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Debt Management Department

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Foreword

The primary objective of Government debt management policy is to cover the government financing requirements at the lowest possible long-term borrowing costs, subject to a prudent degree of risk. The other objective is to deepen the domestic market for Government securities. This *Annual Public Debt Management Report* reviews the state of public debt management over the last ten years and current reforms in this area. The Ministry of Finance will be publishing this report annually as part of its effort to disseminate information on public debt.

Public debt continues to be a major challenge towards achievement of *Millennium Development Goals*. A significant proportion of the Government budget allocation is to service public debt, leaving inadequate financial resources for pro-poor development programmes. The need to strengthen public debt management is critical not only to lowering the cost of debt service to the Exchequer, but also to the development of Kenya's capital markets. Over the last two years, the Government experienced major lapses in systems and controls related to management of external supplier credit loan contracts. In response to these shortcomings, the Government took steps to develop effective institutional and legal framework for public debt management anchored on a public debt strategy consistent with the *Kenya Vision 2030*.

The critical importance of prudent management of public debt has been recognised in many countries and reform measures are being undertaken. Although no specific model is advocated, there are clear set of best practices that should be taken into account when reforms are being designed. In our context, a set of sound practices to strengthen the quality of public debt management has been identified and implementation is underway.

In conclusion, I wish to take this opportunity to express my appreciation to all the stakeholders participating in the on-going public debt management reforms. At the end of the five-year reform process in 2009, it is envisaged that public debt management will be in accordance with best international practice.

Hon. Amos Kimunya
Minister for Finance
March 2007

Acknowledgement

This is the second *Annual Public Debt Management Report*. The first report was published in 1994. Delay in preparing this important report is attributed to inadequate capacity currently being addressed in the on-going public debt management reforms.

Significant milestones have been achieved in the implementation of the reforms since commencement two years ago. The external debt data has been successfully updated, validated and migrated to the CS-DRMS 2000+ database from the CS-DRMS 7.2 version. Similarly, domestic debt data has been successfully uploaded to the new system. This has improved the quality of debt data, a pre-requisite for effective debt management. In addition, commendable progress has been achieved in consolidating debt management operations under the Debt Management Department (DMD). Supported by a reliable debt database and improved coordination of debt management functions, external debt service payments are currently settled promptly.

By June 2007, electronic debt data will be available on-line between the Ministry of Finance (MoF) and Central Bank of Kenya (CBK) upon completion of the fibre-optic link. A debt sustainability analysis to establish tolerable debt burden thresh-holds and develop a formal *National Debt Strategy* to guide public debt management will also be undertaken. These measures, together with the institutional and legal reforms on public debt management are consistent with the Public Financial Management Reforms that are currently being implemented by the Government whose objective is to strengthen fiscal discipline and enhance performance of the public sector.

I wish to acknowledge the important role played by the Debt Management Department at the Ministry of Finance for co-ordinating production of this report and the Central Bank of Kenya for their technical input. In particular, I convey special thanks to the core team which was involved, namely: John Murugu (Director), Haron Sirima (Deputy Director), George Wanjau (Principal Economist), Charles Kairu (Senior Economist) and Jairus Muaka (Senior Economist) all from the Debt Management Department at the Ministry of Finance, and Isaya Maana and Cappitus Chironga from the Central Bank of Kenya. It is expected that future series of this annual publication will be ready by end November each year.

Mr. Joseph K. Kinyua
Permanent Secretary/Treasury
March 2007

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List of Abbreviations

ADB	African Development Bank
AIA	Appropriation In Aid
CBK	Central Bank of Kenya
CDS	Central Depository for Securities
CFS	Consolidated Fund Services
CS-DRMS	Commonwealth Secretariat Debt Recording & Management System
CUB	Committed Un-disbursed Balance
DGIPE	Department of Government Investment and Public Enterprises
DMD	Debt Management Department
DMO	Debt Management Office
DOD	Disbursed Outstanding Debt
DSA	Debt Sustainability Analysis
ERD	External Resources Department
FLSTAP	Financial and Legal Sector Technical Assistance Project
GDP	Gross Domestic Product
GOK	Government of Kenya
HIPC	Highly Indebted Poor Countries
IDA	International Development Association
IMF	International Monetary Fund
KPLC	Kenya Power and Lighting Company
KPTC	Kenya Post and Telecommunications Corporation
Ksh.	Kenya Shilling
MEFMI	Macro Economic and Financial Management Institute of Eastern and Southern Africa
MoF	Ministry of Finance
NBFI	Non Bank Financial Institutions
NCC	Nairobi City Council
NSE	Nairobi Stock Exchange
NSSF	National Social Security Fund
ODA	Official Development Assistance
PADES	Payment Advice Data Entry System
PV	Present Value
TARDA	Tana and Athi River Development Authority
USD	US Dollar
WB	World Bank

Executive Summary

Over the years, public debt management in Kenya was characterized by weak institutional arrangements with debt functions spread across departments at the MoF and CBK. These include the DMD, External Resources Department (ERD), the Department of Government Investments and Public Enterprises (DGIPE), and Accountant-General's Department at the MoF. In addition, debt management functions within MoF and CBK were guided by weak debt policy framework and *adhoc* debt management strategies. Under-staffing and high staff turnover was evident particularly within DMD, undermining operational efficiency. The external debt database was incomplete and unreliable. There were no documented operations manuals on business processes while the existing public debt registry had incomplete debt records.

In 2003, the Government requested the World Bank for technical assistance to carry out a study on existing public debt management practices and make recommendations on appropriate reforms. A joint mission of the World Bank and IMF submitted to the Government an *Assessment Report on Central Government Debt Management and Domestic Debt Market Development Program*. The report recommended a road map for the establishment of a Debt Management Office (DMO) at the MoF by December 2009 responsible for public debt management.

Over the last ten years, Kenya's public debt stock has been rising. The country's public debt increased from Ksh 466,294 million (or 67.8 percent of GDP) at the end of June 1996 to Ksh 789,076 million (50.5 percent of GDP) at the end of June 2006. In terms of debt category, domestic debt rose from Ksh 120,355 million (17.5 percent of GDP) at the end of June 1996 to Ksh 357,839 million (22.9 percent of GDP) at the end of June 2006 while external debt rose from Ksh 345,939 million (50.3 percent of GDP) to Ksh 431,237 million (27.6 percent of GDP) in the same period. Despite the rise in the stock of debt during the period, the proportion of overall debt to GDP declined due to a faster growth in GDP particularly over the last four years.

The composition of public debt has changed significantly with the share of domestic debt increasing from 25.8 percent of total debt at the end of June 1996 to 45.3 percent at the end of June 2006. Over the same period the proportion of external debt in total debt fell from 74.2 percent to 54.7 percent. The shift in the composition of debt during the period is attributed to reduced access to external funding from multilateral and bilateral agencies and increased domestic borrowing to close the shortfall.

The structure of external debt by creditor type has remained relatively unchanged over the last ten years. As at end of June 2006, the leading multilateral creditor was IDA (47.4 percent of total external debt), followed by the African Development Bank Group (6 percent) and the European Investment Bank (3.1 percent) while Japan (18.4 percent) was the leading bilateral creditor. The currency composition of the external debt was in Euros (34 percent), US dollars (32 percent), Japanese Yen (27 percent) and Sterling Pound (6 percent) while about 1 percent of the debt is denominated in other currencies.

In May 2001, driven by the need to lower the rising cost of domestic debt borrowing, reduce refinancing risk and promote the development of Government securities market, the Government, in consultation with stakeholders through the *Market Leaders Forum* agreed to introduce longer dated Treasury Bonds to lengthen the maturity profile of the debt. This initiative led to a dramatic change in the ratio of Treasury Bills to Treasury Bonds from 74:26 at the end of May 2001 to 30:70 at the end of June 2006. In addition, the Treasury Bonds began to trade at the Nairobi Stock Exchange. In order to curb inflationary pressures resulting from monetised borrowing through Government direct borrowing from CBK, the Central Bank of Kenya Act (Cap 491 Laws of Kenya) was amended to limit the overdraft to 5 percent of the latest Government audited revenue.

Overall public debt service declined during the past 10 years mainly as a result of rescheduling of external debts through the Paris Club and London Club. Debt service decreased from Ksh 57,487 million (39.5 percent of revenue) in the fiscal year 1995/96 to Ksh 44,320 million (14.1 percent of revenue) in the fiscal year 2005/06. However, it should be noted that over the last two years external debt service to commercial creditors decreased significantly following the Government's decision to suspend payments of external commercial debts pending the outcome of a special audit and investigations by the Controller & Auditor General and Kenya Anti-Corruption Commission respectively. Over the period 2000/01 to 2004/05, domestic interest payments remained relatively stable. The sharp increase in domestic interest payments in the fiscal year 2005/06 was attributed to an increase in Government domestic borrowing to mitigate the effects of drought as well as to compensate for the shortfalls in the budgeted external financing.

Kenya rescheduled its bi-lateral debts three times through the Paris Club, in 1994 (USD 540 million), 2000 (USD 288 million) and 2004 (USD 350 million). It also rescheduled its commercial debts in 1998 (USD 43 million) and 2001 (USD 10 million) through the London Club. Although Kenya does not qualify for debt relief under both the HIPC and Multilateral Debt Relief Initiatives (MDRI), Government policy has been to seek for deeper relief on bilateral basis by seeking debt-for-development swap arrangements and debt cancellation. However, according to the results of the Debt Sustainability Analysis (DSA) carried out by the IMF in

November 2003, Kenya's external debt burden indicators reveal that external debt is sustainable.

Over the last two years, the Government has been seeking to resolve outstanding external commercial debts suspended pending completion of a special audit and investigations on the supplier credit contracts. The initial audit reports by the Controller and Auditor General raised concerns over accountability and controls in the way supplier credits were contracted. More specifically, the outstanding commercial debts will be subjected to independent forensic audit and valuation to determine the extent to which all parties have performed in accordance with the contracts and in particular determine whether the Government has received value for money. Broadly, the on-going debt management reforms seek to address weaknesses in the institutional and legal frameworks on management of public debt to ensure that such lapses do not re-cur.

Finally, during the fiscal year 2006/07, total debt service is expected to rise to Ksh 59,109 million out of which Ksh 37,309 million and Ksh 21,800 million is domestic and external debt service respectively. This rise is due to resumption of payment of debts not covered under the 2004 Paris Club rescheduling agreement following the end of the *Consolidation Period* at the end of December 2006 and also the increased cost of servicing the domestic debt stock. Reforms in public debt management will focus on undertaking DSA and preparation of the National Debt Strategy, strengthening of the institutional and legal framework, on-line debt database link between MoF and CBK and scaling up of staff capacity building.

1. INTRODUCTION

This is the second *Annual Public Debt Management Report* by the Ministry of Finance. The first report was published in 1994 and considerable changes have taken place in the public debt management arena over the last ten years. In order to close this knowledge gap, the 2005/6 *Annual Public Debt Management Report* will include the following:

- An overview of public debt management over the period 1996-2005 highlighting key developments in public debt management since the last debt report in 1994.
- Analysis of key developments in external and domestic debt in the fiscal year 2005/06.
- Comparative analysis of Kenya's public debt.
- Suspension of settlement of external commercial debts.
- Highlights of 2003 IMF Debt Sustainability Analysis Report on Kenya.
- Current reforms in public debt management.
- Outlook on Government financing and debt through the medium term.

2. OVERVIEW (1996 – 2005)

2.1 Institutional Framework

In 1985, the Swedish International Development Agency (SIDA) and the Commonwealth Secretariat (ComSec) supported a debt management project aimed at capacity building in sovereign debt management at the Ministry of Finance. Consequently, a Debt Management Division was established in 1987 within the Fiscal and Monetary Affairs Department. However by 2001, the Division's core function had been reduced to recording of external debt and determining concessionality of external loan proposals through computation of the grant element as most of the well trained staff had left for better paying jobs. The Division was upgraded to a department status in July 2002.

Public debt management in Kenya over the years was characterized by weak institutional arrangements with debt functions spread across departments at the MoF and CBK. Besides DMD, the other departments/institutions involved in public debt management activities include;

- **External Resources Department (ERD)**: Sources for external finance, negotiates and contracts loans. It monitors disbursements of external loans and grants and, liaises closely with project coordinators in line ministries.

- **The Central Bank of Kenya:** Manages public domestic debt on behalf of the Treasury. This includes contracting domestic debt through sale of Treasury Bills and Bonds, extending overdraft facilities to the Government, maintaining domestic debt register and making payments of domestic debt. As a Banker to the Government, CBK effects payments to external creditors on specific instructions from the Treasury.

- **The Department of Government Investments and Public Enterprises (DGIPE):** Facilitates on lending of donor funds to public enterprises. It also monitors and receives repayments by these enterprises on behalf of the Government.

- **The Attorney General's Office:** Principal legal adviser to Government and is responsible for reviewing draft loan agreements to ensure conformity with the relevant legislation.

- **Accountant General's Department**: Responsible for cash management and in particular the use of the Government overdraft facility at CBK.

- **Controller & Auditor General**: Responsible for issuance of authority to debit the Consolidated Fund Service account to settle Government debts. It under-takes periodic audits of public debt.

The debt management functions within MoF and CBK were guided by weak debt policy framework and *adhoc* debt management strategies. Under-staffing and high staff turnover was evident particularly within DMD thus undermining operational efficiency. The external debt database was incomplete and unreliable. There were no operations manuals documenting business processes including workflows and the public debt registry lacked complete public debt records.

In 2003, the Government requested the World Bank for technical assistance to carry out a study on existing public debt management practises and make recommendations on appropriate reforms. In response, a joint mission of the World Bank and IMF prepared an *Assessment Report on Central Government Debt Management and Domestic Debt Market Development Program.* The report recommended a road map on establishment of a DMO and strengthening of domestic debt markets in accordance with best practice as outlined in the *2001 IMF/World Bank Guidelines* for *Public Debt Reforms*..

In 2004, the Government approved the recommendations of the *IMF/WB Assessment Report* and signed a credit agreement with the World Bank to support establishment of a DMO and strengthen domestic debt markets. A total of USD 1.5 million was earmarked for the project to be financed and coordinated under the five year *Financial and Legal Sector Technical Assistance Project* (FLSTAP). Two other partners in the initiative are the ComSec and the *Macroeconomic and Financial Management Institute of East and Southern Africa (MEFMI).* Two senior officials were seconded from the CBK in August 2004 to spearhead the reforms. The main activities under the project are:

- Establishment of a comprehensive and reliable public debt database supported by an effective back office.

- Consolidation of debt management functions currently spread within MoF and CBK under one unit, the DMO.

- Capacity building

- Preparation of debt objectives and strategies to guide the operations of DMO.

- Develop a legal framework for public debt management.

2.2 The Legal Framework

Currently, there exist four different but related Acts of Parliament governing public debt management in Kenya, namely: the External Loans & Credits Act (Cap 422), Internal Loans Act (Cap 420), Guarantee Loans Act Cap 461 and the Central Bank of Kenya Act (Cap 491).

The External Loans & Credits Act empowers the Minister for Finance to negotiate the terms and conditions for contracting external loans and credits for the country. The current ceiling for the stock of external debt is Ksh 500,000 million, which was set by Parliament in 2000 and is subject to review. The Act requires the Minister for Finance to report to Parliament details of any new borrowing.

The Internal Loans Act empowers the Minister for Finance to borrow on behalf of Government directly from the domestic market through issuance of Treasury bills and bonds. The Act allows the Government access to an overdraft at the CBK when there is a mismatch between revenue receipts and expenditures. However, to check inflationary pressures resulting from use of the overdraft facility, the CBK Act limits the overdraft level to 5 percent of the latest audited Government revenue.

Guaranteed borrowing by Government enterprises and local authorities is contracted under the Guarantee Loans Act. The current ceiling for guaranteed borrowing as set by Parliament in 1993 is Ksh 80,000 million. Parliamentary approval is required for issuance of a Guarantee to a public enterprise and local authority.

2.3 Debt Management Objectives

The Government borrows mainly to cover its financing requirements. In addition, the Government borrows from the IMF for balance of payments purposes. The *ad hoc* strategy of the Government has been to borrow as much as possible from external lenders on concessional terms while domestic borrowing is only used to cover the remaining resource gap.

The strategy ensures that the debt portfolio is divided into two distinct sub-portfolios from a cost and risk perspective. External debt is long term in nature and is characterised by low interest rates while domestic debt is relatively short term with higher interest rates. The emerging risks on the debt portfolio are mainly related to the currency exposure for the foreign debt and the rollover risk on the domestic debt.

Although not documented, the *ad hoc* debt management strategy of the Government is as outlined in Box 1.

