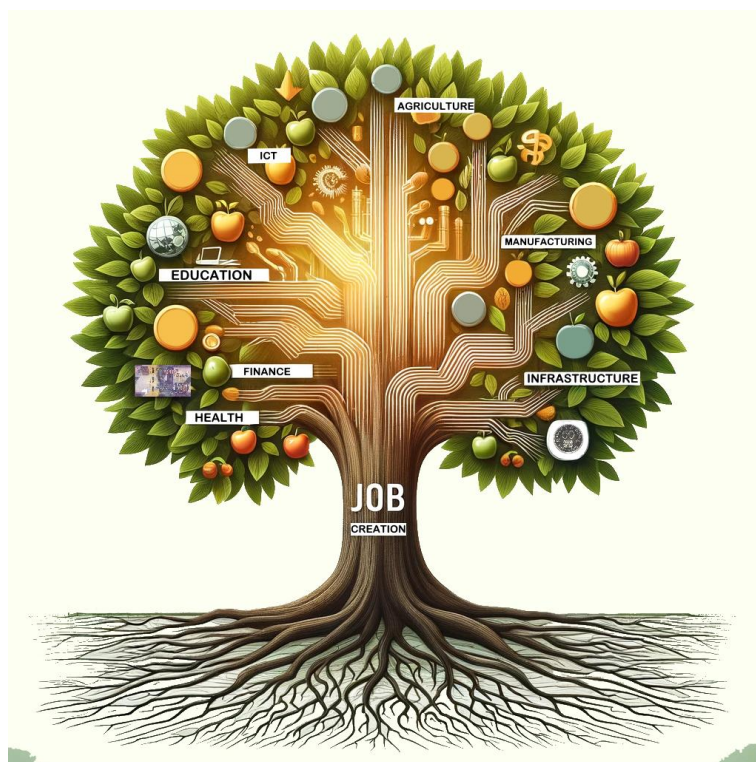




**PARLIAMENT OF KENYA
PARLIAMENTARY BUDGET OFFICE**

**SUPPORTING JOB CREATION AND PRODUCTIVE
GROWTH**



Budget Options for FY 2025/2026 and the Medium Term

FEBRUARY 2025 (EDITION NO. 16)

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Acronyms and Abbreviations

AfCFTA	African Continental Free Trade Area
A-i-A	Appropriations-in-Aid
BETA	Bottom-up Economic Transformation Agenda
BROP	Budget Review and Outlook Paper
CBC	Competency-Based Curriculum
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CFS	Consolidated Fund Services
CIDH	Constituency Innovation Digital Hubs
CMA	Capital Markets Authority
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
ECB	European Central Bank
EPA	Economic Partnership Agreement
EPRA	Energy and Petroleum Regulatory Authority
EPW&NR	Environment Protection, Water and Natural Resources
EUR	Euro
FAO	Food and Agriculture Organization
FED	The Federal Reserve
FIF	Facility Improvement Fund
GBP	Great Britain Pound
GDP	Gross Domestic Product
ICT	Information and Communication Technologies
KeLCoP	Kenya Livestock Commercialization Programme
KSh	Kenyan Shilling
KIA	Kenya Investment Authority
KNBS	Kenya National Bureau of Statistics
KWh	Kilowatt-hour
LCDP	Least Cost Development Plan
MDAs	Ministries, Departments and Agencies
MSMEs	Micro, Small and Medium Enterprises
MTI	Means Testing Instrument
MTP	Medium Term Plan
NOFBI	National Optic Fiber Network Backhaul Initiative
NSE	Nairobi Securities Exchange
OPEC	Organization of Petroleum Exporting Countries

OSR	Own Source Revenue
PAYE	Pay As You Earn
PBO	Parliamentary Budget Office
PDL	Petroleum Development Levy
PFM	Public Finance Management
PIM	Public Investment Management
REREC	Rural Electrification and Renewable Energy Corporation
SASDF	Sports Arts and Social Development Fund
SHA	Social Health Authority
SHIF	Social Health Insurance Fund
TVET	Technical and Vocational Education and Training
UHC	Universal Health Coverage
US	United States
USD	US dollars
VAT	Value Added Tax

Foreword

The outlook for the Kenyan economy in 2025 remains cautiously optimistic, given the delicate balance of risks and growth opportunities that present a mixed picture. Economic performance is expected to be driven by sectors like agriculture and services, which have remained resilient and offer significant growth potential. However, challenges such as climate change, fiscal consolidation, debt vulnerabilities, and global economic trends pose risks that must be carefully navigated.

The fiscal landscape of the country remains turbulent, characterized by shortfalls in revenue collection, substantial debt service costs, and rising expenditure pressures on social programs such as education and health. For instance, revenue performance in the first half of FY 2024/25 indicates that the government is still struggling to meet its annual revenue collection target. As of 31st December 2024, the total ordinary revenue collected amounted to Kshs. 1,160.17 billion, which is equivalent to 44.1 percent of total revenue for FY 2024/25. Similarly, the total external grants received over the period amounted to Kshs. 4 billion, which is equivalent to 8 percent of total budgeted grants for FY 2024/25.

Expenditure performance in the first half of the financial year indicates that the government had disbursed Kshs. 654.5 billion to Ministries, Department and Agencies (MDAs) for recurrent expenditures and Kshs. 129.8 billion for development expenditure and transferred Kshs. 191.6 billion to counties, which is equivalent to 50 percent, 37 percent, and 47 percent of the targets for FY 2024/25, respectively. Notable during the period is Kshs. 653.5 billion in interest payments on public debt is an indication of the cost pressure that public debt servicing is impacting the budget.

The precision of the policy proposals and effective delivery of sought interventions will determine the outlook of key macroeconomic variables over the medium term. This implies that the government will have to focus not just on designing appropriate policies but more so on the effective and efficient implementation of its various programs to enhance economic resilience and improve service delivery.

The 16th publication of the Budget Options provides policy options and an alternative fiscal framework that, if properly pursued, would positively stimulate and impact sustainable economic growth, job creation, and revenue generation.



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Director, Parliamentary Budget Office

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Summary of Budget Options for FY 2025/26

This edition of Budget Options seeks to address Kenya's fiscal challenges by proposing strategies to stimulate economic growth, create jobs, and improve service delivery. The strategies emphasize fiscal responsibility and efficiency in public expenditure and targeted investments in high-growth sectors to maximize economic potential and drive sustainable development. These options are summarized here.

Area of Focus	Proposed Intervention
Medium-Term Economic Outlook	
Investments to support the Export Sector.	<ul style="list-style-type: none"> <i>i.</i> Targeted sector-specific investments to foster private sector-led growth. This includes investments in key agricultural value chains, including horticulture, which is a key export area with significant potential for growth, employment generation, and export revenue enhancement. <i>ii.</i> Regulatory reforms to facilitate a favorable business environment and enhance market access. <i>iii.</i> Sustained efforts in securing regional and global markets for Kenyan products in line with existing Economic Partnership Agreements (EPAs).
Increased Disposable Income	<ul style="list-style-type: none"> <i>i.</i> Enhanced allocation to development expenditure is expected to boost individual income and household purchasing power through the feedback loop, thus stimulating consumption, investment, and overall economic activity.
Private and Government Investment	<ul style="list-style-type: none"> <i>i.</i> Efficiency and improved government investments in foundational areas like infrastructure development, education, healthcare, and energy. <i>ii.</i> Additional investments by individuals and business ventures in manufacturing, service, and technological sectors as a result of an enabling environment, will

Area of Focus	Proposed Intervention
Medium-Term Economic Outlook	
	stimulate market efficiency and mobilize capital facilitating export-led growth.
Job Creation and Productivity Enhancement	
Development of Leather Product Value Chain.	<ul style="list-style-type: none"> <i>i.</i> Provide Kshs. 715.3 million towards the Revitalization of Livestock feed production and conservation, including the establishment of feedlots. <i>ii.</i> Provide Kshs. 3 billion annually to support the establishment of fully equipped extension service stations in all the 1,450 wards across the country. <i>iii.</i> Allocating Kshs. 300 million to clean up all hides and skins and use them for value addition. <i>iv.</i> Allocating Kshs. 600 million to complete the attendant facilities at Kenya Leather Industrial Park—Kenanie.

Area of Focus	Proposed Intervention
Medium-Term Economic Outlook	
Revitalizing Rural Electrification	<ul style="list-style-type: none"> <i>i.</i> Expand the scope of the Petroleum Development Levy Fund to include 30 percent for last-mile connectivity, amounting to upwards of Kshs. 9 billion. <i>ii.</i> Ring-fence 30 percent of the Rural Electrification Programme (REP) Levy to fund off-grid connectivity – amounting to approximately Kshs. 2.3 billion. <i>iii.</i> Prioritizing payment of county pending bills to Kenya Power by ring-fencing them from annual transfers to county governments.
Promotion of Diaspora Investments	<ul style="list-style-type: none"> <i>i.</i> Mechanisms for creating awareness of investment opportunities open to the Kenyans in the diaspora. <i>ii.</i> Linking Kenyans in the diaspora with local businesses and entrepreneurs to undertake joint business ventures. <i>iii.</i> Designing investment vehicles that are attractive to Kenyans in the Diaspora to attract and channel their capital.
Leveraging on Digitization	<ul style="list-style-type: none"> <i>i.</i> Allocating Kshs. 500 million for maintenance and rehabilitation of the NOFBI cable. <i>ii.</i> Allocating Kshs. 600 million to Fastrack the completion of the 290 Constituency Industrial Development Centres (CIDHs) across the country.
Enhancing Service Delivery	

Area of Focus	Proposed Intervention
Medium-Term Economic Outlook	
Leveraging Facility Improvement Fund (FIF) to Achieve UHC	<ul style="list-style-type: none"> <i>i.</i> Conditional Grants to Facility Improvement Fund(FIF) from the Sports Arts and Social Development Fund (SASDF) equivalent to 40 percent reserved for UHC amounting to approximately Kshs. 6.7 billion. <i>ii.</i> Prompt settlement of claims by Social Health Authority (SHA) for primary health care facilities. <i>iii.</i> Widening the scope and quality of services offered under the Social Health Insurance Fund.

**Addressing
Challenges in
Education
Financing**

- i.* Scrap the National Examination/ Assessment Waiver Policy and redirect the Kshs 5 billion to fund other critical learner-centered areas.
- ii.* Consolidate the existing bursary initiatives and allocate Kshs. 20 billion to bursaries to address the capitation gaps in TVET institutions and Secondary schools.
- iii.* Capping the number of Bursaries for Tertiary Students.

I. RECENT ECONOMIC DEVELOPMENTS

1.1. Global Economic Performance

- 1. The global economy has shown resilience over the last three years despite the disruptions emanating from the residual effects of the Covid-19 pandemic, eruption of geopolitical tensions and extreme weather events.** Global Gross Domestic Product (GDP) growth has been steady but underwhelming over the last three years. Despite projections of a slight reduction from 3.3 percent in 2023 to 3.2 percent in 2024, there is uneven performance across regions.
2. Advanced Economies are projected to continue having a steady expansion over the period at 1.7 percent in both 2023 and 2024 while emerging markets and developing economies are projected to witness a slowdown in growth from 4.4 percent in 2023 to 4.2 percent in 2024.
3. The slowdown in the emerging markets and developing economies is largely caused by a slowdown in China and India. China's growth is projected to decline from 5.2 percent in 2023 to 4.8 percent in 2024 due to a slowdown in consumption as delays in the stabilization of their property markets persist and low consumer confidence continues to be rampant.
4. India's growth is projected to decline from 8.2 percent in 2023 to 6.5 percent in 2024 due to a deceleration in industrial activity. However, in Sub-Saharan Africa, GDP is projected to increase from 3.6 percent in 2023 to 3.8 percent in 2024 as supply disruptions continue to gradually ease.
5. Global inflation rates have been reducing over the last three years supported by the easing in supply shock disruptions from Covid-19 pandemic and geopolitical tensions, tightening of monetary policy which gradually aligned aggregate demand with potential output, and normalization of the labour markets.
6. Global headline inflation reduced from 6.7 percent in 2023 to 5.8 percent in 2024 with advanced economies returning to their inflation targets faster than emerging markets and developing economies. Headline inflation in advanced economies reduced from 4.6 percent in 2023 to 2.6 percent in 2024 while that of

emerging markets and developing economies reduced from 8.1 percent in 2023 to 7.9 percent in 2024.

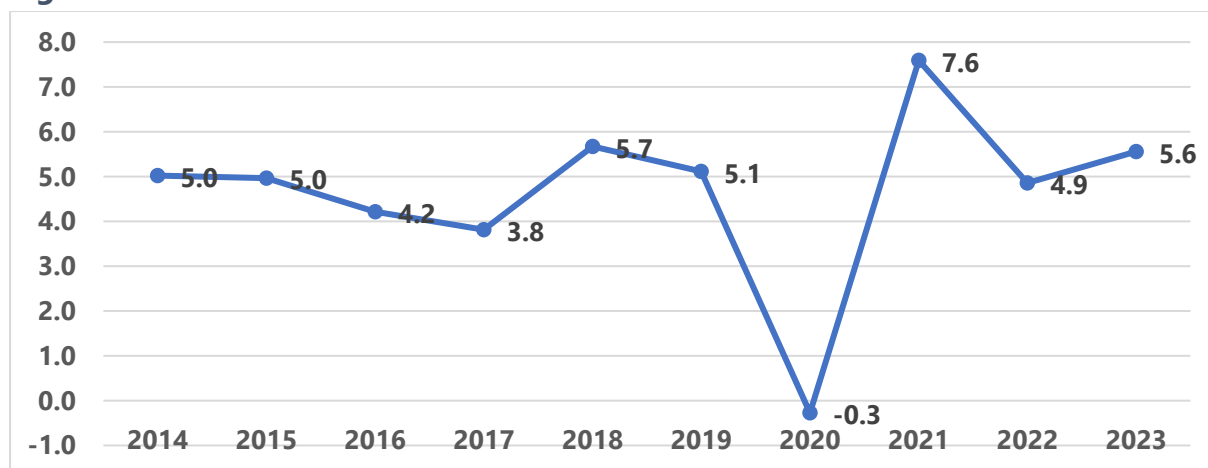
7. There is a great deal of variation in inflation across emerging markets and developing economies. Inflation levels for emerging and developing Asian economies is projected to decline from 2.4 percent in 2023 to 2.1 percent in 2024 thanks to their early and continued monetary policy tightening. In contrast, inflation in Sub-Saharan Africa is expected to increase from 17.6 percent in 2023 to 18.1 percent in 2024 mainly on account of lingering effects of past currency depreciations and adverse weather conditions that have disrupted agricultural production.

1.2. Economic Growth

1.2.1 Macroeconomic Diagnostics for the Past Decade

8. **During the decade leading up to 2023, Kenya's economic growth, averaging 4.7 percent, was influenced by several factors, both domestic and global.** The implementation of strategic interventions like the Big Four Agenda (focused on manufacturing, universal healthcare, affordable housing, and food security) and the Medium-Term Plans (MTPs) II and III under Vision 2030 aimed to promote infrastructural development and industrialization. However, there were economic disruptions like the COVID-19 pandemic in 2020, which impacted global supply chains and productivity and led to economic contractions in various sectors. Adverse weather conditions such as the severe droughts in 2017 and 2022 further strained agricultural output.
9. Private consumption has been a central growth driver, with investment in sectors like infrastructure and transport (roads, housing projects), ICT (through digitalization and tech and tech-infrastructure expansion), and agriculture (mechanization and better equipment) playing significant supportive roles. In terms of sectoral growth, the construction industry saw growth likely due to public infrastructure projects and residential housing developments. ICT, Finance, and Insurance showed promising potential as digital innovation gained traction, especially after the Covid-19 pandemic period.

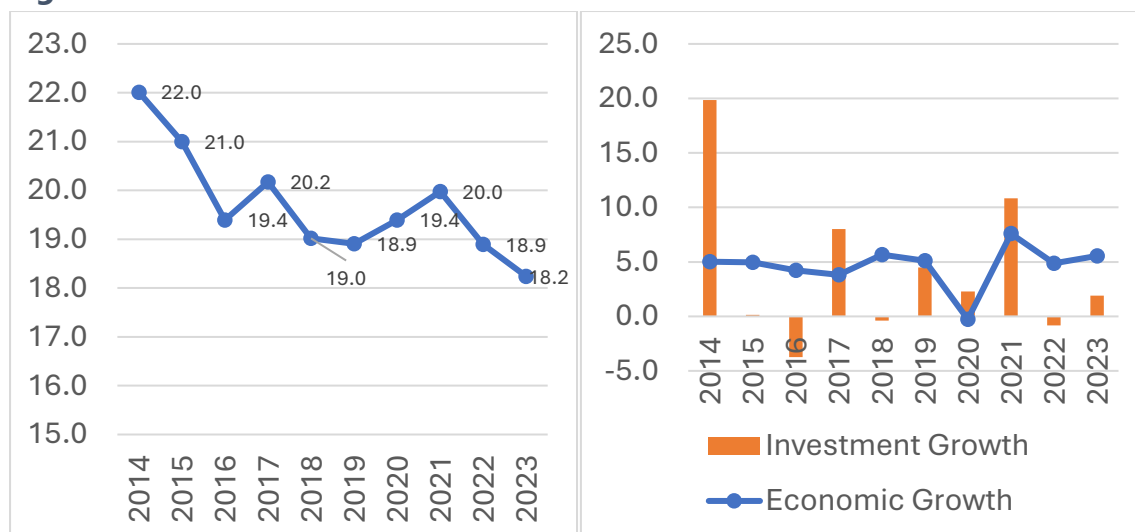
Figure 1: Real GDP Growth



Source: KNBS

- 10. Investment is a key driver of economic growth as it enhances the productivity of production factors. Total investment as a share of real GDP declined from 22 percent in 2024 to 18.2 percent by 2023. This suggests a decrease in the percentage of national income allocated towards investments over that period.**
- 11.** A lower investment rate typically means less capital being directed towards enhancing productive capacities, which might lead to slower economic growth over time. Reduced investment can impact the improvement and maintenance of infrastructure, potentially hindering long-term development projects and economic opportunities.
- 12.** The decline in investment as a share of economic output might reflect underlying factors such as changes in investor confidence, economic policy shifts, or global economic conditions that affect the domestic investment climate. Over the last decade, the slow investment growth in Kenya was occasioned by the decline in demand for Transport Equipment, Other Machinery and Equipment and ICT equipment. Investment in machinery and equipment is often linked to industrial growth and efforts to boost manufacturing capacity.

