Kenya Q2'2018 Balance of Payments Note

This week, the Kenya National Bureau of Statistics released the Quarterly Balance of Payments report for Q2'2018. 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.

A. Current Account Balance

Kenya's current account deficit improved during Q2'2018, coming in at Kshs 85.8 bn from Kshs 130.4 bn in Q2'2017, a decline of 34.2%, equivalent to 7.1% of GDP from 11.4% recorded in Q2'2017. This was mainly due to the 57.1% increase in the Secondary Income (Transfers) Balance, largely attributed to 56.9% increase in the diaspora inflows to Kshs 74.7 bn from Kshs 47.6 bn in Q2'2017. The table below shows the breakdown of the various current account components, comparing Q2'2018 and Q2'2017:

all figures in Kshs bns unless stated otherwise

Q2 Current Account Balance			
Item	**Q2'2017**	**Q2'2018**	**% Change**
Merchandise Trade Balance	(256.2)	(277.5)	**8.3%**
Services Trade Balance	36.3	37.2	**2.4%**
Primary Income Balance	(25.0)	(25.5)	**1.9%**
Secondary Income (Transfers) Balance	114.6	180.0	**57.1%**
Current Account Balance	**(130.4)**	**(85.8)**	**(34.2%)**
GDP at Current Prices (Q2'2018 Quarterly GDP Report by KNBS)	1,142.3	1,214.2	**6.3%**
Current Account Balance as a % of GDP	*(11.4%)*	*(7.1%)*	***(4.3%)***

Key take-outs from the table include:

i. The secondary income/transfers surplus increased by 57.1% to Kshs 180.0 bn from Kshs 114.6 bn in Q2'2017, driven by a 56.9% increase in diaspora remittances to Kshs 74.7 bn from Kshs 47.6 bn recorded in Q2'2017. Diaspora remittances have been constantly increasing 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 widened by 8.3% to Kshs 277.5 bn from Kshs 256.2 bn in Q2'2017 driven by a faster 7.6% rise in merchandise imports compared to the 6.3% rise in merchandise exports. The relatively larger import base compared to the export base contributed to the widening of the trade deficit. The increase in imports was mainly due to a 46.6% increase in value of petroleum imports to Kshs 82.1 bn from Kshs 56.0 bn in Q2'2017,

iii. In terms of exports by region, Africa remained the largest merchandise export destination with 35.2% of the total exports, followed by Asia at 28.4%. The European region accounted for 21.6% owing to increased demand from the UK, The Netherlands, France and Belgium, with tea and horticulture remaining the largest export commodities, accounting for a combined 47.1% of the total value of export commodities,

iv. In terms of imports by region, Asia was the largest merchandise import source, accounting for 69.1% in Q2'2018, with China as the leading source, with 35.9%, maintaining the top spot as Kenya's biggest import source, followed by India and Saudi Arabia at 13.8% and 6.4%, respectively,

v. As a result of the increase in secondary income surplus which outweighed the marginal increase in trade deficit, services balance and primary income, the current account deficit improved faster than the growth in GDP at current prices, resulting in the current account deficit improving to 7.1% of GDP down from 11.4% recorded in Q2'2017.

B. Balance of Payments

Kenya's balance of payments deteriorated during Q2'2018, coming in at a deficit of Kshs 33.6 bn from a surplus of Kshs 23.2 bn in Q2'2017, translating to a balance of payments deficit equivalent to 2.8% of GDP in Q2'2018 from a surplus equivalent to 2.0% recorded in Q2'2017. This was mainly due to the 86.6% decrease in the financial account balance whose decrease was largely attributed to decreased inflows coupled with increased debt securities outflows mainly in portfolio investments and other investments categories. The table below shows the breakdown of the various balance of payments components, comparing Q2'2018 and Q2'2017:

all figures in Kshs bns unless stated otherwise

Q2 Balance of Payments			
Item	**Q2'2017**	**Q2'2018**	**% Change**
Current Account Balance	(130.4)	(85.8)	**(34.2%)**
Capital Account Balance	4.0	9.4	**133.1%**
Financial Account Balance	140.8	18.8	**(86.6%)**
Net Errors & Omissions	8.7	24.1	**175.5%**
Balance of Payments	**23.2**	**(33.6)**	
GDP at Current Prices (Q2'2018 Quarterly GDP Report by KNBS)	1,142.3	1,214.2	6.3%
Balance of Payments as a % of GDP	*2.0%*	(2.8%)	*(4.8%)*

Key take-outs from the table include:

i. The current account deficit narrowed by 34.2% to Kshs 85.8 bn from Kshs 130.4 bn in Q2'2017, largely due to the 57.1% increase in the Secondary Income (Transfers) Balance, largely attributed to a 56.9% increase in the diaspora inflows to Kshs 74.7 bn from Kshs 47.6 bn in Q2'2017,
ii. The financial account balance decreased by 86.6% to Kshs 18.8 bn from Kshs 140.8 bn. This was on the back of decreased inflows coupled with increased debt securities outflows mainly in portfolio investments and other investments categories. In Q2'2018, there was net use of Kshs 41.1 bn of the foreign exchange reserves,
iii. The Balance of Payments (BoP) thus deteriorated to a deficit of Kshs 33.6 bn from a surplus of Kshs 23.2 bn in H1'2017, mainly due to the 86.6% decrease in the financial account balance, which outweighed the 34.2% decline in the current account balance and the 133.1% increase in the capital account balance.

C. Conclusion

The narrowing of the current account in Q2'2018 supported the Kenya Shilling during the quarter, as the shilling gained 2.8% against the dollar to close at Kshs 100.8 from Kshs 103.7 at the end of Q2'2017. The increase of the forex reserves held by the Central Bank of Kenya by 1.7% in the same period to close the quarter at USD 9.0 bn (6.0 months of import cover) from USD 8.9 bn (5.9 months of import cover), mainly due to the receipt of the Eurobond proceeds and increased diaspora remittances, also led to a positive performance of the Shilling.

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, and,
(ii) Encouraging "Made in Kenya" products and strengthening a national marketing body for marketing and promoting such products in international markets to boost exports.

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.