INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/275

KENYA

2021 ARTICLE IV CONSULTATION; SECOND REVIEWS UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY; AND REQUESTS FOR MODIFICATIONS OF PERFORMANCE CRITERIA AND STRUCTURAL CONDITIONALITY

December 2021

In the context of the 2021 Article IV Consultation and Second Reviews Under the Extended Arrangement Under the Extended Fund Facility and Under the Arrangement Under the Extended Credit Facility, and requests for modifications of performance criteria and structural conditionality, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Acting Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 17, 2021, following discussions that ended on November 3, 2021 with the officials of the Kenya on economic developments and policies underpinning the IMF arrangements under the Requests for an Extended Arrangement Under the Extended Fund Facility and an Arrangement Under the Extended Credit Facility. Based on information available at the time of these discussions, the Staff Report was completed on December 2, 2021.
- **Supplements of the Staff Report: Debt Sustainability Analysis,** prepared by the World Bank/IDA and IMF staffs;
- **Informational Annex** prepared by IMF staff.
- A **Statement by the Executive Director** for Kenya.
- A combined **Selected Issues Papers** report prepared by staff team of the IMF.

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

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PRESS RELEASE

PR21/387

IMF Executive Board Completes the 2021 Article IV Consultation and Second Reviews of the Extended Arrangement under the EFF and ECF Arrangements for Kenya

FOR IMMEDIATE RELEASE

- The IMF Executive Board today completed the 2021 Article IV consultation and Second reviews of the EFF/ECF arrangements with Kenya, allowing for an aggregate immediate disbursement equivalent to about US$ 258.1 million for budget support.
- The Kenyan authorities have continued to show strong commitment to their reform agenda in a challenging environment and are acting to reduce debt vulnerabilities while maintaining support for the economic recovery.
- They have maintained careful control of government spending to limit the deficit and are taking steps to reform state-owned enterprises (SOEs) to limit pressure on the budget while protecting social programs.

Washington, DC – December 17, 2021: The Executive Board of the International Monetary Fund (IMF) completed today the 2021 Article IV Consultation[1] and the Second reviews of the 38-month Extended Arrangement under the Extended Fund Facility (EFF) and 38-month arrangement under Extended Credit Facility (ECF) for Kenya. The Board's decision allows for an aggregate immediate disbursement of SDR 185 million (about US$ 258.1 million), bringing Kenya's total disbursements for budget support under the arrangements to about US$ 972.6 million.

Kenya's EFF/ECF arrangements for a total of SDR 1,655 billion (305 percent of quota) or about US$ 2.34 billion at the time of program approval on April 2, 2021 (see Press Release 21/98), are aimed at supporting Kenya's program to address debt vulnerabilities and their response to the COVID-19 pandemic and at enhancing governance.

Kenya showed remarkable resilience to the COVID shock in 2020 and is staging an economic recovery. Growth is now estimated to accelerate to 5.9 percent in 2021. Kenya's COVID-19 vaccination program has picked up speed in the second half of 2021, though uncertainty and pandemic-related pressures will persist until vaccinations become widely available. The political calendar is also a source of uncertainty.

Kenya's economic program aims to reduce debt vulnerabilities through multi-year fiscal consolidation efforts centered on raising tax revenues and tightly controlling spending, while safeguarding resources to protect vulnerable groups. The FY21/22 budget delivers on these objectives. A supplementary budget is being prepared, consistent with the flexibility built into the EFF/ECF arrangements, to expand the authorities' COVID-19 vaccination program,

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

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USA

support the SOE reform plan and execute emergency spending related to the drought in the northern regions and security. Given Kenya's limited fiscal space, the authorities are proactively managing difficult trade-offs with the view to reduce debt vulnerabilities by rationalizing non-priority spending to offset half of the impact of SOE support on the deficit, in line with program commitments.

Kenya has also made notable advances on its structural reform and anti-corruption agendas. Fiscal governance and transparency will be bolstered by the authorities' action plan to address legal impediments that prevented the publication of beneficial ownership information related to public procurements and by planned audits of COVID-19 vaccine spending and of FY20/21 expenditure with a focus on COVID-19-related spending. As part of their strategy to address challenges in the SOE sector and put firms on a financially viable footing, the authorities are formulating robust restructuring strategies with safeguards to protect the Exchequer's financial interest. The authorities also plan to further enhance their monetary policy framework and to continue supporting financial stability.

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

"The Kenyan authorities remain firmly committed to their economic program in a challenging environment. The program performance has been robust. All quantitative targets were met – the FY 2020/21 outturn overperformed – and all 2021 structural benchmarks are now completed except one.

"The authorities should continue executing their multi-year fiscal consolidation plan to reduce debt vulnerabilities. Some additional fiscal space is needed in FY21/22 for emergency spending to face the drought in the north and emerging security needs; the planned supplementary budget should also provide resources for expanding COVID-19 vaccinations and SOEs support, in line with program design. Strengthening domestic revenue mobilization, maintaining expenditure control while protecting priority social spending and improving spending efficiency will remain essential. Bold political commitment by all levels of government is needed to ensure the FY22/23 budget is aligned with the authorities' program.

"Proactive efforts to address fiscal risks from state-owned enterprises (SOEs) should continue. Financial support to SOEs will require difficult tradeoffs and adequate safeguards given Kenya's limited fiscal space and the need to maintain debt sustainability.

"Further strengthening fiscal transparency and governance requires more proactive efforts. The authorities should address legal impediments to begin publishing beneficial ownership information for awarded public tenders in early 2022, proceed with planned audits of COVID-19 spending, and promptly act to follow up on previous audits.

"Well-calibrated Central Bank of Kenya policies have supported economic resilience and the banking sector. The stance of monetary policy should remain accommodative as long as inflation expectations remain well anchored.

"The program is subject to increasing global and domestic risks, including from the pandemic, tightening global financing conditions, and potential pressures from the upcoming political calendar. Kenya's medium-term prospects remain positive, and the authorities' continued commitment to their economic program is essential to maintain macroeconomic balance, while ensuring a more sustainable, greener, and inclusive growth."

Table 1. Kenya: Selected Economic Indicators, 2020–23

	2020 Est.	2021 Proj.	2022 Proj.	2023 Proj.
Output				
Real GDP growth (%)	-0.3	5.9	5.8	5.5
Prices				
Inflation - average (%)	5.2	6.4	5.8	4.8
Central Government Finances (fiscal year)[1]				
Revenue (% GDP)	16.5	16.0	16.8	17.3
Expenditure (% GDP)	24.2	24.2	24.9	23.0
Primary balance (% GDP)	-3.4	-4.0	-3.4	-1.2
Fiscal balance (% GDP)	-7.5	-8.2	-8.2	-5.8
Public debt (% GDP)	63.0	67.9	71.2	71.2
Money and Credit				
Broad money (% change)	13.2	11.1	11.3	11.0
Credit to private sector (% change)	8.4	8.0	7.9	9.8
Policy rate, end of period (%)	7.0	...	...	...
Balance of Payments				
Current account (% GDP)	-4.5	-5.1	-5.1	-5.1
Reserves (in months of imports)	4.7	5.6	4.2	4.2
External debt (% GDP)	35.0	36.7	36.0	35.8
Exchange Rate				
REER (% change)	0.0	...	...	...

INTERNATIONAL MONETARY FUND

KENYA

December 2, 2021

STAFF REPORT FOR 2021 ARTICLE IV CONSULTATION, SECOND REVIEWS UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, AND REQUESTS FOR MODIFICATIONS OF PERFORMANCE CRITERIA AND STRUCTURAL CONDITIONALITY

EXECUTIVE SUMMARY

Context. Kenya's medium-term economic outlook remains positive, supported by the authorities' continued firm commitment to their economic program amidst a complex environment. Economic recovery is well underway, but Kenya's Sustainable Development Goals (SDGs) have suffered significant setbacks, and poverty has increased. The authorities see the program as providing essential support for sound fiscal management ahead of the 2022 elections, reinforcing their multi-year fiscal consolidation plan to reduce debt vulnerabilities and preserve priority social and development spending.

Program status. In April 2021, the IMF's Executive Board approved 38-month arrangements under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) in an amount equivalent to 305 percent of quota. The arrangements support Kenya's response to the COVID-19 shock and the authorities' plan to reduce debt vulnerabilities while advancing the structural reform agenda, strengthen the anti-corruption framework, address financial weaknesses in state-owned enterprises (SOEs), and strengthen the monetary policy framework and support financial stability.

Program performance. Program performance at end-June 2021 was robust in a challenging environment. All end-June PCs and ITs were met. The primary balance significantly overperformed, and social spending modestly overperformed. After some delays, the structural reform agenda has accelerated. All but one structural benchmarks for 2021 are now implemented. Publication of beneficial ownership information, delayed due to conflicting privacy requirements, is expected to begin early next year.

Requests. The Kenyan authorities request modification of the PCs on the primary balance to reflect materialization of previously expected spending needs (COVID-19 vaccines and SOEs) and modest additional spending for humanitarian support; and on net international reserves to reflect revised FX flows (e.g., SDR allocation) and a switch to

end-of-period NIR program monitoring. A new ceiling on the present value of contracting or guaranteeing of new external debt by the national government is proposed to replace the separate nominal ceilings on new external concessional and non-concessional borrowing in line with recent reforms to the IMF Debt Limits Policy.

Risks to the program. Uncertainty remains very high due to the COVID-19 pandemic and upcoming 2022 elections, with medium-term risks tilted to the downside. The program provides flexibility to address continuing challenges (COVID-19 vaccination and SOE restructuring needs) while still achieving program objectives.

Approved By:
Annalisa Fedelino (AFR) and Martin Kaufman (SPR)

The mission team consisted of Mary Goodman (head), Valerio Crispolti, Jehann Jack, Francine Nyankiye, Gabor Pula, Sheriff Touray (all AFR), Plamen Iossifov (SPR), Lahcen Bounader (FAD), Mustafa Saiyid (MCM), Pasquale Di Benedetta, Jane Duasing, Alice French, Ron Snipeliski (all LEG), Tobias Rasmussen, James Maina, and Kevin Tuitoek (IMF Resident Representative Office in Nairobi) with assistance from Richa Kumar, Fernando Morán Arce, and Christine Odwogi (all AFR). The IMF Executive Director, Ita Mannathoko, and Advisor, James Garang (OED) participated in the discussions which were held remotely from Washington, D. C. during October 12–November 3, 2021. The team met with Cabinet Secretary for the National Treasury and Planning, Mr. Ukur Yatani; Governor of the Central Bank of Kenya (CBK), Dr. Patrick Njoroge; Head of the Public Service, Dr. Joseph Kinyua; Deputy Chief of Staff, Executive Office of the President, Ms. Ruth Kagia; Principal Secretary for the National Treasury, Dr. Julius Muia; Deputy Governor of the CBK, Ms. Sheila M'Mbijjewe; and other senior government, and CBK officials. Staff also had productive discussions with the Parliamentary Budget Office and representatives of the private sector, civil society organizations, and development partners.

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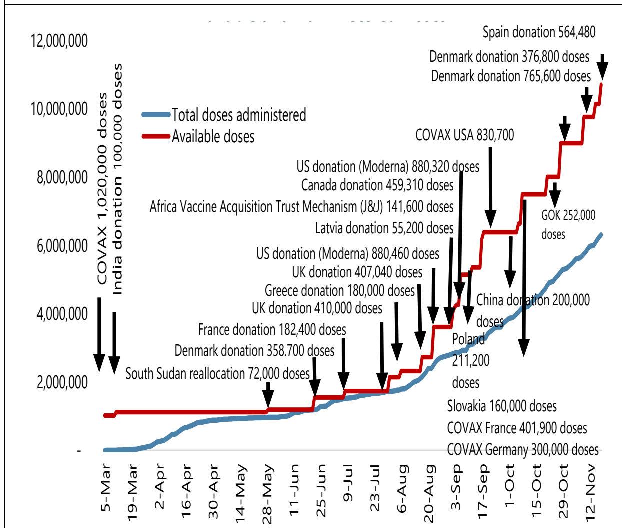
CONTEXT AND RECENT DEVELOPMENTS

1. Kenya's economy was performing well before the COVID-19 shock, although with increasing debt vulnerabilities. GDP growth averaged 5.0 percent over 2010–19, and living standards improved steadily. However, declining government revenues and exports as a share of GDP alongside large infrastructure investments partly financed by non-concessional borrowing contributed to rising fiscal deficits and debt vulnerabilities.

2. The COVID-19 pandemic dealt a blow to Kenya's hard-won progress. While the economy showed impressive resilience to the shock, Kenya's sustainable development goals (SDGs) suffered a significant setback. The World Bank (WB) estimates that the poverty rate (at US$1.9 per day) rose from 34.4 percent in 2019 to 35.7 percent in 2020. On the other hand, early achievement of Kenya's climate action goal has laid the foundation for a greener and more resilient recovery.

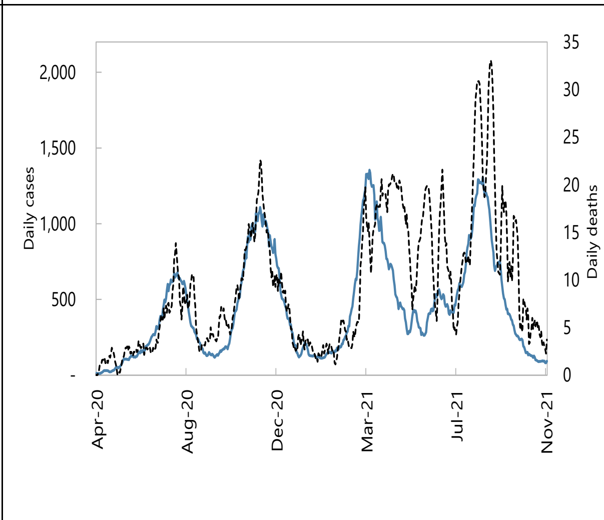
3. Kenya's COVID-19 vaccination program, initially held back by lack of supply, picked up speed in the second half of 2021. Confirmed cases of COVID-19 fell after a fourth wave that peaked in August 2021. At the same time, vaccine supply increased with donations and, increasingly, the government's own procurement. Delivery of 13.3 million doses of Johnson & Johnson ordered by the government with World Bank funding started in September 2021. By late November 2021, some 6.3 million COVID-19 vaccine doses had been administered and 8.4 percent of adults had been fully vaccinated. The government's target is to vaccinate 10 million people by end-2021 and to fully vaccinate all adults (26 million people) by end-2022.

Kenya: Available and Administrative Doses



Source: Kenya's Health Ministry.

Kenya: COVID-19 Cases
(7-day moving averages)



Source: Kenya's Health Ministry.

4. Despite the challenging environment the authorities have been advancing their reform program, including following up on recommendations of the 2018 Article IV consultation (Annex I). Removal of interest rate caps in November 2019 had opened the door to an increase in credit growth to support private investment. Under the EFF/ECF arrangements, the authorities have particularly prioritized meeting the deficit target—enacting tax policy measures and exerting strong spending control in line with prior staff advice—and are addressing financial vulnerabilities in state-owned enterprises (SOEs).

5. **The economic fallout from COVID-19 has been limited by proactive measures to support households and businesses through the crisis.** Temporary tax cuts, cash transfers, introduction of a credit guarantee scheme, a youth employment program, temporarily eased repayment conditions for borrowers, and a more accommodative monetary stance provided much needed support. The economy contracted by just -0.3 percent in 2020 (Box 1), showing remarkable resilience compared to regional peers. Economic recovery is underway despite recent pandemic waves (Figure 1), with 2021 H1 real GDP growth at 5.3 percent y-o-y. Rising domestic food prices and a recent surge in fuel prices on higher global energy prices have pushed headline inflation from 5.9 percent in March to 6.5 percent in October 2021, while non-food / non-fuel inflation remained anchored below 3 percent.

6. **FY20/21 budget execution overperformed the target.** Tax revenues have rebounded following the tax-mobilizing measures in effect since January 1, 2021 notwithstanding legal challenges to the Corporate Minimum Tax (CMT).[1] Public spending was restrained on efforts to further contain non-priority current spending and delays in disbursing project financing. The FY20/21 primary deficit was 4.0 percent of GDP,[2] well below the 4.5 percent of GDP target and limiting impact from the immediate pandemic shock on the fiscal stance.[3] The overall balance was contained to 8.2 percent of GDP (against a programmed 8.6 percent).[4]

7. **In 2020, the current account deficit narrowed to 4.5 percent of GDP, well below its historical average.** The weak demand for imports and lower imported energy bill, combined with the resilience of goods exports and buoyant remittances, helped offset the severe COVID-19 shock on tourism. Exports and remittances have remained strong thus far in 2021, while tourist arrivals in 2021:H1 were just a third of 2019:H1 levels. During the pandemic, the exchange rate acted as a shock absorber, reversing the previous trend of real effective exchange rate (REER) appreciation. At end-September 2021, gross international reserves stood at US$9.4 billion, bolstered by significant financial inflows including Eurobond issuance of US$1 billion, US$750 million in budget support from the World Bank, two disbursements totaling US$715 million under the Fund program in the second quarter and the SDR allocation in August of SDR520.2 million equivalent to US$740 million

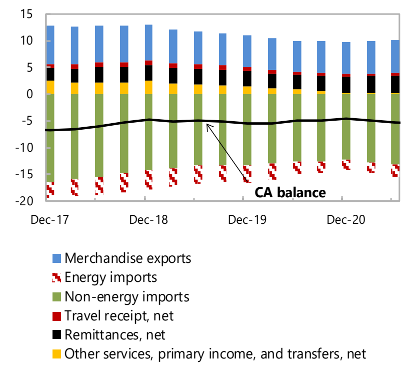
[1] The High Court suspended the CMT in early March 2021 on constitutionality concerns (EBS/21/52). On September 20, 2021, the High Court ruled the CMT unconstitutional. The authorities have appealed the ruling.

[2] The primary balance is assessed from the below the line (TMU) and includes statistical discrepancies for about KSh.20 billion.

[3] A GDP rebasing (see Box 1) modestly lowered fiscal ratios to GDP compared to levels at the first review.

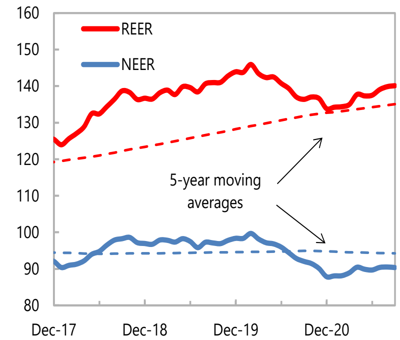
[4] In addition to changes in the primary balance, the difference between projected and actual size of the overall balance reflects a higher than previously anticipated outturn in the debt service payments—particularly for domestic debt. This is partly due to weaknesses in the coordination process among different data producing units that often results in the use of different assumption or cut-off dates for key macroeconomic variables.

Kenya: Contributions to Current Account Balance, 2017–21
(4-quarter moving sums, percent of GDP)



Sources: Haver, Central Bank of Kenya and Fund staff estimates.

Kenya: Effective Exchange Rates, Dec. '17–Sep.'21
(Index, 2010 = 100)



Source: IMF INS.
Note: Increase = appreciation of the Ksh.

8. **Banks have remained resilient during the pandemic.** The banking system remains adequately capitalized at 18.9 percent (total CAR), although five small banks and one midsized bank breached the minimum requirement of 14.5 percent in 2020.[5] The CBK initiative to support borrowers during the pandemic by encouraging banks to extend the terms of their loans also helped to preserve asset quality. About half of all banks' loans were restructured, of which 93 percent had resumed timely repayment of principal and interest by end-August 2021. The NPL ratio rose less than 2 percentage points during the pandemic and stands at 13.9 percent.[6] Lending has remained moderate with private credit growth of 7.7 percent year-on-year at end-August 2021, alongside strong deposit growth of 12 percent. A government credit guarantee scheme has provided KSh.1 billion of loans to MSMEs since end-2020. In 2021, bank profitability has improved after dropping sharply on provisioning charges during 2020, with banks releasing excess provisions, stable margins on the pickup in lending volumes, and income from government securities. Bank liquidity is being supported by significant holdings of government securities (31 percent of banks' assets) and reduced reserve requirements.[7]

9. **General elections are scheduled for August 9th, 2022.** As elections come closer, campaigning will take center stage. Candidates are required to resign from government at least six months before the election. With Parliament expected to adjourn early, the FY2022/23 budget is being prepared on a compressed schedule targeting passage at end-March 2022. Past Kenyan elections have been associated with social tensions and disruptions to economic activity.

[5] The six banks facing small capital shortfalls will mainly address this by retention of future earnings. The authorities are also encouraging consolidation of smaller banks with larger institutions to achieve competitive scale and strengthen profitability.

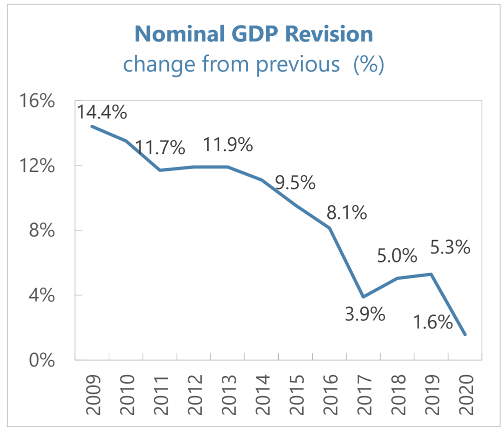
[6] The authorities' recent stress tests, which projected close to a 5 ppt increase in NPLs from already elevated levels during the pandemic in an adverse scenario, found that the aggregate capital shortfall for the banking system relative to the minimum requirement would be less than 0.4 percent of GDP.

[7] Some small banks have remained dependent on central bank liquidity for an extended period, having faced difficulty securing funding in the interbank market.

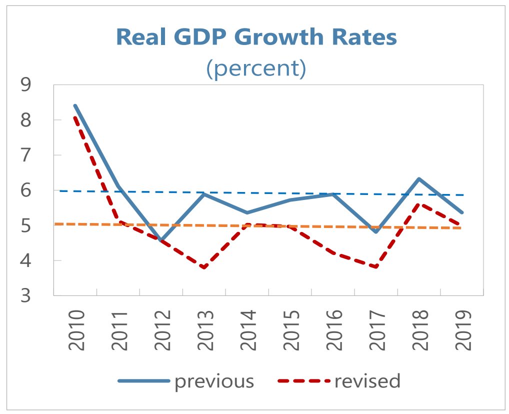
Box 1. Revision and Rebasing of National Accounts

On September 9, 2021, the Kenya National Bureau of Statistics (KNBS) revised 2010–19 annual and quarterly national accounts series and released preliminary 2020 estimates, completing a comprehensive GDP revision and rebasing launched in 2017.[1] The GDP rebasing improved coverage of economic activities due to improved data sources and better estimates of the size of the economy and rate of growth.[2]

Nominal GDP has been revised upwards, more in the beginning and less at the end of the period, due to more comprehensive coverage of economic activities including in the informal sector. The 2019 revised nominal GDP was 5.3 percent higher than the previous estimate, but by 2020 the difference from staff estimates based on the previous data had narrowed to 1.6 percent.[3]



Historical real GDP growth rates for 2010–19 were revised down by 0.8 percentage points on average. Downward revisions were broad-based across major sectors including agriculture (-0.7 percentage points), construction (-2.4), trade (-0.8), transport (-0.5), hotels and accommodation (-2.6), and education (-2.0). The notable exception was manufacturing, where growth rates were revised upwards by 0.5 percentage points on average. On the expenditure side, the average historical growth rates of both private consumption and exports declined by as much as 1 percentage points, while growth rates of investments and public consumption increased slightly.



The contribution of the services sector to the economy was revised up significantly, while agriculture's share of total output was revised down, and the share of manufacturing remained unchanged. In 2019, the services sector share in GDP stood at 62 percent (compared to 50 percent based on the previous data), with transport and storage, real estate and public administration observing the highest increase in shares. The downward revision to agriculture (to 21 percent of GDP) was mainly driven by the revision in the price indexes used to estimate nominal production, which had led to overestimating the sector's contribution to the economy.

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[1] Rebasing of National Accounts is an international best practice, which refers to replacing the old base year used for compilation of the constant price estimates to a new and more recent base year. Corresponding revisions to the national accounts aim to reflect structural changes in the economy, adopt new compilation methods, and take advantage of emergence of new or improved data sources. Such revisions usually, but not always, result in upward adjustments of GDP as improved data sources increase the coverage of economic activities, and as new weights for growing industries more accurately reflect their contributions to the economy, but scale economies can also significantly lower prices. Kenya's rebasing thus improved compliance with the 2008 System of National Accounts compilation guidelines.

[2] The benchmarking and rebasing project received technical support from the IMF East AFRITAC (AFE), backstopped by the IMF Statistics Department, and Statistics Sweden.

[3] Compared to staff's 2020 nominal GDP estimate based on official data for the first three quarters of the year.

Box 1. Revision and Rebasing of National Accounts (concluded)

Implications for staff's GDP forecast. As a result of the revisions, the estimated base effect for recovery from the pandemic in 2021 has declined from +3.2 percent to +1.5 percent on the less severe drop in the second quarter of 2020 (-6.3 percent seasonally adjusted quarter-on-quarter versus -9.4 percent based on previous data). In particular, the education and the manufacturing sector showed improved resilience. Overall, staff's 2021 growth forecast has been revised down from 6.4 percent to 5.9 percent.

The downward revision to historical growth rates also implies lower growth potential going forward. As a result, staff revised the medium-term GDP forecast down from 6.1 to 5.5 percent, while maintaining the previous assumption that the implementation of fiscal structural and governance reforms in the context of the extended arrangements under the EFF/ECF will have a positive impact on growth.

PROGRAM PERFORMANCE

10. **Program performance at end-June was robust in a challenging environment.** The implementation of structural benchmarks has advanced after some delays earlier in the year (MEFP, Table 2).

- **QPCs and ITs:** All end-June quantitative performance criteria (PC) and indicative targets were met comfortably (MEFP, Table 1), with the primary deficit PC met by a wide margin (KSh.455 billion vs. a target of KSh.508 billion).
- **MPCC:** Inflation remained within the 2.5–7.5 percent target range.
- **SB (end-May):** The Kenya Airways' (KQ) financial evaluation (end-May SB on SOE financial evaluations) was completed in August (MEFP, Table 2).
- **SBs (end-June):** Among the three end-June SBs, two were implemented with delay and one is still pending.
  - The Central Bank of Kenya (CBK) in July published its Strategy to Strengthen and Modernize the Monetary Policy Framework. [8]
  - The decision to implement a common payroll system across MDAs and Counties was delivered with the articulation in late October of an agreed roadmap to implement the payroll system by June 2022.
  - Beneficial ownership (BO) information is not yet reflected on the public procurement portal due to conflicting legal and privacy requirements (SB, not met). However, a clear roadmap has been established to allow the adoption of a new bidding document by end-March 2022 that will require consent from beneficial owners to publish BO information in the portal for all awarded contracts. ***(proposed new structural benchmark for end-March 2022)***.

[8] https://www.centralbank.go.ke/wp-content/uploads/2021/07/Modernisation-of-the-Monetary-Policy-Framework-Operations.pdf

- **SBs (end-September and end-December):** Of the three remaining SBs for 2021, one was met, one was implemented with delay, and the end-December SB was met well in advance:
  - The annual report on tax expenditures was launched at end-September, in line with the related SB.
  - Separate reports were issued on fiscal risks from PPPs and SOEs, with the plan to feed into the forthcoming budget process (end-September SB not met, implemented with delay).
  - The end-December SB on tax audits of firms in sectors with large compliance gaps, using risk-based approaches, has been met well-before the target date.

MACROECONOMIC OUTLOOK AND RISKS

11. Kenya's medium-term outlook is positive. Economic growth is projected to rebound in 2021 to 5.9 percent, supported by base effects,[9] and stabilize at 5.5 percent over the medium term. Headline inflation is projected to return to the mid-point of the CBK's target range during 2022 and stay near that level through the medium term, as monetary policy continues to anchor price expectations.[10] The external position is projected to remain comfortable, benefiting from improving export prospects, the recent SDR allocation, and recovery in tourism.

12. The outlook remains highly uncertain and subject to downside risks (Annex II). Uncontrolled outbreaks of the COVID-19 pandemic, globally and locally, with limited availability of vaccines, could undermine Kenya's nascent recovery and increase fiscal and external pressures. Terms-of-trade shocks from high imported commodity prices would widen the current account deficit and heighten price pressures, while Kenya—similar to other frontier economies—could be subject to spillovers via global capital markets from policy responses in the major economies. Within Kenya, upcoming general elections could pressure budget execution and reform implementation and potentially lead to socio-political tensions. Materialization of large contingent liabilities from SOEs could undermine fiscal consolidation efforts, leading to slower reduction in public debt and pressure on FX reserves in the medium term. Unfavorable rain conditions could exacerbate the severe drought and deep food insecurity in the northern regions, increasing social tensions and security risks, and necessitating further temporary and targeted emergency spending.

Authorities' Views

13. The authorities shared staff's views regarding Kenya's positive economic outlook. They considered that the economy showed remarkable resilience to the COVID-19 shock in 2020 but expressed concern about lasting impacts to Kenya's Sustainable Development Goals. They expected growth to be supported in the near term by the unwinding of pent-up demand in particular in

[9] Additional school days to compensate for the fallout in education last year are expected to raise the output of the education sector above its pre-pandemic level. CBK surveys on the hotel and accommodation sector indicate a steady recovery, although tourist arrivals are still at only half of the level of 2019.

[10] Second round effects from the higher fuel and food prices are expected to be muted given negative output gap and well anchored inflation expectations. The CBK has stated it will monitor second round effects closely.

services and noted potential upside risks to staff's baseline projection in 2021 given strong growth in the services sector in the first half of the year. In the medium-term, they anticipate growth at around 6 percent, somewhat above staff's projection, driven importantly by services, especially financial and IT services.

POLICY DISCUSSIONS

Near-term program and medium-term Article IV-related policy discussions focused on: (i) addressing immediate COVID-19 related spending and development needs while reducing debt vulnerabilities via multi-year fiscal consolidation; (ii) promoting external stability and strengthening export competitiveness; (iii) modernizing the monetary policy framework and safeguarding financial stability; and (iv) supporting inclusive growth and improving governance.

A. Supporting the COVID-19 Response While Reducing Medium-Term Debt Vulnerabilities

Near Term

14. Execution of the FY21/22 budget has been strong to date, despite a challenging environment. In the first quarter of the fiscal year (July-September 2021), the primary balance remained in positive territory as opposed to an expected deficit. This reflected sustained revenue collection on buoyant trade-related taxes and enhanced tax compliance measures—more than compensating revenue loss from suspension of the CMT[11]—as well as careful execution of spending commitments through enhanced budget controls and project prioritization. Accordingly, staff expects that end-December fiscal targets are well within reach (MEFP, Table 1). Showing strong determination to follow the programmed fiscal consolidation path, the authorities have resisted recent Parliamentary pressure to cut fuel taxes and have committed to taking compensatory measures should their appeal to reinstate the CMT be rejected.

15. However, several factors will require a recalibration of end-June 2022 fiscal program conditionality, along the lines anticipated at the first EFF/ECF reviews. Contracting of the June 2021 World Bank loan for US$130 million (0.1 percent of GDP) to accelerate COVID-19 vaccination has been finalized, and Kenya has gained visibility on spending needs related to SOE reform (0.4 percent of GDP in FY21/22), both of which are now incorporated in the baseline. In line with program commitments, the authorities have identified needed spending offsets for half of the SOE support (0.2 percent of GDP) to limit the impact on the program deficit path.[12] Additionally, given severe drought in northern regions of the country and the deterioration of security conditions, staff

[11] Kenya Revenue Authority (KRA) had originally estimated CMT yield at KSh.21 billion (EBS/21/29). However, the revenue impact of CMT suspension is now assessed to be about 1/3 lower as some sectors were exempted and some firms that would have paid CMT will now pay corporate income tax instead, boosting overall collection.

[12] Under the EFF/ECF arrangements, the primary balance target is envisaged to accommodate half of SOE extraordinary support up to 1 percentage point of GDP in such support in FY21/22-FY22/23 (adjustor, TMU¶7). Currently identified needs total 0.7 percent of GDP.

also agreed with the authorities' proposal for a targeted and temporary package of urgent measures (0.2 percent of GDP) to address their direct social and economic costs. These will add a combined 0.5 percent of GDP to the FY21/22 primary deficit (after spending cuts equal to half of the SOE support) and require a recalibration of conditionality consistent with the flexibility built in the program's design (EBS/21/29). The FY21/22 primary deficit would thus be 3.4 percent of GDP compared to an original target of 2.9 percent of GDP (excluding vaccine and extraordinary SOE spending) or 3.3 percent of GDP (including vaccine and SOEs extraordinary support) as provisionally estimated at the 1st Reviews of the EFF/ECF arrangements.

16. The authorities are proactively addressing financial vulnerabilities in the SOE sector to limit further drains on budget resources that are needed for priority social and development spending. The in-depth financial evaluations, that were supported by intensive Fund TA (Annex VII), identified a KSh.383 billion liquidity gap over the next five years for 18 SOEs presenting the largest financial and fiscal risks, excluding Kenya Airways. Given limited fiscal space and difficult tradeoffs with other fiscal priorities, that liquidity gap is expected to be mainly covered by cost-saving reforms in those SOEs.

- The authorities are developing plans to restructure Kenya Airways (KQ) and anticipate providing significant financial support over the medium term. Much of the projected US$1 billion cost for KQ's restructuring is unavoidable, as GOK had previously guaranteed US$750 million in debt owed by the airline, and KQ has run large arrears. The authorities are committed to pursue an approach that will minimize the cost to the Exchequer. This will require that KQ undergoes a fundamental restructuring of its business model given the serious challenges facing the global aviation industry in the post-pandemic environment, including downsizing of its operations and staff, measures to enhance its operational efficiency, and renegotiation of its lease and suppliers' contracts. The authorities have indicated their intentions to put in place strong safeguards to ensure progress under this plan, including tight links between phased financial support and performance on restructuring steps. The authorities do not intend to nationalize the carrier and are considering appropriate mechanisms to protect the Exchequer's financial interests during the restructuring process (MEFP ¶44).
- By end-year the authorities will also present a plan to address the financial vulnerabilities in Kenya Power and Lighting (KPLC) based on the findings of the recent Presidential Taskforce report, including the review of KPLC's Power Purchase Agreements with renewable energy producers and fast-tracking the company's restructuring. KPLC's management was replaced in November, and a forensic audit of KPLC's procurement practices has been launched. In FY21/22 the Exchequer will provide KSh.7.5 billion to KPLC, clearing much of its outstanding arrears to the company for last mile electrification. The WB is supporting efforts to address KPLC's financial difficulties in the context of its upcoming Development Policy Operation (DPO).[13]

[13] Policy priorities for the WB's planned early 2022 DPO include a review of signed Power Purchase Agreements (PPAs) that have not reached financial closure or started construction to reduce cost of supply (in particular of green energy).

- In FY21/22 Kenya Airports Authority and Kenya Wildlife Services will receive a total of KSh.4.8 billion temporary support to cover the fallout on revenues due to the pandemic.

17. A supplementary budget for FY21/22 to cover these needs will thus reflect challenging policy trade-offs. It will detail spending offsets in planned current and capital spending related to SOE support to contain the primary deficit within program targets (para MEFP ¶25–26). Recognizing that other priorities may require reprioritization of existing expenditures; the authorities are also committed to introducing additional measures if needed to secure achievement of end-June 2022 targets. The supplementary budget is expected to be submitted to Parliament at the latest in early 2022 (**proposed new SB for end-January 2022**).

Summary of Fiscal Changes in FY21/22 [1/]
(in KSh. billions)

	Sep-21	Dec-21		Jun-22			
				Prior FY21/22 Supplementary Budget		After FY21/22 Supplementary Budget	
	Prel.	*Proj.*	*Target*	*Proj.*	*Target*	*Proj.*	*Target*
Revenue and grants	**513.0**	**989.9**		**2,119.5**		**2,119.5**	
of which: taxes	*401.3*	*783.2*	*783.2*	*1,667.3*	*1,667.3*	*1,667.3*	*1,667.3*
Primary spending and net lending	**496.8**	**1,192.8**		**2,489.1**		**2,547.5**	
of which:							
COVID-19 vaccines /2						*14.4*	
SOEs extraordinary support						*48.4*	
Spending offsets						*24.2*	
Emergency spending (droughts, securi						*20.0*	
Primary balance (cash basis)	**16.2**	**-202.9**	**-202.9**	**-369.6**	**-369.6**	**-428.0**	**-428.0**

Sources: Kenyan authorities and IMF staff estimates and projections.
[1/] Fiscal year runs from July to June.
[2/] Spending additional to COVID-19 vaccination spending in the FY21/22 budget.

18. A portion of Kenya's SDR allocation will be used to finance the larger primary deficit. In addition to resources made available from the World Bank (COVID-19 loan), half of Kenya's SDR allocation (US$370 million SDR) will be on-lent in domestic currency by the CBK.[14]

Medium Term

19. Domestic revenue mobilization, expenditure control, higher public spending efficiency and prudent borrowing are key to safeguarding development spending while reducing debt vulnerabilities.

- **FY22/23 Budget.** The FY22/23 budget will provide a strong indication of continuing commitment to program objectives. Achieving the targeted 2.2 percentage points of GDP reduction in the primary balance would require further efforts to mobilize revenues and a bold political commitment by all levels of government heading into the election period. Non-priority primary spending will need to continue to be reduced, while protecting priority

[14] The authorities also plan to advance the timing of FY21/22 capital market issuance previously-planned for early 2022 into late 2021 given the potential for unsettled global markets in the coming year.

social spending (MEFP ¶26–27) and accommodating needed offsets for planned extraordinary SOE support. To facilitate passage of the FY22/23 budget considering the electoral calendar, the government has set expedited timelines for its preparation with submission to Parliament now expected by end-January as opposed to the legal deadline of end-April (***new proposed SB for end-April***).

Fiscal Financing Needs and Sources 2020/21–2021/22
(in KSh. billions)

	2020/21		2021/22	
	Rev.1	Est.	Rev.1	Proj.
Primary balance incl. grants	-507.8	-455.1	-369.4	-428.0
Interest payments	456.6	505.7	569.8	608.2
Domestic interest	340.0	388.8	421.9	479.2
Foreign interest due (excluding DSSI relief)	116.6	116.9	147.9	129.0
Repayments due (excluding DSSI relief and DMOs)	381.6	163.8	294.0	206.9
Financing needs	**1,346.0**	**1,124.6**	**1,233.2**	**1,243.1**
Financing sources	**1,230.0**	**1,000.3**	**1,133.7**	**1,159.2**
Project loans	241.7	157.1	273.5	273.5
Program loans	83.6	90.5	85.9	105.8
Non-concessional (excluding DMOs)	352.5	114.3	128.2	132.2
Standard Gauge Railway	11.9	11.5	0.0	0.0
Net domestic financing	540.3	626.9	646.1	647.6
o/w SDR	0.0	0.0	0.0	41.3
Financing gap (-=underfinancing)	**-116.0**	**-124.3**	**-99.5**	**-83.9**
IMF (RCF+ proposed EFF/ECF)	77.6	78.2	58.4	58.7
DSSI relief	38.4	46.1	41.1	10.8
Financing for vaccines (World Bank)	0.0	0.0	0.0	14.4
Residual gap (-=underfinancing)	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum:				
Extraordinary SOE Support	*36.3*	*36.3*	*65.0*	*48.4*
Offsets for SOE Support [1]	*36.3*	*36.3*	*32.5*	*24.2*

Sources: Kenyan authorities and IMF staff estimates and projections.
[1/] Specific offsets for FY21/22 extraordinary SOE support have been identified and will be proposed in the supplementary budget authorizing such support; offsets will also be required for subsequent years.

- **Revenues.** Work is ongoing on a Medium-Term Revenue Strategy (MTRS) to identify a well-sequenced and coherent set of tax policy and administrative measures to widen the tax base and achieve the planned tax effort of 0.8–0.9 percent of GDP per year in FY22/23 and FY23/24 (MEFP ¶27 and ¶31), supported by Fund TA (Annex VII). KRA's stepped up risk-based audits and annual reporting on tax expenditures launched in September support this effort. Adoption of appropriate milestones to secure progress in this area will be considered in the context of future reviews.

- **Expenditure control.** The authorities intend to continue their successful approach to limiting primary expenditures by containing the wage bill—including through a rationalization of wage allowances in line with the recommendations of the Salaries and Remuneration Commission—and improving the efficiency of public investment (Box 3) and (MEFP ¶33 and ¶34).

- **Fiscal structural reforms.** Progress is being made in enhancing government effectiveness and proactively managing fiscal risks, supported in several areas by Fund TA (Annex VII). A common payroll system for public employees is being rolled out, and recently released reports on risks from public-private partnerships (PPPs) and SOEs will feed into next year's budget process along with analysis of KQ risks, advancing areas of Kenya's reform agenda that had seen some delay (see ¶10).
- **Lowering medium-term fiscal risks.** As a follow-up to their SOE strategy and blueprint, the authorities will implement further steps to enhance management and oversight of SOEs with continued support by Fund TA. Their measures will include reinforcing the separation of roles and responsibilities among institutions that exercise an oversight role, Cabinet approval of an ownership policy for the entire SOE portfolio, expanding debt coverage to include all SOE debt liabilities and extending financial evaluations to more SOEs (MEFP, ¶47 and ¶48). In addition, the authorities are looking to establish a fiscal risk management structure to be coordinated across government at the senior management level that would oversee monitoring and assessment of fiscal risks across the public sector.
- **Debt anchor.** The limits of Kenya's current nominal debt ceiling at the national level were highlighted earlier in 2021 by the need to clarify treatment of contracted but undisbursed debt, leading to delays in the contracting of new external debt (now resolved). The authorities plan to transition to a medium-term debt anchor of 55 percent of GDP in present value terms and are pursuing a strategy for its achievement by mid-2022 (see MEFP, ¶36).
- **Public debt is sustainable but remains at high risk of distress (DSA).** Under the baseline, public debt is expected to reach 71 percent of GDP in FY21/22–FY22/23 (around 62 percent of GDP in PV terms). As the effects of the pandemic wane and the consolidation efforts continue, the primary deficit is expected to be brought below its debt-stabilizing level by end-2023, putting the debt ratio on a downward path thereafter (DSA, Table 2). Debt dynamics are supported by the authorities' demonstrated ability to limit the pandemic-induced increase in the deficit and broaden the tax base; commitment to the fiscal consolidation under the EFF/ECF arrangements, including actions to limit the impact on the deficit of SOE support; and a favorable overall debt repayment profile, with plans to further optimize the debt structure, if market conditions are favorable.

Authorities' Views

20. The authorities reiterated their commitment to implementing a multi-year consolidation effort centered on revenue-enhancing and spending-reducing measures under the Fund-supported program. They stressed that their prompt response to recent initiatives that threatened to undermine tax revenues are strong indications of their commitment to reduce debt vulnerabilities. Looking ahead, they expressed concerns on the realistic yield of the tax measures envisaged in FY22/23 and FY23/24.

21. The authorities emphasized reducing debt vulnerabilities as a key priority to support Kenya's developmental agenda. They stressed the success in extending the maturity of domestic debt and the need to pursue a financing strategy that balances domestic and external financing, utilizes concessional financing where available, and accesses private capital markets judiciously. They felt the new, national debt ceiling in present value terms would serve as a credible anchor of medium-term fiscal policies. They continue to look for favorable market conditions to undertake debt management operations to lower the costs of debt and refinancing risks.

Box 2. Tax Revenue Performance in Kenya

Kenya's tax-to-GDP ratio has been on a downward trend for almost a decade. After reaching 15.4 percent of GDP in FY2014/15, tax revenues steadily fell to about 13 percent of GDP in FY2019/20 with income taxes declining from 8.5 percent of GDP in FY2014/15 to 6.7 percent of GDP in FY2019/20. This primarily reflected a growing number of discretionary personal income tax incentives; widespread VAT exemptions; and an erosion of the corporate income tax (CIT) base resulting from tax depreciation and capital allowances as well as a reduction in the effective tax base due to the role of the agricultural sector in the economy (which traditionally benefits from low taxation).[1] The COVID-19 shock led to a further reduction of the tax ratio to 12.9 percent of GDP at the end of FY20/21 as economic activity slowed and several temporary tax cuts were introduced to support the economy (EBS/21/29). The fall would have been even larger if the authorities had not repealed most COVID-19 tax cuts and introduced additional base broadening tax measures as of January 1, 2021 (EBS/21/52).

Nevertheless, Kenya's tax revenues are comparable to those in EAC members and other regional peers (Table below). In 2020, Kenya collected less taxes (as a share of GDP) than Burundi and Rwanda; but significantly more than Tanzania and Uganda. Compared to the EAC average, Kenya's tax mobilization relied more on income taxes and less on indirect taxes. During the same period, however, tax collection was stronger in other regional peers with indirect taxes mobilizing on average about 8.8 percent of GDP as opposed to 6.5 percent of GDP in Kenya.[2] Kenya's tax collection is below the average for middle income countries of around 15–20 percent of GDP.

The authorities intend to improve tax mobilization and bring it back to pre-COVID-19 levels. This objective is a cornerstone of the Kenya's fiscal strategy to reduce debt and debt vulnerabilities durably over the medium term, while mobilizing resources to support high-priority service delivery and investment programs. To this end, the authorities are committed to achieving a tax-to-GDP ratio of 15.6 percent by FY24/25 by building on recent base broadening tax interventions (EBS/21/52) and introducing additional tax measures for 0.8–0.9 percent of GDP in FY22/23 and FY23/24—including drawing on past IMF advice in the area of revenue administration (EBS/21/29).

General Government Revenue in 2020 by Source in Selected SSA Countries

(in % of GDP)

Country	Tax Revenue (excl. SSC)	Income, Profits, and Capital Gains	General Goods and Services	International Trade	Unclassified Taxes
Kenya	**13.4**	**6.8**	**5.6**	**0.9**	**0.0**
Burundi	16.6	3.9	10.7	2.0	0.0
Rwanda	15.4	7.1	7.2	1.2	0.0
South Sudan	4.1	0.0	0.0	0.0	4.1
Tanzania	12.0	4.5	5.2	0.8	1.5
Uganda	11.3	4.3	6.0	0.9	0.1
Ghana	11.7	6.0	3.4	2.3	0.0
Côte d'Ivoire	11.9	3.1	3.0	3.5	2.2
Mozambique	18.4	9.2	6.8	1.4	1.0
Senegal	16.8	4.8	9.2	2.2	0.6
Zambia	15.4	8.6	5.7	1.1	0.0
Cameroon	10.7	3.0	5.5	1.7	0.5
EAC average (PPP weights)	12.8	5.7	5.5	0.9	0.6
Selected SSA (excl. Kenya; PPP weights	14.2	4.5	6.8	2.0	0.8

Source: WEO.

[1] The share of economic activity accounted for by agriculture was reduced in the recently completed GDP rebasing.

[2] This was not the case up to 2017 when Kenya's tax collection had been generally higher than in regional peers (15 as opposed to an average of 13 percent of GDP).

Box 2. Tax Revenue Performance in Kenya (concluded)

The IMF supports Kenya's efforts to strengthen tax mobilization. The authorities are developing a Medium-Term Revenue Strategy (MTRS) to reform the tax system with the help of Fund TA (Annex VII). The MTRS will help guide and sustain ongoing efforts to broaden the tax base and make Kenya's tax system able to finance its spending needs and secure macroeconomic sustainability, while creating appropriate incentives for economic and social development. The strategy will also play a critical role in identifying and building broad consensus around the specific measures needed to achieve the medium-term tax path envisaged under the Fund-supported program.

B. Promoting External Stability and Strengthening Export Competitiveness

Near Term

22. **Kenya's FX reserves are projected to remain adequate as the current account normalizes from the COVID-19 shock, receding from the 2021 inter-year peak through end-2022.** Gross international reserves amounted to US$9.6 billion at end-September, at 4.6 months of prospective imports or 148 percent of the IMF's assessing reserves adequacy (ARA) metric. FX reserves have been bolstered by Kenya's US$740 million SDR general allocation, while the lower-than-expected DSSI debt relief in the second half of 2021 and delays of official financing inflows weighed on reserve accumulation compared to the projection at the time of the first reviews. Going forward, the large FX needs associated with the support provided to KQ and the increase in debt repayment are projected to reduce the level of gross international reserves to US$8.9 billion or 4.2 months of imports by end-2022. Strengthening private inflows from 2023 are expected to support the level of FX reserves and import coverage.

Medium Term

23. **Kenya's external position is broadly in line with medium-term economic fundamentals and desirable policies (Annex III).** International reserves are comfortably above the recommended range for the Fund's reserve adequacy metric for credit-constrained economies. As policies begin to normalize globally, staff analysis highlights the importance of continued exchange rate flexibility and steadfast implementation of the fiscal consolidation under the EFF/ECF arrangements for keeping the external position in balance.

24. **Non-price factors have played an important role in the challenges of export competitiveness over the past decade, notwithstanding the significant policy attention devoted to creating a favorable environment for exports.** Exports of goods and services to GDP declined from a high of almost 20 percent in 2011 to about 11 percent in 2019, and relative performance deteriorated vis-à-vis EAC peers. Kenya has attracted just 1.3 percent of GDP in foreign direct investment (FDI) on average in 2010-19, whereas other non-resource-rich countries, such as Ethiopia and Rwanda, have attracted FDI flows around 3 percent of GDP. Lack of export sector dynamism and barriers to entry in certain markets, product market regulations, inefficiencies of the

SOE sector, lack of access to finance by SMEs, non-tariff barriers, and corruption appear to hinder stronger export performance.[15] Within overall exports, the share of services has been increasing, with financial services emerging as Kenyan firms establish a growing regional presence.

Box 3. Public Investment Efficiency in Kenya

Kenya's public investment has increased markedly as a share of GDP over the last decade. After averaging slightly below 4 percent of GDP from 1990-2007, Kenya's investment ratio climbed to exceed 7 percent of GDP in 2016-19—a level above the SSA average but slightly below the EAC average excluding South Sudan (Figure).[1] This followed adoption of the 'Kenya Vision 2030' strategy, a blueprint to unlock the country's economic potential by improving the quality of and access to infrastructure in key sectors (e.g., transportation, telecommunications).[2] Despite this progress, Kenya's public capital stock has remained relatively low, continuing to lag behind that of regional partners and the EAC average (Figure).

The quality of Kenya's infrastructure and citizens' access to services are relatively strong overall, though varying across sectors. A recent IMF report found that in 2015 the country's roads and electricity services stand out, respectively, in terms of coverage and access compared to peers.[3] However, the country's performance was less advanced in the social infrastructure sector, where access to public health infrastructure was comparatively good, whereas access to education and water was relatively limited.

Going forward, in a context of limited fiscal space, unlocking Kenya's growth potential will require further increasing the efficiency of public investment. While the scaling-up of investment spending in the mid-2000s has helped the country address its infrastructure needs, this has yet to translate in a durable increase in overall productivity dynamics (SIP on Non-Price Competitiveness of the Kenyan Economy; World Bank, 2016). Indeed, Kenya's efficiency gap with respect to other EAC members has remained quite significant (Figure). In this regard, the 2018 Public Investment Management Assessment (PIMA) provided several recommendations to improve the quality of Kenya's public investment institutions in the planning, budgeting and implementation stages of PIM, and to strengthen National Treasury's role in validating project viability.

The country has made significant efforts to improve Public Investment Management (PIM) institutions. Over the last few years, the authorities have developed a framework to strengthen oversight of the public investment cycle (planning, allocation and implementation). An automated management information system will help ensure that new projects are based on criteria and costing methodologies in line with the PIM regulations and guidelines.

[1] Factors such as devolution and spending on the Standard Gauge Railway linking Mombasa and Nairobi have been important drivers of the increased investment.

