NATIONAL DEBT MANAGEMENT

ICPAK

18TH AUGUST 2016

KISUMU

Public Debt Management

- Public debt management is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding
- Governments should seek to ensure that both the level and rate of growth in their public debt is fundamentally sustainable
- Individual entities within the private sector typically are faced with enormous problems when inadequate debt management generates vulnerability to a liquidity crisis
- Sound debt management policies are no panacea or substitute for sound fiscal and monetary management

Public Debt in Kenya

Revenue

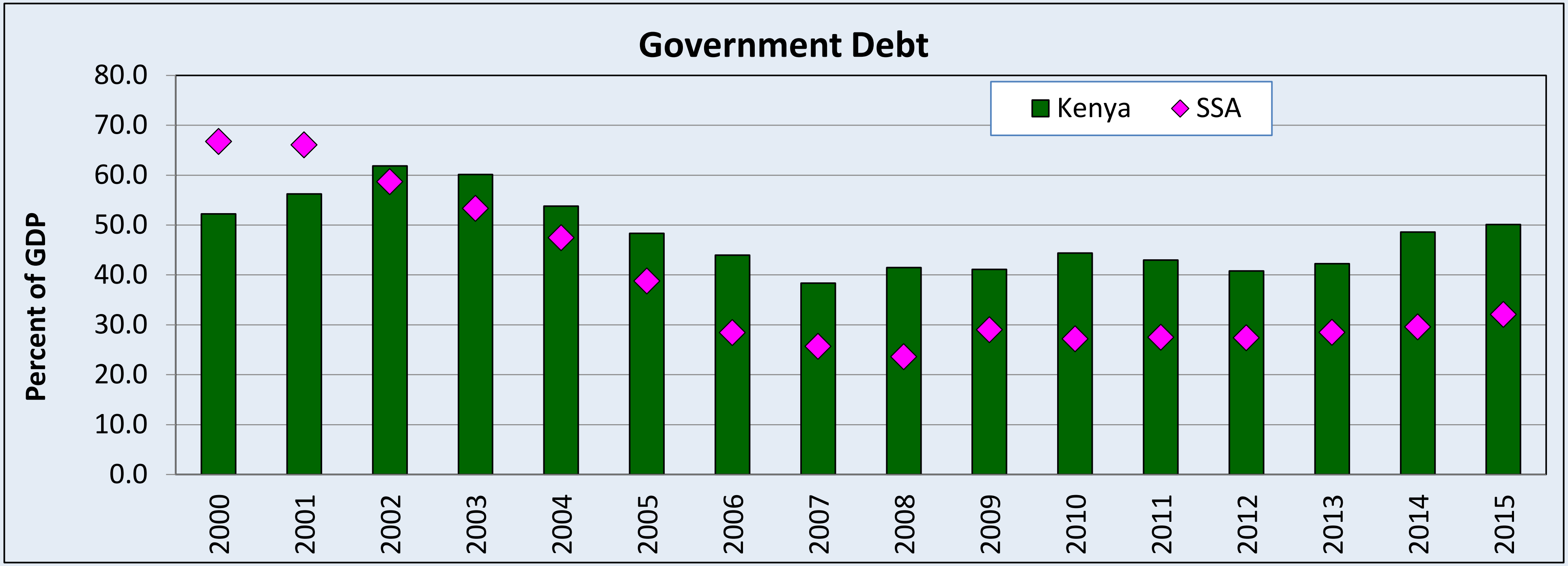
(minus) =>

Expenditure (normally larger)

Fiscal Deficit → Financing and Grants → Higher Stock of debt

- Constitution of Kenya, Article 214: Public Debt defined as "all financial obligations attendant to loans **raised or guaranteed** and securities **issued or guaranteed** by the national government". (Guaranteed debt has reference to county government debt).
- From low-income to middle income status: **Less grants and more financing** (thus, debt would tend to increase faster). Need to contain deficit more pressing.

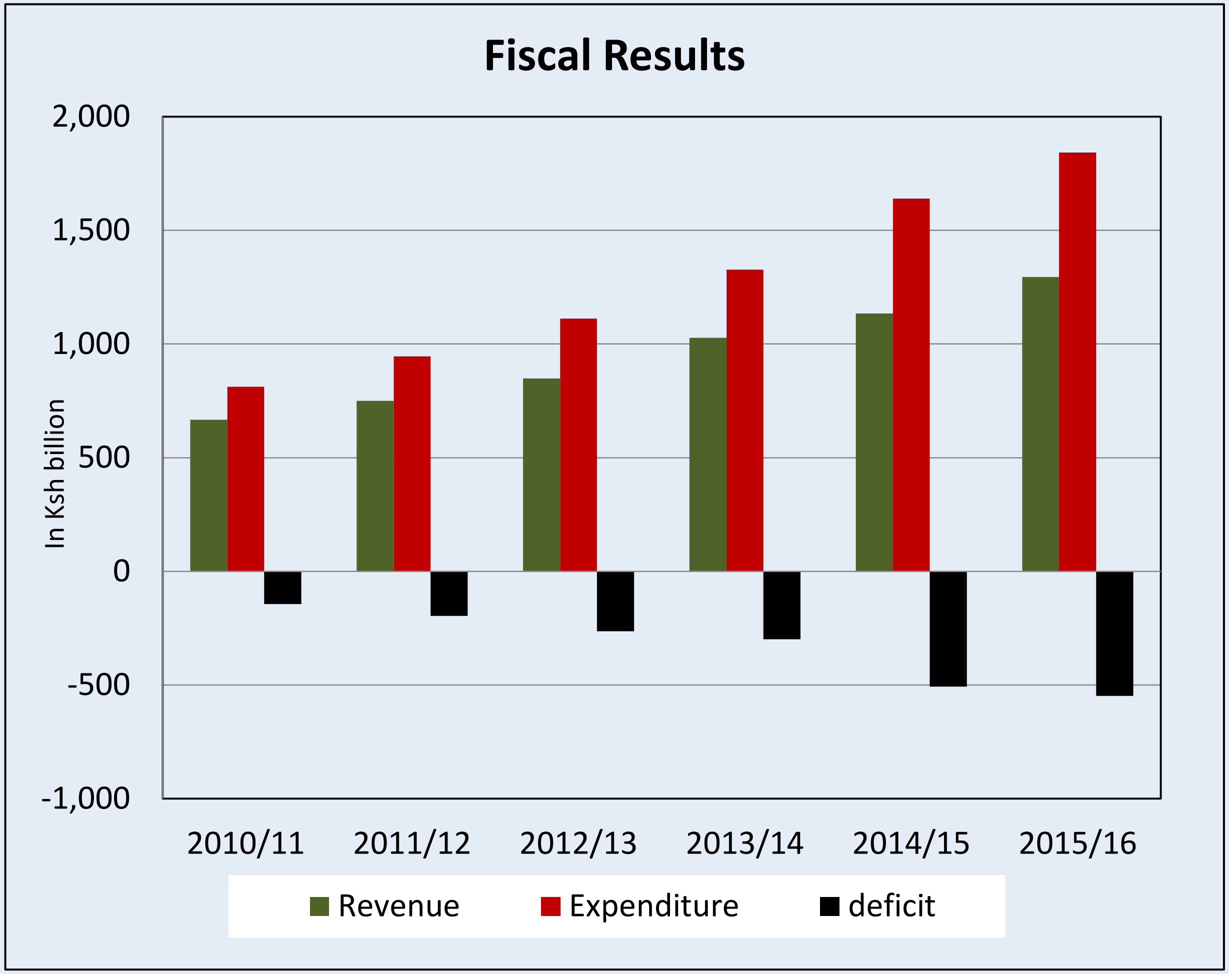
Long-run trends:



- SSA using fiscal space from debt relief.
- Kenya also reduced debt burden, despite not benefiting from debt relief.

