THE EFFECTS OF THE GLOBAL FINANCIAL CRISIS: A CASE STUDY OF KENYA

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Introduction (1)

- *There has been a big debate on the likely impacts of the global financial crisis on Kenya.*
- *According to the Prime Minister, the Kenya economy will be badly affected.*
- *On the other hand, Ministry of Finance and Central Bank official postulate that the impacts will be indirect and most likely small.*

Introduction (2)

- *According to the latter, Kenya is primarily a rural agro-based economy with only a small minority of the population directly interfacing with the developed world.*
- *The main sectors likely to feel any significant impact are tourism and commercially- oriented agriculture such as horticulture, tea and coffee.*
- *Other effects might be felt through foreign exchange volatility, cost and availability of inputs and also the credit and trade restrictions.*

Direct effects (1)

- *It is argued that Kenya banking sector is insulated from foreign finance.*
- *The sector relies on domestic deposits and lending and does not have derivatives or asset-based securities among its portfolio.*
- *Even though some banks have significant foreign ownership, the parent banks are typically not from the US and the foreign ownership share is relatively small.*

Direct Effects (2)

- *Portfolio flows have however adversely affected the stock market, with foreign sales exceeding foreign buys in many counters, as foreign portfolio investors diversify from the market (Kibaara, 2008).*
- *The NSE-20 share index has taken a hit since mid-2008 on the back of the post-election violence and the global financial crisis.*
- *In 2008, the NSE-20 share index slumped by 35%, by 25% since July 2008.*

Direct Effects (3)

- *But according some analysts, the worst is over.*
- *According to Jimnah Mbaru:*
  - *"Most foreign portfolio investments on the Nairobi Stock Exchange (NSE) have been liquidated by the fast moving and unpredictable hedge funds who had invested on the NSE".*
- *The NSE-20 share index however declined by 7.3% in January 2009 alone.*

Direct effects (4)

- *The decline in the stock market makes it more difficult to borrow from the capital market.*
- *The public listing of Cooperative Bank of Kenya in 2008 only managed an 81% subscription even after scaling down the target amount from Kshs10 billion to KShs 6.7 billion, the first under-subscription on the NSE in the recent times.*

Direct effects (5)

- *Another view is that financial links among the world capital centres would bring the global financial crisis to Kenya.*
- *Since cities are closely connected through the international system, Nairobi which reportedly accounts for 60% of Kenya's output would impact negatively with the rest on the country if its economy was not financially well.*

Indirect Effects: Tourism

- *About 75% of Kenya's tourists come from North America and Europe. However the US accounted for only 5.9% of the number of tourists.*
- *According to some estimates, if the number of tourists from North America and Europe were to be halved, the loss would be in the range of $316 million, a major loss of forex earnings.*
- *There has been a substantial decline in tourist earnings, caused by various factors including the post-election violence, increased oil prices and the global financial crisis.*

Commodity exports

- *Commentators have mainly focused on a few products:*
  - *tea,*
  - *cut flowers*
  - *and to a lesser extent, coffee*
- *These are Kenya's main commodity exports.*

Tea (1)

- *The auction tea prices have substantially declined (by 60%) since September 2008.*
- *This has been caused by increased supply of tea in the global market.*
- *This in turn has been induced by unsustainably high prices (US $ 2.15 per kg compared to a realistic price of under US$2 per kg, according to FAO).*
- *The decline has also been caused by political problems in Pakistan which is a major buyer of Kenyan tea (it took 28% of the tea exports).*

Tea (2)

- *Pakistan also entered into a free trade arrangement with Sri Lanka, hence buying more tea from that country.*
- *Other major buyers are Egypt and UK, which may be severely affected by the global financial crisis and hence the demand for tea.*
- *In 2007, Kenya produced 369 million kilograms of processed tea. In 2008, the country was expected to produce a smaller output of 335 million kilograms due to the drought in the country.*

