SUPPORTING ECONOMIC TRANSFORMATION

Economic impacts of and policy responses to the coronavirus pandemic: early evidence from Kenya

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Key messages

- Estimates of the impact of COVID-19 on the Kenyan economy range from a Central Bank of Kenya projected reduction in growth from 6.2% to 3.4% to McKinsey's worst-case scenario of economic contraction of 5%.
- The Kenyan government has responded to the crisis with fiscal and monetary stimulus tools, such as lowering interest rates and taxes.
- Tourism, a major foreign currency earner, which contributes 10% of GDP, is experiencing a drop in demand.

Introduction

Kenya's first confirmed COVID-19 case was on 13 March 2020. As of 8 April, cases stood at 179, with 6 deaths recorded. The government announced a series of sweeping measures: closing borders, suspending air travel (except cargo flights), enforcing a 7pm to 5am curfew and asking government institutions and businesses to allow staff to work from home.

Prior to the pandemic, Kenya was experiencing slowing economic growth, down from 6.5% in 2018 to 5.9% in 2019. This owed largely to unfavourable weather and reduced government investment. Current health spending per capita had also fallen, from $79 per capita in 2011 to $77 in 2017. Nearly 80% of households have no hand-washing facilities in or near a toilet, posing a significant health challenge.

Economic and social impacts

CBK has downgraded economic growth prospects for 2020 by almost half, from 6.2% to 3.4%, as a result of the pandemic. McKinsey has estimated the Kenyan economy will shrink by 5% if the virus is not contained, a fall in output of $10 billion (KSh 1 trillion).

Trade and production impacts

Domestic production and supply chains have already been disrupted and demand from the country's main trading partners has fallen: Pakistan (10.8%), Uganda (10.4%), United States (8.0%) and the Netherlands (7.4%), with the US likely to show the largest drop.

Kenya's economy is particularly vulnerable because its main exports, horticulture and tourism, are very elastic in demand. The two largest export products are vegetables including horticulture (50%) and raw materials (19%). Vegetable production employs nearly 10 million people directly and indirectly and, at $1.15 billion, annual, is the country's third-largest foreign exchange earner (around 19% of goods exports). It has lost $75 million in the past month as a result of lockdowns in Kenya's main markets in Europe. The Kenya Flower Council estimates it is losing around $300,000, with flower farms already forced to send 1,000 workers home given the slump in demand.

Kenya's positive trade in services offsets its current account deficit and fluctuating agricultural output. This is driven by tourism: transport and travel made up 37% and 19.7% of services exports in 2018. However, the tourism industry, which represents around 10% (nearly $8 billion) of GDP), is being hit hard. Kenya Airlines has applied for a bailout, having recorded an $8 million revenue loss since suspension of the Nairobi–Guangzhou route. WTTC figures show that in 2018 Kenyan tourism grew 5.6%, creating 1.1 million jobs. Most of these jobs will be vulnerable if, as predicted, the industry contracts at a faster rate than the rest of the economy. The largest markets for Kenyan tourism, the US, China and some European countries, are all affected by COVID-19-related travel restrictions.

The Stanbic Bank Kenya Purchasing Managers' Index declined to 49 in February 2020 from 49.7 in the prior month, pointing to the second consecutive contraction in private sector output.

Finance

The pandemic has severely disrupted financial markets, with S&P All Africa index returns dropping by 30% since the start of the year. The fall in Kenya has been particularly, with the Nairobi Securities Exchange 20 down 16% compared with this time last year. The shilling has depreciated over 3% against the US dollar since the first COVID-19 case was confirmed.

Remittances from abroad are the largest contributor to capital inflows, at 3.1% of GDP, compared with official development assistance at 2.8% and FDI at 1.8% (World Bank). Remittances, often the first to reduce in times of economic hardship, fell in Kenya by $40 million in February 2020 month-on-month.

Social impact
COVID-19 containment measures are expected to bring additional economic hardship in a country where informal labourers account for 83.6% of the workforce.

Inflation in Kenya increased modestly from 5.78% in January to 6.37% in February 2020. However, food price inflation increased more quickly, from 8.4% in February 2020 to 11.85% in March.

Fiscal impacts
Government revenue has been rising since 2016, and interest payments as a share of revenue fell for the first time in four years to 13% in 2017 (World Bank). However, government revenues fell in the first two months of 2020, reducing by KSh 3.5 billion (1.6%) to KSh 216 billion. Kenya's finance minister has predicted that this underperformance will deepen in the final quarter of the fiscal year as a result of the restrictions on travel and mass gatherings and the curfew.

Initially, the government expected to increase revenue from last fiscal year through dividend transfers from state-owned enterprises and increased efficiency. The former is unlikely now; the latter is still possible.

The Kenyan government has announced plans to respond to COVID-19. This spending package will add to the fiscal deficit, currently at 7.7% of GDP, and exacerbate the debt to GDP ratio, presently 62.1%. Currently, 52% of debt is foreign debt and 48% is domestic debt. Kenya's biggest lender by assets, the KCB, has reduced interest rates to 7.5% to provide an economic stimulus.

Despite falling interest rates, the demand for Emerging Market (EM) bonds globally has remained stable, as it has for other risky assets. Internationally, Kenya has evolved from a funding system of bilateral and multilateral development institutions to Eurobonds and syndicated loans. As a result of COVID-19, sovereign bond yields have fallen and are expected to remain low, as investors look for safe harbour in government bonds at a time of uncertain markets.

Monetary and financial policy

CBK has intervened to alleviate the impacts on the economy and increase the money supply. It has loosened banking policies to encourage spending and lending to boost consumption and lowered banks' cash reserve ratios by 1% to 4.25%, to stimulate lending to businesses and consumers. CBK has also lowered the policy rate by 1% to 7.25%.

CBK has provided a direct stimulus to consumers by earmarking KSh 30 billion for onward lending to M-PESA customers for a period of 90 days. The fund will allow for higher borrowing limits for qualifying customers and extend repayment periods for borrowers with existing facilities. CBK has also encouraged the removal of M-PESA mobile money transaction charges below KSh 1k.

Fiscal policy

On 31 March, the Treasury set up an Emergency Response Fund (over KSh 13 billion, or 0.14% of GDP) to bolster the country's measures to combat COVID-19 impacts. The government is reassessing the budget deficit target for the current fiscal year and has announced cuts to VAT from 16% to 14% until August to help boost consumption. The Treasury has also offered income tax reliefs and a reduction in the maximum rate of PAYE of 25% from 30%.

Small enterprises (classified as those with annual sales below KSh 500,000) are being exempted from turnover tax of 1% of sales. Traders operating small and mid-sized businesses have had their sales taxes reduced from 3% to 1%. Companies building hotels, hospitals, petroleum or gas storage facilities and manufacturing premises will be able to claim up to 50% of investment as tax allowances for the first year of operations.

Other policy

The government is importing 4 million bags of maize, half of it for food consumption, to avert a food crisis. Counties have waived a levy on food prices to help producers and consumers. Government has warned traders it is willing to impose price controls.

Donor support

The World Bank is providing $50 million (or roughly 9% of Kenya's health budget) to cover medical diagnostic services, surveillance and response, capacity-building, quarantine, isolation and treatment centres, medical waste disposal, risk communications and community engagement. Kenya is also in talks with the World Bank for budget support of $750 million and with the IMF for $350 million in emergency assistance.

Information in this note is correct as of 9 April 2020. The authors are ODI Fellows in Nigeria and Ethiopia; this note is written in a personal capacity. Comments welcome to j.adaun.fs@odi.org.uk