MACRO-ECONOMIC OUTLOOK FOR THE MEDIUM TERM BUDGET

PRESENTATION DURING THE LAUNCH OF THE PREPARATION OF THE FY 2024/25 AND THE MEDIUM TERM BUDGET

THE NATIONAL TREASURY AND ECONOMIC PLANNING

18th August 2023

PRESENTATION OUTLINE

1. Global Economic Developments
2. Domestic Economic Developments and Outlook
3. FY 2022/23 Budget Performance
4. Bottom-up Economic Transformation Agenda (BETA)
5. Economic Recovery Programme supported by the IMF
6. FY 2024/25 and the Medium Term Budget
7. Risks to the Macroeconomic Outlook

1: Global Economic Developments

- **Global environment**: Global growth projected at **3.0% in 2023 and 2024** from 3.5% in 2022, reflecting the impact of the tightening of monetary policy, and escalation of geopolitical tensions particularly the ongoing war in Ukraine.
  - Headline inflation rates in advanced economies have continued to ease, but have remained above the respective targets with persistent core inflationary pressures.
- **Advanced economies** continue to drive the decline in growth from 2022 to 2023, with weaker manufacturing offsetting stronger services activity. Growth is projected to decline from 2.7% in 2022 to **1.5% in 2023 and 1.4% in 2024.**
- **In emerging market and developing economies**, the growth outlook is broadly stable at **4.0% in 2022 and 2023, and 4.1% in 2024,** although with notable shifts across regions.
- **In sub-Saharan Africa**, growth is projected to decline to **3.5% in 2023 from 3.9% in 2022 before picking up to 4.1% in 2024.** The slowdown in growth in 2023 reflects the impact of power shortages in South Africa and security issues in the oil sector in Nigeria.

2.1: Domestic Economic Developments and Outlook

- **Kenya's economy expanded by 4.8% in 2022** with growth affected by contraction in agricultural activities reflecting impact of the drought experienced to most parts of the country in 2022.
  - Services sectors positive growths in 2022 supporting the growth in 2022.
- In 2023, the economy remained resilient and expanded by **5.3% in the first quarter of 2023**, compared to 6.2% in a similar quarter in 2022. The growth was mainly supported by a rebound of the agriculture sector and continued resilience of service sectors.
  - All economic sectors recorded positive growths
- The services sector contributed **3.5 percentage points** to the overall GDP growth in **Q1 of 2023** while the Agriculture sector contributed **1.1 percentage points** as compared to a deceleration of -0.3 percentage points in 2022Q1. Previously similar contribution by the Agriculture sector was in 2020Q4 when contribution was1.6 percentage points

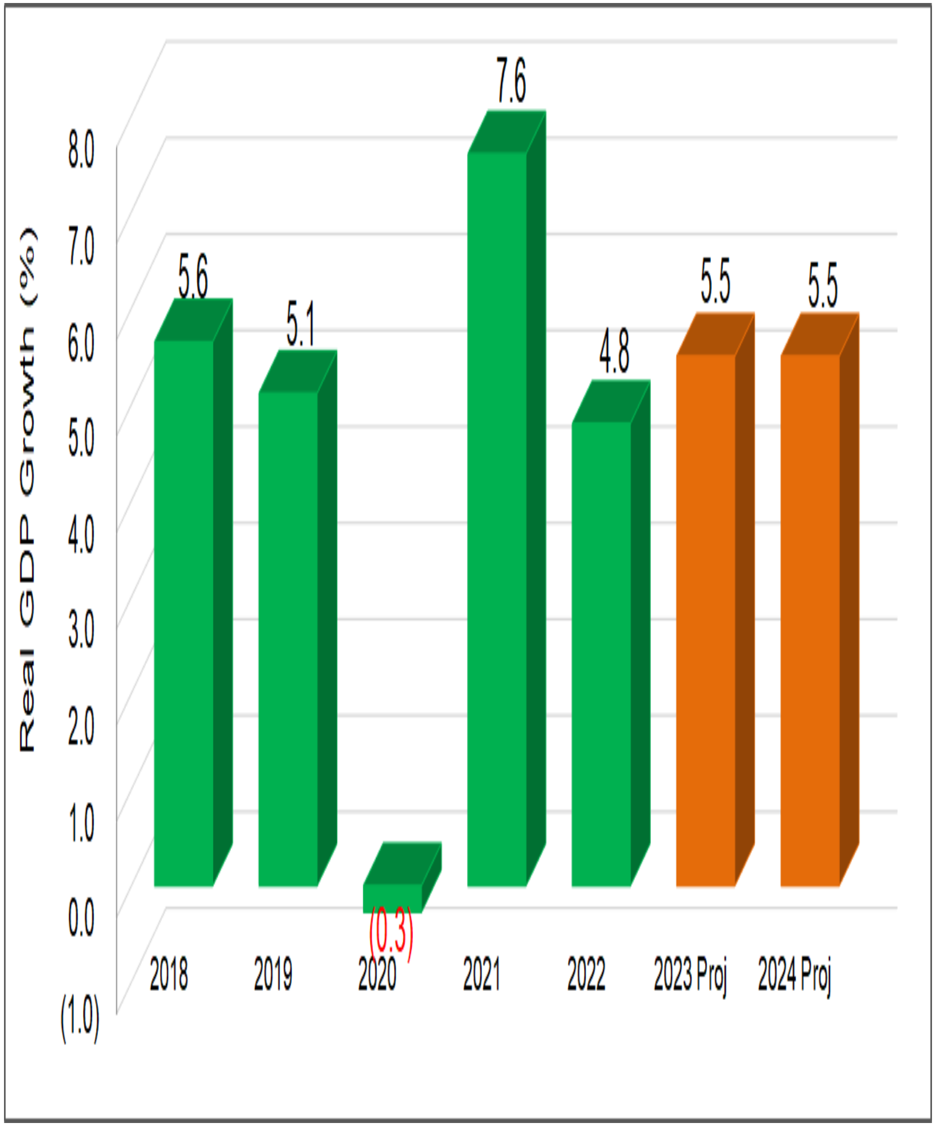
2.2: Domestic Economic Developments: Q12023: Sectoral Performance

- **The agriculture sector recorded a robust performance** in 2023Q1 following the favourable weather conditions experienced which supported increased exports of vegetables and fruits.
- **Manufacturing** sector growth was mainly supported by agro-processing mainly in the manufacture of bakery products and processing of fish.
- **Electricity and Water** supply sector grew largely on account of increased electricity generation from renewable sources. Geothermal and wind electricity generation increased.
- **Construction** sector decelerated mainly attributed a reduction in cement consumption & import of various construction materials such as bitumen and iron and steel.
- **Accommodation:** improved numbers of visitors' arrivals
- **Transport and Storage sector:** Increased transportation via SGR (Passenger & Freight) and cargo through put
- **ICT:** Increased volume of mobile money transactions & increased domestic voice tariffs
- **Finance & Insurance:** Increased yield on investment and Increased return on deposits by commercial banks
- **Wholesale & Retail trade** also remained strong despite anticipated increase in operation costs – increase in fuel costs

2.3: Domestic Economic Developments and Outlook cont'd....

