SIB Standard Investment Bank

Regulated by the Capital Markets Authority

THE YEAR THAT BOTTOM-UP POLICIES TRIGGERED ECONOMIC PROTESTS

> *Headline inflation falls to a 15-year low*

EXECUTIVE SUMMARY

The Year in Review

In what started as grumbles from the business community and the public about tax measures in the Finance Bill 2024, the concerns culminated into a full-fledged political tsunami which took away over half the cabinet in generational led economic protests and the bill ditched entirely. The year also saw the impeachment of the Deputy President Rigathi Gachagua and a new replacement, Professor Kithure Kindiki sworn in. In this report, we do a postmortem of the events leading up to the Gen Z protests and the ramifications that it brought about.

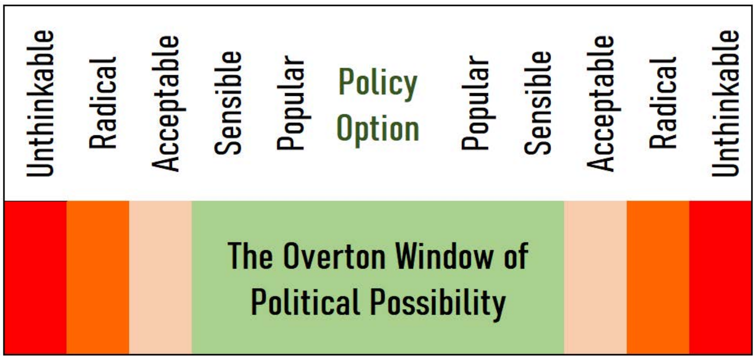
Unlike previous protests, the Gen Z demonstrations exhibited significant literacy and awareness. This comes as no surprise, given that this generation benefited from the free primary education (FPE) policy introduced by the late President Mwai Kibaki in 2003 (Third President of Kenya). This policy, a fulfilment of Kibaki's campaign promises, aimed to eliminate the financial barriers that had previously restricted access to education, resulting in high dropout rates and low enrolment numbers.

The introduction of FPE led to a dramatic increase in enrolment, with the number of pupils rising from approximately 5.9 million in 2002 to over 7.2 million in 2003, and further to about 8.2 million by 2007. This population joined the job market at a time when the country is facing significant headwinds in jobs, leading to a more anxious generation keen to see improvements.

The best laid schemes of mice and men go often askew (*"To a Mouse, on Turning Her Up in Her Nest with the Plough, November, 1785" by Robert Burns)*; is what can be described as the fate of the Kenya Kwanza administration. We ponder the aim was to try and frontload difficult policies early in the electoral cycle and believe the next couple of years will be aimed at achieving the manifesto objectives, seeking redemption from voters and forgiveness for the sins that have been made.

Did Kenya Government Implement Public Policies out of the Overton Window?

We think The Overton Window of Political Possibility may help explain why the Kenya-Kwanza administration stumbled on some of the policy measures proposed and implemented. The Kenya Kwanza administration had a well-articulated manifesto, but few expected that they would actually achieve or attempt to tackle all the promises made almost at the same time. Further, the regime had some proposals which bordered on radical in the context of social-economic background of Kenya.



Source: https://www.mackinac.org/OvertonWindow, SIB

The manifesto mentioned in passing or was quiet on the funding models for the campaign promises, which may have created an impression of a Santa Claus administration which would shower voters with freebies over the course of their tenure.

Bottom-up Policies – is the administration going to fall on its own sword?

After a spirited electioneering period, Dr William Ruto was sworn in as the 5th President of the Republic of Kenya on 13th September 2022 – winning for the first time on an economic empowerment platform. In Kenya, elections have been largely won (or lost) on the basis of political liberation and social justice. In principle, the focus on increasing disposable income and lifting millions from poverty has been taunted as likely to be good for both big and small businesses.

Year after year, we have diligently crafted reports on the budget and economy, tracking progress and highlighting concerns about public finances. Below is a brief of our reflections in recent years;

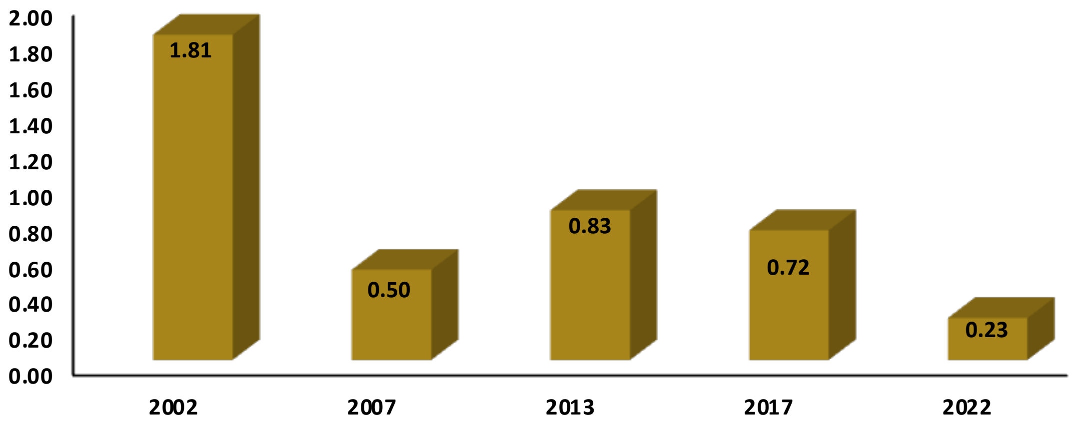
Report	Year
Kenya: Untangling the Web of Debt 'On a Wing & a Prayer'	2023
Arrested Development	2023
WE CAMPAIGN IN poetry BUT GOVERN IN prose - A look into President Ruto's manifesto	2022
Kenya Budget 2022/2023: Damned if you do, Damned if you don't	2022
The Unholy Trinity, Kenya Budget 2021/22 'Higher Spending, Containing Debt, Resistance to Tax Increase'	2021
Budget 2019/20: Does Kenya have a secret weapon to boost Manufacturing? 'Magic most impenetrable'	2019
Finance Bill 2018: Counting the Cost 'Termites at Work'	2018

We contend that the Kenya Kwanza administration was not entirely oblivious of some sort of pushback with some of the measures they were implementing. It seemed they believed the popular mandate received would not dissipate as quickly early in the election cycle, and that they could recover after showing results. Altercations around tax measures in Finance Bill are not new - In 2018, President Uhuru Kenyatta (Fourth President of Kenya) overruled Parliament with regards to proposed tax measurers noting that the House had failed in its leadership after it failed to pass certain tax measures. This was right after the 2017 elections. Kenyan politicians have proven to have robust survival mechanisms and have managed to overcome challenges and avert crisis, year after year. Will the current administration fall on its own sword of not delivering on its electoral promises?

Elements of a Revolution – How the Economic Protests Unfolded

Kenya's presidential elections are consistently tight races, highlighting a deeply divided electorate with strong support for multiple political ideologies. The fierce competition means even minor shifts in voter preferences can significantly impact the outcome. See the chart below;

Vote Margin Between Leading Presidential Candidates (M)



Source: Kenya Law, Chart: SIB

Kenyan politics is always noisy and politicians are a crafty lot that have a good sense to horse trade when there is a crisis. The close races have left winning candidates with weaker mandates, making effective governance and agenda implementation challenging. This has necessitated greater bipartisanship and coalition-building. Polarization has often made Kenyans difficult to govern, frequently resulting in protests and demonstrations over alleged election irregularities. In fact, dissatisfaction with election results has long been a catalyst for unrest, with nearly half the country often feeling discontented.

Kenya had all the making of a full-blown revolution. Borrowing from James Defronzo's Theory of Revolutions, a number of key elements applied.

