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STRENGTHENING EFFICIENCY IN PUBLIC EXPENDITURE





Budget Options for FY 2027/2028 and the Medium Term

NOVEMBER 2026 (EDITION NO. 18)

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Acronyms and Abbreviations

AIA	Appropriations In Aid
AHP	Affordable Housing Programme
BETA	Bottom-Up Economic Transformation Agenda
BROP	Budget Review and Outlook Paper
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CFS	Consolidated Fund Services
EAC	East African Community
FDI	Foreign Direct Investment
FDP	Field Development Plan
GDP	Gross Domestic Product
ICT	Information and Communication Technologies
ILO	International Labour Office
KESONIA	Kenya Shilling Overnight Index Average
KMRC	Kenya Mortgage Refinance Company
KNBS	Kenya National Bureau of Statistics
KPRL	Kenya Petroleum Refineries Limited
LAPSSET	Lamu Port-South Sudan-Ethiopia Transport
MDAs	Ministries, Departments and Agencies
MSMEs	Micro, Small and Medium Enterprises
MTP	Medium Term Plan
PBO	Parliamentary Budget Office
PFM	Public Finance Management
PSC	Private Sector Credit
RBCPM	Risk-Based Credit Pricing Model
SSA	Sub-Saharan Africa
TFP	Total Factor Productivity
TPS	Tenant Purchase Schemes
USD	US dollars
VAT	Value Added Tax

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Executive Summary

Key messages

The economy remains resilient, but growth has not accelerated. Real GDP growth averaged about 4.6 percent in 2017–2025 and stood at 5.1 percent in the first two quarters of 2026. Investment has stayed near 18–20 percent of GDP and productivity has declined, which limits faster growth.

Price and external pressures have risen. Inflation increased to 6.8 percent in September 2026 on account of higher energy costs, though it remains within the Central Bank of Kenya target range. The current account deficit widened in the first quarter of 2026, while foreign exchange reserves strengthened to 6.4 months of import cover.

Fiscal space is limited. Revenue in FY 2025/26 was Kshs. 60.2 billion below target, interest payments reached Kshs. 1,074.4 billion, and public debt rose to Kshs. 13.1 trillion at end-June 2026.

The medium-term outlook is stable, with modest gains possible from targeted measures. Growth is projected to average about 4.8 percent in 2026–2028 under the baseline and 5.0 percent under the alternative scenario. The FY 2027/28 budget is projected at Kshs. 5.303 trillion under the baseline, with a fiscal deficit of 6.2 percent of GDP, compared with 6.0 percent under the alternative scenario.

The budget options emphasise efficiency within existing resources. Most options can be implemented with current resources. The options quantified in this paper amount to Kshs. 9.85 billion in FY 2027/28, alongside an existing health commitment of Kshs. 20 billion.

The FY 2027/28 budget cycle will run ahead of the normal calendar. On account of the General Elections scheduled for August 2027, the Budget Policy Statement will be approved on or before mid-December 2026, and the Appropriations Bill and the Finance Bill on or before the end of March 2027.

Summary of budget options

Area	Budget options	Cost in FY 2027/28 (Kshs. millions)
Research and innovation	Raise research funding progressively towards 2 percent of GDP; establish a functioning research and innovation infrastructure; encourage private investment in research.	2,000
Affordable housing offtake	Prioritise mortgage financing for affordable units; direct Tenant Purchase Schemes and deposit assistance to social housing; encourage cash purchases and improve the Boma Yangu allocation process.	Budget neutral
Lokichar–Lamu crude oil pipeline	Update the feasibility and bankability assessment; revive regional commercial negotiations; develop the pipeline in phases with private partners.	Budget neutral
Empowering Kenya's workforce	Expand Bilateral Labour Agreements; standardise pre-departure training; strengthen the National Employment Authority and its digital systems; fund migrant welfare and protection; support return and reintegration.	7,850
Climate financing	Issue Letters of Authorization in advance; operationalise the carbon budget mechanism; strengthen local verification capacity; clarify benefit-sharing.	Budget neutral
Total, new options		**9,850**
Health system transition	Existing commitment to raise domestic health spending under the Kenya–United States Health Cooperation Framework (not a new option).	20,000

Note: Options that are not quantified in this paper are assumed to be budget neutral and can be implemented within current resources.

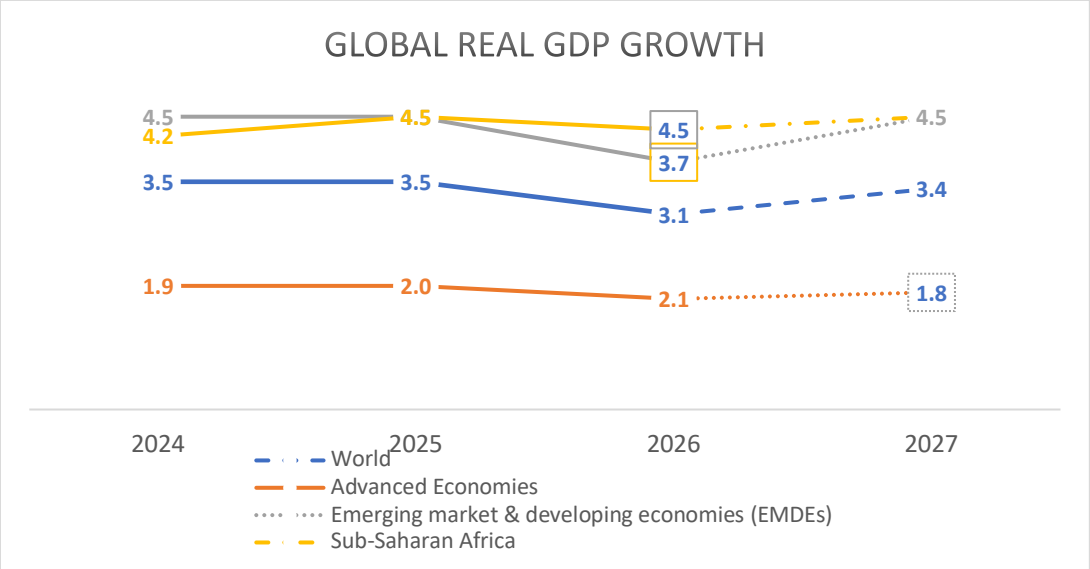
I. RECENT ECONOMIC DEVELOPMENTS

1.1. Global Economic Performance

1. **Global growth is projected at 3.1 percent in 2026 and 3.4 percent in 2027, down from 3.5 percent in 2025.** The outlook reflects the effects of the war in the Middle East: higher energy prices, supply disruptions and increased uncertainty. These pressures are expected to be partly offset by stronger demand in the global technology cycle, supported by advances in artificial intelligence and its adoption. **Global inflation is expected to rise from 4.1 percent in 2025 to 4.7 percent in 2026, before easing to 4.1 percent in 2027.** The increase in 2026 is mainly driven by higher energy and food prices associated with the Middle East conflict.

2. **Growth in advanced economies is projected to increase from 2.0 percent in 2025 to 2.1 percent in 2026.** This largely reflects an unexpected surge in technology-related investment, greater use of alternative energy sources and improved corporate logistics to minimise disruption from regional conflicts. In contrast, growth in emerging market and developing economies is expected to moderate from 4.5 percent in 2025 to 3.7 percent in 2026, reflecting geographical exposure to the Middle East conflict, tighter global financial conditions and uneven integration into global technology value chains.

Figure 1: Global Growth Trend



Source: IMF

3. **Growth in Sub-Saharan Africa (SSA) is projected to remain stable at 4.5 percent in 2026 (Figure 1).** Macroeconomic resilience, early policy reforms and favourable export receipts have helped cushion the region against global shocks. Private consumption and investment are expected to remain supportive, underpinned by accommodative monetary policy and improving external conditions. However, geopolitical tensions in the Middle East and high debt-service costs remain key risks, weighing on growth prospects and limiting job creation.

1.2. Domestic Growth

1.2.1 Economic Growth

4. **Kenya's economy has remained resilient, but growth has not accelerated sustainably.** Real GDP growth averaged about 4.6 percent annually in 2017–2025. Excluding the 2020 contraction and 2021 rebound, annual growth ranged from 3.8 to 5.7 percent in 2016–2025. Growth averaged roughly 5.0 percent in 2022–2025, only slightly above the 4.7 percent recorded in 2016–2019. Services remain the main engine of growth, contributing about 3.5 percentage points annually. Rainfall exposure, modest investment, weak productivity growth and a thin manufacturing base continue to constrain the outlook. Economic growth of 5.1 percent in both the first and second quarters of 2026 signals stability, but does not represent a completed annual result. A broader sector mix is promising; sustained acceleration will require stronger investment and productivity.

Figure 2: Economic Growth Trend

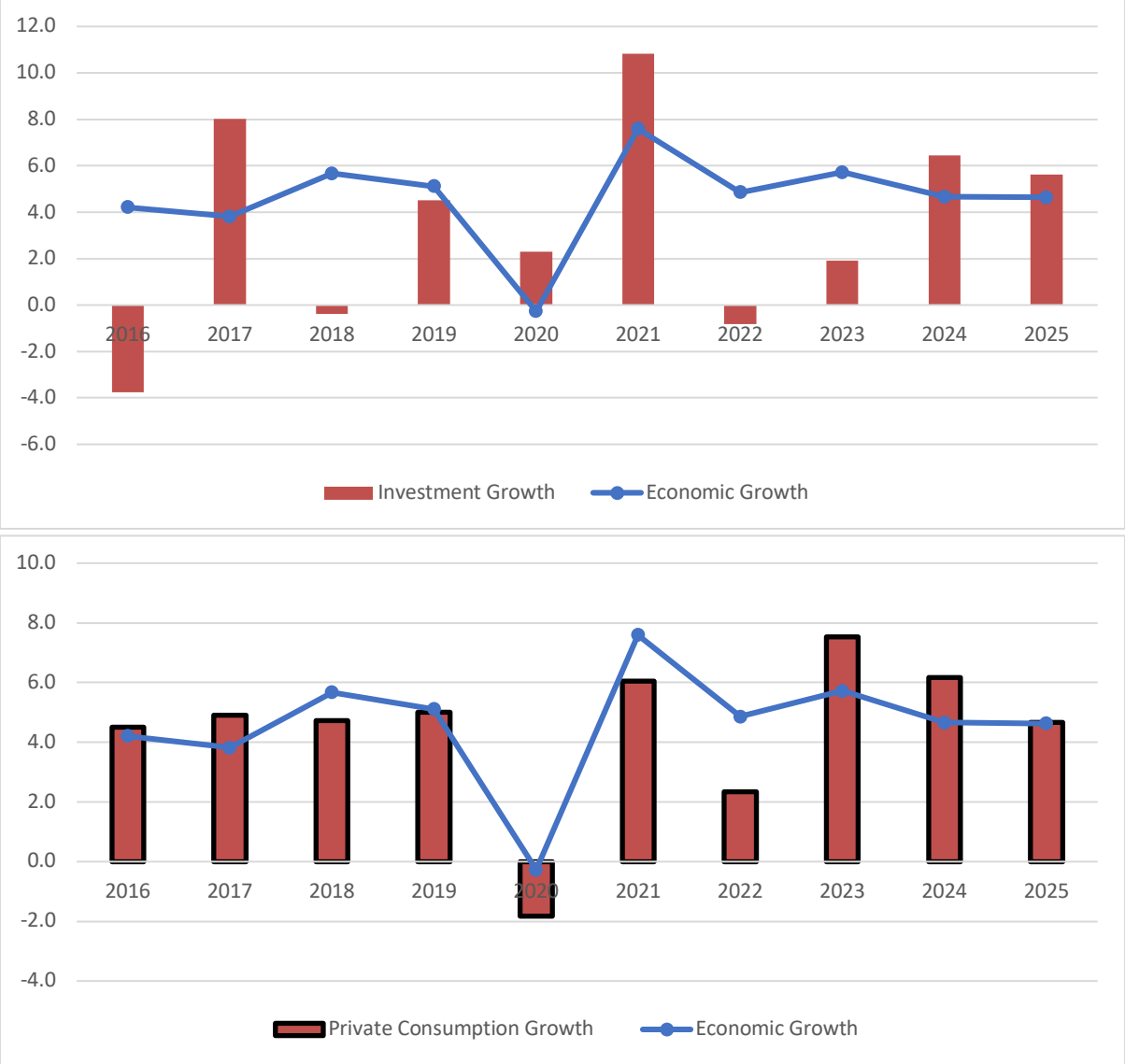


Source: KNBS

5. **Weather, services activity and the pandemic drove growth fluctuations.** Drought weakened agriculture in 2017 and 2022; the sector contracted by 1.5 percent in 2022 amid higher fuel and fertiliser prices. Better rains supported growth in 2018 and 2023, with agriculture expanding by 6.6 percent in 2023. COVID-19 restrictions and collapsing tourism contracted services in 2020. Services' contribution fell from about 4.3 percentage points in 2023 to 3.3 in 2025. Construction and mining contracted by 0.7 and 7.8 percent respectively in 2024; agricultural growth slowed to 3.1 percent in 2025. High borrowing costs and fiscal consolidation may also have dampened activity. Structural constraints persist: agriculture represented about 23 percent of GDP in 2025, leaving output exposed to rainfall variability. Manufacturing accounted for under 8 percent of real output that year and grew by 2.2 percent in Q2 2026.

6. **Investment's modest and volatile recovery remains a constraint on faster growth.** Investment stayed near 18–20 percent of GDP, peaking at 20.2 percent in 2017, falling to 18.2 percent in 2023 amid high borrowing costs and fiscal consolidation, and recovering to 18.7 percent in 2025 (Figure 3). Investment growth was only loosely aligned with GDP growth: it fell by about 0.4 percent in 2018 and 0.8 percent in 2022 despite economic expansion, then recovered to about 6.4 percent in 2024 and 5.6 percent in 2025. Lower borrowing costs could help if they translate into additional capital formation.

Figure 3: Growth in Investment and Private Consumption



Source: KNBS

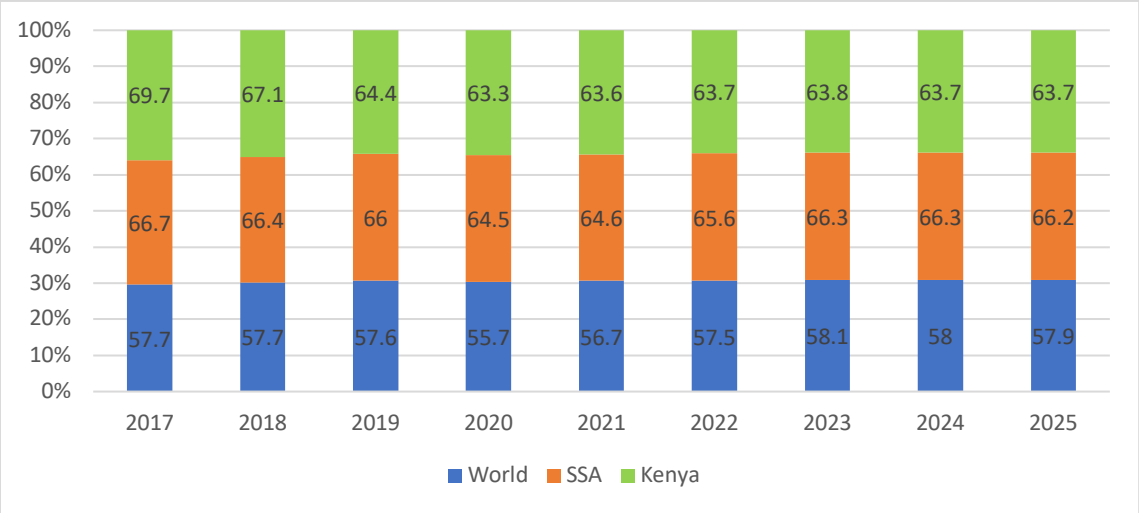
7. **Private consumption has slowed since 2023, while public consumption may have cushioned demand.** Private consumption contracted by about 1.8 percent in 2020 and rebounded by 6.0 percent in 2021 (Figure 3). Growth then weakened to 2.3 percent in 2022, recovered to 7.5 percent in 2023 and slowed to 4.7 percent in 2025. Domestic conditions remain broadly supportive. Easing monetary policy, exchange-rate stability and recovering private sector credit are expected to support household incomes and investment. However, anticipated El Niño-related rains could disrupt agricultural production and weigh on growth.

