DaMina Advisors

www.daminaadvisors.com

Kenya’s Economic Outlook Stabilizing

September 29, 2020

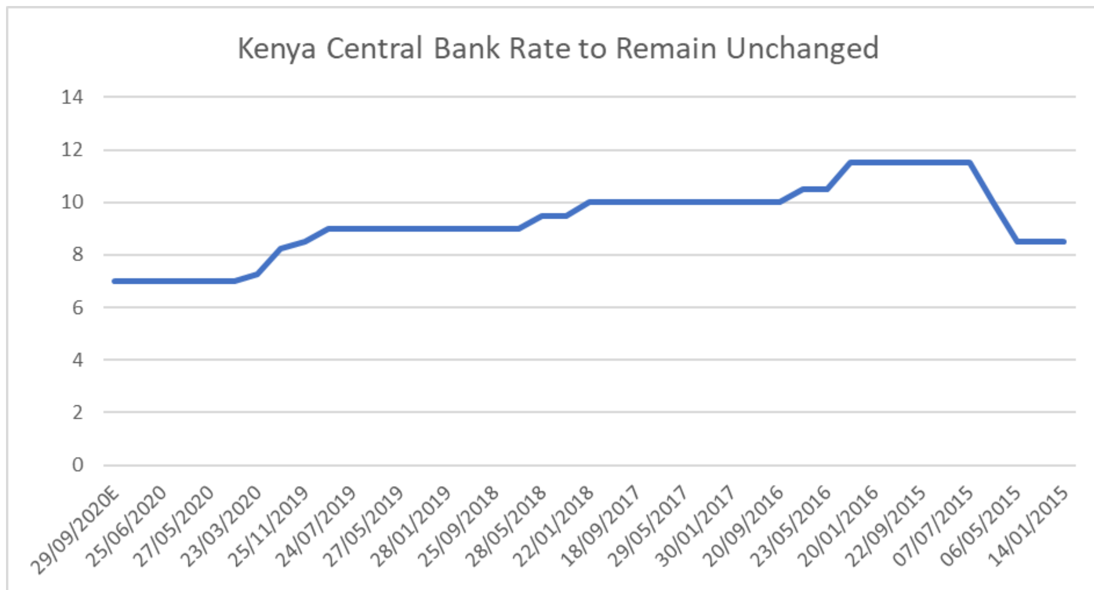
Kenya´s well diversified economy is poised to rebound despite the Covid-19 pandemic, albeit slowly. Even as other countries in Sub-Saharan Africa grapple with much more severe economic contractions, Kenya´s resilient agricultural export sector, domestic manufacturing sector and recovering tourism sector have eased the potential economic difficulties. This has further been supported by accommodative and synchronized monetary and fiscal policies. Kenya’s central bank is likely to begin raising rates in early 2021.

However, Kenya’s rebound has not been entirely encouraging. Kenya’s economy deteriorated significantly after the Covid-19 pandemic hit. An estimated 1.7 million Kenyans have been made unemployed in the pandemic, with prominent non-bank firms going bankrupt, and mounting concerns over debt distress have raised questions over Kenya’s long-term economic health. Across various key metrics, there is not much optimism. Notably, growth forecasts have been revised to al low as 1% GDP growth for 2020. In light of the dark economic clouds earlier this year, the South African supermarket giant, Shoprite, announced at that it would leave the Kenyan market and close both of its existing stores, just over two years after establishing a presence in Kenya. Though the change is relatively insignificant in scale, the market exit of Shoprite signaled skepticism over Kenya’s long-term prospects. Covid-19 was highlighted as the reason behind the decision (as it has for many business decisions), but the move had been construed as a major hit to external confidence in the Kenyan market.

Sebastian Spio-Garbrah,
Chief Analyst
Ontario, Canada
+1 647 808 9671
Sebastian@daminaadvisors.com

Alex Wark,
Partner, Business Development
London, UK
+ 44 7779 656 878
Alex@daminaadvisors.com

Duncan Gellatly,
Associate Director, Africa
London, UK
Duncan@daminaadvisors.com



Source: CBK/ DaMina Advisors

Fiscal difficulties

Despite being lauded for excellent monetary-fiscal policy coordination, probably one of the best of its emerging markets and frontier markets peers, Kenya's mounting fiscal weakness remains a concern. Kenya's commitment to long-term fiscal responsibility was already under doubt before Covid-19 measures were introduced, with the government increasing Kenya's debt ceiling at the end of 2019. Spending is key to President Uhuru Kenyatta's Big Four agenda, but the funding this requires continues to push the boundaries of fiscal responsibility. To the concern of some, reportedly including key individuals at the Central Bank of Kenya (CBK), realizing fiscal consolidation is becoming increasingly less likely whilst spending commitments remain unchecked.