Box 1: Debt Management Strategy

- Ensure that both the level and the rate of growth of Kenya's public debt are fundamentally sustainable over time.
- Seek more debt relief on a bi-lateral basis to release resources to core poverty programs in the Economic Recovery Strategy framework. Debt for development swaps option will be encouraged.
- The Government will contract new concessional foreign loans from multilateral and bilateral sources. Such foreign borrowing must have a grant element of at least 35 percent and will be used to finance core poverty programs.
- In projects that cannot be financed by these type of creditors, external borrowing will be contracted from internationally credit rated commercial banks and financial institutions
- The debt portfolio will continually be reviewed and restructured to minimise debt-servicing costs.
- Domestic borrowing and monetary policies will be closely coordinated so as to ensure that the government raises required resources from the financial market without destabilising interest rates and consequently crowding out the private sector.
- Efforts will be made to lengthen Treasury bond maturity to promote development of the capital markets.
- Ensure that the outstanding external debt stock is within the limit authorised by Parliament.

2.4 Public Debt Stock

Kenya's public debt stock increased from Ksh 466,294 million (67.8 percent of GDP) at the end of June 1996 to Ksh 750,025 million (55.6 percent of GDP) at the end of June 2005 (Table 2.1 and Chart 2.1). Domestic debt rose from Ksh 120,355 million (17.5 percent of GDP) to Ksh 315,573 million (23.4 percent of GDP) while external debt rose from Ksh 345,939 million (50.3 percent of GDP) to Ksh 434,453 million (32.2 percent of GDP) during the period. In US dollar terms, however, external debt fell from US$ 6,025 million in 1996 to US$ 5,701 million in 2005. The increase in external debt in shillings terms was due to depreciation of the Kenya shilling against other currencies over the period.

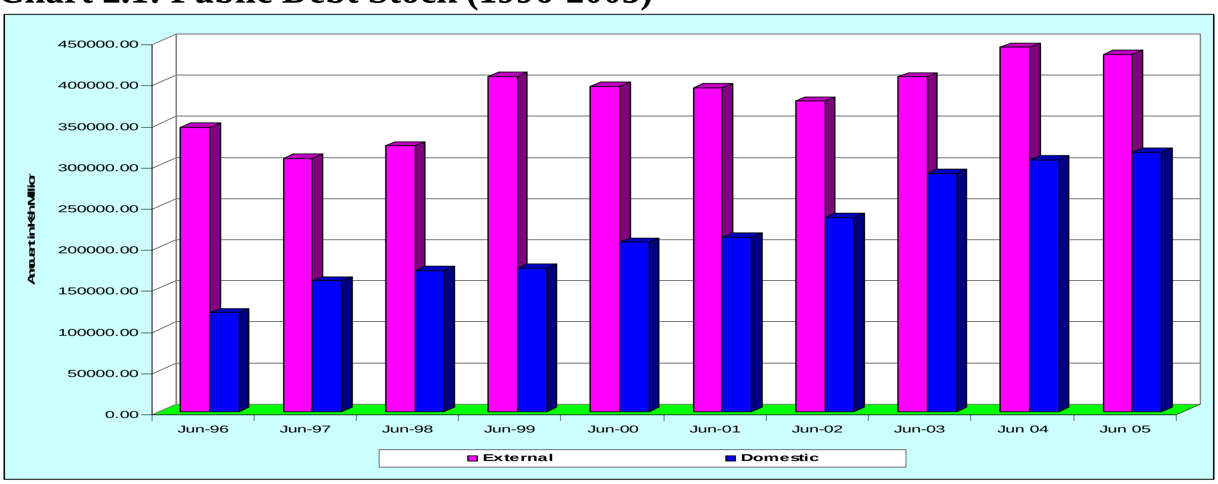
The composition of public debt also changed significantly, with the share of domestic debt increasing from 25.8 percent of total debt at the end of June 1996 to 42.1 percent at the end of June 2005. The proportion of external debt in total debt fell from 74.2 percent to 57.9 percent in the same period. The shift in the composition of debt was mainly attributed to reduced access to external funding. Despite the rise in the stock of debt in the period, the share of overall debt to GDP declined mainly due to a faster growth in GDP compared to the debt.

Table 2.1: Public Debt Stock in Ksh Million (1996-2005)

	Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Jun-01	Jun-02	Jun-03	Jun 04	Jun 05
EXTERNAL	**345,939**	**307,729**	**323,339**	**407,792**	**395,564**	**393,978**	**377,748**	**407,053**	**443,157**	**434,453**
Bilateral	127,753	114,084	108,256	147,937	138,553	132,269	129,973	142,593	162,914	157,669
Multilateral	187,812	163,802	179,276	220,192	230,662	228,497	222,452	233,829	260,658	255,784
Commercial Banks	28,996	26,302	34,915	35,799	24,867	29,423	24,031	3,597	2,912	1,776
Export Credit	1,378	3,540	892	3,864	1,481	3,789	1,292	27,034	16,674	19,224
(As a % of GDP)	50.3	42.2	39.9	55.1	50.9	40.7	36.8	39.2	36.6	32.2
(As a % of total debt)	74.2	65.9	65.3	70.1	65.7	65.0	61.5	58.4	59.1	57.9
DOMESTIC	**120,355**	**159,077**	**171,730**	**174,305**	**206,127**	**211,813**	**235,991**	**289,377**	**306,235**	**315,573**
(As a % of GDP)	17.5	21.8	21.2	23.6	26.5	21.9	23.0	27.9	25.3	23.4
(As a % of total debt)	25.8	34.1	34.7	29.9	34.3	35.0	38.5	41.6	40.9	42.1
GRAND TOTAL	**466,294**	**466,806**	**495,070**	**582,097**	**601,691**	**605,791**	**613,739**	**696,430**	**749,392**	**750,025**
(As a % of GDP)	67.8	64.0	61.1	78.7	77.4	62.6	59.8	67.1	62.0	55.6

Sources: Treasury & Central Bank of Kenya

Chart 2.1: Public Debt Stock (1996-2005)



Source: Treasury and Central Bank of Kenya

During the last decade, a large proportion of external loans were used to finance roads, water and sewerage, energy, education and health projects and programmes. The IDA, African Development Bank Group and the European Investment Bank remained the major multilateral creditors while Japan, France and Germany were the leading bilateral creditors over the same period. External commercial loans were used to finance security related projects.

2.5 Debt Relief Initiatives

A debtor country facing debt-servicing difficulties seeks debt relief. Creditors on a voluntary basis may also grant debt relief. The relief takes the form of waivers, bilateral or commercial debt rescheduling and conversions.

Despite the rising debt stock, recent DSA indicate that Kenya's debt is sustainable in the long run. Thus, the country does not qualify for debt relief under HIPC and MDRI. Both the HIPC and the MDRI debt relief initiatives seek to deliver deeper relief beyond what is currently offered under the Paris Club rescheduling framework. The two initiatives are meant for countries whose debt burdens are unsustainable and cannot be resolved by the various debt rescheduling packages (options) available under the Paris Club.

Over the last ten years, Kenya has received debt relief in various forms:

(i) Under the Paris Club, Kenya has rescheduled arrears and debt flows as follows:

- In 2000 and 2004, Kenya rescheduled, under the Paris Club, debt arrears and flows amounting to US$ 650 million, effectively receiving 50 percent debt relief in present value (PV) terms. Under the Paris Club rescheduling, ODA debt is repaid over 20 years including 10 years grace period at below market interest rates while non-ODA debt is repaid over 15 years including 5 years grace period at commercial interest rates.

- China, Finland and Netherlands opted to cancel debts amounting to US$ 30 million instead of rescheduling the debt under the Paris Club in the same period.

(ii) The Government is negotiating with the Government of Italy for deeper debt relief through a debt-for-development swap. The arrangement will entail cancellation of an equivalent of US$43 million of Paris Club rescheduled ODA debt on condition that the funds are channeled towards poverty alleviation programs.

Although Kenya could have received deeper relief of up to 67 percent under the *Naples Terms*, this would have worsened the country's credit risk rating, undermining the ability of the Government (including Kenya's private sector) to access credit in the international financial markets at competitive terms. Furthermore, some creditors may not be willing to offer additional resources in form of "new loans" to countries seeking relief beyond *Houston Terms*. The

Government intends to build on the debt-for-development swap framework as one option of financing the Millennium Development Goals.

2.6 Debt Service

Kenya's overall debt service[1] declined by Ksh 19,140 million (33.3 percent), from Ksh 57,487 million in the fiscal year 1995/96 to Ksh 38,346 million in the fiscal year 2004/05 (Table 2.2 and Chart 2.2). Expressed as a ratio of total Government revenue, the debt service fell from 39.5 percent to 13.2 percent during the period. Interest payments on domestic debt decreased from Ksh 26,168 million to Ksh 23,375 million during the period while external debt service fell from Ksh 31,319 million to Ksh 14,971 million. This was attributed to a reduction in external borrowing and the impact of 2004 Paris Club debt rescheduling. Furthermore, the Government did not achieve the domestic borrowing target for the fiscal year 2004/05. Instead, there was a Ksh 6,672 million net repayment of domestic debt.

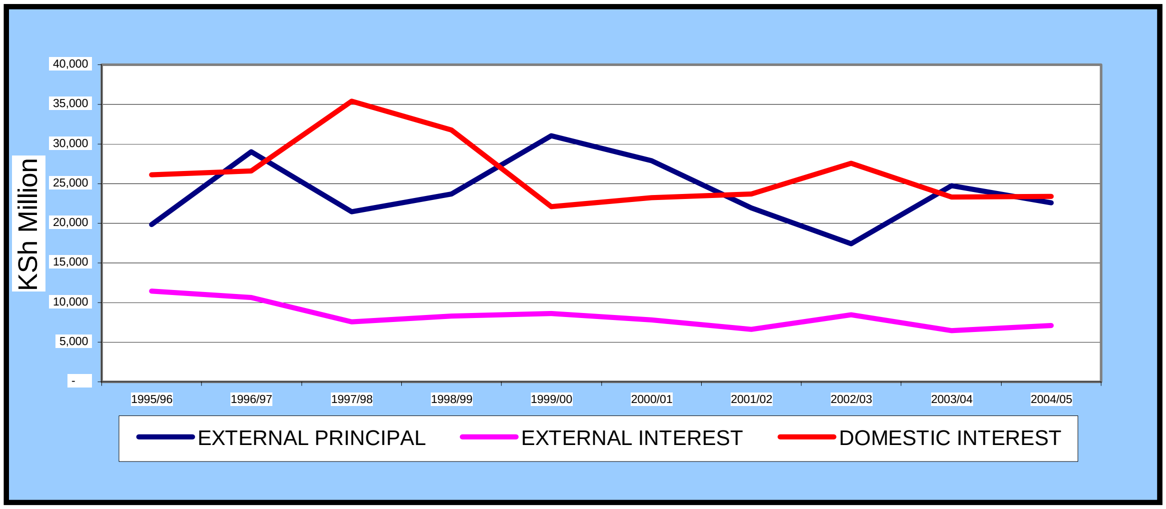
Table 2.2: Public Debt Service in Ksh Million (1995/96 - 2004/05)

Year	**1995/96**	**1996/97**	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**	**2004/05**
External Principal	19,831	19,110	21,399	21,010	28,187	12,529	23,345	19,611	20,448	10,544
External Interest	11,487	8,256	7,804	7,478	8,913	3,886	5,870	9,775	5,830	4,427
Domestic Interest	26,168	26,582	35,414	31,743	22,068	23,231	23,744	27,567	23,281	23,375
Total	**57,486**	**53,948**	**64,617**	**60,231**	**59,168**	**39,646**	**52,959**	**56,953**	**49,559**	**38,346**

Source: Treasury and Central Bank of Kenya

[1] Includes principal and interest repayments on external debt and interest payments on domestic debt

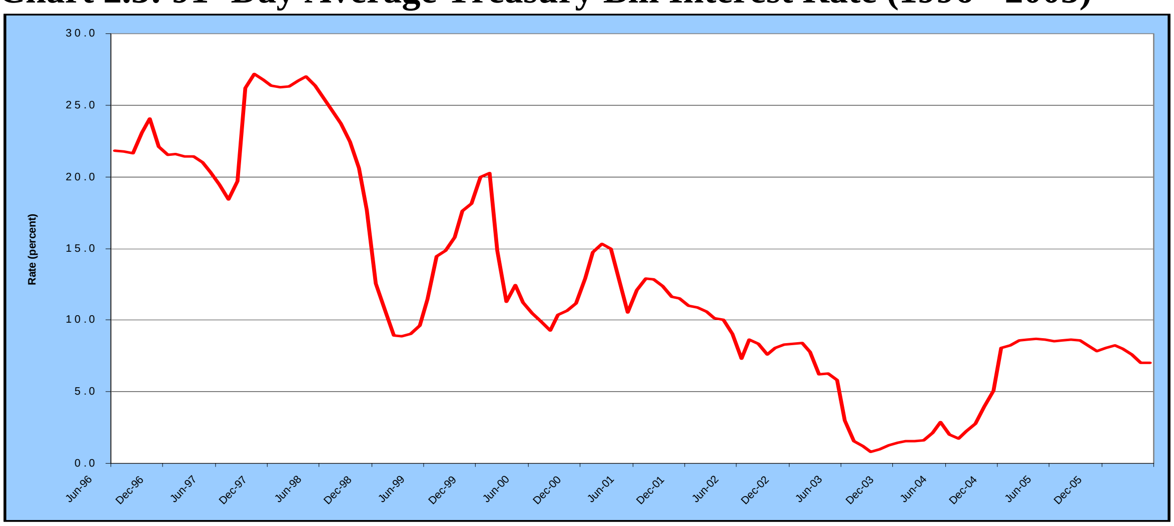
Chart 2.2: Public Debt Service in Ksh Million (1995/96-2004/05)



Source: Treasury and Central Bank of Kenya

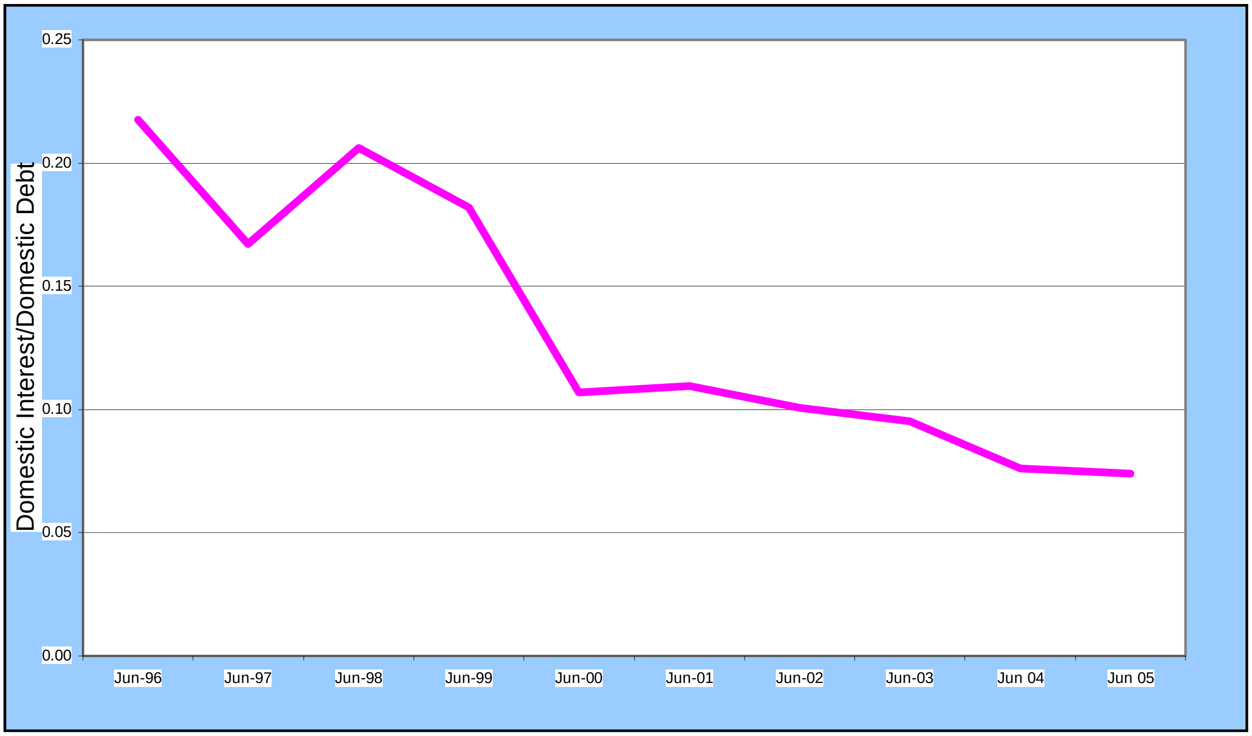
The proportion of the interest payments to the stock of domestic debt has generally been declining since the fiscal year 1997/98 due to a steady decline in interest rates (Chart 2.3 and 2.4). The structure of debt service has been changing. The external debt service accounted for 54.5 percent of the total debt service in 1995/96 compared with domestic interest, which accounted for 45.5 percent. At the end of June 2005, the proportion of external and domestic debt service in total debt service stood at 39.0 percent and 61.0 percent respectively.

