fsd Kenya

The Macroeconomic Environment And The Pensions Sector in Kenya

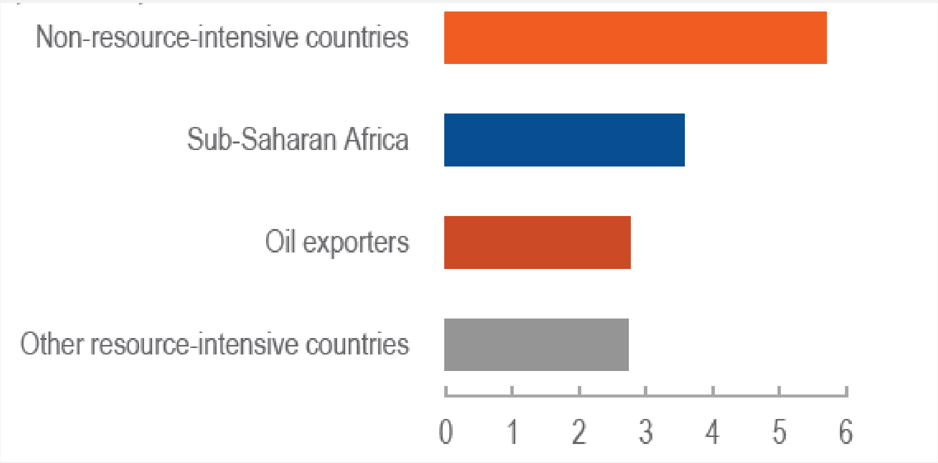
By Anzetse Were (M.Ec.)
Senior Economist and Green Finance Advisor

October 2024

Global and Africa's Economic Context

- Global growth: 3.2% in 2024 & 2025--driven by emerging Asia.
  - Global inflation has been managed- peaked at 9.4% (2022)-- projected to reach 3.5 % by the end of 2025.
- Africa's (SSA) growth: 3.6% in 2024- subdued and uneven
  - Factors dampening growth: Conflict, insecurity, extreme weather events, and electricity shortages.
  - Domestic & external financing conditions remain tight and expensive.
  - High poverty; lack of inclusion & job opportunities; rapid increases in the cost of living, governance.

Sub-Saharan Africa: Real GDP Growth, 2024

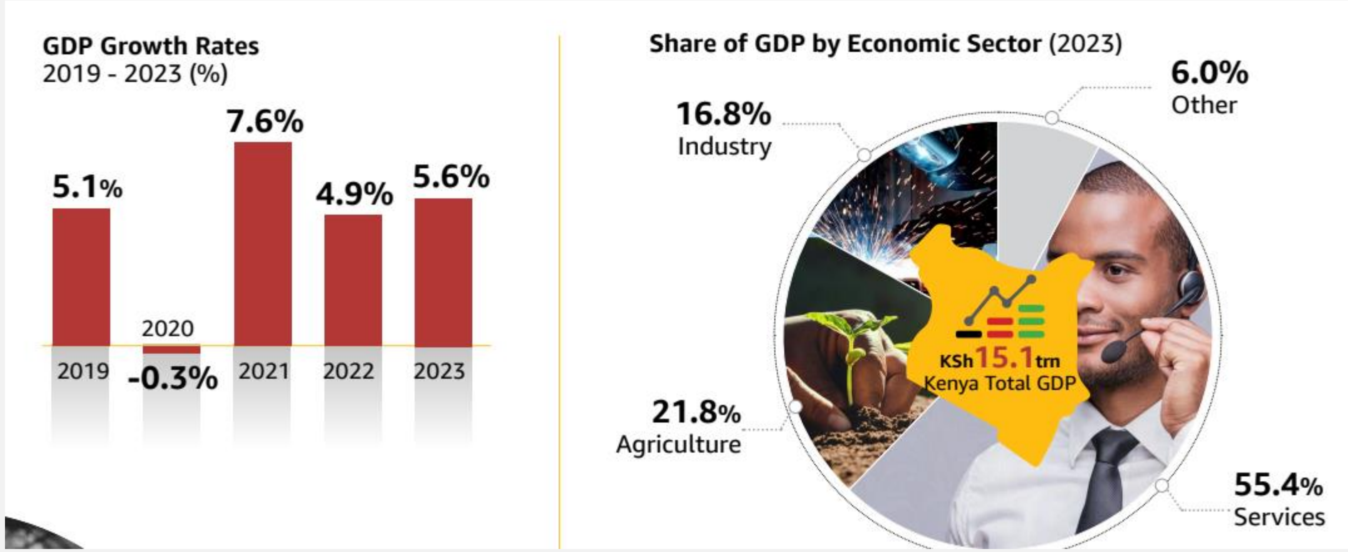


Source: IMF Regional Economic Outlook for Sub-Saharan Africa, October 2024

Kenya's Macroeconomic Environment

GDP Growth

- In 2023 GDP grew by 5.6 % up from 4.9% in 2022- driven by rebound in agriculture.
- Q2 2024: Economy grew at 4.6%
- Growth driven by Agriculture sector at 4.8%--though lower than 7.8% growth in Q2 2023.
- Other growth drivers:
    - Accommodation & Food (26.6%)
    - ICT (7.2%)
    - Professional Services (6.8%)
    - Real Estate (6.0%)
    - Financial & Insurance (5.1%)
    - Wholesale & Retail Trade (4.4%).



