# MACROECONOMIC DEVELOPMENTS AND OULOOK: 2023/24 BUDGET AND MEDIUM TERM

## PRESENTATION AT THE PUBLIC SECTOR HEARINGS

**DR. CHRIS KIPTOO, CBS**
**PRINCIPAL SECRETARY**

**THE NATIONAL TREASURY AND ECONOMIC PLANNING**

11th January 2023

# PRESENTATION OUTLINE

1. State of the Economy and Macroeconomic Outlook
2. FY 2022/23 Budget Execution
3. Economic Recovery Agenda to promote inclusive Growth
4. Economic Recovery Programme supported by the IMF
5. Fiscal Policy for the FY 2023/24 Budget and the Medium Term
6. Risks to the Macroeconomic Outlook

## *1a. State of the Economy and Macroeconomic Outlook*

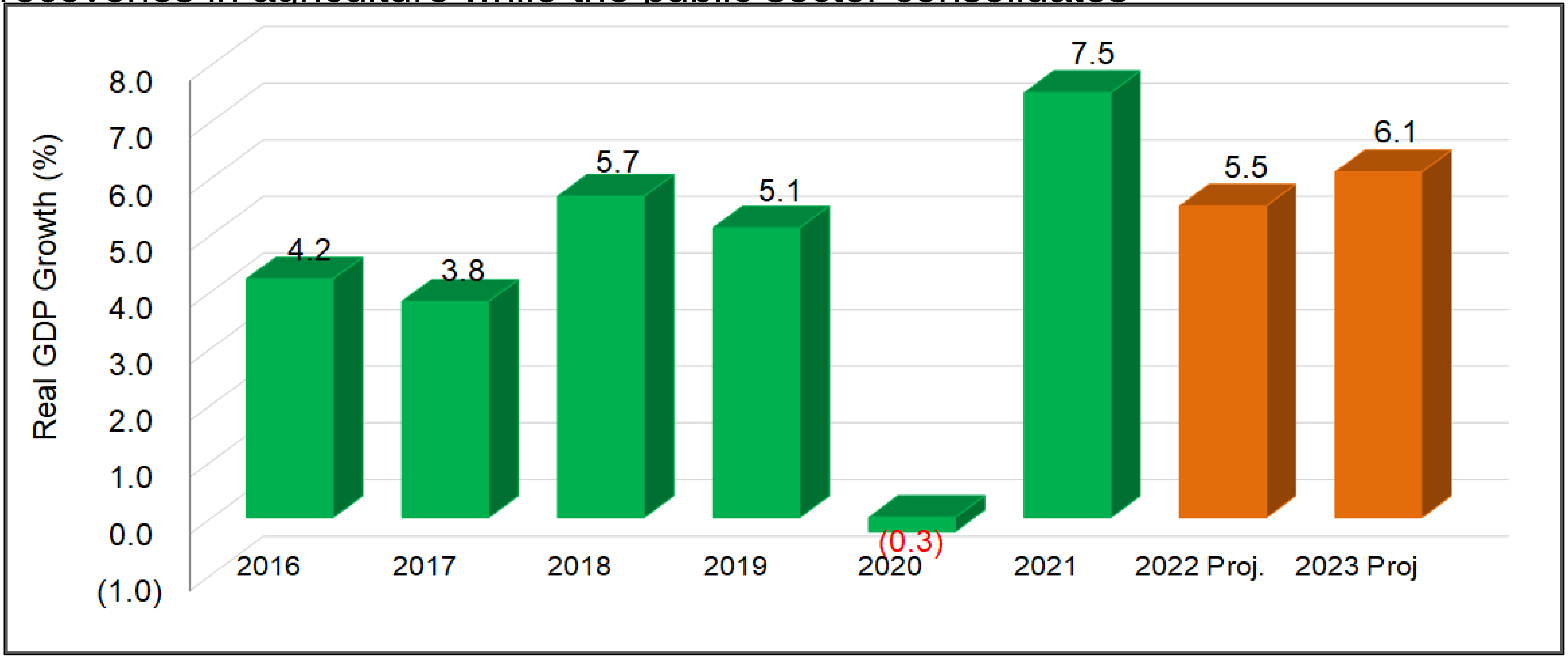
- Global economic outlook has become more uncertain - reflecting the impact of the ongoing Russia-Ukraine conflict, elevated global inflation, lingering effects of COVID-19 pandemic, and persistent supply chain disruptions. Global growth is expected to slowdown to **3.2% in 2022** and is projected to slow down to **2.7% in 2023** from the earlier forecast of 2.9%. The USA economy is projected to slow down to 1.0% in 2023, from 1.6% in 2022, Euro Area economies will slowdown to 0.5% from 3.1% in 2022. China economy is projected to improve to 4.4% from 3.2% in 2022.

- The Kenyan economy continues to demonstrate remarkable resilience and recovery from COVID-19 shock due to its diversification and the proactive measures implemented by the Government to support businesses. The economy expanded by **7.5% in 2021**, a much stronger level from a contraction of **0.3% in 2020 and is estimated to grow by 5.5 percent in 2022 (**already the economy has recorded growths as follows: **6.7% in Q1** and **5.2% in Q2** and **4.7% in Q3**).