Revenue and Expenditure

Kenya's deficit has been rising despite strong revenue growth

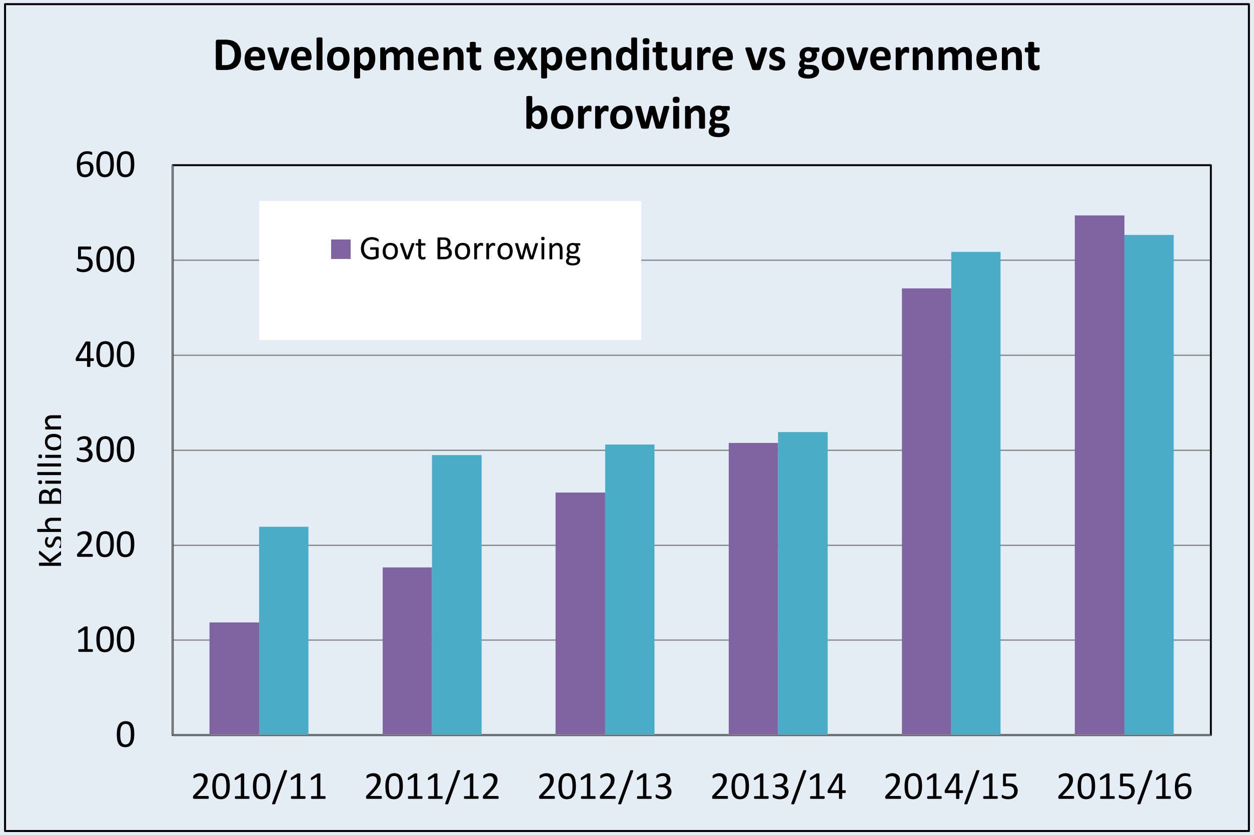


- Deficit rises in line with growing development expenditure.
- Average ordinary revenue growth: 14 percent (slightly higher than nominal GDP growth).
- Average development spending growth: 21 percent (17 percent without the SGR).
- SGR first project of its kind (and size).

Borrowing to be used for Development expenditure

Revenue to be used for Recurrent expenditure

- Public Finance Management Act, Section 15 (2): "… *the national government's borrowings shall be used only for the purpose of financing development expenditure and not for recurrent expenditure*".



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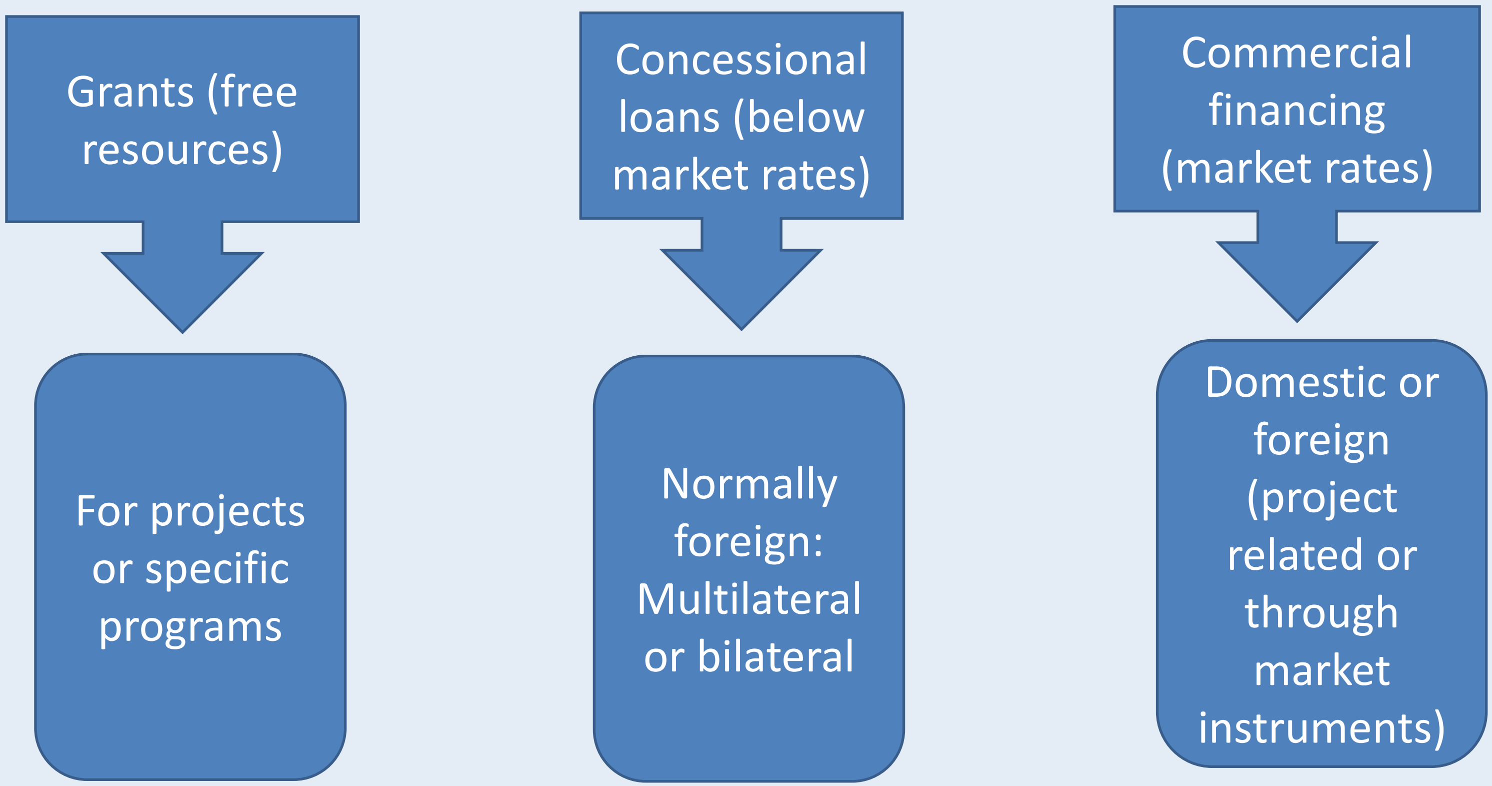
Three types of External Financing