Source: KNBS 2024 Economic Survey, May 2024

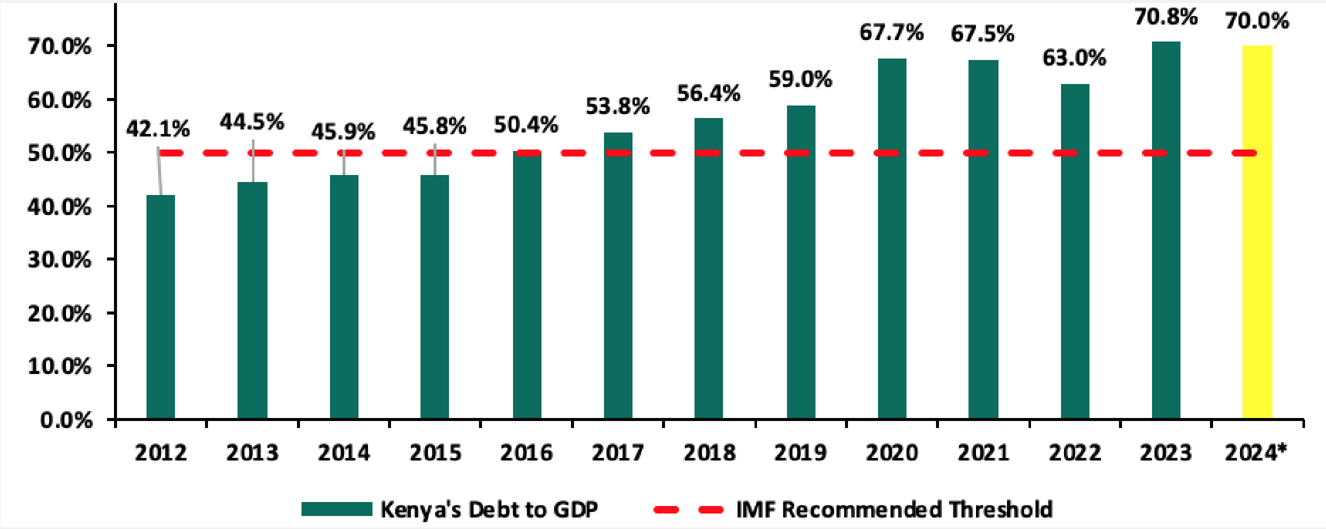
- Most sectors grew at slower rates than in Q2 2023.
- Slowed growth in the economy informed by elevated fuel prices, and the unrest caused by the anti-finance bill protests in June 2024.

Kenya’s Macro Environment

Fiscal Dynamics

- **Debt Position**: Kenya’s public debt reached **Kshs 10.6 tn** in June 2024.
- This is a 70% Debt to GDP ratio.
- Since 2023-- shift towards external borrowing: Proportion of external debt against domestic debt standing at 54.7% to 45.3% in December 2023.
- **Fiscal Deficit**: Averaged 7.5% of the GDP for the last 10 financial years but down to 5.7% for FY 2023/24.
- Debt service to revenue ratio stood at 69.6% as of June 2024.

Kenya’s Debt to GDP ratio



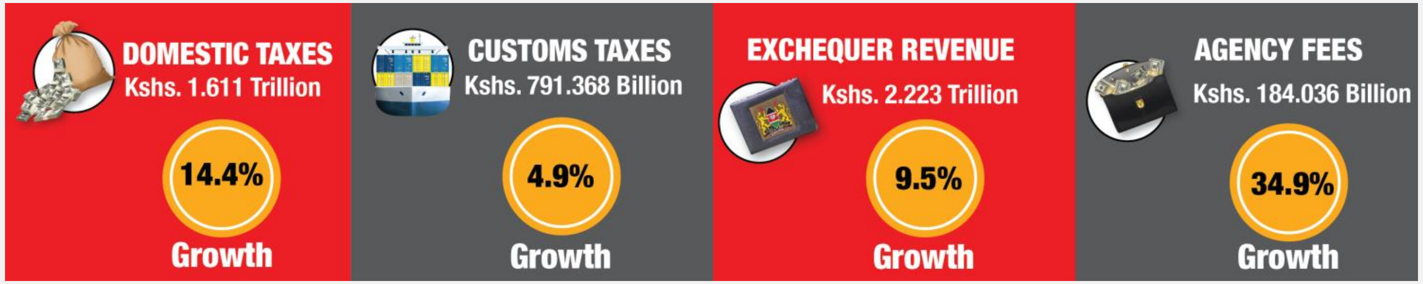
Source: Cytonn Review of Kenya’s Public Debt 2024, July 2024

Kenya’s Macro Environment

Fiscal Dynamics

- **Budget and Spending**: Revision of the Budget following the withdrawal of the 2024 Finance Bill.
- The Supplementary Estimates I for the Fiscal Year 2024/25::
    - Decrease of 2.1% to recurrent expenditure
    - Decrease of 16.4% to development expenditure
    - Decrease of 6.6% to the Ministerial National Government
    - Increase of 2.0% to the Consolidated Fund Services
    - Increase of 2.7% to The County Equitable Share

Revenue Performance 2023/24



Source: KRA Annual Revenue Performance Report FY 2023-2024 , August 2024

- **Focus on Increased Revenue Mobilisation**: Revenue 2023/24 grew by 11.1% to KShs 2.4t from KShs 2.2t.
- Performance rate of 95.5% against the target.
- Revenue growth drivers:
    - Tax Base Expansion
    - Debt collection from non-compliant taxpayers
    - Betting and Gaming Tax
    - Dispute Resolution
- Despite the significant growth in tax revenues, revenue targets have consistently not been met.

