

The global financial crisis and easing of monetary and fiscal policies in kenya: ...



THE GLOBAL FINANCIAL CRISIS AND EASING OF MONETARY AND FISCAL POLICIES IN KENYA: HAS THE ECONOMY ACHIEVED INTERNAL AND EXTERNAL BALANCE? CEC 702: Macroeconomics I Assignment One Submitted by: Peter Kitonyo Registration No. : X80/81901/09 To: Dr. Rose Ngugi 29th January

2010 THE GLOBAL FINANCIAL CRISIS AND EASING OF MONETARY AND FISCAL POLICIES IN KENYA: HAS THE ECONOMY ACHIEVED THE INTERNAL AND EXTERNAL BALANCE? Introduction The global financial crisis continues to cause a considerable slowdown in most countries.

Governments around the world are trying to contain the crisis, but many suggest the worst is not yet over. Stock markets went down by more than 40%. Investment banks have collapsed, rescue packages are drawn up involving more than a trillion US dollars, and interest rates have been cut around the world in what looks like a coordinated response. Leading indicators of global economic activity, such as shipping rates, are declining at alarming rates. Rise in uncertainty in global financial markets has shaken the confidence in the financial system, exerting pressure on the tightening of financial conditions in most economies.

Both of these factors are reflected in reduced consumption, exports and investments, leading to economic activity slow down and exerting pressure on fiscal indicators of budget revenues and budget deficit. On the other hand, the reduction of foreign currency inflows is accompanied by deterioration of the balance of payments indicators and the arising of depreciating pressures on exchange rate, underscoring the role of the

current account stability on macroeconomic and financial balances at home and the need for taking precautions to guarantee it.

In short, the financial crisis caused imbalances in both the internal and external balances of the economic systems of the world, Kenya included. Consequently, most developed economies, USA, Euro-zone, United Kingdom, Japan as well as Kenya, eased their monetary and fiscal policies in order to hamper the economic downturn and improve the financial and capital markets situation. Kenya too, followed easing monetary and fiscal policies to deal with the impact of the crisis.

To understand the extent to which Kenya has achieved internal and external balances using the Monetary and Fiscal policies to deal with the effects of the financial crisis, this paper will examine the impact of the financial crisis on developing countries, theoretical framework for macroeconomic stabilisation, monetary and fiscal policy actions and outcomes in Kenya before drawing conclusions. The paper will however not address the causes of the global financial crisis. Impact of the financial crisis on developing countries

The relationship between OECD GDP and Africa's GDP has weakened as a result of the emergence of countries such as China, as well as structural changes in African economies. According to the IMF World Economic Outlook report in April 2008, a decline in world growth of one percentage point would lead to a 0.5 percentage point drop in Africa's GDP, so the effects of global turmoil on Africa (via trade, FDI, aid) would be quite high. The correlation

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between African GDP and World GDP since 1980 is 0.5, but between 2000 and 2007, it was only 0.2.

As there have been significant structural changes as well as the rise of China, African growth has temporarily decoupled from OECD GDP. Many developing and especially small and African countries are, therefore, in bad position to face yet another crisis. The terms of trade shock tend to be highest in small importing countries such as Fiji, Dominica, and Swaziland. However, African countries such as Kenya, Malawi, Tanzania are projected to have faced terms of trade shocks greater than 5% of GDP (World Bank paper for the October 2008 Commonwealth Finance Ministers meeting)

The current financial crisis was expected to affect developing countries in two possible ways; first there could be financial contagion and spillovers for stock markets in emerging markets. The Russian stock market had to stop trading twice; India stock market dropped by 8% in one day at the same time as stock markets in the USA and Brazil plunged. Stock markets across the world –developed and developing–have all dropped substantially since May 2008. Share prices have tumbled between 12 and 19% in the USA, UK and Japan in just one week, while the MSCI emerging market index fell 23%.

