KENYA ECONOMIC UPDATE

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Beyond Resilience

Increasing Productivity of Public Investments

WORLD BANK GROUP

Beyond Resilience

Increasing Productivity of Public Investments

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ABBREVIATIONS AND ACRONYMS

CBK	Central Bank of Kenya
CIP	Charter Incentive Program
COMESA	Common Market for Eastern and Southern Africa
DANIDA	Danish International Development Agency
DRC	Democratic Republic of Congo
DSA	Debt Sustainability Analysis
EAC	East African Community
EACC	Ethics and Anti-Corruption Commission
ELC	Environment and Land Court
e-PROMIS	Electronic Projects Monitoring System
ESIA	Environment and Social Impact Assessment
EU	European Union
FDI	Foreign Development Investment
GDP	Gross Domestic Product
H1, H2	First Half, Second Half
HICs	High Income Countries
ICORs	Incremental Capital Output ratios
ICT	Information Communication Technology
IFMIS	Integrated Financial Management Information System
IFRS	International Financial Reporting Standards
IIWG	Investment and Infrastructure Working Group
IMF	International Monetary Fund
KBRR	Kenya Bank's Reference Rate
KETRACO	Kenya Electricity Transmission Company
KEU	Kenya Economic Update
KNBS	Kenya National Bureau of Statistics
KRA	Kenya Revenue Authority
KURA	Kenya Urban Roads Authority
KWh	Kilowatt-hour
LICs	Low Income Countries
LMI	Lower Middle Income
MCA	Members of County Assembly
MDA	Ministries and Department Agencies
MFIs	Microfinance Institutions
MICs	Middle Income Countries
MTEF	Medium Term Expenditure Framework
MTP	Medium Term Plan
MW	Mega Watts
NCTIP	Northern Corridor Transport Improvement Project
NEER	Nominal Effective Exchange Rate
NEMA	National Environment Management Authority
NIPSH	Non-Profit Institutions Supporting Households
NLC	National Land Commission
NPLs	Non-Preforming Loans
NSE	Nairobi Security Exchange
OAG	Office of the Auditor General
OECD	Organization for Economic Cooperation and Development
PAPP	Project Analysis and Public-Private Partnerships
PAPs	Project Affected Persons
PBO	Parliamentary Budget Office
PFM	Public Finance Management
PIM	Public Investment management
PMI	Purchasing Manager's Index
PPARB	Public Procurement Administrative Review Board
PPP	Purchasing Power Parity
Q1,2,3	Quarter One, Two, Three, Four
RAP	Resettlement Action Plan
REER	Real Effective Exchange Rate
ROWs	Right of Ways
SACCOs	Savings and Credit Cooperative Organizations
SCF	Standby Credit facility
SDGs	Sustainable Development Goals
SGR	Standard Gauge Railway
SME	Small and Medium Enterprises
SOEs	State Owned Enterprises
SSA	Sub-Saharan Africa
T-bill	Treasury Bills
TFP	Total Factor Productivity
U.S	United States
UK	United Kingdom
UN	United Nations
USA	United States of America
USD	United States Dollar
WAEMU	West African Economic and Monetary Union
WDI	World Development Indicators

FOREWORD

It is my pleasure to present to you our fourteenth edition of the World Bank's *Kenya Economic Update*. Kenya is one of the bright spots in the Sub-Saharan Africa due to robust domestic demand, a stable macroeconomic environment, and the economic dividend from prevailing low oil prices. This report has four main messages:

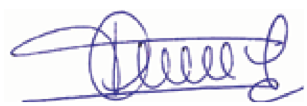
First, for the eighth consecutive years, economic growth in Kenya will outperform the Sub-Saharan African average. The World Bank projects that Kenya's growth rate will reach and be sustained at around 6 percent in the medium term. Ongoing infrastructure investments will ease supply side constraints, lower the cost of doing business and boost Kenya's competitiveness. At the same time growth in private consumption is fueled by a surge in remittances, an emerging middle class and the demographic divided. These two levers of growth—infrastructure investment and private consumption—will benefit from a stable macroeconomic environment characterized by low inflation and currency stability.

Second, Kenya's economy remains vulnerable to risks that could derail the growth momentum. Domestically the recent capping of interest rates could lead to unintended consequences and election related spending could result in fiscal slippage. Adverse la nina climatic conditions could curtail agricultural growth prospects which remain largely weather dependent. In the external sector, subdued global demand could dampen the demand for Kenya's exports, while volatility in global financial markets could trigger destabilizing capital outflows.

Third, the report argues that reforms to address systemic weaknesses in the Public Investment Management (PIM) are warranted. The identified PIM system improvements can enhance the execution of infrastructure projects which in turn can accelerate the catalytic impact of public investment on economic growth.

Fourth, the report argues that there is urgent need to address challenges related to land acquisition, compensation and Resettlement Action Plans (RAPs), which lead to significant delays and cost escalation in the execution of public infrastructure projects.

As in the past, we are proud to have worked with many key Kenyan stakeholders during the preparation of this report. We hope that you too will join us in debating topical policy issues that can contribute to fostering growth, shared prosperity and poverty reduction in Kenya.



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This fourteenth edition of the *Kenya Economic Update* was prepared by a core team led by Jane Kiringai including Allen Dennis who provided overall guidance for Part 1, Jens Kromann Kristensen, Sheila Kamunyori, Christine Awiti, Angélique Umutesi, Christine Owour, Lillian Kahindo, and Rachel Sebudde.

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Partnership with key Kenyan policy makers was instrumental in the production of this report. On October 18, 2016, a draft of the report was presented at the 20th Quarterly Economic Roundtable. The meeting was attended by senior officials from the National Treasury, the Kenya National Bureau of Statistics, the Office of the Controller of Budget, the Ministry of Devolution and Planning, the Central Bank of Kenya, the Kenya School of Monetary Studies, the Commission on Revenue Allocation, the National Economic and Social Council, the Executive Office of the Presidency, the National Land Commission, the International Monetary Fund, the KenInvest, Vision 2030 and the Ministry of Land and Physical Planning.

MAIN MESSAGES AND KEY RECOMMENDATIONS

Kenya is one of the bright spots in Sub-Saharan Africa. With economic growth rates sustained at above 5 percent, Kenya has outperformed the regional average, for 8 consecutive years. Robust domestic demand emanating from private consumption and government investment are the key drivers of growth, underpinned by a stable macroeconomic environment, lower oil prices, diversification, improved security perceptions, and ongoing structural reforms.

Medium term economic prospects for Kenya remain robust. Ongoing public infrastructure investments will continue to play a 'crowding-in' role, easing transport and energy costs, and supporting economic expansion in construction and industry. Private consumption will drive service sector growth, while agricultural sector will remain largely dependent on favorable weather conditions and timely availability of inputs. Though oil prices are expected to pick-up over the forecast horizon, Kenya's external sector account will remain healthy on account of a steady increase in remittances, a rebound in tourism and a rise in foreign direct Investment (FDI).

Nonetheless, there exist downside risks that can dent future growth prospects. Risks to Kenya's future growth prospects that are not included in our baseline outlook emanate from both external and domestic sources. On the external front, these include weaker than expected growth in the global economy, volatility in global financial markets and a spike in oil prices. On the domestic front, these include delays to fiscal consolidation, adverse weather developments, and potential uncertainties associated with the run-up to 2017 elections that could lead to a wait-and-see attitude by investors, thereby dampening short-term growth prospects.

Nevertheless, Kenya can achieve higher levels of growth by enhancing the productivity of public investments, which has declined in the recent years as reflected in the weak execution of infrastructure projects. In this regard, reforms are warranted in two broad areas; the first is to institute a system of Public Investment Management (PIM) which in turn can accelerate the catalytic impact of public investment on economic growth. The second reform is to streamline the process of land acquisition, particularly when determining compensation and preparing Resettlement Action Plans (RAPs), to prevent significant delays and cost escalation in the execution of public infrastructure projects.

While comprehensive PIM reform and strengthening comprises a relatively complex agenda, quick-win high-priority actions include:

- Establishing minimum criteria for project preparation, appraisal and inclusion of a project in the budget;
- Gradually strengthening the role of National Treasury as an independent reviewer of project proposals before selection for funding; while enhancing the capacity to undertake this role.
- Improving transparency and accountability for management of the portfolio of public investment projects.

Mitigating the delays related to land acquisition requires legislative and administration reform which include protecting the public land currently available and strengthening the legislation that governs compulsory land acquisition and involuntary resettlement. Some quick wins in the regard include:

- Providing payment assurance (such as via an escrow account at the National Treasury) for financing land acquisition and resettlement to ensure immediate availability of funds for compensation when needed.
- Evaluating the current proposal to amend the legislation on compensation in land acquisition against international good practice to balance fairness, timeliness, and the public interest.
- Developing a policy on involuntary resettlement, with supporting legislation, which reflects the principles of international good practice.

Building a sustainable PIM system will take time and will have to align a medium-term strengthening of capacity with strengthening of institutions, regulations, guidance and manuals and stakeholder support. A reform action plan for PIM should center on clear performance indicators for results and progress to allow for flexibility in how results are achieved.

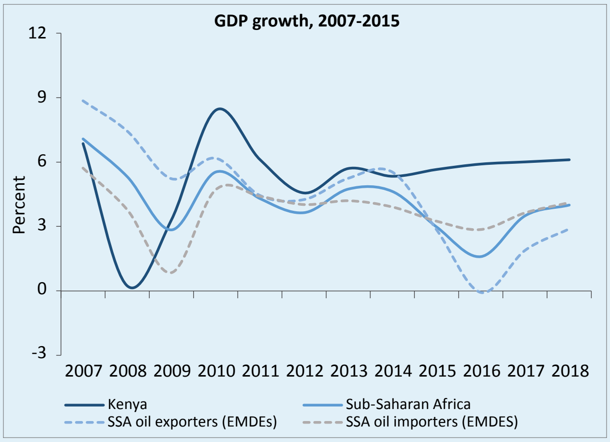
Likewise, a more effective and institutionalized land acquisition will take time. A comprehensive public land inventory should be prepared and periodically updated. Many counties have begun to undertake this exercise. In the preparation of public land inventories the engagement of community groups, local officials, and other non-state actors should be positively encouraged, and ground checks will be essential. More broadly, a major aspect is strengthening administrative systems to safeguard public land by registering and titling all public land parcels in the name of the county or the appropriate national authority. This will be enabled by improvements in land administration.

EXECUTIVE SUMMARY

0.1 Kenya is one of the bright spots in Sub-Saharan Africa

The World Bank projects economic growth at 5.9 percent in 2016, from 5.6 in 2015, and strengthening to 6.1 percent in 2018. This is a relatively robust performance against an average growth of 1.7 percent forecast for Sub-Sahara Africa in 2016, and in the context of the prevailing global headwinds; the tightening in global financial markets, the reversal in capital flows to emerging markets, and the subdued global demand, which has curtailed trade expansion. Notably, this will be the eighth consecutive year of growth outperforming the regional average.

Figure 0.1: Growth will outperform the average for the region for the eighth consecutive year



Source: World Development Indicators and Staff estimates.

Five favorable trends underpin the positive growth outlook. First, growth in private consumption has been supported by structural factors, including rising incomes and a growing middle-income class with higher disposable incomes, and ongoing demographic transition. Second, fiscal expansion driven by public investment and transfers to county governments has spawned growth in the devolved units. Third, the prevailing, low oil prices and the surge in remittances which counter the impact of the global down turn, leading to a contracting current account deficit. Fourth, the diversified structure of the economy is contributing to this growth. Though manufacturing performance remains subdued, vibrant services sector—formal and informal—remains a key pillar of Kenya's growth. And finally, a stable macroeconomic environment characterized by currency stability and low inflation is providing a conducive environment for investment and consumption.

However, growth could moderate if three potential downside materialize. Weaker than expected growth in the global economy could curtail the anticipated strengthening of Kenya's exports, remittance inflows and tourist receipts. Second, resurgence in volatility in global financial markets could trigger destabilizing short-term portfolio outflows that undermine macroeconomic stability. Thirdly, security risks emanating from terrorist activities could undermine the recent uptick in tourism.

Domestic policy environment could also curtail growth prospects. The recent introduction of the interest rate caps could constrain credit growth to the private sector and low-income households. Further, if fiscal consolidation is delayed, particularly due to elections related spending, increased government spending may crowd out private sector investments and lead to overheating of the economy resulting in high inflation.

0.2 Kenya can do even better by increasing the productivity of public investment

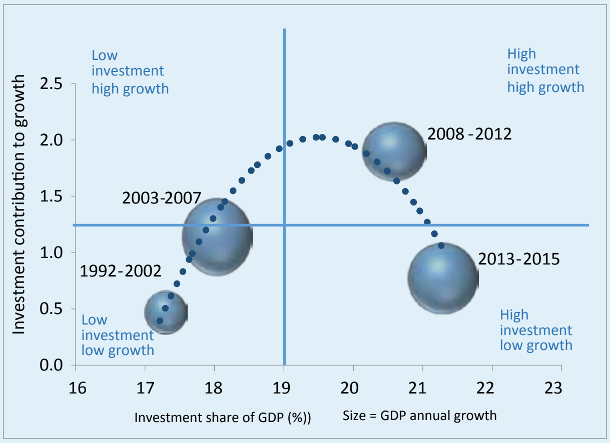
In an effort to close its infrastructure deficit, Kenya has quadrupled spending in the infrastructure sector, and the quality of infrastructure has improved. About half of Kenya's capital budget is allocated for infrastructure—transport, energy and ICT- and this budget increased from about 5 percent of GDP to 7 percent of GDP in 2014/15. Available data shows there has been significant build up in capital stock as a result of recent investments. The index of quality of trade and transport related infrastructure has improved from 2 in 2007 to 3 in 2015.

However, the productivity of these investments has stagnated. This is reflected in declining total factor productivity and increasing capital output ratio. Total factor productivity (TFP) has stagnated at about 1.1 percent and projections show a declining trend to about 0.5 percent in 2018. The incremental Capital Output ratio (ICOR) is rising, which suggests that more inputs are required to produce one unit of output; and the contribution of investment to GDP growth declined. For the period 2008-12, investment contributed 1.9 percentage points to GDP growth compared to 0.9 percentage points in 2013-15, see figure 0.2.

Causes of declining efficiency of investment can be attributed to weakness in the system of public investment management, (PIM) and the process of land acquisition, among other factors. A public investment management index ranked Kenya 44th in a sample of 71 countries. Out of a potential overall score of 4, Kenya scored 1.45, which is a weak performance compared to South Africa's 3.53 score. Performance in each of the sub index, projects appraisal, selection, managing and evaluation indicates that while Kenya is an average performer in managing projects, it is particularly weak in project appraisal and selection, see figure 0.3.

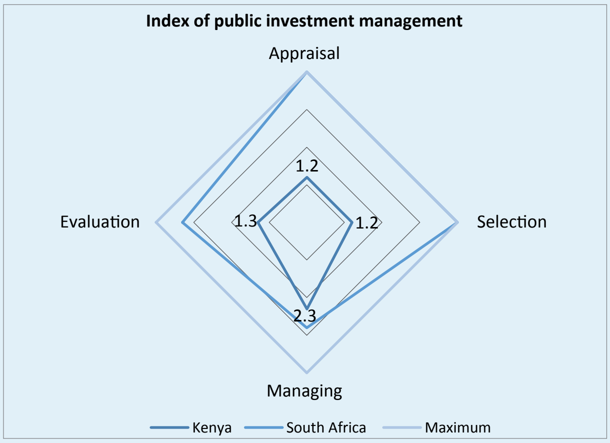
Improving Kenya's PIM system can boost the productivity of ongoing investments. A good PIM system has eight basic functionalities: (i) **strategic guidance** linked to a development strategy which, in Kenya, is the Vision 2030 and the five year Medium Term Plans (MTPs); (ii) a project **appraisal** process that provides a consistency project selection; (iii) an **independent review** process which confers credibility to the process; (iv) a rigorous **selection process** with authority to reject low priority projects and develop a pipeline of fundable projects; (v) an established **implementation process** with effective budget and procurement which is; (vi) flexible enough to **adjust** during implementation; (vii) ensures

Figure 0.2: Investment as a share of GDP has increased but its contribution to growth contracted in the years



Source: Computations from Kenya National Bureau of Statistics (Economic Survey, various issues).

Figure 0.3: Index of Public investment management: Kenya versus South Africa



Source: IMF 2010.

that completed assets are put into **operation** and are maintained; and has (viii) a system for **evaluation** to improve overall guidance.

Setting up a Public Investment Management (PIM) system, will lay the foundation for increasing the returns on public investments. A good starting point would be to promulgate a PIM reform action plan to steer the country to what is a relatively complex reform agenda. Immediate and high priority steps include:

- Establishing minimum criteria for project preparation, appraisal and inclusion of a project in the budget,
- Strengthening the role of National Treasury as an independent reviewer of project proposals before selection for funding,
- Strengthening transparency and accountability for management of the portfolio of public investment projects.

The land acquisition process poses a unique challenge in Kenya's infrastructure development and public investment management. Infrastructure development comes with significant demand for land, which is not readily available. Inventories of the public land available for infrastructure investments are limited, making compulsory land acquisition an often necessary step in infrastructure projects.

Acquisition of land increases the cost of public investments. For instance, current estimates suggest that the cost of land accounted for 10 percent of the cost of Phase I of the Standard Gauge Railway (SGR) project. While not high by global standards, it increases project costs in ways not anticipated by the government as actual compensation costs tend to exceed the budgetary allocations, sometimes as much as twice the budgeted amount. Further, urban centers have the biggest need for network infrastructure but the cost of land in these areas is prohibitive. Estimates suggest that the cost of land in Nairobi has increased by 535 percent in seven years from 2007 to 2014 due to public demand as investment in land has come to provide far higher returns than either the bond or stock market in the country.

Compensation disputes related to compulsory land acquisition also adversely affect large infrastructure projects expected to have high productivity gains. Infrastructure that is expected to translate into savings and economic growth is hindered during the land acquisition process, which is often fraught with compensation challenges. The challenges lead to disputes and delays in project implementation and significant cost overruns, and are felt across four factors:

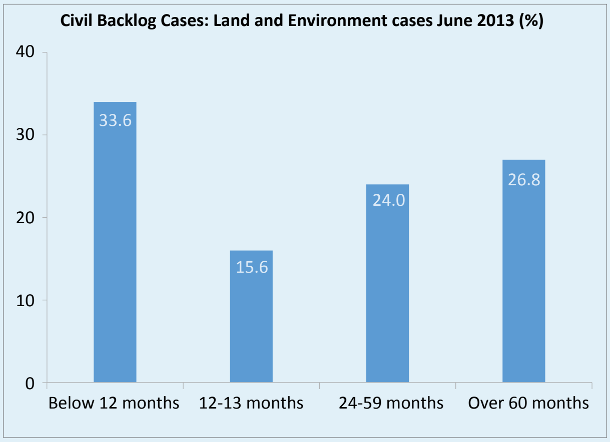
First, identification of legitimate rights' holders can delay acquisition of land. Confusing laws and procedures have resulted in registries of poor integrity with outdated and inaccurate formal ownership information. Further, occupants of the land in good faith must also be compensated and often times it is difficult to establish the legitimate rights holders due for compensation especially if they do not hold formal rights to the land.

Second, determining and agreeing on 'just and prompt' compensation can be a source of dispute and delay in project implementation. While there is agreement that 'market value' constitutes the basis for just compensation, disputes arise when compensation is not made promptly and in full. Disputes in the acquisition of the way leave for the power transmission lines from Olkaria I and IV Geothermal Power Stations to Nairobi, and onwards to Mombasa, also indicate that 'market value' is sometimes a contested value. Yet the high cost of power and regular outages remains a binding constraint to doing business in Kenya. Payment that is not done promptly has also resulted in delays in projects.

Third, resettlement and restoration of livelihoods is not standardized. Compensation packages can vary across implementing agencies and across sub-national jurisdictions. For instance, the SGR and the Kipevu New Container Terminal Resettlement Action Plans (RAPs) provided different compensation rates where project area overlapped due to differences in approaches and methodology. Notably the SGR payments were higher. This difference indicates that while some projects recognize the need for livelihood restoration, others do not. Protests from the communities regarding poor livelihood restoration measures have resulted in stoppages in works.

Finally, the use of courts in resolving grievances related to land acquisition also creates delays and cost overruns. A 2013 survey revealed that 66 percent of land cases in the Environmental and Land Court had been going on for more than one year and nearly half had been going on for over 60 months, see figure 0.4.

Figure 0.4: Only one third of the cases filed in the Land and Environment Court are concluded in 12 months



Source: Judicial Case Audit and Institutional Capacity Survey, June 2013.

Mitigating the delays related to land acquisition requires legislative and administration reform. Measures to improve public land management need to be enhanced and can begin with a comprehensive public land inventory which should be prepared and periodically updated. In parallel, reform of the legislative and regulatory framework to govern land acquisition and involuntary resettlement should be completed. Reforms should focus on crafting a single policy or legislative act on compulsory land acquisition, including livelihood restoration of the displaced persons. Good practices can be drawn from the legislation in other countries.

The State of Kenya's Economy

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1. Kenyan Economy Resilient Despite Global Headwinds

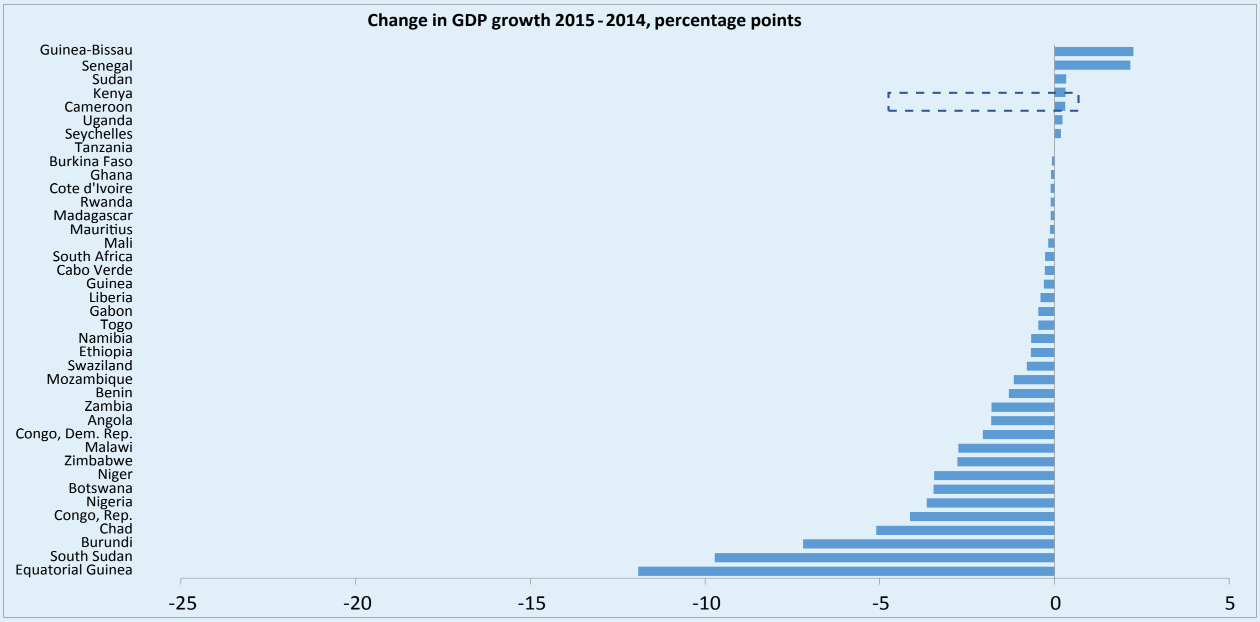
1.1 In Contrast to Several Sub-Saharan African Economies, Kenya's GDP Growth Strengthened in 2015

Consistent with earlier World Bank forecast, the Kenyan economy expanded at a rate of 5.6 percent in 2015, 0.3 percentage points higher than the growth recorded in 2014 (figure 1.1). Kenya's growth performance was all the more remarkable given strong headwinds from the global economy that included: volatility in global financial markets, heightened uncertainty regarding U.S Federal Reserve interest rate hikes, decline in commodity prices, reversal of capital flows to emerging markets, and subdued global demand which has led to a structural slowdown in the pace of global trade expansion. These factors, among others, have been responsible for the significant slowdown in growth amongst the developing countries, including in Sub-Saharan Africa, where GDP growth fell sharply to 3.0 percent, about 1.6 percentage points lower than in 2014.

1.2 Agriculture, Construction and Services Were the Main Drivers of Growth in 2015

Agriculture accounts for about 30 percent of Kenya's GDP and is largely dependent on favorable weather conditions. In 2015, agricultural production increased by 5.6 percent (compared to 3.5 percent in 2014) due to favorable weather conditions. Manufacturing output, although underperforming other sectors, picked up to a modest 3.5 percent (compared to 3.2 percent in 2014) on account of a stable macroeconomic environment, low oil prices, and increased access to, and lower, electricity costs. The fastest growing sub-sector was construction (13.6 percent), supported in part by major government flagship infrastructural projects. Despite a subdued tourism sector in 2015, the service sector grew by 5.5 percent. This reflected the vibrancy of non-tradable sectors of the Kenyan economy such as information and communication (7.3 percent), financial services (8.7 percent), and transport and storage (7.1 percent) sub-sectors.

Figure 1.1: Kenya's growth strengthened in 2015 despite global headwinds



Source: World Development Indicators.

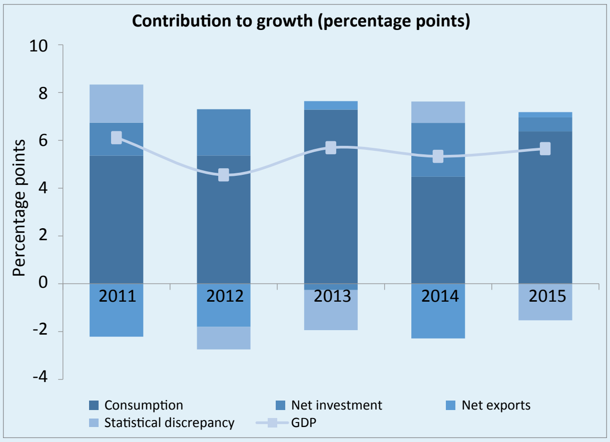
1.3 Consumption and Government Spending Spurred Robust Domestic Demand

Private consumption, which accounts for over 75 percent of GDP, picked-up in 2015 on account of rising employment, a boost to real incomes as oil prices declined, and a rise in remittances. Further, expansionary fiscal policy boosted government consumption and public investment—all of which also supported public-sector wage employment and consumption. Despite weakness in exports, the contribution of net exports to growth turned modestly positive in 2015, thanks to a 37.9 percent decline in the oil import bill as well as the decline in the importation of one-off big-ticket machinery and equipment items related to the Standard Gauge Railway (figure 1.2). The latter also contributed to the slowdown in the expansion of gross fixed investment to 5.2 percent in 2015 (compared to 14.8 percent in 2014).

1.4 Yet Kenya's Growth Performance Falls Short of its Target Level and Remains Below Some EAC Peers

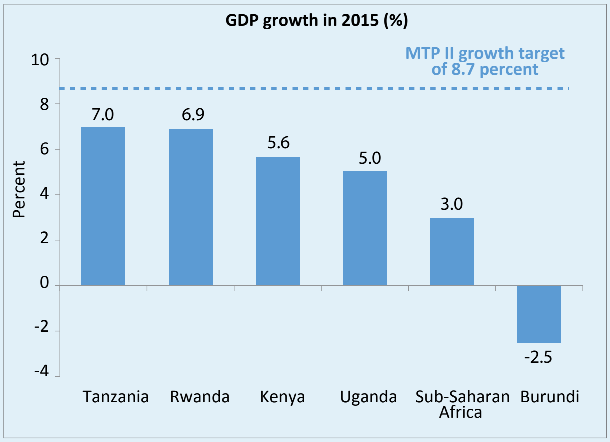
Notwithstanding Kenya's relatively robust performance, GDP growth falls well short of the 8.7 percent target outlined in the Second Medium Term Plan and which is needed to propel Kenya to an upper-middle income economy with significantly lower levels of poverty (figure 1.3).[1] Further, though larger and more diversified than other East African economies, Kenya's growth has lagged behind that of Ethiopia, Tanzania and Rwanda, all of whom grew at least one-percentage points higher than Kenya in 2015. This suggests that while safeguarding current progress (including the relatively stable macroeconomic environment), there exists further scope for accelerating growth in Kenya, particularly, by addressing some of the structural constraints that have capped productivity growth in the Kenyan economy.[2]

Figure 1.2: Growth was consumption driven



Source: 2015 & 2016 Issues of the Kenya National Bureau of Statistics' Economic Survey.