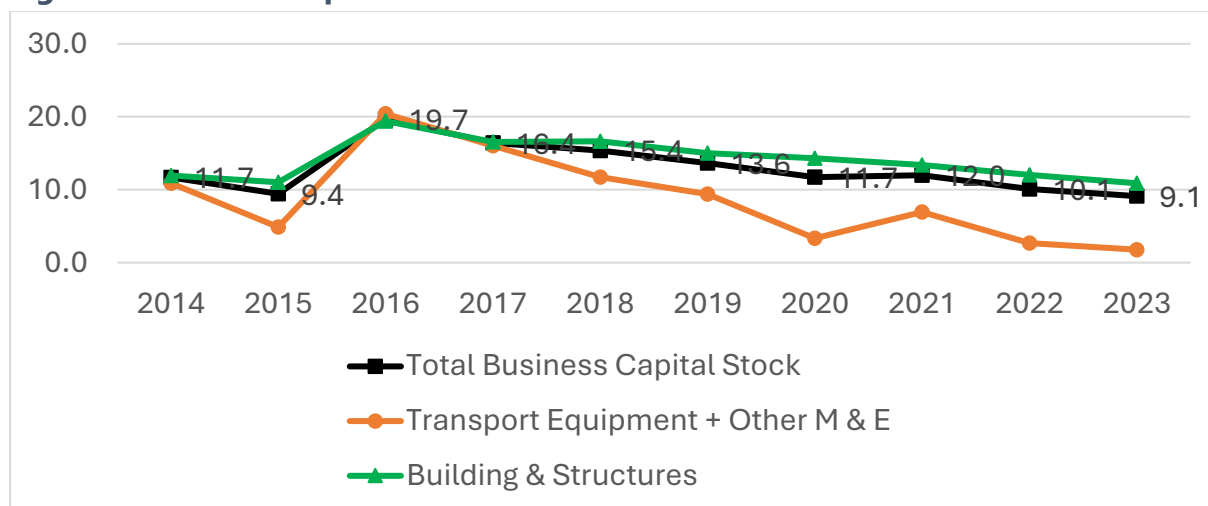
Figure 2: Investment as a share of real GDP & Growth



Source: PBO (Macroeconomic Diagnostics Model)

13. The business capital stock measures the productive capacity of physical assets such as machinery, buildings, and infrastructure, which are used to generate goods and services. The growth in business capital stock declined from 19.7 percent in 2016 to 9.1 percent in 2023, further, machinery and equipment also declined over the same period which partially contributed to the decline in the contribution of the manufacturing sector economic output.

Figure 3: Business Capital Stock Growth in Real Terms

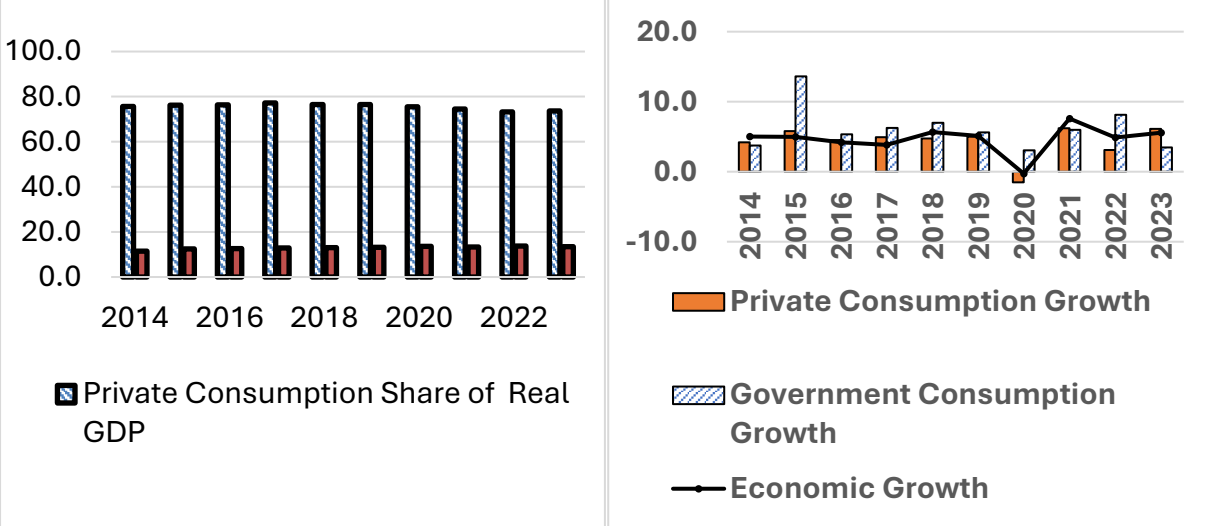


Source: PBO (Macroeconomic Diagnostics Model)

14. Private consumption was a key driver of economic growth, during the decade up to 2023. However, it declined from 77.2 percent as a share of real GDP in 2017 to 73.6 percent in 2023. This reduction highlights a decrease in

household spending's contribution to economic output. Such a decline can stem from various factors, including increased savings rates, shifts in consumer preferences, income stagnation, or an economic environment that encourages more cautious spending. The reduction in private consumption was partially attributed to a slight increase in government consumption expenditure attributed to an increase in operations and maintenance expenditures.

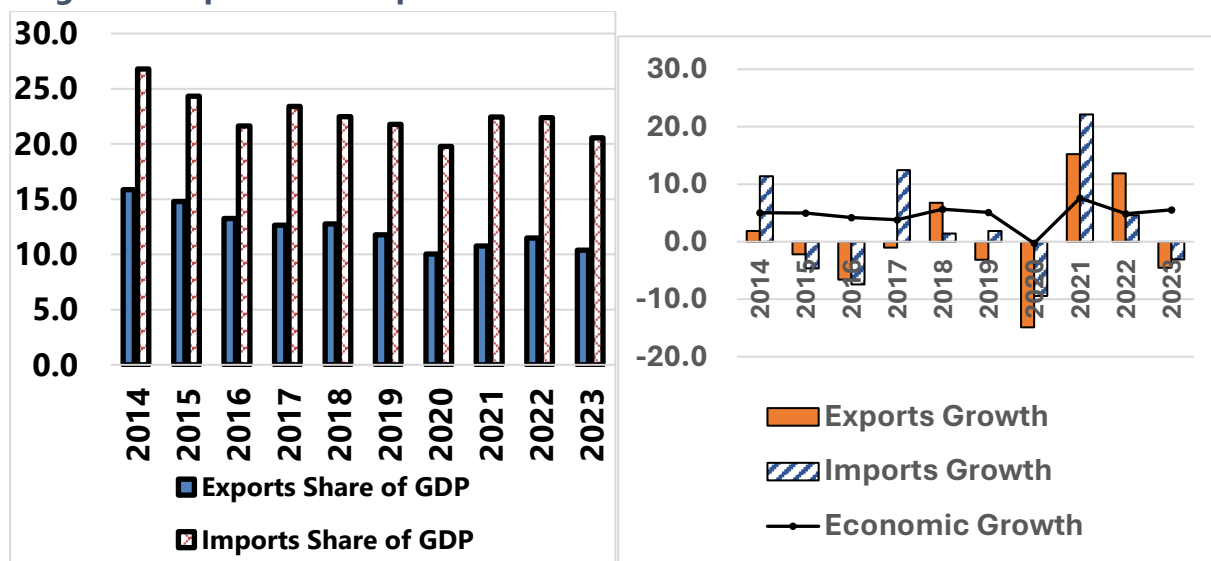
Figure 4: Consumption as a share of real GDP & Growth



Source: PBO (Macroeconomic Diagnostics Model)

15. Exports and imports as a share of real GDP had a gradual decline during the decade to 2023. Exports of goods and services as a share of GDP declined from 15.9 percent in 2014 to 10.4 percent in 2023. The decline was attributed to the relative stagnation of prices of some of Kenya’s agricultural exports and a decline in competitiveness which resulted in a shrinkage in the export of services. Imports as a share of real GDP declined from 26.8 percent to 20.6 percent over the same period. The decline was mainly driven by the reduction in the importation of machinery and transport equipment as a share of GDP.

Figure 5: Exports and Imports as a share of real GDP & Growth



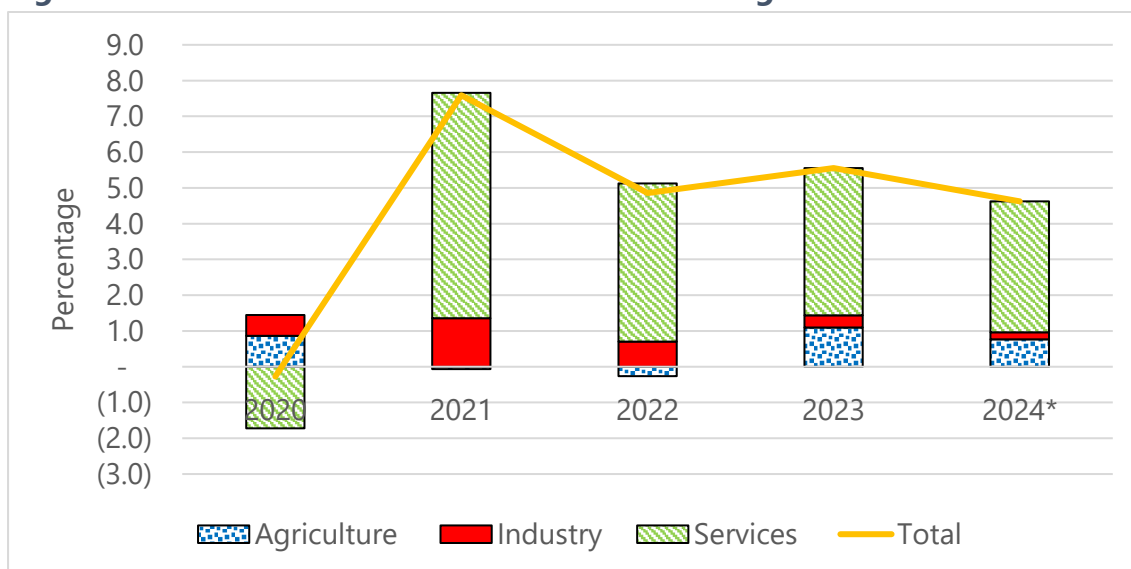
Source: PBO (Macroeconomic Diagnostics Model)

1.2.1 Sectoral Growth

16. **Actual economic growth averaged 4.6 percent in the past four years and is expected to grow at 4.6 percent in 2024 as shown in Figure 6.** The services sector has remained the dominant contributor to GDP over the past five years, averaging 64.1 percent. Its contribution was lowest in 2020 due to the impacts of the Covid-19 pandemic but has gradually recovered over the years to account for 65.6 percent of growth 2023. It is further expected to be the main driver of growth in 2024, accounting for 66.2 percent.
17. The agriculture sector, which was a significant supporter of growth during the Covid-19 pandemic, has been having a gradual decline in its contribution to GDP over the years. It has reduced from 19.5 percent in 2020 to 17.1 percent in 2023 and its contribution is expected to remain steady at 17.1 in 2024.
18. The industrial sector has also witnessed a gradual decline in GDP growth from 18.1 percent in 2020 to 17.3 percent in 2023. Its contribution is also projected to decline to 16.7 percent in 2024. The gradual increase in dependency on the services sector raises concerns about the effectiveness of recent government interventions aimed at supporting the revitalization of both the agriculture and industrial sectors.

- 19. Despite its decline in contribution to GDP, the agriculture sector growth has improved from -0.4 percent in 2021 to 6.5 percent in 2023 and is expected to grow at 4.4 percent in 2024 as shown in Table 1.** In both 2023 and 2024, growth has been driven by favourable weather conditions, albeit with less intensity in 2024, coupled with government intervention through its input subsidy programme. In both years, crop and animal production have been the significant drivers of growth while forestry and fishing have been on a decline.
- 20.** In 2023, agricultural performance was evidenced by the significant increase in production of tea, milk and exported fruits. However, there was a significant decline in the production of coffee, sugarcane and exported cut flowers. In the first three quarters of 2024, there has been a significant increase in the production of tea, milk, sugarcane and exported fruits while coffee and cut flowers are still on a decline.

Figure 6: Sector contribution to overall economic growth



Data Source: KNBS, PBO (* projections)

- 21. The performance in the industrial sector has declined from a 7.5 percent in 2021 to 1.9 percent 2023 and is expected to grow at 1.2 percent in 2024.** There has been a general decline in all its sub-sectors with growth in manufacturing declining from 7.3 percent in 2021 to 2.0 percent in 2023 but expected to recover slightly to 2.4 percent in 2024. The recovery is mainly due to a rebound of food manufacturing in the first three quarters while non-food manufacturing including cement production declined. The decline in growth for

construction is expected to continue in 2024 and this is attributed to the high cost of inputs including cement, iron and steel.

Table 1: Real GDP Growth Rates per Sector

Sector (Sub-Sector)	2020	2021	2022	2023	2024*
	Percentage changes				
Agriculture Sector	4.6	-0.4	-1.5	6.5	4.5
Agriculture, forestry and fishing	4.6	-0.4	-1.5	6.5	4.5
Industrial Sector	3.3	7.5	3.9	1.9	1.2
Mining and quarrying	5.5	18.0	9.3	-6.5	-5.8
Manufacturing	-0.3	7.3	2.6	2.0	2.4
Electricity supply	-0.5	5.3	5.7	2.9	1.8
Water supply	3.6	6.3	5.0	2.5	2.1
Construction	10.1	6.7	4.1	3.0	0.4
Services Sector	-2.7	10.1	6.9	6.3	5.6
Wholesale and retail trade	-0.4	8.0	3.5	2.7	4.5
Transport and storage	-8.0	7.4	5.8	6.2	4.1
Accommodation and food service activities	-47.7	52.6	26.8	33.6	20.7
Information and communication	6.0	6.1	9.0	9.3	7.1
Financial and insurance activities	5.9	11.5	12.0	10.1	6.6
Real estate	4.1	6.7	4.5	7.3	6.0
Professional, scientific and technical activities	-11.5	7.9	5.3	8.6	6.9
Administrative and support service activities	-17.6	5.6	18.0	11.1	7.2
Public administration and defence	7.0	6.0	5.1	4.6	5.6
Education	-9.2	22.8	5.2	3.1	4.1
Human health and social work activities	5.6	8.9	3.4	4.9	5.3
Arts, entertainment and recreation	-28.3	12.4	18.4	14.0	4.6
Other service activities	-19.5	18.9	7.1	3.6	2.7
Activities of households as employers;	1.5	1.5	1.5	1.5	1.2
Financial Intermediation Services Indirectly Measured (FISIM)	-1.8	5.3	0.2	2.7	3.7

Data Source: KNBS, PBO (* projections)

22. The services sector has also experienced a decline in its growth from 10.1 percent in 2021 to 6.3 percent in 2023 and is expected to grow at 5.6 percent in 2024. There has been mixed performance across its sub-sector with some like wholesale & retail, transport & storage, accommodation & food services and financial & insurance services having sustained a decline in growth between 2021 and 2023 and a further decline projected for 2024. On the other hand,

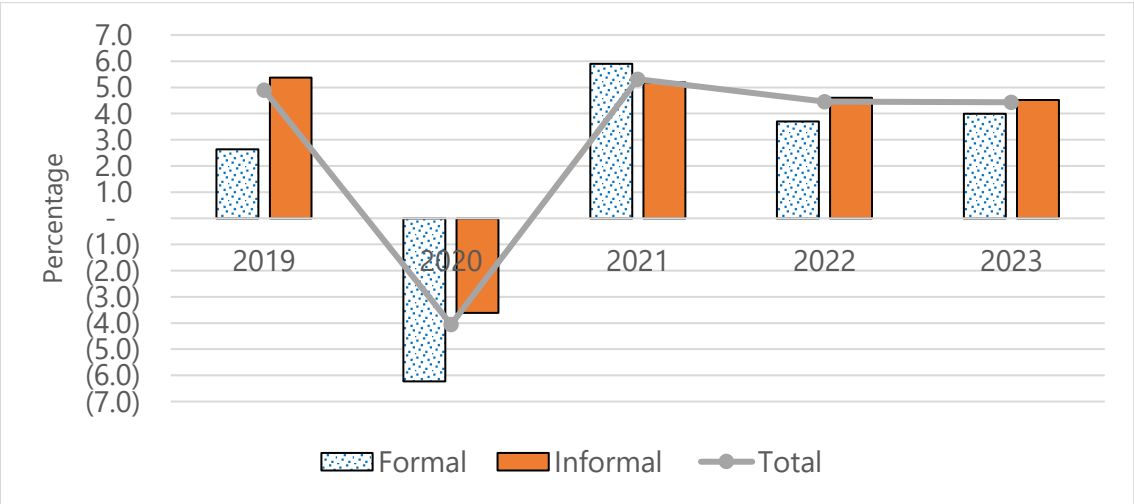
information & communication, real estate, professional activities, and administrative activities have had a gradual increase in their growth between 2021 and 2023 but are also projected to decline in 2024.