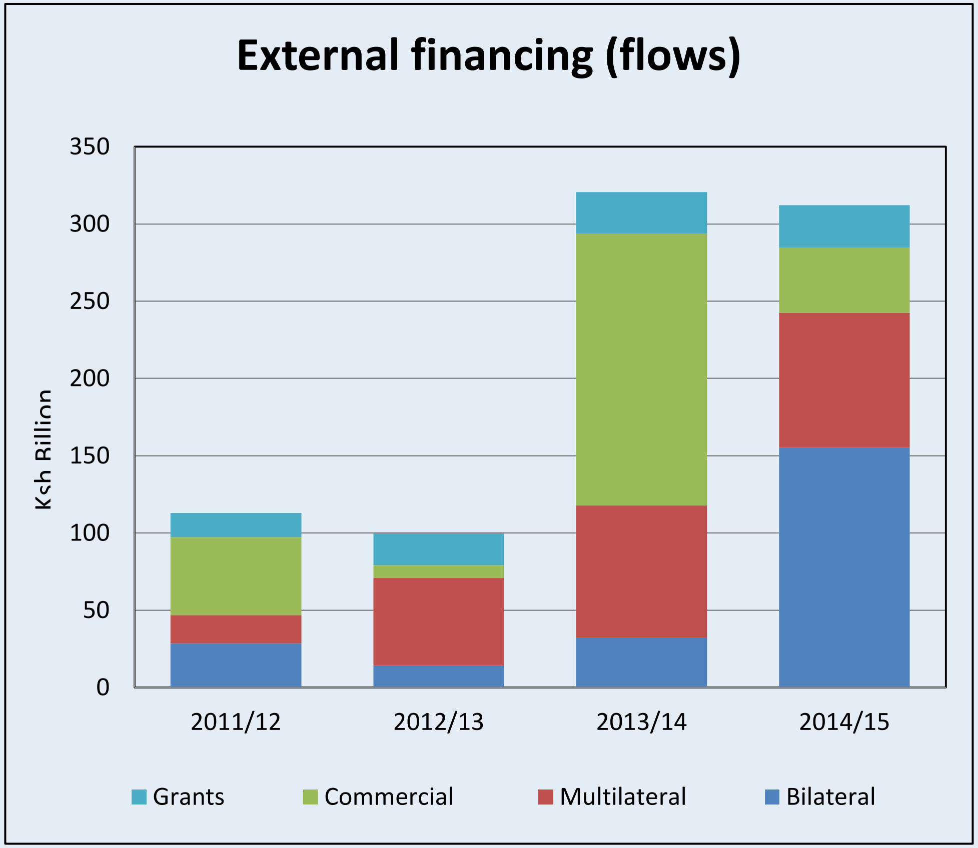


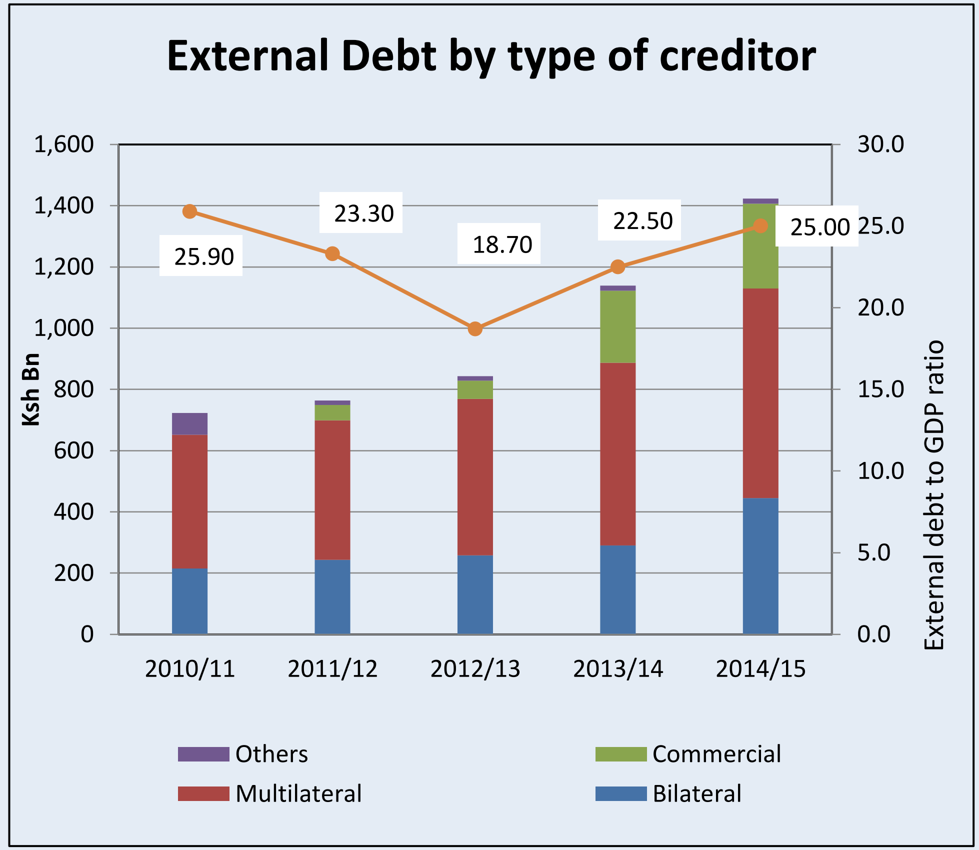
Grants: Free resources, but availability declines as countries develop.

Concessional loans: Low-cost long-term growth-supporting resources, subject to implementation capacity and debt management capabilities.

Commercial financing: Additional access to market financing available as the economy matures.

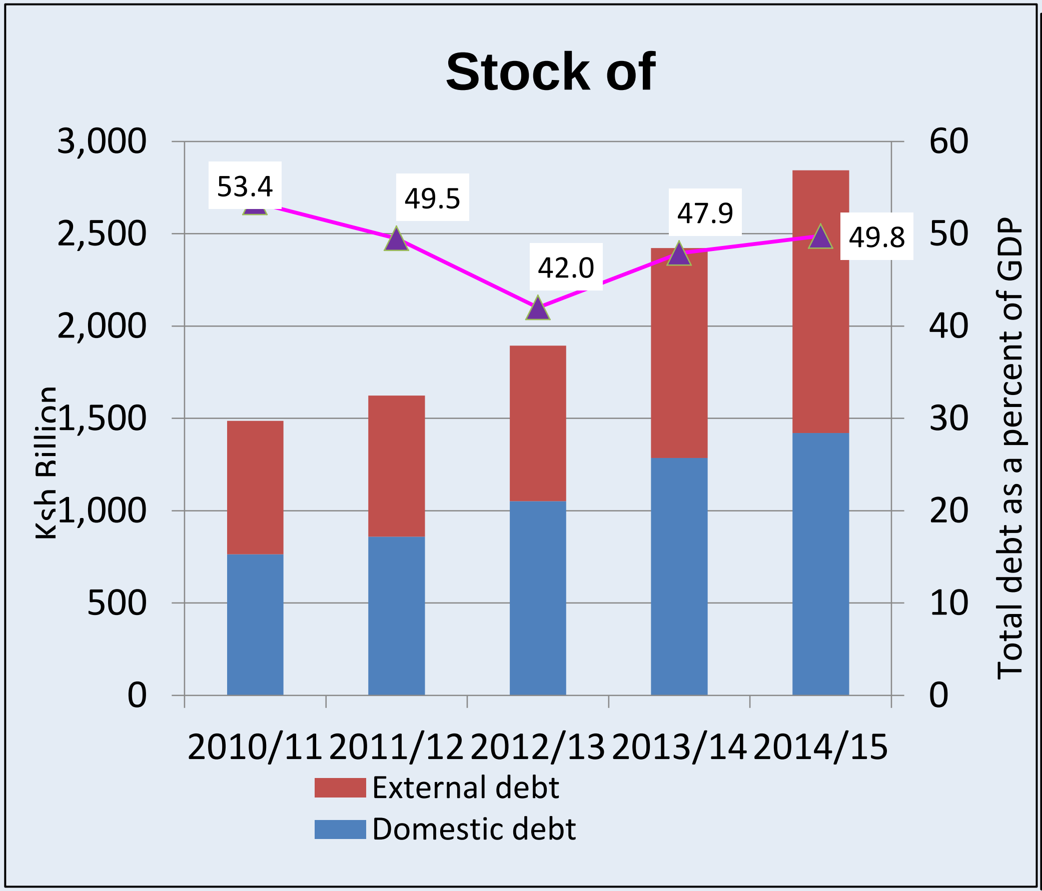
Recent surge in commercial loans and bilateral loans (especially from China), but most debt still concessional (from multilaterals and bilaterals)