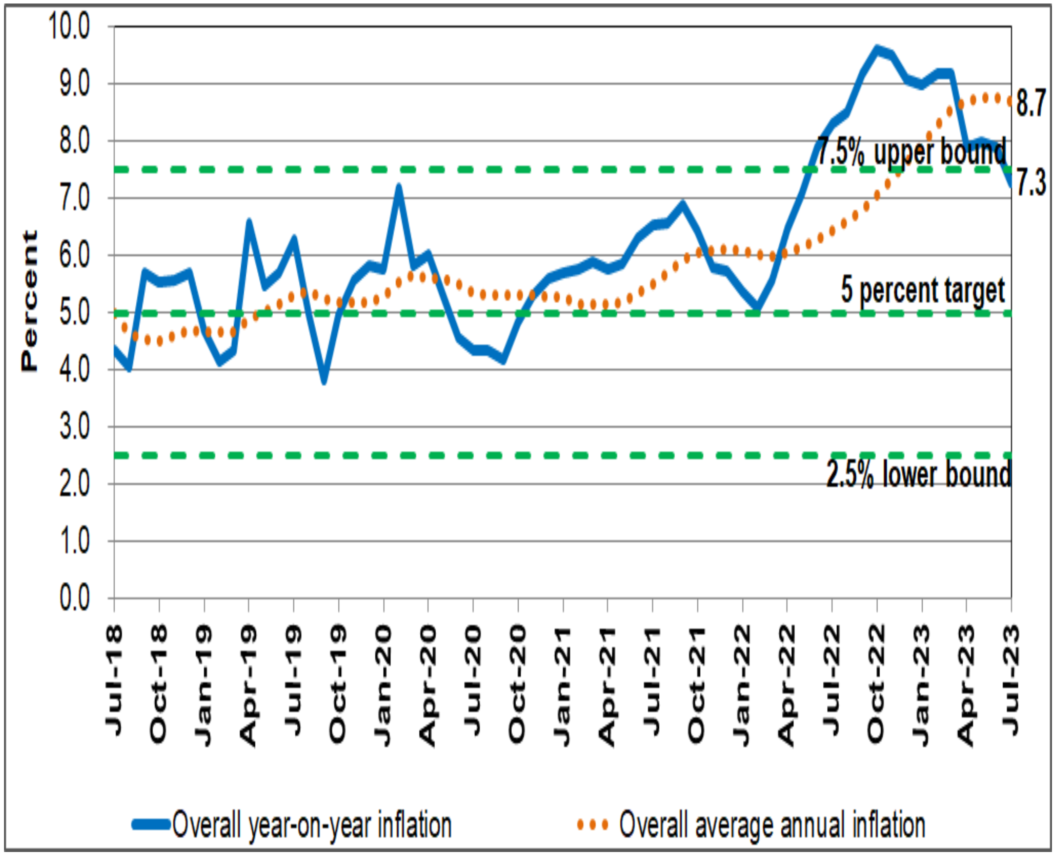
- The economy is projected to grow by 5.5 percent in 2023 and 5.5 percent in 2024 with ssources of growth being broad-based private sector growth, robust performance of the services sector and continued recovery in agriculture sector.

- This growth will be reinforced by the Government's **Bottom – Up Economic Transformation Agenda (BETA)** geared towards economic turnaround and inclusive growth.



2.4: Macroeconomic Indicators: Overall inflation declined in July 2023 and converged to the medium-term target band for the first time since June 2022.

- ❑ Inflation rate declined **to 7.3% in July, 2023** from 7.9% in June 2023, mainly driven by a notable decline in food prices, despite increased pump prices.

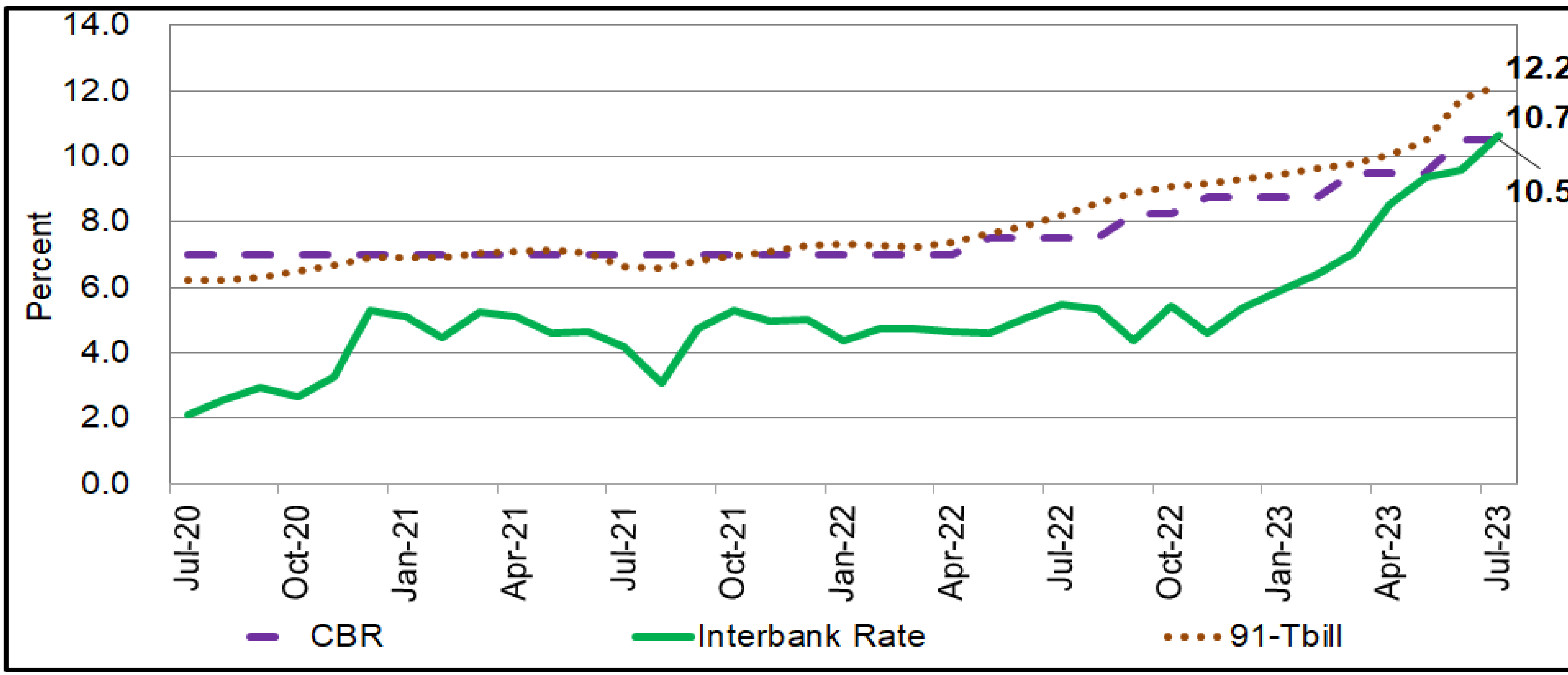


❑**Monetary policy stance remains tight** to anchor inflation expectations. The Central Bank rate was raised to **10.5% in June 2023 from 9.50% in March, 2023** and retained at the same rate on 9th August 2023;