1.3. Employment and Productivity

1.3.1 Employment

- 23. **As of 2023, total employment stood at 20 million with the informal sector employing 16.7 million while the formal sector employed 3.3 million.** Most informal employees are in wholesale & retail (9.7 million), manufacturing (3.4 million) and community social & personal services (2 million). On the other hand, the total number of formal employees comprised 2.1 million (65 percent) working in the private sector, 993,000 (30 percent) working in the public sector and 172,000 (5 percent) were self-employed.
- 24. Within the private sector, the industries with the largest number of employees include manufacturing, (340,6000, agriculture, forestry & fishing (302,400) and wholesale & retail trade (270,700). While in the public sector, the industries with the largest number of employees include education (445,400) and public administration & defence (343,900).
- 25. **Total employment grew at an average annual growth rate of around 3 percent over the last five years.** Specifically informal employment grew at an average annual rate of 3.2 percent while formal employment grew at an average annual rate of 2.0 percent as shown in Figure 7.

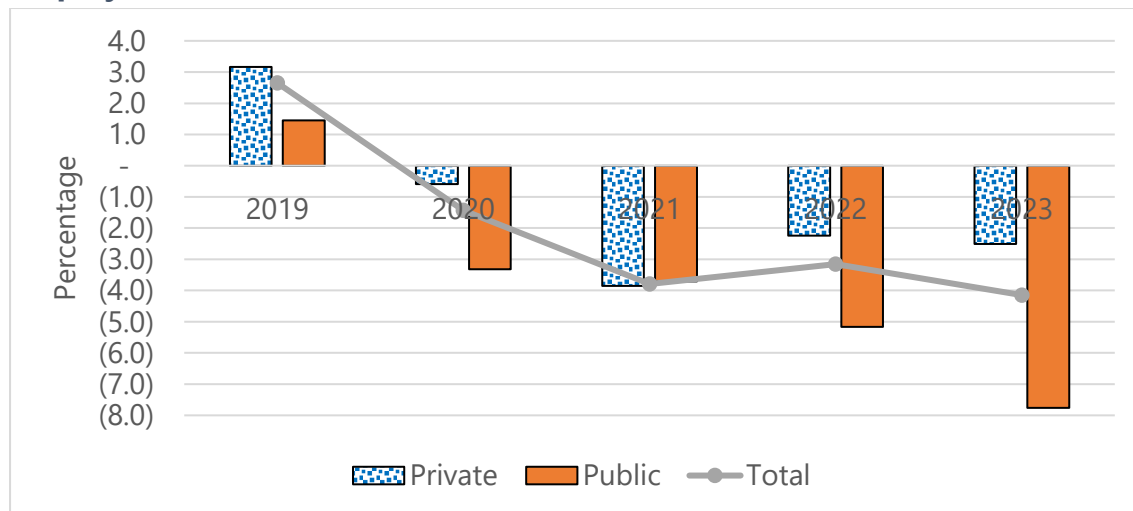
Figure 7: Growth rate of employment in formal and informal sectors



Source: KNBS, PBO

26. Between 2019 and 2023, the country's total employment increased by 1.9 million with the informal sector contributing 1.6 million new jobs while the formal sector contributed 220,000 new jobs. The new jobs in the informal sector were created in the wholesale and retail trade (572,400), community social & personal services (534,900) and manufacturing (354,200). Out of the new jobs in the formal sector, the private sector created 82,000 new jobs, the public sector created 128,000 and the country recorded 10,000 new self-employed persons.
27. Within the private sector, the industries that created the greatest number of new jobs include accommodation and food services (15,800), information and communication (15,200), construction (13,600) and manufacturing industry (11,600). Likewise, in the public sector, the industries that created the highest number of new jobs include education (76,300), public administration & defence (39,300) and human health & social work activities (10,700).
28. **There has been a consecutive negative annual change in real wages per employee in the formal sector since 2020, signifying a reduction in purchasing power for individuals.** Between 2020 and 2023, the combined real wages for both the private and public sectors decreased by -10.7 percent with the highest declines witnessed in 2021 (-3.8 percent) and 2023 (-4.1 percent) as shown in Figure 8.
29. The real wages of public sector employees have decreased more than their private sector counterparts over the past couple of years. Annual average real wages in the private sector reduced from Kshs. 749,112 in 2020 to Kshs. 686,451 in 2023, a reduction of 8.4 percent while that of the public sector real wages reduced from Kshs. 743,063 in 2020 to Kshs. 625,870 in 2023, a reduction of 15.8 percent.

Figure 8: Growth of real average annual wage earnings per formal sector employee



Source: KNBS

1.3.2 Total Factor Productivity and Labour Force Participation Rate

30. The growth in total factor productivity (TFP)¹ for Kenya significantly improved from -5.6 percent in 2014 to 1.6 percent in 2023. This indicates a major positive shift in Kenya's economic efficiency and the overall productivity of its factors of production, such as labour and capital. Labour productivity in Kenya, like in many other economies, is an important indicator of economic performance and development.

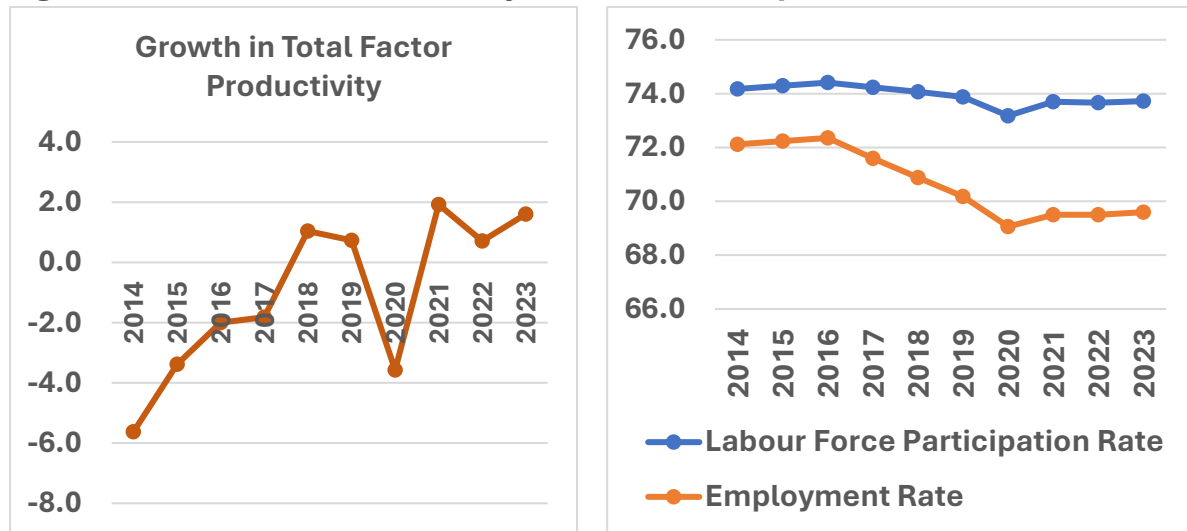
31. Over recent years, the focus has been on improving various factors that contribute to labour productivity, including education and skills development, infrastructure improvements, and technological advancements. Improving access to quality education and skills training can enhance the capabilities of the workforce, leading to higher productivity.

32. Supportive government policies, stable macroeconomic conditions, and a conducive business environment can promote productivity growth. Better infrastructure, such as roads, communication networks, and energy supply, can reduce transaction costs and enhance productivity. Encouraging both domestic

¹ An increase in TFP indicates that an economy can produce more output without increasing the total amount of inputs, reflecting improvements in efficiency or technological progress. Conversely, a decline in TFP suggests that the economy is using its resources less effectively. TFP is a crucial concept in economic growth theory, as it provides insight into how well an economy can enhance productivity independently of input accumulation.

and foreign investments can lead to the expansion of productive activities and the introduction of new technologies.

Figure 9: Total Factor Productivity & Labour Participation Rate



Source: PBO (Macroeconomic Diagnostics Model)

33. **The labour force participation rate in Kenya saw a marginal increase from 73.2 percent in 2014 to 73.7 percent in more recent years.** This rate measures the proportion of the working-age population that is either employed or actively seeking employment. While this is just one component of assessing labour productivity, it indicates a slight increase in the proportion of people contributing to the economy. This can be a sign of increased economic opportunities or improved job market conditions. While participation may be rising, the quality and stability of jobs matter.
34. A high participation rate does not always correlate with a proportional increase in formal employment or decent job opportunities. Rising workforce participation could also mean more people seeking work out of necessity rather than the availability of quality jobs, possibly leading to higher underemployment rates or increased reliance on the informal sector. Even with increased participation, potential skill mismatches may exist, where the education and skills of workers do not align with job market demands.
35. A growing labour force can drive economic growth if matched with job creation and productivity improvements. While the increase in labour force participation is generally a positive indicator, it needs to be accompanied by conducive policies

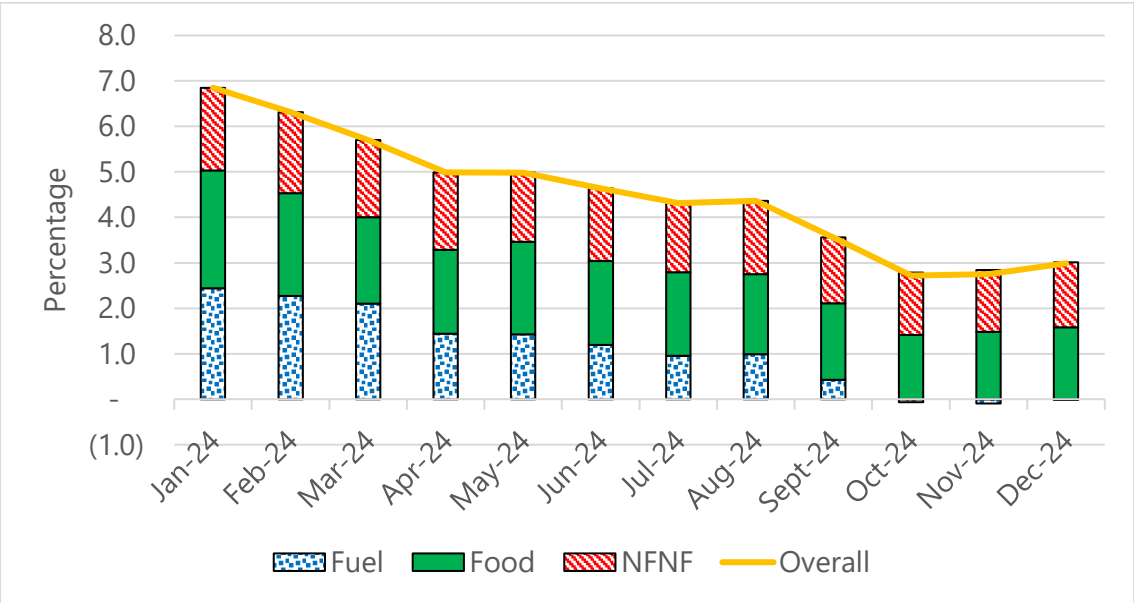
that ensure job creation, equitable labour practices, and sustainable economic development to maximize its benefits. Improving overall labour productivity requires addressing various factors, including enhancing education and skills development, adopting advanced technologies, and improving infrastructure and the business climate. These efforts aim to increase output per worker, ultimately driving economic growth and development.

1.4. Monetary Sector Development

1.4.1 Inflation

36. Kenya’s inflation has gradually been decreasing in 2024, from 6.7 percent in January 2023 to 2.7 percent in October 2024, mainly because of a reduction in prices of food and fuel. Indeed, the largest decrease has been on fuel inflation with its contribution to overall inflation being negative from October to December 2024 as shown in Figure 10.

Figure 10: Trend in Inflation and CBR



Data Source: KNBS

37. This reduction in fuel inflation has been attributed to a decrease in global fuel prices as well as the strengthening of the Kenya Shilling which contributed to a reduction in domestic fuel and electricity prices. Likewise, food inflation has been reducing over the period and this can be attributed to improved weather conditions which boosted agricultural output, and resulted in moderated food

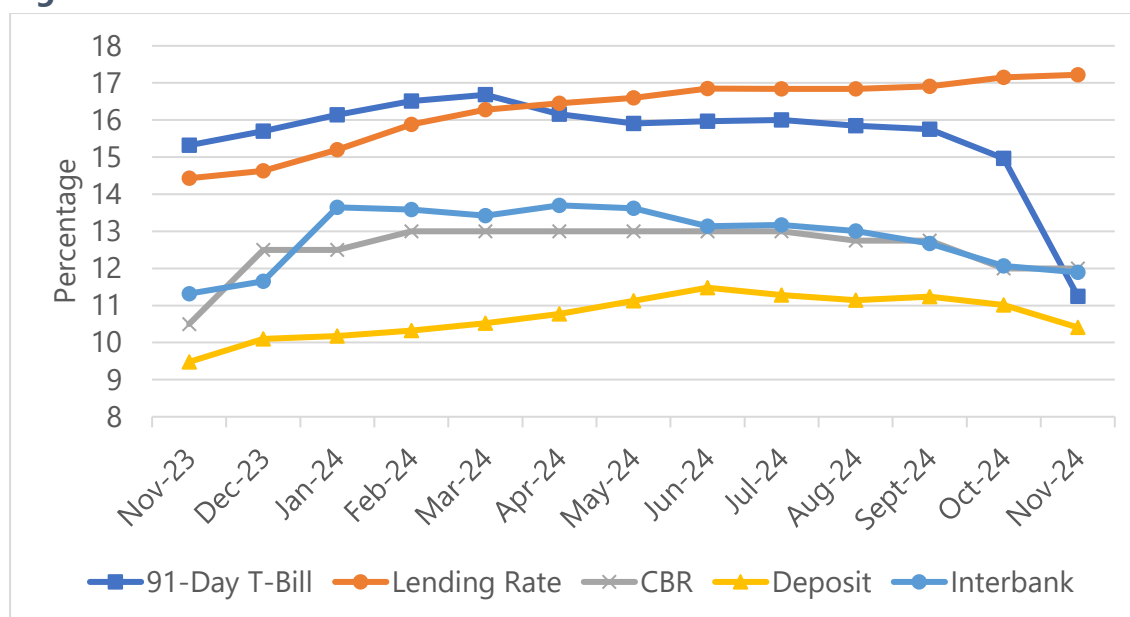
prices, while the stabilization of global commodity prices reduced external inflationary pressures. On the other hand, non-food-non-fuel (NFNF) inflations has remained steady at about 3.5 percent over the period, with a high of 3.6 percent in March 2024 and a low of 3.26 percent in October 2024.

- 38.** Despite the significant decrease witnessed in the year, there has been a slight increment in inflation rates from 2.7 percent in October 2024 to 3 percent in December 2024 owing to an increase in food inflation. Food inflation increased from 4.3 percent in October to 4.5 percent in November and 4.8 percent in December. This has been attributed to the increase in prices of non-vegetable goods including sugar, maize flour and cooking oil. This price increase has been caused by seasonal factors and higher international edible oil prices. However, the overall inflation is still below the mid-point target range of the CBK as fuel inflation is still low and NFNF has remained steady.

1.4.2 Interest Rates

- 39. Interest rates have had mixed performance in 2024 with the upward trajectory from the previous year being sustained for a few months before a significant decline was witnessed as shown in Figure 11.** The upward trajectory of interest rates had been occasioned by constrained liquidity in the domestic market as tightened global financial conditions had a negative impact on Kenya market dynamics since it depends heavily on international markets for borrowing. The situation was further exacerbated by elevated interest rates in developed economies, intensifying the risk of foreign capital outflows buoyed by fairly and relatively developed capital market in the region, thus adding to the financial pressures. This necessitated the CBK to tighten the monetary policy by increasing the CBR rate to 13 percent in February 2024 with an aim of boosting net foreign capital inflows.

Figure 11: Trend in Interest Rates



Source: CBK

40. The CBK measures, combined with the easing of global finance conditions, brought some financial relief to the country and interest rates started to come down from the second quarter of the year and the CBK subsequently reduced the CBR. Consequently, the 91-day treasury bill rate reduced from a high of 16.7 percent in March 2024 to a low of 11.3 percent in November 2024 and the interbank rate reduced from 13.7 percent in April 2024 to 11.9 percent in November 2024.

41. The average deposit rate reduced, albeit at a slower pace, from 11.5 percent in June 2024 to 10.4 percent in November 2024. However, the lending rates have not followed the same movement but have maintained an upward trajectory, increasing from 15.2 percent in January 2024 to 17.22 percent in November 2024. This has led to the undesirable gradual widening of the interest rate spread which negatively impacts the growth of the economy since it reduces availability of credit and increases financial exclusion for individuals and businesses with limited and/or hindered access to credit.

42. The gradual decline in expected inflation, which has fallen to 3.3 percent by January 2025, demonstrates the effectiveness of monetary policy actions. The Central Bank of Kenya (CBK) implemented a series of policy rate rises, raising the Central Bank Rate (CBR) from 8.75% in January 2023 to 12.5% in December 2023,

and then to 13.0% by mid-2024. The decline in inflation expectations shows that CBK's monetary policy operations were having the desired effect of slowing price increases.

43. Despite these monetary policy measures, the Kenyan economy remained below its potential, as seen by a consistent negative output gap of -0.86. This protracted underperformance relative to its potential points to underlying structural difficulties. The combination of tighter monetary policy and a negative output gap creates a difficult economic situation in which the Central Bank must strike a compromise between inflation management and the need to encourage economic growth. The CBR's decrease to 11.25% by December 2024 may signal a cautious shift towards easing interest rates as inflation pressures subside, presumably targeted at closing the persisting output gap.