This includes stock markets in Brazil, South Africa, India and China. Second, the economic downturn in developed countries was expected to have significant impact on developing countries. The channels of impact on developing countries include: ? Trade and trade prices: growth in China and India has increased imports and pushed up the demand for copper, oil and other natural resources, which has led to greater exports and higher prices, <https://assignbuster.com/the-global-financial-crisis-and-easing-of-monetary-and-fiscal-policies-in-kenya-has-the-economy-achieved-internal-and-external-balance-assignment/>

including from African countries. Eventually, growth in China and India is likely to slow down, which will have knock on effects on other poorer countries. Remittances: Remittances to developing countries will decline. There will be fewer economic migrants coming to developed countries when they are in recession, so fewer remittances and also probably lower volumes of remittances per migrant. ? Foreign direct investment (FDI) and equity investment: These will come under pressure. While 2007 was a record year for FDI to developing countries, equity finance is under pressure and corporate and project finance is already weakening.

The proposed Xstrata takeover of a South African mining conglomerate was put on hold as the financing was harder due to the credit crunch. There are several other examples e. g. India. ? Commercial lending: banks under pressure in developed countries may not be able to lend as much as they have done in the past. Investors are, increasingly, factoring in the risk of some emerging market countries defaulting on their debt, following the financial collapse of Iceland. This would limit investment in such countries as Argentina, Iceland, Pakistan and Ukraine. Aid: Aid budgets are under pressure of debt problems and weak fiscal positions, e. g. in the UK and other European countries and in the USA. While the promises of increased aid at the Gleneagles summit in 2005 were already off track just three years later, aid budgets are now likely to be under increased pressure. ? Other official flows: Capital adequacy ratios of development finance institutions will be under pressure. However these have been relatively high recently, so there is scope for taking on more risk.

While the financial crisis lasts, it is important each of these channels are monitored, as changes in these variables have direct consequences for growth and development. Those countries that have done well by participating in the global economy may have lost out most, depending on policy responses. The impact on developing countries will vary. It will depend on the response in developed countries to the financial crisis and the slow down, and the economic characteristics and policy responses, in developing countries.

Based on these listed channels the following types of countries are most likely to be at risk: countries with significant exports to crisis affected countries such as the USA and EU countries either directly or indirectly, exporting products whose prices are affected or products with high income elasticities (e. g Zambia may suffer from lower copper prices), depending on remittances and heavily depended on FDI, portfolio and FDI finance to address their current account problems (e. . South Africa), sophisticated stock markets and banking sectors with weakly regulated markets for securities, a high current account deficit with pressure on exchange rates and inflation rates (e. g South Africa) and those countries that have high government deficits (e. g India). The foregoing helps us understand better how Kenya could be affected by the financial crisis and informs of possible appropriate policy actions. Theoretical Framework for Macroeconomic Stabilization

From the above monetary and fiscal policy actions taken by Kenya since the late 2008 when the country followed easing of monetary and fiscal policies, it

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is important to establish the theoretical framework for analysing the efficacy of the macroeconomic stabilising policies. Macroeconomic stability entails two dimensions: low and non-accelerating inflation (or internal balance) and a sustainable balance of payments (or external balance). The former implies that the economy operates at or close to full capacity (its “ potential output”) and the inflation rate is low and non-accelerating.

The latter ensures that the current account position can be financed in an orderly manner i. e without sharp adjustment in the exchange rate or aggregate demand, restrictions on external trade and payments and external debt restructuring among others. Macroeconomic instabilities are caused by a number of things. These include unexpected shocks that can move the economy away from external or internal balance (e. g commodity prices shocks, natural disasters like the recent earthquake impact in Haiti, wars like the Somalia experience), policy action within the country (e. politically motivated fiscal policy), private sector behaviour (e. g irrational exuberance, speculative investment in financial assets leading to “ bubbles’) and spillovers from events or policies in other countries (e. g the recent financial crisis). One of the ways to stabilise the economy is by use of monetary and fiscal policies, exchange rate and structural reforms. In this paper, the focus will be put on the first three. Kenya is an open economy. Thus, we propose to use the open economy IS-LM-BP model under fixed and floating or flexible exchange rate regimes and incorporate various levels of capital mobility in the framework.

