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KENYA ECONOMIC UPDATE

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Kazi ni kazi
Informal should not be normal

WORLD BANK GROUP

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Informal should not be normal

Cover Photos

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Table of Contents

LIST OF FIGURES

LIST OF TABLES

LIST OF BOXES

Abbreviations and Acronyms

AGOA	African Growth and Opportunity Act
BOP	Balance of payments
CA	Communication Authority of Kenya
CBK	Central Bank of Kenya
CBR	Central Bank Rate
COMESA	Common Market for Eastern and Southern Africa
CPI	Corruption Perception Index
DANIDA	Danish International Development Agency
DSA	Debt Sustainability Analysis
EAC	East Africa community
EU	European Union
FDI	Foreign Direct Investments
FERFA	Foreign Exchange Rate Fluctuations Adjustments
FY	Fiscal Year
GDP	Gross Domestic Product
ICT	Information Communication Technology
IFC	International Finance Corporation
IMF	International Monetary Fund
KENGEN	Kenya Electricity Generating Company
KEU	Kenya Economic Update
KNBS	Kenya National Bureau of Statistics
MPO	Macro Poverty Outlook
MW	Mega Watts
NSE	Nairobi Securities Exchange
OECD	Organization for Economic Co-operation and Development
SCT	Single Custom Territory
SMS	Short Message Service
SSA	Sub-Saharan Africa
STEP	Skills towards Employment and Productivity
USA	United States of America
USD	US Dollar
VAT	Value Added Tax
WARMA	Water Resource Management
WDI	World Development Indicators

Foreword

It is my pleasure to present to you the thirteenth edition of the World Bank's Kenya Economic Update. This economic update reviews economic performance in Kenya in the context of changing trends in the global economy: low commodity prices, the monetary policy in the US which has seen a strengthening of the US dollar, and the cooling and rebalancing of the Chinese economy. This report has three main messages:

First, Kenya experienced strong economic performance in 2015 despite global turbulence. Indeed, in the recent years Kenya's growth has exceeded the average for the countries in Sub Sahara Africa. Growth is projected to reach 6 percent in the medium term underpinned by low oil prices, good agriculture performance, supportive monetary policy that is expected to contain inflation within policy bounds, and the ongoing infrastructure investments.

Second, Kenya's economy remains vulnerable to risks that could derail the growth momentum. The forthcoming elections could see a slowdown in growth momentum through two channels; first is the risk that investors defer investment decisions until after the elections; second, that election related expenditure delay the much needed fiscal consolidation and/or see a cut back in infrastructure spending. Security remains a threat not just in Kenya but globally. Finally, changes in the US monetary policy could trigger volatility in financial markets putting the currency under pressure. Overall the prevailing global market conditions call for a more stringent fiscal policy to preserve buffers and will require a mixture of fiscal consolidation, enhanced revenue mobilization and measures to increase efficiency of spending.

Third, Kenya is not short of jobs; it is short of high productivity jobs. Kenya's economy is creating more jobs now than in the past, but these are mainly in the informal services sector and are low productivity jobs. In the next ten years nine million youth will join the labor market and given the scarcity of formal sector jobs, the youth will continue to find jobs in the small household enterprises. To improve productivity of these jobs policy interventions could be geared towards increasing access to broad skills beyond formal education, creating linkages between formal and informal firms, and helping small scale firms enter local and global value chains. Furthermore, to create more and better jobs, it is also imperative to reduce the cost of doing business which is necessary for a robust private sector.

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 policy issues that are topical in Kenya today, and in making your contribution to helping Kenya to grow, and to achieve a permanent reduction in poverty.

Diariétou Gaye
Country Director for Kenya

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Partnership with key Kenyan policy makers was instrumental in the production of this report. On March 23, 2016, a draft of the report was presented at the 19th Quarterly Economic Roundtable. The meeting was attended by senior officials from the National Treasury, the Central Bank of Kenya, the Kenya School of Monetary Studies, the Commission on Revenue Allocation, the Office of the Controller of Budget, the National Economic and Social Council, the Ministry of Planning and Devolution, the Council of Governors and the Centre for Parliamentary Studies and Training.

Summary

__This update comes in the wake of three game changing and mutually reinforcing trends.__ First, monetary policy in the US will determine the direction of capital flows and currency stability. Second, the persistent decline in commodity prices will determine winners and losers and third, the cooling and rebalancing of the Chinese economy is likely to see a recalibration and change in the direction of trade.

__Kenya's growth will depend on the net impact of these global trends on the one hand and the domestic policy response on the other.__ Kenya's current account deficit contracted, thanks to declining oil prices and rising tea export earnings. Appropriate monetary policy response, raising the central bank rate and modestly drawing down reserves, stabilized the shilling and contained inflation. Expansionary fiscal policy provided a stimulus and created jobs in the construction sector, but domestic deficit financing also led to a spike in lending rates as external lending conditions tightened and revenue shortfalls persisted.

__Growth in 2015 is estimated at 5.6 percent, and is projected to rise to 5.9 percent in 2016 and 6 percent in 2017.__ The positive outlook is predicated on infrastructure investments to gradually reduce supply side constraints. If realized, fiscal consolidation will ease pressure on domestic interest rates and increase credit uptake by the private sector. Complementary monetary policy will ensure continued private investments through stable interest rates while keeping inflation in check. The contraction of the current account deficit will continue, supported by prevailing global trends, and ease pressure on the external account and improve the net exports position. Risks to the outlook remain on the downside.

__The economy has created more jobs in the recent years, but these are low productivity mainly in the informal services sector and are not associated with higher value added.__ Unemployment and underemployment is still high in Kenya's urban areas. Labor productivity in Kenya is significantly higher in the formal than in the informal sector. Within the private formal sector, more productive and more established firms offer better job conditions and higher wages, but these opportunities are limited. Available data suggests that the conditions do not favour entrepreneurship and expansion, especially of more productive and competitive firms in the formal sector.

__In the next ten years, nine million youth will enter the labour market, a majority will continue to find jobs in the informal sector.__ Even in a scenario with rapid growth in the formal wage sector, formal firms will not create jobs for all young Kenyans. A majority will continue to find jobs in the small household enterprises, working for themselves or their family in the Jua Kali, the informal sector. A vast majority of these firms will remain very small with low levels of productivity.

To improve productivity of these jobs, policy interventions could be geared towards increasing access to broad skills beyond formal education, creating linkages between formal and informal firms, and helping small scale firms enter local and global value chains. *A transformation into more formal, higher productivity jobs will require a better trained labor force, a flexible skills development system that fosters basic generic skills. Policy interventions could help create linkages between formal and informal firms and connecting suppliers and customers; and connecting firms with technological solutions; and provides opportunities for acquiring labor market relevant technical skills is needed.*

To encourage private sector growth and create better jobs, the business environment must improve. *Comparing the World Bank's Enterprise Surveys from 2007 and 2013 suggest that the business climate is deteriorating. Firms in 2013 experienced higher financing costs, higher insecurity, and more unreliable access to infrastructure. Kenyan firms make 30 contributions a year, taking 201 staff hours to calculate, file, and pay their taxes. For traders, logistics are a major hindrance. On average, the procedures and documentation needed to import or export take 26 days; connecting to the power grid in Nairobi requires 6 steps, takes more than 5 months, and costs on average 10 times the Gross National Income (GNI) per capita.*

Finally, Kenya can leverage the changes in the global economy to recalibrate its trade as a platform for structural change and provide the impetus for higher levels of growth and creation of productive jobs. *Overall growth in exports to key traditional markets in EAC and Europe has been weak, averaging one percent since 2011.But new export markets have emerged, the Americas, Asia and Australia, growing at 12 and 10 percent respectively between 2010 and 2015. These markets offer hope for expanded production and therefore the creation of productive jobs. The rebalancing of the Chinese economy also holds great potential for expanding exports of consumer goods. However, a clear export strategy would be required if Kenya is to take full advantage of the new markets and expand exports to China.*

Overview

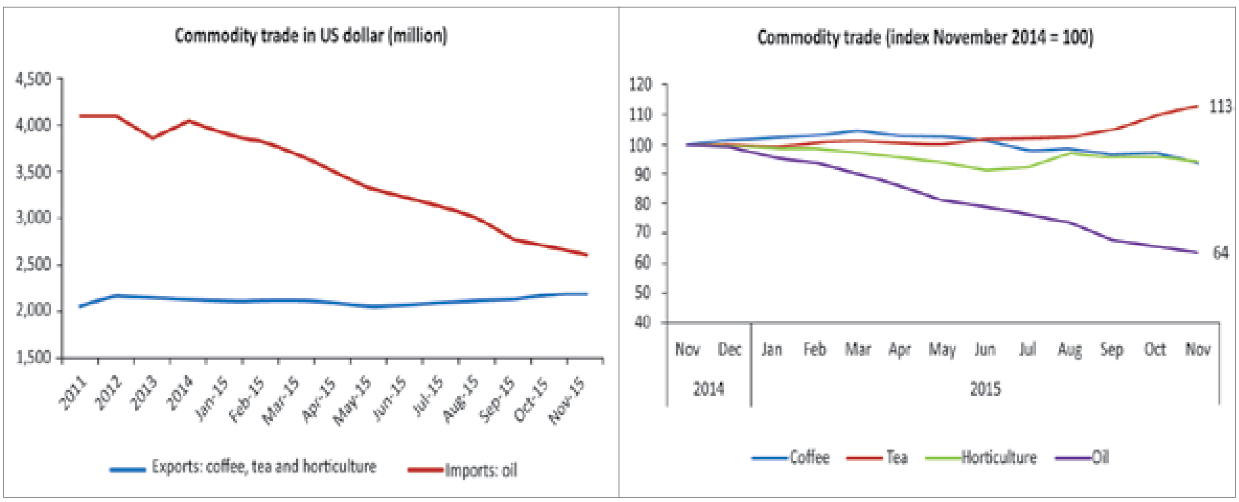
Three global factors that influence Kenya's economic environment and which have been discussed for some time are now in full force: industrialized countries monetary policy adjustment, the end of the commodity price boom, and rebalancing of the Chinese economy. This economic update reviews economic performance in Kenya in the context of these changing trends in the global economy. The cooling and rebalancing of the Chinese economy, the strengthening US dollar, and the spillover effects into the global economy through a softening of growth rates and subdued demand in Kenya's export markets will interact with domestic policy and conditions to determine Kenya's growth in the near term.

Kenya Reaped the Low Oil Price Dividend

Overall, Kenya reaped the dividend of low oil prices. The current account deficit contracted from 10 percent to 7 percent of GDP. This contraction was largely driven by the reduction in oil prices, which saw a gradual reduction in the value of oil imports by about 36 percent in 2015. At the same time, although commodity prices declined globally, tea export earnings increased by about 13 percent and offset the contraction in coffee and horticulture. Thus, Kenya emerged a net winner so far from the ongoing global volatility (figure 1).

Nevertheless, commodity price and currency volatility in the global markets subdued demand for Kenyan goods in the key destination markets, but the weaker shilling shored up earnings from exports outside the region in local currency. The currencies in the regional EAC and COMESA markets weakened against the dollar and the Kenya shilling. Consequently, Kenyan exports became more expensive in the regional markets and earnings declined;

Figure 1 | Coffee, tea and horticulture can now 'pay' for oil imports thanks to declining oil prices



Source: Authors computation from CBK data

Rwanda (-32%), Tanzania (-37%) and Uganda (-0.2%). But export earnings from two leading markets, UK and USA increased by 11.5 and 5.5 percent respectively and protected export earnings and offset the contraction in other markets.

contained inflation. For instance, while the Kenya shilling depreciated by 13 percent against the dollar in December 2015, the Tanzania and Uganda shillings depreciated by 24.4 and 6.6 percent respectively, and the South African Rand by 30.2 percent.

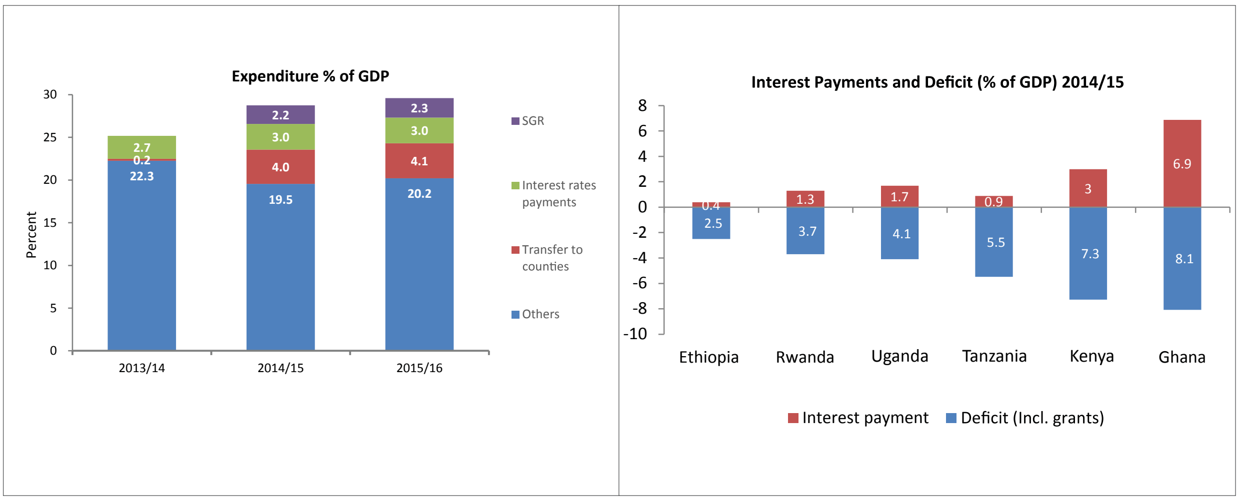
Appropriate monetary policy response moderated the impact of the global turbulence.

The strengthening of the US dollar and more recently the US Fed rate hike triggered volatility in the global financial markets. The response has seen a shift in gears in the management of monetary policy to contain the effects on inflation. In Kenya the Central Bank implemented a raft of policy measures that maintained confidence in the anti-inflation stance. These measures included: (i) raising the CBR rate from 8.5 to 11.5 percent; (ii) running down Forex reserves to cushion the shilling; (iii) publishing commercial bank lending rates to stem a hike in lending rates and; (iv) injecting money through reverse repo operations to ease tight liquidity conditions. Consequently, the Kenya shilling stabilized and contained inflation. For instance, while the Kenya shilling depreciated by 13 percent against the dollar in December 2015, the Tanzania and Uganda shillings depreciated by 24.4 and 6.6 percent respectively, and the South African Rand by 30.2 percent.

Tighter borrowing conditions and revenue shortfalls complicated fiscal management.

Tighter borrowing conditions in domestic and global markets and shortfalls in revenue targets exerted pressure through the expansionary fiscal stance (Figure 2). The Government resorted to domestic deficit financing in response to meet revenue shortfalls and the rising Eurobond yields in the range of 8-12 percent. Interest rate on government securities reached double digit leading to a spike in lending rates to the private sector. Fiscal pressure also saw a delay in exchequer releases to the county governments, and a spike in accumulation of arrears (pending bills, particularly by county governments) which has contributed to the rise in non-performing loans in the banking sector.

Figure 2 | Rising cost of borrowing, the SGR and Transfer to counties drive fiscal expansion



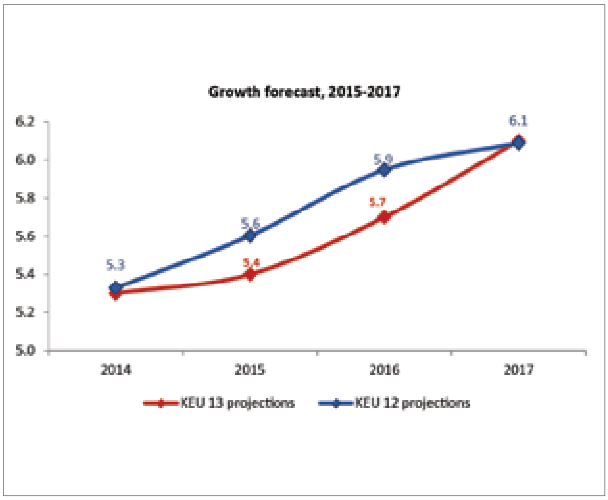
Source: The National Treasury

Source: World Bank Macro Poverty Outlook, 2016

The outlook remains positive

Against this backdrop the World Bank estimates growth in 2015 at 5.6 percent, an upward revision from 5.4 in the last KEU; growth is projected to rise to 5.9 and 6 percent through to 2017 (Figure 3). This performance can be attributed to four main drivers: (i) the decline in oil prices eased the pressure on the external account and improved the net exports position; (ii) good agriculture performance and supportive monetary policy which contained inflation within target; (iii) ongoing innovations in the ICT sector provided a platform for growth in services; and (iv) ongoing infrastructure investments stimulated growth and employment in the construction sector and the completion of energy projects resulted in a gradual reduction in the cost of electricity.

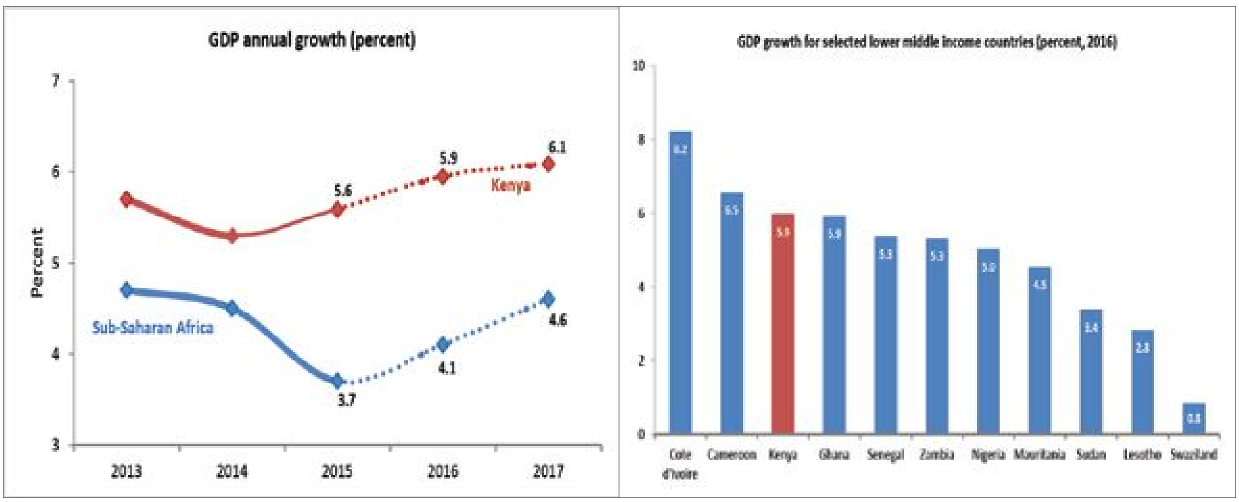
Figure 3 | World Bank revised Kenya growth projections upward



Source: World Bank

Growth will be driven by private consumption and investment as fiscal adjustment enables some crowding in of the private sector. Export performance will remain subdued as a result of declining commodity prices and as structural constraints to competitiveness of Kenyan products persist. Ongoing infrastructure investments will provide tapering fiscal stimulus. The planned fiscal consolidation and the shift from domestic to external financing for key infrastructure projects is expected to stem the rise in lending rates and increase access to credit for the private sector. Stable food supply and a stable macroeconomic environment will boost consumption.

Figure 4 | Growth momentum will be sustained to reach 6 percent, which is well above the average for SSA



Source: WDI and Macro Poverty Outlook.

However, this growth outlook is subject to substantial downside risks. These include security threats, the rebalancing of the Chinese economy, the subdued prices of coffee and tea. The recent hike in the US Fed rate could reverse the direction of short-term flows which finance Kenya's external account. The *'wait and see approach'* for the 2017 elections by private investors could slow down investment. Overall the prevailing global shocks call for a more stringent fiscal policy to preserve buffers and will require a mixture of fiscal consolidation, enhanced revenue mobilization and measures to increase efficiency of spending.

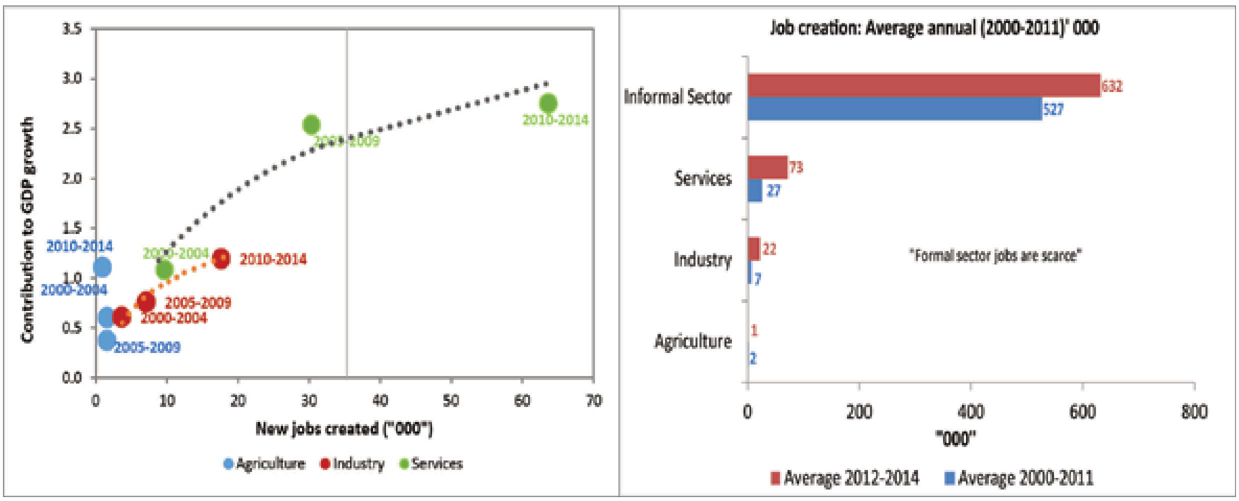
Kenya is not short of jobs; it is short of high productivity jobs

A majority of Kenyans, particularly youth, are locked in low productivity jobs, as the current growth model generates limited quality jobs. Figure 5 shows that the economy is creating more jobs now than in the past, but these are mainly in the informal sector. For instance the economy generated 800,000 jobs in 2014, compared to 650,000 in 2011. But about eighty percent of the new jobs are in the informal services sector. In the formal sector, only about eight percent new jobs are found in the services sector. There has been some progress in job creation in the industrial sector in the recent years. However in agriculture, which has in the past largely contributed to GDP growth, the sector has seen a net loss in jobs to the services sector. Sadly, although the service sector created jobs, productivity declined in the informal segment.

Services account for the highest growth in informal employment, enhancing productivity of these jobs can catalyze growth.

The question of job creation is intrinsically linked to productivity and competiveness of Kenyan firms in the global market. More productive and capital-intensive firms, firms investing in ICT, and exporting firms, offer a better contractual situation than others. Similarly, older and more productive firms tend to hire more permanent workers, and as such offer more job security. But such firms are few in Kenya and only constitute twenty five percent of non-agriculture employment. Economic growth can also emanate from existing jobs becoming

Figure 5 | There are more jobs created in the recent years, mainly in the informal services sector.



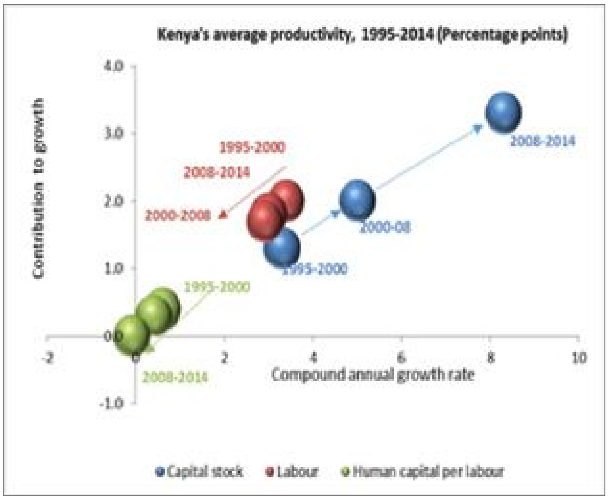
Source: Authors computation based on KNBS data.

more productive. Kenya's increase in value added has been driven by more employment rather than productivity of existing jobs. From Figure 6 below, while total factor productivity has been increasing over time, Kenya's growth has come mainly from growth in capital stock.

Young Firms Can Be Key Drivers of Labor Demand in Kenya

Firm creation is a pathway to productivity growth and employment creation. Young firms contribute disproportionately to job creation and much less to job destruction. However, creation of new firms and formalization of existing firms in Kenya is sluggish, curtailing growth prospects. For instance, young firms account for 35 percent of all firms in the US and 30 percent in OECD countries compared to only 10 percent in Kenya. Furthermore, more productive firms in Kenya do not create more jobs and the relationship between job creation and productivity in Kenya is negative. This is a worrying trend in the food and textile sectors, which are the main sources of employment in the manufacturing sector. Kenya's export performance in these sectors might explain the performance of these sectors.

Figure 6 | Many jobs have been created but were not associated with higher value added

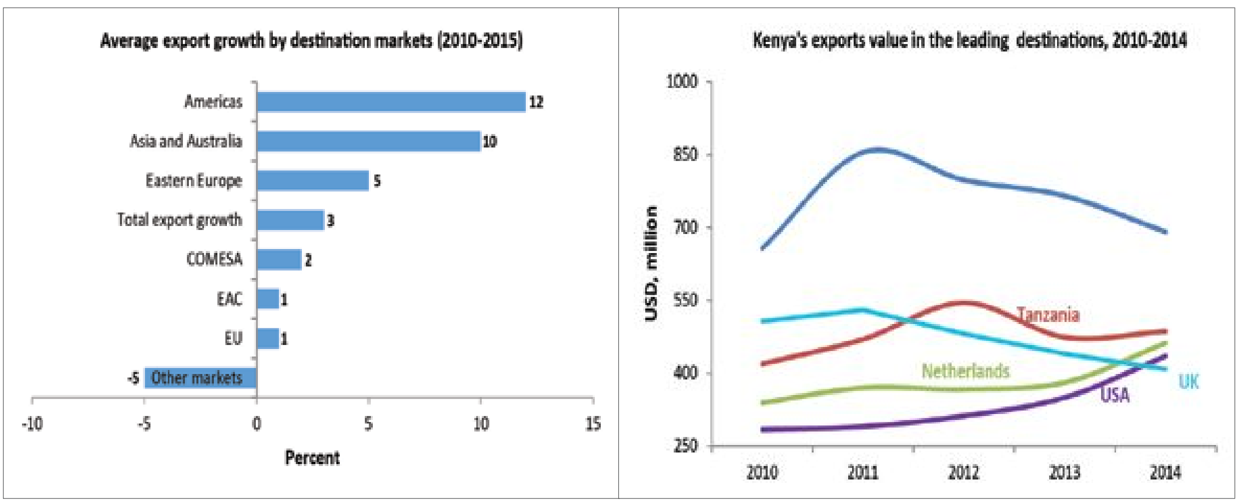


Source: World Bank Staff computations.

Leverage changes in the global economy to recalibrate trade, a path to structural transformation

Trade, productivity, growth and employment creation are intrinsically linked, yet Kenya is losing market share in its traditional and largest export markets (figure 5). Kenya can leverage the changes in the global economy to recalibrate its trade as a platform for structural change and provide the impetus

Figure 7 | Exports to traditional markets have stagnated but new markets have emerged



Source: Authors computation based on KNBS data for higher levels of growth and creation of productive jobs. Overall growth in exports to key traditional markets in EAC and Europe has been weak, at one percent (figure 5). This has been a declining trend in Kenya's largest export market, Uganda, as well as the UK, another significant trading partner, since 2011. Three factors explain the prevailing trends: (i) the weak growth in exports within the EAC coincides with start of the fully fledged EAC customs union, which terminated preferential access for goods produced under various export promotions schemes; (ii) the prevalence of non- tariff barriers to trade; (iii) and, economic slowdown notably in Egypt, UK and Malawi.

However, new export markets have emerged which offer hope for expanded production and therefore the creation of productive jobs. The Americas, Asia and Australia, have emerged as new export destinations, growing at 12 and 10 percent respectively between 2010 and 2015. Notably, trade with the USA now exceeds the UK and is largely driven by preferential access through AGOA. The rebalancing of the Chinese economy also holds great potential for export growth for countries that export consumer goods (see box on China in the main report). These new markets offer an opportunity for policy changes that could encourage productive job creation.

Productive jobs require a skilled labor force. Kenya has a relatively well-educated labor force, but a majority of adults remain functionally illiterate. Access to primary and secondary education in Kenya has expanded remarkably. However, despite higher access to schooling, a majority of adults in Kenya remain functionally illiterate. Even amongst those with tertiary level education, less than 25 percent achieve functional literacy. But the labor market requires more than just education; skills also matter.

Lack of training opportunities after school, undermines labor productivity in Kenya. There is a strong correlation between training and formal wage work. For instance workers who attend on the job training programs are more likely to use their cognitive skills on the job. But such opportunities are rare for the informal wage-worker, and more so for self-employed. As a survey undertaken in 2013 revealed 30 percent of formal wage workers had participated in a training course compared to only 7 percent of informal wage workers.

Connecting Jobs to People, and People to Jobs

Increase productivity in the informal sector and link the sector with formal firms. In the near term, many youth will continue to find jobs in the informal sector, mainly in household enterprises, and in the *jua kali* sector. Increasing productivity of these firms requires clear policy interventions. These include but are not limited to increasing their access to broad skills (such as business management, marketing and accounting), technology, credit and market. The support could also create linkages between formal and informal firms and connecting suppliers and customers and connecting firms with technological solutions. Help to small-scale enterprises might also include assisting them to enter into local, regional and global value chains. Increasing trade with the USA demonstrates that a targeted export strategy can go a long way in opening up new markets.

For existing firms, it is imperative to reduce the cost of doing business to increase their competiveness. Significant progress has been made to reduce the cost of doing business through infrastructure investments. Nevertheless, Kenyan firms still identify electricity and access to finance as obstacles to competitiveness. Compared with 2007, firms in 2013 experienced higher financing costs, higher insecurity, and more unreliable access to infrastructure; over 20 percent of firms in Kenya considered infrastructure, insecurity, customs and trade regulations, informal sector practices, and – importantly – the lack of skills, as major constraints to expanding their businesses.

