INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/232

KENYA

July 2022

THIRD REVIEWS UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, REQUESTS FOR MODIFICATION OF QUANTITATIVE PERFORMANCE CRITERIA, AND WAIVER OF APPLICABILITY FOR PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; STAFF STATEMENT; AND STATEMENTS BY THE EXECUTIVE DIRECTOR AND BY STAFF REPRESENTATIVE FOR KENYA

In the context of the Third Reviews Under the Extended Arrangement Under the Extended Fund Facility and Under the Arrangement Under the Extended Credit Facility, requests for modification of quantitative performance criteria, and waiver of applicability for performance criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Acting Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 18, 2022, following discussions that ended on April 22, 2022, with the officials of Kenya on economic developments and policies underpinning the IMF arrangements under the Requests for an Extended Arrangement Under the Extended Fund Facility and an Arrangement Under the Extended Credit Facility. Based on information available at the time of these discussions, the Staff Report was completed on June 29, 2022.
- **Staff Statement**
- **Statements by the Executive Director** for Kenya

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

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International Monetary Fund
Washington, D.C.

IMF Executive Board Completes the Third Reviews of the ECF and EFF Arrangements for Kenya Providing a US$235.6 Million Disbursement

FOR IMMEDIATE RELEASE

- The IMF Executive Board completed the Third reviews under the EFF/ECF arrangements with Kenya, providing the country with access to SDR 179.13 million (about US$235.6 million).
- A strong recovery is underway, although global shocks due to spillovers from the war in Ukraine are creating new spending needs and adding to inflation pressures through rising global fuel, fertilizer, and food prices.
- Kenya's program is delivering resilience by helping the country navigate these global shocks while still meeting the authorities' targets and continuing to make progress in addressing debt vulnerabilities.

Washington, DC – July 18, 2022: The Executive Board of the International Monetary Fund (IMF) today completed the Third reviews under the 38-month arrangements under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) arrangements. The Board's decision allows for an immediate disbursement of SDR 179.13 million (about US$235.6 million), usable for budget support, bringing Kenya's total disbursements for budget support so far to about US$1,208.2 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) aim to support Kenya's program to address debt vulnerabilities, the authorities' response to the COVID-19 pandemic and global shocks resulting from the war in Ukraine, as well as to improve governance and support broader economic reforms.

Kenya's economy has rebounded strongly in a challenging environment and is projected to grow 5.7 percent in 2022. Inflation moved above the Central Bank of Kenya's (CBK) official target band of 2.5 percent to 7.5 percent in June and is expected to peak this year before easing back within the band in early 2023. Downside risks predominate in the near-term. Uncertainties stem from the war in Ukraine, continuing drought in the semi-arid regions, unsettled global financial market conditions and the political calendar. But Kenya's medium-term outlook remains favorable.

The very strong tax performance seen in fiscal year 2021/22 has created fiscal space to temporarily cushion part of the impact of rising international fuel prices on households and businesses while still meeting program targets. The program targets agreed at the Second Reviews also accommodated emergency spending needs for drought in the semi-arid regions and security. The approved fiscal year 2022/23 budget broadens tax collection and maintains careful expenditure control while protecting social spending.

Kenya's structural reform agenda, focused on improving governance, has advanced despite some delays. Oversight of state-owned enterprises is being reinforced. New tender documents will allow achieving the longstanding goal of publishing beneficial ownership information of successful bidders for public procurements. An ongoing audit of COVID-19 vaccine spending and the recently completed comprehensive audit of FY2020/21 spending with a focus on COVID-19 spending will improve transparency and enable follow-up by enforcement agencies and other stakeholders.

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

"Kenya's economic program supported by the Fund's Extended Fund Facility and the Extended Credit Facility arrangements is providing an essential policy anchor to debt sustainability and public confidence. Despite the resilient economic recovery, the program remains subject to downside risks, including from deeper disruptions from the war in Ukraine, unsettled global market conditions, and an increase of food insecurity. In this context, the authorities' continued steadfast commitment to prudent policies and advancing structural reforms remains essential to maintain macroeconomic stability and safeguard Kenya's positive medium-term prospects.

"Strong fiscal performance is providing a welcome resilience. Although the authorities are adjusting domestic fuel prices to international levels more gradually, program targets are still being met thanks to strong tax revenues. Nevertheless, more targeted programs to support vulnerable households should accompany the ongoing review of the fuel pricing mechanism and plans for reforms to ensure that pricing actions are always aligned to the approved budget. Looking ahead, the authorities should sustain their fiscal consolidation efforts to reduce debt vulnerabilities, while securing space for needed social and development spending. This requires further improving spending efficiency and undertaking additional tax policy and revenue administration measures drawing from the forthcoming Medium-Term Revenue Strategy.

"The Central Bank of Kenya's (CBK) recent monetary policy tightening is welcome. The CBK should stand ready to continue to adjust its stance to limit second-round effects from higher food and fuel prices and to keep inflation expectations well-anchored amid a temporary increase of inflation above the target band. The flexible exchange rate functioned as a shock absorber during the pandemic and should continue to do so against current global shocks, with forex interventions limited to addressing excessive volatility.

"Maintaining the momentum in the authorities' structural reform agenda is critical. Building on the ongoing efforts to improve the oversight of state-owned enterprises, it is essential to advance the restructuring of Kenya Airways and restore the long-term viability of Kenya Power and Lighting Company. Further improvements in the anti-corruption framework and the AML/CFT agenda as well as an effective follow-up of expenditure audits are needed to enhance transparency and accountability."

Kenya: Selected Economic Indicators, 2021—2024				
	2021 Prel.	2022 Proj.	2023 Proj.	2024 Proj.
Output				
Real GDP growth (%)	7.5	5.7	5.3	5.5
Prices				
Inflation - average (%)	6.1	7.3	6.9	5.1
Central government finances (fiscal year)[1]				
Revenue (% GDP)	16.0	17.5	17.2	17.7
Expenditure (% GDP)	24.2	25.4	23.2	22.2
Fiscal balance (% GDP)	-8.2	-7.8	-5.9	-4.4
Public debt (% GDP)	67.8	70.2	70.4	68.7
External debt (% GDP)	35.3	36.3	36.7	35.9
Money and Credit				
Broad money (% change)	6.1	9.7	13.4	12.1
Credit to private sector (% change)	8.6	12.1	13.8	12.7
Policy rate, end of period (%)	7.0	…	…	…
Balance of payments				
Current account (% GDP)	-5.5	-5.9	-5.5	-5.3
Reserves (in months of imports)	4.4	3.9	4.2	4.2
Exchange rate				
REER (% change)	-2.7	…	…	…

Source: Kenyan authorities and IMF staff estimates and projections.

[1] Based on fiscal year (i.e., 2021 represents 2020/21).

INTERNATIONAL MONETARY FUND

KENYA

June 29, 2022

THIRD REVIEWS UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY, REQUESTS FOR MODIFICATION OF QUANTITATIVE PERFORMANCE CRITERIA, AND WAIVER OF APPLICABILITY FOR PERFORMANCE CRITERIA UNDER THE ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

EXECUTIVE SUMMARY

Context. Kenya's economy has been rebounding strongly in a challenging environment. Global shocks from the war in Ukraine and related trade disruptions—alongside more challenging financing conditions for frontier markets due to a normalization of monetary policy in advanced economies—will impact the external position in the near term. Inflation is set to increase, albeit temporarily, with the pass-through of global price shocks. Domestically, shortfall in rains and the continuing drought in the semi-arid regions are adding to uncertainties and pressuring vulnerable groups. The authorities view their IMF-supported program as a key policy anchor in the face of these shocks. While surging global fuel prices have made containing the cost of recently granted fuel subsidies urgent, Kenya's strong fiscal performance provides scope to cushion the adjustment to these shocks without exceeding program deficit targets. Strong performance of tax revenues is a key driver of this resilience. Policy tradeoffs will remain difficult, however, heading into August elections.

Program performance. All quantitative performance criteria (PCs) and one of the two indicative targets (ITs) for end-December were met comfortably. The IT on social priority spending was missed on a brief delay in executing some wage payments. One of four structural benchmarks (SBs) was met, while others saw delays. A supplementary FY2021/22 Budget consistent with the program objectives was submitted to parliament (end-January SB). The SB on adoption of new tender documents to enable the publication of beneficial ownership information for awarded tenders (end-March) was implemented with delay in April. Submission of a FY2022/23 Budget consistent with the program objectives (end-April) was implemented with delay as some tax-enhancing measures were submitted in May and June. The end-May SB on publication of a forensic audit of COVID-19 vaccine spending up to June 2021 and a comprehensive audit of expenditures in FY2021/22 with a chapter on COVID-19 spending was not met and ongoing audits likely will be completed by end-June and published by mid-July.

Requests. The Kenyan authorities request a) waiver of applicability for the end-June 2022 PCs for the Extended arrangement under the Extended Fund Facility (EFF); b) modification of the PC on net international reserves (NIR) for end-June 2022 and end-December 2022; and c) establishment of three new SBs related to (i) issuance of a National Treasury circular presenting an action plan for development of a Medium-Term Revenue Strategy (end-August 2022); (ii) completion of a review of how the fuel pricing mechanism has been applied to date and constitution of a taskforce to oversee the progressive elimination of the fuel subsidy within the first half of FY2022/23 and to ensure that fuel pricing actions are at all times aligned to the approved budget (end-July 2022); and (iii) submission of an action plan on Kenya Power and Lighting Company (KPLC) by end-July 2022 to restore KPLC's medium-term profitability and fully cover financing gaps through end-Dec 2023.

Risks to the program. The outlook is subject to significant downside risks. In the near-term, uncertainty remains elevated due to the COVID-19 pandemic, the economic fallout of the war in Ukraine, and the upcoming 2022 elections. Against this backdrop, the program is delivering resilience and providing flexibility to address continuing challenges (COVID-19 vaccination and SOE restructuring needs) while achieving program objectives.

Approved By:

Catherine Pattillo (AFR) and Eugenio Cerutti (SPR)

The mission team consisted of M. Goodman (head), T. Rasmussen (Resident Representative), V. Crispolti, S. Gupta, J. Weiss, F. Nyankiye (all AFR), L. Bounader (FAD), P. Iossifov (SPR), M. Bazarbash (MCM), A. French, J. Duasing, R. Snipeliski (all LEG), D. Tallam and K. Tuitoek (IMF Resident Representative in Nairobi office), with assistance from R. Kumar, F. Morán Arce (AFR), C. Odwogi, and E. Muiruri (IMF Resident Representative in Nairobi Office). The Executive Director, Ita Mannathoko and Advisor James Garang (both OED) participated in the discussions. Discussions were held in Nairobi and remotely from Washington, D.C. during March 31–April 22, 2022. 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; the Principal Secretary for the National Treasury, Dr. Julius Muia; Deputy Governor of the CBK, Ms. Sheila M'Mbijjewe; and other senior government and CBK officials. Staff also had productive discussions with representatives of leading contenders for the upcoming presidential election, the Parliamentary Budget Office, the private sector, civil society organizations, and development partners as part of their usual practice of taking stock of economic conditions at the country level.

CONTENTS

BOXES

FIGURES

TABLES

ANNEXES

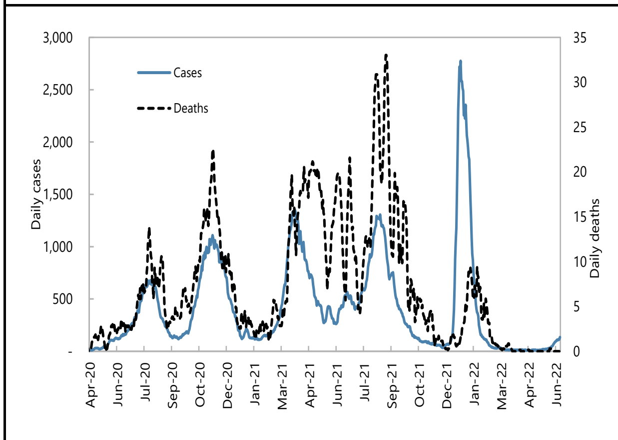
APPENDIX

CONTEXT

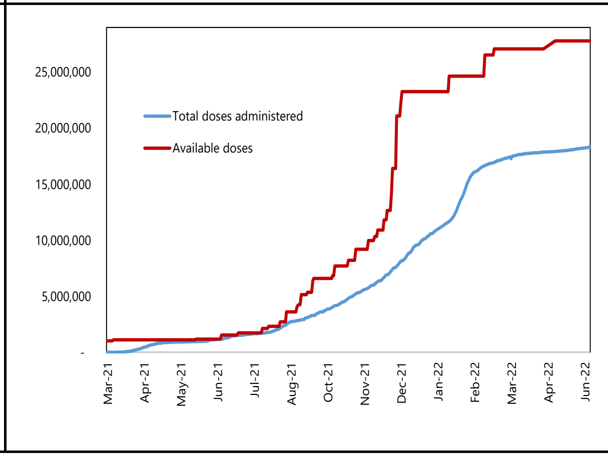
1. **While a strong rebound is under way, disruptions to global trade and finance from the war in Ukraine will impact Kenya** (Box 1)**.** Although direct trade exposure to Russia and Ukraine is relatively small and Kenya is not a traditional tourist destination for these countries, the current account deficit will widen, primarily on higher international prices for fuel, fertilizer, wheat and other imported foodstuffs (combined total of about a third of goods imports). Higher import prices will also pressure inflation. Meanwhile, global financial market pressures—also from tightening monetary conditions in advanced economies—are raising borrowing costs and limiting options for non-concessional external financing for frontier economies like Kenya.[1]

2. **Kenya has relaxed most COVID-19 related restrictions** (Figure 1 and Text Figures 1–2)**.** The Omicron variant resulted in a steep but short-lived spike in cases in December 2021. However, in the first half of June 2022, the infection positivity rate went up from 3.6 percent to 12.5 percent. Vaccination accelerated, with 31.4 percent of adults fully vaccinated as of mid-June 2022 (up from 5 percent at end-2021); but has leveled off since then as demand plateaued. Moderna has announced a US$500 million investment to establish a COVID-19 vaccine manufacturing facility in Kenya. Uncertainty around new waves and variants remains high.

Text Figure 1. COVID-19 Cases
(7-day moving averages)



Text Figure 2. Available and Administered Doses



Source: Kenyan authorities.

3. **The environment for policymaking will remain challenging in the runup to the August 9 general elections.** Some key legislative proposals encountered challenges in Parliament. The rising cost of living is an increasing concern. Leading presidential contenders former Prime Minister Raila Odinga, representing the Orange Democratic Movement party and *Azimio La Umoja* coalition, and Deputy President William Ruto, representing United Democratic Alliance and Kenya Kwanza coalition, have emphasized priorities in line with their respective policy platforms (focusing on small

[1] Staff projections are based on the global assumptions and Kenya-specific information as of June 14, 2022.

businesses, youth, farmers, and low-income households), while also highlighting the importance of addressing debt vulnerabilities. Against this backdrop, the Fund-supported program is generally viewed as providing a critical anchor to debt sustainability and maintaining confidence in the face of global shocks.

Box 1. The War in Ukraine: Channels of Transmission to Kenya

The economic impact of the war in Ukraine on Kenya is unfolding through trade in goods and services, financial channels, and higher imported prices:

Trade disruptions. Kenya's direct trade exposure to Russia and Ukraine is relatively small. These two markets account for around 1.5 percent of Kenyan exports and 2.7 percent of imports and are not among Kenya's traditional tourist markets.[1] However, the war's impact on Kenya's other trading partners, particularly in Europe, likely will dampen demand for Kenya's exports, while sharp increases in international commodity prices will push up the import bill.

- The April 2022 *World Economic Outlook* revised down 2022 growth in the euro area by 1.1 percentage points, in the U.S. by 0.3 percentage point, and in the U.K. by 1 percentage point. France, Germany, and Netherlands accounted for an average 12 percent share in Kenya's exports, while the U.S. and the U.K. accounted for an additional 16 percent (average) share.
- Commodities with relatively inelastic demand, such as oil derivatives, cereals, and fertilizers have seen steep global price increases, while disruption of maritime logistics networks have further increased shipping costs. Between January and May 2022, global prices of crude oil, wheat and fertilizers have risen by around 30, 40, and 11 percent, respectively (source: World Bank `Pink' Sheet).

Inflationary impact and erosion of purchasing power. The negative terms-of-trade shock will pressure inflation and the exchange rate, eroding households' purchasing power.[2] Higher cost of importing essential commodities will have a spillover to domestic inflation, including due to needed adjustments in domestic fuel prices which had lagged behind developments in global oil prices.

Tightening of financial conditions. The deteriorated outlook in international financial markets—triggered by the war in Ukraine against the backdrop of an acceleration in global monetary tightening—has widened frontier EM sovereign bond spreads, pushing Kenya's EMBI spread above 900 basis points by early June from below 500 basis points in mid-February). High spreads also partly reflect idiosyncratic factors and have hampered the cost and availability of global market access. At the same time, the domestic sovereign bond yield curve has shifted up. As of June 10, 2022, yields on Kenya's 2-year Treasury Bond had increased by 134 basis points from end-2021, while the 5-year yield had risen by 113 basis points.

[1] While wheat is not a main staple in Kenya, Russia and Ukraine are nevertheless important sources of Kenya's wheat imports (more than 40 percent share in total wheat imports).

[2] As of mid-June, maximum retail prices for petrol, diesel, and kerosene were up by 23–27 percent since end-2021, while their landed costs have gone up by 57 percent, on average, during this time (source: Energy and Petroleum Regulatory Authority, Kenya).

RECENT ECONOMIC DEVELOPMENTS

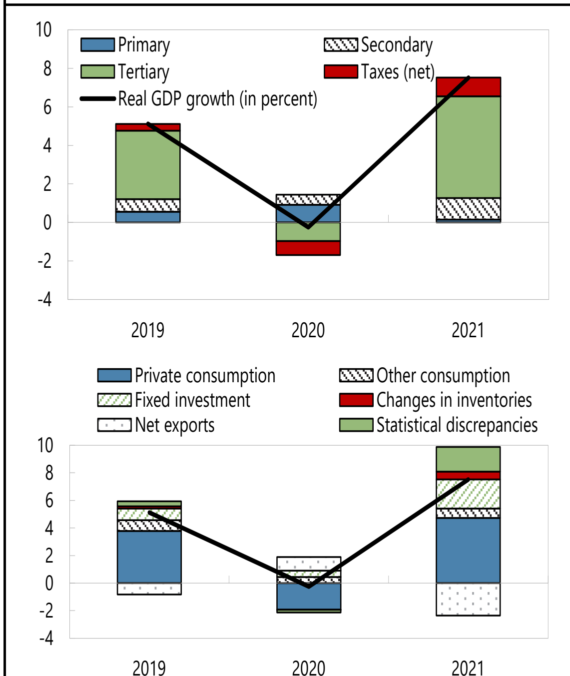
4. **Kenya's economy was staging a robust recovery prior to the latest global shock.**

- Following a modest contraction in 2020, real GDP growth rebounded to 7.5 percent in 2021 on resilient services and manufacturing as private activity recovered sharply (Text Figure 3).

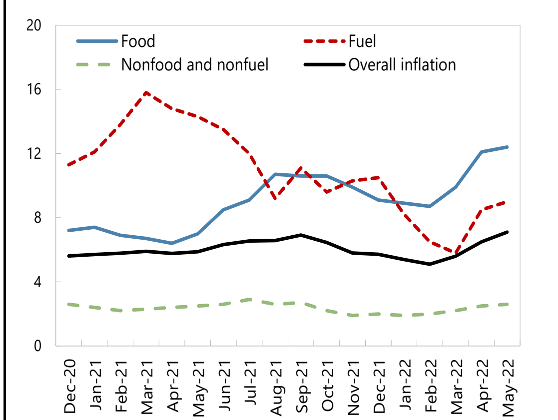
Food insecurity has risen over the past year, particularly in the north-east, following four successive seasons of below-average rainfall.[2]

- Headline inflation had decelerated to 5.1 percent (y/y) by February 2022 as domestic fuel prices were kept unchanged since October 2021 and on a 15 percent reduction in electricity tariffs in January. However, inflation rose to 7.1 percent in May on spillovers from the war in Ukraine, adjustments in domestic fuel prices, and higher food prices (Text Figure 4).[3] Excluding food and fuel, inflation remained modest, increasing from 2 percent in February to 2.6 percent in May. The authorities have announced a 12 percent increase in the minimum wages, the first since 2018.

Text Figure 3. Contributions to Growth
(Percentage points)



Text Figure 4. Consumer Price Inflation
(Year-on-year, percent)



Sources: Kenyan authorities; and IMF staff calculations.

5. **Kenya's external position is being impacted by recent dislocations in global markets.** After reaching 5.5 percent of GDP in 2021, the current account deficit widened in early 2022 on rising global commodity prices and the recovering economy, including investment. This was only partially offset by continued strong performances of goods exports (e.g., horticulture and manufactured goods) and remittances, and a rebound in tourism. International reserves remained at

[2] Food insecurity is highest in the arid and semi-arid lands (ASAL) due to vulnerability to natural disasters and exposure to extreme weather events, where an estimated 3.5 million people (21 percent of ASAL population) faced severe food insecurity by late 2021, up from 2.1 million earlier in the year. This estimate had risen to 4.1 million in the second quarter of 2022 (information sourced from the World Food Programme and the United Nations Office for the Coordination of Humanitarian Affairs).

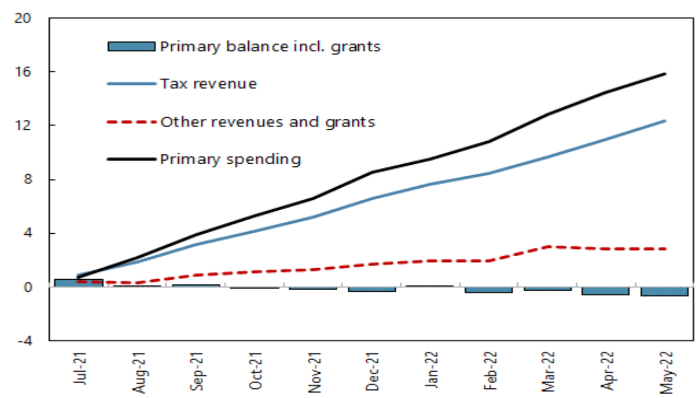
[3] Between February and May, contributions of food inflation to headline inflation increased by 1.7 percentage points.

adequate levels (4.4 months of import coverage, although their build-up through end-March 2022 was smaller than anticipated, including on postponement of planned Eurobond issuance). The Shilling depreciated by 2.7 percent, on average, in real effective terms in 2021 and by 1.3 percent through April 2022 (preliminary estimate), helping cushion the impact from the external shocks.

6. Fiscal performance has been strong, with end-December 2021 nominal targets exceeded by wide margins and robust outturns to date (Text Figure 5). At end-December 2021, the primary deficit fell to Ksh.38 billion (0.3 percent of GDP) compared to a target of Ksh.203 billion (1.9 percent of GDP). This reflected buoyant tax collection-exceeding the end-December PC by 0.4 percentage points of annual GDP-and tight spending execution, especially of foreign-financed projects and transfers to counties. At end-May 2022, the primary deficit stood at Ksh.78.8 billion (0.6 percent of GDP) as tax mobilization continued apace and on low implementation of spending programs. The strength of tax collection reflects both permanent and cyclical factors (Box 2). However, the relatively modest increases in domestic fuel prices through May were not adequate to contain the cost of rising fuel subsidies (Box 3).

Text Figure 5. Fiscal Performance Through May 2022

(Percent of FY2021/22 GDP)



Source: Kenyan authorities

7. A FY2021/22 Supplementary Budget consistent with program objectives was approved on March 30 (Text Table 1). As per EBS/21/112 the supplementary budget targeted a primary deficit of Ksh.419 billion (the equivalent of 3.3 percent of GDP) to accommodate additional spending, agreed in the second EFF/ECF reviews, in critical areas such as COVID-19 vaccine interventions and SOE support (combined total of 0.3 percent of GDP, consistent with the

Text Table 1. Supplementary Budget, FY2021/22[1]

(Billions of Kenyan Shillings)

	2020/21	2021/22		
	June	June		
	actual	*2nd Rev.*	*Suppl. I Budget (approved)*	*Proj.*
Revenues and grants	**1,815**	**2,119**	**2,191**	**2,255**
Tax revenue	1,430	1,667	1,679	1,722
Nontax revenue	354	390	445	469
Grants	31	62	66	63
Expenditure and net lending	**2,749**	**3,153**	**3,215**	**3,260**
Interest payments [2]	495	606	605	585
Other current spending	1,702	1,847	1,963	2,009
Development and net lending	552	701	647	665
Overall balance including measures (cash basis, incl. grants)	-929	-1,034	-1,024	-1,005
Primary balance incl. grants	**-455**	**-428**	**-419**	**-420**
Memorandum:				
IT/PC on tax collection	1,421	1,667		
PC on the primary balance	-508	-428		

Source: Kenyan authorities.

[1] Fiscal year runs from July to June.

[2] Reflects DSSI extension through end-December 2021.

activation of program adjustors). Also as agreed, it allocated funds for emergency drought and security spending (0.2 percent of GDP), supporting efforts to address the hardships in the drought-afflicted semi-arid regions. The SOE support was estimated at Ksh.32.3 billion (Table 2a), about Ksh.16.1 billion below the level projected at the second EFF/ECF reviews, primarily driven by rephasing of support to KQ to FY2022/23, including expected servicing of its guaranteed and unguaranteed debt by the government, subject to discussions with the creditors (MEFP¶23). The supplementary budget conservatively maintained tax collection at the programmed 13.2 percent of GDP, despite the tax overperformance.

Box 2. Tax Performance in FY2021/22

Kenya's tax revenues have been performing strongly so far. Tax collection exceeded program objectives by 0.4 percentage points of GDP at end-December 2021 (MEFP, Table 1). Strong revenue performance continued in 2022. Preliminary data on taxes show that collection likely reached 12.3 percent of GDP through end-May 2022 on healthy excise, PAYE, and VAT on imports—surpassing the authorities' monthly targets (aligned to program objectives) by an average of 10.7 percent. Thus far in FY2021/22, the monthly cumulative tax collection as a share of the expected tax outturn for the year (i.e., the end-June 2022 PC) have been consistently above the historical shares of actual collection over the past twenty years.

Tax collection is expected to significantly overperform the end-June 2022 target. Using historical shares of cumulative tax collection and estimates of tax buoyancy, staff has projected tax revenues to exceed the end-FY2021/22 target by Ksh.55 billion (0.4 percentage points of GDP–a conservative estimate given an overperformance of 0.6 percentage points of GDP at end-May on a cumulative basis). With only one month remaining in the fiscal year, this forecast is subject to limited uncertainty and the end-June 2022 outturn could well be stronger.

The FY2021/22 tax overperformance is likely to reflect permanent improvements. These mainly relate to the stronger-than-previously-anticipated resilience of Kenya's economy and the healthy yield of the January 2021 tax enhancing measures originally subject to high uncertainty about the impact of COVID-19 on Kenya's tax potential (EBS/21/72). Tax collection is also benefiting from durable improvements in tax compliance, which the Kenya Revenue Authority attained by enhancing the voluntary tax disclosure program, stepping up tax debt recovery efforts, and revamping audit functions—supported by IMF TA. By contrast, the temporary component of the FY2021/22 tax overperformance is primarily associated with the spike in input price' inflation, which affects the tax base of VAT and many excises.

Staff expects that the permanent improvements in FY2021/22 tax collection will carry over to next fiscal year (¶10). Based on the stronger than anticipated outturn in May (0.6 percent of GDP overperformance with respect to monthly targets), the carryover to FY2022/23 is conservatively estimated at 0.4 percent of GDP. [1] Staff thus projects the size of the package of new tax measures needed to achieve the FY2022/23 tax objectives at 0.4 percentage points of GDP. (This compares to an estimate of 0.8 percentage point at the second EFF/ECF reviews). Importantly, the authorities have identified, with the support of IMF TA, a menu of contingency tax measures to be implemented should tax mobilization disappoint (MEFP¶26).

[1] Prior to the availability of the May tax data, staff's estimate of the carryover was 0.3 percent of GDP.

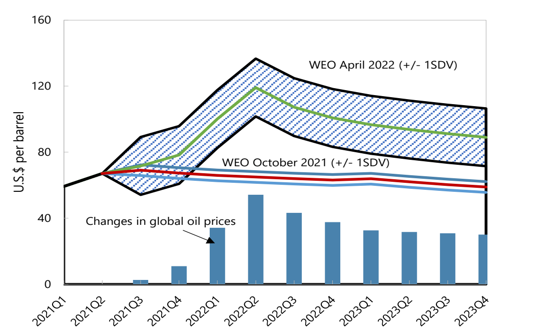
Box 3. Cost of Fuel Subsidies Under Different Scenarios

International fuel prices have increased sharply. After hovering around US$76 per barrel between July 2021 and January 2022, international fuel prices shot up by more than 30 percent during February-May 2022 following Russia's invasion of Ukraine. Prices forecasts based on futures quotes suggest that global prices would remain elevated through end-December 2022.

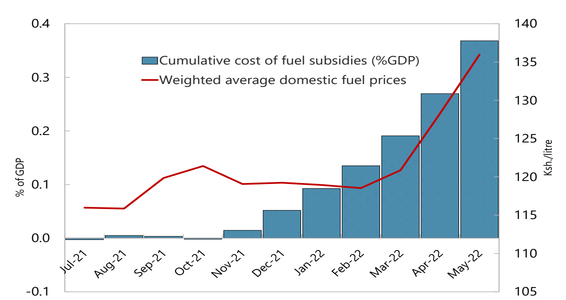
Kenyan domestic fuel prices have, however, only partially caught up with recent international price rises. While Kenya's fuel pricing formula has traditionally passed international price increases fully onto consumers, domestic prices were maintained unchanged between October 2021 and February 2022.[1, 2] Domestic prices were increased by an average of 4.1 percent in March 2022. However, with the strong rise in global prices and delays in payments to oil marketers, early April saw the emergence of widespread fuel supply shortages across Kenya. Domestic prices were subsequently increased on average by 6.3 percent per month in April, May, and June.