Element	Status
Mass Frustration Resulting in Local Uprising	The Finance Bill protests were preceded by smaller 'uprisings' including an 'Intern Doctors' Strike (doctors would eventually play a pivotal role in the protests), protests against corruption scandals (fertilizer scandal), demolition of dwellings in riparian areas (slum dwellers), as well as affluent display of wealth by political elite in the newly elected administration. The eventual anti-government protests were a collation of a number of disgruntled actors who found a unifying factor in the Finance bill 2024, even after the most controversial elements were removed.
Dissident elites	The Gen Z demonstrations attracted a new set of protestors (elites: educated with technical and management skills as well as wealth), who were unhappy about the administration following levies and taxes which targeted 'dynasties' in support of 'hustlers.' 'Gen Zs use iPhones, arrive in Ubers for protests and then go to KFC for lunch and use bottled water.' - Kimani Ichung'wah (MP, National Assembly)
Powerful unifying motivations	Powerful motivations united Kenya's population behind the revolution. There were employers unhappy about higher taxes, struggling business enterprises, jobless citizens seeking employment, anti-corruption activists including churches, pending bills including those owed to entities that provide essential service to society. By the time the Finance Bill protests started, the administration was not short of enemies and the stage was set for the largest protests in Kenya's history.
Severe crisis paralyzing state administrative & coercive powers	This element did not manifest
A permissive or tolerant world context	Even those who couldn't actively participate lent their support, encouraging the young demonstrators. Ignored church leaders stepped back and provided platforms like church pulpits for airing grievances as the administration. This widespread and diverse support amplified the movement.

Kenya did not take the full course of a revolution since the political elites made a settlement which incorporated the opposition into government, essentially fizzling out the protests.

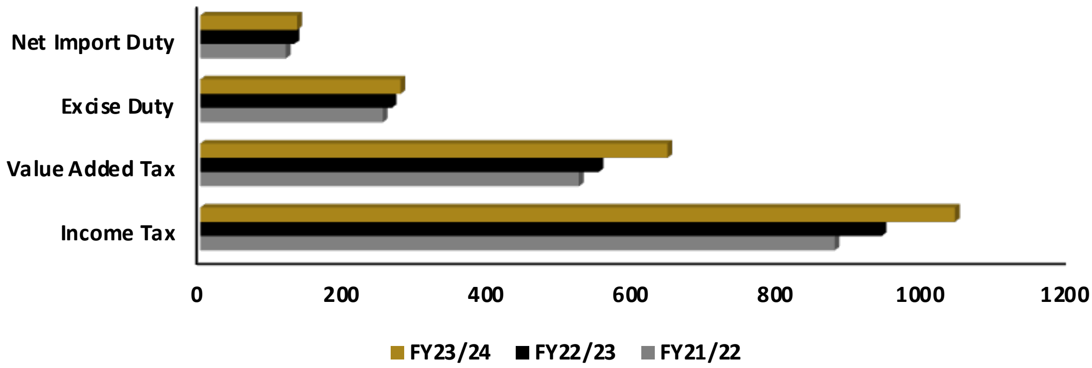
When Odds & Ends become the Main Plot

Finance Bill 2024: The Tipping Point that Shaped the Year in Review

One year after the Finance Act 2023 our report dubbed "Arrested Development", the government proposed a series of tax adjustments and introduced several new taxes, including the Eco Levy, VAT on bread, and a Motor Vehicle Tax, which sparked significant public concern. The Finance Bill 2024 aimed to generate an additional KES 346.7 billion, leveraging primarily on additional taxes to do so. This was notably poised to be the largest Finance Bill in history in targeted additional revenue, marking a 64.3% increase from the KES 211.0bn projected from the Finance Act 2023;

The Finance Act of 2023 raised KES 179bn, achieving an 84.8% performance rate against its target. This was despite the contentious tax increases, a move that fueled debates but ultimately resulted to a notable increase in the key tax heads as shown below;

Key Tax Heads Performance (KES bn)



This would likely have encouraged the administration that they could take painful revenue measures and successfully achieve objectives, early on in the electoral cycle when it was 'politically safe'. Combined with other levies, with think that the proposals along with other bottom-up policies were radical when measured using the Overton window.

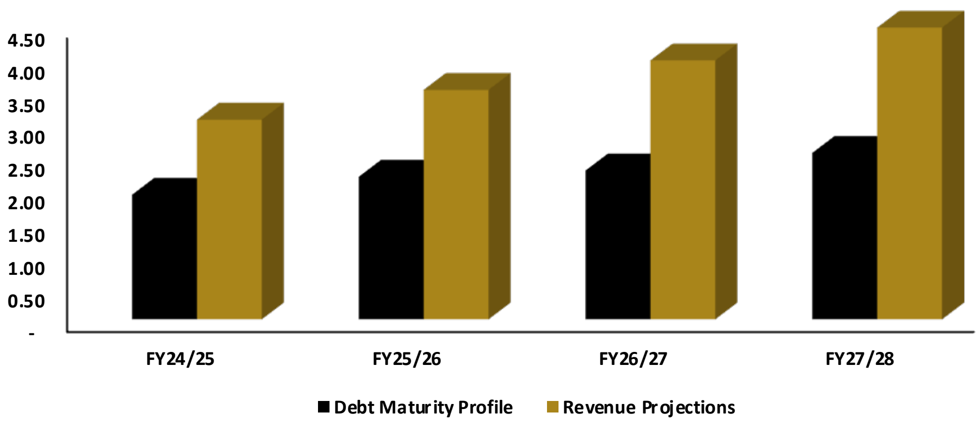
For FY24/25, the government aimed to raise KES 2,631.42bn—a 9.8% reduction from the initial estimate of KES 2,917.20bn, following the withdrawal of the Finance Bill 2024. This adjustment also triggered a downward revision of total expenditure, now set at KES 4,207.91bn, compared to the original projection of KES 4,321.49bn. What began as a simple online campaign evolved into the defining moment of the year, influencing several macroeconomic dynamics. The withdrawal of the Finance Bill, accompanied by the recommendation to delete all its clauses, stands out as a landmark event in recent memory.

Sovereign Credit Downgrade: The Cost of Large Deficits

Following the Finance Bill withdrawal, Kenya was downgraded by all major ratings agencies. This occurred despite the refinancing and partial payment of the 2024 Eurobond, which had sparked significant concerns and initially overshadowed the country's financial outlook. However, both S&P Global and Fitch Ratings revised Kenya's outlook to stable, citing eased external short-term pressures.

The ratings indicate that while the risk of a material default is present, there remains a limited margin of safety. While financial commitments are currently being met, the country's ability to continue servicing its debt is susceptible to deterioration in the broader business and economic environment. Given that the country is grappling with debt servicing costs, which absorb over 60% of collected revenues, we believe the credit score downgrade is justified. However, the amortized nature of the Eurobond maturities, which have historically impacted Kenya's credit rating, provides some relief. Below is the medium-term maturity profile:

Debt Maturity Profile vs Revenue Projections (KES tn)



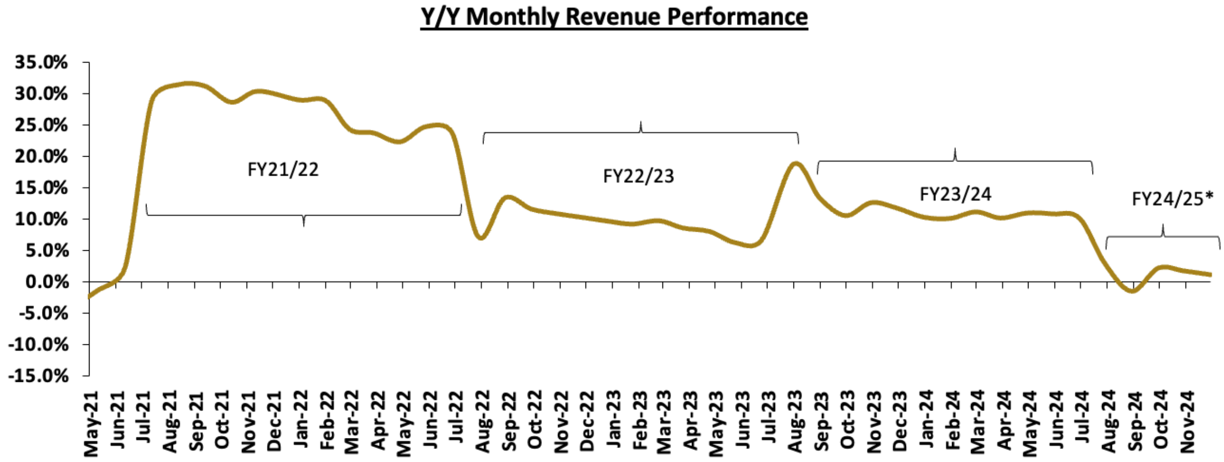
Source: Treasury, Chart: SIB

Tax Laws Amendment Act: Hope or Hype?

