

AFRICA RISK CONSULTING

Kenya Monthly Briefing September 2018

Kenya Summary 24 September 2018

The government cuts its budget by KSh37.6 billion (\$372.9m) but will need to borrow from foreign lenders to bridge its deficit. The cabinet announces large infrastructure projects in the Likoni Cable Car and the Nairobi-Mombasa superhighway. State-owned Kenya Airways shows tentative signs of recovery after it posts a pre-tax loss of \$40m for the first half of 2018.

Government cuts budget by KSh37.6 billion

The **National Assembly** on 20 September approved cuts of KSh37.6 billion (\$372.6m) to the government budget for the 2018-2019 financial year to address the country's KSh500 billion (\$4.96 billion) budget deficit.¹ These austerity measures have hit projects such as the **Last Mile Connectivity** electricity programme, **Laptops for Schools** and roads budgets particularly hard.² The government will resort to extensive external borrowing to tackle the remainder of its KSh500 billion shortfall.³ The projected borrowing is of particular concern given that Kenya's public debt is already at 57% of GDP.⁴

Austerity measures have been unpopular among the general public. The government's imposition of a 16% value added tax (VAT) on petroleum products came into force on 1 September and has been particularly controversial. The fuel tax provoked public outrage and led to "a country-wide fuel crisis"⁵ in which fuel pumps ran dry across the country as fuel distributors staged a strike in protest to the new tax.⁶ Treasury cabinet secretary **Henry Rotich** met with **National Assembly** leadership to discuss the matter days after the tax was introduced.⁷ A parliamentary debate took place on 20 September to address the fuel tax. Members of parliament (MPs) voted on a bill drafted by President **Uhuru Kenyatta** (2013-present) to reduce the fuel tax from 16% to 8%, while raising taxes on money transfer services.⁸ The debate was "chaotic and sometimes absurd" as the bill, unpopular among MPs, was passed.⁹ However, house speaker **Justin Muturi** suspended parliament, announcing that there was a "technical error" in the National Assembly. He returned to announce that fewer than two thirds of MPs had voted to reject the bill, despite the loud and obvious opposition to the bill that was likely to have exceeded two thirds of MPs.¹⁰ Subsequently, National Assembly leader MP **Aden Duale** admitted to using "tricks" and withdrawing MPs' votes against the bill to ensure it was not passed.¹¹

The budget cuts show the incumbent **Jubilee Party** have reneged on their initial terms of the 2018-2019 budget, announced in June 2018, which was the largest in the country's history.¹² Such back-peddalling from the government, along with continued high levels of borrowing and a parliamentary

¹ The Standard, 21 Sept 2018.

² The Standard, 21 Sept 2018.

³ The Standard, 21 Sept 2018.

⁴ The Star, 4 Sept 2018.

⁵ The Standard, 10 Sept 2018.

⁶ The Standard, 6 Sept 2018.

⁷ The Standard, 10 Sept 2018.

⁸ The Star, 21 Sept 2018.

⁹ The Star, 21 Sept 2018.

¹⁰ The Star, 21 Sept 2018.

¹¹ The Star, 20 Sept 2018.

¹² CapitalFM, 14 Jun 2018.

farce brings its financial competence into question, and is a warning sign for Kenya's would-be creditors.

Government announces infrastructure projects

The Kenyan cabinet approved a \$40m cable car project across the **Likoni Channel (Mombasa)** on 14 August, offering an alternative to the busy **Likoni Ferry** connecting **Mombasa Island** (central Mombasa) to the Kenyan mainland.¹³ Once completed, the cable car will be able to carry 180,000 passengers across the Likoni Channel per day, with each journey lasting only two minutes, a large improvement on the existing 10-minute ferry crossing.¹⁴ It is estimated that approximately 300,000 people cross the Likoni Channel daily.¹⁵

Kenya-based **C&C Construction Company** and Austria-based **Doppelmayr Group** are set to carry out works and funding for the project. The consortium will charge passengers a fee to use the service before handing the project over to the Kenyan government after 25 years.¹⁶ **Likoni Cable Express**, a subsidiary of Kenya majority state-owned **Kenya Ferry Services (KFS)** and Kenya-based **Tropos**, will operate the cable car upon the project's completion,¹⁷ expected in 2020.¹⁸