Cut flowers

- *Some expect cut flower exports in decline because cut flowers are a luxury (Kibaara 2008).*
- *Others expect cut flower exports to be fairly stable because of their emotive feel-good factor (Kenya Flower Council, KFC).*
- *According to the KFC, Kenya exported 93,000 tonnes in 2008, a slight increase over the 91,000 tonnes exported in 2007.*
- *Cut flower exports are likely to be boosted further by the planned introduction of direct flights between Kenya and the USA.*

Total exports

- *More generally a large proportion of Kenya's exports are sold in the region.*
- *COMESA accounted for 31.4% of Kenya's total exports in 2007*
- *These are mainly essential manufactured products and are unlikely to be unduly affected by the global crisis, at least in the short-run.*
- *The EU accounts for another 26.4%, mainly agricultural products.*
- *The USA accounts for less than 5%.*
- *A depreciating currency has helped cushion export earnings.*

Remittances

- *The reduction of incomes and the loss of jobs by Kenyan in the Diaspora is expected to reduce remittances.*
- *According to CBK, remittances actually increased by 6.6%, from US$ 573. 6 million in 2007 to US$ 611.2 million in 2008.*
- *Remittances were quite volatile in 2008 – there was no clear pattern.*
- *Data on remittances are quite unreliable. Some other sources give the remittances for 2007 to be US$1.3 billion, almost triple the CBK data.*

ODA

- *Aid flows may also reduce, due to the massive bailouts at home.*
- *Kenya is however not considered to be a high aid-dependent economy.*
- *At its peak in 1989-90, net ODA inflows averaged 14.6% of the gross domestic income, declining to 2.52% in 1999 and were 2.94% in 2002, before increasing to 4% in 2006.*
- *At 3-4% of GNI, Kenya dependence on foreign assistance is low, compared to neighbouring countries.*

Macro impacts (1)

- *Reduced economic activities and capital inflows including a reversal/ reduction of portfolio capital have aggravated the macroeconomic imbalances in the economy.*
- *In the 2008/9 budget, the government expected to incur a budget deficit of Kshs 127 billion, with a component to be financed from abroad.*
- *This has been affected by the financial crisis. A $500 million sovereign bond was postponed while the Kenya Revenue Authority has not been able to achieve its targets.*

Macro impacts (2)

- *These imbalances have also caused a depreciation of the Kenya shilling as well as a running down of foreign exchange reserves.*
- *In 2008, the Kenya shilling depreciated by 22.6% against the US$ and by 15.6% since July 2008.*
- *The reserves declined from 4.94 months of import covers at January 15, 2008 to 3.26 months of import cover as at January 15, 2009.*

Third-party effects

- *First, high fuel prices that peaked in July 2008 fueled inflation and increased current account deficits.*
- *The subsequent tumbling of oil prices has brought some relief.*
- *It is hoped that this is extended to other imported raw imported materials such as fertilizers, reducing the cost of production and increasing food production.*

Impact on growth

- *All these effects have adversely affected the Kenya growth rate.*
- *In 2007, the country experienced a growth rate of 7%, the highest growth in over two decades.*
- *In 2008, the growth was expected to be 4% (IMF) due to the post-election violence in the first quarter of the year, drought and the global financial crisis.*
- *In 2009, growth is expected to about 3% (AIG).*

Policy issues

- *Kenya has set up a Task Force to look into ways of cushioning Kenya's economy from the effects of the global financial crisis.*
- *It is comprised of officials of the ministry of finance and planning as well as the central bank.*

Some suggested solutions:

- *Lower interest rates. CBK has already lowered the cash ratio from 6% to 5% and the Central Bank Rate from 9% to 8.5% , although some contend these actions are not enough to significantly reduce interest rates.*
- *Expand Expenditures e.g. acquisition of shares by the government or its agencies to shore the stock market*
- *Facilitate and lower the cost of remittance costs which are currently quite high.*
- *Etc*

THANK YOU FOR LISTENING