1.2.2 Labour Market

8. **Kenya's employment-to-population ratio has declined substantially since 2017.** It fell from 69.7 percent in 2017 to 63.3 percent in 2020, recovered gradually to 63.8 percent in 2023 and eased slightly to 63.7 percent in 2025 (Figure 4). Over the same period, the SSA ratio declined from 66.7 percent in 2017 to 64.5 percent in 2020, before recovering to 66.2 percent in 2025. The global ratio remained relatively

stable at 58 percent. These figures place Kenya below the SSA average but above the global average in 2025.

Figure 4: Employment as a ratio of population



Source: ILO

9. **Labour force participation has fallen while unemployment has increased since 2017.** Participation declined from 72.3 percent in 2017 to 67.4 percent in 2025, a reduction of 4.9 percentage points. Over the same period, unemployment increased from 3.5 percent to 5.4 percent. Although Kenya's unemployment rate remained below the SSA average of 5.7 percent in 2025 (Figure 5), lower participation suggests that labour market challenges extend beyond unemployment. They also concern the economy's ability to engage the working-age population in employment or active job search.

10. **Kenya's total factor productivity (TFP) declined significantly over 2015–2025.** The TFP measure increased from 874.7 in 2015 to a peak of 952.5 in 2018, before falling to 844.3 in 2019 and 739.0 in 2025 (Figure 6). This represents an overall decline of 15.5 percent from 2015. The sustained decline suggests that gains from efficiency, technology and the productivity of existing resources have not kept pace with the expansion of labour and capital inputs. Growth therefore appears increasingly reliant on factor accumulation rather than productivity gains.

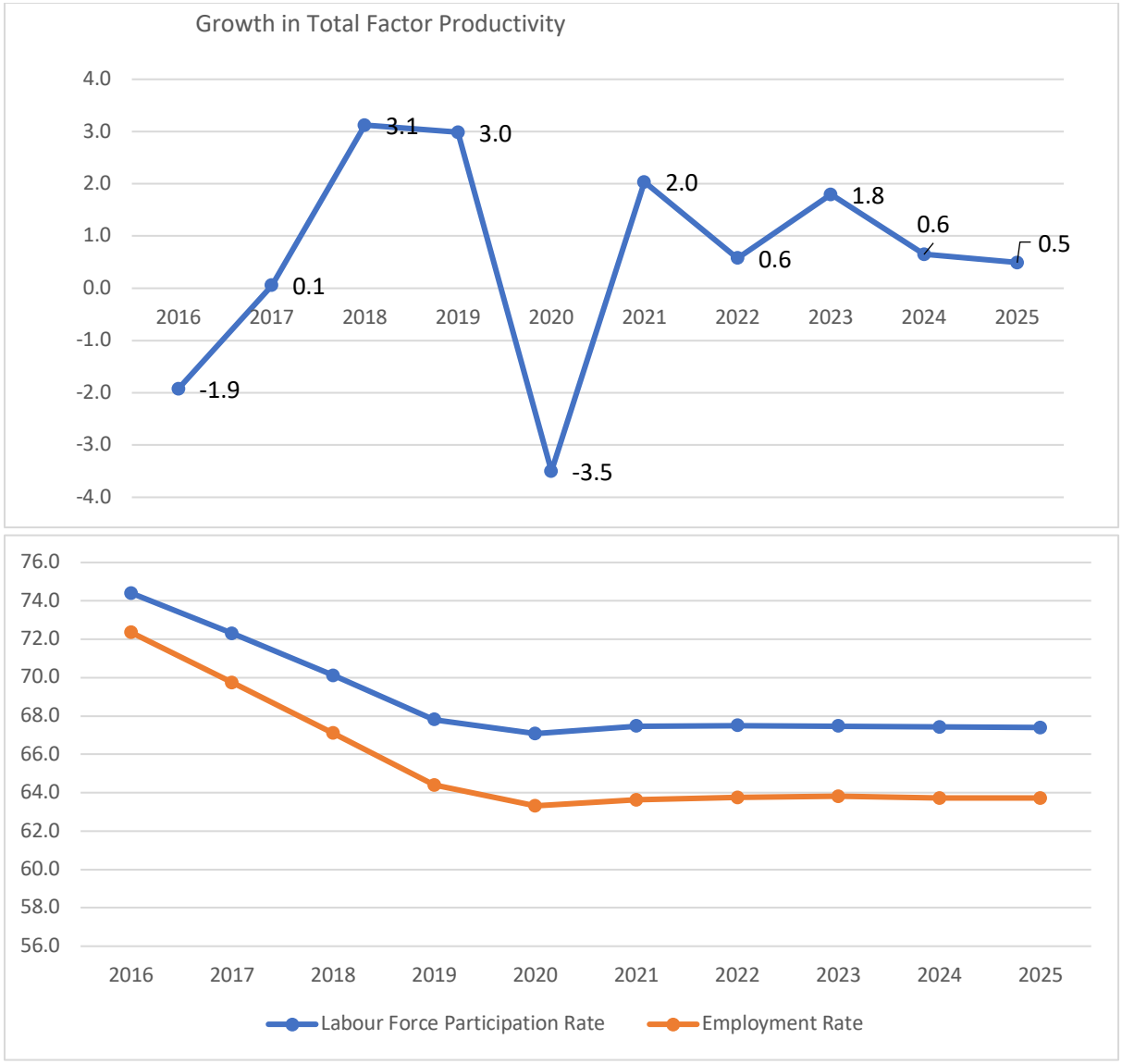
Figure 5: Labour force participation and unemployment rates



Source: ILO

11. **Weak productivity growth limits sustained economic acceleration.** TFP captures output growth unexplained by measured capital and labour, rather than efficiency alone. Its growth reached about 3.1 percent in 2018 and 3.0 percent in 2019, fell to -3.5 percent in 2020 and recovered to 2.0 percent in 2021. It then weakened to about 0.6 percent in 2024 and 0.5 percent in 2025 (Figure 6). Proposed responses include better infrastructure, cheaper energy, technology adoption and stronger manufacturing.

Figure 6: Growth in Total Factor Productivity



Source: PBO

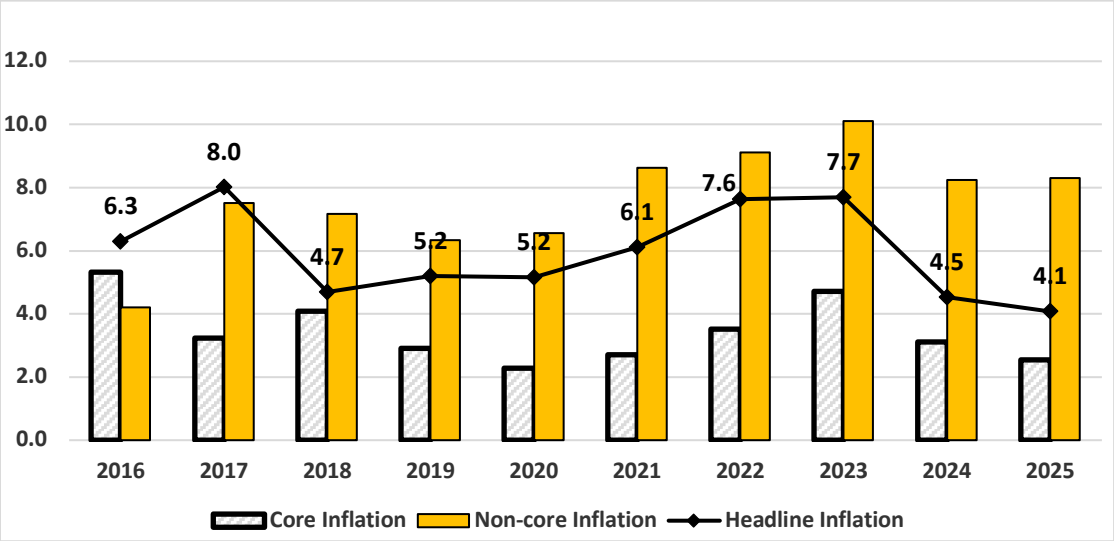
12. **The longer-term comparison also shows participation and employment stabilising below their 2016 levels.** The labour force participation rate fell from about 74.4 percent in 2016 to 67.1 percent in 2020, before settling near 67.4–67.5 percent. Employment fell from 72.3 to 63.3 percent and then settled near 63.7 percent. Assuming compatible definitions and a common working-age population denominator, the gap implies unemployment of roughly 3 percent of the labour force in 2016 and 5.5 percent in 2025.

13. **Declining TFP underscores the need for MTP IV and BETA interventions to raise productivity as well as investment and employment.** Priorities include technology adoption, skills development, infrastructure, industrialisation and support for productive sectors and Micro, Small and Medium Enterprises (MSMEs). Strengthening these areas would shift growth towards productivity gains and reduce reliance on the accumulation of labour and capital.

1.2.3 Inflation

14. **Volatile food and energy prices were the main drivers of inflation in 2016–2025.** Stable core inflation helped bring headline inflation to a decade-low 4.1 percent in 2025. Headline inflation generally stayed within the Central Bank of Kenya's 5±2.5 percent target range, except in 2017, when it peaked at 8.0 percent, and during the 2022–2023 shock, when it reached 7.6–7.7 percent. Non-core inflation rose to 10.1 percent amid global commodity and supply pressures. Core inflation generally ranged between 2.3 percent and 4.7 percent, easing from its 2023 peak to 2.5 percent in 2025, compared with 5.3 percent in 2016. Non-core inflation nevertheless remained elevated at 8.3 percent in both 2024 and 2025. The resulting 5.8 percentage-point gap in 2025 highlights food and energy prices as the main risks to price stability and household living costs.

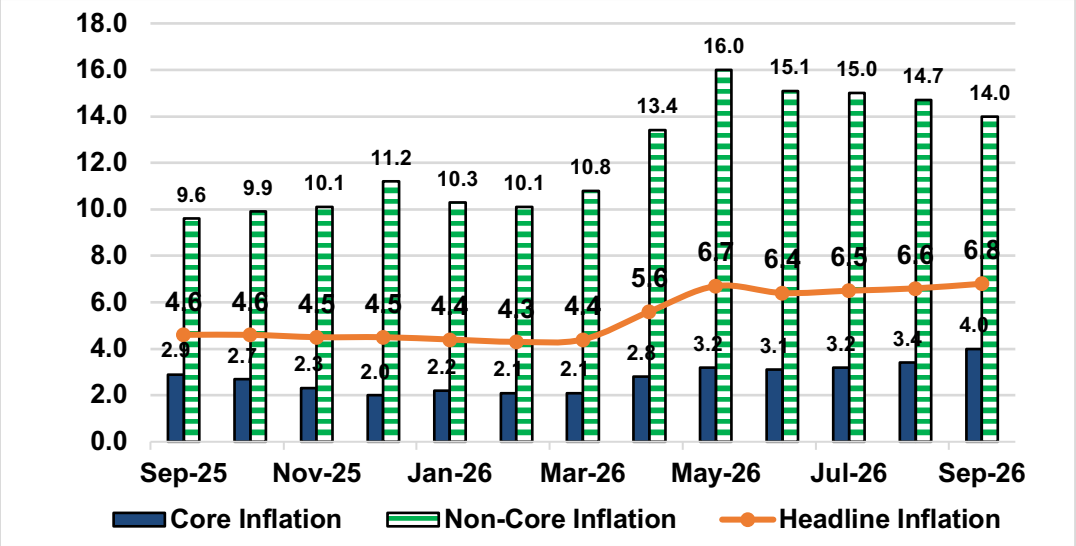
Figure 7: Trend in annual inflation



Source: KNBS

15. **Overall inflation rose from 4.6 percent in September 2025 to 6.8 percent in September 2026, remaining within the CBK's 5±2.5 percent target range (Figure 8).** Higher energy costs were the main driver. Non-core inflation increased sharply from 9.6 percent in September 2025 to 14.0 percent in September 2026, while core inflation remained relatively stable, increasing by about 1.1 percent over the same period (Figure 8). The surge in non-core inflation primarily reflected disruptions to commodity flows from the Gulf region. Higher global energy prices increased production and transport costs, putting upward pressure on consumer prices.

Figure 8: Breakdown of Inflation Rates



Source: KNBS

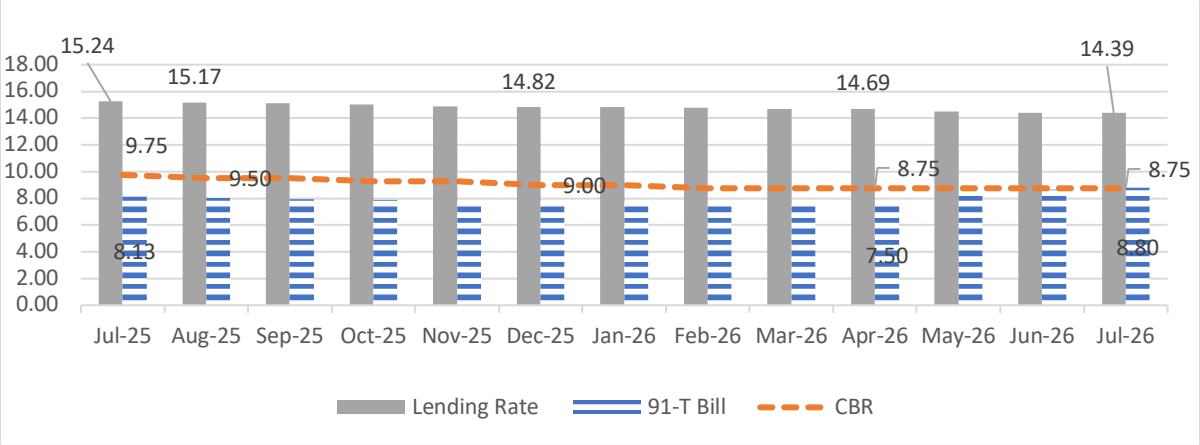
16. **Inflation is projected to remain above the 5 percent midpoint but within the CBK target range (Figure 8).** Food and energy prices remain sources of pressure, although recent easing in non-core inflation offers some relief. Sustained price stability will depend on containing supply-side pressures while maintaining prudent monetary policy.

17. **Growth and inflation outcomes present both progress and challenges for MTP IV and BETA.** Positive economic growth supports their priorities for job creation, productivity and inclusive growth. However, growth remained below the 6.5 percent envisaged under MTP IV by 2025. Inflation has stayed within the CBK target range but above the 5 percent MTP IV objective in recent months, increasing the cost of living and potentially constraining household purchasing power and private investment. These outcomes underscore the importance of productivity-enhancing investment in agriculture, MSMEs, manufacturing, infrastructure, human capital and digitisation, alongside macroeconomic stability, to support durable and inclusive growth.

1.2.4 Monetary Sector

18. **Monetary easing has improved liquidity and lowered private sector borrowing costs, but transmission remains uneven across markets.** Between July 2025 and July 2026 (Figure 9), the Central Bank Rate (CBR) fell by 100 basis points, from 9.75 percent to 8.75 percent. Lending rates declined by 85 basis points, from 15.24 percent to 14.39 percent. In contrast, the 91-day Treasury bill rate rose by 65 basis points, from 8.13 percent to 8.78 percent. This may indicate that government financing needs and market liquidity continued to influence short-term interest rates.

Figure 9: Interest rates trend



Source: CBK

19. **Monetary policy transmission has strengthened in short-term funding markets and commercial banking rates.** The Kenya Shilling Overnight Index Average (KESONIA) declined from 9.51 percent in September 2025 to 8.75 percent in April 2026, remaining at that level through July 2026 (Table 1). Its close alignment with the CBR indicates effective transmission to overnight interbank funding costs. The revised Risk-Based Credit Pricing Model (RBCPM), fully operational from March 2026, further strengthened the framework for transmitting policy changes to commercial bank lending rates through greater transparency and risk-based credit pricing.

20. **Lending rates have continued to decline since the RBCPM became operational.** Although the CBR remained at 8.75 percent between March and July 2026, average lending rates fell from 14.70 percent to 14.39 percent, a reduction of 31 basis points. This suggests that lower policy rates and improved credit-pricing mechanisms are gradually feeding through to borrowing costs.

