Kenya Budget Review

Creating Jobs, Transforming Lives and Sharing Prosperity

2018/2019

Contents

Economic Review

GLOBAL PERSPECTIVE

World growth strengthened in 2017, with a notable rebound in global trade. It was driven by an investment recovery in advanced economies, continued strong growth in emerging Asia, a prominent upswing in emerging Europe, and signs of recovery in several commodity exporters. Global growth is expected to continue to increase this year and next, supported by strong momentum, favorable market sentiment, accommodative financial conditions, and the domestic and international effects of expansionary fiscal policy in the United States.

Global GDP Trends

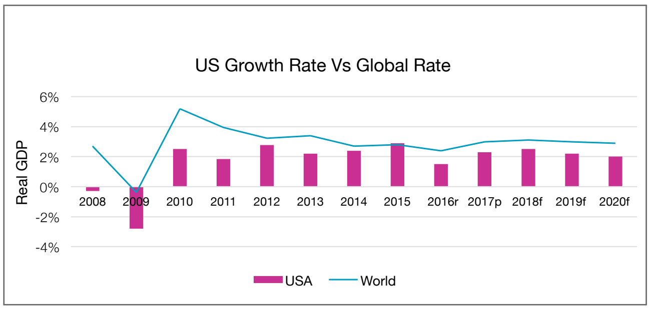
Global GDP growth is estimated to have picked up from 2.4% in 2016 to 3% in 2017, with growth increasing in more than half of the world's economies. This was supported by favourable financing costs, rising profits, and improved business sentiment across both advanced economies and emerging market and developing economies.

In advanced economies, growth in 2017 is estimated to have rebounded to 2.3%, driven by a pickup in capital spending, a turnaround in inventories, and strengthening external demand. While growth accelerated in all major economies, the improvement was markedly stronger than expected in the Euro Area.

Growth among emerging markets is estimated to have accelerated to 4.3% in 2017, reflecting firming activity in commodity exporters and continued solid growth in commodity importers. Most emerging market regions benefited from a recovery in exports. The improvement in economic activity among commodity exporters took place as key economies, such as Brazil and the Russian Federation, emerged from recession, prices of most commodities rose, confidence improved, the drag from earlier policy tightening diminished, and investment growth bottomed out after a prolonged period of weakness.

Global growth is projected to edge up to 3.1% in 2018, as the cyclical momentum continues, and then slightly moderate to an average of 3% in 2019-20.

United States of America

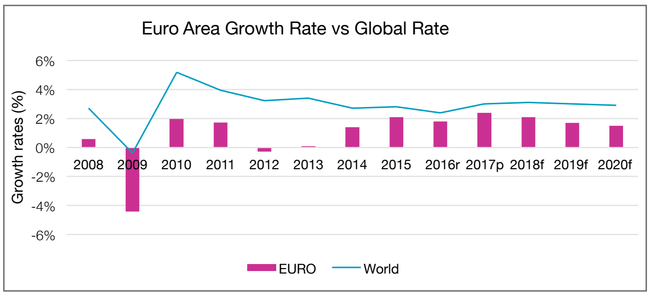


Source: Global Economic Prospects, World Bank Group January 2018
r – Revised   p – Provisional   f - Forecast

Growth picked up in 2017 to an estimated 2.3%, supported by strengthening private investment. The recovery reflected a diminished drag from capacity adjustments in the energy sector, rising profits, a marginally weakening dollar, and robust external demand. Labour market slack diminished further and employment growth slowed.

US growth is expected to reach 2.5% in 2018, and then to moderate to an average of 2.1% in 2019-20.

Euro Area

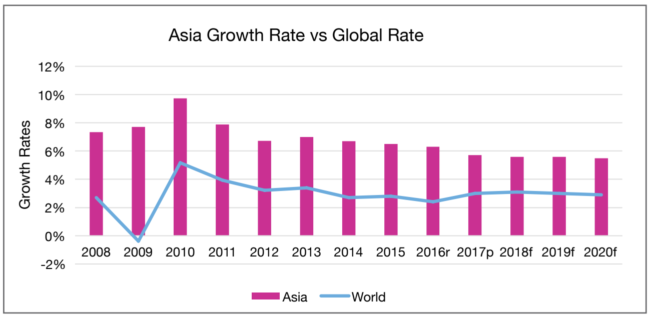


Source: Global Economic Prospects, World Bank Group January 2018
r – Revised   p – Provisional   f - Forecast

Growth gained substantial momentum in 2017, reaching an estimated 2.4%, with broad-based improvements across member countries spurred by policy stimulus and strengthening global demand. The unemployment rate reached its lowest level since 2009, and labour shortages became increasingly prevalent in some countries. However, wage growth remained subdued, and the appreciation of the Euro during 2017 is likely to further delay a pickup in inflation in 2018, as it puts downward pressure on import prices.

With inflation remaining below target, the European Central Bank (ECB) is expected to keep interest rates unchanged during 2018. GDP growth is expected to be 2.1% in 2018 and foreseen to average 1.6% in 2019-20.

Asia



Source: Global Economic Prospects, World Bank Group January 2018

r – Revised p – Provisional f - Forecast

Economic activity in advanced Asian economies closely integrated with China weakened from 6.3% in 2016 to 5.7% in 2017. However, it was noted that China experienced an upward trend in its GDP growth rates to 6.8% in 2017 mainly attributed to various reforms and stronger than expected recovery in exports.

Chinese growth is projected to edge down in 2018 to 6.4% as policies tighten, and an average of 6.3% in 2019-20. Key downside risks to the outlook stem from financial sector vulnerabilities, the possibility of increased protectionist policies in advanced economies, and rising geopolitical tensions. Long-term fundamental drivers of potential growth point to a further slowdown in China's growth over the next decade, as population ageing is expected to depress labour supply.

Africa

Sub-Saharan Africa

Growth in Sub-Saharan Africa is estimated to have rebounded to 2.4% in 2017, after slowing sharply to 1.3% in 2016. The rise reflects a modest recovery in Angola, Nigeria, and South Africa — the region's largest economies, supported by an improvement in commodity prices, favourable global financing conditions, and slowing inflation that helped to lift household demand. This growth was slightly weaker than expected as the region was experiencing negative per capita income growth, weak investments and a decline in productivity growth.

Growth in the region is projected to continue to rise to 3.2% in 2018 and to 3.5% in 2019, because of strengthened commodity prices, and gradually strengthening domestic demand.

Growth in South Africa is forecasted to improve to 1.1% in 2018 from 0.8% in 2017. The recovery is attributed to improving business sentiment supports and a modest rise in investment. However, policy uncertainty is likely to remain and could slow needed structural reforms. Nigeria is anticipated to accelerate to by 2.5% rate this year from 1% growth in the year just ended. An upward revision to Nigeria's forecast is based on expectation that oil production will continue to recover and that reforms will lift non-oil sector growth. Growth in Angola is expected to increase to 1.6% in 2018, as a successful political transition improves the possibility of reforms that ameliorate the business environment.

Although stronger-than-expected activity in the United States and Euro Area could push regional growth up due to greater exports, increased mining, and infrastructure investment, an abrupt slowdown in China could generate adverse effects to the region through lower-than-expected commodity prices. Domestically, excessive external borrowings could worsen the debt-dynamics.

2017 in Africa at a Glance

Kenya's presidential elections – These elections, held on 8 August 2017, were not conducted in accordance with the constitution. A last minute decision to challenge the results of the presidential elections paid off after the Supreme Court annulled the presidential poll. As a result, the country went into a repeat of the polls, where the opposition declined to participate citing irregularities, giving President Uhuru Kenyatta a landslide victory into his 2nd and last term.

Girls kidnapped in Nigeria – The Boko Haram militants kidnapped 276 girls from their boarding school in Chibok in 2015. After 3 years in captivity, Boko Haram released 82 'chibok' girls after negotiations between the terrorist group and the Nigerian government. They were transferred to the capital Abuja for medical check-ups and thereafter re-united with their families.

Gambia's Presidential elections – Adama Barrow was elected as Gambia's new president and his predecessors forced to leave the country. Mr. Barrow defeated the long-time president, Mr. Jammeh, in a surprising outcome to an election. Mr. Jammeh, who had been in power since 1994, when he led a successful coup, initially accepted defeat. A few days after the vote, he changed his mind, declared the election results invalid and vowed to use the power of his military to stay in charge.

Age limited in Uganda's Parliament – The presidential age limit was lifted in parliament after much chaos. Uganda's President Yoweri Museveni, one of Africa's longest-serving leaders, has signed a bill into law that removes a presidential age limit of 75 from the country's constitution. The age-limit issue is controversial because long-standing President Yoweri Museveni is 73 years old and the limit for re-election was capped at 75. President Museveni has been in power since 1986 and democratically elected as president since 1996. However, the current constitutional age limit would prevent him from standing for a sixth term in the 2021 elections. His governing party, the National Resistance Movement (NRM), has been involved in a contentious bill to revise the country's constitution. A previous two-term limit was scrapped in 2005 to allow President Museveni to stand for a third term.

South Sudan Refugees – War pushed more than one million refugees to seek shelter in Uganda. The huge numbers have put immense strain on aid agencies. International relief agencies say that one-third of the South Sudanese population of 13 million people has now been displaced and that half of the population is suffering from severe hunger and is in need of food aid.

Satellite from Ghana – Ghana entered the space race after it launched a satellite from the international space station. It is the culmination of a two-year project, costing USD 500,000 which received support from the Japan Aerospace Exploration Agency (JAXA). The satellite will be used to monitor Ghana's coastline for mapping purposes, and to build capacity in space science and technology.

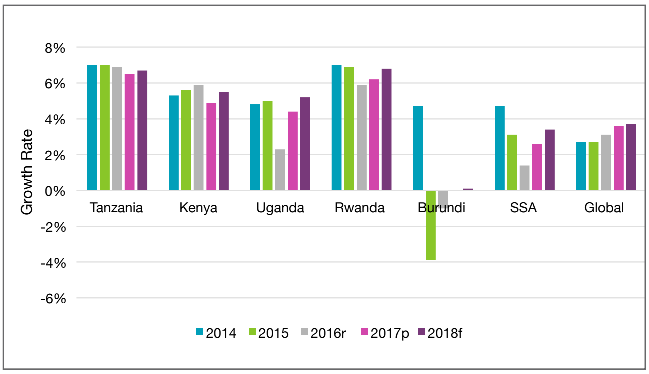
Bombing in Somalia – On 14 October 2017, a massive blast caused by a truck bombing in Mogadishu, the capital of Somalia killed at least 587 people and injured 316. The attack is the deadliest in Somalia's history, surpassing the 2011 Mogadishu bombing that killed 100 people, and the deadliest in Africa.

Zimbabwe presidential rule – Robert Mugabe resigned as Zimbabwe's president ending the 37 year rule, a week after the army and his former political allies moved to end four decades of rule. He resigned moments after parliament began an impeachment process seen as the only legal way to force him out. He was once feted as an independence hero who became feared as a dictator. His former vice president, Emmerson Mnangagwa, whose sacking in the same month prompted the military takeover that forced Mugabe out, was sworn in as president.

Eastern Africa

In 2017, the economic performance in Uganda, Rwanda and Burundi improved whereas that of Kenya and Tanzania declined. The growth in east African nations except that of Burundi remained above average as compared to the Global performance.

East African Community's (EAC) current account deficit as a percentage of GDP widened while inflation rate surged, because of rising food and oil prices. Burundi's economy continues to face political tensions that continued to cause strains on economic activity.



Source: Kenya National Bureau of Statistics 2018
r – Revised p – Provisional f - Forecast

KENYA OUTLOOK

GDP

Kenya's economy is estimated to have expanded by 4.9% in 2017 compared to a revised growth of 5.9% in 2016. The slowdown in the performance of the economy was partly attributable to uncertainty associated with a prolonged electioneering period coupled with adverse effects of weather conditions and the drought. This was also a result of the slowdown in credit growth to the private sector.

