

 **Agusto&Co.**

*Research, Credit Ratings, Credit Risk Management*

# 2020 SOVEREIGN RATING REPORT ON

## The Republic of Kenya



## RATING RATIONALE

**Rating Assigned: B+**

**Outlook: Negative**

**Issue Date: 1 April 2020**

Agusto & Co. assigns a “B+” rating to the Republic of Kenya (“Kenya”, “the Country”, or “the Sovereign”). The assigned rating reflects the country’s resilient macroeconomic fundamentals evidenced by an average gross domestic product (GDP) growth of 5.7% in the last decade. This is in addition to Kenya’s position as the leading business hub within the East African Community (EAC) and the country’s diversified revenue sources from income taxes, tea, coffee, horticulture exports, diaspora remittances and tourism as well as its healthy foreign exchange reserve buffer, which has supported the country’s relatively stable local currency (Kenyan Shillings).

However, the rating is moderated by the following weaknesses: (1) persistent fiscal slippages by the Government of Kenya leading to expanded external borrowings, which have compromised macroeconomic stability; (2) rising budget deficit to GDP ratio; (3) high risk of debt distress resulting from expected decline in government receipt from agricultural exports, foreign remittances and tourist activities owing to the adverse effect of the locust invasion and the Coronavirus (COVID-19) pandemic; and (4) worsening balance of trade deficit due to low demand for the country’s exports. Kenya’s democratic journey has been fragile.

The country’s 2017 presidential election was marred by irregularities and violence which

culminated in its annulment by the Supreme Court. Following the withdrawal of the main opposition candidate Raila Odinga from the re-run election, the incumbent President Uhuru Kenyatta was declared the winner for a second term in office. Although the announcement was initially met with violence and protests, there has been a new political realignment in the East African country after the key actors (the incumbent President and Mr Odinga) agreed to a truce. However, recent rifts between President Kenyatta and his onetime heir apparent, Deputy President William Ruto, could threaten the nation’s relatively stable socio-political environment. Kenya’s frail democracy will be put to test in the next election cycle in 2022.

Kenya has the largest and most diversified economy within the East African Community (EAC) with enhanced revenue mobilisation from income taxes, export proceeds from sale of tea, coffee, horticulture exports, diaspora remittances and tourism. The Country’s real gross domestic product (GDP) expanded by an estimated 5.7% in 2019 down from the 6.3% achieved in the previous year. The 2019 growth was weakened by earlier threats of drought in the first quarter of the year that delayed planting season but rebounded owing to increased consumer consumption, a resilient services sector, credit growth to the private sector following the repeal of the interest rate caps and rising investors’ confidence as the

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political tension that trailed the country's 2017 presidential election eased. With the Country battling its worst locust invasion in seventy years, coupled with the devastating impact of the global outbreak of the deadly Coronavirus (COVID-19) on agricultural export and tourism activities, we expect Kenya's GDP growth to decelerate to 3.5% in 2020 and remain modest at 3.7% in 2021.

Furthermore, the Government's widening fiscal deficit owing to the subpar revenue collection in 2019/2020 fiscal year remains a concern. The performance of top non-tax revenue sources such as receipts from agricultural exports and tourism was crippled by flooding and unprecedented locust swarm resulting from climate change and most recently, the COVID-19 pandemic. Given that Kenya has consistently missed its revenue target by at least 8% since the 2014/2015 fiscal year, we expect the country's fiscal deficit for the 2019/2020 budget cycle to remain well above the government's 5.1% target and the EAC convergence benchmark of 3%.

Kenya's total public debt has been trending upwards from KSh4.6 trillion in 2017 to over KSh6 trillion as at the end of September 2019, which translated to circa 60% of the country's GDP, above the 50% threshold by the International Monetary Fund (IMF). Following recent approval from the lawmakers to raise the country's debt ceiling to KSh9 trillion, we expect Kenya's near to medium term debt profile to almost match the size of the entire economy estimated at KSh9.5 trillion. Kenya's rising debt profile (particularly external borrowing) increases the country's vulnerability to external shocks and portends a possible foreign debt distress, given the persistent decline in the GoK's revenue collections,. Furthermore, we