Table 1: Trends in Interbank, CBR and KESONIA

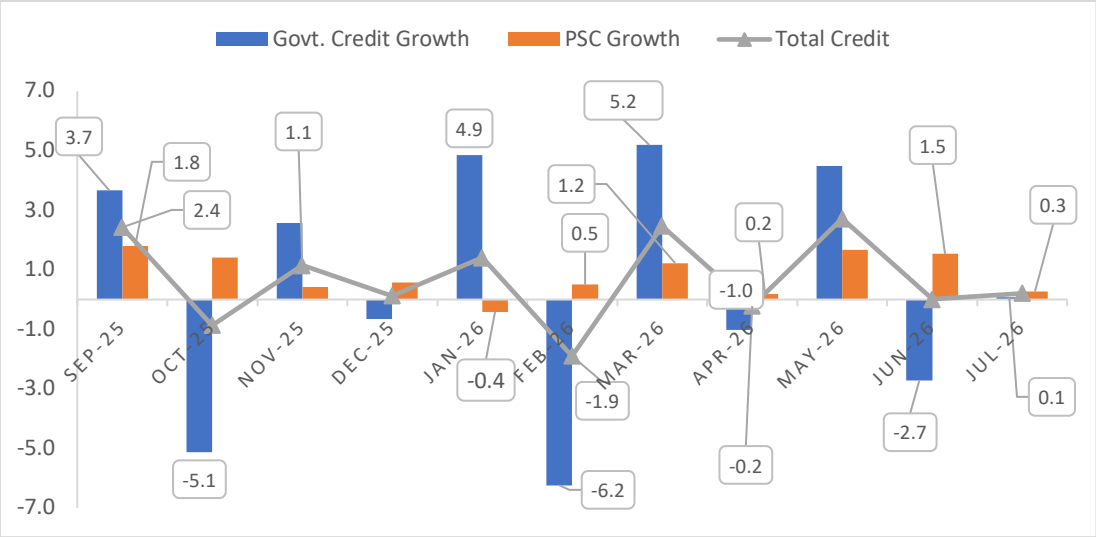
Month	Interbank Rate	CBR	KESONIA
Sep-25	9.48	9.50	9.51
Oct-25	9.33	9.25	9.24
Nov-25	9.24	9.25	9.25
Dec-25	9.08	9.00	9.00
Jan-26	8.99	9.00	9.00
Feb-26	8.84	8.75	8.76
Mar-26	8.7	8.75	8.74
Apr-26	8.75	8.75	8.75
May-26	8.75	8.75	8.75
Jun-26	8.75	8.75	8.75
Jul-26	8.75	8.75	8.75

Source: CBK

21. **Credit growth remained uneven between government and the private sector.** Periods of stronger government credit growth sometimes coincided with weaker private sector credit (PSC) growth. In January 2026, government credit grew by 4.9 percent while PSC contracted by 0.4 percent (Figure 10). In February and June, government credit contracted by 6.2 percent and 2.7 percent respectively, while PSC grew by 0.5 percent and 1.5 percent. These movements are consistent with potential crowding-out during some

periods, but the relationship was not uniform: both government and private sector credit expanded in March and May 2026.

Figure 10: Private sector and government credit growth

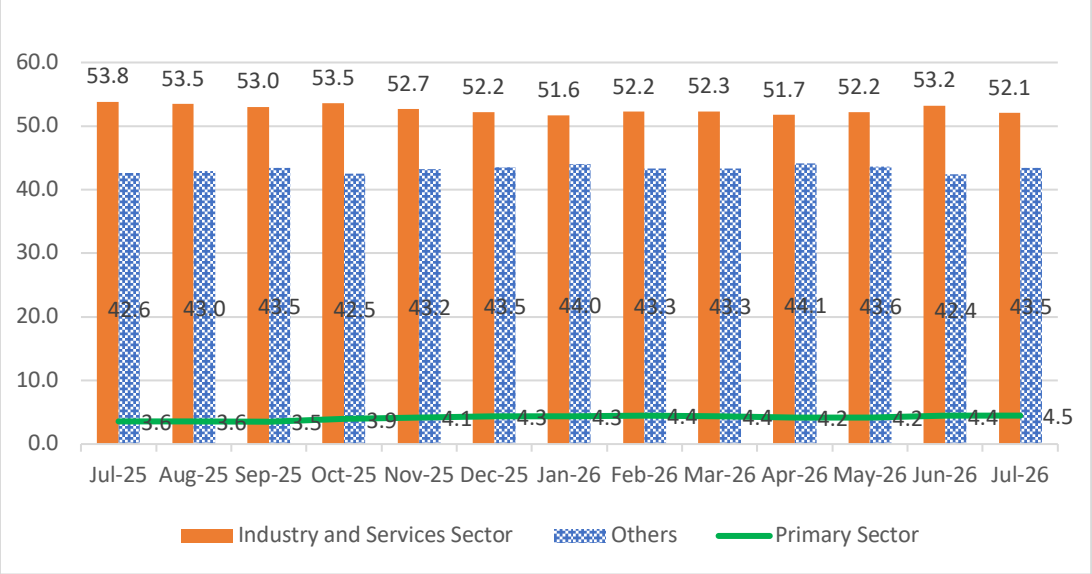


Source: CBK

22. **Lower interest rates improved financing conditions, but private sector credit growth remained modest and uneven.** The CBR and lending rates declined between July 2025 and July 2026. Nevertheless, PSC contracted by 0.4 percent in January 2026 before growing by 1.7 percent in May and 1.5 percent in June. This suggests that credit growth also depends on factors that may include demand, lending conditions and competition for available financial resources.

23. **Private sector credit remained concentrated in services, despite a modest shift towards the primary sector.** Between September 2025 and July 2026 (Figure 11), the services share fell from 53.0 percent to 52.1 percent, while the primary sector share rose from 3.5 percent to 4.5 percent. Other sectors accounted for 43.5 percent in both September 2025 and July 2026. Services therefore continued to receive more than half of PSC.

Figure 11: Distribution of private sector credit by sector



Source: CBK

24. **Easing interest rates and recovering PSC support the Fourth Medium Term Plan (MTP IV) and Bottom-Up Economic Transformation Agenda (BETA), particularly their objectives of affordable credit and productive economic activity.** However, modest and uneven credit growth suggests that lower rates alone may not generate the financing needed to achieve their investment and productivity objectives.

1.2.5 External Sector

25. **Kenya's external position improved between 2022 and 2024, before weakening moderately in 2025.** The current account balance improved from about -4.2 percent of GDP in 2022 to -1.8 percent in 2024, then deteriorated to -2.1 percent in 2025. The earlier improvement reflected a narrower merchandise-trade deficit, stronger services receipts and robust secondary-income inflows. The deterioration in 2025 reflected weaker secondary-income inflows and a wider nominal current account deficit, even as the goods deficit continued to narrow as a share of GDP.

26. **Merchandise trade remains the main structural drag on the current account.** The goods deficit narrowed from about 10.1 percent of GDP in 2022 to 7.8 percent in 2025, but imports remained substantially larger than exports. Between 2024 and 2025, exports declined from 10.2 percent to 9.6 percent of GDP, while imports fell from 18.4 percent to 17.4 percent. The persistent trade gap reflects dependence on imported petroleum, machinery, vehicles and intermediate inputs, alongside an export basket concentrated in agriculture and light manufacturing. In 2025, stronger demand for industrial machinery, motor vehicles, iron and steel raised the import bill, consistent with recovering domestic investment.

27. **Services and transfers continue to offset part of the merchandise-trade deficit.** The services surplus remained at about 1.8 percent of GDP in 2025, supported by travel and other service exports (Table 2). Net secondary income fell from 6.3 percent of GDP in 2024 to 5.4 percent in 2025, while diaspora remittances also moderated. Remittances and tourism receipts nevertheless provide relatively stable foreign exchange to help finance the large import bill without creating debt liabilities.

Table 2: Components of the current account as a share of GDP

% GDP	2022	2023	2024	2025
Current account	-4.2	-2.8	-1.8	-2.1
Goods balance	-10.1	-9.1	-8.3	-7.8
Goods exports	*9.3*	*10.1*	*10.2*	*9.6*
Goods imports	*19.4*	*19.2*	*18.4*	*17.4*
Net services	1.7	1.6	1.9	1.8
Net primary income	-1.5	-1.8	-1.8	-1.6
Net secondary income	5.7	6.5	6.32	5.44

Source: KNBS

28. **Capital and financial flows continued to finance the external balance, but their composition matters for vulnerability.** The capital account surplus increased from Kshs. 16.5 billion in 2022 to Kshs. 23.3 billion. Financial account net inflows rose from Kshs. 488.4 billion in 2022 to Kshs. 524.8 billion in 2025, driven mainly by direct and portfolio investment inflows. Reliance on debt-related and potentially reversible flows exposes the external position to global interest rates and investor sentiment. Stronger foreign direct investment (FDI) would provide more stable financing and support productive capacity.

29. **The external position weakened in Q1 2026 despite stronger domestic growth.** The current account deficit widened from about Kshs. 70.0 billion in Q1 2025 to Kshs. 120.9 billion in Q1 2026, partly reflecting higher merchandise imports and lower export receipts. The services surplus also narrowed. This pattern is consistent with stronger domestic demand increasing import needs while external demand softened.

30. **Q1 2026 flows reveal both vulnerabilities and buffers.** Higher net travel receipts and diaspora remittances provided foreign-exchange support, while the primary-income deficit narrowed. These improvements were insufficient to offset the weaker goods and services balance. The global environment also became less supportive for an oil-importing economy as geopolitical conflict disrupted energy markets and policy uncertainty remained elevated. Higher global energy prices raise Kenya's import bill and domestic transport costs. Weaker global demand can also weigh on exports, tourism and employment in markets that generate remittances.

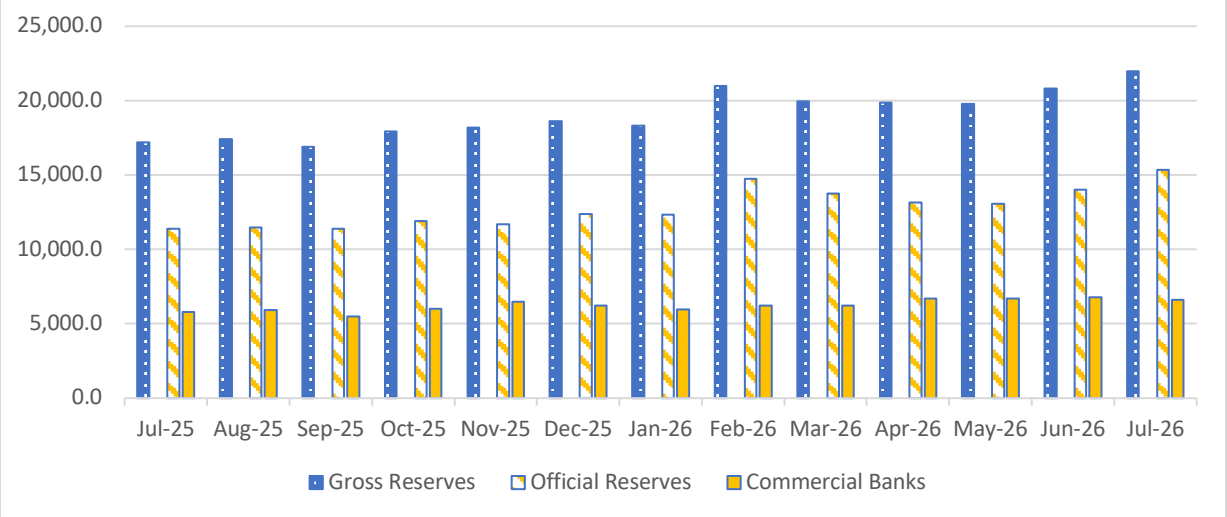
Table 3: Current account 2026

Indicator (Kshs. billion)	Q1 2025 (Kshs. Blns)	Q1 2026 (Kshs. Blns)	Change
Current account balance	-70.0	-120.9	73%
Merchandise exports	411.1	385.6	-6%
Net services	76.7	56.2	-27%
Secondary income	230.9	241.8	5%
Net primary income	-82.7	-66.7	-19%

Source: CBK

31. **Kenya's foreign exchange reserve buffer strengthened in the year to July 2026, although the path was uneven.** Reserve fluctuations shown in Figure 12 reflected the global oil price shock and increased demand for foreign exchange. Reserves rose from USD 11.4 billion in July 2025 to USD 15.4 billion in July 2026. Import cover increased from 5 months to 6.4 months, above the CBK's statutory 4-month threshold. Stronger reserves improve the capacity to absorb external shocks, meet foreign-currency obligations and smooth disorderly exchange-rate movements. Adequacy should nevertheless be assessed alongside the import bill, external debt-service needs and the durability of underlying foreign-exchange inflows.

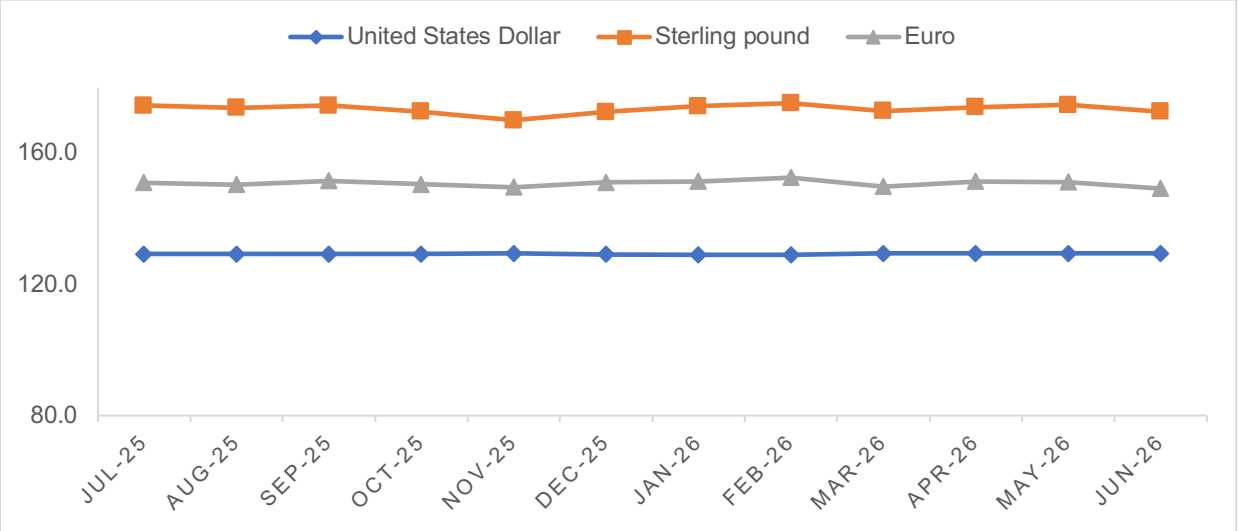
Figure 12: Reserves for the period July 2025 – July 2026



Source: CBK

32. **Reserve accumulation has supported exchange-rate stability, but external risks remain material.** The shilling stayed broadly stable around Kshs. 129 per USD through much of the period (Figure 13), limiting imported inflation and reducing foreign-currency debt-service costs. The 2026 global outlook reflects conflict-related energy shocks, geopolitical fragmentation and volatile financial conditions, with energy importers particularly exposed. For Kenya, renewed oil price spikes, tighter global financing or weaker demand in major export and remittance markets could widen the current account deficit and slow reserve accumulation simultaneously.

Figure 13: Exchange rates for the period July 2025 – July 2026



Source: CBK

1.2.6 Fiscal Developments

33. **Revenue continued to rise, but the FY 2025/26 outturn remained below target.** Total revenue increased from Kshs. 2,702.7 billion in FY 2023/24 to Kshs. 3,198.8 billion in FY 2025/26 (Table 4). The latter was Kshs. 60.2 billion below a target of Kshs. 3,259.0 billion. Rising collections are consistent with growth in nominal activity and the tax base. The shortfall may reflect optimistic budget forecasts, weaker-than-expected taxable activity and limits to the speed at which administrative gains translate into receipts.

34. **Ordinary revenue accounted for most of the FY 2025/26 shortfall.** Collections reached Kshs. 2,588.4 billion against a target of Kshs. 2,640.6 billion, leaving a Kshs. 52.2 billion gap. Income tax, VAT and import duty were broadly in line with or slightly above target, while excise duty, other revenues and Appropriation-in-Aid (AiA) fell short. The strength of major tax heads suggests resilience in formal incomes, consumption and imports. The remaining categories explain the overall ordinary-revenue gap, while the AiA shortfall may reflect slower collections by MDAs or lower-than-planned uptake and delivery of fee-generating public services.

