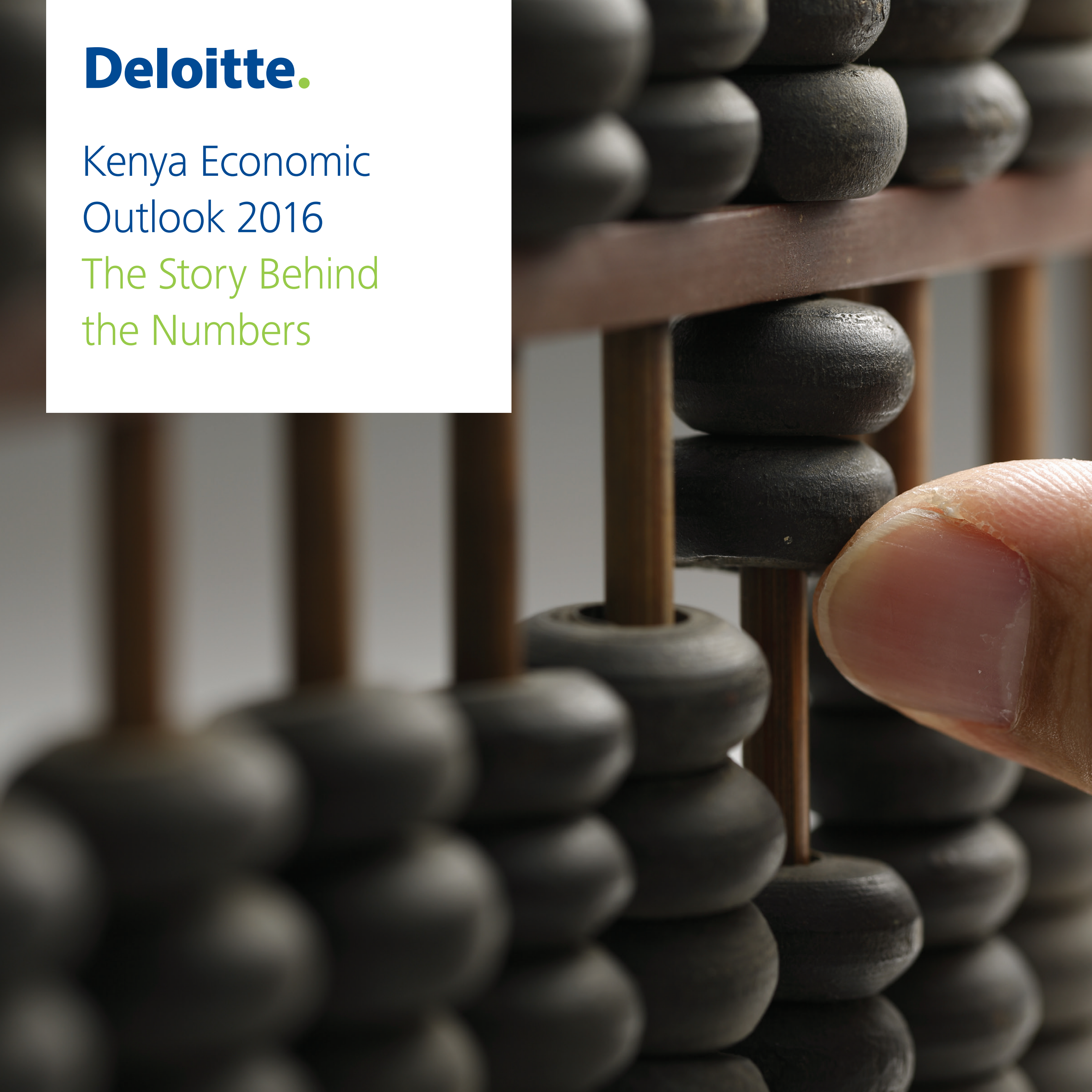
Deloitte.
Kenya Economic
Outlook 2016
The Story Behind
the Numbers

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Preamble

The Kenya Economic Outlook 2016 report provides an overview of Kenya's economic environment and key sectors. The report also highlights significant allocations from the 2016/17 budget to various sectors in the country.

June 2016

Kenya Economic Review

Political overview

With Kenya's next Presidential and legislative elections scheduled for August 2017, the Economic Intelligence Unit (EIU) predicts that political tensions will rise as campaigning gathers momentum. The country's President, Uhuru Kenyatta, is likely to seek re-election for a second and final five-year term as President especially since the International Criminal Court (ICC) dropped both his and the Deputy President's (William Ruto) cases.

Kenya faces insecurity threats most notably from Al-Shabaab, the Somalia-based Islamist group that carried out a string of terrorist attacks such as the massacre of 147 people at Garissa University College in April 2015 and the killing of 67 people at the Westgate Mall in September 2013. The EIU notes that security risks will not necessarily improve after the 2017 election.

Corruption is a major impediment to doing business in Kenya with allegations of misappropriation of public funds on the rise. The 2015 Corruption Perception Index released by Transparency International (TI) ranked Kenya among the most corrupt countries at 139 out of 168 countries.

According to Business Monitor Intelligence (BMI), Uganda's decision to pursue an oil pipeline route through Tanzania instead of Kenya in April 2016 highlights economic competition that will undermine the East African Community's (EAC) goal of regional integration. This decision will see the scope of Kenya's Lamu Port-South Sudan-Ethiopia Transport (LAPSSET) corridor project reduced since the pipeline was a major part of the project.

The EIU notes that Kenya's foreign policy will be driven by economic interests; especially the maintenance of close relations with donors and the advancement of regional integration of the EAC between 2016 and 2020.

