



Enhancing Transparency and Accountability in Domestic Debt Management in Kenya



Introduction

Kenya's public debt has grown rapidly from the beginning of the millennium to date with domestic debt now forming the majority share of total debt (54%) and increasingly concentrated among non-bank institutions such as pension funds, insurance companies and fund managers. This structural shift has diversified the investor base, reduced rollover risks, and strengthened domestic capital markets but it has also raised fiscal and macroeconomic vulnerabilities. Rising domestic interest payments consumed 69 per cent of total domestic debt service in FY 2023/24 (KSh 802 billion) with the remaining 31% accounting for principal redemptions. The fact that nearly 70% of domestic debt service is absorbed by interest payments underscores the high cost of turning to domestic debt as these payments erode the fiscal space without significantly reducing the debt stock, potentially crowd out private sector credit and weaken inclusive growth.^[i] In contrast, external concessional debt typically carries lower interest rates meaning a greater share of repayments goes toward principal reduction which directly reduces the debt stock.

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The findings are that while domestic borrowing has reduced exposure to foreign exchange volatilities, Kenya's reliance on domestic borrowing is proving costly compared to external debt. Domestic debt accounted for 54% of total public debt as of June 2025 and consumed KSh 632 billion in interest payments at an average rate of 12%. To appreciate the premium that Kenya pays by using domestic debt, we can compare the cost it pays to what it would pay if it could fully convert its domestic debt to external debt at the average external debt interest rate: if the same stock of debt were contracted externally at that rate, which is 5%, the interest cost would have been roughly KSh 263 billion, implying that the use of domestic debt adds KSh 369 billion to Kenya's interest burden. This figure should be used with caution, as Kenya cannot simply convert domestic to foreign debt, but it does indicate the scale of the cost of relying so heavily on domestic debt, which squeezes out resources that could otherwise expand health, education, and other development priorities.

Situational Analysis

After gaining independence in 1963, Kenya mainly relied on concessional loans from bilateral and multilateral partners to finance infrastructure and service delivery.^[i] Early nation-building efforts were supported by these loans, which were characterized by low interest rates and long grace periods raising few concerns about sustainability. During the 1960s and 1970s, external borrowing was manageable and debt-to-GDP ratios stayed moderate thanks to careful fiscal management and a relatively diverse economy. Kenya began facing macroeconomic imbalances in the 1970s and 1980s as a result of falling commodity prices and deteriorating terms of trade. To address rising fiscal and current account deficits, the government depended on external borrowing through Structural Adjustment Programs (SAPs) supported by the IMF and World Bank.^[ii] These programs introduced reforms that yielded mixed results, including public employment cuts, subsidy reductions and trade liberalization.^[iv] While they temporarily boosted macroeconomic indicators, they also reduced public investment and social spending, leading to increased poverty and inequality.^[v] As Kenya's external borrowing escalated its debt-to-GDP ratio increased setting the stage for long-term fiscal vulnerabilities.

At the beginning of the millennium, Kenya's debt portfolio was heavily skewed toward external borrowing. In FY 1999/00, two-thirds of total public debt (KSh 601.8 billion) was external while only one-third was domestic. Though Kenya was ineligible for debt relief under the Highly Indebted Poor Countries (HIPC) Initiative or the Multilateral Debt Relief Initiative (MDRI),^[vi] it benefited from a general shift in donor support away from project-based aid toward program lending and concessional budget support. At the same time, the government improved public financial management and the country benefited from stronger economic growth, so debt levels decreased, and the debt-to-GDP ratio fell.^[vii]

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Kenya's domestic debt first overtook external debt in FY 2006/07, when it reached 51 per cent of total public debt. In FY 2009/10, domestic debt reached KSh 660.3 billion (54%) of the total public debt (KSh 1.23 trillion). The composition of Kenya's debt has hovered around a 50/50 balance between domestic and external borrowing, with shifts in either direction. These shifts, while sometimes driven by short-term financing pressures rather than structural rebalancing, are significant since they determine the country's exposure to exchange rate volatilities on one hand and to higher interest rates and rollover risks on the other, thereby determining fiscal risks and the cost of debt service over time. Kenya issued Eurobonds in 2014 raising USD 2 billion from international capital markets.^[viii] This event signaled growing investor confidence in the country but also initiated a shift towards more commercial borrowing which by FY 2016/17 would see external debt as the dominating borrowing strategy in Kenya. Additionally, in 2014, a statistical rebasing of GDP elevated Kenya to lower-middle-income status,^[ix] effectively locking it out from most concessional financing available to low-income economic countries and pushing the government towards more costly debt from commercial and domestic sources to meet its development needs. This diversified the country's sources of funding and demonstrated investor confidence but also increased the country's exposure to global interest rates and currency fluctuations.

