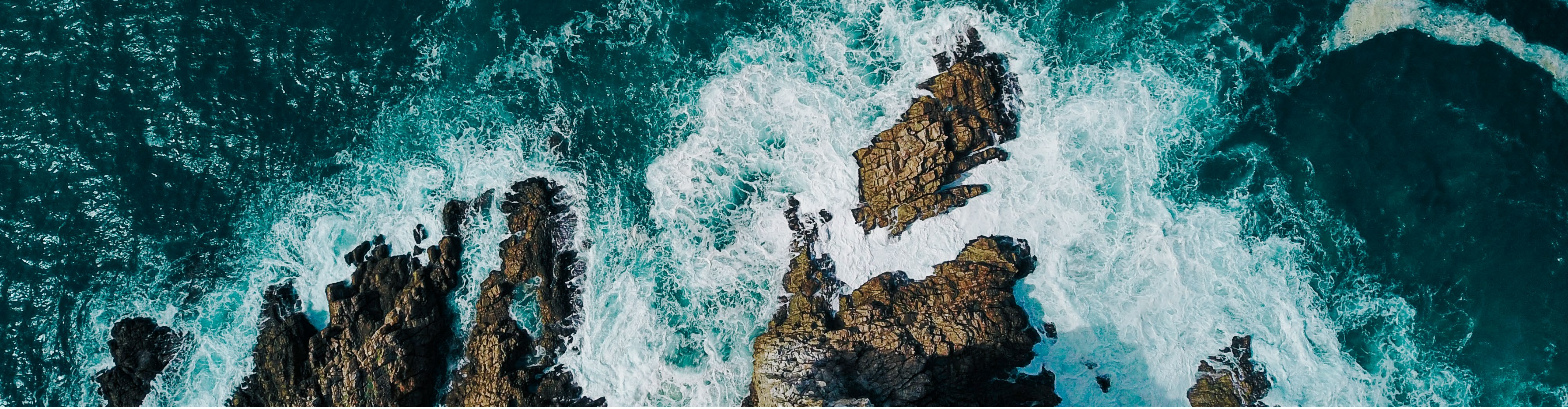

# Kenya's Debt Conundrum: What Is The Path Forward?


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S&P Global
Ratings

# Where Could Kenya Go From Here?

We see risks to Kenya's external debt-servicing capacity amid high external refinancing requirements. Our base-case and downside-case scenarios are as follows:

- **Scenario A (Base Case):** We project that Kenya will retain access to sufficient committed funding sources and foreign exchange (FX) reserves to mitigate immediate external liquidity risks. While expensive, Kenya's recent capital markets issuance and the partial redemption of its 2024 Eurobond have helped restore investor confidence and allay fears that Kenya would draw on its FX reserves to settle its $2 billion obligation. Liquidity risks will remain subject to fluctuations in global interest rates, exchange rates, imports, and fiscal conditions, but we expect continued access to official concessional funding, capital markets, and domestic banks will help Kenya meet its medium-term funding requirements. Budget consolidation efforts, while expected to be gradual, will also ease pressure on domestic yields and place debt-to-GDP on a modestly downward path, in our view.

- **Scenario B (Downside Case):** In a downside scenario, fiscal consolidation would falter on the back of revenue underperformance, weaker growth, arrears repayments, contingent liability risks, and a higher-than-budgeted interest bill. Debt-servicing costs could be pressured by further rounds of monetary tightening, adverse currency movements, and tight government liquidity, especially if fiscal slippages persist. Future exogeneous external shocks, rising global interest rates, and restricted capital market access, could also weigh on FX reserves and strain Kenya's external debt-servicing capacity.

# Kenya Rating Triggers

- **Last Rating Action:** On Feb. 26, 2024, S&P Global Ratings affirmed its 'B' long-term foreign and local currency sovereign credit ratings on Kenya. We previously revised the outlook to negative from stable on Feb. 24, 2023.

- **Negative Outlook:** The negative outlook reflects risks to Kenya's external debt-servicing capacity amid high external refinancing requirements. Kenya's government faces about $2 billion in amortizing external debt repayments annually, against FX reserves of about $7 billion. Our negative outlook also considers tightened liquidity in the domestic capital markets, partly fuelled by inflation and interest rate pressures. Interest costs have spiked to about 34% of general government revenue, reflecting rising domestic yields, monetary tightening, and recent fiscal slippages.

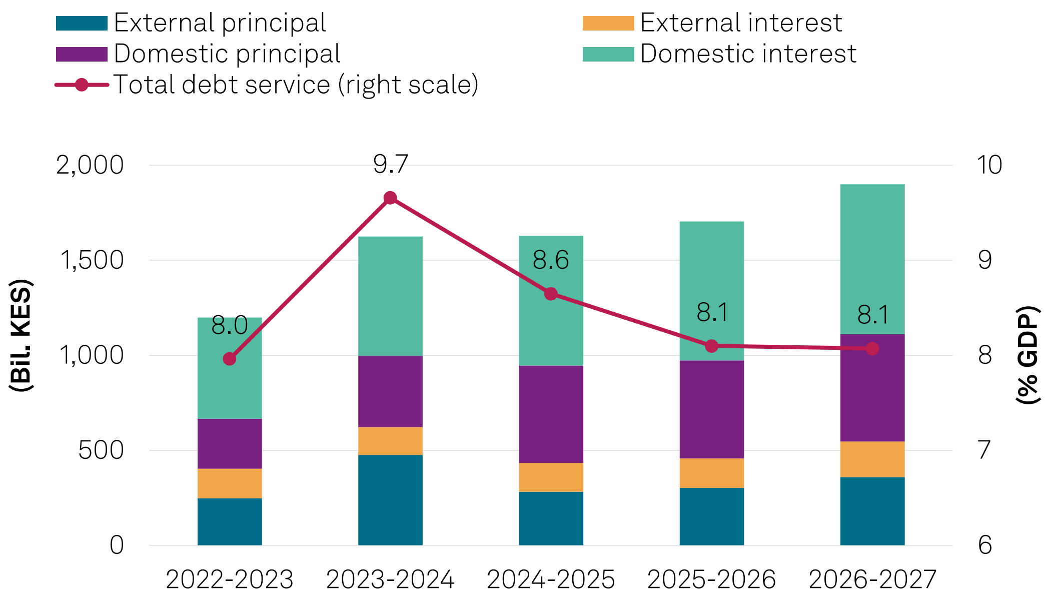
- **Upside Scenario:** We could revise the outlook back to stable over the next six months if Kenya's external and domestic financing pressures are contained, and we see significant progress toward fiscal consolidation.

