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KENYA

March 2016

SECOND REVIEWS UNDER THE STAND-BY ARRANGEMENT AND THE ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY, AND REQUESTS FOR A NEW TWENTY-FOUR MONTH STAND-BY ARRANGEMENT, AND A NEW TWENTY-FOUR MONTH ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR KENYA

In the context of the Second Reviews Under the Stand-by Arrangement and the Arrangement Under the Standby Credit Facility, and Requests for a New Twenty-Four Month Stand-By Arrangement, and a New Twenty-Four Month Arrangement Under the Standby Credit Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 14, 2016 following discussions that ended on December 15, 2015, with the officials of Kenya on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement and Standby Credit Facility. Based on information available at the time of these discussions, the staff report was completed on March 1, 2016.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Kenya.

The documents listed below have been or will be separately released:

Letter of Intent sent to the IMF by the authorities of Kenya*
Memorandum of Economic and Financial Policies by the authorities of Kenya*
Technical Memorandum of Understanding*
*Also included in Staff Report

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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FOR IMMEDIATE RELEASE
March 14, 2016

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IMF Executive Board Approves New Arrangements for Kenya Totaling US$1.5 billion

The Executive Board of the International Monetary Fund (IMF) today approved a new SDR 709.259 million (about US$989.8 million) 24-month Stand-By Arrangement (SBA) and a SDR 354.629 million (about US$494.9 million) 24-month Standby Credit Facility (SCF) for Kenya, for a combined SDR 1.06 billion (about US$1.5 billion, or 196 percent of Kenya's quota).

The Executive Board also completed the second and final reviews under the previous SBA and SCF for Kenya. The SBA and SCF, initially for 12 months, with a combined total access of SDR 488.52 million (about US$688 million), were approved by the IMF's Executive Board on February 2, 2015 (see Press Release No. 15/29), and extended until March 15, 2016 on January 27, 2016.

The Kenyan authorities have indicated that they will continue to treat both arrangements as precautionary, and do not intend to draw on the new SBA and SCF arrangements unless exogenous shocks lead to an actual balance of payments need. Today's decision would make available SDR 542.8 million (about US$757.5 million), and the remainder in four tranches upon completion of semi-annual program reviews.

Following the Executive Board discussion on Kenya, Mr. Min Zhu, Deputy Managing Director and Acting Chair, said:

"Kenya's recent growth performance remains robust and the outlook is positive. Despite positive policy steps undertaken under the current Fund-supported program, the economy remains vulnerable to shocks, reflecting less favorable global financial market conditions, as well as continued security threats and potential extreme weather events. In this context, the new precautionary arrangements would provide a policy anchor for continued macroeconomic and institutional reform, and would help mitigate the impact of potential exogenous shocks if they were to materialize.

“The envisaged reduction of the fiscal deficit by 3 percent of GDP over the next two years through a well-balanced policy mix would maintain space for high-priority infrastructure investments and greater provision of health and education services in a sustainable manner. Continued public financial management reforms—aimed at upgrading efficiency, transparency and accountability, to complement the envisaged fiscal consolidation—are key to containing risks.

“The Central Bank of Kenya is committed to gradually reducing inflation to the mid-point of its target range (5+/- 2.5 percent). To achieve their inflation objective, the authorities will align the interbank rates with the policy rate and formally announce and implement an interest corridor, thereby strengthening the monetary policy transmission mechanisms in the context of a floating exchange rate regime.

“The authorities are taking actions to preserve financial stability. These include steps to strengthen micro and macro prudential stress testing and the capital adequacy assessment framework, and develop a legal and operational crisis management system.

“Continued improvement in the quality of macroeconomic statistics and strengthening the business climate will be key to promoting transparency and evidence-based policy making, and supporting inclusive growth.”

INTERNATIONAL MONETARY FUND

KENYA

March 1, 2016

SECOND REVIEWS UNDER THE STAND-BY ARRANGEMENT AND THE ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY, AND REQUESTS FOR A NEW TWENTY-FOUR MONTH STAND-BY ARRANGEMENT, AND A NEW TWENTY-FOUR MONTH ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY

EXECUTIVE SUMMARY

Precautionary arrangements: The Executive Board approved on February 2, 2015 a Stand-By Arrangement (SBA) and an arrangement under the Standby Credit Facility (SCF), originally for 12 months, with combined access of SDR 488.52 million (90 percent of quota)[1]. The first reviews, focusing on the policy response to external shocks, were completed on September 16, 2015. On January 26, 2016, these arrangements were extended until March 15, 2016 to provide more time for implementing structural and fiscal measures. The authorities have treated both arrangements as precautionary.

Performance under the current program. Although Kenya's macroeconomic performance remains robust, external shocks complicated achievement of some program's macroeconomic objectives**.** All end-September and continuous performance criteria (PCs) were met. Performance under the structural benchmarks was mixed.

New program. In light of persistent external risks and a weaker outlook, the authorities have requested continued program engagement with the Fund under new 24-month SBA and SCF (with access of 130.67 percent and 65.33 percent of quota, respectively). The authorities intend to treat both new arrangements as precautionary. Their economic program for 2016–18 envisages a growth friendly fiscal adjustment, further steps toward a modern inflation targeting framework and improved financial sector supervision and regulation, and measures aimed at improving macroeconomic statistics.

Staff views: The authorities demonstrated satisfactory track record in program implementation and policy adjustment to shocks. Their new 24-month program includes a comprehensive package of measures targeting a significant reduction in vulnerabilities, paving the way for an eventual exit from Fund arrangements. On this basis, the staff recommends completion of the second reviews under the current SBA and SCF and supports the authorities' request for the new 24-month SBA and SCF.

[1] In 2016, Kenya's quota increased from SDR 271.4 million to SDR 542.8 million. Ratios in this report are calculated relative to the new quota.

Approved By
Roger Nord (AFR) and Chris Lane (SPR)

Discussions were held in Nairobi during December 2–15, 2015. The staff team comprised Messrs V. Kramarenko (head), E. Alper, N. Hobdari (all AFR); D. Moore (SPR); C. Abdallah (FAD); G. Gasha (MCM), and A. Remo (RES). Mr. R. Morales (Resident Representative) participated in the discussions and Ms. R. Ngugi (OED) joined the mission. The mission met with Cabinet Secretary to the Treasury Henry Rotich, Central Bank of Kenya (CBK) Governor Patrick Njoroge, as well as other senior government officials, members of the CBK Monetary Policy Committee (MPC), and representatives of the private sector, youth organizations, and the donor community.

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CONTEXT

1. **On February 2, 2015, the Executive Board approved the 12-month SBA and SCF, which the authorities have treated as precautionary.** The blended arrangement has provided insurance against potential exogenous shocks that could have led to balance of payments need while helping anchor pro-growth macroeconomic and institutional reforms.

2. **The First Reviews under the SBA and SCF, completed in September 2015, focused on policy measures to address external shocks.** The tapering of capital inflows and a major terrorist attack adversely affected foreign exchange inflows and growth. The authorities allowed for some exchange rate depreciation and used reserve buffers to contain volatility. On the fiscal front, the authorities took additional revenue measures to partly offset revenue shortfalls. The fiscal deficit and reserve targets were adjusted to reflect the impact of shocks.

3. **In response to significant external shocks in 2015, Kenya tightened economic policies and continued to treat the arrangements as precautionary.** Pressures on foreign exchange and money markets have now subsided, access to domestic fiscal financing has improved, and the authorities have been able to recoup part of the international reserves drawdown. Additional foreign borrowing also helped stabilize budgetary financing and improve the international reserves position. The growth outlook remains robust, albeit weaker than before. However, inflation has increased, and fiscal and external buffers are lower.

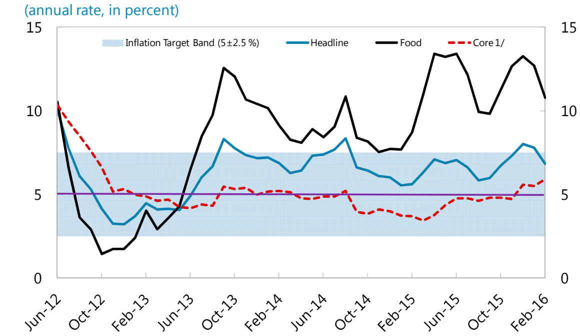
4. **In light of the weaker macroeconomic outlook and continued external risks, the authorities requested new 24-month SBA and SCF, which they will again treat as precautionary**. Discussions on the second reviews under the current 12-month SBA and SCF and the new program were combined. The policy dialogue focused on policies that will balance the authorities' objectives of sustaining inclusive, investment-driven growth while maintaining public debt sustainability, reducing inflation, and increasing resilience.

RECENT ECONOMIC DEVELOPMENTS

5. **In 2015, the economy continued to expand robustly, although at a slower-than-projected pace.** Real GDP grew by an estimated 5.6 percent in 2015, driven by public infrastructure spending, buoyant credit growth, and strong consumer demand. But the growth acceleration in 2015 was slower than projected under the program, due mainly to delays in planned road infrastructure spending, weaker tourism receipts in the wake of an April 2015 terrorist attack, and volatile external financing conditions.

6. **Inflation has exceeded the upper bound of the authorities' target range (5±2.5 percent) since December**. The recent increase in inflation reflected waning base effects of lower oil prices,

Kenya: Recent Inflation Developments, 2012-2016
(annual rate, in percent)



Sources: Kenyan authorities and Fund staff estimates.
1/ Core inflation excludes, food, energy, and transportation.

continued demand pressures, a weaker currency, accommodative monetary policy until June 2015, and adverse weather. In addition, changes in excise taxes (effective as of December 1) are estimated to have contributed 0.4 percentage points to 12-month inflation since then.

7. The large current account deficit has started to decline, but financing flows and reserves have also fallen. The current account deficit for 2015 is estimated to have narrowed to 8.2 percent of GDP in 2015, from 10.4 percent in 2014, which is mainly explained by an estimated decline in oil-related imports of more than 2 percentage points of GDP. However, the decline in financial inflows more than offset the improvement in the current account balance against the background of volatile global markets, contributing to an acceleration of exchange rate depreciation. The CBK intervened between March 2015 and February 2016 on both sides of the market, which reduced exchange rate volatility and contained the pace of depreciation. Net foreign exchange sales during this period led to a decline in gross official reserves from US$7.9 billion (4.8 months of imports) at end-2014 to US$7.5 billion (4.5 months of imports) in December 2015. The 12 percent depreciation of the Kenyan shilling against the U.S. dollar between January and December 2015 was modest by regional standards. Kenya's real effective exchange rate (REER) appreciated in real terms by 4 percent during 2015 (Figure 5), and its level is estimated to be moderately overvalued based on the External Balance Assessment "light" methodology.

8. Improvements to the business climate are becoming evident. Kenya was among the top 10 reformers in 2015 in the World Bank's Doing Business Survey, moving to 108th place (out of 189 countries) from 129th last year, with improvements especially in the provision of electricity, access to credit, and ease of registering property. At the same time, perception of corruption has increased.

PROGRAM PERFORMANCE

9. Taking into account the significant shocks affecting the economy, performance under the current program has been satisfactory. Adverse shocks to the economy caused growth to be lower in 2015 than initially projected by an estimated 1.3 percent of GDP. The slower-than-projected economic growth in turn contributed to a higher-than-initially projected fiscal deficit (by 1 percent of GDP) in 2014/15. International reserves declined but remained adequate at 4.5 months of imports at end-December 2015, broadly consistent with the initial program target, in part reflecting lower imports.

Kenya: Program Performance under the 12-Month SBA and SCF, 2015

	2015		
	Prog.	1st Rev.	Prelim.
Real GDP growth (percent)	6.9	6.5	5.6
CPI inflation, average (percent)	5.2	6.4	6.6
CPI inflation, eop (percent)	5.4	6.4	8.0
Overall fiscal balance (percent of GDP) [1]	-7.6	-8.4	-8.6
Current account balance (percent of GDP)	-7.3	-9.8	-8.2
Gross international reserves (months of imports)	4.4	4.0	4.5

Sources: Kenyan authorities and IMF staff estimates and projections.
[1] Fiscal years (e.g., 2015 refers to FY 2014/15).

- **Quantitative targets.** All end-September and continuous PCs were met (Appendix I, Table 1). The end-September quantitative indicative targets were met. The end-December quantitative targets were also met, with the exception of the end-December indicative target on social spending missed by a small margin (0.1 percent of GDP). This deviation is temporary, and it is expected that the fiscal year's target will be met.

- **Monetary policy consultation clause and inflation objective.** Although the current program's monetary policy consultation clause (for end-September 2015 test date) was not triggered, inflation has risen in recent months and exceeded the upper bound of the authorities' target range since December 2015. Accommodative monetary policy and fiscal expansion largely explain the headline inflation running around 6.5–7.0 percent in the last 2½ years, compared with the mid-point of the inflation target range of 5 percent. Against this background, the recent supply shocks and the increased excises contributed to the overshooting of the target range.

- **Structural reforms.** Four out of six structural benchmarks were completed (Appendix I, Table 2). The implementation of the structural benchmarks laid the preconditions for a stronger, more independent CBK with clearer policy objectives, enhanced analytical capacity at the CBK, improved cash and public debt management, more transparent fiscal operations, and better quality external sector data that will allow for a better assessment of private sector vulnerabilities. Although two structural benchmarks were not completed, significant progress towards their achievement was made (MEFP ¶16): (i) a list of assets and liabilities by counties is ready for all but one of the 47 counties and the auditing is expected to start in July 2016;[2]

[2] Liabilities from pre-devolution local authorities amount to about 1 percent of GDP—a level that is not considered macro-critical.

and (ii) all but one envisioned steps under the Treasury Single Account (TSA) reform were completed; and the inclusion of debt service payments in Integrated Financial Management Information System (IFMIS) is expected in September 2016 (structural benchmark under the new program).

OUTLOOK AND RISKS

10. There was broad agreement that a more challenging external environment warranted a revision of the program's baseline outlook (Tables 1–4). Real GDP growth is projected to accelerate to 6 percent in 2016 (albeit below the initial projection of 6.8 percent), mainly on account of higher growth in agriculture from better rains, and an expected recovery of tourism following the recent removal of travel warnings by several main tourism source markets. Growth is expected to pick up further after 2016, supported by continued improvements in the business environment, modernized and expanded transport and energy infrastructure, and regional integration. However, the authorities and staff agreed to revise downwards medium-term potential growth by about ½ percent (to 6½ percent), as tighter external and domestic financing conditions will reduce private and public investments relative to earlier forecasts. Inflation is expected to remain above the target range's upper bound (7.5 percent) in the coming months. Based on policy commitments outlined below, inflation is expected to fall below 7.5 percent by mid-2016, and to converge gradually towards the mid-point of the target range.

Kenya: Macroeconomic Outlook, Baseline[1], 2014-18

	2014	2015		2016		2017		2018	
	Act.	1st Rev.	Est.	1st Rev.	Proj.	1st Rev.	Proj.	1st Rev.	Proj.
Real GDP growth (percent)	5.3	6.5	5.6	6.8	6.0	7.0	6.1	7.0	6.5
CPI inflation, average (percent)	6.9	6.4	6.6	5.9	6.6	5.1	5.7	5.0	5.1
CPI inflation, eop (percent)	6.0	6.4	8.0	5.3	5.8	5.0	5.5	5.0	5.0
Current account balance (percent of GDP)	-10.4	-9.8	-8.2	-9.7	-8.0	-7.4	-6.7	-6.9	-6.6
Overall fiscal balance (percent of GDP) [1]	-5.9	-8.4	-8.6	-8.0	-8.0	-6.2	-6.5	-4.5	-5.0
Gross international reserves (in billions of US$)	7.9	7.5	7.5	7.6	7.8	8.2	8.3	9.2	9.0
Gross international reserves (months of imports)	4.8	4.0	4.5	3.9	4.5	3.9	4.5	4.0	4.4
Total public debt (gross, percent of GDP)	48.1	52.2	51.2	53.4	53.1	53.0	54.4	51.8	54.0

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Fiscal years (e.g., 2015 refers to FY 2014/15).

11. The authorities and staff concurred that risks to the growth outlook are on the downside. A potential increase in volatility of capital flows represents the strongest downside risk. Other downside risks include residual security challenges, the uncertain impact of weather-related effects of El Nino on agriculture, pockets of vulnerabilities in the banking system, significant uncertainty about FDI in oil and gas exploration, and possible pressures for higher current and capital spending as the 2017 presidential elections approach.

POLICY DISCUSSIONS

12. Discussions focused on policies promoting sustainable, inclusive growth while reducing vulnerabilities. In light of a stronger-than-expected adverse impact of global financial conditions and a somewhat slower growth outlook, there was agreement on the need to rebalance the policy mix. During 2016/17–2017/18, the authorities intend to implement a fiscal adjustment of 3 percentage points of GDP, which would help reduce the burden on monetary policy in dealing with shocks, as well as put the present value of public debt on a trajectory towards 45 percent of GDP (in line with the East African Community (EAC) convergence criterion on debt levels) and support a further reduction in the current account deficit. Also, the authorities intend to press ahead with structural reforms aimed at increasing resilience to shocks, increasing the effectiveness of the government policies, and facilitating the achievement of their poverty reduction and economic modernization objectives.

A. Gearing Toward a Growth-Friendly Medium-Term Fiscal Consolidation

Recent Developments

13. Budget execution faced significant challenges in the first four months of 2015/16, but the fiscal situation is stabilizing. Revenue collection fell significantly short of program projections (by about 0.8 percent of GDP), reflecting lower-than-projected growth, persistent challenges in income tax and VAT collection, and a delay in approving new excise tax measures. Access to domestic financing was constrained during July–September, as a result of tight liquidity conditions and the government's reluctance to accept higher interest rates, which led to accumulation of pending bills. With the stabilization of liquidity conditions and the acceptance of higher rates, the Treasury borrowed about KSh 177 billion (2.5 percent of GDP) on a net basis during October–December. The Treasury has also substituted some of the planned domestic financing with foreign financing, by drawing in early November on a two-year syndicated loan of US$750 million (about 1.2 percent of GDP) at about 8 percent effective cost. An additional $600 million is expected to be borrowed from a bilateral creditor in 2016. Following the stabilization of financing flows, the government has resumed normal implementation of its expenditure program and is settling outstanding pending bills.

Policy Discussions

14. The authorities are committed to maintaining the fiscal deficit at 8 percent of GDP in 2015/16. In addition to the revenue shortfall of 0.8 percent of GDP, expenditure overruns are estimated to be about 0.3 percent of GDP in 2015/16 mainly due to higher domestic interest rates and the shilling depreciation. The authorities intend to close the fiscal gap of 1.2 percent of GDP by adopting a supplementary budget envisaging a reduction in current spending (0.4 percent of GDP), as well as a reduction of lower-priority development spending (0.8 percent of GDP) (MEFP ¶14).

15. There is a downside risk to tax revenue in the second half of 2015/16 that the authorities will mitigate through contingency planning. In the event that cumulative revenues through end–March 2016 fall short of target, the authorities will reschedule new investment projects to fully offset the shortfall (MEFP ¶14).

16. The programmed deficit reduction of 3 percentage points of GDP between 2015/16 and 2017/18 requires additional new measures. The completion of the first phase of the Standard Gauge Railway (SGR) project (Mombasa-Nairobi) would contribute to a 1.8 percent of GDP reduction in the targeted overall deficit. The authorities intend to achieve the remaining 1.2 percent of GDP deficit reduction through a package of revenue and expenditure measures, in the context of a growth-friendly fiscal adjustment that aims at maintaining the sizable envelope for infrastructure projects (MEFP ¶11), which also includes the SGR Phase II (Nairobi-Naivasha).

- **Revenue measures.** The authorities intend to focus their revenue measures on broadening the tax base and improving tax administration. Revenue measures under consideration include a reduction in tax expenditures, acceleration in the process of collecting large outstanding tax debts, an improvement in customs administration and income tax collection procedures, and a strengthening of the revenue-earning potential of counties (structural benchmark).

- **Expenditure measures.** The authorities are committed to increase the effectiveness and efficiency of public spending. In their view, focusing on savings on recurrent expenditures while prioritizing investment projects will help realize significant savings without jeopardizing the achievement of the developmental outcomes. Expenditure measures under consideration include streamlining of pay and allowances for civil servants; rationalizing spending on goods and services; and adopting stricter project selection, appraisal, and monitoring procedures to generate higher value for money.

17. The authorities continue their technical work on quantifying the potential fiscal impact of the above-mentioned measures. The first phase of this work is expected to be completed in May 2016, at the time of the finalization of the budget for 2016/17 in close consultation with the staff. The fiscal impact of the remaining measures will be completed by early 2017 and incorporated in the 2017/18 budget.

18. The authorities and staff agreed on Public Finance Management (PFM) reforms aimed at improving the efficiency of government spending and strengthening expenditure control to mitigate fiscal risks. Measures center on the following outcomes (MEFP ¶16): more effective use of IFMIS**,** improved internal controls to prevent expenditure arrears, enhanced fiscal reporting, and more transparent procurement procedures.

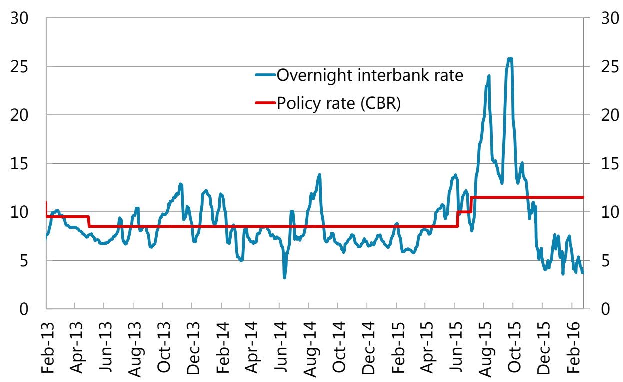
B. Maintaining Price Stability in the Face of Volatile External Flows

Recent Developments

19. The significant capital account shock and emerging financial stability concerns have tested the CBK's interest-rate based monetary policy framework (Figure 2, Table 5).

- **The April–September 2015 period** was characterized by foreign exchange pressures stemming from tapering of capital inflows. The CBK tightened monetary policy sharply out of concerns about excessive exchange rate depreciation and its pass-through effects on inflation. It increased the policy interest rate (CBR) by 300 bps to 11.5 percent, sold foreign exchange, mopped up liquidity through other operations, and restricted banks' access to the overnight discount window. The resulting liquidity squeeze curbed the exchange rate depreciation, but at the expense of a significant increase in the level (up to 26 percent) and volatility of the interbank interest rates.

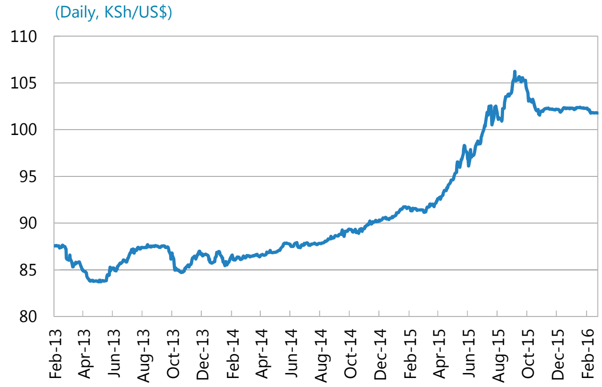
Kenya: Policy Rate and Interbank Rate, 2013-2016
(in percent)



Sources: CBK.

- **The October 2015–February 2016 period** witnessed easing foreign exchange market pressures and emerging financial stability concerns (¶26). Against this backdrop, the CBK loosened its de facto monetary policy stance (as measured by the interbank interest rate). It purchased foreign exchange, reopened the discount window, and engaged in reverse repo operations to support banks experiencing liquidity pressures. Combined with the liquidity impact of the government's drawing under the syndicated loan (¶13), interbank interest rates fell precipitously.

Kenya: Exchange Rate Developments, 2013-2016
(Daily, KSh/US$)



Sources: CBK, staff calculations

Policy Discussions

20. Discussions on the inflation outlook focused on the relative weights of demand and supply factors. The staff argued that inflation risks remain elevated in the near term, reflecting (i) continued demand pressures, including from the fiscal impulse in 2015/16 and still-buoyant credit growth (about 18 percent at end-December 2015); and (ii) possible second-round effects of previous exchange rate depreciation and supply shocks as reflected in rising non-food non-fuel inflation (Figure 2 and Annex I). The CBK, however, is of the view that the recent pickup in inflation reflects mostly temporary supply shocks whose impact on the 12-month inflation rate should subside after April 2016 (MEFP ¶18), and that recent oil price declines would also help lower inflation.

21. Notwithstanding some differences in the assessment of the near-term inflation outlook, the CBK and the staff agreed on the importance of gradually re-aligning the interbank interest rate with the policy rate to achieve the inflation objective. The staff indicated that despite some action to mop-up liquidity since late December 2015, the interbank interest rate (4.0–7.5 percent), which is a better gauge of the monetary policy stance than the CBR, has been negative in real terms. The CBK argued for a cautious approach to the re-alignment of the interbank interest rates with the CBR because of the time needed to improve money markets and avoid liquidity shocks in light of recent liquidity stresses in smaller banks (¶26). The CBK also underscored that it would remain vigilant and stood ready to tighten monetary policy more decisively if clearer evidence of demand pressures emerged and the inflation outlook worsened (MEFP ¶18). The CBK was confident that the inflation target range for June 2016 under the program's monetary policy consultation clause was within reach. While the staff agreed with the gradual approach to re-aligning the interbank interest rate with the CBR,[3] it cautioned that delays in starting the realignment process could entrench inflation expectations above the mid-point of the target range.

22. The CBK reiterated their commitment to a gradual transition to a modern inflation targeting framework. The staff underscored the importance of strengthening the role of the CBR by upgrading the coordination on cash and debt management with the Treasury, by conducting timely open market operations, as necessary, and by reviewing standing facilities. The CBK agreed to adopt a formal interbank interest rate corridor by September 2016 at the latest after strengthening the monetary policy transmission mechanism through reforms in money and credit market operations (MEFP ¶19).

23. The CBK emphasized its commitment to a floating exchange rate regime. The CBK's foreign exchange intervention policy intends to strike a balance between the need to bolster reserve buffers and smooth excessive exchange rate volatility. Staff is of the view that a gradual adjustment of the REER toward equilibrium would be facilitated by increasing credibility of the monetary policy framework, by implementing the targeted fiscal adjustment, and by adhering to the principles of a floating exchange rate arrangement (Table 2).

[3] The staff's model-based projections (Annex I) suggest that a gradual re-alignment of the interbank interest rate with the CBR in the near term would be sufficient to reduce inflation below 7.5 percent by mid-2016.

C. Reducing Financial Sector Vulnerabilities

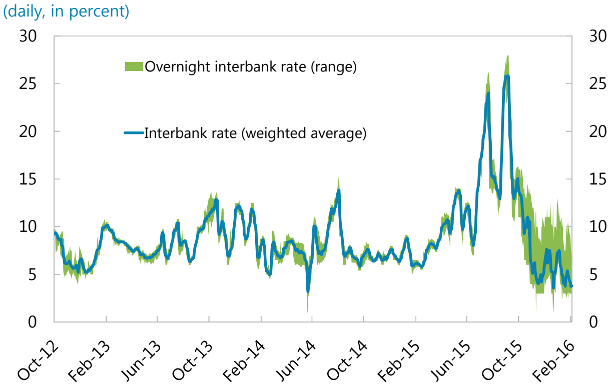
Recent Developments

24. Financial indicators remain sound overall but there are pockets of vulnerabilities. The latest financial soundness indicators suggest that banks remain well-capitalized and that non-performing loans (NPLs) stabilized at about 6 percent of total gross loans; and although provisions remained broadly adequate at about 2/3 of NPLs, they have declined somewhat since early 2015 (Table 5, Figure 5). The average liquidity ratio for the banking system has declined somewhat in recent months, but has remained adequate. At the same time, the system-wide indicators should be interpreted with caution in light of rapid credit growth over the last three years (Figure 2), the recent intervention in two banks (¶25), and an episode of liquidity stress in smaller banks (¶26).

25. The authorities have recently put two small non-systemic banks under receivership. In both cases, the Kenya Deposit Insurance Corporation (KDIC) was appointed as receiver. The smaller of the two banks (0.1 percent of total bank assets) was intervened for serious liquidity and capital deficiencies reasons, and is already put under liquidation. For the second bank (1.8 percent of total bank assets), initial findings suggest violations of statutory limits and inadequate loan-loss provisions.