Kenya's Macro Environment

Credit Rating Downgrades August 2024

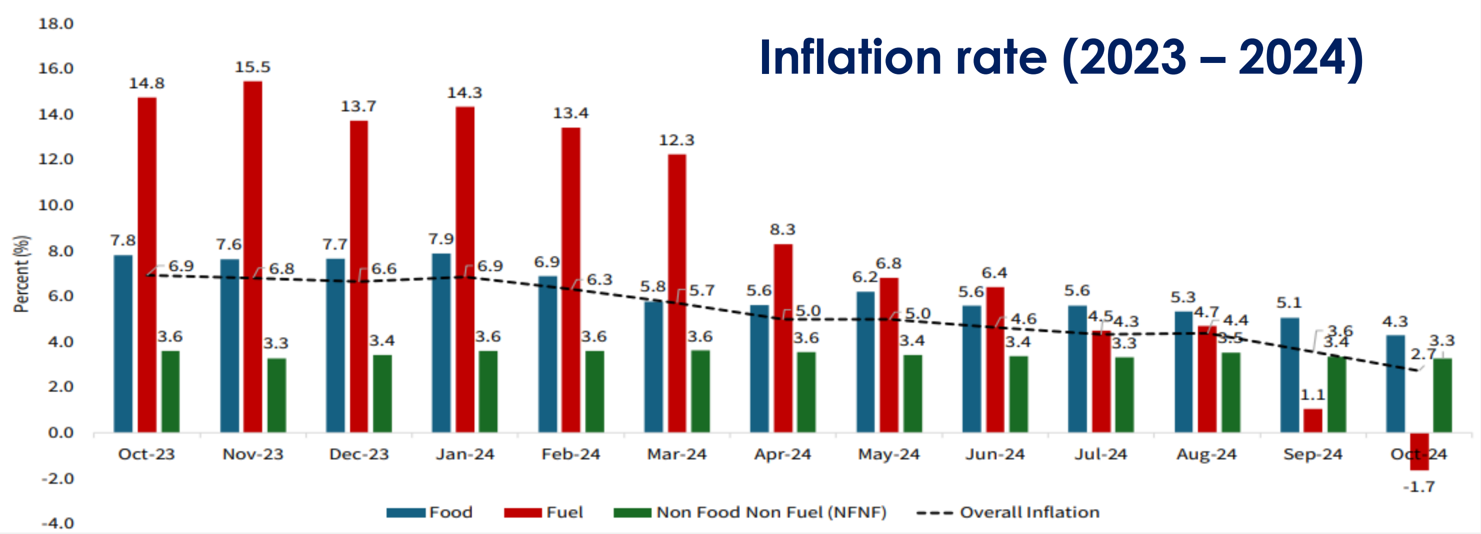
- S&P Global Ratings downgraded Kenya's long-term sovereign credit rating to 'B-' from 'B' with a stable outlook.
- Fitch downgraded Kenya's Long-Term Foreign-Currency Issuer Default Rating to 'B-' from 'B' with a stable outlook.
- Moody's downgraded Kenya to Caa1 from B3 with a maintained negative outlook.
- Collective Rationale:
  - Government's decision to forgo proposed tax increases
  - Increased risk to political stability
  - Rising domestic and external debt costs
  - Low likelihood of sufficient revenue mobilisation

STANDARD & POOR'S RATINGS SERVICES	FitchRatings	Moody's		Rating Grade Description
AAA	AAA	Aaa	Investment Grade	Highest Grade Credit
AA+	AA+	Aa1		Very High Grade Credit
AA	AA	Aa2		
AA-	AA-	Aa3		
A+	A+	A1		High Grade Credit
A	A	A2		
A-	A-	A3		
BBB+	BBB+	Baa1		Good Credit Grade
BBB	BBB	Baa2		
BBB-	BBB-	Baa3		
BB+	BB+	Ba1	Speculative Grade	Speculative Grade Credit
BB	BB	Ba2		
BB-	BB-	Ba3		
B+	B+	B1		Very Speculative Credit
B	B	B2		
B-	B-	B3		
CCC+	CCC+	Caa1		Substantial Risks - In Default
CCC	CCC	Caa2		
CCC-	CCC-	Caa3		
CC	CC	Ca		
C	C			
SD	DDD	C		
D	DD			
	D			

Kenya's Macro Environment

Inflation and Monetary Policy

- Annual inflation rate was 7.7% in 2023 and 2022.
- Inflation in Q3 2024 decreased to 4.1% .
    - Driven by strengthening Kenya Shilling (KShs) and stabilised (although elevated) fuel prices.
- The Monetary Policy Committee (MPC) cut the Central Bank Rate (CBR) to 12.00 in October 2024
- Informed by progress in mitigating exchange rate pressures and anchoring inflation within the CBK target range.



