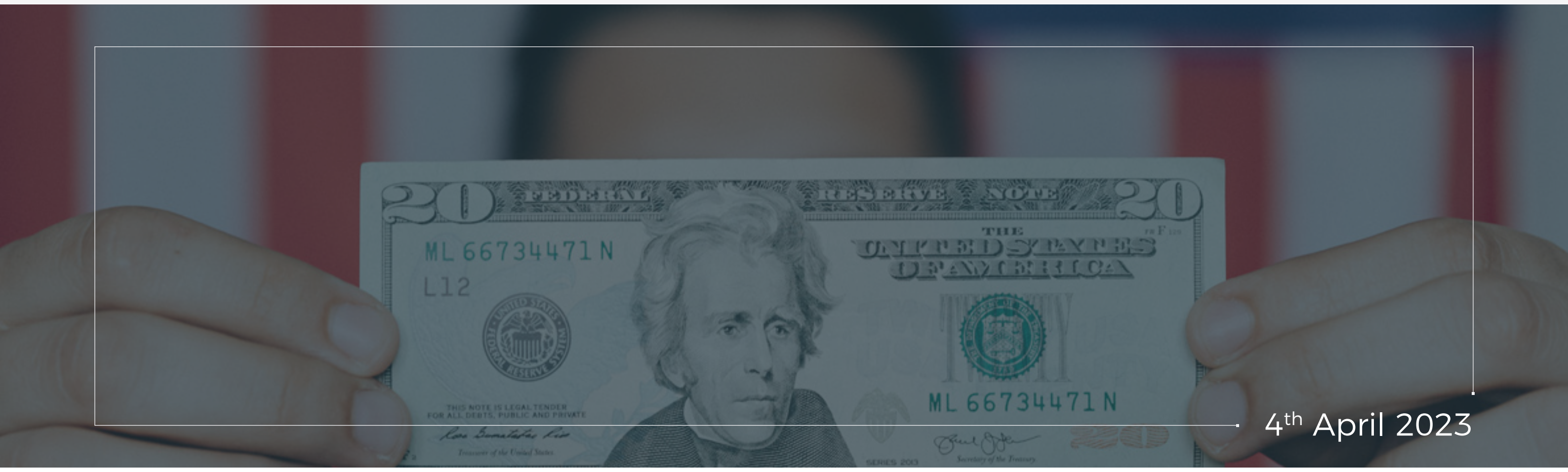
UNPACKING THE DOLLAR CRISIS



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The Dollar Crisis!

The US Dollar has been the world's reserve currency for decades, serving as the backbone of the global financial system. However, in recent months, an increasing shortage of one of the most basic yet essential components of modern economies: the US Dollar, has been experienced in the global economy. As countries scramble to secure the currency to conduct their businesses, experts warn that the Dollar shortage could have far-reaching consequences for the global economy. In this article, we explore the causes, implications and various ways to address shortage and what it means for businesses, investors and ordinary citizens around the world.

Overview

A Dollar crisis occurs when there is a shortage of the US Dollar in a country, leading to a rapid devaluation of the local currency, difficulties in accessing foreign currency, increased cost of imports and reduced foreign investment. This shortage has led to a rise in the value of the USD relative to the Kenyan shilling, making it more expensive for Kenyan to import goods and services.

The shortage of the US Dollar is also affecting Kenya's ability to compete in the global market, as firms are forced to buy at higher rates, reducing their ability to negotiate favorable prices. Kenyan firms have cited the Dollar shortage among a string of domestic challenges that have obstructed their expansion capacity and impacted revenue.

The shortage in Kenya has severely impacted commercial transactions, leading to the proliferation of forex bureaus and a black market due to commercial banks raising the rates thus widening the spread between the official and open market rates.

Reasons for the Dollar Shortage

High level of debt: Kenya has borrowed heavily in recent years to finance infrastructure projects and social programs, resulting in a large amount of debt denominated in foreign currencies. As a result, the government and private sector in Kenya require a significant amount of the US Dollar to service their debt obligations, putting further pressure on the limited supply of the US currency available in the country.

High demand for imports and reduced exports: If a country is importing more goods and services than it exports, there will be an increased demand for the Dollar, leading to a shortage. Kenya relies heavily on exports, to earn foreign currency. However, in recent years, the country's export earnings have been declining, in part due to lower global demand for some of Kenya's key export commodities.

Decreased foreign investments: Kenya's public debt has led to concerns about the country's ability to repay its debts and the sustainability of its long-term economic growth.

Political risks: Political risk creates uncertainty, instability and at times geopolitical tensions in the global financial system. This leads to a reduction in international trade and investment, which in turn leads to a reduction in the flow of the Dollar.