To connect people to jobs will require specific policy interventions to match their risk profiles. Four clusters are identified for support: (i) **Market ready:** The first group is the male youth who are market ready and only require intermediation in the labor market. This group can be served through ICT tools given the high penetration in Kenya (ii) **Intensified action:** The second group are male youth working in low productivity jobs and have limited skills. This group can benefit through skills building and particularly on the job training to increase employability (iii) **Special support:** This group faces social barriers and comprises mainly female both rural and urban with low skills and married. This group requires support including child care in light of household responsibilities, (IV) **Hard to support:** The last group is hard to serve females who are largely unemployable, have little education and are engaged in household work. These require skills development, functional literacy as well as socio-emotional skills.

Photo: Charles Muiru Ngugi

State of the Economy

Recent Economic Developments

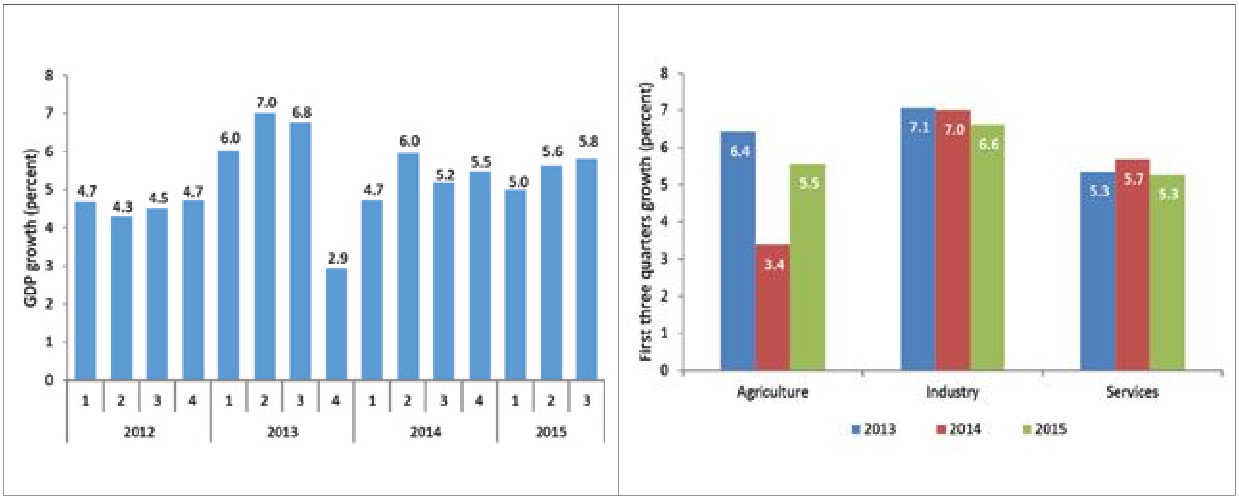
A Resilient Economy in Tough Times

The economy experienced solid growth in 2015 amid volatility in money and foreign exchange markets. *Kenya grew by 5.5 percent in the first three quarters with a rebound in agriculture, thanks to adequate rains. Industrial growth picked up, driven by all sub-sectors, but manufacturing slowed, while services remained robust despite a contraction in the tourism, accomodation and the food sub-sector.*

Kenya's economy grew by 5.5 percent in the first three quarters of 2015. Growth dynamics reflect continued payoffs from innovations in the ICT and financial sectors and the decline in global oil prices. The economy is estimated to have grown by 5.6 percent in 2015, 0.1 percentage point higher than in 2014, but 0.4 percentage points lower than World Bank's projection in the beginning of 2015. In the second and third quarters of 2015, Kenya, like other countries in the region, experienced exchange rate volatility, in response to continued strengthening of the U.S. dollar, and subsequent inflationary pressures from import prices. Against these headwinds, the CBK, on one hand, raised its policy rate in June and July and, on the other hand, intervened in the foreign exchange market which stabilized the currency in August. The strengthened macroeconomic environment supported economic resilience, as evidenced by solid growth at 5.6 percent and 5.8 percent in the second and third quarters, respectively.

Growth in the first three quarters of 2015 was underpinned by strong performance in all sectors. A rebounding agriculture sector (Figure 1.1) contributed significantly to this growth both through its direct production effect and pass-through to retail food prices. Agriculture's growth of 5.5 percent was supported by favorable climatic conditions that improved crop production, unlike in 2014 when the sector only grew by 3.4 percent. Industrial production picked up, driven by all sub-sectors except manufacturing. Industry expanded by 6.6 percent in the first three quarters of 2015 compared to 7.0 percent during the same period in 2014. Services growth was robust despite a slowdown in the tourism, accomodation and food sub-sector. The sector grew by 5.3 percent in the first three quarters of 2015, slightly lower than 5.7 percent in 2014.

Figure 1.1 | Kenya experienced economic resilience

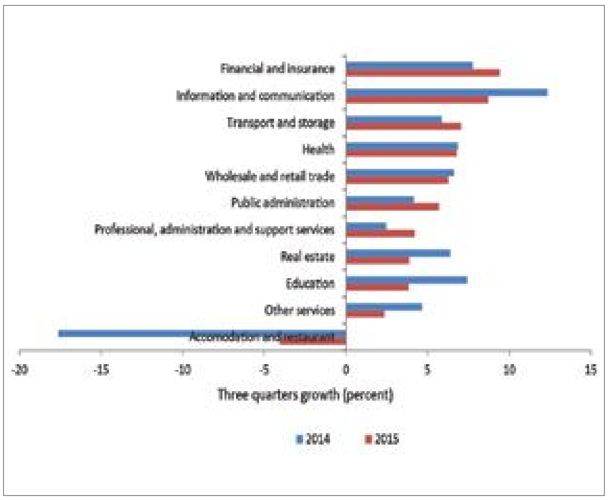


Source: KNBS

The Leading Economy Drivers

Information, communication and technology (ICT) is playing a great role in the services sector. Kenya hosts the largest ICT sector in Africa (World Bank, 2016)[1] with a significant contribution to value added (4.1 percent in 2014). The number of mobile phone subscription has increased to 37.8 million in September 2015, representing population coverage of 82.1 percent and 141.3 percent of total population above 15 years old. The number of Internet users and mobile money subscriptions also peaked (Figure 1.3a). Mobile payments have reduced the cost of money transfers, extended access by rural households, and have also been a source of employment. In the 12 months ending October 2015, the number of mobile money transfer customers reached 28.5 million (equivalent to 63 percent of the total population). The number of mobile money agents increased by 9.3 percent in the same period, from 128.7 thousand agents to 140.6 thousands; indicating 11.9 thousands new jobs were created (Figure 1.3b). The coverage and access of mobile services is expected to increase as competition increases in the sector. Equity Bank launched of a new platform (Equitel) for money transfer in July 2015, joining another six already existing.

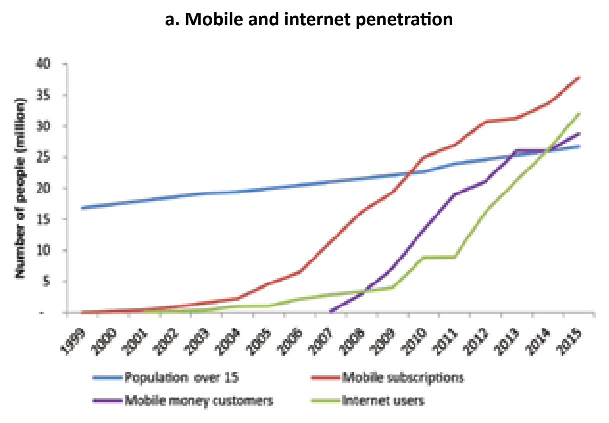
Figure 1.2 | Financial services and ICT led growth in the services sector

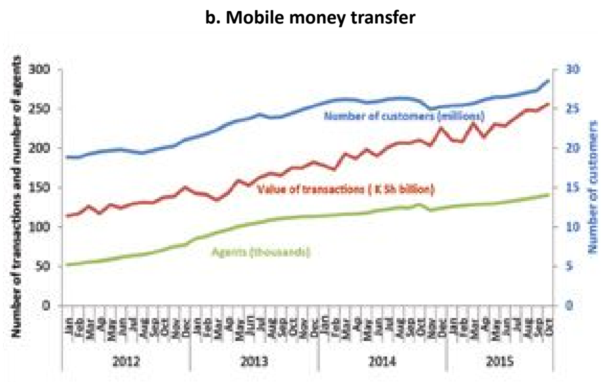


Source: World Bank Staff computations.

[1] World Bank. 2016. World Development Report 2016: Digital Dividends. Washington, DC: World Bank.

Figure 1.3 | Kenya is reaping the benefits of ICT development





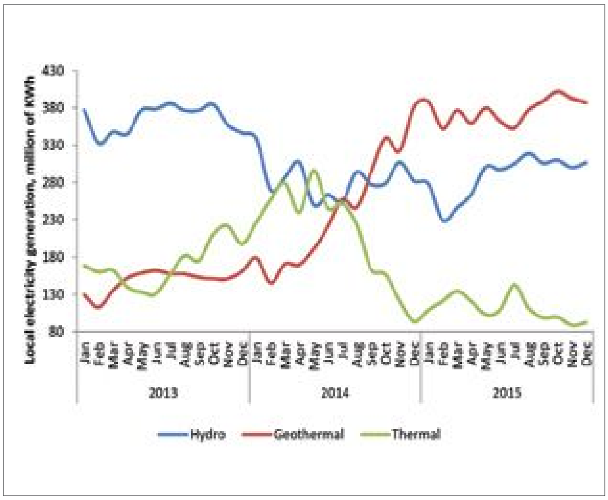
Source: Communications Authority of Kenya (CA) and CBK

Innovations in the ICT sector are also providing a platform for productivity growth in other sectors of the economy particularly financial services, education and trade. These sectors have maintained a growth rate of 8 percent and above on average in the last five years. However, manufacturing, the second largest sector after agriculture, has been experiencing sluggish growth and its contribution to GDP has gradually declined. The declining cost of electricity as supply increased also provided a growth stimulus to the real sectors of the economy.

Financial services activity increased in 2015 (Figure 1.2). Despite the volatility in money market in the third quarter, financial and insurance services grew by 9.4 percent in the first three quarters of 2015. Growth was outstanding in all the three quarters of 2015, at 10.4 percent, 7.6 percent and 10.1 percent respectively. This was supported by a significant increase in credit to government by commercial bank in response to a revenue shortage in September 2015.

Electricity generation accelerated to 9.9 percent in 2015 as new projects were completed. This growth is almost double the 5.2 percent recorded in 2014. This remarkable growth comes as domestic electricity generation increased due to two main factors. First, hydropower generation rose, supported by adequate rainfall in 2015. Second, recent government investments in energy (geothermal power) have started to pay off. Geothermal power generation expanded by 32.6 percent in September 2015, and has taken the lead, contributing 49 percent of total electricity generation (Figure 1.4). Hydropower went up by 10.3 percent while conventional thermal contracted by 39.6 percent. This has led to a decline in electricity tariffs (Box 1.1).

Figure 1.4 | Electricity sector experienced astounding growth



Source: World Bank Staff computations.

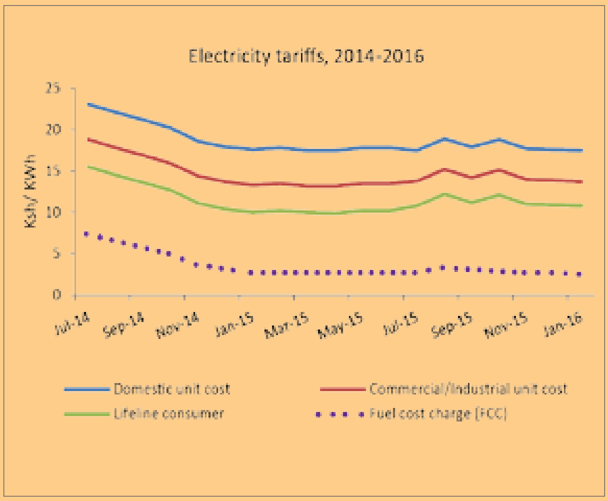
Geothermal power is now the largest contributor to electricity generation. Geothermal now comprise 27 percent of the installed capacities and is providing between 43- 48 percent of the energy produced. The installed generation capacity currently stands at 2,234 MW against a peak demand of 1,549 MW giving a reserve margin of about 31 percent. Hydro plants constitute about 37 percent of the installed capacity and are contributing about 38 percent to the energy mix.

Box 1.1 | Electricity tariff drops as more geothermal power comes online

Government investments in renewable energy have expanded electricity generation and realized cheaper retail electricity prices. With an additional 280 MW from Olkaria IV injected in the national grid in December 2014, there has been a drop in the use of expensive thermal power. The reduction in thermal power was also supported by the sustained hydro power generation in 2015 due to adequate rainfall. Both geothermal and hydropower now account for over 80 percent of the total electricity generation. As a result, the fuel cost charges fell remarkably, from 7.2 Ksh/KWh in July 2014 to 2.3 Ksh/KWh in January 2016.

The reduction of fuel cost charges impacted retail electricity tariff. Fuel cost charges declined by 68.1 % (July 2014 – January 2015) as new energy projects were completed. Fuel cost charge (FCC), foreign exchange rate fluctuations adjustments (FERFA), water resource management (WARMA) and inflation adjustments (IA), are factors that are reviewed when setting retail electricity prices. Yet FCC is the major cost, accounting for 40 percent of the total retail prices in June 2014.[2] The fall in FCC resulted in a decrease

Figure 1.b1 | Retail electricity prices fell as fuel cost charge declined



Source: Energy Regulatory Commission

[2] ERC Annual Report (2013-2014)

Box 1.1 | Electricity tariff drops as more geothermal power comes online (continued)

of retail electricity prices for all consumers. Lifeline consumer (electricity consumption up to 50 Kwh) paid 13.7 Ksh/Kwh in January 2016 compared to Ksh/KWh 15.5 in July 2014. Domestic consumer (average consumption of 200 Kwh) paid 5.6 Ksh/Kwh less in January 2016 than what the price was in July 2014. Similarly, the electricity-cost of production for the industrial consumer (1,000,000 Kwh) shrank by 27.1 percent over the same period (Figure 1.b1).

As a result of availability of these cheaper renewable energy sources and the lower-than-expected growth in electricity demand, the thermal plants are being utilized to provide peaking load and reserve margin. Their dispatch has declined from over 65 percent in 2013-14 to less than 15 percent in 2014-15.

Source: Kenya Electricity Generating Company and Energy Regulatory Commission

The Wallop from the Cross Currents of Reduced Exports, Insecurity and Money Market Volatility

Three factors curtailed growth: economic slowdowns in Kenya's export destinations, insecurity and volatility in the money markets. Insecurity undermined growth in tourism and related services, strains in the regional markets subdued demand for Kenyan goods particularly manufacturing, and domestic interest rate volatility put pressure on the financial sector.

Growth of accommodation and restaurants sub-sector decelerated due to security uncertainties. This continued a trend that has undermined the tourism sector since 2013. Tourism arrivals at Jomo Kenyatta and Moi International Airports declined by 25.1 percent in 12 months ending September 2015, representing the largest contraction compared to 8.8 percent in 2014 and 12.2 percent in 2013. Consequently, accommodation and restaurants sub-sector contracted by 4.1 percent in the first three quarters of 2015, although this represented an improvement compared to a contraction by 17.6 percent during the same period in 2014.

The manufacturing sector grew less than expected despite lower oil and electricity prices. Manufacturing experienced a modest growth of 3.6 percent in the first three quarters of 2015, which was lower than the 5.4 percent in the same period in 2014. Demand for Kenya's manufactured exports declined in 2015 in the EAC region due to volatility in regional currencies which had the net effect of shilling appreciation against neighboring currencies. EAC constitutes the largest market for Kenya's manufactured goods, accounting for over 50 percent of total manufactured goods' exports. In addition, volatility in domestic money market in the third quarter resulted in high cost of credit and a financing squeeze on banks given rising short-term interest rates.

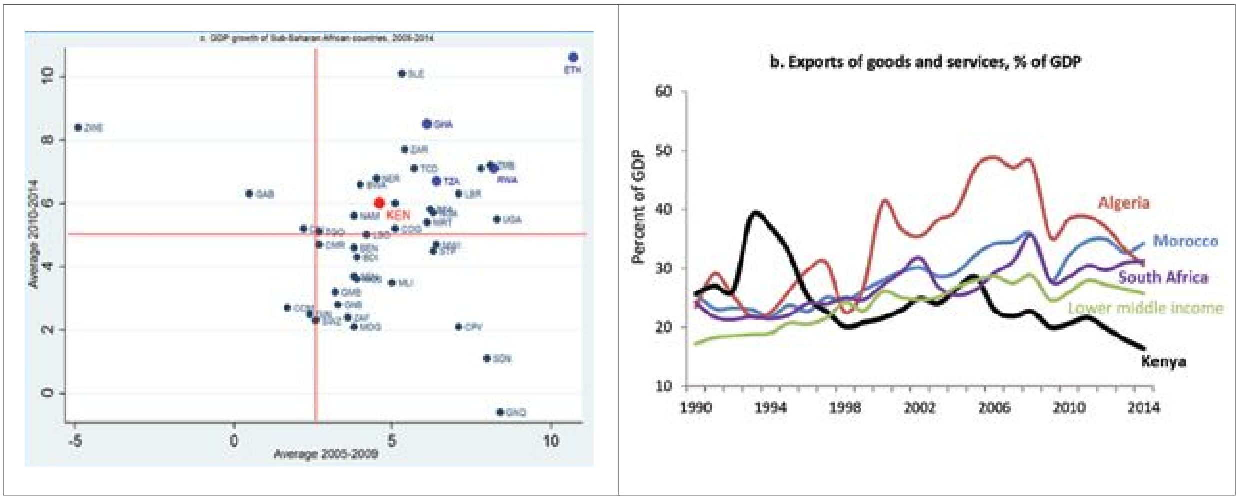
Can Kenya Enhance its Position as a Regional Economic Hub?

Kenya is among solid performers in some of its peer groups. Kenya's growth rate has been above the average for SSA economies since 2010, it grew at 6.0 percent on average during 2010-2014, higher than the SSA average at 4.4 percent. Kenya also fares well among peer, lower middle-income countries (Figure

1.7a). However, Kenya lags behind other Eastern Africa peers like Ethiopia and Rwanda. These economies have sustained a robust annual growth of above 6 percent during 2006-2014. Kenya joined the top ten largest economies in Africa after GDP rebasing in 2014. Kenya also became a lower middle-income country.

Nevertheless, the question is how Kenya can enhance its position? Kenya will need to increase exports to capitalize on the economy's productive capacity. Other big economies are export-led economies with job opportunities. Kenya is not there yet. Instead, Kenya is a consumption-led economy, with declining exports, particularly in manufacturing exports, and fewer job opportunities, mostly concentrated in the agriculture sector. Kenya's exports as a share of GDP shrank to 16.4 percent in 2014 from 25.7 percent in 1990 (Figure 1.7b). Yet, countries with the same level in 1990s have expanded their exports sector to above 30 percent of GDP.

Figure 1.7 | Not accelerating, and export performance lagging

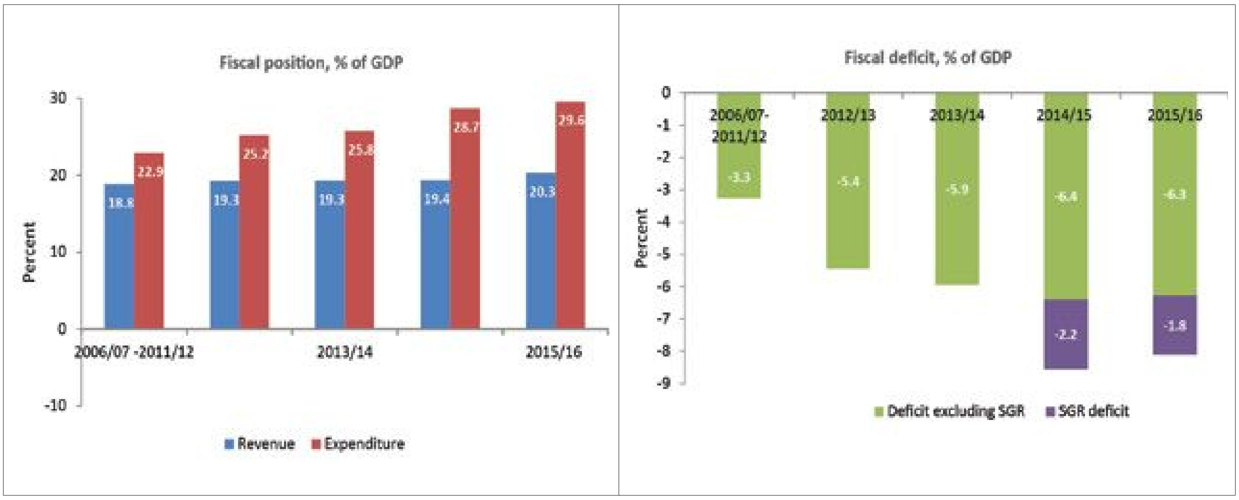


Source: World development Indicators

Fiscal policy: Turning the Corner

Kenya has pursued an expansionary fiscal policy since FY 13/14, which has seen the budget deficit rise from 5.4 percent to 8.7 percent. The deficit is driven by the shift to devolved governance, the construction of the standard gauge rail and the need to enhance security. The deficit increased by 2 percent of GDP, on account of the cost of constructing the Standard Gauge Railway, (SGR). However, the current fiscal framework suggests a gradual fiscal consolidation aligned with the completion of the SGR. The framework also reflects a shift in deficit financing in favor of external debt to ease pressure on domestic money markets.

Figure 1.8 | Fiscal policy turns the corner if trend stays

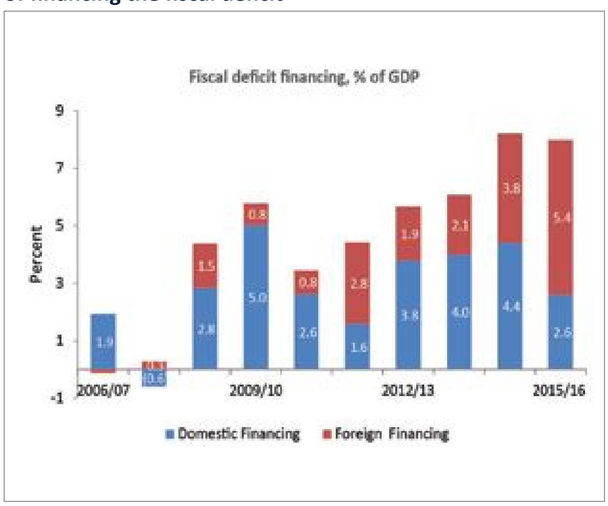


Source: The National Treasury

Kenya's fiscal policy has turned the corner. After three years of fiscal expansion, the government has begun a fiscal consolidation phase. In the past three years, government experienced fiscal pressures emanating from administrative cost of devolution, increasing interest repayments, increasing investment spending, high wage bill and slow growth in revenue collection. This resulted in the widening of the fiscal deficit from 5.4 percent of GDP in 2012/13 to 8.6 percent of GDP in 2014/15. The 2015/16 revised budget marks the beginning of a gradual fiscal adjustments; cutting down KSh. 93.8 billion from the approved budget. As a result, the fiscal deficit was scaled down to 8.1 percent of GDP from 8.7 percent of GDP as per approved budget (Figure 1.8). For the first time since 2006/07, expenditure increase of 0.9 percentage points over 2014/15 - 2015/16 was matched by revenue expansion (excluding grants) of the same magnitude.

Proposed fiscal consolidation suggests a downward revision in development expenditure without sacrificing its role in economic growth (Table 1.1). The revision deferred projects whose implementation has not materialized at the end of the first half of 2015/16 to the following fiscal year 2016/17. As a result, development expenditure contracted by 90 basis points, to 10.1 percent of GDP in the revised budget from 11.0 percent of GDP in the approved budget.

Figure 1.9 | Foreign borrowing has become a secure means of financing the fiscal deficit



Source: The National Treasury

The fiscal framework also reflects a change in deficit financing with a larger share in external financing. After it became clear that domestic borrowing was destabilizing the money market, the government issued a syndicated loan of KSh. 77 billion in October 2015 to plug revenue shortage and ease the strain on domestic money markets.[3] This, in turn, led to a shift in the composition of financing budget deficits. Domestic borrowing declined in the 2015/16 revised budget to 2.6 percent of GDP, which was lower than the 4.4 percent of GDP in 2014/15. Foreign financing reached 5.4 percent of GDP, 1.6 percentage points higher than the 2014/15 level when the government issued a Euro Bond (Figure 1.9).

The fiscal challenge has been to make room for devolution, debt service, and infrastructure at the same time. With devolution in 2012/13, transfers from national to county governments increased from 0.2 percent in 2013/14 of GDP to 4.1 percent of GDP in 2015/16. The national government has also been spending on infrastructure investment, with the SGR as a flagship project. The cost of the SGR held nearly steady at 2.3 percent of GDP in 2015/16 (compared to 2.2 percent in the previous year). Because of increased borrowing since 2012/13, interest rate payments increased to 3.0 percent of GDP in 2015/16 compared to an average of 2.1 percent of GDP during 2006/07 – 2011/12.

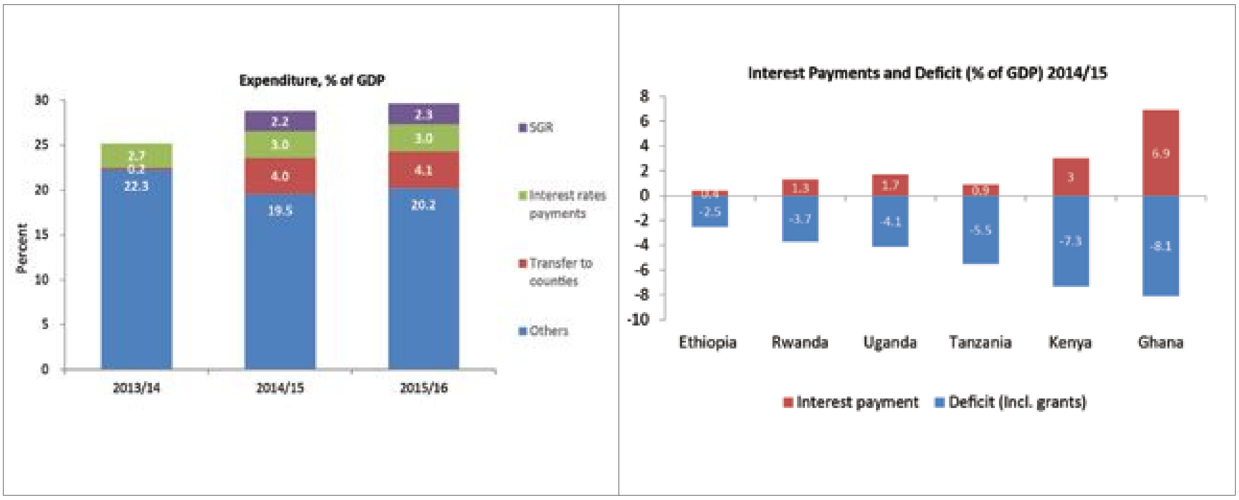
Table 1.1 | Revised budget shows fiscal adjustments in development expenditure (% of GDP)

	2014/15	2015/16 budget	
		Approved	Revised
Total Revenue and Grants	**19.9**	**22.0**	**21.5**
Total Revenue	19.4	20.8	20.3
Income tax	8.9	9.6	9.1
VAT	4.6	4.8	4.6
Expenditure and Net Lending	**28.7**	**30.7**	**29.6**
Recurrent	**15.7**	**15.5**	**15.4**
Development	**8.9**	**11.0**	**10.1**
Transfer to Counties	4.0	4.1	4.1
Deficit including grants (cash basis)	(8.6)	(8.7)	(8.1)
Financing	8.3	8.7	8.1
Domestic Financing	4.4	3.4	2.6
Foreign Financing	3.8	5.2	5.4
Primary balance	(5.5)	(5.9)	(5.1)
Deficit including grants excluding SGR	(6.4)	(6.9)	(6.3)

Source: The National Treasury

[3] The syndicated loan was arranged by Citi Bank, Standard bank and Standard Chartered Bank.

Figure 1.10 | The drivers of the recent increase in national expenditure

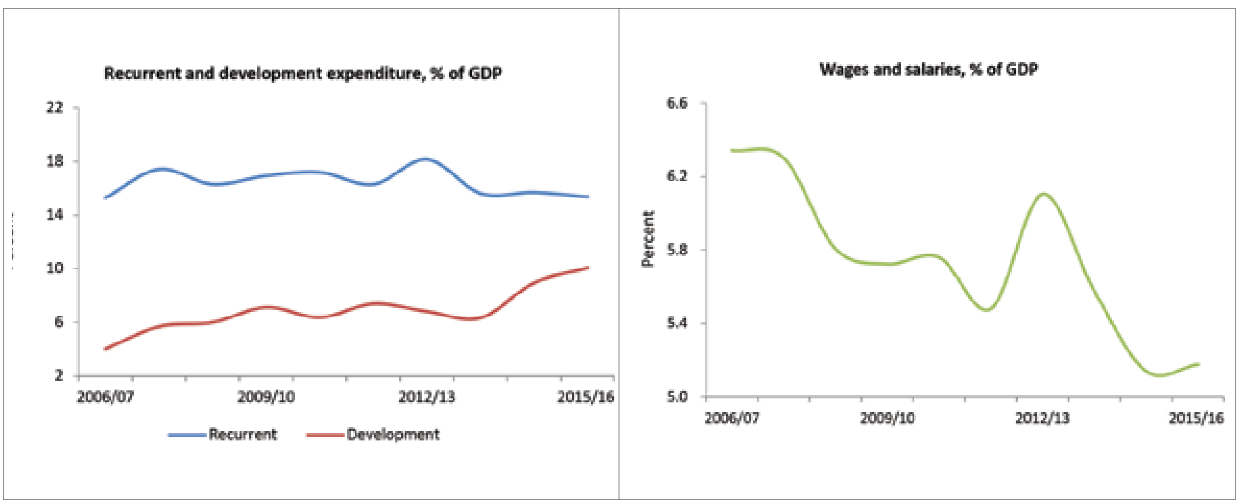


Source: The National T reasury *World Bank MPO 2016*

Without SGR investments and interest rates payment, the fiscal deficit (3.3 percent of GDP) in 2015/16 would be less than a half of what it actually is (8.1 percent of GDP) (Figure 1.10).