Kenya's fiscal deficit for 2020 is projected to grow to an 8.4% shortfall. A key concern has been the continued failure by the Kenya Revenue Authority (KRA) to meet revenue obligations, despite an improvement in tax receipts in 2019/20. This remains a structural challenge, with the economic impact of Covid-19 almost certainly reducing tax receipts for this financial year. Meanwhile, spending obligations are still being made against overestimated tax receipts.

In terms of spending adjustments, austerity has not really been a moot point – at least not in Kenya. Minor spending cuts were announced in June to offset lower revenue, but in recent years government spending has not reduced to meet revenue receipts. Any significant cuts remain unlikely, despite a growing pressure from economists and ratings agencies for Kenya to introduce austerity measures to check the mounting national debt.

Turning to Kenya's key long term economic predicament: debt. Currently, Kenya's national debt stands at an estimated 65.7% of GDP. This is not unusual for the region but outstrips the recommendation of a 60% debt-to-GDP ratio outlined by the International Monetary Fund (IMF). Kenya's foreign currency denominated debt commitments, especially with a weakened Kenyan Shilling, will almost certainly increase the real value of Kenya's debt obligations, as well as making Kenya's ability to provide fiscal stimulus more difficult.

New capital controls

The CBK has implemented several regulatory changes to promote domestic lending. In March, cash reserve ratios were cut for banks to increase liquidity, credit holidays followed alongside other changes to support Kenya's banking system and encourage investment. However, increased caution from lenders and increased borrowing from the government has been the key capital dynamic under Covid-19 in Kenya, despite many key lenders in Kenya being well-capitalized. Despite the need for finance, the widening of fiscal deficits has not prompted a search for external financing, with Kenyan financiers remaining the preference.

Last month, the CBK announced that commercial banks would need approval from the central bank to issue dividends. Under the directive, all lenders must also provide evaluations of their current levels of capitalization as an assurance that commercial banks carry sufficient equity to absorb any further shocks. The capital adequacy assessments must be provided to the CBK by the end of October. Based on this assessment, it will then be the decision of the CBK whether dividends will be issued.

The decision is largely precautionary and, though unusual, follows the actions of other central banks. Firstly, the move is about compliance. Ensuring that banks have sufficient capital to offset potential future external risks is the basis of the international accounting standard IFRS 9. With further stress-testing and 'resilience building' likely, the Kenyan central bank is also keen to portray its responsibility amid criticism of its waning fiscal responsibility in decisions being made in State House.

Difficult working relationships

Kenya's fiscal dilemma is now having a more intangible impact: the relationship between the Kenyatta administration and the CBK. In the region more broadly, the impact of Covid-19 has put pressure on how instruments of economic control work together and accentuated differences in economic goals. Fiscal dominance – where monetary authority is forced to change to accommodate profligacy from the fiscal authority – is a threat across the region.

In Kenya, rumors have emerged of a rift between the CBK's governor, Patrick Njoroge, and President Uhuru Kenyatta. Pressure had already reportedly emerged between the pair over Njoroge's plans to overhaul Kenya's financial regulator. However, Njoroge was reportedly keen to remove the key Kenyatta ally and deputy governor, Sheila M'Mbijjewe, who had been purportedly due for retirement. The alleged deterioration in the relationship is likely to spell unease, with any future top table changes at the CBK likely to be indicative of a move to realign the independent CBK with the Jubilee government. Any such move would be a signal of fiscal dominance and undermine the independence of the CBK. However, any short-term changes at the CBK remain unlikely and the alleged issues have been kept in-house.

As a comparison, tensions between the government and central banks have been evident elsewhere in the region. Notably, Zambia's President Edgar Lungu sacked its central bank governor, Denny Kalyalya last month, replacing Kalyalya with a close ally to the presidency. Though no reason was given for Kalyalya's dismissal, the governor was sacked after cutting the central bank's lending rate to 8% and had also been critical of the Zambian government's efforts to ensure financial stability.

The Zambian case is highly likely to have been a political decision and raises questions over the current independence of central banks and monetary policy committees in the region. International and regional economic bodies are likely to continue to reiterate the needed independence of central banks to mitigate the risk of fiscal dominance. As the economic situation deteriorates in countries across eastern Africa, changes at the top table become more likely. Where political decisions underpin such changes, the credibility of central banks will deteriorate and monetary authority will weaken. Against this backdrop, it is key to monitor the current relationship between Kenya's economic authorities, especially if the economic outlook worsens.

Contact DaMina for a more detailed briefing from our risk analysts:

Alex Wark,
Partner, Business Development
London, UK
+ 44 7779 656 878
+1 647 808 9671

Alex@daminaadvisors.com
research@daminaadvisors.com

DaMina Advisors is a preeminent Africa-Asia focused independent frontier markets political risk research, due diligence, M&A transactions consulting and strategic geopolitical risks advisory firm. DaMina Advisors is legally registered and has offices in Canada, The UK and Ghana. DaMina is headquartered in Toronto.

www.daminaadvisors.com