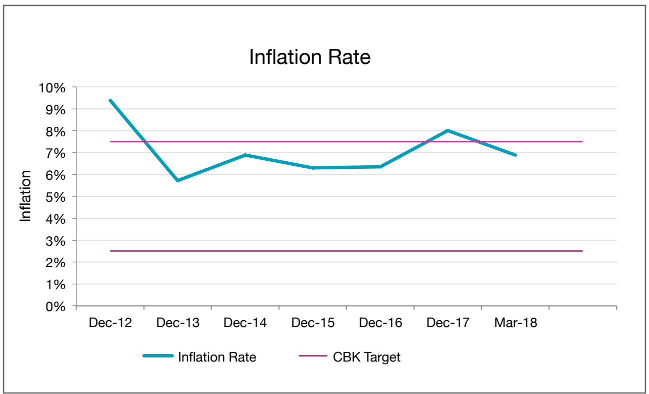
Generally, key macroeconomic indicators largely remained stable. Interest rates declined due to the impact of their capping that became effective in September 2016. In the money market, the Kenyan Shilling strengthened against most of the major trading currencies but weakened against the Euro and the US Dollar in 2017. The current account deficit widened in the year under review on account of significant growth of imports against a slower growth of exports.

Key sectors that performed well in the year included Accommodation & Food Services, ICT and Wholesale & Retail. Manufacturing, Agriculture, Forestry & Fishing and Financial & Insurance decelerated significantly over the same period and therefore dampened the overall growth in 2017.

The expected political stability and favourable macroeconomic environment are likely to be conducive for acceleration in growth in 2018. The on-going investments in infrastructure, improved business confidence, and strong private consumption are likely to support this growth. Weather forecasts point to a possibility of sufficient and well spread rains in 2018 which is likely to be a major boost for activities in agriculture and electricity & water supply sectors. This will in turn be favourable for the manufacturing sector. However, rising oil prices and limited credit access to the private sector with continued interest rate capping laws are likely to dampen growth in 2018.

Inflation

Inflation rates in the country have been on a downward trend since December 2011. The high inflation rate experienced in 2011 was largely due to a rise in commodity prices such as oil & fuel, on which most economies are heavily dependent. Inflation in the period 2013-2016 remained within the government target rate of 2.5% to 7.5%, largely driven by mediocre food inflation. Annual average inflation in 2017 was slightly higher standing at 8%.



Source: CBK

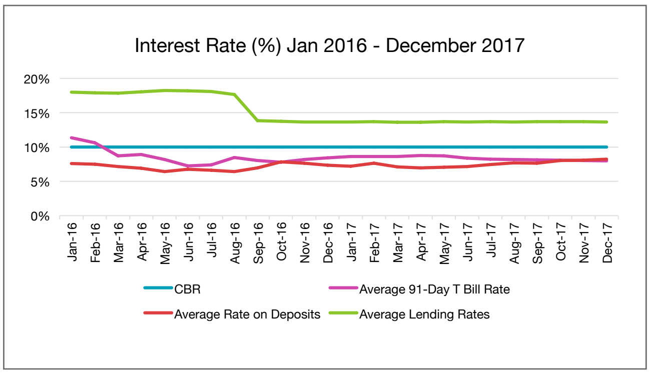
There was upward pressure on inflation in 2017 mainly because of:

- High food prices arising from drought conditions in 2017 with food inflation averaging 11.7% in the period May – December 2017;
- Political tension surrounding the 2017 general election;
- Further devaluation of the KShs in 2017 against the USD owing to the monetary policy tightening cycle currently ongoing in the United States; and
- Negative capital flows that currently stand at USD 5,048.2 million (December 2017)

Inflation in March 2018 dropped to 7% mainly because of improved food production on the back of good rains and a strengthening of the KShs against the USD.

Interest Rates

Amendments to the Banking Act in September 2016 introduced a cap on lending rates at 4.0% above the Central Bank Rate (CBR) and a floor on the deposit rates at 70% of the CBR. This has significantly reduced the spread between deposit rates and lending rates, hurting the banking sectors profitability and propensity to lend.

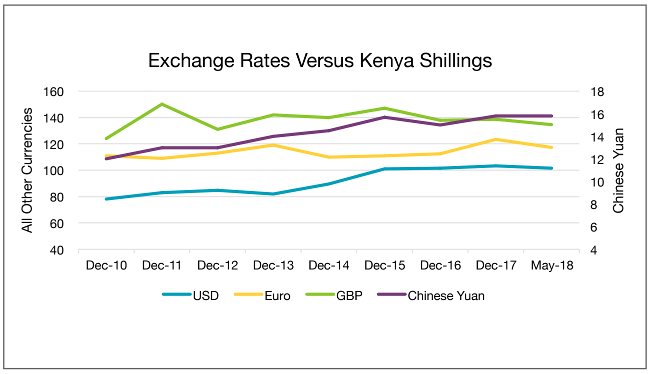


Source: Central Bank of Kenya

Data from the CBK's Quarter 4 2017 credit survey showed that a majority of the commercial banks indicated that interest rate capping negatively affected their lending to SMEs. This has compelled the banks to increase their risk mitigation measures. Commercial banks' average lending rates on loans and advances remained stable at 13.64% in December 2017 compared to average deposit rates of 8.22% in the same month. It is uncertain if the law will remain in force in its current form.

In its March 2018 Monetary Policy Committee (MPC) meeting, the CBK lowered the CBR by 50 basis points to 9.5% on the back increased growth prospects for the country.

Exchange Rates



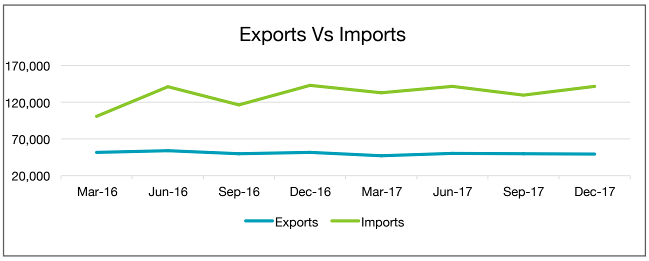
Source: Central Bank of Kenya

Against the USD, the KShs depreciated by 2% in 2017 to close the year at KShs 103 to the USD. This is mainly attributable to the monetary policy tightening process currently ongoing in the United States with 3 rate hikes occurring in the year and the prolonged electioneering period in the country. Against the Euro, it depreciated by 10% to close the year at KSh 123 to the Euro mainly tied to the European Central Bank's hardening stance on monetary easing. The KShs depreciated by 5% against the Chinese Yuan and 1% against the British Pound.

As at May 2018, the KShs had recovered against the USD to stand at KShs 102 to the USD, against the Euro at KShs 117, and against the British Pound at KShs 135. This reflects the improving economic outlook with the elections now behind, better rain conditions that have improved the food outlook and significant foreign currency inflows from the ongoing foreign income tax amnesty. It is worth noting that on 20 April 2018, the KShs closed the day at 100.1 KShs per USD, which represented a 0.7% appreciation over the same day of the previous month and marked the highest value since July 2015.

With rising oil prices, tightening of monetary policies in developed markets (US and possibly Europe), the KShs will still come under pressure albeit lightly. Healthy sum of foreign exchange reserves, currently at USD 8 billion (equivalent to 6 months of import cover) held by the Central Bank will equally support the KShs.

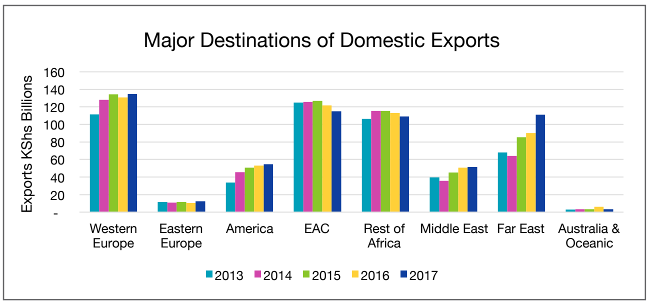
International Trade



Source: Economic Survey 2018

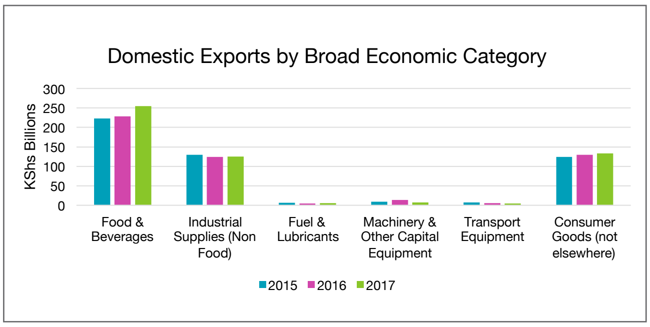
Total exports grew by 2.8% to KShs 594.1 billion in 2017 compared to KShs 578.1 billion in 2016 mainly attributable to export growth in tea, horticulture, articles of apparel and clothing accessories, coffee and titanium ores and concentrates.

Total imports expanded by 21% to KShs 1,725.6 billion from KShs 1,431.8 billion in 2016. The main drivers were industrial machinery, petroleum products, road motor vehicles, iron and steel, animal, vegetable fats, oils, and sugar. The ratio of exports to imports declined to 34% from 40% in 2016. Overall the balance of trade gap continues to widen.



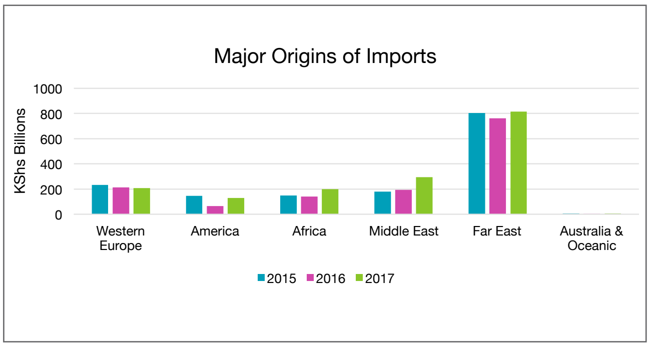
Source: Economic Survey 2018

Western Europe, the Rest of Africa and the East African Community remain the biggest markets for Kenya's exports representing a combined 61% of the total exports in 2017. Exports to the Far East have been rising gradually over the period 2014 – 2017 to stand at 19% of the total exports in 2017.



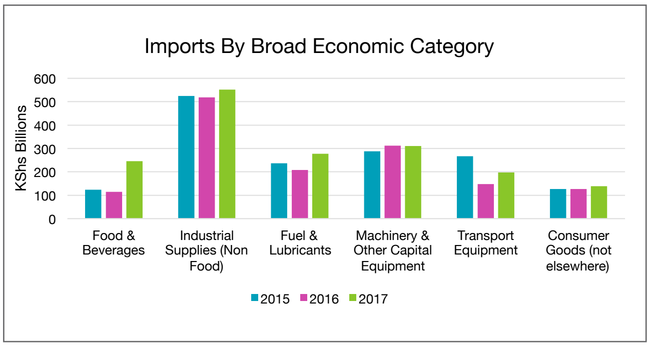
Source: Economic Survey 2018

Domestic exports grew by 2.8% in 2017, mainly attributable to stellar growth in food & beverages by 11% in 2017. Exports of non-food industrial supplies and consumer goods equally rose in 2017.



Source: Economic Survey 2018

Total Imports increased by 20% in 2017, which can be largely attributed to increased imports from the Far East, America, Middle East and Africa. Kenya's imports continued to be dominated by China, which accounted for 23% of total imports representing a value of KShs 390.6 billion.

