INTERNATIONAL MONETARY FUND

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KENYA

December 2022

FOURTH REVIEWS UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, AND REQUESTS FOR AUGMENTATION OF ACCESS UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, AND MODIFICATIONS OF QUANTITATIVE PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR KENYA

In the context of the Fourth Reviews Under the Extended Arrangement Under the Extended Fund Facility and Under the Arrangement under the Extended Credit Facility, and Requests for Augmentation of Access Under the Arrangement under the Extended Credit Facility, and Modifications of Quantitative Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Acting Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 19, 2022, following discussions that ended on November 8, 2022, with the officials of Kenya on economic developments and policies underpinning the IMF arrangements under the Requests for an Extended Arrangement Under the Extended Fund Facility and an Arrangement Under the Extended Credit Facility. Based on information available at the time of these discussions, the Staff Report was completed on December 8, 2022.
- **Statement by the Executive Director** for Kenya.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR22/445

IMF Executive Board Completes Fourth Reviews of EFF and ECF Arrangements for Kenya Providing a US$447.39 million Disbursement

FOR IMMEDIATE RELEASE

- The IMF Executive Board completed the Fourth reviews of the EFF/ECF arrangements with Kenya, providing the country with access to SDR336.54 million (about US$447.39 million). This includes an SDR162.34 million (US$215.81 million) augmentation of access.
- Global developments have contributed to rising inflation and slowing growth, but the economy remains resilient amid a continuing severe drought in some regions.
- With strong commitment to the Fund-supported program, Kenya is making progress in addressing debt vulnerabilities and promoting more inclusive growth.

Washington, DC – December 19, 2022: The Executive Board of the International Monetary Fund (IMF) [today] completed the Fourth reviews of the 38-month arrangements under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) arrangements. The Board's decision enables immediate disbursement of SDR336.54 million (about US$447.39 million) usable for budget support, including an augmentation under the ECF arrangement of SDR162.34 million (30 percent of quota, about US$215.81 million). This brings Kenya's cumulative disbursements under the EFF/ECF arrangements to about US$1.655.59 million. With the augmentation, the total amount under the EFF/ECF arrangements rises to SDR 1.818 billion (335 percent of quota or about US$2.416 billion).

The EFF/ECF arrangements (approved on April 2, 2021, see Press Release 21/98), aim to support Kenya's program to address debt vulnerabilities, the authorities' response to the COVID-19 pandemic and global shocks, and to enhance governance and broader economic reforms.

Kenya's economy remains resilient against a challenging global backdrop and is projected to grow 5.3 percent in 2022. Inflation moved above the Central Bank of Kenya's (CBK) target band in June and is expected to peak in early 2023. Despite double-digit export growth, the current account is expected to widen on higher global oil prices in 2022. Downside risks predominate in the near term, while Kenya's medium-term outlook remains favorable although climate-related risks are elevated.

With progress on fiscal consolidation, public debt has begun leveling off. Taxes performed strongly in FY2021/22, while spending was compressed on shortfalls in external commercial financing, leading to an overperformance of 1.7 percent of GDP in the primary deficit. However, obligations carried over from last fiscal year and an increase in unbudgeted spending in early FY2022/23 increased pressures on the budget. The new administration of President Ruto has reasserted Kenya's commitment to fiscal consolidation, targeting a lower overall fiscal deficit than the original budget.

The CBK has raised policy rates by a cumulative 175 basis points in 2022. The Kenyan Shilling continued to depreciate against the U.S. dollar while the dollar strengthened globally,

and liquidity has declined in the interbank forex market. A lower projected path of FX reserves reflects financing shortfalls last fiscal year and planned cuts in foreign-financed projects during FY2022/23. Reserves remain adequate at 3 months of imports, gradually increasing over the medium term.

Kenya's structural reform agenda is advancing, albeit with some delays. In the areas of governance and transparency, the authorities have now completed and published audits of COVID-19 vaccine spending and begun publishing beneficial ownership information of successful bidders in new procurements. However, progress on addressing financial weaknesses in state-owned enterprises and a planned review of the fuel pricing mechanism were delayed during the political transition.

At the conclusion of the Executive Board's discussion, Ms. Antoinette Sayeh, Deputy Managing Director and Acting Chair, made the following statement:

"Kenya's commitment to its economic program supported by the Fund's Extended Fund Facility and the Extended Credit Facility arrangements is anchoring debt sustainability. The economy has performed well amid slowing global growth, tighter financing conditions and volatile commodity prices, while the continuing drought has increased food insecurity, and climate-related risks pose ongoing challenges. Mutually reinforcing prudent macroeconomic policies and resolute implementation of structural reforms remain essential to safeguard positive medium-term prospects.

"Strong performance of tax revenues supported resilience and cushioned the initial impact of global shocks on households and businesses, and the new administration's elimination of petrol subsidies and plans for significant reprioritization of expenditure to keep the fiscal deficit below the budgeted level are commendable. Looking ahead, continued strong commitment to fiscal consolidation over the medium term remains key to reduce debt vulnerabilities. Additional tax policy measures, anchored in a Medium-Term Revenue Strategy to secure space for needed social and development spending, and improved spending efficiency, revenue administration, and public financial and debt management will be key.

"The Central Bank of Kenya's (CBK) monetary policy stance is welcome. Further tightening would limit second-round effects and keep inflationary expectations well-anchored while supporting external adjustment. The exchange rate should function as a shock absorber, supported by a well-functioning interbank FX market, with forex interventions (sales) limited to addressing excessive volatility. Continued monitoring of the banking system is also important.

"Alongside new initiatives to promote inclusive growth, progress on the structural reform agenda should continue. By beginning to publish beneficial ownership information for successful bidders of new procurements, Kenya delivers on a key commitment to enhance transparency and accountability. However, the AML/CFT legal framework needs strengthening and stepped-up efforts on compliance. Addressing vulnerabilities at Kenya Airways and Kenya Power and Lighting Company is urgent, along with strengthening the governance framework for state-owned corporations. Planned reviews of the fuel pricing mechanism and the audit of extrabudgetary spending are also important. High vulnerability to climate change calls for multi-faceted policy action."

Kenya: Selected Economic Indicators, 2021—2024				
	2021 Act.	2022 Proj.	2023 Proj.	2024 Proj.
Output				
Real GDP growth (%)	7.5	5.3	5.1	5.5
Prices				
Inflation - average (%)	6.1	7.7	7.8	5.7
Central government finances (fiscal year)[1]				
Revenue (% GDP)	16.0	17.3	17.5	17.8
Expenditure (% GDP)	24.2	23.5	23.3	22.1
Fiscal balance (% GDP)	–8.2	–6.2	–5.8	–4.4
Public debt (% GDP)	67.7	66.6	67.6	66.2
External debt (% GDP)	35.2	33.3	34.1	33.9
Money and Credit				
Broad money (% change)	6.1	9.0	7.4	9.4
Credit to private sector (% change)	8.6	12.0	12.3	13.3
Policy rate, end of period (%)	7.0	…	…	…
Balance of payments				
Current account (% GDP)	–5.2	–5.7	–5.4	–5.3
Reserves (in months of imports)	4.5	3.7	3.0	3.2
Exchange rate				
REER (% change)	–2.6	…	…	…

Source: Kenyan authorities and IMF staff estimates and projections.

[1] Based on fiscal year (i.e., 2023 represents 2022/23, ending in June 2023).

INTERNATIONAL MONETARY FUND

KENYA

December 8, 2022

FOURTH REVIEWS UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, AND REQUESTS FOR AUGMENTATION OF ACCESS UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, AND MODIFICATIONS OF QUANTITATIVE PERFORMANCE CRITERIA

EXECUTIVE SUMMARY

Context. Kenya is navigating a turbulent global backdrop marked by volatile commodity prices, slowing growth in key trading partners, and constrained frontier market access to international capital markets. At home, a smooth transition following the August elections demonstrated Kenya's increasing institutional strengths, while the multi-season drought has worsened food insecurity for vulnerable populations in arid and semi-arid regions and kept food prices elevated. Strong tax overperformance in FY2021/22 helped cushion some of these shocks, and the administration of President Ruto eliminated petrol subsidies in their first week in office. Inflation has breached the central bank (CBK) target band, and monetary policy has been tightened by 175 basis points this year. Foreign reserves are adequate, but lower than previously projected given shortfalls in FY2021/22 external public commercial and project financing, spending cuts in FY2022/23 also extending to externally-financed projects, and the prospects for continued challenging market conditions for frontier economies into 2023.

Program performance. All end-June 2022 quantitative performance criteria were met, with tax and primary balance targets met by wide margins. The structural agenda saw delays on electoral uncertainty, but pending items are expected to be completed by end-2022. Publication of beneficial ownership information of awarded tenders has begun.

Requests. The authorities are requesting an augmentation of access by 30 percent of quota (SDR162.84 million) under the Extended Credit Facility arrangement to help meet fiscal financing needs and support FX reserves. The authorities are requesting modifications of end-December 2022 and end-June 2023 targets on the net international reserves and the end-June 2023 targets on tax revenues and the primary fiscal balance (reflecting stronger proposed FY2022/23 fiscal targets). New targets for end-December 2023 and structural benchmarks are also being proposed.

Risks to the program. The near-term outlook is subject to both upside and downside risks, with the balance tilting more toward adverse outcomes. Risks stem from both external and domestic sources, mitigated by the authorities' strong performance to date and demonstrated commitment to adopting contingency measures as needed to achieve program objectives, close engagement with development partners, and a tailored capacity development strategy to support the implementation of reforms, including plans to develop a Medium-Term Revenue Strategy.

Approved By
Catherine Pattillo (AFR) and Eugenio Cerutti (SPR)

The mission team comprised M. Goodman (head), T. Rasmussen (Resident Representative in Nairobi Office), V. Crispolti, S. Gupta, G. Amidžić (all AFR); P. Iossifov (SPR); P. Carapella (FAD); G. Pasricha (MCM); J. Turkewitz, J. Duasing, and R. Snipeliski (all LEG); and D. Tallam and K. Tuitoek (Nairobi local office), with assistance from F. Nyankiye, F. Morán Arce, M. Nsanzimana (all AFR), and C. Odwogi, and E. Muiruri (IMF Nairobi Office). Discussions were held in Nairobi during October 25–November 8, 2022. James Garang (OED) participated in the discussions. The team, accompanied by Director A. Selassie (AFR), met with the President, Dr. William Ruto, and his economic advisers; the Cabinet Secretary for National Treasury and Planning, Prof. Njuguna Ndung'u; Governor of the Central Bank of Kenya (CBK), Dr. Patrick Njoroge; the Principal Secretary for the National Treasury, Dr. Julius Muia; Deputy Governor of the CBK, Ms. Sheila M'Mbijjewe; and other senior government and CBK officials. Staff also had productive discussions with the Parliamentary Budget Office, the Ministry of Justice, the Auditor General, the Controller of Budget, the Commission on Administrative Justice, the Ethics and Anti-Corruption Commission, the private sector, civil society organizations, and development partners.

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Abbreviations

AFRITAC	Africa Regional Technical Assistance Center
AML	Anti-Money Laundering
CA	Current Account
CBK	Central Bank of Kenya
CFT	Combatting the Financing of Terrorism
DSA	Debt Sustainability Analysis
DPO	Development Policy Operation
EAC	East African Community
FATF	Financial Action Task Force
FPAS	Forecasting and Policy Analysis System
FRC	Fiscal Risk Committee
FX	Foreign exchange
GIMIS	Government Investment Management Information System
IT	Indicative Target
KQ	Kenya Airways
KPLC	Kenya Power and Lighting Company
MEFP	Memorandum of Economic and Financial Policies
MPCC	Monetary Policy Consultation Clause
MSME	Micro, Small, and Medium Enterprises
MTRS	Medium-Term Revenue Strategy
NIR	Net International Reserves
NPL	Non-Performing Loans
NT	National Treasury and Planning
PDMO	Public Debt Management Office, National Treasury
PEP	Politically-Exposed Person
PFM	Public Financial Management
PPP	Public-Private Partnership
PPIP	Public Procurement Information Portal
PV	Present Value
QPC	Quantitative Performance Criterion
SB	Structural Benchmark
SC	State Corporation
SOE	State-Owned Enterprises
TA	Technical Assistance
TMU	Technical Memorandum of Understanding
UCT	Upper Credit Tranche
y/y	year-on-year
WB	World Bank

CONTEXT

1. Kenya is navigating a turbulent global economic backdrop. The economy remained broadly resilient in the run-up to August 9 elections.[1] Real GDP grew by 6 percent y/y in the first half (H1) of 2022 despite a continuing drought, while tax overperformance and a strong commitment to the Fund program helped contain risks ahead of the elections. However, slowing global and regional growth, tighter external financing conditions and a surging U.S. dollar, volatile international commodity prices, and elevated global uncertainties have created a challenging backdrop for policy-making. Markets conditions did not allow previously planned international issuance of US$1.1 billion amid heightened investor risk aversion to frontier market debt and election-related uncertainty.[2] High global food, fertilizer, and fuel prices and weak agricultural production have pushed inflation above the CBK's target band. Food insecurity and malnutrition have risen in the areas impacted by drought across the Horn of Africa (Kenya's Arid and Semi-Arid Lands (ASAL)). COVID-19 vaccination rates have plateaued.[3]

2. The new administration has demonstrated its commitment to fiscal consolidation and debt sustainability. William Ruto was sworn in as President on September 13 after the Supreme Court rejected challenges to the official results, completing a peaceful election that demonstrated the growing strength of Kenya's institutions. Ruto campaigned on a "bottom-up" economic model of supporting small businesses in the informal sector while also raising revenue and reducing the fiscal deficit. In his first week in office, fuel subsidies were sharply reduced and monthly adjustments in passthrough of variable costs to electricity consumers were restored. New fertilizer subsidies (smaller than fuel subsidies) were also announced. Despite pressures from delayed, unbudgeted, and emergency spending, the authorities have publicly committed to stay the course of fiscal consolidation, announcing expenditure cuts and an emphasis on tax revenues.

RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

3. Growth momentum has slowed while inflation is above the authorities' target.

- After a strong rebound in 2021 (7.5 percent y/y), 2022 saw a normalization, with easing growth supported by robust services, with a continued recovery in the hospitality sector (Text Figure 1). However, agricultural output declined for the third successive quarter on continued drought (Box 1). In 2022Q3, an indicator of manufacturing activity bottomed out (Figure 1).
- Inflation (9.5 percent y/y in November) has exceeded the CBK's 2.5–7.5 percent target band since June, driven by food, fuel, and electricity prices (Text Figure 2; Box 2). Nonfood,

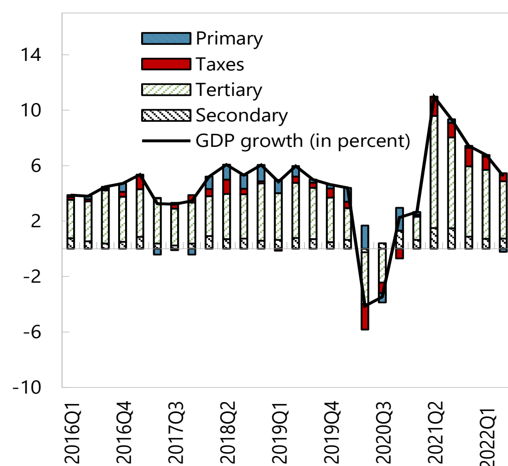
[1] Elections were held for the presidency, both houses of parliament, and county governors and assemblies.

[2] The yield on the 2024 bond rose from as low as 4.25 percent in February 2022 to briefly above 22 percent in mid-July ahead of the elections. As of November 24, it stood at 12.83 percent.

[3] As of November 28, 36.6 percent of population aged 18 years and above were fully vaccinated (end-March 2022: 29.8 percent), against a target of full vaccination for population aged 12 years and above by end-2022.

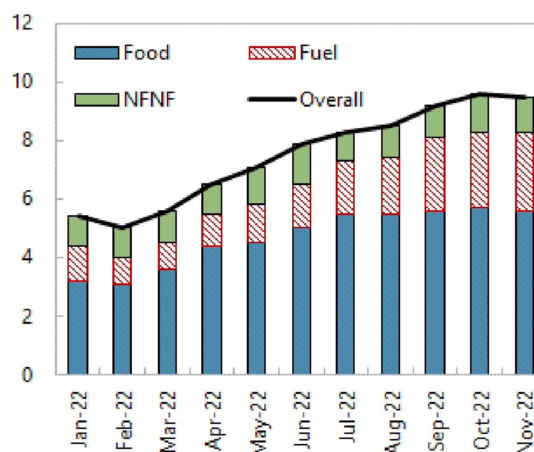
nonfuel (NFNF) inflation has ticked up to 4.2 percent. Monetary policy rate was tightened by a cumulative 175 basis points in three hikes, beginning in May.

Text Figure 1. Kenya: Contribution to GDP Growth
(Percentage points)



Source: Kenya National Bureau of Statistics.

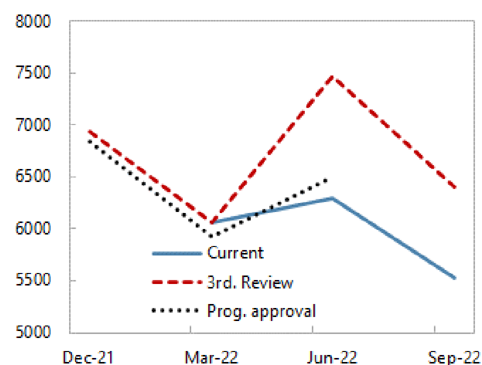
Text Figure 2. Kenya: Contribution to Overall Inflation
(Percentage points)



Sources: Kenya National Bureau of Statistics; and Central Bank of Kenya

- Goods exports through August grew by 11.3 percent y/y, but this was outpaced by goods imports (18.8 percent y/y) on a hefty fuel import bill, while non-oil imports grew just 5.3 percent y/y (Figure 4). The current account impact was mitigated by the steady recovery in tourism and robust growth of remittances (10.4 percent y/y in January–September). Official FX reserves are adequate at above 3.5 months of import coverage but lower than expected at the 3rd reviews, primarily because market conditions have not permitted previously-planned external commercial borrowing (Text figure 3).

Text Figure 3. Kenya: Net International Reserves
(Millions of U.S. dollars, program definition)



Sources: Central Bank of Kenya; and IMF staff projections at program approval and the 3rd reviews.

- Strong tax overperformance provided space to cushion part of the impact of global shocks in FY2021/22 while meeting program targets (Text Table 1, EBS/22/62). However, with external borrowing constrained and terms on domestic issuance deteriorating around the

elections, fiscal financing fell short late in FY2021/22, contributing to a much stronger fiscal outturn than intended, with primary spending under-executed by about 1.9 percentage points of GDP (Figures 2 and 3). Of this, about 0.6 percent of FY2022/23 GDP in committed but undisbursed expenditure—mainly related to transfers to counties, fuel subsidies, and SOE support—will carry over into FY2022/23 (Text Table 2).[4] The lower deficit left overall public debt 3.6 percentage points of GDP lower at end-June 2022 than expected at the 3rd reviews.

- In the first quarter of FY2022/23, tax mobilization was in line with expectations amid political uncertainty and continued financing challenges, with domestic financing short of targeted levels.[5] At the same time, new unbudgeted expenditure of about 1.3 percent of GDP emerged mainly for subsidy costs, drought and security, and projects (MEFP, ¶13).[6] Since September, domestic fuel prices have been adjusted in line with developments in international markets, with petrol subsidies fully eliminated, and modest cross-subsidization to support kerosene and diesel, which are more heavily used by the vulnerable (Box 2). The authorities plan to fully eliminate fuel subsidies by end-year. In November 2022, total amounts accepted in T-bills and T-bond auctions exceeded the offered amounts, a first since February.

Text Table 1. Kenya: Fiscal Developments
(In Ksh. billions)

	2021/22	2022/23		
	June	September	June	
	Actual	*Prel.*	*3rd Rev.*	*Proj.*
Revenues and grants	**2,231**	**570**	**2,496**	**2,541**
Tax revenue	1,770	447	2,024	2,035
Nontax revenue	430	123	438	478
Grants	31	1	33	28
Expenditure and net lending	**3,024**	**759**	**3,354**	**3,386**
Interest payments	578	151	683	687
Other current spending	1,910	492	1,996	2,090
Development and net lending	537	116	674	609
Overall balance including measures (cash basis, incl. grants)	-793	-174	-858	-845
Primary balance incl. grants	**-170**	**9**	**-175**	**-158**
Memorandum:				
IT/PC on tax collection	1,667		2,024	
PC on the primary balance	-428		-175	

Text Table 2. Kenya: Expenditure Carryover to FY2022/23
(In percent of GDP)

item	*% of GDP*
Total carryover	**0.6**
Exchequer requests outstanding at end-June	0.3
Fuel Subsidies (April 15-June 15)	0.1
County transfers (equitable share)	0.2

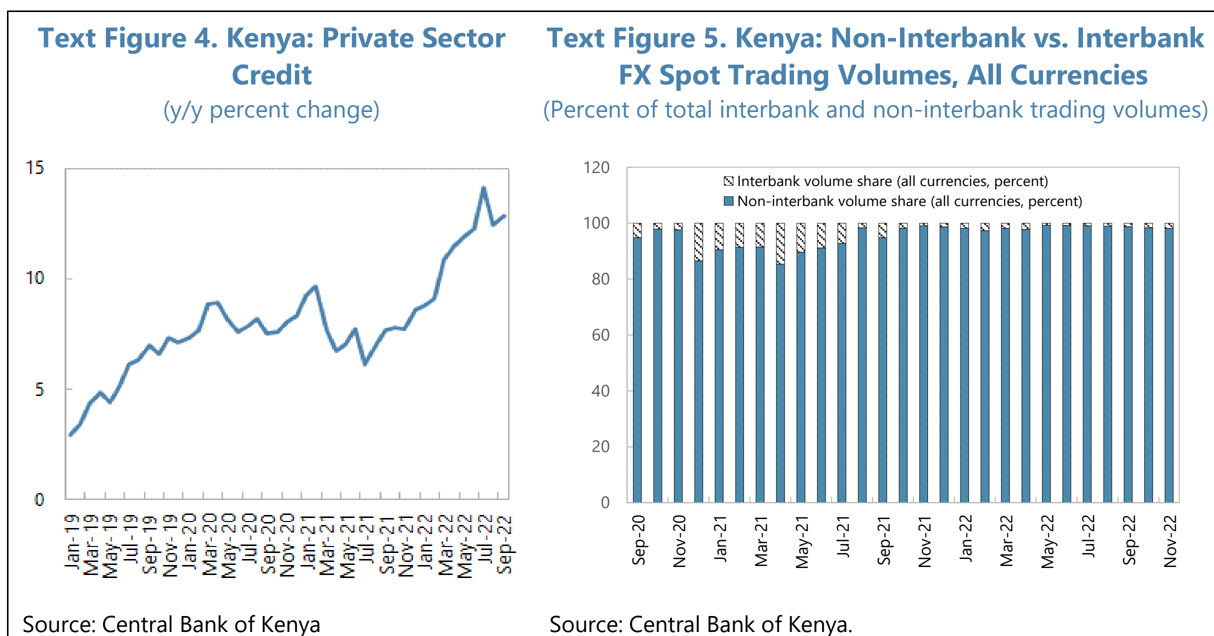
Sources: National Treasury; and IMF, staff calculations.

[4] The national government's stock of pending bills also increased by about Ksh.44 billion at end-June 2022.

[5] During 2022Q3, CBK lent the equivalent of ¼ of Kenya's 2021 general SDR allocation in local currency to the government. The CBK provided similar financing, equivalent to one half of the 2021 general SDR allocation in FY2021/22.

[6] Gross subsidy costs are expected to reach 0.5 percent of GDP in FY2022/23, mainly reflecting the outgoing administration's decision to pause fuel price adjustments in July and August (estimated cost 0.4 percent of GDP).

- The banking sector is sound with adequate capital and liquidity, and strong profitability through 2022Q3, but credit risks remain elevated (Table 5, Figures 6–7).[7] Nonperforming loans (NPLs) declined to 11.4 percent of gross loans as of 2022Q3 but remain elevated, while private sector credit growth has broken into double digits (Text figure 4). By late September, 22 banks accounting for 46.4 percent of sector assets (primarily second- and third-tier banks) had received no-objection certificates from the CBK on their risk-based credit pricing models. Banks' shares of FX loans, deposits, and liabilities have risen, and their net short FX open position has increased.[8] Digital credit providers are now under the CBK's supervisory purview and ten such providers had received approval as of September 2022.
- The Shilling depreciated against the U.S. dollar at a faster but somewhat smoother pace than in 2021 and has begun appreciating in real effective terms.[9] Difficulty in sourcing U.S. dollars in the local market continues. Liquidity in the interbank FX market has dried up and shifted to the bank-client market where forex transactions are executed at a more depreciated rate (Text Figure 5). Banks report delays in meeting some client orders, and bilateral transactions between some non-financial corporates. Staff is closely monitoring the situation with a view to determining the main factors behind the market distortions.



Text Figure 4. Kenya: Private Sector Credit

(y/y percent change)

Source: Central Bank of Kenya

Text Figure 5. Kenya: Non-Interbank vs. Interbank FX Spot Trading Volumes, All Currencies

(Percent of total interbank and non-interbank trading volumes)

Source: Central Bank of Kenya.

- In the first few months of FY2022/23, the government's domestic borrowing moved toward the short end of the yield curve, which has also flattened, reflecting near-term inflationary and financing pressures, while yields have remained largely range-bound despite hikes in the policy rate. The stock market has witnessed net foreign sales in 2022 thus far.

[7] Bank profitability improved on loan growth and higher non-credit revenues, particularly from FX operations.

[8] Nostro deposits from foreign subsidiaries of regionally active banks contributed to this rise. Most FX lending is in the manufacturing, energy, food, and agricultural sectors, and is largely to borrowers with natural hedges.

[9] Between March and October 2022, Kenya's real and nominal effective exchange rates appreciated by 8.1 percent and 4.8 percent respectively.

PROGRAM PERFORMANCE

4. Program quantitative targets are all met, with fiscal targets met by large margins, while the structural agenda saw delays amid uncertainty around elections (MEFP, ¶11). Continuous conditionalities linked to Article VIII of the Fund's Articles of Agreements are also assessed to be met (MEFP, ¶67).

- *Quantitative performance criteria (QPCs):* All end-June 2022 and continuous QPCs were met. Notably, tax collection and the primary balance overperformed by 0.8 and 1.9 percentage points of GDP, respectively.[10] The NIR overperformed the adjusted target by US$418 million.
- *Indicative targets (ITs):* End-June 2022 targets on priority social expenditure overperformed by 0.2 percent of GDP while no outstanding exchequer requests outstanding for more than 90 days were accumulated.
- *Monetary policy consultation clause (MPCC):* The MPCC was met with the three-month average of inflation (7.2 percent) within the target band as of end-June 2022.
- *Structural benchmarks (SBs):* Only one of three benchmarks for July–August 2022 was met amid political uncertainty, while outstanding delayed SBs are either implemented or expected to be completed soon.
- A draft action plan to restore KPLC's medium-term profitability (end-July 2022 SB) was not met. The action plan was prepared but internal consultations on some key proposals could not take place prior to elections. The updated action plan is now expected to be submitted to the Cabinet sub-committee by end-December 2022 *(proposed rephased SB)*.
- A circular was issued on August 30 with an action plan for the development of a Medium-Term Revenue Strategy (MTRS) *(end-August 2022 SB, met)*.
- The review of the fuel pricing mechanism and establishment of a task force to oversee progressive fuel subsidy elimination within the first half of FY2022/23 (end-July 2022 SB) was not met. With steps taken by the new administration toward removing fuel subsidies, remaining actions under the SB are now expected to be implemented by end-December 2022 *(proposed rephased SB)*.
- Publication of beneficial ownership information of entities awarded public contracts (end-June 2021 SB) commenced in November 2022.
- Publication of audits of COVID-19 vaccine spending (end-May 2022 SB) has now been implemented with a delay (the audits were completed by July and subsequently published).

[10] Staff anticipated a tax overperformance of 0.4 percent of GDP at the time of the 3rd reviews. Some spending subject to program adjusters (SOEs, COVID-19) was not executed in FY2021/22 (Table 2A).

MACROECONOMIC OUTLOOK AND RISKS

5. The medium-term outlook is positive, but the near-term has weakened modestly (Table 1).

- While the smooth transition to a new government should support confidence and activity, staff's growth forecast has been revised down on i) a weaker global and regional outlook; ii) the drought's impact on 2022 agricultural output, normalizing in 2023; and iii) planned cuts in public investment and anticipated monetary policy tightening (Text Table 3).
- Staff projects inflation to peak in 2023Q1 but to gradually move back within the central bank's target band in 2023Q3 on global price developments, recovery in agriculture, anticipated administered price adjustments, and the persistence of domestic inflation dynamics.[11] Nonfood, nonfuel inflation is expected to be higher in 2023, peaking in 2023Q2, on a lagged response to food and fuel prices, with the impact mitigated by further anticipated monetary policy tightening.
- The current account (CA) deficit/GDP is projected to widen to 5.7 percent in 2022, as the elevated fuel import bill will be partially offset by improving services balance and higher remittances (Tables 4a and 4b). In 2023, easing energy imports and robust tourism and remittances will see a decline in CA deficit/GDP to 5.4 percent.
- FX reserves during the program have been revised downward relative to the 3rd reviews projections on US$1.8 billion shortfall in external public commercial (US$1.1 billion) and project borrowing (US$0.7 billion) in FY2021/22, further cuts in foreign-financed projects of close to US$1 billion as part of the tighter fiscal stance in FY2022/23, and revisions in the

Text Table 3. Kenya: Growth and Inflation Projections
(In percent)

	2022		2023	
	3rd reviews	Revised	3rd reviews	Revised
Growth	5.7	5.3	5.3	5.1
Inflation (average)	7.3	7.7	6.9	7.8
Inflation (end-year)	8.4	9.5	5.8	6.5

Source: IMF staff projections.

Text Table 4. Kenya: Changes in External Financing Since the 3rd Reviews
(In millions of U.S. dollars)

	2022-24
External financing gap	**1,875**
Current account deficit (excl. grants)	-853
Reduction in net public borrowing (excl. program support	2,728
Sources of financing	**1,875**
Private sector financing (net)	-1,199
Reserves drawdown	2,945
Program support	128
Memorandum Item	
Primary fiscal balance 1/	292

1/ Fiscal year data. Data for 2022 reflect FY2021/22 outturn.

Source: IMF staff projections.

[11] Staff analysis finds some inflationary persistence stemming from food inflation dynamics.

outlook for net private capital flows reflecting expectations of tight global financial conditions persisting in 2023 (Text Table 4).[12] Materialization of upside potential on external fiscal financing would support a higher reserves level than in the current baseline.

- Over the medium term, growth is projected to converge to about 5.5 percent with inflation averaging around 5 percent. Fiscal consolidation would facilitate adjustment, allowing the CA deficit to stabilize around 5 percent of GDP. While the medium-term FX reserves path has shifted downward, reserves will remain adequate over the medium term, supported by mutually-reinforcing policies and the normalization of global financial market conditions.

6. Risks are tilted toward adverse outcomes in the near term, dominated by external factors. Kenya remains exposed to intensification of global spillovers from the war in Ukraine, commodity price shocks, and faster tightening of monetary policy in major economies.

- *Downside risks (adverse outcomes).* A shortfall in rains would worsen food insecurity and malnutrition in impacted areas of the ASAL, slow growth, and push inflation higher. Persistent investor concerns about frontier economies or lack of confidence in Kenya's fiscal path could exacerbate fiscal financing and balance of payments pressures, depressing reserve coverage. Larger decline in prices of key commodity exports would impact FX supply. Higher public sector contingent liabilities and spending, including for security and drought-related needs, could slow the reduction in public debt if not offset.
- *Upside risks (better outcomes).* Better-than-expected rainfall would support a faster recovery in agricultural production, ease food prices and headline inflation, and improve food security. Faster-than-expected easing of global commodity prices would also help contain cost of living and support private consumption. Confidence, investment, and market access could rebound more quickly than expected on resolution of global uncertainty and with Kenya's demonstrated commitment to fiscal consolidation.

POLICY DISCUSSIONS

Discussions centered on the program's main objective of reducing debt risks by putting debt/GDP firmly on a downward trajectory, complemented by a more active role for monetary policy and exchange rate flexibility in addressing current challenges. The mission engaged the new administration on emerging structural reform priorities while seeking progress on addressing weaknesses in state-owned enterprises (SOEs), strengthening governance and anti-corruption efforts, and modernizing the monetary policy framework and protecting financial stability.

A. Reducing Debt Vulnerabilities in the Face of Near-Term Pressures

7. The new government has outlined an ambitious agenda for bottom-up economic development while staying the course on fiscal consolidation. Details of key policy initiatives are

[12] The current baseline assumes the reduction in external financing is permanent, although some or all of it could be potentially offset in the future. In both fiscal years, lower absorption/cuts in project financing are across creditor and credit types.

being firmed up in the coming months. Scaling up of affordable housing and water supply would be done via public private partnerships rather than the government budget. Establishment of a Financial Inclusion Fund (also known as the "Hustler Fund"), is envisaged to have heavy private sector participation with limited budgetary implications. The anticipated scaling up of contributions to the National Social Security Fund from current low levels to 6 percent each from employee and employer is intended to bolster national savings and strengthen the social safety net, also with limited impact on the government budget.

8. Confronted with significant challenges, the new administration has expressed firm commitment to containing spending pressures and increasing tax revenues to safeguard fiscal discipline. On entering office, in addition to the carryover from FY2021/22 (0.6 percent of GDP, ¶3) policymakers had to contend with pressures from unbudgeted expenditures for about 1.3 percent of GDP (Text Table 5, MEFP, ¶13). These reflected spending authorized by the outgoing administration under the constitutional provision of Article 223 for emergency expenditures (0.4 percent of GDP)[13] and additional discretionary spending, including related to subsidies, and needs arising from the ongoing drought emergency and policy priorities of the incoming administration. The authorities plan an ambitious rationalization of non-priority spending (1.7 percentage points of GDP in FY2022/23) to offset most of these pressures, mainly diverting budgeted resources from inactive and/or slow-moving investment projects and introducing additional savings in recurrent administrative spending, while protecting priority social spending (MEFP, ¶14). Together with robust revenue collection, this would allow containing the overall fiscal deficit at 5.8 percent of GDP in FY2022/23—below both the FY2021/22 and budgeted FY2022/23 levels (6.2 and 6.0 percent of GDP, respectively), avoiding a deterioration of the debt situation.

Text Table 5. Kenya: Budgetary Impact of On-Going Fiscal Initiatives
(In Ksh. billions)

budget item	*FY22/23 Budget*	*Impact emerging pressures*	*Impact budgetary offsets*	*Baseline FY22/23*	*FY22/23 Budget*	*Impact emerging pressures*	*Impact budgetary offsets*	*Baseline FY22/23*
		Ksh. billion				*% of GDP*		
Revenue	2,462		50	2,513	17.6	0.0	0.3	17.3
Tax	2,024		11	2,035	14.5	0.0	0.1	14.0
Non-tax	438		40	478	3.1	0.0	0.3	3.3
Grants	33		-5	28	0.2	0.0	0.0	0.2
Total expenditures and net lending	3,359	276	-249	3,386	24.0	1.9	-1.7	23.3
Primary spending (including net lending)	2,668	276	-245	2,699	19.1	1.9	-1.7	18.5
Interest payments	691	0	-4	687	4.9	0.0	0.0	4.7
Overall balance (A)	-863	-276	294	-845	-6.2	-1.9	2.0	-5.8
Total financing (B)	863	90	-108	845	6.2	0.6	-0.7	5.8
Foreign financing	281	92	-102	271	2.0	0.6	-0.7	1.9
Domestic financing	582	-2	-6	574	4.2	0.0	0.0	3.9
o\w use of SDR allocation	0		24	24			0.2	0.2
Financing gap (A+B)	**0**	**-187**	**186**	**0**	**0.0**	**-1.3**	**1.3**	**0.0**
Memorandum:								
Nominal GDP	14,002	14,551	14,551	14,551	100.0	100.0	100.0	100.0
Primary balance	-172	-276	291	-158	-1.2	-1.9	2.0	-1.1

Sources: National Treasury; and IMF staff calculations and projections.

[13] Amounts authorized under Art. 223 included fuel subsidies, roads projects, maintenance, and security.

9. A Supplementary FY2022/23 Budget consistent with program objectives will be submitted to Cabinet by end-January 2023 (proposed new SB). The supplementary would target a primary deficit of 1.1 percent of GDP (stronger than the 1.2 percent under the 3rd reviews, Text Table 6), reflecting determined fiscal consolidation to remain within available resources (Table 2a and 2b, MEFP, ¶14). On the revenue side, collection is expected to slightly overperform, as higher prices boost the yield of tax measures introduced by the 2022 Finance Act and in the Eastern African Countries (EAC) context (EBM/22/67) while non-tax revenues from international transactions also increase. Total public expenditure would remain at 23.3 percent of GDP. Based on current commitments, financing needs would be met via modestly higher domestic financing (including full use of Kenya's SDR allocation) and the requested program augmentation within normal access limits (¶25).[14]

Text Table 6. Kenya: Sources of Improvement in the FY2022/23 Primary Balance Compared to Approved Budget

(In percent of GDP)

Spending pressures (A)	1.9
Revenue windfall (B)	0.3
Tax	0.1
Non-tax	0.3
Grants windfall (C)	0.0
Spending offeset (D)	1.7
Recurrent (e.g., domestic and foreign travels, training expenses, hospitality expenses)	0.3
Capital	1.3
domestic	0.6
foreign	0.8
Impact on the primary balance (E=A-B-C-D)	**-0.1**

Sources: National Treasury; and IMF staff calculations and projections.

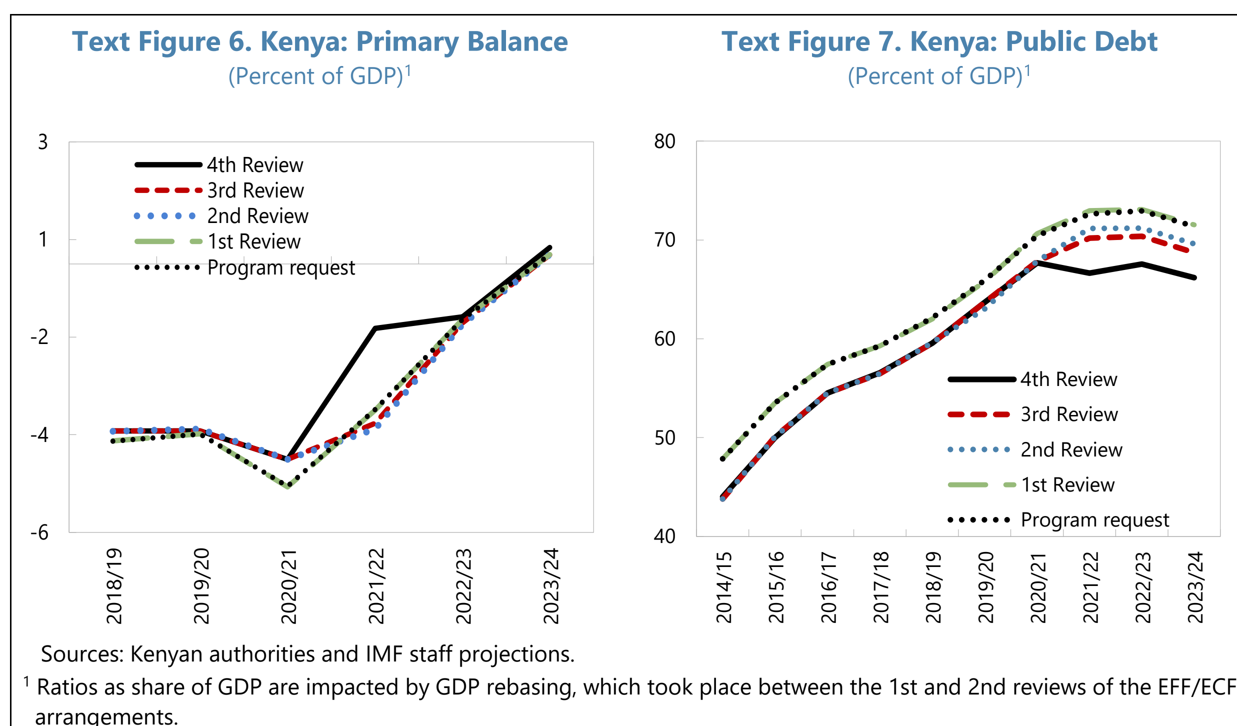
10. Preparations for the FY2023/24 budget have commenced (MEFP, ¶15). The budget proposal is expected to target a primary balance surplus of 0.3 percent of GDP (0.2 percent of GDP at the 3rd reviews) so as to put Kenya's debt-to-GDP ratio firmly on a downward trajectory. Achieving the primary surplus would require a comprehensive package of new tax measures for 0.9 percent of GDP, the composition of which would reflect the authorities' priorities drawing from their Medium-Term Revenue Strategy (MTRS, ¶19; MEFP, ¶19). Further improvements in strengthening the efficiency of tax and custom administration would complement these efforts. On the spending side, ongoing reductions in non-priority primary spending would be needed, while protecting priority social spending and fully offsetting planned extraordinary SOE support (MEFP, ¶22–24). A FY2023/24 Budget proposal consistent with program objectives is expected to be submitted to parliament by end-April 2023 **(proposed new SB)**.

11. Beyond FY2023/24, the authorities' fiscal strategy remains centered on reducing debt vulnerabilities, while protecting high-priority service delivery programs. This will require

[14] Fiscal financing assumed from the forthcoming World Bank Development Policy Operation (DPO) is kept unchanged at levels considered at the 3rd reviews. Discussions on an operation within FY2022/23, including potential scaling-up, are advancing.

maintaining the fiscal primary balance above its debt-stabilizing level through continued efforts to further strengthen tax compliance per Kenya's MTRS and streamline recurrent expenditures—particularly for wages and transfers to public sector entities—while improving public investment management and budgetary controls.

12. Kenya's debt is sustainable but overall and external ratings for risk of debt distress remain high (DSA). Under the baseline, public debt is expected to peak at 67.6 percent of GDP in FY2022/23 (62 percent of GDP in present value (PV) terms). Debt dynamics will be bolstered by fiscal consolidation under the program, bringing debt to more prudent levels over the medium term. The outlook for PV of external debt-to-exports ratio has improved since the last assessment on the stronger-than-anticipated fiscal outturn in FY2021/22 and planned rationalization of capital spending in FY2022/23, including on externally-financed projects.[15] Improvement will remain gradual for the external debt service-to-exports ratio.



Sources: Kenyan authorities and IMF staff projections.
[1] Ratios as share of GDP are impacted by GDP rebasing, which took place between the 1st and 2nd reviews of the EFF/ECF arrangements.

13. The authorities plan further steps to strengthen debt management and reduce debt vulnerabilities (MEFP, ¶26). Key strategic objectives are: (i) reducing refinancing risks by issuance of liquid benchmark domestic government bonds across all maturities and continuing to explore possibilities for market-based, external debt management operations to smoothen the debt service profile; (ii) increasing utilization of committed external concessional financing, while tapping into international financial markets to rollover maturing Eurobonds, and optimize the external debt service profile if market conditions are favorable; (iii) empowering the Public Debt Management Office (PDMO) in management of public debt as envisioned in the Public Financial Management

[15] For the previous DSA, published in December 2021, see EBM/21/112.

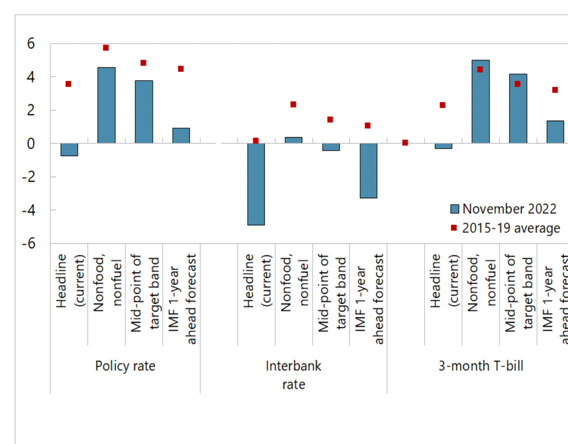
(PFM) Act;[16] and (iv) deepening the domestic debt securities market by implementing reforms developed jointly by the National Treasury (NT) and the CBK.[17]

B. Mutually Reinforcing Monetary and Exchange Rate Policy and a Resilient Banking Sector

14. Achieving and maintaining price stability is the principal objective of monetary policy in Kenya, and spillovers from global shocks present continuing challenges. While the timing of inflation breaching the target band was in line with expectations, the near-term inflation outlook has deteriorated. Staff projects inflation to peak around 10 percent y/y in early 2023Q1 and to remain outside the central bank's target band in 2023Q2.[18] Taking into account the 175 basis points in CBK policy tightening to date in 2022, Kenya's real policy rate on a one-year-looking basis (using staff's inflation projection) was marginally positive, while the real interbank rate remained at multi-year lows (Text Figure 8 shows comparison to the five years preceding the pandemic).[19] Given the extent of US policy tightening, the differential between CBK policy rate and the Federal Funds rate had also narrowed.[20] Banks' excess reserves have remained on an upward trend during this period (Figure 5).[21]

Text Figure 8. Kenya: Real Interest Rates

(In percent; against alternative measures of inflation)



Sources: Kenyan authorities; Haver Analytics; and IMF, *World Economic Outlook* database and staff calculations.

15. With the monetary policy stance remaining relatively accommodative by historical standards, the CBK's stance to further tighten monetary policy is essential to keep inflationary expectations anchored and support external sustainability (MEFP, ¶45). The authorities remain

[16] The authorities plan to resubmit legislative amendments to: (1) harmonize the definition of public debt and replace the existing nominal debt limit with a debt anchor expressed in present value terms in ratio to GDP; and (2) put in place PFM regulations and a delegation contract for PDMO to make operational the framework for debt management envisioned in the PFM Act.

[17] A new Central Securities Depository System that will enable the launch of an active horizontal repo market to support market liquidity is slated to launch in early 2023 (see ¶17). Enhanced outreach to market participants would aim at ensuring liquidity along the entire yield curve.

[18] This projection implies the program's monetary policy consultation clause (MPCC) will be triggered at end-December 2022 and end-June 2023, requiring formal Executive Board consultations in the next two program reviews.

[19] With open market operations aiming at providing market liquidity, nominal interbank rates, as of mid-November, have declined since the September hike in the central bank policy rate (CBR).

[20] During 2015–19, the differential between the CBK policy rate and the Federal Funds rate averaged 8.7 percentage points. As of end-November 2022, it stood at 4.875 percentage points.

[21] Banks' reserve requirements have remained unchanged at 4.25 percent since March 2020. Liquidity conditions are impacted by structural issues in the interbank money market (unsecured transactions and market fragmentation due to credit risks).

committed to mitigating the second-round effects of higher food and fuel prices. Consistent with its inflation projections, staff's analysis indicates that real policy rates peaking at a low single digit levels in early 2023—while lower than the 2015–19 average—would support the return of inflation within the CBK's target in 2023Q3. Related further increases in domestic interest rates could also help underpin market interest as the government seeks to meet domestic financing needs. Monetary policy will also need to remain attentive to external shocks that could undermine achievement of CBK's FX reserves goals and merit an additional response.

