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THE NATIONAL TREASURY
(MINISTRY OF FINANCE)

Quarterly Economic and Budgetary Review

Third Quarter
2013/2014

May 2014 Edition

Quarterly Economic and Budgetary Review

Third Quarter
2013/2014

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LIST OF ABBREVIATIONS AND ACRONYMS

A-I-A	Appropriation in Aid
CBK	Central Bank of Kenya
FY	Fiscal Year
GDP	Gross Domestic Product
IMF	International Monetary Fund
KNBS	Kenya National Bureau of Statistics
KShs.	Kenya Shillings
Mn	Million
NDA	Net Domestic Asset
NFA	Net Foreign Asset
NSE	Nairobi Securities Exchange
RDL	Railway Development Levy

The Quarterly Economic and Budgetary Review Report is Published in accordance with Section 83 of the Public Financial Management Act, 2012. The law states that:

Accounting officer to prepare quarterly reports for national government entity.

83. (1) An accounting officer for a national government entity shall prepare a report for each quarter of the financial year in respect of the entity.

(2) In preparing a quarterly report for a national government entity, the accounting officer shall ensure that the report—

(a) Contains information on the financial and non-financial performance of the entity; and

(b) Is in a form that complies with the standards prescribed and published by the Accounting Standards Board from time to time.

(3) Not later than fifteen days after the end of each quarter, the accounting officer shall submit the quarterly report to the Cabinet Secretary responsible for the entity and the National Treasury.

(4) The Cabinet Secretary responsible for an entity shall forward a copy of the report to the Cabinet Secretary and Controller of Budget.

(5) Not later than forty five days after the end of each quarter, the National Treasury shall—

(a) consolidate the quarterly reports and submit them to the National Assembly and a copy of the reports to the Controller of Budget, Auditor-General and the Commission on Revenue Allocation; and

(b) Publish and publicize the reports.

(6) In the case of an entity that is a state corporation, the accounting officer for the corporation shall submit the quarterly report to the Cabinet Secretary responsible for the corporation who shall, upon approving it, forward a copy to the Cabinet Secretary.

HIGHLIGHTS OF THE THIRD QUARTERLY ECONOMIC AND BUDGETARY REVIEW: 2013/2014

1. **Recent Economic Developments**

The economy grew by 4.7 percent in 2013 compared with 4.6 percent in 2012. This growth was broad-based and was driven by expansion in wholesale and retail trade and repairs, mining, financial intermediation and transport and communication. Growth in the four quarters of 2013 were; 5.7 percent in quarter one, 4.7 percent in quarter two, 4.6 percent in quarter three and 3.9 percent in quarter four..

2. **The Overall Fiscal Balance**

The cumulative overall fiscal balance, on a commitment basis (excluding grants), amounted to a deficit of KSh. 169.4 billion (equivalent to 4.1 percent of GDP), as at end-March 2014, compared with a deficit of KSh. 228.8 billion (equivalent to 6.3 percent of GDP) in a similar period in FY 2012/13.

3. **Total Revenue Collection**

The National Government cumulative revenue collection including A-I-A as at end of the third quarter of FY 2013/2014 amounted to KSh. 674.1 billion (equivalent to 16.2 percent of GDP) against a target of KSh. 726.5 billion or 17.4 percent of GDP. This represented an underperformance of KSh. 52.4 billion. The ordinary revenues accounted for KShs.20.7 billion of this shortfall.

4. **Government Expenditure and Net Lending**

The total cumulative expenditure and net lending inclusive of transfers to county governments for the period ending 31st March 2014 amounted to KSh. 843.5 billion. This was KSh. 281.5 billion below the target of KSh. 1,125.1 billion and was largely attributed to lower than programmed disbursements to the County Governments and operations and maintenance in the National Government, as well as slow utilization of foreign financed development expenditures.

5. **Guaranteed Loans**

At the end of the third quarter of the FY 2013/14, the National Government paid a total of KSh. 737.1 million on guaranteed loan repayments against the projected debt service on guaranteed loans of KSh. 785.6 million. The difference was on account of exchange rate assumption.

6. **External Financing**

External financing amounted to a net borrowing of KSh. 29.7 billion, compared to a net borrowing of KSh. 33.8 billion in a similar period in FY 2012/13.

7. Net Domestic Borrowing

Net domestic financing amounted to KSh. 127.4 billion (equivalent to 3.1 percent of GDP) in the period ending 31st March, 2014, compared to the KSh. 152.8 billion (equivalent to 4.2 percent of GDP) in a similar period in FY 2012/13.

8. Domestic Debt

Total gross domestic debt stock increased by 17.2 percent from KSh. 1,050.6 billion as at end-June 2013 to KSh. 1,231.2 billion by the end-March 2014.