## *1b. State of the Economy and Macroeconomic Outlook*

The economy is projected to grow **by 5.5% in 2022 and 6.1% in 2023** and maintain that momentum over the medium-term**.**

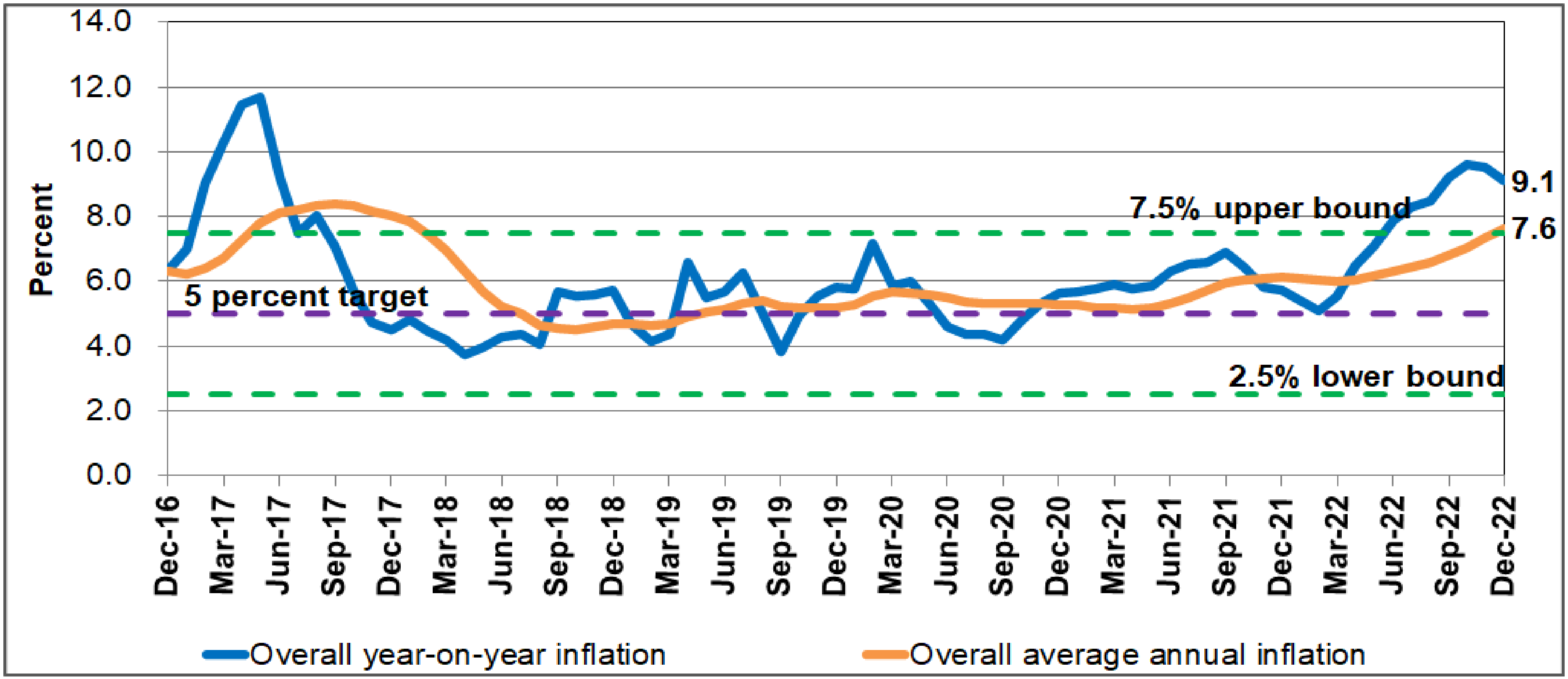
This growth will be supported by a broad-based private sector growth, including recoveries in agriculture while the public sector consolidates




The growth outlook will be reinforced by the **Government's development agenda** geared towards **economic turnaround and inclusive growth**. Special focus will be placed on increased employment, more equitable distribution of income, social security while also expanding the tax revenue base.