Economic overview

According to data released by the Kenya National Bureau of Statistics (KNBS), the increase in the country's gross domestic product (GDP) from 5.3% in 2014 to 5.6% in 2015 was driven by the construction sector that grew by 13.6% in 2015 compared to 13.1% in 2014, the financial and insurance sector that grew by 8.7% in 2015 from 8.3% in 2014 and the agricultural sector that reported a 5.6% growth in 2015 compared to the sector's growth of 3.5% in 2014.

The National Treasury reported that Kenya had a fiscal deficit of 8.7% of GDP in FY15. BMI forecasts a fiscal deficit of 8.1% of GDP in FY16 due to shortfalls in income tax and value added tax (VAT) collections despite efforts by the Government to increase tax compliance through incentive programmes and electronic payment systems.

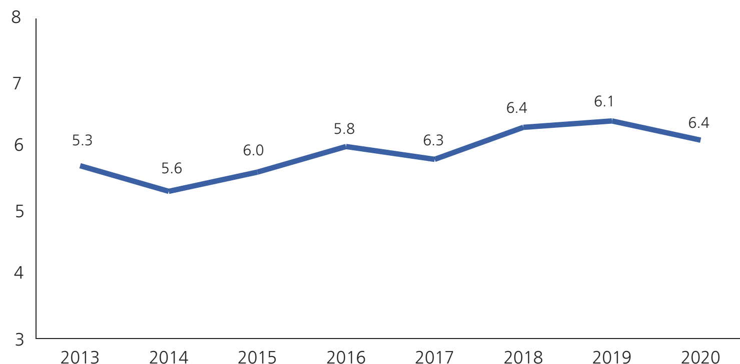
The Central Bank of Kenya's (CBK) Monetary Policy Committee (MPC) in May 2016 lowered its benchmark interest rate to 10.5% from 11.5% due the trends of reducing inflation rates and stabilisation of the Kenyan shilling (KES). Following this move, the MPC is also expected to revise the base lending rate, Kenya Banks' Reference Rate (KBRR) in June 2016 and hence reduce the cost of credit in the country in the second half of 2016.

The health of the banking sector in the country has come under severe scrutiny following the placement of three banks under statutory management by the CBK. BMI notes that the CBK's enforcement of strict prudential regulations along with an over-served banking sector present opportunities for consolidation in the sector.

As a member of the integrated EAC, Kenya's external performance will also depend on the growth rate of EAC countries. According to BMI, all countries in the EAC except Burundi and South Sudan will achieve rapid GDP growth rates.

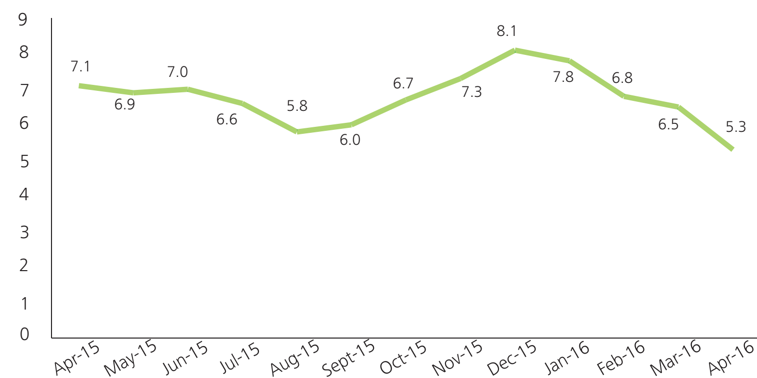
BMI notes that 9.3% of the workforce in Kenya is unemployed while the country's poverty rate is over 40%. BMI however forecasts that the net income per household will reach USD 2,496 in 2020 from USD 1,752 in 2016 due to the country's improving economy.

Chart 1: Kenya's annual GDP growth rate (%)



Source: Business Monitor Intelligence

Chart 2: Kenya's inflation rate (%)



Source: Kenya National Bureau of Statistics

GDP

BMI reported that Kenya remained resilient through a turbulent 2015 characterised by currency instability and monetary tightening to post an economic growth of 5.6% in 2015 from 5.3% in 2013. BMI forecasts Kenya's economy to grow by 6% in 2016 and by an average of 6.1% between 2016 and 2020 supported by strong public investment in infrastructure, a dynamic services sector and favourable demographics.

BMI projects the Kenyan Government's spending to rise by 7.7% in 2016 from 5.8% in 2015 as it remains committed to spending heavily on infrastructure.

According to BMI, consumer spending will also be a key driver of Kenya's economic growth between 2016 and 2020. BMI predicts private spending to grow from KES 4.7 trillion in 2015 to KES 8.7 trillion in 2020 due to rising incomes, favourable demographics and growing financial inclusion as mobile financial services continue to spread across the country.

Inflation

The KNBS reported a reduction in overall inflation to 5.3% in April 2016 from 7.1% in April 2015 due to lower food prices and reduced motoring expenses caused by low fuel prices. The EIU expects inflation to average 5.6% in 2016 due to subdued oil prices, lower electricity tariffs due to increased reliance on drought-resistant geothermal power and low food prices due to improved rainfall.

The EIU forecasts inflation to average 5.1% between 2017 and 2020 due to a prudent monetary policy and efficiency gains arising from regulatory reform and investment in infrastructure. The EIU notes that drought remains a potential risk to inflation and demand pressures will prevent a rapid decline in inflation.

