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Public Debt Dynamics in Kenya

Conrado Garcia, Lydia Ndirangu, Isaya Maana

Abstract
The worsening fiscal positions in both developed and developing countries have made debt and fiscal sustainability take a front seat in public policy debates. In the case of Kenya, prolonged primary deficits and increases in public debt ratios in the last 6 years, after significant declines in external debt necessitates a careful study. The paper assesses through an accounting framework, the main determinants of debt-to-GDP ratio between 2000 and 2014. The framework underscores the importance of the debt composition, management and structure, the exchange rate and the fiscal stance for the dynamics of public debt. These can impact fiscal vulnerability. The study attempts to link changes in debt-to-GDP ratios to episodes of marked policy change. The results show that: (i) primary fiscal surpluses, real GDP growth and re-evaluation effects contributed to drastic decline in total public debt during the 2003-2007; (ii) there was a shift in the contribution of the primary deficit and the real exchange rate towards raising the aggregate debt ratio during period 2008-2011 (iii) other factors followed a similar pattern: largely contributing to debt reduction up to 2009 and to debt accumulation thereafter. Monetisation of the deficits has remained fairly constant at about 3 percent of GDP over the study period.

Key words: Public Debt, Debt Management, Primary Deficit, Fiscal Solvency.

Disclaimer: The views and opinions expressed in this paper are those of the authors and do not reflect the position of Kenya School of Monetary Studies/Central Bank of Kenya and the United States Agency for International Development.

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2 USAID/Kenya
3 Kenya School of Monetary Studies, Central Bank of Kenya. Corresponding Author’s email: lndirangu@ksms.or.ke
4 Central Bank of Kenya.
I. Introduction

In recent years, multilateral financial institutions have praised Kenya’s macroeconomic management, especially after the country was hit by both domestic and exogenous shocks in late 2000s. However, in the last couple of years, increased demand for financing infrastructure development, coupled with unpredictable external financing have exerted pressure on Kenya’s fiscal position. Although Kenya’s revenues reached about 19 percent of GDP\(^5\) in the fiscal year 2013/14, expenditures reached about 26 percent of GDP in the fiscal year. Consequently, the primary balance widened from a deficit of 3.4 percent of GDP to 4.1 percent of GDP during the period. Tax revenues accounted for 85.1 percent of total revenues. However, total government expenditure and net lending increased, resulting in an estimated financing requirement equivalent to 6.2 percent of GDP. Total public debt rose from 41.6 percent of GDP in June 2013 to 46.8 percent in June 2014, largely reflecting the issuance of the Sovereign Bond. The rising primary deficits and increased public debt should be carefully monitored to ensure that public debt remains sustainable.

Empirical evidence by Reinhart et al (2003) on financial crises, which included default episodes, highlights that for a “debt intolerant” country even a foreign debt of 15 percent of GDP may indicate risk of insolvency. Other authors, Daniel et.al (2004), have found that in the three previous decades, 55 percent of emerging countries insolvency episodes occurred when public debt was below 60 percent of GDP. In the case of the crises from the 1980’s and 1990’s in emerging markets, weak fiscal positions, underdeveloped domestic markets, large currency and maturity mismatches made the economies more vulnerable to shocks (Mohanty (2012). The recent experience in developed countries, where issues of capacity to rollover debts and weak fiscal positions led to common sovereign downgrades, financial instability and real output loses are worth noting. The increasing financing needs and rise in debt in Kenya, especially over the last decade indicate the need to analyse the debt dynamics. This is the objective of this paper.

\(^5\) Based on the rebased national accounts released in September 2014.
The rest of the paper is organised as follows: Section II provides a background on debt management; Section III describes the methodology. Results are reported in Section IV and Section V concludes.

II. Public Debt Management in Kenya

Kenya’s total public debt to GDP ratio declined from a high of over 66 percent in 2000 to a low of about 43 percent in 2008, largely due to a decline in external debt and an increase in reliance on domestic markets (Figure 1). During this period external debt declined from about 40 percent to 21.6 percent of GDP while domestic debt dropped to about 22 percent from around 24 percent of GDP. In 2008, an upward trend is observed, and by 2014, total gross public debt had risen to more than 55 percent of GDP of the old GDP series. External and domestic debt had reached 26.9 and 31.9 percent of GDP respectively. With the recent rebasing of the national accounts, total public debt was estimated at 49 percent of GDP in 2014.