The cost of fuel subsidies has increased markedly. The monthly subsidy bill, net of Petroleum Development Levy (PDL) resources, jumped from negligible amounts in July 2021 to an estimated Ksh.13 billion in June 2022 or 0.5 percent of GDP on a cumulative basis since July 2021. Under current WEO price estimates, fuel subsidies would swell to about Ksh.119 billion (0.8 percentage points of GDP) in FY2022/23, if domestic price remain unchanged at the June level.

Box Chart 1. Evolution of International Fuel Prices Under Different Scenarios



Box Chart 2. Evolution of Domestic Fuel Prices and Fuel Subsidies



Sources: Kenyan authorities; and IMF, *World Economic Outlook* database.

Risks around international oil prices are elevated. A scenario analysis based on deviations from the baseline path of international oil prices (US$103 per barrel in July 2022-June 2023) indicates that subsidies will remain costly under adverse and more benign scenarios. Under adverse—but possible—further shocks, international prices could average almost US$119 per barrel (+1 standard deviation from the baseline) in July-June 2023. Maintaining domestic prices unchanged at the June 2022 level in such a case would push the cost of fuel subsidies to about 1.9 percent of GDP in FY2022/23. Should developments in international markets be more favorable, oil prices could decline to average US$86 per barrel (-1 standard deviation from the baseline) in July-June 2023, lowering the cost of fuel subsidies assuming unchanged prices to about 0.5 percent of GDP in FY2022/23.

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[1] In July 2020, a fuel stabilization scheme was announced whereby the already existing PDL would be paid into a Petroleum Development Fund aimed at smoothing the volatility of local petroleum pump prices due to changes in international price and import costs.

[2] Petroleum pricing in Kenya is regulated by the Energy (Petroleum Pricing) Regulations (2010), which give the Energy and Petroleum Regulatory Authority (EPRA) the power to determine—according to a formula and on a monthly basis—the maximum wholesale and retail prices of petrol, diesel, and kerosene. Prices are set, after consultation with the Ministry of Energy, on the basis of fuel costs, covering import, distribution, dealer's margin, and taxes and levies. Starting in 2021, a subsidy component has been added but a policy framework guiding application of those subsidies is lacking.

PROGRAM PERFORMANCE

8. **Observance of quantitative criteria has been generally strong in a very challenging environment although delays continue to be experienced in some structural areas** (MEFP, Tables 1–2).

- *All end-December 2021 PCs and the continuous PC were met.*[4] The ceiling on the primary balance was observed by a wide margin while tax collection overperformed the nominal PC by 0.4 percentage points of GDP. The NIR PC was met by US$411 million after adjusting for postponement of planned Eurobond issuance. The PCs on the contracting and guaranteeing of external debt, granting of new domestic guarantees by the central government, and accumulation of no new external payment arrears were all observed.
- *One of two end-December 2021 ITs was met*. The IT on national government exchequer requests outstanding for 90 days or more was met. However, the IT on priority social spending was missed by about Ksh.10 billion (0.08 percent of GDP) on temporary delays in executing some teachers' wage payments, subsequently made in early January.
- *One out of the four SBs for end-January–end-May 2022 was met.*
  - The authorities submitted to Parliament a FY2021/22 Supplementary Budget, consistent with the program objectives, on January 26 (end-January SB). However, the end-April SB on submission to Parliament of a FY2022/23 Budget consistent with the program objectives was not met but is expected to be implemented with delay by end-June with finalization of the plans for the new tax administrative measures needed to achieve the FY2022/23 tax targets (MEFP¶22).[5]
  - The end-March SB on adoption of the revised bidding documents to obtain consent to publish beneficial ownership information of awarded tenders was not met, but implemented with delay on April 21, 2022, and tender notices after that date will be required to use the revised bidding documents (MEFP¶58).
  - The end-May SB on publication 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 was not met. The comprehensive audit has been completed, but operational issues delayed work on the special audit of COVID-19 vaccine spending, which the authorities expect to complete and submit to Parliament by end-June for publication by mid-July 2022.
- *Inflation remained within the band and the MPCC was met as of end-December 2021.*

[4] See also ¶34.

[5] While the FY2022/23 Budget proposal (submitted to Parliament in April 2022) set tax objectives in line with program targets, the supporting legislation—identifying at the time new tax measures for 0.5 percentage points of GDP—was partially submitted by the agreed timeframe. Namely, the FY2022/23 Finance Bill—containing new tax measures for 0.4 percentage points of GDP—was submitted in April 2022; whereas the remaining 0.1 percentage point of GDP in new tax measures would be enacted through custom measures submitted in May and new tax administrative measures to be submitted by end-June.

MACROECONOMIC OUTLOOK AND RISKS

9. Kenya's medium-term outlook is positive despite recent shocks.[6] **GDP growth is projected at 5.7 percent in 2022, supported by a broad-based private sector growth, including recoveries in agriculture and the hospitality sectors, while the public sector consolidates.** Growth will stabilize at 5.5 percent over the medium term. Headline inflation is expected to continue increasing in the near term, with the supply-side shocks temporarily pushing it above the upper bound of the CBK's target band in 2022, before decelerating in 2023. Revisions in the minimum wages are not expected to have a material impact on inflation.[7] The current account is projected to widen to 5.9 percent of GDP in 2022 and stabilize around 5 percent of GDP over the medium term on robust exports and tourism and a normalization of commodity and financial market conditions. The increased reliance on private FDI and debt flows to cover external financing needs in outer years reflects the crowding-in of the private sector, as public financing requirements gradually decline as a share of GDP. Foreign exchange (FX) reserves projections for 2022 are modestly revised from the second EFF/ECF reviews, reflecting updated assessments of financial flows, and are expected to remain adequate through the medium term.

10. Significant uncertainty surrounds the near-term outlook, particularly for inflation, with risks tilted toward less favorable outcomes (Annex I). Key sources of uncertainty are possible deeper disruptions from the war in Ukraine, including further increases in international commodity prices (especially oil, wheat, and fertilizer). The latter may have a disproportionate impact on the poor households by intensifying food insecurity for some. New disruptive COVID-19 waves could weaken the recovery. Unsettled global market conditions due to faster than previously anticipated normalization of monetary conditions in advanced economies could also negatively impact financing availability for frontier economies such as Kenya. On the domestic side, insufficient precipitation would adversely impact agricultural production, increasing food insecurity for some, and drive a further increase in food prices. Pressures from the upcoming general elections could also undermine reform momentum and give rise to socio-political tensions. Finally, larger-than-expected public sector contingent liabilities—including from SOEs—and/or significantly higher spending needs for security and drought-impacted regions could slow the reduction in public debt.

POLICY DISCUSSIONS

Discussions focused on policies to: i) reduce debt vulnerabilities via the multi-year fiscal consolidation effort centered on raising tax revenues and on containing spending pressures—including new pressures from global shocks—to secure the program fiscal path; ii) advance the broader structural reform and governance agenda; and iii) support modernization of the monetary policy framework while safeguarding financial stability.

[6] Staff currently estimates a drag on economic activity of –0.5 percentage points from the war in Ukraine.

[7] The labor market is characterized by a large share of informal employment, while in the formal sector the minimum wages are not binding for most workers.

A. Managing Pressures from Global Fuel Prices While Reducing Debt Vulnerabilities

11. Pressures have increased since approval of the First Supplementary Budget for FY2021/22 on March 30. With very large surges in fuel and fertilizer import prices early in the planting season and just ahead of general elections, budgetary costs of policies to limit the pass-through on domestic prices have been increasing rapidly. In early April, pressures further intensified with the emergence of widespread fuel supply shortages. This prompted an increase in domestic fuel prices of 8.1 percent on average on April 15, which—together with payment of overdue fuel subsidies to fuel marketing companies—helped alleviate shortages that had emerged. Prices were further increased by 4.1 and 6.5 percent in May and June, respectively.

12. The authorities are responding to these global shocks by cushioning part of the impact on households and businesses, while remaining within their fiscal targets (Text Table 2, MEFP¶21)**.** A second supplementary FY2021/22 Budget consistent with program objectives was submitted to Parliament in late May 2022. It enables use of projected tax overperformance to smooth the adjustment of domestic fuel prices (0.3 percentage points of GDP) and accommodate modest additional spending to support users of fertilizer products and improve security (0.1 percentage points of GDP). On June 6, Parliament amended the second supplementary to allow for a modest further increase in spending for 0.04 percent of GDP. The authorities do not expect that this additional spending will undermine achievement of the end-June primary balance target as is could be easily reabsorbed through a limited rephasing of low priority spending.

Text Table 2. New Supplementary FY2021/22 Budget
(Billions of Kenyan Shillings)

	2021/22			
	Budget	Supplementary I (approved)	Supplementary II (submitted)	IMF proj.
Revenues and grants	**2,119**	**2,191**	**2,255**	**2,255**
Revenue	2,057	2,125	2,192	2,192
Tax revenue	1,667	1,679	1,723	1,722
o/w new tax measures				
o/w unidentified tax measures				
Nontax revenue	390	445	469	469
Grants	62	66	63	63
Expenditure and net lending	**3,153**	**3,215**	**3,279**	**3,259**
Recurrent expenditure	2,453	2,568	2,615	2,594
o/w Interest payments	606	605	605	585
o/w Additional spending for droughts and security	0	20	24	24
o/w Additional spending for fuel and fertilizer subsidies	0	32	39	39
Development and net lending	701	647	665	665
o/w SOEs emergency funding	48	33	33	32
Overall balance including measures (cash basis, incl. grants)	-1,034	-1,024	-1,024	-1,004
Primary balance incl. grants	**-428**	**-419**	**-419**	**-419**
Memorandum:				
Tax overperformance in FY21/22		-	55	55
Tax carryover to FY22/23			55	55
Nominal GDP				12,858

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

13. The authorities intend to continue gradually realigning domestic to global fuel prices in FY2022/23 so as to eliminate the fuel subsidy by October 2022 (MEFP¶21)**.** They are committed to preserve achievement of FY2022/23 fiscal objectives by aligning the pace of the domestic price adjustment to reduce the cost of subsidies and identifying budgetary offsets through rephasing of domestic, non-priority capital spending to keep the net cost of subsidies within available fiscal space.[8] The authorities also plan to complete by end-July 2022 a review of application of Kenya's fuel pricing mechanism and constitute a taskforce to oversee the progressive elimination of the fuel subsidy within the first half of FY2022/23 and to ensure that fuel pricing actions are at all times aligned to the approved budget (**new SB**). The ongoing review of fuel pricing mechanism should assess the impact on the vulnerable for whom the mission advised extending more targeted a support program.

14. The FY2022/23 Budget was submitted to Parliament on April 6. The budget proposal targeted narrowing the primary fiscal deficit by 2.1 percentage points of GDP compared to FY2021/22 on a combination of new tax measures and further rationalization of non-priority primary spending (Text Table 3, MEFP¶22).

- On the revenue side, the proposal recognized the carryover of the FY2021/22 tax overperformance (estimated at the time at 0.3 percent of GDP) and envisaged adoption of new tax measures worth 0.5 percentage points of GDP.[9] This included base-broadening changes in income taxes and VAT (0.15 percent of GDP), rate increases in excises and EAC custom duties (0.3 percent of GDP), and improvements in tax compliance (0.05 percent of GDP). New tax administrative measures are expected to be finalized by end-June 2022, resulting in a delayed implementation of the end-April SB on the FY2022/23 Budget (¶8.).

- On the spending side, the proposal protected priority social spending while carrying forward efforts to contain the wage bill and contain spending by further rationalizing the domestic projects portfolio. Amendments to accommodate the authorities' gradual approach to eliminating fuel subsidies during 2022, while remaining within the primary balance target were submitted in late May.

Text Table 3. FY2022/23 Budget Proposal
(Percent of GDP)

	2022/23		
	2nd Rev.	Budget (submitted in April) [1]	IMF proj.
Revenues and grants	**17.3**	**17.1**	**17.2**
Revenue	16.9	16.9	17.0
Tax revenue	14.4	14.0	14.0
o/w new tax measures	-	0.5	0.4
o/w unidentified tax measures	0.8	0.0	0.0
Nontax revenue	2.5	2.9	3.0
Grants	0.3	0.2	0.2
Expenditure and net lending	**23.0**	**23.1**	**23.2**
Recurrent expenditure	17.9	18.4	18.5
o/w Interest payments	4.5	4.8	4.7
o/w Additional spending for fuel and fertilizer subsidies	0.0	0.0	0.1
Development and net lending	5.2	4.7	4.7
o/w SOEs emergency funding	0.3	0.3	0.3
Overall balance including measures (cash basis, incl. grants)	-5.8	-6.0	-5.9
Primary balance incl. grants	**-1.2**	**-1.2**	**-1.2**
Memorandum:			
Tax overperformance in FY21/22		*0.4*	*0.4*
Tax carryover to FY22/23		*0.3*	*0.4*
Nominal GDP	*14,059*		*14,479*

Sources: National Treasury; and IMF staff estimates and projections.
[1] An addendum to the FY2022/23 budget provided for total spending of Ksh.20 billion on fuel price subsidies (0.14 percent of GDP).

[8] Should domestic prices be kept unchanged in FY22/23, the cumulative cost of the fuel price subsidy would reach 0.8 percent of GDP under current global price assumptions (Box 3).

[9] The FY2022/23 Budget proposal was based on an estimate of the tax base that did not reflect the significantly stronger than previously anticipated performance of taxes in FY2021/22 observed through May.

- The proposal also included extraordinary SOE spending for about Ksh.45.9 billion for direct budget support and debt service on Kenya Airways' guaranteed and non-guaranteed debt, subject to agreements with its creditors. The authorities expect that actual spending in this area will be lower at Ksh.36.6 billion (MEFP¶23). This is reflected in staff's baseline (¶20. Table 2a).[10]

15. The FY2022/23 Budget as approved results in uncertainty on tax revenues, reinforcing the need for contingency plans (MEFP¶22)**.** Amendments to the Finance Bill made shortly before Parliament adjourned ahead of elections, although smaller than originally proposed following engagement by National Treasury, eliminated 0.2 percentage point of GDP in tax measures envisaged under the FY2022/23 Finance Bill (MEFP¶22). The authorities are reacting to this decision by introducing a new package of tax administration measures—drawing on recent Fund TA—and expediting resolution of pending legal challenges to the minimum alternative corporate tax (MACT) by July 2022, which together are expected to compensate for roughly one-half of the tax loss. The reminder would be offset by the higher-than-previously-expected permanent improvement in FY2021/22 tax mobilization (Box 2), estimated to have a tax carryover to FY2022/23 of 0.4 percent of GDP as opposed to a 0.3 percent of GDP envisaged at the time of the FY2022/23 Budget proposal. Should the resolution of the legal challenges to MACT not be favorable, the authorities are committed to introduce in FY2022/23 additional tax measures for an equivalent amount.

16. Cognizant of the uncertainty surrounding fiscal performance in FY2022/23, the authorities stand ready to adopt further contingency measures (MEFP¶24)**.** A deterioration of the macroeconomic environment (¶10.), could significantly affect tax collection by depressing the yield of tax measures and could undermine the feasibility of the strategy of gradual domestic fuel price adjustment thus delaying elimination of fuel subsides. To ensure that the FY2022/23 program targets are observed, the authorities committed to compensate any revenue shortfall with additional tax measures, drawing from their Medium-Term Revenue Strategy (MTRS) developed with support from Fund technical assistance (TA, ¶24.). They also stand ready to adopt spending offsets, if need be, and to consult with the Fund on appropriate policy responses to very large negative surprises from global fuel prices.

17. Beyond FY2022/23, the authorities' fiscal strategy aims to reduce debt vulnerabilities while protecting high-priority service delivery and investment programs. A key objective is to put debt on a downward trajectory by bringing the primary deficit below its debt-stabilizing level in 2023 via revenue-mobilizing and expenditure-curbing measures. On the revenue side, the fiscal path calls for introducing additional tax measures for 0.9 percent of GDP in FY2023/24 (the MTRS will set out possible measures).[11] On the expenditure side, restraining recurrent expenditures—particularly

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[10] As per the TMU (¶7), the envelope of SOE support covered by the SOE adjustor is 1 percent of FY2021/22 GDP (i.e., Ksh.127.5 billion), half of which will be financed through budgetary offsets and the remaining half through higher borrowing. This limits the total increase in the deficit of the primary balance over FY2021/22–FY2022/23 due to SOE support to 0.5 percent of GDP. Staff estimates that the authorities will have used nearly Ksh.69 billion (Ksh.32.3 billion in FY2021/22 and Ksh.36.6 billion in FY2022/23) of the Ksh.127.4 billion covered by the SOE adjustor.

[11] On revenue administration, priorities include: i) detect and deter non-compliance, including strengthening the large taxpayer offices and effective risk management; ii) improve audits; and iii) enhance collection of tax debt.

for wages and transfers—will need to go hand in hand with improvements in public investment management (MEFP¶30–31). These efforts should be supported by continued progress in improving public financial management systems—including by strengthening expenditure controls and public procurement consistent with a recent Public Expenditure Review from the World Bank (MEFP¶29, ¶32).

18. Public debt is sustainable but remains at high risk of distress (DSA, EBS/21/29)**.** Under the baseline, public debt is expected to peak at 70.4 percent of GDP in FY22/23. As the consolidation efforts continue, the primary deficit is projected to fall below its debt-stabilizing level in 2023, putting the debt ratio on a downward path (Tables 2a and 2b).

19. The authorities are also pursuing other actions to reduce debt vulnerabilities. To strengthen their legal framework on indebtedness, National Treasury submitted to Parliament an amendment to the PFM Regulations to replace the current nominal legal ceiling on debt issuance (at KSh.9 trillion) with a medium-term debt-to-GDP anchor of 55 percent of GDP in present value (PV) terms (MEFP¶33). Critically, the proposed anchor would be set at 55 percent of GDP consistent with maintaining debt sustainability in the face of shocks. A key component of the proposed framework is an accountability requirement—whereby the government must explain to Parliament how planned policies would bring the debt ratio from current to targeted levels. The Fund-supported program will provide strong reinforcement for the authorities' plans to durably reduce debt in the coming few years while debt exceeds the anchor level. However, the planned transition from a nominal legal public debt ceiling to a debt anchor has been postponed allowing further consultation and is now expected to be enacted by end-2022. As an interim measure, an amendment of the PFM Regulations was passed to raise the existing legal public debt ceiling to Ksh.10 trillion. Other steps are also underway to strengthen debt management and reporting (MEFP¶33), including by expanding the coverage of public debt to include SOE debts not currently captured.

B. Advancing the Structural Reform Agenda

Addressing SOEs' Financial Challenges

20. Oversight and governance in the SOE sector are being strengthened (MEFP¶45–46)**.** The authorities are finalizing their SOE classification and inventory and are working on the SOE Ownership Policy—drawing on recent Fund TA. This will detail the new SOE governance architecture including efficient allocation of ownership, oversight and policy roles within government, the rationale for state ownership and privatization priorities, corporate governance expectations, performance monitoring and reporting, and disclosure guidelines. These elements from the authorities' SOE Blueprint and SOE Strategy are being prepared by the current administration to be anchored later through legal reform.

21. However, SOEs continue to present risks to the budget (MEFP¶23 and MEFP, section E)**.** Given limited fiscal space amid the needs for priority social and development spending, financial vulnerabilities at the key SOEs are being addressed mainly by cost-saving reforms in those SOEs.

- Progress toward implementing Kenya Airways' (KQ) restructuring plan is being made with advisory support, albeit with some delays. The plan is focused on optimizing operations and reducing costs to help stem KQ's cash burn. An airline consultant with international experience has been hired to assist in negotiating some cost-cutting initiatives while accountability mechanisms and key performance indicators will be put in place consistent with the restructuring plan. Guaranteed and unguaranteed debt, totaling US$868.7 million as of March 2022, are expected to be serviced by the government and discussions are ongoing with KQ's creditors. The mission urged the authorities to advance their loan agreement with KQ to ensure that financial support via the budget is effectively linked to commitments to deliver on KQ reforms.
- On Kenya Power and Lighting Company (KPLC), the authorities have updated their financial evaluation (supported by Fund TA), including the impact of the 15 percent electricity tariff reduction announced in January. The tariff reduction has aggravated KPLC's pre-existing liquidity challenges by lowering revenues by an estimated Ksh.26.3 billion per annum, while additional cost-saving measures currently identified across the electricity supply and distribution chain would only yield benefits over time and are not sufficient to fully offset this revenue impact. The authorities anticipate providing budget support to KPLC in FY2021/22 and FY2022/23 as temporary relief. Without stronger actions on cost-saving measures KPLC's liquidity concerns would persist, creating an adverse feedback loop to the rest of the electricity sector and the budget. The updated financial evaluation should set a basis to formulate a comprehensive action plan, anchored on a strategy of least cost to the budget, that would help identify measures to restore KPLC's long-term profitability and fully cover any financing gaps (pre-existing and new) through end-2023. The authorities committed to submit an action plan to this effect to the Cabinet Sub- Committee on KPLC by end-July (**new SB**). Meanwhile, the implementation of already identified cost-saving measures needs to be accelerated. Any future reduction in electricity tariff should be avoided unless fully backed by well-identified and achievable cost-saving measures to prevent deterioration of KPLC's liquidity and profitability situations.

Strengthening Governance and Fighting Corruption

22. Efforts are needed to strengthen Kenya's anti-corruption framework. With adoption of the beneficial owners' consent form to be included in standard bidding documents for public procurements, tender notices issued effective from April 21, 2022, onwards are required to use the revised bidding documents (end-March SB, not met–implemented with delay). In line with Kenya's existing procurement regulation, comprehensive information—including on beneficial ownership—of the successful tenders should be published on the Public Procurement Information Portal (PPIP) by the 15^{th} day of the subsequent month.[12] This will enable achieving the longstanding objective of publication of beneficial ownership information of successful bidders, originally established as an end-June 2021 SB. While the end-May 2022 SB on audits was not met, the authorities made

[12] *Executive Order No. 2 of 2018* requires procuring public entities to publish information on awarded tenders on the 15^{th} day of every subsequent month, for tenders awarded in the previous month.

important progress towards its implementation by publishing a comprehensive audit of FY2020/21 with a chapter on COVID-19 spending and by advancing the work on an audit of COVID-19 vaccine spending expected to be published by mid-July. With parliament's adoption of earlier audits that had been awaiting deliberation, the mission advised advancing law enforcement 's effective follow-up. Focused efforts are also needed to strengthen the asset declaration and conflict of interest regime and bring it in line with international standards (MEFP ¶62).

23. Intensifying AML/CFT supervision would help prevent corruption proceeds from being laundered in the financial sector. The Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) on-site visit was completed, and a final report is expected in September upon adoption by the ESAAMLG plenary. The authorities have completed their National Risk Assessment (NRA), which should be published (MEFP¶59) and its findings used to inform the AML/CFT supervisory strategy and actions to mitigate corruption-related money laundering risk in banks and other higher risk sectors. Increased use of financial intelligence to detect and disseminate information on corruption-related activities to facilitate investigation would further support anti-corruption efforts.

Modernizing the Fiscal Framework

24. Modernizing revenue administration is key to strengthening revenue mobilization and lowering the costs of compliance (MEFP¶27)**.** The authorities are developing—with support of Fund TA—a MTRS to modernize Kenya's tax policy system, improve compliance, and inform critical policy decisions. An action plan to be issued by end-August 2022 (**new SB**) will provide decisionmakers a coherent framework to identify mutually supportive tax policy and administrative measures to widen the tax base and mobilize domestic revenues, while ensuring equity and fairness.[13] The Kenya Revenue Authority (KRA) is enhancing its large and medium taxpayer offices; strengthening audits and data-driven compliance risk management; implementing risk-based frameworks; bolstering efforts to verify exemptions and reduce abuse—particularly related to VAT; and improving taxpayer services to foster voluntary compliance.

25. The authorities are also taking important steps to strengthen PFM systems (MEFP¶26 and ¶32)**.** To prudently manage public resources, National Treasury is pursuing an ambitious agenda aimed at strengthening budget processes, commitment controls, and cash management. The authorities also intend to establish—with the support of Fund TA—a Fiscal Risk Committee (FRC) to anticipate, monitor, evaluate, manage, and mitigate fiscal risks across the public sector.

C. Enhancing the Monetary Policy Framework and Safeguarding Financial Stability

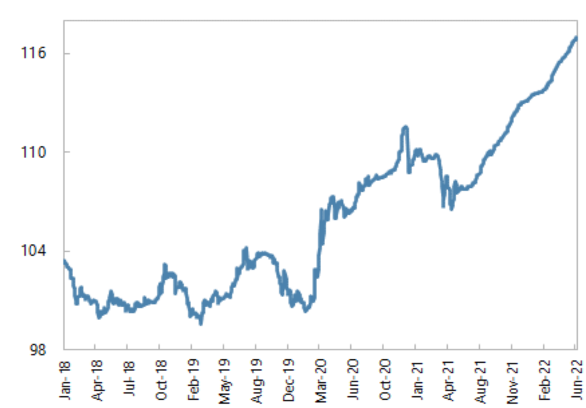
26. The central bank (CBK) is facing an increasingly complex environment. By May 2022, headline inflation had risen by 2 percentage points from February, nearing the upper end of the target band of 2.5–7.5 percent, largely on the pass-through of global shocks, policy adjustments,

[13] The Action Plan will be available to inform the new administration on policy alternatives, reducing potential risks of delays in policy implementation.

and higher food prices. Non-food/non-fuel inflation had picked up modestly. Some businesses also reported increased difficulty in sourcing dollars in the local market. Staff projects headline inflation to rise above the CBK's target band during 2022, peaking in 2022Q3, but return within the band by 2023Q2 as global commodity prices ease somewhat (¶10.). Against this backdrop, the mission advised the CBK to stand ready to adjust the monetary policy stance with a view to limiting any second-round effects on prices. This should help keep inflation expectations well-anchored and reduce external pressures. Staff welcomes the May 30, 2022, decision to raise the policy rate by 50 basis points and the intention to take additional measures as needed. The mission also advised that the exchange rate should continue functioning as a shock absorber, facilitating needed adjustment to global shocks and that use of FX interventions be limited to responding to excessive market volatility and avoiding exchange rate overshooting.

27. Modernization of the monetary policy framework continues, following the July 2021 White Paper agenda (MEFP¶49)**.** The CBK is assessing past experience with its macroeconomic models and forecasting framework, supported by Fund TA. To enhance the functioning of the interbank market, including improved liquidity across the market and better risk management, the CBK plans to roll out a modern central securities depository (CSD) by June 2022, as a precursor to introduction of an interest rate corridor around the policy rate. The CBK is also strengthening market intelligence, transparency, and monetary policy communication.

Text Figure 6. Kenyan Exchange Rate
(Kenyan Shillings per U.S. dollar)



Source: Central Bank of Kenya.

28. The banking system remains resilient yet exposed to evolving shocks. Overall, banks remain well-capitalized, liquid, and profitable. At end-March 2022, regulatory ratios stood well-above the statutory requirements, with the risk-weighted capital adequacy ratio at 18.9 percent and liquidity ratio at 55 percent. However, the pandemic has somewhat exacerbated asset quality weaknesses, and the non-performing loan (NPL) ratio reached 14 percent at end-March 2022 from 12.5 percent at the beginning of the pandemic (March 2020). Loan loss provisions remain adequate. Given the difficult backdrop, provisioning of impaired loans and transition of loans in risk buckets may be impacted as some borrowers may struggle to weather emerging shocks. Positive profitability is supporting banks' capital positions. With a relatively balanced increase in interest, fee, and FX trading income, some large banks' high y/y returns in full-year results reflected notably reduced loan loss allowances. For those small banks which are struggling, the CBK has encouraged consolidation with stronger banks.

29. Credit growth is expected to remain in the single digits as banks will likely pursue a cautious approach in the current environment. Micro, small and medium enterprises (MSMEs) still face a large credit gap, while playing a key role in economic activity. Progress in implementing the banking charter and expanding the Credit Guarantee Scheme (CGS) could promote lending to small businesses. The National Treasury's Credit Guarantee Scheme (CGS), while relatively small and applicable only for formal MSMEs, has provided support to about 1,800 loans valued at around Ksh.3 billion in total issued by seven banks. Almost all the loans (98 percent) were performing as of April 2022. Progress in approving banks' risk-based models would also support lending. One large bank's model and three small banks' models have been approved. Discussions have centered on the approaches to determine the baseline rate (risk-free rate, operational costs and shareholders' margin) and the banks' models that map borrowers' risk buckets to the rate spread.

30. The CBK issued a Central Bank Digital Currency (CBDC) discussion paper for public opinion in February 2022. The paper provides a high-level view of possible benefits of CBDC to enhance the Kenyan payment system, highlighting notably CBDC's potential role in reducing the cost of cross-border payments. Staff provided comments to CBK's CBDC team (Annex II).

PROGRAM ISSUES AND RISKS

31. Financing assurances are in place. The program is fully financed with firm commitments for the twelve months following the third reviews of the EFF/ECF arrangements and good prospects for the remainder of the program. Kenya's external budget financing needs would be met by a mix of official and commercial loans that prioritizes concessional financing:

- Official concessional financing will be provided by the World Bank via DPO and Program-for-Results financing instruments, as well as the African Development Bank, and Japan International Cooperation Agency. The US$750 million World Bank Development Policy Operation was approved in March 2022 and has since been fully disbursed;
- In light of the heightened volatility of market sentiment toward emerging and frontier markets, the planned FY2021/22 EUR1 billion Eurobond issuance has been replaced by US$1.1 billion of bank loans, assumed to be refinanced by a Eurobond issuance in 2025.[14] Additional commercial borrowing is budgeted in FY2022/23, and the potential for on-lending for budget support purposes of a bigger share of the 2021 general SDR allocation to the government also remains as a contingency;
- SDR179.13 million (around US$238.1 million as of June 14, 2022) will be made available upon successful completion of the third EFF/ECF reviews. Purchases under the EFF arrangement (SDR141.13 million) and disbursements under the ECF arrangement (SDR38 million) will be on-lent to the government in local currency and used for budget support.