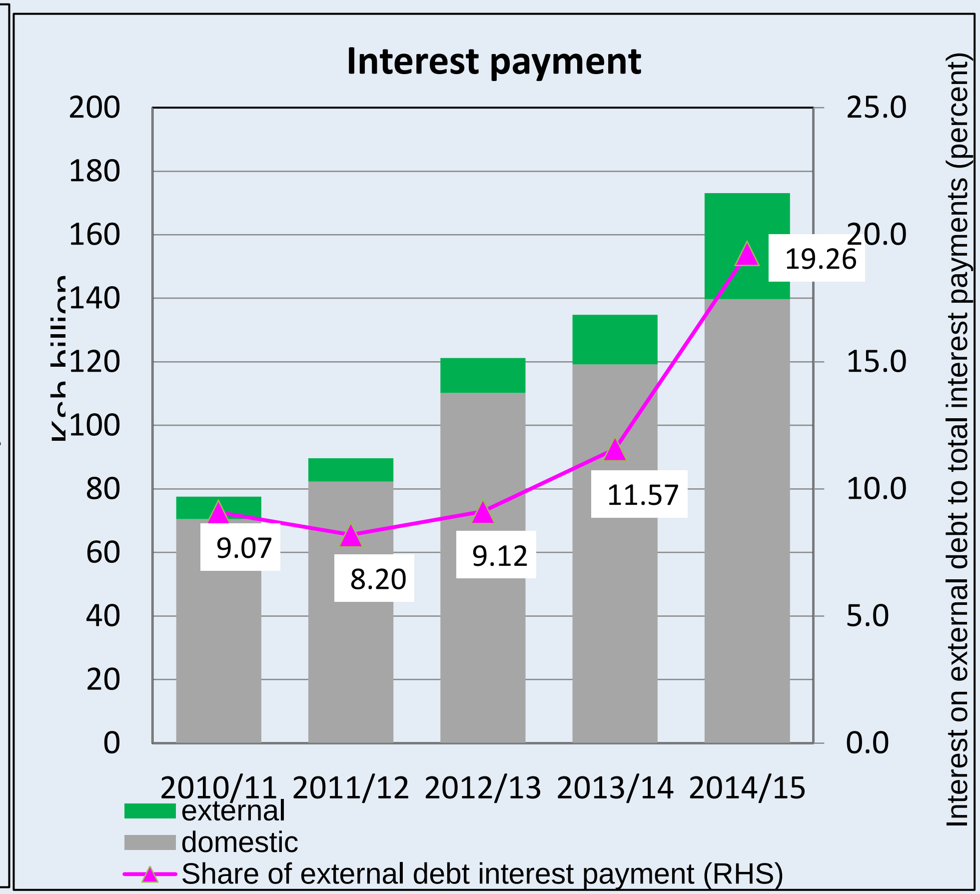




- Larger commercial loans provide new opportunities (at a cost). Need to manage currency and interest rate risks.
- Recent rise in external debt over GDP, still below 2010/11.

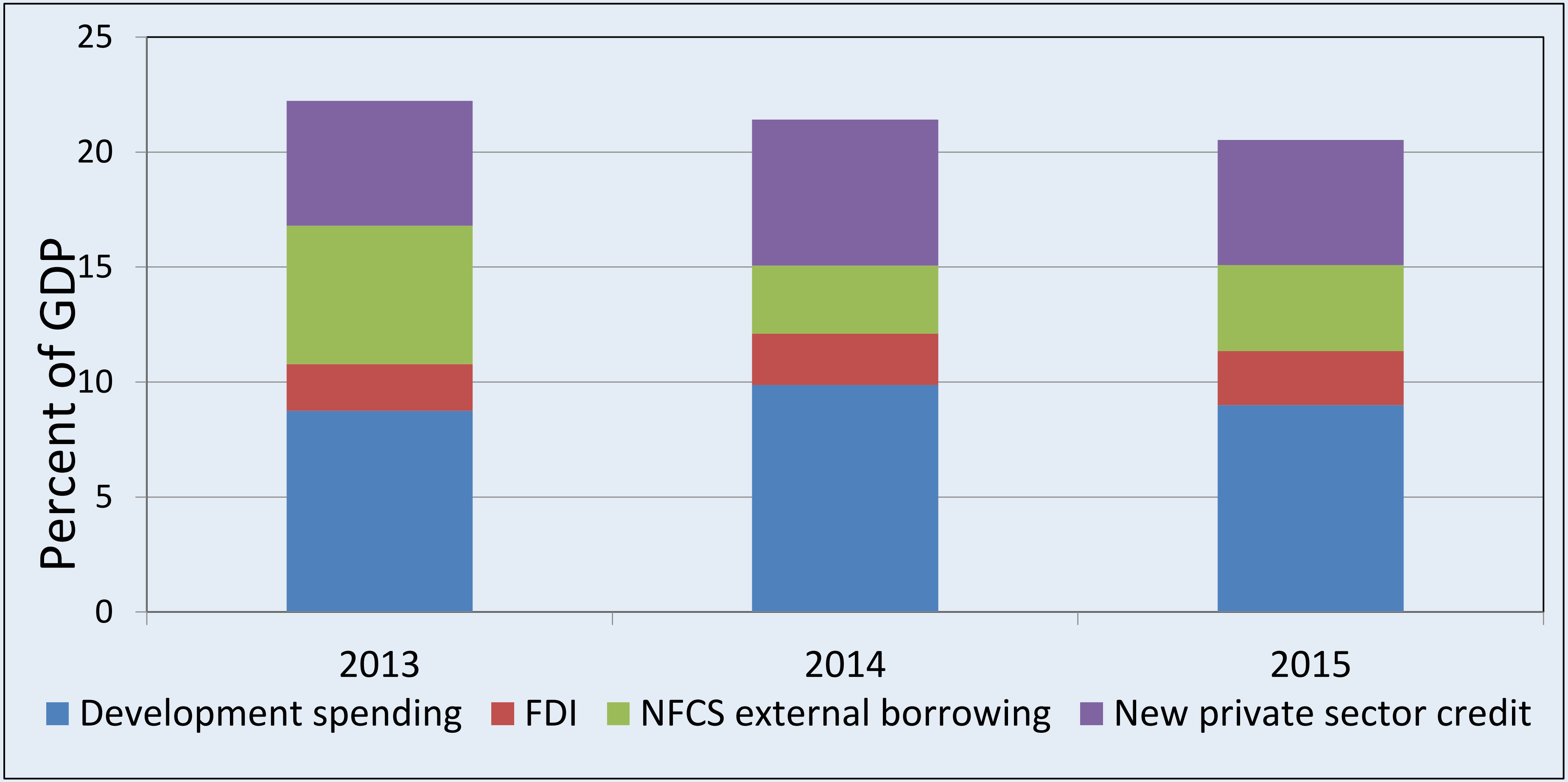
Rising debt burden (Debt to GDP), still below 2010/11. But interest payments are growing faster than stock of debt.





Is government borrowing justified?

Government development spending still explains more than 40 percent of investment in Kenya.



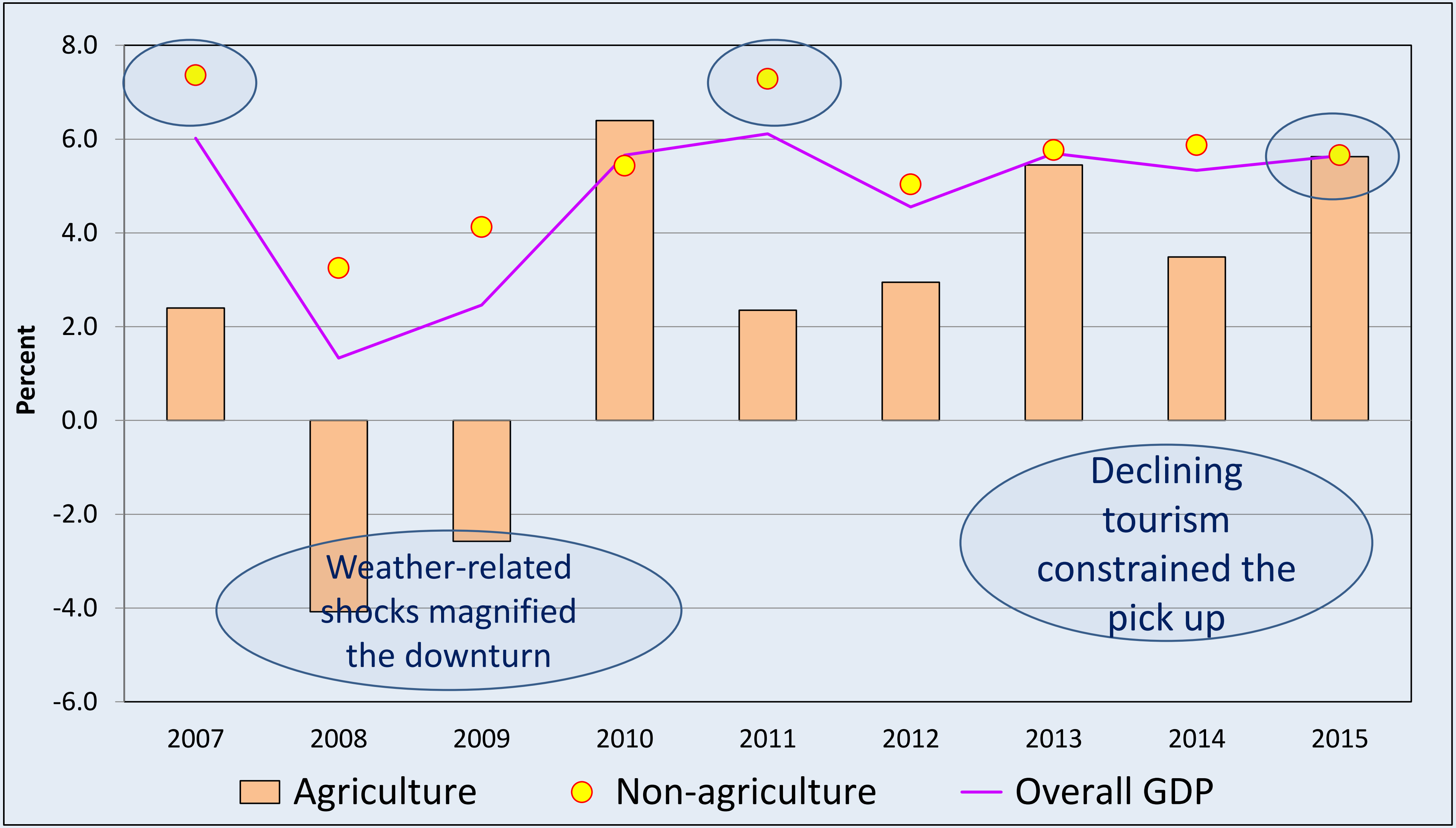
Significant resources needed to close infrastructure gap