Figure 1. Kenya: External and Domestic Debt (in per cent to GDP)

A rise in both the budget deficit and expenditures in the last 7 years (Figure 2 & Figure 3) may signal difficulties in maintaining fiscal discipline and may increase fiscal vulnerability. Primary
deficits and interest payments have increased since 2006, with total interest payments being above 3.5 percent of new rebased GDP in 2013 and 2014 (Figure 3). The largest increase has been real interest payments on domestic debt (Figure 4).

**Figure 2: Kenya: Total Government Revenues and Expenditures**  
(Percent of New Rebased GDP)

![Graph showing government revenues and expenditures](image2)

*Source: KNBS & World Economic Outlook, International Monetary Fund.*

**Figure 3: Kenya: Total Interests on Public Debt and Primary Deficits**  
(Percent of New GDP)

![Graph showing interests on public debt and primary deficits](image3)

*Source: Authors’ computations based on budget outturns*
In light of the increasing public debt ratio, and the increase in the cost of borrowing, debt management policy can play an important role in terms of helping achieve an optimal debt mix and debt maturity. The Bank for International Settlements conference in 2012 (BIS, 2012) addressed issues related to fiscal dominance, average public debt maturity, development of domestic bond markets, and the role of central bank in debt management and its implications for monetary policy for emerging markets. The findings highlighted that improvements in fiscal positions in many emerging markets (EMs) helped them to stabilise their economies during the recent global financial crisis. Montoro, et al., (2012) especially argued that the decline in fiscal deficits and public debt reduced the problem of fiscal dominance in EMs. An examination of these issues in Kenya revealed that fiscal dominance was not a problem by 2008 (see Nyamongo, et al., 2010 and Baldini and Ribeiro (2008). However, there is need to re-look at the issues given the rise in public debt and deficits in recent years — a matter that Nyamongo, et al., (2014) address. In this paper, we analyse the debt dynamics which are a key determinant of fiscal vulnerability.
Public Debt Management Strategy and Recent Evidence in Kenya

The Kenya Medium-Term Debt Management Strategy (MTDS) was formulated to ensure that public debt is sustainable. Following the implementation of the MTDS, the rising trend in the debt-to-GDP ratio was reversed by June 2003 when it stood at 64 percent of GDP (based on the old series). The proportion of external debt in total public debt dropped to 45.8 percent in June 2014 from 54.7 percent in 2006 (Table 1). This shift towards domestic sources can be partly attributed to unpredictable external financing (Ryan and Maana, 2014). Domestic debt accounted for 56 percent of total public debt in June 2013 compared with 45 percent in June 2006. The share of domestic debt held by banks stood at 46 percent in June 2013 compared with 41 percent in 2006, partly reflecting continued dominance by institutional investors.

Average interest rates on public debt have generally increased since 2011 (Table 1) but the average cost of external debt remains lower than that of domestic debt. This is because a large proportion of the external debt is mainly held by multilateral lenders and therefore concessional. As at June 2014, 54 percent of external debt was held by multilateral creditors while 24 percent was held by bilateral lenders. The remaining 22 percent was held by commercial lenders and through export.

Table 1: Trends in Implied Yields and Composition of Public Debt (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>Weighted implicit rate on debt</th>
<th>Implicit rate on domestic debt</th>
<th>Implicit rate on foreign debt</th>
<th>Foreign debt/Total debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>7.10</td>
<td>16.25</td>
<td>2.43</td>
<td>70.16</td>
</tr>
<tr>
<td>2000</td>
<td>4.95</td>
<td>12.28</td>
<td>1.83</td>
<td>65.75</td>
</tr>
<tr>
<td>2001</td>
<td>4.06</td>
<td>9.98</td>
<td>0.97</td>
<td>65.04</td>
</tr>
<tr>
<td>2002</td>
<td>4.93</td>
<td>10.81</td>
<td>1.76</td>
<td>61.55</td>
</tr>
<tr>
<td>2003</td>
<td>5.81</td>
<td>10.94</td>
<td>2.61</td>
<td>58.45</td>
</tr>
<tr>
<td>2004</td>
<td>3.98</td>
<td>7.58</td>
<td>1.43</td>
<td>59.14</td>
</tr>
<tr>
<td>2005</td>
<td>3.57</td>
<td>7.25</td>
<td>1.03</td>
<td>57.93</td>
</tr>
<tr>
<td>2006</td>
<td>4.19</td>
<td>8.55</td>
<td>1.03</td>
<td>54.65</td>
</tr>
<tr>
<td>2007</td>
<td>4.94</td>
<td>9.57</td>
<td>1.10</td>
<td>49.53</td>
</tr>
<tr>
<td>2008</td>
<td>6.22</td>
<td>10.59</td>
<td>1.76</td>
<td>49.63</td>
</tr>
<tr>
<td>2009</td>
<td>5.91</td>
<td>10.23</td>
<td>1.53</td>
<td>49.94</td>
</tr>
<tr>
<td>2010</td>
<td>5.39</td>
<td>9.57</td>
<td>1.20</td>
<td>45.38</td>
</tr>
<tr>
<td>2011</td>
<td>5.68</td>
<td>9.15</td>
<td>1.51</td>
<td>47.73</td>
</tr>
<tr>
<td>2012</td>
<td>6.51</td>
<td>11.14</td>
<td>1.44</td>
<td>46.59</td>
</tr>
<tr>
<td>2013</td>
<td>5.78</td>
<td>9.56</td>
<td>1.44</td>
<td>43.95</td>
</tr>
<tr>
<td>2014</td>
<td>7.15</td>
<td>11.34</td>
<td>1.81</td>
<td>45.79</td>
</tr>
</tbody>
</table>