In further infrastructure developments, the **United States (US)** government announced on 27 August plans to build a "superhighway" between Kenya's capital, **Nairobi**, and its second city and biggest port, Mombasa.¹⁹ The announcement followed President **Uhuru Kenyatta's** (2013-present) state visit to the US. The highway will cut travel time between the two cities from 10 hours to four hours, facilitating economic activity between Kenya's two biggest cities,²⁰ and should mitigate some of the dangers of the current Nairobi-Mombasa road, where fatal accidents occur with regularity.²¹ The road will be built by US-based company **Bechtel Corporation** at a cost of \$3 billion,²² and although the road will generate revenue through tolls,²³ the overall financing of the project is yet to be discussed.²⁴

These large-scale infrastructure projects are likely to make business and travel easier in Kenya once completed and are sound economic decisions by the Kenyan government. The Likoni Cable Car will alleviate pressure on the ferry and allow passengers to conduct their business in Mombasa without the delay.²⁵ Bechtel Corporation estimates that over a period of 25 years, the Nairobi-Mombasa superhighway will generate nearly double the revenue it will cost to build through increased economic activity.²⁶

However, Kenya's state debt, currently at 57% of GDP, is reported to leave Kenya "*struggling to pay for new infrastructure*" and raises doubts about the viability of these projects.²⁷ The most recent budget will increase the deficit and adds to Kenya's debt.²⁸ Bechtel Corporation's plans to build the Nairobi-Mombasa superhighway were delayed in April as MPs expressed concern about Kenya's level of debt amid the prospect of commercial loans owed to Bechtel Corporation.²⁹

¹³ Pulse, 15 Aug 2018.

¹⁴ The East African, 15 Aug 2018.

¹⁵ The East African, 15 Aug 2018.

¹⁶ The East African, 15 Aug 2018.

¹⁷ The East African, 15 Aug 2018.

¹⁸ The East African, 9 Feb 2018.

¹⁹ CapitalFM, 28 Aug 2018.

²⁰ Tuko, 1 Sept 2018.

²¹ The Standard, 22 Apr 2018.

²² Tuko, 1 Sept 2018.

²³ Bloomberg, 13 Apr 2018.

²⁴ CapitalFM, 28 Aug 2018.

²⁵ The East African, 9 Feb 2018.

²⁶ Tuko, 1 Sept 2018.

²⁷ The Star, 4 Sept 2018.

²⁸ Bloomberg, 13 April 2018.

²⁹ Bloomberg, 13 Apr 2018.

Central Bank of Kenya (CBK) governor **Patrick Njoroge** told US-news agency **Bloomberg** in April that the Kenyan government seeks to find “*non-debt creating ways*” of funding infrastructure projects as a solution to Kenya’s debt problem.³⁰ The Likoni Cable Car project appears to be an example of such creative financing. Having C&C Construction Group and Doppelmayr Group fund the project and recoup their investment through passenger fees for 25 years gives Kenya the benefit of improved infrastructure without mounting levels of debt.³¹ Toll collection on the Nairobi-Mombasa superhighway could serve a similar purpose, however, the massive \$3 billion price tag on the project suggests that the Kenyan government will take on more public debt to complete its infrastructure projects.³² If managed poorly, high debt repayments could negate any benefits brought about by infrastructure projects.

Kenya Airways posts \$40m pre-tax loss for first half of 2018

Partially state-owned air carrier **Kenya Airways** announced on 28 August a pre-tax loss of 3.99 billion (\$40m) over the first half of 2018.³³ The company’s \$40m loss during the first half of 2018 is an improvement on its performance over the same period of 2017, during which the company incurred \$55.6m in losses and had to take \$2 billion in financial restructuring, including a government bailout.³⁴ The protracted and politically-uncertain election period throughout 2017 was said to have played a large role in the company’s poor performance in 2017. The murder of **Independent Electoral Boundaries Commission (IEBC)** member **Christopher Msando**, the annulment of the election’s result and the deaths of at least 37 people at political protests, alarmed investors and visitors to Kenya. Kenya Airways suffered as a result of reduced travel to Kenya.³⁵