Table 10. Indicative infrastructure spending needs in Kenya for 2006 to 2015

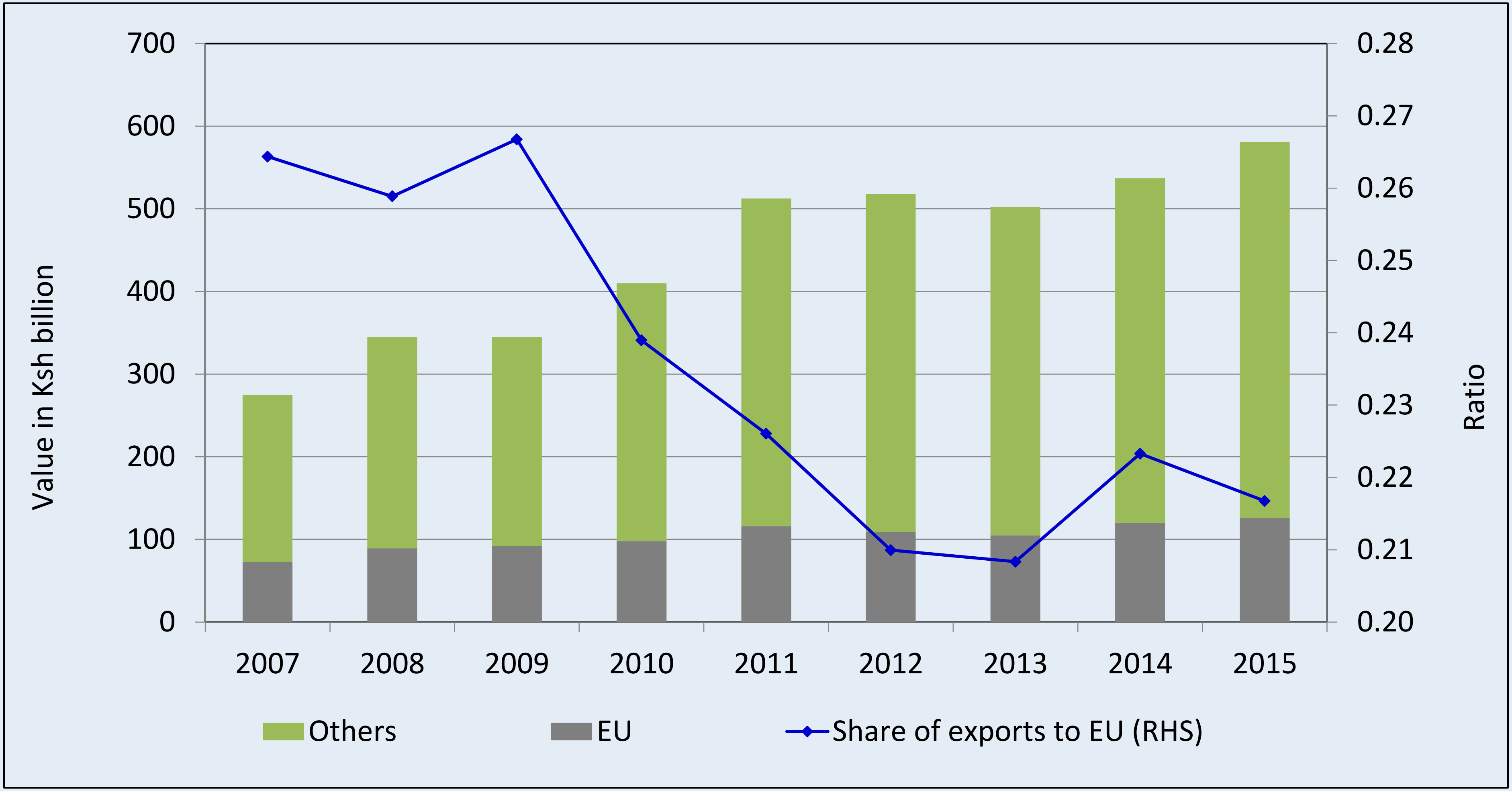
US$ million per year			
Sector	Capital expenditure	Operations and maintenance	Total needs
ICT	485	44	529
Irrigation	13	2	16
Power (trade)	745	274	1,019
Transport (basic)	232	242	474
Water supply and sanitation	1,375	555	1,930
Total	2,850	1,118	3,968

Sources: Mayer and other 2009; Rosnes and Vennemo 2009; Carruthers and others 2009; You and others 2009. Derived from models that are available on-line at http://www.infrastructureafrica.org/aicd/tools/models.

Growth is highly sensitive to external shocks



External sector may remain adverse after Brexit



In conclusion….

- Need to monitor currency and interest rates risks closely and to contain revolving risk (Debt management).
  - Risk of debt distress in Kenya has remained low (last assessment in March 2016). But distress for countries rated at "moderate risk" not uncommon (prepare for the unexpected)
- Allowing more ample room for private sector financing will help bring down interest rates over time.
- **High quality public investment will make the debt-investment-growth trinity more sustainable!**

Asante sana.