❑ Overall inflation is expected to moderate further, supported by lower food prices attributed to improving supply of key food items, and the implementation of Government measures to improve the supply of sugar through imports

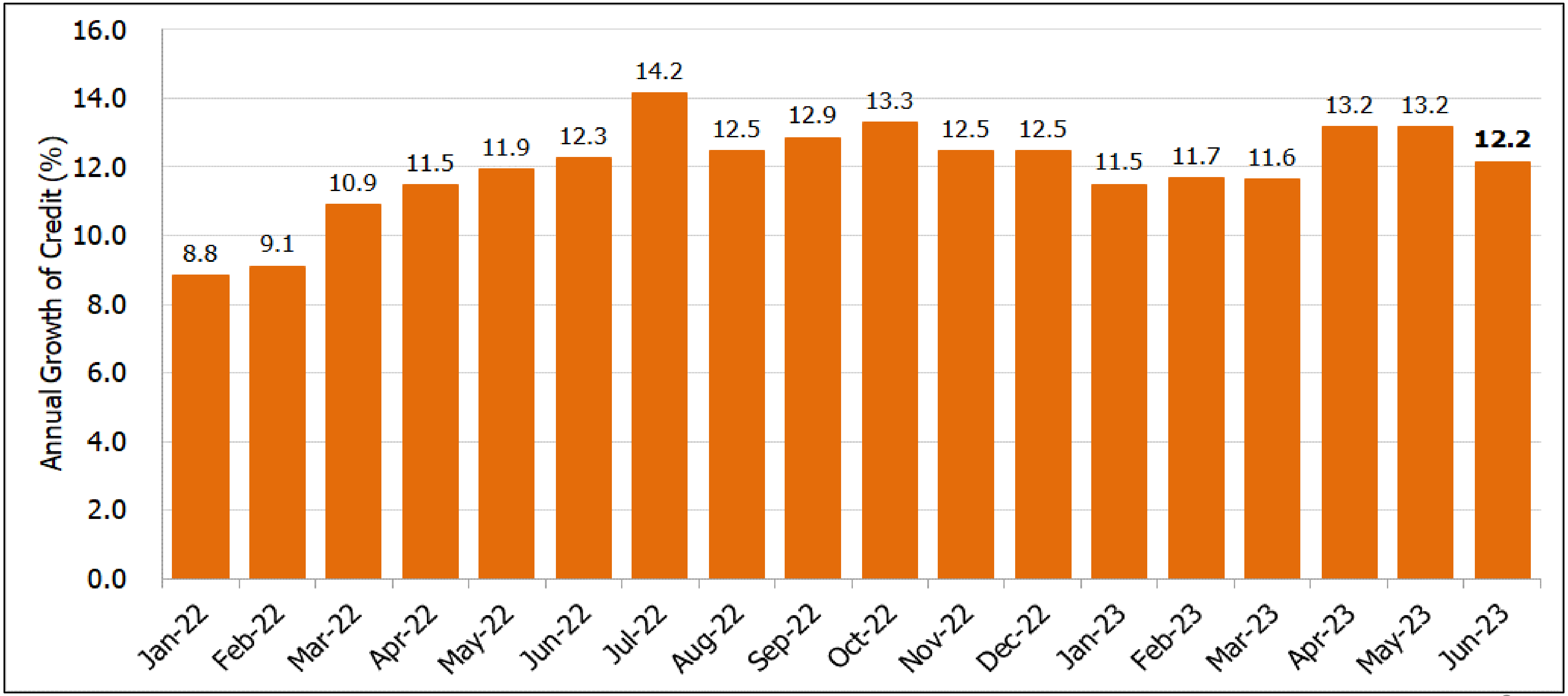
2.5: Macroeconomic Indicators: Interest rates

- Short-term interest rates increased in the year to July 2023, partly reflecting a tightening of monetary policy stance and liquidity conditions in the market.
- The **interbank rate** increased to **10.7% in July 2023** compared to 5.5% in July 2022 while the **91-day Treasury Bills** rate also increased to **12.2%** compared to 8.2% over the same period;



2.6: Macroeconomic Indicators: Credit to private sector

- Lending to the private sector by commercial banks has remained strong with the credit expanding by **12.2% in June 2023 and 13.2% in May.**
- Most of the economic sectors registered positive annual growth rates reflecting increased credit demand following improved economic activities
- Strong credit growth was observed in manufacturing (18.0%), transport and communication (19.9%), trade (12.5%), and consumer durables (11.8%).



2.7: External Sector Developments

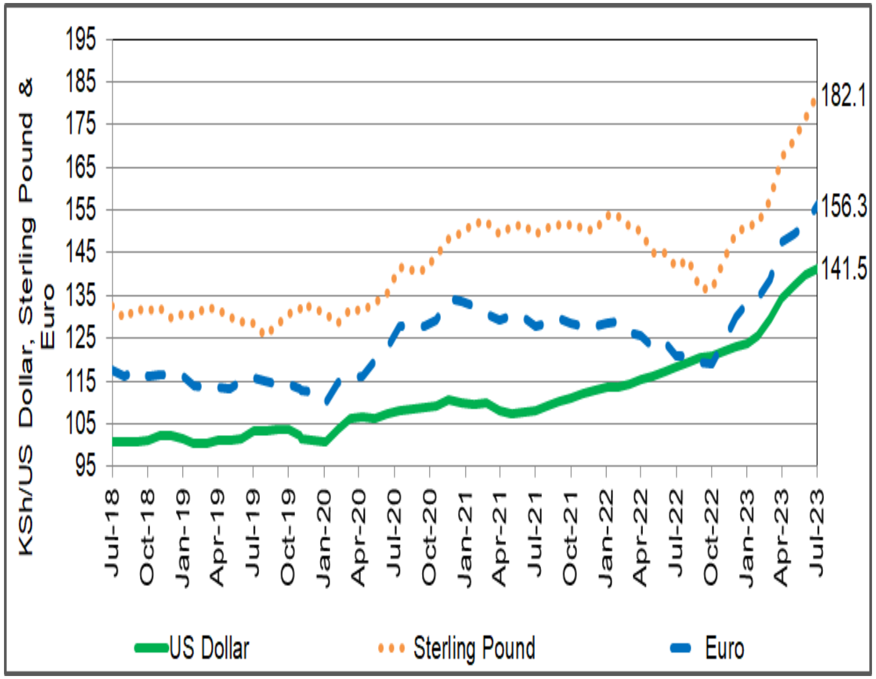
The foreign exchange market remained relatively stable, despite increased uncertainties in the global financial markets and a stronger U.S. Dollar.