16. The authorities affirmed their commitment to exchange rate flexibility and the shock absorbing role of the exchange rate in helping the economy respond to persistent global dislocations and in supporting reserves. To address structural challenges of pricing and liquidity in the interbank FX market, the authorities are considering issuing additional guidelines aligned with international best practices (the FX Global Code). They also recognized that continuing global strength of the U.S. dollar—and the possibility that inflation could peak relatively sooner in Kenya's trading partners—might undermine competitiveness by leading to real appreciation of the shilling. Considering the program's FX reserves goals, the authorities plan to limit FX sales to responding to excessive market volatility while recognizing the role a mutually-consistent policy framework plays in supporting the medium-term buildup in FX reserves. They also acknowledged the role of effective communication of these policy intentions in helping to navigate a period of limited near-term FX liquidity, even as FX reserves remain adequate.

17. The CBK is making progress in modernizing the monetary policy framework along the lines set out in its earlier *White Paper* (MEFP, ¶47). Related efforts to strengthen forecasting and policy analysis are advancing, including with support from AFRITAC East experts.[22] The launch of the Central Securities Depository, which is expected to facilitate collateralized transactions among banks, has been delayed to early 2023 to allow time for further testing.

18. The banking system is sound yet exposed to evolving risks (MEFP, section H). With banks well-capitalized and liquid overall, small and medium-sized banks with greater exposure to riskier lending continue to grapple with resolving NPLs and maintaining adequate provisioning. Improving asset quality remains contingent on the economic recovery, with unpaid government bills, including from local governments, weighing on the sector. The CBK continues to encourage consolidation through takeovers of weaker banks. The CBK has devoted considerable efforts to training loan officers on risk-based pricing and issued no-objection certificates to many institutions, although banks indicate that for reasons of competitiveness, full rollout of their credit pricing models will hinge on sector-wide approvals. The CBK is monitoring the gradually rising share of FX loans and deposits in the banking system to assess vulnerability to currency risks. Kenyan banks have seen strong expansion in the EAC region and are systemic in their host countries, raising the possibility of regional spillovers and spillbacks in financial and economic policy. The central bank continues to closely monitor operational risks from digitalization (including cyber and fraud risks) and risks from corporate exposures across the banking sector.

[22] Future missions are planned to continue assisting the CBK build a nowcasting framework into the FPAS.

C. Advancing the Structural Reform Agenda and Emerging Priorities

Modernizing the Fiscal Framework

19. The authorities remain committed to strengthening revenue administration and mobilization to support the ambitious tax revenue goals announced by President Ruto (MEFP,¶19–20). The MTRS aims to modernize Kenya's tax policy system, improve compliance, and inform critical policy decisions. The action plan issued in August 2022 **(met SB)** provides specific milestones to identify mutually supportive tax policy and administrative measures to widen the tax base and mobilize domestic revenues. An initial draft of the MTRS is expected to be finalized by end-February 2023 with continuing support of Fund technical assistance (TA). The Kenya Revenue Authority (KRA) is enhancing compliance by strengthening audits and data-driven compliance risk management and reducing abuse—particularly related to VAT and improving taxpayer services.

20. Strengthening PFM systems remains key to improving management of fiscal risks. The NT is pursuing an ambitious agenda aimed at improving budget processes and controls, while strengthening fiscal risk management (MEFP, ¶24). Recognizing the significant challenges from extrabudgetary spending in the first months of FY2022/23 and to evaluate the consistency of spending outcomes with plans and enable parliament to serve its function in approving budgets, the Auditor General is launching a special audit on the mechanism, efficiency, and effectiveness of supplementary budgeting—including under Article 223 of the Constitution—to be published by end-of-September **(proposed new SB**; MEFP, ¶63**)**. The authorities have also established—with the support of Fund TA—a Fiscal Risk Committee (FRC) to anticipate, monitor, evaluate, manage, and mitigate fiscal risks across the public sector—including related to Public Private Partnerships (PPPs; MEFP,¶27–28).[23] Furthermore, to prevent unexpected fiscal costs going forward, they are also in the process of reviewing the fuel pricing mechanism and establishing a taskforce to ensure that fuel pricing decisions are at all times aligned with the available resources **(rephased SB proposed for end-December 2022**, MEFP,¶25**)**.

Addressing SOEs' Financial Challenges and Governance

21. While the SOE reform agenda saw limited progress since the third reviews, President Ruto has set out a bold objective to step up privatization as part of efforts to rationalize SOEs. Budget risks from Kenya Airways (KQ) and Kenya Power and Lighting Company (KPLC) remain elevated. The authorities reduced extraordinary SOE support to Ksh.17.5 billion (0.14 percent of GDP) in FY2021/22 from an originally budgeted Ksh.32.3 billion, while the FY2022/23 Supplementary Budget will reflect extraordinary support of Ksh.37.3 billion (0.3 percent of GDP). The bulk of this would go to KQ, while support to KPLC would be reduced.[24] Given limited fiscal space, the focus remains on identifying cost-saving reforms at KQ and KPLC.

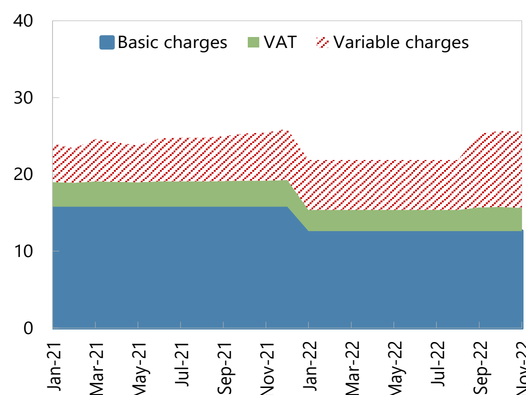
[23] The FRC's first meeting will take place in calendar year 2022.

[24] Cumulative extraordinary SOE support in FY2021/22 and FY2022/23 would thus remain within the maximum envisaged under the program adjustor — e.g., 1 percent of FY2021/22 GDP (TMU, ¶7).

- *Kenya Airways* (MEFP, ¶34–38). KQ remains insolvent with the highest cost base among regional airlines even as it met 75 percent of its targeted cost reduction in FY2021/22. Priorities of its restructuring plan include network optimization, lease negotiation, staff rationalization, and other cost management efforts. The airline has retired sixteen loss-making networks and renegotiated some aircraft leases but faces challenges in rationalizing staff costs.[25] Discussions are also ongoing to novate KQ's guaranteed debt. The authorities aim to provide extraordinary budget support to KQ under safeguards linked to appropriate accountability mechanisms and key performance indicators on KQ's restructuring commitments.

Text Figure 9. Kenya: Consumer Electricity Charges

(Cost per KWH)



Source: https://www.stimatracker.com/.

[1] Variable charges include adjustments for fuel energy cost for thermal plants, foreign exchange fluctuation, and inflation, and some levies.

- *Kenya Power and Lighting Company* (MEFP, ¶39–40). The 15 percent base tariff reduction of January 2022 has had a significant negative impact on KPLC's liquidity position, while the restoration of monthly adjustments in passthrough of variable electricity costs (FX depreciation and inflation adjustments) beginning in September 2022 will help cashflows somewhat. The authorities reported a lower KPLC liquidity gap at Ksh.69 billion as of June 2022 (0.5 percent of GDP, compared to 1 percent of GDP in 2021). However, large sums remain outstanding on payables and receivables, including for government support of the rural electrification scheme, and limited progress has been made on cost-saving measures. Well-identified and achievable cost-saving measures are needed to address KPLC's liquidity and profitability situations, and tariff decisions are under evaluation. The authorities have committed to submit to Cabinet a draft action plan on addressing KPLC's liquidity gap and restoring medium-term profitability **(rephased SB proposed for end-December 2022).**

22. The new administration is prioritizing rationalization of state corporations (SCs), and the authorities remain committed to strengthening SC governance and oversight (MEFP, ¶41–42). The authorities have made progress in developing and operationalizing a Government Investment Management Information System (GIMIS) and plan to further develop its capabilities for assessing fiscal risks from SCs. They also are reviewing the earlier reform strategy (Blueprint) to align it with the administration's new policy priorities and sequencing reform measures. A draft Ownership Policy for SCs, which will describe a new governance architecture and legal ecosystem to improve performance and transparency, will now be submitted to Cabinet by end-June 2023. The

[25] In early November 2022, KQ pilots went on strike, prompting intervention of a Labor Court.

authorities are also beginning work, with Fund TA, on the legal reforms necessary to anchor the new ownership arrangements and other measures outlined in the Blueprint.

Strengthening Governance and Fighting Corruption

23. Strengthening Kenya's anti-corruption legal framework, enhancing transparency, and effective follow up on audit findings remain a priority.

- The authorities have resolved outstanding operational issues and started publication of beneficial ownership information of successful bidders of new procurements that were reported into the Public Procurement Information Portal (PPIP) since mind-November 2022 **(prior action;** MEFP, ¶58**)**.[26] This follows issuance of revised bidding documents in April 2022, which enabled collection of beneficial ownership information. The Public Procurement Regulatory Authority aims to prioritize enhancing data analysis capabilities of procurement-related information to reinforce the fight against corruption (MEFP, ¶59).
- The authorities intend to strengthen follow-up on audit findings of the Auditor-General by promoting greater coordination among state bodies, including law enforcement agencies, strengthening monitoring capabilities, and enhancing public reporting (MEFP, ¶60). The rapid production and publishing of multiple audits of COVID-19-related spending, including the most recent audits of COVID-19 vaccination spending and delivery, have identified numerous structural and transactional issues, initiated investigations of suspicious transactions, while highlighting the broader need for more systematic follow-up of findings and recommendations.
- The recently published Kenya 2022 Mutual Evaluation Report by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), the FATF-style regional body, highlighted major deficiencies in Kenya's AML/CFT regime. To help prevent laundering of illicit proceeds from corruption, the authorities plan by end-June 2023 to submit to the National Assembly, draft amendments to the Proceeds of Crime and Anti-Money Laundering Act and Regulations to address gaps in the AML/CFT legal framework, including requirements on politically exposed persons (PEPs), in line with FATF standards **(proposed new SB;** MEFP, ¶64**)**. To this end, the authorities also aim to prioritize ensuring compliance by banks with enhanced due diligence measures for higher risk customers, including PEPs, through AML/CFT risk-based supervision.
- Stakeholder and public consultations on the draft Access to Information Regulations and the draft Conflict of Interest Bill were finalized, and the authorities plan to, respectively, publish and submit the documents to Parliament before end-2022 (MEFP, ¶57 and 61). However, weaknesses remain in the current draft Conflict of Interest Law relating to the underlying system for asset declaration (scope of coverage, publication of asset declaration information, and mechanisms for validating accuracy of submissions), creating a risk that adoption of new regulations in their current form fails to improve accountability and integrity.

[26] https://tenders.go.ke/Contracts

Emerging Priorities

24. Efforts to operationalize new reform initiatives have intensified, although details are not yet available (MEFP, ¶43). These include: i) a Financial Inclusion Fund (Hustler Fund) to expand access to credit with a built-in savings (pension) component for those outside the formal workforce, supported by partial contributions from the government capped at a limit; ii) raising minimum contributions to the National Social Security Fund; iii) targeted interventions to expand affordable housing; and iv) privatization of SOEs and needed amendments to existing legal framework to facilitate it. Provision will be made in the forthcoming FY2022/23 Supplementary budget for anticipated costs related to the Financial Inclusion Fund of 0.1 percent of GDP. As these policies are further developed, staff will assess their impact in future program reviews, including any fiscal risks.

25. Kenya is highly vulnerable to climate change, especially droughts and floods (Box 3). Kenya has made important strides toward a green economy.[27] Climate-sensitive sectors (i.e., agriculture, tourism, and trade) comprise over a third of domestic production. Building on a strong track record in implementing climate adaptation and mitigation policies, efforts are ongoing to strengthen institutions to deliver and monitor Kenya's ambitious climate objectives and to mobilize green financing from development partners and the private sector. The CBK's 2021 Guidance on Climate-Related Risk Management to the banking sector is expected to help banks integrate climate-related risks into their governance, strategy, risk management and disclosure frameworks, and enable them to leverage on business opportunities from efforts to mitigate and adapt to climate change (MEFP, ¶53). Other priorities include building resilience to large and protracted climate shocks, integrating climate-change considerations in the allocation of government resources, and improving transparency and accountability in their use.[28] The authorities have expressed interest in accessing the Resilience and Sustainability Trust (RST).

PROGRAM ISSUES AND RISKS

26. The authorities request augmentation of access under the ECF arrangement by 30 percent of quota (SDR 162.84 million or about US$215 million; Table 7). This would be made available in full to the CBK upon completion of the 4th ECF/EFF reviews, who will provide it as budget support to the government in local currency.[29] The proposed augmentation will help ease pressures on official FX reserves (actual balance of payments need) and ensure continuity in budget financing, including to respond to the ongoing drought and food security needs, by partially offsetting the impact of the shortfalls in external financing and potentially catalyzing additional support by Kenya's development partners (see footnote 15). It would bring cumulative GRA and

[27] Renewable sources account for more than 90 percent of electricity generation capacity, up from 60 percent a decade ago.

[28] A World Bank Country Climate and Development Report (CCDR) for Kenya, which will help strengthen the authorities' climate-related policies, provide recommendations, and identify policy priorities. is expected to be completed by end-June 2023.

[29] Following the July 2021 PRGT reforms, the proposed augmentation is consistent with applicable PRGT limits, bringing the PRGT:GRA ratio closer to 1:2, and with enhanced safeguards.

PRGT access net of repurchases (including the 2021 Rapid Credit Facility) to 435 percent of quota (about US$3.2 billion) by 2024, remaining within normal cumulative access limits (Table 8). The residual external financing gap, which also reflects more conservative assumptions on private capital flows (¶5), will be absorbed by reserves drawdown, lowering the import coverage to 3.7 months by end-2022 and to 3 months by end-2023 (3rd reviews: 3.9 months and 4.2 months, respectively). There is an upside potential for reserve coverage from stepped-up support by development partners.[30]

27. The program is fully financed, with firm commitments over the next twelve months and good prospects for the remainder of the program (Table 6). In addition to support from the Fund, Kenya's external budget financing needs would be met by a mix of official and commercial loans that prioritizes concessional financing:

- *External commercial financing.* The authorities are well advanced in securing the budgeted US$900 million external commercial borrowing for FY2022/23 (full disbursement anticipated by early 2023) by tapping medium-term loan facilities from international banks (MEFP, ¶26).[31]
- *Official concessional financing.* Concessional program financing is provided by the World Bank (WB) and the African Development Bank (AfDB), with the AfDB support already disbursed. Discussions are underway on a successor arrangement in FY2022/23 to the US$750 million WB Development Policy Operation (DPO) disbursed in FY2021/22.[32] Underutilization of the WB loan targeting acceleration of COVID-19 vaccination in FY2021/22 is also expected to be compensated over the next two fiscal years.

28. The program continues to face significant risks (¶6). These risks are mitigated by the authorities' strong performance to date and demonstrated commitment to adopting contingency measures as needed to achieve program objectives, including evolving challenges presented by the global environment for monetary policymaking, close engagement with donors and creditors, and a tailored capacity development strategy to support the implementation of structural reforms, including plans to develop a MTRS.

29. Kenya's capacity to repay the Fund is adequate but is subject to risks (Table 8).

- At end-2021, the share of Kenya's multilateral debt was less than half of its total external public debt and is projected to remain below 50 percent over the medium term under the baseline (Table 10). There is no collateralized, public and publicly-guaranteed external debt.
- The total amount of outstanding credit to the Fund (including the proposed augmentation) is projected at SDR 2,361.2 million, or 435 percent of quota in 2024, equivalent to 2.4 percent of GDP, and 40 percent of gross international reserves in 2023, with the latter

[30] An upside in official sector financing could also result in higher reserves via the program NIR adjustor (TMU, ¶9).

[31] As of October 2022, the authorities had contracted US$300 million via a 3-year international bank loan.

[32] In evaluating commitments to meet external financing needs, World Bank amounts considered at the 3rd review have been retained.

exceeding the 75th percentile of past Fund UCT-quality arrangements for LICs (Figure 8). External adjustment will be supported by the authorities' ambitious fiscal consolidation and mutually-reinforcing monetary and foreign exchange policies which will sustain FX reserves over the medium term and support Kenya's capacity-to-repay the Fund. Total debt service to the Fund would peak by 2028 at 2.3 percent of exports of goods and services, well above the top quartile of past Fund UCT-quality arrangements for LICs, and 1.8 percent of fiscal revenue, the latter just below the top quartile of the comparator group. These relatively elevated levels of scheduled debt service to the Fund may pose risks to capacity to repay over the medium term. In the near term, the materialization of downside risks, such as a continued lack of market access for frontier issuers and delays in reform implementation could increase pressure on Kenya's capacity-to-repay the Fund. However, these risks are mitigated by Kenya's continued access to concessional financing, expected normalization of international market access toward the end of the program, and Kenya's strong track record of servicing debts to the Fund and other creditors. Risks are further mitigated by the multi-year fiscal consolidation that anchors the program, supported by tax policy measures to boost revenues, and the authorities' commitment to maintain exchange rate flexibility.

- One of the key objectives of the program is to undertake growth-friendly fiscal consolidation, achieving the debt stabilizing primary balance during the program to put the public debt/GDP ratio on a downward path. The four external debt indicators are also on a downward path, with near-term breaches relative to the five LIC-DSA thresholds declining over the medium term.

30. The authorities are requesting the following modifications to program conditionality (MEFP, Tables 1 and 2):

- new QPCs for all relevant indicators for the end-December 2023 test date;
- modifications of QPCs on primary balance and tax revenue for the end-June 2023 test date (stronger fiscal objectives) and of net international reserves for the end-December 2022 and end-June 2023 test dates;
- resetting the timeline for the delayed end-July 2022 SBs (KPLC action plan and review of the fuel pricing mechanism) to end-December 2022; and
- establishment of four new SBs: submissions of FY2022/23 supplementary budget and FY2023/24 budget, both consistent with the program's objectives and targets; special audit of the mechanism, efficiency, and effectiveness of supplementary budgets, including under Article 223 of the Constitution, to improve budget control; and submitting draft amendments to the National Assembly to support anti-corruption efforts in line with FATF standards, including requirements on politically-exposed persons.

STAFF APPRAISAL

31. Kenya is navigating through a turbulent global backdrop. The recent political transition demonstrated growing strength of Kenyan institutions, and the economy exhibited resilience in the

run up to the elections, growing at a 6 percent y/y rate during the first half of 2022. However, the outlook has weakened somewhat and inflation has risen amid a worsening international economic outlook, tighter global financial conditions, and heightened volatility. An expected normalization of rainfall next year should support a recovery in agricultural production, helping ease food and headline inflation, and improving food security and nutrition among vulnerable groups in the ASAL regions. Risks to the near-term outlook are tilted to adverse outcomes. While the medium-term outlook remains positive, it is subject to climate-related shocks.

32. The quantitative targets under the program are all met, but the structural reform agenda has seen delays amid election-related uncertainty. Fiscal targets for end-June 2022 recorded notable overperformance amid challenges in securing planned financing. The program design and the authorities' consistent fiscal performance has provided a strong policy anchor to ensure that debt vulnerabilities are reduced over the medium term and public debt/GDP is put on a downward path before the end of the program. Timely implementation of delayed SOE and governance reforms will remain important going forward, including to reduce fiscal risks.

33. Further efforts are needed to deliver a mutually reinforcing macroeconomic policy mix, with monetary and exchange rate policies playing a more active role given evolving challenges. Fiscal consolidation is supporting external adjustment. However, amid higher inflation, persistent terms of trade shocks from the war in Ukraine and tighter global financing conditions, monetary policy will need to be proactive and exchange rate flexibility will have an increasing role to play in helping the economy to absorb external shocks. The anticipated rise in domestic interest rates remains manageable from the perspective of debt vulnerabilities and would facilitate securing financing from local capital markets while avoiding a shortening of maturities. In this regard, the authorities' earlier dedicated efforts to extend the domestic yield curve have provided an important margin of flexibility to navigate the challenging period around elections.

34. The new administration has taken a firm stance on reducing debt risks, backed by strong actions to preserve fiscal discipline in a difficult environment. In September, shortly after taking office, they eliminated petrol subsidies and reduced other fuel subsidies following delays in adjusting domestic fuel prices in July and August. Confronted with significant spending pressures (1.9 percent of GDP)—mainly related to the carryover from FY2021/22 and additional unbudgeted spending around the August elections—the new administration has identified expenditure savings for about 1.7 percent of GDP to contain the overall fiscal balance within available margins. The Supplementary FY2022/23 Budget will thus target a primary deficit of 1.1 percent of GDP—a slight improvement over the approved FY2022/23 Budget—also reflecting the prospect for higher-than-previously-anticipated revenue collection. In FY2023/24, the adoption of a tax package of 0.9 percent of GDP will be critical to further reduce fiscal imbalances and broaden the tax base to make room for needed social and development spending. In subsequent years, further improvements in strengthening spending efficiency and improving tax policy and revenue administration will remain essential.

35. Kenya's public debt is sustainable but remains at high risk of distress. With a lower realized deficit last fiscal year, public debt is expected to peak below the level anticipated at the

3rd reviews at 67.6 percent of GDP in FY2022/23 (62 percent of GDP in present value (PV) terms). Debt dynamics will be bolstered by the fiscal consolidation under the program, stabilizing debt/GDP and bringing it to more prudent levels over the medium term while securing resources to support social spending. Improvement in the external debt service-to-exports ratio will remain gradual. Staff also welcomes the authorities' comprehensive strategy to strengthen debt management.

36. Monetary policy should be tightened further to anchor inflationary expectations and guide inflation back within the CBK's target band in 2023 while also supporting external sustainability. The authorities have raised the policy rate by a combined 175 basis points in 2022. Staff projections show inflation peaking in 2023Q1, supported by a deceleration in food inflation. Against this backdrop, staff recommends further tightening of monetary policy and sees a rise in the real policy rate (based on prospective inflation) to low single-digit levels as consistent with inflation moving back inside the target band in 2023Q3. Central bank liquidity operations should align the interbank overnight rate and commercial banks' excess reserves with the stance of the monetary policy. Higher real rates should also support external sustainability and FX reserves goals while helping to meet the government's domestic financing needs. Considering the reduced external buffers, mutually-reinforcing policies to support external adjustment and strengthen adequacy of FX reserves are also important to underpin capacity to repay the Fund. Given elevated uncertainties, the CBK should continue to closely monitor domestic and global developments and stand ready to respond as needed.

37. Staff welcomes the authorities' intention to support reactivation of Kenya's interbank foreign exchange market, which, combined with exchange rate flexibility, should help in navigating global shocks. Following the war in Ukraine, Kenya has experienced a period of tight forex demand, accompanied by reduced liquidity in the interbank foreign exchange market and a relatively smooth depreciation of the bilateral exchange rate against the U.S. dollar. However, the Shilling has risen against Kenya's other trading partners following the strong surge of the U.S. dollar on a global basis. Such flexibility should help the exchange rate function as a shock absorber, mitigating the pressures from global shocks, supporting competitiveness, and protecting FX reserves buffers, even as global shocks have impacted projections for capital flows over the medium term. Relatedly, dedicated efforts to reactivate efficient functioning and price discovery in the interbank FX market should help address reported pressures in sourcing foreign exchange and mitigate the trend toward increasing FX exposures (assets, liabilities) in the banking sector. Official interventions in the FX market (FX sales) should be limited to addressing excessive market volatility and consistent with the program's FX reserves goals. While foreign reserves remain adequate, effective communication of the CBK's policy intentions will be important in navigating a period of elevated global uncertainty.

38. Banks are well-capitalized and liquid overall, and the authorities should continue to closely monitor risks. Resolution of NPLs and continued adequate provisioning should be priorities, while the CBK's approach to consolidating weaker banks is welcome. Staff also welcomes the CBK's increased engagement with banks on their risk-based loan pricing, where faster issuance of no-objection certificates could help unlock MSME credit. Continued attention to risks from banks' FX positions—now closely monitored from a capital adequacy perspective alongside the

underwriting of FX loans—should be a priority. The CBK should continue to closely monitor spillovers and spillbacks from local banks' regional expansion and operational risks from digitalization.

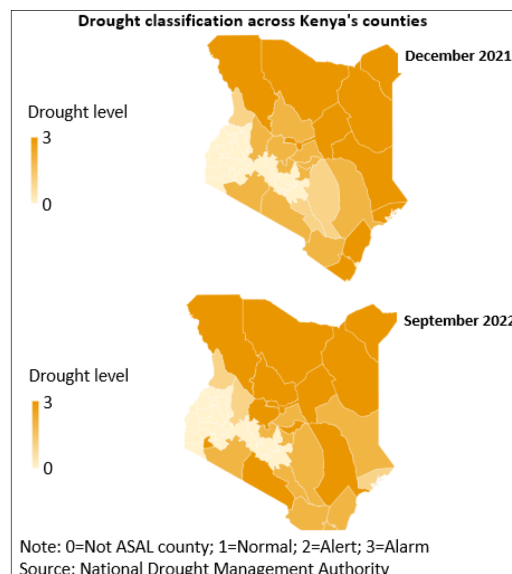
39. The new Administration's focus on minimizing the drain on fiscal resources from SOEs is welcome and should be accompanied by decisive steps to tackle vulnerabilities at KQ and KPLC and improved SOE governance and oversight. KQ and KPLC continue to receive extraordinary budget support, albeit at a lower level than initially budgeted, while progress on fundamentally addressing their financial vulnerabilities has remained limited. Steadfast implementation of KQ's restructuring plan to cut costs, with exchequer support linked to clear accountability—even as needs for servicing KQ's guaranteed debt are being addressed via a process of novation—remains critical to limit fiscal risks. On KPLC, while steps in September to reinstitute passthrough of variable costs are welcome, making progress on an action plan to address KPLC's liquidity gap and medium-term profitability remain critical to limit fiscal risks. Further progress is also needed in improving the governance framework for SOE oversight, including on the SOE Blueprint, even as the new administration sets a course toward achieving the bold privatization objective set out by President Ruto.

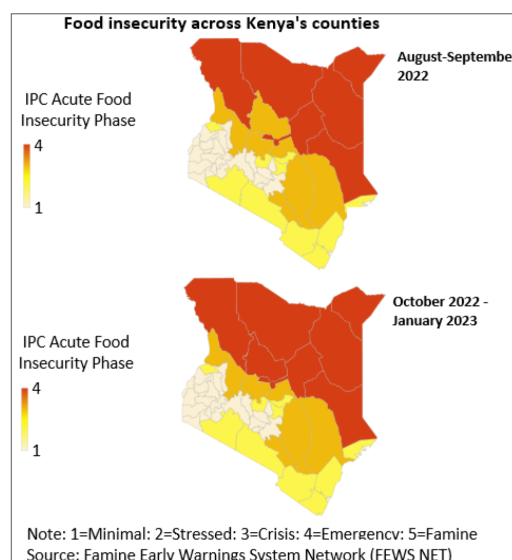
40. Strengthening the anti-corruption legal framework, enhancing transparency and effective follow up on audit findings should remain priorities. Staff welcomes recent publication of beneficial ownership information of winning bidders through the Public Procurement Information Portal, which delivers on a longstanding commitment, and encourages strengthening of data analysis capabilities on procurement-related information. The planned special audit on supplementary budget spending, including under Article 223 of the Constitution, will provide needed transparency and accountability and should help to ensure going forward that spending outcomes are consistent with plans. The authorities should take timely actions to address the strategic deficiencies identified in the Kenya 2022 Mutual Evaluation Report by ESAAMLG to safeguard financial and macroeconomic stability. Amendments to address gaps in the AML/CFT legal framework in line with FATF standards, including requirements on politically-exposed persons, will help support anti-corruption efforts. To this end, the authorities should conduct AML/CFT risk-based supervision to ensure banks' compliance. Government progress in preparing the draft Conflict of Interest Law is noted, but substantial changes are needed in order to align the draft law with principles of good practice, especially relating to asset declarations. Staff encourages the authorities to act rapidly to introduce necessary modifications regarding collection and publication of asset declarations prior to submission of the draft bill to Parliament.

41. Staff supports the authorities' requests for completion of the 4th ECF/EFF reviews with an augmentation of access of 30 percent of quota under the ECF arrangement within the normal cumulative access limit, and modifications of QPCs for end-December 2022 and end-June 2023, given the performance under the arrangements and the commitment toward meeting the program's objectives.

Box 1. Drought in Kenya

A large-scale, climate-induced, humanitarian crisis is unfolding across the Horn of Africa including in parts of Kenya. Following below-average rainfall for four successive seasons, the country is currently experiencing one of the longest droughts in the last 40 years in the Arid and Semi-Arid regions (ASAL).[1] The Predictive Livestock Early Warning System (PLEWs) in Kenya is forecasting that October-December 2022 short rains are likely to underperform with the drought situation not expected to improve before June 2023. The Government of Kenya (GoK) declared a national emergency in September 2021.





The exceptional series of disappointing rainfall seasons are having a devastating impact on agricultural production and water availability in impacted regions, causing a sharp increase in malnourishment and food insecurity while eroding livelihoods. Food availability and access in the ASAL regions saw a sharp decrease as food production shortages increased, which, in addition to a very high pass-through of global staple food price increase to domestic prices in Kenya (estimated to be 97 percent), caused a spike in staple food and water prices.[2] Moreover, malnutrition increased markedly, with data by UNICEF/GoK in July 2022 indicating that 884,464 children under 5 and 115,725 pregnant and breastfeeding women were malnourished and in need of treatment.[3] Similarly, food insecurity escalated with Kenya's National Drought Management Authorities estimating the number of food insecure people to have increased from 3.5 million at end-2021 to 4.5 million by end-October 2022.[4] To help mitigate elevated food insecurity, the FY2022/23 Supplementary Budget is projected to allocate KSh.10.2 billion (0.07 percent of GDP) in drought-related spending, of which nearly 60 percent is intended to finance food provision. Unfavorable weather conditions have also eroded livelihoods and increased social tensions and inter-communal conflicts.

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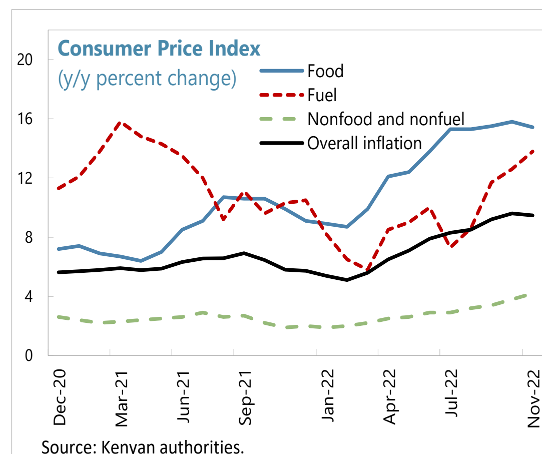
[1] Food Security and Nutrition Working Group, Special Report, July 29, 2022.

[2] IMF, Climate Change and Chronic Food Insecurity in Sub-Saharan Africa (September 2022)

[3] Food and Agricultural Organization (FAO): Predictive Livestock Early Warning Information System (PLEWS)

[4] Kenya Food Security Steering Group (KFSSG) Long Rains Assessment/IPC, July 2022

Box 2. Recent Inflation Developments



Source: Kenyan authorities.

The rise in inflation has been driven by unfavorable weather conditions and spillovers from the war in Ukraine, which, coupled with COVID-19 related supply chain disruptions, increased transportation costs. In the first eleven months of 2022, inflation accelerated from 5.4 percent y/y in January to 9.5 percent in November, breaching the upper bound of the CBK's 2.5–7.5 percent target range for the sixth consecutive month. This acceleration mainly reflected the pass-through of global shocks and poor agricultural performance feeding into food prices, which increased from 8.9 percent to 15.4 percent over the same period. Contribution of some key commodities (namely wheat, maize, milk, and edible oils) increased markedly, from 1.2 percentage points in January 2022 to 3.1 percentage points in October 2022, with overall food inflation contributing nearly 80 percent of the average price increase over the same period.[1]

Inflationary pressures from elevated global oil prices were contained by the authorities' decision to gradually adjust retail fuel prices and lower electricity tariffs earlier in the year. Following the onset of the war in Ukraine, the authorities resumed gradual adjustments in domestic retail fuel prices in March after having kept them unchanged over October 2021 to February 2022. However, adjustments were paused in July and August around the elections.[2] On September 14, the authorities resumed the monthly fuel price adjustments and announced the largest increase of the year (15.6 percent, averaged across products), eliminating the subsidy for petrol and sharply reducing the subsidy for diesel and kerosene. The 15 percent reduction in the retail electricity tariff in January provided some counterweight to inflationary pressures this year, even as it created cashflow challenges at Kenya Power and Lighting Company. With September's move to restore adjustments in variable charges in electricity bills, overall fuel inflation jumped to 13.8 percent in November. Non-food, non-fuel inflation has moved up from 1.9 percent in January 2022 to 4.2 percent in November.

While all households across Kenya will be affected by the rising food inflation, the poorer households have suffered the most. This is due to even higher significance of food products in their consumption basket than the national average. As of November, official data show that for lower income households living in Nairobi, inflation rate was at 10.4 percent as compared to 6.9–7.8 percent for the higher income groups.[3] As a result, the surge seen in inflation is expected to erode living standards, already pressured by elevated levels of food insecurity, and raise poverty rates.

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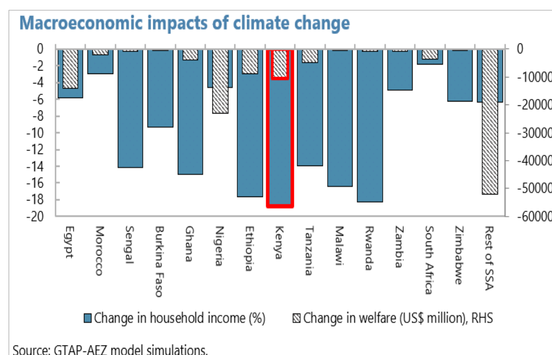
[1] This is despite several types of interventions, including: i) waiver of import duty on 540,000 metric tons of white maize imported into the country before August 22, 2022 (subsequently extended to September 30, 2022); ii) fertilizer subsidy provided during the April planting season (in amount of Ksh.3 billion) and during October for the forthcoming planting season (Ksh.2.2 billion); iii) waiver of the Railway Development Levy and Import Declaration Fee on the imports of the gazetted white maize on July 14, 2022; and iv) temporarily subsidizing sifted maize in the month of July to keep the retail price of 2kg of maize at Ksh.100.

[2] In June, the authorities publicly communicated that fuel subsidies were unsustainable given Kenya's limited fiscal space, and the authorities have committed under the program to remove these subsidies by end-2022.

[3] Kenya National Bureau of Statistics.

Box 3. Climate Change Goals and Financing in Kenya

Kenya is highly vulnerable to consequences of climate change, especially droughts and floods. The 2020 ND-GAIN Country Index ranks Kenya as the 39th most vulnerable country to climate change and 154th in terms of readiness to improve resilience out of 181 countries.[1] As a lower-middle income country depending heavily on rain-fed agriculture, climate change is expected to reduce Kenya's economic activity on average by 2–2.8 percent of GDP every year.[2] The World Bank estimates that climate change has increased the frequency of drought-induced food insecurity episodes from every 20 years (in the 1980s) to every 2–3 years.[3]



The impact of climate change could significantly impact household income and welfare (text figure)[4], in addition to increasing food insecurity and poverty levels. The climate-related impact is expected to lower labor productivity due to an increased incidence of climate-sensitive illnesses and greater food insecurity, which is currently impacting 4.5 million people (8 percent of total population) assessed to be facing severe food insecurity at end-October 2022. Climate change is also likely to worsen poverty, with some estimates suggesting that a 1-degree increase in average temperatures can result in a 2.1 percent increase in the poverty headcount rate.[5]

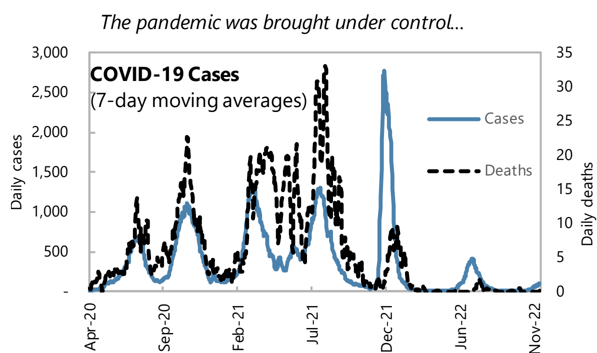
The Government of Kenya is committed to addressing climate change as an integral part of its development agenda. This includes adoption of the National Climate Change Action Plan 2018–22 aimed at maintaining a low carbon development trajectory. As of end-2021, more than 90 percent of electricity production was generated from renewable sources. The country is on track to achieve its target of universal access to clean cooking by 2028, universal use of clean energy by 2030, and 10 percent forest cover by 2030.[6] Moreover, Kenya has committed to reducing 32 percent of its GHG emissions by 2030 and adapt to climate risks as part of its Nationally Determined Contributions (NDCs) under the 2015 Paris Agreement. The Government of Kenya estimated the cost of achieving its NDCs at USD 62 billion and committed to mobilize resources to meet 13 percent of the total cost.[7]

To meet elevated climate investment needs, the authorities are focused on enhancing the country's capacity to attract climate-related finance. Private sector investments are expected to be vital for climate-smart growth in Kenya considering the current fiscally constrained environment. The authorities have already taken decisive steps to stimulate nascent green finance industry, including by issuing a sovereign green bond framework.[8] They have also issued a Guidance on Climate-Related Risk Management to the banking sector aimed at enabling banks to integrate climate-related risks into their governance, strategy, risk management and disclosure frameworks. This is expected to facilitate banks' leverage on business opportunities from efforts to mitigate and adapt to climate change.[9]

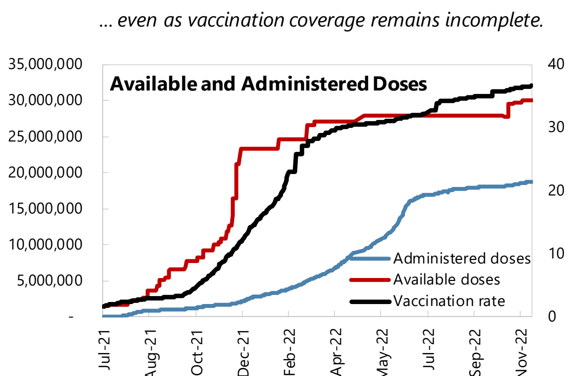
[1] University of Notre Dame Global Adaptation Index.
[2] The National Treasury and Planning, 2021. The Landscape of Climate Finance in Kenya.
[3] World Bank, Country Partnership Framework (July 2022).
[4] Asafu-Adjaye, Ndung'u, and Shimeles, 2022. Macroeconomic consequences of climate change in Africa and policy implications.
[5] Dang, H. & Trinh, T, 2022. Does Hotter Temperature Increase Poverty? Global Evidence from Subnational Data Analysis.
[6] Ministry of Environment and Forestry, 2022. National REDD+ Strategy.
[7] UNFCCC, 2020. Kenya's Updated Nationally Determined Contributions.
[8] The National Treasury and Planning, 2021. Kenya Sovereign Green Bond Framework.
[9] Central Bank of Kenya, 2021. Guidance on Climate-related Risk Management.

Figure 1. Kenya: Real Sector Developments

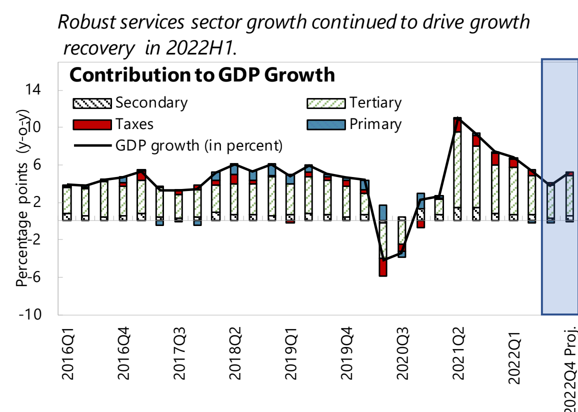
The pandemic was brought under control…



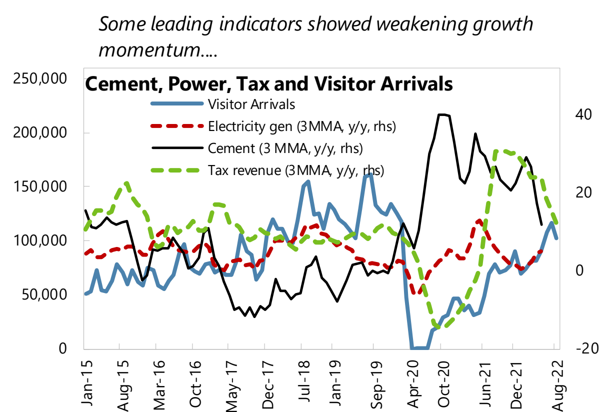
… even as vaccination coverage remains incomplete.



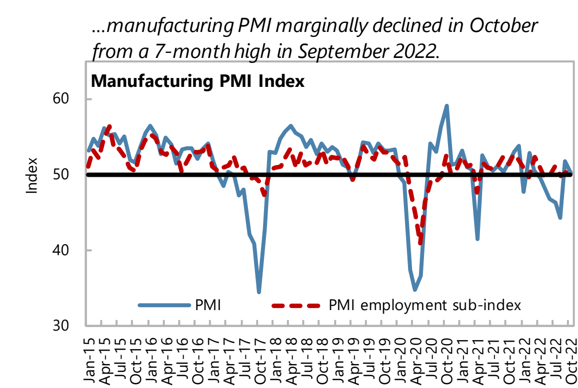
Robust services sector growth continued to drive growth recovery in 2022H1.



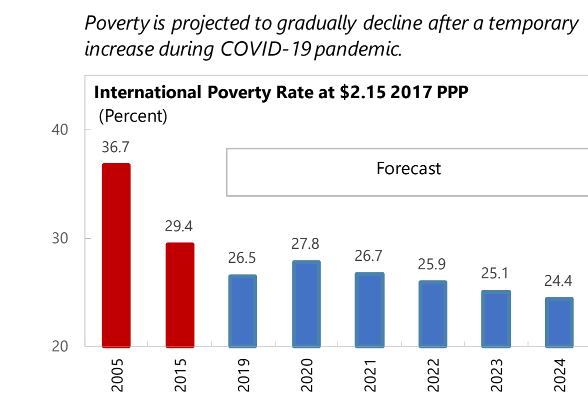
Some leading indicators showed weakening growth momentum….



…manufacturing PMI marginally declined in October from a 7-month high in September 2022.



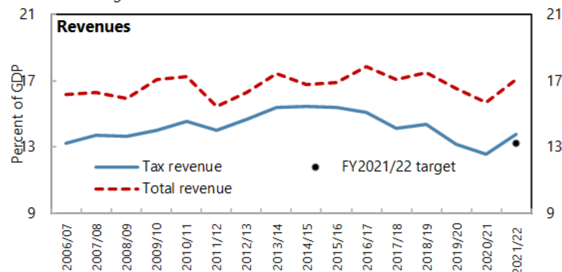
Poverty is projected to gradually decline after a temporary increase during COVID-19 pandemic.



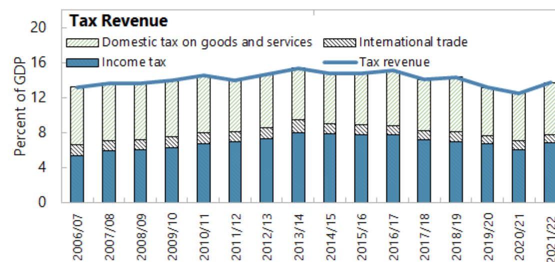
Sources: Kenyan authorities; Markit Economics; World Bank; and IMF staff calculations and projections.

Figure 2. Kenya: Fiscal Sector Developments

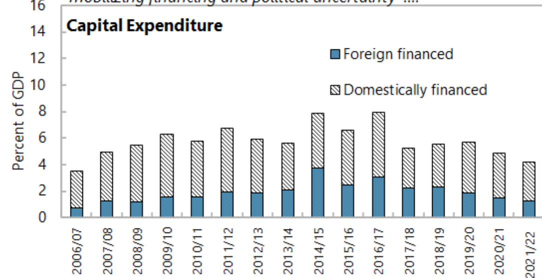
Tax revenues increased markedly in FY2021/22, overperforming the target...



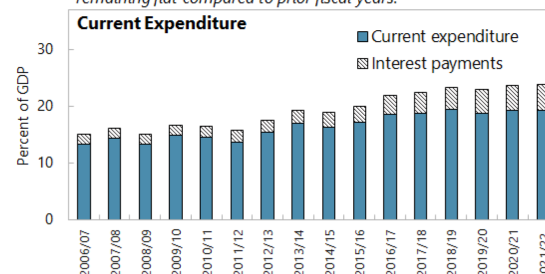
...driven by strong domestic taxes.



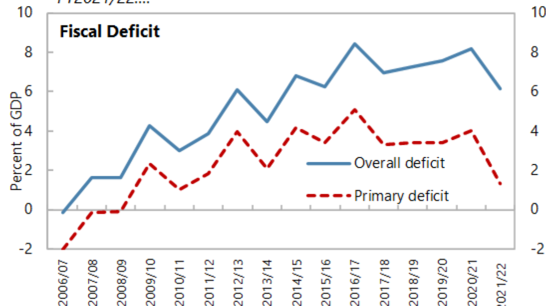
Capital expenditure declined further, reflecting delays in mobilizing financing and political uncertainty ....



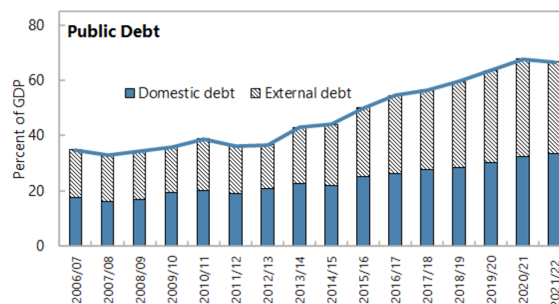
... while current expenditure was also significantly under-executed, remaining flat compared to prior fiscal years.



Strong tax performance and significant spending under-execution resulted in a large fall in primary deficit in FY2021/22....



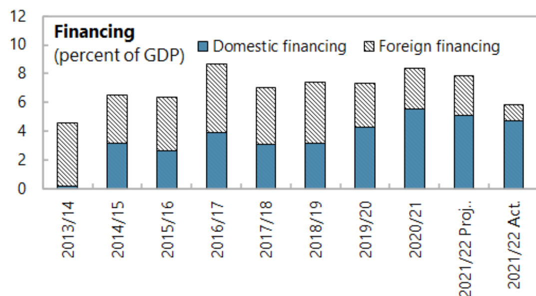
... which helped reduce the debt burden



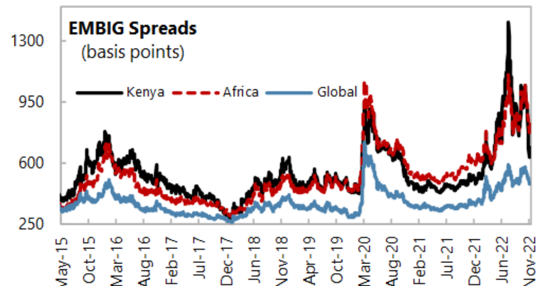
Sources: Kenyan authorities; and IMF staff calculations and projections.