32. Kenya's capacity to repay the Fund is adequate but is subject to risks (Table 8)**.** The total amount of outstanding credit to the Fund is projected at SDR2,198.4 million, or 405 percent of

[14] The yield on the June 2021 US$ Eurobond has since increased by around 550 basis points (as of June 14, 2022), reflecting both the tightening of global monetary conditions led by the advanced countries and the impact of the war in Ukraine on risk sentiment toward frontier emerging markets, as well as idiosyncratic factors. Planned bank borrowing is at a shorter tenor, with an interest rate including fees expected well below 10 percent.

quota in 2024, equivalent to around 2.2 percent of GDP and 26.6 percent of gross international reserves. Total debt service to the Fund would peak by 2028 at 2.1 percent of exports of goods and services and 1.6 percent of fiscal revenue. These relatively elevated levels of scheduled debt service to the Fund may pose risks to capacity to repay over the medium term. In the near term, the materialization of downside risks, such as a persistent pullback of international investors from frontier markets or socio-political tensions and delays in reform implementation related to the upcoming elections, could increase pressure on Kenya's capacity to repay the Fund. However, risks are mitigated given the likelihood of continued access to concessional financing and Kenya's strong track record of servicing debts to the Fund and other creditors. Risks are further mitigated by the multi-year fiscal consolidation that anchors the program, supported by tax policy measures to boost revenues; the authorities' commitment to maintain exchange rate flexibility; the smoothed phasing of Fund disbursements; and continued strength of remittances as source of foreign exchange.

33. **The program continues to face significant risks in an uncertain global and domestic environment** (¶10)**.** While the benefits of the Fund-supported program are broadly acknowledged, competing considerations may inject uncertainty around policy execution in some areas given the political calendar. These risks are mitigated by the authorities' performance to date in a difficult environment—particularly the fiscal overperformance which has provided important buffers to navigate the current global shocks—and their demonstrated commitment to adopting contingency measures as needed to achieve program objectives; close engagement with donors; and a tailored capacity development (CD) strategy to support the implementation of structural reforms, including plans to develop a MTRS. As part of their broad outreach, staff had productive discussions with the economic teams of the leading Presidential candidates on the objectives and main policies of Kenya's Fund-supported program.

34. **The authorities request modification of program conditionality as follows:**

- establishment of new quantitative performance criteria for all relevant indicators for June 2023 as in MEFP, Table 1;
- waiver of applicability of end-June 2022 PCs under the extended arrangement for which no final data are available for assessment;[15]
- modification of quantitative performance criteria on net international reserves (NIR) for end-June 2022 and end-December 2022, reflecting an updated assessment (¶9. and MEFP Table 1);
- establishment of three new structural benchmarks (MEFP, Table 2) for: i) issuance by end-August 2022 of a National Treasury circular presenting an action plan for development of a

[15] Reviews of performance under an arrangement in the Fund's General Resources Account (GRA) are based on the most recent PCs. Thus, completion of the third review under the Extended arrangement requires that the end-June 2022 PCs, as set by the Executive Board at the time of the second reviews, either be assessed (if information is available) or their applicability waived (if information is not available). For the end-June 2022 PCs, no final data are available, prompting the request for a waiver of applicability of PCs under the Extended arrangement. The third review under the ECF arrangement, a facility in the Poverty Reduction and Growth Trust, remains based on end-December 2021 performance criteria.

MTRS setting revenue objectives consistent with program targets, ii) by end-July 2022, completion of a review of how the fuel pricing mechanism has been applied to date and constitution of a taskforce to oversee progressive elimination of the fuel subsidy within the first half of FY2022/23 and to ensure that fuel pricing actions are at all times aligned to the approved budget; and iii) submission to the Cabinet Sub-Committee on KPLC by end-July 2022 of an action plan to restore KPLC's medium-term profitability and fully cover financing gaps through end-December 2023.

STAFF APPRAISAL

35. Kenya's economy has been resilient in a challenging environment. Economic activity is returning to normal as most COVID-19 related restrictions have been relaxed on low case counts. Deeper disruptions from the war in Ukraine are the key sources of risks to the macroeconomic outlook while, domestically, delayed arrival of the long rains has injected new uncertainty into the outlook on top of potential pressures in connection with upcoming general elections. Food insecurity has worsened in impacted regions. Global developments together with a more rapid monetary policy normalization in advanced economies will temporarily weaken the external position and strain international financing conditions. Given unsettled market conditions, staff welcomed the authorities' pragmatic approach of adjusting their financing strategy considering the price and availability of commercial external borrowing, while paying due attention to the impact of financing choices on the debt profile. In 2022, inflation will accelerate on higher import prices and domestic policy actions, including needed adjustments in retail fuel prices, temporarily exceeding the authorities' target range later in the year.

36. The Fund-supported program is providing an essential policy anchor to reduce debt vulnerabilities and mitigate uncertainties as the authorities mount their response to global shocks. Performance on quantitative conditionality has remained strong, especially on fiscal targets, while the structural agenda has seen some delays, although progress is being made in key areas. Staff's engagement with the economic teams of the leading Presidential candidates confirmed their support for the objectives and main policies of Kenya's Fund-supported program. The FY2022/23 Budget is aligned with tax revenue and primary balance targets, carrying forward Kenya's consolidation efforts to reduce debt vulnerabilities, improve tax mobilization, and rationalize non-priority primary spending while protecting priority social spending. Timely follow-through on commitments, particularly where progress has been limited on anti-corruption and governance, will remain important going forward.

37. Strong fiscal efforts have delivered resilience to respond to global shocks without deviating from program targets. In normal times, saving tax overperformance would be advisable to reduce debt vulnerabilities. In the current context, staff commends the authorities' approach geared to using strong results from earlier tax measures to meet emerging needs. This will allow addressing security priorities and temporarily cushioning households and farmers from the impact of rising international fuel prices, while still meeting the FY2021/22 primary deficit target. This complements earlier allocations to support the emergency response to the drought in impacted regions.

38. Domestic fuel prices should be gradually realigned to global levels to eliminate fuel subsidies in H1 FY2022/23 while avoiding abrupt moves which could have socially destabilizing effects. The ongoing review of the pricing mechanism and plans to develop and implement reforms to ensure fuel pricing actions are at all times aligned to the approved budget should be accompanied with more targeted programs to support the most vulnerable households. Should international prices increase further, staff welcomes the authorities' intention to recalibrate the pace of price adjustment and introduce budgetary offsets to achieve FY2022/23 fiscal objectives. Staff also commends the authorities' commitment to consult the Fund on an appropriate policy response in the context of the EFF/ECF arrangements if such global increases are at a scale that would require domestic price increases beyond reasonable levels.

39. Meeting Kenya's evolving spending priorities will require mobilizing domestic resources. The strong performance of tax revenues through May gives confidence that permanent improvements in tax revenue will carry over into FY2022/23. However, changes in the Finance Bill introduced during approval of the budget, while less than initially proposed, have increased uncertainty around tax revenues. Staff welcomes the alternative measures being adopted to secure Kenya's tax revenue objectives and stresses that contingency planning remains essential. Ongoing work on a MTRS, developed with support from Fund TA, will provide policymakers with options for enhancing revenues to stay in line with the program revenue objectives and ensuring that the tax burden is distributed fairly. Recognizing elevated uncertainty in the outlook, staff welcomes the authorities' intention to compensate any revenue shortfall next year with additional tax measures, drawing from their MTRS.

40. Momentum needs to be maintained to contain budget risks from SOEs. The authorities' determined push to implement their Blueprint for Governance Reforms at State Corporations should allow locking in progress on improving SOE financial oversight. Steadfast implementation of Kenya Airways' (KQ) restructuring plan—with clear accountability linking Exchequer support to progress on key performance metrics—remains essential to achieve a least cost approach, even as KQ's debt servicing needs for both guaranteed and unguaranteed amounts are being addressed and options are being sought to achieve cost savings in debt service. Staff welcomes the updating of KPLC's financial evaluation to reflect the recent 15 percent electricity tariff reduction. A comprehensive action plan to restore KPLC's long-term viability and cover financing gaps through end-2023 is urgently needed, along with prompt implementation of identified cost-saving measures. Beyond this, any future reduction in electricity tariff should be fully backed by well-identified and achievable cost-saving measures.

41. Efforts are needed to strengthen Kenya's anti-corruption framework and intensify AML/CFT supervision. With issuance of revised tender documents in April, the authorities will be able to collect and publish beneficial ownership information of successful bidders for newly awarded tenders. This clears the path to deliver on the longstanding commitment to publish beneficial ownership information. The ongoing audit of COVID-19 vaccine spending and recently completed comprehensive audit of FY2020-21 spending of MDAs more broadly with a focus on COVID-19 spending will improve transparency and accountability and should be followed up effectively by enforcement agencies. The anti-corruption preventive framework needs substantial enhancements, and the draft conflict of interest legislation (which has experienced long delays) should be brought in line with international best practices. AML/CFT supervision should be intensified to mitigate corruption-related money laundering risk in banks and other higher risk sectors and make greater use of financial intelligence. The now-completed National Risk Assessment should be published to raise risk awareness.

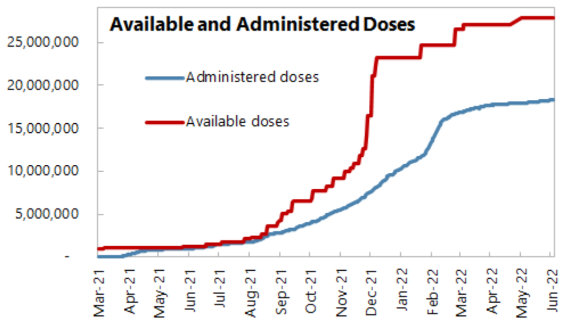
42. The central bank should stand ready to continue to adjust the monetary policy stance given risks in the outlook. With headline inflation likely to increase temporarily beyond the upper bound of the CBK's inflation target band—driven by higher imported prices and pass-through to domestic fuel prices—staff welcomes the CBK's May 2022 adjustment in the monetary policy stance to limit any second-round effects and keep inflation expectations well-anchored within the CBK's inflation band. The Shilling has acted as a shock absorber during the pandemic and should continue to do so in the face of current global shocks, while FX interventions should be limited to minimizing excessive volatility and avoiding overshooting. Progress on strengthening the monetary framework should continue, in line with the CBK's recent White Paper.

43. The authorities should continue to closely monitor the health of the banking sector and support credit growth, especially for the MSME sector. With banks well-capitalized and liquid overall, reducing NPLs should remain a priority. Given the emerging shocks, the CBK should also closely monitor provisioning as some borrowers may have difficulty weathering emerging shocks. For those small banks which are struggling, the CBK's approach to encourage consolidation with stronger banks is welcome. CBK's increased engagement with banks on their risk-based loan pricing could help to unlock MSME credit at rates that reflect riskiness of their activities. The CGS could also play a key role in reducing the risk of lending to MSMEs, while avoiding assuming undue exposure to banks' troubled borrowers.

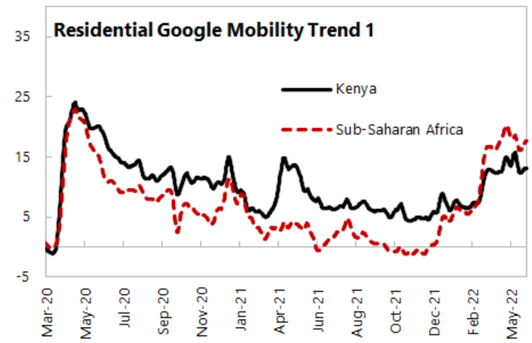
44. Staff supports the authorities' requests for completion of the third reviews, waiver of applicability of the end-June 2022 PCs under the Extended arrangement, and modification of PCs under the EFF/ECF arrangements, given the performance under the arrangements and the commitment toward meeting the program's objectives.

Figure 1. Kenya: Real Sector Developments

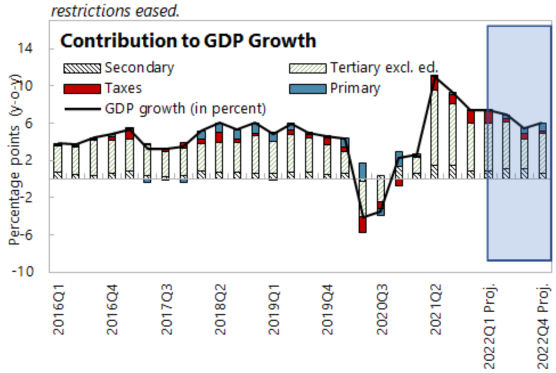
Vaccination accelerated in early 2022 with 30% of adults fully vaccinated as of mid-April 2022 but has since plateaued...



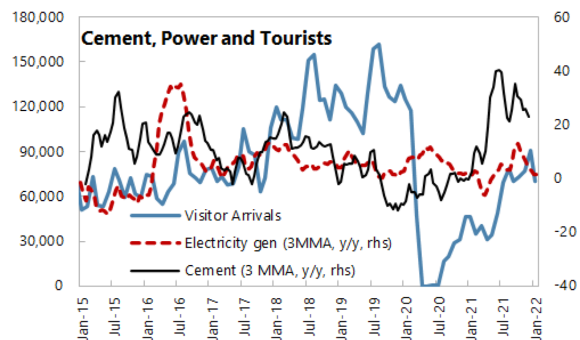
... and residential mobility recovered.



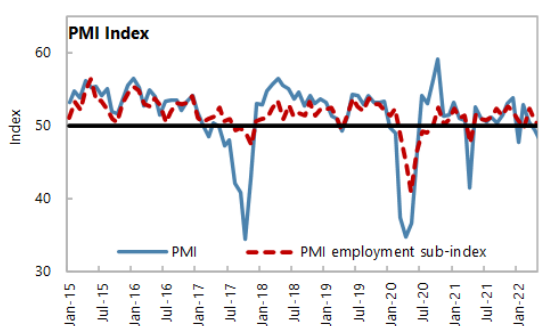
Growth recovery in 2021 was led by the services sector as COVID-19 restrictions eased.



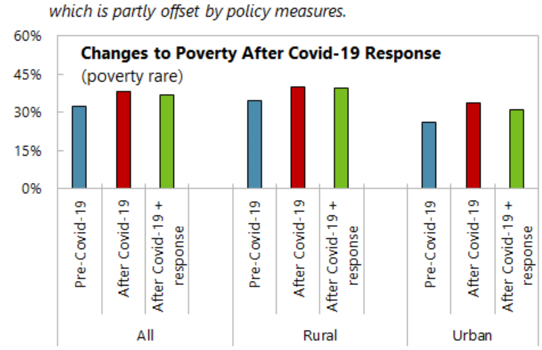
The recovery has moderated in early 2022...



... and PMI dropped to below 50-mark in April and May 2022.

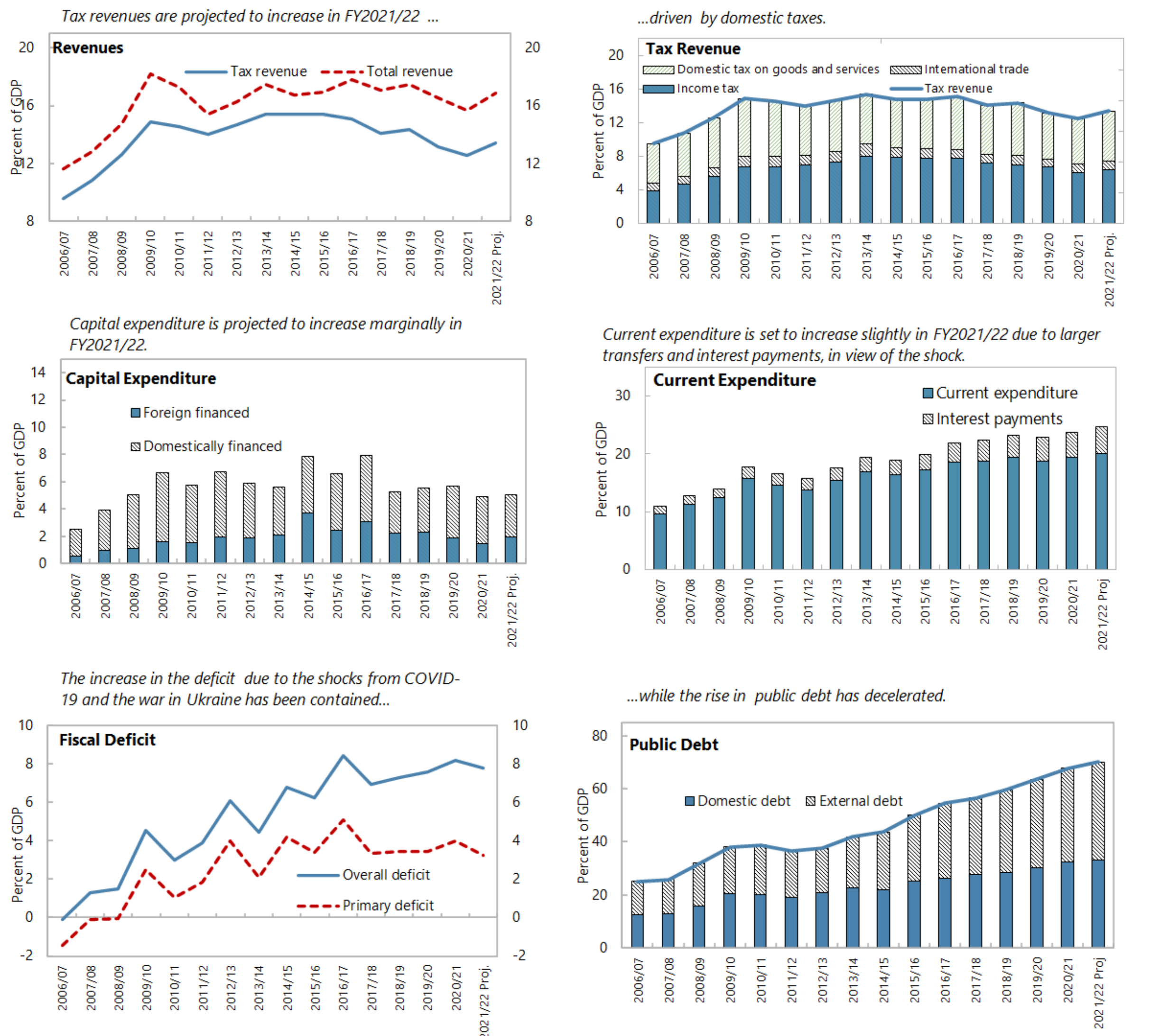


The World Bank estimates an increase in poverty post-COVID-19, which is partly offset by policy measures.



Sources: Kenyan authorities; Oxford COVID-19 Government Response Tracker; Markit Economics; World Bank; and IMF staff calculations and projections.
Series captures mobility trends for places of residence7-day moving averages.

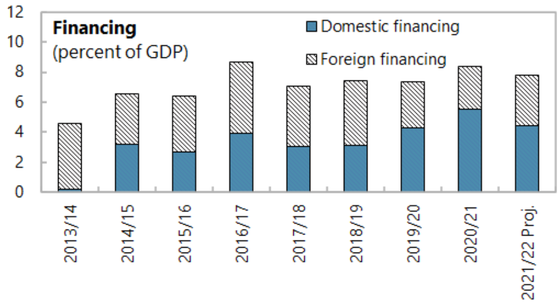
Figure 2. Kenya: Fiscal Sector Developments



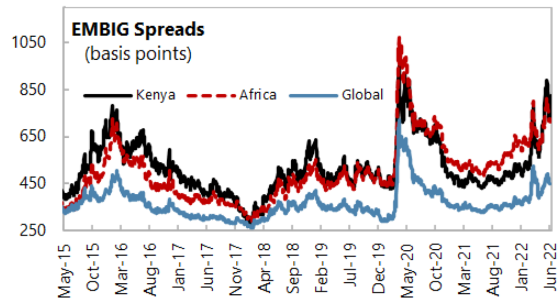
Sources: Kenyan authorities; and IMF staff calculations and projections.

Figure 3. Kenya: Budget Financing

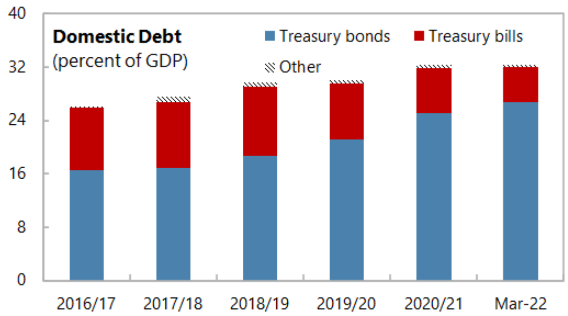
A successful Eurobond issue in June 2021 marked Kenya's first return to global capital markets since the COVID-19 pandemic began...



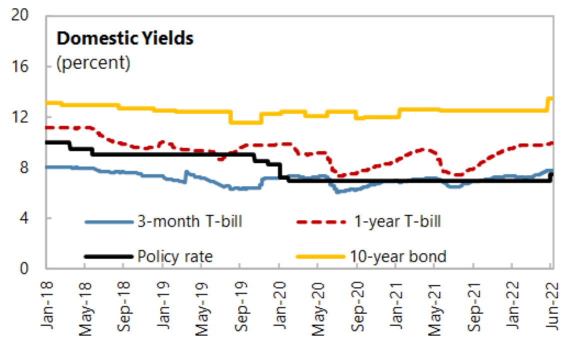
... taking advantage of the improved financing conditions in the first half of 2021, but external borrowing rates have risen



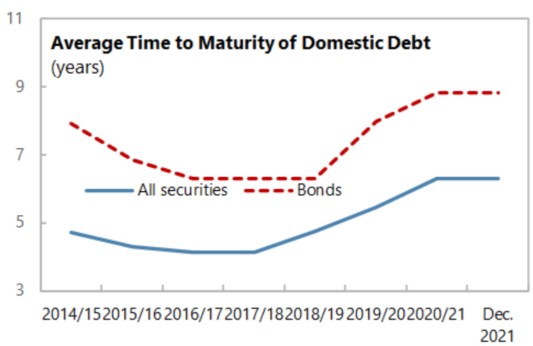
The domestic debt stock has increased, driven by Treasury bonds...



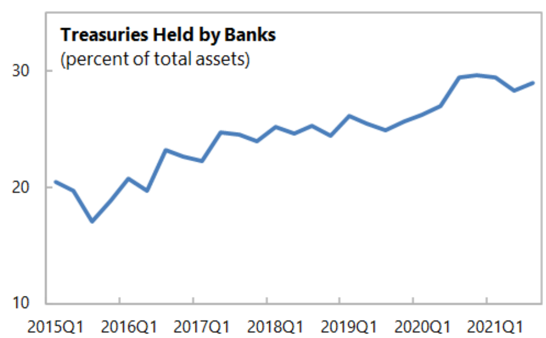
... financing conditions in the domestic market remained favorable towards longer-term securities....



... allowing the government to lock in improvements in the maturity profile of its domestic debt.

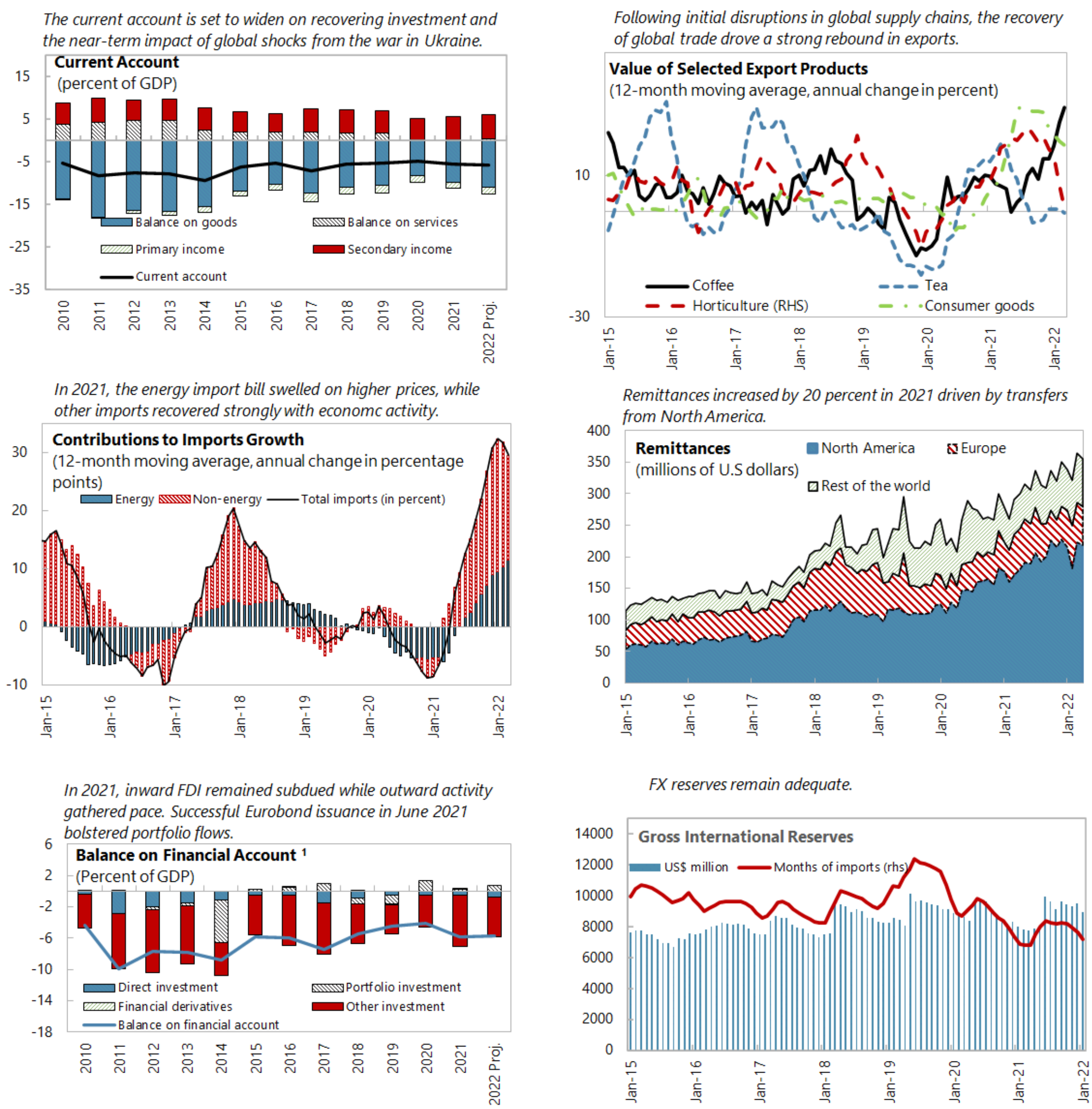


Facing heightened uncertainty, commercial banks increased their exposure to the sovereign.



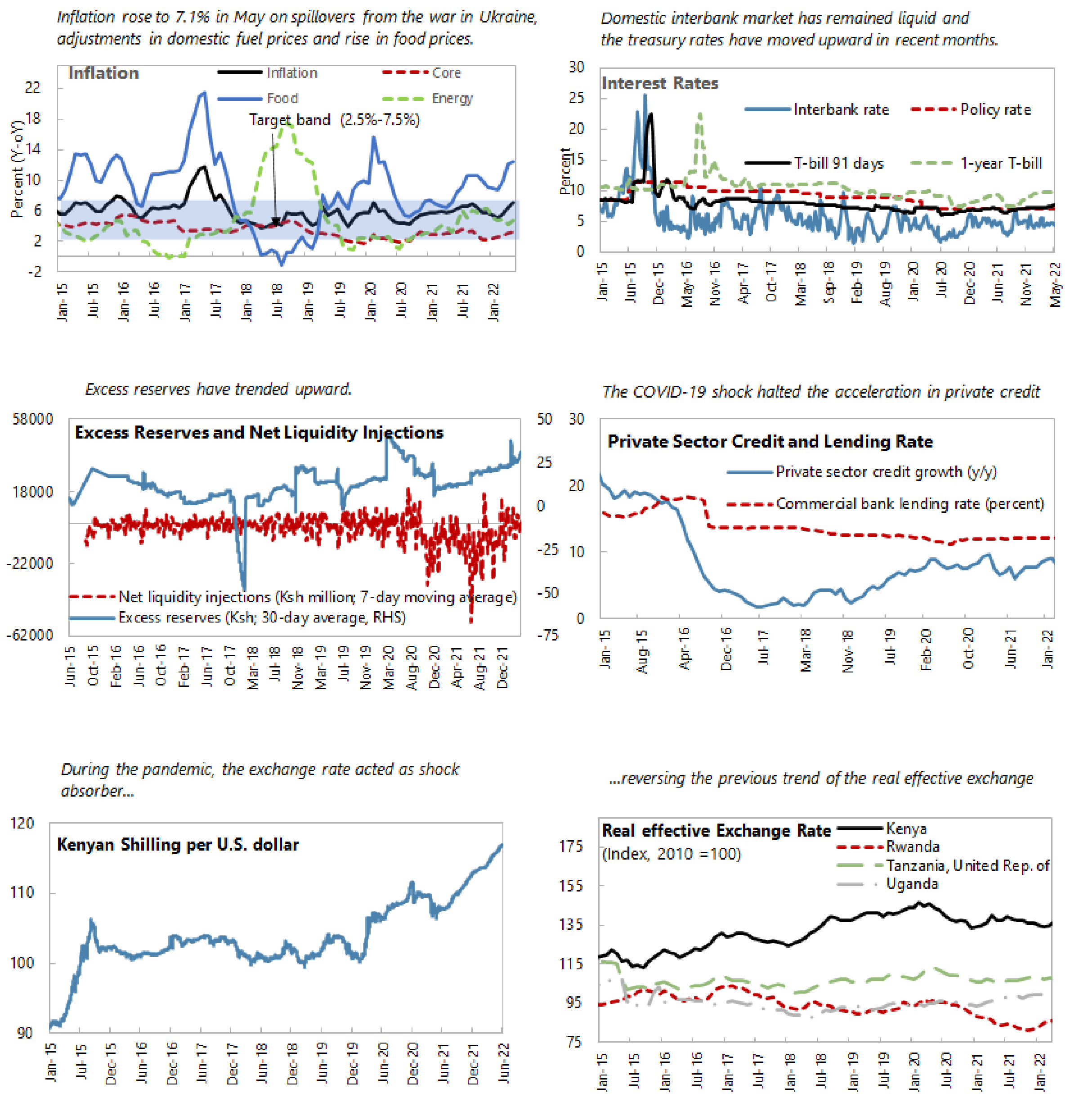
Sources: Kenyan authorities; Bloomberg L.P; and IMF staff calculations and projections.