9. External Debt

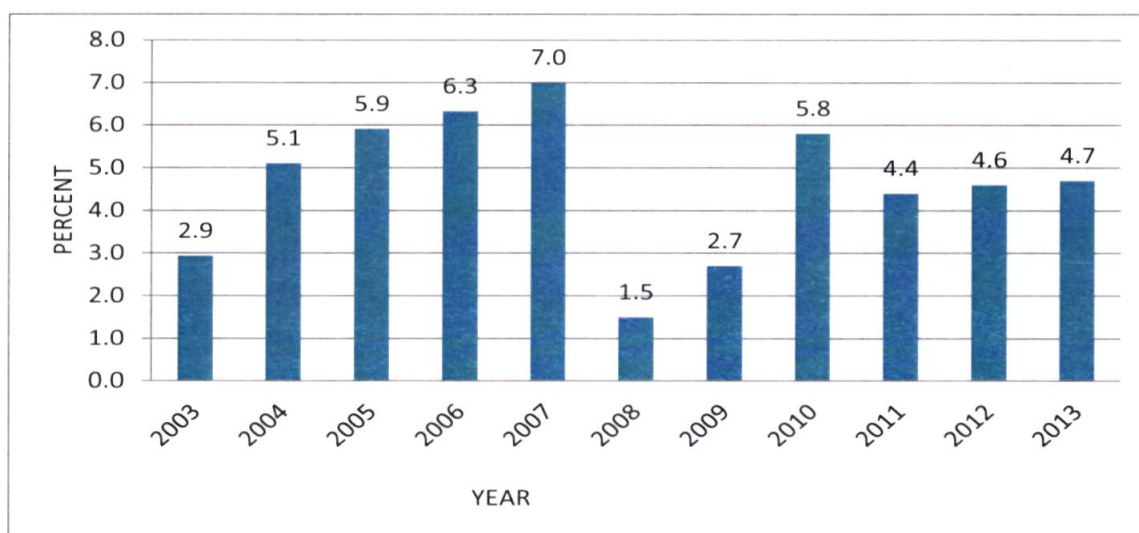
The total external debt stock stood at KSh. 896.4 billion at the period ending March 2014. The debt stock comprised of multilateral debt (64.5%), bilateral debt (27.2%), Export Credit debt (1.8%) and Commercial banks (6.7%).

1.0 RECENT ECONOMIC DEVELOPMENTS

1.1 Economic Growth

- The economy grew by 4.7 percent in 2013 compared with 4.6 percent in 2012. This growth was broad-based and was driven by expansion in wholesale and retail trade and repairs, mining, financial intermediation and transport and communication (**Chart 1**). Growth in the four quarters of 2013 were; 5.7 percent in quarter one, 4.7 percent in quarter two, 4.6 percent in quarter three and 3.9 percent in quarter four. The expansion in GDP growth in 2013 was primarily due to growth in all sectors of the economy apart from the Hotels and restaurants sector which experienced a decline in growth of 4.5 percent (**Table 1**).

Chart 1: Real GDP Growth



Source: KNBS.

*Provisional

Table 1: Sectoral GDP Growth (percent changes at constant prices 2001)

MAIN SECTORS	Share of GDP, Percent			Annual Growth Rates, Percent		
	2011	2012	2013	2011	2012	2013
Agriculture and Forestry	23.8	24.6	25.3	1.5	4.2	2.9
Fishing	0.5	0.5	0.5	3.1	3.4	5.4
Mining and Quarrying	0.7	0.7	0.6	7.1	4.1	7.4
Manufacturing	9.6	9.5	8.9	3.4	3.2	4.8
Electricity and Water Supply	1.0	1.4	1.4	-2.6	10.3	5.9
Construction	4.1	4.2	4.4	4.3	4.8	5.5
Wholesale and Retail Trade, Repairs	10.5	10.5	10.2	7.3	9.0	7.5
Hotels and Restaurants	1.7	1.7	1.5	4.9	2.6	-4.5
Transport and Communication	10.0	9.6	9.1	5.0	4.7	6.0
Financial Intermediation	6.3	5.2	4.8	7.8	6.5	7.2
Real estate, Renting and Business Services	4.4	4.3	4.1	3.6	3.3	4.3
Public Administration and Defence	5.0	5.5	6.7	2.5	2.7	4.7
Education	5.8	6.1	6.7	4.8	5.4	4.9
Health and social work	2.4	2.4	1.9	3.5	3.4	3.3
Other Services	3.2	3.2	3.5	4.6	3.2	3.2
less: Financial Services Indirectly Measured	-1.0	-0.8	-1.0	2.0	2.0	2.0
Taxes less Subsidies on Products	11.5	11.1	10.9	5.2	-1.0	17.5
GDP at constant market prices	100.0	100.0	100.0	4.4	4.6	4.7