Kenya's Public Debt Stock

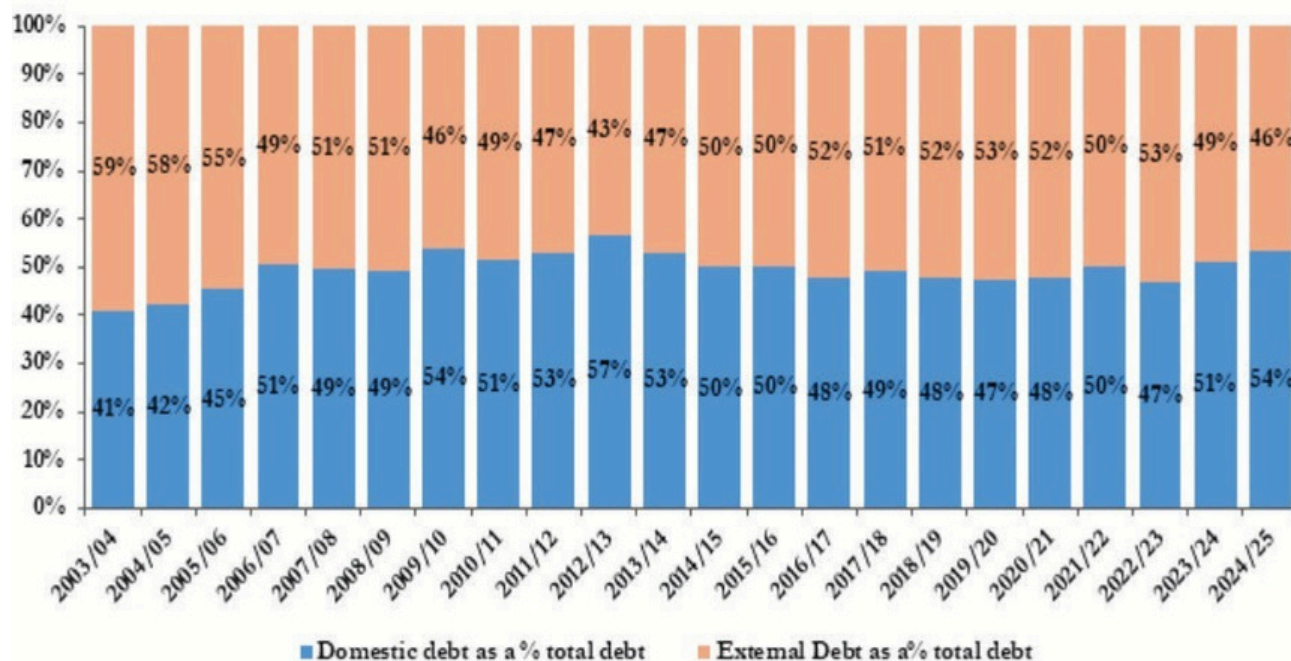


Figure 1: Kenya's External and Domestic Debt as a Share of Total Debt

However, constrained access to concessional external financing, coupled with global financial tightening, has pushed Kenya to rely more heavily on the domestic market in recent years.^[xi] Between 2013 and 2016, Kenya's domestic debt consistently exceeded external debt ranging between 50-57% of the portfolio. However, by FY 2016/17, a surge in external borrowing tipped the balance with external liabilities rising to 52% of total debt and overtaking domestic debt once again. By FY 2021/22, domestic and external debt stood almost equal at about KSh 4.3 trillion each. Kenya's total public debt as of June 2025 stood at KSh 11.8 trillion divided between KSh 6.33 trillion in domestic debt and KSh 5.48 trillion in external borrowing.^[xii] This reflects a debt composition of 54% in domestic obligations and 46% in external commitments. Domestic debt had risen to KSh 6.5757 trillion by August 2025 marking an increase of approximately KSh 240 billion in just three months.^[xiii] This oscillation illustrates how shifts in financing conditions and fiscal pressures have shaped Kenya's debt composition. Periods of higher external borrowing typically coincided with access to syndicated loans and Eurobond issuances often linked to large infrastructure projects such as the Thika Superhighway and Standard Gauge Railway. However, when global markets tighten or concessional financing declines, the government has turned to the domestic market to plug budget deficits.

The result has been a recurring pattern of rebalancing between domestic and external borrowing rather than a stable trend in either direction reflecting the government's adaptation to shifting market access and financing pressures. While this has ensured that the government meets its financing needs, it has also entrenched fiscal vulnerabilities by alternating between exposure to external exchange rate risks and high domestic interest costs. The real goal is not to choose either cheaper debt with exchange rate risk or expensive debt without it, but to design a portfolio that minimizes both vulnerabilities. Therefore, a more deliberate strategy of a 50:50 domestic to external debt mix is most preferred to balance both exchange rates and interest rates risks. The earlier analysis of Kenya's debt service costs highlights the heavy premium attached to domestic borrowing relative to concessional external financing. This strengthens the rationale for a deliberate 50:50 mix where lower-cost and longer-term external debt helps offset the burden of expensive domestic borrowing. As such, the oscillations would be reduced through prioritizing cheaper, longer-term concessional financing complemented by carefully managed domestic borrowing to cushion against external shocks.