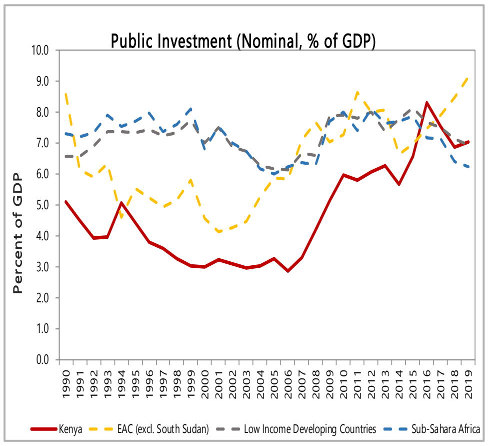
[2] As of 2015, spending on economic infrastructure was approximately 15 percent higher in Kenya compared to other sub-Saharan African countries, whereas spending on the social sectors was some 20 percent lower (2018 Public Investment Management Assessment).

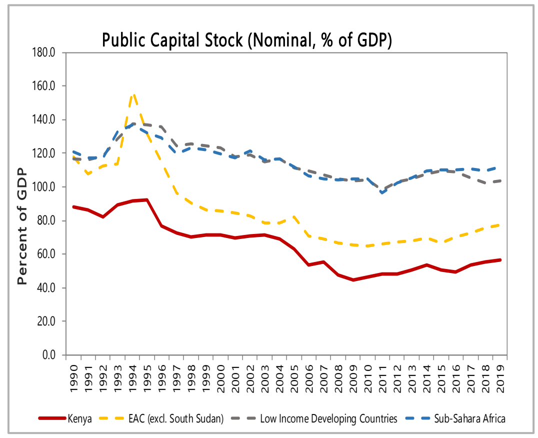
[3] The percentage of the population with access to electricity has almost doubled compared to the nearest EAC comparator, as investment in generation capacity and distribution has been a priority in recent years.

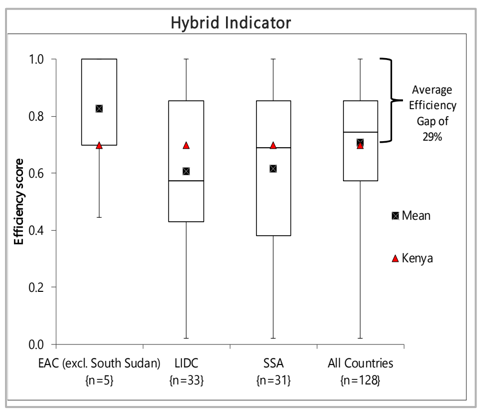
[15] See Selected Issues Paper: Evidence on Non-Price Competitiveness of the Kenyan Economy.

Box 3. Public Investment Efficiency in Kenya (concluded)

The current IMF arrangements with Kenya support the authorities' efforts to improve public investment efficiency (EBS/21/52). Structural conditionality has focused on a stocktaking of existing projects and associated commitments in key areas (i.e., education, health, and infrastructure) with the view to rationalize the investment portfolio (successfully undertaken at end-March 2021). The program has also supported efforts to fully operationalize the new PIM framework covering all phases of the public investment project cycle to support efficient and sustainable scaling up of the PPP program without undue fiscal risks.







Authorities' Views

25. **Noting wide confidence intervals around model results used to assess the external position in the midst of a pandemic, as also emphasized by Fund staff, the authorities broadly concurred with the bottom line that Kenya's external position is broadly in line with fundamentals and desirable policies.** They pointed to the heightened uncertainty about the extent and duration of economic scarring from the COVID-19 shock around the world, which would, in general, tend to weaken the link between price and external position adjustments (as supply-chain disruptions take center stage).

26. **The authorities agreed that improving export performance will be important but were more optimistic than staff about Kenya's export growth prospects.** They pointed to the

resilience of Kenya's goods exports after the 2020 slump, evidenced by the short rebound time for key export receipts (e.g., horticulture, tea, and coffee) to return to pre-pandemic levels. Recalling the significant efforts made to improve the business environment for exporters, they considered that realized and planned free trade arrangements (e.g., AfCFTA, the UK, and US), would offer opportunities to improve Kenya's export share in foreign markets. They highlighted the important role of services, particularly digital technology, financial services, logistics, and transportation, as areas in which Kenya is emerging as a dynamic regional provider.

C. Modernizing the Monetary Policy Framework and Safeguarding Financial Stability

27. The CBK in July set out its strategy to modernize its monetary policy framework. To better anchor inflation expectations and further strengthen monetary policy transmission, the CBK plans to:

- diversify and refine its macroeconomic modelling and forecasting frameworks and improve data collection;
- enhance interbank market functioning via full roll-out of the Central Securities Depository (CSD), followed by steps to introduce a band around the CBK policy rate to provide an anchor for the interbank rate, and strengthen the transparency of banks' loan pricing to eventually reduce variations in cost of credit across customers and banks; and
- improve public understanding of monetary policy decisions.

These priorities are aligned with recommendations of previous and ongoing Fund TA (Annex VII).

28. With an ample capital position and strong deposit growth, banks are positioned to extend credit to the economy to support the recovery, though they may face some headwinds. Banks' holdings of government securities stand at a relatively high 31 percent of assets and are expected to rise further in the coming year.[16] Staff analysis suggests that while banks are adequately positioned to meet government's financing needs, a substantial increase in such needs above anticipated levels could start to crowd out private credit growth (Annex VI). In addition, while the law limiting banks' interest rates was repealed in 2019, lending rates charged by banks have not moved much higher than the previous cap rate (Figure 5). Banks' credit pricing models require approval by the CBK, and banks must justify charging higher rates to customers presenting higher credit risks. Banks consider that approvals could be expedited.

29. Steps are planned to address the competitive challenges of some small banks. In view of the profitability, solvency and liquidity challenges faced by some small banks, the authorities are encouraging consolidation, including mergers and acquisitions with larger institutions, to allow them to achieve appropriate scale. The planned CSD would also facilitate liquidity exchange between large and small banks in the system by enabling efficient provision of financing against repo collateral.

[16] Banks' holdings of sovereign securities in local currency are largely held to maturity, mitigating the risk of an adverse bank-sovereign feedback loop.

30. The authorities plan to continue to strengthen financial safety nets. While the CBK remains responsible for early intervention and emergency liquidity assistance for problem banks, the Kenya Deposit Insurance Corporation (KDIC) has a mandate for bank resolution. Efficient cooperation would be supported by institutional arrangements (inter-agency coordination and data sharing on problem banks), including early intervention arrangements, and review of the legal and operational framework for bank resolution, potentially to include utilization of a bridge bank.

31. In a first for SSA, the CBK is acting to strengthen banks' assessment of climate-related risks. In October 2021, the CBK issued Guidance to banks aimed at integrating climate-related risks into banks' governance, strategy, risk management and disclosure frameworks (see Box 4). The CBK plans to work with banks to build capacity and integrate climate-related risk management in their day-to-day operations.

Authorities' Views

32. The authorities consider that banks are effectively positioned to support the credit needs of the economy as it recovers from the pandemic. Steps toward strengthening the monetary policy transmission framework in line with the White Paper will help to make lending rates more responsive to monetary policy adjustments and promote development of the interbank market. The authorities plan to continue to strengthen the banking sector to maximize on the opportunities presented by emerging technologies and innovations while minimizing the associated risks. The authorities anticipate that the integration of climate-related risk management in banks will enable them to seize the opportunities from the transition to a low carbon-climate resilient economy while managing the related risks.

Box 4. CBK Regulatory Guidance to Banks on Climate Change

Just ahead of the 2021 UN Climate Change Conference (COP26), the CBK took the positive step of issuing guidance to banks concerning climate-related risk management. Only banking supervisors for the UK (2019), Brazil (2020), Netherlands (2020), Denmark (2020), ECB (2020), Singapore (2020) and a few others have done this previously. No other African country has issued such guidance.

Africa is one of the most-exposed regions to the adverse effects of climate change despite contributing the least to global greenhouse emissions. Kenya, in particular, faces significant risk from extreme climatic events, which include floods, droughts, forest fires and landslides. Major droughts have been taking place every 10 years on average, and moderate droughts or floods every three to four years. Historically, these extreme climatic events have caused significant loss of life and led to malnutrition for some communities. Recent examples include severe flooding in 2018, and the recent drought in northern Kenya during 2021.

Kenya has been taking strides in passing climate change-related legislation. The Paris Agreement entered into force for Kenya in January 2017, and now forms part of the laws of the Constitution of Kenya (Article 2(6)). The Climate Change Act, 2016 is the main legislation guiding Kenya's climate change response. The CBK's regulatory guidance for banks is a milestone in scaling up Kenya's climate work and leadership.

Box 4. CBK Regulatory Guidance to Banks on Climate Change (concluded)

Financial sector risks from climate change are manifold. In Kenya, these cover: (i) physical risk; (ii) transition risk; and (iii) legal liability risk. Physical risk relates to losses on banks' loans from borrowers exposed to extreme climatic events or shocks to banks' funding from depositors that may suddenly need cash. Transition risk relates to costs for firms arising from higher taxation of carbon emissions, which would tend to weaken their debt servicing ability on bank loans. Legal liability risk relates to damages extracted from financial institutions held liable for climate-related losses.

The regulatory guidance is aimed at banks' supervisory boards and senior management with a view to integrating climate-related risks in business decisions and activities. It requires banks to consider financial risks from climate change in: (i) governance arrangements; (ii) risk management practices; and (iii) disclosure. It is benchmarked to recommendations of the FSB, the Basel Committee on Banking Supervision, the Network for Greening the Financial System, and other central banks that have already implemented such guidance. It holds banks' supervisory boards and senior management responsible for assessment of climate-related risks, including possible quantification and monitoring of such risks; oversight of mitigation and control; and allocation of appropriate resources. The regulation is not prescriptive and does not provide specific risk weights on banks' climate-related lending exposures or apply higher run-off rates on funding exposed climate events. Banks are expected to submit their implementation plans for assessment, monitoring, mitigation, and resource allocations related to climate risks to the CBK by mid-2022 and to complete disclosure of related reporting by mid-2023.

D. Promoting Sustainable and Inclusive Growth and Improving Governance

33. Kenya's economic agenda needs to promote more and higher quality jobs. Steady poverty reduction over the previous decade accompanied the large share of workers transitioning from agriculture to higher income jobs, but this slowed after 2016.[17] While some segments of services (finance, IT, and skill intensive social services, such as education and health) continue to generate high-skilled jobs, they only account for one-tenth of total employment and remain restricted to urban areas. Promoting spatial and gender equality[18] and reducing youth unemployment would support shared prosperity and fully reap Kenya's demographic dividend. Digitalization has promoted access to finance (financial inclusion rose to 83 percent by 2019 from 27 percent in 2016 on widespread adoption of mobile financial services) and served Kenya well in the pandemic response (Annex V).

Authorities' Views

34. The authorities shared the view that higher quality jobs are necessary to fully utilize Kenya's demographic dividend and reduce youth unemployment. They noted that building on Kenya's services sector dynamism, particularly in the finance and IT sectors, is key to unlock the country's economic potential. To facilitate financial sector development, the 2019 Banking Sector

[17] The World Bank's Kenya Economic Update 2021 June.

[18] See Selected Issues Paper: Towards More Equality in Kenya.

Charter incorporates the adoption of more customer centered business models by banks. They viewed that Kenya's comparative advantage in digitalization can further benefit MSMEs including by enhancing their access to credit, know-how (Finance Plus) and micro-insurance. They considered that promoting exports of financial, IT and professional services and green energy technologies could strengthen Kenya's role as a services hub in the region.

35. Promoting good governance is an essential part of the EFF/ECF-supported program to address known shortcomings and support a dynamic and inclusive recovery. Business interactions with public officials and interlinkages between politics and business may undermine competition and reduce overall economic efficiency. The authorities' priorities include combatting corruption through more transparent procurement practices, forensic audits and follow-up on their findings, implementing laws establishing access to information and asset declarations of public officials, improving revenue administration and tax expenditure transparency, and strengthening AML/CFT supervision in the financial sector.

- Forensic and regulatory audits remain a key tool in Kenya's efforts to promote transparency and surface governance issues requiring appropriate follow-up. By end-May 2022, the authorities will publish results of a forensic audit of COVID-19 vaccine spending up to June 2021 and a comprehensive audit of public expenditures in FY2020/21 with a chapter on COVID-19-related spending (**proposed new SB, end-May 2022**). The Office of the Auditor-General has so far completed three special audits of COVID-19 spending which confirmed important problems in procurement of healthcare equipment and issues with procedural and transactional controls at different levels of government. However, as of early November, none of these audits have been adopted by Parliament, creating a bottleneck for follow-up.[19]
- The authorities are taking steps to address conflicting privacy and legal requirements that prevented publication of BO information of successful bidders on the public procurement website. A wide range of information on tender awards is now published in the newly revamped public procurement portal.[20] However, BO information has not yet been published (**SB for end-June, not met**) due to data privacy requirements. To ensure a robust legal approach, the authorities now plan to amend and adopt revised standard bidding documents to obtain bidders' consent for publication by end-March 2022 (**proposed new SB for end-March 2022**). This should enable BO publication of newly-awarded tenders in the public procurement portal beginning in early 2022.
- Regulations of the Access to Information Act are expected to be finalized and published by December 2021 after some delay, following public consultations that began in June. To strengthen implementation of the preventative anti-corruption framework, active efforts

[19] Kenya has published three special audits on COVID-19-related spending: a specialized forensic audit of the use of COVID-19 funds by national government entities (https://www.oagkenya.go.ke/wp-content-uploads-2021-09-Utilization-of-Covid-19-Funds-National-Government-2021.pdf), an audit on the use of COVID-19 funds by county governments and an audit on healthcare procurement at the Kenya Medical Supplies Authority (KEMSA) (https://www.oagkenya.go.ke/wp-content/uploads/2021/09/Utilization-of-Covid-19-Funds-by-Kensa-2020-pdf).

[20] The public procurement portal (https://www.tenders.go.ke) provides extensive information on tenders and awarded contracts covering all areas of government spending (including COVID-related). For FY2020/21, the portal provides information on some 24 thousand tenders and 6 thousand contracts.

have continued to improve the Conflict-of-Interest Bill and provisions on public officials' asset disclosures (MEFP¶61), with an inter-agency group now finalizing the Bill to resolve outstanding issues with the aim of expediting submission to Parliament.

36. Bolstering the use of financial intelligence and implementation of AML/CFT supervision would help enhance financial integrity and support anti-corruption efforts. The National Risk Assessment report and AML/CFT Action Plan are expected to be published by end-2021 upon approval by Cabinet, with the validation review process recently completed. The Financial Reporting Centre has continued efforts to elevate risk awareness and build capacity to identify and report potential corruption-related activities through training and ongoing engagement. The authorities intend to take steps to further strengthen AML/CFT supervision to ensure its effective implementation in line with Kenya's ongoing 2nd round Mutual Evaluation (ME) by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). Strengthening AML/CFT risk-based supervision would ensure effective implementation of preventive measures by banks to mitigate risk of proceeds of corruption being laundered in the banking system. The on-site mutual evaluation visit is expected in January 2022.

Authorities' Views

37. The authorities agreed on the importance of the governance agenda and highlighted that additional time required to complete ongoing work was in several cases needed to resolve legal complications, inconsistencies and loopholes, which had been identified via inter-agency work. The busy pre-electoral Parliamentary calendar was considered a risk for follow-up on previous audits.

PROGRAM FINANCING AND MODALITIES

38. The program is fully financed—financing assurances are in place, with firm commitments for the twelve months following the 2nd reviews of the EFF and ECF arrangements and good prospects thereafter. Kenya's external financing needs would be covered by a mix of official external budget financing by the World Bank via DPO and Program-for-Results financing instruments, as well as the African Development Bank, and Japan International Cooperation Agency; planned FY21/22 Eurobond issuance (advanced to late-2021); along with access to Fund resources upon successful completion of reviews under the EFF/ECF arrangements. Purchases under the EFF and ECF will be on-lent to the government in local currency and used for budget support.

External Financing Needs and Funding Sources, 2021–24
(In million of U.S. dollars)

	2021	2022 1/	2023	2024
	Proj		Proj	
Financing Needs (after net Eurobond issuance)	**2,601**	**1,453**	**1,212**	**839**
Official Financing	**2,601**	**1,453**	**1,212**	**839**
IMF	984	510	662	239
Other external budget support	1,103	943	550	600
DSSI	514	0	0	0
Memorandum Item				
Eurobond issuance (net)	2,191	0	0	0

Source: IMF staff projections.
1/ 12-month period from 2nd ECF/EFF reviews.

39. The program continues to face significant risks. Program implementation could be weakened in case of uncontrolled COVID-19 outbreaks while the pandemic is still a global threat;

political tensions around the general elections or erosion of consensus behind the need for action to reduce Kenya's debt-related risks; and the materialization of important contingent liabilities from the SOE sector. Challenges of data consistency could delay policy decisions.[21] These risks are mitigated by the authorities' commitment to adopting contingency measures as needed to achieve program objectives, close engagement with donors, and a tailored CD strategy supporting the implementation of key reforms.

40. Kenya's capacity to repay the Fund is adequate, albeit subject to risks (Table 7). The total amount of outstanding credit to the Fund would reach SDR 1,301.4 million, or 239.8 percent of quota, at end-2021. This would peak at SDR 2,198.4 million, or 405 percent of quota in 2024, equivalent to around 2.4 percent of GDP, 18.9 percent of exports of goods and services and 29.4 percent of gross international reserves. IMF repurchases and charges peak at 2.3 percent of exports of goods and services and 4.1 percent of reserves in 2028. The materialization of downside risks, such as uncontrolled outbreaks of COVID-19, pullback of international investors from frontier markets or socio-political tensions and delays in reform implementation due to the upcoming elections, could place stress on Kenya's capacity to repay the Fund. However, given the likelihood of continued access to concessional financing in such a scenario and in light of Kenya's strong track record of servicing debts to the Fund and other creditors, Kenya's ability to repay the Fund would remain adequate.

41. The authorities have requested adjustments to the program's quantitative and structural conditionality:

- Staff proposes performance criteria for end-December 2021, end-June 2022, and end-December 2022 (MEFP Table 1) and changes in the definition of some of them. Notably,
  - increasing the end-June 2022 performance criterion on the primary balance to reflect increased spending related to COVID-19 vaccines, extraordinary financial support for SOEs net of spending offsets, and emergency spending for drought and security.
  - increasing the end-December 2021 and end-June 2022 NIR targets to reflect revisions to main FX flow components, including the SDR allocation and adopting a more standard approach to the NIR calculation for program monitoring (end-of-period) as the current method of monthly average complicates monitoring;[22]
  - a proposed ceiling on the present value of newly contracted or guaranteed external public debt to replace the previous separate nominal ceilings on new external concessional and non-concessional borrowing, as per the recent reforms of the IMF Debt Limits Policy.[23] The nominal equivalent of the proposed end-June 2022 debt ceiling is slightly higher than the combined 1st review targets for the ceilings it replaces, reflecting

[21] Reconciliation of data across institutions requires significant effort.

[22] Monitoring the NIR at end-of-period has been the common practice of all other SSA programs since 2015.

[23] Similar to the debt ceilings it replaces, the proposed new debt limit will accommodate potential borrowing for debt management operations resulting in a reduction of the present value of the overall public external debt and an improvement of the overall public external debt service profile. Accordingly, under-execution of debt management operations compared to plans would be reflected in reduced debt limit ceilings (see TMU¶23).

the impact of the assumption of some additional debts of Kenya Airways as part of its restructuring.

- The program will continue to accommodate, through PC adjustors, all COVID-19 vaccine-related expenditures; SOE extraordinary support up to a cumulative limit of 1.0 percent of GDP in such support in FY21/22 and FY22/23 (adjustor on the primary balance limited to half this amount); and main components of FX inflows (TMU ¶7 and ¶9). The SOE adjustor is modified to become symmetric, ensuring that if execution of SOE extraordinary support faces delays, the primary balance target is correspondingly tightened (TMU ¶7).
- New end-January 2022 and end-April 2022 SBs on the submission of a FY21/22 supplementary budget and the FY22/23 fiscal budget are proposed to support strong program implementation.
- A new end-March 2022 SB on the adoption of a new standard bidding document and publication of BO information for new tenders awarded by early next year is proposed as a reformulation of the pending SB, and a new SB is proposed on publication of audits of relating to COVID-19 spending to enhance transparency.
- The attached Letter of Intent and MEFP describe the authorities' progress in implementing their economic program and set out their commitments (MEFP Table 1 and 2).

42. Data provision and capacity development issues (Annex IV). Data provision is adequate for surveillance and program review. However, further bolstering institutional capacity would help enhance policy design as well as accuracy and timeliness of data provision. Staff encouraged the authorities to implement Fund technical assistance advice and strengthen cooperation between Kenya's statistics-producing agencies, particularly on fiscal and external sector statistics.

STAFF APPRAISAL

43. After showing impressive resilience during the pandemic, Kenya's economy is rebounding. The authorities' prompt policy response limited economic fallout from the COVID-19 shock and prepared the ground for recovery. With increased vaccine availability, the COVID-19 vaccination program is progressing. Kenya's medium-term outlook is positive, but challenges remain in securing an inclusive recovery as the pandemic reversed some previous gains in poverty reduction.

44. Program performance was robust in a challenging environment. All end-June PCs and ITs were met. Fiscal performance was strong, with the primary deficit target met by a wide margin, and social spending modestly overperformed. The authorities accelerated their structural reform agenda after some delays, and all but one 2021 structural benchmarks (SBs) are now implemented.

45. The authorities have shown strong commitment to their economic consolidation plan. The tax policy measures implemented last fiscal year and this are contributing to solid recovery of tax revenue, providing essential resources to sustain critical programs and reduce borrowing needs.

Building broad-based understanding of the key role that restoring lost ground on tax revenue plays in Kenya's strategy to reduce debt vulnerabilities remains important. The authorities' ongoing work on a medium-term revenue strategy should support identifying well-sequenced measures to deliver the anticipated 0.8–0.9 percent of GDP in tax revenue annually in FY22/23 and FY23/24. The CMT remains an important part of the authorities' plans, notwithstanding legal challenges it has faced, and the authorities have committed to compensatory measures should their appeal to reinstate the CMT be rejected.

46. With visibility on the quantum of COVID-19 vaccine spending and extraordinary support for SOEs, the FY21/22 primary deficit target has been recalibrated along lines anticipated under the program. The proposed FY21/22 primary deficit target reflects these amounts in the baseline, taking account of cuts in other areas to offset half of anticipated SOE support. Staff also supports targeted and temporary measures to respond to the drought in the northern part of the country and security challenges. The FY21/22 primary deficit would thus be 3.4 percent of GDP, compared to the 2.9 percent target at the time of the 1st reviews. Given past overperformance, this does not materially alter the debt trajectory under the Fund-supported program.

47. The authorities are showing strong resolve in advancing their SOE agenda and ensuring that support for troubled SOEs does not undermine debt sustainability. They have proactively followed up on earlier work highlighting fiscal risks from SOEs and are taking initiative to reform troubled firms. Providing financial support to SOEs will require difficult tradeoffs given Kenya's limited fiscal space, and the authorities are taking care to protect essential social programs. Given their weight, least-cost strategies to address financial vulnerabilities in KQ and KPLC will be crucial, with the latter informed by the work of the recent Presidential Taskforce. On KQ, minimizing the cost to the Exchequer will require strong safeguards to ensure fundamental restructuring of operations in line with the challenging realities of the post-pandemic global aviation sector, while appropriate mechanisms will be needed to protect Exchequer financial interests during the restructuring process.

48. Further strengthening fiscal transparency and governance remains a priority and requires more proactive efforts. The revamped public procurement website is a valuable source of information. Decisive action on the plan to address conflicting privacy and legal requirements that prevented publication of BO information of successful bidders is critical, and publication on the public procurement website should commence by early 2022. Planned audits of the COVID-19 vaccination program and COVID-19-related spending will support fiscal transparency, while prompt action by the appropriate bodies is needed on earlier audits to bolster confidence, including to follow up on irregularities identified.

49. Kenya's public debt is sustainable, and Kenya remains at high risk of debt distress. The authorities have demonstrated their strong commitment to reducing debt-related vulnerabilities through their actions to limit the pandemic-induced increase in the deficit and broaden Kenya's tax base. Reducing debt vulnerabilities requires continued strong adherence to the multi-year fiscal consolidation effort supported by the IMF EFF/ECF arrangements, while safeguarding resources to protect vulnerable groups. Proposed debt limits under the arrangements support Kenya's borrowing plans, consistent with these goals.

50. Kenya's external position is broadly in line with fundamentals and desirable policies. FX reserves are anticipated to decline from the inter-year peak in 2021 through end-2022 as the current account normalizes from the COVID-19 shock and external repayments increase. Kenya's SDR allocation, half of which is expected to be saved, provides a buffer against potential shocks. Going forward, steadfastly implementing planned fiscal consolidation should also keep the external position in balance as policies begin to normalize globally. Addressing challenges of non-price competitiveness that have held back Kenyan exports should also be a priority.

51. Monetary policy remains appropriately accommodative. Core inflation remains moderate. The CBK remains vigilant against second-round effects from recent increases in headline inflation and should maintain its stance as long as inflation and inflation expectations remain well-anchored within the target band. The CBK appropriately allowed the Shilling to act as shock absorber during the pandemic and should continue to do so, while using FX interventions only to minimize excessive volatility. The CBK has set out an important agenda to enhance the effectiveness of its operations and monetary policy implementation and is encouraged to continue advancing this work.

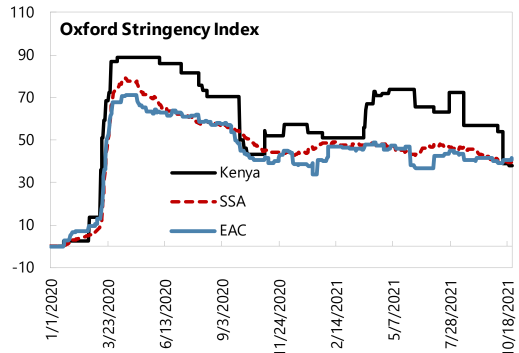
52. The banking sector overall has been resilient during the pandemic, supported by well calibrated policies. Kenya's banking sector appears well positioned to meet public and private financing needs, while private sector credit growth remains moderate. Swift approvals for credit models would help avoid the perception of unnecessary constraints on lending to creditworthy borrowers. The planned Central Securities Depository (CSD) will help facilitate liquidity conditions for small banks by enabling efficient provision of financing on the interbank market.

53. Global and domestic risks are increasing. The multi-speed global recovery and tightening global financing conditions carry the potential to unsettle market financing prospects for frontier borrowers like Kenya. Continued strong policy implementation will be important for smooth access to concessional external financing sources, including under the EFF/ECF arrangements. Given the electoral calendar, bold political commitment by all levels of government will be necessary to ensure that the FY22/23 budget is in line with program objectives.

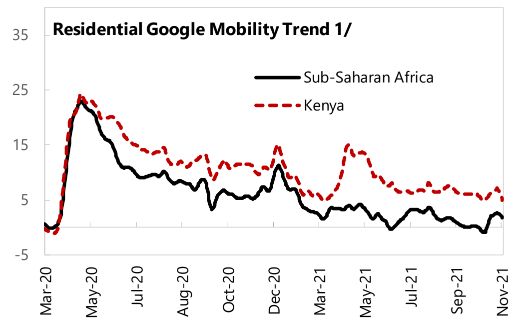
54. Staff supports the authorities' requests for completion of the second reviews and modification of PCs, IT, and SBs under the ECF/EFF arrangements, given the overall robust performance under the arrangements and the authorities' commitment to meeting program objectives. Staff recommends that the next Article IV consultation be held within 24 months in accordance with the Executive Board decision on consultation cycles for members with Fund arrangements.

Figure 1. Kenya: Real Sector Developments

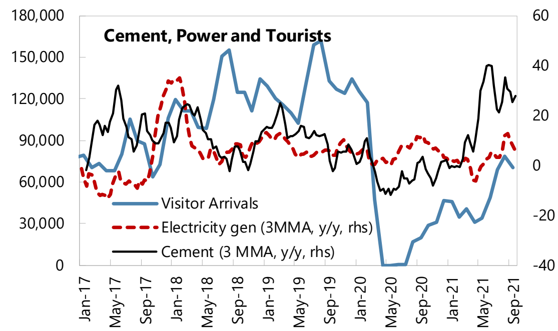
As the fourth COVID-19 wave abated, stringency of containment measures returned to early 2021 levels…



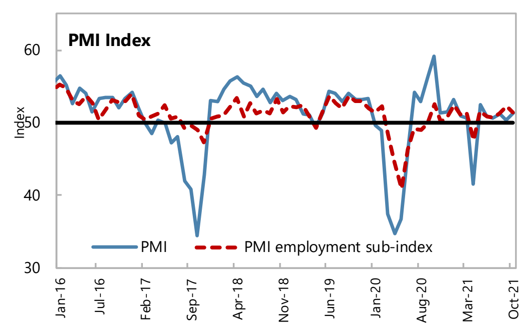
… and residential mobility recovered.



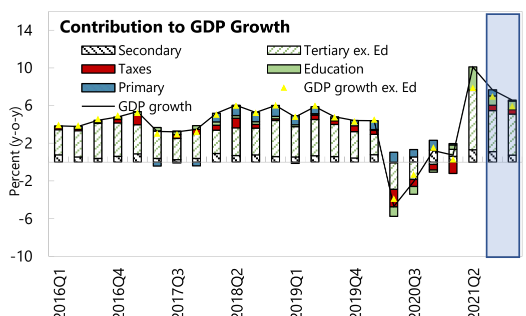
The recovery has continued in the first half of the year…



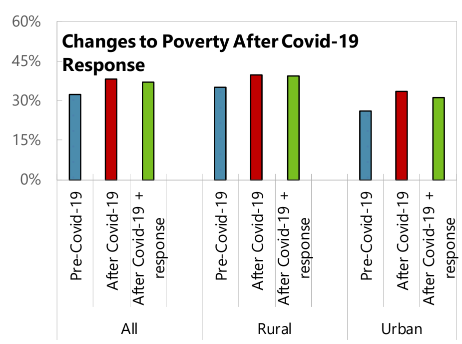
… and PMI indicates a continuing pickup in activity.



In 2021 GDP growth will be driven by strong base effects, and a turnaround in services sector growth.



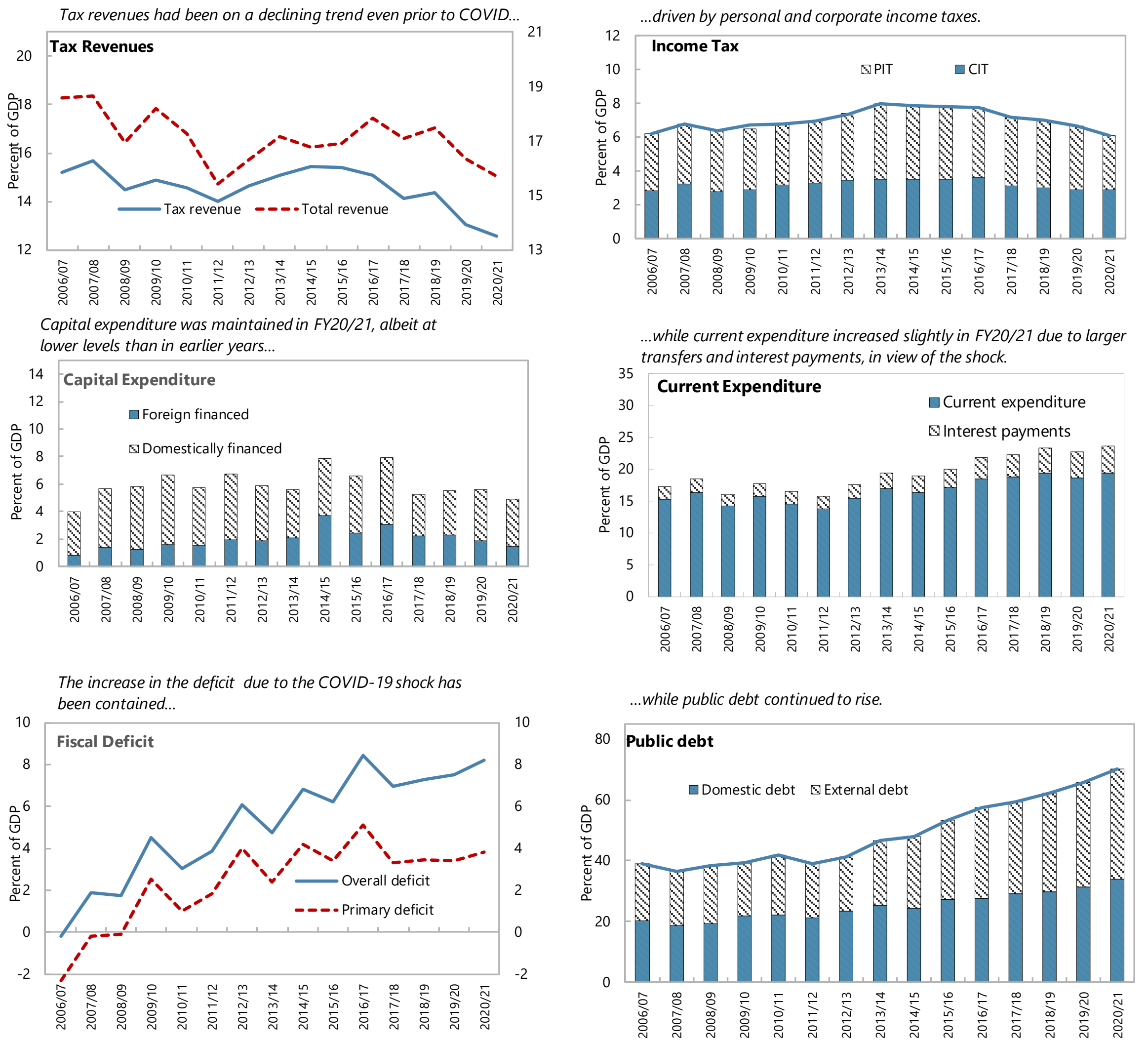
The policy responses only marginally offset the increase in poverty caused by COVID-19.



Sources: Kenyan authorities, Oxford COVID-19 Government Response Tracker, Markit Economics, World Bank and IMF staffs' Calculations and projections.

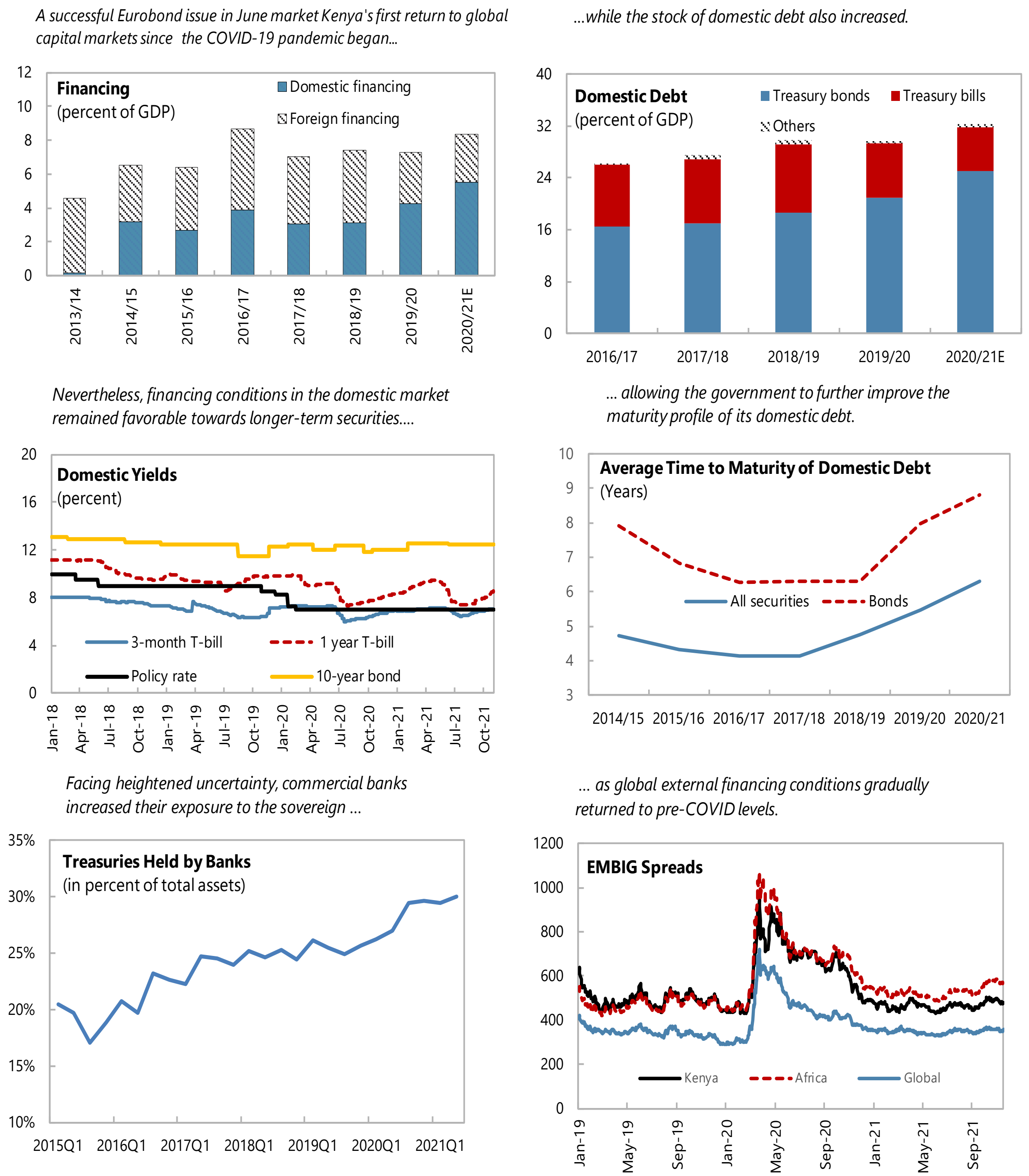
1/ The series captures mobility trends for places of residence. 7-day moving averages.

Figure 2. Kenya: Fiscal Sector Developments



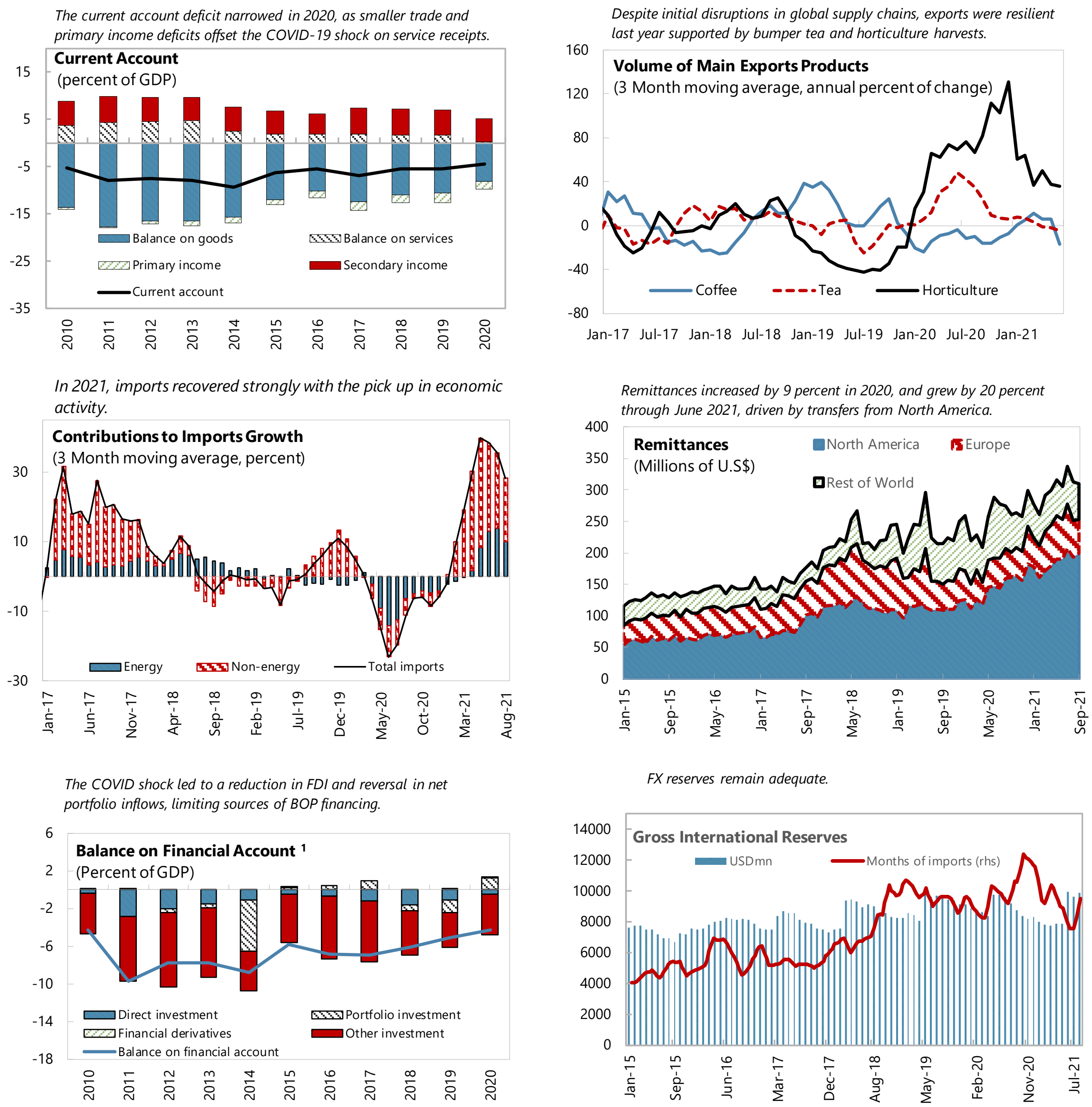
Sources: Kenyan authorities and IMF staff calculations and projections.

Figure 3. Kenya: Financing



Sources: Kenyan authorities, Bloomberg and IMF staff calculations and projections.

Figure 4. Kenya: External Sector Developments

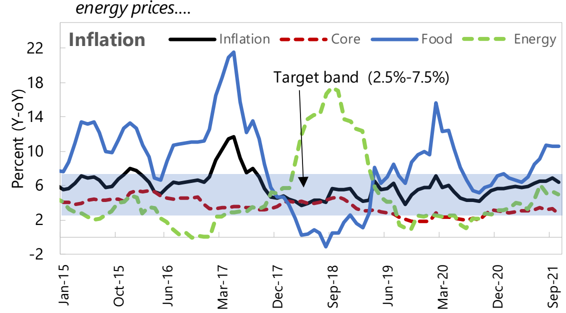


Sources: Kenyan authorities and IMF staff estimates.

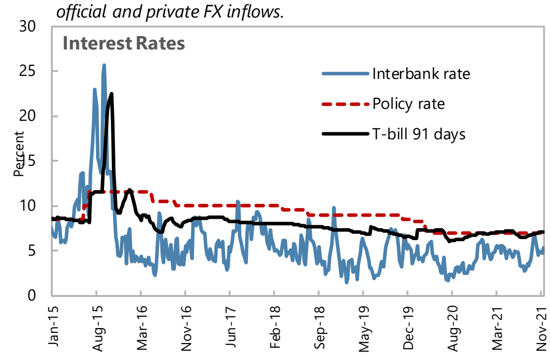
¹ Negative values represent net inflows associated with an increase in net external liabilities.

Figure 5. Kenya: Monetary and Exchange Rate Developments

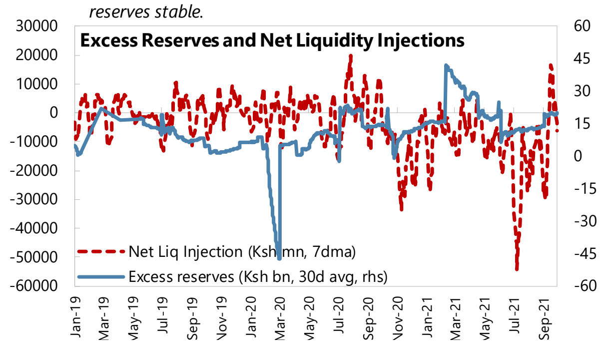
Headline inflation picked-up on the back of surging food and energy prices….



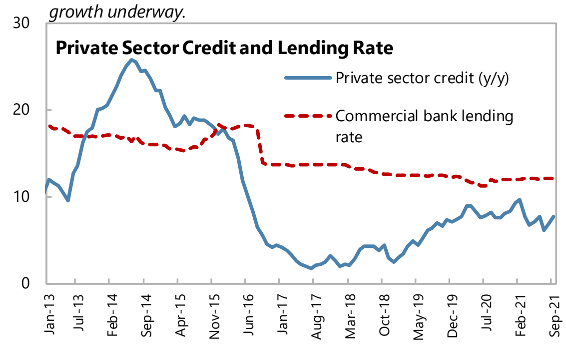
Domestic markets have remained liquid amidst large official and private FX inflows.



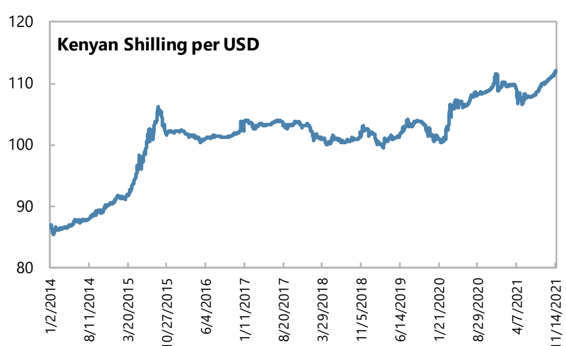
The CBK withdrew liquidity from the market and kept excess reserves stable.



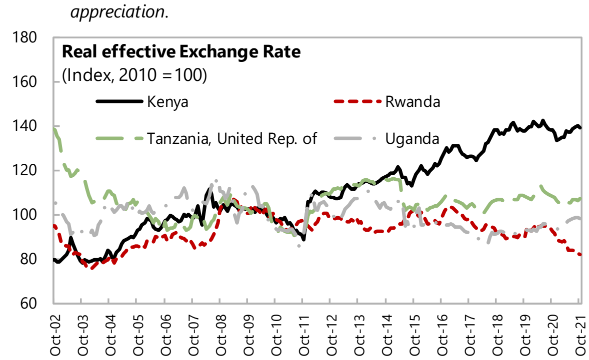
The COVID-19 shock halted the acceleration in private credit growth underway.



During the pandemic, the exchange rate acted as shock absorber,…



…reversing the previous trend of the real effective exchange rate appreciation.



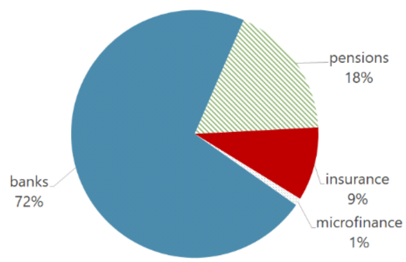
Sources: Kenyan authorities and IMF staff calculations.

