KENYA

WALKING A TIGHTROPE

After years of financing through international markets and China, Kenya is facing a considerable increase in external debt servicing, which has led to strong pressure on external liquidity and on the shilling. Sustained economic growth in 2021-2022 was not enough to stabilise debt ratios. Renewed in late May 2023, support from multilateral creditors has helped to partially reconstitute official foreign exchange reserves and somewhat reassured investors. But the risk of social instability has increased significantly due to committed fiscal consolidation efforts and persistent high inflation.

SEVERE CONSTRAINTS ON LIQUIDITY ...

Over the past decade, Kenya has registered significant fiscal and current account deficits - i.e., twin deficits - financed by an increased use of China's bilateral loans and of international capital markets, against a backdrop of historically low interest rates. As a result, the country's external debt gradually increased to almost 60% of GDP in 2022.

With the war in Ukraine and the cycle of global monetary tightening, Kenya has lost its access to foreign capital markets, the cost of which has become prohibitive. In June 2022, the country had to cancel the sale of a USD 980 mn Eurobond, while spreads exceeded the threshold of 1,000 basis points (bps).

Since then, the country has not been able to reduce its current account deficit and financing requirements. First, the drought in 2022 increased Kenya's dependence on food imports and restricted its exports, primarily made of agricultural goods. Second, with oil accounting for almost 30% of the country's imports, the deterioration in terms of trade also contributed to widening the trade balance deficit. The slight upturn in tourism revenues after the pandemic and diaspora revenues were not enough to offset this gap, so 2022 ended with a current account deficit of 5% of GDP.

In the absence of external financing on capital markets, the interbank liquidity in foreign currency has dried up. As a result, between the end of January and the end of May 2023, the Central Bank of Kenya (CBK) had to draw USD 1 bn from its foreign exchange reserves to cope with foreign currency payments and the servicing of external debt. Foreign exchange reserves fell to their lowest level in ten years, covering over the period less than four months of imports, the convergence criterion set by the East African Community. At the same time, the Kenyan shilling depreciated at an accelerated rate (-14% over H1 2023, compared to -9% in 2022).

... DESPITE SUPPORT FROM ENERGY PROVIDERS AND IFIS

Pressure on external liquidity eased somewhat in May. First, Kenya reached an agreement with its oil suppliers in the Middle East to import fuel on credit, with a grace period running to the end of September 2023. Second, the government received the first tranche of a syndicated loan of USD 500 mn, as well as a disbursement of USD 1 bn from the World Bank. Thanks to this support, Kenya's foreign exchange reserves recovered at the beginning of June, rising slightly above the 4-month import threshold.

However, pressure on external liquidity will remain strong in the coming months. In fact, the country will have to deal with substantial external debt repayments, notably with the settlement of a USD 2 bn Eurobond due to mature in June 2024. However, renewed confidence among multilateral creditors is a recent positive sign for investors. At the end of May, the IMF increased its financial support to the country by an additional USD 1.1 bn as part of its extended credit facility, and through its new Resilience and Sustainability Trust (RST). The programme was extended until April 2025 and therefore covers the period of high repayments. With this support, the government hopes to make half of the repayments in principal of the Eurobond by the end of 2023, and to refinance the other half at a rate of 11% before it matures. After peaking at 21% at the beginning of May, the Eurobond yield currently returned to around 13%, thanks to the announcement of increased support from multilateral creditors. However, efforts must continue to ensure that investors' confidence returns. This is the aim of the new finance bill introduced in Parliament by the Ruto government last June.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-0.2	7.6	4.8	5.3	5.4
Inflation, CPI, year average, %	5.3	6.1	7.7	7.8	5.6
Central. Gov. balance / GDP, %	-8.1	-7.1	-6.0	-4.4	-4.4
Central. Gov. debt / GDP, %	68.0	68.2	68.4	69.5	67.9
Current account balance / GDP, %	-4.8	-5.2	-5.1	-5.3	-5.3
External debt / GDP, %	57.9	58.1	59.4	62.4	64.9
Forex reserves (excl. gold), USD bn	7.7	8.8	8.0	7.5	5.5
Forex reserves, in months of imports	4.7	5.3	4.1	4.0	3.0