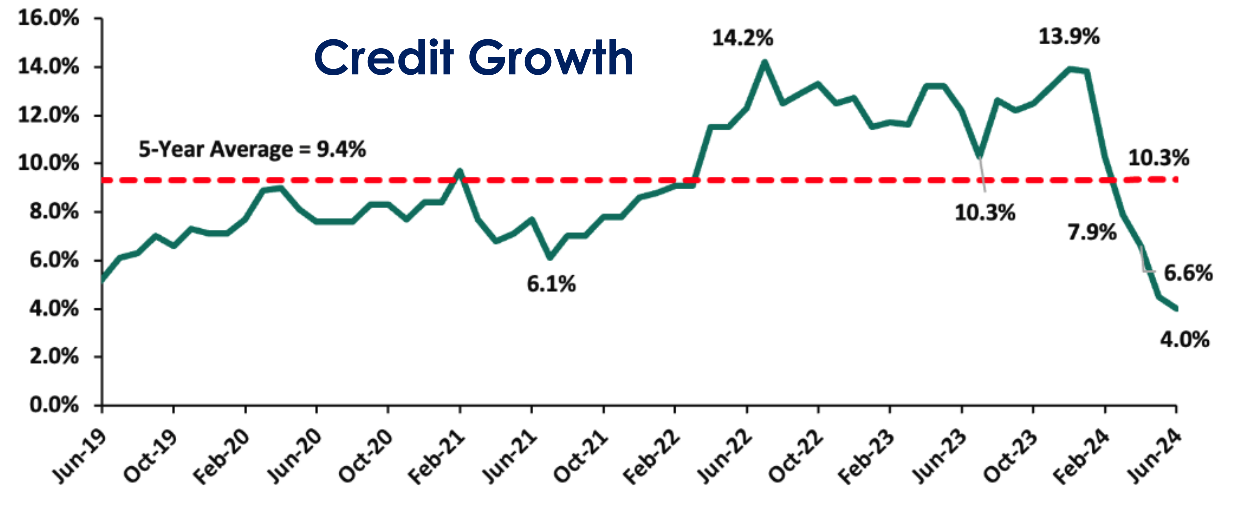
Source: CBK Weekly Bulletin, October 2024

- Shilling appreciated against the US Dollar by 0.3% in Q3 2024, to close at KShs 129.2, from KShs 129.5 as at the end of H1'2024.
- Informed by increased foreign inflows and the US Fed cut in mid-September which made the dollar less attractive compared to other currencies, the Shilling included.

Kenya's Macro Environment

Credit Growth and NPLs

- Decline in growth in commercial bank lending to the private sector to 1.3% in August 2024 compared to 3.7% in July.
- Local currency-denominated loans stood at 5.2% in August.
- Foreign currency-denominated loans, which account for about 26% of total loans, contracted by 10.6%.
- The ratio of gross non-performing loans (NPLs) to gross loans stood at 16.7% August 2024 up from 16.3% in June.
- Increases in NPLs were noted in the transport and communication, personal and household, trade, real estate, and manufacturing sectors.



Source: Cytonn Q3'2024 Markets Review, October 2024

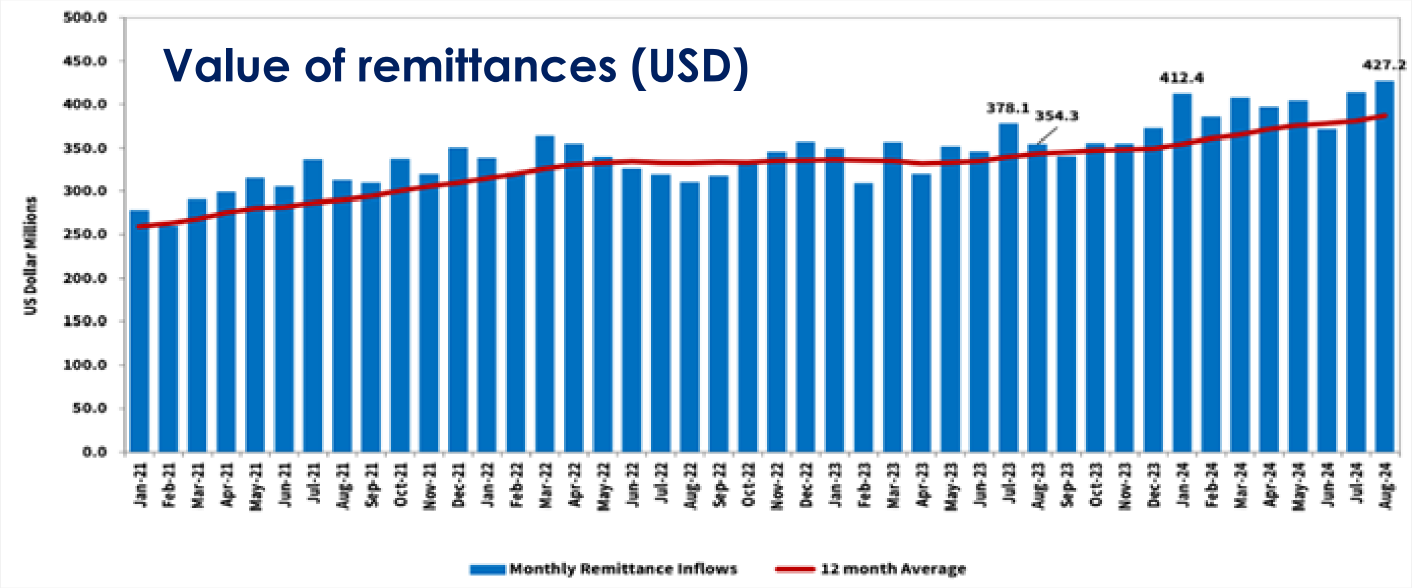
- Interest rates were adjusted upwards to manage inflation for 2022 through most of 2024.
- This has created a high interest environment combined with a high tax and cost of doing business environment.
- In October, the MPC cut the CBR by the highest margin since COVID.

fsd Kenya

Kenya’s Macro Environment

Diaspora Remittances and Forex

- Remittances in August 2024 were up 12.7% from August 2023.
- Cumulative inflows for 12 months to August 2024 stood at USD 4,645m .
- Remittance inflows continue to support the current account and the foreign exchange market.
- USA remains the largest source of remittances, accounting for 56.0% in August 2024.
- The Shilling also supported February Eurobond issuance, tourism inflow receipts; and high forex reserves.