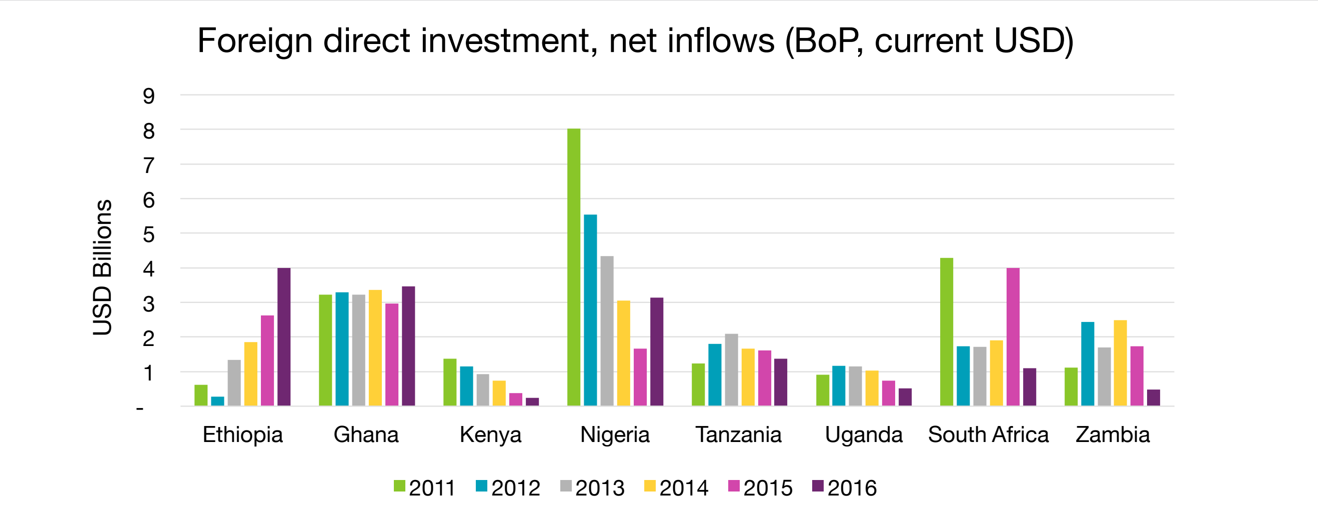


Source: Economic Survey 2018

Growth was seen in food & beverages (114%), fuel & lubricants (33%) and transport equipment (34%). The growth in food & beverages was both in primary and processed products. Processed fuel & lubricants contributed the most to growth in this category with industrial products contributing the most to the transport and equipment category.

Foreign Direct Investment

Global flows of foreign direct investment (FDI) fell by 16% in 2017 to an estimated USD 1.52 trillion, from a revised USD 1.81 trillion in 2016 mainly due to a slump in FDI flows to developed countries (-27%). FDI's to developing economies remained stable, at an estimated USD 653 billion, 2% more than the previous year. However for Kenya, the year-on-year decline over the last 5 years is cause of concern and more needs to be done to improve investor confidence and the attractiveness of Kenya as an investment destination.



Source: World Bank

The "Big Four" Plan

The 2010 Constitution of Kenya introduced a devolved system of government aimed at better service delivery. With that foundation laid and 5 years of implementation experience, the Government of Kenya announced a development agenda for the next 5 years anchored on "the Big Four":

- deliver affordable housing;
- rollout universal health coverage;
- increase the share of manufacturing in the economy; and
- improve food security.

Affordable Housing

The Government intends to provide at least 500,000 affordable new houses to Kenyans by 2022. It is anticipated that this program will create 350,000 new jobs, provide a ready market for manufacturers and suppliers and in so doing raise the contribution of real estate and construction sector to 14% of GDP.

To achieve this, the Government plans to implement policy and administrative reforms targeted at lowering the cost of construction which has been a major obstacle in achieving national affordable housing objectives. There are also plans to popularise mortgages and make them cheaper. The strategy is to raise low cost funds from private and public sectors for investment in large scale housing production. The Government's housing strategy can be surmised as below:

- Land at right location;
- Low construction cost;
- Affordable home buyer financing;
- Supportive eco-system;
- Innovative developer financing e.g. PPP models; and
- Demand driven master plan.

Universal Health Coverage (UHC)

The Government targets 100% Universal Health Coverage for all households to guarantee affordable health care to all Kenyans. To achieve this, the Government plans to restructure the National Hospital Insurance Fund (NHIF) and reforming the governance of private insurance companies. Specifically, the Government will:

- Review and amend the NHIF Act to align it to global best practice;
- Review the laws governing private insurance companies to encourage investment by private health insurers and thus bring the cost of cover within the reach of every Kenyan;
- Scale up the provision of specialized medical equipment and increase the number of health facilities at the community level;
- Establish national data centers at the Kenyatta National Hospital and Moi Teaching and Referral Hospital; and
- Expansion of the Linda Mama programme (free maternity programme) to mission hospitals and private hospitals.

Supporting Value Addition and Increasing Share of Manufacturing

The Government targets to increase the contribution of the manufacturing sector to GDP from 9.2% in 2016 to 15% by 2022 and thus adding USD 2-3 billion to the country's GDP. This will be achieved through the following:

- Specific emphasis on the following key areas; textiles & apparels, leather products, agro-processing and manufacturing of construction materials; and
- Continued focus on oil, mining & gas, iron & steel, ICT and fish processing.

Improve Food Security

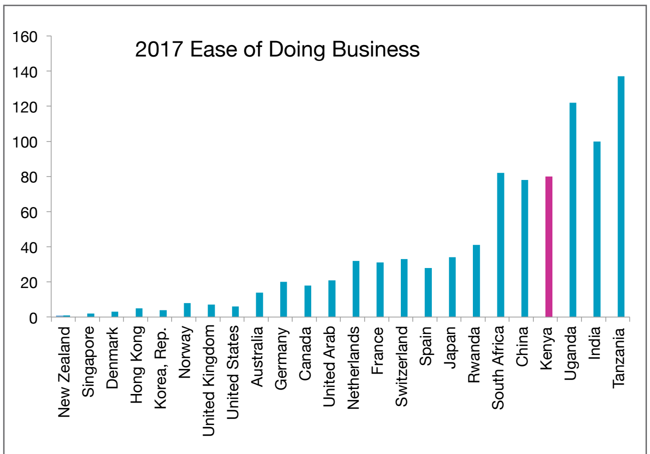
The Government targets to ensure that all citizens enjoy food security and proper nutrition by 2022 by ensuring self-sufficiency in the production of maize, rice and potatoes among others. Specifically, the Governments intends to:

- Increase the production of maize from the current 40 million 90 kg bags annually to 67 million bags by 2022;
- Increase the production of rice from the current 125,000 metric tonnes (mt) to 400,000 mt by 2022; and
- Increase the production of potatoes from the current 1.6 million tonnes to about 2.5 million tonnes by 2022.

All this will enhance large-scale production, boost small holder production and reduce the cost of food.

Ease of Doing Business

According to the latest ranking by World Bank, Kenya's attractiveness to investors improved 12 places. Kenya stood at 80 in the 2017 ease of doing business index that surveyed 190 economies compared to 2016's position of 92. This means that Kenya is the third most competitive economy in Africa after Mauritius (25th) and Rwanda (41st).



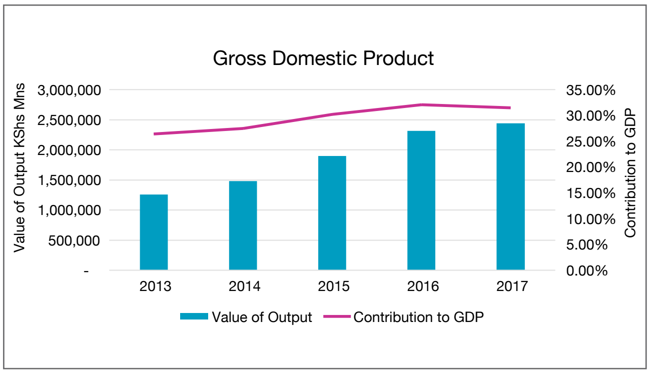
Source: World Bank

SECTORAL OUTLOOK

1. Agriculture

2017 at a Glance

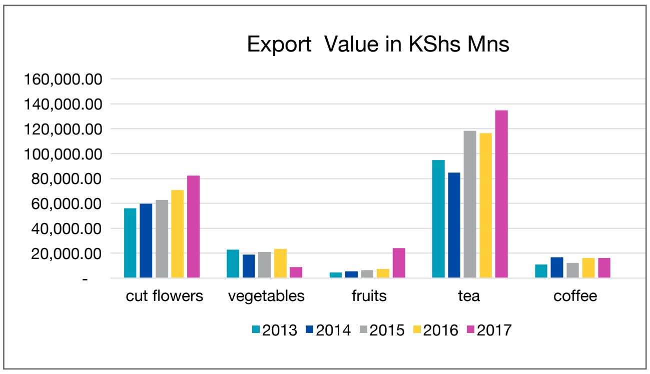
Agriculture, forestry and fishing sector remained the highest contributor to GDP, making up 31.5% of the country's GDP as compared to the previous year's 32.1%.



Source: Economic Survey 2018

The decelerated growth of the Real Gross Value Added of 1.6% in the agricultural sector was caused by depressed long rains, early cessation of short rains and increased pest and disease incidents leading to reduced crop and livestock production.

Overall, marketed agricultural production registered a decelerated growth of 8.1% in 2017, from the 10.8% growth reported in 2016.



Source: Economic Survey 2018

During the period under review, maize imports increased more than eight fold to 1,328 thousand tonnes. This was necessitated by the 6.3% reduction in maize production from 3,402 thousand tonnes in 2016 to 3,186 thousand tonnes in 2017 caused by infestation of fall armyworm coupled with drought experienced during the year.

There was a general decrease in marketed volumes of coffee and tea. The decline in marketed coffee is attributed to adverse weather conditions such as cold, which affected the flowering of the coffee trees as well as incidences of Coffee Berry Disease and Leaf Rust in the main production areas. The decline in the volume of marketed tea was mainly because of hot and dry weather conditions in the first quarter of the year 2017. The price index for permanent crops however, increased from 216.9 in 2016 to 261.9 in 2017 due to improved prices offered for marketed coffee and tea.

Looking Ahead

The Big Four Agenda has listed food security and nutrition as one of the key areas to be focused on since agriculture is the major contributor to the GDP. The government is focused on increasing food production and supply by enhancing large scale production and promoting smallholder activity to ensure affordability and supporting value addition in the agro-processing industry. This is expected to create job opportunities as well as promote economic growth in the country.

The key initiatives under the Big Four Plan includes irrigation, provision of subsidies to farmers, fishing sector and value addition of agricultural products mainly cotton and leather.

Irrigation projects - If the Irrigation Bill, 2017 is passed, the proposed National Irrigation Development Authority (NIDA) is set to replace National Irrigation Board (NIB) with a broader mandate of promoting, regulating development and management of irrigation in the country and ensure proper governance.

There has been delays in the implementation of the Galana Kulalu project with only a pilot of 10,000 acre model farm having been successfully implemented and 19 out of 33 water pans rehabilitated. However, this is going to change since irrigation projects are among the key priorities in the governments Big Four Agenda.

Maize - The Ministry of Agriculture is projecting a 44% increase in maize production this year resulting from good weather and reduced impact of the fall armyworm. The planned increased supply of 100,000 metric tonnes of subsidized fertilizer, implementing liming and use of certified seed will also play a big role in boosting production.

Initiative by the government under the Big Four Agenda to offer subsidies on post-harvest technologies will largely cut post-harvest losses by 5%, this will ensure food security and increased income for farmers.

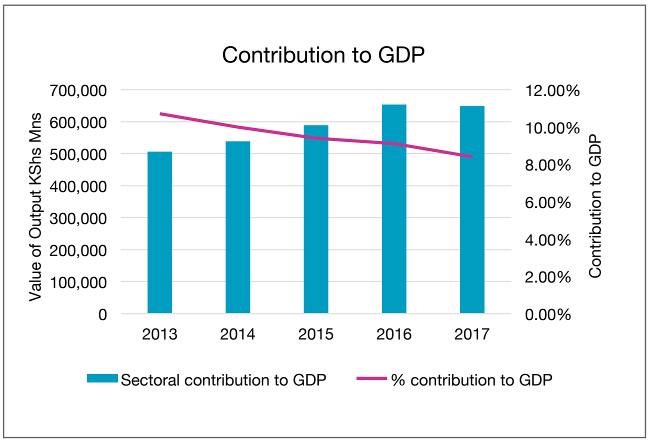
Sugar - The sugar industry has seen increase in imports, which has seen the local millers suffer losses the most. Data from the Sugar Directorate shows stocks held by millers as at 6 April 2018 was 22,492 tonnes which was way beyond the regulatory minimum of 9,000 tonnes with some millers registering zero sales in some days. The government has promised to impose more regulations to protect local millers.

2. Manufacturing

2017 at a Glance

The country's manufacturing sector is still grappling with high cost of power, which has pushed up the cost of production, denying Kenyans low commodity prices.

According to the Kenya Association of Manufacturers, local industries are paying higher tariffs compared to neighboring countries, making locally produced goods uncompetitive. This is pushing Kenyan goods off the shelves in favor of cheap imports from both regional and international markets, denying local industries revenues. This has left local manufacturers struggling to meet their production costs, which is passed to consumers, a move that has also slowed down the sector's growth.