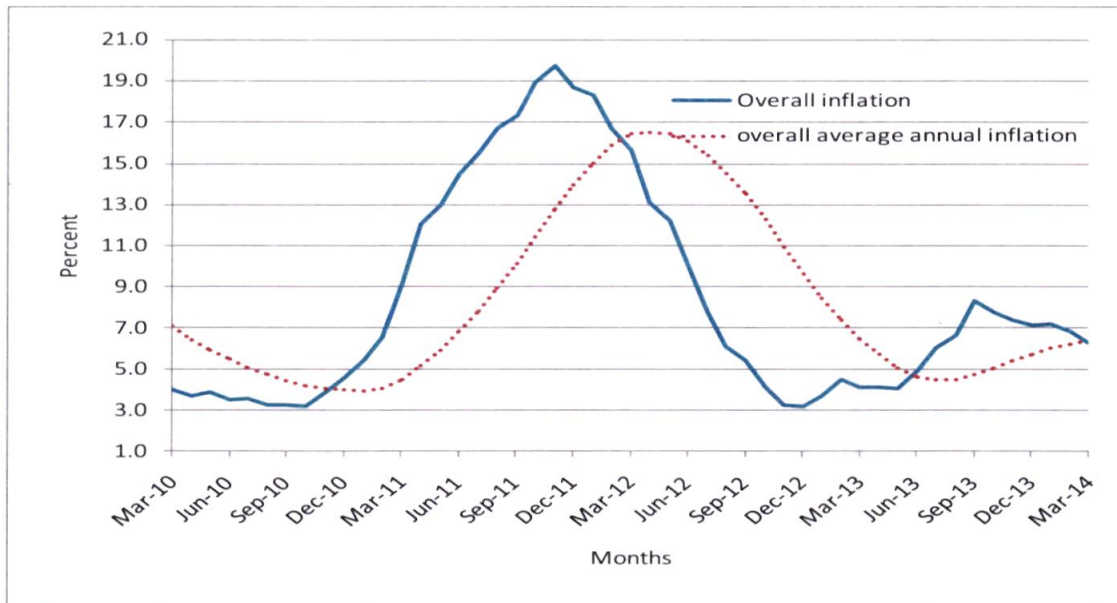
Source: KNBS

2. Transport and Communication sector recorded a growth of 6.0 percent in 2013, up from a growth of 4.7 percent in 2012, mainly on account of an accelerated growth in post and telecommunication which expanded by 9.3 percent while transport and storage grew by 3.6 percent during the review period. The improved performance in the transport subsector was as a result of the expansion of air and land transport. The growth of the communication sector was supported by continued rapid expansion in mobile telephony and related services.
3. Agriculture and forestry sector expanded by 2.9 percent in 2013 compared with a growth of 4.2 percent in 2012. The slowed growth was due to poor rainfall in some ecological zones during the short rains season and unfavorable international prices for key export crops. On the positive side, this sector was boosted by increased production of tea, wheat, vegetables, potatoes and sugarcane.
4. The manufacturing sector expanded by 4.8 percent in 201, up from a growth of 3.2 percent in 2012. Broadly the acceleration in growth was experienced in manufacturing of both food and non-food products. The growth in the manufacture of food, beverages and tobacco was primarily driven by enhanced production of sugar and processed and preserved fruits and vegetables. Manufacturing of non-food products was mainly fuelled by increased manufacture of rubber products, fabricated and basic metals and furniture and pharmaceutical products.
5. The financial intermediation sector grew by 7.2 percent in 2013 compared to 6.5 percent in 2012. The growth in the sector was due to the improvement in demand for domestic credit during the year.
6. The construction sector recorded an overall growth of 5.5 percent in 2013 compared to 4.8 percent in 2012. This was attributed to increased spending on infrastructural development by the Government and improved private sector construction activities.
7. Electricity and water sector activities expanded by 5.9 percent in 2013 compared to 10.3 percent growth in 2012. Generation of electricity by Hydro and geo-thermal expanded by 10.4 percent and 17.5 percent respectively, while generation of thermal shrank by 1.8 percent in 2013.
8. The Hotels and Restaurants sector contracted by 4.5 percent in 2013 compared to a growth of 2.6 percent in 2012. This was attributed to security concerns, arising from negative travel advisories by some governments and a decline in the economic fortunes of major tourists' sources among them USA and European countries.

1.2 Inflation

9. Overall month on month inflation declined to 6.27 percent in March 2014 from 6.86 percent in February 2014 (**Chart 2**). On average, inflation stood 6.39 percent in March 2014 compared with 6.45 percent in March 2013.

Chart 2: Inflation



Source: KNBS

10. Food and Non Alcoholic drinks’ Index increased by 0.56 per cent during the month of March 2014. This was a result of aggregate rise in prices of some food items outweighing notable falls in prices of others

1.3 Balance of Payments

11. Kenya’s overall balance of payments position recorded a surplus of US\$ 1,224 million in the year to February 2014, up from a surplus of US\$ 662 million in the year to February 2013 (**Table 2**). The increased surplus reflected the build up in the capital and financial account and a reduced deficit in the current account.