26. An episode of liquidity stress affected some small banks during October–November 2015. Smaller-size banks suffered loss of wholesale deposits following a "flight-to quality" reaction to the news of the second bank's placement under receivership. This shift was compounded by an increasing segmentation of the interbank market, intensifying liquidity stress in these banks. The CBK acted swiftly by providing the needed liquidity to the affected banks helping stabilize their liquidity positions.

Kenya: Interbank Market Rates, 2012-2016
(daily, in percent)



Sources: CBK, staff calculations.

Policy Discussions

27. Staff and the authorities concurred that risks to the banking system warrant increased monitoring. Risks requiring particular attention in the view of the staff and the CBK are credit and liquidity risks, as well as risks associated with potential shocks to interest and exchange rates in light of heightened instability in global markets.

28. The CBK plans to strengthen banking supervision and regulation to address emerging risks. The CBK intends to assess banking system vulnerabilities by completing the first round of improved banks' stress tests. Based on this assessment, the authorities plan to take necessary actions, including requirements to raise banks' capital when appropriate, and maintain adequate provisions relative to NPLs. The CBK also aims to continue efforts to strengthen the banking sector's regulatory framework based on a recent MCM needs assessment mission with a focus on financial stability. Based on this review, the CBK will prepare an action plan, whose key measures will be reflected in program objectives during subsequent program reviews (MEFP ¶24). Furthermore, the CBK is committed to effectively implementing a risk-based approach to the anti-money laundering and combating of terrorism financing (AML/CFT) supervision.

STRUCTURAL REFORMS AND DATA PROVISION AND QUALITY: SUPPORTING BUSINESS ENVIRONMENT AND POLICY MAKING

29. The authorities' structural reform agenda is centered on further progress in strengthening the business climate. It envisages the implementation of the recently approved Companies Act, which simplifies business requirements, and the Insolvency Act, which allows distressed companies to reorganize themselves prior to liquidation. Further improvements in the automation and simplification of Government services are envisaged (MEFP ¶26).

30. The authorities have made further progress towards improving macroeconomic statistics, especially on the external sector (MEFP ¶28). In September 2015, the Kenya National Bureau of Statistics (KNBS) published Foreign Investment Survey (FIS) data for 2012 and 2013. The KNBS will draw on the FIS to revise historical data on the balance of payments, notably for the financial account, and also to produce first estimates of the International Investment Position statement by end-June 2016. Furthermore, the KNBS began work on the Household Budget Survey in September 2015, with a view to publishing the results by early 2017 (MEFP ¶28).

31. The authorities are also making progress on their commitment to improve the timeliness and quality of fiscal reporting (MEFP ¶28). In its Quarterly Budget and Economic Review (QBER) for the first quarter of 2015/16, the National Treasury published its first estimates for the national government for 2012/13-2015/16 consistent with the methodology of the Government Finance Statistics (GFS) Manual. Steps are being taken towards publishing quarterly consolidated GFS-compliant fiscal accounts for the national government and for county governments in the near future (MEFP ¶28).

ADVERSE SCENARIO AND NEW PROGRAM MODALITIES

32. Kenya remains vulnerable to shocks that could have a significant adverse impact on the economy, the balance of payments, and international reserves. Kenya does not face a financing gap under the baseline scenario, despite a narrower international reserve buffer. Weather and security-related shocks remain possible, although the latter seems to have diminished relative to those at the time of the original request (IMF Country Report No. 15/31). Higher rainfall (El Niño) could boost agricultural production in the short term, and several countries representing key tourism markets have eased travel advisories. But the weaker external environment and more volatile global financial markets have increased the risk of potential capital account shocks. Kenya could be vulnerable to such shocks in view of its sizeable current account deficit, which is largely financed by non-FDI inflows, and its increased integration into global capital markets.

33. An adverse shock scenario simulates a temporary shock to the financial account of the balance of payments during 2016–17. In the event of another bout of instability in global markets, possibly related to the on-going tightening of the U.S. monetary policy or adverse developments in emerging or frontier markets, net capital inflows could be significantly lower than projected under the baseline and adversely affect Kenya's economy. In the adverse scenario, the staff simulated plausible shocks of medium severity (text table and Table 6). As a result of these shocks, net capital inflows could be lower by some $5 billion over the next two years. Portfolio inflows into both equity and debt could be lower by some $3 billion, taking into account significant sensitivity of such flows to global market conditions. Other short-term inflows to Kenya could also decline by $0.6 billion (in line with the experience of emerging markets, a 90-percent roll-over rate is assumed). Finally, FDI projects, which investors finance in global markets, could also be negatively affected, resulting in an estimated decline of $1.2 billion. The lower capital inflows would result in lower imports and investment, which would in turn translate into slower growth and lower reserves. Even assuming a policy adjustment and the related import compression, reserve cover could fall to 3 months of imports in 2017, with the trajectory for reserves undermining confidence.

34. Under the adverse scenario, the authorities intend to respond with corrective policies to safeguard macroeconomic stability and maintain debt sustainability.

- The projected impact of the simulated shock of about $5 billion would be partly offset by the likely compression of the current account deficit of $1.9 billion. Without the proposed Fund financing amounting to $1.5 billion, gross official reserves would be $3.1 billion lower than under the baseline scenario by end-2017. Because the shock arises from the financial account, no balance of payments support from other institutions is assumed.

Box 1. Kenya: Potential Impact of Exogenous Shocks, 2016–17

(in billions of U.S. dollars, relative to baseline, unless otherwise indicated)

	2016	2017	2016–17
Simulated impact: capital flow slowdown[1]	-2.8	-2.0	-4.9
FDI	-0.8	-0.4	-1.2
Portfolio investment	-1.7	-1.3	-3.1
Short-term	-0.3	-0.3	-0.6
Excluding IMF and partner financing			
Current account improvement[2]	0.7	1.2	1.9
Level of reserves (2015: 7.5)[3]	5.6	5.3	
In months of prospective imports (2015: 4.5)	3.4	3.0	
Financing gap	0.8	0.7	1.5
Development partners (uncertain)	0.0	0.0	0.0
IMF program (US$ billion)[4]	0.8	0.7	1.5
In percent of quota[4]	111	86	196
Level of reserves with financing[4] (2015: 7.5)	6.4	6.8	
In months of prospective imports (2015: 4.5)	3.9	3.8	

[1] Channels include FDI, portfolio investment, and short-term flows.
For FDI, assumes decline of net FDI from 1.7 percent of GDP in 2015, to 1.2 percent in 2016. For short-term flows, based on rollover rate of 90 percent for private short-term (around 25th percentile), applied to estimated short-term private debt stock for 2015.

[2] Because the valuation effects of the assumed REER depreciation on GDP dominate the trade volume effects and the shock is temporary, only modest improvement in the external current account deficit relative to GDP is projected during 2016-17, despite a significant improvement in the current account deficit in U.S. dollar terms.

[3] After direct and indirect effects, including the impacts of depreciation and import compression.

[4] Includes final SBA-SCF disbursement (less than $0.1 billion) scheduled for March 2018.

Box 2. Kenya: Macroeconomic Outlook, Adverse Scenario, 2015–17

	2015	2016		2017	
	Est.	Baseline	Adverse	Baseline	Adverse
Real GDP growth (percent)	5.6	6.0	2.5	6.1	5.0
CPI inflation, average (percent)	6.6	6.6	7.6	5.7	6.9
CPI inflation, eop (percent)	8.0	5.8	7.3	5.5	6.5
Current account balance (percent of GDP) [1]	-8.2	-8.0	-7.7	-6.7	-6.0
Overall fiscal balance (percent of GDP) [2]	-8.6	-8.0	-8.1	-6.5	-6.7
Structural overall fiscal balance (percent of GDP) [2]	-8.6	-8.0	-7.6	-6.5	-5.8
Gross international reserves (in billions of US$) [3]	7.5	7.8	6.4	8.3	6.8
Gross international reserves (months of imports) [3]	4.5	4.5	3.9	4.5	3.8
Total public debt (gross, percent of GDP)	51.2	53.1	56.6	54.4	60.6

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Because the valuation effects of the assumed REER depreciation on GDP dominate the trade volume effects and the shock is temporary, only modest improvement in the external current account deficit relative to GDP is projected, despite a significant improvement in the current account deficit in U.S. dollar terms during 2016-17.

[2] Fiscal years (e.g., 2015 refers to FY 2014/15).

[3] Assuming full drawings under the program as shown in Table 7.

- The CBK stands ready to tighten monetary policy in the context of a floating exchange rate regime. The REER is projected to be more depreciated by end-2017 under the adverse scenario than under the baseline scenario.

- It was agreed that fiscal policy would help mitigate the impact of the shocks, by reprioritizing spending to cushion vulnerable groups and to preserve high-priority public investment programs. While the room for a faster-than-targeted fiscal tightening is limited by the devolution effort mandated by the Constitution and the pressing need to upgrade Kenya's infrastructure, the authorities concurred that some additional fiscal measures would be inevitable (including cuts in goods and services spending and a postponement of new capital investment projects). This would help reduce the burden on monetary policy and facilitate domestic demand adjustment in response to external shocks. The cyclically adjusted fiscal deficits under the adverse scenarios are estimated to be about ¾-1 percent of GDP lower in 2016/17 and 2017/18 than under the baseline scenario.

A. Access and Phasing

35. To guard against potential external shocks, the staff proposes the following length and access under the new precautionary program:

- **Length**. The new 24-month SBA and SCF arrangements would continue to cover plausible prospective financing needs and would provide an uninterrupted anchor to the authorities' policies through March 2018. The authorities plan to treat the new arrangements as precautionary. Successful program implementation under the new arrangements would significantly reduce external vulnerabilities and the likelihood that a balance of payments need would arise, paving the way for an eventual exit from program engagement.

- **Access**. The desirable level of access should provide enough room for Kenya to undertake all the necessary additional adjustment measures (¶34) without putting an undue burden on domestic activity, jeopardizing socially-oriented expenditure, and undermining social cohesion. Taking into account these factors and the authorities' satisfactory track record in program implementation and their demonstrated willingness to adjust policies in response to shocks, as well as increased potential balance of payment need, staff supports access of 130.67 percent of quota (or SDR 709.259 million) under the new precautionary SBA and 65.33 percent of quota (or SDR 354.629 million) under the new precautionary SCF. To preserve continued insurance against potential shocks leading to a balance of payments need, the initial access upon approval of the new SBA and SCF will total 100 percent of quota (of which 66.7 percent of quota under the new SBA and 33.33 percent under the new SCF) to ensure adequate financing in case of a sudden, large shock.

B. Implementation of Safeguards Recommendations

36. An updated safeguards assessment of the CBK was completed in May 2015. The assessment concluded that the CBK continued to maintain effective operational controls and that the draft CBK Bill, which has been submitted to Parliament, would strengthen the bank's legal framework once enacted. A majority of the assessment's recommendations, including those to strengthen the bank's internal audit and financial reporting practices, and its legal framework, have been implemented. However, the assessment's recommendation to reconstitute a quorate CBK Board remains outstanding. This will require a parliamentary approval of a sufficient number of non-executive directors to establish a quorate Board.

C. Program Conditionality and Monitoring

37. The new SBA and SCF will be monitored with semi-annual reviews. On the quantitative side, performance will be assessed against semi-annual PCs (June 2016 and December 2016 test dates), indicative targets in intervening quarters (March 2016 and September 2016), and a continuation of the monetary policy consultation clause (Appendix I, Table 3). A number of macro-critical structural measures are included in the list of structural benchmarks during 2016 (Appendix I, Table 4). The first review will focus on the implementation of the budget for 2016/17 and fiscal structural reforms, the establishment of a corridor for the interbank interest rate, near-term inflation risks, and follow-up measures in the financial sector supervision and regulation.

D. Capacity to Repay the Fund and Risks to the Program

38. In addition to the risks to the outlook (¶11), there are a number of program-specific risks. These include fiscal risks from devolution complicating additional fiscal adjustment that could be needed in case of a shock and a possible drawing under the program before initiating the required policy adjustment (¶34) in response to a shock. Mitigating factors include structural measures related to the devolution, legislated debt ceilings on counties, a track record of satisfactory performance in the face of shocks under the current arrangements, and market discipline that would make it costly to draw on Fund resources prematurely without the necessary adjustment of policies.

39. Kenya's capacity to repay the Fund remains strong. Although Kenya has significant current PRGT obligations to the Fund (112 percent of quota at end-2015), the proposed access—which the authorities plan to treat as precautionary—will not affect significantly the level of total debt. Consistent with the findings of the updated debt sustainability analysis (Annex II), Kenya remains at low risk of external debt distress, albeit with lower buffers than previously in view of the authorities' plans for further externally financed infrastructure projects and lower growth.[4]

[4] Kenya's risk of external debt distress remains low also under the adverse scenario.

These narrowing buffers highlight the need to follow through on the intended medium-term fiscal consolidation.

40. Successful implementation of the proposed program would improve prospects for exiting Fund arrangements. The program's fiscal and structural measures should underpin lower fiscal deficits, a convergence of the current account deficit with Kenya's medium-term norm, a strengthening of the monetary policy framework, and maintenance of a sufficient reserve buffer. The achievement of these milestones would translate into an increased resilience to external shocks, significantly reducing the likelihood of balance of payments need.

STAFF APPRAISAL

41. Kenya's economy has maintained robust growth momentum despite headwinds from global developments. Supported by higher public infrastructure spending, buoyant credit growth, and strong consumer demand, real GDP growth has picked up in 2015. Even so, the tapering of capital inflows and the April 2015 terrorist attack dampened growth, while also contributing to pressure on the exchange rate, reserves, and domestic fiscal financing.

42. Policy responses to shocks in 2015 were largely appropriate, taking into account the evolving nature of policy frameworks. On monetary policy, actions by the CBK contributed to stabilizing the foreign exchange market and maintaining financial stability. However, the significant increase in volatility of short-term interest rates has weakened the relevance of the CBR. With respect to fiscal policy, excise increases, spending cuts, and front-loading of external borrowing offset revenue shortfalls and helped stabilize the budgetary cash flow and international reserves. The authorities maintained adequate reserves and continued to treat the program as precautionary in the face of the significant shocks. Thanks to the authorities' determined actions, economic conditions have largely stabilized.

43. Although the macroeconomic outlook is positive overall, the economy remains vulnerable to shocks. Supported by continued improvements in the business environment, modernized and expanded transport and energy infrastructure, and regional integration, growth is projected to average 6.5 percent over the medium term. However, downside risks remain, reflecting growing integration in global markets that exposes Kenya to changing global liquidity conditions, and continued security threats that could adversely affect investor sentiment. Kenya also remains vulnerable to weather-related shocks. While efforts are underway to address vulnerabilities to these shocks, the payoff will take time, in a context of constrained fiscal space and lower international reserve buffers.

44. Fiscal consolidation is key to buttress macroeconomic stability. The authorities' commitment to reduce the fiscal deficit by 3 percentage points of GDP over the next two fiscal years—as part of a well-balanced policy mix—is crucial to alleviate current demand pressures, reduce financing risks, and to limit and eventually reverse the increase in public debt ratios. Staff supports the authorities' program aimed at creating fiscal space for high-priority infrastructure investments and greater provision of health and education services, which are essential ingredients of inclusive growth.

45. Public financial management reforms aimed at upgrading efficiency, transparency and accountability are essential for the credibility of the envisaged fiscal consolidation. The authorities' commitments to strengthen expenditure control and improve the efficiency of public spending are welcome and necessary to free fiscal space for priority social and investment projects and to improve governance in the public sector.

46. Strengthening the monetary policy transmission mechanism is an important priority to achieve the program's inflation target and make further progress in the transition to a modern forward-looking monetary policy framework. Staff welcomes the CBK's commitment to align gradually the interbank rates with the CBR and formally announce and implement an interest rate corridor. Near-term inflation risks should be closely monitored; and the interbank interest rate should be aligned faster to the CBR, and the policy rate raised, if upside risks to inflation materialize. A closer alignment of the interbank rate with the CBR may lead to somewhat higher exchange rate volatility. Also, the exchange rate should play the role of a shock absorber in case of external shocks. In this regard, the CBK's commitment to a floating exchange rate regime is encouraging.

47. Emerging risks to financial stability need to be addressed expeditiously. The authorities' recent decisive actions—intervening two smaller banks and swiftly injecting liquidity to a group of small banks—to preserve financial stability are appropriate. The envisaged steps to further strengthen prudential regulation and supervision—including strengthening micro and macro prudential stress testing and the capital adequacy assessment framework, and developing a legal and operational crisis management system—will increase the authorities' capacity to monitor and address credit and liquidity risks, as well as risks associated with potential shocks to interest and exchange rates in light of heightened instability in global markets. Furthermore, the reconstitution of a quorate CBK Board is an important priority and should be finalized in a timely manner.

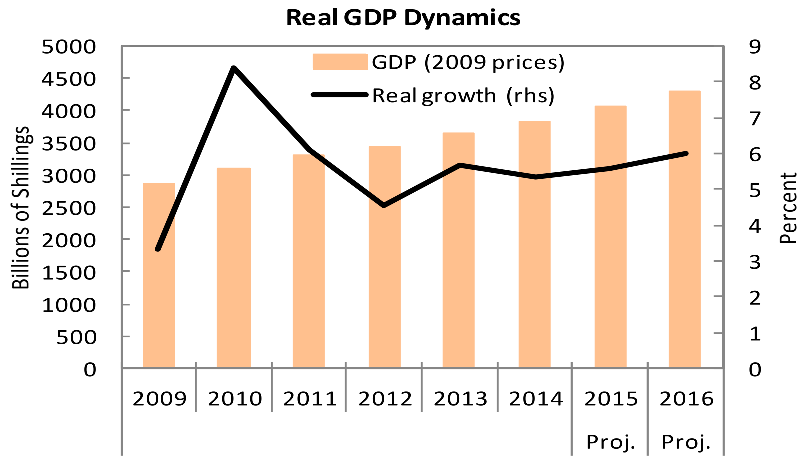
48. Further improvement in macroeconomic statistics is required to enhance the quality of policies and promote transparency. Publication of timely GFS-compliant estimates for the national government and the Foreign Investment Survey through 2013 are welcome steps to improve fiscal and external sector data. The planned improvement of the coverage and timeliness of fiscal and external sector data will promote transparency and evidence-based policy making.

49. The business climate needs to be further strengthened to support inclusive growth. Recent efforts to enhance the business climate, reflected in the World Bank latest assessment, are welcome. The improved legal framework for doing business, thanks to the recent approvals of the Companies and Insolvency Acts, will enhance flexibility in the business environment, helping companies to adapt more easily to changing circumstances.

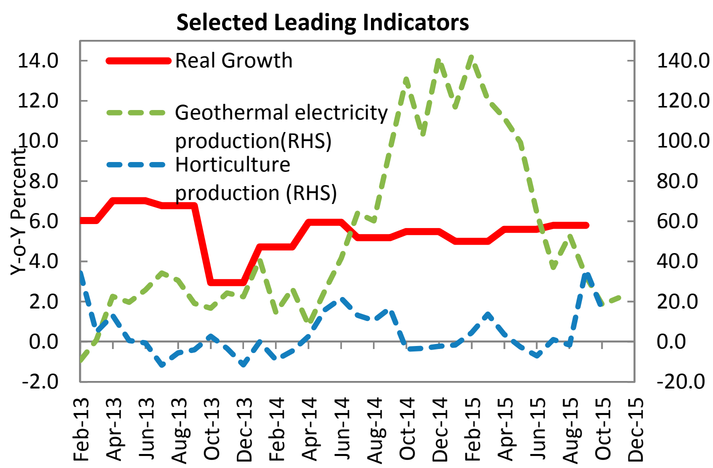
50. The staff recommends completion of the second reviews under the current SBA and SCF and supports the authorities' request for the new 24-month SBA and SCF and the cancellation of the existing arrangements. The economic program supported by the current and prospective precautionary SBA and SCF targets a significant reduction in vulnerabilities, paving the way for an eventual exit from Fund arrangements. The policies envisaged by the authorities would maintain a sustainable debt position, while preserving fiscal space to address bottlenecks and vulnerabilities, thereby enhancing growth prospects and accelerating poverty reduction.

Figure 1. Kenya: Real Sector

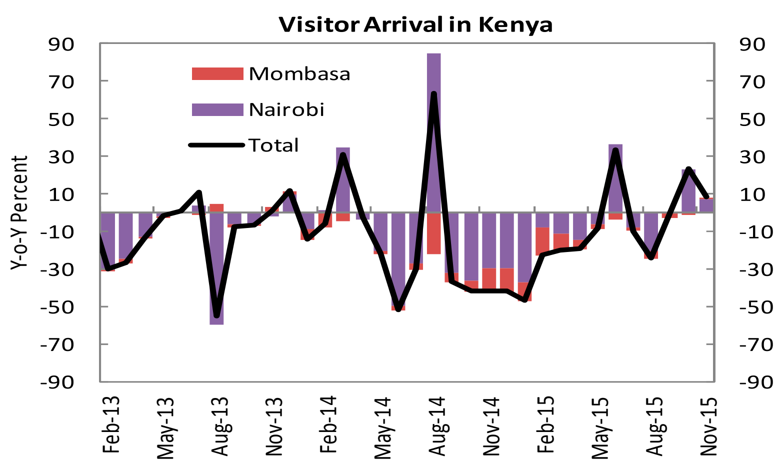
Growth has been robust….



... and high frequency indicators suggest persistent momentum...



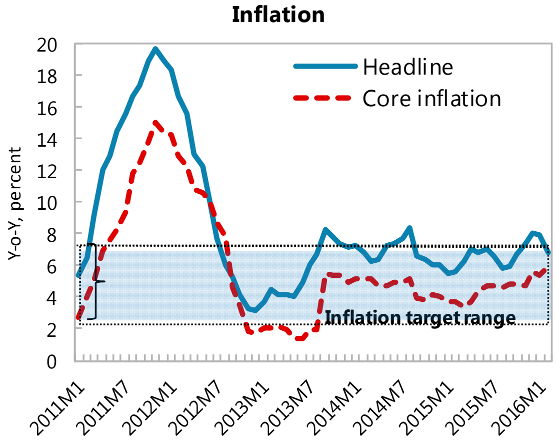
... and visitor arrivals show signs of recovery.



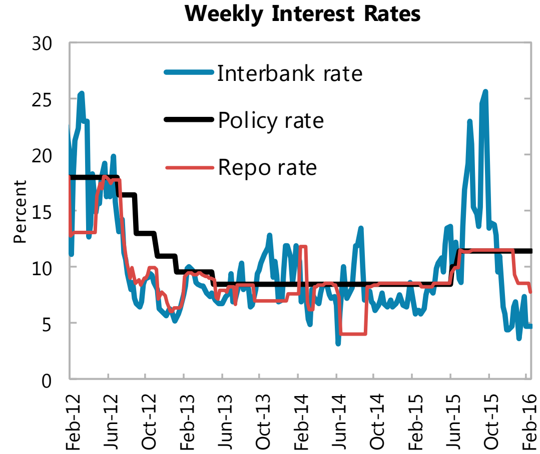
Sources: Kenyan authorities; and IMF staff estimates.

Figure 2. Kenya: Monetary Sector

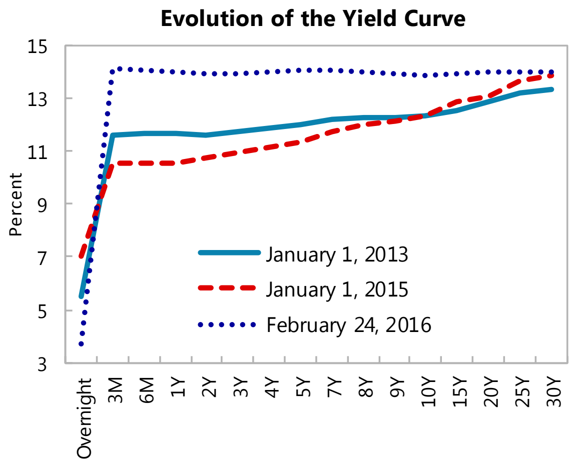
Inflation remains elevated.



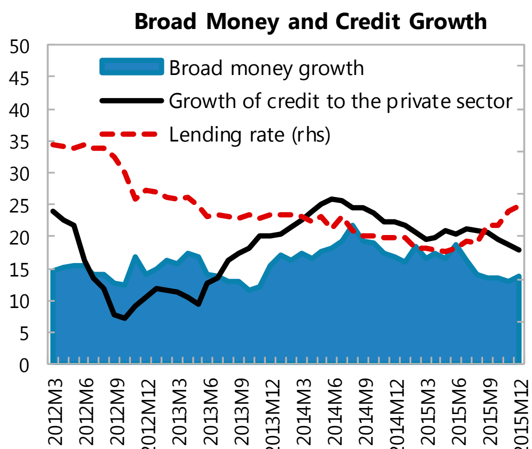
Nonetheless, interbank interest rate deviations from the policy rate persist.



The yields have risen following recent tightening...

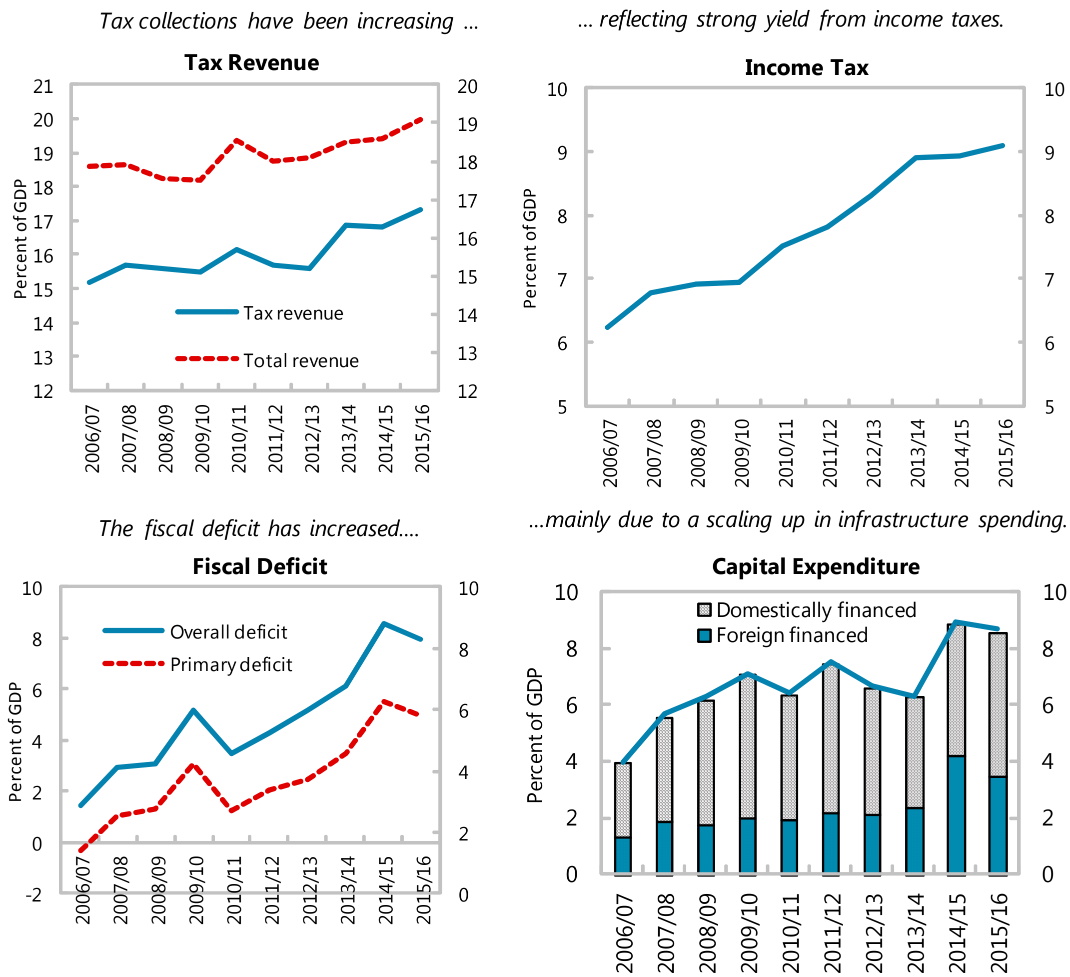


... while credit growth has moderated.



Source: Bloomberg; Kenyan authorities and IMF staff estimates.

