Kenya Q3'2019 Balance of Payments Note

The Kenya National Bureau of Statistics released the Quarterly Balance of Payments report for Q3'2019. In this note, we analyse the changes in the current account balance and the balance of payments before giving an outlook on both.

Current Account Balance

Kenya's current account deficit improved by 7.6% during Q3'2019, coming in at Kshs 101.0 bn, from Kshs 109.3 bn in Q3'2018, equivalent to 8.2% of GDP, from 9.3% recorded in Q3'2018. This was mainly driven by:

(i) The 6.7% narrowing of the merchandise trade deficit (a scenario where imports are greater than exports) from KSh 254.3 billion in Q3'2018 to KSh 237.3 billion in Q3' 2019 mainly caused by a 4.9% decline impeded by the 3.2% decline in exports, and

(ii) The 4.3% rise in the secondary income (transfers recorded in the balance of payments whenever an economy provides or receives goods, services, income or financial items) balance, to Kshs 128.9 bn, from Kshs 123.6 bn in Q3'2018. The table below shows the breakdown of the various current account components, comparing Q3'2018 and Q3'2019:

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Q3'2019 Current Account Balance			
Item	**Q3' 2018**	**Q3'2019**	**% Change**
Merchandise Trade Balance	(254.3)	(237.3)	**(6.7%)**
Service Trade Balance	41.3	40.3	**(2.4%)**
Primary Income Balance	(19.8)	(32.9)	**66.2%**
Secondary Income (Transfers) Balance	123.6	128.9	**4.3%**
Current Account Balance	**(109.3)**	**(101.0)**	**(7.6%)**
GDP at Current Prices (Q3'2019 Quarterly GDP Report by KNBS)	1,171.2	1,230.8	**5.1%**
Current Account Balance as a % of GDP	**(9.3%)**	**(8.2%)**	**(1.1%)**

All values in Kshs bns

Key take-outs from the table include:

i. The secondary income/transfers surplus increased by 4.3% to Kshs 128.9bn, from Kshs 123.6 bn in Q3'2018, driven by various factors such as diaspora remittances which recorded a 5.1% increase to Kshs 68.0 bn, from Kshs 64.7 bn recorded in Q3'2018,

ii. The merchandise trade deficit contracted by 6.7% to Kshs 237.3 bn, from Kshs 254.3 bn in Q3'2018, driven by a 4.9% decline in merchandise imports to Kshs 410.5 bn, from Kshs 430.6 bn in Q3'2018. This improvement was however impeded by a 3.2% decline in merchandise exports to Kshs 145.9 bn from Kshs 150.7 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 by 21.2%,

iii. In terms of exports by region, Africa remained the largest merchandise export destination with 38.9% of the total exports valued at Kshs 56.7 bn, a 48.4% increase from Q3'2018 total exports of Kshs 38.2 bn. Exports to the European region increased by 0.7% to 29.9 bn from the Kshs 29.7bn recorded in Q3'2018. Similarly, exports to the United States of America declined by 1.1% to Kshs 14.1 bn, from Kshs 14.3 bn in Q2'2018, and

iv. In terms of imports by region, the European Union accounted for 12.4% of total imports in Q3'2019, valued at Kshs 50.8 bn, a decline from the Kshs 55.1 bn recorded in Q3'2018. Asia was the largest merchandise import source, accounting for 62.6%, with the value of imports decreasing by 11.1% to Kshs 257.0 bn, from Kshs 289.2 bn recorded in Q3'2018. The decline was attributed to a decrease in imports from China (9.3%), India (18.7%), Korea South (39.7%), and Japan (15.4%). Commodities that recorded marked reductions in import values from China included worn items of clothing reduced imports of flat-rolled products of iron and non-alloy steel from Japan resulted in a reduced import bill from this source.

B. Balance of Payments

Kenya's balance of payments improved during Q3'2019, coming in at a surplus of Kshs 41.3 bn from a deficit of Kshs 39.2 bn in Q3'2018, translating to a balance of payments surplus equivalent to 3.4% of GDP in Q3'2019 from a deficit equivalent to 3.3% recorded in Q3'2018. This was mainly due to the 7.6% improvement in the current account balance. The table below shows the breakdown of the various balance of payments components, comparing Q3'2019 and Q3'2018:

Q3'2019 Balance of Payments			
Item	**Q3' 2018**	**Q3'2019**	**% Change**
Current Account Balance	(109.3)	(101.0)	**(7.6%)**
Capital Account Balance	3.6	2.8	**(22.2%)**
Financial Account Balance	98.5	40.9	**(58.5%)**
Net Errors and Omissions	(32.0)	98.6	**408.1%**
Balance of Payments	**(39.2)**	**41.3**	**205.4%**
GDP at Current Prices (Q3'2019 Quarterly GDP Report by KNBS)	1,171.2	1,230.8	**5.1%**
Balance of Payments as a % of GDP	(3.3%)	3.4%	**6.7%**

All values in Kshs bns

Key take-outs from the table include;

i. The current account deficit narrowed by 7.6% to Kshs 101.6 bn from Kshs 109.3 bn in Q3'2018, largely due to the 4.3% increase in the Secondary Income (Transfers) Balance attributed to a 5.1% increase in the diaspora inflows to Kshs 68.0 bn, from Kshs 64.7 bn recorded in Q3'2018,
ii. The financial account balance declined by 58.5% to a surplus of Kshs 40.9 bn from a surplus of Kshs 98.5 bn in Q3'2018 while the stock of gross official reserves increased by 13.4% to stand at Kshs 978.6 billion,
iii. The Balance of Payments (BoP) thus improved by 205.4% to a surplus of Kshs 41.3 bn from a deficit of Kshs 39.2 bn in Q3'2018, mainly due to the 408.1% increase in the net errors and omissions account balance, coupled with the 7.6% decline in the current account deficit.

Conclusion

The narrowing of the current account in Q3'2019, however, failed to support the Kenya Shilling during the quarter, as the shilling lost by 2.9% y/y to close the quarter at Kshs 103.9 from Kshs 101.0 at the end of Q3'2018. The forex reserves held by the Central Bank of Kenya increased by 4.1% in the same period to close the quarter at Kshs 898.5 bn from Kshs 862.7 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 includes 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 10.0% to 0.0% to promote local production, the import duty on finished products to be retained at 25.0%, 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 2.0% 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.