REPUBLIC OF KENYA

SOVEREIGN CREDIT RATING

19 March 2024

RATING ACTION

Sovereign Africa Ratings (SAR) has completed its assessment of Kenya's creditworthiness and assigned the following credit ratings and outlook:

The long- and short-term foreign currency credit ratings assigned are B and B+ respectively. The outlook on the local currency ratings and foreign currency ratings is Stable.

SAR has assigned B long-term and B+ short-term local currency credit ratings for Kenya.

Date	Rating Category	Rating	Outlook
Foreign Currency Ratings:			
19 March 2024	**Long-term**	**B**	**Stable**
19 March 2024	**Short-term**	**B+**	**Stable**
Local Currency Ratings:			
19 March 2024	**Long-term**	**B**	**Stable**
19 March 2024	**Short-term**	**B+**	**Stable**

Rationale

Kenya's economy is projected to expand by 6,0% in 2024, fuelled by services and consumption. However, weather uncertainties and global instability pose risks. While inflation declined in 2023, the International Monetary Fund (IMF) predicts a slight increase in the first half of 2024 due to global oil prices and exchange rate fluctuations. Maintaining macroeconomic stability will be crucial for navigating these potential headwinds.

Kenya's recent Eurobond issuance attracted over $5 billion in orders, indicating robust investor confidence and a diversification of funding sources. This reflects proactive debt management amidst the elevated US rate. However, challenges arise as demand surpasses the $1,5 billion target, potentially straining long-term affordability with a 10,375% coupon. While reducing reliance on domestic borrowing may mitigate risks from local lenders, the addition of debt could crowd out private investment, impacting fiscal sustainability. Servicing the Eurobond depends on economic performance, global interest rates, and currency fluctuations, requiring careful navigation. The fiscal deficit is expected to narrow to 5,4% of GDP in 2024, reflecting continued efforts towards fiscal consolidation. However, public debt remains a concern, having reached 70% of GDP in 2023. Striking a balance between debt sustainability and essential investment will be key for credit rating stability.

The current account deficit is forecast to narrow to 5,0% of GDP in 2024. Nonetheless, export diversification beyond traditional sectors like tea and coffee is crucial to mitigate external risks and attract foreign investment. Fostering export-oriented manufacturing and agribusiness holds promising potential.

While capital adequacy and liquidity ratios remain robust and exceed targets, the high non-performing loans ratio (13,5% in 2023) demands attention. Implementing effective credit risk management strategies and fostering economic growth are essential for improvement. Further financial sector reforms can promote financial inclusion and long-term stability. Poverty, unemployment, and income inequality remain significant hurdles. Continued focus on inclusive economic growth, targeted social programmes and equitable access to education and healthcare are crucial for addressing these challenges.

Empowering the youth and marginalised communities can unlock Kenya's human capital potential. Addressing bottlenecks in key sectors like agriculture and infrastructure through targeted investment and public-private partnerships can improve Kenya's finances.

Droughts and climate change pose risks to agricultural production, food security, and economic growth. Investing in climate-resilient infrastructure and sustainable practices will be essential. Kenya's ability to harness technology for innovation, financial inclusion, and improved service delivery will be fundamental for competitiveness and future growth.

Kenya's economic landscape presents a complex interplay of opportunities and challenges. While the 2024 outlook is cautiously optimistic, sustained efforts towards fiscal prudence, export diversification, financial sector reforms, and addressing social issues will be essential for long-term economic stability and improved creditworthiness. Navigating the potential risks of global uncertainties and climate change will require strategic investments and proactive adaptation.

Debt Profile

Kenya's economic challenges extend beyond the revised budget deficit forecast for the 2023/24 financial year, which has risen from 4,4% to 5,3% of GDP. The weakening Kenyan shilling against the US dollar is a primary driver, causing heightened interest costs on external debt and an increased debt volume.

The substantial 18% depreciation of the shilling against the dollar in the current year compounds the issue, exacerbating debt repayment costs and limiting efforts to reduce the budget deficit. Notably, the country's public debt levels reached $72,4 billion in August 2023, a slight decrease from the previous month's $73,2 billion.

Amid these economic challenges, revenue collection has become a significant hurdle, with the Kenya Revenue Authority falling short of its first-quarter target by over $500 million. The agricultural sector, contributing significantly to Kenya's GDP, faces additional pressure from both drought and excessive rainfall, impacting the country's overall economic stability.

In response to these difficulties, Kenya is contemplating a privatisation plan. This strategy involves offering stakes in 11 state-owned companies, including key entities such as the oil and gas corporation, pipeline operator, and various agricultural businesses. The objective is twofold: achieving fiscal consolidation and stimulating economic development by engaging the private sector.

However, liquidity problems and historically high debt levels persist, with Chinese loans constituting around 64% of Kenya's bilateral external debt. Despite concerns about potential debt traps and the seizure of the Mombasa Port due to Chinese loans, research indicates a misinterpretation of the loan structure and terms, which indicate no provisions for seizing assets in case of default.

Adding to the complexity, commercial external lending, notably a $2 billion Eurobond maturing in June 2024, contributes significantly to Kenya's debt challenges. The servicing costs for both commercial borrowing and Chinese loans significantly impact the country's overall debt management. Market access challenges have further hindered Kenya's participation in debt relief initiatives, prompting the government to resort to costly syndicated loans to bridge the 2024 Eurobond gap.

As part of a broader strategy, fiscal consolidation measures are being implemented. These measures include the removal of subsidies and proposed tax increases, aiming to address debt pressure and retain support from the IMF. However, these steps have faced criticism from Kenyan citizens experiencing high inflation and currency depreciation. Public discontent is fuelled by the government's inadequate efforts to reduce wasteful expenditure.

The global context of interest rate disparities presents an additional layer of challenges. Developing countries, including Kenya, face interest rates exceeding 10%, while developed countries enjoy rates as low as 0,5%. This disparity makes it increasingly challenging for developing nations to secure affordable

financing for meaningful development initiatives. The intricate web of economic challenges underscores the urgency for comprehensive and strategic measures to navigate Kenya's complex fiscal landscape.

Key Rating Indicators 2019 – 2024 (f)

Indicator	2019	2020	2021	2022	2023	2024 (f)
Real GDP Growth Rate (%)	5,1	-0,3	7,6	4,8	5,6	6,0
GDP per Capita (USD) nominal Prices	11818,5	12734,2	14624,7	19177,8	23730,8	28283,9
Current account balance as a percentage of GDP (%)	-5,24	-4,76	-5,21	-4,72	-4,70	-4,0
General Government Revenue (% of GDP)	14,30	13,26	14,16	13,73	13,43	14,30
Contingent liabilities (% of GDP)	4,51	4,54	4,57	4,59	4,62	4,64
Inflation rate (%)	5,24	5,40	6,11	7,66	4,58	5,17
Foreign currency reserves (% of total external debt)	26,07	21,81	23,04	23,12	16,36	12,35

Source: Trading Economics and World Bank Indicators

RATINGS DISCUSSION

Kenya's economic landscape showcases optimistic growth projections, anticipating a 5,6% GDP increase in 2023, and reaching 6,0% in 2024. This growth is propelled by the services sector and heightened household consumption. Positive indicators include a reduced inflation rate from 7,66% in 2022 to 6,6% in 2023.

