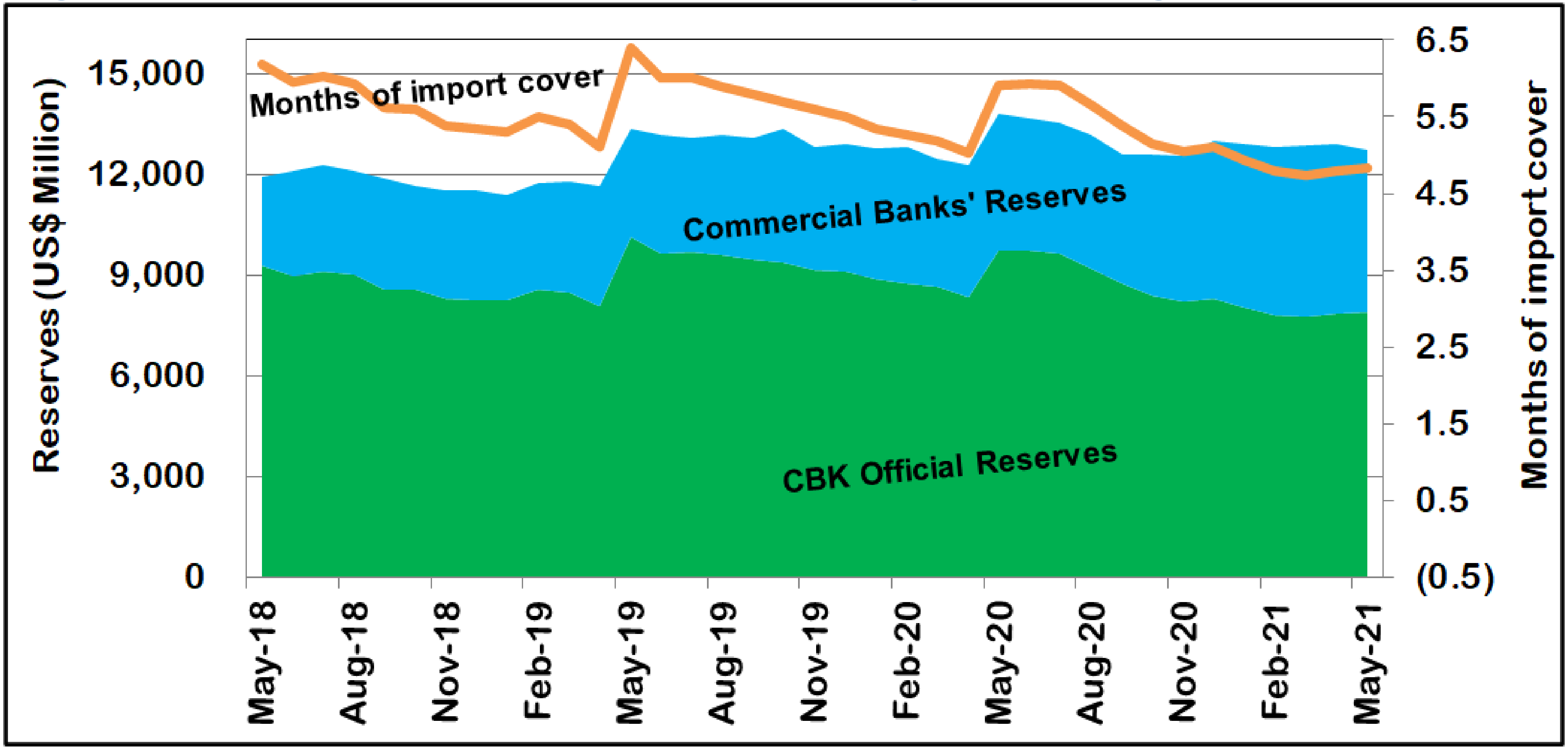


1l. The overall balance of payments position improved to a surplus 2.0% of GDP in the year to May 2021 from a surplus 0.2% of GDP in the year to May 2020 mainly due to an improvement in the merchandise account balance as well as the capital account



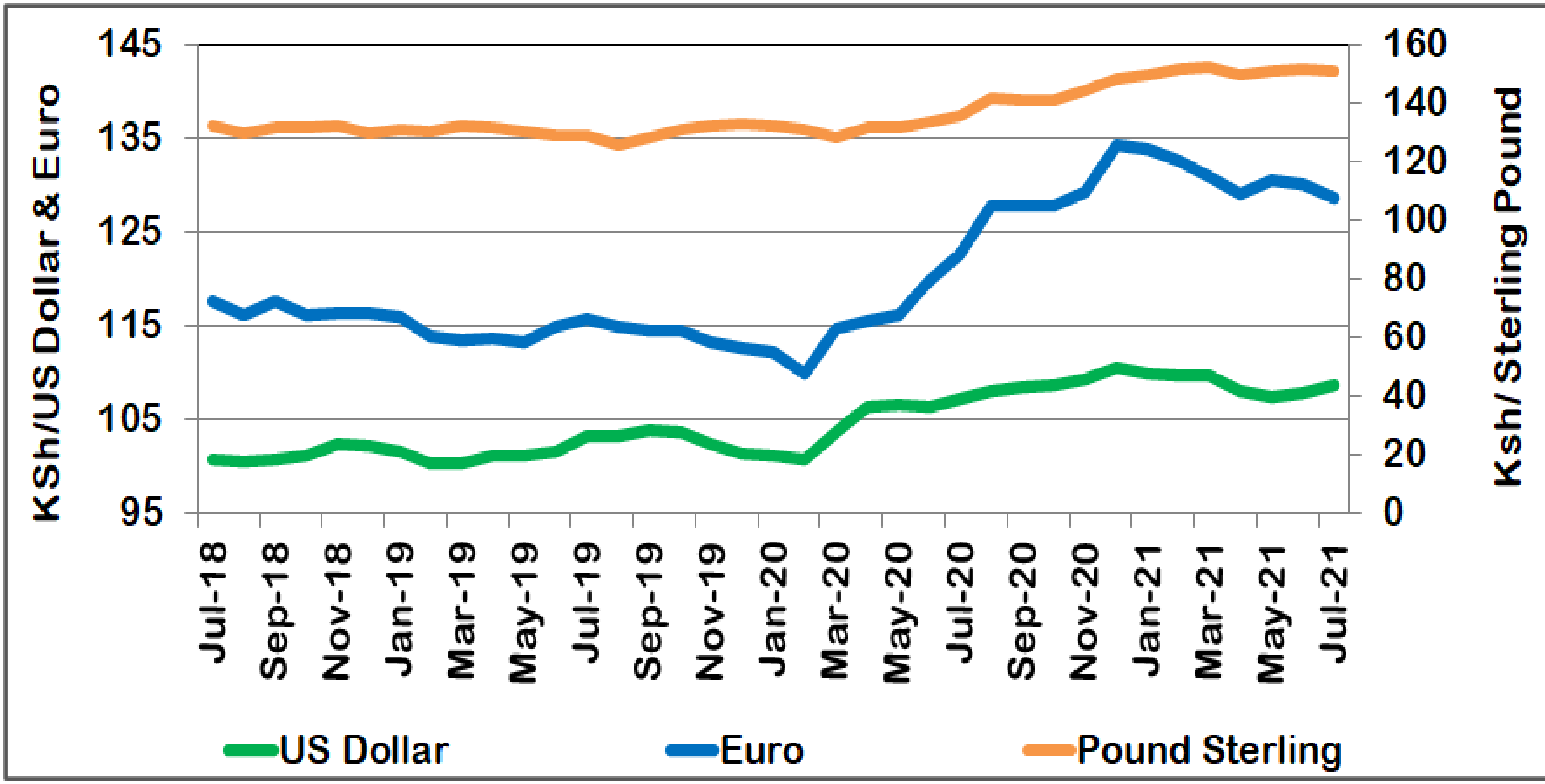
- The current account deficit is estimated at 5.4 percent of GDP in the 12 months to June 2021, and is projected at 5.2 percent of GDP in 2021 supported by strong goods exports particularly horticulture.

