Kenya Q2'2019 Balance of Payments Note

The Kenya National Bureau of Statistics released the Quarterly Balance of Payments report for Q2'2019. In this note, we analyse the changes in the current account balance and the balance of payments before giving an outlook on both.

A. Current Account Balance

Kenya's current account deficit improved by 11.8% during Q2'2019, coming in at a deficit of Kshs 107.6 bn, from Kshs 122.0 bn in Q2'2018, equivalent to (6.2%) of GDP, from (7.6%) recorded in Q2'2018. This was mainly driven by:

(i) A 1.7% narrowing of the merchandise trade deficit from Kshs 277.7 bn in Q2'2018 to Kshs 272.9 billion in Q2'2019,

(ii) A marginal decline in net inflows of international trade in services by 0.1% points to Kshs 38.27 bn, from Kshs 38.29 bn recorded in Q2'2018, and

(iii) A 5.1% rise in the secondary income (transfers) balance, to a surplus of Kshs 149.2 bn, from a surplus of Kshs 142.0 bn in Q2'2018.

The table below shows the breakdown of the various current account components, comparing Q2'2018 and Q2'2019 performance:

Item	Q2' 2018	Q2'2019	% Change
Merchandise Trade Balance	(277.7)	(272.9)	(1.7%)
Service Trade Balance	38.3	38.3	(0.1%)
Primary Income Balance	(24.6)	(22.2)	(9.7%)
Secondary Income (Transfers) Balance	142.0	149.2	5.1%
Current Account Balance	**(122.0)**	**(107.6)**	**(11.8%)**
GDP at Current Prices (Q2'2019 Quarterly GDP Report by KNBS)	1,614.3	1,740.0	7.8%
Current Account Balance as a % of GDP	(7.6%)	(6.2%)	(1.4%)

All values in Kshs bns

Key take-outs from the table include:

i. The secondary income/transfers surplus increased by 5.1% to Kshs 149.2bn, from Kshs 142.0 bn in Q2'2018, driven by various factors such as diaspora remittances which recorded an 8.0% increase to Kshs 80.8 bn, from Kshs 74.8 bn recorded in Q2'2018,

ii. The merchandise trade deficit contracted by 1.7% to Kshs 272.9 bn, from a deficit of Kshs 277.7 bn in Q2'2018, driven by a 3.8% decline in merchandise imports to Kshs 420.6 bn, from Kshs 437.3 bn in Q2'2018. This improvement was however impeded by a 7.5% decline in merchandise exports to Kshs 147.7 bn from Kshs 159.6 bn recorded in a similar period in 2018. The decline in the merchandise imports was mainly on account of declines in the value of tea exports by 26.2% in Q2'2019,

iii. In terms of exports by region, Africa remained the largest merchandise export destination with 37.0% of the total exports valued at Kshs 54.1 bn, a 3.0% decline from Q2'2018 total exports of Kshs 55.7 bn. Total export earnings from the European region decreased by 6.3% to Kshs 32.1 bn, from Kshs 31.2 bn recorded in Q2'2018 on account of decreased domestic exports of tea. Exports to the United States of America rose by 11.5% to Kshs 13.9 bn, from Kshs 12.5 bn in Q2'2018 attributable to increased re-exports of kerosene type jet fuel, which are imported then included in the country's exports,

iv. Total expenditure on imports recorded a 2.3% decline in Q2'2019 to Kshs 449.9 bn from Kshs 460.5 bn recorded in Q2'2018. In terms of imports by region, Asia was the largest merchandise import source, accounting for 66.9%, with the value of imports declining by 5.4% to Kshs 301.2 bn, from Kshs 289.2 bn recorded in Q2'2018. The decline was attributed to a reductions in imports from China, Saudi Arabia, South Korea, Malaysia and

Thailand by 19.3%, 29.2%, 24.6%, 52.5%, and 11.8%, respectively. Commodities that recorded marked reductions in import values from China included railway locomotives, while reduced imports of petroleum products from Saudi Arabia resulted into a reduced import bill from this source. The European Union accounted for 10.7% of total imports in Q2'2019, valued at Kshs 48.4 bn, a 16.8% decline from the Kshs 58.2 bn recorded in Q2'2018.

B. Balance of Payments

Kenya's balance of payments improved during Q2'2019, coming in at a surplus of Kshs 94.5 bn from a deficit of Kshs 33.6 bn in Q2'2018, translating to a balance of payments surplus equivalent to 5.4% of GDP in Q2'2019 from a deficit equivalent to 2.1% recorded in Q2'2018. This was mainly due to the 726.4% improvement in the financial account balance that was attributed to the issuance of the third sovereign bond of Kshs 210.0 bn in May 2019. The table below shows the breakdown of the various balance of payments components, comparing Q2'2019 and Q2'2018:

Item	Q2' 2018	Q2'2019	% Change
Current Account Balance	(122.0)	(107.6)	(11.8%)
Capital Account Balance	9.4	8.7	(7.4%)
Financial Account Balance	34.3	283.7	726.4%
Net Errors and Omissions	44.7	(90.3)	(301.9%)
Balance of Payments	**(33.6)**	**94.5**	**-**
GDP at Current Prices (Q2'2019 Quarterly GDP Report by KNBS)	1,614.3	1,740.0	7.8%
Balance of Payments as a % of GDP	(2.1%)	5.4%	(7.5%)

All values in Kshs bns

Key take-outs from the table include:

I. The current account deficit narrowed by 11.8% to Kshs 107.6 bn from Kshs 122.0 bn in Q2'2018, largely due to the 5.1% increase in the Secondary Income (Transfers) Balance attributed to an 8.0% increase in the diaspora inflows to Kshs 80.8 bn, from Kshs 74.8 bn recorded in Q2'2018,
II. The financial account balance improved by 726.4% to a surplus of Kshs 283.7 bn from a surplus of Kshs 34.3 bn in Q2'2018. This was mainly due to the issuance of the third sovereign bond of Kshs 210.0 bn in May 2019,
III. The Balance of Payments (BoP) thus improved to a surplus of Kshs 94.5 bn from a deficit of Kshs 33.6 bn in Q2'2018, mainly due to the 726.4% improvement in the financial account balance, which outweighed the 301.9% deterioration of net errors and omissions resulting mainly from statistical and recording errors, smuggling, illegal activities, and flawed estimation procedures.

C. Conclusion

In Q2'2019, the Kenyan Shilling steadily depreciated against the US Dollar by 1.5%, closing at Kshs 103.9 at the end of Q2'2019, from Kshs 102.4 in July 2019, following the announcement of the demonetization of the local currency, which offset the positive effects brought about by the narrowing current account balance. While the marginal decline in surplus recorded in the trade deficit is noteworthy, we are still of the view that the government has to focus on putting further practical measures in place to improve this position, 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:
    a. Reduction of import duties on raw timber from 10% to 0% to promote local production, the import duty on finished products to be retained at 25%, as proposed in the Budget 2019/2020, will aid in this;

b. Cushioning local manufacturers by reducing import declaration fees from 2.0% to 1.5% on raw materials and intermediate goods and increasing that on finished goods from 2% to 3.5%, and,
c. Accelerating the implementation of the 'Big Four Plan' through large-scale public infrastructural projects that will spur developments in the manufacturing sector, which in turn will enhance job creation and unlock the potential of the manufacturing sector to drive economic growth.

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.