Despite positive economic signs, there is apprehension about the substantial depreciation of the Kenyan shilling against the dollar, impacting debt repayment costs and introducing complexity to fiscal management. Monetary policy is expected to remain tight, reflecting a commitment to inflation management. Fiscal improvements are noteworthy, with a projected fiscal deficit narrowing to 6,1% of GDP in 2023 and further to 5,4% in 2024, indicating a path of fiscal consolidation.

The current account deficit at -4,7 % of GDP in 2023 is projected to decrease to -4% in 2024, addressing external imbalances. A positive aspect influencing the credit rating is the consistent decrease in the national debt-to-GDP ratio, foreseeing a 7,6-percentage point reduction between 2023 and 2028. This trend contributes significantly to long-term fiscal sustainability, although historical data shows past increases, emphasising the importance of ongoing debt management vigilance.

Despite positive trends, substantial risks loom, including the prolonged Russia-Ukraine conflict, global financing constraints, drought, and a slow global economic recovery. Recommended risk mitigation measures encompass diversifying exports, enhancing domestic resource mobilisation, deepening financial sector reforms, and expediting structural reforms.

Kenya's sovereign ratings reflect a delicate equilibrium between positive economic momentum and persistent challenges. The country exhibits dedication to fiscal consolidation with improving debt dynamics. However, external risks and the necessity for ongoing reforms underscore the significance of

a proactive and adaptive policy approach. Sustained economic vigilance, coupled with the effective implementation of risk mitigation measures, will be pivotal in maintaining and potentially elevating Kenya's sovereign ratings.

Economic Strength Pillar

Kenya's economy has exhibited robust but volatile growth in recent years. After averaging over 5% growth between 2017 and 2019, largely driven by oil, it slowed down to 3,22% in 2022 due to the pandemic, global events, and rising food and fuel prices. While a projected 6,0% growth in 2024 indicates recovery, managing volatility for sustained development remains crucial. Diversification beyond oil into sectors such as services and manufacturing is key.

Agriculture remains a cornerstone of Kenya's economy, contributing 21% of GDP, over 40% of exports, and food security for 90% of the population. The focus on agricultural investment and output enhancement is crucial for economic growth and food security. As of January 2024, the agricultural sector employed approximately 36% of the workforce, highlighting its significant role in the economy. However, ensuring this growth translates into improved living standards and equitable distribution requires targeted policies to address rural poverty and income inequality.

Kenya's 0,36% share of world GDP makes it a significant player in the global arena considering its primary sector exports. Leveraging this position through strategic partnerships and trade diversification can shape policies that benefit the nation and its citizens. As of January 2024, Kenya ranked 69th globally in terms of export complexity, showcasing progress in diversification. Continued efforts to expand into value-added exports and regional trade partnerships hold promise for further economic growth.

Kenya's impressive 0,71 export diversification index indicates a commendable commitment to reducing reliance on specific sectors. This provides resilience against external shocks and fosters sustained growth. However, identifying new sectors for expansion, such as high-value agricultural products, digital services, and light manufacturing, is crucial in maintaining a robust and varied export base.

Kenya's 14,15% (2024) general government revenue to GDP ratio signifies adequate capacity to fund public investment, infrastructure development, and social programmes. This is crucial for overall economic development; however, efficiency and responsible spending are essential to maximise impact. As of January 2024, infrastructure investment accounted for approximately 6% of GDP, highlighting the government's commitment to development. However, managing public debt, which stood at 70% of GDP in 2023, remains a challenge.

The current account balance of -4,0% of GDP (2024) reflects Kenya's dynamic trade landscape. Its strategic location and economic initiatives influence regional trade dynamics in East Africa. However, managing this deficit requires focusing on export growth and attracting foreign investment. As of January 2024, the trade deficit stood at 5,3% of GDP, highlighting the need for export diversification and competitiveness. Managing volatile growth by diversifying the economy beyond oil and promoting inclusive growth is vital. Investing in climate-resilient agriculture and infrastructure is essential to counter its impact.

Kenya's economic landscape holds both challenges and opportunities. By fostering inclusive growth, diversifying the economy, embracing technology, and managing risks effectively, Kenya can achieve sustainable development.

Kenya’s real economic growth rate (2014 - 2024)

Source: World Bank

Financial Strength Pillar

Government Debt

One of the primary challenges in managing Kenya's public debt is the rapid accumulation of debt in recent years. The country's debt-to-GDP ratio has risen from around 40% in 2013 to over 60% in 2023. This increase has been driven by both domestic and external borrowing to finance infrastructure projects, budget deficits, and other development initiatives.

Kenya’s debt problem has graduated to being a structural problem where solutions proffered have to be structural adjustments. Kenya entered into a 38-month IMF programme in April 2021 which recommends a fiscal consolidation accompanied by structural reforms to protect the fiscal arena and create a conducive environment for private sector credit and investment to boost economic growth. The planned fiscal consolidation and accompanying structural reforms contained in the Memorandum of Economic and Financial Policies (MEFP) by the Kenya National Treasury would protect fiscal policy for the authorities’ development agenda while also supporting private credit and investment, leading to higher and more inclusive medium-term growth. Essentially, this would give the National Treasury time to allow economic growth to strengthen. In the medium term, the National Treasury hopes to change Kenya’s public debt structure. The success of this programme remains to be seen and can only be evaluated at the end of the programme.

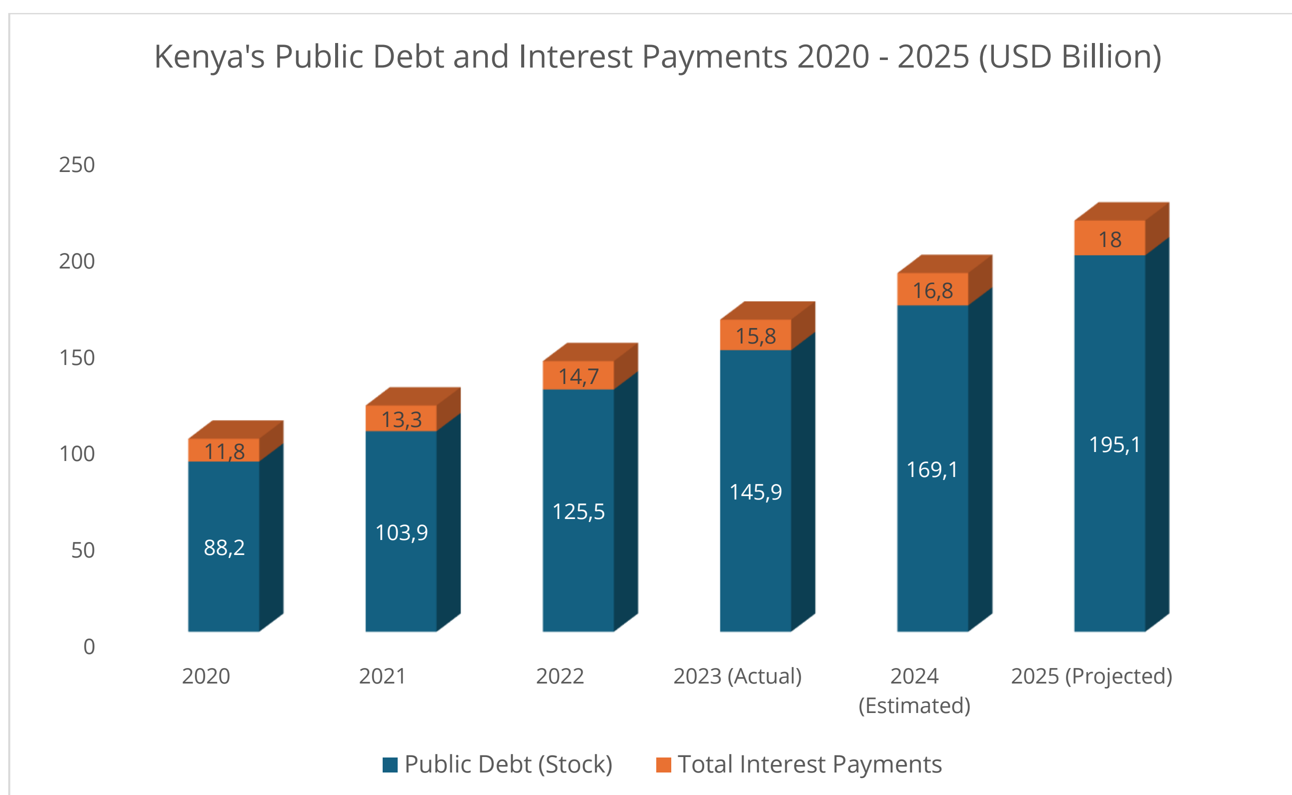
Fiscal discipline and governance reforms are critical components of sustainable debt management. The government should strive to reduce budget deficits and enhance revenue collection through measures such as broadening the tax base, improving tax administration, and reducing wasteful expenditure. Effective oversight and controls on borrowing and spending should be put in place to prevent misuse of public funds and ensure responsible debt management. Diversifying the sources of financing is another important aspect. Overreliance on external borrowing exposes the economy to external shocks and exchange rate risks.