- The current account deficit narrowed to **4.7% of GDP in June 2023** compared to 5.1% of GDP in June 2022 on account of improved receipts from exports of goods and services as well as resilient remittances.

- Remittances inflows amounted to **USD 4,017 million** in the 12 months to June 2023, and were 0.1% higher compared to a similar period in 2022.

- The usable foreign exchange reserves, which stood at **USD7,338 million (4.01 months of import cover) by end July 2023**, continue to provide adequate cover and a buffer against any short-term shocks in the foreign exchange market.

Due to the strong dollar, the exchange rate to the Kenya Shilling like all world currencies weakened by **19.5% in the 12 months to July 2023** compared to 9.4% in the 12 months to June 2022



- Against the **US Dollar, the Kenya Shilling** exchanged at **KSh 141.5 in July 2023** compared to KSh 118.3 in July 2022.

3.1: FY 2022/23 Budget Performance

- The FY 2022/23 closed on a strong and positive note with total revenue collection by the year to June 2023 growing by **7.3% to** amount to **Ksh 2,360.5 billion (16.3% of GDP).**
- Of this, **ordinary revenues** collected amounted to **Ksh 2,041.1 billion** which was an annual growth of **6.4%** and represented a performance rate of **95.1% against target**. All tax revenue categories recorded positive growths, an indication of continued recovery in revenue collection.
  - This revenue collection was below target by **Ksh 118.1 billion** on account **of shortfalls** registered in both **ordinary revenue** of **Ksh 104.3 billion** and in **ministerial A-i-A** of **Ksh 13.8 billion.**

- **Total expenditure** by end of FY 2022/23 amounted to **Ksh 3,218.2 billion** against a target of **Ksh 3,367.6 billion** translating to a shortfall in expenditure of **Ksh 148.4 billion.**
  - The shortfall was largely on account of below target disbursements towards both **recurrent expenditure** and **development expenditure** by **Ksh 58.9 billion** and **Ksh 66.9 billion** respectively.

3.2: FY 2022/23 Budget Performance cont'd....

- Critical payments made that had significant impact at the grassroots included:
  - 100% payment of equitable share was disbursed to the 47 County Governments amounting to Ksh 399.6 billion. This figure included the equitable share of Ksh 370.0 billion and arrears of Ksh 29.6 billion from the previous year;
  - The entire allocation of Ksh 47.2 billion to the National Government Constituency Development Fund (NGCDF)
  - 100% cash transfers to the Elderly to cater for their needs including for food, health and upkeep. Additionally, all arrears for cash transfers to Orphans and Vulnerable Children (OVCs) amounting to Ksh 16 billion were funded.
  - The Government has cleared the pensions arrears of Ksh 12.6 billion which were outstanding at the close of the financial year 2022/23

3.3: Fiscal deficit incl. grants by end of FY 2022/23 was Ksh 770.3 billion (5.3% of GDP) against a target of Ksh 846.2 billion (5.8% of GDP).

- At the closure of the FY 2022/23, the actual outcome was a fiscal deficit including grants of **5.3% of GDP** – a demonstration of Government's commitment to create fiscal space and manage public debt.
- The deficit was funded as follows:
  - **Net Domestic Financing** of **Ksh 459.5 billion** or 3.2% of GDP.
    - The net domestic financing was below the target by Ksh 24.0 billion.
  - **Net Foreign Financing of Ksh 310.8 billion or 2.1% of GDP, which constituted:**
    - Disbursements (inflows) of **Ksh 548.2 billion** and external repayments (outflows) of principal debt of **Ksh 237.4 billion.**

4.1: Bottom-Up Economic Transformation Agenda (BETA)

Focus on interventions that: reduce the cost of living; increase employment; incentivize investment and production; achieve more equitable distribution of income; enhance social security, expand tax base for more revenue; and increase foreign exchange earnings

Micro, Small and Medium Enterprise (MSME) Economy

- ✓ To correct market and institution failure problems through schemes that will ensure that benefits of growth are fairly distributed
- ✓ Promote accessibility to affordable credit to most Kenyans at the bottom of the pyramid through the Hustlers Fund – An intervention that will work and remain at that level

Affordable Healthcare

Promote access to quality and affordable healthcare though ensuring Universal Health Coverage

Digital Superhighway and Creative Economy

- ✓ Digitization and automation to increase productivity and competitiveness - eliminates information asymmetry in market access and risk management
- ✓ Create employment for the youth - promotion of music, theatre, graphic design, digital animation, fashion and craft, among others

Agricultural Transformation and Inclusive Growth

- ✓ To ensure food security in the Country thereby reducing the cost of living
- ✓ Create jobs as agriculture has the highest employment multiplier effect owing to its strong forward and backward linkages to other sectors of the economy
- ✓ Agro-industrial structure at the County levels

Affordable Housing

Reduce proliferation of slums and preserve human dignity through:

- ✓ Facilitating delivery of 250,000 houses per annum and enabling low-cost housing mortgages

4.2: BETA: Highlights on the Five Priority Sectors

a) Transforming the Micro, Small and Medium Enterprise (MSME) Economy:

- The Government has invested a total of **Ksh 11.0 billion** in the Financial Inclusion Fund, or the Hustlers Fund, providing low interest loans at 8% per annum to over **16.07 million** Kenyans, of which over 7.1 million are repeat customers.
- Launched the second product of the Financial Inclusion Fund on 1st June, 2023 targeting groups such as chamas and saccos. The groups can now borrow loans of between Ksh 20,000 and Ksh 1.0 million.

b) Housing and Settlement

- Launched several affordable housing projects across the country, translating to about 36,000 housing units.

c) Healthcare

- Reformed the National Health Insurance Fund - to meet the urgent needs of Kenyans at the bottom of the socioeconomic structure by actualizing its purpose as a social medical insurance facility; and
- In collaboration with County Governments recruited community health promoters (CHP) throughout the country: - One promoter for every 100 households.

