

AFRICA RISK CONSULTING**Kenya Monthly Briefing October 2019**

Kenya Summary 18 October 2019

The International Monetary Fund (IMF) cautions Kenya's increasing debt appetite weeks after government approved the national treasury's proposed new debt limit of 9.1 trillion Kenyan shillings (KSh) (\$87 billion), which significantly expands room for borrowing. Talks between the national treasury and the IMF for the renewal of a \$1.5 billion standby credit facility collapse. The national treasury says the economy grew 5.6% in the second quarter of 2019, down from 6.4% in 2018. The demonetisation process of KSh1,000 banknotes goes smoothly and flushes out potential criminals.

Public debt ceiling rises ...

The **International Monetary Fund (IMF)** on 16 October cautioned **Kenya's** increasing debt appetite weeks after the government approved the national treasury's proposed new debt limit of KSh9.1 trillion (\$87 billion), which significantly expands room for borrowing.¹ The new ceiling effectively expands room to borrow by more than half of the country's debt, which will support President **Uhuru Kenyatta's** (2013-present) public investment plans but not his hopes of regaining access to the IMF's \$1.5 billion standby credit facility.

Lawmakers this month approved the national treasury's new public debt ceiling, under a plan to present the nation's level of debt as an absolute figure and not as a percentage of gross domestic product (GDP). The national treasury forecasts debt to stand at about 60% of GDP this year, which is above its previous debt limit of 50% of GDP. The **Central Bank of Kenya (CBK)** quoted the debt at KSh5.8 trillion (\$55 billion) as at 30 June and forecasts it to reach KSh6.4 trillion (\$61 billion) next year. A document posted on the government's website states that the new ceiling provides:

"... adequate borrowing space to allow the government to access concession funding sources to facilitate government investment".²

President Kenyatta is looking to expand Kenya's economy by increasing public investment in infrastructure, manufacturing, education, health and energy, and he hopes to do this in large part through borrowing. Government is reportedly negotiating plans to sign 44 loan agreements from 15 foreign lenders, including the **African Development Bank, China, Japan** and the **World Bank**, to borrow a combined total of KSh442 billion (\$4.1 billion).³ If successful, this will push Kenya's total public debt to over KSh6.3 trillion (\$60 billion) or 68% of GDP.

However, the IMF's macro-economic outlook on Kenya does not suit Kenyatta's high-spending ambitions. The international lending agency cautioned about Kenya's ballooning debt risks, pushing it into 'moderate' in October 2018.⁴ Last year, the IMF downgraded Kenya's debt distress from low to moderate, indicating that the country's risk of defaulting on debt repayments had grown. The IMF recommends emerging-market nations' debt should not exceed 74% of GDP.

¹ The East African, 16 Oct 2019

² Bloomberg, 14 Oct 2019

³ Bloomberg, 14 Oct 2019

⁴ The East African, 16 Oct 2019

... as talks with the IMF collapse ...

The East African reported on 5 October that talks between the national treasury and the IMF for the renewal of a \$1.5 billion standby credit facility had collapsed following the removal of treasury secretary **Henry Rotich** and his principal secretary, **Kamau Thugge**, on corruption charges.⁵ The country's roller-coaster journey to rebuild relations with the IMF after its suspension from the credit facility in September has reached a low point. Kenya hopes to renew the programme to cushion the Kenyan shilling, which depreciated to a four-month low against the **United States (US)** dollar at the beginning of October. The standby loan also raises the country's credibility in the eyes of foreign lenders.

The IMF team cancelled the trip at the last minute after Rotich and Thugge were placed at the centre of a fraudulent KSh46 billion (\$460m) contract that the treasury awarded to **Italian** company **CMC di Ravenna** for construction of two mega dams. Rotich and Thugge were the most prominent government officials to be charged in connection with the fraudulent scheme in July (see *ARC Briefing Kenya July 2019*). New principal secretary to the treasury **Julius Muia** is hoping to resume talks with the IMF at its annual meeting on 14-20 October in **Washington** (US) and to reassure the IMF delegation that is scheduled to visit Kenya in November.

The IMF suspended the programme in September 2018, which was agreed in 2016, because of **Nairobi's** failure to address a budget deficit that is consistently higher than the 6% agreed (see above), low bank lending to business due to an interest rate cap, and the introduction of VAT on fuel. Several months ago, talks looked to be progressing. Rotich said in May that he expected to conclude talks with the IMF over renewal of the loan in two months. However, parliamentary opposition to the IMF's recommendations has also hindered the national treasury's position with the IMF. The national assembly thwarted government attempts to scrap the interest rate cap legislation and the petrol tax has been halved to 8%, but not scrapped (see *ARC Briefing Kenya September 2019*).