12. The current account deficit narrowed by 30.2 percent from US\$ 4,516 million in the year to February 2013 to US\$ 3,151 million in the year to February 2014. As a share to GDP, current account deficit improved to 7.7 percent from 11.1 percent over the same period. This was largely attributed to the improvement of the value of the service account by 15.9 percent that offset the slowed widening of the merchandise account.

Table 2: Balance of Payments Developments (US \$ Million)

ITEM	Year to FEB 2012	Year to FEB 2013	Year to FEB 2014	Absolute Change	Percentag e Change
1. CURRENT ACCOUNT	-3,448.1	-4,516.4	-3,150.8	1,365.7	-30.2%
2. MERCHANDISE ACCOUNT	-9,199.4	-10,857.6	-10,499.5	358.1	-3.3%
2.1 Exports (fob)	5,914.5	6,228.0	5,773.0	-455.0	-7.3%
Coffee	225.0	256.9	188.3	-68.7	-26.7%
Tea	1,186.2	1,226.7	1,155.3	-71.4	-5.8%
Horticulture	659.1	718.6	746.8	28.2	3.9%
Oil products	110.9	74.9	43.6	-31.4	-41.8%
Manufactured Goods	739.4	693.3	653.4	-40.0	-5.8%
Raw Materials	416.1	377.8	344.8	-33.0	-8.7%
Chemicals and Related Products (n.e.s)	572.3	548.1	459.4	-88.7	-16.2%
Miscellaneous Man. Articles	538.5	566.1	595.0	28.9	5.1%
Re-exports	318.8	489.5	583.5	94.0	19.2%
Other	1,148.2	1,276.0	1,003.0	-273.0	-21.4%
2.2 Imports (cif)	15,113.9	17,085.6	16,272.5	-813.2	-4.8%
Public	271.3	186.1	122.0	-64.1	-34.4%
Private	14,842.6	16,899.5	16,150.5	-749.1	-4.4%
Oil	4,062.0	4,139.5	3,806.0	-333.5	-8.1%
Chemicals	1,970.8	2,084.3	2,315.6	231.3	11.1%
Manufactured Goods	2,285.7	2,436.2	2,577.0	140.7	5.8%
Machinery & Transport Equipment	3,747.6	5,005.4	4,539.3	-466.2	-9.3%
Other	2,776.5	3,234.1	2,912.6	-321.4	-9.9%
3. SERVICES	5,751.3	6,341.2	7,348.2	1,007.0	15.9%
4. CAPITAL & FINANCIAL ACCOUNT	3,577.4	5,178.7	4,374.6	-804.1	-15.5%
4.1 Capital Account	205.5	205.0	163.4	-41.6	-20.3%
4.2 Financial Account	3,371.8	4,973.7	4,211.2	-762.5	-15.3%
5. OVERALL BALANCE	129.2	662.3	1,223.3	561.1	84.7%
Gross Reserves	6,215.5	7,079.5	8,352.4	1,272.8	18.0%
Official	4,434.6	5,290.1	6,679.4	1,389.3	26.3%
Commercial Banks	1,780.9	1,789.5	1,673.0	116.5	6.5%
Imports cover (calender year)	3.21	3.47	4.61	1.1	32.7%
Import cover (36 mths imports)	3.79	3.90	4.61	0.7	18.2%

Source: CBK

13. The surplus in the capital and financial account declined to US\$ 4,375 million in the year to February 2014 from US\$ 5,179 million in the year to February 2013. The shortfall was largely in the financial account which decreased by US\$ 763 million in February 2014 following increased short term flows including errors and omissions in recorded transactions, and a drawdown on commercial banks deposits held abroad

1.4 Foreign Exchange Reserves

14. The gross foreign exchange holdings of the banking system increased by 17.97 percent from US\$ 7,080 million in February 2013 to US\$ 8,352 million in February 2014 (**Table 3 and Chart 3**). Gross Official reserves held by the Central Bank increased due to reserves build up and receipt of disbursements under the Extended Credit Facility (ECF) to US\$ 6,602.2 million (4.61 months of import cover) in March 2014, an improvement from US\$ 5,523.3 million (4.04 months of import cover) in March 2013.

