Kenya

Tough economic times forthcoming

Kenya's real GDP growth was subdued last year and it will come under stress in 2020 due to coronavirus outbreak effects. The lower GDP growth will further constrain the fiscal policy space whereas the country's forex receipts are also weakened by adverse climatic conditions. While political rivalries continue to complicate the implementation of fiscal policy, failure to reduce budget deficits will challenge the sovereign's debt solvency in the medium term. Meanwhile, monetary policy easing and emergency measures in the banking sector could hamper banking sector prospects, which had started to improve following the recent removal of the interest-rate cap law.

Pandemic impact on a subdued economic growth

Kenya is feeling the economic effects of the pandemic outbreak. According to a private-sector organization survey[1], more than 60% of businesses are affected by the measures taken around the world to contain the Covid-19 virus. This is notably due to Kenya's close ties with China, which accounts for about 20% of its imports. With the reduction of imports, some industrial inputs would need to be sourced elsewhere or substituted by local production. Some enterprises have therefore downsized their production capacity.

Additionally, exports to markets such as the Middle East and Europe are also affected. The most vulnerable exports include horticultural goods, especially tea and coffee (respectively 23% and 4% of total exports), whose prices slightly increased by about 4% in 2019 and have suffered diverging dynamics year-to-date (-3% for tea and +5% for coffee).

Moreover, since December 2019, an outbreak of locust swarms in East Africa devastated around 13% of Kenyan crops[2]. This could bring food insecurity, which is also exacerbated by conflicts in the Rift Valley region. Kenya should also suffer from a contraction in forex reserves, which are projected at USD 8.9 billion (5.3 months of imports) at the end of 2020.

Kenya's external imbalances remain large and should stay so even if the decline in the oil import bill offsets the decline in goods exports. Meanwhile, the foreign exchange market has also recently experienced some volatility, and the shilling (KSH) lost more than 4% against the dollar since the beginning of the year.

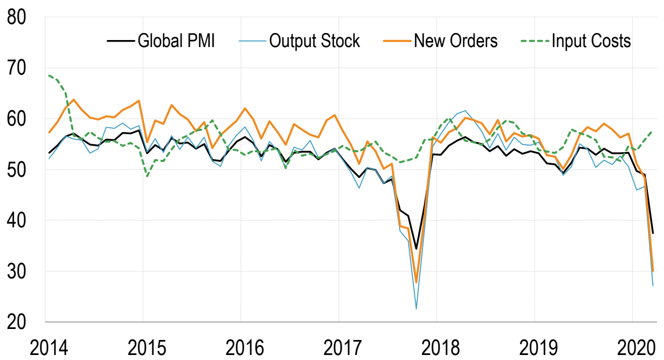
Airlines[3] and the tourism sector should also be affected, considering that Kenya is the third largest tourism economy of Sub-Saharan Africa, where tourism accounts for more than 8% of GDP, 15% of total exports and 8% of total employment. Construction and real estate sectors are also feeling the pinch, as development projects are suffering delays.

1- Forecasts

	2018	2019	2020e	2021e
Real GDP growth (%)	6.3	5.5	3.0	5.2
Inflation (CPI, year average, %)	4.7	5.6	6.3	5.2
Fiscal balance / GDP (%)	-6.9	-7.3	-7.6	-5.2
Current account balance / GDP (%)	-5.0	-4.7	-4.6	-4.6

e: BNP Paribas Group Economic Research estimates and forecasts

2- Deterioration of the private sector since the beginning of the year



Source: National Institut of Statistics

Therefore, economic growth is expected to fall to 3% in 2020, according to the most recent central bank forecasts. This follows a period of already subdued growth in 2019.

Although remaining within the 2.5%–7.5% target range of the central bank, consumer price inflation (CPI) is progressively increasing and spiked at 6.37% on February 2020, due to the related effects of coronavirus outbreak. This trend could reduce the room to maneuver of the central bank to ease the monetary policy in order to boost banking credit and domestic demand.

[1] The Kenya Private Sector Alliance (Kepsa)
[2] Tea represents 22% of Kenya's exports, and 3% of the harvest area is infested by locusts. Coffee accounts for 4% of total exports and 15% of its harvest area are covered by locust swarms.
[3] Even before air travel restrictions, national carrier Kenyan Airways announced a USD 8 million revenue loss, following flights' suspension to China after the first cases of coronavirus were detected.

