KIPPRA
The KENYA INSTITUTE for PUBLIC POLICY RESEARCH and ANALYSIS

Policy Brief

No. 31/2023-2024

Thinking Policy Together

Public Debt in Kenya: Trends and Sustainability

Daniel Omanyo and Lamech Nyamari

Key Highlights

This Policy Brief focuses on the public debt trends while providing policy options on debt sustainability. The key highlights include:

(i) Public debt stock was Ksh 10.3 trillion–70.8 per cent of GDP–as of June 2023 compared to Ksh 1.1 trillion–50.9 per cent of GDP–in June 2010.

(ii) Debt mix has shifted over time. In June 2010, the public debt mix was 53.9:46.1 domestic debt to external debt compared to 49.9: 50.1 in June 2022. Moreover, commercial external debt accounted for 3.7 per cent of the total external debt in 2010, increasing to 26.4 per cent in June 2023.

(iii) Total debt service cost for 2022/23 was Ksh 1.2 trillion, compared to Ksh 80.9 billion in 2009/10. Domestic debt service remained the highest, representing 66.5 per cent of the total debt service in 2022/23.

(iv) Interest payments carried the bulk of debt servicing cost at 57.4 per cent in 2022/23 compared to 78.5 per cent in 2009/10, with the rest accounting for repayment of the principal. Over the analysis period, domestic debt interest payments accounted for an average of 52.1 per cent of the total debt servicing costs.

(v) Public debt is sustainable, with the debt carrying capacity ranked as medium. However, risks of external debt distress remain high and need to be tackled through fiscal consolidation.

Introduction

Before 2013/14, public debt was on a declining trajectory. However, the intensified spending on public infrastructure, implementation of the devolved system of governance, persistent fiscal deficits, and multiple economic shocks have greatly compounded the debt situation in the country. Consequently, the stock of public debt and its sustainability remains a fundamental public policy concern, not only to the government but also to the private sector and the entire citizenry. This is because of rapidly increasing debt accumulation post-2010 and the increasing debt service. In addition, the increasing commercial component of external debt and bilateral debt and the dominance of US dollar-based loans observed recently have intensified public concerns about the risk exposure of public debt.

The country is rated as a medium performer in terms of Debt Carrying Capacity (DCC) with a high risk of debt distress (Medium Term Debt Strategy - MPTDS, 2023). The high risk of debt is largely because of the economic effects of the COVID-19 pandemic contributing to a slowdown of economic growth and, recently, the weakening of the shilling against the US dollar.

This policy brief assesses the dynamics in the public debt profile from 2009/10 to 2022/23, its sustainability, and other new developments.

The brief also provides some practical options on how to better manage existing and emerging public debt vulnerabilities.

Recent Dynamics in Public Debt Profile

(i) Trends in Public Debt

In recent years and post-2013, public debt has remained high and on an upward trajectory, changing substantially in size and structure. The level of public debt rose to 70.8 per cent of GDP in June 2023 from 50.0 per cent of GDP in June 2010. Further, the public debt mix has shifted towards external debt. In 2010, public external debt was 23.2 per cent of GDP while domestic debt was 26.9 per cent, rising steadily to 38.2 per cent of GDP and 33.3 per cent of GDP in June 2023, respectively. As a share of total public debt, external debt accounted for 52.9 per cent of public debt compared to 46.1 per cent in 2010.

