SHAPING MACRO ECONOMY IN RESPONSE TO COVID-19 IN KENYA - A RESPONSIBLE ECONOMIC STIMULUS AND A STABLE FINANCIAL SECTOR

Institute of Economic Affairs

Institute of Economic Affairs

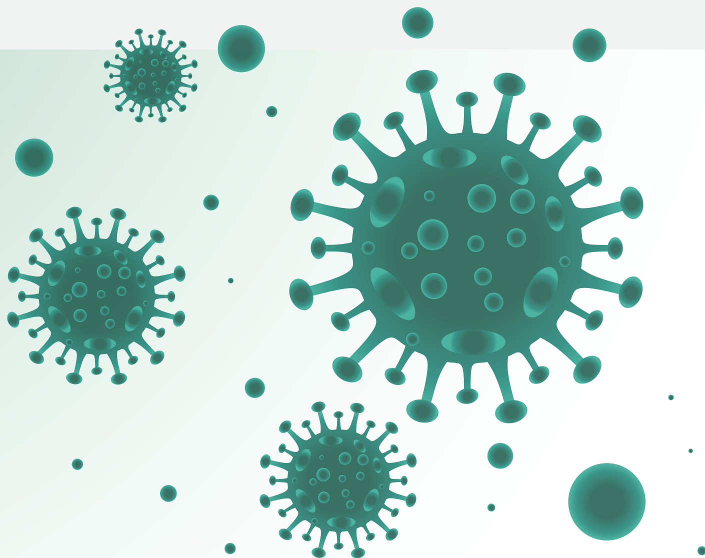
©2022, INSTITUTE OF ECONOMIC AFFAIRS

This work is licensed under the Creative Commons Attribution License (https://creativecommons.org/licenses/by/4.0/legalcode), which permits unrestricted use, distribution, and reproduction, provided the original work is properly credited. Cette œuvre est mise à disposition selon les termes de la licence Creative Commons Attribution (https://creativecommons.org/licenses/by/4.0/legalcode), qui permet l'utilisation, la distribution et la reproduction sans restriction, pourvu que le mérite de la création originale soit adéquatement reconnu.

IDRC GRANT / SUBVENTION DU CRDI : - SHAPING THE MACRO-ECONOMY IN RESPONSE TO COVID-19: A RESPONSIBLE ECONOMIC STIMULUS, A STABLE FINANCIAL SECTOR, AND A REVIVAL IN EXPORTS

Institute of Economic Affairs

Shaping Macro Economy in Response to COVID-19 in Kenya: A Responsible Economic Stimulus and a Stable Financial Sector



Shaping Macro Economy in Response to COVID-19 in Kenya: A Responsible Economic Stimulus and a Stable Financial Sector

©2022

Published by

Institute of
Economic Affairs

With support from
Overseas Development Institute (ODI) and
International Development Research Centre (IDRC)

©Institute of Economic Affairs, 2022

5th Floor ACK Garden House, 1st Ngong Avenue
P.O. Box 53989-00200 Nairobi, Kenya
Tel: 242-20-2721262, 2717402
Fax: 254-20-2716231
Cell: 0724-256510, 0733-272126
Email: admin@ieakenya.or.ke
Website: www.ieakenya.or.ke

Table of Contents

Acknoledments 5
Executive Summary 6
1 Context 8
1.1 COVID 19 Baseline: Macroeconomic Impact and Projection 8
1.2 Economic and Macroeconomic Indicators 8
1.3 External Sector 9
1.4 Fiscal Policy 11
1.4.1 Public Debt Trends 12
1.4.2 Government Fiscal Constrainsts 13
1.5 The Underlying Socio-Economic and Environmental Context 14
1.5.1 Employment Levels 14
2 Broad Macroeconomic Policy Responses So Far 16
2.1 Fiscal policy interventions in Kenya during the pandemic 16
2.1.1 Reversals of Tax Relief Measures 18
2.1.2 Government Expenditures Measures 18
2.1.3 Post Covid 19 Economic Recovery Strategy 20
2.2 Monetary Policy Stimulus and Liquidity Support to Businesses 22
2.2.1 Mobile Money Transactions 23
3 Methodology: Choosing Policies and Tracing Their Impact 25
3.1 Fiscal policy: Back to Business as Usual 26
3.2 Fiscal policy: Building Back Better 26
4 Findings 28
4.1 Socio-Economic Impact of Fiscal Policy Response 28
4.2 Socio-economic Impact of Monetary Policies 32
5 Conclusion and Recommendations 34
References 35

Acknowledgements

This paper was prepared by a team from the Institute of Economic Affairs (IEA)-Kenya, Annah Grace Kemunto; Darmi Jattani, Emmanuel Wa-Kyendo; Fiona Okadia; Leo Kemboi; Maureen Baraza, and Noah Wamalwa with leadership from John Mutua. Special mention goes to Kwame Owino, the Chief Executive for insights on the concept and backstopping throughout the project. We are grateful to the IEA staff for their support and in particular Oscar Ochieng for editing and layout of the paper.

The quality of this paper was sharpened through insights and comments from the entire Overseas Development Institute (ODI) team with special mention going to Sherillyn Raga for her mentorship.

The IEA-Kenya is grateful to be part of the ODI-led project on "Shaping the Macro-Economy in Response to Covid-19: A Responsible Economic Stimulus, a Stable Financial Sector and a Revival in Exports". We acknowledge and appreciate financial support from IDRC.

Executive Summary

Kenya experienced overall macro stability and modest growth of 5.5% for the period 2017 to 2019. This economic performance was achieved despite fiscal health challenges owing to fast rise in stock of public debt. The onset of COVID 19 pandemic in March 2020 however subdued the economy owing to swift containment measures that were imposed to limit the spread of the pandemic. As a result, Kenya suffered its first recession in nearly two decades. Poverty levels increased and about 1.7 million people lost their jobs between March and June 2020 and workers in the services sectors, particularly women were hit hardest due to disruptions in demand and supply chain. Fiscal health of the country deteriorated further amidst rising debt distress risk, while the external sector also weakened albeit resilience in remittance receipts.

The government responded fast by instituting a broad range of macroeconomic policy interventions. From a fiscal policy, the initial response was to take the country back to its economic growth trajectory through a raft of a combination of tax relief and expenditure measures as the first economic stimulus. Monetary policy responses focused on providing liquidity to businesses while other interventions included mobile money transactions to enhance cashless transactions as a way to reduce the contagion and enhance financial inclusion.

In departure from the first economic stimulus, the government launched the 8-Point Economic Stimulus Programme of Ksh 56.2 billion (about 0.5% of GDP) targeted towards building back a better and resilient economy and included improving the infrastructure, the environment, water and sanitation. This policy was chosen to estimate the socio-economic effects of the stimulus. Using available evidence of fiscal multipliers, we came up with three scenarios: (i) untargeted total expansionary fiscal stimulus and (ii) targeted sectoral public spending and (iii) hypothetical reallocation to targeted sectoral with high multiplier effect.

Results of the scenario building exercise suggests that fiscal stimulus could marginally improve Kenya's short-term growth, but the impact greatly improves if public spending are targeted to sectors with higher multiplier effects. The short-term impact scenario from injection of part of economic stimulus II is expected to boost economic activity by 0.12 and 0.15 percentage points against baseline GDP of Ksh 11,276 billion in financial year 2020/21. Simulation results that focus on reallocation of public spending to targeted to sectors with relatively higher multiplier effects, such as social protection, health, education and green investment, increases the impact further by 0.7 percentage points from baseline of fiscal spending on GDP.

The total Ksh 132 billion Covid19 fiscal recovery package (stimulus package III), if allocated to similar targeted measures, could add up to 1.6 percentage points to growth over three years.

Results of the scenario building exercise highlight that fiscal stimulus could contribute to Kenya's growth over the short-term, but the impact greatly improves if measures are targeted to sectors with higher multiplier effects. In medium to long term, focus on environment and green investment could result to higher socio-economic effects.

The government should not only reignite fiscal consolidation efforts but also curb domestic borrowing in the ensuing budget financing while keeping an eye on rise in non-performing loans for more effective monetary policy response.

1

1.0 Context

By 7th of June 2021 Kenya had a total of 174, 285 confirmed cases of COVID from the very first case that was reported in mid-March 2020. Out of these cases, the number of deaths was 3,362 as reported by the Ministry of Health. Over this period, Kenya has witnessed three waves of COVID cases. The first peaked to 1,332 cases per day on 28th July 2020; the second on the 14th December 2020 peaking to 1,587 cases per day and the most recent, highest peak so far, of 2,068 cases per day on 18th April 2021. Within East and Central Africa, Kenya comes second with the highest number of confirmed COVID cases after Ethiopia.