Following the withdrawal of the Finance Bill and a subsequent cabinet reshuffle, the National Treasury, under new leadership, introduced a Tax Laws Amendment Bill—this time accompanied by a prior explainer. The bill was assented to by the president in early December, signaling a fresh attempt to boost revenue collection. However, in our assessment, the Act is unlikely to generate sufficient revenue to meet the government's ambitious targets.

For context, the government projects an additional KES 341.07bn in revenue for FY24/25, a figure that had been well-anchored in the now-withdrawn Finance Bill 2024. Unfortunately, the policy seems to overlook critical economic realities, including the state of the economy and, more importantly, the implications of the Laffer Curve.

Since the fiscal year commenced, tax revenues have shown minimal growth, a clear indication that previous collections were largely driven by upward adjustments in existing tax rates rather than organic economic expansion.



Source: Treasury, Chart: SIB

Government Borrowing: The Deficit Conundrum

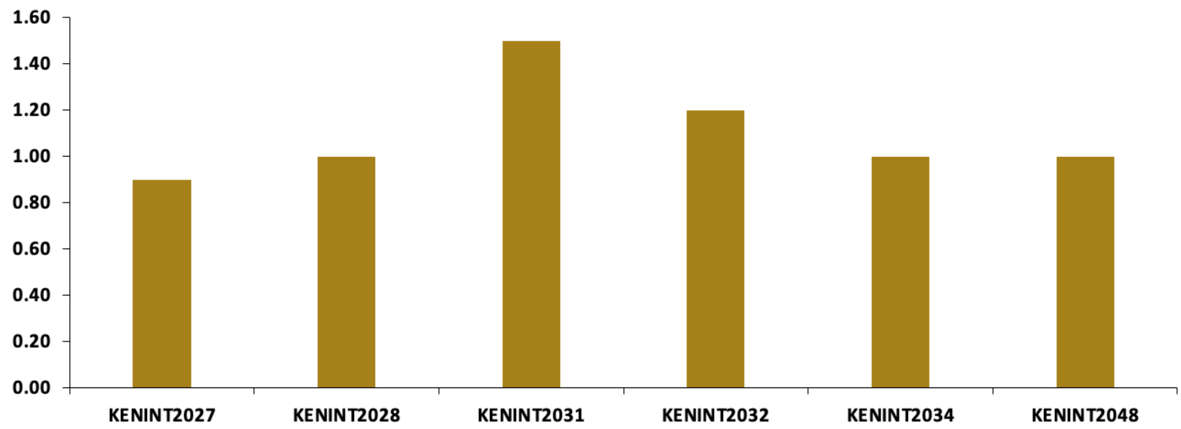
Eurobond Issuance that settled markets – albeit at a higher cost

The defining moment of 2024 was the maturity of the 10-year Eurobond, which sparked widespread concerns about a potential default early in the year. In an unexpected turn of events, the National Treasury mitigated these fears by offering to buy back the maturing Eurobond, replacing it with a 7-year USD 1.5bn amortized note set to fully mature in 2031.

The new issuance carries a coupon rate of 9.75%, notably higher than the 6.88% rate on the bond it refinanced and higher than any of the country's existing Eurobonds. This refinancing underscores the rising cost of debt amid tightening global financial conditions.

Currently, the government holds USD 6.6bn in outstanding Eurobond debt, distributed as follows;

Outstanding Eurobond Debt (USD bn)

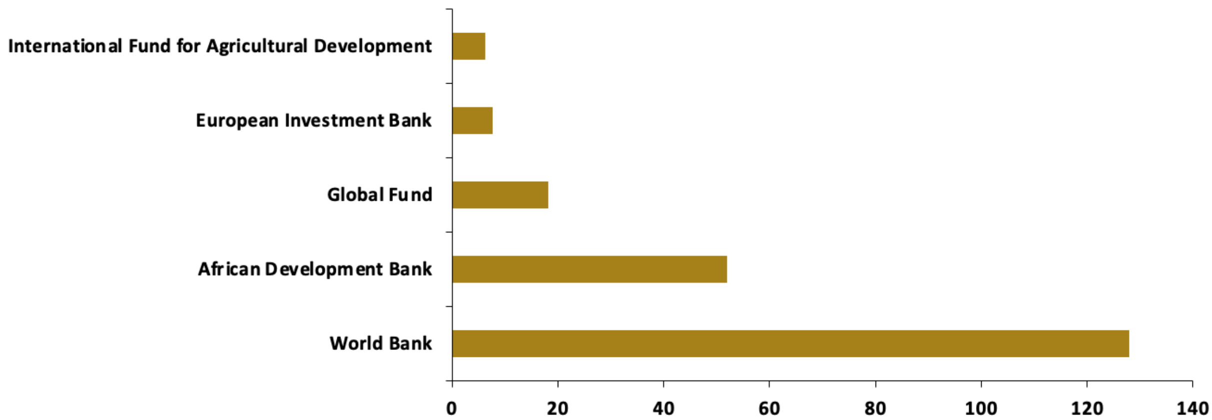


Source: Treasury, Chart: SIB

The government also tapped into funding from existing programs, particularly through the International Monetary Fund (IMF), the African Development Bank Group, and the Trade and Development Bank. Notably, the IMF made two disbursements during the year, with the second tranche covering both the seventh and eighth reviews under the Extended Fund Facility (EFF) and Extended Credit Facility (ECF) program. In total, the IMF disbursed approximately KES 188.16 billion to the Government of Kenya in 2024.

Kenya continued to lean heavily on multilateral loans to finance development, with the World Bank and the African Development Fund emerging as the largest contributors in this category, as shown below;

External Resource Contribution from Multilateral Partners - FY 2023/2024 (KES bn)



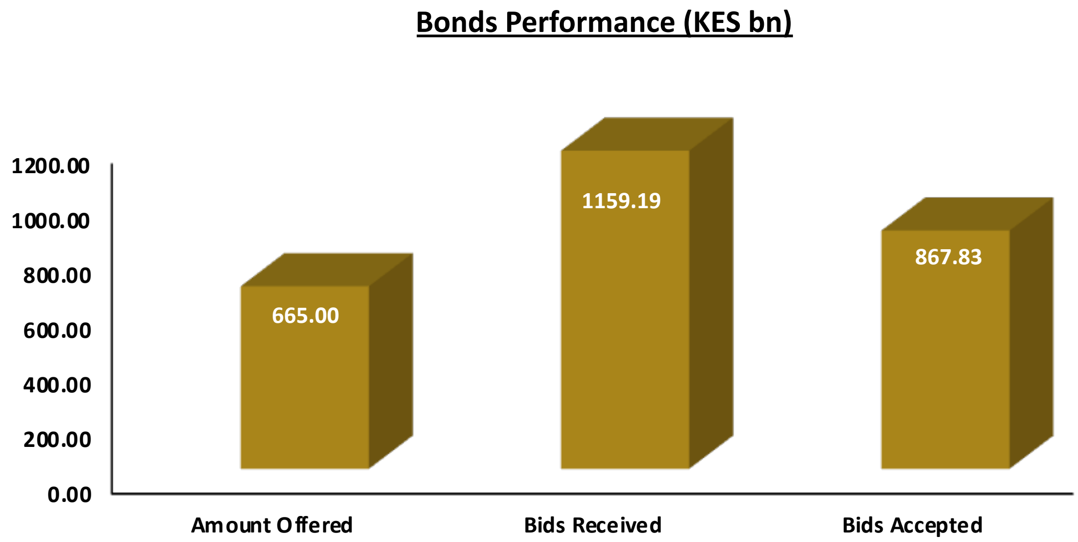
Source: Treasury, Chart: SIB

Overall, external debt stood at KES 5.19tn, as of September 2024, a 14.8% decrease from KES 6.09tn in December 2023. This decline is primarily attributed to the appreciation of the Kenyan shilling against major currencies, particularly the US dollar, in which over 60% of the country's external debt is denominated.