35. **Expenditure expanded, but the FY 2025/26 outturn remained below target.** Total expenditure and net lending rose from Kshs. 3,605.2 billion in FY 2023/24 to Kshs. 4,484.2 billion in FY 2025/26. The latter was reported as Kshs. 172.4 billion below the Kshs. 4,656.5 billion target. Recurrent expenditure remained dominant at Kshs. 3,285.3 billion. The upward trend reflects relatively inflexible commitments, including employee compensation, debt service and government operating costs. Spending below target may signal implementation constraints, procurement delays due to the inception of the electronic

Government Procurement (e-GP) system or cash-release pressures rather than a deliberate reduction in spending needs.

36. **Interest payments remain a major source of budget rigidity.** They rose from Kshs. 840.7 billion in FY 2023/24 to Kshs. 1,074.4 billion in FY 2025/26. Domestic interest accounted for Kshs. 862.7 billion, compared with Kshs. 211.8 billion in foreign interest. Faster accumulation of domestic interest is consistent with greater reliance on domestic financing and the comparatively high cost of local-currency borrowing. As debt service absorbs more recurrent resources, it reduces funding flexibility for discretionary programmes.

37. **County transfers increased over the three years, but remained below target in FY 2025/26.** Transfers rose from Kshs. 380.4 billion in FY 2023/24 to Kshs. 444.6 billion in FY 2024/25 and Kshs. 467.3 billion in FY 2025/26. The latter was Kshs. 17.5 billion below the Kshs. 484.8 billion target. FY 2026/27 transfers are targeted at Kshs. 502.0 billion. The increase reflects growing resource needs for devolved functions and county service delivery. The FY 2025/26 gap may reflect disbursement constraints, especially for additional allocations from development partners. Indeed, delays in disbursement create liquidity pressures for counties, delay payments and contribute to the accumulation of pending bills.

38. **The expenditure structure remains heavily weighted towards recurrent obligations.** In FY 2025/26, recurrent expenditure was Kshs. 3,285.3 billion. Interest payments accounted for Kshs. 1,074.4 billion, Operations and Maintenance (O&M) and other recurrent spending amounted to Kshs. 1,316.7 billion, and wages and salaries reached Kshs. 684.4 billion. These fixed and semi-fixed commitments can reduce the budget's growth impact if they crowd out capital formation or postpone high-return development projects. By comparison, development and net lending expenditure was Kshs. 731.5 billion.

39. **The fiscal deficit widened in FY 2025/26, but remained below target.** The deficit including grants rose from Kshs. 880.5 billion in FY 2023/24 to Kshs. 1,264.7 billion in FY 2025/26, Kshs. 93.0 billion below the Kshs. 1,357.7 billion target. The widening reflects expenditure growing faster than revenue and grants. The below-target result appears to reflect expenditure under-execution rather than revenue overperformance. Consolidation through delayed or forgone spending may be less durable than adjustment based on structural revenue gains and greater spending efficiency.

40. **Financing has shifted increasingly towards domestic borrowing.** Net domestic financing rose from Kshs. 595.5 billion in FY 2023/24 to Kshs. 983.7 billion in FY 2025/26, while net foreign financing increased from Kshs. 222.7 billion to Kshs. 267.3 billion. Domestic financing reduces direct foreign-exchange exposure and may reflect constrained or costly external access. However, sustained government demand for domestic funds can raise yields and absorb liquidity otherwise available for private investment, particularly when borrowing is high relative to domestic savings.

41. **Public debt has continued to rise, although the pace and composition of accumulation have varied.** Outstanding debt increased from Kshs. 10.3 trillion at end-June 2023 to Kshs. 13.1 trillion at end-June 2026 (Figure 14). The acceleration after FY 2023/24 highlights continued financing needs and persistent debt accumulation despite changes in the financing mix.

42. **Domestic debt was the main driver of the increase, reaching Kshs. 7.3 trillion in June 2026.** External debt rose more moderately to Kshs. 5.8 trillion (Figure 14). The domestic share of total debt increased from about 51.2 percent in June 2024 to 55.9 percent in June 2026. This aligns with the fiscal accounts' reliance on net domestic financing, while heightening the importance of managing rollover risk, domestic interest costs and potential crowding-out.

Table 4: Fiscal performance and targets, FY 2023/24–FY 2026/27

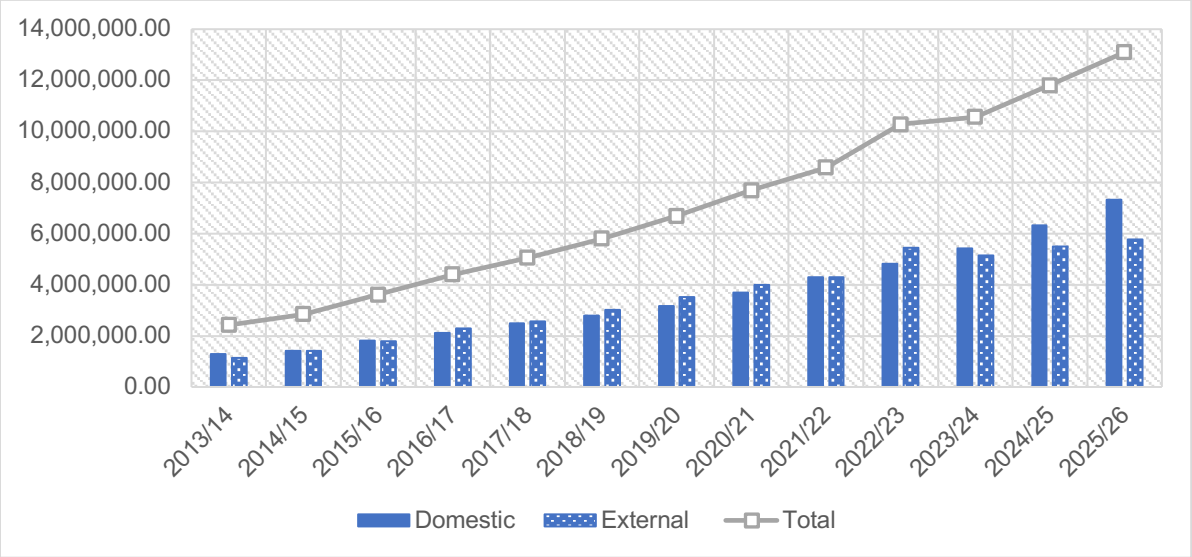
Details	2023/24 Actual	2024/25 Actual	2025/26 Target	2025/26 Actual	2026/27 Target
			(Kshs. Billions)		
A. Total Revenue	**2,702.7**	**2,923.6**	**3,259.0**	**3,198.8**	**3,630.6**
Ordinary Revenue	**2,288.9**	**2,420.2**	**2,640.6**	**2,588.4**	**2,985.7**
Income Tax	1,043.1	1,093.0	1,169.4	1,175.6	1,383.6
VAT	645.5	660.7	721.4	722.4	829.2
Import Duty	133.9	157.1	176.5	180.0	186.2
Excise Duty	276.7	292.5	313.3	312.0	382.2
Other Revenue	189.7	216.8	260.0	198.4	204.5
Appropriation-in-Aid	413.7	503.4	618.3	610.4	644.8
B. Expenditure & Net Lending	**3,605.2**	**3,975.9**	**4,656.5**	**4,484.2**	**4,819.4**
Recurrent Expenditure	**2,678.4**	**2,948.4**	**3,400.7**	**3,285.3**	**3,565.6**
Wages & Salaries	575.3	624.7	689.3	684.4	702.0
Interest Payments	840.7	995.1	1,126.8	1,074.4	1,254.2
Domestic Interest	622.5	784.1	911.9	862.7	986.7
Foreign Interest	218.2	211.0	214.8	211.8	267.5
Pensions	143.9	176.8	240.0	166.2	207.5
O&M / Others	1,084.3	1,117.5	1,676.4	1,316.7	1,362.3
Development & Net Lending	**546.4**	**582.9**	**771.0**	**731.5**	**750.8**
Transfer to County Governments	380.4	444.6	484.8	467.3	502.0
Parliamentary Service	37.3	41.6	45.3	45.3	51
Judicial Service	22.5		0.9	0.9	30.3
Equalization Fund	1.2	0.0	7.6	7.3	10.3
Contingency Fund	0.0	0.0			1.0
Deficit excl. Grants	-902.5	-1,052.4	-1,397.6	-1,285.4	-1,188.8
Grants	22.0	33.3	39.9	20.7	43.6
Deficit incl. Grants	-880.5	-1,019.1	-1,357.7	-1,264.7	-1,145.2
Financing	**818.3**	**1,034.2**	**768.1**	**1,251.0**	**1,145.2**
Net Foreign Financing	222.7	179.7	384.0	267.3	247.2
Net Domestic Financing	595.5	854.5	384.0	983.7	898.0

Source: National Treasury

43. **Changes in debt stock are not identical to annual net budget financing.** Stocks also change through exchange-rate valuation, debt recognition and other stock-flow adjustments. Shilling movements can offset or amplify new borrowing. Debt affordability therefore depends on borrowing volumes, maturity profiles, interest costs, fiscal balances and growth in the revenue base.

44. **Rising public debt reinforces the need for fiscal consolidation and stronger debt management.** Persistent deficits can intensify debt-service pressures and reduce fiscal space for development. Stronger revenue mobilisation, expenditure rationalisation and a balanced financing strategy are critical to moderating debt growth, reducing refinancing risk and safeguarding medium-term fiscal sustainability.

Figure 14: Public debt stock for the period FY 2013/14 – FY 2025/26



Source: CBK

1.3. Emerging Policy Concerns

45. **Several policy concerns emerge from recent economic developments.** The matrix below summarises each concern, what the analysis shows and a possible remedy going forward.

Emerging policy concern	What the analysis shows	Possible remedy going forward
Growth is resilient but not accelerating	Real GDP growth averaged about 4.6 percent in 2017–2025, below the 6.5 percent envisaged under MTP IV. Investment has stayed near 18–20 percent of GDP.	Raise investment and productivity through better infrastructure, cheaper energy, technology adoption and a stronger manufacturing base.
Declining productivity	Total factor productivity fell by 15.5 percent between 2015 and 2025. Growth relies increasingly on adding labour and capital.	Prioritise skills development, technology adoption, research and innovation, and support to MSMEs and productive sectors.
Weaker labour market outcomes	Labour force participation fell from 72.3 percent in 2017 to 67.4 percent in 2025, while unemployment rose from 3.5 to 5.4 percent.	Promote job-rich sectors, align skills with labour-market needs and expand structured access to employment opportunities abroad.
Food and energy price pressures	Non-core inflation rose to 14.0 percent in September 2026, lifting overall inflation to 6.8 percent, near the upper end of the CBK target range.	Contain supply-side pressures, including by reducing reliance on rain-fed agriculture, while maintaining prudent monetary policy.
Uneven private sector credit	Lending rates eased to 14.39 percent, but private sector credit growth remained modest and concentrated in services.	Moderate Government domestic borrowing, sustain risk-based credit pricing and encourage lending to productive sectors.
External vulnerability	The current account deficit widened to Kshs. 120.9 billion in Q1 2026. Imports remain much larger than exports.	Diversify exports and add value, attract more foreign direct investment and preserve reserve buffers.
Revenue below target	Total revenue in FY 2025/26 was Kshs. 60.2 billion below target, mainly on account of ordinary revenue.	Base the budget on realistic revenue forecasts and strengthen tax administration and the tax base.
Rigid expenditure structure	Interest payments reached Kshs. 1,074.4 billion. Recurrent spending was Kshs. 3,285.3 billion against Kshs. 731.5 billion for development.	Rationalise recurrent spending and protect high-return development projects.
Rising public debt	Debt rose to Kshs. 13.1 trillion at end-June 2026, with the domestic share at 55.9 percent.	Pursue gradual fiscal consolidation and a balanced financing strategy that manages rollover risk and interest costs.
County transfers below target	Transfers were Kshs. 17.5 billion below target in FY 2025/26, adding to liquidity pressures and pending bills.	Ensure timely and predictable disbursement to county governments.

II. MEDIUM-TERM ECONOMIC OUTLOOK

46. **This section presents the medium-term outlook under two scenarios.** It covers real GDP growth, revenue and expenditure, and the factors driving them. The baseline scenario assumes unchanged policies and prevailing market conditions, and shows the likely path without a policy shift. The alternative scenario assumes deliberate policy measures to support growth and strengthen macroeconomic stability, and shows what these could achieve relative to the baseline.

2.1. Macroeconomic Outlook

2.2.1 Baseline Scenario Projections

47. **Under the baseline, the economy is expected to remain resilient, with growth averaging about 4.8 percent in 2026–2028.** Agriculture and stronger industrial activity are expected to support growth. The early end of the long rains (March–May) lowered agricultural production in parts of the country, but the Kenya Meteorological Department forecasts above-average rainfall in several regions during the October–December season[1].

48. **Favourable rains would support food supply, prices and rural incomes.** Better rainfall would improve food and fodder availability, raise agricultural and livestock output, and strengthen food security. Higher output could also ease food prices and the cost of living. These gains depend on how the rainfall is distributed, as flooding and other weather disruptions could affect production, infrastructure and livelihoods in some areas.

49. **Construction is expected to support industrial activity.** Affordable housing programmes and continued public infrastructure investment ahead of the 2027 General Elections should sustain the subsector. This would raise demand for construction materials and support related manufacturing and services.

50. **Agro-processing is expected to remain a key driver of industry.** Improved agricultural production would provide a more reliable supply of raw materials, strengthening links between agriculture and manufacturing and increasing value addition.

51. **Risks to the outlook are tilted to the downside.** Externally, high global energy prices and supply-chain disruptions linked to the Middle East conflict could raise commodity prices and slow exports. Domestically, heightened political activity ahead of the 2027 General Elections could create uncertainty, delay private investment, disrupt business operations and divert resources from productive activity.

[1] NCOF_13_Statement_26th_Aug_2026_Final.pdf

Table 5: GDP Projections for Baseline Forecasts

	2025	2026	2027	2028
	Actual		Proj.	
Real GDP growth (%)	4.6	4.9	4.7	5.0
CPI index (Average)	4.1	5.4	6.0	5.5
Broad Money M3	34.3	34.8	35	35.3
Investment % of GDP	17.0	18.6	19.6	21.0
O/W Central Government	4.3	4.6	4.8	5.5
other	12.7	13.9	14.2	15.6
Savings % of GDP	15.5	16.6	17.4	18.2
Current account % of GDP	-2.1	-2.0	-2.2	-2.8

Source: PBO

2.2.2 Alternative Scenario Projections

52. **Under the alternative scenario, growth averages 5.0 percent over the medium term.** Growth rises from 4.9 percent in 2026 to 5.0 percent in 2027 and 5.2 percent in 2028. Targeted policy measures and strategic investments in key sectors are expected to raise productivity, stimulate private sector activity and expand productive capacity. These measures are summarised below and detailed in Chapter Three.

53. **Irrigation and climate finance would make agriculture more stable and ease fiscal pressure.** Investment in irrigation and water harvesting, including completion of ongoing projects, would raise productivity and reduce reliance on rain-fed agriculture. Mobilising climate finance, including by operationalising the carbon market revenue framework, could fund adaptation and mitigation, reduce the fiscal burden of climate measures and open opportunities for green investment.

54. **Well-managed labour migration could expand jobs and remittances.** Using existing bilateral labour agreements and pursuing new ones, with stronger safeguards, accreditation and certification, would widen access to legitimate employment abroad. These measures would better protect migrant workers' rights and welfare, reduce exposure to exploitation, and increase foreign exchange inflows and productive investment at home.

55. **Research and innovation should address the country's immediate and emerging development needs.** Stronger links between research institutions and end-users would help turn findings into practical solutions, commercialise them where appropriate and reach intended beneficiaries. This would speed up technology adoption, raise productivity and support innovation-led growth.

56. **The Affordable Housing Programme's impact will depend on how quickly completed units are sold.** Sustainability rests on efficient delivery and offtake, so that sales proceeds can be reinvested in further construction. Better access to housing finance and a more responsive market are therefore critical to recovering capital, sustaining construction activity and supporting growth and jobs.