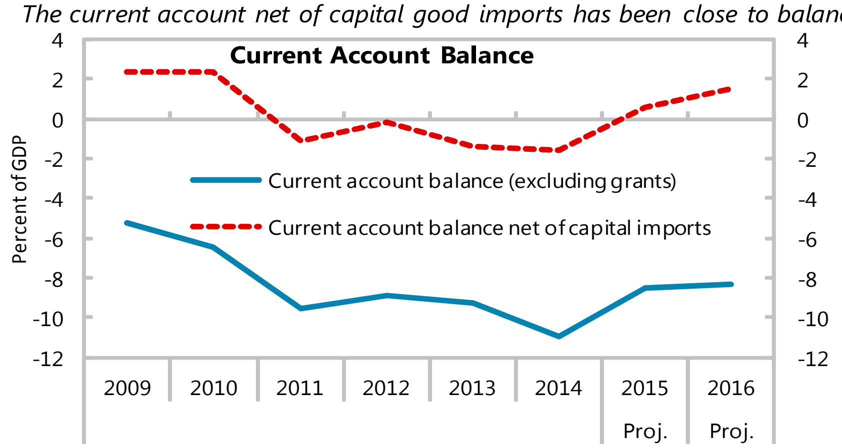
Figure 3. Kenya: Fiscal Operations



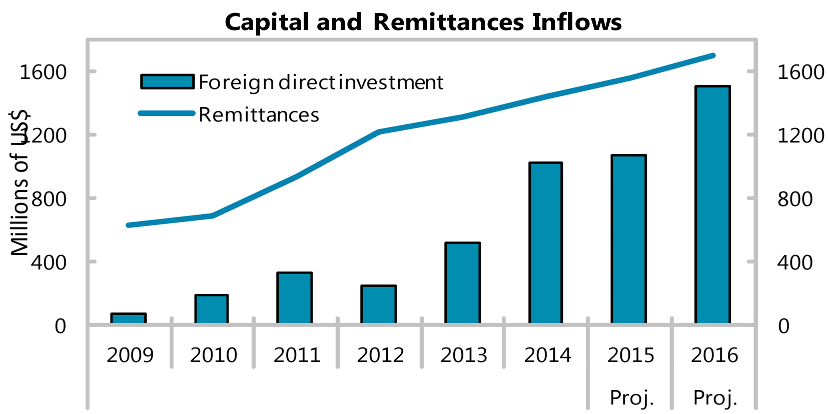
Source: Kenyan authorities and IMF staff estimates.

Figure 4. Kenya: External Sector

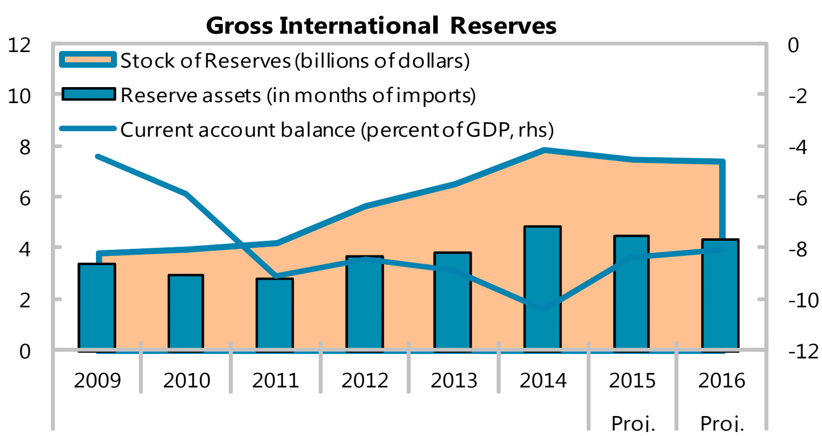
The current account net of capital good imports has been close to balance …



… while remittances and FDI are picking up.



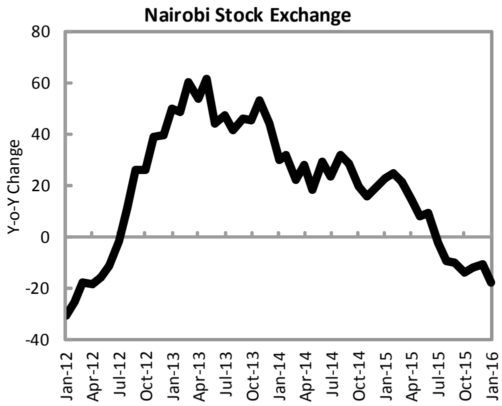
International reserves have declined.



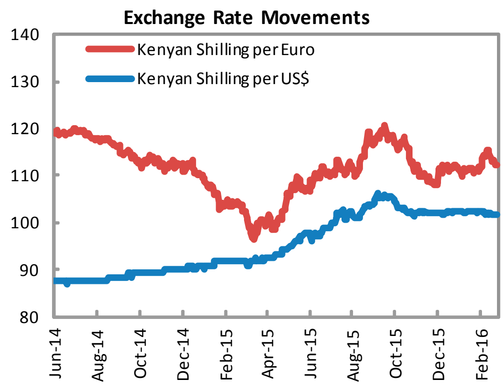
Source: Kenyan authorities and IMF staff estimates.

Figure 5. Kenya: Financial Sector Developments

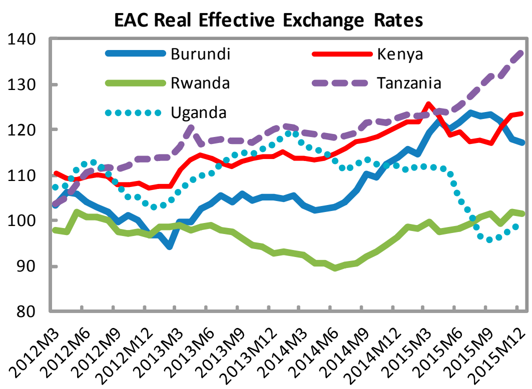
Stock market growth has turned negative.



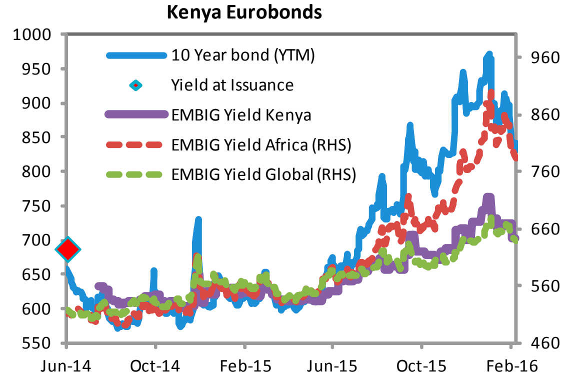
The shilling has stabilized against the U.S.$ since October 2015...



...and the REER is currently at end-2014 levels...



... and the recent rise in Kenya bond yields is in line with global trends.



Source: Bloomberg; IMF staff estimates.

`Table 1a. Kenya: Selected Economic Indicators, 2013/14–2018/19[1]

	2013/14	2014/15	2015/16		2016/17	2017/18	2018/19
	Act.	Est.	First rev.	Proj.		Proj.	
	(Annual percentage change, unless otherwise indicated)						
Output, prices, and exchange rate							
Real GDP	5.5	5.5	6.7	5.8	6.1	6.3	6.5
GDP deflator	6.3	7.2	6.5	6.8	6.2	5.6	5.4
CPI (period average)	7.1	6.6	6.3	6.9	6.0	5.4	5.0
CPI (end of period)	7.4	7.0	6.0	6.3	5.7	5.0	5.0
Core inflation (period average) [2]	4.7	4.4	5.6	5.8	5.7	5.1	5.0
Exports volume	-1.4	4.9	5.6	1.9	3.1	7.1	8.2
Imports volume	4.2	7.8	9.6	9.3	4.5	2.8	6.0
Exchange rate (Kenyan shilling/US$)	87.2	92.7	.	.	.	.	.
Real effective exchange rate (depreciation, -)	3.4	5.6	.	.	.	.	.
Money and credit							
Broad money (M3)	18.2	18.6	17.2	14.6	14.2	.	.
Reserve money	12.6	14.9	15.8	13.1	14.5	.	.
Credit to non-government sector	25.7	20.5	14.5	15.3	17.2	.	.
Policy rate	8.5	10.0	.	.	.	.	.
M3/GDP (percent)	42.7	44.8	44.1	45.4	46.0	.	.
NPLs (percent of total gross loans)	5.8	5.7	.	.	.	.	.
	(Percent of GDP, unless otherwise indicated)						
Central government budget							
Total revenue and grants	19.9	19.9	21.1	20.4	20.7	20.8	21.0
Tax revenues	16.9	16.8	18.0	17.3	17.6	17.7	17.9
Non-tax revenues	2.4	2.6	2.7	2.6	2.7	2.7	2.8
Grants	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Expenditure	25.7	28.8	29.1	28.4	27.4	26.5	25.4
Current	19.4	19.8	19.7	19.7	19.2	18.7	18.0
Capital	6.3	8.9	9.3	8.6	8.2	7.7	7.3
Unidentified measures	0.0	0.0	0.0	0.0	0.3	0.7	0.7
Primary balance	-3.5	-5.6	-5.2	-5.0	-3.4	-2.0	-0.7
Excluding SGR (phase 1) related spending	-3.5	-5.6	-3.4	-3.0	-1.8	-0.7	-0.7
Overall balance	-5.9	-8.6	-8.0	-8.0	-6.5	-5.0	-3.7
Excluding SGR (phase 1) related spending	-5.9	-8.6	-6.2	-6.1	-4.9	-3.7	-3.7
Excluding grants	-6.4	-9.1	-8.4	-8.4	-6.9	-5.4	-4.0
Net domestic borrowing	1.2	4.4	3.5	3.0	2.6	2.5	2.4
Public debt [3]							
Public gross nominal debt	47.1	49.1	53.1	52.1	54.2	54.6	53.3
Public net nominal debt	43.1	44.8	51.0	50.0	52.2	52.6	51.4
of which : external public debt	21.7	24.2	27.1	28.8	30.7	30.9	29.7
Public gross debt, PV	44.8	44.4	48.3	47.0	48.4	48.5	48.2
Public net debt, PV	40.7	40.1	46.2	45.0	46.4	46.5	46.3
Gross domestic debt	25.5	24.9	26.1	23.3	23.5	23.7	23.7
Investment and saving							
Investment	20.8	23.5	25.3	23.7	23.9	23.6	23.3
General government	7.0	9.7	10.5	9.8	9.7	9.4	9.1
Nongovernment	13.8	13.7	14.8	13.9	14.2	14.2	14.2
Saving	11.9	14.3	14.6	14.4	16.5	17.0	16.7
General government	1.7	1.0	2.6	1.9	2.8	3.9	4.7
Nongovernment	10.2	13.3	12.0	12.5	13.7	13.1	12.0
External sector							
Exports (goods and services)	19.0	17.9	18.2	18.0	17.7	17.9	18.1
Imports (goods and services)	33.0	32.4	33.9	32.6	30.4	30.0	30.1
Current account balance (including grants)	-8.9	-9.2	-10.7	-9.3	-7.3	-6.6	-6.6
Gross international reserves							
In billions of US$	8.6	7.2	7.3	7.6	8.0	8.5	9.1
In months of next year imports	5.2	4.2	3.8	4.5	4.5	4.4	4.3
Memorandum items:							
GDP at current market prices							
Billion of Kenyan shillings	5,044	5,703	6,502	6,444	7,259	8,149	9,149
US$ billion	57.9	61.2	66.1	63.0	66.8	71.9	78.0
GDP per capita (nominal US$)	1,366	1,403	1,479	1,404	1,447	1,516	1,599

Sources: Kenyan authorities and IMF staff estimates and projections.

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

[2] Excluding food and fuel.

[3] Excludes guaranteed debt and other contingent liabilities.

Table 1b. Kenya: Selected Economic Indicators, 2014–2019

	2014	2015		2016		2017	2018	2019
	Act.	First rev	Proj.	First rev.	Proj.		Proj.	
	(Annual percentage change, unless otherwise indicated)							
Output, prices, and exchange rate								
Real GDP	5.3	6.5	5.6	6.8	6.0	6.1	6.5	6.5
GDP deflator	7.5	6.7	6.9	6.3	6.7	5.8	5.4	5.5
CPI (period average)	6.9	6.4	6.6	5.9	6.6	5.7	5.1	5.0
CPI (end of period)	6.0	6.4	8.0	5.3	5.8	5.5	5.0	5.0
Core inflation (period average) [1]	4.7	3.1	4.4	5.6	5.8	5.7	5.1	5.0
Exports volume	5.8	7.1	4.1	4.1	-0.2	6.5	7.7	8.8
Imports volume	6.5	12.9	9.0	6.1	9.7	-0.1	5.7	6.3
Exchange rate (Kenyan shilling/US$)	87.9	.	98.5	.	.	.	.	.
Real effective exchange rate (depreciation, -)	3.4	.	4.0	.	.	.	.	.
Money and credit								
Broad money (M3)	16.7	15.7	13.7	15.7	17.4	.	.	.
Reserve money	18.4	13.7	3.4	13.5	13.6	.	.	.
Credit to non-government sector	22.2	13.3	18.0	14.0	16.3	.	.	.
Policy rate	8.5	.	11.5	.	.	.	.	.
M3/GDP (percent)	43.5	44.3	43.8	45.1	45.5	.	.	.
NPLs (percent of total gross loans)	5.4	.	6.1	.	.	.	.	.
	(Percent of GDP, unless otherwise indicated)							
Central government budget								
Total revenue and grants	19.9	20.3	20.1	21.3	20.5	20.7	20.9	21.0
Tax revenues	16.8	17.4	17.1	18.2	17.4	17.6	17.8	17.9
Non-tax revenues	2.5	2.4	2.6	2.7	2.7	2.7	2.7	2.8
Grants	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Expenditure	27.2	28.5	28.6	28.7	27.9	26.9	25.9	25.2
Current	19.6	19.3	19.8	19.4	19.5	19.0	18.4	17.9
Capital	7.6	9.1	8.7	9.2	8.4	7.9	7.5	7.3
Unidentified measures	0.0	0.0	0.0	0.0	0.1	0.5	0.7	0.6
Primary balance	-4.5	-5.4	-5.3	-4.4	-4.2	-2.7	-1.3	-1.0
Excluding SGR (phase 1) related spending	-4.5	-3.4	-4.3	-2.9	-2.4	-2.1	-1.0	-0.8
Overall balance	-7.2	-8.2	-8.3	-7.1	-7.2	-5.7	-4.3	-3.8
Excluding SGR (phase 1) related spending	-7.2	-6.2	-7.3	-5.6	-5.5	-5.2	-3.9	-3.7
Excluding grants	-7.7	-8.7	-8.7	-7.5	-7.7	-6.1	-4.7	-4.2
Net domestic borrowing	2.8	3.9	3.7	3.1	2.8	2.6	2.5	2.1
Public debt [2]								
Public gross nominal debt	48.1	52.2	50.6	53.4	53.1	54.4	54.0	52.8
Public net nominal debt	44.0	49.5	47.4	51.3	51.1	52.4	52.0	50.8
of which : external public debt	22.9	25.9	26.5	27.4	29.7	30.8	30.3	29.3
Public gross debt, PV	42.9	47.7	45.8	48.0	48.3	48.5	48.5	47.9
Public net debt, PV	40.4	45.0	42.6	45.9	45.7	46.5	46.6	46.0
Gross domestic debt	25.2	26.3	24.1	26.0	23.4	23.6	23.7	23.4
Investment and saving								
Investment	22.2	24.9	23.6	25.5	23.8	23.8	23.5	23.4
General government	8.5	10.2	9.8	10.6	9.8	9.6	9.3	9.1
Nongovernment	13.7	14.7	13.8	15.0	14.1	14.2	14.2	14.2
Saving	11.8	15.1	15.4	15.9	15.8	17.1	16.9	16.8
General government	1.4	2.1	1.5	3.4	2.4	3.4	4.3	4.8
Nongovernment	10.4	13.0	13.9	12.4	13.4	13.7	12.6	12.0
External sector								
Exports (goods and services)	18.2	18.3	18.3	17.9	17.6	17.8	18.0	18.2
Imports (goods and services)	-33.7	-33.4	-31.9	-32.8	-31.0	-29.9	-30.0	-30.1
Current account balance (including grants)	-10.4	-9.8	-8.2	-9.7	-8.0	-6.7	-6.6	-6.6
Gross international reserves								
In billions of US$	7.9	7.5	7.5	7.6	7.8	8.3	9.0	9.7
In months of next year imports	4.8	4.0	4.5	3.9	4.5	4.5	4.4	4.4
Memorandum items:								
GDP at current market prices								
Billion of Kenyan shillings	5,358	6,088	6,048	6,915	6,839	7,680	8,619	9,678
US$ billion	60.9	63.3	61.4	68.9	64.6	69.0	74.8	81.1
GDP per capita (nominal US$)	1,417	1,436	1,388	1,522	1,420	1,475	1,556	1,642

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Excluding food and fuel.

[2] Excludes guaranteed debt and other contingent liabilities.

Table 2a. Kenya: Central Government Financial Operations 2013/14–2019/20[1]

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	Act.	Prelim.	Proj.	Proj.	Proj.	Proj.	Proj.
	(in billions of Kenyan Shillings, unless otherwise indicated)						
Revenues and grants	**1,001.4**	**1,133.8**	**1,313.2**	**1,499.5**	**1,697.4**	**1,921.0**	**2,164.7**
Revenue	**974.4**	**1,106.4**	**1,285.6**	**1,469.8**	**1,665.0**	**1,886.7**	**2,127.0**
Tax revenue	851.8	958.2	1,115.9	1,275.8	1,443.5	1,634.0	1,842.2
Income tax	449.6	508.6	585.6	666.1	755.2	856.3	970.3
Import duty (net)	67.6	74.0	86.4	97.1	108.3	119.7	132.9
Excise duty	102.0	115.9	143.6	171.7	194.0	219.6	248.6
Value-added tax	232.6	259.7	300.3	341.0	386.0	438.5	490.4
Nontax revenue	122.6	148.2	169.8	194.0	221.5	252.7	284.8
Investment income	10.2	13.5	21.1	23.8	26.7	30.0	33.7
Other	57.0	59.6	70.1	79.8	90.5	103.1	117.4
Ministerial and Departmental Fees (AIA)	35.7	56.7	58.5	65.9	74.0	83.1	93.2
Railway Levy	19.7	18.4	20.0	24.5	30.3	36.5	40.5
Grants	**27.0**	**27.4**	**27.6**	**29.7**	**32.4**	**34.3**	**37.8**
Project grants	21.7	22.3	19.9	22.4	25.1	28.2	31.7
Program grants	4.7	3.8	6.4	6.1	6.1	6.1	6.1
Expenditure and net lending	**1,297.8**	**1,640.3**	**1,828.2**	**1,991.2**	**2,156.2**	**2,319.9**	**2,577.8**
Recurrent expenditure	**978.4**	**1,126.3**	**1,256.6**	**1,383.2**	**1,514.2**	**1,632.5**	**1,808.1**
Transfer to counties	169.4	229.3	264.2	284.8	302.3	323.4	362.3
Interest payments	132.0	172.9	195.8	223.4	246.2	267.3	288.7
Domestic interest	119.2	139.6	153.8	166.9	178.1	187.4	197.5
Foreign interest due	12.8	33.3	42.0	56.6	68.1	79.9	91.2
Wages and benefits (civil service)	281.2	298.0	333.5	360.8	396.9	436.5	493.5
Pensions, etc.	30.2	38.2	47.4	56.1	64.0	70.4	84.6
Defense and NSIS	93.8	93.7	112.5	117.2	126.7	133.1	149.4
Other	248.0	293.1	302.2	339.3	359.4	382.9	429.6
of which: Social Spending	--	53.3	67.8	81.0	98.2	107.2	130.1
Development and net lending	**319.3**	**508.6**	**558.6**	**596.2**	**629.3**	**674.8**	**756.9**
Domestically financed	198.5	266.0	326.9	349.3	408.6	460.9	511.0
Foreign financed	118.6	240.4	224.5	244.4	217.9	210.7	242.4
of which: SGR (phase 1) project	0.0	123.5	118.2	101.6	0.0	0.0	0.0
Net lending	2.2	2.1	7.2	2.5	2.8	3.1	3.5
Overall balance excluding measures (cash basis, including	**-309.1**	**-489.6**	**-515.0**	**-491.7**	**-458.8**	**-398.9**	**-413.0**
Adjustments to cash basis	**-12.7**	**16.9**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Unidentified measures (deficit reducing)	**0.0**	**0.0**	**0.0**	**20.5**	**53.3**	**63.6**	**53.3**
Overall balance (cash basis, including grants)	**-309.1**	**-489.6**	**-515.0**	**-471.3**	**-405.5**	**-335.3**	**-359.7**
Overall balance excluding SGR (phase 1) related expenditu	**-309.1**	**-366.1**	**-396.8**	**-369.6**	**-405.5**	**-335.3**	**-359.7**
Statistical discrepency	**0.0**	**19.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financing	**309.1**	**470.5**	**515.0**	**471.3**	**405.5**	**335.3**	**359.7**
Net foreign financing	247.1	216.4	309.3	278.5	198.9	115.3	167.0
Disbursements	272.9	296.6	352.3	330.1	346.0	270.8	240.7
Project loans	96.9	94.7	86.4	120.4	192.7	182.5	210.8
Program loans	0.0	3.5	8.2	0.0	0.0	0.0	0.0
Commercial borrowing [2]	176.0	75.0	139.5	108.1	153.3	88.3	30.0
Standard Gauge Railway (phase 1) loan from China	0.0	123.5	118.2	101.6	0.0	0.0	0.0
Repayments due	-25.8	-80.2	-43.0	-51.7	-147.1	-155.5	-73.7
Change in arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic financing	62.0	254.1	205.7	192.8	206.6	220.0	192.7
Memorandum items:							
Nominal GDP	5,044.2	5,702.7	6,443.5	7,259.4	8,149.5	9,148.6	10,264.8
Primary balance incl. grants	-177.2	-316.6	-319.2	-247.8	-159.3	-68.0	-71.0
Primary balance excluding SGR (phase 1) expenditure (incl. gr	-177.2	-193.2	-201.0	-146.2	-159.3	-68.0	-71.0
Cyclically adjusted Primary balance incl. grants	-178.1	-315.6	-317.4	-246.2	-158.5	-68.6	-72.1
Total gross public debt, gross	2,377.6	2,799.8	3,356.8	3,933.4	4,448.0	4,879.5	5,356.1
of which: external debt [3]	1,093.3	1,379.4	1,853.6	2,226.2	2,517.9	2,714.3	2,979.4
of which: domestic debt	1,284.3	1,420.4	1,503.2	1,707.2	1,930.1	2,165.1	2,376.7
Total net public debt [4]	2,172.1	2,557.5	3,223.2	3,787.8	4,286.4	4,703.7	5,161.5
Government deposits	205.5	242.3	133.6	145.6	161.5	175.8	194.6

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July to June.

[2] Includes proceeds from (i) syndicated loans and (ii) planned sovereign bonds.

[3] External debt excludes guarantees.

[4] Total net debt in 2013/14 includes proceeds from US$2.0bn Eurobond.

Table 2b. Kenya: Central Government Financial Operations 2013/14–2019/20[1]

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	Act.	Prelim.	Proj.	Proj.	Proj.	Proj.	Proj.
	(in percent of GDP, unless otherwise indicated)						
Revenues and grants	**19.9**	**19.9**	**20.4**	**20.7**	**20.8**	**21.0**	**21.1**
Revenue	**19.3**	**19.4**	**20.0**	**20.2**	**20.4**	**20.6**	**20.7**
Tax revenue	16.9	16.8	17.3	17.6	17.7	17.9	17.9
Income tax	8.9	8.9	9.1	9.2	9.3	9.4	9.5
Import duty (net)	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Excise duty	2.0	2.0	2.2	2.4	2.4	2.4	2.4
Value-added tax	4.6	4.6	4.7	4.7	4.7	4.8	4.8
Nontax revenue	2.4	2.6	2.6	2.7	2.7	2.8	2.8
Investment income	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Other	1.1	1.0	1.1	1.1	1.1	1.1	1.1
Ministerial and Departmental Fees (AIA)	0.7	1.0	0.9	0.9	0.9	0.9	0.9
Railway Levy	0.4	0.3	0.3	0.3	0.4	0.4	0.4
Grants	**0.5**	**0.5**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**
Project grants	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Program grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Expenditure and net lending	**25.7**	**28.8**	**28.4**	**27.4**	**26.5**	**25.4**	**25.1**
Recurrent expenditure	**19.4**	**19.8**	**19.5**	**19.1**	**18.6**	**17.8**	**17.6**
Transfer to counties	3.4	4.0	4.1	3.9	3.7	3.5	3.5
Interest payments	2.6	3.0	3.0	3.1	3.0	2.9	2.8
Domestic interest	2.4	2.4	2.4	2.3	2.2	2.0	1.9
Foreign interest due	0.3	0.6	0.7	0.8	0.8	0.9	0.9
Wages and benefits (civil service)	5.6	5.2	5.2	5.0	4.9	4.8	4.8
Pensions, etc.	0.6	0.7	0.7	0.8	0.8	0.8	0.8
Defense and NSIS	1.9	1.6	1.7	1.6	1.6	1.5	1.5
Other	4.9	5.1	4.69	4.7	4.4	4.2	4.2
of which: Social Spending	--	0.9	1.1	1.1	1.2	1.2	1.3
Development and net lending	**6.3**	**8.9**	**8.7**	**8.2**	**7.7**	**7.4**	**7.4**
Domestically financed	3.9	4.7	5.1	4.8	5.0	5.0	5.0
Foreign financed	2.4	4.2	3.5	3.4	2.7	2.3	2.4
of which: SGR (phase 1) project	0.0	2.2	1.8	1.4	0.0	0.0	0.0
Net lending	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Overall balance excluding measures (cash basis, including	**-6.1**	**-8.6**	**-8.0**	**-6.8**	**-5.6**	**-4.4**	**-4.0**
Unidentified measures (deficit reducing)	**0.0**	**0.0**	**0.0**	**0.3**	**0.7**	**0.7**	**0.5**
Overall balance (cash basis, including grants)	**-6.1**	**-8.6**	**-8.0**	**-6.5**	**-5.0**	**-3.7**	**-3.5**
Overall balance excluding SGR (phase 1) related expenditu	**-6.1**	**-6.4**	**-6.2**	**-5.1**	**-5.0**	**-3.7**	**-3.5**
Statistical discrepency	**0.0**	**0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financing	**6.1**	**8.2**	**8.0**	**6.5**	**5.0**	**3.7**	**3.5**
Net foreign financing	4.9	3.8	4.8	3.8	2.4	1.3	1.6
Disbursements	5.4	5.2	5.5	4.5	4.2	3.0	2.3
Project loans	1.9	1.7	1.3	1.7	2.4	2.0	2.1
Program loans	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Commercial borrowing [2]	3.5	1.3	2.2	1.5	1.9	1.0	0.3
Standard Gauge Railway (phase 1) loan from China	0.0	2.2	1.8	1.4	0.0	0.0	0.0
Repayments due	-0.5	-1.4	-0.7	-0.7	-1.8	-1.7	-0.7
Change in arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic financing	1.2	4.5	3.2	2.7	2.5	2.4	1.9
Memorandum items:							
Primary balance incl. grants (Central government)	-3.5	-5.6	-5.0	-3.4	-2.0	-0.7	-0.7
Primary balance excluding SGR (phase 1) expenditure (incl. gra	-3.5	-3.4	-3.1	-2.0	-2.0	-0.7	-0.7
Cyclically adjusted Primary balance incl. grants (in percent of	-3.5	-5.5	-4.9	-3.4	-1.9	-0.7	-0.7
Total gross public debt, gross	47.1	49.1	52.1	54.2	54.6	53.3	52.2
of which: external debt [3]	21.7	24.2	28.8	30.7	30.9	29.7	29.0
of which: domestic debt	25.5	24.9	23.3	23.5	23.7	23.7	23.2
Total gross public debt, PV	44.8	44.4	47.0	48.4	48.5	48.2	47.5
Total net public debt [4]	43.1	44.8	50.0	52.2	52.6	51.4	50.3
Government deposits (in months of domestically financed expen	2.1	2.1	1.0	1.0	1.0	1.0	1.0

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July to June.

[2] Includes proceeds from (i) syndicated loans and (ii) planned sovereign bonds.

[3] External debt excludes guarantees.

[4] Total net debt in 2013/14 includes proceeds from US$2.0bn Eurobond.