Figure 1.3: However, Kenya's growth remained below MTP II target



Source: World Development Indicators and MTPII.

1 *As of 2015, the poverty rate (at the $1.90/ day 2011 PPP terms) in Kenya was estimated at 25.3 percent.*

2 *Several editions of KEU's have addressed some of these structural constraints, including trade logistics, regional integration, job creation, high interest rate in banking sector, productivity in manufacturing sector, and informality. The special topic for this edition focuses on another such constraint – the efficiency of public investment.*

2. Kenya's Robust Growth Momentum Has Been Sustained in 2016

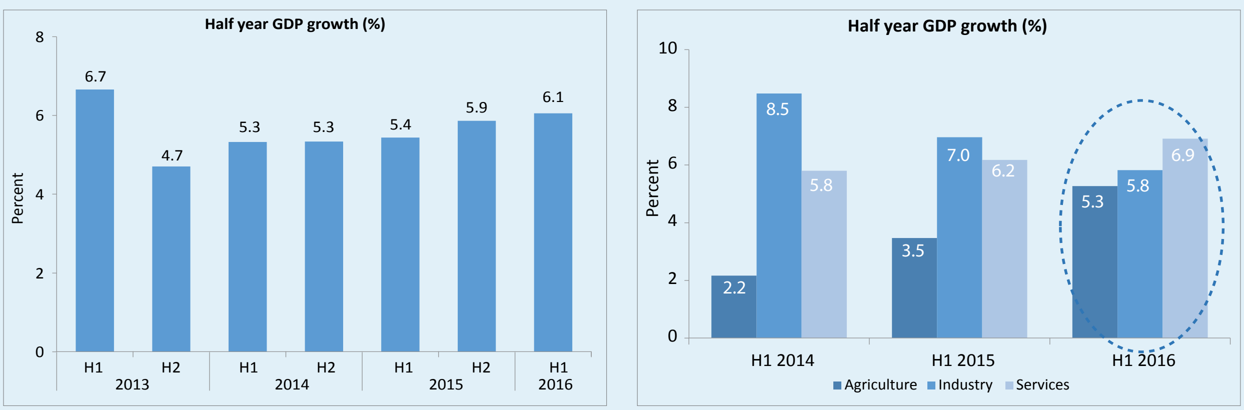
2.1 With the Exception of the Manufacturing Sector, Growth in 2016 Has Been Broad-Based

2.1.1 Economic activity kicked-off at a brisk pace in 2016. The Kenyan economy grew by 6.1 percent in the first half of 2016 (H1 2016). This was 0.7 percentage points higher than the pace of expansion in the same period in 2015 and 0.2 percentage points higher than in H2 2016 (figure 1.4). While all sectors contributed to this performance, the agriculture and services sectors have been the primary drivers of growth, thus far in 2016.

2.1.2 Agriculture growth was relatively strong, but a weak manufacturing sector weighed on industrial sector growth. Agriculture grew by 5.3 percent in the first half of 2016, higher than 3.5 percent experienced in the same half in 2015. The growth was underpinned by adequate rains that led to increased production of key crops such as tea and horticulture. Industry's growth was somewhat subdued; it grew by 5.8 percent in the first half of 2016 compared to 7.0 percent during the same period in 2015 (figure 1.4). However, this was due to a slowdown in manufacturing, the largest industrial sub-sector, to 3.2 percent in 2016 compared to 4.6 percent in 2015. Growth in the manufacturing sub-sector in Kenya continues to be stifled by high cost of credit, infrastructural constraints and a challenging business regulatory environment. Excluding the manufacturing sub-sector, industrial sectors performed well, particularly electricity and water supply (9.7 percent), construction (9.0 percent) and mining (9.0 percent).

2.1.3 Rebound in tourism propelled the rapid expansion in the services sector. The services sector grew by 6.9 percent in the first half of 2016, the highest half year pace of expansion since 2011. The accommodation and restaurants sub-sector (the main tourism sector) grew at 13.4 percent. The number of tourism arrivals and hotel bed occupancy increased in the period under review thanks to the lifting of travel advisories against Kenya's coastal towns by the governments of major tourist-originating countries. Further, apart from its well-established domain as an eco-tourism spot, Kenya is increasingly also becoming a center for conference tourism. In H1 of 2016 alone, Kenya hosted several major international conferences, including the recently concluded TICAD and UNCTAD conferences. The sector also benefitting from government incentive schemes such as the

Figure 1.4: The economy sustained the growth momentum of 2015

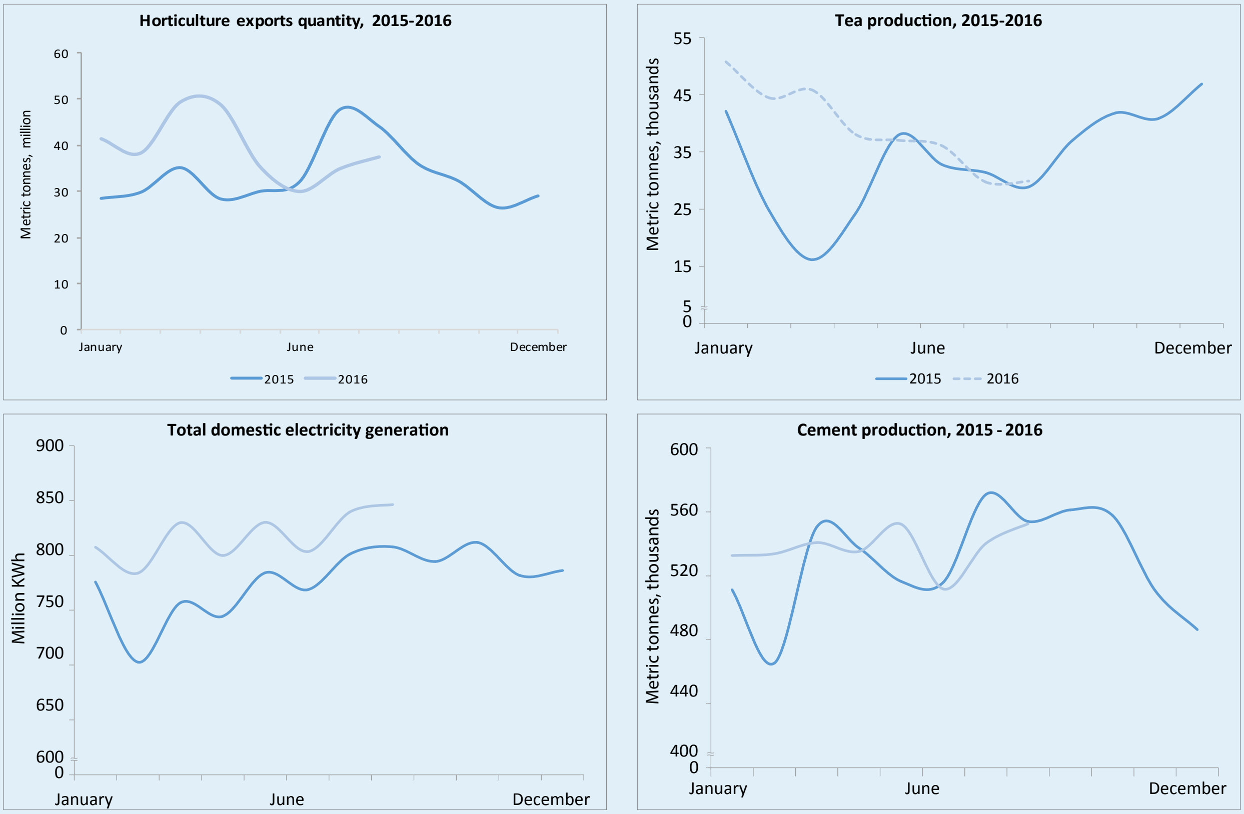


Source: Kenya National Bureau of Statistics (Quarterly Gross Domestic Product and Balance of Payments Report, First Quarter 2016 and Second Quarter, June and September 2016).

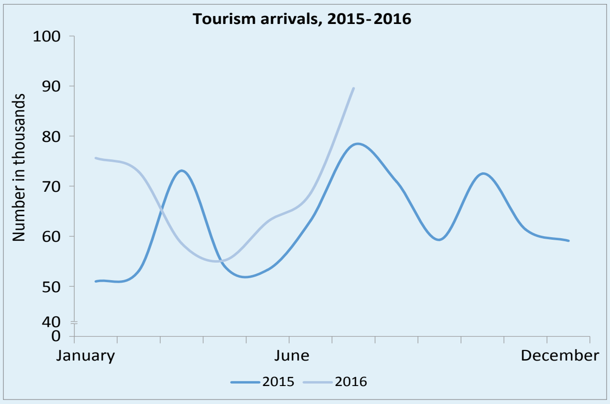
charter incentive program.[3] Besides tourism, another service sub-sector that registered strong growth was the transport and storage (8.6 percent in 2016 compared to 6.8 percent of 2015), which reflects vibrant economic activity as well as lower fuel prices. Wholesale and retail trade grew by 6.6 percent, information and communication by 9.2 percent, while financial and insurance sub-sectors expanded by 7.7 percent. Innovations in the usage of mobile phones to access services (both retail trade and financial services) contributed to the vibrancy of these non-tradable services sectors.

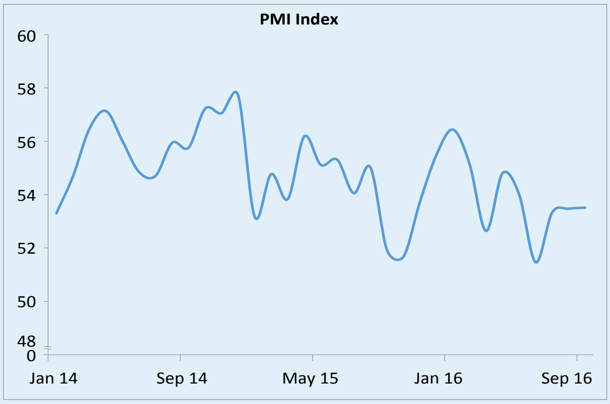
2.1.4 Although quarterly GDP data for Q3 is unavailable, leading economic indicators suggest ongoing robust growth. Though output of key agriculture products weakened in Q3 (e.g. tea and horticulture), on a year-to-date basis the expansion has been robust (figure 1.5). In the industrial sector, domestic electricity generation continued its upward trajectory growing by 3.9 percent in Q3, however manufacturing sector growth was most likely modest given weak growth in key sectors such as cement (decline by 3.9 percent), and sugar (19 percent) production. Third quarter Purchasing Manager's Index for Kenya, although confirming an expansion at a healthy index level of 53.4, reflects a deceleration in the pace of expansion compared to that of H1 2016 (figure 1.5). The strength of the tourism rebound in Q1 and Q2 likely continued into Q3 with the number of tourists' arrival in Q3 keeping apace (on a seasonally adjusted basis) with the strong H1 performance (figure 1.5).

Figure 1.5: Leading economic indicators suggests ongoing robust growth in Q2



[3] *The government has set aside KSh 1.2billion Charter Incentive Program (CIP) aimed at recovering lost business from tourist charters. Landing fees for all charter aircraft terminating at the Kenyan coast have been waived for a period of 30 months beginning from 1st January 2016 to 30th June 2018. Source: http://ktb.go.ke/charter-airlines-to-kenya-coast-get-incentives/ Accessed on September 12, 2016.*





Source: Kenya National Bureau of Statistics (Leading Economic Indicators, various issues) and Stanbic.

2.2. Buoyant Domestic Demand Has Mitigated Subdued Global Demand

2.2.1 Robust domestic demand is driven by consumption and public investment. Private consumption, which accounts for over 70 percent of GDP, has been supported by structural factors including rising incomes and a growing middle-income class with higher disposable incomes and increasing access to credit (if even at high interest rates). Further, for the first half of 2016, a 14 percent increase in remittances, a boost in agricultural output thanks to improved weather conditions, lower oil prices and lower interest rates (Central Bank of Kenya cut interest rates in May), have supported household consumption. As a signal of the ongoing robust consumption in 2016, both the number and value of mobile transactions in H1 2016 has expanded by 36.7 percent and 20.5 percent respectively. Fiscal policy has remained expansionary, with public investment on flagship infrastructure projects and allocations to the counties driving the expansion (see section 3).

2.2.2 Business spending is up though constrained by challenging environment. As a gauge of corporate business spending, we use Markit's CfC Stanbic Bank Kenya PMI sub-indicator for quantity of purchases. On that basis, the pace of corporate spending, which was already robust in 2015, accelerated in 2016 to an average index value of 55.3 (from 54.4 in 2016). This increase in business activity is also reflected in robust investor confidence as reflected in the Standard Chartered MNI business sentiment indicator, which has averaged 60 thus far in 2016 (well above the 50-mark signaling favorable sentiments). Factors underpinning these favorable developments include lower input costs, improvements in electricity supply (thanks to earlier public investments), expanding export orders, more stable macroeconomic environment and decline in interest rates.

2.2.3 Nonetheless, private domestic investment, in particular by small and medium sized enterprises (SME), remain constrained. These constraints include: high cost of credit (notwithstanding the decline in interest rates), delays in payments by the exchequer and a challenging business regulatory environment. Indeed, notwithstanding the robust performance of the private sector, credit growth to the private sector has weakened in 2016, averaging 11.7 percent compared to 20.7 in 2015, with the private households and consumer durables sectors suffering the largest declines in credit growth. The robust increase in business purchases, against the backdrop of weaker private sector credit growth suggests strong corporate cash flows enabled purchases, notwithstanding ongoing developments in the banking sector that have led to slower credit growth (see section 3.5). The recent capping of interest rate spread is also likely to constrain lending to SME sector (Annex 1, Box 1.2).

2.2.4 Supported by ongoing business regulatory reforms, investor confidence is rising. While domestic sources of financing private sector may be constrained, foreign direct investment to Kenya has surged in recent years (in 2015 FDI increased by 52 percent), albeit from a low base suggesting increasing investor confidence of prospects in the Kenyan economy. Indeed, reforms to improve the business environment have picked-up in recent years as reflected in the improvement of Kenya in the World Bank's Ease of Doing Business rankings by 21 places over the past year (from 113th to 92nd in most recent report). Further, a series of critical legislation to improve the business environment have been enacted, including: the Companies Act, the Insolvency Act, the Business Registration Act, and the Special Economic Zones Act.

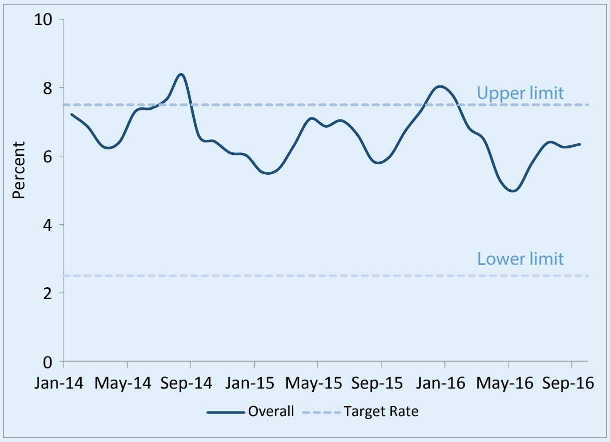
2.2.3 Despite weak exports, the decline in oil prices is supporting net exports contribution to growth. Reflecting sluggish growth in the global economy and weakness in commodity prices, the value of exports of goods and services contracted by 3.3 percent in the first half of 2016 (H1 2016). Notwithstanding the contraction in exports, the net exports contribution to GDP has been positive in H1 2016, thanks to a 16.2 percent decline in the import bill. This decline was mostly on account of a drop in oil prices. As a share of total imports, the share of oil imports fell by 3.3 percentage points in H1 2016 to 15.6 percent from an average of 18.9 percent in 2015. These developments, and the rise in remittances (14.4 percent in H1 2016) have supported the narrowing of the current account deficit to 4.9 percent of GDP in June 2016.

3. A Stable Macroeconomic Environment Has Underpinned Kenya's Performance

3.1 Inflation Has Fallen Within the Central Bank's Target Range

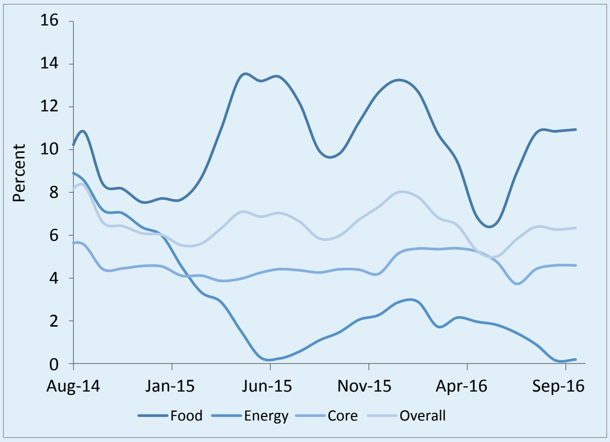
Headline inflation for the first eight months of 2016 averaged 6.3 percent, a decline from the 6.4 percent observed over the same period in 2015. This decline in headline inflation was mainly due to lower oil and food prices, the waning pass through effects from the sharp depreciation of the shilling in Q4 2015 and the lagged transmission of earlier interest rate hikes in Q3 2015. Indeed in May 2016, headline inflation bottomed out at 5.0 percent. However, it has increased in Q3 and been range-bound between 6 and 6.5 percent, which is well within the 7.5 percent Central Bank of Kenya's upper bound. The uptick in inflation in recent months has been largely driven by an increase in food prices. Indeed, heavy rains in April and May had an adverse effect on the harvest of vegetables thereby pushing up prices. Similarly, maize prices adjusted upwards on account of delayed release of maize stocks. Nonetheless, underlying demand pressures are contained as core inflation is only at 3.6 percent as of July 2016 compared to 4.4 percent for the same period in 2015.

Figure 1.6: Overall Inflation has been contained within policy bounds since the beginning of 2016



Source: Kenya National Bureau of Statistics.

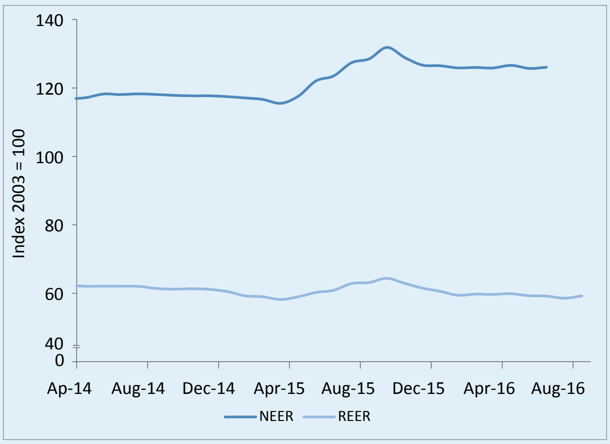
Figure 1.7: Energy inflation has declined, while food inflation continues to be the main driver of overall inflation



3.2 The Exchange Rate Has Stabilized in 2016

The shilling has remained remarkably stable against the currencies of its major trading partners. Both the real and nominal effective exchange rates have appreciated marginally by some 2.2 and 0.2 percent respectively between December 2015 and August 2016. The recent appreciation of the shilling can in part be attributed to the tightening of monetary policy in July 2015, less pressure coming from a reduction in the current account deficit (thanks to the decline in oil prices) and a surge in remittance inflows. Further, the IMF 24 month Standby Credit Facility (SCF) of US$ 1.5 billion has also helped to shore-up further confidence in the Kenyan shilling. Consequently, foreign exchange reserves have remained fairly healthy reaching 5.6 months import cover in August 2016, up from an average of 4.6 in 2015.

Figure 1.8: The Shilling remained stable against the U.S dollar in 2016

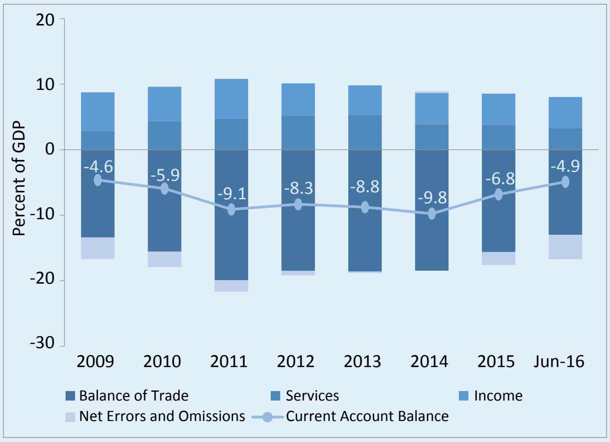


Source: Central Bank of Kenya.

3.3 The Current Account Position is Healthy

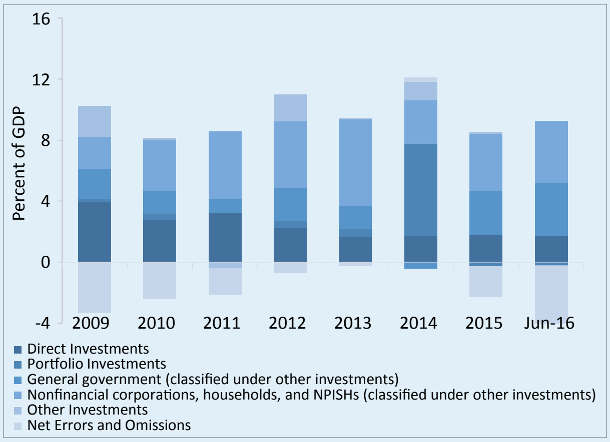
3.3.1 The current account deficit has improved. Driven mostly by oil prices the current account deficit improved to -4.9 percent of GDP in June 2016, compared to -6.8 and -9.8 percent of GDP in 2015 and 2014 respectively. The improvement in Kenya's current account deficit is all the more remarkable against the backdrop of a weakening export position as well as a widened fiscal deficit. As earlier noted, subdued global demand (in particular from the EU) and weak prices of Kenya's main exports, contributed to the decline in the value of merchandise and services exports in the first half of 2016 (3 percent). However, while this served as a drag on the trade balance, the effects of a lower import bill and improved remittance inflows counteracted this. The oil import bill fell by 34.1 percent in H1 2016 compared to the same period in 2015. As a share of GDP, oil imports declined by 0.5 percentage points between December

Figure 1.9: Current Account Balance contracted



Source: Central Bank of Kenya.

Figure 1.10: Current Account Financing

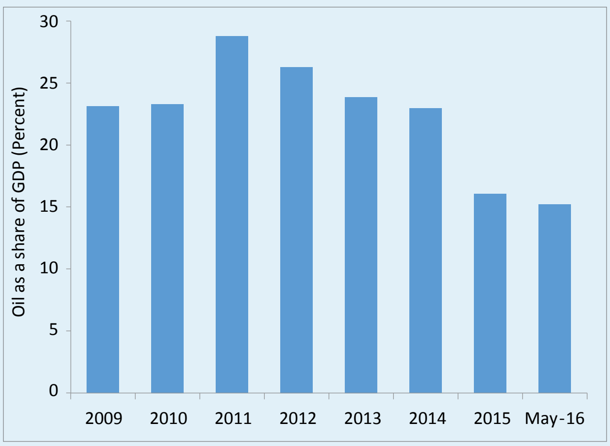


Source: Central Bank of Kenya.

2015 and June 2016 from 3.9 to 3.4 percent as a share of GDP (figure 1.11). The improved current account balance has also been supported by a surge in remittance inflows. For H1 2016, remittances have increased by 14 percent to US$ 1.7 billion, mainly driven by Kenyan Diaspora in the United States, whose economy is on a relatively stronger footing than in Europe, the other abode of a strong Kenyan diaspora.

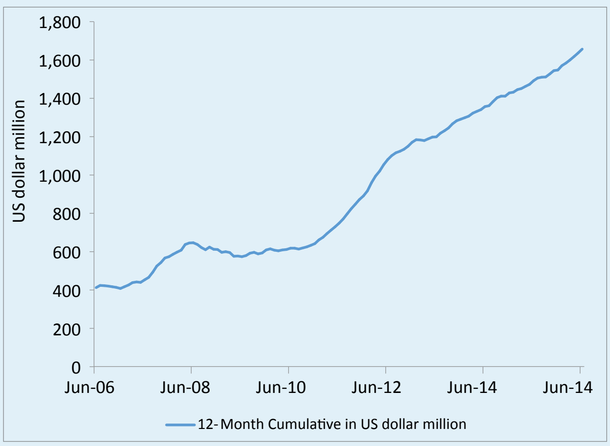
3.3.2 Inflows to the financial accounts have also improved. Reflecting increased investor confidence in the Kenyan economy, capital flows to the financial accounts increased from 8.0 percent to 9.0 percent of GDP between end December 2015 and June 2016. This increase was mainly on account of an increase in investment flows to general government (foreign participation in T-Bills and bonds) as well as to nonfinancial corporations, households and Non-Profit Institutions supporting Households (NPISHs), at 3.5 and 4.1 percent of GDP respectively. Direct investment flows increased marginally by 0.1 percentage points of GDP between December 2015 and June 2016.

Figure 1.11: Oil share in total imports declined



Source: Central Bank of Kenya.

Figure 1.12. Remittances to Kenya remain strong, despite weakness in global economy

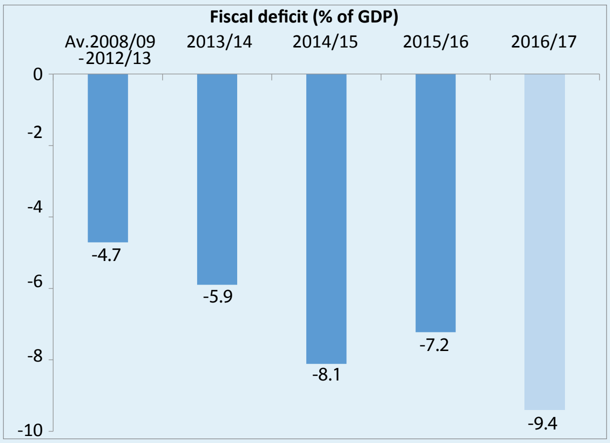


Source: Central Bank of Kenya.

3.4 Nonetheless, Fiscal Consolidation is Delayed

The fiscal deficit is projected to be higher in 2016/17. Contrary to the expected decline in the fiscal balance as proposed in the 2016 Budget Policy Statement the 2016/17 budget suggests an increase in the fiscal balance to -9.4 percent of GDP compared to -7.2 percent of GDP in the previous fiscal year (figure 1.13). It is however important to recognize that the latest deficit estimate assumes full execution of development spending, this is however unlikely to occur based on weaknesses in execution of public investments (see special focus), thus implying the deficit is likely to come in lower than projected. Nonetheless, since 2012/13 when Kenya started its fiscal expansionary policy, devolution related allocations, spending on key infrastructural projects in energy, roads and railway, interest payments and public wage bill have all contributed to the widening fiscal deficit from an average of 3.3 percent of GDP before devolution (2007-2012) to 7.2 percent of GDP in 2015.

Figure 1.13: Kenya's fiscal expansion is driven by infrastructural spending



Source: The National Treasury (Quarterly Budget and Economic Review, August 2016 and the Budget Summary for the FY 2016/17, April 2016).

3.4.1 Public investment is the main driver of Kenya's fiscal expansion. While the rising deficit is narrowing fiscal space, the quality of spending has improved as reflected in an increasing share of development spending relative to recurrent expenditures. Development expenditure increased from 6.9 percent of GDP in 2015/16 to 11 percent of GDP in 2016/17, while recurrent expenditure marginally went up from 15.4 percent of GDP to 15.8 percent of GDP during the same period. The increase in development spending stems largely from infrastructure projects, with the SGR project accounting for 1.2 percent of GDP in 2015. Given that weak infrastructure is a binding constraint, these projects, when completed, should relieve these supply-side constraints, spur economic activity and improve productivity.

3.4.2 National level expenditures have risen faster than county transfers. While the first two years of the implementation of the devolution (2013/14 and 2014/15) led to a spike in county–level expenses, they have remained stable in 2016. On the other hand, expenses at the National level increased in 2016, reflecting a rise in expenditure towards national level projects, especially infrastructure but also in education, by 1.1 percentage points of GDP in the last two years.

3.4.3 Budget execution difficulties contain the realized deficit but at the expense of implementation (see special focus section). Despite higher allocations to capital budget, weak budget execution undermines government's commitment to upgrade infrastructure. Low development budget's execution[4] has been a challenge in recent years, particularly at the National Level as execution rates at the county level are higher than National rates (box 1.1).