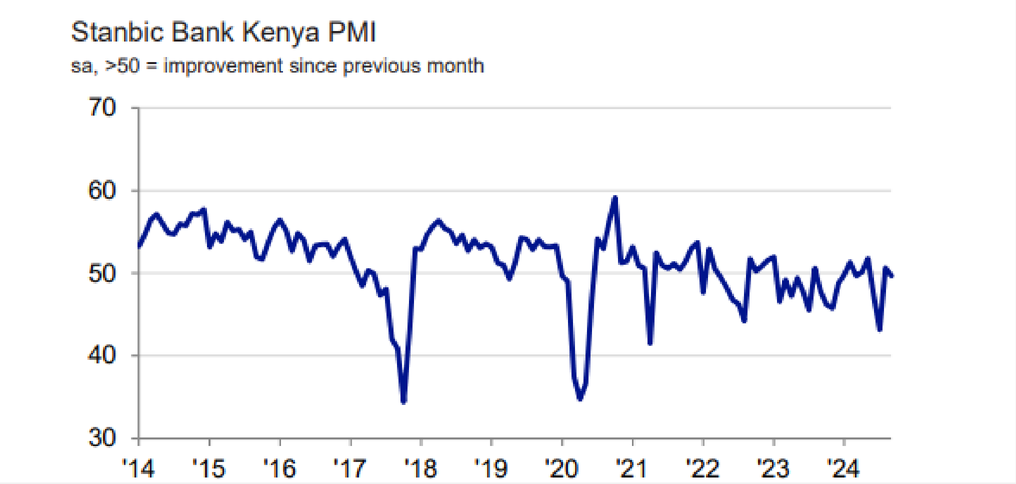
Source: CBK Weekly Bulletin, October 2024

Shilling will face pressure from:
- Current account deficit
- Government external debt servicing.
- Potential decline in tourism receipts

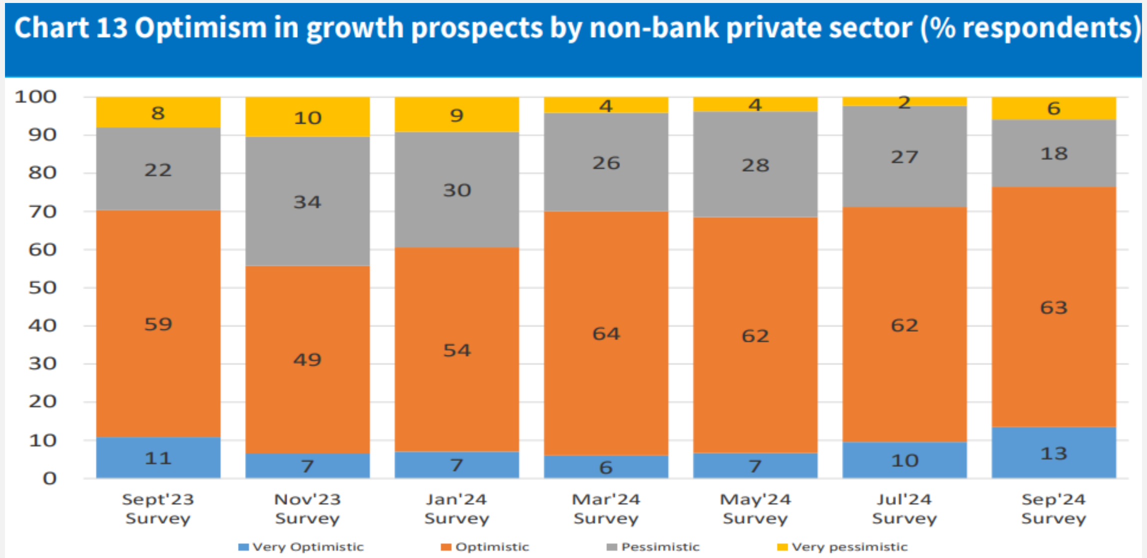
Kenya's Macro Environment

Business Environment and Sentiment

- Stanbic Bank's PMI for September 2024 declined to 49.7, from 50.6 in August 2024, signalling a deterioration in business conditions.
- While employment in the private sector stabilised in September after declining in August, business expectations for the coming year remain at their weakest levels in a decade.
- The CBK's CEOs Survey and Market Perceptions Survey indicated some positive sentiment.
- Positive sentiment is informed by low inflation rate, stable exchange rate, expectations of declining in interest rates, strong performance of agriculture, and resilience of the services sector.
- Key concerns include high cost of doing business, subdued consumer demand, and high cost of credit.



Source: Stanbic Bank Kenya PMI, September 2024



Source: CBK Market Perceptions Survey, September 2024

Kenya's Macro Environment 2024

Bright Spots

- Sustained economic growth rate
- Strong performance in the agriculture and services sectors
- Managed inflation
- Relatively stable exchange rate
- Strong diaspora remittances
- Fiscal consolidation implementation

Key Risks/ Challenges

- Weakening economic growth in 2024
- Fiscal strain and weak debt position
- High-interest rate environment
- Weak consumer demand
- High cost of living and doing business
- Low savings environment
- Political unrest

Financial Sector Dynamics

March 2024: Grey-listing of Kenya by Financial Action Task Force

Financial Sector Stability 2023

- **Banking sector**: Sufficient capital and liquidity buffers and strong earnings in 2023.
  - Elevated credit, interest rate and operational risks. Microfinance banks incurred losses and were thinly capitalized.
- **Capital markets**: Decline in equity and bond prices, significant scale-down by foreign investors and inactive corporate bonds market.
- **Pension sector**: Negatively impacted the returns on investment in capital markets; and recorded decline in member contributions.
- **Insurance sector**: Return on investment and gross premiums improved; claims paid exceeded premiums received, indicating mispricing of risks. Increase in cases of technology related crimes.
- **SACCOs**: Assets quality and profitability of Saccos improved in 2023 despite high cost of living experienced by members.
- Regulation of unregulated digital lenders
- Downside risks to financial sector stability in 2024: Higher-for-longer interest rates environment, evolving technology-related risks, climate change risks, geopolitical conflicts, and geoeconomic fragmentation.