Figure 4. Kenya: External Sector Developments



Sources: Kenyan authorities; and IMF staff estimates and projections.
[1] Negative values represent net inflows associated with an increase in net external liabilities.

Figure 5. Kenya: Monetary and Exchange Rate Developments



Sources: Kenyan authoritie; and IMF staff calculations.

Table 1. Kenya: Selected Economic Indicators, 2020-2026

	2020	2021		2022		2023		2024		2025		2026
	Act.	2nd Rev.	Prel.	2nd Rev.	Proj.	2nd Rev.	Proj.	2nd Rev.	Proj.	2nd Rev.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)											
Output, prices, and exchange rate												
Real GDP	-0.3	5.9	7.5	5.8	5.7	5.5	5.3	5.5	5.5	5.5	5.5	5.5
GDP deflator	4.9	5.2	5.0	5.2	6.5	5.2	7.0	5.0	5.2	5.0	5.1	5.1
CPI (period average)	5.3	6.4	6.1	5.8	7.3	4.8	6.9	5.0	5.1	5.0	5.1	5.0
CPI (end of period)	5.6	7.0	5.7	5.0	8.4	5.0	5.8	5.0	4.7	5.0	5.4	4.8
Terms of trade (goods; deterioration, -)	10.2	-3.9	-2.2	0.7	-7.2	2.1	1.6	1.8	1.2	1.3	0.9	0.9
Exchange rate (Kenyan shilling/US$, average)	106.5	.	109.5	.	.	.	.	.	.	.	.	.
Real effective exchange rate (depreciation, -)	0.0	.	-2.7	.	.	.	.	.	.	.	.	.
Money and credit												
Broad money (M3)	13.2	11.1	6.1	11.3	9.7	11.0	13.4	10.3	12.1	10.8	12.0	12.0
Reserve money	1.9	10.8	11.0	11.0	3.3	10.7	9.0	10.0	8.4	10.6	9.7	10.8
Credit to non-government sector	8.4	8.0	8.6	7.9	12.1	9.8	13.8	10.8	12.7	12.1	12.4	12.3
Policy rate	7.0	7.0	7.0	.	.	.	.	.	.	.	.	.
M3/GDP (percent)	37.2	37.0	35.0	37.0	34.1	37.0	34.3	36.9	34.7	36.9	35.1	35.4
Non-performing loans (percent of total gross loans)	14.1	13.1	13.1	.	.	.	.	.	.		.	.
	(Percent of GDP, unless otherwise indicated)[1]											
Central government budget [2]												
Total revenue, grants and unidentified tax policy measures	16.7	16.0	16.0	16.8	17.5	17.3	17.2	18.2	17.7	18.2	17.9	17.9
Tax revenues	13.2	12.6	12.6	13.2	13.4	14.4	14.0	15.3	14.8	15.4	14.9	15.0
Non-tax revenues	3.4	3.1	3.1	3.1	3.7	2.5	3.0	2.6	2.7	2.5	2.7	2.6
Grants	0.2	0.3	0.3	0.5	0.5	0.3	0.2	0.3	0.3	0.3	0.3	0.3
Expenditure	24.4	24.2	24.2	24.9	25.4	23.0	23.2	22.5	22.2	21.9	22.0	21.9
Current	18.7	19.3	19.3	19.4	20.2	17.9	18.5	17.4	17.4	16.9	17.2	17.0
Capital	5.7	4.9	4.9	5.5	5.2	5.2	4.7	5.1	4.8	5.0	4.9	4.9
Primary balance	-3.4	-4.0	-4.0	-3.4	-3.3	-1.2	-1.2	0.2	0.2	0.5	0.5	0.6
Overall balance	-7.6	-8.2	-8.2	-8.2	-7.8	-5.8	-5.9	-4.2	-4.4	-3.7	-4.1	-4.0
Excluding grants	-7.8	-8.5	-8.4	-8.7	-8.3	-6.1	-6.2	-4.6	-4.7	-3.9	-4.4	-4.3
Net domestic borrowing	4.3	5.5	5.5	5.1	5.1	3.4	3.6	2.3	2.7	2.8	3.0	2.9
Public debt												
Public gross nominal debt	63.7	67.9	67.8	71.2	70.2	71.2	70.4	69.6	68.7	67.4	67.2	65.7
Public net nominal debt	58.9	62.9	62.9	66.7	64.7	67.0	64.8	65.8	63.1	64.0	61.5	59.9
Public gross debt, PV	58.7	61.0	60.3	61.9	61.5	61.7	60.4	60.2	58.2	57.8	55.7	53.0
Public net debt, PV	53.9	56.0	55.4	57.4	56.1	57.6	54.9	56.5	52.6	54.4	50.0	47.2
Gross domestic debt	30.2	32.5	32.5	34.8	33.8	35.2	33.6	34.5	32.8	33.9	32.5	32.2
Gross external debt	33.4	35.3	35.3	36.4	36.3	36.0	36.7	35.1	35.9	33.5	34.7	33.4
Investment and saving												
Investment	19.8	13.2	21.9	14.4	20.4	15.1	20.5	17.0	20.9	18.1	21.2	21.5
General government	5.3	5.2	5.0	5.4	4.9	5.1	4.7	5.0	4.8	5.1	4.9	5.0
Nongovernment	14.5	8.0	16.9	9.0	15.5	10.0	15.8	12.0	16.0	13.0	16.3	16.5
Saving	15.1	8.1	16.4	9.2	14.6	10.0	15.0	12.0	15.5	13.1	16.1	16.5
General government	-3.0	-3.3	-3.3	-1.6	-2.3	1.0	-0.2	2.4	1.2	4.3	2.2	3.4
Nongovernment	18.1	11.4	19.7	10.8	16.8	9.0	15.2	9.6	14.3	8.7	13.9	13.1
External sector												
Exports (goods and services)	9.7	10.1	10.6	11.2	12.0	11.9	12.8	12.5	13.3	12.9	13.6	13.9
Imports (goods and services)	17.7	19.2	20.1	20.0	21.9	20.5	22.0	21.0	22.1	21.4	22.2	22.3
Current account balance (including grants)	-4.8	-5.1	-5.5	-5.1	-5.9	-5.1	-5.5	-5.0	-5.3	-5.0	-5.1	-5.0
Gross international reserves												
In billions of US$	8.3	10.8	9.5	9.0	8.8	9.8	10.2	10.7	11.0	11.6	11.9	12.7
In months of next year imports	4.5	5.6	4.4	4.2	3.9	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Memorandum items:												
GDP at current market prices (billions of Kenyan shilling)	10,716	11,975	12,098	13,328	13,618	14,790	15,341	16,388	17,020	18,163	18,867	20,912
GDP per capita (nominal US$)	2,073	2,199	2,219	2,287	2,311	2,385	2,382	2,498	2,487	2,626	2,608	2,737

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

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

[2] Fiscal year basis. Fiscal year runs from July 1 – June 30 (e.g., FY21-22 runs from July 1, 2021 to June 30, 2022).

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

(Billions of Kenyan Shillings)

	2020/21	2021/22			2022/23			2023/24			2024/25		
	Actual	Supplementary budget [2]	2nd Rev.	Proj.	2nd Rev.	Proj.	Budget /3	2nd Rev.	Proj.	BPS	2nd Rev.	Proj.	BPS
Revenues and grants	1,815.1	2,254.8	2,119.5	2,254.7	2,426.6	2,495.7	2,495.7	2,844.6	2,869.1	2,868.9	3,149.2	3,208.1	3,195.3
Revenue	1,783.7	2,192.0	2,057.2	2,191.8	2,379.7	2,462.4	2,462.4	2,796.5	2,820.9	2,820.8	3,099.9	3,158.9	3,146.0
Tax revenue (including unidentified tax measures)	1,429.5	1,722.6	1,667.3	1,722.5	2,024.0	2,024.0	2,024.1	2,387.6	2,387.6	2,387.5	2,667.8	2,667.8	2,654.8
Income tax	694.1	836.7	811.9	836.7	922.2	997.3	997.3	1,036.3	1,045.1	1,178.6	1,154.8	1,171.7	1,285.7
Personal income	363.3	455.1	426.3	455.1	489.0	512.7	512.7	546.3	552.2	608.7	604.3	613.3	673.9
Corporate income	330.7	381.6	385.6	381.6	433.2	484.6	484.6	489.9	492.9	569.9	550.4	558.4	611.7
Import duty (net)	108.4	115.9	118.8	115.9	142.4	144.9	144.9	159.0	172.0	170.4	174.9	193.8	181.4
Excise duty	216.3	255.9	259.6	255.9	280.9	297.2	297.2	311.2	348.1	346.9	352.3	370.3	395.1
Value-added tax	410.8	514.1	477.0	514.1	567.7	584.6	584.7	635.8	682.7	691.6	712.3	749.4	792.7
Domestic	197.1	249.0	227.7	249.0	275.4	304.2	304.2	314.5	324.5	350.4	349.1	360.2	369.6
Imports	213.7	265.1	249.4	265.1	292.3	280.4	280.4	321.2	358.2	341.2	363.2	389.2	423.1
Nontax revenue	354.2	469.4	389.8	469.4	355.7	438.3	438.3	408.9	433.4	433.2	432.1	491.1	491.1
Investment income	45.1	37.7	29.8	37.7	31.5	31.5	31.5	33.1	33.1	33.1	34.3	34.7	34.7
Other	87.4	91.2	78.2	91.2	86.0	86.0	86.0	95.7	95.7	95.7	105.3	133.1	133.1
Ministerial and Departmental Fees (AIA)	193.2	308.8	251.2	308.8	207.7	285.7	285.7	246.9	271.3	271.3	258.2	279.8	279.8
Railway Levy	28.5	31.6	30.6	31.6	30.4	35.1	35.1	33.2	33.2	33.2	34.4	43.5	43.5
Grants	31.3	62.9	62.3	62.9	46.9	33.3	33.3	48.1	48.1	48.1	49.3	49.3	49.3
Project grants	22.4	59.9	59.8	59.9	46.9	33.3	33.3	48.1	48.1	48.1	49.3	49.3	49.3
Program grants	8.9	3.0	2.5	3.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	2,749.5	3,279.2	3,153.2	3,259.8	3,240.2	3,353.7	3,358.6	3,506.9	3,587.2	3,562.2	3,781.6	3,951.5	3,875.6
Recurrent expenditure	2,197.2	2,614.6	2,452.5	2,594.4	2,512.0	2,679.3	2,675.0	2,713.3	2,813.4	2,783.0	2,926.4	3,078.0	3,000.0
Transfer to counties	368.3	401.2	409.9	401.2	400.5	407.0	407.0	408.8	412.3	412.3	425.2	417.5	417.5
Interest payments	495.1	605.3	605.7	585.5	638.8	683.2	690.6	692.0	747.7	718.0	714.8	825.7	766.5
Domestic interest	388.8	479.2	479.2	464.0	477.9	540.1	553.4	503.7	601.9	572.3	519.1	651.1	615.0
Foreign interest due	106.3	126.1	126.5	121.5	160.9	143.1	137.2	188.3	145.8	145.7	195.6	174.6	151.5
Wages and benefits (civil service)	493.0	525.9	526.1	525.9	560.7	537.2	537.2	595.8	600.0	600.0	645.3	645.3	645.3
Civil service reform	3.3	20.8	27.8	20.8	22.9	25.9	25.9	23.8	28.5	28.5	23.7	31.3	31.3
Pensions and Other Consolidated Fund Services	112.9	137.3	135.7	137.3	152.9	150.6	150.6	167.9	168.2	168.2	192.6	192.9	192.9
Defense and NSIS	157.7	157.1	157.1	157.1	161.9	174.3	174.3	170.0	170.0	170.0	170.0	170.0	170.0
Other	566.8	766.9	590.2	766.5	574.2	701.0	689.4	655.1	686.6	686.0	754.8	795.2	776.5
of which: Emergency spending (droughts, security)		24.0	20.0	24.0									
Development and net lending	552.3	664.6	700.7	665.4	728.1	674.4	683.6	793.6	773.8	779.3	855.2	873.6	875.6
Domestically financed	385.3	416.0	398.8	416.8	415.4	379.7	388.9	443.6	423.9	429.3	461.9	483.6	485.7
of which: SOEs emergency funding	36.6	33.2	48.4	32.3	36.6	36.6	46.0	22.8	30.6	22.8	20.0	24.1	20.0
Foreign financed	167.0	248.6	301.8	248.6	312.7	294.7	294.7	349.9	349.9	349.9	393.3	389.9	390.0
of which: SGR project	11.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: COVID-19 vaccines		8.1	14.4	8.1		6.2	0.0						
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustments to cash basis	5.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance including measures (cash basis, incl. grants)	-929.3	-1,024.3	-1,033.7	-1,005.0	-813.6	-858.0	-862.9	-662.3	-718.1	-693.4	-632.3	-743.4	-680.4
Financing	950.5	1,024.3	1,033.7	1,005.0	813.6	858.0	862.9	662.3	718.1	693.4	632.3	743.4	680.4
Net foreign financing	323.3	310.2	386.1	349.8	334.2	341.4	280.7	302.2	285.5	198.6	153.2	209.4	99.7
Disbursements	451.6	512.2	1,148.1	533.4	553.7	564.3	521.8	482.1	503.2	674.2	428.0	555.2	381.1
Project loans	157.1	224.7	273.5	236.2	302.0	299.7	286.5	338.8	358.4	338.8	343.4	369.8	377.6
Program loans	168.6	163.2	178.9	170.1	146.1	153.9	129.7	143.3	144.9	65.4	0.0	0.0	3.5
of which: IMF (RCF+ EFF/ECF)	77.6	57.5	58.7	56.9	68.2	66.0	63.2	69.7	68.0	61.9	0.0	0.0	0.0
Non-concessional [4]	114.3	124.3	695.7	127.1	105.6	110.7	105.6	0.0	0.0	270.0	84.6	185.4	0.0
Standard Gauge Railway	11.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments due [4]	-128.3	-202.1	-762.0	-183.6	-219.5	-222.9	-241.1	-179.9	-217.7	-475.6	-274.8	-345.9	-281.5
Net domestic financing	627.2	714.2	647.6	655.2	479.4	516.7	582.2	360.1	432.6	494.7	479.2	534.0	580.7
Memorandum items:													
Nominal GDP	11,370.3	12,858.0	12,651.8	12,858.0	14,059.2	14,479.3	14,479.3	15,588.9	16,180.6	15,903.1	17,275.4	17,944.0	17,648.4
Primary balance incl. grants	-455.4	-419.1	-428.0	-419.6	-174.8	-174.8	-172.3	29.6	29.6	30.1	82.4	82.3	88.2
Fuel subsidies (net of Petroleum Levy resources)			0.0	37.0									
Tax overperformance			0.0	55.1									
Tax carryover from FY21/22					0.0	55.1							
Potential additional SOEs supports					0.0	0.0							
Unidentified spending offsets due to SOE supports				0.0		0.0			30.6			24.1	
Total gross public debt, gross	7,712.4		9,005.0	9,023.5	10,008.4	10,189.1		10,852.0	11,117.3		11,665.1	12,059.9	
external debt	4,015.3		4,660.2	4,671.2	5,184.3	5,320.2		5,667.8	5,815.7		6,001.8	6,224.3	
domestic debt	3,697.1		4,344.7	4,352.3	4,824.1	4,869.0		5,184.2	5,301.6		5,663.4	5,835.6	
Total net public debt	7,156.0		8,433.2	8,325.1	9,430.6	9,378.7		10,269.7	10,213.1		11,076.8	11,040.0	
Unidentified tax policy measures	0.0		0.0	0.0	110.8	0.0		134.6	139.7		28.0	42.9	
Pending bills	24.9												
Government deposits	556.4												

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

[1] Fiscal year runs from July to June.

[2] As submitted in late May 2022.

[3] As approved in early June 2022.

[4] At the time of the 2nd review, it included bond issuance for debt management operations (incl. early rollover of the Eurobond maturing in 2024), which remains under active consideration but is no longer in the baseline.

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

(Percent of GDP)

	2020/21	2021/22			2022/23			2023/24			2024/25		
	Actual	Supplementary budget 2	2nd Rev.	Proj.	2nd Rev.	Proj.	Budget /3	2nd Rev.	Proj.	BPS	2nd Rev.	Proj.	BPS
Revenues and grants	**16.0**	**17.5**	**16.8**	**17.5**	**17.3**	**17.2**	**17.2**	**18.2**	**17.7**	**18.0**	**18.2**	**17.9**	**18.1**
Revenue	**15.7**	**17.0**	**16.3**	**17.0**	**16.9**	**17.0**	**17.0**	**17.9**	**17.4**	**17.7**	**17.9**	**17.6**	**17.8**
Tax revenue (including unidentified tax measures)	12.6	13.4	13.2	13.4	14.4	14.0	14.0	15.3	14.8	15.0	15.4	14.9	15.0
Income tax	6.1	6.5	6.4	6.5	6.6	6.9	6.9	6.6	6.5	7.4	6.7	6.5	7.3
Personal income	3.2	3.5	3.4	3.5	3.5	3.5	3.5	3.5	3.4	3.8	3.5	3.4	3.8
Corporate income	2.9	3.0	3.0	3.0	3.1	3.3	3.3	3.1	3.0	3.6	3.2	3.1	3.5
Import duty (net)	1.0	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.1	1.1	1.0	1.1	1.0
Excise duty	1.9	2.0	2.1	2.0	2.0	2.1	2.1	2.0	2.2	2.2	2.0	2.1	2.2
Value-added tax	3.6	4.0	3.8	4.0	4.0	4.0	4.0	4.1	4.2	4.3	4.1	4.2	4.5
Domestic	1.7	1.9	1.8	1.9	2.0	2.1	2.1	2.0	2.0	2.2	2.0	2.0	2.1
Imports	1.9	2.1	2.0	2.1	2.1	1.9	1.9	2.1	2.2	2.1	2.1	2.2	2.4
Nontax revenue	3.1	3.7	3.1	3.7	2.5	3.0	3.0	2.6	2.7	2.7	2.5	2.7	2.8
Investment income	0.4	0.3	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other	0.8	0.7	0.6	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.8
Ministerial and Departmental Fees (AIA)	1.7	2.4	2.0	2.4	1.5	2.0	2.0	1.6	1.7	1.7	1.5	1.6	1.6
Railway Levy	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Grants	**0.3**	**0.5**	**0.5**	**0.5**	**0.3**	**0.2**	**0.2**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**
Project grants	0.2	0.5	0.5	0.5	0.3	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Program grants	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**24.2**	**25.5**	**24.9**	**25.4**	**23.0**	**23.2**	**23.2**	**22.5**	**22.2**	**22.4**	**21.9**	**22.0**	**22.0**
Recurrent expenditure	**19.3**	**20.3**	**19.4**	**20.2**	**17.9**	**18.5**	**18.5**	**17.4**	**17.4**	**17.5**	**16.9**	**17.2**	**17.0**
Transfer to counties	3.2	3.1	3.2	3.1	2.8	2.8	2.8	2.6	2.5	2.6	2.5	2.3	2.4
Interest payments	4.4	4.7	4.8	4.6	4.5	4.7	4.8	4.4	4.6	4.5	4.1	4.6	4.3
Domestic interest	3.4	3.7	3.8	3.6	3.4	3.7	3.8	3.2	3.7	3.6	3.0	3.6	3.5
Foreign interest due	0.9	1.0	1.0	0.9	1.1	1.0	0.9	1.2	0.9	0.9	1.1	1.0	0.9
Wages and benefits (civil service)	4.3	4.1	4.2	4.1	4.0	3.7	3.7	3.8	3.7	3.8	3.7	3.6	3.7
Civil service reform	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2
Pensions and Other Consolidated Fund Services	1.0	1.1	1.1	1.1	1.1	1.0	1.0	1.1	1.0	1.1	1.1	1.1	1.1
Defense and NSIS	1.4	1.2	1.2	1.2	1.2	1.2	1.2	1.1	1.1	1.1	1.0	0.9	1.0
Other	5.0	6.0	4.7	6.0	4.1	4.8	4.8	4.2	4.2	4.3	4.4	4.4	4.4
of which: Emergency spending (droughts, security)		0.2		0.2									
Development and net lending	**4.9**	**5.2**	**5.5**	**5.2**	**5.2**	**4.7**	**4.7**	**5.1**	**4.8**	**4.9**	**5.0**	**4.9**	**5.0**
Domestically financed	3.4	3.2	3.2	3.2	3.0	2.6	2.7	2.8	2.6	2.7	2.7	2.7	2.8
of which: SOEs emergency funding	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.1	0.2	0.1	0.1	0.1	0.1
Foreign financed	1.5	1.9	2.4	1.9	2.2	2.0	2.0	2.2	2.2	2.2	2.3	2.2	2.2
of which: SGR project	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which: COVID-19 vaccines		0.1	0.1	0.1									
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustments to cash basis	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance including measures (cash basis, incl. grants)	**-8.2**	**-8.0**	**-8.2**	**-7.8**	**-5.8**	**-5.9**	**-6.0**	**-4.2**	**-4.4**	**-4.4**	**-3.7**	**-4.1**	**-3.9**
Financing	**8.4**	**8.0**	**8.2**	**7.8**	**5.8**	**5.9**	**6.0**	**4.2**	**4.4**	**4.4**	**3.7**	**4.1**	**3.9**
Net foreign financing	2.8	2.4	3.1	2.7	2.4	2.4	1.9	1.9	1.8	1.2	0.9	1.2	0.6
Disbursements	4.0	4.0	9.1	4.1	3.9	3.9	3.6	3.1	3.1	4.2	2.5	3.1	2.2
Project loans	1.4	1.7	2.2	1.8	2.1	2.1	2.0	2.2	2.2	2.1	2.0	2.1	2.1
Program loans	1.5	1.3	1.4	1.3	1.0	1.1	0.9	0.9	0.9	0.4	0.0	0.0	0.0
of which: IMF (RCF+ EFF/ECF)	0.7	0.4	0.5	0.4	0.5	0.5	0.4	0.4	0.4	0.4	0.0	0.0	0.0
Non-concessional [4]	1.0	1.0	5.5	1.0	0.8	0.8	0.7	0.0	0.0	1.7	0.5	1.0	0.0
Standard Gauge Railway	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments due [4]	-1.1	-1.6	-6.0	-1.4	-1.6	-1.5	-1.7	-1.2	-1.3	-3.0	-1.6	-1.9	-1.6
Net domestic financing	5.5	5.6	5.1	5.1	3.4	3.6	4.0	2.3	2.7	3.1	2.8	3.0	3.3
Memorandum items:													
Primary balance incl. grants	-4.0	-3.3	-3.4	-3.3	-1.2	-1.2	-1.2	0.2	0.2	0.2	0.5	0.5	0.5
Fuel subsidies (net of Petroleum Levy resources)			0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax overperformance			0.0	0.4									
Tax carryover from FY21/22					0.0	0.4						0.0	
Unidentified spending offsets due to SOE supports				0.0		0.0			0.2			0.1	
Total gross public debt, gross	67.8		71.2	70.2	71.2	70.4		69.6	68.7		67.5	67.2	
external debt	35.3		36.8	36.3	36.9	36.7		36.4	35.9		34.7	34.7	
domestic debt	32.5		34.3	33.8	34.3	33.6		33.3	32.8		32.8	32.5	
Total net public debt	62.9		66.7	64.7	67.1	64.8		65.9	63.1		64.1	61.5	
Unidentified tax policy measures	0.0		0.0	0.0	0.8	0.0		0.9	0.9		0.2	0.2	
Pending bills	0.2		0.0	0.0	0.0	0.0		0.0	0.0		0.0	0.0	
Government deposits	4.9												

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

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

[2] As submitted in late May.

[3] As approved in early June.

[4] At the time of the 2nd review, it included bond issuance for debt management operations (incl. early rollover of the Eurobond maturing in 2024), which remains under active consideration but is no longer in the baseline.

Table 3. Kenya: Monetary Survey Dec. 2020–Jun. 2023

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
	Act.	Act.	Act.	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In billions of Kenyan Shillings; end of period)										
Central Bank of Kenya (CBK)											
Net foreign assets	738	691	836	761	701	601	764	637	564	453	563
Net domestic assets	-269	-240	-386	-282	-179	-121	-220	-115	-25	78	1
Net domestic credit	33	44	-53	34	147	180	88	215	318	429	358
Government (net)	-32	-20	-50	-18	67	87	159	159	188	188	227
Of which: on-lending and transfer of IMF resources[1]	85	84	161	163	195	195	267	267	297	297	336
Commercial banks (net)	61	61	-6	48	76	89	-74	53	126	237	127
Private sector (net)	3	3	3	3	3	4	4	4	4	4	4
Other items (net)	-301	-284	-333	-316	-326	-301	-308	-330	-342	-350	-357
Reserve money (RM)	470	451	450	479	522	479	544	522	539	531	564
Currency in circulation	234	226	226	234	253	248	306	277	285	272	295
Bank reserves	236	225	224	244	268	231	238	246	255	259	269
Other depository corporations											
Net foreign assets	8	0	-52	-99	-110	-173	-113	-116	-118	-119	-121
Reserves	236	225	224	244	268	231	238	246	255	259	269
Credit to CBK	-61	-61	6	-48	-76	-89	74	-53	-126	-237	-127
Net domestic assets	3,507	3,597	3,684	3,811	3,850	3,969	3,845	4,112	4,350	4,544	4,580
Net domestic credit	4,274	4,378	4,493	4,659	4,806	4,932	4,762	4,941	5,108	5,283	5,225
Government (net)	1,375	1,427	1,511	1,602	1,656	1,672	1,447	1,530	1,602	1,667	1,498
Other public sector (net)	91	89	84	81	100	87	87	87	87	87	87
Private sector (net)	2,808	2,862	2,898	2,976	3,050	3,174	3,228	3,324	3,419	3,529	3,641
Other items (net)	-767	-781	-809	-848	-956	-963	-917	-829	-759	-739	-645
Total deposits	3,691	3,762	3,862	3,908	3,931	3,938	4,060	4,181	4,335	4,418	4,584
Monetary survey											
Net foreign assets	747	691	784	662	590	428	651	520	445	333	442
Net domestic assets	3,244	3,339	3,354	3,516	3,645	3,793	3,699	3,944	4,199	4,385	4,454
Net domestic credit	4,246	4,361	4,446	4,645	4,877	5,023	4,924	5,103	5,300	5,475	5,456
Government (net)	1,343	1,407	1,460	1,584	1,724	1,758	1,605	1,688	1,790	1,855	1,725
Other public sector (net)	91	89	84	81	100	87	87	87	87	87	87
Private sector (net)	2,811	2,865	2,901	2,979	3,053	3,177	3,232	3,328	3,423	3,533	3,644
Other items (net)	-1,002	-1,022	-1,092	-1,129	-1,232	-1,229	-1,225	-1,159	-1,101	-1,089	-1,002
M1	1,720	1,717	1,779	1,771	1,848	1,796	1,851	1,900	1,976	2,008	2,083
Money and quasi-money (M2)	3,250	3,250	3,377	3,408	3,432	3,410	3,498	3,579	3,700	3,745	3,866
M2 plus resident foreign currency deposits (M3)	3,991	4,030	4,138	4,178	4,235	4,221	4,350	4,465	4,644	4,719	4,896
M3 plus nonbank holdings of government debt (L)	5,665	5,769	5,900	6,073	6,202	6,303	6,525	6,685	6,924	7,103	7,411
Memorandum items	(Annual percentage change, unless otherwise indicated)										
RM	1.9	1.2	5.4	5.9	11.0	6.3	21.0	9.1	3.3	10.8	3.6
M2	11.9	7.7	4.6	7.2	5.6	4.9	3.6	5.0	7.8	9.8	10.5
M3	13.2	10.1	6.4	8.7	6.1	4.7	5.1	6.9	9.7	11.8	12.6
L	17.3	13.0	9.9	11.5	9.5	9.3	10.6	10.1	11.6	12.7	13.6
Deposits	12.0	9.7	7.0	9.1	6.5	4.7	5.1	7.0	10.3	12.2	12.9
Net domestic credit	17.0	15.1	13.1	14.6	14.9	15.2	10.8	9.9	8.7	9.0	10.8
Government (net, monetary survey)	42.7	35.7	27.1	32.5	28.3	25.0	9.9	6.6	3.9	5.5	7.5
Private sector (net)	8.4	7.7	7.7	7.7	8.6	10.9	11.4	11.7	12.1	11.2	12.8
Net domestic assets (NDA) of the banking sector	14.1	11.9	11.8	9.2	9.8	10.3	4.4	7.9	13.0	14.5	19.1
NDA growth (as percent of the base period M3)	12.3	10.5	10.0	8.4	8.6	9.2	3.9	7.2	11.8	13.6	16.9
Multiplier (M2/RM; ratio)	6.9	7.2	7.5	7.1	6.6	7.1	6.4	6.9	6.9	7.1	6.9
Multiplier (M3/RM; ratio)	8.5	8.9	9.2	8.7	8.1	8.8	8.0	8.5	8.6	8.9	8.7
Velocity (GDP/M2; ratio)	3.5	3.6	3.6	3.5	3.5	3.6	3.6	3.7	3.7	3.7	3.7
Velocity (GDP/M3; ratio)	2.8	2.9	2.9	2.8	2.9	2.9	2.9	2.9	2.9	2.9	2.9