Figure 6. Kenya: Financial Sector Structure

(2021 Q2 or latest available)

Financial Sector Structure

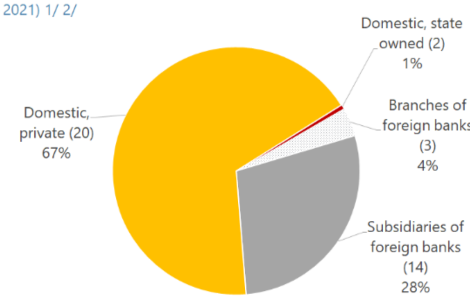
(December 2020) 1/



Source: Central Bank of Kenya
1/ Total assets of 7.9 trillion KSH (71 billion USD, 64 percent of GDP)

Banking System Structure

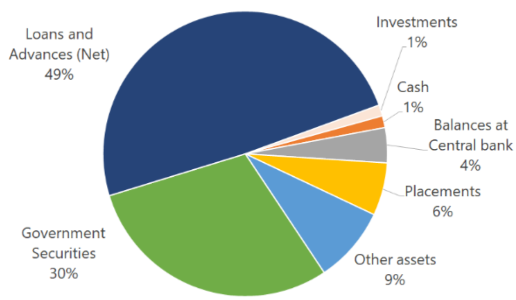
(June 2021) 1/ 2/



Source: Central Bank of Kenya
1/ Total assets of 5.7 trillion KSH (51 billion USD, 46 percent of GDP)
2/ Number of banks in brackets; percentages are for assets

Banks' Assets

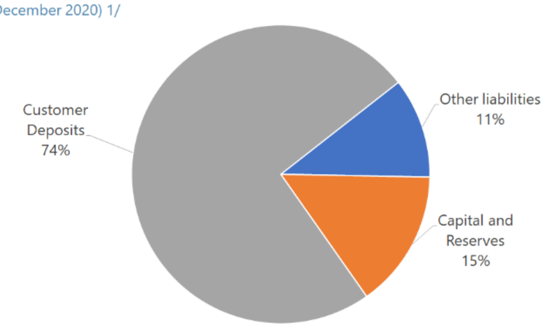
(December 2020) 1/



Source: Central Bank of Kenya
1/ Total assets of 5.4 trillion KSH

Banks' Liabilities

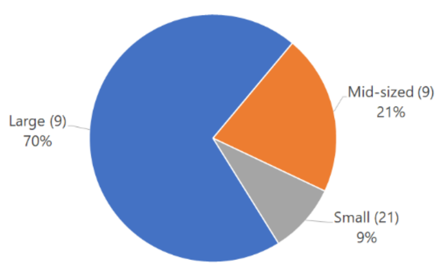
(December 2020) 1/



Source: Central Bank of Kenya
1/ Total liabilities of 5.4 trillion KSH

Banking System Assets by Tier Groups

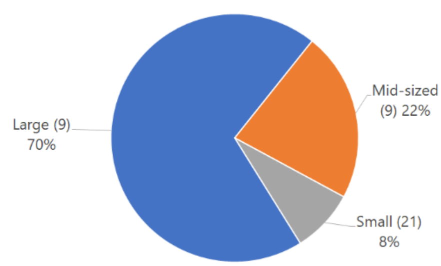
(June 2021) 1/ 2/



Source: Central Bank of Kenya
1/ Total assets of 5.7 trillion KSH (51 billion USD, 46 percent of GDP)
2/ Number of banks in brackets; percentages are for assets

Banking System Deposits by Tier Groups

(June 2021) 1/ 2/



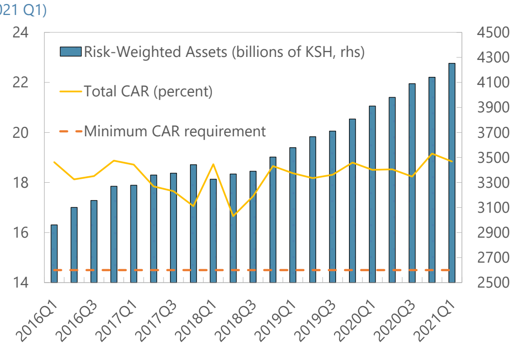
Source: Central Bank of Kenya
1/ Total deposits of 4.1 trillion KSH
2/ Number of banks in brackets; percentages are for assets

Figure 7. Kenya: Financial Sector Developments

(2021 Q2 or latest available)

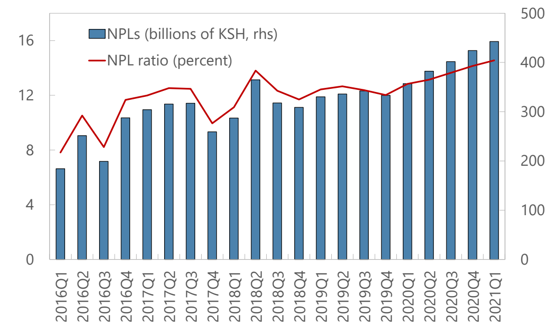
Capital Adequacy

(2021 Q1)



Source: Central Bank of Kenya

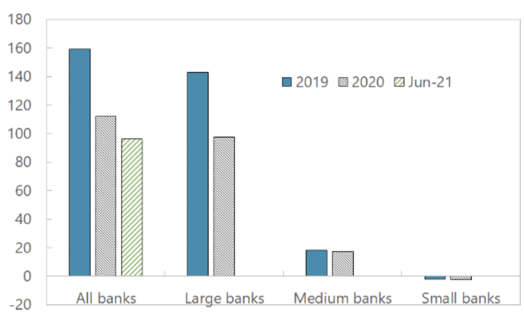
NPLs



Source: Central Bank of Kenya

Pre-tax profits

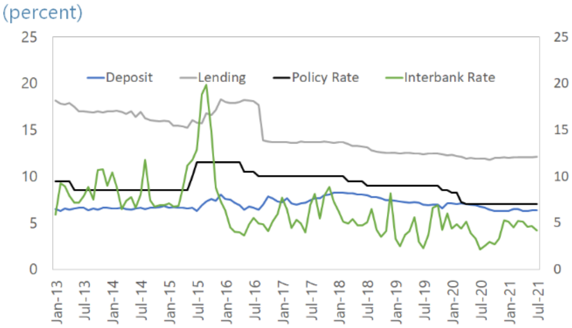
(billions of KSH)



Source: Central Bank of Kenya

Interest rates

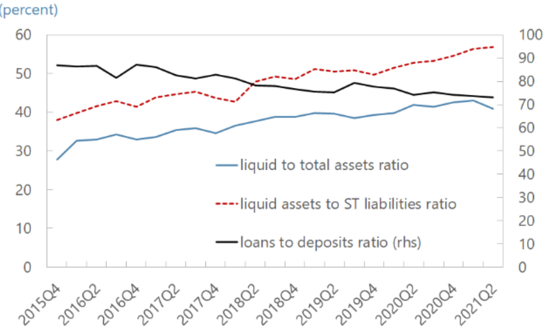
(percent)



Source: Central Bank of Kenya

Liquidity

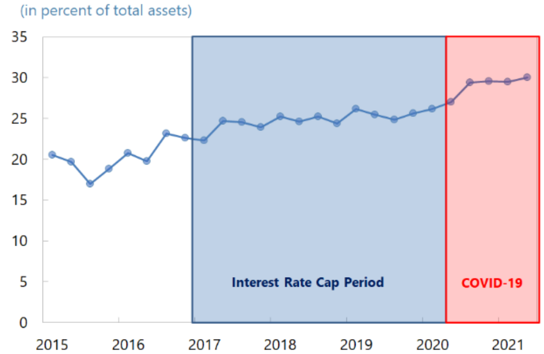
(percent)



Source: IMF FSI

Banks' holdings of government securities

(in percent of total assets)



Sources: Financial Disclosures of Kenyan Banks and IMF Staff Calculations

Table 1a. Kenya: Selected Economic Indicators, 2019/20–2025/26

(Fiscal year basis)[1]

	2019/20	2020/21		2021/22		2022/23		2023/24		2024/25		2025/26
	Est.	Proj.	First Review	Proj.	First Review	Proj.	First review	Proj.	First review	Proj.	First review	Proj.
	(Annual percentage change, unless otherwise indicated)											
Output, prices, and exchange rate												
Real GDP	2.3	2.8	3.1	5.8	6.3	5.6	6.3	5.5	6.1	5.5	6.1	5.5
GDP deflator	6.6	4.1	5.9	5.2	4.5	5.2	4.7	5.1	5.0	5.0	5.1	5.0
CPI (period average)	5.5	5.4	5.4	5.2	5.2	5.0	5.0	5.0	5.0	5.0	5.0	5.0
CPI (end of period)	4.6	5.7	5.7	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Core inflation (period average)[2]	2.4	2.3	2.4	3.4	3.9	4.8	5.2	5.0	5.0	5.0	5.0	5.0
Exchange rate (Kenyan shilling/US$)	103.6	.		.		.		.		.		
Real effective exchange rate (depreciation, -)	3.3	-4.1		.		.		.		.		
Money and credit												
Broad money (M3)	9.1	6.4		.		.		.		.		
Reserve money	-2.9	5.4		.		.		.		.		
Credit to non-government sector	7.6	7.7		.		.		.		.		
Policy rate	7.0	.		.		.		.		.		
M3/GDP (percent)	36.6	.		.		.		.		.		
NPLs (percent of total gross loans)	12.3	.		.		.		.		.		
	(Percent of GDP, unless otherwise indicated)[3]											
Central government budget												
Total revenue, grants and unidentified tax policy measures	16.5	16.0	17.1	16.8	17.0	17.3	17.7	18.2	18.6	18.2	18.5	19.1
Tax revenues (including unidentified tax measures)	13.0	12.6	12.8	13.2	13.5	14.4	14.7	15.3	15.6	15.4	15.6	16.2
Non-tax revenues	3.3	3.1	3.9	3.1	3.2	2.5	2.6	2.6	2.7	2.5	2.5	2.6
Grants	0.2	0.3	0.4	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	24.2	24.2	25.7	24.9	24.6	23.0	23.5	22.5	22.9	21.9	22.2	21.8
Current	18.6	19.3	19.9	19.4	19.6	17.9	18.5	17.4	17.9	16.9	17.3	16.6
Capital	5.6	4.9	5.9	5.5	5.0	5.2	5.0	5.1	5.0	5.0	4.9	5.2
Primary balance	-3.4	-4.0	-4.6	-3.4	-3.0	-1.2	-1.1	0.2	0.2	0.5	0.5	1.3
Excluding SGR related spending	-3.0	-3.9	-4.5	-3.4	-3.0	-1.2	-1.1	0.2	0.2	0.5	0.5	1.3
Cash Adjustment	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-7.5	-8.2	-8.6	-8.2	-7.5	-5.8	-5.8	-4.2	-4.4	-3.7	-3.7	-2.7
Excluding SGR-related spending	-7.1	-8.1	-8.5	-8.2	-7.5	-5.8	-5.8	-4.2	-4.4	-3.7	-3.7	-2.7
Excluding grants	-7.7	-8.5	-9.0	-8.7	-7.9	-6.1	-6.2	-4.6	-4.7	-3.9	-4.0	-3.0
Net domestic borrowing	0.4	-0.6	4.9	-0.7	5.2	-0.5	4.4	-0.3	2.8	-0.4	2.4	-0.2
Public debt												
Public gross nominal debt	63.0	67.9	70.6	71.2	73.0	71.2	73.1	69.6	71.5	67.5	69.4	62.8
Public net nominal debt	58.3	62.9	66.3	66.7	68.6	67.1	68.7	65.9	67.2	64.1	65.0	61.6
Public gross debt, PV	30.1	61.0	63.3	61.9	64.3	61.7	64.2	60.2	63.5	57.8	62.4	54.8
Public net debt, PV	25.4	56.0	59.0	57.4	59.9	57.6	59.8	56.5	59.2	54.4	58.0	53.5
Gross domestic debt	29.9	32.5	33.8	34.3	36.1	34.3	37.3	33.3	36.7	32.8	35.8	30.8
Gross external debt	33.1	35.3	36.8	36.8	36.8	36.9	35.8	36.4	34.8	34.7	33.6	32.0
Investment and saving												
Investment	15.9	12.4	13.4	14.0	13.5	14.7	14.5	16.1	16.0	17.5	17.4	16.7
General government	5.7	4.9	5.9	5.5	5.0	5.2	5.0	5.1	5.0	5.0	4.9	5.2
Nongovernment	10.3	7.5	7.5	8.5	8.5	9.5	9.5	11.0	11.0	12.5	12.5	11.5
Saving	10.9	7.1	8.7	9.3	8.1	9.6	9.0	11.0	10.4	12.4	11.7	11.7
General government	-2.2	-3.5	-3.1	-3.1	-2.9	-0.2	-0.3	2.1	2.0	2.6	2.5	5.9
Nongovernment	13.1	10.7	11.9	12.4	11.0	9.7	9.4	8.9	8.5	9.8	9.2	5.8
External sector												
Exports (goods and services)	10.6	9.7	10.6	10.8	11.4	11.6	12.0	12.2	12.6	12.7	13.0	13.0
Imports (goods and services)	-19.0	-18.7	-19.1	-19.6	-20.8	-20.3	-21.7	-20.8	-22.4	-21.2	-23.0	-21.5
Current account balance (including grants)	-5.0	-5.3	-4.6	-4.8	-5.4	-5.1	-5.5	-5.1	-5.6	-5.0	-5.7	-5.0
Gross international reserves												
In billions of US$	9.7	9.7	10.2	10.3	9.6	13.6	9.9	14.5	10.6	14.6	12.0	15.6
In months of next year imports	5.2	4.7	5.4	4.8	4.6	4.2	4.3	4.2	4.1	4.2	4.2	4.2
Memorandum items:												
GDP at current market prices (Ksh billion)	10,621	11,364	11,109	12,652	12,342	14,059	13,732	15,589	15,306	17,275	17,067	19,148
GDP per capita (nominal US$)	2,094	2,139	2,073	2,243	2,154	2,336	2,254	2,442	2,370	2,562	2,499	2,693

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Fiscal years are from July 1 to June 30.

[2] Excluding food and fuel.

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

Table 1b. Kenya: Selected Economic Indicators, 2020–26

(Calendar year basis)

	2020	2021		2022		2023		2024		2025		2026
	Est.	Proj.	First Review	Proj.	First Review	Proj.	First Review	Proj.	First Review	Proj.	First Review	Proj.
					(Annual percentage change, unless otherwise indicated)							
Output, prices, and exchange rate												
Real GDP	-0.3	5.9	6.3	5.8	6.4	5.5	6.1	5.5	6.1	5.5	6.1	5.5
GDP deflator	5.2	5.2	4.6	5.2	4.4	5.2	5.0	5.0	5.1	5.0	5.1	5.0
CPI (period average)	5.2	6.4	5.5	5.8	5.0	4.8	5.0	5.0	5.0	5.0	5.0	5.0
CPI (end of period)	5.8	7.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Core inflation (period average) [1]	2.3	2.3	2.4	4.5	5.4	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Exchange rate (Kenyan shilling/US$)	106.2	.	.	.	.	.	.	.	.	.	.	
Real effective exchange rate (depreciation, -)	0.0	.	.	.	.	.	.	.	.	.	.	
Money and credit												
Broad money (M3)	13.2	11.1	8.5	11.3	11.1	11.0	11.4	10.3	11.0	10.8	11.5	11.5
Reserve money	1.9	10.8	8.3	11.0	10.8	10.7	11.2	10.0	10.8	10.6	11.3	10.0
Credit to non-government sector	8.4	8.0	9.4	7.9	9.6	9.8	9.6	10.8	10.6	12.1	13.9	12.6
Policy rate	7.0	.	.	.	.	.	.	.	.	.	.	
M3/GDP (percent)	37.1	37.0	37.0	37.0	37.0	37.0	37.0	36.9	36.9	36.9	36.9	37.1
NPLs (percent of total gross loans)	13.2											
						(Percent of GDP, unless otherwise indicated)[2]						
Central government budget												
Total revenue, grants and unidentified tax policy measures	16.6	16.4	17.1	17.1	17.4	17.8	18.2	18.3	18.6	18.7	18.9	19.1
Tax revenues	13.1	12.9	13.2	13.8	14.2	14.9	15.2	15.4	15.7	15.9	16.1	16.3
Non-tax revenues	3.3	3.1	3.5	2.8	2.9	2.6	2.6	2.6	2.6	2.5	2.5	2.6
Grants	0.2	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	24.7	24.6	25.2	24.0	24.1	22.8	23.3	22.2	22.6	21.9	22.1	21.7
Current	19.4	19.4	19.8	18.6	19.0	17.7	18.2	17.2	17.6	16.8	17.2	16.5
Capital	5.3	5.2	5.4	5.4	5.0	5.1	5.1	5.0	5.0	5.1	4.9	5.2
Primary balance	-3.8	-3.6	-3.8	-2.3	-2.0	-0.5	-0.4	0.0	0.3	0.9	0.9	1.3
Excluding SGR-related spending	-3.5	-3.6	-3.7	-2.3	-2.0	-0.5	-0.4	0.0	0.3	0.9	0.9	1.3
Overall balance	-8.1	-8.2	-8.1	-6.9	-6.7	-5.0	-5.1	-4.0	-4.0	-3.2	-3.2	-2.6
Excluding SGR-related spending	-7.8	-8.2	-8.0	-6.9	-6.7	-5.0	-5.1	-4.0	-4.0	-3.2	-3.2	-2.6
Excluding grants	-8.3	-8.6	-8.5	-7.3	-7.0	-5.3	-5.4	-4.2	-4.3	-3.5	-3.5	-2.9
Net domestic borrowing	5.0	5.6	5.1	4.7	4.8	3.3	3.6	2.8	2.6	2.0	3.0	1.1
Public debt												
Public gross nominal debt	67.4	69.5	72.1	70.4	73.1	69.6	72.4	67.4	71.9	64.4	70.1	61.2
Public net nominal debt	62.0	65.1	69.3	67.0	70.9	66.6	69.9	65.1	67.9	62.8	66.7	60.3
Public gross debt, PV	60.3	61.7	63.9	62.2	64.6	61.2	63.8	59.2	63.3	56.3	61.5	53.2
Public net debt, PV	54.9	57.3	61.2	58.8	62.4	58.2	61.3	56.9	59.3	54.8	58.2	52.4
Gross domestic debt	32.4	32.8	33.5	34.4	34.8	33.8	35.2	32.9	35.9	30.4	34.9	27.4
Gross external debt	35.0	36.7	38.5	36.0	38.4	35.8	37.2	34.4	36.0	34.0	35.1	39.1
Investment and saving												
Investment	12.3	13.2	13.4	14.4	14.0	15.1	15.1	17.0	17.0	18.1	17.9	18.2
General government	5.3	5.2	5.4	5.4	5.0	5.1	5.1	5.0	5.0	5.1	4.9	5.2
Nongovernment	7.0	8.0	8.0	9.0	9.0	10.0	10.0	12.0	12.0	13.0	13.0	10.0
Saving	7.9	8.2	8.1	9.2	8.6	10.0	9.5	12.0	11.3	13.1	12.2	13.2
General government	-2.9	-3.3	-3.0	-1.6	-1.5	1.0	0.9	2.4	2.3	4.3	3.4	6.1
Nongovernment	10.8	11.5	11.1	10.8	10.1	9.0	8.6	9.6	9.1	8.7	8.8	7.1
External sector												
Exports (goods and services)	9.7	10.1	11.1	11.2	11.7	11.9	12.3	12.5	12.8	12.9	13.2	13.1
Imports (goods and services)	-17.7	-19.2	-20.3	-20.0	-21.3	-20.5	-22.1	-21.0	-22.8	-21.4	-23.3	-21.6
Current account balance (including grants)	-4.5	-5.1	-5.3	-5.1	-5.5	-5.1	-5.5	-5.0	-5.6	-5.0	-5.7	-5.0
Gross international reserves												
In billions of US$	8.3	10.8	9.6	9.0	9.7	9.8	10.2	10.7	11.1	11.6	12.9	12.5
In months of next year imports	4.7	5.6	4.8	4.2	4.4	4.2	4.2	4.2	4.1	4.2	4.4	4.2
Memorandum items:												
GDP at current market prices (Ksh billion)	10,753	11,975	11,694	13,328	12,990	14,790	14,474	16,388	16,138	18,163	17,995	20,133
GDP per capita (nominal US$)	2,079	2,199	2,110	2,287	2,199	2,385	2,309	2,498	2,431	2,626	2,567	2,759

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Excluding food and fuel.

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

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

(billions of Kenyan Shilling)

	2020/21		2021/22		2022/23		2023/24		2024/25	
	Rev.1	Est.	Rev.1	Proj.	Rev.1	Proj.	Rev.1	Proj.	Rev.1	Proj.
Revenues and grants	**1,904.5**	**1,815.1**	**2,103.9**	**2,119.5**	**2,426.6**	**2,426.6**	**2,844.5**	**2,844.6**	**3,149.2**	**3,149.2**
Revenue	**1,855.4**	**1,783.7**	**2,057.8**	**2,057.2**	**2,379.6**	**2,379.7**	**2,796.4**	**2,796.5**	**3,099.9**	**3,099.9**
Tax revenue (including unidentified tax measures)	1,420.5	1,429.5	1,667.3	1,667.3	2,024.0	2,024.0	2,387.6	2,387.6	2,667.8	2,667.8
Income tax	697.0	694.1	834.4	811.9	942.7	922.2	1,057.4	1,036.3	1,181.1	1,154.8
Personal income	361.0	363.3	435.9	426.3	489.0	489.0	546.2	546.3	607.2	604.3
Corporate income	336.0	330.7	398.5	385.6	453.7	433.2	511.2	489.9	573.9	550.4
Import duty (net)	102.4	108.4	119.0	118.8	136.9	142.4	152.9	159.0	168.2	174.9
Excise duty	217.9	216.3	241.0	259.6	280.9	280.9	311.2	311.2	349.7	352.3
Value-added tax	403.1	410.8	472.9	477.0	552.6	567.7	620.6	635.8	695.1	712.3
Domestic	197.6	197.1	249.0	227.7	275.4	275.4	314.4	314.5	347.9	349.1
Imports	205.5	213.7	223.9	249.4	277.2	292.3	306.2	321.2	347.2	363.2
Nontax revenue	434.9	354.2	390.5	389.8	355.6	355.7	408.8	408.9	432.1	432.1
Investment income	40.1	45.1	30.0	29.8	31.5	31.5	33.1	33.1	34.7	34.3
Other	115.7	87.4	78.2	78.2	86.0	86.0	95.6	95.7	105.0	105.3
Ministerial and Departmental Fees (AIA)	251.9	193.2	251.7	251.2	207.7	207.7	246.9	246.9	256.1	258.2
Railway Levy	27.2	28.5	30.6	30.6	30.4	30.4	33.2	33.2	36.3	34.4
Grants	**49.1**	**31.3**	**46.1**	**62.3**	**47.0**	**46.9**	**48.1**	**48.1**	**49.3**	**49.3**
Project grants	41.3	22.4	43.6	59.8	46.9	46.9	48.1	48.1	49.3	49.3
Program grants	7.8	8.9	2.5	2.5	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**2,860.0**	**2,749.5**	**3,033.7**	**3,153.2**	**3,227.0**	**3,240.2**	**3,510.6**	**3,506.9**	**3,780.6**	**3,781.6**
Recurrent expenditure	**2,210.0**	**2,195.6**	**2,413.6**	**2,452.5**	**2,535.5**	**2,512.0**	**2,739.9**	**2,713.3**	**2,946.2**	**2,926.4**
Transfer to counties	398.9	368.3	409.8	409.9	400.5	400.5	408.8	408.8	425.2	425.2
Interest payments	447.8	495.1	560.3	605.7	644.0	638.8	695.6	692.0	713.8	714.8
Domestic interest	340.0	388.8	421.9	479.2	482.4	477.9	508.0	503.7	518.7	519.1
Foreign interest due	107.8	106.3	138.4	126.5	161.5	160.9	187.6	188.3	195.1	195.6
Wages and benefits (civil service)	493.9	493.0	524.0	526.1	560.7	560.7	595.8	595.8	645.3	645.3
Civil service reform	7.3	3.3	20.8	27.8	22.9	22.9	23.8	23.8	24.8	23.7
Pensions and Other Consolidated Fund Services	115.3	112.9	137.2	135.7	152.9	152.9	167.9	167.9	192.6	192.6
Defense and NSIS	152.0	157.7	156.9	157.1	161.9	161.9	170.0	170.0	170.0	170.0
Other	594.8	565.2	604.5	590.2	592.6	574.2	678.0	655.1	774.5	754.8
of which: Emergency spending (droughts, security)				20.0						
Development and net lending	**650.0**	**553.9**	**620.1**	**700.7**	**691.5**	**728.1**	**770.7**	**793.6**	**834.4**	**855.2**
Domestically financed	377.5	386.9	332.0	398.8	378.8	415.4	420.8	443.6	444.4	461.9
of which: SOEs emergency funding	36.3	36.3	0.0	48.4	0.0	36.6	0.0	22.8	0.0	20.0
Foreign financed	272.5	167.0	288.1	301.8	312.7	312.7	349.9	349.9	390.0	393.3
of which: SGR project	11.9	11.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: COVID-19 vaccines				14.4						
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustments to cash basis	0.0	5.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance including measures (cash basis, incl. grants)	**-955.5**	**-929.3**	**-929.7**	**-1,033.7**	**-800.5**	**-813.6**	**-666.1**	**-662.3**	**-631.4**	**-632.3**
Financing	**955.6**	**950.2**	**929.7**	**1,033.7**	**800.4**	**813.6**	**666.1**	**662.3**	**631.4**	**632.3**
Net foreign financing	415.3	323.3	283.6	386.1	195.8	334.2	238.6	302.2	227.0	153.2
Disbursements	767.3	451.6	896.7	1,148.1	474.8	553.7	520.7	482.1	453.8	428.0
Project loans	241.7	157.1	273.5	273.5	302.0	302.0	338.8	338.8	377.6	343.4
Program loans	161.2	168.6	144.3	178.9	67.2	146.1	68.3	143.3	76.2	0.0
of which: IMF (RCF+ proposed EFF/ECF)	77.6	78.2	58.4	58.7	66.4	68.2	67.3	69.7	0.0	0.0
Non-concessional [2]	352.5	114.3	478.9	695.7	105.6	105.6	113.6	0.0	0.0	84.6
Standard Gauge Railway	11.9	11.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments due	-352.0	-128.3	-613.1	-762.0	-279.1	-219.5	-282.1	-179.9	-226.9	-274.8
Net domestic financing	540.3	626.9	646.1	647.6	604.6	479.4	427.5	360.1	404.4	479.2
Memorandum items:										
Nominal GDP	11,364.3	11,364.2	12,652.0	12,651.8	14,059.5	14,059.2	15,589.1	15,588.9	17,275.5	17,275.4
Primary balance incl. grants	-507.8	-455.1	-369.4	-428.0	-156.4	-174.8	29.6	29.6	82.4	82.4
Additional spending for vaccines [3]			14.2							
Adjusted primary Balance (vaccines)			-383.6							
Potential extraordinary SOE support [3]			65.0							
Unidentified spending offsets due to SOE supports			32.5	0.0		18.3		22.8		20.0
Adjusted primary balance (vaccines, SOE support)			-434.4							
Debt management operations (DMOs)			350.7	563.5						
Debt Service (DS) Relief	38.4	46.1	41.1	10.8	0.0	0.0	0.0	0.0	0.0	0.0
Repayment	0.0	0.0	0.0	5.5	18.1	13.8	17.6	13.9	17.1	14.0
Total gross public debt, gross	7,866.3	7,712.4	9,025.0	9,005.0	10,058.0	10,008.4	10,969.5	10,852.0	11,857.3	11,665.1
external debt	4,088.9	4,015.3	4,545.7	4,660.2	4,913.9	5,184.3	5,328.5	5,667.8	5,734.2	6,001.8
domestic debt	3,777.4	3,697.1	4,479.3	4,344.7	5,144.1	4,824.1	5,641.0	5,184.2	6,123.1	5,663.4
Total net public debt	7,361.3	7,148.8	8,454.3	8,433.2	9,429.9	9,430.6	10,271.9	10,269.7	11,082.4	11,076.8
Unidentified tax policy measures	0.0	0.0	0.0	0.0	110.8	110.8	134.6	134.6	28.3	28.0
Pending bills	0.0	0.0								
Government deposits	0.0									

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July to June.

[2] Includes emission for debt management operations

[3] Incorporated in the baseline starting from the 2nd Review of the EFF/ECF.

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

(in percent of GDP)[2]

	2020/21		2021/22		2022/23		2023/24		2024/25	
	Rev.1	Est.	Rev.1	Proj.	Rev.1	Proj.	Rev.1	Proj.	Rev.1	Proj.
Revenues and grants	**16.8**	**16.0**	**16.6**	**16.8**	**17.3**	**17.3**	**18.2**	**18.2**	**18.2**	**18.2**
Revenue	**16.3**	**15.7**	**16.3**	**16.3**	**16.9**	**16.9**	**17.9**	**17.9**	**17.9**	**17.9**
Tax revenue (including unidentified tax measures)	12.5	12.6	13.2	13.2	14.4	14.4	15.3	15.3	15.4	15.4
Income tax	6.1	6.1	6.6	6.4	6.7	6.6	6.8	6.6	6.8	6.7
Personal income	3.2	3.2	3.4	3.4	3.5	3.5	3.5	3.5	3.5	3.5
Corporate income	3.0	2.9	3.1	3.0	3.2	3.1	3.3	3.1	3.3	3.2
Import duty (net)	0.9	1.0	0.9	0.9	1.0	1.0	1.0	1.0	1.0	1.0
Excise duty	1.9	1.9	1.9	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Value-added tax	3.5	3.6	3.7	3.8	3.9	4.0	4.0	4.1	4.0	4.1
Domestic	1.7	1.7	2.0	1.8	2.0	2.0	2.0	2.0	2.0	2.0
Imports	1.8	1.9	1.8	2.0	2.0	2.1	2.0	2.1	2.0	2.1
Nontax revenue	3.8	3.1	3.1	3.1	2.5	2.5	2.6	2.6	2.5	2.5
Investment income	0.4	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other	1.0	0.8	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Ministerial and Departmental Fees (AIA)	2.2	1.7	2.0	2.0	1.5	1.5	1.6	1.6	1.5	1.5
Railway Levy	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Grants	**0.4**	**0.3**	**0.4**	**0.5**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**
Project grants	0.4	0.2	0.3	0.5	0.3	0.3	0.3	0.3	0.3	0.3
Program grants	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**25.2**	**24.2**	**24.0**	**24.9**	**23.0**	**23.0**	**22.5**	**22.5**	**21.9**	**21.9**
Recurrent expenditure	**19.4**	**19.3**	**19.1**	**19.4**	**18.0**	**17.9**	**17.6**	**17.4**	**17.1**	**16.9**
Transfer to counties	3.5	3.2	3.2	3.2	2.8	2.8	2.6	2.6	2.5	2.5
Interest payments	3.9	4.4	4.4	4.8	4.6	4.5	4.5	4.4	4.1	4.1
Domestic interest	3.0	3.4	3.3	3.8	3.4	3.4	3.3	3.2	3.0	3.0
Foreign interest due	0.9	0.9	1.1	1.0	1.1	1.1	1.2	1.2	1.1	1.1
Wages and benefits (civil service)	4.3	4.3	4.1	4.2	4.0	4.0	3.8	3.8	3.7	3.7
Civil service reform	0.1	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1
Pensions and Other Consolidated Fund Services	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Defense and NSIS	1.3	1.4	1.2	1.2	1.2	1.2	1.1	1.1	1.0	1.0
Other	5.2	5.0	4.8	4.7	4.2	4.1	4.3	4.2	4.5	4.4
of which: Emergency spending (droughts, security)				0.2						
Development and net lending	**5.7**	**4.9**	**4.9**	**5.5**	**4.9**	**5.2**	**4.9**	**5.1**	**4.8**	**5.0**
Domestically financed	3.3	3.4	2.6	3.2	2.7	3.0	2.7	2.8	2.6	2.7
of which: SOEs emergency funding	0.3	0.3	0.0	0.4	0.0	0.3	0.0	0.1	0.0	0.1
Foreign financed	2.4	1.5	2.3	2.4	2.2	2.2	2.2	2.2	2.3	2.3
of which: SGR project	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: COVID-19 vaccines				0.1						
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustments to cash basis	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance including measures (cash basis, incl. grants)	**-8.4**	**-8.2**	**-7.3**	**-8.2**	**-5.7**	**-5.8**	**-4.3**	**-4.2**	**-3.7**	**-3.7**
Financing	**8.4**	**8.4**	**7.3**	**8.2**	**5.7**	**5.8**	**4.3**	**4.2**	**3.7**	**3.7**
Net foreign financing	3.7	2.8	2.2	3.1	1.4	2.4	1.5	1.9	1.3	0.9
Disbursements	6.8	4.0	7.1	9.1	3.4	3.9	3.3	3.1	2.6	2.5
Project loans	2.1	1.4	2.2	2.2	2.1	2.1	2.2	2.2	2.2	2.0
Program loans	1.4	1.5	1.1	1.4	0.5	1.0	0.4	0.9	0.4	0.0
of which: IMF (RCF+ proposed EFF/ECF)	0.7	0.7	0.5	0.5	0.5	0.5	0.4	0.4	0.0	0.0
Non-concessional [3]	3.1	1.0	3.8	5.5	0.8	0.8	0.7	0.0	0.0	0.5
Standard Gauge Railway	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments due	-3.1	-1.1	-4.8	-6.0	-2.0	-1.6	-1.8	-1.2	-1.3	-1.6
Net domestic financing	4.8	5.5	5.1	5.1	4.3	3.4	2.7	2.3	2.3	2.8
Memorandum items:										
Primary balance incl. grants	-4.5	-4.0	-2.9	-3.4	-1.1	-1.2	0.2	0.2	0.5	0.5
Additional spending for vaccines [4]			0.1							
Adjusted primary Balance (vaccines)			-3.0							
Potential extraordinary SOE support [4]			0.5							
Unidentified spending offsets due to SOE supports			0.3	0.0		0.1		0.1		0.1
Adjusted primary balance (vaccines, SOE support)			-3.4							
Debt management operations (DMOs)			2.8	4.5						
Debt Service (DS) Relief	0.3	0.4	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Repayment	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Total gross public debt, gross	69.2	67.9	71.3	71.2	71.5	71.2	70.4	69.6	68.6	67.5
external debt	36.0	35.3	35.9	36.8	35.0	36.9	34.2	36.4	33.2	34.7
domestic debt	33.2	32.5	35.4	34.3	36.6	34.3	36.2	33.3	35.4	32.8
Total net public debt	64.8	62.9	66.8	66.7	67.1	67.1	65.9	65.9	64.2	64.1
Unidentified tax policy measures	0.0	0.0	0.0	0.0	0.8	0.8	0.9	0.9	0.2	0.2
Pending bills	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government deposits	0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July to June.

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

[3] Includes emission for debt management operations

[4] Incorporated in the baseline starting from the 2nd Review of the EFF/ECF.

Table 3. Kenya: Monetary Survey Dec. 2019–Dec. 2021
(In billions of Kenyan shillings, unless otherwise indicated)

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Proj.
	(In billions of Kenyan shillings, unless otherwise indicated)								
Central Bank of Kenya (CBK)									
Net foreign assets	833	801	918	805	738	691	836	761	913
Net domestic assets	-372	-355	-491	-353	-269	-240	-386	-282	-381
Net domestic credit	-168	-117	-190	-86	33	44	-53	34	-50
Government (net)	-182	-119	-63	-177	-32	-20	-50	-18	-30
Commercial banks (net)	11	-1	-131	88	61	61	-6	48	-24
Other items (net)	-204	-238	-301	-267	-301	-284	-333	-316	-330
Reserve money	461	446	427	452	470	451	450	479	532
Currency outside banks	199	198	211	218	234	226	226	234	260
Bank reserves	262	247	216	235	236	225	224	244	272
Banks									
Net foreign assets	-29	-33	-32	-55	8	0	-52	-99	-101
(in millions of US dollars)	-285	-314	-302	-509	78	3	-484	-899	-899
Reserves	262	247	216	235	236	225	224	244	272
Credit to CBK	-11	1	131	-88	-61	-61	6	-48	24
Net domestic assets	3,073	3,214	3,294	3,489	3,507	3,597	3,684	3,811	3,954
Net domestic credit	3,807	3,904	3,990	4,225	4,274	4,378	4,439	4,603	4,744
Government (net)	1,124	1,156	1,211	1,373	1,375	1,427	1,456	1,546	1,546
Other public sector	92	91	88	89	91	89	84	81	81
Private sector	2,591	2,658	2,690	2,763	2,808	2,862	2,898	2,976	3,117
Other items (net)	-734	-690	-695	-736	-767	-781	-754	-792	-790
Total deposits	3,296	3,430	3,609	3,581	3,691	3,762	3,862	3,908	4,149
Monetary survey									
Net foreign assets	804	768	886	750	747	691	784	662	812
Net domestic assets	2,720	2,893	3,004	3,094	3,244	3,339	3,354	3,516	3,623
Net domestic credit	3,628	3,789	3,930	4,051	4,246	4,361	4,392	4,588	4,717
Government (net)	941	1,037	1,149	1,196	1,343	1,407	1,406	1,528	1,516
Other public sector	92	91	88	89	91	89	84	81	81
Private	2,595	2,661	2,693	2,767	2,811	2,865	2,901	2,979	3,121
Other items (net)	-909	-896	-926	-958	-1,002	-1,022	-1,038	-1,072	-1,094
M1	1,525	1,595	1,693	1,666	1,720	1,717	1,779	1,771	1,874
Money and quasi-money (M2)	2,904	3,019	3,228	3,181	3,250	3,250	3,377	3,408	3,607
M2 plus resident foreign currency deposits (M3)	3,524	3,661	3,890	3,843	3,991	4,030	4,138	4,178	4,435
M3 plus nonbank holdings of government debt (L)	4,927	5,180	5,368	5,447	5,665	5,769	5,954	6,130	6,508
Memorandum items									
	(growth in percent yoy, excluding multipliers and velocity)								
M2	5.4	6.4	9.6	11.0	11.9	7.7	4.6	7.2	11.0
M3	5.6	7.2	9.1	10.7	13.2	10.1	6.4	8.7	11.1
Deposits	7.1	8.4	10.8	9.0	12.0	9.7	7.0	9.1	12.4
Reserve money	-6.3	-2.4	-2.9	10.9	1.9	1.2	5.4	5.9	13.2
Net domestic credit	7.3	8.0	12.6	13.6	17.0	15.1	11.7	13.2	11.1
Government (net)	9.7	7.5	29.0	33.7	42.7	35.7	22.4	27.7	12.9
Private	7.1	8.9	7.6	7.6	8.4	7.7	7.7	7.7	11.0
Net domestic assets of the banking sector	3.7	7.3	14.5	17.3	19.3	15.4	11.7	13.6	11.7
NDA growth (as percent of the base period M3)	2.1	4.2	7.8	9.4	10.6	8.6	6.5	7.7	6.7
Multiplier (Average M2/RM)	6.5	6.7	6.9	6.9	7.1	7.2	7.2	7.2	7.1
Multiplier (Average M3/RM)	7.9	8.1	8.4	8.4	8.6	8.8	8.8	8.8	8.8
Velocity (GDP/M2)	3.6	3.6	3.5	3.4	3.3	3.3	3.2	3.3	3.3
Velocity (GDP/M3)	2.9	3.0	2.9	2.9	2.7	2.6	2.6	2.7	2.7

Sources: Kenyan authorities and IMF staff estimates and projections.

Table 4. Kenya: Balance of Payments, 2020–26

(BPM6 presentation, in millions of U.S. dollars, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026
		Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	-4,619	-5,631	-5,962	-6,376	-6,705	-7,185	-7,646
Merchandize trade	-8,430	-10,354	-11,351	-12,293	-13,338	-14,360	-15,538
Exports f.o.b.	6,062	6,937	7,808	8,660	9,581	10,585	11,535
Imports f.o.b.	14,492	17,292	19,158	20,953	22,919	24,946	27,073
Energy	2,080	2,900	3,298	3,537	3,786	4,034	4,334
Non-energy	12,413	14,392	15,861	17,416	19,133	20,912	22,739
Services	355	386	1,164	1,608	1,970	2,256	2,500
Credit, *of which*	3,732	4,161	5,279	6,171	7,016	7,808	8,501
Travel receipts	472	494	658	849	1,024	1,152	1,223
Debit	3,377	3,775	4,115	4,563	5,045	5,552	6,001
Primary income	-1,494	-1,713	-2,161	-2,523	-2,561	-2,772	-2,935
Credit	144	97	153	248	434	511	676
Debit	1,638	1,810	2,314	2,770	2,995	3,283	3,610
Secondary income, *of which*	4,950	6,050	6,385	6,831	7,224	7,692	8,326
Remittances	3,094	3,558	3,893	4,242	4,603	4,991	5,412
Capital account	131	450	205	205	205	205	205
Financial account 1/	-3,023	-4,695	-2,562	-5,803	-6,547	-8,004	-8,705
Direct investment, net	-499	-250	-649	-996	-1,195	-1,496	-1,696
Assets	25	432	175	175	175	175	175
Liabilities	-524	-682	-824	-1,171	-1,370	-1,670	-1,871
Portfolio investment, net, *of which*	1,279	-1,502	869	882	894	904	613
Assets	1,106	1,000	1,000	1,000	1,000	1,000	1,000
Liabilities	173	-2,502	-130	-118	-106	-96	-387
Eurobonds (net)	0	-2,191	0	0	0	0	-300
Financial derivatives, net	-73	0	0	0	0	0	0
Other investment, net	-3,730	-2,943	-2,783	-5,689	-6,246	-7,413	-7,623
Assets	1,018	1,000	1,000	1,000	1,000	1,000	1,000
Liabilities, *of which*	-4,748	-3,942	-3,783	-6,689	-7,246	-8,412	-8,622
Public sector loans (excl. official budget support) (net)	-1,877	-400	-320	-1,541	-1,070	-3,066	-3,087
SDR allocation	0	-740	0	0	0	0	0
Errors and omissions	38	520	0	0	0	0	0
Overall balance ("+" indicates a surplus)	-1,427	34	-3,195	-367	48	1,025	1,264
Financing	1,427	-34	3,195	367	-48	-1,025	-1,264
Reserve assets 2/	819	-2,504	1,814	-813	-887	-902	-942
Program financing	608	1,957	1,381	1,180	839	-123	-322
IMF (net)	608	854	438	630	239	-123	-322
of which, Fund purchases 3/	745	984	510	662	239	0	0
Official budget support (other)	0	1,103	943	550	600	0	0
of which, Unidentified financing	0	0	0	0	0	0	0
Exceptional financing (+ = increase)	0	514	0	0	0	0	0
of which, DSSI	0	514	0	0	0	0	0
Memorandum items:							
Gross international reserves (USD million)	8,284	10,788	8,974	9,787	10,674	11,576	12,518
In months of next year's imports of goods and services	4.7	5.6	4.2	4.2	4.2	4.2	4.2
Current account (CA) (percent of GDP) 4/	-4.5	-5.1	-5.1	-5.1	-5.0	-5.0	-5.0
CA excl. energy imports (percent of GDP) 4/	-2.5	-2.5	-2.3	-2.3	-2.2	-2.2	-2.2
Energy imports (percent of GDP) 4/	2.0	2.6	2.8	2.8	2.8	2.8	2.8
Merchandize exports growth (percent)	3.3	14.4	12.5	10.9	10.6	10.5	9.0
Merchandize imports growth (percent)	-12.5	19.3	10.8	9.4	9.4	8.8	8.5
Energy (percent)	-33.1	39.4	13.7	7.3	7.0	6.5	7.5
Non-energy (percent)	-7.7	15.9	10.2	9.8	9.9	9.3	8.7
Travel receipts growth (percent)	-53.1	4.7	33.3	29.0	20.6	12.5	6.1
Remittances growth (percent)	9.0	15.0	9.4	8.9	8.5	8.4	8.4
Nominal GDP (USD million)	102,427	109,489	116,475	124,192	132,958	142,806	153,337

Sources: Kenyan authorities; and Fund staff estimates and projections.
Notes:
1/ Negative entries reflect a decrease in assets or an increase in liabilities.
2/ Negative entries reflect an increase in assets.
3/ In 2020, purchases under the RCF.
4/ Ratios as share of GDP are impacted by GDP rebasing, which took place between the 1st and 2nd Review.

Table 5. Kenya: Financial Soundness Indicators of the Banking Sector
December 2019–June 2021

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Apr-21	May-21	Jun-21
Capital adequacy									
Regulatory capital to risk-weighted assets	18.8	18.5	18.5	18.2	19.2	18.8	18.6	18.9	18.9
Regulatory tier 1 capital to risk-weighted assets	16.8	16.4	16.4	16.3	16.7	16.5	16.3	16.6	16.5
Total capital to total assets	14.8	14.5	14.2	14.2	14.6	14.5	14.4	14.4	14.4
Asset quality									
Non-performing loans to total gross loans[1]	12.0	12.5	13.1	13.6	14.1	14.6	14.2	14.2	14.0
Bank provisions to NPLs	62.9	66.1	67.3	70.4	71.4	71.5	73.3	73.0	71.6
Non-performing loans net of provisions to capital	16.1	16.7	16.9	15.9	15.3	15.8	14.6	14.6	15.1
Earning assets to total assets	91.9	92.1	91.6	93.8	93.6	93.9	93.5	93.4	93.9
Earning and profitability									
Return on assets (ROA)	2.5	2.3	0.7	1.8	1.6	2.6	2.6	2.6	2.7
Return on equity (ROE)	21.2	20.4	15.6	15.1	13.8	22.0	21.7	21.9	22.7
Interest margin to gross income	25.2	24.1	24.1	23.6	23.6	24.0	24.1	24.1	24.2
Non-interest expenses to gross income	43.9	46.3	51.4	52.6	54.6	43.1	44.2	44.1	43.2
Liquidity									
Liquid assets to total assets	39.3	39.8	41.9	41.5	42.5	43.0	40.3	40.8	41.0
Liquid assets to short-term liabilities	49.7	51.4	52.8	53.2	54.6	56.3	56.5	56.6	56.8
Liquid assets to total deposits	53.2	53.8	55.6	55.8	57.1	57.3	54.1	54.6	54.8
Total loans to total deposits	77.7	77.0	74.2	75.3	74.3	73.6	74.0	73.2	73.2
Sensitivity to market risk									
Net open position in foreign exchange to capital	1.7	1.7	1.8	2.3	1.6	1.6	1.6	0.8	1.2
Interest bearing assets to interest bearing liabilities	124.4	124.4	121.6	126.1	125.6	125.1	125.7	124.4	124.4
FX currency denominated assets to total assets	15.1	15.8	15.6	15.3	15.3	14.7	14.7	14.7	14.8
FX currency denominated liabilities to total liabilities	24.4	24.7	24.3	24.1	26.4	27.0	26.7	26.6	26.8
Spread between lending and deposit rate	5.6	5.6	5.5	5.3	5.5	5.5	5.8	5.7	5.6

Source: Central Bank of Kenya.

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

Table 6. Kenya: Schedule of Approval, Prospective Reviews, and Available Purchases and Loans, 2021–24

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

Source: IMF staff estimates.

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

Table 7. Kenya: Indicators of Fund Credit, 2020–34

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
		Projections													
Existing and prospective Fund arrangements															
Disbursements	542.8	686.6	352.8	453.2	162.8	0	0	0	0	0	0	0	0	0	0
Stock of existing and prospective Fund credit 1/	705.9	1,301.4	1,603.9	2,035.5	2,198.4	2,115.8	1,900.0	1,604.9	1,237.2	842.4	498.7	253.7	101.3	14.1	0
Obligations to the Fund 2/	98.4	95.3	57.4	32.4	16.4	100.4	232.3	308.6	377.8	402.8	349.6	248.6	154.3	87.9	14.3
Principal (repayments/repurchases)	97.7	91.2	50.3	21.6	0.0	82.6	215.8	295.2	367.7	394.8	343.8	245.0	152.4	87.2	14.1
Charges and interest 3/	0.7	4.1	7.0	10.8	16.4	17.8	16.5	13.5	10.1	8.0	5.8	3.6	1.9	0.8	0.2
Stock of existing and prospective Fund credit 1/ 4/															
In percent of quota	130.1	239.8	295.5	375.0	405.0	389.8	350.0	295.7	227.9	155.2	91.9	46.7	18.7	2.6	0.0
In percent of GDP 5/	1.0	1.7	2.0	2.3	2.4	2.1	1.8	1.4	1.0	0.7	0.4	0.2	0.1	0.0	0.0
In percent of exports of goods and services	10.4	16.8	17.5	19.6	18.9	16.4	13.5	10.5	7.4	4.6	2.5	1.2	0.4	0.1	0.0
In percent of gross international reserves	9.4	17.2	25.5	29.7	29.4	26.1	21.7	18.7	13.5	8.6	4.7	2.2	0.8	0.1	0.0
In percent of government revenue	6.0	10.3	11.5	13.1	12.9	11.3	9.3	7.3	5.3	3.4	1.9	0.9	0.3	0.0	0.0
In percent of total external debt	1.7	2.8	3.2	3.7	3.7	3.3	2.7	2.2	1.6	1.0	0.6	0.3	0.1	0.0	0.0
Obligations to the Fund (repurchases and charges) 4/															
In percent of quota	18.1	17.5	10.6	6.0	3.0	18.5	42.8	56.9	69.6	74.2	64.4	45.8	28.4	16.2	2.6
In percent of GDP 5/	0.1	0.1	0.1	0.0	0.0	0.1	0.2	0.3	0.3	0.3	0.3	0.2	0.1	0.1	0.0
In percent of exports of goods and services	1.4	1.2	0.6	0.3	0.1	0.8	1.7	2.0	2.3	2.2	1.8	1.2	0.7	0.3	0.1
In percent of gross international reserves	1.7	1.3	0.9	0.5	0.2	1.2	2.7	3.6	4.1	4.1	3.3	2.2	1.3	0.7	0.1
In percent of government revenue	0.8	0.8	0.4	0.2	0.1	0.5	1.1	1.4	1.6	1.6	1.3	0.9	0.5	0.3	0.0
In percent of total external debt service	2.8	2.5	1.3	0.7	0.3	1.8	4.0	4.9	5.4	5.7	4.6	2.8	1.8	0.9	0.1
Memorandum items															
Quota (SDR million)	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8
Gross domestic product, baseline (USD million)	102,427	109,489	116,475	124,192	132,958	142,806	153,337	163,089	172,100	181,654	191,785	202,548	213,987	226,144	239,069
Exports of goods and services (USD million)	9,794	11,099	13,087	14,831	16,596	18,393	20,036	21,920	23,857	25,898	28,122	30,548	33,533	36,830	40,475
Gross international reserves (USD million)	8,284	10,788	8,974	9,787	10,674	11,576	12,518	12,284	13,125	14,030	15,073	16,225	17,600	19,133	20,971
Government revenue (USD million)	17,012	17,987	19,864	22,131	24,314	26,742	29,342	31,256	33,045	34,950	37,049	39,329	41,801	44,584	47,644
External debt service (USD million)	4,881	5,528	6,404	6,642	8,883	8,075	8,746	9,335	10,428	10,520	11,394	13,349	13,076	14,831	16,904
Total external debt (USD million)	58,396	66,487	71,650	79,519	87,604	95,893	104,494	111,342	119,175	127,245	135,346	143,468	151,649	160,055	168,973

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

1/ End of period.

2/ Repayment schedule based on scheduled debt service obligations.

3/ Using GRA rate of charge of 1.05 (as of November 4, 2021).

4/ Using the program SDR/USD rate (as of February 4, 2021) in 2021-2034 forecasts.

5/ Ratios as share of GDP are impacted by GDP rebasing, which took place between the 1st and 2nd Review.

Table 8. Kenya: External Financing Requirements and Sources, 2020–26

(In millions of U.S. dollars, unless otherwise indicated)

		2020	2021	2022	2023	2024	2025	2026
			Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(1)	**Gross financing requirements**	**6,191**	**7,474**	**8,301**	**8,521**	**10,520**	**9,517**	**10,015**
	Current account deficit (excl. grants)	4,754	5,766	6,097	6,511	6,840	7,320	7,781
	of which: Energy imports	2,080	2,900	3,298	3,537	3,786	4,034	4,334
	Amortization of public sector loans (excl. IMF repurchase)	1,301	1,578	2,131	1,979	1,680	2,074	1,912
	Amortization of sovereign bonds 1/	0	0	0	0	2,000	0	0
	IMF repurchases	136	131	73	31	0	123	322
(2)	**Change in reserves (+ = increase)**	**-819**	**2,504**	**-1,814**	**813**	**887**	**902**	**942**
(3)	**Gross financing sources**	**4,588**	**6,858**	**5,033**	**8,122**	**10,568**	**10,419**	**10,957**
	FDI, net	499	250	649	996	1,195	1,496	1,696
	Public grants	135	135	135	135	135	135	135
	Public sector borrowing (excl. official budget support)	3,179	1,978	2,451	3,519	2,750	5,140	4,999
	SDR allocation	0	740	0	0	0	0	0
	Issuance of sovereign bonds 1/	0	2,191	0	0	2,000	0	300
	Private capital flows, net	775	1,564	1,799	3,471	4,487	3,648	3,827
(4)	**Errors and omissions**	**38**	**520**	**0**	**0**	**0**	**0**	**0**
(1)+(2)-(3)-(4)	**Total financing needs**	**747**	**2,601**	**1,453**	**1,212**	**839**	**0**	**0**
(5)+(6)	**Total financing sources**	**745**	**2,601**	**1,453**	**1,212**	**839**	**0**	**0**
(5)	Official public external financing	745	2,088	1,453	1,212	839	0	0
	Identified official budget support	0	1,103	943	550	600	0	0
	IMF purchases 2/	745	984	510	662	239	0	0
	Unidentified external financing	0	0	0	0	0	0	0
(6)	Exceptional financing (- = increase)	0	514	0	0	0	0	0
	of which, DSSI	0	514	0	0	0	0	0
	Memorandum Items:							
	Gross financing requirements (in percent of GDP) 3/	6.0	6.8	7.1	6.9	7.9	6.7	6.5
	Gross international Reserves	8,284	10,788	8,974	9,787	10,674	11,576	12,518
	In months of next year's imports of GNFS	4.7	5.6	4.2	4.2	4.2	4.2	4.2

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

Notes: 1/ Does not reflect debt management operations, which may be undertaken based on favorable market conditions.

2/ In 2020, purchases under the RCF.

3/ Ratios as share of GDP are impacted by GDP rebasing, which took place between the 1st and 2nd Review.

Annex I. Key Recommendations of the 2018 Article IV Consultation

Policies	Key Recommendations	Status of Implementation
Fiscal Policy	Implement additional revenue measures (including reform of the remaining exemptions in the corporate income tax and value added tax) to complement those in the supplemental budget for FY2017/18 and the draft budget for FY2018/19; expenditure cuts are necessary to achieve the deficit target of 5.7 percent of GDP.	Absent significant tax policy measures, revenues fell short of budget targets for successive years and deficits remained above 7 percent of GDP. Revenue-enhancing measures to broaden the tax base were enacted in April and June 2020 with an estimated yield of 1.2 percent of GDP. Tax cuts implemented at the onset of the pandemic were reversed at the start of 2021. A recently-initiated-annual-tax expenditure report should help to further identify new areas of resource mobilization. A Medium-Term Revenue Strategy (MTRS) is being developed, supported by FAD technical assistance.
	Provide a medium-term focus to budgeting, including the setting of expenditure ceilings that are consistent with medium term fiscal targets and realistic revenue projections.	A more conservative approach to revenue projection was adopted starting with FY19/20. Alongside the pick-up in economic activity and the effect of new tax measures, this contributed to FY20/21 program targets for revenue and the primary deficit being met. The authorities have improved medium-term budgeting, supported by IMF technical assistance. However, more is needed to improve coordination among all units involved in budget preparation.
	PFM. Further clarify Kenya's fiscal rules; reduce pressures on transfers to counties; prevent the accumulation of arrears; improve the efficiency of public investment and expenditure control; closely monitor the implementation of PPPs and new spending programs under the Big Four.	Introduction of a debt anchor is underway. Steps to improve public financial management have included: stocktaking of existing public investment projects with identification of projects to be rationalized and regular quarterly reporting on pending bills. Reports have been published quantifying risks from contingent liabilities from high-risk SOEs and PPPs; and work is ongoing to incorporate an expanded fiscal risk report as part of the annual budget process. Work is under way to enhance IFMIS to enable contract generation and management for multi-year project commitments.
Monetary and Exchange Rate Policy	Eliminate or modify interest rate controls, including by delinking the lending cap from the CBR, significantly increasing the lending rate cap, and abolishing the floor on time deposit rates.	In November 2019 the interest rate caps on commercial loans were repealed.
	Revitalize efforts to modernize the inflation-targeting framework, including establishing an interest rate corridor around the CBR; taking additional steps to smooth volatility in the interbank market; and allowing greater shilling flexibility in response to external shocks.	On July 27, 2021 the CBK published its strategy to strengthen and modernize the monetary policy framework (white paper), much in line with the 2018 Article IV recommendations. Maintaining a flexible exchange rate regime, with market interventions only in response to excess exchange rate volatility is a key monetary policy objective of the CBK. The REER depreciated by 7 percent in 2020 as the CBK appropriately allowed the Shilling to act as a shock absorber during the COVID pandemic.