Figure 3. Kenya: Financing

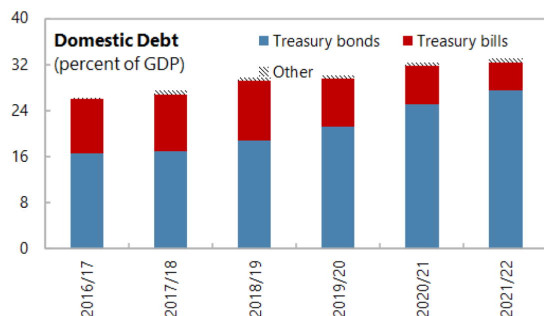
External financing fell short in FY2021/22 as Kenya postponed issuance of a € 1 billion Euro bond...



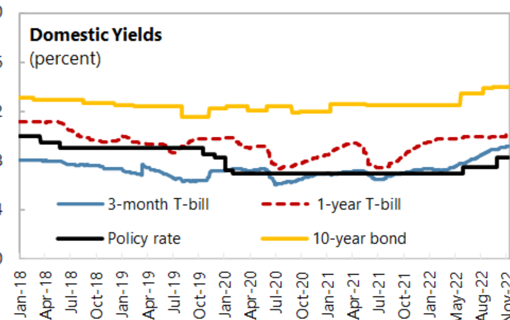
...following a generalized erosion of investor confidence to frontier market debt and political uncertainty ahead of elections.



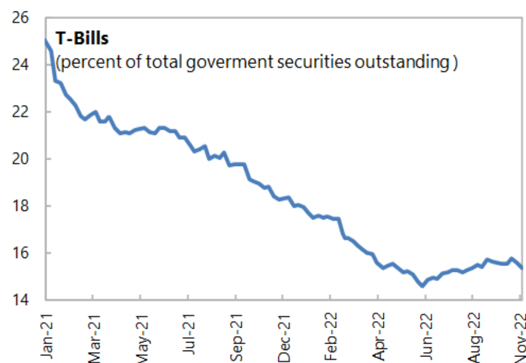
The domestic debt stock has increased, driven by Treasury bonds.



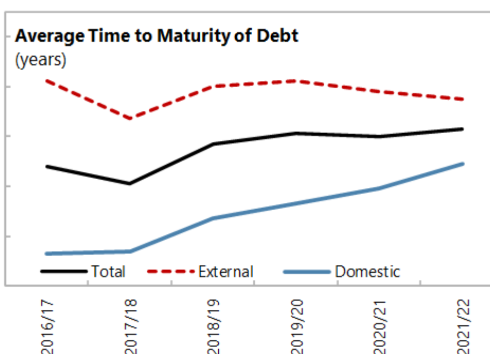
Domestic financing conditions worsened and rates increased faster for the front end of the yield curve ahead of the elections....



... with domestic securities issuance focused on shorter tenors...



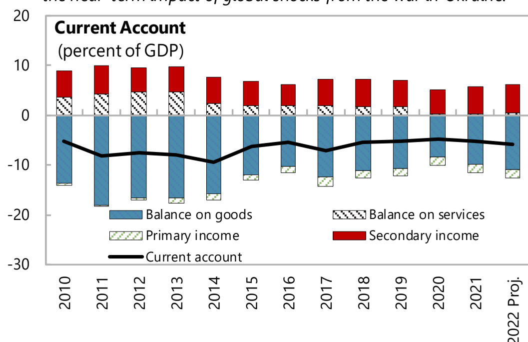
...while still benefiting from past efforts that have locked in improvements in the maturity profile of Kenya's domestic debt.



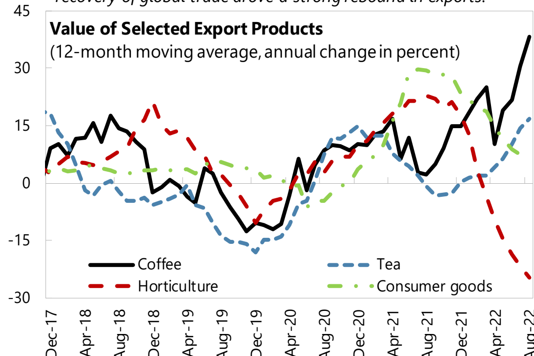
Sources: Kenyan authorities; Bloomberg L.P; and IMF staff calculations and projections.

Figure 4. Kenya: External Sector Developments

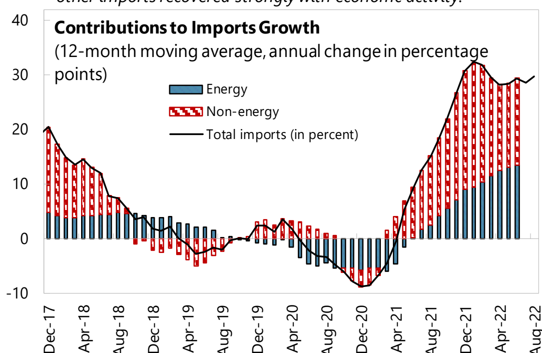
The current account is set to widen on recovering investment and the near-term impact of global shocks from the war in Ukraine.



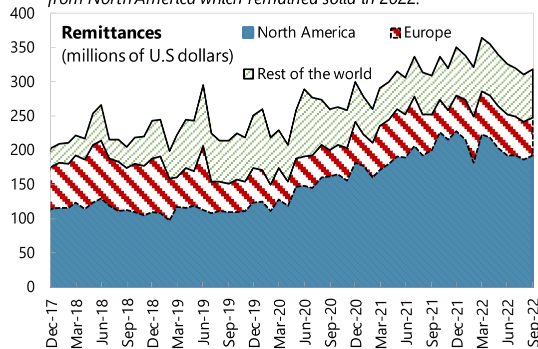
Following initial disruptions in global supply chains, the recovery of global trade drove a strong rebound in exports.



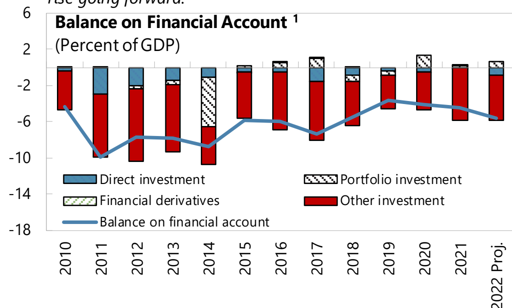
Since 2021, the energy import bill swelled on higher prices, while other imports recovered strongly with economc activity.



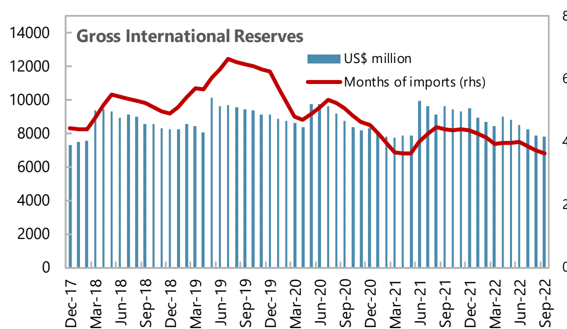
Remittances increased by 20 percent in 2021 driven by transfers from North America which remained solid in 2022.



Public and private debt remains the main source of financing of the current account, the share of equity flows is expected to rise going forward.



FX reserves remain adequate.

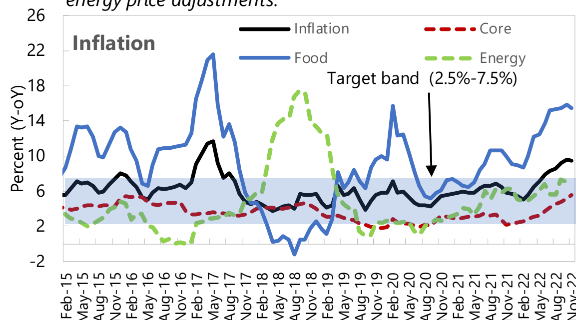


Sources: Kenyan authorities; and IMF staff estimates and projections.

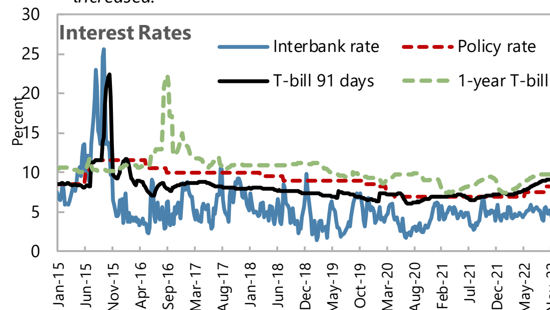
[1] Negative values represent net inflows associated with an increase in net external liabilities.

Figure 5. Kenya: Monetary and Exchange Rate Developments

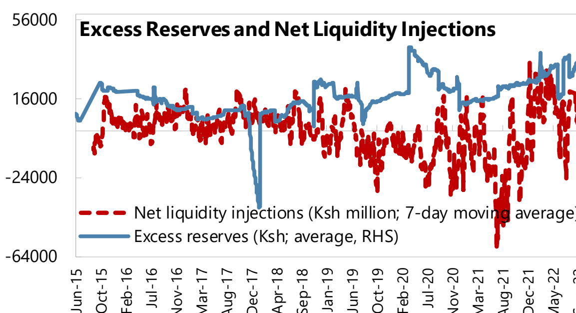
Inflation has breached the target band on spillovers from the war in Ukraine, higher food prices, and domestic fuel and energy price adjustments.



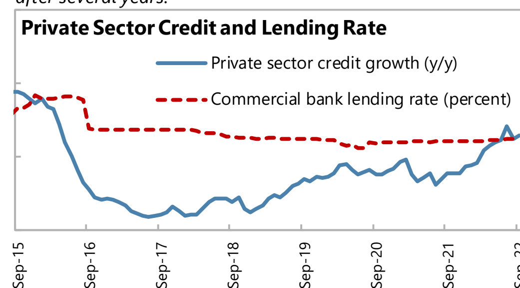
The interbank rate has remained low as other rates have increased.



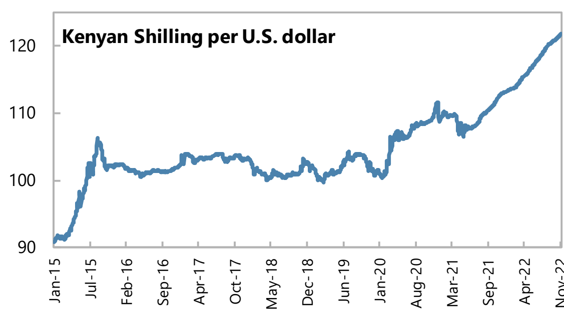
Excess reserves have trended upward.



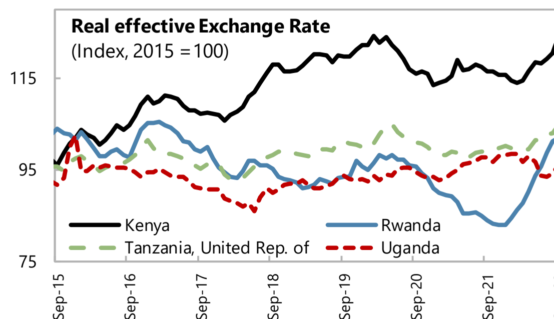
Private sector credit growth has broken into double digits after several years.



The exchange rate has depreciated further against the U.S. dollar but at a much smoother pace in 2022 thus far…



…and yet saw a modest real appreciation back to pre-pandemic levels with the U.S. dollar's global strength.



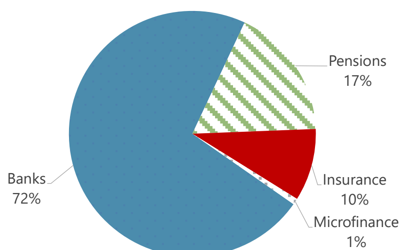
Sources: Kenyan authoritie; and IMF staff calculations.

Figure 6. Kenya: Financial Sector Structure

(2022Q3 or latest available)

Financial sector is dominated by banks….

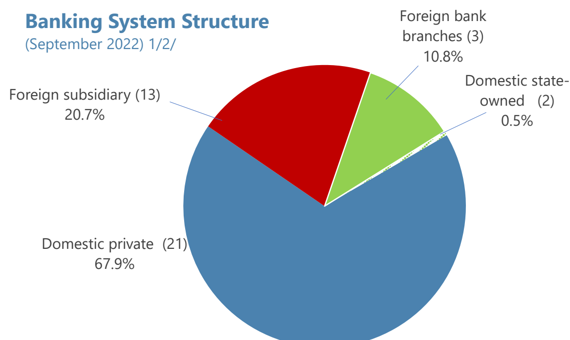
Financial Sector Structure
(September 2022) 1/



1/ Total net assets of 8.9 trillion KSH (76 billion USD, 65 percent of GDP)

…of which most are domestic private banks.

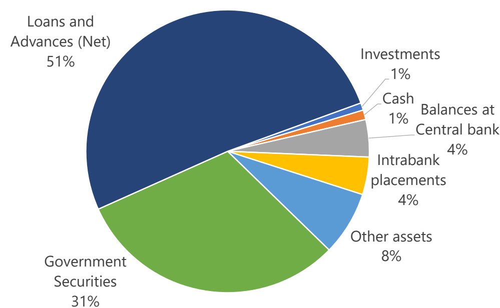
Banking System Structure
(September 2022) 1/2/



1/ Total net assets of 6.4 trillion KSH (55 billion USD, 47 percent of GDP).
2/ Number of banks in brackets; percentages are for net assets.

A significant share of banks' assets are government securities….

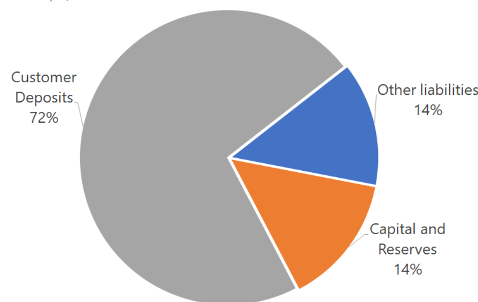
Banks' Assets
(September 2022) 1/



1/ Total net assets of 6.4 trillion KSH.

… and funding is largely from deposits.

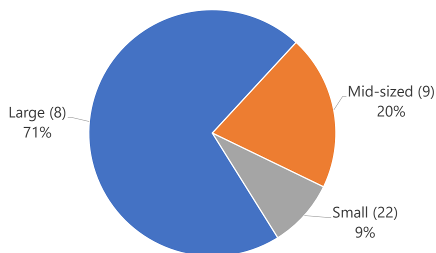
Banks' Liabilities and Shareholders' Funds
(September 2022) 1/



1/ Banks' liabilities and shareholders' funds of 6.4 trillion KSH.

Eight banks account for 70 percent of banking assets…

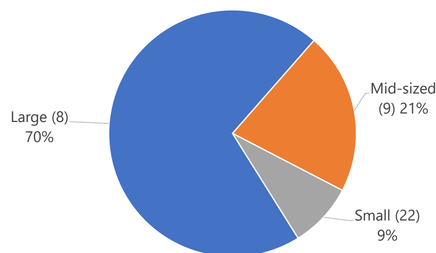
Banking System Assets by Tier Groups
(September 2022) 1/ 2/



1/ Total net assets of 6.4 trillion KSH (55 billion USD, 47 percent of GDP).
2/ Number of banks in brackets; percentages are for assets.

… as well as deposits.

Banking System Deposits by Tier Groups
(September 2022) 1/ 2/

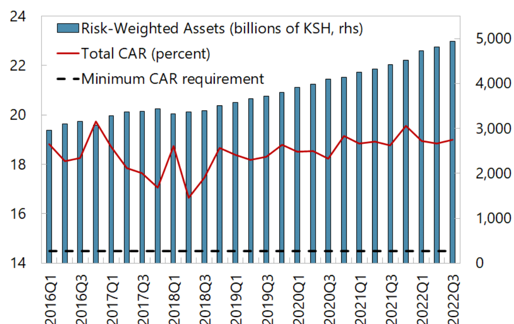


1/ Total deposits of 4.6 trillion KSH.
2/ Number of banks in brackets; percentages are for customer deposits.

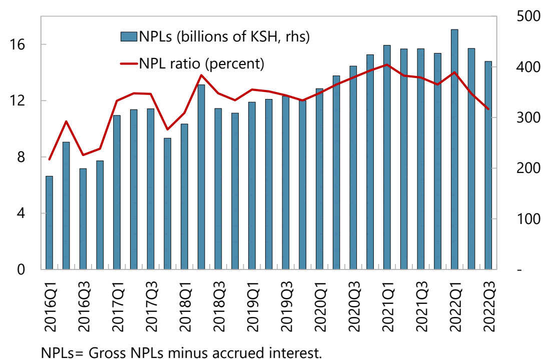
Source: Central Bank of Kenya.

Figure 7. Kenya: Financial Sector Developments

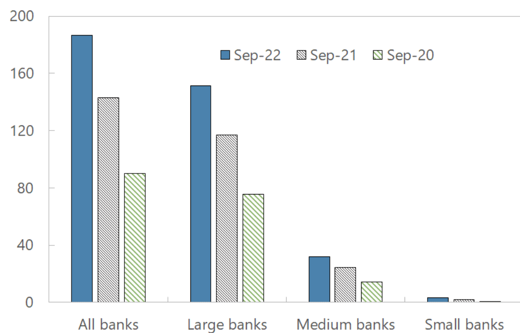
Capital levels are well above the minimums.



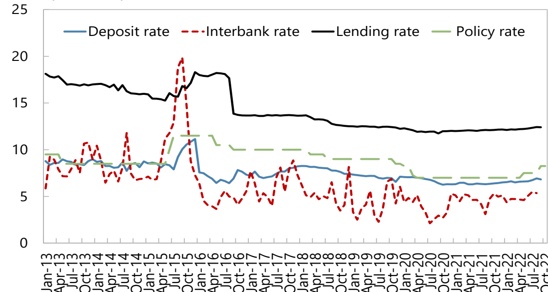
NPLs have started to decline but remain high.



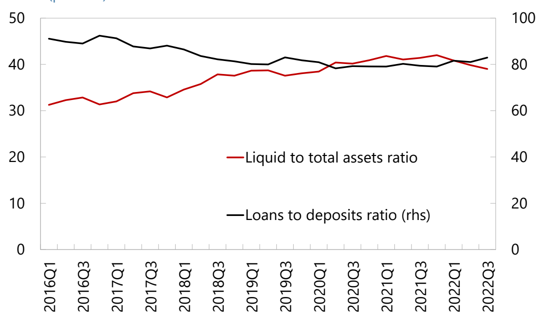
Profitability remains strong....



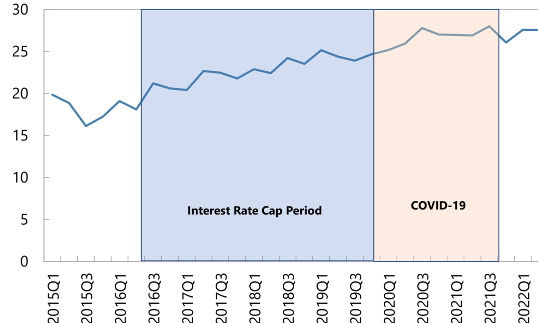
... with significant spreads between deposits and lending rates.



Banking sector has ample liquidity...



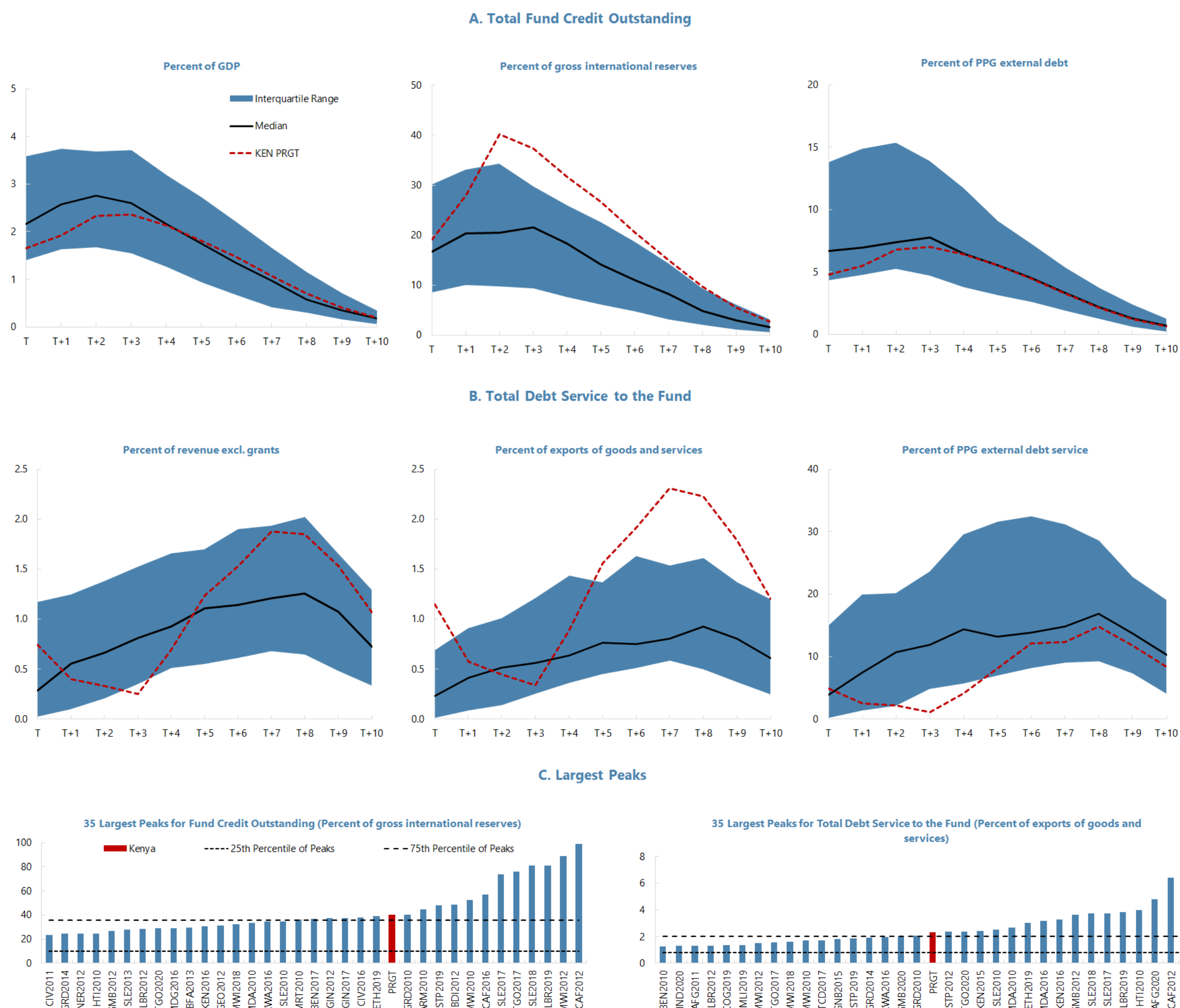
... driven by increasing holdings of government securities.



Source: Central Bank of Kenya; Financial disclosures of Kenyan banks; and IMF staff calculations.
[1] Pre-tax profits pertain to Q3 of the year.
[2] Based on IMF FSI.

Figure 8. Kenya: Capacity to Repay Indicators Compared to UCT Arrangements for PRGT Countries

(In percent of indicated variable)



Notes:
1) T = date of arrangement approval. PPG = public and publicly guaranteed.
2) Red lines/bars indicate the CtR indicator for the arrangement of interest.
3) The median, interquartile range, and comparator bars reflect all UCT arrangements (including blends) approved for PRGT countries between 2010 and 2020.
4) PRGT countries in the control group with multiple arrangements are entered as separate events in the database.
5) Comparator series is for PRGT arrangements only and runs up to T+10.
6) Debt service obligations to the Fund reflect prospective payments, including for the current year.

Table 1. Kenya: Selected Economic Indicators, 2020–25

	2020	2021		2022		2023		2024		2025	
	Act.	3rd Rev.	Prel.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.
	(Annual percentage change, unless otherwise indicated)										
Output, prices, and exchange rate											
Real GDP	-0.3	7.5	7.5	5.7	5.3	5.3	5.1	5.5	5.5	5.5	5.5
GDP deflator	4.9	5.0	5.0	6.5	7.2	7.0	7.7	5.2	5.7	5.1	5.0
CPI (period average)	5.3	6.1	6.1	7.3	7.7	6.9	7.8	5.1	5.7	5.1	5.0
CPI (end of period)	5.6	5.7	5.7	8.4	9.5	5.8	6.5	4.7	5.0	5.4	5.0
Terms of trade (goods; deterioration, -)	10.2	-2.2	-2.2	-7.2	-7.4	1.6	2.1	1.2	0.7	0.9	0.6
Exchange rate (Kenyan shilling/US$, average)	106.5	109.5	109.5	.	.	.	.	.	.	.	.
Real effective exchange rate (depreciation, -)	0.0	-2.7	-2.6	.	.	.	.	.	.	.	.
Money and credit											
Broad money (M3)	13.2	6.1	6.1	9.7	9.0	13.4	7.4	12.1	9.4	12.0	10.7
Reserve money	1.9	11.0	11.0	3.3	11.4	9.0	1.1	8.4	5.6	9.7	8.3
Credit to non-government sector	8.4	8.6	8.6	12.1	12.0	13.8	12.3	12.7	13.3	12.4	12.5
Policy rate	7.0	7.0	7.0	.	.	.	.	.	.	.	.
M3/GDP (percent)	37.2	35.0	35.0	34.1	33.8	34.3	32.1	34.7	31.5	35.1	31.5
Non-performing loans (percent of total gross loans)	14.1	13.1	13.1	.	.	.	.	.	.	.	.
	(Percent of GDP, unless otherwise indicated)[1]										
Central government budget [2]											
Total revenue, grants and unidentified tax policy measures	16.7	16.0	16.0	17.5	17.3	17.2	17.5	17.7	17.8	17.9	18.0
Tax revenues	13.2	12.6	12.6	13.4	13.7	14.0	14.0	14.8	14.9	14.9	15.1
Non-tax revenues	3.4	3.1	3.1	3.7	3.3	3.0	3.3	2.7	2.6	2.7	2.7
Grants	0.2	0.3	0.3	0.5	0.2	0.2	0.2	0.3	0.3	0.3	0.3
Expenditure and unidentified offsets	24.4	24.2	24.2	25.4	23.5	23.2	23.3	22.2	22.1	22.0	21.9
Current	18.7	19.3	19.3	20.2	19.3	18.5	19.1	17.4	17.5	17.2	17.1
Capital	5.7	4.9	4.9	5.2	4.2	4.7	4.2	4.8	4.7	4.9	4.9
Primary balance	-3.4	-4.0	-4.0	-3.3	-1.3	-1.2	-1.1	0.2	0.3	0.5	0.7
Overall balance	-7.6	-8.2	-8.2	-7.8	-6.2	-5.9	-5.8	-4.4	-4.4	-4.1	-3.9
Excluding grants	-7.8	-8.4	-8.4	-8.3	-6.4	-6.2	-6.0	-4.7	-4.7	-4.4	-4.2
Net domestic borrowing	4.3	5.5	5.5	5.1	4.7	3.6	3.9	2.7	2.5	3.0	3.1
Public debt											
Public gross nominal debt	63.7	67.8	67.7	70.2	66.6	70.4	67.6	68.7	66.2	67.2	64.6
Public net nominal debt	58.9	62.9	62.8	64.7	63.4	64.8	64.7	63.1	63.6	61.5	62.3
Public gross debt, PV	58.7	60.3	60.4	61.5	62.0	60.4	61.6	58.2	59.9	55.7	57.9
Public net debt, PV	53.9	55.4	55.5	56.1	58.7	54.9	58.7	52.6	57.4	50.0	55.6
Gross domestic debt	30.2	32.5	32.5	33.8	33.3	33.6	33.4	32.8	32.3	32.5	32.2
Gross external debt	33.4	35.3	35.2	36.3	33.3	36.7	34.1	35.9	33.9	34.7	32.4
Investment and saving											
Investment	19.7	21.9	20.3	20.4	19.5	20.5	20.0	20.9	20.6	21.2	21.0
General government	5.3	5.0	4.5	4.9	4.2	4.7	4.4	4.8	4.8	4.9	4.9
Nongovernment	14.3	16.9	15.8	15.5	15.3	15.8	15.6	16.0	15.8	16.3	16.1
Saving	14.9	16.4	15.1	14.6	13.9	15.0	14.6	15.5	15.3	16.1	16.0
General government	-3.0	-3.3	-2.8	-2.3	-2.0	-0.2	-0.4	1.2	1.3	2.2	2.0
Nongovernment	17.9	19.7	17.9	16.8	15.9	15.2	15.0	14.3	14.0	13.9	14.0
External sector											
Exports (goods and services)	9.6	10.6	10.7	12.0	12.0	12.8	12.8	13.3	13.3	13.6	13.7
Imports (goods and services)	17.6	20.1	19.8	21.9	21.6	22.0	22.0	22.1	22.2	22.2	22.3
Current account balance (including grants)	-4.7	-5.5	-5.2	-5.9	-5.7	-5.5	-5.4	-5.3	-5.3	-5.1	-5.1
Gross international reserves											
In billions of US$	8.3	9.5	9.5	8.8	8.1	10.2	7.0	11.0	8.1	11.9	9.2
In months of next year imports	4.5	4.4	4.5	3.9	3.7	4.2	3.0	4.2	3.2	4.2	3.3
Memorandum items:											
GDP at current market prices (billions of Kenyan shilling)	10,716	12,098	12,098	13,618	13,650	15,341	15,453	17,020	17,237	18,867	19,087
GDP per capita (nominal US$)	2,073	2,219	2,219	2,311	2,299	2,382	2,311	2,487	2,401	2,608	2,511

Sources: Kenyan authorities; and IMF staff estimates and projections.

[1] Ratios as share of GDP are impacted by GDP rebasing, which took place between the 1st and 2nd reviews of the EFF/ECF arrangements.

[2] Fiscal year basis. Fiscal year runs from July 1 – June 30 (e.g., FY22-23 runs from July 1, 2022 to June 30, 2023).

Table 2a. Kenya: Central Government Financial Operations 2020/21–2024/25[1]

(Billions of Kenyan Shilling)

	2020/21	2021/22		2022/23			2023/24			2024/25		
	Actual	3rd Rev.	Prel.	3rd Rev.	Proj.	Budget /2	3rd Rev.	Proj.	BPS	3rd Rev.	Proj.	BPS
Revenues and grants	**1,815.1**	**2,254.7**	**2,230.8**	**2,495.7**	**2,540.8**	**2,495.7**	**2,869.1**	**2,905.8**	**2,868.9**	**3,208.1**	**3,269.4**	**3,195.3**
Revenue	**1,783.7**	**2,191.8**	**2,199.8**	**2,462.4**	**2,512.7**	**2,462.4**	**2,820.9**	**2,856.3**	**2,820.8**	**3,158.9**	**3,220.7**	**3,146.0**
Tax revenue (including unidentified tax measures)	1,429.5	1,722.5	1,770.2	2,024.0	2,035.1	2,024.1	2,387.6	2,427.8	2,387.5	2,667.8	2,734.9	2,654.8
Income tax	694.1	836.7	876.7	997.3	1,004.3	997.3	1,045.1	1,102.4	1,178.6	1,171.7	1,221.0	1,285.7
Personal income	363.3	455.1	462.4	512.7	512.7	512.7	552.2	544.7	608.7	613.3	594.8	673.9
Corporate income	330.7	381.6	414.4	484.6	491.6	484.6	492.9	557.7	569.9	558.4	626.2	611.7
Import duty (net)	108.4	115.9	118.3	144.9	145.9	144.9	172.0	171.0	170.4	193.8	187.9	181.4
Excise duty	216.3	255.9	252.1	297.2	297.2	297.2	348.1	345.5	346.9	370.3	381.0	395.1
Value-added tax	410.8	514.1	523.1	584.6	587.6	584.7	682.7	669.1	691.6	749.4	745.5	792.7
Domestic	197.1	249.0	244.9	304.2	304.2	304.2	324.5	323.8	350.4	360.2	355.7	369.6
Imports	213.7	265.1	278.2	280.4	283.4	280.4	358.2	345.4	341.2	389.2	389.8	423.1
Nontax revenue	354.2	469.4	429.6	438.3	477.6	438.3	433.4	428.5	433.2	491.1	485.7	491.1
Investment income	45.1	37.7	43.7	31.5	35.5	31.5	33.1	32.6	33.1	34.7	34.2	34.7
Other	87.4	91.2	104.1	86.0	121.3	86.0	95.7	94.6	95.7	133.1	131.8	133.1
Ministerial and Departmental Fees (AIA)	193.2	308.8	245.5	285.7	285.7	285.7	271.3	268.4	271.3	279.8	276.7	279.8
Railway Levy	28.5	31.6	36.4	35.1	35.1	35.1	33.2	32.8	33.2	43.5	43.0	43.5
Grants	**31.3**	**62.9**	**31.0**	**33.3**	**28.1**	**33.3**	**48.1**	**49.5**	**48.1**	**49.3**	**48.7**	**49.3**
Project grants	22.4	59.9	27.4	33.3	28.1	33.3	48.1	49.5	48.1	49.3	48.7	49.3
Program grants	8.9	3.0	3.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**2,749.5**	**3,259.8**	**3,024.0**	**3,353.7**	**3,385.7**	**3,358.6**	**3,587.2**	**3,620.1**	**3,562.2**	**3,951.5**	**3,982.0**	**3,875.6**
Recurrent expenditure (including spendig offsets)	**2,197.2**	**2,594.4**	**2,487.4**	**2,679.3**	**2,776.8**	**2,675.0**	**2,813.4**	**2,854.6**	**2,783.0**	**3,078.0**	**3,097.9**	**3,000.0**
Transfer to counties	368.3	401.2	340.4	407.0	407.0	407.0	412.3	417.3	412.3	417.5	417.5	417.5
Interest payments	495.1	585.5	577.7	683.2	686.9	690.6	747.7	769.4	718.0	825.7	846.2	766.5
Domestic interest	388.8	464.0	456.8	540.1	547.7	553.4	601.9	617.9	572.3	651.1	678.8	615.0
Foreign interest due	106.3	121.5	120.8	143.1	139.2	137.2	145.8	151.5	145.7	174.6	167.4	151.5
Wages and benefits (civil service)	493.0	525.9	520.0	537.2	537.2	537.2	600.0	600.0	600.0	645.3	645.3	645.3
Civil service reform	3.3	20.8	26.4	25.9	31.9	25.9	28.5	28.5	28.5	31.3	31.3	31.3
Pensions and Other Consolidated Fund Services	112.9	137.3	122.4	150.6	145.3	150.6	168.2	170.6	168.2	192.9	192.9	192.9
Defense and NSIS	157.7	157.1	175.8	174.3	160.2	174.3	170.0	170.1	170.0	170.0	170.0	170.0
Other	566.8	766.5	724.7	701.0	808.3	689.4	686.6	698.8	686.0	795.2	794.7	776.5
of which: Emergency spending (droughts, security)		24.0	24.0									
Development and net lending	**552.3**	**665.4**	**536.6**	**674.4**	**608.9**	**683.6**	**773.8**	**765.5**	**779.3**	**873.6**	**884.1**	**875.6**
Domestically financed	385.3	416.8	374.7	379.7	419.8	388.9	423.9	415.6	429.3	483.6	494.1	485.7
of which: SOEs emergency funding	36.6	32.3	36.6	36.6	37.3	46.0	30.6	16.8	22.8	24.1	17.2	20.0
Foreign financed	167.0	248.6	161.9	294.7	189.0	294.7	349.9	349.9	349.9	389.9	390.0	390.0
of which: SGR project	11.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: COVID-19 vaccines		14.4	8.1	0.0	6.2	0.0						
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustments to cash basis	5.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance including measures (cash basis, incl. grants)	**-929.3**	**-1,005.0**	**-793.2**	**-858.0**	**-844.9**	**-862.9**	**-718.1**	**-714.3**	**-693.4**	**-743.4**	**-712.6**	**-680.4**
Financing	**950.5**	**1,005.0**	**747.8**	**858.0**	**844.9**	**862.9**	**718.1**	**714.3**	**693.4**	**743.4**	**712.6**	**680.4**
Net foreign financing	323.3	349.8	142.5	341.4	270.8	280.7	285.5	303.9	198.6	209.4	143.4	99.7
Disbursements	451.6	533.4	327.1	564.3	497.2	521.8	503.2	795.4	674.2	555.2	482.1	381.1
Project loans	157.1	236.2	192.0	299.7	178.5	286.5	358.4	374.3	338.8	369.8	398.2	377.6
Program loans	168.6	170.1	135.0	153.9	208.2	129.7	144.9	152.6	65.4	0.0	0.0	3.5
of which: IMF (RCF+ EFF/ECF)	77.6	29.3	28.9	56.9	120.8	63.2	68.0	69.1	61.9	0.0	0.0	0.0
Non-concessional	114.3	127.1	0.0	110.7	110.5	105.6	0.0	268.5	270.0	185.4	83.9	0.0
Standard Gauge Railway	11.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments due	-128.3	-183.6	-184.5	-222.9	-226.4	-241.1	-217.7	-491.6	-475.6	-345.9	-338.7	-281.5
Net domestic financing	627.2	655.2	605.3	516.7	574.1	582.2	432.6	410.4	494.7	534.0	569.2	580.7
Memorandum items:												
Nominal GDP	11,370.3	12,858.0	12,874.1	14,479.3	14,551.3	14,479.3	16,180.6	16,344.7	15,903.1	17,944.0	18,161.8	17,648.4
Primary balance incl. grants	-455.4	-419.6	-170.2	-174.8	-158.0	-172.3	29.6	55.1	30.1	82.3	133.6	88.2
Fuel subsidies (net of Petroleum Levy resources)		82.0	82.0	20.0	59.5			0.0			0.0	
Tax overperformance		55.1	102.8									
Expenditure carryover from FY21/22			112.8									
Unidentified spending offsets due to SOE supports		0.0	0.0	0.0	0.0		30.6	16.8		24.1	17.2	
Total gross public debt, gross	7,696.6	9,023.5	8,579.1	10,189.1	9,831.0		11,117.3	10,816.8		12,059.9	11,728.9	
external debt	3,999.5	4,671.2	4,290.7	5,320.2	4,968.5		5,815.7	5,544.0		6,224.3	5,886.9	
domestic debt	3,697.1	4,352.3	4,288.3	4,869.0	4,862.4		5,301.6	5,272.8		5,835.6	5,842.1	
Total net public debt	7,140.2	8,325.1	8,160.9	9,378.7	9,412.8		10,213.1	10,398.6		11,040.0	11,310.8	
Unidentified tax policy measures	0.0	0.0	0.0	0.0	0.0		139.7	139.7		42.9	59.9	
Pending bills	24.9		112.8									
Government deposits	556.4		418.2									

Sources: Kenyan authorities; and IMF staff estimates and projections.

[1] Fiscal year runs from July to June.

[2] As approved in early June 2022.

Table 2b. Kenya: Central Government Financial Operations 2020/21–2024/25[1]

(Percent of GDP)

	2020/21		2021/22		2022/23			2023/24			2024/25		
	Rev.2	Actual	3rd Rev.	Prel.	3rd Rev.	Proj.	Budget /2	3rd Rev.	Proj.	BPS	3rd Rev.	Proj.	BPS
Revenues and grants	**16.0**	**16.0**	**17.5**	**17.3**	**17.2**	**17.5**	**17.2**	**17.7**	**17.8**	**18.0**	**17.9**	**18.0**	**18.1**
Revenue	**15.7**	**15.7**	**17.0**	**17.1**	**17.0**	**17.3**	**17.0**	**17.4**	**17.5**	**17.7**	**17.6**	**17.7**	**17.8**
Tax revenue (including unidentified tax measures)	12.6	12.6	13.4	13.7	14.0	14.0	14.0	14.8	14.9	15.0	14.9	15.1	15.0
Income tax	6.1	6.1	6.5	6.8	6.9	6.9	6.9	6.5	6.7	7.4	6.5	6.7	7.3
Personal income	3.2	3.2	3.5	3.6	3.5	3.5	3.5	3.4	3.3	3.8	3.4	3.3	3.8
Corporate income	2.9	2.9	3.0	3.2	3.3	3.4	3.3	3.0	3.4	3.6	3.1	3.4	3.5
Import duty (net)	1.0	1.0	0.9	0.9	1.0	1.0	1.0	1.1	1.0	1.1	1.1	1.0	1.0
Excise duty	1.9	1.9	2.0	2.0	2.1	2.0	2.1	2.2	2.1	2.2	2.1	2.1	2.2
Value-added tax	3.6	3.6	4.0	4.1	4.0	4.0	4.0	4.2	4.1	4.3	4.2	4.1	4.5
Domestic	1.7	1.7	1.9	1.9	2.1	2.1	2.1	2.0	2.0	2.2	2.0	2.0	2.1
Imports	1.9	1.9	2.1	2.2	1.9	1.9	1.9	2.2	2.1	2.1	2.2	2.1	2.4
Nontax revenue	3.1	3.1	3.7	3.3	3.0	3.3	3.0	2.7	2.6	2.7	2.7	2.7	2.8
Investment income	0.4	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other	0.8	0.8	0.7	0.8	0.6	0.8	0.6	0.6	0.6	0.6	0.7	0.7	0.8
Ministerial and Departmental Fees (AIA)	1.7	1.7	2.4	1.9	2.0	2.0	2.0	1.7	1.6	1.7	1.6	1.5	1.6
Railway Levy	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Grants	**0.3**	**0.3**	**0.5**	**0.2**	**0.2**	**0.2**	**0.2**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**
Project grants	0.2	0.2	0.5	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Program grants	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**24.2**	**24.2**	**25.4**	**23.5**	**23.2**	**23.3**	**23.2**	**22.2**	**22.1**	**22.4**	**22.0**	**21.9**	**22.0**
Recurrent expenditure (including spendig offsets)	**19.3**	**19.3**	**20.2**	**19.3**	**18.5**	**19.1**	**18.5**	**17.4**	**17.5**	**17.5**	**17.2**	**17.1**	**17.0**
Transfer to counties	3.2	3.2	3.1	2.6	2.8	2.8	2.8	2.5	2.6	2.6	2.3	2.3	2.4
Interest payments	4.4	4.4	4.6	4.5	4.7	4.7	4.8	4.6	4.7	4.5	4.6	4.7	4.3
Domestic interest	3.4	3.4	3.6	3.5	3.7	3.8	3.8	3.7	3.8	3.6	3.6	3.7	3.5
Foreign interest due	0.9	0.9	0.9	0.9	1.0	1.0	0.9	0.9	0.9	0.9	1.0	0.9	0.9
Wages and benefits (civil service)	4.3	4.3	4.1	4.0	3.7	3.7	3.7	3.7	3.7	3.8	3.6	3.6	3.7
Civil service reform	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Pensions and Other Consolidated Fund Services	1.0	1.0	1.1	1.0	1.0	1.0	1.0	1.0	1.0	1.1	1.1	1.1	1.1
Defense and NSIS	1.4	1.4	1.2	1.4	1.2	1.1	1.2	1.1	1.0	1.1	0.9	0.9	1.0
Other	5.0	5.0	6.0	5.6	4.8	5.6	4.8	4.2	4.3	4.3	4.4	4.4	4.4
of which: Emergency spending (droughts, security)			0.2	0.2									
Development and net lending	**4.9**	**4.9**	**5.2**	**4.2**	**4.7**	**4.2**	**4.7**	**4.8**	**4.7**	**4.9**	**4.9**	**4.9**	**5.0**
Domestically financed	3.4	3.4	3.2	2.9	2.6	2.9	2.7	2.6	2.5	2.7	2.7	2.7	2.8
of which: SOEs emergency funding	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.1	0.1	0.1	0.1	0.1
Foreign financed	1.5	1.5	1.9	1.3	2.0	1.3	2.0	2.2	2.1	2.2	2.2	2.1	2.2
of which: SGR project	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: COVID-19 vaccines			0.1	0.1									
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustments to cash basis	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance including measures (cash basis, incl. grants)	**-8.2**	**-8.2**	**-7.8**	**-6.2**	**-5.9**	**-5.8**	**-6.0**	**-4.4**	**-4.4**	**-4.4**	**-4.1**	**-3.9**	**-3.9**
Financing	**8.4**	**8.4**	**7.8**	**5.8**	**5.9**	**5.8**	**6.0**	**4.4**	**4.4**	**4.4**	**4.1**	**3.9**	**3.9**
Net foreign financing	2.8	2.8	2.7	1.1	2.4	1.9	1.9	1.8	1.9	1.2	1.2	0.8	0.6
Disbursements	4.0	4.0	4.1	2.5	3.9	3.4	3.6	3.1	4.9	4.2	3.1	2.7	2.2
Project loans	1.4	1.4	1.8	1.5	2.1	1.2	2.0	2.2	2.3	2.1	2.1	2.2	2.1
Program loans	1.5	1.5	1.3	1.0	1.1	1.4	0.9	0.9	0.9	0.4	0.0	0.0	0.0
of which: IMF (RCF+ EFF/ECF)	0.7	0.7	0.2	0.2	0.4	0.8	0.4	0.4	0.4	0.4	0.0	0.0	0.0
Non-concessional	1.0	1.0	1.0	0.0	0.8	0.8	0.7	0.0	1.6	1.7	1.0	0.5	0.0
Standard Gauge Railway	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments due	-1.1	-1.1	-1.4	-1.4	-1.5	-1.6	-1.7	-1.3	-3.0	-3.0	-1.9	-1.9	-1.6
Net domestic financing	5.5	5.5	5.1	4.7	3.6	3.9	4.0	2.7	2.5	3.1	3.0	3.1	3.3
Memorandum items:													
Primary balance incl. grants	-4.0	-4.0	-3.3	-1.3	-1.2	-1.1	-1.2	0.2	0.3	0.2	0.5	0.7	0.5
Fuel subsidies (net of Petroleum Levy resources)			0.6	0.6	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax overperformance			0.4	0.8									
Expenditure carryover from FY21/22					0.0	0.0						0.0	
Unidentified spending offsets due to SOE supports				0.0		0.0			0.1			0.1	
Total gross public debt, gross	67.8	67.7	70.2	66.6	70.4	67.6		68.7	66.2		67.2	64.6	
external debt	35.3	35.2	36.3	33.3	36.7	34.1		35.9	33.9		34.7	32.4	
domestic debt	32.5	32.5	33.8	33.3	33.6	33.4		32.8	32.3		32.5	32.2	
Total net public debt	62.9	62.8	64.7	63.4	64.8	64.7		63.1	63.6		61.5	62.3	
Unidentified tax policy measures	0.0	0.0	0.0	0.0	0.0	0.0		0.9	0.9		0.2	0.3	
Pending bills	0.0	0.2	0.0	0.9	0.0	0.0		0.0	0.0		0.0	0.0	
Government deposits	4.9	4.9		3.2									

Sources: Kenyan authorities; and IMF staff estimates and projections.

[1] Fiscal year runs from July to June. Ratios as share of GDP are impacted by GDP rebasing, which took place between the 1st and 2nd Reviews.

[2] As approved in early June.