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

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

Table 4a. Kenya: Summary Balance of Payments, 2020–27

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

	2020	2021		2022		2023		2024		2025	2026	2027
	Act.	2nd Rev.	Prel.	2nd Rev.	Proj.	2nd Rev.	Proj.	2nd Rev.	Proj.	Proj.	Proj.	Proj.
Current account	-4,797	-5,631	-6,064	-5,962	-6,888	-6,376	-6,860	-6,705	-7,071	-7,193	-7,641	-8,020
Merchandize trade	-8,430	-10,354	-11,381	-11,351	-13,237	-12,293	-13,419	-13,338	-14,008	-14,767	-15,758	-16,648
Exports f.o.b.	6,052	6,937	6,833	7,808	8,132	8,660	9,111	9,581	10,066	11,123	12,069	13,038
Imports f.o.b.	14,482	17,292	18,214	19,158	21,369	20,953	22,530	22,919	24,074	25,890	27,827	29,686
Energy	2,081	2,900	3,233	3,298	4,892	3,537	4,472	3,786	4,387	4,437	4,443	4,195
Non-energy	12,400	14,392	14,981	15,861	16,477	17,416	18,059	19,133	19,688	21,453	23,385	25,492
Services	352	386	848	1,164	1,641	1,608	2,051	1,970	2,362	2,649	2,891	3,119
Credit, *of which*	3,724	4,161	4,848	5,279	6,051	6,171	6,747	7,016	7,491	8,234	9,004	9,790
Transportation		1,468	1,488	2,124	2,257	2,496	2,668	2,860	3,047	3,335	3,610	3,873
Travel receipts	541	494	845	658	957	849	1,062	1,024	1,163	1,262	1,363	1,453
Debit, *of which*	3,373	3,775	4,000	4,115	4,410	4,563	4,696	5,045	5,129	5,585	6,114	6,670
Transportation		1,525	1,713	1,690	1,885	1,848	1,988	2,022	2,124	2,284	2,455	2,619
Primary income	-1,671	-1,713	-1,658	-2,161	-1,966	-2,523	-2,661	-2,561	-2,972	-3,201	-3,545	-3,957
Credit	118	97	62	153	644	248	1,060	434	1,161	1,063	1,144	1,216
Debit	1,788	1,810	1,720	2,314	2,610	2,770	3,721	2,995	4,132	4,264	4,688	5,173
Secondary income, *of which*	4,952	6,050	6,128	6,385	6,674	6,831	7,169	7,224	7,546	8,125	8,771	9,466
Remittances	3,108	3,558	3,776	3,893	4,155	4,242	4,571	4,603	4,935	5,330	5,758	6,219
Capital account	132	450	196	205	200	205	200	205	200	200	200	200
Financial account [1]	-2,609	-4,695	-5,313	-2,562	-4,514	-5,803	-6,939	-6,547	-6,841	-7,971	-8,589	-9,097
Direct investment, net	-504	-250	-595	-649	-961	-996	-1,127	-1,195	-1,183	-1,484	-1,685	-2,011
Assets	-78	432	-131	175	100	175	100	175	100	100	100	100
Liabilities	-426	-682	-464	-824	-1,060	-1,171	-1,226	-1,370	-1,283	-1,584	-1,785	-2,110
Portfolio investment, net, *of which*	1,325	-1,502	179	869	813	882	832	894	849	-237	877	874
Assets	1,054	1,000	1,022	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Liabilities	271	-2,502	-843	-130	-186	-118	-168	-106	-151	-1,236	-123	-126
Eurobonds (net)	0	-2,191	-1,000	0	0	0	0	0	0	-1,100	0	0
Financial derivatives, net	-16	0	23	0	0	0	0	0	0	0	0	0
Other investment, net	-3,415	-2,943	-4,919	-2,783	-4,367	-5,689	-6,644	-6,246	-6,506	-6,251	-7,780	-7,960
Assets	1,024	1,000	160	1,000	500	1,000	500	1,000	500	500	500	250
Liabilities, *of which*	-4,439	-3,942	-5,078	-3,783	-4,867	-6,689	-7,144	-7,246	-7,006	-6,751	-8,280	-8,210
Public sector loans (excl. official budget support) (net)	-1,882	-400	-641	-320	-1,598	-1,541	-1,818	-1,070	-1,039	-1,385	-3,250	-3,143
SDR allocation	0	-740	-740	0	0	0	0	0	0	0	0	0
Errors and omissions	522	520	-573	0	0	0	0	0	0	0	0	0
Overall balance ("+" indicates a surplus)	-1,534	34	-1,128	-3,195	-2,173	-367	279	48	-29	978	1,148	1,277
Financing	1,534	-34	1,128	3,195	2,173	367	-279	-48	29	-978	-1,148	-1,277
Reserve assets [2]	925	-2,504	-1,163	1,814	712	-813	-1,419	-887	-795	-863	-846	-862
Program financing	608	1,957	1,786	1,381	1,461	1,180	1,140	839	824	-115	-302	-415
IMF (net)	608	854	847	438	409	630	590	239	224	-115	-302	-415
of which, Fund purchases	743	984	980	510	477	662	619	239	224	0	0	0
Official budget support (other)	0	1,103	939	943	1,052	550	550	600	600	0	0	0
Exceptional financing	0	514	505	0	0	0	0	0	0	0	0	0
of which, DSSI	0	514	505	0	0	0	0	0	0	0	0	0
Memorandum items:												
Gross international reserves (USD million)	8,284	10,788	9,514	8,974	8,802	9,787	10,221	10,674	11,016	11,879	12,725	13,587
In months of next year's imports of goods and services	4.5	5.6	4.4	4.2	3.9	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Current account (CA) (percent of GDP)	-4.8	-5.1	-5.5	-5.1	-5.9	-5.1	-5.5	-5.0	-5.3	-5.1	-5.0	-5.0
CA excl. energy imports (percent of GDP)	-2.7	-2.5	-2.6	-2.3	-1.7	-2.3	-1.9	-2.2	-2.0	-1.9	-2.1	-2.4
Energy imports (percent of GDP)	2.1	2.6	2.9	2.8	4.2	2.8	3.6	2.8	3.3	3.1	2.9	2.6
Merchandize exports growth (percent)	3.1	14.4	12.9	12.5	19.0	10.9	12.0	10.6	10.5	10.5	8.5	8.0
Merchandize imports growth (percent)	-12.5	19.3	25.8	10.8	17.3	9.4	5.4	9.4	6.9	7.5	7.5	6.7
Energy (percent)	-33.0	39.4	55.3	13.7	51.3	7.3	-8.6	7.0	-1.9	1.2	0.1	-5.6
Non-energy (percent)	-7.8	15.9	20.8	10.2	10.0	9.8	9.6	9.9	9.0	9.0	9.0	9.0
Travel receipts growth (percent)	-46.3	4.7	56.2	33.3	13.3	29.0	11.0	20.6	9.5	8.5	8.0	6.6
Remittances growth (percent)	9.5	15.0	21.5	9.4	10.0	8.9	10.0	8.5	8.0	8.0	8.0	8.0

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

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

[2] Negative entries reflect an increase in assets.

Table 4b. Kenya: Summary Balance of Payments, 2020–27

(Percent of GDP)[1]

	2020	2021		2022		2023		2024		2025	2026	2027
	Act.	2nd Rev.	Prel.	2nd Rev.	Proj.	2nd Rev.	Proj.	2nd Rev.	Proj.	Proj.	Proj.	Proj.
Current account	-4.8	-5.1	-5.5	-5.1	-5.9	-5.1	-5.5	-5.0	-5.3	-5.1	-5.0	-5.0
Merchandize trade	-8.4	-9.5	-10.3	-9.7	-11.2	-9.9	-10.8	-10.0	-10.6	-10.4	-10.4	-10.3
Exports f.o.b.	6.0	6.3	6.2	6.7	6.9	7.0	7.3	7.2	7.6	7.8	7.9	8.1
Imports f.o.b.	14.3	15.8	16.5	16.4	18.2	16.9	18.2	17.2	18.2	18.3	18.3	18.4
Energy	2.1	2.6	2.9	2.8	4.2	2.8	3.6	2.8	3.3	3.1	2.9	2.6
Non-energy	12.3	13.1	13.6	13.6	14.0	14.0	14.6	14.4	14.9	15.1	15.4	15.8
Services	0.3	0.4	0.8	1.0	1.4	1.3	1.7	1.5	1.8	1.9	1.9	1.9
Credit, *of which*	3.7	3.8	4.4	4.5	5.1	5.0	5.4	5.3	5.7	5.8	5.9	6.1
Transportation	0.0	1.3	1.3	1.8	1.9	2.0	2.2	2.2	2.3	2.4	2.4	2.4
Travel receipts	0.5	0.5	0.8	0.6	0.8	0.7	0.9	0.8	0.9	0.9	0.9	0.9
Debit	3.3	3.4	3.6	3.5	3.7	3.7	3.8	3.8	3.9	3.9	4.0	4.1
Primary income	-1.7	-1.6	-1.5	-1.9	-1.7	-2.0	-2.1	-1.9	-2.2	-2.3	-2.3	-2.4
Credit	0.1	0.1	0.1	0.1	0.5	0.2	0.9	0.3	0.9	0.7	0.8	0.8
Debit	1.8	1.7	1.6	2.0	2.2	2.2	3.0	2.3	3.1	3.0	3.1	3.2
Secondary income, *of which*	4.9	5.5	5.5	5.5	5.7	5.5	5.8	5.4	5.7	5.7	5.8	5.9
Remittances	3.1	3.2	3.4	3.3	3.5	3.4	3.7	3.5	3.7	3.8	3.8	3.8
Capital account	0.1	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Financial account [2]	-2.6	-4.3	-4.8	-2.2	-3.8	-4.7	-5.6	-4.9	-5.2	-5.6	-5.6	-5.6
Direct investment, net	-0.5	-0.2	-0.5	-0.6	-0.8	-0.8	-0.9	-0.9	-0.9	-1.0	-1.1	-1.2
Assets	-0.1	0.4	-0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Liabilities	-0.4	-0.6	-0.4	-0.7	-0.9	-0.9	-1.0	-1.0	-1.0	-1.1	-1.2	-1.3
Portfolio investment, net, *of which*	1.3	-1.4	0.2	0.7	0.7	0.7	0.7	0.7	0.6	-0.2	0.6	0.5
Assets	1.0	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.8	0.7	0.7	0.6
Liabilities	0.3	-2.3	-0.8	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.9	-0.1	-0.1
Eurobonds (net)	0.0	-2.0	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	-0.8	0.0	0.0
Financial derivatives, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment, net	-3.4	-2.7	-4.5	-2.4	-3.7	-4.6	-5.4	-4.7	-4.9	-4.4	-5.1	-4.9
Assets	1.0	0.9	0.1	0.9	0.4	0.8	0.4	0.8	0.4	0.4	0.3	0.2
Liabilities, *of which*	-4.4	-3.6	-4.6	-3.2	-4.1	-5.4	-5.8	-5.4	-5.3	-4.8	-5.4	-5.1
Public sector loans (excl. official budget support) (net)	-1.9	-0.4	-0.6	-0.3	-1.4	-1.2	-1.5	-0.8	-0.8	-1.0	-2.1	-1.9
SDR allocation	0.0	-0.7	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.5	0.5	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance ("+" indicates a surplus)	-1.5	0.0	-1.0	-2.7	-1.8	-0.3	0.2	0.0	0.0	0.7	0.8	0.8
Financing	1.5	0.0	1.0	2.7	1.8	0.3	-0.2	0.0	0.0	-0.7	-0.8	-0.8
Reserve assets [3]	0.9	-2.3	-1.1	1.6	0.6	-0.7	-1.1	-0.7	-0.6	-0.6	-0.6	-0.5
Program financing	0.6	1.8	1.6	1.2	1.2	1.0	0.9	0.6	0.6	-0.1	-0.2	-0.3
IMF (net)	0.6	0.8	0.8	0.4	0.3	0.5	0.5	0.2	0.2	-0.1	-0.2	-0.3
of which, Fund purchases	0.7	0.9	0.9	0.4	0.4	0.5	0.5	0.2	0.2	0.0	0.0	0.0
Official budget support (other)	0.0	1.0	0.8	0.8	0.9	0.4	0.4	0.5	0.5	0.0	0.0	0.0
Exceptional financing	0.0	0.5	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
of which, DSSI	0.0	0.5	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Gross international reserves	8.2	9.9	8.6	7.7	7.5	7.9	8.2	8.0	8.3	8.4	8.4	8.4

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

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

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

[3] Negative entries reflect an increase in assets.

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

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

Source: Kenyan authorities.

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

Table 6. Kenya: External Financing Requirements and Sources, 2020–27
(Millions of U.S. dollars, unless otherwise indicated)

		2020	2021		2022		2023		2024		2025	2026	2027
		Act.	2nd Rev.	Prel.	2nd Rev.	Proj.	2nd Rev.	Proj.	2nd Rev.	Proj.	Proj.	Proj.	Proj.
(1)	**Gross financing requirements**	**6,283**	**7,474**	**7,900**	**8,301**	**8,921**	**8,521**	**9,050**	**10,520**	**11,096**	**10,665**	**9,964**	**10,369**
	Current account deficit (excl. grants)	4,847	5,766	6,199	6,097	7,023	6,511	6,995	6,840	7,206	7,328	7,776	8,155
	of which: Energy imports	2,081	2,900	3,233	3,298	4,892	3,537	4,472	3,786	4,387	4,437	4,443	4,195
	Amortization of general government loans (excl. IMF repurchase)	1,301	1,578	1,568	2,131	1,830	1,979	2,025	1,680	1,890	2,922	1,585	1,498
	Amortization of sovereign bonds	0	0	0	0	0	0	0	2,000	2,000	300	300	300
	IMF repurchases	135	131	133	73	68	31	29	0	0	115	302	415
(2)	**Change in reserves (+ = increase)**	**-925**	**2,504**	**1,163**	**-1,814**	**-712**	**813**	**1,419**	**887**	**795**	**863**	**846**	**862**
(3)	**Gross financing sources**	**4,068**	**6,858**	**7,212**	**5,033**	**6,680**	**8,122**	**9,300**	**10,568**	**11,067**	**11,528**	**10,810**	**11,231**
	FDI, net	504	250	595	649	961	996	1,127	1,195	1,183	1,484	1,685	2,011
	Public grants	49	135	135	135	135	135	135	135	135	135	135	135
	Public sector borrowing (excl. official budget support)	3,184	2,718	2,949	2,451	3,428	3,519	3,844	2,750	2,930	4,306	4,835	4,641
	of which, SDR allocation	0	740	740	0	0	0	0	0	0	0	0	0
	Issuance of sovereign bonds	0	2,191	1,000	0	0	0	0	2,000	2,000	1,400	300	300
	Private capital flows, net	331	1,564	2,531	1,799	2,157	3,471	4,194	4,487	4,819	4,203	3,854	4,144
(4)	**Errors and omissions**	**522**	**520**	**-573**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
(1)+(2)-(3)-(4)	**Total financing needs**	**767**	**2,601**	**2,424**	**1,454**	**1,529**	**1,212**	**1,169**	**839**	**824**	**0**	**0**	**0**
(5)+(6)	**Total financing sources**	**743**	**2,601**	**2,424**	**1,454**	**1,529**	**1,212**	**1,169**	**839**	**824**	**0**	**0**	**0**
(5)	Official public external financing	743	2,088	1,919	1,454	1,529	1,212	1,169	839	824	0	0	0
	Identified official budget support	0	1,103	939	943	1,052	550	550	600	600	0	0	0
	IMF purchases[1]	743	984	980	510	477	662	619	239	224	0	0	0
(6)	Exceptional financing	0	514	505	0	0	0	0	0	0	0	0	0
	of which, DSSI	0	514	505	0	0	0	0	0	0	0	0	0
	Memorandum Items												
	Gross financing requirements (in percent of GDP)	6.2	6.8	7.1	7.1	7.6	6.9	7.3	7.9	8.4	7.5	6.6	6.4
	Gross international Reserves	8,284	10,788	9,514	8,974	8,802	9,787	10,221	10,674	11,016	11,879	12,725	13,587
	In months of next year's imports of GNFS	4.5	5.6	4.4	4.2	3.9	4.2	4.2	4.2	4.2	4.2	4.2	4.2

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

[1] In 2020, disbursements under the RCF.

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

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 calculations.

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

Table 8. Kenya: Indicators of Fund Credit, 2020–34
(Millions of SDR unless stated otherwise)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
	Act.	Prel.	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	59.5	37.5	23.1	107.4	239.1	315.1	383.5	407.6	353.5	251.6	156.6	89.6	15.8
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	9.2	16.0	23.1	24.9	23.4	20.0	15.9	12.8	9.7	6.6	4.1	2.5	1.7
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	1.0	1.6	1.8	2.2	2.2	2.0	1.7	1.3	1.0	0.6	0.4	0.2	0.1	0.0	0.0
In percent of exports of goods and services	10.4	14.9	15.1	17.1	16.7	14.6	12.0	9.4	6.7	4.2	2.3	1.1	0.4	0.0	0.0
In percent of gross international reserves	10.7	18.2	24.3	26.5	26.6	23.7	19.9	15.7	12.6	8.0	4.4	2.1	0.8	0.1	0.0
In percent of government revenue	6.0	9.3	10.4	12.3	12.1	10.9	9.0	7.1	5.1	3.3	1.8	0.9	0.3	0.0	0.0
In percent of total external debt	1.7	2.8	3.0	3.5	3.4	3.1	2.6	2.0	1.5	0.9	0.5	0.3	0.1	0.0	0.0
Obligations to the Fund (repurchases and charges) [4]															
In percent of quota	18.1	17.6	11.0	6.9	4.3	19.8	44.1	58.1	70.7	75.1	65.1	46.3	28.8	16.5	2.9
In percent of GDP	0.1	0.1	0.1	0.0	0.0	0.1	0.2	0.3	0.3	0.3	0.2	0.2	0.1	0.1	0.0
In percent of exports of goods and services	1.4	1.1	0.6	0.3	0.2	0.7	1.5	1.8	2.1	2.0	1.6	1.1	0.6	0.3	0.1
In percent of gross international reserves	1.7	1.3	0.9	0.5	0.3	1.2	2.5	3.1	3.9	3.9	3.1	2.1	1.2	0.6	0.1
In percent of government revenue	0.8	0.7	0.4	0.2	0.1	0.6	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	2.6	1.2	0.6	0.3	1.4	3.2	4.0	4.3	4.7	3.8	2.6	1.5	0.8	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)	100,931	110,519	117,705	124,002	132,354	141,856	152,110	161,672	170,428	179,674	189,437	200,080	211,396	223,354	236,064
Exports of goods and services (USD million)	9,776	11,681	14,183	15,858	17,557	19,357	21,073	22,828	24,685	26,701	28,889	31,625	34,724	38,138	41,901
Gross international reserves (USD million)	8,284	9,514	8,802	10,221	11,016	11,879	12,725	13,587	13,118	13,955	14,964	16,167	17,510	18,931	20,636
Government revenue (USD million)	16,821	18,574	20,643	22,052	24,126	25,992	28,018	30,129	32,185	34,155	36,157	38,331	40,571	43,016	45,751
External debt service (USD million)	4,836	5,450	6,672	8,067	10,671	10,717	10,362	11,182	12,662	12,248	13,070	13,837	14,579	16,388	18,457
Total external debt (USD million)	58,017	65,879	72,208	80,491	88,322	96,058	104,036	111,831	118,324	126,059	133,884	141,627	149,552	157,640	166,138

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 1.498 (as of May 12, 2022).
[4] Using the SDR/USD rate as of May 12, 2022 in 2022-2034 forecasts.

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

	Debt Stock (end of period)			Debt Service					
	2021			2021	2022	2023	2021	2022	2023
	(In US$ mln)	*(Percent total debt)*	*(Percent GDP)*	*(In US$ mln)*			*(Percent GDP)*		
Total	**72,403**	**100.0**	**67.7**	**3,113**	**3,934**	**3,930**	**2.8**	**3.3**	**3.2**
External	**36,762**	**50.8**	**34.4**	**2,266**	**3,051**	**3,152**	**2.1**	**2.6**	**2.5**
Multilateral creditors	15,772	21.8	14.3	504	557	551	0.5	0.5	0.4
IMF	1,833	2.5	1.7	-	-	-	-	-	-
World Bank	10,233	14.1	9.3	-	-	-	-	-	-
African Development Bank	3,220	4.4	2.9	-	-	-	-	-	-
European Economic Community (incl. EIB)	197	0.3	0.2	-	-	-	-	-	-
International Fund For Agricultural Development	206	0.3	0.2	-	-	-	-	-	-
Other Multilaterals	84	0.1	0.1	-	-	-	-	-	-
o/w: Arab Bank For Economic Development In Africa	39	0.1	0.0	-	-	-	-	-	-
Nordic Development Fund	25	0.0	0.0	-	-	-	-	-	-
Bilateral Creditors	11,198	15.5	10.1	585	1,147	1,434	0.5	1.0	1.2
Paris Club	3,979	5.5	3.6	136	352	577	0.1	0.3	0.5
o/w: Japan	1,353	1.9	1.2	-	-	-	-	-	-
France (incl. AFD)	765	1.1	0.7	-	-	-	-	-	-
Non-Paris Club	7,219	10.0	6.5	449	795	857	0.4	0.7	0.7
o/w: EXIM China	7,071	9.8	6.4	-	-	-	-	-	-
EXIM India	65	0.1	0.1	-	-	-	-	-	-
Bonds	7,100	9.8	6.4	452	519.8	514.5	0.4	0.4	0.4
Commercial creditors	2,196	3.0	2.0	774	802	626	0.7	0.7	0.5
o/w: Trade and Development Bank	1,894	2.6	1.7	-	-	-	-	-	-
China Development Bank	283	0.4	0.3	-	-	-	-	-	-
Other international creditors	496	0.7	0.4	78	26	26	0.1	0.0	0.0
o/w: Intesa SanPaolo	294	0.4	0.3	-	-	-	-	-	-
ING Bank Germany	57	0.1	0.1	-	-	-	-	-	-
Domestic	**35,640**	**49.2**	**33.3**	**847**	**883**	**778**	**0.8**	**0.8**	**0.6**
Held by residents, total	35,361	48.8	32.0	-	-	-	-	-	-
Held by non-residents, total	279	0.4	0.3	-	-	-	-	-	-
T-Bills	6,039	8.3	5.5	-	-	-	-	-	-
Bonds	28,345	39.1	25.6	-	-	-	-	-	-
Loans	-	-	-	-	-	-	-	-	-
Memo items:									
Collateralized debt	0	0.0	0.0	-	-	-	-	-	-
o/w: Related	0	0.0	0.0	-	-	-	-	-	-
o/w: Unrelated	0	0.0	0.0	-	-	-	-	-	-
Contingent liabilities	1,429	2.0	1.3	-	-	-	-	-	-
o/w: Public guarantees [2]	1,429	2.0	1.3	-	-	-	-	-	-
o/w: Other explicit contingent liabilities [3, 4]	n.a.	n.a.	n.a.	-	-	-	-	-	-
Nominal GDP (at average Ksh/$ rate)	110,519	-	-	-	-	-	-	-	-

Sources: Kenyan authorities; and IMF staff calculations.

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

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

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

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

Table 10. Kenya: External Borrowing Plan, July 1, 2021 – June 30, 2023

Public and Publicly Guaranteed (PPG) External Debt [1]	Volume of New Debt from Jul 1, 2021 to Jun 30, 2023		PV of New Debt from Jul 1, 2021 to Jun 30, 2023 (Program Purposes)	
	US$ million	Percent	US$ million	Percent
By sources of debt financing	**14,994**	**100**	**11,630**	**100**
Concessional debt, of which	**7,697**	**51**	**4,379**	**38**
Multilateral debt	4,541	30	2,586	22
Bilateral debt	3,106	21	1,760	15
Other	50	0	33	0
Non-concessional debt, of which	**7,298**	**49**	**7,251**	**62**
Semi-concessional [2]	193	1	147	1
Commercial terms	7,104	47	7,104	61
By Creditor Type	**14,994**	**100**	**11,630**	**100**
Multilateral, *of which*	4,541	30	2,586	22
World Bank	3,675	25	2,106	18
Bilateral - Paris Club	1,156	8	682	6
Bilateral - Non-Paris Club	1,950	13	1,078	9
Other, *of which*	7,348	49	7,284	63
For debt management operations [3]	5,000	33	5,000	43
Uses of debt financing	**14,994**	**100**	**11,630**	**100**
Infrastructure	4,717	31	3,563	31
Social Spending	2,939	20	1,665	14
Budget Financing	1,407	9	866	7
Other, *of which*	5,932	39.6	5,536	48
For debt management operations [3]	5,000	33	5,000	43

Source: IMF calculations using authorities' data.

[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. 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.

Annex I. Risk Assessment Matrix[1]

Sources of Risks	Likelihood/ Time Horizon	Expected Impact on Economy	Policy Response
Potential External Shocks			
Rising and volatile food and energy prices. Commodity prices are volatile and trend up amid supply constraints, war in Ukraine, export restrictions, and currency depreciations. This leads to short-run disruptions in the green transition, bouts of price and real sector volatility, food insecurity, social unrest, and acute food and energy crises.	**High** **Short to Medium Term**	**High.** Higher commodity prices would increase external and domestic imbalances and weigh on economic growth.	• Accelerate converge of domestic to global fuel prices while compressing expenditure to contain fiscal pressures; • If the shock is persistent, tighten monetary policy to ensure inflation expectations remain well-anchored; • Maintain exchange rate flexibility; • If the further shock is very large, consult with staff on response consistent with overarching objective of fiscal consolidation to reduce debt vulnerabilities.
Russia's invasion of Ukraine leads to escalation of sanctions and other disruptions. Sanctions on Russia are broadened to include oil, gas, and food sectors. Russia is disconnected almost completely from the global financial system and large parts of the trading system. This, combined with Russian countersanctions and secondary sanctions on countries and companies that continue business with Russia, leads to even higher commodity prices, refugee migration, tighter financial conditions, and other adverse spillovers, which particularly affect LICs and commodity-importing EMs.	**High** **Short to Medium Term**	**Medium.** Such sanctions could disrupt imports of fertilizer and wheat and raise borrowing costs and limit options for non-concessional external financing.	• Diversify sources of imports for key inputs and staples (e.g., fertilizer; wheat) • Deploy targeted support to most vulnerable leveraging existing assistance programs. • Considering alternative financing mixes, including medium-term syndicated loans and on-lending of the 2021 general SDR allocation.

[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.

Sources of Risks	Likelihood/ Time Horizon	Expected Impact on Economy	Policy Response
Outbreaks of lethal and highly contagious COVID-19 variants. Rapidly increasing hospitalizations and deaths due to low vaccine protection or vaccine-resistant variants force more social distancing and/or new lockdowns. This results in extended supply chain disruptions and a reassessment of growth prospects, triggering capital outflows, financial tightening, currency depreciations, and debt distress in some EMDEs.	**Medium** **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.	• Redouble vaccination efforts; • 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. and/or advanced European countries. Worsening supply-demand imbalances, higher commodity prices (in part due to war in Ukraine), and higher nominal wage growth lead to persistently higher inflation and/or inflation expectations, prompting central banks to tighten policies faster than anticipated. The resulting sharp tightening of global financial conditions and spiking risk premia lead to lower global demand, currency depreciations, asset market selloffs, bankruptcies, sovereign defaults, and contagion across EMDEs.	**Medium** for the U.S. and **Medium**/**Low** for the euro area **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.
Cyber-attacks. Cyberattacks on critical physical or digital infrastructure (including digital currency platforms) trigger financial instability or widespread disruptions in socio-economic activities.	**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.
Natural disasters related to climate change. Higher frequency of natural disasters cause severe economic damage to smaller vulnerable economies and accelerate emigration. Severe events in large economies hitting key infrastructure reduce global GDP, cause further supply chain disruptions and inflationary pressures, and prompt a recalculation of risk and growth prospects.	**Medium /Low** **Short to Medium Term**	**High.** This would lead to slower growth, an increase in food inflation, pressures on public spending and the current account, and adversely affect vulnerable households.	• Guard against second-round effects on inflation; • Use targeted programs to help vulnerable groups and reprioritize spending.

Sources of Risks	Likelihood/ Time Horizon	Expected Impact on Economy	Policy Response
Potential Domestic Shocks			
A resumption of adverse weather conditions or locust invasion	**Medium /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, potentially leading to further 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; and • 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 elections, 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 II. Comments on CBK's Discussion Paper on Central Bank Digital Currency[1]

The Central Bank of Kenya (CBK) requested public feedback and ideas on a Discussion Paper on Central Bank Digital Currency (CBDC) published in February 2022. We commend CBK's cautious, paced and consultative approach in exploring CBDC and understanding the gaps in the payment system that CBDC could fill. This note provides comments on the paper, that were given to the CBK, including considerations for the next steps in identifying the optimal design of CBDC fit for fulfilling the intended purpose and accounting for Kenya's circumstances.

1. **Complementary role of CBDC vis-à-vis existing private sector digital money.** The paper could state the intent of potential issuance of CBDC is to complement rather than substitute existing private-sector digital payment solutions, and affirm CBK's commitment to an open, competitive payment system. We note in this regard that the balance between central bank money and private-sector payment instruments is not fixed over time, and there is no "right" balance. CBDC, depending on its design, may in some cases stabilize demand for central bank money rather than substituting away from private sector instruments.

2. **Implications for banks and financial service providers.** Given Kenya's financial sector's remarkable progress in developing digital solutions, it is important that the paper emphasizes CBDC will "do no harm" and does not stifle such welcome digitalization developments by taking away customers of banks and other digital finance providers, increasing the cost of financing for banks, or depriving banks of valuable information they obtain through establishing customer relations. In the case of a widely adopted retail CBDC, while in principle it might be possible to establish information sharing protocols with banks to use transaction activity data in making their lending decisions, we note that it would be very unusual for a central bank to share such information; and the benefits of doing so would only be significant if usage of CBDC were to lead to large-scale substitution of private-sector payment instruments.

