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Unpacking the drivers of public debt dynamics in Kenya

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KEY MESSAGES

- **Kenya remains at high risk of external debt distress, despite the overall public debt being assessed as sustainable. As of June 2024, public debt amounted to over USD 81 billion (equivalent to 65.7% of GDP), of which 48.9% was owed to external lenders. Multilateral borrowing dominated external debt at 50.5%, followed by commercial debt at 25.4%, while bilateral lenders and suppliers' credit[3] account for 23.8% and 0.3%, respectively. Domestic debt is dominated by non-bank creditors.**

- **Kenya has put in place an elaborate legal framework for public debt management, but weaknesses in implementation persist. This has resulted in, among others, accumulation of poorly structured debt with short tenor, expensive bilateral commercial debts and Euro bonds, unfavorable currency composition, and increasing financing of contingent liabilities.**

- **There is a need for institutional reforms to focus on fiscal sustainability as the long-term goal. To achieve this, the current fiscal rules should be calibrated based on emerging risks and linked to public finance management and the budgeting process as part of institutional architecture to strengthen debt management.**

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[3] Bills owed to external suppliers of goods and services.

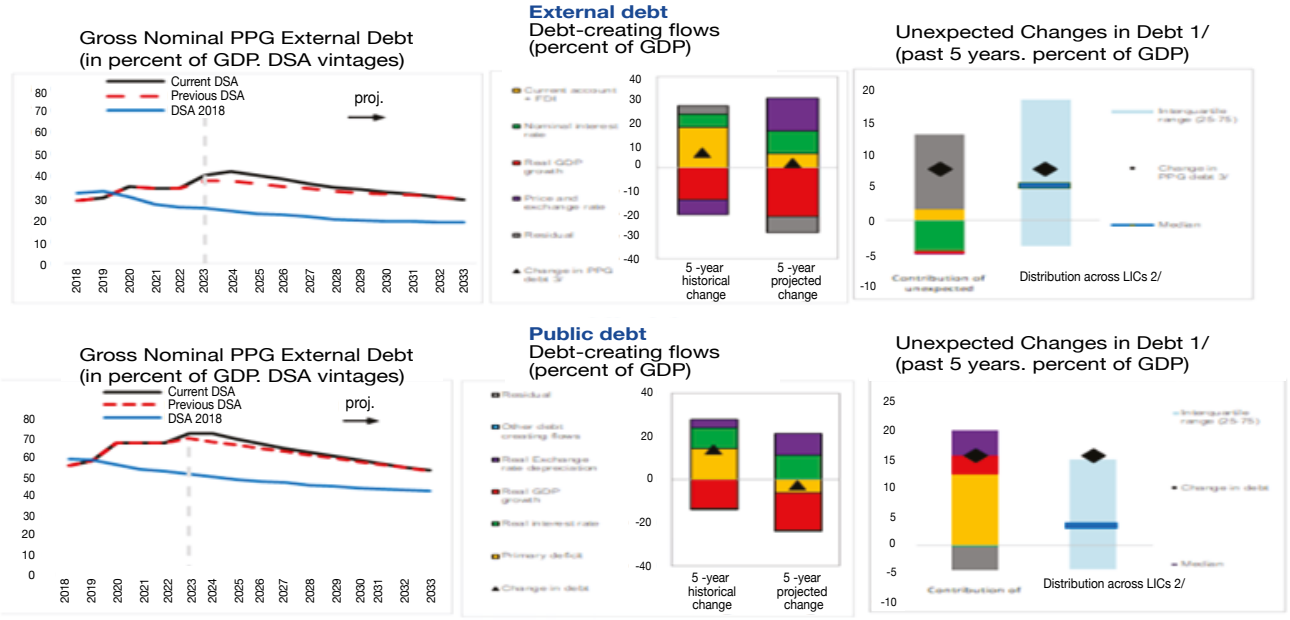
1 | PUBLIC DEBT DYNAMICS AND SUSTAINABILITY