Table 3. Kenya: Monetary Survey June 2014–December 2016

	Jun-14	Dec-14	Jun-15	Sep-15		Dec-15		Mar-16	Jun-16	Sep-16	Dec-16
	Act.	Act.	Prelim.	First Rev.	Prelim.	First Rev.	Prelim.	Proj.			
	(In billions of Kenyan shillings, unless otherwise indicated)										
Central Bank of Kenya (CBK)											
Net foreign assets	615	589	565	538	529	598	621	663	671	667	716
(in millions of US dollars) [1 2]	7,023	6,506	5,730	5,449	5,027	6,061	5,901	6,299	6,375	6,337	6,798
Net domestic assets	-292	-209	-193	-160	-153	-166	-229	-272	-251	-240	-270
Net domestic credit	-176	-98	-53	-22	16	-29	-73	-96	-79	-48	-79
Government (net)	-176	-92	-23	-52	47	-70	-52	0	16	16	16
Commercial banks (net)	0	-6	-30	27	-31	39	-22	-99	-98	-67	-97
Other items (net)	-116	-111	-140	-137	-168	-137	-156	-176	-171	-191	-191
Reserve money	324	380	372	378	377	432	392	391	421	428	446
Currency outside banks	158	173	175	175	175	209	191	159	179	176	189
Bank reserves	166	206	197	203	202	223	201	232	241	252	257
Banks											
Net foreign assets	-86	-109	-130	-96	-140	-99	-130	-133	-135	-138	-140
(in millions of US dollars)	-981	-1,206	-1,314	-977	-1,329	-1,002	-1,234	-1,259	-1,284	-1,309	-1,334
Reserves	166	206	197	203	202	223	201	232	241	252	257
Credit to CBK	0	6	30	-27	31	-39	22	99	98	67	97
Net domestic assets	1,882	2,027	2,250	2,307	2,263	2,388	2,336	2,380	2,477	2,620	2,639
Net domestic credit	2,215	2,401	2,658	2,689	2,735	2,769	2,834	2,913	3,027	3,190	3,240
Government (net)	459	471	545	600	507	595	568	603	596	627	610
Other public sector	40	48	45	44	48	44	46	46	46	46	46
Private sector	1,716	1,881	2,069	2,045	2,180	2,131	2,220	2,264	2,386	2,516	2,583
Other items (net)	-334	-374	-409	-382	-472	-382	-498	-533	-550	-570	-601
Total deposits	1,961	2,130	2,346	2,387	2,356	2,473	2,430	2,578	2,682	2,801	2,853
Monetary survey											
Net foreign assets	529	480	436	441	389	499	491	531	536	529	575
(in millions of US dollars)	6,042	5,300	4,415	4,473	3,698	5,060	4,668	5,040	5,091	5,028	5,464
Net domestic assets	1,623	1,850	2,117	2,160	2,167	2,196	2,159	2,281	2,389	2,526	2,536
Net domestic credit	2,042	2,311	2,638	2,640	2,784	2,702	2,785	2,915	3,046	3,208	3,259
Government (net)	283	379	522	548	553	525	516	603	612	643	626
Other public sector	40	48	45	44	48	44	46	46	46	46	46
Private	1,719	1,883	2,071	2,048	2,183	2,133	2,222	2,266	2,388	2,519	2,586
Other items (net)	-419	-461	-520	-480	-617	-506	-626	-634	-657	-683	-722
M1	913	936	1,001	1,055	980	1,093	1,016	1,078	1,121	1,171	1,193
Money and quasi-money (M2)	1,838	1,982	2,140	2,203	2,133	2,282	2,227	2,363	2,458	2,567	2,614
M2 plus resident foreign currency deposits (M3)	2,152	2,330	2,553	2,601	2,556	2,695	2,650	2,812	2,925	3,055	3,112
M3 plus nonbank holdings of government debt (L)	2,718	2,949	3,197	3,270	3,232	3,388	3,384	3,590	3,735	3,901	3,973
Memorandum items	(Annual percent change unless otherwise specified)										
M2	18.8	18.6	16.4	16.3	12.7	15.2	12.4	15.4	14.9	20.3	17.4
M3	18.2	16.7	18.6	15.5	13.5	15.7	13.7	17.2	14.6	19.5	17.4
Deposits	18.6	18.2	19.7	15.8	14.3	16.1	14.1	17.2	14.3	18.9	17.4
Reserve money	12.6	18.4	14.9	17.0	16.7	13.7	3.4	12.9	13.1	13.5	13.6
Net domestic credit	14.5	16.8	29.2	16.9	23.3	16.9	20.5	19.3	15.5	15.2	17.0
Government (net)	-25.4	-4.5	84.4	37.1	38.3	38.4	36.0	28.3	17.1	16.3	21.4
Private	25.7	22.2	20.5	13.3	20.8	13.3	18.0	17.5	15.3	15.4	16.4
Net domestic assets of the banking sector	11.2	15.0	30.5	19.6	20.0	18.7	16.7	17.8	12.8	16.6	17.5
NDA growth (as percent of the base period M3)	7.2	9.6	18.2	12.3	12.6	11.7	10.5	11.4	8.5	11.1	11.2
Multiplier (Average M2/RM)	5.5	5.6	5.7	5.7	5.6	5.7	5.7	5.8	5.8	5.9	5.9
Multiplier (Average M3/RM)	6.5	6.6	6.7	6.7	6.7	6.7	6.8	6.9	6.9	7.0	7.1
Velocity (GDP/M3)	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.3	2.3
Velocity (GDP/M2)	2.9	2.9	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.7
Nominal GDP growth	10.1	13.3	10.3	13.5	9.5	13.6	12.9	17.6	20.0	22.5	13.1

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] For historical data, at implicit CBK exchange rate.

[2] Starting in June 2014, it includes government deposits abroad on account of the Eurobond issuance, as an asset and as a liability.

Table 4a. Kenya: Balance of Payments, 2014–19

(BPM6 presentation, in millions of U.S. dollars, unless otherwise indicated)[1]

	2014		2015 [2]		2016		2017	2018	2019
	First Rev.	Act.	First Rev.	Proj.	First Rev.	Proj.	Projections		
Current account	-6,339	-6,339	-6,188	-5,012	-6,652	-5,169	-4,597	-4,941	-5,350
Trade balance	-11,497	-11,436	-11,542	-10,314	-12,413	-10,853	-10,734	-11,616	-12,554
Goods: exports, f.o.b.	6,192	6,174	6,590	6,427	6,961	6,245	6,843	7,527	8,334
Coffee	232	232	186	209	181	152	166	184	204
Tea	1,069	1,069	1,295	1,220	1,484	1,372	1,497	1,640	1,804
Horticulture	808	808	771	787	852	749	846	917	1,011
Other	4,083	4,065	4,338	4,211	4,444	3,973	4,334	4,786	5,315
Goods: imports, f.o.b.	17,689	17,610	18,133	16,741	19,374	17,098	17,577	19,142	20,888
Oil products	3,854	3,753	2,992	2,419	2,922	1,716	2,084	2,438	2,738
Other	13,835	13,857	15,140	14,322	16,451	15,382	15,493	16,704	18,150
Capital imports	5,866	5,712	6,140	5,581	6,829	6,356	6,192	6,507	7,013
Services balance	2,062	2,002	2,006	1,968	2,164	2,183	2,415	2,622	2,882
Services, credit	4,917	4,935	5,025	4,795	5,361	5,115	5,463	5,910	6,429
Transportation	2,191	2,191	2,324	2,054	2,419	2,111	2,270	2,469	2,712
Travel	811	811	716	739	814	874	976	1,072	1,178
Services, debit	2,854	2,934	3,018	2,827	3,198	2,933	3,047	3,288	3,547
Goods and services balance	-9,434	-9,434	-9,536	-8,346	-10,250	-8,670	-8,318	-8,993	-9,673
Primary income, balance	-682	-682	-833	-778	-929	-850	-912	-912	-1,008
Credit	181	181	170	185	302	303	439	623	753
Debit	864	864	1,003	963	1,231	1,154	1,351	1,535	1,761
Secondary income, balance	3,777	3,777	4,180	4,112	4,527	4,351	4,633	4,964	5,330
Credit	3,980	3,980	4,235	4,170	4,585	4,414	4,701	5,036	5,406
Remittances	1,441	1,441	1,584	1,551	1,768	1,630	1,732	1,846	1,972
Debit	203	203	55	59	57	63	67	72	76
Capital account	24	24	234	208	210	209	212	230	249
Financial account	-6,971	-6,972	-5,582	-4,487	-7,004	-5,267	-5,071	-5,496	-5,966
Foreign direct investment	-1,023	-1,023	-1,220	-1,069	-1,561	-1,497	-1,534	-1,766	-1,905
Direct investment, assets	28	28	217	217	283	283	376	292	317
Direct investment, liabilities	1,051	1,051	1,437	1,285	1,844	1,780	1,909	2,058	2,222
Portfolio investment	-3,649	-3,649	-1,183	-434	-842	-1,842	-1,718	-1,815	-1,714
Portfolio investment, assets	55	55	58	56	63	59	59	58	57
Portfolio investment, liabilities	3,704	3,704	1,241	489	904	1,901	1,777	1,872	1,770
Equity and investment fund shares	954	954	486	484	904	900	1,033	1,272	1,522
Debt securities	2,750	2,750	755	5	0	1,000	744	600	248
Financial derivatives	0	0	0	0	0	0	0	0	0
Other investment	-2,244	-2,301	-2,746	-2,984	-4,035	-1,928	-1,820	-1,915	-2,347
Net errors and omissions	737	722	0	0	0	0	0	0	0
Overall balance	1,393	1,379	-372	-318	562	306	687	785	864
Reserves and related items	1,393	1,379	-372	-318	562	306	687	785	864
Reserve assets (gross)	1,335	1,321	-445	-384	445	239	568	642	710
Use of Fund credit and loans to the Fund (net)	-58	-58	-73	-66	-117	-67	-119	-143	-154
Disbursements	0	0	0	0	0	0	0	0	0
Repayments	58	58	73	66	117	67	119	143	154
Memorandum items:									
Gross official reserves (end of period) [3]	7,895	7,895	7,450	7,511	7,600	7,750	8,318	8,960	9,670
(in months of next year's imports)	4.5	4.8	4.0	4.5	3.9	4.5	4.5	4.4	4.4
(in months of 3-year-rolling average imports) [4]	5.0	5.0	4.5	4.6	4.3	4.6	5.0	5.1	5.2
(in percent of M3)	33.9	33.9	27.6	28.3	24.4	25.7	23.5	22.0	20.8
WEO oil price (APSP; US$)	96.2	96.2	56.2	50.8	59.6	29.9	35.8	39.7	43.1
Terms of trade [5]	-3.1	-3.1	9.4	8.7	0.8	3.7	-0.6	-1.1	-0.9

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Estimates and projections from the First Review staff report (Country Report No. 15/269) have been converted from BPM5 to BPM6 presentation.

[2] Exports and imports in 2015 are higher by $360 million on account of a sale-leaseback agreement for three Kenya Airways aircraft.

[3] For end-2015, includes proceeds from commercial borrowing by the government in Q4, some of which will be drawn down in 2016Q1.

[4] CBK definition of reserve cover: in months of imports of goods and services over the previous 36 months (annualized rolling average).

[5] Percentage change, goods and services.

Table 4b. Kenya: Balance of Payments, 2014–19
(BPM6 presentation, in percent of GDP)[1]

	2014		2015 [2]		2016		2017	2018	2019
	First Rev.	Act.	First Rev.	Proj.	First Rev.	Proj.	Projections		
Current account	-10.4	-10.4	-9.8	-8.2	-9.7	-8.0	-6.7	-6.6	-6.6
Trade balance	-18.9	-18.8	-18.2	-16.8	-18.0	-16.8	-15.6	-15.5	-15.5
Goods: exports, f.o.b.	10.2	10.1	10.4	10.5	10.1	9.7	9.9	10.1	10.3
Coffee	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.3
Tea	1.8	1.8	2.0	2.0	2.2	2.1	2.2	2.2	2.2
Horticulture	1.3	1.3	1.2	1.3	1.2	1.2	1.2	1.2	1.2
Other	6.7	6.7	6.9	6.9	6.5	6.2	6.3	6.4	6.6
Goods: imports, f.o.b.	29.0	28.9	28.6	27.3	28.1	26.5	25.5	25.6	25.8
Oil products	6.3	6.2	4.7	3.9	4.2	2.7	3.0	3.3	3.4
Other	22.7	22.7	23.9	23.3	23.9	23.8	22.5	22.3	22.4
Capital imports	9.6	9.4	9.7	9.1	9.9	9.8	9.0	8.7	8.6
Services balance	3.4	3.3	3.2	3.2	3.1	3.4	3.5	3.5	3.6
Services, credit	8.1	8.1	7.9	7.8	7.8	7.9	7.9	7.9	7.9
Transportation	3.6	3.6	3.7	3.3	3.5	3.3	3.3	3.3	3.3
Travel	1.3	1.3	1.1	1.2	1.2	1.4	1.4	1.4	1.5
Services, debit	4.7	4.8	4.8	4.6	4.6	4.5	4.4	4.4	4.4
Goods and services balance	-15.5	-15.5	-15.1	-13.6	-14.9	-13.4	-12.1	-12.0	-11.9
Primary income, balance	-1.1	-1.1	-1.3	-1.3	-1.3	-1.3	-1.3	-1.2	-1.2
Credit	0.3	0.3	0.3	0.3	0.4	0.5	0.6	0.8	0.9
Debit	1.4	1.4	1.6	1.6	1.8	1.8	2.0	2.1	2.2
Secondary income, balance	6.2	6.2	6.6	6.7	6.6	6.7	6.7	6.6	6.6
Credit	6.5	6.5	6.7	6.8	6.7	6.8	6.8	6.7	6.7
Remittances	2.4	2.4	2.5	2.5	2.6	2.5	2.5	2.5	2.4
Debit	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital account	0.0	0.0	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Financial account	-11.4	-11.4	-8.8	-7.3	-10.2	-8.2	-7.4	-7.3	-7.4
Foreign direct investment	-1.7	-1.7	-1.9	-1.7	-2.3	-2.3	-2.2	-2.4	-2.3
Direct investment, assets	0.0	0.0	0.3	0.4	0.4	0.4	0.5	0.4	0.4
Direct investment, liabilities	1.7	1.7	2.3	2.1	2.7	2.8	2.8	2.8	2.7
Portfolio investment	-6.0	-6.0	-1.9	-0.7	-1.2	-2.9	-2.5	-2.4	-2.1
Portfolio investment, assets	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Portfolio investment, liabilities	6.1	6.1	2.0	0.8	1.3	2.9	2.6	2.5	2.2
Equity and investment fund shares	1.6	1.6	0.8	0.8	1.3	1.4	1.5	1.7	1.9
Debt securities	4.5	4.5	1.2	0.0	0.0	1.5	1.1	0.8	0.3
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	-3.7	-3.8	-4.3	-4.9	-5.9	-3.0	-2.6	-2.6	-2.9
Net errors and omissions	1.2	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.3	2.3	-0.6	-0.5	0.8	0.5	1.0	1.0	1.1
Reserves and related items	2.3	2.3	-0.6	-0.5	0.8	0.5	1.0	1.0	1.1
Reserve assets (gross)	2.2	2.2	-0.7	-0.6	0.6	0.4	0.8	0.9	0.9
Use of Fund credit and loans to the Fund (net)	-0.1	-0.1	-0.1	-0.1	-0.2	-0.1	-0.2	-0.2	-0.2
Disbursements	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments	0.1	0.1	0.1	0.1	0.2	0.1	0.2	0.2	0.2
Memorandum items:									
Gross official reserves (end of period)	13.0	13.0	11.8	12.2	11.0	12.0	12.1	12.0	11.9
Exports of goods and nonfactor services	18.2	18.2	18.4	18.3	17.9	17.6	17.8	18.0	18.2
Imports of goods and nonfactor services	33.7	33.7	33.4	31.9	32.8	31.0	29.9	30.0	30.1

Sources: Kenyan authorities and IMF staff estimates and projections.
[1] Estimates and projections from the First Review staff report (Country Report No. 15/269) have been converted from BPM5 to BPM6 presentation.
[2] Exports and imports in 2015 are higher by 0.6 percent of GDP on account of a sale-leaseback agreement for three Kenya Airways aircraft.

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

	Dec-10	Dec-11	Dec-12	Dec-13	Jun-14	Dec-14	Jun-15	Sep-15	Dec-15
					(Percent)				
Capital adequacy									
Regulatory capital to risk-weighted assets	20.8	19.4	21.9	23.2	17.6	19.2	18.9	18.7	18.6
Regulatory tier 1 capital to risk-weighted assets	18.7	17.3	18.9	19.4	15.1	15.9	15.7	15.5	15.6
Total capital to total assets	15.6	15.5	16.3	17.1	17.3	17.9	17.7	18.0	18.1
Asset quality									
Non performing loans to total gross loans	6.2	4.4	4.5	5.0	5.8	5.4	5.7	5.4	6.1
Bank provisions to NPLs	75.3	82.2	80.9	70.7	62.0	65.0	64.1	66.3	61.6
Non performing loans net of provisions to capital	6.4	3.5	3.5	5.8	9.0	7.4	8.1	7.5	9.5
Earning assets to total assets	88.8	87.8	87.4	88.9	88.6	88.2	87.5	87.9	88.8
Earning and profitability									
Return on assets (ROA)	3.7	3.3	3.8	3.6	3.7	3.4	3.3	3.3	3.1
Return on equity (ROE)	30.7	32.2	34.2	28.9	30.9	26.5	28.3	27.4	25.2
Interest margin to gross income	34.7	38.6	32.7	37.2	35.9	36.0	35.6	35.2	33.9
Non interest expenses to gross income	48.2	44.6	37.8	41.7	39.9	40.9	38.9	38.7	39.3
Liquidity									
Liquid assets to total assets	38.4	33.3	35.2	34.3	32.3	32.7	32.2	29.1	31.4
Liquid assets to short-term liabilities	44.5	37.0	41.9	38.6	38.7	37.7	38.7	37.4	38.1
liquid assets to total deposits	51.0	43.8	46.8	47.0	44.4	45.2	44.7	41.1	44.0
Total loans to total deposits	72.5	77.4	76.9	80.4	82.6	83.7	83.5	89.5	87.1
Sensitivity to market risk									
Net open position in foreign exchange to capital	4.3	3.3	2.6	2.2	2.9	4.3	2.9	2.6	3.5
Interest bearing assets to interest bearing liabilities	117.8	115.4	116.2	121.6	121.7	122.1	121.5	124.0	124.6
FX currency denominated assets to total assets	10.6	11.8	13.2	13.7	15.0	15.4	16.4	17.3	16.9
FX currency denominated liabilities to total liabilities	17.1	21.5	20.9	22.9	22.0	22.6	23.5	24.6	24.1
Spread between lending and deposit rate	9.3	8.4	10.3	8.9	8.5	8.0	7.9	7.0	7.2

Source: Central Bank of Kenya.

Table 6. Kenya: Potential Impact of Exogenous Shocks
(in billions of U.S. dollars, relative to baseline, unless otherwise indicated

	2016	2017	2016–17
Simulated impact: capital flow slowdown	**-2.8**	**-2.0**	**-4.9**
FDI[1]	-0.8	-0.4	-1.2
Portfolio investment	-1.7	-1.3	-3.1
Short-term[2]	-0.3	-0.3	-0.6
Excluding IMF and partner financing			
Current account improvement[3]	0.7	1.2	1.9
of which: exports of goods and services	0.0	0.3	0.2
of which: imports of goods and services	0.7	0.9	1.5
of which: from FDI shock	0.3	0.3	0.6
Level of reserves excluding IMF and partner financing (2015: 7.5)[4]	**5.6**	**5.3**	
In months of prospective imports (2015: 4.5)	3.4	3.0	
Financing gap	**0.8**	**0.7**	**1.5**
Development partners (uncertain)	0.0	0.0	0.0
IMF program (US$ billion)[5]	0.8	0.7	1.5
In percent of quota[5]	**111**	**86**	**196**
Reserves including IMF disbursements[5] **(2015: 7.5)**	**6.4**	**6.8**	
In months of prospective imports (2015: 4.5)[6]	3.9	3.8	
Memorandum item:			
Level of reserves, baseline	7.8	8.3	

[1] Assumes decline of net FDI from 1.7 percent of GDP in 2015, to 1.2 percent in 2016.
[2] Based on rollover rate of 90 percent for private short-term (around 25th percentile), applied to estimated short-term private debt stock for 2015.
[3] Because the valuation effects of the assumed REER depreciation on GDP dominate the trade volume effects and the shock is temporary, only modest improvement in the external current account deficit relative to GDP is projected during 2016-17, despite a significant improvement in the current account deficit in U.S. dollar terms.
[4] After direct and indirect effects, including the impacts of depreciation and import compression.
[5] Includes final SBA-SCF disbursement (less than $0.1 billion) scheduled for March 2018.
[6] EAMU convergence criterion: reserve cover of 4.5 months of imports by 2021.

Table 7. Kenya: Proposed Schedule of Reviews and Available Purchases, 2016–18[1]

Availability Date	Condition	Available Purchases under the SBA		Available Loans under the SCF		Total Available Purchases and Loans	
		(SDR millions)	(Percent of quota)	(SDR millions)	(Percent of quota)	(SDR millions)	(Percent of quota)
March 14, 2016	Approve the 24-month SBA and SCF arrangements	361.867	66.67	180.933	33.33	542.800	100.00
November 15, 2016	Completion of the first SBA-SCF reviews based on end-June 2016 performance criteria	37.996	7.00	18.998	3.50	56.994	10.50
May 15, 2017	Completion of the second SBA-SCF reviews based on end-December 2016 performance criteria	135.700	25.00	67.850	12.50	203.550	37.50
November 15, 2017	Completion of the third SBA-SCF reviews based on end-June 2017 performance criteria	135.700	25.00	67.850	12.50	203.550	37.50
March 5, 2018	Completion of the fourth SBA-SCF reviews based on end-December 2017 performance criteria	37.996	7.00	18.998	3.50	56.994	10.50
Total available		709.259	130.67	354.629	65.33	1,063.888	196.00

Source: IMF staff estimates.

[1] Excludes amounts available under the precautionary SBA and SCF arrangements approved in 2015, which are assumed to be cancelled effective March 14, 2016 with their balances undrawn.

Table 8. Kenya: Indicators of Fund Credit, 2016–24
(In millions of SDRs)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
		Projections							
Fund obligations based on existing credit									
(In millions of SDRs)									
Principal	48.7	85.8	103.3	111.3	97.7	91.2	50.3	21.6	0.0
Charges and interest [1]	0.1	0.3	0.3	1.0	0.7	0.5	0.3	0.2	0.2
Obligations to the Fund from existing									
and prospective credit [2]									
(In millions of SDRs)	53.2	93.0	112.0	257.1	381.8	377.1	252.1	106.0	59.2
Principal	48.7	85.8	103.3	247.0	373.9	372.4	249.9	105.1	58.7
Stand-by Arrangements (SBA)	0.0	0.0	0.0	135.7	233.9	214.2	120.8	4.8	0.0
ESF Rapid Access Component (RAC)	27.1	27.1	27.1	13.6	0.0	0.0	0.0	0.0	0.0
ECF Arrangements	21.5	58.6	76.1	97.7	97.7	91.2	50.3	21.6	0.0
SCF Arrangements	0.0	0.0	0.0	0.0	42.3	67.1	78.8	78.8	58.7
Charges and interest [1]	4.6	7.3	8.7	10.1	7.9	4.7	2.2	0.9	0.5
Obligations to the Fund from existing and									
prospective credit [1]									
In millions of U.S. dollars	74.9	131.0	157.7	362.0	537.7	531.1	355.0	149.3	83.3
In percent of gross international reserves	1.2	1.9	1.8	3.8	5.0	4.7	2.9	1.1	0.6
In percent of exports of goods and services	0.7	1.0	1.2	2.4	3.3	3.0	1.8	0.7	0.4
In percent of GDP	0.1	0.2	0.3	0.5	0.7	0.6	0.4	0.1	0.1
In percent of quota	9.8	17.1	20.6	47.4	70.3	69.5	46.4	19.5	10.9
Outstanding Fund credit based on existing drawings									
(end-of-period, all PRGT)									
In millions of SDRs	561.1	475.4	372.1	260.8	163.1	71.9	21.6	0.0	0.0
In percent of quota	103.4	87.6	68.6	48.1	30.0	13.2	4.0	0.0	0.0
Outstanding Fund credit based on existing and									
prospective drawings (end-of-period) [2]									
In millions of SDRs	1,160.9	1,482.3	1,436.0	1,189.0	815.1	442.7	192.8	87.7	29.0
In millions of U.S. dollars	1,635.0	2,087.6	2,022.4	1,674.6	1,148.0	623.5	271.5	123.4	40.8
In percent of gross international reserves	25.4	30.9	23.5	17.6	10.6	5.5	2.2	0.9	0.3
In percent of exports of goods and services	14.4	16.6	14.7	11.1	7.0	3.5	1.4	0.6	0.2
In percent of GDP	2.8	3.7	3.3	2.4	1.4	0.7	0.3	0.1	0.0
In percent of quota	213.9	273.1	264.6	219.1	150.2	81.6	35.5	16.1	5.3
General Resources Account	73.7	123.7	130.7	105.7	62.6	23.1	0.9	0.0	0.0
Poverty Reduction and Growth Trust	140.2	149.4	133.9	113.4	87.6	58.4	34.6	16.1	5.3
Memorandum items:									
Nominal GDP (in billions of U.S. dollars)	58.5	56.5	61.7	70.2	79.4	87.0	95.0	103.5	112.8
Exports of goods and services (in billions of U.S. dollars)	11.3	12.6	13.7	15.1	16.4	17.9	19.5	21.3	23.2
Gross international reserves (in billions of U.S. dollars)	6.4	6.8	8.6	9.5	10.8	11.4	12.1	13.8	14.0
Quota (in millions of SDRs)	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8	542.8

Sources: Fund staff estimates; and projections.

1 PRGT interest waived through end-2016. RCF interest set at zero percent and no longer subject to biannual Board reviews. The following rates are assumed beyond 2016: projected interest charges between 2017 and 2018 are based on 0/0.25/0.25 percent per annum for the ECF, SCF, and ESF, respectively, and beyond 2018 0.25/0.5/0.25 percent per annum.

2 Assumes access of 196 percent of quota during 2016-18 and semi-annual disbursements.

Table 9. Kenya: External Financing Requirements and Sources, 2014–19

(BPM6 presentation, financial years)[1]

	2014		2015		2016		2017	2018	2019
	First Rev.	Act.	First Rev.	Proj.	First Rev.	Proj.	Projections		
					(In millions of U.S. dollars)				
Total requirements	8,628	8,971	7,585	6,597	8,178	6,149	5,899	5,349	7,418
Current account deficit	6,339	6,339	6,188	5,012	6,652	4,508	3,374	3,494	3,907
Capital outflows	2,288	2,632	1,397	1,585	1,527	1,641	2,525	1,854	3,511
Repayments of MLT loans	2,288	2,604	1,397	1,369	1,527	1,358	2,149	1,563	2,444
Portfolio investment (sovereign bond)	0	0	0	0	0	0	0	0	750
Foreign direct investment abroad	...	28	...	217	...	283	376	292	317
Total sources	8,628	8,971	7,585	6,597	8,178	6,149	5,899	5,349	7,418
Capital inflows	10,020	7,592	7,212	6,915	8,740	8,006	6,020	3,456	6,324
Public sector	4,118	4,051	3,337	3,128	2,643	2,793	2,020	2,422	2,871
Project grants	24	24	234	208	210	195	177	193	219
Long-term loan disbursements to public sector	1,345	1,277	2,354	2,920	2,433	2,598	1,843	1,629	1,652
Portfolio investment (sovereign bond)	2,750	2,750	750	0	0	0	0	600	1,000
Private sector	5,902	3,541	3,875	3,788	6,097	5,213	4,000	1,034	3,452
Foreign direct investment in Kenya	1,051	1,051	1,437	1,285	1,844	981	1,490	2,076	2,242
Long-term loan disbursements to private sector	1,488	640	1,545	500	1,681	750	1,200	1,000	1,600
Other net inflows (including errors and omissions)	3,364	1,851	893	2,003	2,572	3,481	1,310	-2,042	-389
Financing	1,393	1,379	-372	-318	562	-1,856	-121	1,893	1,094
IMF (net)	-58	-58	-73	-66	-117	776	453	-65	-157
Disbursements	0	0	0	0	0	845	573	80	0
Repayments	58	58	73	66	117	69	121	145	157
Reserve assets (gross)	1,335	1,321	-445	-384	445	-1,080	332	1,827	938
Financing gap	0	0	0	0	0	0	0	0	0
					(In percent of GDP)				
Total requirements	14.2	14.7	12.0	10.7	11.9	10.5	10.4	8.7	10.6
Total sources	14.2	14.7	12.0	10.7	11.9	10.5	10.4	8.7	10.6
Capital inflows	16.4	12.5	11.4	11.3	12.7	13.7	10.7	5.6	9.0
IMF (net)	-0.1	-0.1	-0.1	-0.1	-0.2	1.3	0.8	-0.1	-0.2
Reserve assets (gross)	2.2	2.2	-0.7	-0.6	0.6	-1.8	0.6	3.0	1.3

Sources: Kenyan authorities and IMF staff estimates and projections.