3. **Liquidity management challenges.** In the case of a widely adopted CBDC––i.e., if the CBK balance sheet were to expand substantially––banks may need to resort to borrowing from the central bank to finance the purchases of CBDC by their customers. This may lead to additional liquidity management operations by CBK. CBDC differs from the prevailing widely adopted mobile money, where the MNO should hold (private-sector money) escrow accounts with banks that fully back e-money balances.

4. **Transaction costs and holistic cost-benefit analysis.** CBDC should be designed with a clear understanding of how it reduces transaction costs, accounting for all associated costs, both in the case of retail payments and cross-border payments. Any cost implications for the public sector, for example, in the case of offering free retail transactions or, in particular, subsidized remittances, should be compared with potential benefits. Moreover, a what-if analysis should be done to clarify

[1] Prepared by Majid Bazarbash with inputs from IMF's Monetary and Capital Markets Department staff.

the fiscal cost under different circumstances. Such holistic cost-benefit analysis would also facilitate a sound comparison with existing private-sector models.

5. Systemic players in the payment system. In discussing the financial inclusion benefits of CBDC, the paper asks whether it would be more efficient to provide more affordable mobile phone financial services than CBDC. However, the dominance of M-Pesa in the retail payment market implies that its failure could have systemic implications for the payment system, leading to the disruption of many transactions. The paper could clarify CBK's regulation and supervision of systemic PSPs and measures to ensure their extremely low likelihood of failure. The paper's second point on the opportunities, "mitigating systemic risks," remains relevant. In addition, we note that improving financial inclusion via CBDC could happen at the same time as enhancements are made to mobile phone services: it could be a "both…and" rather than "either…or".

6. Monetary policy considerations. Depending on its design, CBDC could have several implications for CBK's monetary policy:

- **CBK's balance sheet implications and operation of interest rate policy.** If the CBDC were to meet substantial demand in the market, above any substitution for physical cash in circulation, its introduction will lead to a degree of disintermediation that would expand the central bank balance sheet. Analyzing such balance sheet impact could be usefully explored further, possibly in a separate document.
- **Conducting monetary policy.** While less relevant for Kenya at this juncture, an additional benefit of issuing CBDC could be to maintain monetary sovereignty in the face of the currency's displacement by rapid adoption of crypto assets and stable coins (Auer et al., 2021; Diez de los Rios & Zhu, 2020).
- **Interest bearing CBDC.** In case of an interest-bearing CBDC balances[2], payment of interest on CBDC would raise a number of difficult issues and would need very careful consideration before being undertaken.

7. Operational costs and risks. The paper could elaborate on operational risks involved in running CBDC in addition to "cyberattacks" and "fixed and variable" costs (p. 14). For example, the costs and risks could be grouped as a) technology-related (developing and maintaining), b) human resources (employing skilled technical staff, ongoing training to stay abreast of new technological developments and challenges), and c) interfacing with customers (particularly in the retail CBDC where the number of customers could be huge).

8. Reputational risks to CBK. System rundown caused by cyberattacks, technological glitches, and legal pursuits could additionally create reputational damages that may undermine CBDC benefits. Careful management of reputational risks and establishing user trust in seamless service delivery are crucial elements for reaping the benefits of any payment service, including CBDC. The consequences would be substantially more significant if such failures occur after the initially wide adoption of CBDC by households and businesses.

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[2] The report doesn't mention the CBDC will be interest bearing.

9. CBDC experience of other jurisdictions. The paper could clarify that the list of countries is for illustrative purposes and far from being exhaustive. Moreover, the paper could benefit from a closely-related Fintech Notes document by IMF staff that builds on six CBDC projects to discuss policy goals, operating model, design features, technology, legal foundations, and project implementation of CBDCs (Soderberg, 2022).

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Appendix I. Letter of Intent

Nairobi, Kenya, June 29, 2022

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

Dear Ms. Georgieva:

The Kenyan economy demonstrated remarkable resilience to the COVID-19 shock in 2020 and registered a strong recovery in 2021. The war in Ukraine represents a significant global shock that has exacerbated inflationary pressures even as the pandemic is not yet behind us. However, Kenya's underlying strengths are enabling the recovery to continue this year.

The strength of our policy response over the past two years has bolstered both our economic resilience and our ability to respond to new shocks. Measures put in place at the start of the pandemic supported the vulnerable while ensuring a stable and sustainable macroeconomic environment. The good performance of domestic revenues has enabled a purposeful and progressive approach to tackling the challenges arising from the current shock, such as the unanticipated rise in global oil, food, and fertilizer prices. This is allowing us to continue working to bring our economy back to full strength.

After rebounding robustly in 2021 on the back of the easing of COVID-19 restrictions, the reopening of the economy, and targeted stimulus interventions by the government, growth is expected to remain strong in 2022. This success notwithstanding, the pandemic left a deep imprint on our country that is being compounded by shocks emanating from the war in Ukraine. Ensuring progress towards our development objectives places demands on many areas at a time when Kenya continues to be exposed to the effects of climate change (drought) and security risks. We remain focused on securing inclusive growth for the long term.

While COVID-19 cases peaked in December 2021, we cannot assume that the pandemic is behind us. Protecting the health of our population remains a top priority and we are not letting our guard down. Aided by increased international vaccine availability, we have accelerated our vaccination drive. Our target is to vaccinate all adults (27 million people) fully by end-2022.

Our economic program is anchored on a medium-term plan that seeks 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), has four main objectives: (1) in the near term, ensure an effective COVID-19 response and maintain support for those most impacted by shocks 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 as well as 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 targets for the end-December 2021 test date were met, with the exception of the indicative target on social spending. This includes, importantly, the target for the primary balance of the national government, which at Ksh.–37.6 billion (–0.4 percent of GDP) came in well above the floor. Our structural reform agenda has experienced some delays, due in part to legal and operational complications, as well as phased introduction of the legal instruments to enact the agreed tax-enhancing measures, but these will be completed by end-June 2022. We continue to work toward implementing our vaccination program and requirements for addressing challenges in state-owned enterprises (SOEs) and have reflected this in our spending plans. Following recent developments, we request modification of the end-June and end-December 2022 quantitative performance criteria (QPCs) for net international reserves. As final data is not yet available, we request waiver of applicability of the end-June 2022 PCs under the EFF arrangement. We also request the establishment of new structural benchmarks related to i) issuance of a circular that includes an action plan for the development of a medium-term revenue strategy; ii) complete a review of how the pricing mechanism has been applied to date and publicly announce and constitute a taskforce to oversee the progressive elimination of the fuel subsidy within the first half of FY2022/23 and to ensure that fuel pricing actions are at all times aligned to the approved budget; and iii) on submission of an action plan to the Cabinet Sub-Committee on Kenya Power and Lighting Company (KPLC) to restore KPLC's medium-term profitability and fully cover any financing gaps (pre-existing and new) through end-2023, as identified by the updated 2022 financial evaluation.

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, June 29, 2022

I. BACKGROUND

1. **The economy rebounded strongly in 2021 and the momentum is expected to continue this year**. The underlying resilience of the Kenyan economy, easing of COVID-19 restrictions, and a recovery in the global economy helped real GDP grow by a robust 7.5 percent in 2021 following a modest 0.3 percent contraction in 2020. The recovery was supported by the services sector, in particular wholesale and retail trade, transport and storage, education, information and communication (ICT), and financial and insurance services. The manufacturing sector also performed better, but agriculture recorded a modest decline due to inadequate rainfall during the first half of the year. We also experienced changes in normal weather patterns, including a drought in the arid and semi-arid regions that brought acute pressure on people living in the region, necessitating our policy response. High frequency indicators point to continued recovery in the first quarter of 2022, supported by early information on acreage under different crops, faster growth in sales and bank credit, continued good performance of ICT sector indicators, diaspora remittances, and further recovery in the hospitality sector. The central bank's May 2022 survey of business confidence revealed sustained business optimism in company and sectoral growth prospects.

2. **Inflation has remained within the target range of 2.5–7.5 percent but has inched up in recent months.** After remaining below 6 percent in early 2021, inflation rose from June 2021 and reached a peak of 6.9 percent in September 2021. Thereafter, policy decisions on retail fuel pump prices (kept unchanged since October 2021 despite very strong price increases at the global level) and a reduction on the electricity tariff by 15 percent in January 2022) combined with a deceleration in food price inflation helped lower headline inflation to 5.1 percent by February 2022. Since then, headline inflation has inched up to 7.1 percent by May 2022 on a turnaround in food price inflation and partial adjustments in domestic fuel prices against the backdrop of a rise in global fuel prices since the war in Ukraine. Non-food/non-fuel inflation has remained stable at under 3 percent and was at 2.6 percent in May 2022. Minimum wages were raised by 12 percent in May, but this is not expected to impact inflation in any significant way.

3. **Life is returning to normal as COVID-19 case rates fall and our vaccination program gains traction.** After suffering from the Omicron wave that peaked in late December 2021, COVID-19 numbers in Kenya have declined dramatically. As of early June 2022, Kenya had 6 recorded cases per 1,000 population and a case fatality rate of around 2 percent. We thus lifted COVID-19 prevention measures, including restrictions on gatherings and mandatory wearing of facemasks, restored full capacity of in-person worship for vaccinated persons, and resumed public transport facilities at full capacity. Nevertheless, we will continue to closely monitor COVID-19 developments and we stand ready to review containment measures if necessary. With vaccine supply constraints easing—27.9 million doses have been received since the start of the campaign, about two-thirds of which are via the COVAX program—more Kenyans are becoming vaccinated. By early June 2022, we had administered over 18 million doses and 31 percent of adults had been fully vaccinated. Our aim

is to fully vaccinate all adults (27 million people) by end-2022. Moderna has announced plans to build a US$500 million manufacturing facility for RNA COVID-19 vaccines in Kenya. When fully operational, it would be able to supply Kenya and the region with up to 500 million vaccine doses per year.

4. **Global shocks are expected to widen the current account deficit from 5.5 percent of GDP in 2021 to 5.9 percent of GDP in 2022.** Last year, goods exports continued to recover, growing by 11 percent in dollar terms, driven by bumper horticulture output and buoyant exports of consumer goods and industrial supplies. Imports also rose strongly in line with the ongoing economic rebound, with energy and non-energy imports growing by about 59 and 21 percent, respectively. Tourism receipts reached 84 percent of their pre-pandemic level, while remittances, mainly from North America, grew by 20 percent. The strong performance of exports, tourism, and remittances continued in the first two months of 2022. However, the disruption of global trade and finance from the war in Ukraine is expected to widen the current account deficit in 2022. Kenya's direct exposure to Russia and Ukraine is relatively small, as these two markets account for around 1.5 percent of Kenyan exports and 2.7 percent of imports and are not among Kenya's traditional tourist markets. However, the war has spurred sharp increases in international prices of commodities with relatively inelastic demand, such as fuels, cereals, and fertilizers. Prices of Kenya's main agricultural exports (tea, horticulture, and coffee) and consumer and intermediate goods exports are also projected to grow faster than previously anticipated, but this will not be sufficient to fully offset the impact of the global shock. As such, the external trade balance is expected to weaken in 2022 and to return to more normal levels gradually. Kenya's flexible exchange rate serves the economy well in cushioning the impact of global shocks and maintaining competitiveness. Foreign exchange reserves are expected to remain adequate.

5. **Public finances performed strongly through end-December 2021, despite a challenging environment.** The primary fiscal deficit was contained to Ksh.37.6 billion, well below the end-December target of Ksh.202.9 billion. This strong performance reflected a very robust tax performance, exceeding our original target by Ksh.53 billion (0.4 percent of GDP), on the back of both permanent tax improvements—related to healthy yields of the January 2021 tax-enhancing measures (e.g., the reversal of the COVID-19-tax cuts) and headways in strengthening tax compliance—and temporary factors stemming from base effects related to the recovery from the pandemic. The fiscal outturn also reflected continued efforts to restrain non-priority spending and ensure careful implementation of investment projects.

6. **The Supplementary FY2021/22 budget was submitted to Parliament on January 26 to support several critical areas** (end-January 2022 structural benchmark)**.** As agreed during the 2nd reviews of the EFF/ECF arrangements, the Supplementary budget allowed us to execute critical emergency drought- and security-related relief for Ksh.20 billion, additional COVID-19 vaccine interventions for Ksh.8.1 billion, and some necessary spending to support SOEs as the firms work to address their financial challenges (Ksh.32.3 billon). These additional expenditures, which are subject to program adjustors with the exception of the emergency spending, resulted in a widening of the primary fiscal deficit by Ksh.60 billion (0.5 percent of GDP), consistent with the flexibility built into

the design of the EFF/ECF arrangements at program approval. The deterioration of the primary deficit was, however, about 0.1 percentage point less than previously expected as we were able to delay some SOE support. Importantly, the Supplementary maintained a prudent view on tax collection, retaining the expected tax projections at the level of the 2nd EFF/ECF reviews, despite the strong tax overperformance experienced through end-December (¶5). The Supplementary budget was approved on March 30.

7. **Significant spending pressures have, however, emerged since the onset of the Ukraine-Russia war.** While international commodity prices were on an upward trend already in late 2021, the beginning of the war led to a dramatic surge in the prices of many commodities—especially oil and wheat, which increased by an additional 20 and 25 percent between February and March, respectively. Since July 2020, a Petroleum Development Levy (PDL) Fund has been established, whose institutional objective is to smoothen the volatility of domestic fuel prices using the resources directed to that purpose from the PDL. Using these dedicated resources in this way is intended to avoid sharp movements in global fuel prices creating dislocations in the local market but is not intended to create a permanent fuel subsidy. In the current environment, and to avoid volatility in international oil markets translating into hefty domestic fuel price increases with ensuing social implications, we stabilized the prices at the pump by making full use of the resources in the Fund. The decision to shield the population from the social costs associated with a full pass-through of the surge in international oil prices resulted, however, in a rapid increase in fuel subsidies, which reached Ksh.23 billion (0.2 percent of GDP) by end-March 2022. Given the level of domestic prices, which had increased by just 4 percent in March, and the large run-up in global prices, the cost of stabilizing fuel prices had surged to an estimated Ksh.10 billion per month (net of PDL resources) by early April. Financial pressures on fuel distributors had also increased in this environment, with scarce supply at petrol stations causing shortages in many locations.

8. **The banking sector has remained stable and resilient.** This has been helped by steps taken at the outset of the pandemic to sustain the economy's resiliency in the face of the liquidity shock by providing immediate support that enabled households and businesses to navigate the shock and ensuring that the health of the banking system remained strong. Key among these was the encouragement we gave to banks to restructure loans of performing borrowers impacted by the pandemic in March 2020. At the end of the one-year restructuring period, loans to borrowers representing Ksh.1.75 trillion (or 57 percent of banks' gross loan portfolios) were restructured. By end-March 2022, following repayments and reversion to normal terms, the outstanding restructured loans amounted to 11.7 percent of total banks loans, of which 90 percent were performing as per the restructured terms. Thus, only a small share of impacted borrowers has been unable to recover and maintain normal debt service. The challenges faced by these borrowers contributed a modest 1.3 percentage points to the sector's NPL ratio, standing at 14 percent at end-March. These measures helped households and businesses to navigate the shock from the pandemic, creating a bridge that helped to sustain the economy's resilience and power our recovery. Banks' profitability has been recovering during 2021 and early 2022. The overall banking system has remained adequately capitalized, with total CAR strengthening to 18.9 percent, above the minimum requirement of 14.5 percent. Liquidity has remained above the minimum regulatory requirement,

while banks' funding has been supported by solid deposit growth (8 percent in 2021). Helped by our proactive policies, credit to the private sector continued to expand at a broadly steady pace throughout the pandemic, increasing to 9.1 percent growth y-o-y in February 2022. We are also in the process of strengthening financial safety nets. Deposit insurance, which covers all deposit-taking institutions licensed by the Central Bank of Kenya (CBK), was recently expanded from 100 to 500 thousand shillings per depositor. The ex-ante funded deposit insurance fund covers about 17 percent of insured deposits and is growing swiftly towards meeting the International Association of Deposit Insurers (IADI) target of 30 percent coverage.

II. MACROECONOMIC OUTLOOK

9. **The outlook has been affected by the global shock from the war in Ukraine but remains positive.** We expect real GDP to grow by 5.7 percent in 2022, supported by domestic demand, even as higher food and input prices––partly driven by the impact of the war in Ukraine ––weigh on economic activity. Kenya's direct trade exposure to Russia and Ukraine is small, but indirect channels via other countries, especially those in Europe, could impact external demand for Kenya's products. Russia and Ukraine account for about 43 percent of Kenya's wheat imports. The Kenyan economy's resilience is expected to be evidenced by a recovery in agriculture; the continuation of key infrastructure projects; further advances on the path toward post-pandemic normalcy in tourism and hospitality, including in domestic tourism; and continued strong diaspora remittances. The current account deficit is expected to widen modestly on weaker global demand and worsening of the terms of trade. Over the medium term, growth will converge toward 5.5 percent and the current account deficit will narrow as exports continue to recover.

10. **Our strong fiscal performance has enabled taking steps to cushion households and firms from the adverse effect of global spillovers, including from the war in Ukraine, even as we are giving careful attention to the tradeoffs of our policy choices.** We have announced Ksh.5.7 billion in support to subsidize 114,000 metric tons of various types of fertilizers which would help cushion the impact of the higher prices on farmers. In addition, the Government has put measures in place to cushion households and firms from the adverse effect of higher pump prices, and we have kept domestic fuel prices low while international prices have increased dramatically. However, these developments and policy decisions have created important trade-offs. If left unattended, pressures on the fiscal accounts will continue mounting and will worsen Kenya's debt indicators. Thus, an adjustment in domestic fuel prices is necessary to maintain fiscal and debt sustainability. Considering that such adjustment impacts the broader economy, particularly the vulnerable population, it needs to be well calibrated and gradual but timebound. The fuel price stabilization mechanism was not intended to become a permanent subsidy and maintaining the fuel subsidies for a prolonged period of time is not consistent with fiscal sustainability.

11. **Inflation is expected to remain well anchored on prudent macroeconomic policies, although it could temporarily go above the target range in late 2022 due to spillover from higher global prices.** Global price shocks are feeding into higher domestic prices, particularly from international oil prices. International oil prices have increased significantly, partly reflecting the supply chain constraints arising from COVID-19 and the impact of the war in Ukraine. In addition to

measures the Government has put in place to cushion households and firms from the adverse effect of higher pump prices, electricity prices have reflected a 15 percent reduction of tariffs implemented in January 2022. The recovery in agriculture is expected to moderate food inflation for the remainder of the year. Considering that the shocks are supply side, the Central Bank of Kenya stands ready to take necessary measures to stem any second-round effects emanating from these shocks.

12. The outlook is subject to unusually high uncertainty. Possible deeper disruptions from the war in Ukraine could impact activity, our external position, options for meeting financing needs, and confidence. Volatile and higher global commodity prices––especially fuel and food—would have an even more pronounced impact on inflation, with a disproportionate impact on poor households. New disruptive COVID-19 waves, globally or locally, could undermine Kenya's recovery and increase fiscal and external pressures. On the domestic side, unfavorable weather conditions could adversely impact agricultural production and food security. The upcoming general elections and change in administration 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 these risks, we intend to remain nimble and take necessary measures as needed. On the positive side, a resolution of the war in Ukraine and limited impact from the COVID-19 variants would support higher global growth, moderate inflationary pressures, and boost confidence, all of which would augur well for Kenya's economic prospects.

III. PROGRAM PERFORMANCE AND POLICIES

A. Program Objectives

13. 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 Economic Recovery Strategy (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:

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

- ***Governance.*** Enhance institutional oversight arrangements, strengthen preventive frameworks to improve accountability and foster good governance, and 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

14. Program performance at end-December 2021 was good overall. Quantitative results were strong, with all end-December quantitative performance criteria (QPCs) and all but one indicative target (IT) met comfortably. Our structural reform agenda has experienced some delay due to challenges in several areas, partly due to operational and legal issues, as well as to a phased introduction of the legal instruments to enact the agreed tax-enhancing measures, but these will be completed by end-June 2022. This resulted in three structural benchmarks (SBs) not having been met on time. We remain committed to our structural reform agenda and are maintaining efforts in this area, with two of the missed SBs being implemented with delays.

15. Quantitative targets (MEFP, Table 1). All end-December QPCs were met comfortably, with the QPC on the primary deficit met by a wide margin––1.6 percent of GDP (Ksh.37.6 billion versus a ceiling of Ksh.202.9 billion)––supported by a strong performance on the tax revenue QPC (Ksh.836.2billion vs Ksh.783.2 billion) of 0.4 percent of GDP. All but one IT, on priority social expenditure, were met, as was the inflation target under the monetary policy consultation clause. With the processing early in the new year of payments that had seen some delays, spending on priority social expenditures was quickly restored. Our continued strong performance against program targets amid a global economic environment that has continued to generate large and unanticipated shocks is a testament to our strong commitment to fiscal responsibility and a sign that our economic program is delivering its intended results.

16. Structural Benchmarks (MEFP, Table 2).

- **SB for end-June 2021:** 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 significant improvements to the public procurement portal with extensive information available on tender awards, but publication of beneficial ownership information of companies awarded contracts has been hampered due to data privacy requirements. As a result, the SB has not been met. Specific steps to address this impediment have been identified and the actions we have recently taken to adopt revised tender bidding documents should unlock progress on this important objective (see below). With the actions underway and in line with Executive Order No. 2/2018, we will ensure that comprehensive information, including on beneficial ownership, on tenders issued from April 21, 2022, onwards will be publicly available on the PPIP by the 15th day of the subsequent month after the tender is awarded.

- **SB for end-January 2022:** The SB on submitting to Parliament a supplementary budget for FY2021/22 consistent with the programmed deficit target has been met. The supplementary budget was submitted to Parliament on January 26, 2022.
- **SB for end-March 2022:** The SB to adopt the revised bidding documents to obtain consent from beneficial owners to publish beneficial ownership information for awarded tenders in the PPIP to address data privacy requirements was not met at end-March. With publication of the relevant circular on April 8, the revised tender documents have been adopted, to become effective for use by all public procurements as of April 21, 2022. Beneficial owners' consent will thus be required for all new tenders effective April 21, 2022, enabling this SB to be implemented with delay.
- **SB for end-April 2022:** The SB for submitting to Parliament a budget for FY2022/23 consistent with programmed deficit and revenue targets was not met but is expected to be implemented with a delay by end-June. While the FY2022/23 budget proposal submitted on April 6, 2022, had fiscal targets fully consistent with program objectives, the supporting legislation—which was expected to identify new tax measures for 0.5 percentage points of GDP to achieve the FY2022/23 PC on tax collection—was only partially submitted by the agreed timeframe. Specifically, the Finance Bill was submitted on April 5, 2022, containing new tax measures for 0.4 percentage points of GDP. The remaining 0.1 percent of GDP in tax measures was introduced through changes in custom duties at the East African Community (EAC) level (submitted to and adopted by the EAC committee in May 2022) and other administrative instructions introduced by end-June 2022.
- **SB for end-May 2022:** The SB on publication 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 of COVID-19-related spending was not met. The comprehensive audit was published in June, with a chapter on COVID-19-related spending in the summary report. Operational issues delayed work on the special audit of COVID-19 vaccine spending, which is expected to be completed and submitted to Parliament by end-June 2022 and published by mid-July 2022.

C. Fiscal Policy

17. Our fiscal policy path aims at balancing the near-term need to support the economic recovery against the imperative of reducing debt vulnerabilities over the medium term. We remain focused on meeting the needs of the population even as we face new global challenges that have emerged with the economic fallout of the war in Ukraine and the drought that has been 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 the SOEs—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 the debt-to-GDP ratio on a downward path within the timeframe of the program. This will help lower financing risks and facilitate an expansion of credit to the private sector, thus supporting economic growth.

18. Gains in revenue collection are expected to play a major role in our planned fiscal consolidation and are already enhancing our resilience and ability to respond to shocks. Losses in tax revenues were a major contributor to the increase in deficits in recent years, with the tax-to-GDP ratio having dropped from 15.1 percent to 13.1 percent over FY2016/17–2019/20. We intend to recover the lost ground in this area and have already adopted a number of revenue-enhancing measures to that effect (e.g., April 2020 base broadening measures, January 2021 tax-increasing measures). The good performance of tax revenues seen this fiscal year, which owes much to these earlier steps, is providing critical margins to enable a proactive response to challenges presented by shocks from the Ukraine war. This has created fiscal space to enable the provision of support for farmers impacted by the rising cost of fertilizer as well as taking a gradual and progressive approach to passing the rising cost of global fuel prices (petrol, diesel, and kerosene) on to Kenyan consumers. Going forward, we will continue these tax mobilization 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. Consideration by the High Court of pending legal challenges to the minimum alternative corporate tax (MACT) is proceeding. We expect the court review to take place in July 2022 and remain confident of a positive result. If the outcome of the court process is not as we anticipate, we will implement other tax measures to achieve the Ksh.8 billion in FY2022/23 that we expect from the reintroduction of the MACT.

19. We will continue to ensure that priority social programs and development expenditures remain appropriately funded, in line with program design. An indicative target on the government's priority social spending is part of the program design to ensure that this spending is shielded from rationalization efforts. This indicative target covers vaccination and immunization programs, transfers to vulnerable groups (e.g., orphans, people with disabilities, and 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 and intend to keep the overall development spending envelope steady at close to 5 percent of GDP.

20. The economic impact of the war in Ukraine on international markets is, however, confronting us with challenges that require immediate attention. International commodity prices have surged to historically high levels since the war began and are expected to remain elevated over the remainder of the calendar year. The sharp increase in global fuel prices, if fully passed on to domestic prices in a very short timeframe, would risk undermining social stability. At the same time, seeking to protect the population from the higher prices in international markets would rapidly generate increasing claims on scarce public resources and eventually undermine ongoing fiscal consolidation efforts. We intend to address these challenges with a policy response centered on a gradual realignment of domestic fuel prices with global fuel prices that, accompanied by careful reprioritization of non-essential spending, will contain the cost of subsidies within available budgetary resources.

21. On May 19, we submitted to Parliament a second Supplementary FY2021/22 budget to address the emerging challenges within the parameters of the IMF-supported program. The new Supplementary budget enables the use of the resources made available by the strong tax overperformance recorded in the year—estimated at Ksh.55 billion through end-June 2022—to: i) smooth the adjustment of domestic fuel prices (Ksh.37 billion); ii) support users of fertilizer products (Ksh.3 billion), also heavily affected by the dislocations in international commodity markets); and iii) further improve the security situation (Ksh.4 billion). In addition, we have started to gradually realign domestic fuel prices to global prices by increasing pump prices by, on average, 4.1 percent on March 15, 8.1 percent on April 15, 4.1 percent on May 15, and 6.5 percent on June 15. Looking ahead, we will continue the progressive and gradual realignment to global prices by adjusting domestic fuel prices upward each month until subsidies have been eliminated while closely monitoring developments in international commodity markets and continuing to take in due consideration of the social impact of our actions. Considering that this realignment of prices will take time, we will likely still be in a subsidy position at the start of FY2022/23. We have, therefore, included in the draft budget for FY2022/23 an appropriation of Ksh.20 billion for the year. This is broadly consistent with the revenue expected from the PDL for the year, and thus with the intended use of the Petroleum Stabilization Fund and avoiding recourse to additional budget resources. This gradual pace of price adjustment will shield the vulnerable from sharp price movements while allowing us to remain within the fiscal targets for FY2021/22 and FY2022/23. We note, however, that further surges in global prices could undermine the feasibility of our strategy of gradual price adjustments. If global oil prices rise further beyond levels projected currently, we aim to stay within program deficit targets by revisiting the pace of price adjustments to reduce the subsidy cost or by identifying budgetary offsets. If, going forward, global oil price increases are larger than can reasonably be accommodated, we will proactively engage with Fund staff on appropriate policy responses with a view to preserving our overarching objective of fiscal consolidation to reduce debt vulnerabilities. The National Treasury statement issued on June 15, 2022, highlighted the need to progressively eliminate the fuel subsidies reasonably quickly to protect our fiscal and debt sustainability going forward. To help guide actions in this area, we will, by end-July 2022, complete a review of how the pricing mechanism has been applied to date and publicly announce and constitute a taskforce to oversee the progressive elimination of the fuel subsidy within the first half of FY2022/23 and to ensure that fuel pricing actions are at all times aligned to the approved budget (new structural benchmark).

22. Against this backdrop, the FY2022/23 Budget targets a reduction in the primary deficit, in line with program objectives.

- The budget, which was submitted to parliament on April 6, 2022, carries forward our consolidation efforts by targeting a 2.1 percentage points of GDP reduction in the primary deficit compared to FY2021/22 on the back of permanent improvements in revenue mobilization and careful prioritization of spending programs. On the revenue side, the budget proposal, while recognizing the permanent impact on the FY2022/23 tax base of the FY2021/22 tax overperformance (our budget estimated the carryover effect at 0.3 percentage points of GDP), envisaged the adoption of 0.5 percentage points of GDP in new tax measures to achieve the FY2022/23 tax targets under the IMF-supported program. These new measures include changes in income taxes (including on capital gains financial derivatives, digital services), increases in selected excise rates (e.g., gambling, wine and spirits, tobacco), removal of some VAT exemptions (e.g., for specialized institutions), increases in selected custom duties, and improvements in tax compliance (e.g., enhanced tax debt collection, incentives to faster resolution of tax disputes). Most of these various tax measures will be enacted through different legal instruments, including the Finance Bill (submitted to Parliament on April 5), changes to the legislation on the custom duties in the context of the East African Community (submitted to EAC Sectoral Councils on May 13 and approved on May 27), and administrative instructions introduced by end-June 2022. However, despite our strong resistance, Parliament elected to amend or remove measures worth 0.2 percentage points of GDP from the Finance Bill, including related to increases in the tax rates of excise on betting and lottery activities and of VAT on fertilizers and export services, while also dropping some tax administrative measures. Given the very strong tax revenue performance through end-May 2022, our estimate of tax carryover has been increased to 0.4 percentage points of GDP from an initial estimate of 0.3 percent of GDP. This improvement—together with additional revenue we anticipate from positive resolution of pending legal challenges to the minimum alternative corporate tax (0.07 percentage points of GDP if resolved by end-July) and reinforced tax administration efforts which we will initiate in June (0.03 percentage points of GDP)—will ensure achievement of our FY2022/23 tax revenue targets. Should resolution of the legal challenges to minimum alternative tax not be favorable, creating a gap in projected tax revenue, we shall introduce in FY2022/23 additional tax measures for an equivalent amount from among those envisaged in the Medium-Term Revenue Strategy (MTRS) to ensure observance of program tax targets.
- On the expenditure side, we remain committed to pursuing our developmental objectives in a fiscally responsible fashion. Specifically, the budget aims at protecting priority social spending (Ksh.420.8 billion)—including to support the COVID-19 vaccine interventions—and sustain critical projects, while avoiding the reemergence of fuel subsidies by tightly linking the pace of future domestic price changes with the resources available in the PDL Fund. The

budget also reflects a rephasing of support to the SOE sector agreed at the time of the 2nd EFF/ECF reviews with some small adjustments. Finally, we will continue to avoid accumulation of arrears and will promptly pay any exchequer request outstanding at the start of FY2022/23 as a first call on the budget.