In addition to government policy response further efforts to bring the situation under control is premised on the planned COVID 19 vaccine rollout in three phases. The first to run up to end of June 2021 targeting high priority groups such as frontline health workers. This process has however been slow, compounded by low uptake due to fears of side effects including blood clots linked to AstraZeneca even despite an expanded target group. Data show that as of 9th June 2021 a total of 1,030,445 doses have been administered. Overall, the plan is to vaccinate 50% of the population (about 26 million Kenyans) by December 2022[1]. The foregoing paints a picture of the extent to which the government is from their target and therefore portend extra effort to realize this target.

1.1 COVID 19 Baseline: Macroeconomic Impact and Projections

This section presents an overview of the macroeconomic performance as background and the various policy interventions covering the pre and during-COVID period. The aim of this analysis is to identify shifts in these policies stances and plausible social-economic implications.

1.2 Economic and Macroeconomic Indicators

Even before the end of the first quarter of 2020, when the first case of Covid-19 was reported in Kenya, the country was experiencing challenges in economic performance, albeit modest growth. This is shown in table 1, which provides a snapshot of economic performance in terms of overall real GDP growth rates and a breakdown, by the three broad sectors.

---

[1]Ministry of Health, Kenya.

Table 1: Pre and Post COVID-19 Macroeconomic Indicators, 2017-2020 Period (%)

		Pre-Covid							
		2017	2018	2019	2020 Quarterly				2020
					Q1	Q2	Q3	Q4	
% Real GDP	Primary Sector	2.0	6.2	3.6	4.4	4.9	4.3	6.0	4.9
	Secondary (industry) Sector	3.8	5.5	4.8	4.7	-0.5	3.3	7.7	3.8
	Tertiary (services) Sector	6.0	6.7	6.6	3.8	-6.7	-4.6	-1.0	-2.2
	Overall	4.9	6.3	5.4	4.4	-4.7	-2.1	1.2	-0.3
GDP growth projections	Pre COVID (date of projection-Oct 2019)			5.6			6 (2020)		
	Post COVID (date of projection – Oct 2020)			1.0			4.7 (2021)		
% Inflation rate, Year-on-Year (as at the period ended)	Core	0.8	1.0	0.4	0.7	0.6	0.5		0.8
	Fuel	1.1	3.3	0.6	1.2	0.9	1.5		1.7
	Food	3.1	1.3	4.5	4.3	3.0	2.0		2.9
	Overall	5.0	5.6	5.5	6.2	4.5	4.0		5.6

Source: KNBS

During the pre-covid period, from 2017 to 2019 the economy grew from 4.9% to 6.3% but dropped to 5.4%, an average growth rate of 5.5% for the three-year period. This is attributed to a similar overall trend in both primary and industry sectors with the services sector posting a more stable growth.

The onset of COVID in the first quarter of 2020 however dampened the economic situation. Government swift containment measures imposed to contain the spread of pandemic resulted to reduced economic activities as evidenced by contraction in real GDP growth (see table 1).

Overall year on year inflation rate has remained stable between the pre COVID period 2017-2019) and in amid COVID period in 2020, that is, within the neighborhood of 5% policy target. Nevertheless, food inflation in quarter 2 and 3 of year 2020 went up on average owing to dry weather spells and supply constraints.

1.3 External Sector

COVID 19 containment measures have significantly affected trade routes globally. This is the case in in Kenya. Trade is critical to Kenya's economy as it fuels economic growth, providing employment to the locals, which then raises their living standards and ensures the provision of a variety and affordable goods and services to Kenyans. Figure 1 illustrates the effects of COVID on Kenya's external sector contrasting the period after lockdown in 2020, that is April 2020 to December 2020 and a similar period in 2019.

Fig 1: Trends in Growth of Kenyan Trade, 2019-2020

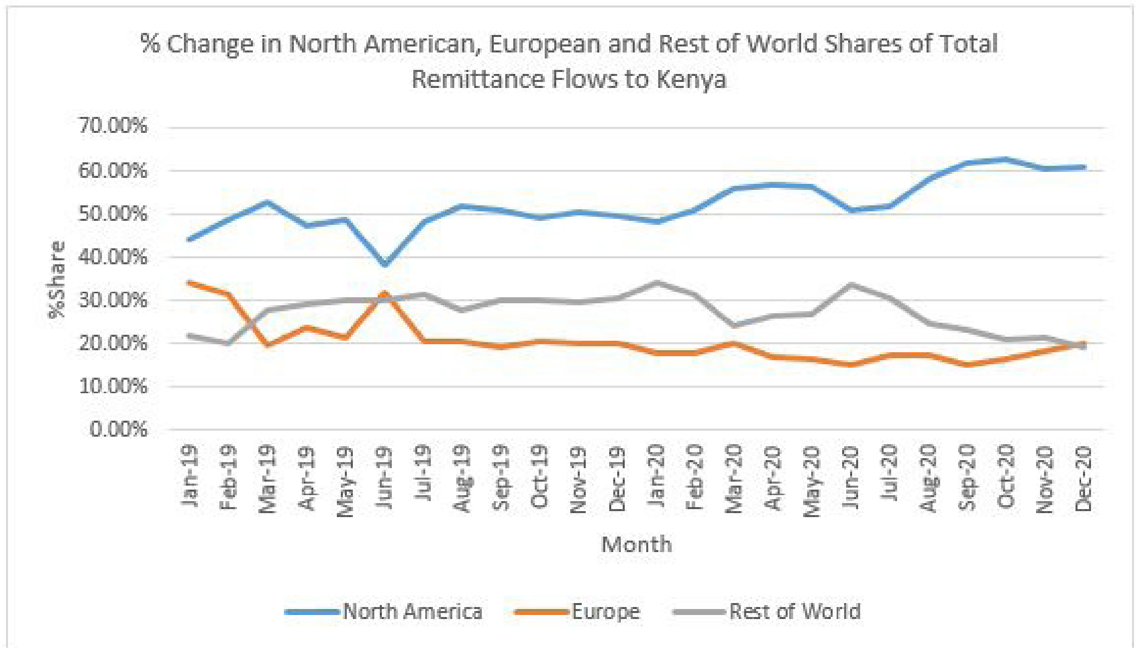
Source: Central Bank of Kenya,

The Central Bank of Kenya estimates that in April and May of 2019, imports grew by 20% and 4%, respectfully. In April of 2020, imports grew by 3%. By April of the same year 2020, import growth rates dropped to 15%. Averaging a -4% growth rate in the three month period leading to April 2020, imports had not been on a strong growth trajectory. In the month of April 2020, export growth rates were (-33%). By May 2020, export growth rates had risen to 9%. Over the three month period beginning January 2020, the average export growth rate was a positive 15%. Relative to the 3 month period year 2019, Kenya's overall trade position experienced a contraction over the year 2020. At the gross level, Kenya's trade position worsened during the year 2020.

Comparison of the growth rates over the 11 month period of April to December 2020 reflects the previous revelation that Kenya's trade position as measured by growth rates actually dropped. In that period, trade growth rates dropped from 5.76% to 4.62%.

Conversely a comparison of the growth rates over the 11 month period of February to December reveals that in the year 2019, imports grew by 0.28%. In that same period, the year 2020 experienced import growth of 0.86%. Import growth was stronger in 2020 than it was in 2019.

Fig 2: Trends in Remittances



Source: Central Bank of Kenya

The Central Bank of Kenya (CBK) divides its remittance origins into three categories namely North America, Europe, Rest of World and Total Remittances. Between the 24-month period of January 2019 and December 2020, the total value of remittances grew by a factor of 1.1. In that period, the value of remittances from North America increased by a factor of 1.7. North America's 24-month average share of remittance flows to Kenya was 52.32%. This was larger than Europe's 20.43% and the rest of worlds 27.25% shares, making North America, the largest source of increased remittances. CBK data shows resilience of remittance inflows despite widening of current accounts deficits where imports have grown at a faster pace than exports.

1.4 Fiscal Policy

The downward trend in the revenue performance continued to worsen in the wake of Covid-19 pandemic. Ordinary revenue, which is mainly driven by tax revenue is estimated to decline to 14.5% of GDP in 2020/21 from 15.5% of GDP in the previous year (see table 2). Tax relief measures coupled with effects of containment measures led to significant reduction of revenue collection in the main sources including income tax and import duty.

Conversely, expenditure remained stable over the period, declining by 0.5 percentage points in relation to GDP (25.2% to 24.7%) between the 2019/20 and 2020/21, partly driven by the economic stimulus programmes and spending on Covid-19 responses across supporting line ministries and counties. Consequentially, the budget deficit is estimated to remain large, 7.9% of GDP, which is above the medium-term target of 3% by 2022/23.