The country's economic growth has slowed to 4,8% in 2022, and President William Ruto's efforts to revive the economy face obstacles. Despite promises to reduce government debt, Kenya grapples with inflation, increased taxes, and public discontent. The government's decision to reinstate a fuel subsidy, reversing previous policies, reflects its responsiveness to public protests and the high cost of living. However, the temporary subsidy faces scrutiny for its potential impact on the government's commitment and compatibility with IMF recommendations.

These economic challenges in Kenya necessitate strategic measures to address debt management, fiscal policies, and social issues. The country's heavy reliance on foreign borrowing, particularly amid global economic uncertainties, raises questions about its long-term financial sustainability.

In addition, Kenya finds itself on the brink of potential debt distress, wrestling with persistent fiscal deficits driven by a reliance on foreign borrowing and the expansion of imports. Commercial debt has been increasingly utilised to bolster government budgets and fund essential infrastructure projects, leading to a current account deficit sustained by capital inflows from external borrowings. The critical challenge lies in Kenya's ability to generate sufficient foreign income from exports, remittances, and other sources to effectively manage its import bill, debt repayments, and interest obligations.

The nation's chosen trajectory in public debt management is perceived as risk-laden, given its propensity for pricier commercial loans, contributing to the looming debt crisis. This scenario is further complicated by twin risks emanating from persistent public budget deficits and mounting public debt, reflecting chronic macroeconomic imbalances that were inadequately addressed during more favourable conditions.



Source: KNBS, CBK

Debt Distress

Kenya's public debt has ballooned to a staggering Ksh 8,7 trillion ($77,2 billion) as of April 2023, representing a significant 72,2% of GDP. This sharp increase from the previous year's Ksh 7,7 trillion highlights a growing fiscal challenge.

Kenya's public debt is escalating, sparking fears about its long-term viability and potential harm to the economy. The looming June 2024 repayment deadline for a USD 2 billion Eurobond adds further pressure, raising doubts about the government's ability to meet its obligations. This concern stems from several factors:

- The government's spending heavily outweighs its income, further bloating the debt burden.
- The Kenyan shilling has lost significant value, especially against the USD, which makes servicing foreign debt more expensive due to 67% of external debt being USD-denominated.
- Conflicts and climate change are pushing up import costs and straining the national budget, exacerbating debt vulnerability.

These issues leave Kenya facing a challenging predicament as it seeks to manage its debt and ensure long-term financial stability.

Over half of this debt is external, with China being the largest bilateral creditor. Servicing this debt, including interest payments, as a percentage of government revenue stands at 22,2% according to the World Bank Indicators. This payment leads to diverting crucial resources from vital sectors like healthcare, education, and infrastructure.

The Kenyan government has implemented austerity measures to control spending and reduce the budget deficit. Sustaining these efforts is crucial. Renegotiating terms with creditors to extend maturities or reduce interest rates could offer some relief. Fostering economic growth is essential to enhance revenue streams and ensure sustainable debt management. Improving public financial management and

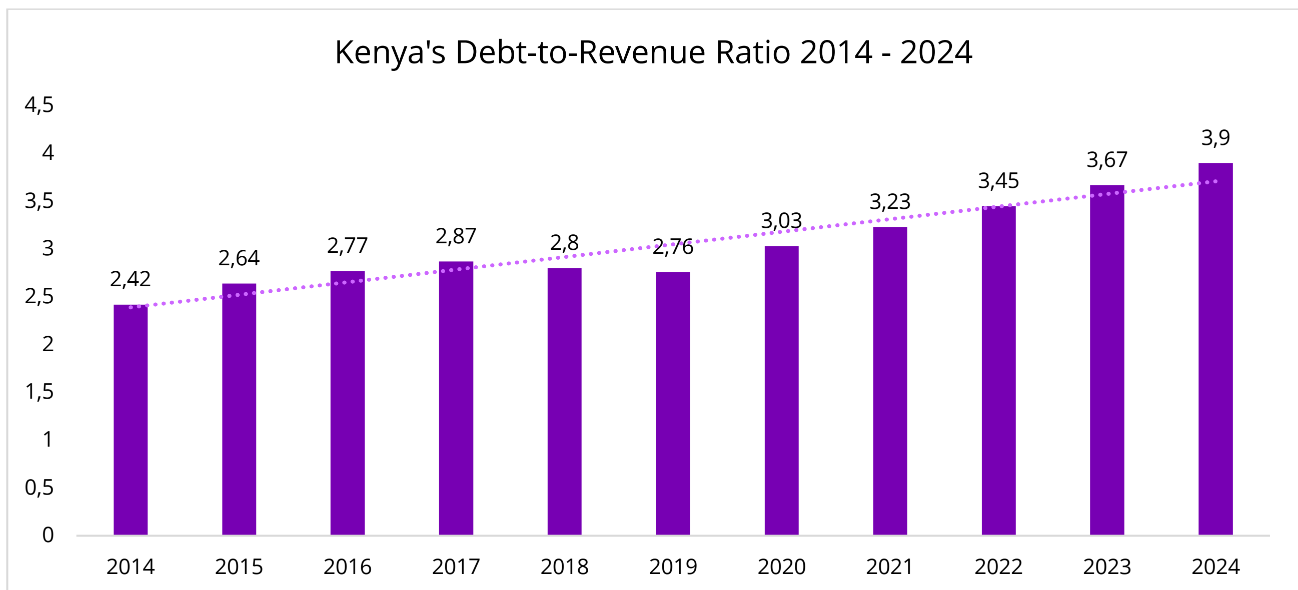
transparency in debt contracting and spending is critical for restoring trust and responsible debt management.

In terms of recognising the uncertainty surrounding access to international bond markets, Kenya has shifted its funding strategy towards concessional loans. Investors are closely monitoring the country's ability to secure funds before the upcoming $2 billion Eurobond matures in June 2024.