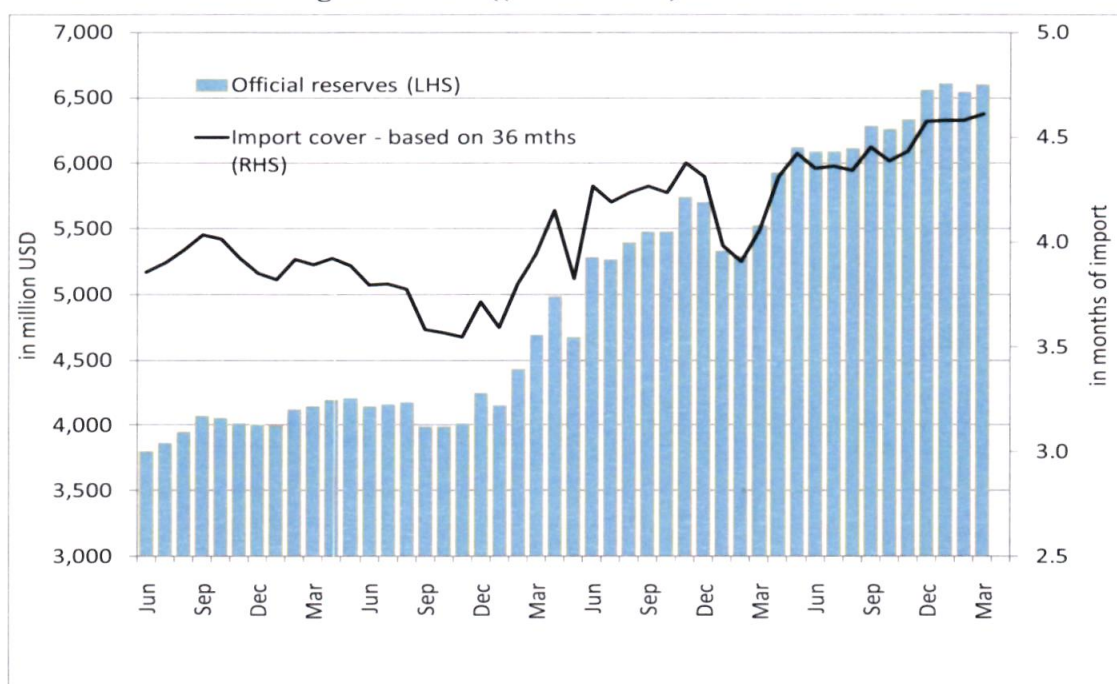
RECENT ECONOMIC DEVELOPMENTS

Table 3: Foreign Exchange Reserves (US\$ million)

	Dec-12	Feb-13	Mar-13	Jun-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14
Gross Foreign Exchange Reserves	7,160.1	7,080.4	7,113.9	7,900.0	7,958.8	7,859.5	7,893.0	8,483.2	8,518.6	8,352.4	
Official	5,701.9	5,290.1	5,523.3	6,089.0	6,290.7	6,263.3	6,333.1	6,560.2	6,611.9	6,679.4	6,602.2
Commercial Banks	1,458.2	1,790.4	1,590.6	1,811.0	1,668.1	1,596.2	1,559.9	1,923.0	1,906.7	1,673.0	
Imports cover (calender year)	3.82	3.45	3.64	4.04	4.33	4.27	4.37	4.53	4.57	4.63	
Import cover (36 mths imports)	4.29	3.89	4.04	4.35	4.45	4.39	4.43	4.57	4.58	4.61	4.61

Source: CBK

Chart 3: Official Foreign Reserves ((US\$ million)

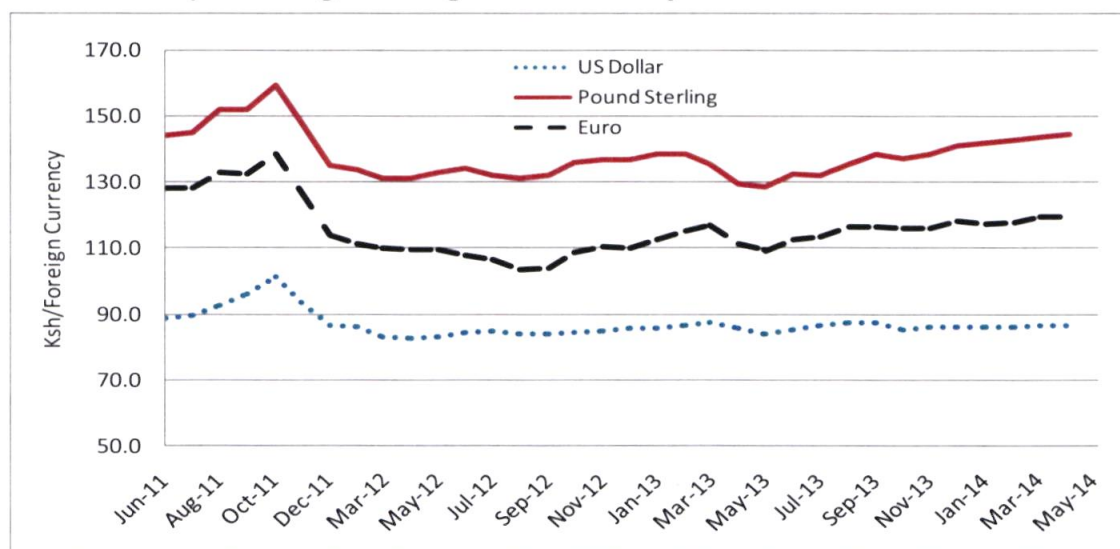


Source: CBK.