1m. The official foreign exchange reserves held by the Central Bank remain strong and continue to provide adequate buffer against short term shocks in the foreign exchange market



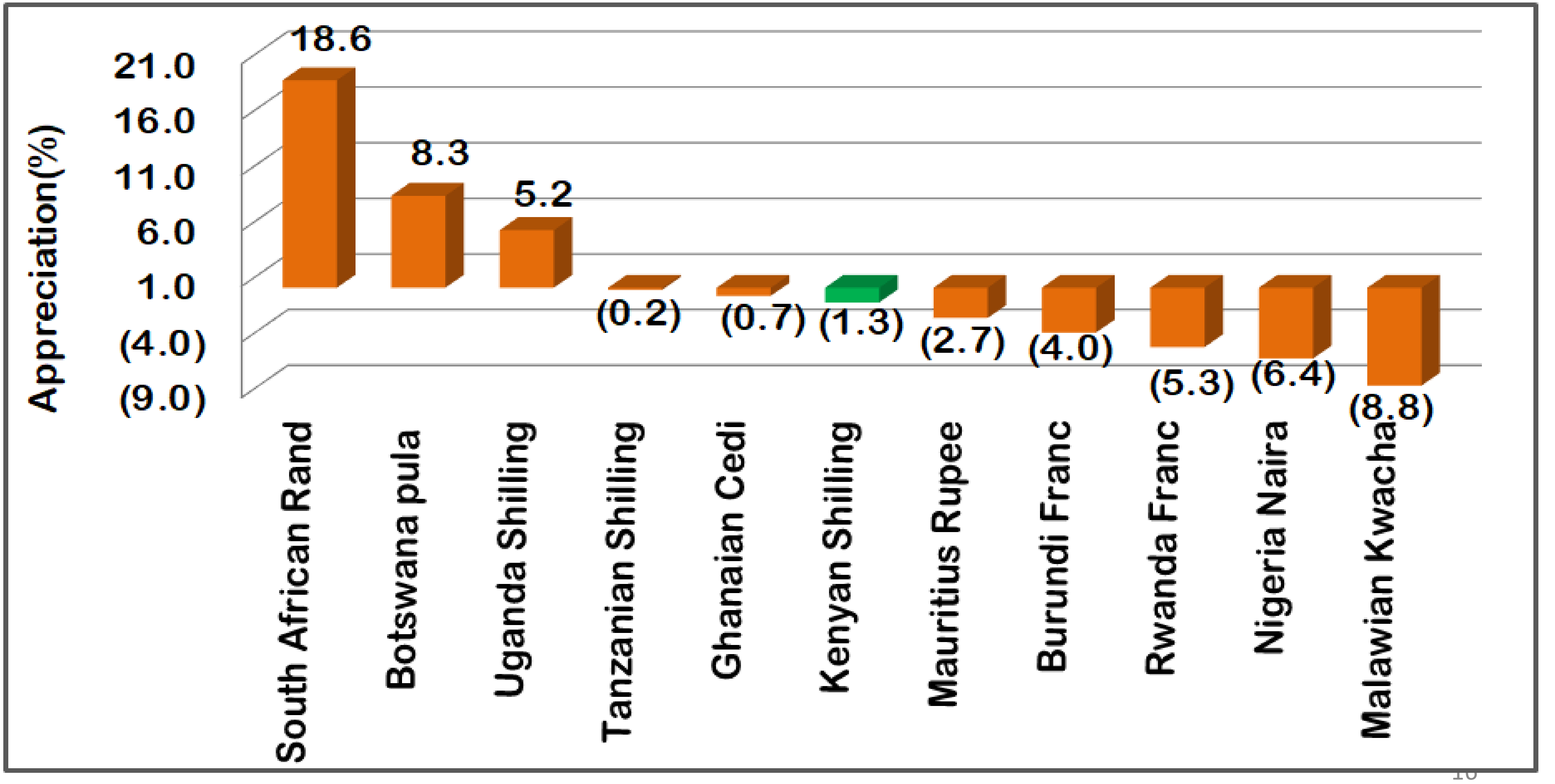
Usable reserves held by CBK in July 2021 were US$ 9.35bn or 5.72 month of import cover.

1n. The foreign exchange market has largely remained stable but partly affected by tight global financial conditions attributed to uncertainty with regard to the COVID-19 pandemic.



- The Kenya Shilling to the US Dollar exchanged at Ksh 108.1 in July 2021 compared to Ksh 107.3 in July 2020

1o. Kenya Shilling continues to record less volatility compared to most Sub-Saharan Africa currencies. The Kenya Shilling has remained relatively stable weakening by only 1.3 percent against the US Dollar in June 2021 as compared to June 2020. This stability in the Kenya Shilling was supported by increased remittances and adequate foreign exchange reserves.