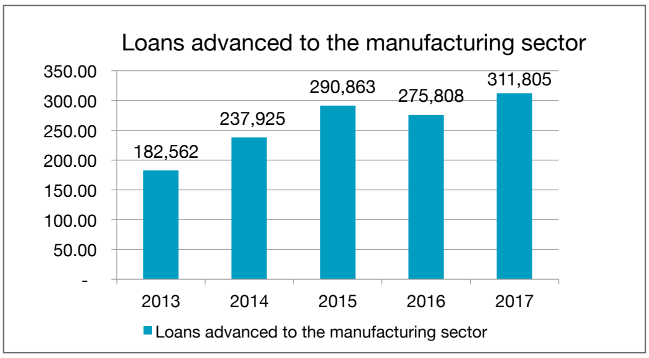
Source: Economic Survey 2018

Apart from the high cost of energy, influx of cheap goods and counterfeit goods among others, local companies have had to deal with increased taxation (including effects of indirect taxation through increased VAT exemption classifications to basic food products), multiple levies, charges, other non-tariff barriers, and inconsistent regulatory environment, that in the end affected prices negatively in 2017.

Uncertainties relating to general elections, rise in inflation, high production costs and competition from imported goods contributed to a decline in the sector. The ban on production and use of plastic carrier bags also had adverse effects on the volume of output of the sector. However this ban has had environmental benefits.

The total approved credit to the sector rose to KShs 311.8 billion in 2017 from KShs 275.8 billion in 2016.

Banks increased lending to key private sector institutions, citing optimism in the future. According to a CBK Private Sector Market Perception Survey conducted in January 2018, more than 90% of the respondents were optimistic about prospects for 2018, compared to 65% in November 2017.



Looking Ahead

The government is working on the Naivasha industrial zone which is poised to locate industries at the source of clean geothermal power that is green (clean) and at nearby 50% less cost than it is currently. This is a critical efficiency enhancer for large manufacturers and provides significant scale to produce in our country for the next 50 years.

This has already attracted significant interest, for instance, the Chinese government has recently verbally committed to investing USD 180 million in two manufacturing plants; one in Thika and another in Kajiado County.

Kenya seeks to produce 20 million shoes by 2022 in the leather industry in order to reduce the current import of finished shoes. Additionally, the agenda seeks to boost the cotton industry using improved hybrid cotton varieties that will boost production volumes.

Kenya secured KShs 27.3 billion from Japan to construct an industrial and commercial hub in Dongo Kundu, Mombasa. The first phase of the Special Economic Zone (SEZ), which is expected to alter the coastal town in terms of infrastructure and business, is scheduled to be ready by 2019. It will also entail establishment of a free trade zone on between 300 and 500 acres for wholesale and retail trading, breaking bulk, re-packaging logistics, warehousing, handling and storage of goods.

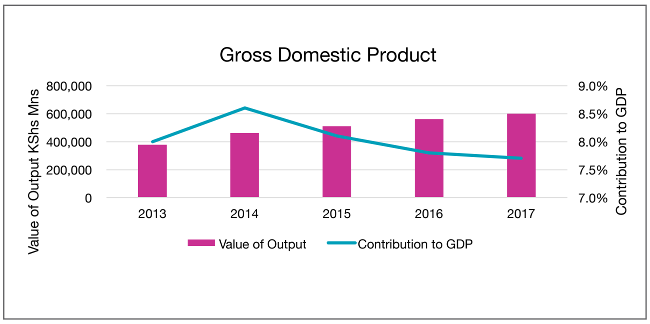
3. Transport, Logistics and ICT

2017 at a Glance

Transport

This sector's gross value decelerated to 7.7% in 2017 compared to a 7.8% growth in 2016. This deceleration was mainly because of slower growth in land transportation, particularly that of freight.

The trend over the last five years is as shown in the graph below:



Source: Economic Survey 2018

The SGR was launched on 31 May 2017. This has since provided a fast, efficient and reliable mode of transportation and further helped to decongest the port of Mombasa by ensuring goods that arrive at the port are moved to the hinterlands without delays. This has reduced the time taken to travel to four and a half hours.

Logistic and Storage

Total cargo throughput handled at the Mombasa Port increased by 10.6% to 30.3 million tonnes in 2017. Increased use of cargo scanners at the port of Mombasa and the JKIA largely helped KRA earn non-oil revenue amounting to KShs 131 million in 6 months ended December 2017.

The President launched an internal container terminal after it was upgraded from initial 180,000 Twenty Foot Equivalent Units (TEU) per annum to 450,000 TEUs and offering incentive to shippers and clearing agents to decongest the port of Mombasa by clearing the goods to Nairobi.

With the launch of SGR cargo train, cargo haulage has increased significantly reducing the cost of transporting goods from Mombasa to Nairobi. The government is keen to extend the same to Naivasha with the ongoing construction of the SGR from Nairobi to Naivasha. Kenya has also begun negotiations for the financing of the Naivasha – Malaba Standard Gauge Railway line (2B and C).

Wood Group Plc was picked to design the oil pipeline to transport crude oil from Turkana to Lamu port in line with the government's plan to commercialise oil by 2022. In the meantime, the government intends to use both road and railway to transport the crude oil from Turkana to Mombasa for export.

Kenya Ports Authority reduced the free storage period for containers at the Inland Container Depot in Embakasi, from 11 days to 4 days, in a move aimed at clearing a backlog of about 1,700 containers, which were lying uncollected at the facility.

ICT

The Central Bank of Kenya in August 2017 issued a Guidance Note on Cybersecurity that outlined the minimum requirements for banks to enhance their cyber security. The Guidelines are mandatory for banks licensed by the Central Bank.

The Ministry of Lands and Physical Planning upgraded the Electronic Transaction Management System to ease the processing of transactions in December 2017. Among the Services offered through the portal are Transfer of Ownership, Payment of Land Rent, Payment of Land Rates, Payment of Consent Fees, Payment of Registration Fees, Payment of Stamp Duty, Application for Caution/Caveat and Official Land Searches.

The Elections (Technology) Regulation, 2017 provided for the use of the integrated electronic electoral system. This system includes biometric voter registration, voter identification and electronic result transmission system, which was successfully implemented in most parts of the country. A key concern of interest that came to the forefront was the role of technology in the elections and the issue of limited read only access to servers.

The Movable Property Security Rights Act, 2017 now provides for new forms of property to be offered as security by borrowers other than the typical and conventional immovable property types. The law recognizes intellectual property as a valid form of immovable property under intangible assets which is a great step for techies and innovators.

The Government passed the regulations on the use, sale and management of drones in Kenya. It is constantly said that law does not keep up with tech changes which is largely true but the efforts of the Kenya Civil Aviation Authority through the Civil Aviation (Remote Piloted Aircraft Systems) Regulations, 2017 are commendable. Several countries have put drones to good use and we are eager to see how innovative we will be as a nation.

Through a presidential order, The Kenya Space Agency Order 2017, Kenya now has the Kenya Space Agency (KENSA). It is expected that the Agency shall spearhead the Kenya Space Programme and encourage interest and development in the industry. Development of space technology was foreseen as an area not to be ignored in the bigger policy picture.

Looking Ahead

Transport

The implementation of a model similar to Colombia's bus rapid transit in Bogota is underway and is intended to end Nairobi's traffic jam menace. This will see special lanes for high-capacity buses constructed in latest efforts to decongest roads in the city. Thika superhighway, Jogoo Road, Mombasa Road and Outer Ring Road are some of the roads that will have the special lanes for Bus Rapid Transit (BRT).

Construction of the second run away at the JKIA is set to commence later this year. The project is designed to improve reliability of air transport to and from JKIA by reducing delays at peak hours and costly flight diversions arising from incidents on the existing runway. It also involves reconfiguration of the existing single runway that impedes the airport's operational efficiency. The African Development Bank (AfDB) will partially fund this project through a USD 160 million loan.

According to the Budget Policy Statement, development of a number of airstrips is set to connect various part of the country, as well as facilities that are meant to enhance connectivity with neighbouring countries.

Kenya Railways is set to open at least 20 upgraded and new railway stations on Nairobi routes to increase commuter numbers. This is part of the Nairobi Metropolitan Transport Master Plan, which aims to decongest the city and create an efficient and affordable mass rapid transit transport system.

The construction of the second phase of Standard Gauge Railway from Nairobi to Naivasha is expected to be completed by September 2019. Eventually, the railway will connect Nairobi to Kampala via Naivasha, Kisumu and Malaba.

Logistics and Storage

The government will implement the International Maritime Organisation's Convention on Facilitation of International Maritime Traffic. This will facilitate smooth transit in ports for ships, cargo, crew and passengers. The move is aimed at making trade through the port of Mombasa and along the northern corridor faster, easier and less costly to traders.

The Lamu port, which forms part of the LAPSSET, is ongoing and the government is keen on this project. The first berth is set to be complete by June this year allowing the country to handle bigger ships, which will translate to more cargo coming in through the Kenyan port.

The launch of the Single African Air Transport Market (SAATM) by the African Union in January 2018 sets great opportunities for the logistics industry as it is bound to encourage Pan-African integration by opening up the continent's skies that could be a huge gain in reducing the cost of air cargo.

The Kenya Railways Corporation is set to review the promotional freight charges on the standard gauge rail (SGR) upwards starting July 2018. The SGR will soon start handling conventional cargo after the extension of the rail line to cover 10 berths at the port of Mombasa in order to ensure efficiency at the port and utilise effectiveness of the facility to generate revenue.

ICT

Computer Misuse and Cybercrimes Bill, 2018 that criminalises abuse of persons on social media, removing the legal lacuna that existed, was signed into law on 16 May 2018. The Law is expected to curb cybercrimes and computer related offences to enable timely and effective detection, prohibition, prevention, response, investigation and prosecution of computer and cybercrimes.

The mobile money interoperability system was introduced in April 2018 allowing subscribers to move money from one operator to another seamlessly. The system is also expected to reduce the barriers set by the operators and improve the services offered by the operators and increase financial inclusion and innovation among subscribers and the operators respectively. The move is also expected to level the playing field thereby enabling other mobile money platforms to effectively compete with the market leader.

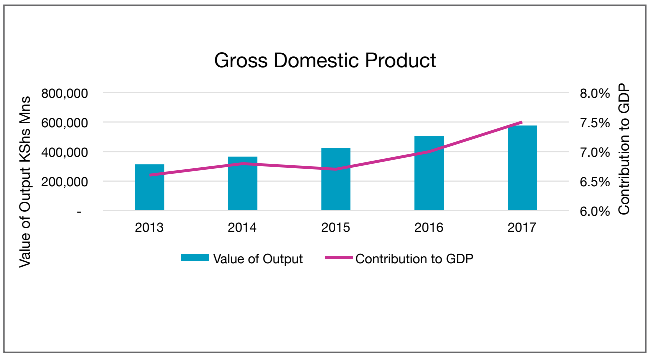
Telkom Kenya have launched their mobile money platform, T-Kash. This will see its subscribers use a one-time eight-digit code to withdraw cash from an agent or ATM as well as to buy goods and services.

4. Financial Intermediation

2017 at a Glance

During the financial year 2016 - 2017, the financial sector recorded a decelerated growth of 3.1% in 2017 compared to a growth of 6.7% in 2016. This was because of low uptake of credit due to the interest cap regulations.

The graph below shows the comparison of the sector's contribution to GDP over the last five years:



Source: Economic survey 2018

In 2017, the monetary policy stance focused on maintaining inflation within the Government's target range of 2.5% on either side of the 5.0% medium-term target. In the first half of 2017, there was an inflation surge, which averaged at 9.8% mainly due to food shortages caused by drought witnessed during the period. The year-on-year inflation in December 2017 stood at 4.5% compared to 6.4% in December 2016.

Banking Sector

Commercial banks' average lending interest rates charged on loans and advances remained stable at 13.64 % in December 2017, owing to the prevailing monetary policy stance and interest rate capping requirement.

Total domestic credit grew by 7.9 % to KShs 3,252.2 billion in December 2017. As at October 2017 private sector credit growth was on its lowest of 2.0% in 8 years. The decline is attributed to structural reforms in the banking sector after the interest rate capping regulations and strict adherence to prudential guidelines in terms of loan book quality and sufficient provisioning in the wake of new accounting requirements that accelerate the recognition of impairment losses. This prompted banks to extend lending to the government and large institutions as opposed to the private sector, which is considered risky.

