BUSINESS DAILY

1st August, 2013

Kenya shilling joins list of weak currencies in Africa

The Kenya shilling was the third worst performing African currency to the dollar in July, weighed heavily by high demand for foreign currency by importers and a drop in interest rates, which deflected international investors' interest in local assets.

In July, the shilling lost 1.66 per cent of its value to the dollar, compared to the Ghanaian cedi, which lost 1.92 per cent and the Malawian kwacha that dropped 3.41 per cent to the greenback, according to an analysis done by Bloomberg.

The Kenyan currency was outdone by other East African units such as the Tanzanian shilling, which was the best performer gaining 0.86 per cent against the dollar and the Ugandan shilling with a marginal gain of 0.1 per cent.

In its latest weekly report, the Central Bank of Kenya (CBK) noted that the shilling weakened against currencies of all East African neighbours. "In the EAC region, the Kenya Shilling weakened against all the EAC regional currencies to trade at an average of Ush29.59, Tsh18.60, Rwf7.44 (Rwandese Franc) and BIF 17.71 (Burundian Franc) in the week ending July 25, 2013 compared to Ush29.78, Tsh18.64, Rwf7.46 and BIF 17.83 in the week ending July 18, 2013," said CBK in the weekly bulletin.

A weakening shilling makes imports more expensive thereby fuelling inflation in the economy, while a strong local currency makes Kenyan exports uncompetitive thereby hurting the agricultural and manufacturing sectors.

Kenya is a net importer, relying on external supplies for raw materials, machinery, medicines and some food items.

Analysts contend that the biggest hurdle facing the shilling is the unfavourable balance of payments, which implies a growing imports basket. The pressure for more import dollars is likely to negate any gains the local unit gets from a rise in interest rates on government securities and an increase in inflation.

The inflation rate rose to 6.02 per cent in July up from June's 4.91 per cent, marking the first time since August 2012 that inflation has touched six per cent, and also bringing the biggest month-on-month jump over one year.

Bank of Africa head of trading Peter Mutuku said that while interest rates on government securities are rising, they may have to go above the base lending rate (to at least nine per cent) to have an effect on the exchange rate. "For the interest rates on government securities to be of help to the shilling they need to be quite high, maybe into double digits to offset the negative effect of the balance of payments and attract the offshore investors. This is not likely, however, given the need to balance it with growth," said Mr Mutuku.

Domestic debt yields started rising in the past month, but the government's borrowing targets indicate that it plans to reduce domestic borrowing, which could prevent a return to the double-digit interest rate levels on Treasury bills.

The Central Bank has stated that it will not intervene in the market to hold the shilling at a certain level of exchange to major global currencies.

The regulator said in a recent statement it believes in allowing the market to determine the exchange rate "and only intervenes when there is excess volatility that prevents the market from functioning efficiently".

Going into August, analysts expect the currency to remain under pressure, with end-month dollar demand from importers providing the early test on the local unit.

ABC Bank in a note to clients cited the expected pressure as the reason for their expectation that the shilling would weaken in the next few days. The bank quoted the shilling trading at an average of 87.35, down from the 87.20 of Tuesday.

Mr Mutuku said that with the local currency being driven by fundamentals, and with the market not expecting external intervention apart from the occasional CBK action, the shilling is likely to depreciate further beyond the 88 level, and could touch a rate of 90 to the dollar by end of the year.