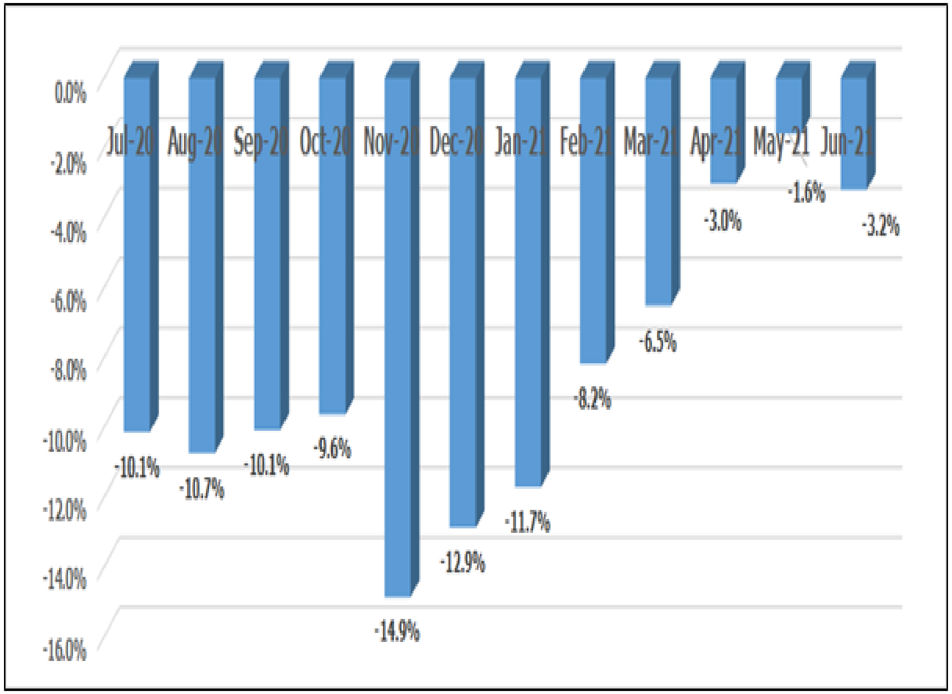


2a: The FY 2020/21 Budget implementation: Total cumulative revenues, including A-i-A for the the FY 2020/21 was Ksh 1,738.4 billion (15.6 % of GDP) against a target of Ksh 1,837.8 billion resulting in a shortfall of Ksh 99.5 billion. Shortfall explained by other revenues (Ksh 25.8 billion) and Ministerial A-i-A (Ksh 82.7 billion).

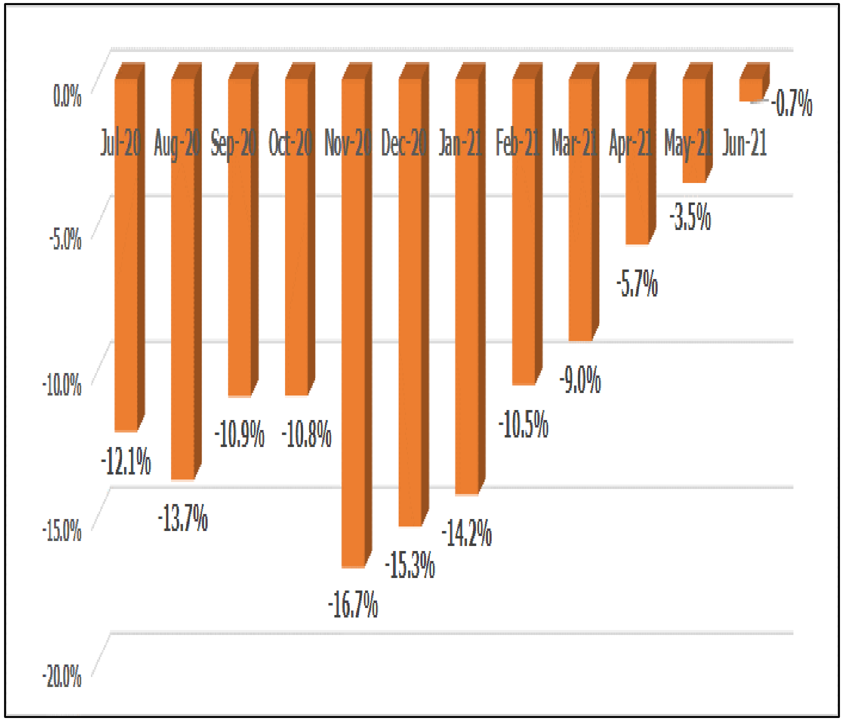
	JULY 2019 - JUNE 2020			JULY 2020-JUNE 2021					
	Prel. Issues	Performance Rate	% of GDP	Target- SUPP II	Prel. Issue	Deviation	% of GDP	Performance Rate	Growth
TOTAL REVENUE	**1,796.0**	**96.3%**	**17.6%**	**1,837.8**	**1,738.4**	**(99.5)**	**15.6%**	**94.6%**	**-3.2%**
Ordinary revenue	**1,573.7**	**97.4%**	**15.4%**	**1,578.8**	**1,562.0**	**(16.8)**	**14.0%**	**98.9%**	**-0.7%**
Import Duty	98.0	102.2%	1.0%	102.4	108.4	6.0	1.0%	105.8%	10.6%
Excise Taxes	195.3	97.1%	1.9%	218.0	216.3	(1.7)	1.9%	99.2%	10.8%
Income Tax	**706.9**	**98.1%**	**6.9%**	**697.0**	**694.1**	**(3.0)**	**6.2%**	**99.6%**	**-1.8%**
o/w PAYE	399.2	99.9%	3.9%	361.0	363.3	2.3	3.3%	100.6%	-9.0%
o/w Other Income Tax	307.7	95.9%	3.0%	336.0	330.7	(5.3)	3.0%	98.4%	7.5%
Value Added Tax (VAT)	**383.7**	**95.9%**	**3.8%**	**403.1**	**410.8**	**7.7**	**3.7%**	**101.9%**	**7.0%**
o/wVAT (Domestic)	213.9	93.7%	2.1%	197.6	197.1	(0.5)	1.8%	99.7%	-7.9%
o/wVAT (Imports)	169.8	98.8%	1.7%	205.5	213.7	8.2	1.9%	104.0%	25.8%
Other Revenue	**189.8**	**95.9%**	**1.9%**	**158.3**	**132.5**	**(25.8)**	**1.2%**	**83.7%**	**-30.2%**
Ministerial AIA	**222.2**	**89.1%**	**2.2%**	**259.0**	**176.4**	**(82.7)**	**1.6%**	**68.1%**	**-20.6%**
Recurrent	165.2	89.2%	1.6%	167.7	98.8	(68.9)	0.9%	58.9%	-40.2%
Development	57.1	88.7%	0.6%	91.4	77.6	(13.7)	0.7%	84.9%	35.9%
o/w RDL	23.3	102.5%	0.2%	27.2	28.5	1.3	0.3%	105.0%	22.6%
GDP	**10,199.9**	**100.0%**	**100%**	**11,168.5**	**11,168.5**	**0**	**100.0%**	100.0%	9.5%

