

Understanding Kenya's 2014/2015 National Budget

Economic analysis

PwC insight and analysis

Budgeted development expenditure must be fully implemented to spur economic growth to enhance productivity.

Transformational efficiencies and effectiveness in service delivery

Execution of budget vital for economic stimulation

Economic growth modest but not enough

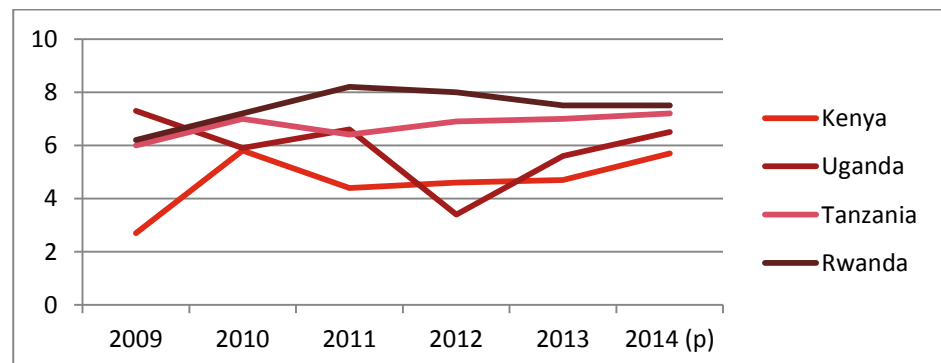
The government's development agenda is founded on 'Economic Transformation for Shared Prosperity' which is the cornerstone of the administration's fiscal strategy. The budgeted expenditure proposal of KES 1.77 trillion in 2014/15, representing an increase of 11% on the 2013/14 budget of KES 1.6 trillion, is geared at stimulating growth through investment in infrastructure and social services. For this to be achieved the government must address challenges

in absorbing development expenditure.

According to the Economic Survey 2013, the Kenyan economy grew by 4.7% and is projected to grow 5.7% in 2014. The growth was achieved against a backdrop of a stable macroeconomic environment, characterized by low inflation of 5.8% and a relatively stable exchange rate. Nonetheless, insecurity increased and is adversely affecting the tourism sector. Additionally poor rains could increase inflation and erode the aggregate demand for goods and services.

Our neighbours are growing fast and so should we by doing more business with them.

Fig 1: Kenya and its neighbours economic growth trend (2009 – 2013)



Data Source: World Bank

Agricultural productivity and value addition needs to be accelerated.

Kenya continues to benefit from fast growing neighbouring economies, which provide markets for exports for manufactured products and human capital. Continued ease of trade in the region will enhance productivity and economic development.

Domestically, growth has largely been driven by significant increase in domestic household consumption and

investment. The financial intermediation and communication sectors which grew by 7.2% and 6.0% respectively were some of the major contributors to the GDP growth. Inadequate rainfall and significant fall in global prices of coffee and tea led to a depressed growth of 2.9% in the agricultural sector compared to 4.2% the previous year.

Table 1: GDP Composition and Sectoral Growth

	2012	2013	2012	2013
Agriculture & Forestry	24.6	25.3	4.2	2.9
Wholesale and Retail Trade	10.5	10.2	9.0	7.5
Transport & Communication	9.6	9.1	4.7	6.0
Manufacturing	9.5	8.9	3.2	4.8
Financial Intermediation	5.2	4.8	6.5	7.2
Construction	4.2	4.4	4.8	5.5
Utilities (Electricity and Water)			10.3	5.9

Structural shift to enhance job creation

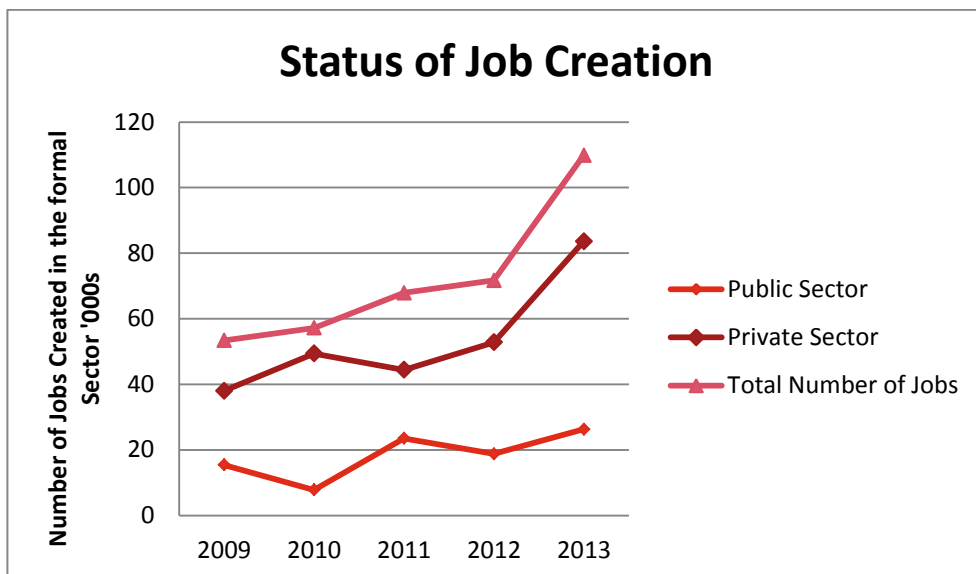
To facilitate economic transformation, there is a need for structural shift of resources such as labour from the less productive economic activities to manufacturing and the service industries. The presence of large productivity gaps between the manufacturing and service sectors on the one hand and the agricultural sector on the other indicates that there is significant potential for growth. However, fulfilling this potential requires increased diversification and a move away from the production of primary products to value added products as outlined in the budget.