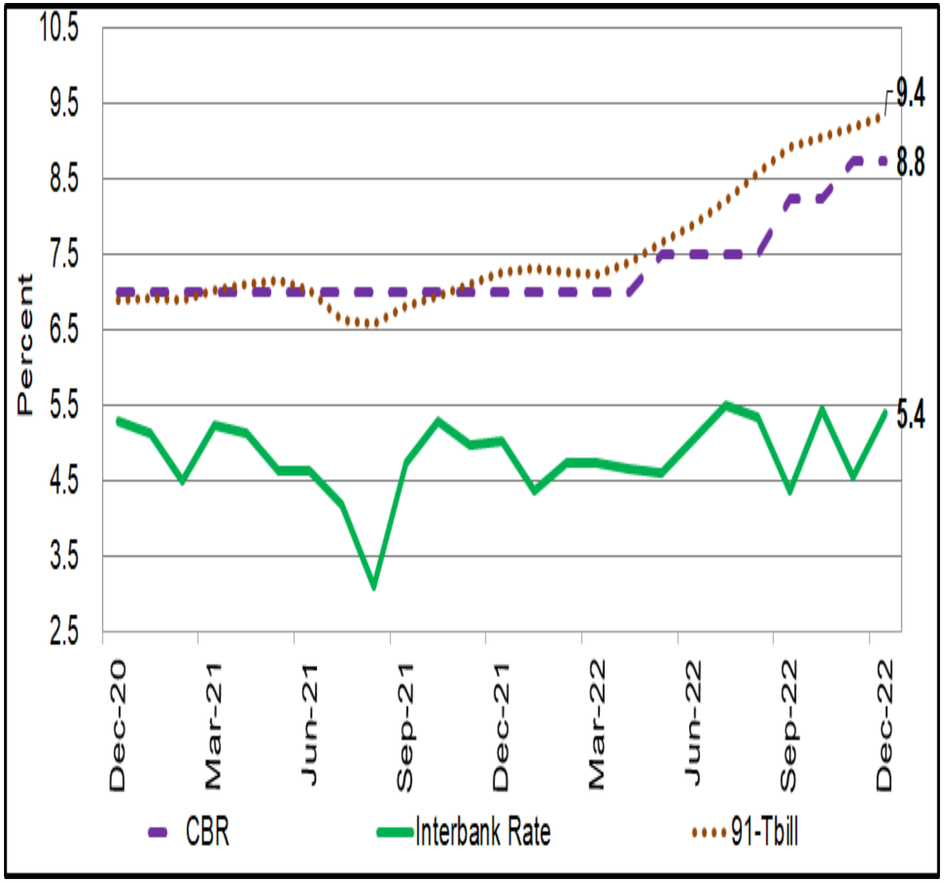
## *1c. Macroeconomic Indicators: Inflation rate eased in November and December but is still above the 7.5% upper target*

- Inflation rate increased from **5.6% in March 2022** to **9.6% in October 2022** due to higher international food and fuel prices but **eased** to **9.1%** in **December 2022** from **9.5% in November 2022** due to a decline in food prices with the favourable rains and declining international prices of edible oils.
- Monetary policy stance remains tight to anchor inflation expectations due to the elevated risk of high inflation. The Central Bank rate was raised to **8.75%** in **November, 2022** from **8.25%**



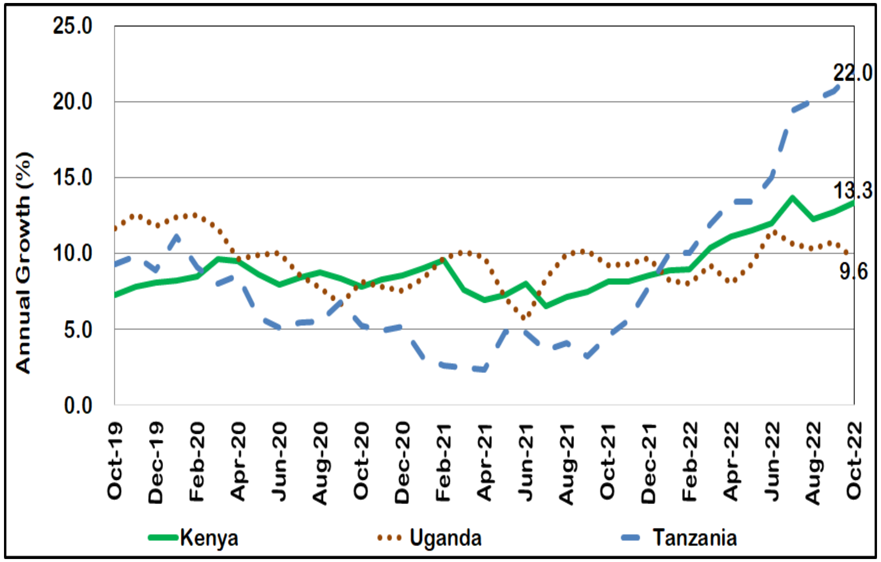
# 1c. Macroeconomic Indicators: Interest rates and Credit to private sector

- The interbank rate remained stable at **5.4% in December 2022** compared to 5.0% in December 2021 while the 91-day Treasury Bills rate increased to **9.4%** from 7.3% over the same period due to tight liquidity conditions.




Lending to the private sector by commercial banks in Kenya has remained strong with the credit expanding by **13.3% in the 12 months to October 2022** compared to a growth of 7.3% over the same period in 2021.

Strong credit growth was observed in the following sectors: manufacturing (17.5%), trade (15.3%), business services (13.2%), and consumer durables (14.0%).