Policies	Key Recommendations	Status of Implementation
Financial Sector Policies	Maintain efforts to strengthen the banking supervision framework and take action to ensure that all banks are compliant with prudential capital and liquidity ratios.	The CBK is on course to pilot the centralized Electronic Data Warehouse (EDW) that enables real-time access to supervisory data for regulators. The Kenyan banking sector's capital position remains robust as regulatory ratios stood well above statutory requirements. The CBK has since 2016 adopted the Internal Capital Adequacy Assessment Program (ICAAP) in ensuring that banks hold adequate capital aligned to their risk profile and market niche. Results of a forward-looking stress test exercise carried out by the CBK were published in their Kenya Financial Sector Stability Report, September 2021. CBK engaged all banks to develop a Credit Risk-Based Pricing Model, a key pillar of the Banking Sector Charter. Individual bank models require approval; this process is continuing. The authorities are committed to strengthening the legal and regulatory framework to safeguard financial stability. This include the amendment of the CBK Act to allow CBK to regulate and supervise the unregulated digital lenders and the amendment of microfinance act that was submitted to Cabinet in March 2021 for approval and submission to the National Assembly.
Structural Policies	Improve governance by strengthening PFM	Advances in the authorities' governance agenda include: publication of comprehensive audits of the use of COVID-19 funds in FY2019/20; launching of a public procurement portal Implementation laws establishing access to information and asset declarations of public officials is ongoing, together with efforts to strengthen the AML/CFT regulatory framework.

Annex II. Risk Assessment Matrix[1]

Source of Risks	Likelihood /Time Horizon	Expected Impact on Economy	Policy Response
Potential External Shocks			
Uncontrolled Covid-19 local outbreaks and subpar/volatile growth Limited access to, and longer-than-expected deployment of vaccines in some countries—combined with dwindling policy space—could force new lockdowns and prompt a reassessment of their growth prospects.	**High** **Short to Medium Term**	**High.** This could adversely impact growth, spur capital outflows from the private sector and pressure the exchange rate. Fiscal balances would worsen, including due to balance sheet scarring in the private sector, and debt vulnerabilities would rise further.	▪ Reprioritize spending to support the vulnerable while compressing overall expenditure to contain the negative fiscal-debt impact; ▪ Maintain exchange rate flexibility; ▪ Accelerate reforms to address structural weakness affecting competitiveness.
De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia. A fast recovery in demand (supported by excess private savings and stimulus policies), combined with COVID-19-related supply constraints, leads to sustained above-target inflation readings and a de-anchoring of expectations. The Fed reacts by signaling a need to tighten earlier than expected. The resulting repositioning by market participants leads to a front-loaded tightening of financial conditions and higher risk premia, including for credit, equities, and emerging and frontier market currencies.	**Medium** **Short to Medium Term**	**High.** This could trigger capital outflows from the private sector and hamper capital market access by the sovereign. The exchange rate would face depreciation pressures, the fiscal balances would worsen, and debt vulnerabilities would rise further.	▪ Compress expenditure to contain the negative fiscal-debt impact; ▪ Maintain exchange rate flexibility.
Rising commodity prices amid bouts of volatility. Commodity prices increase by more than expected against a weaker U.S. dollar, post-pandemic pent-up demand and supply disruptions, and for some materials, accelerated plans for renewable energy adoption. Uncertainty surrounding each of these factors leads to bouts of volatility, especially in oil prices**.**	**Medium** **Short to Medium Term**	**Medium.** Higher commodity prices moving well beyond levels seen in October-November would increase external and domestic imbalances and weigh on economic growth.	▪ Compress expenditure to contain fiscal pressures; ▪ If the shock is persistent and threatens second-round effects, tighten monetary policy to ensure inflation expectations remain well-anchored; ▪ Maintain exchange rate flexibility.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Cyber-attacks	**Medium** **Short to Medium Term**	**Medium.** Such attacks can trigger financial instability or widely disrupt socio-economic activities.	▪ Continue reforms to strengthen cyber security capabilities at both government and private sector level.
Higher frequency and severity of natural disasters	**Medium** **Short to Medium Term**	**High.** This would adversely affect vulnerable households in the impacted areas, and lead to social tensions, slower growth, an increase in food inflation, and pressures on public spending and the current account.	▪ Use targeted programs to help vulnerable groups and reprioritize spending; ▪ Guard against second-round effects on inflation.
Potential Domestic Shocks			
A resumption of adverse weather conditions or locust invasion	**Low** **Short Term to Medium Term**	**High / Low.** Depending on the geographical area impacted this could lead to lower agricultural production and slower growth, an increase in food inflation, pressures on public spending and the current account, and adversely affect vulnerable households.	▪ Use targeted programs to help vulnerable groups and reprioritize spending; ▪ If necessary, guard against second-round effects on inflation.
Political risks	**Medium** **Short to Medium Term**	**High**. Political violence could emerge around the 2022 presidential election as seen in previous elections.	▪ Remain committed to reforms under the program.
Emergence of greater-than-expected weaknesses in the SOE sector	**High** **Short to Medium Term**	**Medium**. This would create additional fiscal pressures and difficult tradeoffs with other priorities; if tradeoffs prove infeasible, could lead to crowding out of the private sector, although the magnitude would be highly uncertain.	▪ Continued financial evaluation of health of top SOEs; ▪ Implement least-cost strategies to address SOE financial pressures.
Deterioration in security situation	**Medium** **Short to Medium Term**	**High.** This would adversely affect recovery of the tourism sector, foreign direct investment and portfolio inflows and, in turn, growth.	▪ Reprioritize fiscal spending to accommodate security needs. ▪ Maintain policies to improve macro fundamentals (e.g., structural and governance reforms). ▪ Strengthen and robustly implement AML/CFT framework to help prevent, detect, and disrupt the financing of terrorism.
Risks from poor implementation capacity, fiscal pressures in the run-up to the election, and weak program ownership	**Medium** **Short to Medium Term**	**Medium**. This would lead to higher budget deficits, which would increase debt ratios, crowd out private investment, and ultimately weaken growth.	▪ Remain committed to fiscal targets and reforms under the program.

Annex III. External Sector Assessment

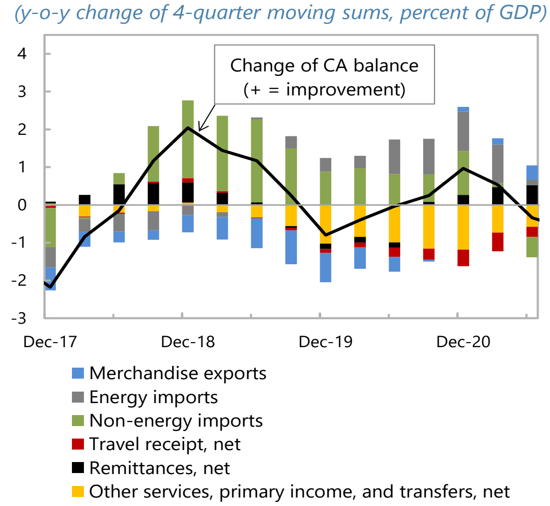
This Annex provides an assessment of Kenya's external position, competitiveness, and reserve adequacy. Based on the Fund's external balance assessment framework, Kenya's overall external position in 2020 is assessed to be broadly in line with the level implied by medium-term fundamentals and desirable policies. While Kenya's scores on some standard measures of non-price competitiveness are above the Sub-Saharan average, its export sector has faced challenges moving up the value chain and diversifying in faster growing market segments, resulting in a stagnating world market share in recent years. International reserves are comfortably above the recommended range for the Fund's reserve adequacy metric for credit-constrained economies. Looking ahead, Kenya's external position, competitiveness, and reserve coverage are expected to be underpinned by the authorities' ambitious reform program supported by the extended arrangements under the EFF and ECF. The programmed fiscal consolidation would help strengthen Kenya's external sector position and support private sector growth, with exchange rate flexibility allowing the economy to absorb external shocks. Further attention to improving Kenya's competitiveness would help boost the world market share of Kenya's exports and further support its external position.

A. Current Account

1. Kenya's current account deficit amounted to 4.5 percent of GDP in 2020—one percentage point lower than in 2019 and below its 2015–19 average (5.9 percent of GDP). Since mid-2018, the CA balance has been supported by a persistent decline in the ratio of non-energy imports to GDP, reflecting the base effect on imports of capital goods (machinery and transport equipment) of the completion of major infrastructure projects in 2017-18. In 2020, the weak demand for imports and lower imported energy bill, combined with the resilience of exports, buoyant remittances and a drop in FDI-related outflows, helped offset the severe COVID-19 shock on tourism. Remittances reached 3 percent of GDP in 2020—0.2 percentage points higher than in 2019—and have grown further by 20 percent in the first half of 2021 relative to 2020:H1. This reflects the strong positioning of the Kenyan diaspora in labor markets abroad, particularly in North America.

Kenya: Contributions to Change of Current Account Balance, 2017-21

(y-o-y change of 4-quarter moving sums, percent of GDP)



Source: Haver, Central Bank of Kenya and Fund staff estimates.

2. The CA deficit is projected to increase to 5.2 percent of GDP in 2021 and stabilize around 5 percent of GDP over the medium term. Kenya's recovery from the COVID-19 shock and higher oil prices are shaping CA developments in 2021. While the global growth recovery will support higher exports, the stronger domestic demand and higher oil prices will also boost imports, leading to a wider current account deficit, despite better tourism and transport receipts and remittances flows. Over the medium term, capital goods imports are expected to gradually increase reflecting improvements in both investor sentiment and the business climate. Oil imports are expected to remain around 2.8 percent of GDP, in line with the post-2015 energy intensity of the economy. Export growth will be supported by Kenya's improving business environment, key infrastructure projects coming to completion, and large potential in the agricultural sector. Services are projected to gradually increase over the medium term, as the tourism sector returns to normal after the COVID-19 shock. Remittances are also projected to remain an important financing item. CA projections under the baseline are subject to downside risks, particularly from weather conditions and commodity prices—which could affect food and oil imports.

3. The external balance is assessed to be broadly in line with the level implied by fundamentals and desirable policies. EBA-lite CA model indicates a CA gap of -0.5 percent of GDP in 2020. It is based on the estimated cyclically adjusted CA of -4.1 percent of GDP and a CA norm of -3.6 percent of GDP.[1] The CA is assessed to be broadly in line with the level implied by fundamentals and desirable policies in 2020. The contribution of policy gaps to the current account gap is 1.4 percent of GDP, with the fiscal deficit being the main contributor (1 percent of GDP). As a result, the assessment reflects the smaller deviation of fiscal policy from its desirable setting in Kenya than in peer countries during the pandemic.[2] This underlies the importance of steadfast implementation of the fiscal consolidation under the EFF/ECF arrangements and proactively boosting non-price competitiveness to keep the external position in balance during the gradual withdrawal of the pandemic-related fiscal stimulus around the world.

Kenya: EBA-Lite Results, 2020

(percent of GDP, unless otherwise indicated)

	CA model	REER model
CA-Actual	**-4.5**	
Cyclical contributions (from model) (-)	0.1	
COVID-19 adjustor (+) 1/	0.04	
Additional temporary/statistical factors (+)	0.0	
Natural disasters and conflicts (-)	-0.5	
Adjusted CA	**-4.1**	
CA Norm (from model) 2/	**-3.6**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**-3.6**	
CA Gap	**-0.5**	**-1.4**
o/w Relative policy gap	1.4	
Elasticity	-0.11	
REER Gap (in percent)	**4.3**	**12.3**

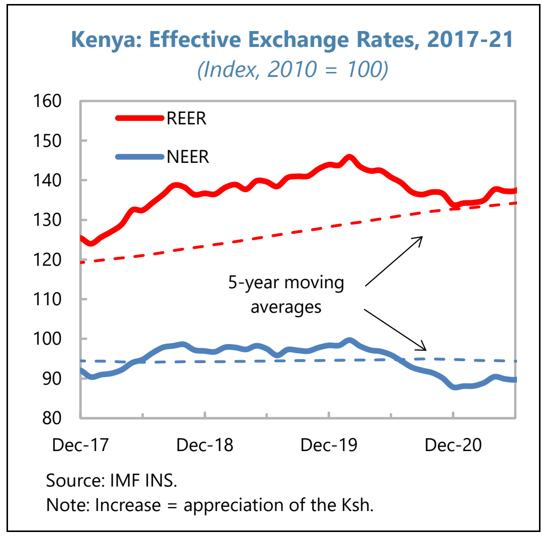
1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on oil trade balances (-0.24 percent of GDP) and on tourism (0.28 percent of GDP), using default model assumptions.
2/ Cyclically adjusted, including multilateral consistency adjustments.

[1] The reported ratios to GDP reflect the revision by the Kenya National Bureau of Statistics of the historical GDP series in September 2021, which resulted in an increase in the level of nominal GDP (e.g., by 5.3 percent in 2019).

[2] Whereas the fiscal deficit in Kenya exceeded its desirable setting in 2020 and, hence, in a single-country regression would have contributed to the widening of the CA gap, in the cross-country regression—the results of which are shown in the text table—the contribution of the fiscal policy gap is positive, reflecting the larger deviation of the fiscal deficit from its desirable policy level for the world as a whole compared to Kenya.

B. Real Exchange Rate

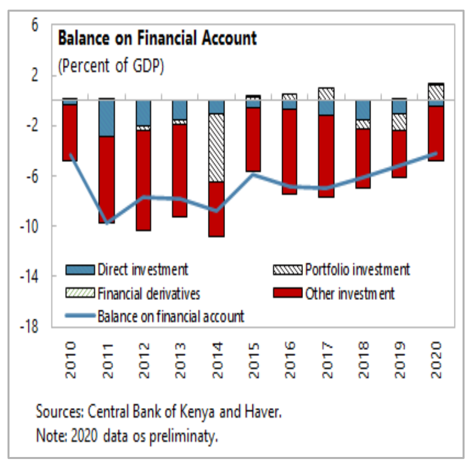
4. Kenya's real effective exchange rate (REER) has been on an appreciating trend in recent years. Despite a stable nominal effective exchange rate (NEER), a relatively higher inflation rate than in trading partners had in recent years contributed to a medium-term real appreciation.[3] With the onset of the pandemic in 2020, the exchange rate acted as a shock absorber, reversing the trend of REER appreciation and helping bring the end-2020 REER to its 5-year moving average and keep the annual average REER unchanged relative to 2019. This has helped absorb some of the impact of the COVID-19 shock, which reduced sources of foreign exchange for Kenya. The REER depreciated further in 2021:Q1, before strengthening in the second quarter of the year, on modest nominal exchange rate moves in the context of program financing by the IMF and the World Bank, and the successful US$1 billion Eurobond issuance.



5. The EBA-lite REER model suggests a gap of 12.3 percent for 2020. The REER data used in the model is the Fund's standard REER index. Taking into account the results of the EBA-lite CA model, staff assesses the REER gap to be in the range of 4 percent and 12 percent.

C. Capital and Financial Accounts

6. In 2020, Kenya's current account deficit was largely financed by debt financing. Other net investment flows amounted to 3.6 percent of GDP, reflecting government borrowing, including IMF emergency support, as well as private sector borrowing, especially by non-bank corporations. Reflecting the impact of the COVID-19 shock on retained earnings, FDI net inflows reached only 0.5 point of GDP. Last year, the volatility in global financial markets driven mainly by the COVID-19 shock reduced portfolio inflows, as well as the government's appetite for external commercial borrowing. Following the normalization of global market conditions, Kenya placed US$1 billion Eurobond in June 2021 amid strong demand that saw the yield fall below the initial guidance to 6.3 percent.



[3] The United States, China, South Africa, United Kingdom, Japan, India, Germany, France, the United Arab Emirates, Uganda, Netherlands, Italy, Belgium, and Tanzania are the major trading (export) partners of Kenya. They together account for about 75 percent of Kenya's exports. For the purposes of Kenya's REER calculation, world inflation is a weighted average of the aforementioned countries' inflation indices.

D. Reserve Adequacy and FX Intervention

7. Reserve coverage remains adequate. At end-2020, reserves stood at US$8.3 billion, compared to US$9.1 billion at end-2019. Reserve coverage was equivalent to 8.3 percent of GDP, about 4.7 months of next year's imports, and about 150 percent of the IMF's reserve adequacy metric for credit-constrained economies.[4] At end-September 2021, gross international reserves had increased to US$9.4 billion, bolstered by significant financial inflows including Eurobond issuance of US$1 billion, US$750 million in budget support from the World Bank, and two disbursements totaling US$715 million under the extended arrangements under the EFF and ECF.

8. Maintaining exchange rate flexibility would help the economy absorb potential shocks. The CBK engages in periodic FX interventions to smooth volatility in the Kenyan shilling. The exchange rate acted as a shock-absorber during the pandemic, helping the economy to adjust to the global shock from COVID-19. Given the CBK's credibility, well-anchored inflation expectations, and adequate reserve coverage, there is scope for greater exchange rate flexibility to absorb external shocks.

E. Competitiveness Measures

9. There are signs of eroding competitiveness in Kenya, which has resulted in weak export performance in recent years. Kenya has had a strong orientation to global markets as part of its development strategy, with exports of goods and services averaging 13 percent of the country's GDP in 2001–13. Since then, the ratio of total exports to GDP has fallen to 6 percent in 2020, as the share of Kenya's exports in world imports has stagnated. While Kenya has continued to implement reforms to facilitate the environment for exporters, keeping its competitiveness rank on broadly-tracked indices above the average for Sub-Saharan Africa, there is evidence that Kenya has lost competitiveness.[5] The Selected Issues Paper "Evidence on Non-Price Competitiveness of the Kenya Economy," issued alongside this report, examines in detail different aspects of non-price competitiveness. It attributes the relative lack of export dynamism in part to export product composition concentrated in products characterized by low technological intensity, low value-added, and low market growth. To support durable and inclusive medium-term growth, policies to strengthen competitiveness, including the business environment, are an integral part of the authorities' ambitious reform program, supported by the extended arrangements under the EFF and ECF. Increasing the efficiency in the use of public resources in connection with the agenda to address financial risks from SOEs should also enhance competitiveness.

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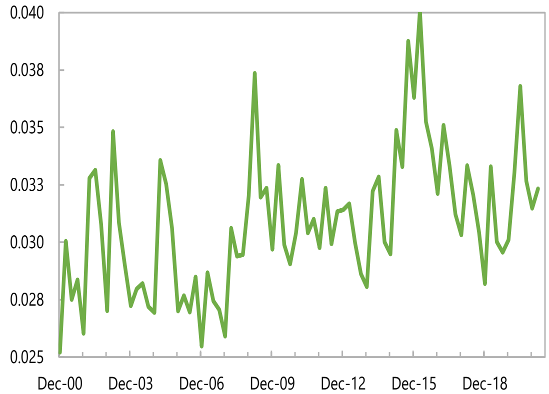
[4] The reserve adequacy metric for credit-constrained economies is calculated by measuring the benefit of holding reserves against the costs. The benefits are the lower probability of a crisis and the reduction in the severity of a crisis, while the cost is measured based on an economy's external funding costs. The model suggests that the optimal level of reserves for Kenya is 3.1 months of imports.

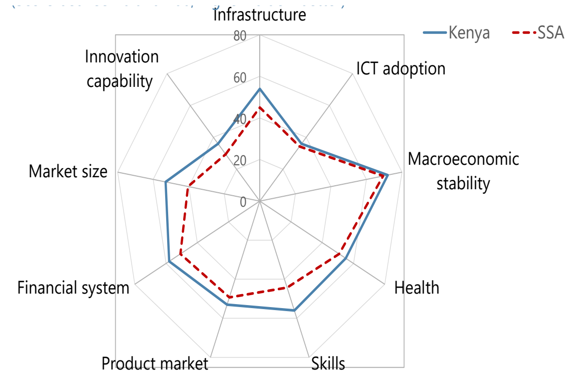
[5] In line with the Use of Third-Party Indicators in Fund Reports from 2017, we present scores for several indicators in a cross-country context. The World Economic Forum's Global Competitiveness Index is entirely based on survey data. The Global Competitiveness Report has been published annually since 2004 and provides information on 141 economies currently.

Share of Kenya Exports in World Imports
(Ratio of 4-quarter sums; percent)



Source: IMF Directions of Trade Statistics.

Global Competitiveness Index, 2019[1]
(Score between 0 and 100, higher value = better)



Source: Global Competitiveness Report, 2019.
[1] Pillars 1, 8 and 11 are not included due suspension of World Bank *Doing Business* database.

Authorities' Views

10. **Noting the wide confidence intervals around the results of such models in the midst of the pandemic shock, as also emphasized by Fund staff, the authorities broadly concurred with the bottom-line assessment that Kenya's external position is broadly in line with fundamentals and desirable policies.** The authorities pointed to the heightened uncertainty about the extent and duration of economic scarring from the COVID-19 shock around the world, which would, in general, tend to weaken the link between price and external position adjustments (as supply-chain disruptions take center stage). Their analysis indicates that Kenya's tourism sector has historically rebounded very quickly from shocks. Looking ahead, they emphasized the favorable prospects for Kenya's financial services firms to continue expanding in Sub-Saharan Africa and highlighted the role that technology and innovation can play in supporting more dynamic growth of services exports, given in Kenya's role as a technology leader in the region.

Annex IV. Fiscal Risks Management: The COVID-19 Crisis in Kenya

1. The COVID-19 shock has complicated fiscal management in Kenya by contributing to the materialization of important fiscal risks. The economic fallout of the pandemic led to a severe fall in tax revenue collection and mounting spending pressures to provide health and economic support to hard-hit groups, in the context of tightening financing conditions. Materialization of important contingent liabilities (SOEs) further aggravated the impact of the shock on Kenya's public finances. This significantly limited Kenya's policy choices and has required difficult trade-offs (e.g., support the economy and reducing debt vulnerabilities).

2. Against this backdrop, Kenya's government acted promptly to mitigate the impact of the shock and manage fiscal risks. In April 2020, several base-broadening measures were introduced to limit the collapse of tax revenue and improve the efficiency of the tax system (e.g., reduction of VAT tax expenditures). In addition, with the help of IMF TA, Kenya has taken steps to evaluate, monitor, and manage fiscal risks arising from SOEs in line with best practices (EBS/21/52).

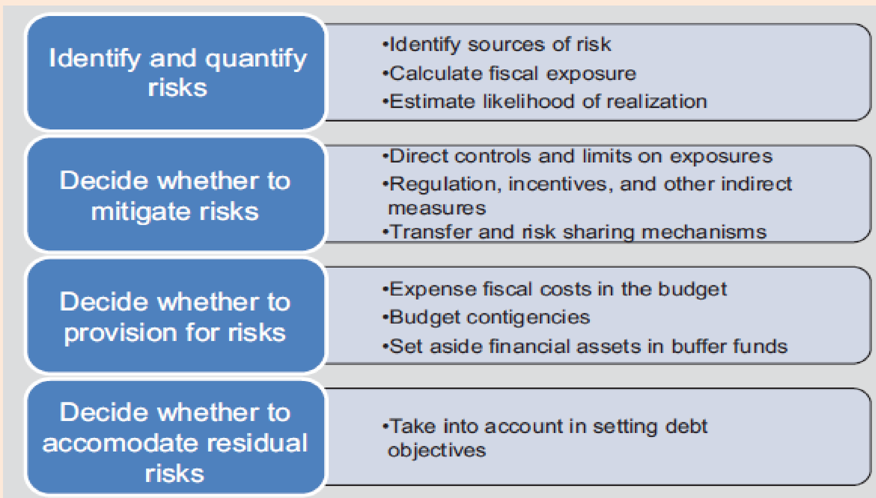
3. Going forward, a holistic approach to fiscal risks management is crucial to secure macroeconomic stability and fiscal sustainability (Graphic 1). This will require gaining a thorough understanding of the nature of existing risks and their potential budgetary implications (IMF, 2016). Based on this analysis, the authorities will have to identify appropriate mitigating measures. A transparent communication around existing fiscal risks is key to establish credibility and improve accountability (IMF, 2018), with ensuing implications for investors/creditors' sentiment—including sovereign bond ratings and access to international capital markets. Cross-country comparison suggests that Kenya's practices of fiscal risks disclosure compare favorably with respect to those in other SSA countries, but fall short of those attained by Georgia (where the coverage of reporting covers 90 percent of SOEs and quasi-fiscal operations) and other advanced country cases such as the Netherlands, New Zealand, or Australia (where reporting includes scenario analysis and stress testing).

4. The current EFF/ECF arrangements support the authorities' efforts in managing and mitigating fiscal risks (MEFP ¶29). With the help of IMF TA, the authorities have prepared fiscal risks reports covering macro-fiscal risks as well as risks arising from SOEs and PPPs. These reports will feed into the annual budget process (MEFP ¶17). The authorities are also considering steps to improve monitoring and assessment of fiscal risks across the public sector by establishing a fiscal risk management structure, to be coordinated across government institutions.

Graphic 1. Four Stages of Fiscal Risks Management

The management of fiscal risks can be divided into four stages

(i) Identifying the sources of fiscal risks and assessing their size and likelihood of realization. The objective should be to assess the maximum possible loss as well as the most likely fiscal impact. In cases where probabilities are difficult to assign, risks may be classified into categories (e.g., probable, possible, and remote) based on judgments to assess their likelihood of occurrence.



(ii) Assessing which mitigating measures could be taken to reduce fiscal exposure. Such measures could be broadly categorized as (i) those that impose a direct control aimed at limiting exposure (e.g., a ceiling on the issuance or stock of guarantees); (ii) regulation charges, incentives, and other indirect measures that would reduce risk-taking behavior (e.g., bank capital adequacy requirements, guarantee fees); (iii) risk sharing (e.g., partial guarantees) that also aims to discourage risk taking; and (iv) risk transfer to avoid or minimize impact (e.g., insurance, securitization).

(iii) Determining whether to budget for unmitigated risks. In general, three budgetary mechanisms are available to accommodate risks—appropriations for costs, rather than cash; contingency appropriations of an appropriate size that could be tapped as needed; and buffer funds-built overtime by setting aside resources for meeting the costs of larger risks should they materialize.

(iv) Determining whether additional fiscal headroom is needed to accommodate some or all remaining fiscal risks and take informed decisions on building a safety margin relative to their debt ceiling.

Source: IMF (2018).

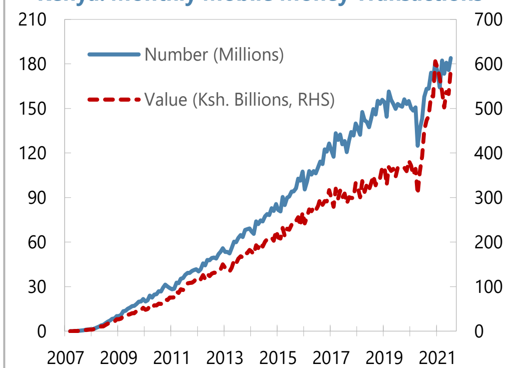
IMF, 2016, "Analyzing and Managing Fiscal Risks—Best Practices," IMF Policy Paper.

IMF, 2018, "Fiscal Transparency Handbook."

Annex V. Pandemic Spurs Digitalization[1]

1. **Kenya's advanced position in technological adoption enabled by widespread mobile phone usage helped the country adjust to the COVID-19 shock.** The country has in recent years attained essentially universal mobile phone coverage, and with that increasingly also internet access as 3G, 4G, and 5G networks have been rolled out. According to the KNBS Economic Survey, broadband internet subscriptions reached 53 percent of the population in 2020, almost all of them wireless. On a broad measure of mobile connectivity, Kenya ranks in the top five countries in Sub-Saharan Africa in terms of both level (in 2019) and increase (from 2014 to 2019). The high degree of digital adoption meant that Kenyans were with relative ease able to adopt remote working practices in response to movement restrictions and social distancing mandates imposed at the onset of the pandemic. This was seen in survey data showing that around half of Kenyans reported that they were working or could work remotely in May 2020.

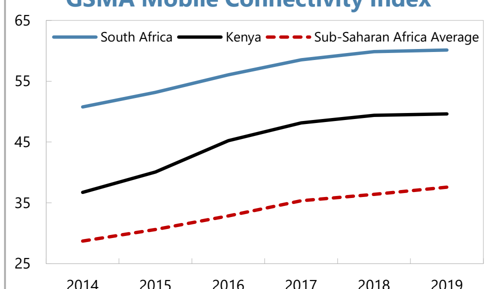
Kenya: Monthly Mobile Money Transactions



Source: Central Bank of Kenya

2. **The Kenyan authorities were able to use digital solutions to fight COVID-19 and to mitigate its impact on vulnerable groups.** Mobile technology assisted digital contact tracing, reporting, and COVID-19 test result verification via a QR code under the Trusted Travel platform. Mobile technologies were also used to scale up social protection programs, with cash transfers distributed via mobile wallets. This leveraged Kenya's ubiquitous use of mobile money—since the introduction of M-Pesa by Safaricom in 2007, the number of mobile money accounts has grown to be larger than the total population, as having more than one M-Pesa-linked mobile phone number has become common.

GSMA Mobile Connectivity Index

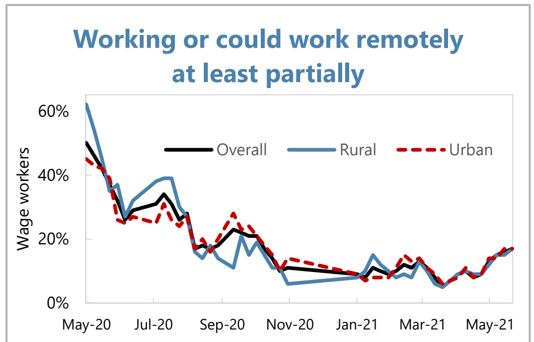


Source: GSMA.
Note: The index is an aggregate of 55 variables considered key enablers of mobile internet adoption, covering infrastructure,

3. **More generally, the pandemic spurred Kenya's preexisting digitalization drive, as the health benefits of contactless transactions became an additional advantage.** A key initiative was lowering of fees and relaxation of regulations governing mobile money, which prompted the value of transactions to almost double to now close to KSh.600 billion (about US$5.5 billion) a month. Other recent initiatives included fast-tracking the Ajira Digital Project, which aims to foster one million online jobs by linking Kenyans with digital opportunities. Moreover, the Ministry of Education has supported digital learning through several platforms; the National Police Service is implementing a digital reporting system; the Special Economic Zones Authority launched an online

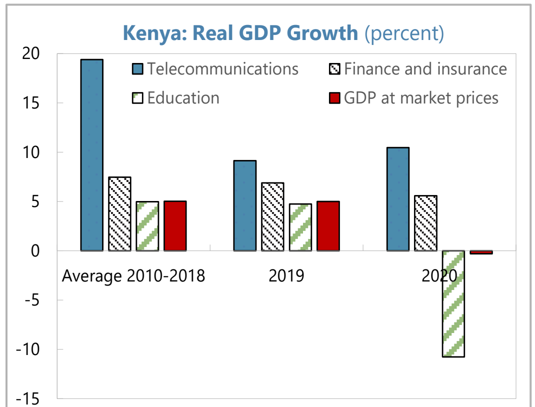
[1] Note: As part of COVID-19 containment measures, schools countrywide were closed from mid-March 2020 to the start of 2021 and (coinciding with a scheduled break) again from end-March to early May 2021.

one-stop shop portal for investors; and the Lands Ministry launched a digital land information management system (*Ardhisasa*) for processing of land transactions.



Sources: World Bank, COVID-19 Rapid Response Phone Survey Households 2020-21.

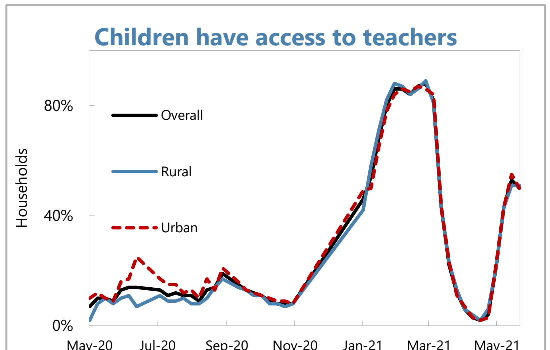
4. The digitalization drive is backed by regulatory strengthening. Recent legislation includes the Computer Misuse and Cybercrimes Act (2018) and the Data Protection Act (2019). The latter is supported by a Data Protection Commissioner appointed in late 2020. To combat crime, mobile payment service providers have been required to adhere to anti-money laundering and countering the financing of terrorism (AML/CFT) frameworks. Lastly, draft legislation that would empower the central bank to supervise digital lenders is under consideration.



Source: Kenya National Bureau of Statistics

5. Overall, Kenya's strengths in information and communication technology mitigated in important ways the downturn in economic output that resulted from the COVID-19 shock. While total real GDP growth fell from 5 percent in 2019 to -0.3 percent in 2020, telecommunications registered an increase in growth from 9.1 percent in 2019 to 10. 5 percent in 2020. Finance and insurance, another ICT heavy sector that was able to largely avoid disruptions to operations by moving online, also maintained healthy growth, at 5.6 percent in 2020.

6. More widespread digitalization could have further reduced the decline in economic output. One of the main drivers of the overall GDP loss in 2020 was a 10.8 percent decline in output of education services. This occurred as schools were closed during April-December 2020 and again in April 2021. This left many students without access to teachers, driving down the measured output of education services. Had more students been able to participate in online learning, education output would not have fallen so much. The constraint to more widespread access to on-line learning, and internet adoption generally, is primarily the cost of acquiring and using smartphones, given that these are the main way of accessing the internet in Kenya. According to a survey by GSMA, 48 percent of Kenyan adults cited affordability as the top barrier to mobile phone usage in 2019.



Sources: World Bank, COVID-19 Rapid Response Phone Survey Households 2020-2021.

Annex VI. Lending Capacity of the Kenyan Banking System

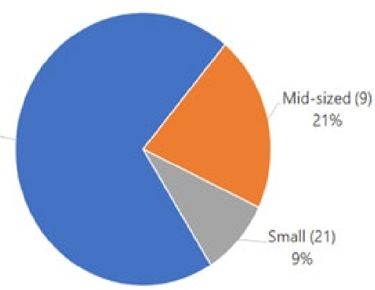
This annex estimates the capacity of the Kenyan banking system to satisfy anticipated financing needs of the government without crowding out the credit needs of the private sector. The partial analysis is based on a simple model that projects the major funding sources of commercial banks, including deposits, borrowing, and other liabilities as well as equity capital based on macro-framework projections, historical data trends and judgment. It finds that banks would be able to meet the government's borrowing needs in the baseline without hurting private credit growth; but the result could be different if there is significant deviation from government borrowing projected in the program.

A. Background

1. The banking system in Kenya is relatively well-diversified. It is comprised of 39 commercial banks: 20 private commercial banks (67 percent of system assets); 17 foreign banks (32 percent); and 2 small state-owned institutions (1 percent). Of the 17 foreign banks, 14 operate as subsidiaries, while three are branches. By size or tier groups, there are: 9 large banks (70 percent of banking system assets); 9 mid-sized banks (21 percent); and 21 small banks (9 percent of assets).

Banking System Assets by Tier Groups

(June 2021) 1/ 2/



Source: Central Bank of Kenya

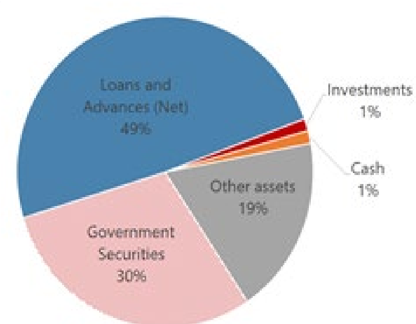
1/ Total assets of 5.7 trillion KSH (51 billion USD, 46 percent of GDP)

2/ Number of banks in brackets; percentages are for assets

2. Banks' carry significant exposure to government securities. Holdings of government securities are 30 percent of assets, which is relatively high in proportion to banks' loans to the private sector (49 percent), while the remainder of banks' assets is comprised of cash, investments, fixed and other assets. Among bank loans, some 28 percent are for consumer purchases,14 percent relate to real estate, and the remaining 58 percent are comprised of loans to various sectors of the economy, including for trade, transport, manufacturing, and agriculture. Foreign currency loans are about one-quarter of all loans extended by banks in the system. The sector's asset base grew by 12.4 percent in 2020, at a pace slightly higher than in 2019, driven mainly by investment in government securities and private sector loans.

Banks' Assets

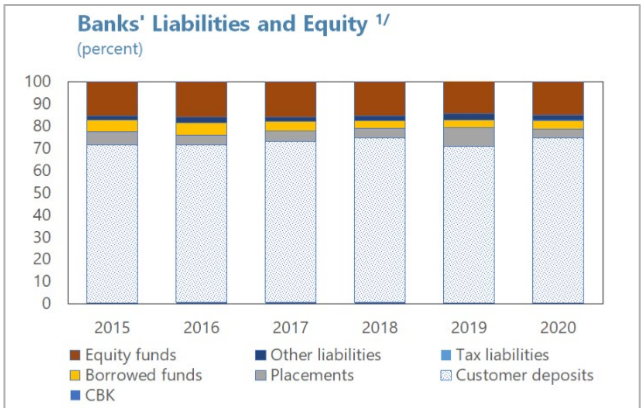
(December 2020) 1/



Source: Central Bank of Kenya

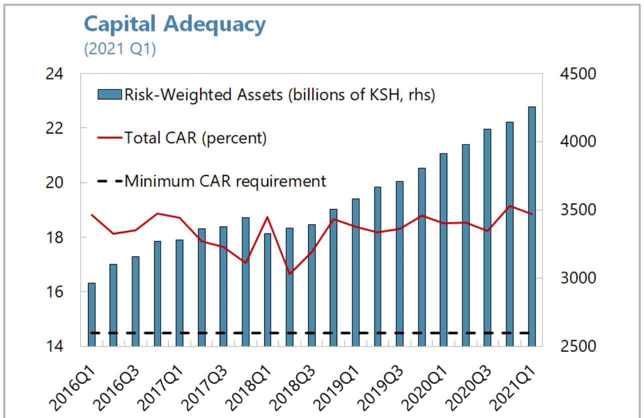
1/ Total assets of 5.4 trillion KSH

3. Customer deposits are banks' main source of funding, accounting for 75 percent of funding at end-2020. During the COVID-19 pandemic, customer deposits grew at annual pace of 13.7 percent in 2020 despite the fall in economic activity. This exceeded the 11 percent growth in 2019, benefiting in part from higher government spending, remittances, lower customer spending in lockdowns, and deposit mobilization via digital and mobile banking.



Source: Central Bank of Kenya
1/ Total liabilities of 5.4 trillion KSH

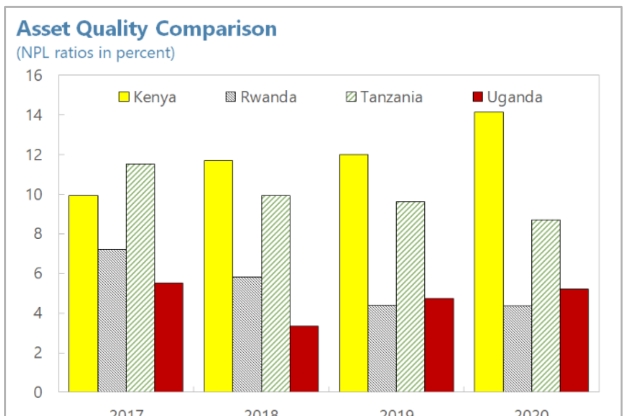
4. In aggregate, banks entered the pandemic with adequate capital and liquidity buffers, although with some variation among different tier groups. Banks' aggregate capital adequacy ratio (CAR) stood at 18.9 percent at end-June 2020, almost unchanged from the pre-pandemic level, and above the 14.5 percent regulatory threshold. However, six banks, with assets of 4.1 percent of the total system, breached the CAR minimum requirement during 2020. Some small banks were undercapitalized relative to the minimum requirement. During 2020, liquidity of the overall banking system remained well above the minimum required liquidity ratio, although some small banks continued to rely on central bank liquidity support.



Source: Central Bank of Kenya

5. The authorities' proactive policy measures to cushion the impact of the pandemic on borrowers also supported banks.

- On the asset side, the CBK encouraged banks to offer borrowers who were current at the onset of the pandemic the chance to restructure their loans and provided some flexibility in banks' classifications of these restructured loans.[1] About half of all banks' loans were restructured, of which 93 percent had resumed timely repayment of principal and interest by end-August 2021. The overall NPL ratio rose by only about 2 ppt since the start of the pandemic to 13.9 percent at end-August 2021, although NPL ratios were somewhat higher at mid-sized and small banks. NPLs were



Source: IMF FSI

[1] The program for restructuring banks' loans during the pandemic expired in March 2021.

highest on loans for trade and manufacturing followed by those to households for consumer and mortgage loans.

- Banks' liquidity in aggregate was supported by significant holdings of government securities and the CBK's actions in lowering the banks' reserve requirement by 100 bps and extending the maturity of repo financing from 28 to 91 days.
- The CBK also helped to bolster banks' earnings and their retention by lowering the policy rate by 125 bps and requiring approval for any dividend payouts. Banks' after-tax profit declined by 28 percent to KSh.304 billion in 2020, largely on account of provisioning against potential credit losses, but has since recovered during 2021, benefiting from some release of provisions, recoveries, and stable margins on credit growth.

B. Methodology for Assessment of Private Sector Credit Capacity

6. The assessment is based on a simple model that projects the major funding sources of commercial banks, including deposits, borrowed funds, placements, other liabilities, equity and retained earnings using the macroframework, historical information and judgment. Specifically, total assets for the next period (A_{t+1}) is equal to the sum of total deposit liabilities (D_{t+1}), borrowed funds for next year (BF_{t+1}), placement accounts PA_{t+1}, other liabilities OL_{t+1}equity capital (E_t) and retained earnings for the next period (π_{t+1}).

$$A_{t+1} = (D_{t+1} + BF_{t+1} + PA_{t+1} + OL_{t+1}) + E_t + \pi_{t+1}$$

The change in asset size is:

$$\Delta A_{t+1} = A_{t+1} - A_t$$

The marginal capacity of the banking system to provide financing is estimated by the change in the projected asset size, which is assumed to be allocated to cash reserves and investment in government securities, and the residual is allocated to private credit.

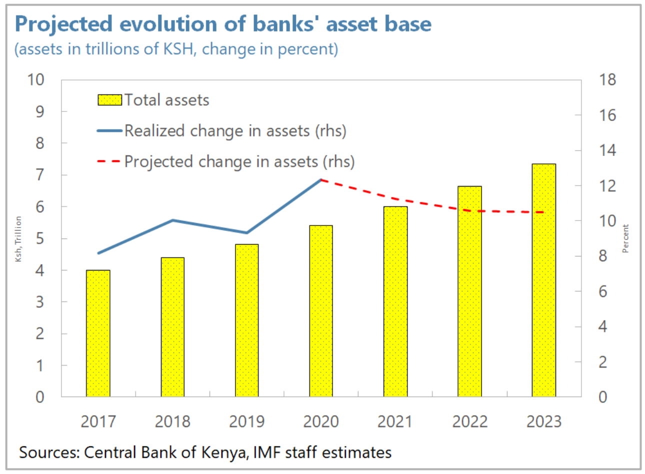
C. Key Assumptions

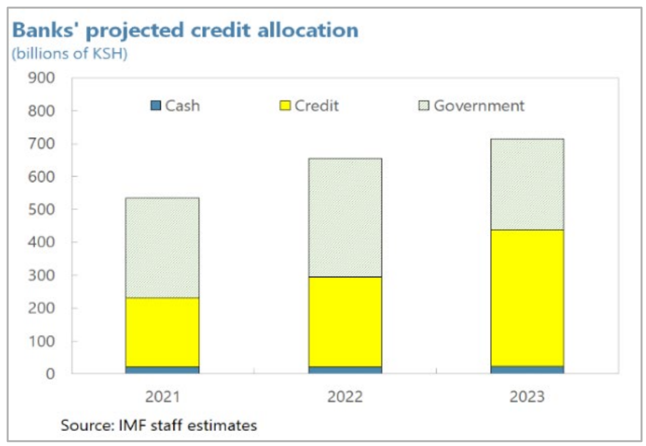
- Customer deposit growth D_{t+1} is linked to nominal GDP growth. (This might be considered a conservative assumption as deposit growth of 13 percent during 2020 significantly outpaced growth in nominal GDP of 4.8 percent.)
- Borrowed funds, placements, other liabilities ($BF_{t+1}, PA_{t+1}\ and\ OL_{t+1}$) are projected by using a simple average of recent history and judgment.
- No banks exit the system and equity capital (E_t) remains constant
- Profit growth is linked to GDP growth and the proportion of profits retained is determined by the historical average retention ratio.

D. Assessment and Findings

Baseline Scenario

7. The resulting change in the asset base of the banking sector (ΔA_{t+1}) is estimated to average 10.6 percent per year from 2021 to 2023 based on historical trends. Banks' cash reserves are equal to the minimum required reserve ratio set by the CBK, which is assumed to remain unchanged through 2023.





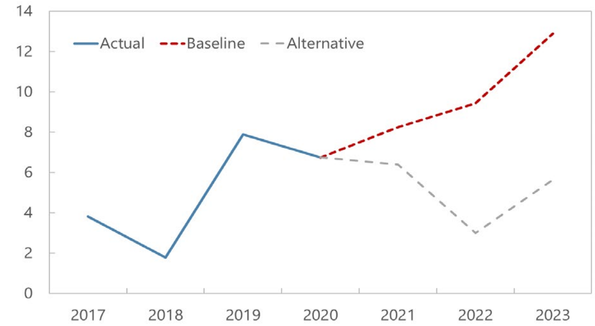
- Banks' holdings of government securities follow the borrowing requirement in the program macroframework, which anticipates needs during 2021–23 of 5.3 percent of GDP, 4.7 percent, and 3.3 percent respectively. The NDF of government for 2021 has been adjusted for SDR resources on-lent by the Central Bank. This is estimated to result in an average increase in banks' holdings of government securities by 21.5 percent in 2021 and 17.6 percent and 11.7 percent in 2022 and 2023, respectively in line with the fall in the borrowing needs of government. Non-bank holdings of government securities are held constant at a historical level of 45 percent of net domestic financing during the projection period.

8. Based on the methodology and assumptions above, banks were found able to meet the government's programmed financing needs without crowding out private sector credit in a baseline scenario. In this scenario, banks are projected to expand lending to the private sector at an average rate of 10.2 percent a year for the next three years. On an annual basis, this would be based on lending growth of 8.4 percent in 2021, 9.1 percent in 2022 and 12.6 percent in 2023.

Alternative Scenario

9. However, in an illustrative alternative scenario, in which the government's financing needs rise significantly above the program level, private sector credit does get crowded out. With other factors being held constant, an increase in the government's net domestic financing needs by 3 ppt, scaled to the last quarter of 2021 and applied fully in 2022 and 2023, causes banks to increase their holdings of government securities by 26 percent, 28 percent, and 20 percent, respectively. This causes private sector credit growth to fall by an average of 5 ppt versus the baseline. This implies that while the banking sector can accommodate some flexibility in fiscal policy, a large deviation of government spending beyond the program level could significantly hamper recovery in private sector credit.

Projections of Private Sector Credit Growth
(percent)



Sources: Central Bank of Kenya, IMF staff estimates

Other Scenarios

This analysis does not take into account that underlying drivers of credit growth could be impacted by various factors:

- It could be supported by continued rollout of vaccines and improved business conditions due to easing of COVID-19 containment-related restrictions. For qualifying borrowers, the continued rollout of the Credit Guarantee Scheme (CGS) introduced by government and the CBK in December 2020 could mitigate credit risk to lenders to support greater credit expansion to MSMEs that have faced tight credit conditions in recent years.
- It could be lower if economic activity were to fall in response to additional waves of COVID-19, which could further weaken asset quality and tighten underwriting credit standards by banks.

E. Policy Implications

- Overall, the exercise indicates that the financial sector in Kenya is adequately positioned to accommodate flexibility in fiscal policy under the program without denying the private sector the resources needed to support economic recovery. However, a substantially large increase in the net domestic financing (NDF) needs of the government beyond the program level could significantly hamper the recovery in private sector credit growth unless matched by a commensurate increase in banks' funding sources or additional increase in non-bank holdings of government securities.
- In the wake of the pandemic, banks should continue to strengthen profitability by adapting their business models, expanding lending opportunities, continuing to develop digitalization and mobile banking, promoting non-interest business activity, and improving cost-efficiency.
- The authorities should continue to take steps, as noted in the 2021 CBK Financial Stability Report, to strengthen the capital, liquidity and profitability of small banks by encouraging consolidation to achieve scale.

Annex VII. Capacity Development Strategy

A. Context

1. **Kenya's economy was performing well before the COVID-19 shock, although with increasing debt vulnerabilities.** Real GDP growth averaged 5.0 percent over 2010-19 and poverty fell steadily in an environment of contained inflation and external stability. However, declining government revenues as a share of GDP alongside large infrastructure investments partly financed by non-concessional borrowing contributed to rising fiscal deficits and debt vulnerabilities.

2. **Starting in March 2020, the COVID-19 pandemic had large negative effects on the economy.** In 2020Q2, real GDP growth contracted by 4.7 percent year-on-year as domestic COVID-19 containment measures and disruptions to international trade led to a marked reduction in economic activity. At the same time, government revenue fell by 20.5 percent in nominal terms, with tax cuts to cushion the impact of COVID-19 on the private sector offsetting measures to streamline tax exemptions. Real GDP contracted by 0.3 percent in 2020, and the government deficit widened to 8.2 percent of GDP in FY2020/21.

3. **While the recovery from the COVID-19 shock is now well underway, Kenya's economy remains highly vulnerable.** Government revenue as a share of GDP, despite the ending of the COVID-19 tax cuts from the start of 2021, remains well below pre-COVID levels. Public debt, at 70.4 percent of GDP at end-June 2021, is at high risk of distress. Key state-owned enterprises face deep financial problems, and banks' NPL ratio increased to 14.0 percent at end-June 2021.

4. **With IMF support, the authorities have embarked on a comprehensive program to address the economic vulnerabilities and lay the ground for durable and inclusive growth over the years to come.** Following a US$739 million RCF disbursement in May 2020, the IMF Board on April 2, 2021, approved 38-month US$2.34 billion EFF/ECF arrangements to support the next phase of the authorities' COVID-19 response and their plan to reduce debt vulnerabilities while safeguarding resources to protect vulnerable groups. The central objective of the EFF/ECF is to over the course of the program put Kenya's debt-to-GDP ratio on a downward path. This would be achieved by reducing the budget deficit through a combination of revenue mobilization and spending rationalization measures. The program also includes measures to promote greater transparency in public accounts, strengthen the anticorruption framework, and address weaknesses in key state-owned enterprises.

5. **The CD agenda for the period ahead will support the objectives of the authorities' economic program, by helping strengthen economic management via revenue mobilization, improved PFM, financial stability, reliable statistics, and good governance.** Within each of these areas, CD activities should in the near term prioritize pressure points arising from the COVID-19 shock. A key initiative will be to support the development of a Medium-Term Revenue Strategy (MTRS).

6. The CD agenda builds on recent TA. In revenue mobilization, the focus in the past two years has been on tax policy, with emphasis on streamlining tax expenditures; on strengthening revenue administration, including via strengthening of risk-based compliance management and completion of a second TADAT; and on extractive industries. In PFM, the focus has been on cash management, budget preparation frameworks, public investment management, fiscal risk management, and SOE oversight, including development of frameworks for financial evaluation and for medium-term reform plans. A fiscal transparency evaluation update was completed in early 2020. In the financial area, the emphasis has been on modernizing the monetary policy framework and on strengthening the supervisory framework. In statistics, the focus has been on broadening coverage and moving to accrual accounting in GFS, external sector, price statistics, and national accounts rebasing. In financial integrity, the focus was on strengthening the functioning of the financial intelligence unit and AML/CFT risk-based supervision.