4.3: BETA: Highlights on the Five Priority Sectors….cont'd

d) Digital Superhighway and Creative Economy

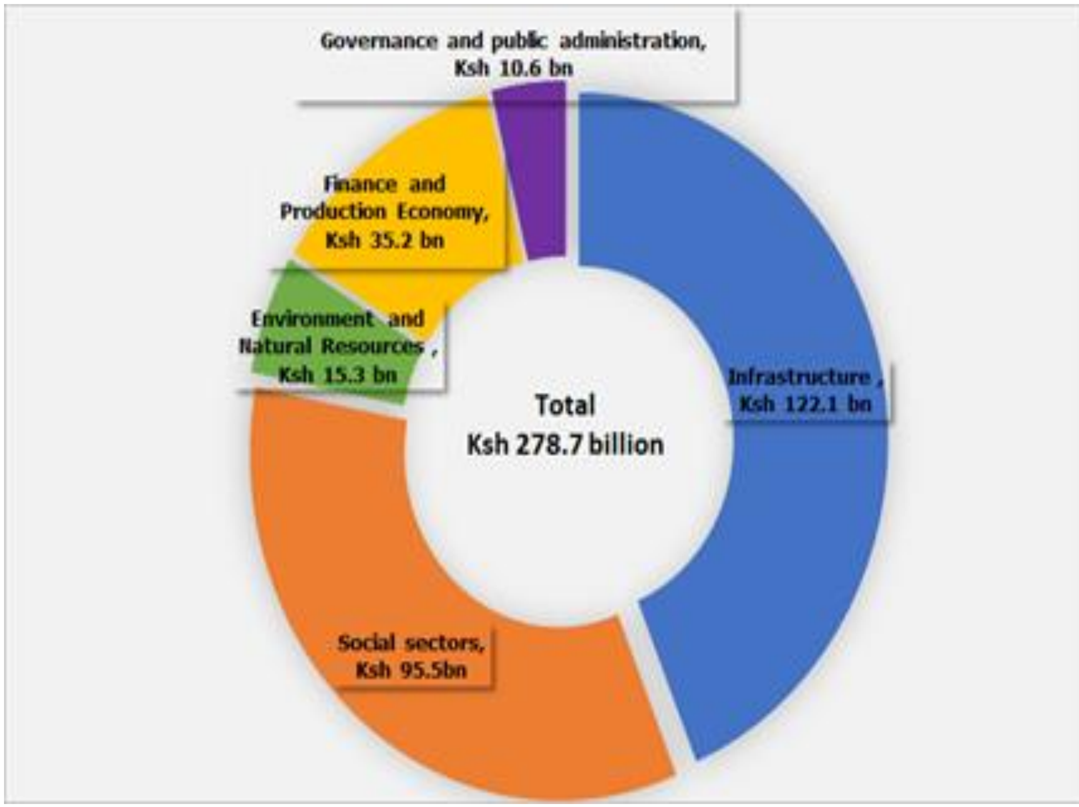
- Continued digitization and automation: Digitized and automated of 5,084 of Government services through the e-Citizen platform that has enhanced access to Government services and brought greater convenience to citizens;
- Initiated the process of constructing 1,450 ICT hubs, so that every county assembly ward in the country will become a centre of digital learning, business transaction and work; and
- Launched a data protection registration system to provide digital identity to all Kenyans in order to facilitate transactions between the Government and its citizens.

e) Agricultural Transformation: Support to agricultural production through provision of subsidized fertilizer; mapping and registration of more than 5 million farmers, issuing of over 3,628,512 e-vouchers and establishment of last-mile distribution centres

4.4: BETA: Focus is on Value Chains

The budgeting process for the priority programmes under BETA was undertaken through **a value chain approach** under five clusters.

In this regard, **Ksh 278.7 billion** has been allocated in the FY 2023/24 under the five clusters:



To implement BETA, the Government has identified **nine key value chain areas** for implementation, namely:

i. Leather;

ii. Cotton;

iii. Dairy;

iv. Edible Oils;

v. Tea;

vi. Rice;

vii. Blue Economy;