57. **Developments in the petroleum sector offer scope to attract private investment in supporting infrastructure.** The proposed Dangote East Africa Refinery in Lamu creates an opportunity to develop the Lokichar–Lamu pipeline through public-private partnerships. Such partnerships could mobilise the capital required, strengthen the petroleum value chain and improve the country's capacity to use its oil resources. If well implemented, these investments could also support industrial development, jobs, energy security and higher medium-term growth.

Table 6: GDP Projections for Alternative Scenario

	2025	2026	2027	2028
	Actual		Proj.	
Real GDP growth (%)	4.6	4.9	5.0	5.2
CPI index (Average)	4.1	5.4	5.8	5.3
Broad Money M3	34.3	34.8	35	35.3
Investment % of GDP	17.0	18.6	19.7	21.1
O/W Central Government	4.3	4.6	5.0	5.4
other	12.7	13.9	14.7	15.6
Savings % of GDP	15.5	16.6	17.5	18.4
Current account % of GDP	-2.1	-2.0	-2.2	-2.7

Source: PBO

2.2. Fiscal Outlook

58. **Revenue is projected to grow modestly over the medium term.** Under the PBO baseline, total revenue and grants reach Kshs. 3,889.5 billion (17.1 percent of GDP). This is Kshs. 215.4 billion above the National Treasury's BROP projection of Kshs. 3,674.1 billion for FY 2026/27. Growth is expected to come from continued economic activity and a wider tax base, with no change in tax rates.

59. **The PBO revenue projection is more cautious than the National Treasury's.** It is about Kshs. 172.9 billion below the Kshs. 4,062.4 billion (17.7 percent of GDP) in the Budget Review and Outlook Paper. The difference reflects macroeconomic assumptions, particularly projected growth, and a different estimate of the FY 2026/27 revenue outturn, which is the base year for the projections.

60. **Recent revenue performance supports a cautious outlook.** Ordinary revenue for FY 2025/26 was Kshs. 2,588.4 billion, Kshs. 52.2 billion below target, and total revenue fell short by Kshs. 60.2 billion. This lower outturn reduces the base for forward projections. It places downward pressure on the FY 2026/27 estimates, which anchor the medium-term projections, and increases the risk of a wider fiscal deficit.

61. **Expenditure pressures are driven mainly by recurrent spending.** Expenditure and net lending under the baseline are projected at Kshs. 5,303.2 billion, Kshs. 483.7 billion above the BROP projection of Kshs. 4,819.5 billion for FY 2026/27. Interest payments are projected to rise by Kshs. 203.2 billion, wages and salaries by Kshs. 76.9 billion, and operations and maintenance by Kshs. 52.1 billion.

62. **Development spending is projected to rise, and its quality will matter.** It increases to Kshs. 824.7 billion, Kshs. 73.8 billion above the BROP projection of Kshs. 750.9 billion for FY 2026/27, supporting ongoing and planned projects in infrastructure, housing, agriculture and other priority sectors. Given pressures on recurrent spending, careful project selection, timely release of funds and stronger public investment management will be needed to direct resources to projects with high economic and social returns.

63. **The baseline points to a wider fiscal deficit.** The deficit is projected at 6.2 percent of GDP, compared with 5.5 percent in the BROP projection for FY 2026/27. This reflects persistent expenditure pressures combined with lower revenue projections than the National Treasury's.

64. **The alternative scenario contains recurrent spending.** Recurrent expenditure is Kshs. 3,958.1 billion, compared with Kshs. 3,999.9 billion under the baseline. The difference comes mainly from lower operations and maintenance spending of Kshs. 1,372.3 billion, against Kshs. 1,414.4 billion. Allocations for wages and salaries, pensions and interest payments are unchanged across the two scenarios.

65. **Development spending is slightly higher under the alternative scenario.** Development expenditure and net lending are projected at Kshs. 827.8 billion, marginally above the baseline but below the BROP projection of Kshs. 915.8 billion. The lower allocations in both scenarios reflect a cautious view of capital spending, in line with realistic financing and revenue performance. The slightly higher allocation under the alternative gives modest priority to economic activity, infrastructure delivery and job creation.

Table 7: Fiscal Framework for Baseline Forecasts

	2025/26	2026/27	2027/28 Proj.		
	Actual	BROP	BROP	PBO Baseline	PBO Alternative
			Kshs. Billions		
Total Revenue & Grants	**3,219.5**	**3,674.1**	**4,062.4**	**3,889.5**	**3,903.6**
Total Revenue	**3,198.8**	**3,630.5**	**4,003.6**	**3,868.3**	**3882.4**
Ordinary Revenue	2,588.4	2,985.7	3,249.1	3,106.5	3117.4
Income Tax	*1,175.6*	*1,383.6*	*1,485.8*	*1,430.4*	*1435.7*
VAT	*722.4*	*829.2*	*939.8*	*883.8*	*887.2*
Import Duty	*180.0*	*186.2*	*220.7*	*209.6*	*210.2*
Excise Duty	*312.0*	*382.2*	*404.6*	*359.0*	*360.0*
Other Revenues	*198.4*	*204.5*	*198.2*	*223.8*	*224.3*
A-i-A	610.4	644.8	754.5	761.8	765.0
Grants	**20.7**	**43.6**	**58.8**	**21.2**	**21.2**
Expenditure & Net Lending	**4,484.2**	**4,819.5**	**5,415.5**	**5,303.2**	**5264.5**
Recurrent	3,285.3	3,565.6	4,021.1	3,999.9	3958.1
Wages and Salaries	*684.4*	*702.0*	*777.9*	*778.9*	*778.9*
Pensions & Other CFS	*166.2*	*207.5*	*218.7*	*218.7*	*218.7*
Interest Payments	*1,074.5*	*1,254.2*	*1,457.4*	*1,457.4*	*1,457.4*
O&M	*1,240.8*	*1,362.3*	*1,526.3*	*1,414.4*	*1372.3*
Contribution to civil servants' pension fund	*43.6*	*39.6*	*40.8*	*40.8*	*40.8*
Development & Net Lending	731.6	750.9	915.8	824.7	827.8
Contingency Fund		1.0	5.0	5.0	5.0
Transfers to County Governments	467.3	502.0	473.6	473.6	473.6
Parliamentary Service				58.5	58.7
Judicial Service				31.2	31.3
Equalization Fund		10.3	18.6	18.6	18.6
Deficit incl. Grants	**(1,264.7)**	**(1,145.4)**	**(1,353.1)**	**(1,413.7)**	**(1360.9)**
			Percentage of GDP		
Total Revenue and Grants	**17.3%**	**17.7%**	**17.7%**	**17.1%**	**17.1%**
Total Revenue	**17.2%**	**17.4%**	**17.5%**	**17.0%**	**17.0%**
Ordinary Revenue	13.9%	14.3%	14.2%	13.7%	13.7%
A-i-A	3.3%	3.1%	3.3%	3.3%	3.4%
Grants	0.1%	0.2%	0.3%	0.1%	0.1%
Expenditure & Net Lending	**24.1%**	**23.2%**	**23.6%**	**23.3%**	**23.1%**
Recurrent	17.6%	17.1%	17.5%	17.6%	17.4%
Development & Net Lending	3.9%	3.6%	4.0%	3.6%	3.6%
Deficit incl. Grants	**(6.8%)**	**(5.5%)**	**(5.9%)**	**(6.2%)**	**(6.0%)**
Primary Balance	**(1.0%)**	**0.5%**	**0.5%**	**0.2%**	**0.4%**
Nominal GDP	**18,626**	**20,816**	**22,943**	**22,745**	**22,808.4**

Source: PBO (* includes allocations for Parliament and the Judiciary)

66. **Both PBO scenarios project a larger deficit than the BROP.** The deficit including grants is projected at Kshs. 1,413.7 billion (6.2 percent of GDP) under the baseline and Kshs. 1,360.9 billion (6.0 percent of GDP) under the alternative, compared with Kshs. 1,353.1 billion (5.9 percent of GDP) under the BROP. The difference reflects the PBO's lower revenue projections and higher expenditure allocations.

2.3. Overall Budget for FY 2025/26

67. **The FY 2027/28 budget is projected at Kshs. 5.303 trillion under the PBO baseline.** This comprises Kshs. 1.717 trillion for Consolidated Fund Services (CFS), Kshs. 2.284 trillion for ministerial recurrent expenditure, Kshs. 862.4 billion for ministerial development expenditure, and Kshs. 440.9 billion as the equitable share to county governments.

68. **Under the alternative scenario, the budget is slightly smaller and tilted towards development.** Total spending is projected at Kshs. 5.265 trillion, with Kshs. 865.5 billion for ministerial development expenditure and Kshs. 2.241 trillion for recurrent expenditure. Consolidated Fund Services and the county equitable share remain at baseline levels. This implies a modest shift of resources from recurrent to development spending while containing overall expenditure.

Table 8: Budget Summary

	2025/26	2026/27	2027/28 Proj.		
	Actual	BROP	BROP	PBO Baseline	PBO Alternative
			Kshs. Billions		
Recurrent	2,001.0	2,064.3	2,304.2	2,283.60	2,241.2
Development	783.9	825.9	953.5	862.4	865.5
Ministerial National Govt	**2,784.9**	**2,890.2**	**3,257.7**	**3,145.4**	**3,106.7**
Pensions & Other CFS	166.2	207.5	218.7	218.7	218.7
Interest	1,074.5	1,254.2	1,457.4	1,457.4	1,457.4
Contribution to the civil service pension fund	43.6	39.6	40.8	40.8	40.8
Net lending	-	-	-	-	-
CFS	**1,284.3**	**1,501.3**	**1,716.9**	**1,716.9**	**1,716.9**
County Equitable Share	**415.0**	**428.0**	**440.9**	**440.9**	**440.9**
Total	**4,484.2**	**4,819.5**	**5,415.5**	**5,303.2**	**5,264.5**

Source: PBO

2.4. Emerging Policy Concerns

69. **The medium-term outlook raises several policy concerns.** The matrix below summarises each concern, what the analysis shows and a possible remedy going forward.

Emerging policy concern	What the analysis shows	Possible remedy going forward
Growth below medium-term aspirations	Baseline growth averages about 4.8 percent in 2026–2028.	Implement the targeted measures in the alternative scenario, which lift average growth to 5.0 percent.
Dependence on rainfall	The early end of the long rains lowered agricultural output; flooding remains a risk to production and infrastructure.	Invest in irrigation and water harvesting, complete ongoing projects and mobilise climate finance.
Exposure to external shocks	High global energy prices and supply-chain disruptions could raise commodity prices and slow exports.	Strengthen energy security, diversify export markets and maintain adequate buffers.
Uncertainty ahead of the 2027 General Elections	Heightened political activity could delay private investment and disrupt business operations.	Maintain policy continuity and clear communication to sustain investor confidence.
Differing revenue projections	PBO baseline revenue of Kshs. 3,889.5 billion is about Kshs. 172.9 billion below the BROP projection.	Anchor the budget on prudent revenue estimates and review them regularly against outturns.
Recurrent spending pressures	Interest payments rise by Kshs. 203.2 billion, wages by Kshs. 76.9 billion and operations and maintenance by Kshs. 52.1 billion.	Contain operations and maintenance spending, as in the alternative scenario, and strengthen debt management.
Wider fiscal deficit	The deficit is projected at 6.2 percent of GDP under the baseline, compared with 5.9 percent under the BROP.	Pursue consolidation through revenue gains and spending efficiency; the alternative scenario lowers the deficit to 6.0 percent.
Quality of development spending	Development spending rises to Kshs. 824.7 billion amid recurrent pressures.	Strengthen project selection, timely release of funds and public investment management.

3. STRENGTHENING EFFICIENCY IN PUBLIC EXPENDITURE

3.1. Investing in Research and Innovation for Inclusive Growth

70. **Research and innovation are widely recognised as anchors of growth and sustainable development.** Countries that have invested deliberately in research and innovation rank highly in competitiveness and productivity. Such countries have consistently committed between 1.5 and 3 percent of GDP to research and development, supported by strong and well-structured research systems.

71. **Africa's investment in research remains below agreed targets.** According to the Kenya Research Financing and Capacity Strengthening Master Plan 2026, the African Union pledge to set aside at least 1 percent of GDP for research and development has not been met across the continent, with leading countries such as South Africa, at 0.76 percent, still short of it. As a result, Africa produces only 1–2 percent of global research output despite accounting for 18 percent of the world's population.

72. **Kenya's research spending is also below target.** Gross expenditure on research and development, public and private, is estimated at about 0.8 percent of GDP, the figure used in the Fourth Medium Term Plan (2023–2027) and the Kenya Research Financing and Capacity Strengthening Master Plan. This places Kenya among the higher spenders in Africa relative to GDP. KIPPRA notes, however, that it remains below the African Union target of 1 percent and the country's own target of 2 percent under the Science, Technology and Innovation (STI) Act, 2013. Current spending is estimated at Kshs. 140 billion against a target of Kshs. 350 billion a year.

73. **Financing is not the only constraint.** The country also relies heavily on external funding, private sector involvement in research is limited, and weak frameworks leave research and development fragmented across sectors without proper coordination.

74. **These gaps limit the impact of research and make oversight more difficult.** They are matters of policy concern that should be addressed so that research and development can contribute fully to growth.

75. **Research can support delivery of national priorities.** This is important as the Government works to deliver BETA, the Medium Term Plan and the Vision 2030 goal of a competitive middle-income country. Priority programmes in food security, healthcare, housing and manufacturing, and emerging issues such as climate change and artificial intelligence, can be addressed more effectively when research is built into them.

76. **Raising research funding progressively towards 2 percent of GDP could change outcomes.** Because under-investment is the main constraint, steady progress towards the target has the potential to strengthen the research landscape and accelerate development.

77. The following budget options can be explored over the medium term so that research and innovation support and complement national priority programmes:
    i. **Raise research funding progressively.** Move from the current 0.8 percent towards 2 percent of GDP as a strategic intervention. For instance, Kshs. 2 billion could be allocated to the National Research Fund in FY 2027/28, with similar recapitalisation over the medium term;
    ii. **Establish a functioning research and innovation infrastructure.** This would address fragmented research activities and programmes and strengthen research governance. A one-stop repository or information system for research is one way to achieve this;

iii. **Encourage private investment in research.** Incentives for the private sector and industry, together with public-private partnerships, would complement Government efforts.

Budgetary Effects of the Options: Research and Innovation

Kshs. millions

	FY 2027/28	FY 2028/29	FY 2029/30	Total
i. Raise research funding progressively (National Research Fund)	2,000	2,000	2,000	6,000
ii. Establish a functioning research and innovation infrastructure	0	0	0	0
iii. Encourage private investment in research	0	0	0	0
Total	**2,000**	**2,000**	**2,000**	**6,000**

Notes: Amounts are additional spending relative to the baseline, as proposed in this paper. Option i assumes the same Kshs. 2 billion recapitalisation in each year of the medium term.
Options shown as 0 are not quantified in this paper and are assumed to be budget neutral; they can be implemented within current resources.

3.2. Accelerating Affordable Housing Offtake

78. **The focus of the Affordable Housing Programme (AHP) is shifting from building units to helping households buy them.** This is consistent with Article 43(1)(b) of the Constitution, which guarantees the right to accessible and adequate housing, and Article 21, which requires progressive measures to realise it. The Affordable Housing Act, 2024 classifies housing into three income categories: social housing for persons earning below Kshs. 20,000 per month; affordable housing for those earning Kshs. 20,000 to Kshs. 149,000; and affordable middle-class housing for those earning above Kshs. 149,000. Housing is generally considered affordable when a household spends no more than about 30 percent of monthly income on it.

79. **Income levels determine which financing arrangement is suitable.** A household earning Kshs. 20,000 per month can afford housing payments of about Kshs. 6,000, which makes a conventional mortgage difficult to sustain once interest, insurance and other costs are included. Tenant Purchase Schemes (TPS) and deposit assistance are therefore better suited to social housing beneficiaries. Mortgages and outright cash purchases should be prioritised for affordable and affordable middle-class beneficiaries, who are more likely to meet the requirements of banks and SACCOs.

80. **The Affordable Housing Levy has enabled a large expansion in construction.** The Government Delivery Unit reports more than 260,000 units under construction, compared with 8,872 in 2022; the Affordable Housing Board and National Housing Corporation place the wider pipeline at close to 300,000 units. Sufficient resources are needed to ensure that units nearing completion are finished on time and released to the market.