- **Downside Scenario:** We could lower the ratings over the next six months if Kenya's external refinancing pressures mount, likely due to a sustained decline in FX reserves; or if we perceive any future debt-repurchase operations to be akin to a distressed exchange. We could also lower the ratings if we see limited progress on fiscal consolidation, further raising the government’s already high debt and interest costs.

# Kenya's Medium-Term Government Funding Needs Will Moderate

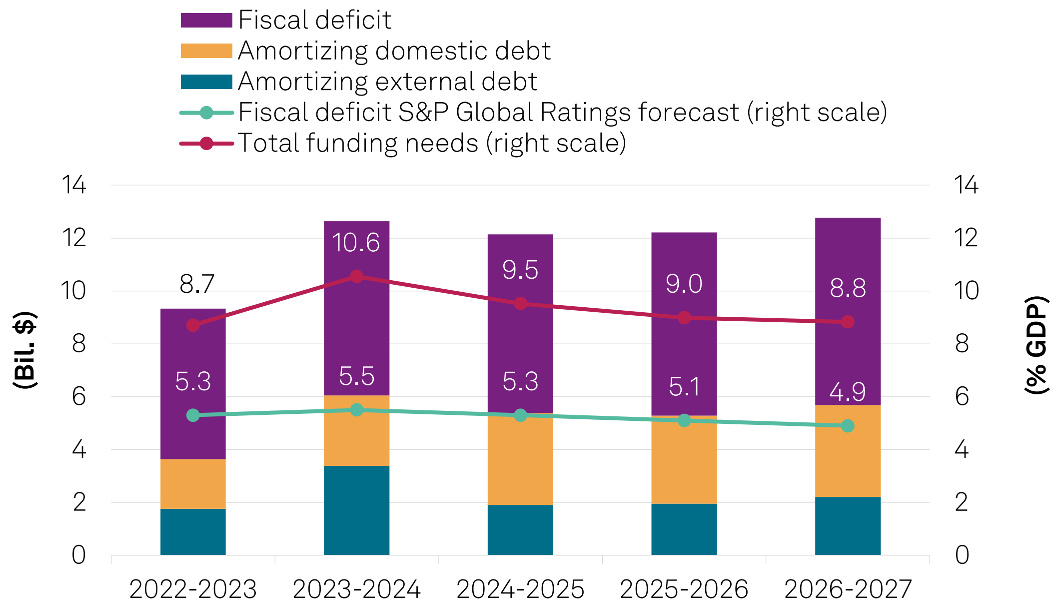
- Kenya's total debt servicing will likely peak at 9.7% of GDP in FY2024 (ending June 30, 2024) with the maturity of a $2 billion Eurobond, but is then expected to fall to 8.6% in FY2025 and 8.1% in FY2026 and FY2027 (left chart).
- Assuming narrowing budget deficits, the Kenyan government's funding needs are projected to decline to 8.8% of GDP in FY2027, from 10.6% in FY2024 (right chart). Amortizing domestic debt is estimated at about $3.5 billion and external debt at $2.0 billion in FY2025.

## Kenya's medium-term total government debt repayments are projected to decline in GDP terms




KES--Kenyan shilling. Source: S&P Global Ratings.

## Total general government funding needs are expected to ease alongside the fiscal deficit




Source: S&P Global Ratings.

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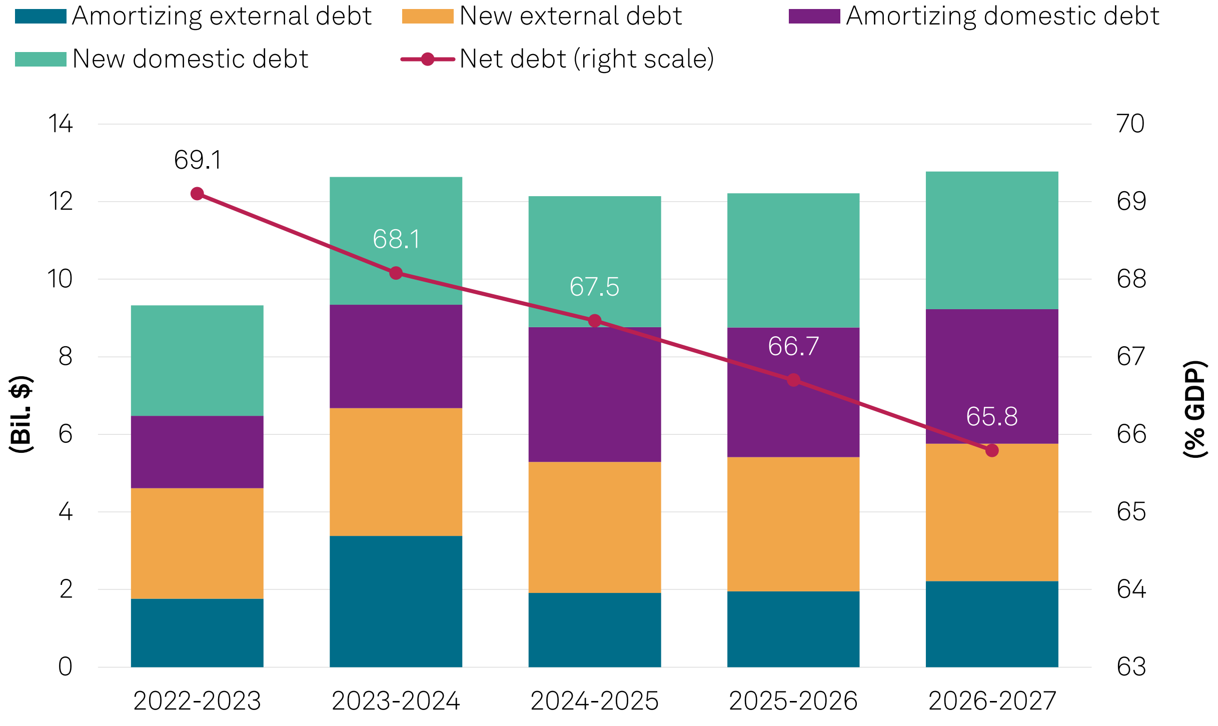
# Kenya's Funding Mix Will Rely Slightly More On Domestic Issuance