2b: As the economy reopened, revenue performance improved since November 2021. Further, tax rate reversals implemented in January 2021 and tax measures in the Finance Act, 2020 supported revenue growth

Growth in Total Revenue (%)

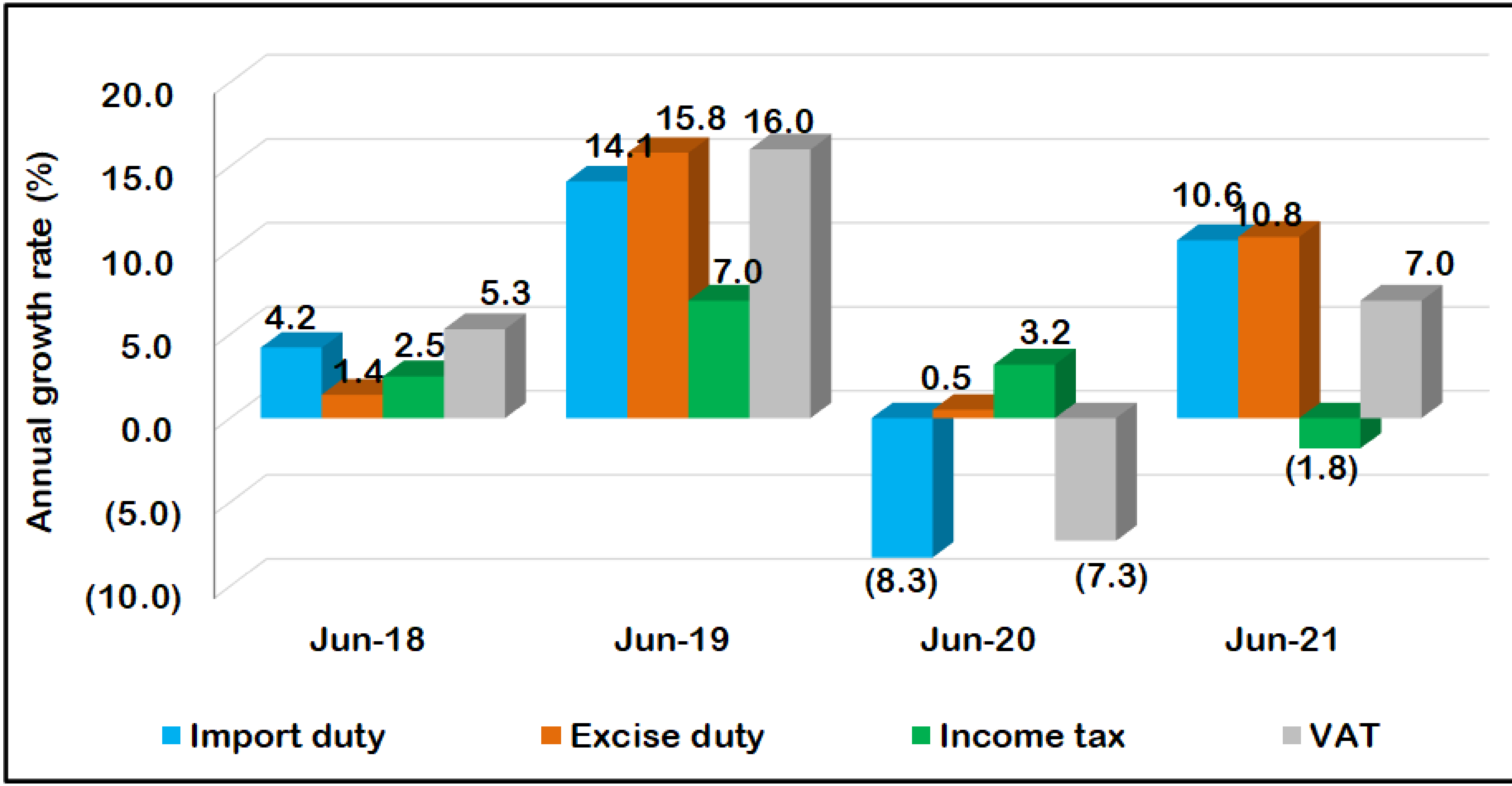


Growth in ordinary Revenue (%)



- Tax measures in the Finance Act, 2020 included: Digital Service Tax (DST) at 1.5% of gross transaction value and minimum tax at 1% of gross turnover.