viii. Natural Resources Including Minerals & Forestry); and

ix. Building Materials

5.1: Fiscal Framework, Ksh Billion

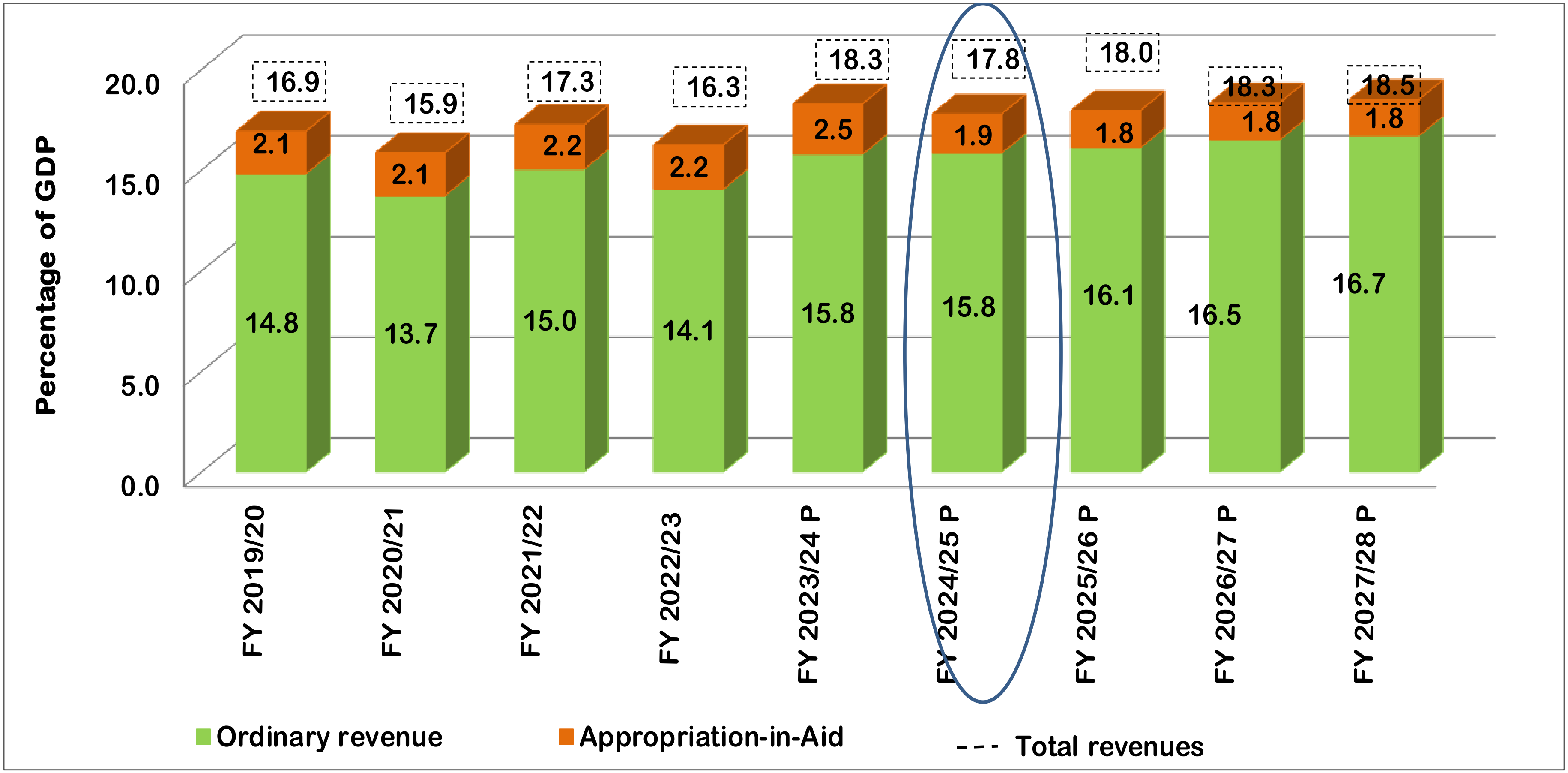
	FY 2019/20	FY 2020/21	FY 2021/22	FY 2022/23	FY 2023/24			FY 2024/25	FY 2025/26	FY 2026/27	FY 2027/28	FY 2028/29
Ksh Billion	Prel Actual	Prel Actual	Prel Actual	Preliminary Actual	BUDGET APPROVED	ADJUSTED BUDGET	Estimates	BROP 2023	BROP 2023	BROP 2023	BROP 2023	Proj
TOTAL REVENUE	**1,797.7**	**1,803.5**	**2,199.8**	**2,326.3**	**2,985.6**	**2,985.6**	**3,002.5**	**3,231.1**	**3,670.0**	**4,195.2**	**4,773.9**	**5,433.1**
Ordinary revenue	**1,573.4**	**1,562.0**	**1,917.9**	**2,041.1**	**2,571.2**	**2,571.2**	**2,634.6**	**2,878.6**	**3,294.2**	**3,775.7**	**4,305.5**	**4,909.8**
Ministerial Appropriation in Aid	224.2	241.5	281.9	285.2	414.4	414.4	368.0	352.5	375.8	419.5	468.5	523.3
Grants	23.9	31.3	31.0	35.9	42.2	42.2	42.2	49.3	53.2	68.6	77.5	87.7
TOTAL EXPENDITURE	**2,629.5**	**2,773.5**	**3,027.8**	**3,132.3**	**3,746.6**	**3,808.8**	**3,825.5**	**3,991.9**	**4,457.9**	**5,097.7**	**5,752.1**	**6,509.5**
Recurrent Expenditure	1,696.1	1,813.3	2,135.3	2,258.8	2,536.3	2,596.8	2,599.2	2,667.5	2,917.9	3,385.2	3,828.1	4,333.6
Development	608.1	561.2	540.1	457.7	780.6	782.2	796.6	906.5	1,097.1	1,160.5	1,306.2	1,481.2
Domestically Financed (Gross)	409.8	394.2	378.2	309.4	482.8	482.8	497.2	494.4	645.8	643.5	722.8	815.9
o/w Domestically Financed (Net	352.7	308.2	293.9	237.2	333.0	333.0	396.2	380.2	521.0	503.6	566.0	640.1
Ministerial Development AI	57.1	86.0	84.4	72.1	149.8	149.8	100.9	114.2	124.8	139.9	156.8	175.7
Foreign Financed	197.6	167.0	161.9	136.0	280.6	280.6	280.6	390.0	431.7	512.7	583.4	665.4
Net Lending	0.7	-	-	12.3	17.2	18.8	18.8	22.2	19.6	4.4	-	-
County Transfer	325.3	399.0	352.4	415.8	429.7	429.7	429.7	417.9	442.9	552.0	617.8	694.6
BALANCE INCLUSIVE OF GRANTS	**(807.9)**	**(938.6)**	**(797.0)**	**(770.1)**	**(718.9)**	**(781.0)**	**(780.8)**	**(711.5)**	**(734.6)**	**(833.9)**	**(900.8)**	**(988.7)**
Adjustments to cash basis	11.8	5.1	11.9	-	-	-	-	-	-	-	-	-
BALANCE INCLUSIVE OF GRANTS	**(796.1)**	**(933.5)**	**(785.1)**	**(770.1)**	**(718.9)**	**(781.0)**	**(780.8)**	**(711.5)**	**(734.6)**	**(833.9)**	**(900.8)**	**(988.7)**
Discrepancy	(5.3)	16.7	(37.3)	(53.5)	-	-	-	-	-	-	0.0	-
TOTAL FINANCING	**790.8**	**950.2**	**747.8**	**716.7**	**718.9**	**781.0**	**780.8**	**711.5**	**734.6**	**833.9**	**900.8**	**988.7**
NET FOREIGN FINANCING	340.4	323.3	142.5	296.4	131.5	464.2	475.8	280.8	219.2	337.9	318.6	317.1
NET DOMESTIC FINANCING	**450.4**	**626.9**	**605.3**	**420.3**	**587.4**	**316.9**	**305.1**	**430.7**	**515.4**	**496.0**	**582.2**	**671.5**
O/w Borrowing thro' Govt Securitie	410.5	556.3	589.5	437.5	584.2	313.7	301.9	442.4	526.7	505.3	577.4	665.1
Other Domestic Financing	39.9	70.6	15.8	(17.3)	3.2	3.2	3.2	(11.7)	(11.3)	(9.3)	4.7	6.4
PRIMARY BALANCE	**(358.9)**	**(438.3)**	**(207.2)**	**(85.6)**	**56.3**	**54.7**	**54.9**	**122.1**	**150.6**	**146.1**	**210.6**	**269.6**
Nominal GDP	10,621	11,370	12,752	14,522	16,290	16,290	16,290	18,180	20,437	22,872	25,817	29,227

