

International Monetary Fund

[Kenya](#) and the IMF

Kenya: Letter of Intent and Technical Memorandum of Understanding

Press Release:

[IMF Executive Board
Concludes 2018
Article IV
Consultation and
Establishes
Performance Criteria
for the Second
Review Under the
Stand-By
Arrangement with
Kenya](#)

May 25, 2018

October 23, 2018

[Country's Policy
Intentions
Documents](#)

The following item is a Letter of Intent of the government of Kenya, which describes the policies that Kenya intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Kenya, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

E-Mail Notification

[Subscribe](#) or [Modify](#)
your subscription



REPUBLIC OF KENYA
THE NATIONAL TREASURY AND PLANNING

Telegraphic Address: 22921
Finance – Nairobi
FAX NO. 310833
Telephone: 2252299
When Replying Please Quote

THE NATIONAL TREASURY
P O BOX 30007 - 00100
NAIROBI

Ref: CONF.MOF/74/01

May 25, 2018

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

Dear Ms. Lagarde,

1. Economic conditions in Kenya have continued to improve since the 6-month extension of our precautionary Stand-By Arrangement (SBA) on March 12, 2018. In particular, GDP growth accelerated to 5.0 percent in the fourth quarter of 2017, from 4.7 percent in the first nine months of the year, and confidence indicators point to a continued strong momentum in 2018. This reflects a recovery from the effects of the protracted presidential election process and improving weather conditions. In addition, inflation remains low (3.7 percent in April), the exchange rate has been stable, and gross international reserves reached an all-time high of US\$9.1 billion at end-April (equivalent to 6.11 months of imports).
2. The economy grew by 4.9 per cent in 2017 supported by activities in the non-agricultural sector—mainly the services sub-sector—that offset the lower performance in the agricultural sector. The growth reflected increased performance in the information and communication, tourism, wholesale and retail, and transport and storage sectors. The impact of the extensive drought, coupled with the election-related expenditures, contributed to missing (i) the performance criteria on the primary fiscal balance for end-December 2016 and end-June 2017, and (ii) the monetary policy consultation clause for June 2017 (Table 1). The introduction of interest rate controls in September 2016, which were aimed at addressing the high cost of credit, has had somewhat unintended adverse consequences on credit growth and monetary policy effectiveness. In addition, there have been some delays in implementing some of the structural benchmarks under the program (Table 2). To bring the program back on track, we are taking steps to help achieve our program objectives, especially to maintain public debt sustainability, avoid the adverse impact of interest rate controls, and continue reforms to strengthen public financial management and modernize the monetary policy framework.



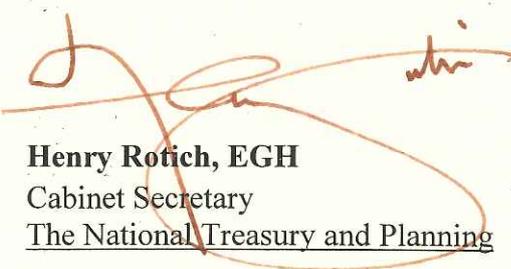
ISO 9001:2008
Certified.

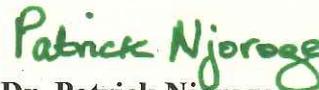
- On fiscal policy, we have introduced specific revenue administration measures that have helped improve revenue collection in the second half of 2017/18. In addition, since revenues remain below target, we issued in May 2018 a circular on expenditure controls to limit spending for the remainder of 2017/18, especially for lower-priority domestically-financed investment projects, with a view to contain the overall deficit to KSh623 billion. We are also monitoring commitments by spending units to ensure no increase in spending arrears (pending bills of 90 days or more). Consistent with the commitment in our letter of intent of March 6, we have submitted to Parliament the budget estimates for 2018/19 that targets a deficit of 5.7 percent of GDP, and will submit the supporting Finance Bill, 2018 to Parliament that will contain revenue raising measures, including removal of some tax exemptions and further improvements in tax administration. In addition, we shall present to Parliament, a modern new Income Tax Bill that overhauls the existing Income Tax Act.
- On interest rate controls, we plan to submit together with the Finance Bill 2018, a proposal that aims to refocus the controls on consumer protection and avoid their adverse impact on the economy, especially ensuring that they no longer block lending and access to finance, or hinder the conduct of monetary policy.
- On structural reforms, we are taking steps to deepen financial sector reforms, improve the transparency and efficiency of public spending, and strengthen public debt management.