Table 2: Fiscal Performance in Pre and Post COVID Period, 2018/19 to 2020/21

		2018/19	2019/20	2020/21 (Estimates)
% Revenue to GDP	Total Revenue	18.2	17.0	16.8
	Ordinary Revenue	16.0	15.5	14.5
% Expenditure to GDP	Recurrent	16.3	16.2	16.2
	Development & Net Lending	5.8	5.8	5.2
	Transfers to County Governments	3.9	3.2	3.3
	Total Expenditure & Net Lending	26.0	25.2	24.7
% Budget Deficit to GDP		7.8	8.2	7.9
% Tax to GDP	Income Tax	7.3	6.9	6.1
	VAT	4.4	3.8	4.3
	Import Duty	**1.1**	**1.0**	**0.9**
% Public Debt to GDP	**Debt Stock**[2]	**62**	**65.8**	**70.4**
	Debt Servicing	**8.0**	**8.6**	**8.2**

Source: The National Treasury and Planning, IMF

1.4.1 Public Debt Trends

The total debt stock is estimated to increase to 64.3% of GDP in 2020/21 compared to 60.8% of GDP in 2019/20. The increase in the public debt is attributed to external loan disbursements; exchange rate fluctuation; and the uptake of domestic debt during the period. The uptake of the external loans is driven by the need to finance the budget deficit and Covid-19 relief measures. The debt servicing charges are projected to remain high at approximately 8.2% of GDP. Large debt obligations by Kenya are likely to remain a challenge and thus may affect its budget implementation in the aftermath of the pandemic. For the case of borrowing through Kenyan Banks, the increased government borrowing has displaced borrowing by private enterprises and households. Data from Kenya National Bureau of Statistics as shown in Table 2 demonstrates that government borrowing as share of total advances has grown from 24% in 2014 to 34% in 2020.

[2]Page 29 of IMF Country Report (Kenya) No. 21/72

Table 3: Commercial Banks' Bills, Loans and Advances (Ksh Billion)

	2014	2015	2016	2017	2018	2019	2020
Government	567.13	648.82	790.97	930.17	1,057.21	1,177.09	1,483.33
Private Enterprises	1,472.72	1,842.55	1,854.31	1,903.76	1,959.79	2,101.75	2,293.58
Private Households	316.19	325.89	380.82	385.08	411.74	434.76	453.95
Government/Total Advances	24%	23%	26%	29%	31%	32%	34%

Source: KNBS Statistical Abstracts & KNBS Economic Survey (Various Issues)

1.4.2 Government Fiscal Constraints

Governments regulate the economy through fiscal and monetary policy. Finding itself within reach of the debt ceiling, the Kenyan government had little room to respond with large stimulus packages. The load of public debt continues to impose significant costs in the form of interest and principal payments. Supply and demand shocks also mean a smaller tax base from which to collect revenue.

The government has been on an expansionary fiscal policy stance in the last decade. To this end, the government has since 2013/14 been borrowing a net amount of Ksh 685.7 billion annually, thus increasing the debt stock by a factor of 3.4. In other words, stock of debt has been on an upward trend, that is, rising from Ksh 2.11 trillion (47% of GDP) in 2013/14 to Ksh 7.25 trillion by November 2020 (66% of GDP) Interestingly projections indicate that by 2023 the net accumulated debt will be Ksh 9.3 trillion, surpassing the current ceiling by Ksh 310 billion.

The high level of debt stock has resulted to a fast rise in debt servicing charges. This situation may get worse owing to continued heavy borrowing and shortfall of revenue on the back of COVID induced low economic activities. Of note is that the debt service to tax revenue ratio for 2019 and 2020 has breached the 30% threshold (see table 4). Equally, increase in the high debt redemption, as per the current trend, may significantly disrupt the budget implementation especially in light of falling revenues.

Table 4: Debt Sustainability Analysis, April 2020

Indicator	Threshold	2019 Actual	2020 Projection
PV of public debt to GDP ratio (%)	74	57.6	62.4
Absolute threshold (Ksh trillion)	9	6.0	6.2
PV of public debt to revenue and grants ratio	300	313.9	338.1
Debt service (Total) to revenue and grants ratio (%)	30	33.4	53.8
Overall risk level	Low	Moderate	High

Source: IMF Country Report No. 20/156

Overall, Kenya has experienced a deterioration in the debt levels and in cost and risk of servicing this debt as shown in the two indicators of PV of debt-to-revenue and grants ratio and debt service-to-revenue and grants ratio under debt sustainability analysis as shown in table 5. Because of breaching these two indicators of Kenya debt distress, the possibility of defaulting in debt repayment situation has worsened from moderate to high.

1.5 The Underlying Socio-Economic and Environmental Context

The Covid-19 pandemic created a financial, health and social shock, which affected households throughout Kenya to varying degrees. Because the rise of the pandemic created both a supply side and demand side shock for firms in Kenya, it constricted the size of the market and reduced consumption and spending simultaneously.

Containment measures have resulted to adverse economic consequences, including dampened demand for agricultural products, disruptions of supply chains and exports thus weakening livelihoods and food security. Although the initial health impact of COVID 19 was largely in urban areas, this has over time spread to rural areas and indeed in the entire country.

1.5.1 Employment levels

Kenya experienced an unprecedented loss of jobs of 1.7 million people within the period between March and June 2020[3] as a consequence of containment measures. Specifically, unemployment levels went up markedly at the onset of COVID in quarter 2 and quarter 3 of 2020 compared to the pre COVID level over the same period in 2019. In particular, unemployment levels increased from 4.7% in quarter two and 5.3% in quarter three of 2019 relative to 10.4% and 7.2% respectively over the same period in 2020 (table 5). In fact, job losses and reduced earnings portend deterioration of household welfare.

Table 5: Comparison of Labour force and unemployment rate in Quarter 2 and Quarter 3 for 2019 and 2020

	Q2		Q3	
	2019	2020	2019	2020
Population (15-64), Million	26.8	27.7	27.0	27.7
Labour Force, Million	18.7	17.7	18.8	19.0
Unemployed, Million	0.9	1.8	1.0	1.4
Unemployment Rate (%)	4.70%	10.40%	5.30%	7.20%

Source: KNBS

[3]KNBS (2020) and Quarter Labour Force Survey 2020 pp1-2

Of note is that workers in the services sectors were disproportionately affected relative to those in both industry and agricultural sectors and specifically women wage workers as their average hours worked reduced by 30% relative to 18% for men[4]. The direct implication of this is that in addition to the shock to demand, many Kenyans lost their primary source of income and therefore suffered a consumption reduction, which created the need for the safety nets to be activated.

Initially the spread of the diseases was confined to the dwellers in the urban areas of Kenya. For example, a study[5] conducted in Nairobi finds that the pandemic social and economic impact on adolescents and young adults is highly gendered, with young women and girls most affected. In this case, women reported more time spent on caregiving and households responsibilities while their male counterparts are more likely to have given up schooling for income generation during the pandemic in Nairobi. Other reports show that over time however, the contagion spread spatially towards rural communities and county government that form Kenya's borders. Thus, not only are Kenyans losing income sources but the economic shock also aggravates the health shock because it creates a need for people to spend on their own medication.

Other effects of the pandemic are on livelihoods and food security. Closures of markets and slowdown at borders for import of food from neighbouring countries resulted in rise in food poverty rates. Reduced earning to purchase food exacerbated this situation, especially in Nairobi and Mombasa. Kenya National Bureau of Statistics survey conducted in May 2020 showed that due to regulations in the transport to curb spread of the pandemic, overall cost of transport countrywide went up by 51.7%, further affecting the most vulnerable (low-income earners and people residing in informal settlements) in the population. Alternatively, about 32.2% of Kenya resorted to walking. Moreover, meeting daily expenses such as housing rent became more difficult with about 30.5% of Kenyan renting houses been unable to pay their rent on time. This category of the population works largely in the informal sector, and live from hand to mouth implying that any disruptions in terms of loss of income hits them hardest and that they are the most sensitive to price hikes whether on transport, food and housing, for instance.

[4]World Bank Group (2021) Socioeconomic impacts of COVID 19 in Kenya on Households. Rapid Response Phone Survey Round 1, January 2021

[5]https://www.pmadata.org/news/study-reveals-stark-gendered-social-and-economic-impacts-covid-19-youth-kenya-0)

2

2.0 Broad Macroeconomic Policy Responses So Far

Kenya continues to endure the effects of COVID 19 and related countermeasures. As earlier noted, in March 2020, the government imposed various containment measures such as curfews and cessations of movement in counties to curb transmission of COVID 19. This resulted in restrictions on working hours, led to job losses and overall adverse effects on economic activities. Put together, these measures created supply and demand side shocks.

To cushion Kenyan households and businesses from these adverse effects of COVID 19 pandemic, the Government of Kenya implemented various fiscal (tax reliefs and other measures), monetary and trade policy measures with varied objectives.