Chart 2.3: 91- Day Average Treasury Bill Interest Rate (1996 - 2005)



Source: Central Bank of Kenya

Chart 2.4: Ratio of Domestic Interest Payments to Domestic Debt Stock (1996 - 2005)



Source: Central Bank of Kenya

2.7 Disbursements

As shown in Table 2.3, donor disbursements through project and programme loans were quite erratic between the fiscal years 1999/00 and 2004/05. For instance, except for 2000/01 and 2003/04, there were no disbursements of programme loans during the period. The large receipt of donor funding in the fiscal year 2000/01 is largely attributed to Ksh 4,382 million loans for financing drought. The decline in disbursements since the fiscal year 2000/01 was attributed to unpredictability of funding from the development partners. This is attributed to slippage in reforms and low absorption capacity.

Table 2.3: Disbursements (Ksh Million)

	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Project Cash Loans	2,805	2,180	1,625	2,830	8,719	2,898	2,191	2,285	3,741
Programme Loans	1,131	249	344	-	4,045	-	-	5,993	-
Project A-I-A	8,540	11,473	10,231	6,020	5,323	7,133	5,276	3,361	3,497
Total	**12,476**	**13,902**	**12,200**	**8,850**	**18,087**	**10,031**	**7,467**	**11,639**	**7,238**

Source: Treasury

2.8 Concessionality of External Debt

The concessionality of a loan is determined by the maturity period, the grace period and the interest rate. The Government external debt strategy is to contract loans with a grant element of at least 35 percent. The current structure of Kenya's external debt shows that a large proportion is owed to multilateral and bilateral creditors on highly concessional terms. The longer maturity and grace period, and the below market interest rates on loans from multilateral and bilateral agencies is ideal for financing projects in the social sectors with longer payback periods.

The concessional nature of the country's external borrowing is also evident from Table 2.4. The average terms of new commitments for Kenya deteriorated slightly between 1996 and 2005. New commitments had a maturity of about 32.5 years down from 36.3 years, an interest rate of 1.3 percent up from 0.8 percent, and a grace period of about 8.6 years down from 9.3 years.

Table 2.4: Average Terms of New Commitments

	1996	**2005**
Interest rate (percent)	0.8	1.3
Maturity (years)	36.3	32.5
Grace period (years)	9.3	8.6
Grant element (percent)	77.1	74

Source: Treasury

2.9 Publicly Guaranteed Debt

A parastatal or public enterprise requires prior authority from the parent Ministry and Treasury to contract new borrowing. The Guarantee (Loans) Act (Cap 461) governs the issuance of Government guarantee to State Corporations (Parastatals) and local authorities. All Government guarantees must be authorised by Parliament. The current ceiling for Government guaranteed borrowing, as set by Parliament in 1993 is Ksh 80,000 million.

2.10 Domestic Debt

Government domestic borrowing from the fiscal years 1995/96 to 2004/05 was mainly through Government securities, overdraft at the CBK and advances from commercial banks. Government securities comprised of Treasury bills, Treasury bonds and long-term stocks. During the period, Treasury bills were issued in maturities of 91 days and 182 days, which were non-tradable in the secondary market. Treasury bonds, on the other hand were issued in maturities of between one and ten years, and were tradable in the secondary market. The types of bonds issued in the period were zero coupon, floating rate, fixed coupon discounted, special floating rate, special fixed rate, and fixed rate bonds.

As shown in Table 2.6, domestic debt increased from Ksh 120,355 million in June 1996 to Ksh 315,573 million in June 2005. This represented an increase of Ksh 195,218 million or a growth of 162.2 percent in domestic debt during the period. The stock of Government securities increased by Ksh 210,648 million or 229.9 percent during the period from Ksh 91,623 million to Ksh 302,271 million. Other forms of domestic debt which include Government overdraft at the CBK, clearing items, advances from commercial banks and tax reservation certificates, decreased by Ksh 15,431 million during the period to stand at Ksh 13,301 million from Ksh 28,732 million. In particular, the level of Government overdraft at the Central bank declined by 78.2 percent during the period to Ksh 5,225 million from Ksh 24,016 million.

The stock of Treasury bills (excluding Repos) decreased by Ksh 6,526 million or 8.3 percent from Ksh 78,464 million in June 1996 to Ksh 71,938 million in June 2005. Similarly, outstanding Government long-term stocks fell by Ksh 3,526 million during the period to stand at Ksh 1,058 million at the end of June 2005. However, the stock of Treasury bonds increased by Ksh 184,783 million or 2,154.9 percent in the period to stand at Ksh 193,358 million at the end of June 2005 from Ksh 8,575 million at the end of June 1996.

Government Stocks are long-term debt instruments with a period to maturity ranging from 5 to 40 years. The first issues of Government Stocks were on September 16th 1980, in attempt to lengthen maturity structure of domestic debt. Interest rates were fixed and payable semi-annually and ranged from 6.0 percent to 11 percent per annum for 5-year and 40-year stocks respectively. The instrument was not tradable, and therefore illiquid and less attractive to investors. During the period under review, there were no new issues of Government long-term stocks.

In May 2001, the Government initiated steps to restructure public domestic debt and develop the domestic debt markets. The purpose was two-fold: First, to restructure domestic debt from the short-dated Treasury bills to the long-dated Treasury bonds in order to reduce the risks associated with short-term borrowing. As a result, the stock of Treasury bills (excluding Repos) declined from Ksh 116,441 million in June 2001 to Ksh 71,938 in June 2005 while the Treasury bonds portfolio rose from Ksh 44,491 million to Ksh 193,358 million in the same period. This led to a complete shift of the ratio of Treasury bills to bonds from 76:24 in May 2001 to 30:70 in June 2005. In addition, the maturity profile of Government securities rose from 3 months in May 2001 to 2 years 2 months in June 2005. Secondly, to develop a secondary market for Government securities.

It was envisaged that the secondary market for Government securities would promote financial resource mobilization for both the public and private sector through the financial market.
Reflecting on the success of the Government bond issuance programme, the volume of Treasury bonds traded at the Nairobi Stock Exchange increased tremendously from Ksh 5,217 million in the fiscal 2000/01 to Ksh 15,137 million in the fiscal year 2004/05.

In addition, as shown in Table 2.5, more institutions successfully issued corporate bonds through the financial market to finance their activities in the period under review. As at end of June 2005, outstanding corporate bonds stood at Ksh 8,100 million

Table 2.5: Corporate Bonds Issued During Fiscal Years 2000/01 to 2004/05

	Bond	**Tenor in years**	**Issue date**	**Amount Issued Ksh Million**	**Interest Rate**	**Maturity Date**
1	East Africa Development Bank FRTB	4	25/04/2001	2,000.00	Ave. 91 DTB+0.75%	25/04/2006
2	Safaricom MTN	5	11/6/2001	4,000.00	Ave. 91 DTB+1.00%	31/03/2006
3	Shelter Afrique	3	9/7/2001	350.00	Ave. 91 DTB+0.75%	9/7/2004
4	Mabati Rolling Mills Ltd FRTB	5	14/10/2002	1,000.00	Ave. 91 DTB+1.25%	8/10/2007
5	Faulu kenya Ltd FRTB	5	4/4/2005	500.00	Ave. 91 DTB+0.50%	6/4/2010
6	Athi River Mining Ltd (TB+1.75%) 2010	5	3/31/2005	600.00	Ave. 91 DTB+1.75%	27/3/2010
	Total			**8,450.00**		

Source: Nairobi Stock Exchange

A weak fiscal framework in the early 1990s led to excessive borrowing by the Government from the CBK through the overdraft facility. The larger overdraft had inflationary effects and CBK was forced to mop the resulting excess liquidity at high interest rates to contain run-away inflation. In 1996, the CBK Act was amended to limit direct borrowing by the Government from the CBK to 5 percent of the most recent audited Government revenues. This legislature measure was meant to establish a cap on Government borrowing from CBK and to strengthen the latter's independence in the conduct of monetary policy. Government overdraft from CBK declined dramatically from Ksh 24,016 in end June 1996 to an average of Ksh 5,000 million over the last 10 years (Table 2.6).

Table 2.6: Domestic Debt (Ksh Million)

	Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Jun-01	Jun-02	Jun-03	Jun-04	Jun-05	Chage Jun-96 to Jun-05
Total Stock of Domestic Debt (A+B)	**120,355**	**159,077**	**171,730**	**174,305**	**206,042**	**211,806**	**236,000**	**289,377**	**306,234**	**315,573**	**195,218**
A. Government Securities	**91,623**	**138,896**	**142,632**	**165,216**	**190,886**	**199,317**	**226,800**	**278,251**	**289,537**	**302,271**	**210,648**
1. Treasury Bills (excluding Repo Bills)	**78,464**	**99,323**	**104,215**	**96,683**	**114,129**	**116,441**	**82,100**	**78,744**	**62,936**	**71,938**	**-6,526**
Banking institutions	45,100	53,543	44,809	56,559	61,919	54,154	30,515	36,231	42,154	32,780	-12,320
Others	33,364	45,780	59,406	40,124	52,210	62,287	51,585	42,513	20,782	39,158	5,794
2. Treasury Bonds	**8,575**	**35,613**	**34,687**	**28,186**	**36,851**	**44,491**	**106,300**	**161,549**	**188,626**	**193,358**	**184,783**
Banking institutions	536	22,930	26,341	5,030	8,637	13,090	47,100	74,452	89,001	89,729	89,193
Others	8,039	12,683	8,346	23,156	28,214	31,401	59,200	87,097	99,625	103,629	95,590
3. Long Term Stocks	**4,584**	**3,960**	**3,730**	**3,430**	**3,006**	**1,468**	**1,500**	**1,058**	**1,058**	**1,058**	**-3,526**
Banking institutions	99	101	27	52	117	-	-	-	-	-	-99
Others	4,485	3,859	3,703	3,378	2,889	1,468	1,500	1,058	1,058	1,058	-3,427
4. Pre-1997 Government Overdraft	**-**	**-**	**-**	**36,917**	**36,900**	**36,917**	**36,900**	**36,900**	**36,917**	**35,917**	**35,917**
Repo T/Bills	2,676	17,296	16,820	5,000	16,883	21,100	36,000	27,000	36,900	35,900	33,224
B. Others:*	**28,732**	**20,181**	**29,098**	**9,089**	**15,156**	**12,489**	**9,200**	**11,126**	**16,697**	**13,301**	**-15,431**
Of which CBK overdraft to Government	24,016	-	5,436	5,625	6,529	2,862	-	4,319	9,232	5,225	-18,791

*Others includes Government overdraft at the CBK, clearing items awaiting transfer to PMG, commercial bank advances and tax reserve certificates

Source: Central Bank of Kenya

3. PUBLIC DEBT DEVELOPMENTS (2005-2006)

Kenya's public debt stock increased by Ksh 39,051 million in the fiscal year 2005/06 to stand at Ksh 789,076 million (50.5 percent of GDP) compared with Ksh 750,025 million (55.6 percent of GDP) at the end of the fiscal year 2004/05 (Table 3.1). Domestic debt rose from Ksh 315,573 million (23.4 percent of GDP) to Ksh 357,839 million (22.9 percent of GDP) while external debt declined from Ksh 434,453 million (32.2 percent of GDP) to Ksh 431,237 million (27.6 percent of GDP) during the period. Despite the rise in the stock of debt in the period, the ratio of overall debt to GDP declined mainly due to faster growth in GDP.

The share of domestic debt in the overall debt increased from 42.1 percent of total debt at the end of June 2005 to 45.3 percent at the end of June 2006 while the proportion of external debt fell from 57.9 percent to 54.7 percent in the same period. The shift in the composition of debt was mainly attributed to reduced access to external funding and increased domestic borrowing to finance the deficit.

Table 3.1: Public Debt Stock (Ksh Million)

	Jun 05	Jun-06	Change
EXTERNAL	**434,453**	**431,237**	**-3,215**
Bilateral	157,669	154,877	-2,792
Multilateral	255,784	255,550	-234
Commercial Banks	1,776	1,274	-501
Export Credit	19,224	19,536	312
(As a % of GDP)	32.2	27.6	
(As a % of total debt)	57.9	54.7	
DOMESTIC	**315,573**	**357,839**	**42,267**
(As a % of GDP)	23.4	22.9	
(As a % of total debt)	42.1	45.3	
GRAND TOTAL	**750,025**	**789,076**	**39,051**
(As a % of GDP)	55.6	50.5	

Sources: Treasury & Central Bank of Kenya

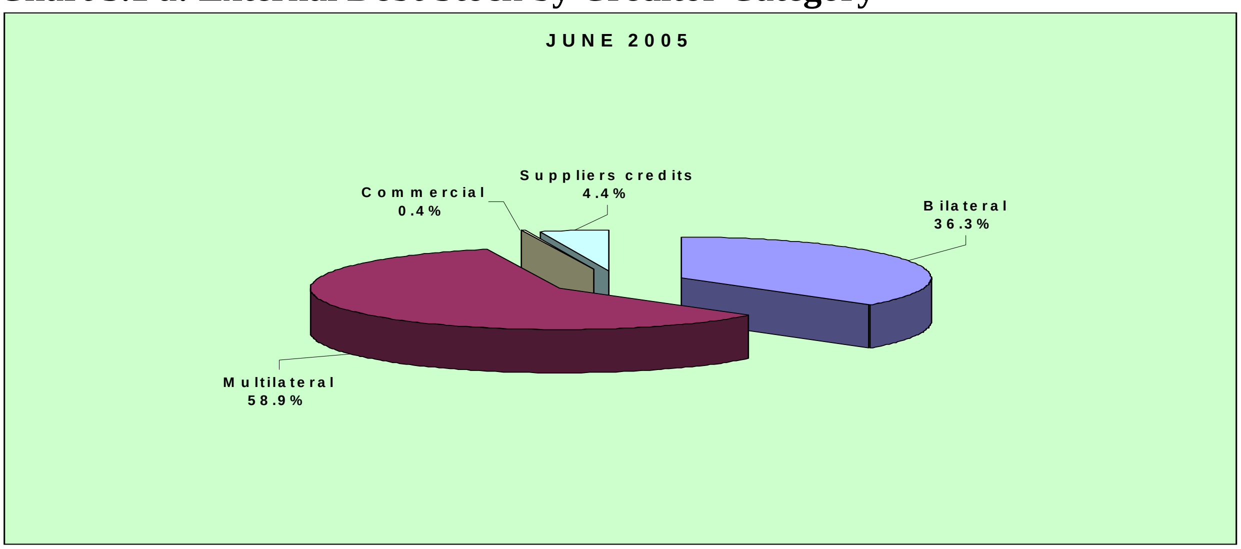
3.1 EXTERNAL DEBT

3.1.1 External Debt Stock

External debt declined by Ksh 3,215 million or 0.7 percent from Ksh 434,453 million at the end of June 2005 to Ksh 431,237 million at the end of June 2006 (Table 3.1). Similarly, the proportion of external debt in GDP fell from 32.2 percent to 27.6 percent in the period while that of external debt to total debt fell from 57.9 percent to 54.7 percent. However, in US dollar terms, the debt stock increased from USD 5,701 million to USD 5,837 million due to the appreciation of the Kenya shilling against the US dollar.

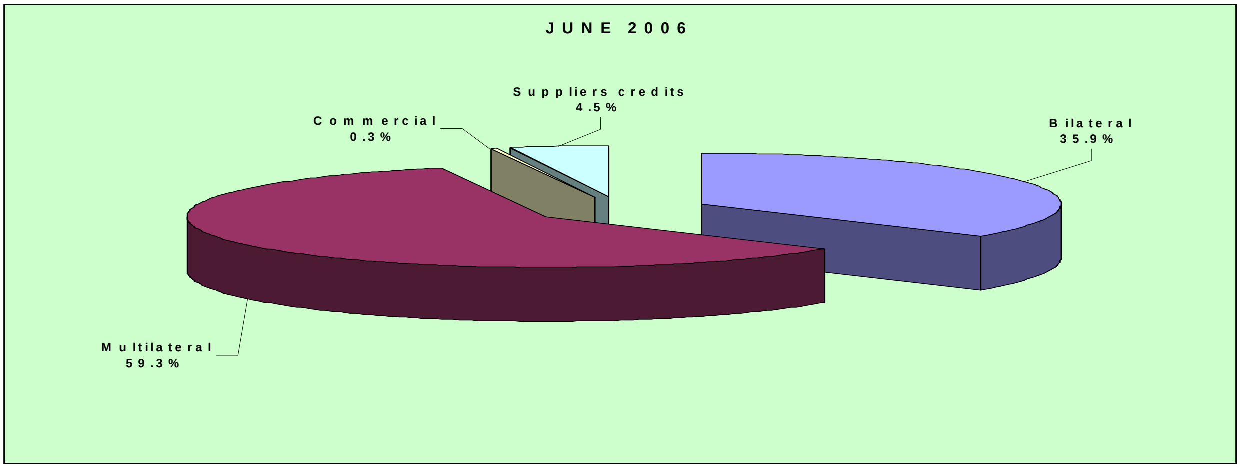
As shown in Table 3.1, external debt owed to multilateral and bilateral creditors stood at Ksh 255,550 million and Ksh 154,877 million respectively at the end of June 2006. This represented 59.3 percent and 35.9 percent of total external debt respectively at the end of June 2006 (Chart 3.1b) as compared to 58.9 percent and 36.3 percent for the previous year (Chart 3.1a). During the period, the debt owed to commercial creditors amounted to Ksh 1,274 million or 0.3 percent of the total external debt. Suppliers' credits amounted to Ksh 19,536 million or 4.5 percent of total external debt at the end of June 2006.