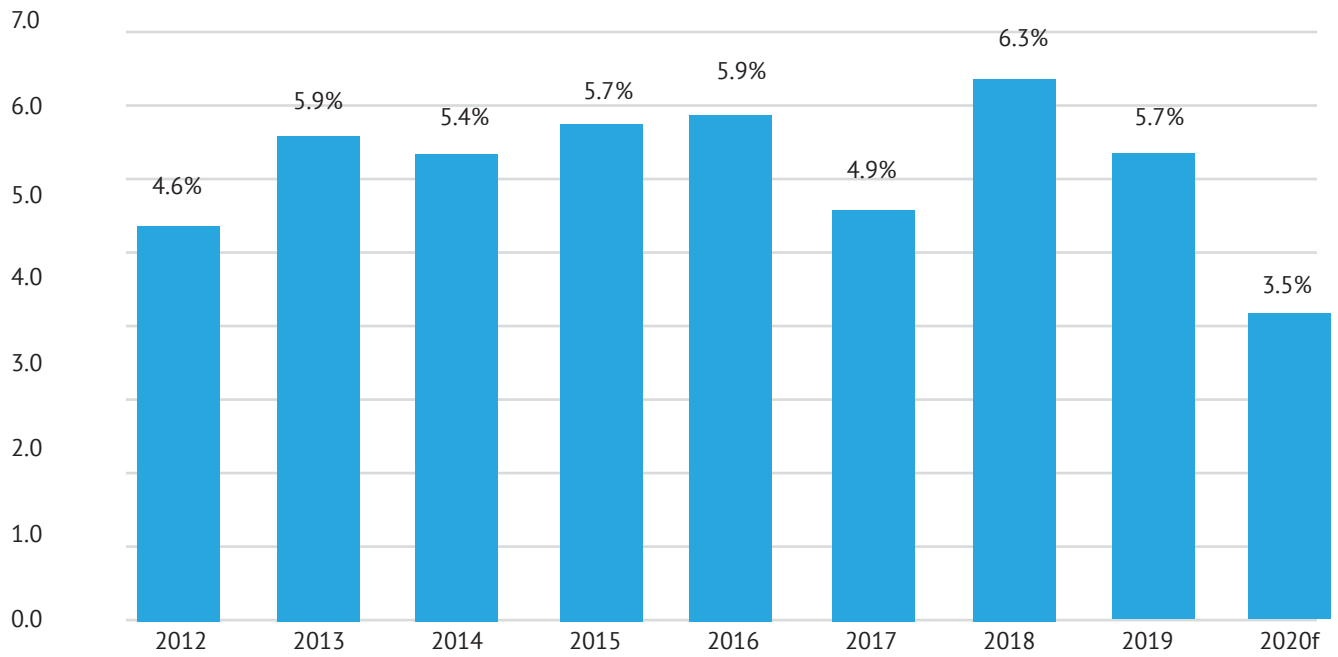
expect Kenya's debt-service to revenue in 2020 to be twice the recommended 30% threshold by the International Monetary Fund (IMF), which would further put a strain on planned development expenditure and its ability to fight the Coronavirus, should there be a widespread outbreak in the country.

Foreign remittances, which has overtaken tourism, tea, coffee and horticulture exports as the government's biggest source of foreign exchange, played a pivotal role in stabilising the country's currency in 2019. Although Kenya's foreign reserves closed at US\$8.7 billion in 2019, which represented 5.5 months import cover, we expect the country's import cover to remain about the same level despite falling foreign exchange earnings as receipts of foreign currency loans from international lenders is likely to have a cushioning effect.

In a bid to stimulate credit growth to the private sector, the Central Bank of Kenya (CBK) recently lowered its benchmark interest by 25-basis point to 8.25% in January 2020 - the second time it had tinkered with the rate in less than three months following a 50-basis point cut from 9% to 8.5% in November 2019. Although the expansionary monetary policy and the repealed interest capping are likely to have positive impact on the country's credit market, much stronger private sector led credit growth will be necessary to sustain high economic expansion.