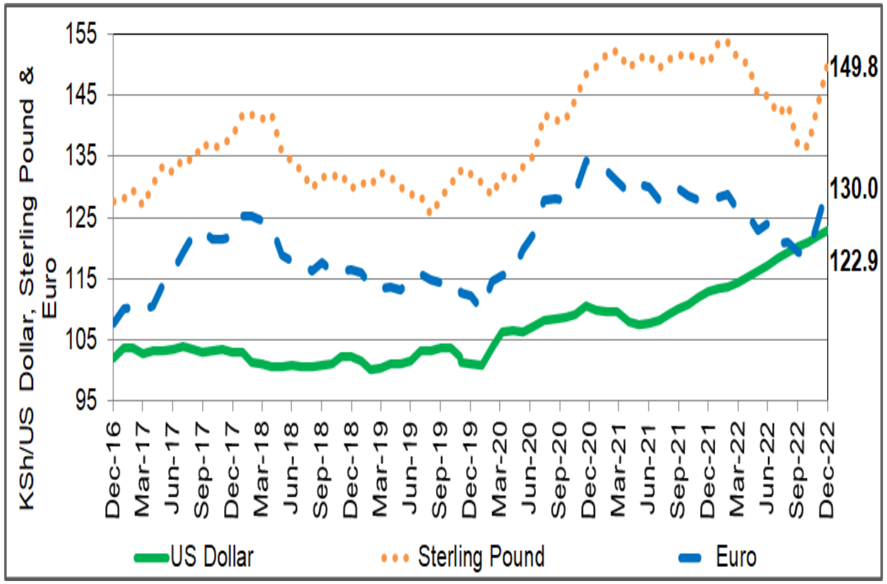

Similar trend of credit growth is also observed in the EAC region. Tanzania has the highest level of lending to the private sector at 22.0% compared with 13.3% for Kenya and 9.6% for Uganda.

## 1d. External Sector Developments

**The external sector has remained stable despite the tight global financial conditions attributed to strengthening of the US Dollar and uncertainties regarding the ongoing Russian-Ukraine conflict.**

- The current account deficit was generally stable at **5.4% of GDP in September 2022** compared to 5.2% of GDP in September 2021 reflecting increased imports of oil and other intermediate goods.
- The current account balance is mainly supported by increased remittances which totalled **USD 3,996 million** in the **12 months to October 2022**, and were **10.9 percent** higher compared to a similar period in 2021.
- The usable foreign exchange reserves remained adequate at **USD 7,439 million (4.17 months of import cover)** as at December 2022 and continues to provide adequate buffer against short term shocks in the foreign exchange market

**Due to the strong dollar, the exchange rate to the Kenya shilling like all world currencies has weakened but strengthened against other major international currencies.**




- The **US Dollar** exchanged at **KSh 122.9 in December 2022** compared to KSh 112.9 in December 2021. **The Euro** exchanged at **KSh 130.0 in December 2022** compared to Ksh 127.6 in December 2021.

## *2a. FY 2022/23 Budget Execution*

- Budget execution in the FY 2022/23 has progressed smoothly to end November 2022. **Total revenues** by end November 2022 amounted to **Ksh 893.8 billion (6.4% of GDP)** against a target of **Ksh 912.9 billion (6.5% of GDP)** recording a shortfall of **Ksh 19.1 billion.**
  - The below target performance was on account **of shortfall** registered in **ordinary revenue** of **Ksh 32.2 billion** despite the **surplus collection** of **Ksh 13.1 billion** in **ministerial A-i-A.**
  - Revenues increased by **10.6%** compared with a growth of **29.5%** in a similar period in 2021. All tax revenue categories recorded positive growths, an indication of continued recovery in revenue collection.

- **Total expenditure** to November 2022 amounted to **Ksh 1,096.6 billion** against a target of **Ksh 1,183.7 billion** translating to a shortfall in expenditure of **Ksh 87.1 billion.**
  - The **shortfall** was largely on account of below target disbursement towards recurrent expenditure of **Ksh 18.8 billion** and development expenditure of **Ksh 26.0 billion**.

## 2b: Preliminary Fiscal deficit incl. grants by end November 2022 was Ksh 199.5 billion (1.4 percent of GDP) against a target of Kshs. 268.2 billion (1.9 percent of GDP)

- The deficit was funded as follows:
  - **Net Domestic Financing** of Ksh 180.7 billion or 1.3% of GDP.
    - The net domestic financing was below the target by Ksh 128.1 billion attributed to liquidity challenges in the domestic debt market.
  - **Net Foreign Financing** of Ksh 39.0 billion or 0.3% of GDP, which constituted:
    - The net foreign financing made up of disbursements (inflows) of **Ksh 138.0 billion** and external repayments (outflows) of principal debt of **Ksh 98.9 billion.**
- Budget execution is affected by less than target financing.

# 3a. *Economic Recovery Agenda to promote inclusive Growth*

The **Government** has started to implement the Development Agenda - **The Bottom-up Approach** that is geared **towards economic turn-around and inclusive growth**. The Agenda will be anchored on:

- **Solidifying the foundations of development** with a focus on **deepening digital economy**; prioritizing **climate change and environmental actions**; and **infrastructure development**.
- Focusing on **sources of growth** including **agriculture transformation**, **manufacturing**, **services economy**, **creative economy**, and **MSMEs**. This is where properly **functioning markets** will support the recovery agenda.

# *3. Economic Recovery Agenda to promote inclusive Growth…Cont'..*

- **Support to MSMEs**
  - Implementation of favorable tax regime
  - Support business start-Ups and MSMEs on industrial property rights protection and training/skills development;
  - Establishment of MSMEs industrial parks
  - Hustler Fund – Bottom of the Pyramid
  - Enhancing market access

- **Support Agricultural Productivity:**
  - Food security and crop diversification;
  - National value chain support;
  - Crops and livestock industry revitalization;
  - Agricultural insurance programme; and
  - Agricultural market access and value addition

## *3. Economic Recovery Agenda to promote inclusive Growth…Cont'....*

- **Digital Superhighway and Creative Economy**
  - Extension of National Optic Fibre Backbone infrastructure;
  - Enhance Government service delivery through digitization and automation;
  - Promote investment in Konza City Technopolis; and
  - Establish E-Waste Management centers for safe disposal of electrical and electronic waste (e-Waste).