1.1 Kenya's public debt has risen significantly over the years, from about 42.2% of GDP in 2013 to 72.0% in 2023 before declining to 65.7% in 2024 largely due to strengthening of Kenya shilling. Kenya continues to access both domestic and international markets, issuing a new Eurobond in February 2024. External debt stood at USD 38.70 billion (52.9% of total debt or 38.2% of GDP) and domestic debt at USD 34.46 billion (47.1% of total debt or 33.3% of GDP). External debt is dominated by multilateral borrowing, accounting for more than half of total debt (50.5%), followed by commercial debt at 25.4%, while bilateral lenders and suppliers' credit account for 23.8% and 0.3%, respectively. The top three largest bilateral lenders include China, France, and Japan, holding about 20.3% of external debt. China is the biggest Non-Paris Club creditor with 16.4% of external debt. Two thirds of the external debt is denominated in US dollars, 21.4% in Euro, while other currencies account for the remaining 11.3%. Domestic debt is dominated by non-bank creditors[4] at 52.5%, while commercial banks hold 43.4% and Central Bank of Kenya hold 4.1% (Republic of Kenya, 2024).

1.2 Public debt is largely driven by the primary deficit, real interest rate, and real exchange rate depreciation, while real GDP growth has been the main moderating factor (IMF, 2024) (Figure 1). These factors are in turn driven by increased development spending, pro-cyclical fiscal policy and limited institutional capacities on public debt management. Budget support to prop up under-performing and poorly governed state-owned enterprises (SOEs) consume the largest share of the total external borrowing at about 38.5%, followed by transport sector spending at 21.8%, while energy sector comes third at about 9.4%. The other sectors benefiting from external borrowing include water supply, health, agriculture, and education, among others. Domestic borrowing mainly finances the budget deficit, despite carrying short tenor and high interest rates (AfDB, 2021). These factors have elevated Kenya's debt service costs.

1.3 According to the December 2024 debt sustainability assessment, Kenya's overall and external public debts were assessed sustainable but remain at high risk of debt distress[5] . The macroeconomic risk signals indicate sustained breaches of sustainability thresholds by solvency and liquidity indicators under the baseline scenario. Except for external debt as a share GDP which is below the 40% threshold, all other indicators of debt sustainability analysis (DSA) that include external debt as share of exports, debt service as a share of export and external debt service as a share of revenue are projected to remain above the thresholds of 180%, 15% and 18%, respectively, in the medium-term. To mitigate the situation and put the country on a fiscal sustainability path, the authorities are undertaking fiscal consolidation reforms focused on improving domestic revenue mobilization and spending rationalization under the International Monetary Fund (IMF) program, to achieve and surpass the primary balance and stabilize debt.

FIGURE 1: TOTAL NUMBER OF IBS SUPPORTED IN TSs (IN % OF TOTAL NUMBER OF IBs SUPPORTED)



1/ Difference between anticipated and actual contributions on debt ratios.
2/ Distribution across LICs for which LIC DSAs were produced
3/ Given the relativety low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by drivers of the external debt dynamics equation

SOURCE: IMF Country Report No. 24/13, 2024.

[4] Individual bondholders, domestic suppliers, pension funds, institutional investors, etc.

2 | PUBLIC DEBT MANAGEMENT

2.1 Compared to other lower middle income African countries, Kenya has an elaborate legal framework for public debt management supported by the public financial management (PFM), fiscal rules, fiscal councils and oversight institutions. However, the policy framework to guide the usage and implementation possesses some weaknesses. For example, although there is political will and the legislature for prudent fiscal management, the oversight of debt procurement and usage is hampered by inadequate capacity at the National Assembly. The ability of the National Assembly to provide oversight and undertake rigorous assessment of the debt situation is limited due to shortage of human and institutional capacity. The situation is compounded by similar inadequacies of the Debt Management Office (DMO) at the National Treasury. The DMO is unable to identify fiscal risks to mitigate rising debt. This is evident in rapid accumulation of poorly structured debt with short maturity, high interest rates, currency composition and financing of contingent liabilities which have propagated repayment pressures.

2.2 While Kenya has performed well in the Eurobond international market, the debt repayment spread is putting pressure on already constrained fiscal space[6]. For example, the current Euro bonds have shorter maturity periods. This could cause fiscal pressure during their retirement. Additionally, the new Eurobond in 2024 was issued at 10.35%, higher than the coupon rate of the maturing Eurobond in 2024 and the average yield rate between 7.6% and 10.7% on Eurobonds for Africa (AfDB, 2025b). The high contraction of external debt in US dollars (67% in 2023) exposed Kenya's shilling to exchange rate shocks. The situation is complicated by geopolitical tensions such as the ongoing Middle East conflict, Russia's invasion of Ukraine, with attendant constrained global supply chains which has negatively affected the external sector, with total reserves declining from USD 9.49 billion in 2021 to USD 7.34 billion in 2023. Domestically, the occurrence of social unrest and policy uncertainty weigh negatively on capital inflows affecting investor appetite that could crucially alleviate the government's resource desire for investment.