## New and rolled-over domestic debt will constitute around 55% of the government's total funding mix

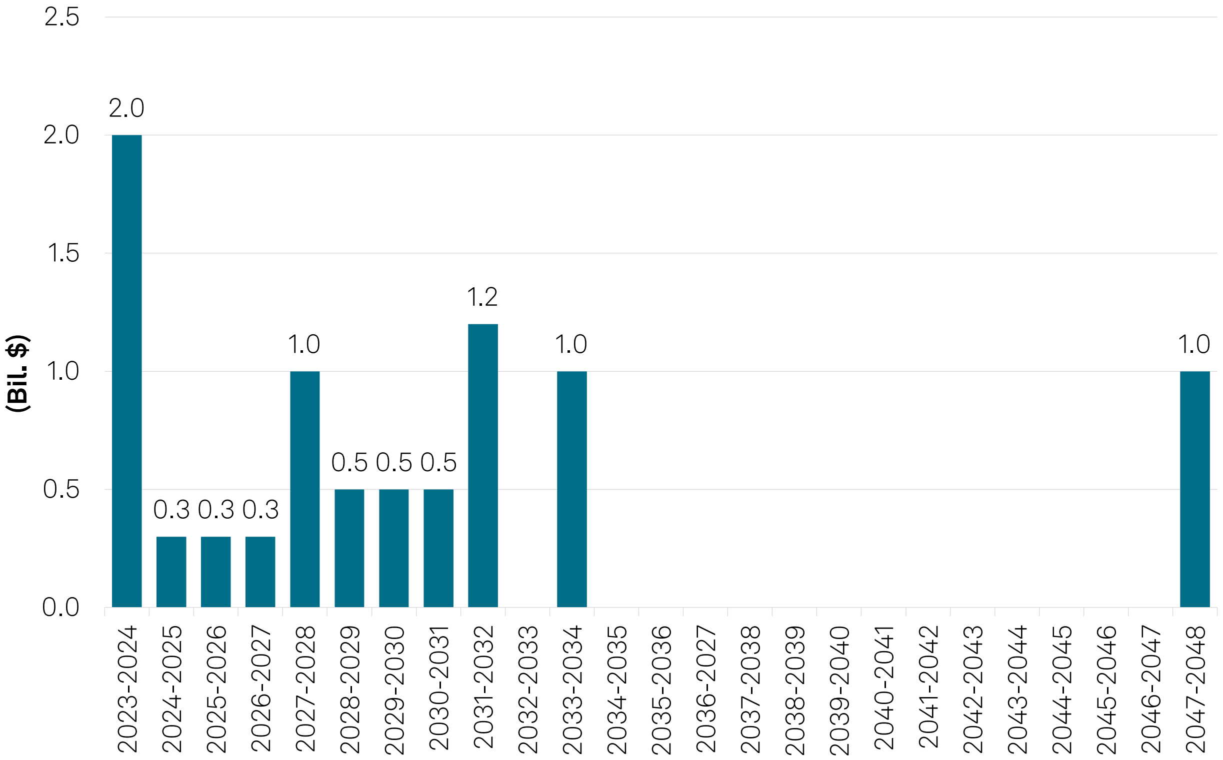



Source: S&P Global Ratings.

- Assuming 50% of fiscal deficits will be funded domestically, new and rolled over domestic debt is set to comprise about 5% of GDP of Kenya's annual funding mix over fiscal years 2025-2027.
- Domestic banks already have high exposure to the government at 27% of total assets, which could pose risks in the event of sovereign stress.
- Positively, the maturity profile of Kenya's domestic debt is lengthening, with government bonds accounting for 73% of domestic debt in FY2024, from 63% in FY2018. The average tenor of government bonds stands at 8.6 years.
- On the external front, we expect Kenya will continue relying on a mix of official concessional debt with long tenors and commercial loans.
- In January 2024, Kenya secured $380 million under a syndicated loan from the Trade and Development Bank and $685 million from the IMF under its sixth review.