3. We propose a set of quantitative performance criteria, a Monetary Policy Consultation Clause, and indicative targets for end-June 2018 (Table 3), and resetting some of the structural benchmarks for end-August 2018 (Table 4). These will serve as a basis for completing delayed reviews under the precautionary SBA, together with a macroeconomic framework and conservative revenue projections for 2018/19 and over the medium term to be agreed with Fund staff, that reflect forward looking policies to be specified in a follow-up letter of intent at the time of the next SBA review. The follow-up letter of intent will be presented to the Executive Board before the expiration of the SBA program on September 14, 2018.

4. We authorize the publication of this letter of intent, the attached technical memorandum of understanding, and the related staff report.

Yours Sincerely,


Henry Rotich, EGH
 Cabinet Secretary
The National Treasury and Planning


Dr. Patrick Njoroge
 Governor
Central Bank of Kenya



ISO 9001:2008
 Certified.

Technical Memorandum of Understanding

Nairobi, Kenya, May 25, 2018

1. This memorandum sets out the understandings between the Kenyan authorities and the IMF regarding the definitions of quantitative performance criteria and indicative targets, their adjusters and data reporting requirements for the Stand-By Arrangement.

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

I. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS

3. Quantitative performance criteria are established for June 30, 2018 with respect to:

- the primary balance of the national government including grants, and excluding spending related to the first phase of the Standard Gauge Railway project SGR I (connecting Mombasa to Nairobi), cash basis (**floor**);
- the net official international reserves (NIR) of the Central Bank of Kenya (CBK) (**floor**);
- national government medium- and long-term external public debt arrears (**continuous ceiling**);
- Contracting or guaranteeing of new debt by the national government and the CBK (**ceiling**);
- monetary policy consultation clause (**band**).

4. The program sets indicative targets for June 30, 2018 with respect to:

- the net domestic assets (NDA) of the CBK (**ceiling**);
- change in the stock of national government domestic bills pending for 90 days or longer (**ceiling**);
- priority social spending of the national government (**floor**); and
- stock of guarantees issued by the national government (**ceiling**).

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

5. The **national government primary balance** on cash basis is defined as national government revenues and grants minus expenditures and net lending, plus due interest payments, and spending related to SGR I, adjusted for cash basis.

6. For program purposes, the **national government primary balance** on 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, excluding the executed amount of disbursements related to SGR I; and (c) domestic and external interest payments of the national government. For all test dates, the national government primary balance will be measured cumulatively from July 1, 2017.

The above items are defined as follows:

- **Net domestic financing** of the national government is defined as the sum of:
 - net domestic bank financing;
 - net domestic nonbank financing; and
 - proceeds from privatization.
- **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 and excluding executed amounts of disbursements related to the first phase of the Standard Gauge Railway project;
 - 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);
 - 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. **Adjustors.** The national government primary balance target will be: (i) adjusted downward by the amount of the shortfall in program grants, which are expected as refunds for Kenya's participation in African Union Mission in Somalia (AMISOM), as specified in TMU Table 1 below; and (ii) adjusted downwards by the excess in project loans (excluding SGR I) relative to the programmed amounts, as specified in MEFP Table 3, up to the maximum amounts, as specified in MEFP Table 3.

TMU Table 1. Kenya: African Mission in Somalia (AMISOM) Grant Schedule
(Billions of Kenyan Shillings)

	2018
	Jun.
Program Amount ¹	6.1

Source: Authorities' data.

¹ For FY2017/18 cumulative from July 1, 2017.

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

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

- **Gross official international reserves** are defined as the sum of:
 - the CBK’s holdings of monetary gold (excluding amounts pledged as collateral);
 - holdings of Special Drawing Rights (SDRs);
 - CBK holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments); and
 - Kenya’s reserve tranche position with the IMF.
- **Gross official 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).
- The following **adjustors** will apply to the target for NIR:
 - if budgetary external program grants and external commercial debt exceed the programmed amounts set out in TMU Table 2 below, the target for NIR will be adjusted upward by half of the difference; and
 - if budgetary external program grants and external commercial debt fall short of the programmed amounts set out in TMU Table 2 below, the target for NIR will be adjusted downward by the difference.