Table 3. Kenya: Monetary Survey December 2020–December 2023

	Dec-20	Jun-21	Dec-21	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
	Act.	Act.	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In billions of Kenyan Shillings; end of period)									
Central Bank of Kenya (CBK)										
Net foreign assets	738	836	701	642	569	540	483	482	349	381
Net domestic assets	-269	-386	-179	-123	-14	41	55	109	206	207
Net domestic credit	33	-53	147	222	315	387	410	472	576	582
Government (net)	-32	-50	67	148	190	245	245	306	305	342
Of which: on-lending and transfer of IMF resources[1]	85	161	195	234	277	332	332	393	392	429
Commercial banks (net)	61	-6	76	70	121	138	161	162	268	236
Private sector (net)	3	3	3	4	4	4	4	4	4	4
Other items (net)	-301	-333	-326	-344	-329	-347	-355	-363	-370	-376
Reserve money (RM)	470	450	522	519	555	581	538	591	555	588
Currency in circulation	234	226	253	251	252	271	224	267	224	251
Bank reserves	236	224	268	268	303	310	313	324	331	336
Other depository corporations										
Net foreign assets	8	-52	-110	-185	-274	-283	-146	-9	-13	-18
Reserves	236	224	268	268	303	310	313	324	331	336
Credit to CBK	-61	6	-76	-70	-121	-138	-161	-162	-268	-236
Net domestic assets	3,507	3,684	3,850	4,179	4,271	4,457	4,404	4,373	4,572	4,624
Net domestic credit	4,274	4,493	4,806	5,034	5,147	5,208	5,380	5,527	5,732	5,817
Government (net)	1,375	1,511	1,656	1,696	1,709	1,713	1,772	1,827	1,879	1,901
Other public sector (net)	91	84	100	84	79	79	79	79	79	79
Private sector (net)	2,808	2,898	3,050	3,253	3,359	3,415	3,529	3,620	3,773	3,836
Other items (net)	-767	-809	-956	-855	-876	-751	-976	-1,154	-1,160	-1,192
Total deposits	3,691	3,862	3,931	4,152	4,145	4,241	4,288	4,434	4,525	4,600
Monetary survey										
Net foreign assets	747	784	590	457	295	258	337	473	336	363
Net domestic assets	3,244	3,354	3,645	3,986	4,136	4,359	4,298	4,320	4,510	4,595
Net domestic credit	4,246	4,446	4,877	5,186	5,341	5,457	5,629	5,837	6,040	6,163
Government (net)	1,343	1,460	1,724	1,845	1,899	1,959	2,017	2,134	2,184	2,244
Other public sector (net)	91	84	100	84	79	79	79	79	79	79
Private sector (net)	2,811	2,901	3,053	3,257	3,362	3,419	3,532	3,624	3,777	3,840
Other items (net)	-1,002	-1,092	-1,232	-1,200	-1,205	-1,098	-1,331	-1,517	-1,530	-1,568
M1	1,720	1,779	1,848	1,907	1,916	1,997	2,004	2,073	2,096	2,144
Money and quasi-money (M2)	3,250	3,377	3,432	3,552	3,553	3,655	3,663	3,769	3,808	3,866
M2 plus resident foreign currency deposits (M3)	3,991	4,138	4,235	4,443	4,430	4,617	4,635	4,793	4,846	4,958
M3 plus nonbank holdings of government debt (L)	5,665	5,900	6,202	6,630	6,694	7,036	7,041	7,265	7,384	7,535
Memorandum items	(Annual percentage change, unless otherwise indicated)									
RM	1.9	5.4	11.0	15.4	15.9	11.4	12.2	13.8	0.1	1.1
M2	11.9	4.6	5.6	5.2	4.3	6.5	7.4	6.1	7.2	5.8
M3	13.2	6.4	6.1	7.4	6.1	9.0	9.8	7.9	9.4	7.4
L	17.3	9.9	9.5	12.4	10.2	13.4	11.7	9.6	10.3	7.1
Deposits	12.0	7.0	6.5	7.5	6.1	7.9	8.9	6.8	9.2	8.5
Net domestic credit	17.0	13.1	14.9	16.6	15.0	11.9	12.1	12.6	13.1	12.9
Government (net, monetary survey)	42.7	27.1	28.3	26.3	19.8	13.6	14.7	15.7	15.0	14.6
Private sector (net)	8.4	7.7	8.6	12.3	12.9	12.0	11.2	11.3	12.3	12.3
Net domestic assets (NDA) of the banking sector	14.1	11.8	9.8	13.4	12.1	15.8	11.0	4.7	7.0	3.8
NDA growth (as percent of the base period M3)	12.3	10.0	8.6	11.9	11.0	14.3	10.3	4.4	6.8	3.6
Multiplier (M2/RM; ratio)	6.9	7.5	6.6	6.8	6.4	6.3	6.8	6.4	6.9	6.6
Multiplier (M3/RM; ratio)	8.5	9.2	8.1	8.6	8.0	7.9	8.6	8.1	8.7	8.4
Velocity (GDP/M2; ratio)	3.5	3.6	3.5	3.6	3.7	3.7	3.8	3.8	4.0	4.0
Velocity (GDP/M3; ratio)	2.8	2.9	2.9	2.9	3.0	3.0	3.0	3.0	3.1	3.1

Sources: Kenyan authorities; and IMF staff estimates and projections.

[1] Includes resources under the RCF (approved on May 6, 2020), the current EFF/ECF arrangements, and a part of the August 2021 SDR allocation.

Table 4a. Kenya: Summary Balance of Payments, 2021–27

(Millions of U.S. dollars, unless otherwise indicated)

	2021	2022		2023		2024		2025		2026		2027	
	Act.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.
Current account	-5,744	-6,888	-6,617	-6,860	-6,530	-7,071	-6,818	-7,193	-6,917	-7,641	-7,351	-8,020	-7,815
Merchandize trade	-11,065	-13,237	-12,907	-13,419	-13,048	-14,008	-13,646	-14,767	-14,327	-15,758	-15,317	-16,648	-16,494
Exports f.o.b.	6,789	8,132	7,742	9,111	8,593	10,066	9,491	11,123	10,491	12,069	11,383	13,038	12,296
Imports f.o.b.	17,854	21,369	20,649	22,530	21,640	24,074	23,137	25,890	24,818	27,827	26,700	29,686	28,790
Energy	3,226	4,892	4,995	4,472	4,573	4,387	4,526	4,437	4,539	4,443	4,601	4,195	4,703
Non-energy	14,628	16,477	15,654	18,059	17,067	19,688	18,611	21,453	20,279	23,385	22,098	25,492	24,088
Services	1,037	1,641	1,631	2,051	2,080	2,362	2,284	2,649	2,572	2,891	2,872	3,119	3,128
Credit, *of which*	5,036	6,051	6,322	6,747	6,867	7,491	7,536	8,234	8,269	9,004	9,041	9,790	9,832
Transportation	1,646	2,257	2,404	2,668	2,656	3,047	2,928	3,335	3,199	3,610	3,464	3,873	3,718
Travel receipts	844	957	1,013	1,062	1,113	1,163	1,225	1,262	1,323	1,363	1,429	1,453	1,523
Debit, *of which*	3,999	4,410	4,691	4,696	4,787	5,129	5,252	5,585	5,696	6,114	6,169	6,670	6,703
Transportation	1,568	1,885	2,069	1,988	1,909	2,124	2,041	2,284	2,189	2,455	2,355	2,619	2,540
Primary income	-1,835	-1,966	-2,073	-2,661	-2,673	-2,972	-2,948	-3,201	-3,236	-3,545	-3,659	-3,957	-3,906
Credit	62	644	235	1,060	405	1,161	307	1,063	237	1,144	234	1,216	250
Debit	1,896	2,610	2,307	3,721	3,079	4,132	3,255	4,264	3,473	4,688	3,894	5,173	4,156
Secondary income, *of which*	6,119	6,674	6,732	7,169	7,111	7,546	7,491	8,125	8,074	8,771	8,753	9,466	9,457
Remittances	3,770	4,155	4,108	4,571	4,478	4,935	4,834	5,330	5,220	5,758	5,635	6,219	6,084
Capital account	196	200	200	200	200	200	200	200	200	200	200	200	200
Financial account [1]	-3,816	-4,514	-3,448	-6,939	-4,064	-6,841	-6,888	-7,971	-7,928	-8,589	-8,189	-9,097	-9,087
Direct investment, net	-53	-961	-700	-1,127	-996	-1,183	-1,201	-1,484	-1,500	-1,685	-1,699	-2,011	-1,998
Assets	410	100	150	100	100	100	100	100	100	100	100	100	100
Liabilities	-463	-1,060	-850	-1,226	-1,096	-1,283	-1,301	-1,584	-1,600	-1,785	-1,799	-2,110	-2,098
Portfolio investment, net, *of which*	225	813	568	832	836	849	852	-237	-34	877	879	874	876
Assets	1,067	1,000	750	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Liabilities	-842	-186	-182	-168	-164	-151	-148	-1,236	-1,033	-123	-120	-126	-123
Eurobonds (net)	-1,000	0	0	0	0	0	0	-1,100	-900	0	0	0	0
Financial derivatives, net	23	0	0	0	0	0	0	0	0	0	0	0	0
Other investment, net	-4,010	-4,367	-3,316	-6,644	-3,903	-6,506	-6,539	-6,251	-6,395	-7,780	-7,370	-7,960	-7,966
Assets	159	500	-750	500	0	500	500	500	500	500	500	250	250
Liabilities, *of which*	-4,169	-4,867	-2,566	-7,144	-3,903	-7,006	-7,039	-6,751	-6,895	-8,280	-7,869	-8,210	-8,216
Public sector loans (excl. official budget support) (net)	258	-1,598	-29	-1,818	-642	-1,039	-1,089	-1,385	-1,531	-3,250	-2,700	-3,143	-3,064
SDR allocation	-740	0	0	0	0	0	0	0	0	0	0	0	0
Errors and omissions	569	0	0	0	0	0	0	0	0	0	0	0	0
Overall balance ("+" indicates a surplus)	-1,164	-2,173	-2,968	279	-2,266	-29	270	978	1,211	1,148	1,038	1,277	1,473
Financing	1,164	2,173	2,968	-279	2,266	29	-270	-978	-1,211	-1,148	-1,038	-1,277	-1,473
Reserve assets [2]	-1,159	712	1,436	-1,419	1,096	-795	-1,088	-863	-1,100	-846	-762	-862	-1,076
Program financing	1,818	1,461	1,533	1,140	1,171	824	818	-115	-111	-302	-276	-415	-397
IMF (net)	850	409	614	590	574	224	218	-115	-111	-302	-276	-415	-397
of which, Fund purchases	980	477	682	619	603	224	218	0	0	0	0	0	0
of which, Access augmentation	…	0	215	…	…	…	…	…	…	…	…	…	…
Official budget support (other)	968	1,052	919	550	596	600	600	0	0	0	0	0	0
Exceptional financing	505	0	0	0	0	0	0	0	0	0	0	0	0
of which, DSSI	505	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:													
Gross international reserves (USD million)	9,514	8,802	8,078	10,221	6,983	11,016	8,071	11,879	9,171	12,725	9,933	13,587	11,009
In months of next year's imports of goods and services	4.5	3.9	3.7	4.2	3.0	4.2	3.2	4.2	3.3	4.2	3.4	4.2	3.5
Current account (CA) (percent of GDP)	-5.2	-5.9	-5.7	-5.5	-5.4	-5.3	-5.3	-5.1	-5.1	-5.0	-5.0	-5.0	-5.0
CA excl. energy imports (percent of GDP)	-2.3	-1.7	-1.4	-1.9	-1.6	-2.0	-1.8	-1.9	-1.7	-2.1	-1.9	-2.4	-2.0
Energy imports (percent of GDP)	2.9	4.2	4.3	3.6	3.8	3.3	3.5	3.1	3.3	2.9	3.1	2.6	3.0
Merchandize exports growth (percent)	12.2	19.0	14.0	12.0	11.0	10.5	10.5	10.5	10.5	8.5	8.5	8.0	8.0
Merchandize imports growth (percent)	24.1	17.3	15.7	5.4	4.8	6.9	6.9	7.5	7.3	7.5	7.6	6.7	7.8
Energy (percent)	56.8	51.3	54.9	-8.6	-8.4	-1.9	-1.0	1.2	0.3	0.1	1.4	-5.6	2.2
Non-energy (percent)	18.6	10.0	7.0	9.6	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0
Travel receipts growth (percent)	55.9	13.3	20.0	11.0	10.0	9.5	10.0	8.5	8.0	8.0	8.0	6.6	6.6
Remittances growth (percent)	21.3	10.0	9.0	10.0	9.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0

Sources: Kenyan authorities; and Fund staff estimates and projections.

[1] Negative entries reflect a decrease in assets or an increase in liabilities.

[2] Negative entries reflect an increase in assets.

Table 4b. Kenya: Summary Balance of Payments, 2021–27

(Percent of GDP)[1]

	2021	2022		2023		2024		2025		2026		2027	
	Act.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.
Current account	-5.2	-5.9	-5.7	-5.5	-5.4	-5.3	-5.3	-5.1	-5.1	-5.0	-5.0	-5.0	-5.0
Merchandize trade	-10.0	-11.2	-11.0	-10.8	-10.8	-10.6	-10.7	-10.4	-10.5	-10.4	-10.5	-10.3	-10.6
Exports f.o.b.	6.1	6.9	6.6	7.3	7.1	7.6	7.4	7.8	7.7	7.9	7.8	8.1	7.9
Imports f.o.b.	16.2	18.2	17.6	18.2	18.0	18.2	18.1	18.3	18.2	18.3	18.3	18.4	18.5
Energy	2.9	4.2	4.3	3.6	3.8	3.3	3.5	3.1	3.3	2.9	3.1	2.6	3.0
Non-energy	13.2	14.0	13.4	14.6	14.2	14.9	14.6	15.1	14.9	15.4	15.1	15.8	15.5
Services	0.9	1.4	1.4	1.7	1.7	1.8	1.8	1.9	1.9	1.9	2.0	1.9	2.0
Credit, *of which*	4.6	5.1	5.4	5.4	5.7	5.7	5.9	5.8	6.1	5.9	6.2	6.1	6.3
Transportation	1.5	1.9	2.1	2.2	2.2	2.3	2.3	2.4	2.3	2.4	2.4	2.4	2.4
Travel receipts	0.8	0.8	0.9	0.9	0.9	0.9	1.0	0.9	1.0	0.9	1.0	0.9	1.0
Debit	3.6	3.7	4.0	3.8	4.0	3.9	4.1	3.9	4.2	4.0	4.2	4.1	4.3
Primary income	-1.7	-1.7	-1.8	-2.1	-2.2	-2.2	-2.3	-2.3	-2.4	-2.3	-2.5	-2.4	-2.5
Credit	0.1	0.5	0.2	0.9	0.3	0.9	0.2	0.7	0.2	0.8	0.2	0.8	0.2
Debit	1.7	2.2	2.0	3.0	2.6	3.1	2.5	3.0	2.5	3.1	2.7	3.2	2.7
Secondary income, *of which*	5.5	5.7	5.8	5.8	5.9	5.7	5.9	5.7	5.9	5.8	6.0	5.9	6.1
Remittances	3.4	3.5	3.5	3.7	3.7	3.7	3.8	3.8	3.8	3.8	3.9	3.8	3.9
Capital account	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Financial account [2]	-3.5	-3.8	-2.9	-5.6	-3.4	-5.2	-5.4	-5.6	-5.8	-5.6	-5.6	-5.6	-5.9
Direct investment, net	0.0	-0.8	-0.6	-0.9	-0.8	-0.9	-0.9	-1.0	-1.1	-1.1	-1.2	-1.2	-1.3
Assets	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Liabilities	-0.4	-0.9	-0.7	-1.0	-0.9	-1.0	-1.0	-1.1	-1.2	-1.2	-1.2	-1.3	-1.4
Portfolio investment, net, *of which*	0.2	0.7	0.5	0.7	0.7	0.6	0.7	-0.2	0.0	0.6	0.6	0.5	0.6
Assets	1.0	0.8	0.6	0.8	0.8	0.8	0.8	0.7	0.7	0.7	0.7	0.6	0.6
Liabilities	-0.8	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.9	-0.8	-0.1	-0.1	-0.1	-0.1
Eurobonds (net)	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	-0.8	-0.7	0.0	0.0	0.0	0.0
Financial derivatives, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	-3.6	-3.7	-2.8	-5.4	-3.2	-4.9	-5.1	-4.4	-4.7	-5.1	-5.0	-4.9	-5.1
Assets	0.1	0.4	-0.6	0.4	0.0	0.4	0.4	0.4	0.4	0.3	0.3	0.2	0.2
Liabilities, *of which*	-3.8	-4.1	-2.2	-5.8	-3.2	-5.3	-5.5	-4.8	-5.0	-5.4	-5.4	-5.1	-5.3
Public sector loans (excl. official budget support) (net)	0.2	-1.4	0.0	-1.5	-0.5	-0.8	-0.9	-1.0	-1.1	-2.1	-1.8	-1.9	-2.0
SDR allocation	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance ("+" indicates a surplus)	-1.1	-1.8	-2.5	0.2	-1.9	0.0	0.2	0.7	0.9	0.8	0.7	0.8	0.9
Financing	1.1	1.8	2.5	-0.2	1.9	0.0	-0.2	-0.7	-0.9	-0.8	-0.7	-0.8	-0.9
Reserve assets [3]	-1.0	0.6	1.2	-1.1	0.9	-0.6	-0.9	-0.6	-0.8	-0.6	-0.5	-0.5	-0.7
Program financing	1.6	1.2	1.3	0.9	1.0	0.6	0.6	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3
IMF (net)	0.8	0.3	0.5	0.5	0.5	0.2	0.2	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3
of which, Fund purchases	0.9	0.4	0.6	0.5	0.5	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
of which, Access augmentation	...	...	0.2	...	...	...	...	...	...	...	...	...	...
Official budget support (other)	0.9	0.9	0.8	0.4	0.5	0.5	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which, DSSI	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:													
Gross international reserves	8.6	7.5	6.9	8.2	5.8	8.3	6.3	8.4	6.7	8.4	6.8	8.4	7.1

Sources: Kenyan authorities; and Fund staff estimates and projections.

[1] Ratios as share of GDP are impacted by GDP rebasing, which took place between the 1st and 2nd Reviews.

[2] Negative entries reflect a decrease in assets or an increase in liabilities.

[3] Negative entries reflect an increase in assets.

Table 5. Kenya: Financial Soundness Indicators of the Banking Sector

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
	(In percent)											
Capital adequacy												
Regulatory capital to risk-weighted assets	18.8	18.5	18.5	18.2	19.2	18.8	18.9	18.8	19.6	18.9	18.8	19.0
Regulatory tier 1 capital to risk-weighted assets	16.8	16.4	16.4	16.3	16.7	16.5	16.5	16.3	16.7	16.2	16.0	16.2
Tier 1 capital to total assets	12.8	12.4	12.1	12.1	12.3	12.2	12.0	11.9	12.1	12.0	11.8	11.9
Asset quality												
Non-performing loans to total gross loans[1]	12.0	12.5	13.1	13.6	14.1	14.6	13.8	13.6	13.1	14.0	12.5	11.4
Bank provisions to NPLs	54.3	55.1	54.7	55.9	59.6	60.5	60.5	60.9	61.9	57.3	61.2	63.8
Non-performing loans net of provisions to capital	21.3	22.1	23.5	23.7	21.6	21.8	21.0	20.5	18.4	22.6	18.7	15.9
Earning and profitability												
Return on assets (ROA)	3.3	3.0	2.3	2.3	2.1	3.2	3.3	3.3	3.3	3.6	3.8	3.9
Return on equity (ROE)	22.2	20.4	15.8	15.5	14.5	22.2	23.4	23.1	22.9	25.2	26.5	27.5
Non-interest expenses to gross income	51.5	50.1	50.6	49.6	50.1	46.4	46.0	46.3	46.8	45.7	45.1	44.4
Liquidity												
Liquid assets to total assets	38.1	38.4	40.4	40.2	40.9	41.8	41.1	41.4	42.0	40.9	39.8	39.0
Liquid assets to total deposits	56.0	56.5	58.7	59.2	60.8	62.2	62.1	62.4	64.1	62.8	60.2	60.2
Total loans to total deposits	81.8	80.9	78.3	79.3	79.1	79.1	80.2	79.4	79.1	81.6	81.0	82.9
Sensitivity to market risk												
FX currency denominated liabilities to total liabilities	26.0	26.3	26.2	26.5	28.0	28.7	28.4	28.0	29.0	29.3	29.9	30.1
Spread between lending and deposit rate	5.3	5.2	4.9	5.2	5.7	5.6	5.7	5.8	5.7	5.7	5.7	5.6

Source: Kenyan authorities.

[1] The data for Chase Bank in receivership and Charterhouse Bank under statutory management have been excluded from May 2016 onward.

Table 6. Kenya: External Financing Requirements and Sources, 2021–27

(Millions of U.S. dollars, unless otherwise indicated)

		2021	2022		2023		2024		2025		2026		2027	
		Act.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.
(1)	**Gross financing requirements**	**7,560**	**8,921**	**8,644**	**9,050**	**8,600**	**11,096**	**10,784**	**10,665**	**9,761**	**9,964**	**10,029**	**10,369**	**10,053**
	Current account deficit (excl. grants)	5,844	7,023	6,752	6,995	6,665	7,206	6,953	7,328	7,052	7,776	7,486	8,155	7,950
	of which: Energy imports	3,226	4,892	4,995	4,472	4,573	4,387	4,526	4,437	4,539	4,443	4,601	4,195	4,703
	Amortization of public sector loans (excl. IMF repurchase)	1,586	1,830	1,825	2,025	1,906	1,890	1,831	2,922	2,297	1,585	1,967	1,498	1,407
	Amortization of sovereign bonds	0	0	0	0	0	2,000	2,000	300	300	300	300	300	300
	IMF repurchases	130	68	67	29	29	0	0	115	111	302	276	415	397
(2)	**Change in reserves (+ = increase)**	**1,159**	**-712**	**-1,436**	**1,419**	**-1,096**	**795**	**1,088**	**863**	**1,100**	**846**	**762**	**862**	**1,076**
(3)	**Gross financing sources**	**5,697**	**6,680**	**5,608**	**9,300**	**6,305**	**11,067**	**11,054**	**11,528**	**10,861**	**10,810**	**10,791**	**11,231**	**11,129**
	FDI, net	53	961	700	1,127	996	1,183	1,201	1,484	1,500	1,685	1,699	2,011	1,998
	Public grants	100	135	135	135	135	135	135	135	135	135	135	135	135
	Public sector borrowing (excl. official budget support)	2,030	3,428	1,853	3,844	2,549	2,930	2,919	4,306	3,828	4,835	4,666	4,641	4,471
	of which, SDR allocation	740	0	0	0	0	0	0	0	0	0	0	0	0
	Issuance of sovereign bonds	1,000	0	0	0	0	2,000	2,000	1,400	1,200	300	300	300	300
	Private capital flows, net	2,517	2,157	2,920	4,194	2,626	4,819	4,799	4,203	4,198	3,854	3,991	4,144	4,226
(4)	**Errors and omissions**	**569**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
(1)+(2)-(3)-(4)	**Total financing needs**	**2,453**	**1,529**	**1,600**	**1,169**	**1,199**	**824**	**818**	**0**	**0**	**0**	**0**	**0**	**0**
(5)+(6)	**Total financing sources**	**2,453**	**1,529**	**1,600**	**1,169**	**1,199**	**824**	**818**	**0**	**0**	**0**	**0**	**0**	**0**
(5)	Official public external financing	1,948	1,529	1,600	1,169	1,199	824	818	0	0	0	0	0	0
	Identified official budget support	968	1,052	919	550	596	600	600	0	0	0	0	0	0
	IMF purchases	980	477	682	619	603	224	218	0	0	0	0	0	0
	of which, Access augmentation	...	0	215	...	...	...	...	...	...	...	...	...	...
(6)	Exceptional financing	505	0	0	0	0	0	0	0	0	0	0	0	0
	of which, DSSI	505	0	0	0	0	0	0	0	0	0	0	0	0
	Memorandum Items													
	Gross financing requirements (in percent of GDP)	6.8	7.6	7.4	7.3	7.1	8.4	8.4	7.5	7.1	6.6	6.9	6.4	6.5
	Gross international Reserves	9,514	8,802	8,078	10,221	6,983	11,016	8,071	11,879	9,171	12,725	9,933	13,587	11,009
	In months of next year's imports of GNFS	4.5	3.9	3.7	4.2	3.0	4.2	3.2	4.2	3.3	4.2	3.4	4.2	3.5

Sources: Kenyan authorities; and IMF staff estimates and projections.

Table 7. Kenya: Access and Phasing Under the Extended Fund Facility and the Extended Credit Facility Arrangements

Current

Availability Date	Condition	Available Purchases under GRA		Available Loans under PRGT		Total Available Purchases and Loans	
		SDR millions	Percent of quota	SDR millions	Percent of quota	SDR millions	Percent of quota
April 2, 2021	Approval of the 38-month EFF and ECF arrangements	141.13	26.00	75.99	14.00	217.12	40.00
June 20, 2021	Completion of the first EFF-ECF reviews and observance of continuous and end-March 2021 performance criteria.	198.12	36.50	86.85	16.00	284.97	52.50
November 7, 2021	Completion of the second EFF-ECF reviews and observance of continuous and end-June 2021 performance criteria. 1/	135.70	25.00	48.85	9.00	184.55	34.00
May 7, 2022	Completion of the third EFF-ECF reviews and observance of continuous and end-December 2021 performance criteria.	141.13	26.00	38.00	7.00	179.13	33.00
November 7, 2022	Completion of the fourth EFF-ECF reviews and observance of continuous and end-June 2022 performance criteria.	135.70	25.00	38.00	7.00	173.70	32.00
May 7, 2023	Completion of the fifth EFF-ECF reviews and observance of continuous and end-December 2022 performance criteria.	181.84	33.50	43.42	8.00	225.26	41.50
November 7, 2023	Completion of the sixth EFF-ECF reviews and observance of continuous and end June 2023 performance criteria.	184.55	34.00	43.42	8.00	227.97	42.00
May 7, 2024	Completion of the seventh EFF-ECF reviews and observance of continuous and end December 2023 performance criteria.	130.27	24.00	32.56	6.00	162.83	30.00
Total		**1,248.44**	**230.00**	**407.09**	**75.00**	**1,655.53**	**305.00**

Proposed

Availability Date	Condition	Available Purchases under GRA		Available Loans under PRGT		Total Available Purchases and Loans	
		SDR millions	Percent of quota	SDR millions	Percent of quota	SDR millions	Percent of quota
April 2, 2021	Approval of the 38-month EFF and ECF arrangements	141.13	26.00	75.99	14.00	217.12	40.00
June 20, 2021	Completion of the first EFF-ECF reviews and observance of continuous and end-March 2021 performance criteria.	198.12	36.50	86.85	16.00	284.97	52.50
November 7, 2021	Completion of the second EFF-ECF reviews and observance of continuous and end-June 2021 performance criteria. 1/	135.70	25.00	48.85	9.00	184.55	34.00
May 7, 2022	Completion of the third EFF-ECF reviews and observance of continuous and end-December 2021 performance criteria. 2/	141.13	26.00	38.00	7.00	179.13	33.00
November 7, 2022	Completion of the fourth EFF-ECF reviews and observance of continuous and end-June 2022 performance criteria.	135.70	25.00	200.84	37.00	336.54	62.00
May 7, 2023	Completion of the fifth EFF-ECF reviews and observance of continuous and end-December 2022 performance criteria.	181.84	33.50	43.42	8.00	225.26	41.50
November 7, 2023	Completion of the sixth EFF-ECF reviews and observance of continuous and end June 2023 performance criteria.	184.55	34.00	43.42	8.00	227.97	42.00
May 7, 2024	Completion of the seventh EFF-ECF reviews and observance of continuous and end December 2023 performance criteria.	130.27	24.00	32.56	6.00	162.83	30.00
Total		**1,248.44**	**230.00**	**569.93**	**105.00**	**1,818.37**	**335.00**

Source: IMF staff estimates.

1/ The second EFF-ECF reviews took place on December 17, 2021.

2/ The third EFF-ECF reviews took place on July 18, 2022.

Table 8. Kenya: Indicators of Fund Credit, 2021–34
(Millions of SDR unless stated otherwise)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
	Act.	Projections												
Existing and prospective Fund arrangements														
Disbursements	686.6	515.7	453.2	162.8	0	0	0	0	0	0	0	0	0	0
Stock of existing and prospective Fund credit [1]	1,301.4	1,766.7	2,198.4	2,361.2	2,278.7	2,074.6	1,783.3	1,383.1	955.7	579.4	301.9	101.3	14.1	0
Obligations to the Fund [2]	95.3	61.9	62.7	56.3	142.1	261.1	343.2	444.6	464.2	405.6	299.2	216.2	98.6	23.6
Principal (repayments/repurchases)	91.2	50.3	21.6	0.0	82.6	204.0	291.4	400.2	427.4	376.3	277.5	200.6	87.2	14.1
Charges and interest [3]	4.1	11.6	41.2	56.3	59.5	57.1	51.8	44.4	36.9	29.3	21.7	15.6	11.4	9.4
Stock of existing and prospective Fund credit [1, 4]														
In percent of quota	239.8	325.5	405.0	435.0	419.8	382.2	328.5	254.8	176.1	106.7	55.6	18.7	2.6	0.0
In percent of GDP	1.6	2.0	2.4	2.4	2.2	1.9	1.5	1.1	0.7	0.4	0.2	0.1	0.0	0.0
In percent of exports of goods and services	15.4	16.5	18.6	18.2	15.9	13.3	10.6	7.5	4.8	2.7	1.3	0.4	0.0	0.0
In percent of gross international reserves	19.1	28.7	41.3	38.3	32.6	27.4	21.2	15.3	10.0	5.6	2.7	0.8	0.1	0.0
In percent of government revenue	9.8	11.3	13.6	13.5	12.2	10.4	8.3	6.0	3.9	2.3	1.1	0.4	0.0	0.0
In percent of total external debt	2.8	3.4	4.0	3.9	3.5	2.9	2.3	1.7	1.1	0.6	0.3	0.1	0.0	0.0
Obligations to the Fund (repurchases and charges) [4]														
In percent of quota	17.6	11.4	11.6	10.4	26.2	48.1	63.2	81.9	85.5	74.7	55.1	39.8	18.2	4.3
In percent of GDP	0.1	0.1	0.1	0.1	0.1	0.2	0.3	0.4	0.4	0.3	0.2	0.1	0.1	0.0
In percent of exports of goods and services	1.1	0.6	0.5	0.4	1.0	1.7	2.0	2.4	2.3	1.9	1.3	0.8	0.3	0.1
In percent of gross international reserves	1.4	1.0	1.2	0.9	2.0	3.4	4.1	4.9	4.9	3.9	2.7	1.8	0.8	0.2
In percent of government revenue	0.7	0.4	0.4	0.3	0.8	1.3	1.6	1.9	1.9	1.6	1.1	0.7	0.3	0.1
In percent of total external debt service	2.5	1.3	1.2	0.8	2.1	3.7	4.8	5.3	5.6	4.5	3.1	2.1	0.9	0.2
Memorandum items														
Quota (SDR million)	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8
Gross domestic product, baseline (USD million)	110,519	117,068	120,322	127,770	136,548	146,277	155,325	163,693	172,526	181,848	191,624	201,910	212,784	224,282
Exports of goods and services (USD million)	11,825	14,064	15,460	17,027	18,759	20,424	22,128	24,048	26,142	28,425	31,101	34,126	37,457	41,127
Gross international reserves (USD million)	9,514	8,078	6,983	8,071	9,171	9,933	11,009	11,819	12,544	13,463	14,479	15,660	16,958	18,114
Government revenue (USD million)	18,480	20,462	21,205	22,887	24,532	26,223	28,138	30,058	31,887	33,738	35,737	37,787	40,054	42,582
External debt service (USD million)	5,479	6,275	7,160	9,455	9,052	9,659	9,821	11,454	11,226	12,174	12,986	13,803	15,006	17,415
Total external debt (USD million)	64,173	68,272	73,346	81,202	88,886	96,479	104,298	111,754	119,014	126,369	133,484	140,586	147,876	155,060

Sources: IMF Finance Department; and IMF staff estimates and projections.

[1] End of period.

[2] Repayment schedule based on scheduled debt service obligations.

[3] Using the GRA rate of charge of 3.666 (as of November 17, 2022).

[4] Using the USD/SDR rate of 1.31068 as of November 17, 2022 in 2022-2034 forecasts.

Table 9. Kenya: Decomposition of Public Debt and Debt Service by Creditor, 2021–23[1]

	Debt Stock (end of period)			Debt Service					
	2021			2021	2022	2023	2021	2022	2023
	(In US$ mln)	(Percent total debt)	(Percent GDP)	(In US$ mln)			(Percent GDP)		
Total	**72,522**	**100.0**	**67.8**	**9,813**	**10,553**	**9,051**	**8.9**	**9.0**	**7.5**
External	**36,882**	**50.9**	**34.5**	**2,266**	**3,087**	**3,058**	**2.1**	**2.6**	**2.5**
Multilateral creditors	15,750	21.7	14.3	504	556	558	0.5	0.5	0.5
IMF	1,833	2.5	1.7	-	-	-	-	-	-
World Bank	10,226	14.1	9.3	-	-	-	-	-	-
African Development Bank	3,199	4.4	2.9	-	-	-	-	-	-
European Economic Community (incl. EIB)	197	0.3	0.2	-	-	-	-	-	-
International Fund For Agricultural Development	212	0.3	0.2	-	-	-	-	-	-
Other Multilaterals	84	0.1	0.1	-	-	-	-	-	-
o/w: Arab Bank For Economic Development In Africa	39	0.1	0.0	-	-	-	-	-	-
Nordic Development Fund	25	0.0	0.0	-	-	-	-	-	-
Bilateral Creditors	11,337	15.6	10.3	585	1,184	1,336	0.5	1.0	1.1
Paris Club	4,117	5.7	3.7	136	390	457	0.1	0.3	0.4
o/w: Japan	1,446	2.0	1.3	-	-	-	-	-	-
France (incl. AFD)	806	1.1	0.7	-	-	-	-	-	-
Non-Paris Club	7,220	10.0	6.5	449	794	878	0.4	0.7	0.7
o/w: EXIM China	7,071	9.8	6.4	-	-	-	-	-	-
EXIM India	65	0.1	0.1	-	-	-	-	-	-
Bonds	7,100	9.8	6.4	452	519.8	514.5	0.4	0.4	0.4
Commercial creditors	2,196	3.0	2.0	774	802	623	0.7	0.7	0.5
o/w: Trade and Development Bank	1,894	2.6	1.7	-	-	-	-	-	-
China Development Bank	283	0.4	0.3	-	-	-	-	-	-
Other international creditors	499	0.7	0.5	78	26	26	0.1	0.0	0.0
o/w: Intesa SanPaolo	294	0.4	0.3	-	-	-	-	-	-
ING Bank Germany	57	0.1	0.1	-	-	-	-	-	-
Domestic	**35,640**	**49.1**	**33.3**	**7,546**	**7,466**	**5,993**	**6.8**	**6.4**	**5.0**
Held by residents, total	35,360	48.8	32.0	-	-	-	-	-	-
Held by non-residents, total	280	0.4	0.3	-	-	-	-	-	-
T-Bills	6,434	8.9	5.8	-	-	-	-	-	-
Bonds	28,657	39.5	25.9	-	-	-	-	-	-
Loans	544	0.7	0.5	-	-	-	-	-	-
Memo items:									
Collateralized debt	0	0.0	0.0	-	-	-	-	-	-
o/w: Related	0	0.0	0.0	-	-	-	-	-	-
o/w: Unrelated	0	0.0	0.0	-	-	-	-	-	-
Contingent liabilities	1,429	2.0	1.3	-	-	-	-	-	-
o/w: Public guarantees [2]	1,429	2.0	1.3	-	-	-	-	-	-
o/w: Other explicit contingent liabilities [3, 4]	n.a.	n.a.	n.a.	-	-	-	-	-	-
Nominal GDP (at average Ksh/$ rate)	110,519	-	-	-	-	-	-	-	-

Sources: Kenyan authorities; and IMF staff calculations.

[1] As reported by Country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as in

[2] Loan guarantees are included in the perimeter of debt covered by the DSA.

[3] Includes other-one off guarantees not included in publicly guaranteed debt (e.g. credit lines) and other explicit contingent liabilities not elsewhere classified (e.g. potential legal claims, payments resulting from PPP arrangements).

[4] Capacity constraints limit data availability on other explicit liabilities not elsewhere classified. Data is expected to become available at the time of the next review of the IMF EFF/ECF arrangements.

Table 10. Kenya: Decomposition of Public Debt, 2021–24[1]

	Actual	Projections		
	2021	2022	2023	2024
	(In US$ mln)	*(In US$ mln)*		
Creditor profile				
Total	**72,522**	**75,170**	**78,208**	**81,392**
External	**36,882**	**38,372**	**40,174**	**42,100**
Multilateral creditors	15,750	17,545	19,038	20,147
IMF	1,833	2,444	3,017	3,235
World Bank	10,226	10,007	9,757	9,492
African Development Bank	3,199	3,233	3,178	3,111
Other Multilaterals	493	447	401	355
Bilateral Creditors	11,337	11,213	11,658	12,901
Paris Club	4,117	4,195	4,554	5,331
Non-Paris Club	7,220	7,017	7,104	7,570
Private creditors	9,795	9,614	9,479	9,186
Bonds	7,100	7,100	7,100	7,100
Commercial creditors	2,695	2,514	2,379	2,086
Domestic	**35,640**	**36,799**	**38,034**	**39,292**
Memorandum items [2]				
Collateralized debt	0.0	0.0	0.0	0.0
o/w: Related	0.0	0.0	0.0	0.0
o/w: Unrelated	0.0	0.0	0.0	0.0
Nominal GDP (at average Ksh/$ rate)	110,519	117,068	120,322	127,770
Multilateral and collateralized debt				
Multilateral debt				
Percent of external debt	42.7	45.7	47.4	47.9
Percent of GDP	14.3	15.0	15.8	15.8
o/w: IMF and WB				
Percent of external debt	32.7	32.4	31.8	30.2
Percent of GDP	10.9	10.6	10.6	10.0
o/w: African Development Bank				
Percent of external debt	8.7	8.4	7.9	7.4
Percent of GDP	2.9	2.8	2.6	2.4
o/w: Other multilateral				
Percent of external debt	1.3	1.2	1.0	0.8
Percent of GDP	0.4	0.4	0.3	0.3
Collateralized debt				
Percent of external debt	0.0	0.0	0.0	0.0
Percent of GDP	0.0	0.0	0.0	0.0

Sources: Kenyan authorities and IMF staff calculations.

[1]As reported by country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as in the DSA.

[2] Capacity constraints limit data availability. Data is expected to become available at time of the next review of the IMF EFF/ECF arrangements.

Appendix I. Letter of Intent

Nairobi, Kenya, December 7, 2022

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
700 19th St, NW
Washington, DC 20431

Dear Ms. Georgieva:

The Kenyan economy has demonstrated remarkable resilience in the face of global shocks—first the COVID-19 pandemic then negative spillovers from the war in Ukraine and tighter global financial market conditions. Notwithstanding these headwinds, Kenya's policy framework and underlying strengths have meant that the economy has continued to register robust growth.

Our new government remains fully committed to the IMF-supported program. The administration intends to continue bolstering economic resilience by pursuing prudent macroeconomic policies geared at reducing debt vulnerabilities and supporting sustainable and inclusive development. The good performance of government revenue has enabled a purposeful and progressive approach to tackling the challenges arising from recent shocks, such as the unanticipated rise in global oil, food, and fertilizer prices, and the higher costs of external commercial financing. Our policy framework has helped maintain stability and fostered economic growth.

The economy grew 6 percent y/y in the first half of 2022 despite a continuing drought that negatively impacted agricultural output and food security. Peaceful resolution of election-related uncertainty has supported the business environment. However, a global slowdown in growth, tighter external financing conditions, a historically strong U.S. dollar, and volatile global commodity prices, have created a challenging backdrop for Kenya's economic policy making. Ensuring progress toward our development objectives places demands on many areas at a time when Kenya continues to be exposed to the effects of climate change and security risks. We remain focused on securing inclusive growth for the long term.

Against this backdrop, Kenya met all the program's quantitative targets as of end-June 2022 but faced delays in implementation of the structural reform agenda amid elections and political uncertainty. We have started publishing information on beneficial owners of successful bidders of new procurements that are reported into the Public Procurement Information Portal (PPIP) since mid-November 2022. Given the changed environment, including a shortfall in external commercial financing in 2022, we request modification of the end-December 2022 and end-June 2023 quantitative performance criteria (QPCs) on the floors on the net international reserves and end-June 2023 QPCs on floors on primary fiscal balance and tax revenues (Table 1). We also request the end-July 2022 SBs (KPLC action plan and review of fuel pricing mechanism) to be reset for end-

December 2022 due to implementation delays. Further, we request setting of new SBs on: submission of FY2022/23 supplemental budget and FY2023/24 budget, both consistent with the program's objectives and targets; special audit on the mechanism, efficiency and effectiveness of the supplementary budgeting, including under Article 223 of the Constitution; and strengthening AML/CFT supervision to support anti-corruption efforts (Table 2). The shortfall in external commercial financing in 2022 has exacerbated fiscal financing and balance of payments pressures. As a result, we request an augmentation of access under the ECF arrangement by 30 percent of quota (SDR162.84 million) to be made available upon completion of the 4th EFF/ECF reviews to support international reserves at the CBK with the corresponding local currency amount made available as budget support.

We consider that our policies described in the attached Memorandum of Economic and Financial Policies are adequate to achieve the program objectives. We remain committed to a multi-year fiscal consolidation, supported by higher revenues and expenditure rationalization, to put the ratio of overall public to GDP on a downward trajectory. With inflation remaining above the target band, our monetary policy actions will remain focused on maintaining price stability by resisting second-round effects from higher food and fuel prices to other prices and keeping inflationary expectations well anchored. Exchange rate flexibility has worked as shock absorber in the face of variety of external shocks and will continue to do so to help support our competitiveness, protect reserves, and facilitate efficient functioning of our domestic foreign exchange market. We will ensure that these policies are mutually reinforcing in support of maintaining macroeconomic stability and resilience, ensuring fiscal and debt sustainability, and enhancing buffers against external shocks.

We stand ready to take additional measures should they be needed to meet the objectives of the program, and we will consult with the IMF in advance of any necessary revisions to the policies contained in this letter and attached memorandum, in line with Fund policies on such matters. We will provide Fund staff all the data and information needed to assess the performance of the policies, particularly those mentioned in the Technical Memorandum of Understanding.

We authorize the publication of this Letter of Intent, the attached Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding, and the related staff report and supplements, after approval by the Executive Board of the IMF.

Sincerely yours,

/s/

Prof. Njuguna Ndung'u
Cabinet Secretary
National Treasury & Planning

/s/

Dr. Patrick Njoroge
Governor
Central Bank of Kenya

Attachments (2):

I. Memorandum of Economic and Financial Policies (MEFP)
II. Technical Memorandum of Understanding (TMU)

Memorandum of Economic and Financial Policies

Nairobi, Kenya, December 7, 2022

I. BACKGROUND

1. **The Kenyan economy has demonstrated considerable resilience amid elevated uncertainties arising from a confluence of external and domestic shocks.** A global growth slowdown dislocated external financing conditions for frontier markets, the sharp appreciation of the U.S. dollar against global currencies, higher commodity prices on the back of war in Ukraine, and elevated global uncertainties have created a challenging environment. Domestic challenges were manifested in a continued drought, which has impacted food security for vulnerable groups in the impacted areas of the country as well as agriculture and food prices. In addition, domestic activity was affected by the under-execution of government spending in FY2021/22.

2. **The economy continued to expand rapidly, albeit at a slower pace than the 7.5 percent recorded in 2021.** Real GDP grew by 6 percent y/y in the first half of 2022. Growth was supported by the ongoing recovery in the services sector, driven by hospitality, trade, transport, and finance. Moreover, mining expanded on the back of elevated global commodity prices. At the same time, low rainfall and worsening drought conditions in parts of the country led to a reduction in agricultural output and rising food insecurity in the Arid and Semi-Arid Lands (ASALs). High frequency indicators point to continued resilience of the economy in 2022Q3, despite increased global risks and the general elections in August. An orderly political transition alongside robust expansion in credit to the private sector, continued strength in diaspora remittances, and further recovery in tourism-related sectors is expected to strengthen economic activity in 2022Q4.

3. **Headline inflation has remained above the target range of 2.5–7.5 percent since June 2022.** Consumer prices increased from 5.4 percent y/y in January to 9.5 percent y/y in November. The increase in inflation was driven by higher food prices resulting from reduced agricultural production, global supply chain constraints, and higher prices of imports. Higher global oil prices also had a significant impact. In September, subsidies for petrol were eliminated while those for diesel and kerosene were substantially reduced. At the same, variable electricity charges for fuel and other cost components were reinstated. However, non-food/non-fuel inflation has remained modest, albeit rising from 2 percent in January to 3.8 percent in October.

4. **Global shocks are expected to widen the current account deficit from 5.2 percent of GDP in 2021 to 5.7 percent of GDP in 2022.** Higher international prices of commodities with relatively inelastic demand—such as oil derivatives, cereals, and fertilizers—resulted in higher import bills. This was partially offset by strong growth in tourism receipts (on track to reach pre-pandemic levels this year), continued robust growth of remittances, and higher prices for Kenya's main agricultural exports (tea, horticulture, and coffee). Foreign exchange reserves have declined but remain adequate.

5. The fiscal deficit was sharply reduced on cash basis. Measured from the financing side, the deficit in FY2021/22 declined to 5.8 percent of GDP against a programed target of 7.8 percent of GDP. The reduction in the deficit was supported by strong tax revenue performance, which increased to 13.7 percent of GDP from 12.6 percent of GDP in FY2020/21. In addition, spending was lower than budgeted, due to a combination of tight controls and reduced availability of financing. The planned EUR 1 billion (around US$1.1 billion) Eurobond issuance did not take place and external project financing and net domestic financing were over US$700 million and Ksh.50 billion below budgeted amounts, respectively.

6. The narrower fiscal deficit resulted in a better-than-expected outturn for public debt. At Ksh.8.6 trillion (68.1 percent of GDP), the stock of public and publicly guaranteed debt at end-June 2022 was Ksh.444 billion lower than programed. At the same time, in part due to the lack of funds, there was a net accumulation of pending bills of Ksh.36.7 billion at Ministries, Departments and Agencies (MDAs), Ksh.57 billion at Counties, and Ksh.71.1 billion at Semi-Autonomous Government Agencies (SAGAs) and State Corporations (SCs)—a total of Ksh.164.8 billion. This increase in pending bills adds to financing needs in FY2022/23.

7. The banking sector has remained stable and resilient. Core and total capital adequacy ratios as of end-September 2022 were 16.2 and 19.0 percent, respectively—above the statutory minimum of 10.5 and 14.5 percent, respectively. At the same date, the liquidity ratio stood at 51.6 percent, well above the statutory minimum of 20 percent. Credit to the private sector has maintained double-digit growth since March 2022, for the first time since the removal of the 2016–19 interest rate cap.

II. MACROECONOMIC OUTLOOK

8. The outlook remains positive, despite the challenging global economic landscape.

- We expect real GDP to grow by 5.3 percent in 2022, even as higher input prices and unfavorable weather conditions continue to weigh on economic activity. In 2023, we expect overall growth to slow down to 5.1 percent on the back of a global slowdown, monetary policy tightening, and drag from continued fiscal consolidation. However, agricultural sector is expected to recover on the basis of a forecast of normal rainfall in 2023 with normalization in tourism and continued strong diaspora remittances providing additional support.
- Inflation is projected to peak in the coming months on gradual downward movement in food inflation, base effects from higher fuel prices, and lagged impact of recent monetary policy actions. We expect inflation to remain outside the target band in the coming months. Recovery in agriculture will support a deceleration in food inflation during 2023, supporting a move inside the band.
- The 2022 current account deficit in percent of GDP is expected to be smaller than previously projected, driven by a narrower trade deficit. In 2023, the current account balance is projected to improve on easing energy imports and continued robust receipts from tourism and remittances.