Domestic Debt Markets offered Refuge as Global Markets Remained Volatile

The withdrawal of the Finance Bill, coupled with lower-than-anticipated expenditure cuts, necessitated an increase in borrowing. As a result, the domestic debt target for FY24/25 was revised upward by 18.1% to KES 978.3bn, with new debt issuance set at KES 408.41bn. By the end of the first half of the fiscal year, the government had already surpassed its borrowing target, having raised KES 428.24bn.

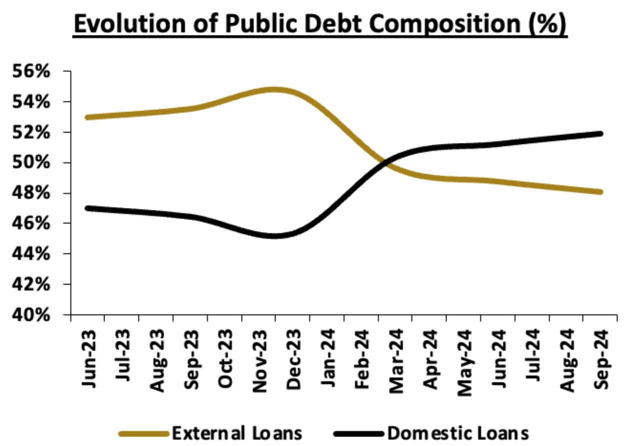
In total, the government borrowed approximately KES 794.69bn in 2024, more than double the amount borrowed in 2023, through government securities. 75.9% of the amount was sourced from bonds with the two infrastructure bond issuances, accounting for 41.7% of the total. Notably, the February issuance attracted significant investor interest, shouldering the bulk of the effort. See below the bond performance for 2024;



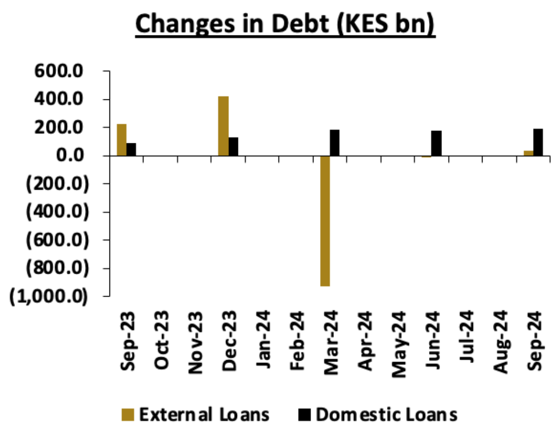
Source: CBK, Chart: SIB

It is important to note that there was a noticeable shift in reliance towards the domestic market, driven in part by unfavorable global market conditions and the availability of a ready market locally. The appreciation of the shilling further contributed to a reduction in external loans due to revaluation effects.

Additionally, the combination of higher returns and a more uncertain private sector environment prompted institutions to increase their investments in government securities. This shift led to significant oversubscriptions, reflecting both investor confidence and the attractive yields offered by government bonds.



Source: CBK, SIB Estimates



Source: CBK, SIB Estimates

Business Environment: What is the Outlook?

The Inflation Paradox – Headline Figure Falls to a 15-year Low, Core Inflation Sticky

In 2024, Kenya's average inflation rate settled at 4.5%, a notable 315bps drop from the 7.7% recorded in 2023. This marked a 15-year low, a level last seen in 2010 when the average was 4.0%. The improvement was attributed to several key factors;

i. A **higher base effect**, especially for food and fuel indices, which dropped by 420bps and 760bps, respectively.
ii. **Constrained liquidity** that tempered inflation from the demand side.
iii. A **stable exchange rate**, resulting in a reduced import bill, particularly for fuel.
iv. Declining international fuel prices.
v. **Favorable weather** conditions that improved harvests, though earlier floods had adversely affected short-season crops like vegetables.

The defining moment of 2024 was the maturity of the 10-year Eurobond, which sparked widespread concerns about a potential default early in the year. In an unexpected turn of events, the National Treasury mitigated these fears by offering to buy back the maturing Eurobond, replacing it with a 7-year USD 1.5bn amortized note set to fully mature in 2031.

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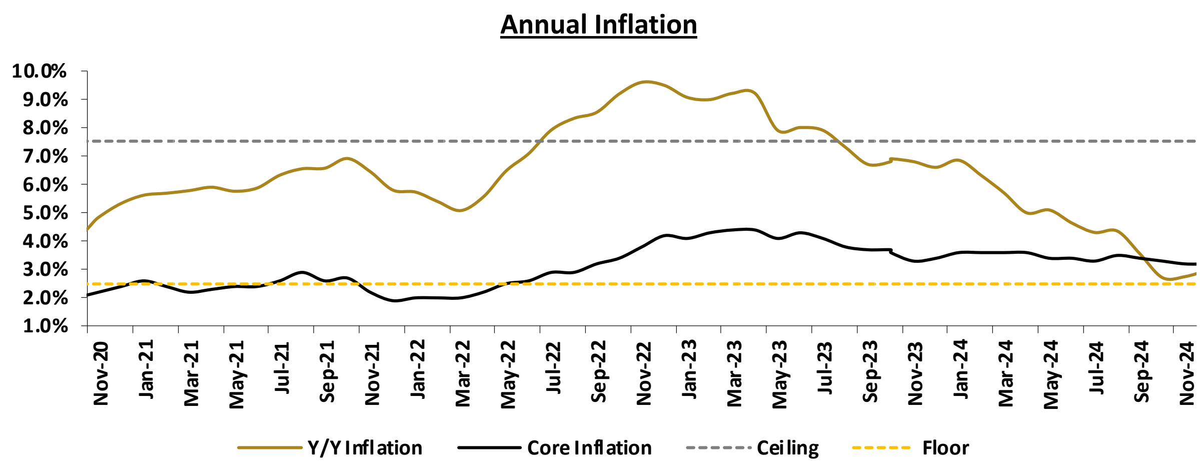
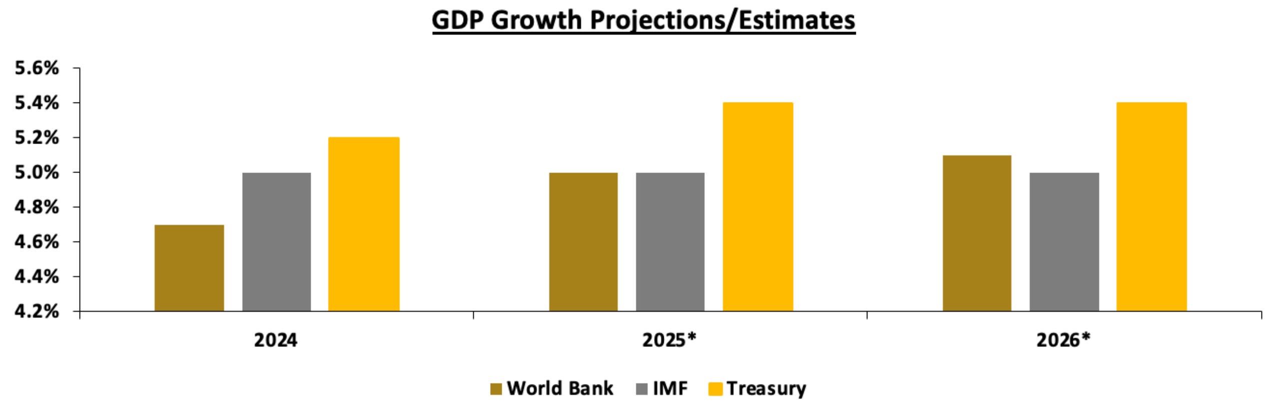


Source: CBK, KNBS, Chart: SIB

GDP Growth Estimates

According to the World Bank, Kenya's economy is estimated to have grown by 4.7% in 2024, marking a slowdown compared to the 5.6% growth recorded in 2023. This subdued performance can be attributed to several key factors;

i. **Flood Crisis** - The devastating floods during the first and part of the second quarter caused immense losses, disrupting economic activities and livelihoods,
ii. **Finance Bill Disruptions** - The controversies surrounding the Finance Bill significantly disrupted economic momentum, creating uncertainty and slowing business operations,
iii. **High-Interest Rate Environment** - Elevated interest rates made borrowing capital prohibitively expensive, stifling investments and growth, and,
iv. **Higher Input Costs and Reduced Disposable Income** - Increased taxes and statutory deductions led to rising input costs and lower disposable incomes, subsequently dampen consumer demand.