- **Health Care Reforms**
  - NHIF for all Kenyans; Expand existing health infrastructure;
  - Recruitment of additional healthcare workers;
  - Enhance supply chain management to ensure efficiency and accountability in medical supplies; and
  - Attract investors to build health products and technologies manufacturing plants;

# *3. Economic Recovery Agenda to promote inclusive Growth…Cont’......*

- **Housing and Settlement**
  - Facilitate delivery of 250,000 houses per annum;
  - Enable low cost housing mortgages;
  - Provide incentives to developers; and
  - Strengthen MSMEs capacity to produce high quality construction materials.
- **Enhancing Governance structures** with a successful devolution process and foreign policy that enables integration at regional and international levels.

## 4. *Economic Recovery Programme supported by the IMF*

I. The Government is implementing a 38-month Economic Recovery Program, supported by the IMF. The Program objectives include among others:

- **strengthen Kenya's COVID-19 response and maintain support for those most impacted by shocks to the economy;**
- **reduce debt vulnerabilities through a revenue-driven fiscal consolidation and stabilize the growth in public debt;**
- **advance the structural reform, governance agenda and address weaknesses in State-Owned Enterprises (SOEs); and**
- **strengthen the monetary policy and support financial stability.**

II. Kenya received **SDR 336.54 million (US$ 447.39 million)** in **December 2022** following the approval of the fourth review. This access included an augmentation of **SDR 162.34 million (about US$ 215.81 million)** to the initial program to cover among others, spending pressures due to the ongoing drought.

III. The cumulative disbursements under program are **US$1,655.59 million**. With the augmentation, the total amount under the program increases to **SDR 1.818 billion (or about US$2.416 billion).**

## *5a. Fiscal Policy for the FY 2023/24 Budget and the Medium Term*

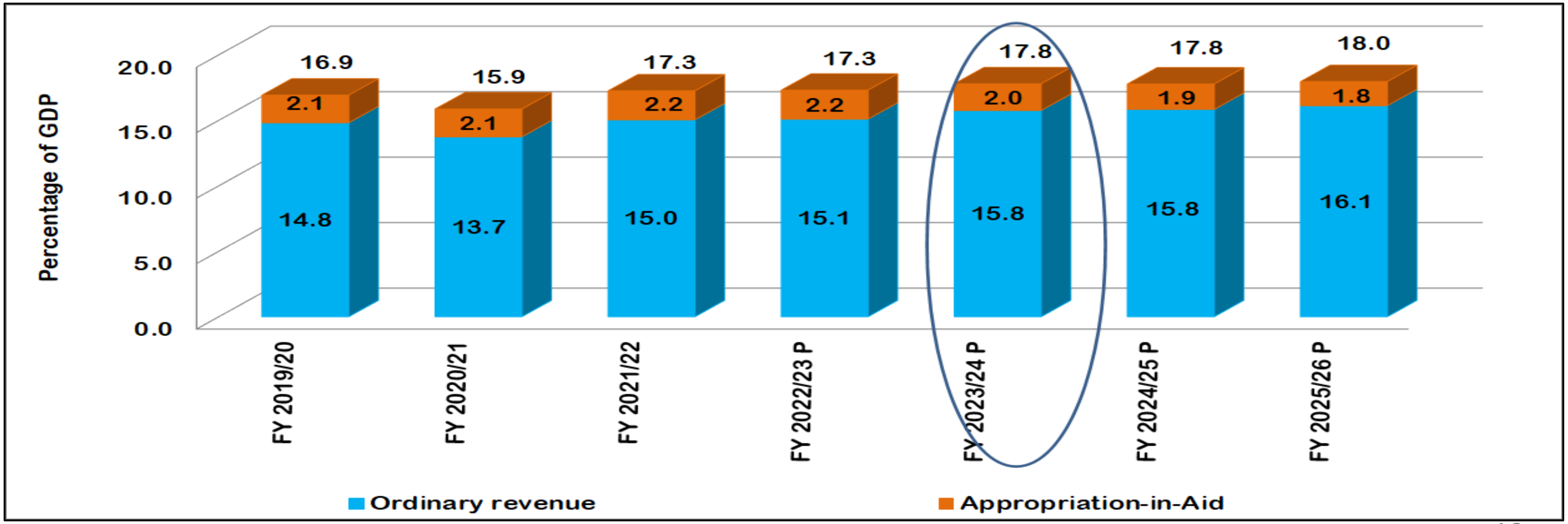
- The fiscal policy continues to **pursue growth friendly fiscal consolidation** to preserve debt sustainability. This will be achieved through **enhancing revenue collection** and suspending expenditures in some recurrent areas such as domestic and foreign travels, communication, printing, training, hospitality, fuel, purchase of furniture, purchase of motor vehicles, refurbishments and routine maintenance.