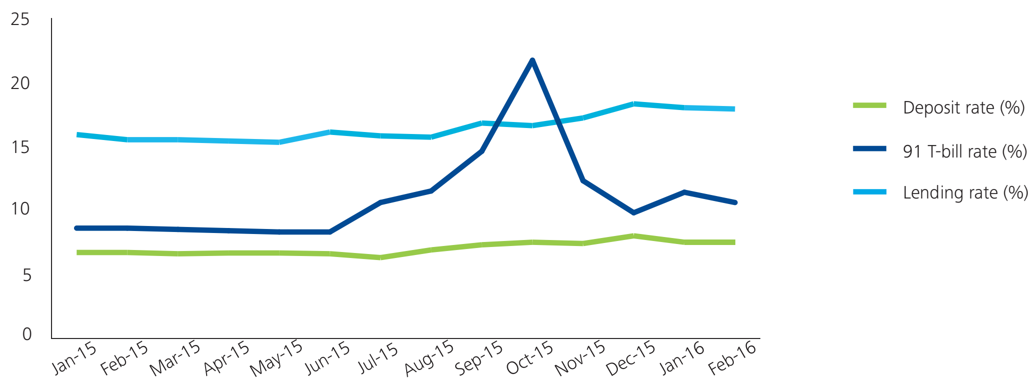
Interest rates

According to the CBK, lending rates in Kenya increased from 15.5% in February 2015 to 17.9% in February 2016 while deposit rates increased from 6.7% to 7.5% in the same period perhaps due to a move by Kenyan banks to maintain their interest spreads following the increase in the base lending rate by CBK by 300 basis points to 11.5% in July 2015.

The World Bank attributes the high interest spreads in Kenya due to lack of competitiveness in the banking sector and the high cost of financial intermediation. The World Bank notes that large banks in Kenya have the power to maintain wide interest spreads at the expense of borrowers and depositors.

The CBK reported that the 91 day Treasury Bill (T-bill) rates were volatile in 2015 increasing from 8.3% in June 2015 to 21.7% in October 2015. BMI attributes this increase to tight liquidity in the market following the decision by CBK to raise its base lending rate in July 2015. The T-bill rates dropped to 10.6% in February 2016 following improved liquidity in the market.

Chart 3: Interest rates in Kenya (%)



Source: Central Bank of Kenya

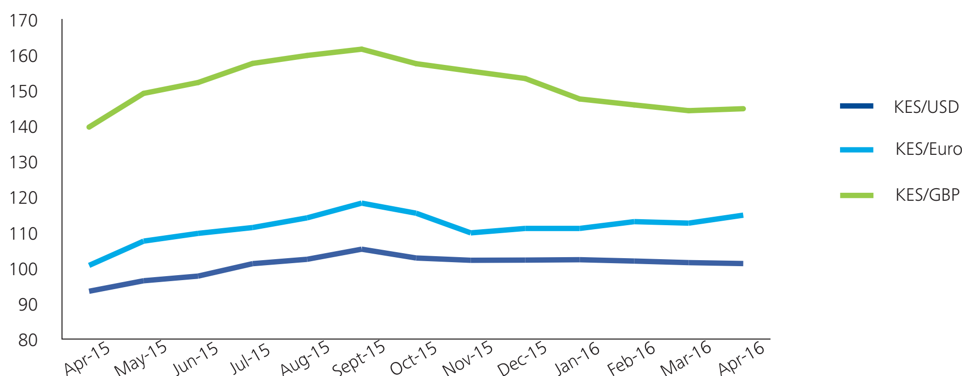
Exchange rates

The KES depreciated by 8% against the USD, by 4% against the British pound (GBP) and by 14% against the Euro (EUR) between April 2015 and April 2016 according to the KNBS. The International Monetary Fund (IMF) attributes the weakening of the KES to reduction in foreign-currency denominated capital inflows, declining of tourism receipts and interventions by the CBK to smooth the foreign exchange market.

Despite the KES depreciation, the EIU notes that KES is resilient compared to other emerging market currencies due to the country's stringent monetary tightening and also due to the country's low level of dependence on hydrocarbons and minerals exports.

The EIU reports that the KES will remain vulnerable to global development such as further rises in US rates and uncertainties surrounding the state of the Chinese economy. The EIU predicts the KES to weaken from an average of 104.23 against the US dollar in 2016 to an average of 117.5 in 2020.

Chart 4: Exchange rates in Kenya



Source: Kenya National Bureau of Statistics, Central Bank of Kenya

Sectoral perspectives

Financial services

The Kenya National Bureau of Statistics (KNBS) reported that the financial services (FSI) industry which contributes 6.8% to the country's Gross Domestic Product (GDP), withstood a turbulent year to post a growth of 9.3% in 2015 compared to 9.1% in 2014. This is attributed to increased lending to the Government and growth in the construction, manufacturing and agriculture sectors.

The FSI industry in Kenya is currently characterised by themes on consolidation, with both the industry's regulators and players expected to consolidate in the near-term.

On 31 May 2016, the Treasury published a bill that proposes the merging of four regulatory agencies: the Capital Markets Authority (CMA), the Retirements Benefits Authority (RBA), the Insurance Regulatory Authority (IRA) and the Sacco Societies Regulatory Agency (SASRA) into one regulatory body: the Financial Sector Authority (FSA). The introduction of risk-based minimum capital ratios together with liquidity constraints in the banking and insurance sectors also point towards the consolidation of small and large banks and of small and large insurers respectively.

Banking

The banking sector in Kenya is dominated by large banks that control an estimated 80% of the market according to BMI. With erosion of consumer confidence in small and mid-sized banks following the placement of three banks into receivership, large banks could become even more dominant by acquiring the businesses of small and mid-sized banks.

