KENYA

UNCERTAINTIES

In 2020-2021, thanks to its diversified economy, Kenya was relatively more resilient to the shock of the pandemic than other sub-Saharan African economies. But in 2022-2023, the recovery will be constrained by the indirect effects of the war in Ukraine and subject to significant downside risks. The country faces a deterioration in its terms of trade. Accelerating inflation will weigh on domestic demand, with the risk of fuelling social instability. This could complicate fiscal consolidation efforts, which are necessary to maintain the support of multilateral creditors, particularly the IMF. The new president has ruled out the option of preventive debt restructuring. But the government's external liquidity and solvency remain fragile.

RECOVERY DENTED BY THE IMPACT OF THE WAR IN UKRAINE

Thanks to the diversification of its economy, Kenya recorded a limited contraction in activity estimated at -0.3% in 2020, compared with the average of -1.6% in sub-Saharan Africa. Although weakened, the economy saw a strong upturn in 2021 (+7.6%), driven by investments in infrastructure, the recovery in private consumption and the services sector. In 2022, real GDP growth is expected to slow to an average of +5.5%, despite a still very dynamic first quarter (+6.9% y/y). The effects of the drought on the agricultural sector and continued fiscal consolidation are expected to dampen the recovery. Kenya is also particularly affected by the consequences of the war in Ukraine. The combined effect of the negative impact of terms of trade and the rising costs of imports on real GDP is estimated at -0.8% .

Manufacturing activity is weakening; the Purchasing Managers' Index (PMI) remained below the expansion zone threshold between April and August with sharp declines in the "production" and "new orders" subcomponents in the first half of 2022. While the index rebounded in September, the outlook remains constrained. Companies are facing a sharp rise in input costs (supply constraint), which they are increasingly passing on to their sales prices, which in turn is weighing on demand.

The indirect effects of the conflict are also expected to have an adverse impact on consumer spending. Since the beginning of the year, consumer price inflation has accelerated and reached +9.2% in September (its highest level in 5 years). The acceleration in inflation is particularly strong in the food component, which represents 1/3 of the consumer basket: the food price index increased by more than +15% in September. Indeed, Kenya is particularly exposed to rising cereal prices, with almost 20% of its consumption coming from Russia and Ukraine. The volatility in prices and the risk of food shortages have also been exacerbated by the unprecedented drought. Price rises are also beginning to permeate across all goods, due to the increase in energy prices which is gradually being passed on to retail prices. These changes have forced the government to introduce temporary subsidies on fuel and maize to ease the pressure on consumer purchasing power. However, these subsidies are gradually being phased out, as required by the IMF.

Against this backdrop, the tightening of monetary policy continues to be limited and the policy mix remains accommodative. In response to the acceleration in inflation, the central bank (CBK) raised its key policy rate by 50 bps to 7.5% in May. The rate remained unchanged at the July committee meeting, with the authorities arguing that the first rate hike had not fully spread through the economy. Nonetheless the persistence of inflationary pressures justified an increase of 75 bps, to 8.25%, at the last meeting at the end of September. Meanwhile, the government has maintained an expansionist fiscal policy in the context of the general elections.

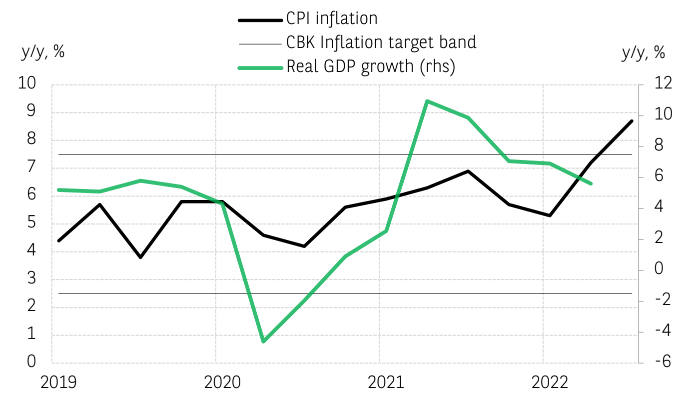
FORECASTS

	2019	2020	2021	2022e	2023e
Real GDP growth (%)	5.0	-0.3	7.6	5.5	5.5
Inflation (CPI, year average, %)	5.2	5.3	6.1	7.3	6.3
Cent. Gov. balance / GDP (%) (1)	-7.6	-8.5	-6.2	-8.5	-7.1
Cent. Gov. debt / GDP (%) (1)	58.6	63.7	67.9	69.4	68.7
Current account balance / GDP (%)	-5.3	-4.7	-5.4	-5.8	-5.1
External debt / GDP (%)	51.5	57.4	57.6	59.7	59.5
Forex reserves (USD bn)	8.8	7.8	8.8	8.1	9.5
Forex reserves, in months of imports	5.4	4.8	4.4	3.9	4.2

TABLE 1

(1) FISCAL YEARS FROM JULY 1ST OF YEAR N TO JUNE 30TH OF YEAR N+1
e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

KENYA: SLOWING GROWTH AND ACCELERATION OF INFLATION



GRAPHIQUE 1

SOURCE: BLOOMBERG, KENYA NATIONAL BUREAU OF STATISTICS, BNP PARIBAS

A SENSITIVE SOCIO-POLITICAL CONTEXT

The election took place on 9 August, in a relatively calm environment. The results were very tight in a country characterised by strong divisions. The opposition's dispute as to the results did not lead to any protests or disruption to economic activity. The results were also confirmed by the Supreme Court, with William Ruto appointed as successor to the incumbent president Uhuru Kenyatta, who had been in power since 2013.