Fiscal, monetary and exchange rate policies will be discussed in the above context. It is important to note that the derivation of the IS-LM-BP model will not be done here but only its applications. The open economy IS-LM model assumes that:

- Prices are fixed in the short run. Output and the interest rate adjust to bring about equilibrium between aggregate supply and demand.
- Fiscal deficits are financed with domestic borrowing
- Expectations are ignored
- Changes in official reserves lead to changes in the money supply (no sterilization)

The IS-LM model, has both goods and money markets.

The IS schedule represents pairs of output Y and interest rate i for which the goods market is in equilibrium whereas the LM schedule represents pairs of output Y and interest rate i for which the money market is in equilibrium (see fig: 1) The Balance of Payment Schedule is also introduced into the discussion. The BP schedule as it is commonly referred, represents pairs of output Y and interest rate i for which the Balance of payment is in equilibrium. The Balance of Payments is defined as the sum of the Current Account balance (CA) and the Financial Capital Account (FIN).

It is important to note that higher Y results in deterioration of CA balance and higher i improve financial account balance. Thus, the BP schedule is upward sloping: higher interest rate attracts capital flows, creating a surplus in the financial account. To offset this surplus, output needs to increase to worsen the CA balance (see fig: 2). Below the BP schedule, the balance of payments is in a deficit whereas above the schedule, the balance of payments is in a surplus. And the higher the degree of capital mobility, the more sensitive are capital flows to the interest rate, the flatter the curve.

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Shifts in the BP schedule are explained by depreciation or appreciation of the exchange rate. For example, an exchange rate depreciation shifts the BP curve and the IS curve to the right. In so doing, the depreciation improves the CA, causing a balance of payments surplus. A higher output level or a lower interest rate is necessary to bring the balance of payments back to balance. The depreciation stimulates exports, pushing up aggregate demand. A higher output level or a lower interest rate is necessary to equilibrate the goods market.

Let consider the following cases: Case 1: Expansionary Fiscal Policy under Fixed Exchange Rate and High Capital mobility. High capital mobility means that the BP schedule is not steep. With a fixed exchange rate and high capital mobility fiscal policy is very effective at changing output. A fiscal expansion increase output and the interest rate and worsens the CA whereas a fiscal contraction lowers output and improves the CA, *ceteris paribus* (see fig: 3). Case 2: Expansionary Fiscal Policy under Fixed Exchange Rate and Low Capital mobility.

Low capital mobility means that the BP schedule is steeper. A fiscal expansion leads to a balance of payments deficit, an outflow of reserves and a reduction in the money supply. This offsets the initial expansionary effect and results in a modest increase in output. Within a fixed exchange rate and low capital mobility fiscal policy has a limited effect on output (see fig: 4)

Case 3: Expansionary Monetary Policy under Fixed Exchange Rate and High Capital mobility. High capital mobility means that the BP schedule is not steep.

When the Central Bank expands money supply under a fixed exchange rate and high capital mobility, the monetary expansion has no effect on output: it is completely reversed by the outflow of reserves. This holds true only when the Central Bank does not sterilise the change in reserves (see fig: 5). Case 4: Expansionary Monetary Policy under Fixed Exchange Rate and Low Capital mobility. Low capital mobility means that the BP schedule is steeper. In this case, monetary expansion results in modest capital outflows. But the CA and balance of payments still move to a deficit.