The proposed acquisition of Chase Bank by KCB, the proposed consolidation of all state-owned banks (National Bank of Kenya, Consolidated Bank and Development Bank of Kenya) and the imminent sale of Barclay Africa Group Limited's 68.5% stake in Barclays Bank of Kenya Limited could set the stage for more mergers and acquisition in the country's banking sector.

Kenya's banking sector will continue to be shaped by stricter prudential and conduct regulations that have been enforced since the appointment of the current Central Bank of Kenya's (CBK) Governor Dr. Patrick Njoroge in June 2015. Since his appointment, the provisioning for non-performing loans (NPLs) in the industry has increased significantly.

The Government has assured Kenyans that the receivership of three commercial banks was due to specific factors related to these banks. However, in order to prevent such occurrences, the following measures are being implemented:

1. Presentation of the Central Bank Bill in Parliament;
2. Enhancement of the oversight of commercial banks IT systems, improvement of the skills of Central Bank supervisory staff on ICT and forensic audits. The Central Bank is also in the process of recruiting skilled IT staff to strengthen its technical capacity;
3. Strengthening Central Bank supervision function in terms of numbers and competences;
4. Strengthening corporate governance practices in banks;
5. Reviewing the quantum of penalties for regulatory violations;
6. CBK is considering publication of its enforcement actions against institutions;
7. Working with relevant agencies to duly investigate and prosecute cases of financial fraud promptly; and
8. Strengthen the bank resolution process under the Banking Act as well as the Kenya Deposit Insurance Corporation Act.

Insurance

According to KNBS, the growth in the insurance sector slowed to 0.7% in 2015 compared to the 0.9% growth the sector posted in 2014. This can be attributed to a depressed domestic equities market and the weakening of the Kenyan shilling.

The new Insurance Regulatory Authority's (IRA) regulations that include the introduction of risk based capital requirements and the increasing of the minimum core capital requirements for both life insurance business (from KES 150m to KES 400m) and long-term insurance business (from KES 300m to KES 600m) are set to begin implementation in June 2016 till June 2018.

The implementation of these regulations together with the rising premium levels and improving rates of penetration in Kenya could lead to consolidation, mergers and acquisitions in the industry. An example of a recent transactions in the sector is the purchase of a 63.3% stake in First Assurance by Barclays Africa in June 2015.

The Insurance Act prohibits placement of "Kenyan Business" with non-Kenyan or foreign insurance markets except under certain circumstances. However, imports into Kenya continue to be on a Cost, Insurance and Freight basis instead of Cost and Freight basis thus denying insurance companies registered in Kenya business that could substantially benefit the economy. The Government is therefore working with the relevant stakeholders to ensure that this part of the law is implemented.

Capital markets

The stock market's performance dipped in 2015 in the backdrop of profit warnings by companies and increasing yields in the fixed income market. KNBS reported that Nairobi Stock Exchange (NSE)-20 index dropped from 5,346 in January 2015 to 4,040 in December 2015. According to KNBS, equity turnover dropped from KES 216 billion in 2014 to KES 209 billion in 2015 while bond turnover dropped from KES 506 billion in 2014 to KES 305 billion in 2015 largely due to increased yields in Government securities.

In October 2015, the NSE got approval from the CMA to operate a derivatives market. The NSE has since signed up 6 commercial banks in Kenya to handle the Central Counter Party (CCP) clearing system of the derivatives market ahead of the market's official launch.

The Government is keen on strengthening the Primary and Secondary markets for Government Securities which constitute a major component of the capital markets. This will include: introducing electronic bond auctions which will spare investors from the current manual process of submitting paper bids; separating the retail and wholesale components of the market, introducing primary dealers and market makers; and establishing an efficient horizontal repo market. In addition, with volatility in interest rates having been tamed, the Government will proceed with the M-Akiba Government Bond, the world's first purely mobile phone based Government security.

Pension sector

The Government is concerned about the confusion, duplication and competition that has characterised the retirement arrangements for county government workers since the enactment of the new constitution. There is a compelling need for a framework that will ensure maximisation of the benefits of pooling staff pension assets, facilitate mobility of staff across county governments and between national and county governments and bring on board universal norms and standards benchmarked to the international best practice. This framework should cover all county government workers including those initially seconded from the National Government, those from the defunct local authorities and those employed by County Public Service Boards and County Assembly Service Boards. In this regard, the National Treasury will work with relevant parties to device a comprehensive solution for the benefit of the county workers.

Public sector

Security

Like many developing countries, Kenya has more than its fair share of crime and security challenges. The crime in Kenya is particularly prominent in the urban areas of Nairobi, Mombasa and Kisumu, as well as tourist-visited coastal areas. The most common crimes are not life-threatening, but are rather "snatch-and-runs" and car-jackings.

In recent years, terrorism has also escalated in Kenya. Since Kenya's involvement in the Somalia wars by sending troops into their neighbors, the Jihadi militant group al-Shabaab has continued to target Kenya. Al-Shabaab has caused havoc in the country, including attacking one of the country's premier mall Westgate (killing 70 people) and Garissa University College (killing 147 people). The constant threat of terrorism has driven away tourists and has caused certain countries to issue travel advisories against the country, which has led to loss in revenue for one of the country's biggest money makers. The country's security apparatus is however making vast strides into combating this threat.