[4] *Budget execution in the document is computed as the ratio of the actual expenditure and the gross estimates.*

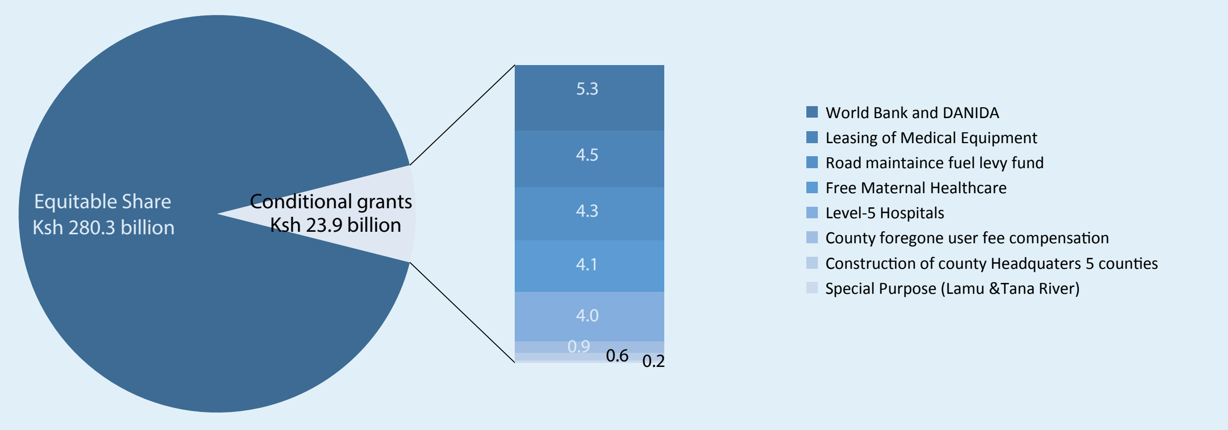
Box 1.1: Status of Kenya's devolution: Counties overcoming challenges

County governments are overcoming some of the challenges experienced in the first year of devolution. At the end of 2014/15, almost all counties met the 30 percent PFM development expenditure threshold while at the same time improving budget execution, which stood higher (62.4 percent) than that at national level (45.8 percent). This is supported by improved staff capacity and setting realistic targets. In addition, public participation (media, citizens) and Members of County Assembly (MCA) have been playing a key role in ensuring accountability.

Counties' own sources of revenues have expanded. Own, diversified sources of revenue have helped county governments set realistic targets and enhance revenue collection. In the first year of devolution, county governments had set unrealistic targets of local revenue collections. But in 2014/15, actual local revenue improved and became closer to the target sets; the target was achieved at 67.2 percent, higher than 48.5 percent of 2013/14. Although revenue streams vary per counties, the number of sources of revenue per county ranges between 6 (lowest) and 20 (highest). They include agriculture produce cess, bus park fees, game park fees, hospital fees, land rates, market fees, property rates, sand cess, transport and infrastructure, royalties, and single business permits. They are tailored to county governments' economic activities.

However, county governments still rely on national transfers. In the 2016/17 budget, national transfers are estimated at KSh 304.2 billion billions (equivalent to 3.9 percent of GDP). Equitable share constitutes the main component of national transfers, accounting for 92.1 percent (KSh 280.3 billion, figure B.1.1.1). Whereas equitable share is set at 15 percent (minimum) of the last audited revenue, there has been a two-year lag in government revenue/expenditure audit. As a result, the Division of Revenue bill (2016) determined 2016/17 estimates by adding a 7.8 percent growth on the 2015/16 equitable share of KSh 259.8 billion. This is equivalent to 30 percent of 2013/14 audited revenue. Additional conditional grant allocations for 2016/17 amounted to KSh 23.9 billion.

Figure B1.1.1: Equitable share constitute the main component of national transfers in the 2016/17 budget



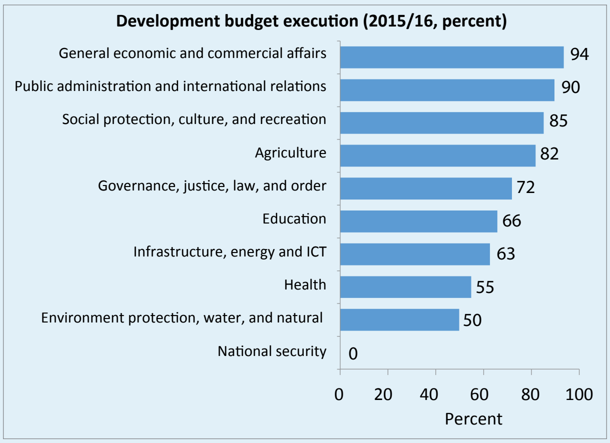
Source: The National Treasury (Budget Highlights for 2016/17, June 2016) and the Division of revenue Bill, 2016.

Development budget execution[4] improved in 2015/16 to 69.2 percent. Energy, infrastructure and ICT sector, which accounts for over 50 percent of total development allocations, were among the sectors with the lowest execution rates (figure 1.14). This state of affairs has been attributed to low donor disbursement and revenue underperformance on one hand. However, challenges in procurement planning have contributed to this. In addition, late exchequer release affects budget execution and has spillover effects on non-performing loans as payments to government suppliers' delayed.

3.4.4 Growth in expenditures have outstripped growth in revenues. There has been a marginal increase in revenue collections, unlike the significant increases in expenditure. Revenue is projected to increase by 2.3 percentage points in 2016/17 to 21.3 percent of GDP compared to 19.0 percent of GDP in 2015/16 (figure 1.15). Expenditure, on the other hand is projected to increase by 3.7 percentage points of GDP during the same period. Growth in revenue is expected to be supported by reforms plugging revenue leakages (e.g. enhancing compliance for rental income tax) and other tax administration measures (e.g. expanding withholding VAT agents). While domestic debt instruments will play an important role, continuing with recent trends, the financing gap is increasingly being plugged from external sources. External financing is estimated at 6.3 percent of GDP (67 percent of the deficit) in the fiscal year 2016/17, higher than its 2015/16 level of 4.1 percent of GDP.

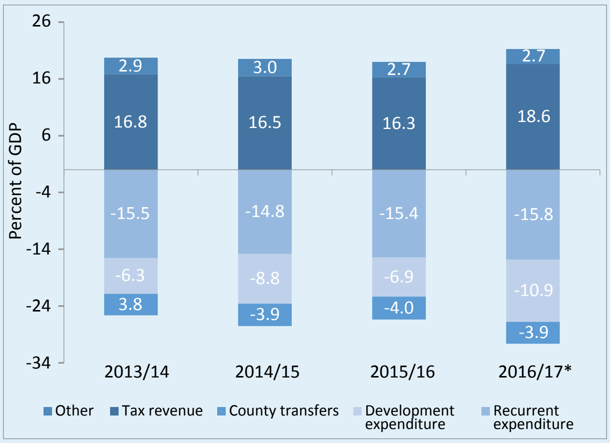
3.4.5 Although public debt remains sustainable, margins for maneuver are rapidly narrowing. Kenya's public debt remains sustainable, but with a declining margin. A recent Debt Sustainability Analysis (DSA) carried out jointly by the IMF and the World Bank show that the risk of distress for the current debt level is still low. Debt levels have, however, increased from 42.1 percent of GDP in 2012/13 to 55.1 percent of GDP in 2015/16, following the increase in development spending (figure 1.16). These infrastructure expenditures are expected to alleviate binding constraints to the productive capacity of the Kenyan economy, thereby ultimately leading to a decline in debt ratios. Nonetheless, with an over 13 percentage point of GDP increase in the debt-to-GDP ratio within a three-year period, and with debt levels over 50 percent of GDP, and fiscal deficits well above the medium term 4.5 percent target, the fiscal policy space is fast eroding and margins for further debt accumulation are narrowing.

Figure 1.14: Budget execution has underperformed



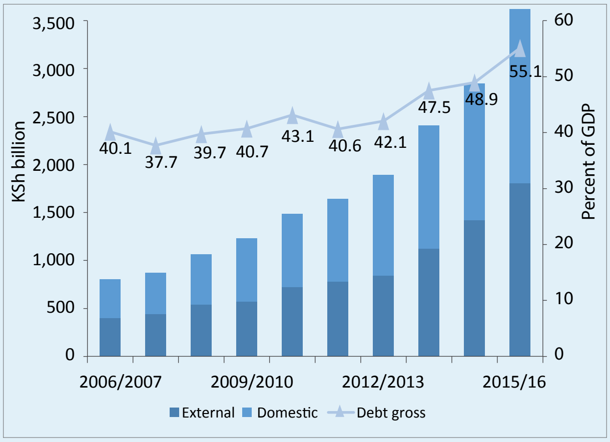
Source: The National Treasury (Quarterly Budget and Economic Review, August 2016).

Figure 1.15: There has been marginal increase in revenue



Source: The National Treasury (Quarterly Budget and Economic Review, August 2016, and Estimates of Revenue, Grants and Loans, April 2016).

Figure 1.16: The increase in debt levels have picked up pace



Source: The National Treasury (Quarterly Budget and Economic Review, August 2016).

3.5 Though Sound, Financial Markets Have Been Affected by Structural Changes and Episodic Disturbances

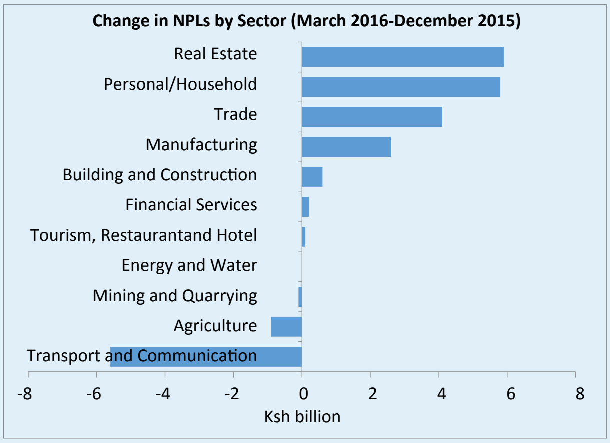
3.5.1 New law jolt Kenya's Banks. On 24th August 2016, the President of Kenya signed into law the Banking (Amendment) Bill 2015. The law caps the maximum interest rate charged for a credit facility by Kenyan Banks at no more than four per cent of the base rate set by the Central Bank of Kenya; and provides a floor for the deposit rate held in interest earning accounts to at least seventy per cent of the Central Bank of Kenya Base Rate. Interest rate spreads in Kenya have on average been perceived to be high, given relatively high levels of return on equity. Interest rate caps are not unique to Kenya, with several countries including both developed and developing having experimented with interest rate caps. It is too early to determine the long-term impact the law will have. However, based on the international experiences, the impact of the new law is likely to be mixed, with the most likely beneficiaries being lower risk profile borrowers such as large corporates, wealthy households and the government, whereas there could be unintended consequences (e.g. credit rationing) to borrowers perceived to be riskier such as low income households and small and medium sized enterprises (Annex1, Box 1.2).

3.5.2 Kenya's banking sector remains fundamentally sound, despite recent receiverships. Capital adequacy ratios are at 16.0 percent, well above what is recommended within the Basel III Tier 1. Further, at 7.8 percent in Q1 of 2016, non-performing loans as a share of GDP are low. Indeed, the banking sector remains one of the most profitable sectors in Kenya with returns of equity averaging 23.9 percent in 2015 and is the largest sub-sectoral contributor to the company income tax. Nonetheless, in April 2016, Chase Bank (the third bank in nine-month period) was placed under statutory management. Initially, this appeared to rattle confidence in the financial sector with depositors withdrawing funds from the smaller banks, leading to liquidity pressures. Quick action from the Central Bank of Kenya, which offered a facility for struggling banks, ensured calm was restored. Nonetheless, with credit growth still decelerating this could be indicative of some residual effects from the wave of receiverships. It is, however, important to recognize that these recent developments were an outcome of audit process initiated by the Central Bank of Kenya. Hence the actions taken were important market disciplinary measures that should increase trust in the banking sector as unscrupulous practices (fraud, money laundering, etc.) are wiped out of the system.

3.5.3 Recorded non-performing loans spiked in 2016. In Q4 2015 and Q1 2016, non-performing loans (NPLs) spiked by 15.8 percent, from 6.8 percent of GDP to 7.8 percent of GDP (figure 1.17). However, an important driver of the spike in NPLs is most likely an accounting artifact resulting from the introduction of guidelines by the Central Bank for banks to appropriately record their provisioning for loan losses, rather than a real structural break in the ability of corporates and households to pay back loans. Nonetheless it draws attention to the need to monitor much closely as there could be other economic factors at work including lagged effects from the macro turbulence experienced in Q3 2015, when there was a sharp increase in the exchange rate and policy rates were hiked. Further there also exist concerns on how delays in payments from the exchequer could be playing a contributory role. Thus far, delinquencies of loans to the real estate, household and trade sectors have risen the most.

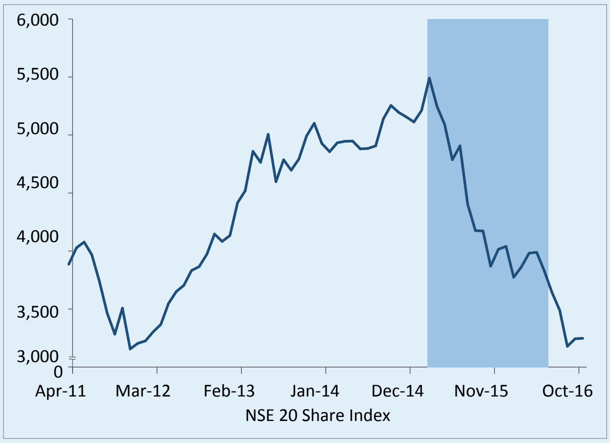
3.5.4 Bearish sentiments persist in equity markets. The Nairobi Stock Exchange has declined since mid-2015, the pace of decline continued to gather steam in 2016 (figure 1.18). On a year-to-date basis (mid-October), stocks are down 13.9 percent, with some of the heaviest declines among banking sector stocks. A number of reasons account for this. Foremost is the skittishness in global financial markets triggered by multiple factors over 2016, including earlier in 2016 worries about rebalancing in China's economy, as well Britain's vote to exit from the European Union (Annex 1, Box 1.1). Further, on the domestic front the enactment of the Banking Act amendment, seemed to have taken market participants by surprise and further accentuated the decline in banking stocks in the Nairobi Stock Exchange (NSE).

Figure 1.17: Growth in Non-performing Loans by Sector



Source: Central Bank of Kenya.

Figure 1.18: The NSE Index has continued its bearish trend in 2016



Source: Central Bank of Kenya.

4. The Medium Term Growth Outlook Remains Bright

4.1 The Drivers of Growth Remain in Place

4.1.1 Kenya's growth momentum is expected to continue over the medium term. The World Bank projects GDP to increase by 5.9 percent in 2016, strengthening to 6.1 percent by 2018. These forecasts are consistent with our March 2016 outlook. Domestic demand, in particular strong consumption and investment growth, are expected to be the main growth drivers (table 4.1). This outlook is predicated on the sustenance of a stable macroeconomic environment, low inflation, and oil prices staying low even if there is a gradual pick-up and favorable weather conditions, and increased remittance flows.

4.1.2 Robust consumption growth will continue. The ongoing favorable trends in the underlying drivers of Kenya's robust consumption growth is expected to continue, including from stable macroeconomic environment, remittances, favorable agricultural harvests, further cuts to policy rates, and increased share of the population entering the labor force. However, this robust consumption growth is likely to be dented by our baseline assumption of a gradual rise in oil prices as well as the recent caps to interests charged by the banks (Annex 1, Box 1.2). We expect the latter to have a double-edged effect on private consumption. On the one hand, existing borrowers, in particular those with fixed-rate mortgages and other fixed-interest consumer loans above the statutory cap will have higher disposable incomes to spend. This will be a further positive for consumption. However, given that only a very small number of consumers have access to such bank credit facilities, this is likely to be negligible. On the other hand, for the vast majority of consumers, our baseline scenario is that, access to credit facilities from banks, which was already out of reach for the vast majority of consumers, is likely to become even more constrained as banks ration credit to consumers on a risk-adjusted basis. While credit rationing should have a dampening effect on consumption, we anticipate other non-bank financial institutions such as Savings and Credit Cooperative Organizations (SACCOs), co-operatives, micro-finance institutions that are not subject to the Banking Amendment Act to partially fill in some of the void left by the banks.

4.1.3 Private and Public Investment will remain robust over the medium term. Given the critical importance the government attaches to relieving infrastructural constraints as articulated in the Medium Term Plan 2, we expect public investment to remain strong over the forecast horizon. Our baseline assumption is that this will be carried out within the context of a post-2017 election fiscal consolidation plan. This should help anchor macroeconomic stability and sustain the progress made to date. Given the increased foreign investor interest in the Kenyan economy, as evidenced in the surge in foreign direct investment in recent years, private investment is expected to increase supported by crowding-in effects of improved infrastructure, access to electricity, and improvements in business regulations. Nonetheless, activity among small and medium sized enterprises will be challenged by bearing the brunt of credit rationing from the banks.

Table 4.1: Medium term Growth Outlook (percent, unless stated)

	2007	2008	2009	2010	2011
Real GDP growth, at market prices	5.3	5.6	5.9	6.0	6.1
Private consumption	4.6	5.3	5.9	6.4	6.6
Government consumption	6.0	15.4	6.3	7.3	5.6
Gross fixed capital investment	14.8	5.2	5.7	6.7	6.7
Exports, goods and services	5.3	-0.9	0.1	5.2	6.0
Imports, goods and services	10.6	-1.2	6.2	7.6	7.6
Agriculture	3.5	5.6	5.6	5.4	5.4
Industry	6.5	6.9	5.7	5.7	5.6
Services	5.8	5.5	5.6	6.2	6.6
Current account balance, % of GDP	**-9.8**	**-6.8**	**-5.6**	**-6.1**	**-7.0**
Fiscal balance, % of GDP	**-7.0**	**-8.3**	**-8.8**	**-7.8**	**-7.4**
Revenue	19.8	19.1	19.5	20.0	19.5
Expenditure	26.7	27.4	28.3	27.8	26.9

Source: World Bank/Macro Poverty Outlook, September 2016. Note: Data for fiscal indicators were converted to calendar year.

4.1.4 The contribution of net exports is expected to weaken. Exports are projected to moderately improve in the medium term as trading partners' growth improves and as commodity prices slowly pick up. In Kenya's trading partners, particularly in Africa (EAC and COMESA), growth is projected to recover as their domestic economies strengthen. However, in line with our baseline assumption of a pick in oil prices to about US$ 60 a barrel by 2018 from its 2016 average of US$ 40 a barrel, we expect the import bill to also increase. As a result, net exports will return to being a drag on GDP with the current account balance projected to rise to 7 percent of GDP over the same period.

4.2 Downside Risks have External and Domestic Sources

4.2.1 On the external side, a slowdown in the global economy, particularly from the European Union, could dent Kenya's growth prospects. The EU remains an important destination for Kenya's exports (in particular, horticulture products), source of remittance flows, and tourist arrivals (Annex 1, Box 1.1). Further, uncertainties related to future U.S interest rate hikes could lead to volatilities in global financial markets and destabilizing short-term capital outflows in emerging and frontier markets. With Kenya's increased integration with global capital markets, as evidenced in increased participation of foreign investors in government securities and Kenya's forays into the Eurobond market, it has become increasingly susceptible to shocks from global financial markets. If that were to occur, Kenya's hard earned macroeconomic stability could be tested with a sharp currency depreciation (or fall in reserves) and potential rise in interest rates, which could hurt growth. This scenario, while feasible, remains a tail risk as Kenya's new precautionary facility with the IMF provides a good buffer against such shocks.

4.2.2 On the domestic front, risks can emanate from fiscal slippages. Kenya's hard-earned macroeconomic stability could be tested if fiscal consolidation is further delayed and increased domestic borrowing puts upward pressure on domestic interest rates, as this will crowd out private investments. This is all the more pertinent as the recent caps on interest rates increases the relative attractiveness of the risk-free high-yielding government paper. Further, even if the funding gap was to be sourced from international capital markets, in an environment where fiscal deficits are perceived by market participants to be high and a credible path to fiscal consolidation is not yet observed, external finances will only be accessed at a higher cost, thereby further complicating the debt dynamics (e.g. as in the case of Ghana and Zambia in recent years). Further, limited fiscal space handicaps the ability to carry out countercyclical fiscal policy were that to be required. Against this backdrop, the commencement of the government's medium term fiscal consolidation plans will help rebuild the fiscal buffers and safeguard macroeconomic stability—one of the foundational pillars identified in the Vision 2030 plan.

4.2.3 Other potential domestic risks include , poor rains, security and terrorism related threats. The onset of La Nina might negatively affect agriculture's performance. Although normal rains are expected in Kenya's main crop growing areas, depressed rainfall in Eastern, Coastal and semi-arid regions might affect livestock. Given the importance of the agriculture sector, on average we observe 0.6-percentage point decline in GDP growth in Kenya in years of poor rains. Uncertainties associated with the run-up to 2017 elections could unduly lead to a wait-and-see attitude by investors that could dampen short-term growth prospects. Based on the current strong institutional frameworks, our baseline scenario is that the elections will occur without any significant disruption to economic activity. Last but not least, given increased investment in the security apparatus, our baseline assumes that the improved security situation currently prevailing will persist over the forecast horizon. However, in the unlikely event that there was a major security incident this will adversely impact investor confidence and dent the ongoing rebound in the tourism sector.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KENYA PORTS AUTHORITY
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Kalmar
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ANNEX 1

Box 1.1: What are the Implications of the UK's vote to leave the European Union on Kenya?

After over four-and-half decades since joining the European Economic Community, voters in the United Kingdom (UK) voted in a referendum on June 23rd 2016 to leave the European Union (EU). This momentous decision has implications not only for the United Kingdom but for several developing countries with strong economic ties to the UK, including Kenya. This note identifies the main channels through which Kenya is likely to be impacted.

Trade in goods and services: Though the share of Kenya's merchandise trade to the UK has been declining in recent years (figure B.2.1.1 and figure B.2.1.2), as the fifth largest trading partner the UK still accounts for a significant share of Kenya's exports (7 percent in 2015). On services trade, the UK is even more important as it remains the leading source of tourist arrivals (98,000 UK tourists visited Kenya in 2015). With the depreciation of the pound and a lower UK GDP trajectory expected demand for Kenya's exports from the UK are expected to be weaker over the long run. We estimate that the volume of Kenya's total merchandise trade will be lower by between 0.6 and 1.7 percent over a 15-year period compared to the status quo (i.e. if the UK voted to remain in the European Union).[5] The decline in Kenya's exports of flowers are likely to be higher than that of its tea and vegetable exports, since the demand for the latter food exports are more price and income inelastic. The impacts on services trade will be larger with an estimated shortfall in Kenya's services exports ranging between 1.2 and 3.1 percent over a 15-year period compared to the status quo.

Remittances: With the UK being home to the largest Kenyan diaspora, it is a significant source of remittances for Kenya, accounting for about a third of total remittances (figure B.2.1.5 and B.2.1.6). Indeed, the flow of remittances from the UK to Kenya has nearly doubled from US$ 275 million in 2010 to US$ 520 million in 2015, and is the single largest source of foreign exchange (about 2.6 percent of GDP in 2015). With both wage growth in the UK and the pound expected to be weaker in the light of UK's vote to leave the EU, this is likely to dampen remittance inflows to Kenya. We estimate that the growth in total remittances to Kenya could be lower by between 0.9 and 1.3 percent over a two-year period compared to the status quo. This will in turn dampen household consumption and add to the current account deficit.

Capital Flows: Capital flows to Kenya are likely to be hit from both direct and indirect channels as a result of the UK's vote to leave the EU. Directly, the UK is major contributor to capital flows to Kenya. UK investors are the largest contributors to the stock of foreign direct investment in Kenya. From agriculture, manufacturing to services sectors (including major banks) there are major UK subsidiaries that operate in Kenya, hence a hit to parent companies in the UK could be deleterious to their Kenyan operations. Secondly, UK investors are among the leading investors into Kenya's Eurobonds Kenya's domestic bond and equity markets. Hence, yields could rise if UK investors decided to pull out their portfolio in emerging markets, including Kenya.

The indirect effects through financial markets are likely to have the largest impact of all channels. With heightened uncertainty in the global economy, financial markets have become increasingly sensitive. Negotiations leading to the formal exit of the UK from the EU will undoubtedly be watched closely by

[5] *Estimates of the impact of UK's vote to leave the EU are inherently uncertain given the unknown final outcome of negotiations. To guide our estimates, we use as inputs the outcomes of the different scenarios laid out by HM Treasury (2016). We translate these outcomes for the UK economy to the Kenyan economy based on the relative share of the UK's contribution to specific modes of transmission (trade and remittances).*

financial markets thereby increasing the likelihood of further episodic risk-on sentiments with the attendant flight to safety and potentially destabilizing capital outflows. This is all the more important for Kenya given its increasing integration with international capital markets. Indeed, as a harbinger of what could further occur, in the immediate aftermath of the decision, the Nairobi Stock Exchange Composite Index fell by 260 basis points to its lowest level in four-days.

Figure B.2.1.1: Export growth and destination share

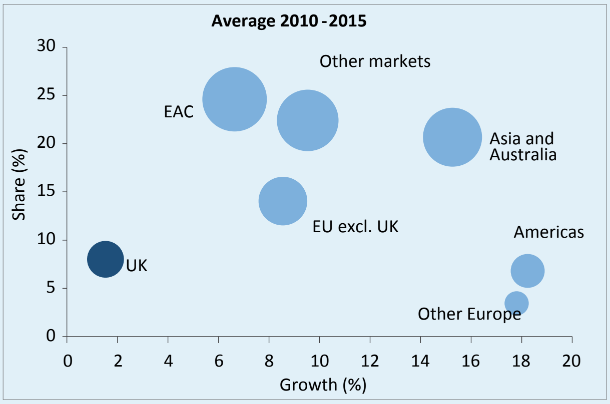


Figure B.2.1.2: Kenya's export value by destination

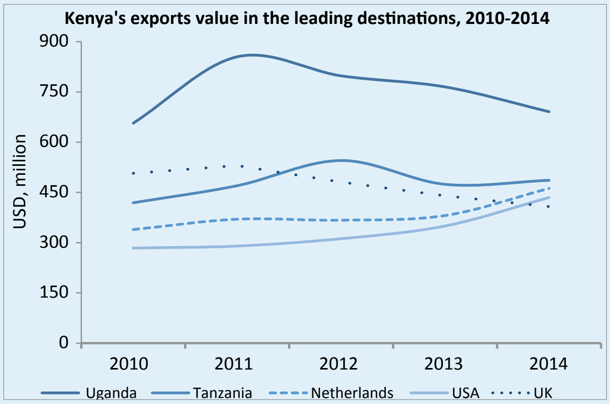


Figure B.2.1.3: Top five origin of tourists (thousands), 2015

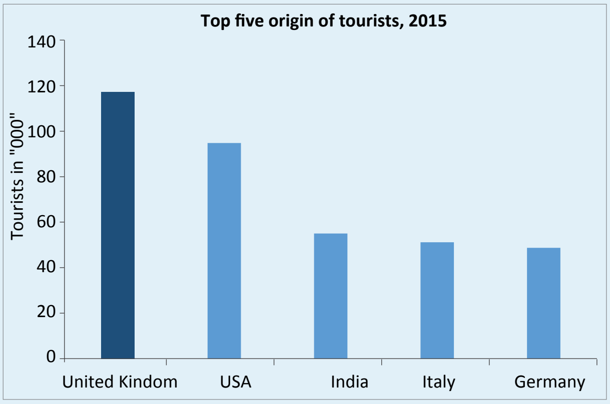


Figure B.2.2.4: Interest rate spread has been on the increase

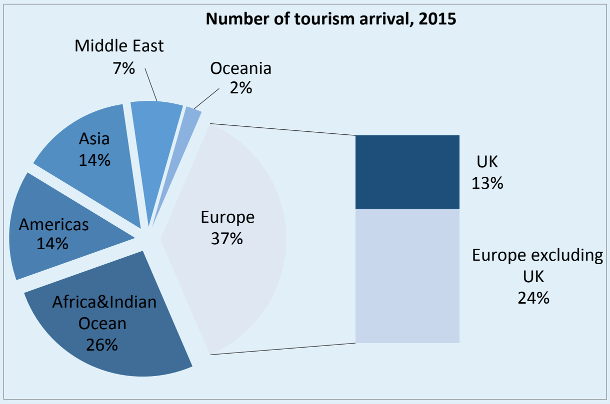


Figure B.2.1.5: Kenya's remittances inflow (thousands, US dollar)

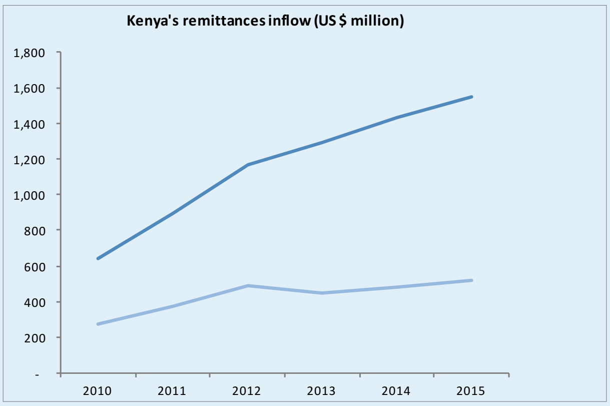
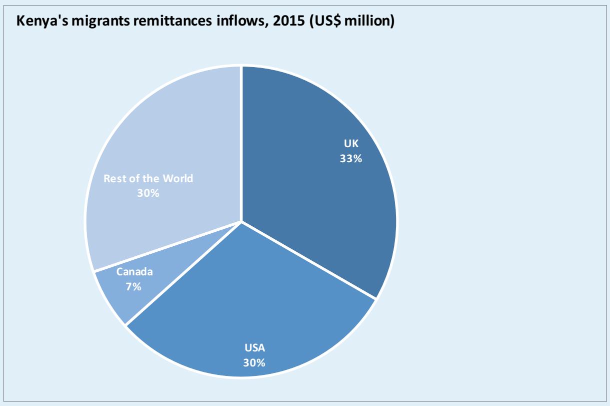


Figure B.2.1.6: Kenya's sources of remittance, 2015



Data Source (for all the charts): Kenya National Bureau of Statistics, Central Bank of Kenya, Kenya Tourism Board, and World Bank.