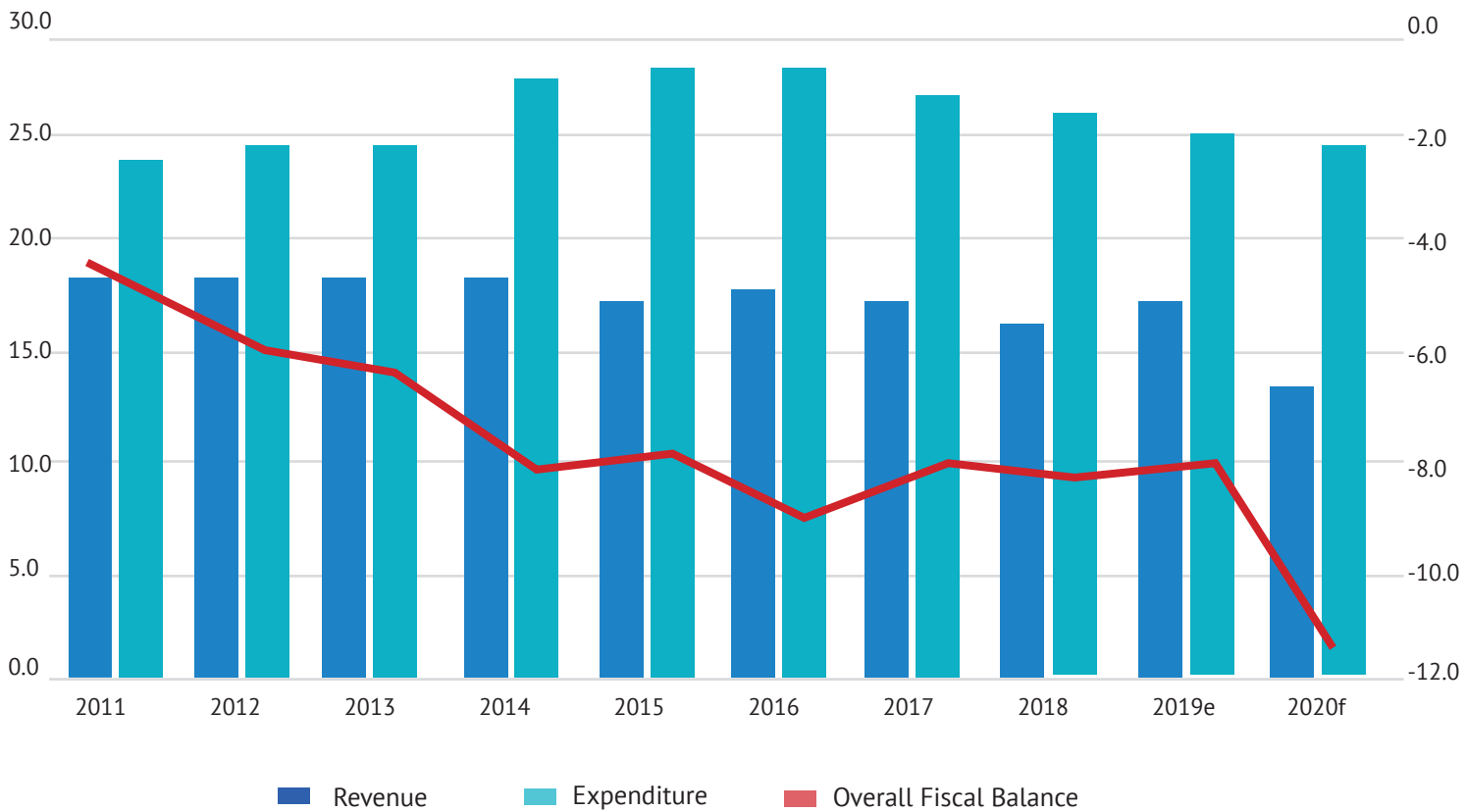
Based on the aforementioned, Agusto & Co. hereby attaches a **negative** outlook to the Republic of Kenya.

### Growth in Real GDP



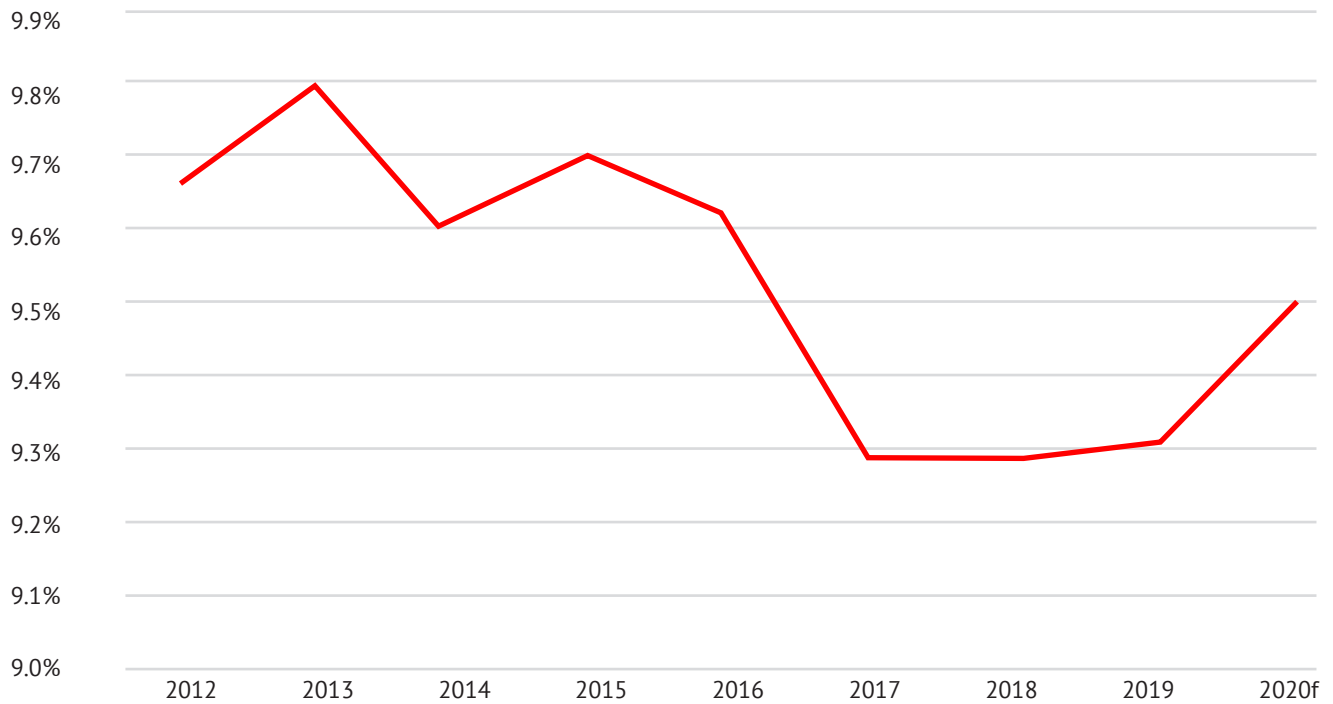
Source: Kenya National Bureau of Statistics (KNBS); Agusto & Co. Research