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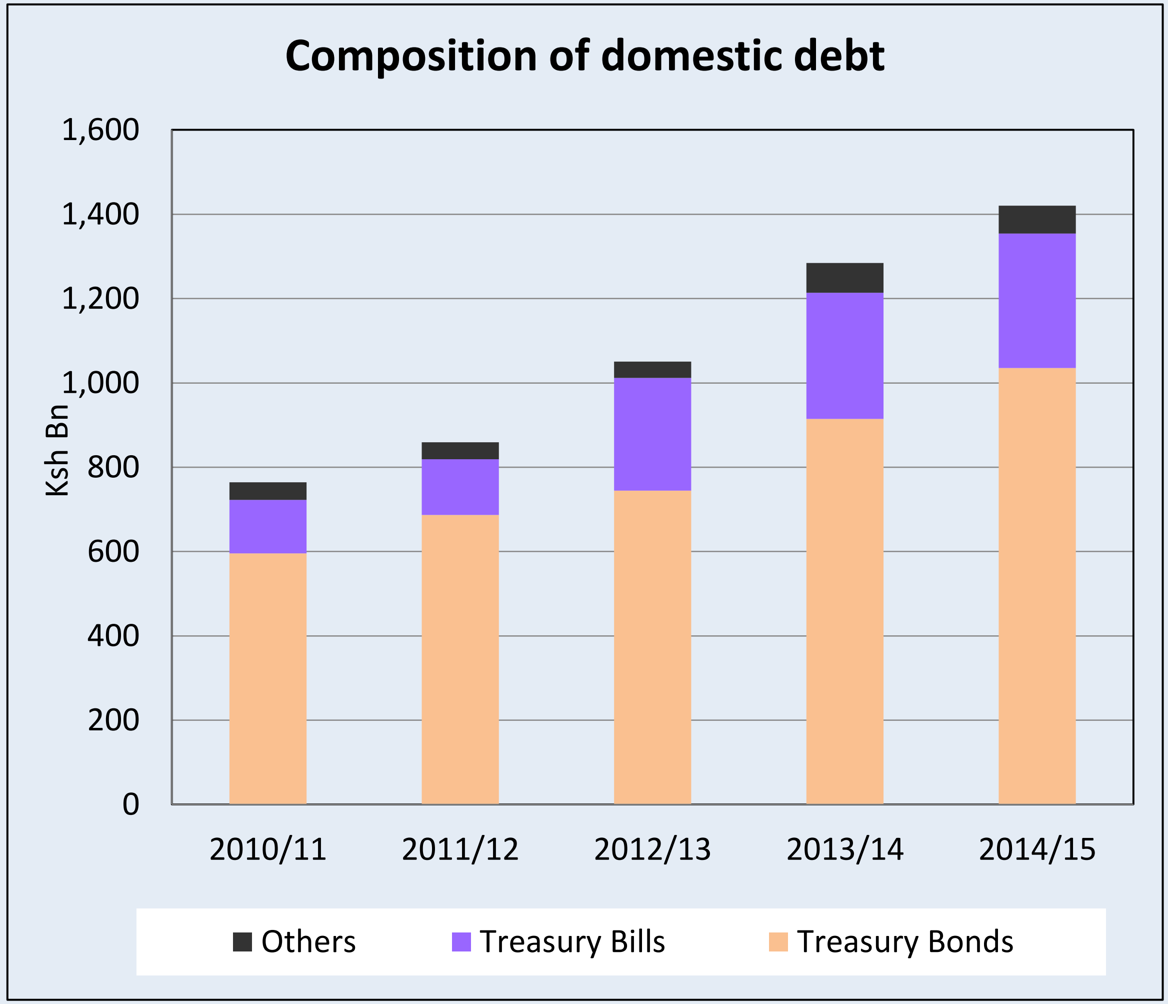
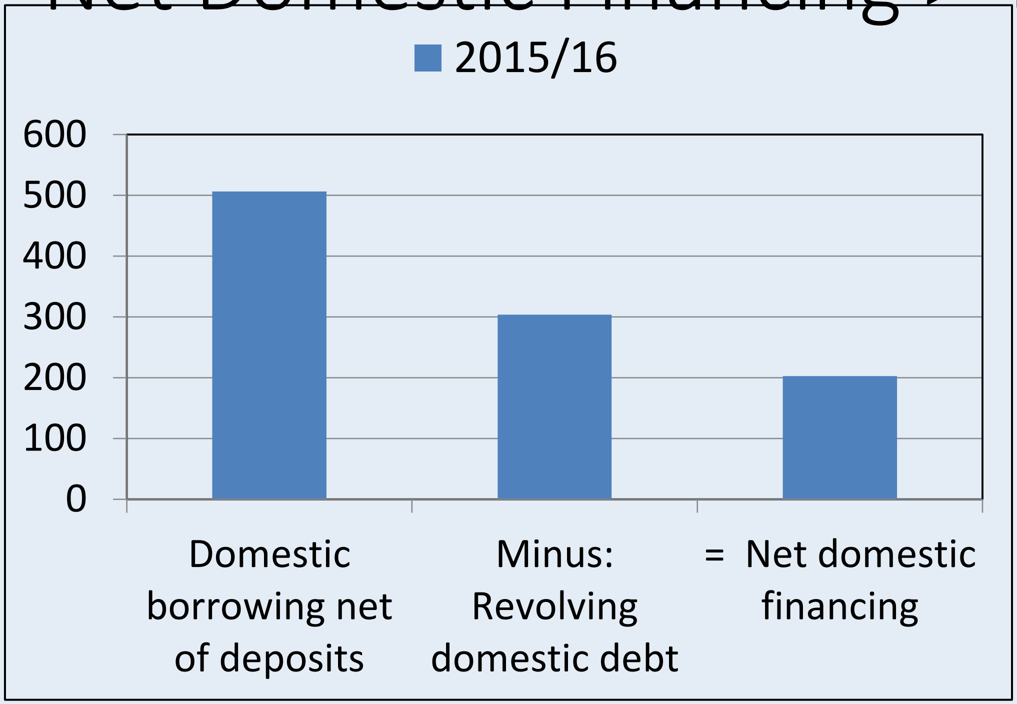
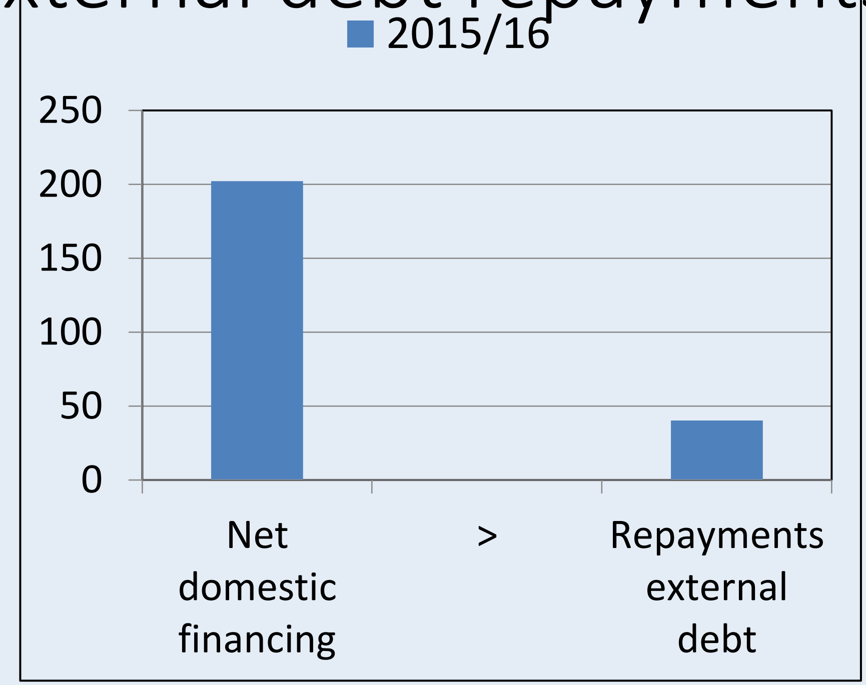
Availability of domestic financing provides an advantage (at a cost).

- Average maturity of domestic debt: 5.3 years.
- But occasional spike of maturities needs to be anticipated (revolving risk).
- Ratio of stock of domestic debt to credit to the private sector: 68.6 percent.



Gross Domestic financing > Domestic debt repayments.
Net Domestic Financing > External debt repayments

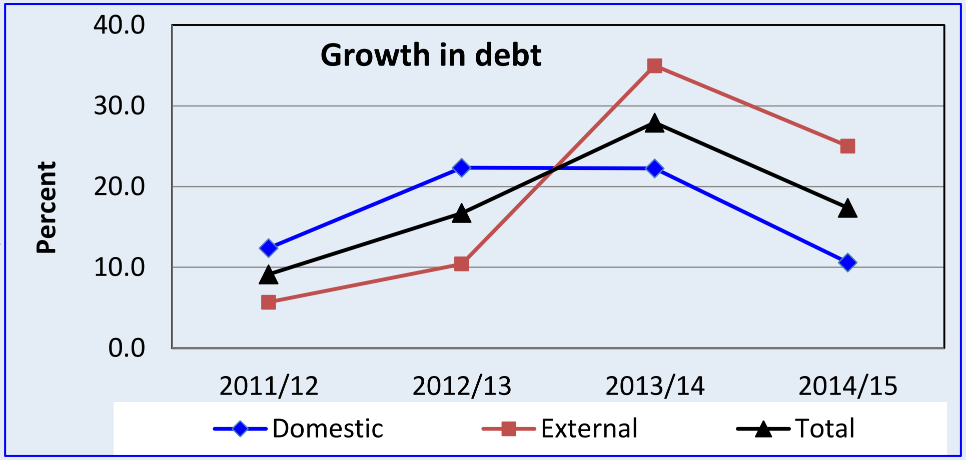




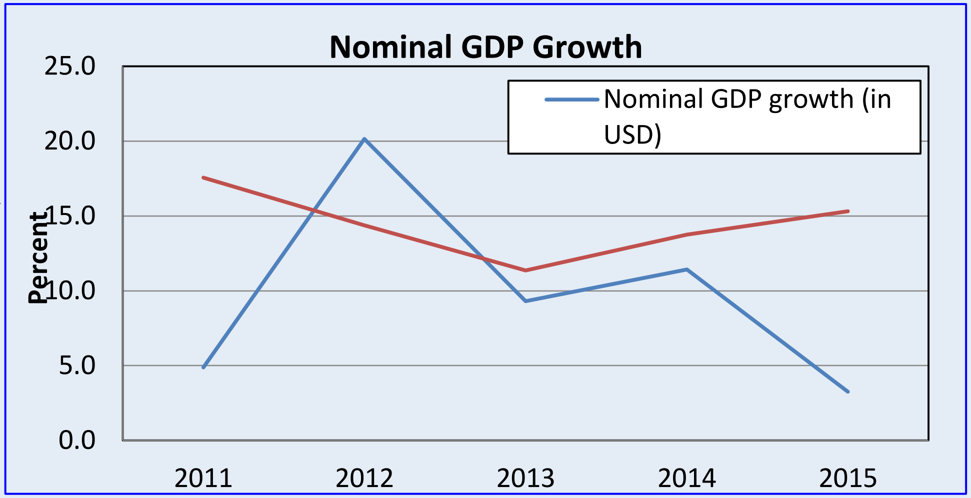
- Active government securities market allows smooth revolving of domestic debt.
- Net domestic financing larger than repayments of external debt (long maturity).
- Domestic debt obligations are repaid with new borrowing.