Box 1.2. New Rules of The Game for Kenya's Banking Sector

A New Banking Law Comes into Effect. On 24th August 2016, the President of Kenya signed into law the Banking (Amendment) Bill 2016. The law caps the maximum interest rate charged for a credit facility in Kenya by the banks at no more than four per cent of the base rate set by the Central Bank of Kenya; and provides a floor for the deposit rate held in interest earning accounts to at least seventy per cent of the Central Bank of Kenya base rate.

Interest Rate Spreads are Perceived to Have Persisted at High Levels for a Long Time. Interest rate spreads in Kenya have averaged 10.1 percent between 2001 and 2015 with profits (48 percent) and overheads (40 percent) accounting for a large portion of the interest rate spread.[6] Further, the high return on equity in the Kenyan banking sector compared to the sub-region is often cited as proof for interest rate spreads to be brought down. However, two previous attempts at legislating curbs to interest rates (2001 and 2013) failed. On both occasions the banks promised to self-regulate their spreads, however the general perception is that they have failed to live up to those expectations. Further the attempt by the CBK to persuade banks to follow a reference rate—the Kenya Bank's Reference Rate (KBRR) introduced in 2014—is also perceived to have failed.

Kenya is not Unique in Introducing Interest Rate Caps. A recent World Bank study finds that globally some 76 countries have experimented with interest rate caps, invariably to protect consumers (figure B.2.2.1). Indeed over 44 percent of countries in Sub-Saharan Africa (24), Latin America (14) and East Asia and the Pacific (7) had some form of interest rate controls.[7] However, these measures were by no means limited to developing economies, as they also persisted in some advanced economies, including in Western Europe, Japan, and certain States in the US. Findings from the empirical literature suggest that, interest rate cap is a blunt tool to address the problem of high spreads and often leads to unintended consequences. These include: reduced financial inclusion for the most poor and vulnerable, decreased lending for productive investments by firms, the introduction of compensatory fees and costs, and declining quality of loan portfolios.

Globally, Interest Rate Caps Have had Unintended Consequences. In South Africa, some financial institutions evaded the interest rate caps by charging credit life insurance and other services, which reduced the transparency of the total cost of credit. In Armenia, the lack of clarity on how to calculate the interest rate spread led to the imposition of various fees and commissions, which reduced transparency and circumvented the interest cap ceilings. Among West African Economic and Monetary Union (WAEMU) countries, the imposition of interest rate caps on micro-finance loans caused micro-finance institutions to withdraw loaning to the poor and more remote areas. In Japan, the supply of credit appeared to contract, acceptance of loan applications fell and illegal lending rose. In France and Germany, interest rate ceilings decreased the diversity of products for low-income households. In Nicaragua, the application of an interest ceiling caused micro-finance institutions to reduce lending and prompted a number of such institutions to leave urban areas due to high operational costs and risks. They also responded by adding fees so as to circumvent the interest rate cap hence passing on a constraint to depositors. In India, the enacting of interest rate margin cap in 2011 led to slower borrowing and lower formal financial access. In the United States, caps on loans in certain states led to the migration of clients to states with less restrictive practices.

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5 *The Kenya Economic Update Edition 9 carried out an analysis on the Banking Sector and looked specifically at the composition of the interest rate spread.*

7 *Maimbo and Gallegas (2014).*

What Are The likely Impacts of the New Law In Kenya? The eventual effect of the law on specific economic agents is likely to be mixed. The likely short-run beneficiaries of this new law will be large corporates and relatively wealthier households with low risk profiles, the government, and existing borrowers with high interest rates. On the other hand, bank profitability is likely to decline, and credit flows to smaller businesses and lower income households could decline or be accessed at higher cost through non-bank channels.

1. ***Effects on the non-bank corporates and consumers*** – In principle, banks charge borrowers interest rates commensurate with their perceived risk profile. Further, because loan processing costs are fixed and interest incomes are proportional to the size of a loan, a cap on rates means that only loans above a certain threshold are economically viable to extend. Both of these effects are likely to constrain lending to small and medium size enterprises as well as low and middle-income consumers since they have a higher risk profile and borrow smaller amounts. On the other hand, larger borrowers with good credit ratings will benefit further as there should be increased competition for their business from the banks. Though still early days, there is some evidence of credit rationing as some Kenyan banks have announced plans to curtail new unsecured consumer loans and loans for motor vehicle purchases. Further, as in other economies where interest rate caps have been introduced, some Kenyan banks have increased existing charges or introduced additional ones (e.g. appraisal fee, processing fee, insurance premiums etc.) to procure a loan have been introduced by some banks in Kenya. It is, however, noteworthy that one major bank has announced plans to compete in this new regime by increasing the volume of loans.

   Besides credit rationing, theoretically the law should benefit all savers, as the minimum rate at which banks are required to pay interest-bearing accounts is higher than what most savers currently receive. However, banks have already announced plans to do away with savings accounts or have imposed a stricter interpretation of what qualifies as an interest bearing savings account (with some savings account being treated as a current accounts based on limited number of withdrawals). Hence, to the extent these practices become prevalent, it would limit any potential benefit to savers.

   While the above discussion considers the effect for new transactions, it is important to recognize that given most banks are applying the law retroactively, in the short-run this represents a boon to borrowers who had loans above the new statutory ceiling (most likely SMEs and low to middle-income consumers), in particular those with fixed-rate products. Indeed, in the few weeks after the law came into effect a number of banks have reported an increase in loan applications, most of them due to re-financing or extension of existing loans at lower interest rates.

2. ***Effect on Banks -*** Average net interest margins are likely to decline by up to 430 basis points from the 11.4 percent they averaged in June 2016. This will impact all categories of Kenyan banks, however, given lower profit margins among Tier 3 banks relative to Tier 1 banks they are likely to be hit the hardest. Reflecting the impact of the new law on bank profitability, some 15 percent of value of bank stocks (5.4 percent of the all share index) was wiped-off within a month of the passing of the Banking Amendment Bill. Further, the law is likely to reduce the ability of banks to differentiate creditworthiness and price accordingly, leading to a more homogenous product, reduced competition and shutting out of certain categories of borrowers. A consolidation of the banking sector may occur, as most of the smaller banks will face even higher challenges given their relatively high cost of funds.

When combined with more stringent capital requirements, the likelihood of consolidation is very high. This will potentially increase the market share of SACCOs and Micro-Finance Institutions (MFIs), who are not subject to the same interest rate restrictions. Indeed, there are also concerns that Banks could create special purpose vehicles outside the purview of the Banking Act, freeing them to charge interest rates without the limitations of statutory cap. Banks are expected to also divert more of their assets to government securities. Further, banks with a regional presence will likely reduce Kenyan exposure in favor of other countries.

3. ***Effects on Government -*** It could lead to a decline in borrowing costs for the government. As the provider of a "risk-free" security, the attractiveness of government treasury bills will likely become relatively higher, as the risk premia that banks charge to non-government borrowers is curtailed by law. This increased demand for government securities from the banks is already driving down government borrowing costs, with the 91-day security declining by 50 basis points within two weeks of the signing of the law (B.2.2.5. However, to the extent that the banking sector is a large revenue contributor of corporate income taxes, a drop in the profitability of the sector will reduce their contribution to government revenues.

4. ***Monetary Policy Setting –*** In a regime where commercial bank interest rates are directly linked to Central Bank's policy rate decisions, the transmission mechanism will be effective immediately, unlike under the previous regime where there was a lagged or weaker transmission to commercial bank rates from CBK's interest rate decisions. In this regard, the stakes for the appropriate calibration of the Central Bank's policy rate in accordance with the economic fundamentals of the Kenyan economy are much higher. Miscalculated decisions on policy rates (e.g. lowering interest rates when there is a growing positive output gap) are likely to become more costly than under the previous regime when the transmission mechanism was much weaker. Communication from the monetary policy committee on their assessment of the Kenyan economy and reasons for their interest rate decisions could provide the appropriate signals for economic agents to respond accordingly.

Reforms To Address Other Underlying Causes Of High Credit Cost Are Needed.

The statutory capping of lending rates and putting a floor on savings rate may succeed in reducing spreads on interest rates, nonetheless it remains a blunt policy instrument that is likely to leave in its trail unintended consequences and may not achieve the goal of making credit less costly and more widely accessible. Indeed, given what is already occurring in these early days, lawmakers are threatening further efforts to tighten any loopholes that the banks may be seeking to exploit. While individual banks have an important part to play, making credit more accessible and less costly goes beyond the reach of regulating the interest rate charges of the banking sector. This section considers other Kenya-specific factors that account for the high cost of credit.

First, although Kenya's banking sector remains one of the most vibrant in the sub-region, it could benefit from greater competition. Indeed, while Kenya has some 42 banks (compared to 19 and 22 in South Africa and Nigeria, both of which have much larger economies and populations), the industry's market structure is oligopolistic as the top seven banks alone account for 57.6percent/58.7 percent of the total assets/deposits as at December 2015. Not surprising, bank size has been found to be positively related to interest rate spreads.[8] Further industry consolidation, particularly among the smaller banks should help erode the exercise of market power by some of the larger banks.

[8] *Were and Wambua (2013).*

Second, macroeconomic conditions affect the cost of credit, and of particular importance is the extent of domestic borrowing by the government, as banks charge a risk premia above the government T-bill rates. A recent study confirms the expected statistically positive relationship between budget deficits and lending rates.[9] Efforts to reduce the government Treasury bill rates, say via external borrowing and more recently through providing a platform for retail investors to purchase Treasury bills should help in this regard. Other macroeconomic factors of importance include maintaining a benign inflationary and stable exchange rate environment.

Thirdly, several microeconomic factors increase the operational cost of banks in underwriting loans or reclaiming collateral.

a) There is the need to reduce the information asymmetry which leads risk adverse banks to shun potentially good borrowers or charge them much higher interest rates than their true risk profile demands. One way to tackle this is by **expanding the credit information-sharing framework** in Kenya to facilitate banks to use positive credit information to offer lower rates to customers with good history and also to widen the participation in the framework to include SACCOs, utilities and other issuers of credit. In other jurisdictions this reform has led to a 5 percentage points decline in the interest rate charged on loans and a 7 month extension in loan maturity.

b) The cost of perfecting a security interest by banks could be significantly reduced if there existed an **electronic central registry of collatera**l. Presently charges related to perfecting security interest (search costs, legal fees, stamp duty etc.) are expensive and add significantly to banks operational costs. They also remain prohibitive to borrowers who may want to refinance loans at cheaper rates with other banks, thereby reducing competition.

c) There is the need to develop a **framework to promote property (both moveable and immovable) as collateral**. This is a reform that has been associated with a 3-percentage point reduction in interest rates and a 6-month extension of the maturity of a loan in other jurisdictions. While many Kenyans own land, it remains "dead capital"[10] due to the lack of associated property rights and missing information. The computerization of land registries will enable the capture, management and analysis of geographically referenced land related data. This will help to create a reliable and accessible land ownership infrastructure that can facilitate the collateralization of land thereby opening up access to credit facilities to a broad cross section of Kenyans.

d) The implementation of the **National Payments System Act** and regulations which will operationalize infrastructure sharing by banks in order to reduce operational costs as well as encouraging banking innovations such as agency banking, currency centers and mobile banking.

e) **Finally the implementation of the New Companies Act and Insolvency Act** should help improve the legal framework when companies are distressed. Since banks price loans based on their rights in case of default it is no surprise that creditor-unfriendly bankruptcy regimes tend to have higher costs, as banks increase costs to mitigate potential higher losses. Kenya ranks as one of the most difficult places to resolve insolvencies according to the World Bank Doing Business indicators. It takes about four and half years to resolve an insolvency compared to 3 years for the average Sub-Saharan African country and 1.7 years for OECD countries. Further the recovery rate in bankruptcy cases is a mere 27 cents on the dollar compared to 72 cents for OECD countries and 64 cents for Botswana.

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[9] *Sambiri, J. Mudaki; Otieno, D. Ojala; Maurice, Mwangi; Ongiyo, O. Charle, and Rombo, Kevin. 2014. "Lending Rates and it's Impact on Economic Growth in Kenya." Journal of Economics and Sustainable Development.*

[10] *Hernando De Soto (2000). The term dead capital is taken from Hernando De Soto's hugely influential book on the mystery of capital. In that book he explains why due to the lack of property rights, missing information etc, many people remain poor even though they own important assets.*

Figure B.2.2.1: Other countries have experimented interest rate caps

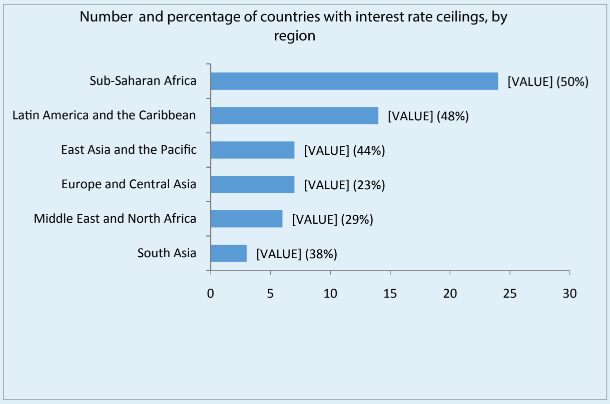


Figure B.2.2.2: Spreads are mainly driven by profits and overheads

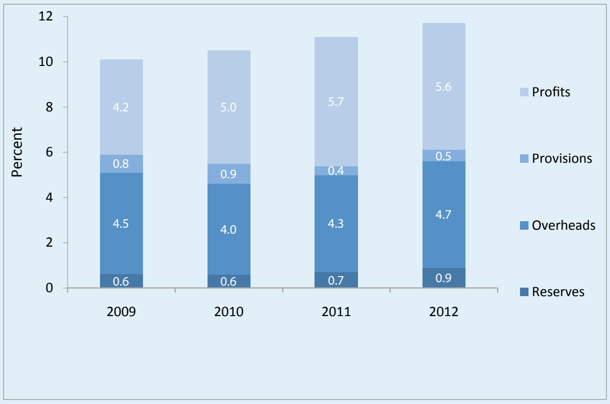


Figure B.2.2.3: Businesses were charged the highest interest rates

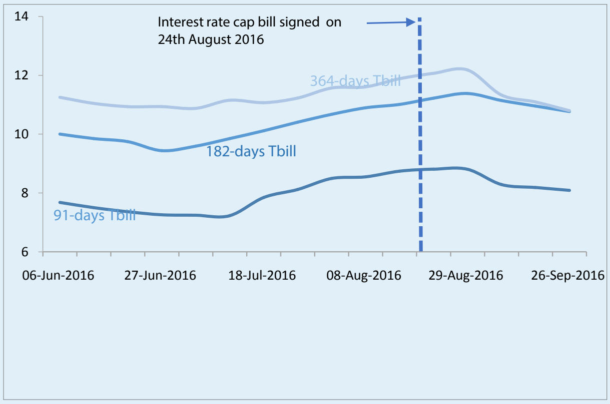


Figure B.2.2.4: Interest rate spread has been on the increase

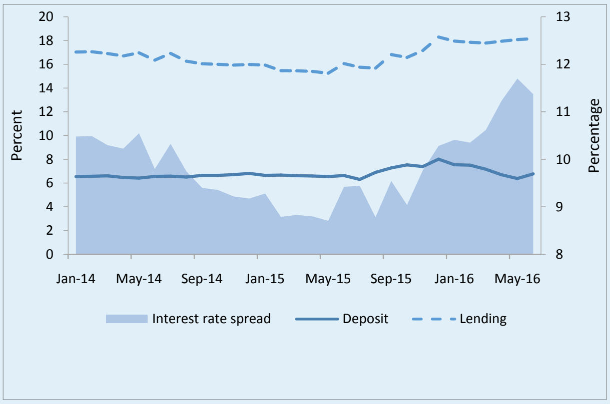
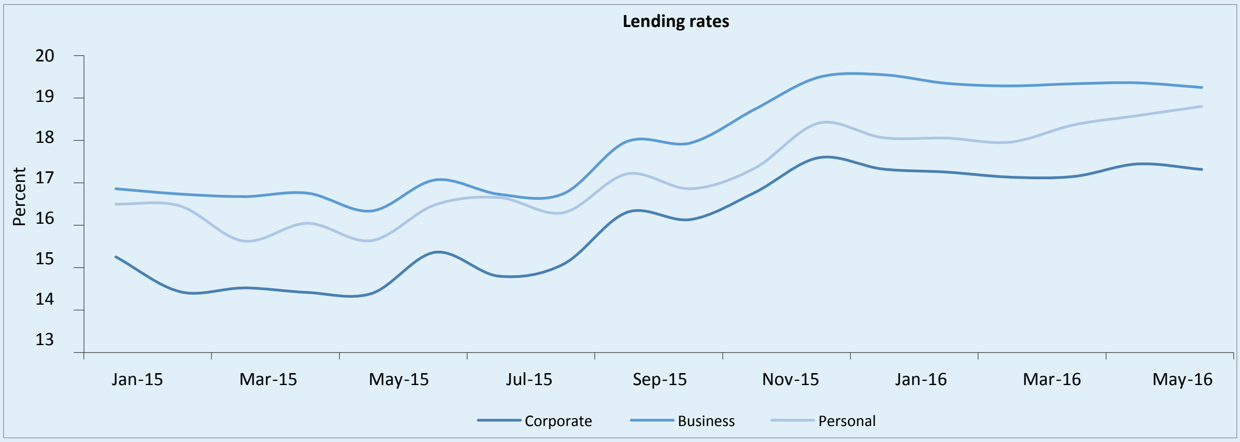


Figure B.2.2.5: Increased demand for government securities from the banks is already driving down government borrowing costs



Data Source (for all the charts): Central Bank of Kenya, Maimbo and Gallegas (2014), and Kenya Economic Update Edition 9, 2013.

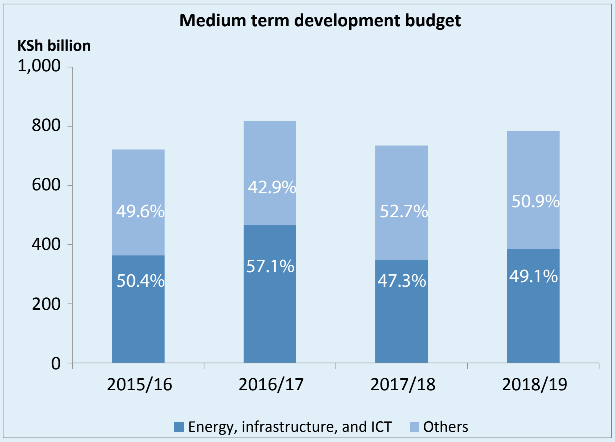
Special Focus: Instituting Systems of Public Investment Management

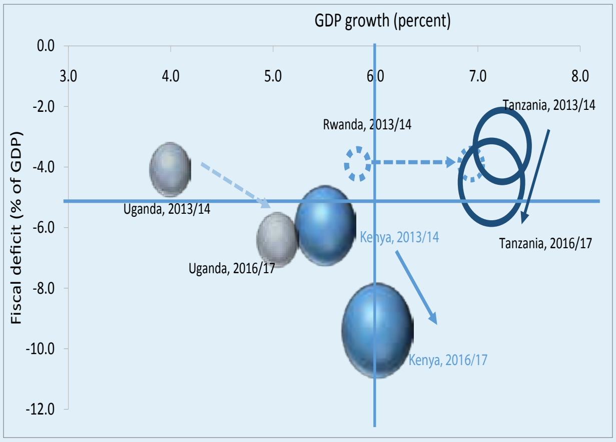
5. Instituting Systems of Public Investment Management

5.1 Kenya is Expanding its Infrastructure Spending

There is political consensus in Kenya on the importance of infrastructure development for economic growth. As a result, the country has significantly expanded infrastructure spending in recent years. Investment on infrastructure has increased and now averages 21 percent of GDP, largely driven by public investment. This is a testimony to the country's ability to act on and implement its policy intentions. Three observations can be made: first, the recent spike in investment is driven by government investment in economic infrastructure projects, which account for about half of the development budget. The budget for economic infrastructure sectors (energy and petroleum, roads, railway, ports and other transport and ICT) has quadrupled in nominal terms, from KSh100 billion to 400 billion in a span of six years, and is estimated at KSh 800 billion (US $ 8 billion) in 2016/17 (see Figure 5.1a). Second, the investments are debt financed, which has resulted in a widening of the budget deficit and corresponding increase in debt. The budget deficit increased from -5.4 percent in 2012/13 to -9.4 percent in the 2016/17 budgets while the stock of debt increased from 42 to 53 percent of GDP. Third, the investment drive has delayed fiscal consolidation and the country is running the highest deficit in the East Africa region. A mapping of GDP growth and budget deficits for EAC countries (figure 5.1b) shows that Kenya is in the "high deficit -moderate growth" quadrant. The situation for a period of time can be a sensible strategy if there is a credible expectation of future payoffs in terms of increased productivity and derived additional economic growth. However, as will be discussed below, models of medium term future developments in productivity does not support expectations of productivity increases.

Figure 5.1: Infrastructure takes half of development budget, financed through debt





Source: Staff computation from National Treasury and World Development Indicators.

Box 5.1: Data on Public Infrastructure spending in Kenya is likely overstated

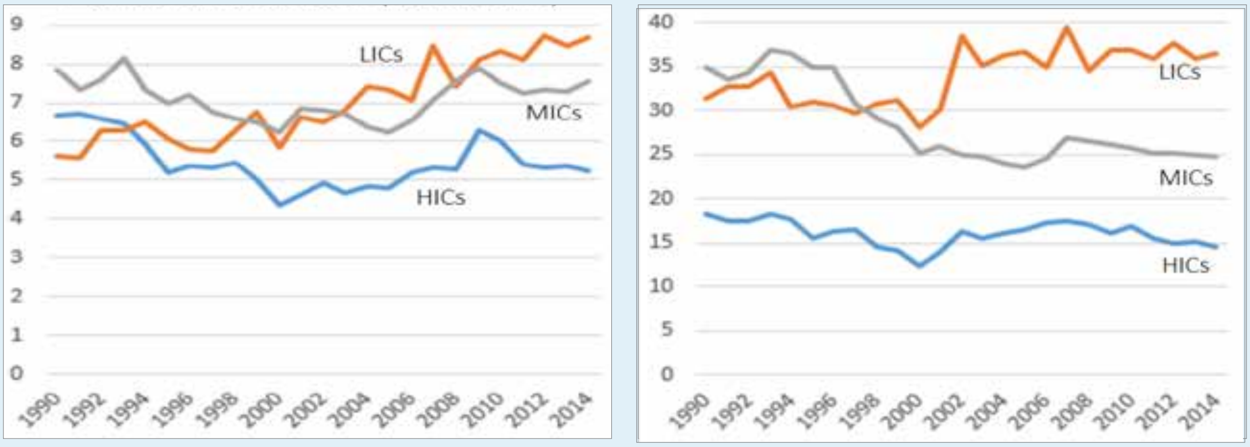
Not all of the growing amount of budgeted development spending is used for public investment—i.e. spending that contributes directly to general government gross fixed capital formation. Many development budget expenditures are recurrent in nature but are included in the development budget because they are associated with specific projects. For example, all donor projects are categorized under the development budget, irrespective of whether they are financing recurrent or capital expenditures. Total public investment (government gross fixed capital formation) is therefore likely to be lower than total development spending in a given year.

After reclassifying development expenditures to isolate investment spending, the IMF estimated total investment spending in Kenya to be around 7 percent of GDP in 2013. This was broken down as follows: 2.7 percent Central Government, 1.6 percent Local Government, and 2.8 percent public corporations and other entities. The combined total for Central Government and public corporations and other entities of 5.5 percent of GDP for 2013 is somewhat below the level of 'development spending' suggested by budget execution data for FY2013/14 of 6.3 percent. The difference may be indicative of the amount of recurrent expenditure included in the development budget.

Source: IMF (2014) Kenya Article IV Report.

Kenya's expansion of public infrastructure investments is aligned with global trends and priorities. Low-income countries as a whole spent approximately 35 percent of their public expenditure on infrastructure while the share for middle-income countries is around 25 percent. For both lower middle-income and middle-income countries, the trend has been towards increased public investments as a share of GDP (figure 5.2).

Figure 5.2: Public Investment in low income countries (LICs), middle income countries (MICs), and high income countries (HICs), percent of GDP and percent of Government Expenditure

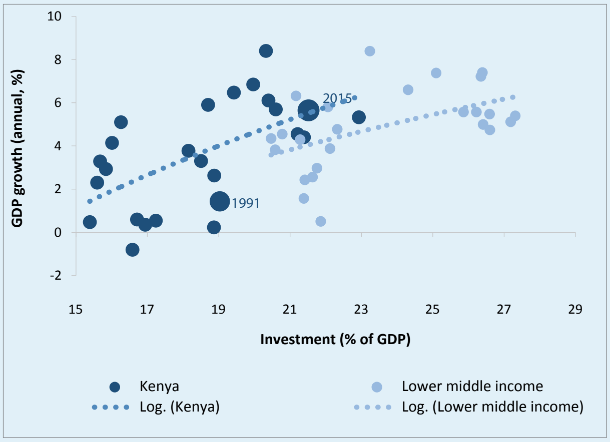


Source: World Economic Outlook, May 2015.

Box 5.2: Drivers of African Economic Growth

There is a positive relationship between infrastructure investment and economic growth. A decade of analytical work has demonstrated that inadequate infrastructure has been a binding constraint to growth for low-income countries. For instance, Calderon and Serven (2008) estimated that if low-income countries in SSA increased infrastructure investments to the same level as Mauritius, the regional leader, growth could increase by 2.3 percent. In response, a significant number of these countries have increased budgetary allocations for investment, Kenya included. Figure B.5.2.1 plots investment as a share of GDP against GDP growth for Kenya and low-income countries and indeed the relationship is positive.

Figure B.5.2.1: Kenya's level of investment has increased and trends low income countries



Source: World Development Indicators

Underlying this increased spending on public infrastructures is recognition of the importance of infrastructure in boosting growth. Globally, the G20 emphasizes infrastructure investment as a growth driver and the Financing for Development agenda acknowledge the key contributions of robust physical infrastructure for achieving the Sustainable Development Goals (SDGs).[11]

In summary, Kenya is in tandem with the global consensus on the need to provide quality infrastructure for economic growth. Politically, there is near consensus on the need to increase public spending on infrastructure, and as a strong testimony to Kenya's ability to act on its intentions, spending is increasing very significantly. Given the inherent challenges in changing the composition of a national budget, this is an impressive starting point. At the same time, the changed composition of the budget has been realized not by cutting recurrent spending but by increasing the available envelope through loan financing. This strategy rests on the assumption that infrastructure will boost growth and thus finance itself over the medium term as public revenues increases in a bigger and better and more productive Kenyan economy.