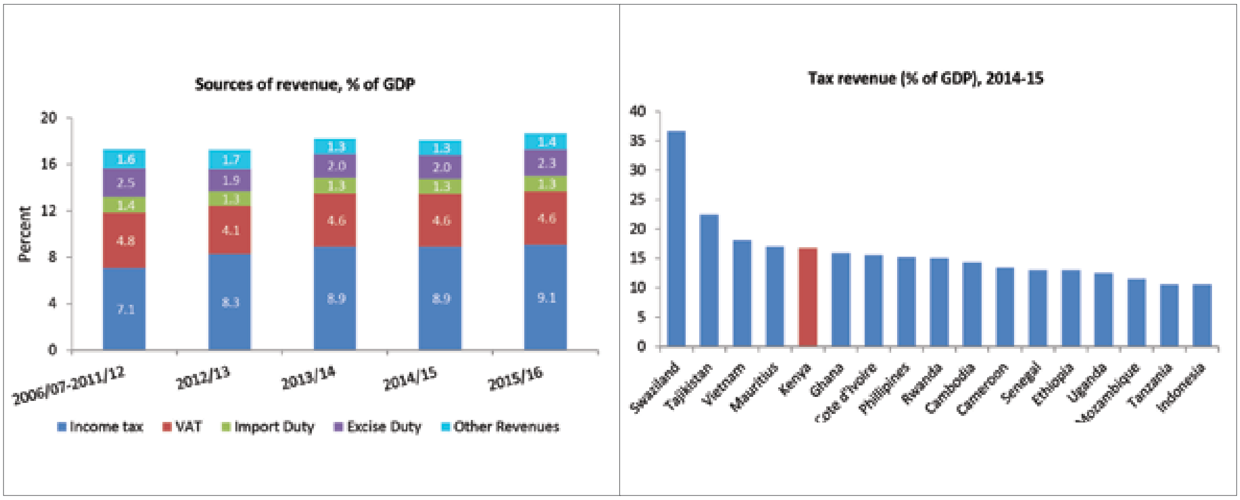
Despite the pressures from recurrent spending and debt service, the fiscal expansion in the past three years has seen a gradual increase in the share of development spending. The gap between development and recurrent expenditures narrowed (Figure 1.11a). Development expenditure reached a double digit for the first time in 2015/16. It reached 10.1 percent of GDP, surpassing the average of 6.5 percent since 2006/07. On the contrary, recurrent expenditure gradually contracted since 2012/13. This was linked to a drop in the wage bill as devolved functions and personnel were transferred to county governments (Figure 1.11b). As county systems get up to speed, this drop is likely to be reversed. However, the contraction in the wage bill can be misleading as it could also reflect the transfer of county staff payroll from national government to counties.

Figure 1.11 | The gap between recurrent and development expenditure significantly narrowed



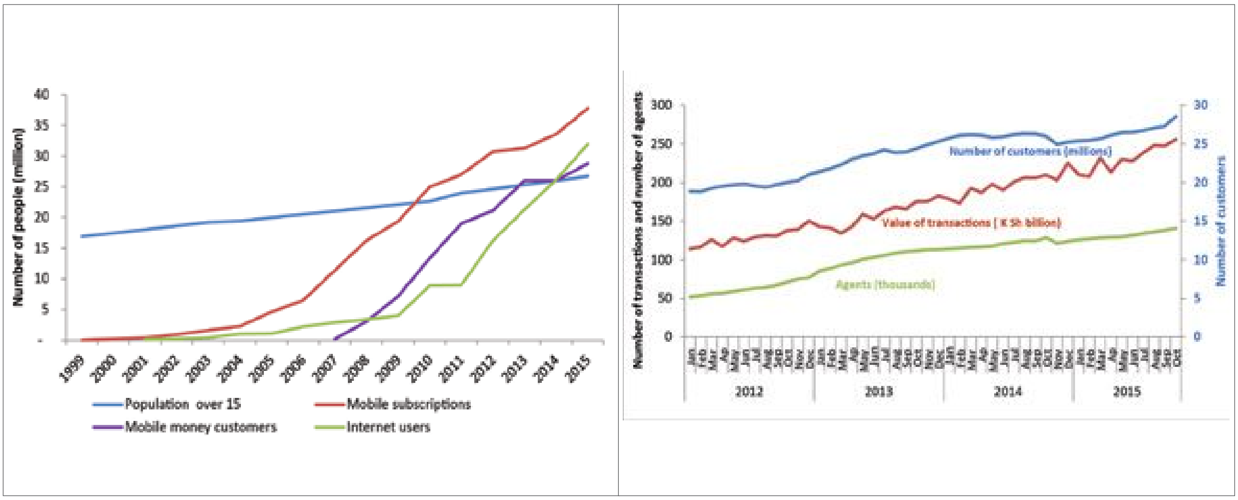
Source: The National Treasury

Figure 1.12 | Revenue growth remain minimal



Source: The National Treasury

Figure 1.13 | Public debt is accumulating at a faster rate



Source: The National Treasury (Quarterly Budget and Economic Review, September 2015)

Revenue as a share of GDP has been stable but is insufficient to match the rising fiscal pressure. Total revenue in the 2015/16 revised budget rose by 0.9 percentage points, exceeding 0.2 percentage points as average growth over 2012/13-2014/15. This marginal increase was driven by income tax and excise duty, while other taxes remained stagnant (Figure 1.12). Income tax growth was supported by collections from corporations and capital gains. Excise duty brought in more than KSh 30.7 billion as the Excise Duty Bill 2015 took effect in the second half of 2015/16. VAT and import duty remained stagnant at 4.6 percent of GDP and 1.3 percent of GDP respectively in 2015/16, a position they held since 2013/14. Income tax and VAT constituted the main source of revenue, accounting for 73.4 percent of total tax revenue.

Public debt remains sustainable, although it has been accumulating at a faster rate. According to the September 2015 Debt Sustainability Assessment by the IMF and the World Bank, all indicators remained below the thresholds in the medium term, implying low risks of debt distress. However, the total debt (net) has increased by 22.8 percent in nominal terms, and 10.9 percentage points as a share of GDP in the year to September 2015. The increase in public debt was driven by a rapid hike in external debt. External debt reached 27.2 percent of GDP in September 2015 from 19.1 percent of GDP in September 2014 (Figure 1.13a).

Domestic debt composition remained dominated by treasury bonds. They accounted for 75.4 percent, while T-bill accounted for 21.1 percent in September 2015.

The composition of external debt is changing. A large share of external debt still remains concessional. The composition, however, has been shifting toward non-concessional. Now the share of concessional borrowing stands at 61.8 percent in 2014, falling from 77.5 percent in 2006 (Figure 1.13b) after the Euro Bond issue in 2014.

Fiscal expansion and the Deepening of Devolution

Intergovernmental transfers, local revenue collection and grants to counties increased during the second year of devolution. Overall the fiscal balance at the devolved level remains positive. However, a high level of pending bills reported at the end of the second financial year indicates a need to align procurement plans and cash flow projections in the counties.

The 2014/15 and 2015/16 budget shows a significant expansion in both revenue and expenditure by county governments (Table 1.3). During the second and third financial years, counties budgeted for Ksh. 326.2 (5.7 percent of the GDP) and 361.1(6.3 percent of the GDP) compared to Ksh. 228.6 billion (3.9 percent of the GDP) during the first year of devolution. This is explained by an increase in the equitable share in Kenya's intergovernmental spending formula, leading to an increase in the allocation for both development and recurrent expenditure to Ksh. 144.9 billion and Ksh.181.3 billion from Ksh. 123.4 billion and Ksh. 165.2 billion in the previous year, respectively.[4]

Table 1.2 | County government budgets indicate a continued expansion in revenues and expenditure (KSh Billion)

	2013-14		2014-15		2015-16
	Budget	Actual	Budget	Actual	Budget
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**	**224.0**	**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[5]			0.7	0.7	0.8
World Bank[6]					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**	

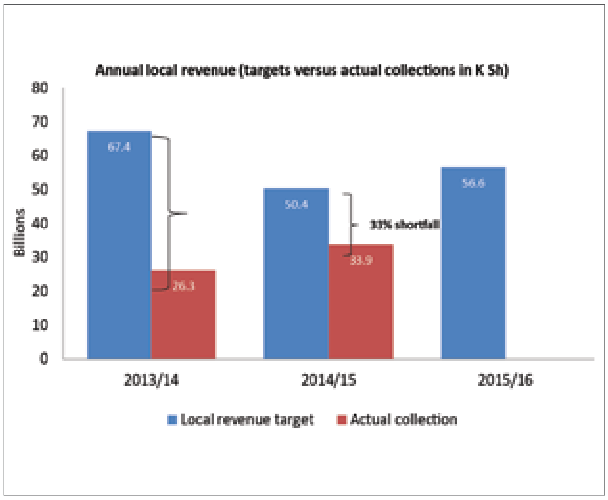
Source: Office of the Controller of Budget

4 The counties receive annual transfers from national government to carry out devolved functions. This financing is primarily provided through an unconditional transfer – called the "Equitable Share" – of nationally collected revenues.
5 DANIDA Grant to supplement financing for county health facilities
6 World Bank Grant to supplement financing of county health facilities

County revenue collections increased by 28.7 percent and revenue forecasting appears more realistic (Figure 1.14). Based on the ambitious local revenue targets for the previous fiscal year, the county government revised their local revenue projections from KSh. 67.4 billion in 2013/14 to KSh. 50.4 billion in 2014/15 and 56.6 in 2015/16. Actual amount collected was KSh. 26.3 billion in 2013/14 (66 percent shortfall) and KSh. 33.9 in 2014/15 (33 percent shortfall). Overall underperformance in local revenue collections means construction and maintenance of roads, heath facilities, ECD centers, water supply infrastructure, purchase of agricultural machinery and other planned development activities were not fully implemented and therefore a need to review local revenue collection mechanism and strategies.

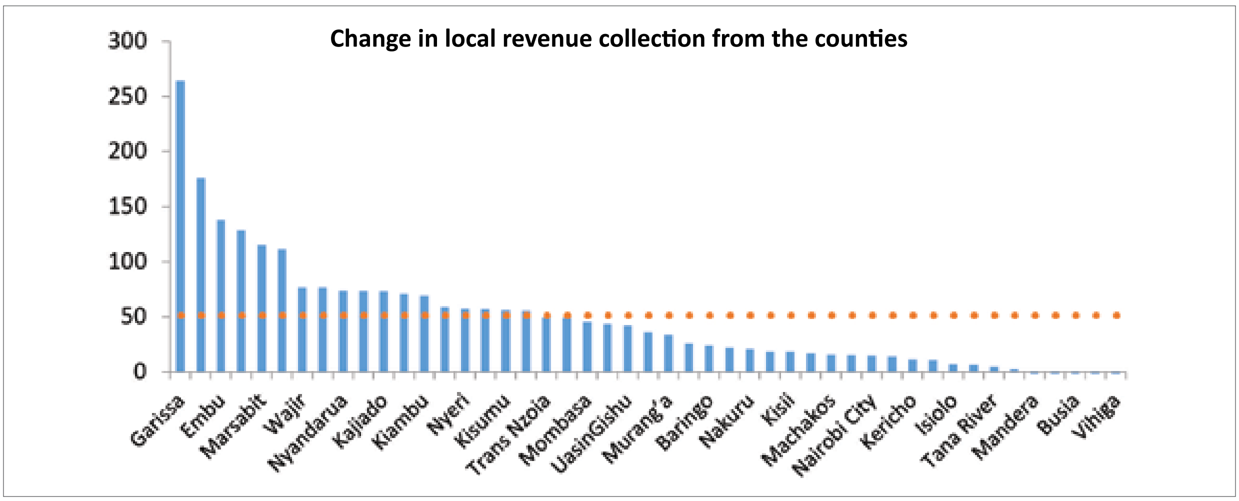
Most counties recorded a significant increase in local revenue collection. However, five counties, Mandera, Samburu, Busia, Turkana and Vihiga, recorded a decline in local revenue realized in 2014/15 compared to 2013/14. The decline in reported revenues is unusual and is could be attributed to pilferage arising from a possible lack of proper internal controls on local revenue management.

Figure 1.14 | Local Revenue collections are improving and Revenue forecasts have become more realistic



Source: Office of the Controller of Budget.

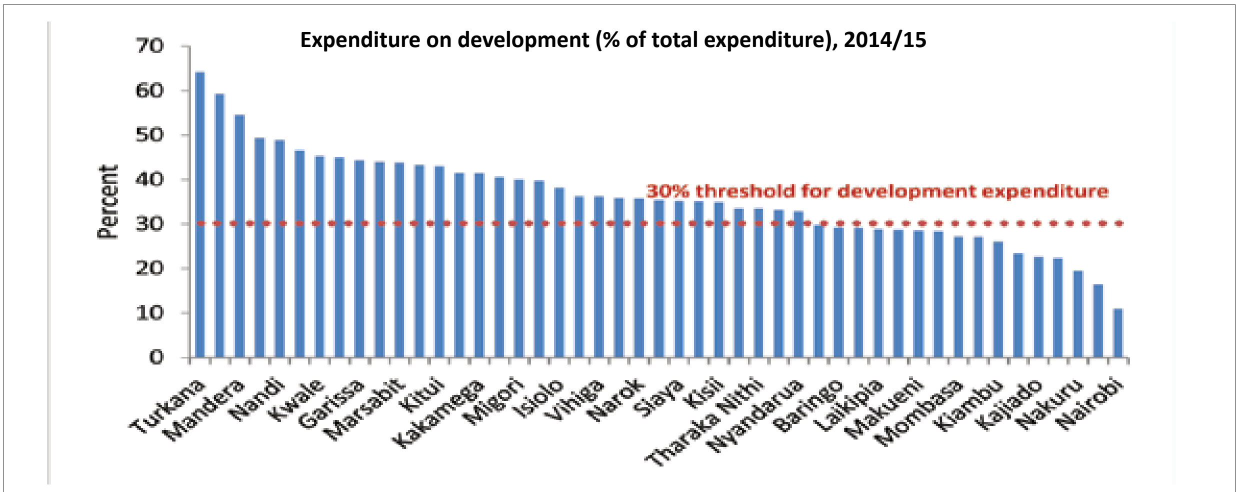
Figure 1.15 | On average Counties recorded an overall increase in Local Revenue collection



Source: Office of the Controller of Budget

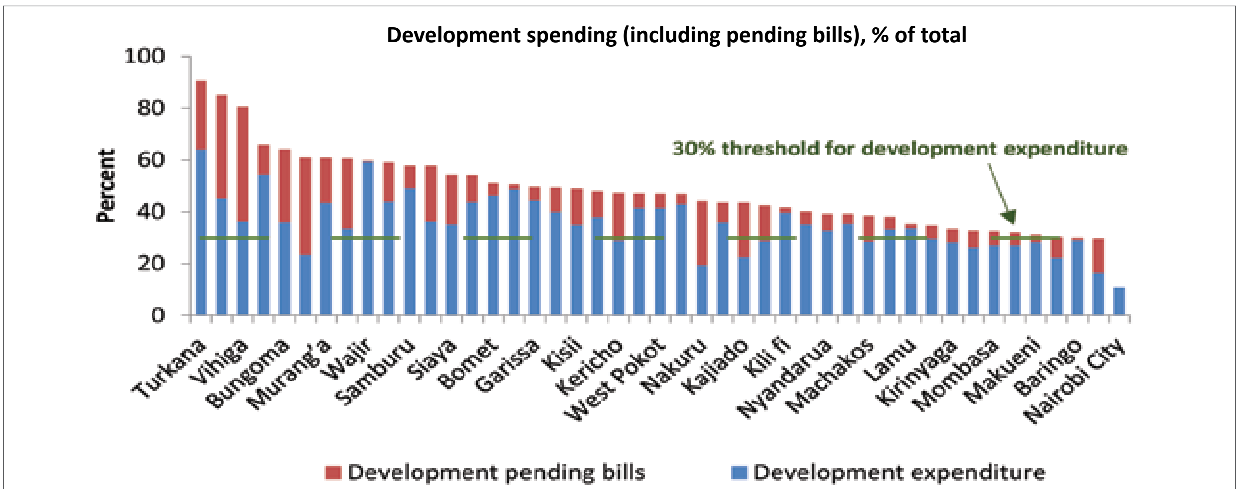
Overall, allocation to capital spending increased by 17.4 percent, but the rising stock of pending bills is worrying. A total of 32 counties attained the 30 percent development spending threshold in the 2014/15 compared to only 10 counties in 2013/14 (Figure 1.16). But there is a worrying trend of the rising share of development pending bills to total pending bills. Unfolding the total pending bills amount shows that almost all the counties would have attained the 30 percent threshold if development pending bills were paid in time (Figure 1.17). High level of pending bills suggest that either procurement remains a challenge at the county level, or the National Treasury delayed the disbursement of funds to counties, or both.

Figure 1.16 | 32 counties attained the 30 percent development-spending threshold.



Source: Office of the Controller of Budget

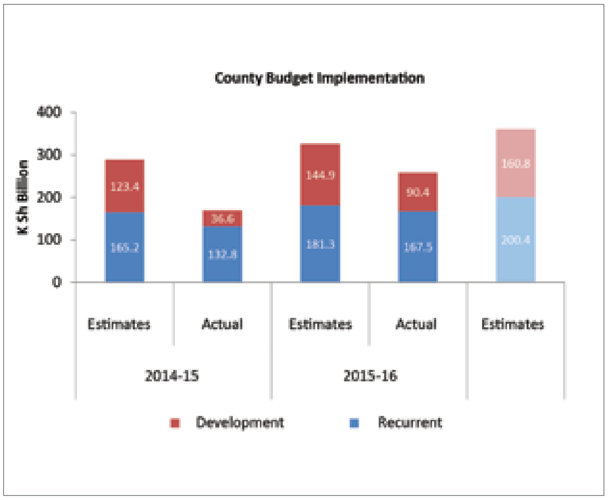
Figure 1.17 | Almost all counties would attain the 30 percent threshold if development pending bills were paid on time.



Source: Office of the Controller of Budget

Better planning and continued efforts to build staff capacity in the counties is driving the focus towards development. In aggregate, the counties underspent in first two years of devolution, arriving at an overall absorption rate of 64.9 percent in 2013/14 and 79.1 percent in 2014/15 respectively. Although the overall budget execution remains low, there is a significant improvement in the absorption of development budget from KSh. 36.6 billion (29.6 percent) in 2013/14 to KSh. 90.4 billion (62.4 percent) in 2014/15.

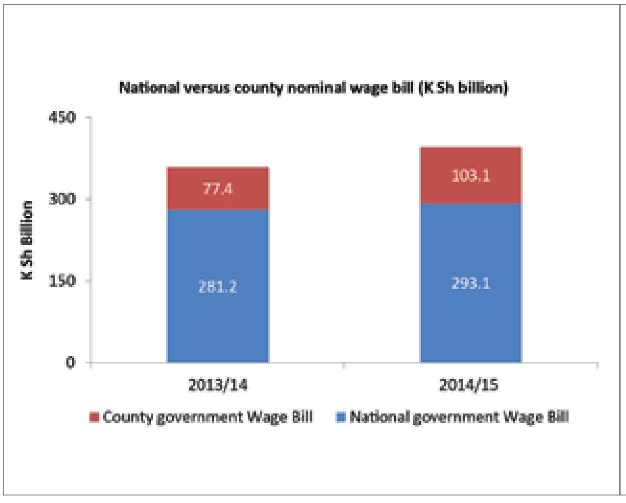
Figure 1.18 | County budget execution has improved

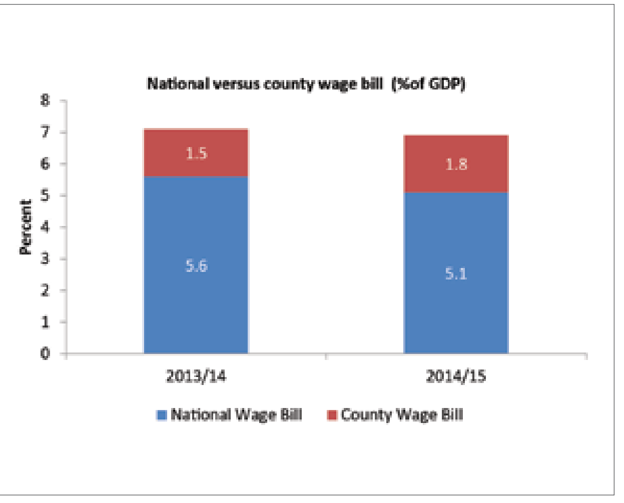


Source: Office of the Controller of Budget

Total wage bill in county governments increased significantly (Figure 1.19). County governments recorded an increase in nominal wage bill from KSh. 77.4 billion (1.5 percent of GDP) in 2013/14 to KSh. 103.1 billion (1.8 percent of GDP) in 2014/15. The increase can be attributed to three factors; first, counties embarked on an ambitious hiring process during the first year of devolution and most of the staffs were not on the payroll until the second year. Second, in 2013/14 the national government covered the wage bill for some of the staff working in the counties prior to the transfer of payrolls; and third, there was a wage increase for former local authority staff working in the county assemblies.

Figure 1.19 | County governments Wage Bill increased significantly in 2014/15





Source: Office of the Controller of Budget

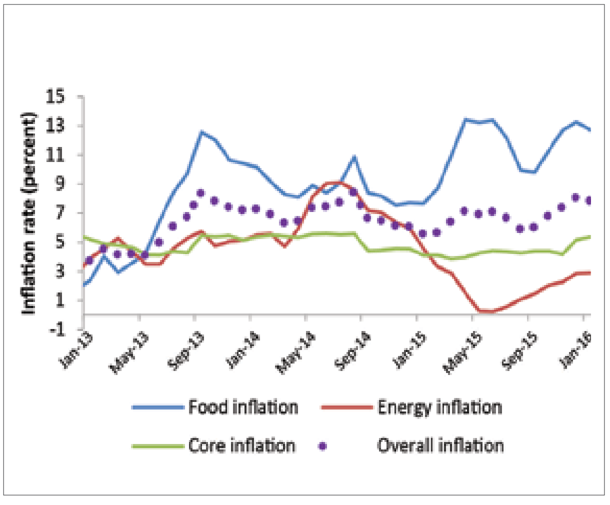
The CBK Intervened in The Foreign Exchange Market by Keeping its Benchmark Rate

Inflation remained low throughout 2015 thanks to lower energy prices, despite double-digit food price inflation and accelerated depreciation of the shilling. Money markets were destabilized when the government resorted to domestic borrowing to meet revenue shortfalls in August. Following the CBK's policy rate hikes in June and July 2015, long-term lending rate gradually rose in the third quarter of 2015. Increased government borrowing and higher lending rate, in turn, led to decelerated credit growth to the private sector and deteriorated banks' asset quality.

Inflation tested the CBK's upper bound set at 7.5 percent, as lower energy price inflation attenuated the impact from double-digit food price inflation. A 12-month average overall inflation fell to 6.6 percent in December 2015 from 6.9 percent in December 2014 (Figure 1.20). 6-month average overall inflation in the second half of 2015 slightly rose to 6.7 percent from 6.4 percent in the first half, but still below the CBK's upper bound. Core inflation, which excludes food and energy, remained below the CBK's 5 percent target since September 2014. 6-month average core inflation stands at 4.5 percent in the second half of 2015.

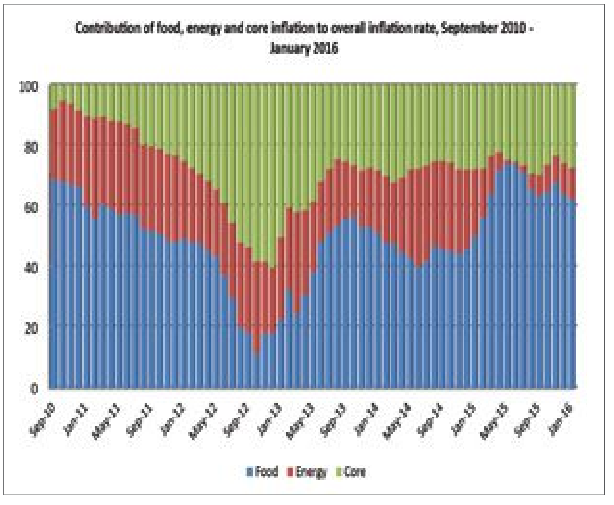
Energy inflation fell to 1.9 percent in 2015 from 6.9 percent in 2014, on account of lower international oil prices. Crude oil prices sharply fell by 38.5 percent in 2015 from US$ 57.3 in December 2014 to US$ 37.2 in December 2015. The sharp decline translated into lower gas and transport prices. Notably, transport price inflation was negative at −0.4 percent. Contrarily, food price inflation was high at 11.4 percent, caused by the El Niño effect disrupting the food supply chain. In 2015, food prices accounted for 64.1 percent of total inflation, up from 45.8 percent in 2014 (Figure 1.21). Energy prices merely accounted for 10.4 percent, and core inflation accounted for 25.6 percent.

Figure 1.20 | County budget execution has improved



Source: Central Bank of Kenya.

Figure 1.21 | Food prices accounted for more than half of overall inflation (Contributions to overall inflation)



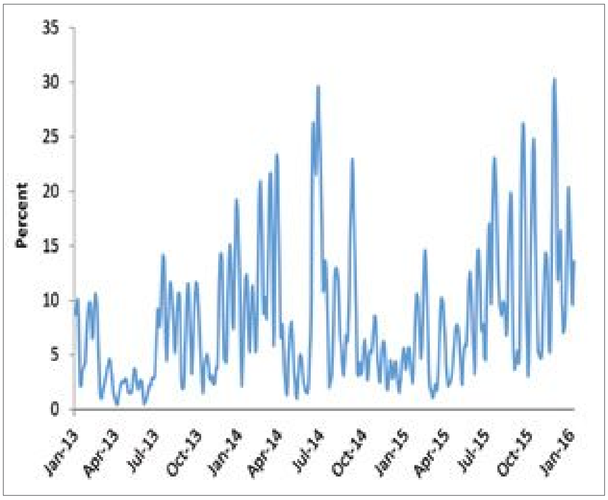
Source: Central Bank of Kenya

By year-end, the disinflationary benefits from energy prices had unwound while other sector pricing pressures remained, pushing year-on-year overall inflation over the target of 7.5 percent in December 2015, for the first time since August 2014. Year-on-year overall inflation reached 8.0 percent in December 2015, again led by food prices, which increased by 13.3 percent. Similarly, core inflation exceeded the CBK's 5 percent target by 0.1 percentage points because of new excise taxes on alcoholic beverages and tobacco products, whose prices rose 15.0 percent in December 2015.

Despite the breach, the CBK's Monetary Policy Committee meeting held in January 2016 maintained its monetary policy stance, keeping its policy rate at 11.5 percent. The CBK lifted its policy rate in July 2015 from 8.5 percent to contain inflationary pressures stemming from the steep depreciation of the shilling since March 2015. Since raising the policy rate, the pace of depreciation moderated despite the rise in U.S. interest rate, slowdown of the Chinese economy, and volatility in the global financial markets. The CBK views the current inflationary pressure caused by food prices as temporary. However, the current monetary policy stance well anchors inflation expectations.

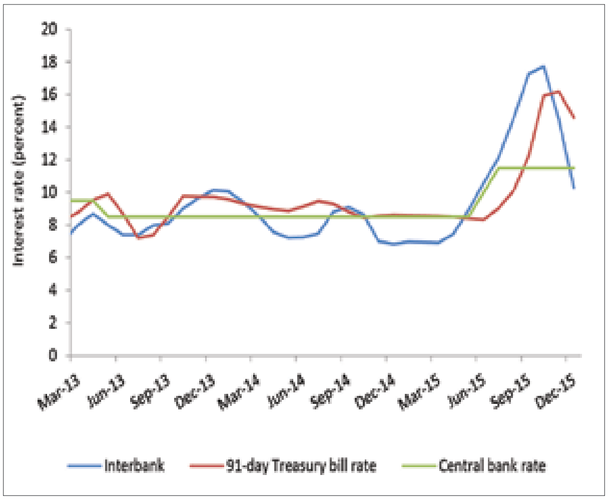
The money market saw magnified volatility along the treasury bill term structure due to the policy (Figures 1.22 and 1.23). The tight liquidity conditions were caused first by the CBK's interventions in the foreign exchange market in August 2015 against the continued strengthening of the U.S. dollar. Secondly, the tight liquidity conditions were caused by government domestic borrowing in September and October 2015 to meet fiscal pressures amidst revenue shortfalls, which led to sharp overshooting of money market rates. While the central bank rate rose by 300 basis points between May and October 2015, the interbank rate and the 91-day Treasury bill rates rose by 880 basis points and 750 basis points, respectively. The liquidity conditions improved in November when the CBK injected money through reverse repo operations, and the National Treasury took fiscal measures including issuing the syndicated loan in October 2015. The interbank rate quickly fell below the central bank rate, while the 91-day Treasury bill rates sluggishly declined, standing at 14.6 percent.

Figure 1.22 | Food prices accounted for more than half of overall inflation



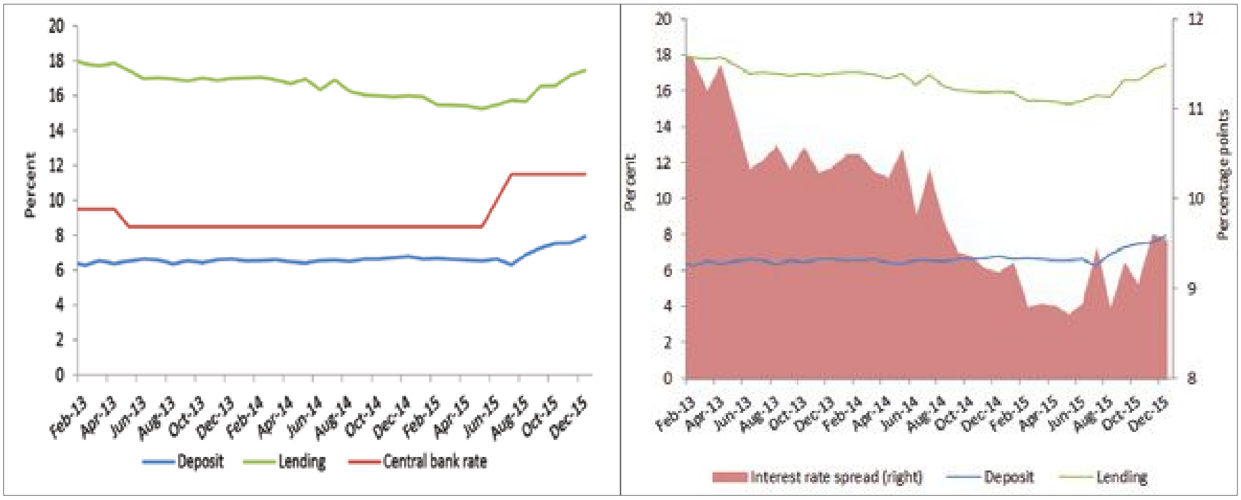
Source: Central Bank of Kenya

Figure 1.23 | Money market rates rose sharply in September and October 2015 due to tight liquidity conditions caused by government domestic borrowing



Source: Central Bank of Kenya

Figure 1.24 | Long-term interest rates rose in response to the change in the Central Bank's monetary policy stance



Source: Central Bank of Kenya.

