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MANAGEMENT AND BOND MARKETS**

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**3<sup>rd</sup> Forum on African Debt Management and Bond Markets**

**USE OF SHORT TERM SECURITIES**

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This document is circulated as a background paper to Joint Session No. 1 for the 3<sup>rd</sup> Forum on African Debt Management and Bond Markets, beginning on 4 December 2008 at 9.00am. Questions concerning this document can be addressed to Hans J. Blommestein, Project Manager ([hans.blommestein@oecd.org](mailto:hans.blommestein@oecd.org)).

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**A PRESENTATION AT THE OECD FORUM ON AFRICAN PUBLIC DEBT MANAGEMENT  
3<sup>RD</sup> – 5<sup>TH</sup> DECEMBER 2008, PARIS, FRANCE IN THE USE OF SHORT TERM  
SECURITIES  
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**I. THE SIZE AND STRUCTURE OF KENYA'S PUBLIC DEBT**

Total public debt as at June 2008 stood at Kshs 867 (USD13.9 billion) or 43.2% of GDP. It is composed of: -

- a. Domestic debt – Kshs 442 billion (USD 7.1 billion which is 51% of total debt and 21.2% of GDP.
  - 30% in short term Treasury bills (92 and 182 days)
  - 70% in long-term Treasury Bonds
  
- b. External debt – Kshs 425 billion (USD 6.8 billion) which is 49% of total debt and 21.1% of GDP.
  - 60% owed to World Bank/ADB Group/EIB
  - 17% owed to Japan
  - 23% others.

During the last four years the debt has been gradually reduced from 55.6% in June 2005 to 43.2% in June 2008, with external debt dropping from 32.2% to 22.1% and domestic debt from 23.4% to 21.2%. Also, the structure of the public debt has changed markedly within the last 7 years with the share of debt denominated in Kenyan Shilling increasing from around one third to 51% at the end June 2008. The Government is also legally empowered to borrow in the form of overdraft at the Central Bank of Kenya but this is restricted to 5% of the last audited revenues.

In Kenya, Treasury bills are used both for funding and liquidity purposes. For the former there is a weekly auction which on average finances 6% of the budget deficit annually while the rest of the deficit is funded using medium and long-term bonds, privatization proceeds and external financing. The budget deficit stands at 5% of GDP. For liquidity purposes, Treasury bills are used by the Central Bank of Kenya for open market operations to mop up excess liquidity. They are also used for supporting/creating the short-end of the yield curve.

## II. STRUCTURAL CHANGES IN BORROWING STRATEGY

- a. In recent years the strategy for debt management in Kenya has been to borrow as much as possible in foreign currency under concessionary terms, and then cover the residual financing need in the domestic market. This strategy has resulted in a debt portfolio consisting of two, from risk perspective very different sub-portfolios. The foreign debt being very long term in nature, and having very low coupon rates, and on the other hand the domestic debt being relatively short term, and with comparably high coupon rates. The market risks on the total debt portfolio are mainly related to the currency exposure of the foreign debt, and to roll over risk on the domestic debt
- b. On domestic debt, the Kenya Government has been implementing since 2001 the strategy of lengthening the maturity profile of Government debt instruments by issuing long-term bonds. The structure of the domestic debt has therefore undergone substantial changes targeting the T-bills (91 and 182 days)/T-bond mix to 30/70% instead of 70/30%. The targeted changes have been implemented successfully.
- c. However, the risks on the domestic debt are still substantial. The debt is sensitive to changes in interest rate – almost 15% of the outstanding debt will have its interest rate re-set within 12 months, and the average maturity is only 3.5 years – in the sense that an increase in market interest rates will have a substantial and immediate impact on the government’s budget. Also, rollover risk is substantial – 25% of the outstanding debt falls due within 24 months, and only 13% of the debt is long-term (11-20 years) – and the government is exposed to changing market sentiment and willingness of the investors to roll over the debt.
- d. The main objective of restructuring domestic debt to the long dated Treasury bonds is to minimize refinancing risks and promote growth of domestic securities market. As a step towards extending the yield curve, a 15-year Treasury bond was issued in Kenya for the first time in March 2007 and was oversubscribed. Since then, more long term bonds including a 20 year bond have been issued to meet increased market demand. The success of the restructuring programme has been boosted by increased participation in the bond market by institutional investors such as insurance companies and pension funds.

### KENYA: OUTSTANDING STOCK OF GOVERNMENT SECURITIES

Security type	30/06/2001	Share %	30.06.2008	Share %
Treasury Bills	114,129	74.2	76,293	19.4

Treasury Bonds	36,774	27.9	283,915	72.3
Kenya Stock	3,006	1.9	755	0.19
<b>Sub-total</b>	<b>153,909</b>	<b>100.0</b>	<b>360,963</b>	<b>91.9</b>
Restructuring Bonds	nil	nil	31,274	8.0
<b>Total</b>	<b>153,909</b>	<b>100.0</b>	<b>392,237</b>	<b>100</b>
CBK Repo	35,900		34,438	

e. Kenya has also been affected, though indirectly by the recent international financial crisis:

- (i) Earnings from tourism will be reduced due to cancelled bookings.
- (ii) With agriculture contributing 60 percent of total export earnings, low consumption especially in Europe is also expected to cause a decline in goods exports especially horticulture and flowers.
- (iii) Another impact will be reduced remittances from Kenyans in the Diaspora.
- (iv) Kenya being a net importer will also suffer from strengthening of the dollar and especially on oil imports.
- (v) Domestic debt holding by non-residents constitutes less than 1% of total debt and there may not be any major negative impact on government securities holdings occasioned by investors exiting the market due to the financial crisis.

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