2.1 Fiscal policy interventions in Kenya during the pandemic

Specifically, fiscal policy interventions included various tax measures (see table 5), adopted alongside increases in government Covid-19 related expenditure which were implemented to cushion citizens against the demand shock caused by the pandemic. Since citizens look up to government during pandemics, measures within the government's immediate control provides for the opportunity of using these tools to restore balance in the economy. Tax relief measures is an efficient tool owing to the fact that it increases individual's disposable income which in turn increase consumption hence stimulating the recovery of the economy. Conversely, increase of government expenditure during pandemics is expected to create positive multiplier effect across the economy.

Table 6: Tax Relief Measures

Tax Relief Measures		Collection pre-COVID (Ksh Billion)				Est. of Rev losses (Ksh Billion)	
	Targeted Beneficiary	2018/19	2019/20 (A)	Est. 2020/21 (B)	Est. 2020/21 (B) Diff' (B-A)	PBO	World-Bank
Reduction of corporate income tax (CIT) from 30% to 25%	Formal firms	292.4	340.9	308	-32.9	45.7	13.7
Reduction of turnover tax (ToT) from 3% to 1% for MSMEs	MSMEs					0.05	0.1
Reduction of Value Added Tax (VAT) from 16% to 14%	General public	414.1	412.6	481.6	69	49.6	13.8
100% PAYE tax relief for earning below Ksh 24,000 pm	Formal employees	393.4	395.4	377	-18.4	26.9	11.7
Reduction of PAYE top income tax band rate from 30% to 25%							

Source: Tax Amendment Act 2020; NT QBER and Est. of Revenue 2020/21; Parliament Budget Office (PBO), Kenya and World Bank

The tax relief measures as shown in table 6 were approved and took effect in April 2020. The government proposed a 100% tax relief for persons earning gross monthly income of up to Ksh 24,000 generally categorized as low-income earners. The additional income for a person earning a monthly income Ksh. 24,000 is approximately Ksh. 1,700 per month. The calculations show an additional 717,497 taxable persons were now being taxed at 0%. In 2019 there were about 49,747 (1.7%) formal sector workers paying the 0% effective tax rate. With the resizing of the first tax band as a Covid-19 relief measure, this number has grown to 767,244 (26.2%). What this means is that an additional 24.5% of the formal sector income earners are relieved from paying personal income tax. The tax burden for this 26.2% of formal sector workers has shifted from both income and consumption taxes towards consumption taxes. The government also proposed to reduce the top Pay-As-You-Earn (PAYE) rate from 30% to 25%. This incentive is expected to align with the 100% tax relief for low-income earners, allowing the government to channel additional resources to cushion the affected individuals from the impact of the virus.

To support businesses and increase their resources, the government effected tax reduction for turnover tax rates and corporate income tax. Turnover tax rate for micro, small and medium-term enterprises (MSMEs) was reduced from 3% to 1%. Corporate income tax was reduced from 30% to 25% to allow companies additional resources to sustain their operations in this difficult time. The effects of the pandemic on businesses like the loss of key markets and ultimately shutting down. The tax relief measures can only yield results if they are sustained over a few years after the current pandemic.

Overall table 6 shows estimation of revenue that will be forgone due to the tax relief measures. For the individual tax relief measures, there is a comparison of the difference between what was collected in the FY 2019/20 and the estimate of what will be collected in 2020/21. Furthermore, Parliament Budget Office (technical arm of parliament) and World Bank also provide their estimates of revenue losses, that however differ significantly but without offering any explanation. It means, whatever is the accurate quantum of revenue foregone, that the government cannot sustain the tax relief measures that long without the opportunity cost in revenue collection.

2.1.1 Reversal of Tax Relief Measures

It is no wonder that on December 4th, 2020, the government proposed reverting to the prevailing tax rates before the onset of Covid-19. The decision to take a short-term recovery strategy on tax relief measures was to increase government revenue, which was lost during the nine-month period of tax relief. The corporate tax rate and turnover tax rate reverted to 30% and 3% respectively. According to a working paper by the World Bank, the Covid-19 shock has been severe and widespread across businesses with persistent negative impact on sales (World Bank, 2020). The paper also notes that smaller firms are disproportionately facing greater financial constraints and the great uncertainty about the future for firms that have experienced larger drop in sales. Reverting to the pre-Covid-19 tax rates only nine months after the tax reductions might limit the capacity of businesses to recover from the effects of the pandemic.

In their defense the National Treasury in a press statement noted that the tax rates are not new but just a return to the prevailing tax rates before the onset of the pandemic. The reversion of pay as you earn to 30% has had a few consequences on the formal sector workers. The government has pushed the tax burden away from lower income earners by maintaining the zero-tax rate for low-income earners. As it is already, more than half of the formal sector workers are already paying the highest tax rate as shown by IEA-Kenya in an analysis of 8 lessons from tax law changes. About 26% of formal sector workers were charged at the maximum tax rate in 2020 while 54% of formal sector workers are charged at the maximum tax rate in 2021.

2.1.2 Government Expenditure Measures

To mitigate the effects of the pandemic on the Kenyan economy, on the 25th of March 2020, the President proposed various expenditure related measures (Presidential Address March 25th, 2020). All Government Ministries and Departments were expected to make the payment of at least of Ksh. 13.8 billion of the verified pending bills, within three weeks so as to improve liquidity in the economy and ensure businesses remain afloat by enhancing their cash flows.

The Kenya Revenue Authority was also mandated to make the payment of all verified VAT refund claims amounting to Ksh. 10 billion within 3 weeks in order to improve cash flows for businesses. Ksh 1.0 billion from the Universal Health Coverage was appropriated towards the recruitment of

additional health workers to support in the management of the spread of COVID-19. An additional Ksh 10 billion was allocated towards cushioning the elderly, orphans and other vulnerable members of the society through cash-transfers by the Ministry of Labour and Social Protection from the adverse economic effects of the COVID-19 pandemic.

To support county governments' response to the pandemic, Ksh 5 billion was allocated towards setting up requisite infrastructure for urgent response. An additional Ksh 2.36 billion was also allocated to county governments for purposes of supplementing allowances for the frontline health care workers with a further allocation of Ksh 1.5 billion to Kitui, Mandera, Kisumu and Coast general hospitals. It is important to note that the funds disbursed to county governments were outside the funds approved under county revenue allocation act (CARA) 2019 as part of Covid-19 emergency response measures.

Table 7: Economic Stimulus I in March 2020

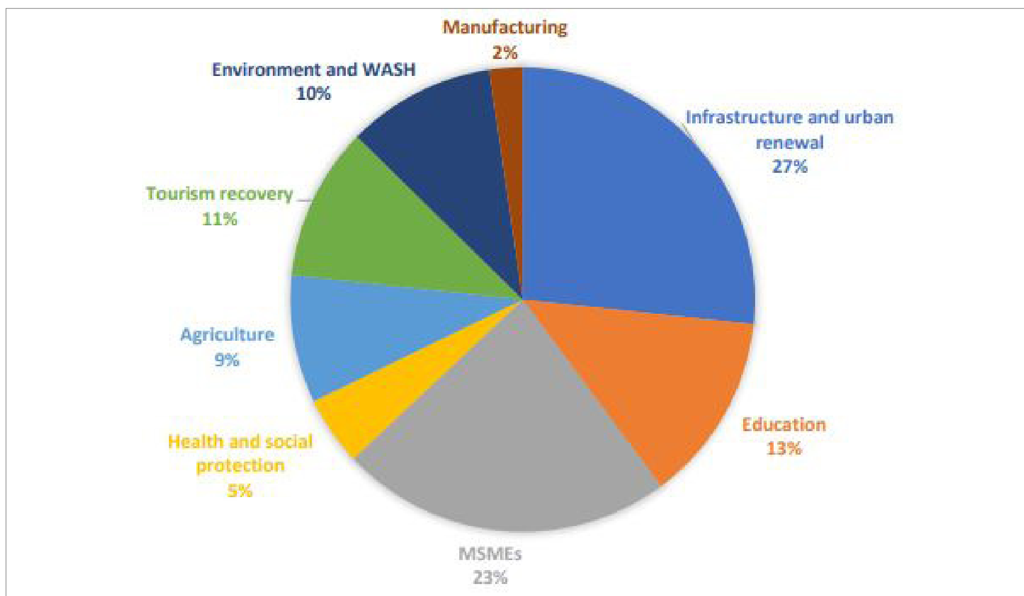
Items	Ksh (Billion)/ Share of total
Food relief, WASH and others	2 (3.9%)
Pending Bill clearance	13.8 (26.8%)
Value Added Tax (VAT) refund	10 (19.4%)
Social protection (cash transfers)	10 (19.4%)
Allocation to county governments for Covid-19 response	8.9 (17.3%)
Health expenditure	6.8 (13.2%)

Source: Economic Recovery Strategy 2020

As shown in the above summary, the economic stimulus in March 2020 was targeted towards fast recovery of the economy. Nevertheless and in departure from this first stimulus programme, the President of Kenya launched the 8-Point Economic Stimulus Programme (Ksh. 56.2 billion) in May 2020 targeted towards building back a better and resilient economy- enhanced resilience of the economy to global supply chain shocks and better disaster preparedness and management (Presidential Address, 2020). This is also well documented in the November 2020 Economic Recovery Strategy report. As captured in figure 3, this Programme's focus is on improving the infrastructure, the environment, water and sanitation and other sectors such as supporting tourism recovery and food security.