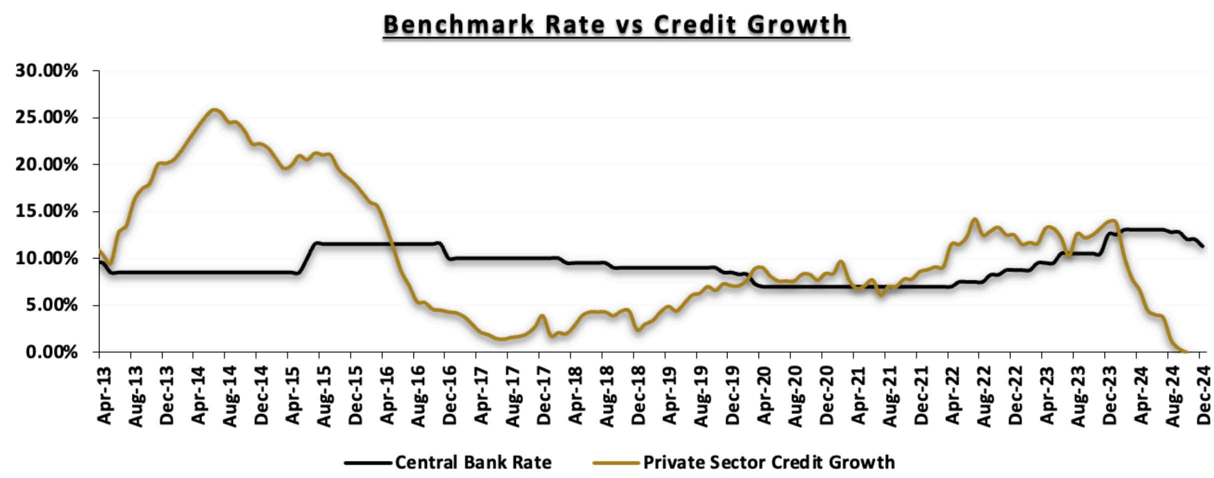
Source: CBK, WB, IMF, Treasury, Chart: SIB

Cost of Credit Drives Private Sector Appetite to a 6-year low

In 2024, the Central Bank's Monetary Policy Committee (MPC) convened six times, initiating the year with a 50bps hike in the Central Bank Rate (CBR), followed by cumulative rate cuts totaling 175bps in the second half of the year. These adjustments were closely aligned with the trajectory of headline inflation, which dipped below the mid-point of CBK's target range.

A sharper rate cut was implemented as inflation neared the lower limit of the target, driven by the need to stimulate economic activity and inject liquidity into the economy.

One intentional effect that greatly manifested from the elevated rates was the deterioration of private sector credit growth which was primarily due to high borrowing costs and the crowding-out effect from government borrowing. The revaluation of foreign currency loans, also played a significant role. In addition, risk aversion, subdued demand, rising input costs, and shrinking profit margins discouraged borrowing, particularly in the construction and manufacturing sectors. See a summary of the rates;



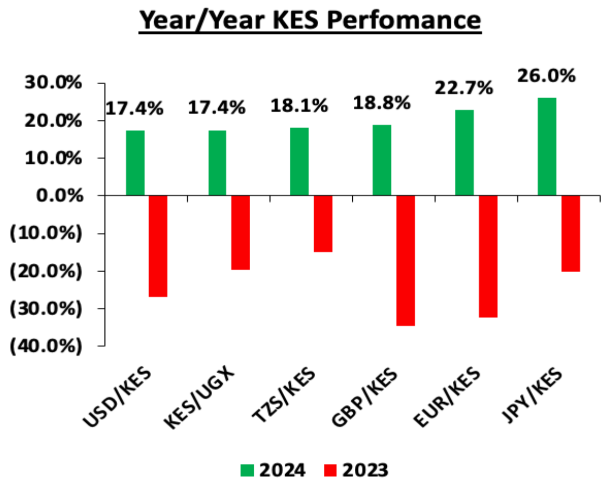
Source: CBK, Chart: SIB

Exchange Rate – Shilling's Victory Lap, Thanks to Eurobond Strategy

Early in the year, the foreign exchange market saw an improvement following the significant depreciation in 2023. The turning point as highlighted in our 1Q24 report, was the Eurobond buyback in February 2024, which boosted investor confidence and softened the outlook.

Additionally, multilateral support and capital inflows into the fixed income market, especially for infrastructure bonds, increased the dollar supply to the country. On the other hand, after the Eurobond refinancing, dollar demand slowed as imports reduced.

Year-on-year, the shilling appreciated the most against the Japanese Yen (+26.0%) and the least against the USD (+17.4%). See the chart below;



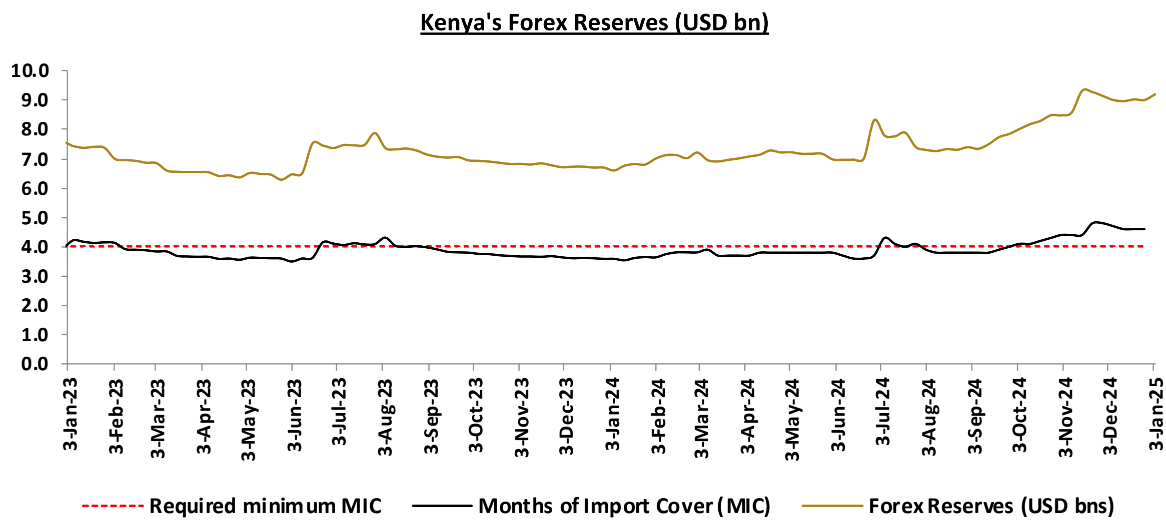
Source: CBK. Chart: SIB

Forex Reserves

In 2024, forex reserves ended the year at a healthy 4.7 months of import cover supported by multilateral loan funding and proactive purchases by the Central Bank of Kenya. As of December 27, 2024, reserves stood at USD 9.20bn, marking a 39.2% increase from USD 6.61bn at the close of 2023.

This growth in reserves has strengthened investor and lender confidence in the country's capacity to meet both short-term debt obligations and import bills.