1.5 Exchange Rates

15. Kenya Shilling exchange rate weakened against major international currencies but stabilized against the US dollar at Kshs 86.5 per US dollar by in March 2014 from KSh. 86.3 per US dollar in February 2014 (**Chart 4**). The stability to the US dollar followed increased short term capital inflows and remittances.

Chart 4: Kenya Shilling Exchange Rate with major currencies



Source: CBK

16. Against the sterling pound, the shilling weakened to Ksh.143.8 in March 2014 from 142.8 in February 2014 and against the Euro it weakened to KSh. 119.6 from Kshs 117.8 over the same period.

1.6 Money and Credit

17. Growth in broad money supply, M3, increased by 14.8 percent in the year to March 2014 down from a growth of 15.7 percent in the year to March 2013 and was below the 15.7 percent target for March 2014 (Table 4).

Table 4: Money Supply, M3 and its Sources, KSh. billion

	2012 Mar	2013 Mar	2014 Mar	Absolute Change		percent change	
				2012-2013 Mar	2013-2014 Mar	12 months to Mar-13	12 months to Mar-14
1. Money supply, M3 (2+3)	1517.1	1755.5	2015.4	238.4	259.9	15.7	14.8
1.1 Money supply, M2	1276.4	1477.4	1713.8	201.0	236.4	15.7	16.0
1.2 Money supply, M1	611.8	720.6	823.1	108.8	102.5	17.8	14.2
1.3 Currency outside banks	129.3	150.0	156.8	20.7	6.7	16.0	4.5
2. Net foreign assets (2.1+2.2)	276.2	319.6	370.5	43.4	51.0	15.7	16.0
2.1 Central Bank	291.1	341.7	442.1	50.6	100.4	17.4	29.4
2.2 Banking Institutions	-15.0	-22.2	-71.5	-7.2	-49.4	48.3	222.6
3. Net domestic assets (3.1+3.2)	1241.0	1435.9	1644.8	195.0	208.9	15.7	14.5
3.1 Domestic credit (3.1.1+3.1.2+3.1.3)	1530.9	1752.2	2052.9	221.3	300.7	14.5	17.2
3.1.1 Government (net)	315.1	391.0	404.9	75.9	13.9	24.1	3.6
3.1.2 Other public sector	32.2	45.1	33.7	13.0	-11.4	40.3	-25.4
3.1.3 Private sector	1183.7	1316.0	1614.3	132.4	298.3	11.2	22.7
3.2 Other assets net (3-3.1)	-290.0	-316.3	-408.1	-26.3	-91.8	9.1	29.0

Source: CBK

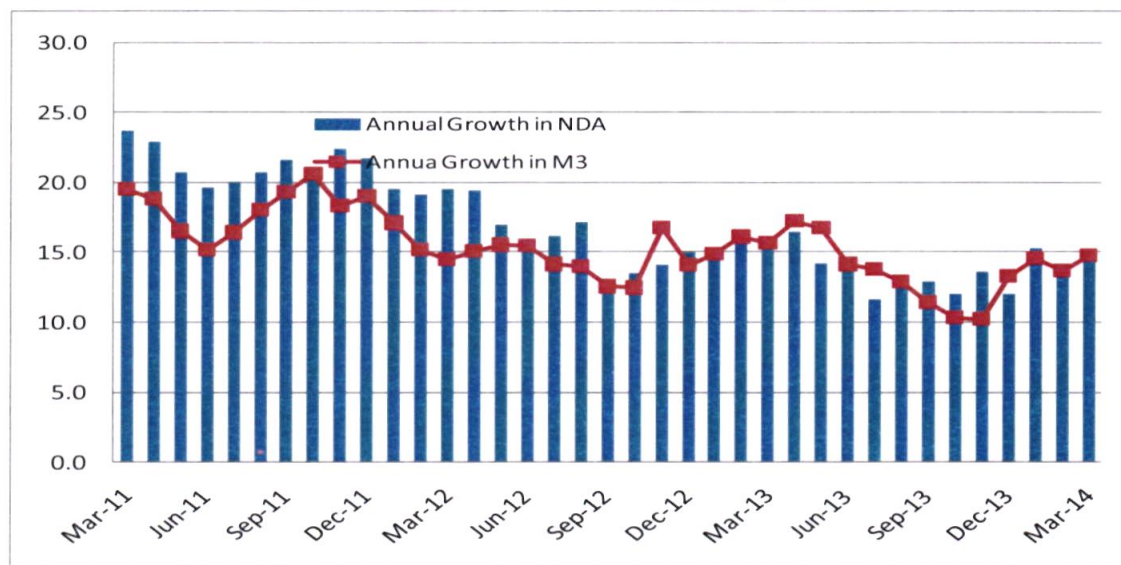
18. The slowdown in M3 growth was attributed to a decline in the growth of the net domestic assets (NDA) of the banking system. Annual growth of the NFA of the banking system increased to 16.0 percent in the year to March 2014 from 15.7 percent over a similar period in 2013 due to an improvement in the official foreign assets of the Central Bank from Ksh 341.7 billion in March 2013 to

RECENT ECONOMIC DEVELOPMENTS

KSh. 442.1 billion in March 2014.