7. Past CD has had a positive impact. Fund TA has supported important progress made in reducing tax exemptions and broadening the tax base, with measures to raise more than 1 percent of GDP introduced in legislation passed in mid-2020. PFM systems have been strengthened, with creation of a new PIM unit in the National Treasury, a budget preparation manual for national government as well as actions to improve liquidity and expenditure chain management in line with the spirit of a treasury single account. Functional departments have in most areas assessed the effectiveness of past TA as high, with the financial and statistics areas viewed particularly favorably.

B. CD Strategy and Priorities

Priorities	Objectives	Challenges
Revenue mobilization (tax policy and revenue administration)	Develop a Medium-Term Revenue Strategy that over the medium term raises tax revenue to at least 15½ percent of GDP to support fiscal consolidation. At local government level, develop own-source revenue in line with the framework for fiscal decentralization.	• Balancing revenue mobilization with support to the economy given the COVID-19 shock. • Tradition of widespread tax incentives. • Opposition to tax increases in pre-election environment. • Limited capacity to raise revenue at county level.
Public Financial Management	Fiscal consolidation plans are credibly anchored in medium term budget and PIM processes. A Fiscal Risk Committee is established to ensure that fiscal risks are comprehensively identified, reported, and managed, including those stemming from SOEs and PPPs. IFMIS systems integration, including a common payroll system, is used across general government and most transactions go through a TSA. Fiscal reporting is strengthened with coverage extended to general government and move to accrual accounting at measured pace.	• History of gaps between budgets and outturns, especially for revenue, and between investment pipeline and MTEF. • Large number of SOEs and extrabudgetary units that are weakly integrated in PFM and fiscal reporting systems. • Weak commitment controls. • Delayed exchequer automation.

Priorities	Objectives	Challenges
Financial Supervision and Regulation	Bank and non-bank supervisory and regulatory frameworks are strengthened with effective implementation of risk-based systems.	• Large proportion of bank loans restructured due to COVID-19. • High NPLs.
Financial Market Infrastructure & Payments	Strengthen the payment system supervisory framework.	• Limited capacity in assessing international standards for payment, clearing and settlement systems.
Central Bank Operations	Monetary policy is made more effective by completing transition to inflation targeting framework to better anchor inflation expectations and stabilize short-term rates close to the policy rate.	• Weak transmission from policy rate to banks' deposit and lending rates. • Interbank market is segmented and volatile.
External Statistics	Improve the timeliness and frequency of publication of BOP statistics and reconcile data on external private debt from different sources, with a view to publishing official IIP statistics.	• Increased focus on private sector debt burden has drawn attention to differences in available information.
Governance and Anti-Corruption	Strengthen governance and anti-corruption frameworks to ensure effective use of public resources with enhanced transparency and accountability.	• Legal framework is incomplete. • Large backlog of cases in courts.

8. **The above priorities are a subset of the broader CD agenda for Kenya, much of which will be covered by East AFRITAC (AFE) as part of their regular ongoing support.** The priorities and larger CD agenda are aligned with the IMF's surveillance and program operations in Kenya.

C. Engagement Strategy

9. **Challenges to effective CD provisions depend on the area.** The main risk to fiscal TA is weak capacity and bottlenecks in decision making at the Treasury. With general elections scheduled for August 2022, tax policy is further complicated by resistance in parliament to tax increases. Kenyan courts have also taken a more activist approach striking down attempts to introduce a minimum alternative tax and even the regular inflation adjustment of excise rates. Across areas, resource constraints (especially at Kenya National Bureau of Statistics, e.g., to conduct agriculture surveys) and high staff turnover (especially at the Central Bank of Kenya) are obstacles to progress. On governance, some topics could become political, with risk that Fund advice is distorted or becomes unintentionally controversial.

10. **To overcome these challenges, Fund CD should be mindful of implementation constraints.** Missions should always evaluate staffing requirements when providing recommendations. Implementation of some reforms may require an expansion or reallocation of staff. Where necessary, need for additional budget allocations will be raised with policymakers by AFR. TA planning will be coordinated with the authorities, Fund Departments, AFE, and development

partners, with a view to maximizing government ownership, consistency of objectives, and effective resource use.

D. Priorities by Department

I. FAD

Topics	Objectives
Public Financial Management	Comprehensive, credible, and policy-based budget preparation; improved PIM; improved coverage and quality of fiscal reporting; improved asset and liability management; strengthened identification, monitoring, and management of fiscal risks.
Revenue Administration	Strengthen revenue administration management and governance arrangements and core tax functions; and improve customs operations. Support to design and implement the MTRS measures. Redesign high net worth individuals' function; develop capacity in digital services tax practices and assessment of legislative framework, processes, and procedures; develop a framework for exports and imports data matching; strengthen data analytics capacity; customs monitoring of oil exports; and post clearance audit and risk management.
Tax Policy	In developing and implementing the MTRS, continue to advance agenda for reducing tax expenditures and broadening the tax base in line with Fund TA recommendations (e.g., by following up on modernization of the property tax) to reverse the declining trend of tax revenues. Review progress in policy refinement, implementation, and revenue outcomes.

II. MCM

Topics	Objectives
Financial Supervision and Regulation	Enhance risk-based supervision and Basel II/III implementation. Strengthen supervisory processes in nonbanks.
Monetary and Macroprudential Policy	Accelerate the modernization of the monetary policy framework and operations and integrate FPAS into monetary policy decision making. Develop and strengthen macroprudential policy tools (heatmaps, network analysis, financial soundness indicators, financial stability analysis tools).
Payments and Financial Markets Infrastructure	PFMI training and assistance to CBK to conduct self-assessment of KEPPS against the PFMI and its regulatory framework against the five responsibilities of the PFMI.

III. STA

Topics	Objectives
Government Finance Statistics	Monthly GFS (for budgetary central government), quarterly GFS (for central government), and annual GFS (for public sector) are compiled according to GFSM 2001/2014 and disseminated on timely basis.
External Sector Statistics	Improve the timeliness of publication of annual BOP statistics in IFS and make progress in submitting quarterly data. Improve data on external private debt and publish official IIP statistics at annual frequency. Make progress in producing quarterly data.
Real Sector Statistics	New exports and imports indexes are compiled and published. Sector accounts are compiled and published. Data on crop and livestock production are compiled and disseminated. Development of Monthly Indicator of Economic Growth (MIEG) using the already compiled leading indicators.

IV. LEG/ICD

Topics	Objectives
Enhance public sector disclosure and integrity	Support implementation of Access to Information Act for Government Administration (2016). Support the conflict-of-interest regime reform in draft.
Enhance accountability and rationalization of SOE portfolio	Support implementation of blueprint for SOE reforms.

E. Summary

11. **Kenya is a high-intensity TA country.** TA focuses on tax policy and revenue administration, including development of a medium-term revenue strategy; public financial management; the regulatory and supervisory framework for the financial sector; monetary policy analysis and macroeconomic forecasting; and on government finance, national accounts, and balance of payment statistics.

Appendix I. Letter of Intent

Nairobi, Kenya, December 2, 2021

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

Dear Ms. Georgieva:

It has been close to two years since COVID-19 first emerged and the world is still struggling with the pandemic. In Kenya, we have experienced four consecutive waves of cases. With the most recent wave having peaked in August 2021, the number of new infections is currently near the lowest we have seen since the start of the pandemic. This encouraging development notwithstanding, it would be imprudent to assume that COVID-19 is behind us in Kenya while the virus is still prevalent globally. Protecting the health of our population remains our top priority and we are not letting our guard down. Aided by increased international vaccine availability in the last few months, we are accelerating our vaccination drive. Our target is to vaccinate 10 million people by end-2021 and to have all adults (26 million people) fully vaccinated by end-2022.

Following last year's unprecedented shock, we are now firmly on the road to bringing our economy back to full strength. The resolute measures we have taken to support households and businesses during the pandemic protected vulnerable groups and tempered the reduction in economic activity. Real GDP contracted by a comparatively modest 0.3 percent in 2020 and growth has been rebounding robustly in 2021. These successes notwithstanding, the pandemic left a deep imprint on our country. Ensuring progress towards our development objectives places demand in many areas at a time when Kenya continues to be exposed to the impacts of climate change (drought) and security risks. We must tend to the immediate pressures in public health, regain ground lost in education from when schools were closed, and secure inclusive growth for the long term.

Our economic program is anchored on a medium-term plan that, in response to the COVID-19 shock, sought to balance near-term support for the economy with a multi-year plan for bolstering macroeconomic stability. The program, which is supported by arrangements under the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF), had four main objectives: (1) in the near term, ensure an effective COVID-19 response that maintains support for our health sector and those most impacted by the shock to the economy; (2) reduce debt vulnerabilities through a revenue-driven fiscal consolidation so that the ratio of public debt to GDP stabilizes and is put firmly on a downward path during the program; (3) advance the structural reform and governance agenda and address weaknesses in state-owned enterprises (SOEs); and (4) strengthen the monetary policy framework and support financial stability.

We remain firmly committed to our IMF-supported program and are encouraged by the results that have been achieved to date. We note with satisfaction that all quantitative program targets for the end-June 2021 test date were met. This includes, importantly, the target for the primary balance of the national government in FY2020/21, which at KSh.-455.12 billion (-4.0 percent of GDP) came in well above the floor. Our structural reform agenda has experienced some delay, due in part to legal complications, but we expect to have the one outstanding structural benchmark implemented expeditiously and, in any event, by no later than end-March 2022. We now have clarity on our vaccination program and requirements for addressing challenges in state-owned enterprises (SOEs) and have reflected this in our spending plans. In line with our very strong commitment to the program, a small adjustment of program targets is needed to reflect recent pressures relating to the drought and security situation in our northern regions. Therefore, we request modification of the end-June 2022 quantitative performance criterion (QPC) for the primary fiscal deficit. We also propose to update the methodology for the calculation of the QPCs for net international reserves for both end-December 2021 and end-June 2022 and the QPC on the debt limit. Planned on-lending of a portion of Kenya's SDR allocation to meet fiscal financing needs, consistent with domestic laws, will be based on an appropriate memorandum of understanding between the CBK and National Treasury.

Looking ahead, we believe that the policies and actions set out in the attached Memorandum of Economic and Financial Policies (MEFP) will enable us to achieve our program objectives. We are committed to working closely with IMF staff on additional measures that may be required to meet program objectives. We will work closely with IMF staff to ensure that the program is successful and will provide the IMF with the relevant information necessary for monitoring our progress.

We authorize the publication of this letter of intent, the attached MEFP and technical memorandum of understanding, and the related staff report upon clearance with the authorities.

Sincerely yours,

/s/	*/s/*
Hon. (Amb.) Ukur Yatani, EGH	**Dr. Patrick Njoroge, CBS**
Cabinet Secretary	Governor
National Treasury & Planning	Central Bank of Kenya

Attachments (2):

I. Memorandum of Economic and Financial Policies (MEFP)

II. Technical Memorandum of Understanding (TMU)

Attachment I. Memorandum of Economic and Financial Policies

Nairobi, Kenya, December 2, 2021

I. BACKGROUND

1. **New COVID-19 cases in Kenya have declined in recent months but uncertainty about the future course of the pandemic remains high.** After suffering a fourth wave that peaked in August 2021, COVID-19 numbers in Kenya have fallen significantly. Overall, the country has been managing well, with as of end-October less than 5 recorded cases per 1,000 population and a case fatality rate of around 2 percent. However, future waves of COVID-19 cannot be ruled out, given the uncertainty associated with the evolution of the pandemic globally and the still low level of vaccination coverage in Kenya.

2. **Our vaccination program is picking up speed.** The key challenge we have faced is obtaining vaccines from abroad. That constraint is gradually being overcome, with increased vaccine supply since mid-2021 from donations as well as our own procurement. This has enabled a rapid acceleration of our vaccination drive. By end-October we had administered 5.3 million doses and 6 percent of adults had been fully vaccinated. Our vaccination program is supported by a World Bank project approved at end-June 2021, which provides US$130 million in financing for vaccine procurement and deployment. That program will enable procurement of some 13.3 million doses of the Johnson & Johnson vaccine for which deliveries started in September. We are also expecting further supply from COVAX and via bilateral donations on top of what has already been received.

3. **Protecting the health of our population remains our top priority.** Our aim is to vaccinate 10 million people by end-2021 and to fully vaccinate all adults (26 million people) by end-2022. In the near term, we are prioritizing vulnerable groups, including health workers, teachers, and those above 58 years of age. We are conducting awareness campaigns to help ensure that all those eligible get vaccinated. We have also continued to enforce containment measures to limit the spread of the disease, including restrictions on large gatherings. As more people are vaccinated and we come closer to herd immunity, we expect to gradually remove remaining containment measures, allowing for a full reopening of the economy. Nevertheless, we will continue to vigorously monitor COVID-19 developments and stand ready to tighten containment measures if necessary.

4. **The economic fallout from COVID-19 has been limited by proactive measures to support households and businesses through the crisis.** Policies under our 8-point *Economic Stimulus Program* (ESP) included a new employment program to support the youth, a guarantee scheme to ease access to credit for small businesses, cash transfers to the vulnerable members of society, and fast-tracked payment of VAT refunds and other government obligations. We also reduced temporarily the tax burden on individuals and corporations in the context of the Tax Law Amendment Act (2020), to provide additional disposable income to households and businesses. Moreover, the Central Bank of Kenya (CBK) lowered its policy rate, introduced a range of liquidity support measures, and temporarily eased repayment conditions for borrowers to support businesses

and households impacted by the pandemic. The CBK also coordinated the reduction of charges on mobile money usage to encourage contactless transactions.

5. **With the economy supported by these policies, the contraction in activity was limited and a recovery is now well underway.** The recently released rebased national accounts show that real GDP contracted by a modest 0.3 percent in 2020, as year-on-year growth fell to -4.7 percent in the second quarter of 2020 but then started to rise, reaching 1.2 percent in the fourth quarter. High frequency indicators suggest that the recovery continued to gather pace in 2021, despite successive waves of the pandemic. Electricity production grew by almost 8 percent y-o-y in the first half of 2021, while cement consumption grew by over 25 percent. While most service sector activities have largely recovered, tourism remains subdued, with airport arrivals up to June 2021 at less than half of pre-pandemic levels.

6. **Inflation has remained within our target range of 2.5–7.5 percent amidst increasing food and fuel prices.** Rising domestic food prices and a recent surge in fuel prices pushed headline inflation from 5.9 percent in March to 6.9 percent in September 2021. However, it declined to 6.5 percent in October 2021 reflecting a reduction in pump prices. Nevertheless, non-food/non-fuel inflation has remained anchored under 3 percent.

7. **Kenya's external position is on the path of normalization following the COVID-19 shock.** In 2020, the current account deficit narrowed to 4.5 percent of GDP as favorable weather patterns boosted horticulture and tea exports, imports slowed on the back of reduced demand and lower energy prices, and remittances bucked the global downward trend. These developments more than offset the negative impact of the COVID-19 shock on international travel and transportation receipts. In the first half of 2021, goods exports grew by 11.1 percent y-o-y in US dollar terms, driven by bumper horticulture output. Imports also rose strongly, with energy and non-energy imports growing by 32 and 20 percent, respectively. The shilling, which acted as a shock absorber with an 8 percent depreciation against the US dollar in 2020, stabilized in 2021. Foreign exchange reserves were bolstered by significant inflows in the second quarter of 2021, including Eurobond issuance of US$1 billion, US$750 million in budget support from the World Bank, and two disbursements totaling US$715 million from the Fund under the present program. At US$9.6 billion at end-September, reserves continue to provide adequate cover against short-term external shocks.

8. **Public finances performed strongly in FY2020/21, despite the challenging environment.** The overall fiscal deficit was contained to KSh.929 billion, compared to KSh.956 billion projected under the first reviews of the EFF/ECF arrangements. This reflected stronger-than-anticipated tax collection on the back of revenue mobilization measures introduced during the year, including the ending on January 1 of most of the temporary tax cuts introduced in April 2020. The outturn also reflected continued efforts to restrain non-priority spending that kept total spending slightly below the program level despite increased needs in some areas due to the COVID-19 crisis. The Corporate Minimum Tax (CMT), which had been introduced at the start of 2021 at a rate of 1 percent of gross turnover, faced legal challenges. Collection of this tax was halted by court order in April and in September found unconstitutional. We have, however, appealed this decision.

9. Budget performance so far in FY2021/22 has been good. Tax collection has continued to benefit from the rebound in economic activity as well as the ongoing strengthening of tax administration. In the first quarter of FY2021/22, revenue was KSh.6.5 billion higher than the budget target while expenditure was slightly under-executed reflecting the continued tight expenditure controls.

10. In the wake of the pandemic, the banking sector has remained stable and resilient. We took policy actions at the start of the pandemic to allow banks to restructure their loan portfolios, and we lowered the policy rate by 125 bps. The maximum tenor on liquidity-injecting reverse repo instruments was increased from 28 to 90 days. About half of all banks' loans were restructured by end-March 2021. By end-August 2021, following repayments and reversion to normal terms, the outstanding restructured loans amounted to 16 percent of total loans, of which 93 percent were performing as per the restructured terms. These measures helped to provide immediate support that enabled households and businesses to navigate the liquidity shock from the pandemic, thus sustaining the resilience of the economy. Banks' asset quality was also preserved, as the overall NPL ratio rose by only about 2 ppt from the start of the pandemic to 13.9 percent at end-August, and the cost of funding lowered. Banks' profitability, which dropped sharply during 2020 due to higher provisioning, has been recovering during 2021. The overall banking system has remained adequately capitalized, with total CAR at 18.9 percent, above the minimum requirement of 14.5 percent. Liquidity, which has remained above the minimum regulatory requirement, has been supported by large holdings of government securities, while banks' funding has been supported by strong deposit growth (12 percent in 2020). Helped by our proactive policies, credit to the private sector continued to expand at a broadly steady pace throughout the pandemic, with 7.7 percent growth y-o-y in September 2021. We are in the process of strengthening financial safety nets. Deposit insurance, which covers all deposit taking institutions licensed by CBK, was recently expanded from 100 to 500 thousand shillings per depositor. The ex-ante funded deposit insurance fund covers about 18 percent of insured deposits and is growing swiftly towards meeting the IADI target of 30 percent coverage.

11. Our Economic Recovery Strategy (ERS) aims at putting the economy on a strong and sustainable growth path. The ERS builds on the gains made under the Economic Stimulus Program (ESP) and focuses on the following policy priorities: (i) enhancing budgetary allocations to strengthen healthcare systems; (ii) investment in ICT and digital infrastructure; (iii) enabling the private sector to play a larger role in the recovery strategy; (iv) facilitating a green and resilient recovery; (v) enhancing the resilience of the economy to global supply chain shocks; (vi) support to MSMEs; (vii) full and timely implementation of the ESP; (viii) enhancement of targeted social protection; (ix) strengthening the national capacity for disaster risk management; (x) mainstreaming diaspora financial and intellectual resources; (xi) enhanced budgetary support to police and security related services to enforce compliance to COVID-19 containment rules and regulations; (xii) strengthening governance and economic management; (xiii) expediting the implementation of policy, legal and institutional reforms; and (xiv) strengthening monitoring and evaluation systems.

II. MACROECONOMIC OUTLOOK

12. Our baseline outlook is for a gradual continuation of the ongoing rebound in economic activity. We expect growth to rise to 5.9 percent in 2021, driven partly by strong base effects, and then to settle at about 5.5 percent over the medium term, with a slightly increasing trend as the program anchors confidence and boosts investment. Inflation is projected to return to near the mid-point of the CBK target range during 2022 and stay near that level through the medium term, as monetary policy continues to anchor price expectations. The external current account deficit is expected to stabilize around 5 percent of GDP over the medium-term.

13. The economic environment continues to be subject to unusually high uncertainty. Uncontrolled outbreaks of the COVID-19 pandemic, globally or locally, could undermine Kenya's nascent recovery and increase fiscal and external pressures. Terms-of-trade shocks from higher prices of imported commodities would widen the current account deficit and heighten inflation pressures while Kenya, like all other countries, could be subject to spillovers in global capital markets from policy responses in the major economies. On the domestic side, the upcoming general elections could pressure budget execution and reform implementation, while socio-political tensions could rise. Materialization of contingent liabilities from SOEs, if not met by a strong response, could undermine fiscal consolidation efforts, leading to slower reduction in public debt and pressure on FX reserves in the medium term. To help manage risks, we intend to keep half of the recent SDR allocation (US$738 million) as reserves at CBK while the other half will be on-lent to Government to help meet budget financing needs in FY2021/22.

III. PROGRAM PERFORMANCE AND POLICIES

A. Program Objectives

14. Our primary policy objective is to secure a strong post-COVID-19 recovery with robust and inclusive growth. Our economic policy plans—outlined in the ERS and supported by our EFF/ECF arrangements with the IMF—place a special focus on (i) promoting good macroeconomic management through prudent debt policies and reforms to improve the efficiency of public spending and (ii) fostering good governance in the management of public resources. Our key policy priorities include in particular:

- ***COVID-19 response.*** Vaccinate all adults, ensure provision of required health services, address urgent needs of vulnerable groups, and support economic activity.
- ***Fiscal policy.*** Undertake growth-friendly fiscal consolidation to preserve debt sustainability by bolstering revenue primarily through broadening of the tax base and curtailing overall spending while prioritizing high-impact social and investment expenditure.
- ***Public financial management.*** Decisively increase the efficiency and transparency of public spending, including by SOEs, to eliminate waste and achieve better value for money.

- ***Governance.*** Enhance institutional oversight arrangements, strengthen preventive frameworks to improve accountability and foster good governance, and move towards overall greater transparency.
- ***Monetary policy.*** Strengthen the monetary policy framework by refining policy operations to keep short-term interest rates stable and close to the policy rate.
- ***Access to affordable finance.*** Transform the banking sector to one that works "*for and with Kenyans*" and is anchored on pillars of customer centricity, risk-based credit pricing, transparency, and ethical banking.
- ***Financial stability.*** Safeguard financial stability by enhancing prudential regulation and supervision and enhancing operational tools in the context of increasing financial sector complexity.
- ***Structural reforms.*** Deepen structural reforms to improve the business environment and boost investment, employment creation, and potential growth.
- ***Statistics.*** Improve data quality in line with international best practices to support economic policymaking, transparency, and accountability.

B. Program Performance

15. Program performance at end-June 2021 was good overall. Quantitative results were strong, with all end-June performance criteria (PCs) and indicative targets (ITs) met. Our structural reform agenda has experienced some delay due to challenges in several areas, including legal complications. This resulted in several structural benchmarks (SBs) not having been met on time. Nevertheless, having redoubled our efforts, we have now implemented all but one of the outstanding structural benchmarks (SBs) and expect to have that last one implemented by end-March 2022.

16. Quantitative targets (MEFP Table 1): All end-June PCs and ITs were met comfortably, as was the inflation target under the monetary policy consultation clause. The PC on the primary deficit was met by a wide margin (KSh.455 billion vs. a ceiling of KSh.508 billion), reflecting good revenue performance and tight spending control. The achievement of this outcome despite the challenging economic environment in the midst of the COVID-19 pandemic is testament to our strong commitment to fiscal responsibility.

17. Structural Benchmarks (MEFP Table 2):

- **SB for end-May** (outstanding from first review): With completion of Kenya Airways' (KQ) financial evaluation in August, the end-May SB on SOEs was implemented with delay.
- **SBs for end-June:** Among the three SBs, two were implemented with delay and one is still in progress.
  - The SB for CBK publishing a White Paper on Modernization of the Monetary Policy Framework was implemented with a slight delay when the Paper was published in late July.

- The SB for issuing a decision to implement across MDAs and Counties a common payroll system linked to IFMIS was implemented with delay with the articulation in late October of an agreed roadmap to implement the payroll system by June 2022.
- The SB for providing comprehensive information on public tenders awarded on the Public Procurement Information Portal (PPIP) has not yet been fully implemented. We have made extensive improvements to the public procurement portal but have encountered difficulties in our approach to providing information related to beneficial ownership. The portal provides extensive information on tenders and awarded contracts covering all areas of government spending, including information on some 24 thousand tenders and 6 thousand contracts issued in FY2020/21. Due to regulatory requirements that necessitate revision of certain tender procedures (see below), however, information on beneficial owners of the companies that have been awarded contracts have yet to be uploaded to the portal. As a result, the SB has not been met. We have, however, established a clear roadmap for adding beneficial ownership information to the portal that will result in this information to begin being published in early 2022 with adoption of new bidding documents for tenders ***(new structural benchmark for end-March 2022)***.

- **SBs for end-September and end-December:** Among the three SBs, two were met and one was implemented with delay.
  - The end-September SB for publishing a report on tax expenditures and their budget implications was met. The report found that tax expenditures amounted to 3.0 percent of GDP in 2020, down from 4.9 percent of GDP in 2017. This encouraging result reflects our efforts to streamline the tax system and broaden the tax base. Going forward, we endeavor to refine the estimates of tax expenditure and to publish the results annually.
  - The end-September SB for including in the annual Budget Review and Outlook Paper (BROP) paper an expanded fiscal risk analysis that quantifies contingent liabilities stemming from high-risk SOEs and initiates coverage of PPPs was implemented with delay in October. A summary report covering PPPs was published at end-September but the part relating to SOEs required more time to complete. The SOE report was published in late October. The two reports were published as standalone documents, as the BROP had been sent to Parliament already at the start of September due to this year's budget calendar having been accelerated on account of the upcoming general elections. The fiscal risks analysis, including coverage of Kenya Airways, will be included in the next Budget Policy Statement (BPS).
  - The end-December SB on Level II audits of firms has already been met. The Kenya Revenue Authority (KRA) has fully operationalized the audit function in Large and Medium Taxpayers Offices (LTO and MTO), where the number of taxpayer audits increased from 40 (mainly transfer pricing audits) in FY2019/20 to 671 in FY2020/21 (mainly in the sectors identified by the IMF VAT-Gap analysis report).

C. Fiscal Policy

18. Our fiscal policy path aims at balancing the near-term need to support economic revitalization and tackle the challenges that emerged with the COVID-19 shock against the imperative of reducing debt vulnerabilities over the medium term. We are accelerating our COVID-19 vaccination program and focusing on meeting the health and economic needs of the population even as new challenges have emerged with the drought afflicting regions in the North and pressuring the security situation. Our policies cater to these needs and respond to the aftereffects of the recent COVID-19 shock including on state-corporations while recognizing the difficult tradeoffs demanded by Kenya's limited fiscal space. Response efforts have therefore been carefully prioritized to limit further buildups in sovereign debt. With the receding of the pandemic, the focus of fiscal policy has shifted to reducing the level of the deficit and putting debt on a downward path within the timeframe of the program. This will help lower financing risks and facilitate an expansion of credit to the private sector, supporting growth.

19. Gains in revenue collection are expected to play a major role in our planned fiscal consolidation. Losses in tax revenues were a major contributor of the increase in deficits in recent years, with the tax-to-GDP ratio having dropped from 15.1 to 13.0 percent over 2016/17–2019/20. We intend to recover the lost ground in this area and have already taken significant measures to that effect (see ¶8). Going forward, we will continue these efforts with a combination of revenue administration reforms and carefully designed tax policy measures to ensure an equitable distribution of the adjustment burden and growth-friendly outcomes.

20. We will continue to ensure that priority social programs and development expenditures remain appropriately funded, in line with the program design. An indicative target on the government's priority social spending is part of the program design to ensure that they are shielded from rationalization efforts. This indicative target covers vaccination and immunization programs, transfers to vulnerable groups (e.g., children, people with disabilities, the elderly), free primary and secondary education, food programs, and health coverage and insurance. Moreover, we have initiated an ambitious reform agenda to improve the efficiency of public investments (see ¶34) and intend to keep the overall development spending envelope steady at close to 5 percent of GDP.

21. Following the overperformance in FY2020/21, the FY2021/22 budget carried forward our consolidation efforts by targeting a further reduction in the overall deficit, in line with program conditionality. For the approved budget, the full-year impact of the reversal of the 2020 tax cuts (0.5 percentage points of GDP) and revenue enhancing measures, as well as progress in rationalizing spending and increasing budget controls, combined for a projected improvement of 1 percent of GDP compared to last year's stronger-than-expected outcome, building on the overperformance in tax revenue in FY2020/21. Significant tax policy measures aimed at broadening the tax base were introduced in the Tax Law Amendment Act No 2 of 2020 and Finance Act 2020. The revenue enhancing measures included there were, on the basis of the pre-pandemic tax base, estimated to have a full-year yield of KSh.102,629 billion excluding the CMT. In addition, as part of

Finance Act 2021, the FY2021/22 budget also brought forward tax measures aimed at simplifying and improving the efficiency of the tax system, while preserving tax collection, with an overall positive impact on revenue estimated at KSh.1,296 million. On the spending side, we remain committed to pursuing our developmental objectives in a fiscally responsible fashion. In particular, the FY2021/22 budget aims at protecting priority social spending (KSh.397 billion), while redirecting available resources to provide targeted support to the vulnerable sectors hit by the pandemic (KSh.28 billion) and sustain critical projects (Big Four Initiative).

22. Our efforts to sustain the revenues needed to support our policy objectives have not been without challenges. In September, the High Court issued an order to abrogate the CMT when it was found unconstitutional, while implementation of the period inflation adjustment for excise tax on petroleum and petroleum products was suspended in a separate legal decision. The Government, aggrieved by the decisions of the High Court, has filed applications to the Court of Appeal seeking to repeal these orders. Successful resolution of the appeals will enable the KRA to resume collection of CMT and implement the periodic inflation adjustment for excises. Looking ahead, we anticipate that the strong performance of import duties and VAT at end-September 2021 is likely to fully compensate the losses stemming from the suspension of the CMT and of the inflation adjustments for excise tax on petroleum and petroleum products, enabling full realization of the FY2021/22 tax target. We remain firmly committed to achieving the PCs on taxes and the primary balance. We have strengthened spending controls, improved expenditure prioritization and delayed execution of non-essential projects to this end. We plan to enhance the design of the CMT to enable it to play its intended role as an important and equitable plank of our tax system. We nonetheless stand ready to take compensating measures should our appeal be rejected.

23. Against this backdrop, we are stepping up efforts to accelerate our COVID-19 vaccine campaign. We have successfully secured a loan from the World Bank for US$130 million to accelerate COVID-19 vaccine interventions in line with our overarching objective to inoculate all adults by end-2022. The flexibility built into the program conditionality caters to this need by allowing Kenya to execute its COVID-19 vaccination program without facing undue constraints. We thus request modification of the end-June 2022 ceiling on the primary balance to accommodate the use of the COVID-19 related resources made available from the World Bank (US$130 million). Further COVAX and bilateral donations to support the vaccination program would help move Kenya even closer to its objective of vaccinating 10 million people by end-2021 and all adults by end-2022.

24. At the same time, we are facing mounting spending pressures due to the urgent need to address a drought emergency in our northern regions and other security-related interventions. The northern regions are experiencing a dramatic deterioration in living conditions. To alleviate the economic and social fallout of these events, we are preparing a package of temporary, targeted spending measures aiming to strengthen national security operations and increase drought mitigation programs (such as livestock offtake, water trucking, food relief, nutritional supplements, and medical supplies). Due to the humanitarian and temporary nature of these expenditures, we request the modification of the end-June 2022 PC on the primary balance to reflect this urgently needed spending of KSh.20 billion.

25. We also expect that the SOE sector will require additional support during FY2021/22. The recent work on the forward-looking financial evaluations of key SOEs allowed us to gain visibility on the most pressing needs in this sector and the associated implications for the budget. Based on this work, we anticipate the need to provide support to the SOEs sector for KSh.48.4 billion. This support includes payment of KSh.7.5 billion to Kenya Power (for previously incurred last mile connectivity); payment of KSh.1.7 billion to Kenya Wildlife Service (for budget support on a temporary basis to enhance the capacity for KWS to conserve and manage wildlife given the sharp drop in tourists and park fees collections as a result of COVID-19); payment of KSh.3.1 billion to Kenya Airports Authority (for support on the back of COVID-19 induced loss of revenue and slump in the aviation sector to ensure the operation and maintenance of airports, including security); and a substantial financial undertaking by the Exchequer in support of a broad-based and decisive restructuring effort to put Kenya Airways on a sustainable footing. The flexibility built into program conditionality caters to these exigencies while ensuring that they do not threaten our program deficit objectives. In line with program commitments and with a view to respect the fiscal path envisaged under the program, we have identified spending offsets that will be introduced for KSh.24.5 billion (equivalent of half of the expected extraordinary support to SOEs in FY21/22). These offsets will be achieved by reducing recurrent spending and further rationalizing the portfolio of non-priority projects, with a significant portion to be realized from the latter. Accordingly, we request modification of the end-June primary balance target to reflect the provision of SOEs support for KSh.48.4 billion. Absent the realization of such extraordinary SOE spending, we commit to target a more ambitious primary balance for an amount equal to half of the under execution in such support (new adjustor).

26. We intend to reflect all additional spending in a FY2021/22 supplementary budget which is consistent with program objectives *(new structural benchmark for end-January 2022)*. The supplementary budget will target a primary deficit of KSh.424 billion in line with program objectives. The supplementary budget will detail the various interventions (COVID-19 vaccines, emergency spending, SOEs support) and clearly identify the offsets to ensure achievement of our fiscal targets. As offsets, we have identified savings for KSh.24.5 billion on account of reductions in recurrent expenditures (related to hospitality, travels, administrative activities) and rationalization of non-priority capital projects. In delivering these expenditure savings, we remain committed to protect priority social spending and projects included in our borrowing plan. In addition, we commit to target a more ambitious primary deficit (i.e., less depressed), should we face delays in the execution of the SOEs support (new adjustor).

27. Going forward, we remain committed to the program path for fiscal consolidation momentum over the medium term, with a view to reducing debt vulnerabilities. We will continue revenue mobilization and tight expenditure control, with a view to bringing the primary deficit below its debt-stabilizing level in 2023 and into positive territory by FY2023/24. To this end, we are committed to raise the ratio of tax to GDP to create space for growth-enhancing investments and priority social spending. To achieve this objective, we plan to introduce additional tax policy measures for 0.8 percent of GDP in FY2022/23 and 0.9 percent of GDP in FY2023/24. We intend in this regard to embark on the development of a Medium-Term Revenue Strategy (MTRS), supported by IMF TA, to inform our selection of suitable tax measures for this effort. At the same time, we will progressively reduce recurrent expenditure as a ratio to GDP, by containing growth in the wage bill and streamlining spending on goods and services, while keeping development spending steady at close to 5 percent of GDP. In support of our fiscal consolidation plan, we will submit to Parliament a budget for FY2022/23 consistent with programed deficit and revenue targets ***(new structural benchmark for end-April 2022)***.

28. We seek to move away from our debt ceiling and introduce a credible debt anchor to crystalize our policy intention of reducing debt and maintaining debt sustainability (see ¶36). The credibility of the new framework will anchor expectations for all stakeholders around the government's intended debt reduction path and will benefit from our commitments under the EFF/ECF-supported program with the IMF.

29. Uncertainties associated with the path and timeline towards a resolution of the COVID-19 pandemic entails high risks to our fiscal program and reinforces the need for contingency planning. The uncertainty is particularly pronounced for government revenues, where a deeper-than-expected legacy of the crisis could depress tax receipts. To ensure that the program performance criterion for the primary fiscal balance is met, any revenue shortfall relative to program targets for FY2021/22 will be compensated by us taking additional revenue measures. We also stand ready to further curtail non-critical spending if this should become necessary to offset further pressures including from newly arising spending priorities. To help manage fiscal risks, we intend to establish by end-June 2022 a fiscal risk management structure, to be coordinated across the government at the senior management level, that would oversee monitoring and assessment of fiscal risks across the public sector. To this end, we will in the coming months be conducting a benchmarking exercise, drawing on international good practices in this area.

D. Fiscal Structural Reforms

30. We will continue to reform our tax system to reverse the previously declining trend of revenues. Over the medium term, we aim to eliminate tax policy and compliance gaps by improving efficiency and equity of revenue collection and by reducing compliance cost. While the impact of new tax incentives on revenues is immediate, many are not delivering the expected impact (e.g., lower prices for consumers or increased supply of specific products). Moreover, the past proliferation of incentives has made our tax system less efficient and difficult to administer, contributing to our challenges in revenue collection. As a result, several incentives were eliminated as part the Tax Law Amendment Act (2020) and the Finance Act (2020). However, existing evidence suggests that there is still potential for further streamlining of the tax system. Our recently published Tax Expenditure Report identified tax expenditures amounting to 2.96 percent of GDP in 2020, down from 4.9 percent of GDP in 2017. The bulk of these tax expenditures (2.18 percent of GDP in 2020) relate to domestic VAT and are spread across a range of sectors, including agriculture, manufacturing, and transport. Corporate income tax accounted for most of the rest (0.53 percent of GDP in 2020), mainly from tax allowances and deductions intended to encourage investment in plant and machinery. While many tax expenditures have been reduced or eliminated, there is considerable scope for further reductions as part of our effort to reform our tax system and increase revenue yield, particularly from VAT and excise taxes. We also continue to view the CMT as a valuable tool to ensure that everyone contributes to the financing of public services. We therefore intend to expeditiously resolve the existing legal challenges to CMT implementation by appropriately amending its design.

31. Revenue administration reforms—aimed at improving compliance and taxpayer services—will continue to play a major role in our fiscal strategy. Our areas of focus include enhancing tax and customs debt management, including by leveraging the iTax debt module; strengthening audits; developing and implementing risk-based frameworks to support targeted tax enforcement; expanding the number of taxpayers by identifying new or non-compliant income earners; stepping up post-clearance audit and risk management; enhancing exemptions compliance; improving customs scanning; strengthening monitoring of petroleum trade; and applying enhanced methods for import valuation. We are also enhancing use of import valuation tools and implementing a new integrated customs management system (iCMS) to strengthen integrity, entrench best practices in risk management, and support automated entry processing. Key objectives include:

- **Strengthening audit function at the KRA.** The audit function in the large and medium taxpayer offices has now been fully operationalized. This has enabled the number of Level II audits to increase from 40 in FY2019/20 to 671 in FY2020/21. Accordingly, the related structural benchmark for end-2021 (to increase by 30 percent the number of Level II audits of firms, using risk-based approaches to select taxpayers with focus on sectors with large gaps in compliance identified by the IMF VAT-Gap analysis) has already been met. Going forward we aim to roll out audit functions to all the KRA regional offices. Only two regions are yet to fully operationalize the audit function and they are expected to be fully set by end-2021.
- **Developing and implementing risk-based compliance strategies.** The Domestic Department has developed a risk matrix tool that is used to score and guide in targeting high risk taxpayers for purposes of audit. Risk based strategies for the extractive sector have been developed and are currently under implementation. In the case of Real Estate Sector, sample risk-based compliance strategies were developed for the North Rift Region and will be rolled out to the rest of the country during the current fiscal year. The implementation of recommendations from IMF technical assistance in relation to high-net-worth individuals is ongoing, with most of the recommended actions already in place. Going forward, we aim to automate risk profiling and case selection for both Level I and Level II Compliance interventions.
- **Strengthening post-clearance audit (PCA).** The number of staff assigned to PCA has been increased from 21 at end-March 2021 to currently 30. This compares to our earlier target of reaching 45 staff by end-June 2021. The key focus of PCA remains centered on large and medium-sized importers in high-risk sectors. Going forward, we aim to increase the number of PCA staff to 45 by end-December 2021, with a view to undertaking 540 PCA audits in 2021. These audits comprise 108 field audits, 324 desk audits, and 108 compliance audits.

- **Enhancing valuation methods in customs.** With help from IMF TA, data analysis (i.e., mirror data analysis and tax and customs data matching) is being applied to identify and focus enforcement actions on the major valuation gaps by sectors or commodities.
- **Verifying exemptions.** To rein in abuse, a team was set up to monitor and verify VAT exemptions in customs issued over the last 5 years. So far, this team has carried out 14 exemption verifications. Going forward we aim to expand exemption verification to broadly consider additional areas, including those administered under the East African Community Customs Management Act.
- **Speeding up processing of custom entries.** To increase operational efficiency, we intend to achieve processing of all compliant customs entries within 24 hours. Currently, 85 percent of compliant entries are processed within 24 hours. A key enabler of our aim to speed up processing time is application of the Sea Cargo module of iCMS (integrated customs management system). We aim to have this module fully rolled out by December 2021.

32. We are working diligently to strengthen our public procurement system. The recent Public Expenditure Review (PER) from the World Bank identified significant potential for reducing transaction costs in government procurements and securing lower prices from further standardization and use of framework agreements in contracts. To this end, we are in the process of acquiring an e-procurement system that will be integrated to our Integrated Financial Management Information System (IFMIS) to automate application of the Procurement Act and regulations. An agreed implementation strategy and roadmap for e-procurement was approved in September 2020. The competitive procurement of a system developer was temporarily delayed due to budget challenges, but an open international invitation to tender for the e-GP system software was advertised in August and the tender was closed in mid-September. A pilot of the new system will be initiated by July 2022 and the full rollout across Government Ministries, Departments, and Agencies (MDAs) planned by July 2023.

33. We expect significant savings from controlling the government wage bill. To create much-needed fiscal space for priority social and development spending, we continue our proactive strategy to contain the ratio of the government wage bill to GDP. Our target is to achieve a decline of 0.5 percentage points between FY2020/21 and FY2023/24. This will be accomplished through continued restraint in hiring and compensation. A key step in this direction was the decision to effectively implement a wage freeze for FY2021/22 and FY2022/23 by not adjusting basic salary structures, allowances, and benefits paid in the public sector for the first two years of the four-year period covered by the 3rd remuneration and benefits review. In addition, we have maintained our policy of limiting new employment to priority areas and are requiring MDAs to obtain prior confirmation from National Treasury on the availability of funding before seeking approval for recruitment. Recruitment is subject to the availability of funding, consistent with our objective of a sustainable wage bill. Further actions planned in relation to controlling the wage bill include:

- **By end-June 2022, Harmonize and rationalize the categories, rates, and rules for allowances.** The Salaries and Remuneration Commission (SRC) has developed and issued in early October Allowances Policy Guidelines for the Public Sector. The SRC is in the process of sensitizing and receiving feedback from stakeholders. The final Allowances Policy Guidelines will be in place from the start of FY2022/23. The guidelines seek to streamline management and administration of allowances, and over time to ensure that allowances are limited to no more than 40 percent of gross pay.

- **By end-June 2022 implement across MDAs and Counties a common payroll system linked to IFMIS.** Authorities, through the Ministry responsible for Public Service, have directed that the Unified Payroll System shall be the upgraded Government Human Resource Information System (GHRIS). Payroll data will be cleaned and audited prior to being transferred to the new common payroll system. Milestones achieved so far include: (i) rolling out of the unified payroll number generating system; (ii) assessment of GHRIS capabilities for integration with IFMIS and other standalone systems; (iii) appointment of a task team to upgrade GHRIS in readiness of data integration; and (iv) development of three prototype modules (Payroll Management and Administration, Leave Management, and Pension Claim) has been finalized and validated. The validated prototype is expected to be piloted with the Teachers Service Commission and one large ministry in November and December 2021. Three additional prototype modules, that is, *establishment control*; *training and development*; and *third-party deduction management* are being developed and will be validated by 31st January 2022.
- **Upon implementation of the common payroll system across MDAs and Counties, we will seek to extend it to some SAGAs (Semi-Autonomous Government Agencies),** prioritizing those that benefit from recurrent budget transfers from the National Government.

34. We remain focused on improving Public Investment Management (PIM) to deliver value for money in public capital expenditure. We are developing a framework for project appraisal and selection as well as an automated project management information system. As part of this process, new PIM guidelines covering all phases of the public investment cycle were issued through Treasury Circular No.16 of 2019. Project proposals prepared by MDAs for review and approval by the National Treasury follow these guidelines. A key objective of our PIM framework is to ensure that our investment portfolio is efficiently managed and that all new projects are based on clearly defined criteria and pre-determined costing methodologies. To achieve this outcome, we are:

- **Rationalizing the pipeline of existing projects.** We have expanded to cover all sectors through a stocktaking exercise of projects and associated commitments. This was an extension of a similar exercise completed in March 2021 that specifically targeted the education, health, and infrastructure sectors. Based on this extended exercise, we have identified 437 stalled or underperforming projects that should be canceled. The stalled projects have not received budget funding for several years but have nevertheless remained in the portfolio of projects. A Cabinet decision to terminate these projects is expected by March 2022, as there are contractual issues to be addressed prior to executing that decision.
- **Developing a Public Investment Management Information System (PIMIS)**. The PIMIS will automate information management across the entire PIM framework. Following some

delay, an expert tasked with developing the system has now been appointed and good progress is being made. We are targeting to have the PIMIS fully operational by 1st July 2022.

- **Introducing a series of manuals to guide operations.** Manuals covering the following areas are virtually complete: Economic Project Appraisal; Monitoring; Evaluation and Reporting; and National Parameters and Commodity Specific Conversion Factors. These manuals establish the use of clearly defined criteria and pre-determined costing methodology in preparation of new investment projects. We aim to have these manuals finalized and in full use across MDAs by January 2022 and Counties by July 2022. The Counties are being brought onboard into this process later owing to the need to finalize PIM Regulations 2021 prior to engaging them.
- **Ensuring that PIM guidelines are being followed.** All new investment projects are required to provide concept notes and costing in compliance with the guidelines. A PIM representative on the budget panel helps ensure that all investments included in the annual budget have followed the stipulated process.
- **Implementing new PIM regulations.** We are converting PIM guidelines into regulations, which will help enforce their use and strengthen outcomes. A draft of the regulation was presented to the National Assembly in May 2021. We are aiming for the regulations to be in place within the current fiscal year (FY2021/22).
- ***Addressing obstacles to the flow of funds from development partners.*** This includes efforts to ensure that: (i) administrative delays are addressed; (ii) budget appropriations are adequate to honor outstanding and planned commitments; and (iii) counterpart funds are made available.

35. Public Financial Management (PFM). Our development agenda is anchored on prudent management of available public resources. As such, we will continue to strengthen expenditure control and improve the efficiency and effectiveness of public spending through necessary public financial management reforms. Focus areas include strengthening budget processes, IFMIS functionality, commitment controls, and cash management. Having strengthened our IFMIS infrastructure, we are adding functionality to the system and enhancing controls. We have also introduced a new Cash Management Framework that involves regularly updated cash and debt plans approved by the Cash Management Committee. Our plans include the following targets:

- By June 2022, complete the rollout of automated cash flow plans as well as automated exchequer releases for MDAs that enable all exchequer requests to be processed online through IFMIS. The system for automating cash flow plans has been completed and will be rolled out once users have been trained. Automation of exchequer requests has also been completed according to the original design but some elements relating to digital signatures that had been overlooked in the original design are being addressed. We expect that these remaining issues will all be resolved to allow for official launch of the integrated and fully automated system by June 2022, with piloting to take place before then. This is six months later than previously planned but the delay is justified by the strengthened system that will result.

- By June 2022, enhance IFMIS to enable contract generation and contract management for multi-year commitments. We have configured the system to enable generation of purchase orders to ensure that all commitments are captured in IFMIS. In addition, the five commonly used procurement methods shall be configured in IFMIS to enable MDAs and Counties to carry out end-to-end procurement through the system.
- By December 2022, develop IFMIS regulations to enforce use of the system for all procurements to ensure that all commitments are captured in IFMIS when they are entered into.
- By June 2023, ensure that all MDA budget proposals for FY2023/24 have been prepared using a common costing approach, which by then will have been built into the Hyperion budget preparation system and elaborated in a budget costing manual.
- By June 2023, complete a review of the number of extra-budgetary units with a view to consolidating these and, where appropriate, bring them within the perimeter of the budgetary central government.

36. Public debt management. As part of strengthening debt management, we are enhancing debt reporting, lengthening maturities, and avoiding bunching of repayments to mitigate refinancing risks. More generally, we are enhancing the structures and functions of the Public Debt Management Office (PDMO) to oversee debt management as envisioned in the PFM Law. To deepen the domestic debt securities market, the National Treasury is working with CBK to implement several reforms. We have strengthened the auction management process by implementing the Treasury Mobile Direct platform for retail sale of government securities, and enabled auction of bids by banks through internet banking. Additionally, we are: (a) further strengthening market infrastructures and auction management processes for government securities by developing the Central Securities Depository System; (b) maintaining a smooth yield curve for domestic debt securities; (c) supporting the enhancement of market structure and conduct through treasurers and dealers of commercial banks; (d) lengthening the maturity profile of government debt securities; (e) enhancing transparency through publication of auction rules and guidelines; and (f) strengthening the bond benchmark building program. As a result of these efforts, the average time to maturity of outstanding treasury securities has increased from 7.7 years in June 2020 to 8.8 years in June 2021, with the ratio of T-bills to T-bonds moving from 30:70 to 20:80. Regarding external debt, we are proactively working to ensure increasing utilization of committed concessional financing while maintaining a presence in the international financial market. We have also established an Investor Relations Unit (IRU) to strengthen communication with external stakeholders. The IRU now has a page on the National Treasury website. Our plans going forward include:

- By end-December 2021, subject to favorable market conditions, issue a Eurobond to provide financing for the FY2021/22 budget. This financing was previously programmed for early 2022.

- By end-June 2022, subject to favorable market conditions, issue a Eurobond to repay in full or in part the bond maturing in 2024 as part of a debt management operation.
- By end-June 2022, launch an enhanced micro-site for the IRU to support external communication.
- By end-June 2022, issue PFM regulations and a service contract for PDMO to make operational the framework for debt management envisioned in the PFM Act. This will help clarify responsibilities relating to debt management and enhance transparency. A taskforce comprising experts from the Attorney General's Office, CBK, and National Treasury has been constituted to review the current situation and make a proposal to strengthen institutional arrangements for public debt management. The taskforce is expected to present its recommendations to Cabinet Secretary, National Treasury and Planning by end-March 2022.
- By end-June 2022, replace the current nominal public legal debt ceiling set at KSh.9 trillion with a debt anchor. The new framework would be centered on two pillars: (i) a medium-term debt anchor set at 55 percent of GDP with debt measured in present value terms; and (ii) an accountability requirement that mandates transparent communication to Parliament and the public on plans and progress towards achieving the debt anchor within a specific timeframe. The National Treasury will submit a proposal for amendment of the PFM law on debt ceiling to the Attorney General and Parliament in November 2021.
- By end-October 2022, in our regular reporting on public debt, expand the coverage of public debt to include non-guaranteed public sector debts (including arrears) not currently included. The Annual Public Debt Management Report for FY2020/21 took an important step in this direction by including non-guaranteed debt of 18 public entities considered to pose the highest fiscal risk as per the financial evaluations conducted earlier this year. Of these 18 SOEs, 9 were found to have non-guaranteed debt totaling KSh.105 billion (1 percent of GDP). For next year’s debt report, we aim to expand the coverage to Counties and the remaining SOEs.

37. Our participation in the G20 Debt Service Suspension Initiative, including the relief provided for the second half of 2021, has helped reduce financing pressures though yielding less than originally expected. During the first phase (January-June 2021) the Government obtained debt suspension of US$425 million (KSh.45.5 billion). During the second phase (July-December 2021), the Government of Kenya made a request to all its bilateral creditors for debt service suspension estimated at US$379 million. However, this amount is now projected to be lower at around US$89 million due to non-participation by some creditors.

38. Public Private Partnerships (PPPs). Given the limited fiscal space, we are revamping the PPP Unit in the National Treasury to support efficient and sustainable scaling up of our PPP program without undue fiscal risks. This has included appointing a Director-General for the PPP Unit to provide strong leadership and strategic oversight. To ensure that only projects with the highest socio-economic returns are undertaken, we are in the process of creating and institutionalizing a joint PIM-PPP planning framework. This will help streamline the decision process of determining whether projects should be procured through the traditional public sector method or as PPPs. We are also strengthening coordination between PDMO and the PPP Unit for effective control of fiscal exposure, as envisioned in the PPP Act. The implementation of the revised institutional structure has progressed significantly. The new institutional structure was approved, and recruitment is underway. This will allow tapping private sector financing to support projects that will make important contributions to Kenya's key development objectives while effectively managing risks to the Exchequer through a strong project selection process. Other specific actions include:

- In the context of a supplementary budget for FY2021/22, fully operationalizing the PPP Project Facilitation Fund through the creation of a budget line for annual funding.