See below the evolution of forex reserves;

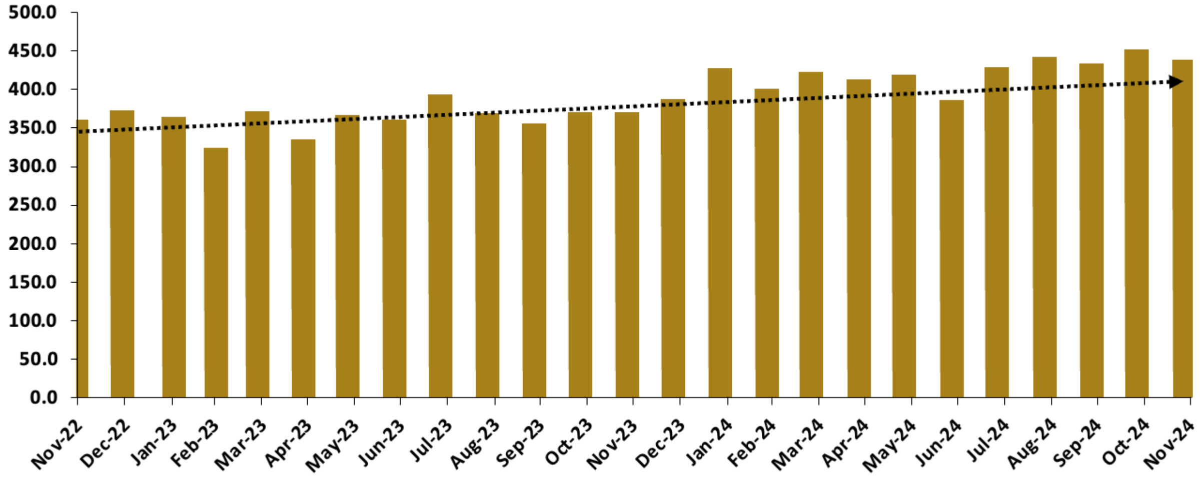


Source: CBK, Chart: SIB

Robust Diaspora Remittances

Cumulative diaspora remittances for the first eleven months of 2024 totaled USD 4.50bn, reflecting a 17.9% increase from USD 3.82bn during the same period in 2023. This growth was fueled by the recovery of economies in the countries from which the remittances originate. See below a chart for the visual presentation;

Diaspora Remittances (USD mn)



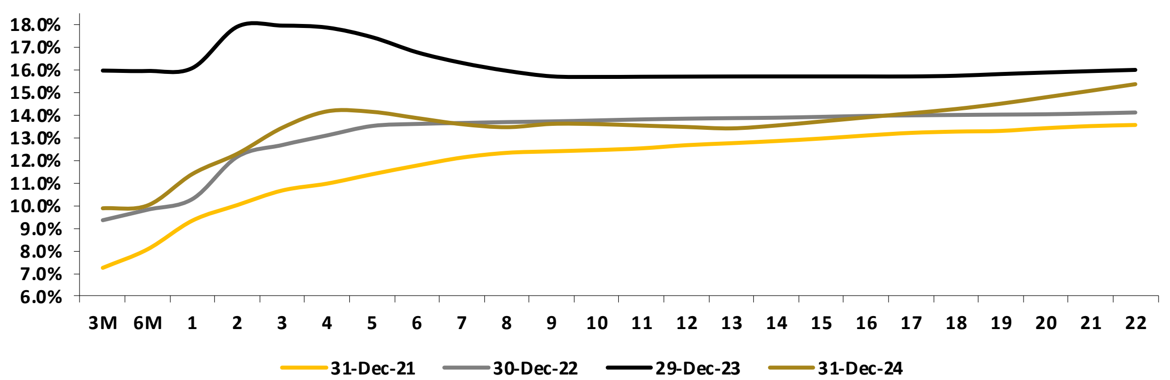
Source; CBK, Chart: SIB

Interest Rates: Turning Tide - Government Security Rates Ease in the Last Quarter of 2024

In our 2023 year-end report, "Like Tides Ebb and Go, Bad Seasons Come and Go," we outlined the struggles brought by elevated interest rates—rising government borrowing costs and diminished portfolio values due to unrealized losses.

2024 marked the beginning of relief, with interest rates on government securities falling strategically. However, this shift also renders fixed-income securities less appealing. Rates on short-term securities experienced a significant cumulative decline of 3,388.06bps, spearheading the adjustments. In addition, the third quarter of the year saw the steepest rate reductions, aligning rates closer to 2022 levels, slightly shy of a normal yield curve, as shown below;

Yield Curve



Source; CBK, Chart: SIB

The dramatic decline was largely influenced by;

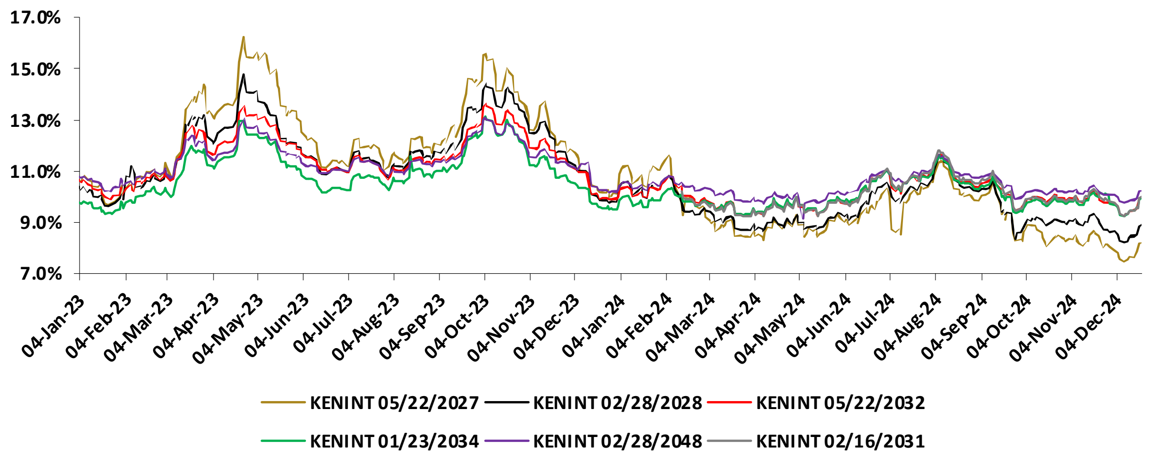
i. **Flexibility in Bid Management** - The government's ability to reject expensive bids, buoyed by access to external funding, provided room for strategic rate adjustments,

ii. **Lower Benchmark Rates** - The cumulative cuts in the Central Bank Rate (CBR) created a ripple effect across the yield spectrum, and,

iii. **Moral Suasion & Stability** - A relatively stable economic outlook in the short term encouraged market players to align with lower rates.

On the global front, Eurobond yields recorded significant declines, settling into a normal curve. This realignment reflected a more accurate pricing of risk, offering relief to external debt markets. See the chart below;

Kenyan Eurobonds



Source: CBK, Chart: SIB

Business Environment Could Improve

While moderate, the business environment remained in the contraction zone on average throughout 2024. The private sector struggled, barely staying afloat, with both internal and external shocks expected to push it further into contraction. This challenging business environment was evident through several indicators;

i. **Purchasing Managers' Index (PMI)** - The PMI averaged 49.5 up to November 2024, a slight improvement over the 48.1 recorded in 2023, but still below the neutral 50-point mark, signaling contraction,

ii. **Persistent Layoffs and Company Closures** - Throughout the year, there was a continued wave of job cuts and business closures, reflecting the difficult operating conditions,

iii. **Slow Tax Revenue Growth Post-Finance Bill Withdrawal** - Tax revenues grew at a slower pace following the withdrawal of the Finance