The Government has stepped up its efforts to increase security by allocating KES 124 billion to Defence and National Intelligence Service (NIS) and KES 140.6 billion to the State Departments of Interior and Co-ordination of National Government. According to the Government, a huge portion of these allocations will go towards Military and Police modernisation, lease financing of police motor vehicles, enhanced security operations, Police and Prison Officers Medical Insurance Scheme, construction and equipping of the National Forensic Laboratory and construction of police stations and housing.

Moreover, the Government has overseen the installation of the security surveillance system in Nairobi and Mombasa that provides real-time footage to the National Police Operations Centre to aid in the monitoring and detection of crime.

To cater for the housing needs of law enforcers, the Government has signed a Bilateral Framework Agreement with Shelter Afrique and is negotiating a Financing Agreement with the African Development Bank and other partners to develop 24,000 Police housing units within 24 months with construction of the same commencing in October 2016.

Construction and Infrastructure

The Kenyan Government has continued to develop the infrastructure of the country at a rapid rate. KNBS reported that the sector grew by 13.6% in 2015 compared to the 13.1% growth the sector posted in 2014 largely due to implementation of mega infrastructure and energy flagship projects under Vision 2030.

The continued development of the Northern Corridor Transport Improvement Project (NCTIP) and the Lamu Port and Lamu Southern Sudan-Ethiopian Transport Corridor (LAPSSET) have been attracting attention and investments from around the world.

The latter project which will serve as a way to expand port access, will boost rail construction, as well as the potential pipeline for oil discovered in the country has been allocated KES 10 billion in the 2016/2017 budget.

The Kenyan Government has received support from the World Bank and the UN, as it plans to support the development of 150,000 new apartments for the lower class "squatters" that currently take up residence in slums. The Government is also working on the "SlumUpgradingProject" with UN Habitat, in order to better living conditions in the country's slums.

A key factor to the immense improvements in Kenya's construction business is the involvement of China. Chinese workers and firms have been working on multiple new projects around the country, which has caused tension in the local community, who feel that they are being deprived of such jobs. However, the Chinese firms have continued to be relentlessly efficient, and thus beneficial to the country's structure.

One issue that the Economist Intelligence Unit (EIU) identified in the past year is that of the Kenya Airports Authority (KAA) cancelling the construction of the new, modern terminal at Nairobi's Jomo Kenyatta

International Airport (JKIA). The cancellation of the multi-million dollar project has sparked a conflict with the contracted firm, China National Aero-Technology Import and Export Corporation (CATIC).

The cancellation of the new terminal also prevents JKIA from increasing its capacity as was planned, which may have consequences in regions of tourism and imports.

Youth Empowerment

The Government revamped the National Youth Service (NYS) as a vehicle for recruiting young men and women to the national service. The programme is essential in preparing the youth for the job market and other income generating activities. The Government has allocated KES 21.2 billion towards Gender and Youth Empowerment Programmes through NYS.

The FY 2015/16 budget speech proposed introduction of a tax rebate scheme for employers who employ and train at least 10 fresh graduates for a period of 6 – 12 months. The Government has developed the regulations and will propose to gazette them under the tax measures. This will increase employment and better prepare the young graduates for the job market.

Small and Micro Enterprises (SMEs) are a key source of employment. However, the growth of this sector is hindered by inadequate capital , limited market access, poor infrastructure, inadequate knowledge and skills and rapid changes in technology. The Government will address these challenges as follows:

- Entrenching Buy-Kenya-Build-Kenya policy in all public procurement;
- Enforcing the legislation on preferences and reservations that requires at least 40 percent local content in all public projects;
- Continuing to increase allocations to Uwezo Fund and the Youth and Women Enterprise Fund by KES 1.6 billion in 2016/17;
- Supporting Small and Medium Enterprises to acquire small industrial plants for value addition of agricultural products currently produced by the informal sector; and
- Supporting research and development to boost science, technology and innovation.

In addition, the Government has allocated a total of KES 1.6 billion for upgrading of national schools, purchase of computers, aquaculture development and for prototype fresh produce and wholesale markets.

Devolution

The National Government has supported devolution as stipulated in the Constitution and the Public Finance Management (PFM) Act 2012 since FY2013/14. Parliament has approved allocations to County Governments amounting to KES 280.3 billion as the equitable share of revenue raised nationally. This allocation guarantees County Governments of a KES 20.5 billion increase over and above the equitable share allocation in the Financial Year 2015/16. Furthermore, this allocation is more than double the constitutional minimum of 15 percent of the latest audited revenues.

By the end of FY2016/17, the Government will have transferred in excess of KES 1 trillion to County Governments since the roll out of the devolved system of Government in Kenya, a remarkable support to service delivery, and a clear demonstration of the Government’s commitment to ensure that devolution succeeds.

Health

As a relatively low-income and tropical country, Kenya can be expected to have various health problems. As a country with almost 42% of the population living in poverty according to United Nations Children’s Emergency Fund (UNICEF), Kenya’s health problems are often further amplified.

The primary issue facing the country is that of diseases like malaria, tuberculosis, and HIV/AIDS. It is estimated that over 3 million Kenyans suffer from HIV/AIDS, and almost 700 die every day due to complications from the disease.

Kenya is also faced with yellow fever and other tropical diseases. All of these diseases take thousands of lives every year. While some of these are very preventable and/or curable, the lack of health education, low access to resources, and lack of doctors makes them fatal. Kenya only has 1 doctor for every 10,000, with 50% of the doctors practicing in Nairobi, which caters to a small proportion of the population. The lack of access to necessary resources causes Kenya's health to decline. The Government has provided free and discounted vaccines, along with camps in rural areas, to bring down disease rates, while also constructing more public hospitals around the country for the betterment of health.