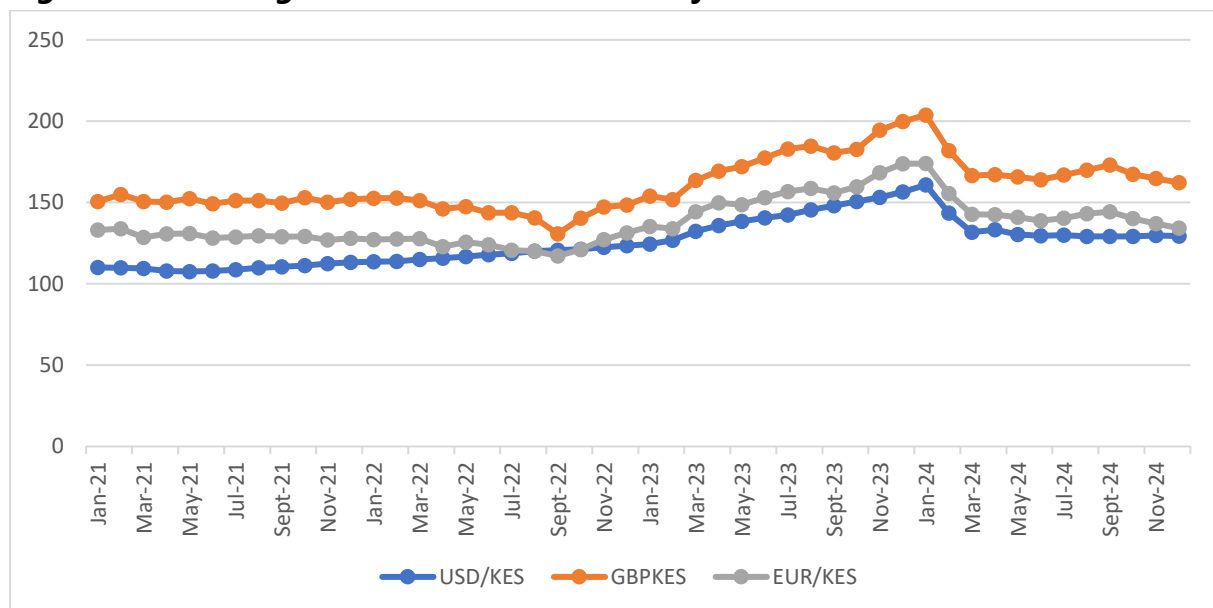
1.4.3 Exchange Rates

44. The USD/KSh exchange rate experienced notable fluctuations from 2021 to 2024, reflecting both domestic and global economic dynamics. Starting at 110.14 in January 2021, the Kenyan Shilling depreciated to 129.68 by December 2024, marking a cumulative depreciation of 17.74%. However, the most significant depreciation occurred between 2022 and January 2024, as the Shilling weakened sharply from 113.57 to a peak of 160.75, representing a depreciation of approximately 41.5%.

45. The period of rapid depreciation was driven by a combination of factors, including geopolitical tensions that elevated global commodity prices, particularly for oil and food imports, and concerns over Kenya's ability to meet its dollar denominated 2024 bullet Eurobond repayment. Investor sentiment was further dampened by political risks and the lingering effects of the 2021–2022 severe and prolonged drought situation, which had disrupted food and livestock production and increased reliance on imports. Additionally, heightened international market risks in 2022–2023, coupled with rising interest rates in advanced economies, made the USD a safe-haven currency, further contributing to the Shilling's depreciation.

- 46. The successful management of Eurobond repayment in 2024 de-risked the Kenyan economy, boosting foreign investor confidence and encouraging capital inflows.** High domestic interest rates also attracted foreign investments, while the stabilization of international commodity prices provided additional support to the Shilling. Furthermore, as global markets stabilized and central banks, including the Federal Reserve, began reducing rates in 2024, the USD weakened against several emerging currencies, including the Kenyan Shilling. This stability allowed Shilling to regain some of its lost ground, closing the year at 129.68.
- 47.** Notably, the Kenyan Shilling also depreciated against other major currencies between 2022 and 2024. From January 2022, the Shilling depreciated by 9.47% against the British Pound (GBP/KSh) and 7.75% against the Euro (EUR/KSh). These trends reflect the broader challenges facing the Shilling, including global economic instability and domestic vulnerabilities.

Figure 12: Exchange Rate Trends from January 2021 to November 2024



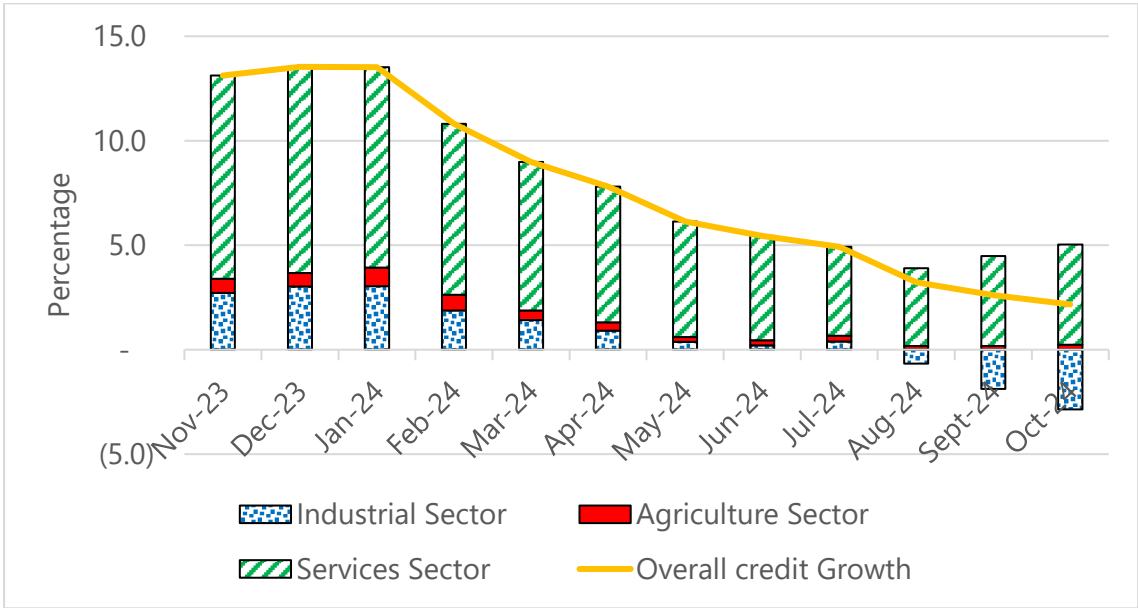
Source: CBK

1.4.4 Credit to Private Sector

- 48. There has been a decrease in the annual growth of credit to the private sector, reducing from 13.5 percent in January 2024 to 2.2 percent in October 2024 as shown in Figure 13.** The lower credit growth has impacted all sectors with the industrial sector facing a contraction since August 2024. The decline can

be attributed to the rise in interest rates and exchange rate valuation effects. Higher interest rates make borrowing more expensive for businesses and households leading to reduced demand for loans. On the other hand, the appreciation of the shilling reduced the valuation of foreign currency-denominated loans and led to a decline in their growth. Foreign currency loans make up 26 percent of total loans to the private sector and are largely concentrated in the industrial sector hence their significant contraction.

Figure 13: Contribution to overall private sector credit growth



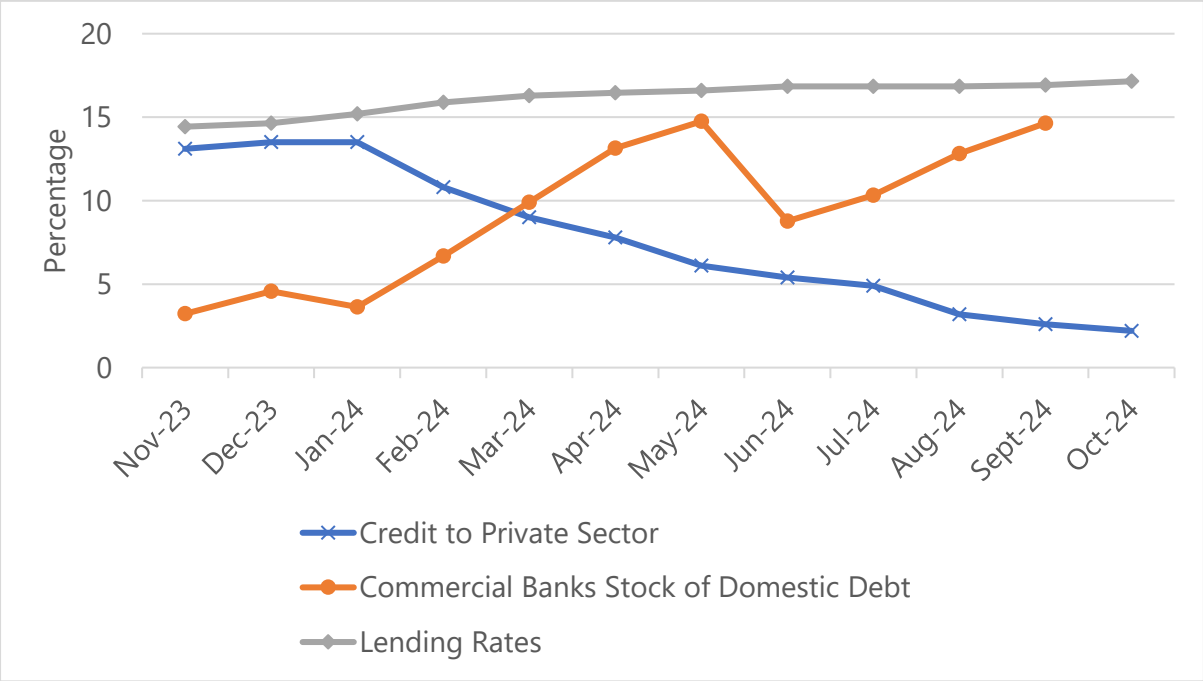
Source: CBK

49. The decline in the annual growth rate of private sector credit is seen to negatively correlate with the rise in lending rates confirming that high interest rates significantly influence uptake in the credit market. Despite the increase in lending rates at the beginning of the year being attributed to the tightening of the monetary policy, its sustained growth even after the CBR was lowered indicates that other prevalent factors influence lending rates. Elevated credit risk is seen to have been a significant contributor since Non-Performing Loans as a share of Gross Loans has increased from 15.1 percent in January 2024 to 16.5 percent in October 2024. The higher risk perception prompts banks to incorporate risk premiums in their lending rates.

50. On the other hand, the decline in credit to the private sector also negatively correlated with an increase in the annual growth of commercial bank’s stock of domestic debt. The policy stance of CBK and elevated credit risk may also

have influenced commercial banks to invest more in the less risky government securities thereby reducing available credit for the private sector. There has been a sustained increase in commercial banks investment in the government's domestic debt in 2024 cementing their position as the largest holders at 42 percent.

Figure 14: Trend in Growth of Credit to the Private Sector



Source: CBK

1.5. Fiscal Development

1.5.1 Revenue Performance

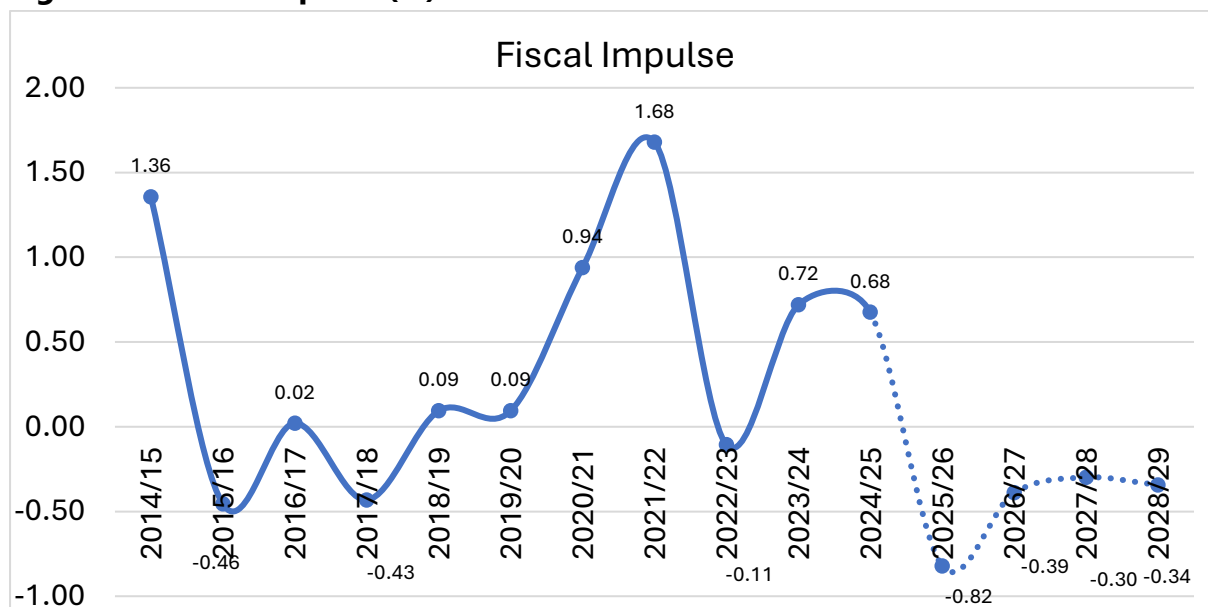
51. An expansionary fiscal policy with a positive fiscal impulse² suggests increase in government spending or cutting taxes to stimulate economic activity.

Over the period indicated in **Figure 15**, the actual fiscal policy was mostly expansionary, meaning that the government was likely spending more money during periods of natural disasters such as droughts and floods, the COVID-19 pandemic and on security programmes. Notably, fiscal impulse projections depict

² Fiscal impulse measures the change in the structural budget balance; that is, the government budget balance adjusted for the economic cycle. This helps isolate the effect of policy changes from variations caused by fluctuations in the economic cycle. (changes in the cyclically adjusted primary balance)

contractionary fiscal policy into the medium term, but these may face the challenges of moving targets occasioned by unforeseen events if mitigation measures and policies are not put in place.

Figure 15: Fiscal Impulse (%)



Source: PBO (Macroeconomic Diagnostics Model)

1.5.2 Revenue Performance

52. Both Total Revenue and Grants as a share of GDP have been reducing gradually since FY 2021/22 indicating that the government’s efforts to enhance domestic revenue mobilization have not been effective. Total revenue as a share of GDP has reduced from 17.3 percent in FY 2021/22 to 17.1 percent in FY 2023/24 with ordinary revenue reducing from 15.1 percent to 14.5 percent while Appropriations-in-Aid (A-i-A) witnessing an increment from 2.2 percent to 2.6 percent over the same period.

53. All ordinary revenue heads have a reduction with the exception of Value Added Tax (VAT) and other revenues which have remained relatively stable over the period at 4.1 percent and 1.2 percent of GDP respectively. The revenue heads with the largest reduction include Income Tax which reduced from 6.9 percent of GDP in FY 2021/22 to 6.6 percent of GDP in FY 2023/24 and excise duty which reduced from 2 percent to 1.7 percent over the same period.

54. Owing to the challenges witnessed in enhancing revenue collection, the government has reduced its revenue target for FY 2024/25 to 16.9 percent of GDP but intends to increase its external grants to 0.3 percent of GDP. Performance in the first half of the financial year indicates the government is still below its half year and by extension the annual revenue target.
55. As of 31st December 2024, the total ordinary revenue collected amounted to Kshs. 1,160.17 billion which is equivalent to 44.1% of total revenue for the current FY 2024/25. Similarly, it had collected or disbursed about Kshs. 4 billion in external grants which is equivalent to 8 % of total budgeted grants for FY 2024/25.

Table 2: Revenue outturn for FY 2020/21 to FY 2024/25

	2020/21	2021/22	2022/23	2023/24	2024/25**
	Kshs. billions				
Total Revenue + Grants	1,949.5	2,230.8	2,383.6	2,724.7	3,112.3
Total Revenue	1,892.6	2,199.8	2,360.5	2,702.7	3,060.0
Ordinary Revenue	1,633.8	1,917.9	2,041.1	2,288.9	2,631.4
<i>Income Tax</i>	685.0	876.7	941.6	1,043.1	1,180.3
VAT	481.6	523.1	550.4	645.5	723.8
<i>Import Duty</i>	106.8	118.3	130.1	133.9	160.0
<i>Excise Duty</i>	241.4	252.1	264.5	276.7	324.8
<i>Other Revenues</i>	119.0	147.7	154.5	189.7	242.5
A-i-A	258.9	281.9	319.4	413.7	428.6
Grants	56.8	31.0	23.1	22.0	52.3
	Percentage of GDP				
Total Revenue + Grants	17.3	17.6	16.7	17.2	17.2
Total Revenue	16.8	17.3	16.5	17.1	16.9
Ordinary Revenue	14.5	15.1	14.3	14.5	14.6
<i>Income Tax</i>	6.1	6.9	6.6	6.6	6.5
VAT	4.3	4.1	3.8	4.1	4.0
<i>Import Duty</i>	0.9	0.9	0.9	0.8	0.9
<i>Excise Duty</i>	2.1	2.0	1.8	1.7	1.8
<i>Other Revenues</i>	1.1	1.2	1.1	1.2	1.3
A-i-A	2.3	2.2	2.2	2.6	2.4
Grants	0.5	0.2	0.2	0.1	0.3

Source: National Treasury

**** Supplementary 1.**

1.5.3 Expenditure Performance

56. The government has been able to reprioritize and rationalize expenditures leading to a contraction in overall expenditure and net lending from 24.6 percent in FY 2020/21 to 22.4 percent in FY 2034/24. Recurrent expenditure as a share of GDP decreased from 16.7 percent in FY 2021/22 to 16.6 percent in FY 2023/24. Under recurrent expenditure, wages and salaries witnessed the largest reduction from 4.1 percent of GDP in FY 2021/22 to 3.6 percent of GDP in FY 2023/24 while Operations & Maintenance (O&M) reduced from 6.8 percent of GDP to 6.5 percent of GDP over the same period. However, there was an increment in expenditure on interest payments which increased from 4.5 percent of GDP in FY 2021/22 to 5.2 percent of GDP in FY 2023/24. On the other hand, development & net lending reduced from 4.2 percent to 3.4 percent and transfers to county governments reduced from 2.8 percent to 2.4 percent.