DSA: an **assessment** of a country's **projected debt burden** over the next 20 years; its **vulnerability** to external and policy shocks; the **risk** of external debt distress; relative to **the quality of the country's policies and institutions**.

DEBT: Growth decelerated in 2014-15 (after Eurobond and initiation of SGR project)



GDP: But, nominal GDP increased by less than debt stocks, especially in US dollars

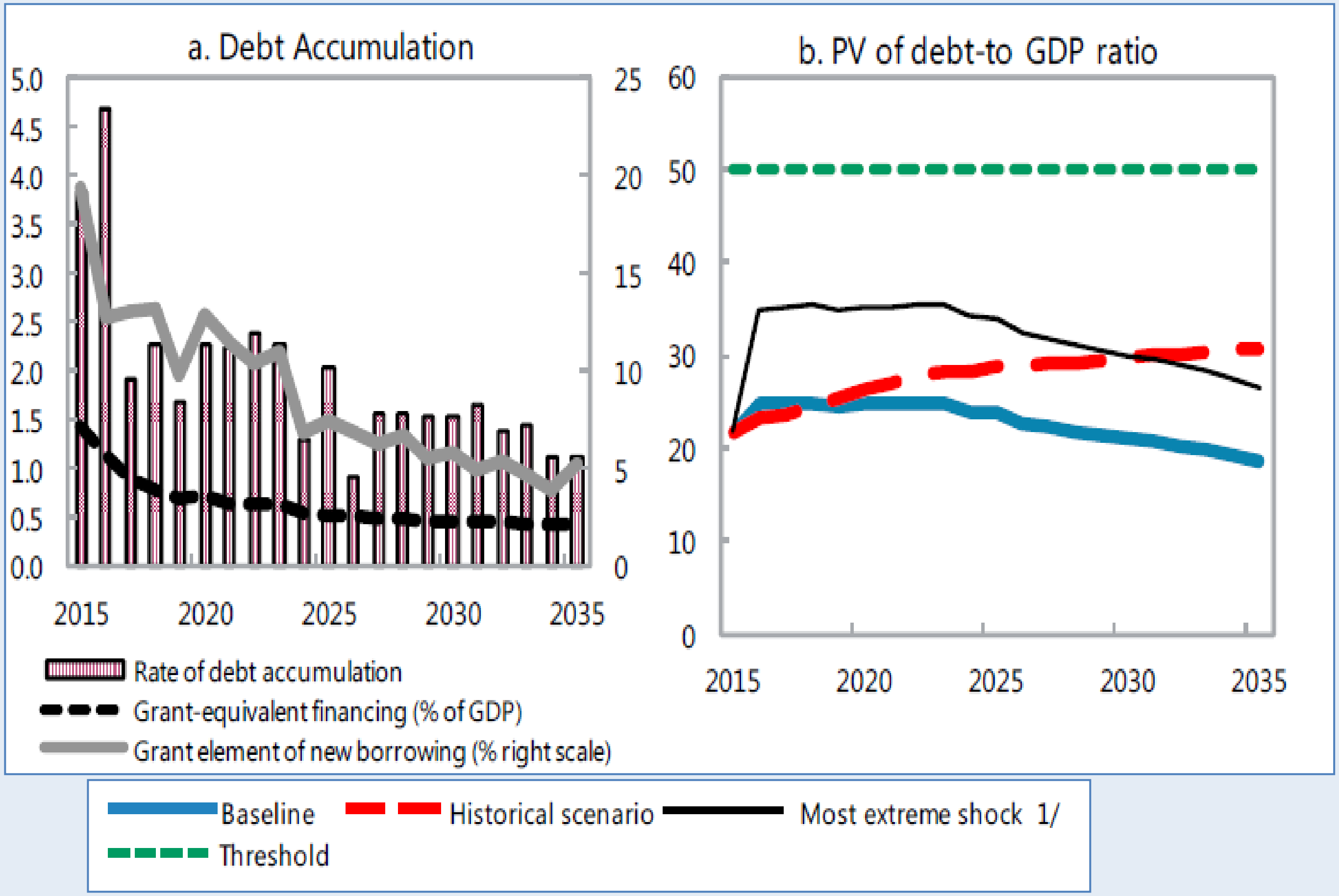


Fiscal consolidation is needed to ensure that debt stocks increase in line with medium-term target.

Underlying Assumptions for 2021-35

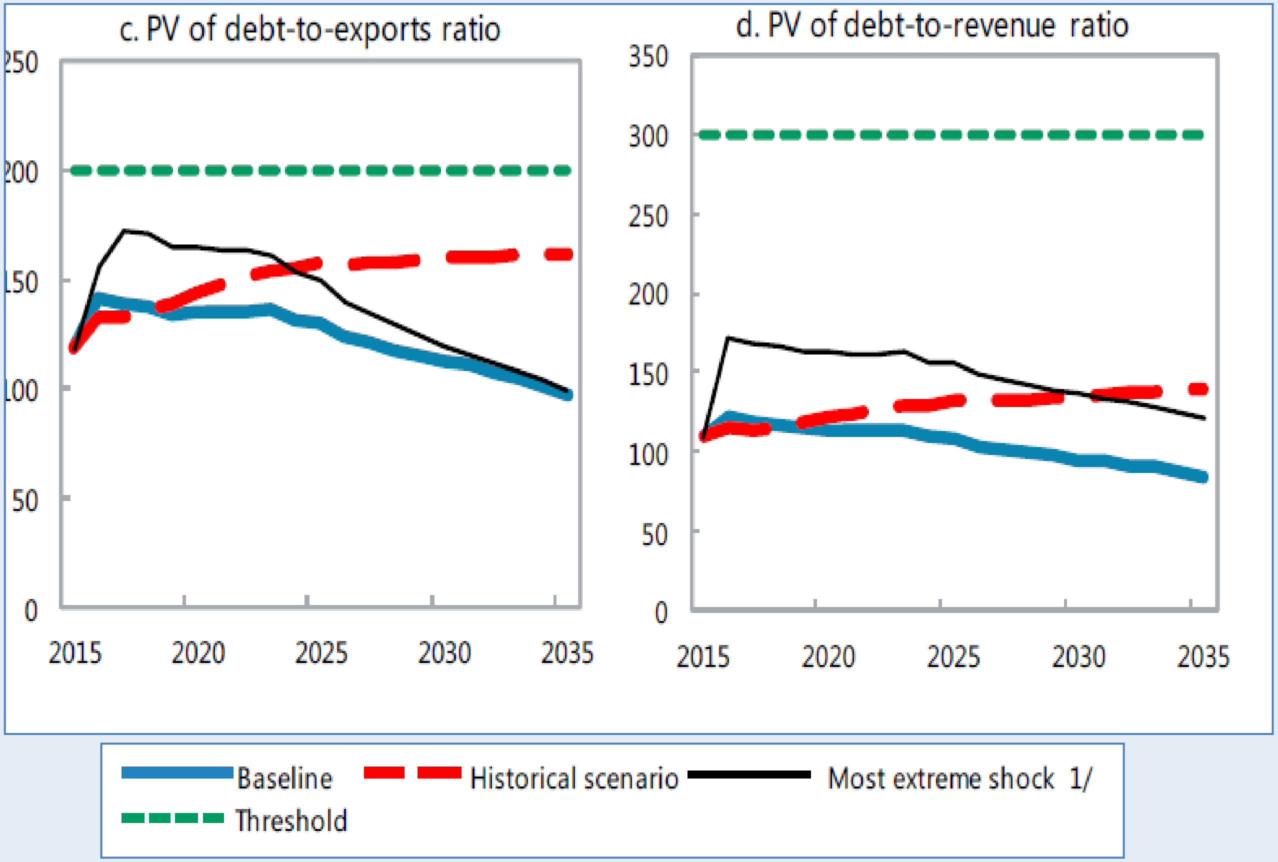
GDP Growth	• Assumption: 6.5 percent • Historical: 5.2 percent
Inflation (Deflator)	• Assumption: 5.1 percent • Historical: 8.6 percent
Local currency interest rates	• Assumption: 2.3 percent (net of inflation). • Historical: 1.5 percent.
Foreign currency interest rates	• Assumption: 4 percent. • Historical: 1.6 percent.
Primary deficit	• Assumption: 0.6 percent of GDP. • Historical: 1.7 percent of GDP (and 5.4 percent in 2015).
Interest rate on external debt	• Assumption: 4 percent (average). • Historical: 1.6 percent.