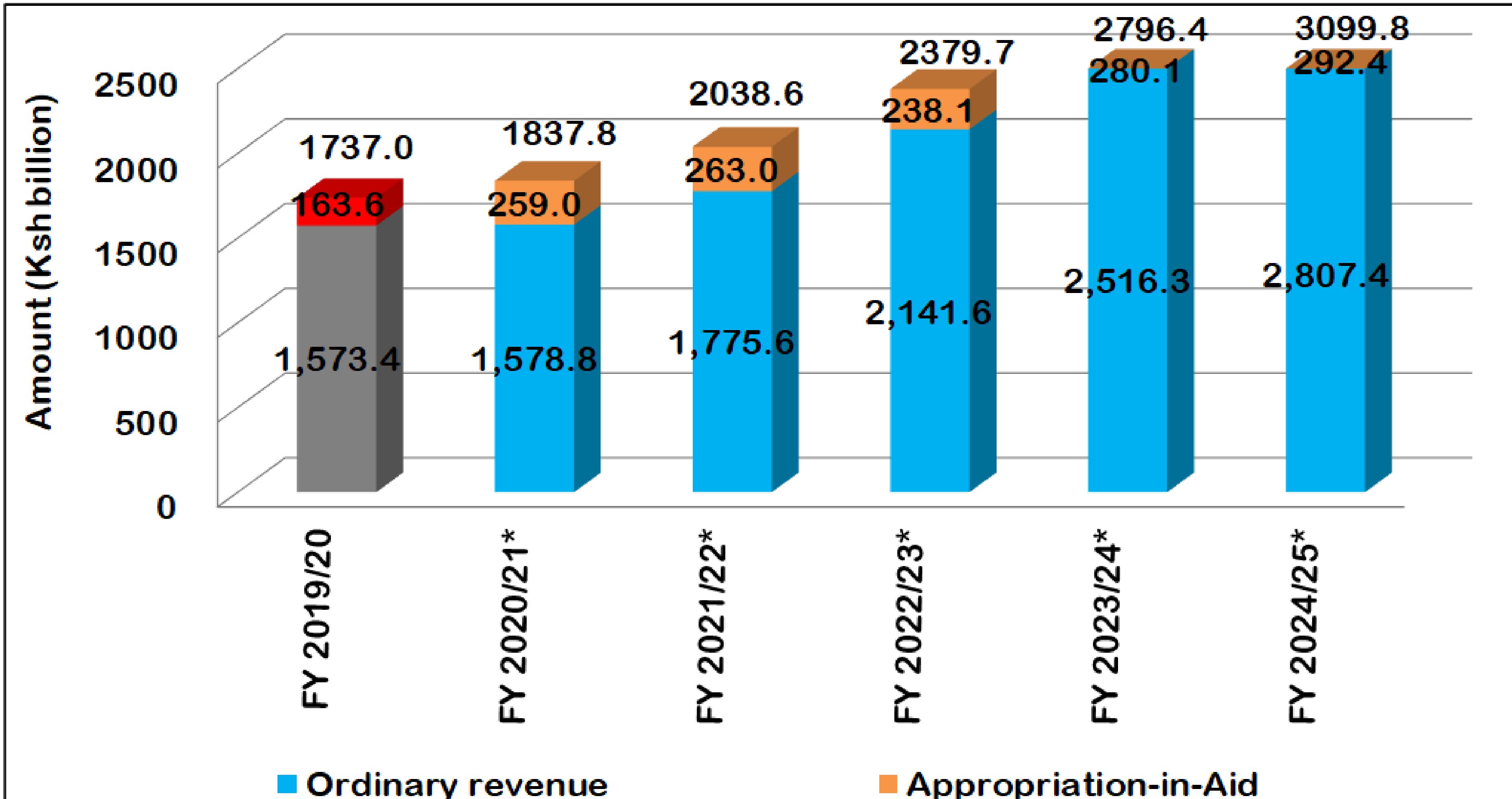
2c.The main tax heads performance: Excise duty, VAT and Import duty registered positive growths while income tax contracted in FY 2020/21



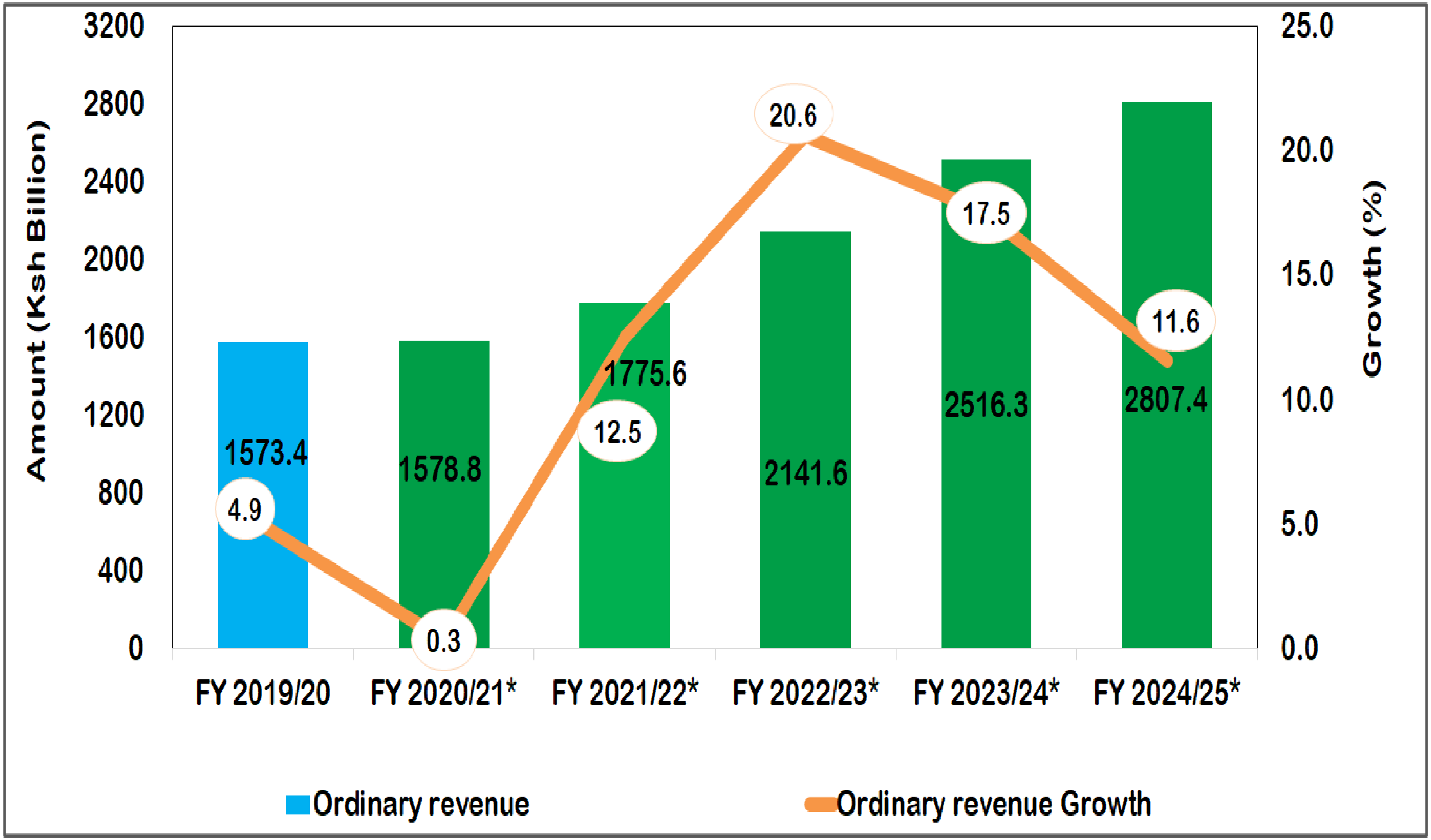
2d. Total expenditure and net lending amounted to Ksh 2,755.0 billion against a target of Ksh 2,886.9 billion. The below target performance of Ksh 131.9 billion was largely attributed to below target absorption of recurrent expenditure by Ksh 52.6 billion and development expenditure by Ksh 71.2 billion.