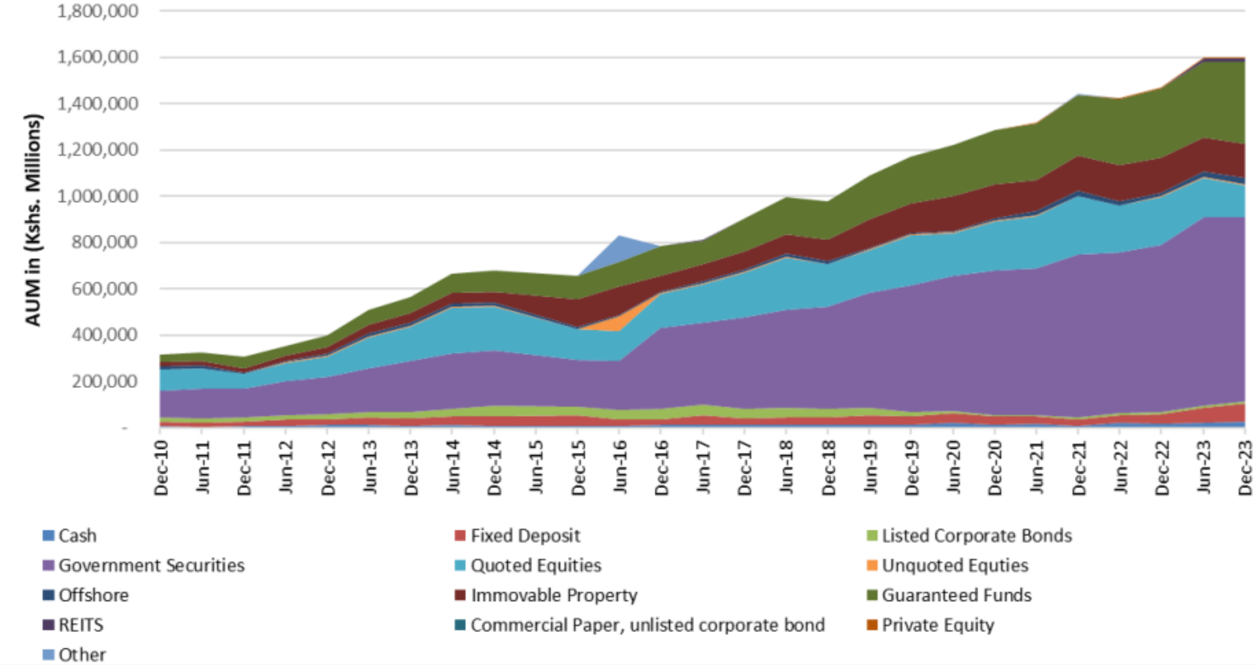
fsd Kenya

Focus on Pension Sector

Performance 2023

- Pensions sector: Between 2016-2023 by 72.7% increase in assets under management.
- More than 100% growth in government securities, guaranteed funds and offshore assets.
- Investment in the listed corporate bonds and REITS declined during the seven-year period.
- Total assets of the pensions sector grew by 9.5% to KShs 1.73 trillion in December 2023 from KShs 1.58 trillion in December 2022.
- Asset classes that recorded the largest scale-down: Quoted equities (-32.6%), corporate bonds (-15.4%) and investment in immovable property (-2.5 %).

Assets Under Fund Management (Dec. 2010 – Dec. 2023)



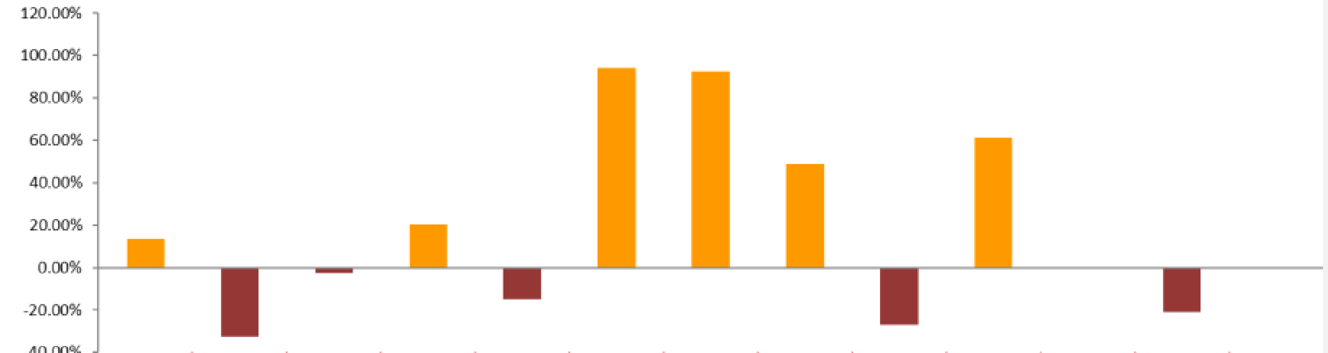
Source: Retirement Benefits Industry Report For December 2023, September 2024

Focus on Pension Sector

Emerging Dynamics

- Significant positive growth in fixed deposits, offshore investments, private equity & venture capital and cash & demand deposits.
- Focus on less volatile assets such as government securities, guaranteed funds and fixed deposits.
- Significant growth in offshore investment: Loss of value in shilling against the dollar increased attractiveness of offshore investments.