Kenya's Domestic Debt Trends

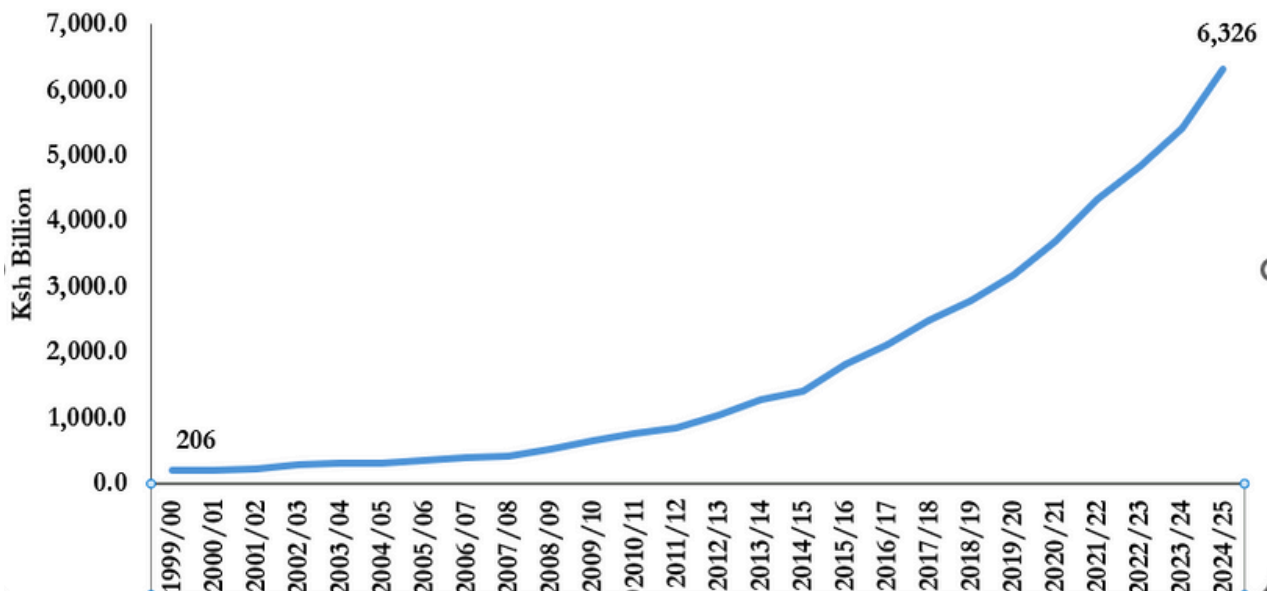


Figure 2: Kenya's Domestic Debt Trends

The rise in domestic debt is driven mainly by Treasury Bonds which remain the dominant instrument, increasing from Ksh 687 billion (80%) in 2012 to Ksh 5.1 trillion (81%) in 2025. Treasury Bills have been volatile, peaking at 59% (Ksh 1.77 trillion) of the portfolio in 2016 before declining to 11% (Ksh 615 billion) in 2024, with a slight uptick to 16% (Ksh 1.04 trillion) in 2025. Pre-1997 debt has steadily declined to near insignificance, while the "Others" domestic borrowing, though small, expanded from Ksh 10 billion in 2012 to Ksh 163 billion in 2025, signalling occasional reliance on alternative domestic instruments as defined by the Central Bank of Kenya to include clearing items in transit (domestic obligations that have been presented for payment but have not yet been fully cleared and settled) and advances from commercial banks.^[xiii]