TABLE 1

KENYA: INCREASE IN FOREX RESERVES THANKS TO INTERNATIONAL LENDERS

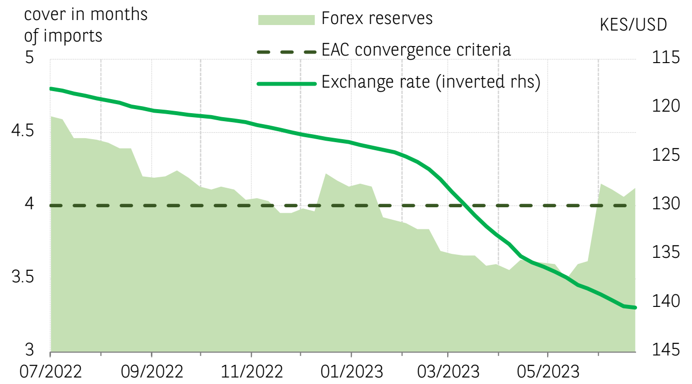

CHART 1 SOURCE: CENTRAL BANK OF KENYA, BNP PARIBAS

FISCAL CONSOLIDATION IS MAINTAINED …

Years of substantial fiscal deficits (7.3% of GDP on average over 2015-2021) brought public debt to almost 70% of GDP and debt servicing to 50% of government revenues in 2021. Sustained growth over the last two years has barely stabilised the debt-to-GDP ratio. The government is facing increasing difficulties in refinancing its debt on the domestic market. In fiscal year (FY) 2021/22 already, it failed to reach its financing target, due to investors' lack of appetite and their perception of increased sovereign risk, while the Central Bank systematically rejected the highest risk premiums demanded by investors.

Coming to power in August 2022, the Ruto government therefore faced the complex task of implementing fiscal consolidation measures in order to restore the sustainability of public debt. Despite these measures, which have enabled the fiscal deficit to decrease to 6% of GDP over FY 2022/23, the government's refinancing capacity has continued to deteriorate. Over the first ten months of the financial year, the government only reached 57% of its financing target on the domestic market. This led to arrears with local institutions, which stood at USD 4 bn at the end of March. Despite renewed support from the IMF at the end of May, demand for domestic debt has remained low and focused on very short-term maturities. However, the share of Treasury bills in total domestic debt is stable, at 15%, and the average maturity of Treasury bonds is still long, standing at 9 years in March 2023.

Pursuing fiscal consolidation has thus been necessary. Last June, the Ruto government introduced in Parliament the 2023 Finance Bill, prepared in conjunction with the IMF. According to projections, the Treasury expects a budget deficit of 4.4% of GDP for 2023/24. The new Finance Bill aims to increase tax income by 17% and contains key measures, such as doubling VAT on fuel (from 8% to 16%), raising the top personal income tax rate, and introducing a mandatory contribution to a national housing fund for all salaries. These highly unpopular measures have revived tensions with the opposition and dissatisfaction among the population, which has endured high inflation for the past year.

… BUT SOCIOECONOMIC AND POLITICAL TENSIONS HAVE INCREASED

Elected by a small majority, President Ruto took over a deeply divided nation. The fiscal consolidation measures implemented since 2022 have profoundly eroded the popularity of his government against a backdrop of high inflation. In October 2022, inflation peaked at 9.6% y/y, a 5-year record high. In the same month, food price inflation, which makes up 30% of Kenya's CPI basket, reached 16%. Since then, inflation has receded but remains very high, stabilising at 8% on average in Q2 2023. It has exceeded the Central Bank's upper target limit since June 2022, despite the various monetary tightening measures. Monetary tightening could be more incisive with CBK's new governor, Kamau Thugge (former Senior Advisor to Mr Ruto), invested last June. Calling an exceptional meeting of the Monetary Policy Committee on 26 June, the CBK raised its key interest rate by 100 bps to 10.5% (compared to an average of 60 bps at the last four committee meetings). The new governor of the Central Bank has therefore adopted a much more hawkish tone than his predecessor, and now expects inflation to reach its target by September.

KENYA: INFLATION HAS REMAINED OVER THE CBK TARGET

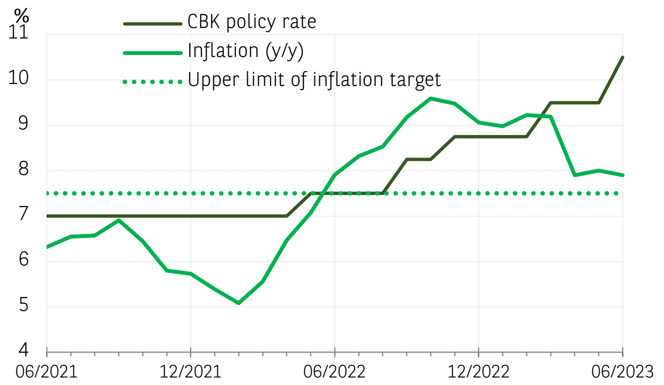

CHART 2 SOURCE: CENTRAL BANK OF KENYA, BNP PARIBAS

The cost-of-living crisis has resulted in a series of public disturbances, encouraged by the unsuccessful candidate in the election of August 2022, Raila Odinga. As leader of the opposition coalition Azimio la Umoja, which holds 45% of the seats in Parliament, Raila Odinga has been able to mobilise its electorate to organise major protests in the capital. In March and April, weekly riots severely disrupted economic activity and caused the death of around a dozen people. Despite the return to calm, social stability remains fragile, pending the heated discussions between the majority party and the opposition in Parliament. This stability might once again be compromised in the coming weeks by the Finance Bill. The Bill was temporarily suspended by the country's High Court at the end of June, despite some amendments made by Parliament a week earlier. Further amendments are possible, to appease the opposition and calm protests among the population. This would then delay fiscal consolidation.

Lucas Plé
lucas.ple@bnpparibas.com