PUBLIC STATEMENT

DEBT STATUS IN KENYA - ORBITING THE PANDEMIC

COVID-19 has negatively impacted key macroeconomic indicators in Kenya. Kenya's real GDP is estimated to have contracted to -1.1% in the third quarter of 2020, compared to a growth of 5.8% in the same period in 2019. Total merchandise trade between the first three quarters of 2019 and 2020 declined by about 8.8%. The greatest slump in trade occurred in the second quarter (Q2) of 2020 where total trade fell by 23%, from the first quarter (Q1). The unemployment rate rapidly increased in 2020, particularly in Q2 of 2020 where it rose from 5.2% in Q1 to 10.4%. In response to the crisis, the government has deployed both fiscal and monetary policies to support the healthcare system which has been stretched to the limit and protect the health workers from contracting the disease, and support vulnerable firms to help preserve jobs, incomes and the economy's productive potential. These interventions have financial implications which have forced the government to borrow thereby increasing the debt burden which was approximated to be 66% of the GDP in FY 2019/2020.

A. INTRODUCTION

The Government of Kenya (GoK) unveiled a Ksh 2.79 trillion (around USD 26 billion) budget for the FY 2020/2021 which began on 1st July 2020 and runs until 30 June 2021. By supporting households and businesses, the budget sought to address the economic impact of the COVID-19 pandemic, locust invasions, floods, and revival of development. It also set out a measured course of fiscal consolidation following the unavoidable deterioration of public finances during the latter half of the FY 2019/2020.

Considering the FY 2019/2020 budget (revenue and expenditure measures) as well as its efficacy (including new governance and public financial management (PFM) glitches) while seeking to recognize the effectiveness of fiscal policy responses to COVID-19; participation controls and public investment management (PIM) issues, we need to see how these metrics contributed towards containing the effect of COVID-19. The government's fiscal policy countermeasures

against the COVID-19 pandemic in Q4 of FY2019/20 combined with the weaker economy, reversed fiscal consolidation efforts, reduced domestic revenue mobilization and irregularities which have emerged in health sector procurement procedures, likely exacerbated by the need to procure medical supplies, have risen very quickly at the height of the pandemic.

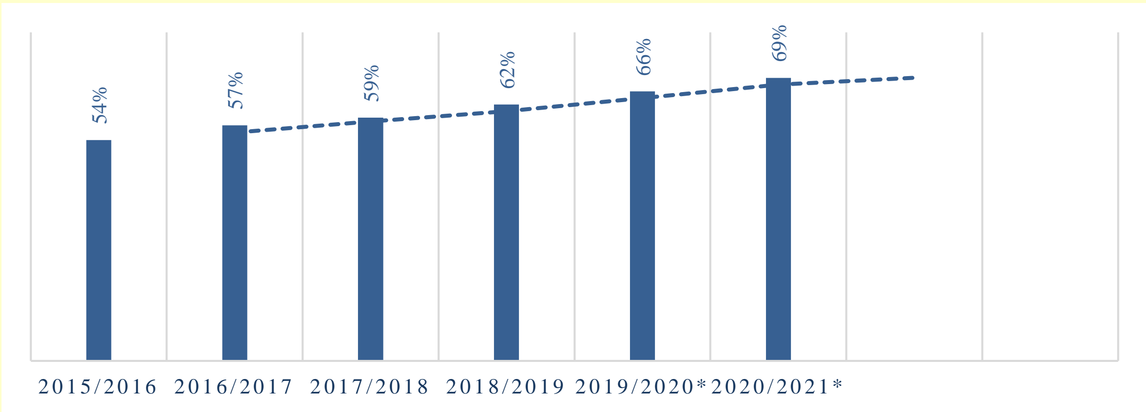
The following pose concerns;