Source: Computations based on Data from the Annual Economic Survey and Budget Outturns
The implementation of the MTDS also resulted in a decline in the rate of increase in the tenor of securitized domestic debt. The proportion of securitized debt with a tenor of below 4 years declined from 75 percent to 45 percent between 2005 and 2013. The maturity profile rose from 2.5 years to around 6.25 years. The diversity of the currency structure of the external debt also increased with 33.0 percent of the debt being in Euros, 32.3 percent in US Dollars, 15.1 percent in Japanese Yen, 5.7 percent in Chinese Yuan, 5.5 percent in Sterling Pounds, and 8.4 percent in other currencies (Republic of Kenya, 2013). The diverse currency structure mitigates against exchange rate risk. The default risk on external debt was also low as 75 percent of the debt stock had a maturity of over 10 years, a grant element of 68.6 percent, grace period of 8 years, average maturity of 33.7 years, and average interest rate of 1.2 percent per annum.

Recent studies indicate that despite the rapid increase in the stock of public debt especially in the last decade, public debt remains sustainable (Ryan and Maana, 2014; IMF, 2003). However, the studies recommend various measures to ensure that the debt remains sustainable. These include, continued lengthening of the maturity profile of domestic debt and diversification of the investor base, macroeconomic stability, faster and sustainable economic growth, and rationalization of recurrent expenditures to contain the widening deficit in the primary balance.

III. Methodology

The following section provides the description of the methodology for decomposing the debt dynamics and its determinants. As mentioned above, we follow Budina and Fiess (2005) approach for accounting for the decomposition of debt dynamics linking the changes in debt-to-GDP ratios in Kenya with policy, structural factors and the macroeconomic context. The analysis breaks down the changes in the debt ratio into components such as real growth, primary fiscal deficits, and appreciation/depreciation effects on foreign currency denominated debt. Under this framework, other factors affecting changes in the debt-to-GDP ratios are debt relief, privatization, and fiscal costs related to contingent liabilities from bank sector bailouts, and bailouts of publicly owned enterprises. This accounting exercise can be a useful tool to interpret the public debt determinants in Kenya in the last decade. The underlying equation for the evolution of public debt is:

\[ D_t = (PD_t - NDFS_t) + D_{d,t-1}(1 + i_d) + e_t D_{f,t-1}(1 + i_f) \]
where $D_t$ is the total stock of debt at time $t$. The debt stock is composed of debt denominated in both domestic and foreign currencies. Domestic-currency debt ($D_{d,t}$) evolves according to the interest rate in the market ($i_d$), while the evolution of the foreign-currency debt ($D_{f,t}$), expressed in domestic currency, is affected not just by the foreign interest rate ($i_f$) but also by changes in the exchange rate ($e_t$).

$D_{t-1}$ is the total stock of debt at time $t-1$, and $PD$ is the primary deficit.