[1] Estimates and projections from the First Review staff report (EBS/15/99) have been converted from BPM5 to BPM6 presentation.

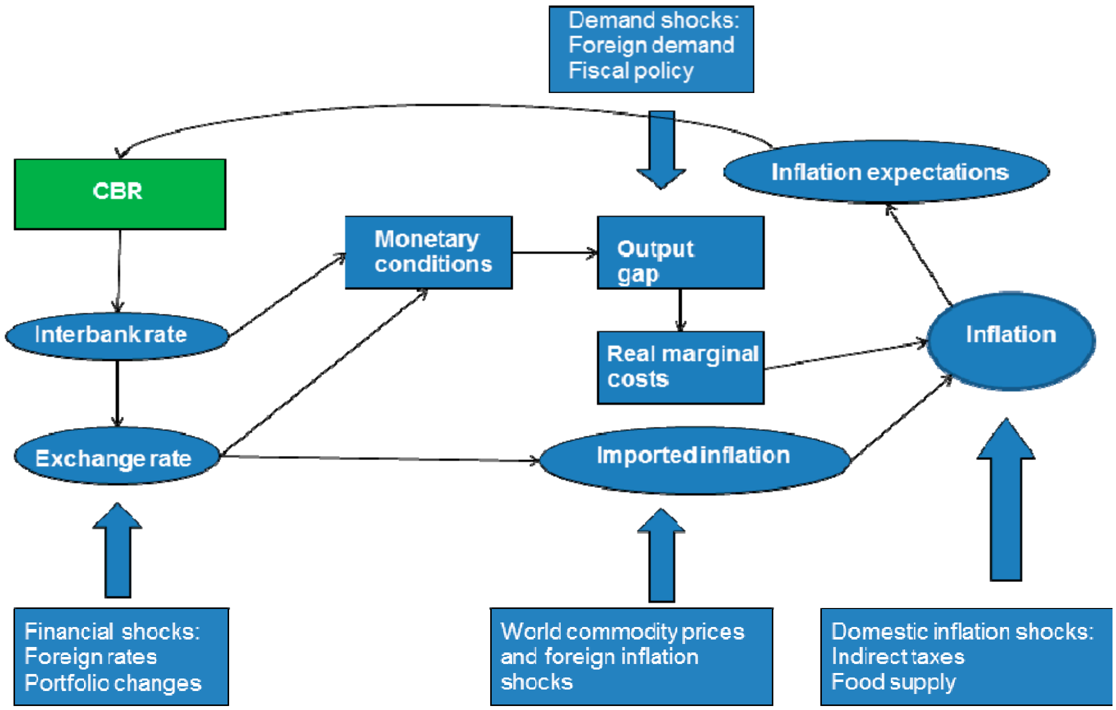
Annex I. Forecasting Policy Analysis Systems (FPAS) Framework for Kenya

We adopt a simple New-Keynesian quarterly projection model (QPM) to analyze monetary policy based on a medium-term inflation outlook. Similar models are often used as core forecasting models in the Forecasting and Policy Analysis Systems (FPAS) adopted by many central banks, including the Central Bank of Kenya.

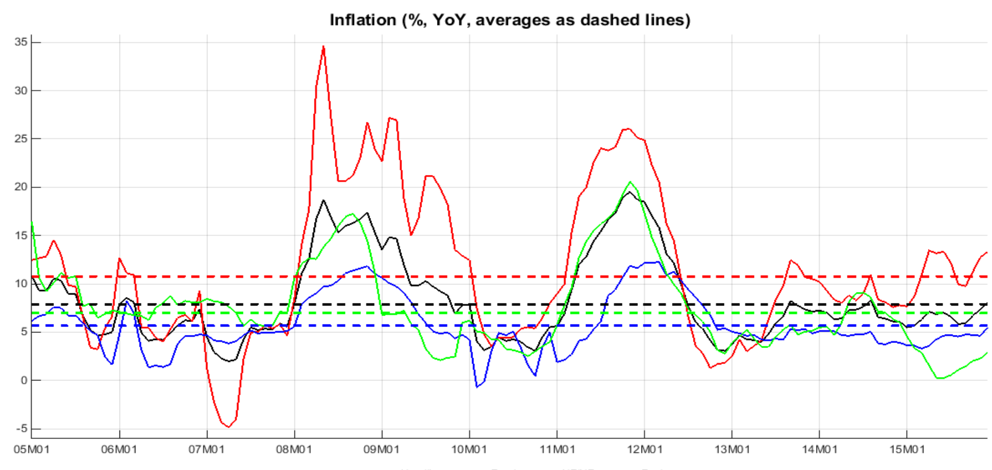
The purpose of the QPM is to facilitate coherent forward-looking analysis of the inflationary factors and to infer an appropriate path for the operational target of monetary policy consistent with attaining the inflation objective in the medium term. In doing so, the model helps distinguish temporary pressures on inflation (e.g., food and energy supply shocks) from more persistent pressures (e.g. from excessive demand). The forward-looking nature of the QPM helps also in distinguishing first- and second-round effects of supply shocks or changes in indirect taxes in guiding the policy decisions.

The adopted QPM is built around four main behavioral equations:

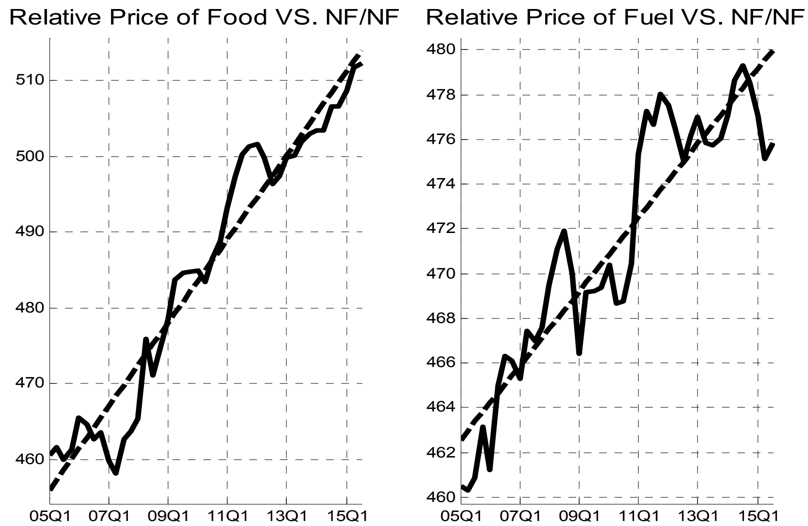
- *IS curve* represents the behavior of aggregate demand. Aggregate demand depends on the real interest rate and real exchange rate, the main drivers of intertemporal substitution in consumption and substitution between domestic and foreign goods, respectively. Aggregate demand is also affected by foreign demand and the fiscal stance. Specification of the IS curve in Kenya's QPM reflects relatively weak interest rate channel of the monetary transmission in Kenya.
- *Phillips curve* represents aggregate supply, which depends on real marginal costs that are approximated by the output gap and real exchange rate. The model includes separate Phillips curves for food, fuel, and non-food non-fuel inflations. The calibration of the Phillips curves includes strong and fast exchange rate pass-through to prices, prevalence of short-lasting supply shocks, and low price stickiness, typical for Kenya's economy.
- *Uncovered interest parity condition* relates domestic and foreign interest rates with expected foreign exchange depreciation and the country risk premium. The condition ensures that there is no arbitrage between investments abroad and in the domestic economy.
- *Taylor rule* describes the behavior of monetary policy, which sets the policy rate (i.e., operational target) around the policy neutral rate in order to bring inflation towards the inflation target in the medium term. The figure below presents the monetary policy transmission mechanism. The recent large deviations of the interbank interest rate from the policy rate blur the transmission channels of monetary policy and reduce the reliability of the forecasting exercise. For the purpose of inflation forecasting, the staff uses the Taylor rule for the interbank interest rate.



The QPM for Kenya treats food, fuel (also includes transportation prices), and non-food non-fuel (NF/NF) inflation separately to better identify food and fuel supply shocks and also to take into account explicitly that food and fuel prices grow faster on average than NF/NF prices. During 2005–15, average food price inflation was over 10 percent while the NF/NF inflation was slightly over 5 percent.



Based on the historical observations, staff estimated steady state values for (i) food inflation—7.9 percent; and (ii) non-food non-fuel inflation—2.8 percent. These estimates are consistent with the steady state for headline inflation of 5 percent, which is the inflation target.



Excluding the impact of the excise taxes (estimated at 0.6 percentage points) in December 2015, NF/NF inflation stood at 5 percent (above its estimated steady state value of 2.8 percent), likely reflecting continued demand pressures and second-round effects of the exchange rate depreciation and the food supply shocks in 2015.

Stand-By Arrangement

Attached hereto is a letter (the "Letter") with its annexed Memorandum of Economic and Financial Programs (the "MEFP") and Technical Memorandum of Understanding (the "TMU") dated February 29, 2016, from the Cabinet Secretary of the National Treasury and the Governor of the Central Bank of Kenya, requesting a Stand-By Arrangement and setting forth:

a) the objectives and policies that the authorities of Kenya intend to pursue for the period of this Stand-by Arrangement;
b) the policies and measures that the authorities of Kenya intend to pursue during the first year of this Stand-by Arrangement; and
c) understandings of Kenya with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Kenya will be pursue for the remaining period of this Stand-by Arrangement.

To support these objectives and policies, the Fund grants this Stand-by Arrangement in accordance with the following provisions:

1. For a period of twenty four (24) months from the date of the approval of this Stand-by Arrangement, Kenya will have the right to make purchases from the Fund in an amount equivalent to SDR 709.259 million, subject to paragraphs 2, 3, 4 and 5 of this Stand-by Arrangement, without further review by the Fund.

2. (a) Purchases under this Stand-by Arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 361.867 million until November 15, 2016, the equivalent of SDR 399.863 million until May 15, 2017, the equivalent of SDR 535.563 million until November 15, 2017 and the equivalent of SDR 671.263 million until March 5, 2018.

(b) None of the limits in (a) above shall apply to a purchase under this Stand-by Arrangement that would not increase the Fund's holdings of Kenya's currency subject to repurchase beyond 25 percent of quota.

3. Kenya will not make purchases under this Stand-by Arrangement that would increase the Fund's holdings of Kenya's currency subject to repurchase beyond 25 percent of quota:

   (a) Subject to paragraph 2 of Decision No. 14407-(09/105), as amended, during any period in which the data at the end of the preceding period indicate that:

      (i) the floor on the primary budget balance of the national government of Kenya; or
      (ii) the floor on the stock of net international reserves of the Central Bank of Kenya

as specified in Table 3 of the MEFP and as further specified in the TMU, is not observed; or

(b) If at any time during the period of this Stand-by Arrangement, the ceiling on the accumulation of new external payment arrears by the national government, as set out in Table 3 of the MEFP and further specified in the TMU, is not observed; or
(c) On or after November 14, 2016, May 145, 2017, November 145, 2017 and March 4, 2018 respectively, until the reviews contemplated in paragraph 6 of the LOI are completed.
(d) If at any time during the period of the Stand-by Arrangement, Kenya:

 (i) imposes or intensifies restrictions on the making of payments and transfers for current international transactions; or
 (ii) introduces or modifies multiple currency practices; or
 (iii) concludes bilateral payments agreements that are inconsistent with Article VIII; or
 (iv) imposes or intensifies import restrictions for balance of payments reasons; or

(e) If Kenya has not consulted with the Fund as provided for in Paragraph 12 of the TMU and Table 3 of the MEFP.

When Kenya is prevented from purchasing under this Stand-by Arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Kenya and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Kenya will not make purchases under this Stand-by Arrangement during any period in which Kenya: (i) has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action; or (ii) is failing to meet a repurchase obligation to the PRG Trust established by Decision No. 8759-(87/176), or a repayment expectation to that Trust, pursuant to the provisions of Appendix I of the PRG Trust Instrument.

5. Kenya's right to engage in the transactions covered by this Stand-by Arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Kenya. When notice of a decision of formal ineligibility, or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this Stand-by Arrangement will be resumed only after consultation has taken place between the Fund and Kenya and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this Stand-by Arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless at the request of Kenya, the Fund agrees to provide SDRs at the time of the purchase.

7. Kenya shall pay a charge for this Stand-by Arrangement in accordance with decisions of the Fund.

8. (a) Kenya shall repurchase the amount of its currency that results from a purchase under this Stand-by Arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases, as Kenya's balance of payments and reserve position improves. (b) Any reductions in Kenya's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

9. During the period of this Stand-by Arrangement, Kenya shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Kenya or of representatives of Kenya to the Fund. Kenya shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Kenya in achieving the objectives and policies set forth in the Letter, MEFP and TMU.

10. In accordance with paragraph 8 of the Letter, Kenya will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 of this Stand-by Arrangement have not been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of this Stand-by Arrangement and while Kenya has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Kenya's balance of payments policies.

Arrangement Under the Standby Credit Facility

Attached hereto is a letter dated February 29, 2016 (the "Letter"), with its attached Memorandum of Economic and Financial Policies (the "MEFP) and Technical Memorandum of Understanding (the "TMU"), from the Cabinet Secretary of the National Treasury and the Governor of the Central Bank of Kenya requesting from the International Monetary Fund, as Trustee of the Poverty Reduction and Growth Trust (the "Trustee"), a twenty four (24) months arrangement under the Standby Credit Facility (the "SCF Arrangement"), and setting forth:

(a) the objectives and policies of the program that the authorities of Kenya intend to pursue during the 24-month period of the SCF Arrangement;
(b) the objectives, policies and measures that the authorities of Kenya intend to pursue during the period of the SCF Arrangement; and
(c) understandings of Kenya with the Trustee regarding reviews that will be made of progress in realizing the objectives of the program.

To support these objectives and policies, the Trustee grants the requested 24-month SCF Arrangement in accordance with the following provisions, and subject to the provisions applying to assistance under the Poverty Reduction and Growth Trust (the "PRG Trust").

1. For a period of 24 months from the date of approval of this SCF Arrangement, Kenya will have the right to obtain disbursements from the Trustee in a total amount equivalent to SDR 354.629 million, subject to the availability of resources in the PRG Trust.

2. During the period of the SCF Arrangement:

   (a) the first disbursement, in an amount equivalent to SDR 180.933 million will be available upon approval of this SCF Arrangement, at the request of Kenya, and subject to paragraphs 3, 4 and 5 below;
   (b) the second disbursement, in an amount equivalent to SDR 18.998 million, will be available on or after November 15, 2016, at the request of Kenya and subject to paragraphs 3, 4 and 5 below;
   (c) the third disbursement, in an amount equivalent to SDR 67.85 million, will be available on or after May 15, 2017, at the request of Kenya and subject to paragraphs 3, 4 and 5 below;
   (d) the fourth disbursement, in an amount equivalent to SDR 67.85 million, will be available on or after November 15, 2017, at the request of Kenya and subject to paragraphs 3, 4 and 5 below; and
   (e) the fifth disbursement, in an amount equivalent to SDR 18.998 million, will be available on or after March 5, 2018, at the request of Kenya and subject to paragraphs 3, 4 and 5 below.

3. Kenya will not request the second, third, fourth and fifth disbursements under this SCF Arrangement specified in paragraphs 2(b), 2(c), 2(d) and 2(e) above respectively:

   (a) if the Managing Director of the Trustee finds that, with respect to the second disbursement, the data as of June 30, 2016; with respect to the third disbursement, the data as of December 31, 2016; with respect to the fourth disbursement, the data as of June 30, 2017 and with respect to the fourth disbursement, the data as of December 31, 2017 indicate that:

      (i) the floor on the primary budget balance of the national government of Kenya; or

      (ii) the floor on the stock of net international reserves of the Central Bank of Kenya;

as set out in Table 3 of the MEFP and further specified in the TMU was not observed; or

   (b) after November 14, 2016 until the Trustee has determined, with respect to the second disbursement, that the first program review has been completed, after May 14, 2017 until the Trustee has determined, with respect to the third disbursement, that the second program review has been completed, after November 14, 2017 until the Trustee has determined, with respect to the fourth disbursement, that the third program review has been completed, and after March 4, 2018 until the Trustee has determined, with respect to the fifth disbursement, that the fourth program review has been completed.

4. Kenya will not request a disbursement if at any time during this SCF Arrangement:

   (a) the ceiling on the accumulation of new external payment arrears by the national government, as set out in Table 3 of the MEFP and further specified in the TMU, is not observed; or
   (b) Kenya imposes or intensified restrictions on the making of payments and transfers for current international transactions, or
   (c) Kenya introduces or modifies multiple currency practices, or
   (d) Kenya concludes bilateral payments agreements that are inconsistent with Article VIII, or
   (e) Kenya imposes or intensifies import restrictions for balance of payments reasons.

5. Kenya will not request a disbursement if it has not consulted with the Fund as provided for in Paragraph 12 of the TMU and Table 3 of the MEFP.

6. Kenya will not request a disbursement that has become available under the SCF Arrangement upon the satisfaction of the conditions for such disbursement set out in paragraphs 3 and 4 above and that remains undrawn:

(i) after November 14, 2016, until the first review referred to in paragraph 3(b) above has been completed;

(ii) after May 14, 2017 until the second review referred to in paragraph 3(b) above has been completed;

(iii) after November 14, 2017 until the third review referred to in paragraph 3(b) above has been completed; and

(iv) after March 4, 2018 until the fourth review referred to in paragraph 3(b) above has been completed.

7. When Kenya is prevented from requesting disbursements under this SCF Arrangement because of paragraphs 3, 4 and 5 above, such disbursements may be made available only after consultation has taken place between the Trustee and Kenya and understandings have been reached regarding the circumstances in which Kenya may request the disbursements.

8. In accordance with paragraph 8 of the Letter, Kenya will provide the Trustee with such information as the Trustee requests in connection with the progress of Kenya in implementing the policies and reaching the objectives of the program supported by this SCF Arrangement.

9. During the period of this SCF Arrangement, Kenya shall remain in close consultation with the Trustee. In accordance with paragraph 8 of the Letter, Kenya shall consult with the Trustee on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director of the Trustee requests such a consultation. Moreover, after the period of this SCF Arrangement and while Kenya has outstanding financial obligations to the Trustee arising from loan disbursements under this SCF Arrangement, Kenya shall consult with the Trustee from time to time, at the initiative of the government or whenever the Managing Director of the Trustee requests such consultation on Kenya's economic and financial policies. These consultations may include correspondence and visits of officials of the Trustee to Kenya and of representatives of Kenya to the Trustee.

Appendix I. Letter of Intent

Nairobi, Kenya

February 29, 2016

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
United States of America

Dear Ms. Lagarde:

1. Kenya's growth performance remains robust, supported by significant public infrastructure investments, lower energy prices, and strong private consumption. We have continued to implement key structural reforms, which have resulted in significant improvements in the business environment, boding well for continued strong, pro-poor growth over the medium term. However, external shocks from heightened volatility in global markets adversely affected capital inflows, put pressure on the exchange rate, and contributed to fiscal financing challenges. Inflation has also risen in recent months largely due to adverse weather-related factors and a new excise tax, and exceeded the upper bound of our target range (5±2.5 percent) in December, but still within single digit levels.

2. Performance under our economic program supported by the Stand-By Arrangement (SBA) and the Standby Credit Facility arrangement (SCF) has been broadly in line with program targets. We met all end-September and continuous performance criteria (PCs), as well as all end-September quantitative indicative targets (Table 1). Four out of six end-September and end-December structural benchmarks were also completed and we made significant progress towards completing the other two structural benchmarks (Table 2). The implementation of the structural measures envisaged under the program are important steps towards improved cash and public debt management, more transparent fiscal operations, more effective instruments for the Central Bank of Kenya (CBK), and better quality external sector data that will allow for a more accurate assessment of private sector vulnerabilities.

3. We are taking determined steps to strengthen our resilience to shocks. To maintain macroeconomic stability, and in response to the external shocks that affected our economy in 2015, we have tightened monetary policy in the context of a flexible exchange rate regime, mobilized additional foreign financing, and submitted to Parliament a Budget Policy Statement containing fiscal measures to meet the original fiscal deficit target of 8 percent of GDP for 2015/16 envisaged under the program.

4. Our policies for the next two years focus on sustaining inclusive, investment-led growth while continuing to build resilience. We remain committed to a gradual consolidation of fiscal policy, in order to maintain public debt sustainability and in the medium term to meet the East African Community monetary union convergence criteria. The CBK's policies aim to bring inflation within the target range (below 7.5 percent) by mid-2016 and subsequently towards the midpoint of our target range (5 percent) by end-2016. We are also committed to further improve public financial management with a strong emphasis on public sector efficiency and transparency, to strengthen the financial sector supervision and regulation, to make further progress in our transition to a modern inflation targeting framework, and to deepen structural reforms aimed at improving the business environment.

5. While these reforms are under way, reducing existing vulnerabilities will take time. In view of the fact that the current account deficit is partly financed by portfolio and other short-term capital inflows, Kenya is vulnerable to possible shifts in investors' risk perception towards emerging and frontier markets, in light of heightened volatility of global markets. Furthermore, while security threats and weather-related shocks are subsiding, these continue to represent additional sources of potential shocks.

6. Against this background, and on the basis of our established track record of program implementation to date and the policy priorities outlined in the attached Memorandum of Economic and Financial Policies (MEFP), we request: (i) completion of the second reviews under the current 14-month SBA and SCF arrangements and hereby cancelation of those arrangements immediately upon completion of the second reviews; and (ii) a follow-up program supported by new SBA and SCF, with combined access of SDR 1,063.888 million (196 percent of quota) over the next 24 months, of which SDR 709.259 million under the SBA and SDR 354.629 million under the SCF. In addition to providing a buffer against exogenous shocks, the requested new SBA-SCF arrangements will continue to provide a policy anchor for our reform program. We expect to complete the first review under the Stand-by and SCF arrangements on or after November 15, 2016, the second review on or after May 15, 2017, the third review on or after November 15, 2017 and the fourth review on or after March 5, 2018.

7. While we do not have balance of payments needs under our baseline projections, potential needs could materialize if major capital account, security or weather-related shocks were to hit our economy. Therefore we intend to treat both new arrangements as precautionary, and we do not intend to draw under these arrangements unless exogenous shocks generate an actual balance of payments financing need. We believe that the envisaged package of macroeconomic policies and structural reforms under the new program, with the performance criteria and structural benchmarks summarized in Tables 3 and 4, would significantly reduce the likelihood of potential balance of payments need after 2017/18.

8. We are confident that the policies set out in the attached MEFP will enable us to achieve our program objectives. However, we will take any further measures that may become necessary for this purpose. We will consult with the IMF on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such

consultations. We will provide such information as the IMF may request in connection with progress in implementing our economic and financial policies. We authorize the publication of the staff report for the request of the program supported by SBA-SCF arrangements, this letter of intent, and the attached MEFP and technical memorandum of understanding.

Sincerely yours,

/s/	/s/
Henry Rotich Cabinet Secretary The National Treasury	Patrick Njoroge Governor Central Bank of Kenya

Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

I. BACKGROUND

1. **The Kenyan economy has continued to perform well despite headwinds from a weaker global economic environment.** Real GDP growth accelerated to 5.8 percent in the third quarter of 2015 (up from 5.0 percent and 5.6 percent, respectively, in the first and second quarters), supported by higher public investment spending, continued strong growth in consumption, and improved weather conditions that have boosted agricultural and hydro-power electricity production. Despite the turbulence in emerging markets associated with the anticipated normalization of the U.S. monetary policy in the third quarter of 2015, key macroeconomic indicators have remained broadly stable in recent months. The eventual hike in the U.S. Fed rate in December 2015 had minimal impact on our financial market. Average inflation increased from 6.1 percent in the third quarter of 2015 to 7.4 percent in the fourth quarter of 2015, largely driven by adverse weather conditions associated with the El Nino rains which disrupted food supply chains, and the revised excise taxes that took effect from December 1, 2015. In December 2015 and January 2016, the 12-month inflation exceeded the upper bound of our target range (5±2.5 percent) on account of these factors.

2. **Notwithstanding external shocks, our external position remains resilient.** The spillover into Kenya of the heightened volatility in global markets, which intensified starting in April 2015, adversely affected capital inflows and put pressure on the exchange rate. Our policy response focused on tightening monetary policy, mobilizing additional foreign financing, and temporarily containing expenditures. The current account deficit is narrowing, due to lower international oil prices, better tea and horticulture exports, and higher remittances. Following the recent removal of travel warnings to tourist destinations by several main tourism source markets which reflects improved security, the decline in tourist arrivals seems to have bottomed out. International reserves remained adequate at US$7.5 billion at end-2015, equivalent to 4.5 months of projected imports of goods and services for 2016.

3. **The banking system's financial soundness indicators remain sound.** The banking sector has continued to demonstrate robust growth and resilience both in its domestic and regional operations. The core capital and total capital to total risk weighted assets ratios for the banking system stood at 15.6 percent and 18.6 percent respectively as at end December 2015, above the respective statutory minimums of 10.5 percent and 14.5 percent. While credit and liquidity indicators remain satisfactory, we are continuously monitoring credit and liquidity risks.

4. **The prevailing precautionary SBA-SCF arrangements helped anchor our macroeconomic policy framework, and also back stopped our foreign exchange reserve buffers**. All end-September and continuous performance criteria (PCs), the end-September inflation target under the Monetary Policy Consultation Clause (MPCC), as well as all end-September quantitative indicative targets were met (Table 1). Four out of six end-September and end-December structural benchmarks were also completed and we made significant progress towards completing the other two structural benchmarks (Table 2). Kenya was among the top 10

reformers in 2015 in the World Bank's Ease of Doing Business Index, moving to 108th place (out of 189 countries) from 129th in 2014, with improvements especially in the provision of electricity, access to credit, and ease of registering property.

5. We are taking deliberate steps to strengthen our economy's resilience to shocks. We remain committed to undertake a gradual consolidation of fiscal policy, in order to maintain public debt sustainability in line with the East African Community (EAC) monetary union convergence criteria. The CBK's policies aim to bring inflation towards the mid-point of our target range (5±2.5 percent), while helping ensure financial sector stability. We are also taking steps to improve the financial sector oversight, strengthen the monetary policy transmission mechanism, and deepen structural reforms to improve the business environment. However, reducing vulnerabilities requires concerted efforts and will take time. The renewed program with the Fund for an additional 24 months will provide continued insurance against potential shocks that could generate a balance of payments need, as well as anchor policies aimed at strengthening Kenya's resilience to shocks.

II. MACROECONOMIC OUTLOOK

6. Based on policies outlined in section IV below, the outlook is for continued robust growth, lower fiscal deficits, the return of inflation within the target range in mid-2016 and its gradual decline thereafter towards the midpoint of our target range, and a gradual improvement in the external current account:

7. ***Real GDP*** growth is projected to reach 5.6 percent in 2015 and accelerate to 6.0 percent in 2016, driven by higher growth in agriculture on account of better rains, an expected recovery of tourism, and continued support from public infrastructure investments and private consumption.

8. ***Inflation*** is projected to decline below 7.5 percent by mid-2016, and to gradually converge towards the mid-point of our target band over time, supported by the policy mix outlined below (including a gradual fiscal consolidation unburdening monetary policy).

9. Kenya's ***external position*** is projected to strengthen over the program period. In 2015, the current account deficit is estimated to have narrowed to 8.2 percent of GDP, or about 2 percentage points of GDP lower than in 2014, following the peak of aircraft imports in 2014, a fall in international oil prices, and a slowdown in consumer imports. The current account deficit is projected at 8.0 percent of GDP in 2016 on the back of SGR-related imports, and to decline to 6.7 percent of GDP in 2017 mainly reflecting the envisaged reduction in the fiscal deficit. We expect reserves to remain at adequate levels in the absence of further shocks.