39. Pension reform. To put pensions on a sustainable footing, we have introduced a funded pension scheme for public sector workers, the Public Service Superannuation Scheme (PSSS). We are also increasing efficiency by re-engineering and digitizing our pension management system, a process we aim to have completed by June 2022. This is being undertaken as part of the wider initiatives the National Treasury is pursuing, with the objective to transform the Public Service Pension ecosystem into a customer centered, modern and technologically driven sector. The PSSS commenced on 1st January 2021 and will replace the current *pay-as-you-go* system over time. Participants in the PSSS include all new public sector employees who were below the age of 45 years as of 1st January 2021 and those employed after that date. The employer (GoK) and the scheme members make monthly contributions at the rate of 15 percent and 7.5 percent, respectively, of the members basic salary into the Public Service Superannuation Fund that is managed by a Board of Trustees and accordingly supervised by the Retirement Benefits Authority. As part of the plan, contributions by members are phased in over the first three years at the rates of 2 percent, 5 percent, and 7.5 percent in the first, second, and third years, respectively. The PSSS allows, amongst other advantages, portability of pension benefits, facilitating free movement of staff into and out of the public sector.

E. State-Owned Enterprises

40. We have made inroads in assessing, monitoring, and addressing vulnerabilities in the SOE sector, in line with the staged approach we set out. As a result of the in-depth financial evaluations (end-May SB), we identified a cumulative KSh.383 billion liquidity gap over the next five years for 18 SOEs involving the largest financial and fiscal risks (excluding Kenya Airways). This gap is expected to be primarily covered via SOE's cost saving measures. Kenya Airways (KQ) and Kenya Power and Lightning Company (KPLC) are the two companies with largest fiscal risks. We plan to address fiscal risks in these two companies as follows.

Kenya Airways PLC

41. Kenya Airways (KQ) has been insolvent for some time with ongoing financial difficulties compounded by the onset of the COVID-19 pandemic. KQ has the highest cost-base among all airlines in the SSA region. The Government of Kenya (GoK) is the largest shareholder of KQ (48.7 percent equity share) and its exposure to the airline also includes US$750 million of guarantees to creditors. Due to its severe cashflow problems over the past three years, KQ has not been able to pay lessors and creditors due invoices, resulting in significant outstanding obligations. The company had to negotiate moratoriums and waivers with lenders and lessors and has been dependent on cash injections from the budget. Even before the pandemic, this was negatively impacting KQ's operations.

42. Restructuring of KQ will have sizeable budget costs. With consideration of the economic benefits of a National Airline, GoK has decided to initiate a multi-year restructuring of the Company. The restructuring plan aims to enable KQ's adaptation to the challenges facing the aviation industry in the post-COVID pandemic environment. KQ will be required to trim down its network, rationalize frequencies of flights, operate a smaller fleet, and rationalize its staff complement. It will be essential to ensure that all parties are aligned, committed, and motivated to deliver on this strategy. As part of putting KQ on a sustainable footing, GoK will take over US$827 million of KQ's debt. In addition, in FY2021/22 and FY2022/23, US$473 million will be provided as direct budgetary support to clear overdue payment obligations and cover the upfront costs of restructuring.

43. Supporting KQ and other SOEs will challenge our planned adjustment path and other spending priorities, and we are determined to decisively meet these challenges. To contain the impact of such intervention on debt dynamics, we will introduce budgetary offsets for 50 percent of KQ fiscal support, in line with program commitments and the flexibility built into program conditionality. We recognize that the size of the envisaged offsets and the available fiscal space will crystallize important tradeoffs. We remain committed to address such tradeoffs with a view to limiting the impact on the budget and protecting priority social spending.

44. Recognizing that full execution of the restructuring plan is essential to ensure that the strategy is carried out at least cost to the Exchequer, we will implement safeguards to that effect. GoK and KQ management will be acting resolutely to minimize cash burn while waiting for the restructuring to take place. Our plan includes the following steps:

- By end-November 2021, the National Treasury (NT) will hire an airline consultant with international experience and know-how to negotiate for concessions.
- Before undertaking any intervention, and at the latest by December 2021, we will prepare a detailed restructuring action plan of measures to improve KQ's operational profitability, which will serve as the basis for further monitoring of progress.
- By December 2021, we will establish an accountability mechanism to ensure that the restructuring will be followed by KQ Board. This will involve implementing a tracker to monitor key actions and milestones in the restructuring process (e.g., trimming the network; rationalizing frequencies and the fleet; and addressing the high-cost structure, including the salary/wage bill with a clear measuring system). Milestones will be included in the key performance indicators applying to KQ's CEO and other senior executives. By December, we will prepare a loan agreement with KQ that shall include conditions for providing financial support to implement the restructuring plan. It will include clear KPIs, timelines, and a reporting obligations and disbursement plan. The signing of loan agreements will occur following the approval of supplementary budget by Parliament.

- Progress under the action plan will be reviewed quarterly by NT, and the reports by NT will be sent to Cabinet.
- Disbursements from NT to KQ will be conditional on progress and released only when there is clear and tangible progress towards pre-agreed targets.
- We will act to protect the GoK's economic interest to the extent feasible by ensuring that the terms of Exchequer support prioritize the liability to the Exchequer while the support is outstanding.

Kenya Power and Lighting Company PLC (KPLC)

45. KPLC's financial performance has been deteriorating over the years. The deteriorating business performance was worrying, as the company plays a pivotal role as the national off-taker in the electricity supply chain and had started accumulating large amounts of pending bills. KPLC had a negative working capital position of KSh.69 billion at 30th June 2020, and outstanding trade payable of KSh.79.4 billion of which over KSh.60 billion was overdue. GoK is the largest shareholder of KPLC (50 percent equity share) and, considering the company's strategic role in the economy, the associated fiscal risks are substantial. Consequently, GoK established a taskforce to look into the Power Purchase Agreements and the financial status of KPLC and to recommend measures to correct the financial difficulties facing KPLC and by extension the electricity sub-sector. The taskforce presented its report on 29th October 2021.

46. By December 2021, we will prepare an action plan that lays out how KPLC's identified KSh.110 billion liquidity gap will be covered in the medium term. This plan will draw on the findings of the recent Presidential Taskforce report. It will identify steps that KPLC will take to improve operational efficiency and realize targeted cost saving by implementing a turnaround strategy that is premised on meeting customer needs, increasing power sales and revenue collection, improvement of cash flow management, reduction of operational costs, reduction of system losses, and restructuring of expensive commercial debt. KPLC will re-engineer its business process, focusing on delivery of services to its customers through automated billing, metering, and payments. It is also expected that KPLC will reduce system losses, resulting from both technical and commercial factors, to be within the medium-term loss benchmark of 15 percent approved by the regulator. Further, KPLC organization structure and staffing levels should be fit for purpose with suitable skills and performance-based management culture to increase staff productivity and reduction of operational costs. Reforms will be undertaken in procurement and stock management to optimize the use of available resources and reduce wastage.

SOE Governance Arrangements

47. We will continue to introduce further governance arrangements that enhance management and oversight of SOEs. Financial pressures were exacerbated by the COVID-19 pandemic and are still acute in many SOEs. The pressures have compounded pre-existing structural weaknesses in the sector, including overlapping mandates, poor financial performance, and weak governance. To remedy this situation, a Strategy on SOE reforms has been completed that lays out steps geared towards enhancing financial and operational efficiency and cost savings.

- By June 2022, we will review organizational arrangements within NT for financial oversight of SCs and ensure that the role and functions for Government investments as a core function of the NT are fully provided for in the legislative framework;
- By June 2022, we will prioritize the development of Government Investment Management Information System (GIMIS) modules that will facilitate reporting by SCs on their full set of unguaranteed, guaranteed, and on-lent loans; and develop a framework to monitor the evolution of individual SC loans, capturing new disbursements, repayments, and outstanding amounts of disbursed loans. This system will be accessible by relevant oversight entities, including line ministries, National Treasury, and SCAC.
- We will extend the coverage of financial evaluations of SCs undertaken in NT. Together with GIMIS, this will facilitate the identification, quantification, monitoring, reporting, and management of fiscal risks stemming from SCs, including guarantees and contingent liabilities.

48. A Blueprint for Governance Reforms of SCs was completed by the end-July 2021 target date. The Blueprint lists actions that will improve governance of SCs by reinforcing the separation of roles and responsibilities among institutions that exercise an oversight role. This includes an ownership role and a policy role for NT on behalf of GoK to avoid the pitfalls of either passive ownership or excessive state intervention. The implementation of the Blueprint will strengthen GoK's ability to (i) act as an informed and active owner, (ii) operate within a legal framework that is more favorable to commercial SCs' activities, and (iii) rely on good governance practices for the operations of SCs. To this end, we will:

- By end December 2021, (i) define categories of SCs for government-wide use and prepare and publish an updated inventory of SCs, (ii) ensure the publication and publicization of all commercial SCs' annual reports in an easily accessible format, and (iii) take concrete actions to enforce compliance by board members with ethics and integrity expectations for Boards of Directors of SCs.
- By end June 2022, (i) obtain approval by Cabinet of an ownership policy for the entire portfolio of SCs that addresses the issues outlined in the Blueprint; (ii) develop a comprehensive performance contracting and monitoring framework for commercial SCs; (iii) ensure that all SCs disclose and publicize their anti-corruption performance indicators; and (iv) initiate institutional coordination efforts for the design of an aggregate report on SCs' anti-corruption performance indicators.
- By end July 2022, publish the performance evaluation reports of SCs for FY2020/2021 and continue annual publications thereafter.

F. Monetary Policy

49. Policy objectives. Our primary policy objectives are to: (i) maintain headline inflation within our target range (5±2.5 percent); (ii) maintain a flexible exchange rate regime, with market interventions only in response to excess exchange rate volatility; and (iii) further improve the monetary policy framework. A monetary policy consultation clause (MPCC) with a 5 percent ±2.5 percent band will help monitor inflation performance, providing for a consultation with the Executive Board to be triggered if inflation falls outside the band (TMU, ¶23).

50. We will continue to push ahead with our monetary policy reform agenda. The removal of interest rate caps in late 2019, which had hindered monetary policy effectiveness, was a welcome development and opened the way for further progress in strengthening our monetary policy framework. To this end, we published in July 2021 a white paper on *"Modernization of the Monetary Policy Framework and Operations"* outlining reforms to strengthen the monetary policy framework (structural benchmark). As conditions permit with the normalization following the COVID-19 shock, the reforms will focus on:

i). Refining our macroeconomic modeling and forecasting frameworks. We will review the FPAS framework, including the strengthening of forecast process and the team, engagements with the MPC, the nowcasting framework including the expectations surveys conducted by the CBK, and the core macro model, the quarterly projection model (QPM), and in this context plan extensions to the model.

ii). Improving the operations of financial markets, including fully developing by April 2022 a Centralized Security Depository (CSD) that will improve monetary policy transmission and promote efficiency and transparency in the government domestic debt market. The CSD will mitigate segmentation in the interbank market and enhance liquidity distribution by strengthening the operation of the secured overnight market. It will help manage systemic risk, improve and automate operations by eliminating paper-based processes via Straight Through Processing (STP) and enable full transfer of collateral for repo transactions. Experience with the CSD will inform further reforms including review of the methodology for calculating the interbank rate as the operational target, and introduction of a band around the CBR to provide an anchor for the interbank rate. In developing financial markets, CBK has rolled-out Treasury Mobile Direct (mobile platform for government securities) and Internet Banking, installed the Enterprise Data Warehouse (EDW) for near-real time data capture and analysis, and is currently assisting ACI-Kenya and the Treasurers forum with the development of a framework designed to further strengthen conduct in the financial markets.

iii). Improving communication of monetary policy decisions to make them more effective, including introducing publication of a quarterly inflation report.

G. Financial Sector

51. Policy objectives. Safeguarding financial stability and expanding access to affordable finance remain our key priorities as the financial sector supports the economic recovery through the COVID-19 pandemic and in the post-COVID-19 recovery. We will continue to take steps to improve prudential regulation and supervision, with a view to addressing the increased sophistication of the financial sector. Our objective is to promote sustainability and resilience of the Kenyan financial sector along four pillars: customer centricity; risk-based credit pricing; transparency; and ethical practices. This will enhance the financial sector's capacity to provide affordable financial services to Kenyans.

52. The banking sector remains stable and resilient. Core capital and total capital adequacy ratios as at end-August 2021 were at 16.3 and 18.9 percent respectively, above the statutory minimums of 10.5 and 14.5 percent. The liquidity ratio at end-August 2021 stood at 57.0 percent well above the statutory minimum of 20 percent. The ratio of gross Non-Performing Loans (NPLs) to Gross Loans has come down slightly to 13.9 percent in August 2021 from 14.1 percent in December 2020, due to progress with recoveries, write-offs and a pickup in credit growth. The outstanding restructured loans amount to about 16 percent of gross loans with about 93 percent of the restructured loans performing as per the restructured terms.

53. We will continue to stress preservation of capital and liquidity buffers to strengthen the resilience of the financial system. We are cognizant of the heterogeneity of the impact of the crisis on different categories of banks. To support a forward-looking evaluation of risk and capital planning in a period characterized by high uncertainty, we recently published credit risk stress test which suggest that a shock increase of some 5 ppt in current NPLs, above and beyond levels which are already elevated due to the pandemic, would lead 10 out of 39 banks to face a capital shortfall relative to minimum requirements, but this would be less than 0.4 percent of GDP. Correspondingly, we remain committed to enhanced surveillance while encouraging banks to strengthen their governance frameworks and business models, embark on mergers and acquisitions, and other capital strengthening efforts.

54. We assess that financial sector measures we put in place to mitigate the adverse impact of COVID-19 have been effective. The CBK implemented temporary regulatory measures at the start of the COVID-19 pandemic that were meant to preserve the resilience of the financial sector and to facilitate lending to borrowers adversely affected by the pandemic. In coordination with other government interventions, the Central Bank of Kenya (CBK) implemented a range of temporary regulatory measures, over the course of the crisis, aimed at cushioning the banking sector and the wider economy from the adverse impact of the pandemic, while facilitating lending to borrowers adversely affect by the pandemic. The interventions, most of which expired by March 2021, focused mainly on provision of regulatory flexibility, loan restructuring and adjustments in fees charged on mobile money transactions:

- **Loan restructuring:** 57 percent of the banking industry's loan portfolio was restructured in 2020 and the facility was maintained until March 2021. By end-August 2021, following repayments and reversion to normal terms, the outstanding restructured loans amounted to 16 percent of total loans, of which 93 percent were performing as per the restructured terms. Restructured loans that have fallen in arrears account for about 1 percent of total banking sector gross loans, suggesting that the borrowers received valuable support to navigate the liquidity shock from the pandemic and that the underlying credit risk is contained. We continue to closely monitor the performance of the outstanding restructured loans and their impact on banks' earnings and capital buffers. Furthermore, we have unwound the regulatory flexibility on loan classification and provisioning that were also introduced in March 2020. After June 3, 2021 standard procedures for loan classification and provisioning have applied. We continue to closely monitor the performance of the outstanding restructured loans and their impact on banks' earnings and capital buffers.

- **Strengthening the Credit Referencing Mechanism:** On April 8, 2020, the Credit Reference Bureau (CRB) Regulations became effective, refreshing the framework that had been in place since 2013. The revised regulations, in addition to supporting the risk-based pricing pillar of the banking sector charter, provided for temporary suspension of listing of negative credit information in exceptional circumstances. Accordingly, and to facilitate the flow of credit during the pandemic period, on April 14, CBK issued Banking Circular Number 7 and Number 8 of 2020, which suspended temporarily the sharing of negative credit information on credit facilities that became non-performing for six months to September 30, 2020. This measure expired on September 30.

- **Business Continuity Planning:** On March 27, 2020, CBK issued guidance to the banking sector on pandemic planning and business continuity. The guidance, which was aligned to protocols from the Ministry of Health, is aimed at monitoring the incidence of the pandemic in the sector and guiding responses thereto. In the pandemic period, over 90 percent of the bank branch network across the country has remained open, including in areas that were under COVID-19 movement restrictions.

- **Ensuring Capital Adequacy during and beyond COVID-19 Pandemic:** CBK has since 2016 adopted the Internal Capital Adequacy Assessment Program (ICAAP) in ensuring that banks hold adequate capital aligned to their risk profile and market niche. ICAAPs are approved by banks' boards and are a critical component of the ongoing Supervisory Review and Evaluation Process (SREP) carried out by CBK on each bank. SREP seeks to assess the risk profile of each bank and ensure that it has adequate capital and liquidity buffers. On August 14, 2020 CBK issued a Circular requiring banks and mortgage finance companies to re-submit by October 31, 2020 their ICAAP documents for 2020 accounting for pandemic-related developments and ensuring adequacy of capital and liquidity buffers. These updated ICAAP submissions were reviewed by the CBK and served as a basis for the review of profit distribution decisions including dividends by the banks. All banks publicly disclosed their audited 2020 financial statements, including their capital adequacy ratios in March 2021, which showed the banking sector is well capitalized and there is no imminent systemic risk in the sector. We published the individual end-year bank capital adequacy ratios and the overall sector capital adequacy status in accordance with existing processes in the annual 2020 Bank Supervision Report in May 2021.

- **Enhancing the use of digital platforms:** At the onset of the pandemic, in consultation with authorized Payment Service Providers (PSPs) and commercial banks, limits on mobile money transactions were enhanced and fees on low value transactions (of up to KSh.1,000) eliminated. The resulting increase in both transaction volumes and values of low-value transactions and transfers between bank and mobile e-wallets directly supported the resilience of the good functioning of financial sector in enabling and underpinning economic activity notwithstanding the pandemic. These measures also allowed banks to scale up initiatives in digital products and services in response to rising customer demands. Bank transactions on mobile phones increased from 55.7 percent before the pandemic to 84.8 percent of all transactions. Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT) checks were also strengthened to guard against abuses. The waiver on fees on low value mobile money transactions was lifted in January 2021 but the expansion of the maximum limit on wallet and transactions remains.

55. A new credit guarantee scheme (CGS) was also established to expand access to affordable credit to MSMEs and support their recovery from the adverse impact of COVID-19. In the CGS, risks are shared on a 50:50 pari-pasu basis; subject to a maximum guarantee exposure of which 25 percent of the principal amount. It is intended to facilitate better financing terms to Kenyan MSMEs and incentivize the extension of the credit that will be essential in reactivating the economy during heightened uncertainty due to the pandemic. Total loans extended to MSMEs under the CGS have topped KSh.1 billion as at August 2021 since the start of the program in December 2020. MSMEs from 40 counties and drawn from 11 different sectors of the economy have benefited from the scheme.

56. Going forward, we intend to maintain the reform momentum towards realizing our vision outlined in the CBK's Banking Sector Charter. As it addresses current challenges from COVID-19, the banking sector remains on track towards realizing the vision outlined in CBK's Banking Sector Charter of a banking sector that works for and with Kenyans. Our reform agenda remains on track, including:

- **Banking Sector Resilience.** The need to build resilience and exploit emerging opportunities has led to increased consolidations and combinations among several players. During the pandemic period, three transactions have been completed, the acquisition of Mayfair Bank by CIB of Egypt, the acquisition of Transnational Bank by Access Bank of Nigeria, and the acquisition of Jamii Bora Bank by Co-operative Bank of Kenya Limited. Additionally, Kenyan banks have continued to expand regionally through acquisitions, including in the Democratic Republic of Congo, Rwanda, and Tanzania. CBK will continue with the focus of building a resilient banking sector with strong business models and governance frameworks that will support Kenya's post-pandemic recovery.
- **Moving towards real-time supervision.** We are implementing a centralized Electronic Data Warehouse (EDW) that will merge all the different information sets provided by banks to CBK. Through Application Program Interfaces (APIs), we shall connect the EDW directly to banks to enable us to access supervisory data on a near real-time basis. This will significantly

enhance the proactiveness of our offsite surveillance systems and provide a laser focus for our onsite inspections of banks. We are working with selected pilot banks as we move towards integrating the EDW with banks.

- **Review of the Microfinance Act.** To accommodate considerable changes that have been experienced in the Microfinance industry over the years, CBK has reviewed the existing regulatory and supervisory framework for microfinance banks and forwarded the finalized draft of Microfinance Bill to the State Law Office for consideration in December 2019. In December 2020, the State Law Office finalized legislative drafting of the Microfinance Bill. In March 2021, the Bill was forwarded to the National Treasury for approval by Cabinet and subsequent tabling for consideration by the National Assembly.
- **Licensing of Kenya Mortgage Refinance Company.** On September 18, 2020, CBK licensed the Kenya Mortgage Refinance Company PLC (KMRC) as the first mortgage refinance company in Kenya. The license was granted pursuant to the CBK (Mortgage Refinance Companies) Regulations, 2019. KMRC's principal objective is to provide long term finance to primary mortgage lenders (commercial banks, mortgage finance companies, microfinance banks and Savings and Credit Co-operatives) to increase the availability and affordability of mortgage loans to the public. As at June 30, 2021, KMRC disbursed KSh.800.2 million to four participating mortgage lenders under the World Bank Group line of credit. In addition, a mortgage portfolio of KSh.5.8 billion from seven other mortgage lenders is under review for refinancing. KMRC is at an advanced stage of issuing a corporate bond to provide a sustainable source of funding for mortgage refinancing to complement the existing credit lines. A transaction advisory team has been hired to guide the process of the bond issuance scheduled in Q4 2021.
- **The Central Bank of Kenya (Amendment) Bill, 2020 on Digital Lenders.** The Central Bank of Kenya (Amendment) Bill, 2020 (the Bill) was published on June 19 and republished in April 2021 to incorporate public consultation input. The principal objective of the Bill is to empower CBK to supervise and regulate digital lenders to ensure a fair and non-discriminatory marketplace for access to credit. The Bill was passed by the National Assembly in October 2021 and is being finalized for Presidential assent.
- **Strengthening the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Framework.** We have made significant progress on various fronts in improving the AML/CFT legal framework but more importantly in its implementation through various initiatives. From a broader perspective, we have strengthened cash transaction monitoring and reporting by banks, enhanced our offsite and onsite surveillance through targeted AML/CFT onsite inspections. We have enforced administrative sanctions and penalties arising from AML/CFT violations identified during our inspections. This includes penalties levied on banks, payment service providers, money remittance providers and other financial institutions. Additionally, we conducted a successful demonetization exercise in 2019 withdrawing the old generation Kenya Shilling 1,000 note. The demonetization was informed by the twin concerns of large banknotes, particularly the older 1,000-shilling series being used for illicit financial flows in Kenya and in the region. The other concern related to

emergence of some counterfeits posing a threat to the credibility of the Kenyan currency. In crafting the demonetization strategy, we reviewed the experiences of other countries and regions that have carried out similar exercises, including Australia, European Union, Pakistan, United Kingdom and most recently India. Critical to the eventual success of the exercise were strong AML/CFT filters in banks that ensured that illicit funds were screened out of the financial sector. AML/CFT monitoring was scaled up by the Central Bank of Kenya with 15 targeted inspections conducted during this period on financial institutions. Financial institutions also scaled up their AML/CFT screening reporting over 3,000 Suspicious Transaction Reports (STRs) for further investigation.

- **Greening Kenya's Banking Sector.** We issued Guidance on Climate-Related Risk Management to the banking sector, on October 15, 2021. The Guidance is aimed at enabling banks to integrate climate-related risks into their governance, strategy, risk management and disclosure frameworks. It is also intended to enable banks leverage on business opportunities from efforts to mitigate and adapt to climate change. These include the adoption of low emission energy sources, development of new products and services, access to new markets, housing and resilient infrastructure. CBK will work with banks to build capacity and integrate climate-related risk management in their day-to-day operations. In turn, this will attract global funds that are looking for opportunities to finance initiatives that build climate resilience, and thus positioning Kenya as a premier green finance hub.

H. Governance

57. We remain committed to transparency in government procurements and are taking steps to improve our framework for public procurements. Significant progress was made with the implementation of the Procurement Act, which provides a legal framework for electronic procurement by all public entities. Public entities are now required to publish all procurement related information in line with open contracting standards and Executive Order No 2 of 2018. Ongoing initiatives on public procurements under the program include:

- **New State Procurement Portal.** We have completed the development phase of the State Procurement Portal and conducted a two-week pilot with a sample of 10 procuring entities. The operational rollout of the new Portal infrastructure has been completed.
- **Publication of information on public tenders awarded including beneficial ownership.** We have published key information on all tender awards in the Public Procurement Information Portal (PPIP) and developed implementation mechanisms to ensure bidders are subject to dissuasive sanctions for non-compliance. We are taking urgent steps to address recently identified privacy impediments to publish information on beneficial owners (BOs) of all firms that win procurement contracts in the PPIP, including by developing procedural measures to obtain consent for publication from the beneficial owners. Specifically, we aim to revise the BO disclosure form in standard tender documents to enable the tenderer to commit to provide BO information and consent to its automatic disclosure in the PPIP upon tender award. This will take approximately three months to implement. As a result, we commit to adopting revised standard bidding documents to obtain consent from beneficial

owners to publish beneficial ownership information for awarded tenders in the PPIP and start requiring consent for all new tenders (***new structural benchmark for end-March 2022***). We plan to correspondingly publish beneficial ownership information in the PPIP for all tenders awarded using the new documents.

- **Cooperation between the Competition Authority of Kenya (CAK) and Public Procurement Regulatory Authority (PPRA).** A joint MOU has been signed between the CAK and PPRA to ensure that any irregularities encountered in the procurement process can be met with appropriate penalties. The MOU has been cleared by the Attorney General and the related completion rules have been gazetted.

58. We are committed to strengthening the implementation of the anti-corruption framework. Kenya has a comprehensive anti-corruption legal framework including the Public Officer and Ethics Act (2003), Anti-Corruption and Economic Crimes Act (2003), the Leadership and Integrity Act (2012), Ethics and Anti-Corruption Commission Act (2012), the Access to Information Law (from 2016), and Law on Bribery (2016). To ensure the effective prosecution and sanction of corruption and economic crimes as required under the Anti-Corruption and Economic Crimes Act, the Multi Agency Team on Corruption (MAT) responsible for the coordination and enforcement of anti-corruption objectives chaired by the Attorney General with the heads of law enforcement and prosecutorial agencies as members (Director of Public Prosecution (DPP), Director Criminal Investigations (DCI), Ethics and Anti-Corruption Commission (EACC), Asset Recovery Agency (ARA), National Intelligence Service (NIS), Central Bank of Kenya (CBK), Kenya Revenue Authority (KRA) & Financial Reporting Centre (FRC)) have facilitated the processing of corruption investigations and prosecutions as well as asset recovery interventions. The Judiciary has established an Anti-Corruption and Economic Crimes Division of the High Court to expedite adjudication of corruption cases.

59. Going forward, we will pursue further needed reforms, including legal, policy and administrative interventions, to strengthen the implementation of the anti-corruption agenda to effectively prevent and enforce against corruption offenses.

60. Access to Information is a guaranteed right of every citizen of Kenya under Article 35 of the Constitution and effective implementation of the Access to Information Act is a key priority to enhance transparency. We have drafted the implementing Regulations associated with the Act and public consultations are being concluded. The Taskforce met with stakeholders and is now considering all the comments submitted for their inclusion into the draft regulations. We will submit the final Regulations to the Ministry of ICT, Innovation and Youth Affairs, Office of the Attorney General, and Parliament in December 2021. Further, by March 2022, standards for digitization and automation of records will be developed to ensure that existing and proposed systems have the capacity to comply with minimum access to information requirements.

61. We are also reviewing our legal framework of asset declarations and conflict of interest rules for senior public officials to bring it in line with international best practices. The planned enhancements will, among others, (i) consolidate the wealth declarations and interest declarations of public officials into one uniform disclosure regime, (ii) rationalize the responsibility of analyzing and verifying the disclosures and imposing adequate sanctions for false declarations or failure to declare in a single agency, and (iii) enhance the role, responsibilities and capability of enforcement agencies to investigate, prosecute and sanction perpetrators of illicit enrichment and other corruption offenses. We will prioritize efforts to implement the preventive anti-corruption framework, along with an operational asset declaration system, the details of which are undergoing final review by the inter-agency committee. The review of the Conflict of Interest Bill, together with the provisions on financial and interest disclosures, has inadvertently taken longer than expected, occasioned by the imperative need to ensure all loopholes are addressed. We will urgently move to finalize the Conflict of Interest Bill and have constituted an interagency group to overcome outstanding issues and fast-track submission to Parliament. We shall continuously review the progress to advance this important piece of legislation.

62. We will continue to collect and publish the status of all corruption cases in the Judiciary website in a timely manner. This information will include filed cases, resolved cases, pending cases, case backlog, case clearance rate, average time to disposition, and reasons for adjournments of cases for the High Court Anti-Corruption Division and Anti-Corruption Magistrates' Court at Milimani. Progress has been made towards reducing the backlog of cases in courts through various strategies including development of a Case Management System that has facilitated the process of reallocating resources based on need and aggregating statistics on workflow.

63. We will continue to collect data on commercial, land and Civil cases and consistently publish caseload statistics to inform court users and consequently enhance market certainty. As such, the Judiciary will publish data on filed cases, resolved cases, pending cases, case backlog, case clearance rate, average time to disposition, and reasons for adjournments for the Milimani Magistrates' Commercial Court and Milimani High Commercial Division, Milimani Civil Division and Environment and Land Courts in the Judiciary website.

64. We will provide full transparency in COVID-19-related spending. We commit to ensure follow-up and proper accountability in relation to the already completed audits of COVID-19 spending during the early part of the pandemic. We further commit to conducting audits of remaining COVID-19 spending to date and will act upon Parliamentary guidance in this important area. The National Audit Office (NAO) of Kenya has so far completed 3 special audits of COVID-19 spending. The KEMSA special audit report was tabled in September 2021 and awaits adoption by Parliament. The audit of subnational government COVID-19 spending was issued in May 2021 and is undergoing parliamentary deliberation, with 38 counties having appeared before Parliament and 9 to submit in writing their responses. The third audit report of COVID-19 spending across ministries was submitted to Parliament in May 2021 but has not yet been deliberated on by Parliament. We view as important that these reports are adopted without delay so that the NAO along with other accountability and enforcement agencies can follow up on Parliament's decisions. In terms of future audits, we commit to publish the results of a forensic audit of COVID-19 vaccine spending up to end June 2021 and a comprehensive audit of expenditures in FY2020/21 with a chapter on COVID-19-related spending (***new structural benchmark for end-May 2022***).

65. We will continue to work diligently on improving our AML/CFT framework to support anti-corruption efforts. The final draft of the National Risk Assessment (NRA) report and National AML/CFT Action Plan will be submitted to Cabinet for approval and be made public by December 2021. Work to amend the AML/CFT legal framework to require lawyers to declare suspicious activity is advancing, with draft legislation currently being reviewed in Parliament. The Financial Reporting Centre has continued to strengthen the use of financial intelligence by enhancing its reporting tools (goAML system) to enable effective and timely reporting of Suspicious Transaction reports, Cash Transaction reports, and Monetary Instrument declarations. The goAML system deployment is progressing, with full adoption by banks completed, while the system roll-out is currently ongoing for the remittance providers and money changers. The new system will also be expanded to the Law Enforcement Agencies (LEAs) in the next six months as permitted by the pandemic situation, to enable an effective end-to-end system of reporting, analysis, and dissemination of financial intelligence. One of our immediate priorities is to continue raising awareness and competencies by fostering adequate training and engagement programs to ensure reporting entities, LEAs, and the financial intelligence analysts of the Centre have greater understanding of ML/TF risks related to corruption. This includes engagement programs covering corruption risk and red flags in public procurement, and ongoing engagement with the LEAs through the Multi Agency Team partnership to support investigation and corruption cases. The Centre is also providing series of training to government departments as part of its effort to curb corruption within the public services. Kenya is currently undergoing the desk review of its 2nd round Mutual Evaluation (ME) conducted by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). The on-site ME visit is expected to take place in January 2022. The outcomes of the NRA and ME will inform our actions to strengthen the AML/CFT legal and regulatory framework in order to fully secure the country. In particular, we will leverage on the ME to assess and strengthen the effectiveness of our supervisory framework as needed. The Business Registration Service continues to implement efforts to ensure all companies submit information on beneficial ownership to the e-Registry, including by publishing the Beneficial Ownership e-Register Manual as a guidance for users, intensifying resources for system processing and outreach events to increase awareness.

I. Data Quality

66. Policy objectives. We view the production and dissemination of high-quality economic statistics as the foundation for good policy through evidence-based decision making. To enhance our macroeconomic data, we will continue to improve the availability, quality, coverage, and timeliness of our statistics.

67. Data coverage, quality, and timeliness. We have enhanced economic statistics with a range of new statistical surveys, including Integrated Survey of Services, Study of Trade Margins, Study of Underground Economy, Study of Informal Transportation, Medium, Small and Micro Enterprises Survey, and Survey of Non-Profit Institutions. To improve macroeconomic data dissemination practices, we joined the Enhanced General Data Dissemination System (e-GDDS) initiative in December 2018. We released the Foreign Investment Survey in April 2019 and submitted international investment position (IIP) data series from 2008 to 2018 to the Fund in July 2020, which are available on the IMF website. We are also working toward improving the quality of our national accounts and government finance statistics and are receiving IMF technical assistance in these areas. We will address capacity gaps in key departments of the National Treasury and in ICT systems and strengthen the coordination at the Inter Department committee on GFS which have contributed to delays in achieving GFS milestones. These actions are expected to lead to the reporting of (i) general government fiscal outturns on a quarterly basis by December 2022; (ii) annual fiscal data of the public corporations' sector (including financial and non-financial corporations) by December 2022; and (iii) migration of the fiscal framework to GFSM 2014 based concepts, starting with the QEBR for second quarter of FY2021/22. All these actions taken together will improve transparency and ensure that all stakeholders have an easy and reliable access to information on the state of the economy and public finances. Additionally, CBK introduced new surveys to assess the impact of policy measures on key sectors in the context of the pandemic.

J. Program Monitoring

68. The program will continue to be monitored based on periodic performance criteria, continuous performance criteria, Monetary Policy Consultation Clause, and indicative targets as set out in Table 1. Structural benchmarks set out in Table 2 will be used for monitoring progress on structural reforms. Detailed definitions and reporting requirements for all performance criteria are contained in the Technical Memorandum of Understanding (TMU) attached to this memorandum, which also defines the scope and frequency of data to be reported for program monitoring purposes. During the program period, the government will not introduce or intensify restrictions on payments and transfers for current international transactions or introduce or modify any multiple currency practice without the IMF's prior approval, conclude bilateral payments agreements that are incompatible with Article VIII of the IMF's Articles of Agreement, or introduce or intensify import restrictions for balance of payments reasons. The third, fourth, and fifth reviews of the program will take place on or after May 7, 2022, November 7, 2022, and May 7, 2023, respectively.

69. We would like to request the IMF Executive Board to approve some modifications to program targets. We request increasing the end-June 2022 performance criterion on the primary balance to reflect higher spending pressures, including for humanitarian support. In addition, the newly introduced ceiling on the present value of contracting or guaranteeing of new external debt by the national government replaces the separate nominal ceilings on new external concessional and non-concessional borrowing, reflecting the reforms of the IMF Debt Limits Policy that entered into effect on June 30, 2021. The higher nominal equivalent of the end-June 2022 PV debt limit than the combined nominal ceiling set at the time of the 1st ECF/EFF reviews reflects the impact of the assumption of some additional debts of Kenya Airways, as part of its restructuring. Adopting a more standard approach to the NIR calculation as done in other countries, we request modifying the basis upon which the QPC is assessed.

Table 1. Kenya: Quantitative Performance Criteria and Indicative Targets, March 2021 – December 2022

(in billions of Kenyan shillings, unless otherwise indicated)

	2021									2022		
	End March			End June				End Dec		End June		End Dec
	1st Rev	Outturn	Status	1st Rev	Adjusted	Outturn	Status	1st Rev	Proposed	1st Rev	Proposed	Proposed
Quantitative performance criteria												
Fiscal targets												
Primary budget balance of the national government (- = deficit; floor)[1]	-407.8	-134.8	met	-507.8		-455.1	met	-202.9	-202.9	-369.4	-428.0	-110.2
Tax revenue (floor)[1, 2]	...	...	...	...		...	...	783.2	783.2	1,667.3	1,667.3	862.3
Monetary targets												
Stock of central bank net international reserves (floor, in millions of US$)[3]	5,862	6,090*	met	7,451	5,591*	6,326*	met	6,634	7,915	6,151	7,265	5,668
Public debt targets												
Contracting and guaranteeing of new external non-concessional borrowing (ceiling, millions of US$)[4]	3,407	0	met	3,407		1,000	met	6,407	...	7,612	...	...
o/w: Debt for a debt management purpose[4,5]	2,000	0	met	2,000		0	met	5,000	...	5,000	...	...
o/w: Debt for projects[4,6]	1,407	0	met	1,407		1,000	met	1,407	...	2,612	...	...
Contracting and guaranteeing of new external concessional borrowing (ceiling, millions of US$)[4]	2,000	0	met	3,100		820	met	4,800	...	4,800	...	...
Public and publicly-guaranteed external debt arrears (ceiling)[7,8]	0	0	met	0		0	met	0	0	0	0	0
New domestic guarantees granted by the central government (ceiling)[1]	5	0	met	5		0	met	5	5	5	5	5
PV of contracting or guaranteeing of new external debt (ceiling, millions of US$)[9]	...	...	...	...		...	...	...	7,726	...	8,846	9,905
Indicative targets												
Tax revenue (floor)[1,2]	996.2	989.7	not met	1,420.5		1,429.5	met	...	...	...	...	...
Priority social expenditures of the national government (floor)[1]	293	290	not met	391		404	met	205	205	397	397	205
Change in the stock of national government exchequer requests outstanding for 90 days or more (ceiling)	0	4.2	not met	0		0	met	0	0	0	0	0
Monetary policy consultation clause			met				met					
Upper band (annual, percentage points)	7.5			7.5				7.5	7.5	7.5	7.5	7.5
Center inflation target (annual, percentage points)[10]	5.0	5.8		5.0		6.0		5.0	5.0	5.0	5.0	5.0
Lower band (annual, percentage points)	2.5			2.5				2.5	2.5	2.5	2.5	2.5
Memorandum items for adjustors												
Programmed amount of new debt issuance for PV-reducing, debt management operations	...	...	...	2,000	...	...	...	5,000	5,000	5,000	5,000	5,000
Memorandum items (other)												
Nominal value of contracting and guaranteeing of new external borrowing under nominal ceilings at time of 1st ECF/EFF reviews (in millions of US$)[4]	5,407	0	met	6,507	...	...	...	11,207	...	12,412	...	...
Nominal value of contracting or guaranteeing of new external debt under new PV ceiling (in millions of US$)[11]	...	...	...	...	...	...	...	...	11,207	...	12,635	14,521

*Note: Calculated at daily average of the month of the test date. Starting from December 2021, NIR targets are set for end-of-period. For comparison, the end-of-period outturn for March and June, 2021 were $6,129 million and $7,672 million.

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

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

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

[4] Cumulative from Program approval. Non-concessional borrowing exceptions.

[5] In line with the IMF Policy on Debt Limits in place until June 30, 2021, debt management operations that improve the overall public debt profile.

[6] In line with the IMF Policy on Debt Limits in place until June 30, 2021, financing for projects integral to the authorities' development program (includes Eurobond borrowing). The list of projects is specified in Annex I of the TMU.

[7] Continuous.

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

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

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

[11] Cumulative from Program approval.

Table 2. Kenya: Existing and Proposed Structural Benchmarks

Measure	Target Date	Status	Macro-Criticality
State-Owned Enterprises (SOEs) Restructuring and Governance			
Prepare a strategy for addressing financial pressures in the SOE sector including an in-depth and forward-looking financial evaluation of the top 15–20 SOEs representing the largest financial and fiscal risks, a framework for deciding on interventions, and reforms to rationalize the SOE sector.	End-May 2021	Not met. Implemented with delay.	Reduce fiscal risks related to SOEs.
Include in the annual Budget Review and Outlook paper an expanded fiscal risk analysis that quantifies contingent liabilities stemming from high-risk SOEs and initiate coverage of PPPs.	End-Sep 2021	Not met. Implemented with delay.	Improve transparency and accessibility of information on the broader public sector to improve fiscal policy planning and reduce fiscal risks.
Fiscal Transparency			
Initiate regular quarterly reporting on pending bills, covering Ministries, Departments and Agencies (MDAs), Counties, Semi-Autonomous Government Agencies (SAGAs) and State Corporations (SCs).	End-Mar. 2021	Met.	Enhance fiscal transparency in a critical area.
Publish the results of an audit of all COVID-19-related expenditures in FY2019/20.	End-May 2021	Not met. Implemented with delay.	Safeguard public resource and enhance transparency and accountability.
Publish results of a forensic audit of COVID-19 vaccine spending up to June 2021 and a comprehensive audit of expenditures in FY2020/21 with a chapter on COVID-19-related spending.	End-May 2022	New.	Strengthen transparency and enhance oversight.
Ensure that comprehensive information on public tenders awarded, including beneficial ownership information of the awarded entities, are publicly available on the government procurement information portal, and that bidders are subject to dissuasive sanctions for non-compliance.	End-Jun. 2021	Not met.	Reduce corruption risks by strengthening transparency and enhancing oversight.
Start publication of annual report on tax expenditures and their budget implications.	End-Sep. 2021	Met.	Strengthen transparency and enhance oversight.

Table 2. Kenya: Existing and Proposed Structural Benchmarks (concluded)

Adopt revised standard bidding documents to obtain consent from beneficial owners to publish beneficial ownership information for awarded tenders in the public procurement information portal (PPIP); and start requiring consent for all new tenders.	End-March 2022	New.	Reduce corruption risks by strengthening transparency and enhancing oversight.
Budget and Revenue Collection			
Submit to Parliament a budget for FY2021/22 consistent with the programmed deficit target.	End-Apr. 2021	Not met. Implemented with delay.	Ensure fiscal consolidation consistent with program objectives.
Submit to Parliament a supplementary budget for FY2021/22 consistent with programmed deficit target.	End-Jan. 2022	New.	Ensure fiscal consolidation consistent with program objectives.
Submit to Parliament a budget for FY2022/23 consistent with programmed deficit and revenue targets.	End-April 2022	New.	Ensure fiscal consolidation consistent with program objectives.
Increase by 30 percent the number of Level II audits of firms, using risk-based approaches to select taxpayers with focus on industry sectors with large gaps in compliance identified by the IMF VAT-Gap analysis.	End-Dec. 2021	Met.	Increase compliance and tax revenue.
Public Financial Management			
Issue decision to implement across MDAs and Counties a common payroll system linked to IFMIS.	End-June 2021	Not met. Implemented with delay.	Contain growth and improve efficiency of expenditure and reduce corruption risks.
Public Investment Management			
Complete stocktaking of existing projects and associated commitments in the areas of education, health, and infrastructure, enter the results in the Hyperion system, and identify projects to be rationalized.	End-March 2021	Met.	Improve debt management and efficiency of spending.
Publish a white paper outlining strategy to strengthen and modernize the monetary policy framework.	End-June 2021	Not met. Implemented with delay.	Strengthen the capacity to implement monetary policy effectively in the context of flexible inflation targeting.

Attachment II. Technical Memorandum of Understanding

Nairobi, Kenya, December 2, 2021

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

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

I. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS

3. The program establishes quantitative performance criteria for December 31, 2021, June 30, 2022, and December 31, 2022 with respect to:

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

4. The program sets indicative targets for December 31, 2021, June 30, 2022, and December 31, 2022 with respect to:

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

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

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

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

6. **For program purposes, the national government primary balance** on a cash basis will be measured from the financing side as the sum of the following: (a) the negative of net domestic financing of the national government; (b) the negative of net external financing of the national government; and (c) domestic and external interest payments of the national government. For the end-December 2021 test date, and end-June 2022 and end-December 2022 test dates, the national government primary balance will be measured cumulatively from July 1, 2021, and July 1, 2022, respectively.

The above items are defined as follows:

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

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

- The floor will be adjusted downward (upward) by half of any SOE support in excess (falling short) of the amounts set out in TMU Table 1 below for FY2021/22 and FY2022/23, provided that the cumulative SOEs support reported in Table 1 below plus any overage does not exceed KSh.126.5 billion (1.0 percent of the FY2021/22 GDP) over that period. For the purpose of monitoring execution of the SOEs amounts indicated in Table 1 throughout the fiscal year, the fiscal outturn tables (BOT) will be amended to show explicitly the amounts paid in each month as well as the targeted levels for the month.

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

	2021	2022	
	Dec.	Jun.	Dec.
Extraordinary Support to SOEs	0	48,426	36,638

Source: Kenyan authorities.

1/ Cumulative from July 1, 2021 for FY2021/22 and from July 1, 2022 for FY2022/23.

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

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

	2021	2022	
	Dec.	Jun.	Dec.
Program grants	547	2,500	0

Source: Kenyan authorities.

1/ Cumulative from July 1, 2021 for FY2021/22 and from July 1, 2022 for FY2022/23.

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

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

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

- **Gross official international reserves** are defined as the sum of:

  - the CBK's holdings of monetary gold (excluding amounts pledged as collateral);
  - holdings of Special Drawing Rights (SDRs);
  - CBK holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments); and
  - Kenya's reserve tranche position with the IMF.

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

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

- If the total of (i) program loans, (ii) the revenue component of project loans, and (iii) external commercial and semi-concessional borrowing (excluding for payments of principal of existing debt with the proceeds from newly issued debt for debt management purposes (¶21 bullet a)) exceeds (falls short) the programmed amounts set out in TMU Table 3 below, the target for NIR will be adjusted upward (downward) by the difference;
- If program grants or the revenue component of project grants falls short of the programmed amounts set out in TMU Table 3 (next page), the target for NIR will be adjusted downward by the difference;
- If foreign exchange outflows related to financial support provided to Kenya Airways exceeds (falls short) the programmed amounts set out in TMU Table 3 below, the target for NIR will be adjusted downward (upward) by the difference;
- The NIR target will be adjusted downward by the full amount of import costs associated with COVID-19 vaccine-related purchases less any external project financing received for this purpose.

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

	2021	2022	
	End-Dec	End-June	End-Dec
Program grants and loans	375	1619	252
Program loans	370	1597	252
Program grants	5	22	0
Project loans and grants	327	816	293
Project loans (revenue component)	296	736	259
Project grants (revenue component)	30	80	34
Commercial and Semi-concessional borrowing	1191	0	0
Foreign exchange outflows related to KQ support	0	240	117

Source: Kenyan authorities.
[1] Cumulative from July 1, 2021 for FY2021/22 and from July 1, 2022 for FY2022/23.

- If the pledged DSSI relief exceeds (falls short of) the programmed amounts set out in TMU Table 4 below, the target for NIR will be adjusted upward (downward) by the difference.

Table 4. Kenya: DSSI Relief[1]
(US$ millions)

	2021			2022
	Mar.	Jun.	Dec.	Jun.
DSSI total debt relief	312.0	424.8	88.9	88.9

Source: Kenyan authorities.
[1] Cumulative from July 1, 2020 to June 30, 2021 for FY2020/21 and from July 1, 2021 to June 30, 2022 for FY2021/22.

10. **NIR is monitored in U.S. dollars,** and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar equivalent values, using the exchange rates as specified in TMU Table 5 (next page).

Table 5. Kenya: Program Exchange Rates
(Rates as of February 4, 2021)

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

Source: Central Bank of Kenya.

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

11. Public and publicly-guaranteed external debt arrears to official and private external creditors are defined as overdue payments (principal or interest), which were not made by their contract due date nor during the applicable grace period thereafter, on debt contracted by the national government. Public and publicly-guaranteed external debt arrears (principal or interest) to official and private creditors are defined as overdue payments beyond 30 days after the original contract due date in order to allow sufficient time to process the due repayment after the original debtor has notified of its inability to pay. The definition excludes arrears relating to debt subject to renegotiation (dispute or ongoing renegotiation) or rescheduling. External debt is defined on a currency basis.

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

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

Definition of Debt

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

14. The term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of financial and

nonfinancial assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms; the primary ones being as follows:

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

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

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

15. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

Coverage of Debt

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

- Public sector external debt includes foreign-currency denominated obligations of the National Government of Kenya, and foreign-currency denominated obligations of the Central Bank of Kenya contracted on behalf of the national government (excluding newly contracted financing from the IMF and the General SDR allocation).
- The definition of debt is presented in the above sub-section, with the exception noted in the previous bullet.

  (i) For program purposes, a 'guaranteed debt' is an explicit promise by the public sector to pay or service a third-party obligation (involving payments in cash or in kind).

- External debts in currencies other than the U.S. dollar will be converted in U.S. dollars at program exchange rates.

Contracting of Debt and Treatment of Credit Lines

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

Definition of Debt Ceiling

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

Present Value Calculation

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

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

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

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

points.[5] Where the variable rate is linked to a benchmark interest rate other than the six-month USD SOFR, a spread reflecting the difference between the benchmark rate and the six-month USD SOFR (rounded to the nearest 50 basis points) will be added.

Debt Management Operations

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

Adjustors to Debt Ceiling

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

22. The debt ceiling would be adjusted upward by the full amount in PV terms of any project financing dedicated to COVID-19 vaccine interventions that was not anticipated at the time of setting of the performance criterion. In this connection, the authorities will consult with IMF staff on any planned external concessional borrowing for this purpose and the conditions on such borrowing before the loans are either contracted or guaranteed by the national government. The rationale for this adjustment will be reassessed in the context of the 3rd Reviews of the EFF/ECF arrangements.

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

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

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

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

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

VII. MONETARY POLICY CONSULTATION CLAUSE

25. The bands around the projected 12-month rate of inflation in consumer prices, as measured by the headline consumer price index (CPI) published by the Kenya National Bureau of Statistics, are specified in the TMU Table 6 below.

- If the observed average of the 12-month rate of CPI inflation for the three months preceding the test date falls outside the lower or upper bands specified in the TMU Table 6 below, the authorities will complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for program deviations, taking into account compensating factors; and (iii) proposed remedial actions if deemed necessary. When the consultation with the IMF Executive Board is triggered, access to Fund resources will be interrupted until the consultation takes place.

Table 6. Kenya: Monetary Policy Consultation Clause, 2021–22
(percent values)

	end-Dec. 2021 Target	end–Jun. 2022 Target	end-Dec. 2022 Target
Upper band	7.5	7.5	7.5
Center point	*5.0*	*5.0*	*5.0*
Lower band	2.5	2.5	2.5

Source: Kenyan authorities.

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

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

IX. INDICATIVE TARGET ON NATIONAL GOVERNMENT OUTSTANDING EXCHEQUER REQUESTS

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

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

X. INDICATIVE TARGET ON PRIORITY SOCIAL SPENDING

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

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

The floor on priority social spending of the national government is defined as the programmed amounts set out in TMU Table 7.

Table 7. Kenya: Priority Social Spending[1]

(KSh. millions)

	2021	2022	
	Dec.	Jun.	Dec.
Priority Social Spending	205,395	397,320	210,389

Source: Kenyan authorities.

[1] Cumulative from July 1, 2021 for FY2021/22 and from July 1, 2022 for FY2022/23.

XI. DATA REPORTING

30. To monitor program performance, the National Treasury and the CBK will provide to the IMF the information at the frequency and within the reporting deadlines specified in TMU Table 8 (next page). The authorities will transmit promptly to Fund staff any data revisions. For any information (and data) that is (are) relevant for assessing performance against program objectives but is (are) not specifically defined in this memorandum, the authorities will consult with Fund staff. The authorities will transmit promptly to IMF staff any data revisions, as well as other information necessary to monitor the arrangements with the IMF.