81. **The Programme's sustainability will increasingly depend on how quickly completed units are sold.** Cash purchases return funds fastest. Mortgage-financed purchases bring a substantial upfront payment from financial institutions, with beneficiaries repaying their loans over time. Under TPS, an initial deposit is followed by monthly instalments over several years, which delays the recovery of funds for new construction. TPS remains necessary for low-income households, but applying it widely to those who qualify for mortgages could slow replenishment of the Affordable Housing Fund and limit expansion.

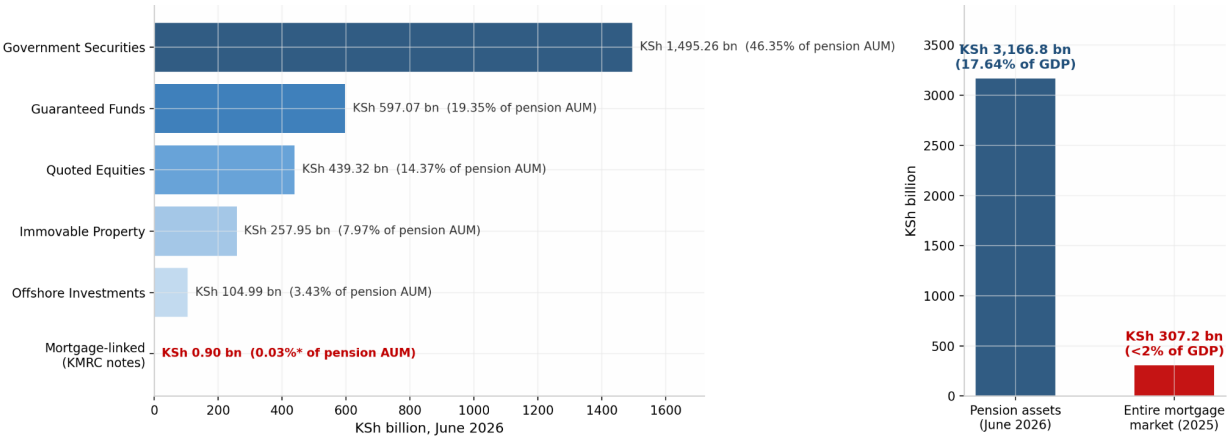
82. **Faster offtake therefore depends on three areas.** These are the mortgage market, the financing measures the Government has already taken, and the arrangements for identifying and allocating units to eligible buyers.

83. **The mortgage market has grown but remains small.** Over the last ten years, the value of outstanding mortgage loans rose by about 40 percent, while the number of mortgage accounts grew by only about 28 percent. Lending therefore remains concentrated among a small share of higher-income households. Conditions have improved recently: according to the Central Bank of Kenya, the average mortgage interest rate fell from 15.2 percent in 2024 to 13.5 percent in 2025, and the average repayment period increased to 11.5 years.

84. **By international standards, the mortgage market is underdeveloped.** Outstanding mortgage loans were about 1.6 percent of GDP in 2022, compared with about 50 percent in the United States, 80 percent or more in Denmark and roughly 20 percent or more in South Africa. The pattern is similar across much of Africa, where mortgage lending is concentrated among middle- and upper-income households and is below 5 percent of GDP in most countries.

85. **Pension funds hold substantial long-term capital that is largely invested elsewhere.** As at June 2026, the retirement benefits sector held assets of Kshs. 3,167 billion (17.64 percent of GDP), about ten times the outstanding mortgage loans of Kshs. 307.2 billion. Most of these assets were in other investments: Kshs. 1,495.26 billion in Government securities, Kshs. 597.07 billion in guaranteed funds, Kshs. 439.32 billion in quoted equities, Kshs. 257.95 billion in immovable property and Kshs. 104.99 billion in offshore investments.

Figure 15: Pension Capital versus the Mortgage Market



Source: RBA

86. **Pension investment in mortgage financing remains low.** As at June 2026, pension schemes held Kshs. 900.04 million in the KMRC Sustainability Note, alongside holdings in the KMRC Fixed Rate Note; together these were less than 0.05 percent of total pension assets. Investments in immovable property and Real Estate Investment Trusts (the latter Kshs. 19.61 billion) are concentrated in property ownership rather than mortgage lending. There is therefore scope to direct a larger share of long-term pension funds to mortgage lending, particularly through KMRC, to improve access to affordable home loans and support the purchase of completed units.

87. **The Government, with World Bank support, has taken several steps to expand mortgage financing through the Kenya Mortgage Refinance Company (KMRC).** These have focused on

increasing long-term funding for lenders, improving mortgage affordability and reducing the risks of lending to underserved households.

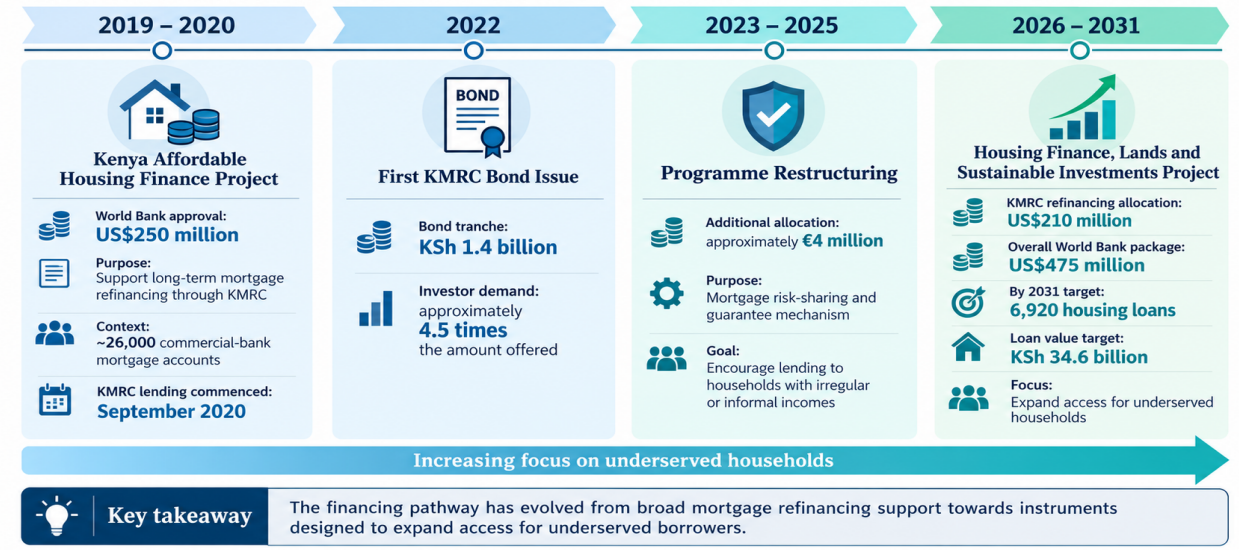
88. **Early support established long-term refinancing.** In 2019–2020, the World Bank approved the Kenya Affordable Housing Finance Project, valued at about US$250 million, to support mortgage refinancing through KMRC, which began lending in September 2020. At the time, the country had about 26,000 commercial bank mortgage accounts. In 2022, KMRC issued its first bond tranche of Kshs. 1.4 billion, which attracted demand of about 4.5 times the amount offered, showing institutional investor appetite for long-term mortgage instruments.

89. **The Programme was later restructured to reach underserved households.** Between 2023 and 2025, about €4 million was allocated to establish a mortgage risk-sharing and guarantee mechanism. The mechanism covers part of lenders' losses when borrowers fail to repay. This is expected to encourage lending to households with irregular or informal incomes who can repay but do not meet conventional requirements.

90. **A new World Bank project extends this support to 2031.** The Housing Finance, Lands and Sustainable Investments Project began in 2026 and provides US$210 million for mortgage refinancing through KMRC, within a financing package of US$475 million. By 2031, it targets refinancing 6,920 housing loans valued at Kshs. 34.6 billion, with a focus on households traditionally excluded from mortgage financing.

91. **Additional financing will be needed as the supply of units grows.** The Affordable Housing Act, 2024 allows the Affordable Housing Fund to provide low-interest or low-monthly-payment home loans and to develop long-term financing solutions for development and offtake. The Third Schedule provides for private-sector agencies approved by the Affordable Housing Board, but does not expressly identify KMRC.

Figure 16: KMRC and World Bank Support for Mortgage Financing



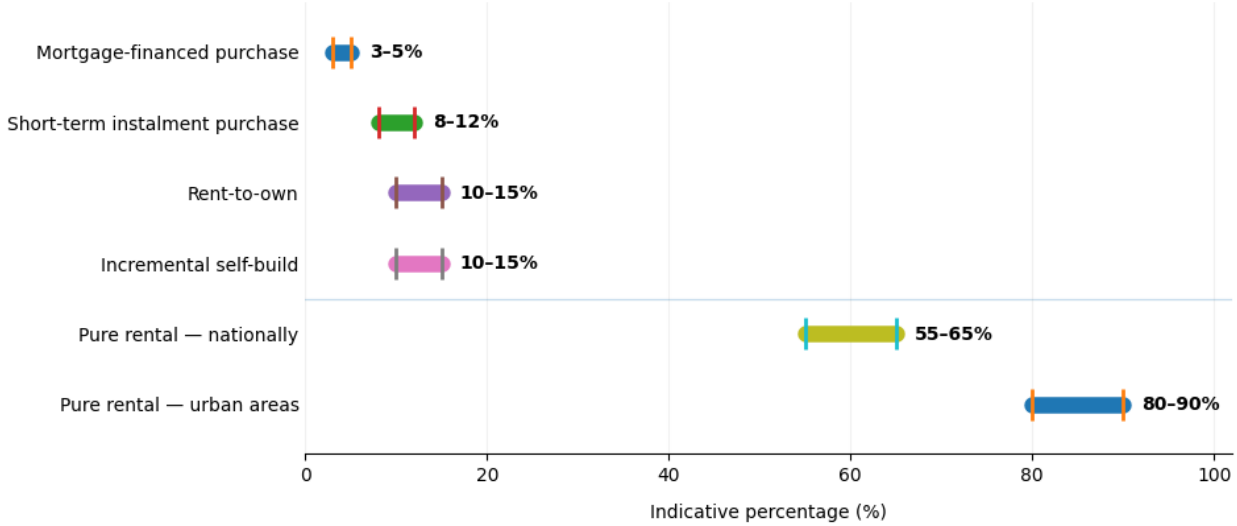
92. **More mortgage financing alone will not guarantee higher offtake.** Prospective buyers also need to be properly assessed and matched to units they can afford. The effectiveness of Boma Yangu, the Programme's main platform for aggregating demand and allocating units, is therefore equally important.

93. Boma Yangu shows strong interest in affordable housing. Through the platform, prospective beneficiaries register, save towards deposits, select units and take part in allocation and financing. By mid-2026, registrations had reached about 1.26 million, with voluntary savings of Kshs. 5.47 billion, of which Kshs. 1.76 billion had been converted into purchase deposits.

94. Registration does not mean that applicants can afford their preferred units. According to Financial Sector Deepening Kenya (FSD Kenya), mortgage-financed purchases account for an estimated 3–5 percent of housing acquisition, compared with 10–15 percent for rent-to-own arrangements and 8–12 percent for short-term instalment purchases. Rental housing accounts for 55–65 percent nationally and 80–90 percent in urban areas.

95. Assessing affordability before applicants select units is a key opportunity. Because the size of a unit determines its price, applicants may choose houses beyond their ability to pay, leading to unsuccessful allocations, delayed payments and unoccupied units. Research by FSD Kenya highlights the importance of verifying household income, savings behaviour and repayment capacity before matching applicants to units.

Figure 17: Housing acquisition pathways and rental prevalence in 2026



Source: FSD Kenya

96. The allocation process could be restructured so that unit selection follows a mandatory affordability assessment. With applicants' consent, the Affordable Housing Board could work with banks, SACCOs and other regulated financial institutions to assess income, transaction history, savings behaviour, existing obligations and repayment capacity. Applicants would keep the freedom to choose their preferred location, while the size and price of the unit would be based on demonstrated financial capacity. The assessment would also establish whether an applicant can buy in cash, qualifies for a mortgage or needs a tenant purchase arrangement.

97. This approach would match applicants to houses they can afford. It would reduce unsuccessful allocations and payment defaults, and help the Board identify applicants able to buy in cash or by mortgage. Recovery of funds from completed units would be faster, while tenant purchase arrangements would remain targeted at lower-income households.

98. The following options can be explored over the next medium-term period:

i) **Prioritise Mortgage Financing for Affordable and Affordable Market Housing Units.** The Government should prioritise mortgages for affordable and affordable middle-class beneficiaries who qualify for loans from banks and SACCOs. This would involve working with KMRC and participating financial institutions to expand affordable long-term mortgages, strengthen credit guarantees for borrowers with irregular incomes and explore ways of mobilising pension funds for mortgage refinancing. Part of the Affordable Housing Fund could also support mortgage refinancing, subject to legal requirements. With about 45,000 units expected to be completed by December 2026 and a further 15,000 by June 2027, higher mortgage uptake would speed up recovery of sales proceeds and provide resources for ongoing construction.

ii) **Prioritise Tenant Purchase Schemes (TPS) and Deposit Assistance for Social Housing.** These should be directed to social housing beneficiaries earning below Kshs. 20,000 per month, who have limited capacity to meet conventional mortgage repayments under the 30 percent affordability benchmark. TPS would give low-income households access to housing through affordable monthly payments, while those who qualify for mortgages are encouraged to borrow from banks and SACCOs. This would preserve access for low-income households while reducing the public resources tied up in long-term tenant purchase arrangements.

iii) **Prioritise Cash Purchases and Improve the Boma Yangu Housing Allocation Process.** The Government should encourage outright cash purchases, particularly for affordable and affordable middle-class units, to speed up replenishment of the Affordable Housing Fund. The Affordable Housing Board should also restructure Boma Yangu so that applicants undergo a mandatory financial assessment before being allocated specific units. Applicants would keep the freedom to choose their preferred location, while the size and price of units would reflect demonstrated financial capacity. This would minimise unaffordable allocations, reduce payment defaults and speed up recovery of funds for ongoing and new construction.

Budgetary Effects of the Options: Affordable Housing Offtake

Kshs. millions

	FY 2027/28	FY 2028/29	FY 2029/30	Total
i. Prioritise mortgage financing for affordable and affordable market units	0	0	0	0
ii. Prioritise Tenant Purchase Schemes and deposit assistance for social housing	0	0	0	0
iii. Prioritise cash purchases and improve the Boma Yangu allocation process	0	0	0	0
Total	**0**	**0**	**0**	**0**

Notes: Options shown as 0 are not quantified in this paper and are assumed to be budget neutral; they can be implemented within current resources. The options redirect existing Affordable Housing Fund resources and are expected to speed up the recovery of sales proceeds.

3.3. Developing a Phased Lokichar–Lamu Crude Oil Pipeline

99. **Kenya is close to producing oil commercially, and the gains will depend on how cheaply the oil reaches buyers.** Production from the South Lokichar Basin is planned at about 20,000 barrels per day in Phase I and 50,000 barrels per day in Phase II. Oil will first move by road to Mombasa and later by rail, while the Lokichar–Lamu pipeline remains a long-term option.[23]

2 Parliament of Kenya, South Lokichar Field Development Plan (Rev. 6.2), submitted in connection with consideration of the Field Development Plan for Blocks 10BB and 13T (T6 and T7), 2025. https://www.parliament.go.ke/sites/default/files/2025-12/South%20Lokichar%20Field%20Development%20Plan%20Rev%206.2.pdf

3 Parliament of Kenya, 'Government Undertakes Environmental Safeguards for Turkana Oil Projects', 2026. https://parliament.go.ke/node/25141

100. The current plan is a practical way to start, but it has limits over time. At 50,000 barrels per day, up to 1,500 trucks a day could be needed, adding pressure on roads and safety. The rail option is estimated at about US$666 million[4], and a later public estimate for what appears to be the same solution is about US$1.7 billion (Kshs. 220 billion)[5]. Both road and rail would deliver oil to Mombasa rather than Lamu.

101. A fresh look at the Lokichar–Lamu pipeline is therefore timely. Much of the groundwork exists for a pipeline of about 824 kilometres, including engineering design, route identification, environmental and social assessment, and land survey. The African Union lists it as a regional priority project costing about US$3.064 billion.[6]

102. Developments at Lamu strengthen the case for a review. The Dangote Group plans a refinery at Lamu able to process 700,000 barrels per day, at an estimated investment of US$16 billion (Kshs. 2.075 trillion)[7], with priority given to regional oil where this makes commercial sense. Kenya has been offered a 10 percent stake worth about US$500 million (Kshs. 64.9 billion), and East African countries a combined 30 percent worth about US$1.5 billion (Kshs. 194.6 billion)[8]. The complex could also supply fuels, industrial materials and up to 1,000 MW of power, of which about 500 MW could be available to the Government.