23. The SOE sector has required support during FY2021/22 and will continue to do so in FY2022/23.

- The FY2021/22 supplemental budget provided support to the SOE sector for Ksh.32.3 billion (0.3 percent of GDP), lower than Ksh.48.4 billion projected at the time of the previous review. This support included payment of Ksh.9.05 billion to Kenya Power and Lighting Company (KPLC), including a Ksh.7.05 billion in budget support intended to fill the liquidity gap through end-FY2021/22 that was aggravated by the January electricity tariff reduction; Ksh.2 billion to Kenya Wildlife Service (KWS) and Ksh.1 billion to Kenya Airports Authority (KAA) for temporary support on the back of COVID-19-induced loss of revenues and the related impact on their operations; and Ksh.20.3 billion in support of a broad-based and decisive restructuring effort to put Kenya Airways (KQ) on a sustainable footing.
- The shortfall in SOE support in FY2021/22, relative to projections at the previous review, is primarily driven by KQ on account of an assumed rephasing of some of the support for the restructuring of obligations to FY2022/23. Additional shortfalls are due to lower-than-projected allocations to KWS and KAA. However, budgetary allocation for KPLC was higher, reflecting the half-yearly impact of electricity tariff cut. At the same time, the government did not implement its plan for compensating, albeit partially, KPLC for the rural electrification scheme in FY2021/22.
- The flexibility built into program conditionality has catered to 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 of Ksh.16.2 billion (0.1 percent of GDP, equivalent to one-half of the extraordinary support to SOEs in FY2021/22). These offsets are being achieved by reducing recurrent spending and further rationalizing the portfolio of non-priority projects, with a significant portion to be realized from the latter.
- In FY2022/23, we anticipate a total need of Ksh.36.6 billion (0.3 percent of GDP), of which KPLC would receive Ksh.7.05 billion in financial support intended to address part of the liquidity gap that had been aggravated by the January electricity tariff reduction. The rest will be allocated to KQ, including assumed payments for debt service that will be supported by the government for guaranteed and unguaranteed debt, subject to agreements with the creditors.
- Thus, cumulative extraordinary support to SOEs in FY2021/22 and FY2022/23 is projected at Ksh.68.98 billion (0.5 percent of FY2021/22 GDP), below the 1.0 percent of GDP agreed under the program and Ksh.16.1 billion lower than the projection at the previous review.

- Absent the realization of such extraordinary SOE spending in FY2022/23, we remain committed to target a more ambitious primary balance for an amount equal to half of the under execution in such support (program adjustor).

24. 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 0.9 percent of GDP in FY2023/24. In this regard, we intend to inform our selection of suitable tax measures by fully leveraging the work done, with the support of IMF TA, around the development of a Medium-Term Revenue Strategy (MTRS). 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.

25. We seek to move away from our fixed, nominal public debt ceiling and introduce a credible anchor of present value of the debt-to-GDP ratio to crystalize our policy intention of reducing debt and maintaining debt sustainability (see ¶32). 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. We believe this new framework will strengthen the credibility of the government's strategy to reduce debt vulnerabilities by enhancing transparency and accountability around the envisaged path to reach the medium-term anchor.

26. Uncertainties associated with global shocks entail high risks to our fiscal program and reinforce the need for contingency planning. The uncertainty is particularly pronounced for government revenues, as rapid changes in the macroeconomic context, including related to further ramifications of the war in Ukraine, could depress yields of the adopted tax measures and hence tax receipts. To ensure that the program performance objectives are met, any revenue shortfall relative to program targets for FY2022/23 will be compensated for by taking additional revenue measures, drawing from the work done in the context of the MTRS with the support of the IMF. We also stand ready to further curtail non-critical spending, if this should become necessary, to offset further pressures, including from newly arising spending priorities. To help manage fiscal risks across the public sector, we intend to establish by end-July 2022 a fiscal risk management structure, to be coordinated across the government at the senior management level, which will oversee monitoring and assessment of fiscal risks. To this end, we have scheduled a workshop for early June 2022 with Fund technical assistance to concretize our plans.

D. Fiscal Structural Reforms

27. Building on the MTRS, we will continue to reform our tax system to reverse the previously declining trend of revenues. The past proliferation of incentives has made our tax system less efficient and difficult to administer, contributing to our challenges in revenue collection. Several initiatives, such as the Tax Law Amendment Act (2020), the Finance Act (2020), and the recently published Tax Expenditure Report, have been implemented to halt and reverse the downward revenue trend. More recently, the MTRS has been initiated to support higher and more certain revenues to support global competitiveness and prosperity under Kenya's Vision 2030 by taking measures to broaden the tax base and improve compliance. We intend to build on the collaboration with the IMF to develop an action plan providing the overarching objectives of the MTRS with quantified targets, specific milestones, and division of roles and responsibilities across our entities by August 2022 (SB).

- End-August 2022 SB: issue a circular that includes an action plan for development of a Medium-Term Revenue Strategy (MTRS) that identifies quantified overarching revenue objectives consistent with programmed tax revenue targets, clarifies the role of each institution involved, and identifies a concrete and time-limited sequence of actions for achievement of such objectives.
- The action plan will be further elaborated in the 2022 Budget Review and Outlook Paper, which will be sent to Parliament by end-September.

28. 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 administration, with a holistic and strategic focus and joint strategic and operational planning and delivery; strengthening administration with measures to enhance compliance risk management and modernize business operations; improving community perceptions about the fairness and equity of tax administration and strengthening the fiscal-social contract by enhancing education about the links between taxes and services; improving staff integrity; and dealing more effectively with taxpayers engaging in aggressive tax planning, tax evasion, and tax fraud. Key objectives include:

- **Developing and implementing risk-based compliance strategies.** Compliance risk management capacity has improved significantly over the years to now include data-driven approaches. In domestic taxes, the focus will be on developing compliance improvement plans (CIPs) targeting: (i) high risk sectors (e.g., construction and e-commerce and the digital economy); (ii) major taxpayer segments (premier clients, large businesses, and SMEs); and (iii) high risk issues (international tax risks, including BEPS, the informal sector, and aggressive tax planning by individuals). With this in mind, we will develop a Premier Tax Office Risk Management Plan by June 2022 and restructure our Compliance Risk Management Committee by June 2023. In addition, the strategy will focus on lifting compliance levels in the core taxpayer obligation areas (registration, filing, and correct reporting and payment). In the customs area, the focus will be on: (i) improving compliance in the areas of valuation and classification of goods; (ii) strengthening management of transits; and (iii) addressing cross-border smuggling, especially of excisable goods.

- **Strengthening the KRA's audit function.** The audit function has recently been re-established. Several actions will be taken to rebuild audit capacity, including to refresh and upgrade staff skills (by December 2022), strengthen feedback loops between the disputes and audit areas (by June 2023), and initiate process changes and capability enhancements to improve quality and establish mechanisms for assessing the impact of the audit function on compliance (by June 2023).
- **Enhancements to improve quality in the large and medium taxpayer offices have 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) was met. Audit functions have now been rolled out to all KRA regional offices.
- **Strengthening data analytics to support compliance risk management (CRM).** The establishment of a data governance framework and a data quality policy have laid a foundation for an enhanced role of data in developing approaches to improve taxpayer compliance. Further actions will be taken to support higher levels of compliance and extract greater business value and revenues from KRA's data assets, including developing credible and reliable taxpayer register and ledger accounts (by December 2022); implementing a data management strategy to better access and utilize current and new data (by June 2023); and committing critical analytical resources on priority and value adding issues.
- **Managing 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, by June 2023.
- **Improving taxpayer service to support voluntary compliance.** Building voluntary compliance begins with strengthening facilitation and access to services to better support taxpayers seeking to comply with their obligations**.** Strategies will focus on use of data science to develop effective and timely services and compliance interventions (by June 2023) and leveraging stakeholder engagement in the design and delivery of taxpayer services.

29. 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, and further approval has been gained from the Ministry of Information and Communications Technology. Business and functional technical requirements have been developed and discussions on shared infrastructure have been held with the IFMIS department. 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 2021. Development began in May 2022, delaying the initiation of a pilot of the new system to January 2023 and the full rollout across Government Ministries, Departments, and Agencies (MDAs) to December 2023.

30. 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) appointment of a task team to upgrade GHRIS in readiness of data integration; (ii) assessment of GHRIS capabilities for integration with IFMIS and other standalone systems; (iii) rolling out of the Unified Payroll Number Generating System; and (iv) development, validation, and completion of three prototype modules (Payroll Management and Administration, Leave Management, and Pension Claim) has been finalized and validated. Piloting of the validated prototype was done in 11 MDAs and Counties between November 2021 and February 2022. Three additional prototype modules, that is, *establishment control*; *training and development*; and *third-party deduction management* are being developed.

- **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.

31. We remain focused on improving Public Investment Management (PIM) to deliver value for money in public capital expenditure. 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 undertaken an expanded stocktaking exercise of projects and associated commitments to cover all sectors. 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 has been made and a task force is now preparing to carry out an analysis of projects to be rationalized. We expect this work to be completed by November 2022, after which rationalizations would begin.
- **Developing a Public Investment Management Information System (PIMIS)**. The PIMIS will automate information management across the entire PIM framework. Following some delay, a consultant tasked with developing the system was appointed, key modules have been completed, and system testing, and stakeholder engagement are being carried out. We are targeting to have the PIMIS fully operational by July 1, 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. These manuals have been completed and published and are being applied across MDAs.
- **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.** PIM guidelines have been converted 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 and were gazetted in April 2022. We anticipate them to be fully in place within the current fiscal year (FY2021/22). In this regard, manuals to guide operations will also be applied to Counties, but this will take place later owing to the need to sensitize Counties on the PIM Regulations 2021 that were gazetted in

April 2022, and then to work with Counties individually to be able to apply these manuals. We except full rollout of these manuals at the County level by July 2023.

- **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.

32. 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 is in use by MDAs. Automation of exchequer requests has also been completed and is being tested by the National Treasury, Office of the Controller of Budget at Central Bank of Kenya. The system is being piloted with plans of a full rolling out at the beginning of FY2022/23. This is six months later than previously planned but the delay is justified by the strengthened system that will result.
- By December 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 the draft 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. Procurement process for a vendor to develop the costing tool in Hyperion Budget Preparation System (production mode) is on-going. Preparation of the Budget Manual (including costing guidelines) which commenced in July 2021 is at an advanced stage. We intend to finalize the manuals and disseminate to MDAs and stakeholders by the end of December 2022.
- 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.

33. Public debt management. As part of strengthening debt management, we are enhancing debt reporting, lengthening maturities, and avoiding bunching of repayments to mitigate refinancing and settlement 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 the 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 9.0 years in March 2022, with the ratio of T-bills to T-bonds moving from 20:80 to 16:84. 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:

- Raise US$1.1 billion external financing for FY2021/22 through bank loans, repayable in 3 years. This financing replaces the planned Eurobond issuance due to unfavorable market conditions.
- In light of the challenging market conditions for emerging markets, the planned Eurobond issuance as part of a market-based, debt management operation to improve the debt profile has been put on hold, while remaining in active consideration.
- By end-June 2022, launch an enhanced micro-site for the IRU to support external communication. A site prototype has been developed and is currently under review by stakeholders.
- In May 2022, the National Treasury presented to Parliament proposal to amend the PFM Act and Regulations to move away from the nominal debt ceiling to a debt anchor. This proposal was subsequently withdrawn to allow further consultation. Public debt is projected at Ksh.8.8 trillion at close of the financial year.
    - As an interim measure, by end-June 2022, raise the legal nominal debt ceiling from the current level of Ksh.9 trillion to Ksh.10 trillion to enable full financing of the FY2022/23 budget;
    - By end-December 2022, replace the nominal debt limit with a debt anchor 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.

- By end-October 2022, in our regular reporting on public debt, expand the coverage of public debt to include non-guaranteed public corporations' 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 in 2021. Of these 18 SOEs, 9 were found to have non-guaranteed debt totaling Ksh.105 billion (1 percent of GDP). For this fiscal year's Debt Management Report (FY2021/22), we aim to expand the coverage to the remaining SOEs.
- By end-March 2023, 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, the CBK, and the National Treasury has been constituted to review the current situation and make a proposal to strengthen institutional arrangements for public debt management. An initial step in this process has been a cabinet approval of the harmonization of the definition of public debt in the Constitution of Kenya 2010 with the PFM Act and its attendant regulations. The Bill amending the harmonization of the definition of public debt has been submitted to Parliament for consideration and approval. The taskforce is expected to present its recommendations on the operational framework for debt management to Cabinet Secretary, National Treasury and Planning by end-October 2022.

34. 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$423.5 million (Ksh.46.5 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, the debt service relief received in 2021:H2 is estimated at US$80.3 million (Ksh.8.8 billion) due to non-participation by non-Paris Club creditors.

35. Public Private Partnerships (PPPs). Given the limited fiscal space, we have revamped the PPP Directorate in the National Treasury to support efficient and sustainable project delivery without undue fiscal risks. This has included the appointment of a Director-General to provide strong leadership and strategic oversight. The implementation of the revised PPP Directorate institutional structure has progressed significantly, and recruitments are underway. To ensure that only projects with the highest socio-economic returns are undertaken, the National Treasury is in the process of creating and institutionalizing a joint PIM planning framework. This will streamline the decision-making process of determining whether projects should be procured through the traditional on-budget public procurement method or through the PPP framework. The National Treasury has also strengthened the coordination between the PPP Directorate and the PDMO for effective control of fiscal exposure, as envisioned in the PPP Act. This will further strengthen the tapping of private sector financing to support projects, making significant contributions to Kenya's key development objectives while effectively managing risks to the Exchequer through a strong project selection process. The National Treasury has also recently fully operationalized, in the context of the FY2021/22 supplementary budget, the PPP Project Facilitation Fund through the creation of a budget line for annual funding. Other specific actions include the inclusion of fiscal risk analysis of PPPs in the Budget Policy Statement, as per the requirements of the PFM Law.

36. 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. The reengineering project has been delayed due to a longer-than-expected bidding process, but we anticipate reaching the testing stage by January 2023 and to have the system complete by end-June 2023. 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 January 1, 2021; and will replace the previous *pay-as-you-go* system over time. It has attracted more than 352,000 members so far, with a current fund value of Ksh.27 billion. Participants in the PSSS include all new public sector employees who were below the age of 45 years as of January 1, 2021; and those employed after that date. The employer (the Government of Kenya, 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 and is expected to eventually ease pressure on the pension wage bill while guaranteeing the sustainability of public service pensions. The government-backed pensions scheme for informal workers, the Kenya National Entrepreneurs Savings Trust, targeting over 15 million informal sector workers, has also now been registered.

E. State-Owned Enterprises

37. We are making progress 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 2021 SB), we had earlier 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, an endeavor that has become complicated with the rise in global fuel prices since late February. 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 below.

38. 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 during FY2021/22 and FY2022/23 budgetary offsets for 50 percent of extraordinary support to SOEs, including KQ, in line with program commitments and the flexibility built into program conditionality. After FY2022/23, such offsets will be set at 100 percent of the extraordinary support. We 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.

Kenya Airways PLC

39. 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. GoK is the largest shareholder of KQ (48.7 percent equity share) and its exposure to the airline also includes US$750 million of previously-issued guarantees to creditors. Despite a notable reduction in losses in 2021, thanks to an improvement in operating revenues, KQ was unable stem the cash burn. As a result, its severe cashflow problems continue, resulting in its inability to pay lessors and creditors due invoices, and 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.

40. 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-19 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 of March 31, 2022, the total value of the KQ's debt portfolio was US$868.7 million, including all debts, loans, letters of credit facilities, and convertible equity amounts. As part of putting KQ on a sustainable footing, GoK will novate US$485 million of KQ's guaranteed debt principal over the coming years. In addition, direct budgetary support will be provided to clear overdue payment obligations, service other debt (guaranteed and unguaranteed) falling due in coming years but not eligible for novation and cover the upfront costs of restructuring (the amounts for such support in FY2021/22 and FY2022/23 are included in ¶23 above). Guarantees on multiple credit facilities by local banks will remain in force. Negotiations for servicing of KQ's guaranteed and unguaranteed debt are ongoing and are expected to be completed in FY2022/23.

41. 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:

- An airline consultant with international experience and know-how to negotiate for concessions was hired.

- In May 2022, we completed preparation of a detailed restructuring action plan of measures to improve KQ's operational profitability, which will serve as the basis for further monitoring of progress.
- In June 2022, we established 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. With the completion of the restructuring action plan, in June 2022, we prepared a loan agreement with KQ that shall include conditions for providing financial support to implement the restructuring plan. It includes clear KPIs, timelines, and a reporting obligations and disbursement plan. The signing of loan agreements will occur by end-June 2022.
- Progress under the action plan will be reviewed quarterly by NT, and the reports by NT will be sent to the 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)

42. 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. GoK is the largest shareholder of KPLC (50 percent equity share). KPLC had a negative working capital position of Ksh.69 billion on June 30, 2021, and outstanding trade payable of Ksh.79.4 billion of which over Ksh.60 billion was overdue. The updated 2022 financial evaluation reveals some success in reducing operating costs in FY2020/21, yet, given large outstanding sums of payables (liabilities) and receivables (assets), including from GoK for the rural electrification scheme, its ability to meet them with its current assets is substantially below par, resulting in an estimated liquidity gap of about 1 percent of GDP. The January tariff cut opened up new liquidity gaps to the tune of Ksh.26.3 billion annually. For the second half of FY2021/22, this gap is expected to be covered by cost-saving measures and government support of Ksh.7.05 billion, although yields from some of the cost-saving measures remain to be confirmed. Going forward, despite additional government support of Ksh.7.05 billion in FY2022/23, there remains significant financing gaps on an annual basis over the medium term, which would need to be addressed by specific cost saving measures developed as part of a turnaround strategy. As a result, KPLC's working capital will remain in deficit in the foreseeable future. Considering the company's strategic role in the economy and linkages to other players in the sector, the associated fiscal risks are substantial. Thus, a comprehensive approach in addressing KPLC's weaknesses is urgently needed including clearance of GoK obligations to KPLC.

43. To assess the financial situation at KPLC, the government established two taskforces last year. A Presidential taskforce looked into the Power Purchase Agreements and submitted its report in September 2021. While a taskforce set up by the National Treasury assessed the financial status of KPLC to recommend corrective measures for its financial difficulties and by extension the electricity sub-sector. This taskforce presented its report in October 2021. A steering committee has been formed to follow up on the recommendations of the Presidential taskforce. The KPLC Board has been reconstituted and a new managing director is being recruited. The January electricity tariff cut was one of the recommendations by the Presidential taskforce. The cut will help the end consumer as the economy emerges from the impact of the pandemic, but it has also created new liquidity gaps for KPLC on an annual basis in the medium term as mentioned above. Additional liquidity gaps will further increase the fiscal risks. Thus, future tariff reductions will need to be fully backed by well-targeted and achievable cost-saving measures and will need to be identified and implemented ahead of any tariff reduction.

44. Considering the fiscal risks posed by KPLC, by end-July 2022, we will prepare and submit to the Cabinet Sub-Committee on KPLC an action plan to restore its medium-term profitability and cover fully any financing gaps (pre-existing and new) through end-2023 (new structural benchmark). This plan will be jointly prepared by National Treasury and the Ministry of Energy and informed by the findings of the recent Presidential Taskforce report and the updated 2022 financial evaluations at KPLC, prepared with technical support from our development partners. 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

45. 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 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. We intend to have user requirements developed for the analytical module by end-December 2022. This system will be accessible by relevant oversight entities, including line ministries, National Treasury, and SCAC.

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

46. Implementation of the Blueprint for Governance Reforms of SCs is underway. The Blueprint lists measures designed to improve governance of SCs by (i) strengthening the GoK's ability to act as an informed, active, and more transparent owner, (ii) putting in place more efficient and effective institutional arrangements for SCs' ownership and oversight, and (iii) introducing a legal framework that is more favorable to commercial SCs' activities.

- A draft document, which contains an updated inventory and a new classification of SCs that will apply across government, as well as guidelines and expectations for SCs' management, has been prepared and is expected to be approved by the Cabinet by end-July 2022 and published immediately thereafter.
- We are also developing a system through which all SCs' audited financial statements and annual reports will be made public via NT's website. It will be fully operational by end-August 2022 and a directive will be issued to require SCs to publish such documents on their own websites.
- Preparation of the government's SCs policy is ongoing with plans for submission for public consultation by end-June 2022 and adoption by the Cabinet by end-July 2022. With the IMF's and World Bank's advice, it will detail, among other issues, the new SCs' governance architecture, a rationale for state ownership, corporate governance expectations, and reporting and disclosure guidelines. Thereafter, these and other elements from the Blueprint and SCs Strategy will be anchored through legal reform.
- In addition, by end-November 2022 we will (i) take concrete actions to ensure that SCs' board members comply with the presentation of their asset declarations; (ii) ensure that all SCs disclose and publicize their anti-corruption performance indicators and initiate institutional coordination efforts for the design of an aggregate report on SCs' anti-corruption performance indicators; (iii) publish the performance evaluation reports of SCs for FY2020/21 and continue annual publications thereafter; and (iv) secure technical assistance for the design of a new performance contracting and monitoring framework for commercial SCs.

F. Monetary Policy

47. 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).

48. After maintaining an accommodative stance since the onset of the pandemic we have recently tightened the monetary policy following developments at home and abroad. The Monetary Policy Committee (MPC) lowered the policy rate by 125 basis points at the beginning of the pandemic to 7 percent. The cash reserve ratio was also lowered by 100 basis points to 4.25 percent to help increase liquidity for the commercial banks. These decisions were retained for the past two years. In its May 30, 2022 meeting, the Committee raised the policy rate by 50 basis points in order to further anchor inflation expectations against a backdrop of elevated risks to the inflation outlook due to increased global commodity prices and supply chain disruptions. Exchange rate flexibility also helped cushion the impact of the external shocks during this period. Looking forward, against the backdrop of elevated uncertainty, the MPC will closely monitor the impact of the policy measures, as well as developments in the global and domestic economy, and stands ready to take additional measures as necessary.

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

- Refining macroeconomic modeling and forecasting frameworks. The CBK hosted an IMF AFRITAC East FPAS scoping mission in October 2021 to map out ways of strengthening the forecasting frameworks and information content of the MPC surveys. Implementation of the mission's recommendations is ongoing, focusing on strengthening nowcasting and business survey frameworks, the quarterly projection model, and data management. The CBK has also continued to enhance the coverage of MPC surveys and has introduced other surveys (such as the remittances survey) to enrich the information content that guides monetary policy decisions. We will continue to review the FPAS framework, including the strengthening of the forecast process and the team, and engagements with the MPC.
- Improving the operations of financial markets, including implementing by June 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, the 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.

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

G. Financial Sector

50. 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.

51. The banking sector remains stable and resilient. Core capital and total capital adequacy ratios as at end-March 2022 were at 16.2 and 18.9 percent respectively, above the statutory minimums of 10.5 and 14.5 percent. The liquidity ratio at end-March 2022 stood at 55.0 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 14.0 percent in March 2022 from 14.1 percent in December 2020, due to progress with recoveries, write-offs and a pickup in credit growth. The outstanding restructured loans amount to about 11.7 percent of gross loans with about 90 percent of the restructured loans performing as per the restructured terms.

52. 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 to an impact of less than 0.4 percent of GDP on capital shortfall relative to minimum requirements. 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.

53. We assess that the 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 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-March 2022, following repayments and reversion to normal terms, the outstanding restructured loans amounted to 11.7 percent of total loans, of which 90 percent were performing as per the restructured terms. Restructured loans that have fallen in arrears account for about 1.1 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, the 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 that date.
- **Ensuring capital adequacy during challenging periods:** 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. ICAAPs are approved by banks' boards and are a critical component of the ongoing Supervisory Review and Evaluation Process (SREP) carried out by the 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, the 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. In 2021, bank profitability improved. Accordingly, after taking into account the adequacy of their capital and liquidity buffers, some banks announced dividend payments after the audit of their 2021 financial statements. All banks publicly disclosed their audited 2021 financial statements, including their capital adequacy ratios in March 2022, which showed the banking sector is well capitalized and there is no imminent systemic risk in the sector.

- **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.

54. A new credit guarantee scheme (CGS) was also established to expand access to affordable credit to MSMEs. In the CGS, risks are shared on a 50:50 *pari-pasu* basis; subject to a maximum guaranteed exposure of which 25 percent of the principal amount. It is intended to facilitate better financing terms to Kenyan MSMEs and incentivize the extension of 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.3.3 billion as at March 2022 since the start of the program in December 2020. MSMEs from 46 counties and drawn from 11 different sectors of the economy have benefited from the scheme. Thus far, the credit quality of loans originations in this program has been high, with 98 percent of guaranteed loans performing.

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

- **Banking sector resilience.** The need to build resilience and exploit emerging opportunities has led to increased consolidations and combinations among several players. 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. The CBK will continue with the focus of building a resilient banking sector with strong business models and governance frameworks that will support Kenya's post-pandemic recovery.

- **Moving towards real-time supervision.** We are implementing a centralized Electronic Data Warehouse (EDW) launched in February 2022, that will merge all the different information sets provided by banks and other regulated institutions to the CBK. Through Application Program Interfaces (APIs), we shall connect the EDW directly to banks to enable us to access supervisory data on a near real-time basis. This will significantly enhance the proactiveness of our offsite surveillance systems and provide a laser focus for our onsite inspections of banks. We are working with selected pilot banks as we move towards integrating the EDW with banks. In March 2022, we completed the EDW Onboarding Portal for Digital Credit Providers that will fully automate their licensing process.
- **Review of the Microfinance Act.** To accommodate considerable changes that have been experienced in the Microfinance industry over the years, the 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 the Cabinet and subsequent tabling for consideration by the National Assembly. The Bill was approved by the Cabinet in November 2021 and forwarded to the National Assembly for consideration.
- **Licensing of Kenya Mortgage Refinance Company.** On September 18, 2020, the CBK licensed the Kenya Mortgage Refinance Company PLC (KMRC) as the first mortgage refinance company in Kenya. 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 of 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 issued a corporate bond of Ksh.1.4 billion in February 2022 to provide a sustainable source of funding for mortgage refinancing to complement the existing credit lines.
- **The Central Bank of Kenya (Amendment) Act, 2021 on Digital Credit Providers (DCPs).** The Central Bank of Kenya (Amendment) Bill, 2020 (the Bill) 2020 was passed by the National Assembly in October 2021 and assented to by the President on December 7, 2021. The principal objective of the Bill is to empower the 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 assented to by the President on December 7, 2021. Subsequently, the Digital Credit Providers Regulations were published on March 18, 2022, and, accordingly, unregulated DCPs should apply for a license from the CBK by September 17, 2022 or cease operations.

- **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. The CBK will work with banks to build capacity and integrate climate-related risk management in their day-to-day operations. Subsequently, a sensitization workshop for Chief Executive Officers of banks was held on October 29, 2021. Capacity building workshops for bank staff in risk and compliance and for the CBK staff were conducted in February to March 2022. This initiative will attract global funds that are looking for opportunities to finance initiatives that build climate resilience, and thus positioning Kenya as a premier green finance hub.

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

57. Given global developments that have led to the emergence of new payment methods, including private and public digital currencies, we issued a Discussion Paper on Central Bank Digital Currency (CBDC) in February 2022. The *Paper* seeks to assess the potential applicability of a CBDC in Kenya, highlighting the risks and opportunities. Given the wide-ranging implications of CBDC to the wider economy, any eventual decision to introduce a CBDC would involve the government, regulators, the private sector, and, most importantly, the public. Any currency rises and falls on public trust and we have sought comments from the public on the *Paper* by May 20, 2022.

H. Governance

58. We remain committed to improving transparency in government procurements in line with international best practices. 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. Steps to adopt the revised standard bidding documents to obtain consent from beneficial owners to publish beneficial ownership information for tender awards are advancing, and we will start requiring consent for all new tenders immediately upon the effective date of the revised bidding documents (SB for end-March 2022). Public consultation on the draft beneficial ownership form was completed on March 15, 2022. We have revised the standard bidding documents to incorporate the beneficial ownership commitment and disclosure form. We have issued the PPRA Circular No.2 of 2022 on April 8, 2022, to inform the adoption of the revised standard bidding documents, which will take effect from April 21, 2022. We will take steps to ensure all tender notices issued after the effective date comply with the requirements of the Circular, including by ensuring the appropriate oversight mechanism is in place throughout the tender process. Accordingly, we will publish beneficial ownership information of companies awarded tenders in the PPIP for new procurements that are issued from April 21, 2022, onwards, together with other key information of tender awards. Comprehensive information, including on beneficial ownership, on these new procurements will become publicly available on the PPIP by the 15th day of the subsequent month of the tender awards.