In 2015, the Government allocated close to KES 90 billion towards the improvement of healthcare in and for the development of better health facilities. The Government's programmes such as the free maternal service have contributed to a decline in the number of deaths for children under the age of 5 years from 100,000 in 2013 to 70,000 currently according to the Treasury Cabinet Secretary Henry Rotich. To further support the programme, the Government has allocated KES 4.3 billion in the 2016/17 budget to free maternal healthcare.

Other notable allocations to the health sector include: KES 8.8 billion for Kenyatta National Hospital (KNH), KES 5.8 billion for Moi Teaching and Referral Hospital, KES 4.5 billion for lease of medical equipment, KES 3.5 billion for the Kenya Medical Training College (KMTC), KES 1.7 billion for Kenya Medical Research Institute (KEMRI), KES 3 billion for the Doctors/ Clinical Officers/Nurses internship programme, KES 1.3 billion for the rollout of universal health coverage, KES 0.9 billion for free primary healthcare, KES 0.7 billion for the Slums Clinics Upgrading Programme, KES 0.6 billion for the National Aids Control Council (NACC) and KES 0.5 billion for the Health Insurance Subsidy Programme for the elderly and disabled.

The country also introduced the Health Management Information System (HMIS), which keeps a better track of health records and spending, and attracts foreign nations to invest in Kenya's health. We anticipate that the Government will continue to increase the emphasis it places on the health sector.

Education

Kenya's education system is what many would regard as a mixed bag. While it is above most African averages for educational rates and enrollment rates, the country still suffers from issues at the background of its educational system.

Kenya offers free primary education to all, and has in fact made it compulsory for parents to send their children to school. This has put it ahead of many countries, with an 85% initial enrollment rate for the youth. The problems, however, arise when the parents are unable to afford uniforms and textbooks for their children, forcing them to withdraw. According to UNESCO, primary education is not of sufficient quality to ensure that all children can learn the basics. Among young men aged 15-29 years who had left school after six years of schooling, 6% were illiterate and 26% were semi-literate. The figures are even worse for young women, with 9% illiterate and 30% semi-literate after being in school for six years.

Kenya is, however, showing a strong commitment to strengthen its education. The Government spent a total of KES 324 billion in the fiscal year 2015/16 compared to the KES 308 billion in the fiscal year 2014/15 according to the National Treasury.

This strong spending helped increase the total enrollment in primary schools from 10 million in 2014 to 10.1 million in 2015 as reported by KENBS. The total enrollment rate in secondary schools on the other hand increased from 2.3 million in 2014 to 2.6 million in 2015. Kenya's secondary schooling is spread across public and private schools, with the richest being able to afford private schooling, while the poor divide themselves among the public schools. This sets a level of disparity even further within the society, which reflects further on in Kenya's society and economy.

Kenya has 49 universities, which range from public to private. Most students that were educated in pubic secondary schools end up at public universities. Those that study at private schools end up at private institutions, or as is recently the trend, study abroad.

To support the on-going programmes within the education sector, the Government has made a number of significant allocations to areas in the education sector. The allocations include: KES 32.4 billion for free day secondary education, KES 14.7 billion for free primary education, KES 4.5 billion for recruitment and promotion of teachers, KES 2.8 billion for the second phase of the teachers' house allowance, KES 2.5 billion for technical training institutes, KES 0.4 billion for sanitary towels for girls in school, KES 2.6 billion for the School Feeding Program, KES 3.2 billion for subsidy to the Kenya National Examinations Council (KNEC) for exam waivers, KES 9.1 billion for Higher Education Loans Board (HELB), KES 57.8 billion for university education and KES 13.4 billion for the Digital Literacy Program (laptop project) to build teacher capacity and computer labs around the country.

Energy and Resource

Kenya's Government has set forth its Vision 2030 program that aims to turn Kenya into a "newly industrialised, middle-income" country. The energy sector has been recognised as one of the three major pillars that must be improved on to help reach this goal.

According to the Energy Regulatory Commission (ERC), Kenya's energy needs derive primarily from three sources: wood fuel, petroleum and electricity (which account for 69%, 22% and 9% of total energy respectively). For a country that is looking to make leaps in development, this backward and rural energy composition is a cause of concern, which the Government has recognised and is actively trying to change through attracting private investors, and promoting renewable energy.

The current wood fuel demand in Kenya is close to 3.5 million tons per year, while supply is at 1.5 million tons per year. This has led to excessive deforestation and destruction of animal habitat, which has thus also adversely affected Kenya's tourism sector. The Government has tried to combat this by attempting to expand its power supply via the electricity grid. The Federation of Universities of Applied Sciences found that Kenya has increased its effective grid from 1700 MW in 2015 to 2200 MW in 2016.

The Government planned to increase capacity to 5,000 MW by the end of the year, while increasing connectivity to the national grid from 28% (an 8% increase from last year) to 65% by 2022.

The current popular sources of electricity are seen below:

- 36% Hydropower
- 35% Fossil fuel (gas, diesel)
- 26% Geothermal
- 1% Wind
- 2% other (solar, bagasse)

Kenya is actively pursuing development in the geothermal sector, standing currently as Africa's leader and 8th in the world in terms of power generation from the earth. Research has shown that there are still close to 10,000 MW of potential geothermal energy in the highly seismic Rift Valley, which should help drive Kenya toward Vision 2030.

The Government has introduced the Scaling-up Renewable Energy Program (SREP) to help utilise this potential. Geothermal is a highly reliable and consistent source of energy, and multiple companies are investing in the sector to capitalise on this.

