Republic of Kenya

THE NATIONAL TREASURY

Medium Term
Debt Management Strategy
2014

February 2014

Enquiries covering the publication should be addressed to:

Director
Debt Management Department
First Floor, Treasury Building, Harambee Avenue
P.O. Box 30007-00100, Nairobi, Kenya
Tel: (254) 20 2252299
Fax: (254) 20 315294
Email: info@treasury.go.ke or dmd@treasury.go.ke
This publication is available at the Treasury Website at: http://www.treasury.go.ke

Table of Contents

FOREWORD

The importance of countries to pay serious attention to management of public debt is evident from the serious consequences on the global economy arising from the Eurozone debt crisis. Many African countries also went through a similar experience about ten years ago and they had to be rescued under the Highly Indebted Poor Countries (HIPC) initiative. Fortunately, for Kenya, Public debt has been managed prudently over the years and this trend should be maintained.

The Constitution and the Public Finance Management Act, 2012 provide the needed framework to ensure our country continues with prudent debt management. The PFM Act, 2012 has provision for the National Treasury to establish a Debt Management Office (DMO). Strict procedures, accountability and reporting requirements have been laid down for both National and County Government on public debt management.

The Medium Term Debt Management Strategy (MTDS) is one of the important deliverables of the National Treasury as provided under the PFM Act, 2012. It provides guidance to the National Government on the amount and type of borrowing to undertake over the medium term. It evaluates the costs and risks of various scenarios and recommends an optimal strategy for implementation. The *2014 MTDS* is aligned to the broad strategic priorities and policy goals set out in the Budget Policy Statement to be tabled in Parliament in February 2014.

As the County Governments become more established, caution is required before they consider borrowing. Many of them have inherited substantial liabilities. It should be underscored that even if the National Government takes over to write off the debts, this will require Kenyans to forego other critical services. It is therefore important to avoid this trend and contract loans for projects which are beneficial to the counties and which are able to generate income for servicing.

The National Treasury will develop guidelines for engagement between the Development Partners, Counties and the National Government to ensure proper co-ordination not only on the area of loans but also in grants and on other forms of Aid. The staff in the DMO will carry out workshops and visit the counties to assist in the preparation of the county MTDS as required by the law.

HENRY ROTICH
CABINET SECRETARY
THE NATIONAL TREASURY
FEBRUARY 2014

ACKNOWLEDGEMENT

This is the sixth Medium Term Debt Management Strategy (MTDS) to be tabled in Parliament. This is however, the second MTDS to be tabled under the requirement of Public Finance Management (PFM) Act, 2012.

The MTDS sets out the debt management strategy of the National Government over the medium term with respect to actual and potential liabilities for both loans and guarantees given by the National Government.

The preparation of MTDS is a fairly technical process involving use of a tool to analyze data inputs to produce scenarios from which an optimal borrowing strategy is determined. The preparation of MTDS in Kenya and indeed many other developing countries has benefited greatly from the World Bank and Commonwealth Secretariat. These institutions provide support for capacity building as well as constantly improving the tool to produce better results. I take this opportunity to express GoK appreciation for the continued assistance.

As required by the PFM Act 2012, the MTDS will be formally submitted to the Commission on Revenue Allocation (CRA) who will ensure sound borrowing principles are adopted in the counties.

To ensure wide circulation of the MTDS, it is available in the Treasury Website: www.treasury.go.ke. However, in view of the fact that the document is technical, a brief non-technical summary will also be distributed and posted on the website.

Let me take this opportunity to acknowledge the staff of the Debt Management Department, National Treasury who were involved in the preparation of the *2014 MTDS*. Specifically, the

core team comprising of Mr. Charles Kairu, Ms. Racheal Njoroge, Mr. Bernard Gibet and Mr. Robert Osudi under the guidance of Mrs. Felister Kivisi – Ag. Director, Debt Management Department.