5.2: Fiscal Framework, percent of GDP

	FY 2019/20	FY 2020/21	FY 2021/22	FY 2022/23	FY 2023/24			FY 2024/25	FY 2025/26	FY 2026/27	FY 2027/28
% of GDP	Prel	Prel Actual	Prel Actual	Preliminary Actual	BUDGET APPROVED	ADJUSTED BUDGET	Estimates	BROP 2023	BROP 2023	BROP 2023	BROP 2023
TOTAL REVENUE	**16.9**	**15.9**	**17.3**	**16.0**	**18.3**	**18.3**	**18.4**	**17.8**	**18.0**	**18.3**	**18.5**
Ordinary revenue	**14.8**	**13.7**	**15.0**	**14.1**	**15.8**	**15.8**	**16.2**	**15.8**	**16.1**	**16.5**	**16.7**
Ministerial Appropriation in Aid	2.1	2.1	2.2	2.0	2.5	2.5	2.3	1.9	1.8	1.8	1.8
Grants	0.2	0.3	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
TOTAL EXPENDITURE	**24.8**	**24.4**	**23.7**	**21.6**	**23.0**	**23.4**	**23.5**	**22.0**	**21.8**	**22.3**	**22.3**
Recurrent Expenditure	16.0	15.9	16.7	15.6	15.6	15.9	16.0	14.7	14.3	14.8	14.8
Development	5.7	4.9	4.2	3.2	4.8	4.8	4.9	5.0	5.4	5.1	5.1
Foreign Financed	1.9	1.5	1.3	0.9	1.7	1.7	1.7	2.1	2.1	2.2	2.3
Net Lending	0.0	-	-	0.1	0.1	0.1	0.1	0.1	0.1	0.0	-
County Transfer	3.1	3.5	2.8	2.9	2.6	2.6	2.6	2.3	2.2	2.4	2.4
BALANCE INCLUSIVE OF GRANTS	**(7.6)**	**(8.3)**	**(6.2)**	**(5.3)**	**(4.4)**	**(4.8)**	**(4.8)**	**(3.9)**	**(3.6)**	**(3.6)**	**(3.5)**
Adjustments to cash basis	0.1	0.0	0.1	-	-	-	-	-	-	-	-
BALANCE INCLUSIVE OF GRANTS	**(7.5)**	**(8.2)**	**(6.2)**	**(5.3)**	**(4.4)**	**(4.8)**	**(4.8)**	**(3.9)**	**(3.6)**	**(3.6)**	**(3.5)**
Discrepancy	(0.0)	0.1	(0.3)	(0.4)	-	-	-	-	-	-	0.0
TOTAL FINANCING	**7.4**	**8.4**	**5.9**	**4.9**	**4.4**	**4.8**	**4.8**	**3.9**	**3.6**	**3.6**	**3.5**
NET FOREIGN FINANCING	3.2	2.8	1.1	2.0	0.8	2.8	2.9	1.5	1.1	1.5	1.2
NET DOMESTIC FINANCING	**4.2**	**5.5**	**4.7**	**2.9**	**3.6**	**1.9**	**1.9**	**2.4**	**2.5**	**2.2**	**2.3**
O/w Borrowing thro' Govt Securitie	3.9	4.9	4.6	3.0	3.6	1.9	1.9	2.4	2.6	2.2	2.2
Other Domestic Financing	0.4	0.6	0.1	(0.1)	0.0	0.0	0.0	(0.1)	(0.1)	(0.0)	0.0
PRIMARY BALANCE	**(3.4)**	**(3.9)**	**(1.6)**	**(0.6)**	**0.3**	**0.3**	**0.3**	**0.7**	**0.7**	**0.6**	**0.8**
Nominal GDP	100	100	100	100	100	100	100	100	100	100	100

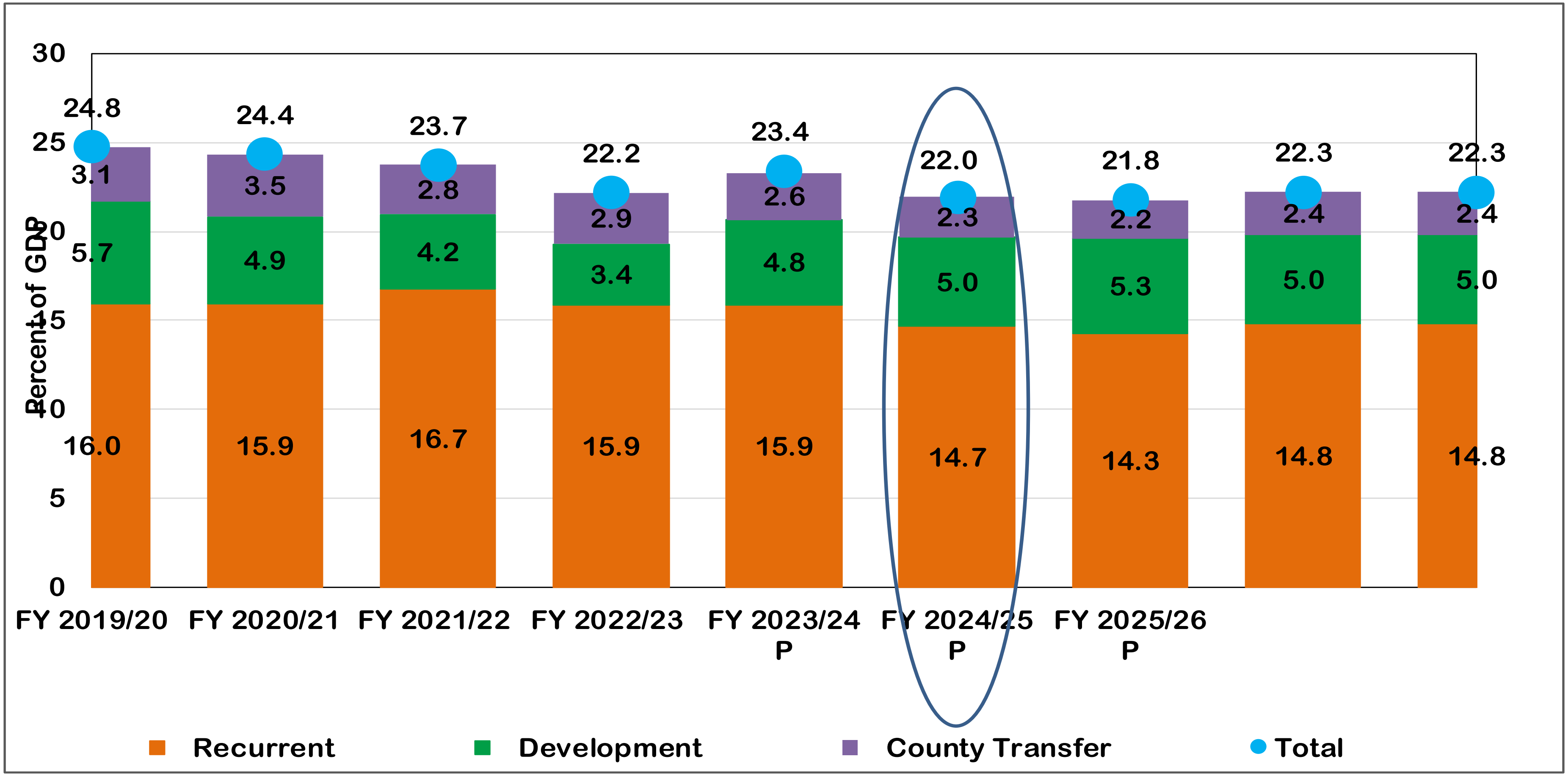
5.3: FY 2024/25 Budget: Increase in revenues to 17.8% of GDP