Dividing both sides by $GDP_t = GDP_{t-1}(1 + g)(1 + \pi)$, with the lower case variables expressed in upper-case variables as a proportion of GDP,

$$d_t = (pd_t - ndfs_t) + \frac{D_{d,t-1}(1 + i_d)}{GDP_{t-1}(1 + g)(1 + \pi)} + \frac{D_{f,t-1}e_{t-1}(1 + i_f)e_t}{GDP_{t-1}(1 + g)(1 + \pi)e_{t-1}}$$

or,

$$d_t = (pd_t - ndfs_t) + d_{d,t-1} \frac{(1 + i_d)}{(1 + g)(1 + \pi)} + d_{f,t-1} \frac{(1 + i_f)(1 + s_t)}{(1 + g)(1 + \pi)} \hspace{1cm} (1)$$

$$d_t = (pd_t - ndfs_t) + (1 - \alpha)d_{t-1} \frac{(1 + i_d)}{(1 + g)(1 + \pi)} + \alpha d_{t-1} \frac{(1 + i_f)(1 + s_t)}{(1 + g)(1 + \pi)}$$

$$d_t = (pd_t - ndfs_t) + \frac{d_{t-1}}{(1 + g)(1 + \pi)}[(1 - \alpha)(1 + i_d) + \alpha(1 + i_f)(1 + s_t)] \hspace{1cm} (2)$$

Define $\hat{i} = (1 - \alpha)i_d + \alpha i_f (1 + s_t)$ as the average nominal interest rate on public debt, and equation (2) can be rewritten as

$$d_t = (pd_t - ndfs_t) + \frac{d_{t-1}}{(1 + g)(1 + \pi)}[\hat{i} + 1 + \alpha s_t], \hspace{1cm} (3)$$

The average nominal interest rate, $\hat{i}$, is calculated as ratio of interest payments on debt divided by the previous period stock of public debt.

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6 In the case of Kenya, there was no issuance of domestic foreign currency debt by this time.
Subtracting $d_{t-1}$ from both sides of equation (3) yields

$$\Delta d_t = (pd_t - ndfs_t) + \frac{\hat{i}}{(1+g)(1+\pi)} d_{t-1} - \frac{g}{1+g} d_{t-1} + \frac{\alpha \pi_t - \pi}{(1+g)(1+\pi)} d_{t-1}$$

(4)

Based on the conversion of nominal change in exchange rate into real terms,

$$\frac{1}{1 + RXR} = \frac{1}{1 + \pi}$$

(5)

after some algebra, it is possible to show that the numerator of the last term in equation (4) is:

$$\alpha \pi_t - \pi = \alpha \frac{1+\pi}{1+\pi^*} + (1 - \alpha) - \frac{\alpha \pi^*}{(1+RXR)(1+\pi^*)} - (1 + \pi)$$

(5)

Substituting (5) into (4) gives the basic accounting framework for public debt decomposition:

$$\Delta d_t = (pd_t - ndfs_t) - \frac{g}{1+g} d_{t-1} + \frac{\hat{i}}{1+g} \left[ \frac{\pi}{1+\pi} + \frac{\pi^*}{1+\pi} - \frac{\alpha}{1+\pi} - \frac{\alpha}{1+\pi^*} \right]$$

$$- \frac{RXR}{(1+\pi^*)(1+RXR)} d_{t-1}$$

(6)

Where,

$D_t$ - total public debt, $d_i = D_i / GDP_t$

$D_{dt}$ - domestic public debt, $d_{dt} = D_{dt} / GDP_t$

$D_{ft}$ - foreign public debt, $d_{ft} = D_{ft} / GDP_t$

$PD_t$ - primary deficit, $pd_i = PD_i / GDP_t$

$NDFS_i$ - non-debt financing sources, $ndfs_i = NDFS_i / GDP_t$

$e_i$ - nominal exchange financing sources, $ndfs_i = NDFS_i / GDP_t$

$RXR$ - change in bilateral real exchange rate, with $RXR > 0$ indicating real exchange rate appreciation defined as: $\frac{1}{1 + RXR} = \frac{(1 + s_i)(1 + \pi^*)}{1 + \pi}$

$\alpha$ - the share of foreign currency denominated debt in total public debt ($\alpha = \frac{d_{ft,t-1}}{d_{t-1}}$).
IV. Results

We provide results for both the ‘old’ and ‘rebased’ GDP series (Figure 5 & Figure 6). The estimation based on the rebased GDP series is limited as data is only available from 2006. The results, however, do not vary much. From Figure 5, a decline in debt-to-GDP ratio is observed during the period 2003-07. This is largely driven by the growth and revaluation effects. The high residuals in 2003 could be associated with a debt relief about this time. In 2000 and 2004, Kenya rescheduled, under the Paris Club, debt arrears and flows effectively receiving 50 percent debt relief in present value terms (GOK, 2007). There is also an indication of tightening of fiscal policy during this period. The combined effects of primary surpluses, strong growth and revaluation effects with smaller interest rate payments on debt and lower expenditure levels led to a reduction of total Debt-to-GDP ratio during the period 2003-2007. After 2008-2011 smaller growth effects and revaluation effects (depreciation) along with a looser fiscal policy with expenditures reaching over 26 percent of GDP (rebased series), pushed debt up. The primary fiscal deficits have steadily increased since 2007 and have reached to over 3.5 percent of the new rebased GDP. Debt monetisation has averaged about 3 percent during the study period.