Domestic Debt by Instruments

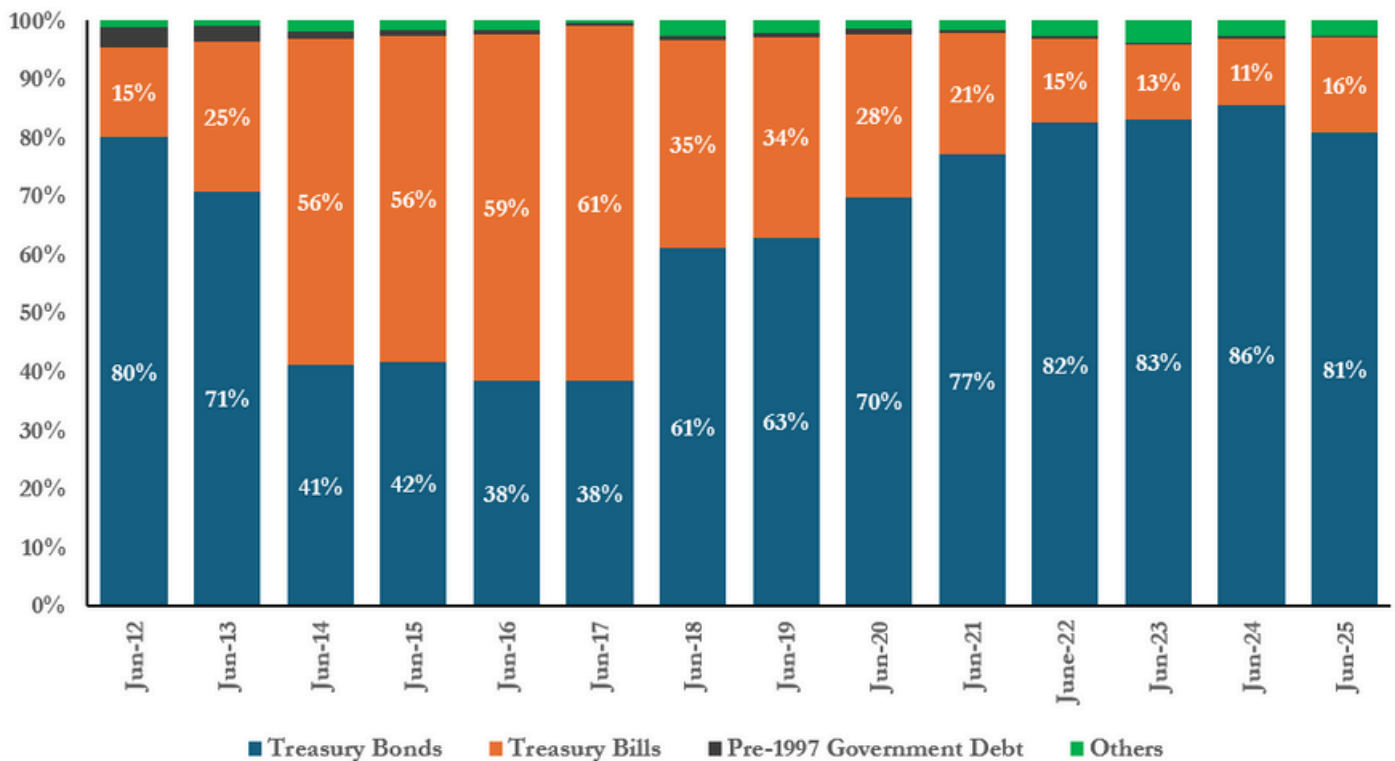


Figure 3: Domestic Debt by Instruments

Debt Service in Kenya

The impact of this borrowing trajectory is most evident in debt servicing. In FY 2010/11, Kenya spent KSh 98.6 billion on debt service, with domestic obligations accounting for 72 per cent (KSh 70.5 billion). By FY 2015/16, domestic service had risen to KSh 349.0 billion representing 82 per cent of total debt service. As external commercial loans began to mature from FY 2016/17 onward, external debt servicing grew rapidly, rising from KSh 94.2 billion in that year to KSh 756.0 billion in FY 2023/24. By FY 2023/24, Kenya's total debt service had reached KSh 1.56 trillion, with domestic and external servicing almost evenly split at KSh 801.1 billion and KSh 756.0 billion, respectively. This means debt servicing grew by more than fifteen times in just 14 years. This trend highlights how domestic debt service drove the early escalation in debt service costs while external obligations have increasingly caught up, leaving Kenya with a dual burden that absorbs resources dwarfing critical sector spending and tightening fiscal space.