Insurance

Gross premium income grew by 14.6% to stand at KShs 17.5 billion in 2017. Gross premium income for general business increased by 2.5% to KShs 124.7 billion in 2017. Assets of general insurance business increased by 3.6% to KShs 179.0 billion while liabilities increased by 2.7% to KShs 108.6 billion in 2017.

Most of the insurance companies embraced technology and digital marketing to cater for the growing millennial consumers as many products were distributed through mobile app and online portals notably for the marine insurance.

The capping of Interest rates by banks introduced in the banking sector greatly affected the insurance industry since the slowdown in lending by banks affected and investments in projects and assets that are insurable.

In 2017, the prevailing political environment regarding elections affected growth in the sector due to uncertainties among the local and foreign investors. However, this also led to increased uptake of the political risk insurance cover (commonly known as PVT) as businesses sought to take a precaution and cushion themselves on the possibility of assets suffering damage during the electioneering period.

Pensions

The amendments to the Retirement Benefits Act restricting foreign ownership in a pension fund administrator to a maximum of 40% saw Alexander Forbes East Africa change its identity to Zamara following ownership changes that resulted to Alexander Forbes Group, South Africa lose majority of its stake held in the Kenyan firm from 60% to 31.3%.

Capital Markets

The Nairobi Securities Exchange (NSE) 20-Share index rose to 3,712 points in December 2017 from 3,186 points in December 2016. However, noticeable volatility was recorded in the weeks before the election months of August and October 2017.

Looking Ahead

Capital Markets

The Capital Markets Authority published a Policy Guidance Note to facilitate the issuance, listing and trading of Global Depository Receipts and Notes. This is expected to raise the country's profile as an attractive investment destination by providing opportunities for international investors' thus spurring growth in the sector.

The CMA is also reviewing eligibility requirements for listing of new companies to avoid unnecessary barriers and attract new listings. This is meant to reduce the risks currently posed as there are very few large firms dominating the markets.

Banking Sector

The ICT Ministry has formed a task force that will look into the possibilities of block chain technologies in Kenya, which if implemented will see the micro and small medium enterprises be able to access sufficient credit. This technology will eliminate complexities of financing processes, high loan costs, collateral requirements and lack of a credit score.

Insurance

Among the initiatives advanced in 2017-2018, include the Area Yield Index Insurance (AYII) and the Kenya Livestock Insurance Projects (KLIP). These products are meant to cushion farmers from unpredictable losses due to weather changes and disease outbreak.

Technology is expected to be among the key component many insurance companies will integrate and this will see an increased market, as it will incorporate the millennials.

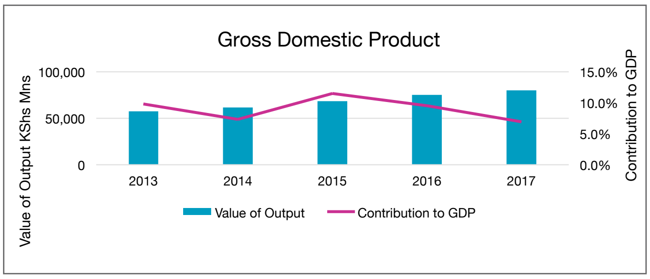
Savings and Credit Cooperative Societies (SACCOs)

The Finance Act, 2017 amended the Cooperatives Societies Act and Sacco Societies Act, which recognised and introduced Islamic finance business practices and services in the Societies. These changes which will take effect from 2018, will see an increased membership growth in the Societies.

5. Energy

2017 at a Glance

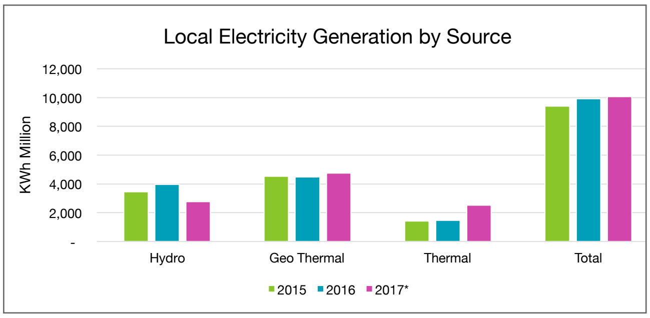
The table below shows comparison of energy output vis a vis contribution to GDP:



Source: Economic Survey 2018

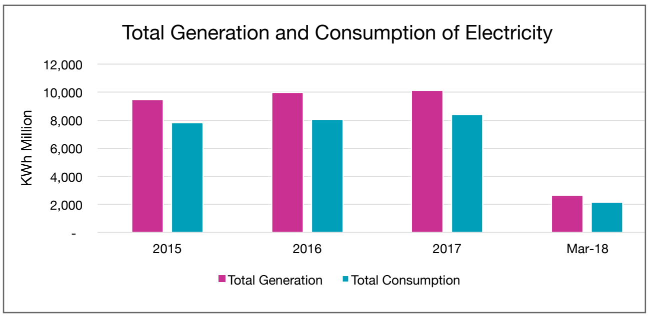
Growth of gross value added of electricity supply decelerated to 6.9% from a revised growth of 9.5% in 2016. The slowdown in performance of the sector in the period under review was mainly attributable to depressed generation of hydro-electricity due to failure of short rains in 2016 and reduced long rains in 2017.

International crude oil prices increased significantly in 2017, with the prices peaking during the last quarter of the year. This was because of supply cuts by top producers under the Organization of Petroleum Exporting Countries, the subsequent decline in commercial crude oil inventories and increased demand mainly from China.



Source: Economic Survey 2018

The total installed and effective electricity generation capacity was 2,339.9 Megawatt (MW) and 2,264.4 MW, respectively, in 2017. Total electricity generation expanded by 3.0% to 10,359 Gigawatt (GWh) while thermal and geothermal generated power expanded by 72.3% and 6.1%, respectively in 2017.



Source: Economic Survey 2018

The import bill of petroleum products increased from KShs 197.6 billion in 2016 to KShs 265.3 billion in 2017. This was attributed to rise in demand and prices of international crude oil during the review period.

Looking Forward

The country's electricity generating capacity is currently being upgraded through various geothermal, wind and solar projects. It is expected to increase by 875.9 MW by 2023 from the current 2,339 MW. Among the projects expected to be commissioned in 2019 are the 50 MW Wellhead Modula plants, 158 MW Olkaria V and 70 MW Olkaria I Unit 6.

The World Bank will provide up to KShs 18 billion to KenGen in the form of risk guarantee allowing it to attract long term capital for its renewable energy development projects.

A new 20-inch diameter pipeline is being constructed from Mombasa to Nairobi, which will have installed capacity of up to 1,000 cubic meters per hour on commissioning. The new pipeline is expected to reduce pipeline maintenance costs, ensure security of supply for the country and the region, enhance safety and environment and remove petroleum trucks from the highway.

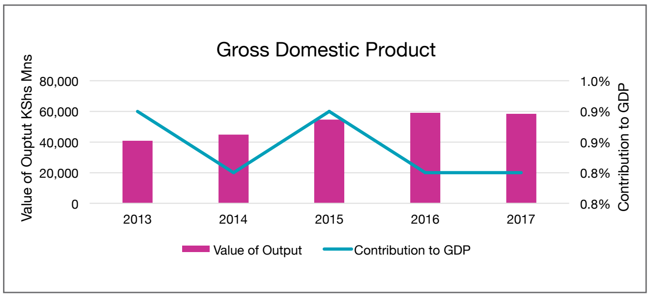
The Government intends to facilitate access of LPG to low income households. The project entails purchasing of 6 Kg cylinders with burners and 'meko' type grills. These cylinders will be purchased and distributed across the country with the objective of increasing LPG up- take. In addition, at least 40 mini LPG storage and filling plants (LPG skids) will be installed to be operated by women and youth. This project is expected to reduce average wood consumption as a source of energy in the country thereby boosting afforestation initiatives.

Electricity bills are expected to increase this year, should the Energy Bill be passed into law. The bill proposes the reintroduction of 16% VAT on petroleum products.

6. Mining

2017 at a Glance

The graph below shows the comparison of the sector contribution to GDP over the last five years:



Source: Economic Survey 2018

The Mineral Rights Board (MRB) was inaugurated in July 2017. The board, among other duties, would be responsible for provision of more consultative processes of evaluation and consideration of concession and mineral rights applications as well as renewals that will ensure transparency and accountability in the management of the Mining Sector in Kenya. Soda ash output increased marginally from 301,700 tonnes in 2016 to 303,600 tonnes in 2017. Gold and salt outputs recorded significant growths, from 200 tonnes and 23,400 tonnes in 2016 to 500 tonnes and 43,200 tonnes in 2017 respectively. The increase in gold output was partly due to an upsurge in gold mining activities following abolition of the special gold license which was prohibitively expensive.

Extraction of Titanium ore increased by 1.5% from 588.4 thousand tonnes in 2016 to 597 thousand tonnes in 2017. During the review period, titanium ore concentrates recorded marginal growths of 0.9%, 4.3% and 1% for Ilmenite, Rutile and Zircon respectively. Gemstones (rough) output reduced by 76% from 518,200 tonnes in 2016 to 124,300 tonnes in 2017. On the other hand, the quantities of crushed refined soda dropped from 741,000 tonnes in 2016 to 539,000 tonnes in 2017, representing a 27.3% decrease.

Total value of mineral output increased by 2.1% from KShs 23.3 billion in 2016 to KShs 23.8 billion in 2017. Decreased earnings from fluorspar, gemstones and salt contributed the low growth in value despite high mineral prices. Earnings from gold more than doubled from KShs 652.5 million in 2016 to KShs 1,533.6 million in 2017.

Looking Ahead

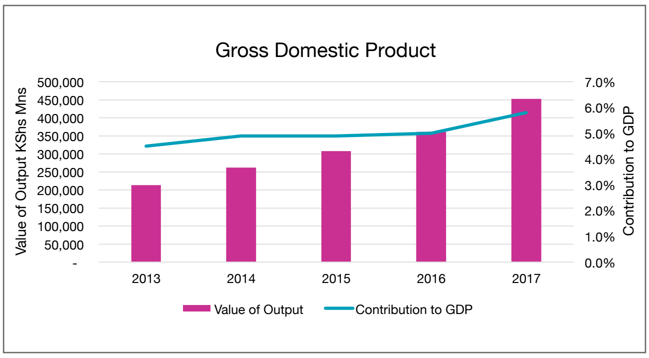
A new Mining Act signed into law by President Uhuru Kenyatta could see Kenya's nascent mining industry finally come into its own. Oil companies, like UK's Tullow Oil, have been prospecting in Kenya for a few years now, and they and other new entrants are expected to start production by 2021.

The Chinese funded mineral mapping project in Kenya commenced in March 2018. About 16 Kenyan geoscientists will be tasked with providing technical oversight and monitoring of the project. Also included are officials from ministries of mining, energy, ICT and security. United Kingdom's International Geoscience Services (IGS) and Canada's Patterson and Grant were picked from 17 international companies that bid for the position of independent consultant supervisors for the project. The aim of the project is to establish the amount of minerals under Kenya's feet.

Building and Construction

2017 at a Glance

The graph below shows the comparison of the sector contribution to GDP over the last five years:

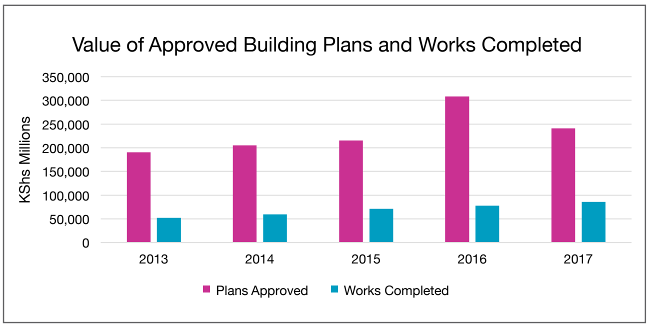


Source: Economic Survey 2018

This sector registered a growth of 8.6% in 2017 compared to a 9.8% growth in 2016. This was because of a decline in imports of construction materials such as iron & steel that recorded a 4.79% drop and non-ferrous metals that posted a 10.43% drop. The prolonged political campaigns also led to a decline in the number of on-going works in the private real estate market. Furthermore, the first phase of the SGR was completed which also led to a sizeable reduction in civil works.