Table 8. Kenya: Summary of Data to Be Reported			
Information	**Frequency**	**Reporting Deadline**	**Responsible Entity**
1. Primary balance of the national government			
Net domestic bank financing (including net commercial bank credit to the national government and net CBK credit to the national government broken down in their main components)	Monthly	Within 20 days after month end.	CBK
Net nonbank financing of the national government	Monthly	Within 20 days after month end.	NT
Proceeds from privatization	Monthly	Within 20 days after month end.	NT
Debt service paid and coming due on domestic debt	Monthly	Within 20 days after month end.	CBK
Debt service paid and coming due on external debt	Monthly	Within 20 days after month end.	NT
Disbursements and repayment schedule of external concessional and non-concessional project loans, including securitization	Monthly	Within 20 days after month end.	NT
Disbursements and repayment schedule of budget support loans	Monthly	Within 20 days after month end.	NT
Disbursements and repayment schedule of on all external loans	Monthly	Within 20 days after month end.	NT
Net proceeds from issuance of external debt	Monthly	Within 20 days after month end.	NT
Any exceptional financing (including rescheduled principal and interest)	Monthly	Within 20 days after month end.	NT
Net changes in the stock of short-term external debt	Quarterly	Within 45 days after quarter end.	NT
Change in external arrears, including interest and principal, and penalties	Monthly	Within 20 days after month end.	NT
Stock and movements in MDAs' pending bills for prior fiscal years	Monthly	Within 20 days after month end.	NT
Stock of exchequer requests made after the start of July 2020 and unpaid for 90 days or more	Monthly	Within 20 days after month end.	NT
Execution of Extraordinary SOE support	Monthly	Within 20 days after month end.	NT
National government transactions with and on behalf of SOEs broken down in main categories	Quarterly	Within 20 days after the end of the quarter.	NT
2. Public debt			
Stock of Treasury Bills and Bonds	Quarterly	Within 45 days after quarter end.	NT
Auctions of T-bills and T-bonds via primary dealers, including the number and value of submitted and accepted bids, minimum, maximum and weighted average interest rates and maturity dates	Weekly	Within 7 working days after the end of the week.	NT
Total new other domestic debt contracted or guaranteed	Monthly	Within 20 days after the end of the quarter.	NT in collaboration with CBK
Total new contracted external project loans	Monthly	Within 20 days after the end of the quarter.	NT
Total other new contracted or guaranteed external concessional debt	Monthly	Within 20 days after the end of the quarter.	NT in collaboration with CBK
Total new Eurobond issuances	Monthly	Within 20 days after the end of the quarter.	NT
Total new other non-concessional external debt contracted or guaranteed	Monthly	Within 20 days after the end of the quarter.	NT in collaboration with CBK

Table 8. Kenya: Summary of Data to Be Reported (concluded)

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

Annex I. List of Projects

	Project	Sector
1	Digital Learning	Access to Universal Information
2	E-Government Services	
3	ICT and BPO Development	
4	ICT Infrastructure Connectivity	
5	Cooperative Development and Management	Agricultural Production and Management
6	Fisheries, Aqua Culture and Blue Economy	
7	Food Security and Crop Diversification Project	
8	KAGRC Liquid Nitrogen	
9	Livestock Resources development and Management	
10	Mechanization of Agricultural Development Project	
11	National Value Chain Support Programme	
12	Promotion of Industrial Development and Investments	
13	Provision of Credit to MSMEs in Manufacturing sector- KIE	
14	Construction of Computer Labs to Support Digital Literacy Programme	Education
15	Infrastructure Development and Expansion of TVETs	
16	Renovation and expansion of infrastructure in public primary schools	
17	Renovation and expansion of infrastructure in public Secondary schools	
18	University Education	
19	Vocational Training and Research	
20	Vocational Training Centres Support(Youth Polytechniques	
21	National Grid System	Energy
22	Rural Electrification	
23	Correctional Facilities	Enhanced Security
24	Digitization of Land registries	Environment Protection and Management
25	Forests and Water Towers Conservation	
26	Irrigation and Drainage	
27	Processing and Registration of Title deeds	
28	Sanitation Infrastructure Development and Management	
29	Sewerage Infrastructure Development	
30	Water Harvesting and Storage for Irrigation	
31	Water Resources Conservation and Protection	
32	Water Storage and Flood Control	
33	Construction of Affordable Housing Units	Improvement of Housing Planning and Infrastructure
34	Construction of Housing Units for National Police & Kenya Prison	
35	Construction of Markets and Fire Stations	
36	Kenya Informal Settlements Improvement& slum upgrading projects	
37	Construction of Roads and Bridges and Roads rehabilitation	Improvement of Infrastructure
38	Expansion of Airports and air strips(Malindi, Lanet, Migori)	
39	Lamu Port- South Sudan- Ethiopia - Transport (LAPSSET)Project	
40	Special Economic Zones(Naivasha & Dongo Kundu)	
41	Expansion of Courts	Improvement/Access to Justice
42	Establishment of Regional Cancer Centres	Universal Health Coverage
43	Expansion of Referral Hospitals	
44	Forensic and Diagnostics	
45	Free Maternity Program	
46	Managed Equipment Service-Hire of Medical Equipment for 98 Hospital	
47	Reproductive Maternal Neo-natal Child & Adolescent Health-RMNCAH	
48	Roll-out of Universal Health Coverage. COVID-19 response and mitigation strateg	
49	Human wildlife mitigation programme	Wildlife conservation/Tourism Promotion and Marketing
50	Maintenance of Access Roads and Airstrips in Parks	
51	Tourism Infrastructure Development and Promotion	

INTERNATIONAL MONETARY FUND

KENYA

December 2, 2021

STAFF REPORT FOR 2021 ARTICLE IV CONSULTATION, SECOND REVIEWS UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, AND REQUESTS FOR MODIFICATION OF PERFORMANCE CRITERIA AND STRUCTURAL CONDITIONALITY—DEBT SUSTAINABILITY ANALYSIS

Approved By:
Annalisa Fedelino (IMF, AFR); Martin Kaufman (IMF, SPR); Marcello Estevão, and Asad Alam (IDA)

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

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

Kenya's debt is sustainable. While overall and external ratings for risk of debt distress remain high, debt dynamics will be bolstered by the fiscal consolidation envisaged under the IMF supported program.[1] *High deficits—from the past and generated by the current shock – combined with the sharp slowdown in export and economic growth in 2020 caused by the pandemic, have resulted in near-term deterioration of solvency and liquidity debt indicators that is only partly offset by the ongoing recovery. Kenya's debt indicators will improve as fiscal consolidation progresses and exports and output recover from the global shock, although improvement is particularly gradual for indicators in terms of exports. Sustained fiscal consolidation would stabilize debt towards the end of the program and bring it to more prudent levels over the medium term while securing resources to support social spending. Kenya has enjoyed strong access to international capital markets, and staff projections assume limited reliance on market financing over the coming three years beyond the roll-over of existing Eurobonds. The DSA suggests that Kenya is susceptible to export and exchange rate shocks; more prolonged and protracted shocks to the economy would also present downside risks to the debt outlook.*

[1] The DSA analysis reflects a debt carrying capacity of Medium considering Kenya's Composite Indicator Index of 3.04, based on the IMF's 2021 October World Economic Outlook and the 2020 World Bank Country Policy and Institutional Assessment (CPIA).

PUBLIC DEBT COVERAGE

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

- The external DSA covers the external debt of the central government and the central bank, including publicly guaranteed debt, as well as of the private sector.
- The public DSA covers both external and domestic debt incurred or guaranteed by the central government. It does not cover the entire public sector, such as extra-budgetary units and county governments.[2] Debt coverage excludes legacy debt of the pre-devolution county governments,[3] estimated at Ksh 53.8 billion (0.5 percent of 2020 GDP). In comparison to peers, Kenya maintains a high standard of debt transparency. The external public debt register includes granular data disclosure.[4] The DSA uses a currency-based definition of external debt. There is no significant difference between a currency-based and residency-based definition of external debt, as nonresidents' direct participation in the domestic debt market is small, at about one percent of total outstanding government securities.

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

- 3.1 percent of GDP to capture non-guaranteed debt of state-owned enterprises (SOEs) and Public Private Partnerships (PPPs). This includes non-guaranteed debt of the 18 SOEs, considered to pose the highest fiscal risk, equal to KSh.105 billion (1 percent of GDP; see paragraph 3). Guaranteed SOE debt and amounts borrowed directly by the Kenyan government and on-lent to SOEs[5] are included in the public debt stock (see above) and are, therefore, not included in the calibration of the contingent liabilities stress test;
- 0.5 percent of GDP to cover legacy debt of the pre-devolution county governments (see above);
- 5 percent of GDP for a financial market shock—a value that exceeds the existing stock of financial sector NPLs of about 4 percent of GDP.

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

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

[4] Debt statistics bulletins with PPG coverage and debt management strategies are regularly published. The Budget Policy Statement publishes contingent liabilities.

[5] This includes the external debt associated with the Standard Gauge Railway (SGR).[6] In June 2021, Kenya successfully issued a new US$1 billion Eurobond.

Text Table 1. Kenya: Public Debt Coverage

Public debt coverage

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

Public debt coverage and the magnitude of the contingent liability tailored stress test

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

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

3. **Kenyan authorities are working on expanding the coverage of public debt in regular reports to include non-guaranteed debt of the public sector (including arrears) by October 2022.** The authorities' efforts in this area are supported by a Policy and Performance Action (PPA) under the IDA Sustainable Development Finance Policy (SDFP). The Annual Public Debt Management Report for FY 2020/21 took an important step, by including non-guaranteed debt of 18 public entities considered to pose the highest fiscal risk as per the financial evaluations conducted earlier this year. Of these 18 SOEs, 9 were found to have non-guaranteed debt totaling KSh.105 billion (1 percent of GDP). Next fiscal year's debt report is expected to extend the coverage to counties and the remaining SOEs.

BACKGROUND ON DEBT

4. **Kenya's overall public debt has increased in recent years.** Gross public debt increased from 44.4 percent of GDP at end-2015 to 67.4 percent of GDP at end-2020 (Table 1), reflecting high deficits, partly driven by past spending on large infrastructure projects, and in 2020 by the COVID-19 global shock. About half of Kenya's public debt is owed to external creditors.

5. **Most of Kenya's external public debt remains on concessional terms.** Nominal PPG external debt at end-2020 amounted to 35 percent of GDP, about five percentage points higher than at end-2019 (Text Table 2 and Table 1):

- Kenya has received important support on very favorable terms from multilateral institutions. At end-2020, multilateral creditors accounted for about 40 percent of external debt, while debt from bilateral creditors represented close to 33 percent (Text Table 2 in next page). Of Kenya's bilateral debt, about 63 percent is owed to non-Paris Club members, mainly loans from China to finance construction of the Standard Gauge Railway (SGR) project.

Text Table 2. Kenya: Decomposition of Public Debt and Debt Service by Creditor, 2020–22[1]

	Debt Stock (end of period) 2020			Debt Service					
				2020	2021	2022	2020	2021	2022
	(In US$)	*(Percent total debt)*	*(Percent GDP)*	*(In US$)*			*(Percent GDP)*		
Total	**66,495**	**100.0**	**67.4**	**3,319**	**3,153**	**3,708**	**3.3**	**2.9**	**3.2**
External	**34,491**	**51.9**	**35.0**	**2,616**	**2,396**	**3,039**	**2.6**	**2.2**	**2.6**
Multilateral creditors	13,695	20.6	13.5	359	504	517	0.4	0.5	0.4
IMF	1,017	1.5	1.0	-	-	-	-	-	-
World Bank	9,278	14.0	9.2	-	-	-	-	-	-
African Development Bank	2,919	4.4	2.9	-	-	-	-	-	-
European Economic Community (incl. EIB)	196	0.3	0.2	-	-	-	-	-	-
International Fund For Agricultural Development	196	0.3	0.2	-	-	-	-	-	-
Other Multilaterals	90	0.1	0.1	-	-	-	-	-	-
o/w: Arab Bank For Economic Development In Africa	38	0.1	0.0	-	-	-	-	-	-
Nordic Development Fund	28	0.0	0.0	-	-	-	-	-	-
Bilateral Creditors	11,278	17.0	11.1	804	585	1,124	0.8	0.5	1.0
Paris Club	4,138	6.2	4.1	222	136	315	0.2	0.1	0.3
o/w: Japan	1,522	2.3	1.5	-	-	-	-	-	-
France (incl. AFD)	825	1.2	0.8	-	-	-	-	-	-
Non-Paris Club	7,141	10.7	7.1	582	449	809	0.6	0.4	0.7
o/w: EXIM China	7,004	10.5	6.9	-	-	-	-	-	-
EXIM India	69	0.1	0.1	-	-	-	-	-	-
Bonds	6,100	9.2	6.0	452	452	520	0.4	0.4	0.4
Commercial creditors	2,826	4.3	2.8	1,333	774	800	1.3	0.7	0.7
o/w: Trade and Development Bank	2,421	3.6	2.4	-	-	-	-	-	-
China Development Bank	378	0.6	0.4	-	-	-	-	-	-
Standard Bank Ltd UK	17	0.0	0.0	-	-	-	-	-	-
Other international creditors	591	0.9	0.6	48.4	78.2	78.0	0.0	0.0	0.0
o/w: Intesa SanPaolo	360	0.5	0.4	-	-	-	-	-	-
ING Bank Germany	64	0.1	0.1	-	-	-	-	-	-
Domestic	**32,005**	**48.1**	**32.4**	**703**	**757**	**668**	**0.7**	**0.7**	**0.6**
Held by residents, total	31,685	47.6	31.3	-	-	-	-	-	-
Held by non-residents, total	320	0.5	0.3	-	-	-	-	-	-
T-Bills	7,851	11.8	7.8	-	-	-	-	-	-
Bonds	23,498	35.3	23.2	-	-	-	-	-	-
Loans	-	-	-	-	-	-	-	-	-
Memo items: 2/									
Collateralized debt	n.a.	n.a.	n.a.	-	-	-	-	-	-
o/w: Related	n.a.	n.a.	n.a.	-	-	-	-	-	-
o/w: Unrelated	n.a.	n.a.	n.a.	-	-	-	-	-	-
Contingent liabilities	n.a.	n.a.	n.a.	-	-	-	-	-	-
o/w: Public guarantees	n.a.	n.a.	n.a.	-	-	-	-	-	-
o/w: Other explicit contingent liabilities	n.a.	n.a.	n.a.	-	-	-	-	-	-
Nominal GDP (at average Ksh/$ rate)	101,233	-	-	-	-	-	-	-	-

Sources: Kenyan authorities and IMF staff calculations.

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

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

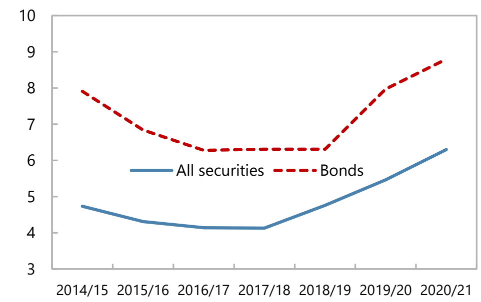
- The share of external commercial debt decreased through June 2021, as the authorities prioritized concessional borrowing during the pandemic after several years of reliable access to global financial markets. Based on end-2020 data, commercial debt (mainly Eurobonds, loans and export credits) accounted for about 28 percent of external public debt—modestly
- above its share at end-2015. Eurobonds accounted for 64 percent of commercial debt (US$6.1 billion),[6] while syndicated loans represented 30 percent (about $2.8 billion).[7]

6 In June 2021, Kenya successfully issued a new US$1 billion Eurobond.

7 Syndicated loans amounting to Euro 305.4 million claimed by a syndicate of Italian commercial banks in relation to Arror, Kimwarer, and Itare dams projects are disputed and subject to on-going arbitration/court proceeding. These syndicated loans are included in the stock of public debt, but not in the debt service schedule, as budget provisions for their servicing are suspended until the matter is determined.

6. Kenya's domestic public debt reached 32.4 percent of GDP at end-2020 (Text Table 2 and Table 2). Domestic debt is issued mostly in the form of Treasury bonds (77 percent of the total stock) and Treasury bills. The 91-day, 182-day, and 364-day average interest rates were 7.0 percent, 7.4 percent and 8.2 percent respectively in October 2021. The average time to maturity for government domestic bonds, excluding T-bills, increased from 6.3 years in June 2019 to 8.6 years in June 2021, as the authorities successfully implemented their strategy to lengthen the maturity profile of domestic debt (Text Figure 1). This has helped alleviate short-term rollover risks. About half of government domestic debt securities are held by commercial banks, followed by pension funds.

Text Figure 1. Kenya: Domestic Public Debt Average Time to Maturity (Years)



Source: National Treasury and Planning, Public Debt Management Report 2020/2021.

7. Published data on private external debt is available through 2018 and is extrapolated going forward with the net private external debt BOP flows. The source of data on private external debt is the International Investment Position (IIP) data published in the IMF Statistics Department IIP database.[8] Compared with the last DSA, the 2020 ratio of total private external debt to GDP is 1.7 percentage points higher, reflecting improved data coverage.

UNDERLYING ASSUMPTIONS

8. Revisions by the Kenya National Bureau of Statistics (KNBS) of the historical GDP series in September 2021 called for revisiting several assumptions underpinning the DSA. Under KNBS' revised methodology, the level of nominal GDP is higher (e.g., by 5.3 percent in 2019), reflecting better coverage of the economy, while the breakdown of growth into real and price components shows that the 2010-19 real growth was on average 0.8 percent lower than previously estimated (5.0 vs 5.8 percent). This has led to a downward revision of the growth potential of the economy and a lower average real growth rate over the entire projection period (Text Table 3). As a result, while the level of nominal GDP is initially higher than in the last DSA published in April 2021,[9] in the long run nominal GDP is below previously-projected levels. This affects all ratios to GDP that enter in the DSA framework. At the same time, it corresponds with slower growth of imports in the long run, helping improve the non-interest current account balance. Assumptions on the underlying primary fiscal deficit and its main components, as well as export performance, remain broadly in line with previous projections but now incorporate the baseline costs associated with SOE restructuring and expansion of the authorities' COVID-19 vaccination program, as well as modest additional emergency spending for drought and security (see ¶13 for more information on SOE-related spending).

[8] See https://data.imf.org/regular.aspx?key=61468209.

[9] IMF Country Report No. 21/072.

Text Table 3. Kenya: Selected Macroeconomic Assumptions, 2021-41

	2021	2022	2023	2024	2025	2026	Long-term 1/
Nominal GDP (Ksh billion)							
Current DSA	11,975	13,328	14,790	16,388	18,163	20,133	50,993
Previous DSA (April 2021)	11,767	13,011	14,498	16,165	18,025	20,098	53,261
Real GDP (growth)							
Current DSA	5.9	5.8	5.5	5.5	5.5	5.5	5.6
Previous DSA (April 2021)	7.6	5.7	6.1	6.1	6.1	6.1	6.0
Revenue and grants (percent of GDP)							
Current DSA	16.0	16.6	17.5	18.0	18.4	18.8	19.5
Previous DSA (April 2021)	16.5	17.0	17.9	18.2	18.6	18.9	19.7
Primary fiscal deficit (percent of GDP)							
Current DSA	-3.6	-2.3	-0.5	0.3	0.9	1.3	1.0
Previous DSA (April 2021)	-3.7	-2.0	-0.4	0.3	0.9	1.3	1.0
Non-interest current account (percent of GDP)							
Current DSA	-3.9	-3.9	-4.0	-3.9	-3.9	-3.8	-3.4
Previous DSA (April 2021)	-3.5	-3.6	-3.6	-3.8	-3.7	-3.7	-3.6
Exports of goods and services (growth)							
Current DSA	13.3	17.9	13.3	11.9	10.8	8.9	9.6
Previous DSA (April 2021)	20.7	12.0	12.5	11.9	11.1	8.7	9.5

Sources: Kenyan authorities and IMF staff estimates.
1/ Average 2027-41.

9. Under the baseline scenario, solid growth is expected over the medium term (Text Table 4). Kenya's strong economic growth in the decade prior to the pandemic was supported by increased public spending aimed at narrowing the large infrastructure gap and implementing devolution. While this growth was accompanied by a substantial reduction in poverty, debt vulnerabilities have mounted. Kenya now faces the challenge to reorient its economy towards sustainable, private-sector-led growth, while implementing fiscal consolidation and strengthening debt management capacity. Despite a modest contraction in 2020 driven by the global COVID-19 shock, medium-term growth prospects remain favorable. The authorities' COVID-19 vaccination program has accelerated on increased availability of vaccines, with a goal of vaccinating 10 million people by end-2021 and to fully vaccinate all adults (26 million people) by end-2022. In 2021, the recovery is being driven by manufacturing and services, particularly transportation and education, activities that have rebounded from the lockdowns implemented to address the health crisis in 2020. Estimated growth for 2021 is significantly affected by base effects driven by the school closures and reopening (0.5 percentage points). In 2022, growth will be supported by the ongoing recovery of tourism. Over the medium to long term, annual trend growth of 5.5 percent, about 0.5 percentage points above the pre-pandemic average, is expected on the basis of robust investment and productivity growth, supported by ongoing reforms to open markets and support credit to the private sector, as well as a broadly favorable demographic backdrop (growing working-age population and falling, though still high, dependency ratio). Medium-term growth is supported by the reform agenda under the IMF 2021 EFF/ECF program, which should underpin a healthy private investment rate, as well as the favorable prospects for external demand propelling exports. The authorities' policy and institutional reforms, supported by the World Bank, should expand the role of markets and foster sustained, private sector-led growth, including measures to make the domestic debt capital market more transparent and liquid, make the land market more transparent and functional (by upgrading valuation regulations and information), and move to competitive auction-based clean energy investment. Inflation is expected to return to the middle of the authorities' target range in the medium term.

Text Table 4. Kenya: Selected Macroeconomic Indicators, 2019–26

	2019	2020	2021	2022	2023	2024	2025	2026
			Projections					
Real GDP growth (percent)	5.0	-0.3	5.9	5.8	5.5	5.5	5.5	5.5
CPI inflation, average (percent)	5.2	5.2	6.4	5.8	4.8	5.0	5.0	5.0
Overall fiscal balance (percent of GDP) [1]	-7.3	-7.6	-8.2	-8.2	-5.8	-4.2	-3.7	-2.7
Primary balance (percent of GDP)[1]	-3.4	-3.4	-4.0	-3.4	-1.2	0.2	0.5	1.3
Current account balance (percent of GDP)	-5.5	-4.6	-5.2	-5.1	-5.1	-5.0	-5.0	-5.0
Exports of goods and services (US$ billion)	11.5	9.8	11.1	13.1	14.8	16.6	18.4	20.0
Exports of goods and services (growth; percent)	-0.6	-14.8	13.3	17.9	13.3	11.9	10.8	8.9
Gross international reserves (US$ billion)	9.1	8.3	10.8	9.0	9.8	10.7	11.6	12.5
Gross international reserves (months of imports)	6.1	4.7	5.2	4.6	4.2	4.2	4.2	4.2

Sources: Kenyan authorities and IMF staff estimates and projections.
[1] Fiscal years (e.g., 2020 refers to FY 2019/20).

10. The fiscal deficit reached 8.2 percent of GDP in 2020/21 on the impact of the COVID-19 shock (Text Table 4). Tax revenues declined to 12.6 percent of GDP in 2020/21—reflecting the economic slowdown and policy measures in response to the shock. The drop in tax revenue would have been more pronounced had the authorities not also implemented measures to broaden the tax base, including removal of several tax exemptions,[10] demonstrating their strong commitment to undertaking adjustment. Under-execution of planned spending held the primary deficit to 4.0 percent of GDP in FY20/21, well below the target of 4.5 percent. Efforts to narrow the deficit prior to the pandemic shock had been mainly achieved through spending cuts to both current outlays and development spending. With continued strong adjustment under the IMF 2021 EFF/ECF program—which reflects the authorities' goals to increase tax revenues and control expenditures, so as to anchor debt sustainability—Kenya's primary deficit would narrow in 2023 below its average debt-stabilizing level over the medium-term, estimated at 1.3 percent of GDP.[11] Over the medium term, the overall deficit is expected to decline and stay below 4 percent of GDP, with on average zero primary balance (Table 2).[12] The authorities are assumed to continue pursuing a strategy of limiting reliance on external commercial borrowing in the coming years to reduce debt-related vulnerabilities (Text Table 5). In 2021, 64 percent of external public financing is expected to come in the form of concessional and semi-concessional borrowing, including from the IMF and the World Bank. Financing from commercial lenders is estimated at US$2.2 billion, reflecting the successful

[10] Kenya's revenue collection remains in line with the regional average.

[11] For more details see Section A "*Supporting the COVID-19 Response While Reducing Medium-Term Debt Vulnerabilities*" in the Staff Report for the 2nd Reviews of Kenya's IMF EFF/ECF Arrangements (forthcoming).

[12] This would lower Kenya's debt below the proposed level under the authorities' new debt anchor of 55 percent of GDP in present value terms.

placement of US$1 billion Eurobond in June 2021—amid strong demand that saw the yield fall below the initial guidance to 6.3 percent—and the likely shift of the previously-planned Eurobond for FY2021/22 to this calendar year.

11. **Under the 2021 general allocation of SDRs, Kenya received the equivalent of US$740 million (or 0.7 percent of GDP).** The authorities have indicated plans to retain half the SDR allocation in reserves and on-lend up to half to substitute foregone fiscal financing. The baseline projection assumes that half of the allocation (US$370 million) is on-lent by the Central Bank of Kenya to the government in the form of 30-year domestic claim with a bullet maturity carrying an interest rate equal to the Ksh equivalent of the average SDR rate over 2021–51. In the DSA, the domestic financing need is reduced by the domestic-currency equivalent of the face value of the claim (Ksh41.4 billion), whereas the claim enters in the calculation of the PV of total public debt with its present value, which reflects a grant element of 47 percent. This reduces the PV of total public debt by 0.35 percent of GDP in 2021.

12. **Relief under the G-20 Debt Service Suspension Initiative (DSSI) has helped reduce external financing needs in 2021.** Relief in the first half of 2021 amounted to 0.39 percent of GDP, with an additional 0.08 percent of GDP anticipated in the second half of 2021 for a total of USD 514 million.[13]

13. **As part of the restructuring of Kenya Airways (KQ), the Government of Kenya expects to take over the responsibility for full repayment of up to USD 827.4 million of loans to KQ.** Out of the total amount, USD 750 million is guaranteed by the Government of Kenya (GoK), with the guarantee already included in the end-2020 stock of public debt. For the purposes of this analysis, the restructuring is assumed to result in a replacement of the full amount of KQ-related guarantees with the full amount of the KQ loans subject to the operation in the DSA debt perimeter, including additional non-guaranteed debt in the amount of USD 77.4 million. The analysis assumes that the GoK will service the debt based on the original amortization schedule of KQ's loan agreements. This approach would avoid the risk of acceleration of guaranteed loans, which contain cross-default clauses to past-due debts owed by KQ to other creditors. To prevent any meaningful deviation in their goal of decisively improving the Exchequer's debt profile under their adjustment program, the authorities plan to undertake offsetting expenditure cuts for half of the amount of extraordinary SOE support (up to one percent of GDP in such support), and to fully offset amounts beyond this level.[14]

14. **The current account deficit amounted to 4.5 percent of GDP in 2020—around one percentage point lower than in 2019.** It narrowed during the pandemic, as positive trends in the trade and primary income accounts offset the negative impact of the global shock on international travel and transportation receipts. The trade deficit narrowed on the back of resilient goods exports, weaker demand for imports, and lower energy and commodity prices. Favorable weather patterns

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[13] For January-June 2021, the Government obtained debt suspension of US$425 million. For July-December 2021, the Government of Kenya made a request to all its bilateral creditors for debt service suspension estimated at US$379 million. Anticipated relief of around US$89 million is now lower due to non-participation by some creditors.

[14] Planned offsets for FY21/22 amounts were identified in the context of the 2nd Review of the IMF EFF/ECF arrangements.

boosted horticulture and tea exports, offsetting demand-side price pressures. The surplus on the income account increased, driven by stronger remittances and a drop in FDI-related outflows. Over the medium term, staff projects a decompression and stabilization of the current account deficit at around 5 percent of GDP. Capital goods imports are expected to gradually increase reflecting improvements in both investor sentiment and the business climate. Exports of goods and services are projected to reach 13.4 percent of GDP in 2026, broadly the same share as observed in 2016.[15] Export growth will be supported by Kenya's improving business environment, large potential in the agricultural sector and the government's Big 4 development agenda and Economic Recovery Strategy with their emphasis on boosting exports.[16] Services are projected to gradually increase over the medium term, as the tourism sector returns to normal after the COVID-19 shock. Remittances are also projected to gradually increase. Under the baseline the current account deficit is expected to be financed by a diversified set of sources, including FDI and financial and non-financial corporate borrowing.

15. As part of a continuing commitment to reduce debt-related vulnerabilities, Kenya is expected to continue to rely on concessional development financing, while tapping international financial markets to roll over maturing Eurobonds and optimize the debt service profile. The authorities' external borrowing program, set out in Text Table 5, reflects the authorities' commitments under the IMF 2021 EFF/ECF arrangements. These include an overall ceiling on the present value of newly contracted or guaranteed external public debt, which is also an SDFP PPA. In addition to concessional development financing, the external borrowing program provides space for the authorities' intentions to pursue debt management operations, if market conditions are favorable. Potential debt management operations are not reflected in the DSA baseline. Looking ahead, Kenya is expected to continue to tap global capital markets to roll over maturing Eurobonds, with the next Eurobond repayment falling due in June 2024.

16. The realism tools flag some optimism compared to historical performance, reflecting a structural break with past trends based on the policies underpinning the authorities' ambitious reform program (Figure 4). While protecting social spending, the baseline scenario assumes an improvement of the fiscal primary balance of 3.3 percentage points of GDP over three years in 2021–23, which falls in the top quartile of the distribution for LICs. Staff is of the view that this is realistic and in line with the authorities' plan for fiscal consolidation under the program as reflected in the approved FY21/22 budget, their careful management of expenditures to achieve fiscal targets in the face of unanticipated pressures, and their medium-term plans. The authorities' commitment to fiscal consolidation, including actions taken during the pandemic to broaden the tax

[15] See the External Sector Assessment in the accompanying Article IV consultation Staff Report for a discussion on export performance and longer-term competitiveness challenges.

[16] Kenya's long-term development objectives were laid out in Vision 2030, which aims at transforming Kenya into an industrialized middle-income country providing a high quality of life to all its citizens. The 3rd Medium Term Plan (MTP III), which covers 2018–22 groups reforms in four broad areas: (i) food security; (ii) affordable housing; (iii) universal health care; and (iv) manufacturing and job creation, including via boosting exports. The Economic Recovery Strategy is designed to mitigate the adverse socio-economic effects of the pandemic and facilitate opening up of the economy, accelerate economic recovery and attainment of higher and sustained economic growth.

revenue base and identify offsets to compensate for COVID-related expenditures, provide assurances that the fiscal adjustment under the program is achievable. The global and domestic recovery from the COVID shock substantiate the near-term growth trajectory during planned fiscal consolidation. Export growth is projected to be higher than the recent past, which is justified as exports recover from Kenya's early 2019 drought and the 2020 global shock. By 2026, exports of goods and services are projected to return to a similar level as the share of GDP observed in 2016.

Text Table 5. Kenya: Summary Table of Projected External Borrowing Program from July 1, 2021 to December 31, 2022

PPG external debt 1/	Volume of new debt from Jul 1, 2021 to Dec 31, 2022		PV of new debt from Jul 1, 2021 to Dec 31, 2022 (program purposes)	
	USD million	Percent	USD million	Percent
By sources of debt financing	**12,700.8**	**100**	**9,904.9**	**100**
Concessional debt, of which	**6,303.3**	**50**	**3,553.8**	**36**
Multilateral debt	3,461.1	27	1,963.4	20
Bilateral debt	2,842.1	22	1,590.5	16
Other	0.0	0	0.0	0
Non-concessional debt, of which	**6,397.6**	**50**	**6,351.1**	**64**
Semi-concessional 2/	193.2	2	146.7	1
Commercial terms	6,204.4	49	6,204.4	63
By Creditor Type	**12,700.8**	**100**	**9,904.9**	**100**
Multilateral, *of which*	3,461.1	27	1,963.4	20
World Bank	2,595.1	20	1,484.1	15
Bilateral - Paris Club	1,159.5	9	684.1	7
Bilateral - Non-Paris Club	1,682.6	13	906.3	9
Other, *of which*	6,397.6	50	6,351.1	64
For debt management operations 3/	5,000.0	39	5,000.0	50
Uses of debt financing	**12,700.8**	**100**	**9,904.9**	**100**
Infrastructure	3,735.3	29	2,611.8	26
Social Spending	2,026.6	16	1,141.4	12
Budget Financing	1,006.8	8	615.7	6
Other, *of which*	5,932.2	46.7	5,536.0	55.9
For debt management operations 3/	5,000.0	39	5,000.0	50

Notes:

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

2/ Including the assumption of non-guaranteed debt of Kenyan Airways as part of its restructuring plan in FY21/22. Loan obligations between the National Government of Kenya (GoK) and the creditors of Kenya Airlines that replace guarantees previously provided by GoK to the same lenders are not included in the borrowing program.

3/ Planned potential borrowing for debt management operations to improve the debt profile (in terms of PV and debt service profile). See Technical Memorandum of Understanding (TMU) for EFF/ECF Arrangements for definition of debt management operations meeting this standard. Debt management operations are not reflected in the DSA baseline.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

17. Kenya's debt carrying capacity is assessed as Medium (Text Table 6). The debt carrying capacity determines the applicable thresholds for the PPG external and total public debt sustainability indicators used in the assessment.[17] It is informed by the value for Kenya of the Composite Indicator (CI) Index of 3.04,[18] which incorporates data from the IMF's 2021 October World Economic Outlook (WEO) macroeconomic projections and the 2020 World Bank's Country Policy and Institutional Assessment (CPIA). The previous value of the CI Index, based on the IMF's April 2021 WEO, exceeded the threshold for a Strong rating. According to the DSA methodology, reverting to the pre-pandemic assessment of Kenya's debt-carrying capacity of Strong would have required a second consecutive Strong signal based on the published October 2021 WEO forecast vintage. Results from the latter show, however, that the CI Index falls again below the 3.05 threshold, and hence will not trigger an upward revision of the assessment from the current rating of Medium.[19]

18. Besides the six standardized stress tests, there are two tailored stress tests:

- One tailored stress test combines contingent liabilities of a one-time shock on debt (equivalent to 8.6 percent of GDP; Text Table 1) to capture a scenario reflecting both contingent liabilities from SOEs (equal to the indicated standard level of 2 percent of GDP), contingent liabilities from PPPs (equal to the indicated level of 35 percent of the existing PPP stock, or 1.1 percent of GDP) and a need for bank recapitalization (equal to the indicated standard level of 5 percent of GDP).
- The second tailored stress test is a market financing shock which is applied to countries with market access, such as Kenya. The scenario assesses rollover risks resulting from a deterioration in global risk sentiment, temporary nominal depreciation, and shortening of maturities of new external commercial borrowing.

[17] See Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries, Section V.

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

[19] The downward revision of the CI score compared to April 2021 is driven by the GDP rebasing that has resulted in a downward revision of the real GDP growth both historically and in projections (the latter on account of the lower estimate of growth potential), combined with the upward revision of the nominal GDP (reflecting the level effect of the improved coverage of the economy). These changes affect the centered 10-year averages of real GDP growth and the ratio of remittances to GDP that enter in the CI score calculation. The upward revision in world economic growth is insufficient to compensate for the impact of the Kenya GDP revisions.

Text Table 6. Kenya: Composite Indicator and Thresholds

Debt Carrying Capacity and Thresholds

Country	Kenya
Debt Carrying Capacity	Medium

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintage
Medium	Medium 3.04	Strong 3.05	Medium 3.01

Calculation of the CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.70	1.43	47%
Real growth rate (in percent)	2.719	4.67	0.13	4%
Import coverage of reserves (in percent)	4.052	42.67	1.73	57%
Import coverage of reserves^2 (in percent)	-3.990	18.21	-0.73	-24%
Remittances (in percent)	2.022	3.04	0.06	2%
World economic growth (in percent)	13.520	3.14	0.42	14%
CI Score			3.04	100%
CI rating			Medium	

Applicable thresholds

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

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

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

19. External debt burden indicators in terms of exports breach thresholds under the baseline, giving rise to a mechanical high-risk signal (Table 1, Table 3, and Figure 1). Based on the debt-carrying capacity analysis,[20] the PV of PPG external debt-to-exports solvency indicator remains above threshold (180 percent) during 2021–27, while the debt service-to-exports liquidity indicator exceeds its threshold (15 percent) throughout the 10-year projection period. The solvency indicator gradually declines as exports recover; the long-term decline in the liquidity indicator is interrupted by Eurobond repayments in 2024, 2028 and 2031. Similar trends were observed in the April 2021 DSA.

20. The PV of PPG external debt as a share of GDP remains firmly below the 40 percent indicative threshold throughout the projection period (Table 1 and Figure 1). Reflecting fiscal consolidation efforts and a borrowing mix that favors concessional borrowing, this solvency indicator is expected to decline from 28.2 percent in 2021 to 17 percent in 2041. It also remains

[20] Breaches of the sustainability thresholds would have been much less pronounced and persistent under the pre-COVID-19 strong assessment of debt carrying capacity.

below the threshold under the most extreme shock—a one-time depreciation. The external debt service-to-revenue ratio exceeds its threshold in 2024, reflecting the maturity of the Eurobond in that year. If market conditions are favorable, the authorities are considering debt management operations to further improve the debt service profile.

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

22. Market financing liquidity risks are low (Figure 5). Kenya's EMBI spread has fallen from 727 basis points in 2020Q1 to 499.5 basis points at end-October and is below the threshold (570 basis points). Gross financing needs have also declined, from 14 percent of GDP at the time of the previous DSA to 12 percent of GDP currently, staying below the threshold (14 percent of GDP) that indicates high risk. The part of the 2021 general allocation of SDRs to Kenya that is not transferred to the budget, and hence is not included in the DSA baseline—equivalent to US$370 million (0.3 percent of GDP)—could serve as an additional safety buffer. Fiscal consolidation efforts under the EFF/ECF program would help keep gross financing needs below the threshold. As is the case for emerging and frontier economies, financing risks could be affected by global liquidity conditions. If global market conditions were to unexpectedly tighten, financing risks for Kenya may increase. The shift in the deficit financing mix towards domestic resources calls for monitoring, although the recent success in extending the maturity profile of domestic debt mitigates some domestic refinancing risk.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

23. The PV of total public debt-to-GDP ratio remains above the 55 percent benchmark—for a country rated at medium debt-carrying capacity—until 2025 (Figure 2 and Table 2), giving rise to a mechanical high-risk signal. Public sector debt is projected to modestly increase from 60.3 percent of GDP (PV terms) in 2020 to 62.2 percent in 2022, followed by a gradual decline. Supported by fiscal consolidation under the program, including revenue mobilization measures, the PV of public debt-to-revenue ratio would initially increase from 363 percent in 2020 to 376 percent in 2021, before gradually declining to 210 percent in 2031 and to 91.1 percent in 2041.

24. The stress scenarios indicate that the PV of debt-to-GDP ratio would remain above the indicative benchmark for most of the projection period (Figure 2 and Table 4). Under the most extreme shock scenario (shock to GDP growth), the PV of the public debt-to-GDP ratio would breach the 55 percent benchmark for a country with medium debt-carrying capacity during the entire projection period.

RISK RATING AND VULNERABILITIES

25. Kenya's risk of external and overall debt distress remains high in the context of the ongoing global COVID-19 shock. The shock led to a sharp temporary decline in export and GDP growth and triggered a strong fiscal response, interrupting planned consolidation. Consequently, the mechanical signal from debt indicators worsened, particularly those expressed in terms of exports. Risks associated with SOEs are being closely monitored under the Fund-supported program, following the financial evaluations of the largest SOEs facing financial risks, and the authorities are leveraging those insights as they move to address the weaknesses in the most troubled firms. Kenya's external and overall public debt vulnerabilities also reflect high past deficits, partly due to large infrastructure projects. The mechanical signals indicate sustained breaches of solvency and liquidity indicators under the baseline scenario —the PV of external debt-to-exports and external debt service-to-exports ratios as well as the PV of overall public debt-to-GDP. The larger breach of liquidity indicators in 2024 under the baseline is mainly attributed to a Eurobond repayment; staff projects that Kenya should be able to roll over maturing Eurobonds, given its historical record of strong global market access and commitment to fiscal consolidation under the program. The DSA suggests that Kenya is susceptible to export and exchange rate depreciation shocks. The political calendar is a source of uncertainty as upcoming general elections could pressure budget execution and reform implementation.

26. Kenya's debt remains sustainable. Several factors are mitigating the risks, supporting the analysis:

- Decisive actions already undertaken in 2020 and 2021 to limit the pandemic-induced increase in the deficit and to broaden the tax base;
- The multi-year fiscal consolidation under the IMF supported program which aims to decisively reduce deficits and increase tax revenue;
- The consistently strong performance of remittances, which supports external sustainability, paired with a more favorable outlook for exports;
- A favorable overall debt profile and generally smooth amortization profile, which authorities plan to further optimize, if market conditions are favorable;
- Close attention to evaluating risks at SOEs and the commitment under the EFF/ECF program to limit the impact on the deficit of any fiscal support (e.g., via offsets);
- Ongoing efforts to strengthen fiscal sustainability under the SDFP by rationalizing public investments on the basis of rigorous criteria.

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

- While the PV of total public debt-to-GDP ratio remains above the indicative threshold (55 percent), the authorities' commitment to fiscal consolidation under the program safeguards debt sustainability. Important actions have already been taken to permanently broaden the tax revenue base, alongside expenditure savings to limit expansion of the deficit from the COVID-19 shock. The multiyear fiscal consolidation plan highlighted in the 2021 Budget Policy Statement (BPS) and substantiated by the FY21/22 Budget is premised on a more conservative approach to revenue projections and a commitment to additional policy steps to increase tax revenues and control expenditures under the EFF/ECF program with the specific objective of anchoring debt sustainability.
- Kenya's PV of external debt as a share of GDP is well below the 40 percent indicative threshold and will gradually decline over time. Kenya's external debt indicators are expected to gradually improve as fiscal consolidation progresses, exports recover after the global shock dissipates, and Kenya makes progress to unlock its substantial export potential.
- Kenya's borrowing plan relies on a balanced mix of commercial and concessional financing that contributes to reducing debt risks, supported by limits on the government's external borrowing under the EFF/ECF program and PPAs under the SDFP, which also support steps to improve debt transparency.
- In addition, in connection with Kenya's good prospects for capital market access at favorable terms, debt management operations (not reflected under the DSA baseline) that seek to refinance syndicated loans and the 2024 Eurobond with long-dated debt instruments could offer a meaningful possibility to further improve the external debt profile.

28. Debt sustainability is also supported by the stable and strong remittances, Kenya's generally smooth debt service profile and the authorities' commitment to insulate the public sector balance sheet from SOE-related contingent liabilities. While the protracted breaches of most debt burden indicators are a source of concern, along with SOE-related contingent liabilities, there are mitigating factors that help support the debt sustainability assessment. The relatively smooth debt service profile—except for the 2024 Eurobond maturity—is on a clear declining trajectory over the projection period, signaling a strengthening in debt servicing capacity. The authorities' commitment to absorb potential fiscal costs associated with materialization of SOE-related contingent liabilities with a limited impact on the programmed fiscal envelope will help avoid further deterioration in the public sector balance sheet.[21] Stable and strong remittances, projected to reach 32 percent of exports of goods and services in 2021, would also continue to be an important source for foreign currency receipts going forward.

29. The debt profile also calls for a strong debt management framework and its effective implementation. The authorities' active plans for managing their portfolio risks, including through refinancing maturities coming due on better terms to improve the overall debt profile, are a source

[21] For more details, see discussion in paragraph 13 above.

of resiliency. In this context, the authorities are encouraged to further strengthen their debt management capacity to manage and prepare for large repayments of commercial borrowing. As part of this strategy, the authorities' plans to refinance loans at a longer maturity to limit refinancing risks is welcome.[22] At the same time, concessional borrowing should continue to play an important role in financing investment projects due to its lower cost and longer maturity profile, while non-concessional borrowing should be utilized to finance those projects that are critical for the authorities' development strategy and have high social and economic returns. Looking ahead, efficient investment in infrastructure will raise growth and export potential, both of which will support Kenya's external debt sustainability. Delivering on fiscal consolidation, while seeking to preserve social and development spending, would further reduce risks. The authorities are also encouraged to expand the coverage of public debt to include county governments and non-guaranteed debts of SOEs and extra budgetary units and continue improving public debt management and revenue administration.

AUTHORITIES' VIEWS

30. The authorities broadly shared Fund staff's assessment, emphasizing that reducing debt vulnerabilities is a key priority to support Kenya's developmental agenda. They highlighted the success in extending the maturity of domestic debt and the need to pursue a financing strategy that balances domestic and external financing, utilizes concessional financing where available, and accesses private capital markets judiciously. The authorities reiterated their commitment to expand the coverage of public debt in regular reports to include non-guaranteed public sector debts (including arrears). They saw the publication of such information for 18 public entities, considered to pose the highest fiscal risk, in the Public Debt Management Report for FY 2020/21 as an important milestone in this direction. The authorities expressed confidence that the new, national debt ceiling in present value terms, expected to be adopted in 2022, will serve as a credible anchor of their medium-term fiscal policies. They noted that they are actively seeking debt management operations to lower the costs of debt and refinancing risks, especially by seeking to refinance syndicated loans and the 2024 Eurobond with long-dated debt instruments.