103. A pipeline could lower transport costs considerably. Preliminary estimates put pipeline transport at about US$5 per barrel, compared with about US$20 per barrel by road[9]. At 50,000 barrels per day, the difference is about US$274 million a year, before pipeline charges, financing and operating costs. This is not a direct saving to the Government, and the estimates should be independently confirmed.

104. Wider economic benefits would follow. Port services, storage and logistics would help Lamu grow into a regional petroleum centre, supporting growth and revenue and easing pressure on public roads. Fuel costs could also fall if locally refined products reach the market more cheaply than imports. Lamu would complement, rather than compete with, the Tanga route served by the East African Crude Oil Pipeline, which was 92.7 percent complete as at 1 September 2026[10].

105. The pipeline needs more oil than Kenya alone will produce. Additional oil from South Sudan and other regional producers, backed by long-term commitments, would be required before construction. The Lamu refinery should not yet be counted as an assured customer, and Uganda's planned 60,000 barrels-per-day refinery at Hoima could reduce the oil available for export through Lamu.

3 Parliament of Kenya, South Lokichar Field Development Plan (Rev. 6.2), submitted in connection with consideration of the Field Development Plan for Blocks 10BB and 13T (T6 and T7), 2025. https://www.parliament.go.ke/sites/default/files/2025-12/South%20Lokichar%20Field%20Development%20Plan%20Rev%206.2.pdf

5 Business Daily Africa, 'Kenya plans Sh220bn rail to transport Turkana oil', 11 March 2026; Bloomberg, 'Kenya Mulls $1.7 Billion Rail Extension to Ex-Tullow Oil Fields', 11 March 2026. https://www.businessdailyafrica.com/bd/economy/kenya-plans-sh220bn-rail-to-transport-turkana-oil-5386682

6 African Union Programme for Infrastructure Development in Africa (PIDA), LAPSSET Crude Oil Pipeline Investment Prospectus. https://www.au-pida.org/prospectus/project.php?id=81

7 https://www.centralbank.go.ke/rates/forex-exchange-rates/ accessed on 30th September 2026

8 Dawan Africa, 'Dangote Offers Kenya $500 Million Stake in Proposed $20 Billion Lamu Oil Refinery', 21 August 2026. https://www.dawan.africa/news/dangote-offers-kenya-dollar500-million-stake-in-sh26-trillion-lamu-refinery

9 https://parliament.go.ke/sites/default/files/2025-11/South%20Lokichar%20Field%20Development%20Plan%20Rev%206.2%20%281%29_0.pdf

10 https://www.eacop.com/ugandas-minister-of-energy-and-mineral-development-visits-eacop-pump-station-1-as-project-reaches-92-7-completion/

106. **Private financing should take the lead.** At about US$3.064 billion, the project is too large for the budget to carry in the current fiscal position. Budget resources are better used to prepare the project so that it can attract private and development financing.

107. **Land and community matters need early attention.** Some communities occupy land set aside for LAPSSET infrastructure without title, compensation or resettlement. Earlier land surveys should be updated to reflect current occupation and compensation status before construction financing is sought.

108. **The appropriate budget step is preparation, not immediate construction.** The following options can be explored over the next medium-term period:
    i. **Allocate resources to update the feasibility and bankability assessment of the Lokichar–Lamu Crude Oil Pipeline:** A limited, dedicated budget would fund an independent update of costs, oil volumes, land needs, safeguards, financing and returns. The study should test Kenya-only, Kenya plus South Sudan, and wider regional supply, and compare road, rail and pipeline side by side. This costs far less than construction and would show whether the project can attract private financing.
    ii. **Revive regional commercial negotiations and secure anchor throughput commitments:** The Government should hold structured discussions with South Sudan, the South Lokichar Joint Venture, Lamu refinery investors, the LAPSSET Corridor Development Authority, lenders and private investors to secure long-term commitments to use the pipeline. South Sudan's reported production of about 110,000 barrels per day[11] could substantially increase its use. The Government should not guarantee pipeline revenues, and any Government shareholding should earn a demonstrated return.
    iii. **Develop the Lokichar–Lamu Pipeline through a phased PPP/project-finance model:** Subject to the study and negotiations, the pipeline should be built in phases with private partners rather than through direct budget funding. The Government's contribution should be limited to land acquisition and access rights, approvals, safeguards and supporting infrastructure. The project would proceed only when minimum oil volumes and financing are in place, avoiding an under-used asset.

Budgetary Effects of the Options: Lokichar–Lamu Crude Oil Pipeline

Kshs. millions

	FY 2027/28	FY 2028/29	FY 2029/30	Total
i. Update the feasibility and bankability assessment	0	0	0	0
ii. Revive regional commercial negotiations and secure commitments	0	0	0	0
iii. Develop the pipeline through a phased PPP/project-finance model	0	0	0	0
Total	**0**	**0**	**0**	**0**

Notes: Options shown as 0 are not quantified in this paper and are assumed to be budget neutral; they can be implemented within current resources. Option i proposes a limited, dedicated allocation, but no amount is specified. Pipeline construction would be privately financed and is not a charge on the budget.

3.4. Empowering Kenya's Workforce

109. **Labour migration is an increasingly important part of Kenya's employment, human-capital development and external economic engagement.** The FY 2027/28 budget framework should therefore treat it as part of a structured national development strategy, and not only as a response to youth

[11] https://www.worldometers.info/oil/south-sudan-oil/

unemployment. The aim is to connect Kenyan workers to legitimate employment abroad, protect their rights and welfare, and increase the development value of remittances. The proposed options focus on expanding Bilateral Labour Agreements (BLAs), strengthening pre-departure preparation and certification, improving the National Employment Authority (NEA) and its digital systems, strengthening worker protection and overseas welfare services, and establishing structured return and reintegration pathways.

110. **The approach moves from fragmented administration to an integrated labour-migration cycle.** The cycle covers labour-market identification, recruitment, contract verification, skills preparation, deployment, overseas welfare and dispute resolution, emergency response, return and reintegration. The National Treasury's Budget Circular proposes Zero-Based Budgeting for FY 2027/28. Each expenditure item should therefore be justified against defined outputs and outcomes, including jobs created, worker protection, reduced irregular recruitment, better skills matching and productive use of remittances. The options below cover both the recurrent and capital spending needed for the supporting infrastructure and digital systems.

111. **The policy framework should bring all stakeholders into a single, coordinated system.** This would make labour migration structured, safe and productive, working through existing institutions and programmes: the State Department for Labour and Skills Development, the NEA, the National Industrial Training Authority (NITA), the Youth Enterprise Development Fund, Labour Attaché offices, foreign missions, private recruitment agencies and county-level structures.

Exporting Labour: Structural Insights from the Kenyan and Philippine Migration Models

112. **The Philippines offers a useful benchmark because it manages labour migration as a full cycle.** Its Department of Migrant Workers and Overseas Workers Welfare Administration are supported by active overseas labour representation, welfare services, recruitment regulation, pre-departure preparation and reintegration measures. For Kenya, the lesson is the need for stronger coordination and connected digital systems across the NEA, NITA, foreign missions, labour attaché services, immigration, private recruitment agencies and county reintegration structures. Kenya can adapt these principles within its own institutional and legal framework.

113. **The comparison also highlights the value of a funded welfare mechanism and recognised skills.** Proposals drawn from this model include a Migrant Workers Welfare Fund with Treasury seed or matching capital, a Global Legal Aid Retainer Fund, a mandatory pre-departure orientation seminar, alignment of TVET and medical certification with international standards, and match-funding for bilateral talent pipelines under a Global Labour Market Strategy. These measures would strengthen worker protection and increase the economic value of labour mobility.

114. **For FY 2027/28, the budget options can be organised around five mutually reinforcing priorities.** These are: expansion of bilateral labour agreements; standardised pre-departure training and certification; a stronger NEA with integrated digital labour-migration systems; institutionalised migrant protection, welfare and emergency response; and structured return, reintegration and productive use of remittances.

115. **Together, these priorities move Kenya from a mainly regulatory approach to an active one.** The aim is to develop international employment opportunities while protecting migrant workers throughout the migration cycle.

Expansion of Bilateral Labour Agreements and Legal Frameworks

116. **Expanding and operationalising BLAs should be a core budget priority.** Predictable and legally protected labour corridors are the means through which Kenyan workers can access verified employment

abroad. Recurrent spending should support faster negotiation and implementation of pending agreements with markets including Germany, Canada, Australia, Poland, Bahrain, Oman, Jordan and Kuwait. It should also cover legal drafting, multi-sector working groups, verification missions, Labour Attaché support and legal-compliance clinics for private recruitment agencies.

117. **An allocation of Kshs. 150 million is proposed for the expansion of Bilateral Labour Agreements.** It would support the digital infrastructure needed to verify contracts, clear recruitment agencies and connect the BLA framework to the NEA's integrated systems. Wider legal and institutional strengthening costs should be met within existing labour-migration recurrent and development votes.

Pre-Departure Training, Certification and High-Value Skills Development

118. **Pre-departure preparation should ensure that workers meet the requirements of destination markets.** These include technical, language, cultural, contractual and professional requirements. Recurrent spending should support the design and standardisation of mandatory Pre-Departure Orientation Training (PDOT), updated training materials, registration and auditing of trainers, rights awareness, financial literacy, psychosocial preparation and language training, with curricula aligned to international standards.

119. **Specialised testing and training infrastructure is also needed.** This would be delivered through NITA and other institutions, including Global Mobility Centres and upgraded technical certification facilities, with attention to medical, ICT, engineering and other high-value professions, and a labour-migration financing window. Indicative allocations are **Kshs. 500 million** for specialised Global Mobility Centres, **Kshs. 300 million** for PDOT subsidies, **Kshs. 500 million** for a Migration Loan Financing Window through the Youth Enterprise Fund, and **Kshs. 150 million** for an Agency Bridging Fund to support registered private recruitment agencies undertaking group deployments.

Strengthening the National Employment Authority and Digital Labour-Migration Systems

120. **The NEA should be strengthened as the coordinating platform.** Its role covers job matching, recruitment regulation, contract verification, worker tracking and welfare monitoring. Recurrent spending should support compliance monitoring, unannounced vetting of Private Recruitment Agencies (PRAs), digital licensing, labour-migration services and maintenance of the systems used to monitor recruitment and deployment.

121. **An allocation of Kshs. 750 million is proposed to expand and integrate the NEA's digital systems.** The National Employment Authority Integrated Management System (NEAIMS) would be linked with the Kenya Labour Market Information System (KLMIS), NITA systems, immigration and e-Citizen processes, recruitment-agency portals and verified foreign-employer information. The proposed allocations are **Kshs. 500 million** for an integrated National Labour Migration Management Portal and **Kshs. 250 million** for digital integration and NEAIMS expansion.

Migrant Protection, Welfare, Labour Attachés and Emergency Response

122. **Migrant protection requires a predictable institutional and financial safety net.** It should be able to respond to worker distress, contractual disputes, unsafe working conditions and emergencies abroad. Recurrent spending should finance Labour Attachés in priority destination markets, welfare services at foreign missions, legal and compliance support, 24-hour emergency response centres, grievance handling and rapid coordination with host-country authorities.

123. **An allocation of Kshs. 4 billion is proposed for migrant welfare and emergency response.** It would establish or equip welfare hubs, safe houses, temporary shelters, emergency response infrastructure and the systems for monitoring migrant welfare. The proposed allocations are **Kshs. 700 million** for deploying

eight more Labour Attachés and Welfare Hubs, **Kshs. 300 million** for a ring-fenced Migrant Workers Social Protection and Emergency Repatriation Fund, and **Kshs. 3 billion** as seed or matching capital for the Migrant Workers Welfare Fund.

Return, Reintegration and Remittance Leveraging

124. **Support should continue after deployment, when workers return.** Returning workers need help to re-enter the domestic economy and invest their savings productively. Recurrent spending should support psychosocial services, employment re-entry assistance, skills recognition, enterprise advisory services and coordination of county-level reintegration programmes.

125. **Reintegration centres and financing windows would channel savings and skills into productive activity.** These would direct diaspora savings and returnee skills into agricultural value chains, agro-processing, manufacturing and other enterprises. The proposed allocations are **Kshs. 1 billion** for a Migrant Returnee Livelihood Scheme and a conditional grant to counties of **Kshs. 500 million** for a migration loan financing window and reintegration pathways. The four pathways are enterprise setup, local labour-market re-entry, psychosocial support and formal skills recognition.

126. The following policy options may be considered for **FY 2027/28 and the medium term:**

i. **Fast-track BLAs.** Negotiate and operationalise agreements with priority destination markets, and establish clear legal and institutional mechanisms for contract verification and worker protection.
ii. **Standardise and subsidise pre-departure training.** Cover PDOT, language, financial literacy, rights awareness and cultural orientation, with accredited trainers and measurable certification outcomes.
iii. **Strengthen NEA and NEAIMS.** Make them the central digital employment and labour-migration platform, integrating recruitment, training, immigration, contract verification and worker tracking.
iv. **Strengthen regulation of Private Recruitment Agencies.** Use digital licensing, routine and unannounced compliance inspections, decentralised vetting and enforceable sanctions for non-compliance.
v. **Expand Labour Attaché and migrant-welfare services.** Cover major and emerging destination markets, including legal support, grievance handling, temporary shelters and emergency coordination.
vi. **Operationalise sustainable welfare and emergency-repatriation financing.** Combine public seed funding with longer-term contributory arrangements where feasible.
vii. **Establish Global Mobility Centres and specialised upskilling laboratories.** Work with NITA and other institutions to widen access to internationally recognised technical and professional certification.
viii. **Establish county-level reintegration pathways.** Support them through conditional grants, focusing on enterprise setup, local labour-market re-entry, psychosocial support and formal recognition of skills.
ix. **Develop migration-financing windows.** Make them available to workers and compliant recruitment agencies.
x. **Apply Zero-Based Budgeting.** Require each proposed allocation to show a clear link to employment outcomes, worker protection, improved labour-market access, remittance generation and measurable service-delivery results.

Budgetary Effects of the Options: Empowering Kenya's Workforce
Kshs. millions

	FY 2027/28	FY 2028/29	FY 2029/30	Total
i. Fast-track Bilateral Labour Agreements	150	–	–	150
ii. Standardise and subsidise pre-departure training	300	–	–	300
iii. Strengthen NEA and NEAIMS	750	–	–	750
iv. Strengthen regulation of Private Recruitment Agencies	0	0	0	0
v. Expand Labour Attaché and migrant-welfare services	700	–	–	700
vi. Operationalise welfare and emergency-repatriation financing	3,300	–	–	3,300
vii. Establish Global Mobility Centres	500	–	–	500
viii. Establish county-level reintegration pathways	1,500	–	–	1,500
ix. Develop migration-financing windows	650	–	–	650
x. Apply Zero-Based Budgeting	0	0	0	0
Total	**7,850**	**–**	**–**	**7,850**

Notes: Amounts are additional spending relative to the baseline, as proposed in this paper. A dash (–) indicates that costs beyond FY 2027/28 are not specified.
Option iii comprises Kshs. 500 million for the National Labour Migration Management Portal and Kshs. 250 million for NEAIMS expansion. Option vi comprises Kshs. 3,000 million in seed capital for the Migrant Workers Welfare Fund and Kshs. 300 million for the Emergency Repatriation Fund. Option viii comprises Kshs. 1,000 million for the Migrant Returnee Livelihood Scheme and a Kshs. 500 million conditional grant to counties. Option ix comprises Kshs. 500 million for the Migration Loan Financing Window and Kshs. 150 million for the Agency Bridging Fund.
Options shown as 0 are not quantified in this paper and are assumed to be budget neutral; they can be implemented within current resources.