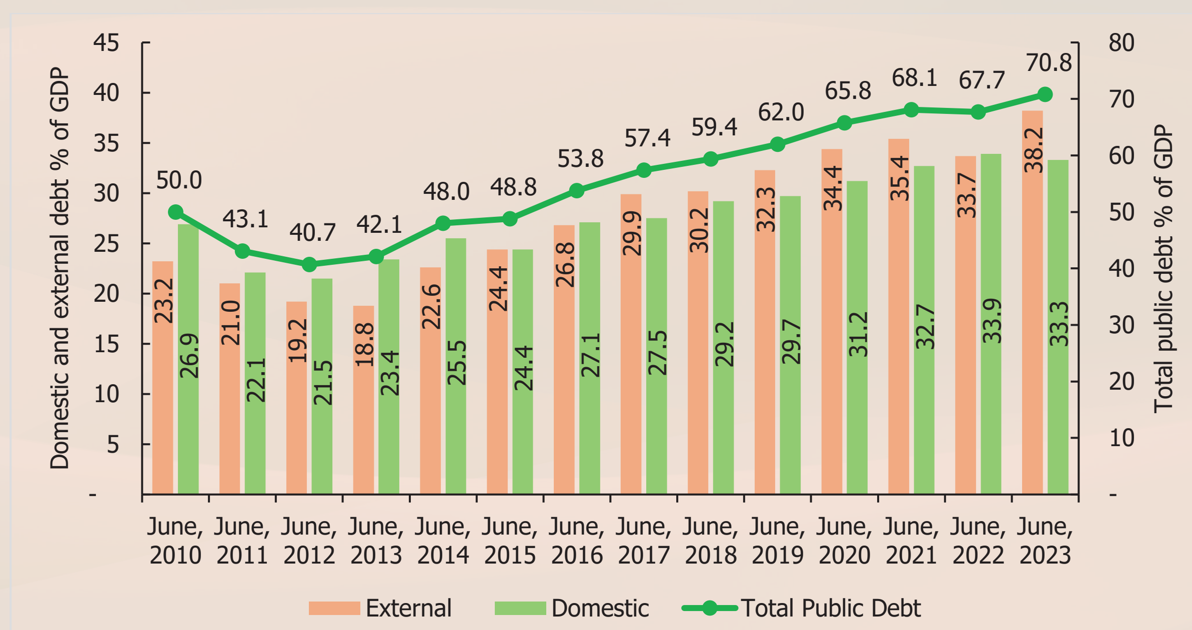
An analysis of domestic debt reveals that Treasury bonds dominate the domestic debt mix, accounting for an average of 71.7 per cent of the total domestic debt between 2009/10 and 2022/23. In June 2010, Treasury bonds and Treasury bills accounted for 68.0 per cent and 24.0 per cent of domestic debt, respectively, compared to 83.1 per cent and 12.7 per cent in June 2023, consistent with the government strategy of accumulating more longer-term domestic debt. Commercial banks are the dominant investors in government securities. The share of government securities held by commercial banks moderated from 53.2 per cent in June 2010 to 49.1 per cent in June 2021 and further down to 43.4 in June 2023 compared to holdings by non-bank creditors at 39.2 per cent in June 2010 and increasing to 48.6 per cent in June 2021 before dominating in June 2022 and June 2023 at 51.3 per cent and 52.5 per cent, respectively.

On external debt, multilateral external debt was dominant, accounting for an average of 48.7 per cent between 2009/10 and 2022/23. Notably, the accumulation of commercial debt intensified over the analysis period. Commercial debt comprises Eurobonds and syndicated loan facilities offered by lenders who work together to avail funds to a single borrower. Commercial external debt accumulation rose to 26.4 per cent of the total external debt in June 2023 from 3.7 per cent in June 2010. Commercial external debts are generally expensive, and increased accumulation implies increased overall debt burden.

(ii) Cost and Risk Characteristics of Public Debt

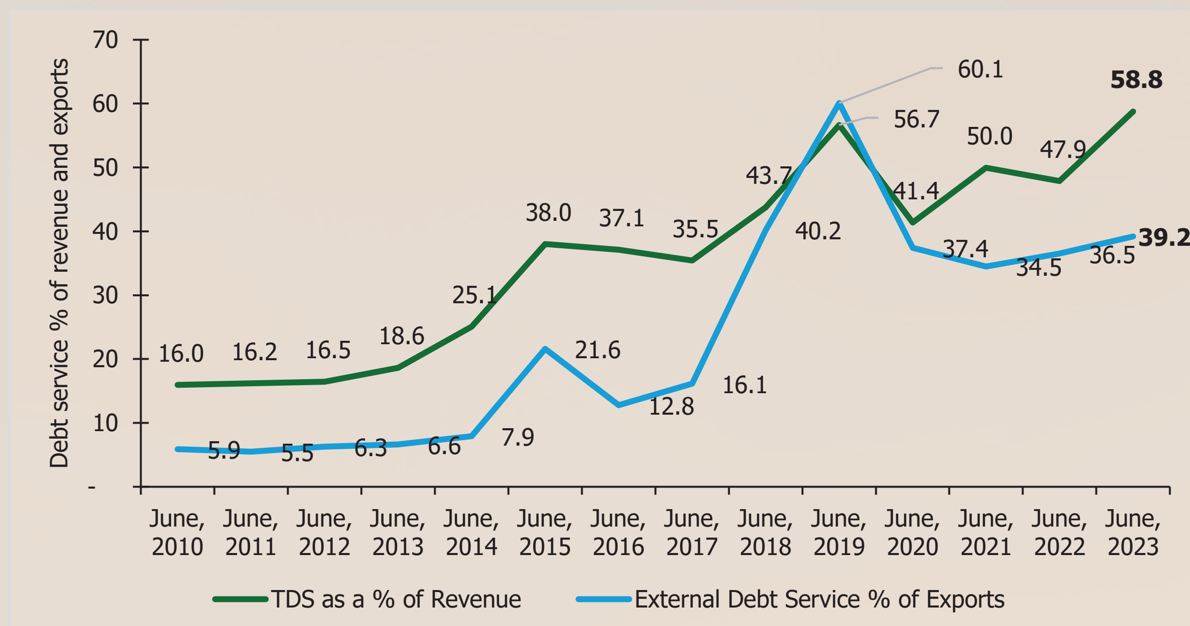
The cost of debt service and the risk of debt distress have risen over time. The progressive