- Over the medium term, growth is expected to converge toward 5.5 percent, inflation to return to the mid-point of the target band, and the current account deficit to about 5 percent of GDP.

9. **The economic environment is subject to unusually high uncertainty.** The Kenyan economy, via its large agricultural sector and its integration with the global economy and financial markets, is vulnerable to weather and climate conditions and exposed to global shocks. Continuation of unfavorable rainfall and higher global commodity prices (especially fuel and food) could worsen existing food insecurity, slow growth, and push inflation higher. New disruptive COVID-19 waves, globally or locally, could undermine Kenya's recovery and increase fiscal and external pressures. An extended period of investor concerns about frontier economies or lack of confidence in Kenya's fiscal path could exacerbate fiscal financing and balance of payments pressures and depress reserve coverage. On the positive side, if the current unsettled conditions in global capital markets normalize, market access could quickly rebound and the cost of financing decrease. Better-than-expected rainfall would boost agricultural recovery, lower food inflation, and reduce fiscal pressures related to emergency needs.

III. PROGRAM PERFORMANCE AND POLICIES

A. Program Objectives

10. **Our primary policy objective is to maintain robust and inclusive growth.** Our economic policy plans—supported by our EFF/ECF arrangements with the IMF—place a special focus on (i) promoting sound macroeconomic management through prudent debt policies and reforms to improve the efficiency of public spending and support competitiveness, and (ii) fostering good governance in the public resource management. Our key policy priorities include:

- ***Fiscal policy.*** Undertake growth-friendly fiscal consolidation to preserve debt sustainability by bolstering revenue primarily through broadening of the tax base and curtailing overall spending while prioritizing high-impact social and investment expenditure.
- ***COVID-19 response.*** Vaccinate all adults, ensure provision of required health services, address urgent needs of vulnerable groups, and support economic activity.
- ***Public financial management.*** Decisively increase the efficiency and transparency of public spending, including by SOEs, to eliminate waste and achieve better value for money.
- ***Governance.*** Enhance institutional oversight arrangements, strengthen preventive frameworks to improve accountability and foster good governance, and boost transparency.
- ***Monetary policy.*** Continue with proactive approach to achieve Kenya's inflation objective in the face of persistent global shocks while strengthening the monetary policy framework by refining policy operations to keep short-term interest rates stable and close to the policy rate, and supporting vibrant interbank markets.

- ***Access to affordable finance.*** Transform the banking sector to one that works "*for and with Kenyans*" and is anchored on pillars of customer centricity, risk-based credit pricing, transparency, and ethical banking.
- ***Financial stability.*** Safeguard financial stability by enhancing prudential regulation and supervision and strengthening operational tools in the context of increasing financial sector complexity.
- ***Structural reforms.*** Deepen structural reforms to improve the business environment and boost investment, employment creation, and potential growth.
- ***Statistics.*** Improve data quality in line with international best practices to support economic policymaking, transparency, and accountability.

B. Program Performance

11. Quantitative targets were met but structural reforms faced delays amid elections and political uncertainty ahead of inauguration of the new president.

- *Quantitative performance criteria (QPCs, Table 1):* All end-June 2022 and continuous QPCs were met. Notably, tax collection and the primary balance overperformed by 0.8 and 1.9 percentage points of GDP, respectively. The NIR overperformed the adjusted target by US$418 million.
- *Indicative targets (ITs, Table 1):* End-June 2022 targets on priority social expenditure overperformed by 0.2 percent of GDP while no outstanding exchequer requests outstanding for more than 90 days were accumulated.
- *Monetary policy consultation clause (MPCC, Table 1):* The MPCC was met with the three-month average of inflation (7.2 percent) within the target band as of end-June 2022.
- *Structural benchmarks (SBs, Table2):* Only one of the three benchmarks for July-August was met amid political uncertainty, while delayed SBs did not advance.
    - A draft action plan to restore Kenya Power and Lighting Company (KPLC) medium-term profitability ***(end-July 2022 SB)*** was prepared but internal consultations on some key proposals could not take place prior to elections. The National Treasury (NT) awaits guidance from the new administration.
    - A circular with action plan for the development of a Medium-Term Revenue Strategy (MTRS) was issued on August 30 ***(end-August 2022 SB)***.
    - The review of the fuel pricing mechanism and establishment of a task force to oversee progressive elimination of the fuel subsidy within the first half of FY2022/23 ***(end-July 2022 SB)*** lagged on lack of political direction.
    - Publications of beneficial ownership information of entities awarded public contracts ***(end-June 2021 SB)*** commenced from November 2022.
    - Publication of audits of COVID-19 vaccine spending ***(end-May 2022 SB)*** were completed with a delay by July 2021 and reports for all 47 counties have now been published.

C. Fiscal Policy

12. Our fiscal policy path balances the near-term need to support the economy in face of recent shocks against the imperative of reducing debt vulnerabilities over the medium term. We remain focused on meeting the needs of the population even as we face new global challenges and ongoing drought. Our policies cater to these needs while recognizing the difficult tradeoffs demanded by Kenya's limited fiscal space. Response efforts have therefore been carefully prioritized to limit further buildups in public debt. As the COVID-19 pandemic receded, the focus of fiscal policy has shifted to reducing the level of the deficit with a view to put the debt-to-GDP ratio on a downward path within the timeframe of the program. This will help lower financing risks and facilitate an expansion of credit to the private sector, thus supporting economic growth. The fiscal consolidation path will be supported by revenue mobilization anchored on the MTRS that we are developing (¶19).

13. Spending pressures have been intensifying in FY2022/23 (Text Table 1). Due to the tight liquidity conditions in late FY2021/22, we have to honor Ksh.89 billion of expenditures that were authorized in the previous fiscal year but undisbursed. Besides the carryover from FY2021/22, we found ourselves confronted with additional spending pressures for Ksh.190 billion stemming from expenditures emerged between July and mid-September 2022, including Ksh.26 billion approved under Article 223 of the constitution. Remaining pressures (Ksh.130 billion) are mainly related to the July and August pause in fuel price adjustments, the July's temporary introduction of a maize flour subsidy, unavoidable drought emergency interventions, and the launch of new initiatives from our administration, including plans to support agricultural production by subsidizing fertilizer. Furthermore, we want to promote financial inclusion by establishing a Financial Inclusion Fund (also known as "Hustler Fund", ¶43).

Text Table 1. Kenya: Total Spending Pressures in FY2022/23

Items	Ksh. millions	in % of GDP
Total Additional Spending	**279,264**	**1.9**
Carryover from FY2021/22	88,660	0.6
Approvals granted under Article 223	61,016	0.4
o/w subsidies (fuel, maize, fertilizer through September 2022)	*26,091*	*0.2*
Other spending needs	129,587	0.9
o/w subsidies (fuel, maize, fertilizer)	*63,366*	*0.4*
o/w drought and security	*18,195*	*0.1*
o/w Financial Inclusion Fund and Pension	*20,000*	*0.1*
Source: National Treasury.		

14. We intend to address these pressures in the context of a Supplementary FY2022/23 Budget. The supplementary budget will target an overall balance of 5.8 percent of GDP compared to an outturn of 6.2 percent of GDP in FY2021/22. This significant reduction will reflect both

improved prospects to mobilize revenues and our intention to reprioritize expenditures, while protecting social spending and recognizing existing liquidity constraints due to the persistence of unfavorable market conditions. On the revenue side, we expect tax collection to reach Ksh.2,035 billion at end-June against a program target of Ksh.2,024 billion, supported by robust indirect and custom taxes on account of the pass-through of higher international prices and the somewhat weaker-than-originally anticipated shilling. On the spending side, we will contain expenditures at Ksh.3,386 billion by partly offsetting existing pressures (Ksh.290 billion) through cuts on non-priority recurrent spending (e.g., domestic and foreign travels, training expenses, hospitality expenses) for Ksh.48.6 billion and an ambitious plan of rationalization of non-priority projects for Ksh.181.6 billion. Financing will be met with a mix of domestic issuance of liquid benchmark bonds across all maturities, and concessional and commercial external financing (¶27). Discussions are underway on up-scaling of the FY2022/23 World Bank DPO, with any additional resources channeled toward replacing more expensive sources of financing. We are also actively exploring market-based debt liability management operations to reduce rollover risks stemming from maturing external commercial debts. The rationalization of projects mainly reflects the recognition of slow absorption of ongoing projects. We will submit the supplementary budget proposal to parliament for approval by end-January 2023.

15. For FY2023/24 we are targeting a fiscal deficit of 4.4 percent of GDP, a 1.4 percentage point reduction from this year's expected outturn. Total revenue and grants are projected to reach 17.8 percent of GDP supported by the introduction of a comprehensive tax package of 0.9 percent of GDP, which will broaden the tax base, especially of indirect taxes, in line with the overarching revenue objectives state by President Ruto in his inaugural speech and our work in the context of our MTRS). Total expenditure is projected to decline by 1.2 percent of GDP reflecting continued efforts to tighten expenditure controls and offset budgetary outlays for SOEs. We will by end-April 2023 submit to Parliament a budget for FY2023/24 that is consistent with our 0.3 percent of GDP primary balance surplus target **(*structural benchmark*)**.

16. Going forward, we remain committed to the program path for fiscal consolidation over the medium term, with a view to reducing debt vulnerabilities. A key priority will be to raise the ratio of revenue to GDP to well above pre-COVID levels to create space for growth-enhancing investments and priority social spending. To achieve this, we plan to introduce additional tax policy measures to yield 0.2 percent of GDP in FY2024/25. We will also continue progressively reduce recurrent expenditure as a ratio to GDP, by containing growth in the wage bill and transfers to counties and public companies, while enhancing development spending close to 5 percent of GDP.

17. We seek to move away from our fixed, nominal public debt ceiling and introduce a credible anchor based on the present value of the debt-to-GDP ratio to crystalize our policy intention of reducing debt and maintaining debt sustainability (¶26). The new framework will anchor expectations for debt reduction under the EFF/ECF arrangement. The new framework will strengthen the credibility of the government's strategy to reduce debt vulnerabilities by enhancing transparency and accountability around the envisaged path to reach the medium-term anchor.

18. Uncertainties associated with global shocks entail high risks to our fiscal program and reinforce the need for contingency planning. The uncertainty is particularly pronounced for government revenues, as rapid changes in the macroeconomic context, including from further ramifications of the war in Ukraine, could depress tax receipts. To ensure that program performance objectives are met, any revenue shortfall relative to program targets for FY2022/23 will be compensated for by taking additional revenue measures, drawing from the work done in the context of the MTRS with the support of the IMF. We also stand ready to further curtail non-critical spending, if this should become necessary, to offset further spending pressures. The recently established Fiscal Risk Committee will help monitoring and assess fiscal risks, including related to contingency liabilities from the PPPs sector (¶28). The National Treasury, with the support of the Technical Assistance from the IMF, is in the process of operationalizing a Fiscal Risk Committee (FRC), which is expected to hold its inaugural meeting before 31st December 2022. To this end, a Fiscal Risk Working Group has been formed with officers from relevant directorates and departments within the National Treasury. Following a technical workshop facilitated by the IMF in October 2022, the working group populated the initial tentative fiscal risk register, developed the fiscal risk sections in briefs and summary memo, prepared the terms of reference for the institutional units, and developed the accompanying calendar to guide the operations of the FRC.

D. Fiscal Structural Reforms

19. We will continue to reform our tax system to strengthen revenue collection building on the work to develop our MTRS. Past increases in tax incentives made our tax system less efficient and fair, resulting in an erosion of the tax base. The development of the MTRS will help us reverse these trends and strengthen tax compliance to achieve our objective of increasing revenue mobilization by 8 percentage points of GDP by 2030, while support global competitiveness and prosperity consistent with Kenya's Vision 2030. After having developed a time-bound action plan for the development of the MTRS ***(end-August 2022 SB)***, we plan to prepare an initial draft of our MRTS in consultation with our development partners by end-February 2023. Following consultation with stakeholders, we intend to submit for approval the draft of the MTRS to Cabinet by August 2023.

20. Revenue administration reforms at the Kenya Revenue Authority (KRA)—aimed at improving compliance and taxpayer services – will continue to play a major role in our fiscal strategy. Key objectives include:

- **Developing and implementing risk-based compliance strategies.** Compliance risk management capacity has improved significantly over recent years and now include data-driven approaches. To further strengthen this capacity, we will restructure our Compliance Risk Management Committee by end-June 2023 with a view to enhance compliance levels in core taxpayer obligation areas (registration, filing, and correct reporting and payment).
- **Strengthening KRA's audit function.** Several actions will be taken to rebuild audit capacity, including to refresh and upgrade staff skills (by end-April 2023), strengthen feedback loops between the disputes and audit areas (by end-June 2023), and initiate process changes and

capability enhancements to improve quality and establish mechanisms for assessing the impact of the audit function on compliance (by end-June 2023).

- **Strengthening data analytics to support compliance risk management (CRM).** In an effort to enhance the role of data in developing approaches to improve taxpayer compliance, we are taking steps to develop a credible and reliable taxpayer register and ledger accounts (by end-March 2023) and implement a data management strategy to better access and utilize current and new data (by end-June 2023).
- **Managing exemptions.** Building on our efforts to improve VAT compliance, we intend to broaden VAT exemption verification at customs to new areas, including those administered under the East African Community Customs Management Act, by end-June 2023.
- **Improving taxpayer service to support voluntary compliance.** We will endeavor to improve the use of data science in developing effective and timely services and compliance interventions, while leveraging stakeholders' engagement in the design and delivery of taxpayer services.

21. We are working diligently to strengthen our public procurement system. We are in the process of acquiring an e-procurement system that will be incorporated in our Integrated Financial Management Information System (IFMIS) to automate application of the Procurement Act and regulations. Due to delays in mobilizing the needed resources, we intend to pilot the new system by July 2023 and to fully roll it out across Government Ministries, Departments, and Agencies (MDAs) by end-December 2023, providing the necessary training with support from the World Bank.

22. We expect significant savings from controlling the government wage bill. We continue pursuing our objective of reducing the ratio of the government wage bill to GDP by 0.6 percentage points between FY2020/21 and FY2023/24 with a view to free much-needed resources for priority social and development spending. To this end, we implemented a wage freeze for FY2021/22 and FY2022/23, and we have maintained our policy of limiting new employment to priority areas. Further actions planned in relation to controlling the wage bill include:

- **Harmonize and rationalize the categories, rates, and rules for allowances.** Consistent with the Salaries and Remuneration Commission (SRC) objectives of containing allowances to no more than 40 percent of gross pay overtime, the SRC has implemented changes to the remuneration of state officers and plans to intervene on cross-cutting, institution specific allowances and embedded in Collective Bargaining Agreements ones.
- **We will implement a common payroll system linked to IFMIS across all National Government ministries and departments as well as all counties (MDCs) by end-December 2022.** Building on the results of pilots for eleven MDCs, we plan to expand our Unified Human Resource (UHR) system—which currently consolidates Human Resource and Payroll data in the Public Service using three modules (Payroll Administration, Leave Management and Pensions Claim)—with four additional modules, including *establishment control*; *training and development*; *Emeriti Identification*: and *third-party deduction management*. We intend to have the UHR system fully rolled out across MDCs by October

2023. State agencies and corporations that currently use standalone systems will need more time to transit to the unified payroll system. We intend in due course to extend the coverage of the new UHR system to all Commissions, State Corporations, Public Universities, and Agencies.

- **Ensuring that Collective Bargaining Agreements consider available resources.**

23. We continue improving Public Investment Management (PIM) to deliver value for money in public capital expenditure. To this end, we are:

- *Rationalizing the pipeline of existing projects.* A Cabinet decision to commence a thorough review of 437 stalled or underperforming projects has been made, whereby a task force is to be appointed to carry out an analysis to identify specific projects to be rationalized. A multi-agency task force to undertake a physical audit and verification exercise of the affected projects is expected to be in place by end-December 2022.
- *Developing a Public Investment Management Information System (PIMIS)* to automate Public Investments (projects) as per the PIM Regulations. The National Treasury is in the process of issuing a circular to the MDAs to start using the PIMIS by end-December 2022.
- *Implementing new PIM regulations.* PIM regulations have been developed and expected to be in place by January 2023. These regulations are expected to be rolled out to national government entities and the Counties as a prerequisite to the roll-out of PIM manuals, which we plan to implement by end-July 2023.

24. Public Financial Management (PFM). We intend to strengthen expenditure control and improve the efficiency and effectiveness of public spending by pursuing the following milestones:

- By end-December 2022, develop draft IFMIS regulations to enforce use of the system for all procurements to ensure that all commitments are captured in IFMIS.
- By end-January 2023, complete the rollout of automated cash flow plans and automated exchequer releases for MDAs (previously expected by January 2022) to enable all exchequer requests to be processed online through IFMIS.
- By end-March 2023, enhance IFMIS to enable generation of purchase orders to ensure that all multi-year commitments are captured in IFMIS. Compared to original plans, this milestone has been postponed by three months due to delays in securing a contractor.
- By end-December 2023, ensure that all MDA budget proposals for FY2024/25 have been prepared using a common costing approach based on the Hyperion system—which is being improved to develop costing tools for vendors. This was previously envisaged to be in place for FY2023/24. The new date accommodates training of system users. We finalized the Budget Manual (including costing guidelines), which will be validated by end-December 2022.
- By end-June 2023, complete a review of the number of extra-budgetary units with a view to consolidating them and, where appropriate, bring them within the perimeter of the budgetary central government.

25. After some delays, we are taking decisive steps to ensure elimination of fuel subsidies. Consistent with the new administration's priorities and program commitments, we are reviewing the functioning of our fuel pricing mechanism with a view to draw lessons on its implementation. Moreover, we will establish a taskforce—comprising members from National Treasury, Ministry of Energy and Petroleum and EPRA—to ensure that fuel pricing actions are at all times aligned to the approved budget ***(rephased to end-December 2022 SB***).

26. Implementation of the FY2022/23 medium-term debt management strategy (MTDS) will strengthen public debt management. Key components of this strategy are:

- **Reducing refinancing risks.** The ratio of Treasury bonds to Treasury bills rose from 79:21 in June 2021 to 85:15 in June 2022, despite the shift in demand from longer dated T-bonds to T-bills observed since the second quarter of 2022. The average time to maturity of outstanding Treasury bonds increased from 7.7 years in June 2020 to 9.1 years in June 2022, and currently stands at 8.9 years. Going forward, the FY2022/23 MTDS aims at increasing the share of domestic borrowing on a flow basis to 32 percent of net financing through June 2025, subject to favorable market conditions. In addition, we will continue to pursue lengthening of the maturity profile of public debt, with issuance of liquid benchmark domestic government bonds across all maturities and are actively exploring market-based commercial debt options to reduce rollover risks stemming from maturing external commercial debts.
- **Primary reliance on concessional external financing.** We will continue our efforts to increase the utilization of committed external concessional financing. The planned US$1.1 billion external commercial financing for FY2021/22 did not take place amid unfavorable market conditions, reflecting the global risk-off attitude toward frontier issuers. In light of the protracted dislocations in international financial markets, we plan to raise the US$900 million external commercial borrowing planned for FY2022/23 from international banks. We have successfully contracted one third of this amount and are in the process of reviewing offers for the remainder.
- **Strengthening the legal framework for PFM:**
  - By end-March 2023, we plan to resubmit to Parliament legislative amendments to harmonize the definition of public debt and replace the existing nominal debt limit with a debt anchor centered on two pillars:[1] (i) a medium-term debt anchor set at 55 percent of GDP with debt measured in present value terms; and (ii) an accountability requirement that mandates transparent communication to Parliament and the public on plans and progress towards achieving the debt anchor within a specific timeframe.
  - By end-June 2023, we will issue PFM regulations and a delegation contract for PDMO to make operational the framework for debt management envisioned in the PFM Act. This will help clarify responsibilities relating to debt management and enhance transparency. To this end, a taskforce comprising experts from the Attorney General's Office, the CBK,

[1] A proposal to amend the PFM Act and Regulations accordingly was submitted in the previous Parliament; but was subsequently withdrawn to allow further consultation. As an interim measure, the existing nominal debt ceiling was increased from Ksh.9 trillion to Ksh.10 trillion to enable full financing of the FY2022/23 budget.

and the National Treasury has been constituted to review the current situation and make a proposal to strengthen institutional arrangements for public debt management. The taskforce is expected to present its recommendations on the operational framework for debt management to the Cabinet Secretary of the National Treasury and Planning by end-March 2023.

- **We have broadened the reporting of State-owned entities' non-guaranteed debts** (excluding debt to government which is already captured in existing metrics) from the 18 entities out of a total of around 260—considered to pose the highest fiscal risk—included in the FY2020/21 Public Debt Management Report (PDMR) to 26 in the FY2021/22 PDMR. Going forward, we plan to automate data collection from all State-owned entities by linking to existing electronic reporting systems.

- **Reforms to deepen the domestic debt securities market:**
    - We have strengthened the auction management process by implementing the Treasury Mobile Direct platform for retail sale of government securities, and enabled auction of bids by banks through internet banking. Additionally, we have lengthened the maturity of government debt securities, strengthened the bond benchmark building program and enhanced transparency through publication of auction rules and guidelines. We will further enhance the market infrastructure through automation of processes via the deployment of a new Central Securities Depository System (CSD) in 2023Q1. The new market infrastructure will accommodate alternative investment opportunities for the retail sector. The new CSD will also enable the launch of an active horizontal repo market, which would drive increased market liquidity.
    - We will undertake all necessary steps to ensure efficient operation of the Government Securities market to support liquidity along the entire yield curve, including by enhancing outreach to market participants.

27. Public Private Partnerships (PPPs). We remain fully committed to carefully evaluate cost and risks associated to PPPs. To this end, the PPP Directorate (PPPD) is expanding its staff with a view to strengthen its analytical capacities by attracting critical talent in project origination and structuring, safeguards and legal support. To ensure that only projects with the highest socio-economic returns are undertaken, the National Treasury is in the process of creating and institutionalizing a joint PIM planning framework by end-March 2023. This will streamline the decision-making process of determining whether projects should be procured through the traditional on-budget public procurement method or through the PPP framework.

28. The PPPD will continue strengthen its reporting on risks. To this end, a quantification and likelihood of fiscal risks associated to PPPs, informed by the Fiscal Commitments and Contingency Liability (FCCL) framework, will be included in the Fiscal Risk Register and discussed within the Fiscal Risk Committee. We will also share the risk profile of the portfolio and expected pipeline of projects with the PPP Committee at different stages of the project cycle. In addition, we started to report on the status of PPP projects in our Annual Report to Parliament in September 2022.

29. Pension reform. To ensure the sustainability of our pension system, we have introduced on January 2021 a funded pension scheme for public sector workers, the Public Service Superannuation Scheme (PSSS). We are also enhancing efficiency by re-engineering and digitizing our pension management system. Due to delays in the bidding process, we now expect to bring our reengineering project to the testing stage by June 2023 and to have the system complete by end-December 2023.

E. State-Owned Enterprises

30. Extraordinary support to SOEs were lower than the budgeted amount. The FY2021/22 supplemental budget provided for Ksh.32.3 billion (0.3 percent of GDP) for this purpose but the actual disbursements were at Ksh.17.5 billion (0.14 percent of GDP). Lower-than-anticipated support to Kenya Airways (KQ) was the primary driver of the shortfall relative to the budgeted amount, while no support was provided to Kenya Wildlife Services (budgeted Ksh.2 billion) and Kenya Airports Authorities (budgeted Ksh.1 billion), both on improved revenues from a turnaround in activities. KPLC received Ksh.9.05 billion allocated under the Supplementary Budget II, up from Ksh.7.05 billion in the originally approved budget. At the same time, the government did not implement its plan for compensating, albeit partially, KPLC for the rural electrification scheme in FY2021/22. The flexibility built into program conditionality has catered to the exigencies at key SOEs, while ensuring that they do not threaten our program deficit objectives. In line with program commitments and with a view to respect the fiscal path envisaged under the program, we identified spending offsets of Ksh.7.4 billion (0.06 percent of GDP, equivalent to one-half of the shortfall in extraordinary support to SOEs in FY2021/22). These offsets were achieved by reducing recurrent spending and further rationalizing the portfolio of non-priority projects, with a significant portion realized from the latter.

31. The SOE sector will continue to require extraordinary support. In FY2022/23, such supports are related to needs at KQ and KPLC. The FY2022/23 supplementary budget has proposed a provision for Ksh.37.3 billion (0.3 percent of GDP), a decline of Ksh.8.7 billion compared to the originally budgeted amount. KPLC would receive Ksh.2.35 billion in financial support to address part of the liquidity gap that had been generated by the January 2022 electricity tariff reduction. The balance will be allocated to KQ including assumed payments for debt service that will be supported by the government for guaranteed and unguaranteed debt, subject to agreements with the creditors. Of the Ksh.20.0 billion budgetary allocation for KQ in FY2022/2023, Ksh.10.0 billion was disbursed in September 2022. Thus, cumulative extraordinary support to SOEs in FY2021/22 and FY2022/23 is projected at Ksh.54.8 billion (0.4 percent of FY2021/22 GDP), below the 1.0 percent of GDP threshold agreed under the program (TMU ¶7). Absent the realization of such extraordinary SOE spending in FY2022/23, we remain committed to target a more ambitious primary balance for an amount equal to half of the under execution in such support (program adjustor).

32. We continue to make progress in assessing, monitoring, and addressing vulnerabilities in the SOE sector, in line with our staged approach. Our financial evaluations had earlier identified a cumulative Ksh.383 billion liquidity gap over a period of five years for 18 SOEs involving the largest financial and fiscal risks (excluding Kenya Airways). This gap is expected to be primarily

covered via SOEs' cost saving measures, which were partially materialized and reflected FY2021/22 financial results. However, the rise in global fuel prices since early 2022 has complicated and challenged some of the measures planned. Kenya Airways (KQ) and Kenya Power and Lightning Company (KPLC) are the two companies posing the largest fiscal risks. We plan to address fiscal risks in these two companies as below.

33. Our spending priorities continue to be challenged by supporting SOEs, KQ in particular, and we are determined to decisively meet those challenges. To contain the impact of such interventions on debt dynamics, in FY2021/22 we introduced and will extend to FY2022/23 budgetary offsets for 50 percent of extraordinary support to SOEs, including KQ, in line with program commitments and the flexibility built into program conditionality. After FY2022/23, such offsets will be set at 100 percent of the extraordinary support. We remain committed to address related fiscal space tradeoffs with a view to limiting the impact on the budget and protecting priority social spending.

Kenya Airways PLC

34. Commercial performance paired with initiatives under the restructuring plan have already had a positive impact on KQ's solvency issues. KQ recorded an operating loss of Ksh.5 billion for the first six months of 2022, a 31.5 percent reduction in operating losses as of end-2021. In the absence of the higher fuel prices observed during this period, KQ would have recorded an operating profit. Currently, KQ is able to cover its operational costs (less financing and legacy costs) buoyed by the recovery in post-COVID-19 volumes. Notwithstanding the recent improvements in some of the financial indicators, KQ still has the highest cost base among all airlines in the Sub-Saharan Africa region and a negative equity position.

35. As of November 17, 2022, the total value of KQ's debt portfolio was US$835 million. This includes all debts, loans, letters of credit facilities, and convertible equity amounts. Of this amount, US$688 million is guaranteed by Government of Kenya (GoK). As of end-October 2022, payables amounted to approximately Ksh.44 billion out of which Ksh.24 billion is overdue. These creditors include aircraft lessors, operation, and maintenance costs, landing and rental fees, fuel cost, rent, navigation, handling charges, taxes amongst others.

36. The detailed restructuring action plan prepared in May 2022, is under implementation. The initiatives under restructuring plan include:

- *Network optimization.* The strategy recommended the review of loss-making network routes, requiring KQ to rationalize twelve loss-making routes. Network optimization is concluded and sixteen destinations across the world have been retired.
- *Operating leases negotiation.* The strategy recommended a reduction in fleet size, and termination of some leases for aircrafts, including the repurposing of select aircrafts to freighters to support cargo business. Negotiations with operating lessors will result in a modest reduction in annual lease costs. Some of these negotiations reached in-principle agreements in 2022Q3, following which KQ begun the process of settling past due amounts

and completion of payments, supported by a GoK disbursement of Ksh.10 billion in October 2022.

- *Staff rationalization.* The strategy anticipated the right sizing of staff to match the revised network, increase productivity, while rationalizing staff costs particularly amongst pilots to match industry standards. Other than organizational redesign actions, substantive reductions on staff costs have yet to be implemented.
- *Collective Bargaining Agreements.* Several clauses in the Collective Bargaining Agreements (CBA) have been onerous to KQ pilots and have led to low productivity. Minimal progress reported. Initiation of CBA reviews has not been affected.
- *Cost management.* The strategy anticipated significant cost reduction aspects as relates to operations and maintenance, distribution costs, ticketing, procurement, fuel etc. Target cost reduction was set at US$120 million per annum by 2024, rising gradually from US$73 million in FY2021/22 to US$93 million in FY2022/23 and further to US$120 million from FY2023/24. In FY2021/22, KQ managed to meet 75 percent of the targeted saving**.**
- *GoK support.* GoK will continue to support KQ financially in FY2022/23 to facilitate normalization of overdue payments to prevent defaults (see above) for settlement of operating lessors' arrears and completion of payments, as well as other working capital support. A lower disbursement from GoK in FY2021/22 limited realized gains from negotiations of aircraft leases.
- *Ancillary business lines and strategic partnerships.* KQ was to grow ancillary and cargo business lines including drone technology deployment, seat related ancillaries, maintenance services and strategic partnership pursuits. KQ has reported a growth of 20 percent across all business lines. KQ has also concluded a strategic partnership framework with South African Airlines (SAA).

37. Novation of the GoK guaranteed debt is under way, but not yet completed. Under the action plan, KQ will novate US$485 million (GoK guaranteed) loans to GoK to facilitate better management of risks and avoid any call up of the guarantee. The guarantees are already part of the GoK debt stock and, not likely to cause significant impact, other than an increase in the annual payment obligations from the Consolidated Funds Services (estimated at Ksh.10 billion per year). As part of the ongoing discussions, GoK has settled outstanding debt service arrears on the guaranteed loan as of end-September 2022 and additional amounts through end-June 2023 on debt service payments on the guaranteed amount have been included in the Supplementary Budget. All payments paid on behalf of KQ are deemed shareholder loans and shareholder agreements with an agreed term sheets that are being prepared.

38. To ensure the KQ restructuring strategy is carried out with the least cost to the Exchequer we will implement safeguards that will track and monitor the process. KQ and GoK continue to act resolutely to minimize cash burn while the restructuring process takes place. The following steps were being taken to monitor the progress of the initiatives under the current plan:

- *Loan agreements*. With the completion and adoption of the restructuring action plan in June 2022, we prepared a loan agreement (for shareholder loans) with clear key performance indicators (KPIs), timelines, reporting obligations and disbursement plan as conditions for providing financial support. The signing of loan agreements was delayed due to the political transition and is now expected to occur before end-December 2022.
- *Accountability mechanism*. To ensure the diligent implementation of the action plan, an accountability mechanism is being discussed to ensure the restructuring plan is followed by KQ Board. A tracker is under development to monitor key actions and milestones in the restructuring process (e.g., trimming the network; rationalizing frequencies and the fleet; and addressing the high-cost structure, including the salary/wage bill with a clear measuring system). Milestones have been included in the KPIs applying to KQ's CEO and other senior executives.
- *Progress review and reporting*. Progress under the action plan will be reviewed quarterly by NT, and the reports by NT will be sent to the Cabinet.

Kenya Power and Lighting Company PLC (KPLC)

39. KPLC's latest results for FY2021/22 point to improving financial stability, despite the history of deteriorating financial performance.

- KPLC had a negative working capital position of Ksh.47.8 billion at end-June 2022, an improvement from Ksh.69 billion in June 2021. The outstanding trade payables were down as the company paid down some of its overdue bills and invoices. For the same period the company eliminated (paid down) all bank overdraft accounts. The updated 2022 financial evaluation reveals some success in reducing operating costs in FY2021/22, yet, large sums remain outstanding on payables (liabilities) and receivables (assets), including from GoK for the rural electrification scheme. Despite the improvements, the company's ability to meet its current liabilities with its current assets is substantially below par, resulting in an estimated liquidity gap of Ksh.69 billion (0.5 percent of GDP, down from 1 percent in 2021).
- The January tariff cut has had a significant negative impact on the company's liquidity position, resulting in annual loss in revenue of Ksh.26.3 billion. The tariff cut is set to expire at the end of December 2022, and if implemented, KPLC's liquidity situation will drastically improve, to a point where GoK support may no longer be necessary.
- The implementation of strict cost cutting measures is critical to lower the fiscal risks and ensure company's future sustainability. The cost cutting measures include Power Purchase Agreement (PPA) renegotiations with independent power producers (IPP) recommended by the Presidential taskforce on KPLC in October 2021. Following the recommendations of the taskforce a PPA Renegotiation Committee has been formed and initiated discussion with the IPPs. Due to a long duration of the renegotiation the benefit of the outcomes is not included in financial projections for KPLC.
- For the half-yearly period ending in June 2022, the liquidity gap was covered by government's support of Ksh.7.05 billion. Going forward, thanks to cost-saving measures the

necessary government support will be lower at Ksh.2.35 billion in FY2022/23. KPLC's working capital will remain in deficit in the medium term, which needs to be further addressed by specific cost saving measures as part of a turnaround strategy. Considering the company's strategic role in the economy and linkages to other players in the sector, the associated fiscal risks are substantial. Thus, a comprehensive approach in addressing KPLC's weaknesses is needed including clearance of GoK obligations to KPLC.

40. Considering the fiscal risks posed by KPLC, by end-December 2022 *(rephased SB)*, we will submit to the relevant Cabinet Sub-Committee an action plan to restore KPLC's medium-term profitability and cover fully any financing gaps (pre-existing and new) through end-2023. This plan will be jointly prepared by National Treasury and the Ministry of Energy and informed by the findings of the Presidential Taskforce report and the updated KPLC's 2022 financial evaluations. It will identify steps that KPLC will take to improve operational efficiency and realize targeted cost saving by implementing a turnaround strategy that is premised on meeting customer needs, increasing power sales and revenue collection, improvement of cashflow management, reduction of operational costs, reduction of system losses, and restructuring of expensive commercial debt. KPLC will re-engineer its business process, focusing on delivery of services to its customers through automated billing, metering, and payments. It is also expected that KPLC will reduce system losses, resulting from both technical and commercial factors, to be within the medium-term loss benchmark of 15 percent approved by the regulator. Further, KPLC organization structure and staffing levels should be fit for purpose with suitable skills and performance-based management culture to increase staff productivity and reduction of operational costs. Reforms will be undertaken in procurement and stock management to optimize the use of available resources and reduce wastage.

SOE Governance Arrangements

41. We will continue to introduce further governance arrangements that enhance management and oversight of SOEs. Current economic pressures such as inflation and high fuel prices have compounded pre-existing structural weaknesses in the SOE sector. The overlapping mandates, poor financial performance, and weak governance, further contribute to sector's inefficiencies. To remedy this situation, a Strategy on SOE reforms has been developed that lays out steps geared towards enhancing financial and operational efficiency and cost savings and strengthening oversight.

- We have prioritized the development of Government Investment Management Information System (GIMIS) that will facilitate reporting by state corporations (SCs) on their full set of unguaranteed, guaranteed, and on-lent loans; and develop a framework to monitor the evolution of individual SC loans, capturing new disbursements, repayments, and outstanding amounts of disbursed loans. The loans module is envisaged to be completed by December 2022.
- With technical support from the IMF, we intend to develop User Requirements for the analytical module (Financial Evaluation and Risk Analysis) by end-January 2023. This system will be accessible by relevant oversight entities, including line ministries, National Treasury,

and SCAC. This will facilitate the identification, quantification, monitoring, reporting, and management of fiscal risks stemming from SCs, including guarantees and contingent liabilities.

- By December 2022, we will review organizational arrangements within NT for financial oversight of SCs and ensure that the role and functions for Government investments as a core function of the NT are fully provided for in the legislative framework.

42. While rationalization of the SCs portfolio will be prioritized going forward, we remain committed to strengthening SCs' governance and oversight. We will revise our ongoing strategy (Blueprint) to align it with the new policy priorities, with the aim of efficiently integrating and sequencing reform measures considering the broader SCs sector reform agenda. A draft Ownership Policy for SCs, describing a new governance architecture and legal ecosystem to enable enhanced performance and transparency, had been developed by NT and SCAC, with Fund and WB advise. The draft was prepared for consultations with line ministries, other external stakeholders and the public that were expected to take place in June 2022 but were delayed due to the political transition. Consultations will be promptly reactivated, and a new draft will be submitted to Cabinet by end-June 2023. Moreover, with Fund TA, we will begin work on the legal reforms necessary to anchor the new ownership arrangements, corporate governance requirements and other measures outlined in the Blueprint. In addition, due to the transition, we are committed to deliver the agreed reform actions on new dates as follows:

- Approval by Cabinet and publication of an updated inventory and a new classification of SCs that will apply across government will occur by end-March 2023.
- Building on the now operational GIMIS interface, that allows SCs to upload their information, by end-November 2022, we will establish a system through which all SCs' audited financial statements and annual reports will be made public via NT's website and ensure continuous disclosure thereof.
- We have published at the beginning of November 2022, SCs performance evaluation report for FY2020/21[2] and will continue annual publications thereafter. The information was already published by the Ministry of Public Service.
- By end-June 2023, we will integrate and disclose a register of "specially permitted procurement procedures" as mandated by Section 107(3) of the Public Procurement and Asset Disposal Regulations.

F. New Initiatives

43. Consistent with the Kenya Vision 2030, we are working to transform Kenya to an industrialized middle-income economy by boosting inclusive and sustainable development. To this end, we are developing a number of new initiatives, including:

[2] https://www.treasury.go.ke/state-corporations/

- **The Financial Inclusion Fund.** This initiative aims at developing bottom-of-the-pyramid, affordable financial products to promote financial inclusion and savings for the vast majority of Kenyans who remain financially insecure and vulnerable to predatory lending through the institution of an informal sector pension scheme. The government will match one shilling for every two shillings of contribution to the pension scheme up to a maximum of Ksh3,000 per year. The Fund is expected to be launched in December 2022.
- **National Social Security Fund Reform.** Consistent with the objectives of the 2013 Social Security Act, the reform will raise the minimum contribution from the current Ksh.200 per employee and employer to a ratio of 6 percent of gross salary.
- **Affordable Housing.** Targeted interventions include increasing the supply of new housing and the share of affordable housing in total housing supply by offering low-cost mortgages and structuring affordable long-term housing finance schemes—including a National Housing Fund and Cooperative Social Housing Schemes.
- **Privatization of SOEs:** The government will overhaul the Privatization Act by June 2023 with view to establishing a simplified framework to facilitate a faster privatization process, while ensuring transparency and accountability. A list of SOEs to be privatized will be identified based on financial and legal due diligence.

G. Monetary Policy

44. Policy objectives. Our primary policy objectives remain to: (i) maintain headline inflation within our target range (5±2.5 percent); (ii) maintain a flexible exchange rate regime, with market interventions only in response to excess exchange rate volatility; and (iii) further improve the monetary policy framework. A monetary policy consultation clause (MPCC) with a 5 percent ±2.5 percent band helps monitor inflation performance, with a consultation with the IMF Executive Board to be triggered if inflation falls outside the band (TMU, ¶25).

45. Our monetary policy stance remains consistent with the overall objective of maintaining price stability by bringing inflation within the target band. Inflation has remained outside our target band since June 2022, mainly driven by food and fuel prices. Specifically, fuel inflation surged to 12.6 percent in October following the gradual withdrawal of the fuel and electricity subsidy from September. Food inflation increased to 15.8 percent in October due to dry weather conditions and global food price developments. Non-food, non-fuel inflation has remained below 4 percent consistent with muted demand pressures in the economy. We proactively tightened monetary policy in May 2022 by increasing the Central Bank Rate (CBR) by 50 basis points. Due to sustained inflationary pressures, elevated global risks and their potential impact on the domestic economy, we tightened monetary policy by increasing the CBR by additional 75 basis points in September 2022 and another 50 basis points in November 2022. Noting that the headline inflation is driven by supply side factors, we remain committed to mitigating the second-round effects and ensuring inflation expectations are well anchored. In this context, we are committed to adjust the monetary policy stance as needed to achieve this objective. In addition to our inflation objectives,

we will ensure that the monetary policy stance is consistent with maintenance of external sustainability and achieving our FX reserves goals.

46. We will maintain a flexible, market-driven exchange rate system to act as an absorber of external shocks. Since the pandemic, the exchange rate has helped absorb the external shocks and preserve our competitiveness. The bilateral Shilling per U.S. dollar exchange rate has weakened further by 8.2 percent in the first eleven months of 2022, but with lower volatility than seen in 2021. The volatility in global financial markets has surged amid significant U.S. dollar strength against major currencies, and rapid changes in policy stance in advanced economies in response to inflationary pressures. In addition, FX demands domestically went up on higher global prices for key imported products (food, fuel, and fertilizers). Together, these developments have significantly impacted liquidity in the domestic FX market. In particular, the interbank FX market transactions have declined, limiting price action in that market. A robust interbank FX market is important to facilitate efficient allocation of resources. To address the challenges of pricing and liquidity, we will issue additional guidelines to support the smooth, fair and efficient functioning of the foreign exchange market. The guidelines will be aligned to best practices adopted in leading jurisdictions and incorporate relevant elements of the FX Global Code. The Code is a set of global principles of good practice developed and adopted in leading jurisdictions to provide a common set of guidelines to promote the integrity and effective functioning of the wholesale foreign exchange market. The leading principles include practices on Execution, Governance, and Risk Management and Compliance which foster a robust, fair, open, liquid and appropriately transparent market. These measures, supported by mutually consistent monetary, exchange rate, and fiscal policies, are essential to maintain competitiveness, revitalize the interbank FX market, protect FX reserves, and ensure continued financial stability. Any FX interventions by the CBK will be limited to responding to excessive market volatility.

47. We have continued to push ahead with our monetary policy reform agenda. The removal of interest rate caps in late 2019, which had hindered monetary policy effectiveness, was a welcome development and opened the way for further progress in strengthening our monetary policy framework. To this end, we published in July 2021 a white paper on *"Modernization of the Monetary Policy Framework and Operations"* outlining reforms to strengthen the monetary policy framework. The reforms are ongoing and focus on:

- Refining macroeconomic modeling and forecasting frameworks. CBK has continued to strengthen the forecasting framework and information content of MPC surveys in line with the recommendations of the IMF AFRITAC East FPAS scoping mission. In August 2022, CBK hosted another IMF AFRITAC East mission on Kenya's FPAS, mainly focusing on refinement of the Quarterly Projection Model (QPM) and its infrastructure to enhance the FPAS output within the context of a forward-looking policy environment. The CBK has also continued to enhance the coverage of MPC surveys and has introduced other surveys including the Agriculture Survey to enrich the information content that guides monetary policy decisions. We will continue to review the analytical tools, including the strengthening of the forecast processes.

- Implementation of measures to improve the functioning of the interbank market including the rollout of a Centralized Securities Depository System (CSD) by March 2023.
- Improving communication of monetary policy decisions to make them more effective.

H. Financial Sector

48. Policy objectives. Safeguarding financial stability and expanding access to affordable finance remain our key priorities. We will continue to take steps to improve prudential regulation and supervision, with a view to addressing the increased sophistication of the financial sector. Our objective is to promote sustainability and resilience of the Kenyan financial sector along four pillars: customer centricity; risk-based credit pricing; transparency; and ethical practices. This will enhance the financial sector's capacity to provide affordable financial services to all Kenyans.

49. The banking sector remains stable and resilient. Helped by our proactive policies, credit to the private sector expanded at a broadly steady pace throughout the pandemic and has continued to accelerate with the economic recovery. The ratio of gross non-performing loans (NPLs) to gross loans has decreased to 13.7 percent in September 2022 from 14.1 percent in December 2020, due to progress with recoveries, write-offs and a pickup in credit growth. The outstanding restructured loans amount to about 10 percent of gross loans with about 90 percent of the restructured loans performing as per the restructured terms.

50. We will continue to stress preservation of capital and liquidity buffers, and closely monitor FX exposures, to strengthen the resilience of the financial system. We are cognizant of the heterogeneity of the impact of the pandemic on different categories of banks. Correspondingly, we remain committed to enhanced surveillance while encouraging banks to strengthen their governance frameworks and business models, embark on mergers and acquisitions, and other capital strengthening efforts. We will continue the monitoring of FX loans, deposits, and liabilities in the banking system with a view to identifying any potential liquidity risks and strengthening resilience and contingency policies should these risks materialize.

51. We assess that the financial sector measures we put in place to mitigate the adverse impact of COVID-19 have been effective. The interventions, most of which expired by March 2021, focused mainly on provision of regulatory flexibility, loan restructuring and adjustments in fees charged on mobile money transactions.[3] The temporary suspension of the sharing of negative credit information by credit facilities and the waiver on fees on low value mobile money transactions have expired, but the expansion of the maximum limit on e-wallet and transactions remains. We continue to closely monitor the performance of the outstanding restructured loans and their impact on banks' earnings and capital buffers. All banks publicly disclosed their audited 2021 financial statements, including their capital adequacy ratios in March 2022, which showed the banking sector is well capitalized and there is no imminent systemic risk in the sector.

[3] For details of these policies, see the MEFP of the Third Reviews Under EFF/ECF Arrangements (Country Report No. 2022/232).

52. A new credit guarantee scheme (CGS) was established to expand access to affordable credit to MSMEs. In the CGS, risks are shared on a 50:50 *pari-pasu* basis; subject to a maximum guaranteed exposure, of which 25 percent of the principal amount. It is intended to facilitate better financing terms to Kenyan MSMEs and incentivize the extension of credit to them. Total loans extended to MSMEs under the CGS have topped Ksh.4 billion as of September 2022 since the start of the program in December 2020.

53. Going forward, we intend to maintain the reform momentum towards realizing our vision outlined in the CBK's Banking Sector Charter. The banking sector remains on track towards realizing the vision outlined in the CBK's Banking Sector Charter of a banking sector that works for and with Kenyans. Our reform agenda remains on track, including:

- **Banking Sector Resilience.** The need to build resilience and exploit emerging opportunities has led to increased consolidations and combinations among several players. Additionally, Kenyan banks have continued to expand regionally through acquisitions, including in the Democratic Republic of Congo, Rwanda, and Tanzania. The CBK will continue with the focus of building a resilient banking sector with strong business models and governance frameworks that will support Kenya's post-pandemic recovery.
- **Moving towards real-time supervision.** We are implementing a centralized Electronic Data Warehouse (EDW) launched in February 2022, that will merge various information sets provided by banks and other regulated institutions to the CBK. Through Application Program Interfaces (APIs), we shall connect the EDW directly to banks to enable us to access supervisory data on a near real-time basis. This will significantly enhance the proactiveness of our offsite surveillance systems and provide a laser focus for our onsite bank inspections. We are working with selected pilot banks as we move towards integrating the EDW with banks. In March 2022, we completed the EDW Onboarding Portal for Digital Credit Providers that will fully automate their licensing process.
- **Review of the Microfinance Act.** To accommodate considerable changes that have been experienced in the Microfinance industry over the years, a Microfinance Bill was approved by the Cabinet in November 2021 and forwarded to the National Assembly for consideration.
- **Licensing of Kenya Mortgage Refinance Company.** On September 18, 2020, the CBK licensed the Kenya Mortgage Refinance Company PLC (KMRC) as the first mortgage refinance company in Kenya. KMRC's principal objective is to provide long-term finance to primary mortgage lenders (commercial banks, mortgage finance companies, microfinance banks and Savings and Credit Co-operatives) to increase the availability and affordability of mortgage loans to the public. KMRC issued a corporate bond of Ksh.1.4 billion in February 2022 to provide a sustainable source of funding for mortgage refinancing to complement the existing credit lines.
- **The Central Bank of Kenya (Amendment) Act, 2021 on Digital Credit Providers (DCPs).** The Central Bank of Kenya (Amendment) Act, 2021, which became effective on December 23, 2021, empowered CBK to license, regulate and supervise digital credit providers (DCPs) to ensure a fair and non-discriminatory marketplace for access to credit. Subsequently, the CBK

Digital Credit Providers Regulations, 2022, were issued and operationalized on March 18, 2022. Accordingly, unregulated DCPs were required to apply for a license from the CBK by September 17, 2022, or cease their operations. As of the latter date, 10 DCPs had been granted licenses.