3 | WHAT WORKED AND WHAT DID NOT WORK?

3.1 The Kenyan authorities have deployed several policy measures to reign in the rising public debt. These measures include fiscal consolidation, improving public debt management and enhancement of resource mobilization. Fiscal consolidation through expenditure prioritization has achieved the planned outcome with reduction in fiscal deficit from 8.2% in 2021 to 5.5% in 2024 (AfDB, 2025). Debt management has remained a challenge due to increased public investment and inadequate reporting on the use of the domestic debt. Resource mobilization has performed below expectation due to low tax base and emerging global shocks such as COVID-19 and geopolitical fragmentation that limit capital inflow. While authorities have deployed policies to reduce short-term debts, investor appetite has increased on short-term instruments, particularly treasury bills, thereby limiting the effectiveness of government efforts.

3.2 The oversight of public debt management through the National Assembly, the Office of the Auditor General and the Controller of Budget have heightened efforts to improve fiscal discipline. Although Kenya has relatively high level of public debt transparency supported by the oversight of institutions, the inadequate capacity of expertise to carry out fiscal stress surveillance has constrained the effectiveness of debt management policy in Kenya. The legal framework using Public Financial Management has also supported the use of external debt for development financing. However, the implementation of existing fiscal rules (debt rule and revenue rule) has not been effective, and the limited capacity of oversight institutions and DMO has hampered fiscal surveillance and debt management

4 | CONCLUSION AND POLICY RECOMMENDATIONS

4.1 The identified public debt challenges call for a targeted approach on the management of drivers of public debt that includes primary balance, interest rates, exchange rate volatility and GDP growth. Therefore, a focus on priority spending, contraction of concessional loans and diversification of the loan currency portfolio are crucial to achieve the public debt target. These efforts should be supported with the Government broadening the tax base to improve its avenues of resource mobilization. These challenges can be mitigated through optimal implementation of existing fiscal rules (debt rule). However, the compliance rate has been low just like other African countries.

4.2 To mitigate risks related to external economic shocks and geopolitics, Kenyan authorities need to continue with policies aimed at expanding and diversifying Kenya's export base and attracting capital inflows. Further efforts on cost minimization policy should focus on monitoring refinancing risks and mitigation of market risks to reign in growing public debt. Improving the redemption profile will instill fiscal discipline and build fiscal buffers to absorb shocks. There is a need to significantly diversify foreign denominated debts to minimize exchange rate volatility.

[6] There are currently six Eurobond liabilities that are pending with maturity dates June 2024, May 2027, February 2028, March 2032, January 2034 and February 2048 (Government of Kenya, 2024). The Eurobond issued in 2024 with maturity in 2031 had a yield rate of 10.35%.

4.3 In addition, there is a need to further strengthen DMO by providing the required resources and human capacity with the requisite skills. Therefore, provision of technical assistance to build capacity is called for and this can be determined through policy dialogues with the authorities to determine areas of intervention in support to the DMO. This will help the DMO identify capacity needs to be clearly determined by market analysis, developing a fiscal risk management framework and annual borrowing strategies. There is need to enhance the coordination of public debt management in Kenya. This can be achieved through partnership between the DMO and the macroeconomic policy and cash management units at the National Treasury. This will be crucial to improve the sharing of fiscal data to improve the debt management strategy and coordination of the cash issuance by the National Treasury. The authorities may consider formation of independent fiscal council by tapping expertise from the National Treasury and academia to make predictable revenue forecasts, determine fiscal risks and provide advisory services on debt contraction to improve fiscal management. There is need to review and reform the current fiscal rules to be calibrated to emerging risks, flexible with escape clauses and the rules be aligned to the PFM for ease of enforcement. The review will enhance the design of rules to focus on long-term objective of fiscal sustainability while helping authorities smooth out public investment and fiscal consolidation efforts.

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