Eventually, the loss of reserves undoes the initial increase in money supply. So there is no effect on output unless intervention is sterilized. It is important to note that cases 1, 2, 3 and 4 are not applicable in Kenya because Kenya pursues a flexible exchange rates policy. Thus, the following cases 5, 6, 7 and 8 are the most appropriate for Kenya. Case 5: Expansionary Fiscal Policy under Flexible Exchange Rate and High Capital mobility. High capital mobility means that the BP schedule is not steep. In this case, a fiscal expansion causes the exchange rate to appreciate (see fig: 6).

Thus, a fiscal expansion is not very effective under high capital mobility because it leads to a higher interest rate, capital inflows, and an appreciation of exchange rate. The appreciation has a contractionary effect, which tends to offset the fiscal expansion. Case 6: Expansionary Fiscal Policy under Flexible Exchange Rate and Low Capital mobility. A fiscal expansion in this case causes the exchange rate to depreciate (see fig. : 7). With Low capital mobility, the fiscal expansion leads to a balance of payments deficit. The

exchange rate depreciates, which has expansionary effects thereby reinforcing the fiscal expansion.

Fiscal policy is very effective with a floating exchange rate and low capital mobility. Case 7: Expansionary Monetary Policy under Flexible Exchange Rate and High Capital mobility. High capital mobility means that the BP schedule is not steep. When the Central Bank expands money supply under a fixed exchange rate and high capital mobility, the monetary expansion leads to a depreciation, which has an additional expansionary effect. Thus, monetary policy is very effective in this case (see fig: 8). Case 8:

Expansionary Monetary Policy under Flexible Exchange Rate and Low Capital mobility.

In this case a monetary expansion results in a small or modest capital outflows and thus less effect on the exchange rate (see fig: 9). Achieving Internal Balance: Under the IS-LM-BP model, the equilibrium point does not necessarily coincide with internal and external balances: equilibrium output may be above or below the potential output. Thus, to achieve internal balance in the economy, the macroeconomic policy under this model depends on the exchange rate and capital mobility regime. If the exchange rate is fixed, use fiscal policy because monetary policy is not effective.

A fiscal contraction will reduce output. If capital mobility is high, a smaller “dose of the medicine” is enough than if capital mobility is low. On the other hand, if the exchange rate is flexible, as is the case in Kenya, both monetary and fiscal policies are used. Where capital mobility is high, monetary policy is extremely effective whereas if the capital mobility is low, fiscal policy is very

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effective. One may also consider other factors in choosing the appropriate policies. Achieving External balance The Balance of payments may be in equilibrium, but with a CA deficit too large for comfort.

So the challenge is to improve the CA. If the exchange rate is fixed and a devaluation is not possible, demand-reducing policies are used instead. In this case monetary policy is ineffective, so a fiscal contraction is necessary. With high capital mobility, a smaller “dose of the medicine” is necessary. On the other hand, if the exchange rate is flexible, as is the case in Kenya, a fiscal contraction reduces aggregate demand, which tends to improve the CA. With high capital mobility, there is also a large capital outflow, balance of payments deficit, and depreciation which helps improve the CA.

And with low capital mobility, there is balance of payment surplus and appreciation, which offsets part of the CA improvement. A stronger fiscal contraction can fix the problem. With flexible exchange rate, a monetary expansion causes the exchange rate to depreciate thus improving the Current Account. In contrast with the fiscal contraction, the monetary expansion also stimulates output growth. Where the economy is overheating, it is better to use the fiscal contraction. If the economy is operating below potential it is better to use the monetary expansion.