Chart 3.1 a: External Debt Stock by Creditor Category



Source: Treasury

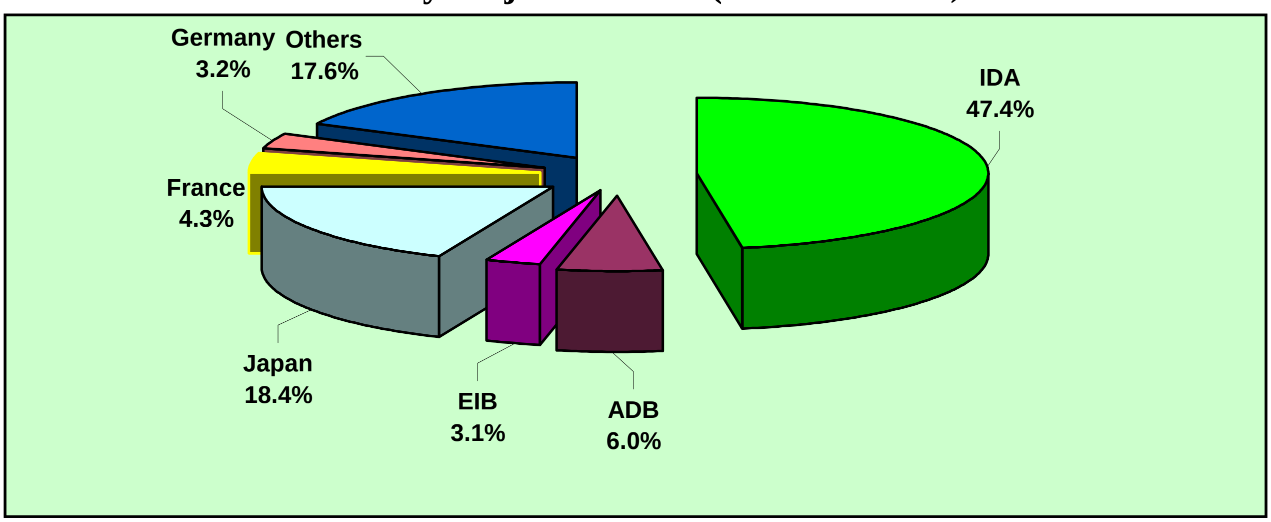
Chart 3.1 b: External Debt Stock by Creditor Category



Source: Treasury

As shown in Chart 3.2, IDA was the largest multilateral creditor to Kenya (47.4 percent), followed by the African Development Bank Group (6 percent) and the European Investment Bank (3.1 percent). On the hand Japan (18.4 percent) was the leading bilateral lender at the end of June 2006 followed by France (4.3 percent) and Germany (3.2 percent)

Chart 3.2: External Debt by Major Creditor (end June 2006)



Source: Treasury

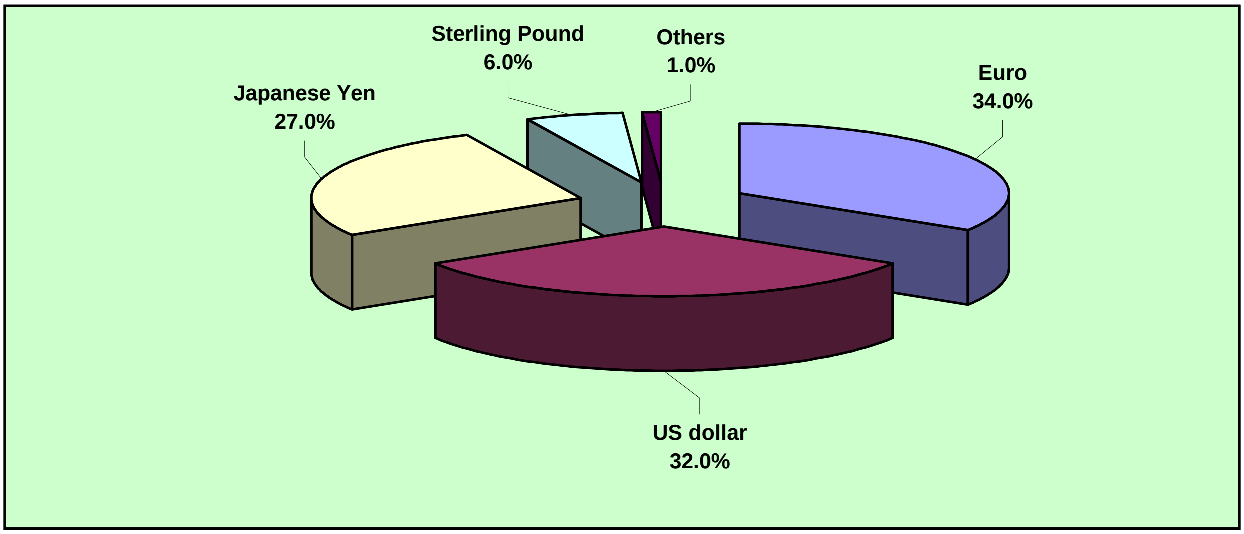
3.1.2 Currency Structure of External Debt

External debt was held in 14 different currencies as at June 2006. These were the Canadian dollar, Danish Kroner, Euro, Indian Rupee, Kenya shilling, Kuwaiti Dinar, Pound Sterling, Saudi Riyal, Swedish Kroner, Swiss Franc, US dollar, Korean Won, Japanese Yen, and Chinese Yuan. The Euro, US dollar, Japanese

Yen and Sterling Pound comprised the largest proportion of the external debt (Chart 3.3).

The currency structure remained virtually unchanged during the fiscal year 2005/06. The share of external debt held in Euros declined marginally from 35 percent at the end of June 2005 to 34 percent at the end of June 2006 while the share of the debt held in US dollars increased from 31 percent to 32 percent in the same period. The proportion of debt held in Japanese Yen and Sterling Pound remained unchanged from the end June 2005 position of 27 percent and 6 percent respectively. However, the currency composition of external debt at the end of the period is not a reflection of a debt management strategy.

Chart 3.3: External Debt by Currency

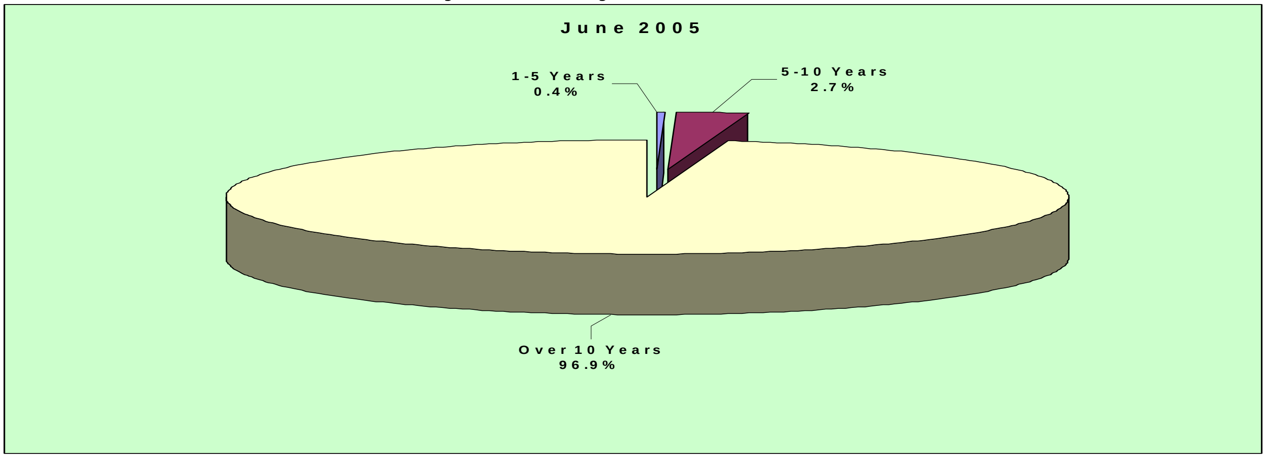


Source: Treasury

3.1.3 Maturity Structure

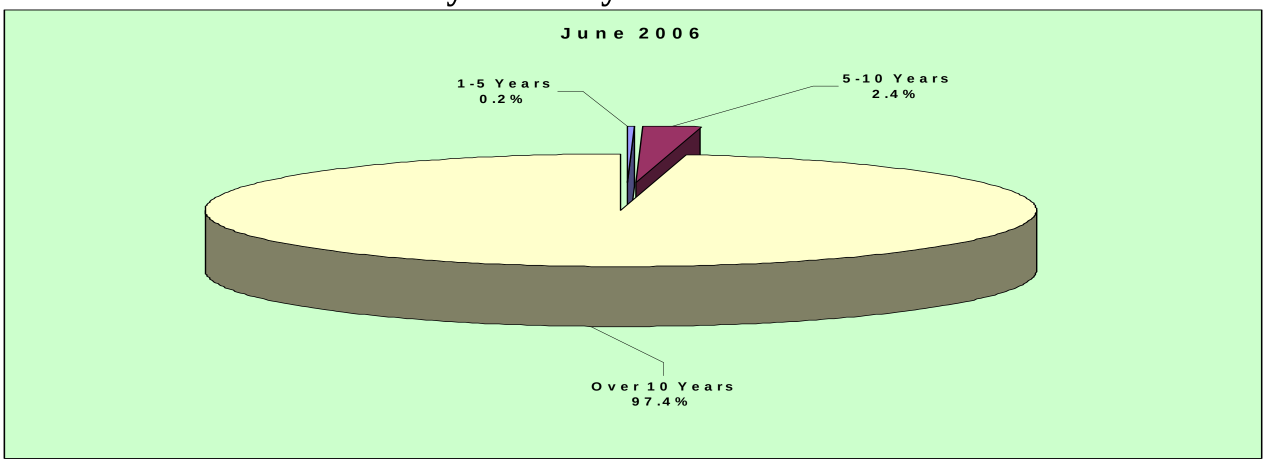
Kenya's external debt is mainly long-term, with about 97 percent having a maturity of over 10 years as at the end of June 2005 and June 2006. Approximately 3 percent of the external debt portfolio had a maturity of less than 10 years during the period (Chart 3.4a and 3.4b). These developments are consistent with the Government's strategy of borrowing on concessional terms.

Chart 3.4a: External Debt by Maturity



Source: Treasury

Chart 3.4b: External Debt by Maturity



Source: Treasury

3.1.4 Concessionality

The largest proportion of external debt was contracted on Official Development Assistance (ODA) concessional terms. The factors determining the concessionality of a loan include interest rates, loan maturity, and grace period. As shown in Table 3.2, there was a general improvement in interest rate and average maturity terms between June 2005 and June 2006. However, at the end of the fiscal year, the debt portfolio reflected a reduction in the average grace period due to new bi-lateral loans with relatively short grace period.

Table 3.2: Average Terms for Outstanding External Loans

Terms	June 2005	June 2006
Interest rate (percent)	1.3	0.8
Maturity (Years)	32.5	36.1
Grace Period (Years)	8.6	8.1
Grant Element (percent)	**74**	**81.4**

Source: Treasury

The average interest rate dropped from the previous year's average of 1.3 percent as at end June 2005 to 0.8 percent at the end of June 2006. The average maturity lengthened by 3.6 years from 32.5 years to 36.1 years in the same period. However, the average grace period on loans fell from 8.6 years at the end of June 2005 to 8.1 years at the end of June 2006.

The overall impact of these developments was an increase in the level of concessionality of the external debt portfolio with the average grant element on loans from 74 percent at the end of June 2005 to 81.4 percent at the end of June 2006. All external loans contracted during the period had a minimum grant element of 35 percent. During the period, the Government did not contract any new commercial loans.

3.1.5 External Debt Service

Total external debt service decreased from Ksh 14,971 million (4.9 percent of revenue) in the fiscal year 2004/05 to Ksh 12,875 million (4.1 percent of revenue) in the fiscal year 2005/06 (Table 3.3). The decline was mainly in principal repayments, which decreased from Ksh 10,544 million to Ksh 9,229.5 million in the same period. Interest payments also decreased from Ksh 4,421 million to Ksh 3,645.4 million during the period.

The substantial decline in external debt service was caused by the Government's decision to defer debt service payments due to some external commercial creditors pending resolution of audit findings by the Controller & Auditor General.

Table 3.3: External Debt Service in Million Ksh (2004/05 - 2005/06)

	Multilateral		**Bilateral**		**Commercial**		**Total**	
	Jun-05	**Jun-06**	**Jun-05**	**Jun-06**	**Jun-05**	**Jun-06**	**Jun-05**	**Jun-06**
Principal Repayments	7,235	7,236.7	2,505	1,547.5	804	445.3	10,544	9,229.5
Interest Payments	2,627	2,337.4	1,417	1,226.5	383	81.6	4,427	3,645.4
Total	**9,862**	**9,574.1**	**3,922**	**2,774.0**	**1,187**	**526.9**	**14,971**	**12,874.9**

Source: Treasury

3.1.6 Disbursements

As shown in Table 3.4, donor disbursements through project loans and programme loans increased by Ksh 1,750 million from Ksh 7,238 million in the fiscal year 2004/05 to Ksh 8,988 million in the fiscal year 2005/06. During the period, programme loans increased from none to Ksh 1,572 million while project loans increased from Ksh 7,238 million to Ksh 7,416 million.

Table 3.4: External Debt Disbursements in Million Ksh (2004/05 - 2005/06)

	2004/05	**2005/06**	**Change**
Project Cash Loans	3,741	2,788	-953
Programme Loans	-	1,572	1,572
Project A-I-A	3,497	4,628	1,131
Total	**7,238**	**8,988**	**1,750**

Source: Treasury

It suffices to note that although there was an improvement in disbursement, the amount was way below the annual target. The amount disbursed of Ksh 8,988 million was only 57.1 percent of the target disbursement of Ksh 15,741 million. Similarly, in the previous year, out of the targeted amount of Ksh 12,978 million, only Ksh 7,298 million (56 percent) was disbursed. The low absorption of donor funds is one of the critical issues to be addressed in the proposed Kenya External Aid Policy[2].

3.1.7 Government Guaranteed Loans

The outstanding publicly guaranteed debt as at 30th June 2006 was Ksh 43,555 million. The amount comprised of Ksh 25,197 million owed to external creditors while Ksh 18,358 million was owed to a local creditor (National Bank of Kenya). Table 2.5 below summarizes the outstanding publicly guaranteed debt. In 2004, the Government issued a guarantee of Ksh 7,356 million to Kenya Electricity

[2] Draft Kenya External Aid Policy is currently under preparation by the Ministry of Finance.

Generating Company Ltd for a borrowing from the Japan Bank for International Cooperation to finance the Sondu Miriu II Hydroelectric power project.

Table 2.5: Publicly Guaranteed Debts as at 30th June 2006

	Parastatal	Creditor	Outstanding Guarantee (Ksh Mn)
1	Nairobi City Council	USA	533.78
2	Telkom Kenya	Italy & Japan	6,533.85
3	Tana & Arthi River Development Authority	Japan	2,498.25
4	East Africa Portland Cement	Japan	3,105.56
5	Kenya Electricity Generating Company Ltd	Japan	12,525.48
6	Various	National Bank of Kenya	18,358.41
	Total		**43,555.33**

Source: Treasury

3.2 DOMESTIC DEBT

3.2.1 Stock of Domestic Debt

Government domestic debt increased by Ksh 42,266 million in the fiscal year 2005/06 to stand at Ksh 357,839 million at the end of June 2006 from Ksh 315,573 million at the end of June 2005. This represents a growth of 13.4 percent in the debt during the period. As shown in Table 3.5, the rise in the debt was attributed to increases of Ksh 22,838 million and Ksh 25,000 million in the stock of Treasury bills and Treasury bonds respectively during the period. However, these increases were partly offset by decreases of Ksh 5,203 million and Ksh 368 million in other forms of domestic debt and the pre-1997 Government overdraft respectively. The Government overdraft at the Central Bank decreased from Ksh 5,225 million at the end of June 2005 to Ksh 5,202 million at the end of June 2006 which was within the prevailing statutory limit of Ksh 11,323 million based on the fiscal year 2003/04 audited Government revenue.