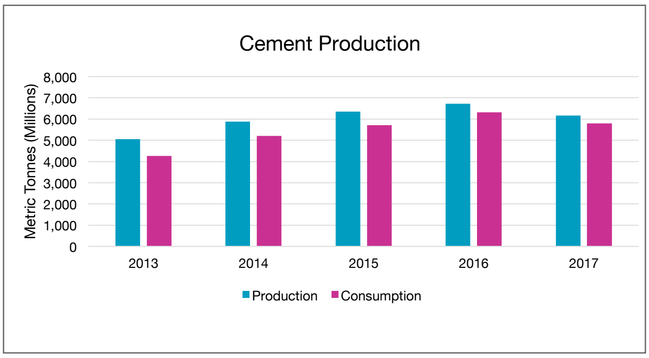
The value of building plans approved reduced significantly from KShs 308.4 billion in 2016 to KShs 240.7 billion in 2017 due to the long electioneering period that saw local and foreign investors defer plans awaiting conclusion of the polls. On the hand, the value of completed buildings issued with certificate of occupancy in Nairobi increased by 10.1% to KShs 85.6 billion in 2017 as the total number of private buildings issued with certificate of occupancy increased by 9.7% from 10,268 in 2016 to 11,202 in 2017.

The trend over the last five years is as shown in the graph below:



Source: KNBC Leading Economic Indicators 2018

In line with decreased construction, the production and consumption of cement reduced as shown by the graph below:



Source: KNBC Leading Economic Indicators 2018

2018 Expectation at Glance

Construction activities are likely to rebound from a six -year affordable housing plan by the state, relatively political certainty, optimism over review of a cap on loan charges, inception of funds targeting mixed-use developments, as well as global equity firms investing in Kenyan developers.

The Government, in its Big Four Plan, intends to provide at least 500,000 affordable new houses to Kenyans by 2022 thereby improving living conditions for its citizens. As a result, the construction sector is set to experience an increase in growth and contribution to GDP over the next five years. Moreover, policies and reforms have to be laid down that will lower construction cost and increase accessibility to low cost funds for investment through the PPP model, both in private and public sectors.

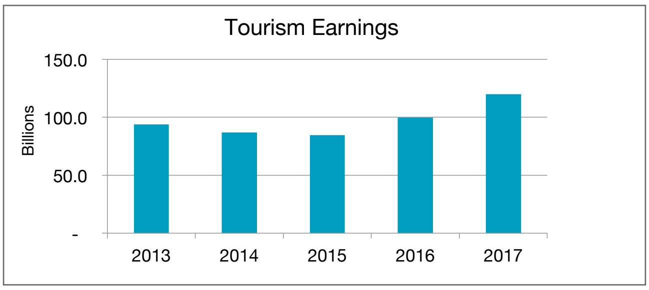
7. Tourism

2017 at a Glance

Strategies to revive Kenya's tourism sector bore fruit after the country recorded a 20.3% growth last year to post earnings of KShs120 billion despite the long electioneering period that was predicted to negatively affect the sector last year. This is a 16% increase from KShs 99.7 billion earned in 2016.

Tourism arrivals grew from 1,342,900 in 2016 to 1,474,700 in 2017 recording a 10% growth. This is after significant improvements in security and various tourism recovery campaigns carried out in both domestic and international markets. This could also be attributed to the various accolades the country received including the world's leading safari destination by World Travel Awards and Africa's leading National Park Award, among others.

Domestic tourism numbers also rose quite significantly, marking the decade's second highest year-on-year growth after 2009 when the numbers rose 37.3% from the previous year.



Source: Economic Survey 2018

American and Briton arrivals grew by 17% and 11% respectively spurring a 9% growth in total international arrivals last year.

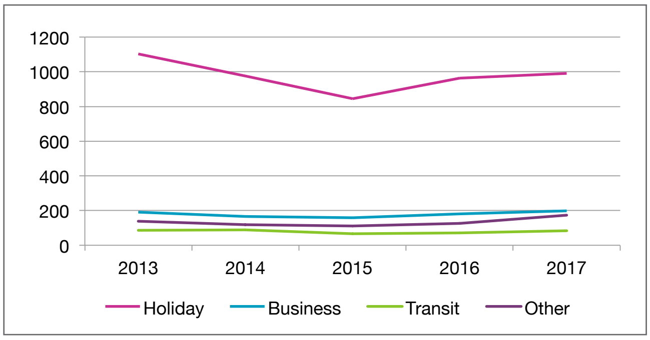
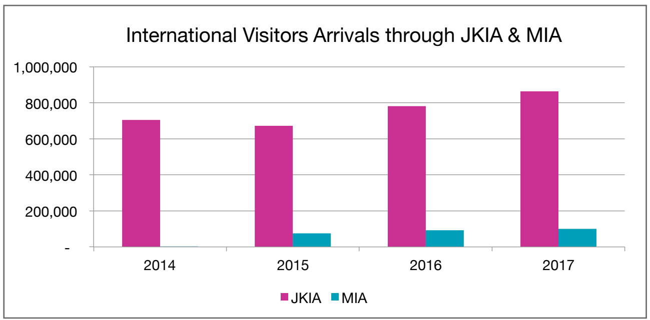


Table 1: International visitor arrivals by purpose of visit



Source: Economic Survey 2018

Looking Ahead

Business/Conference tourism

The government has started prioritising the blue economy as the one of the sectors to drive the achievement of Vision 2030 development agenda and to this effect the government is currently planning to host the first ever high level conference on blue economy in November. Besides the tourism boom that will come with hosting the over 6,000 delegates, according to the government source, Kenya is eyeing business deals in fisheries, aquaculture, tourism, transport, shipbuilding, energy, bio-prospecting and underwater mining which is seen too have a positive impact on the sector in the coming years.

The sector is expected to continue with its impressive performance from 2017. Earlier this year, Kenya along with 22 other African countries adopted the AU Single African Air Transport Market to open their skies. This move will see a reduction in airfares by 25% and increase of intra-Africa travel, giving a major boost to tourism.

Kenya is eyeing more Africans visiting the country after last year's directive by the President to offer a visa on arrival for all the continent's nationals. A new cruise ship facility set to be operational by mid 2018 is foreseen to impact the sector positively.

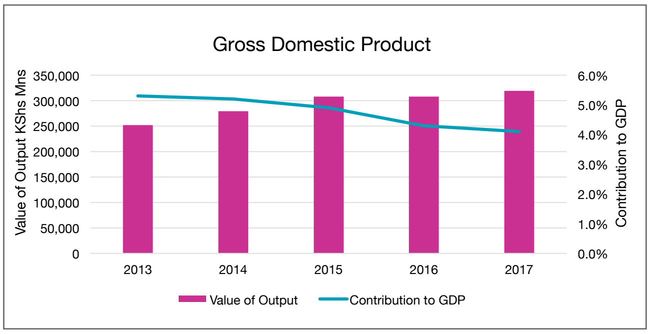
Direct flights to the US will increase the number of tourists to Kenya from the country, as well as boost trade between the two countries. Daily flights are expected to commence between Nairobi and New York in October 2018 and this will cut flight time by more than seven hours.

8. Education

2017 At a glance

Recurrent expenditure for the Ministry of Education increased from KShs 294.7 billion in the year 2016/17 to KShs 385.2 billion in the year 2017/18. Development expenditure by the Ministry of Education increased from KShs 20.9 billion in the year 2016/17 to KShs 30 billion in the year 2017/18. Part of this funding was allocated to the national school feeding programme, previously funded by the World Food Programme.

The table below shows comparison of education output vis a vis contribution to GDP:



Source: Economic Survey 2018

The total number of registered Technical Vocational and Education Training (TVET) institutions increased substantially by 50.9% to 1,962 in 2017. This was intended to boost youth employment in blue-collar jobs in line with the TVET reforms and the Kenya Vision 2030 goals. The table below shows the breakdown of the different types of TVET institutions in the country and their increase over the years.

TVET Institutions	2013	2014	2015	2016	2017
Public Youth Polytechnics	701	701	816	816	1186
Private Youth Polytechnics				29	47
Public Technical and Vocational Colleges	49	51	55	62	91
Private Technical and Vocational Colleges				382	627
National Polytechnics	3	3	3	11	11
Total	753	755	874	1300	1962

Source: Economic Survey 2018

The number of candidates who scored a minimum university entry score of C+ and above decreased by 21.2% to 70,073 in 2017 from 88,929 in 2016. As a result, the number of students selected to join universities in 2018 dropped by nearly a third.

During the period under review, university lecturers went on strike twice over the government's failure to implement the 2017 - 2021 CBA and collapsed negotiations on the same. This resulted in disrupting the learning of nearly 600,000 students across 31 public universities. The strike was recently called off after the government gave a meagre pay rise of 1.75%.

The Ministry of Education issued a directive that all school buses should be painted in yellow in compliance with the Traffic Amendment Act 2017, a move aimed at enhancing safety of students in the country.

Looking Ahead

With a rise in the Kenyan middle class, there has been increased demand for elite education in the country. Investors have increased their investment in the education sector to fill the growing demand that has overstretched the government's facilities. Two new international schools were opened in 2017, Brookhouse Runda and Sabis International. A third international school Crawford international is currently under development and is set to open in September 2018.

The adoption of the new education curriculum commenced in 2018 and is still ongoing. The system was developed to incorporate the needs of special needs children and will integrate ICT at all levels of education. This new curriculum, also known as competence-based curriculum, offers a broad range of subjects at upper primary and junior secondary and is aligned to the country's development blueprint, Vision 2030. The pilot programme will cover pre-school, standards one and two and will be done in standard three in a few schools. Actual implementation will be set for January 2019.

The government recently announced plans to scrap off parallel degree programs from public universities. The planned overhaul of the self-sponsorship programme intends to improve the quality of education offered, staffing, workers' salaries and programmes offered in universities. Kenya Universities and Colleges Central Placement Service announced 70,073 students who scored a mean grade of C+ (46 points) and above in the 2017 KCSE exam could apply to join public and private universities for government-sponsored degree courses. This move would effectively reduce the number of students who would apply for the self-sponsored programme.

In order to enhance the quality of education, the Commission for University Education (CUE) has recommended an increase in the number of years it takes teachers to complete their degree programs from the current two and a half years to eight years. The proposed increase will enable adequate delivery and internalisation of the material covered to the students. This increase will also discourage teachers from studying or doing their assignments during school hours and enable them divert more attention towards their students.

Early this year, the cabinet allocated KShs 25 billion to subsidize secondary education in the country. Some of the funds are to be directed towards infrastructure to accommodate more learners in the free education programme. Under the proposed fee structure, the government will pay a subsidy of KShs 22,244 per student in both day and boarding schools.

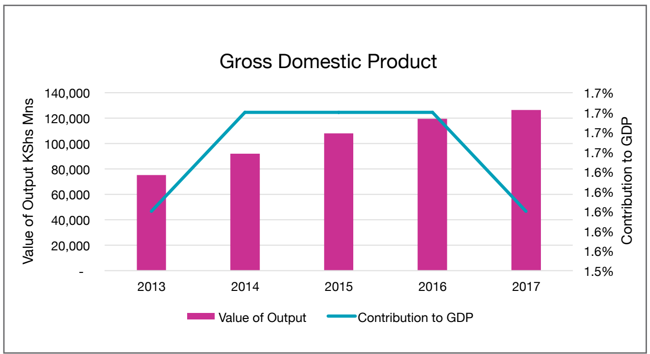
Different education startups have arisen to compliment learning in both the public and private education sectors. The education technology startup M-Shule that currently utilises artificial intelligence to complement learning in schools received a secured cash investment worth KShs 4.15 million from Engineers Without Borders (EWB). This investment will facilitate the startups expansion into the East African region. New strides in technology ensure children especially those in marginalized communities can access their right to quality education.

9. Health

2017 at a Glance

In the last financial year, Health services received KShs 65.6 billion compared to KShs 56.6 billion in 2016/17. KShs 29.8 billion went to recurrent expenditure and KShs 35.8 to development expenditure.

The table below shows comparison of health output vis a vis contribution to GDP:



Source: Economic Survey 2018

During the period under review, doctors went on a 100-day strike followed by a five months strike by nurses over pay and working conditions. This saw dozens of citizens in various health facilities affected, with some deaths experienced for missing the required basic healthcare services. The strikes were called off following a signed deal between the government and union officials including an adjustment on the working hours, where doctors will now work just 40 hours a week and be compensated for extra hours.