DR. KAMAU THUGGE, EBS
PRINCIPAL SECRETARY
THE NATIONAL TREASURY
FEBRUARY 2014

Legal Basis for the Publication of the Debt Management Strategy

The Debt Management Strategy is published in accordance with Section 33 of the Public Finance Management Act, 2012. The law states that:

1) On or before 15th February in each year, the Cabinet Secretary shall submit to Parliament a statement setting out the debt management strategy of the national government over the medium term with respect to its actual liability in respect of loans and guarantees and its plans for dealing with those liabilities.
2) The Cabinet Secretary shall ensure that the medium term debt management strategy is aligned to the broad strategic priorities and policy goals set out in the Budget Policy Statement.
3) The Cabinet Secretary shall include in the statement the following information:-

    a) The total stock of debt as at the date of the statement;
    b) The sources of loans made to the national government and the nature of guarantees given by the national government;
    c) The principal risks associated with those loans and guarantees;
    d) The assumptions underlying the debt management strategy; and
    e) An analysis of the sustainability of the amount of debt, both actual and potential.

4) Within fourteen days after the debt strategy paper is submitted to Parliament under this section, the Cabinet Secretary shall submit the statement to the Commission on Revenue Allocation and the Intergovernmental Budget and Economic Council and publish and publicize the statement.

List of Abbreviations

ADB	African Development Bank
ADF	African Development Fund
ATM	Average Time to Maturity
BoP	Balance of Payments
BPS	Budget Policy Statement
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CPI	Consumer Price Index
CPIA	Country Policy and Institutional Assessment
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
DGIPE	Department of Government Investment and Public Enterprises
DMD	Debt Management Department
DSA	Debt Sustainability Analysis
DX	Domestic currency denominated debt
EAC	East African Community
ECF	Extended Credit Facility
EEC	European Economic Community
EIB	European Investment Bank
EMBI	Emerging Markets Bond Index
ERD	External Resources Department
FX	Foreign currency denominated debt
FY	Financial Year
GDP	Gross Domestic Product
IDA	International Development Association
IFB	Infrastructure Bond
IFC	International Finance Corporation

IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
ISB	International Sovereign Bond
Ksh	Kenya Shilling
LIC	Low Income Country
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
MTDS	Medium Term Debt Strategy
NPV	Net Present Value
NSE	Nairobi Securities Exchange
NT	National Treasury
PFM	Public Financial Management
PPP	Public Private Partnerships
PV	Present Value
SDR	Special Drawing Rights
US	United States
USD	United States Dollars

EXECUTIVE SUMMARY

The key drivers for the *2013 MTDS* were a desire to minimize overall cost by issuing medium term domestic debt to reduce cost associated with longer dated securities and to further develop and deepen the domestic debt market. In contrast, *2014 MTDS* envisages an increased uptake of domestic debt than in previous years to meet the Central Government budget-financing requirement.

In 2013, the Government also highlighted the need to minimize the degree of foreign exchange rate risk exposure associated with the external debt portfolio by borrowing more concessional debt, while maintaining a limited window for borrowing on commercial terms to minimize costs and refinancing risks. The *2014 MTDS* emphasizes that financing on non-concessional window will be limited to projects with high-expected risk-adjusted rates of return including critical infrastructure that would otherwise not be undertaken due to lack of concessional financing.

The *2013 MTDS* reaffirmed Government's commitment in realizing its objective of development of the domestic debt market. Arising from expenditure pressures, the original borrowing target of Ksh 106.7 billion was raised to Ksh 135.7 billion. The performance of the market has demonstrated the depth of the market with over-subscriptions for most of the government securities offered.

While the thrust of the *2013 MTDS* remained unchanged, the increased level of domestic borrowing led to increased refinancing risk. The average time to maturity remained constant at 4.9 years and the proportion of domestic debt to be refinanced within 12 months increased to 20 percent at end June 2014 from 18 percent the previous year.

Managing refinancing risk remains a priority for the *2014 MTDS*. Active debt management operations to smooth the refinancing profile, along with efforts to maintain a wider investor base have been instrumental in mitigating potential fiscal shocks, such as, impact of drought on food security, realization of contingent liabilities, or shortfall in revenues, the country continues to face.