Table 3.5: Domestic Debt (Ksh Million)

	Jun-05		Jun-06		Chage Jun-05 to Jun-06
	Amount	%	Amount	%	
Total Stock of Domestic Debt (A+B)	**315,573**	**100.0**	**357,839**	**100.0**	**42,266**
A. Government Securities	**302,271**	**95.8**	**349,740**	**97.7**	**47,469**
1. Treasury Bills (excluding Repo Bills)	**71,938**	**22.8**	**94,776**	**26.5**	**22,838**
Banking institutions	32,780	10.4	47,035	13.1	14,255
Others	39,158	12.4	47,741	13.3	8,582
2. Treasury Bonds	**193,358**	**61.3**	**218,357**	**61.0**	**25,000**
Banking institutions	89,729	28.4	100,149	28.0	10,420
Others	103,629	32.8	118,208	33.0	14,579
3. Long Term Stocks	**1,058**	**0.3**	**1,058**	**0.3**	**0**
Banking institutions	-	0.0	-	0.0	0
Others	1,058	0.3	1,058	0.3	0
4. Pre-1997 Government Overdraft	**35,917**	**11.4**	**35,549**	**9.9**	**-368**
Repo T/Bills	35,900	11.4	35,532	9.9	-368
B. Others:*	**13,301**	**4.2**	**8,099**	**2.3**	**-5,203**
Of which CBK overdraft to Government	5,225	1.7	5,202	1.5	-23

*Others includes Government overdraft at the CBK, clearing items awaiting transfer to PMG, commercial bank advances and TRCs

Source: Central Bank of Kenya

During the fiscal year 2005/06, the domestic borrowing programme was very successful as Treasury bills and bonds auctions realised average over-subscriptions of 36.8 percent and 41.6 percent, respectively. The success of the domestic borrowing programme followed improved liquidity conditions in the market which ensured stability of interest rates throughout the fiscal year, and improved investor confidence in the Government securities market.

3.2.2 Composition of Domestic Debt by Instrument

The stock of Treasury bills (excluding Repos) increased from Ksh 71,938 million at the end of June 2005 to Ksh 94,776 million at the end of June 2006 while Treasury bonds increased significantly from Ksh 193,358 million to Ksh 218,357 million in the same period. Consequently, the proportion of Treasury bills in total domestic debt increased from 22.8 percent to 26.8 percent in the same period (Chart 3.5a and 3.5b). However, the proportion of Treasury bonds in total domestic debt fell slightly from 61.3 percent to 61.0 percent during the same period.

The proportion of domestic debt held in the Government overdraft declined from 1.7 percent at the end of June 2005 to 1.5 percent at the end of June 2006. Similarly, other forms of domestic debt fell from 13.9 percent to 10.7 percent in the same period. The proportion of debt held in long-term stocks remained unchanged at 0.3 percent, as there were neither new issues nor redemptions during the fiscal year 2005/06.

Chart 3.5a: Composition of Domestic Debt by Instrument (June 2005)

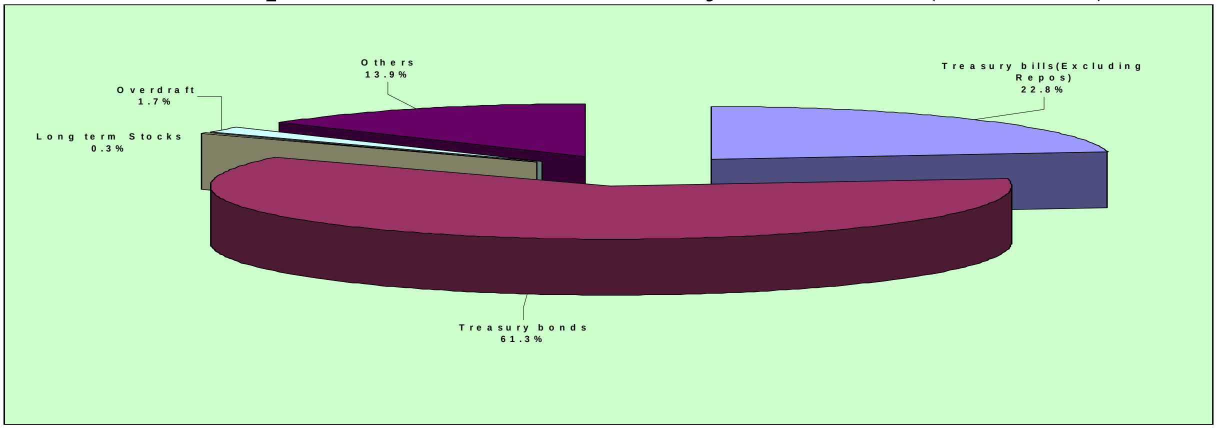
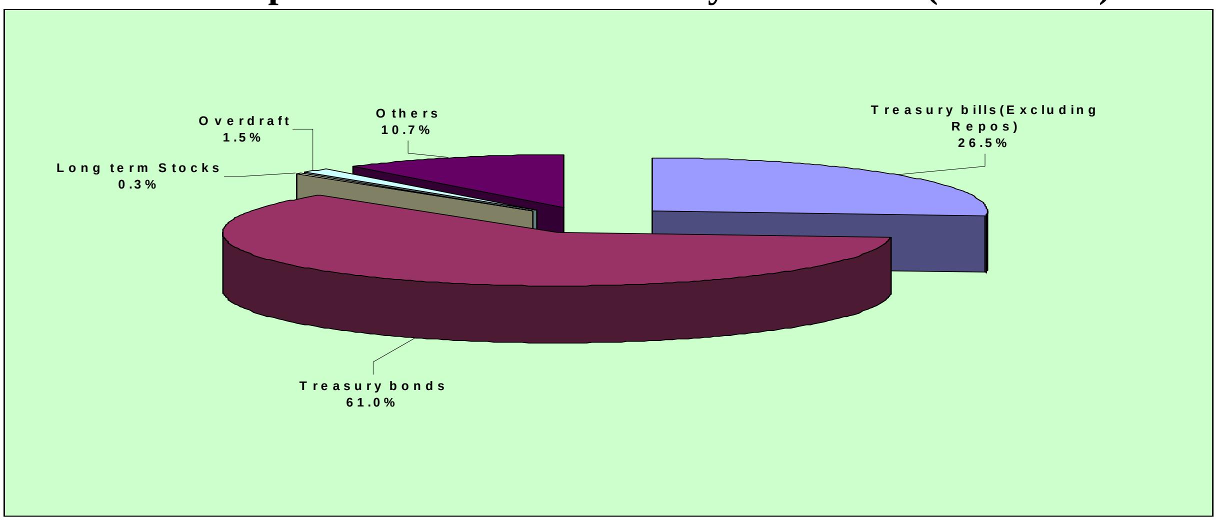


Chart 3.5b: Composition of Domestic Debt by Instrument (June 2006)



Source: Central Bank of Kenya

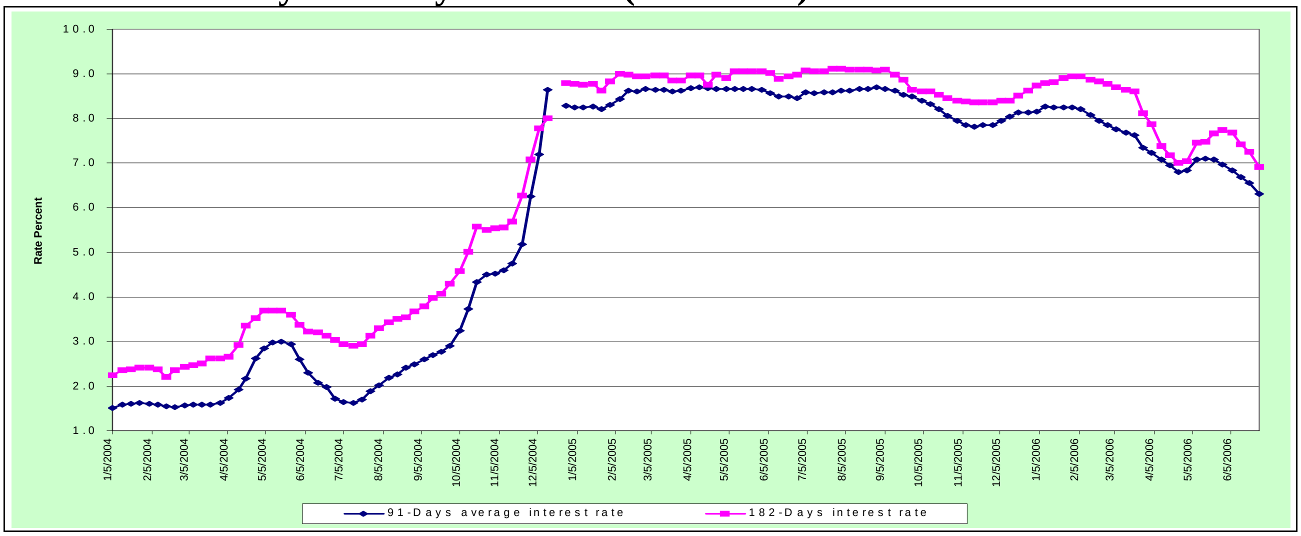
In order to develop a liquid and efficient domestic debt market, the Government continued to implement the policy to lengthen the maturity profile of Government debt instruments by issuing more long-term bonds. Although, the ratio of Treasury bills to Treasury bonds changed from 27:73 in June 2005 to 30:70 at the end of June 2006, the average maturity of domestic debt increased from 1.9 years at the end of June 2005 to 2.2 years at the end of June 2006.

The effects of stable interest rates and lengthened maturity of Government instruments translated into increased activities at the NSE. The volume of Treasury bonds traded at NSE increased by 154 percent from Ksh 15,135 million in the fiscal year 2004/05 to Ksh 38,487 million in the fiscal year 2005/06.

3.2.3 Interest Rates on Government Securities

Over the 12 months period under review, Treasury Bills average interest rate declined. However, there was a temporary upward pressure in December 2005 and January 2006. The 91-day Treasury bill average rate fell by 226 basis points from 8.573 percent in July 2005 to 6.312 percent in end June 2006. Over the same period, the 182-day Treasury bill average rate interest fell by 214 basis points from 9.067 percent to 6.920 percent.

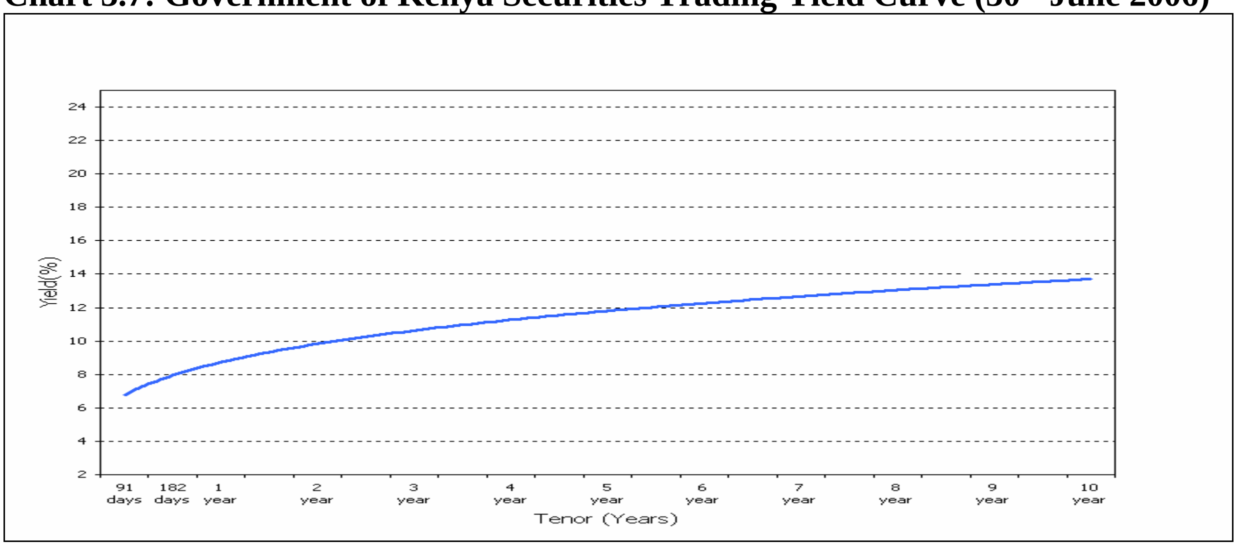
Chart 3.6: Weekly Treasury bill Rates (2004-2006)



Source: Central bank of Kenya

The yields on the longer dated Government securities reflected market expectation. Annex 8 shows yields on the 2 to 10 year Treasury bonds issued during the financial year ended June 2006. The Government securities trading yield curve shows a normal ascending shape reflecting that the yields rise with longer maturities (Chart 3.7)

Chart 3.7: Government of Kenya Securities Trading Yield Curve (30th June 2006)



Source: Central Bank of Kenya

3.2.4 Domestic Debt by Holder

As indicated in Table 3.7, commercial banks holdings of domestic debt increased to 41.8 percent at the end of June 2006 compared with 38.9 percent at the end of June 2005. Similarly, the proportion of domestic debt held by non-bank entities increased from 44.2 percent to 45.3 percent during the period. The higher proportion of debt held by non-bank entities is a positive development as it reflects continued deepening of the Government securities market with increased diversification of investor base.

However, over the period under review, the proportion of domestic debt held by non-resident investors fell from 2.1 percent to 1.4 percent.

Table 3.7: Domestic Debt by Holder (Ksh Million)

	Jun-02	%	Jun-03	%	Jun 04	%	Jun 05	%	Jun-06	%	Change Jun-05 to Jun-06
Banks	**120,800**	**51.2**	**160,179**	**55.4**	**181,512**	**59.3**	**169,529**	**53.7**	**190,762**	**53.3**	**21,234**
Central Bank	42,800	18.1	45,289	15.7	50,774	16.6	46,618	14.8	41,289	11.5	-5,329
Commercial Banks	78,000	33.1	114,889	39.7	130,738	42.7	122,911	38.9	149,473	41.8	26,562
Non-banks	**104,400**	**44.2**	**119,984**	**41.5**	**120,688**	**39.4**	**139,542**	**44.2**	**162,029**	**45.3**	**22,488**
Non-bank Financial Institutions	2,800	1.2	3,077	1.1	3,190	1.0	2,129	0.7	1,400	0.4	-729
Other Non-bank Sources	101,600	43.1	116,907	40.4	117,498	38.4	137,412	43.5	160,629	44.9	23,217
Non-residents	**10,800**	**4.6**	**9,214**	**3.2**	**4,035**	**1.3**	**6,502**	**2.1**	**5,047**	**1.4**	**-1,455**
Total	**236,000**	**100.0**	**289,377**	**100.0**	**306,234**	**100.0**	**315,573**	**100.0**	**357,839**	**100.0**	**42,267**

Source: Central Bank of Kenya

3.2.5 Treasury Bills

As shown in Table 3.8, the stock of Treasury bills holdings by commercial banks increased from Ksh 31,863 million at the end of June 2005 to Ksh 47,034 million at the end of June 2006. This represented an increase from 44.3 percent to 49.6 percent in the proportion of commercial banks holdings of Treasury bills during the period. Similarly, holdings by insurance companies and Parastatals increased during the period.

In the fiscal year 2005/06, the share of 91-day Treasury bills in outstanding Treasury bills and bonds decreased from 16.1 percent at the end of June 2005 to 12.0 percent at the end of June 2006 (Table 3.9). On the other hand, the proportion of the 182-day Treasury bills increased to 18.2 percent from 11.0 percent in the same the period. This is consistent with Government strategy to lengthen the maturity structure of the debt.

Table 3.8: Outstanding Treasury Bills by Holder (Ksh million)

Holders	June 2004		June 2005		June 2006	
	Amount	%	Amount	%	Amount	%
Banking Institutions	42,154	67.0	32,780	45.6	47,560	50.2
Central Bank	2	0.0	7	0.0	1	0.0
Comm. Banks	41,021	65.2	31,863	44.3	47,034	49.6
NBFIs	1,131	1.8	910	1.3	525	0.6
Insurance Companies	4,892	7.8	7,665	10.7	11,037	11.6
Parastatals	4,924	7.8	6,907	9.6	11,240	11.9
Of which: NSSF	874	1.4	90	0.1	600	0.6
Building Societies	-	-	180	0.3	540	0.6
Pension Funds	319	0.5	538	0.7	609	0.6
Others	10,647	16.9	23,868	33.2	23,790	25.1
Total*	**62,936**	**100.0**	**71,938**	**100.0**	**94,777**	**100.0**

* Excludes repurchase order bills
Source: Central Bank of Kenya

Table 3.9: Outstanding Treasury bills and Bonds by Tenor (Ksh Million)

Tenor	Jun-2004	%	Jun-2005	%	Jun-2006	%
91-DAY	29,497	11.7	42,761	16.1	37,632	12.0
182-DAY	33,439	13.3	29,177	11.0	57,144	18.2
1-YEAR	9,343	3.7	30,953	11.7	1,000	0.3
2-YEAR	28,237	11.2	24,686	9.3	39,738	12.7
3-YEAR	44,817	17.8	27,898	10.5	31,255	10.0
4-YEAR	26,520	10.5	26,160	9.9	26,287	8.4
5-YEAR	23,086	9.2	22,740	8.6	28,391	9.1
6-YEAR	17,909	7.1	20,434	7.7	33,105	10.6
7-YEAR	8,558	3.4	10,330	3.9	13,566	4.3
8-YEAR	11,969	4.8	11,969	4.5	15,287	4.9
9-YEAR	9,555	3.8	9,555	3.6	12,615	4.0
10-YEAR	8,634	3.4	8,634	3.3	17,113	5.5
Total	**251,562**	**100.0**	**265,296**	**100.0**	**313,134**	**100.0**

Source: Central Bank of Kenya

3.2.6 Treasury Bonds

Treasury bonds holdings by commercial banks increased from Ksh 88,509 million at the end of June 2005 to Ksh 100,149 million at the end of June 2006. As shown in Table 3.10, this was equivalent to an increase in the proportion of Treasury bonds held by commercial banks from 45.8 percent to 45.9 percent during the period. Similarly, holdings by non-bank financial institutions, corporate entities and individuals increased from Ksh 104,849 million to Ksh 118,208 million in the same period.