Figure 1: Public debt trends as of 30th June (2010-2023)



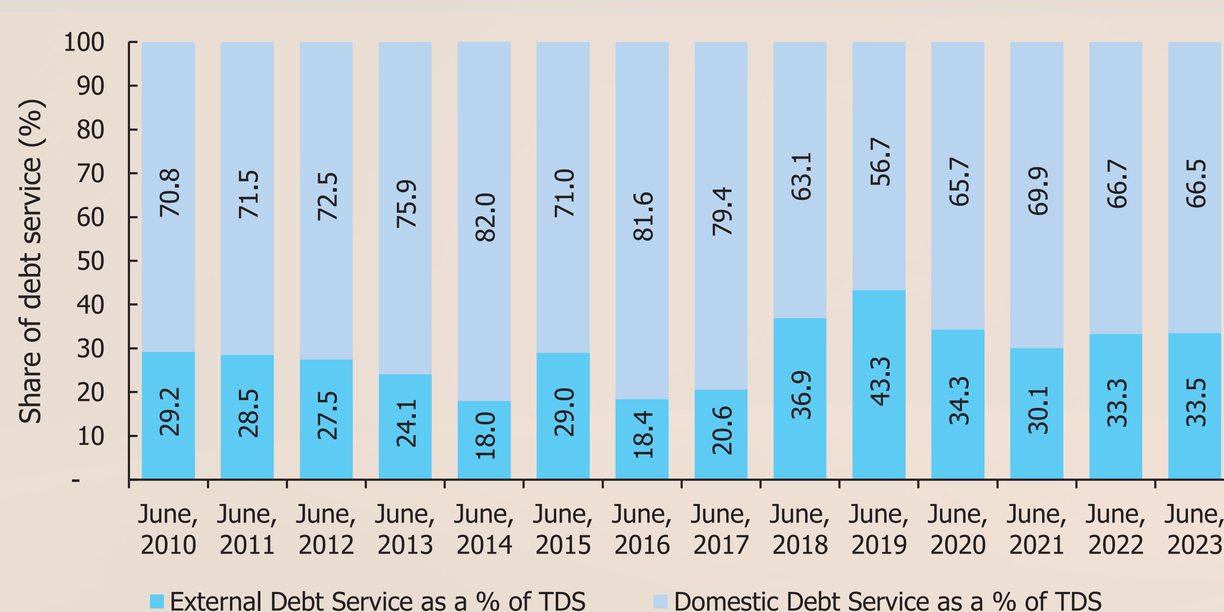
Data source: National Treasury and Economic Planning (Various), Annual Public Debt Management Report

Figure 2: Public debt service trends, as of 30th June (2010-2023)



Data source: National Treasury and Economic Planning (Various), Annual Public Debt Management Report

Figure 3: Domestic and external debt service



Data source: National Treasury and Economic Planning (Various), Annual Public Debt Management Report

and significant surge in public debt stock has resulted in increased cost of borrowing as debt service rises. Debt service refers to the regular payments made by a borrower to repay the principal amount of a loan, and any associated interest or fees.

Total debt service increased from Ksh 80.9 billion in June 2010 to Ksh 917.8 billion in June 2022 and Ksh 1,199.4 billion in June 2023. As of June 2010, 16.0 per cent of government revenue was spent on principal and interest payments on public debt. This increased steadily to 56.7 per cent in June 2019 before declining to 41.4 per cent in June 2021. At the end of June 2022, the debt service to revenue ratio was estimated at 47.9 per cent, increasing further to 58.8 per cent in June 2023. This implies that out of the revenue collected, nearly over half is used in servicing public debt. The increasing total debt service to revenue ratio indicates that generated revenue is increasingly being used to repay public debt at the expense of productive expenditure needs.