- The Government has restrained emerging expenditure pressures but also safeguarded against contracting economic activity and will be proposing a rationalization of the budget to reduce the fiscal deficit to **5.8% of GDP** in the FY 2022/23 budget from 6.2% of GDP in the approved budget**. The deficit** is projected to **decline** further to **4.3% of GDP in the FY 2023/24 budget and 3.5% of GDP over the medium term.**

## *5b. Efforts to grow revenues to 17.8% of GDP in FY 2023/24 from 17.3% of GDP in FY 2022/23 and 18.0 % of GDP over the Medium term have been put in place*

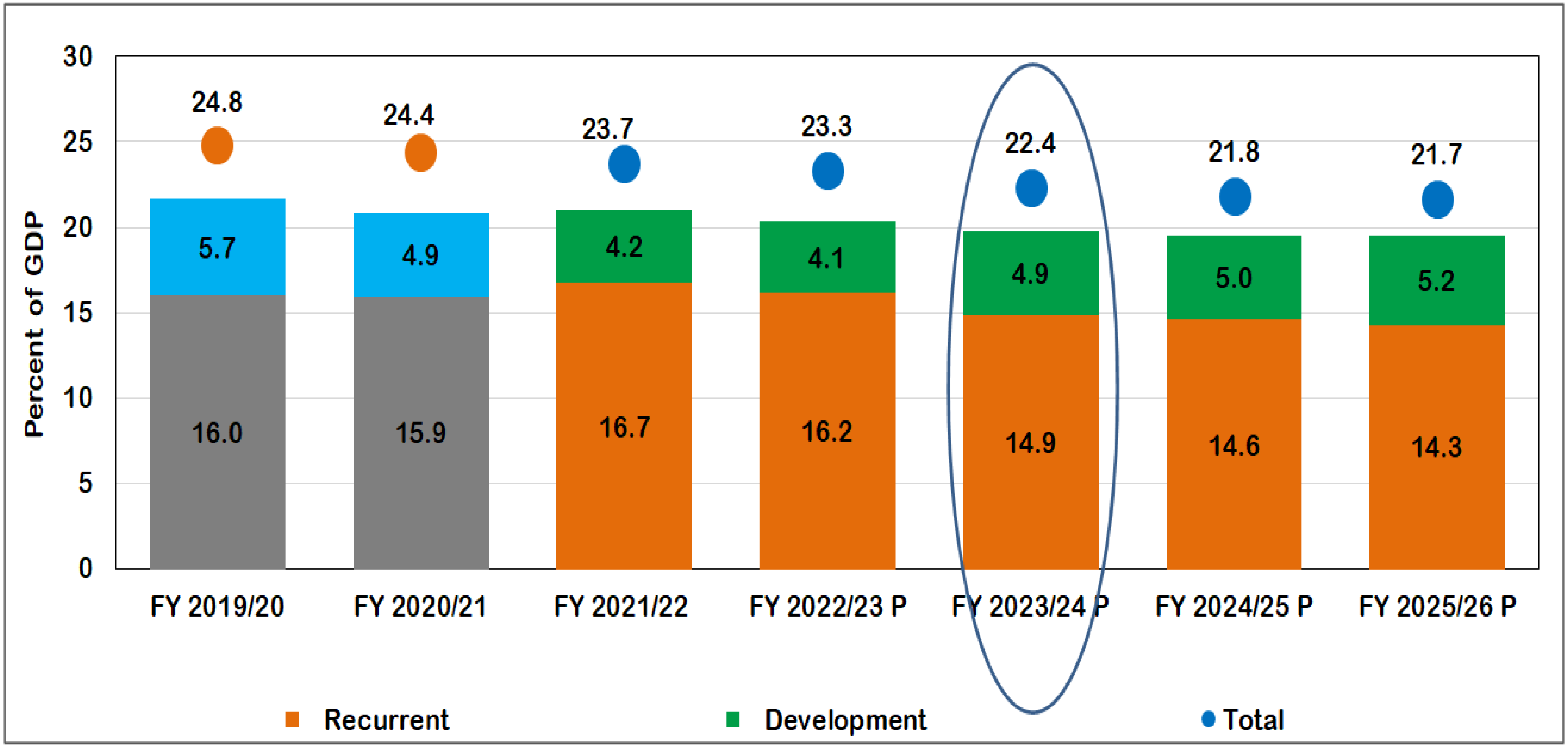
- Reforms under the revenue administration by KRA have been scaled up. The National Treasury, jointly with the KRA, is making improvements on tax administrative measures in order to ensure revenue collection remains on target. These include: implementation of a new web based improved VAT System; integration of KRA system with the Betting Sector and mapping of rental properties.

- On the Tax policy side, the development of the **National Tax Policy** and the **Medium-Term Revenue Strategy (MTRS)** which will strengthen revenue mobilization are at advanced stages.