Decreased tourism: The COVID-19 pandemic had a significant toll on the Kenyan economy. The government's efforts to contain the spread of the virus, including lock-downs and travel restrictions, led to a decline in economic activity as tourism in the country significantly decreased.

Dividend Payments: Efforts by Kenyan companies to pay dividends to their foreign investors have contributed to worsen the Dollar crisis. Dividend repatriations by listed multinationals and firms with significant foreign shareholding look set to worsen the effects of Dollar shortages that have seen banks run out of the US currency on some days.

Implications of the Dollar Shortage in Kenya.

Depreciation of the Kenyan Shilling: When there is a Dollar shortage, the demand for the US Dollar increases relative to the supply, causing the value of the Kenyan shilling to depreciate against the USD.

Reduced foreign exchange reserves: A Dollar shortage can reduce the country's foreign exchange reserves, which are used to support the value of the local currency and to pay for imports. The usable foreign exchange reserves currently stand at USD 6,550 million, an import cover of 3.66 months which falls short of CBK's statutory requirement to maintain 4.0 months of import cover.

Increased cost of imports: A Dollar shortage can lead to an increase in the cost of imports, as importers have to pay more Kenyan shillings to purchase the USD to pay for their imports.

Exchange Rates: The value of the Kenyan Shilling(KES) is heavily influenced by the value of the Dollar. When the Dollar is strong, the KES typically weakens making imports more expensive and exports cheaper. This affects the cost of living for Kenyans, as well as the profitability of Kenyan businesses that heavily rely on exports.

Reduced investment: A Dollar shortage can reduce foreign investment in the country, as investors may be hesitant to invest in a country with a volatile currency. This in turn limits the country's economic growth.

Addressing the Dollar Shortage in the Country

Increase exports: One way to reduce the demand for the Dollar is to increase exports. When a country exports more goods and services, it earns more foreign currency, which can help to offset the demand for the Dollar. To increase exports, a country may need to invest in infrastructure, improve the business environment and promote trade agreements with other countries.

Encourage foreign investment: Foreign investment can help to boost the supply of the USD in the economy. To attract foreign investment, the Kenyan government needs to provide a stable and predictable investment environment, with clear rules, regulations and protections for investors. This involves creating a favorable investment climate through policies that protect foreign investors' rights, provide tax incentives and reduce bureaucratic hurdles.

Implement monetary policies: Central banks can use monetary policies to stabilize the currency and reduce the demand for the US Dollar. This may involve adjusting interest rates, increasing the supply of local currency and intervening in the foreign exchange market to buy and sell the US Dollar.

The Central Bank of Kenya (CBK) announced the issuance of the Kenya Foreign Exchange Code(the FX Code). The FX Code sets out standards for commercial banks and aims to strengthen and promote the integrity and effective functioning of the wholesale foreign exchange (FX) market in Kenya. It will facilitate better functioning of the market, reinforcing Kenya's flexible exchange rate regime for greater resilience of the economy. However, these policies can have unintended consequences such as inflation, so they must be carefully designed and implemented.

Increase remittances: In many developing countries, remittances from overseas workers are an important source of foreign currency. To increase remittances, a country can promote policies that make it easier and cheaper for workers to send money home such as, reducing transfer fees and providing incentives for banks and other financial institutions to offer remittance services.

Diversifying the economy:

Some ways to diversify the economy include;

1. Promoting local production by providing incentives such as tax breaks and subsidies help reduce dependence on imports and foreign currency.
2. Attracting foreign investments in industries that can generate foreign currency. Governments can offer incentives to foreign investors, such as tax breaks or streamlined regulatory processes and promote their economies to potential investors.
3. Developing new export markets for non-dollar denominated exports, to help reduce vulnerability and increase the supply of foreign currency. Governments can work to identify and target markets where local products can be competitive and provide support to local exporters to help them penetrate these markets.

Managing Exchange Rates: The government can manage exchange rates to prevent the value of the currency from falling too low. The Central Bank of Kenya(CBK) has directed commercial banks to ration the Dollar to protect the current reserves.

SUMMARY

In conclusion, the Dollar shortage in Kenya is a significant challenge for the country's economy, which relies heavily on foreign currency to support trade and investment. Addressing this issue will require a multi-faceted approach, including measures to increase exports, attract foreign investment, and reduce reliance on foreign currency debt and imports. Addressing the crisis requires transparency, accountability and coordinated efforts by policymakers and market participants in the management of foreign exchange reserves and monetary policy.

We hope that this article has been insightful in emphasizing the importance of the Dollar in today's complex and rapidly changing financial landscape and encourages individuals to take proactive steps to improve their financial knowledge and skills.

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