5.2 Kenya Has Improved Its Infrastructure but More Work is Needed To Raise Its Competitiveness

Increased spending has resulted in improved infrastructure quality in Kenya. According to the World Bank's Logistics Performance Index,[12] Kenya has improved its ranking on the index from being number 76 out of 150 countries in 2007 to being number 42 out of 160 countries in 2016.[13] Significant improvements have been made on the "Quality of trade and transport related infrastructure." With a score of about

[11] *The G20, under the G20 Investment and Infrastructure Working Group (IIWG), has established the Global Infrastructure Hub, which is mandated to "grow the global pipeline of quality, bankable infrastructure projects" (www.globalinfrastructurehub.org). The Financing for Development Agenda is a UN anchored multi-stakeholder process aimed at increasing multi-source funds for achieving development goals, including through addressing infrastructure gaps (www.un.org/esa/ffd).*

[12] *The World Bank has complied the Logistics Performance Index since 2007. The Index compares the performance of countries on trade logistics along six dimensions, including dimensions such as the efficiency of customs and border.*

[13] *World Bank Logistics Performance Index, 2016, http://lpi.worldbank.org*

3 out of 5, Kenya scored above the average of the group of lower middle income countries and above other countries in Sub-Saharan Africa. Notably, the score has improved significantly between 2012 and 2016 (see figure 5.3 and 5.4 below).

Looking more broadly at Kenya's competitiveness, further improvements in infrastructure are needed. The World Economic Forum, in its 2015-2016 World Competitiveness Report, ranks Kenya 99 out of 140 economies reflecting assessments along 12 pillars relevant to competitiveness. With a score of 3.2 out of 5 on the infrastructure pillar, Kenya ranks 99 out of 140 economies on this pillar—the same as for the overall ranking on this index. Looking at the different dimensions of competitiveness, Kenya gets its lowest score on infrastructure illustrating the continued need to improve (figure 5.6).

Figure 5.3: Quality of trade and transport related infrastructure, in Kenya, 2007-2016

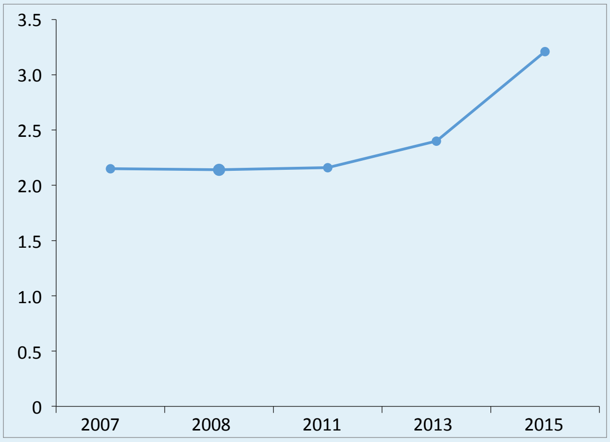


Figure 5.4: Quality of trade and transport related infrastructure, Kenya, LMI and SSA

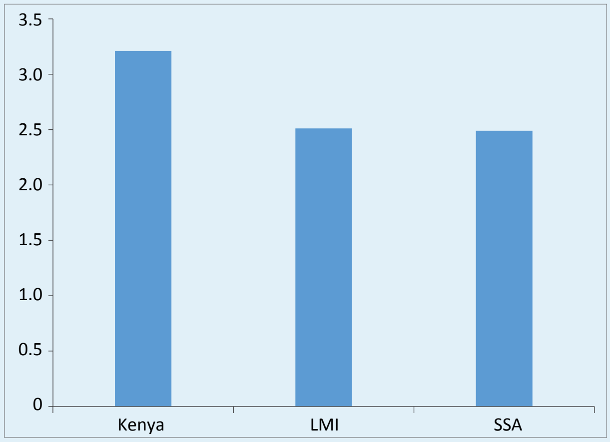
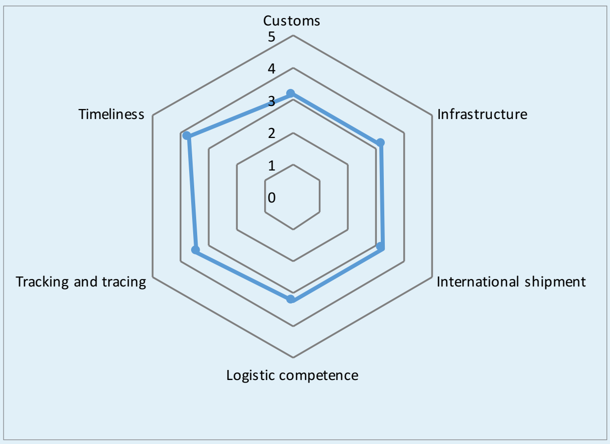
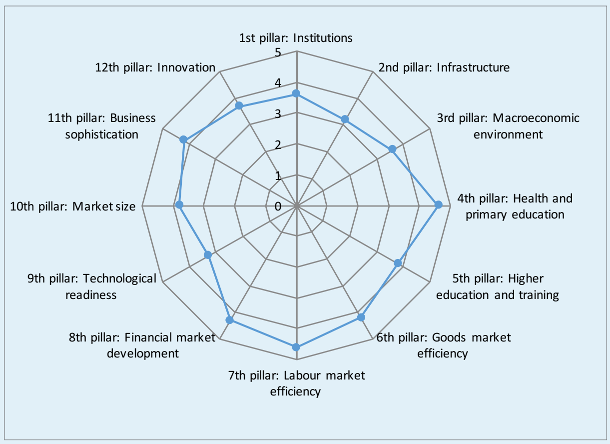


Figure 5.5: Country Score Card for Kenya, 2016, Logistics Performance Index



Source: World Bank Logistics Performance Index, 2016, http://lpi.worldbank.org.

Figure 5.6: Global Competitiveness Index, Kenya, 2015-16



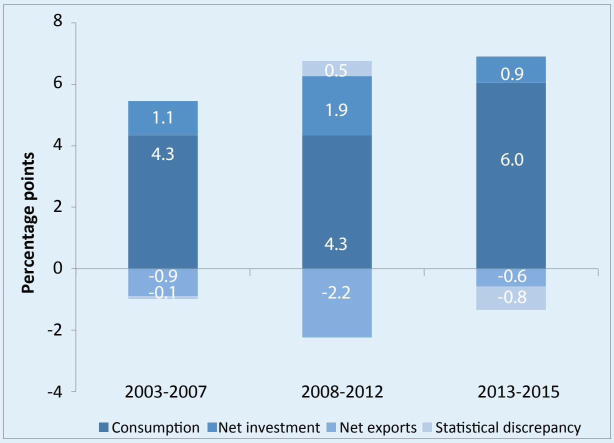
Source: World Economic Forum, http://reports.weforum.org/global-competitiveness-report-2015-2016/.

5.3 The scale-up of investment is yet to boost overall productivity

Kenya has decided to use debt-financed infrastructure expansion to boost growth and in turn help to meet future debt repayments through improved revenues. Much of the argument for public investment relies on the assumption that resources allocated to investment translate into an equivalent value of public capital stock, which, by lowering the cost of production or distribution, benefits the private sector and boosts the overall growth process. This can be measured by the rate of return of such investments to the economy.

Efficiency and effectiveness of public investments in Kenya seems to have declined in recent years. Total Factor Productivity (TFP), which measures how efficiently inputs are utilized in production, has stagnated at about 1.1, and is projected to be declining in the medium term to about 0.5 in 2018, (see Figure 5.7). Another proxy for productivity, the incremental Capital Output Ratio (ICOR), which measures the additional amount of investment necessary to generate an additional unit of production, has been rising. A rising ICOR suggests a more inefficient system of production. Figure 5.8 shows that Kenya's ICOR increased from 3.3 in 2003-07 to 5.3 in 2008-12, which is above the average for Sub Sahara Africa. A third indicator is the contribution of investment to growth. Decomposition of Kenya's growth shows the contribution of net investment to GDP growth declined in the recent years. For the period 2008-12, investment contributed 1.9 percentage points to GDP growth compared to 0.9 percentage points in 2013-15, which was even lower than 1.1 percent for the period 2003-07 (figure 5.9).

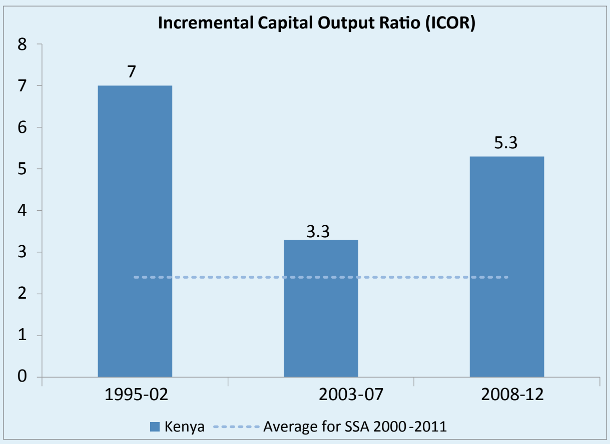
Figure 5.9: Net Investment contribution to growth contracted



Source: World Bank Staff computation based on Kenya National Bureau of Statistics and World Development Indicators.

Figure 5.7: Gains in Total factor Productivity (TFP) have tapered

Figure 5.8: The ICOR is rising: more inputs are required to produce one unit of output

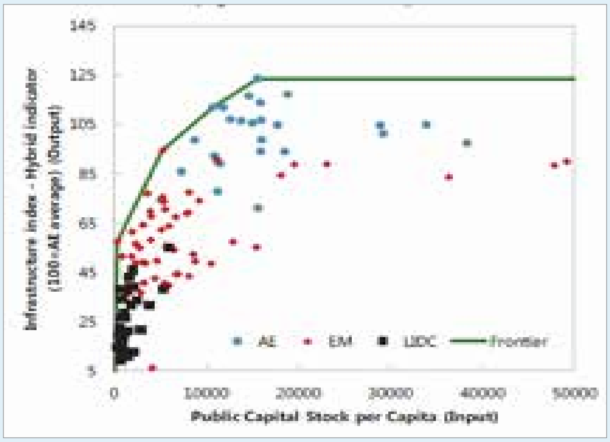


Source: World Bank Staff computation based on Kenya National Bureau of Statistics and World Development Indicators.

Box 5.3: Improving productivity of public investments

Rapidly increasing capital spending is raising concerns about the efficiency of these investments globally and Kenya is not an exception. Globally, there are large differences between countries in terms of what they get out of their public investments. Figure B.5.3.1 below shows a measure of infrastructure quality (vertical axis) compared to the capital stock in those countries (horizontal axis). Countries with the best infrastructure quality at a given level of capital stock define the frontier (the green line). Countries below the frontier have potentials for improvement of efficiency (or productivity) of their capital stock, and thus public investment. Emerging markets countries could—on average—improve the efficiency of public investments by 27 percent, while low income countries have an improvement potential of 40 percent. Looking to the worst performers—the bottom quarter—around half of the capital stock funded through the capital budget does not contribute to quality infrastructure according to this rough measure. To put it differently: Public investment have twice as much impact in countries with the highest efficiency of public investments (top quartile) compared to countries with low efficiency (bottom quartile).

Figure B.5.3.1 Efficiency of Public Capital



Source: IMF, 2015, Making Public Investment More Efficient
Note:
1) Capital stock on the X-Axis summarizes the value of public investments over time adjusted for depreciation.
2) The "hybrid indicator" on the Y-Axis combines indicators for the volume of selected economic and social infrastructure in a country and survey data on perceptions of infrastructure quality as collected by the World Economic Forum.
3) The frontier (green line) is determined by the country with the highest infrastructure index for a given capital stock.

Overall, productivity in Kenya is low and falling, which raises the question of whether Kenya is getting high enough returns on its very significant public investments. Increasing productivity is the sine qua non of growth. While there are many factors affecting productivity, the quality of infrastructure and public investments are major factors.[14]

5.4 Productivity Trends Have Been Affected By the Way the Public Investments Are Managed

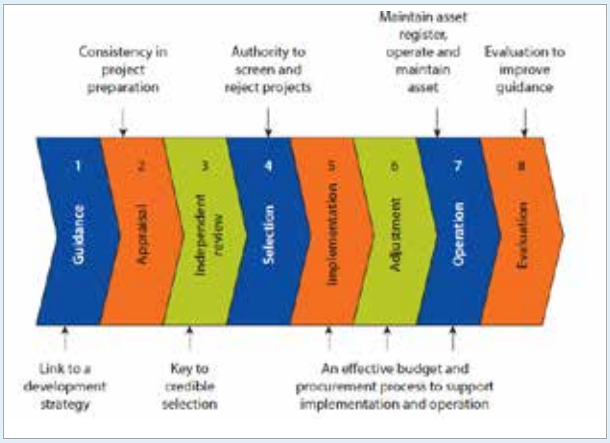
Eight "must have functions" should be in place to improve public investment productivity. Rajaram *et al.* (2014)[15] have developed a framework to guide the way public investments are managed by providing a systemic view of each of the steps of the public investment cycle, pointing out the loopholes or problem areas that can and affect the quality of public investments. There are eight specific functions that a public investment cycle should establish and/or strengthen to ensure quality public investment outcome. These functions are considered to be "must-have" functions that are needed to provide a logical and internally consistent system that countries ought to follow to ensure basic discipline for public project selection and implementation. The framework does not seek to identify "best practice" but rather to identify the bare-bones functional features that would minimize major risks, be achievable in a lower-capacity context, and yet provide an effective systemic process for managing

[14] *IMF, 2015, Making Public Investment More Efficient.*

[15] *Rajaram, Anand, Tuan Minh Le, Kai Kaiser, Jay-Hyung Kim, and Jonas Frank (2014). The Power of Public Investment Management: Transforming Resources into Assets for Growth. Washington: World Bank.*

public investments. The emphasis should be on the basic processes and controls (linked at appropriate stages to broader planning, budgeting and implementation processes) that are likely to yield the greatest assurance of efficiency in public investment decisions.

Figure 5.10: Eight Public Investment Management must-have functionalities



Source: Rajaram et al. (2014), The Power of Public Investment Management: Transforming Resources into Assets for Growth.

In Kenya, land has cultural, political and economic significance and is seen as a major crosscutting challenge to public investment management because access to and acquisition of land for infrastructure projects affect cost and timeliness of project preparation and implementation. Land issues are therefore reviewed separately in a section below.

The review in this Kenya Economic Update is on Public Investment Management at National Level. However, as the devolved system of governance settles in, it would be important to pay equal attention to public investment management at county level and across levels of government.

5.4.1 There is limited screening of project proposals for alignment with Vision 2030 Broad strategic guidance for public investment is an important way to anchor government decisions and to guide sector-level decision makers towards national priorities. The Vision 2030 provides a long-term vision of policies and priority projects that form the country's development program and these are cascaded down through a coherent planning and budgeting hierarchy. The hierarchy includes Medium Term Plans, Annual Budgets, Annual Performance Contracts (for Heads of Ministries and Agencies) and Departmental Work Plans.

However, competing pressures and political interests create ad hoc priorities that are not captured in the Vision 2030, medium term expenditure framework (MTEF) and MTP processes. This happens when non-government actors, such as private sector individuals, enterprises or development partners, sponsor new projects. It also happens when needs are identified by high-level authorities well after the national plans have been drafted. Finally, so-called "complement projects" come up. Currently, little guidance exists on how to deal with new proposals outside the normal planning process. While there is a well-publicized high strategic guidance for public investment decisions at the central, ministerial, and county levels, there is no process or practice for screening project proposals for basic consistency with government policy as regards new proposals not included in the plans.

5.4.2 Project appraisal and independent review lacks basic requirements and capacity. Project Appraisal serves to determine whether to go ahead with an investment project proposal or not. Functionalities that should be in place include pre-feasibility and feasibility studies determining technical, social, environmental and economic viability of the project.

Box 5.4: Project preparation in the energy sector

As the energy sector struggles to achieve the ambitious targets within the plan to increase generation, transmission and distribution of electricity in Kenya, each institution seems to be facing unique challenges that could have been managed if there were standard procedures and coordination across the sector. And while regional interconnectivity is expected to be a significant component of the investments to connect regional neighbors (such as Tanzania, Zambia and eventually South Africa, Ethiopia, and Democratic Republic of Congo-DRC) to tap into the surplus electricity that Kenya hopes to enjoy, there has not been clear feasibility studies and cost benefit analysis to support these ambitious investments before they were embarked on. This example demonstrates the complexity of PIM for projects with a regional dimension.

Without a systematic approach (centralized or decentralized) for appraisal, costing for some of the projects is done carefully but the result is descriptive. Technical personnel in the sector indicate that while they have been well-equipped with relevant skills through numerous training programs in project appraisal and cost benefit analysis. However, there is no mechanism to integrate these skills into value for the sector and hence no incentive for stopping bad projects or rationalization of the portfolio.

It is also not clear who has gatekeeping authority to bring discipline in project selection and enable project prioritization. Sometimes projects that enter the budget are not ready for implementation. In many cases, it is after the project has been identified for funding that feasibility studies are carried out. In other cases, new projects have been misrepresented as ongoing projects to avoid rules that limit new projects.

Appraisal of proposed investment projects is embryonic. The quality of technical project design and costing varies considerably between projects. Economic analysis, including Cost-Benefit and Cost-Effectiveness Analyses, is not systematically done and there is limited capacity for doing them. The legal provisions for project appraisal are very general in nature, and more detailed guidance is very recent and is still too general to improve the quality of appraisal. There is no manual of procedures to guide the project appraisal and selection process. Beside environmental assessments anchored by NEMA, there is no independent review to challenge project design, assumptions, justifications and costing, etc.

It will take time to significantly improve the quality of investment project appraisal but small steps can go a long way. Project appraisal guidelines with minimum standards for technical design, costing and economic analysis should be drafted. Doing appraisal requires technical skills, which are only emerging in Kenya, so implementation of the guidelines should be done gradually and aligned with capacity building. It is important that an administrative check is put in place to ensure that guidelines are being adhered to. This could for example be done by making appraisal a requirement for including a project in the budget. Similarly, transparency and disclosure of appraisals will provide a public check on compliance.

Box 5.5: Steps taken to improve appraisal in Uganda

Recently, the Government has implemented a number of measures intended to start a reform process that may improve Uganda's PIM system. As part of this process, the Ministry of Finance, Planning and Economic Development embarked on measures to strengthen its gate-keeping function by creating a department in charge of Project Analysis and Public-Private-Partnerships (PAPP) in 2015.

This created a systematic structure with clearly defined mandates to manage the project cycle, and project quality assurance. Among other matters, the PAPP Department is expected to ensure that technical and economic analysis of public investment initiatives at the national and/or regional level is conducted, thus acting as an independent reviewer of the projects. Accordingly, it is responsible for:

- Analyzing, appraising and recommending or rejecting public investment projects for financing and execution;
- Defining and updating general and sector rules, guidelines, circulars and norms that inform the formulation and appraisal of investment projects;
- Providing technical support to MDAs and local government evaluation teams or planning units;
- Coordinating the provision of nation-wide training on issues of project preparation and project appraisal;
- Providing the secretariat to the Development Committee, with the latter mandated to approve or reject submitted projects for project execution by granting a seal of approval; and
- Undertaking selected monitoring and post evaluation for selected key projects.

With technical assistance, the unit has developed public investment guidelines and manuals and started building capacity in the area of project appraisal within the Ministry and in other MDAs. Amongst other measures, it has developed a simplified manual for public investment appraisal.

As part of its role to appraise and select projects for financing, this unit may in some cases serve as the independent reviewer. However, lack of clarity on mandate, thresholds, and other aspects, on which projects should be subjected to independent reviews, leaves different projects being subjected to different standards.

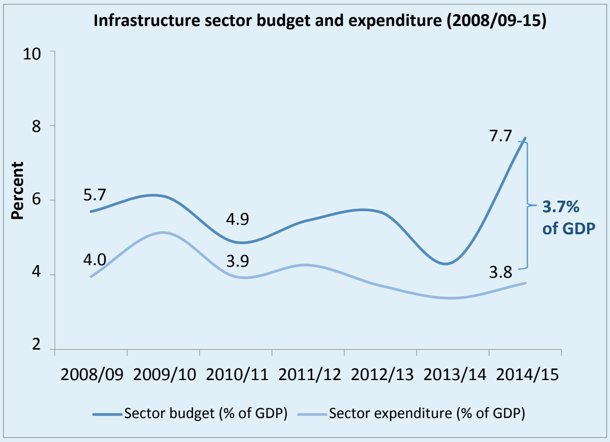
This department is in fact the champion for the strengthening of the overall PIM system in Uganda, but has to remain cautious not to overburden itself with roles that should be undertaken by other agencies along the PIM cycle.

5.4.3 Institutions for project selection and budgeting are weak. The Kenyan budget process has many strengths but the National Treasury could strengthen its role as "gatekeeper" in the project selection and budgeting process. The budget process is well-regulated in the Public Finance Management Act 2012 and there is good discipline around the budget calendar. The decentralized approach to prioritization and vetting of projects provides a setting in which sectoral priorities and technical knowledge is well represented in the selection process. All expenditures, including all development expenditures whether implemented by Ministries, Departments and Agencies or State Owned Enterprises (SOEs) (irrespective of funding source) are on budget. However, problems of optimism bias or conflict of interest in project selection and budgeting are not addressed.

The pressures to include a given project in the budget—independent of the results of any appraisal—can be significant even in the best of settings. This makes the existence of a supervisory or oversight function important to ensuring that only viable projects are included in the budget and that the overall envelope is fiscally responsible. However, the National Treasury's role as challenger of budget proposals and gatekeeper is limited in a number of ways, including by the absence of a formal process to respond to ad hoc or emergency projects, limited data on project information and limitations in existing financial management systems. There is limited staffing within the Budget Department in National Treasury to perform a robust challenge function to Ministries, Departments and Agencies. This is notably the case in the infrastructure, transport and energy sectors that account for 50 percent of the development budget.

5.4.4 Implementation: procurement, cash management and pending land reforms are key impediments. One of the obvious symptoms of the weakness in Kenya's PIM system is the low levels of execution of the infrastructure budget. For instance, in the year 2014/15, only 31 percent of infrastructure budget was executed, compared to 89 percent for general economic and commercial affairs sector. Figure 5.11 shows budget estimates for infrastructure and the actual spending for the period 2008-09 to 20014-15. The difference between the two lines, which we refer to as execution gap, increases as the budget for the sector increases. The highest gap can be observed in 2014-15 when the budget for the sector was 7.7 percent of GDP and only 3.8 percent was executed, leaving a gap of 3.7 percent of GDP. As will be discussed below, badly prepared and selected projects and issues around design and procurement practices, contract management, cash and payment as well as land acquisition are key factors behind the execution gap.

Figure 5.11: The infrastructure budget execution Gap has increased to about 3.7percent of GDP



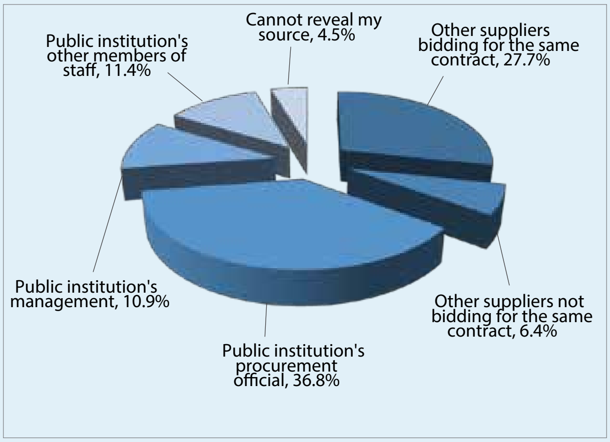
Source: Staff computation from National Treasury (Quarterly Budget and Economic Review, various issues).

Procurement, corruption, cash management and acquisition of land are key impediments to implementation. A key step to improving project and budget execution is to improve the quality of project preparation as discussed above. Badly prepared projects are harder and slower to implement. However, deficiencies in procurement processes/practices, challenges to the management of cash and delayed payments to contractors as well as land acquisition also delay implementation.

Public Procurement and Contracting

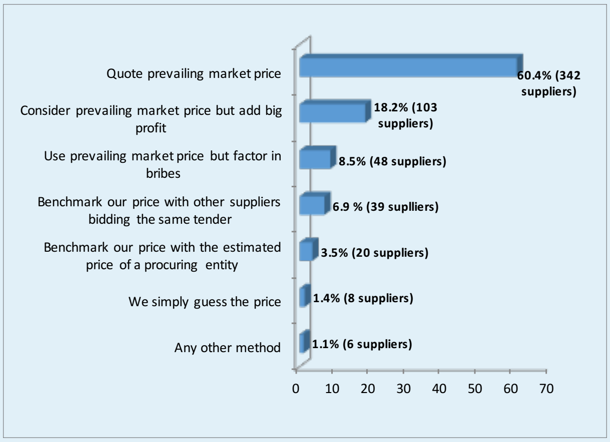
Procurement is a special area of focus in PIM, as the mechanisms for selection and contracting influence price and quality as well as facilitate or mitigates fraud and corruption risks. Public investment procurement is particularly prone to significant efficiency losses because it involves large contracts that can provide possibility for irregular payoffs by means of poor procurement practices and collusion. Between 2012 and 2013 it was estimated that 59 percent of suppliers/private firms had accessed prior knowledge of a public institution's estimated price of goods and services from procurement officials, management or other staff in the procuring institution. During the same period, about 34 percent of suppliers reported adding extra mark-ups for profits, factoring in bribes and "benchmarking" with other suppliers for the same tender, as the basis for determining how to quote when placing tenders with public institutions.

Figure 5.12: Private firms reporting who supplied them with information on the estimated price of goods to be procured by public institutions



Source: EACC, Evaluation of corruption in public procurement, 2015.

Figure 5.13: How suppliers determine the price to quote when placing tenders with public institutions



Source: EACC, Evaluation of corruption in public procurement, 2015.

Some procurement-related delays are a consequence of losing bidders lodging appeals against decisions. In FY 2013/2014, the Public Procurement Administrative Review Board (PPARB) handled 56 cases with a turnaround on completion of the review at 21 days. While on average, 3 weeks does not constitute inordinate delay, 50 percent of the decision made by the PPARB went on to judicial review process, which does then cause delays.[16] As discussed elsewhere in the report, more than 60 percent of cases filed in the Environment and Lands Court take between 12 - 60 months to be concluded.[17]

Kenya has recently passed new procurement legislation. Ongoing efforts to implement the new legislation should help address procurement related delays to investment project implementation. This includes stronger M&E provisions for better contract management, special approvals from the Attorney General and notification of Cabinet for any procurement above KSh 5 billion and enforcement of the procurement planning (including multi-year procurement plans). However, even as the law makes improvements, issues relating to public participation particularly around land and displacement are inevitable, and still cause significant delays and cost escalations as discussed later in this report.

Cash Management

Weak cash management leads to recurrent cash shortfalls which adversely affect the pace and extent of project implementation. Ultimately, this leads to short term building up of arrears to contractors and increased costs for contractors. Contractors reflect this in pricing and cost variation orders and stall project completion. These elements make the system further vulnerable to fraud and corruption as favored providers can be given priority in payment and as the discretionary payments can be made contingent on kickbacks.

[16] *Public Procurement and Oversight Authority 2013/2014 Annual report.*

[17] *Judicial Case Audit and Institutional Capacity Survey June 2013.*

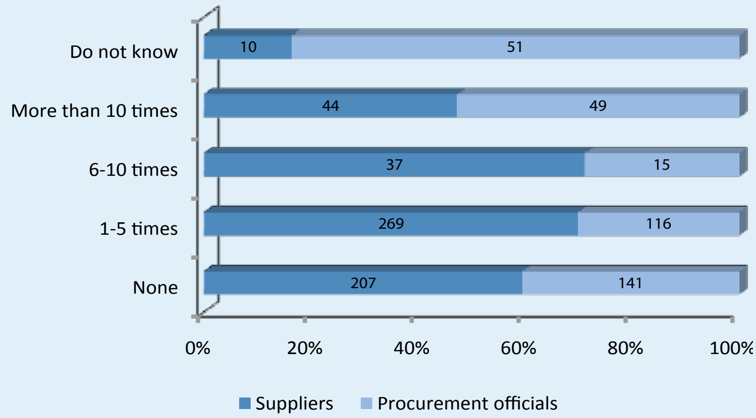
Box 5.6: Cash short falls and delays in making payments

"Delay in government making payment for goods and services [….] plays a big part in creating incentives for bribery and rent seeking. *"I am announcing that every Accounting Officer shall be held responsible for ensuring that all payments for goods and services are paid for in a timely manner…"* H.E. Kenyatta in a police speech on corruption titled: *"National Call to Action against Corruption"* delivered from State House on November 23, 2015.