The largest share of outstanding Treasury bonds as at end June 2006 was in 2-year Treasury bonds, which accounted for 12.7 percent of the stock of Treasury bills and bonds compared with 9.3 percent at the end of June 2005. The proportion of one-year Treasury bonds in outstanding Treasury bills and bonds declined from 11.7 percent to 0.3 percent in the period as the Government issued only one bond of such maturity during the fiscal year 2005/06.

As shown in Table 3.9, the share of Treasury bonds of tenors between 4 and 10 years in outstanding Treasury bills and bonds increased from 41.4 percent at the end of June 2005 to 46.8 percent at the end of June 2006. This follows the successful issuance of Treasury bonds with tenors ranging from 4 to 10 years during the fiscal year 2005/06. Consequently, the proportion of bonds of tenors from 1 to 3 years in outstanding Treasury bills and bonds declined from 31.5 percent at end June 2005 to 23.0 percent at the end of June 2006.

Table 3.10: Outstanding Treasury bonds by Holder (Ksh Million)

Holders	June 2004		June 2005		June 2006	
	Amount	%	Amount	%	Amount	%
Banking Institutions	89,001	47.2	89,728	46.4	101,024	46.3
Central Bank	0	0.0	0	0.0	0	0.0
Comm. Banks	86,942	46.1	88,509	45.8	100,149	45.9
NBFIs	2,059	1.1	1,219	0.6	875	0.4
Insurance Companies	26,634	14.1	25,943	13.4	26,372	12.1
Parastatals	15,936	8.4	19,511	10.1	23,217	10.6
Of which: NSSF	2,839	1.5	2,986	1.5	4,887	2.2
Building Societies	2,660	1.4	1,995	1.0	1,795	0.8
Pension Funds	5,270	2.8	5,830	3.0	6,176	2.8
Others	49,124	26.0	50,351	26.0	59,774	27.4
Total	**188,626**	**100.0**	**193,358**	**100.0**	**218,357**	**100.0**

Source: Central Bank of Kenya

3.2.7 Government Long-term Stocks

During the fiscal year 2005/06, the proportion of Government long-term stocks in total domestic debt remained unchanged at 0.3 percent. Non-bank financial institutions accounted for 61.3 percent of the outstanding stocks while the National Social Security Fund (NSSF) held the remaining 38.7 percent at the end of June 2006.

3.2.8 Government Securities Issuance Process

The current procedure and requirements for investing in Government securities is outlined in Box 2 below.

Box 2: Government Securities Issuance Process

1.0. Central Depository for Securities Account (CDS)

This is a centralized account based at the CBK for holding securities by book entry without necessity of physical certificates for creditors. This ensures that all Government securities are held in paperless form. It is a requirement that all investors in Government securities MUST have a CDS account to facilitate all transactions. Detailed requirements and procedures for opening CDS account can be obtained from the CBK website at http://www.centralbank.go.ke

1.1 Treasury Bills and Bonds Issuance

Treasury Bills are issued through weekly auctions while Treasury Bonds are issued monthly through the same process. The CBK advertises Treasury Bills and Bonds tenders through both print and electronic media. Successful bidders are selected through competitive multi-price bid auctions, usually held on Thursdays, save for holidays. Payments are made on due date as specified in the advertisements or prospectus in case of Treasury Bonds. Details can be found on the CBK website.

1.2 The Auction Management Committee (AMC)

This is a committee mandated to conduct Government securities auctions. The committee meets weekly on Thursday's afternoon, except during holidays. Both print and electronic media publish the results of an auction on the following day. The AMC draws its membership from CBK and the Treasury and is chaired by the Governor of the CBK.

1.3. Payments

Payments by successful bidders are made to the CBK by 2.00pm on the value date as specified in the tender offer. Any Investor who defaults in payment may be suspended from participating in future auctions for some specified period. Payments are made using cash, banker's cheque, KEPSS and Rollovers.

1.4. Market Leaders Forum

This is a consultative forum held on a monthly basis to discuss among other things market developments that may impact on the performance of new issues of Government securities, features of the proposed new issues of Treasury bonds and any other relevant information. The forum consists of representatives from CBK, Commercial banks, Retirement Benefits Authority, the Treasury, Capital Markets Authority, Brokers, Nairobi Stock Exchange, Insurance Companies and Fund Managers. The Governor of CBK chairs the forum.

3.2.9 Domestic Interest Payments

Government expenditure on interest and other charges on domestic debt increased from Ksh 23,375 million (8.1 percent of revenue) in the fiscal year 2004/05 to Ksh 31,445 million (10.0 percent of revenue) in the fiscal year 2005/06. The rise in the interest cost on domestic debt during the period was due to increased domestic borrowing to finance drought related expenses.

The interest cost and other charges on Treasury bonds increased by Ksh 3,795 million from Ksh 16,151 million in the fiscal year 2004/05 to Ksh 19,946 million in the fiscal year 2005/06. The rise in the interest cost on domestic debt was attributed to a substantial increase in the stock of Treasury bonds, which resulted in increased interest payments.

3.2.10 Domestic Debt Management

During the year 2005/06, CBK in consultation with the Treasury implemented reforms to strengthen the management of domestic debt. As a step towards strengthening domestic debt back office operations at the CBK, a domestic debt data base on CS-DRMS 2000+ platform has been established as part of joint effort to set up a comprehensive public debt data base.

The Government's domestic debt management policy objective is to minimize the cost and risk of domestic borrowing in the long run while ensuring consistency with both fiscal and monetary policy objectives. The Government is committed to:

- Pursuing a debt issuance practice that is predictable and transparent;
- Issuing a mix of Government securities to cater for all market segments
- Maintaining a suitable Government debt portfolio based on maturity and composition of debt issuance;
- Strengthening of domestic debt markets.

4. STRENGTHENING MANAGEMENT OF EXTERNAL COMMERCIAL DEBTS

4.1 Background

Over the last three years, the authenticity of the external supplier credits contracted by the Government of Kenya to finance security related projects has been a subject of public interest. This follows the revelation early in 2004 that the Government was servicing a non-existent debt with Anglo Leasing & Finance Company Ltd. As a result, the Ministry of Finance requested the Controller & Auditor General to undertake a special audit of all external commercial loans that were used to finance security related projects.

4.2 Commercial Debts

Although the Government borrowing strategy has been to contract external loans with high level of concessionality from both multi-lateral and official bi-lateral sources, these creditors do not extend loans to finance security or military related projects. The Government has therefore been resorting to borrowing from commercial creditors to finance this category of expenditures. Whereas on average, Kenya's external commercial debt is 5 percent of total external debt, it accounted for over 40 percent of the total external debt service in the financial year 2003/4.

Table 4.1: Comparison of Debt Service for Multilateral, Bilateral and Commercial Loans (Kshs. Million)

	Years	**Loan Stock (LS)**	**Debt Service (DS)**	**DS/LS (%)**
Multilateral	2001/02	228,497	7,880	3.4
	2002/03	222,452	8,109	3.6
	2003/04	233,829	9,157	3.9
	Average			3.6
Bilateral	2001/02	132,269	15,726	11.9
	2002/03	129,973	12,173	9.4
	2003/04	142,593	6,283	4.4
	Average			8.5
Commercial Bank	2001/02	33,212	5,609	16.9
	2002/03	25,323	9,104	36.0
	2003/04	30,641	10,838	35.4
	Average			29.0

As shown in Table 4.1, the average debt service cost relative to debt stock is 3.6 percent for multi-lateral, 8.5 percent for bilateral and 29 percent for commercial debts. The high cost of servicing this debt is due to its onerous terms: *shorter repayment period and market interest rates.*

Following the "*Anglo – Leasing Scandal*" the Controller & Auditor General undertook special audit to establish among other issues, the amount of credit extended to the Government by various commercial creditors. The audit covered eighteen commercial loans with contractual value of Kshs.54.6 billion. The full list of the contracts is shown in Annex 3.

4.3 Special Audit and Investigations

As at end June 2006, a number of steps were taken by the Government and Parliament to identify and take corrective actions on systems and control failures that led to the "*Anglo Leasing Scandal*". The following are some of the initiatives:

- KACC initiated *investigations* on all the eighteen commercial loan contracts.

- Government *cancelled five contracts* and demanded refund of the payments that had been made. Kshs.1.0 billion was refunded in respect to four contracts.

- Government *suspended further payments* on thirteen contracts pending completion of the special audit by the Controller & Auditor General and investigation by KACC. As at end June 2006, total contractual external commercial debt arrears stood at Kshs 12 million.

- The *Auditor General's Report* was completed and tabled in Parliament in May 2006.

- The *Parliamentary Public Accounts Committee* carried out investigations and tabled a detailed report in Parliament in March 2006.

4.3 Preventive measures implemented

Over the past three years, the Government has taken a number of corrective and preventive measures to ensure that Government does not service loans it has not received. On measures related to public debt management, the following have been implemented or are under implementation:

- Government is implementing two key reform programs: The *Public Financial Management Reform* and *Financial and Legal Sector Technical Assistance Program* which seeks to strengthen overall financial management in the public sector.

- Government has begun strengthening the DMD at the Ministry of Finance to effectively manage public debt. Its operation will be guided by new secondary regulations and a *National Debt Strategy*.

- A new public procurement law has been enacted - *Public Procurement and Disposal Act 2005*. The Act outlines procedures for security type procurements that will ensure Government gets value for money without at the same time compromising security. The security procurements will be subjected to classified external audits.

5. DEBT SUSTAINABILITY

5.1 Debt burden

Kenya's debt to GDP ratio has been falling since the fiscal year 1999/2000, reflecting in part the withholding of disbursement of development assistance by donors. Kenya's debt / GDP ratio matches the average of the Sub-Saharan Africa (SSA) in 2004, and the latter is expected to decline markedly in 2006 owing to the implementation of MDRI. The ratio is significantly higher than that of Eastern Europe, East and Central Asia (see Table 5.1)

Table 5.1: Ratio of external debt to GDP in comparison to other regions (in percent)

	1990	1995	2000	2002	2003	2004
Kenya	64.8	73.9	42.9	42.3	41.1	39.3
SSA	54.4	61.5	54.5	52.3	46.8	39.5
East Asia	26.9	20.1	17.3	14.1	12.5	10.9
Eastern Europe& Central Asia	15.9	28.2	33.1	28.2	25.0	20.8

Source: Global Development Finance, 2006

Kenya's debt service ratio in 2004 is slightly above the average prevailing in Sub-Saharan Africa and East Asia, but below that of Eastern Europe and Central Asia. However, the debt ratio can rise significantly if the country chooses to meet its external financing through commercial borrowing in the event concessional financing from both multilateral and bilateral sources is not forthcoming.

Table 5.2: Debt service to export earnings ratio in comparison to other regions (in percent)

	1990	**1995**	**2000**	**2002**	**2003**	**2004**
Kenya	35.4	30.4	20.9	15.7	16.1	8.6
SSA	13.5	16.3	11.6	11.0	8.6	7.9
East Asia	17.5	12.6	11.4	12.2	10.1	6.8
Eastern Europe& Central Asia	44.8	11.8	18.2	20.6	19.0	19.6

Source: Global Development Finance, 2006

5.2 Debt Sustainability Analyses

5.2.1 Sustainability Indicators under BWI- LTDs methodology

The last IMF/World Bank DSA was carried out in November 2003. The results from the DSA show that Kenya's external debt burden with NPV of 27 percent of GDP is not onerous. However, when taken together with domestic debt, the NPV of public debt at end 2005 exceeds 40 percent of GDP, the threshold for debt sustainability for countries like Kenya whose policy is judged as medium quality by the World Bank (Table 5.3).

Table 5.3: Public debt as percent of GDP under various scenarios

	Sustainability threshold	2005	2007	2010	2015
Baseline scenario	40.0	49.4	47.3	44.6	39.9
Alternative scenario					
Historical real GDP & primary bal. 1/	40.0	47.6	44.5	41.4	29.9
Primary balance at 2002 level	40.0	50.9	48.4	44.7	34.8
Stress tests					
Lower GDP growth 2/	40.0	51.7	50.6	48.3	44.5
Lower primary balance 3/	40.0	54.2	52.5	50.0	44.9
Commodity prices shock 4/	40.0	49.8	48.2	45.2	40.1
One-time 30 percent depreciation 5/	40.0	71.2	70.4	67.6	62.7

Source: Treasury and IMF

1/Hisorical averages calculated for 1998-2002.Historical average for real GDP growth is 1.0 percent compared with 3.1 percent for baseline.

2/ Real GDP growth and primary balance at historical averages

3/ Real GDP growth at baseline minus two standard deviations in 2003-2004

4/ A permanent two standard deviation negative shock to major commodity prices in 2003

The IMF/World Bank DSA classified Kenya as a country facing moderate risk of debt distress. The threshold for debt sustainability is unlikely to be breached under baseline macroeconomic scenario. However, the related stress tests indicated that these thresholds are likely to be breached if adverse shocks caused the real GDP growth rate, export value growth and other variables to deviate from the baseline scenario. Also, a combination of such shocks or an exchange rate depreciation of 30 percent would exacerbate these breaches.

Table 5.4: Public debt as percent of exports under sensitivity analysis

	Sustainability threshold	2005	2007	2013	2023
Baseline scenario	150	105	100	85	91
Alternative scenario					
Key variables at historical average 1/	150	85	60	52	114
New loans on less favourable terms 2/	150	112	113	114	157
Stress tests					
Lower GDP growth 3/	150	105	100	85	91
Lower export growth 4/	150	146	138	114	110
Lower non-debt creating flows 5/	150	150	142	113	98
One-time 30 percent depreciation 6/	150	105	100	85	91

Source: Treasury and IMF

1/Hisorical averages calculated for 2004-2023. Variables include real GDP, growth of GDP deflator (in US dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that interest on new borrowing is by 2 percentage points higher than in baseline while grace and maturity periods are the same as in the baseline.

3/ Real GDP growth at baseline minus one standard deviation in 2004-2005.

4/ Export growth at baseline minus one standard deviation in 2004-2005.

5/ Non-debt creating flows at baseline minus one standard deviations in 2004-2005. Includes official and private transfers and foreign direct investment

6/ Nominal depreciation relative to the baseline in 2004. Depreciation is defined as percentage decline in dollar/local currency rate but never exceeds 100 percent.

Kenya's debt appears relatively robust to various shocks. The most serious stress would come from sharp depreciation of the Kenya shilling, which pushes the NPV of debt to GDP to over 71 percent.

5.2.2 Sustainability Indicators under BWI- LTD & HIPC-CPB methodology

The best practice recommended by MEFMI through HIPC-CPB, is for each country to select between these two approaches the appropriate benchmarks/thresholds to guide debt policy and strategies. Key criteria for selecting the indicators are as follows:

- Each country or region to give priority to its own key indicators and thresholds, especially those that are enshrined in Law or regional economic convergence treaties.
- Pre-completion HIPCs to use HIPC indicators as far as possible.
- Post completion point HIPCs to use long-term indicators (LTDs).
- In cases where HIPCs and LTDs and regional convergence indicators do not exist, countries may wish to use HIPC CBP studies indicators.