- **Greening Kenya's Banking Sector.** We issued Guidance on Climate-Related Risk Management to the banking sector, on October 15, 2021. The Guidance was aimed at enabling banks to integrate climate-related risks into their governance, strategy, risk management and disclosure frameworks. It is also intended to enable banks leverage on business opportunities from efforts to mitigate and adapt to climate change. These include the adoption of low emission energy sources, development of new products and services, access to new markets, housing, and resilient infrastructure. The CBK will work with banks to build capacity and integrate climate-related risk management in their day-to-day operations. Capacity building workshops for banks' and CBK staff in risk management and compliance were conducted between February and March 2022. Subsequently, all banks submitted to CBK at end June 2022, their board approved Climate-Related Risk Management Implementation Plans. Banks will submit quarterly progress reports to CBK from end September 2022.This initiative will attract global funds that are looking for opportunities to finance initiatives that build climate resilience, and thus positioning Kenya as a premier green finance hub.

54. We launched the National Payments Strategy, 2022-2025, in February 2022. It seeks to consolidate the gains we have made so far while illuminating the path to a new chapter in Kenya's payment system journey. Further, it aims to realize a vision of a secure, fast, efficient, and collaborative payments system that supports financial inclusion and innovations that benefit Kenyans. The vision will be anchored on core principles of trust, security, usefulness, choice, and innovation.

55. Given global developments that have led to the emergence of new payment methods, including private and public digital currencies, we issued a Discussion Paper on Central Bank Digital Currency (CBDC) in February 2022. The *Paper* seeks to assess the potential applicability of a CBDC in Kenya, highlighting the risks and opportunities. Given the wide-ranging implications of CBDC to the wider economy, any eventual decision to introduce a CBDC would involve the government, regulators, the private sector, and, most importantly, the public. We sought comments from the public on the *Paper* by May 20, 2022. Over 100 submissions were received from Kenya, the broader African continent, Asia, Europe, and North America. The submissions are being analyzed to inform the next steps.

56. We have taken steps to intensify AML/CFT risk-based supervision for banks. We have established a dedicated AML/CFT supervision team under the CBK's supervisory function. We have adopted relevant off-site supervision tools to inform our AML/CFT risk-based supervision for banks and developed the banks' onsite inspection plan for the period of November 2022 to June 2023 based on the identified AML/CFT risks. We are currently enhancing the efficiency of the supervision tools through automation process and updating the banking AML/CFT supervision manual, to be

completed by June 2023. Within the past one year, we had also conducted targeted onsite inspections on AML/CFT for some banks. Appropriate actions have been taken for non-compliances with CBK AML/CFT guidelines and the Proceeds of Crime and Anti-Laundering Act (POCAMLA). Kenya has recently completed its mutual evaluation process by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), with the 2022 Kenya Mutual Evaluation Report issued in November 2022. We will continue to implement measures to enhance the effectiveness of our AML/CFT supervision in line with FATF recommendations.

I. Governance

57. Full and effective implementation of the access to information framework will be prioritized as a pillar for enhanced transparency and accountability. The Access to Information Regulations have gone through the required public consultations process, were finalized with inputs from all relevant government stakeholders and will be gazetted by end-December 2022. Moving forward, we will be vigilant in ensuring that MDA's, SCs, and Counties are taking effective actions towards comprehensive operationalization in this area. In this regard, we will develop with an initial focus on strategic areas like debt, budget, tax expenditures, PPPs and procurement: (i) a methodology to monitor implementation progress at the national and county levels; and (ii) information standards to guide proactive provision of information and processing information requests. In addition, we will focus on developing Standards for the Digitization and Automation of Records and work with county governments to advance legislative actions needed to give full force and effect to the access to information framework.

58. We are taking steps to enhance transparency of beneficial ownership in public procurement. With the issuance of the revised standard tender documents in April 2022, winning bidders are now required to submit beneficial ownership information as a pre-condition to signing of the respective procurement contract. Circular No. 05/2022 was issued on October 27, 2022, requiring all procuring entities to enter beneficial ownership information into the Public Procurement Information Portal (PPIP). To implement this circular, we have enhanced the PPIP to include mandatory fields to capture beneficial ownership information, enabling procuring entities to submit the information electronically. We will publish on the PPIP full names; national identity card number or passport number; postal address; and percentage of voting rights a person holds in the company, of beneficial owners of winning/successful bidders of procurements that were issued from April 21, 2022 onward and reported by procuring entities, and thereafter, by the 15th day of the subsequent month of signing the contract. Starting the publication with names, at a minimum, of the beneficial owners of awarded contracts is a ***prior action*** under the fourth reviews of the Fund-supported program. By end-June 2023, and every six months thereafter, we will publish a report on compliance with the publication of beneficial ownership information by the ten largest spenders in each sector.

59. We will prioritize continuous enhancement of our monitoring and data analysis capabilities of procurement-related information, including identification of red flags and corruption-related trends and risks. This will be supported by the development of a central

repository of data on public procurement, mandated under the Public Procurement and Asset Disposal Act, 2015 (section 9-1-m), and facilitated by the planned rollout of e-procurement and its integration with the PPIP and other government databases, such as IFMIS (¶22). In addition, the PPRA will coordinate with and provide continuous training to procuring entities, law enforcement agencies and other relevant stakeholders, to facilitate data sharing and develop functionalities tailored to their specific information and analysis needs, including generation of relevant reports.

60. Convinced that ensuring timely action to address audit findings and recommendations is a critical element in the state's accountability framework, we will take steps to enhance follow up and implementation of the Auditor-General's audit findings and recommendations, including from the completed audits of COVID-19 spending. The efficacy of these audits' rests largely on sound legal frameworks, efficient institutional arrangements and robust transparency requirements geared towards effective implementation of audit recommendations. To that end, we will explore measures to (i) promote greater coordination and collaboration among state institutions involved in the overall audit and accountability cycle, including law enforcement agencies (ii) strengthen follow up and implementation systems and consolidate monitoring capabilities and structures, including integrating them with social accountability and participatory frameworks, and (iii) enhance public reporting in this area, including publishing a summary of NT's Internal Auditor-General Department's annual reports. In addition, we will enhance coordination during the Parliamentary review process of audit reports in order to strengthen follow up and implementation of Parliamentary recommendations.

61. We have finalized the review process to align our asset declarations and conflict of interest legal framework with international standards and best practices. A draft Conflict of Interest Bill will be approved by Cabinet and submitted to Parliament by end-December 2022. The reform will, among others: (i) consolidate the wealth declarations and interest declarations of public officials into one uniform disclosure regime; (ii) rationalize the responsibility of analyzing and verifying the disclosures and imposing adequate sanctions for false declarations or failure to declare in a single agency; and (iii) enhance the role, responsibilities and capability of enforcement agencies to investigate, prosecute and sanction perpetrators of illicit enrichment and other corruption offenses. Going forward, we will work to achieve full automation of asset declarations for all public officials. A pilot program was put in place for EACC officials, and we plan to begin rollout in other institutions in FY2022/23.

62. We are also making progress in strengthening the Judiciary's capacities to efficiently adjudicate corruption-related criminal cases. In October 2022, 127 principal magistrates with mixed jurisdiction were appointed to oversee corruption and economic crimes cases at the lower level to address backlog, and appropriate training is now a top priority. Delays in court cases are being addressed through the applicable Court Users Committee and Bar Bench and, while we are still experiencing considerable shortages in digital equipment and infrastructure, we have been working towards putting in place video conference and filming capabilities in courtrooms.

63. We will provide proper accountability and transparency on the supplementary budget spending by the various MDAs with a view to ensure greater consistency between

expenditure plans and outcomes for the year. We further commit to facilitate the Auditor-General with the necessary support and access to all the relevant records for the requisitions (demand) and disbursements (supply) to conduct a special audit on the mechanism, efficiency and effectiveness of the supplementary budgeting, including under Article 223 of the Constitution, to establish trends and potential risks. The report will be published by end-September 2023 **(*new SB*)**.

64. We are taking steps to enhance our AML/CFT tools to support the fight against corruption through the following measures:

- **Strengthening the AML/CFT legal framework in line with FATF standards to support anti-corruption efforts.** The FRC will take necessary steps to address strategic deficiencies in Kenya's AML/CFT legal framework, as identified in the Kenya Mutual Evaluation Report 2022 to ensure compliance with the FATF standards. To that end, FRC will prepare draft amendments to the Proceeds of Crime and Anti-Money Laundering Act, 2009 (POCAMLA) and the Proceeds of Crime and Anti-Money Laundering Regulations, 2013 (POCAMLR) for submission to the National Treasury and Economic Planning for onward transmission to the State Law Office. We will submit to the National Assembly draft amendments to the POCAMLA and POCAMLR to be in line with FATF standards addressing the legal and regulatory gaps identified in the Kenya Mutual Evaluation Report 2022 to support anti-corruption efforts. **(end-June 2023 *new SB*).**
- **Enhancing beneficial ownership transparency of companies and other legal persons.** Kenya Business Registration Services (BRS) is taking steps to ensure all existing companies submit their beneficial ownership information to the electronic register by making the submission a pre-requisite to access BRS' online services. We are targeting full compliance and are putting in place measures under the Act and administratively to promote this. We are addressing remaining gaps in the legal framework on transparency of legal persons to bring it in line with FATF standards. Draft amendments have been prepared relating to (i) the Limited Liability Partnership Act requiring partnerships to comply with beneficial ownership requirements; and (ii) the Companies Act requiring nominee shareholders and directors to disclose their nominators. The amendments have undergone public participation and are being finalized for onward transmission to the Attorney General by end-March 2023. To strengthen implementation of AML/CFT measures by reporting institutions, amendments to the Beneficial Ownership Regulations to provide for a mechanism for access by reporting institutions have also been prepared and are being finalized for onward transmission to the Attorney General by end-March 2023.
- **Implementing identified actions to address corruption vulnerabilities following findings of the 2021 National Risk Assessment (NRA) that corruption is amongst the top three proceeds generating predicate offence.** The FRC, as Kenya's financial intelligence unit, continued to provide its expertise through the Multi-Agency Taskforce on anti-corruption and prioritized financial intelligence analysis and dissemination relating to corruption, with 30 percent of intelligence dissemination to law enforcement agencies related to corruption in the past 12 months. Cognizant of the banking sector's significant role in the economy and associated AML/CFT risks identified in the NRA, CBK is taking steps

to enhance the effectiveness of its AML/CFT supervision by conducting inspections based on the onsite plan, with the objective of strengthening banks' compliance with AML/CFT requirements, including on customer due diligence, beneficial ownership, and monitoring and reporting of transactions in accordance with POCAMLA. Following the completion of the 2021 NRA, the national Action Plan on AML/CFT has been developed and shared with all competent authorities for implementation. FRC, as the national coordinator of the NRA, will coordinate the monitoring and evaluation of the implementation of the action items identified in the Action Plan. FRC will provide periodic updates on the status of implementation of the NRA Action Plan through the FRC's annual reports.

J. Data Quality

65. Policy objectives. We view the production and dissemination of high-quality economic statistics as the foundation for evidence-based decision making for good policy formulation, monitoring and evaluation. To this end, we will continue to improve on the availability, quality, coverage, and timeliness of our statistics.

66. Data coverage, quality, and timeliness. We have enhanced macroeconomic statistics with a range of new statistical censuses and sample surveys, including the Integrated Survey of Services, Study of Trade Margins, Study of Underground Economy, Study of Informal Transportation, Micro, Small and Medium Enterprises Survey, Survey of Non-Profit Institutions, and the 2020 Census of Commercial Farms and Green Houses. Work on improvement of IIP data is also in progress. In September 2021, we released national accounts statistics updated to a base period of 2016. We shall also resolve delays in achieving Government Finance Statistics (GFS) milestones by strengthening the coordination of the interdepartmental committee on GFS. These actions are expected to lead to the reporting of (i) general government fiscal outturns on a quarterly basis by February 2023; (ii) annual fiscal data of the public corporations' sector (including financial and non-financial corporations) by February 2023; and (iii) migration of the fiscal framework to GFSM 2014 based concepts, starting with the QEBR for second quarter of FY2022/23. These actions will improve transparency and ensure that all stakeholders have easy and reliable access to information.

K. Program Monitoring

67. The program will continue to be monitored based on periodic performance criteria, continuous performance criteria, Monetary Policy Consultation Clause, and indicative targets as set out in Table 1. Structural benchmarks set out in Table 2 will be used for monitoring progress on structural reforms. Detailed definitions and reporting requirements for all performance criteria are contained in the Technical Memorandum of Understanding (TMU) attached to this memorandum, which also defines the scope and frequency of data to be reported for program monitoring purposes. During the program period, the government will not introduce or intensify restrictions on payments and transfers for current international transactions or introduce or modify any multiple currency practice without the IMF's prior approval, conclude bilateral payments agreements that are incompatible with Article VIII of the IMF's Articles of Agreement, or introduce or intensify import

restrictions for balance of payments reasons. The fifth, sixth, and seventh reviews of the program will take place on or after May 7, 2023; November 7, 2023; and May 7, 2024, respectively.

68. We request that the IMF Executive Board approve some modifications to program targets and augmentation of access under the ECF arrangement. We request revisions to the end-December 2022 and end-June 2023 QPCs on the floors on the net international reserves and end-June 2023 QPCs on floors on primary fiscal balance and tax revenues (Table 2). We also request that the end-July 2022 SBs (KPLC action plan and review of fuel pricing mechanism) that have not been implemented yet be reset for end-December 2022, and will request setting of new SBs on: submissions of FY2022/23 supplemental budget and FY2023/24 budget, both consistent with the program's objectives and targets; special audit on the mechanism, efficiency and effectiveness of the supplementary budgeting—including under Article 223 of the Constitution; and strengthening AML/CFT supervision to support anti-corruption efforts (Table 2). Finally, we request an augmentation of access under the ECF arrangement by 30 percent of quota (SDR162.84 million) to be made available upon completion of the 4th reviews to support international reserves at the CBK with the corresponding local currency amount made available as budget support.

Table 1. Kenya: Quantitative Performance Criteria and Indicative Targets, 2022–23

(In billions of Kenyan Shillings, unless otherwise indicated)

	2022						2023		
	End Jun.				End Dec.		End Jun.		End Dec.
	3rd Rev.	Adjusted	Outturn	Status	3rd Rev.	Proposed	3rd Rev.	Proposed	Proposed
Quantitative performance criteria									
Fiscal targets									
Primary budget balance of the national government (- = deficit; floor)[1]	-428.0	-421.2	-170.2	met	-110.2	-110.2	-174.8	-158.0	63.9
Tax revenue (floor)[1, 2]	1,667.3	...	1,770.2	met	862.3	862.3	2,024	2,035	1,058
Monetary targets									
Stock of central bank net international reserves (floor, in millions of US$)[3]	7,168	5,877	6,295	met	5,494	4,984	5,477	4,393	3,270
Public debt targets									
Public and publicly-guaranteed external debt arrears (ceiling)[4,5]	0	...	0	met	0	0	0	0	0
New domestic guarantees granted by the central government (ceiling)[1]	5	...	0	met	5	5	5	5	5
PV of contracting or guaranteeing of new external debt (ceiling, millions of US$)[6]	8,846	3,846	810	met	9,905	9,905	11,630	11,766	13,340
Indicative targets									
Priority social expenditures of the national government (floor)[1]	397	...	432	met	205	205	421	421	211
Change in the stock of national government exchequer requests outstanding for 90 days or more (ceiling)[1]	0	...	0	met	0	0	0	0	0
Monetary policy consultation clause									
Upper band (annual, percentage points)	7.5	...			7.5	7.5	7.5	7.5	7.5
Center inflation target (annual, percentage points)[7]	5.0	...	7.2	met	5.0	5.0	5.0	5.0	5.0
Lower band (annual, percentage points)	2.5	...			2.5	2.5	2.5	2.5	2.5
Memorandum items for adjustors									
Programmed amount of new debt issuance for PV-reducing, debt management operations	5,000	...	0	...	5,000	5,000	5,000	5,000	5,000
Memorandum items (other)									
Nominal value of contracting or guaranteeing of new external debt under new PV ceiling (in millions of US$)[8]	12,635	7,635	3,161	...	14,521	14,521	16,814	16,963	19,474

Note: For program performance prior to the June 2022 test date, please see IMF Country Report No. 2022/232.

[1] Targets are cumulative flows from July 1, 2021 to June 30, 2022, from July 1, 2022 to June 30, 2023, and from July 1, 2023 to June 30, 2024; except for national government exchequer requests outstanding for 90 days or more that are cumulative from July 1, 2020.

[2] For the purpose of the program, the floor excludes taxes related to "Ministerial appropriation in aid" (i.e., RML, RDL, PDL), "Taxes on international trade and transactions (IDF fee)," "Capital gains," and "Other taxes on goods and services."

[3] For program monitoring, calculated as end of period. Excludes encumbered reserves.

[4] Continuous.

[5] Syndicated loans, amounting to EUR305.4 million claimed by a syndicate of Italian commercial banks in relation to Arror, Kimwarer, and Itare dams projects, are disputed and subject to on-going arbitration/court proceeding.

[6] Cumulative since June 30, 2021. The PV limit on the contracting or guaranteeing of new external debt would be adjusted downward by the full amount of: (1) any shortfall between the actual and programmed issuance of debt for use in DMOs (as specified as a memorandum item above), and (2) the issuance of any debts for use in DMOs that do not result in a reduction of the present value (present value savings) of the overall public external debt and an improvement of the overall public external debt service profile. In the calculation of the present value savings from DMOs, the discounted future stream of payments of debt service due on the newly issued debt instrument (including all costs associated with the operation) will be compared with the discounted future stream of and the debt service due on the instrument it replaces using a discount rate of 7 percent, and these amounts will not be capped by the nominal value of the debt.

[7] Compliance will be evaluated based on the 12-month annual inflation average of the latest three months.

[8] Cumulative from program approval.

Table 2. Kenya: Current and Proposed Structural Benchmarks			
Measure	**Target Date**	**Status**	**Macro-Criticality**
Prior action			
Start publishing on the Public Procurement Information Portal, information reported by Procuring Entities on beneficial owners of companies awarded contracts (i.e., name, at the minimum), as per Executive Order No. 2 of 2018 and the corresponding circulars No. 02/2022 and No. 05/2022 issued by the Public Procurement Regulatory Authority.		Met.	Reduce corruption risks by strengthening transparency and enhancing oversight.
Fiscal Transparency			
Ensure that comprehensive information on public tenders awarded, including beneficial ownership information of the awarded entities, are publicly available on the government procurement information portal and that bidders are subject to dissuasive sanctions for non-compliance.	End-June 2021	Not Met. Reset as prior action for the current reviews.	Reduce corruption risks by strengthening transparency and enhancing oversight.
Publish results of a forensic audit of COVID-19 vaccine spending up to June 2021 and a comprehensive audit of expenditures in FY2020/21 with a chapter on COVID-19-related spending.	End-May 2022	Not Met. Implemented with delay.	Strengthen transparency and enhance oversight
State-Owned Enterprises (SOEs) Restructuring and Governance			
Submit to the Cabinet Sub-Committee on KPLC an action plan to restore KPLC's medium-term profitability and fully cover any financing gaps (pre-existing and new) through end-2023, as identified by the updated 2022 financial evaluation.	End-July 2022	Not met. Revised to end-December 2022.	Reduce fiscal risks related to SOEs.
Budget and Revenue Collection			
Submit to Parliament a supplementary budget for FY2022/23 consistent with programmed deficit and revenue targets.	End-January 2023	Proposed.	Ensure fiscal consolidation consistent with program objectives.
Submit to Parliament a budget and finance bill for FY2023/24 consistent with programmed deficit and revenue targets.	End-April 2023	Proposed.	Ensure fiscal consolidation consistent with program objectives.
Complete a review of how the fuel pricing mechanism has been applied to date; publicly announce and constitute a taskforce to oversee the progressive elimination of the fuel subsidy within the first half of FY2022/23 and to ensure that fuel pricing actions are at all times aligned to the approved budget.	End-July 2022	Not met. Revised to end-December 2022.	Provide clarity on fuel pricing policy and avoid unfunded subsidy costs.

Table 2. Kenya: Current and Proposed Structural Benchmarks (concluded)[1/]

Issue a circular that includes an action plan for the development of a Medium-Term Revenue Strategy (MTRS) that identifies quantified overarching revenue objectives consistent with programmed tax revenue targets, clarifies the role of each institution involved, and identifies a concrete and time-limited sequence of actions for achievement of such objectives.	End-August 2022	Met.	Increase compliance and tax revenue.
Governance, Anti-Money Laundering, and Anti-Corruption			
Submit to the National Assembly, the draft amendments to the POCAMLA and POCAMLR, to be in line with FATF standards addressing the legal and regulatory gaps identified in the Kenya Mutual Evaluation Report 2022 to support anti-corruption efforts.	End-June 2023	Proposed.	Strengthen AML preventive tools to fight corruption.
Conduct and publish a special audit on the mechanism, efficiency and effectiveness of the supplementary budgeting, including under Article 223 of the Constitution, with a view to provide proper accountability and transparency on the supplementary budget spending by the various MDAs and to establish potential risks.	End-September 2023	Proposed.	Reduce fiscal risks and strengthen budget controls.

[1/] The list of all previously assessed structural benchmarks is available in IMF Country Report Nos. 2021/275 and 2022/232.

Technical Memorandum of Understanding

Nairobi, Kenya, December 7, 2022

1. This memorandum sets out the understandings between the Kenyan authorities and the IMF regarding the definitions of quantitative performance criteria (QPCs) and indicative targets (ITs), their adjusters and data reporting requirements for the Extended Fund Facility (EFF) and Extended Credit Facility (ECF) arrangements.

2. For the purposes of the program, the National Government of Kenya (GoK) corresponds to the budgetary national government encompassing the activities of the national executive, legislative and judicial powers covered by the National Budget. Specifically, it includes the parliament, national judiciary, and executive including Ministries, Departments, Agencies (MDAs), and Constitutional Commissions and Independent Offices.

I. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS

3. The program establishes quantitative performance criteria for December 31, 2022, June 30, 2023, and December 31, 2023, with respect to:

- the primary balance of the national government including grants, cash basis (**floor**);
- tax revenue of the national government (**floor**);
- the stock of net official international reserves (NIR) of the Central Bank of Kenya (CBK) (**floor**);
- present value of contracting or guaranteeing of new external debt by the national government and the CBK (**ceiling**);[1]
- accumulation of public and publicly-guaranteed external debt arrears (**continuous ceiling**);
- new domestic guarantees granted by the national government or assumption of state-owned enterprise (SOE) debt not reflected in the primary balance (**ceiling**); and
- a monetary policy consultation clause (**band**).

4. The program sets indicative targets for December 31, 2022, June 30, 2023, and December 31, 2023, with respect to:

- the change in the stock of national government exchequer requests outstanding for 90 days or more (**ceiling**); and
- priority social spending of the national government (**floor**).

[1] This unified ceiling replaces the separate ceilings on the nominal value of contracting and guaranteeing of new external concessional and non-concessional borrowing used in the 1st and 2nd ECF/EFF reviews, reflecting the reforms of the IMF Debt Limits Policy that entered into effect on June 30, 2021.

II. PERFORMANCE CRITERION ON THE PRIMARY BALANCE OF THE NATIONAL GOVERNMENT

5. **The national government primary balance** on a cash basis is defined as national government revenues and grants minus expenditures and net lending, plus due interest payments. For the purpose of the program, any financial support transaction of the national government with and on behalf of SOEs with negative equity as of end-June 2020 would be recorded as a transfer to an entity outside the national government regardless of whether the national government acquires a claim on the SOE. Similarly, all operations such as debt swap or exchange of financial assets between the national government and SOEs with negative equity as of end-June 2020 would be recorded as a reduction in net lending and an increase in grants to SOEs.

6. **For program purposes, the national government primary balance** on a cash basis will be measured from the financing side as the sum of the following: (a) the negative of net domestic financing of the national government; (b) the negative of net external financing of the national government; and (c) domestic and external interest payments of the national government. The national government primary balance will be measured cumulatively from the beginning of respective fiscal year until the test date: July 1, 2022, to December 31, 2022 (for end-December 2022 test date), July 1, 2022, to June 30, 2023 (for end-June 2023 test date), and from July 1, 2023, to December 31, 2023 (for end-December 2023 test dates).

The above items are defined as follows:

- **Net domestic financing** of the national government is comprised of (1) net domestic bank financing (which would include items such as credit to the national government from commercial banks and the CBK, including the overdraft facility and on-lending of part of the SDR General Allocation to the national government; changes in bank holdings of national government debt; and drawdown of national government deposits held at commercial banks or the CBK); (2) net domestic nonbank financing (such as changes in non-bank holdings of national government debt and other obligations); (3) proceeds from privatization; and (4) any other borrowing securitized by, or otherwise to be repaid with national government revenue.
- **Net external financing** of the national government at actual transaction exchange rates is defined as the sum of:
  - disbursements of external project loans, including securitization;
  - disbursements of budget support loans;
  - the negative of principal repayments due on all external loans;
  - net proceeds from issuance of external debt;
  - any exceptional financing (including rescheduled principal and interest on external debt);
  - net changes in the stock of short-term external debt; and
  - any change in external arrears including interest payments.
- **Domestic and external interest payments** of the national government are defined as the due interest charges on domestic and external national government debt.

7. The following adjustors will apply to the target on the **national government primary balance:**

- The floor will be adjusted downward (upward) by half of any SOE support in excess (falling short) of the amounts set out in TMU Table 1 below for FY2021/22 and FY2022/23, provided that the cumulative SOEs support reported in Table 1 below plus any overage does not exceed KSh.127.36 billion (1.0 percent of the FY2021/22 GDP) over that period. The floor will be adjusted downward (upward) by the full amount of any SOE support in excess (falling short) of the amounts set out in TMU Table 1 below for FY2023/24. This adjustor does not apply to FY2023/24. For the purpose of monitoring execution of the SOEs amounts indicated in Table 1 throughout the fiscal year, the fiscal outturn tables (BOT) will be amended to show explicitly the amounts paid in each month as well as the targeted levels for the month.

Table 1. Kenya: Projected Extraordinary Support to SOEs[1]
(KSh. million)

	2022	2023
	Dec.	Jun.
Extraordinary Support to SOEs	37,268	37,268

Source: Kenyan authorities.
[1/] Cumulative from July 1, 2022 for FY2022/23 ending in June 2023, and from July 1, 2023 for FY2023/24 for end-December 2023.

- The floor will be adjusted downward if budgetary program grants not specifically related to COVID-19 vaccination fall short of the programmed amounts set out in TMU Table 2 below.

Table 2. Kenya: Program Grants Disbursements[1]
(KSh. million)

	2022	2023	
	Dec.	Jun.	Dec.
Program grants	0	0	0

Source: Kenyan authorities.
[1/] Cumulative from July 1, 2022 for FY2022/23 ending in June 2023 and from July 1, 2023 for FY2023/24 for end-December 2023.

- If additional resources to finance COVID-19 vaccination become available, the floor will be adjusted downward by the amount of foreign concessional project financing dedicated to COVID-19 vaccine interventions and any COVID-19 vaccine related import cost not covered by foreign concessional project financing.

III. PERFORMANCE CRITERION ON THE NET INTERNATIONAL RESERVES OF THE CENTRAL BANK OF KENYA

8. **The stock of net official international reserves** (NIR) of the CBK will be calculated as the difference between total gross official international reserves and official reserve liabilities.

- **Gross official international reserves** are defined as the sum of:
    - the CBK's holdings of monetary gold (excluding amounts pledged as collateral);
    - holdings of Special Drawing Rights (SDRs);
    - the CBK's holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments); and
    - Kenya's reserve tranche position with the IMF.
- **Gross official international reserves** exclude:
    - pledged, swapped, or any encumbered reserve assets, including but not limited to reserve assets used as collateral or guarantees for third-party external liabilities;
    - deposits with Crown agents; and
    - precious metals other than gold, assets in nonconvertible currencies and illiquid foreign assets.
- **Gross official reserve liabilities** are defined as:
    - the total outstanding liabilities of the CBK to the IMF, excluding the SDR allocations;
    - convertible currency liabilities of the CBK to nonresidents with an original maturity of up to and including one year; and
    - commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options).

9. The following **adjustors** will apply to the target for NIR:

- If the total of (i) program loans, (ii) the revenue component of project loans, and (iii) external commercial and semi-concessional borrowing (excluding for payments of principal of existing debt with the proceeds from newly issued debt for debt management purposes (¶20)) exceeds (falls short) the programmed amounts set out in TMU Table 3 below, the target for NIR will be adjusted upward (downward) by the difference;
- If program grants or the revenue component of project grants falls short of the programmed amounts set out in TMU Table 3, the target for NIR will be adjusted downward by the difference;
- If foreign exchange outflows related to financial support provided to Kenya Airways exceeds (falls short) the programmed amounts set out in TMU Table 3 below, the target for NIR will be adjusted downward (upward) by the difference;
- The NIR target will be adjusted downward by the full amount of import costs associated with COVID-19 vaccine-related purchases less any external project financing received for this purpose.

10. **NIR is monitored in U.S. dollars,** and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar equivalent values, using the exchange rates as specified in TMU Table 4.

Table 3. Kenya: Projected Program and Project Loans, Grants, Commercial Borrowing and Foreign Exchange Outflows Related to Budget Support to Kenya Airways[1]
(US$ millions)

	2022	2023	
	End-Dec.	End-June	End-Dec.
Program grants and loans	769	1,619	304
Program loans	769	1,619	304
Program grants	0	0	0
Project loans and grants	261	693	362
Project loans (revenue component)	239	603	362
Project grants (revenue component)	22	90	0
Commercial and Semi-concessional borrowing	496	896	0
Foreign exchange outflows related to KQ support	81	161	41

Source: Kenyan authorities.
[1] Cumulative from July 1, 2022, for FY2022/23 ending in June 2023, and from July 1, 2023 for FY2023/24 for end-December 2023.

Table 4. Kenya: Program Exchange Rates
(Rates as of February 4, 2021)

Currency	Kenyan Shillings per currency unit	Currency units per US Dollar
US Dollar	109.8647	1.00
STG Pound	149.8768	0.73
Japanese Yen	1.045882	105.05
Canadian Dollar	85.7648	1.28
Euro	131.9809	0.83
Swiss Franc	122.2213	0.90
Swedish Kronor	13.0437	8.42
Danish Kronor	17.7509	6.19
Chinese Yuan	17.0114	6.46
Australian Dollar	83.662	1.31
SDR	157.464	0.70

Source: Central Bank of Kenya.

IV. CONTINUOUS PERFORMANCE CRITERION ON THE PUBLIC AND PUBLICLY-GUARANTEED EXTERNAL DEBT ARREARS

11. Public and publicly-guaranteed external debt arrears to official and private external creditors are defined as overdue payments (principal or interest), which were not made by their contract due date nor during the applicable grace period thereafter, on debt contracted by the national government. Public and publicly-guaranteed external debt arrears (principal or interest) to official

and private creditors are defined as overdue payments beyond 30 days after the original contract due date in order to allow sufficient time to process the due repayment after the original debtor has notified of its inability to pay. The definition excludes arrears relating to debt subject to renegotiation (dispute or ongoing renegotiation) or rescheduling. External debt is defined on a currency basis.

12. The performance criterion on the public and publicly-guaranteed external debt arrears is defined as a cumulative flow in gross terms from January 1, 2021 and applies on a continuous basis.

V. CEILING ON THE CONTRACTING OR GUARANTEEING OF NEW EXTERNAL DEBT

Definition of Debt

13. For program purposes, the definition of debt is set out in paragraph 8(a) of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No.15688-(14/107), adopted December 5, 2014.

14. The term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of financial and nonfinancial assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms; the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

15. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes

debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

Coverage of Debt

16. For the purposes of the ceiling on the contracting or guaranteeing of new external debt (herein, `the ceiling'), external debt is any debt contracted or guaranteed by the public sector denominated in foreign currency, i.e., currency other than the Kenyan Shilling (KSh.):

- Public sector external debt includes foreign-currency denominated obligations of the GoK, and foreign-currency denominated obligations of the CBK contracted on behalf of the national government (excluding newly contracted financing from the IMF and the General SDR allocation).
- The definition of debt is presented in the above sub-section, with the exception noted in the previous bullet.
  (i) For program purposes, a 'guaranteed debt' is an explicit promise by the public sector to pay or service a third-party obligation (involving payments in cash or in kind).
- External debts in currencies other than the U.S. dollar will be converted in U.S. dollars at program exchange rates (Table 4).

Contracting of Debt and Treatment of Credit Lines

17. For program purposes, a debt is considered to be contracted when all conditions for its entry into effect have been met, including approval by the Attorney General. Contracting of credit lines (which can be drawn at any time and entered into effect) with no predetermined disbursement schedules or with multiple disbursements will be also considered as contracting of debt.

Definition of Debt Ceiling

18. A performance criterion (ceiling) applies to the present value (PV) of new external debt contracted or guaranteed by the public sector. The ceiling applies also to debt contracted or guaranteed for which value has not yet been received, including private debt for which official guarantees have been extended. Loan obligations between the GoK and the creditors of Kenya Airlines that (i) replace two guarantees previously provided by GoK to the same lenders; (ii) result in present value savings compared to the debt obligations that GoK would have had to assume had the two guarantees been triggered are excluded from the PC.[2]

Present Value Calculation

[2] In the calculation of the present value savings, the discounted future stream of payments of debt service due on the newly issued debt instrument (including all costs associated with the operation) will be compared with the discounted future stream of debt service due on the instrument it replaces using a discount rate of 7 percent, the interest rate assumed for rollover of commercial debts in Kenya's Debt Sustainability Analysis (DSA), and these amounts will not be capped by the nominal value of the debt.

19. For the purposes of the ceiling on the contracting or guaranteeing of new external debt, the present value (PV) of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt.[3] For debts with a grant element equal or below zero, the PV will be set equal to the nominal value of the debt.[4] The discount rate used for this purpose is the unified discount rate of 5 percent set forth in Executive Board Decision No. 15248-(13/97). The grant element of external debts in currencies other than the U.S. dollar will be calculated in U.S. dollar terms at program exchange rates (Table 4). For any debt carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the debt would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the debt contract. The program reference rate for the six-month USD Secured Overnight Financing Rate (SOFR) is 0.04 percent and will remain fixed for the duration of the program as will the spreads over six-month USD SOFR for interest rates in other currencies as follows: (1) the spread of six-month Euro EURIBOR over six-month USD SOFR is -56 basis points; (2) the spread of six-month JPY Overnight Indexed Swap (OIS) over six-month USD SOFR is -8 basis points; (3) the spread of six-month GBP Sterling Overnight Interbank Average (SONIA) over six-month USD SOFR is 1 basis point; and (4) For interest rates on currencies other than Euro, Japanese Yen, and GBP Sterling, the spread over six-month USD SOFR is 15 basis points.[5] Where the variable rate is linked to a benchmark interest rate other than the six-month USD SOFR, a spread reflecting the difference between the benchmark rate and the six-month USD SOFR (rounded to the nearest 50 basis points) will be added.

Debt Management Operations

20. Debt Management Operations (DMOs) are defined as the repayment or refinancing of the principal of outstanding external public debts prior to or at their maturity dates. The programmed issuance of non-concessional debt for use in DMOs is shown as a memorandum item in Table 1 of the accompanying Memorandum of Economic and Financial Policies.

Adjustors to Debt Ceiling

21. An adjustor of up to 5 percent of the external debt ceiling set in PV terms applies to this ceiling, in case deviations from the performance criterion on the PV of new external debt are prompted by a change in the financing terms (interest, maturity, grace period, payment schedule, upfront commissions, management fees) of a debt or debts. The adjustor cannot be applied when deviations are prompted by an increase in the nominal amount of total debt contracted or guaranteed.

22. The debt ceiling would be adjusted upward by the full amount in PV terms of any project financing dedicated to COVID-19 vaccine interventions that was not anticipated at the time of

[3] The calculation of concessionality takes into account all aspects of the debt agreement, including maturity, grace period, payment schedule, upfront commissions, and management fees.

[4] The grant element of a debt is the difference between the present value of debt and its nominal value, expressed as a percentage of the nominal value of the debt.

[5] The program reference rate and spreads are based on the "average projected rate" for the six-month USD SOFR over the following 10 years from the Fall 2020 World Economic Outlook (WEO).

setting of the performance criterion. In this connection, the authorities will consult with IMF staff on any planned external concessional borrowing for this purpose and the conditions on such borrowing before the loans are either contracted or guaranteed by the national government. The rationale for this adjustment will be reassessed in the context of the next review of the EFF/ECF arrangements.

23. The debt ceiling will be adjusted downward by the full amount of: (1) any shortfall between the actual and programmed issuance of debt for use in DMOs, and (2) the issuance of any debts for use in DMOs that do not result in a reduction of the present value (present value savings) of the overall public external debt and an improvement of the overall public external debt service profile. In the calculation of the present value savings from DMOs, the discounted future stream of payments of debt service due on the newly issued debt instrument (including all costs associated with the operation) will be compared with the discounted future stream of debt service due on the instrument it replaces using a discount rate of 7 percent,[6] and these amounts will not be capped by the nominal value of the debt.

VI. CEILING ON NEW DOMESTIC GUARANTEES GRANTED BY THE NATIONAL GOVERNMENT

24. National government guarantees on domestic borrowing include all guaranteed commitments for (i) borrowing in domestic currency from residents and nonresidents; as well as (ii) guarantees extended by any SOE.

VII. MONETARY POLICY CONSULTATION CLAUSE

25. The bands around the projected 12-month rate of inflation in consumer prices, as measured by the headline consumer price index (CPI) published by the Kenya National Bureau of Statistics, are specified in the TMU Table 5 next page.

- If the observed average of the 12-month rate of CPI inflation for the three months preceding the test date falls outside the lower or upper bands specified in the TMU Table 5 below, the authorities will complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for program deviations, taking into account compensating factors; and (iii) proposed remedial actions if deemed necessary. When the consultation with the IMF Executive Board is triggered, access to Fund resources will be interrupted until the consultation takes place.

[6] The discount rate used for DMOs is set equal to the interest rate assumed for rollover of commercial debts in Kenya's Debt Sustainability Analysis (DSA), with the present value savings thus reflecting the benefit to the public external debt service profile of the longer duration of the newly issued debt instrument compared to that of the debt instrument it replaces.

Table 5. Kenya: Monetary Policy Consultation Clause, 2022–23
(Percent values)

	end–Dec. 2022 Target	end-Jun. 2023 Target	end-Dec. 2023 Target
Upper band	7.5	7.5	7.5
Center point	5.0	5.0	5.0
Lower band	2.5	2.5	2.5

Source: Kenyan authorities.

VIII. FLOOR ON TAX REVENUE OF NATIONAL GOVERNMENT (QUANTITATIVE PERFORMANCE CRITERION)

26. Tax revenue of the national government are defined as the sum of personal income tax (PAYE), corporate income tax, import duties, excise duties, value added tax, and other taxes (e.g., alternative minimum tax, digital sales tax). For the purpose of the program, tax revenues exclude the following items presented in the monthly Budget Outturn Tables (BOT): taxes related to "Ministerial Appropriation in Aid" (i.e., RML, RDL, PDL), "Taxes on International Trade and Transactions (IDF fee)," "Capital gains," and "other taxes on goods and services."

IX. INDICATIVE TARGET ON NATIONAL GOVERNMENT OUTSTANDING EXCHEQUER REQUESTS

27. For the purposes of the program, national government outstanding exchequer requests are defined as invoices for goods or services provided to the national government for which requisitions for payment have been received in the Integrated Financial Management Information System (IFMIS) but corresponding funds from the exchequer account have not been released.

28. The program ceiling for the change in the stock of outstanding exchequer requests refers to requisitions made after the start of July 2021 and invoices unpaid for 90 days or longer, disregarding any changes related to legal rulings or claims found invalid on bills originated before the start of the program.

X. INDICATIVE TARGET ON PRIORITY SOCIAL SPENDING

29. For the purposes of the program, priority social spending of the national government is defined as the sum of:

- cash transfers to orphans and vulnerable children,
- cash transfers to elderly persons,
- cash transfers to persons with severe disabilities,
- free primary education expenditure,

- free secondary education expenditure,
- school food and sanitary programs,
- free maternal healthcare,
- universal health coverage,
- health insurance subsidy for targeted categories (i.e., orphans, vulnerable children, elderly, and people with disabilities), and
- spending for vaccination and immunization.

The floor on priority social spending of the national government is defined as the programmed amounts set out in TMU Table 6.

Table 6. Kenya: Priority Social Spending[1]
(KSh. millions)

	2022	2023	
	Dec.	Jun.	Dec.
Priority Social Spending	210,389	420,777	210,979

Source: Kenyan authorities.
[1] Cumulative from July 1, 2022 for FY2022/23 ending in June 2023 and from July 1, 2023 for FY2023/24 for end-December 2023.

XI. DATA REPORTING

30. To monitor program performance, the National Treasury and the CBK will provide to the IMF the information at the frequency and within the reporting deadlines specified in TMU Table 7. The authorities will transmit promptly to Fund staff any data revisions. For any information (and data) that is (are) relevant for assessing performance against program objectives but is (are) not specifically defined in this memorandum, the authorities will consult with Fund staff. The authorities will transmit promptly to IMF staff any data revisions, as well as other information necessary to monitor the arrangements with the IMF.

Table 7. Kenya: Summary of Data to Be Reported			
Information	**Frequency**	**Reporting Deadline**	**Responsible Entity**
1. Primary balance of the national government			
Net domestic bank financing (including net commercial bank credit to the national government and net CBK credit to the national government broken down in their main components)	Monthly	Within 20 days after month end.	CBK
Net nonbank financing of the national government	Monthly	Within 20 days after month end.	NT
Proceeds from privatization	Monthly	Within 20 days after month end.	NT
Debt service paid and coming due on domestic debt	Monthly	Within 20 days after month end.	CBK
Debt service paid and coming due on external debt	Monthly	Within 20 days after month end.	NT
Disbursements and repayment schedule of external concessional and non-concessional project loans, including securitization	Monthly	Within 20 days after month end.	NT
Disbursements and repayment schedule of budget support loans	Monthly	Within 20 days after month end.	NT
Disbursements and repayment schedule of on all external loans	Monthly	Within 20 days after month end.	NT
Net proceeds from issuance of external debt	Monthly	Within 20 days after month end.	NT
Any exceptional financing (including rescheduled principal and interest)	Monthly	Within 20 days after month end.	NT
Net changes in the stock of short-term external debt	Quarterly	Within 45 days after quarter end.	NT
Change in external arrears, including interest and principal, and penalties	Monthly	Within 20 days after month end.	NT
Stock and movements in MDAs' pending bills for prior fiscal years	Monthly	Within 20 days after month end.	NT
Stock of exchequer requests made after the start of July 2020 and unpaid for 90 days or more	Monthly	Within 20 days after month end.	NT
Execution of Extraordinary SOE support	Monthly	Within 20 days after month end.	NT
National government transactions with and on behalf of SOEs broken down in main categories	Quarterly	Within 20 days after the end of the quarter.	NT
2. Public debt			
Stock of Treasury Bills and Bonds	Quarterly	Within 45 days after quarter end.	NT
Auctions of T-bills and T-bonds via primary dealers, including the number and value of submitted and accepted bids, minimum, maximum and weighted average interest rates and maturity dates	Weekly	Within 7 working days after the end of the week.	NT
Total new other domestic debt contracted or guaranteed	Monthly	Within 20 days after the end of the quarter.	NT in collaboration with CBK
Total new contracted external project loans	Monthly	Within 20 days after the end of the quarter.	NT
Total other new contracted or guaranteed external concessional debt	Monthly	Within 20 days after the end of the quarter.	NT in collaboration with CBK
Total new Eurobond issuances	Monthly	Within 20 days after the end of the quarter.	NT
Total new other non-concessional external debt contracted or guaranteed	Monthly	Within 20 days after the end of the quarter.	NT in collaboration with CBK

Table 7. Kenya: Summary of Data to Be Reported (concluded)

Information	Frequency	Reporting Deadline	Responsible Entity
3. Gross official international reserves			
CBK's holding of monetary gold (excluding amounts pledged as collateral)	Monthly	Within 20 days after the end of the month.	CBK
Holdings of SDRs	Monthly	Within 20 days after the end of the month.	CBK
CBK holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments)	Monthly	Within 20 days after the end of the month.	CBK
4. Official reserve liabilities			
Total outstanding liabilities of the CBK to the IMF excluding the SDR allocations	Monthly	Within 20 days after month end.	CBK
Convertible currency liabilities of the CBK to nonresidents with an original maturity of up to and including one year	Monthly	Within 20 days after month end.	CBK
Commitments to sell foreign exchange arising from derivatives	Monthly	Within 20 days after month end.	CBK
5. Other indicators			
Currency in circulation	Monthly	Within 20 days after month end.	CBK
Required and excess reserves	Monthly	Within 20 days after month end.	CBK
Concessional and non-concessional medium- and long-term external debt contracted or guaranteed by the national government and CBK	Monthly	Within 20 days after month end.	NT
Accumulation of national government external debt arrears	Monthly	Within 20 days after the end of the quarter.	NT
Social priority spending of the national government	Quarterly	Within 45 days after quarter end.	NT
Grants to national government entities and total subsidies	Quarterly	Within 20 days after month end.	NT
Guarantees issued by the national government to counties, public enterprises, and all parastatal entities	Monthly	Within 20 days after the end of the quarter.	NT
Stock of guarantees extended by the national government	Monthly	Within 20 days after the end of the quarter.	NT
12-month CPI inflation	Monthly	Within 15 days after the end of the month.	KNBS
Financial Soundness Indicators (core and expanded) for other depository corporations	Quarterly	Within 20 days after quarter end.	CBK

INTERNATIONAL MONETARY FUND

KENYA

December 8, 2022

FOURTH REVIEWS UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, AND REQUESTS FOR AUGMENTATION OF ACCESS UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, AND MODIFICATIONS OF QUANTITATIVE PERFORMANCE CRITERIA—DEBT SUSTAINABILITY ANALYSIS

Approved By:
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Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)

Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	High
Overall risk of debt distress	High
Granularity in the risk rating	Sustainable
Application of judgment	No

Kenya's debt is sustainable. While overall and external ratings for risk of debt distress remain high, debt dynamics are being bolstered by the fiscal consolidation under the IMF supported program.[1] *High deficits in the past, combined with export and output losses in 2020 caused by the pandemic, have resulted in near-term deterioration of solvency and liquidity debt indicators. Market pressures in the wake of the war in Ukraine and the monetary tightening in advanced countries have limited access to commercial borrowing in 2022. Compared to the last DSA assessment,*[2] *the outlook for present value of external debt-to-exports has improved, due to the stronger than anticipated fiscal outturn in FY2021/22 and planned rationalization of capital spending in FY2022/23, reflected in lower-than-previously anticipated external financing, as well as the faster recovery of tourism and the boost to exports from higher export prices in 2022. These positive trends are partly offset by the impact of the projected higher nominal interest rates on the present value of debt, reflecting the higher cost of external loans with floating interest rates and of new external commercial and domestic debt. Kenya's debt indicators will improve as fiscal consolidation progresses and exports and output recover from global shocks, although the improvement remains gradual for the external debt service-to-exports ratio. Sustained fiscal consolidation would stabilize debt next year and bring it to more prudent levels over the medium term, while protecting social spending. The DSA suggests that Kenya is susceptible to export and exchange rate shocks; more prolonged and protracted shocks to the economy would also present downside risks to the debt outlook.*

[1] The DSA analysis reflects a debt carrying capacity of Medium considering Kenya's Composite Indicator Index of 3.02, based on the IMF's October 2022 *World Economic Outlook* and the 2021 World Bank Country Policy and Institutional Assessment (CPIA).