Kenya's Debt Service

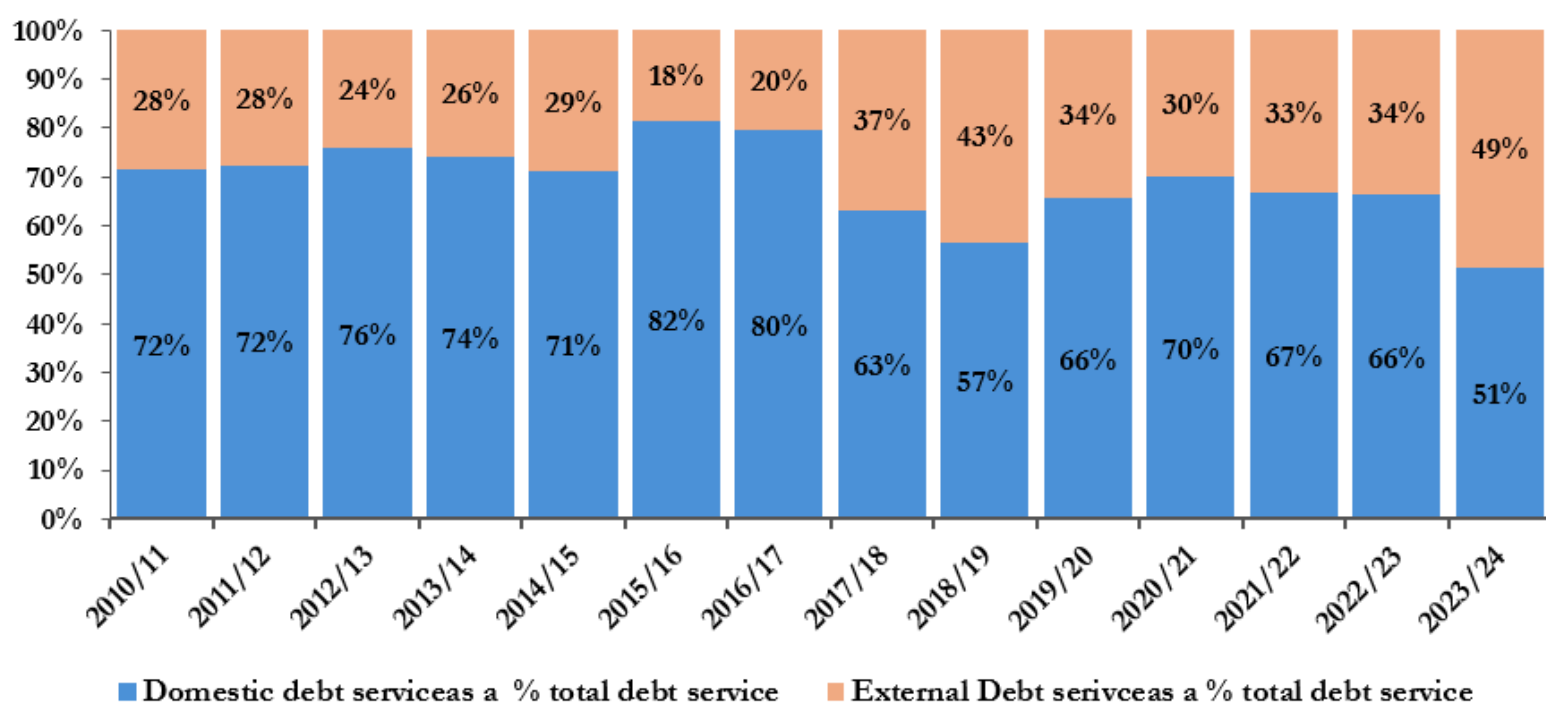


Figure 4: Kenya's Debt Service

Expenditure on Social Sectors

Kenya's rising domestic and external debt servicing has squeezed fiscal space, which disadvantages social sectors like health, education and social protection. Even though allocations to these sectors have grown, actual expenditure has repeatedly fallen short with data showing that these sectors are actually receiving less than they should. For example, while health allocations increased from KSh 41.7 billion in FY 2013/14 to KSh 134.8 billion in FY 2023/24, actual spending reached only KSh 104.2 billion. On the other hand, the education sector which commands the largest share of the budget saw its allocations expanded from KSh 290.6 billion in FY 2013/14 to KSh. 689.4 billion in FY 2023/24. Actual expenditure, however, was KSh 666.1 billion,

with development allocations remaining volatile and modest. Additionally, social protection allocations also grew steadily, from KSh 20.7 billion in FY 2013/14 to KSh 72.8 billion in FY 2023/24. Yet spending was lower at KSh 66.5 billion, with development programs often facing cuts. These trends demonstrate that as debt service obligations rise they crowd out fiscal space and constrain the government's ability to honor commitments to social sectors. The intention hereby is that funds being used to repay debt ought to be channeled towards meeting the financing gaps in health, education and social protection to ensure these sectors receive the resources required to deliver essential services effectively.