Bank lending and deposit rate changes were more muted but the already high interest rate spread increased by 70 basis points. Long-term lending rates, rose 190 basis points from 15.5 percent in June 2015 to 17.4 in December 2015, while deposit rates sluggishly rose 130 basis points from 6.6 percent to 7.9 percent in the same period (Figure 1.24). As a result, interest rate spreads (lending rates minus deposit rates) expanded 70 basis points, standing at 9.5 percent in December 2015.

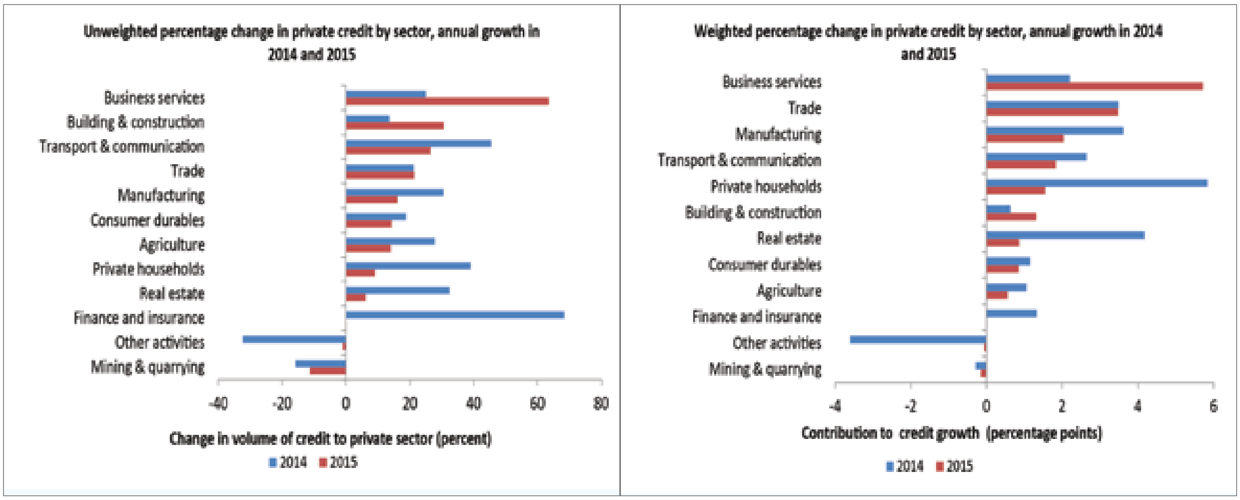
CBK's currency intervention also contributed to tight liquidity conditions. The increased volatility and steep depreciation of the shilling vis-à-vis the dollar and other major currencies forced the CBK to draw down its foreign exchange reserves by injecting dollars into the banking system in the second and third quarters of 2015. This, in return, led to mopping up liquidity as the CBK absorbed the shilling from the financial markets in exchange to the injected dollar. This is reflected by the slowdown of the growth of monetary aggregates by about 5 percentage points during 2015.

Figure 1.25 | Monetary operations slowed the growth of monetary aggregates

Source: Central Bank of Kenya

Growth of credit to the private sector decelerated due to the rise in long-term lending rate, increased government borrowing and prudent banks' behavior. In the first nine months of 2015, the growth rate of private sector credit remained unchanged at 20 percent. Since October 2015, however, the growth of private sector credit started to fall moderately to

Figure 1.26 | Credit to the business services and building and construction sectors increased, while credit to remaining sectors declined



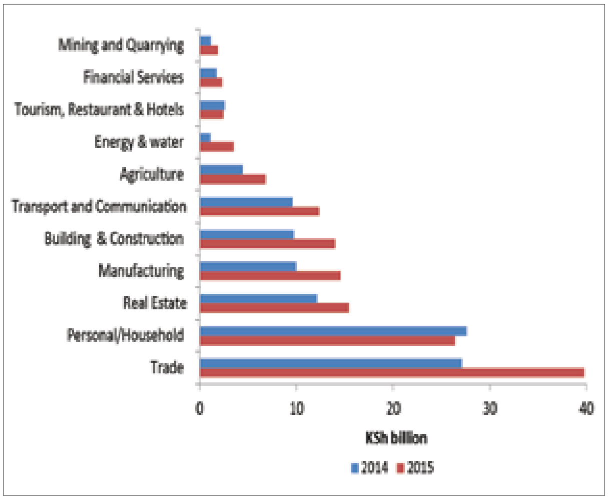
Source: Central Bank of Kenya data.

18.0 percent in December 2015, reflecting higher lending rate, reduced availability of credit to the private sector, and prudent banks' behavior in response to increasing nonperforming loans.

Credit to private sector expanded in construction and business services and contracted in all other sectors. Despite the deceleration in credit growth to the private sector, credit increased significantly in business services (from 25.0 percent in 2014 to 63.5 percent in 2015), building and construction (from 13.6 percent to 30.7 percent). On the contrary, credit growth to transport and communication decelerated from 45.6 percent to 26.5 percent, manufacturing declined from 30.7 percent to 16.2 percent, agriculture fell from 27.9 percent to 14.1 percent, and private households decreased from 39.1 percent to 9.1 percent (Figure 1.26).

The higher lending rates has led to accumulation of nonperforming loans. Nonperforming loans increased from 5.4 percent of total loans in December 2014 to 6.1 percent in December 2015. Volume of nonperforming loans broadly accumulated across all sectors but personal and household sector (Figure 1.27). Nonperforming loans are concentrated in trade (28.5 percent of total) and personal and household (18.9 percent) sectors. Notably, the pace of accumulation in nonperforming loans accelerated in November and December 2015, following the central bank rate hike and the government revenue shortage. Nonperforming loans increased because the rate hike made repaying existing loans expensive and the revenue shortage resulted in delayed disbursement to ministries and counties, and in delayed payment to government contractors.

Figure 1.27 | The volume of nonperforming loans increased in most sectors



Source: Central Bank of Kenya

Figure 1.28 | Security concerns, capital outflows, and depreciation risk reduced the attractiveness of the Nairobi Stock Exchange

Source: Nairobi Securities Exchange.

The stock market was bearish throughout 2015 (Figure 1.28). The Nairobi Securities Exchange (NSE) index marked its record high at 5,491 in February 2015, but ended at 4,041 in December 2015. Continued security concerns, capital outflows induced by anticipated rise in U.S. interest rate, and currency depreciation risk exacerbated market sentiment, especially of foreign investors, triggering more than 25 percent sliding of the NSE index. The NSE index underperformed not only against the U.S stock market but against other emerging markets, which also suffered from the rising of U.S. interest rate and currency depreciation. In 2015, Dow Jones Industrial average fell merely 2.2 percent, while the MSCI Frontier Market index fell by 14.1 percent.[7]

[7] Frontier market countries include Kenya, in addition to Argentina, Bahrain, Bangladesh, Bulgaria, Croatia, Estonia, Jordan, Kuwait, Lebanon, Lithuania, Kazakhstan, Mauritius, Morocco, Nigeria, Oman, Pakistan, Romania, Serbia, Slovenia, Sri Lanka, Tunisia and Vietnam.

Box 1.2 | Capital markets in Kenya

The Kenyan capital market is the third largest in terms of capitalization in Sub-Saharan Africa, after South Africa and Nigeria. The capital market is dominated by equities and government bonds. A total of 63 companies are listed on the Nairobi Securities Exchange (NSE), which has a total market capitalization of about US$ 20 billion, amounting to 31 percent of GDP in 2015. The market is highly concentrated with the top five stocks accounting for over 60 percent of the market capitalization. The ten largest listed companies, the majority of which are commercial banks, accounted for 76 percent of market capitalization and over 80 percent of traded values in 2015.

The fixed income market in Kenya is dominated by government securities, which are fairly developed within the Sub-Saharan African context. The outstanding government bond market (US$ 10.5 billion) represents about 16 percent of GDP. There has been considerable improvement in its debt structure. Between 2000 and 2015, the debt structure shifted from 78 percent in T-bills and 22 percent in T-bonds to the reverse, 77 percent in T-bonds and 23 percent in T-bills. However, issuances are highly fragmented with 55 issues outstanding at the end of 2015.

The non-government bond market in Kenya is still at the early stage of development. Outstanding issues of non-government bonds stood at Ksh. 99.7 billion (US$ 974 million) in 2015, representing only 1.6 percent of GDP. There are only a handful of issuers and non-government bonds represent an insignificant holding in institutional investor portfolios, which is understandably due to the small supply of corporate paper. There is a relatively large variety of issuers represented amongst the issuers but with a general bias towards financial institutions. Most have tenors of between 5 and 7 years.

Kenya's Capital Market Master Plan 2014-2023 envisages that the country will be transformed into an open, competitive market place and a choice market for domestic, regional and international issuers. This can be achieved through the development of dynamic and liquid markets based on leading standards on regulatory frameworks, financial market structure, infrastructure and strong and independent supervision. The master plan has established ambitious short, medium and long-term targets to achieve this goal. For instance, the plan envisages Kenya being reclassified from a frontier to an emerging market in 2016. In addition, the plan targets a twenty-fold increase in the relative size of the corporate bond market in the 10-year period.

Several structural challenges need to be addressed to realize the potential of the capital markets as a funding source in the coming years in line with vision 2030 vision and Kenya's regional aspirations. The Government bond market is still short of providing a long-term, risk-free yield curve to be used

Box 1.2 | Capital markets in Kenya (continued)

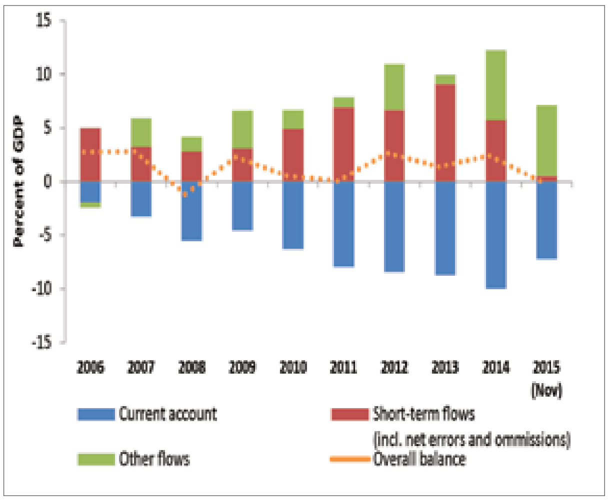
as a reference to price the rest of the financial assets in the economy. Areas that need strengthening include the primary market, which can be improved by implementing a benchmark issuance strategy with regular and predictable issuance of bonds in key benchmark maturities; automation towards more competitive and transparent wholesale market auctions; and the implementation of the Over the Counter wholesale market with greater liquidity and more competitive price formation in secondary market. Additionally, the post-trade infrastructure, namely clearing and settlement, is misaligned with current market needs (processes and institutional arrangements), as well as not complying with international best practice.

Kenya's External Balance Improved, Thanks to Falling Oil Prices

The vulnerability of the external sector relaxed in 2015 as a result of a lower oil import bill despite weak export performance. While tea exports rebounded, most of Kenya's merchandise exports contracted. Although total imports sharply contracted, non-oil imports grew to meet continued import demand for machinery and equipment. CBK successfully intervened in the foreign exchange market by selling foreign reserves. After CBK's intervention in the foreign exchange market, the authorities built up international reserves to the previous level sufficient to cushion external shocks, thanks to the narrowing current account deficit.

The lower oil price bill is the main contributor to improving current account. The current account deficit contracted from 10.0 percent of GDP in December 2014, to 7.2 percent in the 12 months ending in November 2015. This was the lowest since 2010 (Figure 1.29).[8] The contraction is attributable to significant decline in imports (Figure 1.30). While exports of goods and services marginally fell from 15.7 percent to 15.6 percent, imports of goods declined from 31.0 percent to 27.2 percent of GDP thanks to a lower oil import bill.

Figure 1.29 | The current account deficit in 2015 is the lowest since 2010



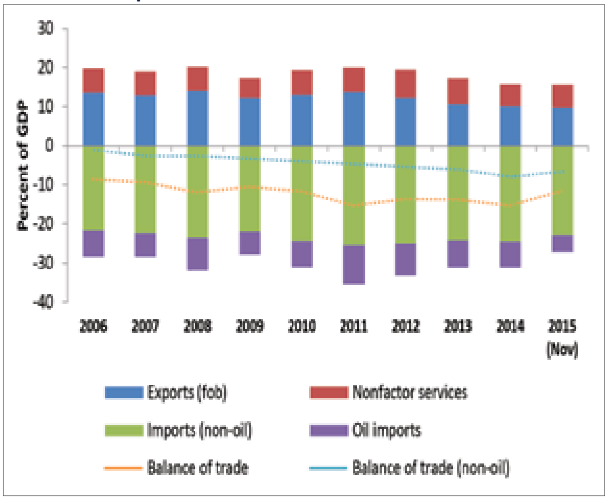
Source: Central Bank of Kenya

[8] Balance of payment data is 12-month cumulative up to November 2015, not the first 11 months in 2015.

Merchandise exports contracted as low commodity prices and currency volatility in the global markets subdued demand for Kenyan goods in key destination markets. Despite favorable performance of Kenya's tea exports (figure 1.31), total exports contracted by 4.8 percent in 12 months ending November 2015. This was due to negative growth experienced in all other exports (manufactured goods, raw materials, horticulture and coffee).

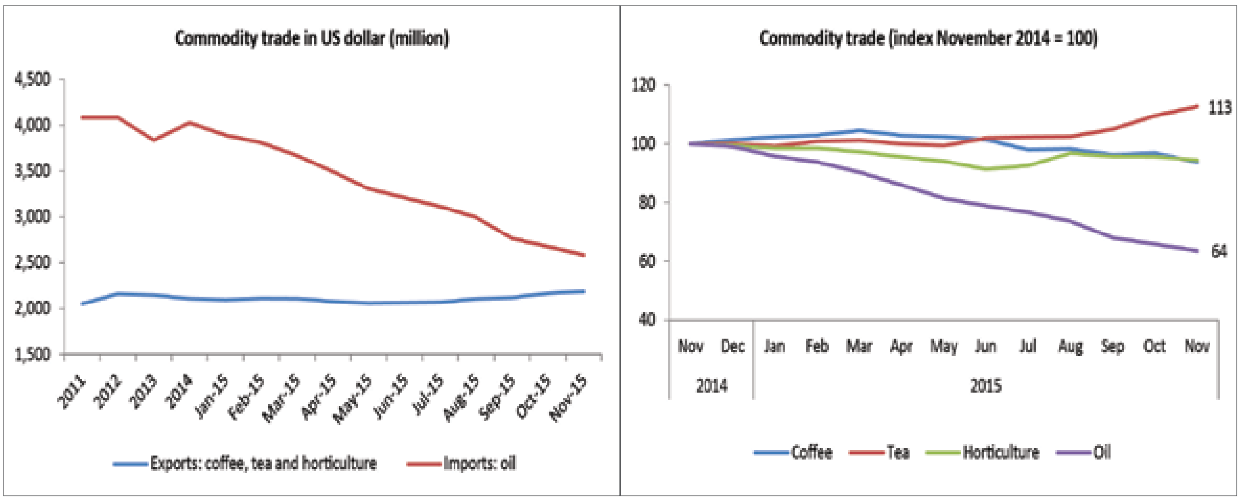
Merchandise imports registered negative growth, driven by oil imports. This is the first time since 2009 when oil price was low due to the global economic slowdown. The negative import growth was again led by oil imports, which contracted 34.5 percent. Non-oil merchandise imports, on the other hand, grew 1.5 percent in 12 months ending November 2015. However, imports of machinery and equipment have become the main driver of Kenya's imports, accounting for 34 percent of Kenya's total imports. Double-digit growth (12 percent in 2015) in machinery and transport equipment imports was led by infrastructure projects, such as the SGR project.

Figure 1.30 | Trade balance improved as imports contracted more than exports



Source: Data from Central Bank of Kenya.

Figure 1.31 | Coffee, tea and horticulture can now pay for oil imports thanks to declining oil prices



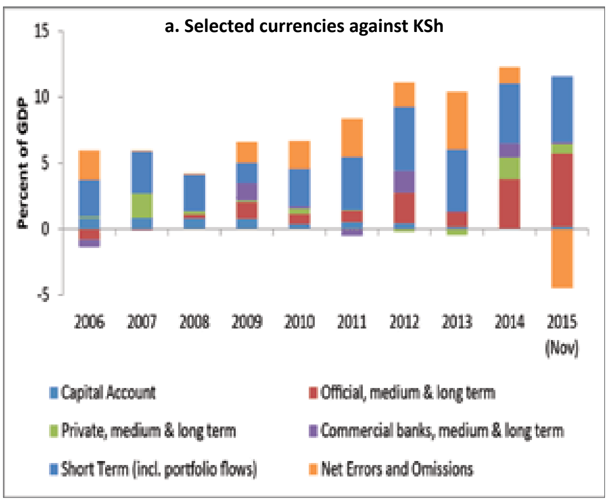
Source: Authors computation from CBK data

The current account deficit was mostly financed by long-term capital inflows (Figure 1.32). Out of US$4.4 billion of the current account deficit, long-term flows, which marginally increased to 6.6 percent of GDP in November 2015 from 6.5 percent in 2014, accounted 89.3 percent of the deficit. Especially, official long-term flows increased from US$2.3 billion (3.8 percent of GDP) in December 2014 to US$3.4 billion (5.5 percent of GDP) in November 2015, thanks to the government's syndicated loan in October 2015. Despite the increased long-term capital inflows, the financial account, in addition to the capital account, marginally fell short to offset the current account deficit, leaving the overall balance of payments slightly negative.

Short-term capital flows declined but the picture is obscured by long-standing issues with interpretation of the statistics. Short-term flows (including net errors and omissions) fell from US$ 3.5 billion (5.7 percent of GDP) in 2014 to US$ 0.3 billion in 2015. The decline reflected significant revision by the CBK of net errors and omission, which fell from US$ 0.7 billion (1.2 percent of GDP) to US$ -2.7 billion (-4.5 percent of GDP).[9] The sum of short- and long-term flows, however, marginally fell short of the current account deficit, leaving overall balance of payment slightly negative by US$60 million in November 2015.

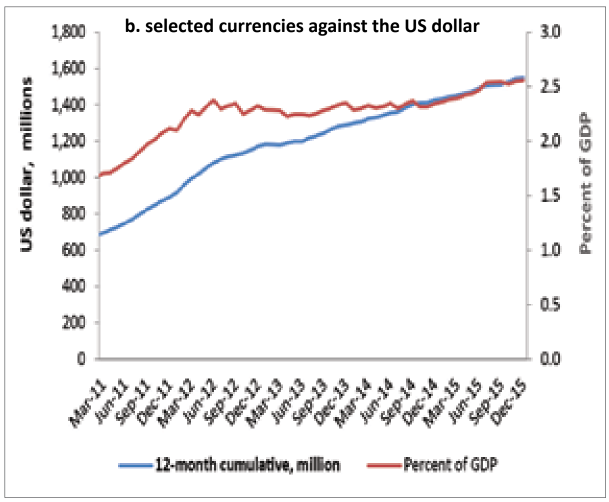
Remittances from Kenya's diaspora are the leading source of foreign exchange and support the local economy. In 2015, remittances to Kenya grew 8.4 percent to US$1.5 billion, equivalent to 2.6 percent of GDP (Figure 1.33). The growth of remittances from Kenya's far exceeded the Sub-Sahara Africa average at 1.9 percent.[10] Increased remittances not only supported the local economy, but also mitigated downward pressure on the exchange rate.

Figure 1.32 | Long-term flows increasingly contribute to financing the current account deficit



Source: Central Bank of Kenya

Figure 1.33 | Remittances are the single most important source of foreign exchange inflows in Kenya

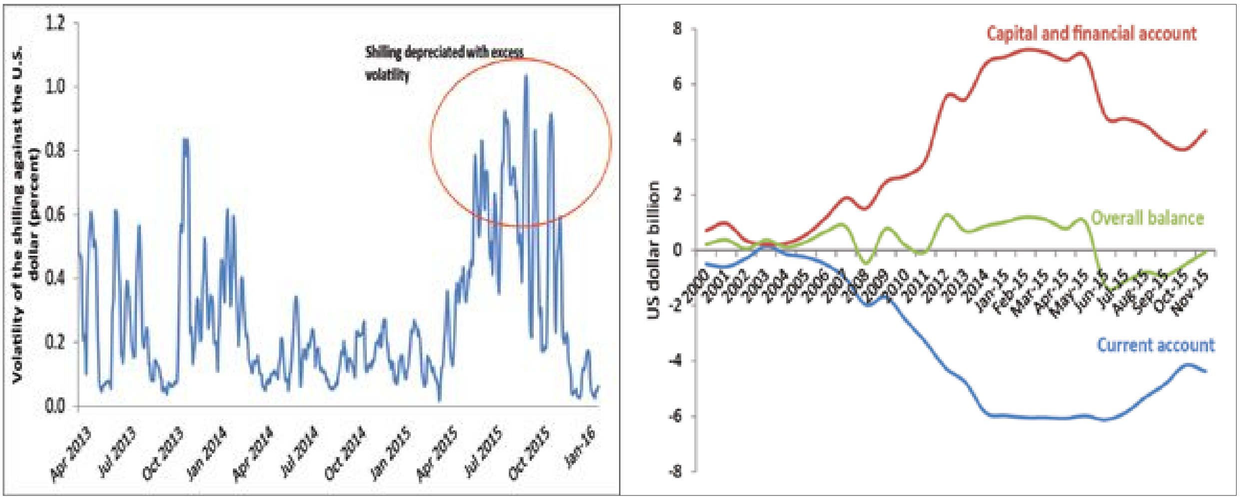


Source: Central Bank of Kenya

9 Short-term flows (excluding net errors and omissions) increased from US$2.8 billion (4.5 percent of GDP) in December 2014 to US$3.0 billion (4.9 percent of GDP) in November 2015.

10 World Bank (2015). "Migration and development brief 25".

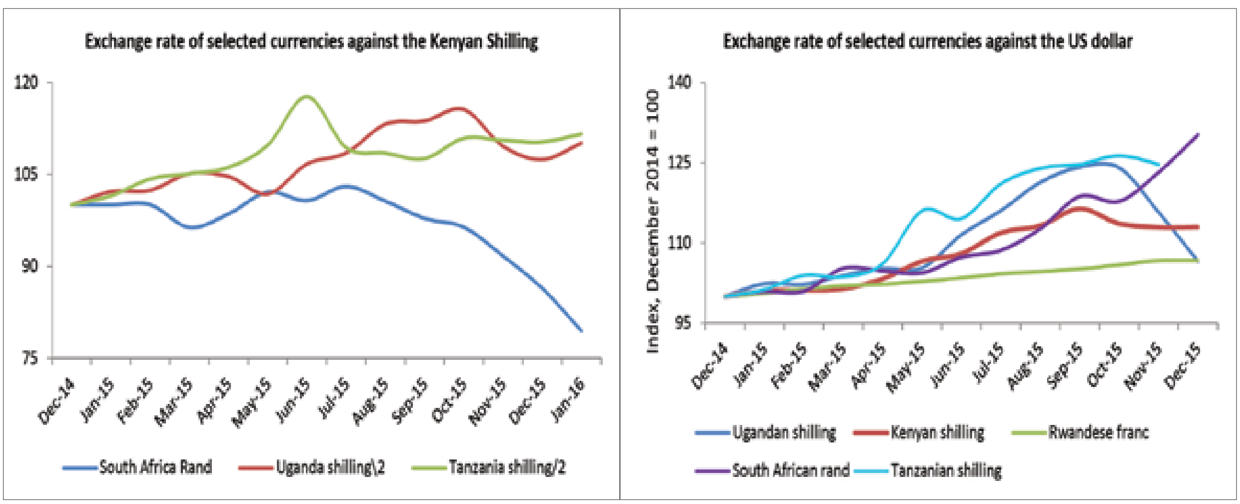
Figure 1.34 | Volatility in foreign exchange market in the third quarter of 2015 affected capital flows



Source: Data from Central Bank of Kenya.

The shilling-US dollar exchange rate exhibited significant volatility in the second and third quarters of 2015, due to anticipated rise in U.S. interest rate (Figure 1.34). The anticipated rise in U.S. interest rate led to shrinking interest rate differential between shilling-denominated assets and U.S. dollar-denominated assets. The shrinking of the interest rate differential led to reversal of capital flows, which Kenya enjoyed along with strengthening of the shilling since 2008. Furthermore, Kenya saw reduced capital inflows due to decline in tourism receipts and poor export performance. The excess volatility, however, was tamed in the fourth quarter of 2015 thanks to CBK's successful intervention to the foreign exchange market and the government's syndicated loan bringing U.S. dollar inflows back to Kenya.

Figure 1.35 | : The Kenyan shilling performed well compared to other regional currencies

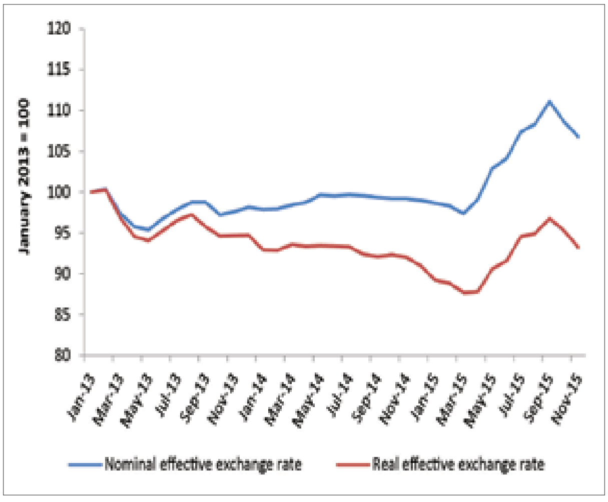


Source: Authors computation from CBK data

The Kenyan shilling appreciated against the euro and regional currencies (Figure 1.35). In the 12 months ending December 2015, it depreciated 13.0 percent against the U.S. dollar, moving from KSh. 90.4 to KSh 102.2. Against the British pound, the shilling also depreciated 8.4 percent, moving from KSh. 141.5 to KSh. 153.3. In contrast, the shilling appreciated 0.4 percent against the euro, moving from KSh. 111.5 to KSh. 111.1. Against regional currencies, the shilling appreciated 10.3 percent against the Tanzanian shilling and 7.5 percent against the Ugandan shilling. It appreciated 13.6 percent against the South African rand. Notably, thanks to the successful intervention, month-on-month exchange rates of the shilling have been appreciating against both world major currencies, including the U.S. dollar, and regional currencies since October 2015, despite the rise in U.S. interest rate, the slowdown of Chinese economy, and volatility in the global financial markets.

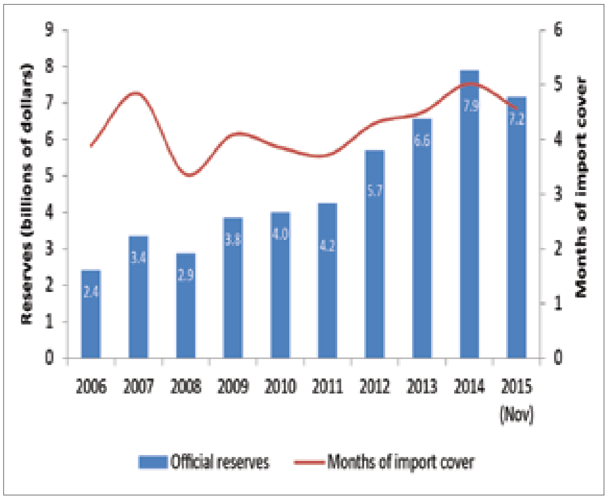
Kenya's nominal and real effective exchange rates continued to depreciate but at a slower pace towards the end of 2015. In the 12 months ending in November 2015, the effective exchange rates, measured as a trade-weighted average of bilateral exchange rates, depreciated 7.6 percent and 1.3 percent in nominal and real terms, respectively (Figure 1.36). The pace of depreciation has been relaxed since September 2015 when it hit the peak, depreciating 11.9 percent and 5.1 percent in nominal and real terms, respectively. Compared to other countries in the region, Kenya has been less tolerant of the potential for large and rapid depreciation against the US dollar.

Figure 1.36 | After three years of moderate appreciation, the shilling depreciated in the real term in the second quarter of 2015



Source: Central Bank of Kenya

Figure 1.37 | Foreign exchange reserves fell due to CBK's intervention, but still high enough to cushion Kenya from short-term shocks



Source: Central Bank of Kenya

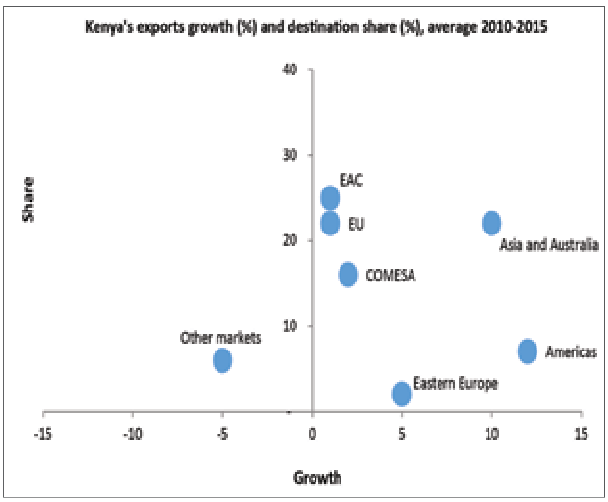
Though slightly declined from 2014, by intervening in the foreign exchange markets,gross international reserves remain sufficient (Figure 1.37). After the intervention in September 2014, Kenya's international reserves fell to US$6.7 billion, equivalent to 4.3 months of imports, from the peak of US$7.9 billion on 2014. The narrowing current account deficit, thank to lower oil import bill and government's external borrowing in October 2015, helped quickly rebuild official reserves, reaching US$7.2 billion, equivalent to 4.6 months of imports as of November 2015. This level of reserves is above the conventional level in low-income countries and the target set by the East African Community convergence criteria at 4.5 months of imports.[11]

[11] Drummond, P., Wajid, S.K., and Williams, O. (eds). 2014. "Quest for Regional Integration in the East African Community.