During the period 2008-2014 period (Figure 6), smaller growth effects and increases in the interest rates can be observed. While a looser fiscal policy may have been in effect, a tightening of monetary policy to contain inflationary pressures was taking place during the same period. The tightening of monetary policy led to an increase in the cost of borrowing, and this brings up the issue of policy coordination.
Figure 5: Kenya: Debt Dynamics, 2004-2014

![Graph showing the contribution of various factors to the year-on-year change in the debt/GDP ratio from 2004 to 2014.](image)

Source: Authors’ calculations

Figure 6: Kenya: Debt Dynamics, 2007-2014

![Graph showing the contribution of various factors to the year-on-year change in the debt/GDP ratio from 2007 to 2014.](image)

Source: Author’s Calculations

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Note: The colored segments of each column represent the contribution of each factor in the debt decomposition to the year on year change in the debt/GDP ratio. Items above the zero line contributed to an increase in the debt/GDP ratio, while items below the zero line contribute to a reduction in the debt/GDP ratio. As an example, a negative sign for Contribution from real GDP growth in a given year indicates that real GDP growth during that year contributed to a reduction in the debt/GDP ratio; and a positive sign for the Contribution from real exchange rate changes indicates that a real depreciation increased the debt/GDP ratio during that year.
These findings are in line with those of Budina and Fiess (2005) who find that in large reductions in debt to GDP, fiscal consolidation was a key component of credible debt reduction. They also find that declines in debt ratios were also determined by growth and appreciation effects. In this study, we find that these factors were also key in lowering the debt ratio during the 2003-2007, when the debt ratio declined from 64 to 42 percent of GDP. However, the exchange rate appreciation need to be assessed further to ensure that the appreciation is not the result of overvaluation⁸, or that may bring short term gains but have long term impacts in terms of competitiveness. On the other hand, if the appreciation is the result of productivity gains, the implications in terms of potential output can contribute to further public debt reduction and reinforce the growth effect. Although the currently available National accounts data do not provide evidence of productivity growth above that of Kenya’s trading partners, there could be under reporting and the on-going revisions will review the true status.

Table 2 further summarizes the cumulative public debt decomposition and tries to link changes in debt-to-GDP ratios to episodes of marked policy change.

### Table 2: Cumulative public debt decomposition

<table>
<thead>
<tr>
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<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in public sector debt</td>
<td>-4.5</td>
<td>-19.2</td>
<td>7.6</td>
<td>1.5</td>
<td>4.6</td>
</tr>
<tr>
<td>Interest payments</td>
<td>7.1</td>
<td>9.0</td>
<td>8.9</td>
<td>5.0</td>
<td>8.6</td>
</tr>
<tr>
<td>Primary Deficit (- a surplus)</td>
<td>-3.0</td>
<td>2.8</td>
<td>10.9</td>
<td>6.2</td>
<td>13.0</td>
</tr>
<tr>
<td>Growth effect</td>
<td>-8.3</td>
<td>-10.8</td>
<td>-6.3</td>
<td>-4.4</td>
<td>-6.9</td>
</tr>
<tr>
<td>Revaluation effect</td>
<td>-5.1</td>
<td>-11.3</td>
<td>1.2</td>
<td>-3.4</td>
<td>-6.8</td>
</tr>
<tr>
<td>Seigniorage</td>
<td>-2.2</td>
<td>-3.3</td>
<td>-3.5</td>
<td>-2.0</td>
<td>-2.5</td>
</tr>
<tr>
<td>Residual (other factors)</td>
<td>7.0</td>
<td>-5.6</td>
<td>-3.7</td>
<td>0.1</td>
<td>-0.8</td>
</tr>
</tbody>
</table>

