Kenya Q1'2018 Balance of Payments Note

Last week, the Kenya National Bureau of Statistics released the Quarterly Balance of Payments report for Q1'2018. In this note, we analyse the changes in the current account balance and look into the change in the country's balance of payments, before giving a forward-looking conclusion on both.

Current Account Balance

Kenya's current account deficit improved during Q1'2018, coming in at Kshs 107.9 bn from Kshs 129.7 bn in Q1'2017, a decline of 16.8%, equivalent to 8.9% of GDP from 11.3% recorded in Q1'2017. This was mainly due to the 28.0% increase in the services trade balance coupled with the 26.9% increase in the secondary income (transfers) balance, whose increase could be attributed to the 46.1% increase in diaspora remittances. Exports increased faster than imports, at 7.1% to Kshs 162.9 bn from Kshs 152.1 bn in Q1'2017 compared to the 6.5% increase in imports to Kshs 432.1 bn from Kshs 406.4 bn in Q1'2017. The table below shows the breakdown of the various current account components, comparing Q1'2018 and Q1'2017:

all figures in Kshs bns unless stated otherwise

Annual Current Account Balance			
Item	**Q1'2017**	**Q1'2018**	**% Change**
Merchandise Trade Balance	(253.7)	(269.3)	**6.1%**
Services Trade Balance	38.5	49.3	**28.0%**
Primary Income Balance	(16.5)	(17.3)	**4.7%**
Secondary Income (Transfers) Balance	101.9	129.3	**26.9%**
Current Account Balance	**(129.7)**	**(107.9)**	**(16.8%)**
GDP at Current Prices (Q1'2018 Quarterly GDP Report by KNBS)	1,147.74	1,213.45	***5.7%***
Current Account Balance as a % of GDP	*11.3%*	*8.9%*	***(2.4%)***

Key take-outs from the table include:

i. The secondary income/transfers surplus increased by 26.9% to Kshs 129.3 bn from Kshs 101.9 bn in Q1'2017, driven by a 46.1% increase in diaspora remittances to Kshs 65.9 bn from Kshs 45.1 bn recorded in Q1'2017. Diaspora remittances have been constantly increasing driven by, (a) recovery of the global economy, (b) increased uptake of financial products by the diaspora due to financial services firms, particularly banks, targeting the diaspora, and (c) new partnerships between international money remittance providers and local commercial banks making the remittance process more convenient,

ii. The merchandise trade deficit widened by 6.1% to Kshs 269.3 bn from Kshs 253.7 bn in Q1'2017 driven by a 6.5% rise in merchandise imports compared to the 7.1% rise in merchandise exports. The relatively larger import base compared to the export base contributed to the widening of the trade deficit. The increase in imports was mainly due to an 18.0% increase in value of petroleum imports to Kshs 64.5 bn from Kshs 54.7 bn in Q1'2017, and the increase in the value of iron and steel imports which increased by 35.5% to Kshs 26.6 bn from Kshs 19.6 bn in Q1'2017,

iii. In terms of exports by region, Africa remained the largest merchandise export destination with 33.4% of the total, followed by Asia exports at 32.0%. The European Union accounted for 27.4% owing to increased demand from the UK, The Netherlands, France and Belgium, with tea and horticulture remaining the largest export commodities, accounting for a combined 52.5% of the total value of export commodities,

iv. In terms of imports by region, the Far East was the largest merchandise import source, accounting for 45.4% in Q1'2018, with China as the leading source, with 20.1% down from 26.9%, though maintaining the top spot as Kenya's biggest import source followed by India and Saudi Arabia at 11.0% and 8.3%, respectively,

v. As a result of the increase in income surplus which outweighed the marginal increase in trade deficits in the four sections, the current account deficit improved faster than the growth in GDP at current prices, resulting in the current account deficit improving to 8.9% of GDP down from 11.3% recorded in Q1'2017.