Percentage Change in Overall Industry Investments



	Govt Securities	Quoted Equities	Immovable Property	Guaranteed Funds	Listed Corp Bonds	Fixed Deposits	Offshore	Cash	Unquoted Equities	Private Equity	REITS	Commercial paper	Any Other Assets
% Change	13.41%	-32.56%	-2.55%	20.17%	-14.99%	94.02%	92.43%	48.62%	-27.16%	61.11%		-20.93%	

Source: Retirement Benefits Industry Report For December 2023, September 2024

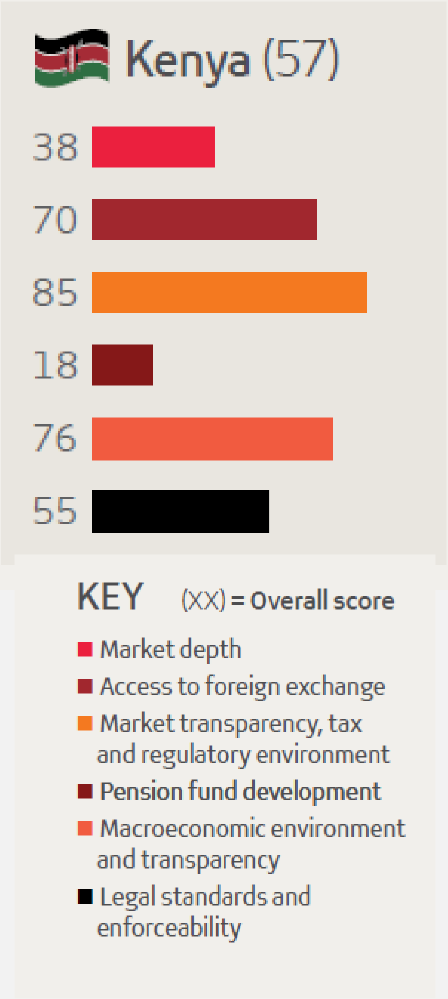
Investment in alternative assets such as REITs and private equity & venture capital continued to be attractive diversification tools.

Focus on Pension Sector

Performance in Africa

- Absa Africa Financial Markets Index ranks 29 Africa countries based on market accessibility, openness and transparency
- Pension Fund development is a pillar of assessment
- Kenya's performance fell slightly, mainly on concerns about depth of the local pension fund sector.
- Kenya's lowest performance was in the pension fund pillar with a score of 18 out of 100.
- Kenya ranked high in ESG and sustainability policies.

Pillar 4: Pension fund development	
Namibia	100
South Africa	66
Mauritius	64
Seychelles	60
Botswana	58
Eswatini	57
Morocco	32
Lesotho	31
Nigeria	28
Ghana	24
Cabo Verde	24
Egypt	22
Zimbabwe	21
Cameroon	19
Tanzania	19
Kenya	18
Rwanda	16
Mozambique	15
Uganda	15
Malawi	14
Angola	12
Senegal	12
Côte d'Ivoire	12
Tunisia	12
Zambia	12
Ethiopia	11
Benin	11
Madagascar	10
DRC	10



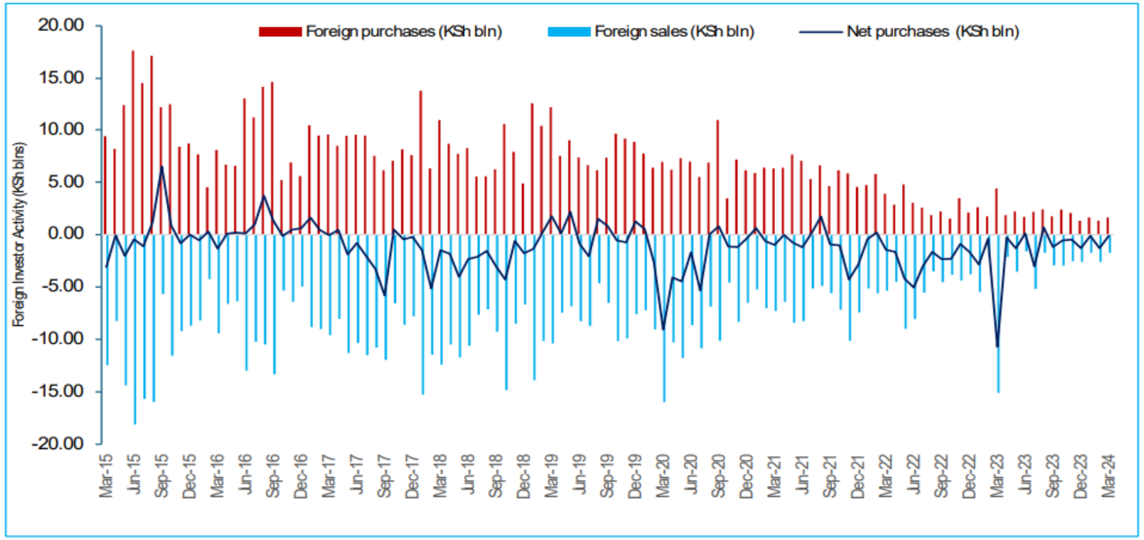
Source: Absa Africa Financial Markets Index 2024, October 2024

Focus on Pension Sector

Risks and Challenges

- **Monetary policy tightening** in advanced countries reduced portfolio inflows.
- More foreign investor outflows as investors to more to safe assets, mainly government securities.
- **Funding Risks**: Underfunding in defined benefits schemes and unremitted contributions in defined contribution schemes.
- **Low Savings Rate**: 14.2% of the adult population in the labour force save; gross savings to GDP stands at just 16.0%
- **Stock market volatility**: The performance in the stock market is unstable and has exhibited high fluctuation.