Nevertheless, there is still significant uncertainty regarding the transition of power. Ruto's main challenge is to preserve national unity in a context where the growing hardship of the population is fuelling frustration and where the low turnout (around 65%, the lowest in 15 years) reflects the reduced confidence of voters in the political system. For the first time since 2002, the new president is not from the majority ethnic group, the Kikuyu. He will therefore have to create a new political and ethnic balance in this country where community membership is an essential cornerstone of the political landscape. The new president will also face economic challenges: a delicate task because the ruling party has only a small majority. It will also be twofold, because the government will have to both implement measures to support the economy against the backdrop of the inflation shock and undertake measures to consolidate the budget and reduce public debt. The president has ruled out the option of preventive debt restructuring.

PUBLIC DEBT FINANCING AND SUSTAINABILITY RISK

The health crisis has accelerated the deterioration in public finances that has been ongoing for several years. The budget deficit fell from -6.6% on average before the pandemic to -8.5% of GDP in 2020, and public debt amounted to some 70% of GDP (vs. 49% in 2015). In addition, the debt profile has deteriorated due to the increasing share of commercial loans and the decrease in concessionary borrowing. The cost of debt has therefore increased. Interest payment charges now represent more than 20% of budgetary revenue and total debt servicing absorbs 50% of revenue (vs. 38% in 2015). These ratios point to a worrying deterioration in the sustainability of public debt. In addition, almost 40% of public debt is denominated in foreign currency. The debt burden is therefore likely to increase further given the depreciation of the shilling (-6% against the US dollar since the start of the year).

In view of this, the government has taken steps and the successful implementation of the 2021/22 budget has been encouraging. The risk of default is moderate in the short term thanks to the support of multilateral creditors. However, Kenya's external liquidity and solvency are weak.

The country's financing capacity is now severely limited. On the domestic market, the issuance of Treasury bonds has not met the expected objectives since the start of the 2022/23 fiscal year. The CBK had to forgo some offers, as the requested rates were higher than anticipated. Furthermore, Kenya had to forgo financing on the international bond market in H1 2022 given the market conditions: spreads exceeded the threshold of 1000 bps in the first half of the year. Even though they have fallen back since then, they remain well above their recorded levels over the past 5 years. Currently the country is financed almost exclusively through multilateral creditors. Support from the IMF, through the facility running until 2023, has allowed Kenya to cover its financing needs and meet the interest payments on its debt. The country recently benefited from a disbursement of USD 235.6 billion bringing the IMF's credit to USD 1.21 billion out of a total of USD 2.34 billion provided for by the agreement. However, Kenya's level of external liquidity remains worrying, equivalent to 4.2 months of imports.

KENYA: INCREASING PUBLIC DEBT RATIO AND BURDEN

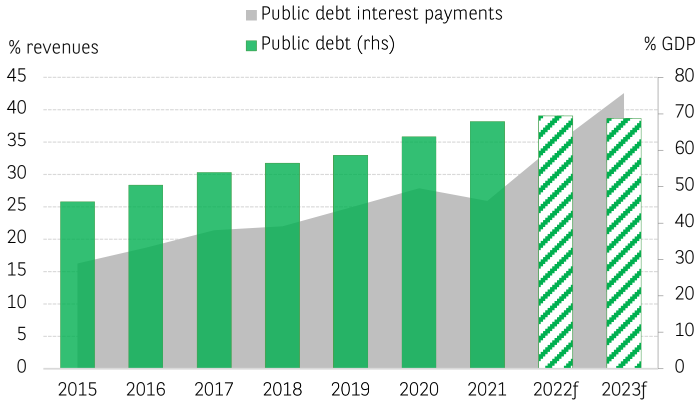


CHART 2
SOURCE: IMF, KENYA'S TREASURY, BNP PARIBAS

The rigorous continuation of fiscal consolidation measures will be crucial to retain the support of multilateral creditors and in particular the IMF. However, the measures targeted by the IMF programme, which are a prerequisite for the disbursement of the next tranches of financing, are extremely restrictive. The objectives envisage halving the deficit by 2024 (USD 4.4 bn compared to USD 6.8 bn in 2021). However, the envisaged reduction in expenditure (-37% in nominal value over the 2021/24 period) may be difficult to implement in the current inflationary environment. The consequences of an incomplete fiscal adjustment could jeopardise the financing of official creditors and the sustainability of public debt.

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