10. There are downside risks to the above baseline outlook. The most severe shock would emanate from the financial account of the balance of payments, in light of heightened volatility in global markets, which could be amplified by expected further increases in US policy interest rates, slower global or regional growth, and difficulties in some emerging market countries. Other downside risks stem from possible security threats and the impact of weather-related shocks that would lower agricultural production and affect hydro power generation, and require higher imports of food and fuel products.

III. PROGRAM OBJECTIVES

11. Our main policy objective is to ensure sustainability of investment-driven, inclusive growth through prudent macroeconomic management and structural reforms. The Fund-supported program would provide a policy anchor to implement our ambitious reform program, which is centered on the following key policy priorities:

- ***Fiscal policy***. Undertaking fiscal consolidation over the medium term to reduce the burden on monetary policy in demand management, maintain public debt sustainability, and support a reduction in the current account deficit.

- ***Public financial management***. Taking decisive steps to increase the efficiency, effectiveness, transparency, and accountability of public spending, in order to ensure that there is sufficient fiscal space for priority social and investment projects.

- ***Monetary policy***. Gradually bringing inflation towards the mid-point of our target range of 5±2.5 percent, and further improving the monetary policy framework to facilitate transition towards a modern inflation targeting framework.

- ***Financial stability***. Safeguarding financial stability by enhancing prudential regulation and supervision in the face of increased growth and complexity of the financial sector. This is in tandem with Kenya's Vision 2030 objective of promoting a sound, safe and inclusive financial system.

- ***Data provision***. Improving data quality in line with international best practices, to support economic policy making.

IV. PROGRAM POLICIES

A. Fiscal Policy

12. Main policy objectives. Our fiscal anchor is to reduce the present value of gross public debt to 45 percent of GDP in the medium term. Consistent with this objective, we are committed to gradually adjusting fiscal policy, through a combination of lower spending and higher revenues. We target a reduction in the fiscal deficit to 6.5 percent of GDP in 2016/17 and 5 percent in 2017/18, from our unchanged deficit target of 8 percent of GDP in 2015/16.

13. We faced significant challenges in implementing the 2015/16 budget. Revenue collections during the first half of the fiscal year (the latest data available) fell short of budget targets by nearly KSh 50 billion (about ¾ percent of GDP). This reflected mainly slower growth, lower-than-expected yields from the income tax and VAT, as well as delays in approving the new excise tax measures. In addition, domestic financing during the first quarter of the fiscal year was constrained by overly tight liquidity conditions, resulting in a net borrowing of about 0.4 percent of GDP (compared to a projected net borrowing of 1.7 percent of GDP), and a significant increase in the cost of financing. Faced with these challenges, we advanced external financing planned in the budget, by drawing (starting in November) on a US$750 million two-year syndicated loan. As a result, overall financing during the first half of the fiscal year was about 2.5 percent of GDP. Nonetheless, the revenue shortfall constrained spending to about 77 percent of budgeted amounts during the period, contributing to delays in spending that fell mainly on capital expenditure.

14. We have taken measures to meet the original fiscal deficit target of 8 percent of GDP for 2015/16 envisaged under the program. On the basis of revenue trends during July-December, the annual revenue shortfall could reach 0.8 percent of GDP. In addition, expenditure over-runs, mainly on account of higher interest payments, are estimated at 0.2 percent of GDP. To achieve the original fiscal deficit target of 8 percent of GDP for the year, we have submitted for parliamentary approval a draft Budget Policy Statement (BPS) that reduces overall spending by about KSh 84 billion (1.2 percent of GDP) relative to the budget approved by parliament, of which about KSh45 billion pertaining to capital expenditure. In addition, the Kenya Revenue Authority (KRA) is taking a number of steps to strengthen revenue collection, which is expected to yield about 0.2 percent of GDP in additional revenue. These include introducing certification at origin of imports and streamlining management of container freight stations, dividing them into clusters to allow better monitoring. While we are confident that the above measures would achieve the 8 percent deficit target for 2015/16, if cumulative revenues (excluding grants and ministerial AIA) at end-March are below KSh 837.1 billion, we will adjust new expenditure commitments from April 2016 to fully offset the shortfall.

15. To maintain fiscal sustainability and meet the EAC monetary union convergence criterion, we remain committed to take fiscal measures to reduce the fiscal deficits by 3 percent of GDP between 2015/16 and 2017/18. These measures will include steps to:

- **Reduce tax expenditures.** With FAD TA, we will complete by end-September 2016 a study on tax expenditures, in order to identify their size, type (e.g., tax exemptions, reduced tax rates), their evolution over time, and the category of taxation to which they apply (**structural benchmark**). Based on the results of this study, we will devise measures to reduce tax expenditures.

- **Streamline allowances and adopt a clear policy for the entire public sector's remunerations and benefits policy framework outlined by the Salary and Remunerations Commission last June.** In this regard, we intend to tighten eligibility for allowances (especially those at the high end of the job scale), freeze them in nominal terms pending their review, and eventually include them as part of the base pay. Furthermore, we plan to adopt a wage and remuneration policy based on a wage grid that ensures comparability of salaries with the private sector. These measures will also help eliminate inefficiencies and foster transparency in remuneration policy. Reforms will be implemented gradually over the medium term, and within the context of a social dialogue to ensure that they are sustained. The first phase will consist of making publicly available by end-September 2016 a study on the magnitude of public sector allowances and potential fiscal savings from streamlining, and include a timetable for reforms in this area.

- **Achieve better value for money in implementation of investment projects through stricter selection and monitoring procedures.** To this end, we will by end-September 2016 issue and adopt guidelines on the appraisal of new investments projects to be incorporated into the Medium-Term Expenditure Framework (**structural benchmark**).

- **Rationalize recurrent expenditure.** We will take steps to contain growth of spending on goods and services and transfers to parastatals, with a view to gradually reduce recurrent expenditure (net of interest payments and pensions) by 0.9 percent of GDP by 2017/18.

- **Improve customs revenue collection.** With a view to reduce tax evasion, we will expand by end-June 2016 a database of up-to-date reference prices for imports, and adopt an adequate sanction policy for undervaluation.

- **Strengthen revenue performance at the county level.** We will develop by end-June 2016 an action plan aimed at initiating KRA's engagement with county governments regarding the shared administration of property rates. In addition, we will submit to parliament by end-December 2016 draft legislation to clarify powers by counties to set taxes/user fees (**structural benchmark**), aimed at increasing revenue at the county level, while maintaining a business-friendly tax system.

- **Improve collection of large outstanding tax debts.** In the first phase, we will by end-April 2016 determine the potential collectible amounts from the largest tax debts. In the second phase, we will launch an enhanced debt collection enforcement campaign.

16. We will continue to improve public finance management.

- To contain and manage fiscal risks from contingent liabilities, we will continue to enhance the reporting in the 2016 Medium-Term Budget Policy Statement on all commitments and obligations under existing PPPs and guarantees.

- To improve the processing of personnel payments and the comprehensiveness of fiscal reports, we intend to incorporate by end-June 2016 personnel payments into the Integrated Financial Management Information System (IFMIS) by interfacing it with the government human resource information systems (GHRIS) (**structural benchmark**).

- To complement this effort, we will gradually implement all GHRIS control modules (unique personal identification number, performance evaluation, and other controls), and pursue the integration of GHRIS with the KRA, the Retirement Benefits Authority (RBA), and other government institutions.

- To prevent the accumulation of pending bills, we will by end-June 2016 establish a tracking system to closely monitor their accumulation and produce monthly Aging Pending Bills reports starting in June 2016 (**structural benchmark**).

- To improve the coverage of fiscal reports, we will publish by end-March 2016 consolidated financial statements of the national government and county governments, as part of the regular annual reporting (**structural benchmark**).

- To improve the efficiency of government spending, we will by end-September 2016 strengthen the role of e-procurement by (i) widening its coverage to include all government entities (including all state-owned enterprises); and (ii) establish a system to monitor the dispersion of prices across government entities, and updating the reference prices for common items on a quarterly basis. The procurement law has been enacted and we have now embarked on developing the regulations.

- To make further progress towards improving the efficiency of the government cash management and payment processes, as part of the Treasury Single Account reform, we will by end-September 2016 capture all public debt payments in IFMIS (**structural benchmark**).

- To strengthen the accountability and transparency of county finances, we will start in June 2016 the verification of outstanding county assets and liabilities.

B. Monetary Policy

17. Policy objectives: Our key policy objective is to bring headline inflation towards the midpoint of our target range (5±2.5 percent), in the context of a floating exchange rate regime. The inflation objective under the program will continue to be monitored through a monetary policy consultation clause (MPCC), developments in CBK's net domestic assets and net international reserves.

18. Inflation outlook. Inflation is expected to remain above the target range in the near term on account of high food prices arising mainly from weather-related food price shocks, exchange rate pass-through, and the impact of the recently introduced excise taxes. However, once the impact of these temporary factors subsides, inflation is expected to decline below 7.5 percent. We stand ready to tighten monetary policy if there is clear evidence of rising demand pressures and/or second-order effects of supply shocks that could threaten our inflation objective.

19. Strengthening the monetary policy framework in the context of a floating exchange rate regime. Interventions will be limited to stemming volatility in the foreign exchange market. We will also continue to take measures to support the transition to a modern inflation targeting framework including:

- **Eliminating the structural rigidities that undermine market signals in money and credit markets.** We are undertaking a review of the Kenya banks' reference rate (KBRR) with a view to improve transmission mechanism and transparency to consumers. We are also enhancing liquidity management via the development of the Horizontal Repo market with a centralized Depository System.

- **Increasing the effectiveness of the CBR.** We are using our monetary policy instruments to align the interbank rate with the CBR. In this regard, we are taking measures to minimize structural rigidities that undermine market signals in the money market. Our ultimate objective is to establish an interest rate corridor for the interbank interest rate by end-September 2016 (**structural benchmark**).

C. Financial Sector

20. Policy objectives: Safeguarding financial stability remains one of our key priorities. We will continue to take steps to further strengthen prudential regulation and supervision, with a view to addressing the increased growth and complexity of the financial sector. This is in tandem with Kenya's Vision 2030 objective of promoting a sound, safe and inclusive financial system to progress towards a regional financial services hub.

21. The banking system's financial soundness indicators remain sound and we are closely monitoring potential risks. The core capital and total capital to total risk weighted assets ratios for the banking system stood at 15.6 percent and 18.6 percent respectively as at end December 2015 above the respective statutory minimums of 10.5 percent and 14.5 percent. We continue to closely monitor credit and liquidity risks through assessment of adequacy of provisions, sufficiency of capital buffers and robustness of liquidity management strategies for banks. The ratio of non-performing loans to total gross loans increased from 5.43 percent as at end-December 2014 to 6.1 percent at end-December 2015. The liquidity ratio increased from 37.7 percent at end December 2014 to 38.1 percent at end-December 2015. Two banks were placed under receivership by the Kenya Deposit Insurance Corporation (KDIC) in August and October 2015 respectively. The two banks were not systemic and the reasons for the placement of the two institutions were unique and not affecting the rest of the banking sector. Working closely with the KDIC, CBK has isolated and contained the impact of the receivership of the two banks on the rest of the banking sector. We will continue monitoring closely both cases, and take necessary actions to ensure an orderly resolution of the two banks.

22. The banking sector has continued to demonstrate robust growth and resilience both in its domestic and regional operations. We have strengthened the legal and regulatory framework by implementing capital conservation buffers, ensuring adequate provisioning for non-performing loans, establishing supervisory colleges for significant regional banking groups and conducting host country legal and regulatory assessments.

23. To further strengthen the legal and regulatory framework in the banking sector, we have identified strategic priority areas. These include:

- The enhancement of bank supervision surveillance processes, procedures and operations, including banking resolution framework.
- Requiring ICT assurance by external auditors of banks.
- Strengthening our macro- and micro-prudential stress testing framework to improve our early warning system for identifying vulnerabilities in the banking sector.
- Strengthening the capital adequacy assessment framework for banks.
- Effectively implementing a risk-based approach to Anti Money Laundering and Combating Financing of Terrorism (AML/CFT) supervision of banks and non-banks under the CBK's regulatory purview.
- Developing a crisis management framework for Kenyan banking groups with significant cross-border operations.
- Developing a legal and operational crisis management framework for Kenya's financial system, including cross border operations.

24. With Fund support, we have conducted a Financial Stability Review. The assessment included a stress testing review and capacity building in this area, a review of the regulatory and supervisory framework for banking supervision, and an assessment of the crisis preparedness and management framework. On this basis, we plan by end-June 2016 to finalize an action plan to strengthen the regulatory and supervisory framework of the banking system **(structural benchmark)**.

D. Other Structural Reforms

25. Policy objectives: We are deepening structural and governance reforms, with a view to ease cost of doing business and thus boost investments and employment creation.

26. We will continue implementing our ambitious reforms aimed at strengthening the business environment in Kenya. We consider creation of a conducive business environment—a key prerequisite for strong economic growth and poverty reduction. To that end, we are taking steps to advance business regulatory reforms with a view to reducing the cost of doing business. These include the implementation of two new Acts—the Companies Act that simplifies business requirements, and the Insolvency Act that allows distressed companies to reorganize themselves prior to liquidation—which should translate into a better integration of Kenyan business in global markets. These efforts will be complemented by further improvements in the automation and simplification of Government services: Huduma Centers, which provide services to citizens in 52 areas; the E-citizens Portal managed by the National Treasury; the Electronic Single Window for customs clearance; and measures to further reduce cost and time for trade along the Northern Corridor and through Mombasa. In addition, we are taking steps to improve the framework for registering property, including the elimination of the requirement for land rent and rates for the transfer of property process, as well as the implementation of new land registration procedures and valuation processes. We are also strengthening the enforcement of contracts. These reforms will encourage investment by foreign and domestic investors.

E. Data Quality

27. Policy objectives: To enhance dissemination of macroeconomic data, we will continue with steps toward improving the quality, coverage, and timeliness of our macroeconomic statistics.

28. Data quality and timeliness. In order to improve macroeconomic data dissemination practices, we intend to participate in the Enhanced General Data Dissemination System (e-GDDS) initiative, subject to the data sensitivities. In this direction, the Kenyan National Bureau of Statistics (KNBS) published the Foreign Investment Survey 2015 (FIS) in September 2015, covering outcomes in 2012 and 2013. The FIS will be an important input for improvements to the balance of payments statistics and production of an International Investment Position (IIP) statement that is fully integrated with the balance of payments. Starting in September 2016, we will publish quarterly consolidated GFS-compliant fiscal accounts for the budgetary central government (national government). The KNBS began work on the Household Budget Survey in September 2015, with a view to publishing the results by March 2017.

V. POLICY RESPONSE TO POTENTIAL SHOCKS

29. Should adverse shocks materialize, we will respond with a combination of corrective fiscal and monetary policies to safeguard macroeconomic stability and the program's objectives, in addition to considering drawing under the precautionary arrangements, up to the extent of the balance of payment need.

Table 1. Kenya: Quantitative Performance Criteria and Indicative Targets, March-December 2015

(in billion of Kenyan shilling, unless otherwise indicated)

	2014		2015												
			Performance Criteria (PC)/Indicative targets (IT)												
	End-Dec.		End-Mar (PC)				End-June (IT)			End-Sep (PC)			End-Dec (IT)		
	Prog.	Prel.	Prog.	Adj. Prog.	Prel.	Met/Not Met	Prog.	Prel.	Met/Not Met	1st Review	Prel.	Met/Not Met	1st Review	Prel.	Met/Not Met
Quantitative performance criteria [1]															
Fiscal targets															
Primary budget balance of the national government (-=deficit, floor) [2, 3]	-104.1	-89.8	-171.9	-174.2	-140.3	Met	-209.9	-174.1	Met	-78.0	52.4	Met	-119.6	-11.0	Met
Monetary targets [4, 5]															
Stock of central bank net international reserves (floor, in millions of US$) [6, 7]	5,909	6,746	5,956	5,956	6,498	Met	6,115	5,918	Not met	5,308	5,545	Met	5,987	6,357	Met
Public debt targets															
Contracting and guaranteeing of all medium and long term nonconcessional	1,100	1,100	1,100	1,100	873	Met	1,600	873	Met	Discontinued	...	...	Discontinued	...	...
National government external payment arrears (ceiling, millions of US$) [10]	0	35	0	0	69	Not met	0	69	Not met	0	0	Met	0	0	Met
Monetary policy consultation clause															
Upper band	...	...	7.5	7.5	...	...	7.5	...		7.5	...		7.5	...	
Center inflation target [11]	...	...	5.0	5.0	5.8	Met	5.0	7.0	Met	5.0	6.1	Met	5.0	7.4	Met
Lower band	...	...	2.5	2.5	...	...	2.5	...		2.5	...		2.5	...	
Indicative targets															
Stock of net domestic assets of the central bank (ceiling) [5]	-230	0	-206	-206	-230	Met	-186	-159	Not met	-111	-121	Met	-124	-165	Met
Priority social expenditures of the national government (floor) [3]	24	24	40	40	42	Met	52	53	Met	12	13	Met	25	18	Not met
Stock of all guarantees issued by the national government (ceiling) [3]	45	45	50	50	0	Met	50	0.0	Met	50	0.0	Met	50	0.0	Met
Memorandum items:															
Maximum upward adjustment of the primary deficit ceiling owing to															
excess in concessional loans relative to program projections [3]	...	...	59.5	...	...	...	79.3	...	...	16.8	16.8	...	42.0	...	...
Programmed concessional loans [3]	...	...	85.6	...	...	...	119.0	...	...	23.7	23.7	...	69.5	...	...
Budgeted concessional loans [3]	...	...	145.1	...	...	...	198.3	...	...	24.8	72.7	...	111.4	...	...
Programmed external commercial debt (millions of US$) [3]	...	...	750	750	750	...	750	750	...	750	0	...	750	750	...
Program grants [3]	...	...	3.8	3.8	3.5	...	6.1	3.8	...	1.3	1.5	...	2.5	...	...

[1] Performance criteria for end-March 2015 and end-September 2015, and indicative target for end-June 2015 and end-December 2015.
[2] The primary budget balance of the national government is defined as overall balance including grants, plus interest payments, excluding SGR-related expenditure. Targets will be adjusted upwards by the excess in concessional loans relative to the programmed amounts, up to the budgeted amounts, and downwards by the shortfall in concessional loans relative to the programmed amounts.
[3] Targets for end-March 2015 and end-June 2015 are cumulative flows from July 1, 2014 (beginning of the 2014/15 fiscal year). Targets for end-September 2015 and end-December 2015 are cumulative flows from July 1, 2015.
[4] For program monitoring, the daily average for the month when testing dates are due.
[5] The NIR floor will be adjusted upward by half of the excess , and downward fully by the shortfall in external budgetary support (program grants) and external commercial debt relative to the programmed amounts. The NDA ceiling will be adjusted downward by half of the excess and upward fully for the shortfall of external budgetary support (program grants) and external commercial debt relative to the programmed amounts.
[6] Excludes encumbered reserves.
[7] Using exchange rates as at end-October 2014.
[8] Cumulative flow of contracted debt, from July 1, 2014.
[9] The targets on the ceiling of non-concessional external debt combine nonconcessional project loans, syndicated loan and sovereign bond.
[10] Continuous. Cumulative flow in gross terms from July 1, 2014 for the period through end-June 2015, and from July 1, 2015 thereafter.
[11] Compliance will be evaluated based on the 12-month inflation average of the latest three months.

Table 2. Kenya: Structural Benchmarks Under the SBA-SCF Program, September–December 2015

Measure	Target Date	Status
Take measures to strengthen the staffing of the Public Debt Management Office at the National Treasury (IMF Country Report No. 15/269, MEFP ¶12).	End-September 2015	Completed.
Submit to Parliament a new Central Bank of Kenya Bill that sets price stability as primary CBK objective (IMF Country Report No. 15/269, MEFP Table 3).	End-September 2015	Completed.
Complete the audit of assets and liabilities of all counties including those inherited at the onset of devolution (IMF Country Report No. 15/269, MEFP ¶12).	End-December 2015	Not completed. A first-ever list of assets and liabilities is ready for all but one of the 47 counties. The auditing phase will start in June 2016.
Produce GFS-compliant consolidated fiscal accounts for the national government and parastatals (IMF Country Report No. 15/269, MEFP ¶13).	End-September 2015	Completed. Authorities have produced consolidated fiscal accounts for the national government on a cash basis, and separate consolidated accounts for the parastatals on an accrual basis.
Publish Foreign Investment Survey covering years 2012-13 (IMF Country Report No. 15/269, MEFP ¶22).	End-September 2015	Completed.
Complete the migration of all National Government MDAs to IFMIS/ Internet Banking (with the exception of security agencies); capture exchequer, debt payments and other Consolidated Fund Services transactions in IFMIS; reach a Service Level Agreement between the National Treasury and the CBK on agency operations; and start automating of Exchequer release process (IMF Country Report No. 15/269, MEFP ¶13).	End-September 2015	Not completed. The inclusion of debt payments into IFMIS is pending, which is expected to be completed by end-September 2016.

Table 3. Kenya: Proposed Quantitative Performance Criteria and Indicative Targets, March-December 2016

(in billion of Kenyan shilling, unless otherwise indicated)

	2015	2016			
	Act/Est	Performance Criteria (PC)/Indicative targets (IT)			
	End-Dec.	End-Mar (IT)	End-Jun (PC)	End-Sep (IT)	End-Dec (PC)
Quantitative performance criteria [1]					
Fiscal targets					
Primary budget balance of the national government (-=deficit, floor) [2, 3]	-99.5	-164.1	-206.0	-46.0	-82.9
Monetary targets [4, 5]					
Stock of central bank net international reserves (floor, in millions of US$) [6, 7]	6,367	5,784	5,900	5,852	6,283
Public debt target					
National government external payment arrears (ceiling, millions of US$) [8]	0	0	0	0	0
Monetary policy consultation clause					
Upper band	...	8.5	7.5	7.5	7.5
Center inflation target [9]	7.4	5.0	5.0	5.0	5.0
Lower band	...	2.5	2.5	2.5	2.5
Indicative targets					
Stock of net domestic assets of the central bank (ceiling)	-246	-169	-151	-139	-165
Priority social expenditures of the national government (floor) [3]	25	41	60	14.5	20.5
Stock of all guarantees issued by the national government (ceiling) [3]	50	50	50	50	50
Change in the stock of national government domestic bills pending for 90 days or more [3]	...	...	...	...	To be set at 1st review
Memorandum items:					
Maximum upward adjustment of the primary deficit ceiling owing to					
excess in concessional loans relative to program projections [3]	42.0	36.7	37.7	13.6	27.1
Programmed project loans [3, 10]	69.5	61.6	86.4	20.0	56.8
Budgeted project loans [3, 10]	111.4	98.3	124.1	33.6	83.9
Programmed external commercial debt (millions of US$) [3]	750	1,350	1,350	0	1,000
Program grants [3]	2.9	4.5	6.4	1.5	2.7

[1] Performance criteria for end-June 2016 and end-December 2016, and indicative target for end-March 2016 and end-September 2016.

[2] The primary budget balance of the national government and related adjusters are defined, respectively, in paragraph 6 and paragraph 7 of the TMU.

[3] Targets for end-March 2016 and end-June 2016 are cumulative flows from July 1, 2015 (beginning of the 2015/16 fiscal year). Targets for end-September 2016 and end-December 2016 are cumulative flows from July 1, 2016.

[4] For program monitoring, the daily average for the month when testing dates are due.

[5] The adjustors to the NIR and NDA targets are specified, respectively, in paragraph 8 and paragraph 13 of the TMU.

[6] Excludes encumbered reserves. Includes Kenya's reserve tranche position in the Fund starting from March 16, 2016.

[7] Using exchange rates as at end-January 2016 (see TMU ¶9).

[8] Continuous.

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

[10] Excludes the first phase of the Standard Gauge Railway (Mombasa to Nairobi).

Table 4. Kenya: Proposed Structural Benchmarks

Measure	Target Date	Macro criticality
Publish consolidated financial statements of all entities in the public sector (includes SAGAs, AGAs, and other state-owned enterprises), as part of the regular annual reporting (¶16)	End-March 2016	To improve the coverage of fiscal reports
Establish an interest rate corridor for the interbank interest rate around CBR (¶16)	End-September 2016	To improve the effectiveness of monetary policy
Establish a tracking system to closely monitor the accumulation of pending bills and produce monthly Aging Pending Bills reports starting in June 2016 (¶16)	End-June 2016	To prevent the accumulation of pending bills
Incorporate personnel payments into the Integrated Financial Management Information System (IFMIS) by interfacing it with the human resources management information systems (IPPD) (¶16)	End-June 2016	To improve the processing of personnel payments and the comprehensiveness of fiscal reports
Finalize an action plan containing measures to further strengthen banking regulations and supervision to align them with best practices (¶19)	End-June 2016	To safeguard financial stability
Complete a study on tax expenditures, in order to identify their size, type (e.g., tax exemptions, reduced tax rates), their evolution over time, and the category of taxation to which they apply (¶15)	End-September 2016	To reduce tax expenditures and help achieve the fiscal deficit target in 2016/17
Issue and adopt Cabinet guidelines on the selection, appraisal, and funding for major investments projects (¶15)	End-September 2016	To improve the efficiency of public investment
As part of the Treasury Single Account reform, capture all public debt payments in IFMIS (¶15)	End-September 2016	To improve liquidity management and facilitate monetary policy implementation.
Submit to parliament draft legislation to clarify powers by counties to set taxes/user fees, aimed at increasing revenue at the county level, while maintaining a business-friendly tax system (¶16)	End-December 2016	To reduce pressures on transfers to counties while maintaining a business-friendly tax system

Attachment II. Technical Memorandum of Understanding

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 24-month Stand-By Arrangement and the arrangement under the Standby Credit Facility.

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, 2016, and December 31, 2016 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 (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**);
- monetary policy consultation clause (**band**).

4. The program sets indicative targets for March 31, 2016 and September 30, 2016 with respect to the above variables, and for March 31, 2016, June 30, 2016, September 30, 2016, and December 31, 2016 unless otherwise specified 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**) effective from end-December, 2016;
- 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 the Standard Gauge Railway project, adjusted for cash basis.

6. For program purposes, the **national government primary balance**[1] 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, excluding securitization of VAT refund arrears; (b) the negative of net external financing of the national government, excluding the executed amount of disbursements related to the first phase of the Standard Gauge Railway project (connecting Mombasa to Nairobi); and (c) domestic and external interest payments of the national government. For the March 31, 2016 and June 30, 2016 test dates, the national government primary balance will be measured cumulatively from July 1, 2015, and for the September 30, 2016 and December 31, 2016 test dates cumulatively from July 1, 2016.

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 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.

[1] The definition of the national government primary balance presented in the TMUs published as IMF Country report No. 15/31 and 15/269 contained inadvertent errors. The actual data reporting was done based on the understandings reached at the time of the initial program discussions. The current version of the TMU reflects these understandings.

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 first phase of the Standard Gauge Railway project) 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)

	2016			
	Mar.	Jun.	Sep.	Dec.
Program Amount [1]	4.5	6.4	1.2	2.7

Source: Authorities' data.

1 For FY2015/16 cumulative from July 1, 2015, and for FY2016/17 cumulative from July 1, 2016.

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).
  - 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;
  - 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.

  - ➢ 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

(US$ millions)

	2016			
	Mar.	Jun.	Sep.	Dec.
Program grants [1]	4.5	6.4	1.5	2.7
External commercial debt [2]	1,350	1,350	0	1,000

Source: Kenyan authorities.

[1] For FY2015/16 cumulative from July 1, 2015, and for FY2016/17 cumulative from July 1, 2016.

[2] For end-March and end-June cumulative from July 1, 2015, and for end-September and end-December cumulative from July 1, 2016.

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 January 26, 2016)

Currency	Kenyan Shillings per currency unit	US Dollars per currency unit
US Dollar	102.24	1.00
STG Pound	145.48	1.42
Japanese Yen	0.87	117.52
Canadian Dollars	71.53	1.43
Euro	110.91	1.08
Swiss Franc	100.85	1.01
Swedish Kronor	11.93	8.57
Danish Kronor	14.87	6.88
Chinese Yuan	15.54	6.58
Australian Dollars	71.02	1.44
SDR	140.87	1.38

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.

11. The performance criterion on the national government external payment arrears is defined as a cumulative flow in gross terms from July 1, 2015 and applies on a continuous basis.

V. MONETARY POLICY CONSULTATION CLAUSE

12. 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 end-June 2016 and end-December 2016 test dates, the authorities will complete a consultation with the Executive 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.