19. Growth of the NDA of the banking system slowed to 14.5 percent in the year to March 2014 from 15.7 percent over a similar period in 2013. The growth in NDA in 2014 was supported by increases domestic credit particularly in the private sector.

Chart 5: M3 Growth and Net Domestic Assets of Banking System

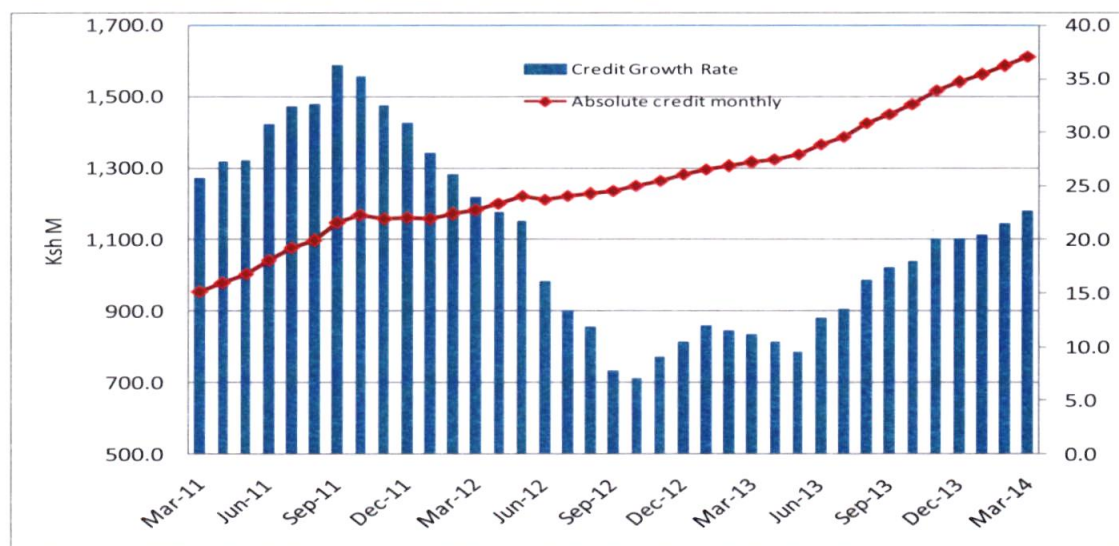


Source: CBK

Recovery in growth of the private sector

20. Growth in net credits to Government slowed to 3.6 per cent in the 12 months to March 2014 compared with 24.1 per cent growth in a corresponding period in 2013. Bank credit to the private sector increased by 22.7 percent in March 2014 from 11.2 percent in the same period in 2013(Chart 6).

Chart 6: Private Sector Annual Credit Growth



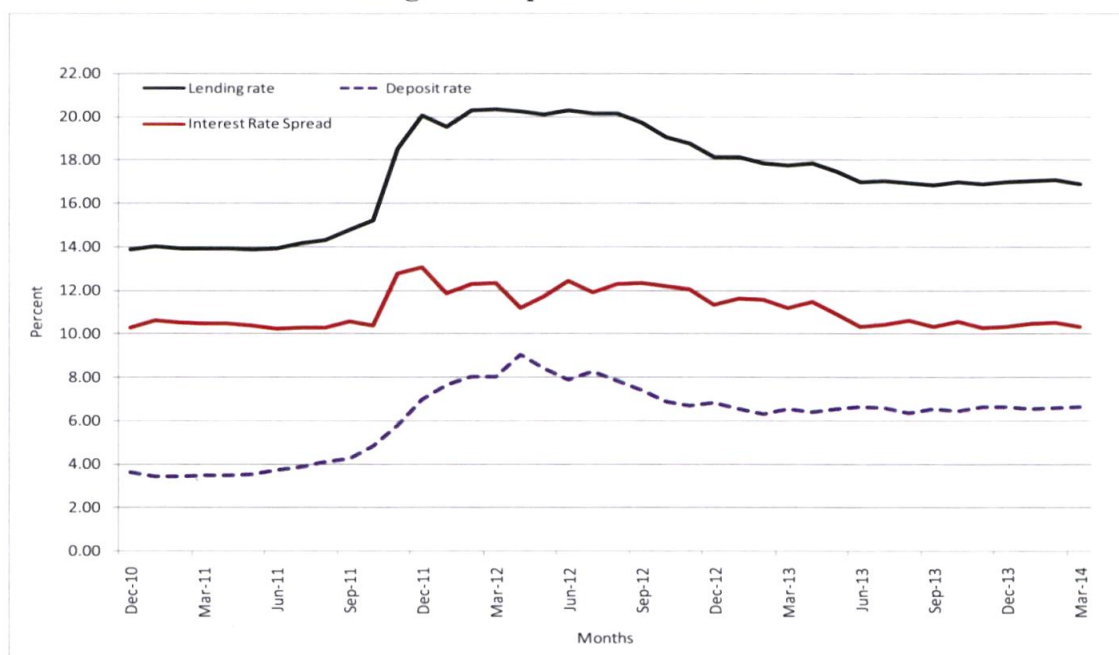
Source: CBK.