### Government of Kenya Fiscal Aggregates (Percentage of GDP)



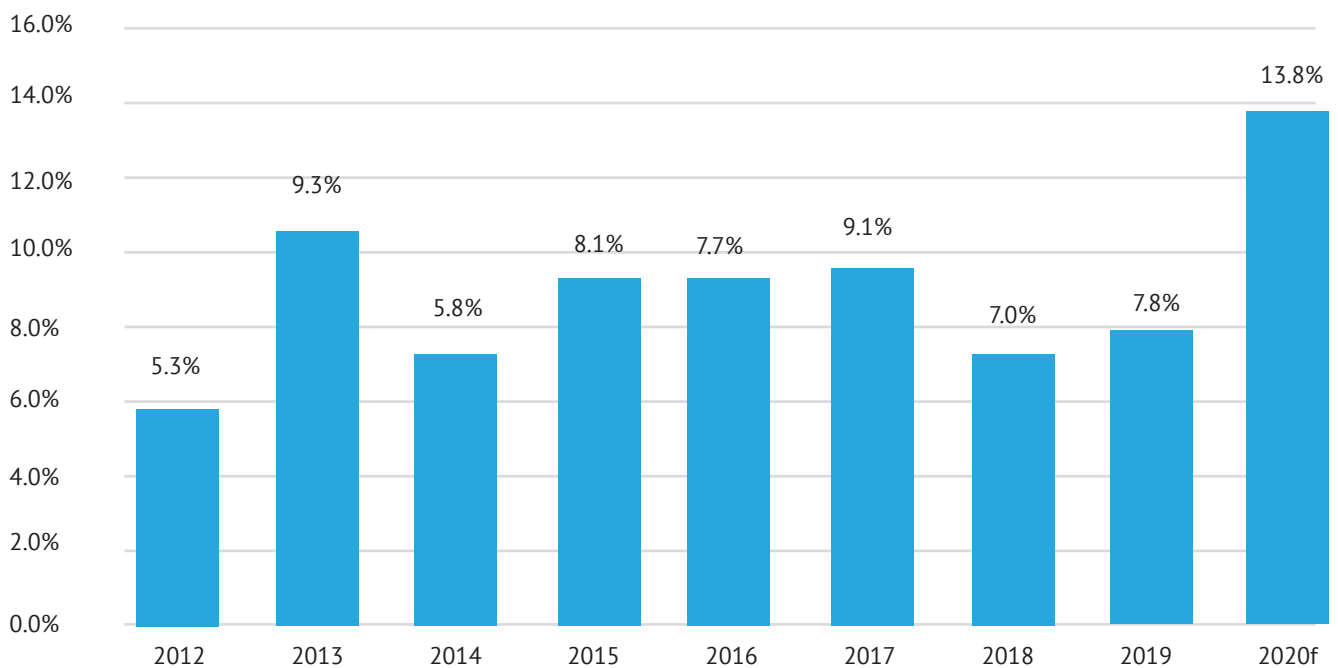
Source: Kenya National Bureau of Statistics (KNBS); Agusto & Co. Research