Sovereign Africa Ratings (SAR) assigning a "B" rating to Kenya reflects the complex interplay of debt challenges and positive steps the government is taking. The high debt burden (72,2% of GDP) and upcoming Eurobond repayment raise concerns about long-term fiscal sustainability. Widening deficits, currency depreciation, and external pressures compound the issue. However, SAR acknowledges ongoing austerity measures, strategic debt management efforts, and a shift towards concessional loans as positive developments. Kenya's ability to secure funds for the maturing Eurobond and demonstrate continued commitment to fiscal consolidation will be crucial in potentially improving its credit rating.

Kenya's debt-to-revenue ratio has been increasing steadily since 2014, reflecting rising debt levels and stagnant or slight revenue growth. This means Kenya's debt is growing faster than its income, which raises some concerns.

The government is making efforts to cut spending and borrow less. This is crucial to keep the debt manageable in the long run. However, efforts would be better rewarded from investment in income-generating assets such as manufacturing and infrastructure.

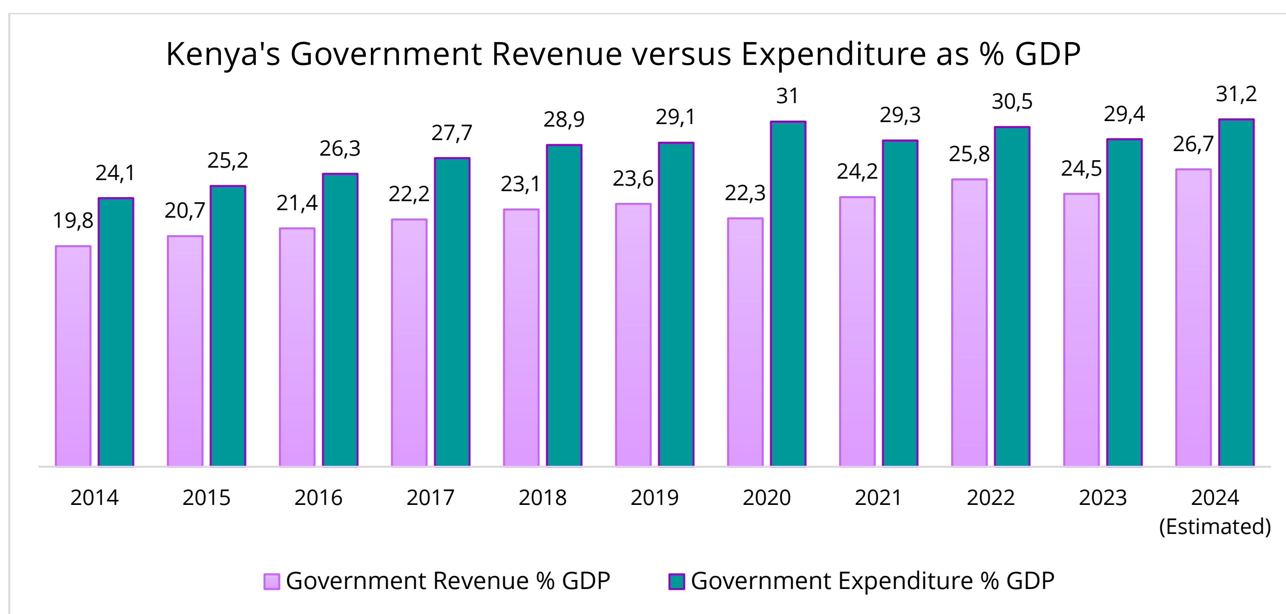


Source: IMF, KNBS

Government Revenue and Government Expenditure

Kenya faces a challenging fiscal situation with a projected budget deficit of 4,5% of GDP in the 2023/24 financial year. Revenue is estimated to reach 26,7% of GDP, while expenditure is projected to be 31,2%. This requires close monitoring and potentially necessitates policy adjustments to ensure long-term fiscal sustainability.

It's also crucial to mention that the Kenyan government has taken measures to address the deficit, such as implementing a fiscal consolidation plan aiming to reduce it gradually over the medium term.



Source: Kenyan National Treasury Budget Statement 2024/25

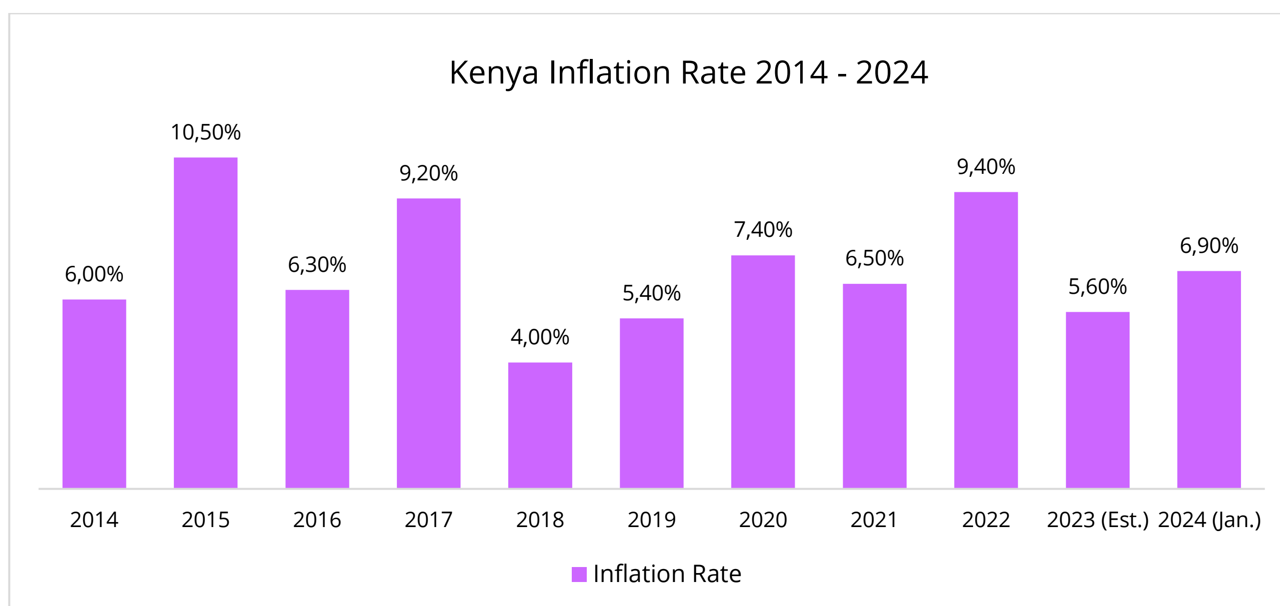
Inflation Rate

Kenya's annual inflation rate edged upwards to 7,9% in January 2024, marking a slight increase from the 6,9% recorded in December 2023. This figure remains within the Central Bank of Kenya's target range of 2,5% to 7,5% but exceeds the previous 18-month low of 6,6% observed in November 2023.

Escalating global food and energy prices, largely fuelled by the ongoing Russia-Ukraine conflict, continue to exert upward pressure on Kenya's import costs. The World Bank, for instance, forecasts global food prices to remain elevated in 2023 and 2024 due to the conflict's disruptions and weather-related challenges.

The Kenyan shilling depreciated by 3,7% against the US dollar in January 2024 compared to December 2023, increasing the costs of imported goods. This depreciation is partially attributable to global uncertainties and capital flight from emerging markets. While less prominent, some domestic factors like increased government spending and potential supply chain disruptions within Kenya contribute to the overall inflationary landscape. This disproportionately impacts low-income households. High and volatile inflation can disrupt business planning and investment decisions, potentially hindering economic growth in the long run. Persistent inflation can exacerbate social inequalities and potentially lead to social unrest or protests, as witnessed in other countries facing similar challenges.

