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Kenya and Bolivia: The differences between winners and losers when the price of oil falls

By Nils Schinasi*

With their opposing exchange rate regimes, energy-exporting Bolivia and energy-importing Kenya have distinct risk profiles.

The fall in commodity prices has been rough for emerging countries: oil prices down threefold since 2014 and currencies down 50% in some cases since then (Russia, Zambia, Azerbaijan, etc.). Not all countries have been affected in the same way: energy importers – like Kenya – and energy exporters – like Bolivia – are managing exchange rates from very different perspectives.

At first glance, given the volatility of the Kenyan shilling (-11% in 2015), the Andean state seems more stable. Bolivia's currency has indeed not declined against the dollar in recent years. However, given the influence that the Bolivian state has on exchange rates – the boliviano is pegged to the dollar –, a backlash cannot be excluded. Other oil exporters with fixed exchange rates – Azerbaijan, Kazakhstan – saw their currencies sharply devalued in 2015. Conversely, expectations for the shilling are pointing towards stabilization.

When the Chinese industry realizes that it suffers from massive overproduction, the entire development strategy of emerging economies over the last fifteen years is called into question. The insatiable demand of the Chinese market indeed ensured that countries rich in raw materials received a steady flow of foreign currency, either as foreign direct investments or in the form of payments in dollars for metal or hydrocarbon deliveries.

A curse?

First scenario: Bolivia, emblematic of commodity-dependent economies. In this country with vast oil and mineral resources (75% of exports), the curse of resources is in full force as the country now finds itself with no alternative sources of income, having failed to diversify its economy. The boliviano remains firmly pegged to the dollar, but this makes it more difficult to diversify the economy because Bolivian goods and services are therefore uncompetitive. The currencies of its two main customers, Argentina and Brazil, have lost 45% and 29% of their value respectively since 2015. In addition, with the plunge in foreign investments and exports not being offset by an exchange rate adjustment, it is Bolivia's ample foreign exchange reserves that must serve as a buffer to even out the country's balance of payment.

The risk of eroding reserves

It should be noted that currency accumulations allow the authorities to continue to fuel growth without worrying about accelerating inflation, since an artificially strong currency maintains inflation at low levels. Knowing that the government also largely subsidizes the credit market through state banks – precisely the opposite of what is recommended to fight capital flight –, the rapid erosion of reserves is

to be feared, forcing the authorities to act. This would mean letting the currency fluctuate more or less freely against the greenback.

Second scenario: Kenya, a country with a more mature financial market and a better diversified economy (finance, telecommunications, etc.); a country with firm domestic growth and whose currency fluctuates freely against the dollar.

Because of the crisis that hit emerging markets, Kenya's currency depreciated sharply in 2015. This has allowed the economy to rebalance itself. Now that this correction has been absorbed, the currency has stabilized and inflation has begun to slow, helped by lower energy costs and declines in food prices.

Kenya is used to loans

The decline in oil prices provides an opportunity to relax fiscal and monetary policy to boost growth – a situation that also benefits a variety of other countries, like India and Costa Rica.

It is important to note that Kenya is accustomed to deficits, of both its current account and budget. The state does not finance deficits by dipping into its reserves but by borrowing on the international capital markets. If capital flows dry up at the same time as investor appetite for risk contracts, Kenya's currency will generally adjust accordingly, helping to rebalance the country's external accounts.

If Kenya seems comparatively more attractive in the current environment, investing in Bolivia could also prove to be interesting. The challenge is for investors to remain vigilant against the boliviano's stability smokescreen by requiring sufficient yields.

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