# Kenya's Eurobond Redemption Schedule Remains Relatively Smooth

## Kenya's next sizable Eurobond repayment is not until 2028

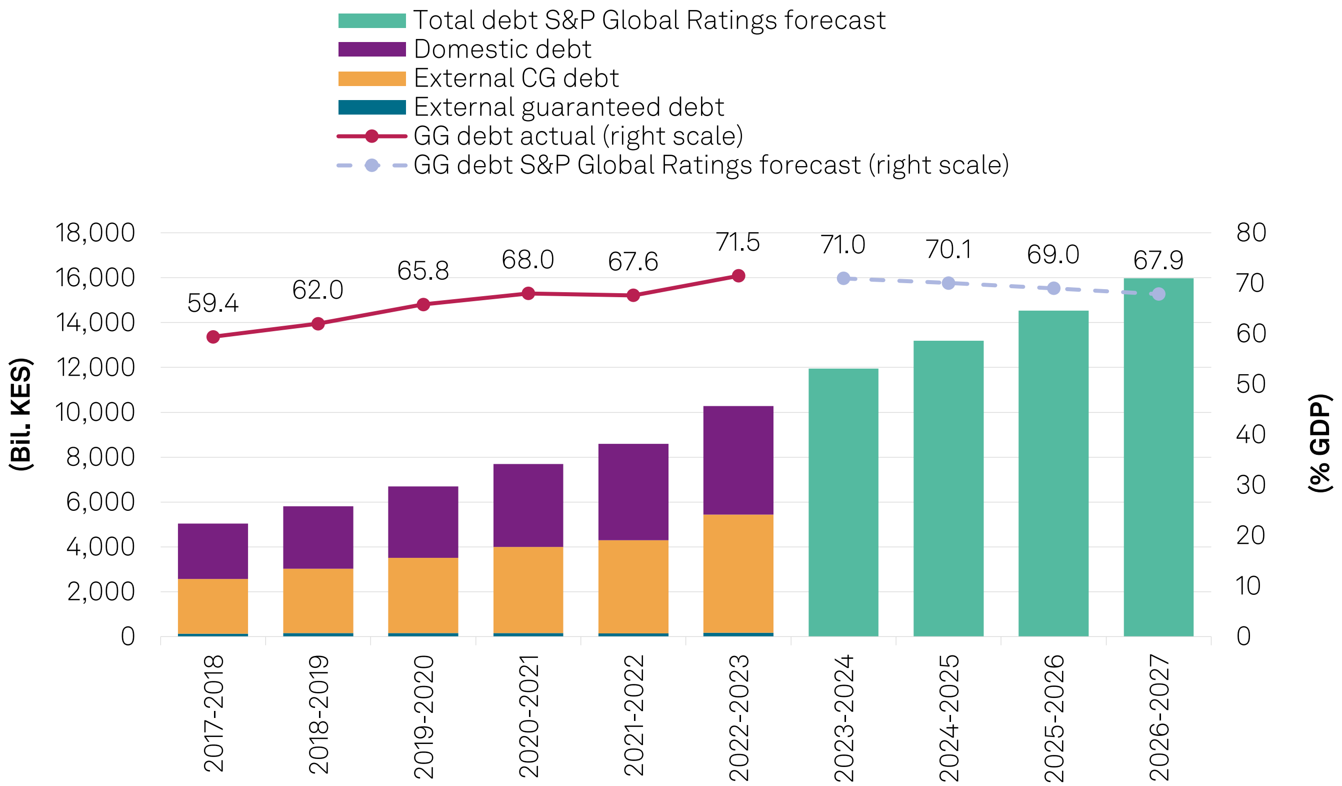



Source: S&P Global Ratings.

- On Feb. 17, 2024, the Kenyan government raised $1.5 billion through a seven-year, U.S. dollar-denominated bond, issued at a coupon of 9.75% and yield of 10.375%. The bond will amortize in three equal instalments of $500 million each, to be paid in 2029, 2030, and 2031.
- The government used the bond proceeds to finance the equivalent $1.5 billion buyback of its 2024 Eurobond, bought back at par, including payment of accrued interest until maturity on June 24, 2024. The portion of the Eurobond ($500 million) still outstanding is due to be financed using external concessional and commercial sources.
- Kenya's large upcoming Eurobond redemptions include $1.0 billion in FY2028 and $1.2 billion in FY2032.

# Kenya's Public Debt Stock Is Projected To Fall Under Our Base-Case

## Kenya's public debt stock is evenly split between domestic and external



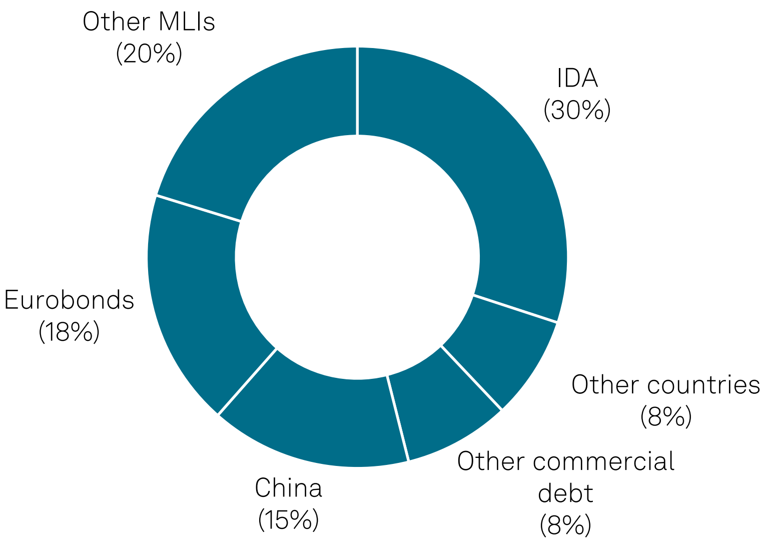

CG--Central government. GG--General government. KES--Kenyan shilling. Source: S&P Global Ratings.

- Debt dynamics have been impacted by rapid exchange rate depreciation and rising interest payments.
- About half of the government's stock of debt is external--foreign currency denominated debt--exposing Kenya to external financing and FX shortfall risks.
- Kenya's stock of external guaranteed debt is small at 1% of total debt: about 50% is provided to Kenya Airways, 30% to Kenya Ports Authority, and 20% to KenGen.
- We expect general government debt-to-GDP to decline to 67.9% by FY2027 from a peak of 71.5% in FY2024, assuming still-resilient growth, a broadly stabilizing currency, and gradual narrowing of fiscal deficits.