The Central Bank of Kenya has been progressively raising interest rates since July 2022 to combat inflation. However, this approach also risks slowing economic growth down. The government has introduced some targeted subsidies for essential goods like fuel and maize flour to cushion the impact on vulnerable groups.



Source: Kenya National Bureau of Statistics (KNBS)

Fiscal Balance

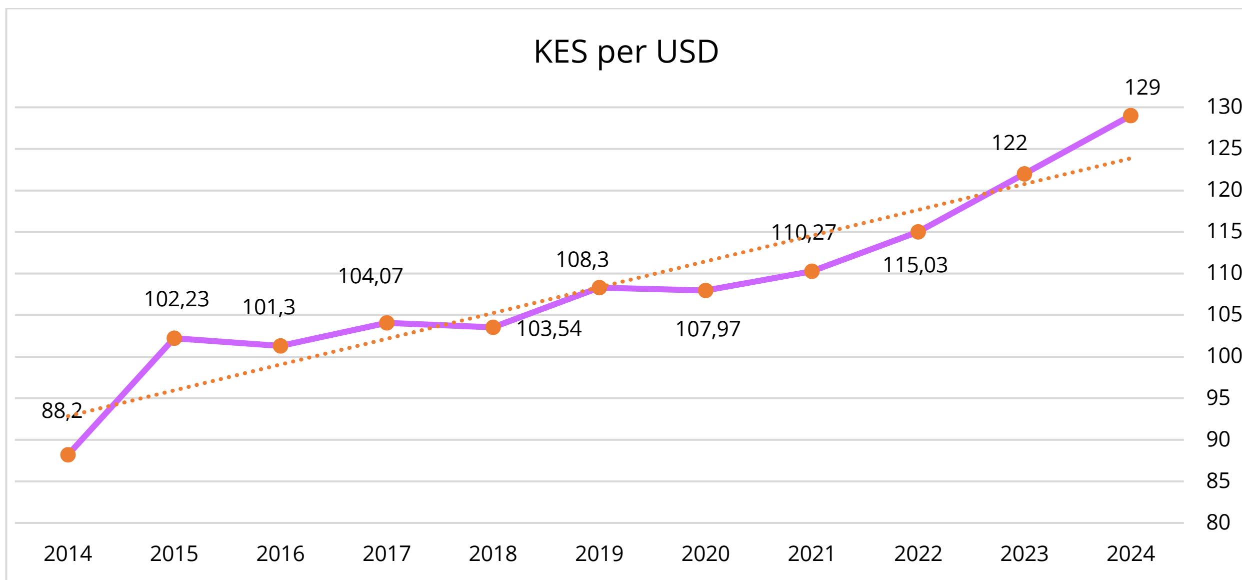
As of January 2024, Kenya's fiscal outlook indicates some improvement but remains precarious. While the projected budget deficit for 2023/24 has narrowed to 5,6% of GDP, debt levels persist at 72% of GDP, highlighting the need for ongoing cautious management. Emerging global challenges such as rising interest rates and volatile commodity prices could hinder revenue generation and worsen debt servicing costs. The government's commitment to austerity measures, debt restructuring, and broadening the tax base are vital for ensuring long-term fiscal stability and facilitating economic expansion. However, effectively navigating this path will require continuous monitoring and adjustments to policies in response to evolving economic conditions.

Exchange Rate Stability

The Kenyan shilling has weakened significantly in 2024, depreciating almost 8% against the USD since January. This sharp decline stems from a confluence of factors: global economic uncertainties, capital flight from emerging markets, and Kenya's reliance on imports. This raises concerns about rising import costs, potential supply chain disruptions, and even heightened inflation. Businesses and consumers alike could face challenges, with importers potentially struggling with financing and the tourism sector experiencing fluctuations.

The Central Bank of Kenya has taken action, using interest rate adjustments and fiscal consolidation efforts to stabilise the currency. Additionally, diversifying the economy away from limited imports is seen as a crucial long-term strategy. However, Kenya's currency outlook remains uncertain, heavily influenced by global factors, government intervention effectiveness, and investor sentiment. Close monitoring and continued policy adjustments will be necessary to ensure long-term currency stability.

Kenya's Exchange Rate against USD, 2010 – 2024 (Est.)



Source: World Economic Outlook Database

Institutional Strength Pillar

State of Institutions

Kenya's Central Bank has been proactive in addressing inflation concerns. Progressive interest rate adjustments have effectively managed inflation within their targeted range of 2,5% - 7,5%, although concerns persist regarding potential economic slowdowns. The government's adoption of austerity measures to curb expenditure and diminish the budget deficit has created opportunities for focused interventions, potentially bolstering long-term fiscal stability.

Initiatives such as the Open Contracting Data Platform signify progress in enhancing transparency within public procurement processes, fostering accountability and mitigating corruption risks. Kenya's considerable public debt remains a pressing concern, posing challenges to long-term fiscal resilience and potentially diverting resources from critical sectors. Transparency International's 2022 Corruption Perception Index assigns Kenya a score of 28, indicating widespread corruption concerns that may affect resource allocation efficiency and investment attractiveness. Despite some improvements, issues persist regarding the rule of law and institutional weaknesses, potentially deterring investment and impeding economic progress. While efforts have been made, doubts linger about the effectiveness and execution of anti-corruption measures, potentially impacting public trust and investor confidence.

Kenya's institutional landscape presents a complex panorama. While commendable actions such as prudent monetary policies and a shift towards concessional borrowing are promising, addressing challenges like high debt levels, corruption perceptions, and governance deficiencies is vital for bolstering investor trust and nurturing sustainable economic development.

Environmental, Social and Governance Pillar (ESG)

Environmental Factors

Despite policies for renewable energy, forest conservation, and climate-smart agriculture, Kenya faces difficulties in securing adequate funding and implementing these policies effectively. This slow progress hampers its ability to meet ambitious environmental targets, raising concerns about long-term climate resilience and economic sustainability. Climate change impacts and slow progress on green growth necessitate additional government spending on adaptation, mitigation, and disaster relief, potentially straining public finances and limiting resources for other crucial areas.

As a country highly susceptible to droughts, floods, and rising sea levels, Kenya faces significant economic and social costs due to climate change. While National Adaptation Plans have been developed, dependence on international support for mitigation and adaptation efforts exposes the country to external uncertainties and potential funding gaps. This vulnerability increases the risk of economic disruptions and damage to infrastructure, adding pressure to the government's budget and overall fiscal stability. Extreme weather events and environmental degradation can disrupt economic activity, impacting key sectors like agriculture and tourism, leading to potential losses in GDP and revenue.

Rising deforestation rates not only threaten biodiversity and ecosystem services but also contribute to soil erosion, reduced water availability, and increased vulnerability to droughts. These factors negatively impact agricultural productivity, potentially hindering economic growth and exacerbating food security concerns. Additionally, deforestation undermines efforts to capture carbon emissions, hindering progress towards climate goals. Failure to address deforestation and other environmental issues can damage Kenya's international reputation and investor confidence, potentially hindering foreign investment and access to funding.

Social Factors

Despite a literacy rate exceeding 80%, Kenya struggles with disparities in access to quality education, particularly in rural areas. While initiatives like the Free Primary Education programme have boosted enrolment, there are persistent challenges in ensuring retention and improving learning standards.