Unemployment remains one of the major challenges in the country. The economy added slightly over 116,800 formal jobs. A solid path out of poverty is through increasing formal employment (including formal self-

employment) which in turn will enhance productivity and significantly raise household incomes. Job-skill mismatch is a challenge the government is addressing by investing KES 6 billion for expansion and equipping technical training institutes which will lead to employable skills.

Predictable,
consistent and
stable economic
policies
maintained

Fig 2: Formal job creation trends



Macro-Economic Environment

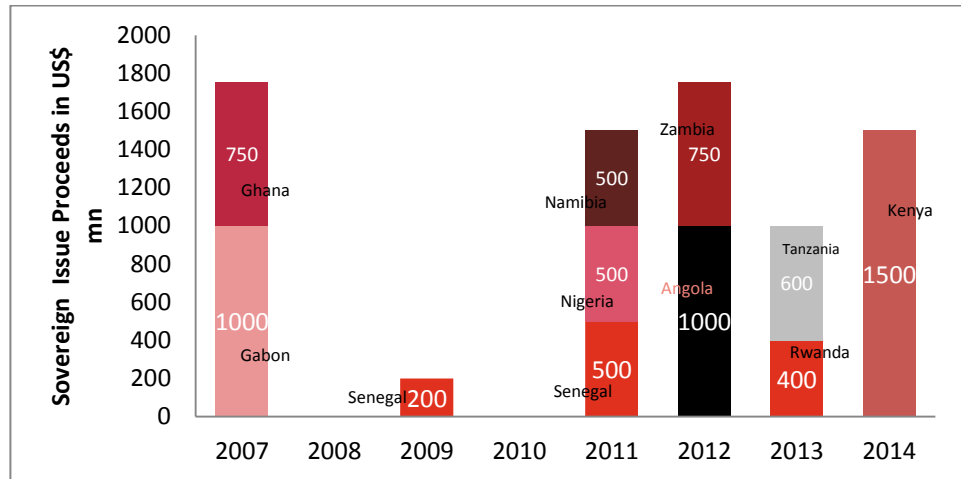
Annual inflation rates declined from 9.4% in 2012 to 5.7% in 2013 thereby increasing real average wage per employee by 7.7% in 2013 compared to a 3.1% decline in 2012. There was an increase in nominal average earnings per person in the formal sector largely attributed to a rise in the minimum wage by 14% and the increase in salaries of unionisable employees by 18.2%.

Inflation is projected to remain within the upper limit of 7.5% in 2014 while the budget deficit is projected to be 4.1% of GDP for the financial year 2014/2015. The deficit will be financed by domestic borrowing but

will have minimal effects on the cost of credit. Revenue collection efficiencies and prudent management are key to managing the budget deficit through automation of tax collection as well as rationalization of recurrent government expenditure.

The government aims to avoid crowding out the private sector in the capital markets by partly financing the budget deficit through raising debt in the international market. The issuing of foreign currency bonds in the international market is expected to be successful based on the success of other African Countries namely Ghana, Angola and Rwanda. However, we expect the Kenyan bonds to attract a relatively higher interest cost which may set the indicative benchmark rate for private sector loans in the country.

Fig 3: Annual Issuance of Sovereign Bonds by Sub-Saharan Africa



Source: Standard & Poor's

Although there was reduced forex earnings from tea, coffee and tourism, foreign exchange stability was supported by stable crude oil prices, forex inflows through diaspora remittances and increased purchase of equity by foreigners. This stability is expected to continue.

Devolution and the Economy

Low absorption rate of the total annual development budget by county governments is a source of concern. Midway through 2013/2014 counties had only used 4.3% (KES 4.8 billion) of the total annual development budget against a target of 50%. Having developed robust plans for increased development spending and productivity, it is expected that economic activities will be enhanced. Ensuring efficient and effective management practices will enhance service provision and accelerated development and attract more investments to the counties.

Business Outlook

There were no shifts in the government's policy direction. This is important for businesses to continue operating within a predictable,

consistent and stable policy environment.

The government's capacity to spend, improved security and social services, equitable distribution of resources through devolution, fast tracked infrastructural development and government rationalization of recurrent expenditure will be critical to the success of the budget execution.

On the other hand, businesses have to be smart. Many have succeeded and in this environment through prudent investments, robust cost control measures and application of modern management and technological innovations to improve efficiency and increase productivity.

Conclusion

This is a fair budget focused on efficiency and prudent use of resources. It has good intentions, accommodating diverse interests but needs continues review during the year to ensure the desired results are achieved. Its full execution will be the shot in the arm the economy requires.