# The Concessional Nature Of Kenya's External Debt Composition Supports Its Creditworthiness

## Kenya's public external debt stock remains mostly concessional

Data as of Dec. 31, 2023

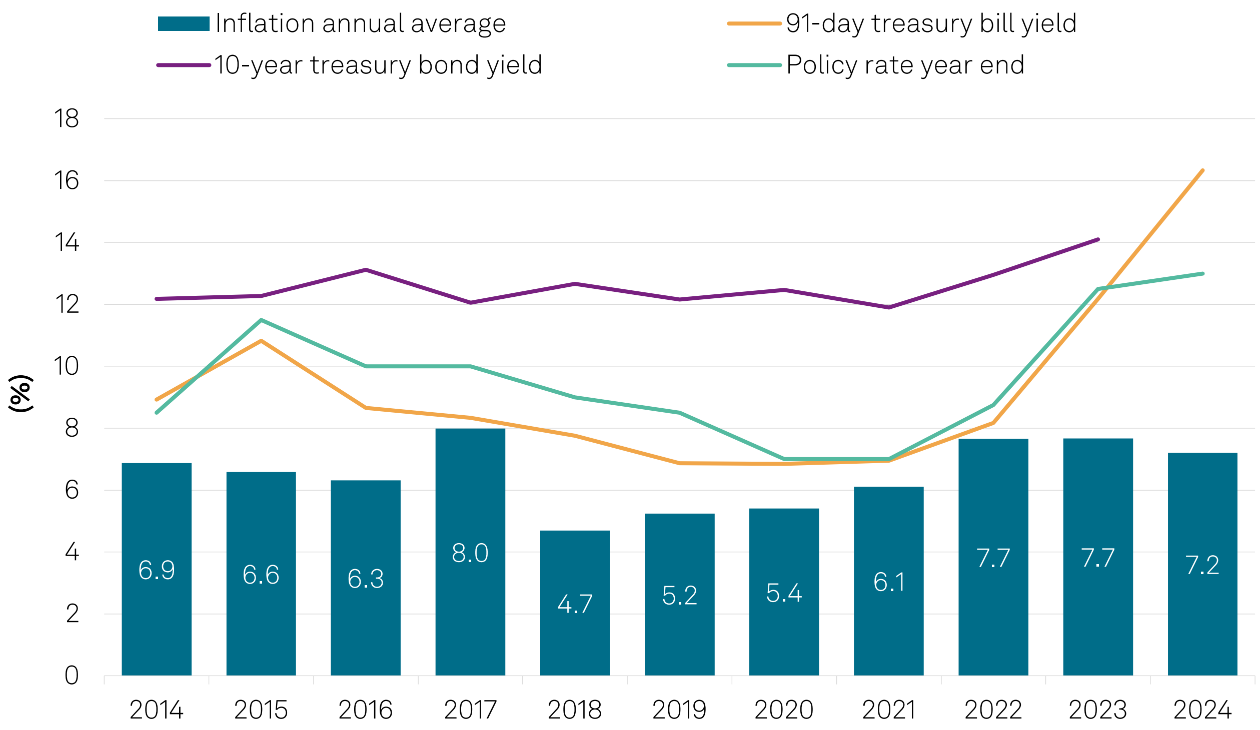



IDA--International development association. MLI--Multilateral lending institution. Source: S&P Global Ratings.

- Kenya borrows most of its external debt on concessional terms (74%), with the World Bank representing the country's largest official creditor (30%) as of end-2023.
- China remains Kenya's largest bilateral creditor (15%) with historical lending primarily channeled toward infrastructure projects.
- In November 2023, the World Bank pledged $12 billion in concessional support to Kenya's economic development over three years.
- In December 2023, the IMF upsized Kenya's Extended Credit Facility/Extended Fund Facility program by $938 million to a total of $4.4 billion (including Kenya's Resilience and Sustainability Facility arrangement).
- Kenya expects additional inflows of up to $1.5 billion from the World Bank in April/May 2024 and a further $1.1 billion from the IMF under its seventh review in May 2024.

# Domestic Funding Conditions Are Yet To Be Restored

## Short-term yields have spiked alongside hikes in the policy rate, but inflation remains in the single digits



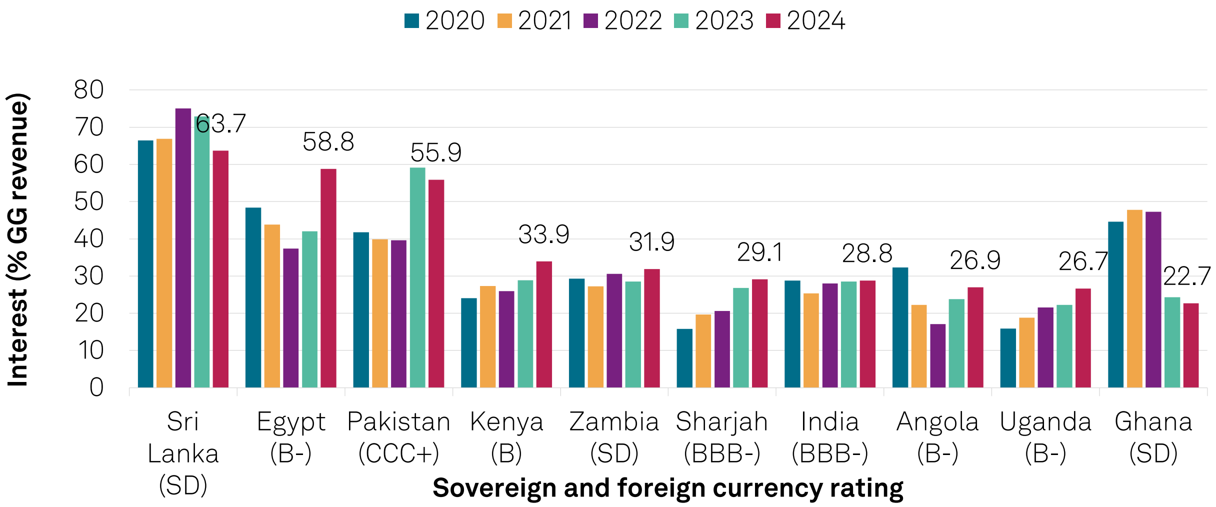

Treasury bill and bond rates represent weighted averages for the calendar year. Source: S&P Global Ratings.