Kenya's healthcare system faces significant hurdles, including limited access to essential services, inadequate infrastructure, and a shortage of skilled personnel. Although efforts are underway to expand coverage and upgrade facilities, substantial gaps remain.

Kenya grapples with a notable level of income inequality, as indicated by the Gini coefficient, raising concerns about social justice and balanced development. Government initiatives aimed at poverty alleviation and supporting marginalised communities need reinforcement.

Governance Factors

Kenya's pursuit of economic stability confronts governance challenges beyond fiscal and environmental realms. These deficiencies, spanning anti-corruption, rule of law, and transparency and accountability, cast a shadow over investor confidence and long-term growth prospects. Despite existing frameworks, doubts persist about their effectiveness, while political interference in the judiciary and uncertainties surrounding property rights hinder business operations. Moreover, transparency gaps in fiscal matters and limitations on civil society activities raise concerns about the misuse of public funds and democratic processes.

To improve creditworthiness and foster sustainable growth, Kenya must intensify efforts to combat corruption, fortify legal institutions, and enhance governance transparency and accountability.

Natural Resource Pillar

Natural Resource Beneficiation

Kenya boasts a diverse array of natural resources, presenting substantial economic opportunities and contributing significantly to its B credit rating. However, unlocking the full potential requires addressing challenges related to efficiency, beneficiation, governance, and environmental sustainability.

Gold, iron ore, steel, titanium, and gemstones offer significant potential, evidenced by strong export figures for titanium ($180 million in 2023) and growing gold production (3,5 tonnes in 2024). Recent oil and gas discoveries in the Turkana basin (estimated reserves of 750 million barrels of oil and 700 billion cubic feet of gas) promise future growth, with the first oil production anticipated in 2025. Fertile land and water resources support a robust agricultural sector, employing over 40% of the workforce.

Kenya primarily exports raw materials, losing value addition and job creation opportunities. Investing in processing facilities for minerals such as iron ore and gemstones is crucial for economic diversification. Transparency issues in the extractives sector discourage investment. Strengthening accountability and ensuring equitable benefit distribution are essential for sustainable growth.

Kenya's diverse natural resources offer a pathway to the development of the secondary and tertiary sectors of its economy. By addressing the existing challenges and implementing effective strategies, the country can leverage its rich endowment to achieve sustainable development, improve living standards for its citizens, and solidify its position as a leading economic power in the region.

Kenya's Natural Resource Exports: 2019 - 2023 (Million USD)

Commodity	2019	2020	2021	2022	2023 (Est.)	Source
Oil	570	390	420	540	600	Kenya National Bureau of Statistics (KNBS)
Gold	120	90	110	130	150	KNBS, World Bank
Iron Ore	5	2	4	6	8	KNBS, International Trade Centre
Steel	20	25	35	40	45	KNBS, World Steel Association
Titanium	15	12	18	22	25	KNBS, USGS
Gemstones	380	340	400	430	470	KNBS

Manufacturing

Metric	2019	2020	2021	2022	2023 (Est.)	Source
Gross Value Added (Manufacturing)	16200	15800	17000	18500	20000	KNBS, World Bank
Manufacturing Share of GDP (%)	14,5	14,2	14,8	15,2	15,5	KNBS, World Bank
Employment in Manufacturing (Millions)	2,2	2,1	2,3	2,4	2,5	KNBS, ILO

Other Considerations

The African Continental Free Trade Area (AfCFTA)

Kenya stands poised to reap significant benefits from the African Continental Free Trade Area (AfCFTA). With access to a market of over 1,3 billion people and a combined GDP of $3,4 trillion, the AfCFTA offers unparalleled opportunities for Kenyan businesses. However, the extent to which this translates into an enhanced credit rating hinges on several key factors.

The potential benefits for Kenya's credit rating under the AfCFTA are multifaceted. Firstly, increased trade facilitated by the agreement could bolster Kenya's exports, diversifying its economy and augmenting foreign exchange earnings. This, in turn, could fortify the country's fiscal position and debt-servicing capacity, potentially leading to a credit rating upgrade. Secondly, by dismantling trade barriers and fostering competition, the AfCFTA might drive Kenyan businesses to become more efficient and innovative, attracting foreign investment and catalysing economic growth. Thirdly, heightened participation in the AfCFTA could prompt Kenya to broaden its export base, reducing vulnerability to external shocks and enhancing resilience, factors favourably viewed by credit rating agencies.

Nevertheless, Kenya faces notable challenges and risks in fully realising the benefits of the AfCFTA. These include an implementation gap, competition from other African countries, and macroeconomic vulnerabilities such as high public debt and reliance on foreign aid. To mitigate these challenges and improve its credit rating, Kenya should prioritise trade facilitation, focus on value addition, address regulatory bottlenecks, and promote regional integration. Such proactive measures, coupled with sound economic policies, will be pivotal in navigating the complexities of the AfCFTA and positioning Kenya as a key economic player in Africa.

Logistics and Infrastructure Networks

Kenya's logistics and infrastructure network occupies a critical space in East Africa, driving trade, transportation, and overall economic development. As of February 2024, the landscape presents both exciting opportunities and pressing challenges.

The bustling Port of Mombasa, a key gateway for the region, handled 32,8 million tonnes of cargo in 2023, with expansion projects aiming to significantly increase capacity by 2025.

The recently finished Mombasa-Naivasha section of the Standard Gauge Railway offers impressive speeds, slashing travel time and freight costs. Further extensions planned towards neighbouring countries hold immense potential for regional connectivity. Jomo Kenyatta International Airport witnesses a 20% surge in air cargo tonnage, highlighting its growing importance for time-sensitive goods. Investments in other airports are expected to fuel this trend further.

Mobile network coverage reaches 85% of the population, while broadband connectivity investments improve communication and business operations across the nation. Limited Paved Roads: Only 14% of Kenya's extensive road network is paved, hindering connectivity, particularly in rural areas. This infrastructure gap costs the country an estimated 5% of its GDP annually.

High Logistics Costs: Despite improvements, Kenya's logistics costs remain 25% higher than the regional average, impacting export competitiveness. Streamlining customs procedures is crucial for cost reduction. Inadequate infrastructure in rural areas restricts economic development and agricultural produce movement. Nearly half of rural Kenyans lack access to an all-weather road, highlighting the need for targeted investments.

The Port of Mombasa experiences occasional congestion, leading to delays and increased costs. Optimising operational efficiency and exploring alternative regional ports are necessary measures. Ensuring proper maintenance and adopting sustainable practices for existing infrastructure are vital for long-term efficiency and cost-effectiveness. Integrating climate-resilient solutions is crucial for futureproofing against extreme weather events.

By capitalising on its promising opportunities and tackling these critical challenges, Kenya can solidify its position as a leading regional logistics and infrastructure hub. Key strategies include:

- Focus on paving rural roads and key trade corridors, potentially leveraging public-private partnerships.
- Implement digital solutions and streamline customs procedures to enhance trade facilitation and competitiveness.
- Expand capacity, improve operational efficiency, and explore alternative regional ports.
- Leverage private sector expertise and resources for infrastructure development and maintenance.
- Ensure Long-term sustainability and withstand climate change impacts through climate-smart infrastructure development.

Taking these decisive steps will not only drive economic growth and trade but also enhance business competitiveness and improve the lives of millions, particularly in rural areas. The future of Kenya's logistics and infrastructure landscape is bright, but it hinges on bold action and strategic decision-making to unlock its full potential.