Figure 35: Foreign Investor Activity at the NSE



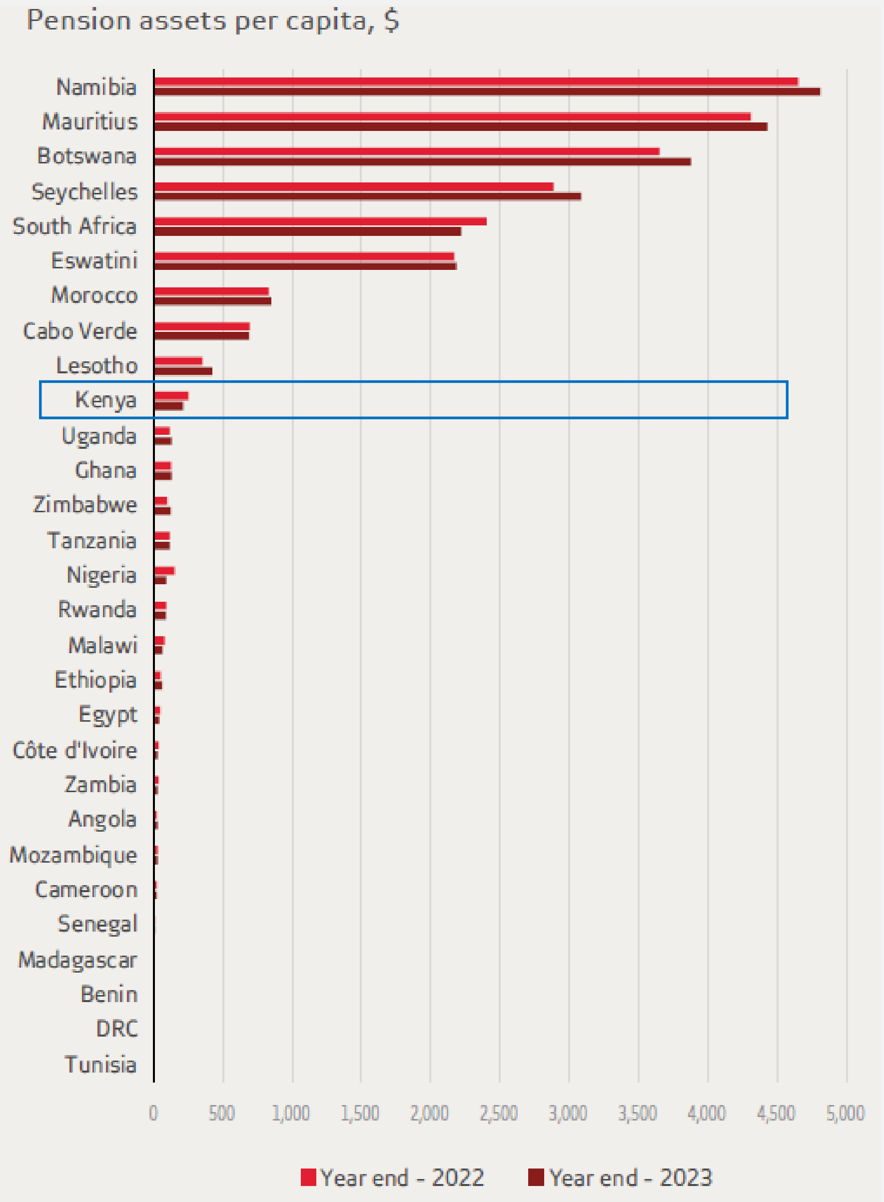
Source:Kenya Financial Stability Report, 2023, September 2024

- **Concentration:** The top five fund managers managed 90% of the total retirement industry assets under management (Dec 2023)

Focus on Pension Sector

Risks and Challenges

- **Exposure to government securities:** Investment in government securities which accounted for 47.46% of the total assets under management (Dec 2023)
- **Legal and Regulatory Risks**: Frequent changes in the legal and regulatory framework governing the retirement benefits sector may affect the sustainability of the sector.
- **Operational Risks**: Most schemes small and may have inadequate internal controls, systems and resources to manage pension scheme assets.
- **Agency/Control Risk**: The retirement benefits sector has outsourced most services including administration, custodial and fund management.



Source: Absa Africa Financial Markets Index 2024, October 2024

Focus on Pensions Sector

Bright Spots

- Robust growth of assets under management
- Increased diversification: Offshore, REITs, PE & VC.
- Strong ESG and Sustainability Policy environment
- Innovation in ESG instruments in the capital markets: Sukuk bond

Key Risks/ Challenges

- Slowed growth in 2023
- Stock market volatility
- High exposure to government securities
- Under-utilisation of ESG opportunity
- Underlying macro challenges

Creating Value through Financial Inclusion

FSD Kenya.

FSD Kenya | Creating value through inclusive finance

Website: www.fsdkenya.org | @FSDKe