External debt service as a proportion of exports rose from 5.9 per cent in June 2010 to 60.1 per cent in June 2019, reflecting the growing interest payments from external debt that emanated from increased uptake of commercial loans, weakening of the shilling and overall increase in interest rates in the international financial markets. At the end of June 2022, external debt service to export ratio had declined to 36.5 per cent before increasing slightly to 39.2 per cent in June 2023. Generally, the International Monetary Fund (IMF) recommends a debt service-to-export ratio of 15 per cent for a country with a debt-carrying capacity classified as medium, such as Kenya. Between 2017/18 and 2022/23, this threshold was persistently breached, as total debt service to export ratio averaged 37.7 per cent over the period. This persistent increase in debt service to export ratio above the recommended threshold is a worrying sign, and points to elevating public debt costs.

The share of domestic debt service in total debt service remained high, averaging 71.0 per cent over the analysis period. In June 2010, domestic debt service accounted for 70.8 per cent of total public debt service, increasing to 81.6 per cent in June 2016. This increase was partly driven by increased uptake of Treasury bills and higher service costs of Treasury bonds during the period. However, as the government increased the accumulation of commercial external loans, the share of domestic debt service in total debt service declined to 56.7 per cent in June 2019 and, as of June 2022, it was 66.7 per cent and 66.5 per cent in June 2023.

Interest payments carry the bulk of the debt servicing cost. Over the 2009/10 to 2022/23 period, an average of 62.9 per cent of the total debt servicing was interest payments. Notably, domestic debt interest payments accounted for an average of 52.1 per cent of the total debt servicing costs over the period under review. In 2022/23, the domestic interest payment was Ksh 533.1 billion, equivalent to 44.4 per cent of the total debt servicing costs. The high interest spending puts substantial strain on government budgets and tends to crowd out spending on basic social services such as education, social protection, and health.

A key indicator of public debt service cost is the weighted average interest rate (WAIR). While the WAIR for domestic debt remained high at an average of 11.4 per cent over the analysis period, it was relatively stable. For instance, the WAIR for domestic debt was 10.4 per cent in June 2010, 11.9 per cent in June 2015, 10.9 in June 2020, 11.5 per cent in June 2022, and 11.7 per cent in June 2023. In contrast, the WAIR for external debt was lower than the domestic debt WAIR, but was on an increasing trend. In June 2010, it was 1.3 per cent, rising steadily to 4.2 per cent in June 2019 before slowing to 3.8 per cent in June 2022 and increasing marginally to 4.0 per cent in June 2023. The weighted average interest rate for the total public and public guaranteed debt remained fairly constant over the years, from 6.2 per cent in June 2010 to 7.2 per cent in June 2017 and 7.6 per cent in June 2023. Over the analysis period, WAIR for public debt was averaging 7.1 per cent.

The government strategy has over the years aimed at reducing public debt refinancing risk, which refers to the uncertainty that the government may be unable to raise funds for the debts maturing or may raise them at an unusually high interest cost. The debt refinancing risk in external debt increased during the analysis period, as reflected by the fall in the average time to maturity (ATM) from 11.8 years in June 2014 to 10.6 years in June 2022, and further down to 9.4 years in June 2023. However, on a positive note, debt refinancing risk has strongly improved with respect to both total debt and domestic debt as reflected by the rise in the ATM. The ATM for total debt increased from 8.9 years in June 2010 to 9.3 years in June 2022 before a slight decline to 8.5 years in June 2023. Likewise, the ATM for domestic debt increased from 5.5 years in June 2010 to 7.9 years in June 2022 before a marginal fall to 7.4 years in June 2023. The general rise in ATM for domestic debt reflects the deliberate government strategy of implementing benchmark long-term securities (T-bonds) for resource mobilization, while short-term securities (T-bills) are used for cash management purposes.

Interest rate risk with respect to external debt increased as reflected by the average time to re-fixing (ATR). ATR is a measure of the weighted average time until all principal payments in the debt portfolio become subject to a new interest rate. Generally, the low value of ATR suggests that the portfolio is, on average, facing a new interest rate frequently and is therefore exposed to re-fixing shocks; that is, an increase in market rates. The ATR for external debt was 8.3 years

in 2010; it increased to 10.9 years in June 2015 before dropping to 9.2 years in June 2022 and further down to 8.5 years in June 2023. Similarly, the average time to re-fixing for total public debt was 8.9 years in June 2010. It dropped to 8.1 years in June 2015 but increased to 8.6 years in June 2023 and for domestic debt from 4.6 years in June 2010 to 5.3 years in June 2015 to 7.9 years in June 2023.