Source: Authors computations

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⁸ In Ndirangu et.al (2014), the real exchange rate appreciation is found to be the main driver of macroeconomic vulnerability in Kenya. A caveat is made that, a break in the real exchange rate may mean a new equilibrium level and not necessarily a misalignment. Mweiga (2014) and Kiptui et al. (2014) observe that the shilling’s overvaluation is marginal at about 4 percent. IMF (2014) reports similar findings. However, this view is at variant with World Bank’s (2013) opinion that an overvalued exchange rate is hurting the countries competitiveness. While the IMF 2011 Article IV found Kenya’s real exchange rate to be broadly in line with fundamentals, subsequent real appreciation has occurred at the same time as a sharp decline in the terms of trade, which declined by some 18 percent from end-2010 to end-June 2014.
During the period 2003-2005, Kenya public sector debt-to-GDP ratio declined by about 4.5 percent. The main factors behind this decline were a combination of primary fiscal surpluses, economic growth and a substantial contribution from real exchange rate change. The only factors driving the debt ratio up were interest payments and unaccounted factors. This period marked general election in December 2002 and a change in government in January 2003.

With economic recovery during the period 2005-2007, Kenya managed to reduce the public debt-to-GDP by almost 19% during the period 2005-2008. A strong growth effect and appreciation of the shilling contributed to this decline.

The public debt-to-GDP ratio took a turn in 2008-2011 driven mainly by growth in primary deficits and interest payments. The ratio increased by 7.6 percentage points driven primary deficits and interest payments. Unlike other periods, changes in real exchange rate contributed positively to the debt ratio. This negative development can be linked to the post-election crisis in early 2008 and the global economic and financial crisis and the associated economic stimulis. The exchange rate crisis of 2011 in Kenya may be responsible for the positive reevaluation effect. The period after the crisis (2011-2012), growth in the debt-to-GDP ratio decelerated to about 1.5 percent. The appreciation of the shilling once again contributed towards debt reduction. The debt-to-GDP ratio has taken a turn in the most recent past. The ratio increased by 4.6 percent during the period 2012-2014, with the contribution of the primary deficit recording the highest rise. Primary deficit grew by 13 percentage points during this period.

Although the primary fiscal balance is an imperfect measure of the fiscal stance because it does not account for the quality or the durability of the fiscal effort and its impact on growth, the rise in the debt ratio since 2007 may be of concern. Although a recent analysis shows Kenya’s debt remains sustainable and resilient to standard shocks, rising contingent liabilities are a fiscal risk (IMF, 2014). The new subnational government level demands that fiscal discipline will have to be observed by both the national and the county government level to ensure long term fiscal sustainability. It is also of concern that the expenditure increases have been due to increases in recurrent expenditures, even though attempts to increase development expenditures have been made. Budina and Fiess also note the strong link between quality of fiscal management and strong efficient institutional arrangements that can aid to implement effective fiscal policy,
manage liabilities and control and limit fiscal risk. And in cases where institutional arrangements are not strong, countries have opted for rule-based fiscal policies to establish fiscal credibility. Kenya adopted a budget base and a revenue rule since 1997. Bova et.al (2014), however, shows that these rules have not been very effective in reducing pro-cyclicality of fiscal policy in Kenya. A pro-cyclical fiscal policy may inhibit growth during downturns and lead to increase public debt.

V. Conclusions

The increase in fiscal deficits and public debt highlights challenges in maintaining fiscal discipline. The loose fiscal policy now may require the government to follow a fiscal tightening in the future in order to achieve a fiscal deficit that is in line with the macro fiscal and debt sustainability framework. The results of the debt dynamics analysis show that the expansionary fiscal policy that started from 2007 and the rising primary deficits, along with increased interest payments on public debt, mainly domestic debt, has led to an erosion of the gains achieved in the reduction of the public debt ratio from 2003-2007. The results show that: (i) primary fiscal surpluses, real GDP growth and re-evaluation effects contributed to a drastic decline in debt-to-GDP during the 2003-2007; (ii) there was a shift in the contribution of the primary deficit and the real exchange rate towards raising the aggregate debt ratio thereafter. However, the re-evaluation effect has pulled down debt since 2012; (iii) other factors have followed a similar pattern: largely contributing to debt reduction up to 2009 and to debt accumulation thereafter. There is need for further examination of the exchange rate appreciation to ensure that the appreciation is the result of productivity gains and not due to undue overvaluation. Appreciation that comes from productivity gains can contribute to further debt reduction and reinforce the growth effect. A commitment for responsible fiscal and debt management will be critical to lower the cost of borrowing and keep public debt in check, reinforcing debt reducing public debt dynamics in Kenya.
References