Trade Performance and Export Growth for Employment Creation

The declining performance of Kenya's merchandise exports is not new, yet reversing it is key to robust growth and employment creation. Overall exports growth averaged 3 percent for the period 2010-2015, which was below average economic growth of 6 percent during the same period. More importantly, export growth to Kenya's largest markets, EU, EAC and COMESA, was only 1-2 percent. At the same time, exports to Asia, Australia and the America's recorded remarkable growth at about 10 percent.

Figure 2.1 | Exports to EAC and EU have stagnated but Asia & Australia are now at par with EU at 22 % of total exports.



Source: Central Bank of Kenya

Notably, exports to Asia and Australia account for similar share with EU, accounting for 22 percent of total exports. But by far the most significant growth on exports recorded was to the Americas, at rates above 10 percent.

Exports to EAC region started declining in 2011. This coincided with the entry of the fully-fledged Customs Union. The customs union abolished preference access of Kenya's manufactured products from Export Promotion Schemes. These products started to attract full Common External Tariff instead of being traded on duty free basis. Box 2.1 shows the export products that have declined in the EAC market. These products are from the manufacturing sector. Notably, Tanzania and Uganda now source these products from other markets outside the region (trade diversion). This market loss, which in real sense means loss of trade related jobs in Kenya, needs to be accompanied by a reallocation of factors to sectors that can compete in a deepened regional trade.

Box 2.1 | Kenya has lost export market for key manufactured goods

Tanzania, where Kenya has lost export market valued at USD200m, leads in the EAC market decline. This represents a decline of 27% of exports between 2012 and 2015. The products behind this market loss include the following: Products of milling industry (HS11), Animal and vegetable fats and oils (HS15), Processed meat and fish products (HS16), Cocoa and cocoa preparations (HS18), Soaps and washing lubricants (HS34), Plastics (HS39), Apparel and clothing (HS61 - 63), Electrical machinery and equipment (HS85), Motor vehicles (HS87) and Furniture (HS94).

Kenya exports to Uganda recorded a decline of 12% or USD96 million between 2011 and 2014. The products behind this decline include: Meat (HS02), Animal or vegetable oils (HS15), Sugar and sugar confectionery (HS17), Tobacco (HS24), Pharmaceutical Products (HS30), Soaps (HS34), Aluminum products (HS35), Plastics (HS39), Paper and paper boards (HS48), Apparel (HS 60 - 63), Footwear (HS64), Iron and Steel products (72), Electrical machinery (HS85), and Glass and glassware (HS70).

A clear strategy will be required to reclaim a competitive edge in these more integrated markets. Impetus for Kenya products to reclaim the market share lies in the revealed export potential targeting Tanzania's extra regional imports of similar products. A case in point is plastics, where Tanzania's imports from outside the EAC stood at USD604million in 2013 against Kenya's exports that had plummeted to USD17.4m by 2014. In Uganda, Kenya exports of Animal or vegetable oils stood at USD11m in 2014, Uganda imports of similar products from Rest of the World stood at USD251m in 2014. This implies a trade potential of USD240m in this one chapter alone!

Kenya Requires a Clear Export Strategy to Expand Exports in Each of the Trading Blocks EAC and COMESA

Retaining and expanding these regional markets requires a genuine commitment to the partnership by all member countries. The factors that have largely been attributed to the decline in exports include restrictive rules of origin across most of the products of Kenya's, and indeed other EAC countries', intra-regional export interest. SPS and Standards are also specific NTBs that may have a role in explaining the decline. Equally restrictive were customs procedures on intra-regionally traded products that ended up making it difficult for exports of certain products into the EAC region. Non-Tariff Barriers, especially SPS and Standards that have been reported by Kenya exporters into the COMESA market and the restrictive Rules of Origin will need to be addressed. Equally important is need for an export strategy targeting growth of exports in strategic markets in COMESA.

The prospect for Kenya, and indeed other EAC Partner States, to increase their intra-regional exports lie in the recently concluded reforms in the EAC. One such reform is the revised EAC Rules of Origin (2014) that have introduced the flexibility that was lacking in the previous rules and as well as ushering in very generous cumulative principle that allows Kenya and other EAC Partner States to cumulate with raw materials from more countries than was the case under the previous rules.

The immediate effect of this is to open up duty free market access for products that were previous denied such privilege on account of origin criteria. Cereals, pasta, bread, pastry, cakes and biscuits, among other processed foods of HS chapter 9, are some the key beneficiary products, where the *'wholly obtained'* criteria was dropped in favour of the more flexible *'Change in Tariff Heading.'* The latter allows all products from EAC milling industries to be traded within the EAC on duty free basis, irrespective of where the raw material was sourced.

This transformative change in the Rules of Origin is expected to see a steady substitution of breakfast cereals imported from outside the EAC region with EAC originating products manufactured using raw material obtained from most competitive global source countries. This will no doubt see investments and new jobs being created as Kenya and EAC Partner States exploit this potential. This story is replicated in many other manufactured products that could not access EAC market on duty free basis as a result of the restrictive rules of origin.

The prospect for Kenya, as well as other EAC Partner States, of enhancing their intra-regional trade is further explained by the recent Single Customs Territory reforms, particularly the destination country model of customs clearance. This model has removed red tape in intra-regional trade and introduced efficiency in intra-regional trade facilitation, leading to enhanced predictability of export/import business in terms of customs and other trade facilitation agencies treatment, reduction in time and cost of transaction.

The revised rules of origin, reforms in the SCT and the ongoing reforms of the EAC Customs Management Act to address CET and Stay of Duty/Duty Remission and related restrictions are low hanging fruit which Kenya could capitalize on, in working towards regaining the EAC market.

Box 2.2 | Kenya has lost export market for key manufactured goods

African countries, mainly concentrated in neighboring countries (such as Sudan, DRC, EAC, Zambia, Angola, and Zimbabwe among others), and Western Africa (Senegal and Cote d'Ivoire).

However, KENAFRIC exports share and destination markets have reduced over time. The company exports represented 70 percent of its products in 1980-1990s, but now exports only accounts for 50 percent of total production. Lost markets include Western Africa (including Mali and Guinea Conakry) due to high transport costs that made their products uncompetitive (Western Africa, DRC) and to competition from cheap imports from China (Ethiopia).

Like other manufacturing companies, KENAFRIC has shelved expansion plans for now. Electricity bill is still high and unpredictable; despite a decline in fuel cost charges. Power outages have reduced in the last months, but electricity tariffs remain high compared to other countries. In addition, labor cost is more expensive in Kenya compared to that of the neighboring countries like Uganda, since minimum wage is adjusted every year.

Box 2.2 | Continued

Imports clearing procedures are still a constraint and impose a significant burden to importers as government introduces new customs clearing procedures to seal revenue leakage. The numbers of clearing days have been reduced from 7 days to 4 days, which is good. However, going beyond four days attracts steep demurrage charges per extra day spend in the Container Freight Services (CFS). Such delays are expected especially for companies that have many containers that need clearance. Four days are often not enough. KENAFRIC imports raw materials for confectionery (including industrial sugar from Egypt), and glucose among others.

There are other challenges that undermine KENAFRIC operations. These include delays in VAT refund by government, unreliable KRA online system, inability of KRA to audit companies' books on annual basis, corruption and additional licenses required by different counties.

There is need for government to initiate dialogue with manufacturers. The government has put efforts in improving the ease of doing business. But, proper execution is a challenge. Listening to manufacturers will help reduce the bottlenecks preventing the industry from expanding and creating more jobs. Furthermore, putting polices in place without consulting stakeholders was cited as a challenge.

Expanding The COMESA Market

Kenya's export growth in COMESA has largely been driven by Ethiopia and Congo DR, where exports grew by 6% and 5% respectively during 2010-15, despite these countries not implementing the full COMESA FTA. Exports to Egypt and Malawi recorded negative growth attributed to a decline that was experienced between 2013 and 2015 for Malawi, and 2013 and 2015 for Egypt.

Exports To The EU

Prospects for increasing exports into the EU market are also demonstrated by low market share by some of the principal export products into the EU. Kenya has opportunity to increase its exports to the EU by increasing exports to lead countries through addressing of factors that have been behind slow growth as well as penetrating other EU countries. Analysis of Kenya exports to the EU by broad product categorization (HS chapter level) shows that exports from 15 broad product categories accounted for 95% of Kenya's total exports to the EU between 2010 and 2014. A further analysis of EU imports of products in these 15 broad product categories over the same period revealed huge export potential for Kenya. For instance Annex Table 2A shows that Kenya's cut flowers account for 19 percent share of the market, vegetables 7 percent, and coffee and tea only 2 percent. The signing and ratification of the EPA, which is envisaged by 1st October 2016 will provide further impetus of accessing the EU market through the flexible rules of origin that are part of this agreement and robust framework of managing SPS and TBT issues between the EU and the EAC.

Exports to Asia and Australia

These regions hold significant potential for expanding Kenya's exports. They now account for 22 percent share of exports, which are growing at 8 percent annually. Eleven countries, which accounted for 87% of Kenya's export to the region, were behind the growth of exports. The lead countries in terms of the average growth rate were South Korea, Australia, China, Iran and Saudi Arabia. In terms of the value of exports, the lead destination countries are Pakistan, United Arab Emirates, Afghanistan, India, China, Yemen and Saudi Arabia.

Analysis of the products destined to this region shows that products similar to those exported to the EU dominate the list, although there are additional products. This product mix offers opportunity to scale up production of existing products. Asia and Australia will, therefore, play a pivotal role in the growth of Kenya's exports, primarily because Kenyan companies that are already producing for the EU market can expand their production to meet the growing demand in Asia and Australia. The region also provides an opportunity for Kenya to grow her exports of products such as processed fish and meat and other agro-processed foods, which have suffered from narrow destination export market. By offering opportunity for Kenya's export growth, Asia and Australia will be contributing towards promotion of the competitiveness of Kenyan firms that will now have an opportunity to produce at full capacity as well as contributing to employment creation as companies increase their production to meet this demand.

These opportunities will need to be tapped through an export development strategy geared towards understanding the market and linking various Kenyan value chains to this market, in order to ensure sustainability and continued growth of the exports.

Exports To The Americas

The U.S.A takes the lead in the share of Kenya's exports to North and South America. This is driven largely by the preferential market access terms under AGOA. The following product categories have been behind the tremendous increase in Kenya's exports to the US: Cut flowers; fruits and nuts; coffee, tea and spices; animal or vegetable fats and oils; preparations of vegetables (frozen vegetables); essentials oils and cosmetic products; leather goods; textile and apparel. Future growth in this market will be aided by the extension of the AGOA by a further 10 years to 30th September 2025.

The other prospect for increased exports of Kenya's products to the U.S. market lie in the untapped potential of the eligible 4,600 products and AGOA-eligible 1,800 tariff lines. Among the products in the AGOA-eligible list which Kenya is not exporting to the U.S. include the following: meat; dairy products; dried fruits; processed fish and meat products; fruit juices and tobacco.

Exports To Eastern Europe

Eastern Europe is emerging as an important destination for Kenya's exports largely driven by Russia and Kazakhstan. There are prospects for Kenya to grow its exports to Eastern Europe as demonstrated by the high growth rate of its limited exports, especially to Russia and other Eastern European countries. There may be need to further understand the demand of other products that Kenya is producing and exporting to EU and other countries, with a view to broadening export base beyond the above four broad categories. This should be integrated in the export development strategy for Kenya's export to Eastern Europe.

Growth Outlook for 2016-18

Current growth momentum will be sustained in the medium term rising from 5.6 percent in 2015 to reach 6 percent in the medium term (table 3.1). Four factors underpin the growth outlook: (i) prudent monetary policy is expected to keep inflation within the policy bounds and mount pressure on commercial banks to reduce lending rates; (ii) Oil prices are projected to reach a low US $ 37 per barrel in 2016 rising gradually to US $ 51 in 2018, which will reduce the cost of production while keeping inflation low and further contracting the current account deficit; (iii) realized fiscal consolidation will ease the pressure from domestic credit market to spur growth in credit to private sector; (iv) and, favorable weather conditions will catalyze growth in agriculture with positive spillovers to the rest of the economy.

Private consumption: Prudent monetary policy is expected to keep inflation within the policy target range. Monetary policy actions will be complemented by the prevailing low oil prices, relatively lower cost of electricity due to the enhanced energy production and declining food prices. Overall stable domestic prices will boost household disposable incomes and free up more income for other forms of spending and/or saving.

Private investment: If realized, the ongoing fiscal consolidation will ease competition for credit with the private sector to spur private sector investments. Central bank vigilance is also expected to mount pressure on commercial banks to reduce lending rates. Falling energy cost (from oil and electricity

Table 3.1 | Medium Term growth outlook (percent)

	2014	2015e	2016f	2017f	2018f
Real GDP growth, at market prices	**5.3**	**5.6**	**5.9**	**6.1**	**6.2**
Private consumption	5.5	5.2	6.0	6.0	6.4
Government consumption	2.7	14.7	10.4	7.6	5.8
Gross fixed capital investment	11.1	8.4	9.0	9.3	9.5
Exports, goods and services	2.3	2.0	3.0	4.8	4.8
Imports, goods and services	9.7	8.7	8.7	8.2	8.0
Agriculture	3.5	3.9	3.5	3.6	3.6
Industry	6.5	5.0	5.0	5.2	5.4
Services	5.8	5.5	5.7	5.2	6.0
Current account balance, % of GDP	**-10.4**	**-7.1**	**-6.0**	**-5.4**	**-5.3**
Fiscal balance, % of GDP	**-7.2**	**-8.3**	**-7.5**	**-6.4**	**-4.4**
Revenue	19.4	19.8	20.6	21.0	21.3
Expenditure	27.3	29.2	29.1	28.1	27.1

Source: World Bank and National Treasury
Note: e (estimate), f (forecast)

prices) is expected to be a catalyst of lower cost of production and operations in the industry sector. The sector is expected to realize some gains from the huge government investment in power generation projects. The business environment has also improved in terms of reduced cost of doing business. According to the World Bank, Kenya moved up 21 places in the ranking in the beginning of 2016, up from position 129 in 2015. This is expected to boost investor confidence. The exchange rate is expected to stabilize, and this will stabilize imports as well, given that most investments rely on imported machinery and transport equipment.

Government Investment: The medium-term fiscal framework outlines a fiscal consolidation program. Fiscal consolidation will be achieved through cutback in recurrent spending supported by a drop in interest rates payments and wages and salaries. Revenue will remain steady, but with low buoyancy. External financing for key flagship projects will ease pressure in the domestic credit market.

Exports: Export growth will remain muted in the near term. Weak export performance is attributed to low commodity prices (coffee and tea) and subdued demand in European markets. Structural constraints to regional trade will undermine export potential. These include non-tariff barriers to trade, high transport and logistics costs within the region, among others. However, net export position will improve largely supported by the drop in oil imports.

Risks To The Outlook

The update identifies five key risks to the outlook; the risk of electoral violence in the run up to 2017 general elections, the rebalancing of the Chinese economy, the signal for further hikes in the Fed rate, the subdued prices of commodity prices and the ever present security threat particularly from terrorism. This security threat remains a risk to tourism and related investments.

There are two elements pertaining to run up to the 2017 elections. First, Kenya's elections years are characteristically associated with low growth, except in the 2013 election, as elections delay private investments due to political uncertainty. Second with election spending in 2016/17, it may be hard to maintain low recurrent expenditure; as a result, election spending may increase at the expense of development expenditure.

The recent hike in the US Fed policy rate and the signal for similar hikes is likely to see reversal in short inflows which in the past years helped finance Kenya's external account. A decline in capital inflows is likely to put pressure in the currency markets. It is also likely to see a rise in interest rates globally, rendering international bond markets as expensive deficit financing options. However, the recent IMF Stand-By Arrangement (SBA) and the Standby Credit Facility (SCF), mitigate against these risks.

The rebalancing of the Chinese economy from export to domestic consumption is also likely to impact Chinese financing of key flagship projects in the region. As China puts a break on the rapid growth witnessed in the last decade and rebalances from exports to consumption the composition of imports is also likely to change from raw materials to consumer goods. The likely impact on Kenya is discussed in Box 3.1 .

Box 3.1 | Impact of China's slowdown on Kenya

Impact of China's slow down and rebalancing: Boom or doom?

China's reform blue print aims to (i) rebalance the economy away from investment to consumption and; (ii) to put a break on fast growth witnessed in the last decade. After averaging 10% annual growth for 30 years, growth is projected in the single digit range in the coming years and investment as a share of GDP will decline to about one third of GDP. This share is taken up by consumption. China's cooling down has tempered the demand for commodities (food and natural resources) and the decline in prices has played out with an overall negative spill overs for commodity exporters. The rebalancing will increase the demand for imported consumer goods and services is expected to see a gradual rise in wages in the services sector in China.

Who are the winners and losers?

The likely winners from the rebalancing are countries that export consumer goods to China. The losers are the countries that export industrial inputs and intermediate commodities. So what about Kenya. A World Bank simulation model estimates show that Kenya along with Madagascar, Nigeria and Cameroon are likely to gain from China's rebalancing. The simulations estimate a 7.5 percent gain in additional GDP compared to the baseline.

How can Kenya leverage China's rebalancing to maximize the gains?

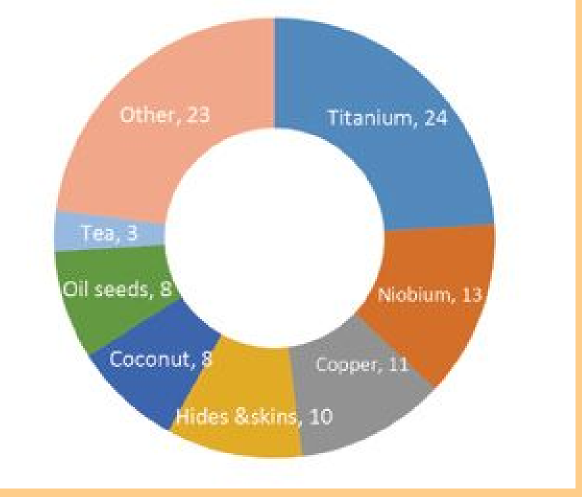
The net impact for Kenya will depend on how it recalibrates its trade with China. Kenya's imports from China are three times Kenya's exports to China. Ores and concentrates rank among her major exports to China, growing from 7% [Ksh. 0.3bn] in 2014 to 56% [KSh. 2.3bn] of major exports in 2015, the growth emanating from exports of titanium. Investment in the extractives sector remains a risky affair for Kenya, for now. Other leading exporters of ore and allied extractives are already feeling the effect. Taiwanese machine-tool makers have seen exports to China fall by more than 20% since 2012 and Australian iron ore for delivery to China recently hit its lowest price in 21 months. More tepid Chinese demand means lower prices for many raw materials.

The spending power of Chinas 1.3 billion and a burgeoning middle-class presents significant opportunity for Kenya to bolster its non-extractive consumer goods such as processed tea and coffee which constitute 3.3 and 1.2 percent of the exports to China, (value of tea exports to China stood at KSh. 206 million in 2015, a decline from KSh. 233 million in 2013).

Box 3.1 | continued

Coffee and tea jointly account for about 4.5 percent of total exports to China.

Figure B 3.1.1. | Composition of Kenya's exports to China 2015 (percent)



Source: Computations from KNBS.

Strikingly, dairy products do not feature at all in the list of Kenya's top-exports to China. Milk exports from New Zealand to China have seen the term "white gold" coined with significant fortunes for the former. Transformative and urgent change to the trade and logistics landscape is needed for Kenyan dairy products to make meaningful entry into the giant Chinese market including matters relating to sanitary and phytosanitary standards.

Kenya's trade with China remains a delicate balancing act that can be strengthened by diversification and recalibration to meet the changing tastes of the growing middle-class. Of more immediate need is a lesson from China itself where the reform of State Owned Enterprises (SOEs) to unleash domestic entrepreneurship.

Sources: Africa's Pulse and World Bank Group analysis.

Special Focus: Transformational Jobs Key to Kenya's Social-Economic Development


Photo: Sarah Farhat / World Bank

Special Focus: Transformational Jobs Key to Kenya's Social-Economic Development

Kenya's Vision 2030 aims at transforming "Kenya into a newly industrializing, middle-income country providing a high quality of life to all its citizens." Kenya plans to achieve this by building a globally competitive and prosperous economy, a just and cohesive society with social equity in a clean and secure environment, and a democratic political system that protects rights and freedoms of every individual.[12] Availability of job opportunities, particularly more productive and transformational jobs, will be key to realizing this vision. This section of the Kenya Economic Update provides a diagnostic of jobs and workers in Kenya, focusing on youth and jobs in urban areas. It draws extensively on different sources of firm data and on a new household level survey in Kenya's urban areas, the Skills Towards Employment and Productivity (STEP) household survey done in 2013, to analyse the links between individual characteristics, skills, and labour market outcomes.

Jobs are fundamental to development. They impact living standards, bring about economic growth, and help foster a sense of identity and belonging. In both developed and industrialized countries, jobs matter tremendously for welfare. Economic growth can result not just from more job creation but also from jobs becoming more productive or from workers moving from low to higher productivity jobs. Widely shared job opportunities are essential to sharing economic prosperity in the population at large. Whether an individual has a job, and the kind of job that person holds, influences his or her identity and role in the community. After all, jobs and work places bring people together. Conversely, lack of job opportunities is critical source of social unrest in many places.[13]

For Kenyan citizens, finding good employment is among their greatest concerns. When asked about key challenges in their society, Kenyans overwhelmingly cite unemployment, sometimes understood to include underemployment, as one of the major issues that need to be tackled by the Government. In urban areas, unemployment is rated second only to crime and security as a key issue for policy, while in rural areas; it falls only behind deficient infrastructure and food shortages.[14]

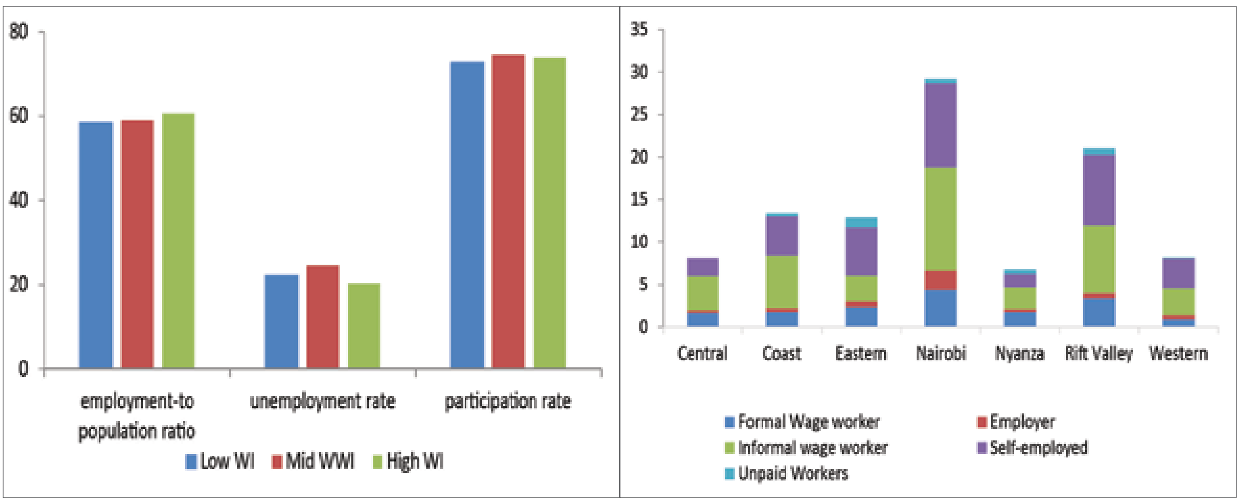
Lack of good jobs is slowing down poverty reduction. Several socio-economic indicators[15] suggest that there has been little reduction in many indicators of poverty.[16] Lack of access to good jobs is a key

[12] Government of Republic of Kenya, 2007, *Kenya's Vision 2030*
[13] World Bank (2012), *World Development Report 2013: Jobs,* World Bank: Washington, DC
[14] Afrobarometer (2015), *Summary of Results, Afrobarometer Round 6 Survey in Kenya, 2014.*
[15] Recent poverty data is not available, with the most recent household survey from 2005.
[16] World Bank (2013), *Kenya Economic Update: Time to shift Gears – Accelerating Growth and Poverty Reduction in the New Kenya,* World Bank: Washington, DC.

factor in slowing down progress in the fight against poverty. Whereas the ratio of employed family members to total family size is very similar across household income levels in Kenya, individuals living in the 30 percent of households at the bottom of the wealth distribution have had virtually no access to better paid jobs. This limits their ability to transition out of poverty. Such Kenyans are likely to work in low paid activities for themselves or their families, or in the informal wage sector. They have effectively no access to better-paid wage jobs in formal firms.

Kenya will continue to face significant demographic pressures for job creation. This requires higher and more productivity-driven growth. Between 2015 and 2025, the working age population will increase, on a net basis, by nearly nine million people. One third of them, or three million, will be made up of young people, between ages 15 and 24. These youths will want jobs, but to find better jobs than is currently the case, the current level and composition of economic growth will not be sufficient. In the past decade, Kenya's increase in value added was largely driven by the need for more employment, rather than more productivity. While the employment-to-growth elasticity was high, with job creation matching value added growth one-for-one, the quality of jobs did not improve. Indeed, if past growth patterns continue, productivity will continue to play a very limited role in value added growth (Figure 4.2, a and b). If Kenya is to realize better quality and higher paying jobs, there will be a need to change the incumbent growth model.

Figure 4.1 | Jobs and wealth index[1]: access matters less than quality of jobs



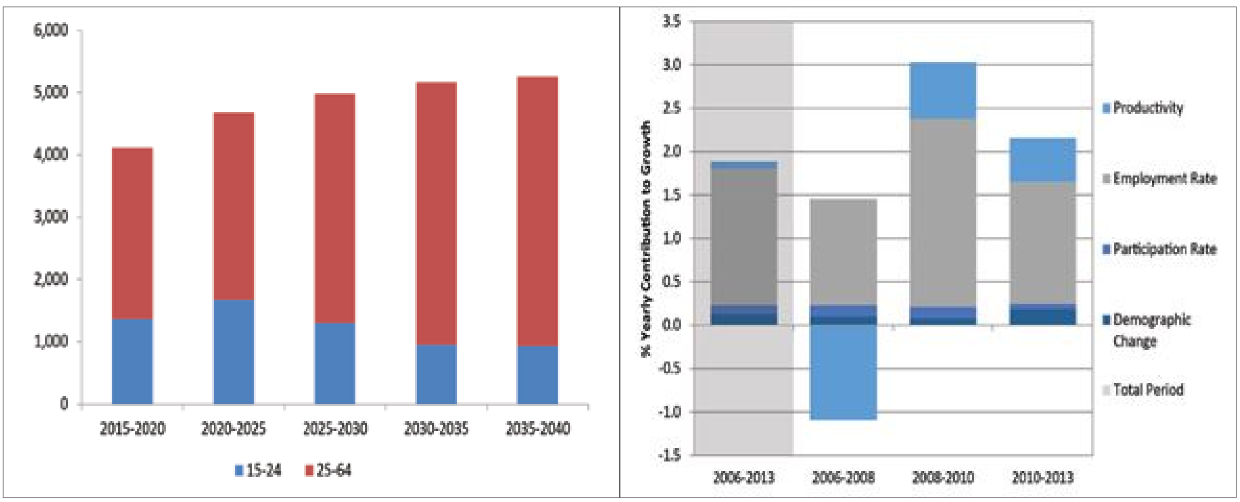
Source: Estimates based on STEP survey. The wealth index is calculated using information on current household dwelling characteristics and assets. Low Wealth Index refers to those in the Bottom 30%, Mid Wealth Index corresponds to those in the middle 30%, and the High Wealth Index represent those in the top 40%.

Regionally balanced job creation in both urban and rural areas will be necessary. Relative to its income level, Kenya is "under-urbanized," with only 25 percent of the population living in urban areas. In comparison, 53 and 40 percent of the population live in urban areas in Ghana and Zambia, respectively. However, Kenya is now a rapidly urbanizing nation. The advantages that urban agglomeration offers, in terms of concentration of skills and resources, and the need for prioritized policies in terms of sector and location suggest that it would be important to focus on policies that foster sustainable urbanization and "job clusters" in cities and smaller towns. At the same time, it is clear that a majority of the population will remain in rural areas for the foreseeable future. They, too, will need more productive jobs.[17]

Needed: More Job opportunities in Kenya

Many jobs have been created but unemployment and underemployment still high in Kenya's urban areas. The Kenyan economy on average created an impressive 800,000 jobs per year between 2006 and 2013. Thus, employment grew at 4.5 percent per year, by far exceeding working-age population growth at 2.8 percent per year. However, high growth was not enough to make a sizeable dent in unemployment and underemployment. The lack of jobs is evident in urban labor markets: nearly two million urban residents between ages 15 and 64 are jobless, not counting college students. Affecting some 20 percent of the active population, or about 0.9 million people, urban unemployment is clearly pervasive. Another 0.9 million adults are inactive (not employed, but not looking for a job), but are not enrolled in education or training (Figure 4.3). Moreover, unemployment is therefore not fictional. Almost one third of the unemployed have been looking for a job for at least one year.

Figure 4.2 | "Business as usual" growth will not result in better jobs



Source: Estimates based on data from the UN and from the Kenya National Bureau of Statistics (KNBS)

[17] Lack of data complicates the analysis of the labor market in Kenya. There is no recent data on labor market trends, particularly in on the rural areas. The most recent comprehensive analysis on a national basis was based only on census data from 2009 and the latest nationally representative household survey was administered ten years ago (another one is being fielded in 2015/1016).