Balance of Payments

Kenya's balance of payments improved during Q1'2018, coming in at Kshs 206.9 bn from Kshs 84.2 bn in Q1'2017, an increase of 145.8% translating to a balance of payments equivalent to 17.1% of GDP in Q1'2018 from 7.3% recorded in Q1'2017. This was mainly due to the 51.8% increase in the financial account balance whose increase could be attributed to the receipt of inflows from the February 2018 Eurobond issue of USD 2.0 bn The table below shows the breakdown of the various balance of payments components, comparing Q1'2018 and Q1'2017:

all figures in Kshs bns unless stated otherwise

Annual Balance of Payments			
Item	**Q1'2017**	**Q1'2018**	**% Change**
Current Account Balance	(129.7)	(107.9)	**(16.8%)**
Capital Account Balance	9.9	8.4	**(15.3%)**
Financial Account Balance	213.3	323.8	**51.8%**
Net Errors & Omissions	(9.3)	(17.4)	**86.5%**
Balance of Payments	**84.2**	**206.9**	**145.8%**
GDP at Current Prices (Q1'2018 Quarterly GDP Report by KNBS)	1,147.7	1,213.4	***5.7%***
Balance of Payments as a % of GDP	*7.3%*	*17.1%*	***9.7%***

Key take-outs from the table include:

i. The current account deficit declined by 16.8% to Kshs 107.9 bn from Kshs 129.7 bn in Q1'2017, largely due to the 28.0% increase in the services trade balance coupled with the 26.9% increase in the secondary income (transfers) balance, whose increase could be attributed to the 46.1% increase in diaspora remittances,

ii. The financial account balance increased by 51.8% to Kshs 323.8 bn from Kshs 213.3 bn indicating that the economy had a negative net capital outflow, indicating more foreign purchases of the local country assets. Furthermore, the receipt of the proceeds of the February 2018 Eurobond issue of USD 2.0 bn helped increase the country's financial account balance,

iii. The Balance of Payments (BoP) thus improved by 145.8% to a surplus of Kshs 206.9 bn from Kshs 84.2 bn in Q1'2017, mainly due to the 51.8% increase in the financial account balance coupled with the 16.8% reduction in the current account balance.

Conclusion

The narrowing of the current account in Q1'2018 affected the Kenya Shilling positively during the quarter, as the shilling gained 1.6% against the dollar to close at Kshs 101.8 from Kshs 103.4 at the end of Q1'2017. The increase of the forex reserves held by the Central Bank of Kenya by 9.4% in the same period to close the quarter at USD 9.4 bn (6.3 months of import cover) from USD 8.6 bn (5.7 months of import cover), mainly due to the receipt of the Eurobond proceeds, also led to positive sentiments about the Shilling.

While the improvement in the trade deficit is commendable, we are still of the view that the government still has to focus on putting further practical measures in place to move to a surplus from the current deficit, which include:

(i) Continue supporting the growth of the domestic manufacturing sector in order to reduce importation of goods that can be produced and sourced locally. Examples of propositions the National Treasury made in the finance bill include: (i) to increase the rate of import duty for a range of steel and iron products from 25.0% to 35.0% so as to protect the local steel and iron

industry, (ii) to increase the rate of import duty on paper and paper products from 25.0% to 35.0%, and (iii) to introduce a specific rate of USD 500 per tonne of imported vegetable oil or 35.0%, whichever is higher.

(ii) Encouraging "Made in Kenya" products and strengthening a national marketing body for such products abroad to boost exports, and,

(iii) Providing incentives for exporters which the government is already planning for through the rolling out of Special Economic Zones (SEZs) in key urban areas including Mombasa, Lamu and Kisumu with incentives such as exemption on VAT, reduced corporate tax rates for a defined period, access to quality infrastructure, one-stop-shops for licenses, and facilitation of exportation of finished goods.

However, with development-essential goods such as machinery & transport equipment being one of the largest contributors to the country's import while weather-dependent agricultural products make up more than 50.0% of our exports, we expect the trade balance to remain at a deficit in the medium term as the country develops, weighed down by imports for the ongoing infrastructure developments such as the second phase of the Standard Gauge Railway. This is likely to reduce the balance of payments in the short to medium term.