The Economic Recovery Strategy places emphasis on climate change adaptation and mitigation measures that will exploit green economic activities to put the economy on a green and climate resilient recovery build-back path. The Strategy will therefore focus on measures that will drive sustainability while boosting green jobs, income and growth at the same time reducing drivers of climate change and environmentally damaging activities. The strategy, however does not specify on the immediate actions and steps to be followed towards attainment of clean and green growth (Budget Policy Statement, 2021).

Fig 3: Economic Stimulus Programme II (Ksh 56.2 Bn) - Nov. 2020



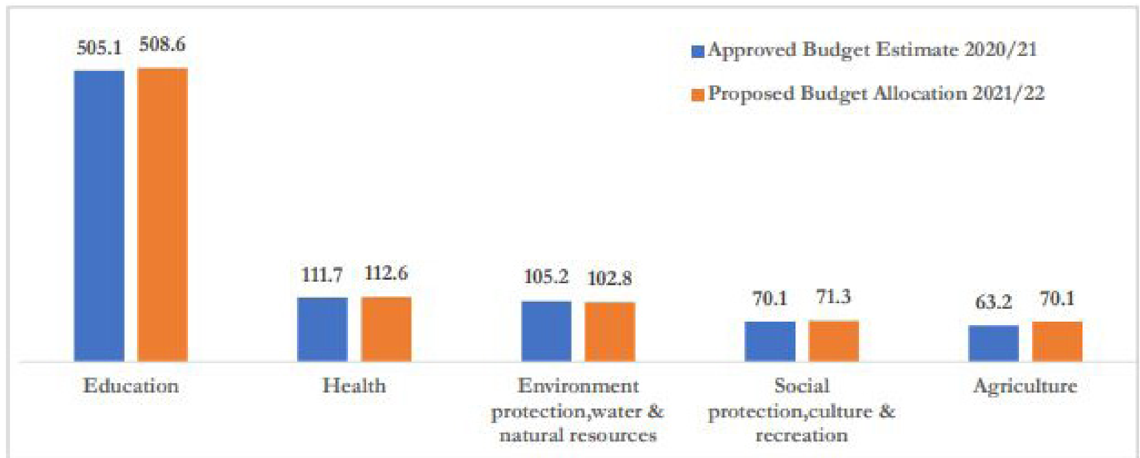
Source: Economic Recovery Strategy 2020

2.1.3 Post COVID 19 Economic Recovery Strategy

Building on the expenditures already proposed in 2020 under the Economic Stimulus Programme, the government has rolled out a 3-year post Covid-19 Economic Recovery Strategy (ERS) to further reposition the economy on a steady and sustainable growth trajectory. The ERS and other policy measures outlined in the 2021 Budget Policy Statement aim at stimulating economic recovery (The National Treasury, 2021). The government also proposes critical review of existing programmes and policies to ensure that they are consistent with the emerging realities brought about by the pandemic.

The ERS considers a long-term economic recovery through incorporation of different policies into the budget. The key pillar of Kenya's ERS is sound macroeconomic framework supported by other key pillars which include enhanced allocation to strengthen health care systems, full implementation of the economic stimulus programme, accelerated growth in private sector, supported recovery of micro, small and medium enterprises with better disaster preparedness and enhanced resilience of the economy to global supply chain shocks. Currently the frameworks for responding to disasters are fragmented across several laws. The Government proposed development of harmonized Disaster Risk Management (DRM) legal framework and finalize the Disaster Management Fund Regulations to facilitate effective and efficient response to disasters in a more coordinated manner. In addition, to strengthen Disaster Risk Management, the Government proposes to finalize the National Disaster Risk Policy, fast track the development and enactment of the National Disaster Management Bill, operationalize the National Drought Emergency Fund (NDEF), speed up implementation of the Disaster Risk Financing Strategy and strengthen National Disaster Management and Coordination Framework (Budget Policy Statement, 2021). The recovery strategy is also cognizant of the inequalities in the society that were amplified by the pandemic and aims to address inequality by enhancing social cohesion, community resilience and strengthening social protection.

Fig 4: Approved Budget Allocation 2020/21 Vs Proposed Budget Allocation 2021/22 (Ksh. Billion)



Source: Budget Policy Statement 2021

As shown in the fig 4, the proposed budgetary allocation to the education, health and social protection, culture and recreation sectors have all increased. The highest increase in allocation is the agriculture sector, with an 11% change, followed by social protection, culture and recreation sector at 2% increase in budgetary allocation. The allocation towards agriculture aims to cushion farmers from adverse effects of locust invasion flooding and further secure food supply chains, through subsidized supply of farm inputs through the e-voucher system to reach 200,000 small scale farmers. Further, the Government proposes expansion of community household irrigation to cushion farmers from the adverse effects of weather and improve productivity (Economic Recovery Strategy, 2020). Both education and health sector are proposed to receive Ksh 508.6 billion and Ksh. 112.6 billion respectively, a 1% increase from the budget allocation in financial year 2020/21. Despite one of the key pillars of economic recovery strategy targeting to facilitate clean, green and resilient growth, proposed budget allocations to the environment protection, water and natural resources for the financial year 2021/22 is contracted by 2% compared to the budget allocation of the previous year.

The County governments' post Covid 19 recovery strategy was also launched on the 4th of December 2020 (Presidential Address December 4th, 2020). The strategy, the third stimulus package which is worth Ksh. 132 billion, comprises a recovery plan that priorities agriculture, water and sanitization, urban development and housing, transport, tourism, health, education, social protection, and gender and youth as anchor sectors that will help Counties to recover from the effects of Covid-19. The allocation towards county post covid-19 recovery strategy is drawn from county government budgets over the next three financial years, supplemented by resources from development partners. The strategy is expected to drive economic growth and economic rebound in the counties as the national government rolls out similar initiatives at the national level. Notably about Ksh 46.2 billion (0.4% of GDP) of the total stimulus III package of Ksh 132 billion was allocated in the national budget for 2021/22[6].

[6]National Treasury Budget Statement 2021/2022

2.2 Monetary Policy Stimulus and Liquidity Support to Businesses

In January 2020, the Central Bank of Kenya (CBK) lowered the Central Bank Rate (CBR) from 8.50% to 8.25% to facilitate more accommodative monetary policy that would promote lending to the private sector. At the time, growth in private sector credit stood at 7.1%. The reduction of the CBR resulted in an increase in the growth of private sector credit by 0.6 percentage points by February 2020[7].

By March 2020, with the onset of the Covid-19 pandemic, it was evident that the health crises would bring along adverse economic consequences and there would be need to provide liquidity support to businesses. In this regard, the CBK responded by not only lowering the CBR even further but also through the operationalization of the Credit Guarantee Scheme for the vulnerable Micro, Small and Medium- sized Enterprises (MSMEs). In particular, the Monetary Policy Committee of the CBK saw it prudent to lower the CBR to 7.25%. This was coupled with the lowering of the Cash Reserve Ratio (CRR) from 5.25% to 4.25%. In effect this resulted to a release of Ksh 35.2 billion additional liquidity to commercial banks available for lending to their depositors[8], which was about 16.7% increase by end of November 2020 relative to the previous year but information on bank lending was not clear.

In as much as additional liquidity was now available to commercial banks for lending purposes, access to funding remained a challenge for most Kenyan MSMEs. This was both a supply and demand side problem. A demand problem because MSMEs have peculiar characteristics such as lack of sufficient collateral which makes them high risk borrowers. A supply side problem due to market imperfections. The Credit Guarantee Scheme sought to close this MSME financing gap by setting aside Ksh 3 billion as a stabilization facility to be used as seed capital for MSMEs to access credit from partnering banks[9].

The scheme was on from March to October 2020 to encourage banks to lend to MSMEs that were tax compliant, with relevant business permits and good credit history on flexible terms, and to reduce collateral requirements. The finance would be utilized for working capital, acquisition of assets and recovery from the effect of Covid-19 pandemic. It is anticipated that by 2023, the National Treasury with the support of the World Bank, the African Development Bank, USAID and Financial Sector Deepening Kenya may make available an additional Ksh 10 billion to the scheme.