- Kenya's domestic funding conditions deteriorated in 2023, with the front end of the treasury yield curve shifting up sharply amid monetary tightening, limited external inflows, fiscal slippages, and heightened uncertainty surrounding the repayment of the Eurobond.
- The average weighted yield on 91-day treasury bills increased to 16% in Dec. 2023, from 7% in Dec. 2021. Real yields averaged 11% in March 2024.
- Local financing conditions were partially restored by investors' oversubscription of an eight-year tax-free infrastructure bond at 18.5%, which raised KES241 billion (about $1.58 million) in February 2024.
- Positively, Kenya's inflation rate remains in the single digits, partially on account of negligible monetary financing of deficits.

# Rising Interest Costs Could Add To Government Debt Sustainability Risks

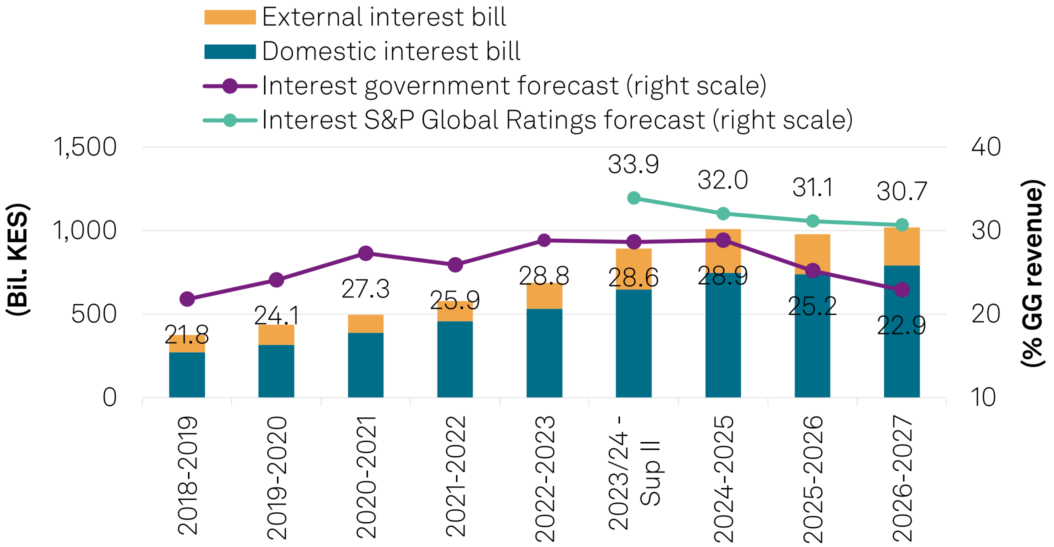
- Elevated global and local interest rates and currency depreciation, combined with monetary tightening and domestic revenue shortfalls, caused government debt-servicing costs to increase to an expected 34% of general government revenue in FY2024 (left chart).
- We assume domestic yields will trend down from FY2025, in line with the government's reduced net domestic borrowing requirement and potential policy rate cuts reflecting lower inflation (right chart).

## Kenya's interest bill as a percentage of government revenue is the fourth highest globally




GG--General government. SD--Selective default. Source: S&P Global Ratings.

## Kenya's debt servicing costs have risen in line with domestic yields and currency depreciation




GG--General government. KES--Kenyan shilling. Sup--Supplementary budget. Source: S&P Global Ratings.