The extent of the delay of payment to suppliers is significant, with longer delays extent of the delay warranting higher "facilitation" fees. While the Public Procurement Code of Ethics prohibits delays to payments due to contractors, suppliers, provides of services or consultants, the practice is still rampant in procurement in Kenya. Between 2012 and 2013, almost 50percent of suppliers interviewed by the Ethics and Anti-Corruption Commission (EACC) had experienced their payments delayed more than 10 times as shown in Figure B.5.6.1.

In October/November 2015, Kenya faced the realities of a significant cash shortfall. The Parliamentary Budget Office attributed the shortfall to: (i) the failure of Kenya Revenue Authority (KRA) to meet their revenue targets from July-September 2015; (ii) high interest rates (spiked increase in domestic borrowing); (iii) sharp weakening of the value of the shilling to the US dollar; and (iv) the failure of Treasury to adequately plan mitigating measures to address challenges.[18] Consequences of this included 15-30 days arrears in payments of salaries to teachers and county government staff, implementation of third term free primary education being disrupted, the procurement of laptops for schools postponed and disbursements to the Tourism Marketing Fund (to mitigate against travel advisories) and Rural Electrification Program, delayed.[19]

Figure B.5.6.1: Number of times in 2012 and 2013 that processing of payment was delayed



Source: EACC Evaluation of corruption in public procurement report, 2015.

[18] *http://www.businessdailyafrica.com/Low-revenues--high-interest-rates-behind-State-cash-crunch/539546-2905322-rkvkfk/index.html*

[19] *Source: Requested from the PBO. http://www.businessdailyafrica.com/Low-revenues--high-interest-rates-behind-State-cash-crunch/539546-2905322-rkvkfk/index.html*

Project adjustment

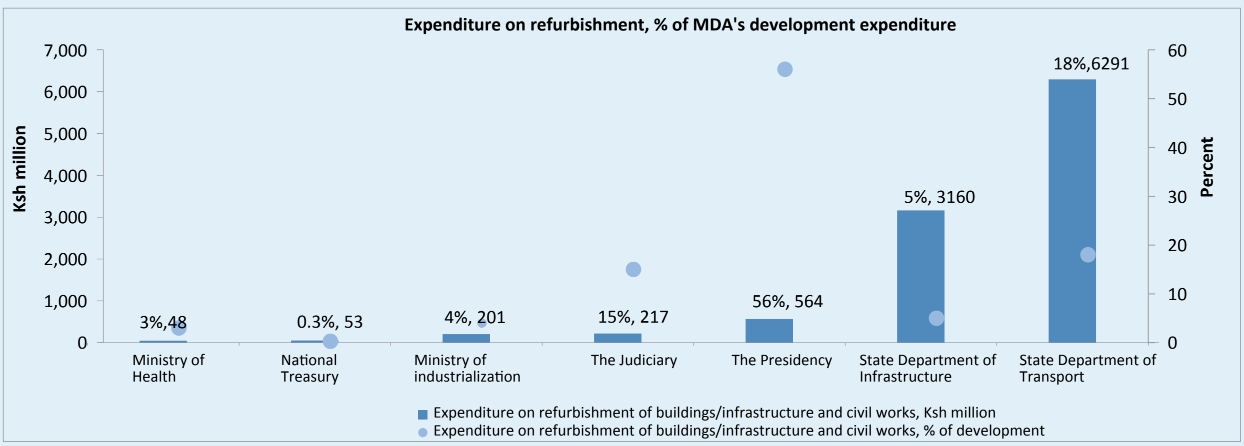
Contract variations and cost overruns are not systematically being monitored and the nature and extent of problems cannot be properly quantified. Coding of projects in IFMIS has until recently only been done for projects funded by development partners. IFMIS is only used for aggregated expenditure reporting that cannot be generated at project level. It is therefore not possible to assess the completion rate of the public investment projects including how these completion rates differ across key sectors. Project tracking and monitoring would provide a basis for improved project adjustment.

5.4.5 Wanted urgently: Updating of Asset Registries and provision adequate funding for maintenance. The national government operates on a cash basis of accounting and does not maintain a balance sheet of assets and attendant liabilities. The value of assets created by the national government are recorded and reported on in terms of only how much money was spent on that asset in the year of its acquisition/creation. SOE's, however, maintain asset registers, as they operate on the accrual basis of accounting. Assets owned by SOEs are valued according to International Financial Reporting Standards (IFRS) and any asset acquired by a SOE is valued periodically every 2-5 and these values are updated in the balance sheet accordingly.

The national government of Kenya spent a total of 18 percent of the annual development budget expenditure on refurbishment of buildings/infrastructure and civil works in fiscal year 2014-2015. However, except for the Presidency and Judiciary, key public investment MDAs such as Health, Infrastructure, Industrialization and Transport spent less than 5 percent of their development budgets on the same. See Figure 5.14.

Anecdotal evidence suggests that the transition from construction to operation and maintenance is not always handled well. Newly completed assets are sometimes not put into use because of lack of funding for operations. Some assets are not probably maintained, which reduces their useful lifetime. Devolution is likely to have temporarily increased this problem, as many assets are not clearly assigned to a level or government, as national government funds construction of assets intended to be operated by counties and as budgeting and other aspect of public financial management is nascent in the counties.

Figure 5.14: Percent of MDA Development Expenditure allocated to Refurbishment of Buildings/Infrastructure and Civil Works



Source: Staff compilation from the Controller of Budget (Annual National Government Budget Implementation Review Report 2014/15).

5.4.6 Evaluation: Improve recording, tracking and transparency. Many aspects of Kenya's public investment program are not clearly and transparently reported. The composition of the development budget between infrastructure and other expenditures is unknown because some recurrent expenditure is included under the development budget. Effective use of the GFS classification of public expenditure does not appear to be present. Thus an important metric of the quality of public spending, the share of expenditure allocated to public capital, cannot be clearly estimated.

Basic information on the number, sectoral allocation, value, and stage of completion of public investment projects is not available either to policy makers or to the general public. Beyond the Vision 2030 and Medium Term Plans, there is no portfolio of planned or assessed investment projects, making project selection unsystematic and without clear criteria. There is no up-to-date or accurate tracking, disclosure and evaluation of project implementation status, timeliness and expenditures.

Because of the lack of project level information, it is difficult to undertake analysis to assess more exactly the scale of problems with project delivery. Similarly, it is hard to assess the impact of reforms and changes to the system and to identify "islands" of good practice and performance in Kenya that serve as role models and inspiration for others. National Treasury's recent efforts to improve the capture of investment projects in the budget, is effectively operating without much information, and cannot therefore fully perform its "watchdog" or oversight role over the PIM portfolio.

Overall, the legal and institutional set-up for public investment management in Kenya does not facilitate good returns on public investments. Kenya has taken initial steps to improve public management with the elaborate planning system as a good point of departure. The ePromis platform is also in place as an important first step towards setting up criteria for project appraisal and selection. However, across the eight "must have features" of a public investment management system, Kenya still has a potential to improve its approach and realize greater returns on its very significant public investment volume.

>> Box 5.7: E-promis

To facilitate project monitoring, an electronic Project Monitoring Information System (e-ProMIS) was developed in 2007/08. The uptake and use of e-ProMIS across line ministries in GoK has been slow. A review of the e-ProMIS data indicates data quality challenges. The largest project in e-ProMIS at the time of writing (February 2016) was listed as the Northern Corridor Transport Improvement Project (NCTIP)—a World Bank financed project—with a total project cost of US$ 5.6 billion. However, World Bank records indicate that the total project cost is closer to US$ 473 million (i.e. 12 times smaller). Furthermore, the SGR project is recorded in e-ProMIS as having a total lifetime project cost of KSh 6.65 billion (71st largest project by total cost), which is only 6 percent of the total budget allocation recorded for only one year of project implementation in the 2015/16 development estimates (KSh 118 billion). In addition, of the 1,818 projects that are listed as 'ongoing', only about 400 (22 percent) have 'planned' or 'actual' end dates that were in the future at time of writing, suggesting that the majority of the data is stale and needs to be updated. These data quality issues raise questions about the usefulness of undertaking detailed analysis of the e-ProMIS data and about the quality assurance systems in place to detect and correct errors.

5.5 Land Presents a Unique Challenge to Public Investment Management

5.5.1 Meeting the growing demand for land for infrastructure projects is a ballooning challenge. With the growing scope and scale of current infrastructure investments in Kenya, demand for land is growing. The amount of land required varies in size, depending on the project. For example, the US$450 million (KSh 4.5 billion) Ruiru Sewerage Treatment Plant required approximately 82 acres to be available in one plot. In other cases, the infrastructure requires a narrow corridor of land along many kilometers. Infrastructure such as railways, roads, pipelines and power lines require this type of land corridor. For example, Phase I of the US$ 3.27 billion (KSh 327 billion) Standard Gauge Railway (SGR) required a narrow corridor of land for 472km from Mombasa to Nairobi.

This demand for land by the public sector can be met through the public land inventory. The principle behind public land is that it is held in trust for the people by the government. Public land is, therefore, to be used for the benefit of the citizens of the country to serve the public interest. Infrastructure investments such as roads, railways, schools, sewage and water treatment plants, etc., serve a public purpose. During the planning process, land is set aside for anticipated future demand of basic services, for example, road reserves and land for health clinics and public schools. The reserved land should remain in the public domain until such a time that it is needed to meet increased demand for services. In this way, there should be a ready supply of public land on which to expand services.

Over the last several decades, however, public land management practices have been sub-optimal. Such practices have resulted in a situation in which much of the stock of public land has been lost to individual uses (see Box 5.8). The allocation of this public land has often been done irregularly with little oversight reducing the stock of land that was set aside for planned interventions. In Nairobi in 2005, only 2.3 percent of the total land area was classified as un-alienated government land[20] and it was estimated in 2010 that only 13 percent of land in urban areas is government owned.[21]

There is no clear inventory of what public land is remaining. From 1963-2010, no systematic or comprehensive inventories of various types of public lands were completed for either rural or urban areas. The common perception is that no public land exists that is unencumbered and available for allocation for public uses or to encourage investment, especially in locations where it is most needed.

Table 1: Examples of Land Required for New Infrastructure across Various Sectors

Sector: Project	Land Required
Transport: Standard Gauge Railway (Phase I Mombasa-Nairobi)	60-130m corridor for 472km
Energy: Suswa-Isinya Geothermal energy transmission line	60m corridor for 100km
Sanitation: Ruiru Sewerage Treatment Plant/Juja Sewerage Treatment Plant	82 acres/120 acres
Solid Waste Management: Mitubiri Landfill Site	50 acres

[20] *JICA, Integrated Urban Development Master Plan for the City of Nairobi, Final Report, May 2014, 2-26. (Nippon Koei Co., Ltd. IDCJ Inc. EJEC Inc.), Table 2.2.1.*

[21] *UN-Habitat, 2010.*

Box 5.8: Findings of the Ndung'u Commission

The Ndung'u Report, released nearly 15 year ago, documented the extent of corruption in the land sector. Known officially as the Report of the Commission of Inquiry into the Illegal/ Irregular Allocation of Land in Kenya (2004), the Ndung'u report confirmed that corruption involving public land was systematic and widespread. The commission found that at least 200,000 illegal titles had been issued to alienate public land[22] between 1962 and 2002. The Ndung'u report also showed how presidents, public officials, and members of the judiciary, well-connected politicians and private businesses had consistently perverted the constitutional requirement for public land to be administered "in the public interest".

Wholesale alienation of public land occurred in both urban and rural areas. The result of the trends exposed by the Ndung'u Report and others was that by 2010 most public land that had not been (1) assigned to government authorities (e.g. railways, forest service, parks service, etc.); (2) demarcated for road, power, and rail Right of Ways (ROWs); (3) assigned for public services; or (4) alienated for urban uses within municipal, town, and market areas was simply lost.

The main methods of land grabbing described in the Ndung'u report have been: letters of allotment treated as saleable interests in land; illegal/irregular allocations/ appropriations of public land; parastatals and ministries paying exorbitant prices to acquire land from private individuals; and illegal and/or irregular excisions of protected forestland to private interests and for unauthorized uses.

The demand for land for infrastructure can also be met through purchase in the open market. Particularly for infrastructure that is site-dependent, such as sanitation treatment plants and landfills, or where a need has been determined where no public land has been set aside, the government may need to acquire land in the open market. Land purchase can be time-consuming and expensive. There is no guarantee that the optimal parcel of land that is required will become available for purchase; and if such land does become available, its scarcity value will result in a high, perhaps prohibitively high, land price.

In Nairobi, the city with the most active property market and the biggest need for network infrastructure, land values are increasing dramatically (table 5.2). Investment in land is providing far higher returns than either the bond or stock market in the country. The city's property market has "been one of the best performing globally over the last 8 years, matched only by Hong Kong".[23] The average price per acre was a little over KSh 30 million in 2007, but is more than KSh 170 million today, an increase of 535 percent in 7 years.[24] In such a market, the option of purchasing private land to convert to public land may be very limited. Further, the announcement of a proposed infrastructure project tends to result in an immediate increase in land prices in the vicinity of the proposed project.

22 *Alienation is the act of transferring public land into private ownership, at the discretion of the relevant government agency/agent, and under the aegis of delegating the utilization of the land 'commons' for the public good.*

23 *Hass Consult 2013.*

24 *Hass Property Land Index Q4 2014.*

Table 5.2: The Escalating Cost of Land in Nairobi 2007-2014

Cost of 1 acre by neighborhood in KSh (millions)	2007	2014	Percent change 2007-2014	Current cost (as of Q2 of 2016)
Average across Nairobi	30	170	535%	-
Upper Hill	60*	470	789%	600
Kilimani	66*	370	557%	430.3
Lang'ata	9*	40	427%	50.9
Westlands	73*	361.7	494%	398.4

Source: Hass Property Index Quarter 2 2016, Quarter 4 2014.
** Author calculation based on HassConsult data*

5.5.2 Compulsory land acquisition facilitates availability of land where needed but can delay the expected productivity gains of infrastructure projects. Kenyan law allows the government to exercise powers of compulsory land acquisition, or eminent domain, which is the mandatory acquisition of private land in the public interest. During compulsory land acquisition, land is bought at market price; however, it is not based on the market's "willing buyer, willing seller" principle, as the landowner cannot refuse the acquisition. While compulsory land acquisition is also expensive and time-consuming, it is the common practice to avail land required for infrastructure investments especially where public land is not available and/or land is not available in the open market.

Challenges encountered in the land acquisition process adversely affect infrastructure projects with consequent impacts on the expected productivity. For example, the Kenya Electricity Transmission Company (KETRACO) continually face land acquisition challenges which delay expected energy savings. KETRACO is a government agency set up 2008 to build the new high voltage electricity transmission infrastructure necessary to the Vision 2030 goal of increased national energy capacity and related economic efficiencies. By 2030, they target an additional 11,230 km of new high voltage transmission lines at an estimated cost of US$ 3.55 billion. This additional infrastructure is expected to translate into savings that are passed on to the consumer, leading to reduced electricity bills. Project delays mean that the country as a whole does not receive these savings until years later than projected.

Similarly, the production of cheaper geothermal energy has not been maximized. The transmission of 280MW of geothermal energy from the Olkaria I and IV Geothermal Power Stations has been hindered due to difficulties in acquiring land for the wayleaves for the transmission line. The 100km 220 KV Suswa-Isinya power transmission line, which is critical to evacuating this power, has not been completed due to disputes related to compensation of the land for the way leave. Construction of the 400KV Nairobi-Mombasa line, also aimed at evacuating cheaper geothermal power to Mombasa, was begun in 2012 and has not been completed for similar reasons. The disputes have reduced the potential of geothermal energy as a cheaper alternative to the more expensive hydropower for electricity.

Further, infrastructure that increases regional integration to Kenya's advantage is also at risk. In at least one regional infrastructure project, Kenya has lost out to Tanzania due to land-related costs and time delays associated with Kenya. In early 2016, Uganda opted out of jointly constructing a crude oil pipeline project through Northern Kenya to Lamu, opting instead to support the construction of a route through Tanzania. Part of the motivation for opting out of the Kenya route included the risks in increased costs and time delays due to the complexities of land acquisition in Kenya.

5.5.3 The gaps in the policy and legislative framework of compulsory land acquisition contribute to delays in infrastructure investments. Ideally, the legal process of involuntary land acquisition should balance the desire to promote economic growth and investment with the need to limit harms to those whose property is taken involuntarily for a public purpose. In Kenya, the 2010 Constitution protects the right to private property but also makes certain provisions for compulsory land acquisition. While it does not define the term "compulsory acquisition" it provides for instances where the state can deprive a person of private property rights for a public purpose or in the public interest. This provision acts as the basis upon which the exercise of the power to compulsorily acquire property is exercised. As seen in Figure 5.15, the process of land acquisition is laid out clearly in the Land Act 2012, and the National Land Commission (NLC) is the entity that administers the land acquisition process.

Figure 5.15: Land Acquisition Process (from the Land Act, 2012)

1
- CS or the County Executive Committee member required to submit request to the National Land Commission to acquire the land on its behalf.

2
- NLC evaluates request for acquisition
- If satisfied that the request meets requirements under guidelines and provisions of Article 40 (3) of the Constitution, the NLC provides approval.

3
- Land is then geo-referenced and authenticated by the office of survey at relevant national or county government level.

4
- NLC then publishes a Notice of Intention to acquire land in the relevant Gazette or the County Gazette.
- The NLC submits a copy of the Notice and every other person who appears to be interested in the land.

5
- Registrar then makes an entry into the register of the intended acquisition.

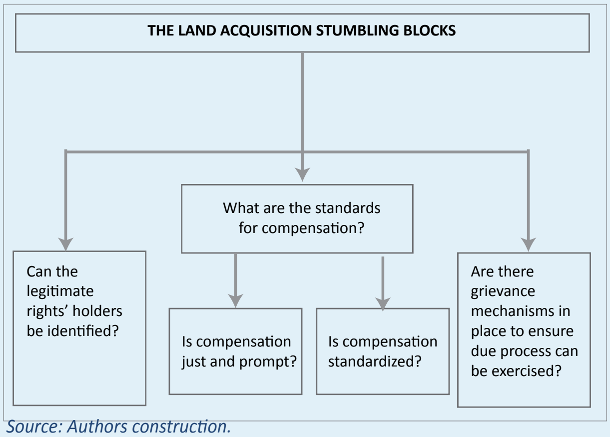
6
- Within 30 days of publishing the Notice of intention to acquire land, the NLC appoints date for inquiry to hear propriety and compensation issues from people interested in the land.
- Notice of Inquiry is published in the Gazette or the County Gazette at least fifteen days before the inquiry and served to every person who appears or claims to be interested in the land.

7
- Once land has been compulsorily acquired, just compensation is paid promptly and in full to all persons whose interests in the land have been determined.

The term public purpose is a key principle behind compulsory land acquisition. A clear definition of what constitutes "public purpose" or "public interest is needed in the legislation to identify whether a project meets a public purpose in order to improve accountability. In many countries, public purpose is not defined clearly in the legislation, which creates space for acquisition that may not be necessarily for public purpose in the strictest sense. In Kenya, the term public purpose is defined in the 2012 Land Act.[25] Purposes of transportation, and public utilities and services, feature centrally in the definition.

If not clearly addressed in legislation or policies, four factors become stumbling blocks that delay compensation and project implementation. They are: (i) eligibility criteria to clearly identify the legitimate rights' holders of the land; (ii) requirements to provide prompt, adequate and effective compensation; (iii) clear standards for determining property valuation and compensation; (iv) provisions to ensure that the right to due process and appeal in an independent forum in cases of dispute can be exercised (figure 5.16). While international good practice related to the legal framework for land acquisition has five benchmarks,[26] this report has focused on evaluating, through the lens of stumbling blocks, the three that have an impact on budget execution.

Figure 5.16: The Land Acquisition Stumbling Blocks



Source: Authors construction.

5.5.3.1 *Identifying the legitimate rights' holders of the land is a persistent challenge*

In Kenya, as in many countries, people who have lived on and used land for long periods of time will not have any formal documentation of their rights. This is especially the case for people who hold secondary and tertiary rights —including women (who often control but do not own parcels for food production); those (men and women) who own trees, but not land; those (men and women) who have rights to use water sources or pastures but only at certain times of the year; those (men and women) who may collect forest products, etc. According to international statutes, these users of the land are considered legitimate rights' holders due for compensation. In some countries, their legitimate customary rights are recognized under the formal law; in other countries they are not recognized.

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[25] *This Act defines "public purposes" to mean the purposes of—*
- *(i). Transportation including roads, canals, highways, railways, bridges, wharves and airports;*
- *(ii). Public buildings including schools, libraries, hospitals, factories, religious institutions and public housing;*
- *(iii). Public utilities for water, sewage, electricity, gas, communication, irrigation and drainage, dams and reservoirs;*
- *(iv). Public parks, playgrounds, gardens, sports facilities and cemeteries;*
- *(v). Security and defence installations;*
- *(vi). Settlement of squatters, the poor and landless, and the internally displaced persons; and*
- *(vii). Any other analogous public purpose.*

[26] *The five benchmarks are: (i) Clear definition of "public purpose" or "public interest"; (ii) Standards for compensation/valuation; (iii) Requirements for consultation; (iv) Recognition and eligibility of legitimate rights' holders; and (v) Due process standards and judicial review.*

These legitimate rights' holders are recognized in the Kenya legislation but can be difficult to conclusively determine who is eligible and their compensation dues. The Constitution of Kenya 2010 provides for compensation for occupants in good faith who may not hold title to land that is subsequently compulsorily acquired. Based on this provision, compensation in Kenya is not linked to ownership of registered interests in land and squatters and other occupiers in good faith are entitled to some form of compensation. Occupiers in good faith are entitled to some form of compensation and this is recognized in practice in Kenya. For this reason, agencies acquiring land must perform the due diligence required to identify these occupants, a process that is not clearly guided in the legislation.

In addition, a poor land records management system has made it difficult to find even the formal rights' holders of the land. Confusing laws and procedures for land registration have resulted in registries of poor integrity, which may be marred by false ownership claims or replete with inaccurate or outdated ownership information. This has undercut trust in the registries and in this case, contributed to an incomplete compensation process. In the SGR project, the NLC reported that paying out the KSh 30 billion of compensation money was delayed due partly to difficulty in identifying both informal and formal rights' holders, in some cases due to the fact that the titleholder was deceased and no transfer of formal rights had been done.

The recently passed Land Laws (Amendment) Act 2016 presents another hurdle to identifying and compensating legitimate rights' holders. In an apparent contradiction to the constitutional provision for compensation of occupants in good faith, the Land Laws (Amendment) Act prohibits unlawful occupation of public and private land. The Constitution allows forced evictions to take place under certain conditions but mandates the passing of legislation to guide the procedures guiding forced evictions. The procedures to be followed during eviction have been included in the Land Laws (Amendment) Act (2016)[27] and stipulate that certain measures are to be taken into account during evictions. Compensation is, however, not explicitly mentioned as one such measure.

5.5.3.2 "Just" compensation of land is provided for in the legislation; but payment is often not prompt

"Just" compensation has been determined in Kenyan courts as compensation that is be quantified in accordance with the market value of the land being acquired. Legislation often requires that compensation amounts be determined in relation to "market value." In Kenya, the Land Acquisition Act 1983[28] defines the term "market value" of the land to be acquired as "the market value of the land at the date of publication in the Gazette of the notice of intention to acquire the land" and lays out the principles to guide the compensation of land using market value. Compensation costs under these regulations refer to, at the least, compensation of the land, developments on the land and a 15 percent disturbance allowance. Additional considerations are provided for including compensation if the remaining land in a parcel loses value due to the acquisition.

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[27] *The eviction procedures that must be followed are:*
- *Prior identification of all person participating in the eviction*
- *Prior presentation of formal authorization for the action*
- *Where groups of people are being evicted, government officials or their representatives be present during the eviction*
- *Be carried out in a manner that respects the dignity, right to life and security of those affected*
- *Include special measures to ensure effective protection of the rights of vulnerable groups*
- *Include measures to ensure that there is no arbitrary deprivation of property or possession as a result of the eviction*
- *Include mechanisms to protect property and possessions left behind involuntarily from destruction*
- *Respect the principles of necessity and proportional use of force give affected person first priority to demolish and salvage property*

[28] *Although repealed by the 2012 Land Act, the regulations to the Land Acquisition Act continue to remain in force until the regulations of the newer 2012 Act is put in place.*

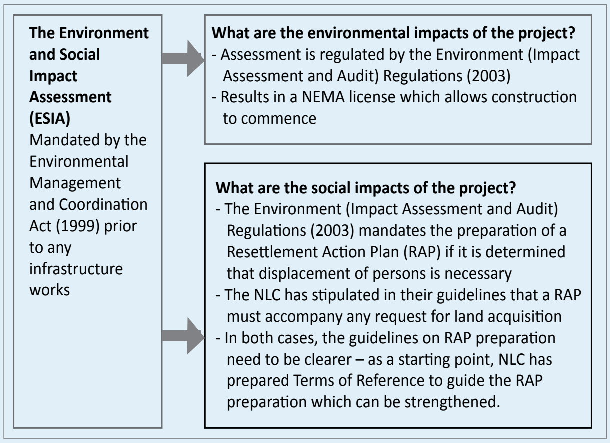
Compensation that is not prompt has halted project implementation. The Constitution of Kenya requires prompt payment in full to the affected party which means that payment is made without undue delay and it should be in the form of currency, land, or other goods/ services that the recipient can readily make use of and that serve to put the recipient in at least as good a position as he or she was in prior to the expropriation. In multiple projects across Kenya, progress has been suspended pending payment of compensation. For instance, the rehabilitation and upgrading of Lang'ata Road affected about 25 property owners near Galleria Mall whose residential properties were vacated in August 2013, but had still not been compensated 15 months later.[29] Works were halted until compensation was resolved. In other cases, actual compensation costs have exceeded the amount set aside in budgetary allocations, sometimes as much as twice the budgeted amount. Not having the money available has delayed payments.

5.5.3.3 While compensation of land is standardized, livelihood restoration is not

Restoration of livelihoods is an important aspect of "just" compensation but has been neglected in the Kenyan legislation. The overarching objective of livelihood restoration is to enhance, or at least restore, the livelihoods of all displaced people in real terms relative to pre-project levels and to improve the standards of living of the displaced poor and other vulnerable groups. Measures to restore livelihoods are established during the resettlement action planning or the RAP process, which is done to ensure that displaced persons are not harmed by the project and that they share in the project benefits.

In Kenya, both the requirements of the NLC and the Environment and Social Impact Assessment (ESIA) require Resettlement Action Planning but there are no clear guidelines to regulate the process. Guidelines on resettlement action planning have been prepared by the NLC, which is a first step towards ensuring that restoration of livelihoods is considered in compensation packages. The guidelines, however, are not complete, as they do not specify the policy principles and the planning parameters that must be applied and clearly established in order to guide the formulation of the RAP. Unclear guidelines results in different standards being applied across similar contexts opening the door for contestation of compensation, which in some cases leads to delays in project implementation.

Figure 5.17: The Key Assessments in the Environment and Social Impact Assessment



Source: Authors construction.

With unclear guidelines, different implementing agencies adopt their own compensation processes with varying compensation amounts. In the absence of a clear approach to RAP preparation, RAPs prepared across different projects are different in format and content. The SGR and Kipevu New Container Terminal Link Road (KNCTLR) each attracted

29 *Report of the Departmental Committee on Lands on Compensation of Evictees of Galleria Mall and the Expansion of Lang'ata Road, Kenya National Assembly, Eleventh Parliament, Second Session, November 2014*

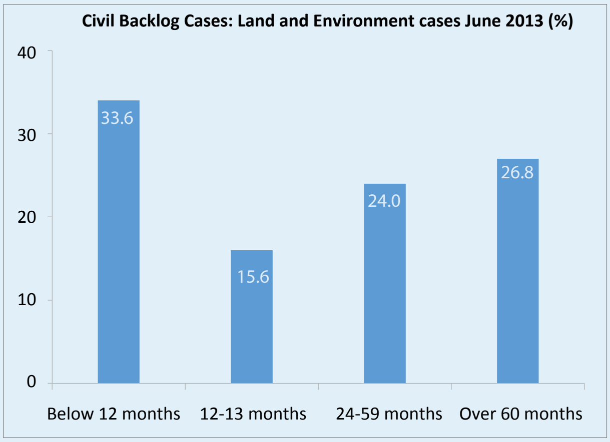
an independent RAP process commissioned by the Kenya Railways Corporation and the Kenya National Highways Authority respectively. The two projects shared a corridor in some areas and where the project area overlapped, the amount of cash compensation paid to the Project Affected Persons (PAPs) in the SGR project was higher than that paid to the KNCTLR. Stoppages in works resulted from communities protesting that the packages do not include livelihood restoration.