Table 3: Expenditure Outturn for FY 2020/21 to FY 2024/25

	2020/21	2021/22	2022/23	2023/24	2024/25**
	Kshs. billions				
Expenditure & Net Lending	2,797.4	3,027.8	3,221.0	3,605.2	3,880.8
Recurrent	1,826.7	2,135.3	2,311.6	2,678.4	2,826.2
<i>Wages and Salaries</i>	481.7	520.0	547.2	575.3	602.7
<i>Interest Payments</i>	463.1	578.0	687.3	840.7	1,009.9
<i>Pensions & Other CFS</i>	123.4	122.4	120.4	178.1	190.4
<i>O&M</i>	725.0	866.1	866.1	1,026.1	919.3
Development & Net Lending	601.5	540.1	493.7	546.4	599.5
Transfers to County Governments	596.5	540.1	493.7	546.4	451.1
	Percentage of GDP				
Expenditure & Net Lending	24.6%	23.7%	22.5%	22.4%	21.5%
Recurrent	16.1%	16.7%	16.2%	16.6%	15.7%
<i>Wages and Salaries</i>	4.2%	4.1%	3.8%	3.6%	3.3%
<i>Interest Payments</i>	4.1%	4.5%	4.8%	5.2%	5.6%
<i>Pensions & Other CFS</i>	1.1%	1.0%	0.8%	0.9%	1.1%
<i>O&M</i>	6.4%	6.8%	6.1%	6.4%	5.1%
Development & Net Lending	5.2%	4.2%	3.5%	3.4%	3.2%
Transfers to County Governments	3.2%	2.8%	2.9%	2.4%	2.5%

Source: National Treasury

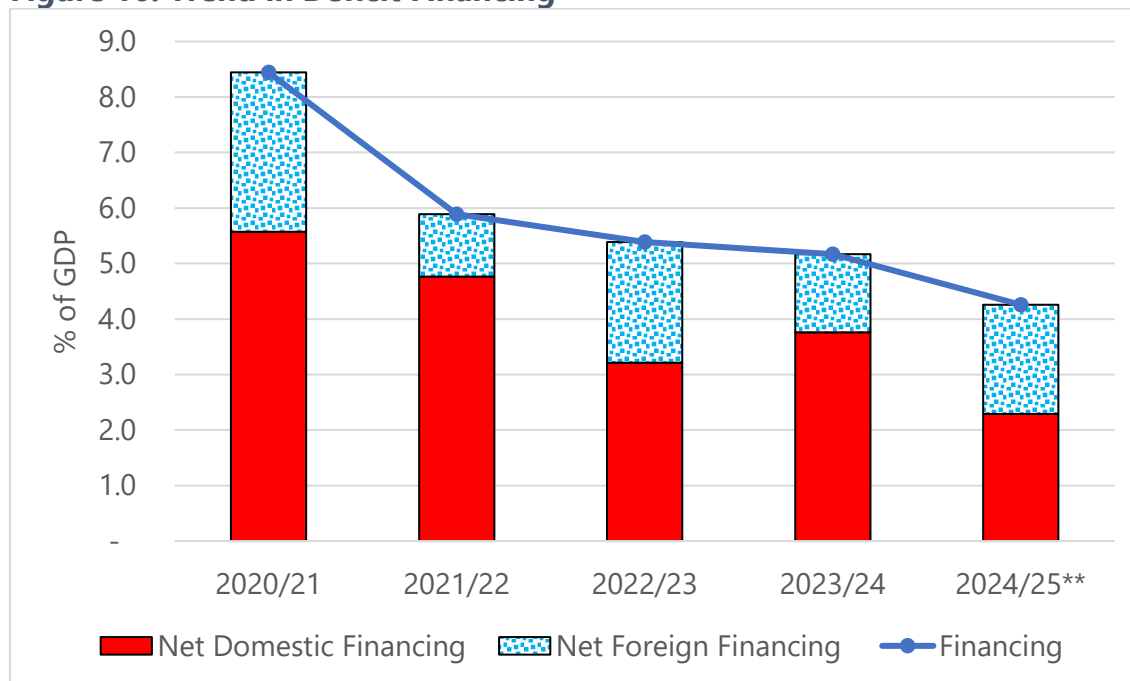
**** Supplementary 1**

57. In FY 2024/25, the government expects to continue with its expenditure rationalization policies with a target of reducing total expenditure and net lending to 21.5 percent of GDP. Performance in the first half of the financial year indicates the government has already disbursed Kshs. 654.5 billion to Ministries Department and Agencies (MDAs) as recurrent exchequer issues and Kshs. 129.8 billion to MDAs as development exchequer issues which is equivalent to 50 percent and 37 percent of the targets for FY 2024/25 respectively. It has also transferred Kshs. 191.6 billion to county governments which is equivalent to 47 percent of the target for FY 2024/25. Further, it has paid Kshs. 653.5 billion in interest payments and Kshs. 84.6 billion for pensions and other CFS expenditures which is equivalent to 34 percent and 37 percent of the targets for FY 2024/25 respectively.

1.5.4 Fiscal Deficit

58. The success of fiscal consolidation from the expenditure side has led to a gradual reduction in fiscal deficit from 8.4 percent of GDP in FY 2020/21 to 5.2 percent of GDP in FY 2023/24. Due to the declining fiscal deficit, deficit financing has reduced with net domestic borrowing witnessing the largest reduction from 5.5 percent of GDP in FY 2020/21 to 3.7 percent of GDP in FY 2023/24. Similarly, net foreign financing has reduced from 2.8 percent of GDP in FY 2020/21 to 1.4 percent of GDP in FY 2023/24.

Figure 16: Trend in Deficit Financing



Source: National Treasury

**** supplementary 1**

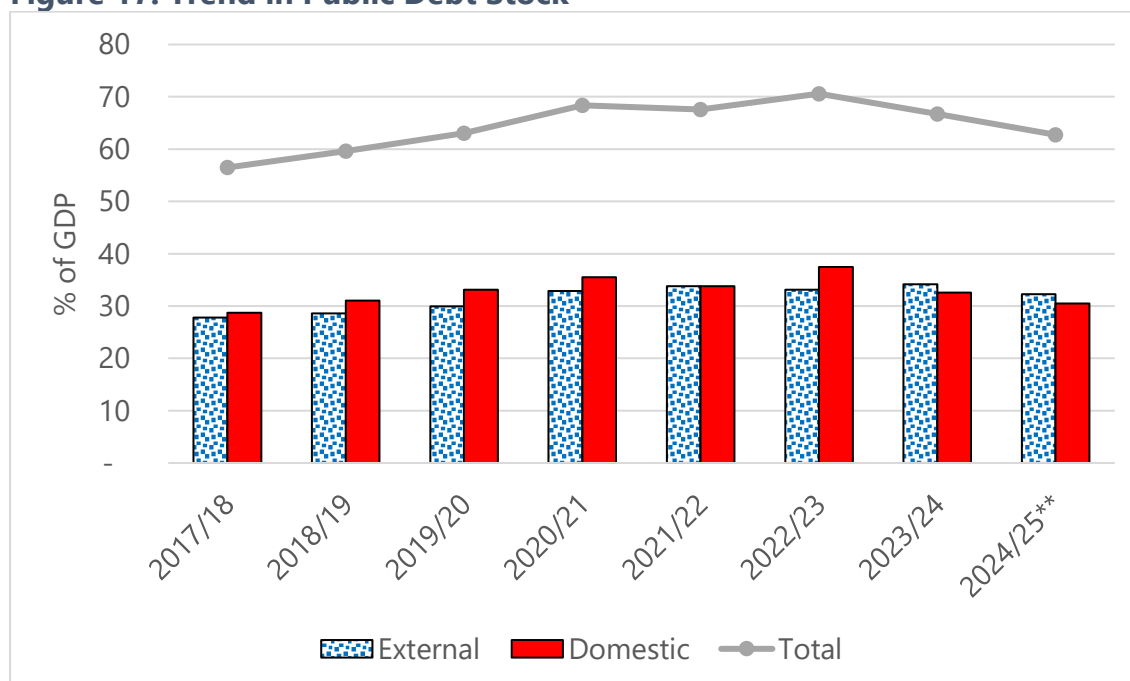
59. In FY 2024/25, the government expects the fiscal deficit to further reduce to 4.3 percent of GDP as it intensifies its fiscal consolidation efforts. It projects to have a fiscal deficit of Kshs. 768.6 billion which will be funded by net domestic borrowing amounting to Kshs. 413.1 billion, equivalent to 2.3 percent of GDP, and net foreign borrowing amounting to Kshs. 355.5 billion, equivalent to 2 percent of GDP.

1.5.5 Public Debt

60. The government’s fiscal consolidation efforts achieved in FY 2023/24 have been successful in turning the tide on the upward trajectory in the growth of public debt. The stock of public debt had been increasing annually to peak in FY 2022/23 at 71 percent of GDP in nominal terms before the government started implementing its fiscal consolidation efforts to try to tame the ballooning debt. FY 2023/24 was the first time since FY 2011/12 that the country witnessed a reduction in the stock of public debt as a share of GDP. The reduction was largely on domestic debt which reduced from 37 percent of GDP in FY 2022/23 to 33 percent of GDP in FY 2023/24 while external debt increased from 33 percent of GDP to 34 percent of GDP over the same period.

- 61.** In FY 2024/25, the government expects that through the implementation of its fiscal consolidation efforts, the stock of public debt will further reduce to 63 percent of GDP in nominal terms. Both domestic and external debts are expected to reduce to 30 percent of GDP and 32 percent of GDP respectively.
- 62. A notable concern is the increasing accumulation of non-disbursed committed loans.** By June 2024, Kenya had contracted but not yet disbursed debt totalling Kshs. 1.38 trillion, resulting in approximately Kshs. 1.583 billion in commitment fees. Between June 2016 and June 2024, the country cumulatively incurred a total of Kshs. 18.9 billion in commitment fees for undisbursed loans, underscoring the financial burden of underutilized borrowed funds.
- 63.** The delays in the disbursement of loans defer the expected economic and social gains of the planned projects or programs. Given the developmental importance of these loans, particularly concessional ones from the World Bank with favourable terms such as low interest rates and extended grace periods, it is critical to ensure their timely utilization to avoid unnecessary commitment fees.

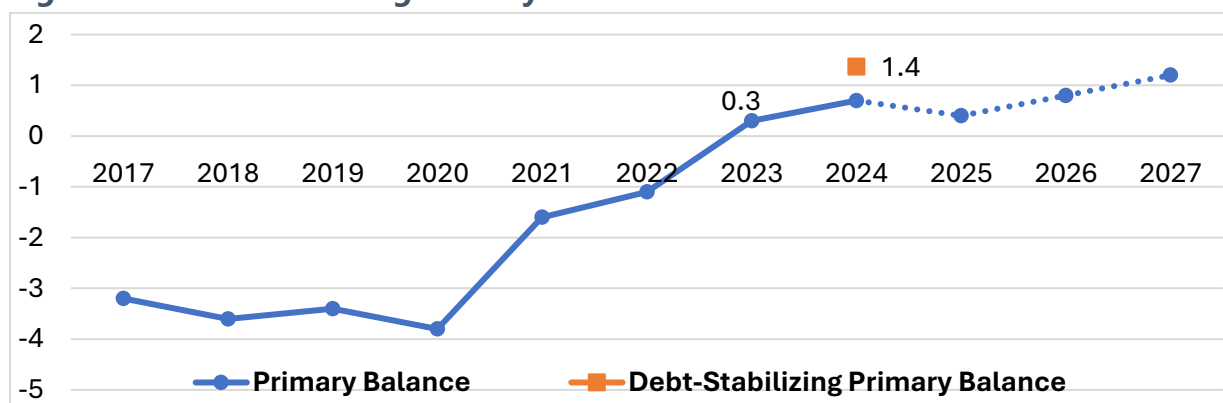
Figure 17: Trend in Public Debt Stock



Source: National Treasury

64. The debt-stabilizing primary balance³ of 1.4 percent of GDP is required to maintain the 2024 debt-to-GDP ratio into 2025. This means that for the debt ratio to remain stable, the government needs to achieve a primary budget surplus equivalent to 1.4 percent of GDP. Therefore, the projected primary balance for 2025 of 0.4 percent of GDP is less than what is needed to stabilize the debt-to-GDP ratio.

Figure 18: Debt-Stabilizing Primary Balance



Source: PBO (Macroeconomic Diagnostics Model)

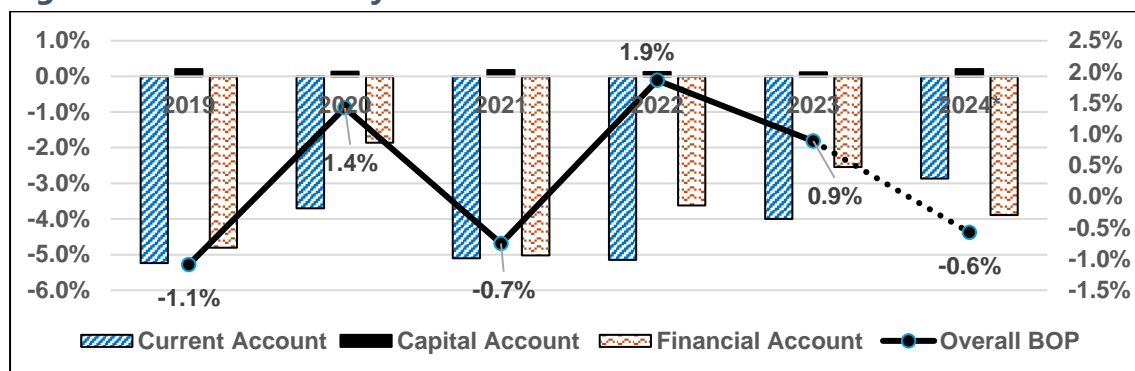
1.6. External Sector

65. **The balance of payments improved from a deficit of -1.1 percent as a share of GDP in 2019 to a surplus of 0.9 percent in 2023.** The improvement in the BOP in 2023 was on account of improvement in the current, capital and financial accounts. The improvement in the current account was attributed largely to the growth in diaspora remittances. The capital account saw improvement primarily from an increase in direct investments into the country. The financial account improved on account of financial flows from increased portfolio investments, changes in loans or international debt positions, and financial derivatives.
66. **By the third quarter of 2024, the BOP shifted back to a deficit of -0.4 percent.** This suggests that although there was a surplus in 2023, some underlying factors such as reduced capital inflows reversed the positive trend observed in 2023, while there was an improvement in the current account majorly as a result of growth in exports, declining growth of imports, and increased diaspora remittances.

³ This is the primary fiscal balance required to keep the debt-to-GDP ratio constant, meaning that the debt grows at the same rate as GDP.

67. Geographically, exports to various regions changed only marginally in the third quarter of 2024 compared to the third quarter of 2023. Exports to EAC increased by 1 percent and declined by 4 percent in the COMESA region. Exports to the EU declined by 2 percent and to Far East Asia exports declined by 6 percent. Kenya is pursuing trade agreements such as the Kenya EU EPA and the AfCFTA with the aim of improving its international trade prospects majorly targeting export growth.

Figure 19: Balance of Payment as a share of GDP



Data Source: KNBS

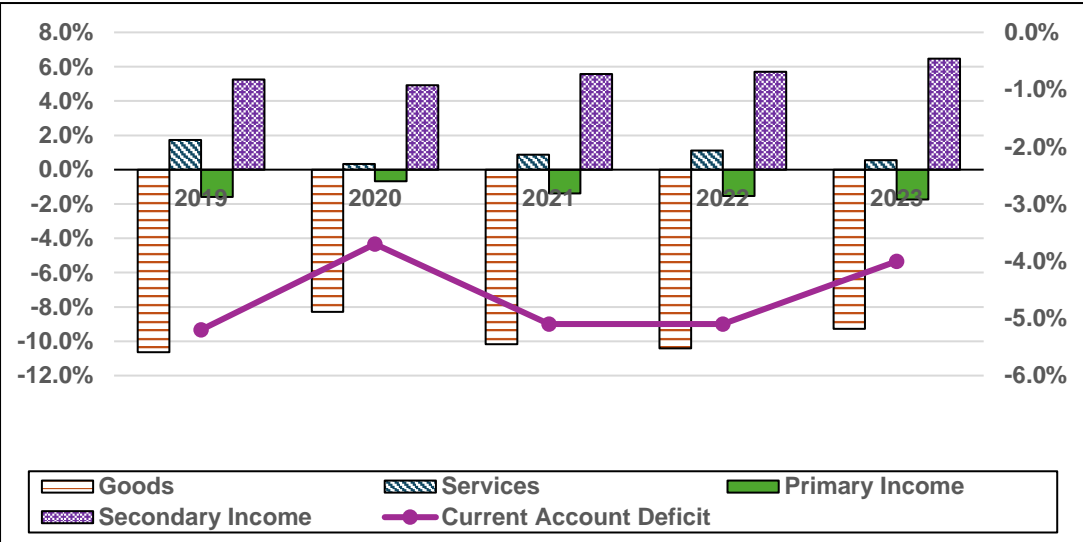
68. **The current account deficit as a share of GDP narrowed from -5.2 percent in 2019 to -4.0 percent in 2023, mainly driven by the significant rise in remittances, despite challenges such as a reduced surplus in services and a worsening primary income deficit.** The deficit narrowed majorly on account of an improvement in the secondary income driven by diaspora remittances which grew by 23.6 percent in 2023 compared to a growth of 5.0 percent in 2019, bolstering the country's foreign income and reducing the current account deficit.