Using the above criteria, Kenya opted for *a blend of indicators* to include the LTDs to measure external debt for sustainability indicators and the HIPC CBP domestic debt sustainability as follows:

5.3 Debt Sustainability Indicators

5.3.1 Bretton Woods Institutions (BWI) Long-Term Debt (LTD) Sustainability Indicators

The IMF and the World Bank have designed a methodology to be used for countries, which are beyond their HIPC completion point as well as those, which do not qualify *(*as in the case of Kenya*)* or opt for HIPC relief. It links debt sustainability thresholds with a country's quality of policy and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA). The rationale is that a country with strong policy and institutions should be able to shoulder a higher debt burden and vice versa. A separate study conducted by the HIPC-Capacity Building Program (CBP) to identify more accurate levels of debt sustainability identified the ratios at which low-income countries debt has become unsustainable in the past. Thus, countries are placed in three groups as shown in Table 5.6 below:

Table 5.6: Summary of International Debt Sustainability Indicators

Figures in percentage					
INDICATOR	HIPC	BWI LONG TERM DEBT INDICATORS (LTDs)			**CBP STUDIES**
		Strong CPIA	Medium CPIA	Poor CPIA	
EXTERNAL DEBT					
SOLVENCY					
PV/XGS	150	200	150	100	140
PV/DBR	250	300	250	200	151
PV/GDP	NA	50	40	30	NA
LIQUIDITY					
DS/XGS	15 - 20	25	20	15	12
DS/DBR		35	30	25	13
DOMESTIC DEBT					
SOLVENCY					
PV/DBR					88
LIQUIDITY					
DS/DBR					28

Source: Treasury

Table 5.7 - Kenya: Debt Sustainability Indicators

Indicator	Threshold	Basis	Current ratios*
EXTERNAL DEBT	(Medium CPIA)		
SOLVENCY			
PV/XGS	150	LTDs	93**
PV/DBR	250	LTDs	99**
PV/GDP	40	LTDs	22**
LIQUIDITY			
DS/XGS	20	LTDs	6**
DS/DBR	30	LTDs	7**
DOMESTIC DEBT			
SOLVENCY			
PV/DBR	88	CBP	104***
LIQUIDITY			
DS/DBR	28	CBP	9***

Source: Treasury
** External debt ratios are based on DSA conducted by the IMF in November 2003*
*** Five-year average [2004 – 2008]*
**** 3-year average [2003-2005]*

The reasons for adopting the above indicators are as follows:

- Kenya's is classified as a non-HIPC with sustainable debt. Therefore, use of post HIPC indicators is the most appropriate.
- Kenya was rated by the World Bank in 2004 and 2005 and classified as *Medium Policy*. Therefore, the appropriate benchmark for external debt sustainability is **LTDs – Medium CPIA**.
- In the absence of other alternative indicators to measure sustainability of domestic debt, the proposed HIPC-CBP studies indicators/benchmarks were adopted.

It is observed that under the adopted *"blend approach"*, *Kenya's* public debt is sustainable except for PV/DBR for domestic debt where the ratio is 104% against the threshold of 88%. In conclusion, the fact that certain shocks have the potential to push indicators above the threshold means that the Government must remain vigilant. The Government has stated its commitment to pursue strong fiscal and debt management policies to ensure debt sustainability.

6 PUBLIC DEBT MANAGEMENT REFORMS

Under the FLSTAP reform programme, several activities were undertaken in the fiscal year 2005/06 aimed at strengthening the management of public debt. These activities focused on reorganization of the debt DMO into three distinct but interrelated functions of Front, Middle and Back office in accordance with best practice. In line with the Project Implementation Plan (PIP) of the FLSTAP, the focus was strengthening the Back Office. The main reform activities that were implemented in the DMD are as outlined below:

6.1 Institutional re-organization - Steps leading to establishment of the Debt Management Office (DMO)

- A Back Office was established through transfer of the Public Debt Section from the Accounts Department to DMD. This section was merged with the external debt data recording section;

- A formal organization structure detailing the functions of the DMO, i.e. Front, Middle and Back office was prepared and forwarded together with job descriptions for the staff under each office, to Directorate of Personnel Management for consideration and approval.

6.2 Strengthening of the Back Office Operations

- The CS-DRMS 2000+ system was installed and the External debt data migrated from the old CS-DRMS (version 7.2) system to the new system.

- Approximately 50 members of staff drawn from departments responsible for debt management functions at MoF and CBK received training on the external and domestic debt modules of CS-DRMS 2000+.

- Work is in progress to set up a fibre optic connection between Treasury and CBK to facilitate sharing of information, including debt data, by the two institutions through establishment of a centralised debt database.

- The external debt information in the new system was validated and updated with the help of the newly trained staff. The process of recording on-lent loans data in the new system within DGIPE was initiated.

- The Back Office was reorganized into functional workstations with modern equipment, and a procedures manual detailing its operations developed and implemented.

- The Payments Advice Data Entry System (PADES) was developed and implemented during the year. The system has facilitated the automation of the Payments Advice (PA) preparation process.

6.3 Records Management and Documentation

- The Department initiated the establishment of a comprehensive Public Debt Registry.

- An inventory of loan agreements and files was carried out and records appropriately filed/archived.

6.4 Future Plans

During the fiscal year 2006/07, the department will give priority to the following activities in order to achieve its objectives:

- Continue focusing on timely and accurate settlement of public debt;
- Maintain a reliable and up to-date public debt database;
- Disseminate debt information on a timely basis;
- In collaboration with MEFMI and the Debt Relief International (DRI), conduct a DSA for Kenya in April/May 2007.
- Prepare External Debt Regulations to effectively manage external debt in accordance with the provisions of the External Loans and Credit Act.
- Facilitate the engagement of a consultancy firm under FLSTAP to prepare the organisation structure and retention policy of the DMO.

In the medium term, DMD will focus on strengthening the Middle Office through recruiting and training of staff to effectively carry out Middle Office functions. The Middle Office should be able to carry out detailed analytical work on debt portfolio to facilitate effective formulation and execution of debt strategies.

7. EVOLUTION OF PUBLIC DEBT IN THE MEDIUM TERM (2006/07 - 2009/10)

In the medium term, public debt is expected to rise in nominal terms from Kshs 809,984 million to Ksh 881,070 million. However, as a percent of GDP, public debt is projected to decline from 46 percent to 36 percent over the period. This decline is attributed to both prudent debt management strategy to maintain overall debt at sustainable level and faster growth of GDP.

External debt is projected to decline from Kshs 431,237 million in June 2006 to Kshs 422,484 million in June 2007 and further to Shs 396,370 million in June 2010. On the other hand, domestic debt is projected to rise gradually from Kshs 357,839 million to Kshs 484,700 million over the same period (Table 7.1).

Table 7.1 Projected Public Debt Stock in Kshs Million

		2006/7	2007/8	2008/9	2009/10
Total Public Debt		**809,984**	**833,084**	**856,106**	**881,070**
	External	422,484	413,684	405,006	396,370
	Domestic	387,500	419,400	451,100	484,700
% of GDP		**46%**	**42%**	**39%**	**36%**

As a result of the increase in domestic debt stock, domestic interest payments are expected to rise from Kshs 37,309 million in 2006/7 to Kshs 44,600 million in 2009/10. On external debt, interest payments are projected to decline from Shs 5,288 million to Kshs 4,996 million in 2009/10. Annual principal repayment of external debt will remain relatively unchanged at about Kshs 16,600 million over the period (Table 7.2). However, total external debt service would rise in the medium term if the suspended external commercial debts currently under forensic audit were to be settled.

Table 7.2 Projected Debt Service in Kshs million

		2006/7	2007/8	2008/9	2009/10
Interest Payments		42,597	45,056	46,594	49,596
	Domestic	37,309	39,600	41,400	44,600
	External	5,288	5,456	5,194	4,996
Principal Repayments					
	External	16,516	16,800	16,678	16,636

Although overall debt service payments are expected to rise in the medium term, the debt burden indicators are projected to be within sustainable levels.

GLOSSARY

- *Concessionality* — A measure of the "softness" of a credit reflecting the benefit to the borrower compared to a loan at market rate. Technically, it is calculated as the difference between the nominal value and the present value of the debt service as of the date of disbursement, calculated at a discount rate applicable to the currency of the transaction and expressed as a percentage of the nominal value.

- *Debt Relief* — Agreements by creditors to lessen the debt burden of debtor countries by either rescheduling interest and principal payments falling due over a specified time period, sometimes on concessional basis, or by partially or fully cancelling debt service payments falling due in a specified period of time.

- *Debt Rescheduling* — A form of debt re-organization in which payments of principal and/or interest previously due at a specified time are deferred for repayment on a new schedule following negotiations between the creditor and debtor.

- *Debt Service* — The amount of funds necessary for or used in the payment of interest or amortization charges of a debt.

- *Debt Sustainability* — Sustainable debt is the level of debt which allows a debtor country to meet its current and future debt service obligations in full, without recourse to further debt relief or rescheduling, avoiding accumulation of arrears, while allowing an acceptable level of economic growth.

- *Debt Sustainability Analysis* Conducted in the context of medium-term scenarios. These scenarios are numerical evaluations that take account of expectations of the behaviour of economic variables and other factors to determine the conditions under which debt and other indicators would stabilize at reasonable levels, the major risks to the economy, and the need and scope for policy adjustment. In these analysis, macroeconomic uncertainties, such as the outlook for the current account, and policy uncertainties, such as for fiscal policy, tend to dominate the medium-term outlook.

- *Disbursement* The actual international transfer of financial resources, or of goods or services by the lender to the borrower.

- *Domestic Borrowing* Government borrowing through issuance of Government securities and direct borrowing from the CBK.

- *Export Credit* Loans for the purpose of trade and which are not represented by a negotiable instrument. They may be extended by the official or the private sector. If extended by the private sector, they may be supported by official guarantees.

- *External borrowing* Government borrowing from both official (Government or Government agencies) and private institutions domiciled outside the country.

- *Government securities* — Financial instruments used by the Government to raise funds from the primary market.

- *Grant Element* — It measures the concessionality of a loan, in the form of the present value of an interest rate below the market rate over the life of a loan.

- *London Club* — An international group of private commercial banks whose credits are not covered by government guarantees or insurance. The group is designed to provide a common approach to rescheduling of such debts owed by debtor country.

- *Monetary Policy* — The management of the money in an economy to achieve desired economic conditions such as the overall level of prices.

- *Net Present Value* — The *net present value (NPV) of debt* is a measure that takes into account the degree of concessionality. It is defined as the sum of all future debt-service obligations (interest and principal) on existing debt, discounted at the appropriate market rate. Whenever the interest rate on a loan is lower than the market rate, the resulting NPV of debt is smaller than its face value.

- *Official Development Assistance* — Loans from official development agencies to countries received by the public sector, for promotion of economic development and welfare as the main objective and, extended at concessional financial terms [with minimum grant element of 25 per cent]. Loans and credits for military purposes are excluded in this definition.

- *Paris Club* — The Paris Club is an *ad-hoc* gathering of creditor governments, chaired by high-ranking official of the French Treasury, which meets for the purpose of rescheduling debts. The Paris Club is open to all creditor governments that are willing to adhere to its unwritten rules and practices and that have claims against a debtor country seeking rescheduling. Debtor countries must have strong adjustment programmes supported by the upper credit tranche IMF arrangements before being considered for debt relief.

- *Primary Market* — A market in which initial issue of financial instruments is made.

- *Public Debt* — Outstanding financial liabilities of the Government arising from past borrowing. It includes Government guaranteed debts to State Corporations and Local Authorities.

- *Public Domestic Debt* — Part of the overall debt owed by the Government to creditors domiciled in the country. The debt includes money owed to commercial banks, non-bank financial institutions and individuals.

- *Public External Debt* — Part of the overall debt owed by the Government to creditors domiciled outside the country. The debt includes money owed to private commercial banks, other governments, or international financial institutions such as the IMF and World Bank.

- *Secondary Market* — A market for already issued financial instruments.
- *Suppliers Credit* — An arrangement under which a supplier or exporter agrees to allow the customer to defer payment under a sales contract.
- *Treasury Bills* — Short term debt instruments currently with maturities of 91 and 182 days issued by the Treasury. In Kenya, this instrument is issued by the Treasury through the CBK.
- *Treasury Bonds* — Medium to long-term term debt instruments issued by the Treasury. In Kenya, this instrument is issued by the Treasury through the CBK.
- *Yield Curve* — Relationship between the return an investor receives by holding a bond to maturity and time value of money.

ANNEXES

Annex 1: External Debt Stock by Creditor (USD Million): June 1996 – June 2006

CREDITOR	Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Jun-01	Jun-02	Jun-03	Jun-04	Jun-05	Jun-06
BILATERAL											
AUSTRIA	55.00	41.00	37.00	40.00	34.40	16.10	25.00	30.50	33.14	32.35	32.99
BELGIUM	10.00	8.00	7.00	25.00	38.00	30.60	29.80	30.40	59.41	68.00	71.02
CANADA	64.00	53.00	60.00	60.00	41.00	67.70	28.00	36.40	22.18	17.00	17.15
DENMARK	61.00	58.00	49.00	53.00	40.00	32.40	24.80	26.10	26.22	31.00	32.38
FINLAND	4.00	3.00	3.00	3.00	2.00	2.50	5.00	3.60	3.08	1.76	2.17
FRANCE	344.00	274.00	282.00	307.00	179.00	219.60	199.00	182.60	201.02	237.33	252.34
GERMANY	129.00	112.00	109.00	112.00	109.00	98.10	94.40	109.80	137.14	169.63	188.28
ITALY	140.00	124.00	125.00	120.00	82.00	125.80	136.10	117.90	126.33	94.14	118.31
JAPAN	1018.00	1089.00	825.00	984.00	1031.00	922.20	824.00	1071.00	1058.80	1109.50	1075.58
NETHERLANDS	113.00	100.00	81.00	80.00	58.00	52.40	44.20	50.40	52.79	28.94	37.25
UK	80.00	74.00	66.00	66.00	37.00	35.80	40.82	35.80	33.35	36.94	36.61
USA	100.00	91.00	84.00	73.00	72.00	43.00	55.40	89.70	74.55	79.40	79.08
OTHERS	107.00	68.00	92.00	106.00	54.00	49.70	143.10	138.40	153.91	163.00	153.17
TOTAL	**2225.00**	**2095.00**	**1820.00**	**2029.00**	**1777.40**	**1695.90**	**1649.62**	**1922.60**	**1981.92**	**2068.99**	**2096.33**
MULTILATERAL											
ADB/ADF	339.00	322.00	308.00	333.00	308.00	328.40	292.80	321.50	315.10	310.00	349.71
EEC/EIB	184.00	163.00	149.00	138.00	115.00	156.70	148.00	115.50	128.92	111.00	180.49
IBRD	312.00	213.00	154.00	147.00	91.00	20.00	11.50	11.50	14.22	0.50	0.00
IDA	2062.00	2032.00	2109.00	2211.00	2332.00	2306.80	2263.00	2516.60	2492.88	2757.00	2765.38
IMF	337.00	255.00	261.00	154.00	104.00	111.30	98.00	80.75	103.95	165.74	154.41
OTHERS	37.00	23.00	33.00	37.00	9.00	6.30	10.05	6.90	8.30	12.26	8.99
TOTAL	**3271.00**	**3008.00**	**3014.00**	**3020.00**	**2959.00**	**2929.50**	**2823.35**	**3052.75**	**3063.37**	**3356.50**	**3458.98**
COMMERCIAL BANKS	**505.00**	**483.00**	**587.00**	**491.00**	**319.00**	**377.20**	**305.00**	**48.50**	**46.90**	**23.30**	**17.25**
EXPORT CREDIT	**24.00**	**65.00**	**15.00**	**53.00**	**19.00**	**48.60**	**16.40**	**364.50**	**200.57**	**252.27**	**264.43**
GRAND TOTAL	**6025.00**	**5651.00**	**5436.00**	**5593.00**	**5074.40**	**5051.20**	**4794.37**	**5388.35**	**5292.76**	**5701.06**	**5836.99**

Source: Treasury

Annex 2: Total Public Debt Service in Ksh Million: 199/96 – 2005/06

		1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
EXTERNAL		**31,318**	**27,366**	**29,203**	**28,488**	**37,100**	**16,415**	**29,215**	**29,386**	**26,278**	**14,971**	**12,875**
Bilateral		**14,933**	**9,264**	**13,704**	**10,764**	**14,328**	**4,589**	**15,726**	**12,173**	**6,283**	**3,922**	**2,774**
Of which:	Principal	8,909	5,570	9,362	7,659	10,304	3,565	12,650	8,452	4,096	2,505	1,547
	Interest	6,024	3,694	4,342	3,105	4,024	1,024	3,076	3,721	2,187	1,417	1,226
Multilateral		**8,936**	**8,004**	**7,990**	**8,757**	**10,438**	**9,234**	**7,880**	**8,109**	**9,157**	**9,862**	**9,574**
Of which:	Principal	5,346	5,010	5,247	5,754	7,327	6,503	5,539	5,481	6,547	7,235	7,237
	Interest	3,590	2,994	2,743	3,003	3,111	2,731	2,341	2,628	2,610	2,627	2,337
Commercial		**7,449**	**10,098**	**7,509**	**8,967**	**12,334**	**2,592**	**5,609**	**9,104**	**10,838**	**1,187**	**527**
Of which:	Principal	5,576	8,530	6,790	7,597	10,556	2,461	5,156	5,678	9,805	804	445
	Interest	1,873	1,568	719	1,370	1,778	131	453	3,426	1,033	383	82
DOMESTIC INTEREST		**26,168**	**26,582**	**35,414**	**31,743**	**22,068**	**23,231**	**23,744**	**27,567**	**23,281**	**23,375**	**31,445**
GRAND TOTAL		**57,486**	**53,948**	**64,617**	**60,231**	**59,168**	**39,646**	**52,959**	**56,953**	**49,559**	**38,346**	**44,320**