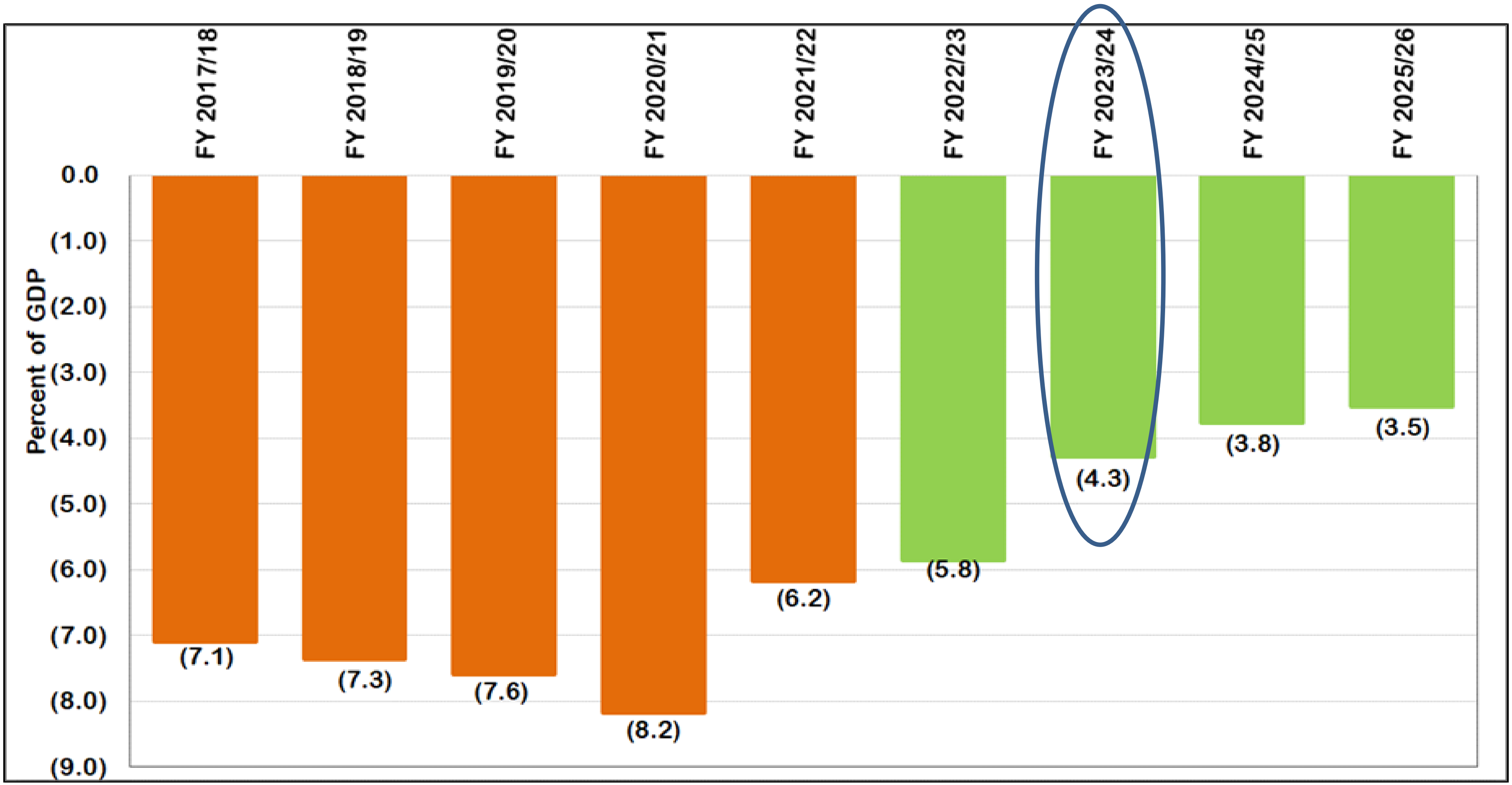


## *5c. FY 2023/24 and the Medium Term Budget: Expenditures*

- The Government will continue to **restrict growth in recurrent spending** through cutting down on non-priority expenditures.
- In this regard, expenditures as a share of GDP are projected to decline from 23.3% in the FY 2022/23 to **22.4%** in the FY 2023/24 and further to **21.7%** in the FY 2025/26.



## 5d: The increase in revenues and the reduction in expenditures will support fiscal consolidation by lowering the fiscal deficit as percent of GDP from 6.2% in FY 2021/22 to 5.8% in FY 2022/23 and 4.3% in the FY 2023/24. This will lead to stability in growth in public debt



## *6. There are Risks to this outlook that have remained elevated*

- **On the domestic side**, the risks emanate from climate change resulting in unfavorable weather conditions. This has affected agricultural production and led to domestic inflationary pressures.
- **Fiscal space** has been diminishing as we continue to experience the Multiple Shocks that have affected the global and the Domestic Economy.
- **On the external front**, uncertainties in the global economic outlook. These include: the possible worsening of the Russia - Ukraine conflict which could heighten the risk of oil and commodity price volatility and elevated inflationary pressures; the lingering adverse effects of COVID-19 that could disrupt the global supply chains; and global monetary policy tightening, especially in the United States, could increase volatility in the financial markets.

# 6. Specific Fiscal Risks

## a. Macroeconomic and Revenue Risks

- Shortfalls in revenue collection. In the first five months of FY 2022/23 total revenue performance was below target by Ksh 19 billion, with ordinary revenue recording a shortfall of Ksh 32.2 billion. This shortfall needs to be recouped to avoid hampering budget execution. Efforts are under way between the National Treasury and KRA to close the gap.

## b. Expenditures by Ministries, Departments and Agencies

- Various Ministries, Departments and Agencies have so far made expenditure requests that are greater than the available resource envelope.
- In addition, there are existing pending bills MDAs that need to be settled to support domestic liquidity.
- County Governments are encouraged to clear pending bills to further support businesses and boost liquidity.