a) Revenue falling below target

Tax revenue underperformed by Ksh 41.8bn (or 0.4% of GDP) to close at KSh 342.5bn (3.0% of GDP) in the first quarter (Q1) of the FY2020/21 (below the target Kshs. 384.3bn). Under-collection of revenue originated from PAYE, VAT, and excise duty deficits owing to tax relief given to alleviate COVID-19 and COVID-19 related impacts. The GoK stated that the review of the personal income tax and the reincorporation of VAT and corporate income tax prices from January 2021 to their previous rate, could contribute to about 0.7% of GDP in additional revenues in the FY2020/21. Execution of the budget has also fallen behind schedule with total investment and net lending under spending of KSh 49.7bn (0.5% of GDP) from the target of Ksh 565.3bn (5% of GDP). The delays in the adoption of the budget were extremely severe for county governments, such as the passage of their Tax Bills. It has been prolonged and as a result, at the end of September 2020, the fiscal deficit was around 1.2 % of GDP compared to the target of 1.1 % of GDP. The deficit was mainly financed by domestic borrowing (1.3% of the total GDP), whereas net external financing recorded a settlement according to the World Banks economic update.

b) The COVID-19 shock, fiscal responses and public debt

Figure 1: Public Debt Status (%age of GDP)

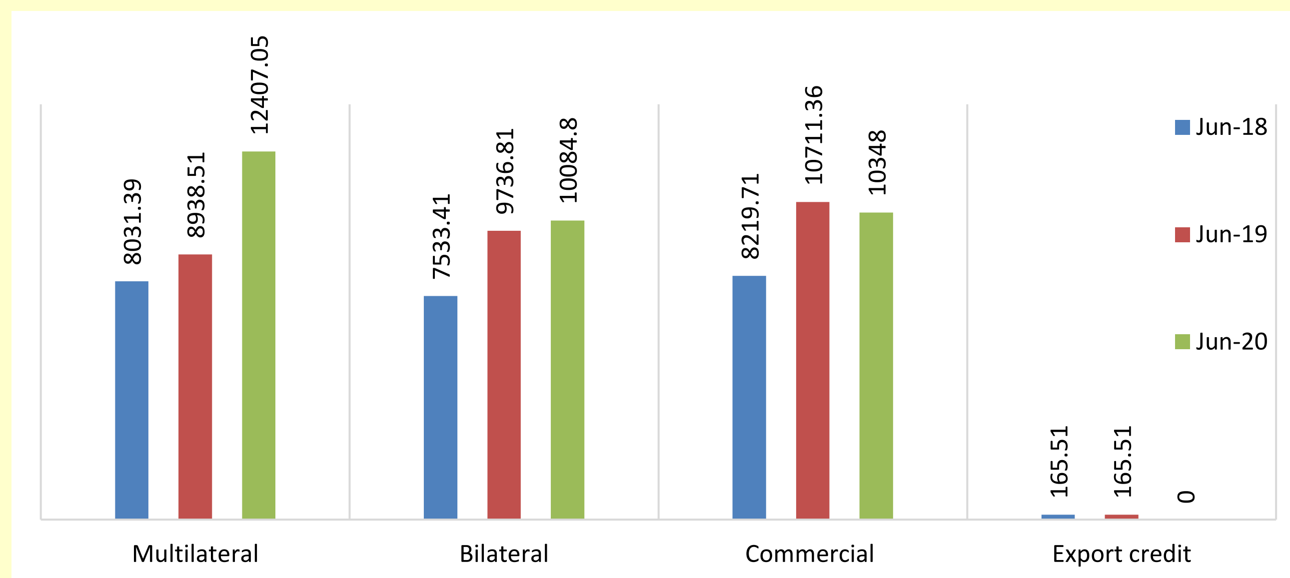


Note: * indicates estimated values

Source: National Treasury of Kenya (2020)

The ratio of debt to GDP has been on the rise in Kenya as shown in Figure 1. The %age of debt to GDP has grown from 54% in the FY 2015/2016 to 66% in the FY 2019/2020, signaling a 12% growth. The %age of debt on GDP is projected to reach 69% in the FY 2020/2021. This could increase in future if the containment of the economic crisis caused by COVID-19 sustains.