	Jun-20	Jun-21				Revised Estimates
	Actual	Target	Actual	Deviation	% Growth	Jun-21
TOTAL EXPENDITURE AND NET LENDING	**2,565.4**	**2,886.9**	**2,755.0**	**(131.9)**	**7.4%**	**2,886.9**
1. Recurrent Expenditure	**1,645.2**	**1,819.6**	**1,767.0**	**(52.6)**	**7.4%**	**1,819.6**
Domestic Interest	315.4	353.1	388.8	35.7	23.3%	353.1
Foreign Interest due	121.8	107.7	106.3	(1.4)	-12.7%	107.7
Pensions & Other CFS	89.6	115.3	113.0	(2.3)	26.1%	115.3
Operations & Maintenance	561.5	590.7	577.1	(13.7)	2.8%	590.7
Wages & Salaries	449.9	493.9	493.9	0.0	9.8%	493.9
Ministerial Recurrent AIA	107.0	158.7	87.9	(70.9)	-17.9%	158.7
2. Development	**594.9**	**668.3**	**597.2**	**(71.2)**	**0.4%**	**668.3**
Domestically Financed (Gross)	396.6	417.8	358.1	(59.7)	-9.7%	417.8
Foreign Financed	197.6	250.5	239.0	(11.5)	0.0%	250.5
Net Lending	0.7	-	-	0.0	0.0%	-
Equalization Fund	-	-	-	0.0	0.0%	-
3. County Transfer	**325.3**	**398.9**	**390.8**	**(8.1)**	**20.1%**	**398.9**
o/w Equitable Share	286.8	346.2	346.2	0.0	**20.7%**	346.2
4. Contingency Fund	-	-	-	0.0	0.0%	-

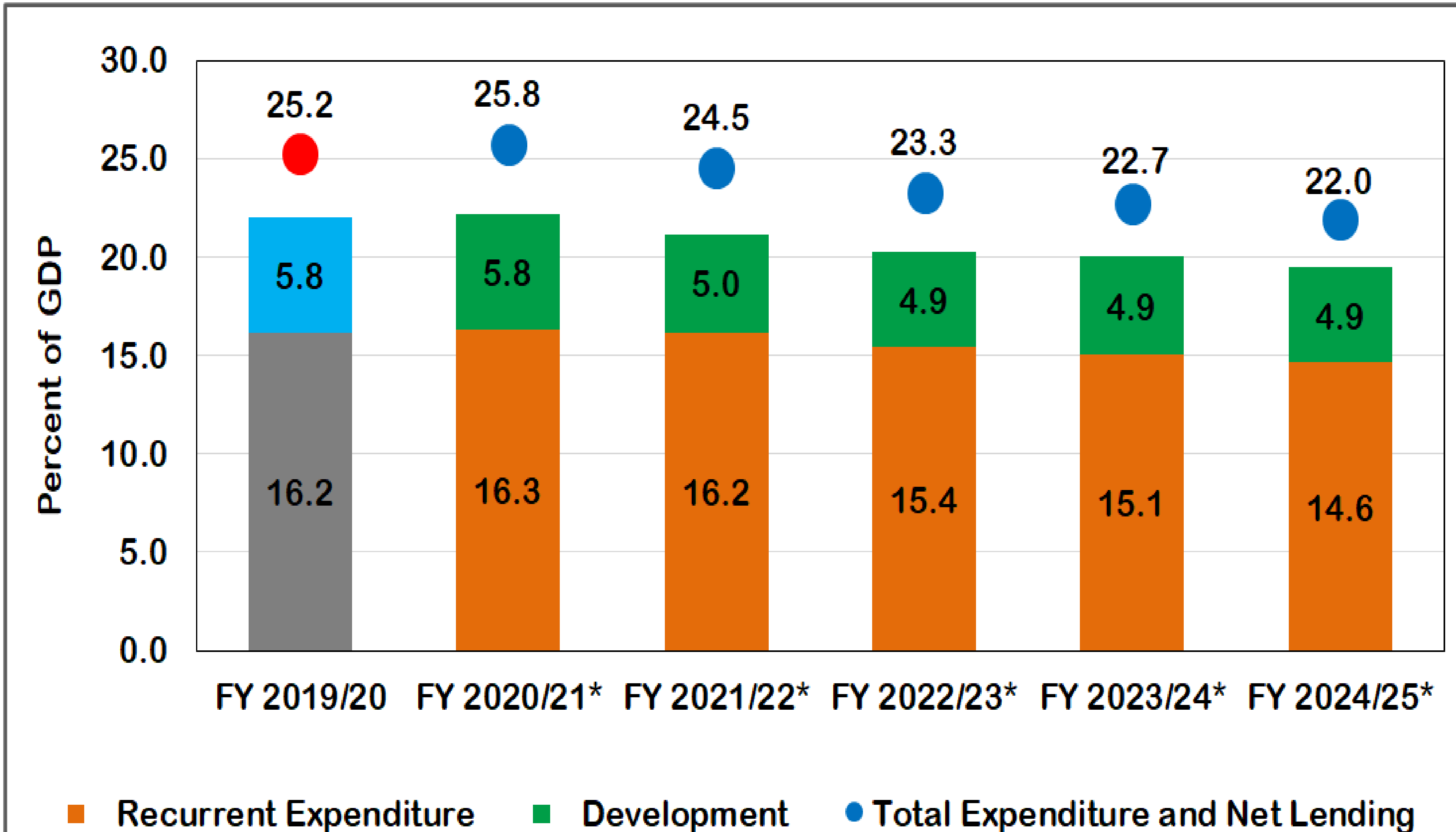
2e. Budget implementation for FY 2021/22 has commenced smoothly with Tax revenues performing slightly above target in July, 2021: Total revenues for FY 2021/22 are projected at Ksh 2,038.6 billion (16.4% of GDP) and Ksh2,379.7 billion (17.3% of GDP) in FY 2022/23



2f. : Ordinary revenue is expected grow by 12.5% in FY 2021/22 and 20.6% in the FY 2022/23 supported by expected economic recovery, lower base effect for FY 2020/21 and enhanced revenue mobilization measures.