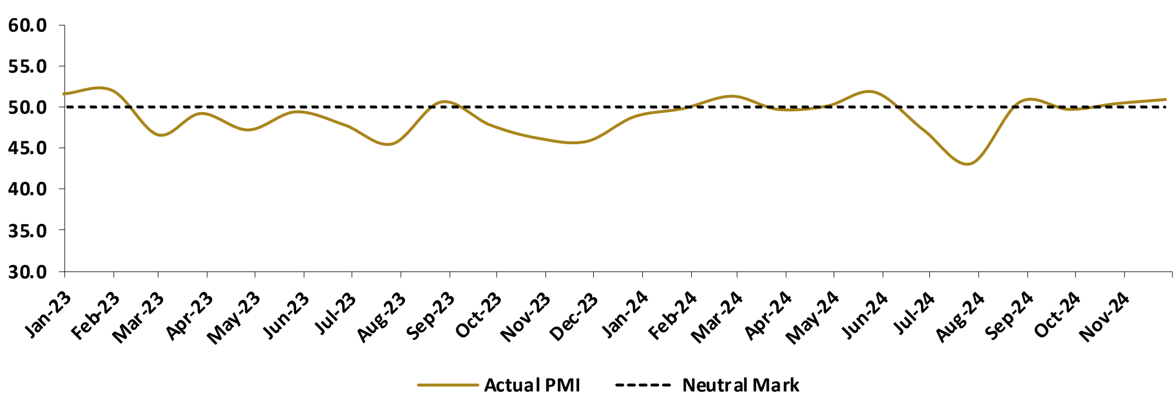
iv. Bill, highlighting the strain businesses are facing,

v. **Slower Growth in Imports** - Imports grew by just 9.6%, compared to a 15% growth in exports for the first ten months of the year. This trend points towards a weakened domestic demand and constrained capital availability,

vi. **Increased Input Costs** - The rising cost of inputs, driven by higher taxes and more expensive capital, added further pressure on businesses.

See below the chart showing the PMI for the last two years;

Purchasing Manager's Index



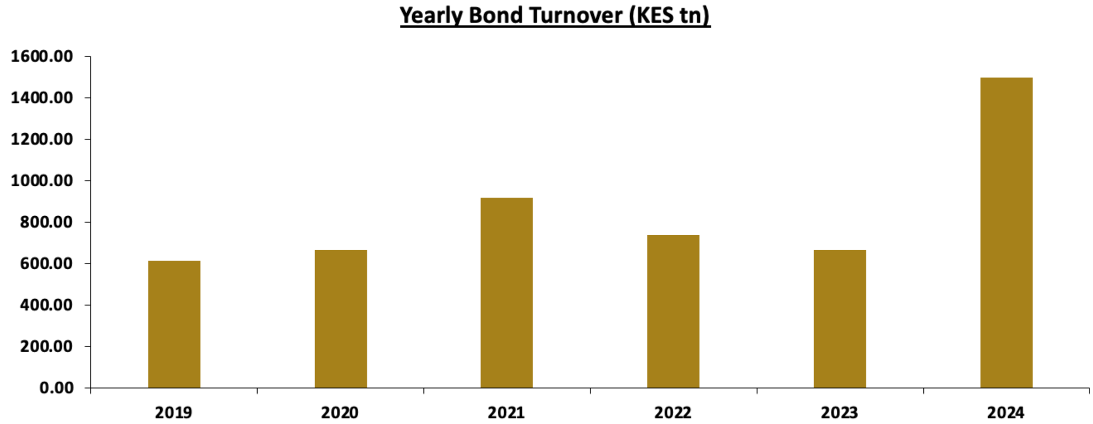
Source: Stanbic, S&P Global, Chart: SIB

Despite major challenges in 2024, we expect some improvement due to a combination of factors including lower cost of credit.

FIXED INCOME MARKETS

Bond Market Activity; Turnover Soars 125% y/y to a Record High

In 2024, the bond market registered a 125%y/y increase to approximately KES 1500.0bn from KES 666.76bn in 2024. The performance was significantly buoyed by the February infrastructure bond that garnered significant interest from investors. See the chart below;

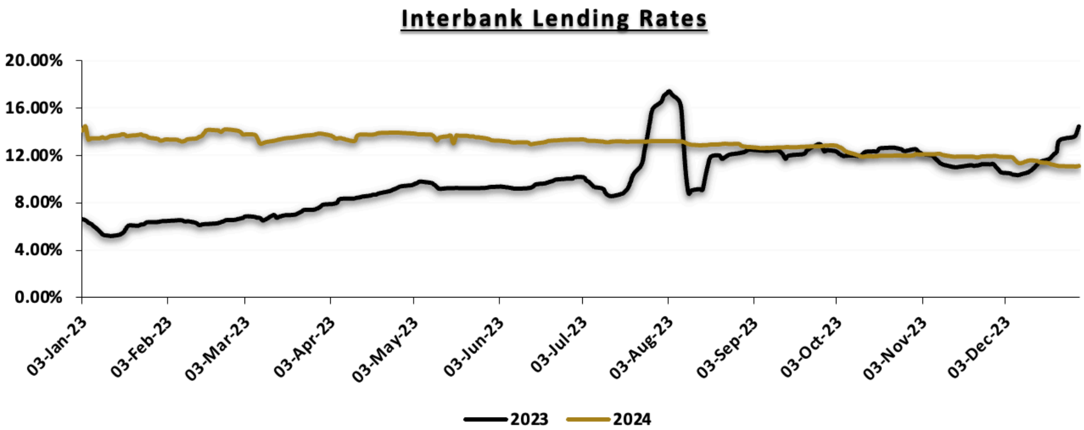


Source: NSE, Chart: SIB

Money Market Liquidity; A Selective Feast, not a Buffet

As depicted by the interbank lending rates and volumes, liquidity conditions in the interbank market improved towards the end of the year, thanks to the CBK's policy reforms. The decision to peg interbank lending rates to the CBR created a direct mechanism for transmitting monetary policy changes with rate cuts in 2H24 significantly influencing the decline in interbank lending rates.

Despite these improvements, interbank rates remained higher than the majority of 2023 levels. This was a consequence of earlier monetary tightening and the transition to a pegged system, which maintained a more controlled liquidity environment. See the chart below;



Source: CBK, Chart: SIB

Nonetheless, several other factors pointed towards constraint liquidity suggesting a bifurcated market, where only a few banks enjoyed smooth liquidity conditions, while others relied heavily on central bank facilities to stay afloat. These factors include;

i. The open market operations which remained active throughout the year even when interbank lending rates begun to drop, and,

ii. The discount window activity whose cumulative lending to banking sector players hit the highest in a decade, as shown below;

Source: CBK, Chart: SIB

However, the strong subscription to government securities suggests that there was liquidity in the interbank market. This contradiction further reinforces our assessment that liquidity was concentrated among only a few players.

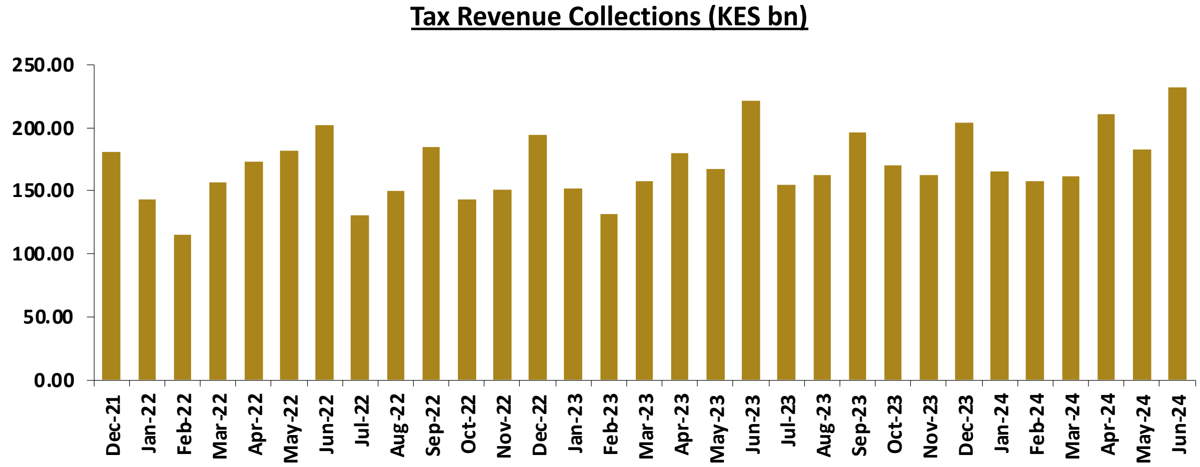
"You cannot stop trouble from coming, but you don't have to give it a chair to sit on" – African Proverb