5.5.3.4 Grievances addressed through the court cases have significant delays

Multiple provisions are made in Kenya to allow aggrieved parties to practice their right to due process and right to appeal in case of disputes. The land acquisition legislation stipulates that the NLC must hold an inquiry where anyone with interest in the land and who feels aggrieved by the acquisition process can lodge a complaint. The Notice of Inquiry must be advertised in the Gazette 15 days before the date. In addition, the NLC must proactively seek out any persons of interest in the land and hand them this Notice of Inquiry. In addition, the Constitution of Kenya 2010 provides for aggrieved parties access to a court of law. Aggrieved parties may file a court case in addition to, or instead of, using the Inquiry set up by the NLC.

Land dispute cases in Kenyan courts take time to be resolved. The time cost of land disputes filed in court is significant and this severely affects project implementation. A case audit carried out in 2013 revealed that 66 percent (5,782) of the cases filed in the Environment and Land Court (ELC) had been ongoing for more than a year, and of those nearly half had been going on for over 60 months. While these cases may include issues of land disputes outside public investment and projects, at best, there would only a 33 percent chance of any dispute of this kind filed in the ELC will be concluded within 12 months. This is shown in Figure 5.18 below.

Figure 5.18: Civil Backlog Cases by Type (High Court – June 2013)[20]



Source: Judicial Case Audit and Institutional Capacity Survey, June 2013.

Using the court system to address grievances can also exacerbate project costs. The Kenya Railway Corporation claimed that it lost KSh 37.9 million daily due to a court order in June 24, 2016 to suspend works until compensation had been paid to Africa Oil and Gas Company, one of the companies affected by the project. As of July 21, 2016, they had estimated a loss at nearly KSh1 billion due to the suspension.[21]

Feeling aggrieved, persons with rights to the land may decide to hold out and refuse to give up the land. This holding out has an impact on the productivity of the infrastructure as it limits the expected large-scale effects. During the upgrading of the Lang'ata Road, next to the Bomas/Galleria Interchange, landowners refused to allow demolition of their multi-million shilling properties pending the resolution of compensation. The functionality of the interchange was subsequently compromised.

[20] *By the time of 2013 case audit, three ELC large registries (Eldoret, Kerugoya and Nyeri) were omitted from the data collection, and after 2013, the industrial court matters relating to land are now included as part of land and environment cases. For these two reasons figures relating to land and environment cases are therefore likely to have increased significantly and will be confirmed once the 2016 audit is published.*

[21] *Business Daily, July 21, 2016.*

5.6 From Spending To Growth

5.6.1 A system of public investment management. As in most countries, there are opposing forces pulling public investment management in different directions. On one hand, technical experts have views and priorities for sector investment plans and specific projects grounded in needs assessments and technical considerations. There is a drive by top officials and the general public to weed out corruption in public life. There are ongoing efforts to strengthen supervisory functions in budgeting as well as strengthening planning, budgeting and audit and evaluation at all levels. On the other hand, drivers of corruption remain. There is little appetite to limit ad hoc public investment project priorities being reflected in the annual budget. And PFM systems remain in need of further improvement.

While comprehensive PIM reform and strengthening comprises a relatively complex agenda, quick-win high-priority actions include:

- Strengthening minimum criteria for project preparation, appraisal and inclusion of a project in the budget;
- Gradually strengthening the role of National Treasury as an independent reviewer of project proposals before selection for funding, while enhancing the capacity to undertake this role.
- Improving transparency and accountability for management of the portfolio of public investment projects.

A more comprehensive and longer terms reform action plan and effort should aim at strengthening public investment management along all the PIM functionalities reviewed in this KEU:

1) Strategic guidance: Ensure that investment proposals are more stringently reviewed for alignment with the strategies of the Vision 2030 and related Medium Term Plans. Supplement the Vision 2030 with criteria for emerging investment priorities that are not captured in the Vision and Plans. This could be in the form of circulars issued by the National Treasury or Ministry of Planning and Devolution at the beginning of the financial year.

2) Project design and appraisal: Draft project appraisal guidelines with minimum standards for technical design, costing and economic analysis. Implement the guidelines to align with increased capacity for design and appraisal etc., and include an independent review or check on the application of the guidelines. Consider anchoring independent review in the National Treasury. These guidelines should include support towards fully and fairly implementing uniform land acquisition and resettlement planning processes and compensation practices. Good practices on reducing land-related costs to improve the productivity of infrastructure investment can be learnt from practices in other countries. Support compliance with guidelines by embedding process requirements in relevant PFM legislation.

3) Project selection and budgeting: Strengthen the role and capacity of the National Treasury to review and challenge proposals by line Ministries as part of the annual budget cycle, including sector-specific expertise focused on the Ministries, Departments and Agencies with the largest investment budgets. This would amount to strengthening the National Treasury's role as overseer or supervisor of investment projects that go into the budget. The legal framework (e.g. State Corporations Act, PFM Act and PFM Regulations) already provides the basis for National Treasury to strengthen this role.[22] In addition to this, a public investment plan/portfolio should be included in the budget documentation. Project designs and costings should also be made publicly available.

[22] *S.6 of the State Corporations Act, Section 11 of the PFM Act, Regulation 32 of the PFM Regulations.*

4) Project implementation: Core PFM systems (procurement, contract management, cash management) must be strengthened as envisioned in the refreshed PFM Reform Strategy. The recently refreshed PFM Reform Strategy anchored by the National Treasury adequately reflect needed steps, including improving cash management, improving IFMIS functionality and compliance, drafting of regulations in support of the new procurement act and building capacity, etc. However, efforts are needed to accelerate and make effective this foundational part of the PFM reform agenda.[23]

5) Operation: An inadequate asset register, which is also in flux because of the ongoing devolution process, impedes proper management of assets once projects are put into operation. The ongoing process of asset inventory and opening of fixed asset registers using a modified cash basis of accounting needs to be prioritized including processes of survey, demarcations and valuation of government land. Another key step would be ensuring that projections of the full cost of capital projects (including construction, operations and maintenance) are reflected in the annual budget and MTEF. A policy should be agreed and implemented in the annual budget and MTEF to give funding priority to routine maintenance, operation and capital maintenance of existing assets.

6) Audit and Monitoring and Evaluation (M&E): Kenya has an elaborate system for audit, monitoring and evaluation. The monitoring and evaluation system appears to be less substantive than is required to identify and address prevailing problems in public investment management. External Audit is being strengthened, but general challenges related to audit quality and capacity also affect its relevance for public investments. Key recommendations include continuation of reforms at the Office of the Auditor General (OAG), and supplement the existing indicator-based approach to M&E at national level with a focus on project and program evaluation. Part of this would be providing and publicizing examples where projects are being implemented well and what they were doing that can be emulated by others.

7) Transparency and disclosure: Improve information and transparency by building, maintaining and using a database of pipeline and ongoing projects to introduce investment portfolio management. Good steps have been taken with the design of the existing e-Promis database that has the technical functionalities to do this, but the data entered in the system is not accurate, is not maintained, and could be used more actively. The National Treasury should initiate a cleaning up of the data in e-Promis and should then start using the database for the purposes discussed above. This would in turn require a reorientation of the reporting and accountability surrounding the database, so that stronger incentives are in place to ensure regular updating, quality assurance, and use of the information. For example, reporting to parliament on the public investment portfolio as part of the budget cycle (for example by restructuring the development estimates).

Building a strong PIM system will take time and will have to align a gradual and medium-term strengthening of capacity with strengthening of institutions, regulations, guidance and manuals and stakeholder support. Addressing the lack of up-to-date and accurate project-level portfolio information should be a first short-term priority. Other aspects of the PIM reform agenda will require a medium-term engagement and can proceed in parallel depending on resources and reform capacity. A reform action plan for PIM should center on clear performance indicators for results and progress.

[23] *Kenya's Public Financial Management (PFM) Performance as measured by the 2012 Public Expenditure and Financial Accountability (PEFA) is evolving with nine B scores, thirteen C scores and nine D scores (PEFA Assessment, Final Report, and August 8, 2012). Comparing the 2008 and 2012 PEFAs, the ratings were reduced for 6 scores, improved for 4 scores and flat for 21 scores, i.e. a relatively modest change in performance. A PEFA is planned for 2016/17.*

Improving PIM will require strengthening systems and capacity in Ministries, Departments and Agencies and SOEs as well as in the National Treasury. As the anchor of the budget process, the National Treasury is at the core of a strengthened approach to PIM. It therefore fitting that National Treasury takes the lead in formulating and implementing that part of the refreshed PFM reform strategy that relates to PIM, including by drafting a PIM Action Plan. The Presidency is currently increasingly getting involved in the national budget process. It would be helpful if the importance of PIM is agreed with the Presidency and that the role of National Treasury in improving the situation is recognized and supported.

To make meaningful improvements to public investment management in Kenya, it will be important to reach out to key stakeholders and establish consensus on the nature of the problem and the desire to solve it. The purpose of this would be to counter the strong private pressure mobilized around individual projects, whether at selection or implementation stage. This KEU special theme offers a large number of technical recommendations, which collectively would result in a higher return on public investments. However, without buy-in and support, the proposed reforms are likely to result in formal changes to regulations and business processes without a real impact.

5.6.2 Closing the Gaps in the Land Acquisition Process. This analysis shows that the legal framework in Kenya related to land acquisition has strengths but contains important gaps when compared against international practice. The restoration of livelihoods needs to be considered as an element of compensation. The RAP process, while guided through existing processes, needs legislative support, and the emerging contradiction brought on by the Land Laws (Amendment) Act 2016 as far as eligibility for legitimate rights' holders are concerned, needs clarification. Ensuring that compensation is prompt also needs stronger support. The legislation is, however, strong on laying out clear standards for determining property valuation and compensation, and providing the right to due process and appeal in an independent forum in cases of dispute. Improving the speed of resolutions in the court system would, however, also needs to be addressed.

The Kenya government has proposed changes to the way compensation is determined. While challenges are experienced throughout the land acquisition process, the challenges related to compensation are a major source of delays and increased project costs. The focus has consequently been on efforts to reform this aspect of the land acquisition process and legislation has been drafted that proposes capping the amount of cash compensation. International practice encourages the use of market value as the basis for compensation of land and this legislation may cap compensation at a ceiling that is below fair market value. Current estimates suggest that the cost of acquiring land in Phase I of the Standard Gauge Railway (SGR) project was about 10 percent of the total cost of the project. This percentage is in line with global experience. Thus, while compensation costs in Kenya are perceived as high, the costs are comparable internationally.

Other proposals in the draft legislation aim to reduce speculation. To manage speculation, the draft legislation proposes that the compensation value of the land is determined as the value three years prior to the date of acquisition notice. Valuation would be done prior to the notice of acquisition and any transfer of titles will also not be allowed for a certain period of time prior to the acquisition. It also proposes that land-for-land swaps are favored over cash compensation. These mechanisms have been practiced elsewhere with varying levels of success and the regulatory processes to operationalize them will need to be considered carefully. For example, the costs of requiring surveying and registration of the land parcel to be given in a swap can present additional bottlenecks.

The draft legislation also proposes removing the automatic stay of execution when a dispute is lodged. According to the Environmental Management and Coordination Act 1999 (EMCA), a temporary halting of works is triggered when a dispute has been lodged in court. The draft legislation proposes that project works be allowed to continue even in cases where grievances have been filed in court. The intention is to reduce the impact of the long delays in the court system on the implementation timeline of the project; however, the stay of execution is put in place to ensure that the aggrieved have an opportunity to practice their right to an appeal, as also advocated in international practice.

Focus should be as much on ensuring that funding for compensation is properly budgeted and reliably available to facilitate prompt compensation. Reforms should also focus on ways to ensure funds for compensation are available. More accurate budgetary allocations for compensation are needed as compensation costs are often not reflected in project budgets or are under-budgeted. To address the funding gap, the Kenya Railway Corporation introduced a railway levy to raise funds for the compensation anticipated in the SGR. More can be done towards this objective which will reduce grievances taken to court for delayed payments.

More broadly, a single, unified legislative and regulatory framework to govern land acquisition and involuntary resettlement should be developed. Currently, the legal and policy provisions for land acquisition and resettlement in Kenya are scattered in different pieces of legislation.[24] This fragmentation has produced a complex legal framework governing compulsory acquisition. Reforms would focus on crafting a single policy or legislative act on compulsory land acquisition. The reforms would in addition develop comprehensive criteria on identifying legitimate rights' holders, and fully support just and prompt compensation and livelihoods restoration. Good practices can be drawn from the legislation in other countries (Annex 2, Box 2.1)

The following key "quick wins" emerge:

- Establishing an escrow account at the National Treasury for financing land acquisition and resettlement to ensure immediate availability of funds for compensation when needed.
- Evaluating the current proposal to amend the legislation on compensation in land acquisition against international good practice.
- Developing a single policy on land acquisition and resettlement, with supporting legislation, which reflects the principles of international good practice.

[24] *The Constitution of Kenya (2010), National Land Commission Act (2012), Land Act (2012), Land Registration Act (2012), Land Control Act (1989), Environment and Land Court Act (2012), Physical Planning Act (1996), Magistrates Court Act (1989), Urban Areas and Cities Act (2011), Community Land Act (2016), Energy Act (2015), Environment Management and Coordination Act (2003), Public Private Partnership Act (2012), repealed Land Acquisition Act (1983), the Public Funds Management Act (2013) and the Land Laws (Amendments) Act (2016). Bills that were pending that have now been included in the Land Laws (Amendment) Act (2016) are the Evictions and Resettlement Procedures Bill (2012) and the Evictions and Resettlement Bill (2014), which were supposed be the legal anchor to regulate forced evictions and resettlement planning. In addition, there are several relevant policies including the National Land Policy (2009) and the National Housing Policy (2008).*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ANNEX 2

>> Annex 2, Box 2.1: Drawing from Legislation in Other Countries

1. Identifying and Compensating Legitimate Rights' Holders

The terms for compensation of legitimate rights' holders who may not have formal rights need to be clearly articulated in legislation. In India, the legislation articulates who are legitimate rights' holders by providing a definition of landowners that provides some flexibility and looks beyond a cadaster or registry to identify those with legitimate claims to land. India also has a specific Act that provides legal recognition of the customary rights of Scheduled Tribes and other forest dwellers.[25]

In the Philippines, the type of compensation to be provided to legitimate rights' holders who do not have formal rights is spelt out in the legislation. Where the government relocates informal settlers, compensation includes 'adequate basic services and community facilities.' It can also include land surveys, relief from interest payments made on a loan used for construction or purchase of a land and other exemptions related to land registration.

Mozambique is often cited as a country that provides a flexible approach to recognizing legitimate customary rights to land, which allows local people to have some security of tenure without necessarily needing to apply for rights. Rights acquired by customary norms have the same status, technically, as rights that are acquired by a long-term (10-year) good faith occupation of land.

2. Ensuring "prompt" compensation

Under the implementing regulations to Tanzania's Village Land Act of 1999, in cases where payment is not prompt (i.e., within six months of the government approving a claim for compensation), the government (or local government authority) is required to pay interest.

3. Standardizing compensation to include livelihood restoration

The Ordinance 317 of Brazilian Ministry of Cities addresses the need to provide housing and public services to people, even those who lack land and formal housing rights, and it expands payment of compensation beyond the replacement of lost assets. It focuses on the need to restore social and livelihood conditions of affected people, including the provisions of public services, and provides that a Social Work Plan be developed alongside a resettlement plan.

4. Ensuring mechanisms for prompt grievance resolution

Under India's 2013 law, and to promote "speedy disposal of disputes", the government is required to establish a "Land Acquisition, Rehabilitation and Resettlement Authority" to exercise jurisdiction, powers and authority conferred by the act (Ch. VII 51.1). This authority has same powers as a civil court (Ch. VII 60) however, is not bound by rules of civil procedure, but is rather "guided by principles of natural justice and subject to the other provisions" of the act; it can regulate its own procedure. This authority is provided with original jurisdiction over land acquisition. How this specialized court functions and how it compares, in times of timely decision making, accessibility and cost-effective dispute resolution has not yet been determined.

In the Philippines under RA 10752, when an expropriation proceeding begins, the appropriate agency is required to initiate expropriation proceedings before the appropriate court by filing a complaint and due notice to the affected party. Owners are permitted to protest compensation offers and the court must make a determination of the amount of compensation to be paid within 60 days of the filing of the case.

[25] *"The Scheduled Tribes and Other Traditional Forest Dwellers (Recognition of Forest Rights) Act, 2006, No. 2 of 2007" (December 29), Gazette of India*

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STATISTICAL TABLES

Table 1: Macroeconomic environment

	2009	2010	2011	2012	2013	2014	2015
GDP growth Rates (percent)	3.3	8.4	6.1	4.6	5.7	5.3	5.6
Agriculture	-2.3	10.0	2.4	2.9	5.4	3.5	5.6
Industry	3.7	8.7	7.2	4.2	5.3	6.5	6.9
Manufacturing	-1.1	4.5	7.2	-0.6	5.6	3.2	3.5
Services	6.2	7.3	6.1	4.7	5.4	5.8	5.5
Fiscal Framework (percent of GDP)/1							
Total revenue	19.4	19.4	18.8	19.2	19.2	19.0	18.6
Total expenditure	24.0	23.5	23.7	25.1	25.6	28.2	26.9
Grants	1.0	0.5	0.4	0.5	0.5	0.5	0.5
Budget deficit (including grants)	-5.8	-3.4	-4.5	-5.4	-5.9	-8.1	-7.2
Total debt (net)	36.6	39.1	37.0	38.5	43.7	44.8	48.9
External Account (percent of GDP)							
Exports (fob)	12.2	13.1	13.9	12.3	10.6	10.1	9.4
Imports (cif)	25.6	28.7	33.8	30.8	29.2	28.6	24.5
Current account balance	-4.6	-5.9	-9.1	-8.3	-8.8	-9.8	-6.8
Financial account	-10.2	-8.1	-8.2	-11.0	-9.4	-11.4	-8.0
Capital account	0.7	0.6	0.6	0.5	0.3	0.4	0.4
Overall balance	-3.0	-0.4	2.1	-2.4	-0.7	-2.4	0.4
Prices							
Inflation (average)	10.5	4.1	14.0	9.6	5.7	6.9	6.6
Exchange rate (average K Sh/$)	77.4	79.2	88.8	84.5	86.1	87.9	98.2

Source:Kenya National Bureau of Statistics, National Treasury and Central Bank of Kenya
End of FY in June (e.g 2009 = 2009/2010)
1/Figures for 2015 are actuals for 2015/16

Table 2: GDP growth rates for Kenya SSA and EAC (2010-2014)

	2010	2011	2012	2013	2014	2015	2010-2015
Kenya	8.4	6.1	4.6	5.7	5.3	5.6	6.0
Sub-Saharan Africa	5.5	4.3	3.6	4.7	4.6	3.0	4.3
Uganda	5.2	9.7	4.4	3.3	4.8	5.0	5.4
Tanzania	6.4	7.9	5.1	7.3	7.0	7.0	6.8
Rwanda	7.3	7.9	8.8	4.7	7.0	6.9	7.1

Source: World Economic Outlook(IMF) and Kenya National Bureau of Statistics.

Table 3: Kenya annual GDP

Years	GDP, current prices	GDP, 2001 constant prices	GDP/capita, current prices	GDP growth
	K Sh Billions	K Sh Billions	US$	Percent
2007	2151	2766	847	6.9
2008	2483	2772	926	0.2
2009	2864	2864	943	3.3
2010	3169	3104	992	8.4
2011	3726	3294	1013	6.1
2012	4261	3444	1185	4.6
2013	4745	3640	1261	5.7
2014	5398	3834	1368	5.3
2015	6224	4051	1377	5.6

Source: Kenya National Bureau of Statistics and World Bank Development Indicators.

Table 4.a: Broad sectors growth (half year, percent)

Year	Half	Agriculture	Industry	Services	GDP
2012	H1	2.9	3.9	4.8	4.4
	H2	3.1	4.5	4.6	4.6
2013	H1	6.6	7.6	5.5	6.7
	H2	3.9	3.1	5.2	4.7
2014	H1	2.2	8.5	5.8	5.3
	H2	5.3	4.5	5.7	5.3
2015	H1	3.5	7.0	6.2	5.4
	H2	8.6	6.8	4.9	5.9
2016	H1	5.3	5.8	6.9	6.1

Source: World Bank, based on data from Kenya National Bureau of Statistics.
Note: 'Agriculture = Agriculture, forestry and Fishing
Industry = Mining and quarrying + Manufacturing + Electricity and gas + Water supply and sewerage + Construction
Services = Wholesale and retail trade + Accomodation and restaurant + Transport and storage + Information and communication
+ Financial and insurance + Public administration + Professional, administrative and support services
+ Real estate + Education + Helath + Other services + FISIM

Table 4.b: Quartely growth rates (percent)

Years	Quarters	AGRICULTURE			INDUSTRY			SERVICES			GDP		
		Q/Q-1	Q/Q-4	(Q:Q-3)/(Q-4:Q-7)	Q/Q-1	Q/Q-4	(Q:Q-3)/(Q-4:Q-7)	Q/Q-1	Q/Q-4	(Q:Q-3)/(Q-4:Q-7)	Q/Q-1	Q/Q-4	(Q:Q-3)/(Q-4:Q-7)
2012	1	48.9	3.5	2.6	-4.6	5.8	6.7	-1.0	4.4	5.2	7.5	4.7	5.4
	2	-10.6	2.1	2.3	-1.2	2.0	4.6	-1.3	5.3	5.2	-3.5	4.3	4.8
	3	-22.7	2.0	1.9	3.8	4.6	4.7	5.2	4.5	4.8	-1.5	4.5	4.5
	4	1.3	4.1	2.9	6.7	4.4	4.2	1.9	4.8	4.7	2.5	4.7	4.6
2013	1	52.2	6.5	3.9	-0.2	9.3	5.1	-2.4	3.3	4.4	8.6	5.8	4.9
	2	-10.4	6.8	5.1	-4.2	6.0	6.0	2.8	7.7	5.1	-1.9	7.5	5.7
	3	-22.9	6.6	6.1	4.6	6.8	6.6	2.4	4.8	5.1	-2.6	6.3	6.1
	4	-3.9	1.1	5.4	-0.4	-0.3	5.3	2.7	5.6	5.4	-0.6	3.1	5.7
2014	1	53.8	2.2	4.1	6.7	6.5	4.7	-2.8	5.2	5.8	10.3	4.7	5.4
	2	-10.4	2.1	2.8	-0.6	10.5	5.8	4.0	6.4	5.5	-0.8	5.9	5.0
	3	-19.3	6.8	2.9	-1.6	4.0	5.1	1.4	5.3	5.6	-3.3	5.2	4.8
	4	-6.6	3.8	3.5	0.6	5.0	6.5	3.5	6.1	5.8	-0.3	5.5	5.3
2015	1	52.5	2.9	3.7	8.2	6.6	6.5	-2.9	6.0	6.0	9.7	5.0	5.4
	2	-9.5	4.0	4.2	0.2	7.4	5.8	4.2	6.3	6.0	0.1	5.9	5.4
	3	-18.2	5.5	4.0	-1.1	7.9	6.7	1.7	6.6	6.3	-3.2	6.0	5.6
	4	-1.0	11.8	5.6	-1.4	5.7	6.9	0.3	3.3	5.5	-0.6	5.7	5.6
2016	1	43.3	5.1	6.3	8.3	5.7	6.7	0.5	6.9	5.7	10.0	5.9	5.9
	2	-9.1	5.5	6.6	0.3	5.9	6.3	4.2	6.9	5.9	0.3	6.2	6.0

Source: World Bank, based on data from Kenya National Bureau of Statistics.

Table 5: Inflation

Year	Month	Overall inflation	Food inflation	Energy inflation	Core inflation
2014	January	7.2	10.1	5.5	5.4
	February	6.9	9.1	5.6	5.5
	March	6.3	8.3	4.7	5.4
	April	6.4	8.1	5.9	5.3
	May	7.3	8.9	8.1	5.6
	June	7.4	8.4	9.0	5.6
	July	7.7	9.1	9.1	5.5
	August	8.4	10.9	8.6	5.6
	September	6.6	8.4	7.2	4.4
	October	6.4	8.2	7.0	4.4
	November	6.1	7.5	6.4	4.6
	December	6.0	7.7	6.0	4.5
2015	January	5.5	7.7	4.5	4.1
	February	5.6	8.7	3.3	4.1
	March	6.3	11.0	2.9	3.9
	April	7.1	13.4	1.5	4.0
	May	6.9	13.2	0.3	4.2
	June	7.0	13.4	0.2	4.4
	July	6.6	12.1	0.6	4.4
	August	5.8	9.9	1.1	4.3
	September	6.0	9.8	1.5	4.4
	October	6.7	11.3	2.0	4.4
	November	7.3	12.7	2.3	4.2
	December	8.0	13.3	2.9	5.1
2016	January	7.8	12.7	2.9	5.4
	February	7.1	10.8	3.2	5.2
	March	6.5	9.4	2.1	5.4
	April	5.3	6.8	2.0	5.2
	May	5.0	6.6	1.8	4.7
	June	5.8	8.9	1.4	4.5
	July	6.4	10.8	0.9	4.4
	August	6.3	10.9	0.1	4.6
	September	6.3	10.9	0.2	4.6

Source: World Bank, based on data from Kenya National Bureau of Statistics.

Table 6: Tea production and exports

Year	Month	Production MT	Price K Sh/Kg	Exports MT	Exports value K Sh million
2014	January	44,970	236	38,652	8,784
	February	33,774	203	33,514	7,317
	March	33,336	187	37,642	7,938
	April	39,975	188	37,439	7,782
	May	41,186	179	36,216	7,380
	June	31,945	178	39,011	7,692
	July	30,790	200	42,393	8,468
	August	26,756	191	38,121	7,974
	September	33,321	178	35,961	7,244
	October	45,368	180	37,637	7,444
	November	38,614	182	38,275	7,595
	December	45,071	182	41,631	8,379
2015	January	41,653	212	40,970	8,485
	February	24,276	221	41,086	9,313
	March	15,688	250	35,700	8,796
	April	23,837	258	28,262	7,189
	May	37,523	297	27,016	7,506
	June	32,286	319	35,915	11,263
	July	30,942	344	30,623	10,146
	August	28,410	330	27,687	9,481
	September	36,484	327	33,528	11,413
	October	41,343	333	40,246	13,538
	November	40,382	313	36,714	12,126
	December	46,387	309	42,779	13,768
2016	January	50,308	279	36,575	11,013
	February	43,969	253	43,287	12,199
	March	45,330	234	37,571	9,887
	April	37,571	214	39,313	9,517
	May	36,573	223	44,901	10,658
	June	35,603	243	52,175	12,613

Source: Kenya National Bureau of Statistics.

Table 7: Coffee production and exports

Year	Month	Production MT	Price K Sh/Kg	Exports MT	Exports value K Sh million
2014	January	2,850	293	3,169	1,055
	February	5,382	399	3,078	1,118
	March	6,212	459	4,584	1,533
	April	6,611	393	4,858	2,013
	May	3,747	349	4,594	2,024
	June	2,860	358	4,587	2,007
	July	1,292	315	5,425	2,383
	August	3,214	381	3,313	1,474
	September	3,424	404	3,944	1,722
	October	2,801	423	3,618	1,645
	November	1,703	410	3,718	1,747
	December	2,354	414	2,551	1,192
2015	January	2,795	412	2,844	1,307
	February	4,837	489	2,884	1,339
	March	5,571	378	4,290	2,025
	April	3,714	310	3,948	1,901
	May	2,969	289	4,383	2,236
	June	0	0	4,220	2,068
	July	2,086	339	3,938	1,943
	August	3,286	371	3,991	1,790
	September	2,643	364	3,405	1,617
	October	1,768	320	4,400	2,019
	November	1,268	337	2,769	1,244
	December	1,282	435	2,528	1,092
2016	January	3,432	462	2,449	1,184
	February	5,220	486	3,277	1,636
	March	6,835	437	4,169	2,206
	April	4,513	340	4,804	2,540
	May	4,731	263	4,814	2,170
	June	1,747	268	4,983	2,369

Source: Kenya National Bureau of Statistics.