RECENT ECONOMIC DEVELOPMENTS

1.7 Interest Rates

21. Short term interest rates declined in March 2014 due to improved domestic liquidity. The Central Bank Rate at 8.5 per cent as of end of March 2014 continued to coordinate movements in the short-term interest rates. The interbank rate averaged 6.4 percent in March 2014 compared with 8.8 percent by February 2014. The 91-day Treasury bill rate averaged 9.0 percent in March 2014 from 9.2 in February 2014 while the 182 day Treasury bill declined to 10.1 percent from 10.3 percent over the same period respectively.
22. Commercial banks average lending rates declined to 16.9 percent in March 2014 compared with 17.8 percent in March 2013 while the deposit rate rose to 6.6 percent from 6.5 percent over the same period (**Chart 7**). This narrowed interest rate spread from 11.2 percent in March 2013 to 10.3 percent in March 2014 reflecting a larger decline in the lending rate.

Chart 7: Commercial Banks Lending and Deposit Interest Rates

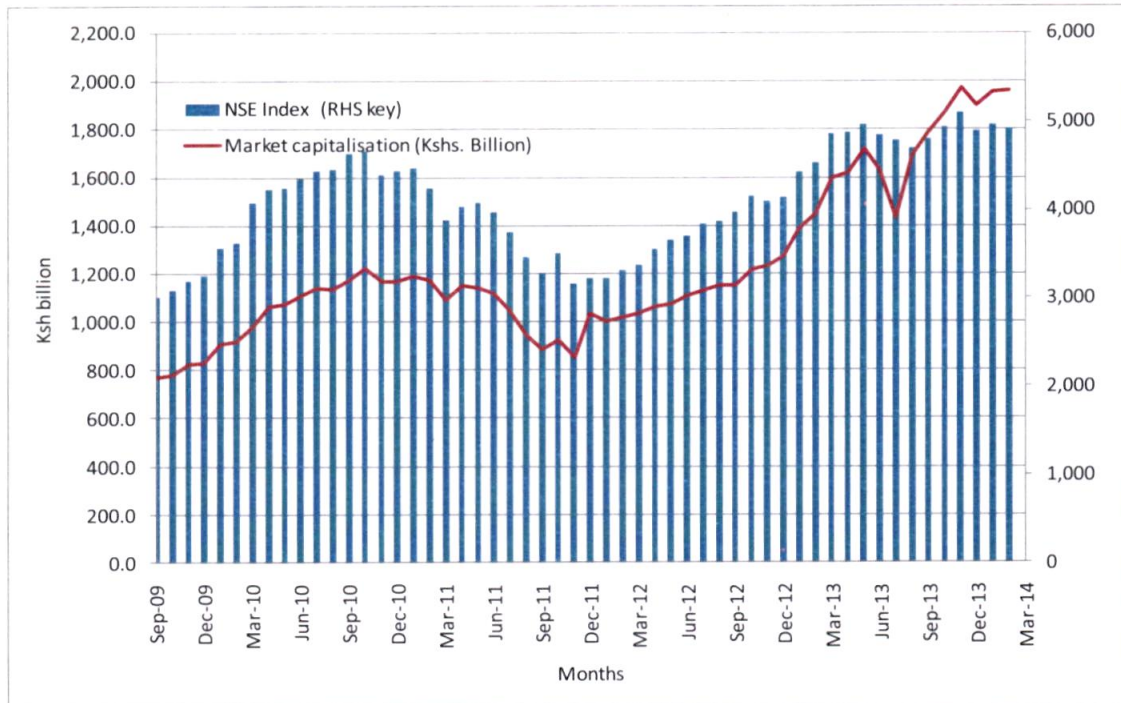


Source: CBK.

1.8 Capital Markets

23. Activity in the stock market has been vibrant in the year to March 2014. The NSE 20 share index improved from 4,860 points in March 2013 to 4,960.0 points in March 2014, representing an increase of 2.06 percent (**Chart 8**). Market capitalization which measures shareholders' wealth improved from KShs 1,599.8 billion in March 2013 to KSh. 1,998.6 billion in March 2014, representing an increase of 24.9 percent

Chart 8: Performance at the NSE



Source: NSE.