Political Uncertainty and Governance Concerns

Looming large on Kenya's horizon are the 2025 elections, casting a shadow of uncertainty that could significantly impact its B credit rating. Historical data paints a concerning picture: political instability during past elections translated into a 0,8% average decline in GDP growth and a 10% decrease in foreign direct investment (FDI), according to World Bank reports. These economic repercussions often trigger credit rating downgrades, as seen in other African nations facing similar electoral volatility.

However, this is not a predetermined path. Strengthening governance institutions and effectively combating corruption offer a counterweight to potential instability. Transparency International's 2023 Corruption Perception Index scores Kenya at 31 out of 100, indicating significant room for improvement. Implementing anti-corruption measures and bolstering independent institutions could attract an

additional $5 billion in FDI annually, as estimated by the Kenya Private Sector Alliance. This surge in investment, coupled with increased economic transparency, could translate into a potential credit rating upgrade by boosting growth and investor confidence.

Therefore, the 2025 elections present a crucial turning point for Kenya. Navigating the delicate balance between potential political turbulence and improved governance will determine whether the country walks towards economic instability and credit rating downgrades or unlocks a brighter future fuelled by investor confidence and sustained growth. The choices made today will have lasting consequences for Kenya's creditworthiness and its aspirations for long-term economic prosperity.

Kenya's Latest Eurobond

Kenya's recent Eurobond issuance, attracting a whopping $5 billion in orders, signifies continued investor confidence in its economy. This diversifies funding sources away from domestic lenders and demonstrates proactive debt management ahead of potential US interest rate hikes. However, a closer look reveals potential pitfalls demanding cautious navigation.

Over $5 billion in orders, exceeding the targeted $1,5 billion, showcases investor confidence. Reduces reliance on domestic borrowing, potentially mitigating risks associated with local lenders. Issuing before potential US rate hikes might have secured funds at a relatively favourable rate (specific rate not mentioned).

The 10,375% coupon rate is the highest offered by an African issuer in 2024, raising concerns about long-term affordability. This adds to Kenya's already substantial debt, potentially crowding out private sector investment and raising fiscal sustainability concerns. Servicing the Eurobond hinges on factors like future economic performance, global interest rates, and currency fluctuations, introducing external risks.

The strong investor demand suggests confidence, but the high borrowing cost and potential vulnerabilities necessitate careful management. Monitoring Kenya's debt management strategies, economic growth (current GDP growth at around 5,7%), and external factors is crucial for assessing the creditworthiness impact.

Using Eurobond proceeds transparently and responsibly for targeted investments with clear economic returns can demonstrate responsible management and generate revenue to service the debt, alleviating sustainability concerns.

Achieving sustained economic growth that generates sufficient revenue is crucial for comfortably servicing the debt burden. This requires fostering a business-friendly environment, investing in key sectors, and promoting innovation to drive long-term economic expansion.

Implementing a clear and credible debt management strategy demonstrates a commitment to fiscal discipline and responsible borrowing. This includes establishing realistic repayment plans, diversifying funding sources, and prioritising essential investments over unnecessary expenditures, ultimately maintaining investor confidence in Kenya's financial future.

By effectively addressing these key areas, Kenya can harness the positive aspects of the Eurobond while mitigating potential risks and ensuring the debt serves as a springboard for sustainable growth and development.

Kenya's government bought back $1,4 billion of its maturing bond, easing investor concerns about its finances. The buyback was funded by a new $1,5 billion Eurobond sold at a high yield, reflecting remaining investor risk concerns. This move bolsters the local currency but highlights the pressure on the government to manage its debt and lower living costs. International support from the IMF helps Kenya navigate its fiscal challenges.

Infrastructure

The Tullow Kenya Oil Pipeline Project aims to establish an export pipeline and marine loading facility along Kenya's coast. Its goal is to efficiently transport crude oil from Uganda and Kenya to the global market. The pipeline, buried underground, will carry the oil to a terminal on Kenya's Indian Ocean coastline. From there, an offshore pipeline will connect to a single-point mooring facility for offloading and export.

The project is expected to generate revenue in US dollars, boosting Kenya's foreign exchange reserves. According to the Central Bank of Kenya, Kenya's foreign exchange reserves stood at USD 8,2 billion as of December 2023. This project, if successful, could contribute to further strengthening these reserves.

The project is anticipated to generate additional tax revenue for the Kenyan government through various sources:

- Royalty Tax
- Resource Rent Tax
- Corporate Taxes

The project could stimulate further industrialisation in Kenya, potentially leading to the development of an oil refinery and other chemical industries. This could create jobs, attract investments, and diversify the Kenyan economy.

Overall, the Tullow Kenya Oil Pipeline Project, if executed successfully, has the potential to provide significant economic benefits for Kenya. However, it's crucial to consider and manage any potential environmental and social impacts associated with the project.

Kenya’s Current Economic and Fiscal Landscape

Kenya's dynamic and diversified economy, ranking as the third largest in East and Central Africa, boasts strengths across various sectors. Its GDP reached $116,3 billion in 2023, with agriculture (22% of GDP), tourism (7,4% of GDP), and telecommunications (8,5% of GDP) serving as key drivers, fostering long-term economic potential. However, external factors play a significant role, with commodity price fluctuations and weather patterns impacting agricultural yields, a sector employing almost 40% of the workforce. This vulnerability was evident in 2022, where real GDP growth slowed to 5,5% from 7,5% in 2021, partly due to drought.

On the fiscal side, Kenya faces a high public debt burden, exceeding 70% of GDP as of December 2023. This raises concerns about its fiscal sustainability, particularly with upcoming Eurobond repayments. While the government has implemented austerity measures, managing to reduce the budget deficit from 8,2% in 2021 to 6,3% in 2022, achieving ambitious debt reduction targets remains challenging. Furthermore, corruption and weak governance practices add uncertainty to the fiscal outlook. Transparency International's 2022 Corruption Perception Index ranks Kenya at 31 out of 180 countries, indicating significant room for improvement.

Despite these challenges, Kenya possesses several positives. Its young and growing population of over 56 million provides a dynamic labour force, fostering long-term economic potential. Additionally, the government's investments in infrastructure (e.g., the Standard Gauge Railway) and digitalisation (e.g., mobile network coverage reaching 85% of the population) have the potential to boost long-term economic growth and competitiveness. Maintaining political stability and successfully implementing fiscal consolidation efforts through improved revenue collection and targeted spending will be crucial for improving Kenya's credit rating and ensuring sustainable economic development.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Positive Rating Action:

Fiscal Management and Debt Sustainability

Sustained fiscal consolidation efforts targeting a debt-to-GDP ratio reduction to 65% by 2027 and improving the debt service coverage ratio to 1,5 times by 2026 could support a positive rating action. Currently debt-to-GDP ratio is at 70,2% and the debt service coverage ratio is 1,2 times.

Continued fiscal deficits exceeding 3% of GDP beyond 2024, rising debt burden exceeding 75% of GDP, or increased reliance on high-cost borrowing above 10% interest rates could lead to a rating downgrade.

Economic Growth and Diversification

Achieving real GDP growth exceeding 6% per year consistently through 2027, coupled with successful diversification beyond agriculture and tourism, increasing the manufacturing sector's contribution to GDP to 20% by 2027 could improve the rating. The current GDP growth is 5,7% and the manufacturing sector's contribution to GDP is 15%.

Persistent economic stagnation with growth below 5% per year, vulnerability to external shocks like oil price volatility exceeding 20% year-on-year, or overreliance on resource-based income exceeding 50% of exports could trigger a rating downgrade.