Figure 4.3 | Distribution of Kenya's urban population (thousands, 15-64 age categories)

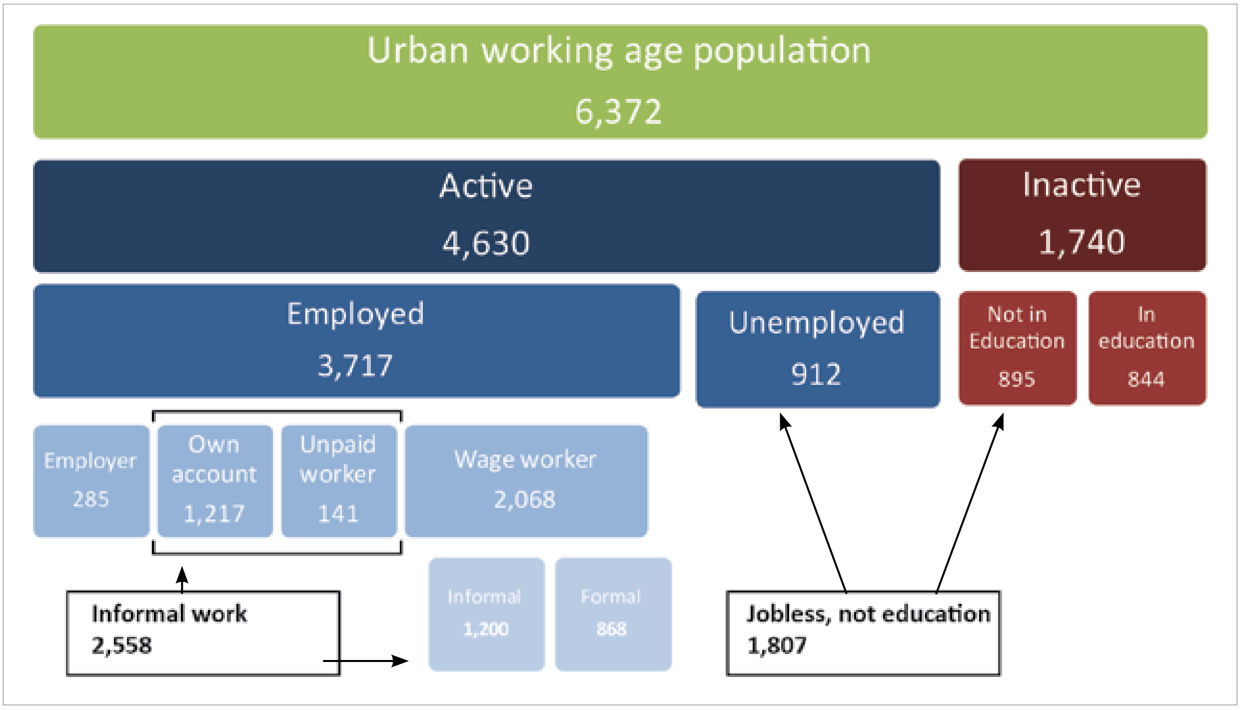
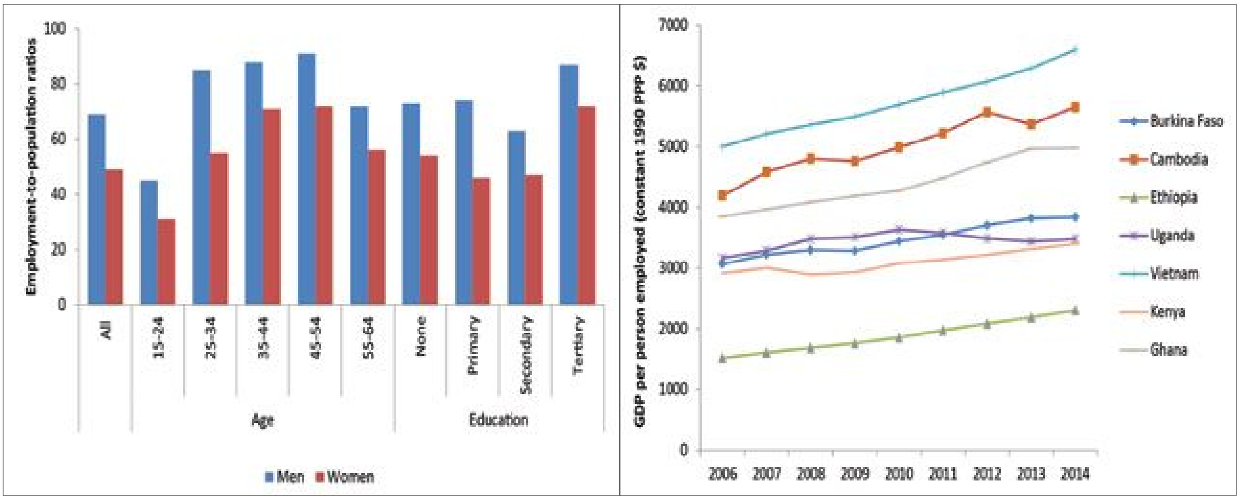


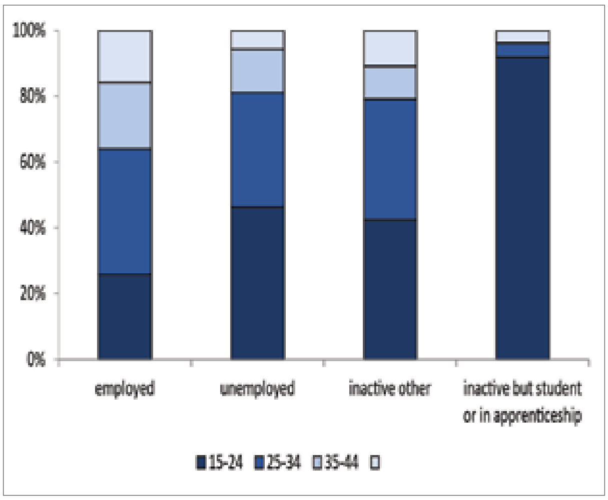
Figure 4.4 | Lack of jobs, and lack of productive jobs



Source: Estimates based on STEP survey (left), and World Development Indicators (right)

Productivity level of jobs is low and productivity growth has stagnated. A majority of Kenyans do work, notwithstanding high unemployment and inactivity rates (Figure 4.4, a). However, Kenyan workers are predominantly locked into low productivity jobs and sectors. Between 2006 and 2013, value added and total employment increased at roughly the same rate. As a result, value-added per worker, a measure of labor productivity remained stagnant, limiting the potential for improving earnings. In fact, GDP per employed person is lower in Kenya than in many African peers (Figure 4.4, b), and has been increasing at a slower rate than in other countries, including poorer ones like Ethiopia, and richer ones like Ghana, Burkina Faso, and Cambodia.

Figure 4.5 | Youth are less likely to have a job, even when they are not in school



Source: Central Bank of Kenya

Feelings of the youth on their exclusion from better jobs. Young Kenyans also voice concerns about how the lack of job opportunities confines them to low earning, sometimes dangerous or illegal activities. They feel vulnerable to nepotism and sense a lack of fairness in accessing well-paying and secure jobs.[18]

Even when they are not in school, young people are less likely than older people to be jobless (Figure 4.5). There are indications that the private sector is not a preferred option for youth. The public sector jobs can absorb only a small share of the youth entering the labor market. Most youth will need to find jobs in the private sector. However, job preferences among youth reveal a preference for public sector jobs. Not only do they offer high potential earnings, but other non-pecuniary rewards such as job security and career opportunities are also important factors. Results from a Discrete Choice Experiment Survey, undertaken to ask young people to choose between different job options, shows that Kenyan youth rate the public sector highly compared to the private sector. The job stability of public sector employment carries a high premium. Consequently, the youth would be prepared to forego 1,700 KES per month in a private sector job in order to hold a public sector one. They are also prepared to forego some salary in exchange for job benefits such as pension and vacations. Together with job stability, these benefits explain why the public sector is a preferred employer to the private sector.

The Economy Not Creating Enough Productive Jobs

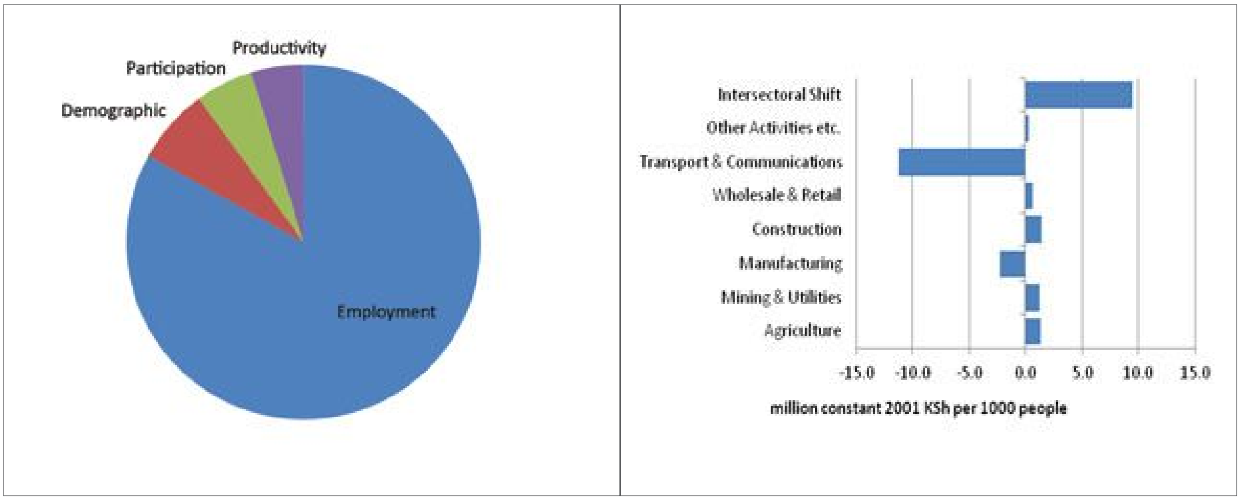
Kenya's growth model is not generating sufficient good jobs. Economic growth in Kenya has been fuelled by public investment in infrastructure, including railways, roads and energy, and domestic consumption. This growth model has generated high economic growth, and also some jobs. However, these jobs have not been sufficiently productive. High consumer demand has spilled over into demand for services, but has not resulted in a take-off in the more dynamic, high productivity services sectors.

[18] World Bank (2012), Kenya Economic Update: Kenya at Work, World Bank: Washington, DC.

Recent growth in value added per capita mostly driven by increase in the share of the employed labor force. The contribution to growth (per capita) can be separated out into several phenomena. Growth can be the result of more people coming of age and thus in principle able to work. Growth can increase because a higher proportion of those adults choose to work, or because more of those looking for a job find one. And finally, growth can come about because the employed become better at what they are doing. For example, because of learning on the job or because of access to more sophisticated technology. Estimates for Kenya show that between 2006 and 2013, the most significant contribution to per capita value added growth was an increase in employment in the active labor force, accounting for 83 percent of total per capita value added growth. Employment growth was in turn driven by a strong growth in employment in services, mostly in the (largely informal) trade sector (Figure 4.6, a). Higher participation and demographic changes contributed 7 and 5 percent.

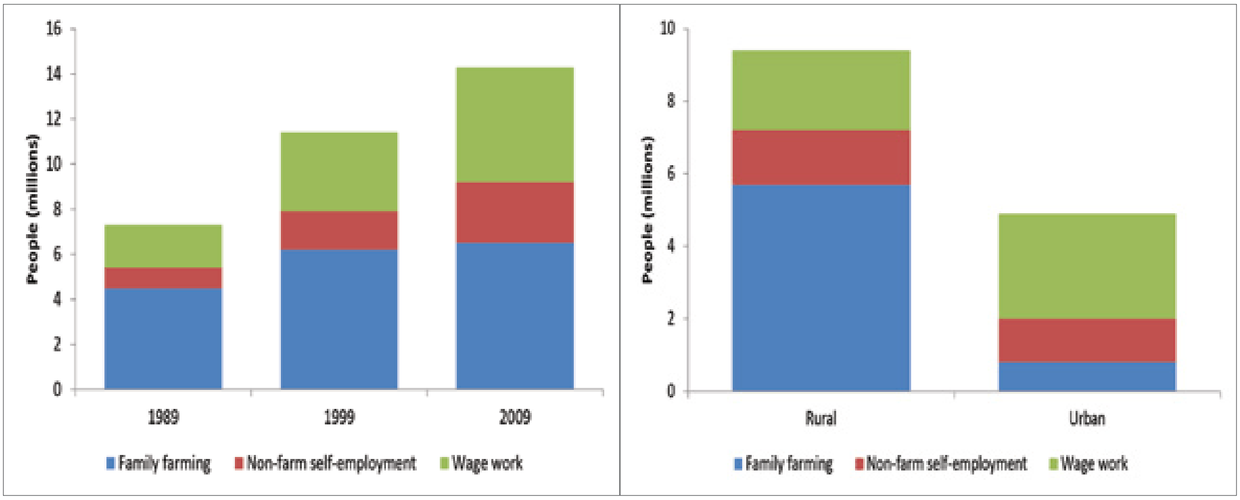
The contribution of labor productivity to growth was minimal. At the same time, labor productivity within sectors remained stagnant, limiting the potential for improved job quality. Given the stagnation in labor productivity growth, its contribution to value added growth was limited, accounting for 5 percent of total value added per capita growth. Thus, while Kenyans were offered more jobs, those jobs were not significantly better as they were not associated with higher value added. The very small contribution of labor productivity to overall value added growth was almost entirely driven by inter-sectoral shifts: a net relative increase in the services sector and a net relative loss in agriculture. However, the shift from agriculture into the informal trade sector did not signify a significant improvement in productivity and further, productivity growth within sectors was negligible (Figure 4.6, b). Given the perception of significant pockets of underemployment in the farm sector, it is remarkable that a reduction in the agricultural work force was not accompanied by an increase in agricultural productivity.

Figure 4.6 | The contributions of growth fail to show significant change into more productive jobs.



Source: Estimates based on KNBS Economic Surveys complemented by 2009 census.

Figure 4.7 | Employment in urban and rural Kenya



Source: Estimates based on KNBS Economic Surveys complemented by 2009 census.

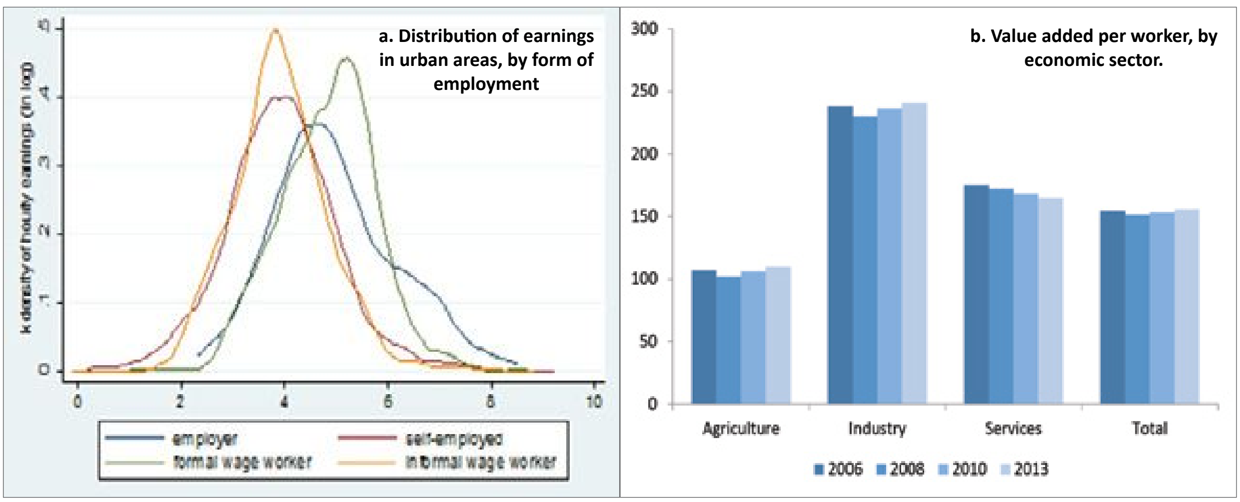
Economic growth therefore did not bring with it a significant increase in the quality of jobs. The slow structural transformation of output was mirrored in a slow structural transformation of employment. Jobs in the non-agricultural sector have been growing faster than agricultural jobs, but not at a rate sufficient to transform the structure of employment. Information from the 1999 and 2009 censuses presented in the *Kenya Economic Update: Kenya at Work* (World Bank, 2012) showed that in absolute terms, wage jobs in the non-agricultural sector increased by 1.5 million, while self-employment in the non-farm sector increased by 1 million over the same period (Figure 4.7, a). The shift out of farming happened for both young and old. However, the very young (age 15-19) were most likely to be working on family farms, possibly representing the limited options for rural youth leaving school early. While this represented a relative shift out of agriculture, some 300,000 jobs were nonetheless created in the agricultural sector (on a net basis). Importantly, farming still made up the largest single sector of employment. Unsurprisingly, opportunities still differed significantly between urban and rural areas. In rural areas, family farming dominated employment, while wage work was the predominant form of work in urban areas (Figure 4.7, b).

Urban labor markets also show evidence of lack of enough productive jobs. The message from the census data is corroborated by data from Kenya's urban areas. Kenya's labor markets are characterized by a much smaller formal wage sector and much more work in the form of self-employment or informal wage work than is typical of more advanced economies. Indeed, "labor markets" is something of a misnomer for the landscape of work in Kenya, since much of the work is not sold or bought for a wage, but takes place in self-employment. As seen in Figure 4.3 above, non-wage work, – self-employment or unpaid work for businesses run by another family member – account for 44 percent of total urban employment, with the remainder in wage work. However, half of wage employees are working in the informal sector and less than one million urban workers hold formal wage jobs. In all, three out of four jobs in urban areas are outside the formal wage sector, mostly in jobs that generally offer low pay and irregular incomes. The lack of productive employment explains why relatively high deprivation can co-exist with a high share of employed adults: work is a necessity, but work does not pay well, so most household members are expected to contribute.

Productivity growth is held back by limited growth in wage jobs in more productive sectors. In Kenya as elsewhere, different forms of jobs offer different opportunities: wage jobs in the formal sector in particular pays much better than self-employment or informal wage work, and labor productivity is much higher in industry (in particular) and services than in agriculture. For Kenyan jobs to become transformational there is need to transition from lower productivity to higher productivity activities and jobs, both within sectors (jobs created in more productive firms) and between sectors (the bulk of jobs shift into more productive sectors). In particular, a shift of workers out of agriculture into more productive activities has the potential to increase overall productivity, including in agriculture. However, the Kenyan economy has not experienced such a transition in economic structure, whether in employment or output, in the past decade.

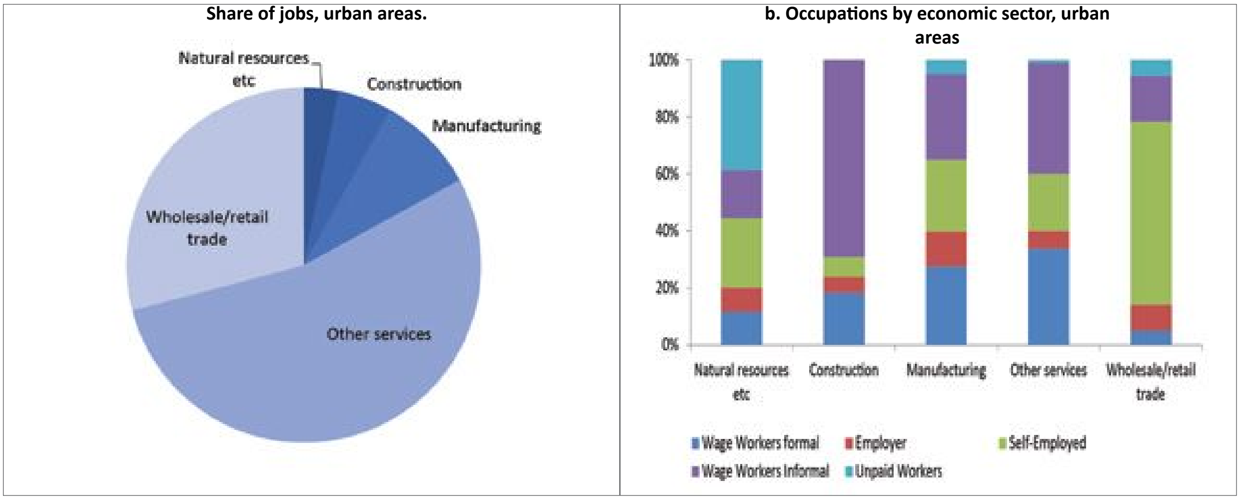
Faster growing non-agricultural sector jobs did not transform the structure of employment. In relative terms, workers shifted out of agriculture and into the services sector. The share of employment in agriculture fell from 43 to 36 percent, and that of services increased from 44 to 50 percent. However, while the services sector accounted for most employment growth between 2006 and 2013, labor productivity actually fell in the services sectors. And most of those jobs were created in the informal trade sector, where earnings and job security is low. The manufacturing sector has also shown poor performance over the last decade. Labor productivity had strongly fallen during the 1980s and 1990s and remained stable since then. Kenyan firms are having difficulties increasing productivity and allocative efficiency is low, reflecting distortions in the use of factors of production.

Figure 4.8 | Wage jobs in higher productivity services and industry are needed



Source: Estimates based on STEP survey and on data from KNBS

Figure 4.9 | Jobs are dominated by services, and by informal occupations



Source: Estimates based on STEP survey and on data from KNBS

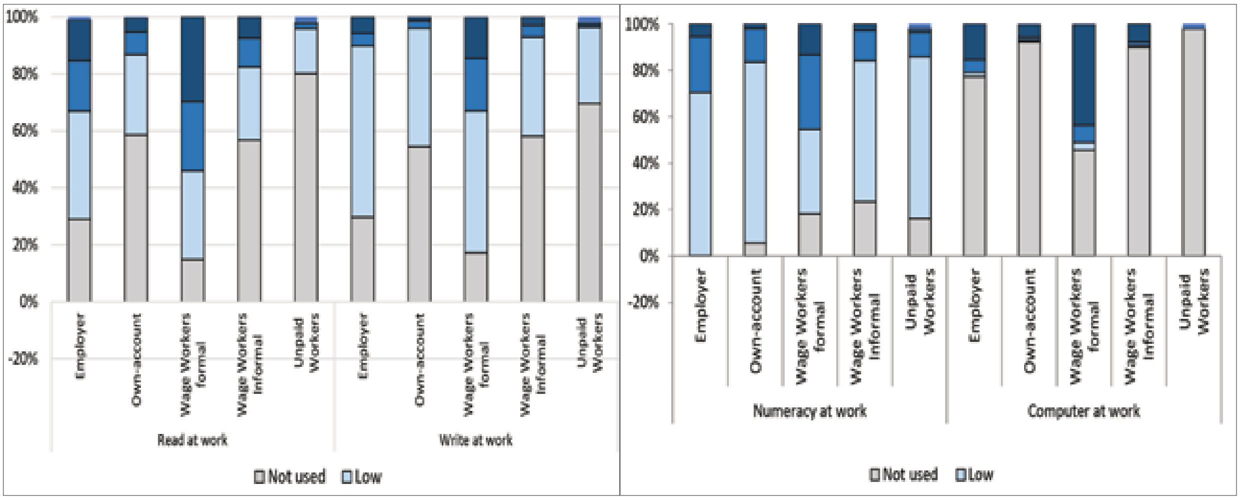
Jobs Needed to Raise Living Standards and Fight Exclusion

Given slow transformation of production and labor markets, majority of workers are confined to low earning jobs. Kenya's labor markets are characterized by a much smaller formal wage sector and much more work in the form of self-employment or informal wage work than is typical of more advanced economies. Indeed, "labor markets" is something of a misnomer for the landscape of work in Kenya, since almost half of all work is not sold or bought for a wage, but takes place in self-employment. Even in urban areas where a vast majority are engaged in non-agricultural activities, the quality of jobs is low. The urban formal wage sector employs less than 900,000 people, which is less than one quarter of the work force, while 2.5 million workers are either in informal wage employment or engaged in self-employment or unpaid work for other family members, mostly in the wholesale and retail trade sector. Those jobs tend to offer significantly lower earnings and less job security than formal sector jobs.

Four out of five jobs in urban areas are in the services sector. Wholesale and retail trade (29 percent) and other services related jobs (54 percent) make up the vast majority of urban jobs. The manufacturing sector is small, employing less than ten percent of urban workers (Figure 4.9, a). The trade sector is dominated by self-employment, while wage employment is more common in other forms of services. Informal wage work is most prevalent in the construction sector (Figure 4.9, b).

Majority of jobs are low skill, indicating lack of modernization of employment and production. In fact, many jobs do not involve the use of some basic cognitive skills. Formal wage workers, especially in high value added services, are more likely to use their cognitive skills intensively than others but these sectors account for a small share of total employment (Figure 4.10). A majority of unpaid family workers, self-employed and informal wage workers do not use foundational skills like reading, writing, or computer at work at all.

Figure 4.10 | Low intensity of skills used on the job ,Use of skills at work, by occupation status

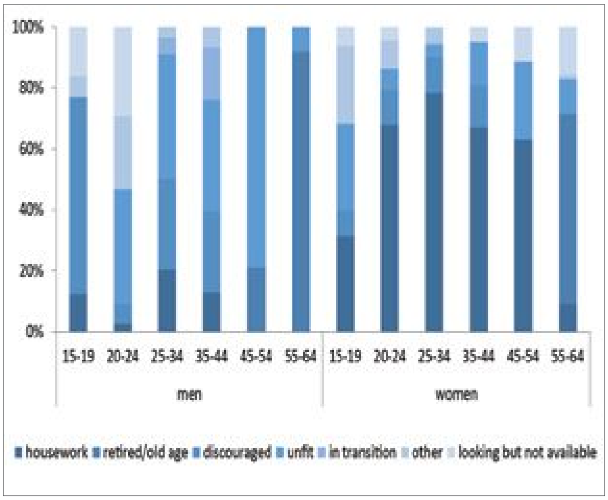


Source: Estimates based on STEP survey

Women, youth and those with little education are excluded from jobs. First, youth and women are especially vulnerable in terms of unemployment. More than one quarter of all urban active women, are unemployed. The unemployment rate reaches 40 percent for young women, and women with little or no education are more likely to be unemployed for much longer than others. Although young men fare better, 20 percent of 15-24 year old active men are also unemployed. The risk of long-term unemployment is also highest for men and women with little or no education. Women, youth, and those with less education are also more likely to be inactive. As a result, employment-to-population ratios are lowest for youth, women, and those with intermediary levels of education. Those who have completed tertiary education are significantly more likely than others to be employed.

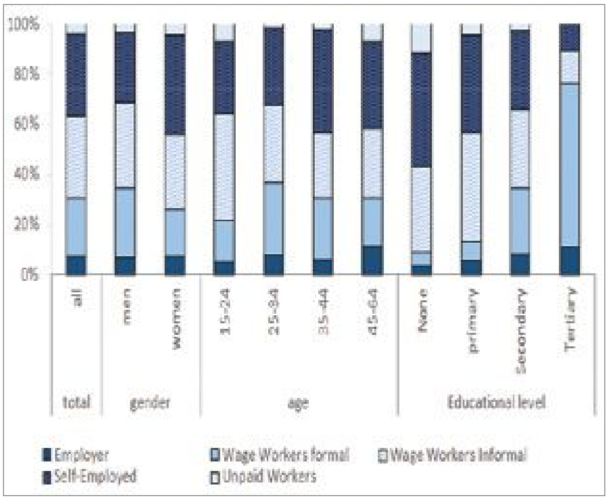
Many young women are not active in labor market because of household work. Although both men and women are among the inactive, their reasons for not looking for a job are widely different. Focusing on the jobless that are not in education, inactive young men are closer to the labor market than women. Young men are either discouraged, that is, they would like to work but have no hope of finding a job and therefore don't look for employment, or are looking for a job, which they had been unable to find within the two weeks following the survey. They are therefore not counted as unemployed. Women, however, are predominantly absorbed by household work, especially between ages 20 to 34, when they are more likely to have young children. Women are more likely than men to be inactive and also make up a majority of the discouraged workers (Figure 4.11).

Figure 4.11 | Reasons for inactivity, by gender and age.



Source: Central Bank of Kenya

Figure 4.12 | Age, gender and education levels matter for the kind of job one gets.



Source: Estimates based on STEP survey (Urban areas only).

Women, youth, and those with less education are also excluded from good jobs. Even more importantly, working women, youth and low educated workers are predominantly confined to low productivity activities. Urban women are more likely to be self-employed than men (39 percent versus 28 percent of total female/male employment), and female workers make up only one third of formal wage jobs. Whereas a majority of young workers are in the wage sector, only 28 percent of them have access to formal sector jobs, compared to 47 percent for older workers.

The youngest urban workers are more likely to be in the trade sector than in other services. Unsurprisingly, since many of them have left school early, they are less likely to be in the public administration, and in professional activities, where education levels are higher. But patterns change significantly for the workers between 25 and 34, who are more likely to be working in manufacturing, in the public sector, or in professional activities.

Slow Creation of Productive Jobs in the Formal Sector

To create better jobs, Kenya needs a thriving private sector that can engage workers in more productive employment. Labor productivity in Kenya is significantly higher in formal than in the informal sector. Within the private formal sector, more productive and more established forms offer better job conditions and higher wages. However, analysis of firm data from enterprise census of the formal manufacturing sector, and surveys of formal services sector, as well as the informal sector, indicate that the conditions for firms do not favour entrepreneurship and expansion, especially of the more productive and competitive firms in the formal sector. This suggests resource allocation is not functioning as it should in a well-established market economy.

More productive and more established firms offer better job conditions and higher wages. In the formal manufacturing sector, job security is relatively high, with more than half of employees holding a permanent job. Some 56 percent of workers have a permanent contract, 26 percent are casual workers, and 17 percent have a temporary contract. Multivariate analysis shows that older, more productive and capital intensive firms, firms investing in ICT, and exporting firms, offer a better contractual situation than others.[19] Larger firms tend to pay higher wages than medium or small firms, excluding micro-firms that surprisingly account for higher wages than the sector average. Again, multivariate analysis allows us to separate out the firm characteristics that are more strongly correlated with higher wages. More productive firms pay higher wages, as do larger firms. In addition, firms with exposure to foreign markets tend to pay more. Wages in Nairobi are higher than in the more remote regions.[20]

Employment is more stable in the services sector than in the manufacturing sector. Over 70 percent of workers have a permanent contract; only in the predominantly public sub-sector including administration, health, and education, are term contracts more common. Again, older and more productive firms tend to hire more permanent workers, and as such offer more job security. As for the manufacturing sector, relative wages are also strongly linked to productivity levels. More productive firms are likely to be better able to sustain higher wages, as they can reallocate resources to cover fixed costs.[21]

Small, formal, firms are significantly more productive than small informal firms. In order to compare formal and informal firms, a synthetic data-set was constructed, incorporating formal firms with less than six workers. The purpose is to allow comparisons between firms of similar size, thus ensuring that what are truly "informal" characteristics are not simply proxies for small firms. On these bases, labor productivity, as measured by sales per worker, is higher in formal firms, even when size is accounted for. The differences are quite significant in both the services and manufacturing sector (Figure 4.13). More productive firms are more likely to start-up in the formal sector, perhaps as a result of having larger revenues to cover the costs of formality. These labor productivity differences are reflected in a concomitant wage gap in the services sector; less so in the manufacturing sector.

