Kenya Q3'2018 Balance of Payments Note

This week, the Kenya National Bureau of Statistics released the Quarterly Balance of Payments report for Q3'2018. 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.

Current Account Balance

Kenya's current account deficit improved during Q3'2018, coming in at Kshs 116.0 bn from Kshs 150.9 bn in Q3'2017, a decline of 23.1%, equivalent to 9.9% of GDP from 13.6% recorded in Q3'2017. This was mainly due to the 19.4% increase in the services trade balance to Kshs 40.3 bn from Kshs 33.8 bn, coupled with a 10.6% decline in the merchandise trade deficit to Kshs 254.3 bn from Kshs 284.4 bn in Q3'2017. The table below shows the breakdown of the various current account components, comparing Q3'2018 and Q3'2017:

all figures in Kshs bns unless stated otherwise

Q3'2018 Current Account Balance			
Item	**Q3'2017**	**Q3'2018**	**% Change**
Merchandise Trade Balance	(284.4)	(254.3)	**(10.6%)**
Services Trade Balance	33.8	40.3	**19.4%**
Primary Income Balance	(20.6)	(25.6)	**24.3%**
Secondary Income (Transfers) Balance	120.3	123.5	**2.7%**
Current Account Balance	**(150.9)**	**(116.0)**	**(23.1%)**
GDP at Current Prices (Q3'2018 Quarterly GDP Report by KNBS)	1,108.3	1,174.2	**6.0%**
Current Account Balance as a % of GDP	***(13.6%)***	***(9.9%)***	***(3.7%)***

Key take-outs from the table include:

i. The secondary income/transfers surplus increased by 2.7% to Kshs 123.5 bn from Kshs 120.3 bn in Q3'2017, driven by a 26.2% increase in diaspora remittances to Kshs 64.7 bn from Kshs 51.3 bn recorded in Q3'2017. The increase in diaspora remittances have been 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 contracted by 10.6% to Kshs 254.3 bn from Kshs 284.4 bn in Q3'2017 driven by a 4.0% rise in merchandise exports to Kshs 152.1 bn from Kshs 146.3 bn in Q3'2017, coupled with a 5.6% decline in merchandise imports to Kshs 406.4 bn from Kshs 430.7 bn in Q3'2017. The decline in the import bill was attributed to the decline in imports of sugar, maize, animal and vegetable oils, and fertilizers. However, the import bill on petroleum products increased by 35.3% to Kshs 76.7 bn from Kshs 56.7 bn,

iii. In terms of exports by region, Africa remained the largest merchandise export destination with 35.9% of the total exports, followed by Asia at 28.4%. The European region accounted for 19.7% of total exports, with Netherlands, Germany and Spain recording increases of 14.4%, 7.7% and 53.3% in the value of total exports, respectively, during the period,

iv. In terms of imports by region, Asia was the largest merchandise import source, accounting for 67.0% in Q3'2018, with the value of imports increasing by 8.3% to Kshs 289.6 bn from Kshs 267.5 bn in Q3'2017. China was the leading source with 20.7%, maintaining the top spot as Kenya's biggest import source, followed by India and Saudi Arabia at 12.5% and 10.7%, respectively, and,

v. As a result of the decline in the merchandise trade deficit, the increase in the services trade balance, and the increase in the secondary income balance the current account deficit improved faster than the growth in GDP at current prices, resulting in the current account deficit improving to 9.9% of GDP down from 13.6% recorded in Q3'2017.

Balance of Payments

Kenya's balance of payments deficit improved during Q3'2018, coming in at a deficit of Kshs 39.2 bn, a 44.0% improvement from a deficit of Kshs 70.1 bn in Q3'2017, translating to a balance of payments deficit equivalent to 3.3% of GDP in Q3'2018, from a deficit of 6.3% recorded in Q3'2017. This was mainly due to the 161.5% increase in the financial account balance whose increase was largely attributed to increased disbursements, coupled with the 23.1% decline in the current deficit. The table below shows the breakdown of the various balance of payments components, comparing Q3'2018 and Q3'2017:

all figures in Kshs bns unless stated otherwise

Q3'2018 Balance of Payments			
Item	**Q3'2017**	**Q3'2018**	**% Change**
Current Account Balance	(150.9)	(116.0)	**(23.1%)**
Capital Account Balance	1.5	3.6	**139.1%**
Financial Account Balance	32.4	84.9	**161.5%**
Net Errors & Omissions	46.8	(11.7)	**(124.9%)**
Balance of Payments	**(70.1)**	**(39.2)**	**(44.0%)**
GDP at Current Prices (Q3'2018 Quarterly GDP Report by KNBS)	1,108.27	1,174.24	6.0%
Balance of Payments as a % of GDP	***(6.3%)***	***(3.3%)***	***3.0%***

Key take-outs from the table include:

i. The current account deficit narrowed by 23.1% to Kshs 116.0 bn from Kshs 150.9 bn in Q3'2017, mainly due to the 19.4% increase in the services trade balance, coupled with 10.6% decline in the merchandise trade deficit to Kshs 254.3 bn from Kshs 284.4 bn in Q3'2017,
ii. The financial account balance rose by 161.5% to Kshs 84.9 bn from Kshs 32.4 bn in Q3'2017 attributed to increased disbursements. Thus, the gross official reserves stood at Kshs 862.7 bn as at end of Q3'2018 compared to Kshs 904.8 bn as at end of Q2'2018, with the decline attributed to the draw down on official gross reserves by Kshs 41.3 bn mainly to service external debt,
iii. The Balance of Payments (BoP) thus improved by 44% to a deficit of Kshs 39.2 bn from a deficit of Kshs 70.1 bn in Q3'2017, mainly due to the 161.5% increase in the financial account balance, coupled with the 23.1% decline in the current account deficit, and the 139.1% increase in the capital account balance.

Conclusion

The narrowing of the current account in Q3'2018 supported the Kenya Shilling during the quarter, as the shilling gained by 2.2% y/y to close the quarter at Kshs 101.0 from Kshs 103.2 at the end of Q3'2017. The forex reserves held by the Central Bank of Kenya increased by 5.8% in the same period to close the quarter at Kshs 862.7 bn from Kshs 815.5 bn, mainly due to increased diaspora remittances.

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. Policies such as (i) increasing 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, and (ii) increasing the rate of import duty on paper and paper products from 25.0% to 35.0%, passed in the Finance bill 2018, are commendable,
(ii) Encouraging "Made in Kenya" products and strengthening a national marketing body for marketing and promoting such products in international markets to boost exports, and,
(iii) Supporting value addition initiatives of agricultural products across the entire value chain, aimed at improving and promoting the export of locally produced agricultural products.

However, with development-essential goods such as machinery & transport equipment being one of the largest contributors to the country's import bill 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.