Spending on Health, Education and Social Protection Vs Debt Service

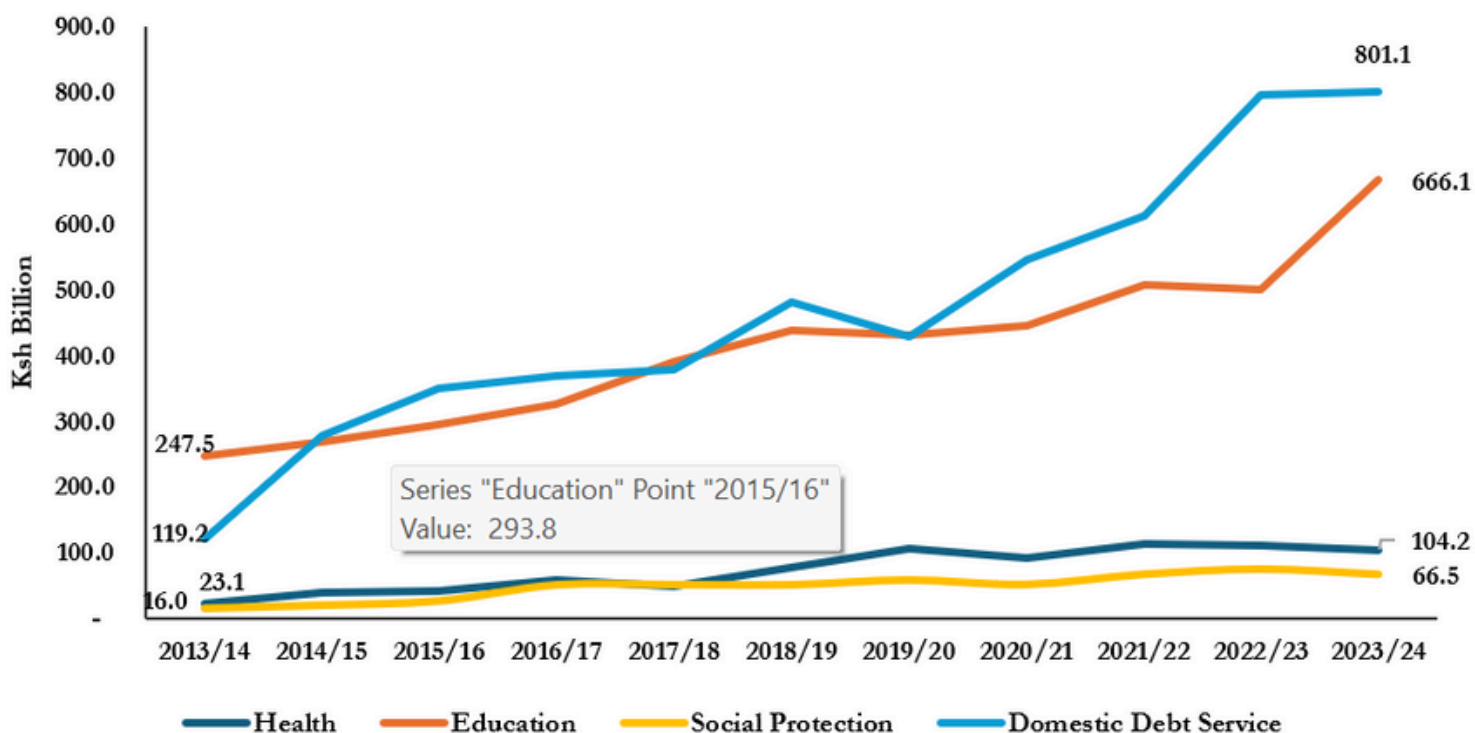


Figure 5: Spending on Health, Education and Social Protection in comparison to Debt Service

Changes in Growth rate from FY 2013/14 to FY 2023/24

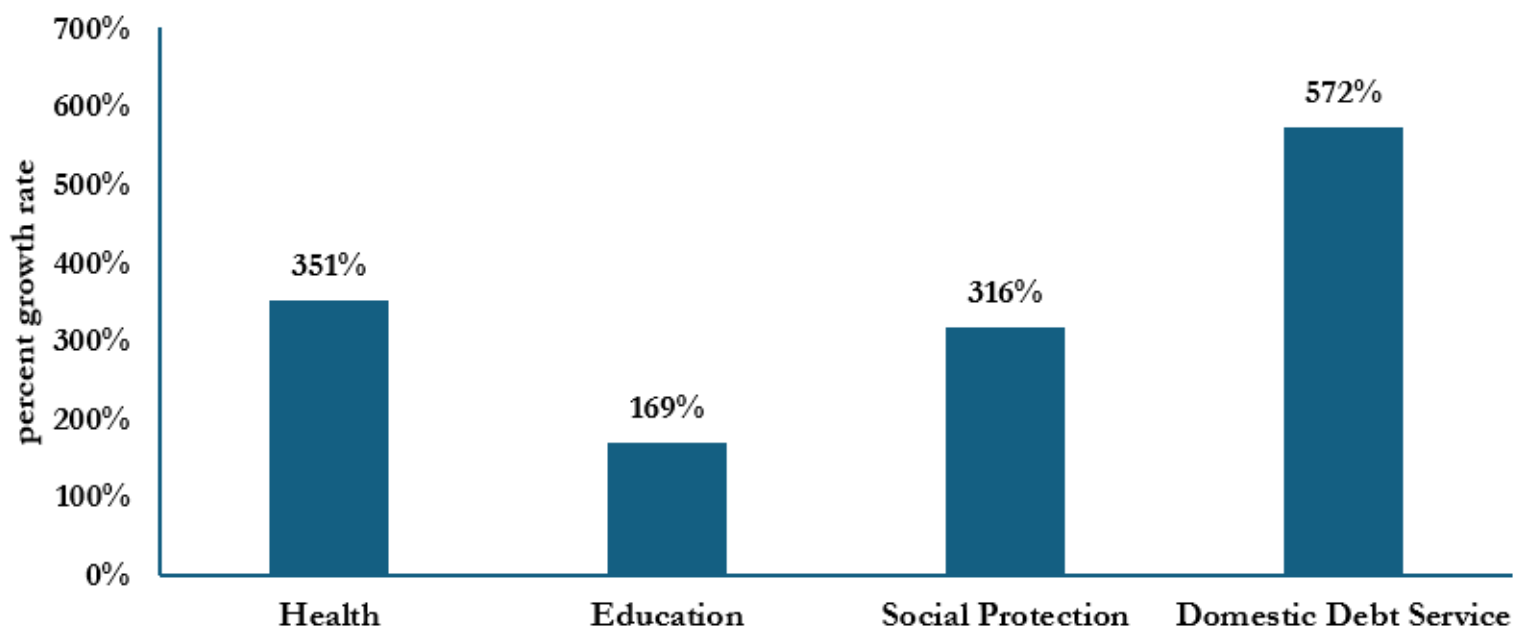


Figure 6: Changes in Growth Rate in Health, Education and Social Protection Sectors Vs Debt Service.