However, the cost of this policy action is a huge depreciation. Limitations of the above IS-LM-BP Model

- Devaluations or depreciations may not always be expansionary e. g balance sheet effects.
- Changes in monetary and fiscal policy lead to changes in expectations of future policies, which are likely to affect the exchange rate today.
- Capital inflows/outflows are likely to be

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sensitive to future expected changes in the exchange rate and in country risk. Monetary and Fiscal Policy Actions and Outcomes in Kenya: Have they achieved any success? The Kenyan economy being a developing country is has been at a risk of facing most of the impacts of the global financial crisis that started taking its toll on the economy late 2008. Specifically, it was expected that Kenya experiences reduced economic growth; low growth in exports due to tightened or cancelled credit lines, shorter contracts and projected reduced demands; weakened Shilling which will adversely affect manufacturers and importers; less tourists visits to the country hence reduced earnings; increased commodity prices and reduced money remittances from the Diaspora; lower foreign direct investment flows and weakened and the financial markets in Kenya will also be affected.

To establish the success of monetary and fiscal policies in achieving internal and external balances since the onset of global financial crisis in late 2008, we consider progress made in the areas of monetary policy, fiscal policy, external sector and international rating. A. Monetary Policy In 2008, the Central Bank of Kenya set an inflation target of 5. 0% or below, as well as the goal of maintaining flexible and stable exchange rates. It also plans to build foreign exchange reserves equivalent to an average of 6 months of import cover, a target already agreed by the East Africa Community.

The Bank maintained a tight monetary policy before the economic slowdown due to the global financial crisis in the last quarter of 2008. However, the Bank eased the monetary and fiscal policies to deal with the adverse effects of the financial crisis. The Central Bank Rate was reduced from 9. 0% in

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November to 8.5% in December 2008. Since then the rate has been further reduced to the current 7%. The Central Bank of Kenya also revised downwards the cash reserve ratio from 6% in June 2008 to 5.0% in order to reduce interest rates and thereby, spur, bank lending as part of a stimulus package.

There was also narrowing of interest rates differential among notes of different maturities. In March 2009 the Bank operationalised the Horizontal Repo to enhance access and improve distribution of liquidity in the interbank market. The tenor for repo transactions was also reviewed to a single 5-day tenor in order to improve liquidity management in the interbank market.

Have these policy actions achieved internal and external balances? 1.

Inflation Kenya's overall inflation declined substantially from 19.5% at the end of 2008 to below 5% at the end of 2009.

Kenya is now a low inflation country- another indication of strong macroeconomic policies. This is in line with the monetary policy target of 5% or below. The overall inflation rate has continued to decline. It is important to note that there has been uncertainty in the past about actual inflation levels due to the use of a methodology which had an upward bias, particularly during food price volatility. However, Kenya revised the inflation computation methodology and corrected the said bias and is now in line with international good practice. . Foreign Exchange Reserves Official foreign exchange reserves of the Central Bank of Kenya fell significantly from USD 3,522 million (4.98 months of import cover) in January 2008 to USD 2,714 million (3.1 months of import cover) in March 2009. The drawdown in reserves

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during the period was attributed to exchange rate revaluation losses and the impact of the global financial crisis. Thus, the country was faced with higher international food, fuel and fertilizer costs, and a slowdown in external demand.

However, the official Central Bank of Kenya foreign exchange reserves have been on an upward trend since March 2009, rising to USD 3, 219 million (3. 6 months of import cover) at the end of June and USD 3, 934 (4. 27 months of import cover) at the end of December 2009. The level of foreign reserves of 4. 27 months of import cover is above the statutory minimum of 4 months of import cover. However, it falls short of the target of 6 months of import cover set by Medium Term Plan (MTP) 2008-2012. The gross foreign exchange reserves of the Bank increased in June 2009 following disbursements of SDR 135. million (about \$ 209 million) in June 2009 under the Exogenous Shocks Facility (ESF). The gross foreign exchange reserves of the Bank have grown from USD 4, 348 in January 2009 to USD 5, 319 in December 2009 (see annex table 1).

3. Liquidity Management

The liquidity (L) level in the economy has grown from 9. 75% in January to 17. 2% in December 2009 whereas the reserve money has grown from 4. 03% to 11. 2% during the same period. The twelve month broad money supply (M3) grew by 16% against the target of 15% in December 2009.