59. 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.

60. 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.

61. 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 have forwarded them to the Attorney General for publishing. We will commit to expediting this approval so that work can begin and so that sufficient funds are allocated to ensuring the rollout of this critical legislation governed by the implementing regulations. Further, by December 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.

62. 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, (iii) enhance the role, responsibilities and capability of enforcement agencies to investigate, prosecute and sanction perpetrators of illicit enrichment and other corruption offenses, and (iv) ensure the publication of information on asset declarations of public officials, including assets beneficially owned. 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 aim at the enactment of the Conflict-of-Interest Act by end-December 2022.

63. 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 Office of the Auditor-General (OAG), Kenya has so far completed 3 special audits of COVID-19 spending. The KEMSA special audit report was committed to the Public Investment Committee (PIC). The final PIC report on KEMSA was approved for tabling in the National Assembly on September 22, 2021, but this is still awaiting adoption and reporting by the National Assembly. The sub-national government COVID-19 spending special audit report was discussed by the Senate Committee on Health and tabled and adopted by the Senate on February 23, 2022. The national government COVID-19 special audit report on spending across ministries was submitted to Parliament in May 2021 but is under deliberations by the Public Accounts Committee. We view it as important that the KEMSA and the national government spending reports are adopted without delay so that there can be systematic follow up by accountability and enforcement agencies on Parliament's recommendations and decisions. We had committed to publish the results of a forensic audit of COVID-19 vaccine spending up to end-March 2022, and a comprehensive audit of expenditures in FY2020/21 with a section on COVID-19-related spending (SB for end-May 2022). The comprehensive audit was published in June, with a dedicated section on COVID-19-related spending in the summary report. The special audit of COVID-19 vaccine spending is expected to be completed and submitted to Parliament by end-June and published by mid-July 2022.

64. We will continue to enhance the use of our AML/CFT tools to support anti-corruption efforts. The National Risk Assessment (NRA) report and National AML/CFT Action Plan (2021–26) are now completed and has been shared with stakeholders, including competent authorities and reporting institutions. The NRA report will be made public in connection with its official launch, which will take place by July 2022. Based on the NRA findings, we are committed to implementing actions identified in our AML/CFT Action Plan to further strengthen Kenya's AML/CFT regime. The amendment to the AML/CFT legal framework to require lawyers to declare suspicious activity was completed with the enactment of the Proceeds of Crime and Anti-Money Laundering (Amendment) Act 2022, which was approved by the Parliament in December 2021 and passed into law by the President in January 2022. The Kenya Financial Reporting Centre (the Centre) has continued to conduct outreach nationwide for reporting institutions to raise awareness on ML/TF risks relating to corruption activities and promote understanding of their AML/CFT obligations, including to improve the quality of suspicious transaction reporting. The Centre will continue to strengthen domestic cooperation with other competent authorities, including law enforcement agencies, particularly through the Multi Agency Team partnership to support investigation and corruption cases. To further support risk awareness and strengthen effectiveness of the Centre, we will publish ML/TF typologies, including corruption-related money laundering typologies, by September 2022, and continue to update these typologies as risks evolve. The second round Mutual Evaluation (ME) process conducted by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) is ongoing with the on-site visit completed in February 2022 and the second face-to-face meetings set for July 2022. The final report of the ME is expected in September 2022 upon adoption by the ESAAMLG plenary. The outcomes of the ME process will further inform our actions to strengthen the AML/CFT framework. In particular, we will assess and strengthen the effectiveness of our AML/CFT risk-based supervision to further support anti-corruption efforts.

I. Data Quality

65. 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.

66. 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 first Foreign Investment Survey in April 2019, and another in August 2021 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 statistics and are receiving IMF technical assistance in this area. In September 2021, we released national accounts statistics updated to a base period of 2016 from the previous base of 2009. 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 easy and reliable access to information on the state of the economy and public finances. Additionally, the CBK introduced new surveys to assess the impact of policy measures on key sectors in the context of the pandemic.

J. Program Monitoring

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

68. We would like to request that the IMF Executive Board approve some modifications to program targets. We request the modification of the QPCs on net international reserves for end-June 2022 and end-December 2022 to lower targets, reflecting lower expected net FX inflows. As final data is not yet available, we request waiver of applicability of the end-June 2022 PCs under the EFF arrangement. We also request the establishment of three new structural benchmarks:
(1) issuance by end-August 2022 of a circular that includes an action plan for the development of an MTRS that sets revenue objectives consistent with program targets; (2) by end-July 2022, review of application of domestic fuel pricing mechanism and publicly announce and constitute a taskforce to oversee the progressive elimination of the fuel subsidy within the first half of FY2022/23 and to ensure that fuel pricing actions are at all times aligned to the approved budget; and (3) submission to the Cabinet Sub-Committee on KPLC by end-July 2022 of an action plan to restore KPLC's medium-term profitability and fully cover any financing gaps (pre-existing and new) through end-2023, as identified by the updated 2022 financial evaluation.

Table 1. Kenya: Quantitative Performance Criteria and Indicative Targets, March 2021—June 2023

(In billions of Kenyan Shillings, unless otherwise indicated)

	2021											2022				2023
	End March			End June				End December				End June		End December		End June
	1st Rev.	Outturn	Status	1st Rev.	Adjusted	Outturn	Status	2nd Rev.	Adjusted	Outturn	Status	2nd Rev.	Proposed	2nd 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		-455.4	met	-202.9		-37.6	met	-428.0	-428.0	-110.2	-110.2	-174.8
Tax revenue (floor)[1,2]	…	…	…	…		…	…	783.2		836.2	met	1,667.3	1,667.3	862.3	862.3	2024.0
Monetary targets																
Stock of central bank net international reserves (floor, in millions of US$)[3]	5,862	6,090*	met	7,451	5,591*	6,326*	met	7,915	6,523	6934**	met	7,265	7,168	5,668	5,494	5,477
Public debt targets																
Public and publicly-guaranteed external debt arrears (ceiling)[4,5]	0	0	met	0	…	0	met	0	…	0	met	0	0	0	0	0
New domestic guarantees granted by the central government (ceiling)[1]	5	0	met	5	…	0	met	5	…	0	met	5	5	5	5	5
PV of contracting or guaranteeing of new external debt (ceiling, millions of US$)[6]	…	…	…	…	…	…	…	7,726	2,726	138	met	8,846	8,846	9,905	9,905	11,630
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		195	not met	397	397	205	205	421
Change in the stock of national government exchequer requests outstanding for 90 days or more (ceiling)[1]	0	4.2	not met	0		0	met	0		0	met	0	0	0	0	0
Monetary policy consultation clause			met				met				met					
Upper band (annual, percentage points)	7.5			7.5				7.5				7.5	7.5	7.5	7.5	7.5
Center inflation target (annual, percentage points)[7]	5.0	5.8		5.0		6.0		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	2.5
Memorandum items for adjustors																
Programmed amount of new debt issuance for PV-reducing, debt management operations	…	…	…	2,000	…	…	…	5,000	…	0		5,000	5,000	5,000	5,000	5,000
Memorandum items (other)																
Nominal value of contracting or guaranteeing of new external debt under new PV ceiling (in millions of US$)[8]	…	…	…	…	…	1,820	…	11,207	6,207	2,060		12,635	12,635	14,521	14,521	16,814

Notes: * 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 US$6,129 million and US$7,672 million. ** From end-December 2021, includes US$347 million Reserve Advisory Management Portfolio (RAMP); NIR excluding the RAMP amounted to US$6,593 million in end-December 2021.

[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] Continuous.

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

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

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

[8] Cumulative from program approval.

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

Measure	Target Date	Status	Macro-Criticality
State-Owned Enterprises (SOEs) Restructuring and Governance			
Submit to the Cabinet Sub-Committee on KPLC an action plan to restore KPLC's medium-term profitability and fully cover any financing gaps (pre-existing and new) through end-2023, as identified by the updated 2022 financial evaluation.	End-July 2022	Proposed	Reduce fiscal risks related to SOEs.
Fiscal Transparency			
Ensure that comprehensive information on public tenders awarded, including beneficial ownership information of the awarded entities, are publicly available on the government procurement information portal, and that bidders are subject to dissuasive sanctions for non-compliance.	End-June 2021	Not met.	Reduce corruption risks by strengthening transparency and enhancing oversight.
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	Not Met. Implemented with delay	Reduce corruption risks by strengthening transparency and enhancing oversight.
Publish results of a forensic audit of COVID-19 vaccine spending up to June 2021 and a comprehensive audit of expenditures in FY2020/21 with a chapter on COVID-19-related spending.	End-May 2022	Not met.	Strengthen transparency and enhance oversight.
Budget and Revenue Collection			
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-December 2021	Met.	Increase compliance and tax revenue.
Submit to Parliament a supplementary budget for FY2021/22 consistent with programmed deficit target.	End-January 2022	Met.	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	Not met. Implemented with delay.	Ensure fiscal consolidation consistent with program objectives.
Complete a review of how the fuel pricing mechanism has been applied to date; publicly announce and constitute a taskforce to oversee the progressive elimination of the fuel subsidy within the first half of FY2022/23 and to ensure that fuel pricing actions are at all times aligned to the approved budget.	End-July 2022	Proposed.	Provide clarity on fuel pricing policy and avoid unfunded subsidy costs.

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

Measure	Target Date	Status	Macro-Criticality
Issue a circular that includes an action plan for the development of a Medium-Term Revenue Strategy (MTRS) that identifies quantified overarching revenue objectives consistent with programmed tax revenue targets, clarifies the role of each institution involved, and identifies a concrete and time-limited sequence of actions for achievement of such objectives.	End-August 2022	Proposed.	Increase compliance and tax revenue.

[1/] The list of all previously assessed structural benchmarks is available in IMF Country Report No. 2021/275.

Attachment II. Technical Memorandum of Understanding

Nairobi, Kenya, June 29, 2022

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

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

I. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS

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

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

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

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

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

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

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

6. **For program purposes, the national government primary balance** on a cash basis will be measured from the financing side as the sum of the following: (a) the negative of net domestic financing of the national government; (b) the negative of net external financing of the national government; and (c) domestic and external interest payments of the national government. For the end-June 2022 test date, end-December 2022, and end-June 2023 test dates, the national government primary balance will be measured cumulatively from July 1, 2021, to June 30, 2022 (end-June 2022 test date), and from July 1, 2022 to June 30, 2023 (end-December 2022 and end-June 2023 test dates), 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.127.5 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)

	2022		2023
	Jun.	Dec.	Jun.
Extraordinary Support to SOEs	48,426	36,638	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)

	2022		2023
	Jun.	Dec.	Jun.
Program grants	2,500	0	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);
  - the CBK's holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments); and
  - Kenya's reserve tranche position with the IMF.
- **Gross official international reserves** exclude:
  - pledged, swapped, or any encumbered reserve assets, including but not limited to reserve assets used as collateral or guarantees for third-party external liabilities;
  - deposits with Crown agents; and
  - precious metals other than gold, assets in nonconvertible currencies and illiquid foreign assets.
- **Gross official reserve liabilities** are defined as:
  - the total outstanding liabilities of the CBK to the IMF, excluding the SDR allocations;
  - convertible currency liabilities of the CBK to nonresidents with an original maturity of up to and including one year; and
  - commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options).

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

- If the total of (i) program loans, (ii) the revenue component of project loans, and (iii) external commercial and semi-concessional borrowing (excluding for payments of principal of existing debt with the proceeds from newly issued debt for debt management purposes (¶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)

	2022		2023
	End-June	**End-Dec**	End-June
Program grants and loans	1451	353	1220
Program loans	1424	353	1220
Program grants	27	0	0
Project loans and grants	753	232	768
Project loans (revenue component)	645	212	700
Project grants (revenue component)	108	20	68
Commercial and Semi-concessional borrowing	1108	0	900
Foreign exchange outflows related to KQ support	132	91	183

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)

	2022 Jun.
DSSI total debt relief	80.3

Source: Kenyan authorities.
1/ Cumulative from July 1, 2021 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.

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 Secured Overnight Financing Rate (SOFR) is 0.04 percent and will remain fixed for the duration of the program as will the spreads over six-month USD SOFR for interest rates in other currencies as follows: (1) The spread of six-month Euro EURIBOR over six-month USD SOFR is -56 basis points; (2) The spread of six-month JPY Overnight Indexed Swap (OIS) over six-month USD SOFR is -8 basis points; (3) The spread of six-

[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.

month GBP Sterling Overnight Interbank Average (SONIA) over six-month USD SOFR is 1 basis point; and (4) For interest rates on currencies other than Euro, JPY, and GBP, the spread over six-month USD SOFR is 15 basis points.[5] Where the variable rate is linked to a benchmark interest rate other than the six-month USD SOFR, a spread reflecting the difference between the benchmark rate and the six-month USD SOFR (rounded to the nearest 50 basis points) will be added.

Debt Management Operations

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

Adjustors to Debt Ceiling

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

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

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

[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, 2022–23
(Percent values)

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

Source: Kenyan authorities.

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

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

IX. INDICATIVE TARGET ON NATIONAL GOVERNMENT OUTSTANDING EXCHEQUER REQUESTS

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

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

X. INDICATIVE TARGET ON PRIORITY SOCIAL SPENDING

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

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

	2022		2023
	Jun.	Dec.	Jun.
Priority Social Spending	397,320	210,389	420,777

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	

Statement by the Staff Representative on Kenya
July 18, 2022

This statement provides an update to the staff report based on recent information but does not alter either the staff recommendations or the thrust of the staff appraisal.

Program Monitoring

1. The Monetary Policy Consultation Clause (MPCC) was met as of June 2022. Headline consumer price inflation rose further in June to 7.9 percent y/y and exceeded the upper bound of the inflation target band of 2.5–7.5 percent. However, on a three-month average basis, inflation remained inside the band at 7.2 percent, meeting the program's MPCC as of June 2022.[1] The outturn was broadly in line with staff projection. Staff expects inflation to temporarily exceed the target band in 2022 before easing back inside the band in 2023 and advised the central bank to stand ready to continue to adjust the monetary policy stance (see ¶9, 26, and 42 of the Staff Report). Should current projections materialize, a formal Board consultation under the MPCC would be triggered during the next program review.

2. Audits of COVID-19 vaccine spending up to June 2021 have advanced (structural benchmark, end-May 2022). Audits covering each of the 47 counties have been sent to parliament, and a consolidated report is being finalized. The reports are expected to be made public within the next few weeks and will complement the already-published comprehensive audit of expenditures in FY2020/21 with a chapter on COVID-related spending (see ¶8, 22, and 41 of the staff report).

Recent Developments

3. Real GDP grew by 6.8 percent year-over-year during the first quarter of 2022. The overall growth outturn was similar to staff expectation. A modest decline in the agriculture sector and smaller than anticipated contribution from the secondary sector were offset by growth in the services sector. The balance of risks to the 2022 outlook is unchanged with downside risks continuing to dominate.

[1] See ¶25 of the Technical Memorandum of Understanding (TMU) for details on the MPCC.

Statement by the Executive Director, Ms. Ita M. Mannathoko and the Senior Advisor of the Executive Director, Mr. James Alic Garang July 18, 2022

Introduction

1. Our Kenyan authorities appreciate the candid discussions held with staff during the third review under the Extended Fund Facility and Extended Credit Facility (EFF/ECF) arrangements. They broadly share staff's assessment and policy recommendations. The program enjoys broad political support, with the mission having received assurances from the leading presidential candidates in the upcoming elections, of their support for key program objectives and policies.

2. The Kenyan economy showed promising recovery in 2021, rebounding from the 2020 pandemic induced recession with an estimated 7.5 percent real GDP growth in 2021, reflecting resilience and the strength of the authorities' policy response, including an eight-point Economic Stimulus Program focusing on youth employment, micro, small and medium-sized enterprises, and vulnerable households. Kenya continues to face a series of significant external shocks: spillovers from the Russian conflict in Ukraine and commodity price increases, alongside supply chain constraints and drought in its semi-arid regions make for an especially difficult economic context. Growth momentum, while slowing, nevertheless remains significant with first quarter GDP growth in 2022 estimated at 6.8 percent (year-on-year).

3. In 2022, global inflationary pressures, with higher food, fertilizer and fuel prices generating new urgent fiscal, and balance of payments needs, another layer of complexity has been added to policy making. Notwithstanding the challenging environment, the authorities have remained committed to the objectives of the EFF/ECF, as it continues to anchor reforms articulated in their Economic Recovery Plan. The program remains guided by a medium-term plan that seeks to balance near-term support for the economy, with a multi-year plan to bolster macroeconomic stability. The authorities have managed to keep the program firmly on-track despite complications from overlapping health, climate, and geo-political shocks. To this end, they seek Directors' support in completing the third EFF/ECF review, along with associated requests. Recent Economic Developments and Outlook

4. The expectation is that GDP growth momentum will be sustained in 2022, within the region of 6.8 percent. As economic activity resumes in full, with the decline in COVID cases and effective vaccination, the strong rebound seen in 2021 supported by recovering exports and services, in particular wholesale and retail trade, transport and storage, education, information and communication, and financial and insurance services, should carry over.

5. Recent dislocations in global supply continue to impact Kenya's external position, with the current account deficit expected to widen by half a percentage point to 5.9 percent of GDP in 2022, relative to 2021, reflecting developments in international prices and import costs.

However, it is expected to gradually return to normalcy as exports continue to improve. Foreign exchange reserves remain adequate and the flexibility in the exchange rate has, in the Kenya context, facilitated adjustment to external shocks with an active productive sector and evident supply response, and the relatively stable environment. Inflation was kept within the target range through 2021. In 2022, however, new global inflationary pressures are pushing inflation up towards the upper policy bound, necessitating closer attention.

6. The authorities are accelerating vaccination to fully immunize all 27 million adults by end-2022. With vaccine supply constraints easing, over 18 million doses have been administered to date, and over 31 percent of Kenyans were inoculated by June 2022. Infection rates have dropped significantly, with 6 recorded cases per 1000 and a case fatality rate of 2 percent, in June. Moderna has announced plans to build a US$500 million manufacturing facility for RNA COVID-19 vaccines in Kenya, which will also further boost vaccination and support a return to economic normalcy.

Program Performance

7. Despite the challenging context, performance on quantitative criteria (QPCs) has been generally strong, with all QPCs and one of the two indicative targets (ITs) for end- December 2021 having been met, some with ample margins. The IT on priority social spending was missed temporarily by 0.08 percent of GDP due to a delay executing some teacher wage payments. This was corrected in January. On structural benchmarks (SBs), the authorities submitted a FY2021/22 supplementary budget in January, in line with the program requirement. Some other structural reforms faced some delivery delays due to legal complications and other challenges. The SB on adoption of new tender documents to enable the publication of beneficial ownership information for awarded tenders (end- March 2022) was implemented with a delay of some weeks in April 2022. Submission of a FY2022/23 Budget consistent with the program objectives (end-April 2022) was implemented with a delay as tax-enhancing measures were only submitted in May and June 2022. For the end-May fiscal governance SB, the comprehensive audit of expenditures in FY2021/22 with a chapter on COVID-19 spending was published with a delay, in June. Beyond this, operational issues that delayed the special audit of COVID-19 vaccine spending for FY2021 are being addressed and the audit should be published this month.

8. The authorities request: a waiver for end-June 2022 PCs under the EFF given absence of final data needed for assessment; modification of the QPCs on net international reserves for end-June 2022 and end-December 2022 to reflect updated assessments; establishment of new quantitative performance criteria for relevant indicators for June 2023 and establishment of three new SBs related to issuance of a National Treasury circular presenting an action plan for development of a medium-term revenue strategy setting revenue objectives consistent with program targets (end-August 2022); completion of a review of how the fuel pricing mechanism has been applied to date and constitution of a taskforce to oversee the progressive elimination of the fuel subsidy within the first half of FY2022/23 and to ensure that fuel pricing actions are at all times aligned to the approved budget (end-July 2022); and submission

by end-July 2022 of an action plan to restore Kenya Power and Lighting Company's medium-term profitability and to fully cover financing gaps through end-Dec 2023.

Fiscal Policy and Debt Management

9. Fiscal revenues have strengthened significantly with robust tax performance, while continued efforts to restrain non-priority spending and to ensure investment efficiency have also supported strong fiscal performance. This has helped the authorities in the face of new pressures induced by the Russian war in Ukraine, enhancing resilience in the face of new shocks and allowing them to cushion the impact of the shock on farmers, the economy and households. Carryover of the strong fiscal performance into FY2022/23 is a key element supporting the coming year's revenue projections. The authorities will also undertake new tax measures under the ongoing medium-term revenue strategy as anticipated under the program, should the need arise. Difficult tradeoffs have been necessitated by limited fiscal space, and therefore response efforts in the face of shocks have been carefully prioritized. Fiscal policy seeks to balance the near-term need to support the economic recovery against the imperative of reducing debt vulnerabilities over the medium term. Thus beyond FY2022/23 the authorities' strategy seeks to curb vulnerabilities and place debt on a downward trajectory with the primary deficit below its debt-stabilizing level.

10. Robust tax collection likely reflects durable improvements in tax compliance following revenue administration reforms at the Kenya Revenue Authority (KRA) supported by IMF technical assistance, and improved taxpayer services. Reforms include managing exemptions and strengthening KRA audit functions. Compliance risk management capacity has also improved significantly and now includes data-driven approaches and an enhanced voluntary tax disclosure program. Compliance improvement plans have also targeted sectors such as construction and e-commerce and the digital economy, major taxpayer segments such as premier clients, large businesses, and SMEs; while also looking at international tax risks, the informal sector, and aggressive tax planning by individuals. Efforts to raise the ratio of tax to GDP and create space for growth-enhancing investments and priority social spending continue.

11. The authorities continue to closely manage expenditures, including with a proactive strategy to contain the ratio of the government wage bill to GDP. This includes continued restraint in hiring and compensation. This is reflected in an effective wage freeze for FY2021/22 and FY2022/23, in the limiting of new employment to priority areas while ensuring recruitment is subject to the availability of funding. The work program also includes harmonization and rationalization of the categories, rates, and rules for allowances, and the implementation of a common payroll system linked to IFMIS initially across all government ministries, departments, agencies and counties, and eventually to include some semi-autonomous government agencies.

12. Other spending lines are also being scrutinized. While state-owned enterprises (SOEs) received support during FY2021/22 and will continue to do so in FY2022/23, the authorities

are exploring ways to implement a least-cost approach to SOEs, including for Kenya Airways and Kenya Power and lighting Company Ltd. On fuel prices, the authorities note that if the sharp increase in global fuel prices is fully passed on to domestic prices over a very short timeframe, these risks undermining social stability. However, they are cognizant that protecting the economy and households from higher international prices would eat into scarce public resources. They intend to pursue a gradual realignment of domestic fuel prices with global fuel prices, accompanied by careful reprioritization of non-essential spending. The budget is fully aligned with the program path, with spending rationalizations absorbing the cost of fuel subsidies, and the outcomes in line with the primary balance target. The National Treasury is also pursuing an ambitious agenda aimed at strengthening budget processes, commitment controls, and cash management. They also plan on rationalizing the pipeline of existing projects and implementing new public investment management regulations. Other reforms supportive of fiscal performance include improvements to procurement, and the bolstering of public financial management (PFM) systems.

13. Fuel price challenges are feeding into social stability concerns. In a bid to eliminate the fuel subsidy and in line with the Kenya's commitment under the ECF/EFF program, the Energy and Petroleum Regulatory Authority (EPRA) has been adjusting fuel pump prices upward each month, despite the very difficult price environment. However rising fuel (and therefore transport) prices, alongside growing food price and supply pressures amidst worsening drought conditions in 19 arid and semi-arid counties raising food security risks, have compelled the authorities to temporarily reconsider the monthly upward adjustment. Social stability risks are a concern amidst ongoing public complaints over food in drought regions and record high fuel prices, with talk of a fuel crisis in local media and social media. After much deliberation in Government, the decision was made on July 14, 2022, to hold fuel pump prices constant for the month July to August 2022. The temporary hold on upward adjustment of fuel pump prices gives Government time to put in place appropriate targeted measures to cushion the rapidly rising number of vulnerable persons impacted (an additional 0.6 million in the month of June 2022 alone). To meet the cost of this temporary measure, the Government authorized an additional budget allocation in the financial year 2022/23. It will cover the fuel subsidy cost in the cycle of July-August 2022, and sufficient budget offsets will be identified to ensure observance of the financial year 2022/23 primary deficit target. The Government remains committed to program goals and will resume gradual fuel pump price adjustment in subsequent months following the establishment of mechanisms to facilitate well targeted subsidy programs. We appeal to fellow Executive Directors to recognize the need for flexibility during current unprecedented times, to avert social crises that could undermine program goals.

14. Prudent debt management remains a priority. The authorities plan to transition away from targeting a fixed, nominal public debt ceiling to the use of a credible debt anchor by the end of the year. This will be done via a medium-term debt anchor set at 55 percent of GDP with debt measured in present value terms; and an accountability requirement with transparent communication to Parliament and the public on plans and progress. The structures and

functions of the Public Debt Management Office are also being enhanced to facilitate implementation of the PFM Law. On domestic debt, the National Treasury is working with the Central Bank of Kenya (CBK) to deepen the domestic debt securities market. They have strengthened the auction management process, implementing the Treasury Mobile Direct platform for retail sale of government securities, and enabled auction of bids by banks through internet banking. They will continue to strengthen market infrastructures and auction management processes for government securities as they develop the Central Securities Depository System.

Monetary and Financial Sector Policies

15. As it now faces an increasingly complex global inflationary environment, the central bank has shifted from post-pandemic accommodation to a tighter monetary stance. At end-May, the Monetary Policy Committee (MPC) raised the policy rate by 50 basis points, seeking to anchor inflation expectations amidst elevated risks to the inflation outlook due to increased global commodity prices and supply chain disruptions. The MPC continues to monitor developments in a data- driven policy stance.

16. In the meantime, the authorities are focused on strengthening the monetary policy framework. This includes refining macroeconomic modeling and forecasting frameworks, enhancing the operations of financial markets, improving monetary policy transmission, improving communication of monetary policy decisions, and promoting efficiency and transparency in the domestic debt market, in line the CBK's White Paper. The modern central securities depository being rolled out ahead of the introduction of an interest rate corridor around the policy rate, will enhance policy efficacy and the functioning of the interbank market. The CBK is also strengthening market intelligence, transparency, and monetary policy communication.

17. The banking sector remains resilient with core capital, capital adequacy and liquidity ratios all above statutory thresholds. While the non-performing loan ratio (as a share of gross loans) remains two percentage points above pre-pandemic levels, measures put in place to mitigate the adverse impacts of the pandemic, including loan restructuring, a strengthened credit referencing mechanism, and ensuring capital adequacy, have been effective, and the authorities continue to monitor NPLs and conduct credit risk stress tests. The CBK continues to safeguard financial sector stability.

18. Going forward, measures continue to expand access to affordable finance, including via fintech, while other reform momentum continues towards realizing the vision outlined in the CBK's Banking Sector Charter. This includes building banking sector resilience, moving towards real-time supervision, updating the Microfinance Act, new legislation to enable regulation of digital lenders, licensing of the Kenya Mortgage Refinance Company, greening Kenya's Banking Sector, and upgrading the AML/CFT framework.

19. Enhancing the national payments system remains an imperative. The authorities launched the National Payments Strategy (NPS: 2022-2025), in February 2022, consolidating the gains made so far while mapping out the next chapter in Kenya's payment journey and building on M-Pesa successes. In this context, the recently announced M-Pesa Global Pay Virtual VISA Card (a partnership between M-PESA and VISA), is linked to M-PESA wallets and enables virtual card-holders to make secure payments to international online sites for goods and services. It can provide access to as many as 100 million foreign merchants including Amazon and Alibaba via mobile phones, without the need for credit cards or formal accounts with processors such as PayPal. The NPS vision is for a secure, fast, efficient, and collaborative payments system that supports financial inclusion and modern innovations that benefit Kenyans. The authorities anchor this vision on the core principles of trust, security, usefulness, choice, and innovation.

20. The authorities are also assessing the potential applicability of a central bank digital currency in Kenya, including the associated risks and opportunities. Given the wide- ranging implications for the wider economy, consultations with government, regulators, the private sector, and, most importantly, the public are crucial, and a discussion paper was published in February seeking comments from the public by May 20, 2022.

Structural Reforms

21. The authorities are deepening structural reforms to improve the business environment and boost investment, enhance employment, and lift potential growth, while enhancing the efficiency and transparency of governance. To this end, a beneficial owners' consent form to be included in standard bidding documents for public procurements, tender notices issued effective from April 21, 2022, has been adopted. In line with Kenya's existing procurement regulation, comprehensive information, including on beneficial ownership, of the successful tenders will be published on the Public Procurement Information Portal by the 15th day of the subsequent month. Full transparency will be provided on COVID-19- related spending.

22. Measures continue with a view to strengthening oversight and governance in the state-owned-enterprise (SOE) sector. The authorities are working to finalize SOE classification and inventory and are working on the SOE Ownership Policy, drawing on recent Fund technical assistance. They have also requested and are receiving Fund support on the establishment of the new Fiscal Risks Committee.

23. Work to strengthen the implementation of the anti-corruption framework continues, including by accelerating asset declaration, and advancing and executing key pieces of legislation. AML/CFT supervision is being intensified to help prevent laundering of corruption proceeds through the financial sector. The Eastern and Southern Africa Anti- Money Laundering Group (ESAAMLG) completed its on-site visit, and a final report is expected in September 2022. The authorities have also completed their National Risk Assessment, and its findings are being used to inform the AML/CFT supervisory strategy and actions to mitigate corruption-related money laundering risk in banks and other higher risk sectors.

Conclusion

24. Our Kenyan authorities remain committed to prudent macroeconomic management with policies to maintain stability, support recovery and foster inclusive growth. Policy efforts to unlock growth potential remain vital to the achievement of key development objectives articulated in the program and in their National Development Plan. They look forward to Executive Directors' support towards conclusion of the third EFF/ECF program review.