# 6. Specific Fiscal Risks…..Cont'

## c. Public Investment

- The government is implementing a huge portfolio of public investment projects but some of the projects estimated at 437 are stalled projects. There is need therefore to clear all stalled projects before embarking on new ones

## d. Pension Liabilities

- Pension liabilities pose a fiscal risk. These exist at both the National and Country Governments.
- Timely remittance of the required contributions to defined contribution schemes will mitigate possible litigation costs and encourage appropriate investment choices.

# *6. Specific Fiscal Risks…..Cont’*

## *e. State Corporations and Government Linked Corporations*

- Some of the State Owned Enterprises faced challenges associated with Covid 19 Pandemic. The Government will continue on the structural reform to improve Governance and address weaknesses in these enterprises

THANK YOU

## *Annex 1: Total Revenues to November 2022*

| Revenue (Kshs. billions) | Jul-Nov 2021 | | Jul-Nov 2022 | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Prel. Issues | % of GDP | Printed Target | Prel. Issues | Deviation | % of GDP | Performance Rate (%) | Growth (%) |
| **TOTAL REVENUE** | **808.2** | **6.3** | **912.9** | **893.8** | **(19.1)** | **6.4** | **97.9** | **10.6** |
| **Ordinary revenue** | **718.0** | **5.6** | **818.7** | **786.5** | **(32.2)** | **5.6** | **96.1** | **9.5** |
| Import Duty | 46.2 | 0.4 | 57.8 | 54.9 | (2.9) | 0.4 | 95.0 | 18.8 |
| Excise Taxes | 100.9 | 0.8 | 114.6 | 108.9 | (5.7) | 0.8 | 95.0 | 7.9 |
| **Income Tax** | **310.5** | **2.4** | **372.9** | **342.5** | **(30.4)** | **2.4** | **91.9** | **10.3** |
| o/w PAYE | 180.3 | 1.4 | 201.7 | 188.9 | (12.8) | 1.3 | 93.7 | 4.8 |
| o/w Other Income Tax | 130.2 | 1.0 | 171.2 | 153.6 | (17.6) | 1.1 | 89.7 | 18.0 |
| **Value Added Tax (VAT)** | **203.9** | **1.6** | **232.5** | **222.1** | **(10.4)** | **15.9** | **95.5** | **8.9** |
| o/wVAT (Domestic) | 99.1 | 0.8 | 120.6 | 107.9 | (12.7) | 0.8 | 89.5 | 8.9 |
| o/wVAT (Imports) | 104.9 | 0.8 | 111.9 | 114.2 | 2.3 | 0.8 | 102.0 | 8.9 |
| **Other Revenue** | **56.5** | **0.4** | **40.9** | **58.1** | **17.2** | **0.4** | **141.9** | **2.9** |
| **Ministerial AIA** | **90.2** | **0.7** | **94.3** | **107.3** | **13.1** | **0.8** | **113.9** | **19.0** |
| Recurrent | 57.7 | 0.5 | 63.0 | 75.8 | 12.7 | 0.5 | 120.2 | 31.4 |
| Development | 32.5 | 0.3 | 31.2 | 31.6 | 0.3 | 0.2 | 101.0 | - 2.9 |
| **GDP** | **12,752** | **100.0** | **14,002** | **14,002** | **-** | **100.0** | **100.0** | **9.8** |

## *Annex 2: Expenditures to November 2022*

| EXPENDITURE (Kshs. billions) | Jul-Nov 2021 | Jul-Nov 2022 | | | |
|---|---|---|---|---|---|
| | Actual | Target | Actual | Deviation | % Growth |
| **TOTAL EXPENDITURE AND NET LENDING** | **1,079.2** | **1,183.7** | **1,096.6** | **(87.1)** | **1.6** |
| **1. Recurrent Expenditure** | **777.7** | **844.4** | **825.6** | **(18.8)** | **6.2** |
| Domestic Interest | 189.4 | 229.4 | 218.4 | (11.0) | 15.3 |
| Foreign Interest due | 47.8 | 54.4 | 55.2 | 0.8 | 15.4 |
| Pensions & Other CFS | 38.1 | 62.7 | 35.7 | (27.1) | -6.5 |
| Contribution to Civil Ser Pension | 16.6 | 10.8 | 4.0 | (6.8) | -75.8 |
| Wages & Salaries | 219.2 | 223.8 | 223.8 | 0.0 | 2.1 |
| Operations & Maintenance | 266.6 | 263.2 | 288.5 | 25.2 | 8.2 |
| o/w Ministerial Recurrent AIA | 53.1 | 59.3 | 75.8 | 16.5 | 42.6 |
| **2. Development** | **193.0** | **174.9** | **149.0** | **(26.0)** | **-22.8** |
| Domestically Financed (Gross) | 147.4 | 114.0 | 99.7 | (14.3) | -32.4 |
| Foreign Financed | 45.5 | 58.0 | 46.4 | (11.6) | 1.9 |
| Net Lending | - | 1.1 | 2.8 | 1.7 | 0.0 |
| Equalization Fund | - | 1.8 | - | (1.8) | 0.0 |
| **3. County Transfer** | **108.5** | **164.4** | **122.1** | **(42.3)** | **12.6** |
| o/w Equitable Share | 108.5 | 153.6 | 122.1 | (31.5) | **12.6** |
| Conditional Allocation | - | 10.9 | - | (10.9) | **0.0** |
| **4. Contingency Fund** | - | - | - | - | 0.0 |