3.5. Climate Financing

127. **Operationalising the carbon market revenue framework is the most immediate climate financing option for the FY 2027/28 Budget Policy Statement.** It would support GDP growth, raise revenue and help rationalise expenditure. The legal basis is the Climate Change Act 2023 and the Climate Change (Carbon Markets) Regulations, 2024; Statutory Instrument 48 of 2025 provides that 30 percent of all carbon credit revenue accrues to Government through taxes, licences and fees. The Kenya National Carbon Registry, launched in February 2026, provides the tracking infrastructure. It is interoperable with the REDD+ Registry launched in July 2025, which integrates forestry emission reductions into national carbon accounting, prevents double counting and improves transparency for Article 6 and voluntary market transactions. The remaining constraint is administrative implementation, not law.

128. **The revenue effect is immediate.** Kenya had generated 22.5 million carbon credits by February 2026, valued at about USD 147.3 million. According to the Institute of Public Finance, Kenya hosts 46 agriculture-related carbon projects on the Verra and Gold Standard registries. Of these, 29 are registered or able to issue, generating about 5.2 million credits a year worth USD 27.2 million to USD 89.2 million. Pipeline projects could add 8.3 million credits a year, worth USD 52.1 million to USD 157.2 million, bringing the agricultural portfolio to between USD 79.3 million and USD 246.4 million a year. By comparison, the Ministry of Environment's FY 2026/27 budget is about USD 369 million: revenue from

currently issuing projects alone equals roughly 7 percent of that budget, rising to 22–67 percent if pipeline projects become operational. Kenya's carbon market was valued at about USD 251 million in 2025 and is projected to reach USD 331 million by 2032.

129. **The growth effect comes with a lag, in FY 2028/29 and FY 2029/30.** Natural capital contributes about 42 percent of GDP and supports nearly 70 percent of jobs, according to the Kenya Watershed Services Improvement Project document of the Ministry of Environment. Climate-smart agriculture linked to carbon finance has raised yields by 15–20 percent in projects such as the Kenya Agricultural Carbon Project. Forestry and land-use projects, which have produced over 99 percent of Kenya's carbon credits since 2011, support a sector contributing 4 percent of GDP and USD 4.8 billion in gross value added. As the issuer of 25 percent of all African carbon credits, Kenya is well placed to become a regional carbon trading hub.

130. **The expenditure effect is also medium term.** Carbon revenue reduces the fiscal burden of climate adaptation. The 2024/25 Budget allocated Kshs. 128 billion to environmental protection, water and natural resources, mainly for water projects, leaving limited funds for climate action and emergency response; the 2024 floods required resources to be diverted from health and education. Carbon revenue offers an alternative source and eases pressure on the Exchequer. Benefit sharing adds to this: land-based projects contribute at least 40 percent of earnings to community development, and non-land-based projects 25 percent, financing locally identified resilience priorities.

131. **The main implementation gap is that authorisation comes only after credits are generated.** Letters of Authorization are issued once credits are generated and verified, which gives no bankable certainty at the project financing stage. FSD Kenya and the Article Six Group identify the lack of clear decision criteria and timelines as "the major financing bottleneck for Article 6 projects." Policy uncertainty on land rights, carbon credit ownership and taxation persists, and local verification capacity remains thin. FY 2027/28 should therefore prioritise issuing bankable Letters of Authorization in advance, with published criteria and timelines; operationalising the carbon budget mechanism; publishing the formal whitelist; strengthening local verification capacity; and clarifying how benefit-sharing funds are disbursed.

132. The following options can be explored over the next medium-term period:
    i. **Issue Letters of Authorization in advance.** Publish the decision criteria and timelines so that projects have certainty at the financing stage;
    ii. **Operationalise the carbon budget mechanism and publish the whitelist.** This would complete the administrative framework that the law already provides for;
    iii. **Strengthen local verification capacity.** A modest allocation would support the Kenya National Carbon Registry and build local capacity to verify carbon credits;
    iv. **Clarify benefit-sharing and track the Government's share.** Set out how community funds are disbursed, and report the Government's 30 percent share of carbon revenue as a distinct line in the budget.

Budgetary Effects of the Options: Climate Financing

	FY 2027/28	FY 2028/29	FY 2029/30	Total
i. Issue Letters of Authorization in advance	0	0	0	0
ii. Operationalise the carbon budget mechanism and publish the whitelist	0	0	0	0
iii. Strengthen local verification capacity	0	0	0	0
iv. Clarify benefit-sharing and track the Government's share	0	0	0	0
Total	**0**	**0**	**0**	**0**

Notes: Options shown as 0 are not quantified in this paper and are assumed to be budget neutral; they can be implemented within current resources. Additional revenue from the Government's 30 percent share of carbon credit proceeds is not estimated here.

3.6. Strengthening the Kenya Health System

133. **The Kenya–United States Government-to-Government Health Cooperation Framework is a five-year partnership to strengthen Kenya's health system.** It covers disease surveillance and outbreak response, laboratory systems and health-product supply chains, the health workforce, digital health infrastructure, and the integration of priority disease programmes into Kenya's health financing and service delivery.

134. **The Framework progressively transfers financing and implementation responsibilities to the Government of Kenya.** It combines U.S. financial and technical assistance with a transition from externally supported programmes to greater domestic financing, institutional ownership and integration within the health system. This matters for sustainability because several of the responsibilities being transferred are recurrent, including healthcare workers, commodities, laboratory services, digital systems and supply-chain operations.

135. **U.S. support is linked to Kenya meeting its co-investment commitments.** If the Government of Kenya does not meet the commitments set out in the Framework within the specified calendar year, the U.S. Government will, within nine months, give notice to reduce or cease funding.

136. **U.S. support declines over the period while Kenya's domestic health spending rises.** Planned U.S. support is US$414.294 million in 2026, US$388.294 million in 2027, US$341.194 million in 2028, US$326.194 million in 2029 and US$161.494 million in 2030. Kenya's additional domestic health expenditure, relative to the 2025 baseline, is expected to rise from Kshs. 10 billion in 2027 to Kshs. 20 billion in 2028, Kshs. 35 billion in 2029 and Kshs. 50 billion in 2030.

Table 9: Overall financing commitments

Year	U.S. planned support (US$ million)	Increase in Kenya's domestic health expenditure
2026	414.294	
2027	388.294	Kshs. 10 billion
2028	341.194	Kshs. 20 billion
2029	326.194	Kshs. 35 billion
2030	161.494	Kshs. 50 billion

Source: Ministry of Health

137. **The key feature of the Framework is the gradual transfer of spending responsibility.** Kenya is not only receiving external resources; it is committing to increase its own financing as U.S. support declines. Sustainability will depend on whether domestic allocations rise sufficiently and predictably to offset the reduction. This is especially important because the areas in transition are core inputs for service delivery, not short-term development projects.

138. **Commodity financing shifts progressively to Kenya.** The U.S. Government currently finances about US$74.8 million a year in specified commodities, including HIV, tuberculosis, malaria and maternal, newborn and child health commodities. U.S. financing is expected to rise to about US$94.8 million in 2026 before declining progressively. Kenya's new financing increases correspondingly, reaching about US$59.8 million by 2030 and US$74.8 million in 2031.

Table 10: Transition in commodity financing

Year	U.S. funding (US$ million)	Existing Kenya funding (US$ million)	New Kenya funding (US$ million)	Total
2026	94.78	105.93	0	200.7
2027	44.87	105.93	29.91	180.7
2028	44.87	105.93	29.91	180.7
2029	29.91	105.93	44.87	180.7
2030	14.96	105.93	59.83	180.7
2031	0	105.93	74.78	180.7

Source: Ministry of Health

139. **The commodity transition also involves a significant institutional change.** The U.S. Government intends to transfer procurement, warehousing and distribution of its commodities to KEMSA by 31 December 2026. A transition framework and a KEMSA readiness assessment are to be developed, while Kenya continues to procure, store and distribute its own commodities through KEMSA. The Framework also provides for GS1-based commodity traceability and stronger systems for detecting loss, diversion and falsification of health products.

140. **The transition is operational as well as financial.** Kenya will need to fund the commodities and also the systems required to forecast, procure, store, distribute and track them. Weaknesses in these systems would affect the use of resources and the availability of essential health products.

141. **A similar transition applies to the health workforce.** The United States intends to finance 28,668 frontline healthcare worker full-time equivalents (FTEs) in 2026 and 21,407 in 2027. From 2028, U.S.

financing for these workers ends, and Kenya is expected to finance 13,293 FTEs annually in 2028, 2029 and 2030. Kenya also intends to absorb the healthcare workers supported under the Framework by 30 June 2028.

Table 11: Health workforce financing transition

Year	U.S.-funded FTEs	Kenya-funded new FTEs
2026	28,668	0
2027	21,407	0
2028	0	13,293
2029	0	13,293
2030	0	13,293

Source: Ministry of Health

142. **The workforce commitment is an important medium-term fiscal obligation.** Wages and related employment costs are recurrent: once workers are absorbed into the Government workforce, their pay continues beyond the five-year Framework. The transition therefore needs adequate fiscal space at the time of absorption and in subsequent years.

143. **Laboratory financing follows the same pattern.** U.S. financing for laboratory commodities declines from about US$15.0 million in 2026 to US$10.5 million in 2027 and US$5.2 million in 2028, and then ends. Kenya's new financing rises from about US$4.5 million in 2027 to US$9.7 million in 2028 and about US$15 million from 2029. Responsibility for frontline laboratory workers and laboratory-system operations transfers gradually over the same period.

144. **The Framework provides US$175 million for data systems over five years.** This comprises US$30 million in 2026, US$75 million in 2027, US$50 million in 2028 and US$10 million a year in 2029 and 2030. The investment supports an integrated digital health architecture, including TaifaCare HMIS, disease surveillance, laboratory information systems, commodity management and other health-information functions. Kenya is expected to sustain the cost of software licences, cloud computing, hardware maintenance and replacement, cybersecurity and other recurrent needs not funded by the United States.

Table 12: U.S. strategic and digital health financing

Area	2026	2027	2028	2029	2030	Total
Data systems (US$ millions)	30	75	50	10	10	**175**
Strategic interventions (US$ millions)	102.71	127.64	168.81	235.12	113.31	**747.59**

Source: Ministry of Health

145. **Strategic interventions are broad and front-loaded.** They support the integration of HIV, TB, malaria and other programmes into the SHA, claims processing and strategic purchasing, laboratory strengthening, disease surveillance, health workforce systems, supply chains and institutional reforms. The allocation rises substantially through the middle of the Framework and declines in 2030. External investment is therefore highest while systems are being strengthened, followed by increasing domestic responsibility for financing and sustaining them.

146. **FY 2027/28 is a particularly important year in the transition.** Under the Framework's year designation, 2028 corresponds to Kenya's FY 2027/28. By then, Kenya's additional domestic health expenditure

commitment rises to Kshs. 20 billion relative to the 2025 baseline. At the same time, U.S. financing for frontline healthcare workers is scheduled to end, domestic financing for laboratory commodities increases, and Kenya's contribution to other commodities continues to rise.

Table 13: Key FY 2027/28 transition obligations

Area	U.S. position in FY 2027/28	Kenya's position in 2028	Fiscal implication
Domestic health expenditure	External support continues	Kshs. 20 billion additional expenditure relative to the 2025 baseline	Increased health-sector fiscal requirement
Frontline health workers	U.S. funding ceases	13,293 FTEs funded	New recurrent wage obligation
Other commodities	US$44.87m	US$29.91m new Kenya financing + existing financing	Increased domestic commodity financing
Laboratory commodities	US$5.24m	US$9.72m new Kenya financing	Accelerating domestic financing
Digital health	US$50m	Increasing responsibility for recurrent sustainability	Future recurrent expenditure
Strategic interventions	US$168.81m	Greater domestic ownership/integration	Need to sustain interventions after external support

Source: Ministry of Health

147. The Framework links continued U.S. support to Kenya's performance on its commitments. Failure to meet agreed co-investment could affect the level of external financing available. This creates an incentive for timely domestic financing. It also introduces a fiscal risk if budget constraints, delayed appropriations or delayed releases prevent the Government from meeting the commitments.

Budgetary Effects: Kenya Health System Transition

Kshs. millions

	FY 2027/28	FY 2028/29	FY 2029/30	Total
Additional domestic health expenditure committed under the Framework	20,000	35,000	50,000	105,000

Notes: Amounts are relative to the 2025 baseline and correspond to Framework years 2028, 2029 and 2030. The commitment for FY 2026/27 (Framework year 2027) is Kshs. 10,000 million.
This is an existing commitment under the Kenya–United States Health Cooperation Framework, not a new option.

Summary of Budgetary Effects of the Options

Kshs. millions

	FY 2027/28	FY 2028/29	FY 2029/30	Total
Research and innovation	2,000	2,000	2,000	6,000
Affordable housing offtake	0	0	0	0
Lokichar–Lamu crude oil pipeline	0	0	0	0
Empowering Kenya's workforce	7,850	–	–	7,850
Climate financing	0	0	0	0
Total, new options	**9,850**	**2,000**	**2,000**	**13,850**
Memorandum:				
Health system transition (existing commitment)	20,000	35,000	50,000	105,000

Notes: Amounts are additional spending relative to the baseline, as proposed in this paper. A dash (–) indicates that costs beyond FY 2027/28 are not specified, so totals for later years cover research and innovation only. Areas shown as 0 contain only options that are not quantified and are assumed to be budget neutral.

4. CONCLUSION AND NEXT STEPS

4.1. Conclusion

148. **The economy remains resilient, but growth has not accelerated.** Growth averaged about 4.6 percent in 2017–2025 and is projected at about 4.8 percent in 2026–2028 under the baseline. Raising investment and productivity remains the central challenge.

149. **Fiscal space is limited.** Revenue has remained below target, interest payments and other recurrent obligations dominate spending, and public debt reached Kshs. 13.1 trillion at end-June 2026. The baseline points to a fiscal deficit of 6.2 percent of GDP in FY 2027/28.

150. **The options in this paper emphasise efficiency within existing resources.** Most can be implemented with current resources. The quantified options amount to about Kshs. 9.85 billion in FY 2027/28, alongside an existing health commitment of Kshs. 20 billion.

151. **Targeted measures could lift growth modestly while containing the deficit.** Under the alternative scenario, growth averages 5.0 percent over the medium term and the deficit is 6.0 percent of GDP in FY 2027/28.

4.2. Next Steps in the Budget Cycle

152. **The FY 2027/28 budget cycle will run ahead of the normal budget calendar.** The Budget Policy Statement will be approved on or before mid-December 2026, while the Appropriations Bill and the Finance Bill will be approved on or before the end of March 2027. The earlier calendar is on account of the General Elections scheduled for August 2027. Ordinarily, the Budget Policy Statement is submitted to Parliament by 15 February, and the Appropriations Bill and the Finance Bill are approved by 30 June. The table below compares the two calendars.

Stage	Normal budget calendar	FY 2027/28 budget calendar
Budget Policy Statement approved by Parliament	Submitted to Parliament by 15 February and approved within 14 days	**On or before mid-December 2026**
Appropriations Bill approved	On or before 30 June	**On or before end of March 2027**
Finance Bill approved	On or before 30 June	**On or before end of March 2027**

153. **The earlier timeline shortens the time available for scrutiny.** Committees will need to plan their review of the Budget Policy Statement, public participation and engagement with Ministries, Departments and Agencies early, so that resolutions are ready by mid-December 2026.

154. **Projections will rest on less outturn data than usual.** With the budget concluded about three months earlier, revenue and expenditure estimates will draw on fewer months of FY 2026/27 performance. This calls for prudent assumptions and close monitoring as new data become available.

155. The matrix below sets out the next steps for the FY 2027/28 budget cycle, with the responsible institution and timeline for each action.

Action	Responsibility	Timeline
Consider the options in this paper when examining sector priorities and ceilings in the Budget Policy Statement	Departmental Committees of the National Assembly and Standing Committees of the Senate	**During review of the Budget Policy Statement, ahead of mid-December 2026**
Reflect agreed options in the committee reports and approve the Budget Policy Statement	Budget and Appropriations Committee; Senate Standing Committee on Finance and Budget; the two Houses	**On or before mid-December 2026**
Align the budget estimates and revenue measures with the approved Budget Policy Statement	The National Treasury; Ministries, Departments and Agencies	**Following approval of the Budget Policy Statement**
Consider and approve the Appropriations Bill and the Finance Bill	National Assembly, through the Budget and Appropriations Committee and the Departmental Committee on Finance and National Planning	**On or before end of March 2027**
Provide analysis of the Budget Policy Statement, the budget estimates and the Finance Bill	Parliamentary Budget Office	**Throughout the cycle, December 2026 to March 2027**