## Unemployment Rate



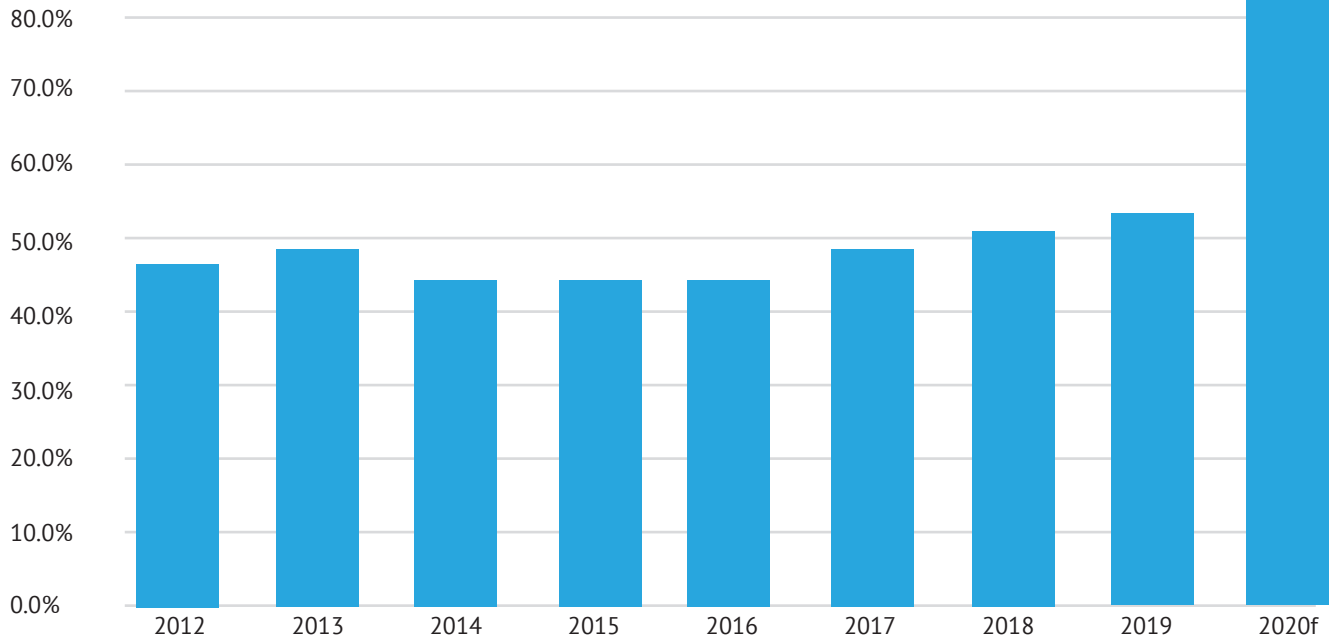
Source: Kenya National Bureau of Statistics (KNBS); Agusto & Co. Research

## Budget Deficit as % of nominal GDP



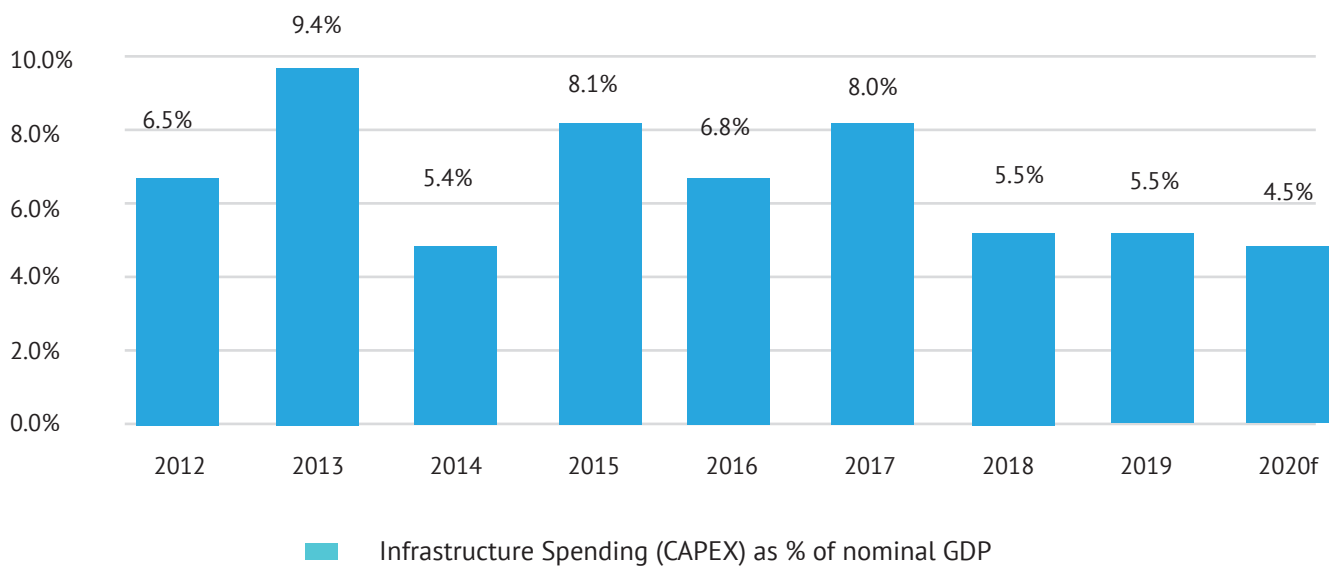
Source: Kenya National Bureau of Statistics (KNBS); Agusto & Co. Research