Thus, the growth targets of monetary aggregates were generally met by December 2009. However, the Government domestic credit has increased from 4. 6% in January to 32. 0% in December 2009 whereas the private sector and other public domestic credit fell from 22. 4% to 15. 3% during the

same period. The credit has been used to finance infrastructure and other development facilities. The Repo interest rates have been falling. The market rate declined from 6.4% in May to 3.6% in December 2009. 4. Commercial banks' interest rates

Despite the lowering of CBR rate and increase of liquidity in the banking system by the Central Bank of Kenya since late 2008, the commercial banks revised their base lending rates upwards arguing for the need to maintain their profits margin in a higher inflationary environment, and eliminate projects and clients who could not weather the shocks buffeting the economy. There were also structural rigidities during June 2008 and June 2009. However, the said increases in lending rates were only minimal and averaged between 14% and 15%.

In addition, the commercial banks increased their deposit rates, albeit by minimal margins (see annex table: 1; table 2.5.2 and table 2.5.1).

However, the interest rate spread (the difference between lending and deposit rates) increased slightly to 10% during May-December 2009 following faster decline in deposit interest rates. In addition, credit to the private sector growth slowed down between January and April 2009, but picked up albeit slowly from May 2009. 5. Financial growth and stability In 2008, bank deposits surpassed a trillion shillings.

The increased mobilisation of deposits that saw an average of 15 billion per month was attributed to the expansionary strategy adopted by the banks and the entry of Islamic banking products. Average liquidity stood at 37%

compared to the statutory minimum of 20%. The Total Capital to Total Risk <https://assignbuster.com/the-global-financial-crisis-and-easing-of-monetary-and-fiscal-policies-in-kenya-has-the-economy-achieved-internal-and-external-balance-assignment/>

Weighted Assets Ratio for the sector stood at 18.9%, which was above the statutory minimum of 12%. The financial sector showed no long term deterioration due to the international events. Non-performing loans as a proportion of total loans continued to decline from 7.3% in June to 7.05% in December 2008. However, the ratio worsened a bit in 2009 and rose slightly to 9%. However, this marks an improvement from the highs of 19.3% in 2006. Introduction of “mobile money” in Kenya coupled with expansion of customer base by banks increased access to finance from 26.4% to 40.5% in 2009. 6. The exchange rate The movement in the exchange rate generally reflected external factors. As the world witnessed the meltdown in the US economy, the first round effects were experienced with the dollar appreciating against other major currencies.

As a result, Kenya felt a significant depreciation of the shilling against the dollar between September and December 2008. The situation was compounded by selling \$50 million to cushion excessive volatility in the shilling in September 2008 (\$20 million) and October, 2008 (\$30 million). During the first half of 2009, whereas the exchange rate of the Kenya shilling remained stable to US dollar, Tanzanian shilling, Uganda shilling and South African rand it depicted significant volatility against the Sterling pound and the Euro.

In much of the 2009, the exchange rate of the Kenya shillings against major currencies has continued to be stable, and that the gross foreign exchange reserves position was above the statutory minimum of 4 months of import cover. In addition, the current account position of the balance of payments

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improved between September and December 2009 and capital inflows, especially from short-term capital, increased greatly during the same period (see annex table 3. 1. 2). 7. Government Securities

During the first half of the 2008/2009 financial year, the market for Government securities was generally undersubscribed, partly reflecting the tight liquidity conditions and spill-over of the impact of the global financial crisis on the domestic financial markets. The 91-day Treasury bill interest rates edged up from 7. 741% on 1st September to 8. 623% on 1st December 2008. With the policy action that saw the injection of liquidity into the market, the Treasury bill rate reduced slightly to 8. 537% on 29th December 2008.