The discovery of oil reserves in the Turkana region also means that Kenya may soon be on the way to commercialise and produce its own oil, which will make the country more self-sufficient and will greatly contribute to the its development. It is expected that Kenya will be capitalising on its oil reserves by 2018. Patrick Nyoike, former Permanent Secretary of the Ministry of Energy and Petroleum says that Kenya is also targeting the development of a nuclear power plant between 2017 and 2022, which will be the best way for the country to produce safe and clean electricity. The project is estimated to cost USD 3.5 billion.

The Government aims to entice private corporations generating electricity via renewal sources such as geothermal, solar and biogas by offering them Feed-in-Tariffs (FiT). Moreover, entities producing electricity via solar energy sources are now offered zero-rated import duty and exempt from paying VAT on all qualifying equipment and accessories according to the ERC.

The Government in the 2016/17 budget has allocated KES 120.2 billion to the energy sector to cater for geothermal development, power transmission, last mile connectivity, connectivity subsidy, rural electrification programme, national street lighting programme, electrification of public facilities, exploration and distribution of oil and gas, LPG distribution installation of transformers in constituencies and infrastructure programme.

Information and Communication Technology

The Government stated that the vision for Kenya is to be “a prosperous ICT-driven society” in its National ICT Policy Bill in order to “improve the livelihoods of Kenyans by ensuring the availability of accessible, efficient, reliable and affordable ICT services”. As such, Kenya has seen tangible growth in the ICT sector.

Key indicators of this as reported by the Communications Authority of Kenya (CAK) are that mobile phone subscription penetration has risen from 79% in FY 2014/15 to 86% in FY 2013/14 while internet subscriptions have risen from 14 million in FY 2013/14 to 24.9 million in FY 2014/15, while data speeds rose by over 67% in the period.

The exit of one of the four telecom providers, YU Essar, however, decreased capacity and infrastructural connection by almost 4%, which is a deficit that must be made up by the remaining providers. The entry of new player Equitel will, however, help better the situation over the next year too.

Kenya is well-known around the world for being a pioneer in the field of mobile money, aka M-Pesa, and has continued to show growth in this field, while constantly improving technology and increasing access, with a 2.8% increase in mobile banking.

There was also a 25% increase in internet connectivity within the country over the last 3 years, with fiber optics accounting for close to 97% of all ground internet connections. This has boosted Kenya’s connectivity within itself, and to the rest of the world.

Agriculture

The agriculture industry in Kenya is by far its most prominent, important and dominant industry. As of 2015, the industry accounts for over 25% of the country’s GDP, 20% of employment, 75% of the labour force, and over 50% of revenue from exports.

The country’s excellent climatic conditions make it an ideal space for growing crops, with tea, coffee, and mangoes being major exports and products of the country, giving it international renown. It should be noted, however, that all of this is stemmed from only 8% of the country’s land, yet only 20% of the country’s land is suitable for such production. This is an issue that Kenya is attempting to battle, as it would be far more productively efficient if more land were used. The Government’s Kenya Agricultural Research Institute (KARI) focuses on researching on ways to make more land arable, and to discover crops that can be grown better in the soil.

Kenya specialises in organic and fresh produce, as GM crops are illegal in the region. This has caused the farmers to develop new and innovative techniques to grow their crops the best they can. These include double-step farming and mini-greenhouses. The low levels of mechanisation and technology involved, however, mean that farming is often slow and inexact, and requires large amount of manual labour, causing many children to end up working at farms for most of their lives.

Globally low tea prices, up and coming competition, droughts and desertification of northern Kenya, and a drop in demand from Europe could all threaten Kenya’s agriculture sector, which is why the Government has begun looking for new trade partners.

BMI predicts that Kenya’s agriculture sector will continue to grow steadily, with a predicted average of 4.7% growth over the next five years. BMI also states that Kenya has many opportunities in the field, as the Government plans to increase financial assistance to farmers, to implement technological training, and has recently limited the import of sugar, to boost domestic production.

The following key allocations have been made to the agriculture sector in the 2016/2017 budget:-

- KES 20.8 billion for irrigation projects including Galana-Kulalu, Mwea and the National Expanded Irrigation Program;
- KES 4.9 billion to subsidise fertiliser and seeds;
- KES 1.6 billion for Strategic Food Reserves;
- KES 2.4 billion for Coffee Debt Waiver and Stabilisation of Export Earnings (STABEX); and
- KES 1 billion for Crop Diversification Programme in the Meru region for the Miraa farmers.

Manufacturing

While Kenya is the most industrially developed country in the East Africa region, manufacturing only accounts for 14% of GDP, according to the World Bank. This can be put down to the fact that most of Kenya's exports such as tea and coffee require little or no processing.

Kenya also has a manufacturing presence in textiles, food and grain milling, cement production, and oil refining. A large portion of manufacturing also comes from the informal sector, with homemade arts and crafts being a popular product for tourists and residents alike. To promote the development of industries and extractive sectors of the economy, the Government has allocated a total of KES 7.7 billion for the National Airborne Geo-Physical Survey, the leather industrial park development, textile development, ease of doing business, modernisation of Rivatex and ongoing modernisation of the New Kenya Co-operative Creameries (KCC).

Kenya's Government is in the process of fully establishing three Special Economic Zones (SEZ) which will help boost industrial manufacturing by allowing for lower tax levels and fewer regulatory hurdles. Textile production is being looked at as the primary industry to benefit from this. The SEZs, and the subsequent boost in manufacturing, is expected to create as many as 1.5 million jobs in the year after it starts, and 10 million in the next 30 years, according to the Oxford Business Group. Vision 2030 also identifies manufacturing as one of the key pillars to achieving.