Besides the strike, the prolonged election period delayed payments from the national government to the counties, hampering healthcare services at the local level.

On the upside, the Ministry of Health rolled out a CT scan project and an ambulance emergency quick response service at the Thika level Five Hospital. The primary objective of the project is to ensure attainment of Universal Health Coverage through collaboration of both the county and national government. The Ministry has invested KShs 800 million in the project with an expected 600 capacities in the wing to help ease congestion the neighboring facilities.

The Linda Mama initiative, a public funded health scheme and expansion of free maternal care programme initiated by the President in June 2013, has positioned Kenya at a competitive edge towards achieving the Universal Health Coverage (UHC). Further, it is a step forward at improving the access and quality of maternal, new born and child health care services in the country as well as attainment of health goals as outlined in Kenya's Vision 2030 and the Sustainable Development Goals.

Looking Ahead

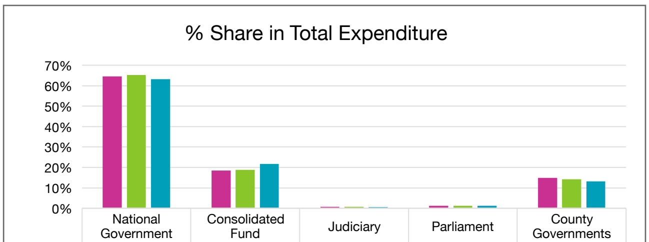
Kenya signed a state memorandum with Cuba to bring on board 100 Cuban doctors to provide the much-needed specialised healthcare services to vulnerable Kenyans. The health specialists will be deployed to all 47 counties. The initiative seeks to address the current staffing issues experienced in various counties, improve access to specialised medical care to citizens and reduce dependency in referral hospitals.

The health sector is expected to benefit from a KShs 11 billion fund backed by the IFC. The IFC intends to, through the fund, construct and set up new clinics and hospitals thereby increasing access to quality and affordable healthcare in Kenya, East and Southern Africa,

Universal Healthcare Coverage (UHC) is one of the Kenya "Big Four" agenda aimed at bringing access to quality and affordable health services. Upscaling of the insurance scheme to all Kenyans has been considered as an imperative step in realising universal healthcare coverage. The key challenges to Universal healthcare include: high cost of providing medical care, inadequate medical personnel, inadequate infrastructure and security, a low collaboration between public and private health providers and limitation of funding for UHC. To address current bottlenecks, the government should consider effective revision of the regulatory framework and collaboration with the private sectors to roll out innovative strategies to streamline the health sector

10. 2018-2021 Budget Allocations

The government has proposed the following summary budget allocations over the next three years to the different arms and the counties as shown below:

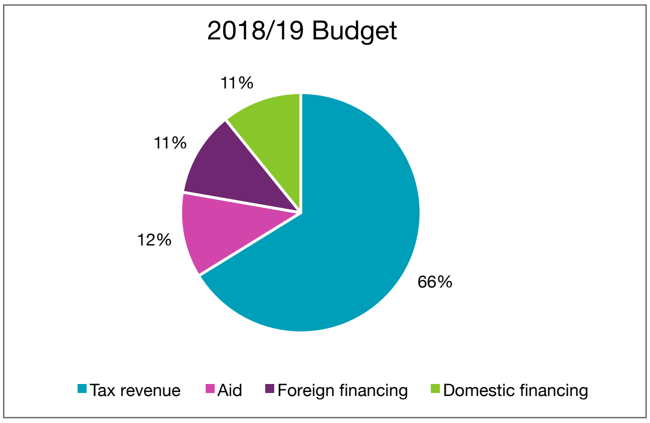


	National Government	Consolidated Fund	Judiciary	Parliament	County Governments
2018/19	64.5%	18.5%	0.7%	1.3%	15.0%
2019/20	65.2%	18.7%	0.8%	1.2%	14.1%
2020/21	63.2%	21.8%	0.6%	1.2%	13.2%

Source: 2018 Budget Policy Statement

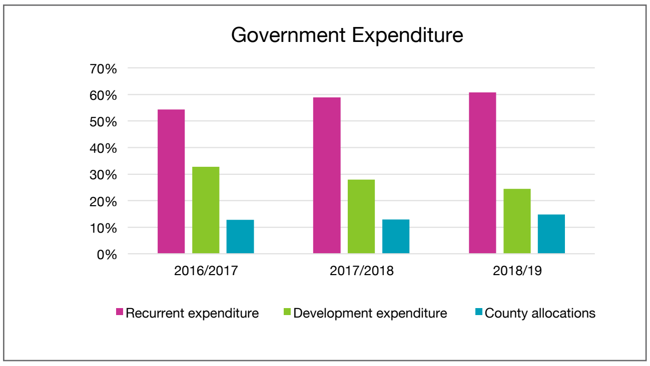
11. 2018/2019 Budgetary Expenditure Allocations

In the 2018 Budget Policy Statement, the CS has set out proposals to incur a total of KShs 2.5 trillion in expenditure and net lending for the 2018/2019 fiscal year. He intends to finance this through a combination of tax revenues, aid and debt as shown in the chart below:



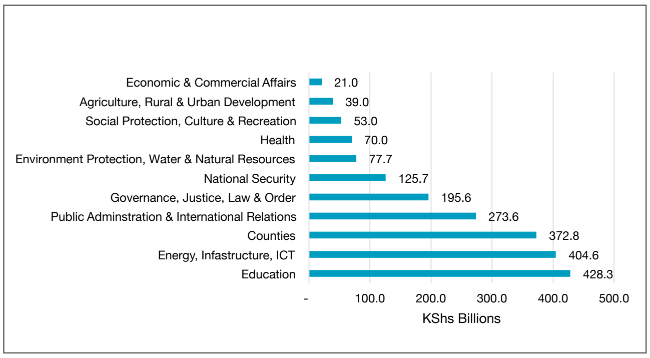
Source: 2018 Budget Policy Statement

Where is the Money going?



Source: 2018 Budget Policy Statement

The principal beneficiaries of the budget are as follows:



Source: 2018 Budget Policy Statement

Tax Measures and Proposals

Income Tax

Abolishment of turnover tax, enter presumptive tax!

The Finance Bill 2018 proposes to introduce presumptive tax as a final tax equivalent to 15% of the single business permit fee levied by County Governments. The tax is for resident persons whose business turnover does not exceed KShs 5 million during a year of income and provided that those persons are issued with a single business permit by the County Governments or are liable to be issued with business permit. This tax does not extend to persons providing management and professional services, rental business or incorporated companies ***(effective 1 January 2019)***.

Deemed electricity expense for manufacturers

The Bill proposes an additional allowable expense equivalent to 30% of the electricity costs incurred by manufacturers in addition to normal deduction of the entire electricity cost. The incentive is however subject to conditions to be set by the Ministry of Energy.

The incentive is a reflection of the Government's commitment to the Big Four Agenda and is aimed at lowering the cost of production for manufacturers ***(effective 1 January 2019)***.

CGT on transfer of property by general insurance

The Bill has provided clarity on the taxation of gains from the transfer of property by a general insurance company. The gains will be subjected to capital gains tax at the rate of 5% ***(effective 1 July 2018)***.

Deemed dividend income

The Bill proposes to widen the definition of dividend income to cover all possible instances where a shareholder or persons related to a shareholder benefit from a company in cash advancement, debt settlement or asset acquisitions will be deemed to be a distribution of dividend ***(effective 1 July 2018)***.

Exit compensating tax, enter distribution tax

The Bill proposes to scrap compensating tax and has proposed to introduce a tax of 30% on distribution of dividends from untaxed gains or profits. Registered collective investment schemes have been exempted from this provision. This will eliminate the need for a dividend tax account and will also mean that no further tax will be levied on distribution of capital gains ***(effective 1 January 2019)***.

Special tax rate for special projects

The Bill proposes to introduce a special corporation tax rate for a company engaged in business under a special operating framework arrangement with the Government to the extent provided in that arrangement. The provision will provide the Government with flexibility to offer lower corporation tax rates as incentive for defined projects ***(effective 1 January 2019)***.

Withholding Tax (WHT)

Demurrage charges to non-residents

The Bill proposes to introduce WHT on demurrage payments to non-residents at the rate of 20%. This matter has been contentious in the past as it was not provided for under the law. The intention is to create a level playing field for residents and non-residents. This proposal seems to contradict generally accepted international Maritime practices and may put Kenya on a collision course with non-resident shipping lines ***(effective 1 July 2018)***.

WHT on insurance premiums to non-residents

The Bill proposes to introduce WHT on insurance premiums paid to non-residents at a rate of 5%, but excluding premiums paid for insurance of aircraft. This is intended at ensuring level playing field for resident and non-resident insurance companies as well as expand the tax net ***(effective 1 July 2018)***.

Value Added Tax (VAT) Changes

Plant and equipment for manufacture of goods

The Bill has clarified that VAT exemption for machinery and equipment under Tariff 84 and 85 including nuclear reactors, boilers, machinery & mechanical appliances, electrical machinery & equipment, television image & sound recorders and reproducers is only applicable where these are used for manufacture ***(effective 1 July 2018)***.

Renewable energy

The Bill has proposed to limit VAT exemption only to specialised equipment used for the development and generation of solar & wind energy, including deep cycle batteries which use or store power. This exemption was previously applicable to solar equipment and accessories ***(effective 1 July 2018)***.

Promoting local assembly of computers

In order to promote the Government's Big Four agenda on manufacturing, the Bill has proposed to exempt from VAT parts imported or purchased locally for the assembly of computers. This exemption was previously applicable to primary school laptop tablets only. The move will encourage assembling of computers locally and create job opportunities in the rapidly growing ICT industry ***(effective 1 July 2018)***.

Safeguarding grain reserves

In a move to promote safe storage of grains and alleviate hunger, the Bill has proposed to exempt from VAT equipment used for construction of grain storage facilities. This exemption was previously applicable to materials used in construction only. This measure seeks to attract investment in construction of quality grain storage facilities to minimise post-harvest losses ***(effective 1 July 2018)***.

Re-classification of VAT status

The following goods and services have been reclassified by the Bill ***(effective 1 July 2018)***:

Item	Current	Proposed
Seed of wheat and meslin	Taxable	Exempt
Seeds of barley	Taxable	Exempt
Cereal straw and husks used in manufacture of animal feeds	Taxable	Exempt
Lucerne (alfalfa) meal and pellets used in manufacture of animal feeds	Taxable	Exempt
Beet-pulp, bagasse and other waste of sugar manufacture used in manufacture of animal feeds	Taxable	Exempt
Alcoholic or non-alcoholic beverages supplied to KDF canteen organization	Taxable	Exempt
Goods imported or purchased locally for direct and exclusive use in the implementation of projects under a special operating arrangement with the government	Taxable	Exempt
Maize (corn) seed	Exempt	Taxable
Garments and leather footwear, manufactured in an EPZ	Exempt	Taxable
Postal Services	Taxable	Exempt
Services imported or purchased locally for direct and exclusive use in the implementation of projects under a special operating arrangement with the government	Taxable	Exempt

The reclassification of the above items is in line with the Government's Big Four agenda on food security and manufacturing. In addition, some reclassification will reduce the cost of undertaking projects under special operating arrangement with the government.

Excise tax

Stringent rules for exemption from excise duty

The Bill proposes to introduce strict measures aimed at ensuring that the exemptions granted under the Excise Duty Act are not abused. Going forward, for a taxpayer to qualify for exemption under the second schedule, he/she must prove that the goods have been consumed by an exempt person. Additionally, for excisable goods and services intended for export, one has to prove that such goods and services were consumed outside Kenya ***(effective 1 July 2018)***.

Annual Inflationary adjustments for excise duty rates

The Bill proposes to amend the period of making inflationary adjustments of the excise duty rates from two years to one year. This will be done at the beginning of every financial year ***(effective 1 July 2018)***.

Commissioner required to give notice before suspension of excise duty licenses

The Bill proposes to make the process of excise license cancellation objective by requiring that the Commissioner gives a notice to the licensee and giving a chance to normalize any irregularities before suspension or cancellation of the license. Currently, the Commissioner is not required to give notice nor give a licensee room to normalize or regularize any deviation from license terms ***(effective 1 July 2018)***.