---

[7]https://www.centralbank.go.ke/uploads/mpc_press_release/464303380_MPC%20Press%20Release%20-%20Meeting%20of%20January%2027%202020.pdf

[8]https://www.centralbank.go.ke/uploads/mpc_press_release/765216187_MPC%20Press%20Release%20-%20Meeting%20of%20March%2023,%202020.pdf

[9]https://www.kba.co.ke/downloads/KBA%20Chairman%20Op%20Credit%20Guarantee%20Scheme.pdf

2.2.1 Mobile Money Transactions

Another notable response made in March 2020 is the digital payment through mobile money transactions targe ting the banking and financial sector. Specifically, changes in mobile money transaction were effected not only to enhance cashless transactions as a way to reduce spread of Covid-19 but also financial inclusion to the most vulnerable population , that is women, children and older persons. The movement to cashless transactions had a number of positive outcomes on mobile money and bank agents, (who provide services in Cash-in (deposits) and Cash-out (withdrawals) referred to as CICO).

Among changes made to mobile money transactions in March to June 2020, was the waiver on transactions for up to Ksh 10,000. This contributed to an increase in the number of bank e-wallet transactions by Ksh 488,000 per week valued at Ksh 1.7 million per month. Mobile money transactions of Ksh 1,000 and below constituted over 80% of all mobile money transactions. The waiver on transactions for up to Ksh 1,000 encouraged customers to make small transfers digitally and this reduced withdrawal at agents. Business related transactions were also reported to have declined. An additional 1.6 million customers used mobile money channels since March 16th 2020. The March to June 2020 wallet and transaction limits were extended to December 31st 2020.

Mobile money transactions daily limit was increased to Ksh 150,000 from the previous limit of Ksh 70,000 per transaction for every person while the daily limit for mobile money transactions was increased to Ksh 300,000 from the previous limit of Ksh 140,000. The mobile money wallet limit was also increased to Ksh 300,000 and the monthly total for mobile money transactions eliminated as well. As a result, the tariff that was applied to the old mobile money transaction limit of Ksh 70,000 effectively applied to the new one of Ksh 150,000.

On top of that, fees on transfers between mobile money wallets and bank accounts was waived by payment service providers and commercial banks during the same period. The charges waived on transfer of funds between mobile wallets and banks made it a preferred deposit option as opposed to depositing cash at physical agent locations.

The Monetary Policy Committee in June 2020 extended the waiver on transactions up to Kshs 1,000 and the tariff for the mobile money transaction limit also remained in force. Charges remained waived by payment service providers and commercial banks for transfers between mobile money wallets and bank accounts. The extended waivers had an impact on telco companies and banks that made losses during this period. For example, by November 9th 2020, telco company Safaricom reported a 6% decline in profits to Kshs 33.07 billion with reported service revenue of Kshs 118.4 billion, a notable 4.8% decline.

By 17th December, it was reported (release by the Monetary Policy Committee) that mobile money usage, that is, monthly volume of person-to-person transactions increased by 87 percent between February and October 2020. Over this period the volume of transactions below Ksh 1,000 increased by 114 percent, while 2.8 million additional customers are using mobile money. Business-related transactions also recorded significant growth over the same period.

Nevertheless, several revisions were announced in relation to the responses made on mobile money transactions in March 2020. These revisions that took effect from 1st of January 2021 and 1st April respectively, these included:

Revisions on Mobile Money Transfers from 1st January 2021

Policies	Implications
No charge for person-to-person transfers of up to Ksh.100 to any customer and network	Increase of mobile payments through agents
Maintained waiver on charges for transfers between mobile money wallets and bank accounts	Increase in mobile money transfers
SACCOs permitted to levy a charge for transfers between themselves and mobile money wallets	Recovering from previously made losses during the period when waivers were implemented
The payment service providers were also directed to propose pricing structures that reflect "pricing principles"	More customer transactions covered as well as maintaining customers gained during the waiver period

Source: Central Bank of Kenya

Revisions on Mobile Money Transfers from 1st April 2021

Resumption of charges for transactions above Ksh 100 through bank specific mobile money wallets linked to the Sacco sector	Increase of mobile payments through bank agents and payment service providers agents
Maintained waiver of charges between mobile money wallets and bank accounts	Recover losses incurred during the waiver period

Source: Central Bank of Kenya

3

3.0 Methodology: Choosing Policies and Tracing Their Impact

The methodology adopts two broad policy anchors, namely: (i) back to business as usual (fast recovery and (ii) building back better (rainbow recovery) for each of the three policy responses. The matrix captures in summary, the chosen policies.

Due to data challenges, we did not undertake or trace the socio-economic impact of the chosen trade policy[10]. Therefore, we have not provided further explanation of what the chosen trade policies under the two broad policy anchors entails. Equally, analysis of financial policy response (particularly monetary policy) is minimal, and is based on deductions. The focus of this report is more on the analysis of effects of fiscal policy response.

	Back to business as usual asap, fast recovery	**Building back better/Rainbow recovery**
Fiscal policy	Increased stimulus as previously implemented (e.g. for households only)	8-Point Economic Stimulus Programme (Ksh 56.2 billion) and consequently County Government post COVID 19 socioeconomic recovery strategy of Ksh 132 billion to be implemented over 3 years (from FY2022/23-2024/25)
Financial policy	More general financial liquidity constrained in use	More targeted liquidity while dealing with non-performing loan (NPL) issues; lifting of interest rate cap
Trade policy and production	Import substitution in garments (ban second hand clothing, more NTB, food)	Focus on integration, trade facilitation, free trade agreements with the US, promoting investment in diversification and manufacturing, retooling factories for personal protective equipment (PPE)

Source: Authors' compilation

[10]The Institute of Economic Affairs-Kenya may pursue conducting an analysis on the effects of trade policy at a later stage.

3.1 Fiscal Policy: Back to Business as Usual

In March 2020 with the outbreak of the pandemic, the government's fiscal response was a shift from fiscal consolidation agenda towards protecting lives and livelihoods. This economic stimulus response, as earlier noted was a mix of tax relief and expenditure related measures (see table 6 and 7).

3.2 Fiscal Policy: Building Back Better

The government launched a more expanded second fiscal policy response dubbed the "8-point Economic Stimulus Programme (ESP) of Ksh 56.2 billion (0.5% of GDP) in May 2020. Unlike the first response, this ESP as shown in fig 3 is more sustainable given that its focus is wide including budgetary allocation towards infrastructure development and the environment. The government is currently implementing this stimulus package whose objective is to return the economy to the pre-COVID 19 growth trajectory. This according to the Budget Policy Statement 2021 is part of the focus of fiscal policy in 2020/21, which remains to respond to the socio-economic impact of COVID 19 pandemic. In particular, this programme seeks to increase demand for local goods and service, cushion the vulnerable groups of the population, secure household food security for the poor and create employment and incomes. Part of the funds allocated are to be spent in creating jobs for the youth under a programme dubbed "Kazi Mtaani" for improving road and related infrastructure such as footbridges and storm water drainage in major cities and urban areas. Other portions are for enhancing liquidity for MSMEs, enhanced cash transfer to the vulnerable populations, supporting tourism recovery and improving health and education outcomes. Successful implementation of this programme is premised on implementation of policy, legal and institutional reforms that are necessary for effective implementation of the post COVID 19 ERS.

To estimate the effect of this injection of funds/stimulus on economic output, we utilized readily available sectoral fiscal multipliers from various secondary sources consolidated in a single empirical report[11]. Of course, the magnitude of the stimulus and how it is financed to a large extent determine the economic effects.

The 3-year post covid 19 economic recovery plan of Ksh 132 billion[12] was also considered for the scenarios for fiscal multiplier effects on overall economic output. This plan (third stimulus package) prioritizes similar sectors to the 8-point ESP (second stimulus package) as well as urban development and housing and gender and youth as anchor sectors that will help Counties to recover from the effects of Covid-19.

[11] Sherillyn R (2022) Fiscal Multipliers: A Review of Fiscal Stimulus Options and Impact on Poor Countries. Supporting Economic Transformation (SET)

[12] https://www.president.go.ke/2020/12/04/president-kenyatta-launches-county-governments-post-covid-recovery-strategy/

We drew three scenarios in the assessment of the socio-economic impact of the expanded ESP under the building back better anchor (effect of injection of stimulus). These three scenarios are:

- Untargeted total expansionary fiscal stimulus (increase in public spending)
- With actual allocation to targeted sectors (summation of individual value for all the sector spending times their respective multiplier effect)
- With hypothetical re-allocation to targeted sectoral with high multiplier effects

The anticipated economic output growth based on each of the three scenarios was compared with the baseline GDP (where there is no increase in usual fiscal spending) position.