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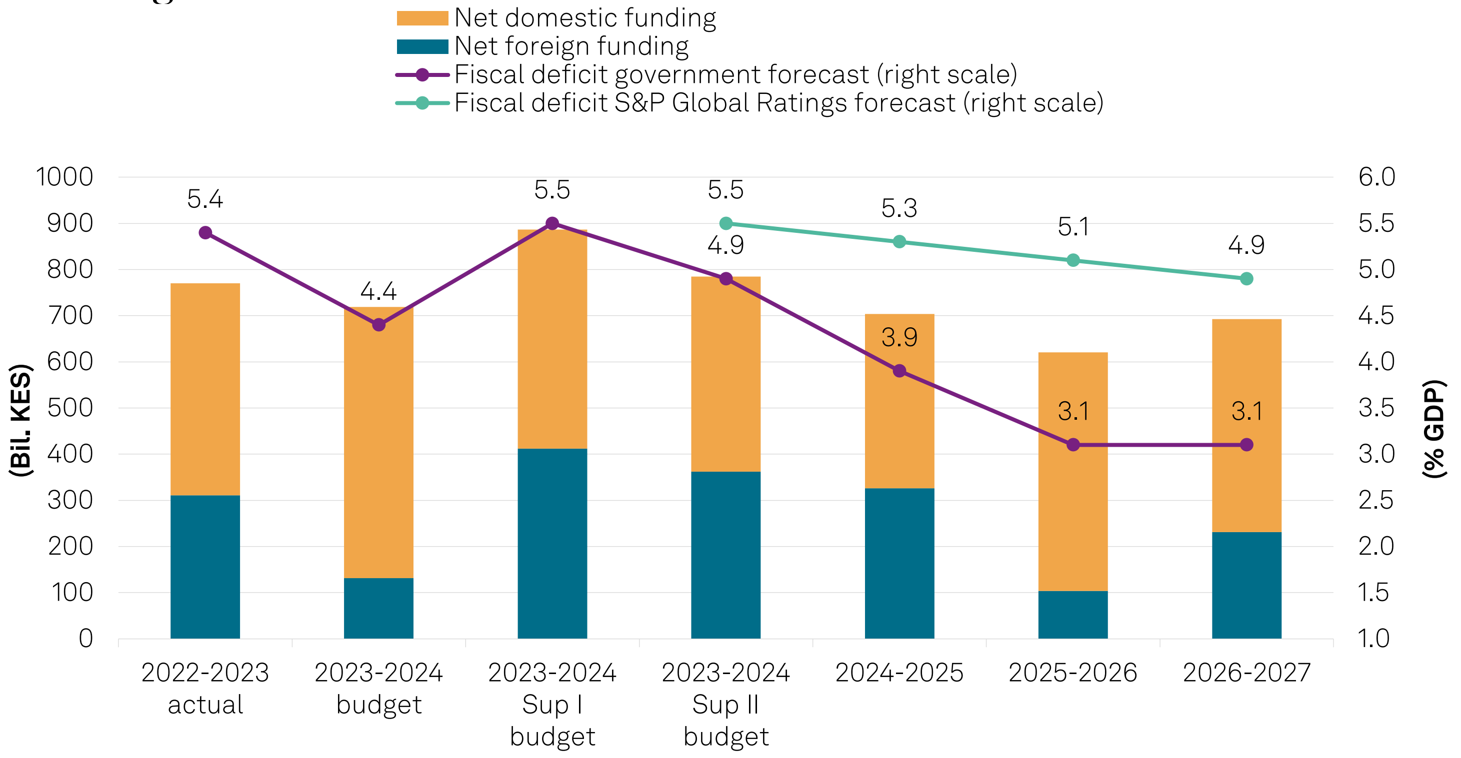
# Fiscal Consolidation Will Be Key To Moderating Debt

## Kenya's revised budget deficit for FY2024 relies increasingly on external financing sources



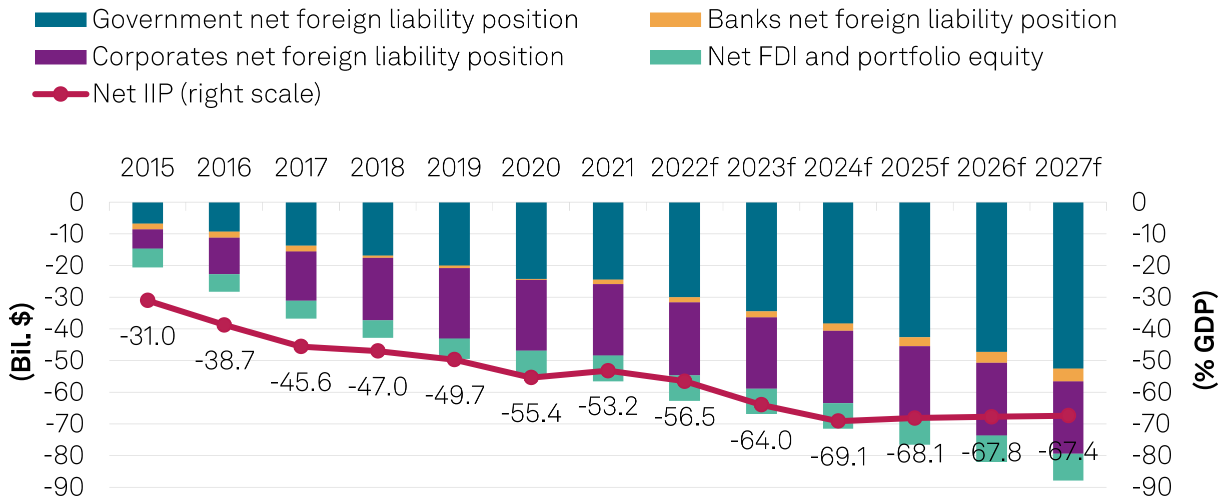

KES--Kenyan shilling. Sup--Supplementary budget. Source: S&P Global Ratings.

- Our base case projects a budget deficit of 5.5% of GDP in FY2024, narrowing to 4.9% by FY2027 on the back of recurrent and development expenditure cuts and new taxation measures introduced under the Finance Act in June 2023.
- However, fiscal slippages could arise because of ongoing revenue underperformance and higher-than-budgeted interest costs, reflecting rising domestic yields.
- Deficit reduction could also be hampered by the need to repay pending supplier and trade bills (estimated at about 4.4% of GDP), including payments to contractors, suppliers, and pensioners.
- We anticipate that the administration will remain cautious about raising further taxes, given the rising cost of living.