### Obligatory spending (payroll and interest) as % of total revenue & grants



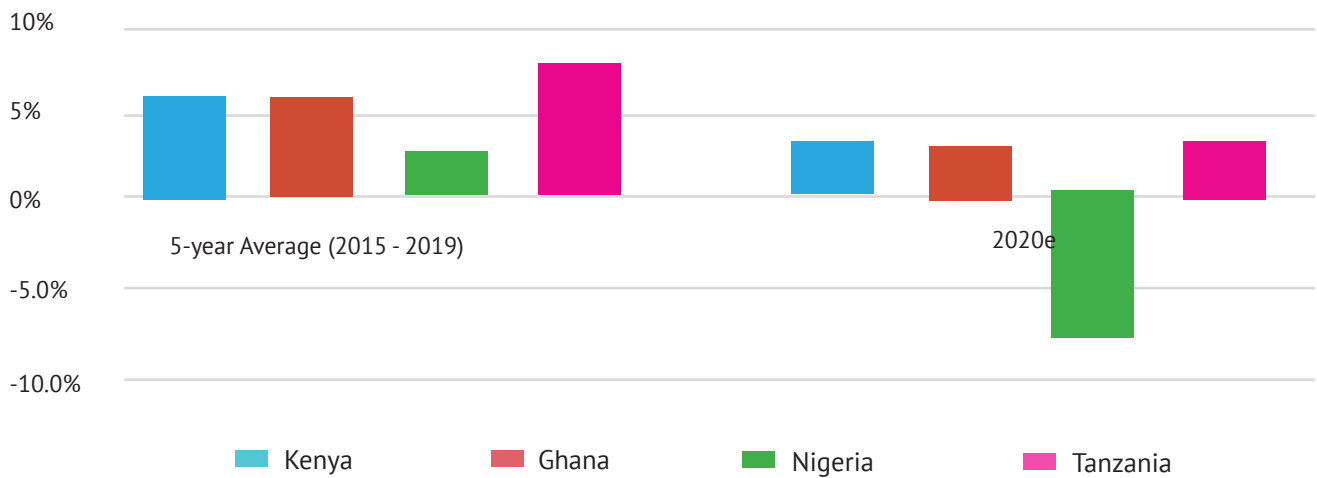
Source: Kenya National Bureau of Statistics (KNBS); Agosto & Co. Research

### Infrastructure Spending (CAPEX) as % of nominal GDP



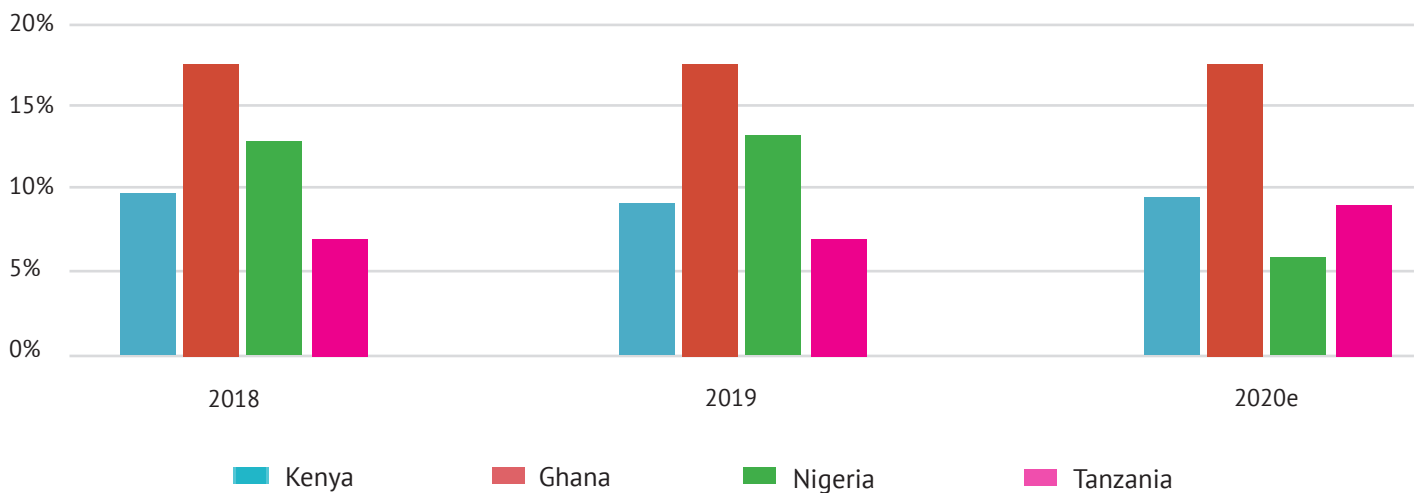
Source: Kenya National Bureau of Statistics (KNBS); Agosto & Co. Research