Information on baseline GDP for 2020/21 was obtained from Kenya National Bureaus of Statistics whereas data on second and third stimulus package was accessed from various National Treasury reports. The second part of the analysis showed simulation of fiscal multiplier effects based on reallocation to the sectors with high sector growth as identified from the same reports with compiled fiscal multipliers information.

4

4.0 Findings

4.1 Socio-Economic Impact of Fiscal Policy Response

With an economic stimulus programme II of Ksh 56.2 billion aimed at building back better, its socioeconomic effects in Kenya at least in the short run, is the question that begs answers. Table 8 presents three scenarios with estimation of this fiscal stimulus effect on growth of economic output from baseline GDP.

Table 8: Scenarios of Socioeconomic Impact of Fiscal Policy Response to GDP

Scenarios			2020/21, Ksh billion (A)	Multiplier effects (B)			Sources (Kenyan cases, except green spending and De Henau for gendered stimulus)	A*B	2021 (baseline GDP+ scenario fiscal stimulus)	Marginal percentage points growth effects from baseline
				Lower bound	Upper bound	Avg				
										2021
I	Baseline GDP (no increase in usual fiscal spending) Ksh billion		11,276.0						11,276.0	0.00
II	Untargeted total expansionary fiscal stimulus (increase in public spending) (Ksh Billion)		56.2	0.1	0.4	0.3	Bucket approach' ala Batini et al (2014); Asea, 2016; World Bank (2010)	14.1	11,290.1	0.12
	% of GDP		0.5							

II	Untargeted total expansionary fiscal stimulus (increase in public spending) (Ksh Billion)		56.2	0.1	0.4	0.3	Bucket approach' ala Batini et al (2014); Asea, 2016; World Bank (2010)	14.1	11,290.1	0.12
	% of GDP		0.5							
III	With actual allocation to targeted sector		56.2					16.8	11,292.8	0.15
	% of GDP		0.5							
*Explicit % share allocation										
	Social protection	1.8	1.0	2.4		2.4	Asea, 2016	2.4		
	Health (upper bound multiplier if gendered/care economy)	3.0	1.7	1.1	3.0	2.1	Asea, 2016; De Henau et al, 2017	5.1		
	Education	13.2	7.4	0.7	1.0	0.8	Asea 2016; Mudaki and Masarivu, 2012	6.0		
	Agriculture	8.9	5.0	-0.9	-0.1	-0.5	Asea, 2016; Mudaki and Masarivu, 2012	-2.4		
	Tourism	10.7	6.0	-0.9		-0.9	Asea, 2016	-5.2		
	Green spending	10.3	5.8	0.6	1.4	1.0	Politt, 2011; Batini et al, 2021	3.5		
	Residual (untargeted)	52.1	29.3	0.1	0.4	0.3	Bucket approach' ala Batini et al (2014); Asea, 2016; World Bank (2010)	7.3		
IV	With hypothetical re-allocation to targeted sectoral with high multiplier effects*		56.2					79.4	11,355.4	0.70

	% of GDP		0.5							
		**proposed % share allocation								
	Social protection	30%	16.9	2.4		2.4		40.5		
	Health (upper bound multiplier if gendered/ care economy)	20%	11.2	1.1	3.0	2.1		33.7		
	Education	15%	8.4	0.7	1.0	0.8		6.8		
	Agriculture	13%	7.3	-0.9	-0.1	-0.5		-3.4		
	Tourism	10%	5.6	-0.9		-0.9		-4.8		
	Green spending	12%	6.7	0.6	1.4	1.0		6.7		

Source: Authors' Computation

For this exercise, we notably adopted the average size of fiscal multipliers based on existing fiscal multiplier estimates in Kenya's context as summarized in Raga (2022). For the impact of the sectoral fiscal spending that lacks estimates for Kenyan context, we adopted the average fiscal multiplier estimate for public spending on green investment in developing country context, and the upper bound fiscal multiplier estimate for the care and health following the Indonesian case.

Scenario II: Untargeted total expansionary fiscal stimulus of Ksh 56.2 billion (0.5% of GDP) factoring average fiscal multiplier effect of 0.3 results to economic output going up by Ksh 14.1 billion.

Therefore, the baseline economic output (GDP) for 2020/21 of Ksh 11,276 billion is expected to go up to Ksh 11,292.8 billion. This translates to a marginal growth of 0.12 percentage points.

Scenario III: Actual allocation to the six targeted sectors and residual allocation leads to a marginally higher growth impact relative to what we see in scenario I. Overall fiscal multiplier effect is higher, Ksh 16.8 billion, translating to baseline GDP for 2020/21 of Ksh 11,276 billion going up to Ksh 11,282.9 billion. This translates to a marginal growth of 0.15 percent.

Scenario IV: By hypothetically re-allocating to targeted sectoral with relatively high multiplier effects leads to an even higher economic output growth impact than what we see in scenarios II and III. As shown in table 8, social protection was reallocated the largest share, 30% of total fiscal stimulus of Ksh 56.2 billion given that it has the highest multiplier effect, followed by the health sector and lowest share went to tourism. Impact of reallocation to sectors with high growth leads to baseline GDP going up to Ksh 11,355.4 billion, 0.7 percentage points more than the based GDP.

4.1.2 Effects of Comprehensive Economic Recovery Strategy Plan (Stimulus Package III)

This section provides two additional scenarios similar to scenarios III and IV of the effect of the stimulus package III (Ksh 132 billion) over 3 years on economic output growth.

Table 9: Fiscal Multiplier Effects for Stimulus Plan of Ksh 132 Billion

Scenarios			2020/21, Ksh billion (A)	Multiplier effects (B)			Sources (Kenyan cases, except green spending and De Henau for gendered stimulus)	A*B	2021 (baseline GDP+ scenario fiscal stimulus)	Marginal percentage points growth effects from baseline
				Lower bound	Upper bound	Avg				
										Over 3 years
V	Untargeted total fiscal stimulus KSh 132 billion recovery plan over 3 years		132	0.1	0.4	0.3	Bucket approach' ala Batini et al (2014); Asea, 2016; World Bank (2010)	33.0	11,309.0	0.29
VI	Hypothetical re-allocation to total KHs 132 billion recovery plan over 3 years to sectors with high multiplier effects*		132					180.3	11,456.3	1.60
	% of GDP		1.2							
		*proposed % share allocation								
	Social protection	30%	39.6	2.4		2.4		95.0		
	Health (upper bound multiplier if gendered/care economy)	20%	26.4	1.1	3.0	2.1		79.2		

	Education	15%	19.8	0.7	1.0	0.8		15.9		
	Agriculture	13%	17.2	-0.9	-0.1	-0.5		-8.1		
	Tourism	10%	13.2	-0.9		-0.9		-11.4		
	Green spending	12%	15.8	0.6	1.4	1.0		9.5		

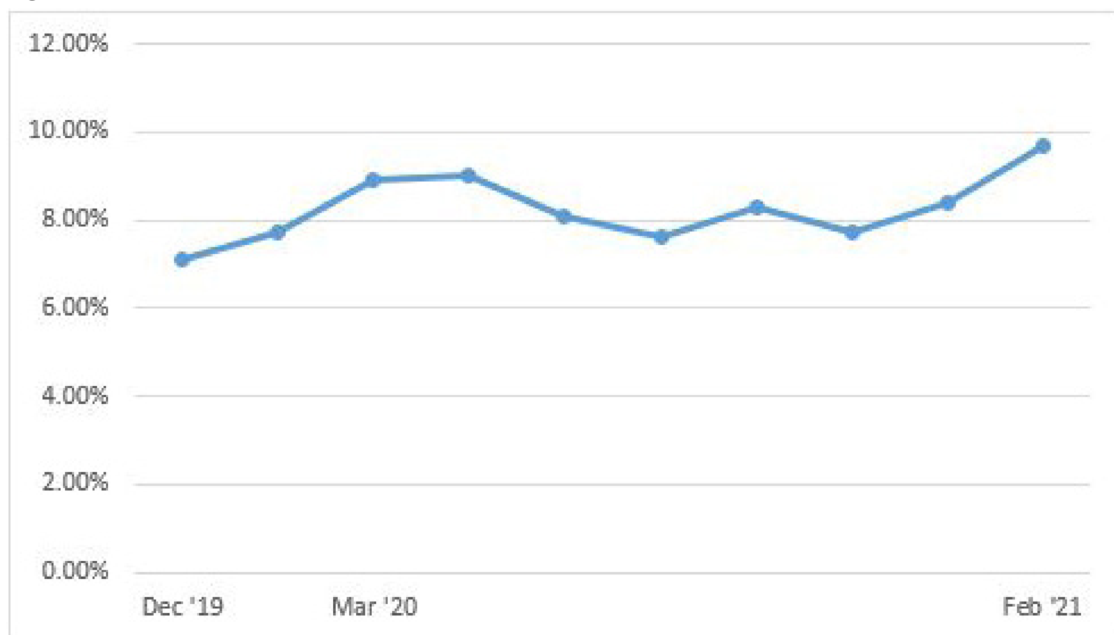
Source: Author's Computation

Table 9 shows that the impact of the significantly bigger stimulus package III of Ksh 132 billion (1.2% of GDP) on economic output is obviously higher than in the ESP II. Under scenario V, untargeted fiscal spending worth 1.2% of GDP can marginally increase Kenya's GDP growth by 0.3 percentage points over three years. But this impact of fiscal stimulus on growth can increase up to 1.6 percentage points if, as shown under scenario VI, public spending are targeted to sectors that have high fiscal multipliers, such as social protection, health sector and green investment.