69. The balance on goods remained relatively steady with a slight decline from -10.6 percent to 9.3 percent during the same period. The services surplus declined on account of growth in the importation of services and a decline in exports of services. There was a worsening in the deficit in the primary income account over the period. The primary income account typically includes cross-border inflows and outflows of income, such as interest, dividends, and profits from foreign investments.

70. **More recently, the capital account declined by 60.4 percent and the financial account improved from a deficit of Kshs. 1.1 billion to a surplus of Kshs.**

62.9 billion in the third quarter of 2024 compared to the third quarter of 2023. This indicates a growth in net financial inflows compared to the outflows previously recorded. Additionally, gross official reserves declined slightly by 0.4 percent. As a result, the overall balance changed from a surplus of Kshs. 131.4 billion to a deficit of Kshs. 17.7 billion majorly as a result of moderate changes in reserves which finance the balance of payments.

Figure 20: Current account balance as a share of GDP

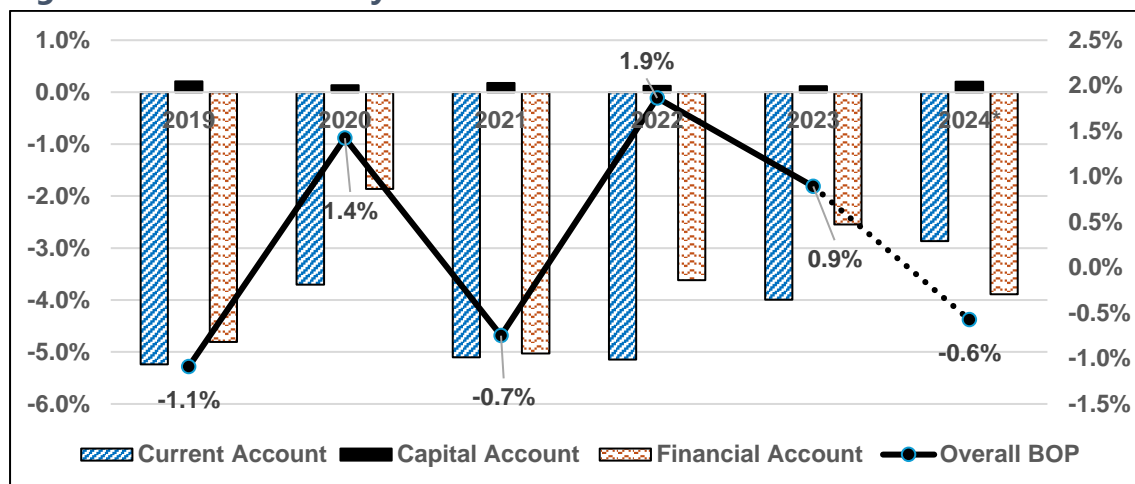


Data Source: KNBS

71. The balance of payments improved from a deficit of -1.1 percent in 2019 to a surplus of 0.9 percent in 2023. The improvement in the BOP in 2023 was on account of improvement in the current, capital and financial accounts. The improvement in the current account was attributed largely to the growth in diaspora remittances. The capital account saw improvement primarily from an

increase in direct investments into the country. This indicates heightened investor confidence and an influx of foreign capital aimed at long-term investment within the country. The financial account improved on account of financial flows from increased portfolio investments, changes in loans or international debt positions, and financial derivatives.

Figure 21: Balance of Payment as a share of GDP



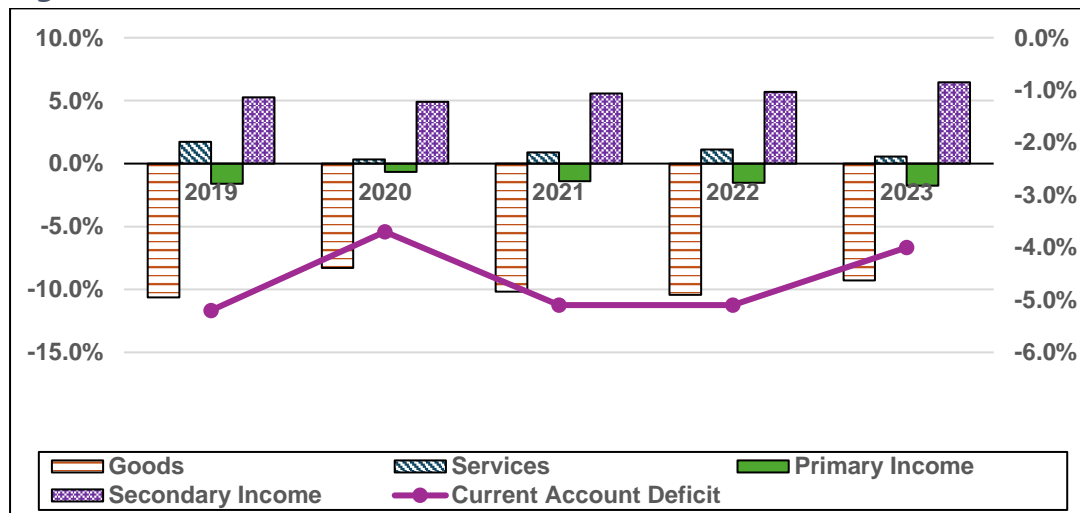
Data Source: KNBS

72. By the first half of 2024, the BOP shifted back to a deficit of -0.6 percent.

This suggests that although there was a surplus in 2023, some underlying factors such as reduced capital inflows reversed the positive trend observed in 2023, while there was an improvement in the current account majorly as a result of growth in exports, declining growth of imports, and increased diaspora remittances. Notably, geographically, exports to various regions changed only marginally. Exports to EAC increased by 1 percent and declined by 3 percent in the COMESA region. Exports to the EU declined by 9 percent and in Far East Asia exports declined by 4 percent. Kenya is pursuing trade agreements such as the Kenya EU EPA and the AfCFTA with the aim of improving its international trade prospects majorly targeting exports growth. The expectation is a further growth in exportation within Africa and in the EU. Exports growth targeting trade agreements is likely to further narrow the balance of trade deficit however, importation is also likely to grow from partner countries. Notably, if diversification of exports from Kenya is pursued, it will likely increase export earnings as the overreliance on primary agricultural commodity exports reduces. The stability of the Kenyan shilling is also likely to boost foreign exchange reserves however, external debt servicing concerns remain a risk.

73. The current account deficit as a share of GDP narrowed from -5.2 percent in 2019 to -4.0 percent in 2023, mainly driven by the significant rise in remittances, despite challenges such as a reduced surplus in services and a worsening primary income deficit. This indicates an improvement in the country's external balance, which reflects an overall better position in international trade, services, income, and transfers. The deficit narrowed majorly on account of an improvement in the secondary income driven by diaspora remittances which grew by 23.6 percent in 2023 compared to a growth of 5.0 percent in 2019, bolstering the country's foreign income and reducing the current account deficit. The balance on goods remained relatively steady with a slight decline from -10.6 percent to 9.3 percent during the same period. The services surplus declined on account of growth in importation of services and a decline in exports of services. With rising imports of services and diminishing exports, the services account no longer contributed as strongly to the overall current account balance as it might have earlier. There was a worsening in the deficit in the primary income account over the period. The primary income account typically includes cross-border inflows and outflows of income, such as interest, dividends, and profits from foreign investments.

Figure 22: Current account balance as a share of GDP



Data Source: KNBS

74. More recently, the capital account grew by 64.4 percent and the surplus in the financial account declined by 40 percent in the second quarter of 2024 compared to the second quarter of 2023. Gross official reserves declined by 45 percent from Kshs. 152 billion to Kshs. 84 billion to finance the overall balance.

Notably, the overall balance declined from a deficit Kshs. 152 billion to 84 billion. Additionally, the deterioration of the financial account and consequently the gross reserves was partly attributed to external debt repayment.

II. MEDIUM-TERM ECONOMIC OUTLOOK

2.1. Macroeconomic Outlook

1. **Assuming no policy change, GDP growth is expected to pick up over the medium term, with a projection of 5.1 percent in FY 2025/26, 5.2 percent in FY 2026/27 and 5.2 percent in FY 2027/28.** This will mainly be supported by growth in the services with promotion of high-profile international conferences and various forms of tourism is expected to catalyze growth in the hospitality and transport sub-sectors.
2. The industrial sector will improve slightly with the easing exchange rate pressures and expected growth in private sector credit and lending rates are expected to reduce over the medium term. Continued investment by the government in productive-enhancing interventions will support agriculture productivity, but it is expected to be slower than growth in FY 2024/25 as weather conditions are projected to worsen in FY 2025/26 as scientists anticipate La Nina conditions to be sustained in 2025.

Table 4: GDP Projections for Baseline Forecasts

	2024/25	2025/26	2026/27	2027/28
Real GDP growth (%)	4.7	5.1	5.2	5.2
CPI index (Average)	4.6	4.8	5.1	5.2
Broad Money M3	9.8	10.1	10.6	10.4
Investment % of GDP	16.2	16.6	16.7	16.8
O/W Central Government	3.9	4.3	4.3	4.3
other	12.3	12.4	12.5	12.5
Savings % of GDP	12.6	12.8	12.6	12.4
Current account % of GDP	-3.7	-3.9	-4.1	-4.5
Agriculture (% growth)	3.4	3.0	3.0	3.4
Industry (% growth)	2.4	2.6	2.6	2.5
Services (% growth)	5.6	6.0	6.1	6.1

Source: PBO

3. Assuming the government implements policies focused on job creation and productivity that are discussed in chapter three, GDP growth is expected to pick up much faster over the medium term, with a projection of 5.2 percent in FY 2025/26, 5.3 percent in FY 2026/27 and 5.2 percent in FY 2027/28. This will be

driven by growth in the industry and services sectors, with the agriculture sector also performing much better than in the baseline forecasts. Under the services sector, in addition to the promotion of international conferences and various forms of tourism, the government will focus on reforms in the ICT such as revamping the National Optic Fiber Network Backhaul Initiative (NOFBI) and enhancing connectivity by investing in constituency digital hubs. These will help boost growth in financial services, health, education, public administration and professional activities.

4. Under the industrial sector, apart from the improved macro-economic conditions, the government will investment in agro-processing especially in the leather sector and restructuring its funding to the roads, energy and water sectors to increase their efficiency and productivity. Under the agriculture sector, apart from productive-enhancing interventions, productivity is expected to improve from the revamping of the agriculture extension services, improvement of rural transport connectivity and investment in water harvesting and storage to support irrigation.

Table 5: GDP Projections for Alternative Forecasts

	2024/25	2025/26	2026/27	2027/28
	Proj.			
Real GDP growth (%)	4.8	5.2	5.3	5.2
CPI index (Average)	5.1	5.3	5.4	5.3
Broad Money M3	10.0	10.5	10.5	10.5
Investment % of GDP	16.5	16.8	16.8	16.9
O/W Central Government	4.1	4.3	4.3	4.3
other	12.4	12.5	12.5	12.6
Savings % of GDP	12.7	12.7	12.5	12.3
Current account % of GDP	-3.8	-4.0	-4.4	-4.6
Agriculture (%)	3.4	3.3	3.4	3.6
Industry (%)	2.4	3.0	3.3	3.0
Services (%)	5.7	6.1	6.2	6.0

Source: PBO (* actuals)

2.2. Fiscal Outlook

5. **Both the baseline and alternative scenarios are premised on an expansionary fiscal policy as the government tries to accelerate economic growth.** This means that revenue, expenditures and fiscal deficit are all projected to increase when compared to FY 2024/25 in both scenarios. When compared to the BROP projections for FY 2025/26, the revenue projections by the PBO are subdued while the expenditure projects are higher indicating a larger fiscal deficit in both PBO scenarios.
6. **Under the baseline scenario, the revenue collections for FY 2025/26 is projected to follow the historical trend, growing at a modest trajectory of 12 percent in line with the average revenue growth rate over the past decade.** Therefore, revenue is projected to increase from 16.9 percent of GDP in FY 2023/24 to 17.2 percent in FY 2024/25 and FY 2025/26. This implies that the total revenue including grants is projected at Kshs 3.3 trillion which is lower than the National Treasury projection on the Budget Review and Outlook Paper (BROP) of Kshs 3.5 trillion. This is partly explained by the fact that the actual revenue collection for the first half of the FY 2024/25 is below target by over Ksh. 70 billion meaning the total revenue projected for FY 2024/25 is likely to be off-target. Since the FY 2024/25 revenue target is the basis for the National Treasury projections for FY 2025/26, the PBO projects that the BROP target is unlikely to be achieved.
7. **Under the baseline scenario, the total expenditure and net lending for FY 2025/26 is projected to slightly increase to 22.9 percent of GDP from 21.5 percent of GDP in FY 2024/25.** This implies that the total expenditure and net lending will increase from Kshs. 3.9 trillion in FY 2024/25 to Kshs. 4.4 trillion in FY 2024/25 due to an increase in both recurrent and development expenditures. When compared to the BROP projections, the total expenditure only deviates from the National Treasury projections by Kshs. 50 billion with a higher projection for recurrent expenditure and a lower projection for development expenditure. Based on the projected revenues and expenditures, the fiscal deficit is projected to increase to 5.7 percent of GDP in FY 2025/26 compared to 4.3 percent of GDP in FY 2024/25. This is higher than the BROP projection due to the lower revenue projections by the PBO.

Table 6: Fiscal Framework for Baseline Forecasts

	2023/24	2024/25	2025/26 Proj.		
	Actual	Approved Budget	BROP	PBO Baseline	PBO Alternative
	Kshs. Billions				
Total Revenue & Grants	2,724.7	3,112.3	3,569.8	3,295.9	3,405.4
Total Revenue	2,702.7	3,060.0	3,516.6	3,254.0	3,363.4
Ordinary Revenue	2,288.9	2,631.4	3,018.8	2,792.2	2,900.7
<i>Income Tax</i>	1,043.1	1,180.3	1,320.7	1,274.2	1,331.2
<i>VAT</i>	645.5	723.8	820.3	779.7	790.7
<i>Import Duty</i>	133.9	160.0	201.3	182.3	176.5
<i>Excise Duty</i>	276.7	324.8	389.6	334.0	364.8
<i>Other Revenues</i>	189.7	242.5	286.9	222.0	237.3
A-i-A	413.7	428.6	497.8	461.8	462.7
Grants	22.0	52.3	53.2	41.9	42.0
Expenditure & Net Lending	3,605.2	3,880.8	4,329.3	4,379.3	4,396.2
Recurrent	2,678.4	2,826.2	3,076.9	3,188.6	3,192.1
<i>Wages and Salaries</i>	575.3	602.7	650.9	656.8	656.7
<i>Pensions & Other CFS</i>	143.9	190.4	214.8	214.8	214.8
<i>Interest Payments</i>	840.7	1,009.9	1,081.3	1,081.3	1,081.3
<i>O&M</i>	1,026.1	919.3	1,094.8*	1,121.8	1,122.0
<i>Contribution to civil servants' pension fund</i>	34.2	37.0	35.1	35.1	35.1
Development & Net Lending	546.4	599.5	804.7	743.0	756.4
Contingency Fund		4.0	5.0	5.0	5.0
Transfers to County Governments	380.4	451.1	442.7	442.7	442.7
Parliamentary service	37.3	40.9		53.6	55.9
Judicial Service	21.0	22.5		25.2	26.3
Equalization Fund		8.0	10.6	10.6	10.6
Deficit incl. Grants	(880.5)	(768.5)	(759.5)	(1,083.4)	(990.8)
	Percentage of GDP				
Total Revenue and Grants	16.9	17.2	17.9	17.2	17.7
Total Revenue	16.8	16.9	17.6	17.0	17.5
Ordinary Revenue	14.2	14.6	15.1	14.6	15.1
A-i-A	2.6	2.4	2.5	2.4	2.4
Grants	0.1	0.3	0.3	0.2	0.2
Expenditure & Net Lending	22.4	21.5	21.7	22.9	22.9
Recurrent	16.6	15.7	15.4	16.6	16.6
Development & Net Lending	3.4	3.3	4.0	3.9	3.9
Deficit excl. Grants	(5.5)	(4.3)	(3.8)	(5.7)	(5.2)
Primary Balance				(0.01)	0.5
Nominal GDP	16,106.0	18,053.7	19,971.6	19,160	19,200

Source: PBO*** includes allocations for Parliament and Judiciary**

- 8. Under the alternative scenario, the revenue collection for FY 2025/26 is projected at 17.7 percent of GDP compared to 17.2 percent in the baseline scenario.** This implies that the total revenue including grants is projected at Kshs 3.4 trillion compared to Kshs. 3.3 trillion in the baseline scenario. The enhanced revenue collection results from improved efficiency in revenue collection and higher growth projections as discussed in the previous section. Similarly, the expenditures are also projected to slightly increase by Kshs. 17 billion compared to the baseline scenario and this will mainly benefit development expenditure. Finally, the enhanced revenue will lead to a reduction in the deficit from Kshs. 1.1 trillion (5.7 percent of GDP) under the baseline scenario to Kshs. 991 billion (5.2 percent of GDP) under the alternative scenario.