[2] See IMF Country Report No. 021/275 published in December 2021.

PUBLIC DEBT COVERAGE

1. For the purposes of this analysis, the perimeter of public debt covers the debt of the central government, Social Security Fund, central bank debt taken on behalf of the government, and government guaranteed debt (Text Table 1). Debt data include both external and domestic obligations and guarantees:

- The external DSA covers the external debt of the central government and the central bank, including publicly guaranteed debt, as well as of the private sector.
- The public DSA covers both external and domestic debt incurred or guaranteed by the central government. It does not cover the entire public sector, such as extra-budgetary units and county governments.[3] Debt coverage excludes legacy debt of the pre-devolution county governments,[4] estimated at Ksh 53.8 billion (0.5 percent of GDP), which is included in a stress scenario.
- The DSA uses a currency-based definition of external debt. There is no significant difference between a currency-based and residency-based definition of external debt, as nonresidents' direct participation in the domestic debt market is small, at below one percent of total outstanding government securities (Text Table 2).

2. The DSA includes a combined contingent liabilities stress test aimed at capturing the public sector's exposure to SOEs, PPPs, and a financial market shock. In particular, the stress test incorporates the following shocks (Text Table 1):

- 3.1 percent of GDP to capture reported non-guaranteed debt of state-owned enterprises (SOEs) and extra-budgetary units and Public Private Partnerships (PPPs). Survey of 26 state-owned entities (out of a total of around 260), including 18 entities considered to pose the highest fiscal risk, showed that 19 had non-guaranteed loan obligations (excluding vis-à-vis the government), including overdrafts, equal to KSh.99.3 billion (0.8 percent of GDP) at end-June 2022. Out of this sum, 77 percent was denominated in U.S. dollars and 4.4 percent was owed by extra-budgetary units. None of the loans were reported to be in arrears. Given that the surveyed entities include all of the ones considered to pose the highest fiscal risk and that the total amount of reported non-guaranteed loan obligations is below one percent of GDP, the standard calibration of 2 percent for non-guaranteed SOE debt is retained in the stress test;[5]
- 0.5 percent of GDP to cover legacy debt of the pre-devolution county governments (see above);

[3] County governments have not been allowed to borrow without central government guarantee since 2010 and borrowing requires National Treasury (NT) authorization, while extra-budgetary units face no such constraint.

[4] A new Constitution was approved by referendum in 2010, devolving substantial powers to 47 new county governments.

[5] Guaranteed State-owned enterprise (SOE) debt and amounts borrowed directly by the Kenyan government and on-lent to SOEs are included in the public debt stock (see above) and thus not included in the calibration of the contingent liabilities stress test.

- 5 percent of GDP for a financial market shock—a value that exceeds the existing stock of financial sector nonperforming loans of about 4 percent of GDP.

Text Table 1. Kenya: Public Debt Coverage

Public Debt Coverage

	Subsectors of the public sector	Check box
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	X
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

Public Debt Coverage and the Magnitude of the Contingent Liability Tailored Stress Test

1	The country's coverage of public debt	The central government plus social security, central bank, government-guaranteed debt	
		Default	Used for the analysis
2	Other elements of the general government not captured in 1.	0.5 percent of GDP	0.5
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2
4	PPP	35 percent of PPP stock	1.1
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5
	Total (2+3+4+5) (in percent of GDP)		8.6

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.).

3. **Kenya maintains a high standard of debt transparency.** Debt statistics bulletins with public and publicly guaranteed (PPG) coverage and medium-term debt management strategies are regularly published, and the Budget Policy Statement and Annual Public Debt Management Report include information about contingent liabilities. Moreover, the external public debt register provides loan-level data. The authorities are working on expanding the reporting of State-owned entities (including SOEs and extrabudgetary units) to cover all 260 entities and automate data collection by linking to existing electronic reporting system. The authorities' efforts in this area were supported by a Policy and Performance Action (PPA) under the IDA Sustainable Development Finance Policy (SDFP).[6]

BACKGROUND ON DEBT

4. **Kenya's overall public debt has increased in recent years.** Gross public debt increased from 45.7 percent of GDP at end-2015 to 67.8 percent of GDP at end-2021 (Table 1), reflecting legacy high deficits, partly driven by spending on large infrastructure projects, and in 2020–21 by the impact of the COVID-19 global shock. External public debt amounts to about half of Kenya's overall public debt (Text Table 2).

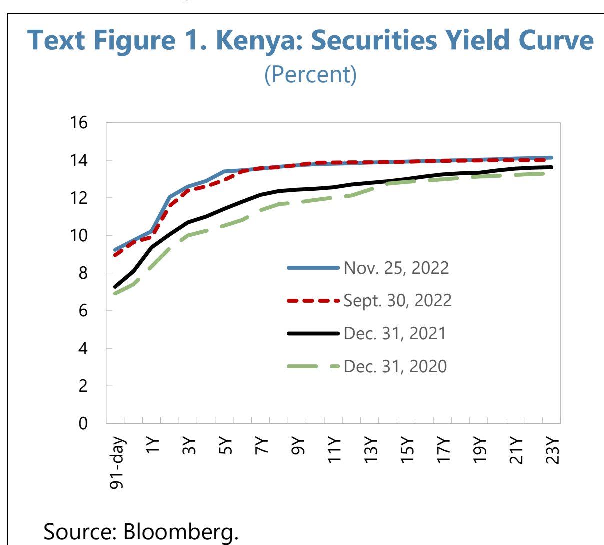
[6] The PPA on debt transparency was achieved with the publication of the outstanding debt of the 18 entities posing the largest fiscal risks in the FY2020/21 Annual Public Debt Management Report.

5. Most of Kenya's external public debt remains on concessional terms. Nominal PPG external debt at end-2021 amounted to 34.5 percent of GDP, corresponding to 27.4 percent of GDP in present value terms (Text Table 2 and Table 1):

- Kenya has benefited from sizeable support from multilateral institutions. At end-2021, multilateral creditors accounted for about 43 percent of external debt, while debt from bilateral creditors represented close to 31 percent (Text Table 2). Of Kenya's bilateral debt, about 64 percent is owed to non-Paris Club members, mainly loans from China.
- The share of commercial debt in total external debt decreased in 2021, as the authorities prioritized concessional borrowing during the pandemic after several years of reliable access to global financial markets. Commercial debt (mainly Eurobonds, loans and export credits) accounted for about 27 percent of external public debt. Eurobonds accounted for 72 percent of commercial debt (US$7.1 billion), while loans represented 28 percent (about US$2.7 billion).[7]
- Kenya has not contracted any collateralized external debt. Guarantees by the central government on debt contracted by other entities amount to US$ 1.4 billion and are included in the stock of PPG debt.

6. Kenya's domestic public debt reached 33.3 percent of GDP at end-2021 (Text Table 2 and Table 2). Since end-2020, the yield curve has shifted up and flattened, reflecting the increase in near-term inflationary pressures and related policy adjustments by the Central Bank of Kenya (CBK), heightened uncertainty in the run-up to the August 2022 elections, and the greater reliance on domestic issuance in the last quarter of the FY2021/22 (Text Figure 1). The successful implementation of authorities' strategy to lengthen the maturity profile of domestic debt has resulted in a significant decline in the share of Treasury bills in the domestic debt stock (from 35 percent at the end of FY2018/19 to 18.7 percent at the end of FY2021/22) and a notable increase in the average time to maturity of government domestic bonds, excluding T-bills (from 6.3 years at the end of FY2018/19 to 9.1 years at end-June 2022). This has helped alleviate short-term rollover risks, enabling the local market to absorb pressures in 2022. About half of government domestic debt securities are held by pension funds, followed by commercial

Text Figure 1. Kenya: Securities Yield Curve
(Percent)



Source: Bloomberg.

[7] Syndicated loans amounting to Euro 305.4 million claimed by a syndicate of Italian commercial banks in relation to Arror, Kimwarer, and Itare dams projects are disputed and subject to on-going arbitration/court proceeding. The debt service schedule associated with these loans is not included in the DSA baseline, as budget provisions for their servicing are suspended until the matter is determined, but the outstanding amount on these loans is kept in the stock of public debt, following authorities' approach for reporting PPG debt in national publications (more conservative than prescribed in the LIC DSA Guidance Note).

banks with 47 percent share. Starting in the last quarter of the FY2021/22, domestic debt issuance has taken place mainly at the short-end of the maturity spectrum in an environment of heightened uncertainty in the run-up to the August 2022 elections and rising inflation.

Text Table 2. Kenya: Decomposition of Public Debt and Debt Service by Creditor, 2021–23[1]

	Debt Stock (end of period)			Debt Service					
	2021			2021	2022	2023	2021	2022	2023
	(In US$ mln)	*(Percent total debt)*	*(Percent GDP)*	*(In US$ mln)*			*(Percent GDP)*		
Total	**72,522**	**100.0**	**67.8**	**9,813**	**10,553**	**9,051**	**8.9**	**9.0**	**7.5**
External	**36,882**	**50.9**	**34.5**	**2,266**	**3,087**	**3,058**	**2.1**	**2.6**	**2.5**
Multilateral creditors	15,750	21.7	14.3	504	556	558	0.5	0.5	0.5
IMF	1,833	2.5	1.7	-	-	-	-	-	-
World Bank	10,226	14.1	9.3	-	-	-	-	-	-
African Development Bank	3,199	4.4	2.9	-	-	-	-	-	-
European Economic Community (incl. EIB)	197	0.3	0.2	-	-	-	-	-	-
International Fund For Agricultural Development	212	0.3	0.2	-	-	-	-	-	-
Other Multilaterals	84	0.1	0.1	-	-	-	-	-	-
o/w: Arab Bank For Economic Development In Africa	39	0.1	0.0	-	-	-	-	-	-
Nordic Development Fund	25	0.0	0.0	-	-	-	-	-	-
Bilateral Creditors	11,337	15.6	10.3	585	1,184	1,336	0.5	1.0	1.1
Paris Club	4,117	5.7	3.7	136	390	457	0.1	0.3	0.4
o/w: Japan	1,446	2.0	1.3	-	-	-	-	-	-
France (incl. AFD)	806	1.1	0.7	-	-	-	-	-	-
Non-Paris Club	7,220	10.0	6.5	449	794	878	0.4	0.7	0.7
o/w: EXIM China	7,071	9.8	6.4	-	-	-	-	-	-
EXIM India	65	0.1	0.1	-	-	-	-	-	-
Bonds	7,100	9.8	6.4	452	519.8	514.5	0.4	0.4	0.4
Commercial creditors	2,196	3.0	2.0	774	802	623	0.7	0.7	0.5
o/w: Trade and Development Bank	1,894	2.6	1.7	-	-	-	-	-	-
China Development Bank	283	0.4	0.3	-	-	-	-	-	-
Other international creditors	499	0.7	0.5	78	26	26	0.1	0.0	0.0
o/w: Intesa SanPaolo	294	0.4	0.3	-	-	-	-	-	-
ING Bank Germany	57	0.1	0.1	-	-	-	-	-	-
Domestic	**35,640**	**49.1**	**33.3**	**7,546**	**7,466**	**5,993**	**6.8**	**6.4**	**5.0**
Held by residents, total	35,360	48.8	32.0	-	-	-	-	-	-
Held by non-residents, total	280	0.4	0.3	-	-	-	-	-	-
T-Bills	6,434	8.9	5.8	-	-	-	-	-	-
Bonds	28,657	39.5	25.9	-	-	-	-	-	-
Loans	544	0.7	0.5	-	-	-	-	-	-
Memo items:									
Collateralized debt	0	0.0	0.0	-	-	-	-	-	-
o/w: Related	0	0.0	0.0	-	-	-	-	-	-
o/w: Unrelated	0	0.0	0.0	-	-	-	-	-	-
Contingent liabilities	1,429	2.0	1.3	-	-	-	-	-	-
o/w: Public guarantees [2]	1,429	2.0	1.3	-	-	-	-	-	-
o/w: Other explicit contingent liabilities [3, 4]	n.a.	n.a.	n.a.	-	-	-	-	-	-
Nominal GDP (at average Ksh/$ rate)	110,519	-	-	-	-	-	-	-	-

Sources: Kenyan authorities; and IMF staff calculations.

[1] As reported by Country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as in the DSA.

[2] Loan guarantees are included in the perimeter of debt covered by the DSA.

[3] Includes other-one off guarantees not included in publicly guaranteed debt (e.g. credit lines) and other explicit contingent liabilities not elsewhere classified (e.g. potential legal claims, payments resulting from PPP arrangements).

[4] Capacity constraints limit data availability on other explicit liabilities not elsewhere classified. Data is expected to become available at the time of the next review of the IMF EFF/ECF arrangements.

7. **Published data on private external debt is available through 2018 and is extrapolated going forward with the net private external debt BOP flows.** The source of pre-2019 data on private external debt is the International Investment Position (IIP) data on "Other sectors", which includes both the private sector and market profit institutions that are controlled or financed by government (financial and nonfinancial public corporations, published in the IMF's IIP database. BOP

data on net private external debt flows through end-2021 point to a steady upward trend in the stock of private debt as a share of GDP, which is also maintained in projections.

UNDERLYING ASSUMPTIONS

8. The analysis incorporates near-term forecast revisions, while the medium- and long-term outlooks remain broadly unchanged compared to the last full assessment. The baseline projections are subject to heightened uncertainty in the global environment (see ¶29 for details). On the negative side, disruptions to global trade and finance from the war in Ukraine are having a sizeable impact on Kenya's near-term prospects. While Kenya's direct trade and tourism exposures to Russia and Ukraine are relatively small, slowing global demand and spikes in international energy, food, and fertilizer prices are widening the current account deficit, and putting pressure on inflation and the exchange rate, eroding households' purchasing power. In addition, the protracted run-to-safety in international financial markets during 2022 in an environment of global monetary tightening has limited the availability and raised the cost of external commercial financing, prompting a compression of the overall fiscal deficit in FY2021/22 to 6.2 percent of GDP (versus the forecast of 8.2 percent of GDP in the last DSA). On the positive side, exports growth has been supported by the faster than anticipated recovery of tourism in the first half of 2022 and the higher global prices of agricultural commodities and manufacturing goods, reflecting global developments, despite the deterioration in the global growth outlook.

9. GDP growth has been revised down on the adverse impact from the war in Ukraine in 2022–23 and continued drought, but it is expected to recover to its potential over the medium term:

- The economy carried strong momentum into early 2022. However, the decline of households' purchasing power due to the spike in food prices and rising domestic fuel prices since the start of the war in Ukraine, continued drought, and the under-execution and rationalization of public capital expenditures are expected to slow real GDP growth to 5.3 and 5.1 percent in 2022 and 2023, respectively. However, nominal GDP in local currency is projected to be slightly higher than in the last DSA over the medium term, reflecting the base effect from the strong 2021 outturn and the forecasted higher inflation in 2022–23.
- Medium-to long-term real GDP growth projections are broadly unchanged at around 5.5 percent, on the back of the projected robust productivity growth, supported by an ambitious structural reform agenda, policies to reinforce credit to the private sector, as well as favorable demographic trends. The reform agenda of the new administration aims at boosting agricultural transformation and inclusive growth; enabling the micro, small and medium enterprise (MSME) economy as a private sector growth driver; improving housing and healthcare; promoting the digital superhighway; and supporting the creative economy. Over the medium term, growth is backstopped by the crowding-in effect of fiscal consolidation (i.e., lowering public financing needs would reduce demand-side pressures on domestic interest rates and free up financing for private investment), which is based on

growth-friendly domestic revenue mobilization and spending rationalization measures to anchor debt sustainability.

10. The adjustment in the primary fiscal balance is expected to remain on track with commitments under the Fund-supported program (Text Table 4):

- The FY2021/22 primary fiscal deficit was 1.9 percent of GDP smaller than budgeted, reflecting better than expected tax collection, strong demonstrated commitment to fiscal consolidation in an election year, and constrained domestic and external financing against a backdrop of rising inflation, largely-closed international market access, reflecting the deterioration in investor sentiment toward frontier markets and heightened country-specific risks in the run-up to the August 2022 elections and transition to the new administration. This resulted in a much stronger fiscal outturn than intended, though about 0.6 percent of the FY2021/22 GDP in committed but undisbursed expenditure (mainly related to transfers to counties, fuel subsidies, and SOE support) will carry over to FY2022/23.[8]

- Beyond the carryover (see above), additional unbudgeted expenditure needs (1.3 percent of GDP) have emerged in FY2022/23, reflecting emergency spending authorized under the constitutional provision of Article 223 (0.4 percent of GDP), and needs associated with decisions to pause adjustment of domestic fuel prices early in July and August and with policy priorities of the new administration and the ongoing drought emergency (0.9 percent of GDP).[9] The authorities have identified a combined set of measures (1.7 percent of projected FY2022/23 GDP) to offset the budgetary impact of such pressures (i.e., expenditure cuts and recognition of some additional tax revenues), while reflecting the difficult financing conditions. As a result, staff's baseline now projects that the FY2022/23 fiscal deficit will be lower than the level targeted by the FY2022/23 approved budget.

- With continued strong adjustment under the IMF-supported EFF/ECF program—which reflects the authorities' goals to increase tax revenues and control expenditures while avoiding nominal cuts in social spending (Text Table 3), so as to anchor debt sustainability—Kenya's primary deficit is expected to narrow in FY2023/24 below its average debt-stabilizing level over the medium term, currently estimated at 1 percent of GDP (Table 2). This will require a comprehensive package of new tax measures amounting to 0.9 percent of GDP—aligned with the priorities of Kenya's Medium-Term Revenue Strategy—combined with further efficiency gains in tax and customs administration, as well as ongoing reductions in non-priority primary spending. Going forward, the overall deficit is expected to durably decline to below 4 percent of GDP (Text Table 5), reflecting continued efforts to strengthen tax compliance and streamline recurrent expenditures—particularly for wages and transfers to public sector entities—while improving public investment management and budgetary controls.

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[8] The stock of pending bills accumulated by Ministries Departments and Agencies (MDAs) reached Ksh84 billion at end-June 2022.

[9] With the September price adjustment, subsidies for gasoline were eliminated, while prices for diesel and kerosene were brought into closer alignment with global prices. Domestic fuel prices were further adjusted in line with developments in international markets in October and November.

Text Table 3. Kenya: Social Spending Outlays, 2016–23

	FY16/17	FY17/18	FY18/19	FY19/20	FY20/21	FY22/23
			(Ksh. Millions)			
Social spending	256,253	305,275	345,956	380,051	407,905	434,585
Social protection	15,489	18,329	26,669	25,554	26,031	26,194
Education	219,010	269,534	295,555	314,027	337,524	359,130
Health	21,754	17,412	23,732	40,470	44,350	49,260
Memo item			*(Percent of GDP)*			
Social spending	3.2	3.4	3.5	3.6	3.6	3.4

Source: Authorities data and estimates.
Note: Fiscal year GDP is estimated as average of its values in the calendar years it spans.

Text Table 4. Kenya: Selected Macroeconomic Assumptions, 2022–42

	2022	2023	2024	2025	2026	2027	Long-term 1/
Nominal GDP (Ksh billion)							
Current DSA	13,650	15,453	17,237	19,087	21,137	23,387	57,822
Previous DSA (December 2021)	13,328	14,790	16,388	18,163	20,133	22,302	50,993
Real GDP (growth)							
Current DSA	5.3	5.1	5.5	5.5	5.5	5.5	5.5
Previous DSA (December 2021)	5.8	5.5	5.5	5.5	5.5	5.5	5.6
Revenue and grants (percent of GDP)							
Current DSA	17.5	17.6	17.9	18.0	17.9	18.1	19.4
Previous DSA (December 2021)	17.1	17.8	18.3	18.7	19.1	19.2	20.0
Primary fiscal balance (percent of GDP)							
Current DSA	-1.4	-0.3	0.5	0.8	0.8	0.9	1.0
Previous DSA (December 2021)	-2.2	-0.5	0.3	0.9	1.3	1.1	1.0
Non-interest current account (percent of GDP)							
Current DSA	-4.3	-3.6	-3.6	-3.4	-3.3	-3.4	-3.0
Previous DSA (December 2021)	-3.9	-4.0	-3.9	-3.9	-3.8	-3.6	-3.4
Exports of goods and services (growth)							
Current DSA	18.9	9.9	10.1	10.2	8.9	8.3	9.6
Previous DSA (December 2021)	17.9	13.3	11.9	10.8	8.9	9.4	9.6

Sources: Kenyan authorities and IMF staff estimates.
1/ Average 2028-42 for current DSA and 2027-41 for the previous one.

11. The narrower fiscal deficit and lower actual and projected external financing in FY2021/22 and FY2022/23 bring down the path of nominal public debt in the DSA baseline. The under-execution of external project financing amounted to over US$700 million in FY2021/22, and a previously-planned EUR1 billion (around US$1.1 billion) Eurobond issuance (Text Table 5) did not take place. In addition, the planned rationalization of capital spending in the FY2022/23 Supplementary Budget, which is under preparation, will lower external financing needs by around US$1 billion. As the authorities' borrowing plan for FY2022/23 does not include the unrealized Eurobond issuance, the latter is not included in the DSA baseline. The actual and projected lower external project financing in FY2021/22 and FY2022/23 is similarly not compensated in the outer years, as limits to investment absorption capacity are expected to be binding. These changes in financing assumptions result in a more favorable path of debt burden metrics than in the last DSA assessment.

12. To support economic recovery, the CBK has lent the equivalent of three-quarters of the 2021 US$740 million general allocation of SDRs to the government in local currency to meet financing needs in FY2021/22 and FY2022/23. Plans to use the remainder of the allocation to meet additional financing needs in FY2022/23 are reflected in the DSA baseline. In the DSA, the amounts lent enter in the calculation of the present value (PV) of total public debt with their present value, which reflects a grant element of 39.4 percent.

Text Table 5. Kenya: Selected Macroeconomic Indicators, 2021–27

	2021	2022	2023	2024	2025	2026	2027
		Projections					
Real GDP growth (percent)	7.5	5.3	5.1	5.5	5.5	5.5	5.5
CPI inflation, average (percent)	6.1	7.7	7.8	5.7	5.0	5.0	4.9
Overall fiscal balance (percent of GDP) [1]	-8.2	-6.2	-5.8	-4.4	-3.9	-3.8	-3.8
Primary balance (percent of GDP)[1]	-4.0	-1.3	-1.1	0.3	0.7	0.8	0.9
Current account balance (percent of GDP)	-5.2	-5.7	-5.4	-5.3	-5.1	-5.0	-5.0
Exports of goods and services (US$ billion)	11.8	14.1	15.5	17.0	18.8	20.4	22.1
Exports of goods and services (growth; percent)	21.8	18.9	9.9	10.1	10.2	8.9	8.3
Gross international reserves (US$ billion)	9.5	8.1	7.0	8.1	9.2	9.9	11.0

Sources: Kenyan authorities and IMF staff estimates and projections.
[1] Fiscal years (e.g., 2021 refers to FY 2020/21).

13. Debt service relief under the G-20 Debt Service Suspension Initiative (DSSI) reduced external financing needs in 2021, while its repayment will have the opposite effect over 2022–28. In 2021, total relief under the DSSI amounted to US$504 million or 0.46 percent of GDP.

14. As part of the restructuring of Kenya Airways (KQ), the Government of Kenya has begun servicing the guaranteed portion of KQ external debts, which the company can no longer service, while discussions on novation of a part of this guaranteed stock is ongoing. The sum of the principal of these obligations and the remaining government guarantee on other KQ external loans (US$688 million as of November 2022) is lower than the US$750 million government guarantee of KQ debts included in the stock of external PPG debt at end-2021. As a result, the operation will lower the nominal stock of external PPG debt, but raise its present value, due to the assumption of the associated interest payments by the government and shorter repayment period than previously assumed.

15. The current account deficit is expected to widen to 5.7 percent of GDP in 2022, before converging to 5 percent over the medium term:

- The disruption of global trade and finance from the war in Ukraine is expected to widen the current account deficit in 2022. While Kenya's direct exposure to Russia and Ukraine is relatively small, the external trade balance has weakened, due to sharp increases in international import prices of commodities with relatively inelastic demand, such as oil derivatives, cereals, and fertilizers. This is only partially being offset by higher prices for Kenya's main agricultural exports (tea, horticulture, and coffee) and consumer and intermediate goods exports in 2022, reflecting global developments.

- Over the medium term, the current account balance is expected to strengthen on the back of further fiscal consolidation, supported by robust goods exports and tourism receipts and a flexible exchange rate, and by the gradual normalization of global commodity and financial market conditions.[10] Export growth stands to benefit from Kenya's improving business environment, leveraging on existing trade and investment agreements,[11] and the new administration's policy priorities to increase the share of manufacturing (including agro-processing) and services (including tourism and financial sector) in the economy. In addition, export growth will be supported by policies to enhance agricultural productivity, including focus on farmer-led irrigation, efforts to modernize Kenya's food systems, and greater value chain integration. Services are projected to gradually increase over the medium term, as the tourism sector realizes its full potential. Remittances are also projected to remain robust over the medium term. The private sector current account deficit is expected to be financed by a diversified set of sources, including foreign direct investment (FDI) and financial and non-financial corporate borrowing.

16. As part of a continuing commitment to reduce external debt-related vulnerabilities, the public sector gross financing needs will be met with a balanced mix of external and domestic financing.[12] For external financing, Kenya is expected to continue to primarily rely on concessional development loans. The authorities' external borrowing program, set out in Text Table 6, is in line with the authorities' commitments under the IMF-supported EFF/ECF program. These include an overall ceiling on the present value of newly contracted or guaranteed external public debt, which is also a performance and policy action (PPA) under the World Bank's Sustainable Development Finance Policy (SDFP).[13] The cumulative external borrowing program through end-December 2023 is consistent with planned drawings of concessional and non-concessional loans in FY2022/23 and FY2023/24. The borrowing program continues to provide space for the US$1.1 billion external commercial financing, which did not take place in FY2021/22, and US$5 billion for debt

[10] Over the medium term, the non-interest current-account deficit, which nets out interest outflows from the overall deficit, is somewhat narrower than in the last DSA, reflecting the impact of the global tightening of financial conditions primarily on the private external interest bill. The impact of the higher projected interest rates on the overall current account deficit is more muted, due to the positive impact on interest income from private sector's sizeable external assets.

[11] Kenya is a member of the East African Community Customs Union and the African Continental Free Trade Area. It has signed an Economic Partnership Agreement (EPA) with the UK and has started bilateral implementation of European Union-East African Community EPA. In 2022, Kenya and the United States engaged in Strategic Trade and Investment Partnership that aims, *inter alia*, to increase investment, promote sustainable and inclusive economic growth, and support African regional economic integration.

[12] The 2022 Medium-Term Debt Management Strategy targets a ratio of gross domestic to external financing of three to one. However, a significant share of gross domestic financing is for rollover of short-term debt that is issued and matures within the same financial year. In the DSA, the share of external in total gross financing is around 50 percent in 2022–25, as the rollover of short-term debt that is issued, matures, and is rolled over within each year is not included in the calculation of the public sector gross financing need.

[13] One FY2022 PPA sought to improve debt management by ensuring that the government limits the present value of new external borrowing to US$5.6 billion in FY2021/22, except if this limit is adjusted by the World Bank to a) reflect any material change of circumstances or b) in coordination with the IMF, in particular in line with adjustments in the IMF Debt Limit Policy. The PPA was observed by a wide margin.

management operations,[14] both of which have been put on hold in light of the current challenging market conditions for frontier markets and are not reflected in the DSA baseline. Looking ahead, Kenya is expected to continue to tap global capital markets to roll over maturing external commercial financing, with the next Eurobond maturity falling due in June 2024.

Text Table 6. Kenya: Summary Table of Projected External Borrowing Program from July 1, 2021, to December 31, 2023

Public and Publicly Guaranteed (PPG) External Debt [1]	Volume of New Debt from Jul 1, 2021 to Dec 31, 2023		PV of New Debt from Jul 1, 2021 to Dec 31, 2023 (Program Purposes)	
	US$ million	Percent	US$ million	Percent
By sources of debt financing	**17,654**	**100**	**13,340**	**100**
Concessional debt, of which	**10,156**	**58**	**5,950**	**45**
Multilateral debt	4,508	26	2,593	19
Bilateral debt	3,107	18	1,765	13
Other	2,511	14	1,574	12
Non-concessional debt, of which	**7,498**	**42**	**7,389**	**55**
Semi-concessional	379	2	270	2
Commercial terms	7,120	40	7,120	53
By Creditor Type	**17,654**	**100**	**13,340**	**100**
Multilateral, *of which*	4,693	27	2,716	20
World Bank	3,894	22	2,231	17
Bilateral - Paris Club	1,146	6	679	5
Bilateral - Non-Paris Club	1,962	11	1,086	8
Other, *of which*	9,853	56	8,858	66
For debt management operations [2]	5,000	28	5,000	37
Uses of debt financing	**17,654**	**100**	**13,340**	**100**
Infrastructure	4,693	27	3,591	27
Social Spending	5,661	32	3,356	25
Budget Financing	1,368	8	856	6
Other, *of which*	5,932	33.6	5,536	42
For debt management operations [2]	5,000	28	5,000	37

1/ Contracting and guaranteeing of new debt. The present value of debt is calculated using the terms of individual loans and applying the 5 percent program discount rate. For commercial debt, the present value is defined as the nominal/face value.

2/ Planned potential borrowing for debt management operations to improve the debt profile (in terms of PV and debt service profile). Debt management operations are not reflected in the DSA baseline.

17. The realism tools flag some optimism compared to historical performance, reflecting a structural break with past trends based on the policies underpinning the authorities' ambitious reform program (Figure 4). While protecting social spending, the baseline scenario assumes an improvement of the fiscal primary balance of 3.3 percentage points of GDP over three years in 2022–24, which falls in the top quartile of the distribution for LICs. Staff is of the view that this is realistic and in line with the authorities' plan for fiscal consolidation under the program, as

[14] The authorities are actively exploring market-based commercial debt options to reduce rollover risks stemming from maturing commercial debts.

reflected in the execution of the FY2021/22 budget, their careful management of expenditures to achieve fiscal targets in the face of unanticipated pressures in FY2022/23, and their medium-term plans to strengthen tax revenues and streamline recurrent expenditures—particularly for wages and transfers to public sector entities—while improving public investment management and budgetary controls. The authorities' commitment to fiscal consolidation, including actions taken during the pandemic to broaden the tax revenue base—which have delivered resilience by creating fiscal space to cover unanticipated needs resulting from the war in Ukraine (e.g., gradual approach to adjusting domestic fuel prices during 2022)—and planned actions to identify offsets to compensate for expenditure pressures in FY2022/23, while reducing the primary balance below budgeted levels, provide assurances that the fiscal adjustment under the program is achievable. The return of real GDP growth to its long-term potential, following the strong recovery from the COVID–19 shock in 2021, explains the near-term growth trajectory during planned fiscal consolidation. Export growth is projected to be higher than in the recent past, as exports of goods and services recover from the 2020 global shock and by 2029 return to a similar share of GDP as observed in 2015.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

18. Kenya's debt carrying capacity is assessed as Medium (Text Table 7). The debt carrying capacity determines the applicable thresholds for the PPG external and total public debt sustainability indicators used in the assessment. It is informed by the value for Kenya of the Composite Indicator (CI) Index of 3.02,[15] which incorporates data from the IMF's October 2022 *World Economic Outlook* (WEO) macroeconomic projections and the 2021 World Bank's Country Policy and Institutional Assessment (CPIA). The marginally lower CI score relative to the last published DSA is on account of the weaker outlook for global growth and slightly lower projected path of import coverage of reserves, which are partly offset by upward revisions in real growth, the ratio of remittances to GDP, and improvement in the CPIA score.

19. Besides the six standardized stress tests, the analysis includes two tailored stress tests. The combined contingent liabilities stress test is described in paragraph 2 above. The market financing shock is applied to countries with market access, such as Kenya. It assesses rollover risks resulting from a deterioration in global risk sentiment, temporary nominal depreciation, and shortening of maturities of new external commercial borrowing.

[15] The CI captures the impact of various factors through a weighted average of an institutional indicator, real GDP growth, remittances, international reserves, and world growth. All inputs are in the form of 10-year averages across 5 years of historical data and 5 years of projection.

Text Table 7. Kenya: Composite Indicator and Thresholds

Debt Carrying Capacity and Thresholds

Country	Kenya
Debt Carrying Capacity	Medium

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintage
Medium	Medium 3.02	Medium 3.03	Medium 3.04

Note: The current-vintage Composite Indicator Index is based on the IMF's 2022 October World Economic Outlook and the 2021 World Bank Country Policy and Institutional Assessment (CPIA).

Calculation of the CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.74	1.44	48%
Real growth rate (in percent)	2.719	4.88	0.13	4%
Import coverage of reserves (in percent)	4.052	39.99	1.62	54%
Import coverage of reserves^2 (in percent)	-3.990	15.99	-0.64	-21%
Remittances (in percent)	2.022	3.40	0.07	2%
World economic growth (in percent)	13.520	2.90	0.39	13%
CI Score			3.02	100%
CI rating			Medium	

Applicable thresholds

APPLICABLE EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	180
GDP	40
Debt service in % of	
Exports	15
Revenue	18

APPLICABLE TOTAL public debt benchmark	
PV of total public debt in percent of GDP	55

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

20. **External debt burden indicators in terms of exports breach thresholds under the baseline, giving rise to a mechanical high-risk signal (Table 1, Table 3, and Figure 1).** Based on the debt-carrying capacity analysis, the PV of PPG external debt-to-exports solvency indicator remains above the threshold (180 percent) through 2025, while the debt service-to-exports liquidity indicator exceeds its threshold (15 percent) until 2030. The solvency indicator gradually declines as exports recover; the long-term decline in the liquidity indicator is interrupted by Eurobond repayments in 2024 and 2028 and the rollover of external bank loans coming due in 2025. Compared to the last DSA assessment, the outlook for the PV of external debt-to-exports has improved, due to the stronger-than-anticipated fiscal outturn in FY2021/22 and planned rationalization of capital spending in FY2022/23, reflected in lower-than-previously anticipated external financing, the faster recovery of tourism, and the boost to exports from higher export prices in 2022 linked to global developments. These positive trends are partly offset by the impact of projected higher nominal interest rates on the PV of debt, reflecting the higher cost of external loans with floating interest rates and of new external commercial and domestic debt.

21. The PV of PPG external debt as a share of GDP remains well below the 40 percent indicative threshold throughout the projection period (Table 1 and Figure 1). Reflecting fiscal consolidation efforts and a borrowing mix that favors concessional borrowing, this solvency indicator is expected to decline from 27 percent in 2021 to 18 percent in 2042. The external debt service-to-revenue ratio exceeds its threshold in 2024, reflecting the maturing Eurobond in that year.

22. Standard stress test results highlight the sensitivity of debt indicators to exports (Figure 1 and Table 1). Specifically, under the most extreme shock scenario (shock to export growth), the PV of debt-to-exports and the debt service-to-exports ratios breach the threshold over the entire medium-term projection period. Under the most extreme scenario involving one-time depreciation, the debt service-to-revenue ratio can potentially breach the threshold in 2023–26 and in 2028.

23. The market financing pressures module ranks market liquidity risks as moderate (Figure 5). Kenya's EMBI spread has widened above the threshold of 570 basis points (641 basis points as of November 14, 2022, having come down from the highs reached prior to the elections). On the plus side, gross financing needs are below the threshold (14 percent of GDP) that indicates high risk. Fiscal consolidation efforts under the IMF-supported EFF/ECF program would help keep gross financing needs below the threshold. As is the case for other emerging and frontier economies, financing risks are affected by global liquidity conditions. Persistent deterioration in global market conditions would exacerbate financing risks for Kenya. The shift in the deficit financing mix toward domestic resources calls for monitoring, given the elevated levels of domestic interest rates.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

24. The PV of total public debt-to-GDP ratio remains above the 55 percent benchmark—for a country rated at medium debt-carrying capacity—until 2025 (Figure 2 and Table 2), giving rise to a mechanical high-risk signal. Public sector debt is projected to peak in 2021–22 (going from 61.6 percent of GDP (PV terms) in 2021 to 61.7 percent in 2022), followed by a steady decline. Supported by fiscal consolidation under the program, including revenue mobilization measures, the PV of public debt-to-revenue ratio would gradually decline from 369 percent in 2021 to 115 percent in 2042.

25. Stress tests indicate that the PV of debt-to-GDP ratio is likely to remain above its indicative benchmark for most of the projection period under these scenarios (Figure 2 and Table 4). This is also the case in the historical scenario, in which key variables are kept at their historical averages, underscoring the importance of the authorities' ambitious reform agenda to reorient the economy to private-sector and export-oriented growth drivers to durably reduce debt-related vulnerabilities. Under the most extreme shock scenario (combined contingent liabilities shock), the PV of the public debt-to-GDP ratio would breach the 55 percent benchmark for a country with medium debt-carrying capacity through 2029.

RISK RATING AND VULNERABILITIES

26. Kenya's overall and external public debts are sustainable but remain at high risk of debt distress. The mechanical risk signals indicate sustained breaches of sustainability thresholds by solvency and liquidity indicators under the baseline scenario—the PV of external debt-to-exports and external debt service-to-exports ratios, as well as the PV of overall public debt-to-GDP ratio. A number of additional considerations mitigate the mechanical risk signals, supporting the analysis:

- The decisive actions already undertaken in 2020-21 to limit the increase in the deficit from global shocks (pandemic, war in Ukraine) and to broaden the tax base;
- The multi-year fiscal consolidation under the IMF supported EFF/ECF program which aims to decisively reduce deficits and increase tax revenue;
- The consistently strong performance of remittances, which supports external sustainability, paired with a more favorable outlook for exports;
- A generally smooth external debt service profile on a clear declining trajectory as share of exports and public revenues, which authorities plan to further optimize if market conditions are favorable;
- Close attention to evaluating risks at SOEs and the commitment under the IMF-supported EFF/ECF program to limit the impact on the deficit of any fiscal support (e.g., via offsets);
- Ongoing efforts to strengthen fiscal sustainability under the SDFP by rationalizing public investments on the basis of rigorous criteria.
- Looking ahead, efficient investment in infrastructure will raise growth and export potential, both of which will support Kenya's external debt sustainability.

27. Fiscal consolidation under Kenya's IMF-supported program would achieve and surpass the debt-stabilizing primary balance. Debt would begin declining as a share of GDP starting in 2023. Indicators measured against exports will also gradually improve with the recovery of exports and reforms under the IMF-supported EFF/ECF program to enhance competitiveness. Given the magnitude of mechanical threshold breaches under the baseline, consolidation efforts would need to be sustained over the medium term to restore fiscal space and reduce debt-related risks. Of note:

- While the PV of total public debt-to-GDP ratio remains above the indicative threshold (55 percent), the authorities' commitment to fiscal consolidation under the program safeguards debt sustainability. Important actions have already been taken to permanently broaden the tax revenue base, alongside expenditure savings to limit expansion of the deficit from the COVID-19 shock and the war in Ukraine. The multiyear fiscal consolidation plan highlighted in the 2022 Budget Policy Statement (BPS) and substantiated by the FY2022/23 Budget is premised on a more conservative approach to revenue projections and a commitment to additional policy steps to increase tax revenues and control expenditures under the EFF/ECF program with the specific objective of anchoring debt sustainability. The authorities are in the process of preparing a Supplementary FY2022/23 Budget aligned with the objectives of the IMF-supported EFF/ECF program.

- Kenya's PV of external debt as a share of GDP is well below the 40 percent indicative threshold and will gradually decline over time. Kenya's external debt indicators are expected to gradually improve as fiscal consolidation progresses, exports recover after the global shocks dissipate, and Kenya makes progress to unlock its substantial export potential.
- Kenya's borrowing plan relies on a balanced mix of commercial and concessional financing that contributes to reducing debt risks, supported by limits on the government's external borrowing under the EFF/ECF program and PPAs under the SDFP, which also support steps to improve debt transparency.

28. Debt sustainability is also supported by stable and strong remittances, Kenya's generally smooth debt service profile and the authorities' commitment to insulate the public sector balance sheet from SOE-related contingent liabilities. While the protracted breaches of most debt burden indicators are a source of concern, there are mitigating factors that help support the debt sustainability assessment. The relatively smooth debt service profile—except for maturing Eurobonds and external bank loans in 2024, 2025, and 2028—is on a clear declining trajectory over the projection period, signaling a strengthening in debt servicing capacity. The authorities' commitment to absorb the fiscal costs associated with materialization of SOE-related contingent liabilities with a limited impact on the programmed fiscal envelope will help avoid further deterioration in the public sector balance sheet. Stable and strong remittances, amounting to 32 percent of exports of goods and services in 2021, would also continue to be an important source for foreign currency receipts going forward.

29. The assessment is subject to heightened uncertainty in the global environment and a narrow scope for deviations from the domestic reform agenda underpinning the baseline. Kenya is exposed to heightened risks to the global outlook through international trade and financing channels. Intensification of global spillovers from the war in Ukraine could drive persistent investor concerns about the prospects of frontier economies and increase the cost of financing. Faster-than-projected tightening of monetary policy in major economies could further tighten financing conditions and result in decline in demand for Kenya exports from the main trading partners. Domestic government bond holdings by pension funds and commercial banks expose the economy to feedback between sovereign and financial sector risks, while the need to rollover maturing external commercial debt exposes the country to risks from a liquidity squeeze. Delays in the implementation of structural reforms, or shocks to the global demand for commodities, could lead to a growth in exports that is lower than the one expected in the baseline. Even with the strong commitment by authorities to fiscal consolidation, there is a risk for slippages especially in the long run. Finally, crowding-in effect of the fiscal consolidation into private sector growth might take longer to materialize.

AUTHORITIES' VIEWS

30. The authorities broadly shared Fund staff's assessment, emphasizing that reducing debt vulnerabilities is a key priority to support Kenya's developmental agenda. At the same time, they stressed the indispensable role of sustainable debt financing in meeting the infrastructure

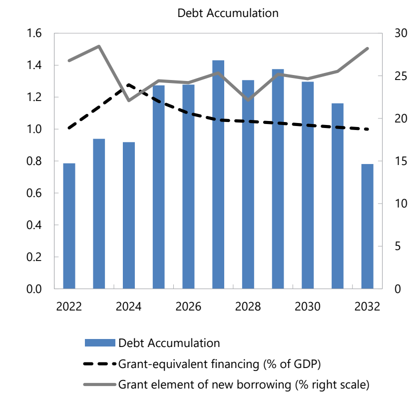
needs of Kenya's vibrant economy. The authorities highlighted their determination to continue to extend the maturity of domestic debt and pursue a financing strategy that balances domestic and external financing, relies primarily on concessional financing, and accesses international capital markets judiciously. The authorities reiterated their strong commitment to debt transparency. The authorities expressed confidence that passage of the new, national debt ceiling in present value terms, which is expected to be a priority for the new parliament, will serve as a credible anchor of their medium-term fiscal policies. They noted that they are actively seeking debt management operations to lower the costs of debt and refinancing risks, especially by seeking to refinance maturing commercial debt with long-dated debt instruments.