# Structural External Vulnerabilities Will Persist

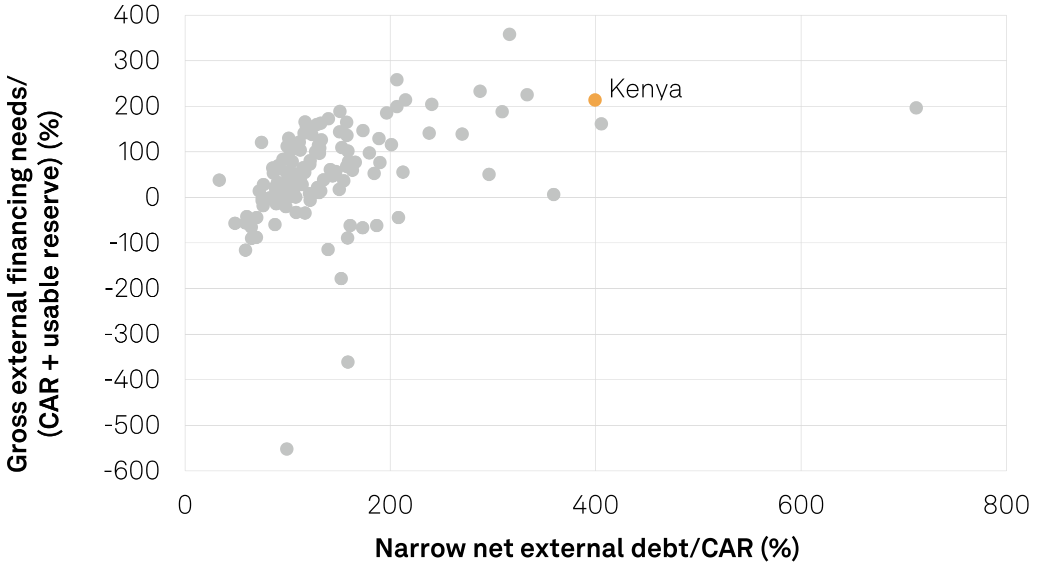
- Kenya's external position remains susceptible to global exogenous shocks given the country's high gross external financing needs, structurally wide current account deficits, and modest FX reserves of about $7 billion.
- Total external debt (loans excluding securities) was about 80% of GDP in 2023 (40% from the public sector, 30% corporates, 6% banks).

## Kenya's net IIP has progressively widened over the years, largely on account of the country's infrastructure investment drive




f--Forecast. FDI--Foreign direct investment. IIP--International investment position. Source: S&P Global Ratings.

## External ratios are among the highest of all rated sovereigns globally given low current account receipt generation




CAR--Current account receipts. Source: S&P Global Ratings.

# Selected Indicators For 'B' Rated Global Peers

- Our ratings on Kenya are constrained by the country's still relatively low GDP per capita (despite strong GDP growth), high fiscal deficits and debt stocks, structurally weak external position, and history of ethnic tensions.
- The ratings are supported by Kenya's track record of strong GDP, dynamic private sector, and diversified economy. Kenya also benefits from flexible monetary settings, as well as a relatively developed institutional framework.

| | | 2024 | 2024 | 2024-2027 | 2024-2027 | 2024-2027 | 2024-2027 | 2024-2027 |
|---|---|---|---|---|---|---|---|---|
| **Sovereign** | **LT FC rating/ outlook** | **GDP per capita ($)** | **Real GDP per capita growth (%)** | **Gross external financing needs/ CAR + usable reserves (%)** | **Narrow net external debt/ CAR (%)** | **Net GG debt/ GDP (%)** | **Change in net GG debt/GDP (%)** | **GG interest/ GG revenue (%)** |
| **Kenya** | **B/Negative** | **1,747.9** | **3.0** | **226.9** | **447.1** | **68.9** | **6.9** | **32.6** |
| Turkey | B/Positive | 9,779.8 | 1.7 | 155.2 | 81.5 | 28.9 | 6.0 | 12.3 |
| Mongolia | B/Stable | 6,233.2 | 4.4 | 109.3 | 60.4 | 34.4 | 0.7 | 3.9 |
| Montenegro | B/Positive | 12,673.1 | 3.5 | 135.1 | 100.8 | 55.2 | 4.0 | 5.9 |
| Nicaragua | B/Stable | 2,715.2 | 2.4 | 89.1 | 49.8 | 31.6 | -0.0 | 3.8 |
| Togo | B/Stable | 1,101.1 | 3.5 | 110.6 | 107.2 | 51.9 | 3.5 | 12.7 |

FC--Foreign currency. GG--General government. LT--Long-term.

# Selected Indicators For 'B' Rated African Peers

| | | 2024 | 2024 | 2024-2027 | 2024-2027 | 2024-2027 | 2024-2027 | 2024-2027 |
|---|---|---|---|---|---|---|---|---|
| **Sovereign** | **LT FC rating/ outlook** | **GDP per capita ($)** | **Real GDP per capita growth (%)** | **Gross external financing needs/ CAR + usable reserves (%)** | **Narrow net external debt/ CAR (%)** | **Net GG debt/ GDP (%)** | **Change in net GG debt/GDP (%)** | **GG interest/ GG revenue (%)** |
| **Kenya** | **B/Negative** | **1,747.9** | **3.0** | **226.9** | **447.1** | **68.9** | **6.9** | **32.6** |
| Angola | B-/Stable | 2,263.0 | -2.0 | 112.3 | 107.1 | 72.2 | 6.1 | 28.6 |
| Benin | B+/Positive | 1,669.4 | 3.9 | 129.5 | 95.2 | 40.7 | 2.7 | 12.5 |
| Cameroon | B-/Stable | 1,862.9 | 1.6 | 107.6 | 100.0 | 32.9 | 1.8 | 6.3 |
| Congo-Brazzaville | B-/Stable | 2,579.8 | 2.0 | 95.6 | 82.4 | 72.2 | -1.6 | 10.7 |
| DRC | B-/Stable | 669.5 | 1.7 | 99.8 | 6.8 | 15.4 | 2.4 | 2.2 |
| Egypt | B-/Positive | 3,190.6 | 1.5 | 127.7 | 112.1 | 64.3 | 9.8 | 54.3 |
| Nigeria | B-/Stable | 1,198.4 | 0.4 | 114.1 | 64.2 | 43.4 | 5.7 | 22.4 |
| Rwanda | B+/Stable | 1,057.7 | 4.5 | 111.8 | 159.6 | 63.2 | 6.5 | 9.0 |
| Uganda | B-/Stable | 1,022.9 | 1.6 | 140.9 | 158.7 | 51.5 | 5.6 | 28.1 |

DRC--Democratic Republic of Congo. FC--Foreign currency. GG--General government. LT--Long-term.

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