- If the observed average for the latest three months of the 12-month rate of CPI inflation falls outside the lower or upper bands specified in the TMU Table 4 below for end-March 2016 and end-September 2016 test dates, the authorities will conduct discussions with the Fund staff.

TMU Table 4. Inflation Consultation Band

	2015				2016			
	Jan.-Mar. Actual	Apr.-Jun. Actual	Jul.-Sep. Actual	Oct.-Dec. Actual	Jan.-Mar. Indicat.	Apr.-Jun. Target	Jul.-Sep. Indicat.	Oct.-Dec. Target
Upper band					8.5	7.5	7.5	7.5
Actual/*Center point*	5.8	7.0	6.1	7.4	*5.0*	*5.0*	*5.0*	*5.0*
Lower band					2.5	2.5	2.5	2.5

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

13. **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.
  - 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.

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

VII. INDICATIVE TARGET ON PRIORITY SOCIAL SPENDING

15. 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**.**

VIII. INDICATIVE TARGET ON GUARANTEES ISSUED BY THE NATIONAL GOVERNMENT

16. The guarantees issued by the national government include all guarantees extended by the national government to counties, public enterprises and all parastatal entities. Indicative targets for end-March 2016 and end-June 2016 are cumulative flows from July 1, 2015, and the indicative target for end-September 2016 and end-December 2016 are cumulative from July 1, 2016.

IX. DATA REPORTING

17. 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 15 days after the end of the month.	CBK
Net nonbank financing of the national government	Monthly	Within 15 days after the end of the month.	CBK
Proceeds from privatization	Monthly	Within 15 days after the end of the month.	National Treasury (NT)
Interest due and paid on domestic debt	Monthly	Within 15 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 nonconcessional 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 15 days after the end of the month.	CBK
Net proceeds from issuance of external debt	Monthly	Within 15 days after the end of the month.	CBK
Any exceptional financing (including rescheduled principal and interest)	Monthly	Within 15 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. Gross official international reserves			
CBK's holding of monetary gold (excluding amounts pledged as collateral)	Monthly	Within 15 days after the end of the month.	CBK
Holdings of SDRs.	Monthly	Within 15 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 15 days after the end of the month.	CBK

TMU Table 5. Summary of Data to Be Reported (concluded)

3. Official reserve liabilities			
Total outstanding liabilities of the CBK to the IMF excluding the SDR allocations.	Monthly	Within 15 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 15 days after the end of the month.	CBK
Commitments to sell foreign exchange arising from derivatives.	Monthly	Within 15 days after the end of the month.	CBK
4. Net domestic assets			
Net CBK credit to the national government.	Monthly	Within 15 days after the end of the month.	CBK
Outstanding net CBK credit to domestic banks (including overdrafts).	Monthly	Within 15 days after the end of the month.	CBK
5. Other indicators			
Currency in circulation.	Monthly	Within 21 days after the end of the month.	CBK
Required and excess reserves	Monthly	Within 21 days after the end of the month.	CBK
Concessional and nonconcessional medium- and long-term external debt contracted or guaranteed by the national government.	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

KENYA

March 1, 2016

SECOND REVIEWS UNDER THE STAND-BY ARRANGEMENT AND THE ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY, AND REQUESTS FOR A NEW TWENTY-FOUR MONTH STAND-BY ARRANGEMENT, AND A NEW TWENTY-FOUR MONTH ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS UPDATE

Approved By
Roger Nord (IMF) and John Panzer (IDA)

Prepared by staffs of the International Monetary Fund and the International Development Association

Risk of external debt distress:	Low
Augmented by significant risks stemming from domestic public and/or private external debt?	No

Kenya's risk of external debt distress remains low, while overall public sector debt dynamics continue to be sustainable.[1] *However, margins have generally narrowed.*

Public debt has risen in recent years, with most new debt financing infrastructure intended to address bottlenecks and boost sustainable growth. The bulk of Kenya's external public debt carries concessional terms, but recent commercial borrowing entails significant repayment needs in 2017 (2015 syndicated loan), in 2019 and, especially, in 2024 (2014 sovereign bond issuance). In the event of a more permanent substitution of external for domestic finance, longer maturities would be needed to avoid bunching of repayments. Reduction of the fiscal deficit over the medium term is also essential to limit and eventually reverse the rise in public debt ratios.

[1] Kenya's policies and institutions are classified as "strong" under the World Bank's Country Policy and Institutional Assessment (CPIA) Index (average score in 2012–14: 3.84). The relevant indicative thresholds for this category are: 50 percent for the NPV of debt-to-GDP ratio, 200 percent for the NPV of debt-to-exports ratio, 300 percent for the NPV of debt-to-revenue ratio, 25 percent for the debt service-to-exports ratio, and 22 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

BACKGROUND

1. **This DSA consists of two parts: external and public.** The external DSA covers external debt of the central government and the central bank, as well as of the private sector; stress tests apply to public and publicly guaranteed (PPG) debt. The public DSA covers total debt—external and domestic—incurred or guaranteed by the central government. Public domestic debt comprises central government debt. Government finance statistics are to be expanded to cover the recently created county governments. In this analysis, total public debt refers to the sum of public domestic and public external debt, but does not cover the entire public sector (e.g., parastatal borrowing without a government guarantee is not covered).

2. **Kenya's overall public debt has increased in the past two years.** Gross public debt increased from 44 percent of GDP at end-2013 to 52 percent at end-September 2015. In the baseline, public debt is expected to stabilize around 54–55 percent of GDP in 2017–19 and gradually decline thereafter. Half of Kenya's public debt is owed to external creditors.

3. **Most of Kenya's external public debt remains on concessional terms, but its commercial component has increased.** Nominal public external debt at end-September 2015 was US$14.7 billion (text table), equivalent to 27½ percent of GDP—somewhat above the average for comparable SSA countries (text chart).

- Multilateral creditors continue to account for nearly half of external credit to Kenya. Debt to bilateral creditors is roughly half to Paris Club creditors, and half to other bilateral creditors, mainly semi-concessional loans from China to finance construction of the first phase (Mombasa-Nairobi) of the Standard Gauge Railway project (SGR; at end-August 2015, some US$2.5 billion was disbursed out of US$3.8 billion contracted). In December 2015, Kenya contracted a further US$1.5 billion, to be disbursed in coming years, for the second SGR phase (Nairobi-Naivasha),

- Kenya's commercial financing has two main elements. In 2014, Kenya issued its inaugural sovereign bonds, at 5-year and 10-year maturities, raising US$2 billion in June and a further US$750 million in December 2014.[2] More recently, in October 2015, Kenya contracted a two-year US$750 million syndicated loan at LIBOR plus 570 basis points, equivalent to an effective yield of 8 percent.

[2] The June 2014 issuance comprised two tranches: a five-year $500 million bond at a yield of 5.875 percent, and a 10-year $1.5 billion bond at 6.875 percent. In December 2014, Kenya added $250 million to the five-year tranche at a 5.0 percent yield and $500 million to the 10-year tranche at 5.9 percent.

Kenya: External Public Debt

	2012		2013		2014		September 2015	
	Billion US$	Share	Billion US$	Share	Billion US$	Share	Billion US$	Share
Multilateral creditors	5.56	57.6	6.47	60.5	7.07	49.2	7.21	49.0
Bilateral creditors	2.71	28.1	2.84	26.6	3.86	26.9	4.08	27.7
Commercial creditors	0.68	7.0	0.69	6.5	2.82	19.6	2.81	19.1
Others (supplier credits)	0.18	1.9	0.18	1.7	0.18	1.3	0.17	1.1
Total (excluding guarantees)	9.13	94.6	10.18	95.2	13.92	96.9	14.27	96.9
Publicly guaranteed debt	0.52	5.4	0.51	4.8	0.44	3.1	0.45	3.1
Total (including guarantees)	9.65	100.0	10.69	100.0	14.36	100.0	14.72	100.0

Source: Kenyan National Treasury.

4. **Kenya's gross domestic public debt was 24½ percent of GDP at end-September 2015.** Domestic debt is issued mostly in the form of Treasury bonds (75 percent of domestic debt) and Treasury bills (19 percent). Commercial banks hold half of the domestic debt, with nonbanks holding another 42 percent and the central bank holding most of the remainder. The domestic debt is of relatively large size by regional standards (text figure). Rollover risks appear moderate. The average maturity of Kenya's domestic debt shortened, from 5.8 years in June 2011 to 5.2 years in June 2013 and 4.9 years in June 2014.

UNDERLYING ASSUMPTIONS

5. **This DSA is based on macroeconomic assumptions that are consistent with the framework for the accompanying staff report, notably a modestly weaker outlook and higher external borrowing compared with previous projections**:

- Real GDP growth is modestly weaker in the short term, reflecting the impact of external shocks, but recovers in the medium term (though somewhat less than projected in the September 2015 DSA update). Faster growth in the longer term is predicated on the assumption that the present infrastructure push successfully addresses key bottlenecks.

Kenya: Selected Macroeconomic Assumptions

	2014	2015	2016	2017	Long term 1/
Real GDP Growth					
Current DSA	5.3	5.6	6.0	6.1	6.5
Previous DSA (September 2015)	5.3	6.5	6.8	7.0	6.8
Primary Fiscal Deficit (percent of GDP)					
Current DSA	4.6	5.4	4.1	2.6	0.6
Previous DSA (September 2015)	4.8	5.4	4.3	2.7	0.7
Non-interest Current Account Deficit (percent of GDP)					
Current DSA	9.7	7.4	7.0	5.5	5.9
Previous DSA (September 2015)	10.2	9.2	8.8	6.5	5.7

Source: IMF staff estimates.

1/ For current DSA update, average 2021-35. For previous DSA update, average 2021-34.

- The primary fiscal deficit is projected to peak in 2015 owing to a frontloading of the SGR-related spending, and then to be brought down in the medium to longer term consistent with the East African Community (EAC) Monetary Union convergence criteria.[3] In the long term, the primary deficit would converge to its previously projected level, consistent with keeping the overall deficit below 3 percent while making room for higher interest payments.

- The current account deficit is estimated to have narrowed in 2015 owing to lower imports of oil products and aircraft. It is projected to narrow further, in 2016 on account of lower oil prices despite an expected peak in SGR-related imports, and in the medium term reflecting fiscal consolidation as well as a pickup in trade as progress is made in regional integration. The current account projections do not include potential exports from recent oil discoveries pending confirmation that these will be commercially viable. Both oil and non-oil exports and imports are lower than previously projected.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

6. **Under the DSA baseline scenario, all external debt indicators remain well below the policy-dependent debt burden thresholds.** In this scenario, the debt burden increases over the next 10 years but remains within sustainable bounds (Table 1). The NPV of external PPG debt would peak at 25 percent of GDP in 2016 and remain around this level through 2025, falling gradually thereafter. This trajectory remains well below the 50-percent indicative threshold. The NPV of the debt-to-exports ratio would reach 141 percent in 2016 and ease gradually in following years, remaining well under an indicative threshold of 200 percent.

7. **The standard stress tests do not indicate breaches of the relevant indicative thresholds, though in one case indicate a temporary near-breach in 2024:**

- The shock that would have the largest impact on the PV of PPG external debt-to-GDP and the PV of debt-to-revenue ratios is a one-time 30-percent nominal depreciation of the exchange rate in 2016—in which case the PV of debt to GDP could increase by 13 percentage points (Figure 1 and Table 2). The depreciation shock results in a near breach of the debt service-to-revenue indicator in 2024, when the bulk of the 2014 sovereign bond is due.

- The largest medium-term impacts on the PV of debt-to-exports ratio are from temporary shocks to export value growth and to non-debt creating flows. The PV of debt-to-exports ratio would reach around 160 percent in the medium term (compared with a 200 percent

[3] The EAC Monetary Union Protocol provides for fiscal convergence criteria, including a ceiling on the fiscal deficit (defined including grants) of 3 percent of GDP; and a ceiling on the gross public debt of 50 percent of GDP in net present value terms. The other macroeconomic convergence criteria include a ceiling on headline inflation (8 percent) and a floor on reserve cover (4.5 months of imports). The fiscal plans outlined in the authorities' budget policy statement are consistent with Kenya meeting the EAC convergence criteria by 2021.

threshold) and fall only gradually in the longer term. This ratio also increases steadily under the historical scenario, in which infrastructure gaps—intended to be closed by the present investment push[4]—are implicitly assumed to continue to constrain output and exports in the longer term.

8. **Under the probability approach applicable to borderline cases, debt burden indicators remain below the relevant thresholds in the baseline and stress-test scenarios.** The estimated probability of external debt distress remains below 10 percent for all variables under all stress tests (Figure 2), compared with the relevant thresholds (ranging from 12.5 percent for the PV of debt to exports, to 15.2 percent for the debt service to revenue ratio.

9. **The authorities intend to rely on concessional external financing while maintaining a limited window for borrowing on commercial terms, in order to minimize costs and refinancing risks.** Concessional financing is complementing private investment, domestic revenues, and public investment financed through nonconcessional sources. The African Development Bank is financing power connections to take full advantage of the expanded energy capacity. The World Bank is financing capacity building at the Ministry of Energy to prepare for the eventual exploitation of oil and oil products. The authorities currently envisage the share of commercial borrowing to increase gradually over time.

10. **Commercial borrowing needs to be managed carefully to minimize the impact of repayment spikes.** Kenya's multilateral and bilateral borrowing, which accounts for most of the external debt, has smooth repayment profiles. However, recent commercial borrowing entails large repayment needs in 2017 for the syndicated loan, and in 2019 and 2024 for the sovereign bond issuance. The authorities had intended the October 2015 syndicated loan as a one-off operation, taking pressure off the temporarily disturbed domestic market; but in the event of a more permanent substitution of external for domestic finance, longer maturities would be needed to avoid bunching of repayments.

11. **Private sector external debt is tentatively estimated at about 13–15 percent of GDP.** Estimates of private sector external debt stocks used in this DSA are based on the results of the Foreign Investment Survey (FIS), which covers assets and liabilities in stock and flow terms for 2012 and 2013 (for the private sector, including banks and nonfinancial enterprises). The published results are aggregates of survey responses and do not reflect estimation or scaling; thus, the published responses reflect lower bounds on asset and liability positions. The Kenyan Bureau of National Statistics is scheduled in spring 2016 to produce its initial International Investment Position estimates and to revise historical information on the financial accounts of the balance of payments, drawing on information from the FIS.

12. **As noted in previous DSAs, recent resource discoveries represent upside potential to Kenya's external position.** Kenya is currently a net importer of petroleum products. Significant oil resources were discovered in Kenya in 2014. Oil and gas exploration activities are so far continuing, despite the weakness in oil prices since late 2014. In the event that recent discoveries are found to be commercially viable—which

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[4] IMF Country Report No. 15/31 estimated that the planned increase in public investment would add around 1 percentage point to annual real GDP growth over the medium term.

could be influenced by oil price movements—Kenya's medium- to long-term external position could improve significantly.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

13. **In the baseline scenario, public debt continues to increase in 2015 and stabilizes in 2017–19 before the projected medium-term fiscal consolidation sets debt on a declining trajectory.** In 2015, overall public debt is projected to have risen by another 3½ percentage points of GDP, to 52.7 percent of GDP. In subsequent years, on the basis of a primary deficit below 3 percent of GDP by 2017 and declining further thereafter, public debt eases to 50 percent of GDP after 2020 (Table 3). In PV terms, the public debt-to-GDP ratio would remain stable around 48–49 percent through end-2019, falling gradually thereafter. The authorities' medium-term debt anchor is 45 percent in PV terms (within the EAC convergence criterion threshold of 50 percent). The PV of public debt-to-revenue ratio would ease from 227 percent in 2015 to 215 percent in 2020 (Table 4).

14. **The projected debt path remains well below the relevant LIC DSA public debt benchmark, but this result is qualified by limits to the coverage of the debt statistics.** The baseline scenario debt trajectory is below the relevant LIC DSA public debt benchmark—in PV terms, 74 percent of GDP, applicable for LICs whose CPIA score for quality of policies and institutions is assessed as strong—above which the risk of public debt distress is heightened. However, this public debt benchmark applies conceptually to the widest possible coverage of the public sector, and ideally should include the obligations of regional and local governments, and government-controlled enterprises (especially in cases where the government owns more than half of the voting shares). The measured public debt path excludes legacy debts of the pre-devolution county governments (whose size is not yet fully clear) as well as borrowings of state-owned enterprises. In addition, public debt should include planned annuities intended to finance road construction: although the annuity obligations may not necessarily be classified as debt under local law, they nevertheless represent public debt obligations according to international (GFS) methodology.

15. **Excluding a fixed-primary-balance scenario that is distorted by temporary factors, the alternative scenarios and bound tests indicate that the projected paths for public debt indicators remain within the relevant thresholds** (Table 4 and Figure 3). Under a standard scenario that keeps the primary balance unchanged from its 2015 level, the PV of public debt to GDP would remain on a steady upwards trajectory, remaining permanently above the EAC convergence criterion reference value and exceeding the 74 percent benchmark by the mid-2020s. Since the 2015 primary deficit is boosted by temporary SGR-related spending, Figure 3 also includes a scenario fixing the primary balance excluding SGR-spending. In this case, public debt in PV terms increases more gradually, remaining below 60 percent of GDP and within sustainable bounds, but above 50 percent of GDP (the EAC convergence criterion threshold).

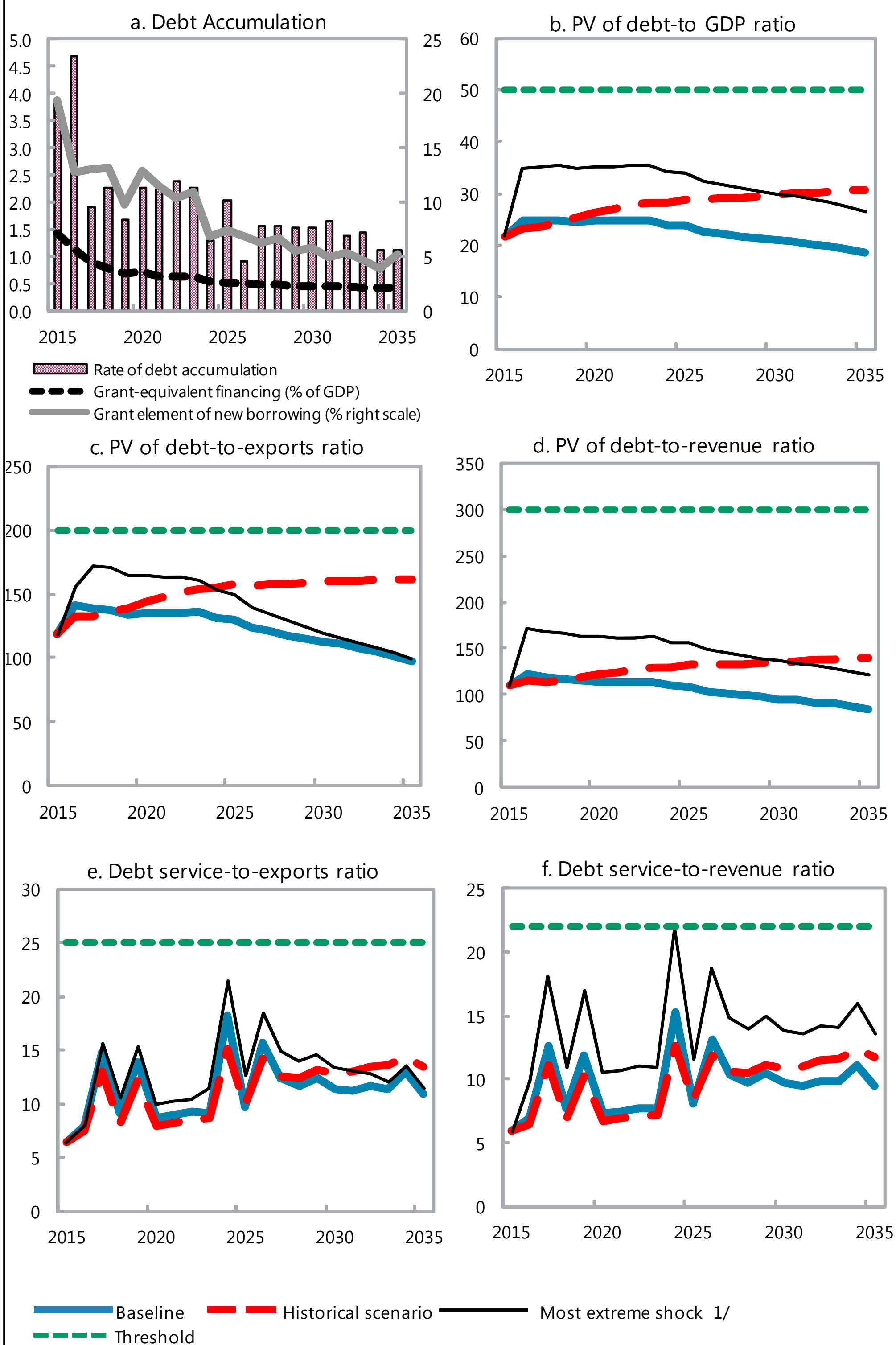
MAIN FINDINGS AND CONCLUSIONS

16. **This DSA finds that Kenya continues to face low risk of external debt distress, but margins are narrower.** Standard stress tests suggest scenarios in which external debt would increase, but remain within sustainable bounds. But the safety margins to the indicative thresholds are lower than previously. A large exchange rate shock continues to represent a significant risk to external debt. The authorities intend to continue making use of concessional resources to the extent possible—which is beneficial from both cost (present value) and maturity perspectives. Commercial borrowing needs to be managed carefully to minimize the impact of repayment spikes. Given the bunched repayments in coming years, strong debt management capacity will be especially important. In the medium term, the authorities' planned fiscal consolidation will help limit external borrowing requirements. In the longer term, the debt outlook will be influenced by the payoff from the present efforts to close infrastructure gaps and address bottlenecks that have constrained growth and exports in the recent past.

17. **Overall public debt remains sustainable, as long as the authorities implement their medium-term fiscal consolidation plans.** The baseline public debt path remains consistent with the EAC convergence criteria (deficit and debt) and below the relevant public debt benchmark, subject to coverage issues. Recent increases in public debt reflect increased borrowing to address infrastructure needs, and the related temporarily high primary deficits. Standard stress-testing scenarios show that if the primary deficit were to remain at current levels, public debt would remain on an upward path. These scenarios are more pessimistic than the authorities' stated policy intentions—which are to reduce the primary deficits in the medium term consistent with the convergence criteria for the EAC monetary union—but also highlight the need to follow through on the intended medium-term fiscal consolidation.

18. **The authorities see their program of externally financed infrastructure investments as improving prospects for growth in output and exports, and consistent with debt sustainability.** The authorities plan to continue their infrastructure push balanced with maintaining debt sustainability. They agree that they remain at low risk of external debt distress. However, they emphasize that their externally financed infrastructure investments will address bottlenecks that have constrained past growth and export performance.

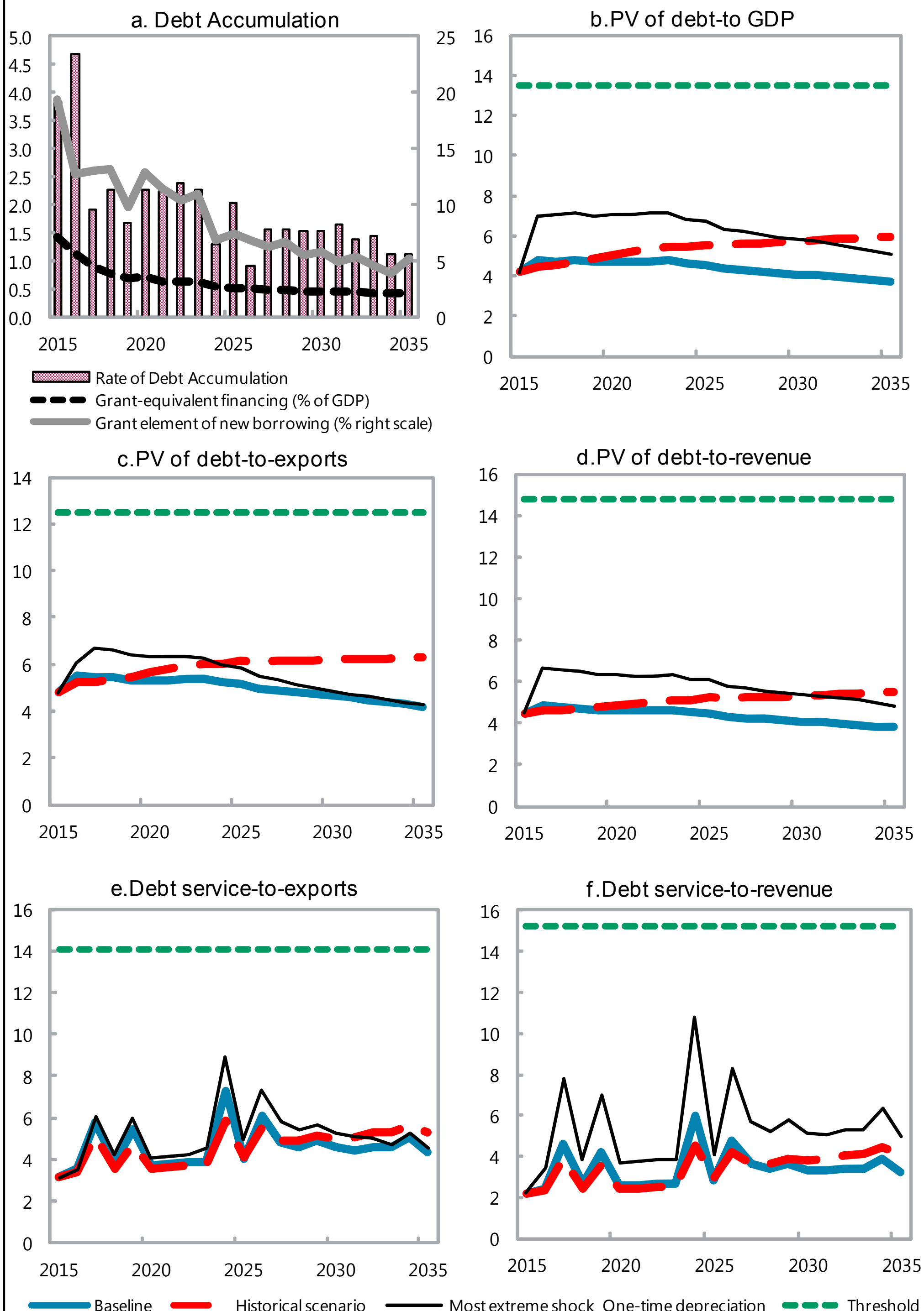
Figure 1. Kenya: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2015-2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Non-debt flows shock; in d. to a One-time depreciation shock; in e. to a Non-debt flows shock and in figure f. to a One-time depreciation shock.