4.2 Socio-economic Impact of Monetary Policies

Monetary policy response by the CBK is a critical determinant of how fast and effective the economic recovery will be. The impact of policy measures is documented through various Monetary Policy Committee (MPC) reports. This deductive result on socio economic impact of monetary policies provide no link to gender and environmental outcome due to data constraints.

Fig 5: Growth in Private Sector Credit



Source: Central Bank of Kenya

So far, these monetary policy measures taken to provide additional liquidity to businesses have proven to be successful as the growth in private sector credit by February 2021 was at 9.7%, the highest since December 2019 (see fig. 5). Recent reports have noted that this growth has remained resilient at 6.8% in the 12 months to April 2021, with significant loan repayment and recoveries in March and April 2021 in the transports and communication, real estate, tourism, restaurants and hotels and agriculture sectors.

Notably, strong credit growth was observed in the following sectors: transport and communication (13.3%); agriculture (10%); finance and insurance (7.6% and consumer durables (19.3%). The same reports also note that despite a dip in loan applications in April, private sector credit growth picked up in May 2020. Moreover, further progress on private sector credit growth was also noted in regard to lending under the Credit Guarantee Scheme that was operationalized in October 2020.

Although a rise of ratio of non-performing loans (NPLs) to gross loans is an impediment to policy stimulus, the banking sector as noted by the MPC has remained stable and resilient with strong liquidity and capital adequacy ratios. Despite projections by Fitch painting a grimmer picture of NPLs rising to 15% as at the end of 2020[13], it stood at 13.6% in September 2020 up from 12% in December 2019 and by April 2021 increased to 14.2%. It is important to note that increased domestic borrowing will however continue to crowd out private sector and pose further risk if commitment to fiscal consolidation is derailed. How this develops is something worth monitoring closely on the necessary additional measures to avoid reversals of gains so far.

[13]Various MPC Press Releases and Coronavirus Impact of Kenyan Banks 2020, Fitch Ratings and Parliament Budget Office Budget Options January 2021

5

5.0 Conclusion and Recommendations

The government of Kenya has promptly responded to allaying the socioeconomic shock experienced disproportionately by those working in the gig economy and generally low-income earners (hand to mouth population) from the pandemic. This response in building back better, through both fiscal and monetary policy stimulus have to some extent resulted to stirring up the economic output. However, our scenario building exercise shows that the growth impact of the government's fiscal stimulus package could greatly be improved if targeted to sectors with high multiplier effects, particularly on social protection, health, education and green spending. The growth impact of targeted fiscal spending could potentially be higher if dedicated to labour-intensive social and physical infrastructure development and in rural areas. In medium to long term, focus on green investment could result to higher socio-economic effects.

As Kenya attempts to revive economic activities while the pandemic continues to evolve, there is a need to pay higher attention to other growing vulnerabilities. The government needs to not only reignite fiscal consolidation efforts, but also to curb domestic borrowing in the ensuing budget financing and to closely monitor the rising NPL in order to design prompt and effective monetary policy response.

References

1. National Treasury. (2020, December 4). National Treasury. Retrieved from National Treasury
2. Presidential Address. (2020, May 23). THE SEVENTH PRESIDENTIAL ADDRESS ON THE CORONAVIRUS PANDEMIC: THE 8-POINT ECONOMIC STIMULUS PROGRAMME SATURDAY 23RD MAY, 2020 . Retrieved from The Presidency: https://www.president.go.ke/2020/05/23/the-seventh-presidential-address-on-the-coronavirus-pandemic-the-8-point-economic-stimulus-programme-saturday-23rd-may-2020/
3. Presidential Address December 4th. (2020, December 4). President Kenyatta Launches County Governments Post-Covid Recovery Strategy. Retrieved from The Presidency: https://www.president.go.ke/2020/12/04/president-kenyatta-launches-county-governments-post-covid-recovery-strategy/
4. Presidential Address March 25th. (2020, March 25). PRESIDENTIAL ADDRESS ON THE STATE INTERVENTIONS TO CUSHION KENYANS AGAINST ECONOMIC EFFECTS OF COVID-19 PANDEMIC. Retrieved from The Presidency: president.go.ke/2020/03/25/presidential-address-on-the-state-interventions-to-cushion-kenyans-against-economic-effects-of-covid-19-pandemic-on-25th-march-2020/
5. Sherillyn R (2021) Fiscal Multipliers: A Review of Fiscal Stimulus Options and Impact on Poor Countries. Supporting Economic Transformation (SET)
6. State Department for Youth Affairs. (2020). Kazi Mtaani Initiative. Retrieved from State Department for Youth Affairs: http://youth.go.ke/kazi-mtaani/
7. The National Treasury. (2021, February). The National Treasury. Retrieved from The National Treasury:http://www.parliament.go.ke/sites/default/files/2021-02/2021%20Budget%20Policy%20Statement%20from%20the%20National%20Treasury.-compressed.pdf
8. World Bank. (2010). Fiscal Policies andInstitutions for Shared Growth in Kenya: Lessons from the Global Crisis. Paper 69709. Washington DC: World Bank.
9. World Bank. (2020). Unmasking the Impact of COVID-19 on Businesses : Firm Level Evidence from Across the World. Retrieved from World Bank: https://openknowledge.worldbank.org/handle/10986/34626
10. https://www.reuters.com/?redirect=true
11. https://www.centralbank.go.ke/uploads/weekly_bulletin/1105259424_Weekly%20Bulletin%20Report%20March%205%202021.pdf
12. https://www.centralbank.go.ke/uploads/weekly_bulletin/1784328936_Weekly%20Report%20-%20Jan%204,%202019.pdf
13. https://www.economist.com/economic-and-financial-indicators/2010/08/12/import-cover

14. https://www.centralbank.go.ke/uploads/weekly_bulletin/169961235_Weekly%20Report%20Dec%2027,%202019.pdf
15. https://www.centralbank.go.ke/statistics/balance-of-payment-statistics/
16. https://www.centralbank.go.ke/diaspora-remittances/
17. https://www.centralbank.go.ke/uploads/weekly_bulletin/1105259424_Weekly%20Bulletin%20Report%20March%205%202021.pdf
18. https://www.centralbank.go.ke/uploads/cbk_annual_reports/322580908_2020%20Annual%20Report.pdf
19. https://www.americanexpress.com/us/foreign-exchange/articles/usd-exchange-rate-affecting-global-credit-international-trade/
20. https://www.thebalance.com/world-currency-3305931#:~:text=According%20to%20the%20International%20Monetary,t%20hold%20an%20official%20title.
21. https://www.reuters.com/article/kenya-markets-idUSL8N2IJ24H
22. https://www.centralbank.go.ke/rates/forex-exchange-rates/
23. https://www.centralbank.go.ke/statistics/monetary-finance-statistics/
24. https://www.csis.org/analysis/kenyas-case-covid-19
25. https://unon.org/COVID-19/response-in-kenya
26. https://www.bowmanslaw.com/insights/corporate-services/covid-19-tracking-government-response-in-kenya/
27. https://www.mondaq.com/operational-impacts-and-strategy/1011992/covid-19-tracking-government-response-in-kenya
28. https://www2.deloitte.com/ke/en/pages/about-deloitte/articles/ke_covid_updates.html
29. https://www.who.int/news-room/feature-stories/detail/eu-and-who-working-together-to-defeat-covid-19-in-kenya
30. https://www.ke.undp.org/content/kenya/en/home/coronavirus.html

Institute of
Economic Affairs

Institute of Economic Affairs

5th Floor, ACK Garden House | P.O. Box 53989 - 00200 Nairobi, Kenya.

Tel: +254-20-2721262, +254-20-2717402 | Fax: +254-20-2716231

Email: admin@ieakenya.or.ke | Website: www.ieakenya.or.ke