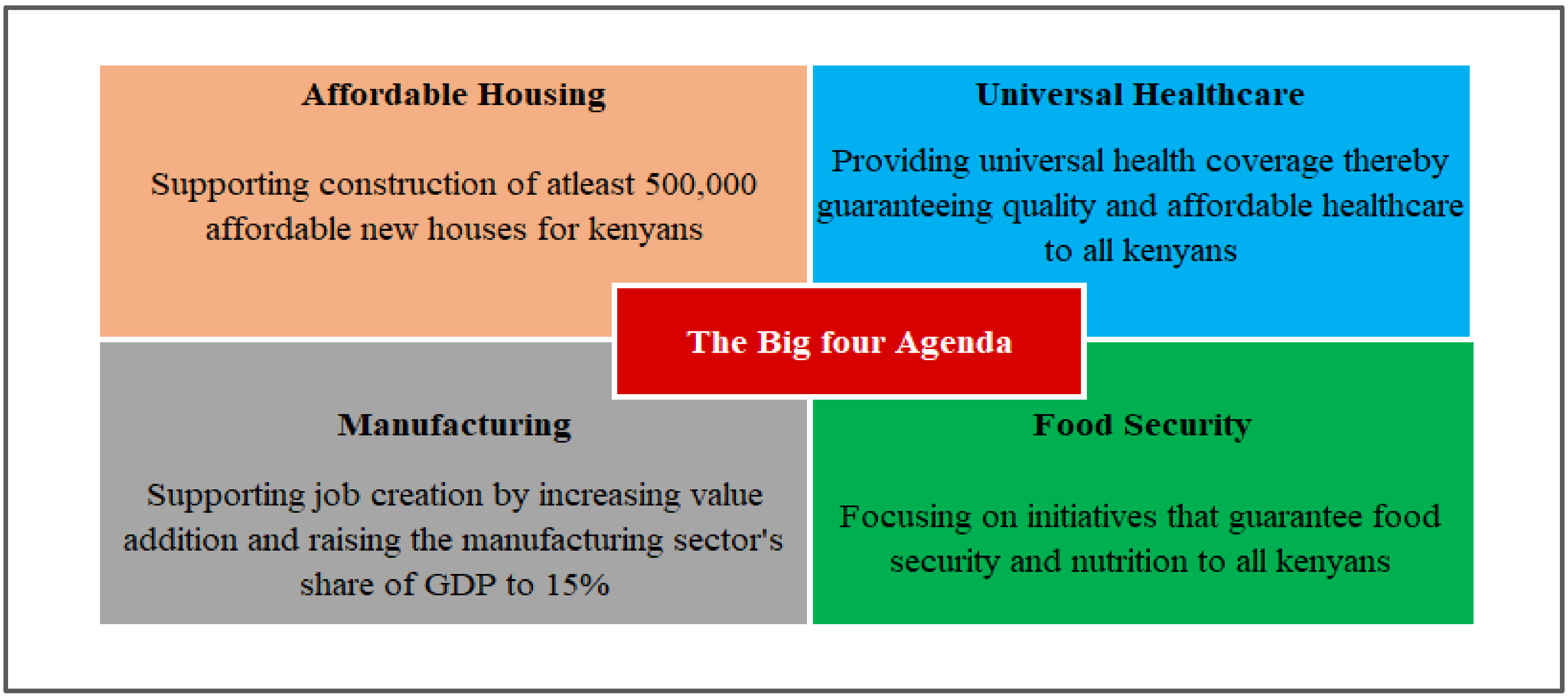


2g. Total expenditure as a share of GDP has been fairly stable and projected at 24.5% of GDP in FY 2021/22 and 23.3% of GDP in FY 2022/23. Total expenditure have been rationalized to ease funding pressures and create fiscal space



3a. Government’s efforts to stimulate economic activity- “*Big Four” Agenda*

- The Government will accelerate implementation of the **“Big Four” Agenda** which has gained traction over the past three years.
- Actualization of policies and programmes under each pillar is expected to accelerate and sustain inclusive growth, create opportunities for decent jobs, reduce poverty and income inequality and ensure that we create a healthy and food secure society in which Kenyans have access to affordable and decent housing.



3b. Government's efforts to stimulate economic activity: *Economic Stimulus Program*.

- In April 2020 the government embarked on the implementation of the Economic stimulus program (ESP) to stimulate economic activities and enhance the ability to respond to adverse impact of the Pandemic. The program focussed on:
  - Enhancing the ability to respond to COVID-19 Pandemic;
  - Reducing debt vulnerabilities through a revenue-driven fiscal consolidation with a view to stabilizing debt to GDP ratio over the medium term;
  - Implementing targeted policy, legal and institutional reforms while at the same time addressing vulnerabilities in the State-Owned Enterprises worsened by the COVID-19 Pandemic; and
  - Strengthening the monetary policy framework and financial stability.

3c. Government's efforts to stimulate economic activity contd - *Economic Recovery Strategy:*

- Building on the gains of the ESP, the Government is implementing an elaborate Economic Recovery Strategy that aims to reposition the economy on an inclusive and sustainable growth trajectory. The Strategy seeks to:

- Strengthen Health care systems;
- Enhance resource mobilization to ensure sustainable funding of development programmes from diverse sources including PPPs and lease financing;
- Support the role of the private sector to enhance its role in economic development by enhancing credit access by MSMEs through the Credit Guarantee Scheme;
- Facilitate the recovery and growth of key economic sectors such as tourism, manufacturing and transport which have been hard hit by the pandemic;
- Upscale investment in ICT and digital infrastructure in order to facilitate e-commerce and efficient delivery of public services;
- Promote local production processes and domestic supply value chains to increase resilience of the economy to global supply chain shocks;
- Strengthen social-protection through targeted policy interventions and programmes.
- Implement various policy, legal and institutional reforms and strengthen monitoring and evaluation systems to enhance efficiency of public service delivery.

- The successful implementation of this Strategy will help realize the aspired economic growth, create employment and narrow income inequalities.

4a Assumptions in the Macroeconomic Framework for the FY 2022/23-2024/25 MTEF Period

	Calender Years	2018	2019	2020*	2021*	2022*	2023*	2024*	2025*
1	Nominal Gross Domestic Product (GDP) Deflator	2.4%	4.0%	7.3%	5.6%	4.8%	5.3%	5.6%	4.5%
2	Consumer Price Index (CPI) (end of period) (%)	4.7%	5.2%	5.3%	5.0%	5.0%	5.0%	5.0%	5.0%
3	Real Gross Domestic Product (GDP) growth (%)	6.3%	5.4%	0.6%	6.6%	5.8%	5.9%	6.1%	6.3%
	Fiscal Years	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	
1	Real Gross Domestic Product (GDP) growth (%)	5.9%	3.0%	3.6%	6.2%	5.9%	6.0%	6.2%	
2	Nominal Gross Domestic Product, Ksh Billion	9,367.3	10,175.2	11,150.0	12,368.5	13,753.0	15,372.5	17,137.4	
3	Real Gross Domestic Product, Growth (%)	5.9%	3.0%	3.6%	6.2%	5.9%	6.0%	6.2%	

