Seventy Third Sovereign Debt News Update: Kenya joins calls for the reform of Global Credit Rating architecture amidst adversity

By:

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On 22 March 2023, Kenya joined the regional and global calls for the reform of the global credit rating architecture. In the call, Kenya agitates for the overhaul of the global credit market, arguing that the move would boost accurate assessment of African countries. While alluding to the gaps in the global credit rating system, the country's Treasury Cabinet Secretary observed that "we are all coordinated and, should I say, harassed within the same framework without actually any resort to what need to be done…Why do MDAs (Multilateral Development Agencies) follow those ratings? Are they giving them a tick?".

This support for global reforms comes at a time when the county faces increased scrutiny from credit rating agencies (CRAs) and mounting political uncertainty following weekly protests led by the former Prime Minister and current leader of opposition calling for *inter alia* the lowering of the cost of living.

The big three CRAs – S&P, Fitch, and Moody's – have downgraded the country's ratings. For example, in February 2023, Standard & Poor Global (S&P) cut Kenya's ratings from stable to negative on concerns about the country's debt servicing capacity due to constrained international market access and underperforming domestic bond issuances. At the same time, on 14 December 2022, Fitch Ratings downgraded Kenya's long-term foreign-currency issuer default rating (IDR) to 'B' from 'B+', citing Kenya's persistent twin fiscal and external deficits, relatively high debt, and deteriorating external liquidity, and high external financing costs, which presently constrain access to international capital markets.

While the secondary market yield for Kenya's Eurobonds – guiding the pricing of new issuances – have eased from the record high of 22% in July 2022, they still remain elevated at between 10.2% and 11.8%. This refinancing risk has already forced Kenya to postpone a Eurobond issuance in the past year, putting pressure on the domestic market to carry the bulk of the budget deficit financing.

The stance taken by these CRAs reflects a growing concern that developing countries that have high exposure to external debt have a high likelihood of struggling to refinance maturing issuances due to the high interest rate demands being put forward by potential creditors. In fact, S&P Global observed that it could lower its ratings for Kenya over the next one year if access to external financing is curtailed, resulting in external financing shortfalls or a sustained decline in foreign exchange reserves.

Notably, Kenya's foreign exchange reserves, from which external debt is repaid, are currently at a near 10-year low of USD 6.9 billion – equivalent of 3.88 months' import cover – having fallen below the required four months import cover. The forex reserves have been deteriorating partly due to repayments of the country's debt to bilateral and commercial lenders, as well as the Central Bank of Kenya's intervention to slow down the shilling's depreciation against the US dollar. The shilling has remained on a steady decline against the dollar, exchanging at KES 131.27 on Friday 24 March 2023.

The government, however, is betting on debt inflows to boost its forex cover with concessional funding from the World Bank and the International Monetary Fund. In fact, the country awaits the disbursement of USD 750 million from the World Bank by June 2023 as well as continued flows from the IMF's 38-month facility of USD 2.4 billion under the Extended Credit Facility and Extended Fund Facility.

The country is also betting on its re-entry to the international capital markets to rebuild the forex cover through the issuing of either a Eurobond or a syndicated loan. This follows the 9 March 2023 announcement by the country's Treasury that it seeks to tap concessional external loans to fund the KES 256 billion (approx. USD 2 billion) bullet repayment of its debut Eurobond due in the next financial year starting July 2023. According to the Treasury's Principal Secretary, Kenya is expected to repay Eurobond debt of KES 254 billion (approx. USD 2 billion) in 2024, KES 114 in 2027 (approx. USD 867 million), and KES 127 billion in 2028 (approx. USD 966 million). The country has already paid USD 127 million as of 1 March 2023.

In addition to optimising the use of concessional external funding to manage its forex reserves, the government is taking several measures such as the continued implementation of fiscal consolidation to guide borrowings during the financial year 2023/24 to 2025/26. For example, it is devising ways of managing maturities including the establishment of a Sinking Fund to manage debt maturities. Furthermore, the government seeks to lengthen the maturity profile of public debt through the issuance of medium to long-dated bonds and deepen the domestic debt market. These will, hopefully, enable the country to finance more budget deficits and cut reliance on external sources.

In all, Africa, despite its incredible diversity and complexity, has for too long been subject to the international credit ratings without any collectivised protection like, say, the EU enjoys. It is time for that to change.

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