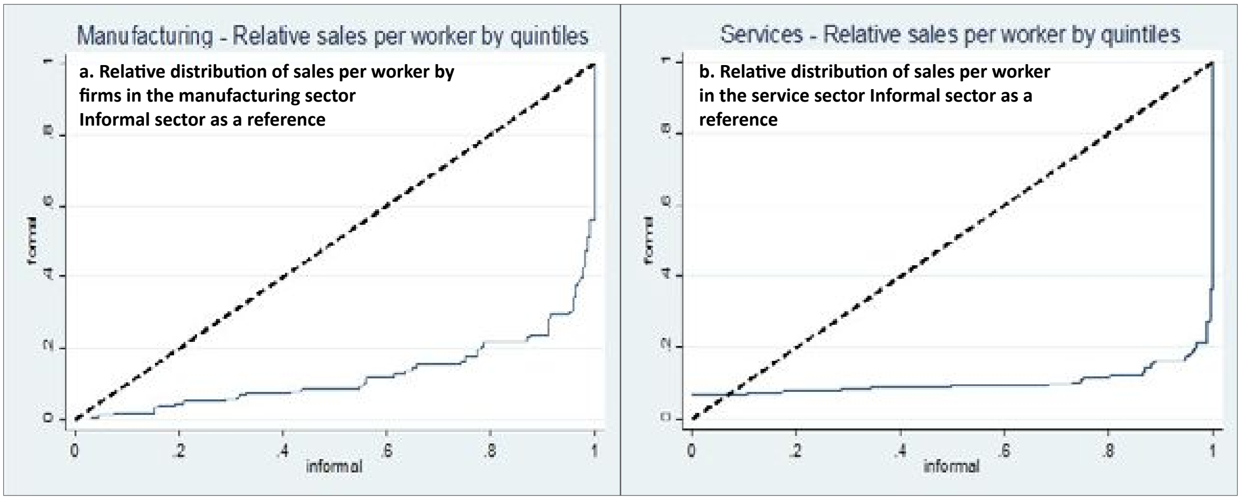
The formal private sector offers better jobs. However, this sector is still small and accounts for less than one in four jobs in the non-agricultural sector. Formal wage jobs, in both public and private sectors, make up 22 percent of all jobs in industry and 24 percent of all jobs in the services sector, including both wage and self-employment jobs. Although the small size of the formal sector suggests that efforts also must concentrate on raising productivity in the informal sector (where, in fact, most jobs will continue to be created in the short term), finding ways to remove obstacles to firm and labor demand growth is essential to improving the jobs landscape in Kenya.

[19] Refers to estimates of a model of the determinants of the share of permanent employment in total employment, based on the following variables: a set of dummy variables for the age of the firm (the excluded category is the young ones, i.e. from 1 to 3), a set of dummies accounting the foreign exposure of the firm (exporter, importer), ICT equipment level (relative to the sector average), a dummy for investments in R&D, the ratio of capital to labor, value added per worker and we control for location and subsectors. A full table with regression results is available in Annex 5.

[20] Wage regressions are based on a set of variables including dummies for the size and age of the firm, its foreign exposure, some innovation indicators as well as the value added per worker. Results are available in Annex 5.

[21] See Annex 5

Figure 4.13 | Labor productivity is significantly higher in the formal sector.



Source: Estimates based on the 2010 Census of Industrial Production for Kenya, the 2011 Integrated Survey of Services and the Kenya Enterprise Informal Survey 2013

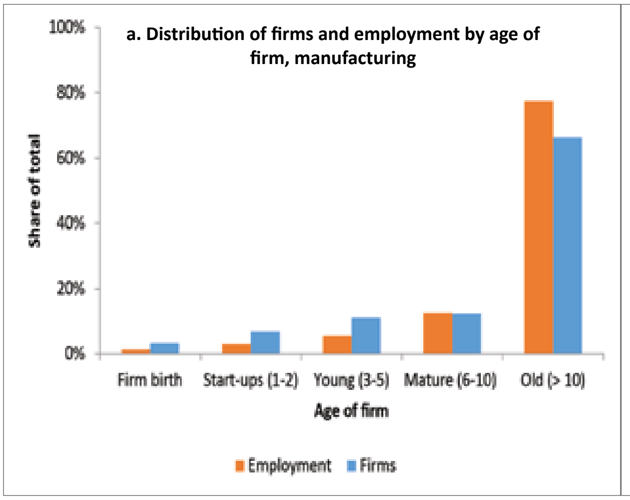
In both the manufacturing and services sectors, firm creation is low. High levels of firm creation can be a mechanism for productivity growth, if more productive firms enter and force less productive firms out of business. However, in the manufacturing sector, less than 19 percent of firms are young, here defined as firms created less than 5 years ago, set against 35 percent in the United States and Ethiopia. The low entry rate of formal firms points to a lack of dynamism. Whether this reflects barriers to start-up, or barriers to formalization, is beyond the scope of this study. However, it remains a fact that entry into formal sector is limited. The potential for dynamic changes to employment through firm entry and exit is therefore by necessity limited (Figure 4.14). In the services sector, new entrants, start-ups, and younger firms account for an even lower share of total firms than in the manufacturing sector. A majority of firms are "old," having been in business for more than ten years. Again, this compares unfavourably with the structure of firms in OECD countries. Although old firms in OECD countries account for a majority of employment, their share is much lower than in Kenya.[22]

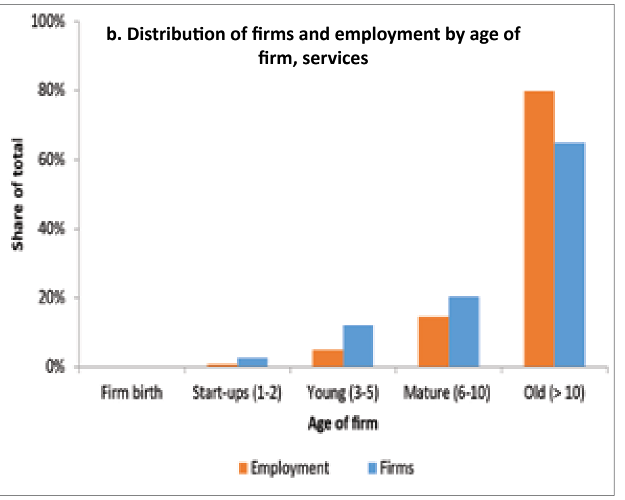
Lack of young firms indicates a problem. This problem is a lack of potential for job creation in the formal sector. In more developed economies such as the OECD members, most firms are old, and most employment is in older firms, but the share of older firms is lower than in Kenya. For example, young firms (0-5) in the US account for some 35 percent of all firms, and nearly 30 percent in the OECD as a whole, compared to 21 percent of Kenyan firms. And in the OECD, some 15 percent of firms are new-born or start-ups (0-2 years), compared to ten percent in Kenya. This is an important characteristic, because young firms in OECD countries contribute disproportionately more to job creation, and much less to job destruction.[23] The lack of young firms in Kenya may therefore be evidence of a lack of potential for job creation in the formal sector.

[22] Criscuolo, Gal and Menon (2014), "The Dynamics of Employment Growth: New Evidence from 18 Countries", OECD Science, Technology and Industry Policy Papers no. 14, OECD Publishing.

[23] Ibid

Figure 4.14 | Firm creation is limited in the formal sector





Source: estimates based on the 2010 Census of Industrial Production for Kenya and the 2011 Integrated Survey of Services

More productive firms do not create more jobs. In a well-functioning market economy, more productive firms should be more competitive. As such, they are able to gain market shares over time. However, more productive manufacturing sector firms do not create more employment in Kenya.

Manufacturing firms experiencing productivity growth do not see more job creation. The lack of relationship between productivity levels and employment growth does indeed suggest that productive firms are held back in the Kenyan economy. In a well-functioning market economy, they should be more competitive than other firms, and as a result be expanding business and creating more employment. However, the correlation between firm size and productivity growth is in fact negative in Kenya, suggesting the opposite. This is particularly true for the food and textile sectors – the major employers in the manufacturing sector.

And larger firms are not more productive. Similarly, firms with lower productivity levels are larger in terms of employment than higher productivity firms. With time, Kenyan manufacturing firms only grow to two or three times the size of young (less than five years) firms. The services sector is also suffering from distortions. The main employing sector (the trade sector), shows evidence of misallocation, with the larger firms being less productive. For comparison, older US firms grow up to six times the size of small firms. In middle-income countries like Lebanon and Tunisia, younger and more productive firms have been creating proportionally more jobs than other firms.[24]

Low Skills Levels Could Constrain All Sectors of Employment

Skills development is also fundamental to the transition to better jobs. Currently, the demand for higher level cognitive skills is low in Kenya's jobs

[24] World Bank (2014) "Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa". Macro and Fiscal Management Global Practice, Middle East and North Africa Region

market, and the World Bank's enterprise surveys do not suggest skills are the most important constraint to doing business. However, there are signs that skills are at least becoming a more important problem for firms. At least 30 percent of firms cite it as a major constraint. A transformation into more formal, higher productivity jobs will require a better trained labor force. A flexible skills development system that fosters basic generic skills and provides opportunities for acquiring labor market relevant technical skills is needed, as are labor markets that reward skills above degrees, personal connections, and other distortions.

What matters between Skills and Education? Importantly, "years of schooling" or "level of education" are very imperfect measures of actual labor market relevant skills. In a labor market that rewards productivity, skills should be what matters for job opportunities. The STEP household survey has been designed to systematically measure different labor market related skills, and how these relate to both education and labor market outcomes (Box I).

Skills matter for labor market outcomes. Socio-emotional skills, especially openness to new experiences and being thorough and careful in work, correspond to higher hourly earnings in Kenya. Technical skills and job related skills are also related to higher hourly earnings. However, these returns tend to vary across age groups. For example, rewards from using a computer at work increases with age.

Box 1 | The STEP Household Survey: Measuring Skills in Kenya

In the economic literature, "level of skills" has often been approximated by "years in school" or "highest degree obtained." However, attending school is not a guarantee for developing skills. Designed as a lighter version of the OECD's Survey of Adults Skills (PIAAC), the STEP household survey thus looks beyond education levels and focuses on individuals and their supply and use of actual skills. More particularly, the STEP is an attempt at a systematic assessment of:

(i) Cognitive skills, that is, analytical, logical, intuitive and creative thinking and problem solving skills are assessed directly, through a reading literacy assessment, and indirectly, through self-reported information of use of skills in daily life and work.

(ii) Socio-emotional skills and personality traits (behavioural skills, soft skills, life skills, personality traits), include behavioural aspects, including openness to new experiences, conscientiousness, extraversion, agreeableness, hostile bias (the tendency to interpret others' behaviours as hostile), perseverance and focus on long term goals (grit), and attitudes and preferences with respect to decision making, time and risk.

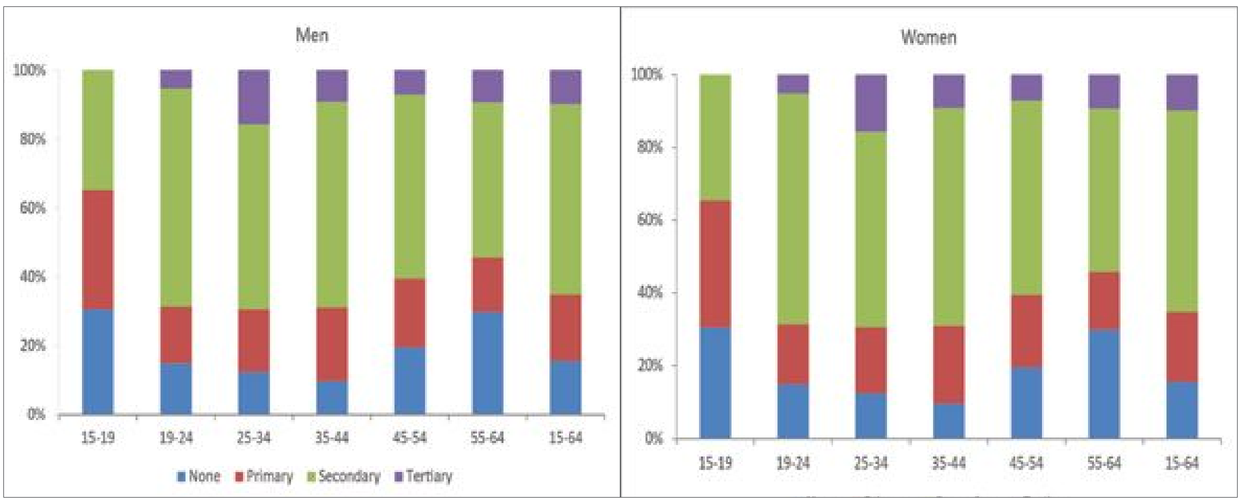
(iii) Job-relevant skills are task related and include technical skills directly related to the specific occupation (e.g., accounting for an accountant) and computer use, repair/maintenance of machinery, operation of machinery, but also soft skills like client contact, problem solving, learning, supervision, and so on.

Both skills and education matter for earnings. Once different skills are accounted for, the returns on education are only significant for those with secondary or tertiary education. Therefore, the impact of tertiary education is much more significant for these groups of people. There is thus a separate effect of years of schooling, over and above of the skills that attending school can produce (and that are measured in the STEP survey). Potential explanations for this include a signalling effect of education. For example, that having passed through tertiary education is a sign of some innate ability that is not well measured in the skills defined by the STEP survey.

Education helps accessing jobs with more intensive use of cognitive skills. The intensity of use of skills like writing documents, reading, computing, is higher for people with higher levels of education, except for numeracy, which is used more intensely than other types of skills, as it is used in most adult life to perform some market related calculations such as buying produce or charging for one's products or services. There is, in particular, a clear "digital divide," with low educated never using computers. Those with a higher level of education also tend to have higher scores in non-cognitive skills, in particular some people-related skills like openness and agreeableness. They also fare better when other characteristics such as age group, socio-economic status and parental education levels are considered. In addition, youth are more likely than older cohorts to use skills, excepting the 15-19 year olds, who most likely are early drop-outs from the education system, and as such in unemployed or working in low skill jobs.

A majority of urban Kenyan adults have at least secondary education and in particular women have been given higher access. Kenya's general education system is based on an 8-4-4 curriculum: 8 years in primary school, 4 years in secondary school and 4 years of college or university. Access to primary and secondary education has increased considerably over time. In particular, women have attained greater access to primary and secondary education. Three out of five women aged between 25 and 34

Figure 4.15 | Distribution of population by age, gender and highest level of education.

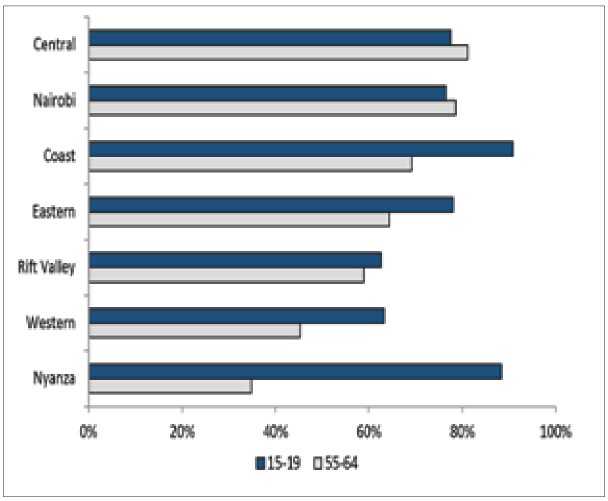


Source: Estimates based on STEP survey have completed at least secondary education, but only two out of five women among the 55-64 year-olds have done so.

But there are still gender, regional, and socio-economic gaps in educational attainment. Almost half of all women, specifically 45 percent, have completed primary education at the most, against 35 percent for men. The largest drop in the gap seems to happen for secondary education. At the other end, the share of tertiary educated is higher among men than women. There are significant regional differences as well, although those have reduced with time. Even when comparing for the 15-19 year olds (reflecting the most recent state of the school system among adults), the primary completion rates for urban areas in the coastal areas reaches above 90 percent while those of the Western inland zones, Rift Valley and the Western Zone, reach just over 60 percent. Finally, a majority of individuals from household with low socio-economic status have no more than primary education, and one in four had no education at all. By contrast, more than three in five individuals with middle socio-economic status, and three in four with high socio-economic status, and at least finished secondary education (Figure 4.16). Access to tertiary education in particular seems to be confined to individuals from well off households.

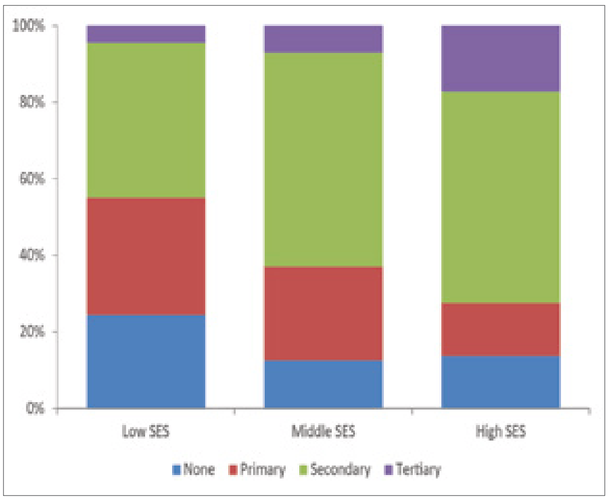
Delayed entry and early drop-outs remain a significant problem in Kenya. Many children are delayed in entering school. This in turn delays and reduces the development of important cognitive skills and penalizes future academic development. The official age of entry for primary school is six years. However, many children enrol at a higher age. This is in fact a problem, because delayed entry is in turn related to early drop-out.[25] Among those that started school at age 9, more than fifty percent did not get further than primary school. Among children who started

Figure 4.16 | Primary completion rates by provinces



Source: Estimates based on STEP survey. Note: Excludes those currently at school

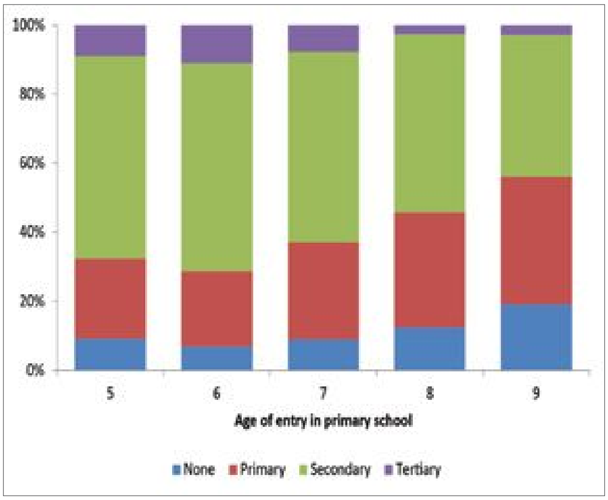
Figure 4.17 | Highest education achieved, by socio-economic status



Source: Estimates based on STEP survey.

[25] Lewin (2009) notes that high variance in age of entry in Sub-Saharan Africa is an important factor for explaining early drop-outs of those with delayed entry. Lewin (2009),"Access to education in sub-Saharan Africa: patterns, problems and possibilities." *Comparative Education,* 45 (2). pp. 151-174.

Figure 4.18 | Highest education completed by age of entry.



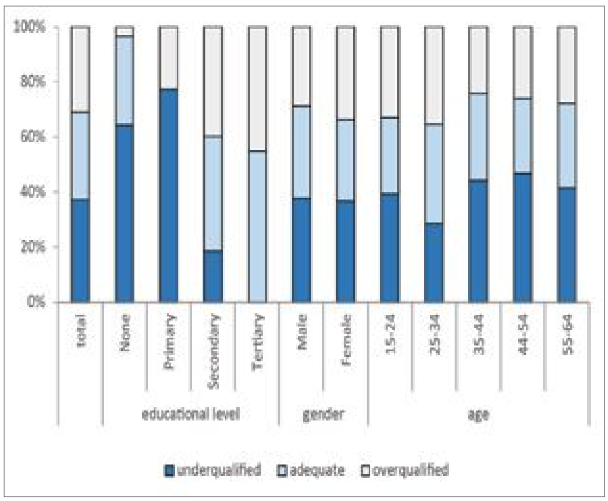
Source: Estimates based on STEP survey.

at age 5 or 6, however, two thirds were likely to finish at least secondary school. Though not shown here, those who started school much later than usual (around 10 or 11 years of age) are more likely to not finish even primary education than those who entered earlier **(Figure 4.18)**

The cost associated with schooling is a constraint for increasing education levels. Early drop-outs are in fact a significant problem in Kenya, as one third of dropouts happen before completion of primary education, preventing the development of basic functional competencies like literacy and numeracy. And importantly, drop-outs is more common among those belonging to households with low socio-economic status (specifically, those who were living in such a household at the age of 15). Almost 40 percent of those with low socio-economic background drop out of school – twice as high as those from a high socio-economic background. Drop-outs are also generally driven by financial considerations, as it is too expensive to attend school, perhaps because of the opportunity cost of not working, and by early family formation (especially for women).

Higher access to school has not translated into sufficient learning. There are also significant indications that the quality of education has not kept up with expansion in access. A vast majority of adults who have passed through secondary levels of education remain functionally illiterate in English. Even among adults with tertiary levels of education, less than one quarter reaches the minimum level of functional literacy. Second chances and other training opportunities are limited in Kenya: only 27 percent of the urban population benefited from some kind of training after school. A 2011 survey showed that 7 out of 10 children in Grade 3 could not do work at the level of Grade 2.[26] Teacher absenteeism and high (and widely varying) teacher/student ratios are among the more critical problems plaguing the education system.

Figure 4.19 | Mismatch by gender, educational level and age categories



Source: Estimates based on STEP survey

[26] World Bank (2013), *Achieving Shared Prosperity in Kenya.*

While Kenya has invested in broadening access to education, the pay-off to educational investment has been low. Many educational assets sit idle because of mismatches, reinforcing the impression that Kenya is not making productive use of its available labor force. A high share of workers reports their education level to be mismatched with the requirements of their jobs: 40 percent consider themselves undereducated, but 30 percent consider they are overeducated for their job (Figure 4.19).

Limited after school training opportunities, especially outside the formal sector, are holding back productivity growth. About one in four in Kenya's urban population benefited from some kind of training at the certificate, traineeship or on-the-job-training levels. Access to different forms of training programs is a strong correlate of formal sector work. Almost 30 percent of formal wage workers had participated in a training course during the year prior to the survey, compared to only 7 percent of informal wage workers. Self-employed and unpaid workers are even less likely to participate in any kind of training. Participation in training programs is linked to jobs with high skills use intensity. For example, those who attended on-the-job training programs are more likely to use their cognitive skills such as learning and thinking, on the job.

Policy Priorities to Foster More, Better and More Inclusive Jobs

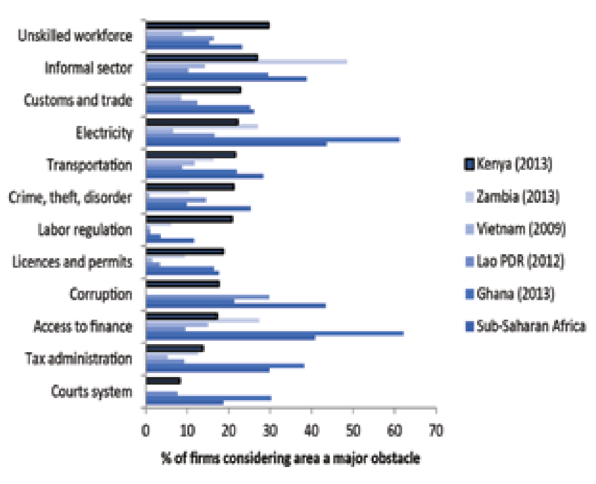
Kenya is a country of great variations in opportunities and challenges. It combines a vibrant economic activity in some of the largest cities together with a continued dependence on agriculture in rural areas, high mobile and internet use and low functional literacy, widely different access to education, and widely different access to more productive jobs. This means that the pillars of a jobs strategy must not only include more and better jobs, but specific and targeted policies to connect people to jobs, and jobs to people.

Improve business environment to encourage private sector growth and create labor demand. The World Bank's Enterprise Surveys from 2007 and 2013 suggest that the business climate is deteriorating in Kenya. Compared with 2007, firms in 2013 experienced higher financing costs, higher insecurity, and more unreliable access to infrastructure. Kenyan firms make 30 contributions a year, taking 201 staff hours to calculate, file, and pay their taxes. For traders, logistics are a major hindrance. On average, the procedures and documentation needed to import or export take 26 days; connecting to the power grid in Nairobi requires 6 steps, takes more than 5 months, and costs 10 times average Gross National Income (GNI) per capita.[27]

Kenyan firms perceived competition from the informal sector, electricity, and lack of access to finance as the top obstacles in 2013. When asked to identify the biggest obstacle to business, 18.5 percent of firms cited "practices of competitors in the informal sector," 16.5 percent cited "electricity," and 12.7 percent cited "access to finance." Focusing instead on major constraints, any area that is considered a major constraint to business, over twenty percent of firms in Kenya considered infrastructure, insecurity, customs and trade regulations, informal sector practices, and, importantly, the lack of skills, as major constraints to expanding their businesses. These areas are also relatively highly ranked by Kenya, compared to peer countries.

[27] World Bank (2014), Kenya Economic Update 2014: Anchoring High Growth: Can Manufacturing Contribute More?, World Bank: Washington, DC.

Figure 4.20 | Major constraints to doing business, Kenya and Comparators



Source: Estimates based on World Bank Enterprise Surveys.

Several measures are needed to promote productivity and employment growth in the formal sector. Policy directions for the manufacturing sector, but with a bearing also on services, include: (i) helping firm access skills, technology and information through, for example, technology extension or technology transfer programs; (ii) ensuring level playing field between informal and formal sector, by streamlining and reducing regulation and ensuring fair enforcement: (iii) decreasing the cost of doing business by addressing critical infrastructure gaps, especially in electricity, developing key financial infrastructure and special programs to help enterprises access financing, and accelerate and facilitate international trade; (iv) supporting firm entry and exit, which is low in Kenya, by facilitating the starting up of a business, and simplifying the insolvency framework; (v) and streamlining revenue raising schemes that are increasing the cost of doing business unduly in Kenya.[28]

Increase informal enterprise and worker productivity to improve overall productivity and job quality in Kenya. Even in a scenario with rapid growth in the formal wage sector, formal firms will not create jobs for all young Kenyans. Many youth will continue to find jobs in the small household enterprises, working for themselves or their family in the *Jua Kali,* the informal sector. A vast majority of these firms will remain very small. The household enterprise sector tends to expand by creating new firms (many of them own-account jobs), rather than by increasing employment.[29]

The government should support interventions that increase productivity of these firms. This could be done by improving the conditions under which they operate, particularly by increasing access to skills, technology, credit and markets, and helping such firms to manage income risk. Raising the skills levels of *Jua Kali* workers involves addressing broad skills needs (technical as well as general business skills like marketing and accounting), and offering flexible modes of training that permit combining work with skills upgrading. Given the granular nature of the informal sector, there is a need address information asymmetries and hook up these micro-firms with the modern economy. This can be achieved by creating linkages between informal and formal firms, connecting suppliers with customers, coordinating producers, connecting firms with technological solutions, and helping small-scale enterprises enter into local, regional and global value chains.

[28] Ibid
[29] Filmer and Fox (2014), Youth Employment in Sub-Saharan Africa. Washington, DC: World Bank and Agence Française de Développement.

More effective safety nets needed beyond formal sector social security coverage to prevent people facing income losses from falling into poverty. Potential avenues include voluntary social insurance programs and specific targeted schemes for informal sector firms, subsidies for low-income workers, raising awareness about labor standards, and delinking social security coverage from formal contracts.

Skills are becoming a more important constraint, pointing to the need for rapid action. Informality, trade regulations, and lack of access to finance became more important constraints in the past six years, while transportation, crime, theft, and disorder became less important. Firms perceived the severity to have fallen most for telecommunications, a development that is likely related to rapid technological improvements over this period, particularly the penetration of mobile networks and devices. The severity of crime, tax rates and tax administration, transport, and workings of the courts also declined. The only obstacle firms perceived to have risen in severity was the availability of educated workers.

Improve quality of education and make education more inclusive. Skills development takes many years, from early childhood education to post-secondary training. To respond to upcoming skills shortages, efforts to increase the quality and impact of education, and improve equity in access, are sorely and urgently needed. While a broad education reform implies action in a wide range of areas, cross cutting systemic problems include lack of accountability and oversight.[30] The importance of lack of sufficient resources to pay for school in determining early drop-outs suggests that demand side issues – how to stimulate demand for education, by alleviating both credit and information constraints, can be important.

To connect people to jobs, targeted policy solutions are called for on the supply side. An analysis of "risk profiles" among the vulnerable youth population[31] arrives at four groups facing similar labor market challenges within each group. These groups could benefit from similar policy approaches. (Figure 4.21). These clusters are defined by type of barriers, along two axes: employability (education, experience, skills) and social barriers (gender, poverty, family responsibilities, etc.). The groups need different and targeted policy assistance, ranging from intermediation in the labor market (helping qualified workers connect to available jobs) to the other extreme, with an emphasis on building very basic functional skills:

Market ready. Males, both rural, low-skilled, married ones working in the informal sector, and urban, semi-skilled unemployed single ones, fit into this category. They require mostly *intermediation* in the labor market. This can be in form of job search assistance and information provision. Given the comparatively high mobile and Internet penetration and use in Kenya (43 percent of the population uses Internet according to the most recent data); this group may be favourably served through different ICT tools.[32]

Intensified action. This group consists of single males, currently working in less productive employment, including both rural low skilled unpaid,

[30] World Bank (2013), *Achieving Shared Prosperity in Kenya.* World Bank: Washington, DC.