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Implications of Domestic Debt in Kenya

Rising domestic debt service in Kenya is a significant part of the broader rising debt burden that constrains the country's ability to deliver on national development priorities such as universal health coverage, education reform and social protection. As shown in Figure 7, growth in domestic debt service outpaces social spending (health, education and social protection altogether). On average, change in domestic debt service is double that of social spending over FY2014/15 – 2023/24.

Debt service constrains investment in social sectors. On average, social spending increased by 12% against debt service at 25% over FY2014/15-2023/24

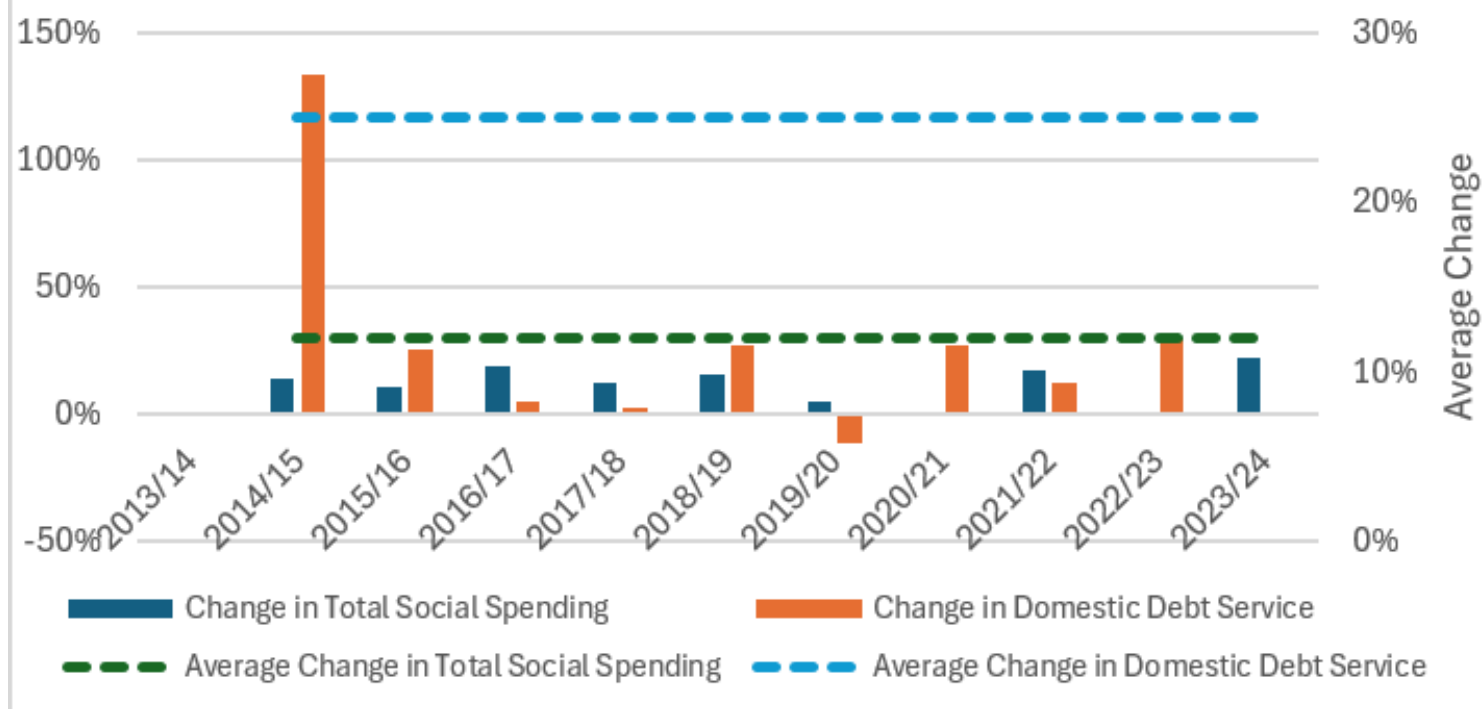


Figure 7: Changes in social spending and domestic debt service

The impact of domestic debt service in crowding out spending on social sectors is confirmed by a negative relationship between social spending and domestic debt service. As shown in Table 1, social spending would reduce by 2% for every percentage increase in domestic debt service.

	Change in Total Social Spending	Change in Domestic Debt Service
Change in Total Social Spending	1	
Change in Domestic Debt Service	-0.0209	1

Table 1: Correlation Matrix

Unlike concessional external borrowing, domestic debt is serviced at higher interest rates and shorter maturities which raises rollover risks and exposes the budget to volatility in domestic financial markets. As reliance on domestic borrowing grows, the Treasury must increasingly divert revenues toward refinancing maturing obligations rather than financing new investments, a cycle that heightens pro-cyclical pressures and weakens fiscal consolidation.