- **On the Tax policy side**, the implementation of the **National Tax Policy** and finalization of the **Medium-Term Revenue Strategy (MTRS)** will further strengthen revenue mobilization efforts. **This will support revenue growth of 17.8% of GDP in FY 2024/25** and over 18.3% of GDP over the medium term



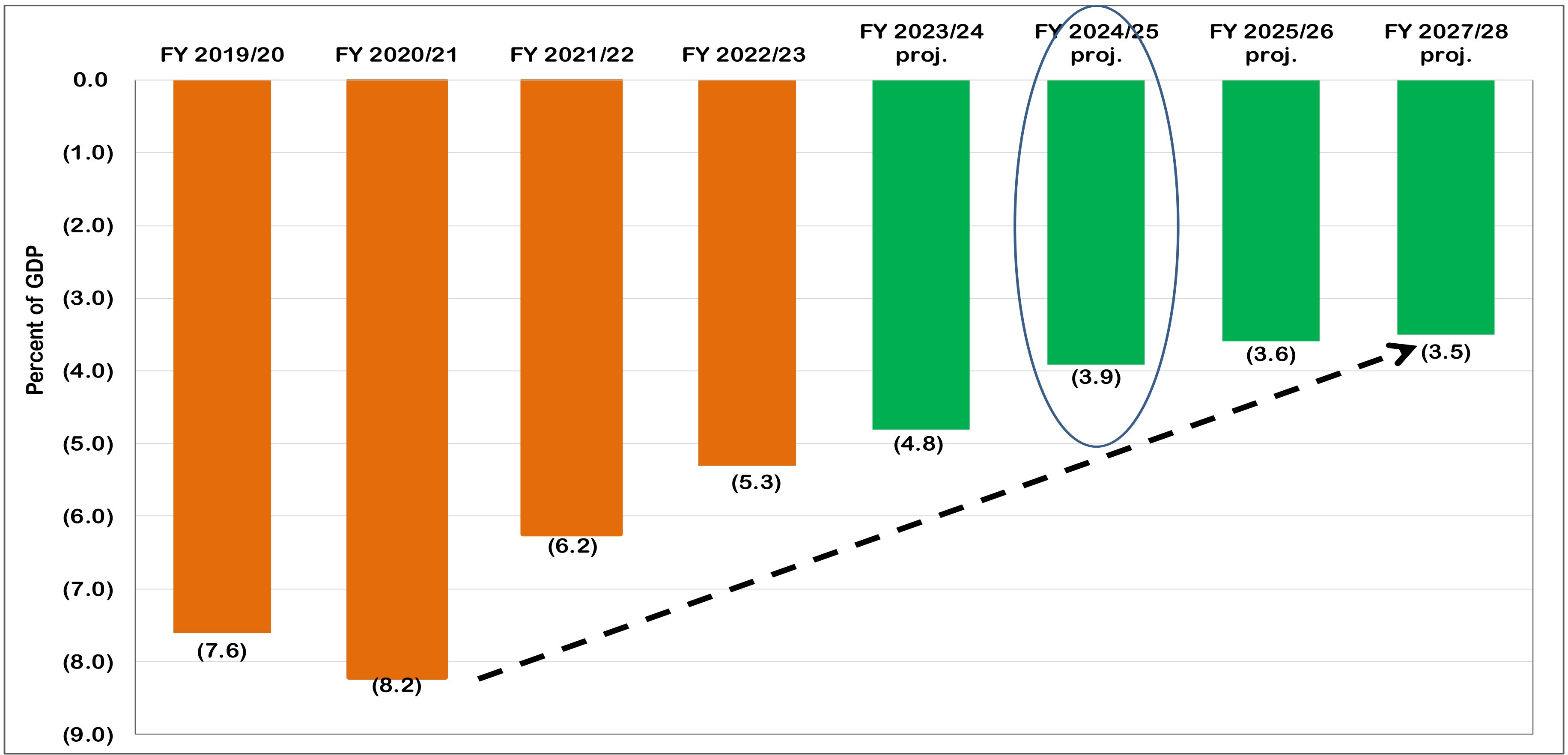
5.4: FY 2023/24 Budget: Reduction in total expenditures….. cont'd

- Total expenditures as a share of GDP to decline as a share to GDP to **23.4%** in the FY 2023/24 and further to **22.0%** in the FY 2024/25



5.5: The Government target to lower the fiscal deficit further to 4.8% of GDP in the FY 2023/24 and 3.9% of GDP in FY 2024/25 in line with the fiscal consolidation plan.

- The decline in fiscal deficit will not only be a strong signal to the private sector of fiscal space but will stabilize growth in debt.
- The reduction in fiscal deficit is an important signal of a predictable tax regime environment. This will incentivize private investment and attract Foreign Direct Investment.



6: Economic Recovery Programme supported by the IMF

The Executive Board of the IMF completed the fifth review under the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF) arrangements on July 17, 2023. Following this:

- Kenya will receive an augmentation of access under the EFF/ECF of 75 percent of quota (SDR 407.1 million, about US$ 544.3 million);
- EFF/ECF arrangements will be extended by **10 months to April 2025** to allow sufficient time for meeting the program objectives
- Agreed on **a new 20-month Resilience and Sustainability Facility** ("RSF") arrangement with access also of 75 percent of quota that will run in parallel with the EFF/ECF arrangements until April 2025
- Kenya will have immediate access to SDR 306.7 million (about **US$ 410 million**), including from the augmentation of access under the ECF/EFF, bringing the cumulative IMF financial support disbursed under the EFF/ECF arrangements to SDR 1,509 million (about US$ 2,017 million)

With the EFF/ECF augmentations and the RSF support, the total IMF commitment under these arrangements would be SDR 2.633 billion (around US$ 3.52 billion)

7: Risks to the outlook

- **Domestic side**: Relate to unpredictable weather conditions due to the impact of climate change which could adversely affect agricultural production and result to domestic inflationary pressures.
- **Tight Fiscal space:** Impact of the multiple shocks that have affected the global and the domestic economy leading to tight liquidity conditions for financing the budget.
- **On the external front:**
- Inflation could remain high and even rise if further shocks occur, including those from an intensification of the Russia - Ukraine conflict and extreme weather-related events, triggering more restrictive monetary policy.
- Financial sector volatility as markets adjust to further policy tightening by central banks may spread to a wider group of economies.

THANK YOU