## Peer Comparison – Kenya, Ghana, Nigeria & Tanzania: Growth in Real GDP



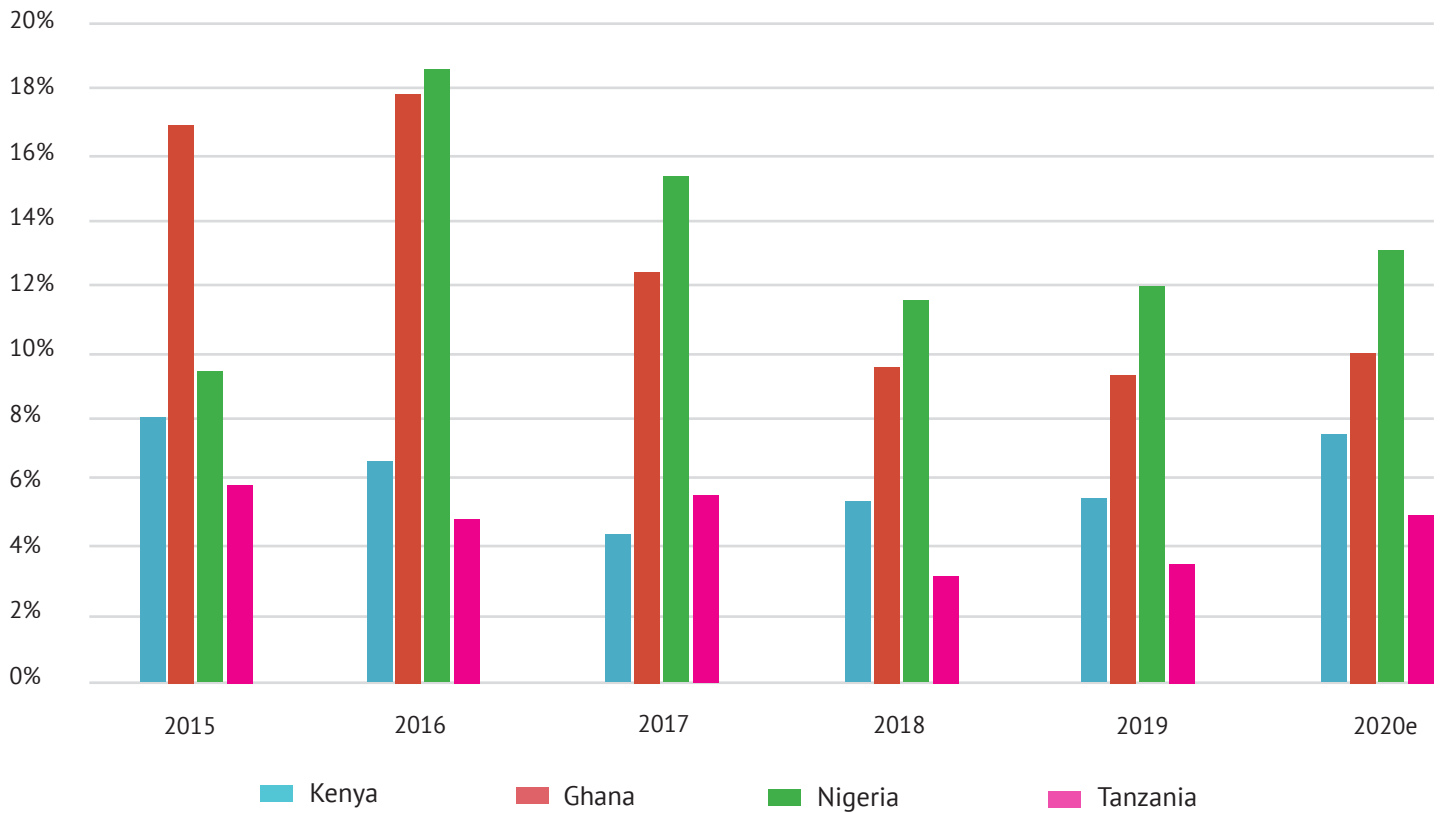
Source: Central Banks of Kenya, Ghana, Nigeria & Tanzania; IMF; Agusto & Co. Research