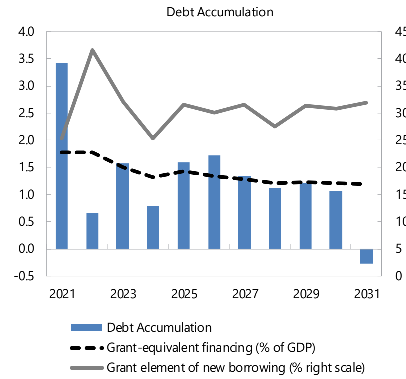
[22] If market conditions are favorable, the authorities are considering debt management operations

Table 1. Kenya: External Debt Sustainability Framework, Baseline Scenario, 2018–41

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2031	2041	Historical	Projection
External debt (nominal) 1/	50.0	52.1	59.7	62.2	62.8	64.9	66.1	67.4	68.5	70.5	66.3	42.6	67.5
of which: public and publicly guaranteed (PPG)	29.2	29.9	35.0	36.7	36.0	35.8	34.4	34.1	33.9	31.5	24.7	23.3	34.2
Change in external debt	-1.0	2.1	7.7	2.4	0.6	2.1	1.2	1.2	1.1	-0.4	-0.8		
Identified net debt-creating flows	-1.7	0.3	3.6	1.7	1.2	1.1	0.8	0.6	0.4	-0.7	-1.6	2.4	0.4
Non-interest current account deficit	4.2	4.1	3.4	3.9	3.9	4.0	3.9	3.9	3.8	3.3	3.4	5.7	3.7
Deficit in balance of goods and services	9.3	8.9	8.0	9.1	8.7	8.6	8.5	8.5	8.5	8.4	8.7	10.6	8.6
Exports	12.5	11.4	9.7	10.1	11.2	11.9	12.5	12.9	13.1	15.1	22.2		
Imports	21.9	20.3	17.7	19.2	20.0	20.5	21.0	21.4	21.6	23.4	30.9		
Net current transfers (negative = inflow)	-5.4	-5.3	-4.9	-5.5	-5.5	-5.5	-5.4	-5.4	-5.4	-6.2	-7.9	-5.1	-5.6
of which: official	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0		
Other current account flows (negative = net inflow)	0.3	0.5	0.3	0.3	0.6	0.9	0.8	0.8	0.8	1.1	2.6	0.3	0.8
Net FDI (negative = inflow)	-1.6	-1.1	-0.5	-0.2	-0.6	-0.8	-0.9	-1.0	-1.1	-1.7	-2.5	-1.3	-1.1
Endogenous debt dynamics 2/	-4.4	-2.6	0.8	-2.0	-2.2	-2.1	-2.2	-2.3	-2.3	-2.3	-2.6		
Contribution from nominal interest rate	1.2	1.4	1.2	1.3	1.2	1.1	1.1	1.1	1.2	1.4	1.1		
Contribution from real GDP growth	-2.6	-2.3	0.2	-3.2	-3.4	-3.2	-3.3	-3.4	-3.5	-3.7	-3.6		
Contribution from price and exchange rate changes	-3.1	-1.8	-0.6	...	...	...	...	...	...	...	...		
Residual 3/	0.7	1.7	4.0	0.8	-0.6	1.0	0.4	0.6	0.7	0.4	0.9	0.5	0.6
of which: exceptional financing	0.0	0.0	0.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	27.1	28.2	27.2	26.9	25.9	25.6	25.5	22.9	17.0		
PV of PPG external debt-to-exports ratio	...	...	280.1	278.5	241.7	225.6	207.5	198.8	194.8	151.9	76.7		
PPG debt service-to-exports ratio	18.3	41.5	24.7	21.6	23.7	19.5	28.8	17.4	15.9	22.8	7.7		
PPG debt service-to-revenue ratio	13.2	28.3	14.6	13.6	16.0	13.3	20.0	12.2	11.0	18.0	8.2		
Gross external financing need (Million of U.S. dollars)	22,671	25,771	22,220	23,095	24,901	25,896	28,865	28,640	29,721	38,849	56,652		
Key macroeconomic assumptions													
Real GDP growth (in percent)	5.6	5.0	-0.3	5.9	5.8	5.5	5.5	5.5	5.5	5.5	5.8	4.2	5.6
GDP deflator in US dollar terms (change in percent)	6.4	3.7	1.1	2.2	0.6	1.1	1.5	1.8	1.8	0.1	0.2	4.1	0.9
Effective interest rate (percent) 4/	2.7	3.1	2.3	2.3	2.1	1.9	1.8	1.8	1.9	2.0	1.7	2.7	2.0
Growth of exports of G&S (US dollar terms, in percent)	10.7	-0.6	-14.8	13.3	17.9	13.3	11.9	10.8	8.9	8.6	10.2	1.2	10.9
Growth of imports of G&S (US dollar terms, in percent)	5.7	1.2	-12.4	17.9	10.5	9.6	9.6	9.1	8.4	7.2	9.2	3.4	9.3
Grant element of new public sector borrowing (in percent)	...	...	...	25.3	41.6	32.1	25.4	31.5	30.1	31.9	35.4	...	30.8
Government revenues (excluding grants, in percent of GDP)	17.3	16.8	16.4	16.0	16.6	17.5	18.0	18.4	18.8	19.1	20.9	16.8	18.2
Aid flows (in Million of US dollars) 5/	1,119	1,476	1,841	2,467	2,900	2,463	2,495	3,341	3,357	3,990	5,923		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	1.8	1.8	1.5	1.3	1.4	1.3	1.2	1.0	...	1.4
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	30.3	48.1	37.6	30.5	36.7	35.6	38.4	43.8	...	36.6
Nominal GDP (Million of US dollars)	92,251	100,416	101,233	109,489	116,475	124,192	132,958	142,806	153,337	202,548	355,744		
Nominal dollar GDP growth	12.4	8.9	0.8	8.2	6.4	6.6	7.1	7.4	7.4	5.6	5.9	8.5	6.5
Memorandum items:													
PV of external debt 7/	...	...	51.9	53.7	54.0	56.1	57.6	58.9	60.1	61.8	58.7		
In percent of exports	...	...	536.3	529.9	480.3	469.6	461.4	457.1	459.7	410.0	264.2		
Total external debt service-to-exports ratio	149.6	178.7	187.1	167.6	150.6	134.5	135.2	117.2	110.6	94.4	45.4		
PV of PPG external debt (in Million of US dollars)			27,437	30,910	31,628	33,461	34,436	36,565	39,034	46,413	60,631		
(PVt-PVt-1)/GDPt-1 (in percent)				3.4	0.7	1.6	0.8	1.6	1.7	-0.3	0.5		
Non-interest current account deficit that stabilizes debt ratio	5.2	2.0	-4.3	1.4	3.3	1.8	2.7	2.7	2.7	3.6	4.2		

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



Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

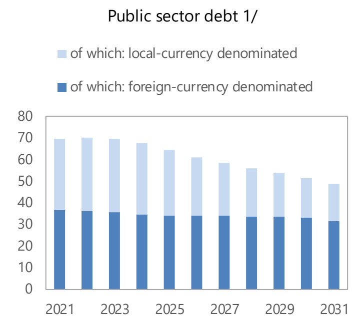
8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 2. Kenya: Public Sector Debt Sustainability Framework, Baseline Scenario, 2018–41

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2031	2041	Historical	Projections
Public sector debt 1/	**56.4**	**58.6**	**67.4**	**69.5**	**70.4**	**69.6**	**67.4**	**64.4**	**61.2**	**48.8**	**26.5**	**47.9**	**61.0**
of which: external debt	**29.2**	**29.9**	**35.0**	**36.7**	**36.0**	**35.8**	**34.4**	**34.1**	**33.9**	**31.5**	**24.7**	**23.3**	**34.2**
Change in public sector debt	2.6	2.2	8.8	2.1	0.9	-0.8	-2.2	-2.9	-3.3	-2.5	-1.5		
Identified debt-creating flows	**2.2**	**2.5**	**7.5**	**1.4**	**-0.1**	**-1.7**	**-2.6**	**-3.0**	**-3.3**	**-2.8**	**-2.0**	**2.6**	**-2.2**
Primary deficit	**3.2**	**3.4**	**3.8**	**3.6**	**2.2**	**0.5**	**-0.3**	**-0.9**	**-1.3**	**-1.0**	**-0.5**	**3.4**	**-0.1**
Revenue and grants	17.5	17.0	16.6	16.4	17.1	17.8	18.3	18.7	19.1	19.4	21.2	**17.3**	**18.5**
of which: grants	0.3	0.2	0.2	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3		
Primary (noninterest) expenditure	20.7	20.4	20.4	20.0	19.3	18.3	17.9	17.8	17.8	18.4	20.7	**20.7**	**18.4**
Automatic debt dynamics	**-1.0**	**-0.9**	**3.7**	**-2.2**	**-2.4**	**-2.2**	**-2.2**	**-2.1**	**-2.0**	**-1.9**	**-1.5**		
Contribution from interest rate/growth differential	-0.4	-0.2	2.8	-2.2	-2.4	-2.2	-2.2	-2.1	-2.0	-1.9	-1.5		
of which: contribution from average real interest rate	2.5	2.5	2.6	1.5	1.4	1.5	1.4	1.4	1.4	0.8	0.0		
of which: contribution from real GDP growth	-2.9	-2.7	0.2	-3.7	-3.8	-3.7	-3.6	-3.5	-3.4	-2.7	-1.5		
Contribution from real exchange rate depreciation	-0.6	-0.8	0.9	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	**0.4**	**-0.3**	**1.3**	**0.7**	**1.0**	**0.9**	**0.4**	**0.1**	**0.0**	**0.4**	**0.5**	**0.2**	**0.5**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**60.3**	**61.7**	**62.2**	**61.2**	**59.2**	**56.3**	**53.2**	**40.7**	**19.3**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**362.8**	**375.5**	**364.5**	**343.7**	**323.9**	**300.8**	**277.9**	**209.8**	**91.1**		
Debt service-to-revenue and grants ratio 3/	**44.7**	**62.0**	**53.7**	**51.8**	**58.2**	**56.0**	**58.1**	**46.8**	**39.8**	**41.4**	**12.4**		
Gross financing need 4/	11.0	14.0	12.7	12.1	12.2	10.5	10.3	7.8	6.3	7.0	2.2		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	5.6	5.0	-0.3	5.9	5.8	5.5	5.5	5.5	5.5	5.5	5.8	**4.2**	**5.6**
Average nominal interest rate on external debt (in percent)	3.3	3.9	3.2	3.3	2.6	2.3	2.0	2.1	2.1	2.6	1.9	**2.6**	**2.4**
Average real interest rate on domestic debt (in percent)	7.0	6.6	6.5	4.6	4.6	4.7	4.7	4.7	4.7	3.9	2.8	**4.1**	**4.5**
Real exchange rate depreciation (in percent, + indicates depreciation)	-3.1	-3.2	3.5	...	...	...	...	...	...	...	...	**-2.1**	**...**
Inflation rate (GDP deflator, in percent)	4.2	4.6	5.2	5.2	5.2	5.2	5.0	5.0	5.0	5.1	5.2	**7.1**	**5.1**
Growth of real primary spending (deflated by GDP deflator, in percent)	1.0	3.3	-0.5	4.1	1.9	0.1	3.4	4.7	5.8	6.0	8.0	**4.7**	**4.6**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	0.6	1.3	-5.0	1.5	1.4	1.3	1.9	2.0	2.0	1.5	1.0	**-1.0**	**1.6**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

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



Sources: Country authorities; and staff estimates and projections.
1/ Coverage of debt: The central government plus social security, central bank, government-guaranteed debt . Definition of external debt is Currency-based.
2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.
4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.
5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.
6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 3. Kenya: Sensitivity Analysis for Key Indicators of Public and Publicly-Guaranteed External Debt, 2021–31
(In percent)

	Projections 1/										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
	PV of debt-to GDP ratio										
Baseline	28	27	27	26	26	25	25	25	25	24	23
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	28	27	28	28	28	29	30	31	32	33	33
B. Bound Tests											
B1. Real GDP growth	28	29	30	29	28	28	28	27	27	27	25
B2. Primary balance	28	28	30	29	29	29	28	28	28	28	26
B3. Exports	28	29	32	31	31	31	30	30	30	29	27
B4. Other flows 3/	28	28	29	28	28	28	27	27	27	26	25
B5. Depreciation	28	34	30	29	29	29	29	28	28	28	26
B6. Combination of B1-B5	28	32	32	31	31	30	30	30	29	29	27
C. Tailored Tests											
C1. Combined contingent liabilities	28	30	30	29	29	29	29	29	29	29	27
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	28	27	27	26	26	25	25	25	25	24	23
C4. Market Financing	28	30	30	29	29	29	28	28	28	27	25
Threshold	40	40	40	40	40	40	40	40	40	40	40
	PV of debt-to-exports ratio										
Baseline	**278**	**242**	**226**	**207**	**199**	**195**	**187**	180	174	167	152
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**278**	**245**	**233**	**222**	**221**	**225**	**225**	**224**	**225**	**225**	**219**
B. Bound Tests											
B1. Real GDP growth	**278**	**242**	**226**	**207**	**199**	**195**	**187**	180	174	167	152
B2. Primary balance	**278**	**248**	**252**	**233**	**223**	**218**	**210**	**202**	**196**	**189**	173
B3. Exports	**278**	**330**	**421**	**388**	**371**	**362**	**348**	**333**	**321**	**305**	**277**
B4. Other flows 3/	**278**	**252**	**245**	**225**	**215**	**211**	**203**	**194**	**187**	179	163
B5. Depreciation	**278**	**242**	**201**	**185**	177	174	168	161	156	151	137
B6. Combination of B1-B5	**278**	**322**	**242**	**318**	**305**	**298**	**287**	**275**	**265**	**253**	**230**
C. Tailored Tests											
C1. Combined contingent liabilities	**278**	**268**	**254**	**235**	**225**	**221**	**213**	**206**	**201**	**195**	180
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**278**	**242**	**226**	**207**	**199**	**195**	**187**	180	174	167	152
C4. Market Financing	**278**	**242**	**226**	**208**	**199**	**196**	**188**	**181**	173	166	151
Threshold	180	180	180	180	180	180	180	180	180	180	180
	Debt service-to-exports ratio										
Baseline	**22**	**24**	**20**	**29**	**17**	**16**	**16**	**19**	**15**	**16**	**23**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**22**	**23**	**19**	**28**	**17**	**16**	**16**	**19**	**16**	**16**	**22**
B. Bound Tests											
B1. Real GDP growth	**22**	**24**	**20**	**29**	**17**	**16**	**16**	**19**	**15**	**16**	**23**
B2. Primary balance	**22**	**24**	**20**	**30**	**19**	**17**	**17**	**20**	**17**	**18**	**24**
B3. Exports	**22**	**30**	**31**	**47**	**29**	**27**	**27**	**32**	**27**	**29**	**40**
B4. Other flows 3/	**22**	**24**	**20**	**29**	**18**	**16**	**17**	**20**	**16**	**17**	**24**
B5. Depreciation	**22**	**24**	**20**	**28**	**17**	**15**	**15**	**19**	15	14	**21**
B6. Combination of B1-B5	**22**	**29**	**29**	**42**	**26**	**23**	**24**	**28**	**24**	**24**	**34**
C. Tailored Tests											
C1. Combined contingent liabilities	**22**	**24**	**20**	**30**	**18**	**17**	**17**	**20**	**16**	**17**	**24**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**22**	**24**	**20**	**29**	**17**	**16**	**16**	**19**	**15**	**16**	**23**
C4. Market Financing	**22**	**24**	**20**	**29**	**19**	**17**	**17**	**20**	**23**	**15**	**22**
Threshold	15	15	15	15	15	15	15	15	15	15	15
	Debt service-to-revenue ratio										
Baseline	14	16	13	**20**	12	11	11	14	12	12	18
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	14	16	13	**19**	12	11	11	14	12	13	17
B. Bound Tests											
B1. Real GDP growth	14	17	15	**22**	13	12	13	15	13	14	**20**
B2. Primary balance	14	16	14	**21**	13	12	12	15	13	14	**19**
B3. Exports	14	16	14	**21**	13	12	12	15	13	15	**20**
B4. Other flows 3/	14	16	14	**20**	13	11	12	14	12	13	**19**
B5. Depreciation	14	**20**	17	**25**	15	13	14	17	14	14	**21**
B6. Combination of B1-B5	14	17	15	**23**	14	13	13	16	14	15	**21**
C. Tailored Tests											
C1. Combined contingent liabilities	14	16	14	**21**	13	12	12	15	12	13	**19**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	14	16	13	**20**	12	11	11	14	12	12	18
C4. Market Financing	14	16	13	**20**	13	12	12	15	17	12	17
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

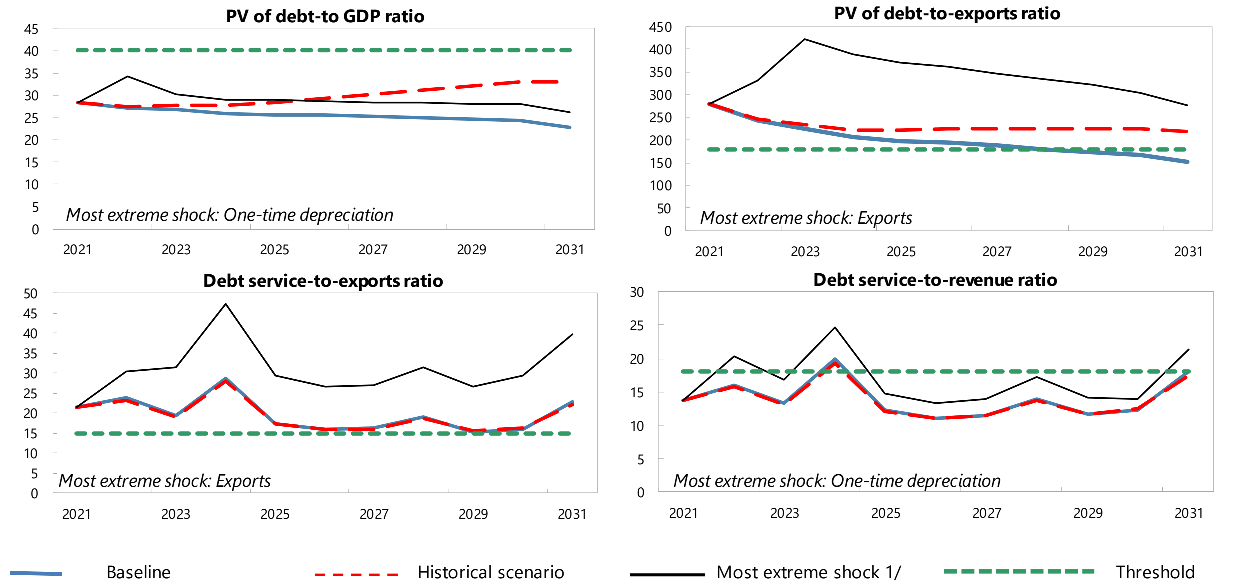
Table 4. Kenya: Sensitivity Analysis for Key Indicators of Public Debt, 2021–31

(In percent)

	Projections 1/										
	2021	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**
					PV of Debt-to-GDP Ratio						
Baseline	**62**	**62**	**61**	**59**	**56**	53	51	48	46	43	41
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**62**	**63**	**64**	**65**	**65**	**66**	**66**	**67**	**68**	**68**	**69**
B. Bound Tests											
B1. Real GDP growth	**62**	**66**	**70**	**69**	**67**	**65**	**64**	**63**	**62**	**60**	**59**
B2. Primary balance	**62**	**64**	**67**	**65**	**62**	**59**	**56**	53	51	48	46
B3. Exports	**62**	**64**	**66**	**64**	**61**	**58**	**55**	53	50	47	45
B4. Other flows 3/	**62**	**63**	**64**	**61**	**59**	**55**	53	50	48	45	42
B5. Depreciation	**62**	**66**	**63**	**59**	**55**	51	47	44	41	37	34
B6. Combination of B1-B5	**62**	**62**	**66**	**64**	**61**	**58**	55	53	50	48	45
C. Tailored Tests											
C1. Combined contingent liabilities	**62**	**70**	**69**	**66**	**63**	**60**	**57**	55	52	49	47
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**62**	**63**	**64**	**63**	**62**	**60**	**59**	**58**	**57**	**56**	55
C4. Market Financing	**62**	**62**	**61**	**59**	**56**	53	51	48	46	43	41
TOTAL public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
					PV of Debt-to-Revenue Ratio						
Baseline	375	364	344	324	301	278	264	251	237	224	210
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	375	369	361	356	349	344	347	350	352	353	353
B. Bound Tests											
B1. Real GDP growth	375	387	391	377	359	342	334	328	320	313	304
B2. Primary balance	375	374	377	356	331	307	292	279	264	250	235
B3. Exports	375	376	373	352	327	303	289	275	261	245	230
B4. Other flows 3/	375	371	357	336	312	289	275	262	248	233	218
B5. Depreciation	375	386	354	325	295	267	248	229	211	193	175
B6. Combination of B1-B5	375	365	368	348	324	301	287	274	260	246	232
C. Tailored Tests											
C1. Combined contingent liabilities	375	409	385	363	338	313	299	285	270	255	241
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	375	370	358	346	330	314	308	302	296	289	282
C4. Market Financing	375	364	344	324	301	278	265	251	237	223	209
					Debt Service-to-Revenue Ratio						
Baseline	52	58	56	58	47	40	36	38	36	36	41
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	52	58	56	60	51	45	43	45	45	48	55
B. Bound Tests											
B1. Real GDP growth	52	61	62	66	54	47	43	46	45	47	54
B2. Primary balance	52	58	58	63	49	42	38	41	40	41	46
B3. Exports	52	58	56	59	48	41	37	38	37	38	43
B4. Other flows 3/	52	58	56	59	47	40	36	38	37	37	42
B5. Depreciation	52	56	56	60	47	40	36	39	36	36	43
B6. Combination of B1-B5	52	57	57	62	49	42	38	40	39	40	45
C. Tailored Tests											
C1. Combined contingent liabilities	52	58	64	61	49	42	38	43	42	42	44
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	52	58	57	60	49	43	40	42	42	43	50
C4. Market Financing	52	58	56	58	48	41	37	38	42	36	41

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

Figure 1. Kenya: Indicators of Public and Publicity Guaranteed External Debt Under Alternatives Scenarios, 2021–31



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

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

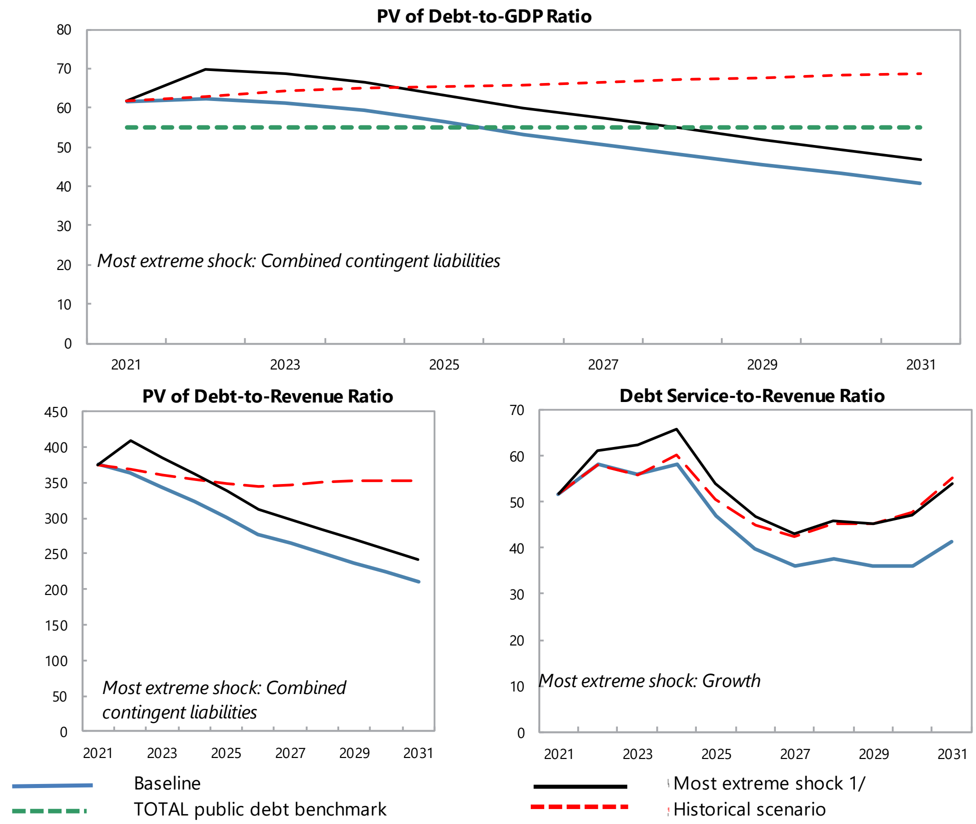
Borrowing assumptions on additional financing needs resulting from the stress	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	2.7%	2.7%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	22	22
Avg. grace period	6	6

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

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 2. Kenya: Indicators of Public Debt Under Alternative Scenarios, 2021–31



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	46%	46%
Domestic medium and long-term	41%	41%
Domestic short-term	14%	14%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	2.7%	2.7%
Avg. maturity (incl. grace period)	22	22
Avg. grace period	6	6
Domestic MLT debt		
Avg. real interest rate on new borrowing	4.0%	4.0%
Avg. maturity (incl. grace period)	8	8
Avg. grace period	5	5
Domestic short-term debt		
Avg. real interest rate	1.2%	1.2%

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

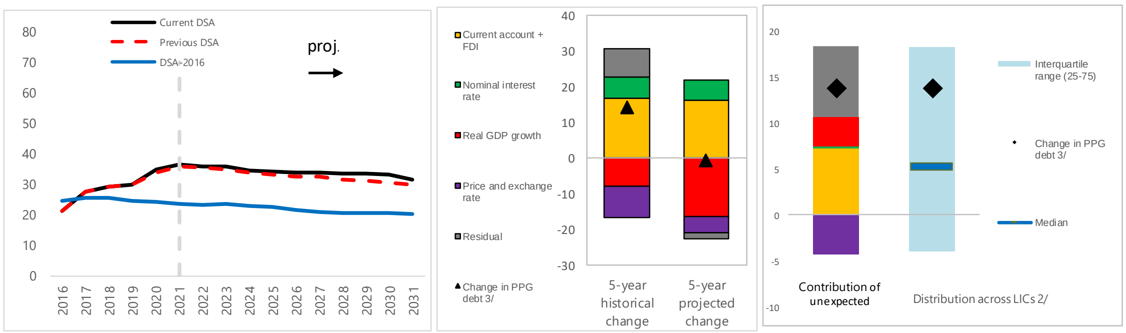
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

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

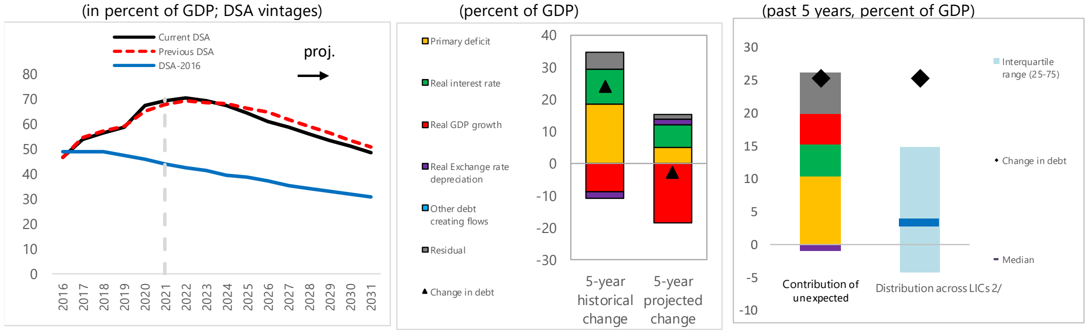
External Debt

Gross Nominal PPG External Debt (in percent of GDP; DSA vintages) | Debt-creating flows (percent of GDP) | Unexpected Changes in Debt 1/ (past 5 years, percent of GDP)



Public Debt

Gross Nominal Public Debt (in percent of GDP; DSA vintages) | Debt-creating flows (percent of GDP) | Unexpected Changes in Debt 1/ (past 5 years, percent of GDP)



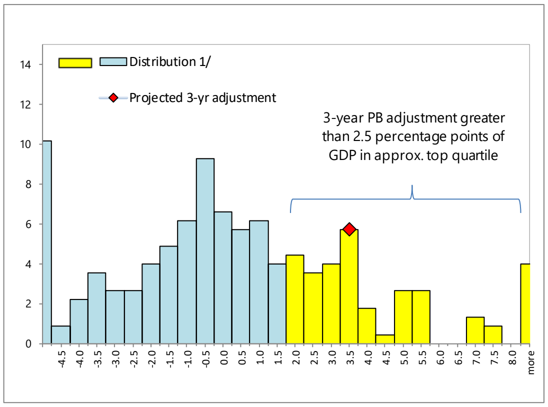
1/ Difference between anticipated and actual contributions on debt ratios.

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

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

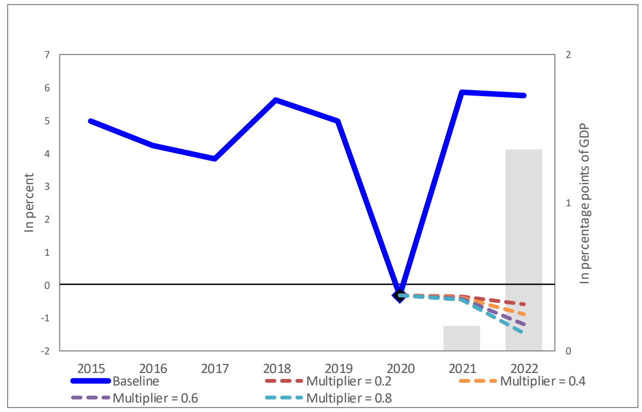
Figure 4. Kenya: Realism Tools

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



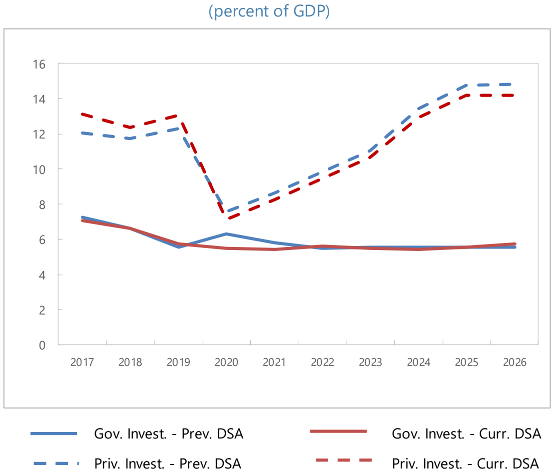
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



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

Public and Private Investment Rates
(percent of GDP)



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

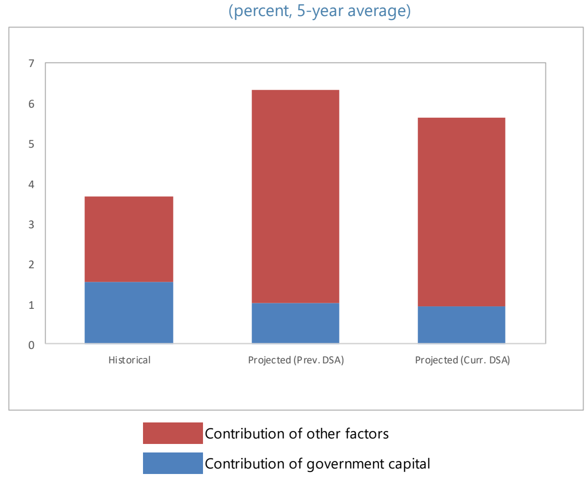
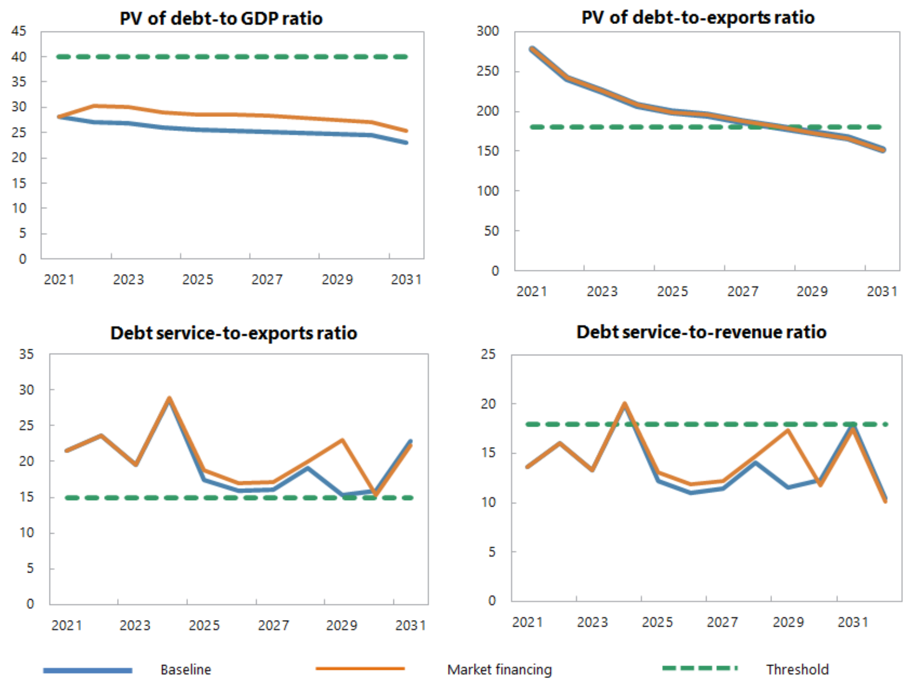


Figure 5. Kenya: Market-Financing Risk Indicators

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	12	499.5
Breach of benchmark	No	No
Potential heightened liquidity needs	Low	

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



Sources: Country authorities; and staff estimates and projections.

INTERNATIONAL MONETARY FUND

KENYA

December 2, 2021

STAFF REPORT FOR 2021 ARTICLE IV CONSULTATION, SECOND REVIEWS UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND UNDER THE ARRANGMENT UNDER THE EXTENDED CREDIT FACILITY, AND REQUESTS FOR MODIFICATION OF PERFORMANCE CRITERIA AND STRUCTURAL CONDITIONALITY—INFORMATIONAL ANNEX

Prepared By: The African Department (in consultation with other Departments).

CONTENTS

RELATIONS WITH THE FUND

(As of October 31, 2021)

Membership Status: Joined: February 03, 1964; Article VIII

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	542.8	100.00
IMF's Holdings of Currency (Holdings Rate)	868.68	160.04
Reserve Tranche Position	13.40	2.47

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	779.9	100.00
Holdings	515.23	66.06

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
RCF loans	542.80	100.00
ECF Arrangements	258.37	47.6
Extended Arrangements	339.25	62.50

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	Apr. 02, 2021	Jun. 01, 2024	1,248.44	339.25
ECF[1]	Apr. 02, 2021	Jun 01, 2024	407.09	162.84
Stand by	Mar 14, 2016	Sep 14, 2018	709.260	0.00

Outright Loans:

Type	Date of Arrangement	Date Drawn	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RCF	May 06, 2020	May 11, 2020	542.80	542.80

Overdue Obligations and Projected Payments to Fund [2] (SDR Million, based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2021	2022	2023	2024	2025
Principal	23.61	50.34	21.58		82.55
Charges/Interest	0.93	3.71	3.71	3.71	3.71
Total	**24.54**	**54.05**	**25.28**	**3.71**	**86.25**

[1] Formerly PRGF.

[2] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

Safeguards Assessments:

An update safeguards assessment of the Central Bank of Kenya (CBK) which was completed in September 2019 found that the CBK has maintained sound external audit and financial reporting practices, and its Board has active oversight of operations.~~,~~ In addition, the CBK continues to maintain effective operational controls. The CBK has implemented most of the recommendations from the 2019 assessment. Draft amendments to the CBK Act, prepared in consultation with IMF, largely address safeguards recommendations and await submission to Parliament.

Exchange Rate Arrangement:

Kenya's currency is the Kenyan Shilling. Kenya's de jure exchange rate arrangement is free floating, and its de facto exchange rate arrangement is classified as floating

Kenya accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement with effect from June 30, 1994 and maintains an exchange system free multiple currency practices and restrictions on payments and transfers for current international transactions, other than restrictions notified to the Fund under Decision No. 144 (52/51).

Article IV Consultation:

The last Article IV consultation with Kenya concluded on June 13, 2018. Kenya is currently on a 24-month Article IV cycle.

Technical Assistance:

Technical assistance activities provided to Kenya since 2020 are listed in next page.

Resident Representative:

Mr. Tobias N. Rasmussen — since October 2019.

Kenya: Technical Assistance, 2020–21

	Year of Delivery
Fiscal Affairs Department (FAD)	
Support to subnational TADAT training	2021
Developing Guidelines for SOE Evaluations	2021
Tax and non-tax revenue policy	2020
Tax Administration Core Functions	2020
Fiscal Reporting	2020
Tax administration	2020
AFRITAC East: Assessment of tax expenditures compliance management	2021
AFRITAC East: Strengthening SOE oversight and governance	2021
AFRITAC East: Review and redesign of high-net-worth individuals function	2021
AFRITAC East: Budget preparation	2020
AFRITAC East: Fiscal Reporting	2020
AFRITAC East: IPSAS implementation, including development of IFMIS for accrual accounting	2020
AFRITAC East: Support to Budget Costing and Project Appraisal	2020
AFRITAC East: Developing capacity in digital services tax practices	2020
Monetary and Capital Markets Department (MCM)	
Central Bank Governance	2020
Government Securities Market Development	2020
Monetary policy design and implementation	2020
AFRITAC East: Forecasting and Policy Analysis	2021
AFRITAC East: Monetary Policy Implementation and Operations	2021
AFRITAC East: Strengthening IFRS 9 Implementation	2020
AFRITAC East: Building Cyber Security Resilience	2020
AFRITAC East: Basel Core principles (BCP) implementation	2020
Legal Department (LEG)	
AML/CFT National Strategy	2020
Statistics Department (STA)	
Balance of Payments and IIP	2021
High frequency economic indicators	2021
Residential property price index	2020
AFRITAC East: Producer price index	2020
AFRITAC East: Review of the preliminary rebased CPI and PPI	2020
AFRITAC East: Review of the preliminary rebased GDP series	2020
AFRITAC East: Government finance statistics	2020
AFRITAC East: Prices: Import and export price indices - Reviewing methodology	2020

STATISTICAL ISSUES

(as of November 30, 2021):

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance and program monitoring, although it has some shortcomings because of capacity constraints. Although the overall quality, timeliness and coverage of macroeconomic statistics have improved over the past few years, further improvements in the methodology of compiling real, fiscal, and external sector statistics would be desirable to facilitate enhanced design and monitoring of economic policies.
National Accounts: The Kenya National Bureau of Statistics (KNBS) has made significant efforts to enhance national statistics compilation. The GDP statistics released in September 2021, were rebased to 2016 from the previous 2009. The main objectives of rebasing to 2016 was to implement more recommendations of the 2008 System of National Accounts (2008 SNA) and to incorporate new data that became available since the 2009 revision. The revision process was done with technical support from the East Afritac and Statistics Sweden, which was also used for benchmarking. The revised and rebased data were also peer reviewed by the International Monetary Fund (IMF). The revised national accounts are based on International Standard Industrial Classification of All Economic Activities Revision 4 (ISIC Rev 4). To improve on the benchmark estimates, KNBS conducted several surveys/censuses which included: the 2015/2016 Kenya Integrated Household Budget Survey (KIHBS), Integrated Survey of Services (ISS) 2017, the Census of Industrial Production (CIP) 2016 and 2017, survey of non-profit institutions serving households (NPISH 2019), the survey of informal transportation and other personal services, the 2016 micro, small and medium enterprise survey (MSMES) and the 2016 Census of Establishments (COE 2016), Income tax data, the 2016 informal cross border trade (ICBT) and the 2019 Kenya Population and Housing Census (KPHC). The ICBT data was used to adjust the customs data. Routine data available for annual GDP compilation included: monthly survey of industrial production (MSIP), monthly survey of hotels, annual labor enumeration survey and data from administrative sources. The data from administrative sources comprised, government accounts, customs records, income tax and value added tax (VAT) returns from the KRA. Other administrative sources were ministry of agriculture, livestock, fisheries and cooperatives (MOA), ministry of environment and forestry, ministry of mining and petroleum, Insurance Regulatory Authority, Central Bank of Kenya and Kenya Ports Authority. The KNBS also compiled Supply and Use Tables (SUT) as part of the revision and rebasing of GDP. The SUT tables will inform the national accounts estimates until the next revision. The SUT methodology provided for more comprehensive coverage of economic activities and a more robust quality assurance approach through balancing of the supply and use of products. This also provided benchmark estimates for the base year (2016).
Price Statistics: The Consumer Price Index (CPI) for Kenya is compiled using weights derived from the 2015/16 Kenya Integrated Household Budget Survey (KIHBS) updated from the 2005/06 KIHBS to reflect the changing household consumption patterns. Consequently, the base year has been updated to February 2019, from February 2009

Government Finance Statistics (GFS): East AFRITAC (AFE) collaborates closely with the EAC Secretariat through a capacity building program to support efforts to improve compilation and dissemination of government finance statistics (GFS) and Public-Sector Debt Statistics (PSDS) based on the Government Finance Statistics Manual 2014 (GFSM 2014) to achieve the fiscal data requirements associated with the East African Monetary Union (EAMU) Protocol. A series of AFE GFS and PSDS TA missions are taking place to further support efforts to improve fiscal data. While GFS is reported at General Government (GG) level, future work will aim to reduce discrepancies (including strengthening coordination among and ensuring consistent use of macroeconomic assumption across data producing units), improve stock data, and the quality of GG data. The authorities committed to compiling and disseminating high-frequency GG data. Process of extending coverage to public corporations is in initial stages. Quarterly Public-Sector Debt is disseminated for certain instruments (mainly loans and debt securities) of Budgetary Central Government, but data is reported at face value and not nominal value.
Monetary and Financial Statistics: Monetary and financial statistics are compiled broadly in line with the *Monetary and Financial Statistics Manual*. The CBK reports monetary and financial statistics monthly, using Standardized Report Forms (SRFs) for the central bank and other depository corporations (ODCs), and monetary data based on these SRFs are published in the *International Financial Statistics*. The CBK has recently made progress: in expanding the coverage of ODCs data to include savings and credit cooperatives (SACCOs) and microfinance banks; and in developing other financial corporations (OFCs) data which comprises insurance corporations and pension funds—expanded ODC has already been reviewed and currently been submitted on a monthly basis while the insurance and pension funds data are still currently undergoing STA's review. The CBK reports data on some key indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).
Financial Sector Surveillance: Kenya does not participate in the IMF's Coordinated Direct Investment Survey (CDIS) and the Coordinated Portfolio Investment Survey (CPIS). The CBK reports Financial Soundness Indicators (FSIs) on a quarterly basis which include 11 cored and 11 encouraged indicators for deposit takers. Data on the household debt to gross domestic product ratio is also reported. However, FSIs on other financial corporations and nonfinancial corporations are not reported.
External Sector Statistics: The KNBS compiles annual balance of payments statistics on BPM6 basis in Kenyan shillings that are regularly reported to STA, while the Central Bank of Kenya (CBK) compile monthly balance of payments statistics in U.S. dollars, which are reported to AFR andused for programming and surveillance purposes. The two datasets are harmonized on a quarterly basis. Further, the CBK reports international reserves data with monthly frequency to STA and the National Treasury reports quarterly external debt statistics to the World Bank. The overall quality of trade data is reasonably good, as it comprehensively captures formal trade based on customs statistics. There are adjustments on coverage to include informal trade and trade in electricity. Data on trade in services is weak because of the reliance on International Transactions Reporting System (ITRS), which suffers from a large and growing element of unclassified inflows and outflows that might well include settlements of current account transactions. The KNBS and the CBK have improved data coverage on financial account, relying mainly on various data sources including the budget out turn for the government sector, the annual Foreign Investment Survey for financial and non-financial corporations and the Monetary Statistics specifically the 1SR for the central bank, 2 SR for the depository corporations. However, estimates for household sector cross-border transactions still relies on the ITRS data.

The last two TA missions on ESS, (October 7–18, 2019 and May 24–June 4, 2021) assisted the KNBS and CBK in developing a preliminary IIP statement consistent with the balance of payments. The authorities have gone further to make improvements on the draft IIP Statement, by including reliable source data, eliminating double counting and inconsistencies between the transactions in the financial account of the BOP and that of IIP. Data on FIS is disaggregated by sector and therefore only used to capture nonfinancial corporations and only specific areas for the depository corporations.

II. Data Standards and Quality

Kenya participates in the Enhanced General Data Dissemination System and disseminates data under the National Summary Data Page (NSDP).

III. Reporting to STA

The data for the General Government is reported to STA in *GFSM 2014* format and disseminated in the *GFS Yearbook*. Monthly and quarterly GFS data are regularly reported for inclusion in the *International Financial Statistics (IFS)*. Monetary data for the central bank and ODCs are regularly reported for inclusion in the *IFS*. Annual balance of payments data, following *BPM6* classifications, are regularly reported to STA.

The data for the General Government is reported to STA in *GFSM 2014* format and disseminated in the *GFS Yearbook*. Monthly and quarterly GFS data are regularly reported for inclusion in the *International Financial Statistics (IFS)*. Monetary data for the central bank and ODCs are regularly reported for inclusion in the *IFS*. Annual balance of payments data, following *BPM6* classifications, are regularly reported to STA.

Table 1. Kenya: Common Indicators Required for Surveillance

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication
Exchange Rate	11/17/2021	11/17/2021	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	9/30/2021	10/31/2021	M	M	NA
Reserve/Base Money	9/30/2021	11/22/2021	D	M	NA
Broad Money	9/30/2021	11/22/2021	D	M	NA
Central Bank Balance Sheet	9/30/2021	11/22/2021	D	M	NA
Consolidated Balance Sheet of the Banking System	9/30/2021	11/22/2021	A	A	A
Interest Rates[2]	11/8/2021	11/8/2021	D	D	NA
Consumer Price Index	10/31/2021	11/09/2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	8/31/2021	10/12/2021	M	M	NA
Stocks of Central Government and Central Government-Guaranteed Debt[5]	6/30/2021	10/12/2021	A	A	NA
External Current Account Balance	6/30/2021	10/12/2021	M	M	NA
Exports and Imports of Goods and Services	8/31/2021	10/12/2021	M	M	M
GDP/GNP	12/31/2020(A) 6/30/2021(Q)	9/9/2021 11/10/2021	Q,A	Q,A	Q,A
Gross External Debt	NA	NA	NA	NA	NA
International Investment Position	NA	NA	NA	NA	NA

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic-bank, and domestic non-bank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

Kenya and the World Bank:

https://www.worldbank.org/en/country/kenya

World Bank Projects:

https://projects.worldbank.org/en/projects-operations/projects-summary?lang=en&searchTerm=&countrycode_exact=KE

Kenya and the African Development Bank:

https://www.afdb.org/en/countries/east-africa/kenya

Statement by the Executive Director, Ms. Ita Mary Mannathoko, and by the Senior Advisor of the Executive Director, Mr. James Alic Garang
December 17, 2021

I. Introduction

1. Our Kenyan authorities appreciate the constructive engagement with staff during the 2021 Article IV consultation and the Second Review of the Extended Fund Facility and Extended Credit Facility (EFF/ECF) arrangements. They consider continued Fund support essential to support stabilization and foster economic recovery.

2. The Kenyan economy has been resilient to the COVID-19 pandemic shock with a strong rebound evident in 2021, thanks in part to diversified sources of growth and sound economic policies. Nonetheless, scarring is evident with the pandemic having increased poverty levels, and undermined achievement of Sustainable Development Goals (SDGs), while creating urgent sizeable fiscal and balance of payments financing needs. The focus of the authorities is on balancing near-term development needs with sustainability, by reducing debt vulnerabilities over the medium term. They remain determined to sustain reforms that will reduce public debt over time, address financial weaknesses and risks from State-owned Enterprises (SOEs), strengthen monetary policy and maintain financial stability, while also advancing the structural agenda, growth and jobs, and importantly, the anti-corruption program.

3. Despite the current difficult context, performance under the Fund-supported program has been strong. The authorities, therefore, hope for Directors' support in concluding the Article IV consultation and completing the Second Review under the EFF/ECF arrangements and requested modifications.

II. Recent Economic Developments and Outlook

4. GDP is expected to grow by 5.9 percent in 2021, a significantly faster recovery than the Sub-Saharan African average, after a contraction of 0.3 percent in 2020. The services sector led the rebound in growth in 2021, particularly transport and storage, education, information and communication, wholesale and retail trade, and strong performance of the construction and manufacturing sectors. This reflects in part, the authorities' strategic response to the pandemic where nightly curfews were in effect through most of 2021, with more economically disruptive measures such as lockdowns and travel restrictions applied in a phased manner, limiting the impact on economic activities. It also demonstrates the authorities' recognition of the economic transformation underway with services-led growth, outpacing manufacturing. Recovery in international tourism has however been slower, and further activity in hotels and restaurants, trade, transport, and other services, will depend on the pace of vaccination to help prevent new waves of infections and associated containment

measures. The growth outlook therefore remains strong due to the impact full vaccination will have on services, especially tourism, with the authorities expecting medium-term growth to remain around 6 percent, above pre-pandemic levels.

5. Monetary policy has continued to anchor price expectations, with inflation remaining within the target range of 2.5–7.5 percent, despite the effects of higher fuel and food prices. In the external sector, the current account balance narrowed due to strong performance in exports and remittances, and weaker import demand. International reserves remain adequate, covering about 5 months of imports in FY2021/2022, and recently buoyed by the general SDR allocation. Risks to the outlook include uncertainty around the evolution of the pandemic and the drought afflicting regions in the North and pressuring the security situation.

III. Program Performance

6. Program performance is robust, with all end-June performance criteria (PCs) and indicative targets (ITs) met. Performance in other areas has also been strong, including the primary balance which has significantly overperformed, and social spending, which modestly overperformed. All structural benchmarks (SBs) for 2021 with the exception of one, have now been implemented. The single SB that was delayed due to conflicting legal requirements is that on publication of beneficial ownership information. The authorities have been working to resolve this and expect to meet the SB by end-March 2022 having established a clear roadmap.

7. Given the materialization of spending needs around vaccines and humanitarian support, as well as SOEs, and revised FX flows due, for example, to the SDR allocation, the authorities are requesting modifications to performance criteria (PCs) on the primary balance and net international reserves (NIR), and a switch to end-of-period NIR monitoring, while a new ceiling on the present value of new external debt will reflect recent reforms to the IMF Debt Limits Policy.

IV. The Government's Response to the Pandemic

8. The government's response to the pandemic has been strategic and effective. Kenya has gone through four waves of infections, peaking in August 2021, and the authorities' plan to fully vaccinate the 30 million adult population by end 2022 has been constrained primarily by supply constraints. The vaccination drive has accelerated with the arrival of new vaccine shipments and donations in the past couple of months. With 10 percent of adults fully vaccinated and 16 percent more partly vaccinated by December 6, 2021 (World Bank), the goal now is to fully vaccinate 33 percent of adults by end-2021, and all adults (almost 50 percent of a total population of about 55 million) by end-2022. The authorities continue to monitor developments and vaccine needs, considering the emergence of the new variant.

9. The authorities are implementing an 8-point Economic Stimulus Program (ESP), which, among other things, includes fast-tracking VAT refunds. Fiscal, monetary, and financial sector measures instituted to mitigate the adverse impact of the pandemic have been effective. These provided support to vulnerable households and businesses, with measures including temporary tax cuts, cash transfers, the introduction of a credit guarantee scheme, a youth employment program, temporary easing of repayment conditions for borrowers, and a more accommodative monetary stance, providing critical support and limiting the impact of the pandemic. The Central Bank of Kenya (CBK) in coordination, with other government policies, implemented a range of temporary regulatory measures throughout the crisis to cushion the adverse impact on the banking sector and the economy, and facilitated lending to borrowers, using regulatory flexibility, loan restructuring, and adjustments in fees charged on mobile transactions. Consequently, asset quality in banks was preserved and banks' profitability, which dropped sharply in 2020 due to higher provisioning, began to recover in 2021.

V. Macroeconomic Policies

Fiscal Policy

10. The authorities remain committed to a multi-year fiscal consolidation plan that will reduce debt vulnerabilities and preserve priority social and development spending, with the Fund program providing essential support for sound fiscal management ahead of the 2022 elections. Cognizant of the need for effective revenue mobilization and a more efficient tax system to support the national agenda, the authorities, with IMF TA support, are making progress developing a Medium-Term Revenue Strategy (MTRS) with well sequenced and coherent tax policy and administrative measures to widen the tax base. They have already registered strong budget performance, exceeding the program target, and the Kenya Revenue Authority (KRA) has identified additional measures (reforming corporate exemptions, and VAT, among others) to enhance revenue administration and collections. In light of the ongoing legal challenges to the Corporate Minimum Tax (CMT), the authorities have identified measures to offset CMT revenue lost, for the FY2021/22. The authorities are confident that the offsets will be achieved with a reduction in recurrent spending and further rationalizing the portfolio of non-priority projects.

11. Expenditure control measures remain vital, to preserve fiscal and debt sustainability, while ensuring priority social programs and development expenditures remain appropriately funded, in line with program design. The authorities also continue to build on their commitment to sound PFM practices, transparency, and accountability. Reducing fiscal risks is also a priority for the authorities, and recent work on the forward-looking financial evaluations of key SOEs has identified the most pressing needs in the sector and the associated implications for the budget in FY2021/22. An SOE reform strategy has been completed that lays out measures to enhance SOE financial and operational efficiency that will generate cost savings. The strategy includes reviewing the organizational arrangements

within the National Treasury (NT) for financial oversight of State Corporations (SCs), extending the coverage of financial evaluations of SCs undertaken by NT, and development of Government Investment Management Information System modules that will facilitate reporting by SCs on all their unguaranteed, guaranteed, and on-lent loans.

12. The authorities are committed to prudent debt management and are pursuing a strategy to transition to a medium-term debt anchor of 55 percent of GDP (present value terms) by mid-2022. They plan to bring the primary deficit below its debt-stabilizing level in 2023 and into positive territory by FY2023/24. Strong fundamentals and a strong rebound will also support this debt stabilization.

Monetary, Exchange Rate, and Financial Sector Policies

13. The authorities' monetary policy stance remains appropriate for now given the ongoing pandemic and well-anchored inflation expectations. They aim to maintain headline inflation within the target range and sustain the flexible exchange rate regime, with market interventions only in response to excessive exchange rate volatility. They are also working to improve the monetary policy framework, as reflected in the CBK *White Paper Modernisation of the Monetary Policy Framework and Operations* published in July 2021, mapping out reforms to strengthen the monetary policy framework, including strengthening macroeconomic modelling and forecasting frameworks, improving operations of financial markets, and enhancing communication of monetary policy decisions so they are more effective.

14. The banking sector is adequately capitalized with strong deposit growth. Nevertheless, safeguarding financial stability remains a priority, and among other things, the authorities plan to continue to strengthen financial safety nets, even as measures are planned to address profitability, solvency, and liquidity challenges in some small banks. Risk management is also being enhanced, with the CBK acting to strengthen banks' assessment of climate-related risks. The CBK issued guidance to banks in October 2021, on integrating climate-related risks into banks' governance, strategy, risk management and disclosure frameworks. The authorities are also moving towards real-time supervision.

15. Expanding access to finance remains a priority, as financial intermediation plays an important role in supporting the recovery. A conducive regulatory environment and digitalization have helped to promote financial inclusion in Kenya. The authorities are advancing this agenda. The CBK (Amendment) Bill 2020 on Digital Lenders, was passed by the National Assembly in October 2021 and received Presidential endorsement in December. It empowers the CBK to supervise and regulate digital lenders, to ensure a fair and nondiscriminatory marketplace for access to credit. CBK will shortly be issuing regulations to operationalize this law.

Structural Reforms

16. The authorities are working to improve governance and combat corruption through more transparent procurement practices, forensic audits and follow-up on their findings, implementing laws establishing access to information and asset declarations of public officials, improving revenue administration and tax expenditure transparency, and strengthening AML/CFT supervision in the financial sector. The inclusion of pertinent reforms in the Fund program supports this effort. The National Risk Assessment report and AML/CFT Action Plan are expected to be published by end-2021 upon approval by Cabinet, with the validation review process recently completed. Other measures relate to fiscal reforms including those to boost investment efficiency, implement newly developed risk-based compliance strategies, contain the wage bill, and verifying exemptions. The authorities also continue to enhance conflict of interest rules for senior public officials to bring them in line with international practice. They are also collecting and publishing all corruption cases on the Judiciary website.

17. Governance reforms include work to ensure full transparency in the use of COVID-19-related resources and close system loopholes. A wide range of information on tender awards is now published in the revamped public procurement information portal (PPIP). The authorities have published information on all tender awards and developed implementation mechanisms to ensure that bidders are compliant. They are taking urgent steps to address recently identified legal impediments to publish information on beneficial owners of firms that win procurement contracts. They are also developing procedural measures to obtain consent for publication from the beneficial owners. Three audits of COVID-19 spending have been conducted so far, with the first report tabled in September 2021, while the other two reports await parliamentary deliberations.

18. Our authorities appreciated the in-depth discussion of critical issues during the 2021 Article IV consultation and value the Selected Issues Paper (SIP). The key issues covered in the SIP, including competitiveness, and inclusion, are pertinent and supportive of authorities' goals. Going forward, digital progression will continue to be an important driver alongside other high-skill activities in absorbing the large young population into the economy. Even prior to the pandemic, there was strong employment growth among the higher-skilled service sub-sectors. The World Bank reports that employment in the global innovator sub-sectors grew by 10% between 2015/16 and 2019, largely led by the finance and insurance sub-sectors. Employment in the skill-intensive social subsectors, such as education and health, increased by an even larger 23%. All this reflects the transformation underway and the importance of appropriate labor market and human capital policies that boost competitiveness. Our authorities are optimistic on the way forward and note that Kenya's comparative advantage in digitalization has already advanced financial inclusion. They intend for digitalization to further support MSMEs, including by enhancing their access to credit, capital, and micro-insurance. They note that boosting exports of financial, IT and

professional services, and green energy technologies, could strengthen Kenya's role as a services hub in the region.

VI. Conclusion

19. The Kenyan authorities reiterate their commitment to sound macroeconomic policies to support the recovery and ensure durable and inclusive growth. They are also committed to policy efforts to unlock their growth potential and achieve key development objectives articulated in the program. They seek Executive Directors' support under the Second EFF/ECF Reviews and requests for modifications of performance criteria and structural conditionality, to anchor current efforts to raise medium-term growth, while catalyzing external support.