Table 8: Horticulture exports

Year	Month	Exports MT	Exports value K Sh million
2014	January	18,494	8,376
	February	19,640	7,729
	March	18,834	9,741
	April	20,569	6,636
	May	19,858	7,533
	June	18,237	6,536
	July	17,114	6,138
	August	16,459	5,203
	September	18,488	5,479
	October	19,638	7,380
	November	17,089	7,815
	December	15,825	5,517
2015	January	18,170	6,413
	February	20,599	7,892
	March	21,259	10,510
	April	21,410	6,223
	May	19,160	6,300
	June	16,904	5,140
	July	17,359	8,551
	August	16,175	5,824
	September	25,188	8,187
	October	22,179	9,905
	November	19,428	8,095
	December	20,179	7,399
2016	January	20,160	10,936
	February	22,335	10,163
	March	24,313	11,157
	April	25,931	8,639
	May	10,783	7,029
	June	20,157	10,311
	July	17,981	5,587

Source: Kenya National Bureau of Statistics.
Annex 9: Local electricity generation by source

Table 9: Local electricity generation by source

Year	Month KWh million	Hydro KWh million	Geo-thermal KWh million	Thermal KWh million	Total KWh million
2014	January	339	179	226	747
	February	270	145	257	674
	March	287	171	279	737
	April	308	170	240	717
	May	250	191	296	737
	June	263	221	246	730
	July	254	258	252	763
	August	294	247	224	765
	September	278	293	164	735
	October	279	339	157	775
	November	307	322	122	751
	December	282	382	94	758
2015	January	278	388	109	776
	February	230	352	121	703
	March	246	377	134	757
	April	264	359	121	744
	May	301	380	103	784
	June	297	362	109	769
	July	305	353	143	801
	August	319	378	112	808
	September	306	389	99	794
	October	310	402	100	812
	November	300	393	89	782
	December	307	387	92	786
2016	January	322	392	93	808
	February	297	392	95	784
	March	335	383	112	830
	April	303	394	102	800
	May	334	403	92	830
	June	348	342	113	803
	July	337	393	110	840

Source: Kenya National Bureau of Statistics.

Table 10: Soft drinks, sugar, galvanized sheets and cement production

Year	Month	Soft drinks litres (thousands)	Sugar MT	Galvanized sheets MT	Cement MT
2014	January	39,007	64,298	22,090	454,960
	February	39,146	60,044	18,573	442,636
	March	40,320	63,365	21,267	478,416
	April	37,885	47,279	25,989	468,022
	May	40,430	44,094	27,433	464,695
	June	28,706	42,866	24,465	464,929
	July	33,790	55,912	21,779	503,428
	August	33,404	50,140	25,733	492,801
	September	35,899	47,915	26,126	499,479
	October	41,601	42,197	26,732	553,186
	November	40,134	34,455	25,763	545,041
	December	49,142	64,298	18,539	492,944
2015	January	45,282	63,227	21,304	511,298
	February	40,021	57,917	20,078	465,471
	March	50,388	63,389	22,797	550,556
	April	39,699	46,280	20,674	537,452
	May	40,185	44,081	23,132	516,513
	June	35,381	46,098	20,358	516,185
	July	38,720	47,957	18,415	570,904
	August	34,994	54,089	20,871	553,929
	September	44,450	61,069	20,581	561,235
	October	42,226	56,360	26,024	557,589
	November	39,297	43,401	25,764	510,747
	December	44,467	48,089	16,938	486,306
2016	January	37,670	64,499	21,330	532,729
	February	38,771	59,863	20,102	533,773
	March	43,454	65,909	20,120	540,792
	April		48,800		535,147
	May		45,122		546,899
	June				536,471

Source: Kenya National Bureau of Statistics.

Table 11: Tourism arrivals

Year	Month	JKIA	MIA	TOTAL
2014	January	75,906	19,853	95,759
	February	50,270	18,334	68,604
	March	76,561	15,041	91,602
	April	59,357	7,293	66,650
	May	54,334	3,967	58,301
	June	42,549	4,758	47,307
	July	78,902	7,764	86,666
	August	82,465	10,962	93,427
	September	53,743	6,778	60,521
	October	52,606	6,323	58,929
	November	51,480	7,153	58,633
	December	65,427	9,570	74,997
2015	January	40,846	10,107	50,952
	February	45,141	7,882	53,053
	March	66,121	6,958	73,079
	April	49,933	4,020	53,953
	May	50,764	2,511	53,275
	June	59,867	3,218	63,146
	July	72,515	5,728	78,243
	August	63,332	7,546	70,878
	September	54,162	5,114	59,276
	October	66,441	6,049	72,490
	November	53,622	7,718	61,340
	December	50,015	9,070	59,085
2016	January	66,185	9,407	75,592
	February	62,856	9,983	72,839
	March	49,996	8,551	58,547
	April	51,311	3,869	55,180
	May	59,294	3,578	62,872

Source: Kenya National Bureau of Statistics.

Table 12: New vehicles registration

Year	Month	All body types (number)
2014	January	15,411
	February	17,779
	March	15,629
	April	12,789
	May	14,109
	June	14,011
	July	16,490
	August	32,401
	September	24,390
	October	17,214
	November	17,226
	December	20,608
2015	January	15,366
	February	17,409
	March	25,067
	April	20,730
	May	22,837
	June	25,070
	July	21,132
	August	17,380
	September	18,596
	October	18,740
	November	23,209
	December	22,308
2016	January	14,690
	February	12,771
	March	10,280
	April	13,693

Source: Kenya National Bureau of Statistics.

Table 13: Exchange rate

Year	Month	USD	UK pound	Euro
2014	January	86.2	142.0	117.5
	February	86.3	142.8	117.8
	March	86.5	143.8	119.6
	April	86.7	145.1	119.8
	May	87.4	147.3	120.1
	June	87.6	148.1	119.2
	July	87.8	150.0	118.9
	August	88.1	147.2	117.4
	September	88.8	145.0	114.7
	October	89.2	143.7	113.2
	November	90.0	142.0	112.3
	December	90.4	141.5	111.5
2015	January	91.4	138.5	106.3
	February	91.5	140.2	103.9
	March	91.7	137.5	99.4
	April	93.4	139.6	100.7
	May	96.4	149.1	107.5
	June	97.7	152.2	109.7
	July	101.2	157.5	111.4
	August	102.4	159.8	114.1
	September	105.3	161.5	118.2
	October	102.8	157.4	115.3
	November	102.2	155.4	109.8
	December	102.2	153.3	111.1
2016	January	102.3	147.5	111.1
	February	101.9	145.9	113.0
	March	101.5	144.2	112.6
	April	101.2	144.8	114.8
	May	100.7	146.3	114.0
	June	101.1	144.3	113.7
	July	101.3	133.4	112.1

Source: Central Bank of Kenya.

Table 14: Interest rates

Year	Month	Short-term			Long -term			
		Interbank	91-Treasury bill	Central bank rate	Average deposit rate	Savings	Overall weighted lending rate	Interest rate spread
2014	January	10.4	9.3	8.5	6.6	1.6	17.0	10.5
	February	8.8	9.2	8.5	6.6	1.5	17.1	10.5
	March	6.5	9.0	8.5	6.6	1.6	16.9	10.3
	April	7.4	8.8	8.5	6.5	1.5	16.7	10.2
	May	7.8	8.8	8.5	6.4	1.5	17.0	10.6
	June	6.6	9.8	8.5	6.6	1.5	16.4	9.8
	July	8.1	9.8	8.5	6.6	1.3	16.9	10.3
	August	11.8	8.3	8.5	6.5	1.5	16.3	9.8
	September	7.4	8.4	8.5	6.6	1.5	16.0	9.4
	October	6.8	8.7	8.5	6.6	1.6	16.0	9.4
	November	6.9	8.6	8.5	6.7	1.5	15.9	9.2
	December	6.9	8.6	8.5	6.8	1.8	16.0	9.2
2015	January	7.1	8.6	8.5	6.7	1.6	15.9	9.3
	February	6.8	8.6	8.5	6.7	1.5	15.5	8.8
	March	6.9	8.5	8.5	6.6	1.5	15.5	8.8
	April	8.8	8.4	8.5	6.6	1.9	15.4	8.8
	May	11.2	8.3	8.5	6.6	1.5	15.3	8.7
	June	11.8	8.3	10.0	6.6	1.9	16.1	9.4
	July	12.9	10.6	11.5	6.3	1.4	15.8	9.4
	August	18.8	11.5	11.5	6.9	1.5	15.7	8.8
	September	19.9	14.6	11.5	7.3	1.7	16.8	9.5
	October	14.8	21.7	11.5	7.5	1.7	16.6	9.0
	November	8.8	12.3	11.5	7.4	1.3	17.2	9.8
	December	7.3	9.8	11.5	8.0	1.6	18.3	10.3
2016	January	6.1	11.4	11.5	7.5	1.6	18.0	10.4
	February	4.5	10.6	11.5	7.5	1.4	17.9	10.4
	March	4.1	8.7	11.5	7.2	1.3	17.8	10.6
	April	4.0	8.9	11.5	6.7	1.4	17.9	11.2
	May	3.8	8.2	10.5	6.4	1.7	18.1	11.7
	June	4.6	7.3	10.5	6.8	1.6	18.2	11.4

Source: Central Bank of Kenya.

Table 15: Credit to private sector

Year	Month	Total private sector annual growth rates	Agricul-ture	Manu-factur-ing	Trade	Building and con-struc-tion	Trans-port and commu-nication	Finance and in-surance	Real estate	Mining and quarry-ing	Private house-holds	Con-sumer durables	Business services	Other activi-ties
2014	January	20.5	-1.1	12.8	18.6	0.1	23.1	-13.6	23.3	-16.3	35.6	20.2	50.1	24.6
	February	21.5	3.4	16.8	20.2	5.4	31.2	12.1	24.0	-14.0	30.9	20.4	48.1	15.1
	March	22.7	7.7	17.3	25.2	2.0	44.8	39.0	28.4	-8.6	44.0	22.5	45.5	-14.6
	April	23.9	16.1	22.8	24.5	4.4	45.4	31.2	33.2	5.9	35.2	21.8	51.0	-15.5
	May	25.0	16.7	28.5	25.4	10.7	50.1	26.5	31.6	9.2	24.7	22.0	44.0	-3.4
	June	25.8	17.9	31.7	24.4	15.1	44.3	31.2	27.5	30.7	28.3	20.6	38.2	3.0
	July	25.5	18.8	27.5	25.9	9.4	42.3	37.8	30.8	24.3	30.2	20.3	36.5	1.8
	August	24.5	20.9	27.0	25.1	10.8	46.1	42.6	29.4	19.6	27.8	18.4	31.7	-0.2
	September	24.5	30.8	35.2	20.7	11.8	43.8	40.4	36.5	-0.5	23.8	16.4	44.1	-12.3
	October	23.6	36.8	32.7	18.7	10.3	45.4	75.1	35.7	3.5	38.0	11.4	27.5	-24.8
	November	22.2	32.1	29.8	19.7	11.3	45.2	66.9	31.6	1.9	38.9	12.4	28.9	-29.9
	December	22.2	27.9	30.7	21.2	13.6	45.6	68.4	32.4	-15.8	39.1	18.7	25.0	-32.3
2015	January	21.8	25.2	30.1	19.8	17.6	43.0	76.1	33.4	-3.8	35.2	14.2	24.8	-31.3
	February	20.7	24.7	27.5	21.5	11.6	38.6	79.6	29.1	-16.2	38.7	15.3	19.3	-31.4
	March	19.6	22.3	21.1	18.8	12.7	31.3	47.5	19.6	-20.1	28.0	12.4	27.8	-8.9
	April	19.9	20.8	21.6	23.6	12.6	32.3	49.2	17.7	-17.1	29.5	13.1	19.7	-8.9
	May	20.9	20.5	25.8	23.0	14.5	27.0	50.8	21.3	-13.7	31.5	11.6	16.4	-3.9
	June	20.5	24.0	20.0	25.9	15.5	33.8	43.3	19.4	-22.1	31.2	21.6	15.8	-11.1
	July	21.2	28.5	22.3	26.7	19.8	33.4	46.8	15.5	-17.9	28.6	21.5	25.3	-12.6
	August	21.0	28.7	25.3	25.9	22.1	30.0	50.5	15.0	-18.0	28.5	21.0	22.5	-14.2
	September	20.8	21.4	19.3	29.7	27.9	29.0	45.7	12.5	-5.4	26.6	19.0	15.9	-0.9
	October	19.5	17.2	20.2	23.6	37.6	32.1	26.4	9.8	-15.5	18.2	18.0	24.1	8.6
	November	18.7	12.5	20.8	22.2	34.0	32.3	28.5	10.6	-22.8	16.7	15.3	19.3	14.6
	December	18.0	14.1	16.2	21.3	30.7	26.5	0.0	6.2	-11.3	9.1	14.3	63.5	-1.0

Year	Month	Total private sector annual growth rates	Agriculture	Manufacturing	Trade	Building and construction	Transport and communication	Finance and insurance	Real estate	Mining and quarrying	Private households	Consumer durables	Business services	Other activities
2016	January	17.0	20.1	16.1	25.9	25.0	28.9	19.4	6.2	-9.3	15.1	16.0	17.8	8.2
	February	16.0	23.5	18.8	23.1	20.0	26.3	18.0	7.4	1.7	12.7	13.2	19.6	-0.4
	March	15.5	20.1	21.2	22.1	23.5	21.1	19.5	12.5	10.4	10.7	13.9	14.9	-7.7
	April	13.5	17.0	15.0	18.6	22.7	18.6	23.1	13.4	5.3	10.8	11.8	7.7	-2.9
	May	10.9	22.3	11.8	17.3	16.1	16.3	14.4	8.0	10.6	8.4	11.6	10.4	-14.3
	June	8.7	15.2	12.2	11.3	12.9	13.8	15.0	10.1	6.5	6.1	3.2	6.4	-8.1

Source: Central Bank of Kenya.

Table 16: Money aggregate

	Growth rates (yoy)	Money supply, M1	Money supply, M2	Money supply, M3	Reserve money
2014	January	19.9	16.7	17.1	10.3
	February	20.3	17.8	16.2	9.9
	March	20.4	19.0	17.3	7.7
	April	16.9	16.1	16.6	17.7
	May	19.9	18.4	17.8	11.9
	June	21.3	18.8	18.2	12.6
	July	18.9	18.8	19.3	7.3
	August	21.0	20.0	21.8	15.2
	September	12.6	17.1	19.4	11.2
	October	12.9	18.4	18.9	13.5
	November	13.5	17.8	17.5	9.3
	December	13.2	18.6	16.7	18.5
2015	January	11.4	17.0	16.0	15.8
	February	10.0	17.2	18.6	22.9
	March	11.9	16.4	16.4	11.8
	April	13.4	17.2	17.3	12.0
	May	10.0	14.8	16.5	15.0
	June	9.6	16.4	18.6	14.9
	July	13.0	16.0	16.4	25.8
	August	10.5	14.3	14.0	2.9
	September	8.5	12.7	13.5	16.7
	October	11.7	14.0	13.9	24.5
	November	9.1	12.2	13.5	13.0
	December	9.3	12.8	14.1	3.3
2016	January	11.2	10.8	11.1	9.1
	February	9.9	9.8	9.1	-1.0
	March	10.9	10.5	11.0	16.1
	April	10.1	9.5	9.2	9.0
	May	12.4	9.5	8.3	7.6
	June	13.0	8.9	7.9	4.9

Source: Central Bank of Kenya.

Table 17: Mobile payments

	Month	Number of agents	Number of customers (Millions)	Number of transactions (Millions)	Value of transactions (Billions)
2014	January	114107	25.8	67.1	178.5
	February	115015	26.1	65.6	172.8
	March	116196	26.2	74.0	192.7
	April	116581	26.1	72.1	186.7
	May	117807	25.8	74.5	198.1
	June	120781	25.9	74.0	189.9
	July	122462	26.2	77.5	201.0
	August	124708	26.3	78.9	206.7
	September	124179	26.3	78.2	206.3
	October	128706	26.0	82.9	210.3
	November	121419	24.9	81.0	203.2
	December	123703	25.2	85.6	225.5
2015	January	125826	25.4	81.7	210.5
	February	127187	25.5	80.7	208.1
	March	128591	25.7	90.3	231.8
	April	129218	26.1	84.9	213.7
	May	129735	26.5	89.9	230.2
	June	131761	26.5	90.7	227.9
	July	133989	26.7	94.0	238.9
	August	136042	27.0	94.1	248.2
	September	138131	27.3	96.3	247.5
	October	140612	28.5	102.8	255.8
	November	142386	30.1	101.3	236.4
	December	143946	31.6	107.4	267.1
2016	January	146710	29.1	108.1	243.4
	February	148982	29.5	114.1	257.2
	March	150987	30.7	121.7	273.6
	April	153762	31.4	120.2	269.8
	May	156349	31.3	122.6	277.9
	June	162465	31.4	121.8	271.0

Source: Central Bank of Kenya.

Table 18: Nairobi stock exchange (20 share index) and the Dow Jones (New York)

	Month	Number of agents
2014	January	4856
	February	4933
	March	4946
	April	4949
	May	4882
	June	4885
	July	4906
	August	5139
	September	5256
	October	5195
	November	5156
	December	5113
2015	January	5212
	February	5491
	March	5248
	April	5091
	May	4787
	June	4906
	July	4405
	August	4176
	September	4173
	October	3869
	November	4016
	December	4041
2016	January	3773
	February	3862
	March	3982
	April	3990
	May	3828
	June	3641
	August	3179

Source: Nairobi Securities Exchange and New York Stock Exchange.

Table 19: Nominal and real exchange rate

Year	Month	NEER 2003=100	REER 2003=100
2014	January	116	62
	February	116	62
	March	117	62
	April	117	62
	May	118	62
	June	118	62
	July	118	62
	August	118	61
	September	118	61
	October	118	61
	November	118	61
	December	117	60
2015	January	117	59
	February	117	59
	March	116	58
	April	118	59
	May	122	60
	June	124	61
	July	127	63
	August	129	63
	September	132	64
	October	129	63
	November	127	62
	December	127	61
2016	January	126	59
	February	126	60
	March	126	60
	April	127	60
	May	126	59
	June	126	59

Source: Central Bank of Kenya.

Table 20: National Fiscal position

Actual (percent of GDP)	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16*
Revenue and grants	19.8	18.9	20.5	19.9	19.2	19.7	19.7	19.5	19.0
Total revenue	18.7	18.2	19.4	19.4	18.8	19.2	19.2	19.0	18.6
Tax revenue	17.1	17.0	17.9	17.7	17.1	17.2	18.1	17.7	17.6
Income tax	6.8	6.9	7.2	7.5	7.8	8.3	8.9	8.8	8.5
VAT	4.8	4.7	4.9	5.0	4.4	4.1	4.6	4.5	4.4
Import duty	1.4	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.2
Excise duty	2.7	2.6	2.5	2.3	2.0	1.9	2.0	2.0	2.1
Other revenues	1.4	1.4	2.0	1.5	1.6	1.7	1.3	1.3	1.3
Railway levy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Appropriation-in-aid	1.5	1.2	1.6	1.7	1.7	2.0	1.1	1.3	1.0
Grants	1.1	0.7	1.0	0.5	0.4	0.5	0.5	0.5	0.5
Expenditure and net lending	23.1	22.3	24.0	23.5	23.7	25.1	25.6	28.2	26.9
Recurrent	17.4	16.3	16.9	17.2	16.3	18.1	15.5	14.8	15.4
Wages and salaries	6.3	5.8	5.7	5.8	5.5	6.1	5.5	5.1	4.7
Interest payments	2.1	1.9	2.1	2.2	2.1	2.7	2.7	3.0	3.3
Development and net lending	5.7	6.0	7.1	6.4	7.4	6.8	6.3	8.8	6.9
Transfer to counties	0.0	0.0	0.0	0.0	0.0	0.2	3.8	3.9	4.0
Parliamentary service	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.4	0.3
Judicial service	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.2	0.2
Fiscal balance									
Deficit excluding grants (commitment basis)	-4.4	-4.0	-4.6	-4.2	-4.9	-5.8	-6.4	-9.2	-8.4
Deficit including grants (commitment basis)	-3.3	-3.4	-3.6	-3.6	-4.5	-5.4	-5.9	-8.7	-7.9
Deficit including grants (cash basis)	0.3	-4.4	-5.8	-3.4	-4.5	-5.4	-5.9	-8.1	-7.2
Financing									

Actual (percent of GDP)	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16*
Foreign	0.3	1.5	0.8	0.8	2.8	1.9	2.1	3.7	4.1
Domestic borrowing	-0.6	2.8	5.0	2.7	1.6	3.8	4.0	4.4	3.1
Public debt to GDP (net)	33.4	35.4	36.6	39.1	37.0	38.5	43.7	44.8	48.9
External debt	19.1	20.2	18.9	21.0	19.6	18.7	22.2	24.5	27.5
Domestic debt	18.6	19.5	21.9	22.2	21.5	23.3	25.3	24.4	27.6
Memo:									
GDP (Calendar year current market prices, KSh billions)	2,483	2,864	3,169	3,726	4,261	4,745	5,398	6,224	
GDP (Fiscal year current market prices, KSh billions)	2,317	2,673	3,017	3,448	3,994	4,503	5,072	5,811	6,566

Source:Quarterly Budget and Economic Review, August 2016 (National Treasury)
**Provisional*

Table 19: County Fiscal Framework

Year	2013-14		2014-15		2015-16	
	Budget	Actual	Budget	Actual	Budget	Actual
Expenditure	228.6	169.4	326.2	258.9	361.1	
Development	123.4	36.6	144.9	90.4	160.7	
Recurrent	165.2	132.8	181.3	167.5	200.4	
Revenue	280.8	224	338.1	304.2	373.7	
Equitable Share	213.4	193.4	242.4	226.7	259.7	
Equalization Fund	190		226.7			
Local revenue	67.4	26.3	50.4	33.9	56.6	
Grants			16.5	2.57	27.2	
Conditional Grants			15.8	1.87	25.9	
DANIDA Grant[1]			0.7	0.7	0.8	
World Bank[2]					0.5	
Balance brought forward		4.3	38.1	41.7	30.2	
Balance	-7.8	54.6	17.9	46.2	12.6	
Pending Bills (as of end-June)				37.6		

Source: The Office of the Controller of Budget
[1] DANIDA Grant to supplement financing for county health facilities
[2] World Bank Grant to supplement financing of county health facilities

Table 22: 12-months cumulative balance of payments

BPM6 Concept (US$ million)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015*
A. Current Account, n.i.e.	-505	-796	-1821	-1713	-2371	-3821	-4205	-4838	-5998	-4325
Merchandise A/C	-3243	-4222	-5593	-4952	-6216	-8355	-9315	-10243	-11319	-9580
Goods: exports f.o.b.	3509	4153	5067	4526	5248	5834	6212	5846	6219	5982
Goods: imports f.o.b.	6752	8375	10659	9479	11464	14189	15527	16089	17538	15563
Oil	1745	1919	3051	2192	2673	4082	4081	3838	4026	2500
Services	1013	1263	1377	1084	1744	1994	2602	2926	2405	2329
Services: credit	2431	2938	3260	2904	3789	4131	4990	5130	5066	4496
Services: debit	1418	1675	1883	1820	2045	2138	2387	2204	2662	2167
Income	1725	2162	2395	2156	2101	2540	2507	2479	2916	2926
B. Capital Account, n.i.e.	168	157	94	261	240	235	235	158	275	257
C. Financial Account, n.i.e.	-677	-2247	-1423	-3782	-3252	-3425	-5542	-5183	-7008	-5070
Foreign Direct Investments	-27	-1001	-384	-1452	-1117	-1364	-1142	-920	-1045	-1088
Private Investments (Medium and Long-term)	21	16	25	-81	-156	1	-218	-273	-3716	156
Official Investments (Medium and Long-Term)	-671	-1262	-1064	-2249	-1979	-2062	-4182	-3990	-2248	-4139
D. Net Errors and Omissions	235	-805	-189	-1215	-947	-734	-348	-134	168	-1256
E. Overall Balance	-575	-802	493	-1115	-174	896	-1223	-369	-1453	255
F. Reserves and Related Items	575	802	-493	1115	174	-896	1223	369	1453	-255
Reserve assets	618	941	-480	1322	154	246	1455	859	1333	-361
Credit and loans from the IMF	-6	116	-17	199	-34	284	193	177	-119	-107
Exceptional financing	48	23	30	8	13	858	38	312	0	0
Gross Reserves (USD Million)	3331	4557	4641	5064	5123	6045	7160	8483	9738	9794

Official	2415	3355	2875	3847	4002	4248	5702	6560	7895	7534
Commercial Banks	916	1202	1765	1217	1121	1797	1458	1923	1843	2259
Imports cover (calender year)	3.5	4.0	2.8	4.1	3.6	3.1	3.8	4.3	4.7	5.1
Import cover (36 mths imports)	3.9	4.4	3.1	3.9	3.9	3.4	4.0	4.3	4.9	4.8
Memo:										
Annual GDP at Current Prices (USD Million)	25,826	31,958	35,895	37,022	40,000	41,953	50,411	55,101	61,395	63,398

Source: Central Bank of Kenya.

Table 23: Growth Outlook

Annual growth (percent)	2014	2015	2016e	2017f	2018f
BASELINE					
GDP					
Revised projections	5.3	5.6	5.9	6.0	6.1
Previous projections (KEU 13)	5.3	5.6	5.9	6.1	6.2
Previous projections (KEU 12)	5.3	5.4	5.7	6.1	
Private consumption	4.6	5.3	5.9	6.4	6.6
Government consumption	6.0	15.4	6.3	7.3	5.6
Gross fixed capital investment	14.8	5.2	5.7	6.7	6.7
Exports, goods and services	5.3	-0.9	0.1	5.2	6.0
Imports, goods and services	10.6	-1.2	6.2	7.6	7.6
Agriculture	3.5	5.6	5.6	5.4	5.4
Industry	6.5	6.9	5.7	5.7	5.6
Services	5.8	5.5	5.6	6.2	6.6
Current account balance, % of GDP	-9.8	-6.8	-5.6	-6.1	-7.0
Fiscal balance, % of GDP	-7.0	-8.3	-8.8	-7.8	-7.4

Source: World Bank.
Note: e(estimate); f(forecast)

Beyond Resilience

Increasing Productivity of Public Investments

Kenya is one of the bright spots in the Sub-Saharan Africa due to robust domestic demand, a stable macroeconomic environment, and the economic dividend from prevailing low oil prices. This report has four main messages:

First, for the eighth consecutive years, economic growth in Kenya will outperform the Sub-Saharan African average. The World Bank projects that Kenya's growth rate will reach and be sustained at around 6 percent in the medium term. Ongoing infrastructure investments will ease supply side constraints, lower the cost of doing business and boost Kenya's competitiveness. At the same time growth in private consumption is fueled by a surge in remittances, an emerging middle class and the demographic divided. These two levers of growth—infrastructure investment and private consumption—will benefit from a stable macroeconomic environment characterized by low inflation and currency stability.

Second, Kenya's economy remains vulnerable to risks that could derail the growth momentum. Domestically the recent capping of interest rates could lead to unintended consequences and election related spending could result in fiscal slippage. Adverse la nina climatic conditions could curtail agricultural growth prospects which remain largely weather dependent. In the external sector, subdued global demand could dampen the demand for Kenya's exports, while volatility in global financial markets could trigger destabilizing capital outflows.

Third, the report argues that reforms to address systemic weaknesses in the Public Investment Management (PIM) are warranted. The identified PIM system improvements can enhance the execution of infrastructure projects which in turn can accelerate the catalytic impact of public investment on economic growth.

Fourth, the report argues that there is urgent need to address challenges related to land acquisition, compensation and Resettlement Action Plans (RAPs), which lead to significant delays and cost escalation in the execution of public infrastructure projects.

As in the past, we are proud to have worked with many key Kenyan stakeholders during the preparation of this report. We hope that you too will join us in debating topical policy issues that can contribute to fostering growth, shared prosperity and poverty reduction in Kenya.

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