In order to boost manufacturing, the following points are considered as key:

- Development of the iron and steel industries through establishment of an Integrated Steel Mill;
- Development of Small and Medium Enterprise (SME) Parks, Industrial and Technology Parks, Industrial Manufacturing Clusters;
- Skills Development for the Technical Human Resource for the Manufacturing Sector; and
- Commercialisation of research and development results, attraction of strategic investors in strategic sectors i.e. iron and steel industries, agro-processing, machine tools and machinery, motor vehicle assembly and manufacture of spare parts.

As is the case for many emerging markets in Africa, high labour and energy input costs are a challenge that hinder the potential growth. A recent study estimated that energy costs account for 40% of manufacturing production costs in Kenya. Sold at a rate of USD 0.15 per kWh, energy is more than twice as expensive in Kenya as China's USD 0.07 and almost four times as expensive as the USD 0.04 charged in South Africa and Ethiopia.

The World Bank recognises the potential for Kenya's growth, and based on the WBG's recommendations, the United States included Kenya as a part of its African Growth and Opportunity Act (AGOA) to help boost manufacturing, by providing education and resources to individuals and to the firms within the country. This has seen textile sales soar from USD 44m in 2001 to USD 270m in 2006.

Transport and Logistics

The World Bank has called Kenya "a country of contrasts" when it comes to logistics and transport. The public sector side is lagging behind, with no form of Government provided public transport within cities, and many other public commodities sub-par. The private sector, on the other hand, is thriving, well-organised, and competitive. The public sector's performance could however improve especially since the Government has allocated a total of KES 117.6 billion for air and sea transport reforms and KES 30 billion for low volume seal roads.

The Standard Gauge Railway (SGR) project is one key Government project that aims to connect Kenya, Uganda, Rwanda and South Sudan. The Mombasa-Nairobi phase of the project (phase one) is estimated to cost USD 3.8 billion.

According to the Government, phase one is currently over 80 percent complete and is expected to be launched by June 2017 by the President. The Government has allocated KES 154.4 billion for the SGR of which KES 118.2 billion is external financing from China and KES 36.2 billion is financing from the Government. It is expected that the second phase of the project (from Nairobi to Naivasha) will kick off in the FY 2016/17. The sea transport is also faring well, with the Government providing USD 130 million for the purpose of acquiring new ferries for Mombasa, making the port more accessible and easy to maneuver through. KNBS states that the port grew by 7.5% in the past year while container traffic increased by 6.3%. These statistics mirror the Government's position that there has been progress in the reforms and modernisation of the Mombasa port which have contributed to the expansion of container terminals.

Logistics show larger issues. Customs operations are still slow, tedious and full of crime and corruption. The Mombasa port faces congestion and bottlenecking, which is only amplified by the increased number of ferries. The Kenya Railways Corporation has essentially left the railway area, causing a decline to the train system that brought Kenya to the world. The condition of roads is currently poor, albeit improving (see Construction and Infrastructure). Border crossing procedures are also extremely complex, with Ugandan and Rwandan borders slowing down the transport of freight goods.

To fix the situation, the Government has begun working on customs reforms, transport and trade partnerships, and encouraging privatisation (through Public Private Partnerships, or PPP). According to the National Treasury, the Government has so far received over KES 9.5 billion from various private sector players that were channeled to an Annuity Fund to be used construct roads.

Tourism

Inflows from the Tourism sector decreased to KES 84.6 billion in 2015 from KES 87.1 billion in 2014. International visitor arrivals declined by 12.6% to 1.1 million in 2015.

This is despite the fact that Kenya played host to a number of high profile conferences including the 10th World Trade Organisation, Ministerial Conference and the Global Entrepreneurship Summit. The slow performance was attributed to security issues, particularly in the coastal region, and negative publicity occasioned by restrictive travel advisories in our key source markets. The aftermath of the Ebola outbreak in West Africa in 2014 slowed international visitor arrivals in 2015.

The Government has made some efforts to revive the sector. For instance, it increased budgetary allocation to the State Department of Tourism from KES 5.6 billion in 2014/15 to KES 10.7 billion in 2015/16.

The Government also created a stand-alone Ministry of Tourism, which is intended to focus more on issues that directly affect the sector.

Some incentives designed to attract tourists back to the country and boost the sector include:

- Scrapping of Visa fees for children under 16 indefinitely from February 2016;

- Removal of Value Added Tax (VAT) charges on National Park fees and capping Kenya Wildlife Service (KWS) Park fees at USD 60 (down from USD 90) for the 2016/17 financial year; and
- The USD 11.7 million Charter Incentive Scheme that waives landing fees at Mombasa and Malindi airports for all Charter Aircraft. It provides a USD 30 rebate for all disembarking tourists up to June 2018.

The Government allocated KES 4.5 billion for tourism promotion activities in the 2016/17 budget. It proposes to exempt entry fees charged into the National parks from payment of VAT and also commissions earned by tour operators. Further, the Government also aims to promote tourism using revenue realised from increasing the Air Passenger Service Charges for external travel.

To ensure full recovery of the tourism sector the Government has asserted its commitment to improving security in the country, and to strengthening tourist experience by packaging tourism sector incentives and revamping the tourism communication strategy.
KES 1.9 billion has been allocated for sports, culture and art programmes, in order to develop, preserve and protect Kenyan culture and National Heritage.

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