Kenya's debt service (KSh 1.56 trillion in FY 2023/24) already exceeded combined spending on health, education, and social protection (KSh 897 billion) but its domestic component poses an added vulnerability: interest rate spikes or revenue shortfalls could sharply escalate costs, further narrowing fiscal space. This dynamic underscores that rising domestic debt service not only squeezes out development spending but also amplifies fiscal risks, leaving the economy more exposed to shocks .

Weak legal and institutional frameworks as reflected in limited parliamentary scrutiny and poor coordination between the National Treasury and the Central Bank of Kenya have heightened refinancing risks and weakened accountability in the management of domestic debt.^[xiv] The result is not only fiscal strain but also political and social risks, as unmet development promises lead to eroded public trust. Ultimately, unsustainable domestic debt becomes a structural obstacle to both inclusive growth and long-term resilience, as Kenya's rising domestic debt service now absorbs over half of total debt service costs, diverting resources from development spending and creating pressures that, if sustained, will further constrain fiscal space and weaken resilience.^[xv]

The composition of domestic debt raises further governance and equity concerns. Pension funds, insurance companies and other institutional investors now hold a growing share of government securities. While this broadens the investor base and supports capital markets development, the benefits are concentrated among formal sector savers leaving informal workers excluded. This distributional skew highlights the need for policies that expand financial inclusion so that the gains from domestic

debt markets are more widely shared. The broadening of the investor base has been aided by government efforts to mobilise domestic resources amid tightening global financing conditions. Long-term savings such as pensions are increasingly tied to sovereign performance, exposing retirement incomes to fiscal risk, whereas in the past, they were more diversified across bank deposits, equities, and property.

The trade-off in the allocation of scarce fiscal resources is clear, as debt service consumes resources that would otherwise go to social spending for citizens, evident in underfunded hospitals, overcrowded classrooms and constrained safety nets, even as debt service obligations expand. The burden is also intergenerational since a larger share of current domestic borrowing is used for recurrent expenditure and debt rollover rather than productive investment and therefore future generations will shoulder repayment obligations without corresponding benefits in improved infrastructure or social services. These dynamics highlight why domestic debt management must be viewed not only as a fiscal matter but as a democratic concern, central to equity and accountability.

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Conclusion

The sustainability of Kenya's domestic debt trajectory is increasingly under strain. Continued reliance on borrowing to finance recurrent expenditure at high interest rates of around 14% for Treasury bonds and around 8% for Treasury bills^[xvii] compared to external loans averaging 5% raises the risk of debt distress hence threatening both fiscal stability and the resilience of the financial sector. Domestic debt can still serve as a viable financing instrument if anchored in stronger governance and strategic use. This calls for a rules-based debt management framework that enhances transparency and accountability alongside policies to reduce crowding-out, such as expanding access to affordable credit for small and medium-sized enterprises that are squeezed by high

government demand for domestic financing. Broadening pension coverage for informal workers would also ensure that the benefits of domestic debt markets extend beyond formal sector savers. Most importantly, domestic borrowing must be better aligned with productivity-enhancing investments by unlocking its development potential rather than contributing mainly to debt service obligations without corresponding or visible development projects. It must also be accompanied by firm commitments to fiscal discipline. Such a shift would allow domestic debt to contribute to long-term growth, safeguard social and intergenerational equity and sustain investor confidence.

Recommendations

- Parliament should strengthen its oversight of domestic debt by setting clear borrowing limits and the permissible uses of domestic borrowing, explicitly prohibiting its use for recurrent expenditure while requiring regular debt sustainability analyses alongside mandatory disclosure of borrowing plans and liabilities. Such a framework would institutionalize fiscal discipline and subject borrowing decisions to democratic oversight.
- The government should prioritize borrowing for high-return, productivity-enhancing investments in infrastructure, renewable energy and job-creating sectors given that most of Kenya's domestic borrowing currently finances recurrent spending. Aligning debt with growth-generating projects would help expand revenue streams, ease repayment burdens and prevent the intergenerational transfer of debt without social benefits. The National Treasury should introduce fiscal rules that safeguard human capital development by ring-fencing minimum budgetary allocations for health, education and social protection, even during years of high debt service. While the sectors have recorded nominal growth, their budget shares remained low compared to rapidly rising debt service leaving them exposed in periods of fiscal tightening. Clear safeguards would help stabilise financing for social priorities even when debt service consumes a growing share of resources.
- A joint Domestic Debt Oversight Committee bringing together the National Treasury, the Central Bank and Parliament's Budget Office should be established to improve coordination. This committee would publish quarterly reports on domestic debt composition, investor concentration and service projections, ensuring that borrowing decisions are transparent, accountable and responsive to fiscal risks.
- The Central Bank and National Treasury should broaden retail investor participation by scaling up platforms such as M-Akiba and designing safe, small-scale savings products for informal workers, cooperatives and Micro, Small and Medium Enterprises. To avoid shifting fiscal risks onto vulnerable groups, such instruments should include safeguards such as caps on exposure and clear protection mechanisms. Done carefully, this would reduce concentration risks with institutional investors while ensuring that the benefits of domestic borrowing are more equitably shared.

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