(iii) Sustainability of Public Debt

Public debt remains sustainable, despite the risk of external and overall debt distress remaining high punctuated by the effects of the COVID-19 pandemic. Three out of the five threshold indicators of public debt sustainability were breached in 2023 (Table 1). These include the present value (PV) of the External Debt-to-Exports ratio (220.4 against 180), public and publicly guaranteed (PPG) external debt service-to-exports ratio (22.0 against 15), and PV of public debt-to-GDP ratio (64.4 against 55). Projections indicate that this trend could remain so until 2026 and beyond.

Policy Options Towards Debt Sustainability

To manage public debt vulnerabilities and drive debt to more sustainable levels, the following recommendations are critical:

(i) Re-focus debt management strategy. New debt management strategies should emphasize the acquisition of more concessional loans and prudent utilization of new loans for growth impact to be realized. Prudently utilizing newly acquired loans on concessional terms will be critical for driving the recovery process while ensuring that growth is broad-based and all-inclusive in line with the bottom-up economic transformation agenda (BETA).

(ii) Scale up domestic resource mobilization and prioritize expanding fiscal headroom. It is important to escalate the streamlining and broadening of the tax base particularly by bringing all eligible entities into the tax base and ensuring that all individuals and companies pay their fair share of taxes.

(ii) Prioritize fiscal adjustment. While fiscal deficit targets have been elusive over time, the fiscal deficit has been narrowing. The fiscal deficit declined to 6.2 per cent of GDP in 2021/22 from 8.2 per cent in 2020/21. Concerted implementation of the fiscal strategy laid out in the 2023 Budget Policy Statement will be vital, especially in reducing wasteful public spending.

Table 1: Debt sustainability indicators (%)

Indicators	Thresholds	2006-2010	2011-2015	2016-2020	2021	2022	2023	2024*	2025*	2026*	2027*
External Debt Sustainability Analysis											
PV of PPG ED/ GDP	40	-	-	-	28.2	27.8	29.5	30.5	29.4	27.9	27.1
PV of PPG ED/ Export	180	52.40	85.87	226.03	278.5	228.3	220.4	210.8	195.6	181.7	170.3
PPG ED service/ export	15	7.98	7.18	20.44	21.6	21.2	22.0	31.1	21.7	21.9	19.7
PPG ED service/ revenue	18	9.24	7.22	14.12	13.6	14.8	16.6	24.9	18.2	19.2	17.6
Public Debt Sustainability Analysis											
PV of PD/GDP	55	-	-	60.3	61.7	63.1	64.4	61.9	60.2	58.3	56.6

Data source: National Treasury and Economic Planning (2023), Medium-Term Debt Management Strategy

*Note: PV= Present Value; ED= External Debt; PPG= Public and Publicly Guaranteed; PD= Public Debt; * means projection*

(iii) Strengthen foreign currency earnings. External debt vulnerabilities could be addressed by revamping foreign currency earnings through increased value addition and diversification of export products and seeking new export markets. Kenya has untapped and potential markets in Africa and South America. Further, providing a conducive environment to promote and attract foreign direct investment (FDI), especially in the manufacturing and digital sectors is imperative.

References

Awadzi, E. A. (2015). Designing legal frameworks for public debt management. International Monetary Fund. WP/15/147.

Government of Kenya (2022). Annual Public Debt Reports FY 2021/22. Nairobi: National Treasury and Economic Planning.

Government of Kenya (2023), 2023 Medium Term Debt Management Strategy. Nairobi: National Treasury and Economic Planning.

World Bank (2017). Government Debt Management: Designing Debt Management Strategies. Debt Management Learning and Training Notes. World Bank Washington DC. August 2017.

World Bank and IMF (2022). Joint World Bank/ IMF Debt Sustainability Analysis for Kenya. International Development Association and International Monetary Fund.

About KIPPRA Policy Briefs

KIPPRA Policy Briefs are aimed at a wide dissemination of the Institute's policy research findings. The findings are expected to stimulate discussion and also build capacity in the public policy making process in Kenya.

KIPPRA acknowledges generous support from the Government of Kenya and the Think Tank Initiative of IDRC, who have continued to support the Institute's activities over the years.

For More Information Contact:

Kenya Institute for Public Policy Research and Analysis
Bishops Road, Bishops Garden Towers
P.O. Box 56445-00200, Nairobi
Tel: 2719933/4, Cell: 0736712724, 0724256078
Email:admin@kippra.or.ke
Website: http://www.kippra.org
Twitter: @kippra.kenya