2.3. Sectoral Ceilings

- 9. The sectoral ceilings for both the baseline and alternative scenarios are aligned to the attendant expenditure projections in the fiscal framework to ensure that they are in line with revenue projections and the resultant fiscal deficit.** Under the baseline scenario, the total ministerial expenditure including that of the Judiciary and Parliament, is projected at Kshs. 2.6 trillion. This consists of Kshs. 1.86 trillion for recurrent expenditure and Kshs. 743 billion for development expenditure. Under the alternative scenario, the total ministerial expenditure is projected at Kshs. 2.62 trillion, consisting of Kshs. 1.87 trillion for recurrent expenditure and Kshs. 756 billion for development expenditure. In both scenarios, the projected expenditure ceilings adhere to fiscal responsibility principles with recurrent expenditure being 70 percent while development expenditure is 30 percent of total ministerial expenditure as a share of total expenditure.
- 10. Based on the expenditure projections under the baseline scenario, the total allocation for Ministries Department and Agencies (MDAs) is projected at Kshs. 2.6 trillion comprising of Kshs. 1.9 trillion for recurrent expenditure and Kshs. 743 billion for development expenditure.** The sectors which will account for the largest share of expenditure include the Education sector with Kshs. 762 billion; Energy, Infrastructure and ICT sector with Kshs. 500 billion and Public Administration and International Relations sector with Kshs. 316 billion.

- 11. When compared to the BROP projections, the ministerial expenditure under the baseline scenario is lower by Kshs. 19 billion with the recurrent expenditure being higher by Kshs. 98 billion while the development expenditure is lower by 117 billion.** The largest difference is under the Education sector for which the PBO proposes an allocation of Kshs. 762 billion compared to the BROP proposal of Kshs. 719 billion. The difference is mainly because of the resource demand for recruitment of teachers and infrastructure development as the country rolls-out the Competency Based Curriculum (CBC), capitation for basic education institutions and allocation for Universities and Tertiary Education. Another sector with a significant difference is the Public Administration and International Relations sector for which PBO proposes an allocation of Kshs. 316 billion compared to BROP proposal of Kshs. 364 billion. The lower projection by PBO is due to the need to rationalize development expenditure in the sector and create resources for shortfalls in critical recurrent expenditure.
- 12. The expenditure projections under the alternative scenario deviate from that of the baseline scenario by Kshs. 26 billion with the recurrent expenditure being higher by Kshs. 12 billion while the development expenditure is higher by 14 billion.** The additional resources will be allocated to sectors with the highest potential for job creation and productivity. These include the Public Administration and International Relations sector which has an increment of Kshs. 10 billion to improve service delivery in the public service and the Agriculture, Rural and Urban Development Sector which has an increment of Kshs. 6 billion to support agriculture value chains as discussed in chapter 3.

Table 7: Sectoral Expenditure Ceilings for Alternative Forecasts

Sector		FY 2023/24	FY 2024/25	FY 2025/26		
		Act.	Approved Budget	BROP	PBO Baseline	PBO Alternative
		Kshs. Billions				
Agriculture, Rural & Urban Development	Sub-Total	88,998	73,933	85,210	86,720	90,252
	Rec. Gross	33,015	29,362	30,727	33,766	36,766
	Dev. Gross	55,982	44,571	54,483	52,954	53,485
Energy, Infrastructure & ICT	Sub-Total	336,692	444,290	503,585	499,924	503,526
	Rec. Gross	149,826	142,034	142,977	163,339	163,339
	Dev. Gross	186,866	302,256	360,607	336,585	340,187
General Economic & Commercial Affairs	Sub-Total	52,516	45,626	62,906	53,539	55,255
	Rec. Gross	32,150	29,866	36,127	34,627	36,343
	Dev. Gross	20,367	15,760	26,779	18,912	18,912
Health	Sub-Total	104,207	118,856	134,679	135,872	135,872
	Rec. Gross	60,194	86,828	94,876	99,853	99,853
	Dev. Gross	44,012	32,028	39,803	36,020	36,020
Education	Sub-Total	666,076	627,758	718,758	761,663	765,455
	Rec. Gross	640,957	606,679	691,330	736,368	740,161
	Dev. Gross	25,119	21,079	27,428	25,295	25,295
Governance, Justice, Law & Order	Sub-Total	241,049	231,061	267,048	276,214	279,805
	Rec. Gross	225,513	225,180	244,145	258,957	262,548
	Dev. Gross	15,536	5,881	22,903	17,257	17,257
Public Admin. & International Relations	Sub-Total	272,422	301,782	363,832	315,941	325,208
	Rec. Gross	188,387	176,440	196,902	202,906	202,906
	Dev. Gross	84,035	125,342	166,929	113,035	122,302
National Security	Sub-Total	209,535	219,312	272,023	273,023	273,023
	Rec. Gross	207,259	217,769	237,507	238,507	238,507
	Dev. Gross	2,276	1,543	34,516	34,516	34,516
Social Protection, Culture and Recreation	Sub-Total	66,476	68,943	78,399	77,646	77,646
	Rec. Gross	44,528	45,281	51,556	52,073	52,073
	Dev. Gross	21,948	23,662	26,843	25,572	25,572
Environment Protection, Water & Nat. Resources	Sub-Total	94,526	101,197	132,773	119,859	119,859
	Rec. Gross	33,813	32,152	32,681	37,005	37,005
	Dev. Gross	60,714	69,045	100,092	82,854	82,854
Total	Sub-Total	2,132,497	2,232,757	2,619,211	2,600,400	2,625,900
	Rec. Gross	1,615,642	1,591,591	1,758,827	1,857,400	1,869,500
	Dev. Gross	516,855	641,166	860,384	743,000	756,400

Source: PBO

3. SUPPORTING JOB CREATION AND PRODUCTIVITY GROWTH

3.1. Enhancing the Leather Product Value Chain

13. **Agriculture is very crucial in supporting job creation and productivity growth. According to the Agriculture Sector Survey 2023, the sector is one of the biggest employers employing approximately 40 percent of the Kenyan population and more than 70 percent of the rural population.** It also contributed on average 21.8 percent to GDP and accounted for 59 percent of total exports in 2023 (Economic Survey, 2024). It has been recording improved performance in the last few years and this is attributed to favorable climatic conditions as well as government interventions including the fertilizer subsidy. Despite previous interventions the sector is yet to be fully exploited and still has immense potential not only in ensuring food and nutritional security to all citizens but also in providing surplus for exports and supporting other sectors.

14. **The Fourth Medium Term Plan (MTP-IV) of Vision 2030 proposes to pursue a value chain approach to ensure agricultural transformation and inclusive growth.** One of the nine value chains identified is the leather and leather products value chain. Kenya has the third highest livestock population in Africa translating to an abundance of materials to be used in the leather industry. Livestock contributes 40 percent of Agriculture sector's GDP and 50 percent of employment within the sector (Kenya Market Trust, 2019). Despite this, Kenya has not transformed into an industrial leather giant due to the poor quality of hides and illegal exports of raw hides.

15. **Recognizing its potential, the objective of the MTP-IV is to boost productivity along the value chain so as to increase income from the leather industry from the current Kshs. 15 billion to Kshs. 120 billion annually and realize the goal of creating 100,000 jobs through the industry.** To achieve this, the government has been implementing a number of ongoing interventions to facilitate local processing of all hides and skins like setting up of leather cottage industries, expansion of existing tanneries, development of leather parks such as the Kenya Leather Industrial Park - Kenanie and supporting establishment of processing clusters in Isiolo, Wajir, Narok, Ewaso Ng'iro. In addition to these ongoing interventions, the government may consider the implementation of the following policy options to spur up the growth of the leather and leather products value chain:

- i) **Revitalization of Livestock feed production and conservation** - Livestock feed production and conservation is a critical element serving the dairy, leather and meat value chains through enhancing the availability and affordability of livestock feeds as well as averting feed shortages during drought. With the rising cost of production for dairy, meat and leather, it is essential for the government to facilitate and invest in livestock feed production and conservation through fodder seed multiplication and distribution, establishment of feedlots, rangeland development, provision of feed mechanization equipment, feed bulking at livestock farms, and establishment of a strategic livestock feed reserve among others. The policy intervention will entail the establishment of Feedlots centers, fodder and pasture in drought-prone areas to mitigate against the effects of drought. It will require Kshs. 715.3 million. The funding will be provided from savings from other MDAs in the national government.
- ii) **Ring-fencing County Allocations to support the Agricultural Extensions Service** - Agricultural extension services are designed to improve knowledge transfer and technology adoption among smallholder farmers. These services focus on empowering farmers with critical information on sustainable farming practices, modern techniques, and market access, contributing to a more resilient agricultural sector. Despite their importance, Kenya faces significant gaps in extension services, with only one officer per 1,500 farmers, far below the FAO's recommended ratio of 1:400. Additionally, only 25% of farmers access these services, and nearly half report dissatisfaction due to quality issues stemming from funding shortages and inadequate personnel. The MTP-IV envisaged deployment of over 7,000 extension officers across all counties, focusing on key objectives; supporting farmers in adopting modern practices, facilitating access to financial services, and promoting climate-smart techniques. The policy intervention requires a budget of Kshs. 3 billion annually to support the establishment of fully equipped extension service stations in all the 1,450 wards across the country. The funding will be ring-fenced from annual transfers to county governments and each county will be required to meet a condition of appropriating a specified amount of money annually for operationalizing the extension offices in each ward.
- iii) **Supporting Value Addition of Leather Products** - Central to the exploitation of the leather industry is the increased production of quality

raw hides and skin, processing and value addition as well as review of the existing policies. There is a need to train and capacity-build value chain players to ensure quality production. Approximately 3.35 million cattle are slaughtered annually, however, most hides are illegally exported with undervaluation out of the country, with over 90% exported to West Africa as food. The exportation of raw hides and skin deprives the local industry of the essential raw materials. Despite the government having already enhanced the export levy of raw hides and skins to limit their exportation, the country still faces the challenge of illegal exploitation. Therefore, the policy intervention will entail:

- a) Mopping up all hides and skins and availing them for value addition. This activity will require Kshs. 300 million as a start-up capital which can be achieved by reallocating Kshs. 100 million from the funds under the Hides, Skins and Leather Fund and Kshs. 200 million from the restructuring of the Kenya Livestock Commercialization Programme (KeLCoP).
- b) Completion of the attendant facilities at Kenya Leather Industrial Park – Kenanie including Common Effluent Treatment Plant, link roads, water reticulation, ICT, security, power station and four warehouses to enable immediate utilization of the facility by leather investors. The project requires Kshs. 600 million which can be achieved from a restructuring of KeLCoP.

3.2. Revitalizing of Rural Electrification

- 16. Electricity demand in Kenya has been steadily rising, from 1,882 MW in 2018–19 to 2,304.62 MW in January 2025.** The Least Cost Development Plan (LCDP), a strategic blueprint for ensuring a cost-effective energy supply, projects peak demand will reach 10,841 MW by 2041. However, the country's existing transmission and distribution infrastructure is inadequate to meet this growing demand, particularly in underserved rural areas and rapidly industrializing regions. The limitations of current transmission and distribution lines result in inefficiencies and frequent power outages, hampering industrial expansion, rural electrification, and Kenya's participation in the regional energy market. Addressing these shortcomings is critical to meeting energy demands, fostering economic growth, and ensuring a reliable power supply.

- 17. The inadequacy of the transmission and distribution network not only affects energy reliability but also has severe implications on employment and economic stability.** Power outages disrupt business operations, leading to job losses, particularly in non-agricultural sectors. A World Bank study highlights that electricity shortages can increase unemployment rates by up to 13.5 percent⁴ since it discourages investment, reduces economic productivity, and limits job creation opportunities.
- 18. Despite the government's progress in the expansion of the transmission and distribution networks, 62.7% of Kenyan households, predominantly in rural and off-grid areas, lack access to reliable electricity from the main grid.** This energy deficit hinders economic development, limits access to essential services like education and healthcare, and perpetuates poverty. While initiatives like the Last Mile Connectivity Project, electrification of public facilities, and the installation of transformers have improved access, sustained funding remains a critical challenge. To be able to effectively increase connectivity and expand the distribution networks, the government requires Kshs. 77.6 billion for last mile connectivity project, Kshs. 65 billion for electrification of public facilities and Kshs. 15 billion for the installation of transformers. Sole reliance on the exchequer and donors to fund these projects is both unpredictable and insufficient to achieve universal electrification.
- 19. Further, county governments have also contributed to some of the challenges facing the energy sector.** Although counties are responsible for functions such as electricity reticulation and street lighting as per Schedule 4 of the Constitution, they have not been providing budget allocations to support these devolved functions. As of April 2024, counties owed Kenya Power Kshs. 4.2 billion in outstanding debts related to county facilities, street lighting, public health, and other devolved services. These debts have negatively impacted Kenya Power's operations including its ability to pay power generators and connect additional households with electricity.
- 20.** Given the high capital requirements, innovative financing mechanisms are essential to enhance energy access and improve infrastructure. The government may consider implementation of the following policy options:

⁴<https://documents1.worldbank.org/curated/en/659751524142624281/pdf/Jobs-electricity-shortages-and-unemployment-in-Africa.pdf>

- i) **Expand the scope of the Petroleum Development Levy (PDL) Fund to include last-mile connectivity** – The PDL is a government-imposed charge applied at the time of importation of petroleum fuels. It was established by the PDL Fund Act, 1991, and used for the development of the petroleum industry and stabilization of fuel prices in times of erratic rise in international crude oil prices. In FY 2024/25, the annual collections in the PDL Fund are projected to amount to Kshs. 30.85 billion and the funds are to be utilized as follows: Kshs. 27.00 billion for stabilization of fuel, Kshs. 3.31 billion for the development of the petroleum industry and Kshs. 0.54 billion majorly for projects in the alternative energy technologies programme. With stabilization needs now nominal, given the decline in crude oil prices, a portion of the fund could be utilized toward electrification efforts. Therefore, expanding the Petroleum Development Levy (PDL) Fund’s scope to include last-mile connectivity and rural electrification is critical. Considering the budget deficits for the aforementioned projects, Section 4(4) of the PDL Fund Act, 1991 can be amended to provide for up to 30 percent of the PDL Funds to be utilized for these projects.
- ii) **Ring-fence Rural Electrification Programme (REP) Levy to fund off-grid connectivity** – The REP Levy is a 5 percent government-imposed charge applied to the total units of electricity consumed by each customer. The levy is collected by Kenya Power and passed to the Rural Electrification and Renewable Energy Corporation (REREC) to fund rural electrification projects. Most of the current rural electrification projects include the electrification of public facilities, installation of transformers, and connection of households who are within a 600-meter radius of the distribution transformers. However, the most underserved rural regions in the country with over 1.2 million unelectrified households are unable to enjoy the benefits of rural electrification projects since they depend on off-grid power stations that are currently dysfunctional. There are 56 off-grid stations with 26 solar mini-grids and 30 thermal power stations running on diesel generators. Most of the thermal off-grid power stations are currently grounded due to insufficient funding by Kenya Power for maintenance and provision of fuel. To ensure these underserved rural regions are connected to electricity, the government may consider ring-fencing up to 30 percent of the money collected in the REP Fund to operationalize off-grid power stations. The levy is projected to generate Kshs. 7.66 billion in FY 2024/25 and 30 percent of the funding will amount to about Kshs. 2.3 billion.

- iii) **Prioritizing Payment of County Pending Bills to Kenya Power** - Counties are responsible for electricity reticulation and street lighting as per Schedule 4 of the Constitution. However, they have not been spending sufficient funds on energy-related functions. In FY 2023/24, counties approved a combined budget of Kshs. 3.1 billion for energy-related functions but only spent Kshs. 1.7 billion by the end of the financial year. These debts have negatively impacted Kenya Power's operations including its ability to pay power generators and connect additional households with electricity. The counties must therefore prioritize payment of verified debts in their FY 2025/26 budgets to improve Kenya Power's financial health. The funding should be ring-fenced from annual transfers to county governments and each county will be required to meet a condition of appropriating a specified amount of money annually for payment of their pending bills.

3.3. Leveraging on Facility Improvement Fund to achieve Universal Health Coverage

- 21. Research and global best practices have shown that successful implementation of UHC is majorly dependent on a well-functioning primary health care, which is mainly preventive health care, with supplementary support from higher levels of health care.** Investing in primary health care is relatively cost-effective since health issues affecting the population are detected and addressed before they metamorphose into serious complications which become a burden to both households and the government. Thus, robust primary healthcare serves as an early warning system which in the long run will save households as well as the government against high healthcare costs and expenditures. It is for this reason that the government is implementing a referral-based system in the provision of healthcare.
- 22. The health facilities which offer primary health care services and act as the interface between the community and the higher-level facilities are expected to serve more patients seeking medical services.** For a successful referral system to be implemented, the primary healthcare facilities need to have the ability to handle patients' needs. The ability of primary facilities to attend to the patients' needs is measured by their capability to provide high-quality and low-cost care as and when required.

- 23. To support the functioning of primary healthcare services, the government enacted the Facilities Improvement Financing Act, 2023 which established a system for managing and utilizing funds generated from primary healthcare facilities to improve their infrastructure and operations.** The Act established the Facilities Improvement Fund (FIF) where user fees are deposited and expenditures for the facilities are settled. The operationalization of the FIF has been very successful, with the counties collecting Kshs. 18 billion in Own Source Revenue (OSR) from the health sector in FY 2023/24 compared to Kshs. 6 billion in FY 2022/23. This is an indication of the potential counties have when provided with appropriate incentives.
- 24.** The primary health facilities can raise resources and in so doing improve on the primary health care services they are expected to offer as well as undertake an upgrade and expansion of their facilities to ensure they provide the appropriate demanded services and attract usage. Based on the success of the FIF, the government may consider the following policy options to support the primary health facilities as the key drivers of UHC:
- i) **Conditional Grants to FIF from the Sports Arts and Social Development Fund (SASDF)** – The SASDF was established under the Public Finance Management (SASDF) Regulations, 2018 to provide funding to support the development and promotion of sports and arts and the promotion of social development including UHC. The regulations provide that UHC will be allocated 40 percent of the total funds each financial year. In FY 2024/25 the fund is projected to collect Kshs. 16.8 billion so the apportionment meant for UHC will be about Kshs. 6.7 billion. Therefore, the government should consider amending the PFM (SASDF) Regulations, 2018 so that counties can be provided conditional grants from the SASDF directly channelled to the primary health facilities through the FIF. These conditional grants should be approved by Parliament on an annual basis.
 - ii) **Prompt settlement of claims by Social Health Authority (SHA) for primary healthcare facilities** – There have been significant delays in settlement of claims by SHA for healthcare facilities due to challenges faced when transitioning from the National Health Insurance Fund (NHIF) to the Social Health Insurance Fund (SHIF). These have adversely affected the operations of the health sector, especially the primary healthcare facilities. The government’s directive to pay claims within 90 days of being lodged

has not been effective with most primary healthcare facilities still facing delays.