MACROECONOMIC BACKGROUND – DATA & KEY CHARTS

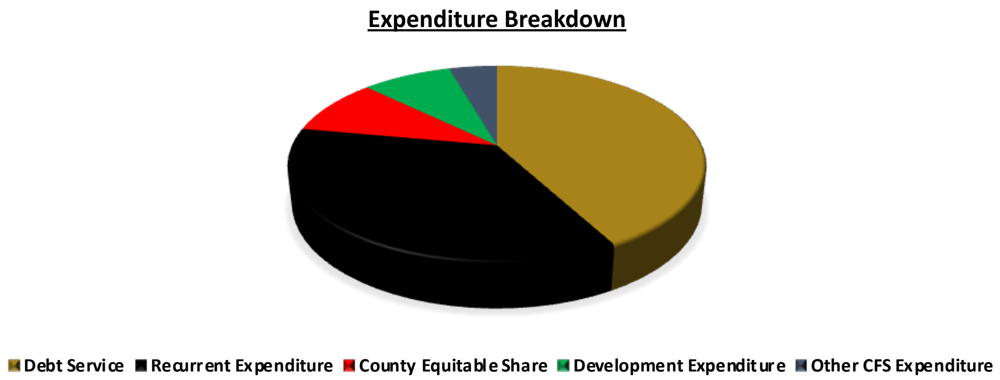
Country Key Statistics:

Official Name	Republic of Kenya
Population	51.5m (2023)
President	Dr. William Samoei Ruto
Deputy President	Professor Abraham Kithure Kindiki
National Assembly Speaker	Moses Francis Masika Wetangula
Senate Speaker	Amason Jeffah Kingi
Capital City	Nairobi
Currency	Kenya Shilling
Currency Code	KES
Per Capital Income	USD 2,259.64
GDP	USD 116.32bn (2024)
Official Language	English, Swahili
Area	580,367 sq km
Time zone	GMT+3

Relevant Charts:



Source: Treasury, Chart: SIB



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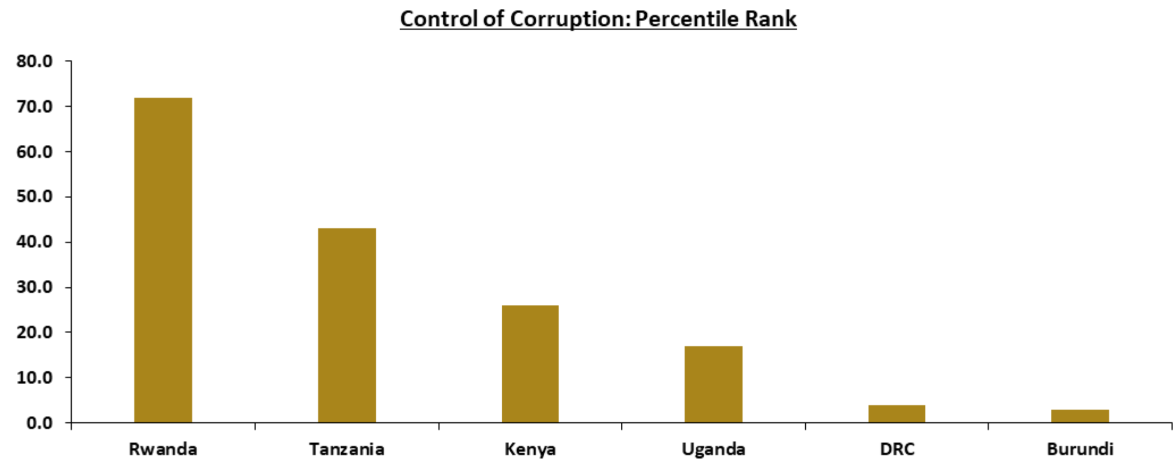
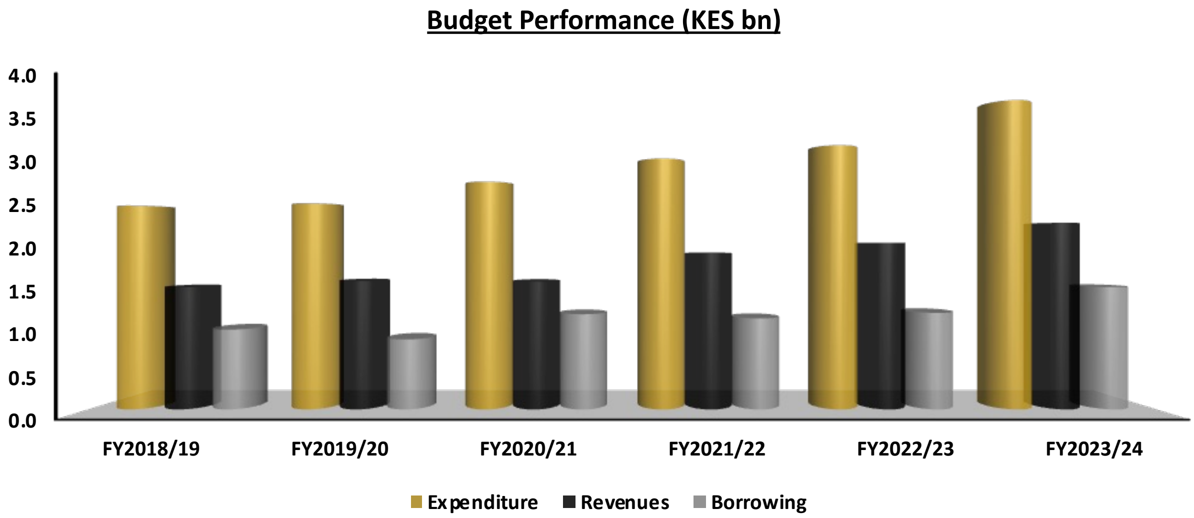


Source: World Bank, SIB Estimates



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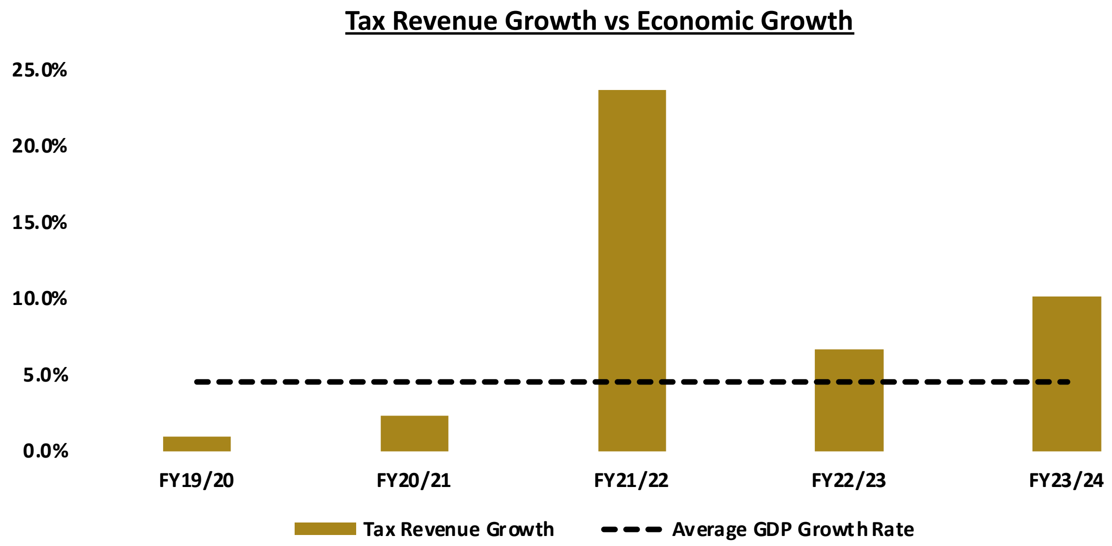

Source: Treasury, Chart: SIB

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