TMU Table 2. Projected Budgetary External Grants and Loans ¹

(US\$ millions)

	2018
	Jun.
Program grants	60.55
External commercial debt	2,880.82

Source: Kenyan authorities.

¹ Cumulative from July 1, 2017.

9. **NIR are 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 3 below, and net international reserves will be computed as the daily average for the month when the testing date is due.

TMU Table 3. Kenya: Program Exchange Rates (Rates as of March 29, 2018)		
Currency	Kenyan Shillings per currency unit	US Dollars per currency unit
US Dollar	100.74	1.00
STG Pound	142.15	1.41
Japanese Yen	0.95	106.3
Canadian Dollars	78.17	1.29
Euro	124.60	1.24
Swiss Franc	105.53	0.95
Swedish Kronor	12.12	8.32
Danish Kronor	16.69	6.04
Chinese Yuan	15.99	6.30
Australian Dollars	77.32	1.30
SDR	146.84	0.69

Source: Central Bank of Kenya.

IV. CONTINUOUS PERFORMANCE CRITERION ON THE NATIONAL GOVERNMENT EXTERNAL PAYMENT ARREARS

10. National government external payment 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. National government guaranteed external debt payment 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 the national government 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 rescheduling. External debt is defined on a residency basis.

11. The performance criterion on the national government external payment arrears is defined as a cumulative flow in gross terms from July 1, 2017 and applies on a continuous basis.

V. CONTRACTING OR GUARANTEEING OF NEW PUBLIC DEBT (CEILING)

12. A performance criterion (ceiling) applies to the nominal value of new debt (external and domestic) contracted or guaranteed by the national government and the CBK. For debt with original maturity of one year or less, new debt would be measured as the change in the outstanding stock

over the specified period. The ceiling does not apply to the use of Fund resources, operations related to external debt restructuring; or normal import related credits. Public debt issued in foreign currency shall be valued in in local currency using the program exchange rates.

13. For the purposes of this TMU, the definition of debt is set out in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements (Executive Board’s Decision No.15688-(14/107). The definition also refers to commitments contracted or guaranteed for which value has not been received. The definition of debt is as follows:

- For the purpose of these guidelines, 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.

14. 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.

VI. MONETARY POLICY CONSULTATION CLAUSE

15. The quarterly 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 4 below.

- If the observed average for the latest three months of the 12-months rate of CPI inflation falls outside the lower or upper bands specified in the TMU Table 4 below for the end-June 2018 test date, 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.

	2018 Apr.- Jun. Target
Upper band	7.5
<i>Center point</i>	5.0
Lower band	2.5

VII. INDICATIVE TARGET ON THE NET DOMESTIC ASSETS OF THE CENTRAL BANK OF KENYA

16. **Net domestic assets (NDA)** are defined as reserve money minus NIR converted in shillings at the accounting exchange rate specified in TMU Table 3, plus medium- and long-term liabilities (i.e., liabilities with a maturity of one year or more) of the CBK; minus the value in shillings of encumbered reserves converted at the accounting exchange rate specified in TMU Table 3.

- NDA is composed of:
 - net CBK credit to the national government;
 - outstanding net credit to domestic banks by the CBK (including overdrafts); and
 - other items net.
- Reserve money is defined as the sum of:
 - currency in circulation; and
 - required and excess reserves.
- The following **adjustors** will apply to the target for NDA:
 - if budgetary support (external grants and loans) and external commercial debt exceed the programmed amounts, the target for NDA will be adjusted downward by half of the difference; and
 - if budgetary support (external grants and loans) and external commercial debt fall short of the programmed amounts, the target for NDA will be adjusted upward by the difference.

17. NDA are monitored in shillings, and will be computed as the daily average for the month when the testing date is due.

VIII. INDICATIVE TARGET ON NATIONAL GOVERNMENT DOMESTIC PENDING BILLS

18. For the purposes of the program, national government domestic pending bills are defined as outstanding invoices for which requisitions for payment have been received in Integrated Financial Management Information System (IFMIS) but no corresponding release of funds from the exchequer account has taken place. The Indicative Target (ceiling) applies to the change in the total stock of bills that have been pending for 90 days or more.