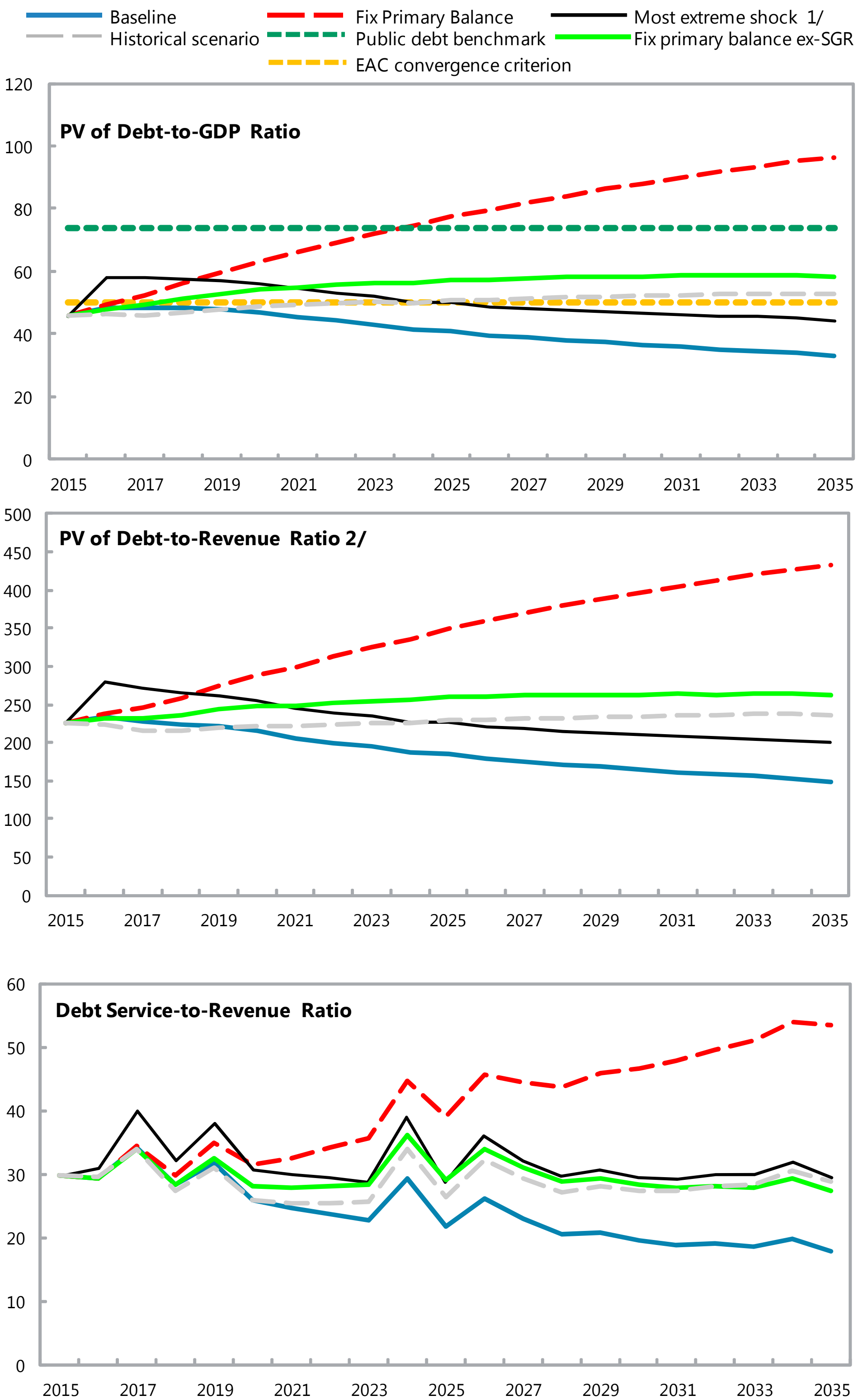
Figure 2. Kenya: Probability of Debt Distress of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2015-2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Non-debt flows shock; in d. to a One-time depreciation shock; in e. to a Non-debt flows shock and in figure f. to a One-time depreciation shock

Figure 3. Kenya: Indicators of Public Debt Under Alternative Scenarios, 2015-2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.

2/ Revenues are defined inclusive of grants.

Table 1. Kenya: External Debt Sustainability Framework, Baseline Scenario, 2012-2035[1]

(In percent of GDP, unless otherwise indicated)

	Actual			Historical [6/] Average	Standard [6/] Deviation	Projections									
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	**28.4**	**29.5**	**37.2**			**42.5**	**45.1**	**46.2**	**46.2**	**47.3**	**48.0**		**51.7**	**59.9**	
of which: public and publicly guaranteed (PPG)	19.3	19.4	24.0			28.5	31.6	31.3	30.9	30.1	30.1		27.9	20.9	
Change in external debt	1.3	1.0	7.7			5.4	2.6	1.1	0.1	1.0	0.7		1.6	0.3	
Identified net debt-creating flows	3.4	5.6	5.8			4.4	3.3	1.9	1.5	1.5	1.6		2.3	1.6	
Non-interest current account deficit	**8.0**	**8.4**	**9.7**	**5.4**	**3.2**	**7.4**	**7.0**	**5.5**	**5.4**	**5.4**	**5.5**		**6.1**	**5.4**	5.9
Deficit in balance of goods and services	13.7	14.0	15.5			13.6	13.4	12.1	12.0	11.9	12.0		12.2	11.1	
Exports	21.9	19.6	18.2			18.3	17.6	17.8	18.0	18.2	18.3		18.3	19.0	
Imports	35.5	33.6	33.7			31.9	31.0	29.9	30.0	30.1	30.4		30.5	30.1	
Net current transfers (negative = inflow)	-5.6	-5.7	-6.2	-6.2	0.4	-6.7	-6.7	-6.7	-6.6	-6.6	-6.5		-6.2	-5.5	-6.0
of which: official	-0.4	-0.4	-0.5			-0.4	-0.4	-0.3	-0.3	-0.3	-0.3		-0.3	-0.3	
Other current account flows (negative = net inflow)	-0.1	0.1	0.4			0.5	0.3	0.2	0.1	0.0	0.0		0.1	-0.1	
Net FDI (negative = inflow)	**-0.5**	**-0.9**	**-1.7**	**-0.7**	**0.7**	**-1.7**	**-2.3**	**-2.2**	**-2.4**	**-2.3**	**-2.3**		**-2.3**	**-1.9**	-2.2
Endogenous debt dynamics 2/	**-4.1**	**-1.8**	**-2.2**			**-1.2**	**-1.4**	**-1.4**	**-1.6**	**-1.5**	**-1.6**		**-1.5**	**-1.9**	
Contribution from nominal interest rate	0.4	0.5	0.7			0.8	1.0	1.1	1.2	1.2	1.3		1.5	1.7	
Contribution from real GDP growth	-1.0	-1.5	-1.4			-2.1	-2.4	-2.6	-2.7	-2.8	-2.9		-3.0	-3.6	
Contribution from price and exchange rate changes	-3.5	-0.9	-1.5			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-2.1**	**-4.6**	**1.9**			**1.0**	**-0.7**	**-0.8**	**-1.4**	**-0.5**	**-0.9**		**-0.7**	**-1.3**	
of which: exceptional financing	-0.1	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	30.9			35.7	38.3	39.6	40.1	41.6	42.6		47.6	57.5	
In percent of exports	...	...	169.5			195.3	217.5	222.1	223.5	228.5	232.3		260.6	302.5	
PV of PPG external debt	**...**	**...**	**17.7**			**21.7**	**24.8**	**24.8**	**24.8**	**24.4**	**24.7**		**23.8**	**18.6**	
In percent of exports	**...**	**...**	**97.0**			**118.5**	**140.9**	**138.8**	**138.0**	**134.3**	**134.6**		**130.3**	**97.6**	
In percent of government revenues	**...**	**...**	**91.1**			**109.5**	**122.2**	**118.6**	**116.5**	**114.5**	**114.4**		**109.3**	**84.7**	
Debt service-to-exports ratio (in percent)	**39.3**	**51.1**	**59.3**			**28.8**	**24.8**	**43.1**	**33.9**	**46.0**	**35.9**		**48.8**	**53.6**	
PPG debt service-to-exports ratio (in percent)	**4.0**	**4.5**	**16.6**			**6.4**	**8.0**	**14.8**	**9.1**	**13.9**	**8.7**		**9.7**	**10.9**	
PPG debt service-to-revenue ratio (in percent)	**4.6**	**4.5**	**15.6**			**5.9**	**6.9**	**12.7**	**7.7**	**11.9**	**7.4**		**8.1**	**9.4**	
Total gross financing need (Billions of U.S. dollars)	9.7	11.5	13.5			10.0	10.0	11.9	12.3	15.8	17.0		35.7	123.8	
Non-interest current account deficit that stabilizes debt ratio	6.7	7.3	2.0			2.0	4.4	4.5	5.4	4.3	4.8		4.5	5.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.6	5.7	5.3	5.2	2.2	5.6	6.0	6.1	6.5	6.5	6.5	6.2	6.5	6.5	6.5
GDP deflator in US dollar terms (change in percent)	14.9	3.1	5.3	7.6	7.0	-4.6	-0.8	0.6	1.9	1.9	1.6	0.1	2.5	2.5	2.5
Effective interest rate (percent) 5/	1.8	1.9	2.7	2.2	0.6	2.2	2.6	2.7	2.8	2.9	2.9	2.7	3.3	3.1	3.1
Growth of exports of G&S (US dollar terms, in percent)	11.3	-2.3	3.1	10.5	11.2	1.0	1.2	8.3	9.2	9.9	9.0	6.4	9.2	9.8	9.4
Growth of imports of G&S (US dollar terms, in percent)	9.6	2.9	11.4	15.1	11.6	-4.7	2.4	3.0	8.8	8.9	9.2	4.6	9.2	9.0	9.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	19.4	12.8	13.1	13.2	9.8	12.9	13.5	7.4	5.2	6.8
Government revenues (excluding grants, in percent of GDP)	18.7	19.3	19.4			19.8	20.3	20.9	21.3	21.3	21.6		21.8	21.9	21.9
Aid flows (in Billions of US dollars) 7/	...	...	...			1.1	1.3	0.8	0.8	0.8	0.8		0.6	1.4	
of which: Grants	0.2	0.3	0.3			0.3	0.3	0.3	0.3	0.3	0.3		0.4	1.0	
of which: Concessional loans	...	...	...			0.8	1.0	0.5	0.5	0.5	0.5		0.2	0.4	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.4	1.1	0.9	0.8	0.7	0.7		0.5	0.4	0.5
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			26.1	18.9	21.5	23.2	19.0	21.9		16.8	16.2	16.1
Memorandum items:															
Nominal GDP (Billions of US dollars)	50.4	54.9	60.9			61.4	64.6	69.0	74.8	81.1	87.8		135.7	327.7	
Nominal dollar GDP growth	20.2	9.0	10.9			0.8	5.2	6.8	8.5	8.4	8.3	6.3	9.2	9.2	9.2
PV of PPG external debt (in Billions of US dollars)			10.5			12.8	15.7	16.9	18.5	19.7	21.6		32.2	60.6	
(PVt-PVt-1)/GDPt-1 (in percent)						3.8	4.7	1.9	2.3	1.7	2.3	2.8	2.0	1.1	1.6
Gross workers' remittances (Billions of US dollars)	1.2	1.3	1.4			1.6	1.6	1.7	1.8	2.0	2.1		3.1	6.6	
PV of PPG external debt (in percent of GDP + remittances)	...	...	17.3			21.1	24.2	24.2	24.2	23.9	24.1		23.3	18.2	
PV of PPG external debt (in percent of exports + remittances)	...	...	85.9			104.1	123.2	121.7	121.3	118.4	118.9		115.8	88.2	
Debt service of PPG external debt (in percent of exports + remittanc	...	...	14.7			5.6	7.0	13.0	8.0	12.3	7.7		8.6	9.8	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate cha
4/ Assumes that PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Kenya: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35
(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to GDP ratio								
Baseline	22	25	25	25	24	25	**24**	19
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	22	23	24	25	25	26	**29**	31
A2. New public sector loans on less favorable terms in 2015-2035 2	22	26	27	27	28	28	**30**	27
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	22	25	26	26	26	26	**25**	20
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	22	25	26	27	26	26	**25**	19
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	22	24	24	24	24	24	**23**	18
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	22	27	31	31	30	30	**27**	19
B5. Combination of B1-B4 using one-half standard deviation shocks	22	25	27	27	27	27	**25**	18
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	22	35	35	35	35	35	**34**	26
PV of debt-to-exports ratio								
Baseline	119	141	139	138	134	135	**130**	98
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	119	132	132	136	139	144	**158**	161
A2. New public sector loans on less favorable terms in 2015-2035 2	119	146	149	152	151	155	**163**	142
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	119	138	137	137	133	134	**130**	97
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	119	142	165	164	159	159	**151**	109
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	119	138	137	137	133	134	**130**	97
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	119	156	172	170	165	164	**149**	100
B5. Combination of B1-B4 using one-half standard deviation shocks	119	143	159	158	153	152	**142**	98
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	119	138	137	137	133	134	**130**	97
PV of debt-to-revenue ratio								
Baseline	110	122	119	116	115	114	**109**	85
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	110	115	113	115	119	122	**132**	140
A2. New public sector loans on less favorable terms in 2015-2035 2	110	126	127	128	129	131	**137**	123
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	110	123	124	123	121	121	**115**	89
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	110	121	127	125	122	122	**114**	85
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	110	118	116	114	112	112	**107**	83
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	110	135	147	144	141	139	**125**	87
B5. Combination of B1-B4 using one-half standard deviation shocks	110	125	130	128	125	125	**114**	82
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	110	171	168	166	163	163	**156**	121

Table 2. Kenya: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–35 (concluded)

(In percent)

Debt service-to-exports ratio								
Baseline	6	8	15	9	14	9	**10**	11
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	6	7	13	8	12	8	**10**	14
A2. New public sector loans on less favorable terms in 2015-2035 2	6	8	8	9	14	9	**11**	16
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	6	8	15	9	14	9	**10**	11
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	6	8	17	11	16	10	**12**	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	6	8	15	9	14	9	**10**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	6	8	16	11	15	10	**13**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	6	8	15	10	15	9	**12**	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	6	8	15	9	14	9	**10**	11
Debt service-to-revenue ratio								
Baseline	6	7	13	8	12	7	**8**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	6	6	11	7	10	7	**8**	12
A2. New public sector loans on less favorable terms in 2015-2035 2	6	7	7	7	12	8	**10**	14
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	6	7	13	8	13	8	**9**	10
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	6	7	13	8	12	8	**9**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	6	7	12	8	12	7	**8**	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	6	7	13	9	13	8	**11**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	6	7	12	8	12	8	**9**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	6	10	18	11	17	11	**12**	14
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	5	5	5	5	5	5	**5**	5

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. Kenya: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012–35

(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	41.7	44.1	49.2			52.7	55.1	55.0	54.6	53.6	52.4		45.0	35.4	
of which: foreign-currency denominated	19.3	19.4	24.0			28.5	31.6	31.3	30.9	30.1	30.1		27.9	20.9	
Change in public sector debt	1.5	2.4	5.1			3.5	2.4	-0.1	-0.4	-1.0	-1.2		-0.7	-1.0	
Identified debt-creating flows	-0.1	1.6	3.1			5.5	2.6	0.8	-0.9	-1.4	-1.7		-1.4	-0.9	
Primary deficit	2.3	3.0	4.6	1.7	1.6	5.4	4.1	2.6	1.3	0.7	0.4	2.4	0.5	0.9	0.6
Revenue and grants	19.1	19.8	19.9			20.2	20.7	21.3	21.7	21.7	21.9		22.1	22.2	
of which: grants	0.4	0.5	0.5			0.5	0.4	0.4	0.4	0.4	0.3		0.3	0.3	
Primary (noninterest) expenditure	21.4	22.8	24.5			25.6	24.9	23.9	23.0	22.4	22.3		22.6	23.1	
Automatic debt dynamics	-2.4	-1.4	-1.5			0.1	-1.6	-1.8	-2.2	-2.1	-2.1		-1.9	-1.8	
Contribution from interest rate/growth differential	-1.3	-0.9	-1.3			-1.4	-1.7	-1.9	-2.1	-2.2	-2.2		-1.6	-1.5	
of which: contribution from average real interest rate	0.4	1.4	0.9			1.2	1.3	1.3	1.2	1.1	1.1		1.2	0.7	
of which: contribution from real GDP growth	-1.8	-2.2	-2.2			-2.6	-3.0	-3.2	-3.3	-3.3	-3.3		-2.8	-2.2	
Contribution from real exchange rate depreciation	-1.0	-0.5	-0.2			1.6	0.1	0.0	-0.1	0.1	0.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.6	0.8	2.0			-2.0	-0.1	-0.9	0.6	0.3	0.5		0.6	-0.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	42.9			45.8	48.3	48.5	48.5	47.9	47.0		40.9	33.0	
of which: foreign-currency denominated	...	...	17.7			21.7	24.8	24.8	24.8	24.4	24.7		23.8	18.6	
of which: external	...	...	17.7			21.7	24.8	24.8	24.8	24.4	24.7		23.8	18.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	13.3	14.9	19.1			18.1	16.6	16.2	13.8	13.9	12.4		10.0	8.8	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	215.4			226.6	233.0	227.6	224.0	220.6	214.6		185.0	148.5	
PV of public sector debt-to-revenue ratio (in percent)	...	...	221.1			231.8	237.8	232.0	228.1	224.5	218.0		187.6	150.6	
of which: external 3/	...	...	91.1			109.5	122.2	118.6	116.5	114.5	114.4		109.3	84.7	
Debt service-to-revenue and grants ratio (in percent) 4/	28.0	29.2	40.0			29.7	29.4	34.1	28.3	31.6	26.0		21.7	17.9	
Debt service-to-revenue ratio (in percent) 4/	28.7	30.0	41.0			30.4	30.0	34.7	28.8	32.2	26.4		22.0	18.1	
Primary deficit that stabilizes the debt-to-GDP ratio	0.7	0.7	-0.5			1.9	1.7	2.8	1.7	1.8	1.6		1.3	1.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.6	5.7	5.3	5.2	2.2	5.6	6.0	6.1	6.5	6.5	6.5	6.2	6.5	6.5	6.5
Average nominal interest rate on forex debt (in percent)	1.5	1.4	2.5	1.6	0.4	2.2	2.8	2.8	3.0	3.1	3.3	2.9	3.9	4.4	4.0
Average real interest rate on domestic debt (in percent)	2.3	6.6	3.3	1.5	4.0	3.7	4.0	4.7	4.4	3.7	3.5	4.0	3.3	0.8	2.3
Real exchange rate depreciation (in percent, + indicates depreciation	-5.9	-2.9	-0.9	-4.2	7.7	6.8	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	9.4	5.0	7.5	8.6	3.8	6.9	6.7	5.8	5.4	5.5	5.3	5.9	5.1	5.1	5.1
Growth of real primary spending (deflated by GDP deflator, in percer	5.9	12.6	13.3	3.2	5.4	10.1	2.9	2.2	2.3	3.8	6.0	4.6	6.8	6.8	6.7
Grant element of new external borrowing (in percent)	...	...	...	...	...	19.4	12.8	13.1	13.2	9.8	12.9	13.5	7.4	5.2	...

Sources: Country authorities; and staff estimates and projections.

1/ Refers to gross debt of the central government, including CBK obligations to the IMF, excluding government deposits.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. Kenya: Sensitivity Analysis for Key Indicators of Public Debt, 2015–35

Table 4. Kenya: Sensitivity Analysis for Key Indicators of Public Debt, 2015-2035

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	46	48	48	49	48	47	41	33
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	46	46	46	47	48	49	51	53
A2. Primary balance is unchanged from 2015	46	49	52	56	60	63	77	96
A3. Permanently lower GDP growth 1/	46	49	49	50	50	49	48	53
A4. Fix primary balance ex-SGR	46	48	49	51	53	54	57	58
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	46	50	53	54	55	55	54	53
B2. Primary balance is at historical average minus one standard deviations in 2016-201	46	47	48	48	48	47	41	33
B3. Combination of B1-B2 using one half standard deviation shocks	46	47	48	49	49	49	47	44
B4. One-time 30 percent real depreciation in 2016	46	58	58	58	57	56	50	44
B5. 10 percent of GDP increase in other debt-creating flows in 2016	46	58	58	58	57	56	48	38
PV of Debt-to-Revenue Ratio 2/								
Baseline	227	233	228	224	221	215	185	148
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	227	223	215	216	220	222	230	236
A2. Primary balance is unchanged from 2015	227	239	245	259	275	289	350	434
A3. Permanently lower GDP growth 1/	227	234	231	230	229	226	216	240
A4. Fix primary balance ex-SGR	227	232	231	236	243	247	260	262
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	227	242	249	251	253	251	243	239
B2. Primary balance is at historical average minus one standard deviations in 2016-201	227	229	226	223	220	214	184	148
B3. Combination of B1-B2 using one half standard deviation shocks	227	229	227	227	227	225	211	198
B4. One-time 30 percent real depreciation in 2016	227	280	272	266	262	255	226	199
B5. 10 percent of GDP increase in other debt-creating flows in 2016	227	280	272	266	262	254	218	171
Debt Service-to-Revenue Ratio 2/								
Baseline	30	29	34	28	32	26	22	18
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	30	30	34	27	31	26	26	29
A2. Primary balance is unchanged from 2015	30	29	34	30	35	32	39	53
A3. Permanently lower GDP growth 1/	30	30	34	29	32	27	25	28
A4. Fix primary balance ex-SGR	30	29	34	28	33	28	29	27
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	30	30	36	31	35	30	28	29
B2. Primary balance is at historical average minus one standard deviations in 2016-201	30	29	34	28	31	26	22	18
B3. Combination of B1-B2 using one half standard deviation shocks	30	30	35	28	32	27	24	24
B4. One-time 30 percent real depreciation in 2016	30	31	40	32	38	31	29	30
B5. 10 percent of GDP increase in other debt-creating flows in 2016	30	29	37	34	37	31	26	21

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

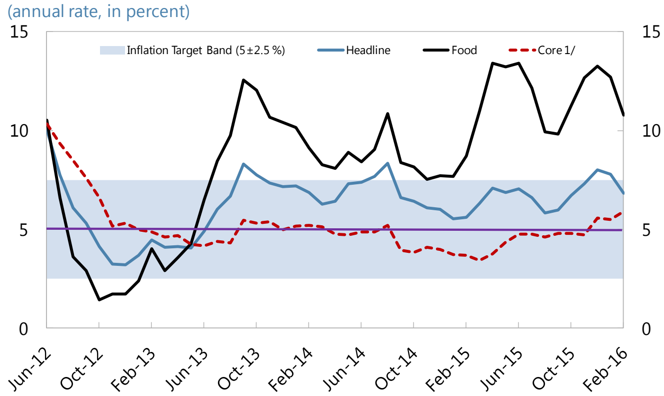
2/ Revenues are defined inclusive of grants.

Statement by the Staff Representative on Kenya
March 14, 2016

The information below has become available following the issuance of the staff report. It does not alter the thrust of the staff appraisal.

1. **Inflation decreased to 6.8 percent in February, after breaching the upper bound of the target range (5±2.5 percent) in December and January.** The decrease in inflation reflected lower food prices (-0.43 percent compared to January) and a significant decline in energy prices (-1 .81 percent compared to January). However, non-food non-fuel inflation picked up to 5.9 percent in February 2016 (the highest level since October 2012) from 5.5 percent in January 2016.

Kenya: Recent Inflation Developments, 2012-2016
(annual rate, in percent)



Sources: Kenyan authorities and Fund staff estimates.
1/ Core inflation excludes, food, energy, and transportation.

Statement by Ms. Kapwepwe, Executive Director for Kenya
and
Ms. Ngugi, Senior Advisor to the Executive Director

March 14, 2016

On behalf of the Kenyan authorities, we thank staff for their constructive engagement during the second review of the economic program under the 12-month Stand-By Arrangement and an Arrangement under the Standby Credit Facility, and also during the negotiations for the successor Arrangements. The current arrangements, which have been maintained as precautionary, have served the authorities well in maintaining macroeconomic stability and supporting investment-led growth, allowing for timely policy adjustments and bolstering implementation of key structural reforms. To maintain momentum in the face of elevated external risks, the authorities are requesting for successor Arrangements to continue providing a policy anchor to the reform agenda in strengthening the resilience of the economy. In this regard, they look forward to the Executive Board's support in the completion of this second review, and the approval of the new Arrangement.

1) Recent Economic Developments and Prospects

Kenya's economy remains strong despite the headwinds from global economic slowdown. Growth accelerated to 5.6 percent in 2015 from 5.4 percent in 2014, supported by continued investment in quality infrastructure, construction, mining, lower energy prices, and improved agricultural productivity. It is projected that economic growth will increase to 6.0 percent in 2016. Overall inflation declined from 7.8 percent in January 2016 to 6.8 percent in February 2016, as a result of a decline in food and fuel inflation. This has brought back inflation to the target range (5±2.5) after being outside the upper range in the last two months. With prudent monetary policy, the authorities aim to keep inflation in the mid of the target range.

External balance is improving and the fiscal balance is being maintained on the program target. Current account deficit is narrowing with the lowering oil prices, and it is expected to get to 8.0 percent of GDP in 2016. The foreign exchange market is relatively stable while foreign reserves which stand at 4.6 months of import cover provide adequate buffer against short term shocks. The fiscal deficit for 2015/16 is projected at 8.0 percent of GDP. Although implementation of the budget FY2015/16 was initially hampered by sluggish revenue collections and shortfalls in domestic borrowing, the authorities took appropriate and timely mitigating measures to ensure fiscal position is maintained on the program path. Revenue projections were revised downwards, and various expenditure measures, including curbing non priority expenditures and cutting expenditures on slow and delayed projects, were instituted to align the expenditures with the revised resource envelope.

2) Program Performance and Request for a Successor Program

The authorities have successfully implemented the economic program under the 12-month SBA and SCF Arrangements. All the quantitative performance criteria were met and nearly all the structural benchmarks were completed. Significant progress was made in the remaining two structural benchmarks, and the authorities are determined to have them fully completed in due course. For the list of assets and liabilities of counties, the auditing process will start in June 2016, while the inclusion of the debt service payments in IFMIS is one of the structural benchmarks under the new program, expected to be completed in September 2016.

Nevertheless, Kenya remains vulnerable to external shocks which have the potential to create external imbalances and derail the growth momentum. In this context, the authorities are requesting for a new program under a 24-month SBA and SCF to strengthen their buffers against exogenous shocks and provide a policy anchor to the reform agenda. The authorities aim to continue improving fiscal management, strengthening monetary policy operations, and improving business environment to build resilience and allow for a sustained inclusive investment-led growth. They intend to treat the Arrangements as precautionary and only draw should an actual balance of payments problem materialize.

3) Macroeconomic Policies

The economy is facing elevated downside risks with the potential to create imbalances. These include volatility in global financial market, slower global and regional growth, falling commodity prices, adverse weather conditions, and security threats. To maintain macroeconomic stability and continue supporting investment-led growth, the authorities are committed to undertake key policy and structural reforms.

a) Fiscal policy

The authorities aim to maintain a growth-friendly fiscal policy ensuring a sustainable debt level. They are committed to a gradual fiscal consolidation to be achieved through containing growth in recurrent expenditures while protecting public investments and social spending, and strengthening tax administration to boost revenue mobilization. The fiscal consolidation path is also aimed to ensure a smoother transition towards the EAC convergence criteria on deficit to GDP of 3 percent.

Among the proposed measures include, on the expenditure side, reducing tax expenditures, adopting a clear public sector remuneration and benefits policy framework, tightening selection and monitoring procedures of investment projects, and reducing growth in expenditures of goods and services and transfers to parastatals. With a modern and simplified Excise Duty and Tax Procedure Legislation now enacted, the authorities are gearing to review the Income Tax Act. Modernization of tax legislation and administrative reforms are being undertaken to improve customs revenue collection, strengthen revenue collection by counties; and improve collection of large outstanding tax debts.

Fiscal policy is also aimed at supporting the devolved system of government for effective delivery of services. In this regard, the national government is gearing to roll out the 2015 Public Finance Management Regulations to strengthen the intergovernmental fiscal relations as well as public expenditure controls and reporting frameworks.

b) Monetary policy and financial sector

Maintaining price stability remains the principle objective of monetary policy. In this regard, the authorities stand ready to tighten monetary policy should demand pressures arise and second round effects of supply shocks set in. They also remain committed to strengthen the monetary policy framework and are undertaking to improve the transmission mechanism of monetary policy through money and credit markets reforms and establish an interbank interest rate corridor.

Safeguarding financial stability remains a key priority in further deepening the financial sector. In this regard, the authorities are strengthening bank supervision legal and regulatory framework and are in the process of recruiting additional supervisory staff. Following the recent Financial Stability Review undertaken with the help of the Fund, the Central Bank of Kenya will put together an action plan to strengthen the supervision and regulation of the banking system. Further, the authorities are developing a crisis management framework for banks with significant cross-border operations, and implementing a risk-based approach to AML/CFT supervision for all financial institutions under the central bank purview; an IMF mission is already proposed for end March 2016 to support this efforts.

c) Structural reforms and Data Quality

Creating conducive business environment for job creation is core in the economic transformation agenda that the authorities are pursing. In this regard, they continue to improve security by deepening reforms in the security sector; boost infrastructure development to unlock constraints to growth; advance business regulatory reforms; improve the automation and simplification of government services; and improve the framework for registering property.

The authorities remain committed to improve the quality, coverage and timeliness of macroeconomic statistics. They have agreed to participate in the enhanced general data dissemination system and as a step towards improving the balance of payment statistics and production of an international investment position, they have published data for the foreign investment survey for 2012 and 2013.

4) Conclusion

Maintaining macroeconomic stability and supporting strong economic growth are central to the transformation agenda the authorities are implementing as they gear to become a middle income country by 2030. In this context, they remain committed to maintain the momentum to the reform agenda to strengthen the resilience of the economy in achieving the development goals. They highly appreciated the continued engagement with the Fund as this contributes immensely to their economic development.