3.4. Addressing Challenges in Education financing

25. Allocation to student-centered areas including capitation, student loans and scholarships is on a decline. This is partly due to the ever-increasing enrolment levels in a resource-constrained environment as the government ensures 100 percent transition at each level is achieved. For instance, in FY 2024/25 the allocation towards capitation, loans and scholarships is Kshs 191.2 Billion, which is Kshs 23.6 Billion less compared to the FY 2023/24 allocation of Kshs 214 Billion. To further illustrate the resource challenge, in FY 2024/25, the resource gap for capitation, loans and scholarship funding is Kshs 91.8 Billion as indicated in Table 8 below.

Table 8: Resource Gap for Student-Centered Funds in FY 2024/25

Description	Requirement	Allocation	Resource Gap
	Kshs. Millions		
1. Capitation (Primary Education)	9,781	9,120	(661)
2. Capitation (Secondary Education)	76,654	59,886	(16,768)
3. Capitation (Junior School)	46,100	30,660	(15,440)
4. Capitation (TVET)	8,834	5,200	(3,634)
5. Scholarship TVET	7,800	2,500	(5,300)
6. Scholarship -University	22,300	16,921	(5,379)
7. Education Loans - TVET & University	47,311	35,911	(11,400)
8. Capitation (DUC- continuing students)	59,300	26,100	(33,200)
Total	278,080	186,298	(91,782)

Source: Ministry of Education

26. This resource gap is a clear indication that learners at various levels are not funded as expected based on existing policies on funding. This may in the long run affect the quality of education being delivered in our learning institutions hence negatively affecting the education outcomes. To try to address and minimize the resource challenge in the sector and ensure that available resources are directed to the most impactful areas, the Budget Options available are:

- i) **Scrapping of the National Examination / Assessment Waiver Policy** - Currently the government annually provide funds to cater for examination costs for all learners sitting for the National examinations. Due to the increasing enrolment levels, the government usually struggles to meet the entire cost on time resulting in huge budget deficits at KNEC. To address this, the government should develop a government-guardian cost-sharing approach for households to absorb this cost and in doing so, the government will be able to re-direct the Kshs 5 billion allocated annually to fund other critical areas in the sector.
- ii) **Consolidation of the existing bursary initiatives** - The National and County Governments on average allocate Kshs. 20 billion annually to bursary programmes. These programmes are implemented parallel and outside the sector framework. The fragmented and silo approach to the management of the bursaries results in an opaque picture of resource needs for learners creating room for inefficiencies, especially on multiple allocations. A coordinated framework is essential for efficient and optimal use of resources in the sector which may assist address the resource challenge as well as enable the government to have a clearer picture of the exact resource gap for the sector. For instance, the Kshs. 20 billion allocation to bursaries may address the capitation gaps in both TVET institutions and Secondary schools.
- iii) **Capping number of Bursaries for Tertiary Students** - Addressing the inadequacies of the Means Testing Instrument (MTI) under the new funding model as well as capping the number of Tertiary students the government can support based on a criteria that reflects equity.

3.5. Promotion of Diaspora Investments

27. The Kenyan diaspora does play a pivotal role in economic development through remittances, knowledge and skills transfer. Diaspora remittances are a source of much-needed funding for investments in healthcare, education, and infrastructure (housing), and help in alleviating economic inequalities in developing economies. Moreover, the diaspora through their "soft power," can influence political and economic affairs back home. Therefore, engaging diaspora communities in local investment initiatives transcend a mere financial transaction since it serves as a powerful tool for social transformation and economic development.

28. From 2019-2023, diaspora remittances have exhibited consistent year-over-year growth, surpassing traditional leading foreign exchange earners such as tea, tourism, and horticulture. As a share of total exports, diaspora remittances account for more than 50%, and this has been on an upward trajectory, as shown in Table 9. The increase in diaspora remittances is linked to the expansion of digital payment systems, such as mobile money, and the rising population of the Kenyan diaspora, which currently exceeds three million individuals residing globally. Thus, diaspora remittances, as the leading foreign exchange earner, play a crucial economic role by contributing to household income (supporting families back home), and employment creation (investment in productive ventures such as real estate) which does contribute to economic development.

Table 9: Trends in Diaspora Remittances vs Other top foreign exchange earners

Year	2019	2020	2021	2022	2023
	Kshs. Billions				
Total Exports	520.8	567.4	666.7	779.6	906.3
Diaspora Remittances	289.5	330.8	413.3	478.5	591.2
Tourism Earnings	296.2	88.6	146.5	268.1	352.5
Tea Exports	113.6	130.4	130.9	163.4	188.7
Horticulture Exports	122.9	136.0	165.7	152.3	187.4
Diaspora Remittances as a Percentage of Total Exports	56%	58%	62%	61%	65%

Source: KNBS

29. The MTP IV outlines the government's goal of increasing diaspora remittances to over Ksh.1 trillion by 2027. This is to be achieved by establishing products targeting the diaspora including bonds, private equity funds and shares among others. So far the Government has established the State Department for Diaspora Affairs to safeguard the rights of the diaspora, promote their welfare, enhance international job placements and incentivize remittances. Despite the ongoing government initiatives targeting the diaspora, their enormous potential has not been fully realized due to several barriers and challenges that inhibit diaspora investments. These include the lack of awareness among the diaspora about investment options that are open to them making it difficult for them to find the right investment opportunities and high remittance

transfer costs deterring diaspora investors. To address these challenges, the government may consider the following policy options:

- i) **Awareness of Investment Options Open to the diaspora** - The Ministry of Foreign and Diaspora Affairs through their missions abroad should spearhead engagements between Kenyans living in the diaspora and relevant stakeholders in Kenya including the Kenya Investment Authority (KIA), the Central Bank of Kenya (CBK), the National Securities Exchange (NSE) and Capital Markets Authority (CMA) on local investment opportunities including investments in bonds, private equity funds and shares among others. Through such engagements, Kenyans in the diaspora can also be linked up with local businesses and entrepreneurs to undertake joint business ventures.

3.6. Leveraging on Digitization to Improve Public Service Delivery

30. **The MTP-IV has prioritized digitalization to promote investments in the digital superhighway and the creative economy to further enhance productivity and overall competitiveness.** The government committed to providing universal broadband connectivity throughout the country by constructing 100,000 kms of new fibre optic lines and establishing 25,000 free Wi-Fi hotspots in market Centres as well as constructing 1,450 digital hubs in every ward⁵. Further, the government promises to leverage digitization to coordinate various initiatives and interventions by specifically digitizing and automating all critical government processes throughout the country for the greater convenience of the citizens.
31. **The government has made some progress in achieving this target with the government launching the e-citizen platform in June 2023 and onboarding several services as part of the innovation to overcome the challenges which were barring ordinary citizens from accessing government services.** As of January 2025, about 7,000 services had already been onboarded on the e-Citizen platform as detailed in Table 10. Despite the onboarding of services to improve public service delivery, challenges still abound which may negate the overall outcome of the initiative. First, the success of any digitization largely depends on the physical infrastructure available. Electricity supply in Kenya has remained unreliable, more so in rural areas where there are frequent power outages. The

⁵ <https://www.president.go.ke/wp-content/uploads/DURING-THE-LAUNCH-OF-THE-E-CITIZEN-PLATFORM.pdf>

unreliable electricity combined with low levels of internet connectivity and mobile phone penetration will negatively impact the digitization initiatives. According to DataReportal, there are 22.7 million internet users in Kenya with internet penetration standing at 40.8 percent.

Table 10: Number of On-Boarded Government Services on e-Citizen Platform

Sector	No. of Agencies	Total Services
1. Agriculture, Rural & Urban Development	37	997
2. Energy, Infrastructure & ICT	26	2,194
3. General Economic & Commercial Affairs	30	415
4. Health	19	350
5. Education	54	605
6. GJLOS	25	305
7. PAIR	23	813
8. National Security	3	14
9. Environment, Water & Natural Resources	18	547
10. Social Protection	27	379
11. Legislative Affairs	2	40
12. Devolved Units	9	350
Total		7,009

Source: KNBS

32. Moreover, the degree of e-literacy and access to technology among citizens will be key to the success of such initiatives especially where the initiatives require the citizen to engage with new technology. This could pose a serious challenge to digitization initiatives in terms of guaranteeing inclusion, especially for the elderly, the disabled and those who are illiterate. To address these challenges, the government may consider implementation of the following policy options:

- i) **Maintenance and Upgrade of NOFBI** - NOFBI has significantly improved digital connectivity in Kenya. By laying thousands of kilometres of optic fibre cables across the country, NOFBI has brought high-speed internet access to urban and rural areas. This infrastructure supports various sectors, including education, healthcare, and business, by providing reliable internet connections. However, there have been concerns raised with respect to the NOFBI cable including damage to equipment from vandalism, civil works from road constructions and harsh environmental conditions. Further, the

lack of regular maintenance and upgrades of NOFBI to keep it up to date with the latest technological advancement and ensure its optimal performance is also a significant issue. To address these challenges, the government should consider allocating Kshs. 500 million for maintenance & rehabilitation of the NOFBI cable. The funding will be provided from savings from other MDAs in the national government.

- ii) **Fastrack Completion of Constituency Innovation Digital Hubs (CIDH) –**
The CIDH are centers that provide digital skills training to youth and support entrepreneurs and access to free Wi-Fi countrywide. The government should consider allocating Kshs. 600 million to fastrack the completion of the 290 CIDHs across the country.

ANNEXTURES

Annex 1: Recurrent Expenditure Ceilings for FY 2024/25

Sector		2023/24	2024/25	2025/26 Proj.		
		Actual	Approved Budget	BROP	PBO Baseline	PBO Alternative
		Kshs. Billions				
Agriculture, Rural & Urban Development	Gross	33,015	29,362	30,727	33,766	36,766
	A-i-A	10,723	11,334	13,490	13,490	13,490
	Net	22,293	18,029	17,238	20,277	23,277
	Salaries	6,767	6,859	7,065	7,888	7,888
	O&M	26,249	22,503	23,663	25,879	28,879
Energy, Infrastructure and ICT	Gross	149,826	142,034	142,977	163,339	163,339
	A-i-A	108,263	127,612	127,823	127,823	127,823
	Net	41,564	14,422	15,154	35,516	35,516
	Salaries	5,080	5,075	5,417	5,836	5,836
	O&M	144,746	136,960	137,560	157,503	157,503
General Economic and Commercial Affairs	Gross	32,150	29,866	36,127	34,627	36,343
	A-i-A	8,725	13,960	19,679	19,679	19,679
	Net	23,425	15,906	16,448	14,948	16,664
	Salaries	1,804	2,619	2,795	3,012	3,012
	O&M	30,346	27,247	33,332	31,615	33,332
Health	Gross	60,194	86,828	94,876	99,853	99,853
	A-i-A	19,665	30,397	34,436	34,436	34,436
	Net	40,529	56,431	60,440	65,416	65,416
	Salaries	13,535	13,240	13,637	15,226	15,226
	O&M	46,659	73,588	81,239	84,627	84,627
Education	Gross	640,957	606,679	691,330	736,368	740,161
	A-i-A	49,053	52,645	65,949	65,949	65,949
	Net	591,905	554,034	625,381	670,419	674,212
	Salaries	290,301	331,452	338,218	384,049	384,049
	O&M	350,656	275,227	353,112	352,319	356,112
Governance, Justice, Law and Order	Gross	225,513	225,180	244,145	258,957	262,548
	A-i-A	2,669	1,925	1,985	1,985	1,985
	Net	222,844	223,255	242,159	256,971	260,562
	Salaries	133,057	148,743	153,714	171,055	171,055
	O&M	92,456	76,436	90,431	87,902	91,493
Public Administration and International Relations	Gross	188,387	176,440	196,902	202,906	202,906
	A-i-A	19,821	18,867	18,727	18,727	18,727
	Net	168,566	157,573	178,175	184,179	184,179
	Salaries	48,388	51,107	52,770	58,773	58,773
	O&M	139,999	125,333	144,133	144,133	144,133
National Security	Gross	207,259	217,769	237,507	238,507	238,507
	A-i-A	-	5,432	7,827	7,827	7,827
	Net	207,259	212,337	229,680	230,680	230,680
	Salaries	2,130	2,271	2,339	2,611	2,611
	O&M	205,129	215,498	235,168	235,896	235,896
Social Protection, Culture and Recreation	Gross	44,528	45,281	51,556	52,073	52,073
	A-i-A	1,676	4,135	4,135	4,135	4,135
	Net	42,852	41,146	47,421	47,938	47,938

Sector		2023/24	2024/25	2025/26 Proj.		
		Actual	Approved Budget	BROP	PBO Baseline	PBO Alternative
	Salaries	3,603	4,455	4,611	5,123	5,123
	O&M	40,925	40,826	46,945	46,950	46,950
	Gross	33,813	32,152	32,681	37,005	37,005
Environment Protection, Water and Natural Resources	A-i-A	6,876	17,341	17,341	17,341	17,341
	Net	26,936	14,811	15,340	19,664	19,664
	Salaries	2,249	2,822	2,935	3,245	3,245
	O&M	31,564	29,330	29,746	33,759	33,759
Total	Gross	1,615,642	1,591,591	1,758,827	1,857,400	1,869,500
	A-i-A	227,470	283,647	311,392	311,392	311,392
	Net	1,388,172	1,307,943	1,447,436	1,546,008	1,558,108
	Salaries	506,914	568,642	583,500	656,817	656,817
	O&M	1,108,728	1,022,949	1,175,328	1,200,583	1,212,683

Annex 2: Development Expenditure Ceilings for FY 2024/25

Sector		2023/24	2024/25	2025/26 Proj.		
		Actual	Approved Budget	BROP	PBO Baseline	PBO Alternative
				Kshs. Billions		
Agriculture, Rural & Urban Development	Gross	55,982	44,571	54,483	52,954	53,485
	GoK	28,635	15,309	16,838	15,309	15,841
	Loans	24,730	26,416	32,439	32,439	32,439
	Grants	2,617	1,201	2,361	2,361	2,361
	Local AiA	-	1,645	2,845	2,845	2,845
Energy, Infrastructure and ICT	Gross	186,866	302,256	360,607	336,585	340,187
	GoK	(7,254)	66,191	84,022	60,000	63,602
	Loans	152,647	107,678	115,485	115,485	115,485
	Grants	5,206	5,295	5,644	5,644	5,644
	Local AiA	36,267	123,091	155,456	155,456	155,456
General Economic and Commercial Affairs	Gross	20,367	15,760	26,779	18,912	18,912
	GoK	17,347	9,677	16,560	8,693	8,693
	Loans	2,945	3,940	7,057	7,057	7,057
	Grants	74	1,673	1,673	1,673	1,673
	Local AiA	-	470	1,490	1,490	1,490
Health	Gross	44,012	32,028	39,803	36,020	36,020
	GoK	23,642	14,909	17,556	13,773	13,773
	Loans	12,613	9,281	13,292	13,292	13,292
	Grants	7,758	7,838	8,955	8,955	8,955
	Local AiA	-	-	-	-	-
Education	Gross	25,119	21,079	27,428	25,295	25,295
	GoK	9,426	2,348	8,697	6,563	6,563
	Loans	14,657	9,154	9,154	9,154	9,154
	Grants	1,035	9,577	9,577	9,577	9,577
	Local AiA	-	-	-	-	-
Governance, Justice, Law and Order	Gross	15,536	5,881	22,903	17,257	17,257
	GoK	14,691	3,114	15,646	10,000	10,000
	Loans	160	-	-	-	-
	Grants	685	67	57	57	57
	Local AiA	-	2,700	7,200	7,200	7,200
Public Administration and International Relations	Gross	84,035	125,342	166,929	113,035	122,302
	GoK	12,580	83,721	123,894	70,000	79,267
	Loans	27,222	18,568	30,923	30,923	30,923
	Grants	11,062	23,054	12,112	12,112	12,112
	Local AiA	33,171	-	-	-	-
National Security	Gross	2,276	1,543	34,516	34,516	34,516
	GoK	2,276	9	1,000	1,000	1,000
	Loans	-	1,000	32,982	32,982	32,982
	Grants	-	-	-	-	-
	Local AiA	-	534	534	534	534
Social Protection, Culture and Recreation	Gross	21,948	23,662	26,843	25,572	25,572
	GoK	730	3,674	5,271	4,000	4,000
	Loans	4,178	3,196	4,145	4,145	4,145
	Grants	1,290	327	427	427	427

Sector		2023/24	2024/25	2025/26 Proj.		
		Actual	Approved Budget	BROP	PBO Baseline	PBO Alternative
	Local AiA	15,750	16,464	17,000	17,000	17,000
Environment Protection, Water and Natural Resources	Gross	60,714	69,045	100,092	82,854	82,854
	GoK	3,519	19,985	32,238	15,000	15,000
	Loans	53,605	45,807	62,070	62,070	62,070
	Grants	3,590	3,253	5,784	5,784	5,784
	Local AiA	-	-	-	-	-
Total	Gross	516,855	641,166	860,384	743,000	756,400
	GoK	105,594	218,936	321,722	204,338	217,738
	Loans	292,757	225,041	307,547	307,547	307,547
	Grants	33,317	52,285	46,590	46,590	46,590
	Local AiA	85,188	144,904	184,525	184,525	184,525