[31] The vulnerable youth population refers to individuals aged 15 to 24 that are economically inactive out-of-school, unemployed, or employed in the informal sector (i.e., unpaid family workers, self-employed or informal wage-workers).

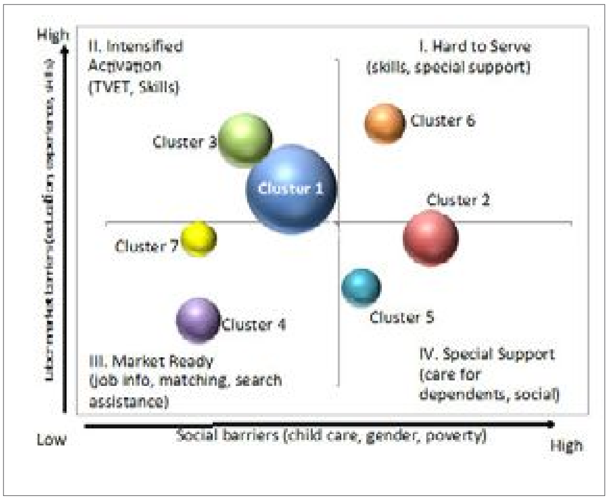
[32] World Bank (2015), *World Development Report 2016: Digital Dividends.* World Bank: Washington, DC., and data from the World Development Indicators.

self-employed, and informal wage workers. They face, in particular, education/skills barriers and as such are likely to benefit from long term measures for building skills, such as increased access to education, as well as shorter term job-relevant training, to increase their employability.

Special support. This group is made up of female clusters: rural, unskilled, married, self-employed or unpaid workers and urban, low-skilled, inactive married female. These two groups face social barriers as well. They are likely to need childcare services to enter the labor market, as they carry large household responsibilities. They may benefit from intensified action as for the above group, but with attention to childcare and other social barriers.

Hard to serve. This includes rural, unskilled, inactive, single females who face high employability and family barriers. They lack work experience, have little education, and are engaged in household work. This may be the most difficult group and time consuming group to activate – they require skills development, functional literacy and numeracy, as well as socio-emotional skills.

Figure 4.21 | Policy targeting: identifying groups



Source: Estimates based on KIHBS 2005. The Clusters are defined as: 1. low skilled unpaid worker single male (40 percent of total sample); 2. Rural unskilled "unpaid-self-employed worker" married female (15 percent); 3. Rural, unskilled, single male worker (14%); 4. Urban semiskilled, unemployed or informal wage workers, single male (10%); Urban low skilled inactive married female (8%); 6. Rural, unskilled, inactive single female; 7. Rural low skilled informal married male

ANNEXES

Annex 1 | Macroeconomic environment

	2009	2010	2011	2012	2013	2014	2015
GDP growth Rates (percent)/1	3.3	8.4	6.1	4.5	5.7	5.3	5.5
Agriculture	-2.3	10.0	2.4	2.9	5.2	3.5	5.5
Industry	3.7	8.7	7.2	4.2	5.0	6.5	3.6
Manufacturing	-1.1	4.5	7.2	-0.6	5.6	3.4	6.6
Services	6.2	7.3	6.1	4.7	5.4	5.7	5.3
Fiscal Framework (percent of GDP)/2							
Total revenue	19.4	19.4	18.8	18.8	19.3	19.4	20.3
Total expenditure	24.0	23.5	23.7	25.2	25.8	28.7	29.6
Grants	1.0	0.5	0.4	0.5	0.5	0.5	1.1
Budget deficit (including grants)	-5.8	-3.4	-4.5	-5.4	-5.9	-8.6	-8.1
Total debt (net)	36.6	39.1	37.0	38.5	44.0	45.6	46.5
External Account (percent of GDP)/3							
Exports (fob)	12.2	13.1	13.8	12.3	10.6	10.1	9.7
Imports (cif)	27.8	31.0	35.3	33.2	31.0	31.0	27.2
Balance of trade	-10.5	-11.6	-15.3	-13.7	-13.8	-15.3	-11.6
Current account balance	-4.5	-6.3	-7.9	-8.4	-8.7	-10.0	-7.2
Financial and capital account	6.6	6.7	7.8	10.9	10.0	12.3	7.1
Overall balance	2.1	0.4	-0.1	2.5	1.2	2.3	-0.1
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/ Figure s for 2015 are average for Q1, Q2 and Q3
2/Figures for 2015 are from the resived budget for 2015/16
3/ Figures for 2015 are for the 12 months ending November 2015

Annex 2 | GDP growth rates for Kenya SSA and EAC (2010-2014)

	2010	2011	2012	2013	2014	2010-2014
Kenya	8.4	6.1	4.5	5.7	5.3	5.4
SSA (excluding South Africa)	5.7	5.0	4.2	4.6	4.4	4.6
Uganda	7.7	6.8	2.6	3.9	4.9	4.6
Tanzania	6.4	7.9	5.1	7.3	7.2	6.9
Rwanda	6.3	7.5	8.8	4.7	7.0	7.0

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

Annex 3 | Kenya annual GDP

Years	GDP, current prices	GDP, 2001 constant prices	GDP/ capita, current prices	GDP growth
	KSh Billions	KSh Billions	KSh Billions	Percent
2007	2151	2766	847	6.9
2008	2483	2772	926	0.2
2009	2864	2864	930	3.3
2010	3169	3104	978	8.4
2011	3726	3294	998	6.1
2012	4261	3444	1167	4.5
2013	4731	3640	1238	5.7
2014	5358	3834	1338	5.3

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

Annex 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	6.4	7.3	5.3	6.6
	H2	3.7	2.8	5.5	4.8
2014	H1	2.1	8.5	5.8	5.3
	H2	5.3	4.5	5.7	5.3
2015	H1	5.0	6.3	5.1	5.3

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

Annex 4.b | Quartely growth rates (percent)

		AGRICULTURE			INDUSTRY			SERVICES			GDP		
Years	Quarters	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	-3.6	4.3	4.8
	3	-22.7	2.0	1.9	3.8	4.6	4.7	5.2	4.5	4.8	-1.4	4.5	4.4
	4	1.3	4.1	2.9	6.7	4.4	4.2	1.9	4.8	4.7	2.5	4.7	4.5
2013	1	51.9	6.3	3.8	-0.5	8.9	5.0	-1.6	4.1	4.7	8.8	6.0	4.9
	2	-10.4	6.6	5.0	-4.1	5.7	5.9	1.0	6.5	5.0	-2.6	7.0	5.6
	3	-22.9	6.4	5.9	4.6	6.5	6.4	4.0	5.4	5.2	-1.7	6.8	6.2
	4	-3.9	0.9	5.2	-0.4	-0.6	5.0	2.2	5.6	5.4	-1.2	2.9	5.7
2014	1	53.8	2.2	4.0	6.7	6.6	4.5	-2.0	5.2	5.7	10.7	4.7	5.4
	2	-10.4	2.1	2.8	-0.6	10.5	5.7	2.2	6.5	5.6	-1.4	6.0	5.1
	3	-19.3	6.8	2.9	-1.6	4.0	5.1	3.0	5.4	5.7	-2.4	5.2	4.7
	4	-6.6	3.8	3.5	0.6	5.1	6.5	2.8	6.1	5.8	-0.9	5.5	5.3
2015	1	54.8	4.4	4.2	7.6	5.9	6.3	-3.0	5.0	5.7	10.2	5.0	5.4
	2	-9.5	5.6	5.1	0.2	6.7	5.5	2.3	5.2	5.4	-0.9	5.6	5.3
	3	-18.2	7.1	5.2	-1.2	7.2	6.2	3.3	5.5	5.5	-2.2	5.8	5.5

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

Annex 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

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

Annex 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

Source: Kenya National Bureau of Statistics.

Annex 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

Source: Kenya National Bureau of Statistics.

Annex 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

Source: Kenya National Bureau of Statistics.

Annex 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

Source: Kenya National Bureau of Statistics.

Annex 10 | Soft drinks, sugar, galvanized sheets and cement production

Year	Month	Soft drinks	Sugar	Galvanized sheets	Cement
		litres (thousands)	MT	MT	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	39,120	46,280	20,674	537,452
	May	40,112	44,081	23,132	516,513
	June	36,387	46,098	20,358	516,185
	July	39,401	47,957	18,415	570,904
	August	35,748	54,089	20,871	553,929
	September	42,528	61,069	20,564	556,873
	October	43,215	56,360	26,008	547,509
	November	41,323	43,401	25,726	522,446
	December		48,089		481,857

Source: Kenya National Bureau of Statistics.

Annex 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	20,015	9,070	59,085

Source: Kenya National Bureau of Statistics.

Annex 12 | New vehicles registration

Year	Month	All body types (number)
2015	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	17,381
	September	18,595
	October	18,740
	November	23,209
	December	22,308

Source: Kenya National Bureau of Statistics.

Annex 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

Source: Central Bank of Kenya.

Annex 14 | Interest Rates

		Short-term			Longterm			
		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	15.5	8.8
	July	13.5	10.6	11.5	6.3	1.4	15.8	9.4
	August	18.5	11.5	11.5	6.9	1.5	15.7	8.8
	September	19.9	14.6	11.5	7.3	1.7	16.6	9.3
	October	14.8	21.7	11.5	7.5	1.7	16.6	9.0
	November	8.8	12.3	11.5	7.6	1.4	17.2	9.6
	December	7.3	9.8	11.5	7.9	1.6	17.4	9.5

Source: Central Bank of Kenya.

Annex 15 | Credit to private sector

		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
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

Source: Central Bank of Kenya.

Annex 16 | Money aggregate

	Growth rates (yoy)	Broad money supply (M2)	Money (M1)	Money (M0)	Reserve money
2014	January	16.7	19.9	10.6	10.3
	February	17.8	20.3	5.0	9.9
	March	19.0	20.4	4.5	7.7
	April	16.1	16.9	8.4	17.7
	May	18.4	19.9	9.2	11.9
	June	18.8	21.3	6.9	12.6
	July	18.8	18.9	8.6	7.3
	August	20.0	21.0	7.9	15.2
	September	17.1	12.6	7.9	11.2
	October	18.4	12.9	6.3	13.5
	November	17.8	13.5	4.2	9.3
	December	18.6	13.2	6.2	18.5
2015	January	17.8	12.7	6.2	14.5
	February	17.6	11.5	8.1	19.1
	March	16.8	11.1	9.1	16.8
	April	16.9	11.8	10.1	15.6
	May	16.2	11.8	10.0	12.9
	June	16.2	11.0	10.5	14.0
	July	15.8	10.9	11.0	18.6
	August	15.6	11.1	10.9	14.5
	September	14.3	10.7	10.9	15.2
	October	13.5	10.0	10.5	14.7
	November	12.6			
	December	12.5			

Source: Central Bank of Kenya.

Annex 17 | Mobile payments

	Month	Number of agents	Number of customers (Millions)	Number of transactions (Millions)	Value of transac-tions (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

Source: Central Bank of Kenya.

Annex 18 | Nairobi stock exchange (20 share index) and the Dow Jones (New York)

Year	Month	NSE (1966 = 100)	Dow Jones
2014	January	4856	15,699
	February	4933	16,322
	March	4946	16,458
	April	4949	16,581
	May	4882	16,717
	June	4885	16,827
	July	4906	16,563
	August	5139	17,098
	September	5256	17,043
	October	5195	17,391
	November	5156	17,828
	December	5113	17,823
2015	January	5212	17,165
	February	5491	18,133
	March	5248	17,776
	April	5091	17,841
	May	4787	18,011
	June	4906	17,620
	July	4405	17,690
	August	4176	16,528
	September	4173	16,285
	October	3869	17,664
	November	4016	17,720
	December	4041	17,425

Source: Nairobi Securities Exchange and New York Stock Exchange.

Annex 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	58
	May	122	60
	June	124	61
	July	127	63
	August	129	63
	September	132	64
	October	129	63
	November	127	62
	December		

Source: Central Bank of Kenya

Annex 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	19.9	19.9	21.5
Total revenue	18.7	18.2	19.4	19.4	18.8	19.3	19.3	19.4	20.3
Tax revenue	17.1	17.0	17.9	17.7	17.1	17.3	18.2	18.1	18.7
Income tax	6.8	6.9	7.2	7.5	7.8	8.3	8.9	8.9	9.1
VAT	4.8	4.7	4.9	5.0	4.4	4.1	4.6	4.6	4.6
Import duty	1.4	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.3
Excise duty	2.7	2.6	2.5	2.3	2.0	1.9	2.0	2.0	2.3
Other revenues	1.4	1.4	2.0	1.5	1.6	1.7	1.3	1.3	1.4
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	1.7
Grants	1.1	0.7	1.0	0.5	0.4	0.5	0.5	0.5	1.1
Expenditure and net lending	23.1	22.3	24.0	23.5	23.7	25.2	25.8	28.7	29.6
Recurrent	17.4	16.3	16.9	17.2	16.3	18.2	15.6	15.7	15.4
Wages and salaries	6.3	5.8	5.7	5.8	5.5	6.1	5.6	5.1	5.2
Interest payments	2.1	1.9	2.1	2.2	2.1	2.7	2.7	3.0	3.0
Development and net lending	5.7	6.0	7.1	6.4	7.4	6.8	6.3	8.9	10.1
Transfer to counties	0.0	0.0	0.0	0.0	0.0	0.2	3.8	4.0	4.1
Parliamentary service	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.4	0.4
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	-9.4	0.0
Deficit including grants (commitment basis)	-3.3	-3.4	-3.6	-3.6	-4.5	-5.4	-5.9	-8.8	-8.1
Deficit including grants (cash basis)	0.3	-4.4	-5.8	-3.4	-4.5	-5.4	-5.9	-8.6	-8.1
Financing									
Foreign	0.3	1.5	0.8	0.8	2.8	1.9	2.1	3.8	5.4
Domestic borrowing	-0.6	2.8	5.0	2.6	1.6	3.8	4.0	4.4	2.6
Public debt to GDP (net)	33.4	35.4	36.6	39.1	37.0	38.5	44.0	45.6	46.5
External debt	19.1	20.2	18.9	21.0	19.4	18.7	22.6	25.0	26.3
Domestic debt	18.6	19.5	21.9	22.2	21.5	23.3	25.5	24.9	24.0
Memo:									
GDP (Calendar year current market prices, KSh billions)	2483.1	2863.7	3169.3	3725.9	4261.2	4730.8	5357.7		
GDP (Fiscal year current market prices, KSh billions)	2317.2	2673.4	3016.5	3447.6	3993.5	4496.0	5044.2	5703.3	6443.0

Source:Quarterly Budget and Economic Review, August2015 (National Treasury) and Kenya National Bureau of Statistics.
**Provosional   ** Revised budget*

Annex 21 | County Fiscal position

	2013-14		2014-15		2015-16
	Budget	Actual	Budget	Actual	Budget
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

Annex 22 | 12-months cumulative balance of payments

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015*
1. CURRENT ACCOUNT	-511	-1034	-1973	-1671	-2512	-3330	-4253	-4786	-6097	-4366
Balance of trade	-2226	-2996	-4260	-3892	-4642	-6440	-6893	-7584	-8049	-6998
2. MERCHANDISE ACCOUNT	-3817	-4936	-6444	-5768	-7169	-9007	-10539	-11229	-12719	-12340
2.1 Exports (fob)	3516	4132	5048	4528	5225	5807	6183	5822	6174	5875
Coffee	138	166	155	201	209	222	269	192	232	214
Tea	656	693	924	892	1159	1153	1199	1215	1069	1205
Horticulture	509	607	763	692	725	678	695	741	808	767
Manufactured goods	422	513	625	526	608	729	700	705	592	517
Other	1792	2153	2580	2216	2525	3026	3320	2969	3473	3172
2.2 Imports (cif)	7333	9069	11492	10296	12395	14814	16722	17051	18893	16443
Oil	1745	1919	3051	2192	2673	4081	4081	3838	4026	2587
Chemicals	1004	1156	1446	1324	1603	1947	2076	2279	2388	2455
Manufactured goods	1065	1435	1589	1411	1774	2250	2302	2624	2677	2754
Machinery and transport equipment	2252	2800	3063	3065	3808	3686	4748	4600	6128	5508
Other	1267	1759	2343	2304	2537	2848	3251	3593	3673	3139
3. SERVICES	3306	3902	4470	4097	4657	5676	6286	6443	6622	6202
3.1 Non-factor services	1591	1940	2184	1876	2527	2566	3645	3646	3373	3569
3.2 Income account	-70	-143	-45	-38	-158	7	-164	-339	-528	-491
3.3 Current transfers account	1785	2106	2331	2259	2288	3103	2804	3137	3777	3123
of which remittances	408	574	611	609	642	891	1171	1291	1428	1544

Annex 22 | 12-months cumulative balance of payments (continued)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015*
4. CAPITAL & FINANCIAL ACCOUNT	1186	1888	1505	2451	2675	3288	5514	5471	7475	4305
4.1 Capital account	211	267	294	290	154	235	235	98	24	110
4.2 Financial account	975	1621	1210	2161	2522	3053	5278	5373	7451	4195
4.2.1.1 Official, medium and long-term	-202	-16	106	466	308	340	1147	592	2289	3355
4.2.1.2 Private, medium and long-term	38	592	72	44	176	35	-87	-258	981	444
4.2.1.2.3 Direct investment (FDI)	-11	438	153	127	106	107	107	218	1023	439
4.2.1.3 Commercial banks (net)	-156	-5	15	494	61	-213	854	49	666	97
4.2.2 Short term and net errorsand omissions (NEO)	1296	1050	1017	1158	1977	2891	3364	4989	3515	299
Short term (including portfolio flows)	714	1032	995	577	1130	1678	2429	2579	2763	2992
Net errors and omissions (NEO)	582	18	22	581	847	1213	935	2410	752	-2694
5. OVERALL BALANCE	675	854	-469	781	163	-43	1261	685	1378	-60
Memo:										
Gross reserves	3331	4557	4641	5064	5123	6045	7160	8483	9738	9411
Official	2415	3355	2875	3847	4002	4248	5702	6560	7895	7161
Commercial banks	916	1202	1765	1217	1121	1797	1458	1923	1843	2250
Imports cover (calender year)	3.5	4.0	2.7	4.1	3.5	3.1	3.8	4.3	4.6	4.8
Import cover (36 mths imports)	3.9	4.8	3.4	4.1	3.9	3.7	4.3	4.5	5.0	4.6
GDP market price (Kshs billion)	1862	2151	2483	2864	3169	3726	4261	4731	5358	5632
GDP market price (US$ billiom)	25.8	32.0	35.9	37.0	40.0	42.0	50.4	54.9	60.9	60.5

Source: Central Bank of Kenya.
** Cumulative 12 months to November 2015*

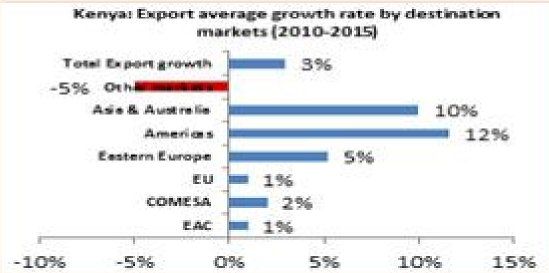
Annex 23 | Growth Outlook

Annual growth (percent)	2014	2015e	2016f	2017f	2018f
BASELINE					
GDP					
Revised projections	5.3	5.6	5.9	6.1	6.2
Previous projections (KEU 12)	5.3	5.4	5.7	6.1	
Private consumption	5.5	5.2	6.0	6.0	6
Government consumption	2.7	14.7	10.4	7.6	7.6
Gross fixed capital investment	11.1	8.4	9	9.3	9.3
Exports, goods and services	2.3	2.0	3.0	4.8	4.8
Imports, goods and services	9.7	8.7	8.7	8.2	8.2
Agriculture	3.5	3.9	3.5	3.6	3.6
Industry	6.5	5	5	5.2	5.2
Services	5.8	5.5	5.7	5.2	5.2
Current account balance, % of GDP	-10.4	-7.1	-6.0	-5.4	-5.3
Fiscal balance, % of GDP	-7.2	-8.3	-7.5	-6.4	-5.1

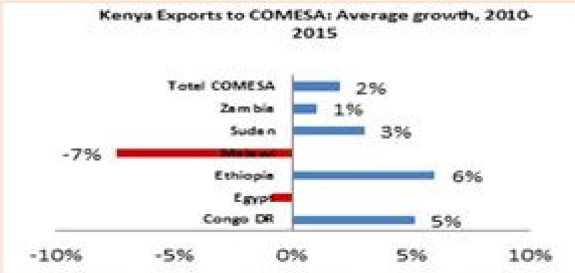
Source: World Bank.
Note: e(estimate); f(forecast)

Annex 24 | Average growth and share of Kenya's exports: 2010-15

a. Export average growth rate by destination markets (2010-2015)

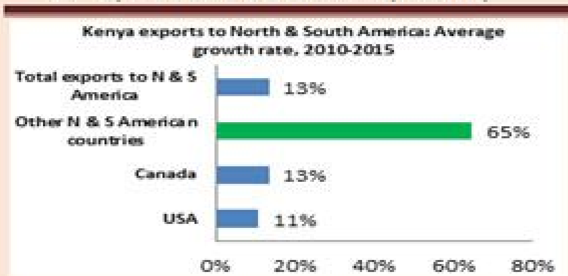


b. Exports to COMESA: Average Growth (2010-1015)

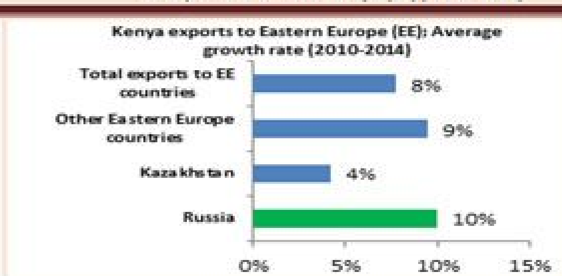


America, Asia and Australia have been the leading export destination for Kenya for the period 2010-2015. Kenyan exports to Malawi and Egypt have declined over the last five years.

a. Exports to North & South America (2010-2015)

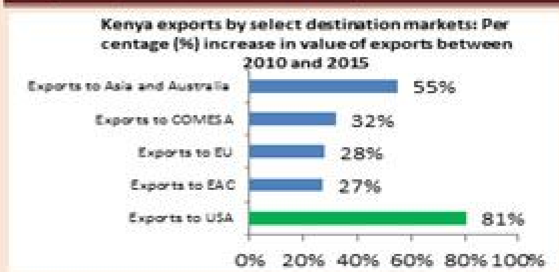


b. Exports to Eastern Europe (EE) (2010-2014)

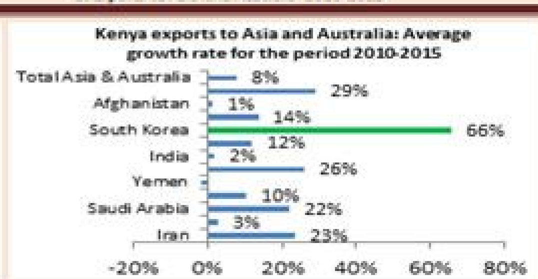


Kenyan Exports to other North and South America grew at higher rate than Export to Canada and the USA. Export to Russia also grew at a bigger percentage point compared to other Eastern Europe Countries.

a. Exports by selected destination 2010-2015)

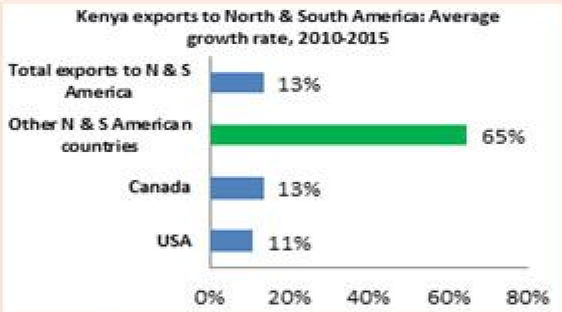


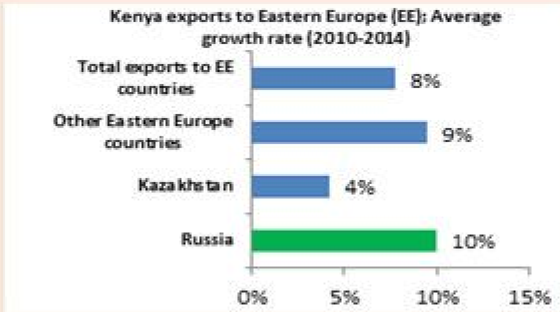
b. Exports to Asia and Australia 2010-2015



The Increase of Kenya's exports to United States of America has been high compared to the old export market of EAC and the European Union. Export to South Korea has also increased significantly among the Asian Countries.

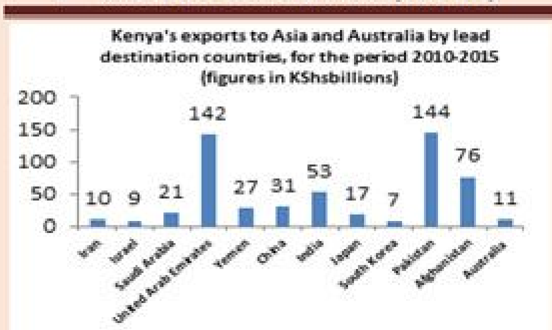
a. Exports to North & South America (2010-2015) **b. Exports to Eastern Europe (EE) (2010-2014)**





Kenyan Exports to other North and South America grew at higher rate than Export to Canada and the USA. Export to Russia also grew at a bigger percentage point compared to other Eastern Europe Countries.

a. Share of Lead Destination Markets (2010-2015) **b. Exports to Asia And Australia by Lead Destination countries**



In Asia and Australia, United Arab Emirates and Pakistan are Kenya main export destination. EAC still remain the main export destination for Kenya while EU, Asia & Australia comes second. COMESA is the third leading export destination for Kenya

Annex 25 | Kenya Exports to COMESA, 2010-2015. Figures in KSh Millions

	2010	2011	2012	2013	2014	2015
Congo DR	12,792	17,537	18,427	18,437	21,052	20,673
Egypt	18,116	23,422	21,464	17,001	17,509	20,166
Ethiopia	4,385	4,826	4,578	4,885	6,919	7,154
Malawi	4,262	5,818	4,694	3,497	3,326	3,047
Sudan	18,814	22,153	24,597	23,105	26,064	26,979
Zambia	4,688	6,138	6,667	6,288	6,668	5,909
Top COMESA	63,057	79,894	80,427	73,213	81,538	85,945
Other	4,652	6,216	6,395	5,997	5,366	3,957
Total COMESA	67,709	86,110	86,822	79,210	86,904	89,901

Source: KNBS Economic Survey 2015 (data for the period 2010-2014) and KNBS 2015 data (unpublished)

Annex 26 | Kenya exports to the EU and EU imports from extra-EU countries of product categories that Kenya has an export interest in the EU market

Products	Kenya Exports (2010-2014)	EU 28Countries Imports from the World (2011-2014)	Kenya's share (%)
Fish (HS03)	15,992,622	81,854,806,666	0.02%
Cut Flowers & Plants (HS06)	1,643,652,240	8,531,398,651	19.27%
Vegetables (HS07)	573,399,826	20,508,853,799	2.80%
Fruits and Nuts (HS08)	99,413,432	78,142,606,690	0.13%
Coffee & Tea (HS09)	1,305,037,361	52,730,974,211	2.47%
Oil seeds, medicinal plants (HS12)	17,272,016	50,518,230,969	0.03%
Vegetable plaiting materials and vegetable products (HS14)	79,420,238	1,087,305,658	7.30%

Products	Kenya Exports (2010-2014)	EU 28Countries Imports from the World (2011-2014)	Kenya's share (%)
Animal and Vegetable fats and oils (HS15)	7,265,965	46,681,242,234	0.02%
Processed fish and meat products (HS16)	55,245,979	29,111,006,251	0.19%
Preparations of cereals, flour, starch or milk (cereals, pasta, etc.) - HS 19	8,584,412	6,458,898,448	0.13%
Preparations of vegetables, fruits, nuts or other parts of plants (frozen vegetables, etc.) - HS 20	473,738,040	26,270,183,006	1.80%
Tobacco and manufactured tobacco substitutes (HS 24)	89,401,652	13,954,355,994	0.64%
Salt, sulphur; earths and stone; plastering materials lime and cement (HS25)	76,775,408	22,759,554,275	0.34%
Textile and Apparel (HS61-63)	16,061,958	415,163,253,570	0.004%

Source: EAC Trade Help Desk - http://tradehelpdesk.eac.int/ (Kenya exports to the EU) and EU Export Help Desk - http://exporthelp.europa.eu/ (for EU Extra-EU Imports)

Kazi ni kazi
Informal should not be normal

This economic update reviews economic performance in Kenya in the context of changing trends in the global economy: low commodity prices, the monetary policy in the US which has seen a strengthening of the US dollar, and the cooling and rebalancing of the Chi nese economy. This report has three main messages:

First, Kenya experienced strong economic performance in 2015 despite global turbulence. Indeed, in the recent years Kenya's growth has exceeded the average for the countries in Sub Sahara Africa. Growth is projected to reach 6 percent in the medium term underpinned by low oil prices, good agriculture performance, supportive monetary policy that is expected to contain inflation within policy bounds, and the ongoing infrastructure investments.

Second, Kenya's economy remains vulnerable to risks that could derail the growth momentum. The forthcoming elections could see a slowdown in growth momentum through two channels; first is the risk that investors defer investment decisions until after the elections; second, that election related expenditure delay the much needed fiscal consolidation and/or see a cut back in infrastructure spending. Security remains a threat not just in Kenya but globally. Finally, changes in the US monetary policy could trigger volatility in financial markets putting the currency under pressure. Overall the prevailing global market conditions call for a more stringent fiscal policy to preserve buffers and will require a mixture of fiscal consolidation, enhanced revenue mobilization and measures to increase efficiency of spending.

Third, Kenya is not short of jobs; it is short of high productivity jobs. Kenya's economy is creating more jobs now than in the past, but these are mainly in the informal services sector and are low productivity jobs. In the next ten years nine million youth will join the labor market and given the scarcity of formal sector jobs, the youth will continue to find jobs in the small household enterprises. To improve productivity of these jobs policy interventions could be geared towards increasing access to broad skills beyond formal education, creating linkages between formal and informal firms, and helping small scale firms enter local and global value chains. Furthermore, to create more and better jobs, it is also imperative to reduce the cost of doing business which is necessary for a robust private sector.

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