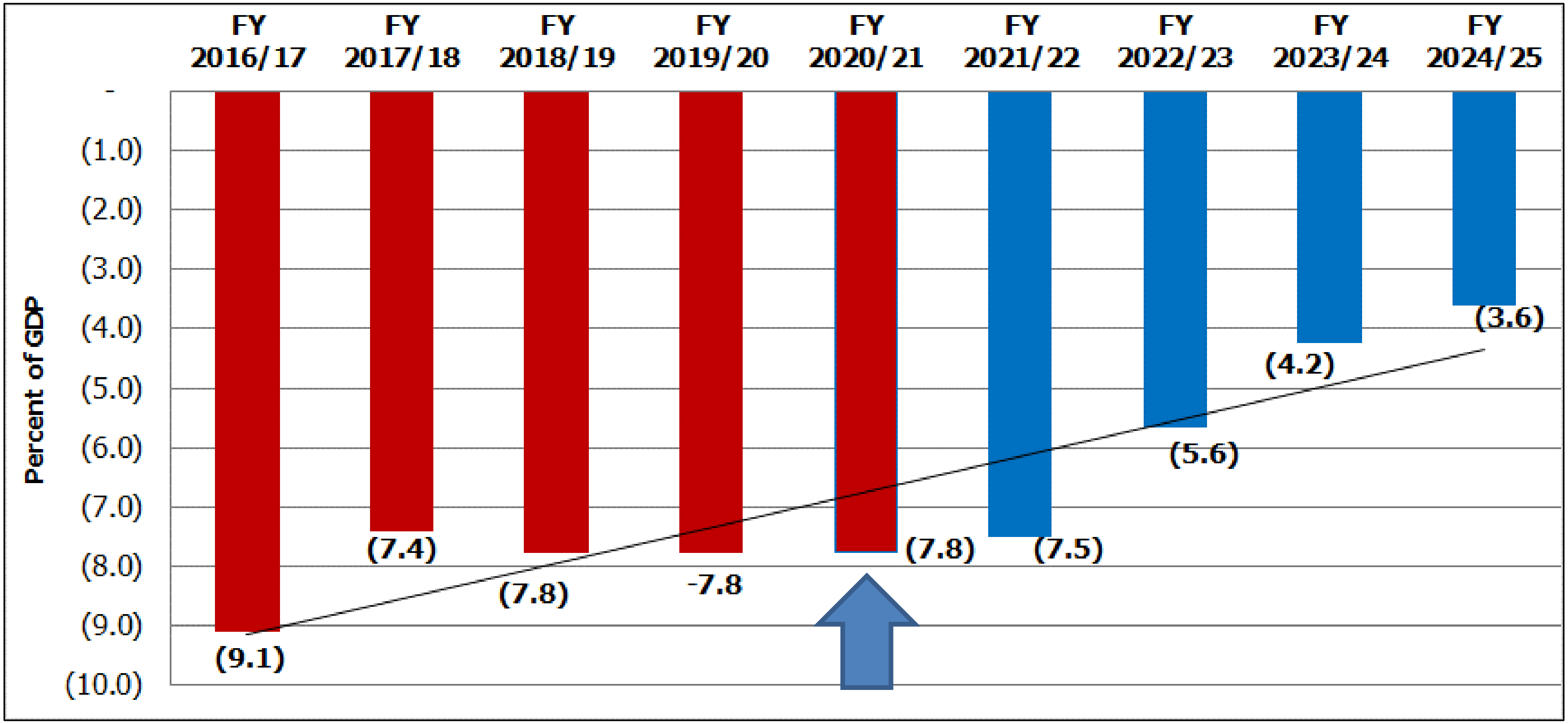
- Inflation remains within the target
- Real GDP growth projected at 6.6% in 2021 and 5.8% in 2022.
- Economy will be supported by the stable macroeconomic environment, ongoing investments under the “Big Four” Agenda, turn around in trade as economies recover from Covid-19 Pandemic and expected favorable weather that will support agricultural output.

4b. Medium Term Fiscal Framework FY 2022/23-2024/25, % of GDP

	FY 2019/20	FY 2020/21	FY 2021/22	FY 2022/23	FY 2023/24	FY 2024/25
	Act.	BUDGET	PROJECTION			
A.Total Revenue and External Grants	17.3	17.1	17.0	17.6	18.5	18.4
Total revenue incl A-I-A	17.1	16.4	16.4	17.3	18.2	18.1
External Grants	0.2	0.7	0.5	0.3	0.3	0.3
B. Total Expenditure and Net lending	25.2	25.8	24.5	23.3	22.7	22.0
Recurrent Expenditure	16.2	16.3	16.1	15.4	15.1	14.6
Development Expenditure	5.8	5.8	5.0	4.9	4.9	4.9
County Allocation	3.2	3.6	3.3	3.0	2.7	2.4
Contigency fund	0.0	0.0	0.0	0.0	0.0	0.0
C. Fiscal Deficit Excl Grants	(8.1)	(9.3)	(8.0)	(6.0)	(4.5)	(3.9)
D. Fiscal Deficit incl Grants	(7.9)	(8.7)	(7.5)	(5.6)	(4.2)	(3.6)
E. Total Financing	7.8	8.7	7.5	5.6	4.2	3.6

- In the FY 2022/23, total revenue incl. grants as % of GDP is projected at **17.6%** and expenditures at **23.3%** which gives a deficit of **5.6% of GDP.**

4.c: Fiscal Consolidation: The FY 2020/21 realised a fiscal deficit of 7.8% of GDP against a target of 8.7% of GDP. This was a consolidation of 0.9 percent of GDP. In 3 years fiscal deficit has stabilised at 7.8% of GDP. Deficit projected to decline further to 5.6% in FY 2022/23 from 7.5% in FY 2021/22



6: Potential Risks: The macroeconomic outlook is not without risks from both external and domestic sources

- **On the external side**, risks depends on how the world responds to the health crisis, including whether the new COVID-19 strains are susceptible to vaccines. Slower-than-anticipated vaccine rollout would allow the virus to mutate further. World economies will continue to be affected by the effectiveness of policies taken to limit persistent economic disruptions; the evolution of financial conditions and commodity prices especially oil in the international market;
- **On the domestic front,** the emergence of new COVID-19 variants, in Kenya and its trading partners, could lead to renewed disruptions to trade and tourism and require broader reinstatement of containment measures.
- Lower agricultural output due to potential adverse weather conditions.
- Increased public expenditure pressures, particularly wage and other recurrent expenditures would put a strain to the fiscal space.

The Government continues to monitor the domestic and external environment and stands ready to take appropriate policy measures to safeguard the economy against the adverse effects were the risks to materialize.

THANK YOU