The growth in credit to Government picked up significantly on account of increased borrowing through Treasury bills and bonds mainly to finance infrastructure development in the country. The maintenance of low short term interest rates during 2009 has resulted in some success. The interbank and 91-day Treasury bill rates declined from 5. 6% and 7. 5% in May 2009 to 3. 0% and 6. 8% in December 2009, respectively At the same time, the Repo market rate declined from 6. 45 to 3. 6%. B. Fiscal Policies

The aim of the Medium Term Plan (MTP) 2008-12 is to redirect spending to high priority areas, including increased capital spending on infrastructure, education and agriculture. Increased spending will be balanced by increased revenue collection and improved management. Government budgetary operations in the fiscal year 2008/2009 resulted in budget deficit of 4. 6% of

GDP compared with 4. 5% of GDP in the fiscal year 2007/2008. From July
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2009 to December the budget deficit has been falling. Public and publicly guaranteed debt, both domestic and foreign, increased from 42. % of GDP in June 2008 to 44. 0% of GDP in June 2009 following a slower growth in GDP.

There is no significant reduction of the public debt since June 2009.

Consistent with the Government debt management strategy of reducing the market risk on domestic debt by restructuring the debt to longer term instruments, the average maturity of domestic debt (by period of maturity) increased from 3 years and 8 months in June 2008 to 3 years and 9 months in June 2009. The overall Government expenditure increased from Ksh. 534 billion in June 2008 to Ksh. 621 in June 2009.

The composition of Government expenditure reveals a slight increase from 24% of the share of development expenditure to total government expenditure at the end of June 2008 as compared to 25% at the end of June 2009 (Table 4. 1. 2B). However, there was no significant change in the share of development expenditure to total Government expenditure during 2009. Tax revenues increased from Ksh. 363 billion in June 2008 to 436 billion in June 2009. This was mainly due to an increased tax base, a rise in value-added tax(VAT) and higher import duties. C.

External Sector Since the onset of the global financial crisis, Kenya's current account deficit increased from 4. 5% in 2008 to 7. 5% in 2009. Kenya has structural current account deficit which was driven by a large trade deficit (USD 6 billion), which is partly compensated by a strong service balance USD over 3. 3 billion). The overall balance remains stable due to strong capital inflows which have been increasing to above USD 2 billion in 2009, mainly

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due to rising “ other flows”, stable transfers of remittances and increasing ODA disbursements.

With the onset of the financial crisis, Kenya’s overall balance turned negative as the trade imbalance widened further and service exports levelled off.

After a sharp increase in Kenya’s import bill in 2008, mainly due to rising oil and fertilizer prices, the trade balance improved slightly in 2009 when imports started to decline. Exports never benefitted from the global commodity boom of 2008 due to disruptions in agriculture production after post-elections crisis.

In 2009, the global crisis constrained the demand for exports and the drought limited the growth of agriculture exports while creating additional need for imports. D. International rating The positive rating of the country signalled an improved environment and restored confidence in the economy by end of 2008. On 3rd November 2008 Standard and Poors upgraded Kenya’s rating to B stable for both the long and short sovereign debt, Fitch ratings in January 2009 also upgraded Kenya to B stable from B negative.

Conclusion Overall, the Kenyan economy has responded well to the monetary and fiscal policies implemented to deal with the effects of financial crisis and economic slowdown. The said performance ties very well with the postulations of the IS-LM-BP framework discussed above and particularly in view cases 5, 6, 7 & 8. However, the internal and external balance were not achieved, the economy was resilient enough to survive the negative effects of the financial crisis through use of prudent macroeconomic policies.

The Kenyan government should monitor closely foreign trade credits, remittances, the current account, foreign exchange reserves and the exchange rate with a view to adopting appropriate measures to safeguard the macroeconomic stability. Specifically, the government should monitor the level of reserves to ensure that it remains consistent with the balance of payments path underlying the prudent macro-fiscal framework. References African Economic Outlook report on Kenya, (2010) Baker, Dean (2008) “ The housing bubble and the financial crisis,” Centre for economic and policy Research.

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