In June 2017, the IMF denied Kenya access to its \$1.5 billion credit facility due to prolonged political instability during the 2017 election period. This instability inhibited any chance of a necessary IMF fiscal review and contributed to Kenya's failure to decrease its budget deficit. Following the 2017 denial of access to credit, Rotich assured the IMF that Kenya would halve its budget deficit by 2021 and stimulate the private sector through lifting an interest rate cap on lending to private companies. The IMF approved the Kenyan government's request for a six-month extension to their credit facility worth \$989.8m in March 2018.⁶

Kenya's creditworthiness is of increased concern due to increased levels of public debt, with its external debt stock particularly concerning without the buffer that the IMF's standby credit facility previously provided.

... and growth forecasts are downgraded

The **Kenya National Bureau of Statistics (KNBS)** said on 30 September that the economy grew 5.6% in the second quarter of 2019, down from 6.4% in 2018, and that inflation fell to 3.83% last month from 5% in August.⁷ The statistics bureau joins other institutions, such as the IMF and World Bank, which have all lowered the country's economic outlook. While Kenya's growth figures have been downgraded, they remain significantly higher than average annual growth in **Africa**, which stands at 3.2% according to the IMF, and they are expected to pick up again, along with the weather.

The IMF this month downgraded Kenya's economic forecast for the current financial year to 5.6% from 5.8% stated in April. The recent growth deceleration is attributed a slowdown in manufacturing, transportation and the agriculture sector, the mainstay of the country's economy which accounts for almost a third of output. The KNBS report said performance in these sectors was mostly hampered by

⁵ The East African, 5 Oct 2019

⁶ Press Release, International Monetary Fund, 3 Aug 2018

⁷ Reuters, 30 Sep 2019

bad weather. The agriculture sector grew 4.1% during the period, down from 6.5% a year earlier. Kenya's economy has also taken a hit from a slowdown in the world economy. The IMF forecasts a 3% growth in global GDP in 2019, which will be the global economy's lowest level since 2008-09 and a 0.3% downgrade from IMF's April 2019 **World Economic Outlook**. That said, the IMF expects Kenya's economy to grow by 6% in 2020, as the agricultural sector recovers from the effects of poor rains.

Central bank governor **Patrick Njoroge** said this month that he expects a full-year growth forecast of 6%, citing robust bookings in the tourism sector. He said the bank would review its forecast after release of the second quarter data on 7 October. A government statistician noted that other macro-economic factors such as inflation, the exchange rate and interest rates remained largely conducive for growth.

Central bank has a clean up

CBK governor Patrick Njoroge said on 2 October that KSh7.4 billion (\$71.2m) of old bank notes were not converted to new bank notes and were likely the proceeds from criminal activities, after the central bank demonetised its highest banknote, the KSh1,000 note, on 30 September.⁸ The primary aim of demonetising the note was to fight corruption, money laundering and counterfeiting by forcing out those with illegal stashes of cash. The demonetisation process illustrates the high level of bank penetration in Kenya and the central bank's financial maturity, given that the move did not cause significant harm to the wider economy.

The CBK required anyone seeking to exchange more than KSh5m (\$48,200) in the old banknotes to seek approval. Within the first month of the June announcement, deposits in banks grew by KSh22.3 billion (\$215m) while currency outside banks fell by KSh 25.1 billion (\$241m), which was the first negative growth since the central bank started making the data public. By the end of August, the CBK said it had collected roughly half of the 217 million notes in circulation. **Tanzania** and **Uganda** banned the use of the old notes within their jurisdictions as soon as the demonetisation was announced in order to prevent their financial systems from being used to launder Kenyan currency. Telcom major **Safaricom** and multiple other large Kenyan companies issued circulars to their staff and clients with deadlines for the use of the old banknotes.

The CBK had feared the demonetisation would lead to a rush of people purchasing goods and push up inflation. There were reports of a possible sudden surge in wheat purchases in one part of Kenya due to people trying to evade the currency clampdown. However, the feared buying spree did not materialise. Inflation fell 3.83% in September. Out of 217 million KSh1,000 banknotes in circulation as of 1 June, when the exercise was announced, 210 million (96.6%) were returned by 30 September.

Njoroge says the process was a huge success in the fight against corruption. Commercial banks flagged some 3,172 transactions as suspicious and reported them to the authorities during the conversion exercise over the four months. Njoroge said that information will be used by other investigative agencies, including the tax authority, to uncover more cases of handling of proceeds of crime. He said the \$71.29m worth of unexchanged old notes were now rendered invalid, hitting the suspected corrupt owners hard, and that the money is equivalent to a quarter of the annual budget of the government's top hospitals in the country. He also said the event marked the first time in the country that the corrupt have been made to lose a huge chunk of their wealth, with the biggest ever corruption fine handed out by the courts standing at KSh52m (\$501,300). However, the four-month exchange window still allowed criminals to launder their money. Many reportedly exchanged old notes for dollars or ironed out the cash buying cash and other assets.⁹