Monetary and fiscal stimulus

The government has responded to the epidemic with tough measures on travel, mass gathering and isolation rules to curb the spread of the virus[4]. Yet the main sources of concern are related to the weakness of the health system and to job losses. While the World Bank would give USD 60 million to the health sector to deal with the outbreak, Kenya is also seeking emergency assistance from the IMF of up to USD 350 million. In the meantime, local stimulus measures have been introduced by the authorities.

In line with the accommodative stance of other African central banks, Kenya's last Monetary Policy Committee held on March 23rd cut the policy rate by 100 basis points (the third consecutive cut despite inflationary pressures). It has also reduced the reserve requirement ratio for commercial banks (to 4.25% from 5.25%, thus releasing an extra KSH 32.2 billion for lending to households and small businesses expected to suffer from reduced cash flows.

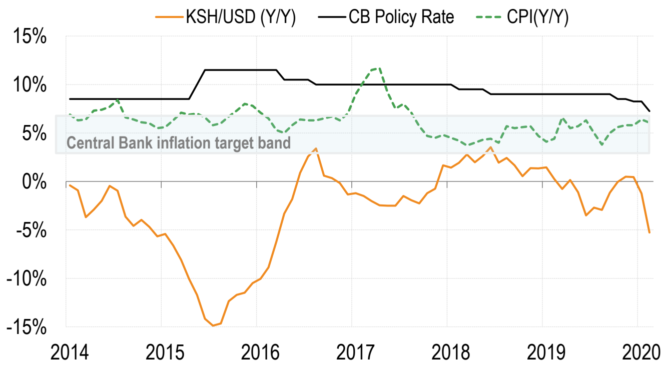
Additionally, on March 18th, the central bank issued a set of emergency measures to be applied in the banking system. These include: the extension of personal loan repayment delays by up to 12 months, restructuring of corporate credits, dropping charges on banking transactions with a mobile phone until the end of June; and the increase in the duration of repurchase agreement (repo) transactions with banks to 90 days from 28 days in order to ensure there is sufficient liquidity in the banking sector.

The government has also announced fiscal measures to be effective on April 1st, including tax relief for low-income households, reductions in both personal income and corporate tax[5], and a cut in the value-added tax (VAT) rates. The government also plans to release KSH 49 bn (USD 460 million) to cover suppliers' unpaid bills and KSH 10 bn to refund VAT to corporates in the next three months. Finally, additional spending totaling KSH 10 bn is being considered to support the most vulnerable people.

Public finances under big pressure

Public finances are expected to deteriorate due to the economic slowdown and support policy measures. They are also threatened by several issues. Firstly, the rivalries within the ruling party hinder the implementation of fiscal policy. The pace of fiscal consolidation has slowed since Ukur Kanacho was appointed new finance minister, taking over from Henry Rotich[6].

3- Currency depreciation and inflationary pressures



Source: National Institut of Statistics, Central Bank

Moreover, many infrastructure projects have stalled or generated inadequate returns to service the debt borrowed for their construction. Total debt service is rising with the total interest payments-to-fiscal revenue ratio doubling over the past three years (to 31% in 2019 from 16% in 2016).

As a result of the COVID-19 epidemic effects, the governement expects revenues to drop by an additional KHS 70 billion by the end of this current fiscal year. The budget deficit is expected to increase to 7.6% of GDP in 2020.

The government needs to issue additional bonds in the international market, as recently announced[7], and also needs a precautionary line from the IMF (USD 1.5 bn three-year stand-by credit facility). The first large debt maturity falling due (USD 2 bn) is scheduled at the end of 2024.

Finally, the central bank's measures in the banking sector could also challenge banking-sector prospects, which were starting to improve following the removal of the controversial Banking Amendment act[8] in November 2019.

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[4] These include the cancellation of all international flights (except cargo planes), the shutdown of bars and nightclubs, banned church congregations and weddings, and the capping of funeral gatherings to 15 people.

[5] Reduction of the pay as you earn tax (PAYE) from 30% to 25%; reduction of the Resident Income Tax from 30% to 25%; and reduction of the turnover tax rate from 3% to 1% for all Micro, Small and Medium Enterprises.

[6] On July 22nd, President Kenyatta ordered to arrest of Finance Minister Henry Rotich over alleged corruption surrounding the Kimwarer Dam and Arror Dam hydropower projects.

[7] On March 4th, the government announced a USD 1.5-billion issue by June, and a second possible bond issue in S2 2020.

[8] Approved in September 2016, the Bill limited commercial banks' interest rates to no more than 4 percentage points above the central bank's reference rate.