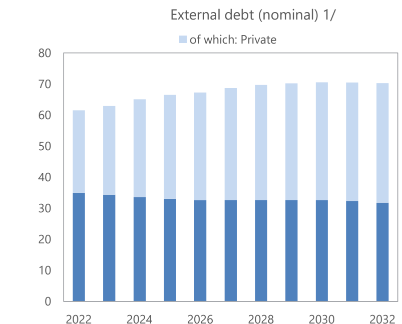
Table 1. Kenya: External Debt Sustainability Framework, Baseline Scenario, 2019–42

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2032	2042	Historical	Projections
External debt (nominal) 1/	52.6	60.0	60.3	61.5	62.9	65.1	66.5	67.3	68.7	70.3	66.7	46.5	67.5
of which: public and publicly guaranteed (PPG)	30.3	35.4	34.5	35.0	34.4	33.6	33.1	32.6	32.7	31.8	24.0	26.0	33.0
Change in external debt	2.6	7.4	0.3	1.2	1.4	2.2	1.4	0.8	1.4	-0.2	-0.7		
Identified net debt-creating flows	0.8	3.9	-0.1	2.1	1.5	1.1	0.6	0.5	0.3	-1.2	-1.9	2.1	0.3
Non-interest current account deficit	4.0	3.6	4.0	4.3	3.6	3.6	3.4	3.3	3.4	2.8	3.1	5.5	3.4
Deficit in balance of goods and services	8.9	7.9	9.1	9.6	9.1	8.9	8.6	8.5	8.6	7.4	6.8	10.1	8.5
Exports	11.4	9.6	10.7	12.0	12.8	13.3	13.7	14.0	14.2	16.9	25.7		
Imports	20.3	17.6	19.8	21.6	22.0	22.2	22.3	22.5	22.9	24.3	32.4		
Net current transfers (negative = inflow)	-5.3	-4.9	-5.5	-5.8	-5.9	-5.9	-5.9	-6.0	-6.1	-6.2	-6.5	-5.1	-6.0
of which: official	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0		
Other current account flows (negative = net inflow)	0.4	0.6	0.5	0.4	0.4	0.5	0.7	0.8	0.9	1.5	2.8	0.5	0.9
Net FDI (negative = inflow)	-0.4	-0.6	0.0	-0.6	-0.8	-0.9	-1.1	-1.2	-1.3	-2.0	-2.9	-0.9	-1.3
Endogenous debt dynamics 2/	-2.8	0.8	-4.0	-1.6	-1.3	-1.5	-1.6	-1.7	-1.9	-2.0	-2.2		
Contribution from nominal interest rate	1.2	1.2	1.2	1.4	1.8	1.8	1.7	1.7	1.6	1.7	1.4		
Contribution from real GDP growth	-2.4	0.1	-4.1	-3.0	-3.1	-3.3	-3.3	-3.4	-3.5	-3.7	-3.5		
Contribution from price and exchange rate changes	-1.7	-0.4	-1.1	...	...	...	...	...	...	...	...		
Residual 3/	1.8	3.6	0.3	-0.8	-0.1	1.0	0.8	0.3	1.1	1.0	1.2	1.0	0.7
of which: exceptional financing	0.0	0.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	27.4	26.6	26.8	26.1	25.6	25.1	25.0	24.2	17.7		
PV of PPG external debt-to-exports ratio	...	...	256.1	221.5	208.6	195.9	186.5	179.8	175.4	143.4	68.8		
PPG debt service-to-exports ratio	35.0	25.8	23.5	22.6	20.5	29.6	21.2	19.2	15.8	14.5	7.3		
PPG debt service-to-revenue ratio	23.8	15.1	15.3	15.7	15.2	22.3	16.5	15.2	12.6	13.3	9.0		
Gross external financing need (Million of U.S. dollars)	24,024	22,467	23,437	25,575	26,016	28,701	28,551	29,626	30,403	36,776	56,928		
Key macroeconomic assumptions													
Real GDP growth (in percent)	5.1	-0.3	7.5	5.3	5.1	5.5	5.5	5.5	5.5	5.5	5.6	4.4	5.4
GDP deflator in US dollar terms (change in percent)	3.5	0.9	1.8	0.6	-2.2	0.6	1.3	1.6	0.7	-0.1	-0.2	4.5	0.2
Effective interest rate (percent) 4/	2.6	2.2	2.1	2.4	3.0	3.0	2.8	2.7	2.5	2.5	2.2	2.3	2.6
Growth of exports of G&S (US dollar terms, in percent)	-0.8	-15.4	21.8	18.9	9.9	10.1	10.2	8.9	8.3	9.7	10.0	2.2	10.1
Growth of imports of G&S (US dollar terms, in percent)	1.2	-13.2	23.3	16.0	4.3	7.4	7.5	7.7	8.0	7.4	8.8	3.6	7.7
Grant element of new public sector borrowing (in percent)	...	...	...	26.8	28.5	22.1	24.4	24.2	25.3	28.2	31.6	...	25.2
Government revenues (excluding grants, in percent of GDP)	16.8	16.4	16.5	17.3	17.4	17.6	17.7	17.6	17.8	18.4	20.7	16.9	17.9
Aid flows (in Million of US dollars) 5/	1,476	1,841	1,785	2,133	2,300	2,749	3,103	3,114	3,195	3,923	5,576		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	1.0	1.1	1.3	1.2	1.1	1.1	1.0	0.8	...	1.1
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	31.8	33.8	26.7	29.6	29.9	31.5	35.3	41.4	...	31.0
Nominal GDP (Million of U.S. dollars)	100,328	100,931	110,519	117,068	120,322	127,770	136,548	146,277	155,325	201,910	341,482		
Nominal dollar GDP growth	8.8	0.6	9.5	5.9	2.8	6.2	6.9	7.1	6.2	5.4	5.4	9.2	5.6
Memorandum items:													
PV of external debt 7/	...	...	53.2	53.1	55.3	57.6	59.0	59.8	61.0	62.7	60.3		
In percent of exports	...	...	496.9	442.0	430.3	432.1	429.5	428.3	428.1	370.9	235.1		
Total external debt service-to-exports ratio	170.3	188.3	160.0	141.2	133.5	134.8	119.7	112.9	104.2	79.7	41.6		
PV of PPG external debt (in Million of US dollars)			30,279	31,148	32,247	33,352	34,979	36,723	38,816	48,939	60,316		
(PVt-PVt-1)/GDPt-1 (in percent)				0.8	0.9	0.9	1.3	1.3	1.4	0.8	0.3		
Non-interest current account deficit that stabilizes debt ratio	1.5	-3.8	3.8	3.1	2.2	1.4	1.9	2.6	2.0	3.0	3.8		

Definition of external/domestic debt	Currency-based
Is there a material difference between the two criteria?	No





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

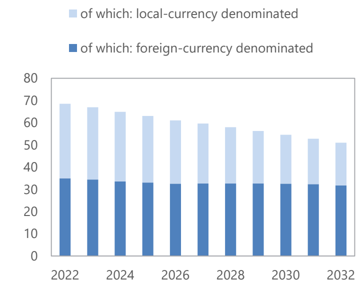
Table 2. Kenya: Public Sector Debt Sustainability Framework, Baseline Scenario, 2019–42

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2032	2042	Historical	Projections
Public sector debt 1/	**59.1**	**68.0**	**67.8**	**68.6**	**67.0**	**64.9**	**63.0**	**61.1**	**59.6**	**51.0**	**30.0**	**52.0**	**59.7**
of which: external debt	**30.3**	**35.4**	**34.5**	**35.0**	**34.4**	**33.6**	**33.1**	**32.6**	**32.7**	**31.8**	**24.0**	**26.0**	**33.0**
Change in public sector debt	2.6	8.9	-0.1	0.7	-1.6	-2.1	-1.9	-1.9	-1.5	-1.8	-2.3		
Identified debt-creating flows	**2.3**	**7.8**	**0.6**	**-2.4**	**-2.3**	**-2.2**	**-2.0**	**-2.1**	**-2.1**	**-2.4**	**-2.8**	**2.6**	**-2.3**
Primary deficit	**3.4**	**3.8**	**2.7**	**1.4**	**0.3**	**-0.5**	**-0.8**	**-0.8**	**-0.9**	**-0.9**	**-1.3**	**3.5**	**-0.6**
Revenue and grants	17.0	16.7	16.7	17.5	17.6	17.9	18.0	17.9	18.1	18.7	21.0	**17.3**	**18.2**
of which: grants	0.2	0.2	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3		
Primary (noninterest) expenditure	20.4	20.4	19.4	18.8	18.0	17.4	17.2	17.1	17.2	17.8	19.7	**20.8**	**17.6**
Automatic debt dynamics	**-1.2**	**4.0**	**-2.1**	**-3.7**	**-2.6**	**-1.6**	**-1.2**	**-1.2**	**-1.2**	**-1.5**	**-1.4**		
Contribution from interest rate/growth differential	-0.4	2.8	-3.0	-3.7	-2.6	-1.6	-1.2	-1.2	-1.2	-1.5	-1.4		
of which: contribution from average real interest rate	2.4	2.6	1.7	-0.3	0.7	1.9	2.2	2.1	1.9	1.2	0.2		
of which: contribution from real GDP growth	-2.7	0.1	-4.8	-3.4	-3.3	-3.5	-3.4	-3.3	-3.2	-2.8	-1.7		
Contribution from real exchange rate depreciation	-0.8	1.2	0.9	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	**0.4**	**1.1**	**-0.7**	**3.1**	**0.7**	**0.1**	**0.1**	**0.1**	**0.7**	**0.6**	**0.5**	**0.7**	**0.7**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**61.6**	**61.7**	**60.0**	**57.8**	**55.9**	**54.0**	**52.5**	**44.0**	**24.1**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**368.7**	**353.1**	**340.4**	**322.5**	**310.9**	**301.0**	**289.6**	**235.3**	**114.9**		
Debt service-to-revenue and grants ratio 3/	**57.4**	**54.1**	**55.9**	**52.0**	**57.0**	**62.7**	**54.5**	**49.9**	**43.9**	**39.1**	**17.0**		
Gross financing need 4/	13.2	12.8	12.1	10.5	10.4	10.7	9.0	8.1	7.1	6.4	2.3		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	5.1	-0.3	7.5	5.3	5.1	5.5	5.5	5.5	5.5	5.5	5.6	**4.4**	**5.4**
Average nominal interest rate on external debt (in percent)	3.9	3.5	3.1	3.3	3.2	3.0	3.1	3.1	3.0	3.2	2.5	**2.7**	**3.1**
Average real interest rate on domestic debt (in percent)	7.0	6.7	6.8	2.6	2.6	5.1	6.1	6.0	5.9	4.4	1.8	**4.8**	**4.9**
Real exchange rate depreciation (in percent, + indicates depreciation)	-2.9	3.9	2.8	...	...	...	...	...	...	...	...	**-1.5**	**...**
Inflation rate (GDP deflator, in percent)	4.3	4.9	5.0	7.2	7.7	5.7	5.0	5.0	4.9	4.9	4.8	**6.6**	**5.4**
Growth of real primary spending (deflated by GDP deflator, in percent)	3.7	-0.2	2.1	2.1	0.2	2.1	4.3	5.0	6.3	6.3	6.8	**5.2**	**4.6**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	0.8	-5.1	2.8	0.6	1.9	1.5	1.1	1.1	0.6	0.9	1.0	**-0.5**	**1.0**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Currency-based**
Is there a material difference between the two criteria?	**No**

Public sector debt 1/



Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government plus social security, central bank, government-guaranteed debt . Definition of external debt is Currency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 3. Kenya: Sensitivity Analysis for Key Indicators of Public and Publicly-Guaranteed External Debt, 2022–32

(In percent)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
PV of debt-to GDP ratio											
Baseline	27	27	26	26	25	25	25	25	25	25	24
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	27	27	27	29	30	32	33	35	37	39	40
B. Bound Tests											
B1. Real GDP growth	27	28	29	28	27	27	27	27	27	27	27
B2. Primary balance	27	28	31	30	30	30	30	30	30	30	29
B3. Exports	27	29	32	31	31	31	30	30	30	29	29
B4. Other flows 3/	27	28	29	29	28	28	28	28	27	27	26
B5. Depreciation	27	34	29	29	28	28	28	28	28	28	28
B6. Combination of B1-B5	27	31	31	31	30	30	30	30	30	29	29
C. Tailored Tests											
C1. Combined contingent liabilities	27	30	30	29	29	29	29	29	29	29	29
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	27	27	26	26	25	25	25	25	25	25	24
C4. Market Financing	27	30	29	29	28	28	28	28	28	27	27
Threshold	40	40	40	40	40	40	40	40	40	40	40
PV of debt-to-exports ratio											
Baseline	**221**	**209**	**196**	**186**	180	175	170	165	159	153	143
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	**221**	**209**	**206**	**209**	**216**	**222**	**226**	**231**	**235**	**237**	**237**
B. Bound Tests											
B1. Real GDP growth	**221**	**209**	**196**	**186**	180	175	170	165	159	153	143
B2. Primary balance	**221**	**219**	**230**	**220**	**213**	**208**	**202**	**197**	**191**	**183**	173
B3. Exports	**221**	**268**	**343**	**326**	**314**	**306**	**296**	**286**	**273**	**259**	**241**
B4. Other flows 3/	**221**	**221**	**219**	**208**	**201**	**196**	**189**	**183**	176	167	156
B5. Depreciation	**221**	**209**	172	163	158	154	149	145	142	137	129
B6. Combination of B1-B5	**221**	**260**	**216**	**266**	**257**	**251**	**243**	**235**	**226**	**215**	**202**
C. Tailored Tests											
C1. Combined contingent liabilities	**221**	**233**	**222**	**213**	**206**	**201**	**196**	**192**	**188**	**181**	171
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**221**	**209**	**196**	**186**	180	175	170	165	159	153	143
C4. Market Financing	**221**	**209**	**196**	**187**	**181**	177	172	164	158	150	141
Threshold	180	180	180	180	180	180	180	180	180	180	180
Debt service-to-exports ratio											
Baseline	**23**	**21**	**30**	**21**	**19**	**16**	**19**	**15**	**15**	15	15
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	**23**	**19**	**28**	**20**	**19**	**16**	**18**	**16**	**16**	**17**	**17**
B. Bound Tests											
B1. Real GDP growth	**23**	**21**	**30**	**21**	**19**	**16**	**19**	**15**	**15**	15	15
B2. Primary balance	**23**	**21**	**30**	**23**	**21**	**18**	**21**	**17**	**18**	**17**	**17**
B3. Exports	**23**	**25**	**44**	**33**	**30**	**25**	**29**	**25**	**27**	**26**	**25**
B4. Other flows 3/	**23**	**21**	**30**	**22**	**20**	**17**	**20**	**16**	**17**	**16**	**16**
B5. Depreciation	**23**	**21**	**30**	**20**	**18**	15	**18**	14	14	13	13
B6. Combination of B1-B5	**23**	**23**	**39**	**29**	**26**	**22**	**26**	**22**	**22**	**21**	**21**
C. Tailored Tests											
C1. Combined contingent liabilities	**23**	**21**	**30**	**22**	**20**	**17**	**20**	**16**	**16**	**16**	**16**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**23**	**21**	**30**	**21**	**19**	**16**	**19**	**15**	**15**	15	15
C4. Market Financing	**23**	**21**	**30**	**24**	**18**	**17**	**20**	**26**	**20**	14	14
Threshold	15	15	15	15	15	15	15	15	15	15	15
Debt service-to-revenue ratio											
Baseline	16	15	**22**	16	15	13	15	13	13	13	13
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	16	14	**21**	16	15	12	15	13	14	15	16
B. Bound Tests											
B1. Real GDP growth	16	16	**24**	18	17	14	17	14	14	14	15
B2. Primary balance	16	15	**23**	18	17	14	17	14	15	15	16
B3. Exports	16	15	**23**	18	17	14	17	14	16	16	16
B4. Other flows 3/	16	15	**23**	17	16	13	16	14	15	14	15
B5. Depreciation	16	**19**	**28**	**20**	**19**	15	**19**	15	15	15	15
B6. Combination of B1-B5	16	16	**25**	**19**	17	15	18	15	16	16	16
C. Tailored Tests											
C1. Combined contingent liabilities	16	15	**23**	17	16	13	16	13	14	14	14
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	16	15	**22**	16	15	13	15	13	13	13	13
C4. Market Financing	16	15	**22**	**19**	14	14	16	**21**	17	12	13
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

3/ Includes official and private transfers and FDI.

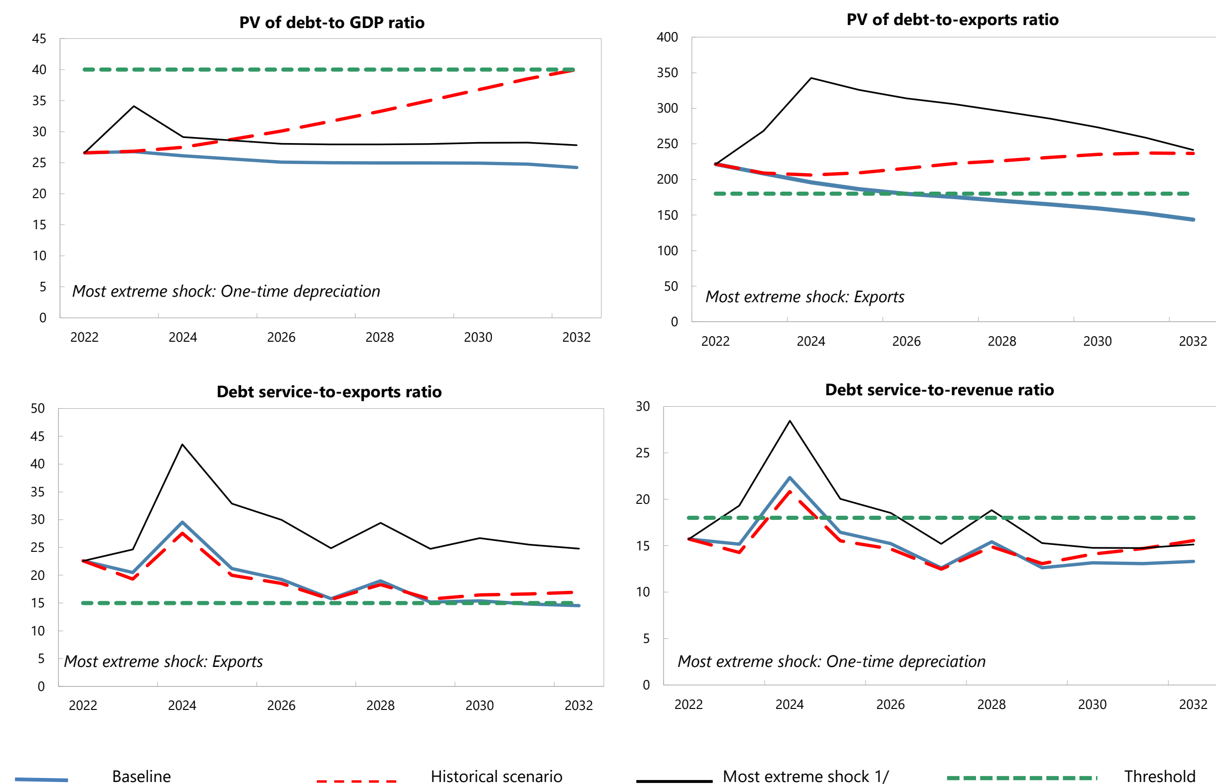
Table 4. Kenya: Sensitivity Analysis for Key Indicators of Public Debt, 2022–32

(In percent)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
PV of Debt-to-GDP Ratio											
Baseline	**62**	**60**	**58**	**56**	54	52	51	49	47	46	44
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	**62**	**64**	**66**	**67**	**69**	**70**	**72**	**74**	**75**	**77**	**78**
B. Bound Tests											
B1. Real GDP growth	**62**	**63**	**65**	**65**	**64**	**64**	**64**	**63**	**63**	**62**	**62**
B2. Primary balance	**62**	**64**	**67**	**65**	**63**	**61**	**59**	**58**	**56**	54	52
B3. Exports	**62**	**62**	**63**	**61**	**59**	**58**	**56**	54	52	50	48
B4. Other flows 3/	**62**	**62**	**61**	**59**	**57**	**55**	54	52	50	48	46
B5. Depreciation	**62**	**63**	**59**	**56**	53	50	47	45	42	40	37
B6. Combination of B1-B5	**62**	**62**	**65**	**63**	**61**	**59**	**58**	**56**	54	52	50
C. Tailored Tests											
C1. Combined contingent liabilities	**62**	**68**	**66**	**64**	**62**	**60**	**58**	**56**	55	53	51
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**62**	**61**	**59**	**58**	**57**	**57**	**56**	**56**	**56**	**55**	**55**
C4. Market Financing	**62**	**60**	**58**	**56**	54	53	51	49	47	45	44
TOTAL public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Revenue Ratio											
Baseline	353	340	322	311	301	290	277	266	256	245	235
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	355	364	366	373	382	389	393	400	407	412	418
B. Bound Tests											
B1. Real GDP growth	355	359	365	360	357	352	346	341	338	334	330
B2. Primary balance	355	361	374	361	350	338	324	312	301	290	279
B3. Exports	353	351	353	341	330	318	305	293	281	269	257
B4. Other flows 3/	353	350	340	328	318	306	293	281	270	258	247
B5. Depreciation	355	359	331	312	295	277	259	243	228	213	198
B6. Combination of B1-B5	355	351	362	350	339	327	313	302	291	280	269
C. Tailored Tests											
C1. Combined contingent liabilities	355	387	367	354	344	331	317	305	295	283	273
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	355	346	331	323	318	312	306	303	300	297	294
C4. Market Financing	353	340	323	311	302	291	278	265	254	243	233
Debt Service-to-Revenue Ratio											
Baseline	52	57	63	55	50	44	43	40	40	39	39
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	52	58	66	60	56	50	51	50	52	53	53
B. Bound Tests											
B1. Real GDP growth	52	59	69	62	57	51	51	49	50	51	52
B2. Primary balance	52	57	67	62	55	48	49	47	48	48	46
B3. Exports	52	57	63	56	51	45	44	41	43	42	41
B4. Other flows 3/	52	57	63	55	51	44	44	41	41	41	40
B5. Depreciation	52	55	65	55	51	44	44	40	40	39	38
B6. Combination of B1-B5	52	56	64	61	53	47	46	45	45	44	43
C. Tailored Tests											
C1. Combined contingent liabilities	52	57	72	59	53	47	49	46	46	46	43
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	52	57	63	55	51	45	45	43	45	45	46
C4. Market Financing	52	57	63	57	49	45	44	48	44	39	38

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Figure 1. Kenya: Indicators of Public and Publicity Guaranteed External Debt Under Alternatives Scenarios, 2022–32



Customization of Default Settings		
	Size	Interactions
Tailored Stress		
Combined CL	No	
Natural disaster	n.a.	n.a.
Commodity price	No	No
Market financing	No	No

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

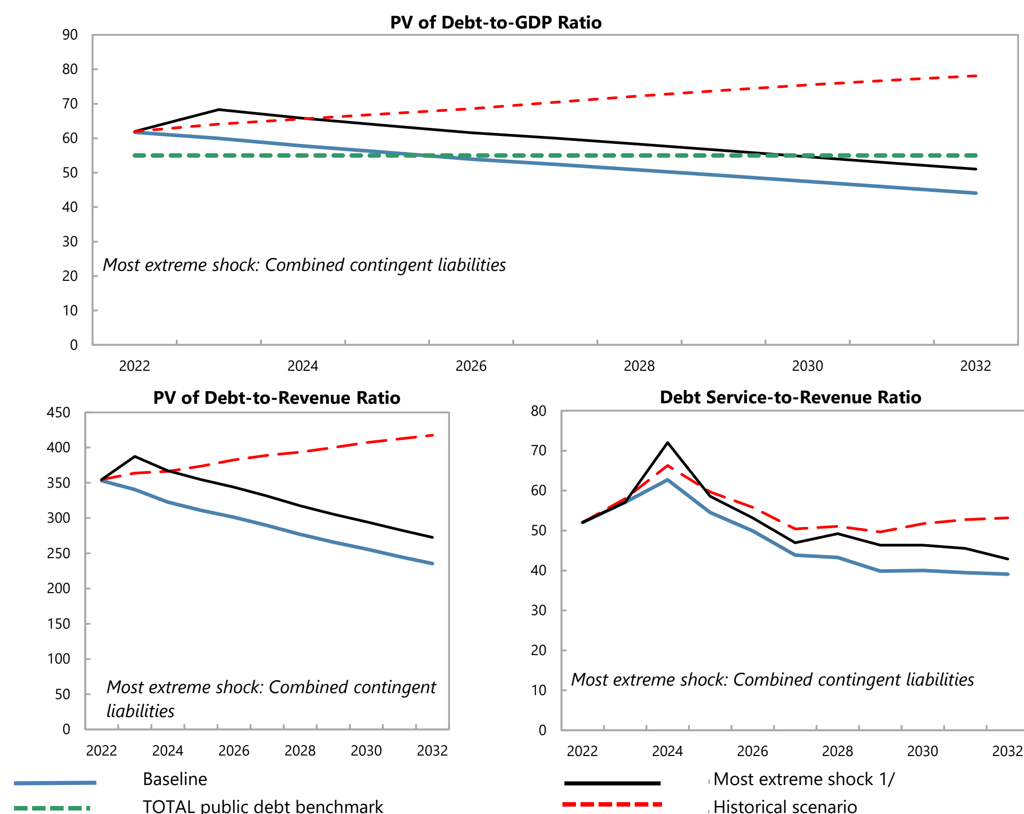
Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	3.6%	3.6%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	20	20
Avg. grace period	5	5

* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 2. Kenya: Indicators of Public Debt Under Alternative Scenarios, 2022–32



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	41%	41%
Domestic medium and long-term	44%	44%
Domestic short-term	15%	15%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	3.6%	3.6%
Avg. maturity (incl. grace period)	20	20
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	4.5%	4.5%
Avg. maturity (incl. grace period)	8	8
Avg. grace period	4	4
Domestic short-term debt		
Avg. real interest rate	1.6%	1.6%

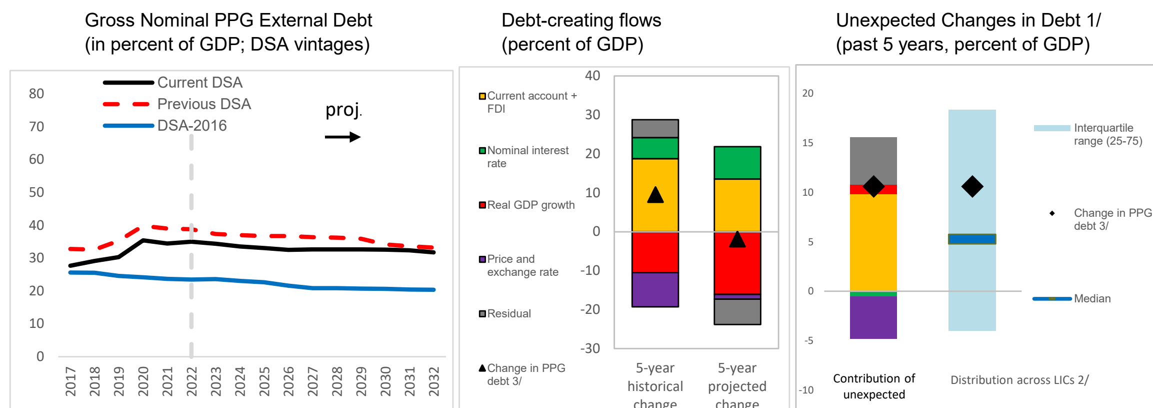
* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

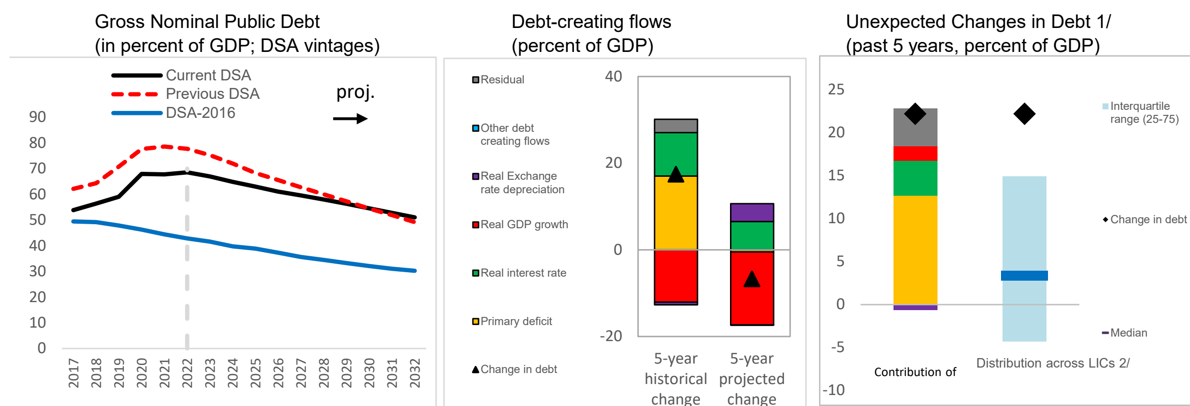
1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 3. Kenya: Drivers of Debt Dynamics–Baseline Scenario External Debt

External Debt



Public Debt



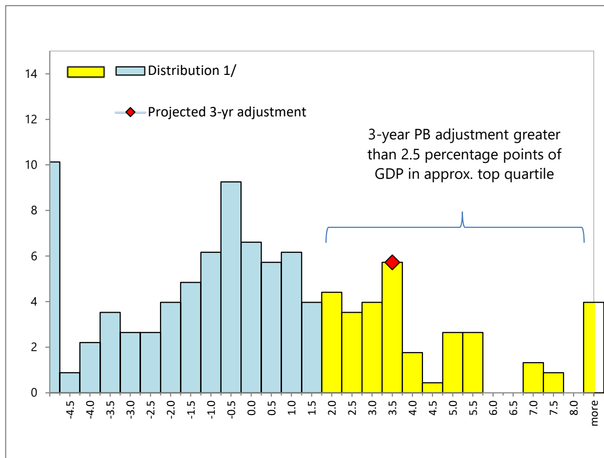
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

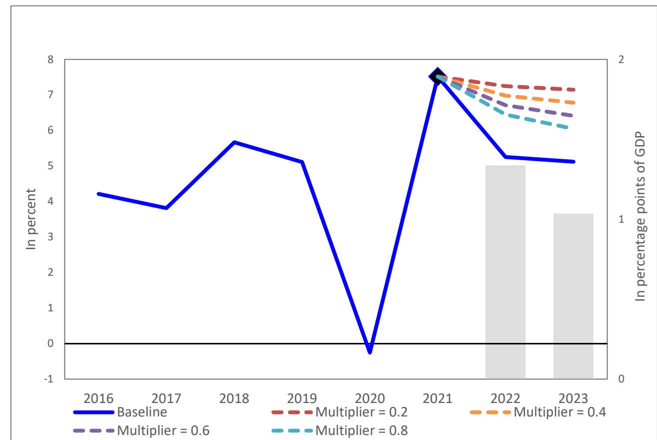
Figure 4. Kenya: Realism Tools

3-Year Adjustment in Primary Balance (Percentage points of GDP)



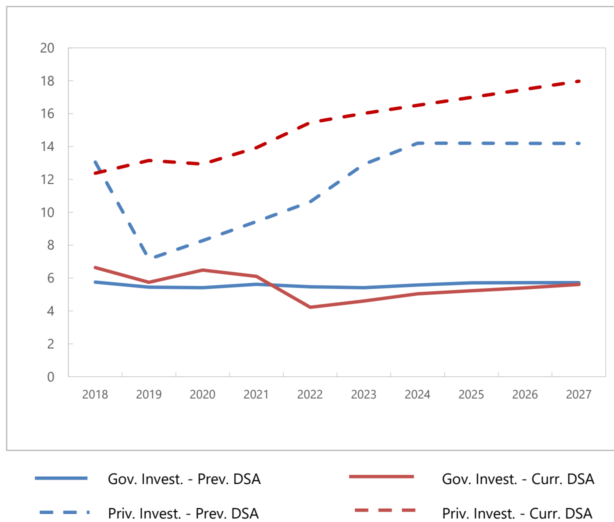
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(percent of GDP)



Contribution to Real GDP growth
(percent, 5-year average)

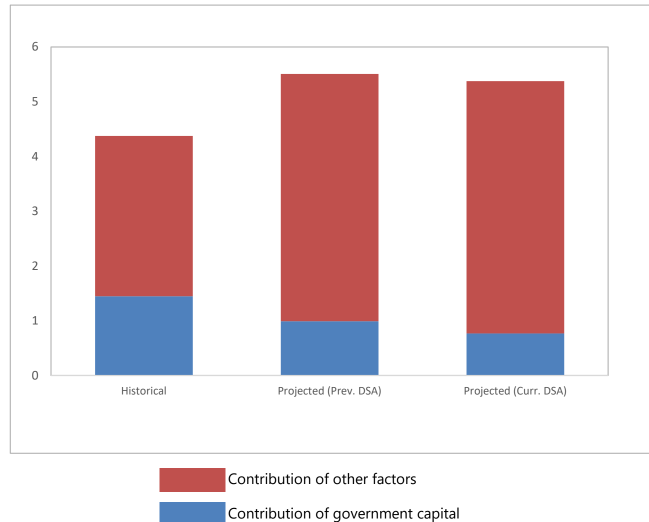
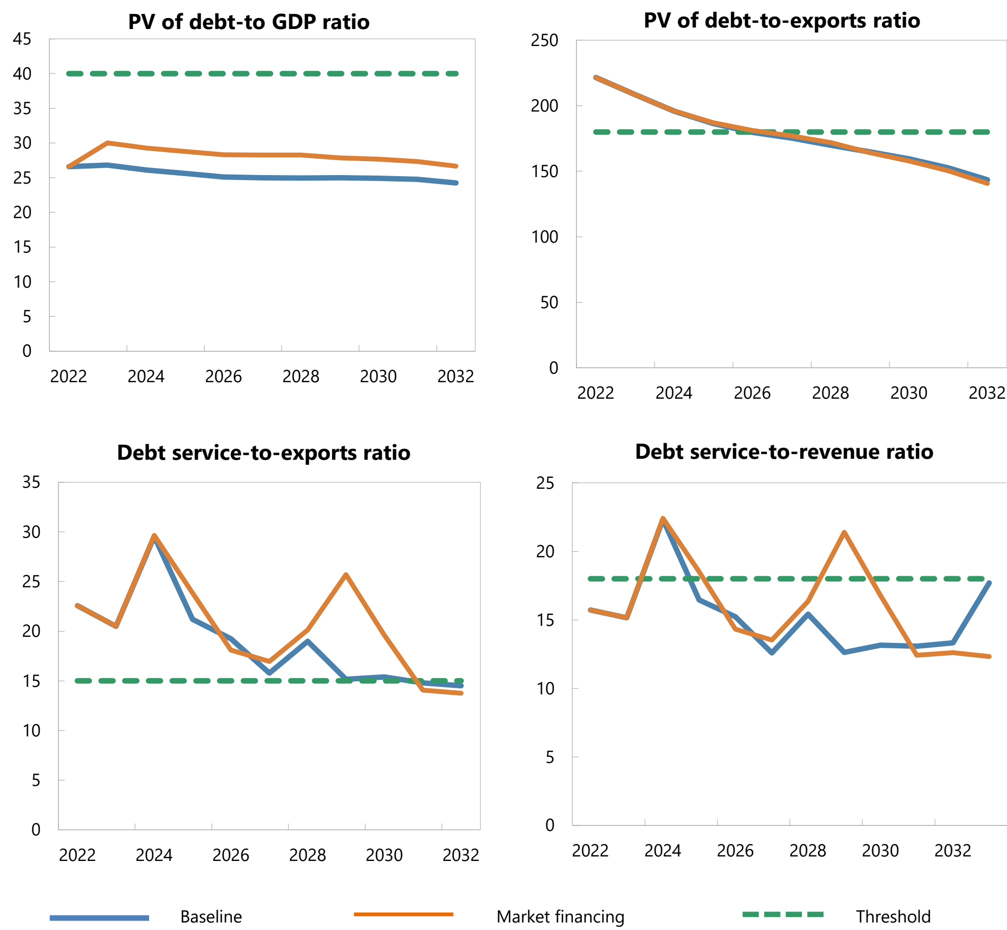


Figure 5. Kenya: Market-Financing Risk Indicators

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	11	641
Breach of benchmark	No	Yes
Potential heightened liquidity needs	Moderate	

1/ Maximum gross financing needs (GFN) over 3-year baseline projection horizon.
2/ EMBI spreads correspond to the latest available data.



Sources: Country authorities; and staff estimates and projections.

Statement by the Executive Director, Mr. Willie Nakunyada, and by the Senior Advisor of the Executive Director, Mr. James Alic Garang
December 19, 2022

Introduction

1. Our Kenyan authorities appreciate the robust policy discussions during the fourth reviews under the Extended Credit Facility and Extended Fund Facility (ECF/EFF) arrangements. They broadly share staff's appraisal and recommendations.

2. The Kenyan economy has successfully weathered the effects of external and domestic shocks, including the spillovers from the war in Ukraine and multi-season droughts. Such resilience largely reflects the benefits from economic diversification. While the circumstances remain challenging, the new administration remains committed to a bottom-up economic development approach, alongside revenue based fiscal consolidation efforts aimed to place public debt on a sustainable footing. Going forward, the authorities' primary policy objective is to maintain price stability to support robust and inclusive growth, anchored on strong policies focusing on promoting sound macroeconomic management. The authorities are also determined to fulfill their commitments to the ECF/EFF program and achieve the overarching objectives of their National Development Plan. Consequently, program performance was exceptionally strong with comfortable margins registered in key targets. At the same time, they remain committed to implementing their 8-point Economic Stimulus Program, focusing on supporting Micro, Small and Medium-sized Enterprises (MSMEs), youth, and women.

Program Performance

3. All quantitative targets were met, though some structural benchmarks were delayed amid elections and associated political uncertainty. A Eurobond issuance of $1.1bn that was planned for the first half of 2022 was suspended given the difficulty faced by Emerging Markets and Frontier Economies in accessing the international capital markets. All end-June 2022 and continuous QPCs were met. The tax collection, and primary balance overperformed by 0.7 and 1.7 percentage points of GDP, respectively. The net international reserves overperformed the adjusted target; and end-June 2022 IT targets on priority social expenditure overperformed. Further, no exchequer requests outstanding for more than 90 days were accumulated; and the MPCC was met with the three-month average of inflation within the target band as of end-June 2022.

4. Regarding the structural reform agenda, delays were experienced due to electoral process. Consequently, 1/3 SBs (end-July-August) was completed on time and our authorities

are committed to complete pending items by end-2022. Specifically, a draft action plan to restore Kenya Power and Lighting Company (KPLC) medium-term Profitability which was prepared but internal consultations on some key proposals, could not take place prior to elections. Further, a circular with the action plan for the development of a Medium-Term Revenue Strategy (MTRS) was issued on August 30. At the same time, the review of the fuel pricing mechanism and establishment of a task force to oversee progressive elimination of the fuel subsidy within the first half of FY2022/23 awaits further consultations. Finally, publication of audits of COVID-19 vaccine spending were completed by July 2021, albeit with a delay and reports for all 47 counties have now been published. Considering the above performance, and notable progress on remedial actions on SBs, the authorities look forward to Directors' support to complete this EFF/ECF review.

5. To meet fiscal financing needs and build reserves, the authorities are requesting an augmentation of access by 30 percent of quota under the ECF program. In addition, they are requesting modifications of end-December 2022 and end-June 2023 targets on the net international reserves and the end-June 2023 targets on tax revenues and the primary fiscal balance. The authorities requested revisions to end-June targets on tax revenues and the primary fiscal balance to achieve a somewhat higher tax revenue target and a lower primary balance deficit. On the other hand, the lower reserves path reflects unfavorable global financial conditions in FY21/22, as well as the authorities' strong efforts to rationalize public investment projects which will correspondingly reduce associated inflows of foreign project finance. In addition, a more cautious view on private sector capital flows over the medium term considering the uncertain global outlook also accounted for the lower reserve path. They are also proposing new targets for end-December 2023 and structural benchmarks.

Recent Economic Development and Outlook

6. Despite multiple shocks, the growth continued to expand rapidly to 5.6 percent in 2022, albeit at a slower pace than the 7.5 percent recorded in 2021. A quick and orderly political transition, alongside robust expansion in credit to the private sector, service sector, and continued strength in remittances have underpinned the growth performance. Going forward, the near-term outlook is subject to upside risks, including from the authorities' strong performance to date and demonstrated commitment to adopting contingency measures as needed to achieve program objectives. Moreover, the smooth transition to a new government should support confidence and activity; while better-than-expected rainfall would support a faster recovery in agricultural production and improve food security. Further, confidence, investment, and market access could rebound more quickly than expected on resolution of global uncertainty and with Kenya's demonstrated commitment to fiscal consolidation. Consumer prices increased from 5.4 percent in January to 9.5 percent in

November 2022. The increase in inflation was driven by higher food prices resulting from reduced agricultural production, global supply constraints, and higher import prices.

7. Further, global shocks are expected to slightly widen the current account deficit from 5.2 percent of GDP in 2021 to 5.7 percent of GDP in 2022, as the elevated fuel import bill will be partially offset by improving services balance and higher remittances. Nonetheless, gross international reserves remain adequate, covering 3.5 months of imports. That said, the authorities are confident that any materialization of upside potential on external fiscal financing would support a higher level of reserve than in the current baseline.

Fiscal Policy and Debt Management

8. The Kenyan authorities remain committed to ensuring fiscal and debt sustainability, including through multi-year fiscal consolidation efforts aimed to place the public debt on a downward trajectory. They are bolstering revenue collection and controlling overall spending while prioritizing investment expenditures. They are also making extra efforts to address challenges emanating from the multi-season drought which led to higher food prices and exacerbating food insecurity in vulnerable regions such as the arid and semi-arid regions. Though downside risks from external and domestic sources loom large, the authorities remain optimistic that these would be mitigated. Specific mitigating options include the strong performance and commitment to adopt contingency measures as warranted to achieve program objectives, close engagement with development partners, and a tailored CD strategy, including plans to develop a Medium-Term Revenue Strategy (MTRS).

9. The authorities' steadfast efforts to mobilize revenues continue to bear fruit as evidenced by the recent strong tax overperformance. Broadly, Kenya Revenue Authority (KRA) is committed to developing and implementing risk-based compliance strategies; strengthening KRA's audit function, including by rebuilding audit capacity, upgrading staff skills, strengthening feedback loops between the disputes and audit areas; and strengthening data analytics to support compliance risk management. Further, KRA will continue to manage exemptions by building on their efforts to improve VAT compliance and broaden VAT exemption verification at customs to new areas, including those administered under the East African Community Customs Management Act, by end-June 2023. In addition, KRA plans to improve taxpayer service to support voluntary compliance. They will also endeavor to improve the use of data science in developing effective and timely services and compliance interventions, while leveraging stakeholders' engagement in the design and delivery of taxpayer services. Further, in light of the court decision that does not uphold the Minimum Alternative Tax, the authorities plan to meet any resulting gap that could arise for the FY2022/23 tax targets through administrative measures.

10. The authorities remain committed to contain spending pressures and strengthen the PFM system to safeguard fiscal discipline. They plan to implement an ambitious rationalization of non-priority spending (1.7 percentage points of GDP in FY2022/23) to offset most of these pressures, for instance, from carryovers. These efforts are geared to divert budgeted resources from inactive and/or slow-moving investment projects and introducing additional savings in recurrent administrative spending, while protecting priority social spending. They will submit to Cabinet the supplementary FY2022/23 Budget consistent with program objectives by end-January 2023. The National Treasury pursues an ambitious agenda geared at improving budget processes and controls, while strengthening fiscal risk management.

11. The authorities are addressing SOEs' financial and governance challenges, including through privatization initiatives. To this end, the authorities reduced extraordinary SOE support, given limited fiscal space, and they will focus on identifying cost-saving reforms at Kenya Airways (KQ) and Kenya Power & Lighting Company Ltd (KPLC). They also plan to eliminate fuel subsidies. The authorities have adjusted domestic fuel prices since September, in line with developments in international markets. In this connection petrol subsidies were fully eliminated during the first week of the new government, with modest cross-subsidization to support kerosene and diesel, which are more heavily used by the vulnerable households. The authorities expect landed costs of diesel and kerosene to drop further in December and January 2023, effectively eliminating the need for subsidies.

12. Strengthening debt management continues to rank high on our authorities' reform agenda. To this effect the new administration's strong commitment aiming at an overall budget target below the approved budget in FY22/23 is envisaged to deliver a more favorable debt/GDP path than envisaged at the time of the third reviews. Debt is now projected to stabilize at a lower level (as a share of GDP). They will make efforts to reduce refinancing risks by issuing liquid benchmark domestic government bonds across all maturities; and increase utilization of committed external concessional financing. They will also tap into international financial markets to roll over maturing Eurobonds and optimize the external debt service profile if market conditions permit. Our authorities are also committed to strengthen the Public Debt Management Office (PDMO), to effectively manage public debt as envisioned in the Public Financial Management (PFM) Act. They will deepen the domestic debt securities market by implementing reforms developed jointly by the National Treasury (NT) and the CBK. The authorities plan to resubmit to Parliament legislative amendments to harmonize the definition of public debt and replace the existing nominal debt limit with a debt anchor centered on two pillars, by end-March 2023.

Monetary, Exchange Rate, and Financial Sector Policies

13. The Central Bank of Kenya's (CBK) policy objectives remain focused on maintaining headline inflation within the target range; and a flexible, market-determined exchange rate system that absorbs external shocks with interventions only limited to smoothening excess market volatility. Additionally, CBK will issue guidelines to support the smooth, fair, and efficient functioning of the foreign exchange market. The guidelines will be aligned to best practices adopted in leading jurisdictions and incorporate relevant elements of the FX Global code. The CBK acted proactively in the face of elevated inflationary pressures by tightening monetary policy in May 2022, increasing Central Bank Rate (CBR) by 50 basis points (bps). Due to sustained pressures, elevated global risks, and the potential impact on the economy, the CBK further tightened monetary policy by increasing the CBR by an additional 75 basis points in September 2022 and 50 basis points in November 2022, with the three hikes in the policy rate bringing the total to 175 bps this year.

14. The authorities' monetary policy stance remains data dependent. To this end, considering that the current inflation rate, which is outside the CBK's band, is largely driven by food and fuel prices, the authorities' policy direction would be to minimize any second-round effects and ensure that inflationary expectations remain well anchored. Nevertheless, the authorities stand ready to react to further fight inflation if warranted. The CBK is also modernizing its monetary policy framework along the lines set out in the 2021 White Paper. This includes introducing a Central Securities Depository (CSD) which will improve the transmission of monetary policy. They also continue to place high premium on the role of effective communication of these policy intentions in navigating an uncertain path ahead.

15. While the banking sector remains stable, profitable, and resilient, the CBK fully commits to safeguarding financial stability and expanding access to affordable finance. The central bank, therefore, attaches prominence to the need for preservation of capital and liquidity buffers, and close monitoring of FX exposures. In addition, they are committed to ensure banks reduce NPLs, maintain adequate provisioning, and improve asset quality to strengthen the resilience of the financial system. The CBK also continues to closely monitor operational risks from digitalization (including cyber and fraud risks) and corporate exposures across the banking sector – while upgrading the AML/CFT framework. The authorities will maintain the reform momentum to build banking sector resilience and support a move towards real-time supervision. By September 22, more than half of banks had received no-objections certificates from the CBK on their risk-based credit pricing models.

16. The authorities are committed to address challenges related to climate change. The CBK's 2021 Guidance on Climate-Related Risk Management to the banking sector is expected to help banks integrate climate-related risks into their governance, strategy, risk

management and disclosure frameworks. This will enable them to leverage on business opportunities from efforts to mitigate and adapt to climate change. As among early pioneers, the CBK strives to green the banking sector. To this end, the authorities have made a strong case for positive consideration under the Resilience and Sustainability Trust (RST) and aligning that with their climate policies, which are in place. There is now an ongoing CCRD with the WB, targeted to be completed by end-June 2023.

Structural, Transparency, and Governance Reforms

17. The authorities are deepening structural reforms to improve the business environment and boost investment, create employment, and raise potential growth. Further, they are working diligently to strengthen the public procurement system. They are in the process of acquiring an e-procurement system that will be incorporated in their Integrated Financial Management Information System (IFMIS) to automate application of the Procurement Act and regulations. They also expect significant savings from controlling the government wage bill, including by planning to implement a common payroll system linked to IFMIS across all National Government ministries and departments as well as all counties (MDCs) by end-December 2023, while continuing to improve Public Investment Management (PIM) to deliver value for money in public investments. The planned special audit on supplementary budget spending, including under the Article 223 of the Constitution, will provide transparency and accountability while ensuring spending outcomes are consistent with plans.

18. Our authorities have delivered on their LOI commitments to ensure timely action to address audit findings and recommendations. As a critical element in the state's accountability framework, the authorities are taking steps to implement the Auditor-General's audit recommendations, including the audits completed under the COVID-19 spending. They are aligning their asset declaration and conflict of interest legal frameworks with international standards. They are also strengthening the judiciary's capacities to efficiently adjudicate corruption-related criminal cases; and are publishing beneficial ownership of companies and legal persons. In addition, they are implementing the identified actions to address corruption vulnerabilities following the findings of the 2021 National Risk Assessment. These include prudent debt policies and reforms to improve the efficiency of public spending and support competitiveness while fostering good governance in the public resource management.

19. Strengthening AML/CFT remains central to our authorities' efforts to bolster financial integrity. The authorities will take timely actions to address the strategic deficiencies identified in the Kenya 2022 Mutual Evaluation Report by ESAAMLG to safeguard financial and macroeconomic stability. To this end, they plan to submit to the

National Assembly, draft amendments on the Proceeds of Crime and Anti-Money Laundering Act while enhancing due diligence through risk-based supervision.

20. Consistent with the Kenya Vision 2030, the authorities are working to transform the country into an industrialized middle-income economy by boosting inclusive and sustainable development. To this end, they are developing several new initiatives, including the Hustler Fund (Financial Inclusion Fund), National Social Security Fund Reforms, affordable housing, and privatizing SOEs to reduce related fiscal risks. Broadly, preliminary estimates show that these initiatives will have very limited impact on the national budget. Therefore, revamping affordable housing and water supply would be achieved through public private partnerships rather than the government budget. Establishing a Financial Inclusion Fund is envisioned to secure private sector participation with limited budgetary implications. Enhanced contributions to the National Social Security Fund from current low levels to 6 percent each from employee and employer is intended to bolster national savings and strengthen the social safety net.

Conclusion

21. Our Kenyan authorities remain committed to an optimal mix of congruent policies designed to maintain macroeconomic stability and resilience, ensuring fiscal and debt sustainability, and enhancing buffers against external shocks. They continue to view policy efforts to unlock their growth potential as critical to achieve key development objectives articulated in the program and in line with the National Development Plan and priorities of the new administration. To this end, they look forward to the Executive Directors' support to conclude the fourth program reviews, which is important in catalyzing additional external support.