⁸ Reuters, 2 Oct 2019

⁹ The Economist, 10 Oct 2019

Planner

25 Nov 2019 **Nairobi (Kenya) Central Bank of Kenya** Monetary Policy Committee meeting;

12 Dec 2019 **(Kenya)** Jamhuri Day national holiday;

8 Jun 2020 **The Hague (Netherlands) International Justice Court (ICJ)** hearings for **Maritime Delimitation in the Indian Ocean (Somalia v. Kenya)** case to begin;

2022 **(Kenya)** *Daily Nation*. General elections to be held;

Chronology

17 Oct 2019 **Nairobi (Kenya)** *The East African*. President **Uhuru Kenyatta** rejects the 2019/20 **Finance Bill** and demands lawmakers remove the commercial lending rates cap;

16 Oct 2019 **Washington (United States)** *The East African*. The **International Monetary Fund's Global Financial Stability Report** cautions Kenya's increasing debt appetite and downgrades its economic forecast for the current financial year to 5.6% from 5.8% stated in April;

16 Oct 2019 **Nairobi (Kenya)** *Daily Nation*. **Kenya** opens the \$1.5 billion **Chinese**-built railway connecting **Nairobi** and **Naivasha**;

9 Oct 2019 **Nairobi (Kenya)** *Bloomberg*. National assembly majority leader **Aden Duale** says that legislators approved a \$86 billion debt limit for Kenya;

7 Oct 2019 **Nairobi (Kenya)** *Electrek*. **Stanbic Bank** announces it raised \$41.45m in its first green bond, which will be used to build climate-resilient student accommodation in **Nairobi**;

5 Oct 2019 **Nairobi (Kenya)** *The East African*. Talks between Kenya and the **International Monetary Fund** for the renewal of a \$1.5 billion standby credit facility collapse after corruption charges against senior Kenyan officials;

2 Oct 2019 **Nairobi (Kenya)** *Reuters*. **Central Bank of Kenya** governor **Patrick Njoroge** says that \$71.29m of old bank notes were not converted to new bank notes and were likely the proceeds of criminal activities;

2 Oct 2019 **Nairobi (Kenya)** *Xinhua*. Tourism and wildlife ministry cabinet secretary **Najib Balala** says that **Kenya** will achieve a 10% growth in international tourist arrivals in 2019;

1 Oct 2019 **Mombasa (Kenya)** *Reuters*. Kenyan police shoot dead three men suspected of planning militant attacks in **Majengo Mpya**, seven others are detained and a weapons cache seized;

30 Sep 2019 **Nairobi (Kenya)** *CNBC Africa*. The **Kenya National Bureau of Statistics** says that inflation fell to 3.83% in September from 5% in August;

30 Sep 2019 **Nairobi (Kenya)** *Reuters*. The **Kenya National Bureau of Statistics** says that the economy grew 5.6% in the second quarter of 2019, down from 6.4% in 2018;

28 Sep 2019 **Nairobi (Kenya)** *Reuters*. Online betting firm **SportPesa** says it is halting operations due to a drastic hike in taxes, from 10% to 20%, on betting stakes in the **2019/20 Finance Bill**;

27 Sep 2019 **Nairobi (Kenya)** *Daily Nation*. The **Central Bank of Kenya** approves the merger of **Commercial Bank of Africa** and the **NIC Group**, the second major merger of Kenyan banks in 2019;

27 Sep 2019 **Mogadishu (Somalia)** *Bloomberg*. President **Mohamed Abdhullahi Farmajo** says **Somalia** will comply with any **International Court of Justice** ruling on a disputed maritime border with **Kenya**;

26 Sep 2019 **Nairobi (Kenya)** *Reuters*. The **Communications Authority of Kenya** says transactions worth \$20.3 billion were conducted via mobile money services in the three months to the end of June, up 47% from the same period a year earlier;

25 Sep 2019 **Nairobi (Kenya)** *africanews*. **Kenya** and **Somalia** agree to normalise relations despite a border dispute during meetings on the sidelines of the **United Nations General Assembly**;

25 Sep 2019 **Nairobi (Kenya)** *Reuters*. Budget airline **Jambojet** CEO **Allan Kilavuka** says the airline will double passengers to 1.5 million in three years with new routes in **East Africa**;

22 Sep 2019 **Nairobi (Kenya)** *Reuters*. Local lender **KCB Group** says loss-making **Mumias Sugar Company** has been placed under receivership to protect its assets and maintain its operations;

20 Sep 2019 **Nairobi (Kenya)** *Kitco*. **Japanese** ambassador to **Kenya**, **Katsutoshi Komori**, says Japan will give \$860m in concessional loans and grants to construct a bridge in **Mombasa** and other infrastructure projects;

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