## Average Yield on 1-Year Central Government Treasury Bills



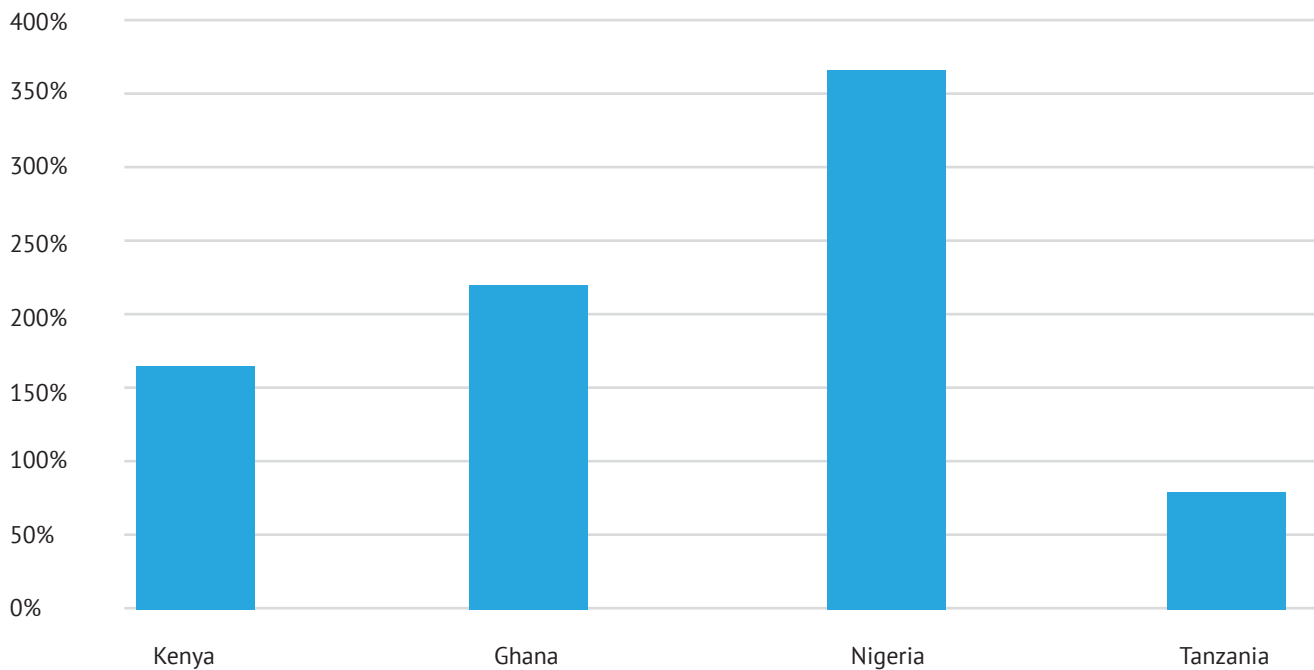
Source: Central Banks of Kenya, Ghana, Nigeria & Tanzania; IMF; Agusto & Co. Research

### Consumer Price Inflation (2015 - 2020e)



Source: Various National Central Banks; IMF; Agusto & Co. Research

### 2019 LCY Debt as % a of Total Revenue (excluding grants)



Source: Various National Central Banks; IMF; Agusto & Co. Research



<b>Aaa</b>	<b>Extremely Low Risk</b>
	Peaceful changes in leadership is assured, government pursues outstanding economic policies. Life, property and investments are very secure. The country therefore attracts very significant savings and investments and her citizens enjoy an extremely high standard of living.
<b>Aa</b>	<b>Very Low Risk</b>
	Peaceful changes in leadership is assured, government pursues very good economic policies. Life, property and investments are secure. The country therefore attracts significant savings and investments and her citizens enjoy a very high standard of living.
<b>A</b>	<b>Low Risk</b>
	Recent track record of peaceful changes in leadership, government pursues acceptable economic policies characterized by moderate government deficits financed by borrowing. Crimes involving fatalities are infrequent therefore the country attracts moderately high level of investments and savings, can access international credit and her citizens enjoy a moderately high standard of living.
<b>Bbb</b>	<b>Acceptable Risk</b>
	Recent track record of peaceful changes in leadership, government pursues acceptable economic policies characterized by moderate government deficits financed partly by monetary growth. Crimes rates are high but declining therefore the level of investments and savings is low but improving, Country may not be able to access international credit however new private investments are being attracted. Although standard of living of the citizens is low it is improving.
<b>Bb</b>	<b>Moderately High Risk</b>
	Country has a history of violent changes in leadership, central government runs a large deficit financed mainly with monetary growth thereby resulting in a moderate level of inflation. Crime rate is high and poses a risk to life and property, therefore savings and investments are low. A significant proportion of the population cannot access all the basic needs.
<b>B</b>	<b>High Risk</b>
	Violent changes to leadership are not unusual, central government runs large deficit financed with monetary growth resulting in a high inflationary environment. Serious crimes are prevalent and pose a high risk to life and property and investments therefore savings and investments are very low. A substantial proportion of the population does not have access to all the basic needs.
<b>C</b>	<b>Very High Risk</b>
	Violent changes to leadership are normal, central government runs very large deficits financed with monetary growth resulting in hyperinflation. Serious crimes are prevalent and pose a very high risk to life, property and investments therefore savings and investments are virtually non-existent. A very large proportion of the population lives in abject poverty.
<b>D</b>	<b>Major Civil Disturbance or Breakdown of the system or War</b>
	There really is no central government as the country is at war or there is a major civil disturbance. Central government financing is unrecorded or there is an unreasonably large deficits financed with monetary growth resulting in hyperinflation. Life, property and investments are not secure therefore there is significant capital flight. A significant proportion of the population lives in extreme poverty.

#### Rating Category Modifiers

A "+" (plus) or "-" (minus) sign may be assigned to ratings from 'Aa' to 'C' to reflect comparative position within the rating category. Therefore, a rating with + (plus) attached to it is a notch higher than a rating without the + (plus) sign and two notches higher than a rating with the - (minus) sign.

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