Punitive penalties for unlicensed persons

The Bill seeks to introduce a minimum penalty of KShs 5 million for persons operating without an excise duty license. This proposal will discourage unlicensed operators and manufactures of substandard products from engaging in unscrupulous trade ***(effective 1 July 2018)***.

Illuminating kerosene

The Bill proposes to increase excise duty rate on illuminating kerosene from KShs 7,205 per 1,000 litres to KShs 10,305 per 1,000 litres. Although the proposal is aimed at reducing adulteration of fuel products, it is likely to result in increased price of illuminating kerosene ***(effective 1 July 2018)***.

Only bottled water to attract excise tax

The Bill proposes retain excise duty on bottled and packaged waters only at the current rate of KShs 5 per litre ***(effective 1 July 2018)***.

Costly ride!

The Bill proposes to increase the excise duty rate on private motor vehicles with an engine capacity higher than 2,500cc for diesel and 3,000cc for petrol-powered vehicles from 20% to 30% ***(effective 1 July 2018)***.

Taxing money transfer services

The Bill proposes to introduce excise duty at a rate of 0.05% on transfers of KShs 500,000 and above, where transfer of money is done through a bank or financial institution. In addition, fees on money transfer services by cellular phone service providers will attract a higher excise duty of 12% up from 10% ***(effective 1 July 2018)***.

Taxing confectionary

Sugar confectionary products including white chocolates, chocolate bars and slabs will attract excise duty at the rate of KShs 20 per kg ***(effective 1 July 2018)***.

Excise Duty Exemptions

The Bill proposes to introduce exemptions on alcoholic or non-alcoholic beverages supplied to the Kenya Defence Forces Canteen Organization and goods imported or purchased locally for direct and exclusive use in the implementation of projects under special operating framework arrangements with the Government ***(effective 1 July 2018)***.

Customs

The East Africa Customs Management Act, Common External Tariff has been proposed to be amended ***(effective 1 July 2018)*** as follows:

Item	Old duty rate	New duty rate	Objective
Steel and iron products	25%	35%	To protect the local iron and steel industries.
Paper and paper products	25%	35%	To protect local manufacturers of paper and paper products.
Textile and footwear	0% to 25%	USD 5 per unit or 35% whichever is higher	To protect the textile and footwear sector from unfair competition arising from cheap imported textiles and footwear.
Particle board	10% to 25%	USD 110/MT or 35% whichever is higher	To enhance local production of timber products and to protect the timber and furniture industry from increasing cheap timber products.
Medium density fiber board	25%	USD 120/MT or 35% whichever is higher	
Plywood	25%	USD 230/MT or 35% whichever is higher	
Block boards	25%	USD 200/MT or 35% whichever is higher	
Inputs and raw materials for manufacture of Pesticides and Acaricides	0%	100% remission	To protect local manufacturers and increase crop production.
Sightseeing buses and overland trucks	25%	100% remission	To promote the tourism industry.
Inputs and raw materials for assembly of clean energy cooking stoves	10-25%	100% remission	To promote local production of clean cooking stoves.
Vegetable oils	25%	USD 500/MT or 35% whichever is higher	To promote and protect local manufacturers from cheap imports.

Tax Procedures Act (TPA) Changes

Liabilities and obligations of a tax representative

Where a taxpayer has more than one tax representative, each tax representative shall be responsible for the tax obligation they have been appointed for and not all tax obligations as was the case previously ***(effective 1 July 2018)***.

Extension of time to file returns

The TPA has now clarified that an application for extension of time to file a return must be made at least 15 days before the due date in the case of a monthly return or at least 30 days before the due date in the case of an annual return.

The Commissioner shall notify the applicant at least 5 days before the due date if he grants the extension. Where there is no notification by the Commissioner, the application shall be deemed to have been granted.

An applicant may only be granted one extension in respect of a tax period ***(effective 1 July 2018)***.

Amended self-assessment return

The Commissioner is not bound by time to either accept or reject a taxpayer's amended self-assessment return. Previously, the Commissioner was required to respond within 30 days of receiving the application ***(effective 1 July 2018)***.

Extension of foreign income tax amnesty

The foreign income tax amnesty filing deadline has been extended from 30 June 2018 to 30 June 2019. In addition, the income to be declared is for the year ending 31 December 2017.

The amendment to the foreign income tax amnesty has also clarified that the funds transferred under the amnesty shall be exempt from the provisions of Proceeds of Crime and Anti-Money Laundering Act, 2009 or any other Act relating to reporting and investigation of financial transactions to the extent of the source of the funds excluding funds derived from proceeds of terrorism, poaching and drug trafficking.

This is a welcome provision because it will ensure that there is more uptake of the amnesty ***(effective 1 July 2018)***.

Late payment interest increased

Late tax payment interest has been increased from 1% to 2% per month ***(effective 1 July 2018)***.

Recovery of tax from debtors

The TPA has clarified that the Commissioner may recover tax from debtors who owe money to a taxpayer ***(effective 1 July 2018)***.

Expounded conditions for lodging a notice of objection

A notice of objection shall be considered to be validly lodged by a taxpayer if he has applied for an extension of time to pay the tax not in dispute. Previously, an objection was only considered validly lodged if the taxpayer has paid the entire amount of tax due under the assessment that is not in dispute ***(effective 1 July 2018)***.

Enhanced penalties for late submission of returns and late payment of tax

The TPA has clarified that the late filing penalty for VAT and excise returns is 5% of tax due or KShs 10,000, whichever is higher.

For corporation tax returns, the penalty for late filling of the return is 5% of tax due or KShs 20,000, whichever is higher.

For individuals, the late filing penalty is 5% of the tax due or KShs 2,000, whichever is higher.

There is an additional 20% penalty for any person who fails to pay tax by the due date ***(effective 1 July 2018)***.

Waiver of penalties and interest

As was the case in the repealed provisions under the Income Tax Act, CAP 470, the Commissioner may on his own motion remit in whole or in part any penalty and interest which is less than KShs 1.5 million. However, if the penalties and interest are more than KShs 1.5 million the Commissioner must seek approval from the CS in charge of The National Treasury ***(effective 1 July 2018)***.

Tax Appeals Tribunal (TAT)

Adjournment of proceedings

Proceedings at the TAT will no longer be adjourned in the event a member of the panel ceases to be a member or is not available for the proceedings. In such a case, the Chairperson of the Tribunal shall assign another member to the panel for the proceedings to continue. This will ensure that proceeding continue without delay ***(effective 1 July 2018)***.

Settlement of disputes outside the Tribunal

Parties to an appeal may now apply in writing to the Tribunal to settle the dispute out of the Tribunal. The time taken to resolve or conclude the settlement out of the Tribunal shall be excluded when computing the duration it takes the Tribunal to hear and determine an appeal. This is a welcome move since many cases will be resolved before the matters proceed to the Courts ***(effective 1 July 2018)***.

Miscellaneous Provisions

The Finance Bill, 2018 and the Budget Statement have proposed several changes to a number of laws and regulations as set-out below:

Financial services sector

- Section 33B of the Banking Act has been amended to scrap interest rate capping. This will provide bankers with the much sought freedom to price credit products with reference to their risk and therefore increase their ability to offer credit to the markets. It will however also result in higher cost of credit ***(effective 1 October 2018)***.
- Section 2 of the Central Bank Act has been amended to include the definitions of mortgage refinance business, mortgage refinance company and specified mortgage refinance company. Mortgage refinance companies shall also be regulated by the Central Bank of Kenya, including licencing requirements and determination of capital adequacy and liquidity requirements ***(effective 1 October 2018)***.
- Section 62 of the Co-operative Societies Act is amended to provide for a legal basis to trigger the deregistration of a Cooperative Society upon the revocation of the licence by the Sacco Societies Regulatory Authority. This amendment provides the power to the Authority to more stringently apply its licencing requirements ***(effective 1 October 2018)***.
- The Proceeds of Crime and Anti-Money Laundering Act, 2009 requires a reporting institution to apply enhanced customer due diligence and enhanced measures on monitoring of business relationships and transactions originating from countries identified as posing a higher risk of money laundering, terrorism financing or proliferation by the Financial Action Task Force (FATF). Sacco's will also fall under the ambit of The Proceeds of Crime and Anti-Money Laundering Act, 2009 ***(effective 1 October 2018)***.

Manufacturing and trading sectors

- An export levy of 20% to apply to copper waste and scrap. This will encourage local use of such scrap within the Kenyan metal industry ***(effective 1 October 2018)***.
- Goods imported for implementation of projects under a special operating framework arrangement with the Government shall not be subject to an import declaration fee and railway development levy ***(effective 1 October 2018)***.

Betting and gaming sector

- In issuing a permit or a licence to a company, The Betting, Lotteries and Gaming Act gives the Betting Control and Licencing Board the power to determine if the company has adequate financial status including the solvency of the company, educational qualifications of the applicant, licences granted by any financial sector regulator, ability to carry on the activity competently, honestly and fairly, their reputation, character, financial integrity and reliability, including the consideration as to whether the applicant is fit and proper. The Act also gives the opportunity to the applicant to be heard by the Board in determining whether or not the applicant is fit and proper ***(effective 1 October 2018)***.
- The Betting, Lotteries and Gaming Act requires the collector to pay the betting tax, lottery tax, gaming tax and prize competition tax into the Sports, Arts and Social Development Fund established under Section 25 of the Public Finance Management Act, 2012. Further to this a penalty of 20% and interest at a rate of 2% per month shall be levied for late payments. Waiver applications can be made for the penalties and interest ***(effective 1 July 2018)***.

Stamp Duty

- Section 117 of The Stamp Duty Act has been amended to exempt from duty all instruments executed for the purposes of collection and recovery of tax (for example stamp duty will no longer apply to repossession and subsequent disposal of assets for purposes of tax recovery) and an instrument relating to the business activities of Special Economic Zone enterprises, developers and operators ***(effective 1 October 2018)***.

Retirement benefit schemes

- Section 34 of the Retirement Benefits Act, 1997 is amended by making it the responsibility of the Trustee to submit accounts and returns to the Authority and failure to do so attracts a penalty of KShs 100,000 and thereafter KShs 1,000 per day of delay. Penalties of KShs 10,000 and thereafter KShs 1,000 per day have also been imposed on the fund manager and administrator, for not filing the required returns ***(effective 1 October 2018)***.
- Section 53B will be introduced into the Retirement Benefits Act, 1997 to levy a penalty of 5% or KShs 20,000, whichever is higher for any un-remitted

contributions and interest accrued, payable within 7 days of receipt of the notice. The penalty shall be levied on the employer who will then have to immediately cease further deductions from employees and notify members of the scheme. The defaulting scheme could also be wound up ***(effective 1 January 2019)***.

Employment

- Section 31 of the Employment Act is amended, requiring an employer to pay to the National Housing Development Fund in respect of each employee contributions that will not exceed KShs 5,000 per month comprising ***(effective 1 October 2018)***:
    - The employer's contribution at 1% of the employee's gross emoluments; and
    - The employee's contribution also at 1% of the employee's earnings.

Other proposed amendments covered in the Cabinet Secretary's budget statement are as follows:

- With a view to extending long term loans to financial institutions secured against mortgages, the Kenya Mortgage Refinance Company (KMRC) has been established which will ultimately be controlled by the Government, the private sector and select development partners. It is anticipated that this will facilitate greater mortgage lending by commercial banks.
- A National Toll Fund as a special toll fund is to be established to support the development of world class trunk roads.
- Proposed amendment to the Capital Markets Act to introduce enhanced financial controls and provide for investor protection in the sector.
- Proposal on formulation of regulations to allow utilization of a portion of retirement benefits for post-retirement medical cover.
- Amendment of the Insurance Act to introduce index-based insurance for farmers, criminalization of insurance fraud and requirements for the insured to make payments directly to the insurer. Whilst index-based insurance is expected to benefit the farming community, the proposed payment restrictions are likely to have significant implications on the insurance sector, and particularly brokers and agents.
- Reforms have been proposed to improve the Public Procurement and Disposal System in order to effectively and efficiently manage resources. These reforms include establishment of common user agency, enhancement of the e-procurement platform, facilitate prompt payment for performed contracts within 60 days upon proper certification of the same, Buy-Kenya-build-Kenya policy and margin of preference to be extended to local contractors where Kenyans are shareholders offering supplies. Accounting officers will be expected to share reports on contract awards to the National Treasury and the Public Procurement Regulatory Authority.

PKF

right people
right size
right solutions

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