Sources: Treasury & Central Bank of Kenya

Annex 3: SECURITY PROJECTS STATUS AS AT 30th June 2006

No.	PROJECT	PURPOSE	DATE SIGNED	PROJECT AMOUNT		PAYMENTS (KSHS.M)
				KSHSM	FOREX	
A. COMPLETE						
1	Kenya Police: Supply of Security Equipment Addendum 2	Supply of Police Security equipment. Project concluded	9 April 2002	2,250	$30.0	2,856
2	Kenya Police Airwing Support Project I	Supply of 4 mi helicopters. Project concluded	8 June 1998	2,700	$36.0	2,844
3	Kenya Prisons Security and Telecommunication Project I	Supply, installation and commissioning of a dedicated security communication network for Prisons department. Project concluded	30 Oct 1997	1,845	$24.6	1,944
B. ON-GOING						
4	NEXUS (Defence Command Centre)	Construction of a command and control center for the Department of Defence to be overseen by Ministry of Transport.	19 Nov 2002	3,284	€36.9	1,262
5	Kenya Police: Supply of Security Equipment Addendum 3	Supply of Police Security equipment.	14 June 2002	2,385	$31.8	1,921
6	Kenya Police Airwing Support Project II	Technical service to the Kenya Police Airwing helicopters.	12 July 2002	960	$12.8	705
7	Telecommunication Network for Administration Police	Supply, installation, commissioning and support for secure communication for Administration Police and Provincial Administration	29 May 2003	4,423	€49.7	688
8	National Early Warning and Security System	Supply, installation and commissioning of an early warning system for meteorological department.	12 July 2002	2,625	$35.0	1,464
9	Broadband Network	Supply for telecommunication equipment for networking all the Post Offices.	11 July 2002	885	$11.8	538
10	Bandwidth Spectrum & Network Operations & Control Project	Supply of bandwidth spectrum and service for ten years to operate the equipment under project 7.	11 July 2002	2,108	$28.1	1,266
11	Kenya Prisons Security & Telecommunication Project II	Supply, installation and commissioning of a dedicated security communication network for Prisons department. Project concluded	19 Nov 2002	2,643	€29.7	324
12	Oceanographic survey vessel	Delivery of warship to Kenya Navy. Component financed by Euromarine	15 July 2003	926	€10.4	473
		Delivery of warship to Kenya Navy. Component financed by Empressa De Financas	15 July 2003	1,335	€15.0	244
		Delivery of warship to Kenya Navy. Component financed by Navigia Capital.	15 July 2003	2,367	€26.6	438
	Total – Survey Vessel			4,628		1,155
13	Project Flagstaff (National Counter Terrorism Control Centre – NCTC)	Establishment of an anti terrorism center.	20 Nov 2003	3,135	$41.8	214
	Sub – total			33,871		17,181
C. CANCELLED						
14	Forensic Science Laboratories - CID	Construction of Forensic Laboratories and supply of Forensic Equipment for the CID.	16 Aug 2001	4,095	$54.6	375
15	Immigration Security & Document Control System	Implementation of Passport, Visa issuing and border control systems.	4 Dec 2003	2,393	$31.9	93
16	Export Lease Purchase – various Security Vehicles (Silverson)	Lease purchase of 994 security vehicles and assorted spares	16 Aug 2001	6,750	$90.0	72
17	Modernization of Police Equipment & Accessories	Supply of police equipment. However it was not budgeted for.	17 Dec 2003	3,000	$40. 0	0.00
18	Kenya Police Law and Order(E-COPS Infotalent)	Supply, installation and commissioning of the Kenya Police Computer Project	19 Nov 2003	4,478	$59.7	509
	Sub- total			20,716		1,049
	Grand total			**54,587**		**18,230**

Source: Treasury

Annex 4: Trends in Gross Domestic Debt Stock in Ksh Million: June 1996 – June 2006

	Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Jun-01	Jun-02	Jun-03	Jun-04	Jun-05	Jun-06
TOTAL STOCK OF DOMESTIC DEBT (A+B)	**120,355**	**159,077**	**171,730**	**174,305**	**206,042**	**211,806**	**236,000**	**289,377**	**306,234**	315,573	**357,839**
A. Government Securities	**91,623**	**138,896**	**142,632**	**165,216**	**190,886**	**199,317**	**226,768**	**278,251**	**289,537**	**302,271**	**349,740**
1. Treasury Bills (excl.Repos)	**78,464**	**99,323**	**104,215**	**96,683**	**114,129**	**116,441**	**82,100**	**78,744**	**62,936**	**71,938**	**94,776**
Banking institutions	45,100	53,543	44,809	56,559	61,919	54,154	30,515	36,231	42,154	32,780	47
Others	33,364	45,780	59,406	40,124	52,210	62,287	51,585	42,513	20,782	39,158	47,741
2. Treasury Bonds	**8,575**	**35,613**	**34,687**	**28,186**	**36,851**	**44,491**	**106,300**	**161,549**	**188,626**	**193,358**	**218,357**
Banking institutions	536	22,930	26,341	5,030	8,637	13,090	47,100	74,452	89,001	89,729	100,149
Others	8,039	12,683	8,346	23,156	28,214	31,401	59,200	87,097	99,625	103,629	118,208
3. Long Term Stocks	**4,584**	**3,960**	**3,730**	**3,430**	**3,006**	**1,468**	**1,468**	**1,058**	**1,058**	**1,058**	**1,058**
Banking institutions	99	101	27	52	117	-	-	-	-	-	-
Others	4,485	3,859	3,703	3,378	2,889	1,468	1,468	1,058	1,058	1,058	1,058
4. Pre-1997 Government O/D	**-**	**-**	**-**	**36,917**	**36,900**	**36,917**	**36,900**	**36,900**	**36,917**	**35,917**	**35,549**
Repo T/Bills	2,676	17,296	16,820	5,000	16,883	21,100	36,000	27,000	36,900	35,900	35,532
B. Others:*	**28,732**	**20,181**	**29,098**	**9,089**	**15,156**	**12,489**	**9,232**	**11,126**	**16,697**	**13,301**	**8,099**
Of which CBK o/d to Gov't	24,016	-	5,436	5,625	6,529	2,862	-	4,319	9,232	5,225	5,202

*Others includes Government overdraft at the CBK, clearing items awaiting transfer to PMG, commercial bank advances and tax reserve certificates

Source: Central Bank of Kenya

Annex 5: Treasury Bills and Bonds Stock by Tenor in Ksh Million: March 2001 – June 2006

	91-DAYS	182-DAYS	1-YEAR	1.5-YEAR	2-YEAR	3-YEAR	4-YEAR	5-YEAR	6-YEAR	7-YEAR	8-YEAR	9-YEAR	10-YEAR
Mar-01	112,714	4,295	21,611	-	9,747	3,139	-	55	-	-	-	-	-
Jun-01	109,539	6,901	20,197	-	9,952	9,969	-	4,381	-	-	-	-	-
Sep-01	114,042	2,797	20,538	3,999	10,090	13,468	7,994	4,372	-	-	-	-	-
Dec-01	96,769	34	18,404	3,999	24,964	17,657	7,994	4,328	2,982	-	-	-	-
Mar-02	86,198	8,141	17,176	3,999	29,078	25,127	7,994	6,324	2,982	-	-	-	-
Jun-02	61,420	20,630	15,258	3,999	33,117	31,845	9,797	9,336	2,982	-	-	-	-
Sep-02	55,893	30,697	12,821	3,999	35,049	36,279	11,802	11,291	4,979	-	-	-	-
Dec-02	60,015	22,896	18,760	3,999	39,652	38,075	12,638	12,381	4,979	-	-	-	-
Mar-03	60,839	18,401	14,593	-	43,308	41,597	15,504	15,319	6,404	2,801	-	-	-
Jun-03	48,186	30,558	14,593	-	44,214	40,973	20,187	18,003	11,800	2,801	3,907	2,368	2,705
Sep-03	31,972	43,350	12,395	-	43,714	42,829	20,187	21,564	11,800	2,801	8,931	9,555	8,634
Dec-03	36,480	40,247	8,572	-	28,549	50,535	22,622	21,564	13,494	5,896	8,931	9,555	8,634
Mar-04	34,585	31,279	5,429	-	31,212	50,243	22,463	21,564	17,909	8,558	11,969	9,555	8,634
Jun-04	29,497	33,439	9,343	-	28,237	44,817	26,520	23,086	17,909	8,558	11,969	9,555	8,634
Sep-04	22,178	40,835	6,538	-	27,812	44,562	24,528	23,086	20,434	10,330	11,969	9,555	8,634
Dec-04	33,153	31,604	11,506	-	21,550	40,373	24,528	21,990	20,434	10,330	11,969	9,555	8,634
Mar-05	41,051	20,401	25,332	-	23,353	31,898	22,535	21,990	20,434	10,330	11,969	9,555	8,634
Jun-05	42,761	29,177	30,953	-	24,686	27,898	26,160	22,740	20,434	10,330	11,969	9,555	8,634
Sep-05	47,266	32,292	30,772	-	32,481	29,810	24,167	22,740	20,434	10,330	11,969	9,555	8,634
Dec-05	44,191	33,246	23,361	-	38,088	27,876	24,167	27,604	27,841	10,330	11,969	9,555	8,634
Mar-06	38,373	46,576	9,535	-	40,673	30,011	24,167	27,604	27,841	13,566	15,287	9,555	12,085
Jun-06	37,632	57,144	1,000	-	39,738	31,255	26,287	28,391	33,105	13,566	15,287	12,615	17,113

Source: Central Bank of Kenya

Annex 6: Outstanding Treasury Bonds by Holder in Ksh Million: June 2001 –June 2006

	Commercial Banks	Non-Banks	nsurance co.	Parastatals	Building Societies	Pension funds	Others
Jun-01	12,530	550	9,920	2,480	120	-	18,890
Sep-01	21,490	470	9,460	3,280	310	-	25,460
Dec-01	32,030	760	12,290	3,730	1,140	-	30,370
Jun-02	45,790	1,150	15,600	4,390	1,590	2,850	34,960
Sep-02	49,310	1,950	17,670	4,510	1,590	5,030	36,160
Dec-02	55,250	2,050	19,050	4,630	1,600	5,540	42,360
Mar-03	63,100	2,100	18,800	5,000	1,600	5,700	43,300
Jun-03	74,500	2,100	21,500	7,300	2,100	6,500	47,500
Sep-03	81,700	2,200	24,300	12,600	2,800	7,900	50,900
Dec-03	78,400	2,100	24,400	14,000	2,300	6,700	50,400
Mar-04	83,900	2,200	25,800	15,700	2,500	7,400	50,000
Jun-04	84,400	2,100	26,100	16,600	2,700	6,400	50,400
Sep-04	83,260	1,790	25,720	14,560	2,680	5,450	53,980
Dec-04	82,630	1,720	23,970	14,100	2,440	5,480	49,330
Mar-05	86,900	1,620	24,620	14,690	2,440	5,590	50,180
Jun-05	88,510	1,220	25,940	19,510	2,000	5,830	50,350
Sep-05	91,630	1,080	26,560	21,660	2,000	5,830	52,135
Dec-05	96,957	1,050	28,492	22,963	1,963	5,783	52,219
Mar-06	97,900	900	27,000	22,300	1,900	6,000	54,400
Jun-06	100,100	900	26,400	23,200	1,800	6,200	59,800

Source: Central Bank of Kenya

Annex 7: Outstanding Treasury Bills by Holder in Ksh Million: June 2001 – June 2006

	CBK	Commercial Banks	Non-Banks	Insurance co.s	Parastatals	Building Societies	Pension funds	Others
Jun-01	-	47,300	3,300	9,500	9,600	2,600	-	44,100
Sep-01	100	53,100	2,600	10,200	8,200	2,500	-	40,300
Dec-01	-	43,300	1,800	13,100	3,200	1,500	-	33,800
Jun-02	-	39,900	1,400	11,600	2,000	1,200	-	38,300
Sep-02	-	28,700	1,500	8,700	5,800	400	-	36,700
Dec-02	300	32,800	1,200	8,900	4,600	500	-	38,600
Mar-03	-	35,200	1,000	8,600	2,900	700	-	34,600
Jun-03	-	29,900	400	6,900	5,600	300	-	36,200
Sep-03	-	35,200	1,000	5,900	6,200	200	1,000	29,240
Dec-03	-	46,500	1,600	3,600	5,300	-	600	17,740
Mar-04	-	54,300	1,100	4,600	2,200	-	600	14,000
Jun-04	-	43,900	500	4,900	4,800	-	360	11,460
Sep-04	-	41,000	1,100	4,900	4,900	-	320	10,650
Dec-04	-	33,900	1,400	8,560	2,380	-	590	17,040
Mar-05	21	27,230	950	8,990	4,200	50	570	19,450
Jun-05	10	31,860	910	7,665	6,907	180	538	23,868
Sep-05	6	36,585	730	8,954	10,084	130	392	22,680
Dec-05	-	35,649	906	10,303	6,955	125	327	23,171
Mar-06	-	39,500	900	11,000	8,100	200	400	25,000
Jun-06	-	47,000	500	11,000	11,200	500	600	23,800

Source: Central Bank of Kenya

Annex 8: Treasury Bonds Issues in Ksh Million: January 2004 – June 2006

Issue date	Bond Type	Tenor	Maturity Date	Average rate	Coupon Rate	Amount (Face)
26-Jan-04	Fixed	4 Year	21-Jan-08	5.71%	5.00%	1856.90
26-Jan-04	Fixed	7 Year	17-Jan-11	7.44%	6.75%	2661.30
23-Feb-04	Fixed	2 Year	20-Feb-06	4.52%	4.00%	3737.90
23-Feb-04	Fixed	6 Year	15-Feb-10	7.23%	6.50%	4415.00
22-Mar-04	Fixed	2 Year	20-Mar-06	4.67%	4.00%	5111.80
22-Mar-04	Fixed	8 Year	12-Mar-12	8.07%	7.50%	3037.80
26-Apr-04	Fixed	3 Year	23-Apr-07	5.55%	4.75%	1400.55
26-Apr-04	Fixed	5 Year	20-Apr-09	6.95%	6.00%	1521.25
24-May-04	Fixed	2 Year	22-May-06	4.95%	4.95%	1935.25
21-Jun-04	Fixed	1 Year	20-Jun-05	3.69%	3.75%	3914.30
21-Jun-04	Fixed	4 Year	16-Jun-08	5.79%	6.00%	4056.75
27-Dec-04	Zero coupon	1 Year	26-Dec-05	12.22%	N/A	4096.55
17-Jan-05	Zero coupon	1 Year	16-Jan-06	12.23%	N/A	5596.05
21-Feb-05	Zero coupon	1 Year	20-Feb-06	11.35%	N/A	5593.20
21-Mar-05	Zero coupon	1 Year	20-Mar-06	10.02%	N/A	2637.30
21-Mar-05	Zero coupon	2 Year	19-Mar-07	11.39%	N/A	5750.05
25-Apr-05	Zero coupon	1 Year	24-Apr-06	9.73%	N/A	4272.70
25-Apr-05	fixed	2 Year	23-Apr-07	10.88%	10.8750%	3603.95
25-Apr-05	fixed	3 Year	21-Apr-08	11.63%	11.6250%	2518.45
23-May-05	Zero coupon	1 Year	22-May-06	10.05%	N/A	2400.25
23-May-05	fixed	3 Year	19-May-08	12.15%	11.6250%	528.3
23-May-05	fixed	4 Year	18-May-09	12.61%	12.2500%	3624.9
20-Jun-05	Zero coupon	1 Year	19-Jun-06	9.97%	N/A	2861.8
20-Jun-05	fixed	5 Year	14-Jun-10	13.33%	12.5000%	1827.3
25-Jul-05	fixed	3 Year	21-Jul-08	12.53%	11.5000%	6890.6
29-Aug-05	fixed	2 Year	27-Aug-07	11.16%	10.5000%	2207.8
26-Sep-05	fixed	2 Year	24-Sep-07	10.48%	10.25%	5586.6
31-Oct-05	fixed	4 Year	26-Oct-09	12.35%	12.25%	5607.05
28-Nov-05	fixed	5 Year	22-Nov-10	12.75%	13.00%	5941.25
26-Dec-05	fixed	6 Year	19-Dec-11	13.34%	13.00%	7407.25
30-Jan-06	fixed	2 Year	28-Jan-08	10.14%	10.50%	5782.35
30-Jan-06	fixed	7 Year	21-Jan-13	13.66%	13.25%	3235.4
27-Feb-06	fixed	3 Year	23-Feb-09	10.54%	11.00%	5731.0
27-Feb-06	fixed	8 Year	17-Feb-14	14.01%	13.25%	3318.8
27-Mar-06	fixed	2 Year	24-Mar-08	9.68%	10.00%	5652.45
27-Mar-06	fixed	10 Year	14-Mar-16	14.60%	14.00%	3451.05
24-Apr-06	fixed	4 Year	19-Apr-10	11.02%	11.25%	3923.25
24-Apr-06	fixed	9 Year	13-Apr-15	13.60%	13.50%	3060.25
29-May-06	fixed	5 year	23-May-11	11.58%	11.75%	1864.3
29-May-06	fixed	10 year	16-May-16	13.78%	14.00%	5028.1
26-Jun-06	fixed	6 year	18-Jun-12	11.81%	11.75%	6013.35