The company expects much better earnings over the second half of 2018.³⁶ Kenya Airways’ CEO **Sebastian Mikosz** told **United Kingdom**-based news agency **Reuters** that air traffic and earnings for August 2018 were vastly improved in relation to 2017’s figures.³⁷ Kenya Airways plans to expand, adding up to 20 new routes over the next five years as well as new aircraft to their fleet and hiring as many as 100 new pilots.³⁸ During his state visit to the US on 24 September, Uhuru Kenyatta celebrated the direct Kenya Airways flights between Nairobi and **New York** that are due to begin on 28 October, and threw his support behind the company’s expansion.³⁹ A further sign of Kenya Airways’ recovery is its resumption of fuel hedging, which should leave the airline more resilient against the fluctuating global price of oil.⁴⁰

Kenya Airways outperforms regional rival **South African Airways**, an airline reliant on bailouts from the South African government. However, unlike **Ethiopia**’s state-owned **Ethiopian Airlines**, the only profitable airline in **Africa**, Kenya Airways is far from making a profit. Nevertheless, Kenya Airways’ tentative signs of economic recovery, coupled with the Kenyan government’s commitment to the development of the airline as part of improving the country’s transport infrastructure (see above), are good news for prospective investors.

³⁰ Bloomberg, 13 Apr 2018.

³¹ The East African, 15 Aug 2018.

³² Bloomberg, 13 Apr 2018.

³³ Reuters, 29 Aug 2018.

³⁴ The Star, 30 Aug 2018.

³⁵ The Standard, 10 Oct 2017.

³⁶ Reuters, 29 Aug 2018.

³⁷ Reuters, 29 Aug 2018.

³⁸ Bloomberg, 29 Aug 2018.

³⁹ ChimpReports, 24 Sept 2018.

⁴⁰ The Star, 30 Aug 2018.

Planner

28 Oct 2018 **(Kenya)** *Daily Nation*. Daily direct flights to **New York (United States)** expected to begin;

20 Nov 2018 **Nairobi (Kenya)** *10Times*. **Flower Logistics Africa** Conference;

21-22 Nov 2018 **Nairobi (Kenya)** *10Times*. **East Africa Rail** trade show;

6-8 Mar 2019 **Mombasa (Kenya)** *East African Community*. **East African Petroleum Conference** and Exhibition;

Aug 2019 **(Kenya)** *The Star*. National census planned;

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

13 Jan 2019 **(DRC)** President to be sworn into office

Chronology

19 Sep 2018 **Nairobi (Kenya)** *Reuters*. Finance minister **Henry Rotich** cuts the spending budget by \$546.9m for the 2018 fiscal year due to the halving of the VAT rate on fuel that will leave a funding shortfall;

14 Sep 2018 **Nairobi (Kenya)** *Bloomberg*. President **Uhuru Kenyatta** proposes a 50% reduction on petroleum product tax increases after criticism;

13 Sep 2018 **Nairobi (Kenya)** *Citizen*. President **Uhuru Kenyatta** rejects a finance bill that postpones a tax on fuel;

5 Sep 2018 **Nairobi (Kenya)** *Engineering Weekly*. Energy minister **Charles Keter** states that the transmission line from the **Lake Turkana Wind Power** project will be complete by December;

29 Aug 2018 **Lamu (Kenya)** *Al Jazeera*. An explosion kills five **Kenyan** soldiers and wounds 10 others near **Lamu**, close to the **Somali** border;

28 Aug 2018 **Nairobi (Kenya)** *Reuters*. State-owned airline **Kenya Airways** posts a pre-tax loss of 3.99 billion Kenyan shillings (\$40m) for the first half of 2018;

28 Aug 2018 **Nairobi (Kenya)** *Business Day*. President **Uhuru Kenyatta** agrees to build a superhighway from **Nairobi** to **Mombasa** during meetings with **United States** President **Donald Trump**;

28 Aug 2018 **Nairobi (Kenya)** *Daily Nation*. Authorities arrest deputy chief justice **Philomena Mwilu** over corruption allegations;

16 Aug 2018 **Nairobi (Kenya)** *The Star*. President **Uhuru Kenyatta** revives **Kenya National Shipping Line** in agreement with **Switzerland**-based shipping company, **Mediterranean Shipping Company**;

15 Aug 2018 **Nairobi (Kenya)** *Washington Post*. Foreign minister **Monica Juma** states that **United Kingdom** prime minister, **Theresa May**, will visit **Kenya** by the end of August;

11 Aug 2018 **Nairobi (Kenya)** *Al Jazeera*. The **National Prosecution Authority** arrests several senior officials for corruption over the \$3.2 billion **Nairobi-Mombasa** railway project;