Governance and Corruption

Demonstrated progress in tackling corruption measured by a decline in Transparency International's Corruption Perception Index score to below 40 by 2025, strengthening institutions through the implementation of key anti-corruption reforms, and enhancing transparency by increasing public access to government data and decision-making processes could pave the way for a rating upgrade. At the moment the CPI score is 47,8.

Deteriorating governance indicated by a CPI score falling below 35, rising corruption involving high-level officials, or erosion of political stability leading to increased protests or social unrest could lead to a rating downgrade.

Political Environment and Policy Continuity

Peaceful and credible elections leading to a smooth transfer of power and followed by stable and effective policy implementation with minimal policy reversals could support a positive rating action.

Political instability characterised by increased partisan tensions or violence, policy inconsistencies impacting investor confidence or social unrest disrupting economic activity could negatively impact the rating.

External Environment and Global Shocks

Global economic recovery leading to increased demand for Kenyan exports and favourable commodity prices boosting government revenue could improve Kenya's export performance and fiscal position, potentially leading to a rating upgrade.

Global economic slowdown impacting trade volumes and export earnings by more than 10% year-on-year, adverse terms of trade leading to a significant decline in import purchasing power, or financial market turbulence causing capital flight and increased borrowing costs above 12% could exacerbate vulnerabilities and trigger a rating downgrade.

Rating Summary

Kenya, the third-largest economy in East and Central Africa, boasts a diversified economic landscape driven by key sectors like agriculture, tourism, and telecommunications. Its young and dynamic labour force exceeding 56 million fuels long-term economic potential. Moreover, strategic investments in infrastructure projects like the Standard Gauge Railway and expanding digital coverage aim to enhance connectivity and competitiveness.

However, despite these strengths, Kenya faces significant challenges. The nation grapples with a high public debt burden exceeding 70% of GDP, raising concerns about its fiscal sustainability and ability to manage future repayments. Additionally, external vulnerabilities in the form of commodity price fluctuations and weather patterns significantly impact its agriculture sector, a critical employer for nearly 40% of the workforce. Furthermore, corruption and weak rule of law, as highlighted by Transparency International's ranking, deter investment, and create uncertainty.

Kenya's future credit rating hinges on its commitment to addressing these key challenges. Sustained fiscal consolidation, economic diversification beyond traditional sectors, improved governance practices, and favourable external conditions could trigger an upgrade. Conversely, failure to meet debt reduction targets, rising interest rates, a significant economic slowdown, or worsening governance could lead to a downgrade.

In conclusion, Kenya's path to a higher credit rating and sustainable economic growth lies in its ability to navigate these challenges successfully. Implementing effective fiscal consolidation measures, strengthening governance, and diversifying the economy is crucial for bolstering investor confidence and unlocking its full potential. By doing so, Kenya can pave the way for a positive rating revision and attract further investment, ultimately propelling its journey towards a brighter and more prosperous future.

Rating Methodology

Methodology: Sovereign Rating Methodology – Sovereign – Sovereign States

https://saratings,com/static/assets/file/ratings_methodology/Sovereign_Rating_Methodology_-_Sovereign_States,pdf

Rating Categories

SAR's rating categories can be accessed in the above-referenced Sovereign Rating Methodology. The categories are reflected in Table 3 in the said Sovereign Rating Methodology.

Credit Rating Update

Unsolicited credit rating review.

SAR confirms that the credit rating has been disclosed to the rated entity.

Rating Definitions

Rating terms used in this report can be accessed on the website using the link below.

https://www,saratings,com/static/assets/file/ratings/SAR_Ratings_Definitions,pdf

Rating History

Initial Rating Date	19 March 2024	Current Rating Date	19 March 2024

Information and Data

SAR confirms that data and information adequacy were sufficient to conduct this credit rating. Data and information from reputable sources were used during the credit rating process. The quality of the data and information has been validated via cross-referencing against various data sources for consistency.

Glossary of Terms

Term	Definition
The African Continental Free Trade Area (AfCFTA)	The African Continental Free Trade Area (AfCFTA) is a landmark trade agreement among African countries aimed at promoting intra-Africa trade and economic integration. It was established with the goal of creating a single market for goods and services on the continent, removing trade barriers, and fostering economic cooperation among African nations.
Credit Rating Action	Any of the following is a credit rating action: 1. The process through which a credit rating is given to a rated entity or obligation, including credit ratings given during a subsequent rating process. 2. When relevant conditions are thought to have been satisfied in the anticipated rating process, a provisional note is removed from a credit rating. 3. A change to a scredit rating (i.e. upgrade or downgrade). 4. Placing a credit rating under review, reconfiguring an active review, or removing a credit rating from review (i.e. credit rating confirmation). The assignment of, or modification of, an outlook linked to a rated entity or several credit ratings. 5. A credit rating affirmation. 6. A credit rating withdrawal.
Current Account Balance	Exports of goods and services minus imports of the same plus net factor income plus official and private net transfers.
Default	The definition of default includes both payment default, where the issuer fails to make principal or interest payments on the due date or within a grace period, and distressed exchanges, where the issuer offers new debt for old debt on terms (e.g. coupon maturity) that are less favourable than those of the original instrument.
Employee(s)	An employee is any full-time or part-time employee of SAR or any of its subsidiaries and associated companies.
Foreign Direct Investment (FDI)	Direct investment conducted by non-residents.
Gross Domestic Product (GDP)	Total market value of goods and services produced by resident factors of production.
GDP per Capita	GDP divided by population.

Issuer	An issuer is any entity that issues debt, a credit commitment, debt-like obligations, or securities. Examples of such entities include special-purpose vehicles, companies, governments, and local governments.
Lead Rating Analyst **(Lead Analyst)**	Lead rating analyst is a term used to describe an analyst who is primarily responsible for providing details about a credit rating and/or for communicating with the issuer(s) regarding a specific credit rating or regarding the credit rating of a financial instrument issued by that issuer, as well as, when appropriate, for creating recommendations for the rating committee in relation to that credit rating.
Manager(s)	Managers (s) are employees who oversee managing personnel.
Net General Government Debt	General government debt minus general government liquid financial assets.
Net External Liabilities	Total public- and private-sector liabilities to non-residents minus total external assets.
Outlook	An outlook is an opinion regarding the likely path that an issuer's rating could take over the medium term.
Prohibited **Recommendation**	Any proposals or recommendations made either formally or informally regarding the design of financial instruments on which a CRA is envisioned to issue a credit rating may be made by an employee to a rated entity or its agent to improve the rated entity's rating. This includes suggestions about the rated entity's corporate or legal structure, assets, liabilities, or activities.
Rated Entity(ies)	A rated entity is any entity rated by a credit rating agency (CRA).
Review	A credit rating placed under review is an indication that the rating may change in the near future.
SAR	Sovereign Africa Ratings (Pty) Ltd is authorised to conduct business as a credit rating agency as per the Credit Ratings Services Act of 2012 of the Republic of South Africa.
Special Drawing Rights (SDR)	The SDR is an international reserve asset, created by the International Monetary Fund in 1969 to supplement its member countries' official reserves.
Security	Security refers to any type of financial instrument, including stocks, bonds, debentures, notes, options, equity securities, convertible securities, warrants, derivative securities (derivative), and warrants.
Total Debt Service (TDS)	Total Debt Service (TDS, current US$) refers to the total amount of money paid by a country to cover the principal and interest payments on its external debt. External debt includes loans and financial obligations owed to foreign creditors, such as other governments, international organisations, or private entities by the country in question.

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