IX. INDICATIVE TARGET ON PRIORITY SOCIAL SPENDING

19. 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;
- free primary education expenditure; and
- free secondary education expenditure

X. INDICATIVE TARGET ON GUARANTEES ISSUED BY THE NATIONAL GOVERNMENT

20. The guarantees issued by the national government include all guarantees extended by the national government to counties, public enterprises and all parastatal entities. All indicative targets are cumulative from July 1, 2016.

XI. DATA REPORTING

21. 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 5 below.

TMU Table 5. 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)	Monthly	Within 20 days after the end of the month.	CBK
Net nonbank financing of the national government	Monthly	Within 20 days after the end of the month.	National Treasury (NT)
Proceeds from privatization	Monthly	Within 20 days after the end of the month.	NT
Interest due and paid on domestic debt	Monthly	Within 20 days after the end of the month.	CBK
Interest due and paid on external debt	Quarterly	Within 4 weeks after the end of the quarter.	CBK
Disbursements of external concessional and non-concessional project loans, including securitization	Quarterly	Within 45 days after the end of the quarter.	NT
Disbursements of budget support loans	Quarterly	Within 45 days after the end of the quarter.	NT
Principal repayments due and paid on all external loans	Quarterly	Within 20 days after the end of the month.	CBK
Net proceeds from issuance of external debt	Monthly	Within 20 days after the end of the month.	CBK
Any exceptional financing (including rescheduled principal and interest)	Monthly	Within 20 days after the end of the month.	NT
Net changes in the stock of short-term external debt	Quarterly	Within 45 days after the end of the quarter.	NT
Net change in external arrears, including interest and principal, and penalties	Monthly	Within 45 days after the end of the quarter.	NT
2. Public debt			
Stock of Treasury Bills	Quarterly	Within 45 days after the end of the quarter.	NT
Total new issuance of Treasury Bonds	Quarterly	Within 45 days after the end of the quarter.	NT
Total new other domestic debt contracted or guaranteed	Quarterly	Within 45 days after the end of the quarter.	NT and CBK
Total new contracted external project loans	Quarterly	Within 45 days after the end of the quarter.	NT
Total other new contracted or guaranteed external concessional debt	Quarterly	Within 45 days after the end of the quarter.	NT and CBK
Total new Eurobond issuances	Quarterly	Within 45 days after the end of the quarter.	NT
Total new other non-concessional external debt contracted or guaranteed	Quarterly	Within 45 days after the end of the quarter.	NT and CBK
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

TMU Table 5. Summary of Data to Be Reported (concluded)			
Information	Frequency	Reporting Deadline	Responsible Entity
4. Official reserve liabilities			
Total outstanding liabilities of the CBK to the IMF excluding the SDR allocations.	Monthly	Within 20 days after the end of the month.	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 the end of the month.	CBK
Commitments to sell foreign exchange arising from derivatives.	Monthly	Within 20 days after the end of the month.	CBK
5. Net domestic assets			
Net CBK credit to the national government.	Monthly	Within 20 days after the end of the month.	CBK
Outstanding net CBK credit to domestic banks (including overdrafts).	Monthly	Within 20 days after the end of the month.	CBK
6. Other indicators			
Currency in circulation.	Monthly	Within 20 days after the end of the month.	CBK
Required and excess reserves	Monthly	Within 20 days after the end of the month.	CBK
Concessional and non-concessional medium- and long-term external debt contracted or guaranteed by the national government and CBK	Quarterly	Within 45 days after the end of the quarter.	NT
Accumulation of national government external payment arrears	Monthly	Within 45 days after the end of the quarter.	NT
Change in the stock of national government domestic bills pending for 90 days or more starting June 2016	Quarterly	Within 45 days after the end of the quarter.	NT
Social priority spending of the national government	Quarterly	Within 45 days after the end of the quarter.	NT
Grants to government entities and total subsidies.	Quarterly	Within 45 days after the end of the quarter.	NT
Guarantees issued by the national government to counties, public enterprises and all parastatal entities.	Monthly	Within 45 days after the end of the quarter.	NT
Inflows/outflows related to the SGR project.	Quarterly	Within 45 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 the end of the quarter.	CBK