Figure 2: Sources of debt (USD) between June 2018 and June 2020



Source: National Treasury of Kenya (2020)

Figure 2 shows that multilateral corporations (e.g., World Bank and IMF) are the key lenders of Kenya followed by bilateral parties (for instance countries), commercial corporations and export credit, respectively. With the advent of COVID-19, Kenya's borrowing from multilateral corporations has increased by about 39% compared to 3.6% of bilateral parties (period is June 2019 to June 2020). Borrowing from commercial corporations reduced by 3.4% while borrowing from export credit has stagnated for the period between June 2019 and June 2020. In general, the current debt status of Kenya is risky but sustainable as per the World Bank and IMF.

c) Debt service obligations

The latest Debt Sustainability Analysis by the IMF/World Bank, published in May 2020, indicates that rising interest payment obligations (currently at 4.3% of GDP which is responsible for more than 25.2% of overall revenue) leaves little space for public expenditures on priority areas and COVID-19 emergency spending. Moreover, well before the COVID-19 pandemic, Kenya's trade balance was deteriorating. Reversing this downward trend will increase the potential of Kenya to fulfill both domestic and foreign debt obligations pertaining to service. Using

the foreign debt service relief and other debt optimization techniques available could lead to the release of the fiscal room required. In addition, because much of Kenya's external debt is denominated in US dollars (67.3%), the burden of external debt service commitments to Kenya is susceptible to the strengthening of the US Dollar.

B. THE INSTITUTES' POLICY RECOMMENDATIONS

First, the authorities can begin to devote adequate money to the health sector to battle the pandemic, to continue mass testing, to encourage self-quarantine, social distancing, and to secure the most vulnerable groups. There is also a need to ensure continued access to safe healthcare for health conditions not aligned with COVID-19 by allocating sufficient services to these regions (including non-communicable diseases). This will involve the redirection of investment to the higher priority areas in the face of fiscal restrictions during the Christmas break and into the New Year, while keeping an emphasis on increasing spending efficiency and ensuring the transparent use of funds. As the crisis declines, the country will need to improve its current institutional structure for tracking and reacting to future outbreaks of communicable diseases and to further the still-critical "Big 4" medium-term inclusive development agenda, including realizing the government's vision of delivering universal healthcare in a sustainable manner.

Second, it remains necessary to help the liquidity and digital capability of companies to shield healthy firms from irreversible closing. In addition, assistance is required for the "new poor" who have lost livelihoods following the work and tax losses precipitated by the crisis. This may be done by a horizontal, sufficiently tailored, timely, and temporary scale-up of social security services as the crisis continues. Continued funding for disadvantaged families is crucial, thus safeguarding intellectual resources by increased access to new technologies, together with enhanced access to knowledge to reduce the usage of harmful coping mechanisms (i.e. wealth liquidation) and to tackle food insecurity while compensating for the rise in poverty.

Finally, and most importantly, in order to reduce rising debt risks and preserve macroeconomic stability, policymakers should seek effective and balanced fiscal restructuring over the medium term. Tax and investment policies should aim to promote the healthcare system and support the neediest families in the long term in areas such as:

i. Streamlining the broad existing public investment portfolio to build room for innovative and impactful initiatives that could help create jobs;
ii. Involve professional institutes to provide expertise on public debt management as well as efficient/prudent debt refinancing ingenuities and in the creation of the public debt

management authority. Ensure that adequate representation can take place at the level of the board by including ICIFA and;

iii. Reducing unnecessary costs and raising budget productivity (including by using digitalization to reduce operations), the development of fiscal space to finance these vital measures could be assisted by possible fast wins.

ICIFA Council,

February, 2021

About ICIFA

ICIFA is the professional Investment and Financial Analysts' body mandated by law to regulate the Investment and Financial Analysis profession in Kenya, being the only body authorized by law to register and grant practicing certificates to Certified Investment and Financial Analysts (CIFAs) in Kenya both in private and public practice under the Investment and Financial Analysts Act (No.13 of 2015).

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