External Debt accumulation slows down, as well as concessionality



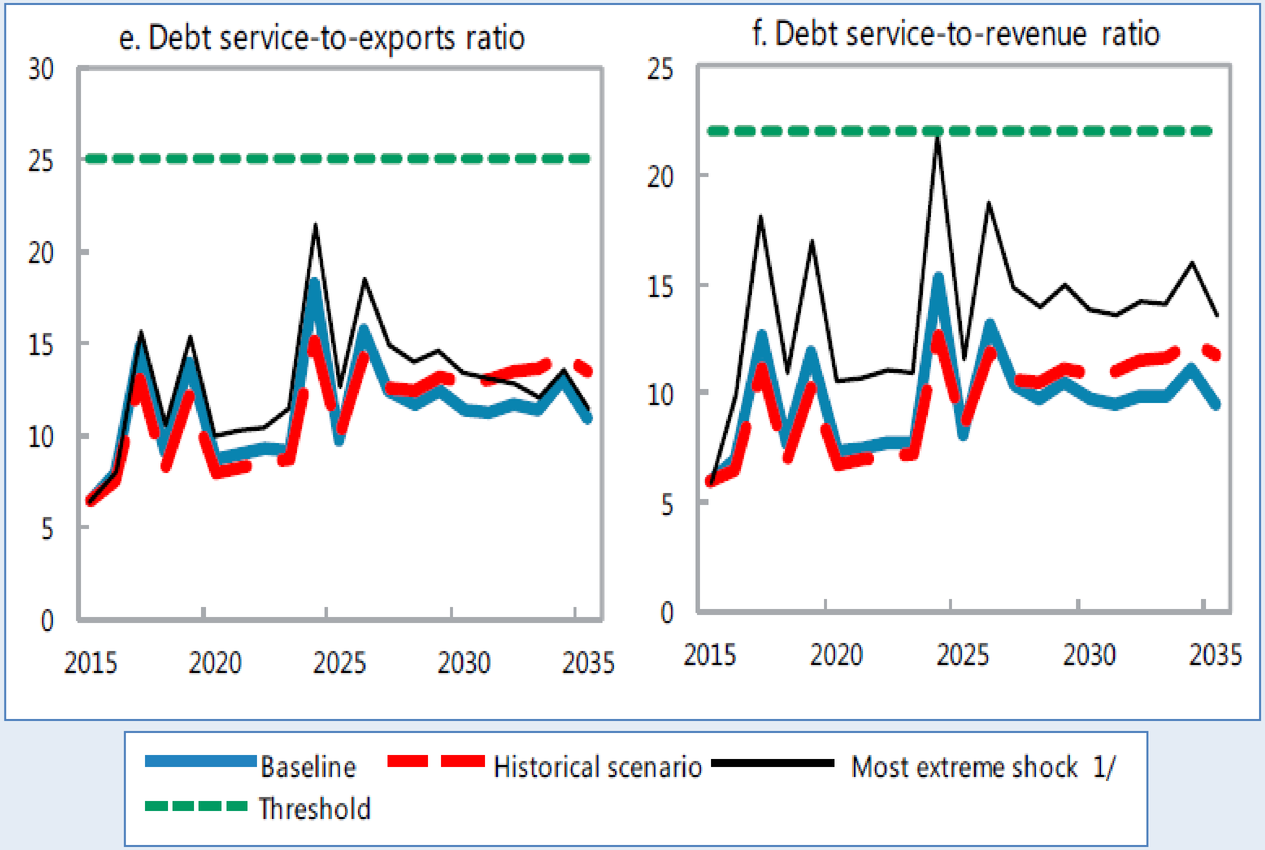
- Standard threshold 50 percent.
- Most extreme shock: 30 percent depreciation in 2016.

How about availability of foreign exchange and tax revenue?



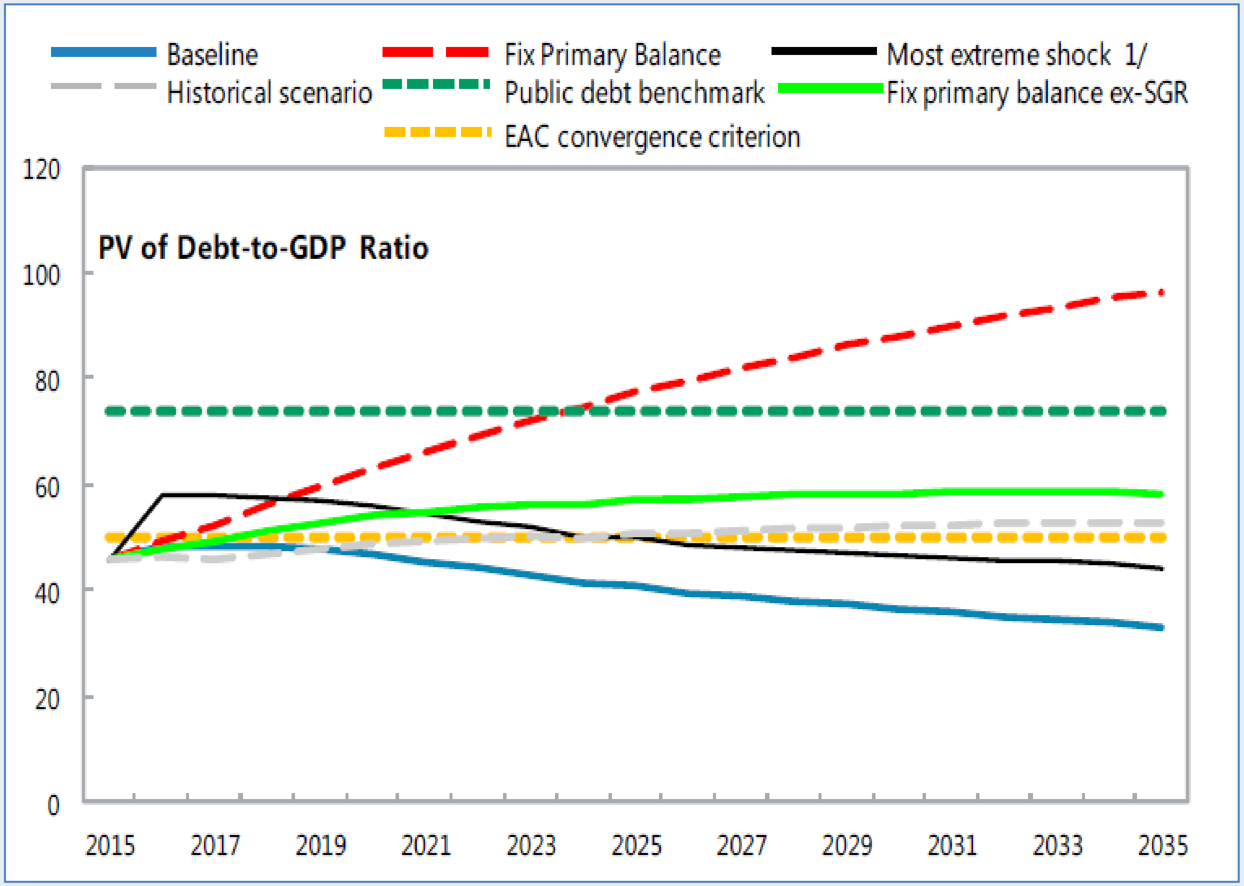
- More room relative to revenue threshold.
- Most extreme shock: 30 percent depreciation in 2016 and export shortfalls.

How about debt service?



- Not much difference between scenarios relative to exports.
- But depreciation shock could be important in the

What about total public debt?



- If primary fiscal balance is not contained, threshold could be crossed in the medium term.
- Bad policies and slow consolidation more adverse than shocks!.